Quarterly economic review

Introduction

In the first half of 1991 the downturn in economic activity deepened somewhat. This was more clearly reflected in developments in expenditure aggregates than in total output. After declining for six consecutive quarters, real gross domestic product moved sideways in the second quarter of 1991. This levelling-out of aggregate real output was mainly due to an increase in the production of agriculture and enterprises involved in gold and coal mining. The real value added by other mining enterprises and by the secondary and tertiary sectors registered either lower growth rates or kept on declining. In particular, the real value added by manufacturing, which had begun to recede from the middle of 1989, contracted sharply further. This decline took place despite the strong growth in exports of manufactured goods, which therefore meant that production for domestic consumption contracted even more markedly. The utilisation of production capacity in manufacturing has accordingly declined steadily to very low levels.

Real gross domestic expenditure decreased at an annualised rate of approximately 3 per cent in the second quarter of 1991. The demand for consumer goods and services, which had remained relatively firm up to the fourth quarter of 1990, began to level out in the first quarter of 1991 and actually decreased in the second quarter of 1991. This contraction in household consumption expenditure occurred mainly in purchases of durable and non-durable goods and was probably associated with a slight decrease in real personal disposable income.

The rate of decrease in aggregate real gross domestic fixed investment accelerated in the second quarter of 1991 and contributed to the deepening of recessionary conditions. Real capital formation has now declined for seven consecutive quarters. Various longer-term factors have been responsible for this sustained contraction in fixed investment, including the low and decreasing level of economic activity, uncertainty regarding the political future of the country, internal unrest, the weak performance of international commodity prices, and tension in the labour market. More recently a postponement of outlays on capital goods in view of the implementation of the value added tax also brought about a decrease in real outlays by the private sector on machinery and transport equipment.

Notwithstanding the generally negative sentiment towards fixed investment and a continued decrease in the real value added by manufacturing, private manufacturing enterprises increased their real investment expenditure considerably in the first half of 1991. These investment outlays were mainly concentrated in certain sub-sectors of manufacturing, such as the paper and printing industry, the chemical industry and base metal processing, which generally had considerable success on export markets.

The decline in domestic expenditure in the second quarter of 1991 was also the result of a more rapid rate of destocking. Inventory investment has now declined for eight consecutive quarters, and the level of industrial and commercial stocks amounted to only 18½ per cent of non-agricultural gross domestic product in the second quarter of 1991.

As could be expected, the decline in economic activity was accompanied by further reductions in employment. However, nominal labour costs per worker continued to rise at high rates, which were nonetheless somewhat lower than at the beginning of the downswing. From the beginning of 1989 increases in labour remuneration have consistently exceeded growth in operating surpluses, with important implications for the saving potential of the South African economy. Recent negotiations with labour unions, however, have shown some moderation in wage demands.

Although this is a healthy development, wage increases still do not reflect underlying supply and demand conditions in the labour market and productivity changes. Continuing excessive increases in labour costs can become a serious impediment to future economic growth in South Africa and where development does take place it could tend to be more capital-intensive rather than labour-intensive. As indicated in the *Annual Economic Report* for 1991, this has already occurred to a considerable extent and has contributed to a low and declining labour absorption capacity of the economy. This does not mean that high and rising labour costs are the only reason for the low labour absorption capacity – obviously lower economic growth also played an important part. The increasing capital intensity of the economy, however, clearly indicates that developments that have transpired were not a true reflection of the relative scarcities of the production factors of the country and therefore not the kind of growth needed for a more healthy economy. South Africa does not only need higher growth in real gross domestic product; it needs a combination of high growth in production and in employment.

The large increases in nominal labour costs and only recent moderate improvements in productivity resulted in increases in real unit labour costs of about 2 per cent per annum in the past two years, with negative effects on the international competitiveness of the country and the lowering of inflation. The persistently high rates of domestic price increases were also partly related to inflationary expectations and high rates of increase in the prices of food.

On the balance of payments front, increases in the value of merchandise exports and the net gold exports were mainly responsible for a further large surplus on the current account in the second quarter of 1991. Net service and transfer payments fell further because of an increase in service receipts from the sales of ships' stores and income received on foreign direct and non-direct investment. In contrast to these favourable developments, the volume of merchandise imports rose sharply largely because of the purchase of a macro-jet aircraft and the further replenishment of depleted inventories of mineral products. Despite this further rise, the volume of imports was still at a comparatively low level.

The capital account of the balance of payments has been characterised by increased volatility since the middle of 1990 because of sharp fluctuations in short-term capital movements. Notwithstanding a further decline in the outflow of long-term capital, short-term capital movements were responsible for a total net outflow of capital not related to reserves of R2,1 billion in the second quarter of 1991. South Africa's net gold and other foreign reserves accordingly declined by R0,8 billion, which brought the increase in these reserves in the first half of 1991 down to R1,0 billion. After taking changes in reserve-related liabilities and valuation adjustments into account, the total gross gold and other foreign reserves at the end of June were on more or less the same level as at the end of the first quarter of 1991. In July and August 1991 both the net and gross reserves of the Reserve Bank increased again sharply.

The nominal and real effective exchange rate of the rand remained fairly stable during the first eight months of 1991. At the end of August 1991 the nominal effective exchange rate of the rand was only 5,7 per cent below its previous lower turning-point on 18 September 1989.

In the sphere of money and banking, year-on-year increases in nearly all the main monetary aggregates increased sharply during the first six months of 1991, mostly due to the implementation of new regulations under the Deposit-taking Institutions Act implemented on 1 February 1991. These regulatory changes led to the conversion by monetary institutions of various kinds of off-balance-sheet items into conventional deposits and advances, thereby increasing the growth in money supply and bank credit. If the growth in money supply and bank credit is measured from the end of February (the month in which the new regulations came into effect) to the end of June, the seasonally adjusted and annualised growth rates amounted to only 11,6 and 13,8 per cent respectively.

The money market remained relatively liquid since the beginning of 1991 because of the improvement in the overall balance of payments position, a decline in government deposits during the first four months of the year, deficits recorded on the Reserve Bank's forward book, and the lowering of the monetary institutions' cash reserve requirements. In accordance with the restrictive monetary policy stance, the Reserve Bank countered these easier money market conditions by making use of foreign exchange intervention swaps and the issuing of special short-dated Treasury bills. The higher underlying liquidity in the money market and interest rate expectations, however, led to a moderate decrease in short-term interest rates.

Long-term interest rates, on the other hand, firmed in the second quarter of 1991 because of doubts about a decline in the inflation rate and the ability of the Central Government to contain its budgeted borrowing requirement. Trading activity in the secondary capital market as a whole accelerated during the first eight months of 1991. Marked increases in the prices of all main categories of shares also took place over the same period.

In the sphere of government finance the first five months of the fiscal year (April to August 1991) were characterised by increases in Exchequer issues moderately above the projected increase in government expenditure, but with revenue increases that were considerably lower than envisaged in the Budget. Moreover, the rate of increase in Exchequer receipts has shown a marked declining tendency since the June quarter of 1990. These lower receipts were mainly responsible for an Exchequer deficit before borrowing and debt repayment of R 8 665 million in the first five months of fiscal 1991/92, or equivalent to 85,6 per cent of the total projected deficit for the fiscal year as a whole. Additional fiscal measures were announced by the Government in August 1991 and early September, related mainly to the value added tax, socio-economic upliftment and short-term tax incentives for export ventures, which should increase the expansionary effect of the Budget.

As indicated in the Governor's Address at the Bank's Annual General Meeting on 27 August 1991, the more stimulatory fiscal package should encourage both consumer and new capital investment expenditure and could contribute to a bottomming-out of the mild cyclical decline in economic activity, or even to an upturn in economic activities in the near future. The leading business cycle indicator of the Bank had also moved upwards during the first five months of 1991, suggesting a possible prospective upturn in economic activity. The low level of inventories could mean that any increase in domestic demand will soon be reflected in higher production and growth, while the favourable balance of payments position and higher level of foreign reserves should provide some cushion for increases in imports related to a higher level of domestic activity. At this stage a mild upturn in the South African economy seems to be a distinct possibility.

Domestic economic developments

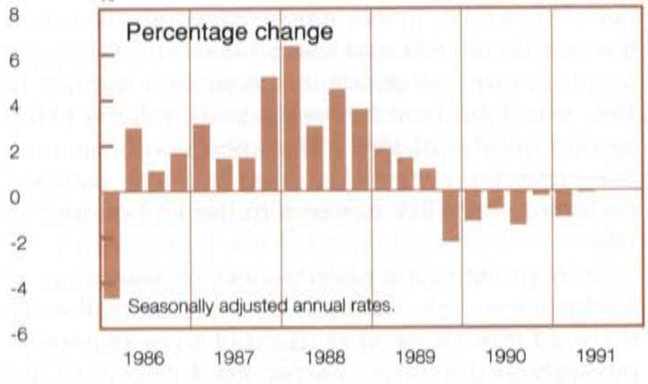
Domestic output

The *total* real gross domestic product, which had declined for six consecutive quarters from the fourth quarter of 1989 to the first quarter of 1991 at annualised rates varying between ½ and 2½ per cent per quarter, showed virtually no change in the second quarter of 1991. This sideways movement in total real output was the combined result of a rise in the real value added in the primary and tertiary sectors and a lower rate of decrease in the output of the secondary sectors.

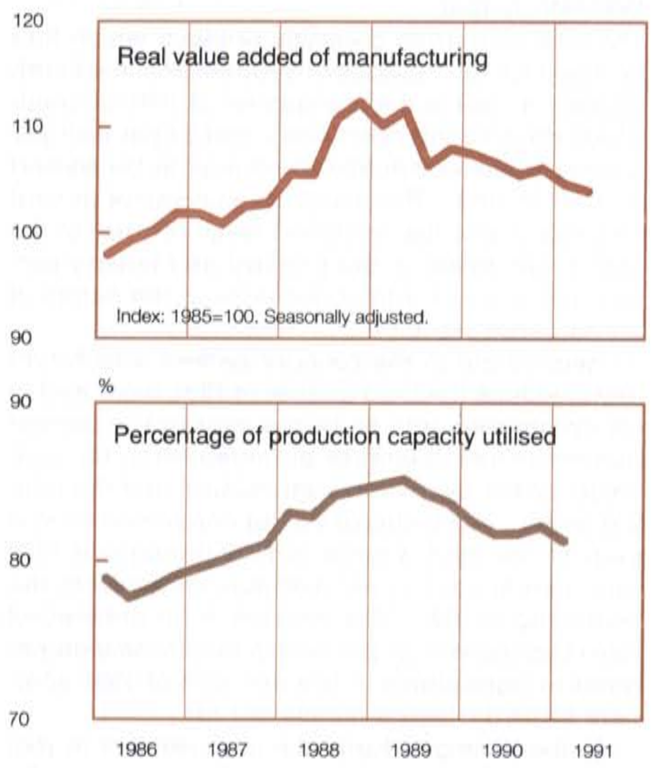
Real output in the *primary sectors*, which had declined from the third quarter of 1990, increased at an annualised rate of 2½ per cent in the second quarter of 1991 because of increases in the real value added by both the agricultural and the mining sector. Agricultural output contracted from a peak in the third quarter of 1989 throughout 1990 and then started to recover marginally from the beginning of 1991. This resulted in an annualised rate of increase of 2½ per cent in real income originating in agriculture in the first half of 1991 compared with the last six months of 1990.

In the mining industry the improvement in real value added stemmed from small increases in the sub-sectors gold and coal mining which more than offset declines in diamond and other mining enterprises. Increases in the tonnage of gold ore milled and relatively stable labour conditions led to a rise in the physical volume of gold production, while the higher levels of coal production were associated with favourable developments on international markets. Declines in real value added by diamond and "other" mining reflected lower economic activity in a number of industrial countries, excess world

Real gross domestic product



Manufacturing



stocks of certain metals and minerals and the prevailing lacklustre performance of some international base metal prices.

The rate of decline in real output in the *secondary sectors* slowed down from an annualised level of about 5 per cent in the first quarter of 1991 to approximately 2½ per cent in the second quarter; a further decline in the volume of manufacturing production and the depressed state of the construction industry more than offset a small increase in the real output by the sector supplying electricity, gas and water. A distinct declining trend has now been discernible in manufacturing production from the middle of 1989 and the production of durable and non-durable goods in the second quarter of 1991 was 3 per cent below the peak volume of the second quarter of 1989. The utilisation of production capacity in manufacturing has also receded steadily to only 81½ per cent in the first quarter of 1991.

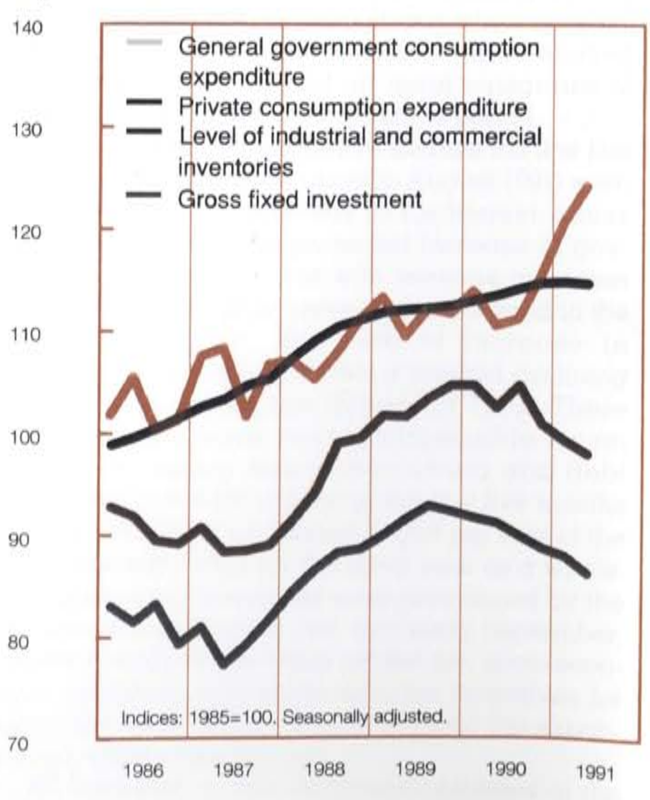
In contrast to the previous two downswings of the business cycle, the real value added by the *tertiary sector* showed a distinct upward trend throughout the current downward phase. In the second quarter of 1991, however, the annualised rate of growth in real value added by the tertiary sector slowed down to approximately ½ per cent from almost 1 per cent in the preceding quarter. Slower growth in real value added of the tertiary sector occurred in nearly all sub-sectors, with the notable exception of commerce. After real value added by commerce had declined in the first quarter of 1991, it remained on this lower level during the second quarter; increases in real output of wholesale trade, which were mainly related to the continuing high level of foreign trade, were almost fully neutralised by declines in the real value added by the retail and the motor trade.

The rate of increase in real value added in both the sectors transport and finance reached an annualised level of some 1 per cent in the second quarter of 1991. This followed rates of increase of about 1½ and 2 per cent, respectively, in the first quarter of 1991. The lower but nonetheless further positive growth rates of these two sectors could mainly be attributed to the sustained high level of real exports, the buoyancy on the stock exchange and the high level of fixed-property transactions.

Domestic expenditure

After modest recoveries at annualised rates of 3

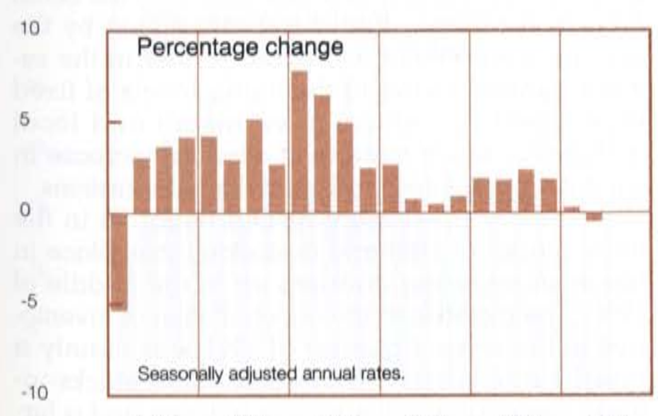
Main components of real gross domestic expenditure



and 4 per cent in aggregate *real gross domestic expenditure* in the second and third quarter of 1990, the growth rate in expenditure fluctuated sharply in the next two quarters from a large negative to a large positive rate of change. Real gross domestic expenditure then contracted again at an annualised rate of about 3 per cent in the second quarter of 1991, to a level of just more than 4 per cent below that of the first quarter of 1989. This decrease in total real domestic expenditure was brought about by contractions in real private consumption expenditure and in total real fixed capital expenditure. In addition, the rate of decumulation of total real inventories accelerated again. In contrast to these developments, real consumption expenditure by general government continued to increase substantially.

The relatively firm demand for consumer goods and services in the current economic downswing began to level out in early 1991. From the beginning of 1991 revised estimates show a contraction in expenditure on durable and semi-durable goods and services resulting at first in a considerably lower growth in total *real private consumption expenditure* at an annual rate of ½ per cent in the first quarter of the year. In the second quarter of 1991 households' real outlays on consumer goods and services decreased at an annual rate of ½ per cent. This was the first decrease in real private consumption expenditure since the first quarter of 1986 and it was largely related to a slight decrease in real personal disposable income. The rate of increase in real personal disposable income contracted from an average of 1½ per cent in 1990 to ½ per cent in the first quarter of 1991, followed by a decrease in disposable income of ½ per cent in the second quarter. The persistent cooling-down of the economy and considerable retrenchments of labour probably also led to more cautionary budgeting by households.

Real private consumption expenditure



The rate of decrease in real expenditure on durable consumer goods accelerated from 2 per cent in the first quarter of 1991 to some 4½ per cent in the second quarter. This more pronounced decrease in the second quarter occurred largely in expenditure on furniture and household appliances, personal transport equipment, and recreational and entertainment goods. Real household consumption expenditure on semi-durable goods contracted at an annualised rate of 1½ per cent in the second quarter of 1991, while expenditure on services remained more or less on the level of the preceding quarter. The further increase in households' aggregate expenditure on non-durable consumer goods at an annualised rate of 1 per cent reflects the more essential and non-discretionary nature of spending on items in this category, which normally rises with the growth in population.

Real consumption expenditure by general government again rose substantially in the second quarter of 1991. This increase, at an annualised rate of more than 12 per cent, followed increases at annualised rates of 16 per cent in the fourth quarter of 1990 and 19½ per cent in the first quarter of 1991. As a result, real government consumption expenditure was 5 per cent higher in the twelve months ended June 1991 than in the preceding twelve months, and in the first half of 1991 real government consumption expenditure was approximately 9½ per cent above its level in the corresponding period of 1990. This continued strong increase in real government consumption expenditure took place almost entirely in real expenditure on intermediate goods and services; real remuneration of government employees rose only marginally at a seasonally adjusted and annualised rate of some ½ per cent in the second quarter of 1991.

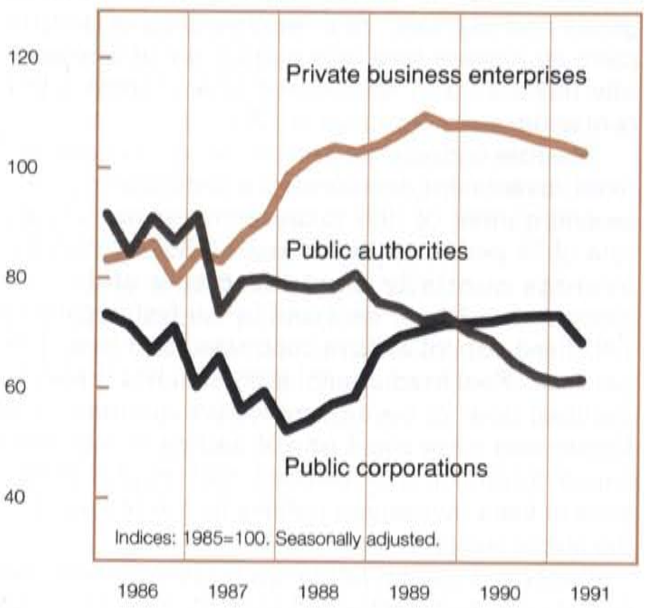
The rate of decrease in total *real gross domestic fixed investment* accelerated substantially in the second quarter of 1991 to an estimated annualised rate of 7½ per cent; in the second half of 1990 the average quarterly annualised rate of decline amounted to 5½ per cent and in the first quarter of 1991 fixed capital outlays contracted at a rate of 3½ per cent. Real fixed capital formation has therefore declined now for seven consecutive quarters. The further and more rapid rate of decline in real fixed capital formation was the combined result of reductions in fixed investment outlays by the private and the public sector.

Real fixed capital formation by *private business enterprises* has decreased continuously from the second quarter of 1990. In the second quarter of 1991 it contracted at an annualised rate of no less than 5½ per cent, which was significantly higher than the annualised rates of contraction varying between 1½ and 4½ per cent in the preceding four quarters. In general, a number of factors have had a negative effect on fixed investment in the private sector, such as political uncertainties, the low and decreasing level of economic activity, internal unrest and discord in management-labour relations. More recently, a postponement of outlays on capital goods until after the implementation of value added tax also contributed to the decline in real outlays by the private sector on machinery and transport equipment.

More specifically, the decline in real fixed capital formation in the agricultural sector stemmed also from mounting levels of the debt of farmers, relatively high nominal interest rates, a sustained deterioration in the terms of trade in agriculture and uncertainties regarding future land reform policies. Real fixed capital formation in the mining sector also contracted significantly further in the second quarter of 1991, mainly because of rationalisation programmes in the gold-mining industry. The disappointingly weak performance of certain international base metal prices also precluded any increases in the production capacity of other mining enterprises.

Despite the generally negative climate for fixed investment in the country, the fixed investment expenditure of private manufacturing concerns improved noticeably in the first half of 1991. After recording an increase of 5 per cent at an annualised rate in the first quarter, real fixed investment in private manufacturing rose further at an annualised rate of 3 per cent in the second quarter. These increases at an advanced stage of the downturn in the business cycle could mainly be ascribed to vigorous growth of exports of manufactured goods and the expansion of production capacity in sub-sectors such as paper and printing, the chemical industry and base metal working. It also contributed, of course, to the low utilisation of production capacity in manufacturing.

Real gross domestic fixed investment



Real fixed capital formation by the *public sector* contracted at an annualised rate of approximately 11 per cent in the second quarter of 1991, as against 3½ per cent in the first quarter. This was the net result of a substantial reduction in real fixed investment outlays by public corporations, which outweighed a moderate increase in capital outlays by public authorities.

Real fixed investment by public corporations, which had increased at an annualised rate of ½ per cent in the first quarter of 1991, contracted substantially in the second quarter. This decline largely reflected reduced investment spending by public corporations in the primary and secondary sectors of the economy. In particular, Eskom made further cut-backs in its capital expenditure programmes, and the capital outlays on the on-shore and off-shore development activities of Mossgas started to peter out as the project was nearing completion.

After a distinct declining trend had been discernible in real fixed investment expenditure by public authorities, the capital outlays of these authorities rose moderately at an annualised rate of 2½ per cent in the second quarter of 1991. This turn-about in fixed investment expenditure by public authorities was mainly caused by increases in the capital outlays of the Department of Posts and Telecommunications and Transnet (mostly associated with the delivery of a new aircraft to the South African Airways). Real fixed investment by the general government decreased further in the second quarter owing to declining levels of fixed investment by central government and local authorities, which more than offset an increase in capital expenditure by provincial administrations.

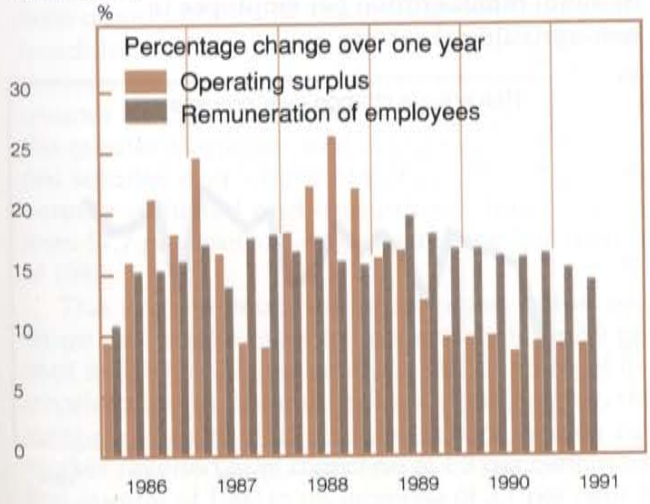
Inventory investment turned negative in the third quarter of 1989 and destocking took place in the ensuing seven quarters up to the middle of 1991. The increase in the decumulation of inventories in the second quarter of 1991 was mainly a reflection of low levels of agricultural stocks-in-trade, destocking in the mining industry and a further drawing-down of industrial and commercial inventories. The ratio of real industrial and commercial inventories to the non-agricultural real gross domestic product nevertheless remained almost unchanged in the second quarter of 1991 at the low level of 18½ per cent that had been reached in the fourth quarter of 1990; this level can be compared with an average ratio of 25 per cent in the early 1980s.

Factor income and domestic saving

Growth in *aggregate nominal factor income* at market prices slowed down from a year-to-year rate of increase of 17½ per cent in 1989 to 13 per cent in 1990. In the first half of 1991 the rate of increase over four quarters continued to decelerate moderately from 12½ per cent in the first quarter to 11 per cent in the second quarter. However, the quarter-to-quarter rate of growth in total nominal factor income accelerated to an annualised rate of about 17 per cent in the second quarter of 1991, after varying between 7½ and 10 per cent in the previous three quarters. This high increase in the second quarter of 1991 was the result of increases in both nominal labour remuneration and gross operating surpluses.

The increase in *nominal labour remuneration* accelerated from a seasonally adjusted and annualised rate of 13½ per cent in the first quarter, to 18½ per cent in the second quarter of 1991. However, the increase over one year slowed down from 16½ per cent in calendar 1990 to about 15 per cent in the first half of 1991. Increases in the salaries and wages of employees on mines were mainly responsible for the high quarterly increase in total nominal labour remuneration in the second quarter of 1991. This substantial rise in the nominal wage bill of the mining sector transpired after an actual *decrease* in the first quarter, and was obtained partly because of retrenchments and other measures to reduce costs. In addition, the quarter-to-quarter rates of increase in labour remuneration for the sectors manufacturing, commerce, electricity, gas and water, finance and general government were also in excess of the rise in the consumer price index in the first half of 1991.

Gross operating surplus and remuneration of employees



As shown in the accompanying graph, the rate of increase in labour remuneration has consistently exceeded the growth in operating surpluses from the beginning of 1989. Accordingly, the share of labour remuneration in total nominal factor income rose from a low of 56½ per cent in the third quarter of 1988 to an average of 60 per cent in the first two quarters of 1991. Although this is to some extent a normal cyclical pattern, the sustained increase during the current downswing stood in sharp contrast to the previous two downswings and occurred despite the lack of meaningful employment growth in the formal sector of the economy. This provides evidence of forces working towards the redistribution of factor income in favour of labour, which has important implications for the future saving potential of the economy.

The rate of increase in the *gross operating surplus* accelerated from 12 per cent in the first quarter of 1991 to 20 per cent in the second quarter. Although this acceleration took place in a number of sectors, it was particularly evident in gold mining. A favourable rand price of gold and the industry's success in minimising cost increases were probably responsible for this improvement. Despite the acceleration in the growth of the total gross operating surplus in the second quarter of 1991, the year-on-year rate of increase slowed down marginally to slightly more than 9 per cent in the first half of 1991, compared with 9½ per cent in calendar 1990.

The ratio of *gross domestic saving* to gross domestic product declined to a new low of 19½ per cent in the first half of 1991, as against 22½ per cent in 1989. This decline could mainly be attributed to the net dissaving by the general government during the first half of 1991. In contrast to the preceding four quarters (or calendar 1990) when government registered positive net saving, its current income fell short of its current expenditure in the first and the second quarter of 1991.

The level of net saving in the private sector improved moderately in the first two quarters of 1991. The ratio of net personal saving relative to personal disposable income fluctuated around an average of 2 per cent since the fourth quarter of 1990, which is slightly more than the average of 1½ per cent recorded in calendar 1990. In the corporate sector net saving was positively affected by the rise in the gross operating surplus of companies. The provision for consumption of fixed capital proceeded along a steadily upward course in the second quarter of 1991.

Employment

In accordance with the cyclical downswing in economic activity, the rate of increase in *total non-agricultural employment* slowed down from 1,5 per cent in 1988 to 0,7 per cent in 1989. Non-agricultural employment then actually decreased by 0,4 per cent in 1990. This decline started to take place from the second quarter of 1990. More recently, non-agricultural employment decreased at quarter-to-quarter rates, in seasonally adjusted and annualised terms, of 2,4 and 2,6 per cent in the fourth quarter of 1990 and the first quarter of 1991.

The year-to-year rate of increase in employment in the *non-agricultural private sector* also contracted, namely from 1,6 per cent in 1988 to 0,5 per cent in 1989, before turning negative to the extent of 0,5 per cent in 1990. During the course of 1990 employment in the non-agricultural private sector rose substantially at first at a seasonally adjusted and annualised rate of 3,2 per cent in the first quarter of 1990, largely because of the reversal of previous lay-offs. It then started to decrease from the second quarter of 1990 and the quarter-to-quarter rate of decline, seasonally adjusted and annualised, accelerated to 5,3 and 5,4 per cent in the fourth quarter of 1990 and the first quarter of 1991 respectively – i.e. new record rates of decrease. Data available for the second quarter of 1991 indicate continued decreases in the workforce in manufacturing, construction, electricity generation and insurers.

Total employment by *public authorities* also started to decrease from the second quarter of 1990, but then increased sharply at seasonally adjusted and annualised rates of 4,9 and 4,2 per cent in the fourth quarter of 1990 and the first quarter of 1991. Increases in employment by public authorities during cyclical downswings are, however, not uncommon; employment by public authorities recorded positive rates of increase during most of the cyclical downswing phases of the economy in the 1970s and the 1980s. On an annual basis, employment by public authorities nonetheless decreased marginally by 0,1 per cent in 1990.

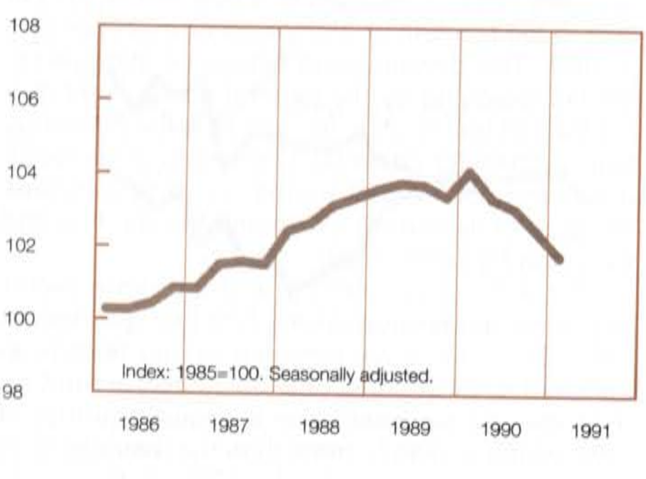
The ratio of *overtime hours to normal hours* worked in manufacturing declined from the third quarter of 1989 to the first quarter of 1991, and stayed roughly unchanged in the second quarter. In the construction sector this ratio has recovered somewhat in both the first and the second quarter of 1991, after having declined during the second half of 1990.

The seasonally adjusted number of *registered unemployed workers* decreased from its earlier peak of 136 400 in December 1985 to 109 600 in January 1989. It then increased again and fluctuated around an average level of 220 000 in the first five months of 1991.

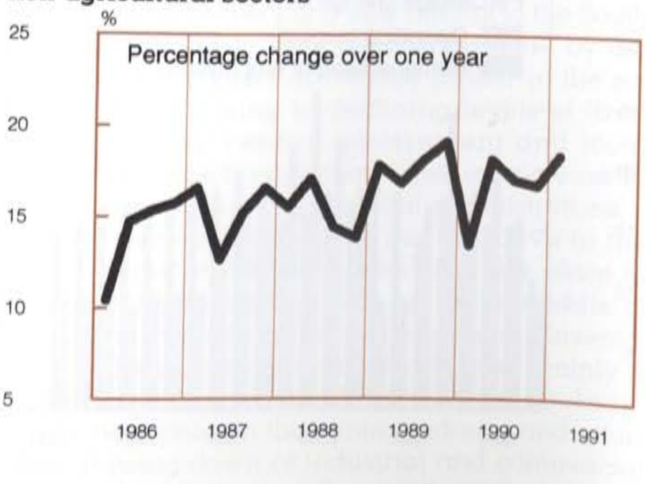
Labour costs and productivity

The year-to-year rate of increase in the average amount of *nominal salaries and wages* per worker in the non-agricultural sectors of the economy accelerated from 15,3 per cent in 1988 to 18,0 per cent in 1989, and then declined only mildly to 16,8 per cent in 1990. Moreover, after the year-on-year rate of increase in nominal salaries and wages per

Non-agricultural employment



Nominal remuneration per employee in non-agricultural sectors



worker had declined from 19,2 per cent in the fourth quarter of 1989 to 13,5 per cent in the first quarter of 1990, it reaccelerated to rates close on and even more than 17 per cent in the ensuing three quarters. In the first quarter of 1991 this rate amounted to 18,5 per cent. Data available for the second quarter point to further accelerations in nominal wage increases in the construction and insurance sectors. Milder, but still high, wage increases were granted in the electricity-generating sector and by deposit-taking institutions. Wage increases are, therefore, clearly related only partly and weakly to the underlying demand and supply conditions in the labour market and are probably contributing to the low labour absorption capacity of the economy.

The recent reacceleration in the rate of increase in average wages occurred in both the private and public sectors. The year-on-year rate of increase in the nominal salaries and wages per worker in the non-agricultural *private sector* accelerated from 14,4 per cent in the fourth quarter of 1990 to 16,6 per cent in the first quarter of 1991, mainly because of wage increases of more than 20 per cent in, among other sectors and sub-sectors, the mining industry, wholesale trade, deposit-taking institutions, hotels and laundry services. In the general climate of still high wage increases, the recent agreement between the National Union of Mineworkers and the Chamber of Mines – granting general salary and wage increases of only 5 per cent, but linking bonus payments to the gold price and productivity improvements – should be welcomed.

The year-on-year rate of increase in the nominal salaries and wages per worker employed by public authorities increased even more dramatically from 5,6 per cent in the first quarter of 1990 to rates varying between approximately 21 and 22 per cent in the next four quarters. This sharp acceleration in year-on-year rates of increase in the nominal remuneration per worker employed by public authorities was mainly due to material improvements in the conditions of service that were implemented for various categories of workers during the second quarter of 1990. Since the second quarter of 1990 the quarter-to-quarter rate of increase in the nominal salaries and wages of public authorities, seasonally adjusted and annualised, has declined from 57,7 per cent to 6,4 per cent in the first quarter of 1991.

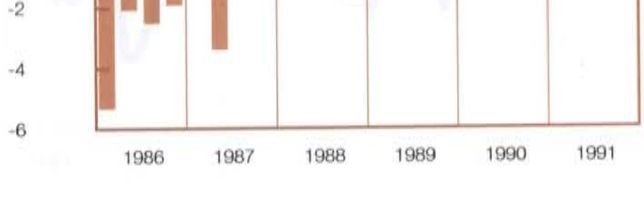
The year-to-year rate of increase in the *real* wage per worker receded moderately from 2,9 per cent in 1989 to 2,1 per cent in 1990. In view of the acceleration in nominal salaries and wages, the year-on-year rate of change in real wages per worker reverted from a decline of 1,3 per cent in the first quarter of 1990 to an increase of 3,7 per cent in the second quarter. It then declined moderately in the next two quarters, before increasing again to 3,5 per cent in the first quarter of 1991.

Real non-agricultural *labour productivity*, after increasing at a relatively impressive rate of 2,3 per cent in 1988, slowed down in 1989 (0,8 per cent) and actually decreased in 1990 (-0,1 per cent). Continuous decreases were recorded in real output per non-agricultural worker from the third quarter of 1989 to the second quarter of 1990. It then increased at a year-on-year rate of 0,5 per cent in the third quarter and by rates of 0,6 and 1,4 per cent in the next two quarters. These recent improvements in real labour productivity are probably related to decreases in employment, as well as in the number of man-days lost because of strikes and work stoppages.

The continued high rates of increase in nominal remuneration per worker led to a reacceleration in the year-on-year rate of increase in *nominal unit labour costs* from 14,5 per cent in the first quarter of 1990 to 18,9 per cent in the second quarter. Nominal labour costs per unit of physical output then increased at slightly lower, but still high, rates varying between 16 and 17 per cent. Despite this more rapid quarterly rise in nominal unit labour costs, its year-to-year rate of increase contracted mildly from 17,2 per cent in 1989 to 16,5 per cent in 1990.

The year-to-year rate of increase in *real unit labour costs* also declined slightly from 2,1 per cent in 1989 to 1,9 per cent in 1990. The year-on-year rate of increase in real unit labour costs, in line with the reported slower rates of increase in the real wage per worker and improvements in real labour productivity, decelerated from 4,3 per cent in the second quarter of 1990 to 1,3 per cent in the fourth quarter. It subsequently rose again to 2,0 per cent

Real unit labour costs in non-agricultural sectors



in the first quarter of 1991 because of the concomitant sharp real wage increase.

Prices

The downward trend in both the production and consumer price indices from the middle of 1989 was reversed from August 1990 when the conflict in the Middle East started. The sharp rise in international prices of crude oil resulted in substantial increases in the prices of imported goods and domestic fuel. Although international oil prices early in 1991 returned to levels that had prevailed before the invasion of Kuwait by Iraq, the rates of increase in domestic prices remained generally at the higher levels. The persistent high rate of domestic inflation was probably mainly related to higher inflationary expectations, continued high rates of increase in the prices of food, and high wage settlements.

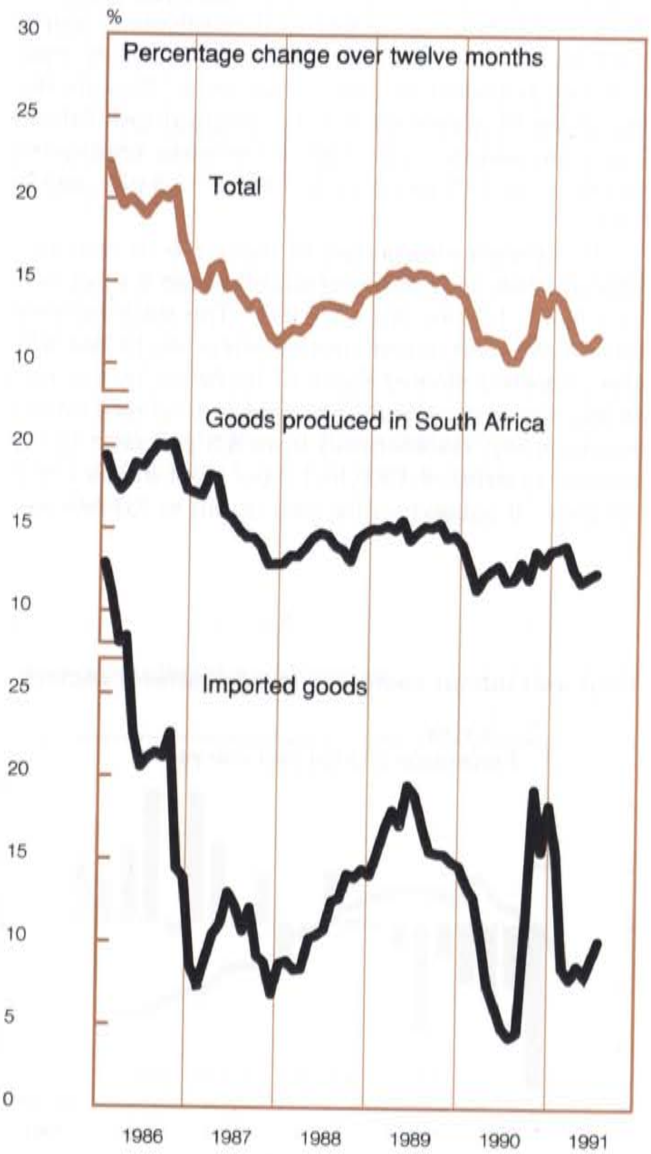
Despite this reacceleration of price inflation, the year-to-year rate of increase in the total *production price index** declined from 15,2 per cent in 1989 to 12,0 per cent in 1990. This decline was mainly due to slower growth in the prices of imported goods, which fell from a rate of 16,3 per cent to a rate of 10,2 per cent over the same period, as well as a lower rate of increase in the prices of domestically produced goods of 12,4 per cent in 1990 as against 14,8 per cent in 1989.

The *quarter-to-quarter* rate of increase in the *prices of imported goods*, however, rose substantially from a seasonally adjusted and annualised rate of 2,0 per cent in the third quarter of 1990 to 53,8 per cent in the fourth quarter. The ending of the Gulf War caused this rate of increase to decline to only 5,1 per cent in the first quarter of 1991. The prices of imported goods then actually decreased at a seasonally adjusted and annualised rate of 17,3 per cent in the second quarter, owing largely to a further lowering of import surcharges announced in the Budget for 1991/92 and a relatively stable exchange rate of the rand. Over *periods of twelve months*, the rate of increase in the prices of imported goods rose from 3,8 per cent in August 1990 to 19,1 per cent in November. It then fell back to 7,6 per cent in April 1991, before rising again to 10,2 per cent in July.

The *quarter-to-quarter* rate of increase in the *prices of domestically produced goods* started to accelerate before the rise in fuel prices from 9,0 per cent in the first quarter of 1990 to 14,7 per cent in both the fourth quarter of 1990 and the first quarter of 1991. It then declined again to a level of 5,8 per cent in the second quarter of 1991. Measured over a period of twelve months, the rate of price inflation of domestically produced goods also accelerated from 11,2 per cent in March 1990 to 13,9 per cent in March 1991, and then slowed down, on balance, to 12,5 per cent in July.

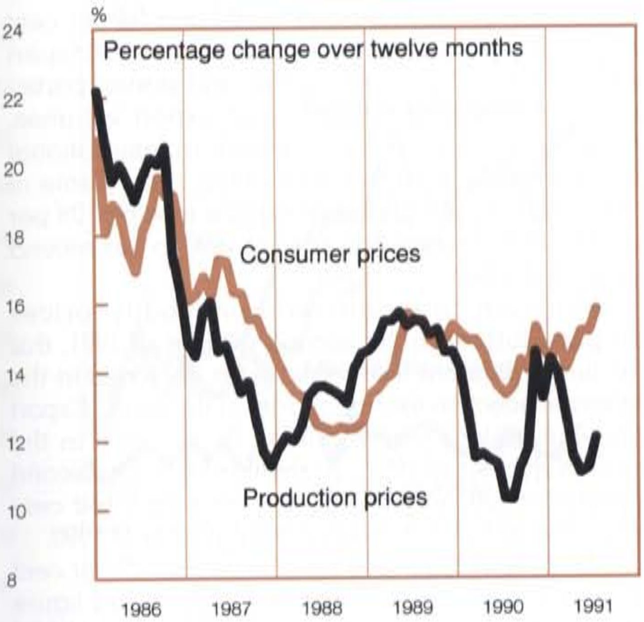
Reflecting these price movements of its two main components, the *quarter-to-quarter* rate of increase in the *total production price index* rose from a seasonally adjusted and annualised rate of 9,6 per cent in the first quarter of 1990 to 20,8 per cent in the fourth quarter. It then declined to a rate of only 1,7 per cent in the second quarter of 1991 – the lowest quarter-to-quarter rate of increase since the 0,2 per cent recorded in the third quarter of 1969. The rate of increase in the total production price index over *periods of twelve* months similarly increased from

Production prices



* Revised figures made available by Central Statistical Services on 28 August 1991.

Production and consumer prices



10,3 per cent in both July and August 1990 to 14,6 per cent in November, and then dropped to 11,2 per .cent in June 1991 and 12,1 per cent in July.

The recent changes in the *consumer price index* diverged substantially from movements in the producer price index. For instance, the *quarter-to-quarter* rate of increase in the consumer price index rose sharply from a seasonally adjusted and annualised 13,5 per cent in the second and third quarter of 1990 to 16,8 per cent in the fourth quarter. It then declined only briefly to 14,1 per cent in the first quarter of 1991, before rising again to 15,0 per cent in the second quarter. The twelve-month rate of increase in the consumer price index similarly rose from 13,3 per cent in July 1990 to 15,3 per cent in November and then fluctuated around this level until June 1991. In July 1991 it increased further to 15,8 per cent.

The reluctance of this price index to resume the downward trend it had displayed before the Gulf War, is caused mainly by continued high rates of increase and in some cases even accelerated increases in the prices of consumer goods rather than in the prices of consumer services. The quarter-to-quarter rate of increase in the prices of consumer goods, seasonally adjusted and annualised, amounted to 15,9 per cent in the second quarter of 1991, compared with the 13,5 per cent for the prices of consumer services. As indicated in the *Annual Economic Report* for 1991, this continued high rate of inflation in the prices of consumer goods occurred mainly in the prices of food, alcoholic beverages and tobacco and new vehicles. The prices of transport services also rose sharply. With the exception of food prices, which have been increasing rather erratically, the prices of these other items have, on average, been increasing at rates close to and even higher than 20 per cent from the second quarter of 1990 to the second quarter of 1991.

Balance of payments and exchange rates

Current account

The surplus on the current account of the balance of payments increased substantially from a seasonally adjusted and annualised rate of R1,5 billion in the first quarter of 1991 to R6,2 billion in the second quarter. As already pointed out on various previous occasions, the small surplus on the current account in the first quarter of 1991 was due to exceptional circumstances related to the crisis in the Persian Gulf. In analysing balance of payments trends it is, therefore, more appropriate to work with averages of the fourth quarter of 1990 and the first quarter of 1991. In comparison with this quarterly average surplus on the current account (at a seasonally adjusted annual rate of R5,6 billion), a slight further improvement took place in the second quarter of 1991. On this basis a distinct improvement is discernible in the current account balance since the third quarter of 1990.

The increasing trend in the surplus on the current account over the past four quarters can be attributed mainly to increases in the volume of merchandise exports and lower net service and transfer payments to the rest of the world; the volume of merchandise imports fluctuated upwards and net gold exports generally remained depressed before increasing sharply in the second quarter of 1991. Higher surpluses were also recorded on the current account despite a downward movement in the terms of trade of the country over this period until the first quarter of 1991. In the second quarter of 1991 the terms of trade rose again by 5,2 per cent. More specifically, the rise in the current account balance in the second quarter of 1991 was due to significant improvements in all the main items of the current account, apart from an increase in the value of merchandise imports.

During the second quarter of 1991 both the value and the volume of *merchandise exports* rose to new record highs and increased by 9½ and 5½ per cent respectively. Higher exports of textiles, transport equipment and precious metals and stones, particularly contributed to the higher export volumes. Notwithstanding the lower growth in international trade over the past twelve months, the volume of South Africa's merchandise exports rose by 10½ per cent from the second quarter of 1990 to the second quarter of 1991.

Although international commodity prices dropped further in the second quarter of 1991, this decline was more than offset by a decrease in the average effective exchange rate of the rand. Export prices therefore rose by about 3½ per cent in the second quarter of 1991. At their level in the second quarter of 1991 export prices were only 5 per cent higher than in the corresponding quarter of 1990.

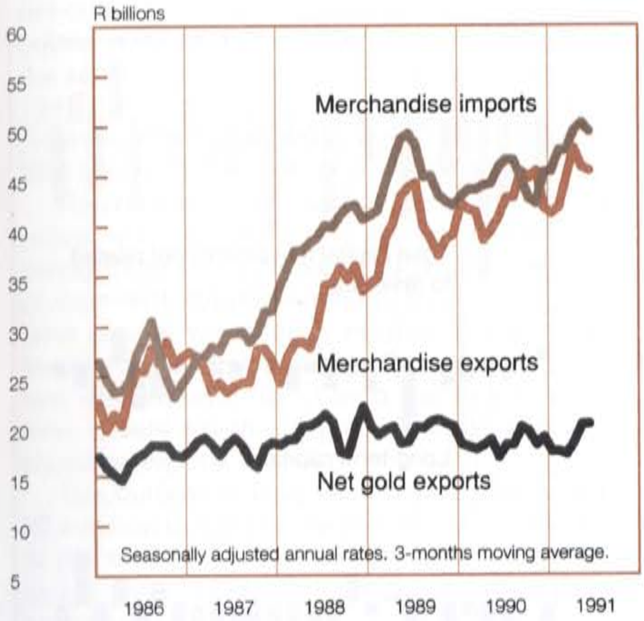
Net gold exports rose by no less than 15 per cent from a seasonally adjusted and annualised figure of R17,3 billion in the first quarter of 1991 to R20,0 billion in the second quarter. Both price and volume increases contributed to the higher net gold exports in the second quarter of 1991: the rand price of gold rose from an average of R957 per fine ounce in the first quarter to R1 010 per fine ounce in the second quarter, while the volume of net gold exports increased by 10½ per cent. The higher rand price of gold was due to the depreciation of the rand against the dollar, while the dollar price of gold declined from an average of $370 per fine ounce in the first quarter of 1991 to $361 per fine ounce in the second quarter as a reflection of the strengthening of the US dollar in international exchange markets and further increases in the supply of gold on international markets. On 30 August 1991 the gold price declined to $347 per fine ounce –

Balance of payments on current account
Seasonally adjusted annual rates

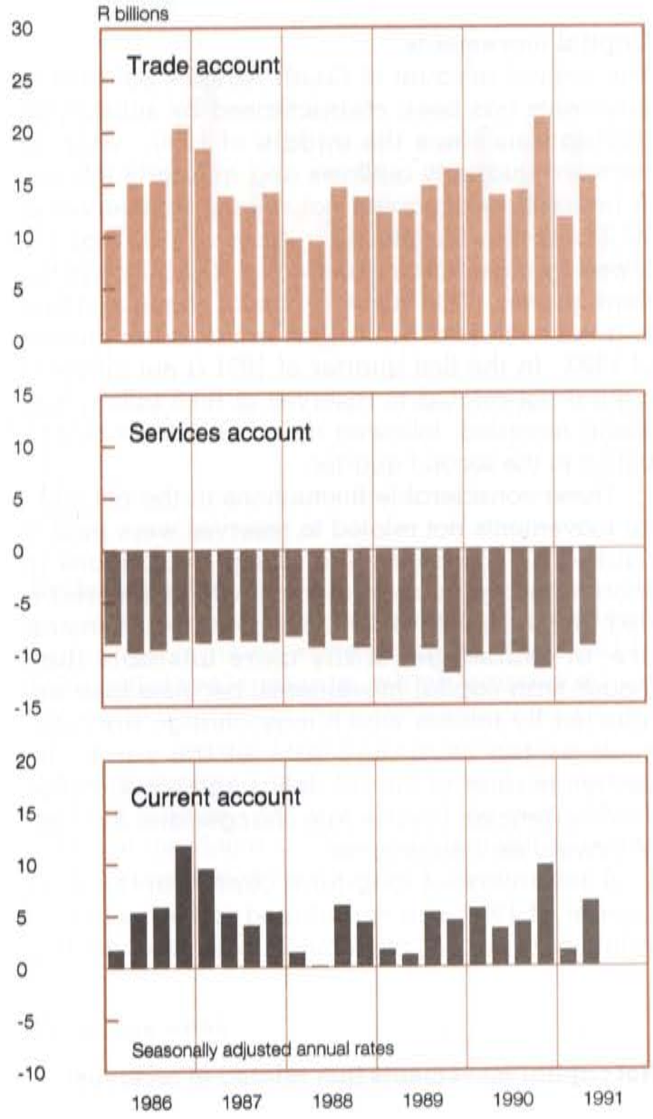
R billions

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

Trade account



Balance of payments : Current account



its lowest level since 14 June 1990. The rise in the volume of net gold exports was aided by an increase in tonnages of ore milled, which more than offset a slight decline in the grade of ore milled.

Owing entirely to an increase in the volume of *merchandise imports*, the value of merchandise imports rose from a seasonally adjusted and annualised level of R47,5 billion in the first quarter of 1991 to a new record figure of R50,2 billion in the second quarter. This increase was mainly brought about by the purchase of another Boeing aircraft as well as by the further replenishment of depleted inventories of mineral products. Reflecting a decline in international oil prices, total import prices were 1½ per cent lower in the second quarter of 1991 compared with the first quarter of 1991.

Although the volume of merchandise imports has increased fairly sharply since the fourth quarter of 1990 – which is rather exceptional at this stage of the business cycle – this increase occurred from the low level reached in the fourth quarter of last year following the crisis in the Persian Gulf. The recent rise in the volume of merchandise imports throughout the first half of 1991 was brought about mainly by the purchases of two macro-jet aircraft and mineral products, and not to a general rise in the volume of most imports. Despite these purchases, the import penetration ratio (i.e. real merchandise imports as a percentage of real gross domestic expenditure), was, at 23,7 per cent, only marginally higher in the first half of 1991 than in the first half of 1990 and still below the 24,7 per cent at the beginning of the current economic downswing.

After *net service and transfer payments* to non-residents, seasonally adjusted and annualised, had climbed to a very high level of R11,6 billion in the fourth quarter of 1990 (owing mainly to developments in the Middle East), these payments fell again to R10,1 billion in the first quarter of 1991 and to R9,5 billion in the second quarter. The further decrease in net service and transfer payments in the second quarter was mainly the result of higher service receipts, which outstripped a small rise in service payments. In particular, large increases were recorded in service receipts from the sales of ships' stores at South African harbours and from income received on foreign direct and non-direct investment.

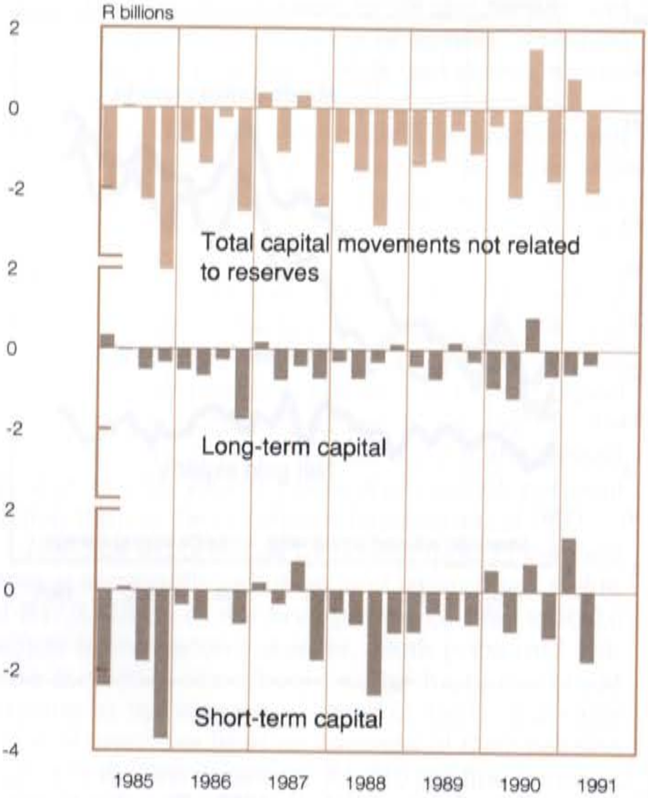
Capital movements

The capital account of South Africa's balance of payments has been characterised by substantial fluctuations since the middle of 1990, varying between quarterly outflows and quarterly inflows. A net outflow of capital not related to reserves of R2,2 billion in the second quarter of 1990 was followed by a net inflow of capital of R1,5 billion in the third quarter. This inflow of capital changed again to a net outflow of R1,8 billion in the fourth quarter of 1990. In the first quarter of 1991 a net inflow of capital not related to reserves of R0,8 billion was again recorded, followed by a net outflow of R2,1 billion in the second quarter.

These considerable fluctuations in the net capital movements not related to reserves were mainly caused by corresponding sharp fluctuations in *short-term capital movements* (including unrecorded transactions). Short-term capital movements are, of course, generally more unstable than longer-term capital movements, because they are affected by factors which may change abruptly, such as the exchange rate of the rand, the exchange rates of the US dollar against so-called third currencies, interest rate changes and the costs of forward exchange cover.

A net inflow of *long-term capital* in the third quarter of 1990 also contributed to the increased volatility of capital movements over the past four

Net capital movements



Net capital movements (not related to reserves)

R millions

	1990				1991	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Long-term capital						
Public authorities	–206	–673	47	–328	–167	116
Public corporations	473	–35	279	173	188	345
Private sector	–1 204	–482	495	–484	–604	–787
Total long-term capital	–937	–1 190	821	–639	–583	–326
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	531	–1 000	694	–1 154	1 362	–1748
Total capital movements, excluding liabilities related to reserves	**–406**	**–2 190**	**1 515**	**–1 793**	**779**	**–2074**

Hopes of a rapid resolution of the Gulf crisis as well as political turmoil in the USSR tended to favour the US dollar, and on 5 July 1991 the value of the dollar against the German mark was 27 per cent above its low point of 12 February 1991 before drifting downwards again. The status of the US dollar as a safe haven during times of political upheaval was again demonstrated when the dollar rose from DM1,75 on 16 August to DM1,82 on 19 August 1991, or by 4 per cent, in response to the attempted coup in the Soviet Union.

The South African rand was obviously not immune to these movements of the US dollar. The exchange rate of the rand against the dollar therefore fluctuated between R2,52 and R2,91 per dollar during the first eight months of 1991. Despite these fluctuations, the *nominal effective exchange rate* of the rand remained fairly stable and declined only moderately by 4,8 per cent from the end of 1990 to 31 August 1991. At the end of August 1991 the nominal effective exchange rate of the rand was only 5,7 per cent below its previous lower turning-point on 18 September 1989.

During the first six months of 1991 (latest available information) the *real effective exchange rate* of the rand also remained very stable. In June 1991 the real effective exchange rate of the rand was only 1½ per cent lower than in December 1990.

Following upon the opening of Parliament by the State President, the *financial rand discount* vis-á-vis the commercial rand shrank from approximately 30 per cent at the end of October 1990 to 18 per cent on 6 February 1991. The financial rand discount then fell to an all-time low of 7½ per cent on 12 July after the announcement that the United States Federal Government was prepared to lift most of its sanctions against South Africa. During the rest of July and August the financial rand discount fluctuated between 10 and 12 per cent.

Changes in exchange rates of the rand
%

	18 Sept '89 to 5 Jan '90	5 Jan '90 to 12 Feb '91	12 Feb '91 to 19 Aug '91	18 Sept '89 to 31 Aug '91
Weighted average	6,6	–7,6	–3,9	–5,7
US dollar	11,5	0,6	–13,2	–1,5
British pound	6,8	–17,6	6,6	–8,5
German mark	–4,2	–13,6	9,1	–12,4
Swiss franc	1,7	–19,3	10,7	–11,4
Japanese yen	9,8	–10,7	–6,0	–7,8
French franc	–2,9	–13,8	8,5	–11,9
Financial rand	12,3	13,3	–2,3	24,5

Financial markets

Money supply

The twelve-month growth rates of almost all the monetary aggregates increased sharply during the first six months of 1991. As already explained in some detail in the *Annual Economic Report*, this acceleration in money growth was mostly due to new regulations under the Deposit-taking Institutions Act which were implemented from 1 February 1991. These regulatory changes led to the conversion by monetary institutions of various kinds of off-balance-sheet items into conventional deposits and credit extended to the private sector, thereby increasing money supply and bank credit.

Measured over a period of twelve months, the rate of increase in the *broadly defined money supply*, M3, was more than halved from a peak of 27,5 per cent in August 1988 to only 10,1 per cent in January 1991; this deceleration was mainly a reflection of the cyclical downswing and a levelling-off in reintermediation phenomena, brought about by the sustained high and relatively stable money market interest rates. Under the impact of the new regulations, this growth rate reaccelerated to 15,8 per cent in February 1991 and then remained between 14 and 16 per cent in the ensuing five months. Measured from the "guideline" base in the fourth quarter of 1990 the growth in M3 also stayed above the upper boundary of the money supply guidelines of 8 to 12 per cent for the 1991 "guideline" year. However, the underlying rate of increase in the money supply remained more subdued. For example, if the growth in M3 is measured from the end of February 1991 (the month in which the new regulations came into effect) to the end of June 1991, its seasonally adjusted and annualised rate of increase amounted to only 11,6 per cent.

Even measured in this way, this rate of increase in M3 includes the effect of further changes made to the regulations in May 1991. These changes *inter alia* stipulated that deposit-taking institutions have to keep reserves against promissory notes and other debt instruments which are issued by clients wishing to borrow funds and are sold to surplus units by the deposit-taking institutions on behalf of these clients (which may involve that the deposit-taking institution endorses the paper). Deposit-taking institutions reacted to these changes by converting such instruments into conventional deposits and advances on a significant scale. When the effect of these conversions – estimated at around R1,5 billion – is removed, the underlying seasonally adjusted and annualised growth rate of M3 amounted to 8,7 per cent in the four months ended June 1991.

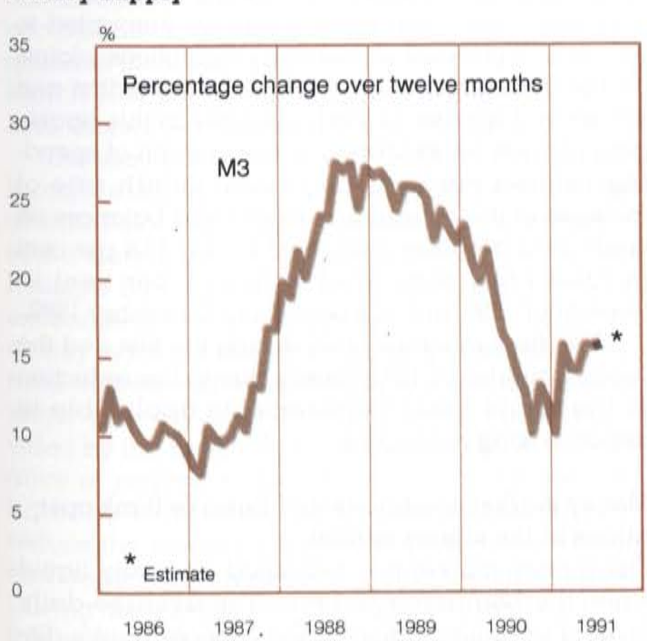
The *narrower monetary aggregates* were also distorted to various degrees by these regulatory changes. On balance, the twelve-month rates of growth in these aggregates changed as follows from the end of December 1990 to June 1991:

- M1A from 14,3 to 16,9 per cent;
- M1 from 15,9 to 15,2 per cent; and
- M2 from 13,1 to 20,3 per cent.

The monetary aggregate that was probably least affected by the new regulations was "notes and coin in circulation outside monetary institutions". Although this indicator has obvious shortcomings, its twelve-month rate of increase – which, on balance, showed little movement, namely from 12,4 per cent in December 1990 to 11,9 per cent in June 1991 – was probably more indicative of developments in the real economy than the growth of the other monetary aggregates during the period concerned.

From the growth rates of the narrower monetary aggregates it is also interesting to note that growth in M2 showed the largest acceleration, indicating that deposits with an unexpired maturity of more than one day up to six months increased much more rapidly than call deposits. To the extent that the movements between various deposit categories in 1991 may be regarded as a response to normal economic rather than regulatory forces, this change probably indicates a change in depositors' preferences for certain maturities, given somewhat lower

Money supply



interest rates and expectations of a further decline in interest rates.

As could be expected, the reintermediation effects of the new regulations also led to a decline in the *velocity of circulation of M3* in 1991, after this had remained virtually constant from the second to the fourth quarter of 1990. The velocity of circulation of M3 decreased by approximately 3 per cent in the first quarter of 1991 and by a further ¾ per cent in the second quarter.

In a statistical or accounting sense the *main counterpart* of the increase in M3 during the first six months of 1991 continued to be the increase in monetary institutions' claims on the domestic private sector (which was also most affected by the regulatory changes). Increases in the net gold and other foreign reserves also contributed to this increase, especially during the first quarter of 1991.

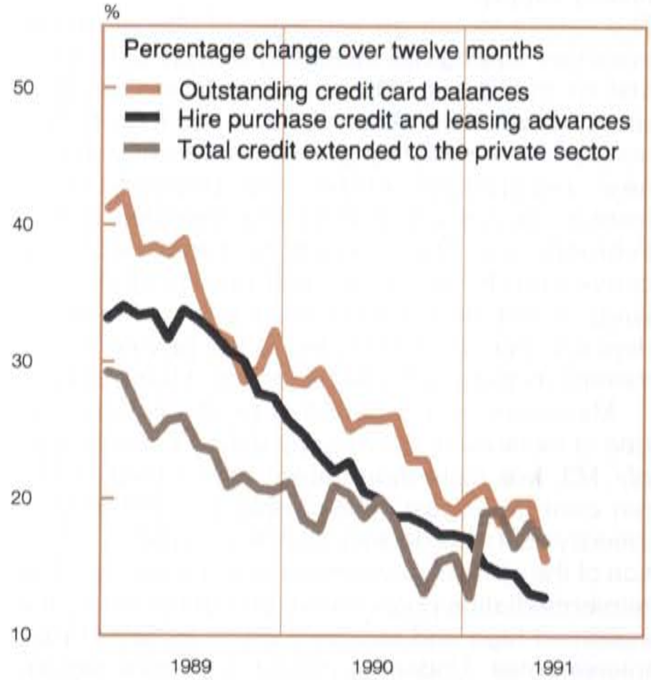
Credit extension by monetary institutions

The twelve-month rate of increase in *credit extended* by monetary institutions to the domestic private sector, which had receded from a peak of 30,2 per cent in October 1988 to 12,9 per cent in January 1991, rose to 19,0 per cent in February 1991. This substantial rise in credit extended to the private sector was to a large extent due to the implementation of the new regulations. Measured over a period of twelve months, the growth in credit extended to the private sector then declined, on balance, to 18,2 per cent in May and 16,8 per cent in June. From the end of February 1991 to the end of June, the growth rate in monetary institutions' claims on the private sector (seasonally adjusted and annualised) amounted to only 13,8 per cent.

An analysis of credit extended to the private sector by type of claim shows that the acceleration in monetary institutions' credit extension during the first six months of 1991 took place mainly in general *non-mortgage advances and investments*. The bringing onto these institutions' balance sheets of previously off-balance-sheet items was mainly reflected in these asset categories. *Mortgage advances* by banks and building societies also rose relatively sharply. The twelve-month rate of increase in mortgage advances amounted to 15,7 per cent in June 1991; this was only marginally below the 17,3 per cent of December 1990.

In contrast to these developments, the expansion of credit more closely related to private consumption and investment expenditure was far less buoyant than overall credit extension. This was clearly reflected in the twelve-month rate of increase in *hire-purchase credit and leasing finance*, which declined from 17,4 per cent in December 1990 to only 12,8 per cent in June 1991. This slowdown in growth may have been reinforced by the withdrawal, from 1 March 1991, of certain tax benefits previously enjoyed by institutions extending such credit.

Credit extension to the private sector



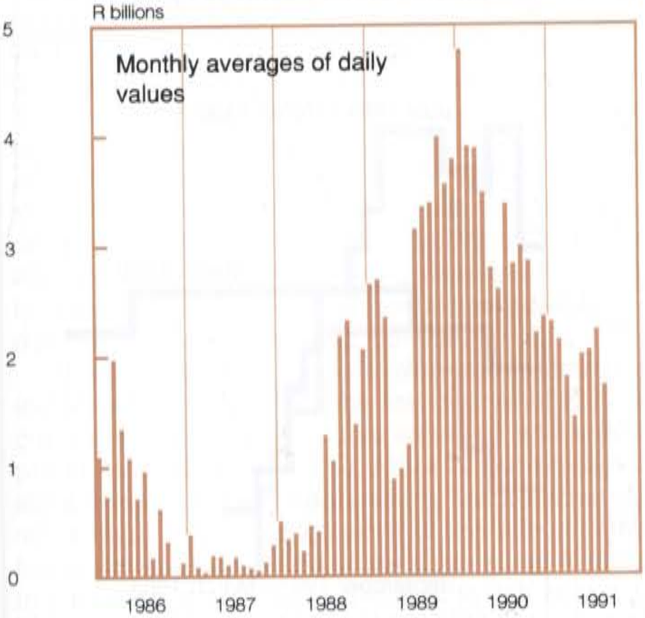
The downward pressure on domestic expenditure by private businesses and households was also reflected in the balances outstanding on *credit card accounts*. Although these balances amounted to less than 2 per cent of monetary institutions' claims on the domestic private sector in both the first and the second quarter of 1991, changes in this aggregate provide an indication of the strength of spending-related credit. The twelve-month rate of increase in the outstanding month-end balances on credit card accounts amounted to only 15,6 per cent in June 1991, compared with 19,1 per cent in December 1990 and 32,2 per cent in December 1989.

Bills discounted declined during the first and the second quarter of 1991, mostly due to the reduction of the liquid asset requirements applicable to deposit-taking institutions.

Money market conditions and Reserve Bank operations in the money market

The money market has remained relatively liquid since the beginning 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

Accommodation at the discount window



April. It then rose somewhat to R2,2 billion in July, before declining again to R1,7 billion in August. In 1990 the average daily level of accommodation amounted to R3,2 billion.

The easier conditions in the money market during the first eight months of 1991 are further underlined by the fact that overnight loan accommodation to banks had to be provided only occasionally at month-ends and that even then the amounts involved were insignificant. At the end of March 1991 such assistance amounted to R0,4 billion; thereafter it declined to virtually nil.

The easier money market conditions were partly brought about by the continued improvement in the *overall balance of payments* position, described in some detail above. Deficits recorded by the Reserve Bank in its provision of forward foreign exchange cover also added to the liquidity in the money market during the second quarter, when the rand depreciated markedly against the dollar – the major currency against which forward cover is provided by the Bank. The relative strength of the balance of payments and the associated increased liquidity contributed to the Bank's decision to reduce the preferential margin for forward foreign exchange cover in respect of new foreign finance. During the period June to early September 1991, this margin was gradually reduced from 1 per cent to approximately ¼ per cent per annum below that for ordinary cover transactions.

Money market liquidity was also enhanced during the first four months by a decline in *government deposits* with the Reserve Bank. The average level of deposits in the Exchequer, Paymaster-General and Stabilisation Accounts decreased from R7,6 billion in January 1991 to R5,7 billion in April. It then rose sharply again to R9,5 billion in July 1991. However, this recent build-up of government deposits was to a large extent a reflection of the selling of short-dated Treasury bills by the Reserve Bank in an attempt to maintain more stable money market conditions. That part of these deposits transferred to the Stabilisation Account was increased from R2,1 billion to R3,5 billion during February 1991 and to R3,7 billion at the beginning of May 1991. It was then kept at this level in the ensuing period.

The average daily amount of *notes in circulation* remained fairly stable from the beginning of 1991 and no major influences on the money market arose from this source. Easier money market conditions were, however, also brought about by the reduction, by R1,0 billion from February to June 1991 in the monetary institutions' cash reserves held as deposits with the Reserve Bank owing to the lowering of these institutions' *cash reserve* requirements. The lower requirements in accordance with the new Deposit-taking Institutions Act were phased in over a period of four months from March to June 1991.

The Reserve Bank continued to counter the easier money market conditions during the first eight months of 1991. In order to do this, the Bank made extensive use of foreign exchange intervention swaps with major banking institutions. The monthly peak in the amounts of these swaps accordingly rose from R0,9 billion in January 1991 to R2,6 billion in June and further to R3,1 billion in August. The decline in discount window accommodation was also countered by the issuing of special short-dated Treasury bills, which reached a peak of R1,8 billion in August 1991. Reverse repurchase agreements were also employed by the Bank in May and June to peak amounts of R0,5 billion and R0,6 billion,for draining liquidity from the market. In the first four months of 1991 these measures were applied only in the course of these months, but since then continuous Reserve Bank intervention has had to be carried out even over month-ends.

Net sales of government stock by the Reserve Bank rose from R0,6 billion in the first quarter of 1991 to R2,8 billion in the second quarter; however, this was still considerably less than the amount of R3,8 billion recorded in the second quarter of 1990. In July and August 1991, net sales amounted to R2,1 billion. The Bank's *gross transactions in government stock* reached R9,7 billion in the second quarter of 1991 and R11,6 billion in July and August. The average monthly amount of the Reserve Bank's transactions in traded government stock options amounted to R1,5 billion in the second quarter and to R3,0 billion in July and August 1991.

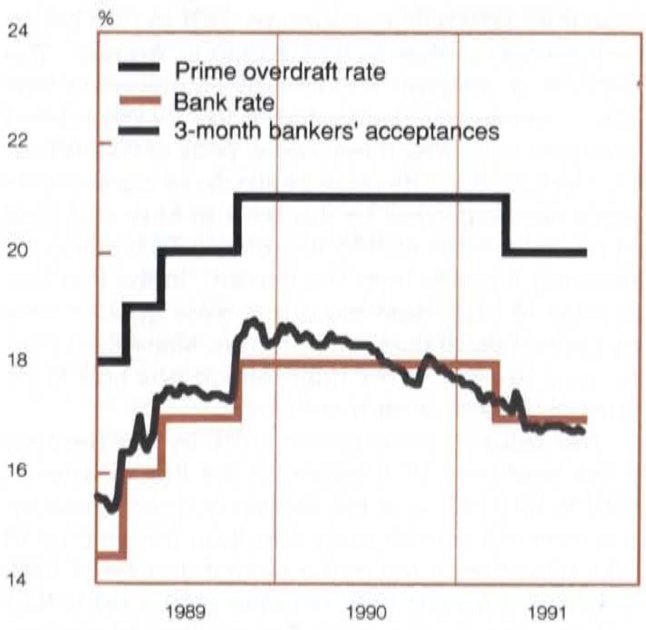
The amount of *Treasury bills* offered at the weekly tender was raised from R100 million to R130 million from 5 April 1991, and to R150 million from 30 May.

Money market interest rates

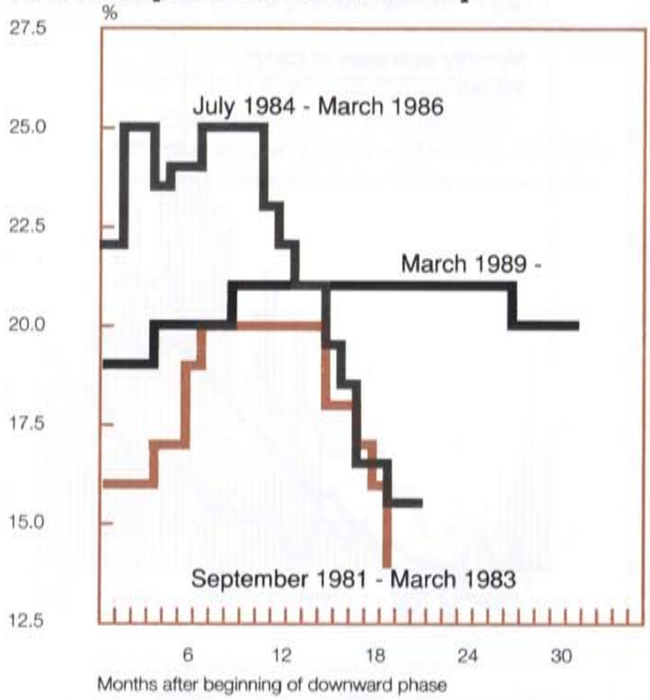
After the lowering of Bank rate on 11 March 1991, money market interest rates generally declined moderately during the period up to early September 1991. For example, the market rate on liquid *three-month bankers' acceptances*, which had stood at 17,40 per cent immediately following the Bank rate reduction, had receded below 17 per cent by mid-May and thereafter traded within a narrow band from 16,75 to 16,90 per cent. This was significantly lower than the Reserve Bank's rediscount rate for such acceptances of 17,50 per cent, indicating that the underlying level of liquidity in the money market was high and that the availability of foreign finance was increasing. It also suggested that the market participants were still anticipating a Bank rate reduction.

Given the underlying high level of liquidity in the money market, even the usual month-end hardening of call rates remained very subdued from May 1991 onwards; whereas in June 1990,

Short-term interest rates



Behaviour of the prime overdraft rate in the downward phases of the business cycle



for instance, the *rate on interbank funds* fluctuated between 18,25 per cent in the middle of the month and 21,00 per cent over the month-end, in June 1991 this rate moved only within a very narrow range of 16,75 to 17,25 per cent. In July and August 1991 it stayed within this same range.

An analysis of the behaviour of short-term interest rates over a longer period of time underscores the more stable policy stance adopted by the Reserve Bank which was discussed in some detail in the *Annual Economic Report* of the Bank. From the accompanying graph it is apparent that the 17 month plateau in the prime overdraft rate (at a level of 21 per cent) from October 1989 to March 1991 was considerably longer than its two predecessors (of 8 to 9 months) since the implementation of more market-oriented monetary policies in 1979. Similarly, the adoption since 1989 of policies to prevent excessive money creation *throughout the business cycle* is reflected in the movements of short-term interest rates after the beginning of the current cyclical downturn. In the two previous downward phases, the prime overdraft rate had already declined substantially from its initial level within 1½ years after the onset of the recession; in the present cycle it is, after 2½ years, still marginally higher than at the beginning of the downturn.

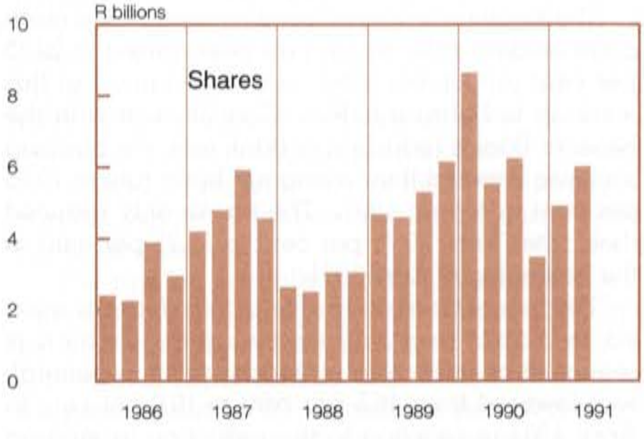
Capital market developments

Opposing sentiments existed in the capital market during the first eight months of 1991. The reduction in Bank rate in March, the subsequent softening of short-term interest rates and the lifting of sanctions against South Africa by some countries were, followed by a strong rise in share prices at high levels of activity – reflecting a fairly optimistic view of the future. Against this, long-term interest rates started to firm in the second quarter because of doubts concerning the authorities' ability to bring down the inflation rates and the central government's ability to adhere to its budgeted borrowing requirement – a generally more pessimistic outlook.

Trading activity in the *secondary capital markets* increased substantially in the first quarter of 1991 as capital market interest rates softened and share prices started to rise. The value of public-sector stock traded on the Johannesburg Stock Exchange accordingly rose to a high point of R68 billion in the first quarter, but because of the subsequent firming in long-term interest rates declined to R55 billion in the second quarter. The monthly average value of public-sector stock traded, however, increased again from R18,4 billion in the second quarter to R26,8 billion in July and August, despite an *increase* in the yield on such stock during July and August 1991.

The value of *shares traded* on the Johannesburg Stock Exchange strengthened from R3,5 billion in the fourth quarter of 1990 to R4,9 billion in the first quarter of 1991 and to R6,0 billion in the second quarter. This increase in trading activity continued in July and August, when the average monthly value of shares traded increased to R2,3 billion, compared with the monthly average of R2,0 billion in the second quarter.

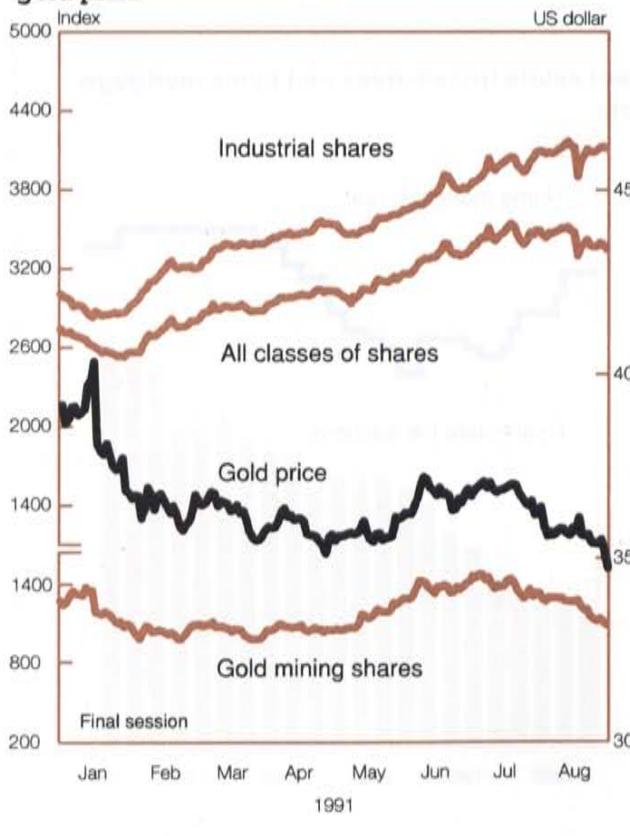
Stock exchange transactions



Transactions by non-residents contributed to this higher level of trading activity in the secondary capital market. Net purchases of public-sector stock by non-residents increased from R153 million in the fourth quarter of 1990 to R285 million in the first and R665 million in the second quarter of 1991. Non-residents' net purchases of public-sector stock increased even further to R266 million in July, compared with a monthly average of R222 million in the second quarter. The markedly higher share prices and the strengthening of the financial rand boosted non-residents' net sales of shares, which increased from R564 million in the fourth quarter of 1990 to R892 million in the first and R977 million in the second quarter of 1991. Non-residents' net sales of shares amounted to R604 million in July, compared with the monthly average of R326 million in the second quarter of 1991.

The *share prices* of all main categories of shares showed a marked improvement during the first eight months of 1991. The prices of gold-mining shares improved by 35 per cent from a recent low point in February to July 1991, but softened in August as the dollar price of gold failed to come up

JSE-Actuaries' share price indices and gold price



to expectations. Industrial share prices, which had started to improve towards the end of 1990, subsequently surged ahead to exceed the most recent peak of February 1990 by about 28 per cent in July 1991. The Johannesburg Stock Exchange followed closely the reaction on international stock exchanges to the attempted coup in the Soviet Union; in a somewhat nervous market, the overall share price index declined by 5,2 per cent on 19 August. Subsequent developments resulted in the recouping of a substantial portion of these losses.

The monthly total value of deals in *futures contracts* improved markedly, in response to the buoyant share market, from R4,6 billion in the first quarter of 1991 to R5,9 billion in the second quarter. In August 1991 the monthly level of these transactions amounted to a major R3,1 billion.

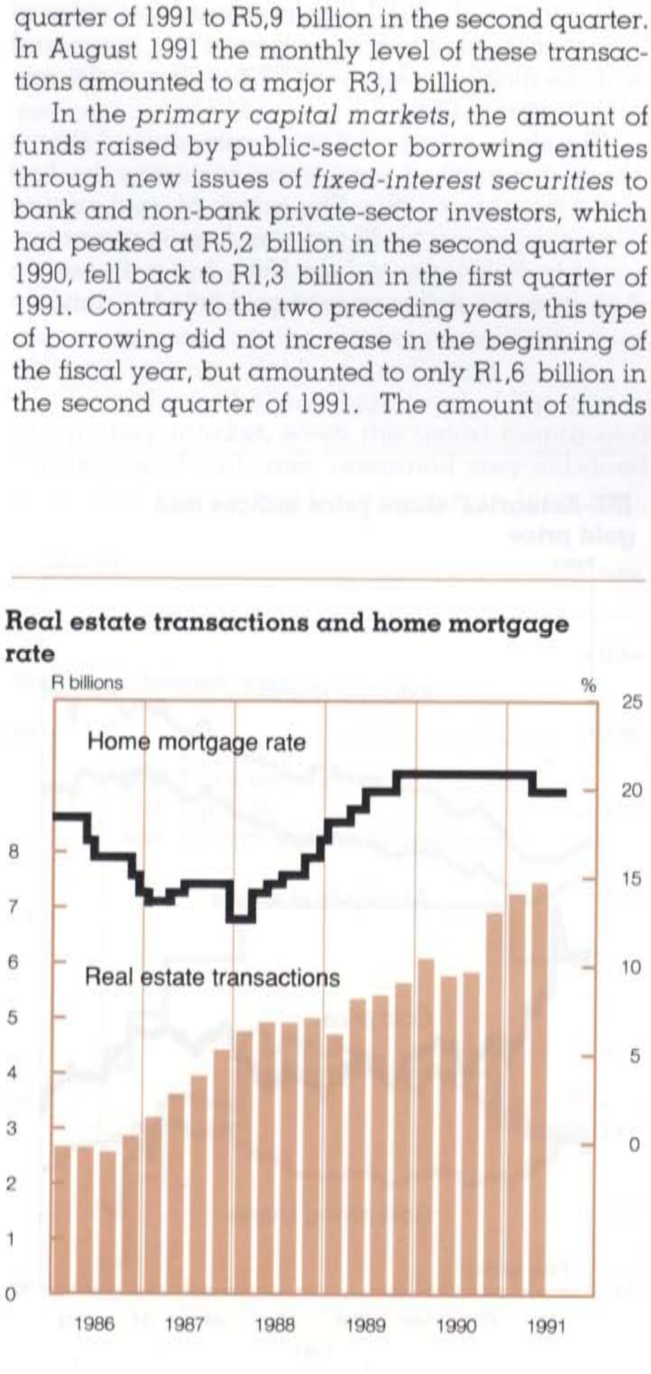
In the *primary capital markets*, the amount of funds raised by public-sector borrowing entities through new issues of *fixed-interest securities* to bank and non-bank private-sector investors, which had peaked at R5,2 billion in the second quarter of 1990, fell back to R1,3 billion in the first quarter of 1991. Contrary to the two preceding years, this type of borrowing did not increase in the beginning of the fiscal year, but amounted to only R1,6 billion in the second quarter of 1991. The amount of funds raised by private-sector companies through new issues of fixed-interest securities decreased from R316 million in the fourth quarter of 1990 to R106 million in the first quarter of 1991 and R91 million in the second quarter.

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 consequently increased from R0,3 billion in the first quarter to R1,9 billion in the second quarter of 1991. The latter total included a major individual issue of R1,1 billion.

In the *mortgage market*, the amount of mortgage loans *paid out* by the major deposit-taking institutions increased from R2,3 billion in the first quarter of 1991 to R3,0 billion in the second quarter. The increase in these institutions' *holdings* of mortgage loans strengthened from R2,0 billion to R2,2 billion over the same period.

The value of *real estate transactions* increased from an impressive R7,3 billion in the first quarter of 1991 to a record R7,5 billion in the second quarter. These transactions increased substantially from about the middle of 1987 and do not seem to have been affected significantly by the high level of interest rates during most of this period.

Real estate transactions and home mortgage rate



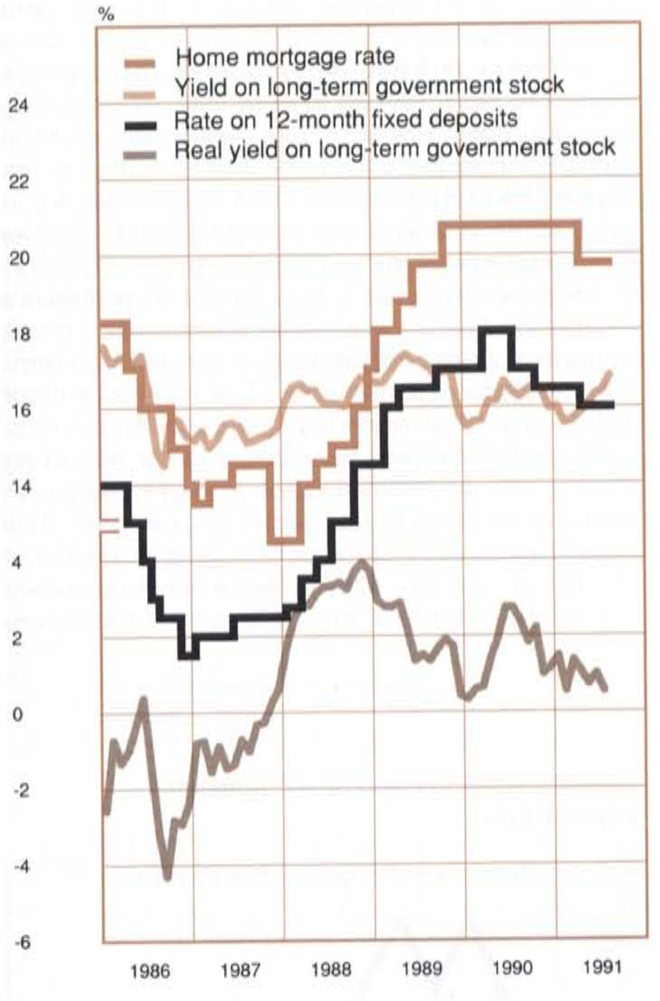
Capital market yields and interest rates

The average monthly *yield on long-term government stock* fell back from 16,0 per cent in January 1991 to 15,6 per cent in February and March, before firming significantly to 16,4 per cent in July and further to 16,8 per cent in August 1991. As already indicated, this reflected the market's perception that inflation would remain on higher levels for a longer period of time than had previously been expected. Despite this mild upward trend in long-term yields, the increase in the measured inflation rate caused a decline in the *real yield* on long-term government stock from an already low rate of 1,5 per cent in January to 0,5 per cent in July 1991.

The building societies' *predominant home mortgage lending rate*, which had been raised to 20,75 per cent in October 1989, was maintained at this level up to February 1991. Concomitant with the Reserve Bank's reduction of Bank rate, the building societies lowered their mortgage bond rate to 19,75 per cent in March 1991. The banks only reduced their rates from 20,75 per cent to 19,75 per cent at the beginning of April 1991.

The interest rate on *twelve-month deposits* quoted by banks and building societies, which is regarded as indicative of deposit rates in general, was lowered from 16,5 per cent to 16,0 per cent in April 1991 in reaction to the reduction in lending rates and in an effort to restore more comfortable interest rate margins.

Capital market interest rates and yields



The *dividend yield* on all classes of shares decreased by 1,2 percentage points from November 1990 to July 1991 because of the improvement in the average level of share prices on the Johannesburg Stock Exchange. The decrease in the *earnings yield* over the same period was an even more pronounced 3,4 percentage points, due to the less impressive financial results of listed companies in various sectors of the economy in the current economic downswing.

The rate on partially *tax-free investments* was raised by 1,5 percentage points in March 1990 and by 0,5 percentage points in March 1991 to its present level of 12 per cent by way of compensation for the phasing-out (by 20 per cent per year over a five-year period) of the partially tax-free status of the interest income earned on these investments.

The maximum permissible *finance charges rates* as determined in terms of the Usury Act, and which had been lowered in July 1990 from 30 to 29 per cent and from 33 to 32 per cent for "large" and "small" money lending, credit and leasing transactions respectively, were maintained at these levels.

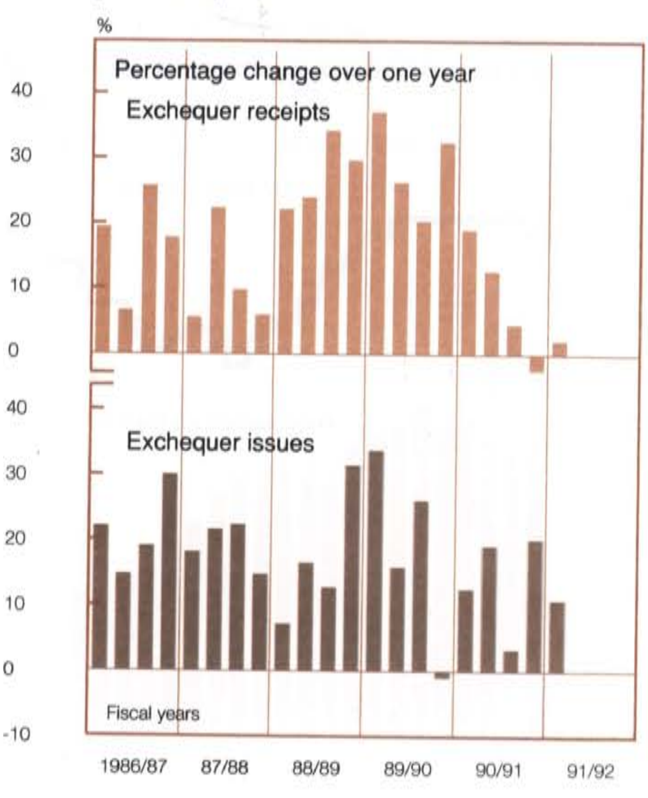
Government finance

Government expenditure and Exchequer issues

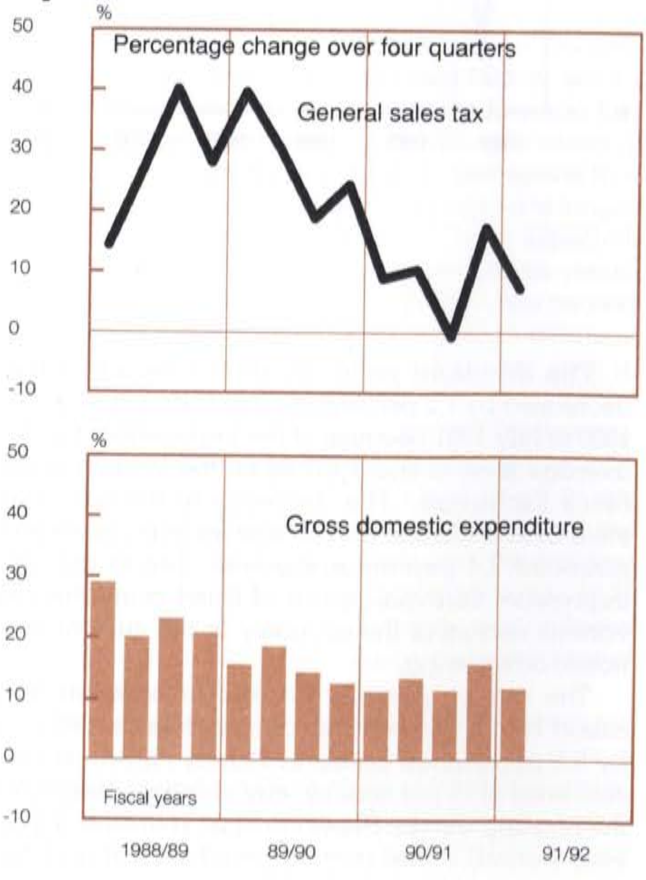
The recorded outcomes of government expenditure (compiled on a basis comparable with the Budget of the Central Government) and of Exchequer issues gave contradictory indications of developments in expenditure in the June quarter of 1991 (i.e. the first quarter of fiscal 1991/92). The year-on-year rate of increase in *government expenditure* amounted to as much as 20,7 per cent in the June quarter; this was only slightly less than the 21,3 per cent in the March quarter. Seeing that this rate of increase was substantially higher than the budgeted increase in government expenditure of 13,7 per cent for fiscal 1991/92 as a whole, this high figure obviously gave cause for concern. However, the year-on-year rate of increase in *Exchequer issues* (after the usual adjustment for changes in the balance on the Paymaster-General Account) decreased from 20,1 per cent in the March quarter of 1991 to 11,9 per cent in the June quarter. This more realistic interpretation of developments on the expenditure side of the Budget therefore indicated that expenditure is still within the budgetary parameters.

In July-August 1991 the year-on-year rate of increase in Exchequer issues to government departments rose substantially. As a result, these issues were 15,4 per cent higher in the first five months of fiscal 1991/92 than in the corresponding period of fiscal 1990/91. Total Exchequer issues in July 1991 included a transfer of R450 million to the Export Credit Reinsurance Fund as provided for in the Budget. This expenditure was funded from the Government's financing surplus in fiscal 1990/91 and was not included in the Central Government's 1991/92 budgetary expenditure estimates. If this amount is added to Exchequer issues to government departments in the first five months of fiscal 1991/92 and if the result is compared with the budgeted and off-budget expenditure in the preceding fiscal year, the year-on-year rate of increase in these issues actually receded to 10,2 per cent. This lower rate of increase was, however, the result of the inclusion of R2,0 billion paid to the Independent Development Trust in July 1990 in the expenditure

Exchequer receipts and issues



General sales tax and gross domestic expenditure



figures of fiscal 1990/91. As these amounts are only now being spent by the Independent Development Trust, they are only now affecting economic activities.

Government revenue and Exchequer receipts

The year-on-year rate of change in government revenue (also compiled on a basis comparable with the Budget) rose marginally from a negative figure of 0,8 per cent in the March quarter of 1991 to a positive figure of only 0,7 per cent in the June quarter. The corresponding rate of change in Exchequer receipts (including the "own incomes" of the Administrations for Own Affairs) also changed from a negative figure of 2,5 per cent to a positive figure of 2,1 per cent over the same period. However, slightly higher revenues were collected in July-August 1991, with the result that total Exchequer receipts in the first five months of fiscal 1991/92 were 5,0 per cent higher than in the corresponding period of fiscal 1990/91. This rate of increase is, nevertheless, still significantly lower than the increase of 11,1 per cent envisaged in the March 1991 Budget for the fiscal year as a whole. This relatively poor performance of Exchequer receipts in the first five months of fiscal 1991/92 could be attributed to lower-than-expected increases in excise duties, the fuel levy and income tax receipts.

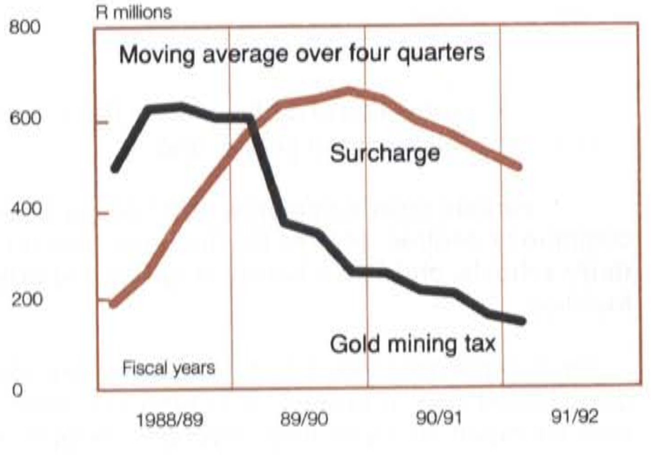
More alarming may be the fact that the rate of increase in Exchequer receipts has shown a marked declining tendency since the June quarter of 1990. In particular, this declining tendency could be ascribed to actual decreases in the receipts from gold mines because of the further phasing-in of a revised tax formula and as a result of lower profits made by mines related to the stagnant rand price of gold and rising production costs. In addition, the receipts from the surcharge on imports decreased over this period as a result of cuts in the differentiated surcharge rates on various import goods in the Budgets of March 1990 and March 1991. The declining tendency in Exchequer receipts was also influenced by the slackening in domestic economic activity, leading to lower growth in the receipts from general sales tax and the fuel levy.

Deficit before borrowing

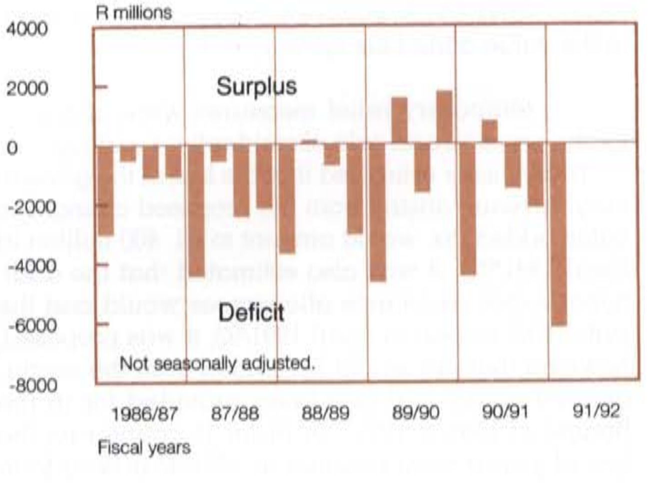
The Exchequer deficit before borrowing and debt repayment in the first five months of fiscal 1991/92 amounted to R8 665 million, or to R3 537 million more than in the corresponding period in fiscal 1990/91. At this level the cumulative deficit in the five months to August 1991 was equal to 85,6 per cent of the deficit of R10 118 million that was envisaged in the March 1991 Budget for the fiscal year 1991/92 as a whole. The Exchequer deficit of R8 665 million in these five months was financed by the utilisation of the following borrowing instruments and available cash balances:

	R millions
Government stock	7 254
Treasury bills	1 810
Non-marketable securities	–42
Foreign loans	–22
Use of cash balances	115
Total gross financing	9 115
Less: transfer to the Export Credit Reinsurance Fund	450
Total net financing of Exchequer deficit	**8 665**

Surcharge and gold mining tax



Exchequer deficit



The Exchequer deficit of R6 014 million in the *four* months to July 1991, plus the discount of R1 395 million on new issues of government stock (for a total of R7 409 million), was financed from the following sources:

	R millions
Public Investment Commissioners	3 822
Non-bank private sector	1 804
Banking sector:	
Corporation for Public Deposits	14
Other banks	1 998
Foreign sector	–229
Total financing	**7 409**

Additional fiscal measures announced in August and September 1991

On 21 August 1991 the Minister of Finance announced certain additional tax and spending measures, aimed mainly at providing more assistance to people in the lower-income groups. These measures included:

- the introduction of value added tax on 30 September 1991 at a rate of 10 per cent, instead of 12 per cent as announced in the Budget of March 1991;

- an increase in social assistance allowances;

- medical services rendered and medicine provided by medical schemes and funds, government and provincial hospitals as well as clinics of the government and local authorities would be exempted from value added tax;

- subscriptions to "traditional" or any other trade union would be exempted from value added tax;

- gold coins would be taxed at the zero-rate in the value added tax system; and

- temporary relief measures were instituted for the erection and sale of residential buildings.

The Minister estimated that the loss of the government revenue arising from the proposed changes to value added tax, would amount to R1 400 million in fiscal 1991/92. It was also estimated that the additional social assistance allowances would cost the state R150 million in fiscal 1991/92; it was proposed, however,that this would be funded from the contingency reserve that had been provided for in the Budget of March 1991. In order to counteract the loss of government revenue in 1991/92 arising from these measures, the Minister announced increases in the fuel levy and in excise duties on liquor, tobacco, cars and other luxury items. These adjustments in the fuel levy and excise duties were estimated to increase government revenue by R890 million in fiscal 1991/92.

The net effect of these additional measures would therefore be an increase of R510 million in the Budget deficit before borrowing. Taking into account the additional R1,0 billion for socio-economic upliftment that had also been announced after the Budget of March 1991, the adjusted Budget deficit in fiscal 1991/92 would be R11,6 billion, or about 3,8 per cent of the expected gross domestic product. The magnitude of this adjusted Budget deficit indicates a more expansionary fiscal policy stance than had been envisaged in the Budget of March 1991.

On 27 August 1991 the Minister of Economic Coordination and Public Enterprises announced details of the allocation of the additional R1,0 billion that had been earmarked for socio-economic upliftment. As stated by the State President in April 1991, this additional government expenditure would be funded from the sale of strategic stockpiles. According to the Minister the approved projects had been accepted on the basis that they were labour intensive and would initiate longer-term growth. The major portion of the available R1,0 billion, namely 74 per cent, would be utilised to reduce backlogs in less privileged communities. The approved allocations to socio-economic projects included the following:

- the establishment of site-and-service schemes for squatter settlements and the provision of drinking water in rural areas;

- road-building projects;

- the building of 1 900 new classrooms;

- the construction of 141 clinics and 64 crèches;

- the upgrading of hostels;

- the construction of additional satellite police stations and police contact points; and

- various other community services, such as community centres, centres for the aged, pre-primary schools, children's homes and basic sports facilities.

On 5 September 1991 it was announced that the government had approved short-term tax incentives for export ventures; these incentives comprise accelerated tax write-offs for capital expenditure used in the beneficiation of local raw materials.

These incentives will enable enterprises to start writing off the capital costs of machinery, property and pre-production interest as soon as these costs are incurred, and at a rate of 20 per cent per year. The Commissioner for Inland Revenue will issue negotiable tax credit certificates in cases where deductions cannot immediately be written off against income. These incentives will only apply to projects approved by a committee appointed by the government.