Quarterly economic review

Introduction

The impact of the drought, a lack of investors' confidence, mass actions, labour and other internal unrest, the lacklustre economic performance of the major industrialised countries and important structural deficiencies inherent to the South African economy, were responsible for a further deepening of the economic downturn in the third quarter of 1992. Economic conditions in the third quarter were, in particular, affected by a substantial decrease in agricultural production, which not only led to sharply lower economic growth and employment, but also contributed to higher rates of inflation, a significant deterioration in the current account of the balance of payments, higher farm debt and financing needs, and an increase in government expenditure in the form of assistance to farmers and retrenched farm labourers.

The rate of decrease in real gross domestic product therefore accelerated sharply from an annualised level of 3 per cent in the second quarter of 1992 to 5½ per cent in the third quarter. Excluding agriculture, the decrease in real output still accelerated somewhat from about ½ per cent to slightly more than 1 per cent over the same period, owing to contractions in the output of other major sectors, such as mining, manufacturing, construction, electricity, gas and water, commerce and finance, real estate and business services. The real value added by general government remained virtually unchanged in the third quarter of 1992, while only the real value added by transport, storage and communication rose. The increase in the real value added in this sector was related mainly to maize imports and the re-export of food to drought-stricken neighbouring countries.

Aggregate real gross domestic expenditure declined further in the third quarter of 1992 because of decreases recorded in all the main expenditure components. Real outlays on private consumption have now contracted for six consecutive quarters reflecting declining real incomes of households because of some moderation in wage settlements, rising unemployment, depressed farm income and more conservative payouts of dividends by the corporate sector. A general lack of job security and an already high level of consumer debt especially affected the purchase of furniture and household appliances. After having increased in the preceding two quarters, real consumption expenditure by general government also declined fairly sharply in the third quarter of 1992.

The poor outlook for domestic and world economic growth, the low level of capacity utilisation in manufacturing and uncertainty about future social and political developments have led to a decline in real gross domestic fixed investment for eleven consecutive quarters. The ratio of gross domestic fixed investment to gross domestic product therefore amounted to only 16 per cent in the third quarter of 1992, this being the lowest recorded level since 1946. To regain past economic performance and create employment opportunities, it is of the utmost importance that this ratio be strengthened again to considerably higher levels and that the productivity of such investment be increased. Substantial further destocking also took place in the third quarter of 1992 because of decreases in agricultural stocks-in-trade and the running-down of industrial and commercial inventories.

The domestic savings ratio of the economy deteriorated further in the third quarter of 1992, owing largely to increased dissaving by general government, which outweighed the modestly higher saving by the private sector. Increased uncertainty about future income earnings and employment security led many households to reduce their debts and increase saving. Despite lower operating surpluses, corporate saving remained unchanged because dividend payments were reduced.

As could be expected, the deepening of the economic downswing resulted in the redundancy of a large number of employees in the private sector. Nominal salaries and wages per worker, however, continued to rise at rates in excess of price inflation and productivity increases, causing real unit labour costs to rise sharply. These developments, together with increases in the prices of agricultural products and imports, prevented a further decline in producer price inflation. Consumer price inflation, however, showed a distinct downward tendency in 1992 and would have reached even lower levels but for the effect of the drought on food prices.

The surplus on the current account of the balance of payments dropped sharply in the third quarter of 1992 owing to seasonal factors and net imports of agricultural goods. If these factors are eliminated, the adjusted surplus on the current account weakened only moderately. A further net outflow of capital to the amount of R1 billion was recorded in the third quarter of 1992. This outflow, which mainly took the form of short-term capital movements, was related to further repayments under the Third Interim Debt Arrangements with foreign creditor banks, a switching from foreign to domestic trade financing, an appreciation of the dollar against third currencies, the redemption of bearer bonds and notes falling due, and repayments on debt guaranteed by agencies of foreign governments.

As a result of the smaller surplus on current account and the net outflow of capital, the total net gold and other foreign reserves of the country fell quite sharply in the third quarter of 1992. Despite this decrease, the net gold and other foreign reserves of South Africa as at the end of September 1992 were still R5,1 billion above the level of reserves at the beginning of 1990. The gross gold and other foreign reserves were also built up sharply over this period, and are now equivalent to just over 8 weeks' imports of goods and services.

In view of this improvement in the overall balance of payments position, a fairly stable real effective exchange rate of the rand was maintained from the beginning of 1990. In fact, the authorities had to intervene quite heavily at times to prevent the rand from appreciating unduly. Over this period the real effective exchange rate of the rand therefore rose only marginally at an average annual rate of about 1½ per cent. The financial rand, however, fluctuated sharply during the first eleven months of 1992 and depreciated, on balance, by more than 36 per cent against the US dollar.

Reflecting the generally depressed real economic conditions, combined with a fairly restrictive monetary policy stance, the growth rates of the monetary and credit aggregates decreased further during the first nine months of 1992. In certain months, volatile movements in deposits brought about by new regulations under the Deposit-taking Institutions Act of 1991 caused wide fluctuations in the twelve-month growth rates of monetary aggregates. On balance, however, the growth in M3 remained well within the guideline range of between 7 and 10 per cent.

Money market conditions, which were relatively easy during the first four months of 1992, became tighter in the next six months. The average daily level of accommodation at the discount window increased sharply from R1,0 billion in April 1992 to R4,1 billion in October. From July 1992 the Reserve Bank had to intervene from time to time in the money market in order to prevent the market from becoming too tight.

Trading activity in the secondary capital markets remained buoyant throughout the first nine months of 1992, but the underlying conditions in the markets showed a marked change in the third quarter. Worse than expected financial results of some companies began reflecting the deeper recession and reversed positive share market sentiment. These developments, together with declines in share prices on international markets, resulted in a significant softening in domestic share prices and a sharp rise in stock prices from July to October 1992. The value of public-sector stock traded on the Johannesburg Stock Exchange therefore increased substantially in this period. Activity in the primary capital markets, however, fell back sharply in the third quarter of 1992 as a large part of the public-sector borrowing requirement had already been met in the preceding quarter.

As a ratio of gross domestic product, the public-sector borrowing requirement amounted to more than 9 per cent in the first half of fiscal 1992/93, compared with about 3½ per cent in the corresponding period of the preceding year. This substantial weakening in public finance was the result of a sharp increase in the deficit before borrowing and debt repayment on the Main Budget: government expenditure was more or less in line with the budgeted amount while government revenue was well below target. The substantial shortfall in Exchequer receipts was, in turn, brought about by the severe downturn in economic activity, leading to lower proceeds from value-added tax and income tax on companies.

The higher deficit before borrowing by the government was financed mainly by means of new government stock issues at rates which moved down sharply. The monthly average yield on long-term government stock, which had eased gradually from a peak of 17,2 per cent in October 1991 to 16,9 per cent in February 1992, declined more rapidly to 13,9 per cent in October. This decrease in long rates reflected a significant softening of money market rates, expected lower inflation rates, a weak real economy and the lowering of Bank rate. Long rates, however, rebounded again towards the end of October and in the first half of November when traders became aware of an imminent larger deficit before borrowing in the budget of the government.

In view of the progress made towards establishing greater financial stability in South Africa, the Reserve Bank reduced its Bank rate from 15 to 14 per cent with effect from 18 November 1992. This represented the fourth reduction of one percentage point in the Bank rate since March 1991, and was again followed by a corresponding one percentage point lowering in the prime overdraft rates of deposit-taking institutions to 17,25 per cent by some institutions in the last week of November and by others from the beginning of December. The predominant mortgage bond rate was also reduced by ½ percentage point to 16,75 per cent from 1 December 1992.

Domestic economic developments

Domestic output[1]

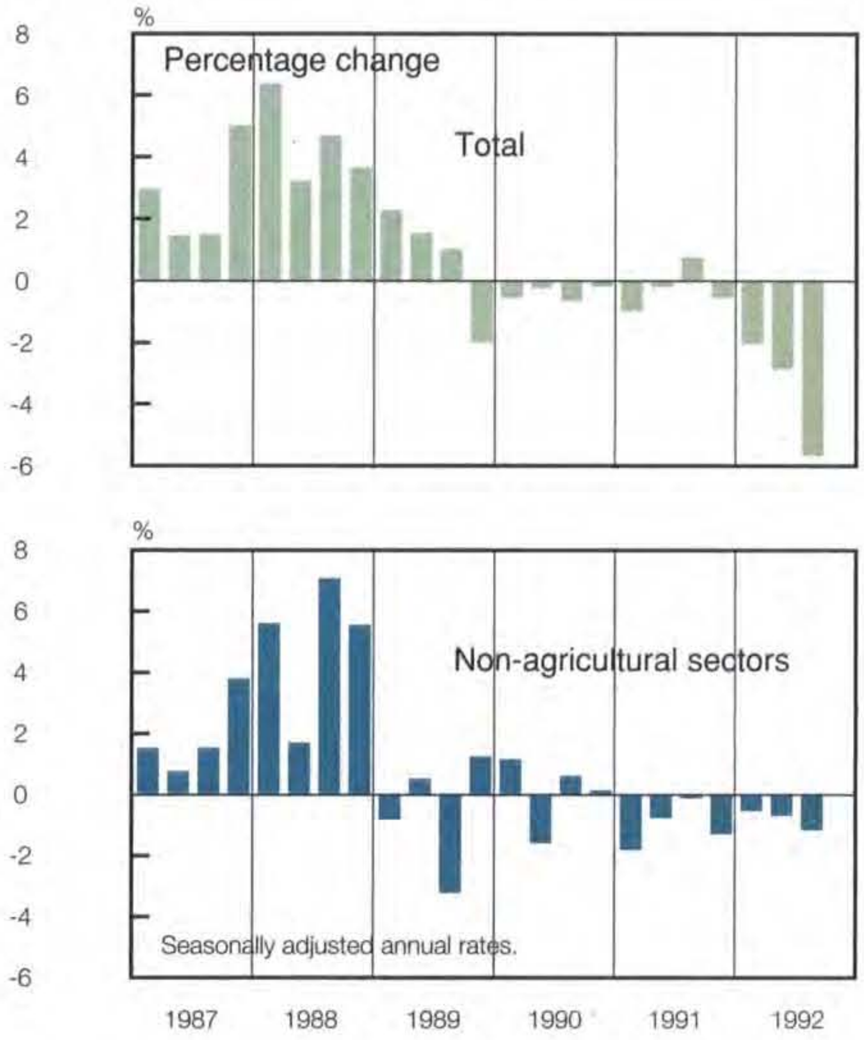
Current estimates show that the real gross domestic product contracted sharply in the third quarter of 1992. After having declined by 2 per cent in the first quarter of 1992 and by nearly 3 per cent in the second quarter, the quarter-to-quarter rate of decline in *total gross domestic product* accelerated to a seasonally adjusted and annualised rate of approximately 5½ per cent in the third quarter. In the first nine months of 1992 total real gross domestic product declined by about 1½ per cent compared with its counterpart of 1991. This indicates that the decrease in real output during calendar 1992 may well amount to 2 per cent, following declines of ½ per cent in both 1990 and 1991. From the beginning of the economic downswing in the first quarter of 1989 up to the third quarter of 1992 real gross domestic product has now contracted by 3½ per cent.

The extensive drought damage to *agricultural production* contributed materially to the decline in domestic production in the third quarter of 1992. Agricultural output volumes in this quarter were depressed further by the early harvesting of the maize crop: the bulk of the very small crop of 3 million tons was harvested in the second quarter. Wheat is also expected to deliver a crop in the current season which could be 40 per cent less than that of the previous season, which implies that the decline in total agricultural output volumes for the year as a whole will probably be even more than the 15 per cent envisaged earlier this year.

Excluding agricultural production, the rate of decline in the real output of the *other economic sectors* nevertheless worsened somewhat from an annualised rate in excess of ½ per cent in both the first and the second quarter of 1992 to slightly more than 1 per cent in the third quarter. Moreover, this deepening of the recession was fairly widespread and declines in real output of mining, manufacturing, electricity, gas and water, construction, commerce and finance, real estate and business services were recorded in the third quarter of 1992. A small increase was registered in the real value added by transport, storage and communication, while the real output by general government remained broadly unchanged.

The positive contribution made by the mining industry to total output from the middle of 1991 was reversed in the third quarter of 1992. After having increased consistently in the previous four quarters owing to the processing of ore with a relatively high

Real gross domestic product



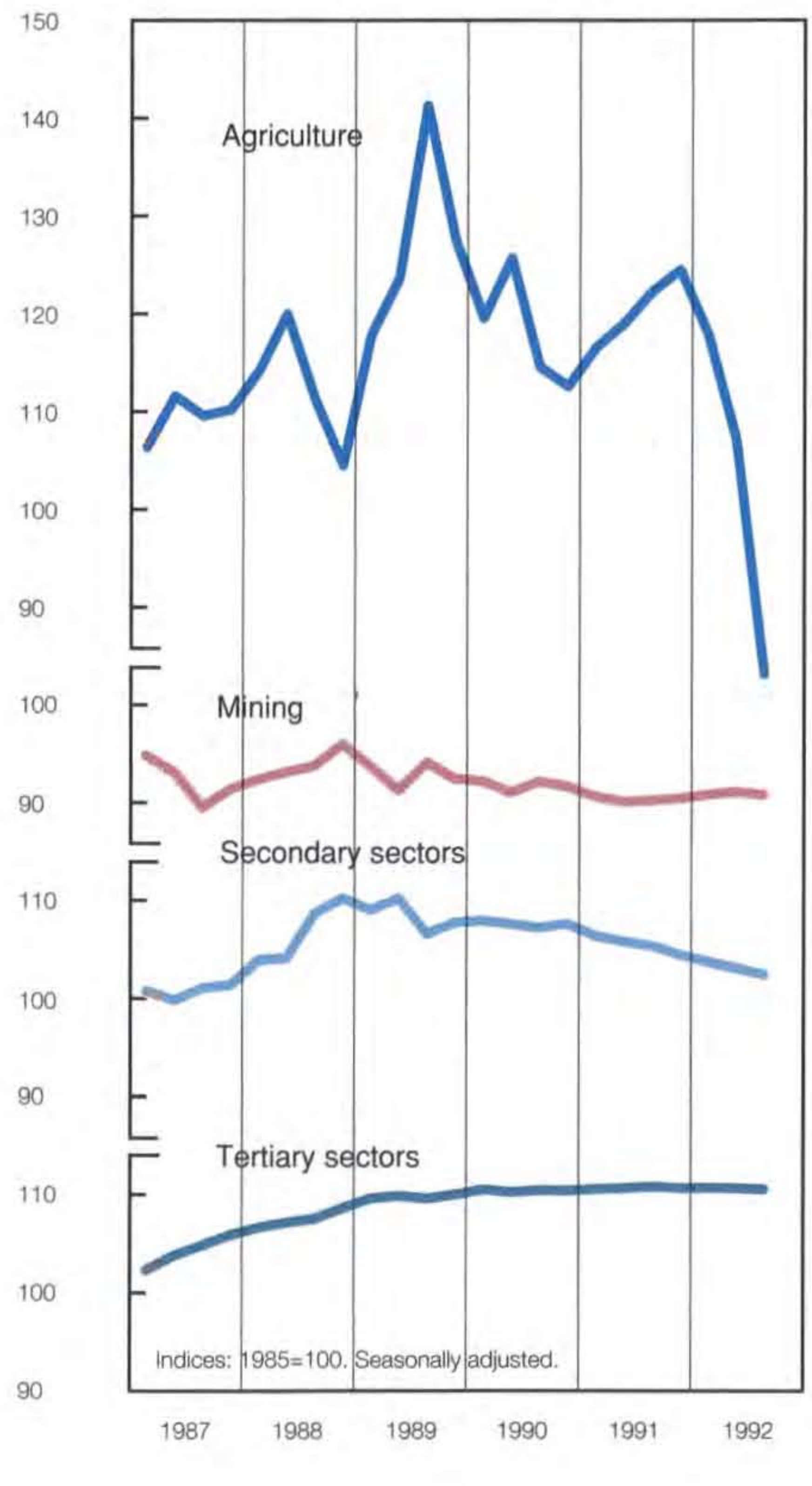
gold content and productivity improvements, the real production of gold mines contracted at an annualised rate of 3½ per cent in the third quarter. The declining trend discernible in the real value added by other mines throughout 1991 and the first half of 1992, on the other hand, levelled out in the third quarter of 1992.

The real value added by all three *secondary sectors* (manufacturing, construction, and electricity, gas and water) shrank further in the third quarter. The depressed domestic demand, slowing global economic growth, weak commodity prices, man-days lost on account of strikes, mass actions and stay-aways, destroyed business confidence and resulted in widespread declines in the output of almost all the subsectors of the manufacturing industry. Owing to these factors, the real value added by manufacturing shrank to a level in the third quarter of 1992 that was more than 7 per cent below the level at the beginning of the current cyclical downturn of the economy.

In the *tertiary sectors*, the quarter-to-quarter rate of decrease in the real value added by commerce, which had amounted to an annualised rate of ½ per cent in each of the first two quarters of 1992, accelerated to nearly 2 per cent in the third quarter. While the real value added by wholesale and motor trade improved somewhat, the real value added by retail trade declined

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

Components of real gross domestic product



substantially in the third quarter of 1992. In the sector finance, insurance, real estate and business services, the decline in real value added by real estate and business services more than neutralised an increase in the real value added by finance and insurance. The real value added by general government, which had slowed down to an increase of less than ½ per cent in the second quarter of 1992, remained unchanged in the third quarter. The increase in the real value added by transport, storage and communication amounted to only ½ per cent in the third quarter of 1992 and could be attributed mainly to maize imports and the re-exportation of food to drought-stricken neighbouring countries.

Domestic expenditure

Aggregate real gross domestic expenditure is estimated to have declined further in the third quarter of 1992. After having increased sharply in the first quarter of 1992 (on account of an involuntary build-up of inventories), real domestic expenditure decreased at a seasonally adjusted and annualised rate of nearly 7 per cent in the second quarter and at approximately 7½ per cent in the third quarter. This brought the decrease to about 2 per cent in the first nine months of 1992 compared with the corresponding period in the preceding year.

Decreases were recorded in all the main expenditure components in the third quarter of 1992. Real *outlays on private consumption* have now declined for six consecutive quarters and in the first nine months of 1992 it was 3 per cent lower than in the corresponding period in 1991. Households' consumption expenditure was still repressed by factors such as declining real personal disposable income, a general lack of job security, an already high level of consumer debt and a decline in the net wealth of households. Real personal disposable income, which had started to decline from the second quarter of 1991, decreased at an average annualised quarterly rate of 2½ per cent in the first nine months of 1992. The further decrease in households' real income in the third quarter of 1992 was the combined result of smaller increases in nominal salaries and wages and a deterioration in income from property because of low farm income and conservative payouts of dividends by the corporate sector.

The decline in real private consumption expenditure was particularly evident in the spending on durable and non-durable goods. After having recorded annualised rates of decline of 10 per cent and 7½ per cent in the first and second quarter of 1992, real expenditure on

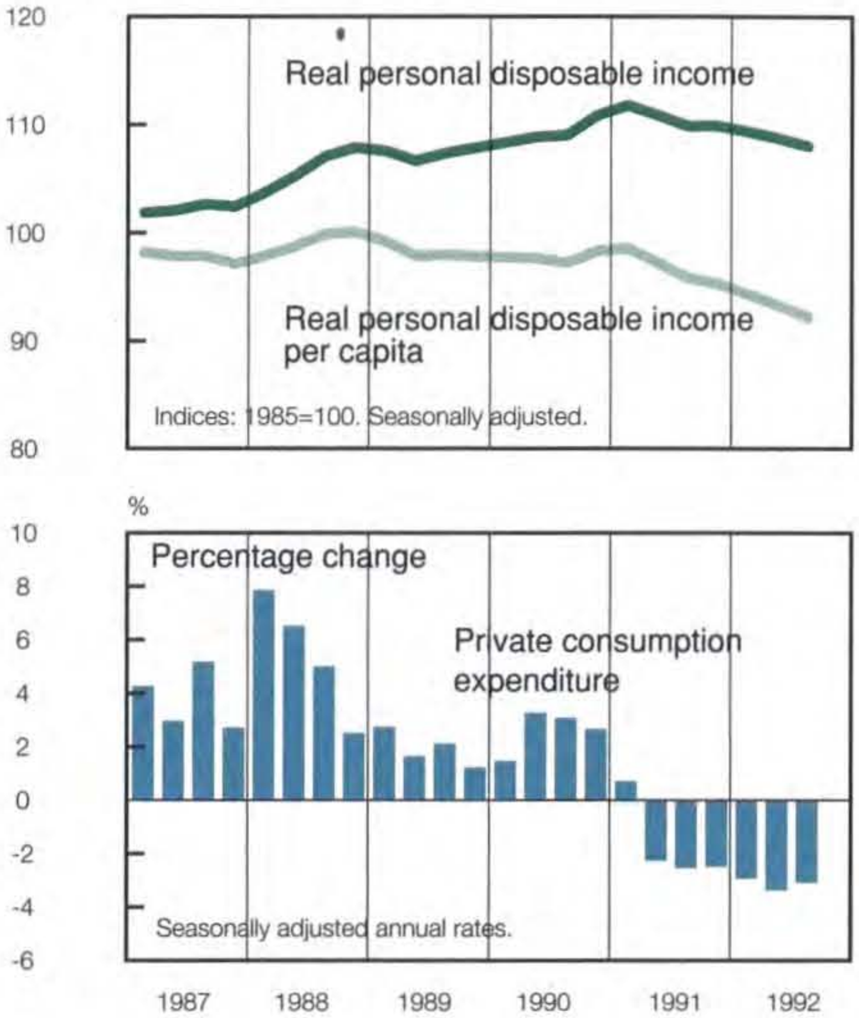
Real gross domestic expenditure

Quarter-to-quarter rates of change at annualised rates

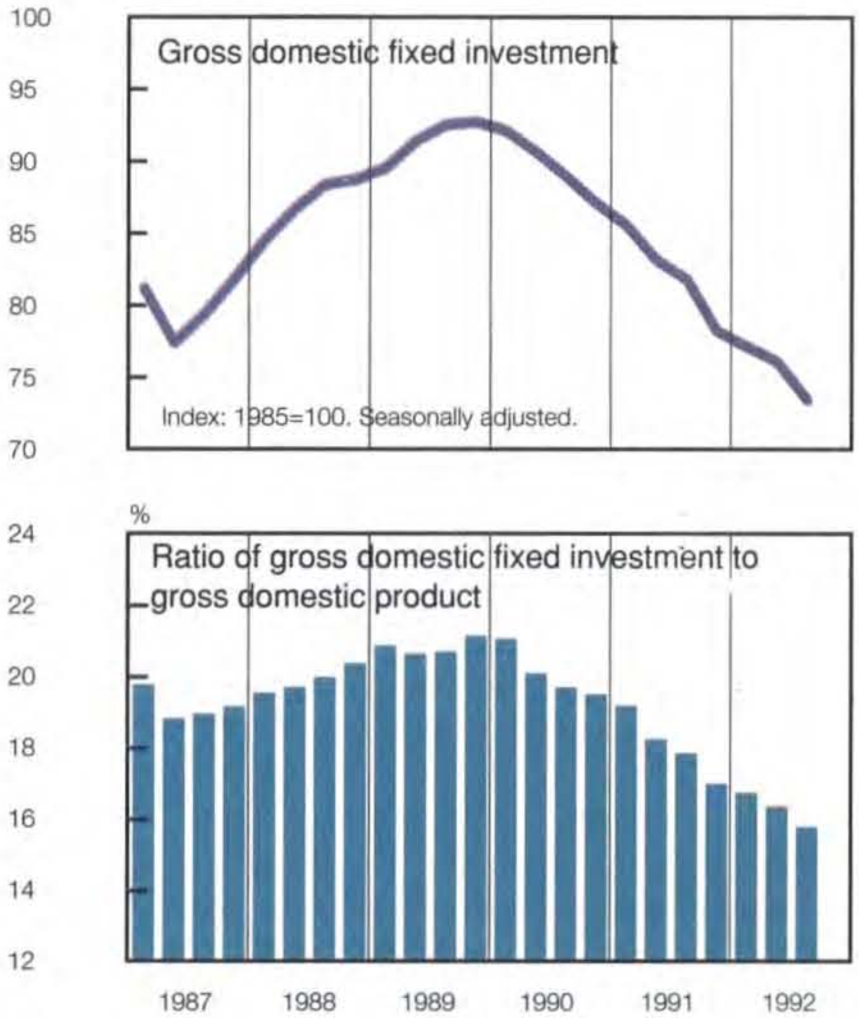
%

	1992		
	1st qr	2nd qr	3rd qr
Private consumption expenditure	-3	-3½	-3
Consumption expenditure by general government...	7	2	-3
Gross domestic fixed investment......................	-5½	-5½	-13
Change in inventories (R millions)......................	788	-1 256	-4 312
Real gross domestic expenditure	8	-7	-7½

Real personal disposable income and private consumption expenditure



Gross domestic fixed investment



durable goods decreased further at a rate of 6 per cent in the third quarter. This could be attributed mainly to a pronounced contraction in real expenditure on furniture and household appliances. The number of new motor cars sold in the first nine months of 1992 shrank to a level that was more than 11 per cent lower than the sales in the corresponding period of 1991.

Real outlays by households on non-durable goods also decreased at an annualised rate of about 6 per cent in the third quarter of 1992, while real spending on semi-durable goods registered a more modest decrease. In contrast to these developments, households' real outlays on services increased in the third quarter of 1992, albeit at an annualised rate of only 1 per cent.

Real *consumption expenditure by general government* declined at an annualised rate of about 3 per cent in the third quarter of 1992; in the preceding two quarters it had increased fairly sharply. This turnaround in real consumption expenditure by general government occurred in the spending on intermediate goods and services; real remuneration of government employees remained more or less on the level of the preceding quarter. In the first nine months of 1992 real consumption expenditure by general government was about equal to the level of such expenditure in the corresponding period of 1991.

Total *real gross domestic fixed investment* declined substantially further in the third quarter, bringing the cumulative decline in this aggregate from a high point in the fourth quarter of 1989 to no less than 21 per cent. Relative to gross domestic product, gross domestic fixed investment declined to its lowest level ever recorded of 16 per cent in the third quarter of 1992. This can be compared with an average ratio of 23½ per cent in the 1980s; the corresponding ratios for industrial and newly industrialised countries amounted to 21 and 31 per cent, respectively, in the 1980s.

At present, investment in new plant and equipment is still constrained by factors such as the poor outlook for domestic and global economic growth, the low level of capacity utilisation in manufacturing and a generally conservative attitude towards capacity creation in an environment of political uncertainty. The decrease in real fixed investment in the third quarter of 1992 was therefore evident in all the major sectors of the economy, with the notable exception of public corporations. The rise in the investment of public corporations was, however, relatively small and started from a low base in the second quarter of 1992. Further sharp cut-backs were recorded in capital expenditure by public authorities and by the private sector. Pronounced declines were registered in particular by private business undertakings involved in agriculture, manufacturing, commerce and finance.

The rate of *inventory depletion* accelerated in the third quarter of 1992, mainly because of large inventory reductions in mining, manufacturing, commerce and agricultural stocks-in-trade. As a result of these declines, the ratio of industrial and commercial inventories relative to non-agricultural gross domestic product decreased further to slightly under 17½ per cent in the third quarter of 1992, which was only marginally lower than the average ratio of nearly 18 per cent registered in the preceding two quarters, but considerably lower than the average level of 24 per cent in the 1980s.

Factor income

The growth in *aggregate nominal factor income* over a period of twelve months slowed down markedly during the course of 1992 from a high point of 14 per cent in the fourth quarter of 1991 to only 8 per cent in the third quarter of 1992. In the first nine months of 1992 nominal factor income was about 10 per cent higher than in the corresponding period of the preceding year; it still increased by 13 per cent in calendar 1991. The slower growth in aggregate factor income over periods of twelve months was caused largely by a weakening in the rate of increase in the gross operating surpluses of business enterprises, while the growth rates in nominal remuneration of employees receded only moderately.

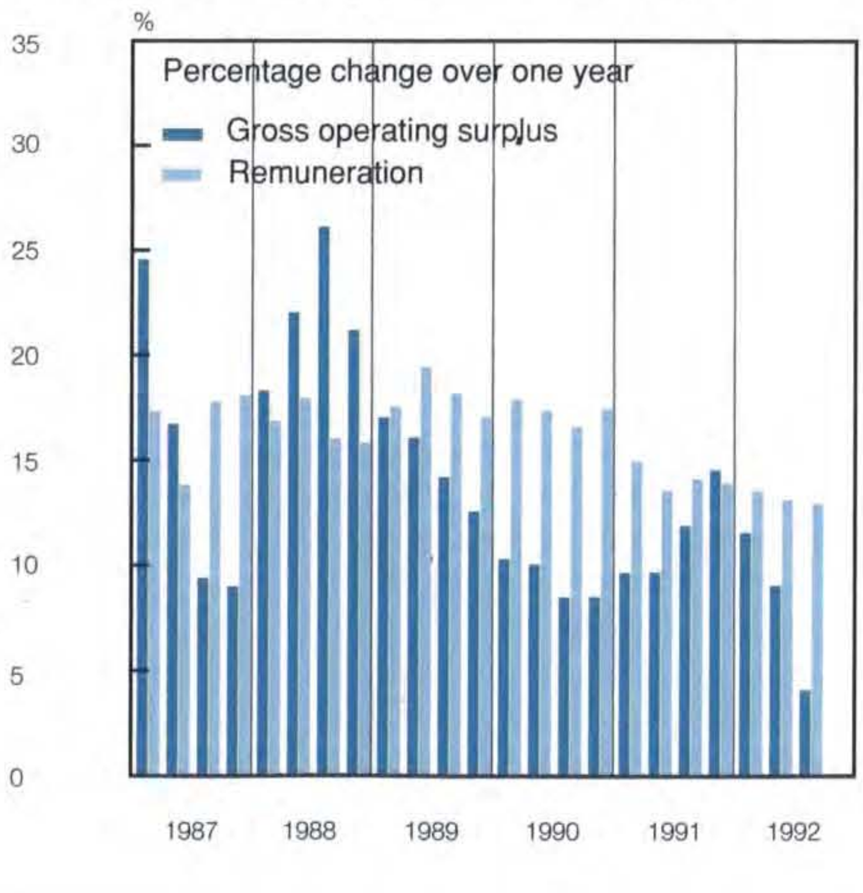
However, measured from quarter to quarter at a seasonally adjusted and annualised rate, the rate of increase in aggregate *remuneration of employees* slowed down noticeably from a high of 24½ per cent in the second quarter of 1989 to 14½ per cent in the second quarter of 1992 and further to only 12 per cent in the third quarter. This slower growth was mainly the result of a decrease in employment, but some moderation in wage demands and eventual wage settlements has also become discernible. The share of aggregate employee remuneration in total factor income nevertheless increased further from 60½ per cent in the first half of 1992 to 61½ per cent in the third quarter.

The accumulative *gross operating surplus* in the first three quarters of 1992 exceeded its counterpart in 1991 by only 8 per cent. The decline in gross operating surpluses in the third quarter of 1992 was brought about mainly by a lower surplus generated in the agricultural sector, and by only modest increases in the profits of enterprises in mining, commerce and construction.

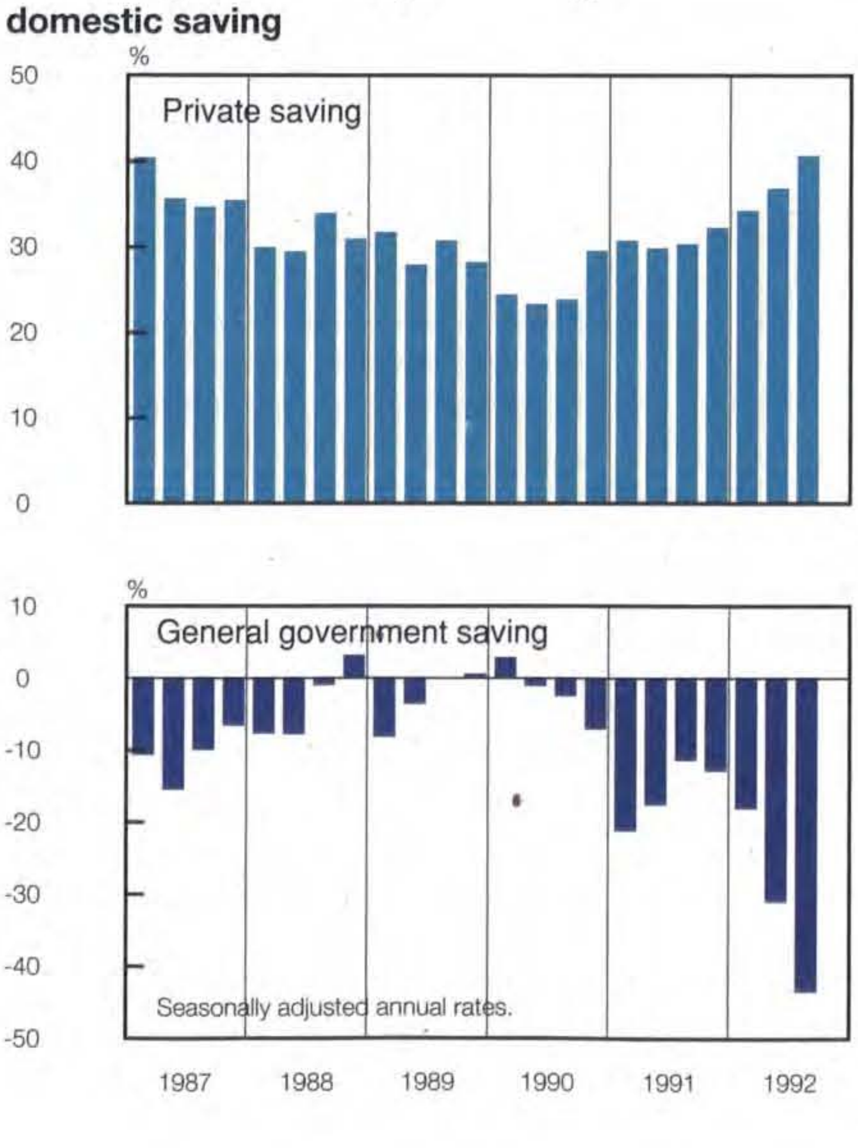
Domestic saving

The ratio of *gross domestic saving* to gross domestic product, which had weakened considerably from a high of 23½ per cent in the third quarter of 1989 to 16½ per cent in the second quarter of 1992, fell further to about 15 per cent in the third quarter. Increased dissaving by general government was responsible for the deterioration in the savings ratio in the third quarter

Gross operating surplus and remuneration



Net saving as percentage of total gross domestic saving



of 1992; saving by the private sector, on the other hand, improved modestly.

Aggregate corporate saving remained virtually unchanged in the third quarter of 1992, but personal saving continued to rise. After having increased from a low of slightly less than 1 per cent in the third quarter of 1990 to 3 per cent in the second quarter of 1992, the ratio of personal saving to personal disposable income strengthened to 3½ per cent in the third quarter. This rise in the *personal savings* ratio probably reflected growing insecurity regarding future earnings and employment opportunities in an environment undergoing rapid and sweeping social and political change, which urged many households to change spending patterns and to reduce indebtedness.

Net *dissaving by general government* (seasonally adjusted and annualised) rose from R10,6 billion in the first quarter of 1992 to more than R21 billion in the third quarter. Although this dissaving by the general government does not pose any immediate financing problems for private-sector investors in the current slack economic conditions, crowding-out of private investments could become a serious problem if dissaving by the government were to be continued by the time the economy starts approaching full capacity utilisation.

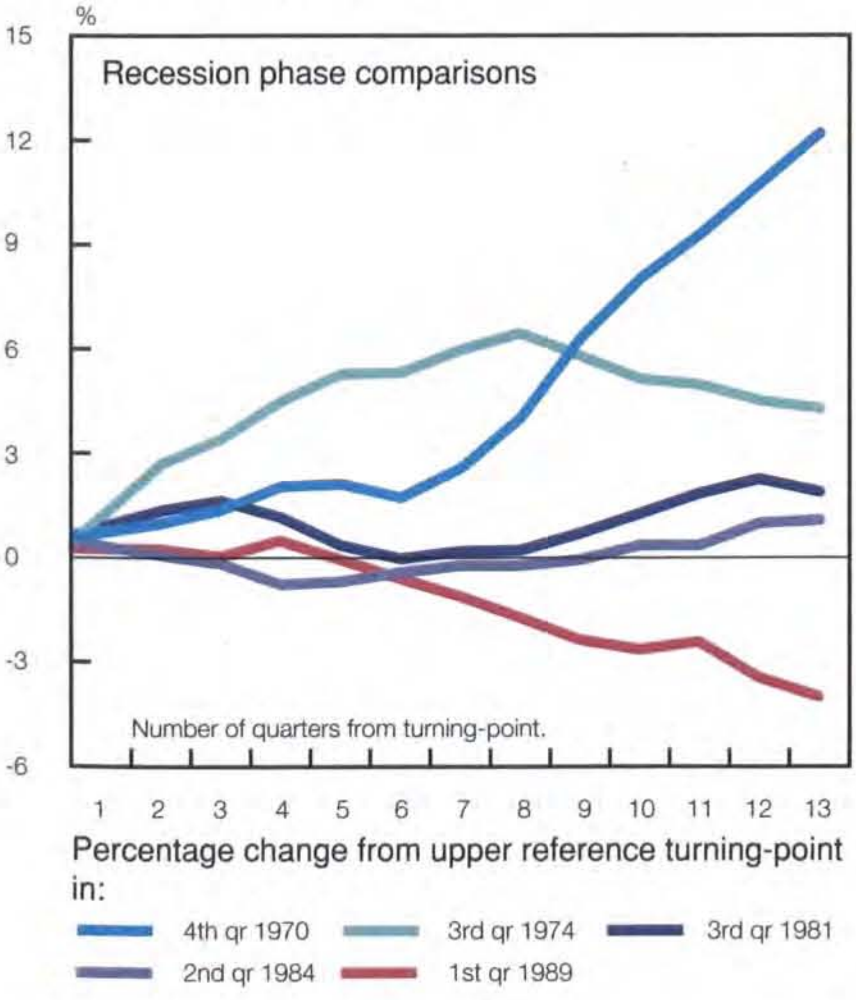
Employment

Total employment in the non-agricultural sectors of the economy was severely affected by the cyclical downswing in economic activity. Reflecting the progressively weaker state of the economy, non-agricultural employment declined by 0,5 per cent in 1990 and by 2,0 per cent in 1991. The quarter-to-quarter rate of decrease in total employment then amounted to a seasonally adjusted and annualised rate of 4,1 per cent in the first quarter of 1992 – the highest rate of decrease recorded in the current recession – before easing to a still high level of 2,3 per cent in the second quarter.

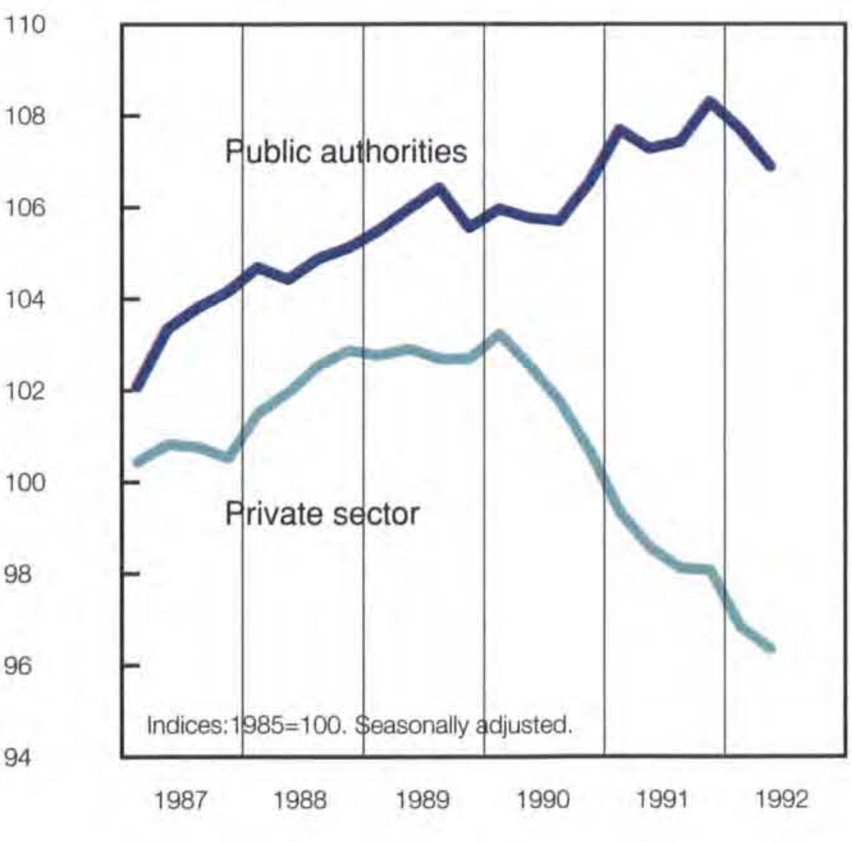
As illustrated by the accompanying graph, the changes observed in the level of total non-agricultural employment six quarters into the current cyclical downswing (i.e. in the third quarter of 1990) still compared relatively favourably with those recorded at similar stages of previous downswings. However, a comparison of the percentage changes in employment over thirteen quarters from the beginning of each downswing shows that the current decline in employment levels is much more severe than the declines in any of the previous downswings in the 1970s or the 1980s. No fewer than 233 000 workers became redundant in the non-agricultural sectors of the formal economy from the beginning of the recession up to the second quarter of 1992, i.e. without taking into consideration the effect of the severe drought on employment in agriculture over the latter part of this period.

The rate of decrease in employment in the non-agricultural *private sector* accelerated sharply from 0,7 per cent in 1990 to 3,4 per cent in 1991. In the first

Non-agricultural employment



Non-agricultural employment



and the second quarter of 1992 employment in the private sector decreased further at seasonally adjusted and annualised quarter-to-quarter rates of 5,0 and 2,0 per cent, respectively. This labour-shedding was mainly brought about by cost-cutting in some businesses, which resulted in lower employment numbers in most subsectors of the private sector.

In contrast to these developments in the private sector, total employment by *public authorities* rose by 0,1 per cent in 1990 and at an even higher rate of 1,6 per cent in 1991. As already reported in previous Quarterly Reviews, the short-term changes observed in the total employment of public authorities during the current cyclical downswing were rather volatile. Reductions in personnel in certain calendar quarters were followed by similarly strong increases in employment in subsequent quarters. More recently, total employment by public authorities declined at quarter-to-quarter (seasonally adjusted and annualised) rates of 2,2 and 3,0 per cent in the first and second quarter of 1992. Despite these recent declines, public-sector bodies were still net creators of employment opportunities during the cyclical downturn. From the second quarter of 1989 to the second quarter of 1992 the total employment by public authorities increased by about 14 000 persons.

Mirroring the declining level of formal-sector employment, the seasonally adjusted number of *registered unemployed* persons increased from a lower turning-point of 111 200 in November 1988 to a high of 308 200 in December 1991; it then fluctuated around a slightly lower level in the first seven months of 1992, and amounted to approximately 300 000 in July 1992. The number of registered unemployed persons in the first seven months of 1992 was nevertheless some 13,6 per cent higher than in the corresponding period of 1991.

Labour costs and productivity

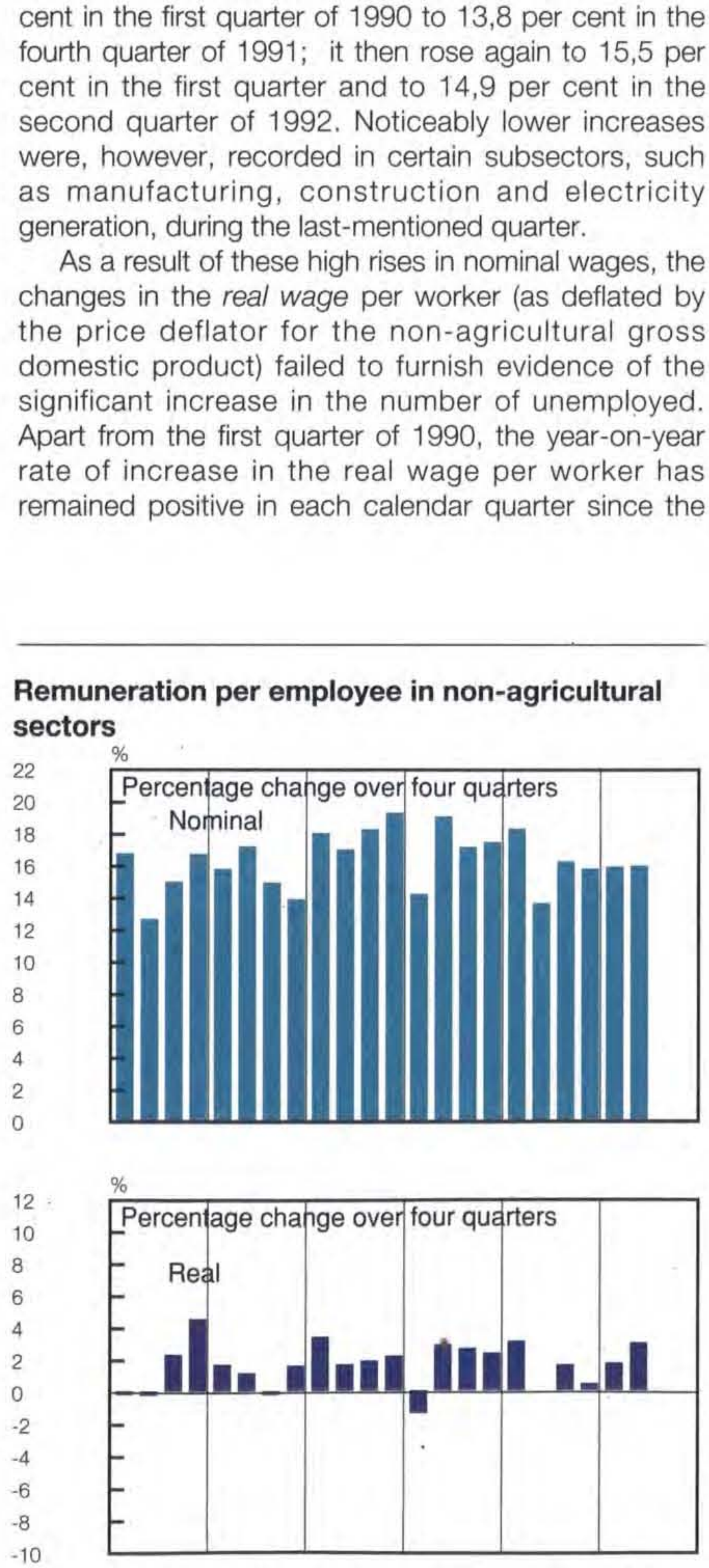
Despite the decline in employment, *nominal labour remuneration* per worker continued to rise at high rates during the current recession. The average monthly nominal salaries and wages per worker in the non-agricultural sectors of the economy increased by 18,0 per cent in 1989, 16,9 per cent in 1990 and 15,8 per cent in 1991. In the first quarter of 1992 the year-on-year rate of increase in the average nominal wage per worker remained at a level of 15,8 per cent, rising marginally to 15,9 per cent in the second quarter.

The rates of increase in the nominal remuneration per worker employed by *public authorities* remained generally higher during the recession than those of workers in the private sector. After having increased sharply to a high of 21,9 per cent in 1989, the rate of increase in the nominal salaries and wages per worker employed by public authorities amounted to 17,6 per cent in 1990 and 17,3 per cent in 1991. The year-on-year rate of increase in this aggregate moderated somewhat to 16,2 per cent in the first quarter of 1992 before rising again to 17,7 per cent in the second quarter.

The rate of increase in the average nominal salaries and wages per worker in the non-agricultural *private sector* accelerated from 16,3 per cent in 1989 to 16,6 per cent in 1990, but then slowed down to 14,8 per cent in 1991. Over the shorter term, the year-on-year rate of increase in the nominal salaries and wages per worker in the private sector declined from 18,3 per cent in the first quarter of 1990 to 13,8 per cent in the fourth quarter of 1991; it then rose again to 15,5 per cent in the first quarter and to 14,9 per cent in the second quarter of 1992. Noticeably lower increases were, however, recorded in certain subsectors, such as manufacturing, construction and electricity generation, during the last-mentioned quarter.

As a result of these high rises in nominal wages, the changes in the *real wage* per worker (as deflated by the price deflator for the non-agricultural gross domestic product) failed to furnish evidence of the significant increase in the number of unemployed. Apart from the first quarter of 1990, the year-on-year rate of increase in the real wage per worker has remained positive in each calendar quarter since the

Remuneration per employee in non-agricultural sectors



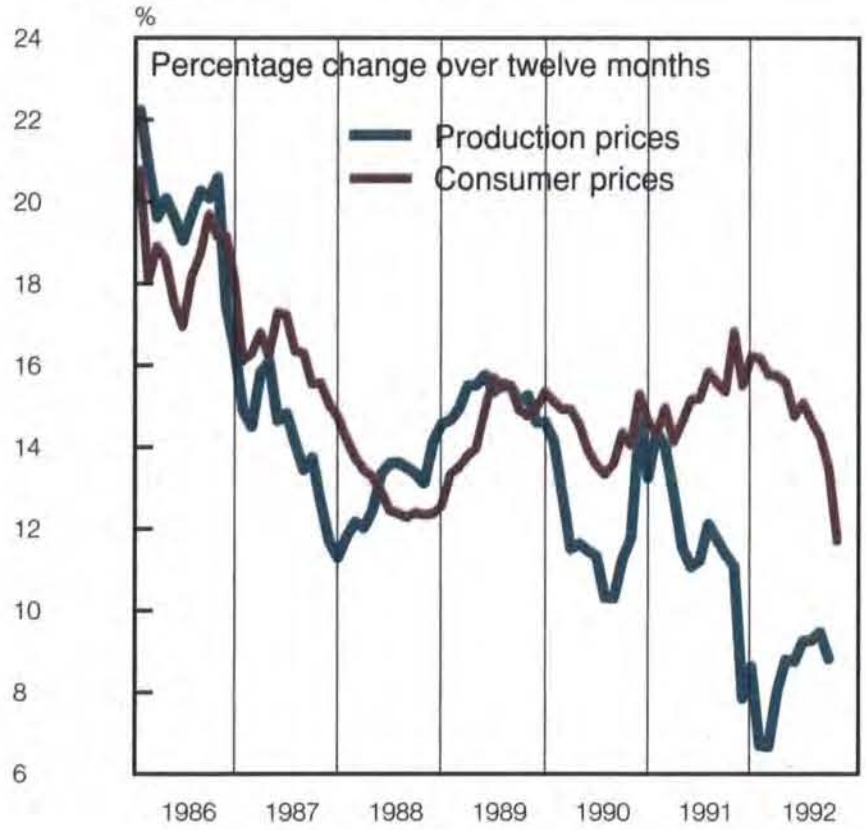
beginning of 1989. It even tended to accelerate in the first half of 1992. The average monthly real wage per worker accordingly increased by 2,2 per cent in 1989, 1,6 per cent in 1990 and 1,4 per cent in 1991. The year-on-year rate of increase in the real wage per worker accelerated again recently from 0,6 per cent in the final quarter of 1991 to 2,0 and 3,0 per cent in the first two quarters of 1992. These positive rates of increase in real wages per worker could be ascribed to a large extent to the reluctance of labour unions to moderate their wage demands and to the fact that business enterprises met these demands by introducing labour-saving devices.

The rate of increase in *labour productivity* in the non-agricultural sectors declined sharply from 2,3 per cent in 1988 to only 0,4 per cent in 1990. Widespread rationalisation programmes and improved cost-effectiveness then caused this rate to accelerate to 1,3 per cent in 1991. On a quarterly basis, the year-on-year rate of increase in labour productivity rose from 1,2 per cent in the third quarter of 1990 to 1,9 per cent in the second quarter of 1991; it then declined to 0,3 per cent in the fourth quarter, but rose again to 1,1 and 1,0 per cent in the first and the second quarter of 1992.

The rapid increase in the nominal remuneration per worker and the relatively modest improvements in labour productivity caused the *nominal unit labour costs* in the non-agricultural sectors to increase by 17,0 per cent in 1989 and by 16,5 per cent in 1990 before slowing down to 14,4 per cent in 1991. Measured over a period of four quarters, nominal unit labour costs rose by 14,6 and 14,7 per cent in the first two quarters of 1992.

Real unit labour costs (as deflated by the price deflator for the non-agricultural gross domestic product) increased by 1,4 per cent in 1989 and by 1,1 per cent in 1990 before declining modestly by 0,1 per cent in 1991. As from the third quarter of 1991, real unit labour costs increased again at year-on-year rates which accelerated from 0,4 and 0,3 per cent in the last two quarters of 1991 to 0,9 and 2,0 per cent in the first two quarters of 1992.

Production and consumer prices



Prices

The divergent movement between the production price index and the consumer price index (discussed in some detail in the *Quarterly Bulletin* of June 1992) began to narrow significantly during the course of 1992 as many of the factors responsible for the gap between the growth rates of these two indices started to disappear. The narrowing of the gap was the combined result of a fairly sharp upward movement in production price inflation and a distinct downturn in the rate of increase in the consumer price index.

The rate of increase in the *all-goods production price index*, which had declined sharply during 1991, started to rise again from March 1992. Measured over a period of twelve months, the growth in the production price index declined from a peak of 14,6 per cent in November 1990 to 6,7 per cent in January and February 1992, and then rose again to 9,5 per cent in August before declining to 8,8 per cent in September. After having declined from a seasonally adjusted and annualised quarter-to-quarter rate of 20,8 per cent in the fourth quarter of 1990 to 3,2 per cent in the first quarter of 1992, this rate of increase in the production price index rose again to 11,4 per cent in the second quarter of 1992 and to 13,6 per cent in the third quarter.

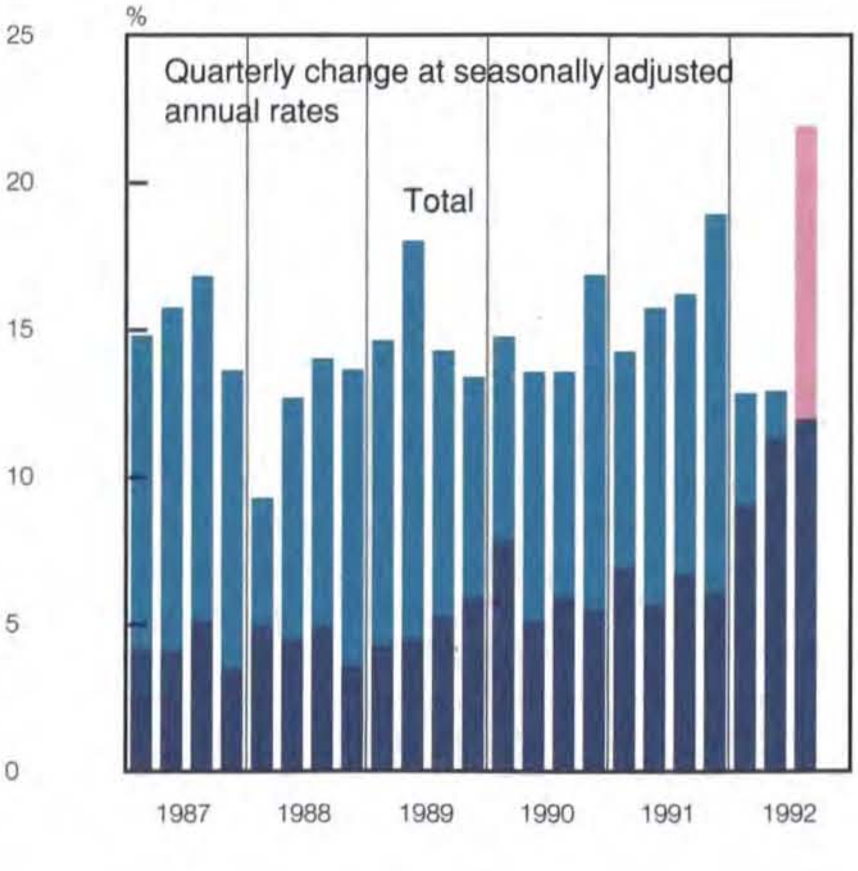
The recent acceleration in production price inflation was partly due to an upward movement in the prices of imported goods. The rate of increase in the *prices of imported goods* over periods of twelve months, which had plummeted from 19,1 per cent in November 1990 to 1,9 per cent in December 1991 and to negative rates of 1,9 and 0,9 per cent in January and February 1992, accelerated to 7,5 per cent in July 1992 and then slowed down modestly to 7,1 per cent in September. The quarter-to-quarter rate of increase in the prices of imported goods changed from a seasonally adjusted and annualised rate of 10,9 per cent in the third quarter of 1991 to a negative rate of 0,7 per cent in the first quarter of 1992; it then rose again to a level of 9,6 per cent in the second quarter and to 17,1 per cent in the third quarter of 1992.

The higher rates of increase in the overall production price index were also caused by an acceleration the *price inflation of domestically* *produced goods*. The rate of increase in the prices of domestically produced goods over periods of twelve months declined from a recent high point of 13,9 per cent in March 1991 to 8,5 per cent in February 1992, but then rose again to 10,3 per cent in August before declining to 9,2 per cent in September. The quarter-to-quarter rate of increase in the prices of domestically produced goods also declined from a seasonally adjusted and annualised rate of 12,0 per cent in the third quarter of 1991 to 3,7 per cent in the first quarter of 1992, but accelerated sharply to 12,3 per cent in the second quarter and to 12,4 per cent in the third quarter. These price increases were caused mainly by sharp rises in the prices of agricultural products reflecting supply shortages because of the very poor rainfall in the previous summer season.

In contrast to this rising trend in production price inflation, the quarter-to-quarter rate of increase in the overall *consumer price index*, which had accelerated from a seasonally adjusted and annualised rate of 14,2 per cent in the first quarter of 1991 to 18,8 per cent in the fourth quarter, declined to 12,8 per cent in both the first and the second quarter of 1992 and to 11,9 per cent in the third quarter. A decline in home-owners' costs in the third quarter contributed meaningfully to the lower rate of increase in the prices of consumer services. Although the quarter-to-quarter rate of increase in the prices of consumer goods also receded from a seasonally adjusted and annualised rate of 21,1 per cent in the fourth quarter of 1991 to 14,8 per cent in the second quarter of 1992, it reaccelerated to 16,9 per cent in the third quarter because of higher increases in the prices of food and non-alcoholic beverages.

After having accelerated rapidly from a recent low point of 13,3 per cent in July 1990 to 16,8 per cent in October 1991, the rate of increase in the consumer price index over periods of twelve months declined to 13,5 per cent in September 1992 and 11,7 per cent in October. This slower growth in consumer prices would have been more pronounced but for the effect of the drought on food prices. This is clearly evident in the sharp decrease in the growth in consumer prices if food and non-alcoholic beverages are excluded from the index, from a twelve-month rate of increase of 15,4 per cent in July 1991 to 9,3 per cent in October 1992.

Consumer price index

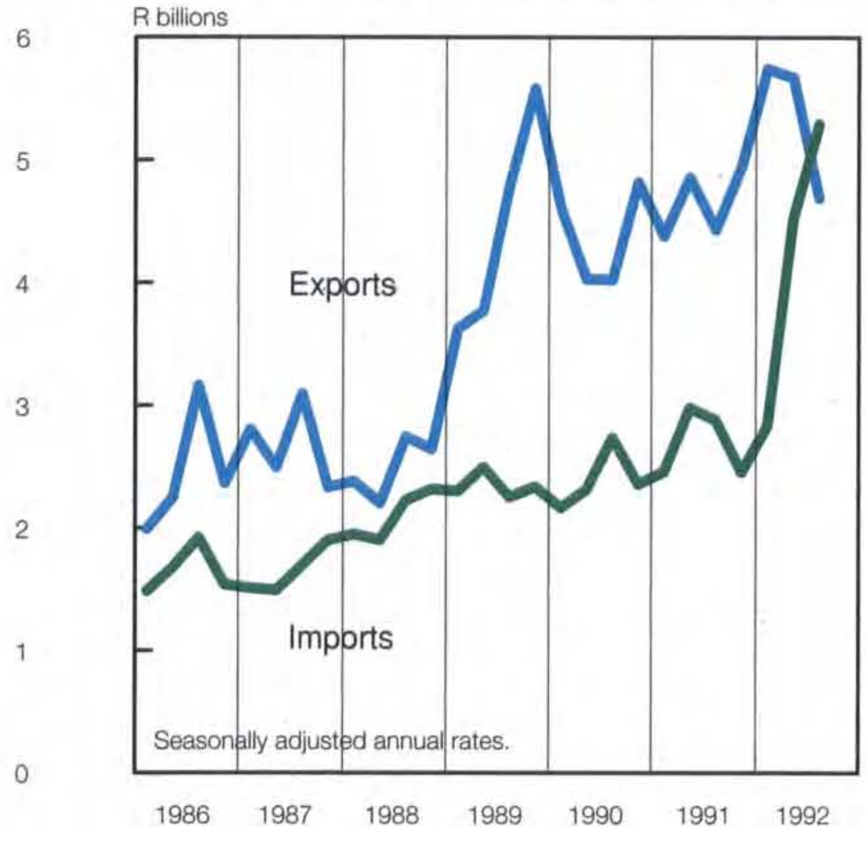


Balance of payments

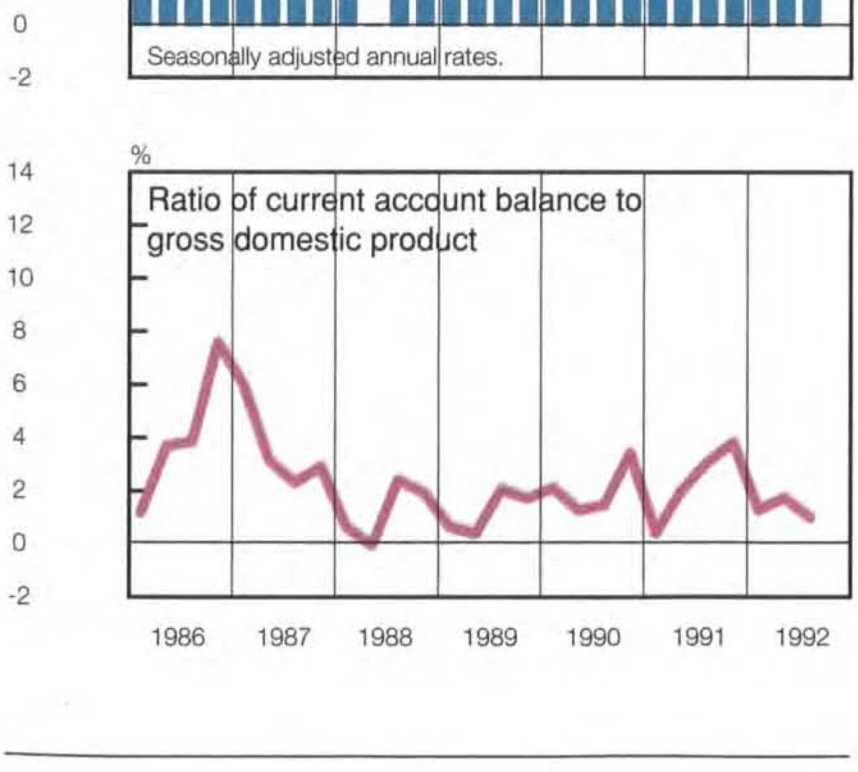
Current account

Although South Africa is currently in the grip of a long and severe recession that is normally characterised by a low volume of merchandise imports, the *surplus on the current account* of the balance of payments dropped sharply from R1,3 billion in the second quarter of 1992 to only R0,4 billion in the third quarter. Part of this decline was due to seasonal factors. Taken at a seasonally adjusted and annualised rate, the surplus on current account nevertheless decreased from R6,0 billion to R3,7 billion over the same period, or from 1,8 per cent to 1,1 per cent of gross domestic product. More importantly, however, the low current account surplus in the third quarter of 1992 was the result of the severe drought, which led to a sharp drop in agricultural exports and a substantial rise in the imports of agricultural products. If agricultural imports and exports are excluded from the current account, the adjusted surplus (after seasonal adjustment and at an annualised rate) receded only slightly from R4,8 billion to R4,3 billion from the second to the third quarter of 1992.

Imports and exports of agricultural products



Balance of payments



The substantial decrease in the surplus on current account was therefore to a large extent caused by a sharp increase in the value of merchandise imports combined with a marginal decline in the value of merchandise exports. After having declined in the second quarter of 1992, net service and transfer payments to non-residents also rose considerably in the third quarter of 1992. These negative effects on the current account balance outweighed an increase in the value of net gold exports.

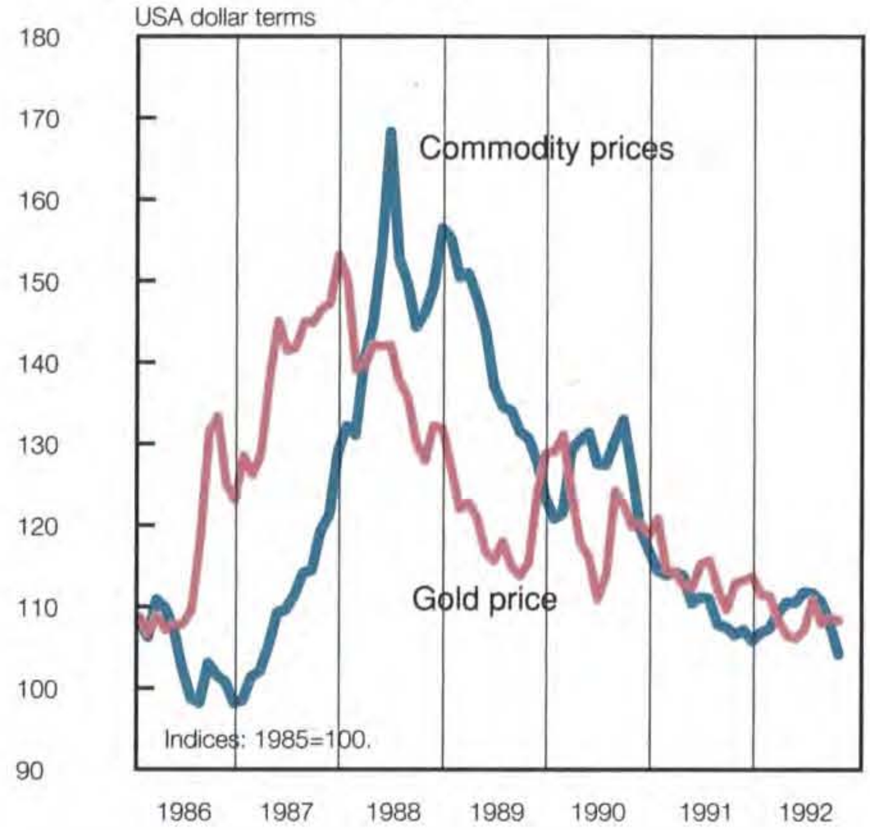
The value of *merchandise imports* increased from a seasonally adjusted and annualised rate of R49,1 billion in the second quarter of 1992 to R54,8 billion in the third quarter, or by 11½ per cent. Higher international oil prices, moderate rises in the prices of other imported goods and a decline of 1 per cent in the nominal average effective exchange rate of the rand caused the prices of merchandise imports to increase by 4 per cent in the third quarter of 1992.

Import volumes rose by some 7½ per cent from the second to the third quarter of 1992, mainly reflecting higher agricultural imports necessitated by the drought. Total agricultural imports increased from a seasonally adjusted and annualised rate of R2,9 billion in the first quarter of 1992 to R4,5 billion in the second quarter and R5,3 billion in the third quarter. For the first time since the drought of 1983 South Africa became a net importer of agricultural products in the third quarter of 1992; in the previous three years net agricultural exports averaged R2,0 billion per year. On top of the high agricultural imports, higher volumes of mineral imports and the importation of aircraft added to the total merchandise import bill. The import penetration ratio (i.e. real merchandise imports to gross domestic expenditure) therefore rose from 23,5 per cent in the second quarter of 1992 to 25,8 per cent in the third quarter.

Merchandise exports in the third quarter of 1992 were seriously affected by a decline in the exports of agricultural products from a seasonally adjusted and annualised rate of R5,7 billion in the second quarter of 1992 to R4,7 billion in the third quarter. In addition, the exports of mineral products also dropped sharply. These decreases were, however, largely offset by increases in the exports of textiles, machinery and electrical equipment, and transport equipment. Weaker international commodity prices in the third quarter of 1992 led to a decline of some 2 per cent in export prices. Export volumes rose by only 1½ per cent, with the result that the value of merchandise exports contracted slightly.

After having declined substantially from R21,2 billion in the fourth quarter of 1991 to R16,0 billion in the second quarter of 1992, the value of *net gold exports* (seasonally adjusted and annualised) recovered again to R20,4 billion in the third quarter. This increase of 27½ per cent was entirely due to a sharp increase in the physical volume of gold exports owing to a substantial running-down of inventories stockpiled over the preceding quarters. The rand price of gold per fine ounce receded slightly from R964 in the second quarter of 1992 to R962 in the third quarter, although the dollar fixing price of gold improved from $339 to $347 per fine ounce over the same period. The gold price rose only slightly from $346 per fine ounce on 15 September 1992 to $350 on 17 September during the exchange rate crisis in Europe and fell again to under $340 when the dollar started to appreciate, confirming once again that at this stage gold no longer serves as a safe investment haven in times of uncertainty.

Gold and commodity prices



Net *service and transfer payments* to non-residents (seasonally adjusted and annualised), which had improved from R10,7 billion in the first quarter of 1992 to R10,3 billion in the second quarter, amounted to R11,0 billion in the third quarter. The higher deficit on the services account was due to a decrease in service receipts on account of significantly lower receipts from foreign tourists travelling in South Africa, probably because of the political situation. Higher imports, on the other hand, contributed to higher freight and merchandise insurance payments.

Balance of payments on current account
Seasonally adjusted annual rates

R billions

	1991					1992		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	41,8	45,9	48,6	47,3	45,9	47,6	49,4	49,1
Net gold exports	17,3	20,0	20,1	21,2	19,6	18,1	16,0	20,4
Merchandise imports	–47,5	–50,2	–49,1	–45,9	–48,2	–50,5	–49,1	–54,8
Net service and transfer payments	–10,1	–9,5	–9,9	–10,3	–9,9	–10,7	–10,3	–11,0
Balance on current account	**1,5**	**6,2**	**9,7**	**12,3**	**7,4**	**4,5**	**6,0**	**3,7**

Capital account

The *net outflow of capital* not related to reserves contracted to R1,0 billion in the third quarter of 1992 from R1,9 billion in the preceding quarter. This brought the total net outflow for the first nine months of 1992 to R2,9 billion, compared with R1,4 billion in the corresponding period in 1991 and R6,1 billion in 1991 as a whole.

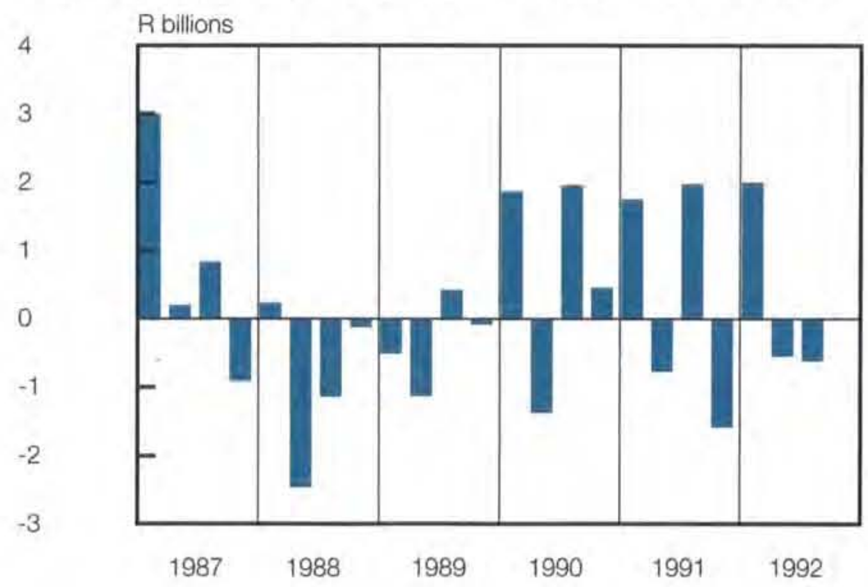
This outflow of funds from the country took place largely in *short-term capital* (including unrecorded transactions in the current and capital account), which registered a net outflow of nearly R0,7 billion in the third quarter of 1992; in the second quarter of 1992 the net outflow of short-term capital came to R1,8 billion. Part of the outflow of short-term capital in the third quarter of 1992 could be ascribed to the repayment of about R500 million on debt in terms of the Third Interim Debt Arrangements with foreign creditor banks. A considerable switching from foreign to domestic trade financing also took place in the third quarter of 1992, probably because of the relatively favourable costs of domestic credit. The sharp appreciation of the US dollar in international exchange markets also caused an outflow of short-term capital via forward cover in third currencies by South African organisations.

The net outflow of *long-term capital*, which had receded gradually from R1,4 billion in the third quarter of 1991 to only R37 million in the second quarter of 1992, increased again to R0,3 billion in the third quarter. An outflow of long-term capital from public corporations and public authorities, reflecting mainly the redemption of bearer bonds and notes falling due and repayments on debt guaranteed by agencies of foreign governments, was partly neutralised by a small net inflow of long-term capital to the private non-monetary sector.

Foreign reserves

As a result of the small surplus on current account and the further net outflow of capital not related to reserves, the total *net gold and other foreign reserves* of the country fell by R597 million in the third quarter of 1992. In the first nine months of 1992 the total net reserves, however, still increased by R0,8 billion, compared with R1,4 billion in 1991 and R2,9 billion in 1990. The net gold and other foreign reserves of the Reserve Bank rose by R275 million in October 1992.

Changes in net gold and other foreign reserves



Net capital movements (not related to reserves)

R millions

	1991					1992		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Long-term capital								
Public authorities	–167	116	–398	346	–103	941	303	–133
Public corporations	188	345	–183	–20	330	55	540	–227
Private sector	–604	–787	–774	–768	–2 933	–1 283	–880	48
Total long-term capital	–583	–326	–1 355	–442	–2 706	–287	–37	–312
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	1 362	–1 748	1 258	–4 217	–3 345	266	–1 832	–650
Total capital movements, excluding liabilities related to reserves	**779**	**–2074**	**–97**	**–4 659**	**–6 051**	**–21**	**–1 869**	**–962**

South Africa's *gross gold and other foreign reserves* continued to increase during July and August 1992 and amounted to R13,2 billion at the end of August 1992, sharply up from the R9,8 billion recorded at the end of 1991. In September 1992, however, the total gross reserves dropped again to R12,5 billion, which is equivalent to just more than 8 weeks' imports of goods and services. The gross gold and other foreign reserves of the South African Reserve Bank rose again by R0,3 billion in October 1992.

Exchange rates

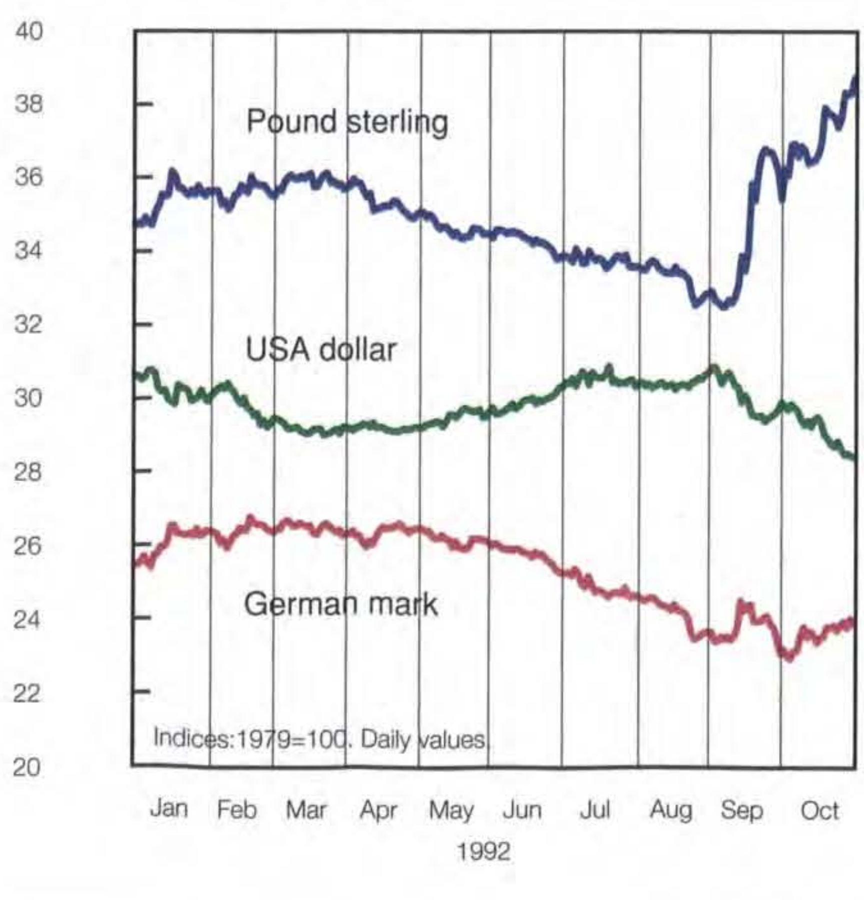
The *foreign exchange markets* in the third quarter and October 1992 were dominated by events which came to a head on 16 September 1992, generally referred to as the ERM crisis (i.e. the European Exchange Rate Mechanism crisis). The British pound and Italian lira started to depreciate from the end of August 1992 towards their lower limits within the European Exchange Rate Mechanism amid growing tension in European foreign exchange markets. Massive intervention by the Bank of England and other European central banks as well as a last attempt to reverse market sentiment by increasing Bank rate from 10 to 15 per cent, failed to prevent the withdrawal of the pound, together with the lira, from the Exchange Rate Mechanism. This was followed by a sharp depreciation of both these currencies in foreign exchange markets.

The *rand* was not immune to these developments in Western Europe and the weakening of the British pound resulted in an overnight appreciation of the rand against sterling of more than 5 per cent on 16 September 1992. Subsequently, the rand appreciated further by 8,8 per cent against the pound until 20 November 1992. The rand also appreciated substantially against the Italian lira, but depreciated against all the other main currencies over this same period.

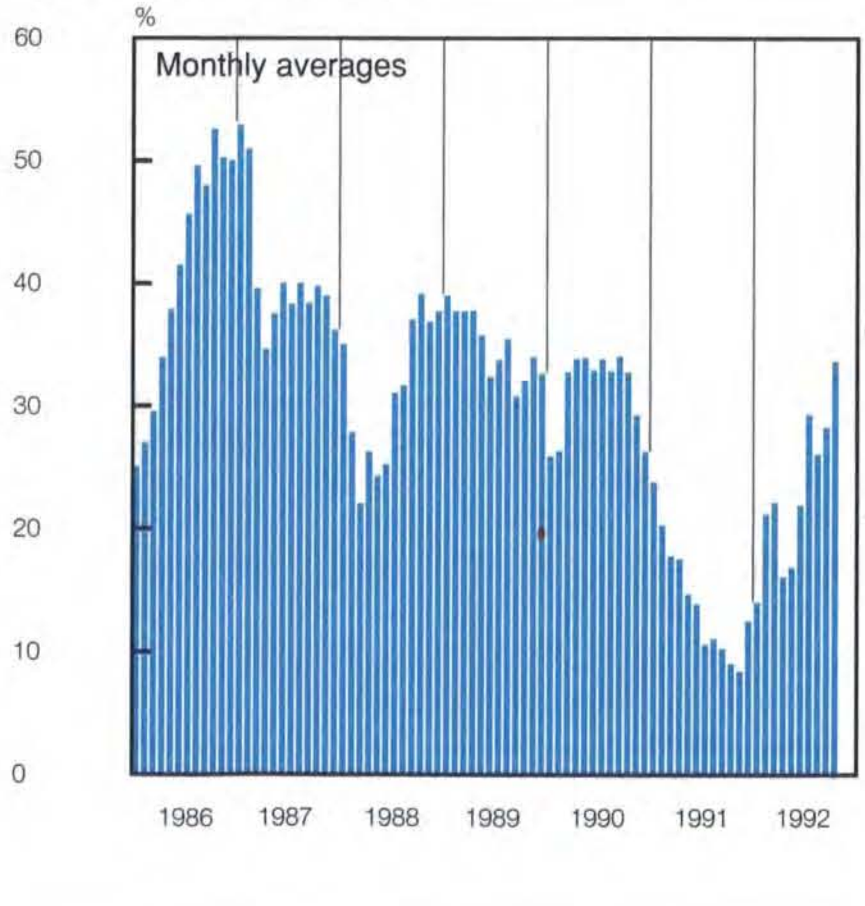
The net result of these exchange rate movements was a decline of 2,1 per cent in the *nominal effective exchange rate* of the rand from the end of June 1992 to 20 November 1992. The effective exchange rate of the rand also showed a higher degree of volatility in August and September 1992 with a margin of 2 per cent between its minimum and maximum values, compared with an average monthly margin of 0,8 per cent in the preceding seven months of the year. On 20 November 1992 the nominal effective exchange rate of the rand was 3,2 per cent below its level at the end of 1991.

The moderate decline in the nominal effective exchange rate of the rand in the first seven months of 1992 was smaller than the inflation differential between South Africa and its main trading partners, with the result that the real effective exchange rate of the rand increased by 1,7 per cent from the beginning of the year until July 1992. In the next two months, however, the real effective exchange rate of the rand declined again by ½ per cent.

Exchange rates of the rand



Financial rand discount



The financial rand fluctuated sharply during the first eleven months of 1992 and depreciated, on balance, by more than 36 per cent from the end of 1991 to 20 November 1992. The exchange rate of the financial rand was especially affected by the suspension of the negotiating process in Codesa and the instigation of mass actions, the events at Boipatong on 17 June, the Bisho incident on 7 September and speculation based on rumours that the acquisition of foreign companies by South African organisations would increase the supply of financial rand significantly. The speculation against the financial rand also coincided with the uncertain conditions in the European foreign exchange markets. As a result of all these developments, the financial rand discount has fluctuated widely from the beginning of 1992, varying between 12 and 41 per cent.

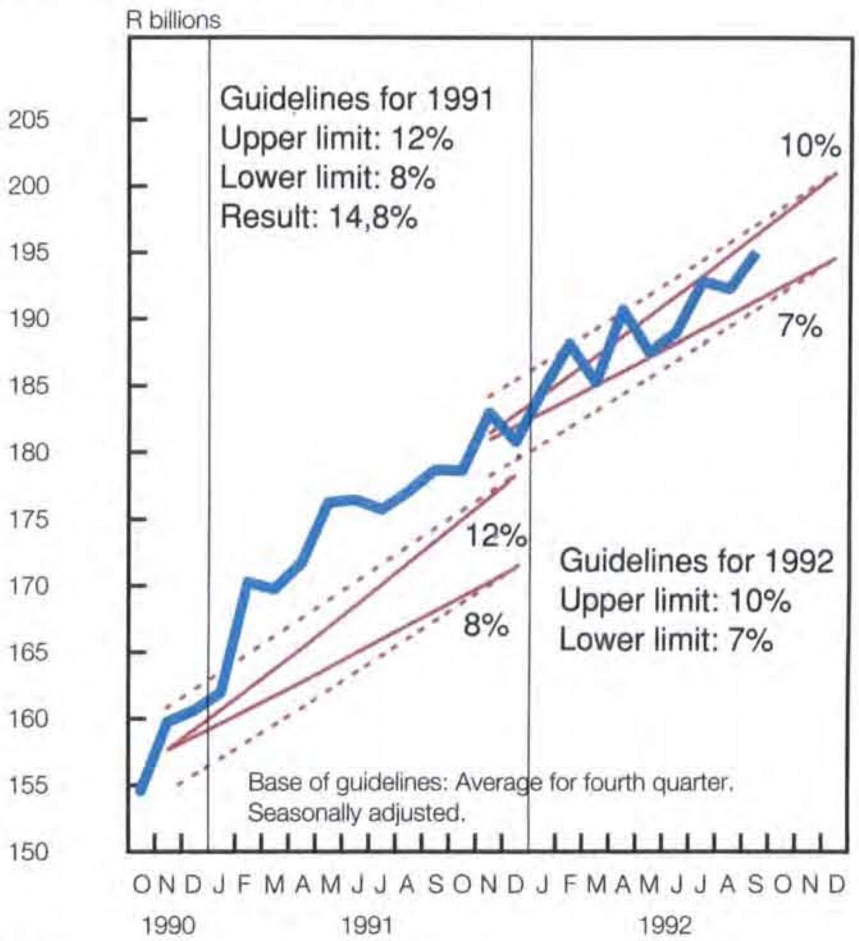
Financial markets

Money supply

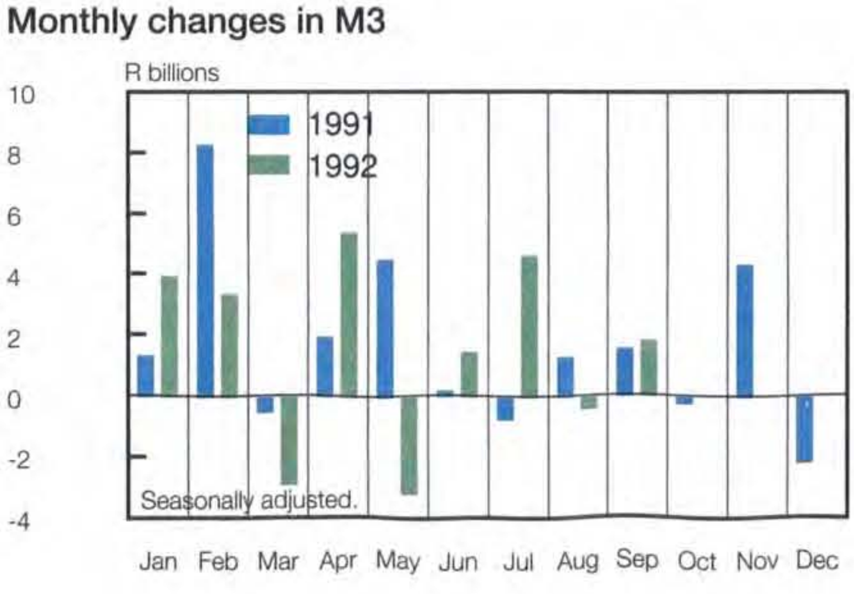
Reflecting the generally depressed real economic conditions combined with a fairly restrictive monetary policy stance, the growth rates of the major monetary aggregates decreased further during the first nine months of 1992. In certain months, however, erratic changes in deposits brought about by the new regulations and statistical returns introduced in February 1991, caused wide fluctuations in the twelve-month growth rates of monetary aggregates. Growth in the narrower monetary aggregates, in particular,

Money supply

Guidelines for growth in M3



Monthly changes in M3



fluctuated quite sharply, but even the broadly defined money supply showed quite a volatile growth pattern. The income velocity of broadly defined money supply, however, remained fairly stable in the first three quarters of 1992.

The twelve-month rate of increase in the *broadly defined money supply* (M3) receded from 12,7 per cent in December 1991 to 10,6 per cent in February 1992 and 7,1 per cent in May before rising again to 8,7 per cent in September 1992. The growth in the quarterly average value of M3 (seasonally adjusted) also contracted from an annualised rate of increase of 8,5 per cent in the fourth quarter of 1991 to 7,0 per cent in the second quarter of 1992, and then increased again to 8,7 per cent in the third quarter.

Although most of the monthly growth rates in M3 during the first nine months were well within the *guideline range* for the growth in M3 of between 7 and 10 per cent from the fourth quarter of 1991 to the fourth quarter of 1992, sharp fluctuations at times caused some of the monthly growth rates to move above the upper limit for the guideline year. The rate of increase in M3 as measured for guideline purposes, amounted to 9,3 per cent (seasonally adjusted and annualised) from the fourth quarter of 1991 to September 1992.

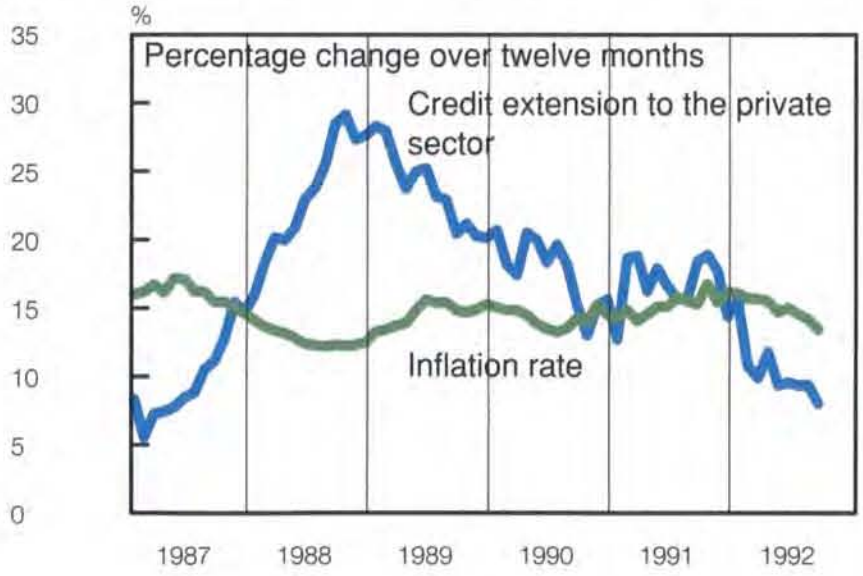
The rates of increase in the *narrower monetary aggregates* displayed sharp fluctuations during the first nine months of 1992. The rates of increase in M1 and M2 over periods of twelve months fluctuated but tended downwards from 14,8 and 16,1 per cent in December 1991 to 6,6 and 11,3 per cent, respectively, in May 1992, but then rose again to 23,2 and 12,8 per cent in September. The corresponding growth rate of M1A decreased from 17,7 per cent in December 1991 to 8,1 per cent in May 1992; reverted to 18,6 per cent in June, decreased to 10,3 per cent in August and increased again to 23,6 per cent in September 1992. The rising trend in the narrower monetary aggregates reflected a shift from longer-term to shorter-term deposits with deposit-taking institutions mainly because of more favourable interest rates offered by these institutions on deposits with a shorter maturity, based on expectations of a general decline in interest rates.

In a *statistical or accounting sense* the main counterpart to the R12,1 billion rise in M3 during the first nine months of 1992 was a R10,3 billion increase in the claims of monetary institutions on the private sector. An increase of R0,8 billion in the net gold and other foreign reserves, and a rise in net other assets and liabilities to the amount of R1,6 billion, were countered to some extent by a small decline of R0,6 billion in the monetary institutions' net claims on the government sector.

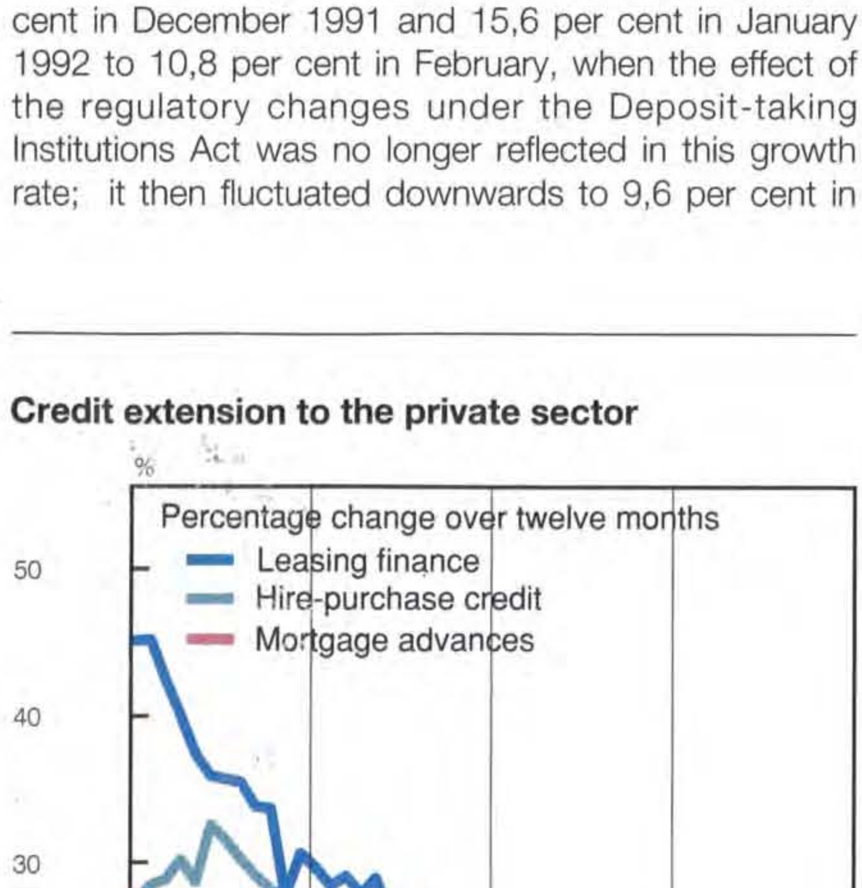
Credit extension by monetary institutions

The underlying growth in credit extended by monetary institutions to the domestic *private sector* during the first nine months of 1992 remained well below the rate of inflation as measured by changes in the consumer price index. The twelve-month growth rate in credit extended to the private sector fell back from 14,5 per cent in December 1991 and 15,6 per cent in January 1992 to 10,8 per cent in February, when the effect of the regulatory changes under the Deposit-taking Institutions Act was no longer reflected in this growth rate; it then fluctuated downwards to 9,6 per cent in

Credit extension and inflation rate



Credit extension to the private sector



June and to 8,6 per cent in September. This low growth in credit extended could mainly be attributed to a low demand for credit because of the depressed economic conditions, decelerating inflation and the relatively high cost of borrowing. Some monetary institutions also became less accommodating in providing credit to certain customers in the process of active credit risk management.

The lower growth in credit extension was mainly due to a contraction in the growth in hire-purchase credit and so-called "other loans and advances". The rate of increase in *hire-purchase credit* over periods of twelve months decelerated from 6,7 per cent in December 1991 to only 1,3 per cent in June 1992 before rising again to a still low 2,3 per cent in September. The rate of increase over twelve months in *"other loans and advances"* (mainly overdrafts) similarly receded from 12,6 per cent in December 1991 to 1,5 per cent in June 1992 and to a negative 0,7 per cent in September.

In contrast to these developments, the twelve-month growth rate in *mortgage advances* by deposit-taking institutions contracted only slightly from 18,0 per cent in December 1991 to 17,2 per cent in June 1992 and further to 16,9 per cent in September 1992. The sustained relatively high rates of increase in this type of credit could be ascribed to relatively lower interest rates and cash-flow advantages, as well as to the fact that deposit-taking institutions actively promoted mortgage lending because of lower capital requirements. The demand for *leasing finance* also remained buoyant during 1992 and such advances increased by 15,4 per cent between September 1991 and September 1992.

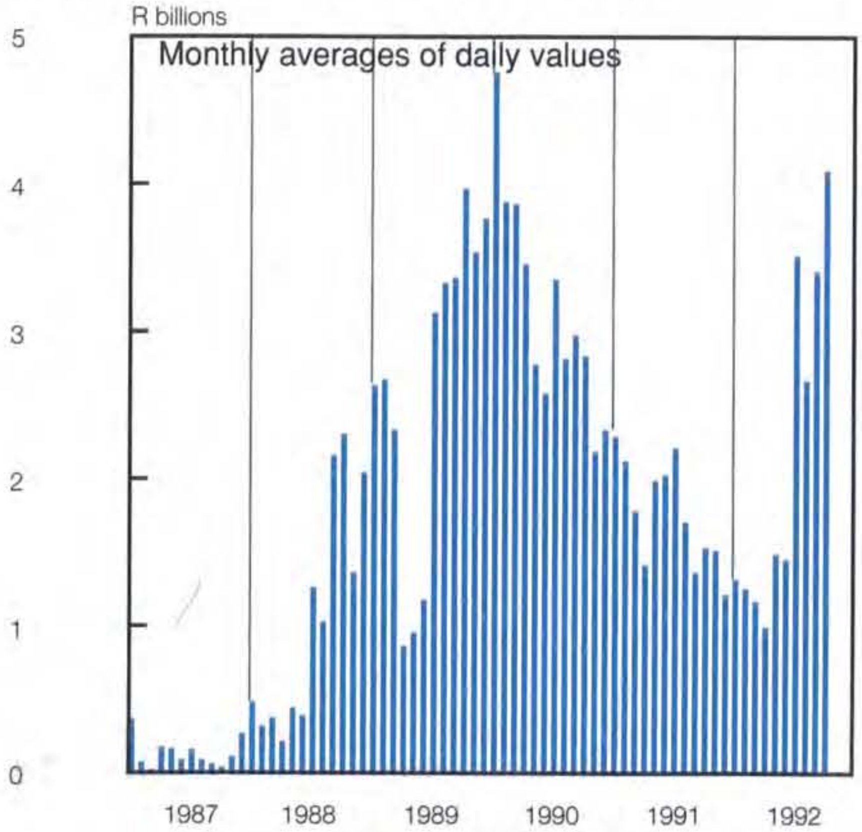
After having decreased by R2,1 billion in the first half of 1992, the net claims on the *government sector* of monetary institutions increased by R1,5 billion in the third quarter of 1992. This increase was mainly the result of a R0,9 billion decline in net government deposits with the Reserve Bank; that is after taking account of the balance of R3,8 billion on the Stabilisation Account which was transferred to the Reserve Bank in partial settlement of the deficits incurred on the Gold and Foreign Exchange Contingency Reserve Account.

Despite this rise in net credit to the government sector, the twelve-month rate of increase in *total domestic credit extension* remained at a low level of 8,5 per cent in September 1992, compared with 8,4 per cent in June 1992 and 21,1 per cent in October 1991.

Money market conditions and Reserve Bank operations in the money market

Money market conditions, which had been relatively easy during the first four months of 1992, subsequently tightened significantly. At first the average daily *level of accommodation* at the discount window declined slightly from R1,2 billion in December 1991 to R1,0 billion in April 1992, but then increased sharply to R1,5 billion in June and R4,1 billion in October. The amount of accommodation at month-ends decreased from R2,8 billion in December 1991 to R1,2 billion in February 1992; it then increased sharply to R4,8 billion in September and to R4,7 billion in October 1992.

Accommodation at the discount window



With this tightening in the money market, the financial instruments utilised by deposit-taking institutions for taking up accommodation at the discount window changed markedly. Under the relatively easy money market conditions in the first four months of 1992, deposit-taking institutions used mainly Treasury and Land Bank bills for this purpose. In the next six months, with tighter money market conditions, greater use was made of bankers' acceptances for accommodation at the discount window.

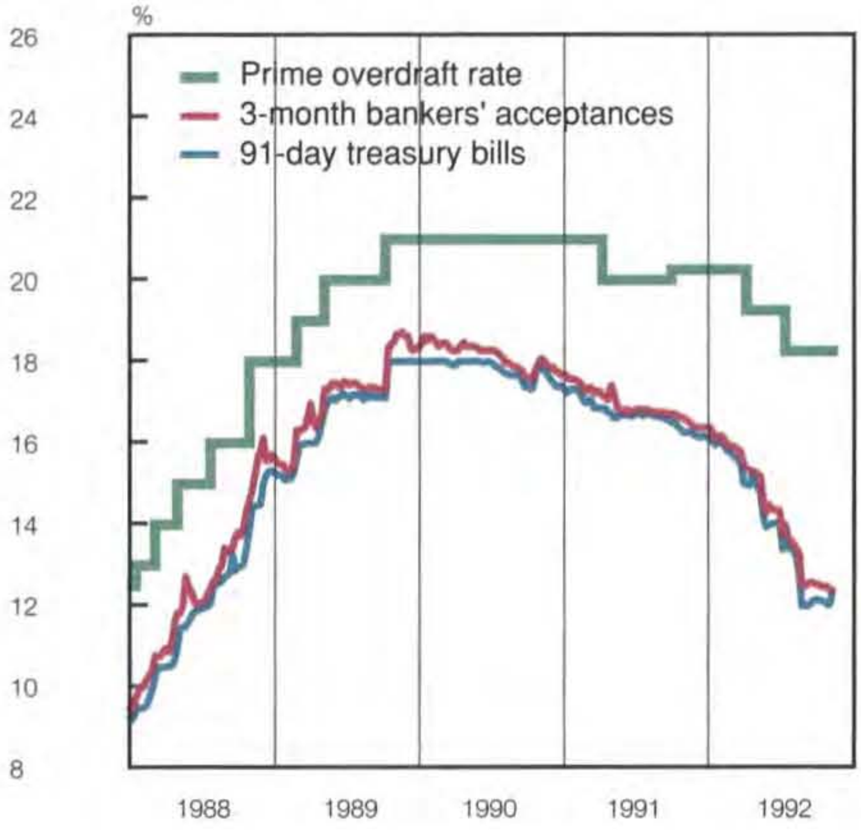
The tighter money market conditions in the period from May to October 1992 were mainly due to an increase of R2,8 billion in government deposits with the Reserve Bank and a decrease in the gold and other foreign reserves of the Reserve Bank of R0,3 billion. Notes in circulation increased over this period by R0,6 billion. The introduction of an additional cash reserve requirement of 1 per cent from 21 July 1992 absorbed more than R1,0 billion from the market and an additional R0,5 billion was drained from the market by the issuing of Reserve Bank bills. This tightening of the market was partly offset by purchases of Land Bank promissory notes by the Reserve Bank and the Corporation for Public Deposits to the value of R1,4 billion.

The *Reserve Bank's actions* in the money market during the first ten months of 1992 were initially aimed at neutralising excess liquidity by means of foreign exchange intervention swaps with major deposit-taking institutions, the issuing of special short-dated Treasury and Reserve Bank bills, and increasing the cash reserve requirement on deposit-taking institutions' short-term liabilities to the public. However, in July 1992 the Reserve Bank eased money market conditions by allowing deposit-taking institutions to place special foreign-exchange deposits with the Bank to the amount of R0,7 billion and by entering into repurchase agreements on behalf of the Corporation for Public Deposits to a peak outstanding amount of R1,0 billion. All these agreements were terminated on 3 August 1992. In October 1992 the Reserve Bank again entered into repurchase agreements to a peak outstanding amount of R0,5 billion.

The Reserve Bank's transactions in *government stock* increased markedly in 1992 in an attempt to support the development of this market in bullish and very active trading conditions. *Gross* sales of government stock by the Bank in the first ten months of 1992 came to no less than R95,5 billion, against R29,4 billion in 1991 as a whole. *Net* sales of government stock amounted to R13,7 billion from January to October 1992.

The amount of three-month *Treasury bills* on offer at the weekly tender was reduced on 20 March 1992 from R200 million to R100 million, and new categories of six- and nine-month Treasury bills were introduced with weekly offers of R50 million each. On 3 April 1992 the weekly offers of both these last-mentioned two categories of Treasury bills were increased to R100 million, with the result that the total weekly issuance of Treasury bills amounted to R300 million. From 5 June 1992 the Bank issued only Treasury bills for three and six months, to the amount of R150 million each. As from 25 September 1992 the weekly offer of three-month Treasury bills was increased to R200 million and the amount of the six-month bills on offer was lowered to R50 million.

Short-term interest rates



Money market interest rates

The gradual decline in *money market interest rates* since early 1990 gathered momentum in the first ten months of 1992. This was clearly reflected in the rate on three-month liquid bankers' acceptances, which declined from 18,70 per cent in January 1990 to 16,40 per cent in December 1991 and then more rapidly to 12,40 per cent at the end of October 1992, and to 12,00 per cent after the reduction in Bank rate on 18 November. However, most other money market interest rates also softened sharply in the first eleven months of 1992. For instance, the predominant rate for interbank call money of clearing banks decreased from 16,00 per cent at the end of 1991 to 12,75 per cent at the end of October 1992 and 11,50 per cent on 18 November 1992. The three-month Treasury bill tender rate declined even more steeply from 16,13 per cent to 12,02 and 12,16 per cent, or by 3,97 percentage points, over the same period.

Changes in the *prime lending rate* of deposit-taking institutions followed the changes in Bank rate and the prime lending rate was reduced by 1 percentage point to 19,25 per cent on 1 April 1992 and to 18,25 per cent on 6 July 1992. Some institutions in the last week of November 1992 and others from the beginning of December reduced their prime lending rates further to 17,25 per cent, following a lowering of Bank rate by one percentage point to 14 per cent on 18 November 1992. The inflation-adjusted prime lending rate fluctuated around 3,5 per cent during the first eight months of 1992 and then increased to 4,2 per cent in September because of the decline in the rate of inflation. At this level the real prime lending rate in South Africa was slightly higher than the most recent corresponding rates in Japan (3,1 per cent) and the United States of America (2,9 per cent), but well below the rates in Germany (9,7 per cent) and the United Kingdom (6,2 per cent).

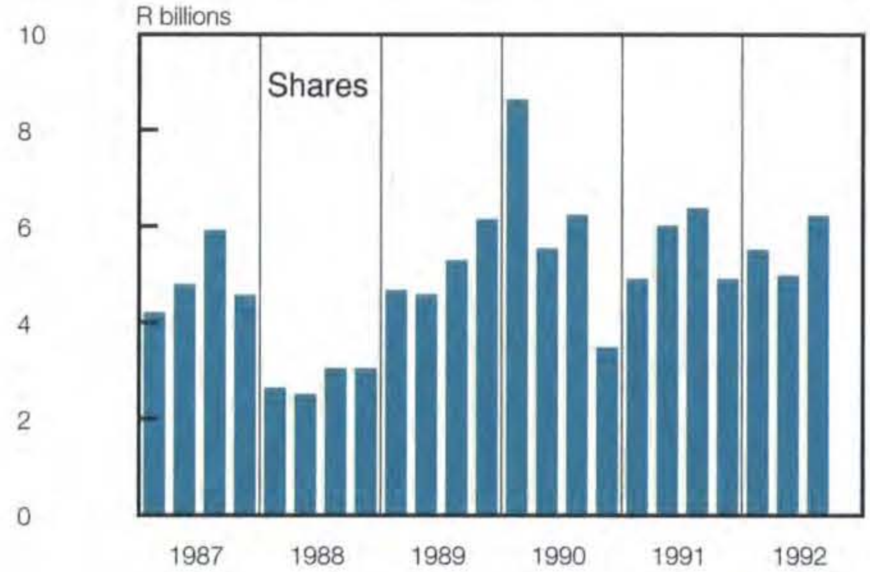
Capital market developments

Activity in the *secondary capital markets* remained buoyant in the first three quarters of 1992, but the underlying conditions in the markets started to change markedly in the third quarter. Worse than expected financial results of companies began reflecting the recessionary conditions and increased uncertainty created by political actions served to reverse positive market sentiment further. These developments, together with a weakening in share prices on international markets, resulted in a significant softening in share prices and a sharp rise in stock prices.

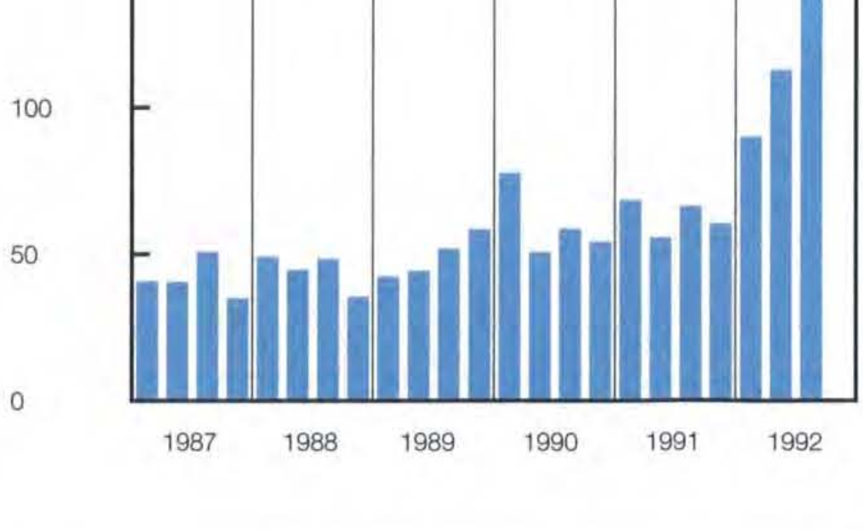
After having risen sharply to R89,5 billion and R112,3 billion in the first and the second quarter of 1992, the value of *public-sector stock* traded on the Johannesburg Stock Exchange rose to a new quarterly record level of R218,3 billion in the third quarter of 1992. The shift from equities to gilts, which had started in the first quarter of 1992, gathered momentum in the ensuing four months. Institutional investors continued to readjust their portfolios in favour of public-sector stock as share prices weakened and the yield on long-term stock softened. An all-time monthly high of R79,3 billion in transactions in public-sector stock in July 1992 was followed by a moderately lower average monthly level of R69,5 billion in August and September. With the firming of the yield on long-term stock in October, trading activity fell back further to R56,0 billion, which was still significantly higher than the average monthly level of R37,4 billion in the second quarter of 1992.

Net purchases of public-sector stock by *non-residents* decreased from R823 million in the first quarter of 1992 to R253 million in the second quarter and to only R7 million in the third quarter. In October 1992 non-residents were net sellers of public-sector stock to the amount of R359 million despite the markedly weaker financial rand. After having been net sellers of shares since the third quarter of 1988, non-residents became net purchasers of shares to an amount of R213 million in the third quarter of 1992 and R72 million in October 1992.

Stock exchange transactions



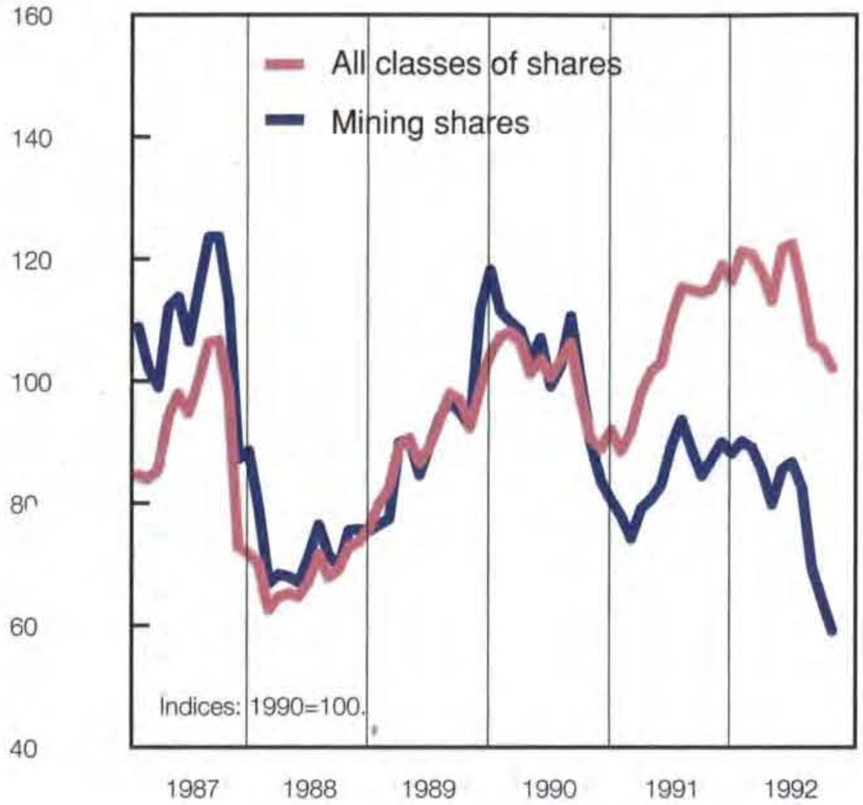
Stock exchange transactions



Reflecting an increasingly bearish sentiment, the value of *shares traded* on the Johannesburg Stock Exchange increased sharply in the third quarter of 1992. The turnover of shares, which had dropped from R5,5 billion in the first quarter of 1992 to R5,0 billion in the second quarter, rose again to R6,2 billion in the third quarter. This increase was due mainly to a rise in the number of blue-chip shares traded and the amendment to the Stock Exchanges Control Act in July 1992, which allows bear sales at the last recorded selling price. In October 1992 the value of shares traded receded to R1,8 billion from the average monthly value of R2,1 billion in the preceding three months.

Share prices reached a record monthly average peak in June 1992, but then dropped sharply in the following four months: the average monthly price level of all classes of shares fell by 16,7 per cent over these four months. Uncertainty on the local equity market arising from disappointing corporate financial results, sharp corrections in the prices of certain blue-chip shares quoted on international markets, and the deepening of the recession, were exacerbated by mass actions and domestic internal unrest and increasing turbulence on international equity and currency markets. These factors led to a sharp weakening in the prices of mining shares in particular, but also in the prices of industrial, commercial and financial shares. The prices of banking and insurance shares, on the other hand, declined only slightly.

Share prices



In the *primary capital markets*, the favourable borrowing climate during the second quarter of 1992 facilitated a high level of net borrowing by the *public sector* through issues of fixed-interest securities, which came to R9,8 billion. Since the largest part of the estimated public-sector borrowing requirement had been met in the first fiscal quarter, the value of net new borrowing fell back to R1,2 billion in July 1992 and the redemption of stock led to a net repayment of R1,3 billion in August and R0,9 billion in September.

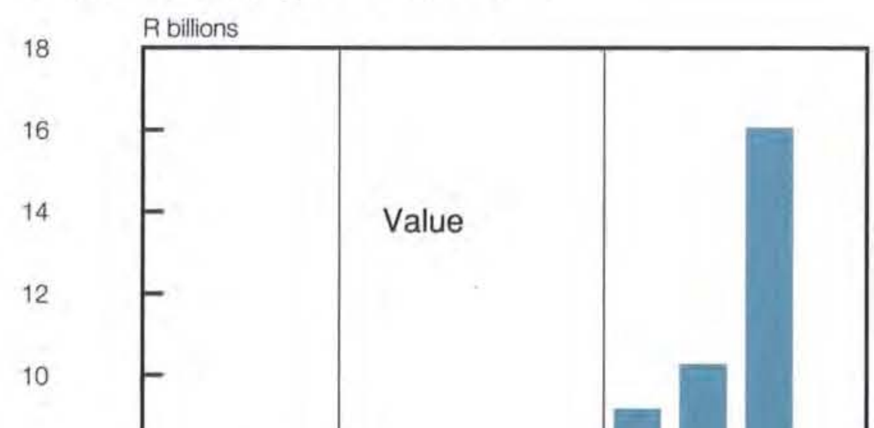
The value of new issues of fixed-interest securities (including convertible preference shares and debentures) by listed *private-sector* companies decreased from R1,4 billion in the first quarter of 1992 to R0,4 billion in the second quarter. The protracted recession, an improved borrowing climate and the subsequent decline in share prices adversely affected share capital issues from March 1992 onwards. The value of new issues of ordinary shares by listed private-sector companies therefore also decreased from R2,9 billion in the first quarter of 1992 to R0,1 billion in the second quarter and to only R11 million in the third quarter. None the less, the high prices of shares in the banking and insurance sector continued to favour share capital issues by companies in this sector and in October 1992 a major bank announced that it would be increasing capital by means of a R650 million rights issue.

In the *mortgage market* the average net amount of mortgage advances paid out monthly by deposit-taking institutions and mutual building societies amounted to R0,9 billion in the first nine months of 1992. The total holdings of mortgage loans by these institutions consequently increased from R67,3 billion in January 1992 to R75,0 billion in September. As already indicated, the continued increase in mortgage holdings in an increasingly depressed real estate market could be attributed to reductions in bond rates and the aggressive marketing of mortgage finance which is not necessarily earmarked for real estate purposes only. Deposit-taking institutions have promoted mortgage finance because of the lower capital requirements attached to such loans and the opportunity they provide for marketing a wide variety of banking services.

The value of *real estate transactions* contracted from R7,1 billion and R6,1 billion in the first two quarters of 1992 to R5,9 billion in the third quarter. The average number of transactions in fixed property fell back by 18 per cent in the first nine months of 1992 compared with the corresponding period in the preceding year, while the average value of property transactions rose by nearly 6,5 per cent to R131 000.

Activity in the *derivative markets* increased considerably throughout the first three quarters of 1992. The value of transactions in *futures contracts* rose from a quarterly average of R5,8 billion in 1991 to an average of R11,7 billion in the first nine months of 1992. Increased share price volatility and uncertainty arising from political actions led to successive record transaction levels of R9,1 billion, R10,2 billion and R15,9 billion in the first three quarters of 1992,

Futures exchange transactions



respectively. The high average monthly transaction level of R5,3 billion in the third quarter of 1992 then contracted only moderately to R4,9 billion in October 1992. Trade in options on futures contracts commenced on the South African Futures Exchange on 16 October 1992. In the two weeks to the end of October 1992, 4 100 contracts with an underlying value of R11,5 million were traded.

The low activity on the Johannesburg Stock Exchange's *Traded Options Market* in the second quarter of 1992 was followed by somewhat increased activity in the third quarter. Although 2 276 contracts with an underlying value of R9,2 million were traded in the third quarter of 1992, this still represented only 0,15 per cent of the value of listed shares traded in this quarter. Moreover, the share options traded started to decline again from the end of September and in October only 146 contracts with an underlying value of R715 350 were traded. In the bond market, on the other hand, gilt options were heavily traded throughout the third quarter of 1992, mainly because of divergent yield expectations and the large volume of transactions in the spot market.

Capital market yields and interest rates

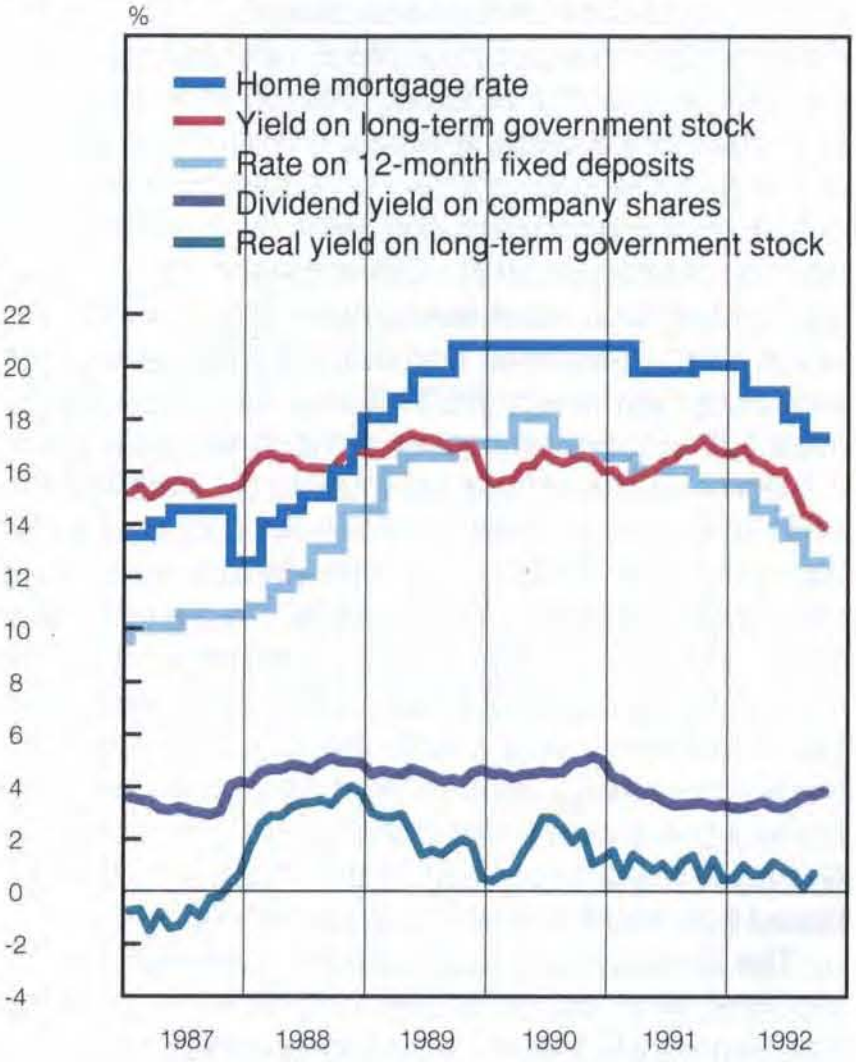
The monthly average *yield on long-term government stock*, which had eased gradually from a peak of 17,2 per cent in October 1991 to 16,9 per cent in February 1992, declined more rapidly to 13,9 per cent in October 1992 - its lowest level since March 1984. This decrease in long rates reflected a softening in short rates, expected lower inflation rates, a weaker than expected real economy and the lowering of Bank rate. It was also accompanied by an improved marketability, which caused the yield on government stock to move 0,17 percentage points below Eskom stock in October 1992; the yield on government stock in February 1992 was 0,49 percentage points higher than Eskom stock. The yield on long-term government stock, however, subsequently hardened from 13,76 per cent on 1 October to 14,57 per cent on 17 November 1992.

The monthly average *real yield on government stock* also softened from 0,9 per cent in February 1992 to 0,1 per cent in August, but then firmed again to 1,9 per cent in October as a result of a significant decrease in the measured inflation rate.

The deposit-taking institutions' *predominant mortgage bond rate* was reduced gradually during the first ten months of 1992 based on expected reductions of Bank rate and the attempt to capture as large a segment of the stagnating lending market as possible. The home mortgage rate was first reduced from 20 per cent by 1,0 percentage point with effect from 2 March 1992 and later by another 1,0 percentage point with effect from 1 July 1992. This rate was lowered further to 17,25 per cent from 1 September 1992 and to 16,75 per cent from 1 December 1992.

Deposit-taking institutions also lowered their longer-term deposit rates further during the first ten months of 1992. The *twelve-month deposit rate* was reduced in four steps from 15,5 per cent in March 1992 to 12,5 per cent in October 1992. Since these reductions exceeded decreases in the prime lending rate, the margin between the prime rate and the rate on twelve-month deposits widened from 4,75 per cent in March 1992 to 5,75 per cent in October. The twelve-month deposit rate provided depositors with a positive before-tax real yield of 0,68 per cent in October 1992.

Capital market interest rates and yields



The significant decline in the average level of share prices from July to October 1992 resulted in a firming of the *dividend yield* from 3,15 per cent in June to 3,76 per cent in October. The *earnings yield* on all classes of shares (excluding gold-mining shares) also rose from 7,28 per cent to 8,35 per cent over the same period, despite the continued weakening of financial results of listed companies in most sectors of the economy.

After having remained unchanged since 27 July 1990, the maximum permissible *finance charges rates*, as determined by the Usury Act, were reduced with effect from 29 May 1992 from 29 to 28 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 (but not exceeding R500 000), and from 32 to 31 per cent in respect of amounts of up to R6 000.

Public finance

Public-sector borrowing requirement

Fiscal policy turned out to be more expansionary during the first six months of fiscal 1992/93 than originally intended. This is clearly reflected in the further increase in the *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated Central Government, provincial administrations, local authorities and non-financial government enterprises and public corporations) from an already high level of R5,9 billion in the final quarter of fiscal 1991/92 (March quarter of 1992) and R5,9 billion in the first quarter of fiscal 1992/93, to R8,9 billion in the second quarter of fiscal 1992/93. As a ratio of gross domestic product, the public-sector borrowing requirement amounted to 9,0 per cent in the first half of fiscal 1992/93, compared with 3,6 per cent in the corresponding period of the preceding year. As shown in the accompanying graph, the ratio of the public-sector borrowing requirement to gross domestic product has shown a disturbingly rapid rise in the past two fiscal years, in contrast to the sharp decline in the period from fiscal 1986/87 to fiscal 1989/90.

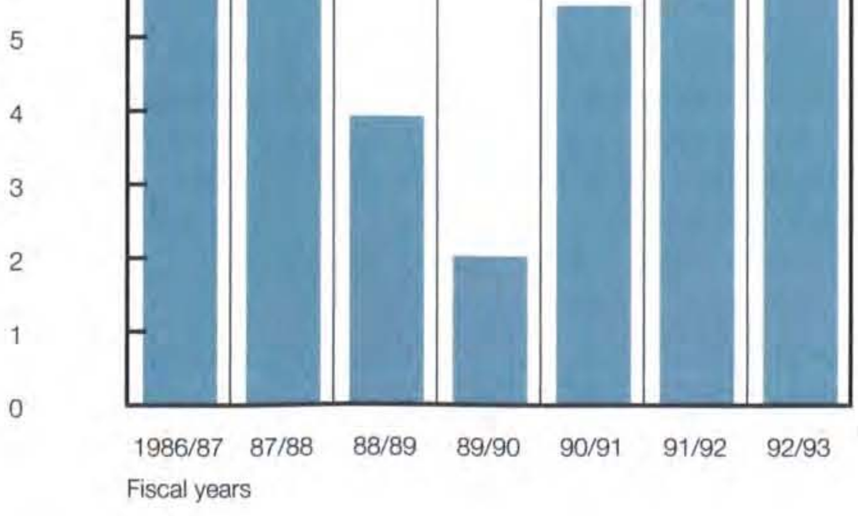
This deterioration in public finance took place in the income and expenditure patterns of *general government* (i.e. the consolidated accounts of Central Government, provincial administrations and local authorities). The general-government borrowing requirement amounted to R5,2 billion and R9,3 billion in the first two quarters of fiscal 1992/93. Excess capacity, rationalisation programmes and cutbacks in expenditure caused the borrowing requirement of the non-financial enterprises to decrease from a deficit of R0,8 billion in the first half of fiscal 1991/92 to R0,2 billion in the first half of fiscal 1992/93.

The larger deficit before borrowing and debt repayment of the general government took place despite the fact that the grants and income received by provincial administrations and local authorities exceeded their current and capital expenditure in the first half of fiscal 1992/93. The deterioration in the finances of general government was partly due to the fact that the consolidated surplus of extra-budgetary institutions, TBVC-countries and the self-governing states of R2,3 billion in the first half of fiscal 1991/92 declined to R0,5 billion in the first half of fiscal 1992/93. To a more important extent it was, however, caused by a substantial increase in the deficit before borrowing and debt repayment on the Main Budget because government expenditure was more or less in line with the budgeted amount while government revenue was well below target.

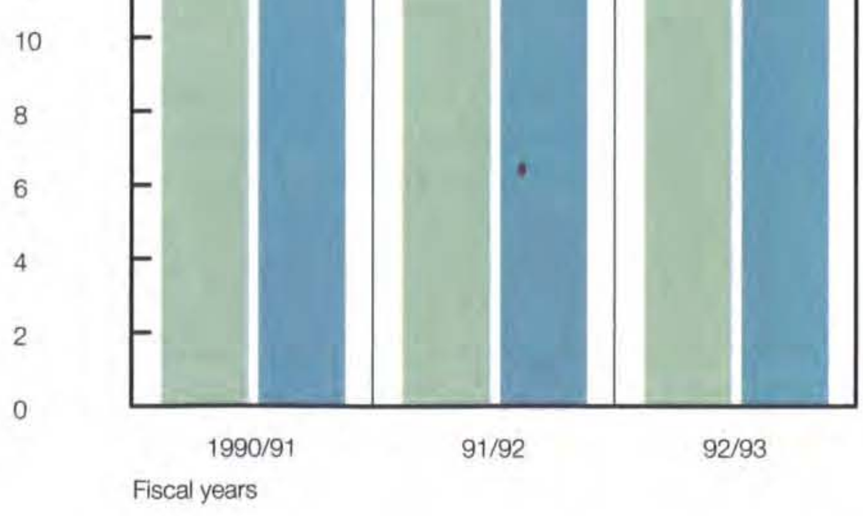
Exchequer Account

The year-on-year rate of increase in *Exchequer issues* (after the usual adjustment for changes in the balance on the Paymaster-General Account) accelerated sharply from 13,0 per cent in the first quarter of fiscal 1992/93 to 18,6 per cent in the second quarter. This brought the level of Exchequer issues in the first half of

Public-sector borrowing requirement as percentage of gross domestic product



Budgeted and actual Exchequer issues to government departments

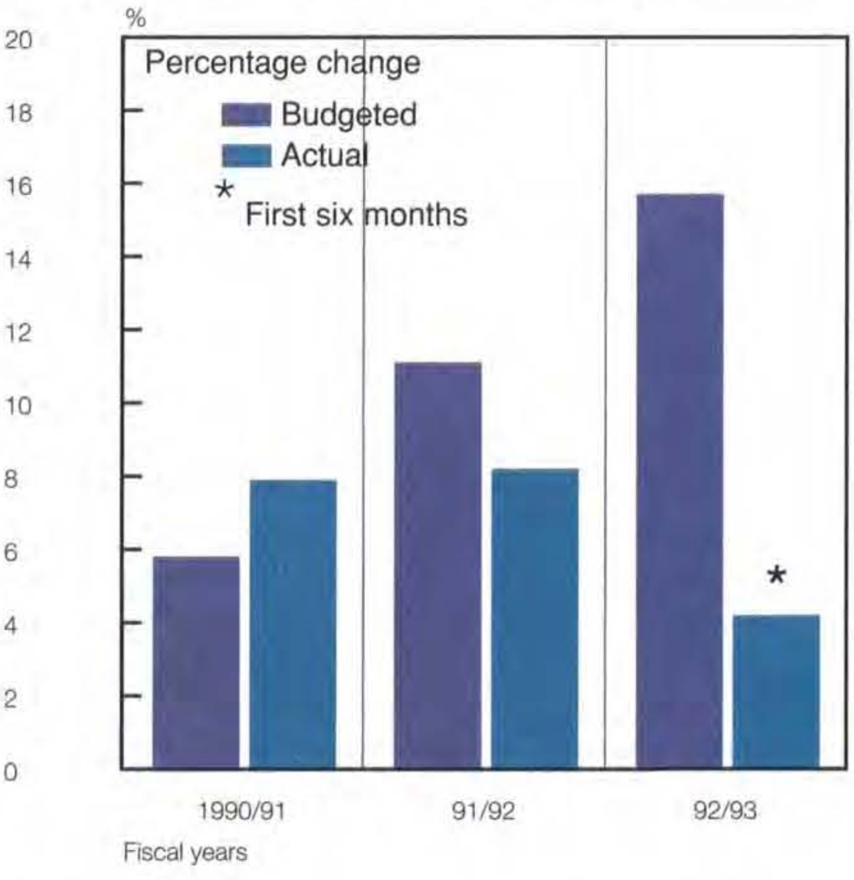


fiscal 1992/93 to 15,9 per cent above the level in the corresponding period in the preceding year - a rise which was more or less in line with the budgetary provision for an increase of 16,5 per cent for fiscal 1992/93 as a whole. This rate of increase in Exchequer issues during the six months to September 1992 was also below the average year-on-year rate of increase of 17,6 per cent in the corresponding period of the preceding five fiscal years. In October, however, Exchequer issues rose sharply, which brought the year-on-year rate of increase in these issues in the first seven months of fiscal 1992/93 to 19,6 per cent.

As a ratio of gross domestic product, Exchequer issues amounted to 31,1 per cent in the first half of fiscal 1992/93. This ratio was considerably higher than the ratio of 29,2 per cent in the first half of fiscal 1991/92, the 28,2 per cent in fiscal 1991/92 as a whole and an average ratio of 25,2 per cent in the 1980s.

The year-on-year rate of increase in *Exchequer receipts* (excluding proceeds from privatisation), which had decelerated from 16,5 per cent in the third quarter of fiscal 1991/92 to 8,3 per cent in the final quarter and to 8,9 per cent in the first quarter of fiscal 1992/93, fell back even further to the low level of only 1,0 per cent in the second quarter. The year-on-year rate of increase in Exchequer receipts for the first six months of fiscal 1992/93 therefore amounted to 4,2 per cent, against a budgeted increase of 15,7 per cent for the year as a whole and an average level of 18,1 per cent for the corresponding period in the preceding five fiscal years. As a ratio of gross domestic product, Exchequer

Budgeted and actual Exchequer receipts



receipts amounted to 22,9 per cent in the first six months of fiscal 1992/93, compared with 24,0 per cent in the first half of fiscal 1991/92 as well as for the year as a whole, and an average level of 22,1 per cent in the 1980s.

The substantial shortfall in Exchequer receipts in the first half of fiscal 1992/93 could to a large extent be ascribed to the prolonged and severe downturn in economic activity. This was clearly reflected in the proceeds from *value-added tax* in the first six months of fiscal 1992/93, which were no less than 12,0 per cent below the income from general sales tax in the first half of the preceding year. The actual proceeds from *value-added tax* amounted to R7,9 billion in the six months ended September 1992, compared with the budgeted amount of R21,0 billion for the fiscal year as a whole.

Income tax revenue also rose at a rate lower than budgeted, namely by 4,4 per cent in the first six months of fiscal 1992/93 against a budgeted figure of 16,9 per cent for the fiscal year as a whole. This disappointing growth in income tax revenue was mainly the result of a decrease over twelve months in tax collections from companies of 19 per cent in the first six months of fiscal 1992/93, compared with an increase of 5,4 per cent projected in the Budget for the full fiscal year. Income tax collections from individuals also fell below expectations, increasing at a rate of 16,0 per cent in the same period; in the Budget the revenue had been estimated to rise by 22,5 per cent during the full fiscal year.

The increase in revenue from *customs and excise duties* at a year-on-year rate of 29,8 per cent in the first half of fiscal 1992/93 was more or less in line with the budgeted increase of 28,4 per cent for the fiscal year as a whole. As shown in the accompanying table, this was the combined result of higher than expected receipts from the fuel levy and excise duties and a decrease in the income from other sources of customs revenue.

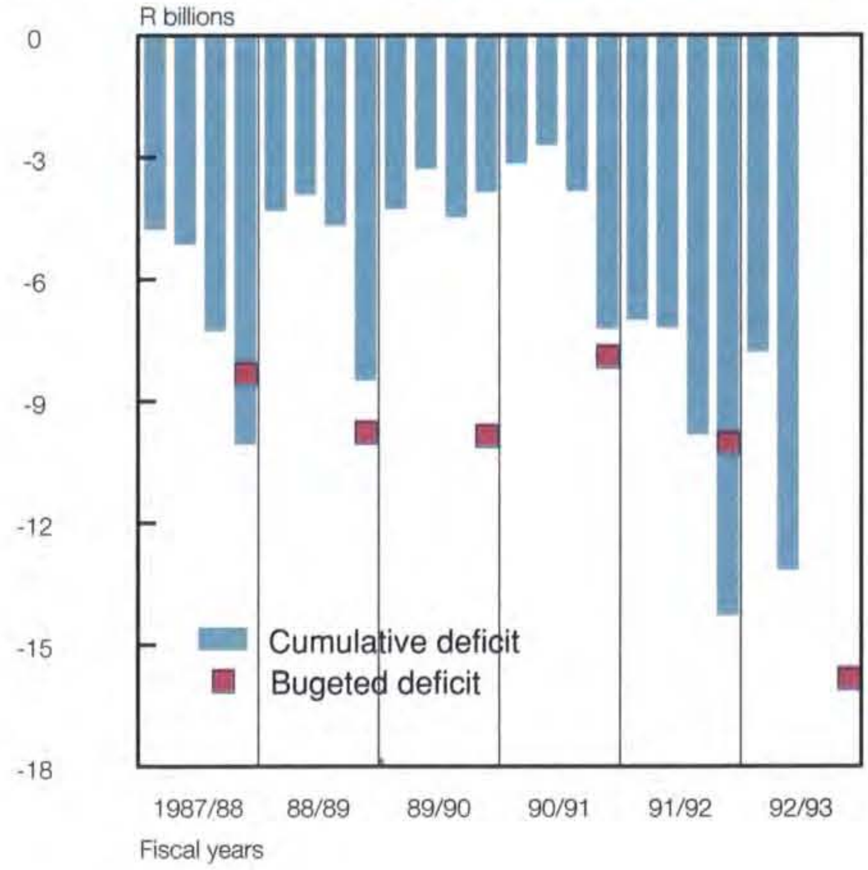
The year-on-year rate of increase in total Exchequer receipts accelerated sharply to 13,6 per cent in October 1992. The year-on-year rate of increase in

Income from customs and excise duties

Percentage change

	Budgeted for fiscal year 1992/93	Change in first half of 1992/93
Fuel levy	27,6	47,1
Excise duty	21,8	24,6
Customs duty	13,6	–0,1
Surcharge	13,6	–2,6
Other	7,9	–35,8
Total	**28,4**	**29,8**

Deficit before borrowing



In the first seven months of fiscal 1992/93 the deficit before borrowing and debt repayment (including the discount on new government stock) amounted to R18 222 million. The *borrowing instruments* utilised in the financing of the Exchequer deficit were as follows:

	R millions
Government stock (including discount)........	19 435
Treasury bills...	5 495
Foreign loans	815
Non-marketable securities	42
Increase in available cash balances............	-1 788
Total financing	23 999
Less: Transfers	5 777
Less: Discount on new government stock..	2 671
Total net financing	**15 551**

Exchequer receipts for the first seven months of fiscal 1992/93 therefore amounted to 5,6 per cent.

The relatively small increase in Exchequer receipts led to a *deficit on the Exchequer Account* before borrowing and debt repayment of R5 381 million in the September quarter of 1992. This brought the deficit before borrowing for the first half of fiscal 1992/93 to R13 195 million, or 8,2 per cent of gross domestic product; for the full fiscal year the deficit was budgeted at R15 927 million, or 4,5 per cent of gross domestic product.

The deficit of R13 195 million for the first half of fiscal 1992/93, plus the discount on new government stock of R2 660 million, was *financed* by funds obtained from:

	R millions
Public Investment Commissioners...............	10 445
Non-monetary private sector.......................	13 041
Monetary institutions:..................................	-2 894
Corporation for Public Deposits	-136
Other monetary institutions	-2 758
Foreign sector	1 040
Total gross financing	21 632
Less: Discount on government stock	2 660
Less: Transfers to:	
Gold and Foreign Exchange Contingency	
Reserve Account	3 777
Civil services pension fund	2 000
Total net financing	**13 195**