Quarterly economic review

Introduction

The first quarter of 1989 saw growth of the real gross domestic product of the South African economy at a modest annual rate of approximately 1½ per cent. Real gross domestic expenditure, on the other hand, having declined on balance from the first quarter of 1988, showed a renewed increase at an annualised rate of about 6 per cent, mostly because of an extraordinarily rapid rise in real government consumption expenditure and a rebuilding of aggregate real inventories.

In contrast, the second quarter of 1989 witnessed a further slackening of the growth rate in real domestic production to an annualised level of only some ½ per cent, together with a resumption of the mild downward tendency in real gross domestic expenditure at an annualised rate of some 2 per cent. This renewed softening of real domestic spending would appear to have reflected spontaneously more reserved spending behaviour by private sector households and quarter-to-quarter volatility in real government consumption expenditure, as well as the economy's responses to the cumulative impact of measures of more restrictive monetary, fiscal and credit policy from late 1987 or early 1988.

The second-quarter configuration of further shrinkage of the real growth rate and some renewed diminution of total real gross domestic expenditure provided further evidence of the economy's cyclical cooling-down and of its having moved into the early stages of a consolidation phase. Similar impressions of a loss of momentum could be gained from a variety of cyclically sensitive time series: the composite coincident business cycle indicator declined in the first quarter of 1989 and slipped down more significantly in the second quarter. The index of real manufacturing production of non-durable goods has displayed a declining tendency since the third quarter of 1988; the volumes of wholesale and retail sales levelled out in the second quarter and in the first half of 1989, respectively; and the number of registered unemployed workers in the White, Coloured and Asian population groups rose from February through May 1989. A softer trend in motor vehicle sales was apparent from May 1989 through August, while net new company registrations, after having levelled out through most of 1988, declined materially in the second quarter of 1989.

The behaviour of the broad national accounts aggregates of domestic output and expenditure over the first half of 1989, nevertheless still remained compatible in broad terms with the policy objective of a "soft landing" for the economy and with the growth and expenditure projections that underlay the adoption of a target rate of increase of 14 to 18 per cent in the M3 money supply in the targeting year 1989.

Various cautionary observations should, however, be made about this seemingly fairly comfortable situation; such cautions were, in fact, sounded in both the Reserve Bank's recent *Annual Economic Report* for 1989 and the *Governor's Address* at the Bank's Annual General Meeting on 29 August 1989.

Firstly, inflation, as measured by all major price indices (i.e. those for the prices of imported and domestically produced goods, production prices and consumer prices), accelerated markedly and disturbingly on a short-term (i.e. quarter-to-quarter) basis in the first two quarters of 1989 from its already relatively high levels in the final two quarters of 1988. The extent of this acceleration tends to be concealed by the generally more wide-spread practice of quoting percentage increases in the various price indices only on a twelve-month or year-on-year basis.

Secondly, far too little progress has been made as yet in slowing down the twelve-month and quarter-to-quarter rates of increase in the money supply. Recently revised monetary statistics show M3 as at month-ends from May through July 1989 again to have been well above the upper limit of the target range.

Thirdly, the remarkable, unexpected but highly gratifying strength of the South African merchandise export performance in the second quarter of 1989 was matched by a similarly strong rise in the volume and value of merchandise imports. In conjunction with certain other adverse developments (notably the steep decline in the dollar price of gold), this high level of import demand resulted in a further contraction of the surpluses on the current account of the balance of payments from their rather more adequate levels in the second half of 1988. Also because of the somewhat disappointing behaviour of merchandise exports in the first few months of 1989, the annualised current account surplus in the first half of 1989, at R2,3 billion, fell well short of the current account surpluses of the second half of 1988. Before seasonal adjustment and annualisation, the current account surplus in the first six months of 1989 amounted to R1,7 billion. The extent to which this surplus may improve in the third and fourth quarter will depend, among other things, on whether the present strength of private-sector fixed investment expenditure (and imports occasioned by such expenditure) are going to be maintained.

Fourthly, up to the end of August 1989 large outflows of non-reserve-related capital, in conjunction with narrowing of the current account surplus in the first half of the year, had prevented any *major* rebuilding of the total South African gross gold and other foreign reserves and had, in fact, resulted in a further diminution of these reserves in US dollar terms. The more recent levels of the gross reserves were still equal only to some 1½–1¾ months' imports of goods. Known and obligatory repayments on foreign debt during the remainder of 1989 will, however, be significantly smaller than during the first half of the year.

Finally, the year-on-year increase in Exchequer issues *in real terms* during the first four months (April to July 1989) of fiscal 1989/90 amounted to an exceptionally high 13,7 per cent. As observed in the main text of this *Review*, this means that the rate of increase in Exchequer issues will have to decline substantially during the remainder of the fiscal year if the Budget's objective of avoiding an increase in real government expenditure during fiscal 1989/90 as a whole is to be met.

The Reserve Bank's recent *Annual Economic Report* noted South Africa's declining dependence on its gold export earnings as a source of foreign exchange; the share of South Africa's net gold exports in the country's total export earnings shrank from 44½ per cent in 1980 to only 28 per cent in the first half of 1989. Even at this reduced level of relative importance, however, movements in the dollar price of gold continued to have large and pervasive effects on the South African economy in recent months. As discussed in somewhat more detail in the various sections of this *Review*, the accelerated decline in the gold price from more than US$412 per fine ounce at the beginning of 1989 to less than US$360 early in the fourth week of May, had a depressing effect on real value added by the gold mining industry, and therefore on real value added by the mining sector and by all primary sectors, in the second quarter of 1989. The gold price decline obviously also contributed to the narrowing of the current account surplus of that quarter and therefore to weakening of the exchange rate and to downward pressure on the foreign reserves. It also played a part in shaping interest rate expectations in the money and capital markets, which fed back into liquidity preference and reintermediation phenomena and therefore into the observed rate of growth of the money supply, and held back or reversed the recovery of gold mining share prices, thereby influencing significantly the behaviour of the all-shares price index on the Johannesburg Stock Exchange.

In the area of monetary and credit developments, the second quarter of 1989 saw a significant decline in the quarter-to-quarter rate of increase in the quarterly averages of monetary institutions' credit to the private sector, to an annualised level of 13 per cent. The rate of increase in M3, however, continued to exceed the concurrent rate of increase in gross domestic product at current prices. M3's velocity of circulation accordingly declined further in this quarter, albeit only marginally, from the peak value it had reached in the first quarter of 1987. In the light of reported firm credit demand from corporate entities, recent slowdowns in the rate of monetary institutions' credit extension to private borrowers are likely to have reflected a significant deceleration of the growth in consumer debt.

In the capital markets, increased turnovers were recorded in public sector securities and fixed property. New-issue activity in the second quarter of 1989 was significantly higher than in the preceding three months. A slight decline was recorded, however, in the turnover of company shares on the stock exchange. The average level of all share prices stagnated in the second quarter under the impact of the weakening dollar price of gold, but reached new post-"crash" high points in July.

In the area of government finance, year-on-year percentage increases greatly in excess of those of the Budget proposals for the fiscal year as a whole were recorded during the first four months of fiscal 1989/90 in Exchequer receipts as well as in *real* Exchequer issues, as referred to earlier. The limited size of the deficit before borrowing in these four months suggested that the eventual deficit for fiscal 1989/90 as a whole may well be less than was envisaged in the Budget proposals; a budgetary *surplus* was, in fact, recorded in July 1989 for the first time in any month of July since 1974.

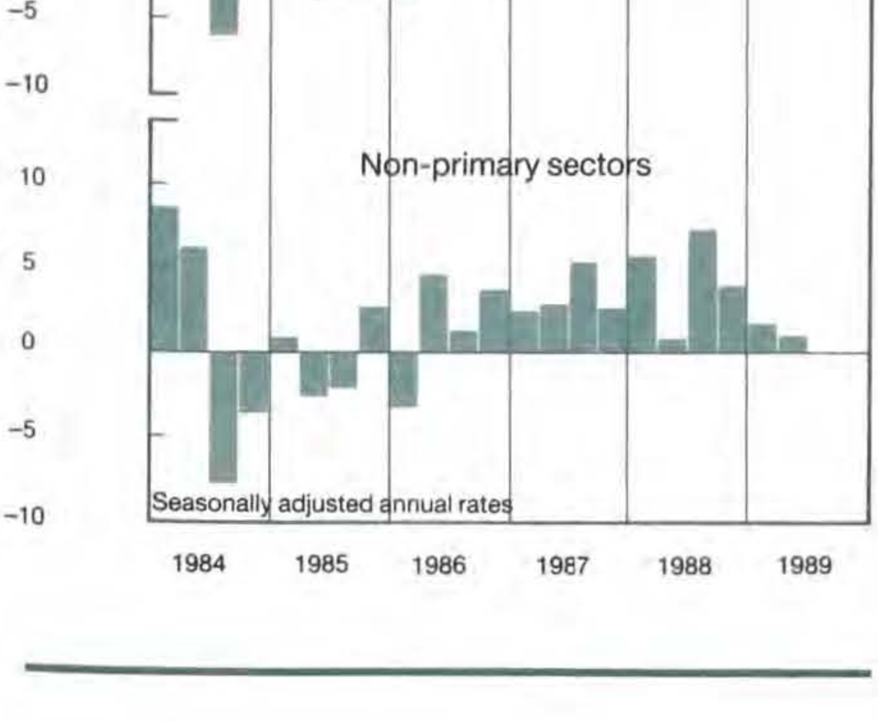
Domestic economic developments

Domestic output

Growth in the real gross domestic product of the South African economy reached seasonally adjusted and annualised rates of 3½ per cent and nearly 3 per cent in the third and the fourth quarter of 1988 and amounted to somewhat more than 3 per cent during the calendar year 1988. The tempo of growth then slowed down, however, to annualised rates of 1½ per cent and only ½ per cent in the first and the second quarter of 1989. Unlike earlier temporary subsidences of the real growth rate in the second quarters of 1987 and 1988, the progressive slackening of output increases in the first half of 1989 – which perpetuated a loss of growth momentum that had already become observable after the third quarter of 1988 – should almost certainly be read as further evidence of the 1986-1988 cyclical upswing having come to an end near the close of 1988. From the approximate start of 1989, therefore, the South African economy has found itself in a consolidation phase.

Real gross domestic product in the *non-agricultural* sectors of the economy actually contracted slightly in the second quarter of 1989 at an annualised rate of some ½ per cent. The *level* of *total* real domestic production in the first half of 1989 was, however, still more than 2 per cent higher than in the first half of 1988. Also given good prospects for agricultural production during the remainder of 1989, aggregate activity in the first two quarters of 1989 may well turn out still to have been consistent with earlier projections of a real growth rate of approximately 2 per cent for the year as a whole.

Real gross domestic product



Improved weather conditions in 1988/89 in the summer rainfall areas had a favourable effect on agricultural production. Total real output of *all primary* sectors of the economy nevertheless declined at an annualised rate of ½ per cent in the second quarter of 1989. This could be attributed to a substantial decline – at an annualised rate of nearly 8 per cent – of real value added by the mining sector. Real output in coal mining and other non-gold mining operations was boosted by substantial increases in the volumes of mineral exports in the second quarter of 1989. Real value added by the gold mining industry, on the other hand, was affected adversely by the steadily downward drift of and generally unpromising prospects for the dollar price of gold, the declining grade of ore milled by a number of mines, the rising costs of mining operations, and the fact that virtually no increase at all was recorded, on balance, in the average *rand* price of gold per fine ounce from the second quarter of 1988 to the second quarter of 1989. As a result, the increase in real value added by the non-gold mining sector was more than fully offset by the decline in real output of the gold mining industry.

Real value added by manufacturing advanced comparatively rapidly through most of the 1986-1988 upswing up to the middle of 1988, but levelled out from the second half of 1988. It actually declined mildly, at seasonally adjusted annual rates of ½ and 2 per cent, in the first two quarters of 1989. The *level* of real manufacturing production in the second quarter of 1989 nevertheless was still some 4½ per cent higher than in the second quarter of 1988.

A slackening of real growth rates was also apparent in almost all other sectors of the economy. A notable exception, however, was presented by the sector transport, storage and communication. Largely because of the sharply higher volumes of both exports and imports in the second quarter of 1989, real value added by transport, storage and communication rose at an annualised rate of 4½ per cent during this quarter. Real exports and imports of goods and non-factor services contracted at annualised rates of 15 per cent and 4 per cent in the first quarter of 1989, but expanded at quite remarkable annualised rates of over 50 per cent in both cases in the ensuing three months.

Domestic expenditure

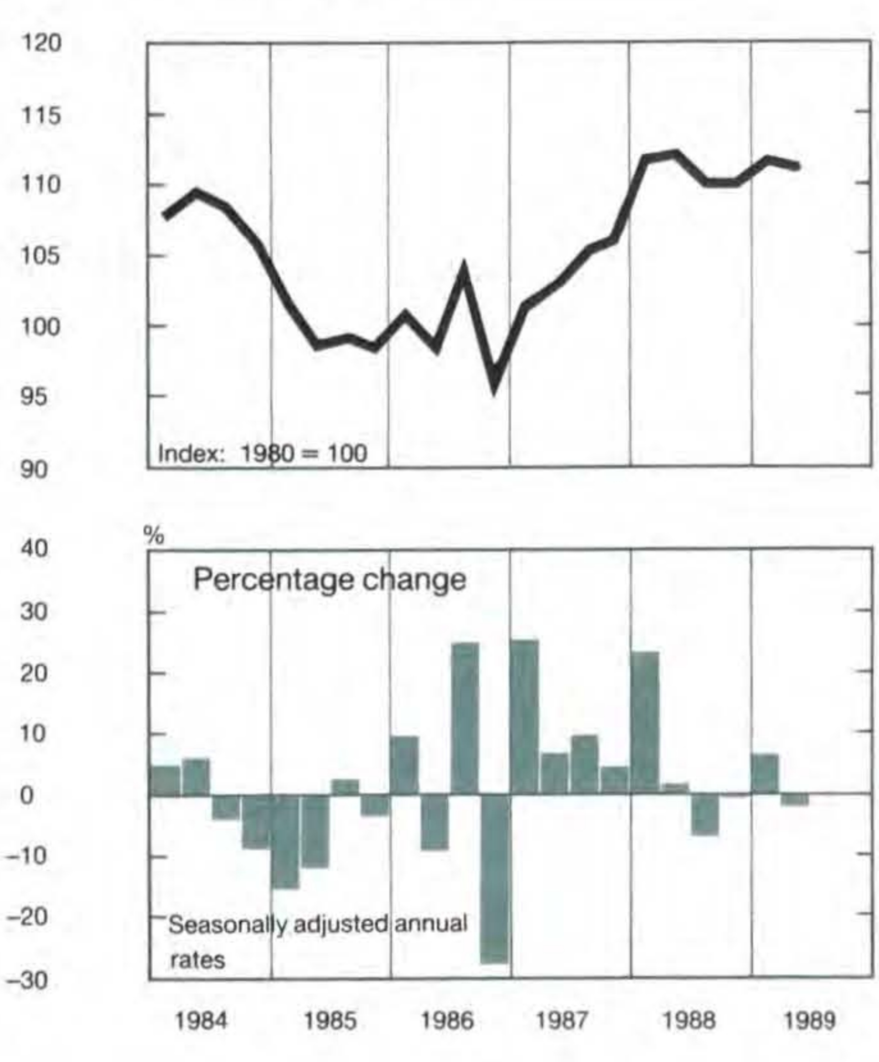
Aggregate real gross domestic expenditure declined in the second half of 1988, rose at an annualised rate of 6 per cent in the first quarter of 1989, but receded once more in the second quarter of 1989. The tempo of the renewed contraction in aggregate real domestic spending in the second quarter of 1989 amounted to a provisionally estimated annualised rate of some 2 per cent. As a result, the level of total real domestic spending in the second quarter of 1989 actually was 2 per cent lower than in the second quarter of 1988. This mild downward tendency in real domestic expenditure over the past four calendar quarters, *in combination with* moderate further increases in real domestic production (which rose by about 2 per cent over the four-quarter period concerned), was, of course, the essential factor in restoring surpluses to the current account of the balance of payments after the dip into marginal current account deficit in the first quarter of 1988.

Real domestic *final demand* – consisting of the sum total of real private and government consumption expenditure and real gross domestic fixed investment – declined in the second quarter of 1989 at an annualised rate of some 1½ per cent. This would appear to have reflected spontaneously more cautious household spending behaviour and quarter-to-quarter volatility in government consumption expenditure, as well as the economy's responses to the gradually more restrictive stance of the authorities' monetary, fiscal and credit policies from early 1988.

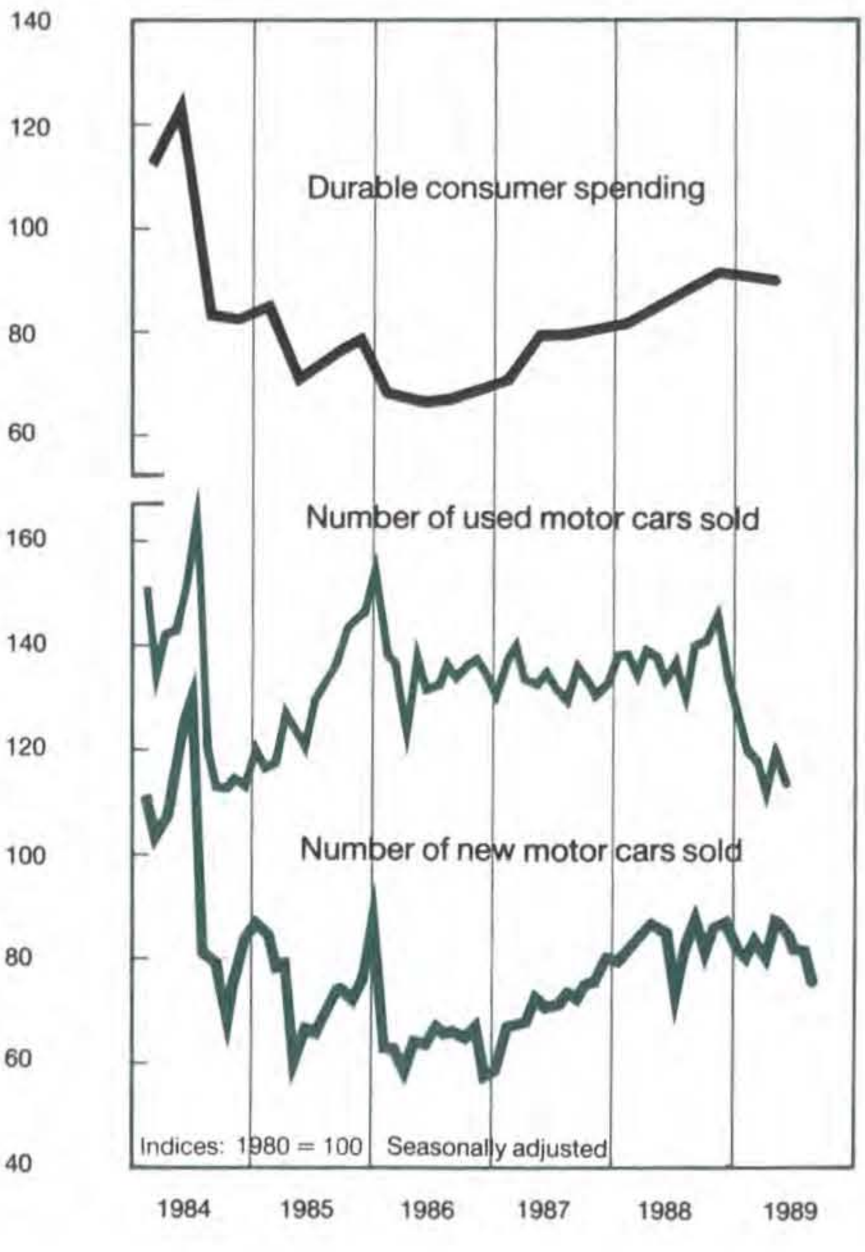
The increase in *real private consumption expenditure* amounted to nearly 5 per cent in 1988 vis-à-vis 1987, but slowed down to annualised rates of approximately 2 per cent in the first quarter and approximately 1 per cent in the second quarter of 1989. This slowdown arose from accelerated declines in households' real purchases of durable goods and from significant decelerations of the rates of increase in real spending on semi-durable and non-durable goods and on services.

Households' real spending on new motor vehicles recovered sharply but briefly at the beginning of the second quarter of 1989 in anticipation of the effects of the introduction of a new local-content programme for

Real gross domestic expenditure



Real expenditure on durable consumer goods



motor car manufacturing from June and because of the introduction of certain new motor car models. Aggregate real private sector expenditure on all consumer durables nevertheless declined further in the second quarter of 1989 at an annualised rate of 4 per cent. This reflected declines in real spending on personal transport equipment as well as on furniture and household appliances.

Real private-sector expenditure on semi-durable consumer goods still expanded in the second quarter of 1989 at an annualised rate of 1 per cent; the annualised rates of increase in real household expenditures on non-durable goods and on services both amounted to approximately 1½ per cent. Continued real growth – albeit at modest rates – in household expenditure on semi-durable goods could be attributed in particular to higher real outlays on certain sub-categories of spending such as clothing and footwear and on automotive components and accessories. Increased spending on items for the maintenance of personal transport equipment, in turn, was an obvious counterpart of the decline in the new and replacement demand for new motor vehicles; the latter was influenced downwards by the effect of recent policy measures, exchange rate and other developments on the prices of motor vehicles, and on households' willingness further to increase the level of consumer debt.

Despite the distinct slackening of the growth in real private-sector consumption expenditure in the past few quarters, various reasons may be advanced why any *decline* in real consumer spending – if any such decline were to occur at all – would be likely both to remain more limited and to take place more gradually than was the case in the course of the sharp downward adjustment in such spending from the second half of 1984 through the first quarter of 1986. Firstly, the general level of consumer confidence is much higher than in late 1984 and in 1985. Secondly, any further softening of the growth in real private-sector consumption expenditure would take place within the general environment of an economy that appears to be heading for a "soft landing" and in which room still remains for some further expansion of aggregate real gross domestic expenditure and real economic activity at moderate to modest rates of growth.

Thirdly, relatively high nominal wage increases as well as improvements in real income from property (owing to favourable conditions in agriculture and to significant increases in dividends declared and in interest received) caused aggregate real personal disposable income to strengthen significantly from the fourth quarter of 1988 onward. The average annualised rate of increase in aggregate real personal disposable income in the fourth quarter of 1988 and the first half of 1989 (which amounted to more than 2½ per cent) resulted in a mild increase in real personal disposable income per head of the population. Finally, support for aggregate real expenditure on non-durable goods in particular is provided by the stable and relatively buoyant level of the demand for such goods among the lower income groups, as is also evidenced by active trading in the so-called "spaza" shops in black metropolitan areas.

Real consumption expenditure by general government rose extraordinarily rapidly (at an annualised rate of more than 40 per cent) in the first quarter of 1989 – i.e. in the final quarter of fiscal 1988/89 – but fell back at an annualised rate of 11½ per cent in the second quarter of 1989. The level of this category of domestic expenditure in the second quarter of 1989 was nevertheless still 3 per cent higher than in the second quarter of 1988; the rate of increase in the level of the government's real consumption outlays in the past four quarters, therefore, significantly exceeded the 2 per cent rise in the level of the real gross domestic product over this period.

Similar rates of increase were displayed by the two principal components of real government consumption expenditure – remuneration of employees as measured by employment in the general government services departments, and spending on intermediate goods and services – in the first quarter of 1989. In the second quarter of 1989, however, aggregate real remuneration of employees continued to rise at a modest annualised rate of 1½ per cent; real outlays on intermediate goods and services, in contrast, fell back at an annualised rate of approximately 17 per cent. In the first *half* of 1989 general government's real wage payments and real purchases of intermediate goods and services exceeded their counterparts in the first half of 1988 by 2½ per cent and by as much as 9½ per cent.

Total real gross domestic fixed investment rose by 6½ per cent from 1987 to 1988 and at an annualised rate of 5 per cent in the first quarter of 1989. This rate of increase then weakened further, however, to an annualised level of 3 per cent in the second quarter of 1989, mainly because of further cutbacks in real fixed capital spending by public authorities and renewed reductions in real fixed capital formation by public corporations. Real gross fixed investment by the private sector, which had increased by as much as 16 per cent in 1988 vis-à-vis 1987 and had strengthened further at an annualised rate of 7½ per cent in the first three months of 1989, actually reaccelerated somewhat to an annualised rate of increase of 9 per cent in the second quarter of 1989.

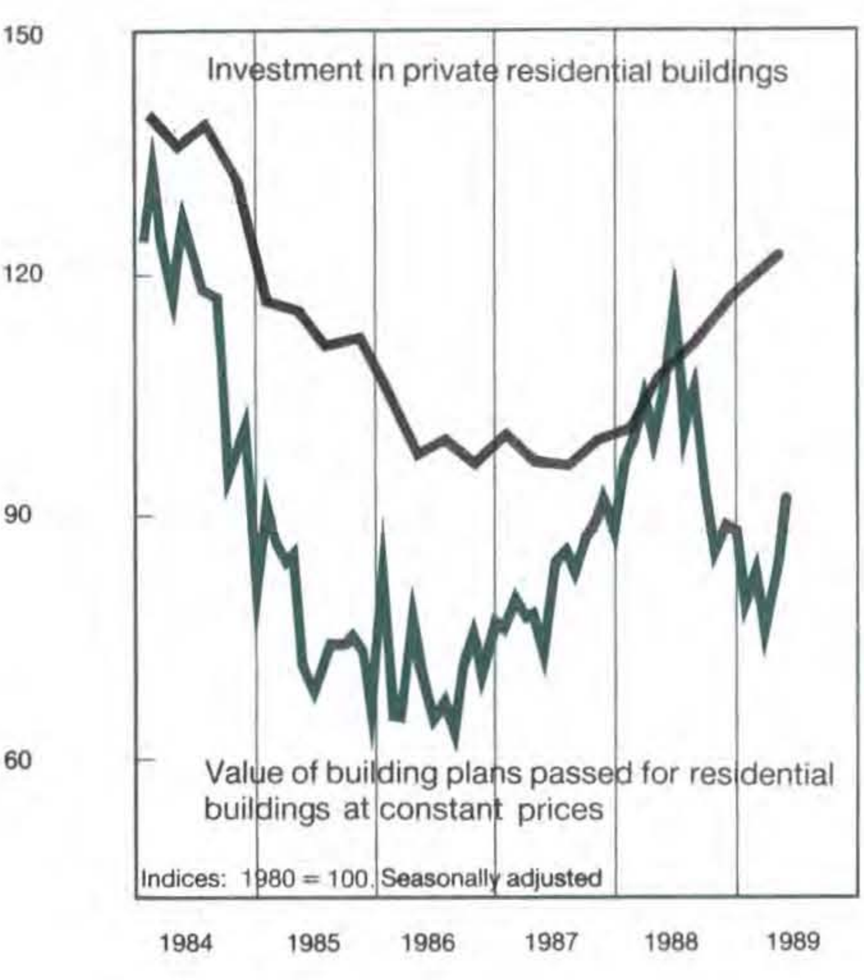
Notable increases in real fixed capital formation in the private sector in the second quarter of 1989 were observed in sectors such as manufacturing, commerce, transport and finance. To an important extent, the further strengthening of this kind of expenditure well after the presumed upper turning-point of the general business cycle had been reached, merely reflected the lags that normally occur between cyclical increases in business firms' output and sales and their responses in the form of expansion of their physical production capacities. At 84,7 per cent, however, the degree of capacity utilisation in manufacturing industry in the second quarter of 1989 was also nearly one-tenth higher than the degree of capacity utilisation of 77,7 per cent at the start of the 1986-1988 upswing in the second quarter of 1986, and was also marginally higher than capacity utilisation at its high point in the mini-boom of 1983-1984. In addition, various industries have been seeking to expand or adapt their production capacity or production capabilities with a view to more active exploitation of export markets. Finally, renewal gaps and technological backlogs remained to be made up after the years of generally very low fixed investment activity from 1986 through the first half of 1988.

Real gross fixed investment in manufacturing in the first half of 1989 actually exceeded the depreciation allowances in respect of manufacturing industry's capital stock for the first time since the start of the cyclical decline in real gross fixed capital formation in the first quarter of 1985. Stepped-up fixed investment activity in the first half of 1989 therefore resulted in the first actual net additions – albeit only marginal ones – to the physical production apparatus of manufacturing industry in a period of more than four years.

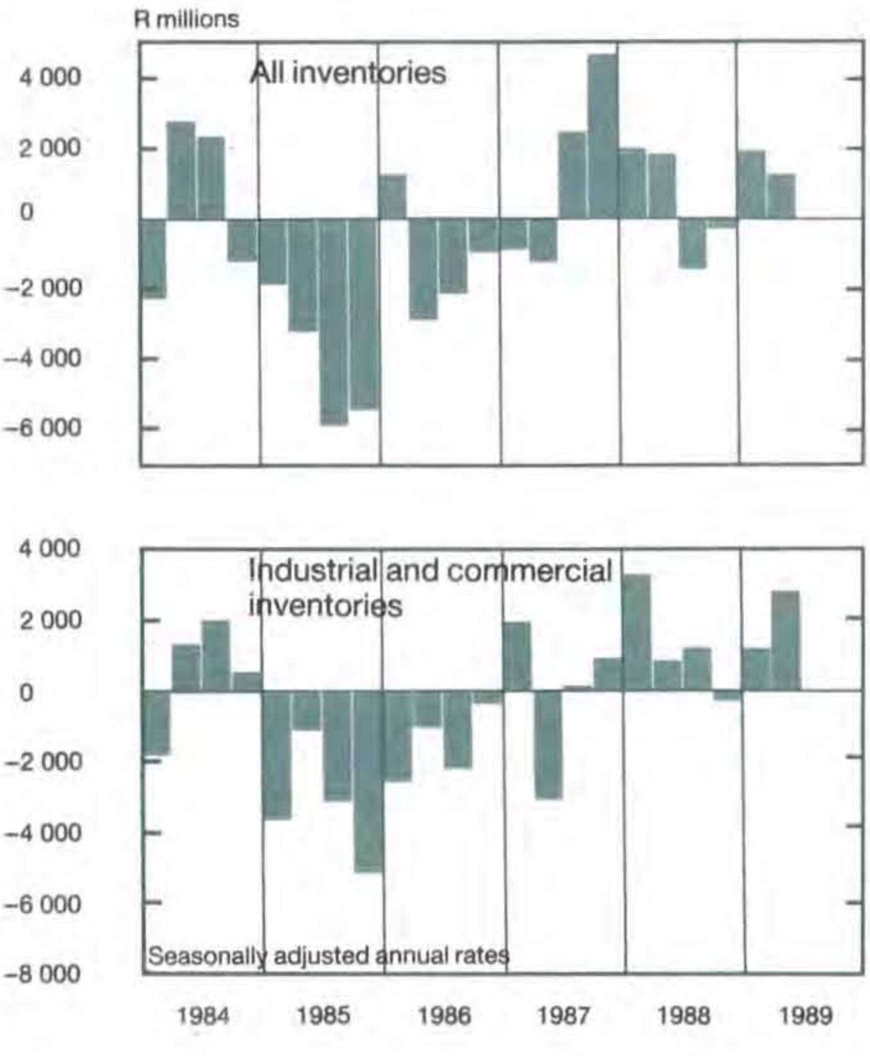
Real fixed capital outlays by public *corporations* rose substantially in the third and the fourth quarter of 1988 and the first quarter of 1989, but declined in the second quarter. Real fixed investment expenditure by public *authorities* declined in the first quarter of 1989 and continued to do so in the second quarter, at an annualised rate of 3½ per cent. An appreciable increase in fixed capital formation by the business enterprises of general government – more specifically by the Department of Post and Telecommunications – was offset more than fully by reductions in real fixed capital spending at all three levels of general government itself.

An analysis of gross domestic fixed investment in the second quarter of 1989 by type of capital asset shows further accelerations in residential building and in real expenditures on transport, machinery and equipment. Real expenditure on private residential buildings displayed a well-above-average rate of recovery in the course of the 1986-1988 upswing. Its average annual rate of increase of 6½ per cent during the thirteen quarters from the second quarter of 1986 to the second quarter of 1989 (against the average annual rate of increase of only 2 per cent in *total* real gross domestic fixed investment during the same

Real investment in private residential buildings



Change in inventories



period) caused its share in total fixed investment to rise significantly from 9½ per cent in the second quarter of 1986 to 12 per cent in the second quarter of 1989. Against the continued strength of residential building, however, real outlays on non-residential building and on construction works declined in the second quarter of 1989.

Real inventory investment, although still positive, was significantly smaller in the second quarter of 1989 than in the preceding quarter. Declines were recorded in real inventories in the non-gold mining sector, in real agricultural inventories and in diamond stocks-in-trade. This could be attributed largely to the sharp second-quarter rise in the volumes of exports of mineral products. Increases, on the other hand, were recorded in industrial and commercial inventories partly as a reflection of the large second-quarter rise in the volume of merchandise imports, which occurred in the face of a mild contraction in aggregate real domestic final demand and of a further deceleration of the growth rate in aggregate real economic activity. Relative to gross domestic product in the non-agricultural sectors of the economy, the level of industrial and commercial inventories rose from a recent low point of 19½ per cent in the fourth quarter of 1988 to slightly more than 21 per cent in the second quarter of 1989.

Factor income and saving

Nominal factor income *at market prices*, which had advanced at an accelerated annualised rate of 18 per cent in the first quarter of 1989 partly because of various increases in indirect taxes, rose at an annualised rate of approximatley 19½ per cent in the second quarter. However, both these rates of increase, although higher than the quarter-to-quarter annualised rate of increase in the fourth quarter of 1988, were still marginally lower than their counterparts in the first two quarters of 1988. This could be attributed to the slowdown of real economic growth that has been in evidence since the beginning of 1989.

Analysis of the components of nominal factor income *at factor cost* shows the annualised rate of increase in the *gross operating surplus* of business enterprises to have accelerated from its comparatively low level of 8 per cent in the first quarter of 1989 to 16 per cent in the second quarter; this more recent rate of increase closely approximated the average growth rate of the total gross operating surplus in the calendar year 1988. Improved performances of businesses' operating surpluses were widely spread through the economy. The operating surplus of the mining sector, which had *declined* in the first quarter of 1989, rose at an annualised rate of 14½ per cent in the second quarter, not least because of the stepped-up export activity and increased buoyancy of profits of non-gold mining companies.

The annualised rate of increase in aggregate *nominal labour remuneration* contracted from 23½ per cent in the fourth quarter of 1988 to 22½ per cent in the first quarter of 1989 and to 19½ per cent in the second quarter. The year-on-year rise in total labour remuneration of 17½ per cent in the first *half* of 1989 vis-à-vis the first half of 1988 was, however, still higher than the increase of some 16½ per cent from the year 1987 to the year 1988. The increased rates of increase in nominal wage packages of the past several quarters were a reflection of, among other things, improved conditions of service in employment by public authorities and of stepped-up wage demands by labour unions in accordance with reaccelerating inflation rates and deteriorating inflation expectations.

The ratio of *gross domestic saving* to gross domestic product showed no change from the first to the second quarter of 1989 at a level of 22½ per cent. This level was slightly higher than the average ratio of nearly 22 per cent in calendar 1988.

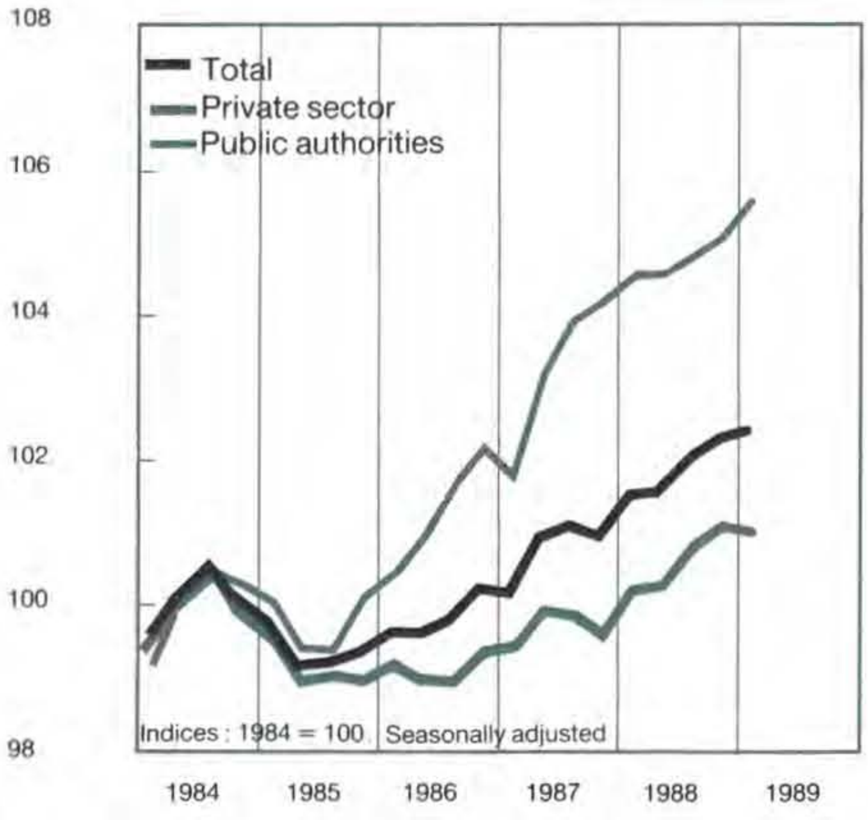
Net saving by companies declined marginally in the second quarter of 1989 as a reflection of higher tax and dividend payments. Against this, net *dis*saving by general government also decreased, as a result of the decline in real consumption expenditure by general government during this quarter and because of substantial increases in direct and indirect tax receipts. The ratio of personal saving to personal disposable income strengthened from 1½ per cent in the first quarter of 1989 to 2 per cent in the second quarter. This could be attributed to the fairly marked increases in aggregate real personal disposable income from the fourth quarter of 1988 in conjunction with the recent more modest rates of increase in households' real consumption expenditure.

Employment

Employment increases in the non-agricultural sectors of the South African economy accelerated modestly in the course of the 1986-1988 upswing from 0,5 per cent in 1986 to 1,1 per cent in 1988. In the course of 1988, a high point in the quarter-to-quarter rate of increase in total non-agricultural employment, in seasonally adjusted and annualised terms, was reached at a level of 2,2 per cent in the first quarter of the year. This rate subsequently slowed down, however, to 1,1 per cent in the fourth quarter of 1988 and to only 0,4 per cent in the first quarter of 1989.

Employment increases in the *private* sector strengthened from an annualised rate of less than 0,3 per cent in the second quarter of 1988 to 2,1 per cent in the third quarter, but fell back to 1,1 per cent in the fourth quarter. Private-sector employment then actually decreased at an annualised rate of 0,3 per cent in the first quarter of 1989, mainly because of renewed lay-offs in the mining industry and staff reductions in certain service industries (such as banks, agricultural marketing boards, hotels, laundries and drycleaning establish-

Employment in non-agricultural sectors



ments). Information currently available for the second quarter of 1989 shows private-sector employment to have increased further, but at a much reduced rate, in manufacturing but to have decreased in the construction industry. In contrast, employment increases by *public authorities* accelerated from a seasonally adjusted and annualised rate of 0,3 per cent in the second quarter of 1988 to 1,0 per cent in the fourth quarter, and to a comparatively high 2,1 per cent in the first quarter of 1989.

The ratio of overtime hours to normal hours worked in manufacturing and construction – which in the course of the 1986-1988 upswing remained at relatively low levels compared with previous cyclical upswings in the 1970s and early 1980s – appeared to have reached its cyclical peak in the third quarter of 1988. It then retreated mildly in the ensuing two quarters but recovered slightly in the second quarter of 1989.

The number of registered *unemployed* workers among the White, Coloured and Asian population groups declined from a cyclical peak of 82 300 in August 1986 to its presumed cyclical trough of 45 100 in January 1989. It then rose to 51 600 in April 1989, but showed another mild decline to 50 100 in May. The *total* number of registered unemployed workers declined from 136 900 as late as September 1987 to 107 200 in February 1989, but returned to a level of 117 100 in May.

The number of unemployed Black workers as measured by the Current Population Survey declined from more than one million in August 1987 to only 732 000 in April 1989, but rose from this low point to 789 000 in May. Relative to the estimated Black labour force, these fluctuations took the unemployment ratio from approximately 15,5 per cent in August 1987 to approximately 11,2 per cent in April 1989 and to 11,8 per cent in May.

Labour costs and productivity

The year-to-year rate of increase in the annual average amount of nominal salaries and wages per worker in the non-agricultural sectors of the economy rose during the 1986-1988 upswing period from 14,4 per cent in 1986 to 16,0 per cent in 1988. The further acceleration of the rise in the average nominal wage in 1988 was due entirely to the stepped-up tempo of wage increases in the private sector, which reached a level of 17,7 per cent. In contrast, the rate of increase in the average nominal wage paid by public authorities slowed down from 15,0 per cent in 1987 to 12,4 per cent in 1988.

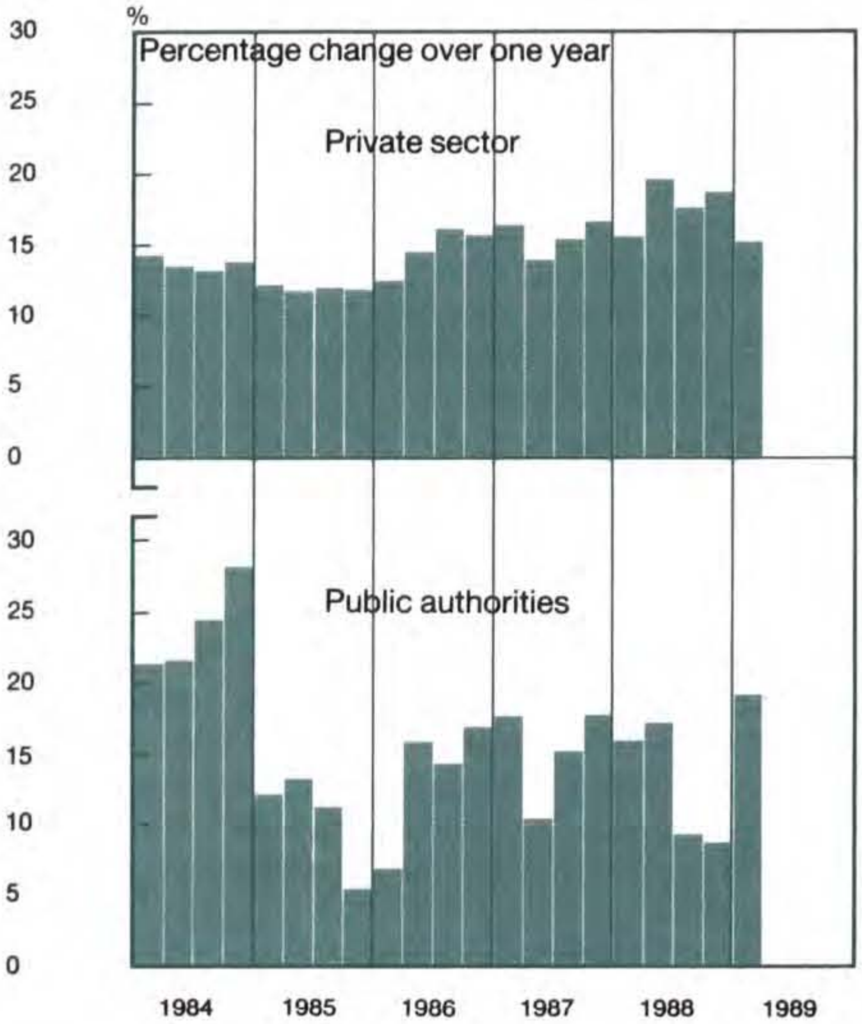
The year-*on*-year rate of increase in the nominal amount of wages per worker in the non-agricultural private sector accelerated also in the course of 1988 from an average of 17,4 per cent in the first half of the year to 17,9 per cent in the second half. It then fell back quite abruptly, however, to 14,9 per cent in the first quarter of 1989. Again in contrast to these developments, the year-on-year rate of increase in the nominal wage per worker paid by public authorities slowed down in the course of 1988 from 16,4 per cent in the first half of the year to only 8,7 per cent in the second half. It then rose sharply, however, to as much as 18,9 per cent in the first quarter of 1989.

The wage restraint exercised by public authorities in the second half of 1988 still caused the year-on-year rate of increase in the average nominal amount of labour remuneration of *all* non-agricultural workers to slow down from the first to the second half of 1988. This rate did accelerate, however, from 14,7 per cent in the third quarter of 1988 to 15,2 per cent in the fourth quarter, and to 16,2 per cent in the first three months of 1989.

The acceleration of nominal wage increases from 1987 to 1988, and the renewed acceleration of these increases in the past few calendar quarters, helped to preserve most of the recent year-on-year increases in the average *real* wage of all non-agricultural workers, despite the reacceleration of most inflation rates from early 1988. The average real wage per worker was 2,9 per cent higher in 1988 than in 1987. On a quarterly basis, the average real wage per worker in the third and the fourth quarter of 1988 and in the first quarter of 1989 exceeded their counterparts of one year earlier by 2,0, 2,5 and 2,4 per cent.

Comparatively impressive rates of increase in non-agricultural labour productivity from the second

Average remuneration per worker in non-agricultural sectors



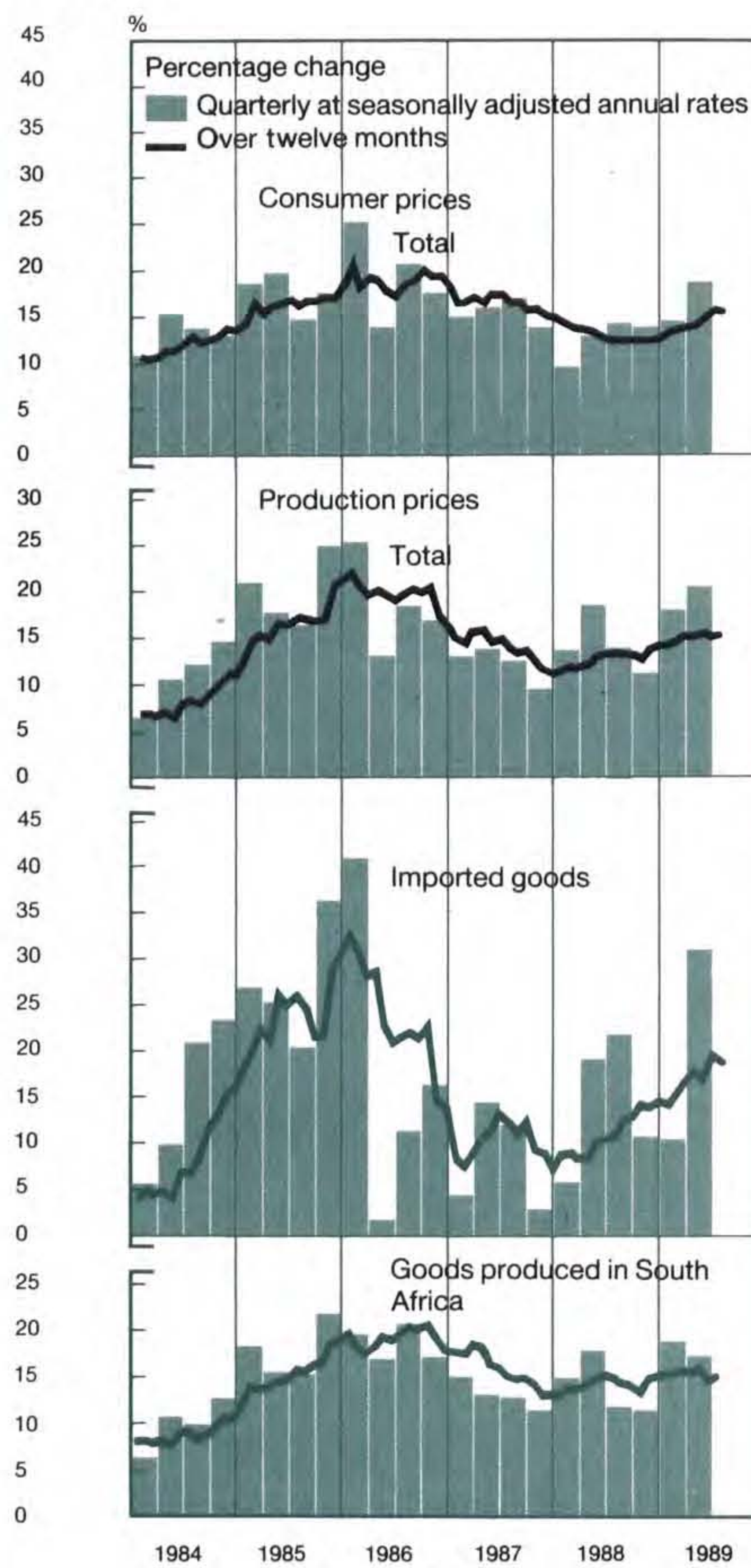
quarter of 1988 served to hold down the year-on-year rate of increase in nominal labour costs per unit of physical production to 11,4 per cent in the third quarter of 1988 and to 12,2 per cent in the fourth quarter. In the first quarter of 1989, however, the advance in labour productivity slowed down to a year-on-year rate of 2 per cent. In conjunction with the accelerated advance in the average nominal wage of all non-agricultural workers, this caused the year-on-year rise in nominal unit labour costs to accelerate to 13,9 per cent.

Real unit labour costs declined in the recession year 1985 and in the early upswing years 1986 and 1987. Because of broadly similar rates of increase in the real wage per worker and in physical labour productivity, the real unit labour costs subsequently rose only marginally by 0,4 per cent in 1988 and at a year-on-year rate of 0,3 per cent in the first quarter of 1989.

Prices

The temporary strengthening of the effective exchange rate of the rand in the fourth quarter of 1988 was an important factor in reducing the quarter-to-quarter rate of increase in the prices of *imported goods*, in seasonally adjusted and annualised terms, from 21,6 per cent in the third quarter of 1988 to 10,3 per cent in the first quarter of 1989. However, the renewed slide in the exchange value of the rand through most of the first half of 1989, and the spreading effect of the increased import surcharges, then caused this rate to reaccelerate dramatically to an annualised level of no less than 30,7 per cent in the second quarter of 1989. The *twelve-month* rate of increase in the prices of imported goods (which had turned around from a low point of 6,7 per

Prices



cent in December 1987) rose from 13,9 per cent in January 1989 to 17,8 per cent in April, and to 19,3 and 18,7 per cent in June and July.

The quarter-to-quarter and annualised rate of increase in the prices of *domestically produced goods* rose from 11,5 per cent in the fourth quarter of 1988 to 18,9 per cent in the first quarter and 17,2 per cent in the second quarter of 1989. This was mainly a reflection of accelerated increases in the prices of manufactured goods.

The marked worsening of price advances in the areas of both imported and domestically produced goods caused a near-doubling of the quarter-to-quarter seasonally adjusted and annualised rate of increase in the total *production price index* over a six-month period from a comparatively moderate 10,9 per cent in the fourth quarter of 1988 to 20,2 per cent in the second quarter of 1989. The *twelve-month* rate of increase in the production price index, however, rose only fairly modestly from 14,6 per cent in January 1989 to 15,8 per cent in May. It then retreated somewhat unexpectedly, but mildly, to 15,3 and 15,5 per cent in June and July.

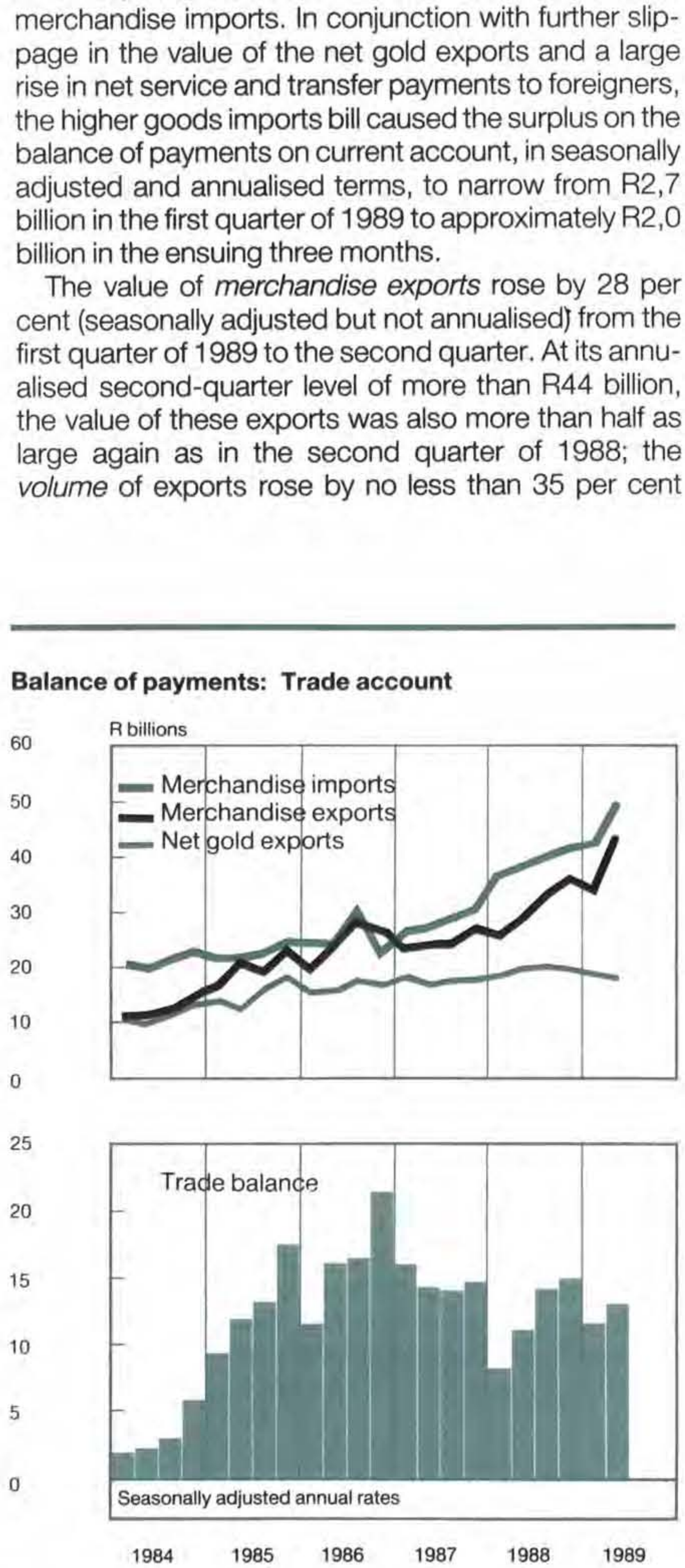
The tempo of inflation as measured by the quarter-to-quarter rate of increase in the *consumer price index,* seasonally adjusted and annualised, quickened sharply during the six quarters to mid-1989 from 9,2 per cent in the first quarter of 1988 through 13,9 per cent in the third quarter of 1988, to 14,3 per cent and as much as 18,4 per cent in the first and the second quarter of 1989. The slowdown in the price advances of consumer *goods* that had been observed in the second half of 1988 and the first quarter of 1989, was reversed in the second quarter of 1989, when the annualised rate of these price increases amounted to 19,7 per cent. In contrast, the rate of increase in the prices of *services* accelerated from mid-1988 to 19,0 per cent in the first quarter of 1989, but slowed down to 14,9 per cent in the second quarter. The *twelve-month* rate of increase in the overall consumer price index rose from 13,3 per cent in January 1989 to 15,7 per cent in June, but decelerated marginally to 15,5 per cent in July.

Balance of payments and exchange rates

After a moderate slackening in the first quarter of 1989, the South African merchandise export performance showed a quite exceptional strengthening in the second quarter. An unexpectedly large increase was, however, also recorded in the volume and value of merchandise imports. In conjunction with further slippage in the value of the net gold exports and a large rise in net service and transfer payments to foreigners, the higher goods imports bill caused the surplus on the balance of payments on current account, in seasonally adjusted and annualised terms, to narrow from R2,7 billion in the first quarter of 1989 to approximately R2,0 billion in the ensuing three months.

The value of *merchandise exports* rose by 28 per cent (seasonally adjusted but not annualised) from the first quarter of 1989 to the second quarter. At its annualised second-quarter level of more than R44 billion, the value of these exports was also more than half as large again as in the second quarter of 1988; the *volume* of exports rose by no less than 35 per cent

Balance of payments: Trade account



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

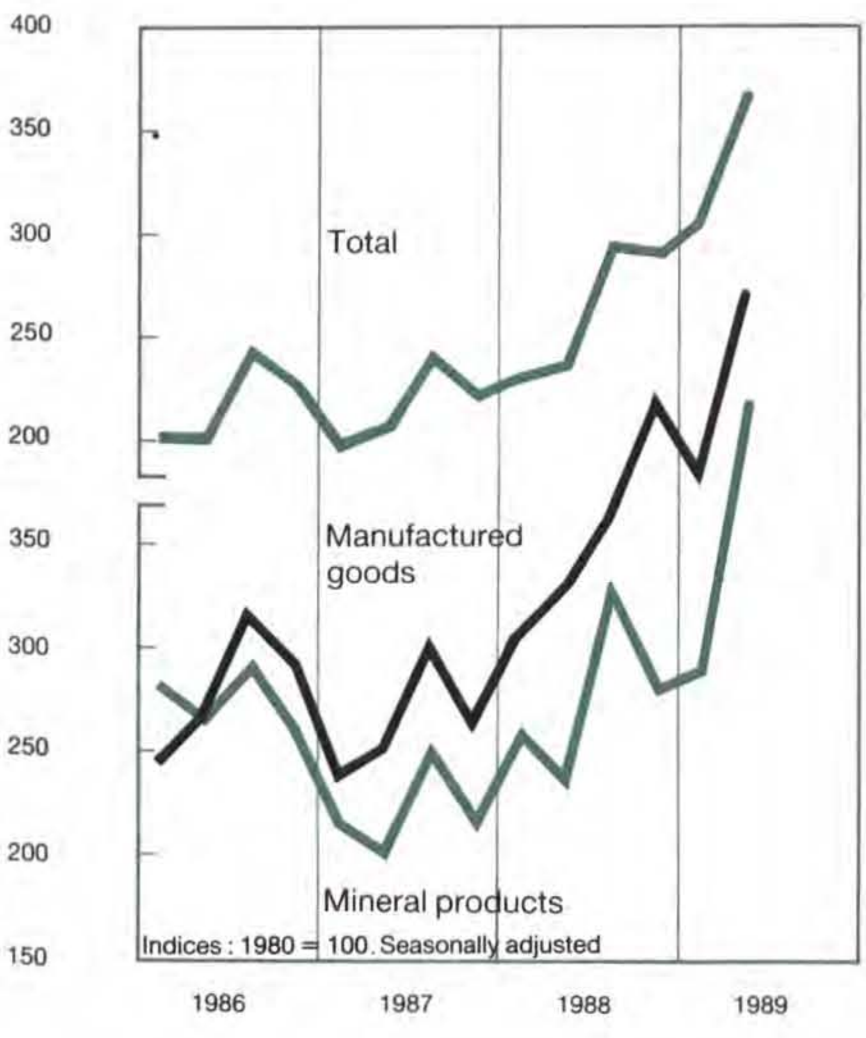
	1988					1989	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	26 300	29 282	33 830	36 476	31 472	34 560	44 320
Net gold exports	18 530	19 948	20 230	19 780	19 622	18 970	18 150
Merchandise imports	-36 780	-38 310	-40 070	-41 520	-39 170	-42 150	-49 580
Net service and transfer payments	-8 108	-9 172	-9 370	-9 290	-8 985	-8 670	-10 920
Balance on current account	**-58**	**1 748**	**4 620**	**5 446**	**2 939**	**2 710**	**1 970**

over this four-quarter period. As a result, and despite the somewhat disappointing behaviour of merchandise exports in January-February 1989, the seasonally adjusted and annualised rate of expansion of the value of South African exports from its average level in the year 1988 to its average level in the first half of 1989 amounted to some 25½ per cent.

The 28 per cent increase in the value of merchandise exports from the first to the second quarter of 1989 consisted of a 20 per cent increase in export volumes and a 7 per cent rise in the average level of export prices. Improved export performances were observed in all goods categories. Particularly large increases were recorded, however, in the exports of various manufactured goods (including base metals, machinery and electrical equipment, transport equipment, chemical products and textiles) as well as of mineral products. The 7 per cent rise in export prices was attributable to a further decline (of 4,8 per cent) in the average effective exchange value of the rand during the second quarter as well as to certain commodity price increases in the international commodity markets.

The average dollar price of gold weakened from US$394 per fine ounce in the first quarter of 1989 to US$374 in the second quarter and amounted to US$384 in the first half of the year (against $453 in the first half of 1988). Accelerated weakening of the rand/dollar exchange rate, however, caused the *rand* price of gold to

Merchandise exports



Gold price

recover mildly from R970 to R998 per fine ounce from the first to the second quarter of 1989. The 4½ per cent decline in the rand value of *net gold exports* during this period was accounted for more than fully by a shrinkage of physical gold production, which, in turn, was due to some further decline in the grade of ore milled.

The value of *merchandise imports* rose rather unexpectedly – in the face of a mild decline in real gross domestic expenditure, slackening of the growth rate in real gross domestic product, and policy measures to discourage imports – by as much as 17½ per cent (seasonally adjusted but not annualised) from the first to the second quarter of 1989. This rise in the value of imports was mainly due to an increase of 10 per cent in import volumes; the new spurt in import volumes, in turn, would appear to have been explained partly by South African businesses' pre-emptive purchases of imported goods in anticipation of possible further exchange rate depreciation, higher world oil prices or possible further measures for the curbing of imports, as well as by firms' rebuilding of inventories of imported goods. The more important increases in the quantities of imports were recorded under the headings of mineral products, machinery and electrical equipment, and transport equipment.

The 6½ per cent rise in the average rand price of imported goods from the first to the second quarter of 1989 was accounted for by the decline in the average effective exchange rate of the rand, higher international crude oil prices, and some acceleration of inflation in trading partner countries.

Net service and transfer payments to foreigners rose very strongly (by a seasonally adjusted but unannualised 26 per cent) from an annual level of R8,7 billion in the first quarter of 1989 to a new record high at an annual level of R10,9 billion in the second quarter. This was mainly a reflection of higher freight and merchandise insurance payments on the markedly higher rand value of merchandise imports, higher South African interest payments to foreigners, and increased South African travel expenditures abroad.

Capital account

Despite substantial repayments on foreign debt under the standstill agreement, the total outflow of capital not related to reserves shrank significantly from its relatively high level of around R1,9 billion in the first quarter of 1989 to R1,1 billion in the second quarter. An unusually large proportion of this second-quarter outflow consisted of outflows of long-term capital. Long-term capital outflows actually exceeded the outflow of short-term capital for the first time since the third quarter of 1987.

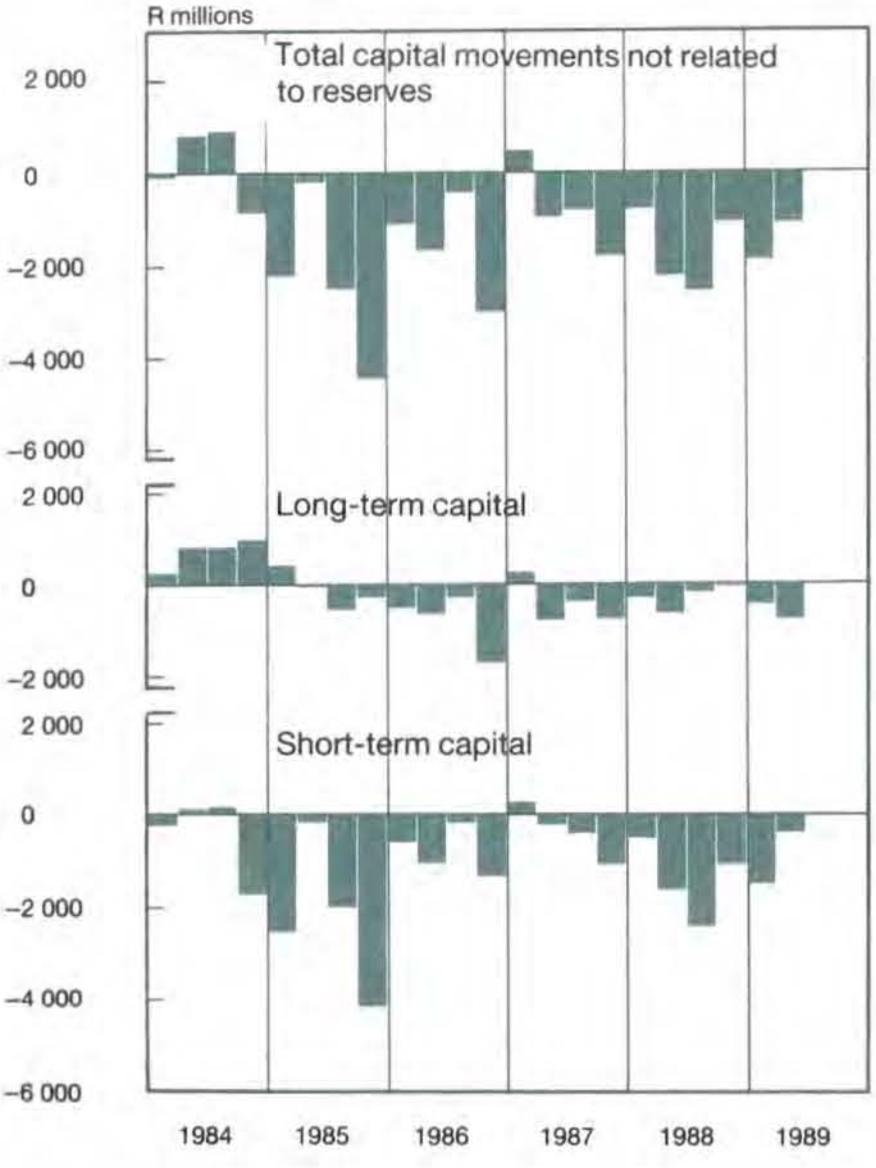
The outflow of long-term capital rose from some R0,4 billion in the first quarter of 1989 to more than R0,7 billion in the second quarter, mainly on account of the half-yearly repayments (in June) on debt that had fallen due in terms of the standstill arrangements and because of further repayments outside the standstill net on maturing bearer bonds and notes. Transactions by foreigners in securities listed on the Johannesburg Stock Exchange – as included in these amounts – turned around from net *purchases* of R67 million during the year 1988 to net *sales* amounting to R269 million and R381 million in the first and the second quarter of 1989. Public corporations, however, were net importers of long-term foreign capital (mainly in the form of project financing) for the third consecutive quarter.

The outflow of non-reserve-related short-term capital (which, at nearly R1,5 billion in the first quarter of 1989, had somewhat exceeded the high average

Net capital movements (not related to reserves)
R millions

	1988					1989	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Long-term capital							
Public authorities	–24	–138	5	–276	–433	–306	–143
Public corporations	–140	–179	–233	146	–406	124	316
Private sector:							
Net purchases of listed securities by non-residents	–35	9	75	18	67	–269	–381
Other capital	–88	–307	9	106	–280	56	–520
Total long-term capital	–287	–615	–144	–6	–1 052	–395	–728
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities	–475	–1 594	–2 390	–1 035	–5 494	–1 456	–335
Total capital movements excluding liabilities related to reserves	**–762**	**–2 209**	**–2 534**	**–1 041**	**–6 546**	**–1 851**	**–1 063**

Net capital movements



quarterly amount of such outflows in the course of 1988) fell back substantially to only somewhat more than R0,3 billion in the second quarter of 1989. This was the smallest such quarterly outflow since the second quarter of 1987. The sharp drop in this outflow would appear to have indicated an abatement and partial reversal of earlier unfavourable leads and lags in international payments and receipts in the second half of June 1989 in particular. In addition, foreign funds in the form of short-term capital were attracted by public corporations in the second quarter of 1989 to an amount of R185 million.

Foreign reserves

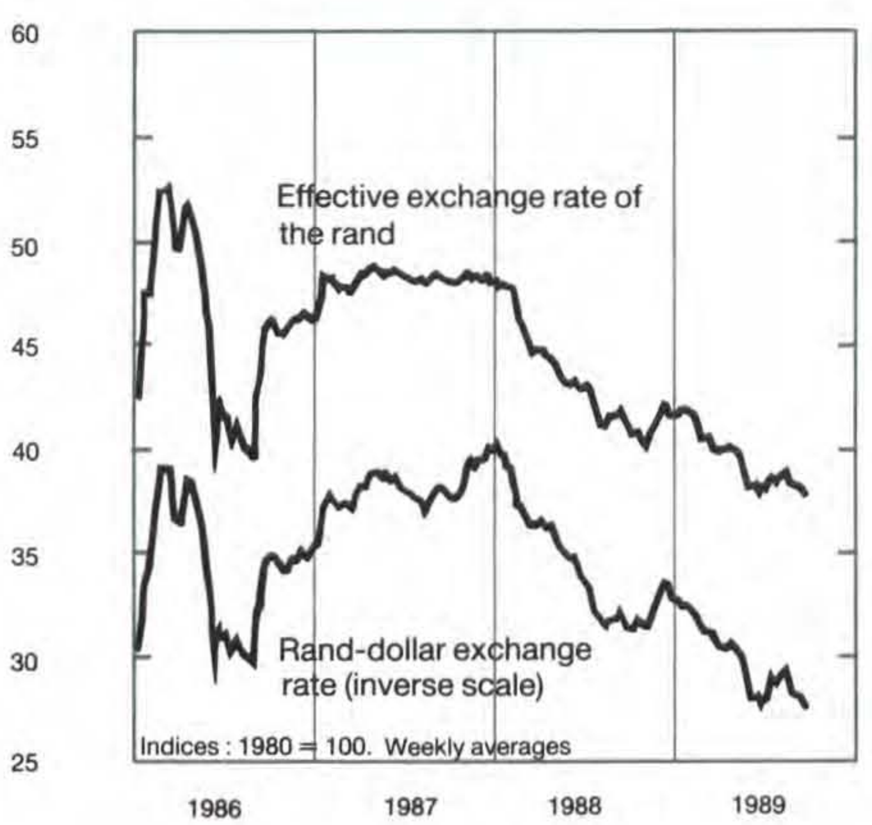
The total South African gross gold and other foreign reserves strengthened by R462 million during the second quarter of 1989 to R7,4 billion at the end of June, largely because of reserve-related borrowing. The rise in these reserves during the first half of 1989 was thereby brought to R698 million. In terms of the US dollar, however, the gross reserves still *declined* by US$157 million during this period. In July and August, the gross gold and other foreign reserves of the Reserve Bank rose further by R163 million. The Bank's gold reserves declined from 4,1 million fine ounces at the end of March 1989 to 3,7 million fine ounces at the end of August.

Exchange rates

Large outflows of non-reserve-related capital from South Africa and the declining dollar price of gold, but more in particular a new surge of strength of the US dollar in the world foreign exchange markets from the beginning of 1989, caused the effective exchange rate of the rand to decline by nearly 11 per cent from 12 January to 15 June 1989. The petering-out and slight *net* reversal of this strenghtening of the dollar from mid-June to mid-September subsequently caused the rand to regain 2,2 per cent of its value in terms of the dollar up to the middle of September. However, because of mild depreciations of the rand against other major currencies, the strengthening of the effective exchange rate of the rand from mid-June to the middle of September 1989 amounted to only 1,0 per cent.

The financial rand fluctuated in the second quarter of 1989 between a high point of R3,91 to the dollar and a low point of R4,26 to the dollar. It then weakened, however, during the ensuing eight weeks, when it was traded between limits of R3,94 and R4,38 to the dollar. Disinvestment from South Africa by a major British-based gold mining company was announced in August 1989. In addition, the facility allowing non-residents to buy fixed property in South Africa partly through the

Exchange rates



Changes in exchange rates of the rand
%

	12 Jan 1989 to 15 Jun 1989	15 Jun 1989 to 12 Sept 1989
Weighted average	–10,9	1,0
US dollar	–17,6	2,2
British pound	–2,4	–0,2
German mark	–7,9	–0,3
Swiss franc	–6,3	–0,6
Japanese yen	–1,3	–0,6
French franc	–8,6	–0,8
Financial rand	–5,1	4,9

use of financial rand, was withdrawn with effect from 11 August 1989. These events, however, did not prevent the discount of the financial rand vis-à-vis the commercial rand from narrowing marginally in the course of July and August 1989 from 35,5 per cent in the second quarter to 34,7 per cent. Partly because of the rand's recently renewed depreciation against the dollar, and partly because of some strengthening of the financial rand, the discount then narrowed further to 30,0 per cent on 12 September 1989.

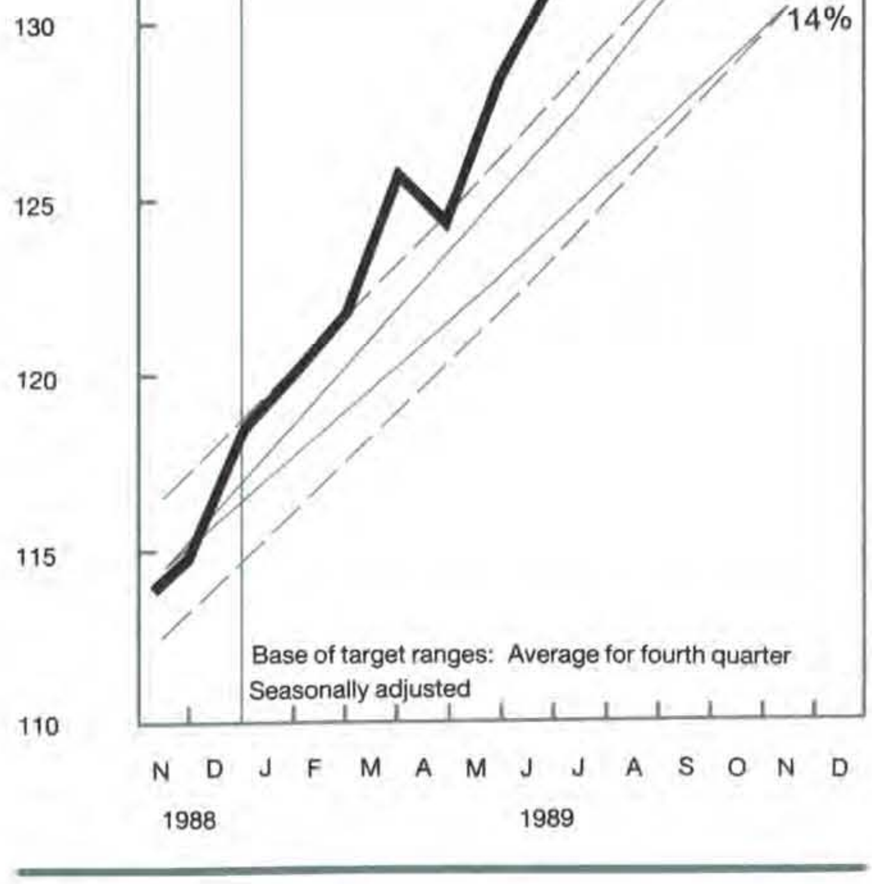
Financial markets

Money supply

Rates of increase in the broadly defined money supply, M3, which had accelerated sharply from the second quarter of 1987, peaked at high levels in the third quarter of 1988 and receded only mildly thereafter. The twelve-month rate of increase in M3 touched a high point of 27,9 per cent in August 1988 before sinking back slightly to a low point of marginally less than 25,3 per cent in April 1989. Revised data show it to have amounted to marginally more than 25,3 per cent in July.

The seasonally adjusted and annualised rate of increase in M3 from the notional starting-point of the 1989 targeting year (mid-November 1988) to the end of July 1989 amounted to 23,5 per cent. This rate therefore also still substantially exceeded the 18 per cent upper limit of the 1989 target range. The level of M3 as at the end of July permitted monetary expansion at a seasonally adjusted and annualised rate of only 5,7 per cent up to the end of December 1989 if the

Target ranges for growth in M3



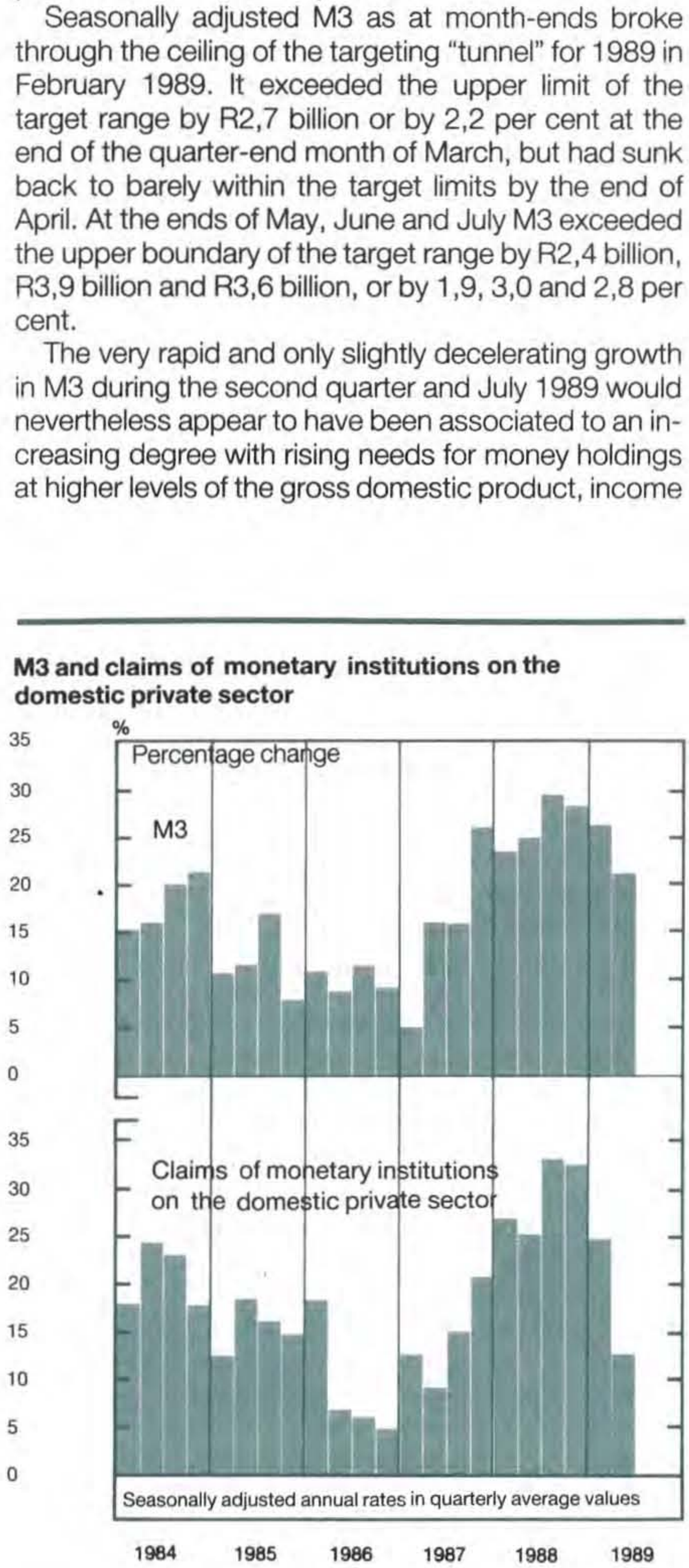
quarterly average of M3 in the fourth quarter of 1989 is not to exceed M3's quarterly average in the fourth quarter of 1988 by more than 18 per cent.

The quarter-to-quarter rate of increase in M3 in seasonally adjusted and annualised terms similarly retreated only slightly from its high point of 29,5 per cent in the third quarter of 1988 to 28,3 per cent in the fourth quarter, but more impressively, namely to 21,0 per cent, in the second quarter of 1989.

Seasonally adjusted M3 as at month-ends broke through the ceiling of the targeting "tunnel" for 1989 in February 1989. It exceeded the upper limit of the target range by R2,7 billion or by 2,2 per cent at the end of the quarter-end month of March, but had sunk back to barely within the target limits by the end of April. At the ends of May, June and July M3 exceeded the upper boundary of the target range by R2,4 billion, R3,9 billion and R3,6 billion, or by 1,9, 3,0 and 2,8 per cent.

The very rapid and only slightly decelerating growth in M3 during the second quarter and July 1989 would nevertheless appear to have been associated to an increasing degree with rising needs for money holdings at higher levels of the gross domestic product, income and expenditure at current prices, rather than with reintermediation phenomena and investors' strengthening "liquidity preference proper". The rates of increase in M3 from the fourth quarter of 1988 to the first and the second quarter of 1989 still exceeded the rates of increase in nominal gross domestic product. As a result, M3's velocity of circulation – which had reached its most recent cyclical peak value in the first quarter of 1987, at a level of 2,020 – declined further from 1,832 in the fourth quarter of 1988 to 1,801 in the first quarter of 1989 and to 1,796 in the second quarter. The marginal extent of the decline in velocity from the first to the second quarter of 1989 suggests, however, that the various factors that have been driving the downward movement of velocity over the past nine quarters have no longer been as powerful recently as they were before.

M3 and claims of monetary institutions on the domestic private sector



The diminishing significance of reintermediation phenomena and of investors' "liquidity preference proper" could be accounted for partly by the fact that from late in the second quarter of 1989 interest rates were generally considered to have peaked, although no expectations of significant *declines* in interest rates could be derived from the monetary authorities' official pronouncements concerning interest rate policy in the second and the third quarter of the year. Diminished prospects of further interest rate increases also served to strengthen the price performances of shares on the Johannesburg Stock Exchange, and even of longer-dated fixed-interest securities. Finally, enhanced interest rate stability meant a bottoming-out of the shrinking of the differentials between banks' average lending and average deposit interest rates; the narrowing of these differentials from early 1987 through 1988 and early 1989 had acted as a stimulus to reintermediation and therefore contributed to lower velocities of circulation of the money supply.

In much of the year to mid-1989, rising interest rates and expectations of further rises in interest rates contributed to increases in M3 that were 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 in the twelve-month period to the end of July 1989 amounted to 13,3 per cent, 9,9 per cent, 30,8 per cent and 25,3 per cent. "Other short" and medium-term deposits, however – comprising that part of M2 that can more obviously be regarded as being held as highly liquid financial *investments* – rose by as much as 49,2 per cent during this period. Long-term deposits, on the other hand, rose by only 9,2 per cent. Against this, the seasonally adjusted and annualised rates of increase in "other short" and medium-term deposits and in long-term deposits in the more stable interest rate environment for the period from the end of March to the end of July 1989 amounted to 36,3 per cent and to a remarkable 40,3 per cent – the latter increase reflecting mainly banks' large issues of negotiable certificates of deposit. The comparable *de*crease of 19,2 per cent in M1 during this period may be held to have been a reflection of depositors' expectations that interest rates had reached their peak or near-maximum levels.

As during the first quarter of 1989, the most important single statistical counterpart of the increase in the seasonally adjusted M3 money supply during the June quarter of 1989 (which amounted to R5,8 billion) was a further large increase in monetary institutions' domestic credit extension. Total domestic credit extended by these institutions actually still rose by a seasonally adjusted amount of as much as R6,6 billion during this period. Changes in the net gold and other foreign reserves of the monetary sector made a negative contribution (amounting to R0,8 billion) to M3 growth in the second quarter of 1989 - as they had done during most of 1988. Net claims on the government sector – as included in domestic credit – made a negative contribution to the growth in M3 in the second quarter of 1989 to an amount of R0,1 billion.

Credit extension by monetary institutions

The annualised quarter-to-quarter rate of increase in the *quarterly average* of all monetary institutions' seasonally adjusted claims on the private sector, which had still amounted to well over 30 per cent in the third and the fourth quarter of 1988, slowed down significantly to 24,8 per cent in the first quarter of 1989. It then fell back quite dramatically, however, to a comparatively moderate 13,1 per cent in the second quarter of 1989.

The rate of growth in monetary institutions' credit to private sector borrowers in the second quarter of 1989 fell short of the concurrent rates of growth in gross domestic product and gross domestic expenditure at current prices. It also occurred in the face of continued increases in real private-sector fixed investment activities, uncommonly large second-quarter increases in the volume and value of merchandise imports and exports, and increases in industrial and commercial inventories. This suggests a significant decline in the *incremental* credit demand of households and individuals as an offset to the rising credit needs of companies and "other" borrowers.

Not surprisingly (in the light of accelerations in credit extension still taking place in the third quarter of *1988)*, the *twelve-month* rate of increase in monetary institutions' total claims on the private sector retreated only moderately from its high point of 30,5 per cent in October 1988 to 26,1 per cent in June 1989.

The increase in monetary institutions' *total* claims on the private sector of R6,7 billion from the end of March to the end of June 1989 actually was still significantly larger than the first-quarter increase of R5,7 billion and was close to the average quarterly increase in these claims in 1988. The average quarterly increase of R2,6 billion in monetary institutions' *mortgage lending* in the first half of 1989 similarly still exceeded the average quarterly increase (of R2,3 billion) in such lending in 1988. As was also noted in the Reserve Bank's recent *Annual Economic Report* for 1989, however, mortgage lending by banks and building societies has been raised somewhat artificially in recent quarters through change-overs from mortgage finance provided to employees of certain public enterprises by the pension funds of these enterprises to conventional mortgage loans.

Changes in claims on domestic private sector*
Seasonally adjusted annual rates

		Al monetary institutions %
1988:	First quarter	27,0
	Second quarter	25,3
	Third quarter	33,2
	Fourth quarter	32,6
1989:	First quarter	24,8
	Second quarter	13,1

*Changes from quarter to quarter in the quarterly average of claims on the domestic private sector.

The increases in the monetary sector's extension of hire-purchase credit and leasing finance receded from R1,5 billion and R1,6 billion in the third and the fourth quarter of 1988 to R1,2 billion and R1,4 billion in the first and the second quarter of 1989, thereby providing corroborating evidence of the decline in households' real expenditure on consumer durables and of the slackening of households' incremental credit demand in general. Bank credit in the form of banking institutions' holdings of bills discounted, which had increased very rapidly in the second half of 1988, actually decreased marginally in both the first and the second quarter of 1989. It nevertheless still exhibited year-on-year increases which, in the first half of 1989, ranged from a very large 85,3 per cent at the end of February to 29,9 per cent at the end of June.

Banking institutions' "acceptance facilities utilised" similarly increased strongly from R7,0 billion at the end of June 1988 to R8,8 billion at the end of December 1988. Like the increase in the banks' *holdings* of liquid bills and acceptances, this rise in acceptance facilities utilised partly represented the private banking system's response to occasionally perceived scarcities of statutorily liquid and/or rediscountable assets. The amount of acceptance facilities utilised subsequently moved essentially sideways, however, during 1989 to date. It reached a level of R9,0 billion at the end of June 1989.

Unusually large flows of revenue to the Exchequer in the fiscal year 1988/89 and in the first quarter (the June quarter) of fiscal 1989/90 occasionally contributed to substantial build-ups of government balances with the Reserve Bank. This was reflected in correspondingly large declines in the monetary system's net claims on the government sector. The change in these claims over twelve-month periods dramatically reversed itself from a peak rate of *in*crease of 74,6 per cent in August 1988 to a *de*crease of 33,7 per cent in June 1989.

Reserve Bank operations in the money market

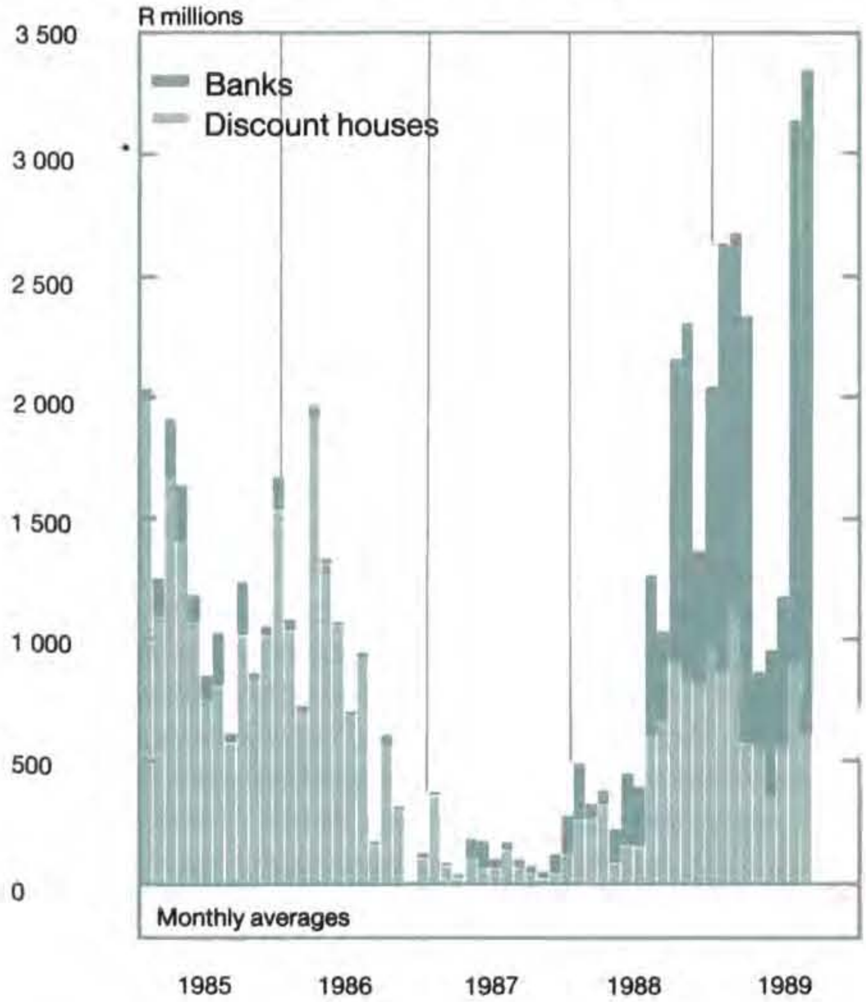
Money market conditions, as measured by the market's need for Reserve Bank accommodation, eased during the period from April to June 1989 but tightened considerably during July and August. Easier conditions in the market in the second quarter of 1989 could be attributed initially to the sharp decline in government deposits with the Reserve Bank in February and March and the substantially reduced average level of these deposits in April. In addition, the market's easier tone was aided by the second-quarter decline in the rate of increase in the money supply. Finally, the substantial losses incurred by the Reserve Bank in its provision of forward foreign exchange cover were an important element in keeping up the availability of cash reserves to the banking system.

The average daily level of the Reserve Bank's accommodation of the money market at the discount window declined from R2,6 billion in the first quarter of 1989 to R1,0 billion in the second quarter. No repurchase agreements with market parties were concluded by the Reserve Bank during this period.

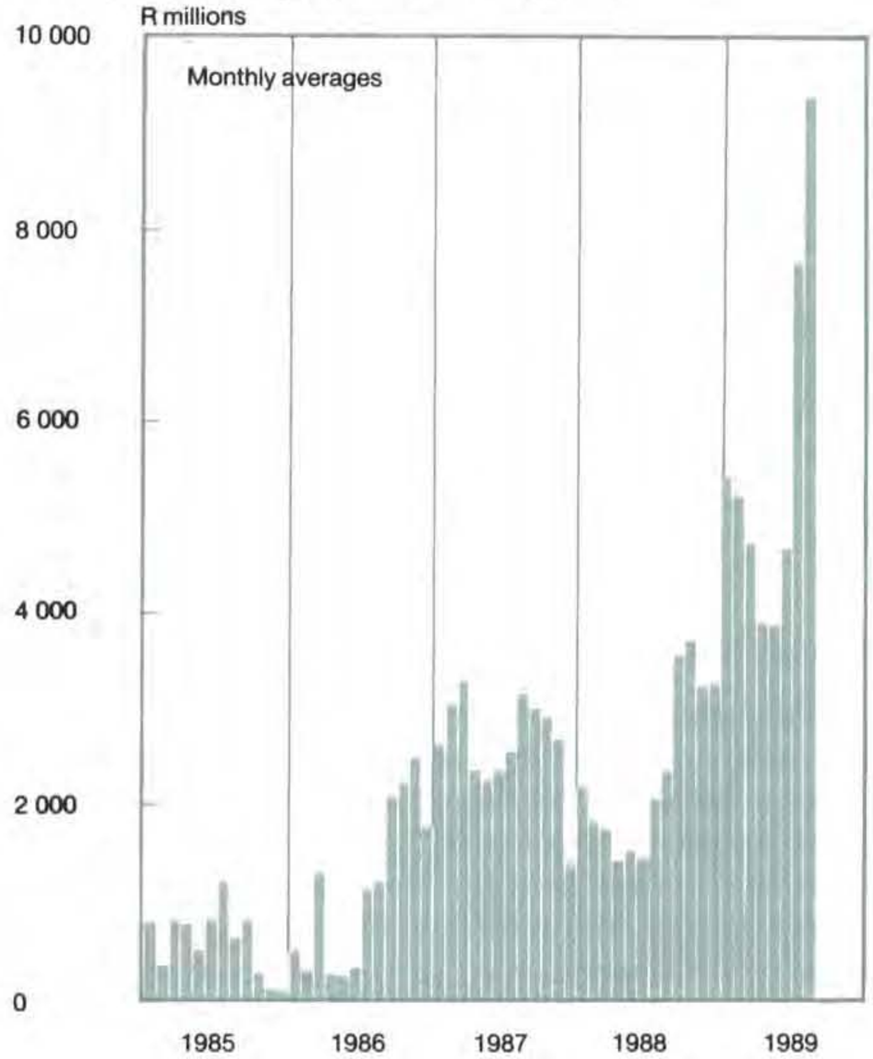
Exchequer and Paymaster General deposits with the Reserve Bank rose from R3,9 billion at the end of April 1989 to R4,7 billion at the end of May. They then rose to R6,7 billion at the end of June and to an unprecedented R10,4 billion at the end of August. In conjunction with other forces, this increase in government balances caused the market shortage, which had dwindled to a mere R110 million on 3 April, to rise to an average daily amount of R1,2 billion during June. In the course of July the average daily amount of accommodation at the discount window rose to a high R3,1 billion.

R0,2 billion of special short-dated Treasury bills matured on 31 July. Market conditions nevertheless remained tight during August, partly because of the payment by companies of the loan levy, to an amount of 10 per cent of companies' immediately preceding annual tax assessment, that had been announced on

Accommodation at the discount window



Government deposits (Exchequer and Paymaster-General Account) with the Reserve Bank



5 May 1989. Although these payments were due on 31 July, their clearance by the banking system spilled over into August.

The average daily amount of accommodation extended at the discount window during August amounted to a record R3,3 billion. In a statement dated 3 August 1989 the Reserve Bank, noting the absence of the two "traditional" reasons for issuing Treasury bills (namely, to provide bridging finance to the Treasury, or to prevent interest rates from falling), announced that as a temporary measure "no" or only "very small amounts" of Treasury bills would again be offered at the weekly tender. The Bank would, however, in the customary fashion, continue to market short, medium and long-term government stock for the purpose of funding the Government in ways that would de-emphasise the issuance of statutorily liquid instruments.

In accordance with this announcement, the amount of 91-day Treasury bills offered at the weekly tender was brought down from R100 million on 28 July to nil on 4 August. However - because of the market's tendency to misinterpret this step as a gesture towards a relaxation of monetary policy and as a condonation of a possible easing of interest rates – a small amount (of R20 million on each occasion) was again offered, in accordance with the statement of 3 August, at the tenders from 11 August 1989 onward.

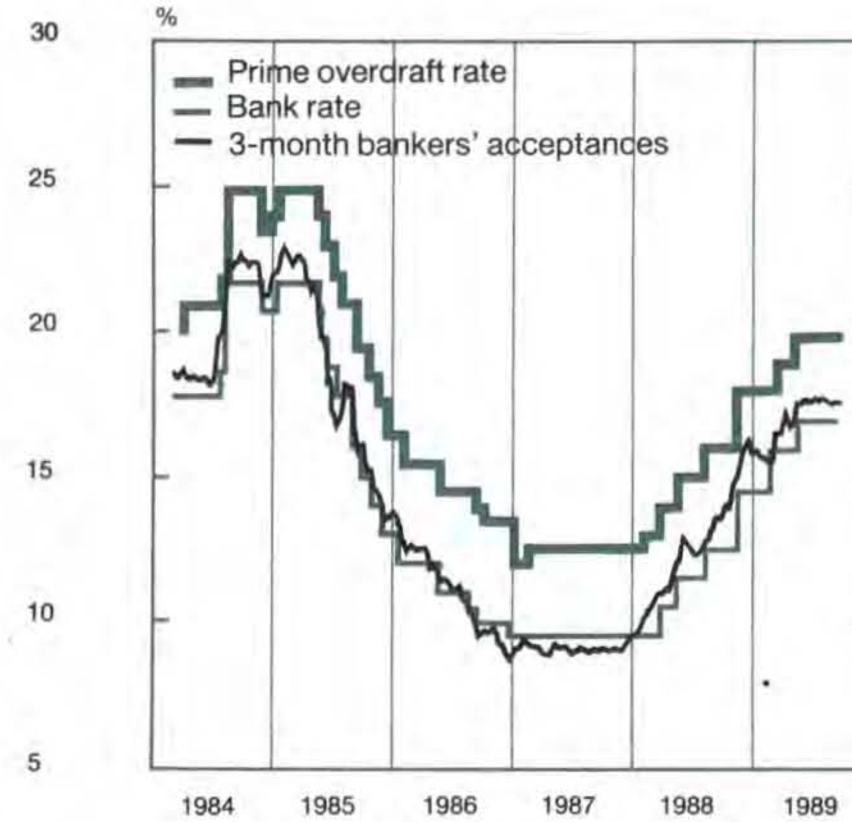
A temporary rise in market liquidity in mid-August was countered by the sale into the market of an amount of R300 million of six-day Treasury bills on 15 August. No specially-dated *tax* Treasury bills were sold in June, July or August 1989. An amount of R0,8 billion of such bills, which had been issued in May 1989, did, however, mature at the end of August and served as a partial offset to the flow of tax payments to the Exchequer over the August month-end.

The total amount of the Reserve Bank's net sales of government stock ran to R0,8 billion during July 1989 and to R1,5 billion during August. The total of such sales for the first five months of the fiscal year 1989/90 was thereby brought to R5,8 billion. The corresponding amount in the first five months of fiscal 1988/89 had been R6,7 billion.

Money market interest rates

Expectations of further increases in interest rates still prevailed in late April and most of May 1989, in the light of the accelerated downward slide of the dollar price of gold, further weakening of the exchange rate of the rand vis-à-vis the US dollar, and relatively discouraging money supply data in respect of February and March. Bank rate was raised, from 16 to 17 per cent, with effect from 8 May 1989. This was followed immediately by an increase of 1 percentage point in the clearing banks' prime overdraft rate; the banks' preponderant prime rate was thereby raised to 20 per cent.

Short-term interest rates

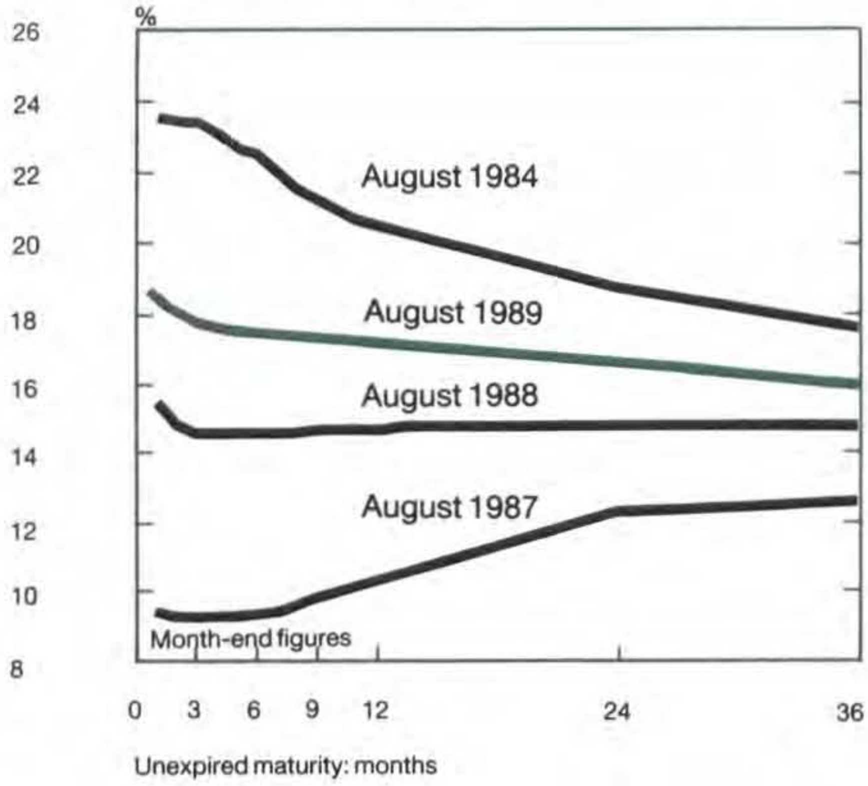


After the Bank rate increase of 8 May, the market rate on three-month liquid bankers' acceptances firmed from 16,70 to 17,35 per cent (against the Reserve Bank's new rediscount rate for such acceptances of 17,30 per cent). It then hovered around this level during the ensuing two weeks. However, negative market sentiment provoked by the steep decline in the dollar price of gold (to less than US$360 per fine ounce) and by weakness of the exchange rate of the rand in the third week of May in particular, subsequently caused the acceptance rate to harden further to 17,60 per cent in the fourth week of May.

Market rates then appeared to have topped out from late May 1989. The market rate on three-month liquid acceptances fluctuated within a relatively narrow range from 17,35 to 17,60 per cent during June, July and August. Relative interest rate stability at the short end of the maturity spectrum during this period was fostered, on the one hand, by the Reserve Bank's public statement, on 11 July 1989, of its belief that the then prevailing level of interest rates would prove "adequate for the job in hand", and, on the other hand, by the Bank's official pronouncement, on 29 August 1989, that a need remained for a continuation of a restrictive monetary and fiscal policy and that a number of reasons still existed for interest rates to remain "relatively high in nominal terms".

At the end of August 1989, the market rate on three-month liquid bankers' acceptances amounted to 17,40 per cent despite the then existing high level of refinancing accommodation at the Reserve Bank's

Yield curves for negotiable certificates of deposit



discount window. Close proximity of this market rate to the Bank's rediscount rate for bankers' acceptances of 17,30 per cent suggested a market conviction that no major adjustments to the Bank's rediscount rates were likely to be contemplated for the time being. At the same time, the relative flatness of the yield curve in respect of market instruments over a broad range of maturities suggested relative "neutrality" of the market's interest rate expectations in regard to a more extensive period.

Capital market activity

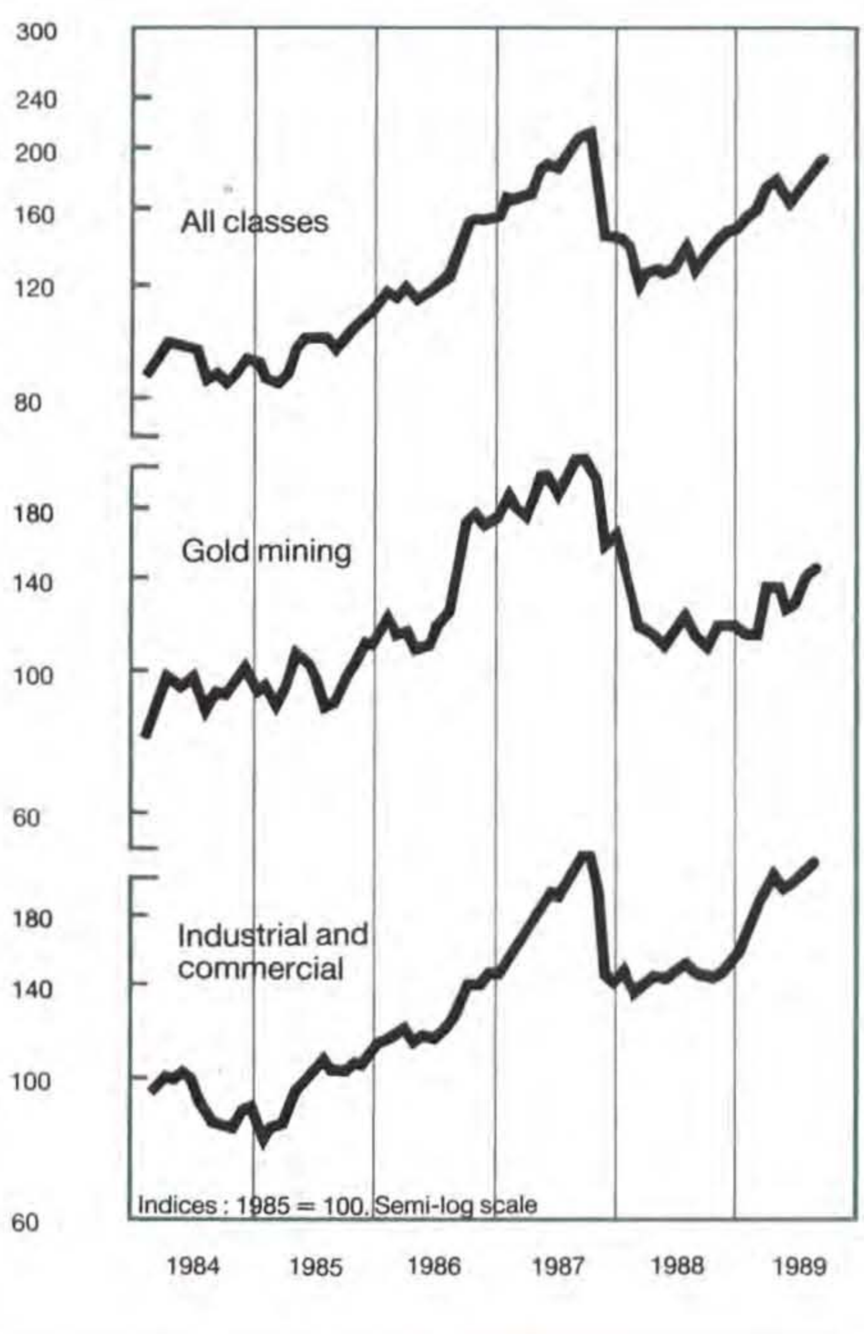
Trading activity in the capital markets, which had recovered significantly in the first quarter of 1989 from its mostly more subdued 1988 levels, strengthened somewhat further in the second quarter of 1989. Increased turnovers were recorded in public sector securities on the stock exchange and in the fixed property market. New-issue activity in the primary markets was significantly higher than in the preceding three months. A slight decline was recorded, however, in the turnover of shares on the stock exchange.

The value of public sector stock traded on the stock exchange rose from R35,0 billion in the fourth quarter of 1988 to R41,9 billion in the first quarter of 1989 and to R43,8 billion in the second quarter. However, the value of these transactions in July 1989, at R10,7 billion, was down significantly on the average monthly amount of R14,6 billion in the preceding three months.

The value of shares traded on the stock exchange, which had increased uncommonly rapidly from R3,0 billion in both the third and the fourth quarter of 1988 to R4,7 billion in the first quarter of 1989, levelled out and contracted slightly to R4,6 billion in the second quarter. The average monthly value of these transactions, however, subsequently increased from slightly more than R1,5 billion in the second quarter of 1989 to almost R1,7 billion in July.

The average price level of all classes of shares, which had recovered energetically (by a total of 29 per cent) during the fourth quarter of 1988 and the first quarter of 1989, failed to show any further rise, on balance, from the quarter-end month of March 1989 to the quarter-end month of June. Indeed, the behaviour of the all-shares price index in May 1989 momentarily appeared to suggest an end to the secondary upward phase, which had come into evidence since the October 1987 "crash", of the share market upswing that had commenced in the early months of 1985. The average price level of all classes of shares subsequently rose again, however, by a total of 10 per cent during July and August, but still failed to regain – by some 8 per cent – the high point in share prices that had been attained in September 1987.

Share prices



Stagnation of the general level of the prices of all classes of shares over the second quarter of 1989 could be attributed primarily to the effect of the sharp weakening of the dollar price of gold and associated problems of the gold mining industry in the second quarter of 1989. The 6 per cent decline in the average price level of gold mining shares from March 1989 to June 1989 was accompanied by a 1 per cent decline in the quarterly average of financial share prices. Both these downward movements were, however, neutralised by a 4 per cent rise in the average price level of industrial and commercial shares.

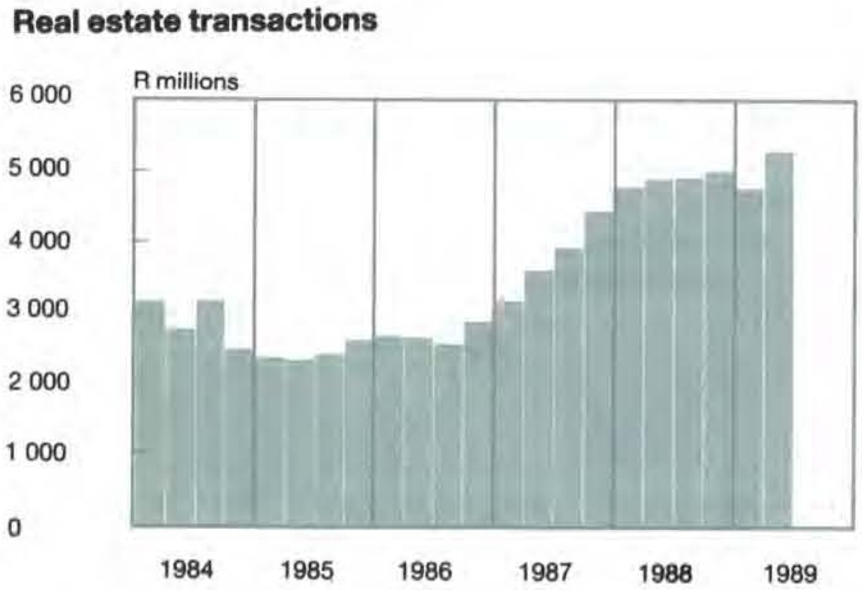
In the *primary* capital markets, the amount of funds raised by the public sector through new issues of fixed-interest securities to bank and non-bank private sector investors more than doubled from R1,1 billion in the first quarter of 1989 to R2,3 billion in the second quarter. Private companies, which had made no new issues of fixed interest securities in the first quarter of 1989, raised R555 million by means of such issues in the ensuing three months. Companies listed on the stock exchange also increased the amounts of new issues of ordinary share capital from only R58 million in the first quarter of 1989 to R342 million in the second quarter. The generally higher – albeit still relatively modest – level of new share-issuing activity in the second quarter of 1989 vis-à-vis the first quarter of 1989 and the first half of 1988 could be attributed fairly obviously to the renewed buoyancy of the share market, further increases in private companies' real fixed investment activity and the higher interest costs of bank credit. Increased recourse by corporate borrowers to the primary capital markets therefore probably also provided a minor strand in the general pattern of waning reintermediation phenomena that had set in towards the end of the 1988-1989 cyclical rise in interest rates.

In the mortgage market, mortgage loans *paid out* by building societies reached a peak of R2,7 billion in the third quarter of 1988. This amount then declined steadily to R2,3 billion, R1,9 billion and R1,8 billion in the fourth quarter of 1988 and in the first and second quarter of 1989. The amounts of these outpayments by building societies in the first two quarters of 1989 were affected downwards, however, by the mergers of three building societies with banks in the course of that period.

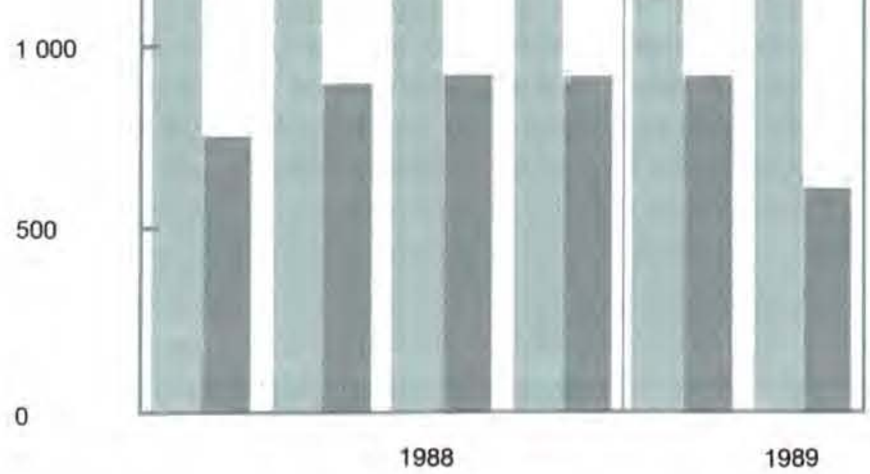
Increases in building societies' *holdings* of mortgage loans (after adjustment for the effect of a merger of a building society with a bank in February 1989) were remarkably stable at a level of around R0,9 billion in each of the four calendar quarters from the second quarter of 1988 to the first quarter of 1989. This amount then fell back quite abruptly, however, to only R0,6 billion in the second quarter of 1989 (after adjustment for two further mergers of building societies with banks in April and June).

Banking institutions increased their holdings of mortgage loans by substantially larger quarterly amounts than the building societies throughout 1988 and the first half of 1989. Considerations of declining bank liquidity, shrinking interest rate differentials, and the pressures of the demand for more conventional bank lending, nevertheless caused the amounts of the quarterly increases in the banks' holdings of housing finance mortgages (again after adjustment for the building society/bank merger in February 1989) to decline from R1,8 billion in the third quarter of 1988 to R1,2 billion in the first quarter of 1989. Slackening of credit demand from other sources subsequently was a fac-

Real estate transactions



Increase in mortgage bond holdings



tor in prompting the banks to restore the amount of this quarterly increase (after adjustment for the building society/bank mergers in April and June) to R1,4 billion in the second quarter of 1989.

Interest rates and yields

The average monthly yield on long-term government stock hardened from 16,7 per cent in the second half of February 1989 to 17,4 per cent in May in the light of a sequence of factors such as the market's uncertainties concerning the abolition of the prescribed investment requirements for institutional investors, doubts about the realisability of the 1989/90 Budget proposals, the continued upward tendency in short-term interest rates, concerns about the possible introduction of further restrictive policy measures, and the eventual increase in Bank rate to 17 per cent from 8 May. The average long stock yield then edged down to 17,2 per cent in both June and July 1989 and to 17,0 per cent in August. A more significant softening of this yield would appear to have been prevented, among other things, by the authorities' declination to accept, as yet, a significant easing of short-term interest rates, by the poor performance of the dollar price of gold, and by the deterioration of prospects for the inflation rate.

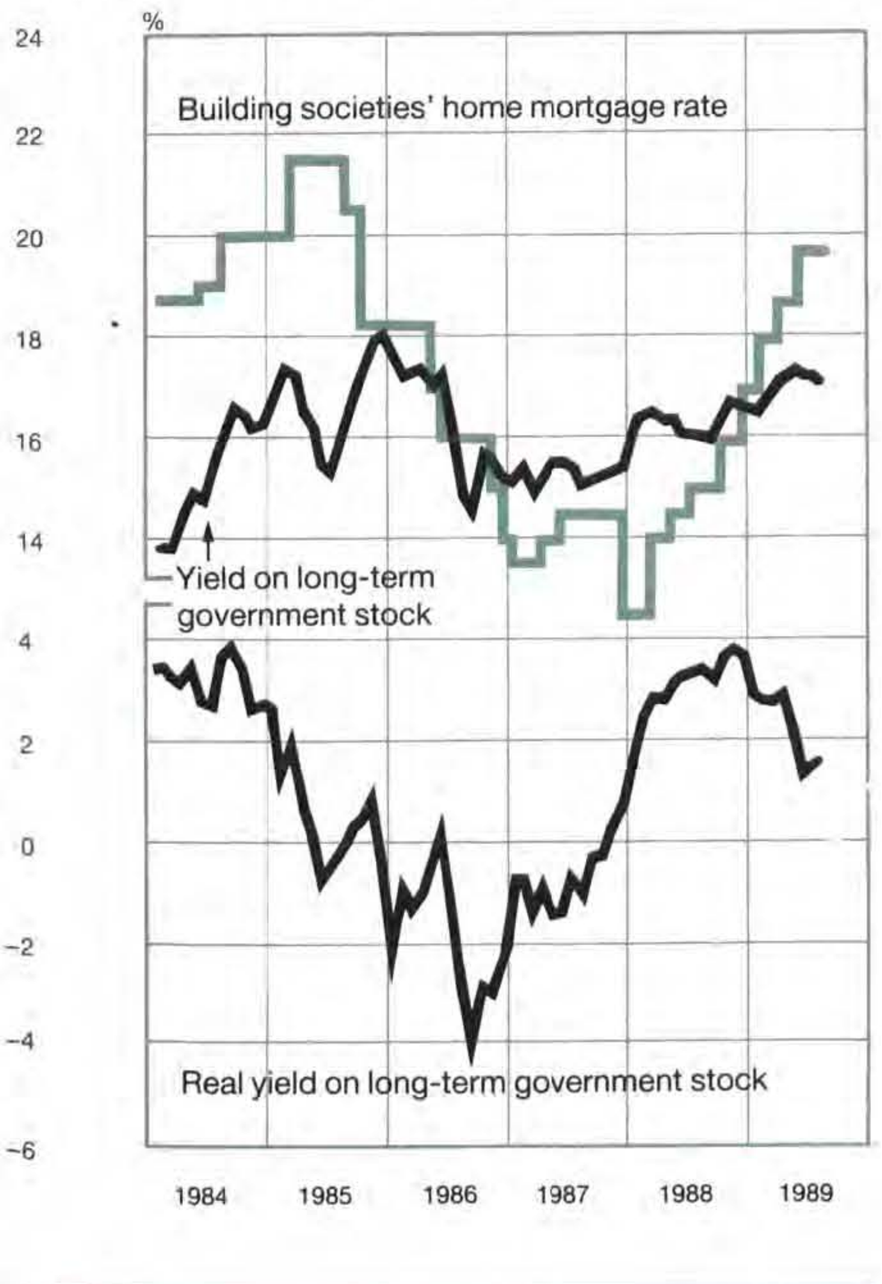
The *real* interest rate on long-term government stock (i.e. the nominal rate after adjustment for the prevailing inflation rate) turned positive in November 1987 and reached a high point of 3,9 per cent in November 1988. However, acceleration of the inflation rate well in excess of the mild further net increase in the nominal yield on long-term government stock, subsequently caused this real interest rate to decline to only 1,3 per cent in June 1989.

Despite major improvements in the financial results of listed companies, the sustained recovery of share prices caused the monthly average dividend yield on all classes of shares to decline from 6,0 per cent in December 1988 to 5,5 per cent in April 1989. The weaker share market in May, and its recovery in June, July and August, were accompanied by a rise and by a renewed decline in this yield to 5,7 per cent and to 5,2 per cent, respectively.

Following the increase in Bank rate of 23 February 1989, the predominant home mortgage rate of the building societies was raised from 18,0 per cent in March 1989 to 18,75 per cent in April. This rate subsequently was raised further, to 19,75 per cent, in June 1989, after the Bank rate increase of 8 May.

The predominant rate on twelve-month deposits with banks and building societies, which is regarded as representative of deposit rates in general, was raised to 16,0 per cent in March 1989 and to 16,5 per cent in May by both these groups of institutions. The rates on tax-free investments with building societies, the Post Office Savings Bank and the Treasury were raised by 0,5 per cent from 15 April 1989. The rate on Post Office Savings Certificates and on subscription shares and deposits with building societies was thereby brought to 9,5 per cent.

Long-term interest rates and yields



Government finance

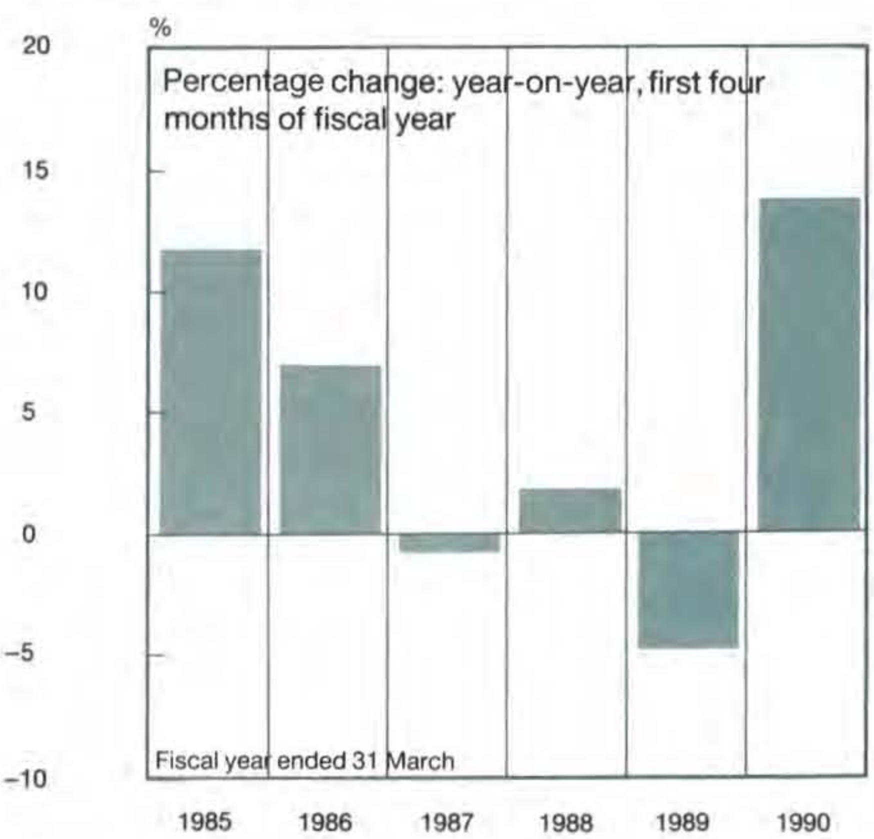
Exchequer issues and receipts

The year-on-year rate of increase in Exchequer *issues* to Central Government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) accelerated further from its high level of 31,5 per cent in the March quarter of 1989 to 33,8 per cent in the June quarter (i.e. in the first quarter of fiscal 1989/90). The rate of increase in the June quarter therefore was substantially higher than the budgeted rate of increase in government expenditure of 15,0 per cent for the fiscal year 1989/90 as a whole.

In July 1989 the year-on-year rate of increase in Exchequer issues slowed down marginally. It continued, however, at a rate well in excess of the budgeted increase in government expenditure. Total issues to government departments in the first four months of fiscal 1989/90 accordingly were 30,7 per cent higher than in the corresponding period of fiscal 1988/89.

In *real* terms the year-on-year increase in Exchequer issues during the four months to July 1989 amounted to a very large 13,7 per cent. This means that the rate of increase in Exchequer issues will have to decline sharply during the remainder of the current fiscal year if the Budget objective of avoiding any growth in real government expenditure during fiscal 1989/90 as a whole is to be adhered to.

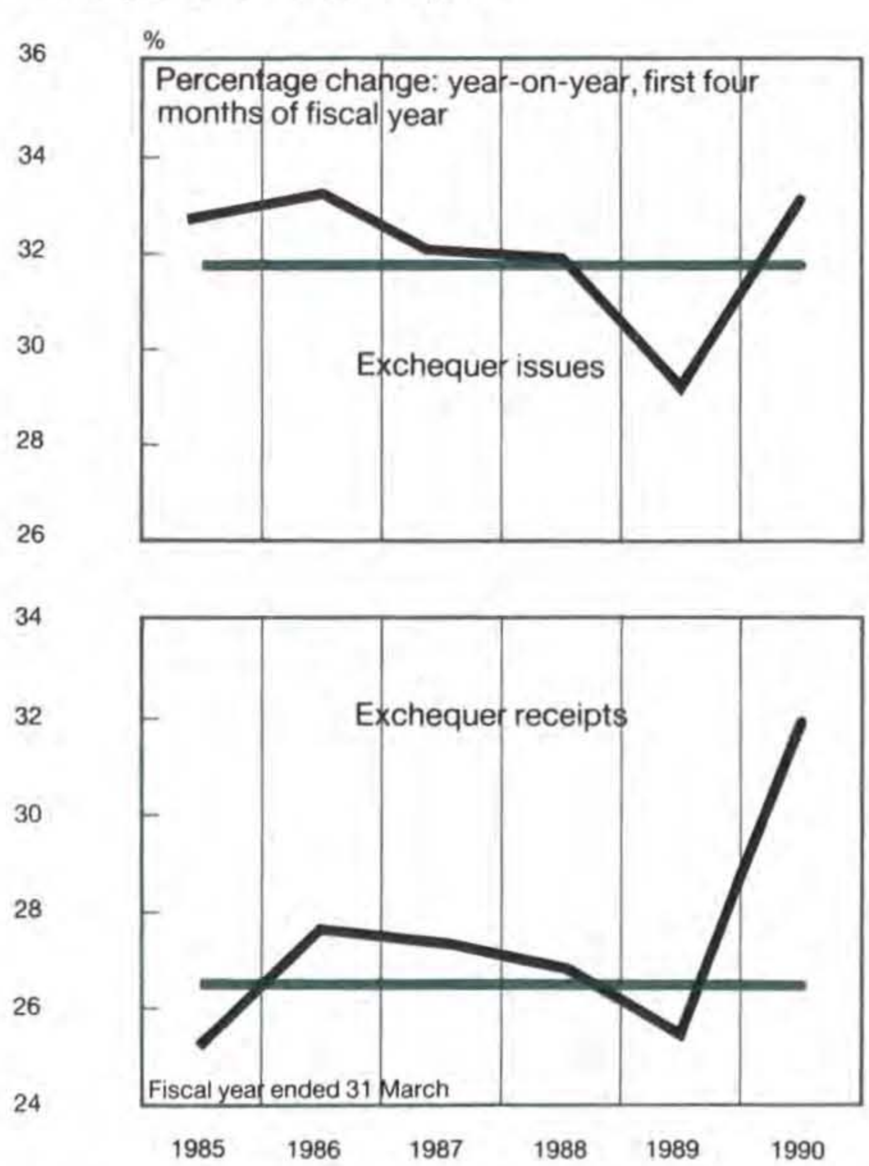
Real Exchequer issues



The nominal amount of Exchequer issues to government departments during the first four months of fiscal 1989/90 was equal to 33,0 per cent of total budgeted Central Government expenditure for the fiscal year as a whole. This may be compared with an average percentage share of issues during the first four months of fiscal years to total *actual* issues during those fiscal years of 31,7 per cent in the five fiscal years from 1984/85 to 1988/89. (The ratio of issues during the first four months of fiscal years to total *budgeted expenditure* in those fiscal years amounted to a slightly higher figure of 33,5 per cent during the five-year period concerned.) These figures again imply a need for strict fiscal discipline on the spending side of the Central Government's budgetary behaviour during the remainder of 1989/90.

The year-on-year rate of increase in Exchequer *receipts* rose from 35,2 per cent in the March quarter of 1989 to 37,2 per cent in the June quarter. This rate of increase then rose even further during July. In the first four months of fiscal 1989/90, total receipts were 39,0 per cent higher than in the first four months of fiscal 1988/89, against a budgeted increase in revenue of 16,0 per cent for the fiscal year as a whole.

Exchequer issues and receipts



*Average for fiscal years 1984/85 to 1988/89

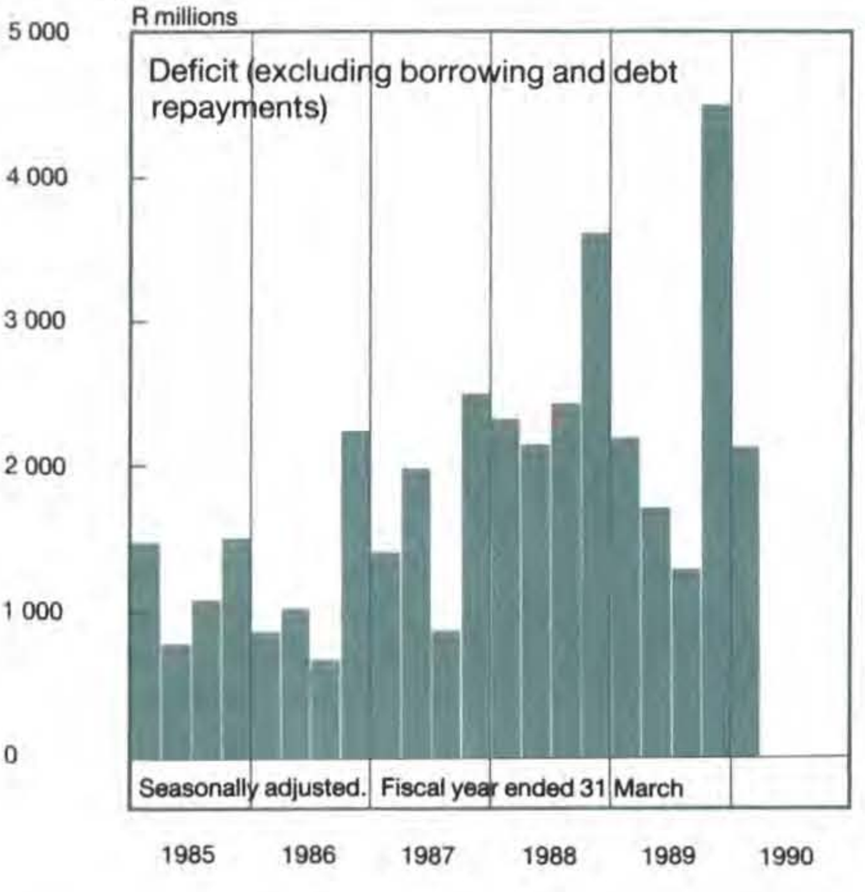
During the four months to July 1989 total Exchequer receipts were equal to 31,9 per cent of total budgeted government revenue for fiscal 1989/90. This may be compared with an average percentage share of receipts during the first four months of fiscal years to total *actual* receipts during those fiscal years of 26,5 per cent with regard to the five fiscal years from 1984/85 to 1988/89. Government revenue in fiscal 1989/90 as a whole should therefore almost certainly be expected to exceed the budgeted figure for such revenue by a considerable amount.

The strength of Exchequer receipts in the first four months of fiscal 1989/90 derived mainly from the cumulative effect of the increases in the fuel levy and in the surcharge on imports that had been introduced in August 1988. In addition, revenue collections from the general sales tax were significantly higher during this period than in the corresponding period in fiscal 1988/89.

Deficit before borrowing

The deficit before borrowing and debt repayment in the first four months of fiscal 1989/90 amounted to R3 887 million, or to R106 million more than in the corresponding period in 1988/89. At this level the cumulative deficit in the four months to July 1989 was equal to 39,1 per cent of the deficit of R9 949 million that had been envisaged in the March 1989 Budget for the fiscal year as a whole.

Exchequer Account deficit



In comparison, the deficit in the first four months of fiscal years relative to the total *actual* deficits during those fiscal years amounted, on average, to 61,6 per cent during the preceding five fiscal years. At the present, relatively early, stage in fiscal 1989/90 this information therefore clearly suggests that the eventual deficit for fiscal 1989/90 may be lower than budgeted for in March 1989. A budgetary *surplus* was, in fact, recorded in July 1989 for the first time in any month of July in the past fifteen years. The deficit of R3 887 million in the four months to July 1989, and the discount of R1 142 million on new issues of government stock, were financed from the following sources:

	R millions
Public Investment Commissioners	1 196
Non-bank private sector	5 496
Banking sector:	
Corporation for Public Deposits	2 150
Other banks	–3 704
Foreign sector	–109
	5 029
Less: discount on government stock	1 142
Total financing	3 887