Quarterly economic review

Introduction

Considerable firmness continued to be displayed by the South African economy in the fourth quarter of 1988. The annualised rate of increase in *real gross domestic product* in this quarter, amounting to nearly 3 per cent, was broadly in line with the growth rate for 1988 as a whole, which reached a higher than generally expected level of somewhat more than 3 per cent.

Nearly all sectors of the economy experienced real growth in the fourth quarter of 1988. For the calendar year as a whole, above-average rates of growth were recorded by the non-agricultural and non-primary sectors. The growth rates of real output in the secondary sectors and in manufacturing industry attained impressive figures of the order of 5½ and 6 per cent.

Aggregate *real gross domestic expenditure* in calendar 1988 was more than 7 per cent higher than in 1987. This strong rate of increase markedly exceeded the approximate 4 per cent rate of growth in the preceding year.

Total real gross domestic expenditure advanced strongly in the first quarter of 1988, levelled off in the second quarter, and then fell back quite significantly in the third quarter. It subsequently moved sideways again in the fourth quarter, essentially because further increases in real private consumption expenditure, another marked rise in total real gross domestic fixed investment, and an increase in real government consumption expenditure were neutralised by a further drawing-down of real inventories. Because of the decline in aggregate real inventories in both the third and the fourth quarter of 1988, the distinct topping-out and mild retreat of total real gross domestic *expenditure* in the course of 1988 from its high first-quarter level may have created an exaggerated impression of a loss of buoyancy in aggregate real domestic *final demand.*

Various selected business cycle indicators in the fourth quarter of 1988 nevertheless continued to suggest an incipient slowing-down of the economic upswing. The composite coincident business cycle indicator advanced further up to September-October 1988. The *leading* indicator, however, showed a significant further decline in October.

The volume of manufacturing production declined moderately on average in October-November 1988 from its high third-quarter level. Wholesale and retail sales at constant prices in the fourth quarter of 1988 were down on the third quarter. The value of residential building plans passed, which had already contracted significantly in the third quarter, showed a substantially accelerated decline in October-November. Certain "patches" of an incipient slackening of credit demand were also reported by major financial institutions towards the end of 1988 and in the first few months of 1989.

Against this, a variety of factors appeared to have joined forces in keeping up the level of aggregate domestic expenditure, sustaining the demand for bank credit generally, and maintaining an atmosphere of business bullishness and consumer confidence in January and February 1989. Such factors included the rise in public sector salaries and other wage increases from the beginning of the year, stepped-up government expenditure in the closing stages of fiscal 1988/89, prospects for good agricultural harvests in the course of 1988, the momentum that had been built up in real fixed domestic capital formation, and the strength of the share market in February and March. Prospects of a worsening of inflation and of a further weakening of the exchange rate of the rand continued to be advanced as reasons for "pre-emptive" buying and for giving early effect to spending plans. Good or excellent financial results of companies and high levels of profitability of business enterprises generally were said to be giving rise to demands for higher than otherwise wage increases and to be adding to employers' willingness to accede to such demands.

The levelling-out and mild retreat of aggregate real gross domestic expenditure after the first quarter of 1988 caused the growth in real output in the course of 1988 to become more export-driven. The marked further reinvigoration of the South African merchandise export performance in the second half of 1988 in particular, was the principal factor in bringing about the transformation of the slight deficit on the current account of the balance of payments in the first quarter of 1988 into progressively larger surpluses that reached an annualised level of R5,4 billion by the fourth quarter. The current account surplus for 1988 as a whole, at R2,9 billion, exceeded most forecasts and projections that had been drawn up earlier in the year.

In conjunction with the marked further strengthening of the current account, a markedly smaller outflow of non-reserve-related capital in the fourth quarter of 1988 helped to arrest the decline in the South African gross gold and other foreign reserves in December 1988 and in January and February 1989. Having weakened almost continuously during the first ten months of 1988, the effective exchange rate of the rand firmed again after the first few days of November. In January 1989 the rand lost ground against the strengthening dollar but firmed against all other major currencies. In February, however, a renewed bout of weakness of the dollar price of gold, and further strengthening of the dollar in the international foreign exchange markets, wiped out the gains that had been made by the effective exchange rate of the rand from November 1988 up to the end of January 1989.

Few signs of abatement in the very high rates of expansion in bank credit and the monetary aggregates were apparent as yet in the fourth quarter of 1988 and in early 1989. The rate of increase in the quarterly average of the comprehensively defined money supply, M3, from the fourth quarter of 1987 to the fourth quarter of 1988, at 26,5 per cent, was some 10,5 percentage points in excess of the 16 per cent upper limit of the monetary target for 1988. The very high rate of increase in M3 was partly due, however, to reintermediation phenomena and to investors' increased "liquidity preference". As a result, it was accompanied by an appreciable decline in M3's velocity of circulation; the increase in the "effective" M3 money supply – i.e. in M3 after adjustment for changes in its velocity of circulation – in the course of the 1988 targeting year amounted to 17,3 per cent.

A new target, ranging from 14 to 18 per cent, for the rate of increase in M3 from the fourth quarter of 1988 to the fourth quarter of 1989 was announced by the Reserve Bank on 7 March 1989. In explaining the monetary authorities' decision to raise the upper and lower limits of the target range by two percentage points from their 1988 levels, the Reserve Bank stated that this was based on the acceptance by the authorities of a broad economic projection for 1989 that provided for a further increase in real gross domestic product of around 2 per cent, a surplus on the current account of the balance of payments of roughly R4 billion, a gradual rise in the official gold and foreign exchange reserves, and an average rate of increase of the consumer price index of about 15 per cent. An assumption of a temporary acceleration of the inflation rate in 1989 therefore was regarded as realistic for purposes of this scenario.

The decline in the dollar price of gold and other adverse developments in January-February 1989, viewed in conjunction with the obviously excessive rates of growth in bank credit and the money supply in the targeting year 1988, caused the Reserve Bank to raise Bank rate – i.e. its rediscounting rate for Treasury bills for discount houses – from 14½ to 16 per cent with effect from 23 February 1989. This higher Bank rate would be applied to the rediscounting of Treasury bills for both the discount houses and the banks; it therefore involved abolition of the preferential margin of ½ per cent that had previously been extended to the discount houses in the Bank's refinancing facilities. The Bank's statement accompanying this Bank rate increase again stressed the need for a curbing of its own credit creation as an indispensable element in slowing down the rates of increase in bank credit generally, in the money supply, and in aggregate monetary demand.

The capital markets in the fourth quarter of 1988 saw a drop in the turnover of public sector stock and low levels of new-issue activity in the share market. Share *prices*, however, rose significantly in the third and the fourth quarter of 1988 and continued to do so at an accelerating pace in the first ten weeks of 1989.

In the area of government finance, the outcome of fiscal policy in 1988/89 was slightly less simulatory than had been envisaged in the Budget as presented in March 1988. Against a budgeted increase of 16,3 per cent, exchequer issues in 1988/89 increased by an estimated 18,4 per cent, or by approximately 5,0 per cent in real terms. Exchequer receipts, however, rose by an estimated 25,2 per cent, against a budgeted increase of 12,6 per cent. The deficit before borrowing relative to gross domestic product accordingly amounted to an estimated 4,4 per cent, as against the original Budget estimate of 4,9 per cent.

A somewhat more restrictive approach to fiscal policy for moderating the growth in domestic expenditure was indicated by the Minister of Finance for fiscal 1989/90. In his Budget speech delivered to Parliament on 15 March 1989, the Minister budgeted for no growth in 1989/90 in government expenditure in real terms. In nominal terms, the Budget provided for an increase of 15,0 per cent in expenditure, an increase of 16,0 per cent in revenue, and a deficit before borrowing of 4,1 per cent of gross domestic product. Projected revenue included the effect of an increase in general sales tax to 13 per cent. As a part of the ongoing process of tax reform, further steps were taken towards the separate taxation of married couples through the Minister's proposal that all salaried married women be taxed under the system of the so-called Standard Income Tax on Employees.

Domestic economic developments

Domestic output

Considerable strength of the growth rate of real gross domestic product in the fourth quarter of 1987 was followed by growth at firm and sustained although generally somewhat more moderate rates in the four quarters of 1988. Current indications are that, after seasonally adjusted and annualised rates of real economic growth of nearly 4 per cent, more than 2 per cent and 3½ per cent in the first three quarters of 1988, the annualised growth rate in the fourth quarter of 1988 amounted to nearly 3 per cent.

Nearly all sectors of the economy experienced positive real growth in the fourth quarter of 1988. Notable increases in real output were recorded by the sectors manufacturing, electricity, gas and water, commerce, construction, and general government. Within the manufacturing sector, significant increases in production were registered in the chemical, basic metals and machinery, and transport industries. This could mainly be traced to strong demand and forward orders.

Output increases in the sector electricity, gas and water were a reflection of higher levels of economic activity and more lively business conditions in general. Further advances in real value added in the sector commerce were mainly accounted for by the sub-sectors retail and motor trade and by catering and accommodation. Increased value added by general government went hand in hand with a continuation of increases in the number of workers employed, notably in the independent national and self-governing states.

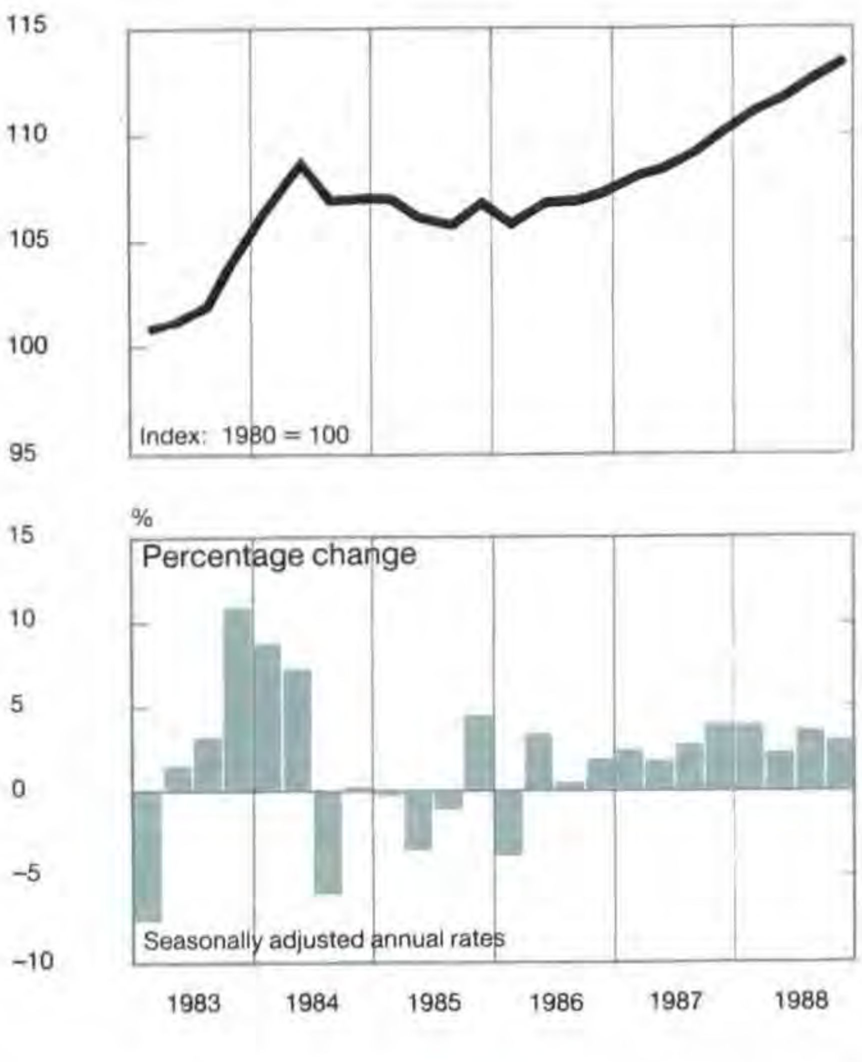
Growth in real output in the construction sector in the fourth quarter of 1988 reached an annualised level of nearly 8 per cent. This strong performance stemmed from relatively buoyant conditions in the building industry in general and from stepped-up fixed investment activity in the form of building and construction works. This kind of fixed capital formation itself reached an annualised real rate of increase in the fourth quarter of 1988 of no less than 18 per cent.

Growth in aggregate real gross domestic product in the *calendar year* 1988 amounted to somewhat more than 3 per cent (against growth at somewhat more than 2 per cent in 1987 and at ½ per cent in 1986). This further acceleration of the real economic growth rate in the third year of the economic upswing was attained in the face of a gradually tightening stance of monetary policy and other restrictive measures. It derived support from continued buoyancy in real private consumption expenditure and from a marked reinvigoration of the South African real merchandise export performance in the second half of the year in particular. The resultant higher corporate profits, rising degrees of capacity utilisation and improved business confidence, in turn, provided foundations for a further strengthening of private sector fixed investment demand.

A decline (of 3 per cent) was shown by real value added by *agriculture* from 1987 to 1988. The further strengthening of aggregate real output growth in calendar 1988 could be attributed mainly to a sharply higher rate of increase in real manufacturing production and to a reversal of the change in real mining output from decreases in 1986 and 1987 to a mild increase (of approximately 1 per cent) in 1988. Above-average growth rates for 1988 as a whole were accordingly displayed by the *non-agricultural* and *non-primary* sectors (both estimated at 4 per cent); the growth rates of real output in the *secondary* sectors and in *manufacturing* reached impressive figures of the order of 5½ and 6 per cent.

A higher level of real value added by the mining sector in 1988 vis-à-vis 1987 was accounted for by the gold mining industry in particular. This could be attributed to more stable labour relations, new mines having come on stream, an increase in the tonnage of ore milled, and (in some cases, more particularly in the fourth quarter of 1988 as a possible response to a further weakening of the gold price) also the mining of higher-grade ore. The marked further gains in manufacturing production in 1988 were explained by the

Real gross domestic product



unexpectedly firm levels of aggregate domestic demand as well as by the renewed upswing in merchandise exports; increased real fixed investment expenditure during the year included rising outlays by public corporations in projects such as Mossgas and Mossref.

The expected slackening of real private consumer demand in the course of 1989 may be foreseen to affect certain sub-sectors of the manufacturing sector. This will probably be neutralised, however, by expansion in the metal fabrication and heavy engineering industries.

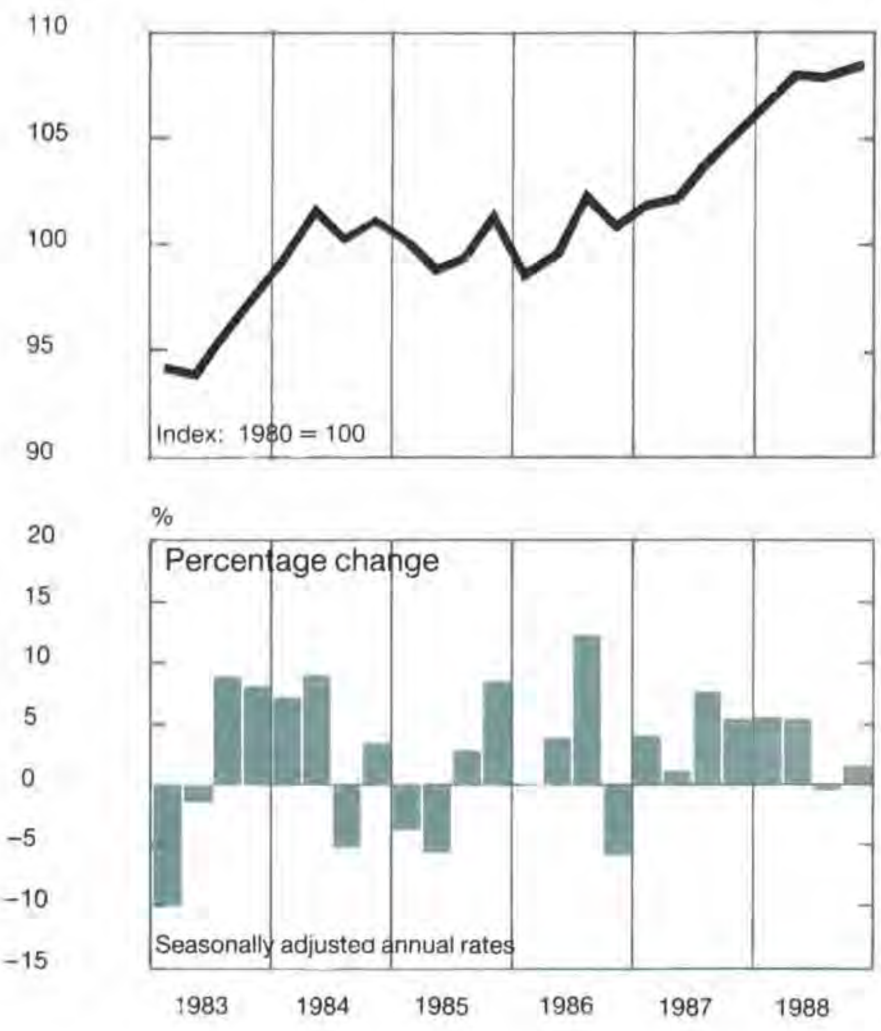
Total real gross *national* product rose by almost 4½ per cent in 1988 (against a revised growth rate of 3 per cent in the preceding year). Real gross national product per head of the population accordingly advanced by slightly more than 2 per cent in 1988, against an increase of slightly less than 1 per cent in 1987.

Growth in real gross national product, at seasonally adjusted and annualised rates, reached an average level of approximately 5½ per cent in the first two quarters of 1988. Real gross national product, however, then moved sideways in the third quarter of 1988 because of increased net factor payments (including upwardly revised net interest payments) to foreigners; in addition, a 22½ per cent annualised rate of increase in import prices, vis-à-vis a 15 per cent annualised rate of increase in export prices, meant a weakening of the terms of trade. In the fourth quarter of 1988 some further increase was recorded in net factor payments, while the terms of trade showed little change. The 1½ per cent annualised rate of growth in real gross national product during this quarter fell significantly short of the growth rate in real gross *domestic* product, which, as noted earlier, reached an annualised rate of increase of nearly 3 per cent during this period.

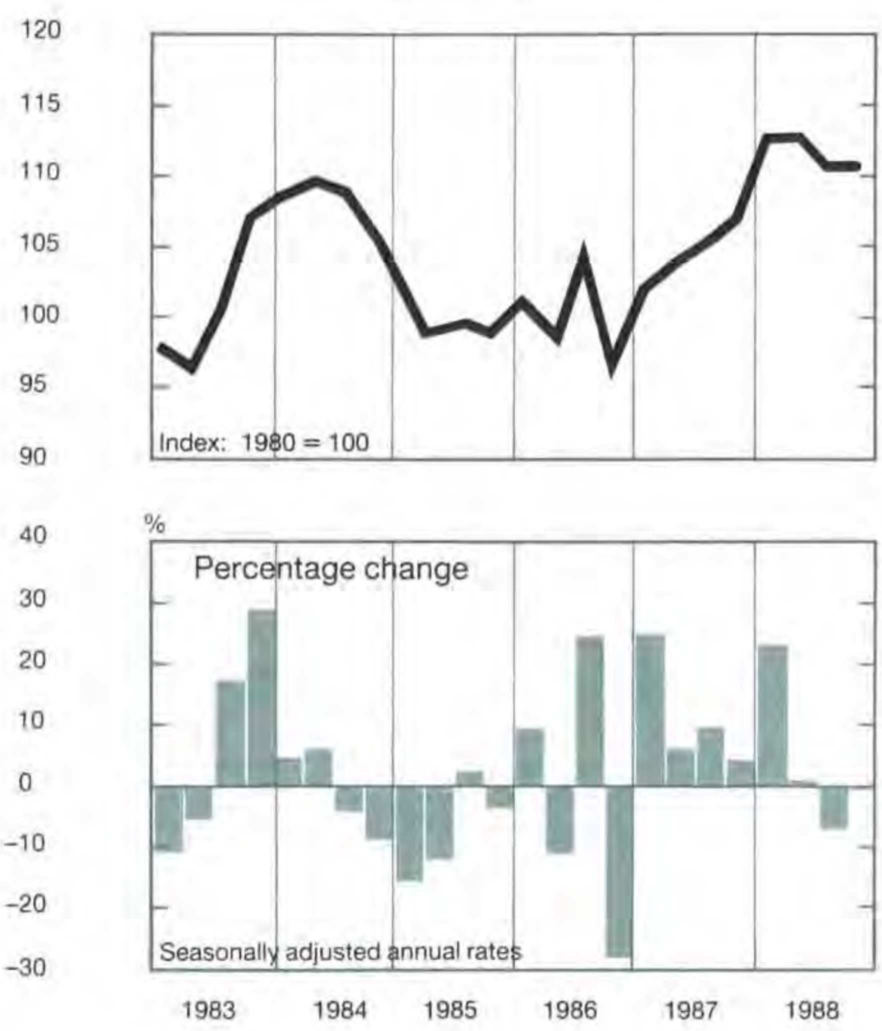
Domestic expenditure

Total real gross domestic expenditure advanced strongly in the first quarter of 1988, levelled off in the second quarter, and then fell back quite significantly in the third quarter. Current estimates show it to have moved essentially sideways again in the fourth quarter of 1988. The sideways movement in the fourth quarter was the net outcome of a further strengthening of real private consumer spending, another marked rise in total real gross domestic fixed investment, and some increase in real government consumption expenditure, which were essentially neutralised by a further drawing-down of aggregate real inventories. Aggregate real gross domestic expenditure in *calendar 1988* was more than 7 per cent higher than in 1987. This rate of

Real gross national product



Real gross domestic expenditure



increase markedly exceeded the approximate 4 per cent rate of growth in the preceding year.

Real *private consumption expenditure* rose during the fourth quarter of 1988 for the eleventh consecutive quarter. Its seasonally adjusted and annualised rate of expansion in the fourth quarter of 1988 (amounting to about 4 per cent) was broadly in line with the longer-term rate of increase in this kind of expenditure from the second quarter of 1986, but significantly lower than the annualised rate of increase (of some 5½ per cent) in the third quarter of 1988.

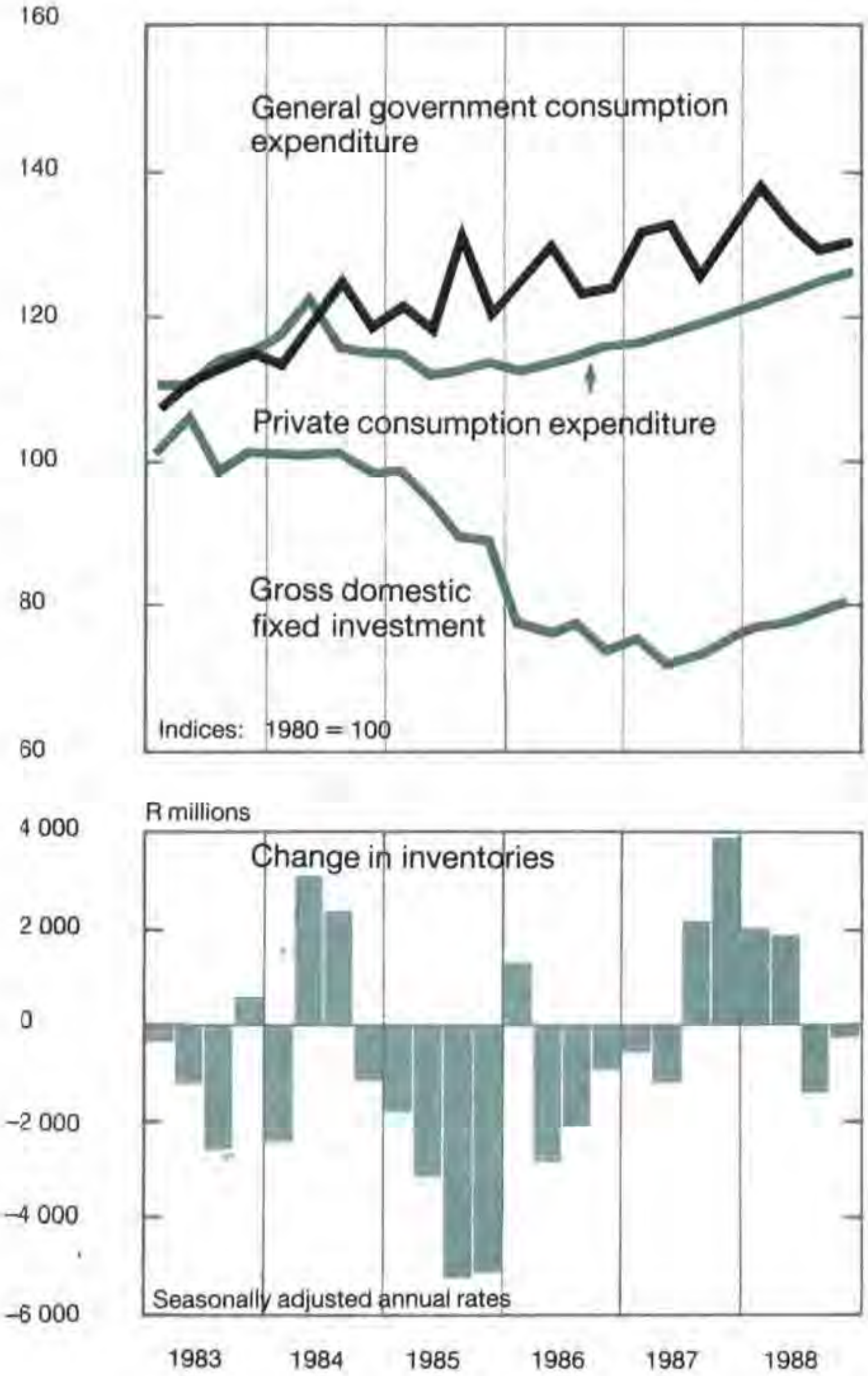
Growth in real private consumer spending in the fourth quarter of 1988 was broadly based. Special emphasis, however, fell on households' purchases of personal transport equipment. Consumer spending in the fourth quarter of 1988, as in preceding quarters, was favoured by a significantly higher level of aggregate real personal disposable income in the course of 1988, an absence of consumer boycotts, and increased consumer confidence in a generally more tranquil social, political and economic environment, as well as being supported by "pre-emptive" buying in anticipation of expected price increases (including such increases as would arise from the renewed weakening of the exchange rate of the rand from January to October 1988). As in the third quarter of 1988, moreover, incentives continued to exist in the early fourth quarter for purchases of consumer durables out of "old" stocks of such durables which had not yet incurred the increased import surcharges that came into force on 15 August 1988. Against this, certain branches of retail trade (notably furniture and "white goods") towards the end of 1988 were reporting a slackening of demand on account of the tightening of hire-purchase conditions earlier in the year and because of both the direct and the more round-about effects of higher interest rates.

The growth rate of aggregate real private consumption expenditure from the year 1987 to the year 1988 amounted to almost 5 per cent, against a compound average annual rate of increase of a slender 2 per cent in the years from 1980 to 1988. The rates of increase in real spending on consumer durables and semi-durables in 1988 reached levels of approximately 12 and 7 per cent.

Real *government consumption expenditure* declined substantially in the June and September quarters of fiscal 1988/89, but rose again in the December quarter at an annualised rate of close to 3 per cent. An increase in total real remuneration of government employees more than offset a decline in real expenditure on intermediate goods and services in the December quarter. Total real government consumption expenditure in calendar 1988 is estimated to have exceeded such expenditure in 1987 by a fairly modest 1½ per cent.

Total *real gross domestic fixed investment* increased further in the fourth quarter of 1988 and did so at a slightly faster pace than in the preceding six months.

Main components of real gross domestic expenditure



As an unusual event in the past few years, the fourth-quarter increase was the result of increased real fixed capital expenditure by all three institutional sectors (i.e. by public corporations and public authorities as well as by the private sector). For the year as a whole the level of total real gross domestic fixed investment was about 6½ per cent higher than in 1987. This followed *declines* of nearly 18 per cent and 3 per cent in the preceding two years.

Quarter-to-quarter growth in real gross domestic fixed capital spending in the *private sector*, at seasonally adjusted and annualised rates, tapered off rapidly from 25 per cent in the first quarter of 1988 to 22½, 6½ and 3½ per cent in the second, third and fourth quarter. The average level of such spending in the year 1988, however, nevertheless was an impressive 16 per cent higher than in 1987. In the fourth quarter of 1988, a decline in real fixed capital spending by the mining industry was more than fully compensated for by increases in fixed capital formation by the manufacturing sector and in the sector finance.

Among *public corporations*, increases in the fourth quarter of 1988 in real fixed investment expenditures by enterprises in mining and manufacturing (notably on projects such as Mossgas and Mossref) more than fully neutralised renewed reductions in such expenditure by Eskom in accordance with Eskom's budgetary intentions for 1988. *Total* real fixed capital formation by all public corporations continued to decline in calendar 1988 for the third consecutive year. Its decline in 1988 amounted to approximately 13 per cent.

The fourth-quarter increase in real fixed capital spending by *public authorities* could be attributed mainly to increased capital outlays by the South African Transport Services and the provincial administrations. As in the case of the public corporations, however, real fixed capital formation by public authorities was lower in the calendar year 1988 than in the preceding year. The declines in real fixed capital spending by government business enterprises and by general government from 1987 to 1988 amounted to 9 and 2½ per cent.

Broken down according to types of assets, aggregate real gross domestic fixed investment in 1988 showed substantial increases in real spending on residential and non-residential buildings (amounting, on average, to about 10 per cent), and on machinery and transport equipment. The latter kind of real investment expenditure rose by about 7½ per cent; as regards *private sector* investment spending, however, this increase amounted to 20½ per cent.

The encouraging rise in aggregate real gross fixed capital formation in 1988 from its 1987 levels could be attributed to "special" inducements to invest – such as those arising from import replacement demand and from fears of increases in the prices of imported capital equipment resulting from depreciation of the rand – as well as to the pressures of rising degrees of capacity utilisation of existing production facilities and to the normal processes of replacement, renewal and renovation of existing capital goods.

The 1988 increase in total real gross domestic fixed investment was only the fourth such increase to be recorded in a full calendar year in the past decade. However, it also started from a low base resulting from six years of sustained declines; the level of gross real fixed investment in 1988 actually was still some 27 per cent lower than in the peak investment year 1981. Gross real fixed investment expenditure in private manufacturing industry in 1988, moreover, still did not fully match the level of depreciation allowances. It therefore resulted in some further (although steadily diminishing) shrinkage of manufacturing industry's real fixed capital stock.

Aggregate *real inventories* are estimated to have declined further in the fourth quarter of 1988. This reflected a diminution of agricultural and diamond stocks-in-trade as well as a drawing-down of commercial inventories. The declines in commercial inventories could be attributed to the generally high levels of domestic demand (including the above-mentioned "pre-emptive" buying out of "old" stocks of consumer durables and investment goods), the sharp rise in merchandise export volumes in the second half of 1988, and some presumed sensitivity of commercial and industrial inventory levels to the rising level of domestic interest rates.

Aggregate real inventories still rose, on balance, during 1988 as a whole. The ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy rose mildly in 1988 to an average level during the year of slightly more than 19½ per cent.

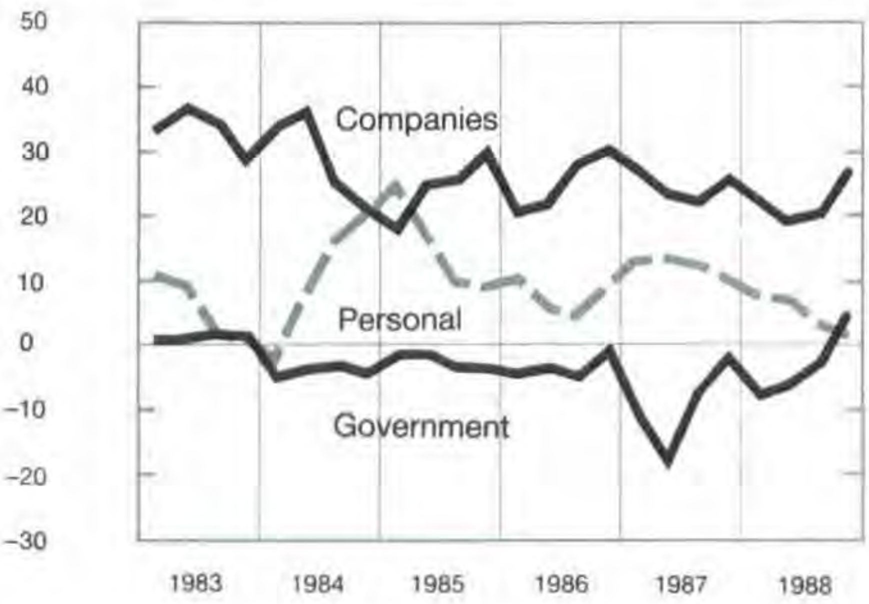
Factor income and saving

The quarter-to-quarter rate of increase in aggregate nominal factor income, in seasonally adjusted and annualised terms, amounted to 16½ per cent in the fourth quarter of 1988. This followed rates of 20 and 22½ per cent in the first two quarters of 1988 and of 10½ per cent in the third quarter. The year-on-year rise in nominal factor incomes in the fourth quarter amounted to 17½ per cent. The increase in these incomes from the *year* 1987 to the *year* 1988, at 18 per cent, was significantly higher than the 15½ – 16 per cent increases of the preceding two years.

The accelerated rise in total factor incomes in the fourth quarter of 1988 reflected mainly a strengthening of *gross operating surpluses* in agriculture, manufacturing, transport and finance. With regard to 1988 as a whole, the more notable increases in operating surpluses were recorded in manufacturing, commerce, transport and finance. The profitability of corporate entities in their various sectors in 1988 was raised by higher turnovers and productivity increases as well as by windfalls arising from new export opportunities and declines in the exchange value of the rand. Mining and parts of agriculture also enjoyed the benefits of relatively high international commodity prices and the rise in the average level of these prices up to the middle of 1988; the mining sector was affected adversely, however, by the decline in the gold price, especially in the second half of the year.

The quarter-to-quarter increase in nominal *remuneration of employees*, in seasonally adjusted and annualised terms, accelerated sharply to as much as 23½ per cent in the fourth quarter. This was accounted for by broadly all major contributors in the secondary and tertiary sectors of the economy. The increase in total remuneration of employees in the year 1988 vis-à-vis 1987, at an estimated 16½ per cent, was marginally lower than the 17 per cent increase in 1987 vis-à-vis 1986. This would appear to have been due to the more

Components of savings as percentage of gross domestic saving



selective nature of salary increases in the public sector and to a contraction of the labour force in the mining industry.

Gross domestic saving, relative to gross domestic product, rose slightly from 20 per cent in the second quarter of 1988 to nearly 21 per cent in the third quarter and more substantially to 24½ per cent in the fourth quarter. The fourth-quarter increase in this ratio reflected a further rise in company saving as well as a reversal (for the first time since the fourth quarter of 1983) from net dissaving to net saving by general government. Between them, these two improvements in savings performances more than offset a further decline in personal saving. In the calendar year 1988, however, the "excess" of domestic saving over domestic investment amounted to only 7 per cent, against high points in this "excess" savings ratio of 18½ and 25½ per cent in the low-investment years 1987 and 1986.

The improved savings performance by general government essentially reflected the substantially higher than budgeted rise in current revenue, against the more moderately higher than budgeted rise in current expenditure, during much of fiscal 1988/89. Increased savings by incorporated business enterprises were a reflection of increased company profitability. Net personal saving, on the other hand, weakened further in the fourth quarter of 1988 as further advances in real private consumption expenditure again failed to be matched fully by increases in aggregate real personal disposable income during this period.

The tightening of hire-purchase conditions in the second half of 1988 would appear to have elicited significant switching by households from this type of credit to alternative sources of consumer finance. The personal savings ratio (i.e. the ratio of net personal savings to personal disposable income) declined to a very slim ½ per cent in the fourth quarter of 1988. With regard to the calendar year 1988, this ratio amounted to 1½ per cent, against a revised value of this ratio of 4½ per cent in the preceding year.

Employment

After a very limited (0,5 per cent) increase in 1986, total employment in the non-agricultural sectors of the economy rose by 1,0 per cent in 1987 and by 1,2 per cent in the first three quarters of 1988. Employment increases in the course of 1988 were particularly strong in the first and the third quarter, reaching seasonally adjusted annual rates of 3,2, 0,2 and 2,2 per cent in the first, second and third quarter, respectively.

Broadly similar patterns were displayed by increases in employment by public authorities and in the private sector. The mining industry, however, still showed a continuation of the decline in employment that had been in evidence since the third quarter of 1987. Information for the fourth quarter of 1988 shows employment to have expanded moderately in manufacturing but to have declined in construction and electricity generation.

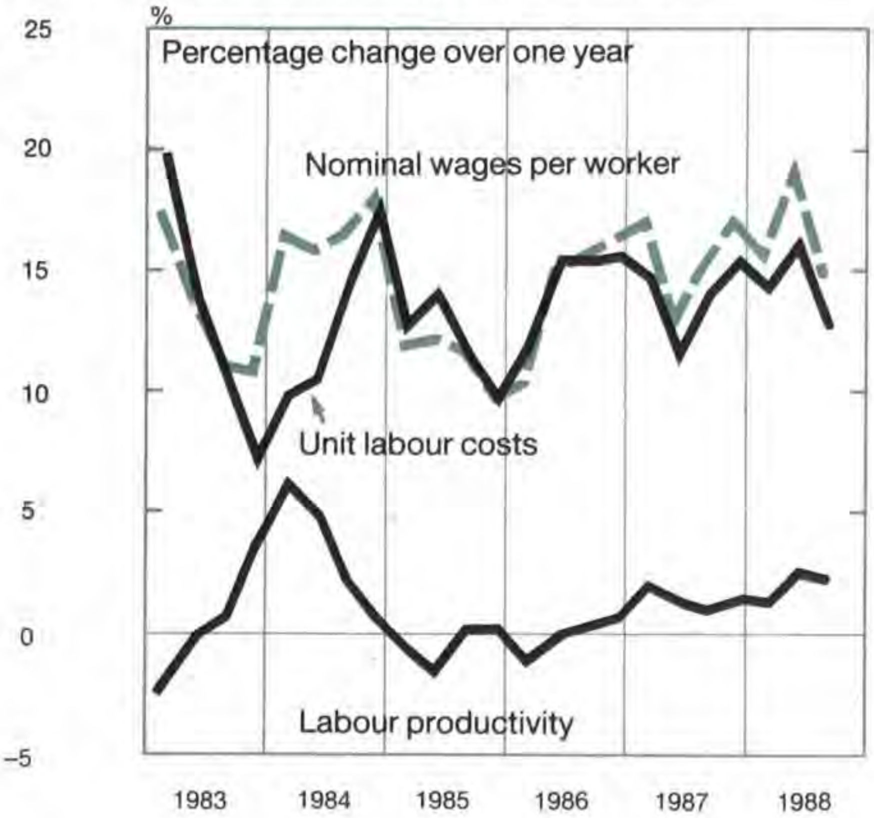
Contrary to trends since the fourth quarter of 1986, rising employment numbers in manufacturing in the fourth quarter of 1988 were accompanied by a *decline* in the overtime ratio. The ratio of overtime hours to normal hours worked decreased from 12,5 per cent in the third quarter of 1988 to 11,9 per cent in the fourth quarter in manufacturing, and from 8,7 to 7,8 per cent in the construction industry.

The seasonally adjusted number of registered *unemployed* Whites, Coloureds and Asians declined from 82 500 in August 1986 to 50 500 in September 1988, but *rose* to 51 200 in October 1988. Similarly, the *total* number of registered unemployed workers, which had declined from 138 000 in September 1987 to 119 300 in September 1988, subsequently increased to 121 000 in October. The number of unemployed Black workers as measured by the Current Population Survey, which had retreated from nearly 1,2 million in July 1986 to 817 000 in August 1988, advanced slightly again to 823 000 in September 1988 – equalling approximately 12,5 per cent of the Black labour force.

Labour costs and productivity

The year-on-year increase in the average nominal wage of all workers outside agriculture in the third quarter of 1988 (at 14,5 per cent) was significantly lower than in the preceding two quarters (when these increases had amounted to 15,6 and 18,8 per cent). As a result, the year-on-year increase in the average nominal wage per worker with regard to the first three quarters of 1988 declined to 16,3 per cent (from 17,2 per cent in the first half of the year). At this level the rate

Labour productivity, nominal wages per worker and unit labour costs in non-agricultural sectors



of increase in the average nominal wage was nevertheless still significantly higher than the preceding increases of 15,4 per cent in calendar 1987 and of 14,4 per cent in calendar 1986.

Accelerated nominal wage increases, and a lower level of inflation, caused the *real* wage per worker in the first three quarters of 1988 to rise by 2,9 per cent over the first three quarters of 1987. *Declines* in the real wage per worker (of 4,2, 3,6 and 0,7 per cent) had been recorded in the preceding three calendar years.

Labour productivity (i.e. real gross domestic product per worker outside the agricultural sector) rose by 1,4 per cent in calendar 1987 and by 1,9 per cent in the first three quarters of 1988 vis-à-vis the first three quarters of 1987. Productivity gains over four-quarter periods in the second and third quarter of 1988, at 2,5 and 2,2 per cent, actually were the highest such gains to be recorded since the second half of 1984.

Despite more rapid advances in labour productivity, the accelerated rise in nominal labour remuneration caused the rate of increase in labour costs per unit of physical output to be raised slightly from 13,8 per cent in calendar 1987 to 14,1 per cent in the first three quarters of 1988.

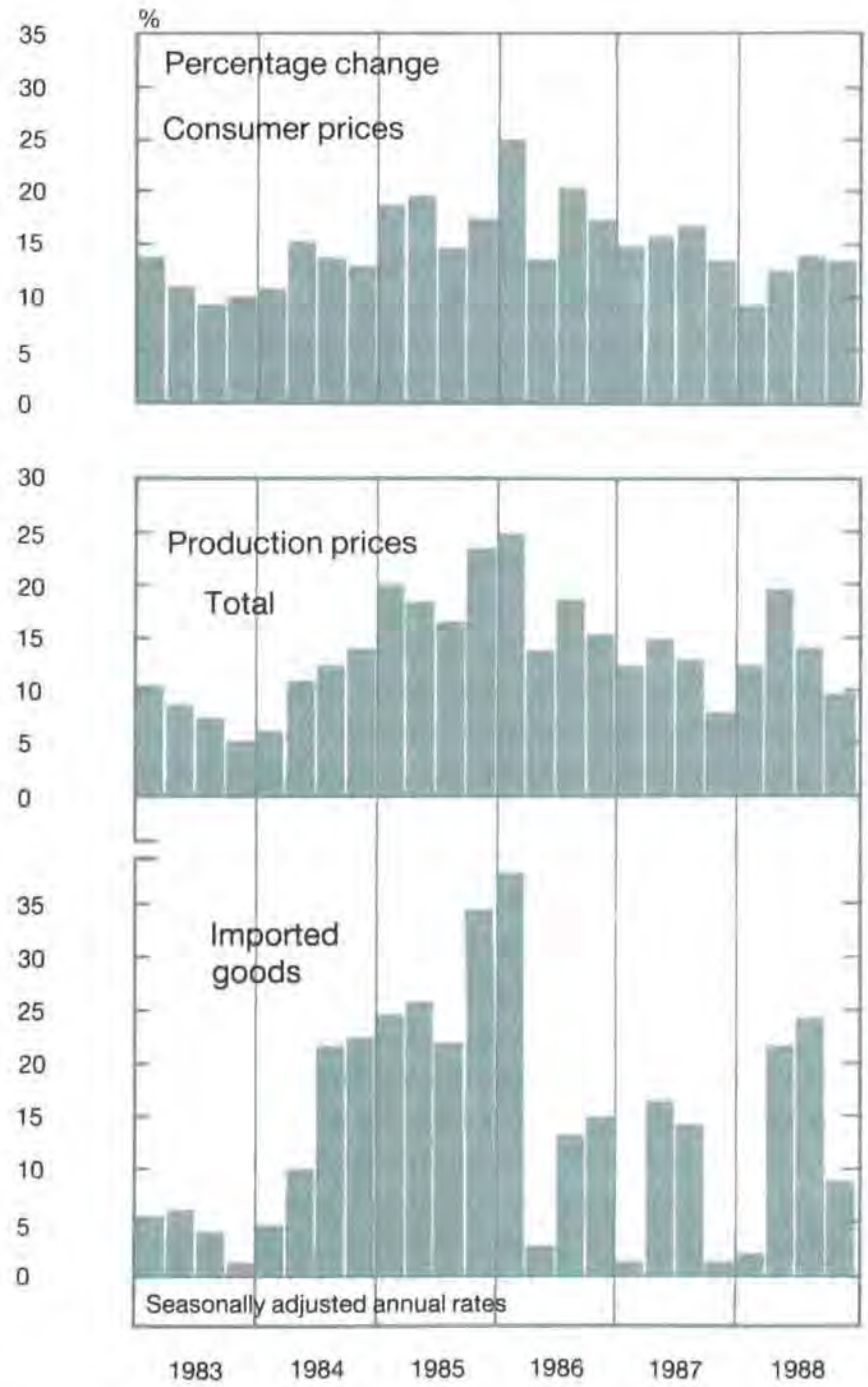
Inflation

The seasonally adjusted and annualised quarter-to-quarter rates of increase in the prices of *imported goods* slowed down markedly from 24,4 to only 9,1 per cent, and in the case of the prices of *domestically produced goods* from 12,1 to 10,1 per cent, from the third to the fourth quarter of 1988. As a result, the seasonally adjusted and annualised rate of increase in the *production price index* (which had increased from only 7,9 per cent in the fourth quarter of 1987 to 19,6 per cent in the second quarter of 1988) fell back from 14,3 per cent in the third quarter of 1988 to only 9,6 per cent in the fourth quarter. The twelve-month rate of increase in the production price index, however, accelerated to 14,1 per cent in November and to 14,6 per cent in both December 1988 and January 1989.

The year-to-year rise in the annual average level of production prices, which had slowed down markedly from 19,6 per cent in the calendar year 1986 to 13,9 per cent in 1987, showed a mild further deceleration to 13,2 per cent in 1988.

In somewhat similar fashion, the year-to-year rise in the average level of the *consumer price index* slowed down encouragingly from 18,6 per cent in calendar

Prices



1986 and 16,1 per cent in calendar 1987 to 12,9 per cent in 1988. However, the *quarter-to-quarter* increase in the consumer price index, at seasonally adjusted and annualised rates, began to rise at an early stage in 1988 from a low point of only 9,2 per cent in the first quarter to 12,6 per cent in the second quarter, and to 13,9 and 13,6 per cent in the third and fourth quarter, respectively. The marginal slow-down in the fourth quarter was a reflection of more modest food price increases (including an actual decline in the price of meat) in particular. Service costs rose more rapidly, however, partly as a result of increased home-owners' costs.

The *twelve-month* rate of increase in consumer prices declined from 14,2 per cent in January 1988 to 12,4 per cent in June and held at levels from 12,3 to 12,5 per cent during the ensuing six months. It then rose to 13,3 per cent in January 1989. The level of consumer prices in January 1989 was already affected by various administered price increases. Higher interest charges on housing mortgage loans, continuing lagged effects of the exchange rate depreciation from January to October 1988 and in February – March 1989, lagged effects of the increases in import surcharges from August 1988, the increased levies on motor fuels from 16 January 1989 and earlier behaviour of the production price index and of the quarter-to-quarter changes in the consumer price index, are likely to mean that the tempo of inflation in consumer prices will quicken further in ensuing months before probably moderating again later in 1989.

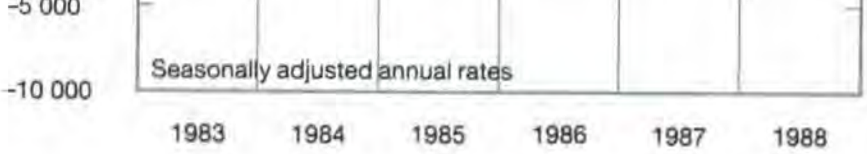
Balance of payments

Current account

Having dipped into a marginal deficit (at a seasonally adjusted annual rate of less than R0,1 billion) in the first quarter of 1988, the current account of the balance of payments returned to a surplus, at a seasonally adjusted annual rate, of R1,7 billion in the second quarter and of notably more substantial amounts of R4,6 billion and R5,4 billion in the third and the fourth quarter. These growing current account surpluses were attained despite continued relatively high levels of domestic expenditure and the impact of "pre-emptive" purchases of consumer and investment goods in the third and early fourth quarter of 1988 in particular. For 1988 as a whole, however, the current account surplus shrank to R2,9 billion from R6,2 billion in the preceding year.

Further strengthening of the current account surplus in the fourth quarter of 1988 could be attributed almost exclusively to another marked increase, of nearly 8 per cent, in *merchandise export earnings*; this increase, in

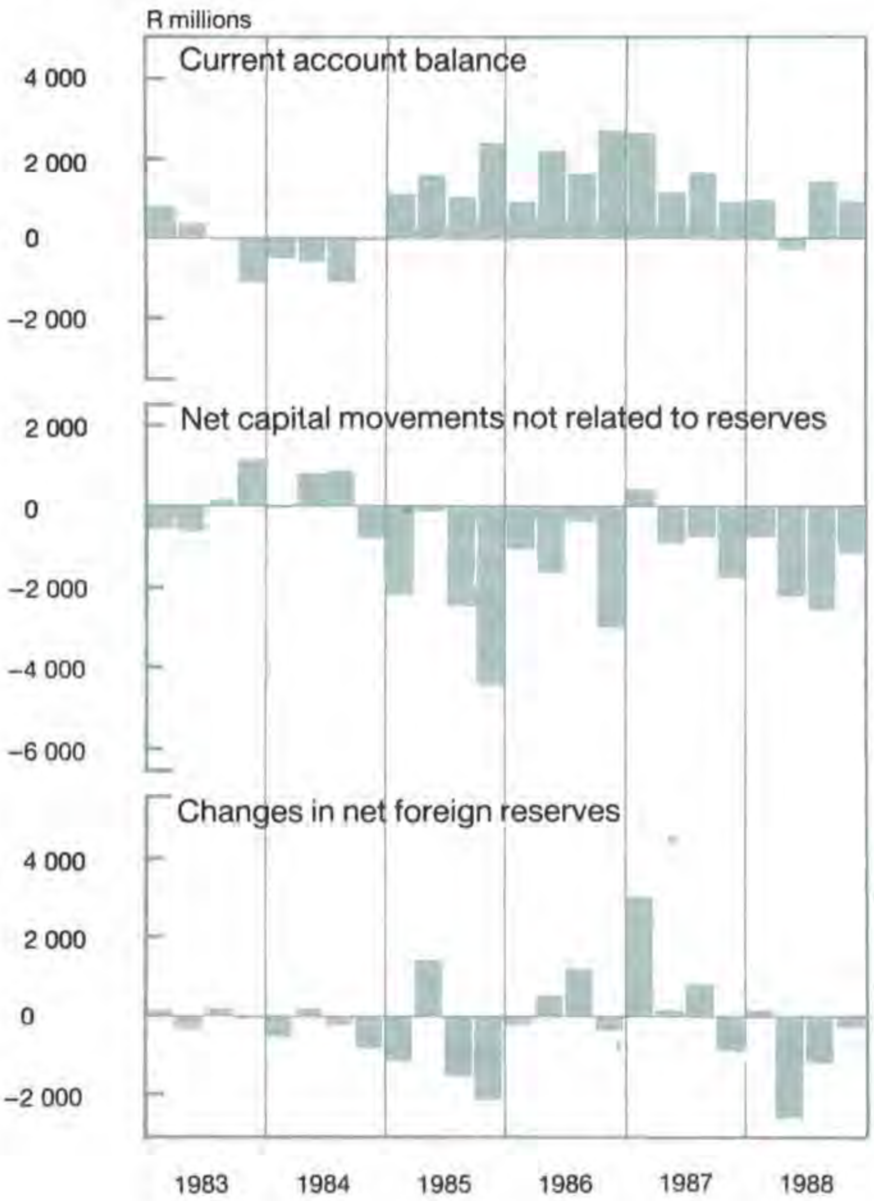
Balance of payments on current account



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

	1987	1988				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	25 146	26 300	29 282	33 830	36 476	31 472
Net gold exports	17 792	18 530	19 948	20 230	19 780	19 622
Merchandise imports	–28 320	–36 780	–38 310	–40 070	–41 520	–39 170
Net service and transfer payments	–8 466	–8 108	–9 172	–9 370	–9 290	–8 985
Balance on current account	**6 152**	**–58**	**1 748**	**4 620**	**5 446**	**2 939**

Balance of payments



16½ per cent higher than in the year 1987. The total *value* of merchandise exports accordingly rose by 25 per cent during the year.

The value of the *net gold exports* declined slightly in the fourth quarter of 1988. This could be attributed mainly to a weakening of the average dollar price of gold from US$427 per fine ounce in the third quarter to US$415 in the fourth quarter; the rand price of gold declined somewhat more significantly from R1 040 to R997 per fine ounce between these two periods. A renewed surge of strength of the US dollar in the international foreign exchange markets, new gold loans, a suspension of Taiwanese gold imports, and stepped-up sales of gold by Australian producers after depreciation of the Australian currency vis-à-vis the US dollar, then caused the average dollar price of gold to fall back further to US$404 in January 1989 and to US$388 in February – its lowest level for some 2½ years.

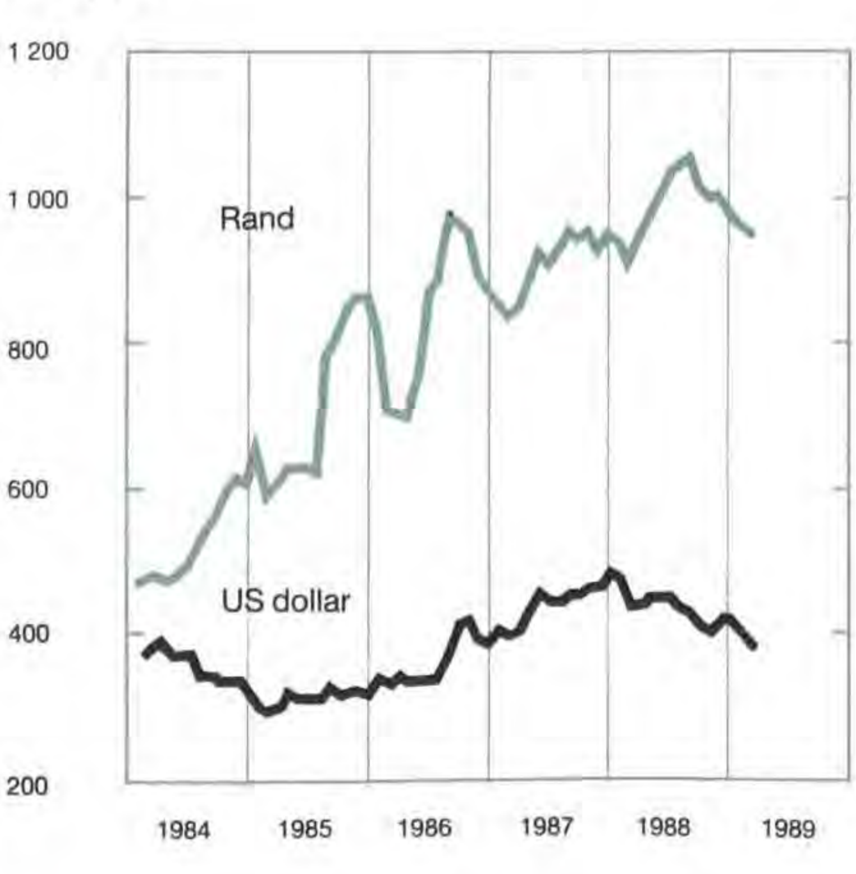
The average grade of South African gold ore milled declined from 5,28 grams per ton in 1987 to 5,13 grams in 1988. The physical volume of South African gold production nevertheless rose by some 3 per cent (i.e. from 596 tons to 615 tons) from 1987 to 1988. The average rand price of gold rose from R909 per fine ounce in 1987 to R992 per fine ounce in 1988. The total rand value of the South African gold output accordingly increased to R19,6 billion in 1988 from R17,8 billion in the preceding year.

Narrowing of the South African current account surplus from the calendar year 1987 to the calendar year

turn, was explained more than fully by a 10 per cent rise in export *volumes*. Export volumes of South African mining and, to a lesser extent, agricultural products were raised by the sustained strengthening of manufacturing output in the economies of trading partner nations, declining international stock levels of certain commodities and production problems in competitor countries. The total volume of merchandise exports in the fourth quarter of 1988 actually was some 11 per cent higher than the volume of these exports at its presumed cyclical upper turning-point in the third quarter of 1986. From the year 1987 to the year 1988 the volume of merchandise exports increased by approximately 7 per cent.

The average level of export *prices*, having risen substantially in the first three quarters of 1988, slid back by some 2 per cent in the fourth quarter. This was a result of a moderate retreat of international commodity prices from the middle of the year as well as of appreciation of the rand against the US dollar in particular. The average price level in domestic currency of South African exports in the year 1988 was, however,

Gold price



1988 was accounted for mainly by the sharply higher level of *merchandise imports* in the third year of the economic upswing. The volume, average price level and value of these imports rose by 25, 10½ and 38 per cent, respectively, in 1988 vis-à-vis the preceding year. The volume of imports in 1988 was also some 4½ per cent higher than in the mini-boom year 1984. It was still lower by about 14½ per cent, however, than the record volume of imports in the advanced gold boom year 1981.

The volume of imports rose sharply in the first quarter of 1988 in accordance with the marked strengthening of domestic expenditure during that period, but actually declined slightly in the ensuing six months. It then rose by some 3 per cent in the fourth quarter of 1988 to a level that was approximately 1½ per cent higher than in the first quarter of the year. Major increases were recorded in the fourth quarter in imports of mineral products; import volumes of other goods, however, also rose moderately.

Strengthening of the rand in the foreign exchange markets, and a renewed weakening of oil prices in the international commodity markets, served to hold down the rise in the average price level of imports in the fourth quarter of 1988 to a fractional ½ per cent. The 10½ per cent rise in the annual average of import prices in the year 1988 (against a rise of 6½ per cent in 1987) could mainly be accounted for by the decline in the effective exchange rate of the rand during the first ten months of 1988.

Volume of merchandise imports and exports

A strong rise in travel receipts in the fourth quarter of 1988 caused the *net service and transfer payments* to contract slightly from the third to the fourth quarter. Having dipped in 1987, net service and transfer payments rose again, however, in the calendar year 1988 as a whole. This was mainly the result of increased freight and merchandise insurance payments on the higher level of imports, higher interest payments because of the rise in international interest rates, and increased payments for South Africans' travels abroad. Against this increase in payments, but insufficient to make up for them, were arrayed increases in receipts of dividends from foreign sources and of foreign tourist expenditure in South Africa.

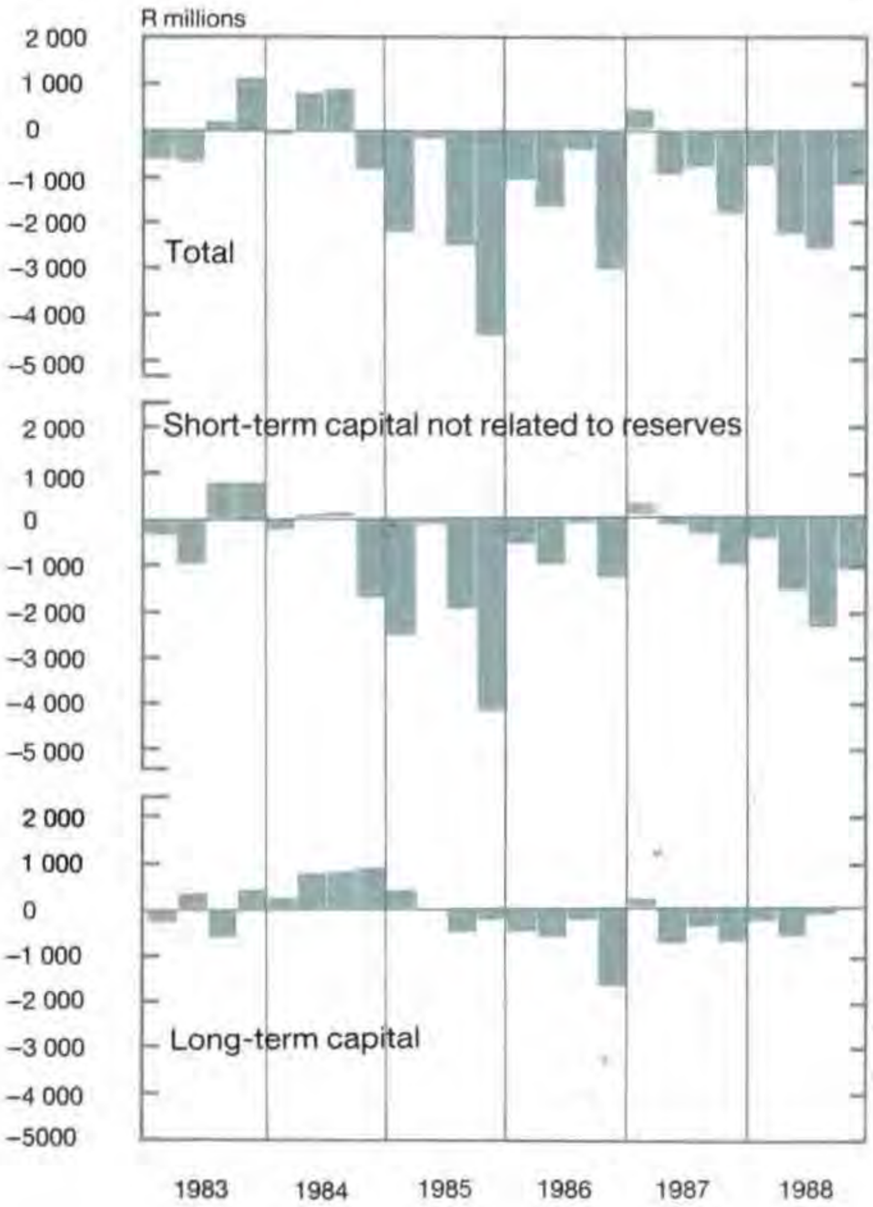
Capital account

The net outflow of capital not related to reserves shrank substantially from R2,5 billion in the third quarter of 1988 to R1,2 billion in the fourth quarter, despite major "lump sum" redemptions of foreign debt inside the standstill net as well as other capital outflows. In 1988 as a whole, however, the total net outflow of non-reserve-related capital amounted to R6,7 billion. This could be compared with an outflow to a broadly similar amount of R6,1 billion in 1986 but with a much smaller outflow of R3,1 billion in 1987.

The strengthened position of the capital account in the fourth quarter of 1988 reflected improvements in movements of both long-term and short-term capital. The outflow of long-term capital contracted from R144 million in the third quarter of 1988 to a diminutive amount of only R6 million in the ensuing three months. This was mainly a result of renewed net inflows of foreign capital to public corporations and to the private sector. Having made net repayments in the preceding three quarters, public corporations were net borrowers again (in the form of project financing) to an amount of R146 million in the fourth quarter. Net *purchases* also continued to be made by non-residents of South African securities listed on the stock exchange. In addition, however, the South African government took up a foreign loan that had been arranged for it by a group of overseas banks in the form of a private placing of public bonded debt.

The outflow of short-term capital of R2,4 billion in the third quarter of 1988 was halved to R1,2 billion in the fourth quarter. The large outflows of short-term capital in the second, third and early fourth quarter of 1988 – and more particularly those outflows that had resulted from switchings from off-shore to domestic sources of trade finance – were arrested following the increase in Bank rate and in the general South African interest rate level from 3 November 1988 onward. At the same time the appreciation of the rand against major other currencies after the first few days of November also brought about a reversal of speculative

Capital movements



capital outflows, including leads and lags in foreign payments and receipts.

Liabilities related to reserves showed a decrease – i.e. an outflow of capital – in the fourth quarter after large amounts had been borrowed in the preceding six months. An inflow of capital of R1,9 billion in the form of increased reserve-related liabilities was, however, recorded during 1988 as a whole.

Foreign reserves

Capital outflows well in excess of the current account surpluses caused South Africa's total gross gold and other foreign reserves to decline by R1 746 million from the end of March 1988 to the end of November. The marked moderation of the capital outflows after the first few days of November, however, subsequently allowed the total reserves to rise again by R251 million in December to R6,7 billion at the end of the year. In January and February 1989, the Reserve Bank's foreign reserves rose by another R160 million. The gold component of the Bank's foreign reserve holdings strengthened from 3,43 million fine ounces at the end of November to 3,64 million fine ounces at the end of February 1989.

Exchange rates

Having declined almost continuously during the first ten months of 1988, the effective exchange rate of the rand firmed again from early November. As a result, it strengthened on balance by 1,7 per cent in the fourth quarter. During 1988 as a whole the effective exchange rate weakened by 13,1 per cent.

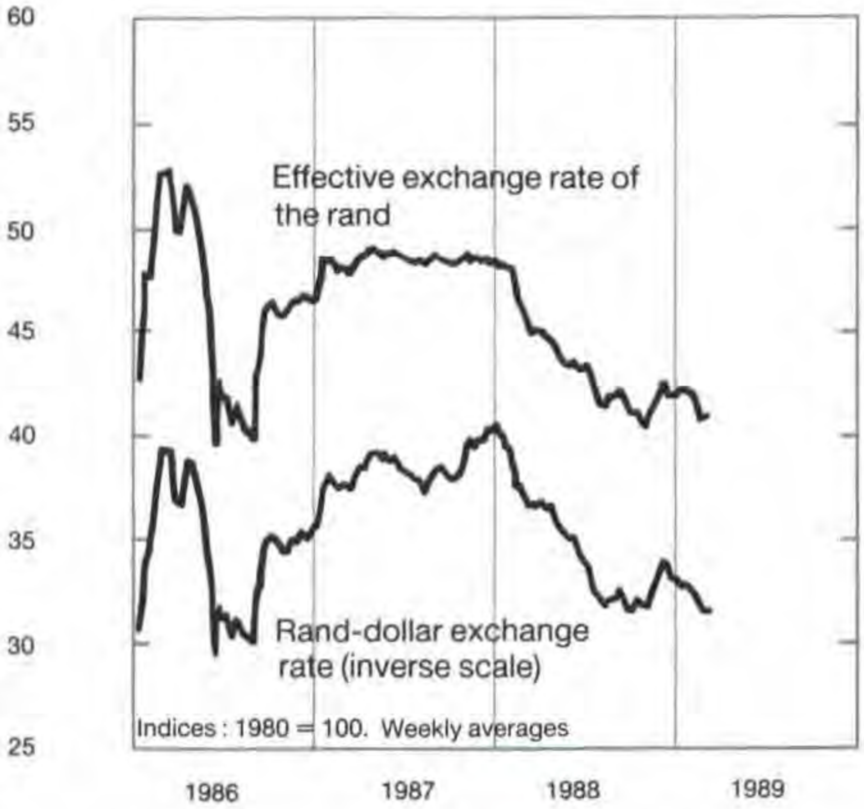
Net capital movements (not related to reserves)
R millions

	1987	1988				
		1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	–529	–24	–138	5	–276	–433
Public corporations	817	–140	–179	–233	146	–406
Private sector:						
Net purchases of listed securities by non-residents	–1 213	–35	9	75	18	67
Other capital	–773	–88	–307	9	106	–280
Total long-term capital	–1 698	–287	–615	–144	–6	–1 052
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities	–1 371	–475	–1 594	–2 390	–1 152	–5 611
Total capital movements excluding liabilities related to reserves	**–3 069**	**–762**	**–2 209**	**–2 534**	**–1 158**	**–6 663**
Change in liabilities related to reserves	–1 167	–13	1 668	586	–316	1 925

During January 1989 the rand lost ground against the strengthening dollar but firmed against all other major currencies; the effective exchange rate of the rand accordingly rose by 0,7 per cent. In February, however, the renewed bout of weakness in the dollar price of gold, and further strengthening of the American dollar, wiped out all gains that had been made by the effective exchange rate of the rand from November 1988 up to the end of January 1989.

The financial rand, which had weakened substantially in the middle quarters of 1988, remained fairly stable in the fourth quarter of 1988 and in January and February 1989. Fluctuating between R3,49 and R4,10 to the dollar, the exchange value of the financial rand represented discounts vis-à-vis the commercial rand which ranged from 33 to 41 per cent during this period.

Exchange rates



Changes in exchange rates of the rand

%

	31 Dec 1987 to 31 Mar 1988	31 Mar 1988 to 30 Jun 1988	30 Jun 1988 to 30 Sep 1988	30 Sep 1988 to 31 Dec 1988	31 Dec 1987 to 31 Dec 1988	31 Dec 1988 to 28 Feb 1989
Weighted average	−6,7	−3,8	−4,9	1,7	−13,1	−3,1
US dollar	−9,1	−8,3	−6,9	4,5	−19,0	−4,5
British pound	−9,4	–	−5,1	−1,7	−15,5	−1,6
German mark	−4,7	–	−4,0	−0,5	−8,8	−2,4
Swiss frank	−2,7	0,9	−1,5	−0,5	−4,2	−1,7
Japanese yen	−7,1	−2,6	−5,8	−1,9	−16,7	−3,6
French franc	−4,7	−0,8	−2,4	−0,5	−8,1	−2,6
Financial rand	4,8	−13,4	−15,5	6,0	−18,7	−3,3

Financial markets

Money supply

Hardly any signs of abatement in the very high rates of expansion of the money supply were apparent as yet in the fourth quarter of 1988. The quarter-to-quarter rate of increase in M3, seasonally adjusted and annualised, declined marginally from 29,5 per cent in the third quarter of 1988 to 28,3 per cent in the fourth quarter. This followed rates of increase of 26,1, 23,5 and 25,0 per cent in the preceding three quarters from the approximate beginning of the further acceleration of growth in the money supply in September 1987. Data for M3 as at the end of January 1989 suggest that the forces driving this monetary expansion still retained a major part of their strength in the first several weeks of 1989.

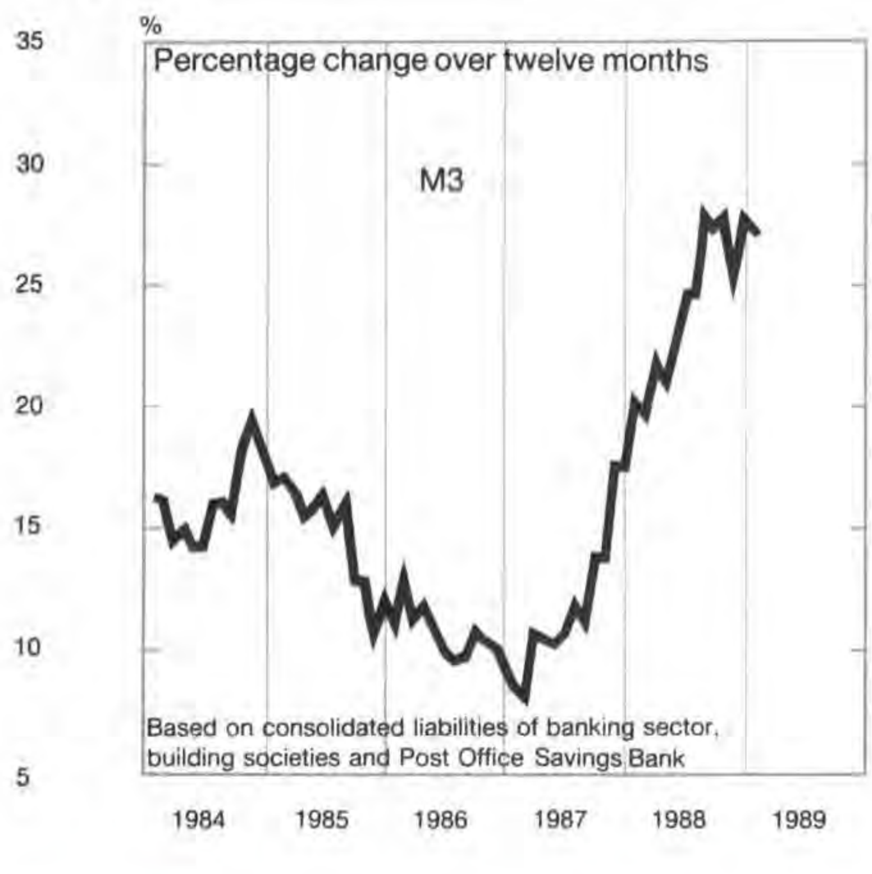
Very rapid growth in M3 in the fourth quarter of 1988 could still be explained in terms of reintermediation phenomena (reflecting, among other things, a further narrowing of the lending rate/deposit rate differentials of monetary institutions), the continued buoyant levels of economic activity and spending, and the enduring strength of investors' "liquidity preference proper" in the situation of a rapid hardening of interest rates and rising rate expectations that prevailed during most of the fourth quarter.

The fourth-quarter increment in M3 was heavily concentrated in call money and overnight deposits as well as in the non-M1 part of M2, i.e. in deposits with unexpired maturities from more than one day up to six months inclusive. Between them, the increases in these two components of M2, which made up approximately three quarters of M3 at the end of September 1988, more than fully accounted for the increase in M3 from the end of September to the end of December 1988. In contrast, a substantial *de*crease (before seasonal adjustment, translating into stagnancy when seasonal factors are taken into account) was recorded in the long-term deposit component of M3 during this period.

The twelve-month rate of increase in M3, which had amounted to 17,4 per cent in the very early stages of the 1988 targeting year, i.e. at the end of November and December 1987, did not decline below 19 per cent in the course of the calendar year 1988. Having reached 27,7 per cent in October 1988, this rate of increase dipped to 25,0 per cent in November before returning to levels of more than 27 per cent in both December 1988 and January 1989.

The principal statistical counterpart of the R6,1 billion increase in M3 (seasonally adjusted) in the fourth quarter of 1988 was an increase of R5,2 billion in domestic credit extension. The net gold and other foreign reserves of the monetary sector, which had declined by R1,5 billion in the third quarter of 1988, made a positive contribution of R0,4 billion to M3 in the ensuing three months.

Money supply



The 1988 targeting year

As was discussed in some detail in the Reserve Bank's recent publication *Money Supply Targets for 1989*, the growth in the quarterly average of M3 in the course of the 1988 targeting year, i.e. from the fourth quarter of 1987 to the fourth quarter of 1988, amounted to 26,5 per cent. This rate of increase therefore was substantially higher than the target range of 12 to 16 per cent with regard to growth in M3 in 1988. At R114,5 billion, the quarterly average of M3 as in the fourth quarter of 1988 exceeded the upper and lower boundaries of the target zone by approximately R9,5 billion and R13,1 billion, or by 9,1 and 13,0 per cent. M3 as at month-ends lay above the upper limit of the target "cone" from the very start of the 1988 targeting year (taken as mid-November 1987), and also exceeded the upper limit of the target "tunnel" from as early as February 1988. It then continued to fall above both the "cone" and the "tunnel" during the remainder of the targeting year to mid-November 1988.

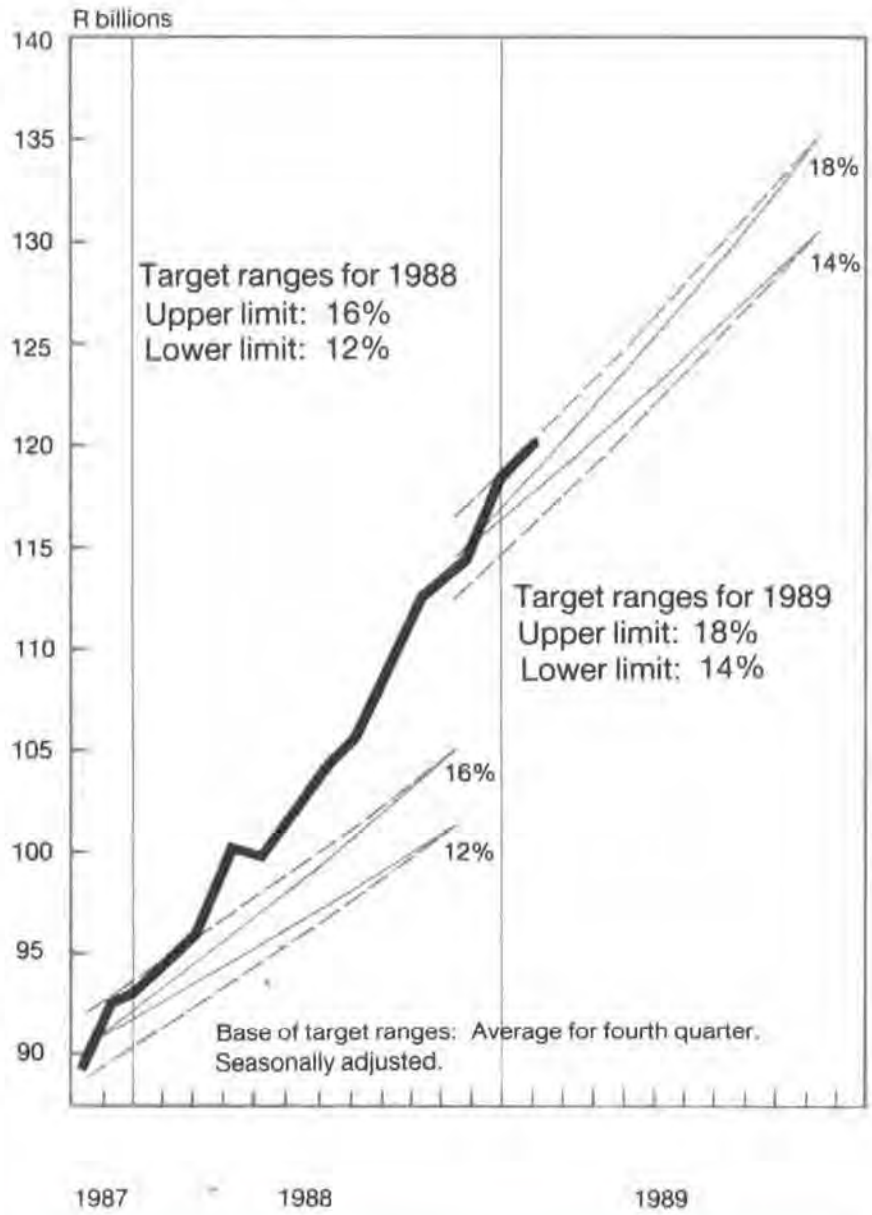
Growth in M3 in the successive calendar quarters of 1988 consistently exceeded the rates of increase in gross domestic product at current prices during these quarters. As a result, M3's "income" velocity of circulation (i.e. the ratio of the quarterly gross domestic product, at current prices and at a seasonally adjusted annual rate, to the quarterly average of M3, seasonally adjusted, during the quarter concerned) declined from 1,976 in the fourth quarter of 1987 to 1,832 in the fourth quarter of 1988, i.e. by 7,3 per cent. The increase in the "effective" or "velocity-adjusted" M3 money supply during the targeting year accordingly amounted to 17,3 per cent.

Growth rates of M3 well in excess of the upper limit of the 12 to 16 per cent target range were explained partly by the unexpected strength of the upswing in domestic spending and production in 1988 and partly by a marked increase in "liquidity preference proper", i.e. by an increase in the demand for money as an "asset to hold" that could not be related in any direct manner to "transaction" needs for money or close money substitutes at given levels of the gross domestic product at current prices. Velocity-reducing increases in the demand for "money to hold" could, in turn, be traced partly to various factors enhancing the relative attractiveness of fixed-value depository investments with monetary institutions (as included in M3) vis-à-vis the attractions of longer-term fixed interest bearing financial instruments, equities or equity-based investments, or tangible assets, in the general conditions prevailing in 1988. Increases in the demand for money and close money substitutes could also be traced partly to reintermediation phenomena arising from a steady narrowing of the gap between monetary institutions' average lending and average deposit interest rates in the course of the year.

The counterpart of the increase in M3 in the books of monetary institutions in the targeting year 1988 was overwhelmingly found in a R25,9 billion (or 29,3 per cent) increase in these institutions' extension of credit to the domestic private sector. Despite the decline in M3's velocity of circulation, both the increase in M3 and the increase in bank credit to the private sector were deemed clearly excessive by the monetary authorities in the prevailing circumstances. As such, they provided a major reason for the authorities' shift to a more restrictive stance of monetary policy in December 1987 and for the adoption of further tightening measures (including five Bank rate increases, raising Bank rate from 9,5 to 16,0 per cent) between March 1988 and February 1989.

Growth rates lower than that of M3 (as measured for targeting purposes) in 1988 were displayed by long-term deposits as well as by notes and coin in circulation, cheque and transmission deposits, and total M1A. Growth rates well in excess of that in M3 were shown by "other demand" deposits and by "other short" and medium-term deposits, and therefore also by M1 and M2. The relatively very low (5,0 per cent) rate of increase in long-term deposits appeared to have been stimulated but little, on balance, by the introduction of the interest rate subsidy on these deposits for senior citizens in May 1988.

Target ranges for growth in M3



New money supply target for 1989 targeting year

A new target, ranging from 14 to 18 per cent, for the rate of increase in M3 from the fourth quarter of 1988 to the fourth quarter of 1989 was announced by the Reserve Bank on 7 March 1989. In terms of these limits to M3 growth, the quarterly average of M3 in the fourth quarter of 1989 was not to be more than R135,1 billion nor less than R130,6 billion.

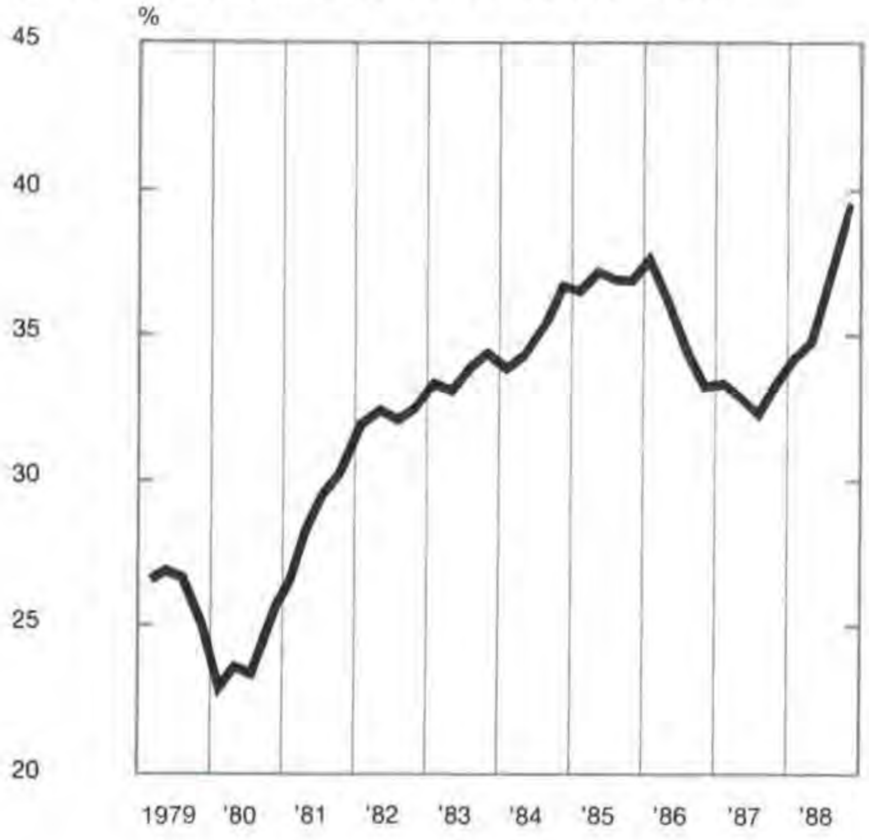
In explaining the monetary authorities' decision to raise the upper and lower bounds of the target range by two percentage points from their 1988 levels, the Reserve Bank stated that this was based on the acceptance by the authorities of a broad economic projection for 1989 that provided for a further increase in real gross domestic product of around 2 per cent, a surplus on the current account of the balance of payments of roughly R4 billion, a gradual rise in the official gold and foreign exchange reserves, and an average rate of increase of the consumer price index of about 15 per cent. It was, therefore, considered realistic to recognise that the rate of inflation in the South African economy would probably continue to rise in the months ahead before resuming the downward trend it had exhibited in 1987 and 1988. Acceptance of a temporary quickening of inflation, however, did not imply a weakening of the authorities' resolve to control the growth of the "effective" (or "velocity-adjusted") money supply for bringing down the inflation rate. Instead, it was believed that attainment of the new monetary target, in conjunction with realisation of the projected real economic growth rate of 2 per cent, would minimise the expected acceleration of inflation before reversing it.

Credit extension by monetary institutions

Total claims of all *monetary* institutions (banks, building societies and the Post Office Savings Bank) on the private sector rose at a seasonally adjusted annual rate of approximately 32½ per cent in both the third and the fourth quarter of 1988. *Banking* institutions' claims on the private sector, which had increased at an annualised rate of a mere 2,5 per cent as recently as the second quarter of 1987, rose at extraordinarily high annualised rates of more than 40 per cent in both these quarters; the rate of 48,0 per cent in the fourth quarter of 1988 was within striking distance of the all-time record rate of 53,4 per cent in the second quarter of the advanced gold boom year 1981.

Private sector demand for monetary institutions' credit received an additional impetus in the third and early fourth quarter from "pre-emptive" buying by households and business enterprises. It was also supported throughout the third and fourth quarter by the strengthening of private sector fixed investment spending, which had not yet given rise to any broadly commensurate increase in corporate borrowers' new-issue activity on the stock exchange.

Claims of banking sector on domestic private sector as percentage of nominal gross domestic product



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

		All monetary institutions %	Banking system %
1987:	1st quarter	12,7	13,7
	2nd quarter	9,2	2,5
	3rd quarter	15,1	13,1
	4th quarter	20,9	36,0
1988:	1st quarter	27,0	32,8
	2nd quarter	25,3	31,0
	3rd quarter	32,4	43,3
	4th quarter	32,7	48,0

*Quarter-to-quarter percentage changes in quarterly averages

Total claims of all monetary institutions on the private sector expanded by R5,5 billion in the fourth quarter. The average monthly rise in hire-purchase and leasing finance amounted to R455 million in the fourth quarter, against an average monthly increase of R355 million in the preceding nine months.

A slight fall-off in the demand for mortgage advances appeared to have set in towards the end of the year. This found a supporting element in banks' reduced willingness to grant such advances in the face of tighter bank liquidity and shrinking interest rate differentials. The increase in the banks' holdings of mortgage loans accordingly showed a moderate decline from R1,8 billion in the third quarter to R1,6 billion in the fourth quarter. The building societies, however, still expanded their mortgage holdings by approximately R1,0 billion in both these periods.

Monetary institutions' net claims on the government sector receded slightly (by R0,3 billion) in the fourth quarter. However, substantial losses (for account of the Treasury) continued to be sustained by the Reserve Bank in its provision of forward foreign exchange cover.

Reserve Bank operations in the money market

Money market conditions, as measured by the market's need for Reserve Bank accommodation, remained tight during November and December 1988 and in January, February and the first half of March 1989. This could be attributed to monetary institutions' continued high lending activity as well as to seasonal factors (including large increases in the note circulation in December), large tax payments at the end of February 1989, and the sustained high level of government balances with the Reserve Bank.

In a statement dated 2 December 1988 the Reserve Bank announced that although no *relaxation* of monetary policy was intended, recent increases in interest rates, the improved prospects for the Government's finances (owing, among other things, to the proposed imposition of increased fuel levies from 16 January 1989) and other developments warranted Bank rate being kept unchanged at 14,5 per cent for the time being. In addition, the Bank would counter the then expected seasonal tightening of money market conditions by means of repurchase agreements or other open-market operations.

Buy-backs for amounts ranging from R200 million to R900 million were entered into by the Bank over the period from 27 December to 12 January. Assistance in the form of repurchase agreements for amounts of up to R1 000 million was again provided by the Bank during the period from 23 January to 8 February. Repurchase agreements entered into by the Bank during the period from 24 February to 7 March similarly reached a peak amount of R1 000 million.

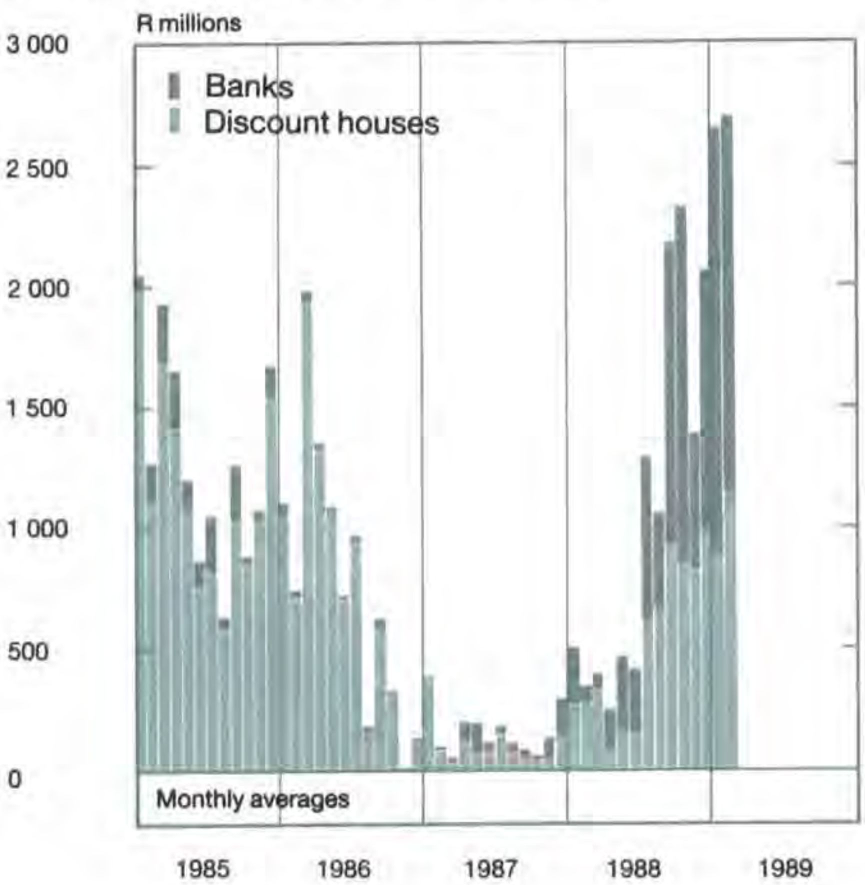
Despite this assistance through the Bank's market transactions, accommodation of the money market at the Bank's discount window rose from an average daily amount of R1,4 billion in November 1988 to R2,1 billion in December. Partly because of the accumulation of government balances with the Reserve Bank (to a peak level of as much as R6,2 billion on 26 January 1989), the average daily amount of discount window accommodation then rose further to R2,6 billion in January, R2,7 billion in February and R2,7 billion in the first two weeks of March 1989. It reached a new record level of R3,4 billion on 31 January 1989.

Net sales of government stock by the Reserve Bank in the open securities markets amounted to R2,3 billion in the fourth quarter of 1988 and to R0,7 billion in January and February 1989. In contrast, a small amount of net *purchases* of stock had been made in the first two months of 1988.

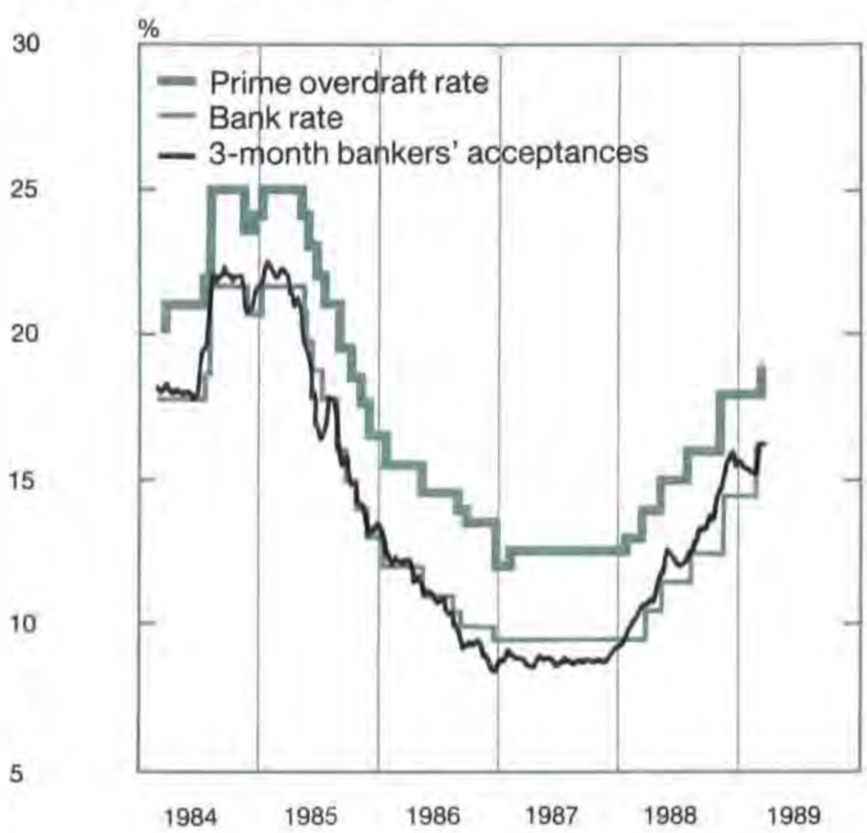
Money market interest rates

Money market interest rates continued to harden for some time after the increase in Bank rate (from 12,5 to 14,5 per cent) on 3 November 1988, under the influence of the sustained rapid increases in bank credit and above-target growth of the money supply, the upward trend in interest rates in major overseas economies, and the market's perceptions of the strained balance of payments and foreign reserves situation. Hand in hand with the Bank rate increase, the clearing banks' prime overdraft rates were generally raised (from 16,0 to 18,0 per cent) with effect from 3 November. The market rate on three-month liquid bankers' acceptances firmed from 14,7 per cent at the end of October to 16,0 per cent at the end of November. At this level, it exceeded the Reserve Bank's new minimum rediscount rate for such acceptances by a marked 1,2 percentage points.

Accommodation at the discount window



Short-term interest rates



Market rates softened appreciably following the Reserve Bank's policy statement of 2 December. The market rate on three-month liquid bankers' acceptances eased from its level of 16,0 per cent as at the end of November 1988 to a low of 15,20 per cent on 7 February 1989. From 23 December 1988 the Treasury bill tender rate was allowed to align itself more closely, in accordance with market forces, to the rates on comparable money market instruments. This rate accordingly *rose* to 15,33 per cent on 23 December before easing, on balance, to a low of 14,98 per cent on 3 February 1989.

Various adverse developments in the course of January and February 1989 – notably the decline of the dollar price of gold to a level well below US$400 per fine ounce, further increases in interest rate levels in Europe and the United States, and the persistent very high rate of increase in the money supply – caused the Reserve Bank to raise Bank rate (i.e. the Bank's minimum rate for rediscounting Treasury bills) to 16,0 per cent for *both* the banks and the discount houses with effect from 23 February 1989. This step, therefore, also signified abolition of the preferential margin of ½ per cent that had previously been enjoyed by the discount houses in respect of the Reserve Bank's various refinancing rates. Abolition of this margin – which meant that, for the discount houses, the Bank's rediscount rate for Treasury bills was raised from 14,5 to 16,0 per cent – was effected mainly as a technical adjustment in recognition of the evolutionary changes that had occurred in recent years in the functions of the discount houses. In particular, it reflected the fact that the houses no longer served as the main conduit through which banks obtained accommodation from the Reserve Bank.

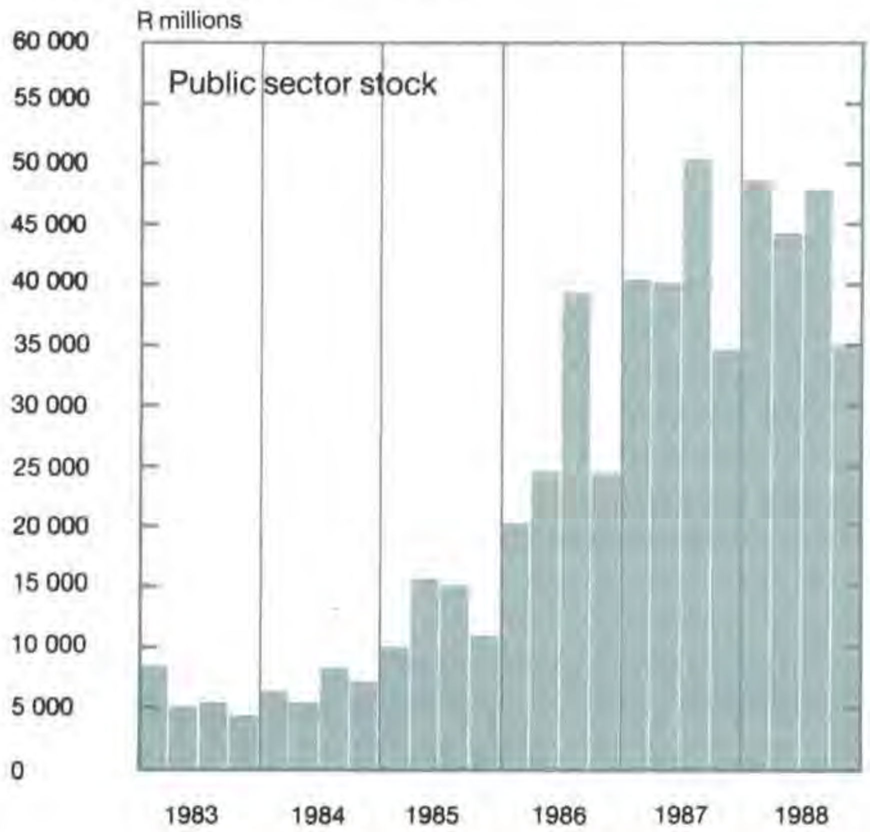
In response to the Bank rate increase, the clearing banks – acting under some initial uncertainty arising from recent amendments to the Usury Act – generally raised their prime overdraft rates from 18 to 19 per cent with effect from dates between 24 and 28 February. The market rate on three-month liquid bankers' acceptances rose from 15,70 per cent immediately prior to the Bank rate increase to 16,25 per cent on 23 February (against the Reserve Bank's new rediscount rate for such acceptances of 16,30 per cent), and to 16,4 per cent on 15 March.

Capital market activity

Having recovered slightly in the third quarter of 1988, trading activity in the capital market receded in the fourth quarter. Share prices, however, showed significant further gains. A slight further increase was also shown by the value of real estate transactions.

Turnover of public sector stock declined sharply after the Bank rate increase which took effect from 3 November. The value of public sector stock traded on

Stock exchange transactions

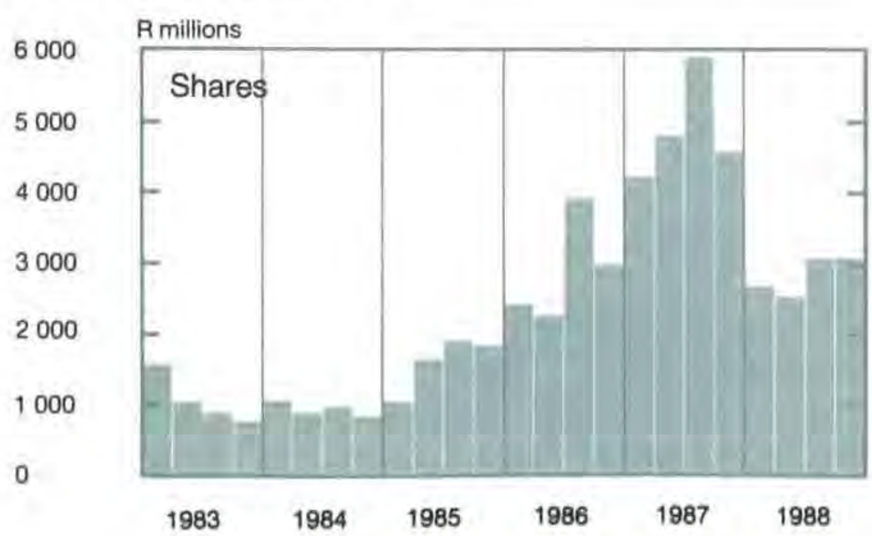


the stock exchange declined from R47,9 billion in the third quarter of 1988 to R35,0 billion in the fourth quarter. Turnover in such stock during 1988 as a whole nevertheless still rose by 6 per cent to R175,7 billion, against R165,2 billion in the preceding year.

The value of shares traded on the stock exchange remained unchanged at R3,0 billion from the third to the fourth quarter of 1988. Share trading activity in the year 1988, at R11,2 billion, was down 43 per cent on the total turnover of R19,5 billion in 1987.

The average price level of all classes of shares, which had begun to recover intermittently from the

Stock exchange transactions



second quarter of 1988 after the slump in share prices of October-November 1987, rose by 3 per cent in the third quarter of 1988 and by an impressive 9 per cent in the fourth quarter. It then advanced further by a substantial 9 per cent in January-February 1989. The average price levels of gold mining shares, industrial and commercial shares and "all classes" of shares in February 1989 were, however, still lower than in September 1987 by 47, 17 and 23 per cent. On a daily basis, the JSE Actuaries' industrial share price index overtook its pre-"crash" record level as on 19 October 1987, on 7 March 1989.

Share prices

In the primary markets, net new issues of public sector stock to private sector investors declined slightly from R1,1 billion in the third quarter of 1988 to R1,0 billion in the fourth quarter. The total of such issues in calendar 1988, at R4,0 billion, was 22 per cent lower than the figure of R5,1 billion in the preceding year.

Issues of ordinary shares by companies listed on the Johannesburg Stock Exchange declined from R326 million in the third quarter of 1988 to R301 million in the fourth quarter. In contrast, issues of fixed interest securities by such companies rose from nil in the third quarter to R183 million in the fourth quarter. Corporate entities' resort to the capital market in the course of 1988 was obviously affected by share market conditions during the year. New share capital raised by companies accordingly fell back from R1 974 million in 1987 to R876 million in 1988; companies' new issues of fixed interest securities declined from R537 million in 1987 to R222 million in 1988.

In the mortgage market, housing loans paid out by building societies amounted to R2,4 billion in the fourth quarter, against R2,8 billion in the preceding three months. The total amount of loans paid out in 1988, at R9,7 billion, was, however, R1,0 billion higher than in 1987.

Building societies' total *holdings* of housing finance rose by R0,9 billion in both the third and the fourth quarter of 1988 (to a total of R29,6 billion at the end of the year). However, the year's increase in such holdings, of R3,5 billion, represented a fairly marked retreat from the 1987 rise of R3,9 billion. In contrast, the rise in *banks'* holdings of housing finance declined from R1,8 billion in the third quarter to R1,3 billion in the fourth quarter of 1988 (bringing the total of these holdings to R10,3 billion at the end of the year), as rising shorter-term interest rates and shrinking or vanishing interest rate margins, the banks' tighter liquidity positions and their sustained high lending activity in the shorter-term credit areas reduced the attractions of providing mortgage finance. The total increase in the banks' holdings of housing finance during the year 1988, at R5,9 billion, was, however, a remarkable 180 per cent higher than in the year 1987.

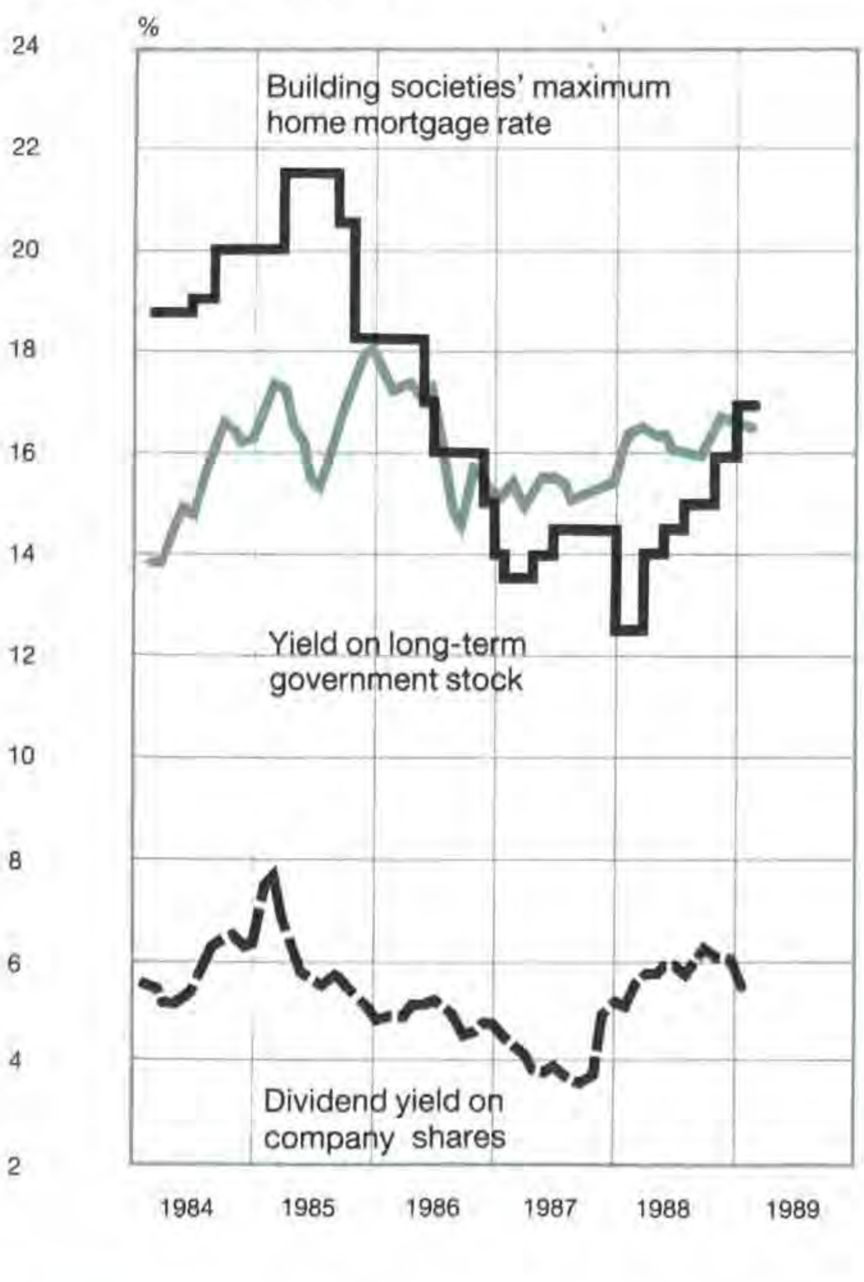
The relatively small increase in building societies' mortgage holdings, despite the relatively large amounts of mortgage loans paid out, was a result of large capital redemptions in consequence of home-owners' switching from building society loans to bank loans and other sources of mortgage finance. Towards the end of 1988 and in early 1989 the demand for home finance was beginning to be affected not insignificantly by the various bond rate increases since October 1988.

The value of real estate transactions in the fourth quarter of 1988 amounted to R5,0 billion, against R4,9 billion in the third quarter. The total value of these transactions in 1988, at R19,6 billion, was a substantial 29 per cent higher than in the preceding year.

Interest rates and yields

The downward movement in long-term interest rates, which had started at the beginning of the second quarter of 1988, ran out of steam and was reversed in October. The monthly average yield on long-term government stock declined from 16,6 per cent in March 1988 to 16,0 per cent in September, but reverted to 16,5 per cent in October and to 16,8 per cent in November before easing marginally again to 16,6 per cent in January 1989. It then softened mildly further to 16,5 per cent in the first half of February. The disappointing performance of the dollar price of gold in February 1989,

Long-term interest rates



persistent large increases in the money supply and rising short-term interest rates, and concern about the possible extent of the Government's budgetary deficit in fiscal 1989/1990, subsequently caused this yield to harden modestly again to an average of 16,7 per cent in the second half of February 1989, for an unchanged monthly average of 16,6 per cent.

Mirroring the improvement in share prices, the monthly average dividend yield on all classes of shares declined from 6,3 per cent in September 1988 to 6,0 per cent in December and to 5,7 per cent in February 1989. In September 1987, this yield had reached a low point of 3,6 per cent.

Following the increase in Bank rate from 12,5 per cent to 14,5 per cent with effect from 3 November 1988, the building societies' predominant home mortgage rate was raised from 15,0 per cent in the third quarter of 1988 to 18,0 per cent at the end of February 1989, against a rate of 12,5 per cent in February 1988. Certain societies raised their bond rates to 18,25 per cent. These increases were effected before the Bank rate increase which came into force on 23 February; no further bond rate increases were announced by the building societies from 23 February up to the third week of March.

The predominant rate on twelve-month deposits with banks and building societies was raised in various steps during 1988. At the end of February 1989 a rate of 14,5 per cent was quoted on these deposits by both banks and building societies, against a rate of 10,8 per cent as quoted by banks and 11,0 per cent as quoted by building societies in February 1988.

Government finance

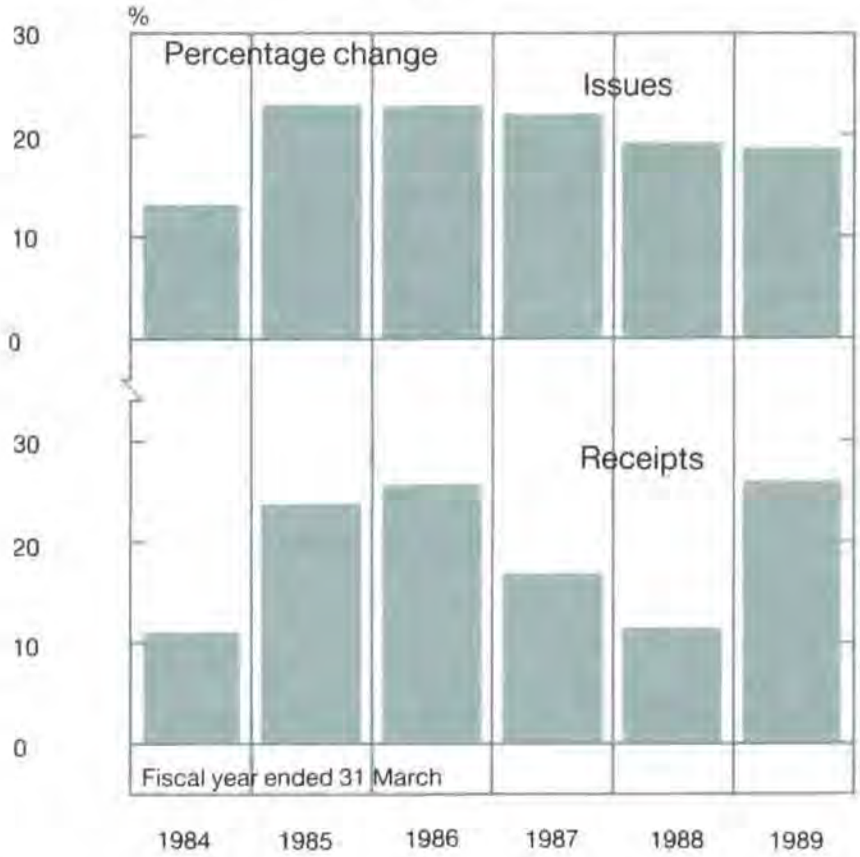
Outcome of Central Government Budget for fiscal 1988/89

The expected outcome of the Central Government Budget for fiscal 1988/89, as reported by the Minister of Finance in his Budget speech of 15 March 1989, departed to an important extent from the original budget estimates of March 1988. Both Exchequer issues and Exchequer receipts markedly exceeded the original budget estimates. The eventual short-term stimulatory impact of the 1988/89 Budget, however, was slightly lower than had been envisaged in March 1988.

Exchequer issues to government departments in fiscal 1988/89 were estimated by the Minister to amount to R56 556 million. This would exceed the original Budget estimates by R2 691 million, or by 5,0 per cent. The increase in Exchequer issues in fiscal 1988/89 from actual issues in fiscal 1987/88 would amount to 18,4 per cent, representing an increase in real terms of approximately 5,0 per cent.

Total revenue receipts in fiscal 1988/89 were estimated by the Minister to amount to R47 460 million. This would exceed the original Budget estimates by a substantial R3 455 million, or by close to 7,9 per cent. The increase in revenue receipts in fiscal 1988/89 from actual receipts in 1987/88 would amount to a remarkable 25,2 per cent, or to nearly 11,0 per cent in real terms. As shown in the accompanying table, large increases in revenue receipts in fiscal 1988/89 were recorded in income tax collections from companies (other than mining companies) and from general sales tax. In addition, the relative increase in receipts from customs and excise duties amounted to an exceptional and far higher than budgeted 90 per cent. A decline in receipts from gold and other mines had been anticipated in the original Budget estimates; the receipts from mining companies *other than* gold mines, however, actually *exceeded* the Budget estimates by about 32 per cent.

Exchequer issues and receipts



General sales tax receipts were significantly higher than in the original Budget estimates because of the higher than expected level of domestic economic activity and expenditure and because of the phasing-out of the debtors' allowances regarding sales tax, which was introduced from 1 July 1988. Total receipts from customs and excise duties also showed a marked increase, mainly because of substantial increases in customs duties in general, the surcharge on imports and the fuel levy. The higher level of customs duties

State Revenue Fund – Revenue collections in 1988/89

	Budget[1]		Anticipated collections	
	R millions	Percentage change[2]	R millions	Percentage change[2]
Total collections from gold and other mines	2 840	–16,5	3 076	–9,6
Income tax collections from other companies	7 535	26,8	8 100	36,3
Income tax collections from individuals	13 595	11,6	13 960	14,6
General sales tax	11 600	14,0	12 900	26,8
Customs and excise duties	5 320	54,8	6 530	90,0
Other receipts	3 115	18,7	2 894	10,3
Total receipts	**44 005**	**15,9**	**47 460**	**25,0**

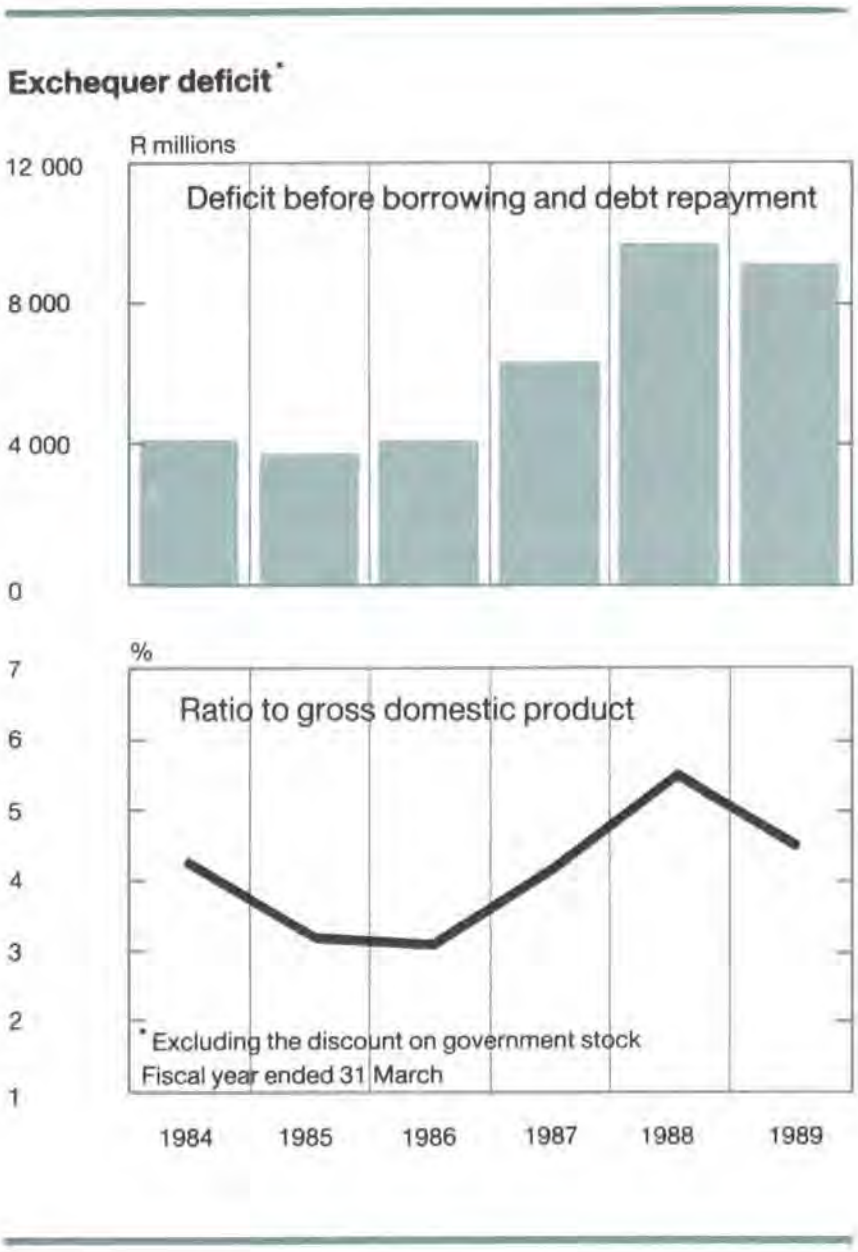
1 Budget speech, March 1988.
2 Compared with actual collections during the 1987/88 fiscal year.

was related to the higher level of imports in general; the higher surcharges on certain categories of imports became effective from 15 August 1988. The fuel levies were raised on three occasions during the 1988/89 fiscal year.

The estimated deficit before borrowing and debt repayment for fiscal 1988/89 amounted to R9 096 million, or to R764 million less than in the original Budget estimates. At this level the recorded deficit amounted to 4,4 per cent of expected gross domestic product, which was slightly lower than the ratio to gross domestic product of 4,9 per cent that had been envisaged in the original Budget estimates. The estimated deficit of R9 096 million and loan redemptions of R4 991 million were expected to be financed, and it was proposed that the 1988/89 surplus be utilised, in the following way:

	R millions
Public Investment Commissioners (PIC) ...	4 800
New government stock issues	6 489
Non-marketable securities (net)	–405
Foreign loans [1](net)	412
Short-term loans (net)	–1 760
Use of available cash balances[2]	280
Transfers to:	
Reserve Bank	–1 000
Special Defence Account	–320
Sale of assets	600
Total	9 096

1 Including funds from foreign deposits held with the PIC.
2 Increase –; decrease +.



The 1989/90 Government Budget

In his presentation of the Budget for 1989/90 to Parliament on 15 March 1989 the Minister of Finance stated that economic policy in the year ahead would have to temper the strong expansion that had occurred in domestic spending during the past year, and that a special responsibility in this regard rested with fiscal policy. The Budget as presented was aimed at both the short-term and the long-term economic objectives of the Government and would also seek to reinforce desirable structural adjustments that were already taking place in the economy.

With regard to the Government's *short-term* economic policy objectives the Minister stated that the Budget should seek to consolidate the successes of the past year. It should contribute to the strengthening of the balance of payments and avoid adding to concerns about the exchange rate and the country's foreign debt repayment obligations. It should not aggravate the inflation problem by permitting undue increases in domestic expenditure or through unsound ways of financing of the deficit before borrowing. An excessively large deficit before borrowing should be avoided to forestall unnecessary further pressure on the money and capital markets that would lead to higher interest rates. The strong upswing in the private sector should not, however, be constrained or cooled down needlessly, but should be allowed as much scope as possible.

The Minister also stated that fiscal policy should adhere as closely as possible to the Government's *long-term* economic objectives. The Government had accepted the Long-term Economic Strategy that had been drawn up by the Economic Advisory Council, which required that government expenditure should rise more slowly than expenditure elsewhere in the economy, that the deficit before borrowing be reduced gradually to a level of not more than 3 per cent of gross domestic product, that the five-year guide plan for state expenditure be adhered to, and that the tax burden, particularly the tax burden on the personal sector, should not be increased further but should, instead, be gradually reduced. Various developments such as the Government's peace initiatives, the institution of user charges and privatisation held out possibilities for an eventual structural reduction of government expenditure. However, the impact of these developments on government expenditure to date had been too limited as yet to allow of a significant alleviation of tax burdens or to create room for a more rapid shift from direct to indirect taxation. Progress had, however, already been made in the direction of a reduction of the deficit before borrowing in relative terms.

With regard to desirable *structural* adjustments in the economy, the Budget was aimed at reinforcing adjustment programmes in agriculture, mining, manufacturing industry and the financial sectors. These programmes and the Budget proposals concerned were directed at creating a sounder base for high economic growth rates in the future.

Government revenue in fiscal 1989/90 was estimated to rise by 16,0 per cent. Incorporated in this estimate were the revenue-raising effects of an increase of 1 percentage point in the rate of general sales tax (to 13 per cent) with effect from 20 March 1989 and an increase in excise duties on a range of products, as well as the revenue-reducing effects of increases in the primary rebates for individual taxpayers and of a small reduction in mining taxation. The proposed separate taxation of married couples, in terms of which all salaried married women are to be taxed under the Standard Income Tax on Employees (the "SITE" system), and increases in the SITE ceilings for men and unmarried women, would not result in a tax loss in fiscal 1989/90.

Government expenditure in fiscal 1989/90 as budgeted for would increase by 15,0 per cent; this was expected to mean an absence of growth in real terms. The 15 per cent increase in budgeted expenditure included an amount of R1 000 million as a provision for unforeseen spending needs. The share of capital expenditure in total expenditure was estimated to amount to R5 076 million. This would be about 7,0 per cent more than the amount that had originally been budgeted for in fiscal 1988/89. The deficit before borrowing was projected at R9 949 million, or approximately 4,1 per cent of gross domestic product. It was proposed that this budget be financed in the following way:

	R millions
Revenue	55 068
Expenditure	65 017
Deficit (before borrowing)	9 949
Financing (net of debt repayment):	
Public Investment Commissioners (PIC)	5 200
New government stock issues	4 370
Non-marketable securities (net)	–280
Debt standstill and foreign funds (net)	367
Available balances[1]	292
Total	9 949

[1] Increase –; decrease +.

Budget of the South African Transport Services for 1989/90

In the Budget of the South African Transport Services for the financial year 1989/90, which was presented to Parliament on 22 February 1989, total revenue in the new financial year was estimated at R12 402 million. Domestic tariffs and fares were increased by an average of 8,7 per cent. Operating expenditure in 1989/90 was estimated at R12 400 million. This represented an increase of R1 552 million, or 14,3 per cent, in such expenditure from the financial year 1988/89 to the financial year 1989/90. The resulting operating surplus was accordingly estimated at R2 million, against the budgeted *deficit* of R96 million and an anticipated actual deficit of R115 million in 1988/89. Capital expenditure in 1989/90 was estimated at R1 710 million, this being R783 million or a substantial 84,5 per cent more than had been provided for in the Budget for 1988/89. Since it is planned that the legal structure of the South African Transport Services will be converted into that of an autonomous corporate entity, the SATS Budget of 22 February 1989 is likely to have been the last such Budget to have been presented to Parliament.

Budget of the Department of Posts and Telecommunications for 1989/90

In the Budget of the Department of Posts and Telecommunications for the financial year 1989/90, which was presented to Parliament on 6 March 1989, operating expenditure was estimated at R5 155 million, representing an increase of some R805 million or 18,5 per cent over the preceding year. Despite this marked rise in expenditure, only modest increases were proposed in a wide range of postal and telecommunications tariffs.

Income in 1989/90 was estimated at R5 350 million, or 4,1 per cent more than in 1988/89. This would leave an operating surplus of R195 million. Capital expenditure was estimated at R1 450 million, or 10,9 per cent less than in 1988/89.

As in the case of the South African Transport Services, the operations of the Department of Posts and Telecommunications may also be restructured in the relatively near future. Two separate autonomous corporate entities are envisaged, to take over the postal and the telecommunications operations of the Department, respectively.