Quarterly economic review

Introduction

The South African economy in the fourth quarter of 1990 continued to be in a state of slow cyclical contraction. No evidence of a fading of this downward movement could as yet be derived from the recent behaviour of the composite leading or coincident business cycle indicators, which are available up to October and November 1990 respectively. In line with the reduced rate of decline of the real gross domestic product in the fourth quarter, however, the somewhat longer-term trends in various cyclically sensitive time series – such as those of new orders in manufacturing, the physical volume of durable, non-durable and total manufacturing production, the physical volume of mining production, wholesale sales volumes, and new and used motor car sales – have since early or mid-1990 been essentially sideways. A diagnosis of an imminent bottoming-out of the current downswing would not be warranted at this stage; the balance of the currently available information does not, however, suggest a (recent or current) serious further weakening of the economy.

Real gross domestic product, which had declined at a seasonally adjusted and annualised rate of 2½ per cent in the fourth quarter of 1989 and at rates of 1 to 1½ per cent in the first three quarters of 1990, shrank at a provisionally estimated rate of approximately ½ per cent in the fourth quarter. Real gross domestic product was some 1 per cent lower in the *year* 1990 than in the preceding year. Seasonally adjusted, it was some 1½ per cent lower in the fourth quarter of 1990 than at its cyclical high point in the third quarter of 1989.

Declines were recorded in the fourth quarter of 1990 in real value added in the sectors agriculture, mining, construction and transport. Agriculture and mining – i.e. the primary sectors – also accounted for a major proportion of the decline in total real output from the beginning of the current downswing to the fourth quarter of 1990; *excluding* agriculture, real gross domestic product since March 1989 has, in fact, not yet displayed the two consecutive calendar quarters of negative growth which, in terms of a well-known definition, are the minimum requirement for a recession. Real *manufacturing* output, however, was also respectively some 5½ and some 5 per cent lower in the third and the fourth quarter of 1990 than at its cyclical high point in the second quarter of 1989.

On the spending side of the economy, the modest recovery in *real gross domestic expenditure* in the second and the third quarter of 1990 was followed by a material decline in the fourth quarter; as a result, aggregate real gross domestic expenditure was about as high in the fourth quarter of 1990 as in the third quarter of 1987. The marked retreat of real gross domestic spending in the fourth quarter of 1990 was mainly accounted for by a further contraction of real gross domestic fixed capital formation and a major drawing-down of total real inventories; the downward movements in these investment items outweighed the effect of another modest rise in real private consumption expenditure and a second consecutive quarterly increase in real consumption expenditure by general government.

The large size of the drop in total real inventories in the fourth quarter of 1990 meant a growing divergence between total real gross domestic *expenditure* and total real gross domestic *final demand* (i.e. the sum total of real private and government consumption expenditure plus real gross domestic fixed investment). Real gross domestic expenditure shrank by some 3 per cent from 1989 to 1990. In contrast, real gross domestic *final demand* was about 1 per cent *higher* in 1990 than in the preceding year.

The significantly lower level of real domestic spending in the fourth quarter of 1990 was also reflected in a large and sudden rise in the surplus on the current account of the *balance of payments* to an annualised level of nearly R10 billion. On the capital account of the balance of payments, the net *in*flow of capital not related to reserves in the third quarter of 1990 was re-transformed into a significant outflow in the fourth quarter.

In conjunction with 1990's current account surplus, the comparatively moderate outflow of non-reserve-related capital during the year 1990 allowed a major rebuilding of the net foreign reserves. South Africa's total net gold and other foreign reserves rose by R2,9 billion in the calendar year 1990; the *Reserve Bank's* net foreign reserves then strengthened by another R1,7 billion in January-February 1991. This major reinvigoration of the net foreign reserve position was accompanied by a high degree of stability of the exchange rate: the nominal effective exchange rate of the rand was 0,7 per cent higher at the end of February 1991 than at its lower turning-point on 18 September 1989.

Slackening of the domestic economy resulted in erratic *employment growth* in 1989 and early 1990, employment declines in the second and (most probably) also the third quarter of 1990, and significant increases in registered unemployment in 1990 (up to October) in particular. Some enhanced moderation was apparent in the course of 1990 in the tempo of year-on-year money wage increases in important sub-divisions of the private economy. Money wage increases in 1990 nevertheless still involved significant net year-on-year increments in the *real* wage per worker – in the face of declines in real labour productivity.

On the *inflation* front the general subsidence of most inflation rates from the second quarter or the approximate middle of 1989 up to approximately July 1990 was interrupted in August-September 1990 and reversed sharply in October-November, notably as regards the rates of increase in the prices of imported goods and in the overall production price index. This was mostly, but not exclusively, a matter of the effect of the Middle East crisis and the world oil price increases on the prices of oil, petrol and other liquid fuels, and other oil-based commodities and household goods. Following the South African fuel price reductions of November and December 1990, the twelve-month rate of increase in the consumer price index fell back significantly again – although probably less than had been hoped for – in December 1990 and January 1991.

In the area of *monetary and banking developments*, the decelerations of growth in M3 and in monetary institutions' claims on the private sector, which had commenced in the third and the fourth quarter of 1988 and had become more pronounced from mid-1990, were maintained up to October 1990; they were resumed in December 1990 and (in the case of M3) continued in January 1991. The provisionally calculated twelve-month rate of increase in M3 as in January 1991 amounted to 10,3 per cent. Growth in M3 over the guideline year 1990 and as calculated for guideline purposes – i.e. the increase in the quarterly average of M3 from the fourth quarter of 1989 to the fourth quarter of 1990 – amounted to 12,0 per cent; this rate was, therefore, comfortably within the 1990 guideline range of 11 to 15 per cent. An abrupt reacceleration of money and credit growth in November 1990 appeared to have been based largely on conversions of repurchase agreements held by non-bank parties into conventional deposits with monetary institutions, in anticipation of changes to the financial requirements pertaining to deposit-taking institutions.

The *capital markets* in the fourth quarter of 1990 witnessed renewed declines in trading activity in both shares and public sector stock, a further weakening of share prices, and sustained relatively low levels of new-issue activity. Continued firmness was displayed, however, by new mortgage lending, and the value of fixed-property transactions improved slightly. Capital market interest rates fluctuated during 1990 and in early 1991 within relatively narrow bands and along a slightly downward trend.

In the area of *government finance*, Exchequer results up to January 1991, and projections of issues and receipts in February and March, indicate that the actual deficit for the full fiscal year 1990/91 is likely to be somewhat smaller than the deficit of virtually R8 billion originally budgeted for.

Informed opinion at the beginning of the year held that 1991 would most probably turn out to be another year of "consolidation", i.e. of little or no positive, and quite possibly mildly negative, real growth, while the groundwork was being laid for a more decisive cyclical recovery from late 1991 or early 1992 onwards. Factors seen as holding back a more lively growth performance of the domestic economy in 1991 included a prospective further slowing-down of real growth in the world economy and in world trade, with attendant effects on the international demand for South African export commodities; a prospective indifferent performance of the dollar price of gold, but a substantially higher average dollar price of oil on account of the Middle East crisis; and expectations of relatively poor agricultural harvests, with an accompanying need for imports of certain staple cereals. Lack of room for manoeuvre on the balance of payments and stubborn inflation rates would preclude any *substantial* easing of monetary and fiscal policies; domestic spending propensities would, in any case, still be constrained by the lingering effects of the authorities' fairly restrictive policies from early 1988 to early 1991. Investment spending would also continue to be held back by the uncertainty factor, arising from current unrest and the unforeseeable nature of South Africa's future economic and constitutional dispensation. Finally, allowance had to be made for a possible setback to consumer confidence, in the light of less buoyant employment opportunities, less favourable prospects for inflation-matching or inflation-beating salary and wage increases, and the heightened burden of household debt.

By mid-March 1991, several of these factors remained in force, and prospects for growth of the South African economy in 1991 had still to be approached with realistic sobriety. Certain recent developments, however, implied "turns for the better" in various respects:

- The rapid and generally satisfactory end of the war in the Persian Gulf region appeared to have lifted the outlook for the United States economy; the recessionary contraction of that economy could now prove of commensurately reduced depth and shorter duration.

- Prospects for South African agriculture had improved with good rains in several areas in January-February 1991.

- Prospects were seen more confidently for a crumbling, a gradual dismantling, and/or (possibly) the eventual lifting, of various countries' trade and investment sanctions against South Africa.

- Some evidence had been forthcoming of recently enhanced moderation in money wage increases in important sub-divisions of the private economy, as noted above.

- Certain sections of the share market on the Johannesburg Stock Exchange were improving on the strength of declining interest rate expectations and in correspondence with stock market developments in some of the major economies.

- The financial markets' widely held expectations of reductions of domestic interest rates in the course of 1991 were endorsed by the Reserve Bank's lowering of Bank rate that was announced on 8 March 1991.

Bank rate – i.e. the Bank's rediscount rate for Treasury bills – was reduced by 1 per cent, to 17 per cent, with effect from 11 March 1991. Differential adjustments of more or less than 1 percentage point were effected to the Bank's associated refinancing rates. In its motivation of this policy move, the Bank made reference to recent improvements in the inflation rates, the recent strengthening of the balance of payments and the foreign reserves, and the markedly lower recent rates of increase in bank credit and the M3 money supply. The Bank, however, reiterated its commitment to further reductions of inflation, to positive real rates of interest, and to financial discipline and generally conservative monetary policies.

The Bank's announcement of the lowering of Bank rate was accompanied by its announcement of a monetary "guideline" for 1991 ranging from 8 to 12 per cent, and by its determination (at 4 per cent) of deposit-taking institutions' cash reserve requirement against their short-term liabilities under the new Deposit-taking Institutions Act. The full text of the Bank's policy statement of 8 March 1991 is reproduced elsewhere in this *Quarterly Bulletin*.

The main text of this *Review*, like various earlier ones, draws attention to certain noteworthy developments in the South African economy. First among these is the quite remarkable performance of South African merchandise exports since 1983. This export achievement has benefitted from the longest uninterrupted post-war period of world-wide economic expansion as well as from a 27 per cent decline in the average *real* effective exchange rate of the rand from 1983 to 1990. In its macro-economic context the provision (on a net basis) of greatly increased quantities of tradeable goods to the rest of the world was to a major extent made possible, recently and cyclically, by the drawing-down of domestic inventories. "Structurally" and in the longer run, room was made for this net foreign investment largely at the expense of real domestic fixed capital formation.

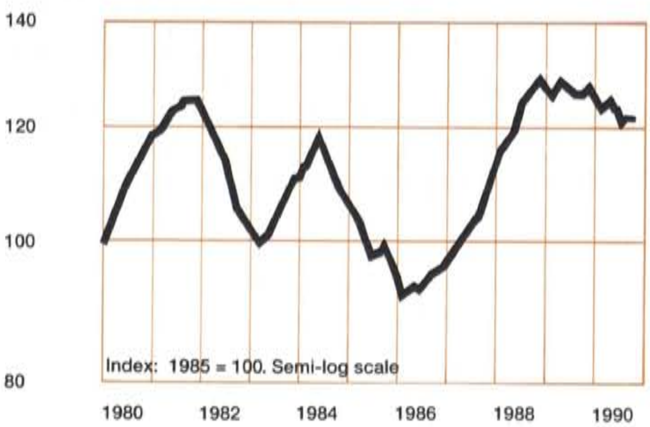
Secondly, recent cyclical developments have seen an acceleration of the long-term upward drift of the ratio of real private and government consumption expenditure to the real gross domestic product. The behaviour of this relationship quantifies the increasingly consumption-minded and consumption-orientated nature of South African society and its production activities. Not least in the light of the rapid expansion of the South African labour force, the implied gratification of present at the expense of future needs and desires is clearly at variance with the long-term interests and requirements of the economy.

Domestic economic developments

Domestic output

The South African economy entered a downward phase of the business cycle in March 1989. Negative rates of growth in the real gross domestic product were recorded in the fourth quarter of 1989 and in the four quarters of 1990. The seasonally adjusted and annualised rate of contraction of real gross domestic product in the fourth quarter of 1989 amounted to not quite 2½ per cent; the negative growth rates in the first three quarters of 1990, seasonally adjusted and annualised, are now estimated at less than 1½ per cent and at approximately 1 and 1½ per cent respectively. The seasonally adjusted and annualised rate of contraction of real gross domestic product in the fourth quarter of 1990 is provisionally estimated at approximately ½ per cent. As a result of these developments, real gross domestic product in the fourth quarter of 1990 was some 1 per cent lower than in the fourth quarter of 1989.

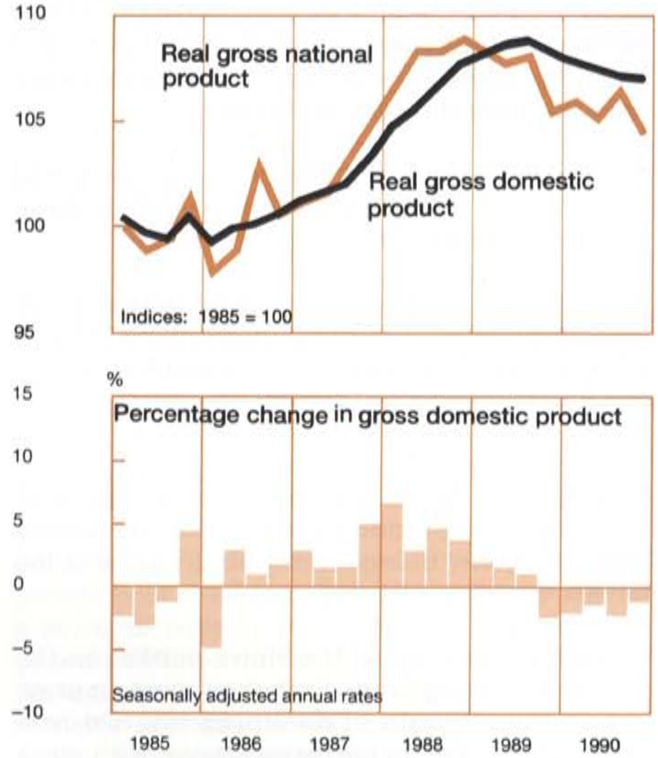
Coincident business cycle indicator



The rate of decline of the real gross domestic product from the *calendar year* 1989 to the *calendar* year 1990 is similarly estimated at approximately 1 per cent. This follows positive rates of growth of about 4 per cent in the advanced upswing year 1988 and of about 2 per cent in the early downswing year 1989.

Sectoral analysis shows that *declines* in real output were recorded in the fourth quarter of 1990 in agriculture, mining and quarrying, construction, and transport, storage and communication.

Real gross domestic product and national product



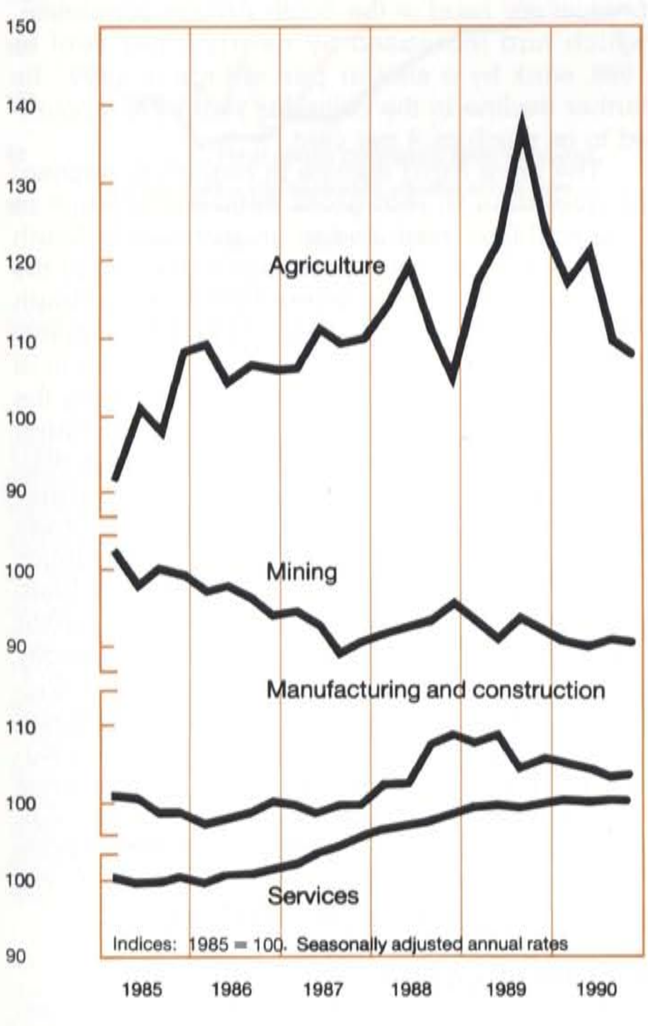
Moderate *increases* in real value added were shown by manufacturing, by the sector electricity, gas and water, and by the sector finance, real estate and business services. Little change in real output from the third to the fourth quarter of 1990 was shown by the sector commerce and by general government.

The fourth-quarter decline in real value added in *agriculture* meant a continuation, at a more moderate pace, of the drop in real agricultural production in the third quarter of 1990. It also meant a further retreat of agricultural output from the peak in such production that had been reached in the third quarter of 1989. The contraction of real value added in agriculture in the fourth quarter of 1990 could primarily be attributed to a notable decline in the wheat harvest as a result of adverse weather conditions in the main wheat-growing areas. Lower real gross incomes than in the fourth quarter of 1989 were, however, also recorded in livestock production. In addition, farmers' aggregate real expenditure on intermediate goods and services was some 2 per cent higher in the fourth quarter of 1990 than in the fourth quarter of 1989.

The fourth-quarter decline in real value added in the *mining sector* was mainly due to a levelling-out of real value added in gold mining and to minor declines in production in the non-gold mining industry, especially in the mining of metal products. Gold production *rose* in the *third* quarter of 1990 in the face of its longer-term downward trend (which is dominated by the marginalisation of a growing number of mines as a result of rising operating costs and a near-stagnant rand price of gold). The mild weakening of gold production in the fourth quarter of 1990 represented the net result of divergent movements in the throughput and gold content of ore on different mines, as well as of the termination or curtailment of operations in or at some of the older shafts.

Lower levels of real value added in the *construction* and *transport* sectors in the fourth quarter of 1990 were associated with declines in specific areas of domestic demand and activity, such as decreases in real fixed investment in building and construction works, the lower level of agricultural production, and a sharply lower volume of merchandise imports.

Components of real gross domestic product



Real *manufacturing* production reached its most recent cyclical high point in the second quarter of 1989; in the third quarter of 1990 it was some 5½ per cent lower than at this cyclical high. The *increase* in real manufacturing production in the fourth quarter of 1990 – which, although moderate, was broadly based – represented a slight reversal of sustained declines in output in the preceding three calendar quarters.

Manufacturing output in the final few months of 1990 would appear to have been influenced positively by the termination of certain major strikes and stay-aways and some abatement of labour unrest. Increased industrial production in the fourth quarter of 1990 was accompanied by a slowing-down of the decline in the degree of capacity utilisation in the manufacturing industry and by a moderate rise in the ratio of overtime hours to ordinary hours worked at the beginning of that quarter. This may have reflected attempts by certain firms to make up for man-days lost through industrial action and related labour problems in preceding months.

Increases in real output were also recorded in the fourth quarter of 1990 in the sector *electricity, gas and water* and in the sector *finance*; in addition, real value added in the sector *commerce* moved along an essentially sideways course. The comparative buoyancy of activity in these sectors seems likely to have been associated in various ways with the continued firmness – up to the end of 1990 at least – of real private consumption expenditure and (more generally) of total real domestic final demand (i.e. the sum total of real private and government consumption expenditure and real gross domestic fixed investment).

Real private consumption expenditure was noted in the December 1990 issue of this *Bulletin* never to have stopped rising during the current cyclical downswing to date. As regards real domestic final demand, limited declines were, in fact, recorded in this variable in three calendar quarters since the second quarter of 1989; broadly speaking, however, the effect of the current downswing on real domestic final demand has been to slow down its growth rather than to reduce it in absolute terms. Real domestic final demand expanded in the third quarter of 1990 at an annualised rate of approximately 1 per cent. The tempo of its increase then quickened in the fourth quarter of 1990 to an annualised rate which is currently estimated at more than 3 per cent.

Output data for the successive quarters of

1990 show that the South African economy in late 1990 continued to be in a state of slow cyclical contraction and was very gradually moving more deeply into recession. The 1 per cent decline in aggregate real gross domestic product in the *year* 1990 vis-à-vis the year 1989 could, however, still be attributed *primarily* to declines in real output in (1) agriculture and mining (i.e. the primary sectors), and (2) the manufacturing industry. The comparative shallowness of the recession up to the end of 1990 was, accordingly, also apparent from the fact that the decline in total real value added by the *non-agricultural* sectors of the economy from the year 1989 to the year 1990 amounted to only about ½ per cent; total real value added of the aggregate *non-primary* sectors actually showed little change between these two years. Moderate *increases* in real gross domestic product in the year 1990 vis-à-vis the year 1989 were still displayed by the sectors electricity, gas and water; commerce; transport, storage and communication; finance, real estate and business services; and general government.

Real value added by the joint *primary sectors*, which had increased by more than 3 per cent in 1989, fell by 4½ per cent in 1990. This consisted of a 9½ per cent decline in real agricultural production and a 1½ per cent decline in real output of the mining industry. The lacklustre performance of the mining sector was mostly a matter of difficulties experienced by the gold-mining industry; in addition to the industry's longer-term problems already referred to, gold-mining companies in 1990 were also troubled by tense labour conditions and labour unrest. In addition, diamond and other non-gold mining concerns were affected adversely by a weakening of the prices of various base and precious metals in the international commodity markets, on account of slower growth in the world economy. A virtually stable level of output was, however, maintained by the coal-mining industry: certain countries which had formerly placed restrictions on their coal imports from South Africa, have been reviewing these policies in the light of recent South African constitutional and socio-political developments.

Aggregate real value added by the *secondary sectors* shrank by some 1½ per cent in 1990 after having expanded by a similar percentage in 1989. This was mainly the result of a decline in real output of 2½ per cent in the manufacturing industry. Lower levels of output in manufacturing reflected the slow-down in growth of aggregate real domestic final demand and a running-down of inventories. A cross-sectoral analysis shows falling sales volumes in manufacturing also to have been due to a major downturn of real fixed capital formation in all the different sub-groups of the mining sector. The decline in real manufacturing production during 1990 was also apparent from higher levels of surplus capacity and declines in the degree of capacity utilisation.

In contrast to the declines in real output of the primary and secondary sectors, real value added in the *tertiary sectors* strengthened by another ½ per cent in 1990, after having expanded by some 2 per cent in 1989. This comparative firmness of tertiary production could be attributed to the surprising buoyancy of output in wholesale and retail trade and to rising levels of activity in the sub-sectors private transport and communication. Real output by public transport declined in 1990; increased shipping activity at South African harbours and increased handling of cargo resulted, however, in a healthy performance by Portnet.

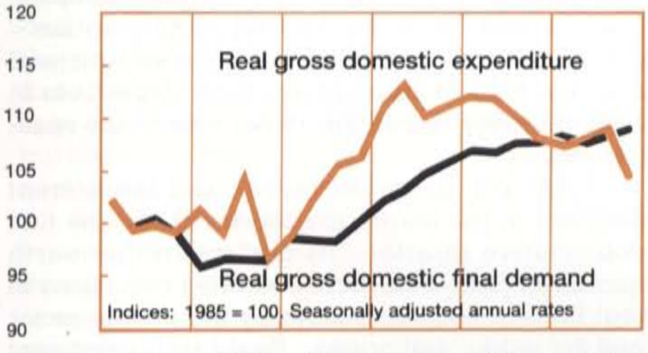
The approximate 1 per cent decline in real gross *domestic* product from 1989 to 1990 was accompanied by a decline in real gross *national* product of more than 1½ per cent. This followed a modest decrease in real gross *national* product of some ½ per cent in 1989. Real gross national product per head of the South African population, which had *in*creased by nearly 3 per cent in 1988, sank by a similar percentage in 1989. Its further decline in the calendar year 1990 amounted to as much as 4 per cent.

The more rapid decline in real gross national product than in real gross domestic product in 1990 could be attributed to an increase in South Africa's real net factor payments to the rest of the world as well as to a deterioration of the South African terms of trade. Real net factor payments rose by 4½ per cent in 1990, mainly on account of increased interest payments which arose from the sustained, comparatively high, level of nominal interest rates in South Africa and from a hardening of interest rates in certain trading partner countries. The deterioration of the terms of trade reflected the downward tendency in the dollar price of gold in the first half of 1990 and its limited response to the Gulf crisis, as well as a further net weakening of international non-oil commodity prices relative to the world prices of manufactured goods; the substantial rise in international crude oil prices from July-August 1990 had a significant adverse effect on the South African terms of trade in the fourth quarter of 1990 in particular. The average levels of the export and import price "deflators" rose in 1990 by only about 1½ per cent and by nearly 3½ per cent respectively

Domestic expenditure

Modest recoveries in aggregate real gross domestic expenditure (at seasonally adjusted and annualised rates of some 3 and 4 per cent) were recorded in the second and the third quarter of 1990. In the *fourth* quarter of 1990, in contrast, total real gross domestic spending fell back significantly to a level that was some 7½ per cent lower than in the first quarter of 1989. This was mainly due to a further contraction of total real gross domestic fixed investment expenditure. In addition, the rate of decumulation of total real inventories accelerated substantially again, after having slowed down in the preceding three months. The declines in these investment items more than neutralised another modest rise in real private consumption expenditure and a second consecutive quarterly increase in real consumption expenditure by general government.

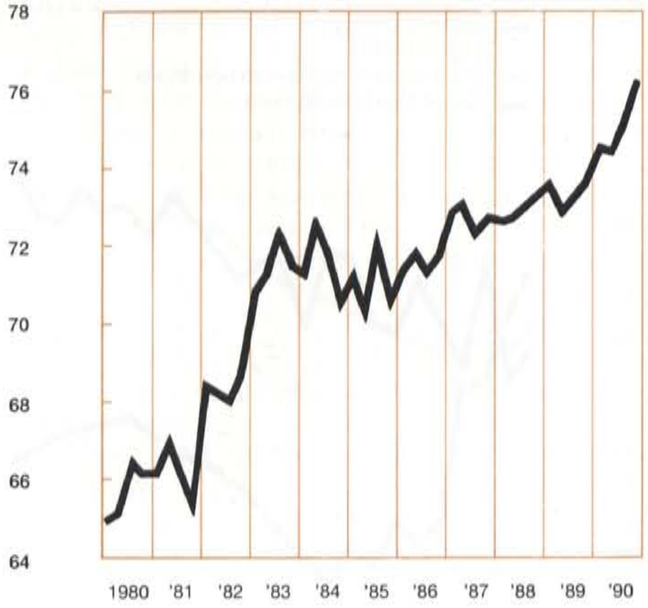
Real gross domestic expenditure and final demand



Total real gross domestic expenditure in the *year* 1990 is estimated to have been some 3 per cent lower than in the preceding year; this decline was markedly larger than the decrease of not quite 1 per cent from 1988 to 1989. In contrast to the accelerated shrinkage of total real gross domestic *expenditure*, however, a modest further *increase* (of slightly less than 1 per cent) was recorded in total real gross domestic *final demand*. The modest rise in this aggregate in 1990 followed an increase of close to 3½ per cent in 1989. It arose from the fact that increases in real private and government consumption expenditures again outweighed the cyclical decline in total real domestic fixed capital formation during the year.

Being based on the longer-term upward trend in real consumption by both the private and the government sector, the sustained upward tendency in real gross domestic final demand throughout the current cyclical downturn to date presented itself as further evidence of the increasingly consumption-minded and consumption-orientated character of the South African economy. The accompanying graph shows the marked and seemingly irresistible upward drift of the ratio of real private plus government consumption expenditure to the real gross domestic product since the end of the 1970s and its recent acceleration in the current downward phase of the business cycle.

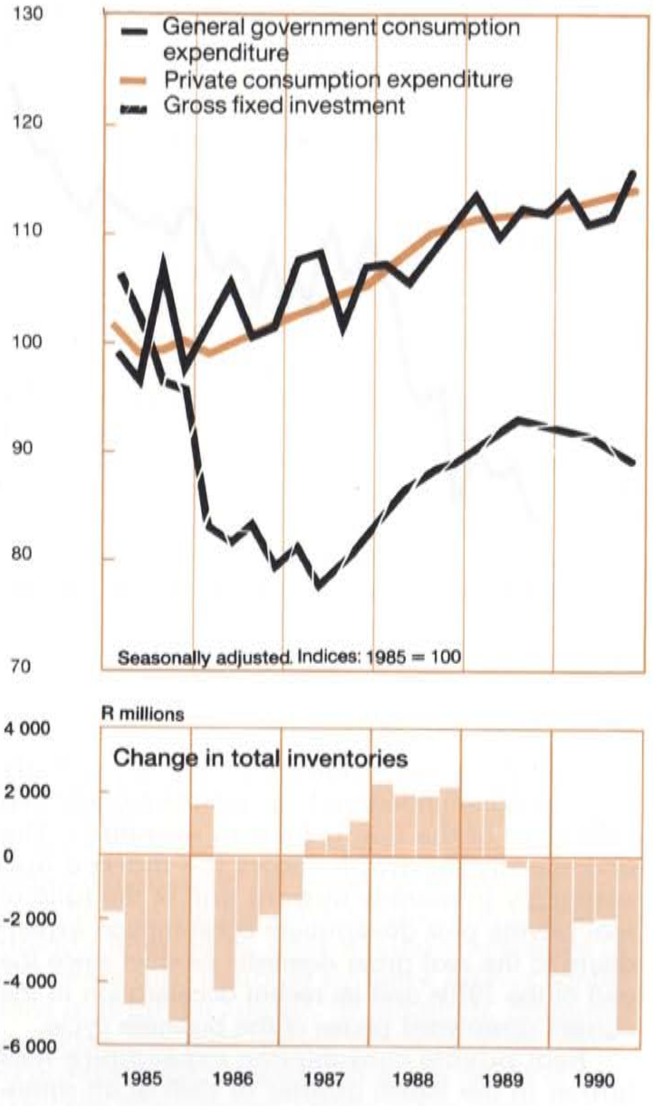
Ratio of total consumption expenditure to gross domestic product



Real *private consumption expenditure* rose further in the fourth quarter of 1990 at an annualised rate of close to 2 per cent. This growth rate was mildly weaker than in the preceding quarter but broadly similar to consumption growth in the first half of the year.

The increase in total real private consumption in the fourth quarter of 1990 was widely spread over most household spending categories. Real outlays on consumer durables advanced at a remarkably firm annualised rate of approximately 5 per cent. Significant increases were recorded in particular in private-sector expenditures on certain sub-categories of durable household goods, such as furniture and household appliances and articles for recreational and entertainment purposes (e.g. radio and television equipment). Against this, a decline at an annualised rate of some 4 per cent was recorded in real spending on personal transport equipment (after an increase in the preceding three months). This could be attributed at least partly to the increase

Main components of real gross domestic expenditure



of nearly 30 per cent in the price index of new motor cars since the start of the current downswing in early 1989. Real household consumption expenditure on *semi-durable* goods advanced in the fourth quarter of 1990 at an annualised rate of some 2 per cent.

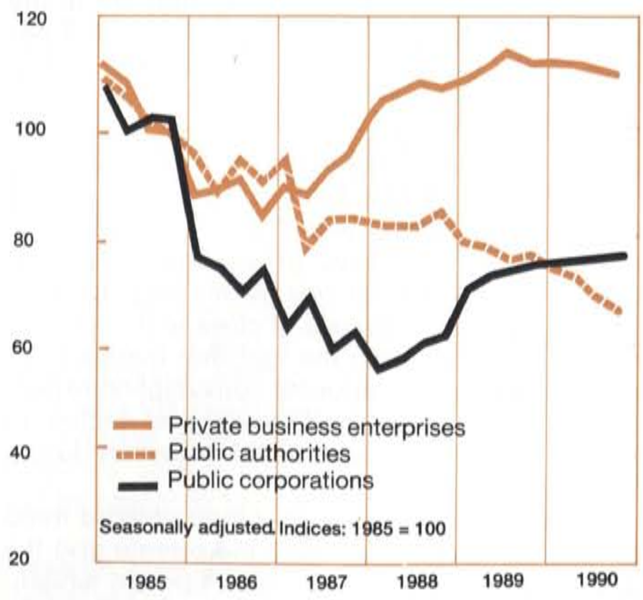
Real private consumption expenditure in the *year* 1990 was about 1½ per cent higher than in 1989. All sub-categories of this kind of spending showed increases during the year; the rates of increase in these various spending components ranged from 1 per cent in the case of consumer services to some 3 per cent in respect of durable goods.

Real *government consumption expenditure* rose in the first quarter of 1990, declined in the second quarter (i.e. in the first quarter of fiscal 1990/91), but increased markedly again in the third quarter. It then continued to rise strongly in the fourth quarter of 1990 at an annualised rate of approximately 16 per cent. This was mostly a reflection of increased real expenditure on intermediate goods and services.

Total real government consumption expenditure in the calendar *year* 1990 is estimated to have been some 1 per cent higher than in calendar 1989. This rate of increase was, therefore, substantially lower than the rate of increase of some 3½ per cent from 1988 to 1989. Moderation of the year-to-year growth in real government consumption outlays from 1989 to 1990 could be attributed to a reduced rate of employment expansion in the government sector and to a marked drop (from 4½ to 1 per cent) in the year-to-year increase in real expenditure on intermediate goods and services. The ratio of government consumption expenditure to the gross domestic product nevertheless advanced slightly further – contrary to the authorities' intentions of structural reform – from marginally less than 18 per cent in 1989 to slightly more than 18 per cent in the ensuing year.

Total real *gross domestic fixed investment* declined in the fourth quarter of 1990 for the fifth consecutive quarter. Its decline in the fourth quarter of 1990 arose from sustained reductions in real fixed investment outlays by the private sector and by public authorities. Real fixed investment

Real gross domestic fixed investment



spending by public *corporations*, which has been on an upward trend since the second quarter of 1988, showed another modest increase in the fourth quarter of 1990.

The fourth-quarter decline in real fixed capital formation in the *private sector* reached an annualised rate of some 4½ per cent. This was a significantly faster decline than in the preceding four quarters, when the annualised rates of contraction had varied from some 2 to 3 per cent. The more notable cut-backs in private-sector real fixed capital spending in the fourth quarter of 1990 were recorded in agriculture and in real private residential construction. More limited rates of contraction, ranging from 2 to 4 per cent, were registered in the mining sector, commerce and the manufacturing industry.

In the *year* 1990, the declines in *total* real gross domestic fixed investment and in real fixed investment by the *private sector* amounted to surprisingly modest figures of approximately 1 per cent and ½ per cent respectively. In the case of the private sector, the effect of declines in real fixed investment in the sectors agriculture, mining, commerce and finance in 1990 somewhat outweighed the effect of an actual *in*crease in such investment in manufacturing.

Real fixed investment in *agriculture* was influenced downwards during 1990 by, among other things, adverse weather conditions in certain areas, lower volumes of maize and wheat production, high levels of farm debt, and the high cost of servicing this debt at the prevailing interest rates. The real stock of fixed capital in agriculture has, in fact, been on a downward trend since late 1982.

Real fixed capital formation in the *mining sector* in 1990 was discouraged by rationalisations and retrenchments in the hard-pressed gold-mining industry and by the weaker performance of certain international base metal prices. The decline in real outlays on private residential buildings – which accounted for the decline in fixed investment by the sector *finance, real estate and business services* and has also been a major element in explaining the downward movement of total real fixed capital formation since late 1989 – could be attributed in 1990 to factors such as relatively high mortgage interest rates, a diminution of interest in town houses as substitutes for free-standing homes, and contractors' reluctance to conduct building operations in strife-torn or otherwise dangerous residential areas. Only a small part of the funds made available to the Independent Development Trust has as yet been effective in activating financing for residential construction.

The comparatively strong performance of real fixed investment in the private *manufacturing industry* during 1990 reflected investment activities in sub-sectors such as paper and printing, the chemical industry and base metal working. Not least because of the investment programmes of public corporations in the manufacturing area, the total real fixed capital stock in the manufacturing sector actually rose during 1990 for the second consecutive calendar year. The level of this stock in 1990 was, however, still some 4 per cent lower than at its peak in 1984.

Real fixed investment expenditure by *public authorities*, which has been on a downward trend since the first quarter of 1989, shrank at an annualised rate of 13½ per cent in the fourth quarter of 1990. Little change was shown by real fixed capital spending by general government. Against this, real fixed capital spending by the business enterprises of general government fell back substantially. In the *year* 1990 total real fixed capital formation by public authorities shrank by a major 10 per cent. The main sources of this decline were reductions of real fixed capital spending by general government and by the Department of Posts and Telecommunications. A small *in*crease, on the other hand, was reported by Transnet.

A small further *in*crease in real outlays on fixed capital items was also shown in the fourth quarter of 1990 by the *public corporations*. As indicated earlier, this reflected a further increase in real fixed capital expenditure by public corporations in the manufacturing sector, which more than offset a reduction of such expenditures in the sector electricity, gas and water. The continuing cut-backs on Eskom's capital programmes in the light of abundant electricity-generating capacity also resulted in a slow-down of the growth rate of all public corporations' real fixed capital expenditure from more than 25 per cent in 1989 to only 4 per cent in 1990. Public-corporation investment spending was dominated in 1990 as well as in 1989 by the on-shore and off-shore development activities of Mossgas.

An analysis by *type* of capital asset shows declines in 1990 in aggregate real fixed capital expenditure on residential buildings, construction works, machinery and equipment, and transport equipment. Real spending on non-residential buildings, on the other hand, still expanded in 1990 for the third consecutive calendar year. The level of this kind of expenditure was a major 12½ per cent higher in 1990 than in 1989.

Inventory investment, which had turned negative in the third quarter of 1989 and had continued to be negative in the ensuing four quarters, became more strongly negative in the fourth quarter of 1990. This 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. As a result, the ratio of real industrial and commercial inventories to the real gross domestic product declined from about 19 per cent in the third quarter of 1990 to about 18½ per cent in the ensuing three months.

In the case of the industrial and commercial sectors, the drawing-down of inventories in the fourth quarter of 1990 could mainly be regarded as the counterpart of an increase in the so-called "net trade balance". The net trade balance expanded sharply (by more than R5 billion) from the third to the fourth quarter of 1990. This was a reflection of the rise in merchandise export volumes and the sharp drop in merchandise import volumes in the fourth quarter. In contrast, a *narrowing* of the net trade balance in the *third* quarter of 1990 – when imports rose rapidly – had helped to account for the slowing-down of the rate of inventory decumulation during that period.

In respect of the *year* 1990 a net drawing-down of real inventories could be observed in all major sectors of the economy, with the exception of agriculture and mining. The "net change in real inventories over one year" as in 1990 amounted to a decline in real inventories of more than R3 billion. This destocking action contributed more than 2½ percentage points to the 3 per cent decline in aggregate real gross domestic expenditure from 1989 to 1990.

Factor income

The annualised quarter-to-quarter increase in aggregate nominal factor income slowed down from an average of almost 17½ er cent in the first half of 1990 to approximately 10 per cent in the third quarter and to approximately 7½ per cent in the fourth quarter. This marked deceleration of the growth in aggregate nominal factor remuneration reflected pronounced downward pressure on the gross operating surpluses of business enterprises as well as some moderation of the rate of expansion of nominal labour rewards.

Quarter-to-quarter growth in the total nominal *gross operating surplus* of business enterprises, which had shrunk from an annualised rate of 13 per cent in the first quarter of 1990 to less than 8 per cent in the third quarter, slipped down markedly further to an annualised rate of *contraction* of 1½ per cent in the fourth quarter. Sectoral analysis shows that the actual decline in the total nominal operating surplus in the fourth quarter of 1990 was based on substantial decreases in the operating surpluses in the agricultural sector and on near-sideways movements of the operating surpluses in mining and manufacturing. The weakening of the profit performances of firms in these sectors more than neutralised increases in operating surpluses that were still being recorded in the tertiary sectors in particular.

On a year-to-year basis growth in the total nominal gross operating surplus of business enterprises sank from 13½ per cent in 1989 to 9½ per cent in 1990. Incorporated in the reduced growth rate of the surplus in 1990 were an average year-to-year increase in operating surpluses of only 5½ per cent in the primary and secondary sectors, against an increase of 16 per cent in the tertiary industries. Profit performances in the secondary industries in particular, were adversely affected in 1990, not only by the general slackening of economic activity, but also by the heightened militancy of the trade union movement and by the increased incidence of industrial action, work stoppages and labour unrest. In these conditions, firms' drawing-down of inventories and liquidations of other asset holdings appeared as a part of their attempts at cost-cutting, retrenchment and rationalisation and the general strengthening of corporate balance sheets.

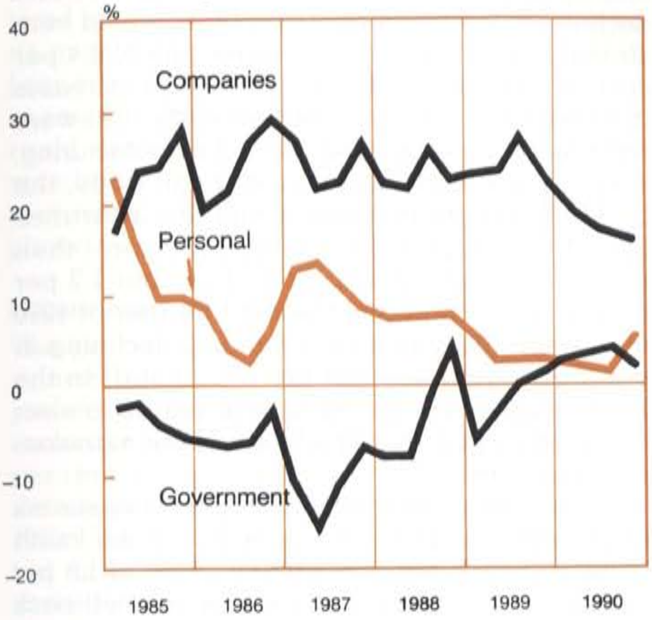
Quarter-to-quarter growth in the total *remuneration of employees* accelerated from an annualised rate of 18 per cent in the first quarter of 1990 to 23 per cent in the second quarter, partly because of the large wage and salary increases in the public sector that became effective in the second quarter. This rate then slowed down to 12 and 13 per cent in the third and the fourth quarter of 1990 respectively.

In the calendar *year* 1990 the increase in total nominal labour remuneration slowed down mildly to 16½ per cent, from 18 per cent in the preceding year. The 16½ per cent increase in 1990, however, still exceeded the concurrent year-to-year inflation rate. Growth in the total *real* wage bill during the downswing year 1990 could also be attributed to some extent to a variety of factors such as the special salary increases for teaching staff, health workers and security personnel in the public sector, the strong bargaining power of the labour unions, the employment of temporary workers during strikes, and the granting of improved severance allowances, retrenchment provisions and other concessions to workers who were laid off during the year.

Domestic saving

The most recent estimates indicate that the domestic saving ratio (i.e. the ratio of gross domestic saving to gross domestic product) improved marginally to almost 21½ per cent in the fourth quarter of 1990 from nearly 21 per cent in the preceding quarter. This could be attributed to net saving by general government as well as to an improvement in total net saving by the private

Components of savings as percentage of gross domestic saving



sector. For the *year* 1990 as a whole the ratio of gross domestic saving to gross domestic product declined from 22½ per cent in 1989 to 21½ per cent. This reflected a decline in the level of net private saving which more than offset an increase in net saving by general government.

Positive saving was recorded by *general government* in each of the four quarters of 1990; the resultant net saving by general government during the calendar year 1990 amounted to R1,7 billion. This was the first time since 1983 that current government income exceeded current government expenditure during a full calendar year.

Current government expenditure rose by a relatively limited 12½ per cent in the calendar year 1990, compared with an increase of 23 per cent in 1989. One of the principal components of this expenditure, namely the payment of interest on government debt, rose by only 4 per cent in 1990, against 34 per cent in the preceding year. This was partly a consequence of the consolidation of government debt that had been effected in late 1989; as a result of this consolidation, the interest payment dates in respect of an important portion of the debt fell outside the calendar year 1990 (though not, of course, also outside the fiscal year 1990/91). The reduced rate of growth in current government expenditure was supported by an increased rate of growth in current revenue: mainly owing to a very large overall increase (of 27 per cent) in income tax receipts, current government income rose in 1990 by 16½ per cent.

The lower level of net saving by the *private sector* in 1990 stemmed mainly from reduced saving by corporate entities. This was a reflection of lower earnings growth of companies (notably of companies in the primary sectors) and of the rising number of company liquidations. In addition, declarations of special dividends by companies appear to have been encouraged by the exemption from normal income tax of dividends received by individuals and close corporations, which was announced in the Central Government's Budget for 1990/91; the counterpart of companies' increased dividend pay-outs was, of course, a decline in their retained earnings. Finally, the paying-out of corporate earnings in the form of dividends may also have been fostered by companies' limited fixed-investment intentions; plans for expansion or renewal seem likely to have been affected adversely by the risks and uncertainties that currently still surround South Africa's economic and socio-political future.

Net *personal* saving (comprising household saving and total net profits of unincorporated business enterprises) stayed at very low levels throughout 1990. The seasonally adjusted and annualised level of household saving did, however, rise in the fourth quarter of 1990; this caused a marginal improvement in net personal saving during 1990 as a whole. The mild rise in household saving in late 1990 could probably be attributed to a slight rise in the real remuneration of employees and to the fact that pay-outs of dividends by some companies were maintained even in the face of reduced corporate earnings. Households' savings propensities may also have begun to be affected upwards, however, by less buoyant "confidence", by perceptions of less favourable employment opportunities and reduced prospects for inflation-matching salary and wage increases, and by the large burden of household debt that was already being borne at the prevailing level of interest rates.

Employment

The rise in total non-agricultural employment in the South African economy accelerated from 0,5 per cent to 0,9 and 1,2 per cent in the three upswing years 1986-1988, but slowed down again to 0,5 per cent in the early downswing year 1989. Employment increases in the upswing years 1986-1988 compared poorly with those in the cyclical expansions of 1972-74 and 1978-81]

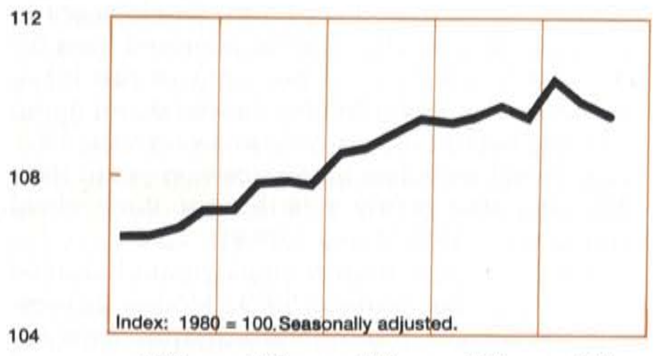
Total non-agricultural employment behaved erratically in the course of 1989. Modest increases in the second and the third quarter were followed by a decrease at a seasonally adjusted and annualised rate of 1,2 per cent in the fourth quarter. Partly because of reversals of certain lay-offs of staff in the fourth quarter of 1989, total employment then *rose* at a remarkable annualised rate of 3,7 per cent in the first quarter of 1990. As a result, total employment in the first quarter of 1990 was actually conspicuously higher than at any time during the upswing of 1986-89 or during the preceding stages of the current downswing period.

In correspondence with the recessionary tendencies in the economy, however, total employment decreased subsequently in both the second and third quarter of 1990, at annualised rates of 2,1 and 1,2 per cent respectively. This was the first decline in total employment during two consecutive calendar quarters since the first half of 1985. The average level of employment in the first three quarters of 1990 was nevertheless still 0,4 per cent *higher* than in the first three quarters of 1989. The overall behaviour of employment in the first six quarters of the current downward phase of the business cycle accordingly compared favourably with employment developments in the cyclical slow-downs of 1981-83 and 1984-86. It also served to confirm the comparatively mild character of the current downswing until very recently at least.

Employment decreases, or further decelerations of employment growth, were reported in the third quarter of 1990 by a majority of sectors and sub-sectors of the economy. Notable exceptions to this general trend were, however, recorded – among various other sectors and sub-sectors – in the gold-mining industry, the motor trade, the insurance industry and general government.

Total employment in the non-agricultural *private sector* rose by 1,1 per cent in 1988 and by 0,3 per cent in 1989; both these rates fell short of the concurrent rates of increase in non-agricultural employment in the economy generally. Like total non-agricultural employment, private-sector employment rose in the third quarter of 1989 and declined in the fourth quarter, but recovered very strongly again (at an annualised rate of 4,4 per cent) in the first quarter of 1990. Large increases in private-sector employment in early 1990 were recorded in (among other sectors) manufacturing, construction, non-gold mining, retail trade, the building society movement and the insurance industry. Private-sector employment then declined at annualised rates of 2,1 and 1,2 per cent in the second and the third quarter of 1990 and seems likely to have continued declining in the fourth quarter. Net lay-offs of staff in the *fourth* quarter are indicated with regard to electricity generation, construction and the manufacturing industry.

Non-agricultural employment



Total employment by *public authorities* shrank at an annualised rate of 2,1 per cent in the fourth quarter of 1989, but expanded at a rate of 1,8 per cent in the first quarter of 1990. It then fell back again at annualised rates of 2,1 and 1,3 per cent in the second and the third quarter. These rates of contraction in the middle quarters of 1990 closely approximated those in the private sector. In contrast with the public authorities, however, the non-agricultural private sector continued to be a source of employment creation during the first three quarters of 1990 as a whole: the change in the average level of employment in the private sector and by public authorities from the first three quarters of 1989 to the first three quarters of 1990 amounted to 0,6 per cent and to *minus* 0,2 per cent respectively.

The ratio of *overtime hours* to normal hours worked in manufacturing declined from the third quarter of 1989 to the third quarter of 1990 and continued to do so, on balance, up to November. In the construction industry this ratio declined, on balance, from the second quarter of 1989 to the first quarter of 1990, but recovered somewhat in the second quarter. It then declined again up to November.

The seasonally adjusted number of registered *unemployed workers* in the White, Coloured and Asian population groups rose, on balance, from a six-year low of 42 000 reached as recently as December 1989 (i.e. well into the current cyclical downswing) to 86 400 in September 1990, before retreating mildly to 84 200 in November. Although the number of registered unemployed workers in these population groups increased dramatically from July 1990, the average rate of growth in unemployment in this category during the first six quarters after the economy's cyclical upper turning-point in early 1989 was still less than the average tempo of unemployment advances during the comparable stages of the downswings of 1981-83 and 1984-86.

The seasonally adjusted *total* number of registered unemployed workers rose, on balance, from its most recent cyclical low point of 108 900 in January 1989 to 226 000 in November 1990. It seems likely, however, that the uncommonly rapid rise in this number from June to July 1990 was influenced upwards by the adoption of a new method for measuring the number of unemployed.

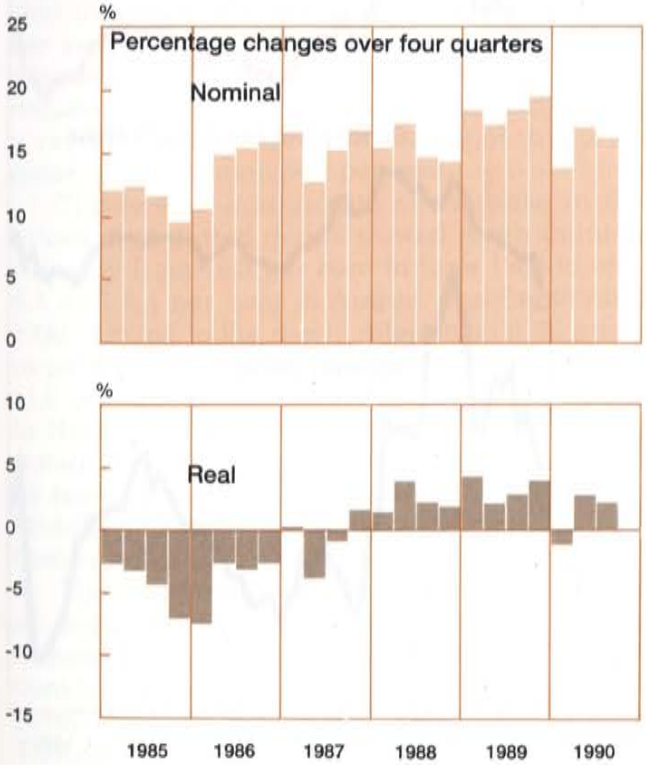
Labour costs and productivity

The year-to-year rate of increase in the average annual amount of nominal salaries and wages per worker in the non-agricultural sectors of the economy rose from 11,4 per cent in 1985 to 18,3 per cent in the consolidation year 1989 – the highest tempo of annual money wage increases since 1982. This rate then slowed down, encouragingly but inadequately, to an average of 15,7 per cent in the first three quarters of 1990 vis-à-vis the first three quarters of 1989. In the course of the first three quarters of 1990 the year-on-year rate of increase in the nominal wage per worker fell from its disturbingly high level of 19,4 per cent in the fourth quarter of 1989 to 13,8 per cent in the first quarter of 1990, before reaccelerating to 17,0 and 16,2 per cent in the ensuing two quarters.

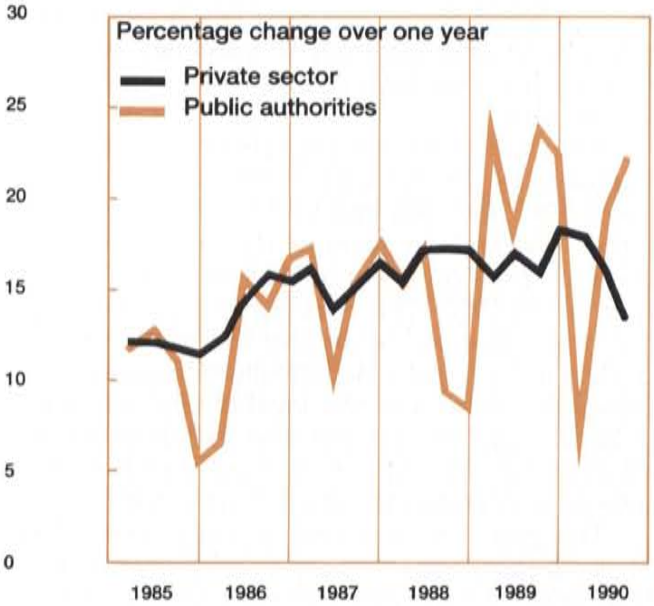
In the non-agricultural *private* sector, the year-to-year increase in the nominal wage per worker amounted to 16,7 per cent in 1989. In the course of 1990 the speed of the year-on-year nominal wage increases in the private sector retreated from its peak level of 18,3 per cent in the fourth quarter of 1989 to rates of 17,8, 16,3 and a comparatively modest 13,4 per cent in the first, second and third quarter of 1990 respectively. Data for the fourth quarter of 1990 indicate a further moderation of the tempo of year-on-year wage increases in electricity generation, manufacturing and the construction industry. This welcome retardation of money wage advances would appear to have reflected employers' increased resistance to extravagant wage demands in the less buoyant business conditions of 1990, as well as labour unions' less aggressive wage claims and some shift of emphasis in the unions' demands from money wage improvements to assurances of job security in a slackening labour market situation.

The year-to-year increase in the nominal wage per worker employed by *public authorities* amounted to a major 21,9 per cent in 1989. The year-on-year rate of these increases fell back sharply, on balance, from as much as 24,4 per cent in the first quarter and 24,0 per cent in the

Remuneration per employee in non-agricultural sectors



Average remuneration per worker in non-agricultural sectors



third quarter of 1989 to only 5,6 per cent in the first quarter of 1990. However, these increases then reaccelerated to year-on-year rates of 18,6 and 22,2 per cent in the second and the third quarter of 1990.

The sharp slow-down of these increases in the first quarter of 1990 and their subsequent reacceleration in the ensuing six months have been attributed on earlier occasions to (1) initial delay in the granting of the regular annual general salary increases in the public service, and (2) structural adjustments in the public service, which included improvements in the employment conditions of teaching staff, health workers and personnel in the police force, the prisons administration, the Department of Justice and the Defence Force. Despite these special salary adjustments, however, the rise in the average level of the nominal wage per worker from the first three quarters of 1989 to the first three quarters of 1990 was still marginally lower among public-authority staff than in the private sector; the two rates concerned amounted to 15,5 and 15,8 per cent.

The *real* wage per non-agricultural worker rose by 2,3 per cent in 1988 and by 3,2 per cent in 1989. In the fourth quarter of 1989 the year-on-year rate of increase in the real wage per worker amounted to a major 3,9 per cent. In the first quarter of 1990, the abrupt drop in the year-on-year percentage rise in the *nominal* wage per worker caused the year-on-year growth in the *real* wage per worker to be reduced to *minus* 1,0 per cent. However, in the second and the third quarter of 1990 the year-on-year percentage increases in the average nominal wage per worker again exceeded the concurrent year-on-year rates of inflation in consumer prices. The rise in the real wage per worker over four-quarter periods recovered accordingly in these two quarters to comparatively high positive levels of 2,6 and 2,1 per cent.

Real non-agricultural *labour productivity* improved by 0,6 and 2,6 per cent in the upswing years 1987 and 1988 and by 1,0 per cent in 1989. It then *declined*, on average, by 0,9 per cent from the first three quarters of 1989 to the first three quarters of 1990. This was partly a purely cyclical phenomenon (reflecting the mild cyclical decline in total real non-agricultural production at a slightly higher average level of total non-agricultural employment), but also incorporated the effect of man-days lost on account of strikes, stay-aways, work stoppages and labour unrest.

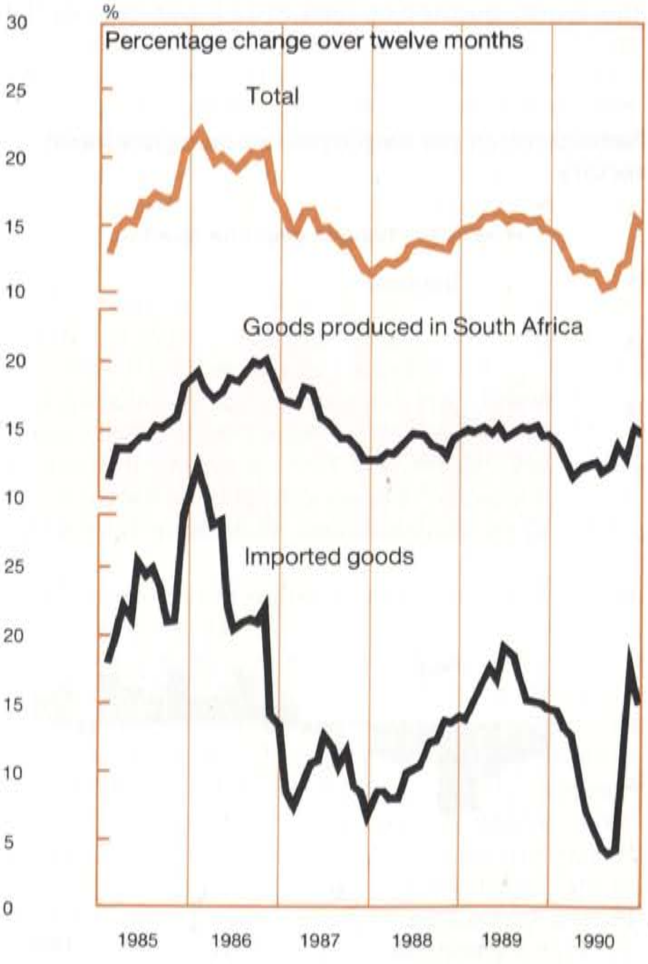
The year-on-year rate of improvement in physical labour productivity slowed down from a high point of 3,4 per cent in the fourth quarter of 1988 to 2,3 per cent in the second quarter of 1989. Real labour productivity then *declined* at year-on-year rates of 0,2 and 0,6 per cent in the third and the fourth quarter of 1989 and at rates of 1,4 and 1,3 per cent in the first two quarters of 1990, but showed a marginal increase again (of 0,1 per cent) in the third quarter of 1990.

The rise in *nominal unit labour costs* accelerated from 12,4 per cent in 1988 to 17,2 per cent in 1989, and to 16,6 per cent in the first three quarters of 1990. This was a reflection of the generally high level of nominal wage increases and of the slow-downs of the improvement in real labour productivity. *Real* unit labour costs decreased from 1985 to 1988, but rose by 2,2 per cent in 1989 and by 2,1 per cent in the first three quarters of 1990.

Inflation

Relatively restrictive monetary and fiscal policies from early 1988 onwards, and increased stability of the exchange rate of the rand from mid-September 1989, contributed to a significant

Production prices



abatement of most inflation rates from approximately the middle of 1989 up to approximately July 1990. This generally downward tendency in the tempo of general price advances was, however, interrupted in August-September 1990 and reversed sharply in October-November. This was mostly, but not exclusively, a matter of the effect of the Middle East crisis and the world oil price increases on the prices of oil, petrol and other liquid fuels and of other oil-based commodities and household goods.

Sustained upward pressure on prices also still arose, however, from the continued relatively high levels of money wage claims and settlements and the attendant increases in nominal unit labour costs, and from the effect of adverse weather conditions on the prices of various processed and unprocessed foods. Petrol and related fuel price *reductions* were announced in November and December 1990. Following these declines, the twelve-month rates of increase in the indices of production and consumer prices fell back significantly in December 1990 and January 1991. They were, however, still substantially higher than at their lower turning-points in July 1990.

Relative stability of the effective exchange rate of the rand, and lowering of the import surcharges in the Budget for 1990/91, caused the quarter-to-quarter rate of increase in the prices of *imported goods*, seasonally adjusted and annualised, to drop from its cyclical peak of 26,8 per cent in the second quarter of 1989 to a mere 0,5 per cent in the third quarter of 1990. In the fourth quarter of 1990, however, this rate – seasonally adjusted and annualised – soared dramatically to a record high point in the history of this price index of no less than 58,3 per cent.

The *twelve-month* rate of increase in the prices of imported goods slowed down uninterruptedly from 19,3 per cent in June 1989 to only 4,1 and 4,4 per cent in August and September 1990. Owing to the rise in international oil prices in particular, this rate then rebounded sharply to 11,0 per cent in October 1990 and to 19,1 per cent in November. Mainly because of the subsequent retreat of petroleum prices on the world markets – as fears of major oil shortages on account of the Middle East crisis were diminishing – this rate then receded to 15,4 per cent in December.

The quarter-to-quarter increase in the prices of *domestically produced* goods, seasonally adjusted and annualised, fell back from 18,1 per cent in the *first* quarter of 1989 to a single-digit level of 9,7 per cent in the *first* quarter of 1990. This rate then reaccelerated disturbingly to 14,2 per cent in the second quarter of 1990 – well before the first rumblings of the so-called third oil crisis and its secondary effects on domestic production prices made themselves felt. After retreating slightly to 13,8 per cent in the third quarter of 1990, this rate advanced to 18,6 per cent in the final quarter. Incorporated in the fourth-quarter acceleration of this inflation rate were major price increases of (among other items) paper and paper products, footwear and non-metallic mineral products, in addition to large price increases of coal, petroleum products and food.

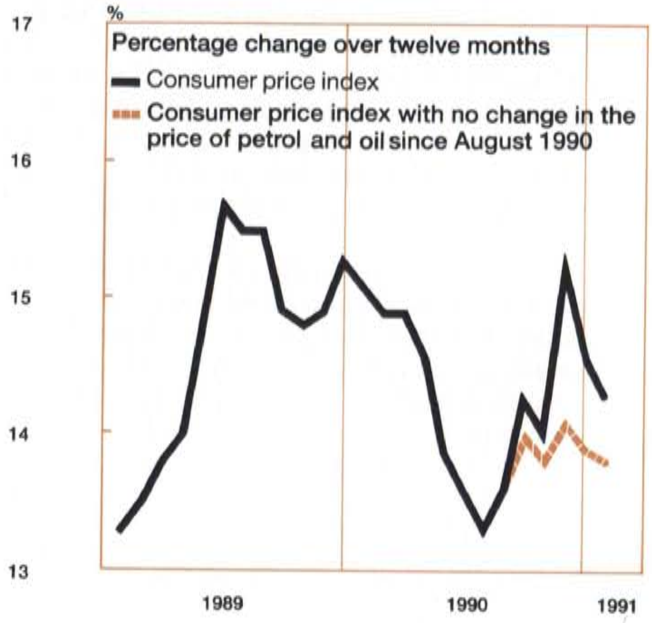
The *twelve-month* rate of increase in the prices of domestically produced goods decelerated moderately from 15,4 per cent in May 1989 to low points of 11,3 per cent in March 1990 and 12,0 per cent in August. This rate then picked up to 12,3 per cent in October and jumped to 15,1 per cent in November, mainly because of price increases of petroleum products, coal and various foodstuffs. In December this rate fell back mildly to 14,6 per cent, reflecting markedly lower twelve-month rates of increase in the prices of petroleum products and coal.

The seasonally adjusted and annualised quarter-to-quarter increase in the total *production price index*, which tends to replicate the movements in the price index of domestically produced goods at a currently slightly lower level, fell from 17,9 per cent in the second quarter of 1989 to a single-digit level of 9,2 per cent in the *first* quarter of 1990. Having reaccelerated to a level of 11-12 per cent in the second and the third quarter of 1990, this rate leapt to 25,4 per cent in the oil-price-afflicted fourth quarter - largely, but not exclusively, because of the sharp concurrent rise in import prices. This was the fastest quarter-to-quarter rise in production prices since early 1986. The *twelve-month* rate of increase in the production price index retreated quite impressively from 15,8 per cent in May 1989 to 10,3 per cent in July 1990, but returned to 15,8 per cent in November 1990. It then declined fairly significantly again to 14,7 per cent in December.

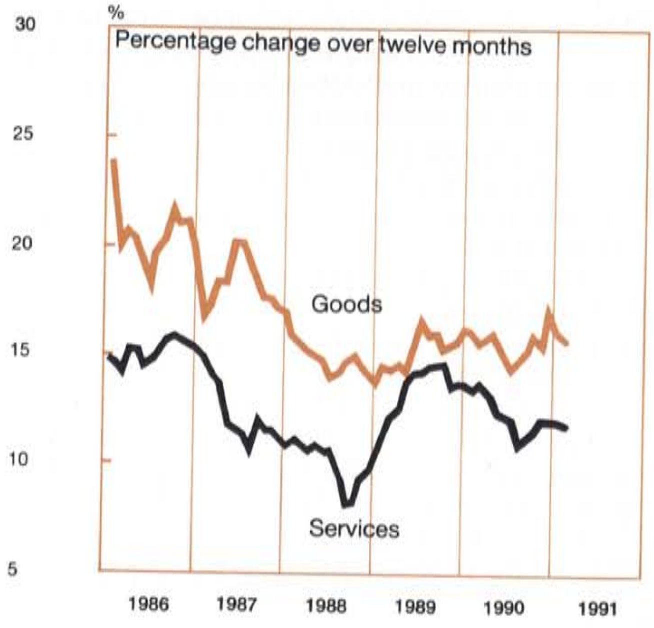
On a year-to-year basis, the rise in the annual average of the production price index accelerated from 13,2 per cent in 1988 to 15,2 per cent in 1989, but slowed down quite significantly again to 12,3 per cent in 1990.

The quarter-to-quarter increase in the *consumer price index*, in seasonally adjusted and annualised terms, declined on balance from 18,0 per cent in the second quarter of 1989 to 13,5 per cent in both the second and the third quarter of 1990 before reaccelerating to 16,8 per cent in the fourth quarter of 1990. With the exception of the first quarter of 1990, the quarter-to-quarter rates of increase in the prices of consumer goods have since early 1989 been consistently higher than

Consumer price index



Consumer prices



those in the prices of consumer *services* (and, therefore, also higher than the quarter-to-quarter rates of increase in the overall consumer price index). In the third quarter of 1990 the annualised quarter-to-quarter rates of inflation in the prices of consumer goods and consumer services amounted to as much as 16,7 per cent and as relatively little as 6,7 per cent respectively. However, the differential between these two rates narrowed sharply in the fourth quarter of 1990, when they amounted to 18,2 and 14,6 per cent.

The rate of increase in the consumer price index *over periods of twelve months* declined moderately from its 1989 high point of 15,7 per cent in June of that year to 13,3 per cent in July 1990. The fuel price increases of September and October 1990 and their secondary effects, superimposed on the "underlying" inflation rate, then caused this rate to return to 15,3 per cent in November 1990. After the fuel price reductions of November and December, this rate receded again to 14,6 per cent in December 1990 and – rather disappointingly – to 14,3 per cent in January 1991.

The twelve-month rate of increase in the prices of consumer *goods* declined somewhat more strongly (from its generally higher average level) than the inflation rate in the overall consumer price index. Inflation in consumer goods prices fell from 17,1 per cent in November 1990 to 15,6 per cent in January 1991.

Twelve-month rates of inflation higher than those in the overall consumer price index were recorded in January 1991 for articles such as foodstuffs, furniture, household hardware and crockery, footwear, new vehicles, spare parts and petrol, tobacco, and alcoholic beverages. The twelve-month rate of increase in the cost of consumer *services* as in January 1991 amounted to 12,1 per cent.

On a year-to-year basis the rise in the annual average of the consumer price index advanced from 12,9 per cent in 1988 to 14,7 per cent in 1989. It then retreated only marginally to 14,4 per cent in 1990. This minor shrinkage in the annual rate of inflation in consumer prices therefore failed to match the more impressive decline in the year-to-year rise in the annual average of production prices, which from 1989 to 1990 amounted to 2,9 percentage points.

Balance of payments and exchange rates

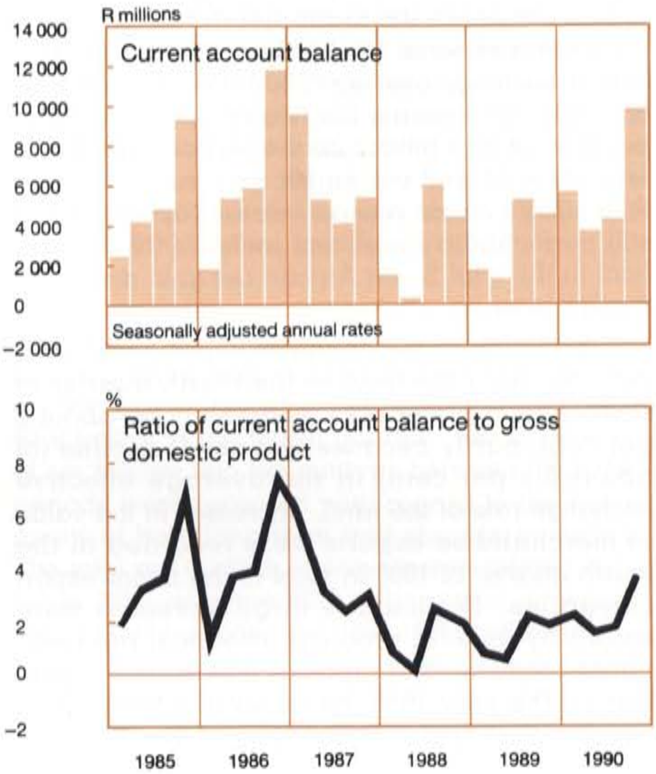
Current account

The surplus on the current account of the South African balance of payments strengthened impressively in the fourth quarter of 1990 to a seasonally adjusted and annualised level of no less than R9,7 billion, from R4,2 billion in the preceding three months. The current account surplus in the fourth quarter of 1990 was, in fact, the second-largest such surplus ever recorded (after the surplus in the fourth quarter of 1986, which had reached an annualised level of R11,7 billion). The surplus for the calendar *year* 1990 amounted to R5,8 billion. This was South Africa's third-largest annual current account surplus (after the surpluses of 1986 and 1987), and was close to twice as high as the surplus of R3,1 billion in 1989.

The current account surplus in the fourth quarter of 1990 was South Africa's twenty-fourth consecutive quarterly current account surplus. The surpluses in the preceding five calendar years amounted to R5,1 billion, R6,1 billion, R6,0 billion, R2,7 billion and R3,1 billion respectively. The cumulative current account surplus from 1985 to 1990 accordingly amounted to a very substantial R28,8 billion, or to approximately 2,6 per cent of nominal gross domestic product over this six-year period.

The sharp increase in the current account surplus in the fourth quarter of 1990 was the combined result of a new *record high* level of the value of merchandise exports and a substantial *decline* in the value of merchandise imports. Between them, the effect of these two movements in merchandise trade significantly outweighed the effect of an increase in net service and transfer payments to foreigners and a marginal decline in the value of the net gold exports.

Balance of payments



The scissors movement in the two components of the trade account in the fourth quarter of 1990 caused the value of South African merchandise exports to exceed the value of merchandise imports – on a quarterly basis – for only the sec-

Balance of payments on current account
Seasonally adjusted annual rates

R millions

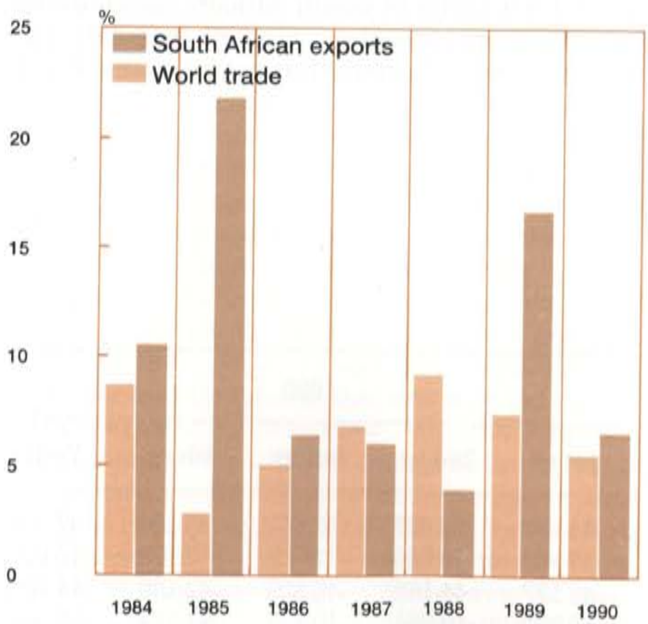
	1989	1990				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	39 085	41 660	39 527	42 852	45 501	42 385
Net gold exports	19 228	17 793	18 500	18 008	17 979	18 070
Merchandise imports	-44 322	-43 577	-44 140	-46 503	-42 180	-44 100
Net service and transfer payments	-10 883	-10 299	-10 264	-10 125	-11 584	-10 568
Balance on current account	3 108	5 577	3 623	4 232	9 716	5 787

ond time since 1962. In this situation, the entire value of South Africa's net gold exports (of some R4,5 billion, before seasonal adjustment and annualisation) in the fourth quarter of 1990 (*plus* the excess of some R0,7 billion of merchandise export earnings over merchandise imports) was available for covering the negative fourth-quarter balance (of R2,9 billion) on the services and transfers account and the fourth-quarter outflow (of R1,8 billion) of non-reserve-related capital – while still permitting a significant increase (of R0,5 billion) in the total South African net gold and other foreign reserves.

The *value* of *merchandise exports* rose by 6 per cent from the third to the fourth quarter of 1990. Export *prices* rose moderately by about 2 per cent, partly because of a small decline (of about 0,5 per cent) in the average effective exchange rate of the rand. Increases in the value of merchandise exports were recorded in the fourth quarter of 1990 in most of the major export categories. Particularly large increases were shown by mineral products, chemical products, paper products, and precious metals and stones. During the *year* 1990 the value of merchandise exports increased to R42,4 billion from R39,1 billion in 1989, or by 8½ per cent.

The total *volume* of merchandise exports was some 4 per cent higher in the fourth quarter of 1990 than in the third quarter, and some 6½ percent higher in the *year* 1990 than in the year 1989. In the seven-year period 1984 -1990 the volume of South African merchandise exports grew impressively at an average annual rate of slightly more than 10 per cent, despite the effect of international trading sanctions during the larger part of that period. This rate of increase was well in excess of the average rate of growth in total world trade and also somewhat higher than the average annual rate of increase (of about 9 per cent) in total imports by volume of South Africa's principal international trading partners. The rate of increase in South Africa's merchandise exports *by value* also clearly exceeded the rate of growth in the nominal gross domestic product; South Africa's merchandise export ratio (i.e. the ratio of merchandise export earnings to nominal GDP) accordingly rose from a low level of 11,0 per cent in 1983 to 16,1 per cent in 1990.

Percentage changes in trade volume



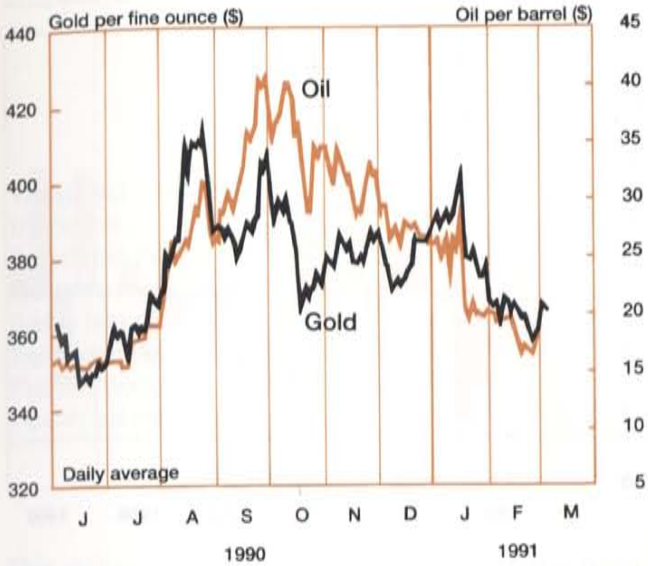
The *value* of merchandise *imports* declined by nearly 9½ per cent from the third to the fourth quarter of 1990. The average level of import *prices*, however, rose sharply by about 6 per cent, mainly because of the initial effect of the Middle East crisis on the world prices of petroleum products. Import *volumes*, which had previously responded comparatively little to the cyclical slowing-down of the economy, accordingly fell back considerably from the third to the fourth quarter of 1990, namely by 14½ per cent.

Major volume declines were recorded in imports of transport equipment and mineral products in the fourth quarter; a substantial *rise* in imports of mineral products had been recorded in the preceding three months. As a result of the fourth-quarter drop in import volumes, the import penetration ratio (i.e. the ratio of real merchandise imports to real gross domestic expenditure) fell back from its unusually high level of 24,3 per cent in the third quarter of 1990 to 21,7 per cent in the fourth quarter – its lowest level since late 1987. Merchandise imports by volume in the *year* 1990 were 4 per cent lower than in the preceding year.

Net gold exports declined marginally (by 0,2 per cent) from the third to the fourth quarter of 1990. The quarterly average dollar price of gold declined slightly (from US$382 per fine ounce to US$380) between these two periods, despite the threat of war in the Persian Gulf region. Because of strengthening of the rand vis-à-vis the dollar, however, the *rand* price of gold retreated more markedly from a quarterly average of R990 per fine ounce in the third quarter of 1990 to R962 in the fourth quarter. A small rise in the volume of the net gold exports almost neutralised this price decline.

The average dollar price of gold of $384 per fine ounce in the *year* 1990 was little different from gold's average dollar price of $382 in 1989. Mainly because of heavy sales of gold by the

Gold and oil prices



Soviet Union, the dollar price of gold sank to less than $370 per fine ounce at the end of January 1991 and in the beginning of February; it dipped to low points of $361 on 6 February (in the light of seemingly improved prospects for an early settlement of the Middle East conflict) and of $358 on 25 February (on the basis of expectations of a speedy conclusion of the war in the Persian Gulf region). Total South African gold production shrank from 603 tons in the *year* 1989 to 592 tons in 1990, despite a small increase in the average gold content of ore milled from 4,99 grams per ton in 1989 to 5,06 grams per ton in 1990.

Net service and transfer payments to non-residents, which had subsided very gently in the first three quarters of 1990, rose markedly from an average annualised level of R10,2 billion in the first three quarters to R11,6 billion in the fourth quarter, despite an increase in service receipts. This was a result of a 10 per cent increase in service payments, which was mainly accounted for by higher interest costs and transportation charges. During 1990 as a whole, the total of R10,6 billion of net service and transfer payments was some R0,3 billion less than in 1989.

Capital account

The highly encouraging net inflow of R1,5 billion of non-reserve-related capital in the third quarter of 1990 was re-transformed into a net outflow of R1,8 billion in the fourth quarter. Re-conversions of net inflows into net outflows between these two periods were recorded with regard to the movements of both long-term and short-term capital. The total net outflow of non-reserve-related capital in 1990, at some R2,9 billion, was, however, substantially smaller than the 1988 outflow of R6,2 billion and the 1989 outflow of R4,3 billion. It was also substantially smaller than the outflow that had been anticipated at the beginning of the year.

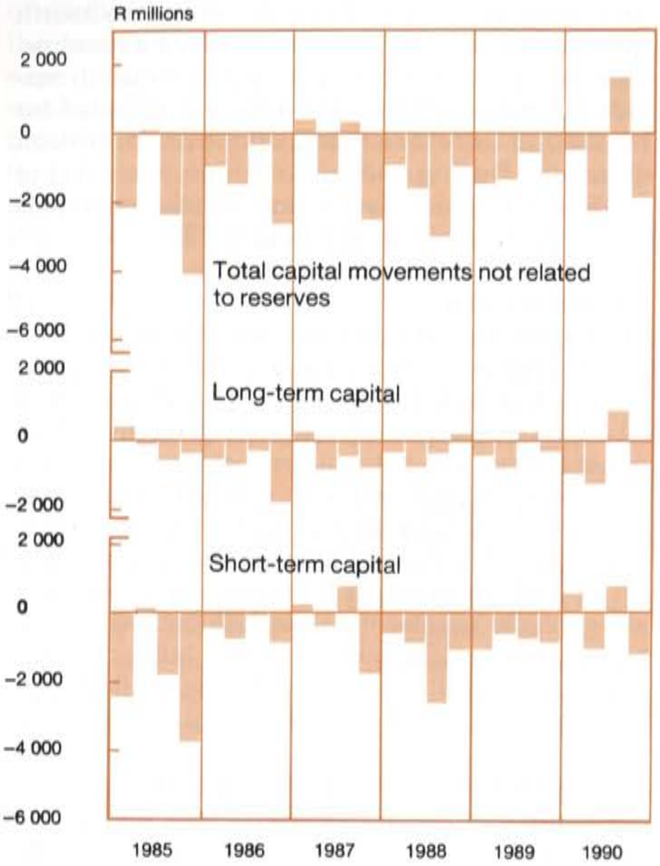
The renewed outflow of long-term capital in the fourth quarter of 1990 mainly took the form of repayments on debt that was falling due outside the standstill net, as well as of an increase in South Africa's foreign asset holdings. The fourth-quarter outflow of short-term capital was mainly a reflection of a decline in foreign trade credits which accompanied the fourth-quarter decline in the value of merchandise imports. In addition, the first repayment (of about US$100 million) was made in December 1990 in terms of the Third

Net capital movements (not related to reserves)

R millions

	1989	1990				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	-646	-206	-673	47	-328	-1 160
Public corporations	436	473	-35	279	173	890
Private sector	-1 020	-1 204	-482	495	-484	-1 675
Total long-term capital	**-1 230**	**-937**	**-1 190**	**821**	**-639**	**-1 945**
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	-3 115	531	-1 000	694	-1 154	-929
Total capital movements, excluding liabilities related to reserves	**-4 345**	**-406**	**-2 190**	**1 515**	**-1 793**	**-2 874**

Net capital movements



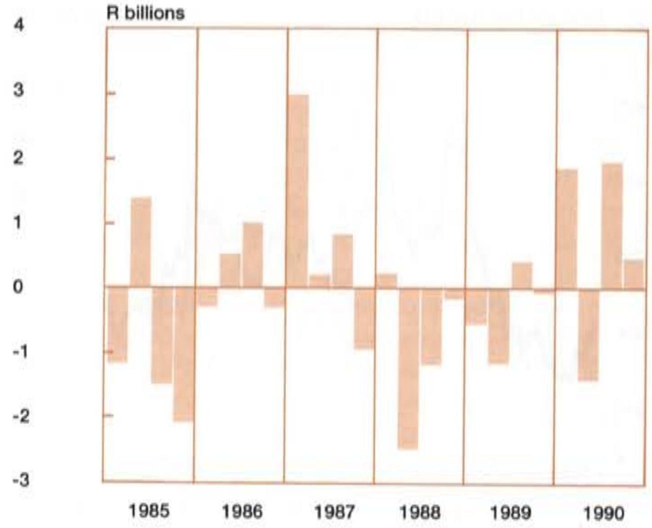
Interim Debt Arrangements with foreign creditor banks.

The increase (from R1,2 billion to R1,9 billion) in the outflow of long-term capital from the *year* 1989 to the *year* 1990 was a reflection of increased debt repayment obligations outside the standstill net, in particular on bearer bonds and notes and on debt inside the net that had been converted into medium-term loans outside the net. Public *corporations*, however, actually raised the amount of their net new long-term overseas borrowings from R0,4 billion in 1989 to R0,9 billion in 1990. The sharp decline in the outflow of short-term capital from 1989 to 1990 could be attributed to declines in and reversals of unfavourable leads and lags in foreign payments and receipts, which were brought about by the increased stability of the effective exchange rate of the rand.

Foreign reserves

The large current account surplus of the fourth quarter of 1990, in conjunction with debt repayments, caused the *total* South African *gross* gold and other foreign reserves to rise by R0,2 billion

Changes in net gold and other foreign reserves



during that quarter to R7,3 billion at the end of December. The *net* foreign reserves rose by R0,5 billion during that period. In January 1991 the gross and net reserves of *the Reserve Bank* rose further by R0,5 billion and by a major R1,5 billion respectively.

During the year 1990 the total South African gross and net foreign reserves rose by R0,4 billion and by R2,9 billion respectively. In this strengthening reserve position, R2,0 billion of the R2,9 billion increase in the net foreign reserves took the form of reductions of short-term foreign liabilities by the monetary authorities.

The *gold* reserves of the Reserve Bank, which had shrunk to an all-time low of 3,0 million fine ounces at the end of January 1990, had been rebuilt to 4,4 million fine ounces by the end of January 1991.

Exchange rates

The effective exchange rate of the rand was 0,7 per cent higher on 28 February 1991 than at its lower turning-point on 18 September 1989. This slight strengthening was, however, due entirely to the rand's appreciation against the US dollar, mainly during the dollar's weakening spell in the foreign exchange markets from July to December 1990. The rand itself actually depreciated sharply, on balance, from mid-September 1989 against most major currencies, but only slightly against the Japanese yen.

In the fourth quarter of 1990 and the first two months of 1991 the rand appreciated modestly against the weak US dollar and the Swiss franc.

Changes in exchange rates of the rand

%	18 Sept 1989 to 28 Feb 1991	30 Sept 1990 to 28 Feb 1991
Weighted average............	0,7	-0,7
US dollar..........................	10,4	0,1
British pound......................	-10,0	-1,4
German mark......................	-14,6	-2,1
Swiss franc..........................	-14,4	2,4
Japanese yen......................	-0,4	-3,8
French franc.......................	-13,9	-0,5
Financial rand....................	25,0	20,2

Exchange rates

The dollar strengthened temporarily in the days immediately prior to the outbreak (on 16 January 1991) of armed hostilities in the Persian Gulf region. It lost ground again, however, in the four weeks from 14 January 1991 to 12 February, to a new record low of DM1,4474 on 12 February. This course of events was influenced greatly by an increase in German interest rates from 31 January, and by a lowering of American interest rates from 1 February in response to the slackening US business situation. New record lows of the rand *against* the German mark, the Swiss franc and the French franc were also registered on 12 February. However, the dollar recovered moderately again from mid-February, as military developments in and around Kuwait held out hopes of a fairly quick end to the Middle East war.

The average *real* effective exchange rate of the rand declined slightly (by 0,2 per cent) from December 1989 to December 1990. (A *rise* in the real effective exchange rate – on account of South Africa's comparatively high inflation rates – was prevented by the decline in the nominal effective exchange rate of the rand in the course of the year 1990, which slightly more than matched the differential between the South African inflation rate and the weighted average inflation rate in South Africa's trading partner countries.) The real effective exchange rate of the rand as in December 1990 was, however, still an important 10½ per cent higher than at its low point in June 1989.

The *financial* rand, in a repeat performance of the events that followed the opening of Parliament in February 1990, strengthened significantly after the opening of Parliament on 1 February 1991. Improved foreign perceptions of South Africa's socio-political future, and prospects of a relaxation of economic sanctions, caused the financial rand to firm from R3,33 per dollar on 31 January 1991 to R3,07 per dollar on 6 February. The financial rand's discount vis-à-vis the commercial rand of 17,8 per cent on 6 February 1991 was somewhat more favourable than its discount of 19,2 per cent on 6 February 1990. It was also the smallest such discount since 2 December 1985.

Financial markets

Money supply

The rate of increase in the broadly defined money supply, M3, over twelve-month periods fell back, on balance, from its high point of 27,5 per cent in August 1988 to 10,2 per cent in October 1990, 13,2 per cent in November 1990 and 12,4 per cent in December. The provisionally calculated twelve-month rate of increase in M3 of 10,3 per cent in January 1991 was notably less than half as high as the rate of 23,5 per cent in January 1990.

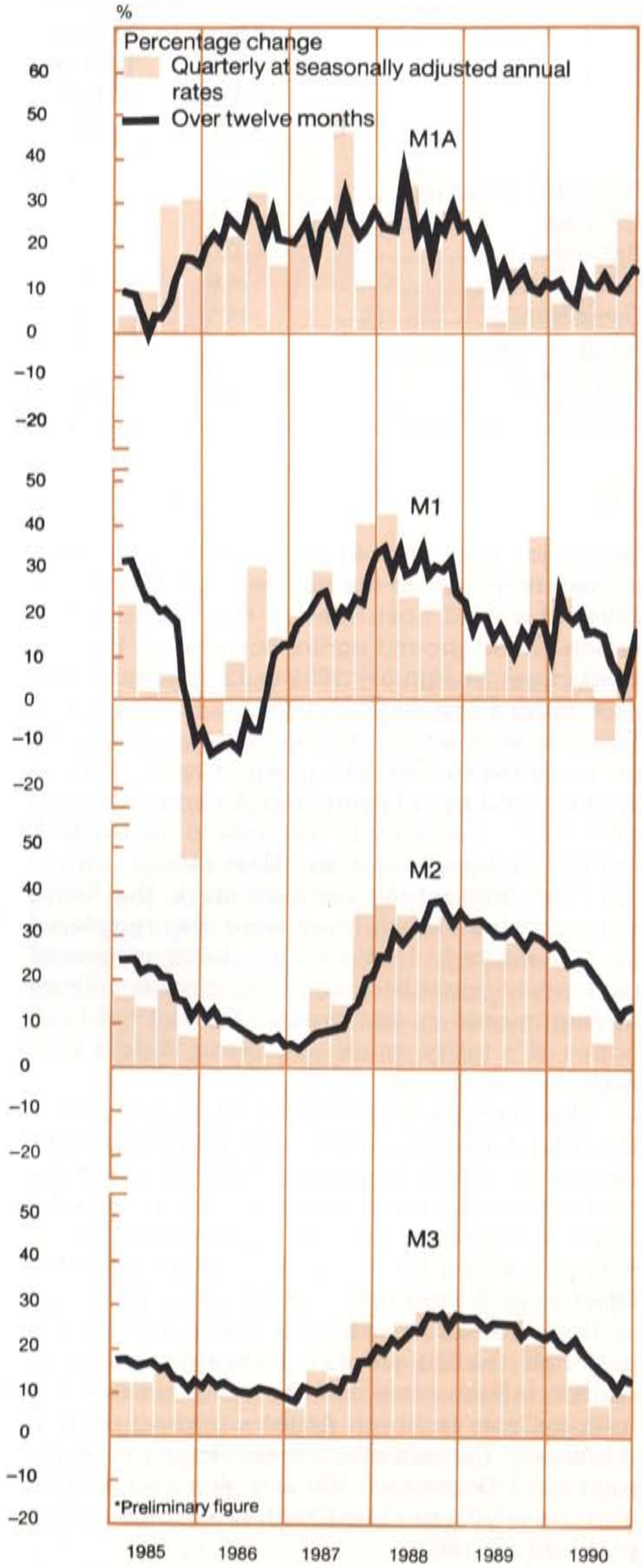
The slow-down in money growth on a twelve-month basis over the past 2½ years was primarily a reflection of the cyclical cooling-down of the economy from early 1989 and of the downward movement of the domestic inflation rates from approximately mid-1989 up to approximately July 1990. In addition, market participants in the middle quarters of 1990 increasingly came to expect a further softening of interest rates and an early lowering of Bank rate, which served to weaken asset holders' "liquidity preference proper" and, therefore, investors' demand for the more highly liquid depository investments with monetary institutions.

A mixture of cyclical and more "structural" factors also contributed to a widening of monetary institutions' lending rate/deposit rate margins. This is likely to have called forth some renewed disintermediation and a corresponding decline in the growth rate of M3.

Relevant cyclical elements in the banking situation of the past several quarters included the slackening of credit demand that accompanied the contractions in domestic expenditure and product (thereby reducing the pressures of inter-institutional competition for deposits), and declining interest rate expectations (at unchanged refinancing rates quoted by the Reserve Bank and a stable prime lending rate of the clearing banks). In addition, for both cyclical and structural reasons banks have begun to look more closely at the quality of their outstanding credits and to put less emphasis on quantitative balance sheet expansion. Like the cyclical waning of credit demand, this has also had a moderating effect on the intensity of the inter-institutional competition in the deposit markets.

Furthermore, banks and building societies, in preparation for the more stringent capital requirements of the new Deposit-taking Institutions Act (the DTI Act)[1], are concerned to increase their

Monetary aggregates



[1] The provisions of the Deposit-taking Institutions Act Act No 94 of 1990) came into effect on 1 February 1991.

profitability through increases in earnings for services rendered and through the paring of costs, so as to strengthen their reserves and possibly to support future capital issues. The banks' and the building societies' drive for increased efficiency and cost-effectiveness has also given rise to rationalisations (or attempted rationalisations) in the form of mergers of institutions or the absorption of certain institutions by others. A possible structural outcome of the DTI Act may, in fact, be to "permanently" widen somewhat the long-term average margin between monetary institutions' lending and deposit interest rates. This may result in a "permanently" somewhat smaller monetary system relative to various measurements of the macro-economy, although the application of statutory restrictions to the money-intermediating activities of non-bank organisations may partly counteract this effect.

The month-to-month increases in M3, like the twelve-month growth rates in M3, fell back in October 1990, rose sharply in November, but retreated again in December 1990 and January 1991. The comparatively low level of M3 at the end of October was partly due to technical problems with the clearing of cheques, which resulted in large "net remittances in transit" over the October month-end.

Against this, a temporary check on the markets' declining interest rate expectations was experienced in the course of October on account of developments in the Middle East crisis, a worsening of the then most recently reported inflation rates, less favourable balance of payments forecasts for 1991, and cautionary policy pronouncements by the authorities. However, more important in the temporary reacceleration of the money growth rates in November 1990 is likely to have been the effect on M3 of conversions of repurchase agreements – which, whether included "above" or "below" the line of monetary institutions' reservable liabilities to the public, are not included in M3 – into conventional deposits, in anticipation of regulatory changes to the relevant financial requirements that would be brought about by the Deposit-taking Institutions Act.

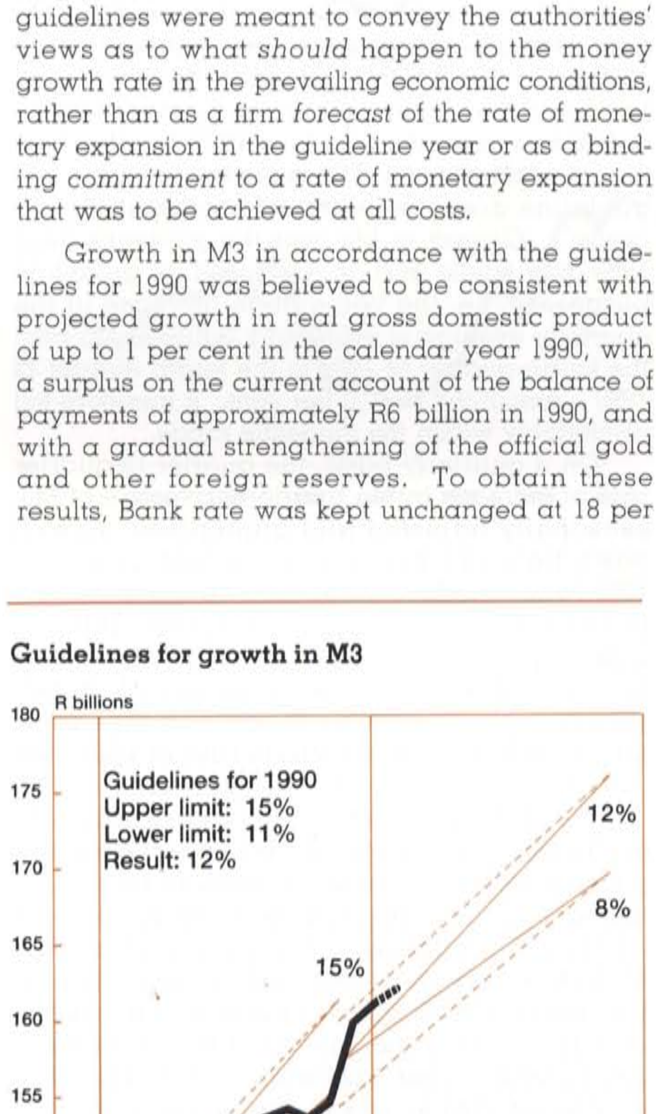
Twelve-month growth in the more transactions-related and low or non-interest-bearing monetary aggregate M1A generally remained around 10 per cent from April 1989, but rose to 14,3 per cent in December 1990. The corresponding growth rates for M1 and M2 were 15,9 and 13,5 per cent respectively.

The 1990 "guideline" year

"Guidelines" for the growth in M3 from the fourth quarter of 1989 to the fourth quarter of 1990 – ranging from a lower limit of 11 to an upper limit of 15 per cent – were announced by the Reserve Bank on 23 March 1990. The quite substantial lowering of these limits by three percentage points from the "target" range of 14-18 per cent that had applied in the targeting year 1989, was intended to signal the monetary authorities' determination to contribute to the combating of inflation by appropriately restricting the expansion of the money supply. At the same time, the change in terminology from "monetary targets" to "monetary guidelines" aimed to make clear that the guidelines were meant to convey the authorities' views as to what *should* happen to the money growth rate in the prevailing economic conditions, rather than as a firm *forecast* of the rate of monetary expansion in the guideline year or as a binding *commitment* to a rate of monetary expansion that was to be achieved at all costs.

Growth in M3 in accordance with the guidelines for 1990 was believed to be consistent with projected growth in real gross domestic product of up to 1 per cent in the calendar year 1990, with a surplus on the current account of the balance of payments of approximately R6 billion in 1990, and with a gradual strengthening of the official gold and other foreign reserves. To obtain these results, Bank rate was kept unchanged at 18 per

Guidelines for growth in M3



cent throughout the guideline year; in support of this fairly restrictive stance of the authorities' interest rate policy, open-market operations and related actions were employed by the Reserve Bank to ensure adequate levels of the money market's indebtedness to the Reserve Bank at the Bank's discount window.

The rate of growth in M3 substantially exceeded the upper limits of the target ranges in the targeting years 1988 and 1989. In the first five months of the guideline year 1990, the seasonally adjusted and annualised rate of increase in M3 from its quarterly average in the fourth quarter of 1989 up to the month-ends concerned continued to exceed the 15 per cent upper boundary of the guideline range. As from June 1990, however, the month-end values of M3 retreated to within the guideline area (as delimited by the guideline "cone"). Growth in M3 over the guideline year 1990 as a whole and as measured for guideline purposes – i.e. the percentage increase in the quarterly average of seasonally adjusted M3 from the fourth quarter of 1989 to the fourth quarter of 1990 – amounted to 12,0 per cent. It therefore fell comfortably within the guideline range.

On a quarterly basis, the quarter-to-quarter rate of increase in the quarterly average of M3, seasonally adjusted and annualised, slowed down from 19,0 per cent in the first quarter of 1990 (when the 1990 guidelines were announced) to 12,2 per cent in the second quarter and to a single-digit level of only 7,2 per cent in the third quarter. The short-lived rebound of money growth in November and its effect on M3's quarterly average in the fourth quarter of 1990 then caused this rate to revert to 10,0 per cent.

The downward trend in the rate of monetary expansion in the course of 1990 nevertheless outpaced somewhat the deceleration in the rate of increase in the nominal gross domestic product (or the gross domestic product at current prices). M3's *velocity of circulation* rose accordingly from the second quarter of 1990 onwards; it advanced, on balance, by some 1 per cent in the course of the guideline year 1990 from 1,72 in the fourth quarter of 1989 to 1,74 in the fourth quarter of 1990. The mild speeding-up of velocity from the second quarter of 1990 onwards stood in contrast to the declining trend in velocity that had prevailed in the preceding 2½ years. During this earlier period, velocity had slowed down by some 13,6 per cent from its most recent cyclical high point of 1,96 in the third quarter of 1987 to 1,70 in the first quarter of 1990.

Growth in M3 in the course of 1990 also fell somewhat short of most of the concurrent inflation rates. The "real" quantity of M3 in the South African economy – i.e. the quarterly average of M3 after adjustment for changes in the general price level as measured by the gross domestic product deflator – accordingly shrank slightly (by approximately 1,9 per cent) from the fourth quarter of 1989 to the fourth quarter of the ensuing year.

In the statistical or accounting sense, the R17,9 billion increase in seasonally adjusted M3 from the end of December 1989 to the end of December 1990 was more than fully explained by an increase of R20,9 billion in monetary institutions' claims on the domestic private sector. However, increases in M3 in the course of 1990 were also counterparts of increases in the monetary system's net gold and other foreign reserve holdings and in monetary institutions' net claims on the government sector. The monetary system's net gold and other foreign reserves, which had declined by R1,2 billion in 1989, rose by R2,9 billion in 1990; net claims on the government sector, which had declined by R2,7 billion in 1989, increased by a major R5,2 billion in the ensuing year.

A *negative* contribution, in the accounting sense, to the growth in M3 in 1990 was made by the monetary sector's "net other assets". "Net other assets" in the consolidated accounts of the money-creating institutions declined in the course of 1990 by a major R11,1 billion. This could be attributed, firstly, to surpluses experienced by the Reserve Bank (acting on behalf of the Treasury) in its provision of forward foreign exchange cover, which meant a commensurate reduction in the debit balance on the Bank's Gold and Foreign Exchange Contingency Reserve Account. Secondly, a payment of R3,0 billion was made on 24 December 1990 from the Treasury's Exchequer Account with the Reserve Bank to the Gold and Foreign Exchange Contingency Reserve Account. By reducing government deposits, this payment – while further lowering the debit balance on the Contingency Reserve Account – simultaneously increased the Reserve Bank's *net* claims on the government sector.

Thirdly, private banking institutions – apparently acting partly in response to changes in the regulations governing repurchase agreements, which had come into force from the end of May 1990 – effected changes in their funding strategies in the course of the year. During 1990 these banks increased their liabilities on account of their own promissory notes and bills issued by a total of R2,0 billion. Since these non-deposit liabilities to the public are ranked as a part of the banks' "other liabilities" (i.e. are not included in M3), this change in funding methods was also reflected in a decline in the monetary sector's "net other assets" as a "cause of change" in the money supply. Finally, banking institutions strengthened their capital and reserve funds during 1990 by R1,8 billion.

In an evaluation of the authorities' monetary policies during the guideline year 1990, the results of these policies may be deemed satisfactory in that–
- growth in the broad money supply M3 was brought down to levels that were comfortably within the Reserve Bank's unambiguously disinflationary guideline range;
- the balance of payments was strengthened and the foreign reserve position improved appreciably;
- the "underlying" inflation rate – i.e. the measured inflation rate after adjustment for the effects and after-effects of the world oil and domestic fuel price increases in the period July-October 1990 – was checked, and a basis has probably been laid for further declines in the measured inflation rates once the oil and fuel price shocks have moved out of the inflation measurement.

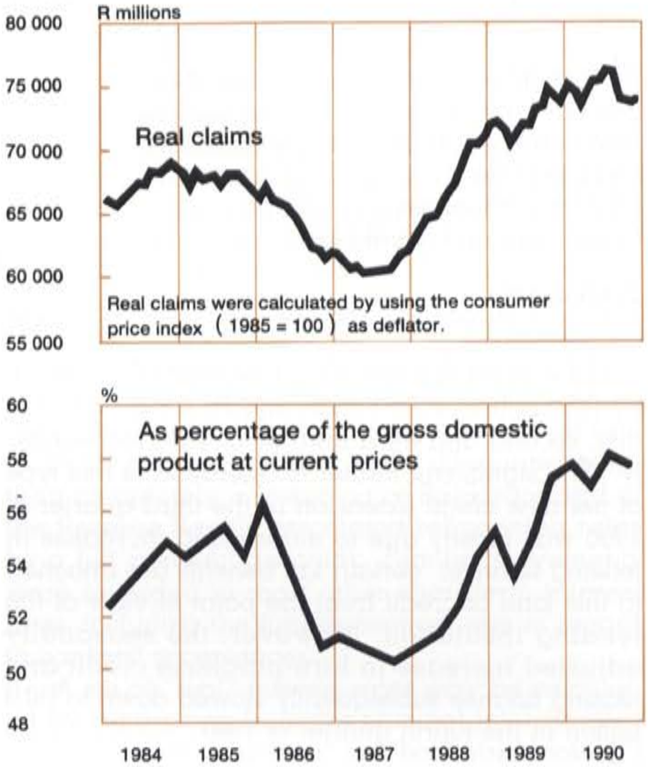
Throughout 1990 and early 1991, however, the authorities did not see their way clear explicitly to relax their official interest rate policies. Firstly, the results of these policies up to February 1991 were encouraging rather than firmly established and adequate. The gross foreign reserves in early 1991 were still a substantial way short of their "minimally comfortable" level of some three months' imports of goods and services. Inflation, as measured by changes in the consumer price index, had fallen back but little in December 1990-January 1991 – in fact, disappointingly little – from its oil-price-induced rebounds in September-November 1990. It had thereby provided corroborative evidence of the remaining – deep-seated, easily rekindled and easily reinforceable – inflationary forces in the *domestic* economy.

Bank rate was eventually reduced from 18 to 17 per cent on 8 March 1991. In announcing this reduction, the Governor warned, however, that this step "should not be interpreted as a sign of any progressive relaxation in monetary policy and should create the expectation of any premature further reduction in interest rates. In the final instance it remains the objective to reduce the rate of inflation first."

Credit extension by monetary institutions

The twelve-month rate of growth in credit extended by monetary institutions to the domestic private sector retreated from its peak of 30,2 per cent in October 1988 to 13,2 per cent in October 1990, as the cumulative effect of recent and present interest rates on economic activity was translated into slower growth of credit demand. The "real" or inflation-adjusted value of monetary institutions' claims on the private sector remained virtually unchanged, on balance, from December 1989 to December 1990.

Monetary institutions' claims on the private sector



During the fourth quarter of 1990 the month-to-month increase in monetary institutions' claims on the private sector, like the month-to-month increase in M3, rose abruptly in November 1990 before falling back in December. In consequence, the twelve-month rate of increase in these claims advanced again from 13,2 per cent in October 1990 to 14,7 per cent in both November and December. This was a result, among other things, of the conversion of assets held under repurchase agreements by non-bank parties into deposits with monetary institutions (as already referred to above) and corresponding increases in these institutions' asset holdings.

An analysis by *type* of credit extended shows that increases in mortgage lending continued to be the most important form of new credit extension. The quarterly increase in monetary institutions' mortgage advances amounted to approximately R2,1 billion in each of the first three quarters of 1990 and actually accelerated to R2,4 billion in the ensuing three months.

Monetary institutions' claims on the domestic private sector

	Dec 1989 R billions	Dec 1990 R billions	Change %
Investments	3,2	4,9	53,6
Bills discounted	8,4	8,7	4,5
Hire-purchase credit	15,6	18,0	15,6
Leasing finance	9,1	11,0	20,1
Mortgage advances	54,3	63,0	16,0
Other loans and advances	51,6	57,4	11,3
Total claims	**142,1**	**163,0**	**14,7**

Hire-purchase credit and leasing finance rose by R0,9 billion, R1,1 billion and R1,4 billion in the first, second and third quarter of 1990 respectively. The significant further acceleration of this type of net new credit extension in the third quarter of 1990 was mostly due to more rapid increases in leasing finance; certain tax benefits are attached to this kind of credit from the point of view of the lending institution. However, the seasonally adjusted increase in hire-purchase credit and leasing finance subsequently slowed down to R0,9 billion in the fourth quarter of 1990.

Money market conditions and Reserve Bank operations in the money market

The average daily level of accommodation at the Reserve Bank's discount window slipped from a high point of R4,8 billion in January 1990 to R2,9 billion in October, R2,2 billion in November, and R2,3 billion in both December 1990 and January 1991. In February 1991 it declined somewhat further to R2,1 billion.

Easing effects on the money market's liquidity were exerted in the fourth quarter of 1990 and the first two months of 1991 by the strengthening of the Reserve Bank's net gold and other foreign reserve holdings and by occasionally sharp declines in the Central Government's balances with the Reserve Bank. These effects were neutralised partly by steady increases in the level of notes in circulation. In a similar manner, the surpluses recorded by the Reserve Bank in the provision of forward foreign exchange cover caused the market to lose some liquidity.

The combined total of the balances on the Exchequer, Paymaster-General and Stabilisation Accounts declined from an average daily level of R10,7 billion in October 1990 to R10,6 billion in November, R8,2 billion in December and R7,6 billion in January 1991. It amounted to R8,2 billion in February 1991. From 24 December, however, the amount of the Treasury's balances with the Reserve Bank was affected by the transfer, on that date, of R3 billion from the Treasury's Exchequer Account to the Gold and Foreign Exchange Contingency Reserve Account – already referred to – in partial redemption of the Treasury's liability to the Bank that had arisen earlier from shortfalls experienced by the Bank in its provision of forward foreign exchange cover. Consisting solely of a transaction between the Bank and the Treasury (no third parties being involved), this rearrangement of claims did not, of course, influence the money market's liquidity.

Deliberate action for draining liquidity from the money market was taken, among other things, through the Reserve Bank's foreign-exchange intervention swaps with major banking institutions. Such swaps are usually entered into by the Bank in the course of each month and are allowed to run off before the end of the month. Monthly peaks in the volumes of these swaps amounted to R1,4 billion in November 1990 and to R0,9 billion in December 1990 as well as in January and February 1991. Also, an amount of R0,5 billion of specially dated, very short-term Treasury bills was issued on 19 November 1990 and, through various renewals, was held outstanding up to 13 December.

Net sales of government stock by the Reserve Bank amounted to R1,2 billion in the three months from October to December 1990, compared with R1,4 billion in the fourth quarter of 1989. In January and February 1991 such sales amounted to R0,3 billion, against R0,6 billion in the corresponding period of 1990. However, in the Bank's efforts to increase the marketability of government stock, its *gross* transactions in such stock continued to rise markedly. Total transactions of R4,0 billion were, for example, concluded during the first two months of 1991, compared with R0,7 billion during the corresponding period in the preceding year.

In a related move, the Bank continued to step up its activity in the government stock options market. Whereas in the first half of 1990 the Bank was a party to traded options contracts of R0,3 billion per month, the extent of its participation rose to R1,1 billion per month in the September quarter and to R1,2 billion per month in the December quarter and in January and February 1991.

Short-term interest rates

Money market rates softened through most of 1990 (in the face of unchanged refinancing rates quoted by the Reserve Bank) on the basis of market expectations engendered by the cooling-down of the economy, slackening monetary expansion and credit growth, the strengthening balance-of-payments position, and declining inflation rates up to July. The market rates on money market instruments then hardened abruptly in the final two weeks of October on the basis of gloomier views of the Middle East crisis, the oil-price-induced rebounds of the measured inflation rates, and the more cautionary character of policy pronouncements by the authorities. Market rates quickly resumed their downward course, however, as the effect of the Persian Gulf confrontation on international oil prices appeared to be well contained and as further information was received which appeared to confirm a progressive slackening of the economy.

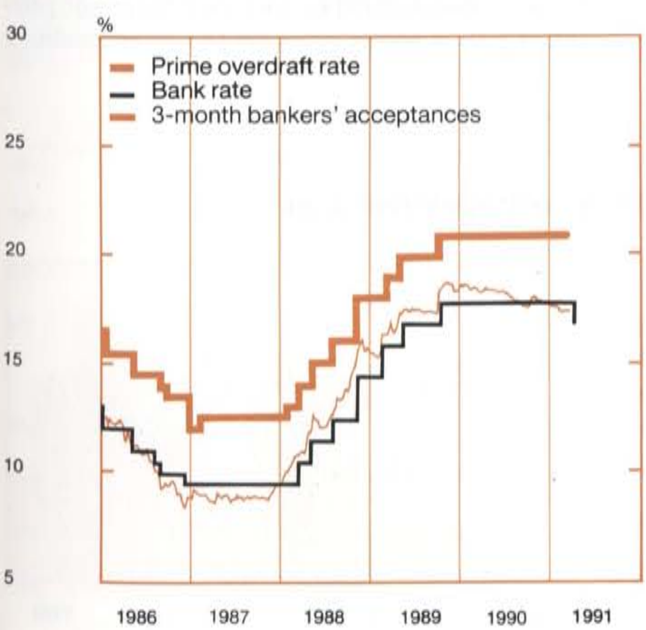
The market rate on liquid three-month bankers' acceptances rose from a low point of 17,60 per cent on 3 October 1990 to 18,20 per cent over the October month-end. This rate then receded to 17,90 per cent at the end of November, 17,70 per cent at the end of December and 17,55 per cent at the end of January 1991. On 23 February 1991 it reached a low point of 17,25 per cent, when a Bank rate reduction of 1 percentage point seemingly appeared imminent to most market participants.

The three-month acceptance rate subsequently hardened again to 17,40 per cent over the February month-end and remained on that level during the first ten days of March, in the light of (among other things) disappointing inflation rates reported for January. It may be noted that as from late December 1990 the market rate on bankers' acceptances was more than half a percentage point below the Reserve Bank's rediscount rate for such acceptances; the market rate as on 23 February 1991 actually discounted more than completely a lowering of Bank rate and of the Reserve Bank's associated refinancing rates by a full percentage point. Similar movements were recorded in most other short-term interest rates, including the futures contract rate in regard to bankers' acceptances.

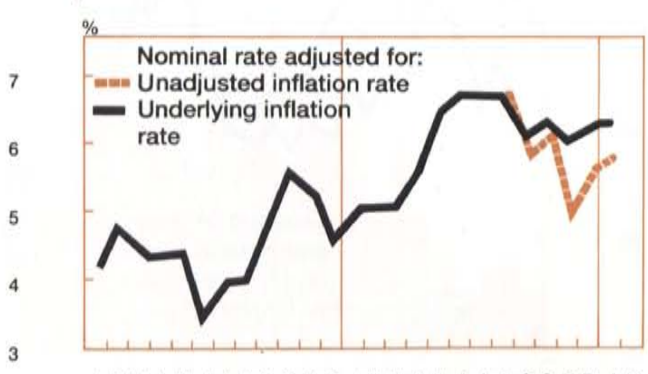
A set of "real" interest rates may be calculated by subtracting from the nominal interest rates the concurrent "historical" (or "backward-looking") twelve-month inflation rates in consumer prices as a proxy for *expected* inflation. When computed in this way, the clearing banks' real prime lending rate would appear to have eased markedly (and monetary policy would therefore appear to have become significantly less restrictive) in the second half of 1990. This is essentially a consequence of the impact of higher world petroleum prices on the measured South African inflation rates during that period.

Since "rational" market participants may have taken the oil price and liquid-fuel price increases

Short-term interest rates



Real prime overdraft rate



of August-October 1990 to be transient and temporary, market participants' average *expectation* of inflation may well have been influenced relatively little by these oil price movements and may have adhered more closely to the "underlying" inflation rate.

The "underlying" inflation rate was estimated by keeping the price of fuel unchanged at its pre-Middle East crisis level in the consumer price index and by calculating the twelve-month rates of increase in this adjusted measure of households' living costs. (The more indirect and roundabout effects of the increases in the costs of petroleum products on the consumer price index were not taken into account in these calculations.) When this adjusted inflation rate is used to calculate the clearing banks' real prime overdraft rate, the behaviour of this real prime rate suggests that the "bite" of the authorities' interest rate policies has not changed materially from early 1990 to early 1991.

Capital market developments

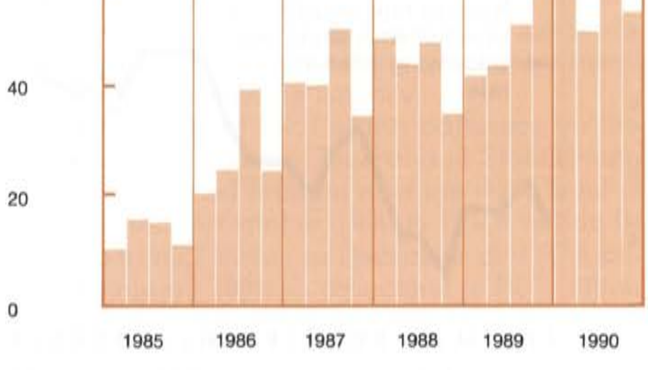
Trading activity in the secondary capital markets – which had reached quite extraordinary heights in the first quarter of 1990, dropped sharply in the second quarter, but recovered somewhat in the third quarter – fell back significantly again in the fourth quarter. Real estate transactions, however, strengthened further in the fourth quarter. The monthly average of share prices retreated further from the high point it had reached in February 1990. In the *primary* markets the amount of new issues by public-sector borrowers showed another decline.

The value of *public-sector stock* traded on the stock exchange fell back, on balance, from a very high R77,3 billion in the first quarter of 1990 to R53,7 billion in the fourth quarter. The *annual* turnover of these stocks of R239 billion in 1990 was, however, still nearly 23 per cent higher than in 1989. In January and February 1991 the average monthly level of transactions in these stocks rose to R24,0 billion, from R17,9 billion in the fourth quarter of 1990.

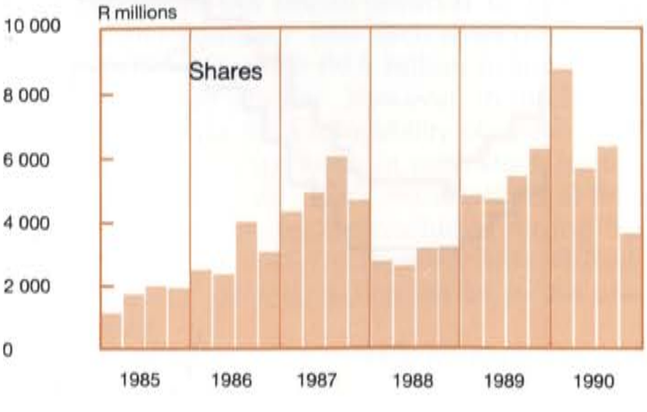
The value of *shares* traded on the stock exchange dropped, on balance, from a record R8,6 billion in the first quarter of 1990 to R6,2 billion in the third quarter, and by a further 44 per cent to a meagre R3,5 billion in the fourth quarter. Total turnover in the year 1990, at R23,9 billion, was, however, still 15 per cent higher than in 1989. The average monthly turnover of shares in January and February 1991, which amounted to R1,5 billion, was similar to the low average monthly level of these transactions in the fourth quarter of 1990. Downward pressure on share-trading activity in the past several months to February 1991 arose, among other things, from the disappointing performance of the dollar price of gold in the wake of the confrontation and subsequent war in the Middle East and from the expected or presumed unfavourable net direct and indirect effects of these developments on the South African balance of payments, the authorities' policy responses, and the overall business situation in 1991.

Non-residents sharply reduced their net *purchases* of public-sector *stock* on the Johannesburg

Stock exchange transactions



Stock exchange transactions



Stock Exchange in the course of 1990, namely from R883 million in the fourth quarter of 1989 to only R153 million in the fourth quarter of 1990. Non-residents' total net purchases of such stock of R1,5 billion in the year 1990 were some 50 per cent *lower* than in 1989. In January-February 1991 such purchases amounted to R207 million.

While reducing their net purchases of public-sector stock, however, non-residents also reduced their net *sales* of South African equities. Non-residents' net sales of shares fell back from R2,8 billion in the first quarter of 1990 to only R273 million and R564 million in the third and the fourth quarter. Their total net sales of shares of R4,5 billion in 1990 were nevertheless some 32 per cent *higher* than in 1989.

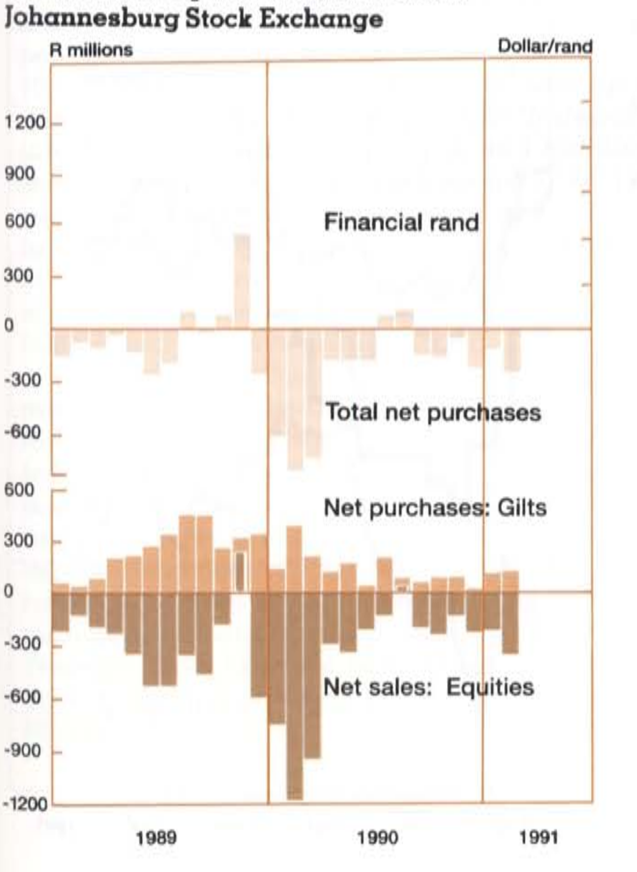
In January-February 1991 non-residents' net sales of shares amounted to R548 million. The average monthly level of these sales therefore responded to only a fairly limited extent to the concurrent marked strengthening of the financial rand. In contrast, a record level of foreigners' net sales of South African equities had accompanied the strengthening of the financial rand in the first two months of 1990, although the exchange value of the financial rand in that earlier period was actually somewhat lower than in January-February 1991.

A net amount of purchases by non-residents of *both* stocks and shares was recorded briefly in the third quarter of 1990, but was re-transformed into net sales in the fourth quarter. In similar manner, non-residents' net sales of equities of R548 million in January-February 1991, already referred to, again exceeded their net purchases of public-sector stock of R207 million during that period.

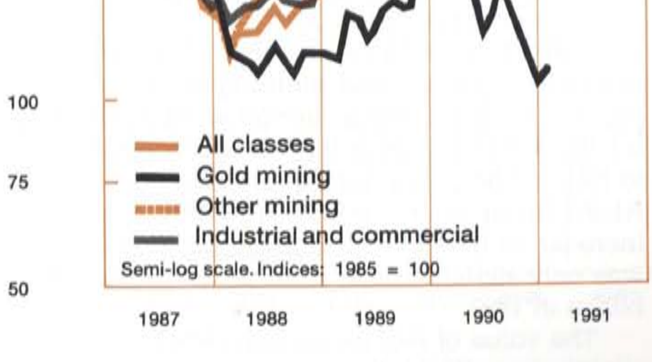
The average *price level of all classes of shares*, which had peaked in February 1990, declined by 7 per cent and 4 per cent in the second and the third quarter of 1990 and fell back, on balance, by another 6 per cent in the fourth quarter. The overall decline in the average level of all share prices from its all-time high point in February 1990 to December 1990 accordingly amounted to 17 per cent; the year-on-year decline as in December 1990 amounted to 12 per cent. Share prices then declined further in January 1991, by an average of 1 per cent.

The fourth-quarter weakening of the general level of share prices was mainly accounted for by declines in gold-mining share prices and in prices in the "other metals and minerals" category. After their recovery in July-August 1990, which had been associated mainly with Iraq's invasion of Kuwait, these share prices fell back rapidly

Transactions by non-residents on the Johannesburg Stock Exchange



Share prices



from September 1990 onwards in broad correspondence with the reaction of the world's major share markets to developments in the Persian Gulf. Industrial and commercial share prices, on the other hand, gained 6 per cent in the fourth quarter. Little change was shown by financial share prices, other than those of mining-financial shares, during that period.

The value of transactions in *futures contracts* strengthened from R1,9 billion in September 1990 to R2,4 billion in October, but fell back to R1,5 billion in November and to only R0,9 billion in December. It then recovered to R1,6 billion in January 1991, of which 43 per cent, 30 per cent and 18 per cent consisted of contracts in bankers' acceptances and with regard to the all-share index and the all-gold index respectively.

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, eased further to only R1,4 billion during the fourth quarter. In the second and the third quarter of 1990 these issues had amounted to R5,2 billion and R2,2 billion respectively; the total of these issues of R9,2 billion in 1990 was 30,3 per cent higher than in the preceding year.

The amount of funds raised by *private-sector* companies through new issues of fixed-interest securities rose from only R173 million in the first six months of 1990 to R316 million in the fourth quarter. However, the total of such issues of R722 million in 1990 still fell significantly short of the total of R823 million in 1989. New issues of ordinary *shares* by listed private-sector companies fell from R2,2 billion in the second quarter of 1990 to only R0,3 billion in the third quarter, but recovered to R1,7 billion in the final quarter. The 1990 total of new share issues of R4,5 billion was, however, only half as large as the total of R9,0 billion of such issues in 1989.

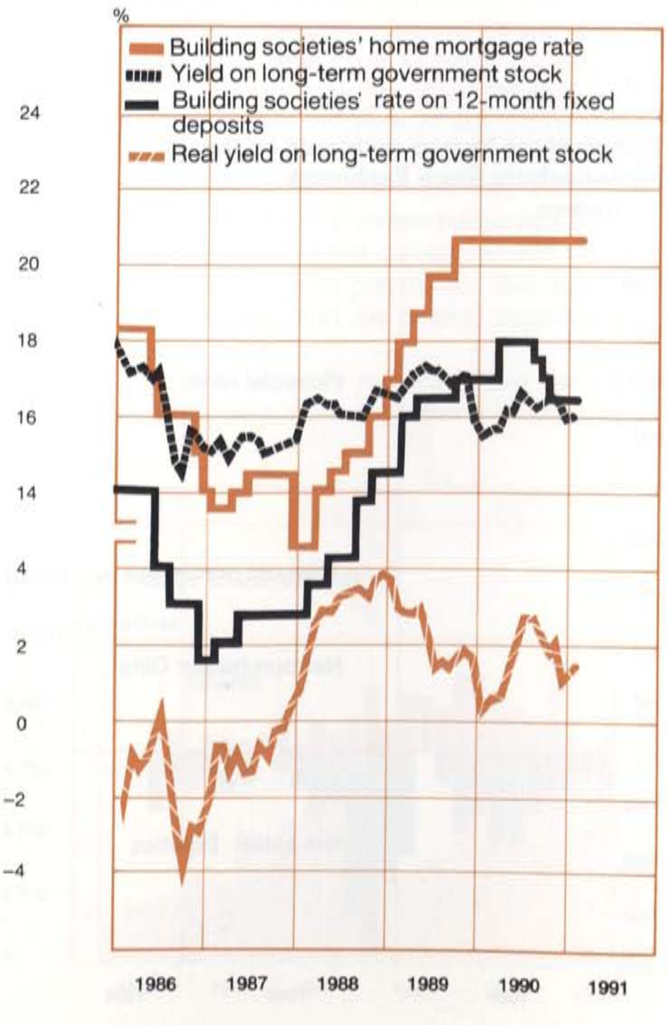
In the *mortgage market*, the amount of mortgage loans *paid out* by the building societies strengthened from R1,8 billion in each of the first two quarters of 1990 to R2,2 billion in both the third and the fourth quarter. The total of R8,0 billion of mortgage loans paid out in 1990 was 21 per cent higher than in 1989. Similarly, the increase in banks' and building societies' *holdings* of mortgage loans strengthened mildly from a total of R3,5 billion in the first six months of 1990 to R2,0 billion in the third quarter, but declined to R1,9 billion in the fourth quarter. The total increase of R7,4 billion in these holdings in 1990 was only slightly higher than the increase of R7,2 billion in 1989.

The value of *real estate transactions* improved slightly from R5,7 billion in the second quarter to R5,8 billion in the third quarter, and more impressively to R6,9 billion in the fourth quarter. Total turnover of fixed property in 1990 amounted to R24,7 billion, or to 16 per cent more than in 1989.

Capital market yields and interest rates

Capital market rates fluctuated during 1990 within relatively narrow channels and along a slightly downward longer-term trend. The average monthly yield on long-term government stock eased from 16,9 per cent in November 1989 to 15,5 per cent in January 1990, firmed to 16,7 per cent in June, eased to 16,3 per cent in August, firmed to 16,6 per cent in October, and eased to 16,0 per cent in both December 1990 and January 1991. It then eased slightly further to15,6 per cent in February 1991. Fluctuations in this rate in 1990 and early 1991 *inter alia* reflected changes in the actual and expected inflation rates, movements in

Capital market interest rates and yields



the dollar price of gold, the dimming or brightening of prospects for an early easing of monetary policy, and growing or diminishing concern about the situation in the Middle East.

The *real* rate on long-term government stock (i.e. the nominal rate after adjustment for the concurrent year-on-year inflation rate) rose from only 0,3 per cent in January 1990 to 2,7 per cent in July, mainly as a result of the then declining inflation rate. This rate subsequently fell back, on balance, to only 1,0 per cent in November and 1,2 per cent in December, mainly because of the oil-price-induced increases in the measured inflation rates.

The monthly average *dividend yield* on all classes of shares rose from 5,3 per cent in March 1990 to 6,3 per cent in November, but eased to 6,1 per cent in December 1990. This was a reflection of the December improvement in the average level of share prices on the Johannesburg Stock Exchange. In January 1991 the average dividend yield on all classes of shares still amounted to 6,1 per cent.

The average *earnings yield* on all classes of shares (excluding gold-mining shares) eased from 15,4 per cent in December 1989 to 14,5 per cent in June 1990, but recovered to 15,4 per cent in October before retreating to 14,2 per cent in January 1991.

The building societies' predominant *home mortgage rate*, which had been raised to 20,75 per cent in October 1989 from its previous level of 19,75 per cent, was maintained at this level up to early March 1991. The *twelve-month deposit interest rate* as quoted by banks and building societies, which had been lowered from 18,0 per cent to 17,0 per cent in August 1990, was reduced further to 16,5 per cent in October, in a further effort by these institutions to restore somewhat more comfortable interest rate margins in a climate of less intensive credit demand.

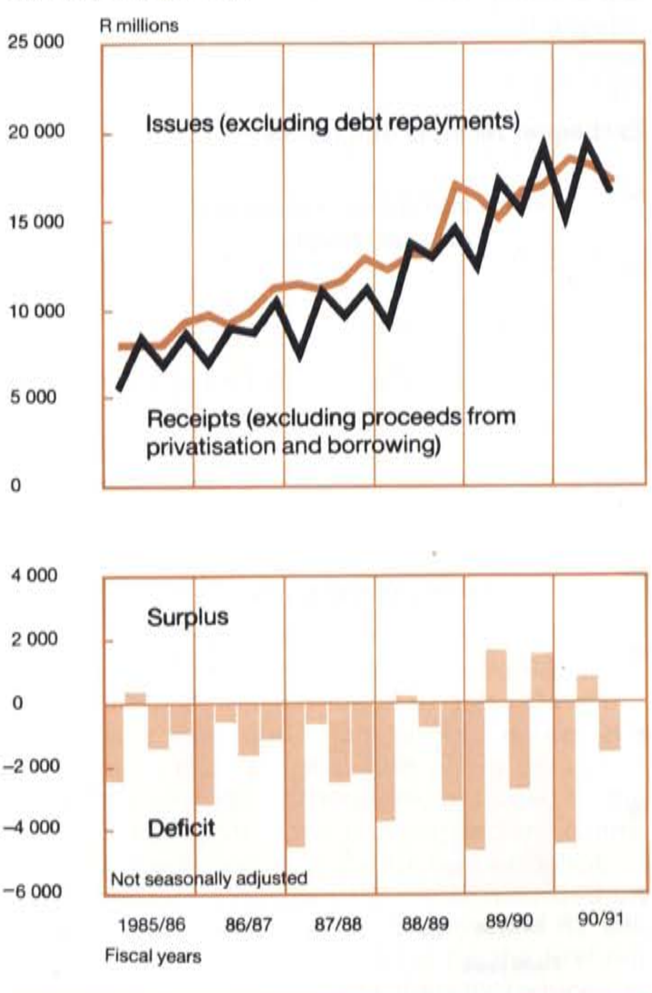
The *maximum finance charges rates* as determined in terms of the Usury Act, which had been lowered in July 1990 from 30 to 29 per cent and from 33 to 32 per cent for "large" and "small" money lending, credit and leasing transactions respectively, were maintained at these levels during the remainder of 1990 and in early 1991. The rates on *tax-free investments* with building societies, the Post Office Savings Bank and the Treasury have like-wise been heldunchanged to date at the higher levels that were approved in March 1990.

Government finance

Exchequer issues

The year-on-year increase in Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) declined significantly from 12,6 per cent and 19,2 per cent in the June and September quarters of fiscal 1990/91 to only 3,4 per cent in the December quarter. The year-on-year increase in these issues in the first nine months of fiscal 1990/91 was thereby brought down to 11,5 per cent; this rate of expansion was actually *lower* than the 11,9 per cent increase in government expenditure that had been envisaged in the March 1990 Budget for the fiscal year as a whole. In *real* or inflation-adjusted terms, the year-on-year change in Exchequer issues to government departments during the first three quar-

Exchequer Account

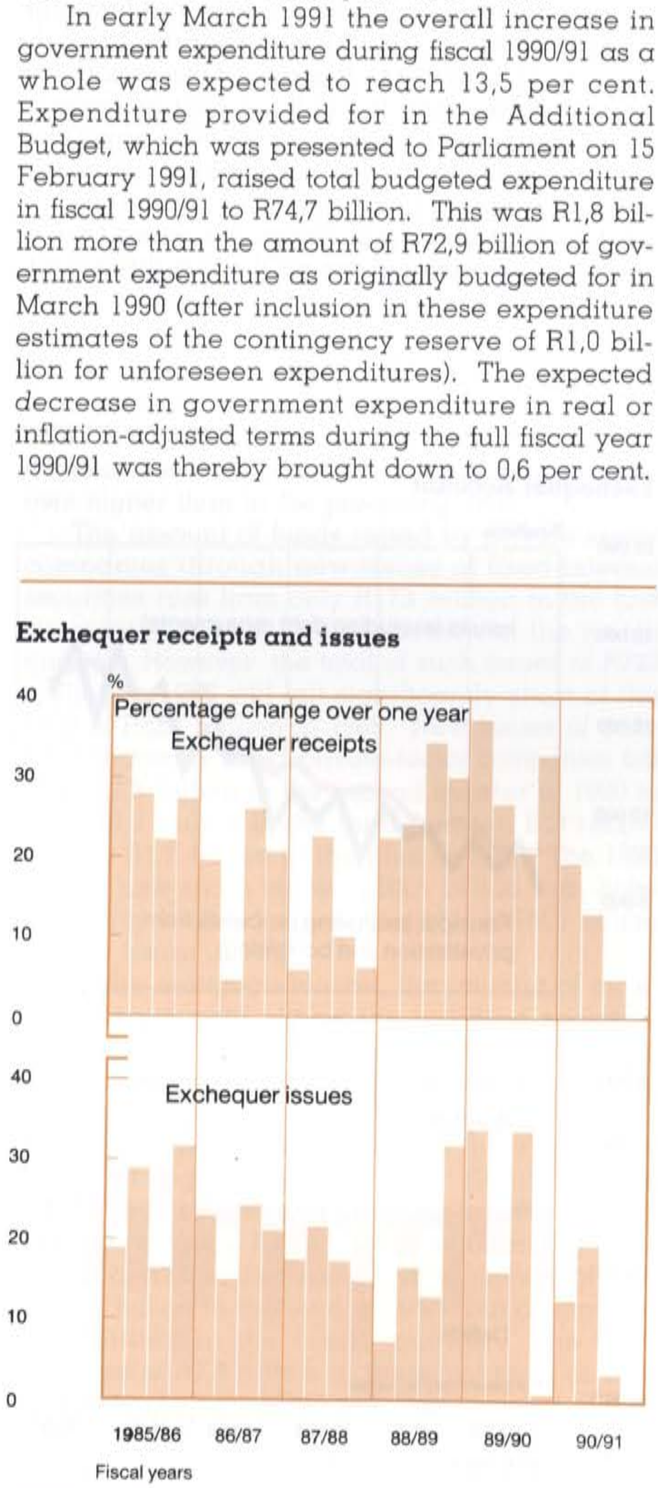


ters of fiscal 1990/91 amounted to a *decrease* of 2,3 per cent.

In January 1991 the year-on-year rate of increase in Exchequer issues to government departments accelerated substantially; the year-on-year rate of increase in these issues in the first *ten* months of fiscal 1990/91 rose accordingly to 12,5 per cent. As in the first half of fiscal 1990/91, this rate of increase was, therefore, again higher than the budgeted rate of increase in government expenditure for the fiscal year as a whole.

In early March 1991 the overall increase in government expenditure during fiscal 1990/91 as a whole was expected to reach 13,5 per cent. Expenditure provided for in the Additional Budget, which was presented to Parliament on 15 February 1991, raised total budgeted expenditure in fiscal 1990/91 to R74,7 billion. This was R1,8 billion more than the amount of R72,9 billion of government expenditure as originally budgeted for in March 1990 (after inclusion in these expenditure estimates of the contingency reserve of R1,0 billion for unforeseen expenditures). The expected *decrease* in government expenditure in real or inflation-adjusted terms during the full fiscal year 1990/91 was thereby brought down to 0,6 per cent.

Exchequer receipts and issues



Total Exchequer issues (as distinct from Exchequer issues to government departments) in the first ten months of fiscal 1990/91 also included, among other things: (1) the payment of R2,0 billion to the Independent Development Trust (IDT) in July 1990; (2) a payment, in December 1990, of R3,0 billion to the Gold and Foreign Exchange Contingency Reserve Account in the books of the South African Reserve Bank, as a partial redemption of the Government's liability in respect of the accumulated amount of shortfalls experienced by the Bank in providing forward foreign exchange cover; (3) a payment, in December 1990, of R1,0 billion to the Government pension funds; and (4) a payment, also in December 1990, of R0,2 billion to the Development Bank of Southern Africa.

The total expenditure of R6,2 billion on this foursome of items was funded from the Government's financing surplus in fiscal 1989/90 and was not included in the Government's budgetary expenditure estimates for fiscal 1990/91. However, only the payments to the IDT and the Development Bank (R2,2 billion in total) could potentially have an expansionary impact on the economy. If these payments of R2,2 billion were regarded as government expenditure, the estimated year-on-year rate of increase in government expenditure for the full fiscal year 1990/91 could be as high as 16,9 per cent. Finally, an amount of R723 million was transferred to the Central Government's Stabilisation Account with the Reserve Bank in January 1991.

Exchequer receipts

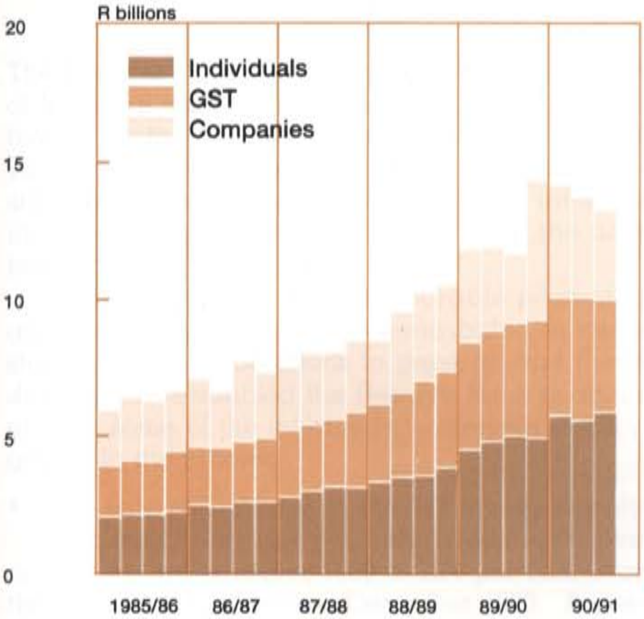
The year-on-year increase in receipts on the Exchequer Account (excluding proceeds from the privatisation of public-sector business enterprises) decreased from 19,1 per cent in the June quarter of fiscal 1990/91 to 12,8 per cent in the September quarter and to only 4,6 per cent in the December quarter.

Total receipts (excluding privatisation proceeds) in the first nine months of fiscal 1990/91 were 11,7 per cent higher than in the corresponding period of fiscal 1989/90. This rate of increase in Exchequer receipts was, therefore, still substantially higher than the rate of increase of 5,8 per cent in government revenue that had been envisaged in the March 1990 Budget for the fiscal year as a whole. In real terms, the year-on-year decrease in these receipts during the first nine months of fiscal 1990/91 amounted to 2,2 per cent.

In January 1991 the year-on-year rate of increase in Exchequer receipts decelerated further. The year-on-year rate of increase in these receipts during the first *ten* months of fiscal 1990/91 was thereby reduced to 8,7 per cent.

During the first ten months of fiscal 1990/91,

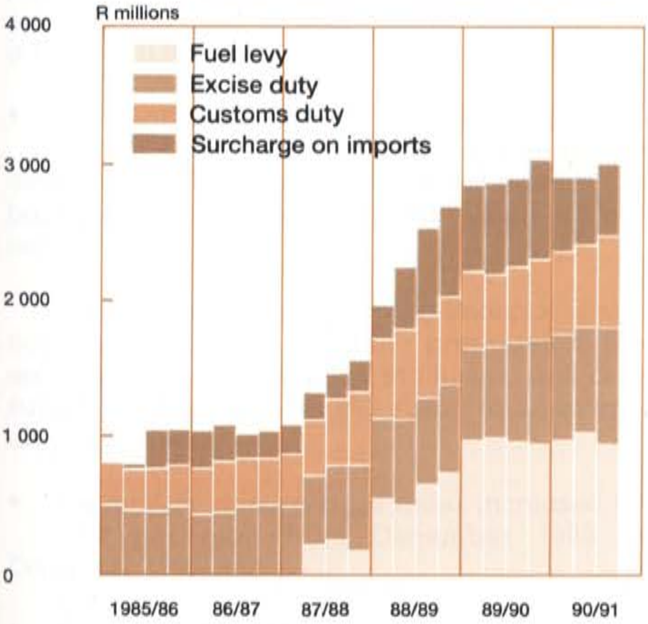
Inland Revenue



Fiscal years. Seasonally adjusted

receipts from income tax on individuals, customs and excise duties and the surcharge on imports were more than proportionate to expected receipts under these headings as in the Budget estimates for the full fiscal year. In contrast, receipts from the general sales tax and the fuel

Customs and excise duties



Fiscal years. Seasonally adjusted, except the fuel levy.

levy during these ten months fell short of their pro rata shares in the budgeted receipts under these headings for the fiscal year as a whole.

Despite the declining tendency in Exchequer receipts in the first ten months of fiscal 1990/91, Exchequer receipts for the fiscal year as a whole are still expected to exceed the Budget estimates to a considerable extent.

Deficit before borrowing

The deficit before borrowing and debt repayment in the first nine months of fiscal 1990/91 amounted to R5 267 million, or to approximately 66 per cent of the budgeted deficit of R7 994 million for the fiscal year as a whole. The corresponding deficit in the first nine months of fiscal 1989/90 amounted to R5 788 million, or to 58 per cent of the budgeted deficit. Relative to the gross domestic product, the actual deficit from April to December 1990 amounted to 2,6 per cent. The Budget estimates of March 1990 provided for a ratio of the deficit to the gross domestic product during the fiscal year as a whole of 2,8 per cent.

Information available in early March 1991 showed that the deficit of R5 267 million during the first nine months of fiscal 1990/91, *plus* the discount of R2 609 million on new issues of government stock and *plus* the amount of R6 216 million of Exchequer issues other than to government departments, as described earlier – for a total funding requirement of R14 092 million – was financed from the following sources:

	R millions
Public Debt Commissioners	1 181
Non-bank private sector	5 920
Banking sector:	
Corporation for Public Deposits	-312
Other banks	7 355
Foreign sector	-52
Total financing	**14 092**

As was observed earlier, the payment of R6 216 million to the IDT, the Reserve Bank, the Government's pension funds and the Development Bank was funded out of the Exchequer's financing surplus of fiscal 1989/90. In the above table this amount is, therefore, included in the "other banks" part of the banking sector's contribution to the financing of the Exchequer deficit.

In January 1991 a *surplus* was recorded on the Exchequer Account to an amount of R1 686 million. The cumulative deficit for the first *ten* months of fiscal 1990/91 was thereby reduced to only R3 581 million. This was financed in the following manner:

	R millions
Government stock	6 398
Treasury bills	1 886
Non-marketable securities	-129
Foreign loans	-309
Decrease in available cash balance	2 674
Total financing of Exchequer deficit	**10 520**
Less payments to:	
IDT	2 000
South African Reserve Bank	3 000
Government pension funds	1 000
Development Bank of Southern Africa	216
Less transfer to the Stabilisation Account	723
Total net financing (= deficit before borrowing)	**3 581**

As of early March 1991 estimates and projetions suggested that the eventual actual deficit for fiscal 1990/91 as a whole would be fairly significantly less than the deficit of R7 994 million originally budgeted for.