Quarterly economic review

Introduction

The gradual downswing in economic activity, which had started in March 1989 and became slightly sharper and more dispersed during the first half of 1991, deepened further in the four months up to October 1991. This is clearly reflected in sharp decreases in all the components of gross domestic expenditure. In particular, real consumption expenditure by general government, which had expanded at relatively high rates in the preceding four quarters and had supported aggregate domestic expenditure to some extent, decreased substantially in the third quarter of 1991. Moreover, the rates of decrease in real private consumption expenditure and real fixed capital formation also accelerated in the third quarter.

In contrast to these developments, aggregate real domestic output increased marginally in the third quarter of 1991, after having declined for seven consecutive quarters. This increase in real output was mainly brought about by a rise in export volumes, higher agricultural and mining production and a decrease in the rate of destocking related to the harvesting of the maize crop being concentrated abnormally heavily in the third quarter. Despite a sharp rise in the exports of manufactured goods, real manufacturing output decreased sharply further in the third quarter of 1991 and the average utilisation of production capacity in manufacturing enterprises reached a very low level. The real value added by the commercial sector also declined at a rapid rate, and neutralised increases in value added by most of the other tertiary sectors. Real non-primary production therefore still decreased in the third quarter of 1991.

Even though the business cycle has now been in a downward phase for nearly thirty-two months, the downturn has remained relatively mild. From the beginning of the downturn until the third quarter of 1991 the real gross domestic product contracted by less than 1 per cent, which represents a modest decline when compared with the sharper decrease in real output during previous recessions in South Africa. The mildness of the recession is also evident from the fact that the import penetration ratio (the ratio of real merchandise imports to real gross domestic expenditure) has not decreased significantly in this downturn. Economic activity was supported in particular by the sharp increase in the volume of merchandise exports; the volume of merchandise exports rose by nearly 24 per cent from the beginning of the downturn in the first quarter of 1989 to the third quarter of 1991.

A further sharp increase in the volume of exports, coupled with an increase in the rand prices of exports and a decrease in the volume of imports, was mainly responsible for a substantial improvement in the surplus on the current account of the balance of payments in the third quarter of 1991. At a seasonally adjusted and annualised rate this surplus amounted to R9,7 billion, compared with R6,2 billion in the second quarter of 1991. It therefore seems highly likely that a surplus of at least R6 billion will be recorded for 1991 as a whole.

The large surplus on the current account during the third quarter of 1991 was accompanied by a considerable improvement on the capital account; the total net outflow of capital not related to reserves declined from R2,1 billion in the second quarter of 1991 to merely R0,1 billion in the third quarter. Although this considerably smaller net outflow of capital in the third quarter was the net result of an inflow of short-term capital and an outflow of long-term capital, it is also an indication of the normalisation of the international financial relations of South Africa. This is substantiated by the recent successful launching of a public debt issue on the German capital market.

The improved overall balance of payments position led to a further rise in the net gold and other foreign reserves of the country, which brought the total increase in net foreign reserves to R5,9 billion from the beginning of 1990 to the end of September 1991. A large part of this increase took the form of a reduction of reserve-related liabilities, but the gross foreign reserves were also built up to a level equivalent to the value of about two months' imports of goods and services.

Although the current downswing has been relatively mild, it has had a much more serious effect on unemployment than any of the previous cyclical downswings in the past twenty years. In fact, the formal labour market was not only unable to absorb new workers entering the labour force, but employment in the non-agricultural sectors of the economy declined at a much more rapid rate than in any of the previous downswings. As discussed in more detail below, various factors contributed to this sharp decline in employment, including: the long duration of the downswing; the fact that the downturn followed a number of years of low growth in production and employment; general uncertainty regarding future political developments; internal unrest; the high level and still continuing sharp increases in labour costs; the "hassle element" associated with labour because of unionisation and politically motivated actions; the declining trend in fixed capital stock; the inefficient utilisation of saving and capital; and the rationalisation taking place in certain economic sectors leading to retrenchments of labour.

Nevertheless, until fairly recently nominal salaries and wages continued to rise at rates well above the inflation rate. Only from the second quarter of 1991 did the real wage per worker start to decline. Labour productivity in the non-agricultural sectors of the economy, which had contracted from the middle of 1989, started to improve again from the middle of 1990. This increase, together with lower growth in nominal labour remuneration, brought about a decrease in the year-on-year growth rate of real unit labour costs in the second quarter of 1991.

The lower rate of increase in labour costs was accompanied by a lower rate of increase in the prices of domestically produced goods from March 1991. The prices of imported goods started to slow down even earlier towards the end of 1990 with the decline in international oil prices. As a result of these movements in its two main components, the rate of increase in the total production price index measured over periods of twelve months contracted from 14,6 per cent in November 1990 to 11,4 per cent in September 1991. The rate of increase in the consumer price index over periods of twelve months at first also declined moderately from 15,3 per cent in November 1990 to 14,1 per cent in March 1991, but then rose again, on balance, to 15,4 per cent in September 1991.

The rates of increase in the consumer price index from August 1991, however, have been influenced by the implementation of a new set of weights based on households' spending patterns in 1990, being compared with index values in the preceding year still based on 1985 weights. According to an alternative measurement, which is calculated by comparing index numbers for 1990 and 1991 that are both constructed on the basis of 1990 weights, the year-on-year rate of increase in consumer prices amounted to 13,7 per cent in September 1991.

Similarly, growth in the measured money supply has been distorted by regulatory changes under the Deposit-taking Institutions Act which led to the conversion of off-balance sheet items into conventional deposits and assets on the balance sheets of these institutions. A large part of the acceleration in the year-on-year growth rate in M3 from a low of 10,2 per cent in January 1991 to 15,7 per cent in September 1991 was probably due to these regulatory changes. The underlying rate of increase in money supply is probably considerably lower than indicated by the increase in M3 over periods of twelve months. This is clearly illustrated by the growth of M3 measured from the end of February 1991 (when the regulatory changes were implemented) to October, which amounted to a seasonally adjusted and annualised rate of about 8 per cent.

The growth in credit extended by monetary institutions to the domestic private sector levelled off during the course of 1991. Measured from the end of February 1991 to the end of September to allow to some extent for the regulatory changes, the growth in credit extended amounted to a seasonally adjusted and annualised rate of 14,1 per cent. In particular, the growth in credit extended for purposes of durable private consumption and investment expenditure decreased considerably in the first nine months of 1991.

Money market conditions, which had eased markedly in the final months of 1990, became progressively more liquid during the first ten months of 1991 as a result of the improvement in the overall balance of payments position, lower cash reserve requirements of deposit-taking institutions, deficits recorded in the provision of forward exhange cover by the Reserve Bank, and Krugerrand sold to the Reserve Bank by private organisations and individuals. In order to keep its rediscount rate effective and to prevent undue expectations of rapidly declining money market rates, the Reserve Bank made use of foreign exchange intervention swaps and the issuing of special short-dated Treasury bills to neutralise the excess liquidity.

In the secondary capital markets trading activity decreased moderately during the course of the third quarter. However, for the quarter as a whole the levels of activity in most of these markets were still significantly above the levels of the preceding quarter. The primary capital markets were mainly characterised by a substantial increase in the funds raised by private-sector companies by way of new issues of debentures, preference shares and ordinary shares.

The very gradual softening of most money market rates, which had started as early as February 1990, continued throughout the first eleven months of 1991. In contrast, capital market yields firmed from about March 1991, but declined again sharply in November.

Monetary policy remained fairly restrictive with interest rates at moderately positive levels in real terms. The real effective exchange rate of the rand was also relatively stable and declined by only 0,6 per cent from December 1990 to September 1991. Fiscal policy, however, turned out to be more expansionary during the first half of fiscal 1991/92 than envisaged in the Budget for the year as a whole. This more stimulatory policy stance was the result of moderately higher than budgeted expenditure, combined with government revenue growth which was significantly lower than budgeted for the year as a whole. The Central Government's deficit before borrowing and debt repayment during the first two quarters of fiscal 1991/92 therefore amounted to no less than 77 per cent of the deficit estimated for the fiscal year as a whole. As a ratio of gross domestic product, the deficit in the first half of fiscal 1991/92 amounted to 5,3 per cent.

This more expansionary fiscal policy should contribute to the revival of the domestic economy. In addition, higher growth may be forthcoming because of a continued good export performance, the substantially improved economic and financial relations of South Africa with other countries and the current low level of inventories. The outlook for the South African economy therefore seems moderately better than at the beginning of the year and a small positive real growth rate in gross domestic product will probably be forthcoming in 1992.

Domestic economic developments

Domestic output*

Current estimates show that South Africa's *aggregate real gross domestic product* increased slightly in the third quarter of 1991. After growth in real domestic product had turned negative in the fourth quarter of 1989, total real value added continued to decline throughout 1990 and the first half of 1991 at annualised rates that varied between approximately ½ and 1½ per cent. The increase in real output in the third quarter of 1991 is provisionally estimated at a seasonally adjusted and annualised rate of about ½ per cent.

This increase in real output was brought about mainly by a continued sharp improvement in the volume of exports, a rise in agricultural and mining production and a lower rate of destocking.

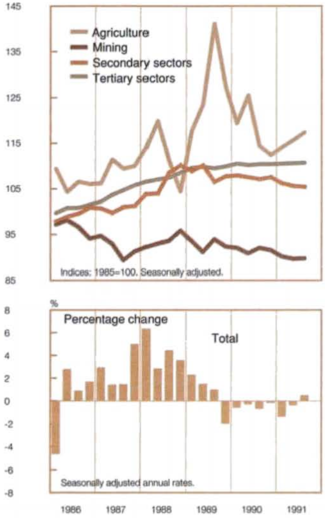
Agricultural output started to increase marginally from the beginning of 1991 and rose further at an annualised rate of some 6 per cent in the third quarter of 1991. This could be attributed mainly to the disproportionaly large part (approximately 70 per cent) of a higher-than-expected maize crop that was harvested during the third quarter. However, recent estimates indicate that the maize crop in the 1990/91 season could still be about 14 per cent less than the crop of 8,4 million tons harvested in the 1989/90 season.

The physical volume of *mining output* rose fractionally in the third quarter of 1991 at an annualised rate of about ½ per cent, compared with a decline of approximately 2½ per cent in the second quarter of 1991. Increases in the tons of ore milled of an unchanged average gold content resulted in a further increase in real gold production in the third quarter. Coal production also continued to rise because of favourable developments in international markets and the lifting of sanctions against South Africa by certain countries. These favourable developments in the mining sector were largely offset by lower levels of production by diamond and "other" mines, following a slowdown in the world economy.

Despite a sharp rise in the exports of manufactured goods, real *manufacturing production* decreased further in the third quarter of 1991. Declines in real output were widespread among most of the major sub-sectors of manufacturing, reflecting mainly the weaker domestic demand and

* In accordance with normal practice during the third quarter of every year, revisions have been made to national accounts data and are incorporated in this issue of the *Quarterly Bulletin*. These revisions are based on more complete, more detailed or otherwise more appropriate available data. In addition, seasonal factors have been updated.

Components of real gross domestic product



production losses arising from strikes in certain sub-sectors of the industry. The level of the real output in manufacturing was 4½ per cent below the level at the beginning of the downturn in economic activity. The percentage utilisation of production capacity therefore moved down to a new low of 81 per cent in the second quarter of 1991.

Among the *tertiary sectors*, real value added by the commercial sector declined at a more rapid rate in the third quarter of 1991. This decline virtually neutralised small increases in the real value added by the other tertiary sectors. The contraction in real value added by the commercial sector was particularly evident in sub-sectors such as wholesale and motor trade, while real value added by the retail trade stayed more or less on the level of the previous quarter. This relative weakness in the commercial sector could mainly be ascribed to the prevailing weakness of consumer spending. In the third quarter of 1991 it also reflected lacklustre business investment in machinery and transport equipment, as a result of the postponement of capital expenditure to take advantage of the introduction of the value added tax.

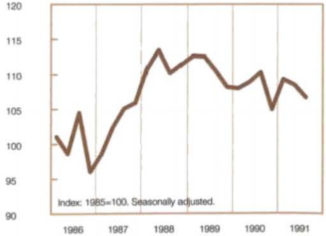
The moderately negative to slightly positive growth rates in the middle quarters of 1991 meant that real gross domestic product in the first nine months of 1991 was about ½ per cent below its level in the corresponding period of 1990.

Domestic expenditure

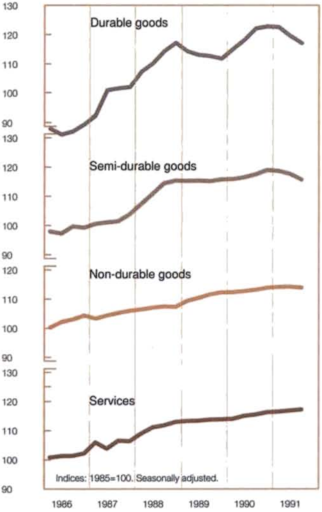
The rate of decline in *aggregate real gross domestic expenditure* accelerated to an annualised rate of approximately 6½ per cent in the third quarter of 1991 from about 3 per cent in the preceding quarter. This brought the average level of real domestic expenditure during the first nine months of 1991 to 1 per cent below the level of the corresponding period of 1990. The acceleration in the rate of decrease in domestic expenditure in the third quarter was the combined result of decreases in all its main components.

After real *private consumption expenditure* had started to decrease in the second quarter of 1991, the rate of decrease accelerated in the third quarter. Revised estimates show that real outlays on consumer goods and services decreased at an annual rate of 1 per cent in the second quarter of 1991. This was followed in the third quarter by an even larger decline at an annual rate of 2 per cent related to a decrease in real personal disposable

Real gross domestic expenditure



Components of real private consumption expenditure



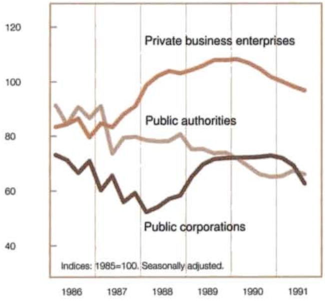
income because of more modest salary and wage adjustments, continued cut-backs in labour and lower profits of unincorporated business enterprises.

The more pronounced rate of decrease in real private consumption expenditure took place mainly in outlays on goods, while expenditure on services stayed relatively firm. Having declined at an annualised rate of 9½ per cent in the second quarter of 1991, real outlays on durable consumer goods registered a further sharp decline at an annualised rate of some 8 per cent in the third quarter of 1991. This sharp decrease arose from continued contractions in consumption expenditure on household appliances, personal transport equipment and recreational and entertainment goods. Real household consumption expenditure on semi-durable goods contracted at an annualised rate of 6½ per cent, while even expenditure on non-durable goods declined at an annualised rate of 1 per cent in the third quarter of 1991. In contrast to these developments, real private consumption expenditure on services continued to increase steadily and recorded a rate of increase at an annualised rate of 1½ per cent in the third quarter of 1991.

Real consumption expenditure by general government, which had increased sharply from the third quarter of 1990, contracted at an annualised rate of about 24 per cent in the third quarter of 1991. Despite this decrease, real outlays on consumer goods and services by general government in the first half of fiscal 1991/92 were still 9 per cent higher than in the first half of fiscal 1990/91. This rapid rate of increase caused the ratio of real government consumption expenditure to real gross domestic product to rise marginally from 19 per cent in 1990 to 19½ per cent in the first nine months of 1991.

Real gross *domestic fixed investment* continued to decline in the third quarter of 1991, and the annualised rate of decrease accelerated to 11½ per cent from 5 per cent in the second quarter of 1991. Real capital expenditure have declined by no less than 11 per cent from a peak in the fourth quarter of 1989 to the third quarter of 1991. The faster rate of decline in real fixed investment spending in the third quarter was brought about by reductions in real capital formation by both the private and the public sector.

Real gross domestic fixed investment



Following marked contractions in the two preceding quarters, real fixed capital formation by the *private sector* declined at an annualised rate of nearly 6 per cent in the third quarter of 1991. In particular, cut-backs in real fixed investment were made in the sectors mining, manufacturing, commerce and finance. Although political uncertainty, civil unrest and the deepening of the downswing contributed to this further decrease in capital formation by private enterprises, it was also influenced in the third quarter of 1991 by the postponement of capital expenditure until after the implementation of value added tax which allows businesses to claim input tax credits on capital goods acquired. Capital expenditure by the private sector also continued to be influenced by excess production capacity, rationalisation programmes in mining, and relatively high interest costs.

Real fixed investment by the public sector contracted at an annualised rate of approximately 21 per cent in the third quarter of 1991, compared with 1½ per cent in the preceding quarter. This substantial decrease was mainly due to a decline in the real capital formation of public corporations. The real outlays on fixed investment by public authorities contracted sharply and all levels of general government recorded declines in real fixed investment expenditure.

Although real *inventories* declined for the ninth consecutive quarter, the rate of decumulation decelerated in the third quarter of 1991. This more limited destocking was, however, mainly brought about by an increase in agricultural stocks -in-trade. Inventories in the sectors mining, private manufacturing and commerce continued to decline at a rapid rate. The ratio of real industrial and commercial inventories to real gross domestic product therefore decreased further from the already low level of 18½ per cent in the second quarter of 1991 to 18 per cent in the third quarter.

Factor income

The growth in *aggregate nominal factor income* at market prices, which had slowed down from almost 18 per cent in 1989 to 13½ per cent in 1990, decelerated further to about 12½ per cent in the first three quarters of 1991 relative to the first three quarters of 1990. The quarter-to-quarter rate of increase in nominal factor income also slowed down from nearly 17 per cent in the second quarter of 1991 to 15 per cent in the third quarter because of lower rates of growth in both components of factor income (remuneration of employees and gross operating surplus).

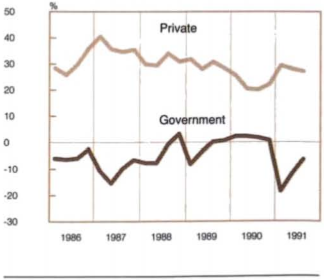
After total *remuneration of employees* had increased at a revised annualised rate of about 16 per cent in the second quarter of 1991, it rose at a lower rate of 15½ per cent in the third quarter. This moderation of growth in total salaries and wages in the economy could be ascribed to factors such as lower rates of increase in labour remuneration per worker, retrenchments of workers and an increase in company liquidations; in general it was due to the lower level of overall economic activity rather than to structural phenomena.

The quarter-to-quarter rate of increase in the nominal *gross operating surplus* decelerated from a recent high of more than 20 per cent in the second quarter of 1991 to 15½ per cent in the third quarter. This slowdown came about because of smaller increases in the gross operating surpluses of the secondary and tertiary sectors, which neutralised the more rapid rates of increase in agriculture and mining. In general, the operating surpluses of many of the non-primary sectors were detrimentally affected by the sharper decline in domestic final demand and a decrease in the volume of imports. At the same time, production costs continued to rise at fairly high rates. Rationalisation programmes in the gold-mining sector contained production cost increases and resulted in sharply higher operating surpluses in spite of only moderate increases in the rand price of gold.

Domestic saving

Gross domestic saving as a ratio of gross domestic product rose steadily from a low of 18 per cent in the first quarter of 1991 to 19½ per cent in the third quarter. At this level, however, the *domestic savings ratio* is still well below its average value of 23

Ratio of savings to gross domestic savings



per cent in the 1980s and 25 per cent in the past thirty years.

Domestic saving increased in the third quarter of 1991 regardless of *net dissaving by the general government*. For a brief period in the four quarters of 1990 the general government recorded positive savings, following a period of six years of negative saving. From the first quarter of 1991 the current expenditure of general government again outstripped current revenue. The substantial increase in the current expenditure of general government in the first nine months of 1991 could mainly be attributed to increases of 24½ per cent in government consumption expenditure and 29½ per cent in service costs on public debt compared with these expenses in the corresponding period of the preceding year. On top of this, general government's current income rose by only 5 per cent over the same period.

An improvement in *private sector saving*, especially net personal saving, was mainly responsible for a rise in the domestic savings ratio. Net saving by the corporate sector had also remained relatively firm, mainly because of an increased awareness of the need to contain costs and a more conservative dividend policy.

The ratio of net personal savings to personal disposable income increased from a low not quite reaching 1 per cent in the third quarter of 1990 to approximately 2 per cent in the third quarter of 1991. Although this is an encouraging development, the personal savings ratio is still very low in comparison with the average ratio of slightly more than 9 per cent in the 1960s and 1970s. This improvement nevertheless came to pass during a time when the rate of increase in net personal disposable income slowed down, and was probably related to some extent to a more cautious attitude of individuals towards incurring further debt.

Employment

Total non-agricultural employment started to decline from the third quarter of 1989. At first the rate of decrease in aggregate employment was fairly modest, but subsequently it accelerated considerably; the quarter-to-quarter decrease rose from a seasonally adjusted and annualised rate of 0,2 per cent in the third quarter of 1989 to 3,2 per cent in the second quarter of 1991. In sharp contrast to other macro-economic aggregates which remained relatively firm in the current downswing, employment decreased more steeply than in any of the cyclical downswings in the past twenty years. As shown in the accompanying graph, the decline in aggregate employment during the current downswing still compared relatively favourably with other periods of economic downswing up to the third quarter of 1990. Since the fourth quarter of 1990, however, it has moved to levels substantially below those of previous downswings.

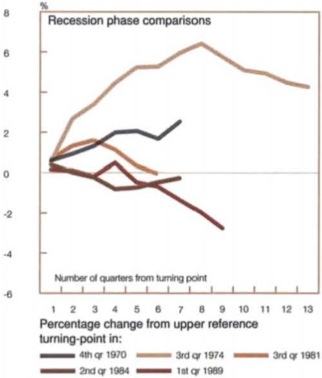
An important contributing factor to this exceptionally sharp decline in employment is the long duration of the current downswing; yet even more significant is the fact that the downswing started after a number of years of low growth in production and employment. For instance, in the protracted downswing of 1974-77 employment continued to increase during the first eight quarters of a relatively mild recession. When the downturn later deepened, total non-agricultural employment decreased, but at the end of the downswing it was still higher than at the start of the recession.

Other factors probably also made an important contribution to the sharp decline in aggregate employment in the current downswing, including:

- a general mood of uncertainty regarding future political developments, which, in combination with sporadic internal unrest, negatively affected investments in new and existing business enterprises;

- the already high level of and large increases in labour costs which do not recognise the relative abundance of less-skilled labour;

Non-agricultural employment



Percentage change from upper reference turning-point in:

– the effect of the "hassle element" on management, arising from unionisation and political actions and leading to loss of output on account of worker intimidation, unauthorised absenteeism, work stoppages, and stayaways;

– the declining trend experienced in fixed capital investment during the 1980s and the inefficient utilisation of the capital stock of the country; and

– the rationalisation taking place particularly in the gold-mining industry in response to the generally depressed gold price and a more stable exchange rate of the rand, which forced the gold mines to, *inter alia*, retrench a large number of employees in order to restrict production costs.

As could be expected, the rapid rate of decline in employment was particularly evident in the *non-agricultural private sector;* this sector's employment decreased at seasonally adjusted and annualised rates of 4,9 per cent in the fourth quarter of 1990 and 5,5 and 3,8 per cent in the first and second quarter of 1991. Incomplete information for the third quarter of 1991 indicates a continuation of this trend with further reductions in the workforce of manufacturing, construction, electricity generation and the mining sector.

In contrast to these developments, employment by *public authorities* increased at seasonally adjusted and annualised rates of 3,2 and 4,8 per cent in the fourth quarter of 1990 and the first quarter of 1991. As already stated in the *Quarterly Bulletin* of September 1991, such increases in employment by public authorities during cyclical downswings are not uncommon. However, in the second quarter of 1991 employment by public authorities decreased at a seasonally adjusted and annualised rate of 1,9 per cent.

The *ratio of overtime hours* to normal hours worked in manufacturing declined uninterruptedly from the third quarter of 1989 to the second quarter of 1991, and moved more or less horizontally in July 1991. In the construction industry this ratio remained at a relatively low level from the second quarter of 1989 to the second quarter of 1991, but picked up unexpectedly in July 1991.

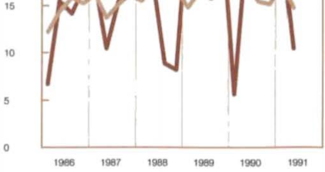
The seasonally adjusted *number of registered unemployed workers* in the White, Coloured and Asian population groups increased, on balance, from a low point of 42 700 in December 1989 to 93 800 in August 1991. Since the introduction of a new method for measuring unemployment levels in the second half of 1990, wide fluctuations have occurred in unemployment numbers. None the less, unemployment in the first eight months of 1991 was 6,5 per cent higher than the average level in the second half of 1990. The seasonally adjusted total number of registered unemployed workers has fluctuated around a relatively high average level of roughly 230 000 since about the middle of 1990 and amounted to 241 500 in August 1991.

Labour costs and productivity

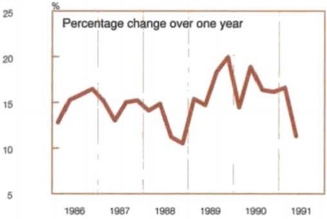
Despite the downturn in economic activity, the rate of increase in nominal salaries and wages per worker remained on a high level during 1990 and the first quarter of 1991. The year-on-year rate of increase in nominal remuneration per non-agricultural worker still amounted to 18,6 per cent in the first quarter of 1991. However, in the second quarter of 1991 it slowed down quite markedly to 13,5 per cent. If this moderation in wage increases continues, it augurs well for an eventual slowdown in inflation.

The slower growth in nominal salaries and wages per worker during the second quarter occurred in private enterprises and among public authorities. The year-on-year rate of increase in wages per worker in the non-agricultural private sector dropped from 17,2 per cent in the first quarter of 1991 to 14,8 per cent in the second quarter. Similarly, the nominal salaries and wages per worker employed by public authorities, which had increased at rates of more than 20 per cent in the four quarters up to the first quarter of 1991 (i.e. in the fiscal year 1990/91), rose at a rate of only 10,4

Average remuneration per worker in non-agricultural sectors



Nominal unit labour costs in non-agricultural sectors



per cent in the second quarter of 1991.

The contraction of nominal wage increases caused the *real wage* per worker in the non-agricultural sectors to decrease by 1,3 per cent in the second quarter of 1991 compared with the corresponding quarter of 1990. This decline in real wages followed increases varying between 2 and 3 per cent in the three years 1988 to 1990. In the first quarter of 1991 the year-on-year rate of increase in the real wage per worker still amounted to 3,6 per cent.

Labour productivity in the non-agricultural sectors of the economy, which had decreased from the middle of 1989, started to improve again from the middle of 1990. The year-on-year rate of increase in labour productivity accelerated strongly from 0,7 per cent in the third quarter of 1990 to 1,9 per cent in the second quarter of 1991. This improvement in the real value of production per worker could probably be attributed to a faster decline in the number of non-agricultural employed workers than in output volumes, rather than to a determined increase in work-effort on the part of the workforce.

The rise in labour productivity combined with the recent lower growth in nominal labour remuneration caused the year-on-year rate of increase in *nominal unit labour costs* to decline from a high rate of 18,9 per cent in the second quarter of 1990 to 11,3 per cent in the second quarter of 1991. This latter rate of increase can also be compared with an average rate of increase of 16,5 per cent in nominal costs per unit of physical production in 1990. The year-on-year rate of increase in *real unit labour costs* (as deflated by the price deflator for non-agricultural gross domestic product) declined from 2,9 per cent in the second quarter of 1990 to 0,8 per cent in the fourth quarter. It then reaccelerated to 1,7 per cent in the first quarter of 1991, before real labour costs per unit of physical output decreased by 2,1 per cent in the second quarter.

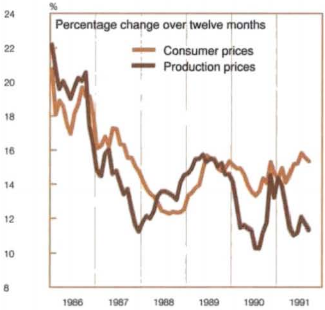
Prices

After the rates of increase in the production and consumer price indices had generally moved downward from the second half of 1989 up to the first half of 1990, the crisis in the Middle East and the ensuing rising oil prices caused the rates of increase in these price indices to accelerate again in the second half of 1990. However, these more rapid price increases could not be ascribed only to the situation in the Persian Gulf Area. In fact, the rates of increase in the production price index for domestically produced goods and the overall consumer price index started to accelerate even before this crisis could have had an impact on the development of domestic prices. Other factors, such as the rise in labour costs, increases in food prices and continued expectations of high inflation, probably also contributed to the faster rise in prices.

From the beginning of 1991 the changes in the production and consumer price indices deviated considerably from each other: the rate of increase in the production price index resumed a downward trend, while the rate of increase in consumer prices remained on high levels.

The rate of increase in the *production price*

Production and consumer prices



index over *periods of twelve months* accelerated from 10,3 per cent in both July and August 1990 to 14,6 per cent in November, but then declined again to 11,4 per cent in September 1991. These developments were mainly influenced by roughly similar changes in the prices of imported goods. The rate of increase in the prices of imported goods over twelve months accelerated at first from 3,8 per cent in August 1990 to 19,1 per cent in November, but then declined to 7,6 per cent in April 1991. It subsequently rose again to 10,1 per cent in September owing largely to a mild weakening of the effective exchange rate of the rand over this period. Similarly, the rate of increase of domestically produced goods measured over periods of twelve months rose from 11,2 per cent in March 1990 to 13,9 per cent in March 1991, but then slowed to 11,7 per cent in August and September.

The *quarter-to-quarter* rate of increase in the production price index (seasonally adjusted and annualised) dropped from a peak of 20,8 per cent in the fourth quarter of 1990 to only 1,7 per cent in the second quarter of 1991 – a twenty-one-year low. This sharply lower rate of increase in the production price index was the result of an unusually small increase in the prices of domestically produced goods and a decline in the prices of imported goods. The quarter-to-quarter rate of increase in the prices of domestically produced goods declined from an annualised level of 14,7 per cent in both the fourth quarter of 1990 and the first quarter of 1991 to an annualised rate of only 5,8 per cent in the second quarter of 1991 – the lowest such increase since the 5,6 per cent recorded in the third quarter of 1977. The prices of domestically produced goods then increased again by 12,7 per cent in the third quarter of 1991.

The quarter-to-quarter rate of increase in the prices of imported goods, which soared to an inordinately high annualised rate of 53,8 per cent in the fourth quarter of 1990 at the time of the conflict in the Middle East, declined to only 5,1 per cent in the first quarter of 1991. The lowering of import surcharges in the Budget for 1991/92 then caused the prices of imported goods to decrease at a seasonally adjusted and annualised rate of 17,3 per cent in the second quarter of 1991. In the third quarter the prices of imported goods rose again by 13,6 per cent, partly because of a moderate decrease in the effective exchange rate of the rand. This brought the quarter-to-quarter rate of increase in the total production price index again to a seasonally adjusted and annualised rate of 13,3 per cent.

In contrast to these developments, the movements in the *consumer price index* were rather disappointing. After the *quarter-to-quarter* rate of increase in consumer prices had reached a seasonally adjusted and annualised low of 13,5 per cent in the second and third quarter of 1990, it accelerated to 16,8 per cent in the fourth quarter, also mainly because of the impact of the higher international crude oil prices on domestic fuel prices. It then declined briefly to 14,1 per cent in the first quarter of 1991, before reaccelerating to 15,0 and 16,7 per cent in the second and third quarter. This acceleration in consumer price increases was brought about mainly by corresponding higher increases in the prices of consumer goods, while the prices of consumer services rose at much more moderate rates.

The rate of increase in the consumer price index over *periods of twelve months*, which had increased from 13,3 per cent in July 1990 to 15,3 per cent in November 1990, declined only moderately with the lowering of domestic fuel prices to 14,1 per cent in March 1991. It then reaccelerated to an even higher level of 15,8 per cent in July 1991, largely because of increases in the price of goods such as food, clothing and footwear. The rate of increase in the overall consumer price index then declined somewhat to 15,6 and 15,4 per cent in August and September 1991. These rates were influenced by the implementation of a new weighting system (derived from the observed spending patterns of a representative sample of households in 1990) in calculating the price index. In accordance with the results of this survey, the weight of consumer goods in the calculation of the overall consumer price index was reduced from 60,5 per cent (1985-weights) to 57,9 per cent (1990-weights), while that of consumer services was increased from 39,5 per cent to 42,1 per cent.

The Central Statistical Service also calculates *alternative rates of increase* in the consumer price index. Whereas the officially announced rates of change are still partly influenced by the 1985-weighting structure (because the index values for 1991 – 1990 weights – are compared with index values for 1990 – 1985 weights – to calculate rates of increase over periods of twelve months), the alternative rates of increase are calculated by comparing index numbers for 1990 and 1991 which are both constructed by using the 1990 weights. The alternative twelve-month rates of increase in the consumer price index amounted to 13,7, 13,9 and 13,7 per cent in July, August and September 1991.

Balance of payments and exchange rates

Current account

A *further surplus* was recorded on the current account of South Africa's balance of payments during the third quarter of 1991. This was the twenty-seventh consecutive quarterly surplus if seasonal influences are eliminated. Moreover, the surplus on the current account at a seasonally adjusted and annualised rate rose from a low of R1,5 billion in the first quarter of 1991 to R6,2 billion in the second quarter and R9,7 billion in the third quarter, or from 0,5 per cent of gross domestic product to 2,1 and 3,2 per cent, respectively. In the first nine months of 1991 the total unadjusted surplus amounted to R4,3 billion, compared with R3,5 billion in the corresponding period of 1990. For 1991 as a whole a total surplus on the current account of the balance of payments of at least R6 billion will probably be realised.

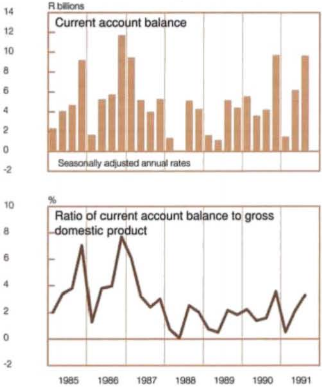
The substantial increase in the surplus on the current account in the third quarter of 1991 was the result of an improvement in all the components of the trade account: merchandise exports rose substantially, imports declined moderately and net gold exports increased marginally. On the other hand, net service and transfer payments to non-residents increased somewhat again, following sharp declines in the two preceding quarters.

Both the value and the volume of *merchandise exports* advanced to new record levels during the third quarter of 1991. At a seasonally adjusted and annualised rate of R48,6 billion, the value of merchandise exports in the third quarter was about 6 per cent higher than in the second quarter of 1991. This increase was almost equally attributable to volume and price increases.

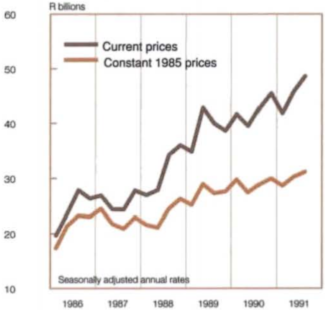
Despite the generally slack economic conditions in South Africa's main trading partner countries and an apparently small increase in the volume of world trade during 1991, South Africa's volume of exports rose by 4½ per cent during the first nine months of the year compared with the same period in 1990. Substantially higher exports of manufactured goods were offset to some extent by lower exports of agricultural products, while the exports of mining products remained more or less on the same level as in the second quarter. The continued strong export performance was probably related mainly to a competitive exchange rate level of the rand and the slack domestic economic conditions, which compelled some local manufacturers to find alternative outlets.

Although international commodity prices in dol-

Balance of payments



Merchandise exports



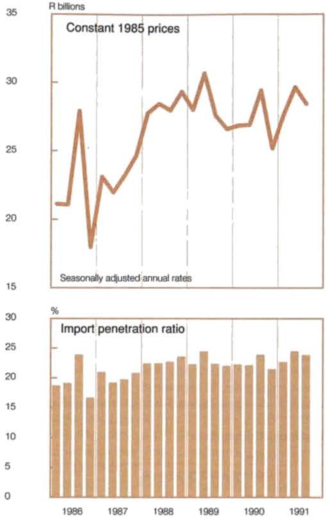
lar terms declined further in the third quarter of 1991, the rand prices of merchandise exports rose again sharply. In fact, international commodity prices have decreased by 30 per cent from a peak in the middle of 1988 to the third quarter of 1991, while South Africa's merchandise export prices still rose by 18 per cent over the same period and the nominal effective exchange rate of the rand declined only moderately. This is explained by the fact that prices of the major proportion of South Africa's exports are denominated in US dollars; from the middle of 1988 to the third quarter of 1991, the rand depreciated against the dollar by no less than 23 per cent.

Net gold exports, at a seasonally adjusted and annualised rate, rose only slightly from R20,0 billion in the second quarter of 1991 to R20,1 billion in the third quarter. This increase took place despite a decline in the average dollar price of gold from US$361 to US$358 per fine ounce over the same period; the depreciation of the rand against the dollar caused the rand price to rise from R1 010 to R1 024 per fine ounce. The volume of the net gold exports contracted slightly by ½ per cent in the third quarter of 1991.

After the value of *merchandise imports* (seasonally adjusted and annualised) had increased from R42,2 billion in the fourth quarter of 1990 to R50,2 billion in the second quarter of 1991, it fell to R49,1 billion in the third quarter. This decline was more than fully accounted for by a decrease of 4 per cent in the volume of imports, following the importation of two macro aircraft and sharply higher imports of mineral products in the first half of the year. Import prices rose by about 2 per cent in the third quarter of 1991 because of higher international oil prices, moderate increases in other import prices and a decline in the effective exchange rate of the rand.

The import penetration ratio (the ratio of real merchandise imports to real gross domestic expen-

Real merchandise imports



Balance of payments on current account
Seasonally adjusted annual rates

R billions

	1990				1991		
	1 st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Merchandise exports	41,7	39,5	42,8	45,5	41,8	45,9	48,6
Net gold exports	17,8	18,5	18,0	18,0	17,3	20,0	20,1
Merchandise imports	–43,6	–44,1	–46,5	–42,2	–47,5	–50,2	–49,1
Net service and transfer payments	–10,3	–10,3	–10,1	–11,6	–10,1	–9,5	–9,9
Balance on current account	**5,6**	**3,6**	**4,2**	**9,7**	**1,5**	**6,2**	**9,7**

diture) declined from 24,5 per cent in the second quarter of 1991 to 23,9 per cent in the third quarter. At this level it was still above the average figure of 22,5 per cent recorded in 1990 and only moderately below the level of 24,5 per cent at the beginning of the downturn in economic activity. The relatively high import penetration ratio is, of course, mainly a reflection of the mildness of the current downturn in economic activity.

Net service and transfer payments to non-residents, at a seasonally adjusted and annualised rate, which had decreased from the abnormally high level of R11,6 billion in the fourth quarter of 1990 to R9,5 billion in the second quarter of 1991, rose slightly again to R9,9 billion in the third quarter. This turnaround was the combined result of higher tourist expenditure and lower dividend income on investments made in other countries.

Capital account

The *total net outflow* of capital not related to reserves declined from R2,1 billion in the second quarter of 1991 to only R0,1 billion in the third quarter. The total net outflow of capital of R1,4 billion during the first nine months of 1991 was, however, higher than the R1,1 billion registered in the corresponding period of 1990, but still fell considerably short of the outflow of R2,9 billion during 1990 as a whole.

A net *long-term capital* outflow of R1,4 billion was recorded during the third quarter of 1991, due to some extent to the repayment of some US$180 million (R500 million) of debt inside the standstill net in accordance with the Third Interim Debt Arrangements with foreign creditor banks. Approximately $480 million of the outstanding affected debt of just under $7,0 billion at the beginning of the Third Interim Debt Arrangements have already been repaid. If conversions of debt into long-term loans and debt/equity swaps are taken into consideration, the outstanding affected debt of the country at present is probably close to $6 billion.

These repayments on debt inside the standstill net were partly responsible for a reversal in the distinctly improving trend in the net outflow of long-term capital since the fourth quarter of 1990. The larger outflow of long-term capital in the third quarter of 1991 compared with the second quarter was, however, also due to the fact that in the preceding two quarters the South African Airways financed a large part of the purchases of new aircraft with offshore funds and that no such transactions occurred in the third quarter. The amount of project finance raised abroad by public corporations was also distinctly smaller in the third quarter than the average amount of such financing in the preceding six quarters, probably because of the nearing completion of the Mossgas project.

On 19 September 1991 a *public debt issue* of DM400 million was successfully launched on the German capital market. This was the first such issue since the adoption of the standstill arrangements in September 1985. The actual inflow of capital, however, only took place on 11 October 1991; this foreign loan will, therefore, be recorded in the capital account of the balance of payments in the fourth quarter. Part of this loan (DM217 million) will

Net capital movements (not related to reserves)

R millions

	1990				1991		
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Long-term capital							
Public authorities	–206	–673	47	–328	–167	116	–398
Public corporations	473	–35	279	173	188	345	–183
Private sector	–1 204	–482	495	–484	–604	–787	–774
Total long-term capital	–937	–1 190	821	–639	–583	–326	–1 355
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	531	–1 000	694	–1 154	1 362	–1 748	1 258
Total capital movements, excluding liabilities related to reserves	**–406**	**–2 190**	**1 515**	**–1 793**	**779**	**–2074**	**–97**

be utilised to redeem an existing loan maturing in December 1991.

Net *short-term capital* movements not related to reserves continued their volatile quarterly pattern, which has shown outflows in one quarter being followed by inflows in the next quarter and by outflows again in the ensuing quarter. These volatile short-term capital movements – which started in 1990 – clearly reflect a more normal behaviour of short-term capital movements, which are affected mainly by economic considerations such as changes in the value of foreign trade, expected exchange rate movements, relative interest rates and the cost of forward exchange cover.

Foreign reserves

The surplus on current account (not adjusted for seasonal factors) of R2,1 billion exceeded the net outflow of capital in the third quarter of 1991, resulting in an increase in South Africa's *net gold and other foreign reserves* of R2,0 billion over this period. This brought the increase in the net foreign reserves over the first nine months of 1991 to R3,0 billion, following an increase of R2,9 billion in 1990.

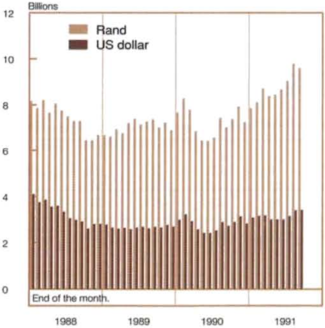
A large part of the increase in the net foreign reserves again took the form of a reduction in the reserve-related liabilities of the country. After taking valuation adjustments into consideration, the total *gross gold and other foreign reserves* therefore increased more moderately by R0,9 billion, reaching R9,6 billion at the end of September 1991. In US dollar terms, the total gross reserves amounted to $3,4 billion – roughly the same level as at the end of May 1988 but still equivalent to only about two months' imports of goods and services. In October the gross reserves of the Reserve Bank rose further by R0,6 billion.

These increases in the total gross foreign reserves were again mainly discernible in the gold component of the reserves. The *gold reserves* of the country have now increased from 4,1 million fine ounces at the end of December 1990 to 6,4 million fine ounces at the end of October 1991. This was partly due to the fact that some of the gold production of the mines was not sold concurrently on the international markets; however, the Reserve Bank also purchased a large number of Krugerrands from the domestic private sector.

Exchange rates

After the *nominal effective exchange rate* of the rand had declined slightly by 0,8 per cent in the first quarter of 1991, the downward movement in the weighted average exchange rate of the rand accelerated to 3,1 per cent in the second quarter. During this period the rand depreciated sharply against the US dollar and the Japanese yen in view of the strength of these two currencies on the international markets. During the third quarter and in October 1991 the dollar lost most of its vigour in the major exchange markets, particularly after a further reduction in US interest rates on 13 September 1991. This caused the rand to appreciate against the dollar; the rand still depreciated, however, against the currencies of all South Africa's other major trading partner countries. The overall result was that the effective exchange rate of the rand declined by 1,6 per cent over these four

Gross gold and other foreign reserves

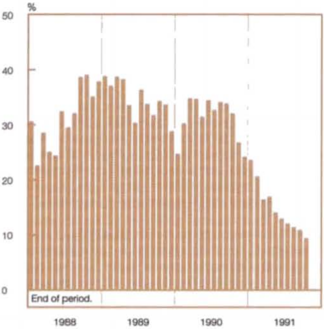


Changes in exchange rates of the rand

%

	31 Dec 1990 to 30 Mar 1991	30 Mar 1991 to 30 Jun 1991	30 Jun 1991 to 31 Oct 1991
Weighted average.	–0,8	–3,1	–1,6
US dollar	–6,2	–5,3	2,0
British pound	3,6	0,8	–4,5
German mark	7,2	–0,5	–5,2
Japanese yen	–2,9	–6,3	–3,5
Netherlands guilder	7,7	–0,8	–5,2
Italian lira	6,2	–0,6	–4,7
Financial rand	3,4	–1,4	6,1

Financial rand discount



months. The nominal effective exchange rate of the rand has now declined by 5½ per cent from the end of 1990 until the end of October 1991.

The decline in the nominal effective exchange rate of the rand during the first nine months of 1991 exceeded the inflation differential between South Africa and its main trading partner countries. The *real effective exchange rate* therefore also declined slightly, namely by 0,6 per cent from December 1990 until September 1991.

The *financial rand*, which had started to appreciate sharply towards the end of 1990, continued to strengthen during the third quarter and in October 1991. From the end of June 1991 to the end of October the financial rand appreciated by 6,1 per cent against the US dollar, compared with an appreciation of 2,0 per cent of the commercial rand. The financial rand discount consequently narrowed from 13 per cent to 9 per cent over the same period. This improvement in the financial rand discount was particularly evident after the lifting of sanctions by Japan and the improvement in the disposition of the Commonwealth countries towards South Africa.

Financial markets

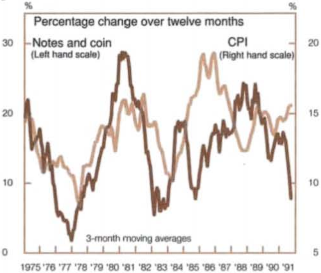
Money supply

The growth rates of all the *narrower monetary aggregates* accelerated sharply in the third quarter of 1991. This more rapid growth in money supply was mainly due to regulatory changes under the Deposit-taking Institutions Act. These changes led to the conversion of off-balance-sheet items into conventional deposits and assets, which increased the measured money supply and bank credit. The rate of increase in *M1A* over periods of twelve months therefore rose from 14,3 per cent at the end of December 1990 to 17,0 per cent at the end of June 1991 and to 26,2 per cent at the end of September. In contrast to these developments, the rate of increase in *M1* over periods of twelve months slowed down marginally at first from 15,9 per cent at the end of December 1990 to 15,5 per cent at the end of June 1991, before rising again to 24,4 per cent at the end of September. Measured over periods of twelve months the rate of increase in *M2* accelerated in the first six months of 1991 from 13,1 per cent at the end of December 1990 to 20,3 per cent at the end of June 1991. It then remained on this high level, rising only slightly to 22,9 per cent at the end of September 1991.

Having receded from a peak of 27,5 per cent in August 1988 to 10,2 per cent in January 1991, the twelve-month growth rate of *M3* rose again to 15,9 per cent in February and then fluctuated around this level up to the end of October 1991. Measured from the "guideline" base in the fourth quarter of 1990, the growth in M3 stayed above the upper boundary of the money supply guidelines of 8 to 12 per cent set for 1991. If allowance is made for the effects of the regulatory changes, the underlying rate of increase in M3 remained relatively low. This is clearly illustrated by the growth in M3 if measured from the end of February 1991 to the end of October, which amounted to a seasonally adjusted and annualised rate of only 7,9 per cent. This moderate growth rate reflected the cooling-down of the economy and the higher but more stable interest rates which have been maintained since 1989.

In the third quarter of 1991 M3 was also less affected by reintermediation phenomena than during the first half of the year. This is clearly illustrated by changes in the income velocity of circulation of M3. After remaining virtually constant from the second to the fourth quarter of 1990, the velocity of circulation of M3 decreased by 2½ per cent in the first quarter of 1991 and by a further 1½ per cent in the second quarter. During the third quarter of 1991, however, the relatively slow growth in M3 – only 7,3 per cent at a seasonally adjusted and annualised rate – was reflected in

Notes and coin in circulation and consumer prices



Different scales are used for notes and coin and for consumer prices because the amplitudes of the series differ.

an increase of 2 per cent in the velocity of circulation.

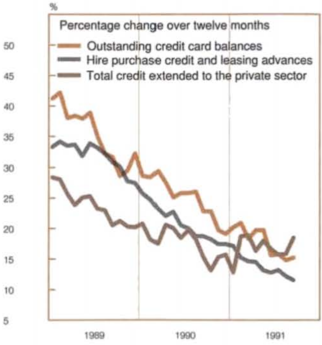
The monetary aggregate least affected by the regulatory changes was probably *notes and coin in circulation* outside monetary institutions. The rate of increase in this aggregate, measured over twelve months, slowed down abruptly from approximately 17 per cent in the first three months of 1991 to an average of only 7,8 per cent in the three months up to September. This growth is therefore now well below the rate of inflation. As shown in the accompanying graph, changes in the twelve-month growth rate in notes and coin in circulation (which is broadly associated, with a lag, with changes in the gross domestic expenditure) tends to lead changes in the twelve-month growth in the consumer price index. The recent developments in the growth of this aggregate may therefore be interpreted as mildly encouraging for the likely future course of inflation. However, like all other aggregates, it also has certain important shortcomings which have to be taken into consideration; these include its failure as a leading indicator of inflation in 1985 and 1986, when the sharp depreciation of the exchange rate of the rand underpinned the rate of inflation in spite of the recessionary conditions and slow monetary growth. More fundamentally, the ease of substitution between cash and other means of payment and the possibility of structural changes could also affect the growth in notes and coin in circulation and make it less reliable as an indicator of likely inflationary developments.

In a *statistical or accounting sense*, the seasonally adjusted increase of R2,2 billion in M3 during the third quarter of 1991 was more than fully explained by an increase of some R6 billion in monetary institutions' claims on the domestic private sector. A substantial increase in the net gold and other foreign reserves of the monetary sector, amounting to R1,5 billion, was also recorded during the three months up to the end of September 1991. Net claims on the government sector were relatively stable over this same period, rising by only R0,4 billion. On the other hand, "net other assets" of monetary institutions declined substantially in the third quarter of 1991, inter alia, because of a build-up of capital and reserves by these institutions and an increase in loans received under repurchase agreements.

Credit extension by monetary institutions

The growth in credit extended by monetary institutions to the domestic private sector levelled off during the course of 1991. Measured over a period of twelve months, the rate of increase in *credit extended to the private sector*, which had receded from a peak of 29,2 per cent in October 1988 to 12,8 per cent in January 1991, rose to 18,7 per cent in February 1991, largely because of the regulatory changes already referred to above. It then declined to 15,7 per cent in July 1991, before rising again to 18,5 per cent in September. From the end of February 1991

Credit extention to the private sector



(the month in which the new regulations came into effect) to the end of September, the growth in the monetary institutions' claims on the domestic private sector (seasonally adjusted and annualised) amounted to 14,1 per cent – a clear indication that the public was making less use of credit provided by deposit-taking institutions.

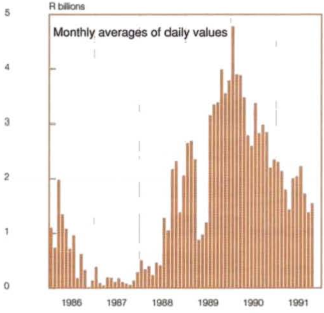
This growth in credit close to or below the rate of inflation provides evidence of the cumulative effect of positive real interest rates and of the generally more depressed conditions of the economy. It was probably also an indication of households' increased hesitancy in adding further to consumer debt, and of the cutting-down of expenses by business enterprises under current conditions. Some monetary institutions have also become less accommodative in providing further credit to their customers in general.

As already pointed out in the *Quarterly Bulletin* of September 1991, overall credit extension remained more buoyant than credit that is more closely related to durable private consumption and investment expenditure; the twelve-month rate of increase in *hire-purchase credit and leasing finance* declined from 17,4 per cent in December 1990 to 11,5 per cent in September 1991. Similarly, the rate of increase in balances outstanding on *credit cards* measured over periods of twelve months amounted to only 15,2 per cent in September 1991, compared with 19,1 per cent in December 1990 and 32,2 per cent in December 1989.

In contrast to these developments, the growth in *mortgage advances* of monetary institutions continued to outstrip the inflation rate. The twelve-month rate of increase in mortgage advances rose somewhat from 14,7 per cent in December 1990 to 17,5 per cent in September 1991. These relatively high growth rates in mortgage advances were probably in part an indication of the slower repayment of capital because of tight financial conditions, and of homeowners (whose homes had appreciated over time) making use of this credit facility to finance purchases of especially durable goods. At the same time, the lower capital requirements against mortgage advances vis-à-vis general advances induced some banks to promote this form of credit extension.

Bills discounted and investments rose by 10,9 per cent and 80,1 per cent respectively in the twelve months to the end of September 1991; however, the substantial percentage increase in investments obscures the fact that the absolute increase amounted to only R2,4 billion.

Accommodation at the discount window



Money market conditions and Reserve Bank operations in the money market

Money market conditions, which had already eased markedly in the final months of 1990, became progressively more liquid during the first eleven months of 1991. The average daily level of accommodation at the Reserve Bank's discount window decreased from R2,3 billion in both December 1990 and January 1991 to R1,4 billion in April. It then rose somewhat to R2,2 billion in July before declining again to R1,4 billion in September and R1,5 billion in October. From the April 1991 month-end this accommodation consisted mainly of bills rediscounted. The fact that deposit-taking institutions did not make use of overnight loans further underlined the easier conditions in the money market.

These easier conditions were brought about mainly by the continued improvement in the overall balance of payments position. The sales of Krugerrand by the domestic private sector to the Reserve Bank also caused the creation of additional liquidity in the money market during 1991. In addition, lower cash reserve requirements for deposit-taking institutions were phased in from March to June 1991. Finally, deficits recorded by the Reserve Bank in its provision of forward exchange cover in the second and third quarter of 1991 contributed to the easier undertone in the money market.

The average daily level of *government deposits* with the Reserve Bank stayed at about the same level during the months from July to October 1991. The average level of such deposits, which had decreased from R7,6 billion in January 1991 to R5,7 billion in April and then increased again to R9,5 billion in July 1991, amounted to R8,3 billion in September and R9,1 billion in October. Similarly, the average daily amount of *notes in circulation* outside the Reserve Bank remained fairly stable during the period July to October 1991. Both of these factors therefore did not exacerbate the already high underlying level of money market liquidity.

In order to keep its rediscount rates effective and to prevent undue expectations of rapidly declining money market interest rates, the *Reserve Bank's actions* concentrated on neutralising excess liquidity. In this regard it made extensive use of foreign exchange intervention swaps with major banking institutions and the issuing of special short-dated Treasury bills. The monthly peak value in the amounts of foreign exchange swaps accordingly rose from R0,9 billion in January 1991 to R2,6 billion in June and further to R4,3 billion in October 1991. By mid-November it reached a new record value of R4,8 billion. The issuing of special short-dated Treasury bills reached a peak of R1,8 billion in August 1991 and then declined to a peak value of R1,0 billion in October.

Net sales of government stock by the Reserve Bank amounted to R2,8 billion in the second quarter of 1991 and to R3,7 billion in the third quarter. From the beginning of October to the middle of November a further R3,4 billion in net sales of stock were recorded. This brought the total net sales of government stock in fiscal 1991/92 to R9,9 billion, or only slightly below the budgeted deficit before borrowing. The corresponding total up to mid-November 1990 was R5,9 billion. The Reserve Bank's *gross transactions in government stock* amounted to R9,7 billion in the second quarter of 1991, and to no less than R16,5 billion in the third quarter; this rise in turnover contributed to a higher level of marketability of government paper. The amount of the Reserve Bank's transactions in *traded government stock options* also increased from R6,3 billion in the second quarter of 1991 to R7,4 billion in the third quarter.

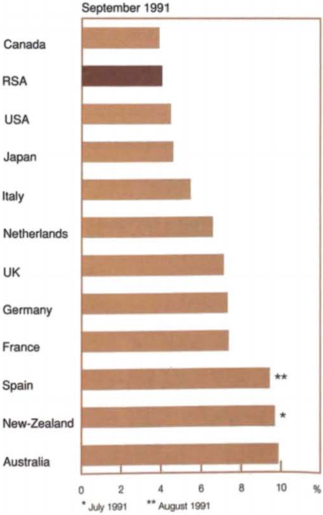
The amount of *Treasury bills* offered at the weekly tender was raised periodically during 1991. At the beginning of the year Treasury bills amounting to R100 million were provided on tender each week. This amount was then increased to R130 million from 5 April 1991, to R150 million from 30 May and to R200 million from 1 November.

Money market interest rates

The very gradual softening of most money market interest rates, which had started as early as February 1990, continued throughout the first eleven months of 1991. The market rate on *three-month liquid bankers' acceptances* stood at 16,50 per cent by mid-November 1991; this was more than 2 percentage points below its peak values of late 1989 and early 1990 and 1,00 percentage point lower than the Reserve Bank's rediscount rate for such acceptances. This clearly indicated that the underlying level of liquidity in the market was high, that the availability of foreign finance was increasing and that market participants were expecting the next adjustment in Bank rate to be downward. This was confirmed by the fact that the usual month-end hardening of *call rates* was limited to around 0,25 percentage points from August 1991, compared with 0,50 percentage points in July 1991 and 2,75 percentage points over the June 1990 month-end.

On 1 October 1991 the *prime overdraft rate* of the clearing banks was increased by 0,25 percentage points to 20,25 per cent, because of the introduction of a tax on financial services. However, this had no significant effect on most other money mar-

Real minimum lending rate of banks



ket interest rates. In fact, the average level of the rate on interbank call funds, which had amounted to 16,8 per cent since April 1991 and to 16,7 per cent in September, declined somewhat to 16,2 per cent in October. However, monetary institutions widened their lending/deposit rate margins somewhat to generate funds for the tax.

The inflation-adjusted prime lending rate in South Africa has fluctuated downwards from approximately 6 per cent in January 1991 to only 4 per cent in September 1991. Recent levels of the South African real prime rate were relatively low when compared internationally. Indeed, as shown in the accompanying graph in which minimum lending rates of selected countries in September 1991 (the latest month for which data are available) are compared, the real prime overdraft rate in South Africa was actually comparatively low. In certain countries pursuing restrictive monetary policies, such as Spain, Australia and New Zealand, real rates of between 10 and 12 per cent were applicable in September 1991.

As a reflection of the easier money market conditions, the part of the *yield curve* covering unexpired maturities of up to one year from September 1991 started to display a "normal" – if only marginally upward – slope for the first time since June 1989. This changed significantly the profile of carry costs associated with the accumulation of longer-term assets by investors. This development may also have given borrowers an incentive to substitute short-term for somewhat longer-term debt.

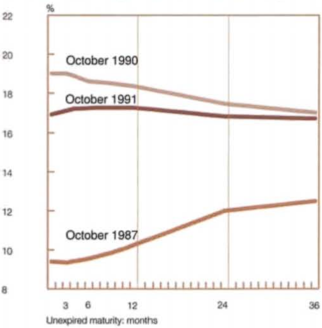
Capital market developments

Trading activity in the *secondary capital markets* in the third quarter of 1991 was influenced mainly by two factors: a marked further increase in the yield on long-term stock and unease about a possible downward correction of share prices. Both these factors led to a decrease in activity during the quarter.

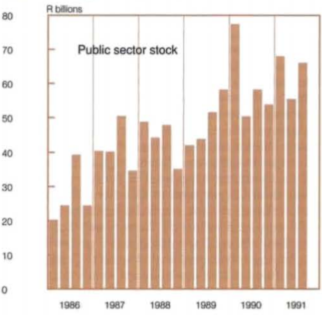
The value of *public-sector stock* traded on the Johannesburg Stock Exchange fell back from R26,8 billion in both July and August 1991 to R12,3 billion in September, as yields continued to harden. Trading activity then increased markedly again to R25,1 billion in October, as the yield on such stock started to soften. The changes in the yield on these stocks, combined with a marked strengthening of the financial rand, resulted in a similar pattern in the net purchases of public-sector stock by non-residents. On a monthly basis the value of these net purchases by non-residents decreased from R265 million in July 1991 to R94 million in September, and then rose to R216 million in October. For the third quarter as a whole the value of public-sector stock traded amounted to R65,9 billion, compared with R55,3 billion in the second quarter of 1991.

The value of *shares traded* on the Johannesburg

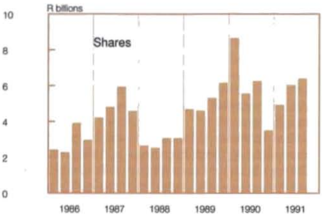
Yield curves for negotiable certificates of deposit



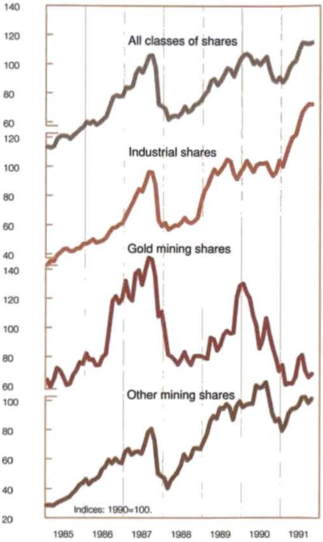
Stock exchange transactions



Stock exchange transactions



Share prices



Stock Exchange increased with the rise in share prices from R4,9 billion in the first quarter of 1991 to R6,0 billion in the second quarter and to R6,4 billion in the third quarter. However, uncertainty about share price movements caused trading activity to decline during the third quarter from R2,5 billion in July to R1,7 billion in September, and then to rise moderately to R1,9 billion in October as market sentiment became more optimistic. The unease about the sustainability of the strong bull market and the strengthening of the financial rand boosted non-residents' net sales of shares, which increased from R892 million in the first quarter of 1991 to R977 million and R1 107 million in the next two quarters. The monthly value of these net sales at R395 million in October 1991, was also slightly higher than the average monthly amount of sales of R369 million in the third quarter of 1991.

The monthly average *price level of all classes of shares* peaked in July, following a marked improvement of 30 per cent since the beginning of 1991. In the next three months prices moved more or less sideways, reflecting mainly uncertain market sentiments. Industrial share prices, however, continued to surge ahead to an all-time high in September – 33 per cent above the level of February 1991 – but then shed 0,3 per cent in October. The prices of gold-mining shares started declining in August 1991 and had fallen by 16 per cent from July to October, while other mining share prices declined slightly by 1,2 per cent from August to October.

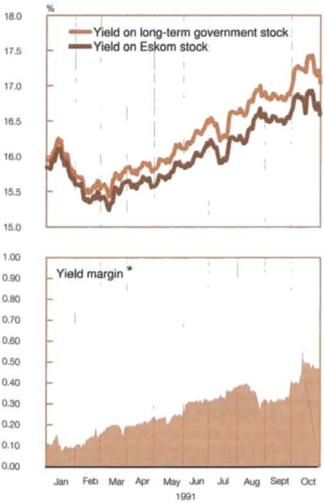
In response to the buoyant share market, the monthly total value of deals in *futures contracts* increased markedly during the first three quarters of 1991, from R4,6 billion in the first quarter of 1991 to R5,9 billion and R7,7 billion in the second and third quarter respectively. The monthly level of these transactions amounted to a substantial R3,1 billion in August, but fell back to R2,0 billion in October. Futures contracts in share-price indices in October accounted for 73 per cent of the value of futures contracts.

In the *primary capital markets*, the amount of funds raised by public-sector entities' borrowing through new issues of *fixed-interest securities* amounted to only R1,6 billion in the second quarter of 1991. In July the monthly value of such borrowing increased to R1,1 billion, but the redemption of government stock led to a net repayment of R0,8 billion in August 1991.

The amount of funds raised by *private-sector* *companies* through new issues of *fixed-interest securities* increased very rapidly from R91 million in the second quarter of 1991 to R967 million in the third quarter; R517 million of this amount was in the form of issues of preference shares. The buoyant conditions on the stock exchange and the relatively high cost of borrowed funds favoured share capital issues by companies. The value of *new issues of ordinary shares* by listed private-sector companies increased from R0,3 billion in the first quarter of 1991 to R1,9 billion in the second quarter, before declining moderately to R1,5 billion in the third quarter.

In the *mortgage market* the net amount of mortgage loans paid out by the major deposit-taking institutions increased slightly from a monthly average of R894 million in the second quarter of 1991 to R927 million in the third quarter. The average monthly value of *real estate transactions* in July and August, at R2,4 billion, was nearly equal to the average monthly level in the first half of 1991.

Capital market yields



* Margin between long-term government stock and Eskom stock

Capital market yields and interest rates

The average monthly *yield on long-term government stock* rose sharply from a low of 15,6 per cent in February and March 1991 to 17,2 per cent in October. This reflected the market's perception that inflation would remain high and fears that the public sector's borrowing requirement may well exceed the budgeted figure by a substantial margin. The average monthly yield on Eskom stock followed the trend in long-term government stock closely, though at a slightly lower level. The average margin between long-term government stock and Eskom stock widened from a narrow 0,11 percentage points in January to 0,45 percentage points in October. This margin is influenced by the trading activities of non-residents, the greater marketability of Eskom stock and the ability to hedge in the futures markets.

Recent developments in the *trading of options* indicate that the market is expecting a decline in yields, as call options began to exceed put options by a considerable margin. For instance, with the yield at about 17,4 per cent for the week ending 24 October 1991, call options amounted to R6,5 billion and put options to only R2,0 billion.

The upward trend in long-term yields and the marginal levelling-off in the measured inflation rate caused a slight increase in the *real yield* on long-term government stock from a low of 0,5 per cent in July 1991 to 1,3 per cent in September.

The deposit-taking institutions' predominant *home mortgage rate*, which had been maintained at 19,75 per cent since April 1991, was raised by 0,25 percentage points to 20,0 per cent in October 1991. This increase was made in reaction to the taxation introduced on financial institutions in lieu of value added tax. The introduction of this tax also led to a reduction in the *twelve-month deposit rate* of these institutions, which is regarded as indicative of deposit rates in general, by 0,50 percentage points to 15,5 per cent, to alleviate the pressure on interest rate margins.

The improvement in the average level of share prices was mainly responsible for a decrease in the dividend yield by 1,05 percentage points from January 1991 to July. In accordance with the subsequent levelling-off of share prices, the *dividend yield* then increased by 0,07 percentage points from July to October 1991. In October this yield therefore averaged 3,30 per cent. The *earnings yield* on shares decreased by 3,00 percentage points from January 1991 to August because of lower profits made by listed companies. It then recovered briefly by 0,05 percentage points to September, before again shedding 0,10 percentage points in October.

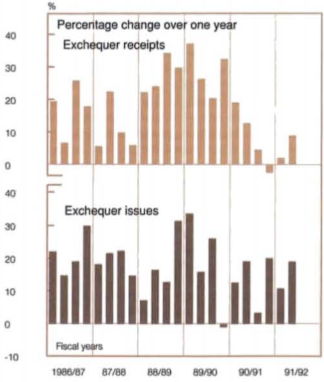
Government finance

Fiscal policy turned out to be more expansionary during the first half of the fiscal year 1991/92 than envisaged in the Budget for the year as a whole. This was not so much due to the fact that the growth in government expenditure exceeded the budgeted growth rate in expenditure by a moderate margin, but more specifically because the increase in government revenue was substantially lower than estimated in the Budget for the fiscal year as a whole. The Central Government's deficit before borrowing and debt repayment during the first half of fiscal 1991/92 therefore amounted to no less than 77 per cent of the deficit projected for the year as a whole.

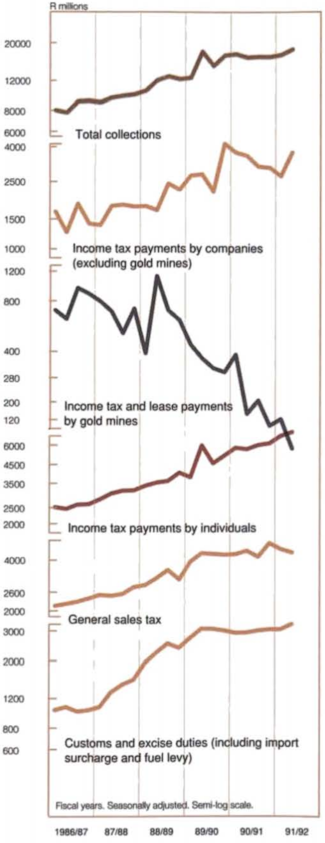
Exchequer issues

The year-on-year rate of increase in *Exchequer issues to government departments* (after the usual adjustment for changes in the balance on the Paymaster-General Account) accelerated markedly from 10,9 per cent in the first or June quarter of fiscal 1991/92 to 20,6 per cent in the September quarter. In October 1991 this rate of increase

Exchequer receipts and issues



Revenue collections - State Revenue Fund



amounted to 26,9 per cent. During the first seven months of the year these issues were 17,0 per cent higher than in the corresponding period of the preceding year, or markedly above the increase of 13,7 per cent in government expenditure that had been envisaged in the Budget for the year as a whole.

These Exchequer issues, however, exclude the transfer of R450 million to the Export Credit Reinsurance Fund in July 1991. This expenditure was not included in the Central Government's 1991/92 expenditure estimates because it was funded from the Exchequer's financing surplus in fiscal 1990/91. If *total Exchequer issues* in the first seven months of fiscal 1991/92 are compared with the budgeted and off-budget Exchequer issues in the corresponding period of the previous year, the rate of increase in these issues amounted to only 13,7 per cent. This comparison is, however, affected by the fact that figures for the first seven months of 1990/91 include the exceptionally large transfer to the Independent Development Trust of R2,0 billion.

Exchequer issues to government departments in the first seven months of fiscal 1991/92 were equivalent to 58,1 per cent of total budgeted expenditure for the fiscal year as a whole, against a ratio of 57,6 per cent in the corresponding period of fiscal 1990/91 and an average ratio of 58,4 per cent for the first seven months in the preceding five fiscal years. From these comparisons and taking into consideration the amounts of additional expenditure already announced, it can be deduced that Exchequer issues to government departments in fiscal 1991/92 are likely to exceed the Budget estimates for government expenditure by a marked amount.

Exchequer receipts

The year-on-year rate of increase in *Exchequer receipts* increased from 2,1 per cent in the June quarter of fiscal 1991/92 to 9,0 per cent in the September quarter. In October 1991 this rate of increase in Exchequer receipts amounted to 5,8 per cent. Accordingly, total receipts in the first seven months of fiscal 1991/92 were 6,0 per cent higher than in the first seven months of fiscal 1990/91. This rate of increase is significantly lower than the increase of 11,1 per cent in government revenue envisaged in the Budget for the fiscal year as a whole.

Exchequer receipts in the first seven months of fiscal 1991/92 constituted only 54,2 per cent of total budgeted revenue for the fiscal year, against a ratio of 59,7 per cent in the corresponding period of fiscal 1990/91 and an average ratio of 58,2 per cent for the same period in the preceding five fiscal years.

The fact that Exchequer receipts in the first six months of fiscal 1991/92 did not come up to expectations was caused mainly by lower than expected increases in the revenues from the fuel levy, the general sales tax and income tax on mining and non-mining companies. The year-on-year rate of increase in the receipts from general sales tax in the first half of fiscal 1991/92 amounted to only 2,5 per cent; an overall increase of 6,8 per cent from this source and from value added tax had been budgeted for the fiscal year as a whole. Although income tax on individuals rose fairly sharply, a decline in receipts from companies in the first half of 1991/92 was responsible for a moderate rise of 10,7 per cent in total income tax collections above the level in the corresponding period of the previous year, compared with a budgeted increase of 18,7 per cent. The year-on-year rate of increase in the fuel levy during the first half of fiscal 1991/92 amounted to only 11,4 per cent, against the budgeted increase of 15,1 per cent for fiscal 1991/92 as a whole.

Deficit before borrowing

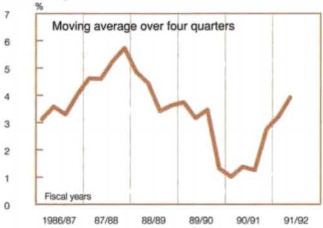
The *deficit before borrowing and debt repayment* in the first seven months of fiscal 1991/92 amounted to R8 129 million, or about 80,3 per cent of the budgeted deficit of R10 118 million for the fiscal year as a whole. The deficit in the first seven months of fiscal 1990/91 amounted to R3 053 million, or to 38 per cent of the budgeted deficit. As a percentage of gross domestic product, the deficit before borrowing in the first half of fiscal 1991/92 amounted to 5,3 per cent; the original Budget estimates provided for a ratio of 3,4 per cent of gross domestic product for the fiscal year as a whole.

The deficit of R8 129 million in the first seven months of fiscal 1991/92, *plus* the discount of R3 099 million on new government stock issues and the transfer of R450 million to the Export Credit Reinsurance Fund (for a total of R11 678 million), were financed by means of the following *debt instruments*:

	R millions
Government stock (including discount)	14 121
Treasury bills	-1 115
Non-marketable securities	-56
Foreign loans	282
Decrease in available cash balances	-1 554
Total financing of Exchequer deficit	11 678
Less: Transfer to the Export Credit Reinsurance Fund	450
Discount on new government stock	3 099
Total net financing (= deficit before borrowing)	**8 129**

An analysis of the financing of the deficit before borrowing by *type of lender* is available only for the first half of 1991/92. During this period the total

Deficit before borrowing as percentage of gross domestic product



deficit of R10 628 million was financed from the following sources:

	R millions
Public Investment Commissioners	4 677
Non-monetary institutions	3 686
Monetary institutions:	
Corporation for Public Deposits	190
Other monetary institutions*	1 940
Foreign sector	135
Total financing	**10 628**

* Including the transfer of R450 million to the Export Credit Reinsurance Fund.

Further changes to value added tax

On 29 September 1991 the Minister of Finance announced a further adjustment in value added tax which became effective on 30 September 1991. The Minister stated that an additional number of food items would be taxed at the zero-rate until the end of fiscal 1991/92. These items included samp, crushed maize, whole maize, dried beans, soya beans, lentils, canned pilchards, fresh milk and milk powder. The estimated loss of government revenue because of these changes amounted to about R170 million for fiscal 1991/92.