Quarterly economic review

Introduction

Growth of the real gross domestic *product* of the South African economy, which had attained annualised rates ranging from more than 2 per cent to nearly 4 per cent in the various quarters of 1988 and a rate of somewhat more than 3 per cent during 1988 as a whole, slowed down significantly to an annualised rate of approximately 1 1/2 per cent in the first quarter of 1989. In contrast, aggregate real gross domestic *expenditure,* having retreated on balance during the last three quarters of 1988 from the relatively high level it had reached in the first quarter, reaccelerated to an annualised rate of increase of approximately 6 per cent in the first three months of 1989.

The return to a relatively rapid rise in aggregate real gross domestic expenditure in the first quarter of 1989 reflected essentially a spurt in real government consumption expenditure in the final quarter of the fiscal year 1988/89 and a reversal to significantly positive real inventory accumulation. Aggregate real gross domestic fixed investment, although rising further, did so at a more moderate pace than in the preceding six months. A marked further slowdown, which may signify a more long-lasting (i.e. cyclical) change in consumer attitudes within the framework of general business cycle developments, was observed in the rate of increase in real private consumption expenditure.

A mixed appearance was presented by selected indicators of the general business cycle in the fourth quarter of 1988 and the first quarter of 1989. The composite *leading* business cycle indicator declined further up to January 1989; the composite *coincident* business cycle indicator, however, kept on rising at least through December 1988.

Accelerations were observed from the fourth quarter of 1988 to the first quarter of 1989 in the rates of increase in most of the more important price indices, on a quarter-to-quarter basis as well as over twelve-month periods. A strengthening of the rise in non-agricultural labour productivity from 1987 to 1988, however, caused the rise in nominal labour costs per unit of physical non-agricultural production to be lower in 1988 than in 1987 despite an accelerated increase in average nominal worker remuneration. The year-on-year rise in these unit labour costs, moreover, slowed down from the first to the second half of 1988.

The surplus on the current account of the balance of payments in the first quarter of 1989, at a seasonally adjusted and annualised level of R2,7 billion, was notably lower than the surpluses that had been recorded in the preceding two quarters. It was also lower than could have been hoped for with a view to attaining a current account surplus of up to R4 billion during 1989 as a whole, such as was deemed desirable for a comfortable handling of South Africa's prospective foreign debt repayment obligations in the course of 1989 and for an adequate strengthening of the gold and other foreign reserves.

Outflows of non-reserve-related capital in the first quarter of 1989 were significantly larger than in the fourth quarter of 1988 and also exceeded the first-quarter current account surplus (before seasonal adjustment). A small rise was nevertheless recorded in the South African total gross gold and other foreign reserves during the first quarter of 1989; minor further increases were registered in the Reserve Bank's gross foreign reserve holdings (valued in rand) in April and May 1989.

The effective exchange rate of the rand, which had strengthened mildly, on balance, from the end of September 1988 to 11 January 1989, weakened considerably during the ensuing period up to 22 May. This was primarily a reflection of unexpected vigour of the US dollar vis-à-vis virtually all other major currencies and of associated declines in the dollar price of gold. A slightly downward movement was displayed by the effective exchange rate of the rand from 23 May up to the middle of June.

Only mild slowdowns were observed in the quarter-to-quarter rate of increase in the M3 money supply up to the first quarter of 1989, and in the twelve-month rate of increase in M3 up to April 1989. More significant decelerations were shown by the quarter-to-quarter and twelve-month rates of increase in the monetary system's and banking institutions' claims on the private sector in the first quarter of 1989, from the inordinately high levels these growth rates had reached in the third and the fourth quarter of 1988. At levels ranging from 25 or 26 to nearly 30 per cent, however, the annualised rates of increase in these various monetary and credit aggregates remained clearly excessive and unacceptable.

In the first quarter of 1989, therefore, the South African economy, while having throttled back significantly from earlier exuberance, was still exhibiting uncomfortably high strength in various spending and related areas. In a large number of spending and production activities, it was also still measuring its slowdown in terms of diminished rates of increase rather than in terms of actual contractions or declines. Additional pressures for seeking to effect a moderation of domestic monetary demand to a fairly modest level of "affordable" demand growth in 1989 were created by, among other things, the accelerated decline in the dollar price of gold and the associated weakening of the exchange rate of the rand through most of May.

Bank rate was raised from 14,5 to 16 per cent with effect from 23 February 1989. The central government's Budget for 1989/90, as presented on 15 March 1989, was aimed at tempering the strong expansion that had occurred in domestic spending during the preceding year. A new "package" of restrictive monetary, fiscal and credit measures – as referred to in the relevant sections of this *Review* – was announced by the Reserve Bank and the Minister of Finance on 5 May 1989.

Bank rate was raised further, as a part of this new policy package, to 17 per cent with effect from 8 May 1989. This was supplemented by, among other things, further adjustments in the Reserve Bank's accommodation arrangements, so as to discourage monetary institutions' recourse to Reserve Bank credit for obtaining cash reserves in support of their own extension of credit and money creation. However, it was also announced by the Minister of Finance that steps would be taken to ease the burden of higher interest charges on farmers, small business enterprises, and home mortgagors in lower income groups who did not enjoy the benefits of access to subsidised bond finance. Details of the assistance to be provided in this way to homeowners owing less than a certain maximum amount on houses of less than a certain maximum value, were disclosed by the Government on 8 and 9 June 1989.

During April, May and the first half of June 1989 the more recent monthly or quarterly observations in cyclically sensitive data series mostly continued to suggest a topping-out or mild decline in a variety of economic activities and a loss of buoyancy in various spending categories or subcategories. This left room for a tentative conclusion that an upper turning-point in the South African business cycle had probably been reached towards the very end of 1988 or in the early months of 1989.

Since by the beginning of 1989 the economic upswing would have moved into its thirty-third month, the start of a cyclical contraction in economic activity at that stage would not have been unusual as a spontaneous event within the framework of normal cyclical developments. However, the mild slackening-off of certain varieties of output and demand in the first several months of 1989 undoubtedly also represented partly the economy's response to the tightening stance of monetary policy from as early as late 1987 and to the authorities' more restrictive measures of fiscal and credit policy in the course of 1988.

By mid-June 1989 the consensus view appeared to be that the economy was cooling down and was heading for lower, although not necessarily negative, rates of increase in real output and demand. "Sentiment" and spending propensities were also being affected by that time by, among other things, the authorities' new package of policy measures of 5 May 1989 and by the markedly lower dollar price of gold. Given the level of real gross domestic expenditure in the first quarter of 1989, the authorities' informal objective of limiting growth in aggregate real gross domestic expenditure to some 1 per cent from 1988 to 1989 (after increases of 4 per cent and as much as 7 per cent in the preceding two years) would allow the levels of such expenditure in the second, third and fourth quarter of 1989 to exceed their counterparts in 1988 by an average of some 1,3 per cent. It would also permit the compound annualised quarter-to-quarter rate of growth in real gross domestic expenditure in these quarters of 1989 to amount to some 0,8 to 0,9 per cent.

Domestic economic developments

Domestic output

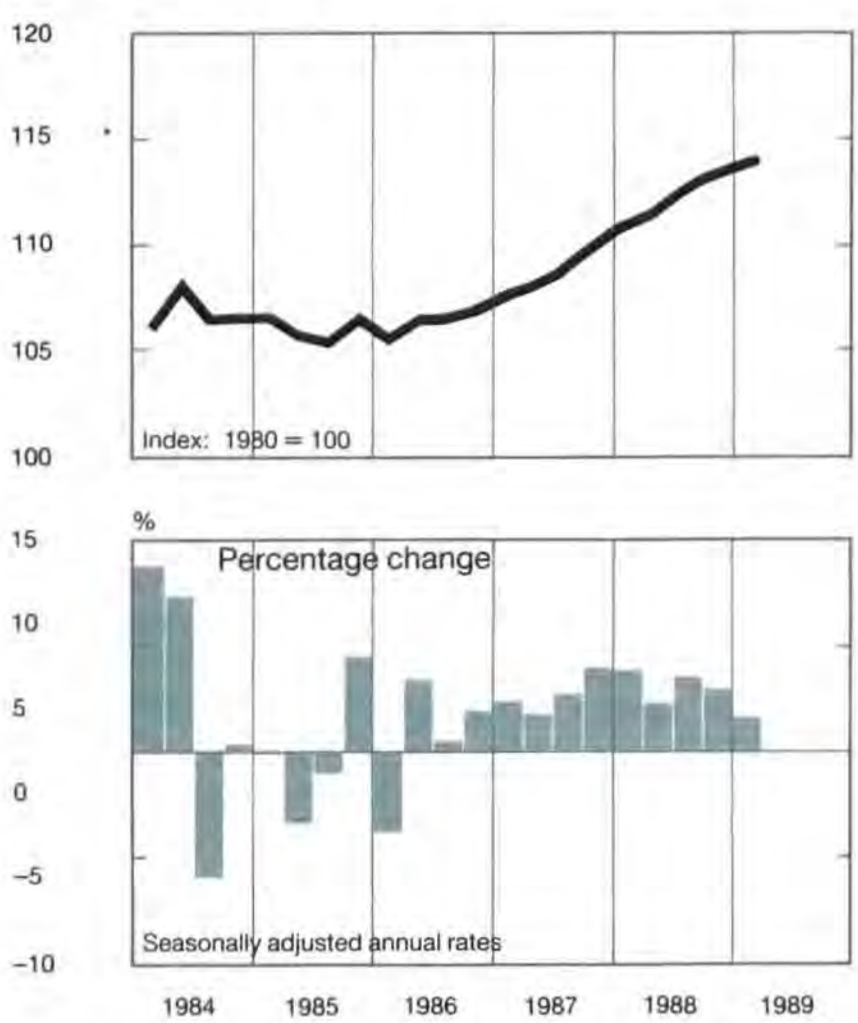
Real gross domestic product in the South African economy grew at seasonally adjusted and annualised rates of nearly 4 per cent, 2 per cent, 3½ per cent and 3 per cent in the four successive quarters of 1988. Early estimates indicate that output growth in the first quarter of 1989 – which rounded off a third year of uninterrupted real economic expansion from the start of the cyclical upswing in the second quarter of 1986 – slowed down markedly to an annualised rate of approximately 1½ per cent. At the same time, a mixed appearance was presented by selected indicators of business cycle developments. This suggested that the economy in the first quarter of 1989 was close to, if it had not already reached or passed, a cyclical upper turning-point.

On a sectoral basis, *increases* in real output were still recorded in the first three months of 1989 in non-manufacturing sectors such as agriculture, finance and general government. Significant *decreases* in real value added, on the other hand, were registered in the mining industry (notably in gold mining), and in electricity, gas and water. Similarly, substantial *declines* in real output were recorded in certain sub-sectors of manufacturing, such as base metals and the chemical industry; the decline in chemical production could be attributed partly, however, to a fire at the Sasol Three plant in January 1989. Lower levels of output in these various sub-sectors of manufacturing more than offset further production increases in branches such as clothing, paper and printing, and industries related to the manufacturing of machinery and transport equipment. As a result, a slight contraction was also displayed by real value added in the manufacturing sector in general.

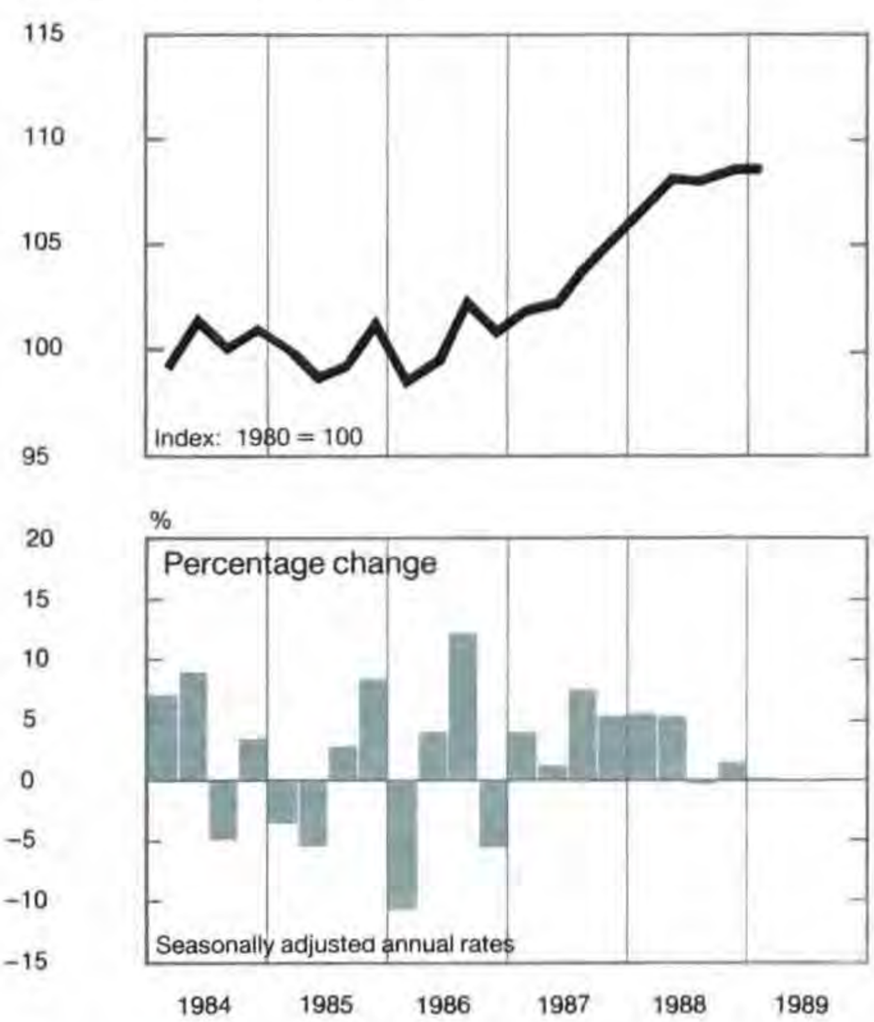
Measured real output in agriculture was raised by, among other things, an overflow of the large 1988 wheat harvest from the fourth quarter of 1988 into the first quarter of 1989. The financial sector's increased contribution to real gross domestic product stemmed from developments and conditions such as the marked further upswing in stock market activity in the first three months of 1989, financial transactions called forth by high levels of corporate liquidity, and the deposit-taking, lending and investment activities of financial intermediaries that accompanied the sustained rapid rise in the money supply.

Real gross *national* product rose energetically (at an average seasonally adjusted annual rate of nearly 5½

Real gross domestic product



Real gross national product



per cent) in the first two quarters of 1988, but changed course relatively abruptly to a more nearly horizontal movement in the third and fourth quarter of 1988 and the first quarter of 1989. The lack of further upward momentum in real national product in the first quarter of 1989 resulted from the opposing forces of an improvement (i.e. a decline) in net factor payments to foreigners (mainly because of a decline in interest payments to overseas creditors and investors) and a substantial weakening of the terms of trade. Merchandise import prices rose faster than export prices in the first three months of 1989. In addition, the average dollar price of gold fell back appreciably during this period.

Domestic expenditure

Total real gross domestic expenditure advanced very strongly (at an annualised rate of some 23 per cent) in the first quarter of 1988, levelled off in the second quarter, fell back significantly in the third quarter, and showed almost no change in the fourth quarter. Provisional estimates show that it then rose quite briskly again (at an annualised rate of some 6 per cent) in the first quarter of 1989. This rate of increase broadly matched the 7 per cent increase in aggregate real gross domestic expenditure from the calendar year 1987 to the calendar year 1988. The level of real gross domestic spending in the first quarter of 1989 appears to have been only fractionally higher than in the first quarter of the preceding year.

The return to a substantially positive rate of increase in total real domestic spending in the first three months of 1989 was due essentially to a large rise in real consumption expenditure by general government and to a reversal from a net drawing-down of aggregate real inventories in the third and the fourth quarter of 1988 to significantly positive real inventory accumulation in the first quarter of 1989. Real private consumption expenditure, although rising further, did so at a significantly lower rate than in preceding quarters. Another firm rise was shown by total real gross domestic fixed investment in the first quarter of 1989; the rate of increase in real fixed investment spending during this quarter nevertheless was significantly lower than in the preceding six months.

The rate of growth in *real private consumption expenditure* – which had been maintained at relatively steady annualised levels ranging from 4 to 5½ per cent in the various quarters of 1988 and at an average annual level of 4 per cent from the second quarter of 1986 to the fourth quarter of 1988 - receded to approximately 2 per cent in the first quarter of 1989. The firm and sustained expansion of real private consumption expenditure from the second quarter of 1986 to the fourth quarter of 1988 had taken place in the face of an average annual rate of increase in aggregate real personal disposable income of only 2 per cent. In contrast, the moderate slowdown of the increase in real private consumption expenditure in the fourth quarter of 1988 and its more pronounced further deceleration in the first quarter of 1989 took place against a background of a rise in aggregate real personal disposable income – incorporating accelerated increases in real wage remuneration as well as in real income from property – at an average annual rate of some 3 per cent.

Real household expenditure on consumer durables, which had advanced at an annualised rate of 14½ per cent in the fourth quarter of 1988, *declined* at a rate of some 2 per cent in the first quarter of 1989. Real expenditure on personal transport equipment (consisting mainly of new motor vehicles) fell back at an annualised rate of 15 per cent. Little change was, however, shown as yet by real outlays on furniture and household appliances.

Real expenditure on semi-durable consumer goods, having increased at an annualised rate of more than 7 per cent in the fourth quarter of 1988, showed only a marginal further rise in the ensuing three months. The slackening of the growth in consumer demand in this area reflected mainly actual declines in real household spending on clothing and footwear. Mild increases, on the other hand, were recorded in real outlays on motor car parts and accessories; spending on these items picked up in sympathy with markedly more buoyant conditions in the market for second-hand motor cars in the first few months of 1989. Real household expenditure on non-durable goods and on services still rose fairly steadily. Compared with consumption expenditure in general, the annualised rates of increase of real outlays in these spending categories attained slightly above-average levels of approximately 2½ and 2 per cent.

Negative or barely positive rates of advance in the first quarter of 1989 in real consumer spending on durable and semi-durable consumer goods in particular, may well indicate the start of a longer-lasting (i.e. cyclical) waning of households' spending proclivities within the framework of general business cycle developments. This would represent the joint impact of, among other things: (1) the tightening of hire-purchase conditions in the third quarter of 1988, and substantially higher interest rates; (2) increases in administered prices, the raised level of import surcharges, and accelerating inflation generally; (3) the cumulative effect of relative increases in aggregate real personal disposable income having trailed relative increases in aggregate real private consumption expenditure during most of the period from the start of the revival in consumer demand in the second quarter of 1986; (4) households' resultant less sanguine views of their real after-tax income positions, despite the significant recovery of the growth rate in aggregate real personal disposable income in the fourth quarter of 1988 and the first quarter of 1989; (5) a reaction to households' earlier stocking-up with durable consumer goods in the course of 1987 and 1988, including their "preemptive" purchases of such goods in a large part of 1988; and (6) households' heavy recourse to consumer credit in 1988 in particular, the resultant deterioration of their debt-to-income ratios, and the eventually unsustainable weakening of the personal savings ratio.

Real *consumption expenditure by general government* increased substantially in the first quarter of the calendar year 1988 (i.e. in the final quarter of the fiscal year 1987/88), fell back in the second and the third quarter of 1988, and increased only slightly in the fourth quarter. It then raced ahead at an uncommonly rapid pace in the first quarter of 1989. The effect of this spurt in real government consumption expenditure was to raise the increase in such expenditure in the *fiscal* year 1988/89 from the fiscal year 1987/88 to 3½ per cent, against an increase in real government consumption expenditure of only 1½ per cent from the *calendar* year 1987 to the calendar year 1988. The 3½ per cent increase in real consumption expenditure by general government in fiscal 1988/89 was, however, still broadly in line with the relatively high average annual rate of growth in such expenditure in the years from 1980 to 1988.

The rise in real government consumption outlays in the first three months of calendar 1989 stemmed mainly from a very large increase in spending on goods and services other than remuneration of employees. However, real outlays on salaries and wages also rose appreciably. This would appear to have been explained partly by higher employment levels in the services departments of central government as well as among local authorities, in the TBVC countries and in the self-governing states. It should also be attributed, however, to the better conditions of service that were implemented in the public sector in general from January 1989.

Aggregate real *gross domestic fixed investment* rose in the first quarter of 1989 for the seventh consecutive quarter. The rate of increase in real fixed investment spending in this quarter, which in annualised terms amounted to nearly 5 per cent, was, however, somewhat less robust than the annualised rates of increase of more than 7 per cent and approximately 8½ per cent that had been recorded in the third and the fourth quarter of 1988. The *level* of total real fixed investment spending in the first quarter of 1989 was some 6 per cent higher than in the first quarter of the preceding year.

Further increases were recorded in real fixed capital outlays by the private sector and by public corporations. A decline, on the other hand, was registered again in real fixed capital spending by public authorities.

The annualised rate of increase in real fixed capital formation by the *private sector* in the first quarter of 1989 amounted to some 7½ per cent (against an average annualised rate of 9½ per cent in the preceding six months). This further advance in private sector fixed investment was broadly based; the more notable sectoral increases in investment activity, however, could be observed in agriculture, mining, manufacturing and commerce. Against these various increases, a decline was recorded in real fixed investment in the form of machinery and transport equipment financed through leasing contracts in the financial sector.

The strengthening of fixed investment demand in the agricultural sector was a reflection of improved farming conditions and crop results in the preceding two years, good farming prospects for 1989 and higher levels of confidence among the farming community, and growing needs for replacement, renewal and augmentation of the agricultural capital stock. In the decade of the 1980s, net increases in the real fixed capital stock in the agricultural sector were recorded only in the pre-drought period up to the fourth quarter of 1982; the level of this capital stock in the first quarter of 1989 still fell short by some 13½ per cent of the high point it had reached in 1982.

The mining industry displayed increased real capital spending on machinery and transport equipment in particular. This was associated with the development of new mines, as well as with advancing mechanisation that will ensure increased stability in the production process. In the light of the rapidly rising cost structure of mining operations, the future opening-up of new mines and the expansion of existing mining ventures will, however, depend heavily on a suitable structure of mining taxation.

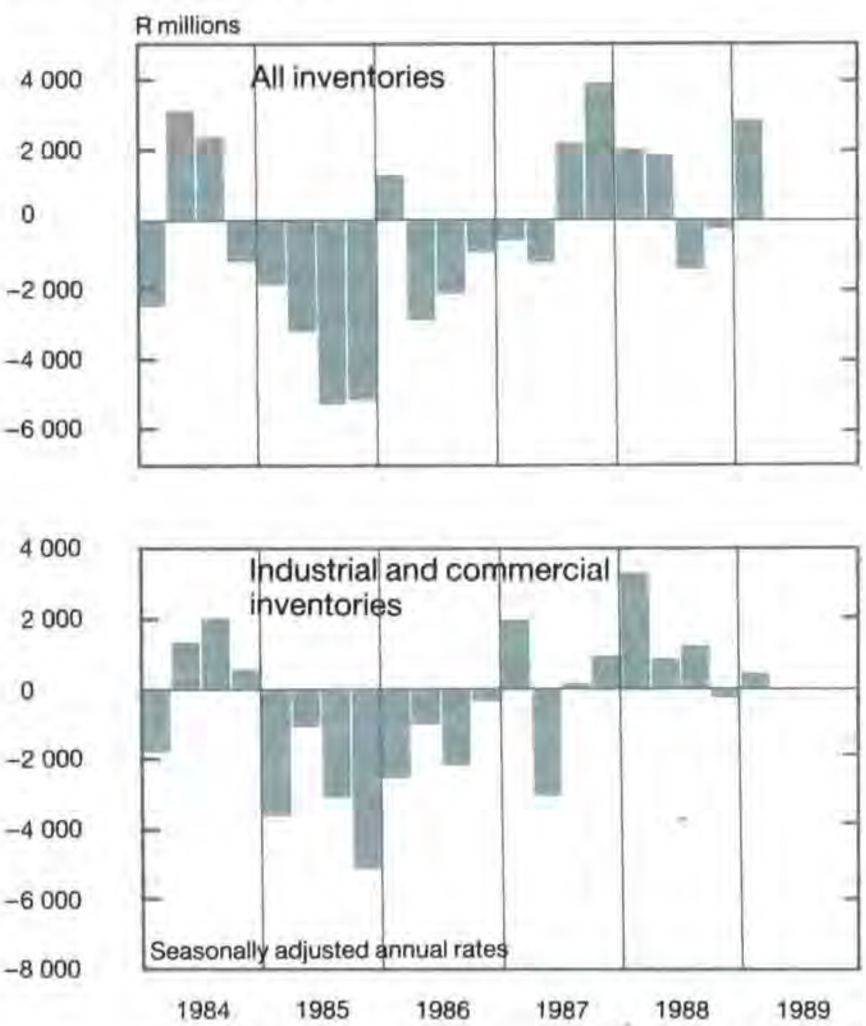
In manufacturing industry and in the commercial sector higher levels of new fixed capital formation were essentially a continuing response to some two and a half years of economic upswing in which relatively little investment activity had taken place, the associated rise in degrees of capacity utilisation, and a more positive business mood that had been brought about by stable labour relations and conditions of general socio-political tranquility.

The decline in real fixed investment spending by *public authorities* in the first quarter of 1989 could be attributed to further decreases in such spending by the Department of Posts and Telecommunications and the South African Transport Services. In the case of general government, increases in real fixed investment by the central government and local authorities more than neutralised declines in real fixed capital expenditure by the provincial administrations, which had increased markedly in the second half of 1988.

An analysis of aggregate real gross domestic fixed investment in the first quarter of 1989 by type of capital assets shows notable increases in residential and non-residential building. Little change was shown, in the *aggregate* investment data, by real outlays on construction and on machinery and transport equipment.

Aggregate *real inventories* – which had been drawn down in the third and, to a lesser extent, also in the

Change in inventories



fourth quarter of 1988 – were estimated to have risen quite substantially in the first quarter of 1989. To a major extent, this build-up of inventories would appear to have been of an unintended or "involuntary" nature. As such, it is likely to have reflected an unanticipated decline in certain components of domestic final demand (or in the rate of *increase* in these components of final demand), as well as a fairly abrupt shrinkage of the volume of the trade balance (i.e. the excess of exports of goods over imports of goods at constant prices) from the fourth quarter of 1988 to the first quarter of 1989. Having strengthened steadily through the final three quarters of 1988 from a seasonally adjusted and annualised level of some R6,3 billion in the first quarter to some R11,4 billion in the fourth quarter, the real trade balance in seasonally adjusted and annualised terms fell back to approximately R10 billion in the first three months of 1989.

Although broadly based, increases in real inventories at book values in the first quarter of 1989 were significant in particular in manufacturing industry and in the commercial sector. In the commercial sector inventory build-ups were recorded in both wholesale and retail trade; in addition, the partial spill-over of the wheat harvest from the fourth quarter of 1988 to the first quarter of 1989, and other factors, were reflected in an increase in agricultural stocks-in-trade. The motor trade, on the other hand, while exposed to a slackening of demand for new motor vehicles, still experienced a further shrinkage of inventories, although at a lower rate than in the preceding six months.

Having receded to 19½ per cent in the fourth quarter of 1988, the ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy rose to slightly more than this level in the first quarter of 1989. Relative to turnover, industrial and commercial inventories declined substantially in the second half of 1987 and throughout 1988 to a low point of 1½ months' sales, on average, in 1988. The largely "involuntary" nature of the build-up of industrial and commercial inventories in the first several months of 1989 was apparent from an increase in the inventories/sales ratio to approximately 1¾ months' sales in the first quarter. At this level, the value of this ratio was, however, more in line with the (generally flat) long-term trend which the relationship between inventories and sales has exhibited in the course of the 1980s to date.

Factor income and saving

The rate of increase in aggregate nominal factor income, at *factor cost* and in seasonally adjusted and annualised terms, slowed down fairly significantly to 16½ per cent in the first quarter of 1989 from 19 per cent in the fourth quarter of 1988. Factor income actually declined in the mining industry and showed only a marginal further rise in manufacturing. These developments more than offset an acceleration of the rate of increase in factor income in the tertiary sectors of the economy.

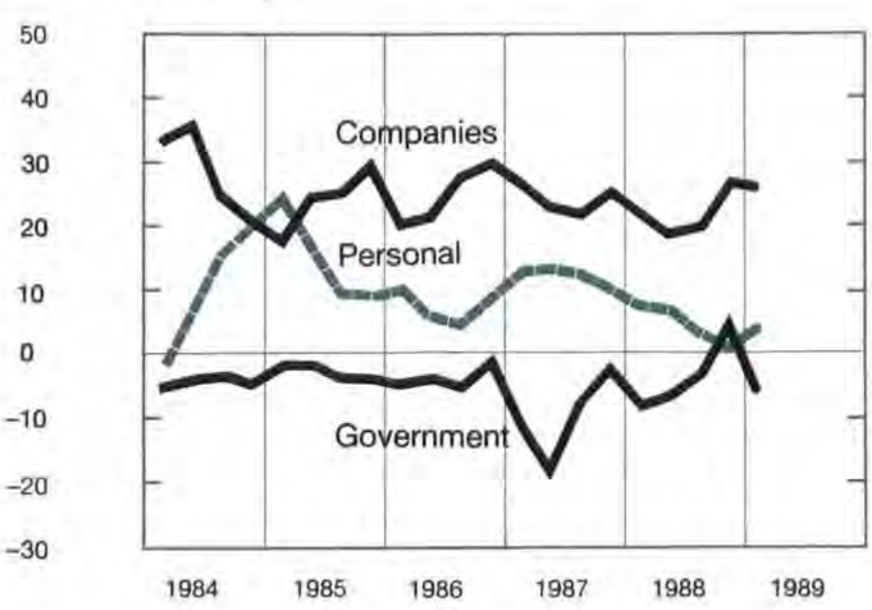
In contrast to the slowdown of growth in nominal factor income *at factor cost,* the tempo of growth in aggregate nominal factor income *at market prices* (which equals the gross domestic *product* at market prices) quickened materially from a seasonally adjusted and annualised rate of 16½ per cent in the fourth quarter of 1988 to a rate of 18 per cent in the first quarter of 1989. The divergence in the behaviour of these two growth rates was a result of a significant increase in indirect taxes. Incorporated in the rise in indirect taxation in the first quarter of 1989 were the effects of the imposition of increased surcharges on imports from 15 August 1988 and of the increase in fuel levies from 16 January 1989. The total amount of indirect tax collections rose substantially in the year to the end of March 1989; in the first quarter of 1989 Exchequer income from indirect taxation was 28 per cent higher than in the first quarter of 1988.

Deceleration of the growth rate of aggregate nominal factor income at factor cost in the first quarter of 1989 was mainly a matter of more moderate increases in the aggregate *gross operating surplus* of business enterprises. A decline was recorded in the operating surplus of the mining sector, while operating surpluses in manufacturing and in electricity, gas and water advanced only moderately. As in the fourth quarter of 1988, profitability in the gold mining industry was influenced adversely by the downward slide of the rand price of gold as well as by the rising cost of mining operations. Profits of non-gold mining companies, and profits in manufacturing industry, were affected by, among other things, first-quarter declines in the volumes of their merchandise exports.

The rate of increase in aggregate nominal *remuneration of employees*, which, in seasonally adjusted and annualised terms, had amounted to 23½ per cent in the fourth quarter of 1988, slowed down only slightly to 22½ per cent in the first quarter of 1989. The year-on-year increase in total labour remuneration in the first quarter of 1989, at 18 per cent, somewhat exceeded the rate of increase of 16½ per cent in the average level of remuneration of employees from the calendar year 1987 to the calendar year 1988. Moderate to relatively large adjustments of nominal wages and salaries could be observed in virtually all sectors of the economy. The most significant single contribution to the increase in aggregate nominal salary pay-outs in the first quarter of 1989 was, however, made by the general salary increase in the public sector, which took effect from the beginning of the year.

The ratio of *gross domestic saving* to gross domestic product, which had strengthened from an average level of 20½ per cent in the first three quarters of 1988 to 24½ per cent in the fourth quarter, slipped back to approximately 22½ per cent in the first quarter of 1989. Similarly, the ratio of gross domestic saving to gross domestic investment weakened from an average of 112 per cent in the second half of 1988 to only 106 per cent in the first quarter of 1989.

Components of savings as percentage of gross domestic saving



Renewed slackening of the overall domestic savings performance – which the economy can ill afford if stepped-up domestic investment efforts are to be reconciled with the continuing need for financing an outflow of capital – resulted primarily from a return by general government from net saving in the fourth quarter of 1988 (the only such saving to have been recorded by general government in any quarter during the years from 1984 to 1988) to net *dis*saving in the first quarter of 1989. In addition, a very low level of the personal savings ratio (i.e. the ratio of net personal saving to personal disposable income) still prevailed during the first three months of 1989.

Depreciation allowances continued at a steady pace. In addition to the poor savings performances of households and general government, however, corporate saving in the first quarter of 1989 was affected adversely and to a material extent by dissaving by gold mining companies. Net corporate saving, at current prices and at an annualised rate, is estimated to have fallen back in the first quarter of 1989 by approximately R1 billion from the high point it had attained in the fourth quarter of the preceding year.

Employment

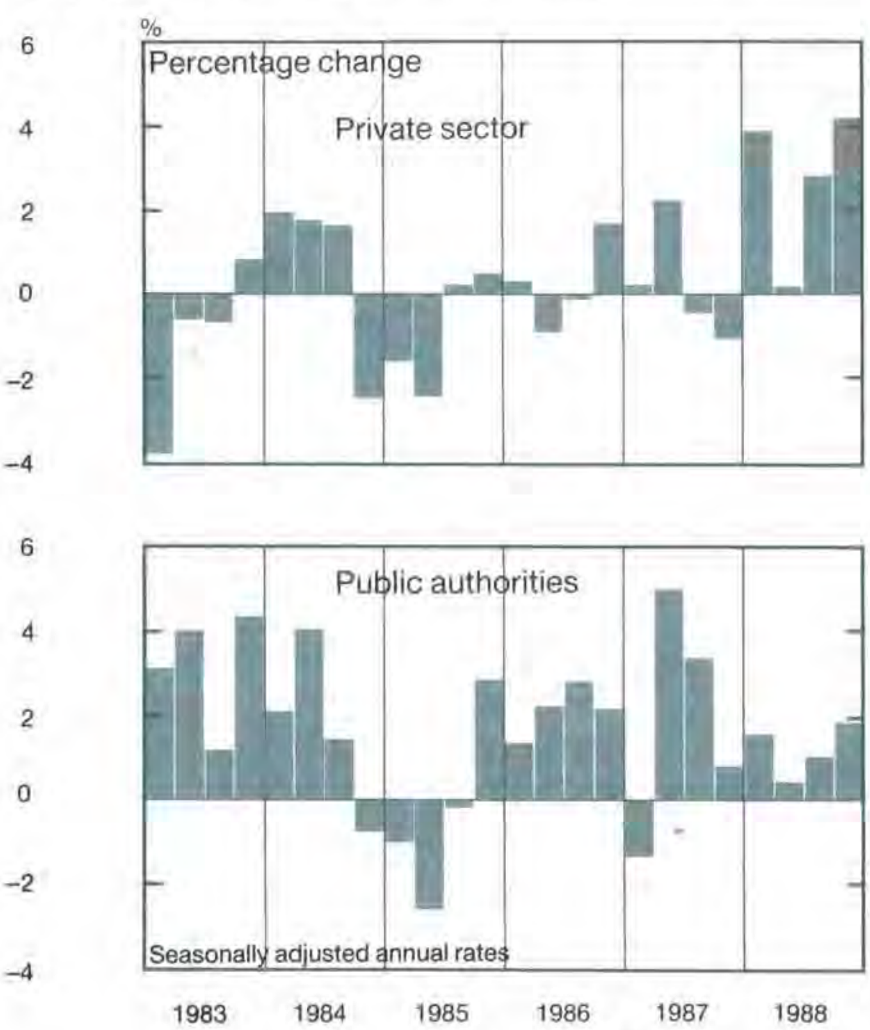
Total non-agricultural employment in the South African economy rose by 0,5 per cent in 1986, 1,0 per cent in 1987 and 1,5 per cent in 1988. In 1988, similar percentage increases in employment were recorded in both the public and the private sector. However, employment creation accelerated in the private sector from 0,6 per cent in 1987 to 1,5 per cent in 1988, while slowing down in the public sector to 1,5 per cent in 1988 from 1,9 per cent in the preceding year.

The quarter-to-quarter rate of increase in total non-agricultural employment, in seasonally adjusted and annualised terms, rose from only 0,2 per cent in the second quarter of 1988 to 2,2 per cent in the third quarter and to 3,5 per cent in the fourth quarter. Unusually large employment increases were recorded in the fourth quarter of 1988 mainly in the motor trade and in the mining sector; pronounced *reductions* of labour complements had still been experienced in the mining industry in the preceding six months.

Information with regard to the first quarter of 1989 shows employment increases to have continued in manufacturing and to have been resumed in construction. Both these sectors, however, saw further decreases in the ratio of overtime to normal hours worked. Employment in electricity generation, which had already declined in the third and the fourth quarter of 1988, showed a sharp further contraction in the first quarter of 1989.

The seasonally adjusted number of registered *unemployed* Whites, Coloureds and Asians declined, on balance, from 82 500 in August 1986 to 45 100 in January 1989. The *total* number of registered unem-

Employment in non-agricultural sectors



ployed decreased somewhat similarly from 137 000 in September 1987 to 108 300 in January 1989. The number of unemployed Blacks, as measured by the Current Population Survey, shrank from a peak figure of more than 1 million in August 1987 to 773 000 in January 1989 – equalling approximately 11 ½ per cent of the Black labour force.

Labour costs and productivity

The year-to-year increase in the annual average amount of nominal salaries and wages per worker among all workers in the non-agricultural sectors of the economy accelerated from 14,4 per cent in 1986 to 15,4 per cent in 1987 and to 15,9 per cent in 1988. Among workers employed by *public authorities*, however, the rate of increase in the average nominal wage actually slowed down materially from 15,0 per cent in 1987 to 12,3 per cent in 1988.

The year-*on*-year increase in the average nominal wage of all non-agricultural workers also decelerated significantly in the course of 1988 from an average rate of 17,2 per cent in the first half of the year to an average rate of 14,7 per cent in the second half. This could be attributed primarily to relatively low year-on-year rates of increase in the average nominal salary of workers employed by public authorities in the third and the fourth quarter of 1988.

Accelerated nominal wage increases, and a lower level of the inflation rate, caused the *real* wage per worker outside agriculture to rise by 2,8 per cent in the calendar year 1988. Decreases in the real wage per worker (of 4,2, 3,7 and 0,6 per cent) had been recorded in the preceding three years. Workers employed by public authorities, however, again provided an exception to this course of events; the average real wage enjoyed by these workers actually showed a marginal further contraction (of 0,4 per cent) from 1987 to 1988.

Labour productivity (i.e. real gross domestic product per worker in the non-agricultural sectors of the economy) rose by some 2,0 per cent from 1987 to 1988, its largest annual increase since 1985. The year-on-year increases in physical output per non-agricultural worker in the four successive quarters of 1988 amounted to 1,3, 2,2, 2,6 and 1,7 per cent. The year-on-year increases in the second and third quarter of 1988 represented the largest improvements in labour productivity over four-quarter periods to have been recorded since the second half of 1984; this should be viewed, essentially, as a cyclical development.

Accelerated advances in labour productivity served to reduce the rate of increase in labour costs per unit of physical output from a high point of 14,9 per cent in 1986 and 14,4 per cent in 1987 to 13,7 per cent in 1988, despite the accelerated rise in nominal worker remuneration. Partly as a reflection of the slowdown in the year-on-year rate of nominal wage increases from the first to the second half of 1988, the year-on-year rate of increase in nominal unit labour costs also slowed down in the course of 1988 from an average of 15,2 per cent in the first half of the year to an average of 12,3 per cent in the second half.

Prices

Reflecting, among other things, the strengthening of the effective exchange rate of the rand in the fourth quarter of 1988, the seasonally adjusted and annualised quarter-to-quarter rate of increase in the prices of *imported goods* shrank markedly from a high point of 21,6 per cent in the third quarter of 1988 to 10,6 per cent in the fourth quarter. It then remained at approximately this level (10,3 per cent) in the first quarter of 1989.

In contrast, the quarter-to-quarter rate of increase in the prices of *domestically produced goods*, in seasonally adjusted and annualised terms, accelerated sharply from 11,8 per cent in the third and 11,5 per cent in the fourth quarter of 1988 to 18,9 per cent in the first quarter of 1989. Substantial price increases were experienced in the first three months of 1989 over a wide range of domestically produced goods, the most prominent being non-food agricultural products and metal products.

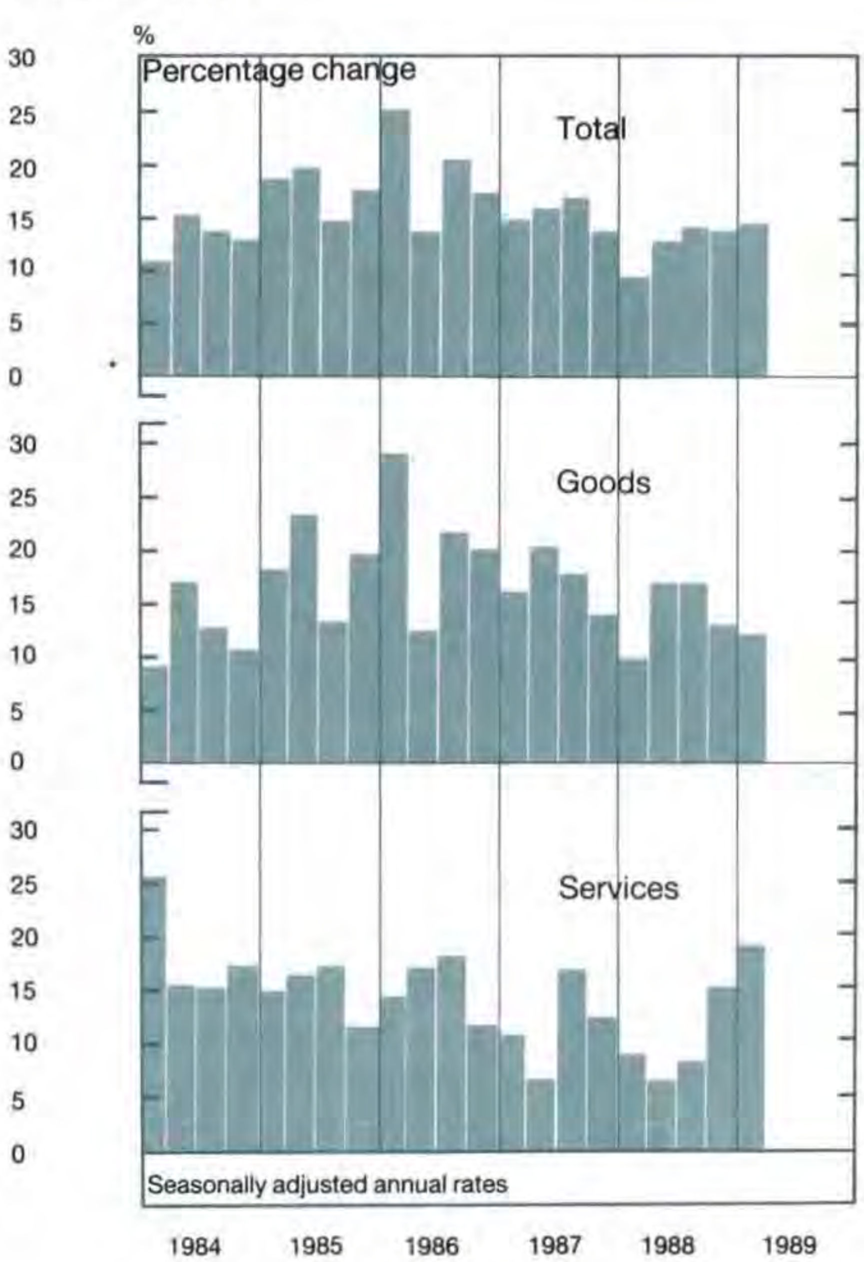
As a result of these movements in its components, the seasonally adjusted and annualised rate of increase in the *production price index* (which had fallen back to only 10,9 per cent in the fourth quarter of 1988) reaccelerated to as much as 17,7 per cent in the first quarter of 1989.

The *twelve-month* rate of increase in the prices of imported goods accelerated from 13,9 per cent in January 1989 to 15,2 per cent in February, 16,7 per cent in March and 17,8 per cent in April. This could, however, be attributed largely to the effect of the "shedding" of months of relatively very low price increases in early 1988 in the calculation of rates of increase in the price index of imported goods over consecutive twelve-month periods. The twelve-month rate of increase in the *production price index* advanced from a low point of 13,1 per cent in October 1988 to 14,6 per cent in both December 1988 and January 1989, 14,9 per cent in February and 15,5 per cent in both March and April.

The quarter-to-quarter rate of increase in the *consumer price index*, in seasonally adjusted and annualised terms, began to accelerate at an early stage in 1988 from a low point of only 9,2 per cent in the first quarter of 1988 to 12,6 per cent in the second quarter and 13,9 per cent in the third quarter. Having slowed down marginally to 13,6 per cent in the fourth quarter of 1988, this rate then accelerated further to 14,3 per cent in the first quarter of 1989. In the two most recently completed calendar quarters (viz., the fourth quarter of 1988 and the first quarter of 1989), the rate of increase in the prices of *services* (including home owners' costs) significantly exceeded the rate of increase in the prices of consumer *goods*.

The *twelve-month* rate of increase in the consumer price index stayed within a narrow band from 12,3 to 12,5 per cent from June to December 1988. It then rose fairly rapidly from 12,5 per cent in December 1988 to 13,3 per cent in January, 13,5 per cent in February, 13,8 per cent in March and 14,0 per cent in April 1989.

Consumer prices



Balance of payments and exchange rates

Current account

The balance on the current account of the balance of payments dipped into a marginal deficit in the first quarter of 1988, but strengthened progressively to annualised surpluses of R1,7 billion, R4,6 billion and R5,4 billion in the second, third and fourth quarter. It reached an annualised surplus of R2,7 billion in the first quarter of 1989. Although the surplus in the first three months of 1989 was substantially smaller than in the preceding two quarters, it was larger than had been expected earlier on the basis of disappointing foreign trade figures for January and February 1989.

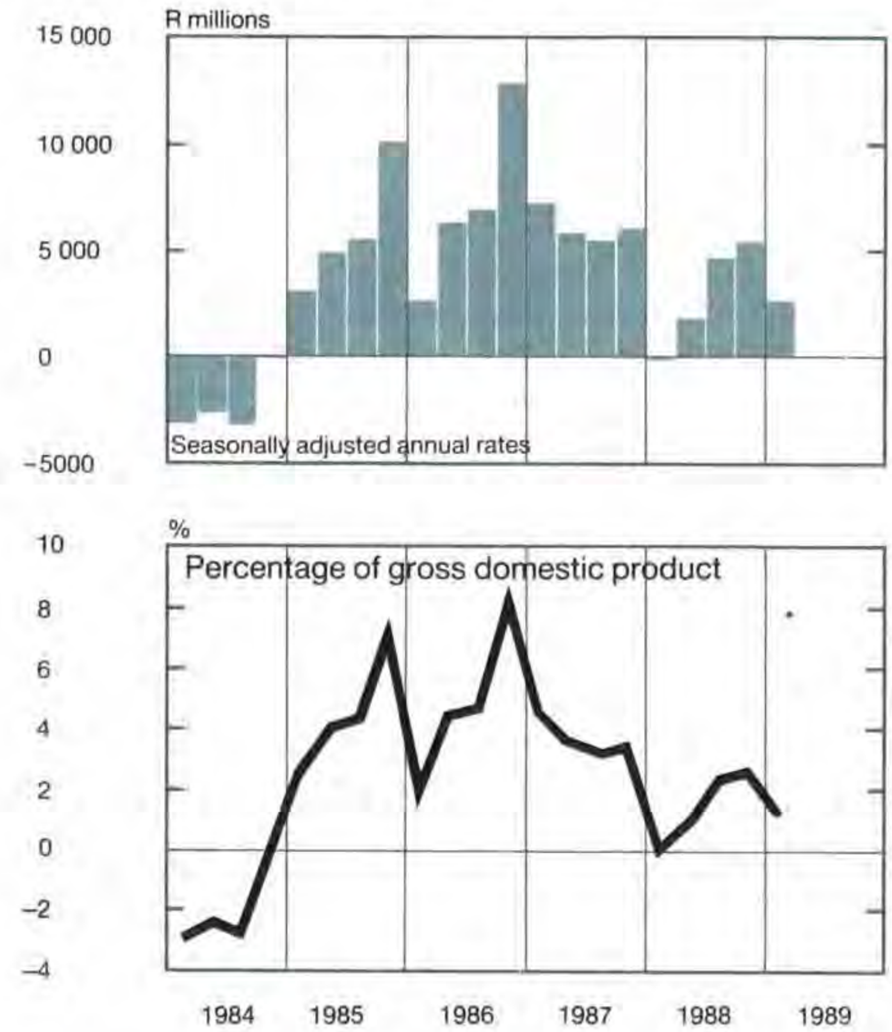
The marked shrinkage of the current account surplus from the fourth quarter of 1988 to the first quarter of 1989 could be attributed to a significant decline in the value of merchandise exports, a moderate decline in the value of net gold exports, and continuation, although at a modest rate, of the upward trend in the value of merchandise imports, which had been in evidence since the first quarter of 1987. A small offset to these developments was provided by a decline in the amount of net service and transfer payments to foreigners.

The value of *merchandise exports*, which had increased impressively from R26,3 billion in the first quarter of 1988 to R36,5 billion in the fourth quarter, fell back by some 5 per cent, to R34,6 billion, in the first quarter of 1989. Merchandise export earnings in rand in the first quarter of 1989 were, however, still nearly 10 per cent higher than their average quarterly level in 1988. A further rise in the value of exports from its average monthly level in the first quarter of 1989 was recorded in April 1989.

The 5 per cent drop in the value of merchandise exports in the first quarter of 1989 was explained more than fully by a decline in export *volumes*, more particularly of mining products. Export *prices* in domestic currency showed a slight increase of approximately 1 per cent. A small rise was shown by the quarterly average level of commodity prices in the international markets; at the same time, the average exchange value of the rand declined only marginally (by 0,6 per cent) from the fourth quarter of 1988 to the first quarter of 1989.

The 4 per cent decline in *net gold exports* could be attributed more or less equally to volume and price decreases. The average dollar price of gold as determined at the London price fixings declined from US $415 per fine ounce in the fourth quarter of 1988 to

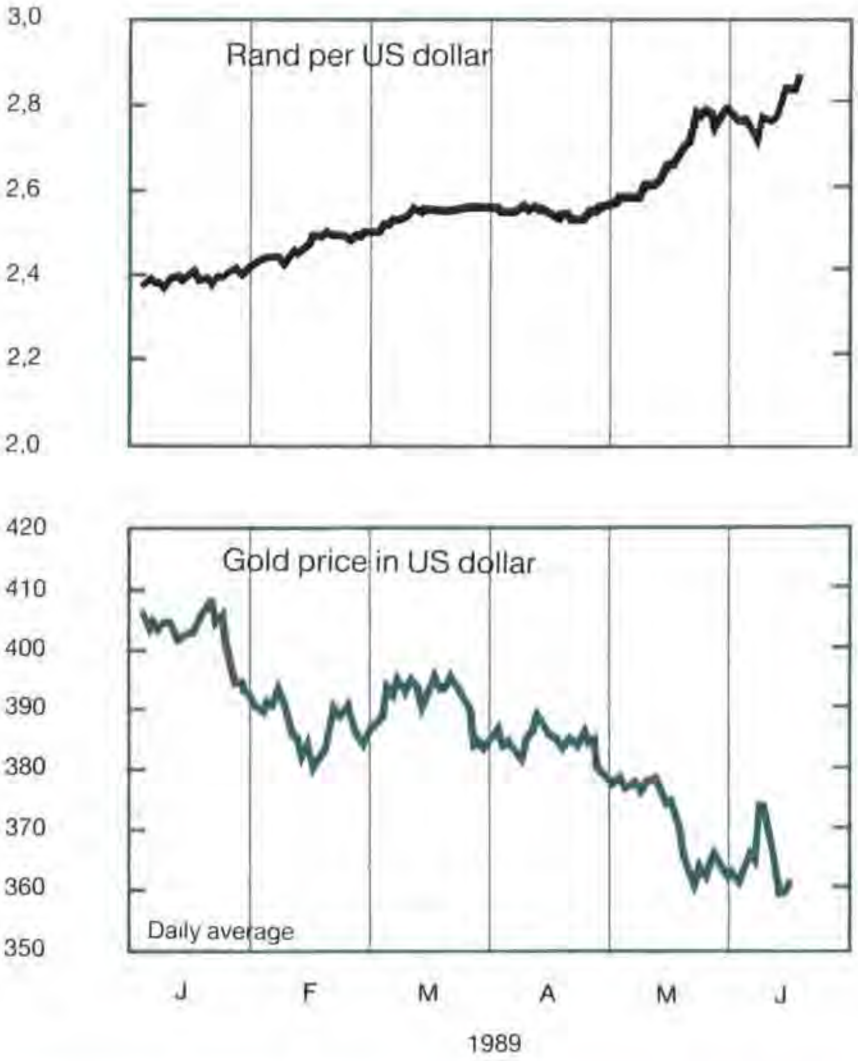
Balance of payments on current account



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
Merchandise exports	26 300	29 282	33 830	36 476	31 472	34 560
Net gold exports	18 530	19 948	20 230	19 780	19 622	18 970
Merchandise imports	–36 780	–38 310	–40 070	–41 520	–39 170	–42 150
Net service and transfer payments	–8 108	–9 172	–9 370	–9 290	–8 985	–8 670
Balance on current account	–58	1 748	4 620	5 446	2 939	2 710

Rand-dollar exchange rate and gold price



$394 in the first quarter of 1989 (i.e. by 5 per cent); it then fell further, to $385, in April. In terms of rand the gold price showed a more moderate decline (of 2,7 per cent) from an average of R997 in the fourth quarter of 1988 to R970 in the first quarter of 1989; it then recovered to R980 in April.

In May, the dollar price of gold slid down further to a monthly average of $371 per fine ounce, touching a low point of $359,50 (the average of the two fixing prices during the day) on 22 May. This, however, was essentially the counterpart of a renewed and generally unexpected surge of strength of the US dollar in the international foreign exchange markets. In terms of sterling and the Swiss franc the gold price actually rose slightly from averages of £225 and Swiss F622 per fine ounce in the first quarter of 1989 to averages of £227 and Swiss F637 in April-May. The increase in the exchange value of the dollar, therefore, made up to some extent for the loss of international purchasing power of South Africa's gold exports that was implicit in the lower dollar price of gold.

An increase of some 3½ per cent in the average price level of *merchandise imports* more than fully accounted for the increase of 1½ per cent in the value of these imports from the fourth quarter of 1988 to the first quarter of 1989. Higher import prices in rand stemmed mainly from an acceleration of inflation rates in trading partner countries and from sharply higher prices in the international crude oil markets. Higher values of merchandise imports were registered in particular under the headings of machinery and electrical equipment and of transport equipment. A decline was recorded in imports of mineral products.

The *volume* of merchandise imports in the first quarter of 1989 was some 1½ per cent *lower* than in the preceding quarter and was also some ½ per cent less than in the first quarter of 1988. This fractional decrease in import quantities over the four-quarter period concerned broadly matched the absence of any significant further expansion, on balance, in total real gross domestic expenditure from the first quarter of 1988 to the first quarter of 1989.

Net *service and transfer payments* to foreigners declined significantly, i.e. by some 6½ per cent, from the fourth quarter of 1988 to the first quarter of 1989. Service payments decreased mainly because of a decline in travel expenditure by South Africans abroad. At the same time, higher earnings from transportation services were a prime contributor to a rise in total South African service receipts.

Capital account

The total outflow of capital not related to reserves rose from R1,0 billion in the fourth quarter of 1988 to R1,9 billion in the first three months of 1989. Significant increases were recorded in the outflow of both long-term and short-term capital. The total outflow of non-reserve-related capital in the first quarter of 1989 mildly exceeded the average quarterly figure of R1,6 billion that had been registered in 1988.

The outflow of long-term capital rose from a negligible amount of R6 million in the fourth quarter of 1988 to R395 million in the first quarter of 1989. Included in this first-quarter outflow were large repayments of foreign debt outside the standstill net in the form of bearer bonds and notes and other debt obligations generated by foreign governments. At the same time foreigners, who had been net purchasers of securities listed on the Johannesburg Stock Exchange to a total amount of R102 million in the last three quarters of 1988, became net sellers again to an amount of R269 million in the first quarter of 1989. In contrast, *imports* of long-term capital – mainly in the form of project financing – were again recorded by the private sector and public corporations. The amount of this inflow in the first quarter of 1989 was R180 million, against R252 million in the preceding three months.

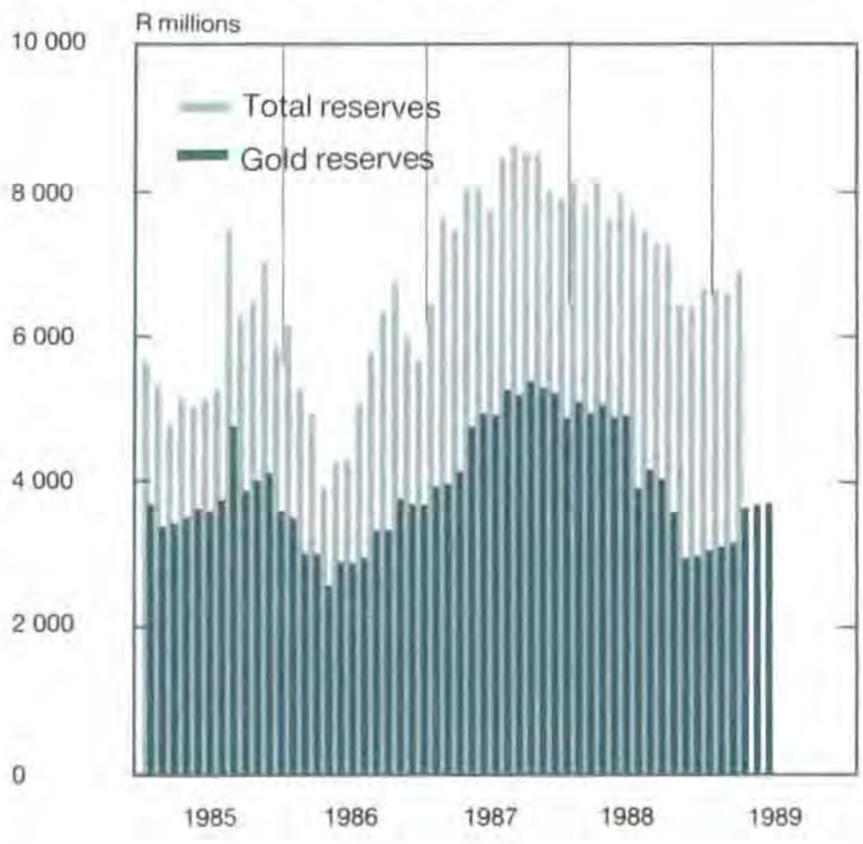
The outflow of short-term capital, not related to reserves but including unrecorded transactions, advanced from approximately R1,0 billion in the fourth quarter of 1988 to approximately R1,5 billion in the first quarter of 1989. The outflow in the first quarter of 1989 slightly exceeded the average quarterly amount of

Net capital movements (not related to reserves)
R millions

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

such flows in 1988; it would appear to have been attributable primarily to further switching from foreign to domestic sources of trade finance.

Gross gold and other foreign reserves



Foreign reserves

Having declined by R593 million in the fourth quarter of 1988, the South African total gross gold and other foreign reserves rose by R236 million in the first quarter of 1989. The reserves of the Reserve Bank advanced by another R40 million in April and by R46 million in May.

The *gold* component of the Reserve Bank's foreign reserve holdings strengthened, on balance, from 3,47 million fine ounces at the end of December 1988 to 4,08 million ounces at the end of May 1989. This increase was substantially larger than could be attributed to the Bank's domestic purchases of gold coins (Krugerrands) during this period.

Exchange rates

Partly because of upward adjustments to the general level of South African interest rates from early November 1988, and partly because of the rising current account surplus in the fourth quarter of 1988, the effective exchange rate of the rand firmed, on balance, by 2,9 per cent from the end of September 1988 to 11 January 1989. Incorporated in this general strengthening were mild appreciations of the rand against most of the major currencies; the more notable gains were recorded against the US dollar, the Swiss franc and the German mark.

From 12 January 1989, renewed vigour of the US dollar in the international foreign exchange markets, associated declines in the dollar price of gold, and sustained outflows of non-reserve-related capital from the South African economy caused the effective exchange rate of the rand to weaken by 11,0 per cent up to 15 June. Unexpected and surprising strength was displayed by the US dollar from 16 May. On 15 June the commercial rand reached its lowest level ever of R2,8743 against the dollar, or US $0,3479 per rand; the German mark on that date touched its lowest value in terms of the dollar in a 30-month period.

The *financial* rand firmed from a low point of R4,18 to the dollar at the end of March 1989 to R3,99 per dollar on 14 April, largely on the strength of increased

Changes in exchange rates of the rand

%

	31 Dec 1987 to 30 Sep 1988	30 Sep 1988 to 11 Jan 1989	11 Jan 1989 to 15 Jun 1989
Weighted average	−14,7	2,9	−11,0
US dollar	−22,6	4,7	−17,3
British pound	−14,1	0,2	−3,3
German mark	− 8,3	2,4	−8,2
Swiss franc	−3,7	3,1	−7,0
Japanese yen	−15,0	−1,0	−1,8
French franc	−7,7	2,2	−8,8
Financial rand	−23,3	0,7	−4,4

European investor interest in gilt-edged and semi-gilt-edged South African securities. It then weakened to R4,26 per dollar on 10 May on the basis of the decline in the dollar price of gold, the depreciation of the commercial rand, and the announced disinvestment from South Africa of a major multinational oil company.

Further declines of the commercial rand against the US dollar, and some recovery of the financial rand, caused the discount of the financial rand vis-à-vis the commercial rand to narrow from 38,8 per cent on 10 May 1989 to 31,8 per cent on 15 June. Both these rates of discount were still smaller than the discount of 41,0 per cent that had been recorded on 11 January 1989.

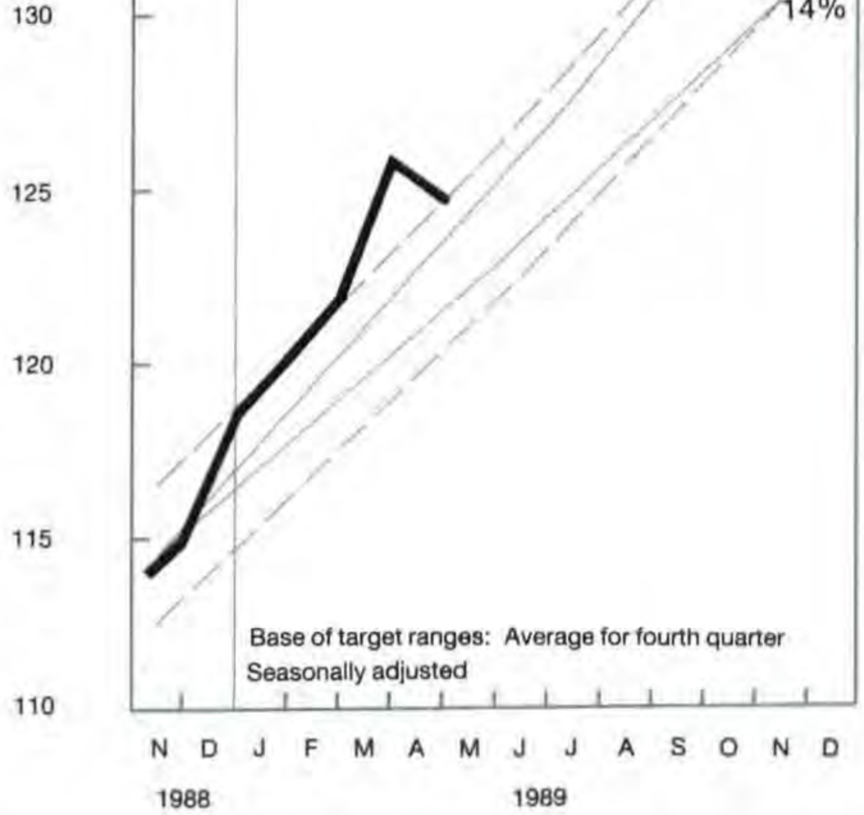
Financial markets

Money supply

The excessive acceleration of the growth rates of the M3 money supply, which had started from single-digit levels in the first quarter of 1987, came to an end in the third quarter of 1988. The tempo of monetary expansion in late 1988 and early 1989 nevertheless still remained at relatively high levels. The quarter-to-quarter rate of increase in M3, seasonally adjusted and annualised, sank back mildly from its high point of 29,5 per cent in the third quarter of 1988 to 28,3 per cent in the fourth quarter and to 26,3 per cent in the first quarter of 1989. The twelve-month growth rate in M3, showing some fairly pronounced month-to-month fluctuations, retreated on balance from a peak figure of 27,9 per cent in August 1988 to 26,6 per cent in March 1989 and to 25,2 per cent in April.

Quarter-to-quarter growth in M3 continued to exceed the rate of growth in gross domestic product at current prices. The income velocity of circulation of M3

Target ranges for growth in M3



accordingly declined further from its upper turning-point of 2,020 in the first quarter of 1987 to 1,832 in the fourth quarter of 1988 and to a preliminarily estimated 1,801 in the first quarter of 1989. The decrease in velocity of 1,7 per cent from the fourth quarter of 1988 to the first quarter of 1989 somewhat exceeded its average quarterly rate of decline of some 1,4 per cent in the preceding seven calendar quarters. At the same time the compound *annual* rate of decline in M3's velocity of circulation of some 5,6 per cent from the first quarter of 1987 to the first quarter of 1989 may be said effectively to have "neutralised" approximately one fourth of the 23,7 per cent compound annual rate of increase in the quarterly average of M3 over the two-year period concerned.

Seasonally adjusted M3 as at month-ends broke through the ceiling of the target "tunnel" for the targeting year 1989 in February 1989. At its level of R125,9 billion at the end of March 1989, M3 exceeded the upper limit of the target tunnel by approximately R2,7 billion, or by 2,2 per cent. However, in a turn of events reminiscent of 1988, M3 in April 1989 fell back to marginally within the target tunnel. Its level of R124,4 billion was R0,3 billion, or 0,2 per cent, below the upper boundary of the tunnel.

High rates of expansion in the M3 money supply in the first four months of 1989 were still supported by rising transaction needs for money at rapidly rising levels of nominal gross domestic expenditure and gross domestic product. They would also appear still to have derived from sustained reintermediation phenomena, as well as from investors' "liquidity preference proper" in a general climate of cyclical upward movements in interest rates and of relatively attractive interest returns on depository investments. The 26,6 per cent increase in M3 in the twelve-month period to the end of March 1989 was accompanied by rates of increase in M1A, M1 and M2 of 19,9, 19,4 and 33,9 per cent. Exceptionally high growth, amounting to 47,6 per cent, accordingly was registered in the non-M1 component of M2 (comprising deposits with unexpired maturities of more than one day but not exceeding six months) during this period. In contrast, growth in long-term deposits during the twelve months concerned amounted to a comparatively very modest 3,9 per cent.

Depositors' preferences for the more highly liquid and short-dated deposits naturally meant a contraction of the *average* unexpired maturity of monetary institutions' deposit liabilities. This was reflected in a more than proportional increase in monetary institutions' required minimum cash reserve holdings (which derive from cash reserve requirement ratios – of 5 and 2 per cent respectively – against banks' and building societies' short-term and medium-term liabilities to the public only). From approximately 21 April 1988 to approximately 21 April 1989, the banks' and the building societies' aggregate required cash reserves rose by R808 million or 30,4 per cent, against an increase in their total liabilities to the public (as calculated for reserve requirement purposes) of 20,0 per cent from the end of March 1988 to the end of March 1989.

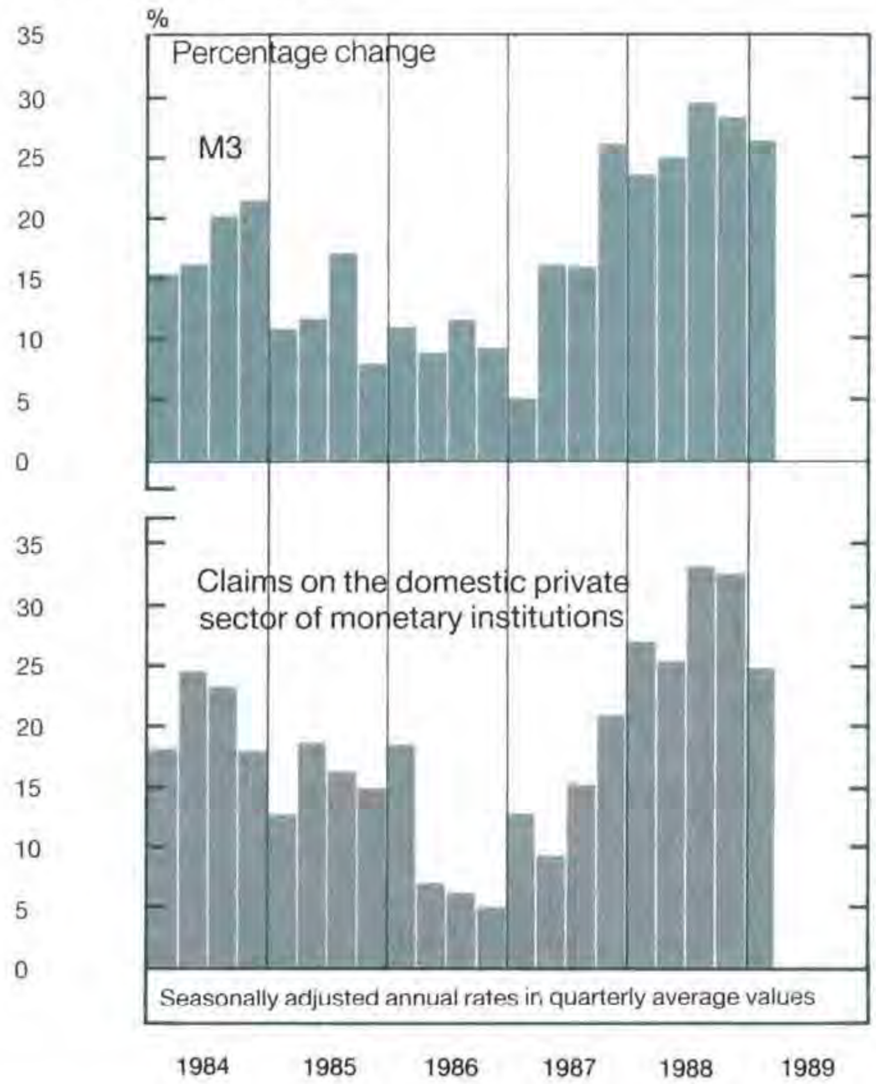
As during 1988, the most important single statistical counterpart (or "cause") of the increase in the seasonally adjusted M3 money supply from the end of December 1988 to the end of March 1989 (which amounted to R7,6 billion) was a further large increase in monetary institutions' domestic credit extension. Total domestic credit extended by these institutions rose by a seasonally adjusted amount of R5,7 billion during this period. However, "causes" of changes in M3 in the first quarter of 1989 also included losses incurred by the Reserve Bank in its provision of forward foreign exchange cover, as well as high levels of government spending and sharp declines in government sector balances with the Reserve Bank in March 1989. Changes in the net gold and other foreign reserves of the monetary sector, although having made a negative contribution (of R3,6 billion) to growth in M3 during 1988 as a whole, actually made a positive contribution (to a seasonally adjusted amount of R0,5 billion) in the fourth quarter. Changes in the net foreign reserves, however, again made a negative contribution to monetary expansion (to a seasonally adjusted amount of R0,7 billion) in the first quarter of 1989.

Credit extension by monetary institutions

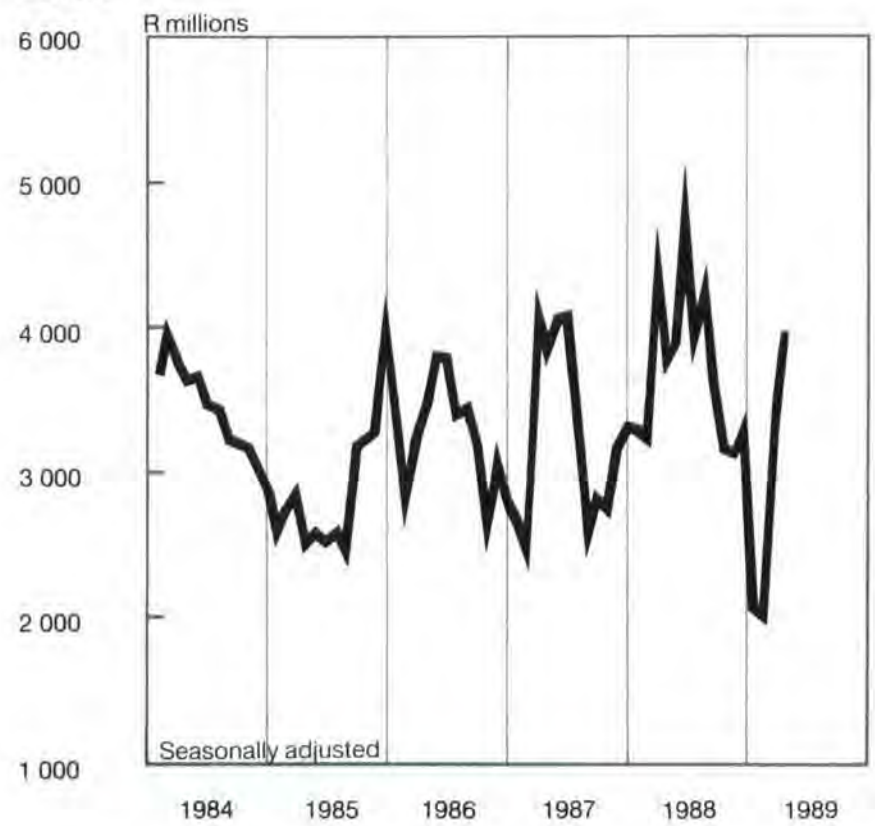
Rather more significant decelerations than in the growth rate of M3 were recorded in the growth rates of monetary institutions' and banking institutions' claims on the private sector in the first quarter of 1989 from the extraordinarily high levels these growth rates had attained – notably in the case of the banks – in the preceding six months. At levels of some 30 and 25 per cent, the seasonally adjusted and annualised quarter-to-quarter rates of increase in the banks' and all monetary institutions' claims on the private sector in the first quarter of 1989 were broadly on a par with the tempo of these institutions' credit-creating activities in the first half of 1988. The *twelve-month* rate of increase in monetary institutions' claims on the private sector retreated somewhat less pronouncedly from its high point of 30,5 per cent in October 1988 to 26,7 per cent in March 1989.

The increase in the seasonally adjusted level of monetary institutions' total claims on the private sector in the first quarter of 1989, amounting to R5,7 billion, was significantly smaller than the average quarterly increase in these claims of R6,7 billion in 1988. Among the components of these claims, on the other hand, the R2,6 billion increase in monetary institutions' mortgage lending in the first quarter of 1989 was still somewhat *larger* than the average quarterly increase in such lending (amounting to R2,3 billion) in 1988. Mortgage lending by monetary institutions has, however, been raised somewhat artificially in recent quarters through

M3 and claims on the domestic private sector of monetary institutions



Net claims of monetary institutions on government sector



a change-over from mortgage finance provided to employees of certain public enterprises by the pension funds of these enterprises to conventional mortgage loans.

The R1,0 billion increase in monetary institutions' extension of hire-purchase credit and leasing finance in the first three months of 1989 fell short of the increase in these types of credit in the preceding quarter, as well as of the average quarterly increase (of R1,1 billion) in these kinds of lending during 1988. The slowdown in hire-purchase credit extension also provided corroborating evidence of the first-quarter slackening of households' spending on durable goods.

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

		All monetary institutions %	Banking system %
1987:	Fourth quarter	20,9	36,0
1988:	First quarter	27,0	32,8
	Second quarter ..	25,3	31,0
	Third quarter	33,2	43,3
	Fourth quarter	32,6	48,0
1989:	First quarter	24,8	29,5

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

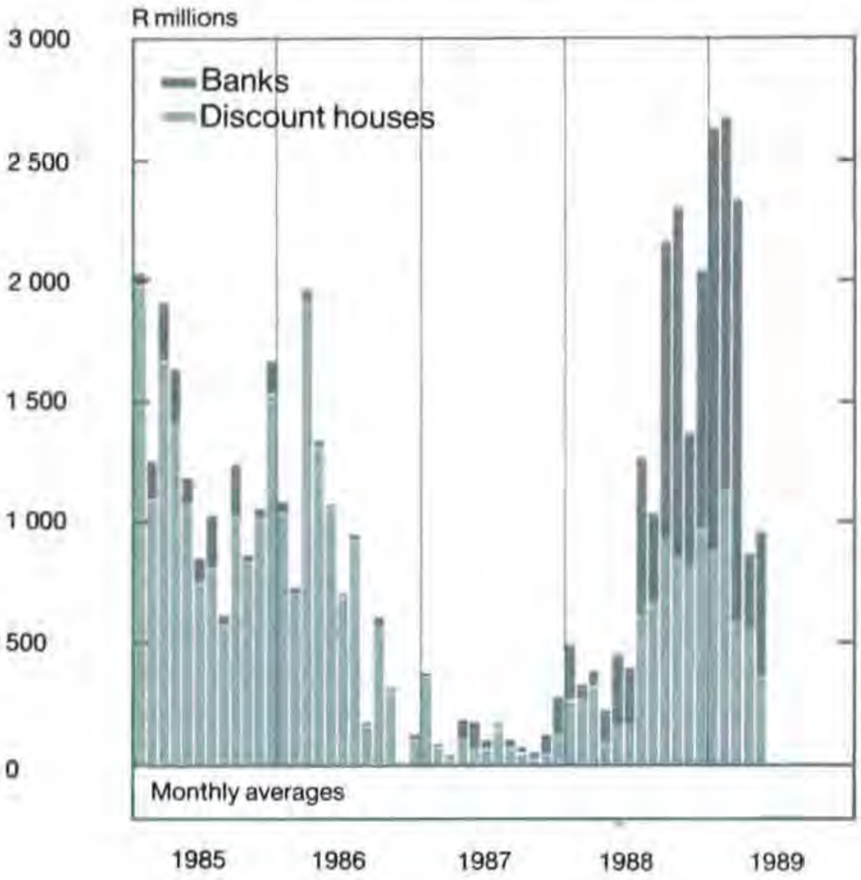
Unusually large flows of government revenue to the Exchequer at various stages in the fiscal year 1988/89 occasionally led to major build-ups of government deposits with the Reserve Bank. This was reflected in commensurately large dips in net claims of the monetary system on the government sector. The change in monetary institutions' net claims on the government sector over twelve-month periods dramatically reversed itself, on balance, from a peak rate of *increase* of 74,6 per cent in August 1988 to a *decrease* of 24,2 per cent in March 1989.

Reserve Bank operations in the money market

Money market conditions, as measured by the market's need for Reserve Bank accommodation, remained tight during the period January-March 1989. This could be attributed, among other things, to the high average level of government deposits with the Reserve Bank in January and February, banking institutions' sustained high lending activities, and the near-stagnant level of the Reserve Bank's net foreign reserves throughout the first quarter.

The average daily level of the Reserve Bank's accommodation of the market at the discount window, which had increased to R2,1 billion in December 1988, amounted to R2,6 billion, R2,7 billion and R2,3 billion in January, February and March 1989. High levels of

Accommodation at the discount window



refinancing accommodation were recorded in spite of the Bank's assistance to the market in the form of repurchase agreements. Assistance by means of such agreements was provided, for amounts of up to R1 000 million, during a 16-day period and a 12-day period straddling the month-ends of February and March 1989, respectively.

Exchequer and Paymaster General deposits with the Reserve Bank fell back from a peak of R6,2 billion on 26 February 1989 to R4,7 billion at the end of February and to R3,8 billion at the end of March. They amounted to R3,9 billion at the end of April. In conjunction with other forces (including the Reserve Bank's losses on forward foreign exchange contracts), this release of government balances caused the market shortage at the discount window to dwindle rapidly to a low point of only R0,1 billion on 3 April and to an average daily amount of only R0,9 billion during the month of April as a whole.

Relatively easy conditions prevailed in the money market during April despite various actions by the Reserve Bank to absorb cash reserves from the financial system. These actions included the issuance, to a peak amount of R1,4 billion, of special very-short-dated (9 to 12 day) Treasury bills during the period from 12 to 17 April. In addition, financing of the Land Bank by the Reserve Bank and the Corporation for Public Deposits was reduced to less than R0,2 billion at the end of April, from R1,5 billion at the end of the preceding month.

Market conditions remained relatively easy during May. The average daily amount of accommodation at the discount window during May amounted to less than R1,0 billion. In this relatively liquid environment, the amount of 91-day Treasury bills offered at the weekly tender, which had been raised to R80 million on 28 April and 5 May, was increased further to R100 million at the tenders as from 12 May. In addition, specially-dated tax Treasury bills, maturing at the end of August 1989, were sold to an amount of R0,8 billion during the period from 5 to 12 May. Finally, ultra-short-dated Treasury bills, of one and five days' currency, were marketed, to an aggregate amount of R0,5 billion, on 17 and 22 May.

Government stock, mainly in the long-term (2005) maturity category, were sold by the Reserve Bank in generally unreceptive market conditions during April, May and early June to an amount of R1,1 billion for settlement in May and to an amount of R1,3 billion for settlement in June. The total amount of the Bank's net sales of such stock from 1 April to the end of the second quarter of 1989 was thereby brought to at least R3,0 billion.

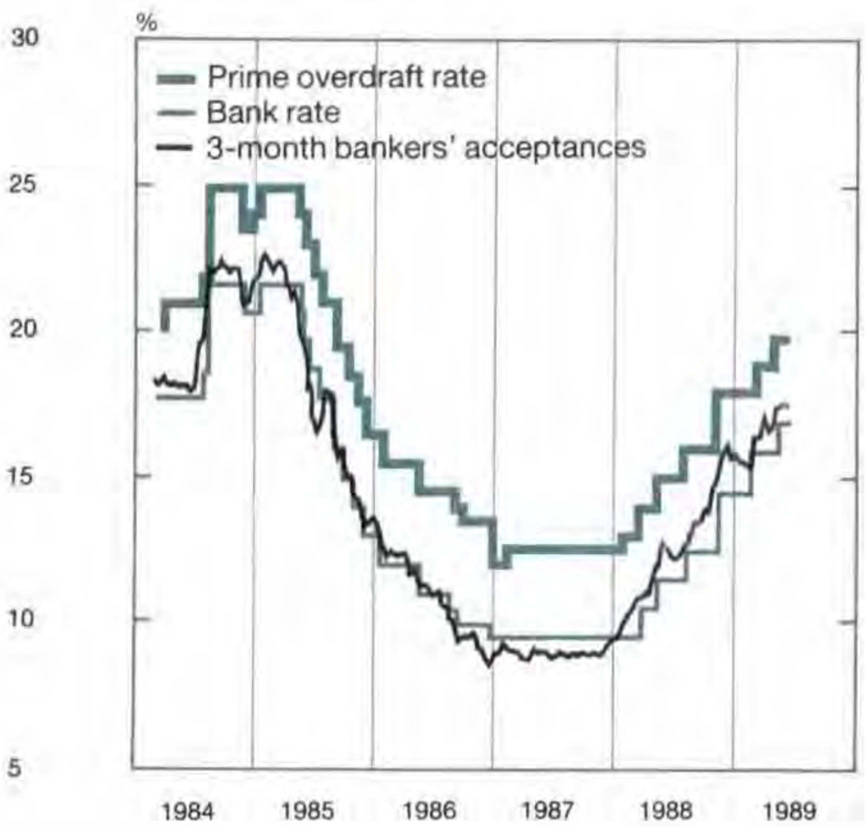
Money market interest rates

The market rate on three-month liquid bankers' acceptances rose from 15,90 per cent immediately before the Bank rate increase (from 14,5 to 16 per cent) of 23 February 1989 to 17 per cent at the end of March. The 17 per cent rate at the end of March exceeded the Reserve Bank's then prevailing rediscount rate for liquid bankers' acceptances by 0,7 percentage points; the rate differential gave evidence of the market's conviction that a further increase in Bank rate and in the general pattern of short-term interest rates was not yet to be ruled out.

A sharp rise in the market's liquidity, and a temporary improvement in market sentiment called forth by the release of the March foreign trade statistics, caused the market rate on three-month liquid bankers' acceptances to ease to 16,5 per cent by 18 April. New reasons for rising rate expectations among market participants could, however, be found in the sustained decline of the dollar price of gold, continued weakening of the exchange rate of the rand vis-à-vis the US dollar, and the sharp increase in the M3 money supply during March. The three-month bankers' acceptance rate consequently hardened to 16,7 per cent immediately prior to the announcement (on 5 May) of the Bank rate increase of 8 May.

Weakening of the gold price and the exchange rate, and sustained rapid monetary expansion, also provided important contributory reasons for the authorities' introduction on 5 May of a new "package" of restrictive fiscal, monetary and credit measures. In its policy statement of that date announcing the increase of Bank rate to 17 per cent, the Reserve Bank again stressed its de-

Short-term interest rates



termination to curb the increase in its own credit extension as the crucial factor that had allowed bank credit and the money supply to be expanded excessively. To this end the Bank, among other things, also laid down that: (1) until further notice, accommodation by means of the Bank's actions in the open market would be provided only to iron out *excessively* large month-end or other seasonal fluctuations in money market conditions; (2) any undue easing of market conditions would be countered by sales by the Bank of suitable securities in the money or capital market; (3) accommodation by means of rediscounting would be limited strictly to the rediscounting of Treasury and Land Bank bills and of *genuinely liquid* bankers' acceptances; and (4) overnight loans would henceforth be extended in exceptional circumstances, for short periods and at penal rates only. Against the increase of 1 percentage point in the Bank's rediscounting rates, the set of rates applying to the Bank's overnight lending facilities was raised by 1,5 percentage points.

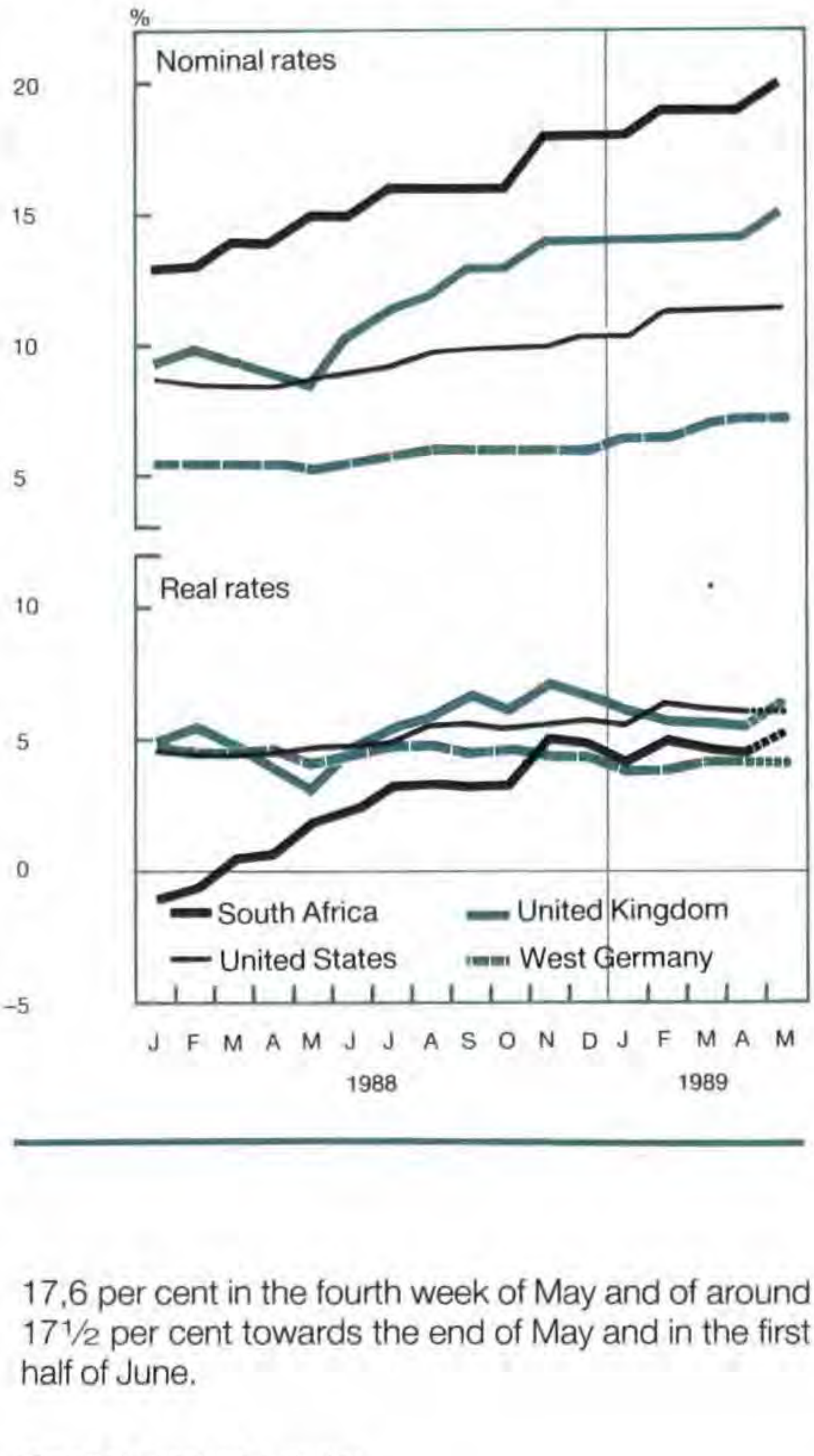
Provision was made, however, for an easing of the burden of higher interest rates on certain categories of more highly interest-sensitive borrowers, such as farmers, small business enterprises and home mortgagors in lower income groups who do not enjoy the benefits of subsidised bond finance. With this in mind, it was announced by the Minister of Finance that: (1) the Reserve Bank would extend special credit facilities to the Land Bank at a low interest rate, so as to enable the Land Bank to keep its own short-term lending rates unchanged; (2) the maximum permissible finance charges rates, as determined under the Usury Act, on money loans, credit transactions and leasing transactions would not be revised upwards from their current levels of 28 and 31 per cent; (3) additional financial assistance would be provided by the Department of Finance to the Industrial Development Corporation, the Small Business Development Corporation and other development corporations, so as to allow these institutions to keep their lending rates to small businesses as low as possible; and (4) the Government would consider ways of increasing the scope and extent of interest rate subsidies on certain categories of housing loans as extended by building societies and banks.

Details of the Government's relief measures for assisting homeowners were announced on 8 June 1989 and augmented the following day. As stated by the Acting Minister of Public Works and Land Affairs on 9 June, assistance would be available to bondholders who owed less than R90 000 on a house currently valued at less than R120 000, provided the loan concerned was granted before May 1989. Monthly instalments for homeowners taking part in this scheme would be calculated at an interest rate of 17 per cent. The difference between 17 per cent and the standard mortgage bond rate would be capitalised. Repayment of this deferred portion of the interest charge would be guaranteed by the Government. The bondholders concerned would, however, continue to pay interest at 17 per cent – even if the standard mortgage bond rate were subsequently to fall below this level – until the deferred portion of their interest charges had been repaid.

The increase in Bank rate to 17 per cent on 8 May was followed quickly by increases of 1 percentage point in the clearing banks' prime overdraft rate; the predominant prime overdraft rate was thereby raised to 20 per cent. As shown by the accompanying graph, this prime rate increase also brought the South African "real" or inflation-adjusted prime overdraft rate to a level that approximated the corresponding real bank lending rates in major Western economies more closely than had been the case at any time since 1985. At the same time, the real pre-tax returns on depository investments with South African financial intermediaries now also came close to the levels of these returns on comparable investments with institutions in these overseas economies.

After the Bank rate increase of 8 May, the market rate on three-month liquid bankers' acceptances firmed 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 that level during the ensuing two weeks. However, the negative effect on market sentiment of continued weakening of the dollar price of gold and of the exchange rate of the rand vis-à-vis the American dollar subsequently caused the acceptance rate to harden further to somewhat higher levels of

Prime lending rates in selected countries



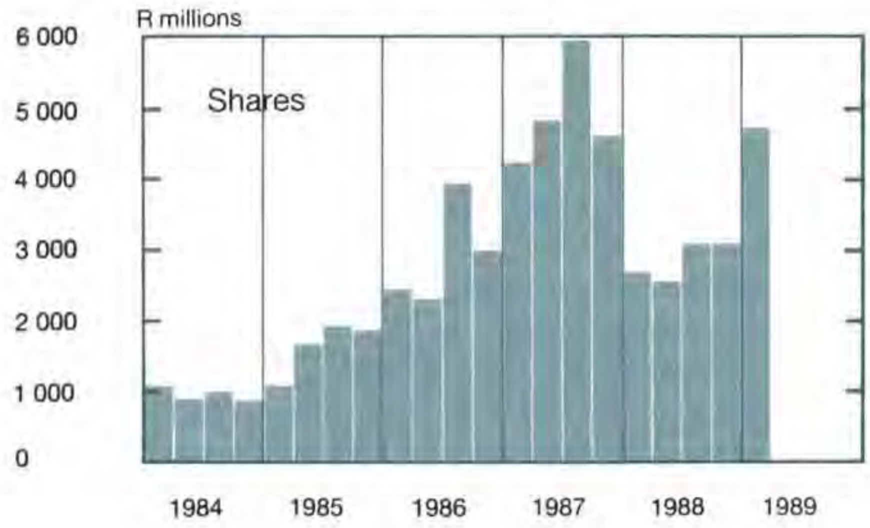
17,6 per cent in the fourth week of May and of around 17½ per cent towards the end of May and in the first half of June.

Capital market activity

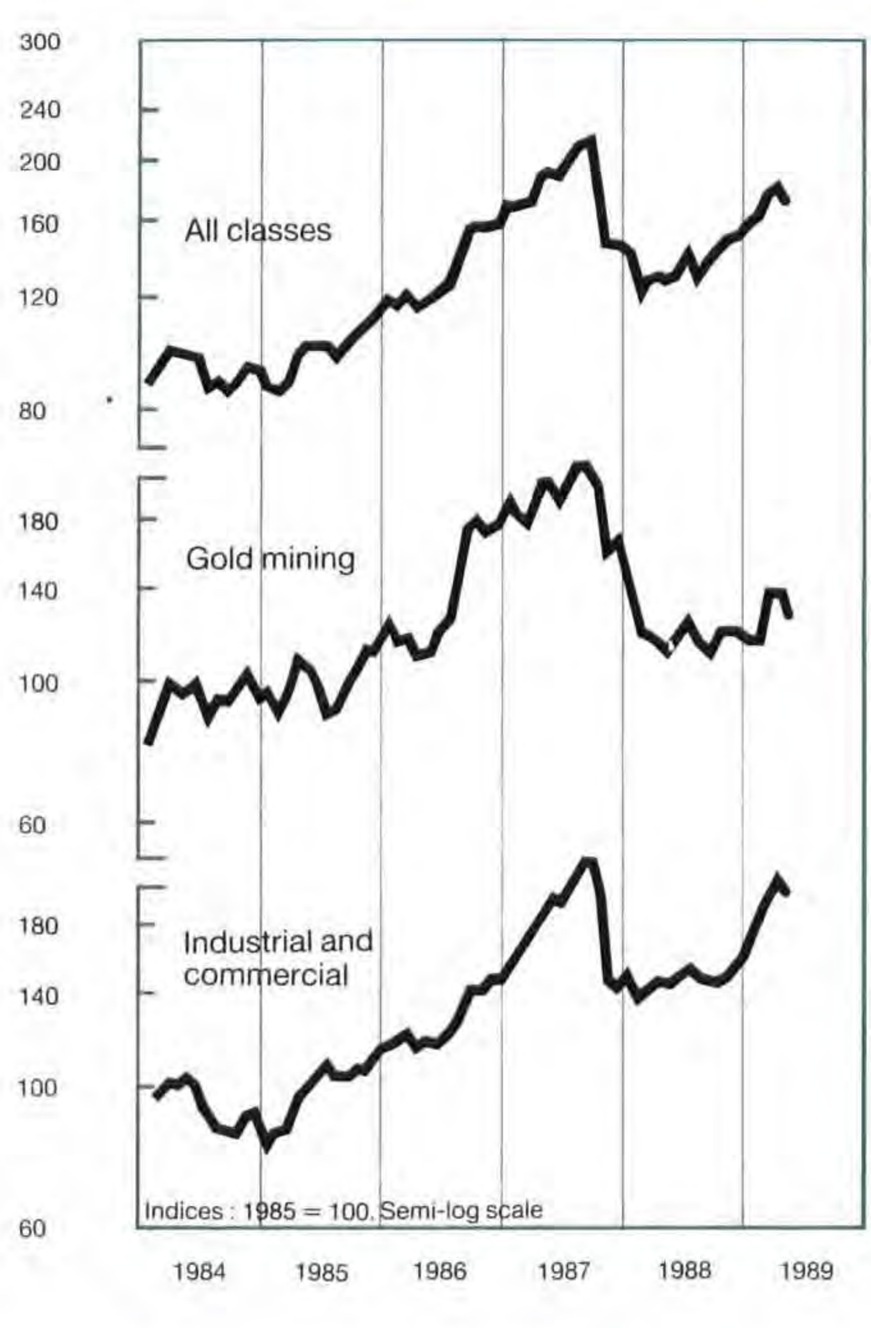
Activity in the capital market, which had receded in the fourth quarter of 1988, strengthened significantly again in the first quarter of 1989. Higher turnovers were recorded in the trading of public sector stock and of company shares on the stock exchange. The fixed property market, on the other hand, appeared to have peaked in the fourth quarter of 1988.

The value of public sector stock traded on the stock exchange rose substantially from R35,0 billion in the fourth quarter of 1988 to R41,9 billion in the first quarter of 1989. Gilt trading activity in the second half of March and in subsequent weeks appeared to have been influenced greatly by the Minister of Finance's announcement in the Budget speech of 15 March 1989 that the prescribed investment requirements for institutional investors were to be abolished. During April 1989 the value of public sector stock traded on the

Stock exchange transactions



Share prices



stock exchange amounted to R14,3 billion, exceeding slightly the monthly average of some R14 billion during the preceding three months.

The *share* market saw a rise in the value of shares traded from R3,0 billion in the fourth quarter of 1988 to R4,7 billion in the first quarter of 1989 – the highest quarterly turnover in this market since the September quarter of 1987. Share trading activity subsequently contracted moderately, however, from a monthly average of R1,6 billion in the first quarter of 1989 to R1,4 billion in April.

The quarterly average price level of all classes of shares, which had begun to recover intermittently from the second quarter of 1988, rose by 18 per cent, on balance, in the first quarter of 1989; share price indices thereby attained their highest values since the stock market slump that had begun on 20 October 1987. The price levels of gold mining shares and of industrial and commercial shares showed impressive gains of 16 and 22 per cent, respectively. A further but notably more modest increase of 2 per cent in the monthly average price level of all classes of shares was recorded in April I989.

In May 1989 the average price level of all shares fell back materially by 5 per cent. As shown in the accompanying graph, movements in share prices, as represented by the JSE-Actuaries index, from early April to early June 1989 closely followed the (generally downward) fluctuations in the dollar price of gold almost on a day-to-day basis. They did so, however, in the face of considerable underlying support of the share price level. By the end of the two-month period concerned, the value of the JSE-Actuaries index had returned virtually to its starting point, despite the markedly lower dollar price of gold.

Relatively low levels of new-issue activity were still observed in the primary capital markets on the part of both private sector and public sector borrowing entities in the first quarter of 1989. An amount of only R19

JSE – Actuaries' all share price index

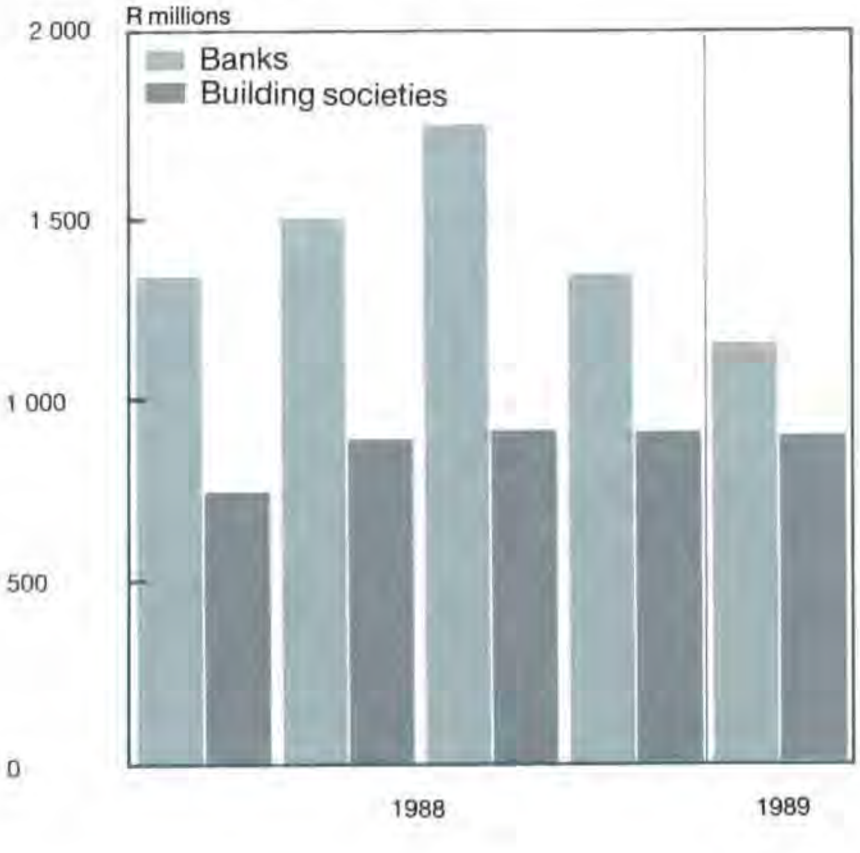
million was raised by companies listed on the stock exchange through new issues of fixed income securities during the first quarter of 1989. In addition an amount of R58,0 million was raised by listed companies through the issuance of new share capital. The low level of new issues by private sector parties could still be attributed partly to substantial corporate saving in preceding quarters, continuing relatively high levels of corporate liquidity and the availability of internally generated corporate funds. Funds raised by the public sector through the issue of fixed-interest securities did, however, rise from R0,3 billion in the fourth quarter of 1988 to R1,1 billion in the first quarter of 1989.

In the mortgage market, mortgage loans *paid out* by building societies declined to R1,9 billion in the first quarter of 1989 from R2,3 billion in the fourth quarter of 1988. The quarterly increase in building societies' *holdings* of mortgage loans in the first quarter of 1989 (amounting to R0,9 billion, after adjustment for the effect of a building society's merger with a banking institution in February) showed almost no change from the increase recorded in the preceding three months. In contrast, the rise in *banking* institutions' holdings of mortgage loans (after similar adjustment) shrank further to R1,1 billion in the first quarter of 1989 from R1,3 billion in the fourth quarter of 1988. The value of real estate transactions contracted slightly from R5,0 billion in the fourth quarter of 1988 to R4,8 billion in the first quarter of 1989.

New limitations on the holdings of insurers, pension funds and friendly societies of investment assets in various categories were laid down by the Minister of Finance, in legislation that became effective on 5 May 1989, to take the place of the former prescribed investment requirements. In terms of these new limitations, pension funds and friendly societies are allowed to invest in fixed property, company shares, mortgage bonds, and certain other asset categories of minor importance, amounts up to an aggregate proportion of 90 per cent of their total asset holdings. Sub-maxima of 30 per cent, 65 per cent and 25 per cent of their total assets apply, however, to their holdings of fixed property, company shares and mortgage bonds respectively. Investments of up to 100 per cent of total assets may be made in the previously "prescribed" assets (i.e. in money on hand; deposits with banks and building societies; bills, bonds and stocks issued by, and loans to or guaranteed by, central, provincial and local government, certain public utilities and certain public corporations; debt issues of other "approved" institutions; and individually "approved" debt issues). In practice, the new limitations mean that pension funds and friendly societies have been allowed to reduce their holdings of the former "prescribed" assets to a minimum of 10 per cent of their total assets.

The same percentage restrictions as for pension funds and friendly societies were imposed on the portfolio compositions of long-term insurers; in the long-term insurers' case, however, the maximum percentage ratios concerned apply to total assets required to cover an insurer's liabilities. *Short-term* insurers are permitted to invest in fixed property, company shares, mortgage bonds and specified other (minor) asset categories amounts up to an aggregate proportion of 70 per cent of their liabilities. Sub-maxima of 10 per cent, 40 per cent and 25 per cent of their liabilities apply to their holdings of fixed property, company shares and mortgage bonds respectively. Short-term insurers have, therefore, effectively been permitted to reduce their holdings of the former "prescribed" assets to a minimum of 30 per cent of their liabilities.

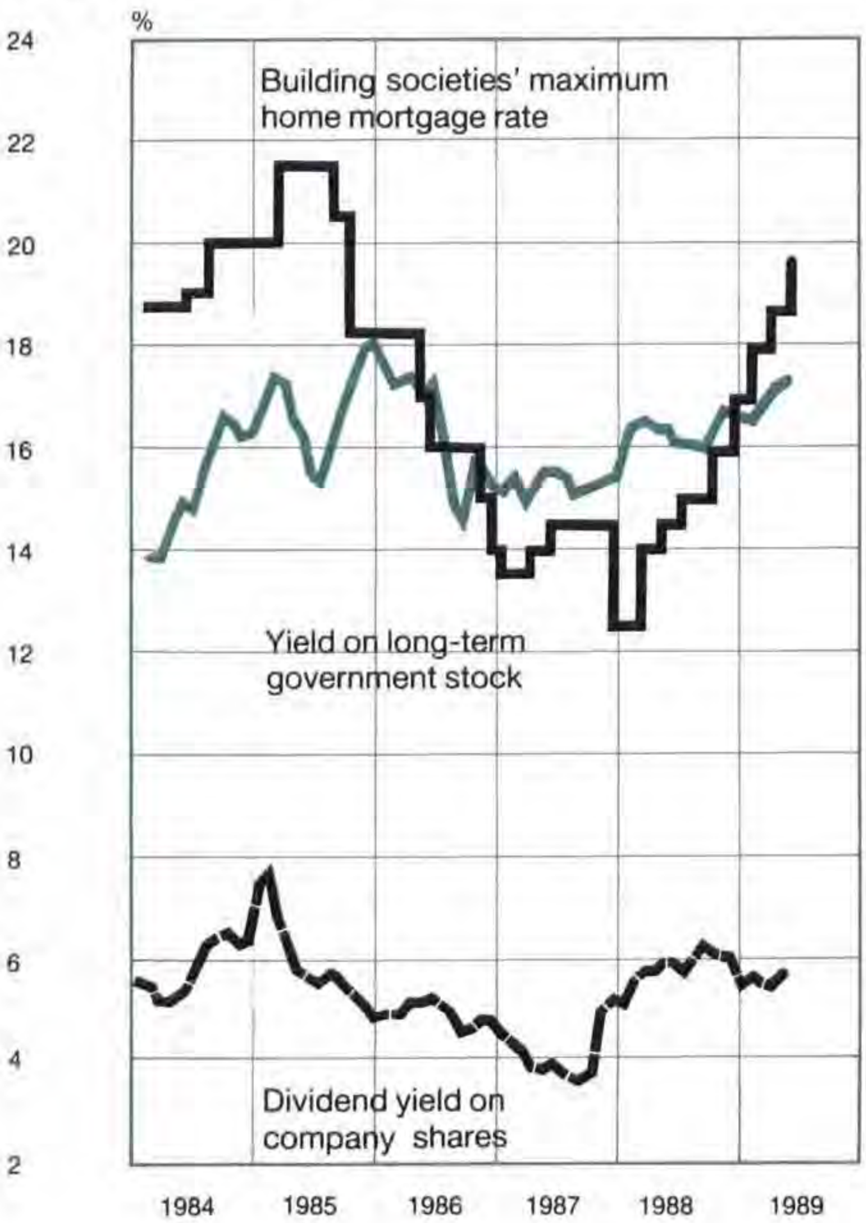
Increase in mortgage holdings



Interest rates and yields

The average yield on long-term government stock, which had eased mildly from 16,8 per cent in November 1988 to 16,5 per cent in the first half of February 1989, reverted to 16,7 per cent in the second half of February on the strength of considerations such as the hardening of short-term interest rates, the disappointing behaviour of the dollar price of gold and the market's concern about the eventual size of the Government's budgetary deficit for fiscal 1989/90. The average long-term stock yield then firmed further to 16,9 per cent in March and to 17,2 per cent in April, largely on the basis of uncertainties created by the proposed abolition of the prescribed investment requirements for institutional investors, the market's doubts as to the

Long-term interest rates



realisability of the Government's Budget proposals for fiscal 1989/90, and concerns about policy measures that might still have to be applied for effecting a speedier cooling-down of the economy. The Bank rate increase of 8 May 1989 contributed to a further rise of the monthly average yield on long-term government stock to 17,4 per cent during May.

In the course of the calendar year 1988 and the first quarter of 1989 the monthly average yield on long-term government stock fluctuated within an unusually narrow band from 16,0 to 16,9 per cent; it did not, therefore, stray beyond the limits of a single percentage point. Its average level of 17,4 per cent during May 1989 was its highest monthly average level since June 1986.

Despite major improvements in the financial results of companies, the sustained recovery of share prices caused the overall dividend yield on all classes of shares to decline further in the first quarter of 1989. This rate declined from 6,0 per cent in December 1988 to 5,5 per cent in March 1989. The opposing forces of strengthened profit results of companies and rising share prices then caused the average dividend yield to remain unchanged at the 5,5 per cent level in April. It subsequently rose marginally to 5,7 per cent in May.

Building societies' predominant home mortgage rate was raised in various steps from 15,0 per cent in September 1988 to 18,75 per cent in April 1989. These rate revisions incorporated the building societies' responses to the Bank rate increases from 12,5 to 14,5 per cent on 3 November 1988 and from 14,5 to 16,0 per cent on 23 February 1989. Following the Bank rate increase to 17,0 per cent on 8 May 1989, certain building societies on 29 May announced a further bond rate increase to 19,75 per cent, to become effective immediately on new loans and from 1 July 1989 on existing loans. However, it was announced by the Minister of Finance on 5 May that, within the framework of the package of policy measures introduced on that date (as outlined elsewhere in this *Review*), an amount of R50 million was to be set aside by the Government for assisting recipients of unsubsidised bond finance in lower-income groups.

The predominant rate on twelve-month deposits with banks and building societies, which had been raised to 14,5 per cent in November 1988 and had been maintained at that level in the ensuing three months, 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 interest rates on tax-free investments with building societies and the Post Office Savings Bank were raised, following ministerial authorisation, by 0,5 per cent with effect from 15 April 1989.

Government finance

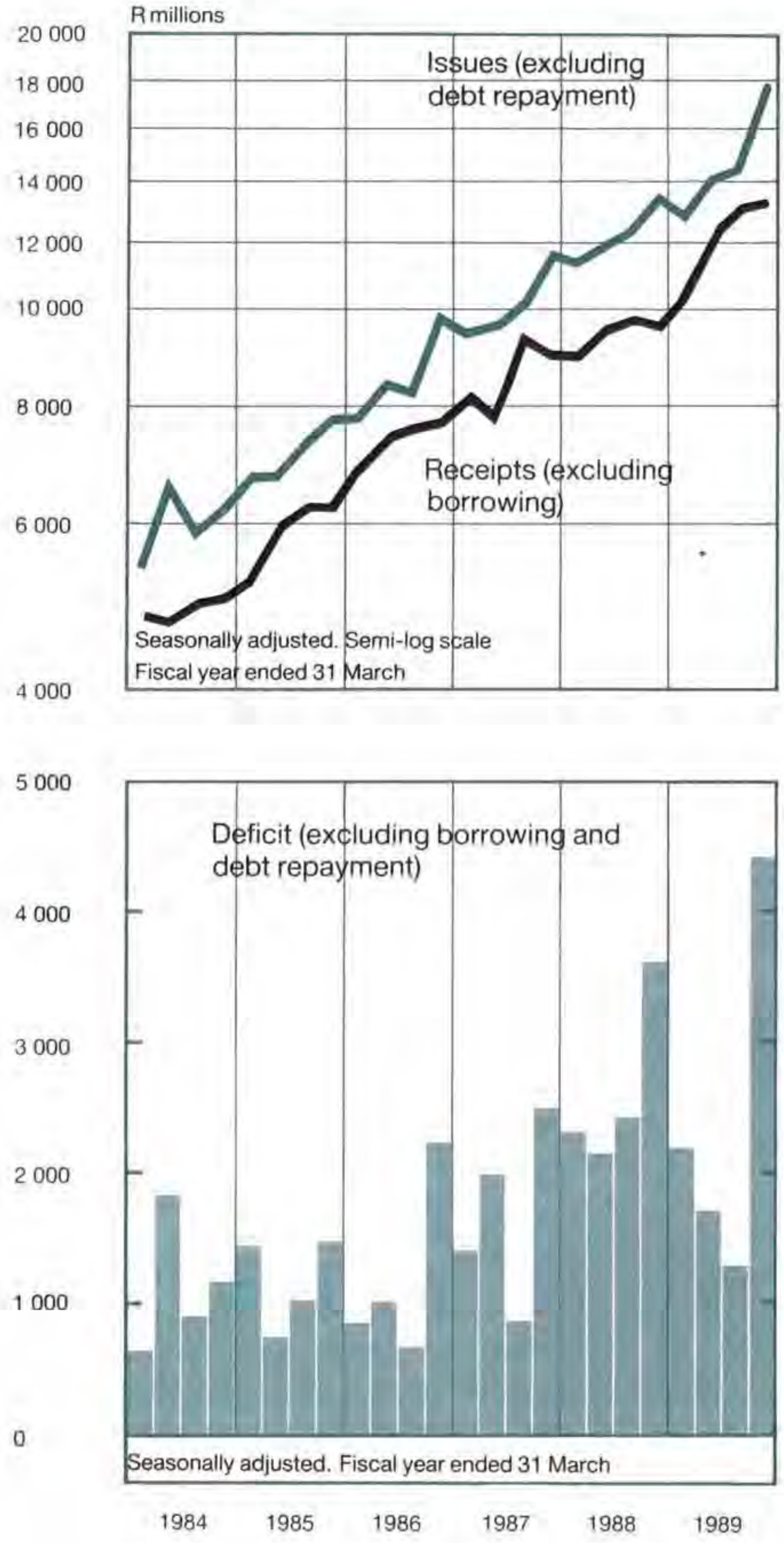
Further adjustments in fiscal policy

The somewhat more restrictive stance of fiscal policy that was aimed at in the central government's Budget of 15 March 1989 was reinforced in the second quarter of 1989 by additional fiscal measures introduced during that quarter. The effect of these measures will be to increase government revenue.

On 14 April 1989 it was announced by the Commissioner of Inland Revenue that the taxable amount of the benefit which, for the purposes of fringe benefit taxation, was deemed to be derived from the private use of company cars, was to be increased with effect from 1 June 1989. At the same time, the "official" rate of interest used in the calculation of the taxable benefit deemed to be derived from loans granted by employers to employees at below-market rates of interest, was to be raised from 13 to 16 per cent. Thirdly, the prescribed interest rates pertaining to provisional taxpayers and to the late submission of tax returns were to be increased from 12 to 14 and from 15 to 18 per cent.

Fiscal actions also made up an important part of the package of fiscal, monetary and credit measures that was announced on 5 May 1989. Fiscal measures in this package consisted, firstly, of the imposition of a loan levy on companies, to an amount of 10 per cent of tax payable in respect of the most recent financial year for which a tax assessment had been furnished to the companies concerned; payment of these levies was to be made on or before 31 July 1989. Secondly, exemptions that had been granted earlier from the surcharge on imports in the case of the importation of capital goods and components of capital goods, were abolished with effect from 5 May 1989. Exceptions would henceforth be allowed only in special circumstances, as, for example, in the case of counter-trade. The *level* of the surcharge on capital goods imports was, however, reduced from 20 to 15 per cent with effect from 10 May 1989. Thirdly, in the area of credit measures a further tightening was announced of certain hire-purchase conditions. Effective from 8 May 1989, increased minimum deposits and shorter repayment periods were made to apply to the purchase by means of hire-purchase contracts of a variety of less essential durable consumer goods.

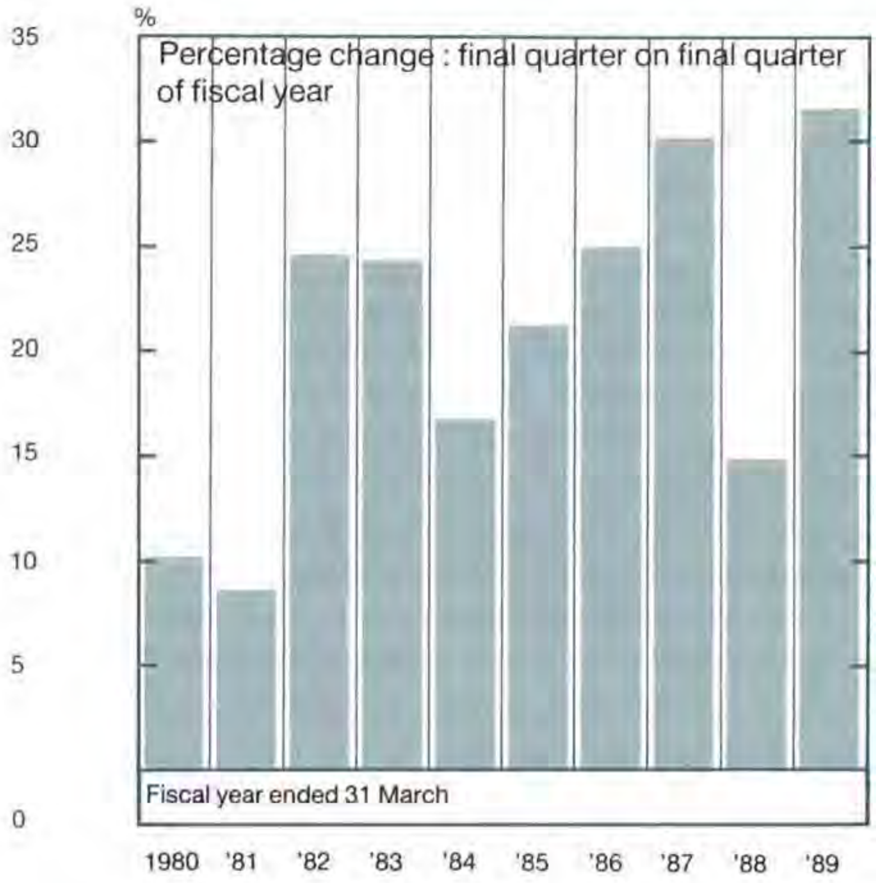
Exchequer account



Exchequer issues and receipts

The year-on-year increase in Exchequer *issues* to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) accelerated sharply from 12,8 per cent in the December quarter of 1988 to 31,5 per cent in the March quarter of 1989 – the highest year-on-year increase in any quarter in the past ten fiscal years. As a result, the increase in total government *expenditure* from the fiscal year 1987/88 to the fiscal year 1988/89 amounted to 18,0 per cent (diminishing to 17,5 per cent after adjustment for changes in the balance on the Paymaster-General Account). This rate of increase substantially exceeded the increase of 12,6 per cent in government expenditure that had been provided for in the original Budget estimates. Government expenditure in *real* terms rose by 4,6 per cent from fiscal 1987/88 to fiscal

Exchequer issues



1988/89 (diminishing to an increase of 4,2 per cent after adjustment for changes in the balance on the Paymaster-General Account).

In April 1989, i.e. the first month of fiscal 1989/90, Exchequer issues (after adjustment for changes in the balance on the Paymaster-General Account) exceeded their level of one year earlier by no less than 38 per cent. This, however, was mainly a result of the relatively low level of these issues in April 1988. Although obviously very much higher than the 15 per cent increase in Exchequer issues that was envisaged in the Budget for fiscal 1989/90 as a whole, the exceptionally large rise of issues in April 1989 over April 1988 therefore clearly did not provide an indication of the prospective course of such issues during the remainder of the current fiscal year.

The year-on-year increase in Exchequer *receipts* rose somewhat further from 34,3 per cent in the December quarter of 1988 to 35,2 per cent in the March quarter of 1989. Government *revenue* during fiscal 1988/89 as a whole rose by 28,5 per cent from the preceding year, against an increase as originally budgeted for of 16,3 per cent. In *real* terms this increase in Government revenue amounted to a very substantial 13,9 per cent.

Exchequer receipts in April 1989, compared with April 1988, increased markedly by 32,0 per cent. This was well in excess of the budgeted rate of increase of 16,0 per cent for the fiscal year 1989/90 as a whole.

Deficit before borrowing

The deficit before borrowing and debt repayment in the March quarter of 1989 amounted to R2 480 million (against R2 168 million in the March quarter of 1988). The deficit for fiscal 1988/89 as a whole was thereby brought to R7 794 million, or to approximately 3,8 per cent of gross domestic product. This outcome compared favourably with the deficit of R9 860 million, or 4,9 per cent of the then projected gross domestic product, that had been envisaged in the original Budget estimates.

The fiscal year's deficit of R7 794 million, plus the discount of R2 367 million on new issues of government stock (adding up to a total of R10 161 million), was financed from the following sources:

	R millions
Public Investment Commissioners	6 629
Non-bank private sector	4 794
Banking sector:	
Corporation for Public Deposits	–3 087
Other banks	1 923
Foreign sector	–98
Total	10 161

Budgets of Own Affairs administrations for 1989/90

Provision was made in the General Affairs Budget for 1989/90 of the Minister of Finance for a total allocation to Own Affairs administrations of R10 143 million. In addition, these administrations were to utilise R242 million from their own resources; aggregate expenditure by these administrations in 1989/90 therefore was budgeted to amount to R10 385 million. Of this total sum, amounts of R6 615 million, R2 765 million and R1 005 million were to be spent by the Administration: House of Assembly, the Administration: House of Representatives, and the Administration: House of Delegates, respectively.