Quarterly economic review

Introduction

Real economic activity and real output in South Africa have now been contracting for just more than three years, and the current downward phase of the business cycle is close to becoming the longest cyclical downswing in the post-war period. At first the cyclical downturn in economic activity was fairly modest and confined to certain sectors. However, during 1991 the rate of decrease accelerated and became more dispersed, and then deepened considerably in the first quarter of 1992. This increase in intensity was exacerbated in the current downswing by the serious drought in certain areas of the country, the uncertainties regarding the outcome of political negotiations and the unrest in Black townships.

The deepening of the recession in South Africa was clearly evident in a decrease of almost 2 per cent (at an annualised rate) in real gross domestic product in the first quarter of 1992. Decreases in real output were recorded in most major sectors, such as agriculture, non-gold mining, manufacturing, construction and commerce, but were cushioned to some extent by moderate rises in the value added by mainly the tertiary sectors. In addition, the real output by the gold-mining industry rose noticeably further because of the processing of ore with a relatively high gold content.

The decline in domestic output in the first quarter of 1992 took place despite a stronger domestic demand in the form of an increase in inventories and a further rise in real government consumption expenditure. The apparently involuntary build-up of industrial and commercial stocks was probably based on an expected rise in economic activity and pre-emptive imports of goods in anticipation of a depreciation of the rand. The rise in real domestic spending therefore found expression mainly in an increase in the volume of imports. In contrast to these developments, the real outlay of households on consumer goods and services decreased even more rapidly than during 1991 and real gross domestic fixed investment declined further in the first quarter of 1992.

The ratio of gross domestic saving to gross domestic product also deteriorated further in the first quarter of 1992, mainly because of the exceptionally large dissaving by general government. Net saving by the corporate sector also weakened slightly, but the personal savings ratio continued to improve despite a decrease in real personal disposable income. This rise in personal saving was probably related to a reduction in personal debt to avoid the burden of high interest costs, and to a decline in job security because of continued retrenchments.

Despite the rise in the number of unemployed or underemployed persons in the country, the rate of increase in nominal salaries and wages per worker subsided only moderately. The continued unrealistically high wage settlements can be attributed mainly to the centralisation of the wage negotiation process in South Africa. Labour unions have been concerned with broader social and political issues, which are not always work-related and are often aimed at maximising short-term benefits for their members, but have disregarded the long-term effects of such actions on labour and unemployment.

These high labour costs have been an important contributing factor to the unacceptably high rates of inflation which the country has experienced in the past few years. The distinct declining trend that became discernible in production price inflation during 1991, continued in the first three months of 1992. Although the rate of increase in the consumer price index measured over a period of twelve months has remained stubbornly high, the quarter-to-quarter rate of increase in this index slowed down sharply from a seasonally adjusted and annualised rate of 18,8 per cent in the fourth quarter of 1991 to 12,8 per cent in the first quarter of 1992 – the lowest rate of increase since the second quarter of 1988.

The higher volume of merchandise imports and a sharp decrease in the value of net gold exports were responsible for a substantial decline in the balance of payments' surplus on current account (seasonally adjusted and annualised) from R12,3 billion in the fourth quarter of 1991 to R4,5 billion in the first quarter of 1992. Further but moderate increases were recorded in the volume of merchandise exports, although the exports of manufactured goods continued to perform well.

After having recorded a very large net outflow of capital not related to reserves of R4,7 billion in the fourth quarter of 1991 (largely because of the abolition of preferential rates on forward exchange transactions in September 1991), the net outflow declined to a negligible amount of R21 million in the first quarter of 1992. As could be expected, this dramatic improvement in the capital account occurred mainly in short-term capital movements, which changed from a substantial net outflow in the fourth quarter of 1991 to a small inflow in the first quarter of 1992. Only a small net outflow of long-term capital was recorded, because large bond issues undertaken in the European capital market more or less offset redemptions of maturing loans.

The improvement in the overall balance of payments position resulted in a sharp increase in the net and gross gold and other foreign reserves and at the end of March 1992 the total gross foreign reserves exceeded the value of two months' imports of goods and services. The rise in the foreign reserves made it possible to maintain a relatively stable real effective exchange rate of the rand. This index of the rand's value declined by only 0,4 per cent from December 1991 to March 1992.

The deepening of the cyclical downturn, together with a sustained restrictive monetary policy stance and disintermediation phenomena arising from wider margins between lending and deposit rates of deposit-taking institutions, were responsible for a continued slow growth in the broadly defined money supply. The disintermediation of financial transactions, in turn, also caused the income velocity of money to rise somewhat.

The underlying growth in credit extension by monetary institutions also remained relatively low in the first quarter of 1992 because of the depressed economic conditions and the effect of positive real interest rates. The general public was less inclined to make use of additional credit to finance the purchase of durable goods, while business enterprises curtailed working costs as much as possible. In the process of active credit risk management the monetary institutions also became less accommodating in providing further credit to certain clients. In particular the growth in hire-purchase credit and overdrafts receded sharply further in the first quarter of 1992, but mortgage advances and leasing finance remained buoyant.

Money market conditions, which had already eased markedly from the final months of 1990, became very liquid during the first five months of 1992 because of the improvement in the overall balance of payments position, a sharp increase in government expenditure, a seasonal decrease in notes in circulation and a low demand for bank credit. The Reserve Bank's actions in neutralising the excess liquidity still consisted mainly of foreign exchange intervention swaps with major banking institutions and the issuing of special short-dated Treasury bills. Fairly large amounts of government stock were also sold in April and May 1992 to raise funds for the financing of the projected deficit before borrowing on the Budget for 1992/93. The Bank also started issuing six-month and nine-month Treasury bills. On 5 June 1992 the Governor of the Reserve Bank announced that the liquidity in the market would be accommodated further by the issuance of nine-month Reserve Bank bills, a doubling of the amount of foreign reserves that authorised dealers may hold abroad, and the introduction of a supplementary cash reserve requirement of 1 per cent on the short-term liabilities of deposit-taking institutions. The Governor further stated that government securities may be sold in excess of the borrowing requirement indicated in the Budget if circumstances made this necessary.

The softening of money market rates gained marked momentum in the first five months of 1992 and the three-month bankers' acceptance rate on 31 May 1992 was 2,50 percentage points below the Reserve Bank's rediscount rate for such acceptances. The yield on government stock, which had begun to decline in the last quarter of 1991, also receded further in the first five months of 1992. In order to protect their profit margins and in view of the low demand for bank credit, the deposit-taking institutions reduced their deposit rates considerably. The margin between the twelve-month deposit rate and the predominant prime overdraft rate of clearing banks accordingly widened from 3 percentage points in July 1990 to 4,75 percentage points in April 1992.

In the area of government finance, the actual outcome of the central government's finances for the fiscal year 1991/92 was characterised by an underestimation of Exchequer issues to government departments and an overestimation of government revenue. This resulted in a deficit before borrowing and debt repayment of 4,7 per cent of gross domestic product, which represented a more expansionary fiscal policy stance than had been envisaged in the Central Government's Budget in March 1991. In the Budget of March 1992 the Central Government indicated the continuation of a fairly stimulatory policy.

The short-term outlook for the South African economy nevertheless remains fairly bleak. Up to the end of 1991 and even during the beginning of 1992 most economic forecasters were still predicting a moderate upturn in economic activity with modest, but at least positive, growth in gross domestic product for 1992. During the first few months of 1992 it became clear that the drought was taking on disastrous dimensions and that it could even affect winter crop production. The failure of the agricultural crops will lead to a sharp decline in the real income of the agricultural sector, which will influence the real income of other sectors. Ongoing violence in Black residential areas and uncertainties regarding political negotiations could also lead to a postponement of investment and consumer spending. Moreover, world economic growth seems to be proceeding at a slower rate than originally anticipated.

In view of these developments it seems realistic to predict that the South African economy may again experience a small decrease in real gross domestic product – i.e. negative growth may be recorded for the third year in a row for the first time in the post-war period. Although the drought will also have a negative effect on exports and lead to a substantial increase in the imports of agricultural products, the imports of other goods will probably be reduced because of the lower level of economic activity. A surplus on the current account is therefore expected, which should again exceed a moderate outflow of capital. It also seems reasonable to expect domestic consumer price inflation to recede during 1992.

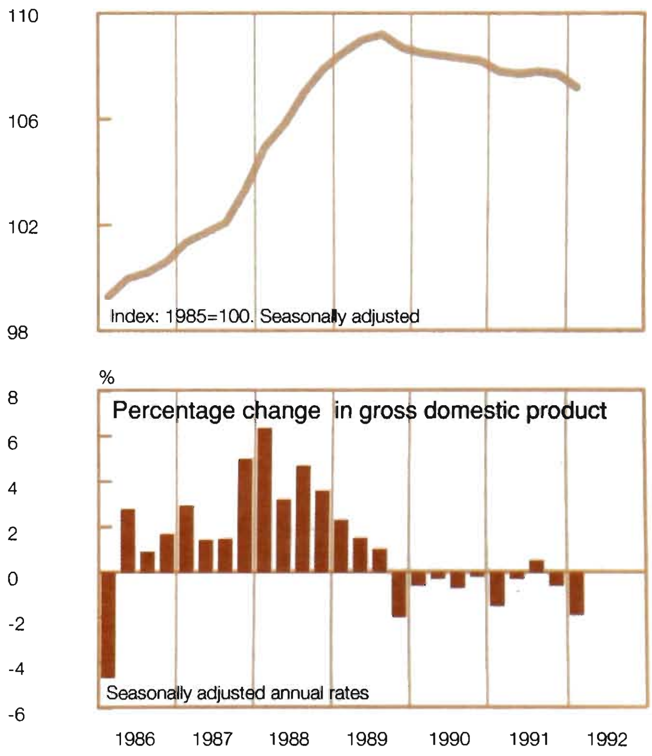
Domestic economic developments

Domestic production

The deepening of the downturn in economic activity was clearly reflected in a decrease in *real gross domestic product* at a seasonally adjusted and annualised rate of nearly 2 per cent in the first quarter of 1992. This more pronounced decline in domestic output followed fairly gradual quarter-to-quarter declines during 1991; in fact an increase was recorded at an annualised rate of ½ per cent in the third quarter of the year owing to a relatively good maize crop at that time. From the first quarter of 1991 to the first quarter of 1992 the decrease in real output amounted to only ½ per cent, signifying a rate of decline not much different from that in calendar 1991. The further decrease in real gross domestic product in the first quarter of 1992 brought the total decline in output to 1½ per cent over the three-year period of the current cyclical downturn.

On a *sectoral basis*, declines in real output during the first quarter of 1992 were recorded in major sectors such as agriculture, non-gold mining, manufacturing, construction and commerce. Small

Real gross domestic product



increases in real value added, on the other hand, were registered in the sectors electricity, gas and water; finance, insurance, real estate and business services; and general government. In addition, real output of the gold-mining industry rose noticeably further in the first quarter of 1992 because of the processing of ore with a relatively high gold content.

After having supported real gross domestic product during the course of 1991, *agricultural output* contracted substantially in the first quarter of 1992 because of the severe drought experienced in the summer rainfall areas of the country. The quarterly rate of increase in agricultural output varied between annualised levels of 5 and 6 per cent in 1991; in the first quarter of 1992 value added by this sector dropped at an annualised rate of nearly 16 per cent.

The prevailing recessionary conditions in the domestic market, a hesitant upturn in world economic activity, and work stoppages experienced in certain sub-sectors of the mining industry, caused the real output of the *non-gold-mining industry* to contract at an annualised rate of 9 per cent in the first quarter of 1992. The production of non-gold mines has been severely affected in the current recession and the value added by these mines receded by no less than 8 per cent from the first quarter of 1989 to the first quarter of 1992.

The real output of *manufacturing enterprises* continued to decrease sharply and this decrease became more broadly based. Manufacturing output, which started to decrease from the middle of 1990, declined by a further 3 per cent (at an annualised rate) in the first quarter of 1992. This brought the total decline in the volume of manufacturing production since the beginning of the current downturn in economic activity to about 6½ per cent. The more general contraction in the output of manufacturers could probably be ascribed mainly to the weak domestic final demand and a slower growth in merchandise export volumes. The weaker-than-expected economic conditions induced some factories to cut working weeks from five to four days and in some cases even to three days. The percentage utilisation of manufacturing production capacity was therefore down to a low of 80½ per cent in the fourth quarter of 1991.

The real output of the *construction sector*, which also began to recede from the second half of 1990, declined further at an annualised rate of 8 per cent in the first quarter of 1992, while the real value added by *commerce* contracted at an annualised rate of 3 per cent. This latter contraction occurred mainly in the real value added of the wholesale and retail trade, while the volume of motorcar sales (which sagged to a very low level in the fourth quarter of 1991) rose in the first quarter of 1992. The level of real output in the motor trade was nevertheless still 8½ per cent lower than in the first quarter of 1991.

In contrast to these decreases in sectoral outputs, the real output of *other sectors* generally recorded moderate rises in the first quarter of 1992, which cushioned the contraction in total real output somewhat.

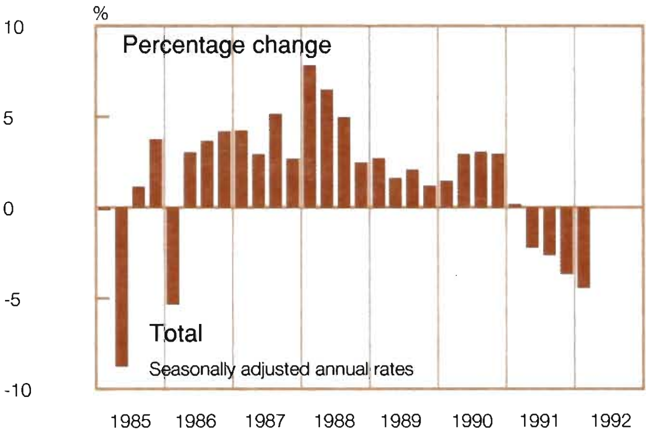
Domestic expenditure

According to current estimates, *aggregate real gross domestic expenditure*, which had declined at annualised rates that varied between 2½ and 5½ per cent in the last three quarters of 1991, rose by 8 per cent in the first quarter of 1992. Notwithstanding this increase in domestic expenditure in the first quarter of 1992, the level of such expenditure was still some 1 per cent lower than in the corresponding quarter of 1991 and almost 4 per cent lower than at the beginning of the cyclical downturn.

The increase in real gross domestic expenditure in the first quarter of 1992 could be associated with a turnaround in the decline in inventories and a further moderate increase in general government consumption expenditure. However, real private consumption expenditure and real gross domestic fixed investment decreased again sharply.

After having contracted at annualised rates of 2, 2½ and slightly more than 3½ per cent in the last three quarters of 1991, aggregate real *private consumption expenditure* decreased at a rate of 4½ per cent in the first quarter of 1992. This large decline was particularly evident in real outlays on durable goods by households, but real expenditure on semi-durable and non-durable goods also contracted more pronouncedly in the first quarter of 1992. Real

Real private consumption expenditure



expenditure on services (which has declined since the second quarter of 1991) decreased further in the first quarter of 1992. The lower demand for consumer goods and services appears to be related to declining real personal disposable income and waning consumer confidence. The retrenchment of a large number of employees and general uncertainty about future political developments have also made households more wary of incurring further debt.

Real *consumption expenditure by general government*, which had declined substantially at an annualised rate of 23 per cent in the third quarter of 1991, rose moderately by 4 per cent in the fourth quarter and further by 3 per cent in the first quarter of 1992. This brought the increase in real consumption expenditure by general government to 2 per cent in fiscal 1991/92, compared with 4½ per cent in fiscal 1990/91. Despite the apparent slow-down in the growth of real consumption expenditure by general government from the second quarter of 1991, the total increase in such expenditure since the start of the downswing in economic activity amounted to 3½ per cent. As a ratio of gross domestic product, government consumption expenditure has risen from 18 per cent in the first quarter of 1989 to 19 per cent in the first quarter of 1992.

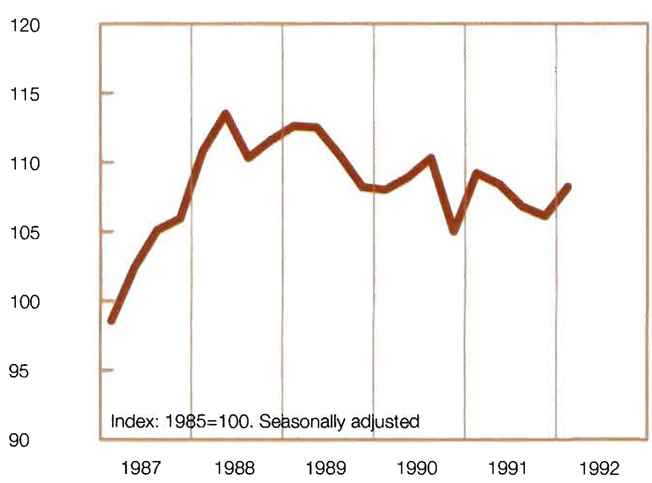
Total real *gross domestic fixed investment* is estimated to have declined further in the first quarter of 1992. After having decreased at the exceptionally high annualised rate of 20½ per cent in the fourth quarter of 1991, real fixed investment contracted further at an annualised rate of 7½ per cent in the first quarter of 1992. Since the beginning of the downturn in the economy real outlays on capital formation have declined by no less than 15 per cent.

The decline in fixed investment in the first quarter of 1992 reflected lower levels of real capital outlays in all three of the main institutional sectors: the private sector, public corporations and public authorities. The quarter-to-quarter rate of decrease in real fixed capital formation of the *private sector* amounted to an annualised rate of some 2 per cent in the first quarter of 1992; this was the eighth consecutive quarterly decline, but the tempo of decline slowed down from 5½ per cent in calendar 1991. Declines in real fixed investment by the private sector were recorded mainly in the sectors agriculture, mining, manufacturing and finance. This continued weak performance of investment by the private sector could be associated with the weak domestic demand, a general lack of confidence regarding future economic developments, political uncertainties and a low level of capacity utilisation.

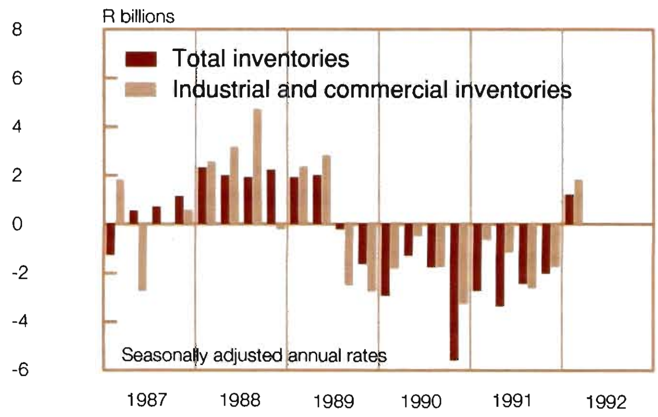
The decline in real gross domestic fixed capital formation by *public corporations and public authorities* could be ascribed to the low level of real expenditure on basic infrastructural investment by central and local government and by cutbacks made in the budgets of public corporations on new development expenditure. In addition, real outlays on capital expenditure by Transnet contracted in the first quarter of 1992; this followed substantial increases that were recorded in calendar 1991 owing to investment in aircraft and related equipment.

As a *ratio of gross domestic product*, aggregate fixed investment contracted to 16½ per cent in the first quarter of 1992. This was close to its all-time low of 16 per cent in the second quarter of 1962.

Real gross domestic expenditure



Change in inventories



The average ratios of real fixed investment relative to gross domestic product in the 1960s, 1970s and 1980s were 19½, 25½ and 23 per cent, respectively.

Real *inventory investment*, which became negative in the third quarter of 1989, turned positive in the first quarter of 1992. This change was recorded despite sales of stockpiled strategic goods and poor agricultural conditions in the country. The apparent involuntary build-up of inventories was mainly evident in industrial and commercial inventories and was probably related to a sharp increase in the inventories of imported goods. This could possibly be ascribed to expectations about an early upturn in economic activity and the pre-emptive importing of goods in anticipation of an expected depreciation of the rand. As a ratio of real gross domestic product, industrial and commercial inventories rose to a level moderately above 18 per cent, compared with a level slightly below 18 per cent in the fourth quarter of 1991.

Factor income

The growth in *total nominal factor income* at market prices slowed down from an annualised rate of approximately 13 per cent in the fourth quarter of 1991 to 8 per cent in the first quarter of 1992. This substantially lower rate of growth could be attributed mainly to a substantial contraction in the growth of the aggregate remuneration of employees, while the gross operating surplus continued to rise at a relatively low rate.

The rate of increase in total *labour remuneration* slowed down from an annualised figure of 14½ per cent in the fourth quarter of 1991 to 8 per cent in the first quarter of 1992. This deceleration in the rate of increase in total outlays on salaries and wages took place in most sectors but was particularly evident in mining, manufacturing and electricity, gas and water. The more moderate growth in the total remuneration of employees was related to rationalisation programmes introduced by many companies. Employment was also adversely affected by the sharp increase of 60 per cent (compared with the corresponding quarter in the preceding year) in the number of company liquidations in the first quarter of 1992. In order to circumvent militant trade unions, many companies have also resorted to the practice of employing part-time or temporary workers, and in this way saved on employee benefits such as pensions, medical aid and retrenchment packages.

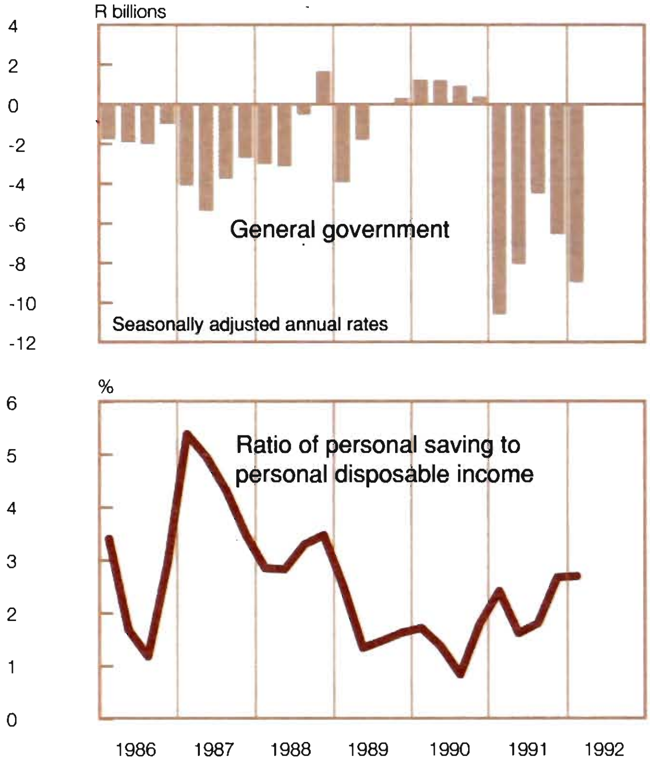
Growth in the nominal *gross operating surplus* slowed down from quarterly changes at annualised rates that varied between 13 and 19 per cent in the first three quarters of 1991 to 8 per cent in both the fourth quarter of 1991 and the first quarter of 1992. The lower growth in the operating surplus over the last two quarters is typical of the advanced stages of a downturn in economic activity.

Domestic saving

The ratio of gross domestic saving to gross domestic product declined to almost 19 per cent in 1991, which was its most recent annual low. Estimates for the first quarter of 1992 show that this ratio then receded further to 18½ per cent. This very low domestic savings ratio was largely due to continued large dissaving by general government. The seasonally adjusted and annualised dissaving by general government amounted to nearly R9 billion in the first quarter of 1992; this was higher than the dissaving of R7,4 billion by the government for the full calendar year 1991. The substantial dissaving of the general government was mainly the result of the growth in interest paid on government debt and in consumption expenditure by general government which exceeded the slower growth of current income.

Net saving by the corporate sector, which had remained relatively firm during 1991, weakened in the first quarter of 1992. In contrast to these developments the ratio of net personal saving to personal disposable income increased from a low of not quite 1 per cent in the third quarter of 1990 to

Saving

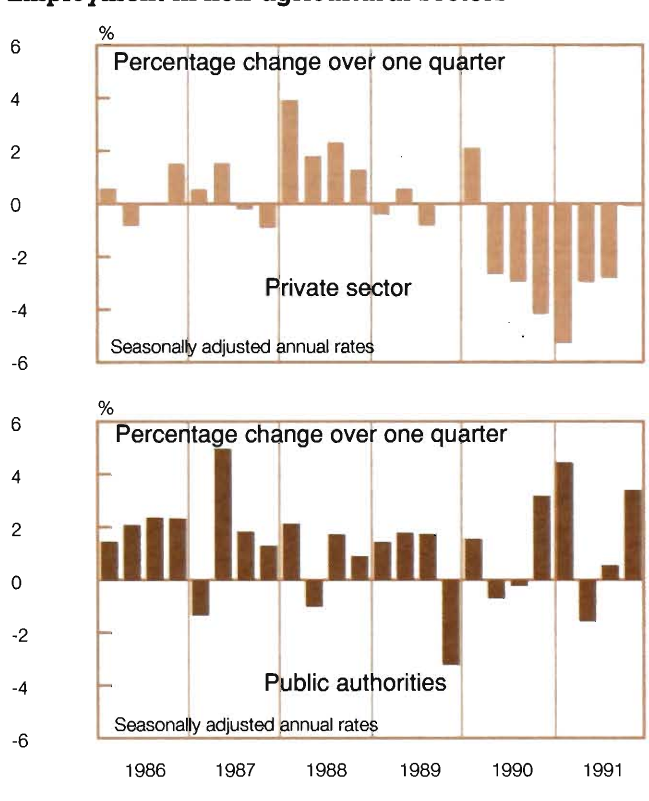


2½ per cent in both the fourth quarter of 1991 and the first quarter of 1992. This marginal improvement in the level of net savings by households was the result of a decrease in the ratio of real private consumption expenditure to real personal disposable income. Despite this moderate increase in the personal savings ratio, it is still extremely low compared with average ratios of 8½ and 4 per cent in the 1970s and 1980s, respectively.

Employment

Employment opportunities in the formal sectors of the economy deteriorated considerably in the current economic downswing because of the decrease in domestic demand and the rationalisation programmes introduced in many industries. Many employers were forced to retrench employees in order to contain rising labour costs so as to remain competitive in a weak domestic market and, in many cases, also in an international market characterised by falling commodity prices and lower rates of increase in the production costs of many competitors. From the beginning of the downswing to the fourth quarter of 1991 employment in the formal non-agricultural sectors of the economy declined by almost 160 000 persons. In the meantime, the economically active population rose by approximately 300 000 persons per year, implying that more than one million people have not been able to find employment in the formal non-agricultural economic sectors during the past three years.

Employment in non-agricultural sectors



Total non-agricultural employment already started to decline in the third quarter of 1989, and the rate of decrease accelerated from a seasonally adjusted and annualised figure of 0,1 per cent in that quarter to 2,5 per cent in the second quarter of 1991, before moderating somewhat to 1,8 per cent in the third quarter. A strong rise in employment by public authorities, assisted by lower decreases in private-sector employment, then caused total non-agricultural employment to increase at a seasonally adjusted and annualised rate of 1,0 per cent in the fourth quarter of 1991. For the year 1991 as a whole total employment in the non-agricultural sectors receded by 2,1 per cent, compared with 0,5 per cent in 1990.

As could be expected, this decrease in formal employment took place mainly in the *private sector*: employment in the private sector contracted at rates of 0,7 and 3,6 per cent in 1990 and 1991. The rate of decrease in private-sector employment at seasonally adjusted and annualised rates also accelerated sharply from 0,8 per cent in the third quarter of 1989 to 5,3 per cent in the first quarter of 1991; it then fell significantly, however, to only 0,1 per cent in the fourth quarter, owing to fewer personnel reductions in most industries.

The year-to-year rate of increase in employment by *public authorities*, which had decelerated from 1,7 per cent in both 1986 and 1987 to only 0,1 per cent in 1990, rose again to 1,6 per cent in 1991. This higher rate of increase was mainly due to increases in the police force, teachers involved in the education of black children, and staff employed in the correctional services.

The cyclically weak demand for labour in the formal sectors of the economy was also evident in the number of *overtime hours worked* in the manufacturing and construction industries. The ratio of overtime to normal hours worked in manufacturing declined uninterruptedly from the third quarter of 1989 to the second quarter of 1991; in the ensuing two quarters and in January 1992 it picked up slightly. In the construction industry this ratio showed a declining tendency from the second quarter of 1989 to the end of 1990, recovered somewhat in the first half of 1991 and moved sideways in the next seven months.

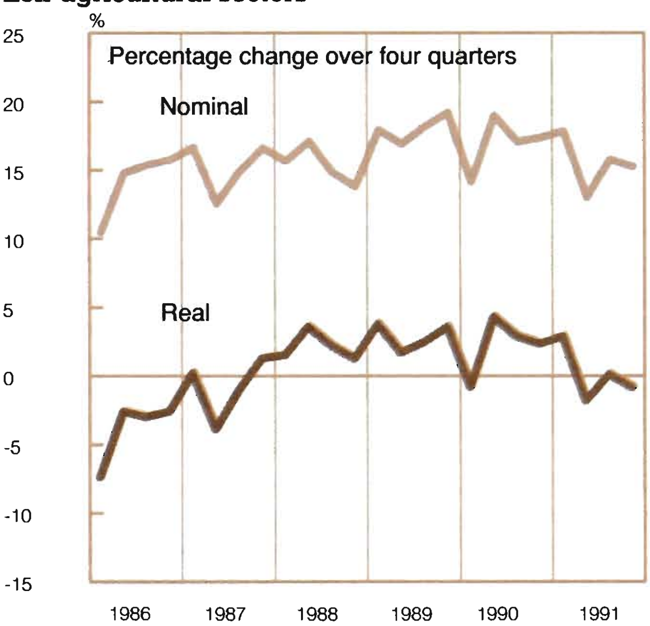
Intermittent changes in *registered unemployment* occurred during 1991, but the number of registered unemployed nevertheless increased, on balance, from 263 000 in December 1990 to 303 000 in November 1991. The average level of registered unemployment in the first eleven months of 1991 was 8,6 per cent higher than the average for the second half of 1990.

Labour costs and productivity

Despite the substantial deterioration in *employment opportunities* in the formal sectors of the economy, the rate of increase in the average monthly amount of nominal salaries and wages per worker declined only marginally from 18,0 per cent in 1989 to 16,9 per cent in 1990 and 15,4 per cent in 1991. These high rates of increase probably contributed to the rising unemployment and the apparent inertia of consumer price inflation to react more positively to restrictive economic policy measures. The year-on-year rate of increase in nominal wages per worker dropped more sharply from 19,0 per cent in the second quarter of 1990 to 13,0 per cent in the second quarter of 1991, but then reaccelerated to 15,8 and 15,3 per cent in the next two quarters.

The year-on-year rate of increase in the nominal salaries and wages per worker in the *private sector* also declined from a high of 18,3 per cent in the first quarter of 1990 to 14,3 per cent in the second quarter of 1991; it then accelerated somewhat to 15,4 per cent in the third quarter before declining again to 14,1 per cent in the fourth quarter. This brought the increase in wages per worker in the private sector to 14,9 per cent in 1991; in 1990 the average wage rose by 16,6 per cent and in 1989 by 16,3 per cent.

Average remuneration per worker in non-agricultural sectors



The rate of increase in the nominal salaries and wages per worker employed by *public authorities* also declined sharply from a high of 21,9 per cent in 1989 to 15,7 per cent in 1991. For the third year in a row the increases in the average remuneration of workers employed by the public authorities were nevertheless higher than those of workers in the private sector. On a quarterly basis, the year-on-year rate of increase in the average nominal salaries and wages per worker employed by public authorities receded from rates of more than 20 per cent in each of the four quarters from the second quarter of 1990 to the first quarter of 1991 to 9,9 per cent in the second quarter of 1991; it then reaccelerated, however, to rates of 16,0 and 17,0 per cent in the ensuing two quarters.

As a result of the lower rate of increase in nominal salaries and wages, the rate of increase in the average *real wage per worker* in the non-agricultural sectors of the economy declined from 2,9 per cent in 1989 to 2,2 per cent in 1990; the average real wage then remained virtually unchanged in 1991. However, during 1991 the year-on-year change in the real wage per worker fluctuated markedly: a large rate of increase of 3,0 per cent in the first quarter was followed by a decrease of 1,7 per cent in the second quarter, a slightly positive growth of 0,2 per cent in the third quarter and a negative figure of 0,8 per cent in the fourth quarter.

The rate of increase in *labour productivity* of the non-agricultural sectors decreased initially in the downturn from 2,5 per cent in 1988 to 0,4 per cent in 1990. It then, however, rose at a higher rate of 1,4 per cent in 1991. The reacceleration in the growth rate of labour productivity already became apparent from the middle of 1990, when the rate of increase over four quarters started to rise from 1,2 per cent in the third quarter of 1990 to 1,9 per cent in the second quarter of 1991. This rate of increase in real production per worker then slowed again to 0,5 per cent in the fourth quarter of 1991.

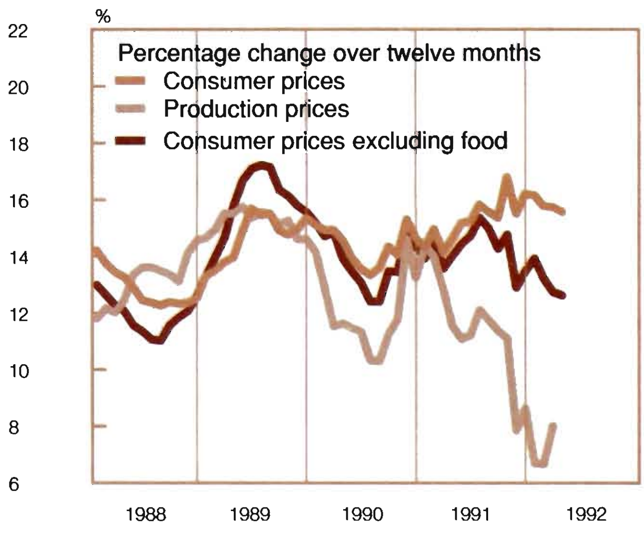
The continued increases in labour productivity and the lower rate of increase in nominal remuneration of workers caused the rate of increase in *nominal unit labour costs* to slow down moderately from 17,2 per cent in 1989 to 16,5 per cent in 1990 and then more significantly to 13,9 per cent in 1991. Similarly, the rate of increase in *real unit labour costs* (as deflated by the non-agricultural gross domestic product deflator) also declined moderately from 1,4 per cent in 1989 to 1,2 per cent in 1990, before real unit labour costs decreased by 0,5 per cent in 1991.

Prices

The distinct declining trend that was discernible in *production price inflation* during 1991, continued in the first three months of 1991. Measured over periods of twelve months, the rate of increase in the production price index slowed down from 14,6 per cent in November 1990 to 8,6 per cent in December 1991; it then amounted to 6,7 per cent in both the first two months of 1992 before rising again to 8,0 per cent in March. The quarter-to-quarter rate of increase in the production price index dropped even more markedly from a seasonally adjusted and annualised rate of 20,8 per cent in the fourth quarter of 1990 to 3,2 per cent in the first quarter of 1992.

The declining trend in production price inflation was largely due to a downward movement in the price increases of *imported goods*, reflecting only moderate declines in the effective exchange rate of the rand, the lowering of import surcharges in 1990 and 1991, and relative price stability in South Africa's main trading partner countries. The rate of increase in the prices of imported goods over periods of twelve months plummeted from 19,1 per cent in November 1990 to 1,9 per cent in December 1991. In January and February 1992 the prices of imported goods compared with the same months in the preceding year actually declined by 1,9 and 0,9 per cent, respectively, before increasing again at a rate of 4,1 per cent in March. The last-mentioned increase, however, was mainly related to a decrease in oil prices in March 1991, which led to a low statistical base for calculating growth over twelve months. The quarter-to-quarter rate of change (seasonally adjusted and annualised) in the prices of imported goods recorded a decrease of 0,7 per cent in the first quarter of 1992.

Inflation



The lower rates of increase in the overall production price index were also due to lower rates of increase in the prices of *domestically produced goods*. The rate of increase in the prices of domestically produced goods over periods of twelve months declined from a high of 13,9 per cent in March 1991 to only 8,5 per cent in February 1992; in March 1992 it accelerated slightly to 8,9 per cent, already reflecting to some extent the rises in the prices of agricultural products as a result of the current drought in the country. The quarter-to-quarter rate of increase in the prices of domestically produced goods also declined from a seasonally adjusted and annualised rate of 14,7 per cent in the fourth quarter of 1990 to 8,2 per cent in the second quarter of 1991; it then accelerated briefly to 12,0 per cent in the third quarter before declining once again to only 3,7 per cent in the first quarter of 1992.

In contrast to this sharp declining trend in production price inflation, *consumer price inflation* has only recently started to decline moderately. Measured over a *period of twelve months*, the rate of increase in the overall consumer price index rose from 13,3 per cent in July 1990 to 16,8 per cent in October 1991, and then moved downwards hesitantly to 15,7 per cent in March 1992 and to 15,6 per cent in April. To some extent the stubborness of consumer price inflation to recede can be ascribed to substantial rises in food prices. If food prices (including non-alcoholic beverages) are excluded from the index, the rate of increase in other consumer prices declined more markedly from 15,4 per cent in July 1991 to 12,4 per cent in April 1992.

Various factors were probably responsible for the divergent movement in the consumer and production price indices, including:

- a much more rapid rate of increase in the labour costs of enterprises involved in the retail trade than in manufacturing during 1990 and 1991;
- the relatively large direct effect of lower price rises of imported goods on production prices, against the proportionally much smaller direct effect on consumer prices;
- a sharp acceleration in the prices of services which are included in the consumer price index but do not form part of the production price index;
- the introduction of value-added tax, which increased certain retail prices (especially the prices of food and consumer services), but zero-rated capital and intermediate goods; and
- the rebasing of the consumer price index from August 1991, which now reflects the spending patterns of households in 1990. The official rates of change as published are, however, still being influenced by the 1985 weighting structure, because index values determined since August 1991 (1990 weights) are compared with index values for 1990 (1985 weights).

The *quarter-to-quarter* rate of increase in the overall consumer price index has nevertheless recently slowed down sharply from a seasonally adjusted and annualised level of 18,8 per cent in the fourth quarter of 1991 to 12,8 per cent in the first quarter of 1992 – the lowest rate of increase since the second quarter of 1988. This lower rate of increase was caused by slower increases in the prices of both consumer goods and services. The quarter-to-quarter rate of increase (seasonally adjusted and annualised) in the prices of consumer goods slowed down from 21,1 per cent in the fourth quarter of 1991 to 14,8 per cent in the first quarter of 1992, while the corresponding rate of increase in the prices of consumer services slowed down from 16,6 per cent to 9,5 per cent over the same period.

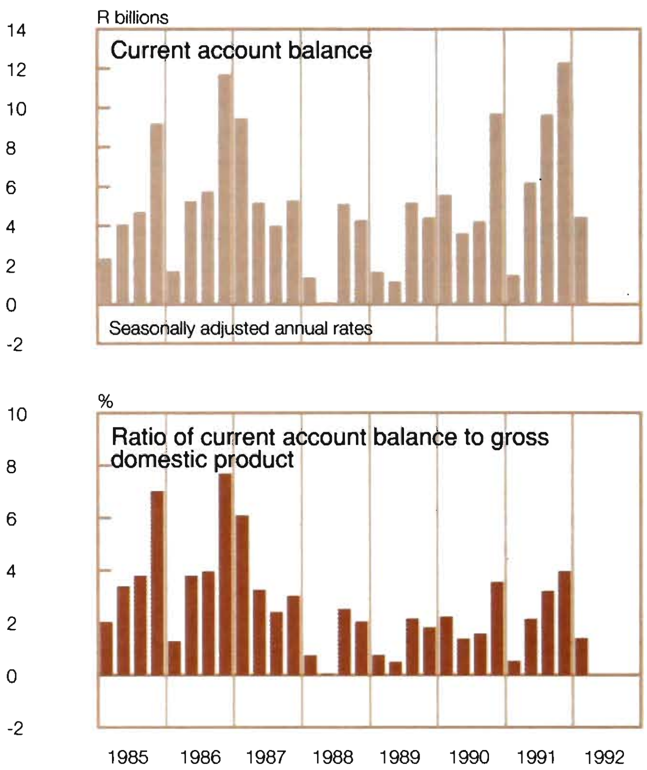
Balance of payments and exchange rates

Current account

The *surplus on the current account* of the balance of payments decreased substantially from the exceptionally high figure of R3,1 billion in the fourth quarter of 1991 to R2,0 billion in the first quarter of 1992. The level of this surplus was only marginally lower than the surplus of R2,1 billion in the third quarter of 1991, but marginally higher than the average quarterly surplus of R1,9 billion in 1991 as a whole. Taken at a seasonally adjusted and annualised rate, the surplus on the current account declined more markedly from R9,7 billion in the third quarter and R12,3 billion in the fourth quarter of 1991 to R4,5 billion in the first quarter of 1992.

This substantial decline in the surplus on current account after adjustment for seasonal factors was largely the result of a sharp increase in the value of merchandise imports and a decline in the value of net gold exports. Net service and transfer payments to non-residents also rose moderately, whereas the value of merchandise exports improved slightly.

Balance of payments



The value of *merchandise imports* (seasonally adjusted and annualised), which had decreased from R50,2 billion in the second quarter of 1991 to R45,9 billion in the fourth quarter, rose again to R50,5 billion in the first quarter of 1992. The increase of some 10 per cent in the value of merchandise imports from the fourth quarter of 1991 to the first quarter of 1992 was more than fully accounted for by an increase in the volume of merchandise imports amounting to 11 per cent. Volume increases occurred over a wide range of goods, but particularly the imports of mineral products increased substantially. In fact, if mineral products are excluded, the import volumes of all other goods rose by only 4½ per cent.

Import prices declined marginally by just less than 1 per cent in the first quarter of 1992, following relatively moderate rates of increase in the second half of 1991 and an average rate of increase of 5½ per cent for the year as a whole. Lower international oil prices, which were not fully offset by the depreciation of the rand against the US dollar, were mainly responsible for the lower import prices.

The value of *net gold exports* at a seasonally adjusted and annualised rate fell from a peak of R21,2 billion in the fourth quarter of 1991 to R18,1 billion in the first quarter of 1992, or by 14½ per cent. This substantial drop in net gold exports could be attributed mainly to a decrease of 9 per cent in the volume of exports which, in turn, was related to lower domestic production. The average realised price of gold, which had increased by 5½ per cent from the third to the fourth quarter of 1991 because of favourable forward sales, declined again by 6 per cent to more normal levels in the first quarter of 1992. The average fixing price of gold on the London market receded only slightly from US$360 per fine ounce in the fourth quarter of 1991 to $351 in the first quarter of 1992.

After the value of *merchandise exports* (seasonally adjusted and annualised) had risen to a record level of R48,6 billion in the third quarter of 1991, it declined to still high amounts of R47,3 billion in the fourth quarter and R47,6 billion in the first quarter of 1992. Export volumes increased by about 3 per cent in the first quarter of 1992, more than offsetting a decline of 2½ per cent in export prices. The exports of manufactured goods (chemical products, paper products and machinery and electrical equipment) continued to perform well, while the exports of metal and mineral products decreased.

Net service and transfer payments to non-residents increased from a seasonally adjusted and annualised value of R10,3 billion in the fourth quarter of 1991 to R10,7 billion in the first quarter of 1992. This increase was the result of higher service payments which exceeded an increase in service receipts. Higher freight and merchandise insurance related to the higher volume of imports and a rise in tourist expenditure abroad were mainly responsible for the rise in service payments, whereas higher receipts for transport services rendered and income earned on investment abroad contributed mainly to the higher service receipts.

Capital account

After a very large *outflow of capital* not related to reserves of R4,7 billion had been recorded in the fourth quarter of 1991 (largely as a result of the abolition of preferential rates on forward exchange transactions), the net outflow declined to a negligible R21 million in the first quarter of 1992. As could be expected, this dramatic improvement in the capital account took place mainly in short-term capital movements, but a moderately lower net outflow of long-term capital was also recorded.

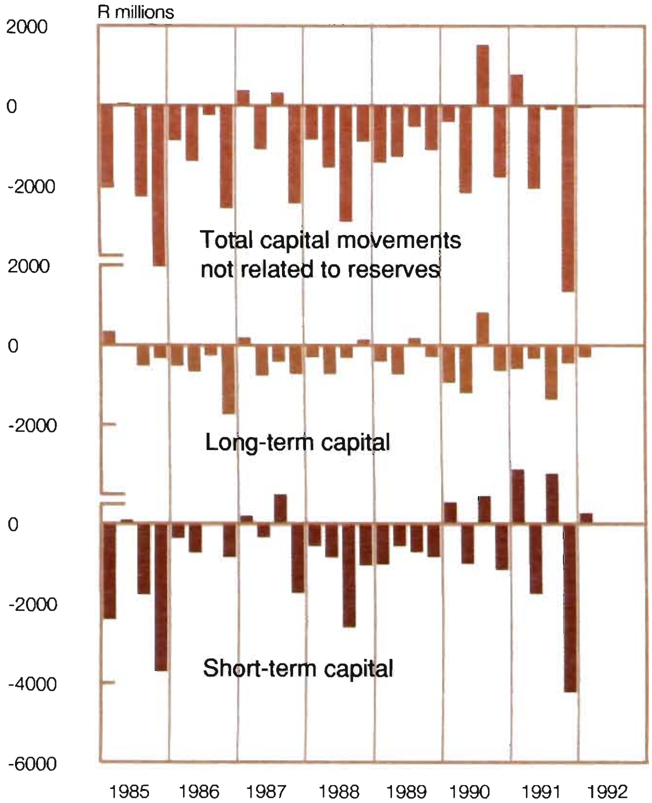
The net outflow of *long-term capital* decreased from R442 million in the fourth quarter of 1991 to

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
Merchandise exports	41,8	45,9	48,6	47,3	45,9	47,6
Net gold exports	17,3	20,0	20,1	21,2	19,6	18,1
Merchandise imports	–47,5	–50,2	–49,1	–45,9	–48,2	–50,5
Net service and transfer payments	–10,1	–9,5	–9,9	–10,3	–9,9	–10,7
Balance on current account	**1,5**	**6,2**	**9,7**	**12,3**	**7,4**	**4,5**

Net capital movements



R287 million in the first quarter of 1992. This outflow occurred despite the fact that two bond issues were successfully launched in European capital markets and the proceeds paid over to the borrowers: an issue of ECU250 million (R896 million) on behalf of the Treasury and an issue of DM200 million (R350 million) for the Development Bank of Southern Africa. A third bond issue of DM300 million for Eskom was also launched successfully in the first quarter of 1992, but the proceeds were only paid over in April and will be reflected in the capital account in the second quarter. As a result of these bond issues, a net capital inflow of R1,0 billion was recorded for the public sector in the first quarter of 1992.

This net inflow of capital to public authorities and public corporations was neutralised by the repayment of some US$200 million in debt inside the standstill net in terms of the Third Interim Debt Arrangements with foreign creditor banks in February 1992. These debt repayments were partly included in the large net outflow of long-term capital of the private sector of R1,3 billion in the first quarter of 1992, which was more than the average quarterly outflow of R0,7 billion in this category of capital in 1991.

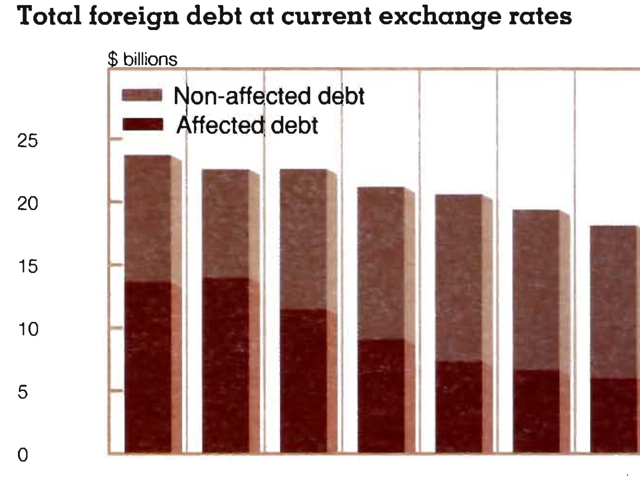
Short-term capital movements changed from a very large outflow of R4,2 billion (related to more expensive forward exchange cover) in the fourth quarter of 1991, to an inflow of R0,3 billion in the first quarter of 1992. The inflow of capital in the first quarter of 1992 was mainly in the form of trade finance because of the higher value of imports.

Foreign debt

South Africa's *total outstanding foreign debt* declined further during 1991 from US$19,4 billion at the end of 1990 to $18,1 billion at the end of 1991. Valued at the exchange rates of the US dollar against other currencies as at 31 August 1985, South Africa's total outstanding foreign debt amounted to $15,6 billion at 31 December 1991, compared with $16,4 billion at the end of 1990 and $23,7 billion at the beginning of the debt standstill arrangements on 31 August 1985. This implies that, valued at the exchange rates prevailing on 31 August 1985, the outstanding debt was reduced by $8,1 billion, or by 34 per cent.

The *affected foreign debt* of South Africa also decreased further from $6,6 billion at the end of 1990 to $6,0 billion at the end of 1991. Valued at the exchange rates of 31 August 1985, the affected debt decreased by $8,3 billion from $13,6 billion at the end of August 1985 to $5,3 billion at the end of 1991. No less than $3,2 billion has been repaid on affected debt in terms of the interim debt arrangements concluded with foreign creditor banks. The further reduction in affected debt was due to conversions into longer-term loans outside the net and of debt-equity swaps.

Total foreign debt at current exchange rates



South Africa's *non-affected debt* also declined, namely from $12,8 billion at the end of 1990 to $12,2 billion at the end of 1991. Valued at the exchange rates prevailing on 31 August 1985, the non-affected debt increased from $10,1 billion at the end of August 1985 to $10,3 billion at the end of 1991.

The net repayments on South Africa's foreign debt should help to improve the *credit rating* of the country further. As a percentage of the exports of goods and services, South Africa's foreign debt, for instance, decreased from 70 per cent in 1990 to 65 per cent in 1991; the corresponding ratio in Western Hemisphere developing countries amounted to 250 per cent. South Africa's foreign debt as a ratio of gross domestic product has also been reduced from 43 per cent at the end of August 1985 to 19 per cent at the end of 1990 and to 17 per cent at the end of 1991.

Foreign reserves

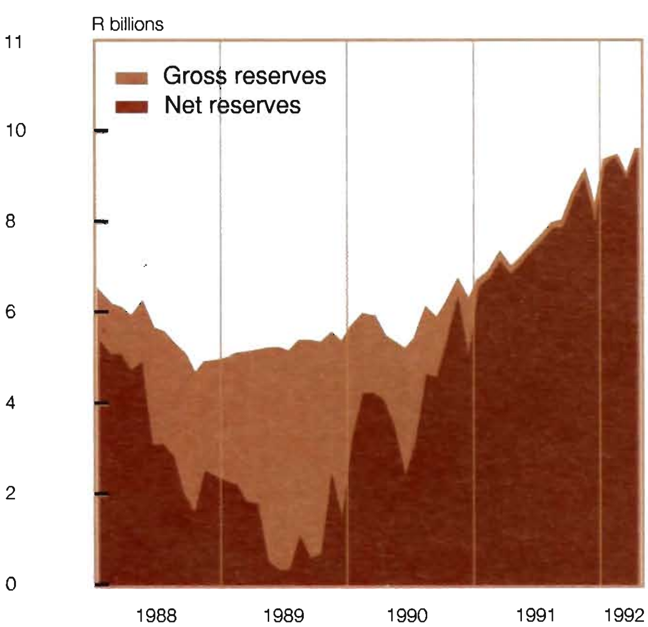
The net result of the surplus on current account and the small outflow of capital, was an increase of R2,0 billion in South Africa's *net* gold and other foreign reserves in the first quarter of 1992; in the fourth quarter of 1991 these net reserves had declined by R1,6 billion. After taking valuation adjustments and changes in reserve-related liabilities into consideration, the total *gross* gold and foreign reserves increased by R1,8 billion in the first three months of 1992 to a level of R11,6 billion at the end of March. Included in this rise were the proceeds of the ECU public debt issue to the amount of R0,9 billion, which were temporarily invested abroad by the Treasury. The transfer of the proceeds of this loan to the Reserve Bank in April was responsible for a corresponding decline in the foreign exchange holdings of the Central Government, and also for the rise in the foreign reserves of the Reserve Bank by R0,7 billion to R9,6 billion at the end of the month. In May 1992 the Reserve Bank's gross gold and other foreign reserves increased further by R0,8 billion to a level of R10,4 billion.

At the end of the first quarter of 1992 South Africa's total gross foreign reserves exceeded the value of two months' imports of goods and services for the first time since the first quarter of 1988. However, the current net reserve position is, of course, much healthier than during 1988, when the Reserve Bank had borrowed extensively abroad to support the level of the foreign exchange holdings; at the end of March 1992 the Reserve Bank had no outstanding reserve-related short-term loans.

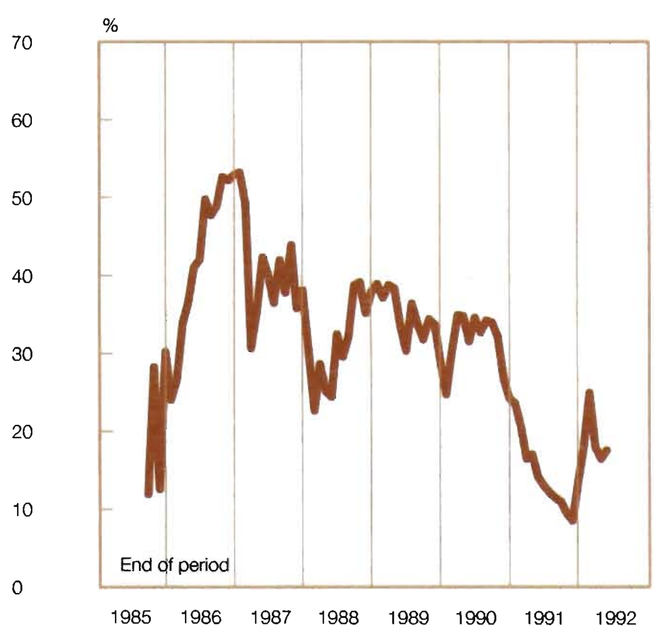
Exchange rates

During the first three months of 1992 the US dollar reversed its declining trend against all the main currencies and started to appreciate on account of more positive economic developments in the United States. The rand therefore depreciated by 6,2 per cent against the US dollar from 8 January 1992 until 20 March, but appreciated against all the other main currencies. However, renewed concern

Gross and net reserves of the Reserve Bank



Financial rand discount



about the performance of the United States' economy, expectations of an increasing interest rate differential between Germany and the United States and an appreciation of the UK pound after the elections, then led to a renewed weakening of the dollar. The rand appreciated again against the dollar, but depreciated against all the other main currencies until the end of May 1992. The net result of these exchange rate movements was a decline of 1,1 per cent in the *nominal effective exchange rate* of the rand from the end of 1991 to the end of May 1992.

The decline in the nominal effective exchange rate of the rand during the first quarter of 1992 exceeded slightly the inflation differential between South Africa and its major trading partner countries. The *real effective exchange rate* of the rand accordingly declined by 0,4 per cent from December 1991 to March 1992.

Uncertainties arising from the taxability of non-residents' income originating from local sources, as well as fears of a negative outcome in the referendum held in South Africa to determine its political reform, resulted in a sharp weakening of the *financial rand* from a high of R2,99 per dollar on 19 November 1991 to R3,95 per dollar on 17 March 1992 and a financial rand discount of 27 per cent - the highest discount since 14 December 1990. The result of the referendum and the announcement by the Reserve Bank on 20 March 1992 that it was to intervene in the financial rand market with the objective of stabilising the rate of the financial rand against the dollar, strengthened the financial rand to R3,44 per dollar and to a discount of 17½ per cent on 31 May 1992. From the beginning of April 1992 to the end of May the financial rand discount fluctuated between the narrow margins of 15 and 18 per cent. On 3 June 1992 the Minister of Finance announced that all interest payments to non-residents will in future be exempted from South African income taxes.

Changes in exchange rates of the rand
%

	31 Dec 1991 to 31 Mar 1992	31 Mar 1992 to 31 May 1992	31 Dec 1991 to 31 May 1992
Weighted average	–0,7	–0,4	–1,1
US dollar	–4,7	1,6	–3,2
British pound	2,8	–3,6	–0,9
German mark	3,5	–0,8	2,6
Japanese yen	1,1	–2,1	–1,1
Netherlands guilder	3,4	–0,9	2,5
Italian lira	3,1	–1,2	1,9
Financial rand	–9,7	2,1	–7,8

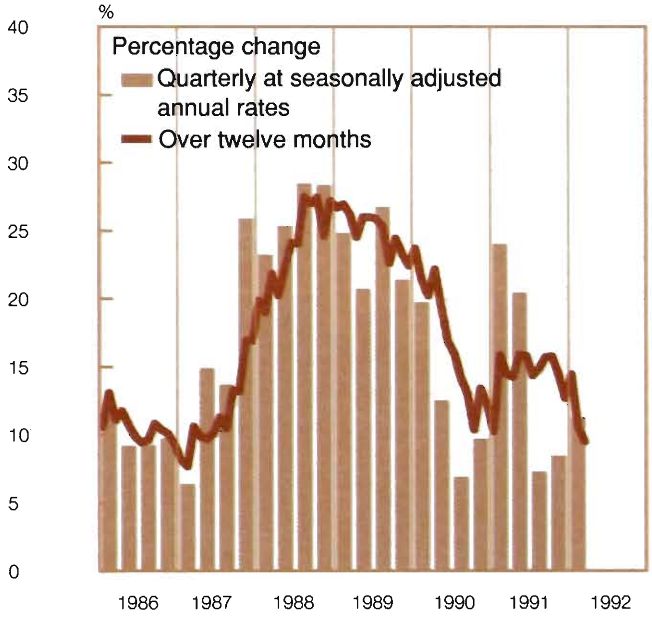
Financial markets

Money supply

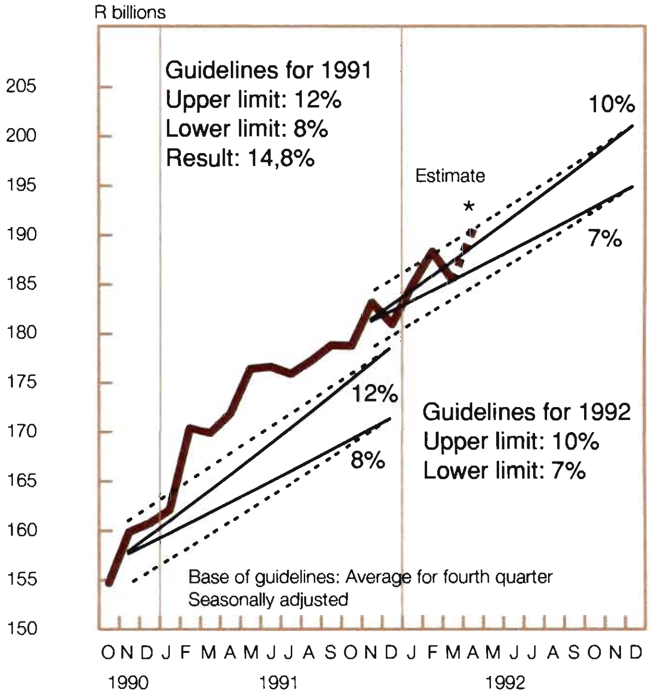
The twelve-month rate of increase in the *broadly defined money supply* (M3) fell from a peak of 27,5 per cent in August 1988 to 10,2 per cent in January 1991; it then rose again to 15,9 per cent in February, fluctuated around this higher level throughout the rest of 1991 and amounted to 14,4 per cent in January 1992. These higher rates of increase were caused mainly by the regulatory changes under the Deposit-taking Institutions Act which became effective from 1 February 1991 and which led to the reporting of off-balance-sheet items back on the balance sheets of these institutions. Because the effect of the regulatory changes was no longer reflected in the twelve-month growth rate of M3, this rate of increase decelerated to 10,6 per cent in February 1992 and to 9,5 per cent in March – more or less the levels which prevailed before the new regulations became applicable. Preliminary estimates for April 1992 indicate that the growth in M3 then reaccelerated slightly to 11,1 per cent.

This relatively slow growth in M3 was mainly due to the sustained restrictive monetary policy stance, the deepening of the cyclical downturn in economic activity and disintermediation practices. Despite the low growth in money supply, its rate of

Money supply



Guidelines for growth in M3



increase continued to fluctuate around the upper limits of the *new guidelines* for the growth in money supply of between 7 and 10 per cent from the fourth quarter of 1991 to the fourth quarter of 1992. After having exceeded the guideline cone in January 1992 and both the tunnel and cone in February, the final calculated value of M3 for March 1992 fell inside the ranges of both the guideline cone and the tunnel. However, the preliminary estimates for April 1992 exceeded the upper limit of the guideline cone by R1,9 billion (1,0 per cent) and the tunnel by R0,5 billion (0,3 per cent).

In contrast to the growth in M3, the rates of increase in the *narrower monetary aggregates* rose fairly sharply during the first nine months of 1991 (also mainly because of technical factors relating to the new regulations), but then moved sharply downwards in the ensuing months: the growth rates of M1 and M2 over periods of twelve months, which had accelerated sharply to 24,4 and 22,9 per cent at the end of September 1991, fell back to 14,2 and 11,8 per cent at the end of March 1992. Similarly, the corresponding growth rate in M1A fluctuated downwards from a peak of 29,6 per cent in August 1991 to 16,4 per cent in February 1992. However, it increased again sharply to 25,2 per cent at the end of March 1992 because of a switching of longer-term deposits to cheque deposits.

As already indicated, the lower growth in money supply was partly due to renewed disintermediation as the margin between the lending and deposit rates of deposit-taking institutions widened considerably. This caused the *income velocity* of M3 to rise somewhat. After having decreased to its lowest level in the past twelve years of 1,67 in the second quarter of 1991, the *income velocity* of M3 rose again to 1,72 in the fourth quarter of 1991 and to 1,71 in the first quarter of 1992.

In a *statistical* or *accounting sense* the main counterparts of the increase of R5,7 billion in M3 during the first quarter of 1992 were increases of R2,1 billion in the monetary institutions' claims on the private sector, R2,0 billion in the net gold and other foreign reserves of the country and R2,6 billion in the so-called "net other assets" of the monetary sector. The net claims on the government sector of monetary institutions declined by R1,0 billion in the first quarter of 1992.

Credit extension by monetary institutions

The underlying *growth in credit extended* by monetary institutions to the domestic private sector remained relatively low during 1991. Mainly as a result of the regulatory changes under the Deposit-taking Institutions Act, the rate of increase in credit extended, as measured over a period of twelve months, rose from 12,8 per cent in January 1991 to 18,7 per cent in February 1991; it then fluctuated around this level during most of the year before dropping substantially to 14,5 per cent in December 1991 and 15,6 per cent in January 1992. However, the underlying growth rate in credit extended to the private sector, as measured from the end of February 1991 (the month in which the new regulations came into effect) to the end of January 1992, amounted to only 10,9 per cent (seasonally adjusted and annualised). This relatively low underlying growth rate was subsequently confirmed by rates of increase over twelve months of 10,9 and 10,0 per cent in credit extended to the private sector in February and March 1992, respectively.

The general easing of growth in credit extension by monetary institutions since January 1991 was largely related to a lower demand for credit, reflecting the more depressed economic conditions combined with the effect of positive real interest rates. The general public became less inclined to make use of additional consumer credit to finance the purchases of durable goods, while business enterprises began cutting expenses. Some monetary institutions also became less accommodating in providing further credit to certain clients in the process of active credit risk management.

An analysis of monetary institutions' claims on the domestic private sector by *type of credit* extended, reveals that the lower growth in credit extension occurred mainly in hire-purchase credit and overdrafts. The twelve-month rate of increase in *hire-purchase credit* decelerated from 15,7 per cent in December 1990 to 6,7 per cent in December 1991 and to only 2,2 per cent in March 1992. The twelve-month rate of increase in "*other loans and advances*" (mainly overdrafts) receded similarly from 12,8 per cent in December 1990 to 7,0 per cent in March 1992.

In contrast to these developments, the twelve-month rate of increase in *mortgage advances* rose from 14,7 per cent in December 1990 to 18,0 per cent in December 1991 and to 17,8 per cent in March 1992. These growth rates in mortgage advances were well in excess of the inflation rate and could be related to a slower repayment of capital, an increase in the value of real estate transactions, increased use of this credit facility to finance consumer expenditure, and comparatively favourable interest rates attached to this type of credit. Deposit-taking institutions were also induced by lower capital requirements against mortgage advances to promote this kind of credit extension.

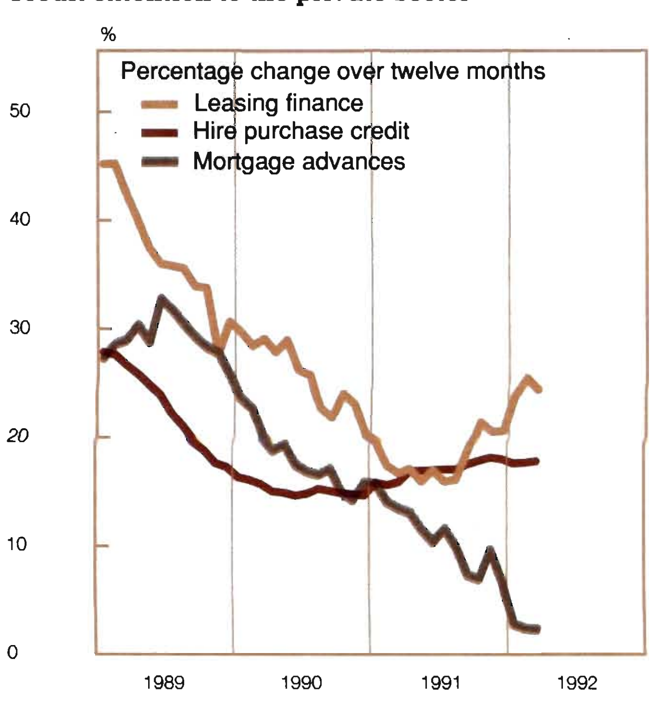
Leasing finance also remained buoyant despite the sluggish demand for durable goods in 1991 and the first quarter of 1992. Indicative of the extent to which such credit was being utilised to purchase industrial, commercial and office equipment because of certain associated tax and cash flow benefits, leasing finance increased by 20,6 per cent between December 1990 and December 1991. This twelve-month rate of increase then rose even further to 24,4 per cent in March 1992.

Money market conditions and Reserve Bank operations in the money market

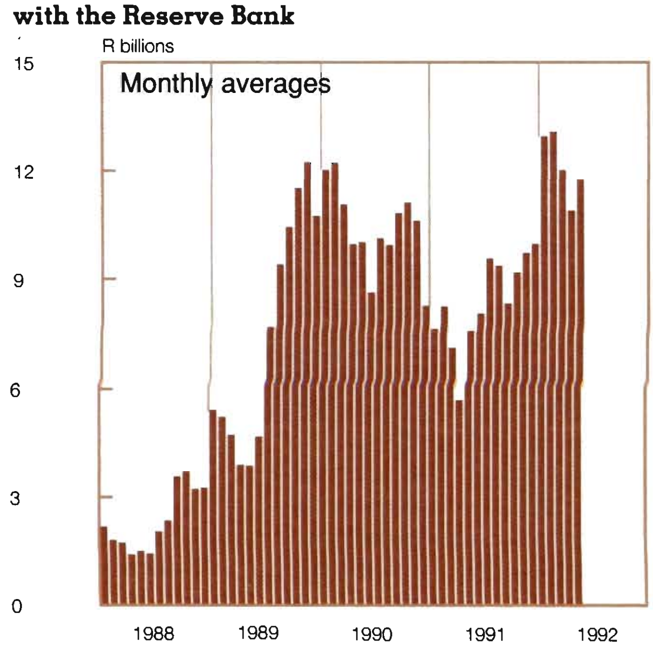
Money market conditions, which had already eased markedly from the final months of 1990, became very liquid during the first five months of 1992. These easier conditions were clearly reflected in the increase in the average daily level of *money market liquidity* before Reserve Bank intervention from a deficit of R0,7 billion in January 1992, to a surplus of R0,6 billion from February 1992 to May. After taking the Reserve Bank's intervention into account, the average daily *level of accommodation* at the discount window also remained moderate, ranging from R1,0 billion to R1,5 billion in the first five months of 1992.

The easy money market conditions during the first five months of 1992 could be attributed mainly to an increase in the Reserve Bank's net gold and other foreign reserves, while decreases in government deposits with the Reserve Bank and in the notes in circulation occasionally reinforced the high level of liquidity. The net gold and other foreign reserves of the Reserve Bank (excluding transactions not affecting the money market and foreign exchange intervention swaps) increased by no less than R1,6 billion during the first five months of 1992.

Credit extention to the private sector



Government deposits (Exchequer, Paymaster-General and Stabilisation account) with the Reserve Bank



A temporary decrease in government deposits from the end of February 1992 to the end of April made a net contribution of R1,5 billion to these easier conditions. In addition, the demand for bank credit remained fairly low.

The *Reserve Bank's actions* in neutralising the excess liquidity in the money market in the first five months of 1992 still consisted mainly of foreign exchange intervention swaps with major banking institutions and the issuing of special short-dated Treasury bills. The combined utilisation of both intervention swaps and short-dated bills rose from a peak amount of R1,8 billion in January 1992 to peaks of R3,9 billion in both March and April. The Reserve Bank also allowed R1,0 billion of its own holdings of Land Bank bills to be redeemed by the Land Bank in March in order to neutralise excess money market liquidity. In May 1992 the Reserve Bank used mainly foreign exchange intervention swaps to drain liquidity from the market; the highest outstanding amount of such swaps was R2,2 billion.

Net sales of government stock by the Reserve Bank from January 1992 to May amounted to R9,7 billion, compared with R2,9 billion in the first five months of 1991. The Bank's trading of *government stock options* also rose from a monthly average of R2,0 billion in 1991 to a monthly average of R4,4 billion in the first five months of 1992.

The amount of *Treasury bills* on offer at the weekly tender was raised from R150 million on 25 October 1991 to R200 million on 1 November 1991. From 20 March 1992 the Reserve Bank reduced the amount of three-month Treasury bills issued to R100 million, but additionally issued six-month and nine-month Treasury bills to the amount of R50 million each. The amounts offered of these latter categories of Treasury bills were both increased to R100 million since 3 April, bringing the total amount of Treasury bills issued weekly to R300 million. The issuing of additional Treasury bills with six and nine months' maturities was introduced in order to:

- develop the market for Treasury bills further;
- create an instrument for purposes of money market intervention through repurchase and reverse repurchase agreements; and
- satisfy the apparent demand for money market instruments with a longer maturity in addition to the existing negotiable certificates of deposit.

On 5 June 1992 the Governor of the Reserve Bank announced additional measures to accommodate excess liquidity in the money market. These measures comprised:

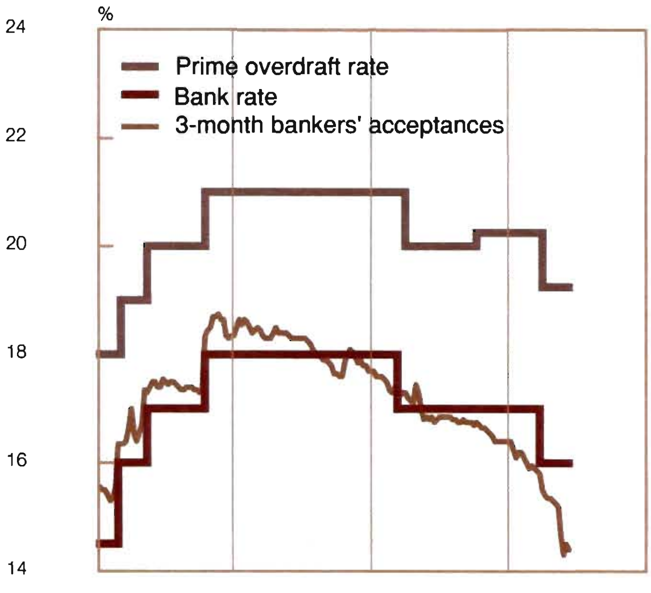
- the issuing of special Reserve Bank bills with a maturity of nine months;
- a doubling of the limit on the foreign exchange holdings of authorised foreign exchange dealers from $316 million to $632 million; and
- the introduction of a special cash reserve requirement equal to 1 per cent of deposit-taking institutions' short-term liabilities to the public. This brought the total cash reserve requirement of deposit-taking institutions to 5 per cent of their short-term liabilities. For the first time the Reserve Bank would also pay interest on cash reserves, namely at a rate 0,50 per cent below the weekly Treasury bill tender rate on the supplementary 1 per cent cash reserve requirement.

The Governor also stated that government securities in excess of the borrowing requirement indicated in the Budget might be issued by the Reserve Bank if the liquidity in the market or the government's needs required this.

Money market interest rates

The gradual softening of money market rates, which had started in February 1990, continued throughout 1991 and gathered marked momentum in 1992. This was clearly reflected in the rate on *three-month liquid bankers' acceptances*, which declined by 2,20 percentage points to reach 16,40 per cent at the end of December 1991; in the first three months of 1992 this rate declined more rapidly by 0,60 percentage points to 15,80 per cent on 21 March 1992. This sharp downward trend in money market interest rates could be attributed to increased expectations of a lower Bank rate, an increase in money market liquidity and a general easing in the demand for funds in the private sector.

Short-term interest rates



After the Reserve Bank had reduced its rediscount and other lending rates by 1 percentage point (with the exception of the rate for the rediscounting of liquid bankers' acceptances, which was reduced by only 0,50 percentage points) on 23 March 1992, money market rates generally continued to soften. The rate on three-month liquid bankers' acceptances receded by a further 0,35 percentage points up to the end of March 1992, and then receded further by 0,95 percentage points to 14,50 per cent at the end of May 1992. At this level the rate on three-month bankers' acceptances was 2,50 percentage points below the Reserve Bank's rediscount rate for such acceptances, reflecting the market's expectations of further reductions in Bank rate.

Most *other money market rates* recorded a similar declining tendency. The three-month Treasury bill rate declined from 18,0 per cent at the beginning of January 1990 to 16,13 per cent at the end of December 1991 and further to 13,97 per cent at the end of May 1992. The rates on the newly introduced six-and nine-month Treasury bills softened after their introduction on 23 March 1992 from 14,88 and 14,33 per cent, respectively, to 13,57 and 13,10 per cent at the end of May 1992. The rates on other longer-term money market instruments, such as the six-and nine-month negotiable certificates of deposit, also declined fairly rapidly.

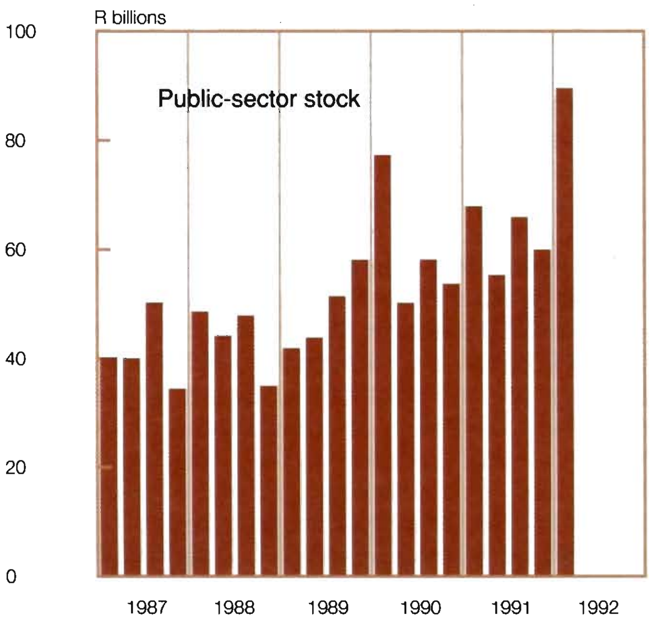
In response to the lower Bank rate, the *prime lending rate* of deposit-taking institutions was reduced by 1 percentage point from 20,25 to 19,25 per cent on 1 April 1992. This contributed to the decline in the inflation-adjusted prime lending rate from 3,5 per cent in December 1991 to 3,2 per cent in April 1992.

Capital market activity

After having declined moderately during the fourth quarter of 1991, the value of trading on the *secondary capital markets* recovered markedly in the first quarter of 1992. This was the result of an increase in the volume of activity and the continued high level of prices on these markets. Towards the end of the first quarter of 1992 and practically throughout April share prices weakened somewhat and long-term interest rates and yields softened. By the end of April share prices began to recover again, but the large number of public holidays (there were only nineteen trading days in April) was responsible for a sharp decline in the measured value and volume of trading in the capital market in this month.

The value of *public-sector stock* traded on the Johannesburg Stock Exchange, which had fallen back from R65,9 billion in the third quarter of 1991 to R60,0 billion in the fourth quarter, increased substantially to an all-time high of R89,5 billion in the first quarter of 1992, or to a level that was 43,7 per cent above the average quarterly level in the preceding year. This high turnover was based mainly on expectations of a decrease in yields on long-term fixed-interest stock. In March 1992 the value of transactions in public-sector stock reached an all-time monthly high of R39,8 billion, before declining significantly, because of the above-mentioned seasonal factors, to R22,6 billion in April.

Stock exchange transactions



The value of *shares* traded on the Johannesburg Stock Exchange also recovered somewhat in the first quarter of 1992. The turnover of shares, which had dropped sharply from R6,4 billion in the third quarter of 1991 to R4,9 billion in the fourth quarter, rose again to R5,5 billion in the first quarter of 1992. The increase in this turnover was attributable to a slight rise in the number of shares traded in the first quarter of 1992 which outweighed the marginal decline in average share prices in February and March 1992.

The monthly average *price level of shares* reached a historic peak in January 1992 owing mainly to a substantial rise in the prices of shares in the financial and industrial sectors. After having increased by 37,1 per cent from January 1991 to January 1992, the average price level of all classes of shares weakened by 6,7 per cent from January 1992 to April; this easing occurred in all the main categories of shares and was related to a decline in some of the main stock exchanges of the world.

Lower gold prices and the market's growing concern about the profitability of certain gold mines resulted in a decrease of 18,8 per cent in the share prices of gold mines from January 1992 to April. The prices of industrial and commercial shares and financial shares also declined by 4,9 and 5,7 per cent, respectively, over the same period. Slightly improved world economic growth prospects, more stable and positive trading conditions on the larger stock exchanges of the world and a decline in domestic interest rates, then started to support the equity market and share prices on the Johannesburg Stock Exchange began to recover by the end of April.

Non-residents remained net sellers of shares and net purchasers of public-sector stock on the Johannesburg Stock Exchange in the first quarter of 1992. Although the spectacular returns offered by the equity market throughout 1991 levelled off in the first quarter of 1992, the bond market continued to offer non-residents excellent returns. The significant weakening of the financial rand and lower share prices led to a decline in non-residents' net sales of shares from R1 134 million in the fourth quarter of 1991 to R695 million in the first quarter of 1992; their net purchases of public-sector stock increased from R616 million to R823 million over the same period. After having been net sellers of shares and public-sector stock at a quarterly average of R500 million for five consecutive quarters, non-residents became net purchasers of securities to an amount of R127 million in the first quarter of 1992. In April 1992 non-residents were once again net sellers of securities to an amount of R37 million because of a sharper decline in their net purchases of public-sector stock than in their net sales of shares.

In the *primary capital markets* the level of activity in general remained fairly high. However, in accordance with the normal seasonal pattern during the course of a fiscal year, the amount of funds raised through new issues of *fixed-interest securities* by *public-sector* borrowing entities tapered off; the average monthly value of these issues fell from R1,6 billion in the fourth quarter of 1991 to R0,2 billion in the first quarter of 1992.

The value of new issues of fixed-interest securities (including convertible preference shares and debentures) by listed *private-sector* companies increased significantly from a monthly average of R149 million in the fourth quarter of 1991 to R446 million in the first quarter of 1992. A record amount of R1,0 billion in the form of convertible bonds was raised by a single company in February 1992.

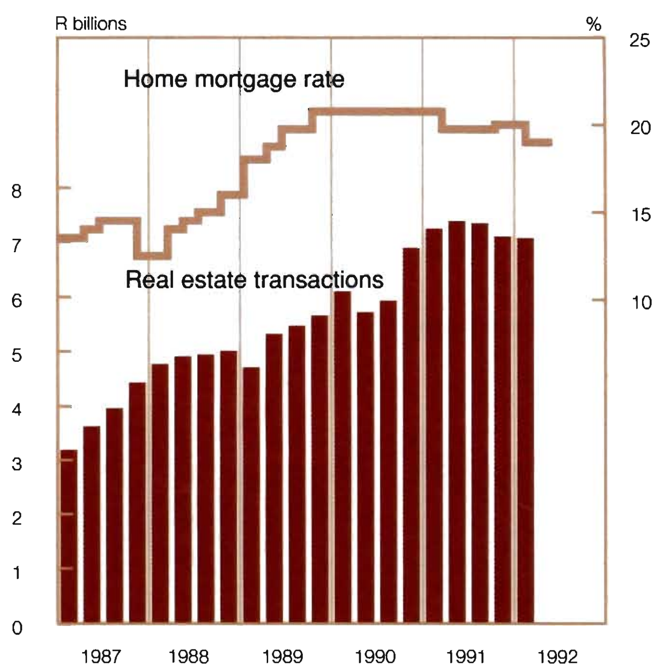
The value of new issues of *ordinary shares* by listed private-sector companies increased from a monthly average of R862 million in the fourth quarter of 1991 to R1,3 billion in the first quarter of 1992. In January alone the value of new issues of ordinary shares amounted to R4,3 billion, of which R2,0 billion was taken up by holding companies and subsidiaries. The vast amount of funds raised in this way once again underscores the fact that the relatively high cost of borrowed funds and the shortage of good quality scrip continue to favour share capital issues.

In the *mortgage market* the increase in deposit-taking institutions' and mutual building societies' holdings of mortgage loans increased slightly from an average monthly amount of R874 million in the fourth quarter of 1991 to R921 million in the first quarter of 1992. The total holdings of mortgage loans by the deposit-taking institutions, mutual building societies, the Land Bank and participation mortgage bond schemes increased from R72 billion in the third quarter to R75 billion in the fourth quarter of 1991.

The seasonally adjusted value of *real estate transactions* decreased marginally from an impressive R7,3 billion in the third quarter of 1991 to R7,1 billion in both the fourth quarter of 1991 and the first quarter of 1992.

The total value of deals in *futures contracts* rose substantially from a relatively low R5,0 billion in the fourth quarter of 1991 to R9,1 billion in the first quarter of 1992. At a monthly value of R3,8 billion an all-time high was recorded in these transactions

Real estate transactions



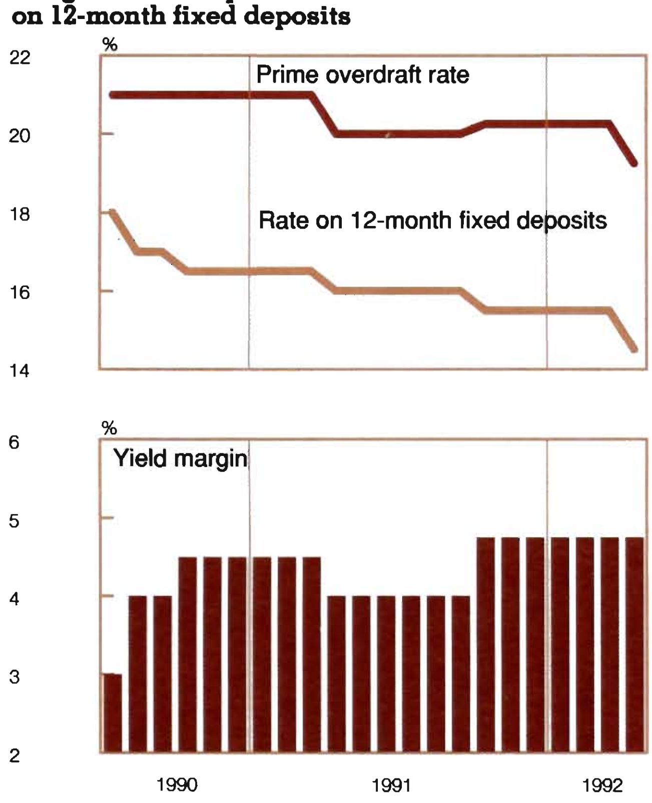
in March 1992, before they declined to R2,3 billion in April. This significant increase in activity in the futures market during the first quarter of 1992 could be ascribed to increasingly divergent views on the future direction of the stock exchange and an increase in perceived risks associated with the outcome of the referendum. Contracts in share indices represented 80 per cent of the total value of futures contracts in the first quarter of 1992.

After the *Traded Options Market* had started operating on 24 January 1992, activity was at first fairly brisk in February but then weakened progressively in the ensuing two months: the 395 contracts with an underlying value of R3,6 million in February 1992 decreased to 40 contracts with an underlying value of R0,4 million in April. This lacklustre performance was probably in part due to investors' inexperience with the new market and its procedures, the recovery in the equity market and generally lower levels of activity in the capital market during April 1992.

Capital market yields and interest rates

The *yield on government stock*, which began to decline in the last quarter of 1991, softened further in the first four months of 1992. The monthly average yield on long-term government stock increased from a low of 15,6 per cent in February and March 1991 to 17,2 per cent in October; it then started moving downwards to 16,6 per cent in January 1992, firmed to 16,9 per cent in February and fell back to 16,3 per cent in April. At this level the real yield on long-term government stock amounted to the low rate of only 0,6 per cent in April.

Margin between prime overdraft rate and rate on 12-month fixed deposits



The deposit-taking institutions' predominant home *mortgage bond rate*, which had been increased by 0,25 percentage points in October 1991 in response to the taxation introduced on financial institutions in lieu of value-added tax, was reduced by 1,0 percentage point to 19,0 per cent with effect from 2 March 1992 to pre-empt an expected cut in Bank rate. The reduction in Bank rate of 23 March therefore had no further impact on the mortgage bond rate. In May deposit-taking institutions announced a further reduction in their predominant bond rate by 1 percentage point with effect from 1 July 1992.

In reaction to the cut in Bank rate, the *twelve-month deposit rate* of deposit-taking institutions was reduced by 1 percentage point to 14,5 per cent in April 1992. These deposit rates have already been reduced considerably by no less than 3,5 percentage points over the past two years, while lending rates have not declined to the same extent. The margin between the twelve-month deposit rate and the predominant prime overdraft rate of clearing banks accordingly widened from 3 percentage points in July 1990 to 4,75 percentage points in April 1992. At its present level the twelve-month deposit rate provides a negative real yield of 0,92 per cent to depositors even without taking income tax payments into consideration.

The higher average level of share prices in the first quarter of 1992 depressed further the *dividend yield* on all classes of shares from 3,25 per cent in the fourth quarter of 1991 to 3,17 per cent. The *earnings yield* on all classes of shares, excluding gold-mining shares, also decreased from 7,85 per cent in the fourth quarter of 1991 to 7,58 per cent in the first quarter of 1992 because of higher average share prices and lower profits. The dividend yield on all classes of shares firmed to 3,36 per cent and the earnings yield to 7,90 per cent in April 1992 as a result of the decline in average share prices.

The maximum permissible *finance charges rates* as determined in terms of the Usury Act, were reduced with effect from 29 May 1992 from 29 to 28 per cent for "large" and from 32 to 31 per cent for "small" money lending, credit and leasing transactions.

Government finance

Exchequer account in final quarter of fiscal 1991/92

A marked deceleration in the growth of *Exchequer issues* was reported during the March or final quarter of fiscal 1991/92. The year-on-year rate of increase in Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) at first rose markedly from 10,9 per cent in the June quarter of 1991 to 20,6 per cent in the September quarter and then declined only moderately to 18,8 per cent in the December quarter. In the final quarter of the fiscal year this rate of increase fell sharply to 10,6 per cent.

The year-on-year rate of increase in *Exchequer receipts* (excluding the proceeds from privatisation), which had accelerated from 2,1 per cent in the June quarter of fiscal 1991/92 to 9,0 per cent and 16,5 per cent in the next two quarters, decreased to only 6,5 per cent in the final quarter. This relatively low rise in Exchequer receipts was related mainly to slack domestic economic conditions. This is clearly reflected in the revenue collected from value-added tax and general sales tax which was 7,6 per cent lower in the final quarter of fiscal 1991/92 than the income from general sales tax collections in the final quarter of fiscal 1990/91. The low year-on-year rate of increase in Exchequer receipts in the final quarter of fiscal 1991/92 could also be attributed to a decline in the growth in income tax collections, because the amount of provisional tax due at the end of December 1991 but collected in January 1992, was much lower than the overflow in the preceding year.

The *Exchequer deficit* before borrowing and debt repayment amounted to R3 067 million or 4,0 per cent of gross domestic product in the March quarter of fiscal 1991/92. This deficit was financed by means of:

	R millions
Government stock (including discount on new government stock)	548
Treasury bills	-1 838
Foreign loans	3
Non-marketable securities	-13
Decrease in available cash balances	4 002
Total	**2 702**
Plus: Transfers from the National Supplies Procurement Fund and Central Energy Fund	809
Less: Discount on new government stock	-444
Total financing	**3 067**

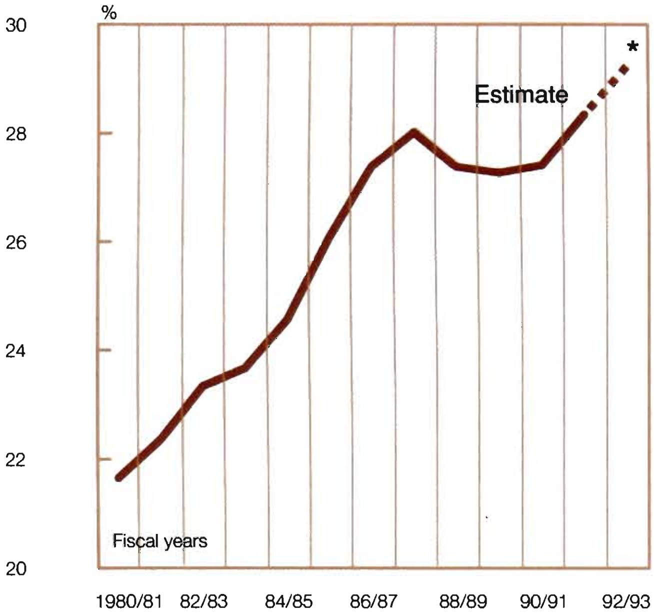
Outcome of the Budget for fiscal 1991/92

The actual outcome of the central government's finances for the fiscal year 1991/92 was characterised by an underestimation of Exchequer issues to government departments and an overestimation of government revenue. This, of course, resulted in a deficit before borrowing and debt repayment that was substantially higher than the amount originally budgeted.

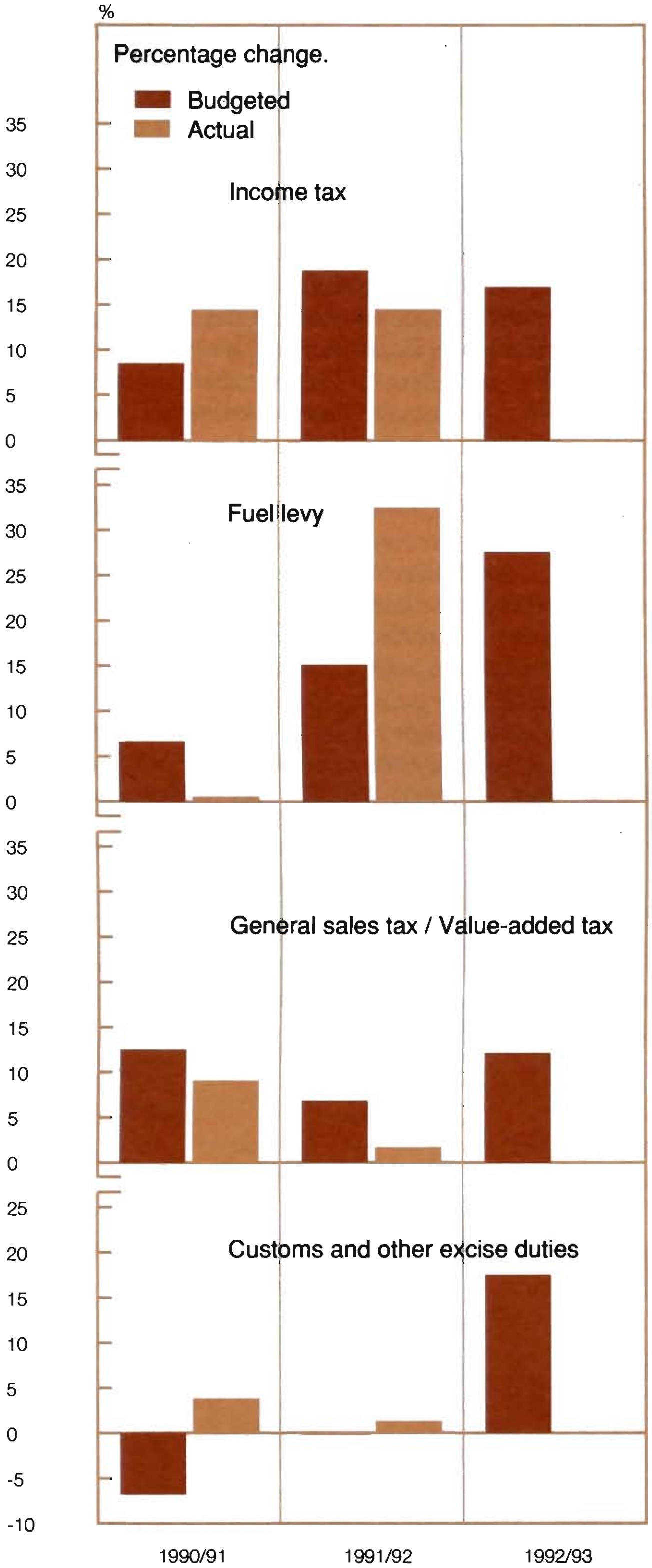
Exchequer issues to government departments amounted to R86,4 billion in fiscal 1991/92, which was 1,7 per cent higher than the original Budget estimate. These higher-than-expected expenditures were related mainly to additional appropriations for the attenuation of socio-economic backlogs. The rate of increase in Exchequer issues in fiscal 1991/92 therefore amounted to 16,1 per cent, against the original budgetary provision of an increase of 13,7 per cent. Although this rate of increase was much higher than the rate of increase of 13,1 per cent for fiscal 1990/91 as a whole, it was still considerably lower than the average annual growth of about 19 per cent in the 1980s. However, contrary to the government's adopted longer-term objective of reducing the ratio of Exchequer issues to gross domestic product, this ratio rose from 27,4 per cent in fiscal 1990/91 to 28,3 per cent in fiscal 1991/92.

Total *government revenue* (on a basis comparable to the Budget) increased to R72,1 billion, or by 7,4 per cent, in fiscal 1991/92; the budget provided

Exchequer issues to government departments as percentage of gross domestic product



Budgeted and actual revenue *



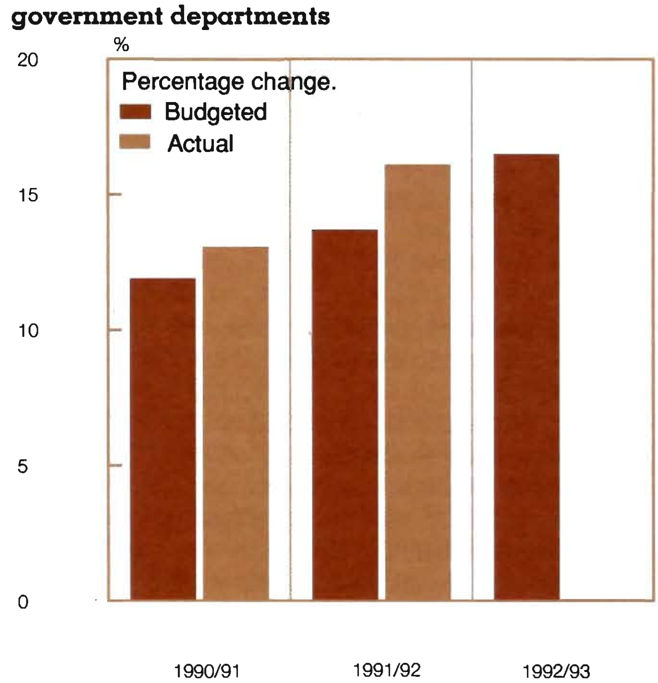
* Including transfers to self-governing territories and TBVC-countries
Fiscal years.

for an increase of 11,1 per cent. This lower-than-budgeted increase in government revenue led to a shortfall of R2 785 million, or 3,7 per cent of the original amount budgeted. This relatively poor performance of government revenue was mainly related to the fact that the current economic downswing is lasting longer than had been expected at the time of the Budget and that some revenue was forfeited when the value-added tax was introduced at 10 per cent instead of the originally planned 12 per cent.

All the major revenue items except income from customs and excise duties recorded lower-than-budgeted increases in fiscal 1991/92. The increase that was reported in customs and excise duties could mainly be attributed to an increase in the fuel levy on petrol and diesel of 10 cent and 8 cent per litre, respectively, introduced from 24 August 1991, and an additional ad valorem duty of 2,5 per cent on certain goods, which became effective from 30 September 1991.

	Budgeted increase %	Actual increase %
Total government revenue	11,1	7,4
Customs and excise duties	-2,3	3,3
Inland revenue	13,0	8,0
Income tax	18,7	14,3
GST/VAT	6,8	1,7

Budgeted and actual exchequer issues to government departments



Fiscal years.

The ratio of government revenue to gross domestic product decreased for the second consecutive year; this ratio has declined from 25,7 per cent in fiscal 1989/90 to 24,7 per cent in fiscal 1990/91 and 23,6 per cent in fiscal 1991/92. However, this decline occurred mainly in the relative contribution of indirect taxes, whereas direct taxes as a percentage of gross domestic product continued to rise sharply. In particular, income tax on individuals as a percentage of gross domestic product rose virtually consistently from 3,4 per cent in fiscal 1980/81 to 8,5 per cent in fiscal 1990/91 and further to 9,5 per cent in fiscal 1991/92.

The higher-than-expected expenditure and lower-than-expected revenue resulted in a *deficit* before borrowing and debt repayment of R14 307 million in fiscal 1991/92, or 4,7 per cent of gross domestic product. This ratio was considerably higher than the budget estimate of 3,4 per cent and the ratio of 2,7 per cent in fiscal 1990/91. The deficit for fiscal 1991/92 was financed in the following way:

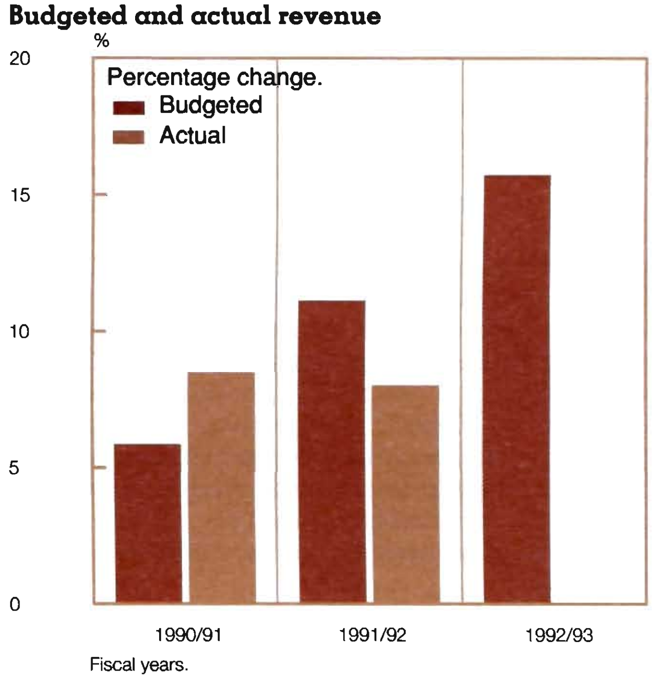
	R millions
Government stock (including discount on new government stock)	17 838
Treasury bills	-129
Foreign loans	549
Non-marketable securities	-77
Increase in available cash balances	1 417
Total financing of Exchequer deficit	**19 598**
Plus: Transfers from the National Supplies Procurement Fund and the Central Energy Fund	809
Less tranfers to:	
Reinsurance Fund for Export Credit and Foreign Investment	450
Government Service Pension Fund	1 000
Maize Board	350
Less: Discount on new government stock	4 300
Total net financing	**14 307**

The Budget for 1992/93

In his presentation of the Budget for fiscal 1992/93 to Parliament on 18 March 1992, the Minister of Finance stated that the Budget had to seek a balance between the meeting of expectations that are increasing in intensity and the country's limited financial resources. Although the Budget had to have special compassion for those in need, it had to steer away from fiscally irresponsible actions and be geared towards the attainment of sustainable economic growth. In the process of forging a new society, fiscal policy had to continue enunciating the theme: "equity through growth and stability".

The expenditure side of the Budget therefore again provided for substantial increases in expenditure on socio-economic services. Endeavouring to address certain important imbalances, the Minister announced further large increases of 24 per cent on education, 22 per cent on health and 22 per cent on housing. In contrast to these high rates of increase, expenditure on defence was projected to rise by only 5,6 per cent. In view of the high incidence of crime and violence, the larger part of this saving on expenditure had to be reallocated to policing, the administration of justice and corrective services. In accordance with this need, a total sum of R5 645 million was proposed to uphold domestic police services.

Budgeted and actual revenue



An amount of R2 029 million was set aside in the Budget for fiscal 1992/93 for the financing of export incentives. Of this amount no less than R872 million was destined for the redemption of promissory notes issued under the old export promotion scheme.

The large borrowing requirement of the Central Government, arising partly from the unsound financial practice of financing current expenditure by means of borrowed funds, together with the high level of nominal interest rates, gave rise to an increase of 17,1 per cent in the expenditure on the servicing of public debt. This brought the servicing costs of debt to no less than 16,2 per cent of total expenditure in fiscal 1992/93. In contrast to the two preceding years, the Budget did not provide for a general contingency reserve for additional expenditure, but created targeted reserves instead. These targeted reserves amounted to R1 250 million, which included R1 000 million for drought relief and R250 million for retrenchment costs. Subsequently on 7 May 1992 the Minister of Agriculture and Agricultural Development announced that an amount of R3 826 million would be granted for drought relief. This amount includes the R1 billion set aside in the targeted reserve. The remaining portion of this amount (R2 826 million) will be spread over the next three fiscal years.

Total government expenditure was accordingly estimated to increase by 16,5 per cent to R100,7 billion for the fiscal year as a whole. This could cause Exchequer issues to government departments to increase further to 29,1 per cent of gross domestic product. Total ordinary revenue of the government was budgeted to rise by 15,7 per cent to R84,8 billion in fiscal 1992/93. After having decreased for two years, this should result in an increase in total ordinary government revenue as a ratio of gross domestic product to 24,5 per cent.

The main features on the revenue side of the Budget are:

- Tax relief for those people most severely hit by bracket creep, for married women and for the elderly. Although these concessions will give rise to a decline of R1,4 billion on the taxation of individuals, the expected revenue from income tax on individuals should nevertheless rise by 22,3 per cent.
- The ad valorem excise duty introduced on 30 September 1991 was converted into an equivalent specific duty and certain specific excise duties were increased. The total revenue from the higher excise duties is estimated at R295 million.
- An increase in the levy on petrol by 8 cents per litre and that on diesel by 6 cents per litre, while the farmers' diesel rebate was increased by 2 cents per litre.
- Transfer duties and stamp duties on bank debits were raised.
- Further progress was made in the phasing-out of the surcharge on non-gold-mining companies and the formula rate for gold mines was adjusted downwards to bring it more into line with the company tax rate.

No new proposals were made in the case of tax on non-mining companies and it is estimated that this source of income will grow only modestly by 7,2 per cent in fiscal 1992/93. The income collected from value-added tax was estimated to increase by 9,9 per cent in the fiscal year, but the temporary exemption from this tax granted on certain selected foodstuffs which should have terminated on 31 March 1992, was subsequently extended indefinitely.

Summary of Budget for 1992/93

	Budget 1992/93 Rand millions	Budget 1992/93 Percentage increase
Total government expenditure	100 676	16,5
Total government revenue	84 749	15,7
Customs and excise duties	11 223	28,4
Inland revenue	73 526	14,0
Income tax	48 867	16,7
GST/VAT	20 225	9,9
Other	4 434	5,4
Budget deficit before borrowing	15 927	
Deficit as % of GDP	4,5	

As a result of the more rapid rise in budget expenditure than in budget revenue, the deficit before borrowing and debt repayment was estimated at R15 927 million, or 4,5 per cent of the estimated gross domestic product. This deficit was to be financed as follows:

	R millions
Government stock	13 023
Bonds	-66
Foreign loans	351
Total	13 308
Plus: Transfers from National Supplies Procurement Fund and Central Energy Fund	1 600
Change in cash balances	1 019
Total financing	**15 927**

Exchequer account in April 1992

In April 1992 the Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) were 10,3 per cent higher than in April 1991. Exchequer receipts also increased at a rate well below the Budget figure and, compared with the same month in the preceding year, rose by only 2,4 per cent in April 1992. The deficit before borrowing and debt repayment amounted to R3 212 million in April 1992.