Quarterly economic review

Introduction

The fourth quarter of 1989 concluded the first year of the current "consolidation" phase in the South African economy after the upper turning-point of the business cycle that was presumably reached towards the close of 1988. In the fourth quarter of 1989, a decrease was recorded in the real gross domestic product which amounted to a seasonally adjusted and annualised rate of some 1½ per cent.

The fourth-quarter decline in real gross domestic product was the first quarterly decline in total real output since the first quarter of 1986. It was, however, essentially due only to a drop in real value added in agriculture: in a marked reversal of developments in the third quarter – when slow but positive growth of the overall economy was essentially maintained only because of harvesting of the near-record 1988/89 maize crop – positive real growth was displayed again in the fourth quarter of 1989 by all principal sectors of the economy, with the exception of agriculture and commerce.

Aggregate real gross domestic *expenditure* continued to decrease in the fourth quarter of 1989 at much the same pace (of some 7 per cent per annum) as in the preceding three months. More clearly than domestic output, therefore, the behaviour of domestic spending in 1989 showed the effects of the authorities' restrictive monetary and fiscal policies. Continued declines were recorded in the fourth quarter in real government consumption expenditure and in aggregate real inventories. Total real gross domestic fixed investment receded in the fourth quarter of 1989 for the first time since the second quarter of 1987. A slight *rise* was still registered in total real private consumption expenditure; declines were recorded, however, in real household outlays on both durable and semi-durable consumer goods.

Positive growth – at a rate of slightly more than 2 per cent – was maintained in the South African real gross domestic product for the consolidation *year* 1989 as a whole. Although lower than the firm 3½ per cent growth rate of 1988, the 1989 growth rate still exceeded significantly the average tempo of expansion of the economy of some 1½ per cent during the period from 1980 to 1989.

A major (10 per cent) increase was recorded in real value added by agriculture from 1988 to 1989; lower (but still positive) rates of real growth than in 1988 were, however, displayed by all other major sectors of the economy. Divergencies in the extent of the slowdown of real growth in various sectors and sub-sectors could be attributed partly to the sustained strength of the South African merchandise export performance throughout 1989 as compared with the slackening and decline of aggregate real gross domestic monetary demand. On the *expenditure* side, the *year* 1989 as compared with the *year* 1988 still saw a substantial rise (of 4½ per cent) in real government consumption expenditure, a smaller but still fairly vigorous rise in real private consumption expenditure, a reduced rate of increase in total real gross domestic fixed investment, and a small further rise in real inventories.

The *labour market* in 1989 showed a rise in the average level of employment that, although unsatisfactory, was not yet substantially weaker than in the upswing years 1987 and 1988. Some renewed declines in *un*employment were registered in the third quarter and October 1989 in an apparent contradiction of the cooling-down of the economy; the most recent available data suggest more clearly, however, that unemployment is now on a mildly upward course.

Marked accelerations were recorded in the first three quarters of 1989 in the quarterly year-on-year rates of increase in both the nominal and the real wage per worker in the non-agricultural sectors of the economy and in both nominal and real non-agricultural unit labour costs. Wage developments of this kind are not unusual in the initial stages of a cyclical downturn. The recent movements in wages and unit costs do, however, stress the importance of responsible processes of wage determination against a background of waxing unemployment and within the framework of a comprehensive anti-inflation strategy.

Inflation, as measured by the quarter-to-quarter rates of change in the more important price indices, generally was notably higher in the first two quarters of 1989 than in the final two quarters of 1988, but fell back in most cases to significantly lower levels in the third and the fourth quarter of 1989. Similarly, the twelve-month rates of increase in the major price indices tended to accelerate up to approximately the middle of 1989, but showed some improvement during the remainder of 1989 and in January 1990. From the year 1988 to the year 1989 the rate of increase in the annual average level of consumer prices nevertheless accelerated from 12,9 to 14,7 per cent.

More pronounced slackening of aggregate real domestic expenditure than of real domestic production in the fourth quarter of 1989 also found expression in a mild further strengthening (to an annualised level of R5,9 billion) in the surplus on the *balance of payments on current account*. The most important single reason for this improvement was found in a marked further decline in the value of merchandise imports. As regards the year 1989, the renewed rise in the current account surplus (to R4,1 billion, from R2,9 billion in 1988) could, however, be attributed solely to the quite remarkable vigour of the South African merchandise export performance. Having increased by 7½ per cent in 1988, the volume of these exports rose by a major 17 per cent in 1989.

The outflow of capital not related to reserves, which had shrunk fairly dramatically in the third quarter of 1989, increased substantially again in the fourth quarter. Most of this increase arose from larger outflows of short-term capital; more than half of these short-term capital outflows appears to have consisted of increases in foreign asset holdings by South African residents.

The South African total gross gold and other foreign reserves rose during the first nine months of 1989, but fell back in the fourth quarter. They did so, however, partly as the counterpart of a reduction in short-term foreign liabilities. In the first 2½ months of 1990 both the gross and the net foreign reserves of the Reserve Bank rose encouragingly. Apart from reflecting the present large current account surpluses, the recent strengthenings of the foreign reserves would also appear to have incorporated the effect of foreigners' more favourable impressions of the South African socio-political situation and of increased availability and accessiblity of overseas trade and trade-related credit facilities.

The effective exchange rate of the rand weakened from the start of 1989 up to mid-September, but took on a firmer tone in the third quarter and strengthened up to the end of the year. It held essentially steady in the first 2½ months of 1990.

Viewed from the vantage point of middle March 1990, one of the most conspicuous features of recent developments in the real South African economy has been the quite remarkable softness of the cyclical "landing" in economic activity from late 1988. Economic activity has in fact been "coasting" – along an essentially sideways trajectory, although at diminishing rates of real economic growth – rather than adjusting downwards abruptly (as in 1984/85) in response to the authorities' more restrictive monetary and fiscal policies.

In its consolidation phase to date, the economy has been "moving in the right direction" satisfactorily as regards the balance of payments/foreign reserves/exchange rate situation in particular. Less satisfactory progress has clearly been made as yet in, among other things, subduing inflation, moderating wage adjustments and slowing down the expansion of bank credit and the money supply.

The soft landing of the economy up to the early months of 1990 came about despite the progressive tightening of monetary policy since late 1987 and the *de facto* quite restrictive posture of fiscal policy in the fiscal year 1989/90. It would appear to have been due to a variety of factors, including:-

- The sharp rise in real agricultural production from 1988 to 1989. An econometric simulation suggests that this increase in agricultural output may, directly and indirectly, have contributed 0,8 percentage points to the real growth rate of the overall economy of slightly more than 2 per cent in 1989. Allowance should, of course, be made for a return to more normal crops and harvests in 1990.
- Relatively receptive export markets and the vigour of the South African merchandise export performance in 1989.
- The increased average age (and more markedly depreciated value) of businesses' stock of fixed capital goods and of households' stock of consumer durables in 1989 as compared with 1984/85, implying reduced deferability of new acquisitions for replacement purposes.
- The more positive business mood and higher level of consumer confidence in 1989 and the beginning of 1990 than in 1984, 1985 or 1986.
- Various other factors, such as the rise in the real wage per non-agricultural worker and the increased share of labour remuneration in total factor rewards, that are likely to have supported household spending and the average propensity to consume in the economy as a whole.
- The public's view of the authorities' recent policy actions as arising from a need for tempering buoyancy in the economy rather than from a need for coping with an acute crisis situation, which could itself have become a source of uncertainty and concern.

Fairly significant decelerations were recorded in the rates of increase in monetary institutions' *claims on the private sector* and in the *M3 money supply* from the peak levels of these rates in the third quarter of 1988. None of the more recent annualised quarter-to-quarter and twelve-month rates of increase in the broader monetary and credit aggregates did, however, decline as yet to below the 20 per cent level.

Short-term interest rates were, however, notably higher in February 1990 than at the economy's cyclical upper turning-point towards the end of 1988. Relatively high and rising interest rates in the third and the fourth quarter of 1989 had the effect of maintaining or reinforcing reintermediation phenomena, investors' "liquidity preference proper" and the relative attractiveness of bank deposits. They thereby held back a more pronounced cyclical decline in the rates of increase in bank credit and in the M3 money supply.

The twelve-month rate of increase in M3 as in February 1990 amounted to a provisional 22,0 per cent. Both this rate of monetary expansion and the tempo of the rise in bank credit as its prime underlying "cause", must be regarded as unsatisfactory within the prevailing business cycle situation and the framework of the authorities' current anti-inflationary policy stance.

Tight conditions continued to be maintained in the *money market* in the fourth quarter of 1989 and the first 2½ months of 1990. The *capital markets* during this period witnessed another surge in trading activity, high levels of buying and selling by non-residents on the Johannesburg Stock Exchange, significant further advances in share prices (after the "mini-crash" of these prices in the second half of October 1989), the listing of the Iscor share issue on 8 November, an appreciable softening of long-term yields and interest rates, and a small further increase in real estate transactions.

In the area of *government finance*, the outcome of fiscal policy in the fiscal year 1989/90 was notably more restrictive than had been envisaged in the Budget as presented in March 1989. The anticipated rise in Central Government expenditure in 1989/90 vis-à-vis 1988/89, at 15,2 per cent, adhered very closely to the budgeted increase in Exchequer issues to government departments of 15,0 per cent. Central Government revenue, on the other hand, rose by an estimated 27,3 per cent, against the budgeted increase of 16,0 per cent. The deficit before borrowing relative to gross domestic product accordingly amounted to a mere 1,5 per cent, against the original Budget estimate of 4,1 per cent.

The Central Government Budget for 1990/91, as presented to Parliament by the Minister of Finance on 14 March 1990, provided for increases in nominal government expenditure and in government revenue of only 11,9 per cent and 5,8 per cent respectively; the deficit before borrowing in 1990/91 was estimated to reach an amount of fractionally less than R8,0 billion or 2,8 per cent of the prospective nominal gross domestic product during the fiscal year. In addition, however, provision was made for the establishment of a fund for actions of socio-economic upliftment. The amount of R2 000 million to be made available to this fund from excess Exchequer financing in 1989/90 was subsequently raised to R3 000 million by the State President – the additional R1 000 million to be funded from anticipated privatisation proceeds.

Emphasis in the 1990/91 Budget, which is likely to prove mildly stimulatory, was placed on a threesome of broad socio-economic objectives, namely: (1) to assist in a restructuring of the South African economy, with increased stress on the "supply" or production side of economic activity and on private-sector endeavour as the prime source of income and employment-creating growth; (2) to accord higher priorities than before to the alleviation of problems of poverty and to the redressing of "backlogs" in education, housing and health; and (3) to contribute to short-run stabilisation of the economy through the use of contra-cyclical fiscal policy measures. Increased emphasis was to be placed, however, on the Government's debt and borrowing operations (rather than on its taxing and spending operations) for such stabilisation purposes.

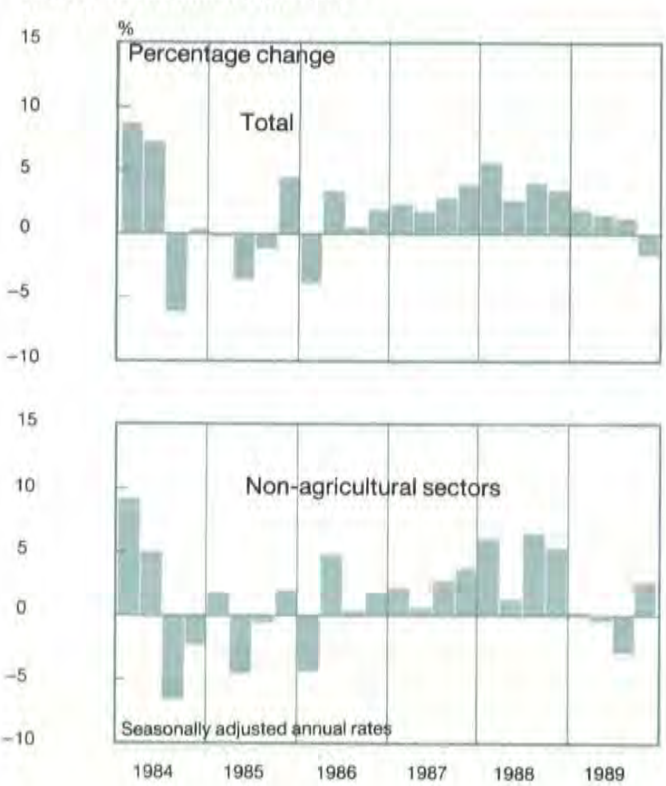
Domestic economic developments

Domestic output

The growth rate of the real gross domestic product of the South African economy tapered off from a seasonally adjusted and annualised level of 2 per cent in the first quarter of 1989 to approximately 1½ per cent in the second quarter and 1 per cent in the third quarter. Present estimates indicate that aggregate real output then *contracted* at an annualised rate of approximately 1½ per cent in the fourth quarter. This was the first quarterly decline in the real gross domestic product since the first quarter of 1986.

Aggregate real output declined in the fourth quarter of 1989 despite the fact that, with the exception of agriculture and commerce, positive real growth was again displayed during this quarter by all principal sectors of the economy (as well as by the total of all non-agricultural production). This state of affairs therefore stood in marked contrast to developments during the third quarter of 1989, which had witnessed a *decline* in total real non-agricultural production: continued positive real growth of the overall economy in the third quarter

Real gross domestic product



of 1989 had been due, essentially, to the cushioning after-effects of the large maize crop of 1988/89.

The substantial decline in real value added by *agriculture* in the *fourth* quarter of 1989 could be attributed to relatively less favourable weather conditions. These conditions resulted in a 1989 wheat crop that is likely to be some 40 per cent smaller in terms of volume than the wheat crop of 1988. In addition, real value added in agriculture fell back in the fourth quarter of 1989 after the bulk (i.e. nearly 80 per cent) of the near-record 1988/89 maize crop had been harvested in the preceding three months.

Virtually no change was recorded in real value added by the sector *commerce* in the fourth quarter of 1989. This represented the net outcome of, on the one hand, a mild rise in real output in the motor trade and, on the other hand, mild contractions in real value added in wholesale and retail trade. Real value added in the motor trade recovered in the fourth quarter as the various problems that had been troubling the automotive industry and motor dealers in the third quarter (strikes, stay-aways and work stoppages, interruptions of supply and low inventories) were largely resolved in the ensuing months.

The slight shrinkage of real output in wholesale and retail trade could be attributed to the mild slowing-down of the domestic economy generally, to a further weakening (although at a lower rate) of the foreign trade balance (i.e. of the excess of real merchandise exports over real merchandise imports), and to the fact that the prolonged strike among railway workers in the South African Transport Services in December 1989-January 1990 may have hampered deliveries of goods and materials in certain parts of the country.

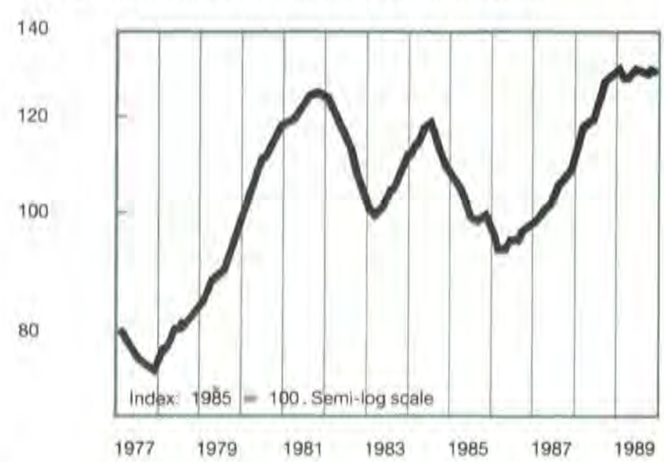
The notable further rise in real output of the *mining* sector in the fourth quarter mainly reflected increases in physical gold production, partly as a result of the processing of somewhat higher-grade ore. In addition, non-gold mining production was maintained at relatively high levels by sustained high (although diminishing) levels of export demand.

Real output of the *manufacturing sector* recovered somewhat in the fourth quarter of 1989 after three consecutive quarters of output declines; marked contractions of real value added in manufacturing industry – due, essentially, to external factors – had been observed in the third quarter of 1989 in particular. Notable increases in production were registered in sub-sectors such as the chemical industry and in the manufacturing of machinery and transport equipment. Rather more marginal departures from third-quarter output levels were recorded in other industries. To a not insignificant extent, the overall improvement in real manufacturing production in the fourth quarter of 1989 was based on a working-down of unfilled orders.

Real growth of the South African economy in the consolidation *year* 1989 slowed down to approximately 2 per cent, from a fairly impressive 3½ per cent in the advanced upswing year 1988. Incorporated in the 1989 slackening of the real growth rate were the effects of the authorities' progressive tightening of monetary policy from the end of 1987 or early 1988 and of the *de facto* quite restrictive stance of fiscal policy in the course of 1989. The 2 per cent growth rate of 1989 still compared relatively favourably, however, with the average annual real growth rate of the South African economy of only approximately 1½ per cent in the years from 1980 to 1989. The moderate slowing of positive real growth from 3½ per cent in the mature upswing year 1988 to 2 per cent in the early downswing year 1989 also compared very favourably with the considerably more abrupt change-overs from expansion at 4½ per cent per annum in the four quarters immediately preceding the cyclical upper turning-point of August 1981, to actual *contraction*, at 1½ per cent per annum, in the four quarters following that turning-point, and from expansion at 7½ per cent per annum in the four quarters immediately preceding the upper turning point of the 1983-84 mini-boom in June 1984 to *contraction*, at more than 2½ per cent per annum, in the four quarters immediately thereafter. The growth path traced out by the South African real gross domestic product in 1989 therefore bore witness to the relative "softness" of the cyclical "landing" of economic activity that is also apparent from the behaviour of the composite business cycle indicators and from a variety of other cyclically sensitive time series to date.

An analysis of *sectoral* output performances during the year 1989 shows that the positive rates of growth in real value added in the various sub-divisions of the economy declined from their 1988 levels in all principal sectors of the economy, with the exception of agriculture. Fairly pronounced divergencies could, however, be observed in the extent of the slow-down of the real

Composite coincident business cycle indicator



growth rates in various sectors and sub-sectors. This could be attributed partly to the sustained strength of the South African merchandise export performance throughout 1989 compared with the slackening and decline of aggregate real gross domestic monetary demand.

Real value added in *agriculture* was a major 10 per cent higher in 1989 than in 1988. This remarkable outcome was based on increases in real gross income in sub-sectors such as field crop production (including maize), horticulture and livestock production, as well as on a slow-down in the increase in farmers' real purchases of intermediate goods.

Significant decelerations were shown by the growth rates of real value added in *manufacturing* and *commerce* from 1988 to 1989; more moderate slowdowns of real output growth could be observed in the sectors *transport, finance* and *general government.* Real value added in the *mining sector* remained substantially unchanged from 1988 to 1989. This was a result of the fact that, during 1989 as a whole, the increase in real output of the sub-sector "other mining" was neutralised fully by a decline in production in the gold-mining industry.

Real gross *national* product, which had expanded at relatively very firm rates of 3 per cent and 5 per cent in 1987 and 1988, contracted in 1989 to an average level that was some ½ per cent lower than in the preceding year. This was accounted for by a weakening of the South African terms of trade throughout 1989 as well as by increases in real net factor payments to the non-resident owners of means of production that are employed in the South African economy.

The higher level of real net factor rewards to non-residents in 1989 stemmed primarily from increased payments of dividends and interest. The rise in dividend payments was a reflection of favourable financial results of South African companies in the first half of 1989 in particular; increased net payments of interest arose from the generally hardening trend in interest rates in South Africa as well as in the major economies abroad and from foreign investors' increased holdings of fixed-interest-bearing South African securities.

The 1989 weakening of the South African terms of trade (which represented a continuation of a downward drift of the terms of trade that had started in approximately the middle of 1988) reflected a scissors movement of import and export prices. The South African import price level was affected adversely by an upward trend in the world prices of crude oil (and, in a more subdued manner, of fossil fuels generally); South African export prices, on the other hand, were influenced downwards by a further softening of the world markets for various metals and minerals and for several other non-oil commodities.

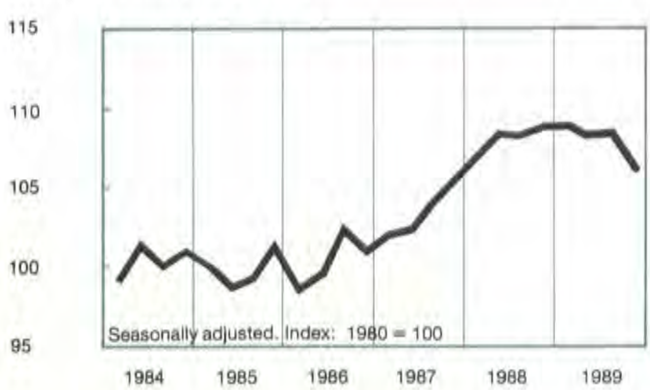
The slowing-down of growth in the real gross domestic product in 1989 caused real gross domestic product *per capita*, which had increased significantly (i.e. by some 1½ per cent) in 1988, to decrease fractionally in 1989. The slight decline in total real gross *national* product in 1989 meant that the quite substantial increases in real gross national product *per capita* in 1987 and 1988 (of nearly 1 per cent and more than 2½ per cent respectively) were largely, although not fully, reversed in the ensuing year.

Domestic expenditure

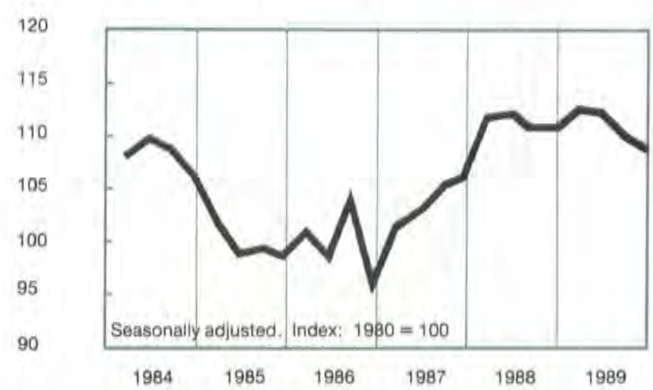
Total real gross domestic expenditure rose strongly at a seasonally adjusted and annualised rate of 6 per cent in the first quarter of 1989, but declined in the second and the third quarter at annualised rates of 1½ and 7½ per cent. It then continued to decline in the fourth quarter of 1989 at an annualised rate that is currently estimated to have amounted to some 7 per cent.

Total real gross domestic expenditure in the calendar year 1989 is estimated to have been lower than in 1988 by approximately 1 per cent. This mild contrac-

Real gross national product



Real gross domestic expenditure



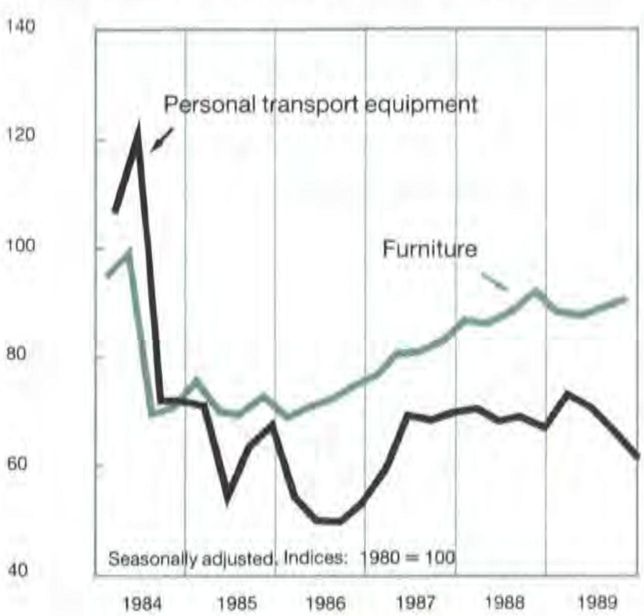
tion followed an increase in real domestic spending in 1988 of as much as 7½ per cent. More clearly than domestic output, therefore, the behaviour of domestic spending in 1989 showed the effects of the authorities' moderately restrictive monetary and fiscal policies.

The decline in total real gross domestic expenditure in the fourth quarter of 1989 was accounted for by further reductions of real government consumption expenditure, a decline in real gross domestic fixed investment, and a significant further drawing-down of real inventories. A slight further rise was, however, still recorded in real private consumption expenditure.

Growth in *real private consumption expenditure* slackened from an annualised rate of 2 per cent in the first quarter of 1989 to a rate of approximately 1½ per cent in the second quarter and to virtual stagnation in the third quarter. The annualised growth rate of real private consumption in the fourth quarter is currently estimated to have amounted to approximately ½ per cent. This slight rise was fully explained by increases in real household outlays on non-durable goods and on services. Declines were recorded in real household spending on both durable and semi-durable goods.

The fourth-quarter decline in households' real outlays on consumer durables mainly reflected substantial cut-backs in real spending on personal transport equipment; the downward tendency in new motor vehicle sales which had commenced in the second quarter of 1988, continued into early 1990. Relatively high levels were still recorded, however, in respect of households' real spending on furniture, both in the fourth quarter of 1989 and during 1989 as a whole.

Real expenditure on durable consumer goods



The relative strength of households' furniture purchases served to support the aggregate volume of real household spending in the "furniture and household appliances" category, as well as the total of real durable consumer expenditure. At the same time, the absence of any significant decline in households' real outlays on furniture and appliances from 1988 to 1989 stood in marked contrast to the sharp drop in such spending in the first four quarters after the mini-boom of 1983-84, i.e. from mid-1984 to mid-1985.

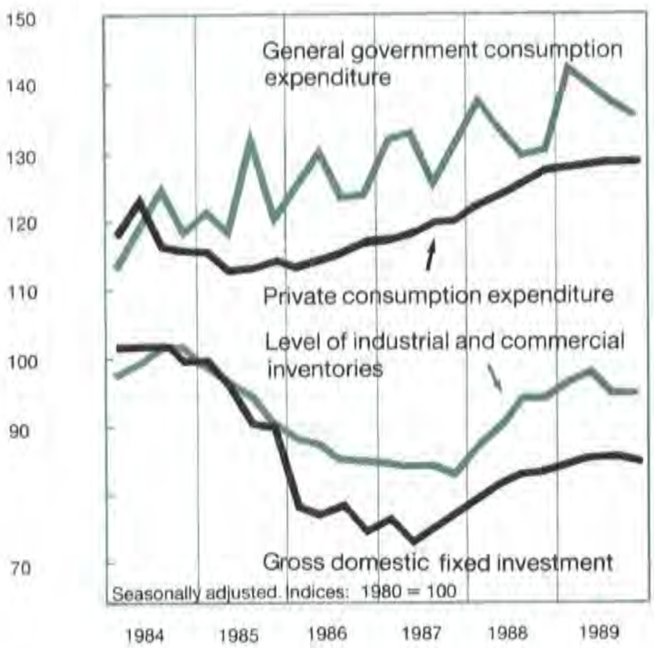
Various factors appear to have contributed to the comparative liveliness of furniture sales in 1989. These included the relative buoyancy of low-cost housing construction during the year, the exemption of certain types of furniture from hire-purchase restrictions and the normal pressures of replacement demand. In addition, however, comparatively low price inflation in respect of furniture and appliances served to preserve the *relative* affordability of these items within the broad category of consumer durables and may have induced some quasi-permanent shifts in households' spending patterns. During the four years from 1986 to 1989 the average price level of personal transport equipment (mostly motor vehicles) rose by some 150 per cent. By comparison, the price level of furniture and appliances rose rather less dramatically during this period by an approximate 70 per cent.

The decline in households' real expenditure on *semi-durable* goods in the fourth quarter of 1989 arose from the fact that increases in outlays on clothing and footwear were neutralised more than fully by reductions in spending on items such as textiles and motor-car tyres, parts and accessories – the latter in association with and in response to the downward trend in second-hand car sales that has been in evidence since the first quarter of 1988. The fourth-quarter *rise* in real private-sector consumption expenditure on *non-durables* and on *services* mainly consisted of increased spending on food, beverages and tobacco, but also comprised higher outlays on items such as rent, household services, and catering and accommodation.

Aggregate real private consumption expenditure in the year 1989 is estimated to have been nearly 3 per cent higher than in 1988. This firm rate of expansion, however, was notably lower than the vigorous rate of growth in real private consumption expenditure of nearly 5 per cent in the preceding year. A slackening of the growth rate of real consumer demand was to be expected, partly because of the lower rate of growth in real personal disposable income in 1989 than in 1988; the decline in the growth rate of disposable income, in turn, was related, among other things, to the high and rising level of consumer debt, the effects of increased debt and higher interest rates on households' interest payment obligations, and the accelerating rise in insolvencies in the personal sector.

Various factors nevertheless supported both real disposable income and households' spending propensi-

Main components of real gross domestic expenditure



ties in 1989. These factors included good harvests and relatively substantial gross operating surpluses in the agricultural sector and the multiplier effects of increased farmers' incomes and expenditures on other parts of the economy; accelerated nominal wage increases and a higher average level of the real wage per non-agricultural worker in most of 1989 than in the preceding year; the strengthening of the dollar price of gold from late 1989 and buoyant conditions in the share market; and more confident views among consumers of the current and prospective socio-political situation.

Real *government consumption expenditure* rose at an annualised rate of more than 40 per cent in the first quarter of 1989 (the final quarter of the fiscal year 1988/89), but fell back at annualised rates of 6½, 8 and 5½ per cent in the ensuing three quarters. In the fourth quarter of 1989, appreciable reductions in real government spending on intermediate goods and services more than offset further increases in real remuneration of employees.

Despite these more recent reductions, however, the very sharp rise in government consumption expenditure in the first quarter of 1989 (which followed a deliberate holding back of government spending in the preceding three quarters) still resulted in a high average *level* of such spending during 1989 as a whole. The average level of real government consumption expenditure during the calendar *year* 1989 was, in fact, some 4½ per cent higher than in 1988; the average level of this spending in the first three quarters (April to December) of the *fiscal* year 1989/90 was as much as 5½ per cent higher than in the corresponding three quarters of fiscal 1988/89.

From the calendar year 1988 to the calendar year 1989, real government consumption expenditure on intermediate goods and services and on remuneration of employees rose by 7½ per cent and by 2 per cent respectively. Since the government's real consumption expenditure is unlikely to have risen significantly from the *fiscal* year 1988/89 to the *fiscal* year 1989/90, a markedly negative year-on-year rate of change in such spending is to be expected in the first quarter of 1990 vis-à-vis the first quarter of 1989.

The upward momentum in aggregate *real gross domestic fixed investment expenditure* faded in the course of the first three quarters of 1989 and fell away entirely in the fourth quarter. The seasonally adjusted and annualised rate of increase in total real fixed investment shrank from some 5½ per cent in the first quarter of 1989 to 4½ and ½ per cent in the second and the third quarter. It then changed to an annualised rate of *de*crease of more than 3 per cent in the ensuing three months. Total real gross domestic fixed investment was higher by a fairly impressive 8½ per cent in 1988 than in 1987, but was only 4 per cent higher in 1989 than in 1988.

An analysis in institutional terms shows that the decline in total real gross domestic fixed investment expenditure in the fourth quarter of 1989 was accounted for almost exclusively by reductions in real fixed capital outlays in the private sector. Real fixed capital formation by private-sector parties rose by a major 17½ per cent from 1987 to 1988, but by only 2 per cent from 1988 to 1989. In the course of 1989, the seasonally adjusted and annualised rate of change in real private fixed investment receded from 1½ per cent in the first half of the year to −2½ per cent in the third quarter and to a provisionally estimated −3½ per cent in the ensuing three months.

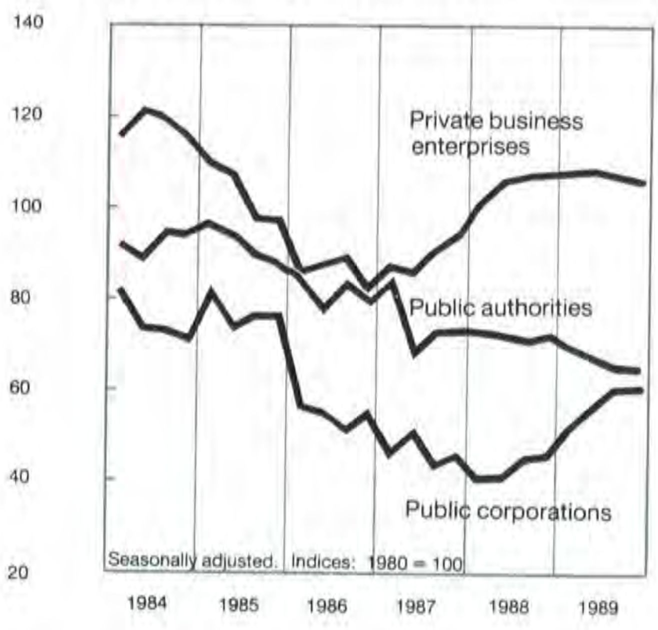
An initial further strengthening of private real fixed capital formation in the early stages of a cyclical downturn is one of the more regular features of the business cycle in the South African economy. The shrinking of private real fixed investment expenditure from the third quarter of 1989 (i.e. from approximately six to nine months after the presumed upper turning-point of the general business cycle towards the close of 1988) actually marked a relatively short time-lag in the response of such spending to a change in business conditions in the context of normal cyclical developments in the South African economy.

The decline in private real fixed capital formation in the fourth quarter of 1989 was mainly due to reductions of investment expenditure in sectors such as agriculture, mining and commerce. It took place against a background of less buoyant crop expectations in the farming sector, a weakening of profit growth among business enterprises (in the second half of 1989 in particular), relatively high interest rates, and the softening trend in world commodity markets as well as in real domestic monetary demand. During 1989 *as a whole*, the lower rate of expansion in private real fixed capital formation mainly reflected slow-downs in the rate of growth in real fixed investment spending in agriculture, manufacturing and finance and an actual decline in real fixed capital outlays in the mining industry.

Real gross fixed investment by *public authorities* continued to decline in the fourth quarter of 1989, but did so at an annualised rate of only about 2½ per cent (against an average rate of decline of some 12 per cent in the preceding three quarters). The fourth-quarter decrease in real fixed investment by public authorities arose from reductions in real fixed capital formation by the business enterprises of general government. These reductions more than offset increases in real fixed investment by all three levels of the general government itself.

During the calendar *year* 1989 real fixed capital expenditure by public authorities retreated to an average level that was some 7½ per cent lower than in 1988; the extent of this fall-back in 1989 was more than twice as large as the decline in the preceding year. This could again be attributed to significant reductions in real fixed investment by the business enterprises of general government. As such, it was a further reflection of the rationalisation programmes instituted by the Department of Posts and Telecommunications and by the South African Transport Services. The level of real fixed investment by *general government* was approximately 2 per cent lower in 1989 than in 1988.

Real gross domestic fixed investment



Real fixed investment by *public corporations* rose substantially in the first three quarters of 1989, but took a more sideways course in the ensuing three months. In the calendar *year* 1989, however, real fixed capital formation by public corporations rose substantially from its 1988 levels, mainly because of progress in the on-shore and off-shore development activities of the Mossgas project. Nevertheless, the level of real fixed investment by public corporations in 1989 still fell short of peak levels it had attained as long ago as 1975.

A breakdown of total real gross domestic fixed investment by type of capital asset in 1989 shows that increases in real outlays for residential and non-residential buildings, construction and transport from their 1988 levels varied between 5½ and 16 per cent. Real fixed investment in machinery and equipment, however, contracted by 3½ per cent in 1989 to a level that approximated that of the 1970s and was some 22½ per cent lower than its average level in the first half of the 1980s. This was reflected in the slow-down of merchandise imports in most of 1989 and could be attributed to the slackening of real domestic monetary demand and to a widening of the margins of unused capacity in manufacturing industry. It may also have reflected an impact on investment activity of the 15 per cent surcharge on imported capital goods. As an unusual feature of the 1989 consolidation phase, however, the upper turning-point in real fixed investment in machinery and equipment appears to have *preceded* a decline in the degree of capacity utilisation.

The effects of the easing of final demand from the second quarter of 1989 onwards were reinforced by *inventory disinvestment* in the second half of the year. Total real inventories continued to rise (although at a diminishing pace) in the first and the second quarter of 1989, but declined in the third quarter of 1989 and fell back more rapidly in the fourth quarter. The reduction of total real inventories in the fourth quarter of 1989 was due primarily to a further drawing-down of industrial and commercial inventories and, to a lesser extent, also to reductions of agricultural inventories and of diamond stocks-in-trade. The ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy showed a slight further decline in the fourth quarter of 1989 to 20¾ per cent, from very nearly 21 per cent in the preceding three months.

Total real inventories rose by R0,3 billion in 1987 and by R2,1 billion in 1988. They then increased mildly further, on balance, by approximately R200 million in the course of 1989. The decline in these inventories from the third quarter of 1989 began relatively early within the context of normal cyclical timing relationships. This is likely to have reflected the comparatively high real-interest cost of carrying inventories in the present consolidation phase of the business cycle as well as the more widespread use of superior techniques of inventory management.

Factor income and saving

The rate of increase in aggregate nominal factor income *at market prices* slowed down from a seasonally adjusted and annualised level of more than 20 per cent in each of the first two quarters of 1989 to 13½ per cent in the third quarter and 6 per cent in the fourth quarter. From the calendar year 1988 to the calendar year 1989, the rate of increase in aggregate nominal factor income decelerated undramatically, partly under the influence of the lower rate of increase in overall economic activity, from nearly 19½ per cent to slightly more than 18 per cent.

Among the two principal components of factor income *at factor cost* (namely, remuneration of employees and the gross operating surplus), the rate of increase in nominal *remuneration of employees* fell back from an average annualised level of 23 per cent in the first half of 1989 to 12½ per cent in the second half. Decelerations in the rate of growth in nominal wage and related payments could be observed in most sectors of the economy, with the notable exceptions of the mining industry and general government. The slow-down in the rate of increase in total nominal labour remuneration in the course of 1989 could be attributed *inter alia* to the relatively high levels of salary adjustments in the first half of the year, to the rationalisation of certain business enterprises in the public sector, and to certain more temporary losses of workers' earnings, for instance on account of the prolonged strike by some 20 000 employees of the South African Transport Services in December 1989-January 1990.

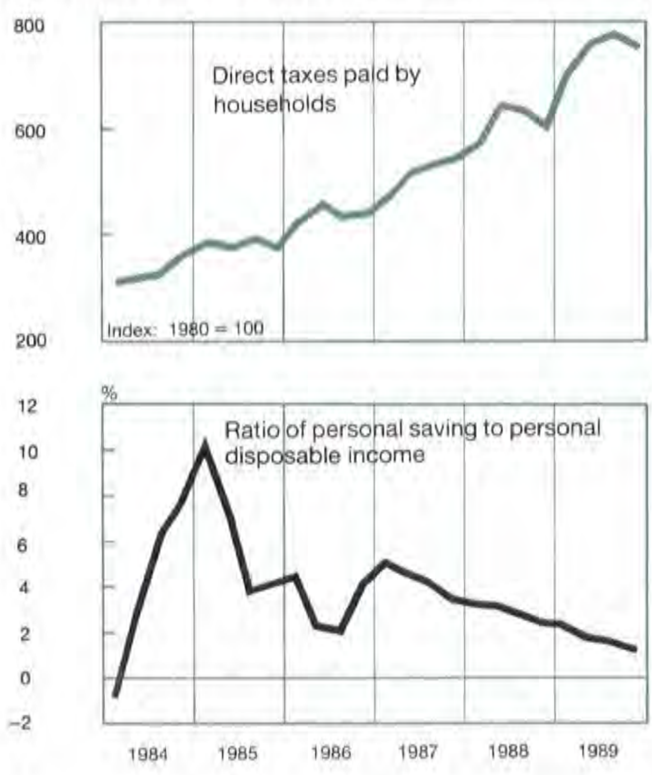
Despite these various developments in the course of 1989, the year-to-year rate of increase in total nominal labour rewards actually accelerated from 16½ per cent in 1988 to 18½ per cent in 1989. As is not uncommon in the earlier stages of cyclical downswings (when initially still rising nominal wage increases tend to combine with a slackening of growth in businesses' gross operating surpluses), this acceleration in the rate of increase in nominal labour remuneration resulted in an increase of labour's share in total value added. This share expanded from slightly more than 57½ per cent in 1988 to approximately 58½ per cent in 1989. Apart from increases in total employment and continued relatively high levels of economic activity, the rise in the share of labour rewards in total factor income was also aided to some extent by trade union action and by the persistence or aggravation of certain skills bottlenecks.

The total *gross operating surplus* actually *contracted* slightly in the fourth quarter of 1989, mainly on account of lower operating surpluses in the agricultural sector and lower rates of increase in company profits in manufacturing industry, commerce and finance. From 1988 to 1989, the year-to-year rate of increase in the total gross operating surplus retreated significantly from 19 to 15½ per cent. This slow-down occurred widely through the economy and became more pronounced in the second half of 1989.

The topping-out of the total gross operating surplus in the first half of 1989 and its downward drift in the second half, reflected changes in domestic as well as external conditions. Domestically, the rate of expansion of real final demand slowed down from 5 per cent in 1988 to 3½ per cent in 1989. In addition, firms' profit margins were squeezed by rapid increases in capital maintenance and operating costs. Externally, exporting firms were exposed to the effects of the downward trend in world commodity prices and of the appreciation of the rand in the fourth quarter of 1989.

The ratio of *gross domestic saving* to gross domestic product reached a low point (of some 21½ per cent) in the second quarter of 1989, but was significantly higher (at some 23 per cent) in both the third and the fourth quarter. The absence of change in this ratio from the third to the fourth quarter was due to the opposing forces of a slackening of saving by private sector parties and a mild improvement in net saving by general government.

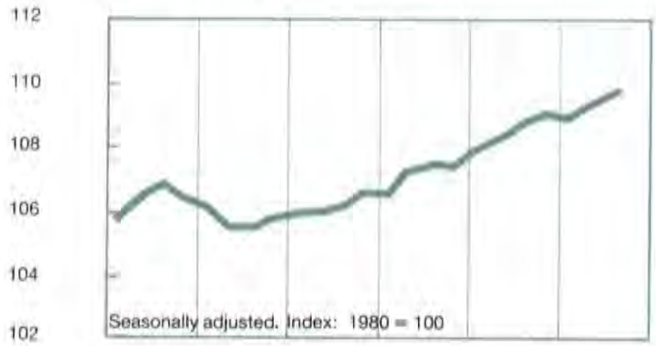
Households: Saving and direct taxes paid



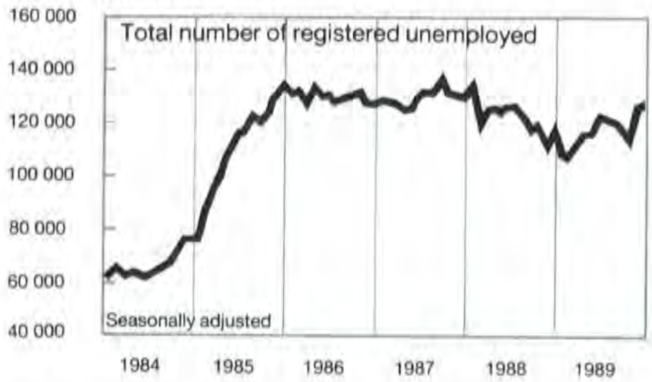
The government's improved net savings performance during a large part of the year 1989 primarily reflected sharply higher tax receipts. These could be attributed to the unexpected strength of the economy in its early consolidation phase, continued high imports and accompanying high surcharge revenues, accelerated nominal salary and wage increases and more stringent measures for collecting general sales tax dues and income tax arrears.

Declines were recorded in the fourth quarter of 1989 in net saving of the personal as well as the corporate *private* sector. Although net saving by corporate businesses was still at a high level, it was affected adversely by the shrinkage of gross operating surpluses, increased payments of interest and dividends (to foreigners in particular), and higher tax obligations. Net *personal* saving fell back slightly in the fourth quarter, mainly because of the slackening of growth in total real personal disposable income in the course of the year to only 1½ per cent in 1989 from 3½ per cent in 1988: higher interest payments and a 12 per cent increase in payments of real direct personal taxes wiped out a large part of the rise in real remuneration of employees and in real income from property in 1989. The ratio of net personal saving to personal disposable income is estimated to have shrunk to 1½ per cent in 1989 from 2½ per cent in the preceding year.

Employment in non-agricultural sectors



Unemployment



Employment

Total employment in the non-agricultural sectors of the economy rose by 0,4, 0,9 and 1,2 per cent in the three upswing years 1986, 1987 and 1988 respectively. In the first three quarters of the consolidation year 1989 the average level of non-agricultural employment was a modest 0,9 per cent higher than in the first three quarters of 1988.

The seasonally adjusted and annualised rates of change in total non-agricultural employment in the first three quarters of 1989 amounted to –0,4, +1,7 and +1,2 per cent. The renewed slow-down of growth in total employment in the third quarter reflected continued staff reductions in (among other sectors and sub-sectors) the South African Transport Services and the Department of Posts and Telecommunications, the provincial administrations, construction, electricity generation and the gold-mining industry, as well as labour retrenchments by local authorities, in private road transport services, and in wholesale trade. Data for the *fourth* quarter of 1989 indicate further net layoffs in construction and electricity generation and a decrease in employment in manufacturing industry.

Total employment in the non-agricultural *private* sector declined (at a seasonally adjusted annual rate of 1,3 per cent) in the first quarter of 1989, but rose at an annualised rate of 1,6 per cent in the second quarter and at a comparatively favourable rate of 1,3 per cent in the third quarter. Apart from the actual staff *reductions* in those sectors already referred to, the renewed slowing-down of private sector employment increases in the third quarter of 1989 also reflected a slow expansion of job opportunities in manufacturing, trade, banking and certain other service industries.

Total employment by *public authorities* rose relatively rapidly at seasonally adjusted and annualised rates of 1,7 and 2,0 per cent in the first and the second quarter of 1989, but slowed down to an annualised rate of increase of 1,0 per cent in the third quarter. During the first nine months of 1989 as a whole, the average tempo of employment increases by public authorities significantly exceeded the average rate of employment growth in the private sector. At annualised levels, the two growth rates concerned amounted to 1,3 and 0,7 per cent.

The ratio of *overtime hours* to normal hours worked in manufacturing and construction appeared to have peaked in the third quarter of 1988. In keeping with the slackening incremental demand for labour, this ratio then moved broadly sideways, on balance, up to October 1989 in manufacturing, but moved downwards rather more clearly in the construction industry.

The seasonally adjusted number of registered *unemployed* workers in the White, Coloured and Asian population groups declined from a high point of 82 300 in August 1986 (in the early stages of the 1986-1988 upswing) to a low point of 45 100 in January 1989. It then reverted briefly to 51 600 in April 1989 before decreasing – in an apparent contradiction of the cyclical cooling-down of the economy – to a new four-year low of 41 100 in December 1989.

The seasonally adjusted *total* number of registered unemployed workers retreated from a high point of 136 900 as late as September 1987 to a low point of 107 200 in February 1989. It then increased, on balance, to 127 500 in December. The net increase in total registered unemployment up to December 1989 was, however, still considerably smaller than the increases recorded up to comparable points in time in the preceding three cyclical downswings in the South African economy.

The number of unemployed *Black* workers, as measured by the Current Population Survey, reached a low point of 734 000 in April 1989, rose briefly to 791 000 in May, but declined again to a new low point of 724 000 in October 1989. The unemployment figure in October was equal to some 10,7 per cent of the estimated Black labour force.

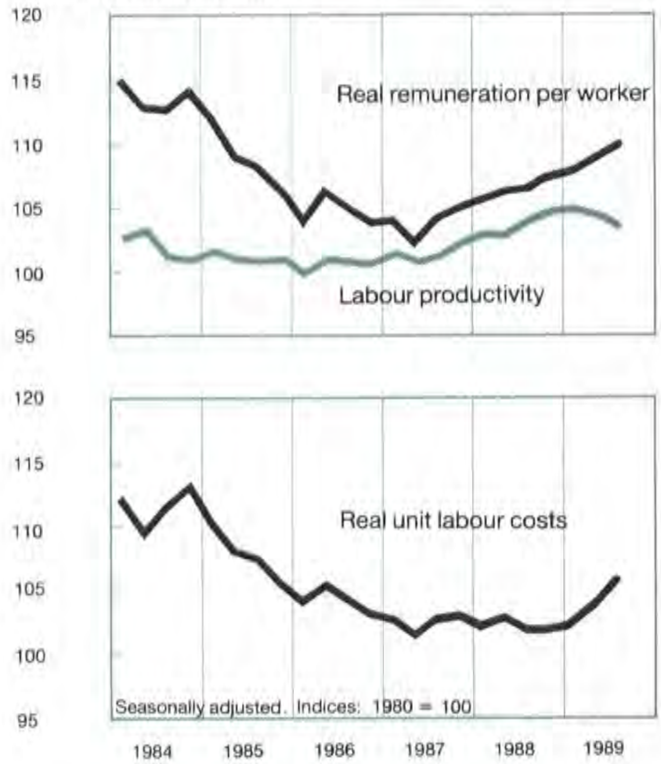
Labour costs and productivity

The year-to-year increase in the annual amount of nominal salaries and wages per worker in the non-agricultural sectors of the economy accelerated from 11,4 per cent in the recession year 1985 to 15,6 per cent in 1988. In the first three quarters of 1989 the average level of nominal wages per worker was higher than in the first three quarters of 1988 by a substantial 17,9 per cent.

From 1985 to 1988, and especially in 1988, the year-to-year rates of increase in the nominal amount of salaries and wages per worker in the non-agricultural *private* sector exceeded significantly the tempo of nominal wage increases among workers employed by *public authorities*. This tendency was, however, reversed in 1989: the average levels of nominal salaries and wages per worker in the first three quarters of 1989 in the private sector and among workers employed by public authorities exceeded their respective counterparts in the first three quarters of 1988 by 16,9 and 20,1 per cent.

The tempo of increases in the nominal wage per worker in the non-agricultural *private* sector of the economy decelerated fractionally, on average, from relatively steady year-on-year rates of 17,5, 17,7 and 17,6 per cent in the final three quarters of 1988, to 14,7, 18,2 and 17,6 per cent in the first three quarters of 1989. In marked contrast to this development, however, the tempo of increases in the nominal wage per worker employed by *public authorities* accelerated sharply from year-on-year rates of only 9,0 and 8,4 per cent in the third and the fourth quarter of 1988 to as much as 19,7, 17,5 and 23,1 per cent in the first three quarters of 1989. The year-on-year rates of increase in the average nominal wage of *all* non-agricultural workers consequently accelerated steadily from 14,7 per cent in the final quarter of 1988 to 16,3, 18,0 and 19,3 per cent in the first three quarters of 1989.

Labour productivity, remuneration and unit costs in non-agricultural sectors



The *real* wage per worker declined in the recession year 1985 and in the early upswing years 1986 and 1987. It rose, however, by 2,5 per cent in 1988 vis-à-vis 1987 and was higher in the first three quarters of 1989 than in the first three quarters of 1988 by an average of 2,9 per cent. The year-on-year rates of increase in the real wage per worker advanced in the first three quarters of 1989 from 2,4 per cent in the first quarter to 2,7 per cent in the second quarter and as much as 3,4 per cent in the third quarter.

Real non-agricultural *labour productivity* improved relatively strongly by 2,6 per cent from 1987 to 1988. In the course of 1989, however, the pace of productivity advances sagged from a year-on-year rate of 2,3 per cent in the first quarter to 1,8 per cent in the second quarter. The change in labour productivity over four-quarter periods then fell back further to an actual *decline* of 0,4 per cent in the third quarter.

The marked improvement in labour productivity in 1988 helped to hold down the increase in *nominal labour costs per unit of physical output* in the non-agricultural sectors to an average level of 12,6 per cent during that year. However, in the course of 1989 the acceleration of nominal wage increases on the one hand, and the more sideways movement and eventual decline of physical labour productivity on the other hand, caused the year-on-year rate of increase in nominal unit labour costs to accelerate from 13,7 per cent in the first quarter to 15,9 per cent in the second quarter and to a disturbing 19,7 per cent in the ensuing three months.

Real unit labour costs decreased continuously from 1985 to 1988. Rising real wages per worker and the slowing-down and eventual reversal of improvements in physical labour productivity subsequently caused the real labour costs per unit of output to rise again at year-on-year rates of 0,1 per cent, 0,9 per cent and as much as 3,8 per cent in the first, second and third quarter of 1989 respectively. Accordingly, the average level of real unit labour costs in the first nine months of 1989 was some 1,6 per cent higher than in the first nine months of 1988.

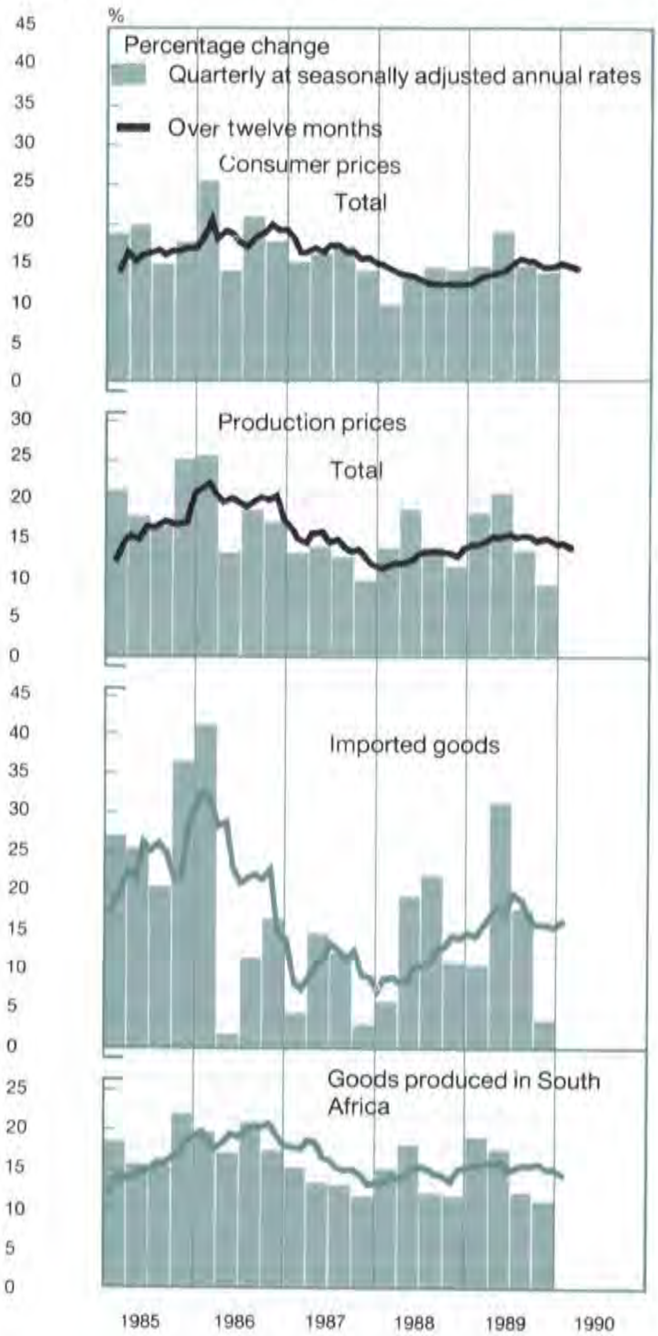
Prices

Inflation, as measured by the quarter-to-quarter rates of change in the major price indices, generally was notably higher in the first two quarters of 1989 than in the third and the fourth quarter of 1988, but fell back in most cases to significantly lower levels in both the third and the fourth quarter of 1989. Similarly, the twelve-month rates of increase in these indices tended to accelerate up to approximately the middle of 1989, but showed some improvement in the second half of the year. From the year 1988 to the year 1989 the rates of increase in the annual average levels of production prices and consumer prices nevertheless still accelerated from 13,2 to 15,2 per cent and from 12,9 to 14,7 per cent.

The 1988 depreciation of the rand caused the seasonally adjusted and annualised quarter-to-quarter rate of change in the prices of *imported goods* to rise to 21,6 per cent in the third quarter of 1988. Renewed weakening of the exchange rate from early 1989, and the effects of the increased import surcharges initially imposed in August 1988, subsequently caused this rate to rise dramatically from only 10,3 per cent in the first quarter of 1989 to as much as 30,7 per cent in the second quarter. A somewhat firmer appearance was, however, presented by the rand in the foreign exchange markets in the third quarter of 1989, and in the fourth quarter the effective exchange rate of the rand actually strengthened appreciably. As a result, the quarter-to-quarter rate of inflation in the prices of imported goods, in annualised terms, fell back to 17,4 per cent in the third quarter and shrank to as low as 3,4 per cent in the fourth quarter.

The *twelve-month* rate of increase in the price index of imported goods rose from a lower turning-point of only 6,7 per cent in December 1987 to 19,3 per cent in June 1989. The firmer tone and subsequent appreciation of the rand in the third and fourth quarter of 1989 are likely to have made an early contribution to the steady decline in this rate to 14,7 per cent in December 1989 and to 14,4 per cent in January 1990.

Prices



The annualised quarter-to-quarter rate of increase in the prices of *domestically produced goods* accelerated from a low point of 11,5 per cent in the fourth quarter of 1988 to a high point of 18,9 per cent in the first quarter of 1989, but declined to 12,0 and 10,7 per cent in the third and the fourth quarter of 1989. The *twelve-month* rate of increase in the prices of domestically produced goods increased gradually from the beginning of 1988 to 15,4 per cent in May 1989, but retreated to 14,0 per cent in January 1990.

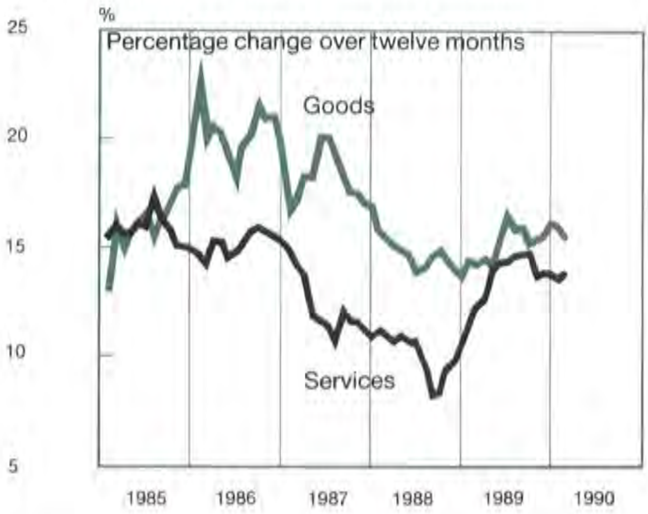
The quarter-to-quarter rate of increase in the total *production price index*, which incorporates the movements in the price indices of both imported and domestically produced goods, rose from a seasonally adjusted and annualised level of 10,9 per cent in the fourth quarter of 1988 to levels of 17,7 and 20,2 per cent in the first two quarters of 1989. In accordance with the movements in both its component indices, this rate then contracted to only 13,0 and 8,7 per cent in the third and the fourth quarter of 1989. The rate of increase in the total production price index *over periods of twelve months* rose gradually, in close correspondence with the behaviour of the price index for domestically produced goods, from the beginning of 1988 to a peak of 15,8 per cent in May 1989. It then retreated, gradually and on balance, to 14,6 per cent in both November and December 1989 and to 14,1 per cent in January 1990.

The annualised quarter-to-quarter rate of increase in the *consumer price index* doubled from a low point of 9,2 per cent in the first quarter of 1988 to a high point of 18,4 per cent in the second quarter of 1989. It then fell back to 13,3 per cent in the fourth quarter of 1989.

Rates of increases in the prices of consumer *goods* (which account for 60,5 per cent of all items in the consumer price index) were notably higher than the percentage increases in the overall consumer price index in the second and the third quarter of 1989, but retreated to the same level as that of the rate of increase in the overall index in the fourth quarter. Increases in the prices of consumer *services* slowed down from an annualised rate of 19,0 per cent in the first quarter of 1989 to only 9,4 per cent in the third quarter, but reaccelerated to 11,5 per cent in the fourth quarter. The moderate reacceleration of these price increases in the fourth quarter occurred despite declines in the rates of increase in the costs of transport services and in housing costs.

The *twelve-month* rate of increase in consumer prices rose from a low point of 12,3 per cent as recently as October 1988 to 15,7 per cent in June 1989. This rate then declined to 14,8 per cent in October 1989, reaccelerated somewhat to 15,3 per cent in December, and stood at 14,9 per cent in February 1990. Partly because of higher fuel and power tariffs and prices of foodstuffs and medicines (among several other large price increases), the twelve-month inflation rate in the prices of consumer *goods* in February, at 15,6 per cent, again exceeded the twelve-month rate of increase in the prices of consumer services and in the overall consumer price index.

Consumer prices



Balance of payments and exchange rates

Current account

Having strengthened substantially in the third quarter of 1989, the seasonally adjusted and annualised surplus on the balance of payments current account widened marginally further (by R28 million) to R5,9 billion in the ensuing three months. The current account surplus in the year 1989 was thereby brought to R4,1 billion, against R2,9 billion in 1988. The surplus in 1989 was South Africa's fifth consecutive annual current account surplus; the cumulative surplus of R26,3 billion from 1985 through 1989 was equal to some 3 per cent of gross domestic product during this five-year period.

The slight further strengthening of the current account surplus in the fourth quarter of 1989 was accounted for by (1) a mild further rise in the value of net gold exports, and (2) a significant further decline in the value of merchandise imports. Between them, these two factors more than made up for the effect of (1) a further decline in merchandise export earnings, and (2) substantially higher net service and transfer payments to foreigners.

The 2,3 per cent increase in the value of the *net gold exports* in the fourth quarter of 1989 could be attributed almost entirely to a 6 per cent rise (from US$367 to US$390 per fine ounce) in the average dollar price of gold from the third to the fourth quarter; appreciation of the rand vis-à-vis the dollar, however, held down the increase in the rand price of gold to approximately 2 per cent (from R1 004 to R1 024) during this period. In January and February 1990 the averages of the dollar price and the rand price of gold moved up further to US$413 and R1 054 per fine ounce respectively.

In the course of the calendar year 1989 the average dollar gold price declined to $382 per fine ounce from $437 in the preceding year, in a broadly inverse relationship with the upward trend of the value of the dollar in the international foreign exchange markets that had started at the beginning of 1988 and had persisted, on balance, up to the early third quarter of 1989. The 1989 decline in the average dollar price of gold was, however, neutralised more than fully by depreciation of the rand against the dollar during the year; the annual average *rand* price of gold accordingly rose slightly from R992 per fine ounce in 1988 to R999 per fine ounce in 1989. The 2 per cent decline in the rand value of the South African net gold exports in 1989 was, therefore, attributable solely to the decline in physical gold production to approximately 608 tons in 1989, from approximately 618 tons in the preceding year.

The value of *merchandise imports* declined sharply (by some 11½ per cent) from the second to the third quarter of 1989, and by a further 7 per cent in the fourth quarter. Reflecting the downward drift of aggregate real gross domestic expenditure after the first few months of 1989, the *volume* of merchandise imports declined by 13½ per cent in the third quarter of 1989 from its high second-quarter level, and by a further 5 per cent in the fourth quarter. The average *price level* of imported goods was only some 2 per cent lower in the fourth quarter of 1989 than in the preceding three months, despite a 3,6 per cent strengthening of the average effective exchange rate of the rand during this period. The impact of rand appreciation on the prices of imported goods was partly neutralised, however, by a hardening of prices in the international crude oil markets and by some acceleration of inflation in trading partner countries.

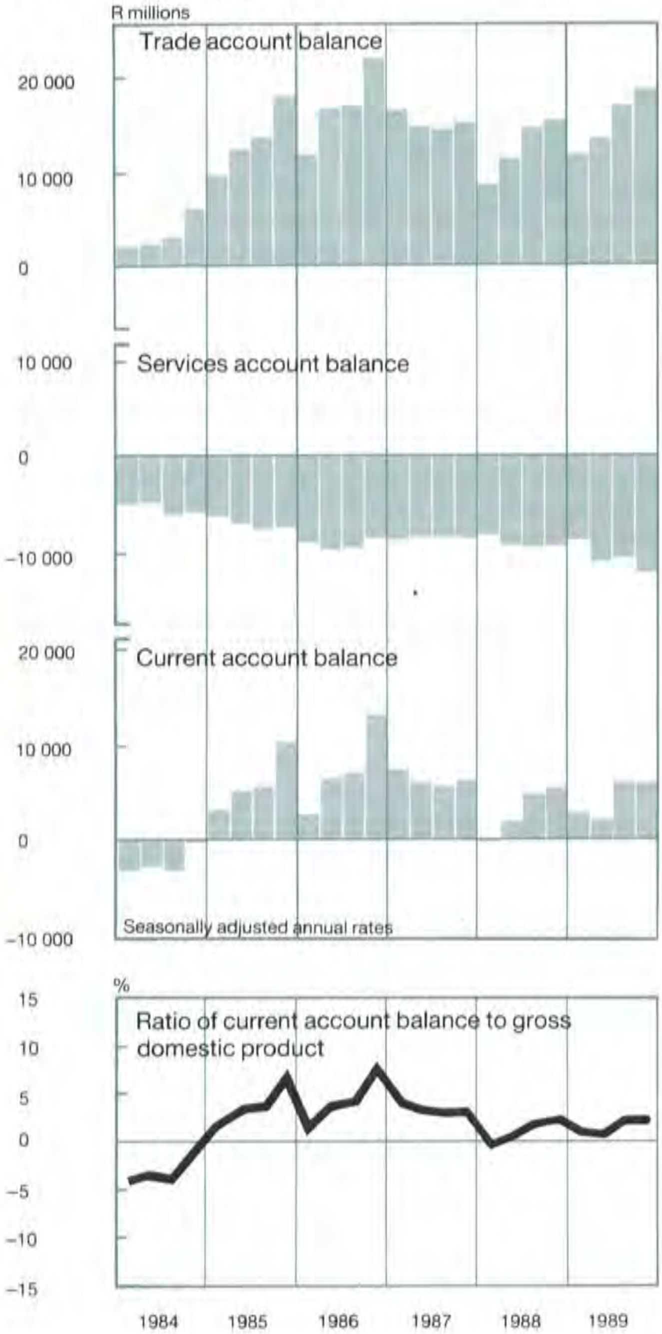
During 1989 as a whole, the approximate 1 per cent decline in total real gross domestic expenditure was accompanied by a decline in real merchandise imports of 1½ per cent. The average rand price level of merchandise imports was, however, some 14½ per cent higher in 1989 than in 1988. As a result, the value of merchandise imports in 1989, at R44,1 billion, was more than 12½ per cent higher than in the preceding twelve months.

The value of *merchandise exports*, having reached a new record high in the second quarter of 1989, declined by 8½ per cent in the third quarter of 1989 and by a further 4½ per cent in the fourth quarter. Contrary

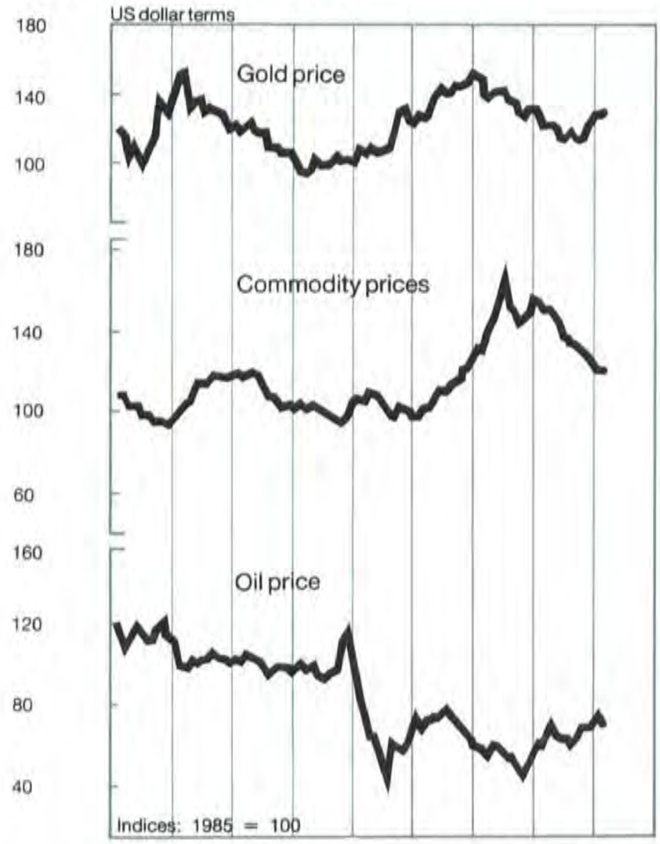
Balance of payments on current account
Seasonally adjusted annual rates
R millions

	1988	1989				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	31 472	34 560	44 320	40 610	38 730	39 555
Net gold exports	19 622	18 970	18 150	19 670	20 122	19 228
Merchandise imports	–39 170	–42 150	–49 580	–43 930	–40 872	–44 133
Net service and transfer payments	–8 985	–8 670	–10 920	–10 510	–12 112	–10 553
Balance on current account	**2 939**	**2 710**	**1 970**	**5 840**	**5 868**	**4 097**

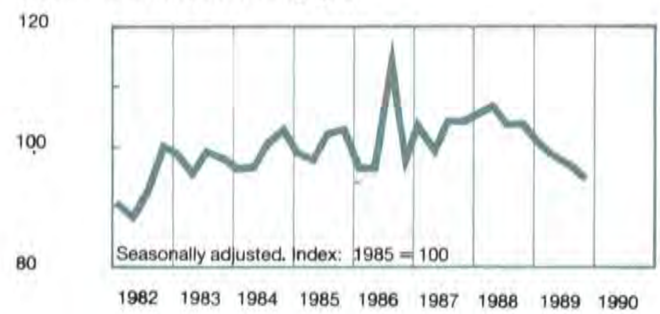
Balance of payments



Gold, commodity and oil prices



Terms of trade, including gold



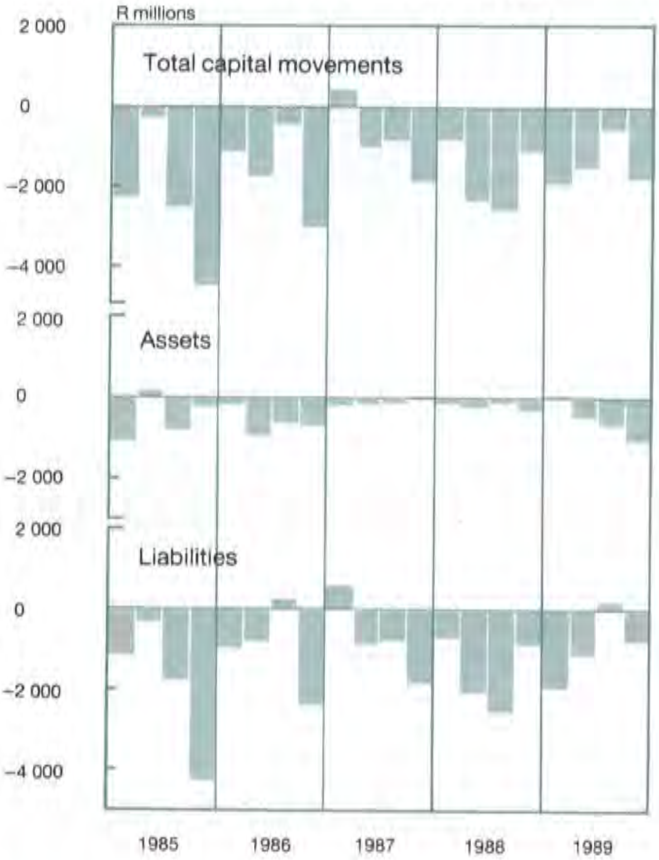
to developments in merchandise imports, the fourth-quarter decline in merchandise export earnings was accounted for almost entirely by a decline of more than 4 per cent in export *prices*. The effect on these prices of the strengthening of the exchange rate of the rand in the fourth quarter was reinforced by a further weakening of certain commodity prices (mainly of certain base metals such as nickel, copper and chrome, and of wool and maize) in the international markets.

The *volume* of merchandise exports held up well in the fourth quarter: its decline from the third to the fourth quarter amounted to a slender ½ per cent. When the value of South African merchandise exports is expressed in US dollars, the decline in these exports in the fourth quarter similarly amounted to ½ per cent. Declines in merchandise export earnings in the final three months of 1989 were recorded mainly in mineral exports and in exports of chemical products, precious metals and precious stones.

Net service and transfer payments to non-residents rose strongly again (by 15 per cent) from the third to the fourth quarter of 1989 to a new record level (in seasonally adjusted and annualised terms) of more than R12 billion. This increase partly reflected a decline in interest and dividend receipts from overseas sources. South African service payments to foreigners, on the other hand, rose very strongly, mainly because of increased interest payments. Increases in such payments arose from a further hardening of overseas interest rates as well as from non-residents' substantial switching from investments in South African shares to investments in South African interest-bearing securities; the extent of this switching rose significantly in the course of the final three quarters of 1989.

An overview of the principal current account items in the *year* 1989 makes it clear that the renewed strengthening of the current account surplus during the year as a whole was due exclusively to the quite remarkable vigour of the South African merchandise export performance. The average price level of these exports was some 7½ per cent higher in 1989 than in 1988. The *volume* of South African exports, however, was a major 17 per cent higher in 1989 than in the preceding year. This growth in export volumes therefore compared very favourably with the estimated expansion of the volume of world trade in 1989 of approximately 7 per cent. In the face of only moderate to modest growth of the real South African economy in the advanced upswing year 1988 and in the consolidation year 1989, the South African merchandise export "quota" (i.e. the ratio of real merchandise exports to real gross domestic product) rose from some 17 per cent in 1987 to more than 20 per cent in 1989.

Net capital movements not related to reserves



Capital account

The total outflow of capital not related to reserves, which had shrunk quite dramatically from nearly R1,5 billion in the second quarter of 1989 to only R0,5 billion in the third quarter, rose sharply again to R1,7 billion in the fourth quarter. For the year 1989, however, the total outflow of capital fell to R5,6 billion, from R6,5 billion in 1988. This was the result of substantially smaller outflows of short-term capital.

The renewed rise in the outflow of non-reserve-related capital in the fourth quarter of 1989 was due to a recurrence of outflows of long-term capital and to a substantial increase in the outflows of short-term capital. The outflows would appear to have comprised an increase in South African residents' short-term foreign asset holdings as well as debt repayments in

Net capital movements (not related to reserves)
R millions

	1988	1989				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	-433	-306	-143	-170	-20	-639
Public corporations	-636	124	316	-62	58	436
Private sector	-33	-213	-901	411	-319	-1 022
Total long-term capital	-1 102	-395	-728	179	-281	-1 225
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities	-5 444	-1 456	-752	-678	-1 445	-4 331
Total capital movements excluding liabilities related to reserves	-6 546	-1 851	-1 480	-499	-1 726	-5 556

terms of the standstill arrangements and repayments on debt outside the standstill net.

Long-term capital movements reverted from an inflow of R179 million in the third quarter of 1989 to an outflow of R281 million in the ensuing three months, mainly because of large net ouflows of private capital. Public corporations, which had made small net repayments on their foreign indebtedness in the third quarter, were net borrowers of foreign funds again in the fourth quarter. In the course of 1989, public corporations actually attracted new foreign capital – mostly in the form of project financing – to a significant net amount of R436 million.

Large net *sales* by foreigners of securities listed on the Johannesburg Stock Exchange in the first half of 1989 (which had amounted to R650 million) were replaced by large net *purchases* of such securities in the second half of the year. Non-residents' increased buying and selling operations on the Johannesburg Stock Exchange – which had their origins largely in overseas investors' improved perceptions of South Africa's socio-political situation and prospects, but also involved the process of switching by these investors from company shares to interest-bearing securities referred to earlier – were, in fact, a major feature of trading activity in the South African capital markets in the third and the fourth quarter of 1989.

The outflow of *short-term* capital doubled from R0,7 billion in the third quarter of 1989 to R1,4 billion in the fourth quarter; the fourth-quarter outflow somewhat exceeded the quarterly average of such outflows in the past two calendar years. Included in the outflow of short-term capital in the fourth quarter was an increase of some R0,8 billion in South African residents' foreign asset holdings in the form of trade financing.

Foreign reserves

The South African *total gross* and other foreign reserves, which had increased by R671 million during the first nine months of 1989, fell back by R470 million in the fourth quarter. In terms of the US dollar, however, the total gross reserves still rose fractionally (by $5 million) from the end of September 1989 to the end of December. To a significant extent, moreover, the fourth-quarter decline in the rand value of the gross reserves was accounted for by a reduction (i.e. by redemptions) of short-term foreign liabilities. The total *net* gold and other foreign reserves, which had increased by R429 milllion in the third quarter, shrank by R307 million in the fourth quarter.

In the period January-February 1990 the gross and the net gold and other foreign reserves of the Reserve Bank rose encouragingly by R632 million and by as much as R2 913 million respectively. The total gold reserves of the Reserve Bank, which had shrunk from 3,6 million fine ounces at the end of September 1989 to 3,0 million fine ounces at the end of January 1990, recovered to 3,5 million fine ounces at the end of February.

Exchange rates

The effective exchange rate of the rand, although stronger on average in the third quarter of 1989 than in the preceding three months, recorded its lowest level ever on 18 September 1989; on the same date, the value of the rand in terms of the US dollar reached a near-record low of $0,3536 per rand (equalling R2,8280 per dollar). The effective exchange rate then strengthened, however, by 7 per cent from 18 September up to the end of the year.

The recovery of the rand in the last 3½ months of 1989 mainly reflected weakening of the US dollar (against the German mark in particular), South Africa's large and well-sustained current account surpluses, and the upward movement of the dollar price of gold from its low point of $357,70 per fine ounce on 15 September. Apart from strengthening against the dollar, the rand also gained ground significantly against sterling and the Japanese yen during this period.

During 1989 as a whole, the effective exchange rate of the rand declined by 3,8 per cent. Appreciations of the rand against sterling and the yen were overshadowed by depreciations against all other major currencies.

Exchange rates

Changes in exchange rates of the rand
%

	18 Sept 1989 to 31 Dec 1989	31 Dec 1988 to 31 Dec 1989	31 Dec 1989 to 28 Feb 1990
Weighted average	7,0	–3,8	–1,1
US dollar	11,0	–6,7	–0,3
British pound	8,2	4,2	–5,1
German mark	–4,4	–11,8	–0,1
Swiss franc	0,9	–5,1	–3,8
Japanese yen	8,9	6,3	3,3
French franc	–3,2	–11,6	–1,0
Financial rand	12,7	6,8	–2,3

In January and February 1990 the effective exchange rate of the rand essentially held stable at the higher levels it had attained towards the end of 1989. It weakened, on balance, by a modest 1,1 per cent over this two-month period.

The *financial* rand appreciated remarkably, by 28½ per cent, from its recent low point of R4,38 to the US dollar on 25 August 1989 to R3,40 per dollar at the end of January 1990; following the State President's address at the opening of Parliament on 2 February 1990, it strengthened further to R3,13 per dollar on 6 February. This improvement could be attributed mainly to non-residents' favourable impressions of some of the South African government's recent and current socio-political initiatives and to the accompanying surge in foreign investors' demand for South African securities.

The financial rand's discount vis-à-vis the commercial rand narrowed substantially from 36,9 per cent on 25 August 1989 to 28,9 per cent at the end of December and to 19,2 per cent on 6 February 1990. By the end of February, however, the financial rand had depreciated again to a level of R3,67 to the dollar. Its discount vis-à-vis the commercial rand then stood at 30,3 per cent.

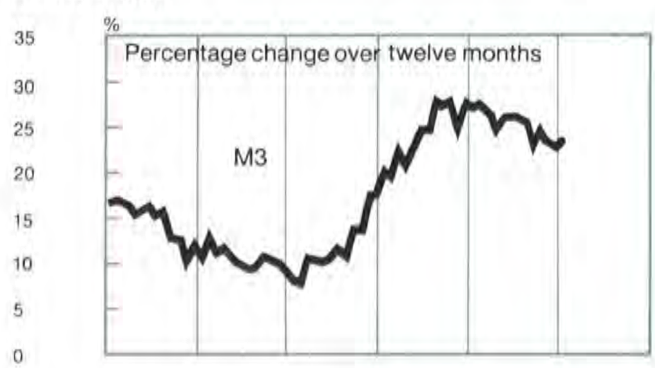
Financial markets

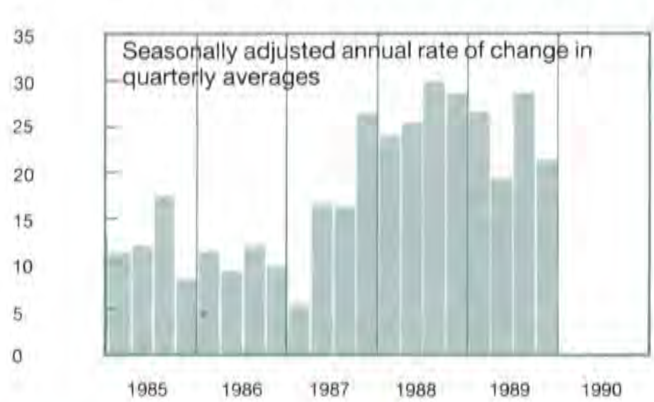
Money supply

The rate of increase in the M3 money supply over twelve-month periods, which had peaked at 27,9 per cent in August 1988, retreated fairly gradually to 22,9 per cent in September 1989, but reaccelerated to 24,6 per cent in October. The October reacceleration in money growth could partly be contributed to the additional extension of bank credit and creation of bank deposits that preceded the share issue by Iscor in early November. In the absence of similar disturbing elements, the twelve-month growth rate in M3 subsequently retreated again to 23,3 per cent in November 1989 and to 22,7 per cent in December. It then reaccelerated once more, however, to 23,6 per cent in January 1990.

Renewed deposit interest rate increases from September 1989, the Bank rate increase of 11 October, expectations of possible further increases in interest rates, and an unforthcoming policy stance of the Reserve Bank at the discount window, resulted in renewed downward pressure on banks' interest rate margins and sustained phenomena of reintermediation and "liquidity preference proper". These are likely to have

Money supply





added significantly to the observed rates of monetary expansion in late 1989 and early 1990. On balance, the seasonally adjusted and annualised *quarter-to-quarter* rate of growth in the quarterly average of M3 nevertheless fell back appreciably – although as yet inadequately – from its high point of 29,5 per cent in the third quarter of 1988 to 20,9 per cent in the fourth quarter of 1989.

The domestic private non-banking sector's holdings of negotiable certificates of deposit (as included in M3) rose by no less than R9,2 billion from the end of December 1988 to the end of December 1989, contributing more than one third to the increase of R27,0 billion in M3 during this period.

The more recent quarter-to-quarter rates of increase in M3, although at lower levels than in late 1988, nevertheless continued to exceed the quarter-to-quarter rates of growth in gross domestic product at current prices. M3's velocity of circulation accordingly shrank further to 1,745 in the fourth quarter of 1989, from its most recent peak value of 2,005 in the first quarter of 1987 and from 1,803 in the third quarter of 1989. Velocity in the fourth quarter of 1989 was actually at its lowest level since the fourth quarter of 1976.

Partly because of the enduring role of "liquidity preference proper" in depositors' investment decisions, growth in M3 remained concentrated in deposits with unexpired maturities of more than one day but not exceeding six months (i.e. in "other short" and medium-term deposits), on which, in addition, comparatively high interest could be earned. In December 1989, the twelve-month rate of increase in "other short" and medium-term deposits amounted to no less than 40,7 per cent. The comparatively very rapid growth in these deposits caused their share in M3 to be raised from 43,8 per cent in December 1988 to more than half of the total (50,2 per cent) in December 1989. Conversely, the twelve-month rate of increase in the *long-term* deposit liabilities of monetary institutions as in December 1989 still amounted to only a slender 4,8 per cent.

Quarter-to-quarter and twelve-month rates of increase in the narrower monetary aggregates, M1A and M1, generally remained well below those of M3 in the course of 1989. In December 1989 the twelve-month rates of increase in M1A and M1 amounted to 10,8 and 10,9 per cent. Relatively slow growth in M1A was a reflection of a more limited expansion of the demand for money for transaction purposes and of the non-interestearning nature of important components of the M1A aggregate. In contrast, the twelve-month rate of increase in M2 - because of the explosive growth in its "other short" and medium-term deposit component already referred to – in December 1989 amounted to a substantial 27,4 per cent.

In the statistical or accounting sense, the R27,0 billion increase in M3 from the end of December 1988 to the end of December 1989 was explained primarily by a R24,6 billion increase in monetary institutions' credit to the domestic private sector. Monetary institutions' net claims on the *government* sector *de*creased by R2,7 billion during 1989; in addition, their net gold and other foreign reserve holdings declined by R1,5 billion during this period. "Net other assets" of the money-creating sector – including the Reserve Bank's claims on the Treasury on account of shortfalls experienced in the Bank's provision of forward foreign exchange cover – made a positive contribution to M3 of R6,6 billion during the twelve months concerned.

The 1989 targeting year

The increase in the quarterly average of M3 from the fourth quarter of 1988 to the fourth quarter of 1989 amounted to 23,5 per cent. This should be compared with the 18 per cent upper limit to the 1989 target range for the M3 money supply of 14 to 18 per cent. At R141,5 billion, M3's quarterly average level in the fourth quarter of 1989 exceeded the upper boundary of the target by R6,3 billion or 4,7 per cent.

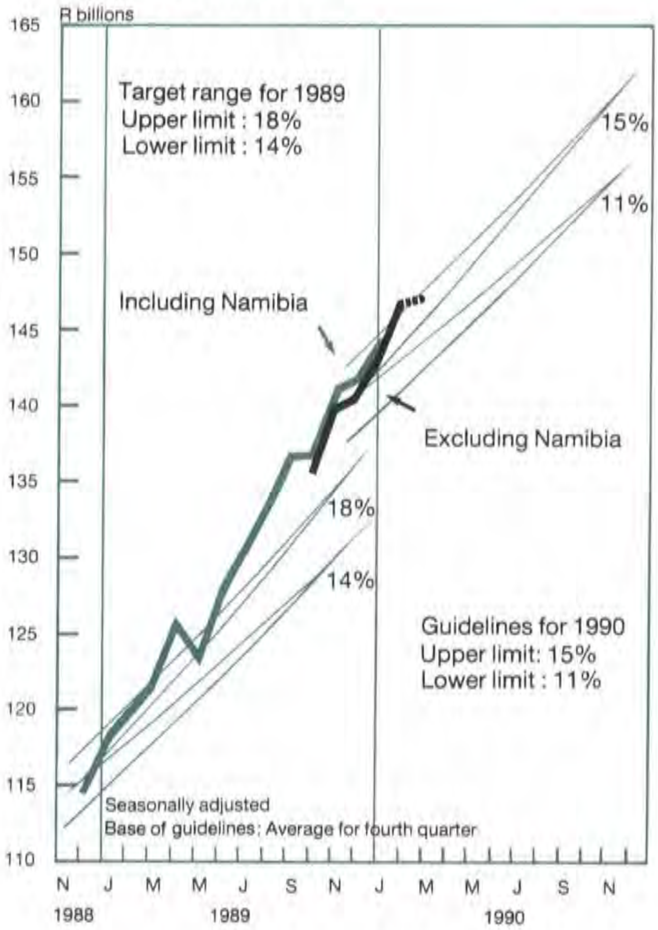
Sustained rapid growth in M3 through the fourth quarter of 1988 caused the month-end values of M3 to lie above the upper limit of the target "cone" for 1989 from the end of December 1988 onwards. From as early as February 1989, the month-end values of M3 also exceeded the upper boundary of the new target "tunnel". With the exception of April 1989, they continued to do so throughout the remainder of the 1989 targeting year.

The income velocity of circulation of M3 declined on balance during the targeting year. This followed a similar decline in velocity (of 6,8 per cent) from the fourth quarter of 1987 to the fourth quarter of 1988; in 1987, on the other hand, M3's velocity of circulation had receded only marginally (by 1,0 per cent) from the peak value it had attained in the first quarter of that year to the fourth quarter.

Gross domestic product at current prices rose by 16,5 per cent from the fourth quarter of 1988 to the fourth quarter of 1989. M3's increase of 23,5 per cent over that period, as calculated for targeting purposes, accordingly meant a decline in M3's velocity of circulation of approximately 5,7 per cent. As in earlier targeting years, the increase in the "effective" or "velocity-adjusted" M3 money supply (i.e. the increase in M x V, which by definition must be equal to the increase in the gross domestic product at current prices of 16,5 per cent in 1989) therefore fell close to the centre point of the 14 to 18 per cent target range.

Growth in M3 at rates well in excess of the upper limit of the target range, in conjunction with the observed behaviour of inflation, the balance of payments/foreign reserves/exchange rate situation and various other considerations, was a factor in guiding the authorities' policy actions during 1989. These included three upward revisions of Bank rate during

Guidelines for growth in M3



the year and the generally stringent posture assumed by the Reserve Bank in its extension of refinancing accommodation at the discount window. As in preceding years, the observed behaviour of M3 relative to its target path should therefore again have proved of assistance to private-sector parties in formulating expectations concerning the monetary authorities' future policy stance.

New guidelines for the rate of increase in M3 of 11 to 15 per cent between the fourth quarter of 1989 and the fourth quarter of 1990 were unannounced by the Governor of the Reserve Bank on 23 March 1990. The full text of the Governor's statement is published on page 43 of this *Bulletin*.

Credit extension by monetary institutions

The *twelve-month* rate of increase in all monetary institutions' claims on the private sector decreased fairly steadily from its peak value of 30,8 per cent in October 1988 to 20,7 per cent in December 1989. The *quarter-to-quarter* rate of increase in the quarterly

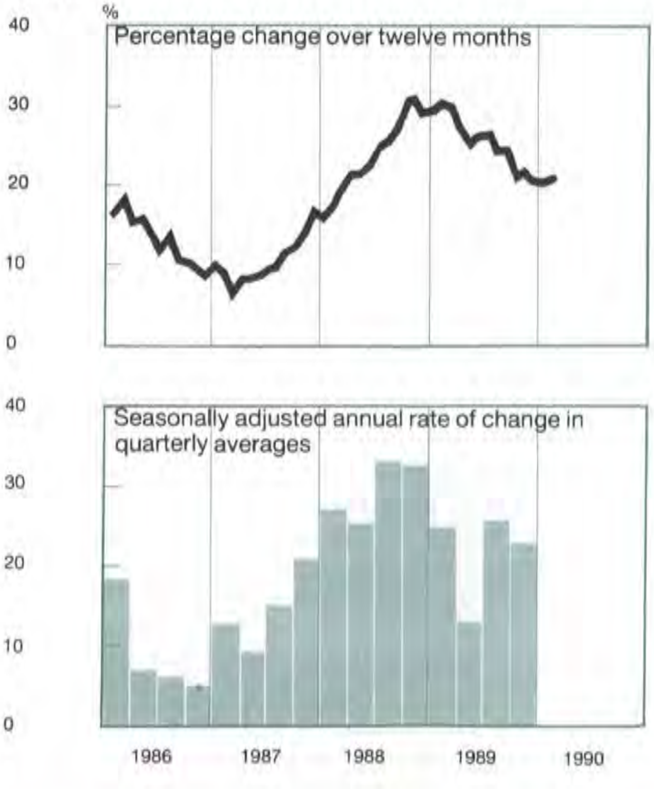
Changes in monetary institutions' claims on the domestic private sector

January to December 1989

	R billions	%
Bills discounted	1,5	21,4
Investments	0,1	4,3
Hire-purchase credit	3,2	25,7
Leasing finance	2,2	30,8
Mortgage advances	8,9	19,6
Other advances	8,6	19,6
Total	24,6	20,7

average of these claims, seasonally adjusted and unnualised, retreated, on balance, from high points of well over 30 per cent in the third and the fourth quarter of 1988 to 22,9 per cent in the fourth quarter of 1989. The generally downward trend of this growth rate was, however, disturbed severely by an uncommonly low, and inadequately explained, level of monetary institutions' credit extension to the private sector as at the end of April 1989. (A similar random element in the M3 money supply at the end of April 1989 also affected the course of the quarter-to-quarter growth rates of M3 in 1989.) Because of this disturbance, the quarter-to-quarter growth rate in the money-creating institutions'

Claims of monetary institutions on domestic private sector



claims on the private sector fell back to only 12,8 per cent in the second quarter of 1989 before rising again, partly by way of reaction, to 25,7 per cent in the ensuing three months.

The downward drift of the rate of increase in monetary institutions' credit to the private sector in 1989 could be explained by, among other things, lower rates of increase in gross domestic product and expenditure at current prices, the declining values of merchandise imports and exports and reductions of real inventories in the second half of 1989, a decline in the demand for mortgage finance, and households' increased hesitance to enter into new debt commitments, as well as by the relatively high level of interest rates in the present early-consolidation phase of the business cycle and by the stricter criteria now applied by monetary institutions when providing new credit facilities.

Against these various conditions making for a slowdown in new credit extension, corporate borrowers' liquidity was lower in the past several quarters than in 1987 or 1988. In addition, households may occasionally have felt themselves "forced" to make increased use of personal overdrafts or credit card facilities because of the strains imposed on family budgets by, for example, significantly higher levels of their monthly mortgage payments.

At the same time, however, the level of measured credit extension was supported by the various reintermediation phenomena that also held up the growth rates of the M3 money supply. If it can be assumed that reintermediation was responsible for the margin by which the growth rate in measured credit outstanding exceeded the growth rate in the nominal gross domestic product in the past several calendar quarters, reintermediation phenomena would have accounted for an approximate 4,7 percentage points or more than one fifth of the 21,2 per cent rise in the quarterly average of monetary institutions' claims on the private sector from the fourth quarter of 1988 to the fourth quarter of 1989.

An analysis by *type* of credit of the R24,6 billion increase in the money-creating institutions' claims on the private sector from the end of December 1988 to the end of December 1989 shows that expansions of these institutions' mortgage advances and "other" advances outstanding each accounted for over one third of the overall increase in these claims. More rapid *rates* of growth were, however, displayed by hire-purchase credit and leasing finance.

The total of hire-purchase credit and leasing finance rose by R1,1 billion in the fourth quarter of 1989, following increases of R1,4 billion, R1,4 billion and R1,5 billion in the preceding three quarters. The extent of the slow-down in the fourth quarter is, of course, more significant when allowance is made for inflation. The extension of new mortgage finance similarly decelerated during the year; the quarterly increases in this kind of lending declined from R2,6 billion in each of the first two quarters of 1989 to R1,9 billion in each of the final two quarters.

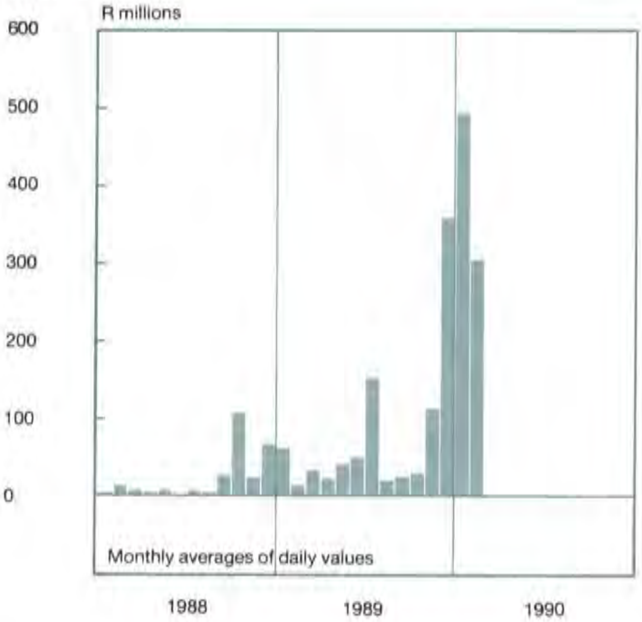
Consumer durables and monetary hire-purchase and leasing credit extended

Reserve Bank operations in the money market

Money market conditions, as measured by the market's needs for Reserve Bank accommodation, tightened considerably in the course of 1989 and remained tight during the first 2½ months of 1990. The average daily level of the Bank's accommodation of the market at the discount window amounted to R1,8 billion in the first half of 1989, but rose to R3,3 billion in the third quarter and R3,8 billion in the fourth quarter of 1989 and to R4,8 billion and R3,9 billion in January and February 1990 respectively. Accommodation at the window reached highs of R4,8 billion on 23 December 1989, R5,4 billion on 10 January 1990, and R5,5 billion on 31 January. In *real* terms, however, these amounts still did not match the amount of R2,8 billion that had been recorded on 5 July 1984, which would have exceeded R6 billion at present-day price levels.

In accounting terms, the market's shortages up to and during December and early January could be explained from intermittent declines in the net gold and other foreign reserves, the high and rising level of government deposits with the Reserve Bank, and the very large seasonal increase in banknotes in circulation over the December holiday period. The daily average of the amount of notes in circulation rose from R7,9 billion in November 1989 to R9,4 billion in December; it broke all previous records by reaching a peak daily figure of R9,8 billion on 21 December. The daily average of the note circulation then retreated to R8,1 billion in January 1990 and to R7,9 billion in February.

Overnight loans



The more recent market shortages have remained linked to the high but varying level of government deposits with the Reserve Bank. During both January and February 1990, however, the shortages were alleviated significantly by marked increases in the Reserve Bank's net gold and other foreign reserves.

Assistance to the market by other means than refinancing at the discount window was provided during the period 27 December 1989 to 15 January 1990, and again from 22 January 1990 into February, in particular; certain forms of this assistance were, however, maintained or rolled over more continually. Varieties of such assistance included the buying of short-dated assets (either outright or under repurchase agreements) by the Corporation for Public Deposits, purchases of money market assets by the Public Investment Commissioners, and the placement with banking institutions of deposits that normally would have been held with the CPD. Overnight loans to banking institutions (as a less attractive supplement to the rediscounting of bills at the discount window) nevertheless rose from a daily average of R75 million in 1989 to R492 million in January 1990 and to R304 million in February.

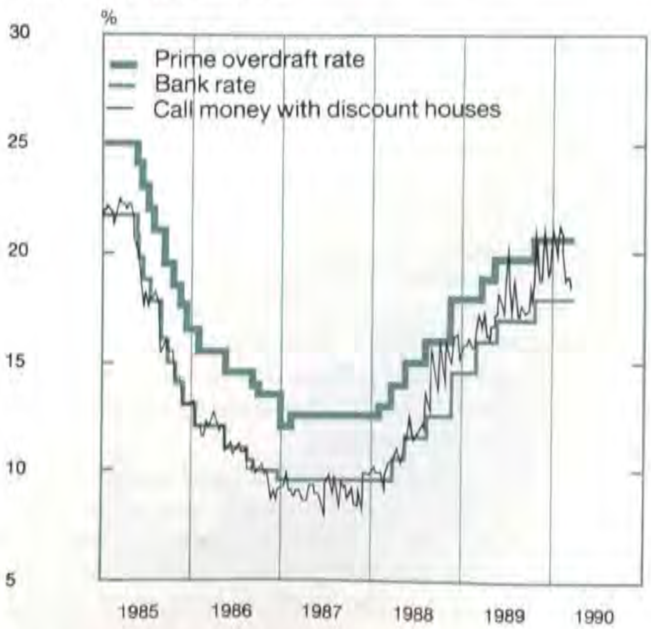
Net sales of government stock by the Reserve Bank during the fourth quarter of 1989 amounted to R1,4 billion. From 1 January 1990 to 28 February 1990 further sales amounting to R0,6 billion was concluded. A part of the proceeds from these sales was deposited in the stabilisation account that was re-established in September 1989.

Money market interest rates

Money market interest rates adjusted to the Bank rate increase (from 17 to 18 per cent) of 11 October 1989. The rate on liquid three-month bankers' acceptances rose from 17,35 per cent immediately prior to this Bank rate increase to 18,35 per cent immediately thereafter. During the remainder of 1989 the three-month acceptance rate varied between a high point of 18,80 per cent (from 18 to 21 November) and a low point of 18,25 per cent (on 13 December); it amounted to 18,35 per cent over the December month-end. In the tight liquidity conditions of early 1990 this rate subsequently hardened again to 18,70 per cent over the January month-end, before again easing somewhat to 18,40 per cent by mid-February and to 18,50 per cent at the February month-end.

Following the announcement by the Reserve Bank of penal rates of up to 22,75 per cent on accommodation in the form of overnight loans from 11 October 1989 onwards, rates on interbank funds and wholesale call deposits rose more sharply than rates on other money market instruments of somewhat longer maturity. The discount houses' call rate, for example, firmed from 18,50 per cent at the end of September 1989 to 21,25 per cent over each of the subsequent four month-ends before declining somewhat to 20,00 per cent at the end of February 1990. The yield curve in respect of money market instruments became more strongly inverse in the wake of the combination of penal rates on overnight loan accommodation and the generally high level of the money market shortages.

Short-term interest rates

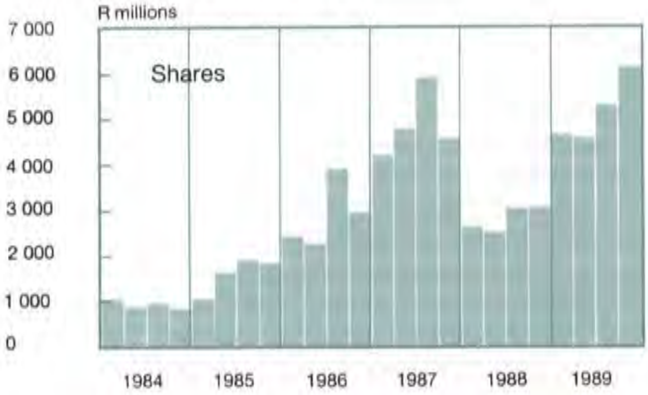


Capital market developments

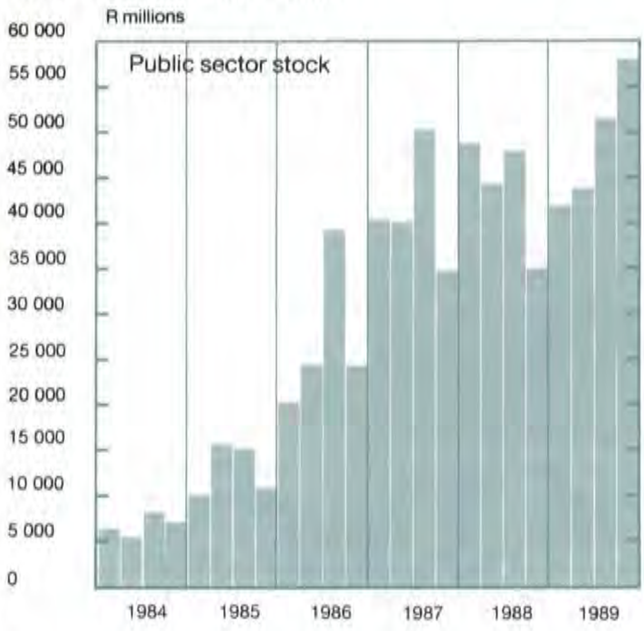
Trading activity in the capital markets, which had already recovered vigorously in the third quarter of 1989, generally showed substantial further increases in the fourth quarter of 1989 and the first two months of 1990. Significant further advances in share prices were recorded on the Johannesburg Stock Exchange. A small further increase was also recorded in the value of real estate transactions.

The value of *public sector stock* traded on the stock exchange rose by 13 per cent to a new record level of R58,1 billion in the fourth quarter of 1989 from its previous record level of R51,5 billion in the third quarter. In January and February 1990 the monthly average of the turnover of these stocks rose further to a wholly unprecedented R29,1 billion, from approximately R19,4 billion in the fourth quarter of 1989.

Stock exchange transactions



Stock exchange transactions

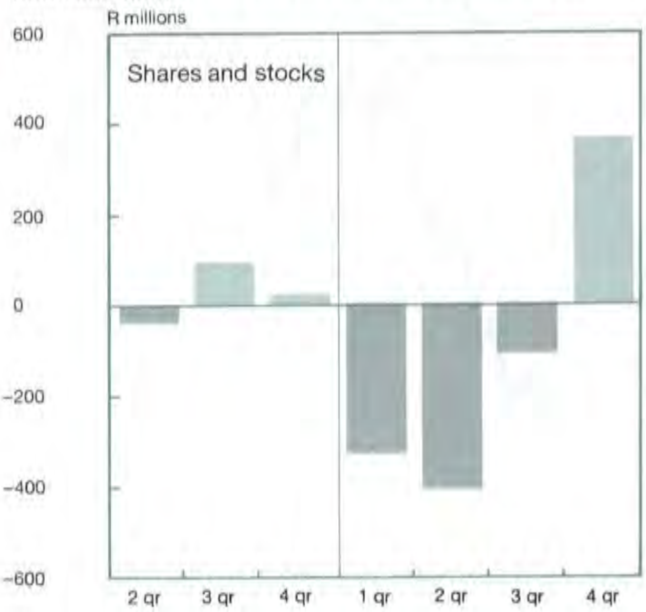


The value of *shares* traded on the stock exchange rose from R5,3 billion in the third quarter of 1989 to R6,2 billion in the fourth quarter, thereby exceeding for the first time the record quarterly amount (of R5,9 billion) of shares traded in the third quarter of 1987. The monthly average turnover of shares subsequently rose further from nearly R2,1 billion in the fourth quarter of 1989 to R2,9 billion in January and February 1990.

Net *purchases* of public sector stock by *non-residents* on the Johannesburg Stock Exchange decreased from R1,2 billion in the third quarter of 1989 to R0,9 billion in the fourth quarter. In the course of 1989, non-residents' total net purchases of such stock reached an amount of R2,9 billion. Further such purchases were made in January-February 1990 to a net amount of R0,5 billion.

Net *sales* of *shares* by non-residents similarly dropped from R1,3 billion in the third quarter of 1989 to R0,5 billion in the fourth quarter. The total amount of these sales by non-residents in the course of 1989 was approximately R3,4 billion. During January-February 1990 foreign investors took advantage of both the buoyant state of the South African share market and the prevailing relative strength of the

Johannesburg Stock Exchange: Net purchases by non-residents



financial rand. The net amount of sales of shares by non-residents through members of the Stock Exchange during these two months ran to R1,9 billion.

The average *price level* of all classes of shares, which had risen by 9 per cent in the third quarter of 1989, increased by a further 7 per cent in the fourth quarter and by 5 per cent in January-February 1990. These further increases in the general level of share prices mainly resulted from increases in the prices of financial and gold mining shares, which rose by 3 per cent and by as much as 34 per cent in the fourth quarter of 1989; the prices of gold mining shares then rose marginally further in January 1990, but fell back by 5 per cent in February, whereas financial share prices rose by another 8 per cent in January-February. In contrast, the average price level of industrial and commercial shares *dropped* by 8 per cent in the fourth quarter of 1989; it recovered, however, by 13 per cent in January-February. Sustained relative bullishness in large segments of the share market in late 1989 and early 1990 and its underlying causes (such as the rise in the gold price to above the $400 mark from late November 1989, mildly more sanguine inflation expectations, a more relaxed socio-political atmosphere, and a marked softening of long-term interest rates) also played a part in sustaining business confidence and consumer sentiment and contributed to the softness of the economy's "landing" in the fourth and early fifth quarter of its current consolidation phase.

JSE-Actuaries' indices and gold price

Despite the lively condition of the share market in the fourth quarter of 1989, the average price levels of gold mining shares, industrial and commercial shares and "all classes" of shares in December 1989 still fell short by 12, 10 and 2 per cent of their respective peaks in September 1987. Further increases of 2, 8 and 6 per cent respectively were, however, recorded in January 1990 in the average prices of gold mining shares, industrial and commercial shares, and financial shares. As a result, the average prices of financial shares and "all shares" as in January 1990 exceeded their earlier record levels of September 1987 by 9 and 2 per cent.

In the primary market, a net *repayment* of R0,8 billion was made in the fourth quarter of 1989 to banks and private non-bank investors in public sector stock, compared with an amount of net new issues of R3,0 billion in the third quarter of 1989. *Private companies*, which had raised a total of R156 million through new issues of fixed-interest securities in the third quarter of 1989, raised R111 million by means of such issues in the fourth quarter. Issues of ordinary shares by such companies rose from R2,1 billion in the third quarter to R5,3 billion in the fourth quarter. This sharp increase was, however, mainly due to the R3,1 billion privatisation issue by Iscor Ltd., which was listed on 8 November 1989.

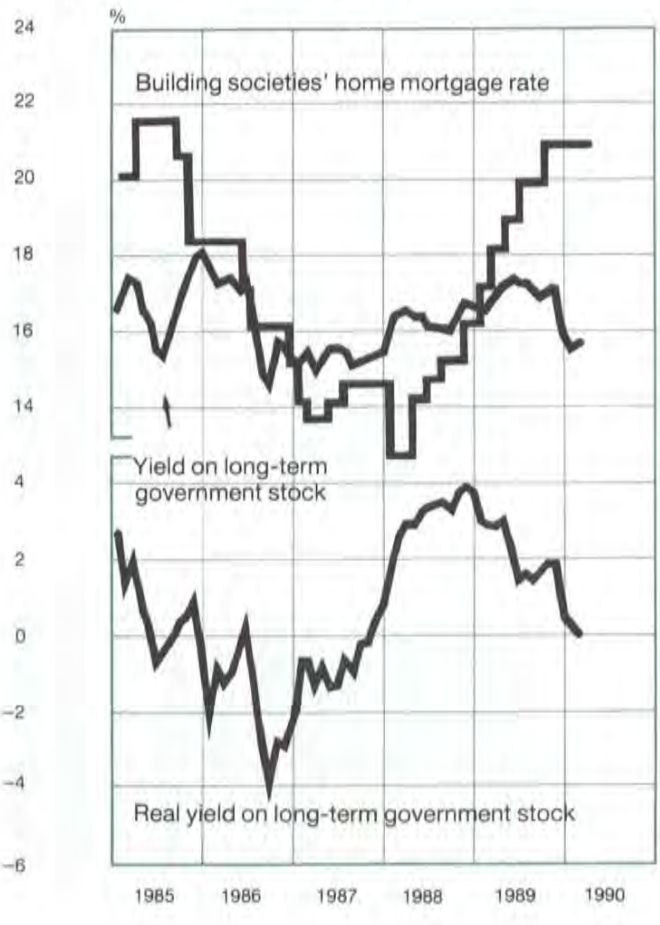
In the *mortgage market* the amount of mortgage loans paid out by building societies, which had declined from its record level of R2,7 billion in the third quarter of 1988 to R1,4 billion in the third quarter of 1989, recovered slightly to R1,5 billion in the fourth quarter of 1989. The increase in building societies' total *holdings* of mortgage loans, which had amounted to R0,5 billion in the third quarter of 1989, was maintained at that level in the fourth quarter. In contrast, the increase in *banking institutions'* holdings of mortgage loans (which, on a quarterly basis, has consistently exceeded the increase in the building societies' holdings from the beginning of 1988 onward) retreated fairly substantially from R1,0 billion in the third quarter of 1989 to R0,8 billion in the fourth quarter.

The value of *real estate transactions* nearly doubled (in nominal terms) from the third quarter of 1986 to the fourth quarter of 1988, but appeared to have topped out (at R4,8 billion) in the first quarter of 1989. It then rose again, however, to new record amounts of R5,3 billion in the second quarter of 1989, R5,4 billion in the third quarter and R5,6 billion in the fourth quarter.

Yields and interest rates

The monthly average *yield on long-term government stock*, which had eased from 17,4 per cent in May 1989 to 16,8 per cent in September, firmed marginally to 16,9 per cent in October, partly under the impact of the Bank rate increase of 11 October. Various factors – such as completion of the Central Government's borrowing programme for budgetary purposes in the fiscal year 1989/90, the increased strength of the dollar price of gold and of the South African economy's external position generally, more favourable foreign perceptions of current and prospective South African socio-political developments, non-residents' markedly enhanced interest in South African securities, and more favourable views of the somewhat longer-term prospects for the inflation rate - subsequently caused this rate to fall back appreciably to 15,8 per cent in December and to 15,5 per cent in January 1990. However, this rate then hardened marginally again (to 15,6 per cent) in February in the light of the market's uncertainties concerning potential longer-run politico-economic developments.

Long-term interest rates and yields



The further recovery of share prices in the fourth quarter of 1989 did not prevent another increase in the monthly average dividend yield on all classes of shares from 5,2 per cent in September 1989 to 5,7 per cent in December, mainly on the basis of improved financial results of industrial companies in particular. The average dividend yield then eased, however, to 5,5 per cent in February 1990. The average *earnings* yield on industrial shares that are listed on the Johannesburg Stock Exchange strengthened markedly from 14,5 per cent in September 1989 to 21,2 per cent in December, but retreated to 20,7 per cent in February 1990.

The building societies' predominant home mortgage rate, which had been raised to 19,75 per cent in June 1989, was held at this level in the ensuing four months. Following the increase in Bank rate on 11 October, this rate was raised in October to 20,75 per cent with immediate effect for new mortgage loans and with effect from 1 December 1989 for existing mortgage loans.

Also following the Bank rate increase of 11 October, the predominant rate on twelve-month deposits with banks and building societies, which is regarded as indicative of deposit rates in general, was raised from 16,5 per cent to 17,0 per cent.

Government finance

Outcome of Central Government Budget for fiscal 1989/90

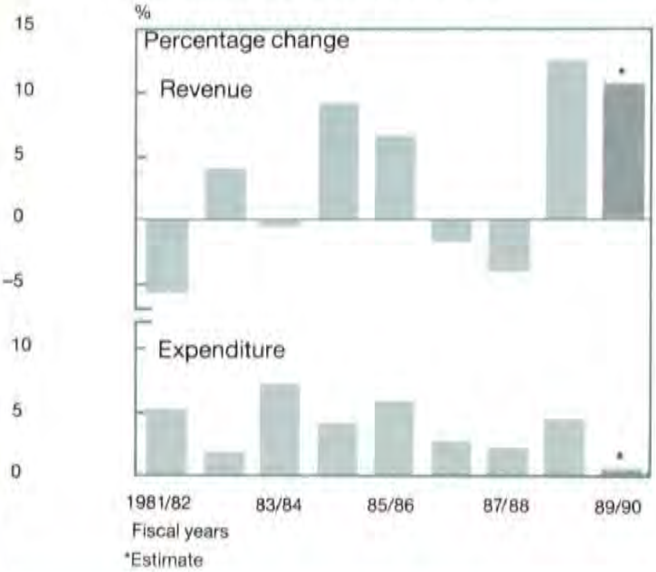
Principal features of the expected outcome of the Central Government Budget for the fiscal year 1989/90, as reported on by the Minister of Finance in his Budget speech of 14 March 1990, were, firstly, the high degree of discipline that had been exercised by the authorities over government expenditure during the year. This would result in actual total expenditure in the fiscal year 1989/90 being very close to the original Budget estimates. Secondly, government revenue had been under-estimated to an uncommonly large degree. Between them, these two features were set to result in an eventual deficit before borrowing and debt repayment for the fiscal year 1989/90 as a whole that would be considerably smaller than had been envisaged in the Budget speech of March 1989. At the same time, the actual impact on the economy of the Central Government's fiscal operations in 1989/90 was considerably more restrictive than had been either intended or foreseen in the March 1989 Budget proposals. These proposals, in fact, had been expected to be mildly expansionary in their effect on the then prevailing and anticipated business conditions.

Exchequer *issues* to government departments in fiscal 1989/90 were estimated by the Minister ultimately to amount to R65 181 million. This would be only 1,8 per cent higher than the estimate of total expenditure of R64 017 million in the Budget of March 1989, and an insignificant R164 million, or 0,3 per cent, higher than the expenditure provided for in that Budget after inclusion in the estimates of the additional R1 000 million that had been allowed for unforeseen spending needs. The extent of this overspending could be compared with overspending to an amount of 5,1 per cent of originally budgeted expenditure in fiscal 1988/89, and with an average "overspending ratio" of 6,5 per cent in the five fiscal years from 1984/85 to 1988/89. The year-on-year increase in government expenditure in fiscal 1989/90 would amount to 15,2 per cent. This meant an increase of only 0,1 per cent in real or inflation-adjusted terms.

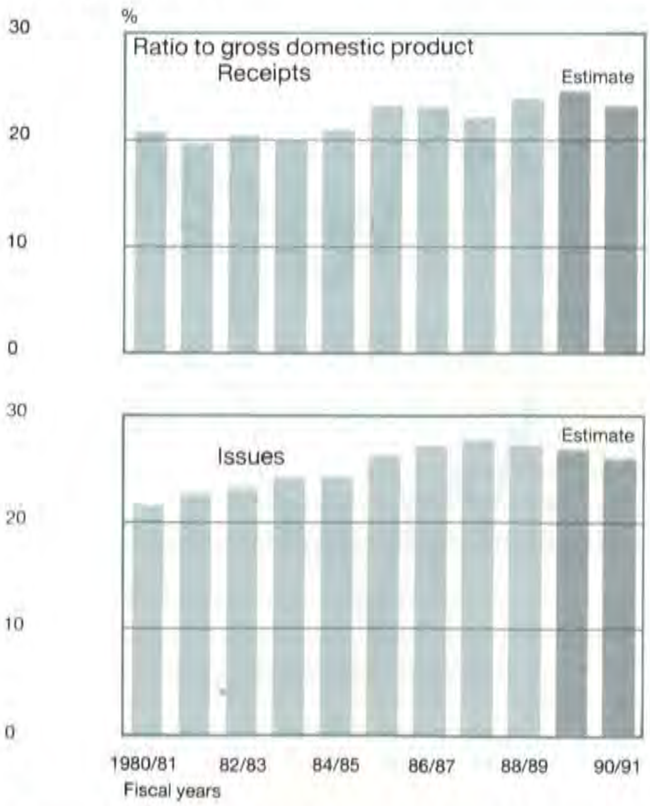
Total revenue *receipts* in fiscal 1989/90 were estimated by the Minister eventually to amount to R61 385 million. This would exceed the original Budget estimates by a very large amount of R6 317 million, or by 11,5 per cent. It would also exceed government revenue in the fiscal year 1988/89 by an unprecedented 27,3 per cent, or by a large 10,6 per cent in real terms.

Marked excesses of the anticipated actual revenue receipts over the original Budget estimates were recorded both in customs and excise duties and in the receipts from inland revenue. Receipts from customs and excise duties were expected by the Minister to exceed the Budget estimates by R1 444 million (i.e. by some 19,7 per cent), and would be roughly one quarter

Real government revenue and expenditure



Exchequer Account



Revenue collections in 1989/90

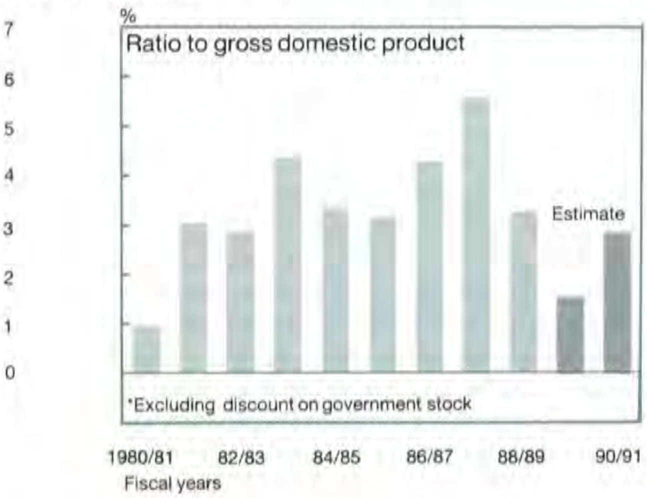
	Budget[1]		Anticipated collections	
	R millions	Percentage change[2]	R millions	Percentage change[2]
Mining companies	2 467	–19,5	2 671	–12,9
Non-mining companies	9 500	16,8	11 001	35,3
Individuals	16 710	15,7	19 558	35,5
General sales tax	16 300	25,7	16 480	27,0
Customs and excise duties	7 320	5,0	8 764	25,7
Other collections	2 771	5,4	2 911	10,7
Total revenue collections	55 068	14,2	61 385	27,3

1 Budget estimates as presented in Budget speech of 15 March 1989.
2 Compared with actual collections during the fiscal year 1988/89.

higher than in the preceding fiscal year. This was mainly due to larger than expected receipts from the fuel levy, the surcharge on imports, and customs duties in general. Expected receipts from excise duties, on the other hand, were likely to fall slightly short of the Budget estimates.

Receipts from inland revenue were expected to exceed the Budget estimates by no less than R4 873 million (i.e. by some 10,2 per cent), and to be as much as 27,6 per cent higher than actual receipts in fiscal 1988/89. With the exception of revenue from gold mining companies, revenue receipts under all major sub-headings of Inland Revenue were expected to end up well above the Budget estimates. Income tax receipts from individuals and from non-mining companies, in particular, were foreseen to have been under-estimated in the March 1989 Budget to amounts of some R2 848 million and R1 501 million respectively.

Exchequer deficit*



On the basis of the anticipated outcomes of both government expenditure and government revenue, the deficit before borrowing and debt repayment for the fiscal year 1989/90 was foreseen by the Minister to amount to only R3 796 million, or a mere 1,5 per cent of the projected gross domestic product during the four calendar quarters concerned. This could be compared with the actual deficit of R8 395 million (4,0 per cent of gross domestic product) in fiscal 1988/89, and with the deficit of R9 949 million (4,1 per cent of the then expected gross domestic product) that had been envisaged for fiscal 1989/90 in the Budget of March 1989. The deficit of R3 796 million, as foreseen by the Minister, would be financed in the following manner:

	R millions
Government stock (net)	7 080
Non-marketable securities (net)	–800
Foreign loans[1] (net)	–155
Loan levy	700
Use of available cash balances[2]	936
Transfers to:	
State pension funds	–1 000
Reserve Bank (i.r.o. shortfalls on forward exchange transactions)	–3 000
Fund for socio-economic actions	–2 000
Other (including Stabilisation Account)	–970
Sale of assets (privatisation proceeds)	3 005
Total	3 796

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

The 1990/91 Budget of the Central Government

In his presentation of the 1990/91 Budget of the Central Government to Parliament on 14 March 1990, the Minister of Finance stated that this Budget, and the

Budgets for the next few years, would have to comply with three broad objectives or considerations of policy. Firstly, structural changes should be effected in the South African economy, with a view to raising materially the standard of living of the entire South African population. In this restructuring process, the private sector should be recognised as the most important source of economic growth, and factors capable of strengthening this sector's powers of creating income and employment would have to be promoted as much as possible. Special attention would have to be paid to the curbing of inflation and to the alleviation of shortages of skilled manpower and capital. Major attention was, therefore, to be focused on the "supply" or production side of the economy and on making the public sector smaller and more efficient.

Secondly, higher priorities than before would have to be accorded to the pressing socio-economic problems of poverty and of "backlogs" in education and training, housing, literacy and basic health needs. Fiscal discipline would, however, have to be maintained in this process.

Thirdly, macro-economic fiscal policy in its shorter-term aspects should continue to be aimed at the stabilisation of economic activity in the course of the business cycle. Emphasis in such an active stabilisation policy would, however, be placed to an increased extent on the Government's debt and borrowing operations. Adjustments in government *revenue and expenditure* should be made to serve to an enhanced degree the aims of economic restructuring and of socio-economic development.

As regards the Budget's broad twofold aim of, firstly, maximum encouragement of stable long-term economic growth and, secondly, the alleviation of poverty and deprivation, the Minister stated that the developed or "formal" sector of the economy should be strengthened to the maximum possible degree in its powers of creating new and better opportunities for the developing or "informal" sector. To this end, the *revenue* side of the Budget was to be regarded – not least through a lightening of the burden of personal income tax in particular – as the most appropriate area for promoting saving, investment and entrepreneurship. In contrast, little could be done that had not already been done on the revenue side of the Budget to lighten the fiscal burden on the less well-to-do sections of the South African population. For these population groups, therefore, maximum possible provision was to be made in the Budget's proposed *expenditure* plans.

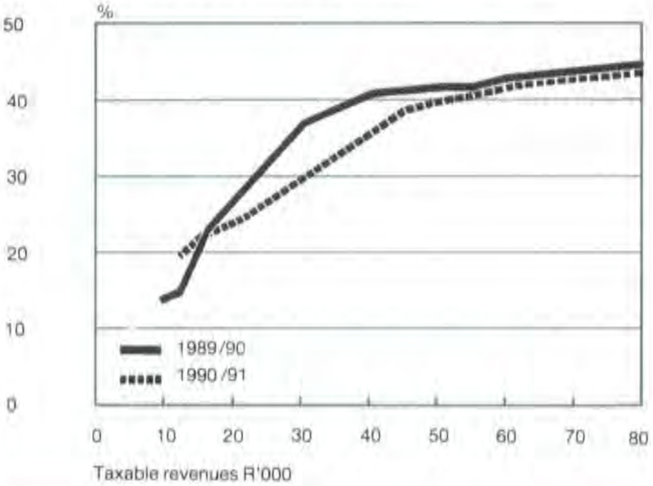
Regarding the specifics of the Government's proposed fiscal measures, the Minister reiterated the Government's commitment to a reduction of taxation on individuals and companies, to the promotion of effective utilisation of labour and capital through the introduction of other appropriate tax reforms, to a lowering of the Budget deficit to levels not exceeding 3 per cent of the gross domestic product and, eventually, to levels that would eliminate government dissaving, to a reduction of the share of government expenditure in the overall economy, to increased emphasis on socio-economic development, and to the promotion of "corporatisation, privatisation and deregulation". In the pursuit of these various aims and endeavours, the Budget for fiscal 1990/91 was to be regarded as the first step in a five-year programme of fiscal reform.

Against the background of these policy intentions, the Minister budgeted for total government *expenditure* in fiscal 1990/91 to an amount of R72 932 million. Included in this amount was a "contingency reserve" for unforeseen expenditures of R1 000 million; *not* included in this amount were any prospective expenditures out of a special capital fund (to amount to R2 000 million) that was to be created out of the Government's borrowing surplus in the fiscal year 1989/90 for the specific purpose of making good "backlogs" among the country's various population groups with regard to their socio-economic conditions and development. The intended establishment of this fund was announced by the Minister of Finance in his Budget speech; particulars regarding its management, purposes and manner of operation were, however, made public by the State President on 16 March. In his statement on 16 March, the State President announced that a further R1 000 million would be made available to the fund out of the prospective proceeds of the privatisation of suitable business enterprises of the General Government.

On the revenue side of the Budget, the Minister made provision for total *revenue receipts* in fiscal 1990/91 of R64 938 million, representing an increase vis-à-vis fiscal 1989/90 of only R3 553 million or 5,8 per cent. Being substantially less than the anticipated inflation rate, this relatively small percentage increase also meant a major reduction in total revenue in real or inflation-adjusted terms.

The more important tax proposals of the 1990/91 Budget comprised an increase in customs and excise duties on liquor and tobacco products; abolition of the *ad valorem* customs and excise duties on jewellery; reductions of the rates of the surcharge on imports by one third or one quarter (namely from 60, 20, 15 and 10 per cent to 40, 15, 10 and 7,5 per cent) as a first step towards the eventual phasing-out of these surcharges; an increase in the taxation of fringe benefits with regard to the use of company cars and of employers' subsidised loans to employees; the exemption from normal income tax of a further R1 000 in earnings of interest and of building society dividends by individuals; the exemption from normal income tax of all other dividends received by individuals and closed corporations; additional allowances for the elderly; further steps towards the separate taxation of married women; and a substantial reduction of personal income tax, mainly through increases in the primary income tax rebates for married male and un-

Marginal tax scale for married men



married taxpayers, reductions of the average tax rates payable by the lower and middle-income groups, and a lowering of the maximum marginal personal income tax rate from 45 to 44 per cent. The new tax scales involved in the last-mentioned of these proposals were structured in such a way as to eliminate most of the "bracket creep" that would otherwise have been experienced in fiscal 1990/91; the lowering of the maximum marginal tax rate to 44 per cent was to be seen as the first step in bringing this rate down to 40 per cent over a five-year period.

Other tax proposals contained in the Budget included a revised implicit specification of the concept of capital gains, through introduction of a "safe haven" notion, so as to exclude from the incurrence of income tax any profits made from the sale of shares that had been held for a period of more than ten years; the phasing-out of certain so-called "tax expenditures", such as tax reductions with regard to the cost of training of employees; changes in the definition of stocks-in-trade with regard to consumable stores and spare parts, and with regard to work in progress in the construction industry; and a partial suspension of the reserves that had originated from the LIFO method of valuation of inventories.

The deficit before borrowing and debt repayment as envisaged by the Minister for the fiscal year 1990/91 amounted to R7 994 million, or to approximately 2,8 per cent of the prospective gross domestic product in the new fiscal year. Given proposed capital expenditure of R5 113 million, the anticipated size of this deficit implied a return to dissaving by the Central Government (on a full-fiscal-year basis) to an amount of R2 881 million. Revenue, expenditure and the deficit as budgeted for, and the proposed manner of financing of the deficit, are summarised in the accompanying table.

1990/91 Budget of the Central Government

	R millions
Revenue	64 938
Expenditure	72 932
Deficit (before borrowing and debt repayment)	7 994
Financing (net of debt repayment):	
Government stock issues (net)	8 021
Non-marketable securities (net)	–175
Debt standstill and foreign funds (net)	174
Available balances[1]	–26
Total	7 994

1 Increase –; decrease +.

Post Office Budget for 1990/91

In the Post Office Budget for 1990/91, which was presented to Parliament on 26 February 1990, operating expenditure of the Department of Posts and Telecommunications was estimated at R6 117 million. This would represent an increase of R830 million or approximately 15,7 per cent over the preceding year. Other applications in 1990/91 would amount to a further R233 million. An average increase of 4,1 per cent was announced in selected postal and telecommunications tariffs. Operating income in 1990/91 would accordingly amount to R6 629 million, leaving an operating surplus of approximately R279 million. Capital expenditure was estimated at R1 739 million, this being 6,5 per cent higher than in 1989/90.

South African Transport Services

With the corporatisation of the South African Transport Services from 1 April 1990, its legal successor, namely Transnet Limited (a company registered in terms of the Companies Act), is exempted from having to submit an annual budget to Parliament for parliamentary approval. The same applies to the South African Rail Commuter Corporation Limited, whose assets and operations will be handled by Transnet Limited in terms of an operating agreement between these two organisations. Losses sustained by the Commuter Corporation will be reimbursed by the State. Only the annual accounting and financial statements of both organisations will have to be tabled in Parliament.