Quarterly economic review

Introduction

The downturn in economic activity deepened further in the fourth quarter of 1991 and a small decline at an annualised rate of ½ per cent was recorded in real gross domestic product. The South African economy has now been in a recession for close to three years; this is more than double the average length of 17 months of such cyclical downswings in the post-war period.

Until early 1991 the downturn in economic activity was largely restricted to decreases in the production of certain economic sectors, but during the course of the year it became more widespread and large decreases were recorded in the real value added by manufacturing, construction, commerce and transport. As shown in the accompanying graph, economic activity (as measured by real non-agricultural domestic product) during the first part of the downturn remained above the trend line it had displayed in the 1980s, and moved below this line only from early 1991.

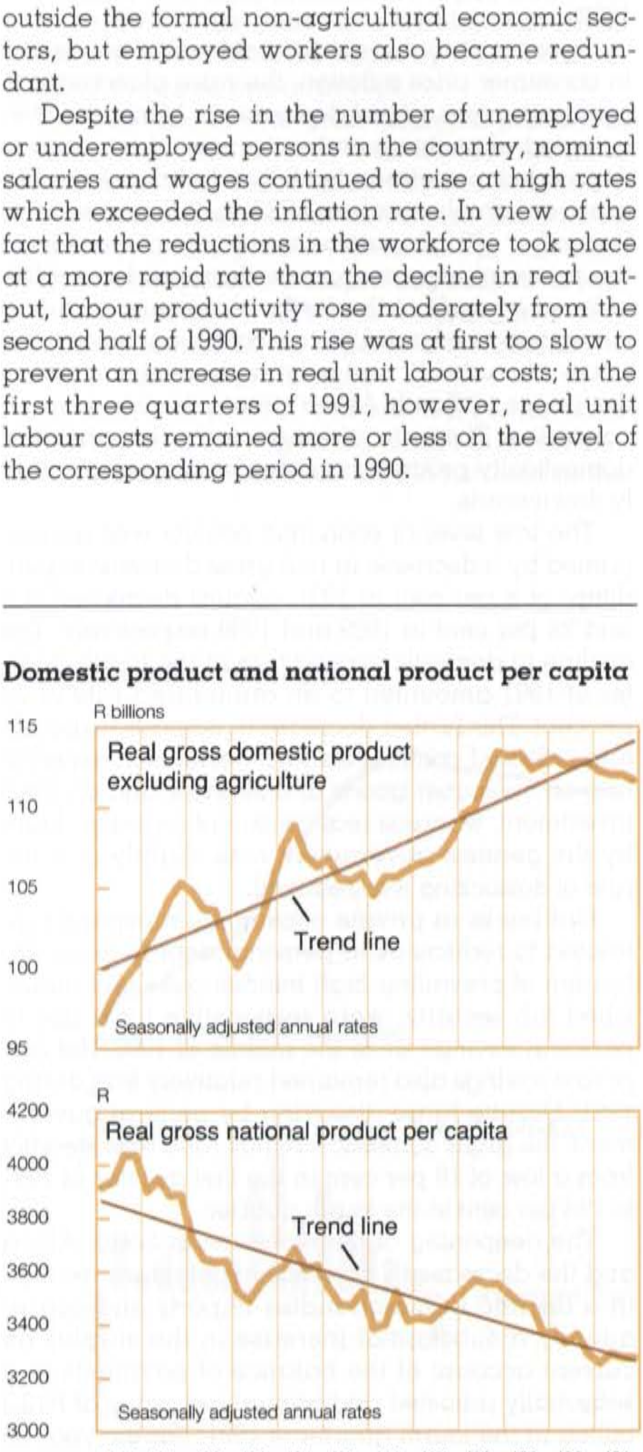
However, even more important than this cyclical development is the fact that real non-agricultural domestic product increased at a very modest rate during the 1980s, i.e. trend growth was relatively flat. This caused real income levels (as measured by the real gross national product *per capita*) to decline substantially during the 1980s. In 1991 the real gross national product per head of the population amounted to R3 275, compared with R3 208 in 1971 and R3 905 in 1981.

The graph clearly illustrates the main problem of the South African economy: a slow growth in production combined with a rapid increase in population. The graph also indicates that in addition to the cyclical downturn that the country is currently experiencing, serious structural deficiencies exist in the economy; the challenge facing the authorities is not only to bring economic activity back to its trend line, but rather to increase the slope of the trend line. It therefore shows that it is important to restructure the economy in order to improve its production potential without over-heating it in the short term and having to return to the current growth trend line.

What is more, the low rate of growth in domestic production coincided with an increased capital intensity, with the result that non-agricultural employment grew by a meagre 0,2 per cent per year from 1981 to 1991. This means that approximately 2 million people had to find a means of livelihood outside the formal non-agricultural sectors, or become unemployed. In the past two years this structural deficiency was aggravated by the cyclical downturn, which led to a *decrease* in non-agricultural employment. Not only did new entrants to the labour market have to be accommodated outside the formal non-agricultural economic sectors, but employed workers also became redundant.

Despite the rise in the number of unemployed or underemployed persons in the country, nominal salaries and wages continued to rise at high rates which exceeded the inflation rate. In view of the fact that the reductions in the workforce took place at a more rapid rate than the decline in real output, labour productivity rose moderately from the second half of 1990. This rise was at first too slow to prevent an increase in real unit labour costs; in the first three quarters of 1991, however, real unit labour costs remained more or less on the level of the corresponding period in 1990.

Domestic product and national product per capita



The continued high rate of increase in labour costs was an important factor in keeping the rate of increase in consumer prices at high levels throughout 1991 and in January 1992. This factor was assisted by continued high inflationary expectations incorporated in price and wage-setting decisions, the introduction of value added tax and substantial increases in food prices. If food is excluded, the rate of increase in other consumer prices declined from 15,4 per cent in July 1991 to 13,9 per cent in January 1992.

In contrast to the virtually sideways movement in consumer price inflation, the rates of increase in producer prices edged downwards. Measured over a period of twelve months, the rate of increase in the production price index fell on balance from 14,6 per cent in November 1990 to 8,6 per cent in December 1991. In particular, the rate of increase in the prices of imported goods decreased considerably as a result of the further lowering of import surcharges in March 1991, a decline in international prices of crude oil, and only moderate increases in the prices in South Africa's main trading partner countries. The rate of increase in the prices of domestically produced goods also moved gradually downwards.

The low level of economic activity was accompanied by a decrease in real gross domestic expenditure of ½ per cent in 1991, against decreases of ½ and 2½ per cent in 1989 and 1990 respectively. The decline in domestic expenditure in the fourth quarter of 1991 amounted to an annualised rate of 2½ per cent. This further decrease in domestic expenditure reflected continued sharp declines in expenditure on consumer goods and services and on fixed investment, whereas real consumption expenditure by the general government rose slightly and the rate of destocking was reduced.

Cut-backs in private consumption expenditure related to reductions in personal debt to avoid the burden of prevailing high interest costs and diminished job security, were responsible for a rise in personal savings since the middle of 1990. Net corporate savings also remained relatively firm during 1991. Despite large dissaving by general government, the gross domestic savings ratio rose steadily from a low of 18 per cent in the first quarter of 1991 to 19½ per cent in the fourth quarter.

The deepening of the recession in South Africa and the decrease in domestic expenditure resulted in a decline in merchandise imports and consequently a substantial increase in the surplus on current account of the balance of payments to a seasonally adjusted and annualised value of R12,3 billion in the fourth quarter of 1991. For the year as a whole the surplus amounted to R7,4 billion.

The value and volume of merchandise exports rose at a fairly rapid rate during 1991, but tapered off in the fourth quarter. For the second year running a substantial expansion in the exports of manufactured products was largely responsible for the sound export performance. As a percentage of total merchandise exports, manufactured products have now increased their share consistently from 13½ per cent in 1987 to 18½ per cent in 1991. Although this may be regarded as a reflection of a realistic value of the exchange rate of the rand, it is probably also due to the low level of domestic economic activity, which has forced manufacturers to seek other outlets for their goods.

The large surplus on current account was supported by an improvement in the capital account of the balance of payments. The total net outflow of capital not related to reserves came down from an annual average of R5 billion in the period 1985 to 1989, to R2,9 billion in 1990 and to only R1,4 billion in the first nine months of 1991. This enabled the Reserve Bank to stop quoting preferential rates on forward exchange cover transactions, which had been specifically introduced at the end of 1988 to encourage foreign trade financing. Owing largely to this change, but also because of the practice followed by some foreign banks of reducing their outstanding assets against non-residents at the end of their financial years in December, a net outflow of no less than R4,6 billion was recorded in the fourth quarter of 1991.

The improvement in the overall balance of payments position resulted in a rise of R2,5 billion in the gross gold and other foreign reserves in 1991 to a level of R9,8 billion at the end of the year; these reserves are equivalent to the value of nearly two months' imports of goods and services. In particular, the gold reserves of the Reserve Bank increased by 2,4 million fine ounces during the year to 6,5 million fine ounces at the end of 1991.

The rising foreign exchange reserves of the country made it possible to maintain a relatively stable exchange rate of the rand. The nominal effective exchange rate of the rand declined by about 6½ per cent in 1991, and then decreased marginally by 0,6 per cent from the end of 1991 to 29 February 1992. In December 1991 the real effective exchange rate of the rand was therefore only 0,1 per cent below its level in December 1990.

At first the rate of growth in money supply in the guideline year 1991 remained within the guideline range of 8 to 12 per cent, but with the implementation of the regulatory changes under the Deposit-taking Institutions Act it moved sharply above the upper limit of the so-called cone. For the rest of the year the growth in M3 exceeded the upper limit of the guidelines. From the fourth quarter of 1990 to the fourth quarter of 1991 M3 increased by 14,8 per cent. If allowance is made, however, for the regulatory changes by measuring the growth in M3 from the end of February 1991 (the month in which they took effect) to the end of January 1992, the underlying growth rate (at a seasonally adjusted and annualised rate) amounted to a provisionally estimated 9,7 per cent.

Slower growth in credit extended was recorded in 1991, reflecting the generally depressed conditions of the economy and the effect of positive real interest rates. Some monetary institutions also became less accommodating in providing further credit to clients, and concentrated less on expanding their total assets and more on upgrading or maintaining the quality of credit extension. However, homeowners continued to make use of mortgage advances to purchase durable and other consumer goods because of the relative low cost of this type of financing and the general flexibility of repayments.

Fairly liquid conditions prevailed in the financial markets in 1991. The money market, which had already eased markedly in the final months of 1990, became more flushed with funds during 1991; accordingly the Reserve Bank had to make extensive use of specially-dated Treasury bills and foreign exchange intervention swaps in order to counter excessive increases in liquidity. Trading activity in the capital market, although fluctuating at times, remained at relatively high levels.

These fairly easy conditions and an expected decrease in Bank rate resulted in a gradual softening of most money market rates in 1991 and the first two months of 1992. The average yield on long-term government stock, on the other hand, rose from a low of 15,6 per cent in February and March 1991 to 17,2 per cent in October. Expectations of a Bank rate reduction then caused this rate to soften to 16,6 per cent in January 1992.

Fiscal policy turned out to be more expansionary in the first ten months of fiscal 1991/92 than had been envisaged in the Central Government's Budget of March 1991. Exchequer issues rose at a higher rate and Exchequer receipts at a lower rate than budgeted. The deficit before borrowing and debt repayment was therefore equal to 4,4 per cent of gross domestic product up to the end of December 1991, compared with a budgeted figure of 3,4 per cent for the fiscal year as a whole.

Domestic economic developments

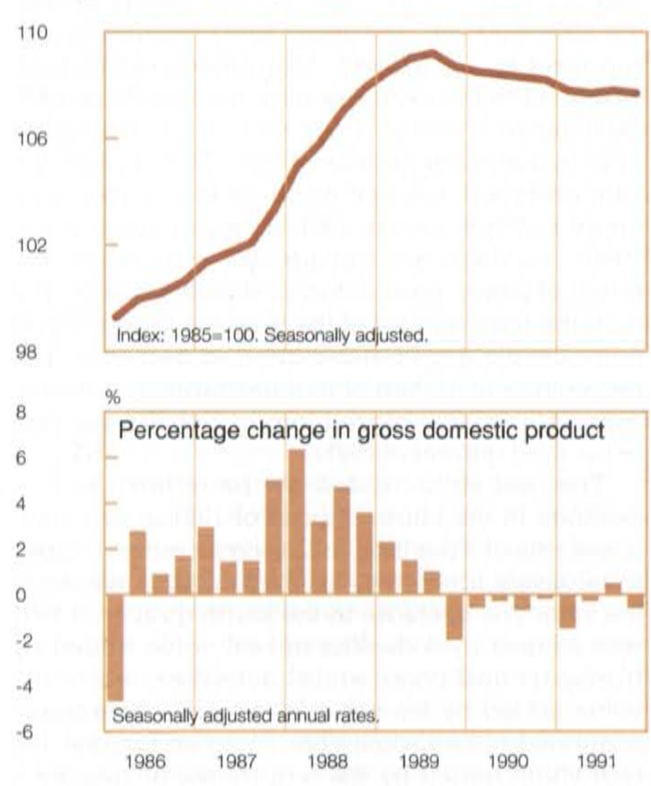
Domestic production

The modest rise in *aggregate domestic product* in the third quarter of 1991 – after seven quarters of uninterrupted declines – proved to be rather shortlived. Provisional data for the fourth quarter of the year indicate that total real output declined at an annualised rate of approximately ½ per cent. This means that for the year as a whole, real gross domestic product declined again by ½ per cent, i.e. by about the same rate as in 1990.

The decrease in real gross domestic product in the fourth quarter of 1991 was the net result of decreases in real value added by the secondary and tertiary sectors, which more than neutralised the growth in the primary sectors. For calendar 1991 the value added by the primary sectors as well as by the secondary sectors contracted, and only the tertiary sectors made a positive contribution to growth in domestic production.

Agricultural production started to increase marginally from the beginning of 1991 and rose further at annualised rates of 6 and 5 per cent in the

Real gross domestic product



last two quarters of the year. The increase in the fourth quarter of 1991 could be attributed mainly to higher field crop production. According to current estimates, the 1991 wheat crop amounted to about 2,1 million tons, which is approximately 23 per cent more than the 1,7 million tons harvested in the previous season. This increase in agricultural production, however, started off from a low level at the end of 1990; the real value added by agriculture for 1991 as a whole therefore still decreased by 1½ per cent, despite the rising trend evidenced during the course of the year.

After the physical volume of *mining output* had declined for three successive quarters, it increased again during the second half of 1991. The rate of increase in mining production accelerated somewhat from an annualised rate of ½ per cent in the third quarter of 1991 to a preliminary estimated rate of 1 per cent in the fourth quarter. This rise mainly reflected an increase in gold production because of the processing of ore with a higher gold content. Diamond and coal mining production were also maintained at relatively high levels, but the real output of other mining products contracted markedly in view of a weak international demand for base metals and mineral products. For the year as a whole, mining output declined by about 1½ per cent, compared with a decrease of 1 per cent in 1990.

The decline in real value added by the *secondary sectors* in the fourth quarter of 1991 could be attributed mainly to a decrease in real output by manufacturing enterprises, but the sectors providing electricity, gas and water, and construction also reported lower growth. Manufacturing output, which started to decrease from the middle of 1990, declined by a further 4 per cent (at an annualised rate) in the fourth quarter of 1991. This brought the total decline in the real value added by manufacturing to 2½ per cent in 1991, against 1½ per cent in 1990. The decrease during 1991 was again the result of lower production of durable goods, but from the third quarter of the year the production of non-durable goods also started to decrease. The percentage utilisation of manufacturing production capacity therefore moved to a low of 80,4 per cent in the third quarter of 1991.

The real value added by the *tertiary sectors* declined in the fourth quarter of 1991 at an annualised rate of ½ per cent, following increases – albeit at relatively low rates – in the first nine months of the year. The decrease in the fourth quarter of 1991 was caused by a decline in real value added by transport and commercial activities, while the value added by finance and general government continued to rise somewhat. In calendar 1991 the real value added by the tertiary sector rose by ½ per cent, or at roughly the same rate as in the preceding year.

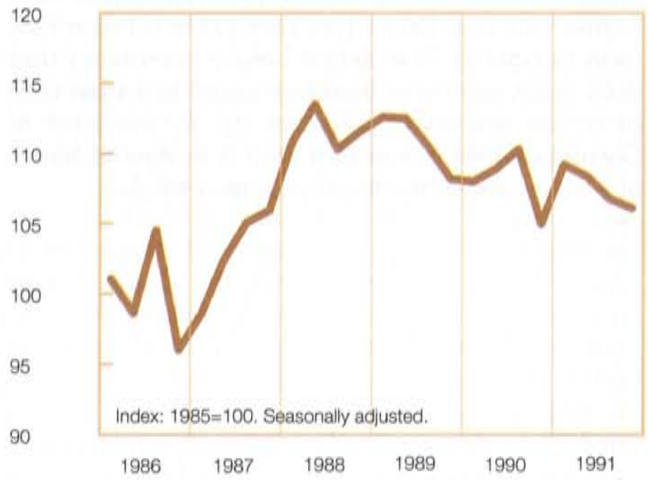
In contrast to the contraction in real gross domestic product, *real gross national product* rose marginally by almost ½ per cent in 1991. This moderate increase – following a decline of more than 1 per cent in 1990 – could be attributed to a decline in South Africa's real net factor payments to the rest of the world, which offset a further deterioration in the country's terms of trade. Real gross national product *per capita*, however, continued to contract in 1991; the rate of decrease amounted to 2 per cent, compared with 2½ and 3½ per cent in the two preceding years. In 1991 gross national product per capita at constant 1985 prices amounted to R3 275, which may be compared with a figure of R3 208 in 1971 and R3 905 in 1981.

Domestic expenditure

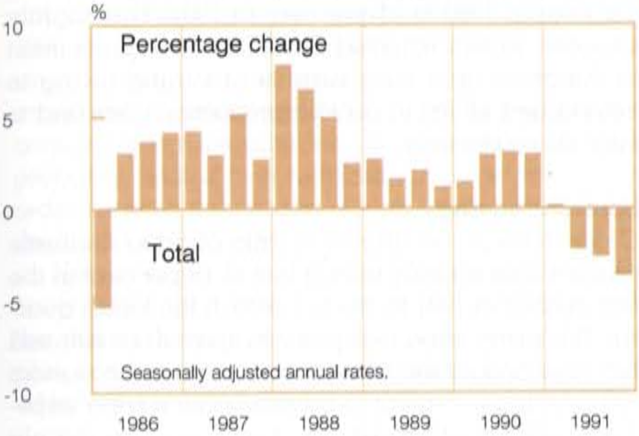
Real *gross domestic expenditure* decreased only slightly by ½ per cent in 1991; this may be compared with rates of decline of ½ and 2½ per cent in 1989 and 1990, respectively. The decline in domestic expenditure in the fourth quarter of 1991 amounted to an annualised rate of nearly 2½ per cent. This further decrease in domestic expenditure reflected sharp declines in expenditure on consumer goods and services and on fixed investment, whereas real consumption expenditure by general government rose slightly and the rate of destocking was reduced.

Aggregate real *private consumption expenditure*, which had begun to decline in the second quarter of 1991, decreased at an annualised rate of 3½ per cent in the fourth quarter of 1991. For 1991 as a whole real private consumption expenditure

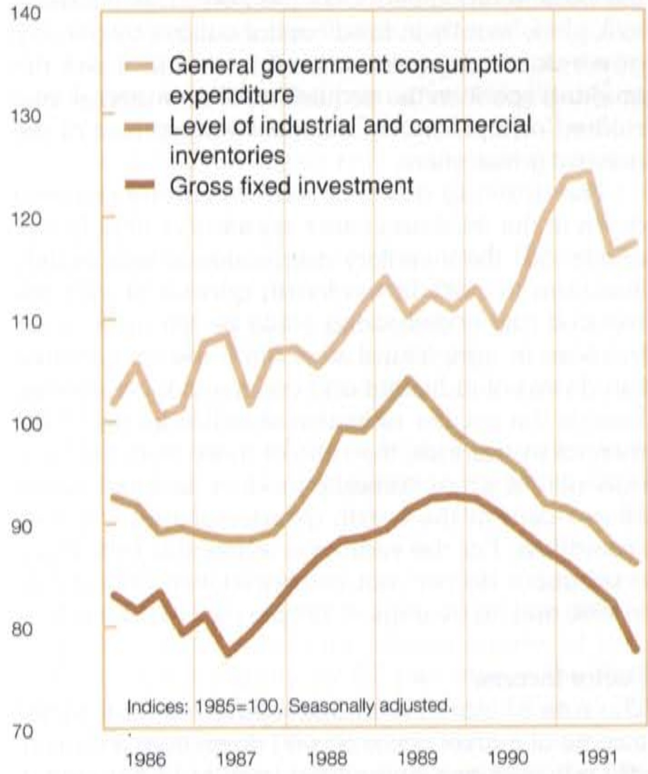
Real gross domestic expenditure



Real private consumption expenditure



Main components of real gross domestic expenditure



remained more or less at the level of 1990. The decline in consumption expenditure during the course of 1991 occurred mainly in the expenditure on goods, while expenditure on services remained relatively firm.

In particular, households' real outlays on durable goods contracted throughout 1991, and in the fourth quarter these outlays dropped at an annualised rate of nearly 15 per cent. The latter decrease was widely spread amongst most categories of durable consumer goods, but households cut back significantly on outlays on furniture, household appliances and new motor vehicles. In the second half of 1991 households' expenditure on semi-durable and non-durable goods also subsided, and in the fourth quarter even expenditure on consumer services contracted at an annualised rate of 1½ per cent.

The growth in real *government consumption expenditure*, which had increased at high rates in the last two quarters of fiscal 1990/91, tapered off in fiscal 1991/92. In the second quarter of 1991 (or the first quarter of the fiscal year) the rise in real government consumption expenditure slowed down to an annualised rate of 1½ per cent, before this kind of expenditure fell back at an annualised rate of 23 per cent in the third quarter; it then rose again by almost 4 per cent in the fourth quarter. In calendar 1991, real government consumption expenditure still increased by 5½ per cent.

Total real *gross domestic fixed investment* declined substantially in the fourth quarter of 1991 – the eighth consecutive quarterly decline in this aggregate. Declines occurred in all three of the main institutional sectors, but particularly private-sector companies and public corporations cut back on capital expenditure. The further curtailment of capital expenditure brought about an acceleration in the rate of decrease in real fixed investment from 1½ per cent in 1990 to 8½ per cent in 1991.

Following marked declines in the preceding three quarters, real fixed capital formation by the private sector fell back further by about 3 per cent in the fourth quarter of 1991. The more noticeable reductions in the private sector's capital outlays in the fourth quarter were recorded in the mining sector and in residential construction. More limited rates of contraction were, however, also recorded in nearly all the other economic sectors.

The investment expenditure of *public corporations* was dominated in 1989 and 1990 by activities related to the development of the Mossgas project. Up to the end of 1990 this expenditure was so large that it neutralised cut-backs in Eskom's capital programmes. With the Mossgas project nearing completion, the resultant decline in capital expenditure brought about a considerable decline in total capital expenditure by public corporations. The real fixed capital formation of the public corporations in 1991 was approximately 27 per cent lower than in 1990.

Real fixed investment expenditure by *public authorities* contracted at an annualised rate of 4½ per cent in the fourth quarter of 1991. In 1991 as a whole, the decline amounted to 2½ per cent. This decrease took place mainly in fixed capital outlays by general government departments, which neutralised the amounts spent on the acquisition of new aircraft and related equipment by business enterprises of the general government.

The drawing-down of real *inventories* slowed down in the third and fourth quarters of 1991. In calendar 1991 the inventory disinvestment was slightly less than in 1990. In the fourth quarter of 1991 the reduced rate of destocking could be attributed to an increase in agricultural stocks-in-trade and smaller run-downs of industrial and commercial inventories. Despite the smaller reduction of industrial and commercial inventories, the ratio of these stocks to non-agricultural gross domestic product declined below 18 per cent in the fourth quarter of 1991 – a new record low. For the year as a whole this ratio averaged about 18½ per cent, compared with 19½ per cent in 1990 and an average of 22½ per cent in the 1980s.

Factor income

The rate of increase in *aggregate nominal factor income* at market prices slowed down from a seasonally adjusted and annualised level of 14 per cent in the first three quarters of 1991 to 12 per cent in the fourth quarter. The average rate of increase in calendar 1991 amounted to 12½ per cent, against 13 per cent in 1990.

An analysis of the two principal components of factor income at factor cost (namely remuneration of employees and the gross operating surplus) shows that the rate of increase in the *remuneration of employees* decelerated from 15 per cent in the first half of 1991 to 14 per cent in the second half. This slower growth could be observed in sectors such as agriculture, electricity, gas and water, commerce and general government.

On an annual basis the rate of increase in nominal labour rewards slowed down from 17 per cent in 1990 to 14½ per cent in 1991. The growth in labour costs of business enterprises (i.e. excluding general government) was 13½ per cent in 1991. The total wage bill of general government, however, rose by 19½ per cent; this increase was only slightly smaller than the increase of 20 per cent in 1990.

Despite the lower growth in nominal salaries and wages in 1991, the share of labour rewards in total factor income continued to rise; it expanded from approximately 59½ per cent in 1990 to 60 per cent in 1991. This ratio reached a low of 57 per cent in 1988.

The slower growth in factor income in the fourth quarter of 1991 also reflected a lower rate of increase in the *gross operating surplus*; this aggregate rose at an annualised rate of 8 per cent in the fourth quarter, compared with 16 per cent in the previous quarter. On an annual basis, however, the rate of increase in nominal gross operating surpluses increased from 9½ per cent in 1990 to 11 per cent in 1991. This slightly stronger growth reflected a noticeable improvement in the gross operating surplus of mining owing to determined efforts to contain production costs and to improve productivity.

Domestic saving

Gross domestic saving as a ratio of gross domestic product rose steadily from a low of 18 per cent in the first quarter of 1991 to 19½ per cent in the fourth quarter. This rising trend took place in spite of a continued net dissaving by the general government throughout 1991. An improvement in private-sector saving, especially net personal saving, was therefore mainly responsible for the stronger savings performance of the economy. For the year as a whole, gross domestic saving as a ratio of gross domestic product was at 19 per cent, well below the average 24½ per cent of the 1980s.

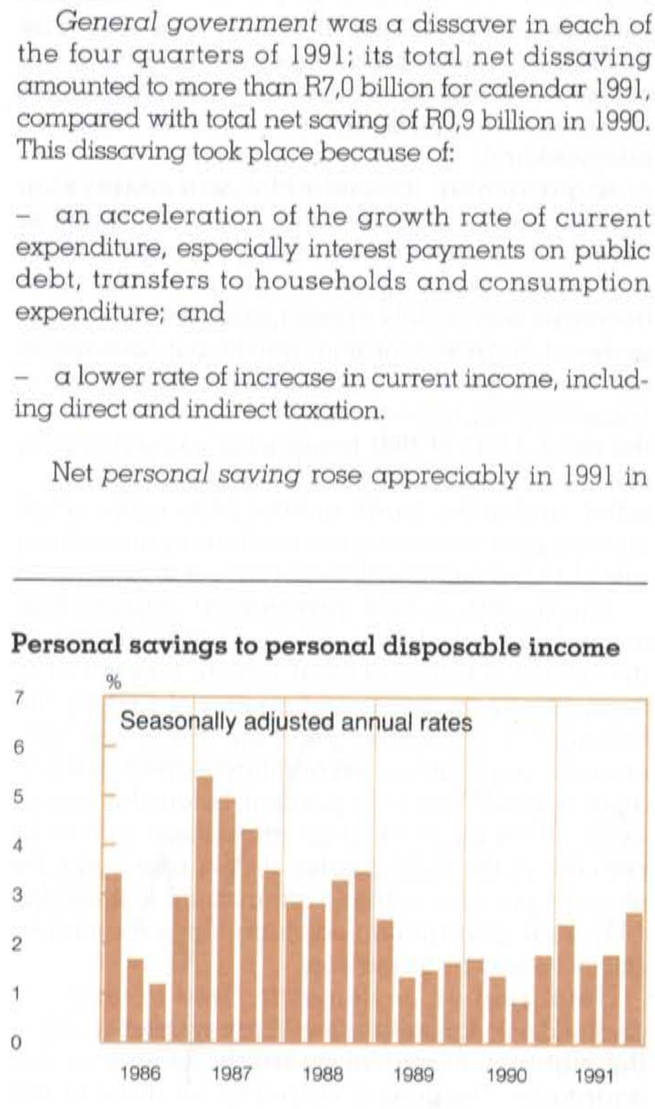
General government was a dissaver in each of the four quarters of 1991; its total net dissaving amounted to more than R7,0 billion for calendar 1991, compared with total net saving of R0,9 billion in 1990. This dissaving took place because of:

– an acceleration of the growth rate of current expenditure, especially interest payments on public debt, transfers to households and consumption expenditure; and

– a lower rate of increase in current income, including direct and indirect taxation.

Net *personal saving* rose appreciably in 1991 in

Personal savings to personal disposable income



the face of declining per capita real income of households. The ratio of net personal saving to personal disposable income therefore increased from a low not quite reaching 1 per cent in the third quarter of 1990 to 2½ per cent in the fourth quarter of 1991. This improvement in net personal saving could be attributed to meaningful cut-backs in real private consumption expenditure during the course of 1991, probably related to a reduction in personal debt in order to avoid the burden of high interest costs and a decline in job security.

Net *saving by the corporate sector* remained relatively firm during 1991. This could be associated with the rise in the primary sector's gross operating surplus and more conservative dividend policies adopted by several companies.

Employment

Apart from the first quarter of 1990, *non-agricultural employment* has declined in every calendar quarter since the third quarter of 1989. Moreover, the quarter-to-quarter rate of decrease in non-agricultural employment (seasonally adjusted and annualised) accelerated during this period and amounted to 2,1 and 3,5 per cent, respectively, in the first and second quarter of 1991; it then moderated to 0,9 per cent in the third quarter because of a rise in employment by public authorities and a slower rate of reduction in employment by the private sector. In the first nine months of 1991 total non-agricultural employment was 2,3 per cent below its level in the corresponding period of the previous year.

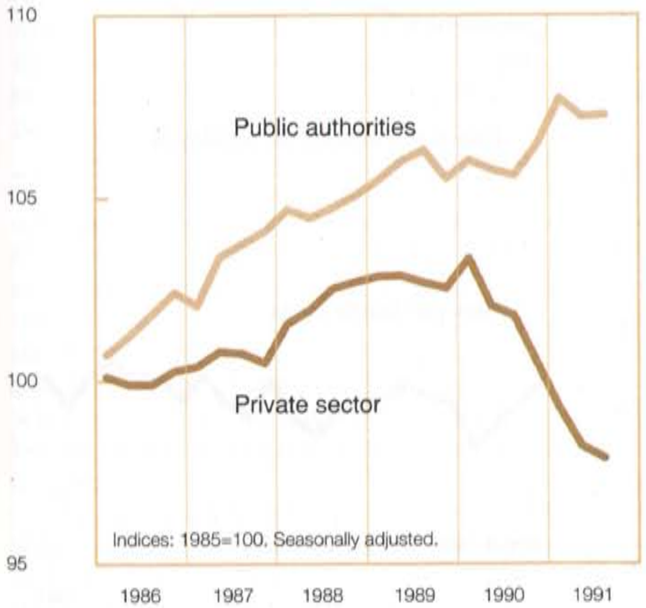
Total employment in the *private sector* also started to decline from the third quarter of 1989. The quarter-to-quarter rate of decrease in private-sector employment accelerated from a seasonally adjusted and annualised rate of 0,7 per cent in the third quarter of 1989 to 4,9 per cent in the first quarter of 1991. In the second quarter this rate of decrease slowed down to 4,2 per cent, it then decelerated further to 1,3 per cent in the third quarter. The level of employment in the private sector in the third quarter of 1991 was roughly equal to that of the fourth quarter of 1980. This means that over a period of eleven years no growth has taken place in private non-agricultural employment.

After also decreasing at fairly high rates from the fourth quarter of 1989 (except in the first quarter of 1990), employment by *public authorities* increased at seasonally adjusted and annualised rates of 3,2 and 4,8 per cent in the fourth quarter of 1990 and the first quarter of 1991; it then decreased again by 1,8 per cent in the second quarter of 1991, but recovered slightly by 0,2 per cent in the third quarter. Employment by public authorities in the first nine months of 1991 was therefore 1,5 per cent higher than in the corresponding period of the previous year. This rise 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 relatively weak demand for labour was also evident from the number of *overtime hours worked* in the manufacturing and construction sectors. The ratio of overtime hours to normal hours worked in manufacturing declined in eight consecutive quarters from the third quarter of 1989 to the second quarter of 1991; it then increased in the third quarter. The movement of this ratio in the construction industry was characterised by fluctuations around a downward sloping trend from the second quarter of 1989 to the fourth quarter of 1990. In 1991 it fluctuated around a relatively higher level up to the third quarter.

The seasonally adjusted total number of *registered unemployed workers* increased from a low point of 111 200 in November 1988 to 288 300 in July 1991 before falling back to 211 700 in September. As indicated in previous surveys, the number of registered unemployed persons increased dramatically in July 1990 to a higher level because of the adoption of a new method for measuring the number of unemployed.

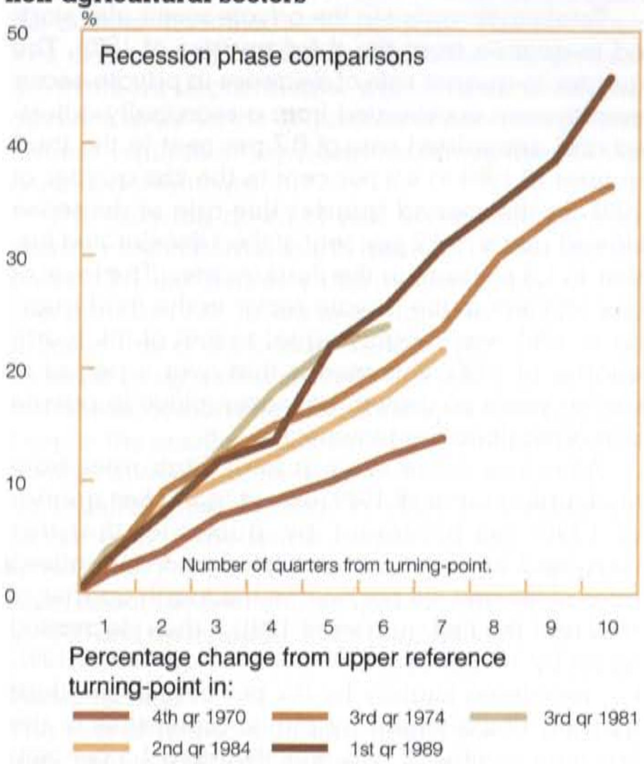
Employment in non-agricultural sectors



Labour costs and productivity

The rate of increase in the average *nominal amount of salaries and wages* per worker of *all*

Average nominal remuneration per worker in non-agricultural sectors



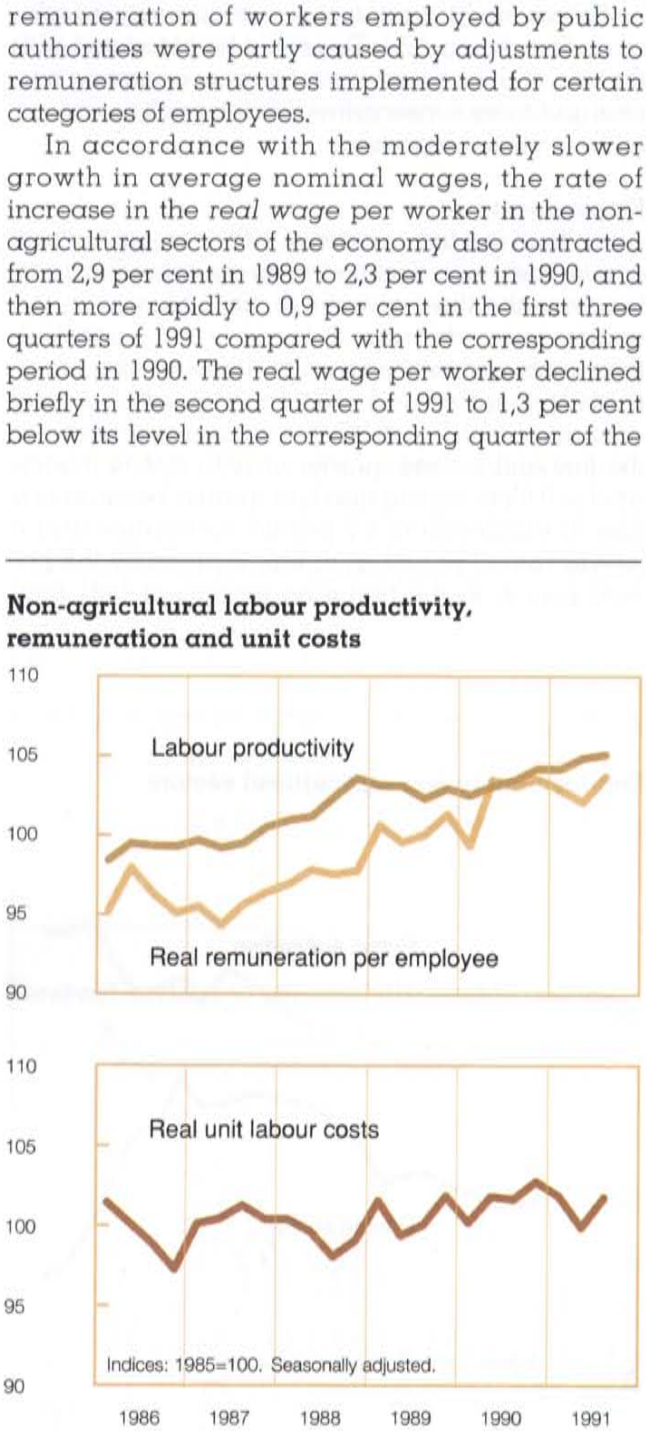
workers in the non-agricultural sectors decelerated from 18,0 per cent in 1989 to 17,0 per cent in 1990 and 16,0 per cent in the first three quarters of 1991 compared with the corresponding period of 1990. The year-on-year rate of increase in nominal salaries and wages per worker in the non-agricultural sectors remained relatively high between the first quarter of 1989 and the first quarter of 1991; it then decelerated, however, from 18,5 per cent in the first quarter of 1991 to only 13,5 per cent in the second quarter, but rose again to 16,2 per cent in the third quarter.

The rate of increase in nominal salaries and wages per worker in the *private sector* remained on a high level throughout the current downturn of economic activity. In fact, the rate of increase in the remuneration per worker in the private sector rose from 16,3 per cent in 1989 to 16,6 per cent in 1990, and then declined only marginally to 15,8 per cent in the first three quarters of 1991 compared with the same period of 1990. Ten quarters into the current downswing, the rate of wage increases is higher than during any of the previous downswings in the 1970s and 1980s. These continued high rates of increase can partly be ascribed to the efforts of trade unions to improve the welfare of their members further without taking their productivity and the increasing number of unemployed persons into consideration.

Increases in the nominal salaries and wages of people employed by the *public authorities* also contributed to the exorbitant rise in labour costs. The nominal wage per worker employed by public authorities rose by no less than 21,9 per cent in 1989 before this rate of increase decelerated to 17,6 per cent in 1990 and 15,9 per cent in the first three quarters of 1991 compared with the corresponding period of 1990. These rapid rises in the nominal remuneration of workers employed by public authorities were partly caused by adjustments to remuneration structures implemented for certain categories of employees.

In accordance with the moderately slower growth in average nominal wages, the rate of increase in the *real wage* per worker in the non-agricultural sectors of the economy also contracted from 2,9 per cent in 1989 to 2,3 per cent in 1990, and then more rapidly to 0,9 per cent in the first three quarters of 1991 compared with the corresponding period in 1990. The real wage per worker declined briefly in the second quarter of 1991 to 1,3 per cent below its level in the corresponding quarter of the

Non-agricultural labour productivity, remuneration and unit costs



previous year. The year-on-year rate of increase in the real wage per worker then rose again to 0,6 per cent in the third quarter because of accelerated nominal wage increases for workers employed by both the public authorities and the private sector.

Measured in terms of year-on-year changes, *labour productivity* started rising in the third quarter of 1990 at a rate of 1,1 per cent. This rate of increase then accelerated in the ensuing quarters to 1,7 per cent in the second quarter of 1991 and to 1,6 per cent in the third quarter. The improvement in the real production per worker was due to the fact that reductions in the workforce took place more rapidly than declines in the volume of real production in the economy.

The rate of increase in *nominal unit labour costs* accelerated from 12,6 per cent in 1988 to 17,2 per cent in 1989, and then slowed down to 16,1 per cent in 1990 and to 14,2 per cent in the first three quarters of 1991 compared with the corresponding period of 1990. The year-to-year rate of increase in *real unit labour costs* (as deflated by the non-agricultural gross domestic product price deflator) declined from 1,4 per cent in 1989 to 0,9 per cent in 1990. In the first three quarters of 1991, real unit labour costs stayed virtually unchanged compared with the first three quarters of 1990.

Prices

A distinct declining trend was discernible in the rate of increase in the *production price index* during 1991. Measured over *periods of twelve months*, the rate of increase in this index fell, on balance, from 14,6 per cent in November 1990 to 7,9 per cent in November 1991 and to 8,6 per cent in December. These were the first single-digit increases in this price index since October 1984. The *year-to-year* rate of increase in the total production price index therefore also declined from a recent high of 15,2 per cent in 1989 to 12,0 per cent in 1990 and to 11,4 per cent in 1991.

The *quarter-to-quarter* rate of increase in the production price index declined from a seasonally adjusted and annualised rate of 20,8 per cent in the fourth quarter of 1990 to only 3,2 per cent in the second quarter of 1991, mainly owing to a decrease in the prices of imported oil and a lower rate of increase in the prices of domestically produced goods. This rate of increase then accelerated somewhat to 12,5 per cent in the third quarter of 1991 before receding again to 9,0 per cent in the fourth quarter.

The declining trend in production price inflation was mainly due to a downward trend in the price increases of *imported goods*, which was related to the *moderate* extent of the decrease in the nominal effective exchange rate of the rand, the lowering of import surcharges in March 1991, a decline in the prices of imported petroleum products, 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* therefore declined from a peak of 19,1 per cent in November 1990 to only 4,9 per cent in October 1991; the prices of imported goods then declined by 2,0 per cent in November before rising again by 1,9 per cent in December.

The *quarter-to-quarter* rate of increase in the prices of imported goods also changed from a historically high seasonally adjusted and annualised rate of 53,8 per cent in the fourth quarter of 1990 to a negative rate of 14,0 per cent in the second quarter of 1991. This significant decline was mainly the result of a decline in crude oil prices at the end of the war in the Persian Gulf, as well as of the lowering of the surcharges on imported goods. The prices of imported goods then increased again at quarter-to-quarter seasonally adjusted and annualised rates of 10,9 and 5,1 per cent in the next two quarters.

The rate of increase in the prices of *domestically produced goods* over *periods of twelve months* accelerated from a recent low point of 11,2 per cent in March 1990 to 13,9 per cent in March 1991; this rate then varied around a level of 12 per cent up to October 1991 and receded to 10,3 and 10,2 per cent in the last two months of the year.

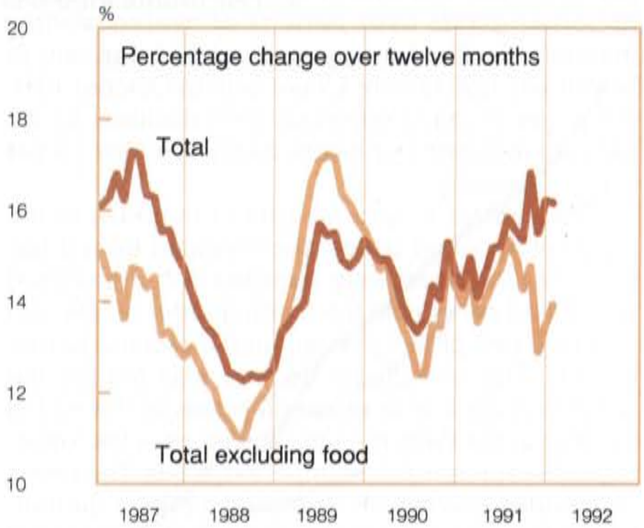
The *quarter-to-quarter* rate of increase in the prices of domestically produced goods also declined from a seasonally adjusted and annualised rate of 14,7 per cent in the fourth quarter of 1990 to 8,2 per cent in the second quarter of 1991; it then reaccelerated to 12,0 per cent in the third quarter before declining once again to 10,3 per cent in the fourth quarter. The further decline in the fourth quarter of 1991 was achieved despite continued high increases in the prices of food and a sharply higher rate of increase in the prices of alcoholic beverages and tobacco.

In contrast to the declining trend in production price increases, the rate of increase in the *consumer price index* has remained relatively high. In fact, the *year-to-year* rate of increase in the consumer price index actually rose marginally from 14,4 per cent in 1990 to 15,3 per cent in 1991.

The rates of increase in this price index over *periods of twelve months* started to increase from August 1990 – before the outbreak of the war in the Persian Gulf – and varied between 14 and 16 per cent in the ensuing months up to September 1991. In October it accelerated sharply to 16,8 per cent because of the implementation of the value added tax; it then declined again to 15,5 per cent in November and rose to 16,2 per cent in December 1991 and January 1992.

The *quarter-to-quarter* rate of increase in the

Consumer prices



consumer price index also accelerated on balance from a seasonally adjusted and annualised rate of 13,5 per cent in both the second and the third quarter of 1990 to rates of 16,7 and 18,4 per cent in the third and the fourth quarter of 1991. As has already been noted in previous quarterly reviews, the rising trend in the increases in this price index was once again caused by high and rising rates of increase in the prices of consumer goods. The rates of increase in the prices of consumer services declined in the first three quarters of 1991, but then accelerated sharply in the fourth quarter because of the implementation of value added tax.

Various *factors* have contributed to the persistently high rates of increase in consumer prices over the past year, including:

– Consumer prices of food increased at high and even accelerating rates from the beginning of 1989 up to January 1992. The twelve-month rates of increase in the consumer prices of food rose from 8,1 per cent in April 1989 to 27,7 per cent in December 1991 and 25,8 per cent in January 1992.

– The implementation of value added tax on 30 September 1991 led to a substantial non-recurrent rise in the level of the prices of both consumer goods and services.

– Continued high rates of increase occurred in the nominal remuneration per worker in the formal sectors of the economy up to the third quarter of 1991, despite weakened economic conditions. In conjunction with low increases in labour productivity, this put upward pressure on business costs and prices.

– The changes observed in the total consumer price index havestrengthened inflationary expectations which were incorporated into price and wage-setting decisions.

Balance of payments and exchange rates

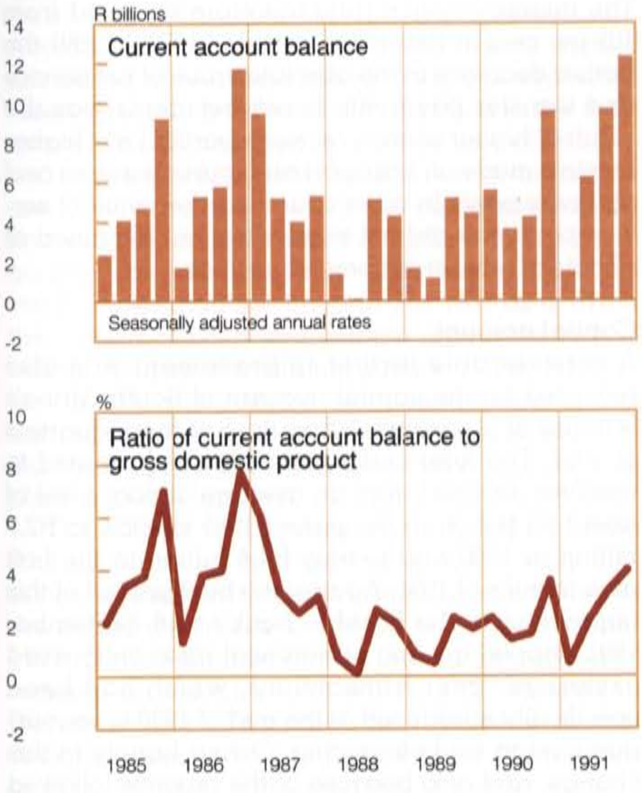
Current account

The *surplus on the current account* of the balance of payments improved considerably during the course of 1991. After having reached the low figure of R1,5 billion (at a seasonally adjusted and annualised rate) in the first quarter of 1991 due to exceptional circumstances at the time (already explained at length in previous *Quarterly Bulletins*), the surplus on the current account at first rose again to R6,2 billion in the second quarter – i.e. to about its average level in 1990; it then, however, increased further to R9,7 billion in the third quarter of 1991 and to R12,3 billion in the fourth quarter. For 1991 as a whole, the surplus on the current account amounted to R7,4 billion; this brought the cumulative surplus during the past seven years to no less than R36,2 billion, or to 2,5 per cent of gross domestic product.

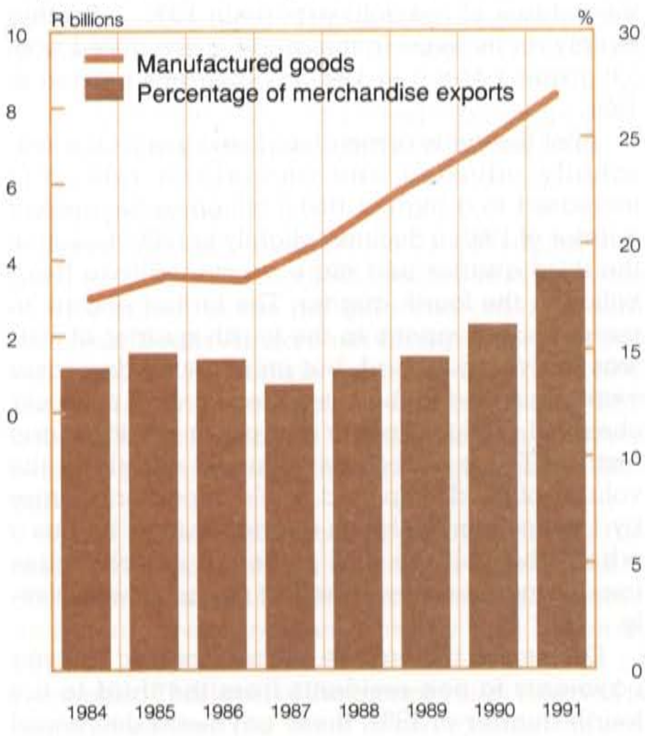
The sharply rising trend in the surplus on current account during 1991 was mainly related to the deepening of the recession in the South African economy, which led to a sharp decline in merchandise imports during the year. The exceptionally large surplus on the current account in the fourth quarter of 1991 was therefore also mainly due to lower imports combined with higher net gold exports, which more than offset a decline in the value of merchandise exports and a rise in net service and transfer payments to non-residents. For the year as a whole, however, the value of merchandise imports still rose by 9 per cent; the higher surplus for calendar 1991 was the result of higher merchandise and net gold exports and lower net service and transfer payments to non-residents.

The value of *merchandise exports*, which had progressed to a new record high of R48,6 billion (seasonally adjusted and annualised) in the third quarter of 1991, contracted by 2½ per cent in the fourth quarter. This decrease in exports was caused by a decline of 3½ per cent in the volume of exported goods, while export prices rose by 1 per cent. For 1991 as a whole, however, the total value of merchandise exports increased by 8½ per cent and its volume by 3½ per cent. Although international commodity prices declined by 12½ per cent in US dollar terms, South Africa's export prices increased by 4½ per cent during the year, reflecting the decline in the nominal effective exchange rate of the rand and a declining share of primary com-

Balance of payments



Export of manufactured goods



modities in total merchandise exports.

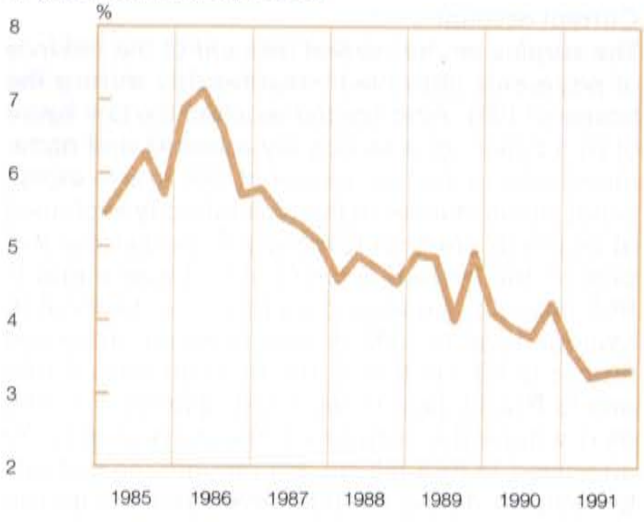
For the second year running a substantial expansion in the exports of manufactured products was largely responsible for the sound export performance. The exports of manufactured products rose by 21 per cent in 1991, following an increase of 19½ per cent in the previous year. As a percentage of total merchandise exports, manufactured products have now increased their share consistently during the past four years from 13½ per cent in 1987 to 18½ per cent in 1991 – an indication that the level of the exchange rate of the rand still allows South African exporters to compete successfully in international markets. The continued strong performance of manufactured exports is probably also a reflection of the low level of domestic demand, which is prompting manufacturers to seek other outlets for their goods.

The value of *net gold exports* (seasonally adjusted and annualised) also rose persistently from R17,3 billion in the first quarter of 1991 to R21,2 billion in the fourth quarter, owing mainly to a rise in the price of gold. The average price of South Africa's gold exports rose by 7 per cent in 1991, i.e. at a considerably higher rate than the rise in the average London fixing price of gold (expressed in rand) from R992 per fine ounce in 1990 to R1 000 per fine ounce in 1991 or by only 0,8 per cent. This higher price for South African gold exports can be attributed to forward gold sales on favourable terms. The volume of net gold exports also contributed to the rise in the value of these exports in 1991. An increase of 1½ per cent was recorded in the volume of net gold exports in 1991, reflecting mainly an increase in the grade of ore milled from 5,0 grams per ton in 1990 to 5,2 grams per ton in 1991.

After the value of *merchandise imports* (at a seasonally adjusted and annualised rate) had increased to a high of R50,2 billion in the second quarter of 1991, it declined slightly to R49,1 billion in the third quarter and more substantially to R45,9 billion in the fourth quarter. The further decline in merchandise imports in the fourth quarter of 1991 was fairly widespread, but pronounced decreases were registered in the categories mineral products, chemical products, paper and paper products, and textiles. These decreases occurred mainly in the volume of goods imported, while import prices rose by 1 per cent in the fourth quarter. During 1991 as a whole the volume and prices of merchandise imports increased by 3½ and 5½ per cent respectively.

Despite an increase in *net service and transfer payments* to non-residents from the third to the fourth quarter of 1991, these payments decreased from R10,6 billion in 1990 to R9,9 billion in 1991 as a whole – their second consecutive annual decline.

Net services and transfer payments as percentage of gross domestic product



Moreover, as a percentage of gross domestic product, net service and transfer payments to non-residents have declined for five years running from 6½ per cent in 1986 to 4 per cent in 1990 and 3½ per cent in 1991. Lower interest payments to foreigners, reflecting the decline in South Africa's foreign debt, were mainly responsible for this declining trend. The interest-service ratio therefore declined from 10½ per cent in 1985 to 6 per cent in 1991. In 1991 the further decrease in the absolute value of net service and transfer payments to non-residents was the result of higher service receipts, particularly higher receipts made on transport and tourist services and on investments in other countries; the value of service payments did not rise further but remained at about the level of the preceding year.

Capital account

A considerable further improvement was also recorded on the capital account of South Africa's balance of payments during the first three quarters of 1991. The *total* outflow of capital not related to reserves declined from an average annual level of about R5 billion in the period 1985 to 1989, to R2,9 billion in 1990 and to only R1,4 billion in the first nine months of 1991. Against the background of this improvement, the Reserve Bank on 16 September 1991 stopped quoting preferential rates on forward exchange cover transactions, which had been specifically introduced at the end of 1988 to encourage foreign trade financing. Owing largely to this change, and also because of the practice followed by some foreign banks of reducing their outstanding assets against non-residents at the end of their

Net capital movements (not related to reserves)

R millions

	1990	1991				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	-1 160	-167	116	-398	346	-103
Public corporations	890	188	345	-183	-20	330
Private sector	-1 675	-604	-787	-774	-768	-2 933
Total long-term capital	-1 945	-583	-326	-1 355	-442	-2 706
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	-929	1 362	-1 748	1 258	-4 217	-3 345
Total capital movements, excluding liabilities related to reserves	**-2874**	**779**	**-2 074**	**-97**	**-4 659**	**-6 051**

financial years, a net outflow of capital of no less than R4,6 billion was recorded in the fourth quarter of 1991. This brought the net outflow of capital not related to reserves to R6,1 billion for calendar 1991 and to R35,7 billion in the period 1985 to 1991.

The substantial net outflow of capital in the fourth quarter of 1991 occurred mainly in the form of a reduction in South Africa's foreign short-term liabilities related to foreign-trade financing. Accordingly, the net inflow of *short-term capital* (including unrecorded transactions, but excluding reserve-related liabilities) of R1,3 billion in the third quarter of 1991 changed to a net outflow of R4,2 billion in the fourth quarter. In addition to the higher cost of forward cover which encouraged domestic financing of foreign trade, this outflow in the fourth quarter was also partly related to the decline in the value of merchandise imports. For 1991 as a whole the outflow of short-term capital amounted to R3,3 billion, compared with a net outflow of only R0,9 billion in 1990. Preliminary information indicates that this outflow of short-term capital was reversed during the beginning of 1992 and that an inflow took place again in January.

The outflow of *long-term capital* declined from R1,4 billion in the third quarter of 1991 to only R0,4 billion in the fourth quarter, mainly on account of the public debt issue of DM400 million in October 1991; DM217 million of this loan was utilised to redeem an existing loan which had matured in December 1991. Two other debt issues were successfully launched in the European capital markets in January and February 1992: a public issue of ECU400 million and an issue of the Development Bank of Southern Africa of DM200 million.

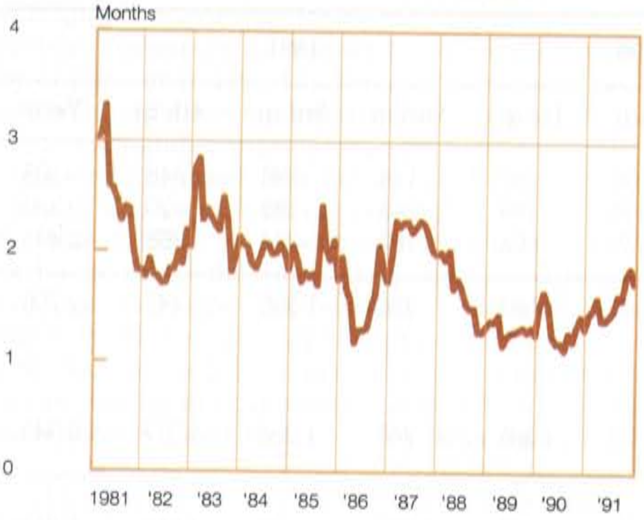
A substantial further outflow of long-term capital from the private sector occurred again in the fourth quarter of 1991. The net outflow of capital from the private sector in 1991 as a whole therefore came to a total of R2,9 billion. The largest part of this recorded outflow was, however, due to net sales by non-residents of securities listed on the Johannesburg Stock Exchange of R2,1 billion; these transactions do not represent a loss of gross foreign exchange reserves but are neutralised by corresponding inflows in other items of the capital account in view of the financial rand system in operation in South Africa. In particular, financial rand deposits by non-residents at authorised foreign exchange dealers rose sharply as a result of these transactions.

Foreign reserves

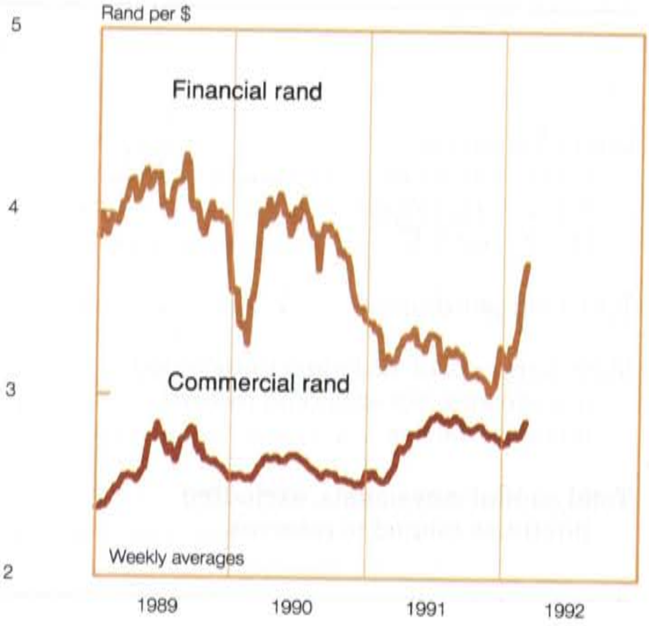
Although the substantial net outflow of capital during the fourth quarter of 1991 resulted in a decrease of R1,6 billion in *the net gold and other foreign reserves*, South Africa's net foreign reserves still increased by R1,4 billion in calendar 1991. In 1990 the net foreign reserves of the country rose by R2,9 billion. The total increase in the net foreign reserves over the past two years therefore amounted to R4,3 billion.

After taking into account an increase in the reserve-related liabilities which was offset by valuation adjustments, South Africa's total *gross gold and other foreign reserves* rose by R2,5 billion in 1991 to a level of R9,8 billion at the end of December. This level of the gross foreign reserves is slightly less than the value of two months' imports of goods and services. The gross reserves of the Reserve Bank, which had declined by R0,9 billion

Imports covered by gross foreign reserves



Exchange rates



in December 1991, more than fully recovered by R1,2 billion in January 1992 to R9,4 billion at the end of the month. In particular, the gold reserves of the Reserve Bank increased sharply during 1991 from 4,1 million fine ounces at the beginning of the year to 6,5 million fine ounces at the end of the year.

Exchange rates

The *nominal effective exchange rate* of the rand declined gradually by 6½ per cent during 1991, compared with 7 per cent during 1990. The further decrease in the average weighted exchange rate of the rand took place against all the main currencies. In particular, the rand depreciated substantially against the Japanese yen during 1991 on account of the relative strength of this currency in the international markets. During the first two months of 1992 the dollar appreciated sharply, with the result that the rand depreciated against the dollar but appreciated against nearly all the other main currencies. The net result of these exchange rate developments was a small decrease of 0,6 per cent in the nominal effective exchange rate of the rand from the end of December 1991 to the end of February 1992.

The decline in the nominal effective exchange rate of the rand during 1991 was slightly more than sufficient to counter the difference in inflation rates between South Africa and its main trading partners; the *real effective exchange rate* of the rand in December 1991 was therefore only 0,1 per cent below its level in December 1990.

The *financial rand*, which had started to appreciate sharply from about the end of 1990, reached a record low discount against the commercial rand of only 7 per cent on 19 November 1991. It then started depreciating again to a rate of R3,43 per dollar, or a discount of 18,1 per cent, at the end of January 1992. During February the financial rand rate fell sharply further because of uncertainties arising from the taxability of non-residents' income from investments originating from local sources. On 29 February 1992 the financial rand discount therefore amounted to 24,9 per cent.

Changes in exchange rates of the rand
%

	30 Jun 1991 to 30 Sep 1991	30 Sep 1991 to 31 Dec 1991	31 Dec 1990 to 31 Dec 1991	31 Dec 1991 to 28 Feb 1992
Weighted average ..	–0,7	–1,8	–6,3	–0,6
US dollar	2,9	2,3	–6,6	–3,8
British pound	–4,0	–4,4	–4,2	2,1
German mark	–4,8	–6,8	–5,4	3,7
Japanese yen	–1,2	–3,4	–13,2	–0,9
Netherlands guilder	–4,8	–6,7	–5,1	3,5
Italian lira	–4,3	–5,6	–4,6	2,7
Financial rand	5,3	–0,6	6,7	–16,5

Financial markets

Money supply

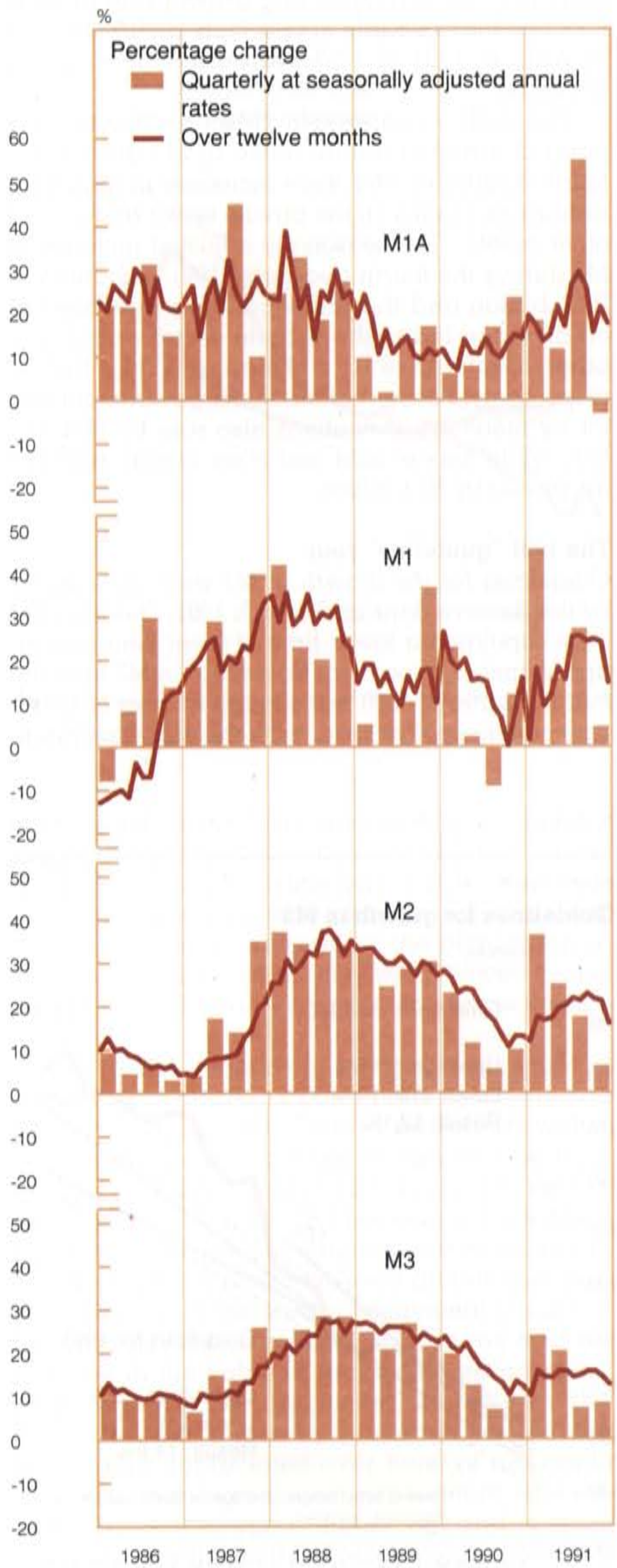
The *growth in money supply* subsided further in the fourth quarter of 1991. The rate of increase in the broadly defined money supply (M3) over twelve-month periods fell back from a peak of 27,5 per cent in August 1988 to 10,2 per cent in January 1991; it then rose again to 15,9 per cent in February, and fluctuated around this higher level up to November before declining to 12,7 per cent in December 1991. In January 1992 it rose again to a provisionally estimated 14,7 per cent. As already indicated in previous *Quarterly Bulletins*, this movement in the growth of M3 to higher levels was mainly caused by regulatory changes under the Deposit-taking Institutions Act which became effective from 1 February 1991 and which led to the conversion of existing off-balance-sheet items back onto the balance sheets of these institutions.

If allowance is made for the distortions created by these regulatory changes, the *underlying growth in M3* continued to decelerate during the fourth quarter of 1991 and January 1992: the growth rate in M3, seasonally adjusted and annualised, from the end of February 1991 to the end of January 1992 amounted to only 9,7 per cent. This further slow-down in money growth was primarily a reflection of the low level of economic activity in the domestic economy, leading to a decline in the demand for money despite a continued high level of domestic inflation. An expected softening of interest rates probably also weakened market participants' liquidity preference and led to adjustments in their portfolios of financial assets.

The reintermediation brought forth by the regulatory changes was also responsible for a reversal of the rising trend in the *income velocity* of the broadly defined money supply. After having increased by 2 per cent from the first quarter of 1990 to the fourth quarter of 1990, the *income velocity of M3* declined in the second quarter of 1991 to its lowest value (only 1,67) in the past twelve years. It then rose moderately during the second half of 1991 to a level (1,72) in the fourth quarter that was about 3 per cent above the trough in the second quarter of 1991, inter alia due to renewed disintermediation as the banks' lending/deposit rate margins widened somewhat.

In contrast to the declining trend in the growth of the broadly defined money supply, the rates of increase in the *narrower monetary aggregates* increased fairly sharply during the first nine months of 1991 due mainly to technical factors related to the new regulations, but then moved down sharply in the last few months of the year: the growth rates of M1 and M2 over periods of twelve

Monetary aggregates



months, which accelerated strongly to 24,4 and 22,9 per cent respectively at the end of September, fell back to 14,8 and 16,1 per cent in December 1991. Similarly, the corresponding growth rate in M1A fluctuated downwards from a high of 29,6 per cent in August 1991 to 17,7 per cent at the end of December.

The main *counterparts* (from an accounting point of view) of the increase in M3 during the fourth quarter of 1991 were increases in monetary institutions' claims on the private sector and in "net other assets". The seasonally adjusted increase in M3 during the fourth quarter of 1991 amounted to R2,1 billion and the corresponding increases in credit extended to the private sector and in net other assets were R1,5 billion and R1,6 billion respectively. The net claims on the government sector by monetary institutions also rose by R0,6 billion, while the net gold and other foreign reserves decreased by R1,6 billion.

The 1991 "guideline" year

Guidelines for the growth in M3 were announced by the Reserve Bank on 8 March 1991. These guidelines stipulated a lower limit of 8 per cent and an upper limit of 12 per cent for growth in M3 from the fourth quarter of 1990 to the fourth quarter of 1991 – 3 percentage points lower than the guideline range of 11 to 15 per cent that had applied in the 1990 guideline year. This signalled the monetary authorities' continuous pursuit of financial stability through the combating of inflation by the restriction of money supply growth.

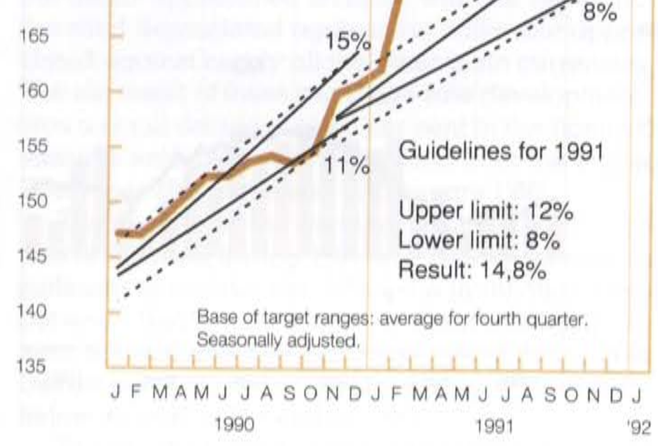
These guidelines were believed to be consistent with a projected small growth in real gross domestic product, a substantial surplus on the current account of the balance of payments, and a gradual strengthening of the official gold and other foreign reserves. They were also believed to be in line with a meaningful reduction in the inflation rate and allowed for a small downward adjustment of 1 percentage point in Bank rate from 18 to 17 per cent from 11 March 1991. To obtain these desired results, Bank rate was maintained at this slightly lower level throughout the remainder of the guideline year. Moreover, open-market transactions and other money market operations were used to ensure adequate levels of accommodation at the discount window to support the fairly restrictive policy stance of the monetary authorities.

At first the rate of *growth in money supply* in the guideline year remained within the guideline area, but with the introduction of the new regulatory changes in February 1991 the value of M3 moved sharply upwards to 5,0 per cent above the upper limit of the so-called "cone". During the remainder of the year M3 continued to expand on a path well above the guidelines, although it declined appreciably in December to only 1,4 per cent above the upper limit. From the fourth quarter of 1990 to the fourth quarter of 1991 M3 nevertheless still increased by 14,8 per cent. However, as already indicated, the underlying rate of growth in M3 during 1991 was fairly subdued. This adjusted growth rate fell marginally below the *lower* boundary of the guideline range.

On a *quarterly basis*, the quarter-to-quarter rate of increase in the average value of M3 (seasonally adjusted and annualised) contracted from 24,0 per cent in the first quarter of 1991 to 7,3 per cent in the third quarter; it then accelerated somewhat to 8,5 per cent in the December quarter – a rate only marginally higher than the lower limit of the guideline range.

In the *statistical or accounting* sense the R20,6 billion increase in M3 from the end of December 1990 to the end of December 1991 was more than fully explained by an increase of R24,3 billion in monetary institutions' claims on the domestic private sector. The monetary system's net gold and other foreign reserve holdings also rose by R1,4 billion over the same period. In contrast to these positive contributions to money growth, the monetary institutions' net claims on the government sector decreased by R2,2 billion and their net other assets by R2,9 billion.

Guidelines for growth in M3



All in all, the monetary authorities were therefore able to contain the growth in money supply at relatively satisfactory levels in order to uphold a restrictive monetary policy stance. Although the healthy balance of payments position resulted in a strengthening of the foreign reserves and facilitated the maintenance of a stable real effective exchange rate of the rand, certain other factors prevented the adoption of less stringent financial measures. The obvious and most important reason for not reducing Bank rate was the persistently high level of inflation as measured by changes in the consumer price index. Despite the marked increase in the gross foreign reserves in 1991, these reserves as at the end of the year were still well below a "minimum comfortable" level of some three months' imports of goods and services.

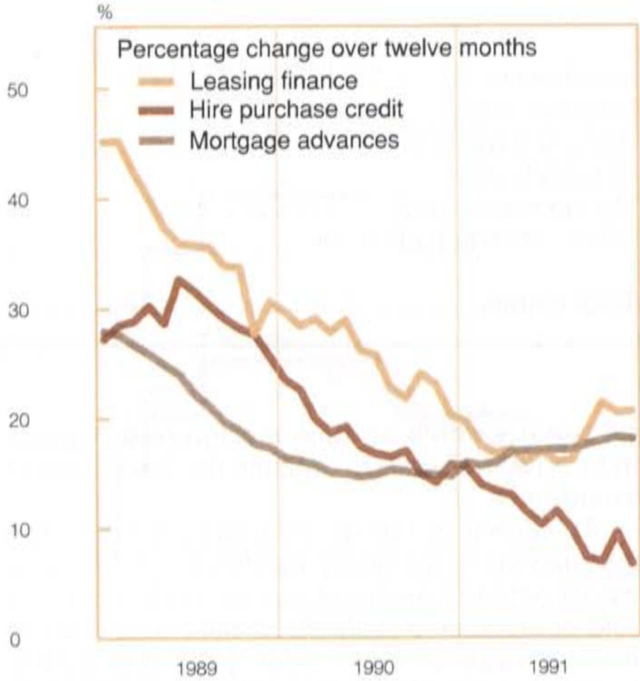
Credit extension by monetary institutions

At first the growth in *credit extended* by monetary institutions *to the domestic private* sector rose during the beginning of 1991, and then decelerated markedly in the last month of the year. The more rapid growth in credit extension early in 1991 was mainly due to regulatory changes under the Deposit-taking Institutions Act which induced these institutions to bring certain existing off-balance-sheet assets back onto their books. Measured over a period of twelve months, the rate of increase in credit extended to the private sector, which had receded from a peak of 29,2 per cent in October 1988 to 12,8 per cent in January 1991, therefore rose again to 18,7 per cent in February; it then fluctuated around this high level during the remainder of the year, before dropping substantially to 14,5 per cent in December 1991.

From the end of February 1991 (the month in which the new regulations came into effect) to the end of December, the growth in the monetary institutions' claims on the domestic private sector (seasonally adjusted and annualised) amounted to only 10,7 per cent, i.e. well below the rate of inflation. This slower growth in credit extension by monetary institutions was probably largely related to a lower demand for credit, reflecting the generally more depressed conditions of the economy together with the effect of positive real interest rates. Some monetary institutions have also become less accommodative in providing further credit to certain customers, concentrating less on increasing their total assets and more on improving the quality of their credit extension.

An analysis of the monetary institutions' claims on the domestic private sector by *type of credit* extended reveals that the twelve-month rate of increase in *hire-purchase credit* decelerated sharply from 15,7 per cent in December 1990 to only 7,2 per cent in December 1991. The rate of increase

Credit extention to the private sector



in so-called *"other loans and advances"* (mainly overdrafts) receded slightly from 12,8 per cent to 12,7 per cent over the same period. Both these relatively low rates of increase probably reflect a lower demand for credit utilised for the acquisition of durable consumer goods; they were, however, also partly the result of a switching to mortgage finance by borrowers.

The rate of increase in *mortgage advances* of monetary institutions continued to accelerate sharply during 1991. Over a period of twelve months the growth in these advances rose from 14,7 per cent in December 1990 to 17,5 per cent in September 1991 and to 18,0 per cent in December. These growth rates in mortgage advances well in excess of the inflation rate were probably in part an indication of the slower repayment of capital because of tight financial conditions and an increase in the value of real estate transactions. More importantly, however, it reflects the increased use made by homeowners (whose homes had appreciated over time) of this credit facility to finance consumer expenditure. The relative cost of this type of financing, and in some cases also the flexibility of repayments, made this form of financing more attractive to borrowers than other forms of advances provided by monetary institutions. At the same time, the lower capi-

Monetary institutions' claims on the domestic private sector

	Dec 1990 R billions	Dec 1991 R billions	Change %
Investments	4,9	4,0	–18,4
Bills discounted	10,2	13,1	28,4
Hire-purchase credit	18,0	19,3	7,2
Leasing finance	11,0	13,2	20,0
Mortgage advances	59,5	70,2	18,0
Other loans and advances	64,7	72,9	12,7
Total claims	**168,3**	**192,7**	**14,5**

tal requirements against mortgage advances induced some banks to promote this kind of credit extension.

As shown in the accompanying table, the *investments* of monetary institutions in financial assets actually declined during 1991, while the rate of increase in *bills discounted* amounted to no less than 28,4 per cent, probably partly because of a considerable switch from foreign to domestic financing of international trade in the last quarter of 1991 (after the termination of preferential forward rates on such transactions in September). Despite the sluggish demand for durable goods in 1991, *leasing finance* still increased by 20,0 per cent between December 1990 and December 1991; this is partly indicative of the extent to which such credit was utilised for the purchasing of industrial, commercial and office equipment, because of certain tax benefits associated with this form of financing.

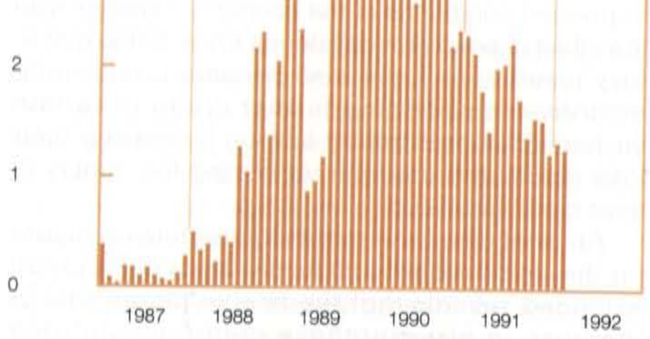
Money market conditions and Reserve Bank operations in the money market

Money market conditions, which had already eased markedly in the final months of 1990, became relatively more liquid during the course of 1991. The average daily level of accommodation at the Reserve Bank's discount window decreased from R2,3 billion in both December 1990 and January 1991 to R1,4 billion in April; it then rose somewhat to R2,2 billion in July before declining to R1,4 billion in September and R1,2 billion in December 1991. Early in 1992 it reached R1,3 billion in both January and February. The average daily amount of accommodation in 1991 was R1,8 billion, which was R1,4 billion less than the average of R3,2 billion recorded in 1990. The relative easier money market conditions in 1991 were also apparent from the fact that only negligible amounts of overnight loans were extended to the banks on rare occasions in the course of the year.

These easier conditions were the combined result of a number of factors, including:

- an improvement in the overall balance of payments position,which was especially important during the first nine months of the year;
- the phasing-in of a reduction of almost R1 billion in the minimum cash reserve requirements for all deposit-taking institutions over a period of four months from February 1991; and
- the cumulative deficits recorded by the Reserve Bank in its provision of forward exchange cover in the last threequarters of 1991.

Accommodation at the discount window

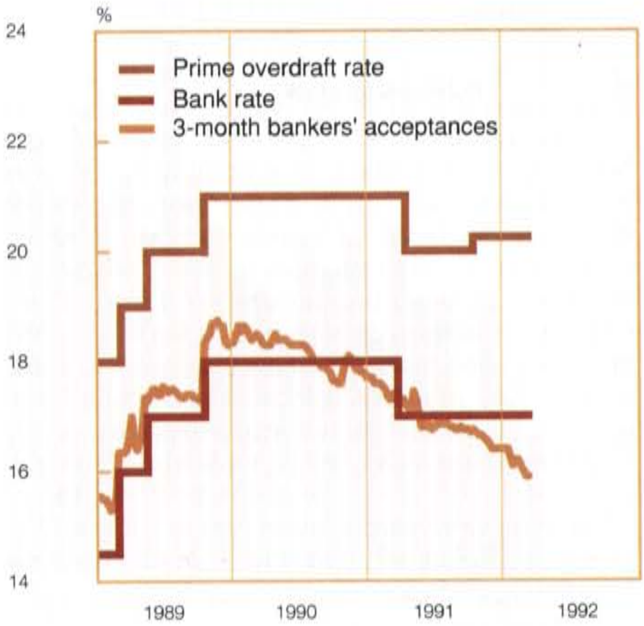


The *Reserve Bank's actions* in neutralising excess liquidity in the money market consisted mainly of foreign exchange intervention swaps with major banking institutions and the issuing of special short-dated Treasury bills. In December 1991, however, market liquidity declined to such an extent that it was unnecessary for the Reserve Bank to intervene. This was mainly due to an increase of nearly R1,8 billion in government deposits with the Reserve Bank, an increase in notes in circulation of close to R1,4 billion and a decrease of R0,9 billion in the net gold and other foreign reserves. In the first two months of 1992 the Reserve Bank again had to counter increased liquidity. During the course of January 1992 the Reserve Bank issued special short-dated Treasury bills to a maximum amount outstanding of R1,8 billion in order to drain liquidity on a short-term basis from the market, while in February it made use of both intervention swaps and short-dated Treasury bills to a combined maximum amount of R2,2 billion.

The average daily *level of government deposits* with the Reserve Bank rose somewhat in the last quarter of 1991 from R8,3 billion in September 1991 to R10,0 billion in December. These deposits then rose further to R12,9 billion in January 1992 and to R13,0 billion in February. The average daily amount of *notes in circulation* rose substantially from R9,5 billion in September 1991 to R11,9 billion in December; it then receded again to R10,1 billion in January 1992 and to R9,9 billion in February.

Net sales of *government stock* by the Reserve Bank amounted to R11,6 billion in 1991, compared with R8,0 billion in 1990, while the Bank's trading of *government stock options* rose substantially from R9,0 billion in 1990 to R23,5 billion in 1991. This brought more depth to the government stock market.

Short-term interest rates



Money market interest rates

The very gradual softening of most money market rates, which had started as early as February 1990, continued throughout 1991 and the beginning of 1992. This was clearly reflected in the rate on *three-month liquid bankers' acceptances*, which decreased from an average value of 18,57 per cent in January 1990 to 17,76 per cent in December 1990 and 16,40 per cent in December 1991. During the beginning of 1992 this rate declined further to 15,95 per cent on 29 February. At this level the bankers' acceptance rate was 1,55 percentage points below the Reserve Bank's rediscount rate for such acceptances.

Similar movements were recorded in most other short-term interest rates, including the futures contract rate in respect of bankers' acceptances. However, the tighter money market conditions experienced in December 1991 and again towards the end of January 1992 caused the *call rates between deposit-taking institutions* to remain at 16,0 per cent at the end of both December 1991 and January 1992. However, increased money market liquidity was then responsible for a decline in this rate to 15,75 per cent at the end of February 1992.

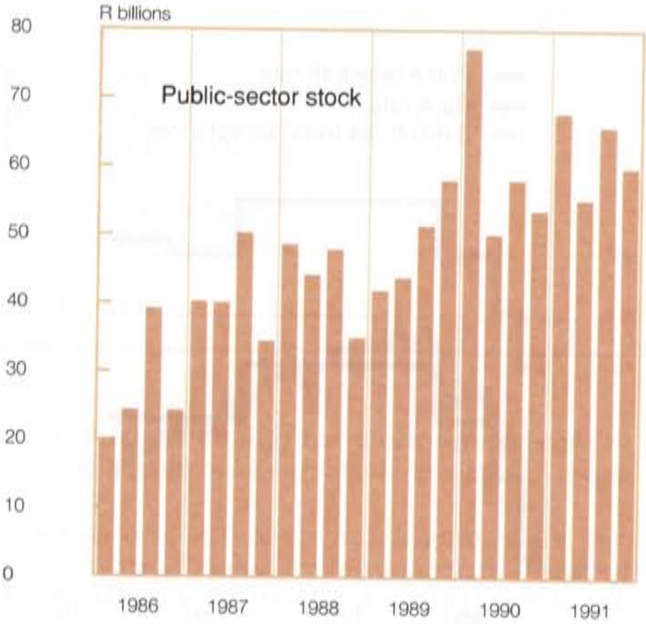
The *inflation-adjusted prime lending rate* also fluctuated downwards from approximately 6 per cent in January 1991 to only 4 per cent in September; it then decreased to 3½ per cent in October when the value added tax was introduced, before rising again to 4 per cent in December. In comparison with most of the industrialised countries, the level of this real interest rate remained comparatively low.

Capital market activity

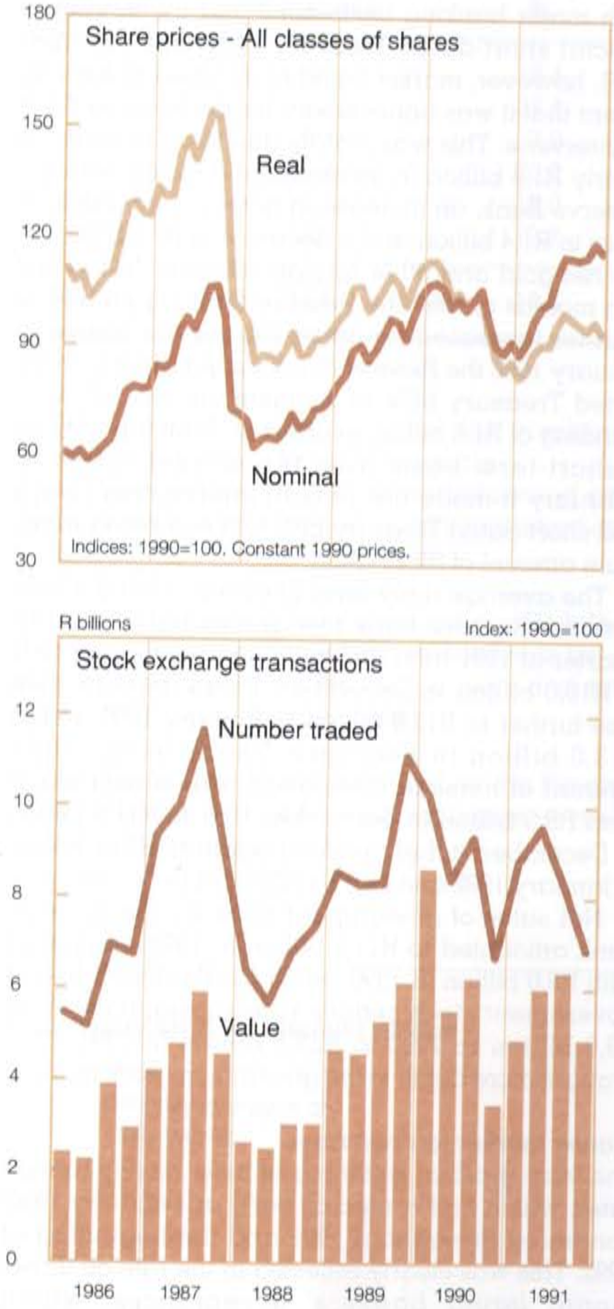
Trading activity on the *secondary capital markets* declined moderately during the fourth quarter of 1991. This decrease occurred in the volume of activity, whereas prices on these markets continued to rise or remained on a high level.

The value of *public-sector stock* traded on the Johannesburg Stock Exchange fell back from R65,9 billion in the third quarter of 1991 to R60,0 billion in the fourth quarter, i.e. roughly equivalent to its average quarterly level in 1990. These transactions during the fourth quarter of 1991 brought the value of public-sector stock traded on the stock exchange for the year as a whole to R249 billion, which was 4 per cent higher than the R239,4 billion recorded in

Stock exchange transactions



Shares



1990. During the course of the fourth quarter of 1991 trading in public-sector stock was influenced considerably by movements in the yield on long-term fixed- interest stock and by normal seasonal factors: with the easing of the yield from the middle of October 1991, transactions in public-sector stock picked up substantially in October and November 1991, only to decline again in December at the onset of the main holiday season in the country. In January 1992 the value of these transactions moved up to R27,6 billion.

The value of *shares* traded on the Johannesburg Stock Exchange, which had increased from R4,9 billion in the first quarter of 1991 to R6,4 billion in the third quarter, dropped again to R4,9 billion in the fourth quarter. The annual turnover of shares traded therefore also declined by 7 per cent from R23,9 billion in 1990 to R22,2 billion in 1991. The decrease in the value of shares traded in the fourth quarter was due to a further decline in the volume of shares traded; the average price of shares on the stock exchange firmed further. The *number of shares traded* declined consistently from 281,2 million in June 1991 to only 139,9 million in December, before rising again to 155,7 million in January 1992. This rise, together with an increase in share prices, brought the monthly value of shares traded in January 1992 to R1,9 billion, compared with an average monthly value of R1,6 billion in the fourth quarter of 1991.

The monthly average *price level of all classes of shares* reached an all-time high in January 1992. After having declined by about 12 per cent in 1990 and having reached a lower turning- point in January 1991, the average price level of all classes of shares strengthened by a substantial 37,1 per cent in the twelve months to January 1992. This sharp appreciation in average share values was the result of a surge in the prices of industrial and commercial shares by 51,6 per cent and in financial shares by 40,3 per cent over the twelve months until January 1992. Despite the poor international demand for metals and minerals and the relatively low prices for raw materials on world markets, mining share prices firmed by 15,9 per cent over the same period.

The excellent performance of share prices on the Johannesburg Stock Exchange during the advanced stages of the downturn in economic activity was probably related to a number of factors, including buying pressure by institutions in need of prime equities; a scarcity of high quality paper; a sharp rise in some of the world's stock markets, reflecting positive expectations of improved world economic conditions; higher domestic liquidity arising mainly from a better overall balance of payments position; and an expected decline in Bank rate and short-term interest rates in general.

Mainly as a result of this increase in share prices, the price-earnings ratio of industrial shares in South Africa rose from 8,18 in October 1990 to 13,45 in January 1992 – an increase closely in line with some of the major stock exchanges of the world. Equity investments as a hedge against inflation also performed well, with the price index of all classes of shares outpacing the consumer price index by almost 10 per cent from December 1990 to December 1991.

Non-residents remained active participants on the Johannesburg Stock Exchange in the fourth quarter of 1991 as net purchasers of public-sector stock and net sellers of shares. Total net sales of shares by non-residents amounted to R4,1 billion in 1991 (8 per cent less than in 1990), whereas their net purchases of public-sector stock amounted to R2,0 billion (38 per cent more than in 1990).

Fairly active conditions prevailed in the *primary capital markets* during the fourth quarter of 1991. The average quarterly value of funds raised by *public-sector* entities through new issues of *fixed-interest securities* to private-sector investors rose from R1,5 billion in the first three quarters of 1991 to no less than R4,9 billion in the fourth quarter. In the year 1991 these issues amounted to R9,3 billion, or 15 per cent more than the R8,1 billion recorded in 1990.

The value of funds raised by *private-sector* companies through new issues of *fixed-interest securities*, inclusive of convertible preference shares and debentures declined, however, from R967 million in the third quarter of 1991 to R446 million in the fourth quarter. In calendar 1991 the value of these issues at R1,6 billion was nevertheless way above the figure of R0,7 billion in 1990. This surge in fund raising – especially through convertible debentures – to meet cash flow requirements, is based on the fact that such debentures are offered at lower coupon rates than non-convertible debt and that there is no immediate effect on net earnings.

The buoyant conditions on the stock exchange and the relatively high cost of borrowed funds favoured *share capital* issues by companies as a means to raise funds. Rights issues also provide relatively cheap finance and offer relief to a market requiring good quality scrip. The value of new issues of ordinary shares by listed private-sector companies therefore increased from an average of R1,5 billion in the second and the third quarter of 1991 to R2,6 billion in the fourth quarter of 1991. The value of these issues on an annual basis rose from R4,5 billion in 1990 to R6,0 billion in 1991. Taking into account the number of issues of ordinary shares already planned for 1992, it could become a record year for such issues.

The value of *real estate transactions* grew by 18 per cent from R24,6 billion in 1990 to R29,1 billion in 1991; this was the combined result of increases of 13 per cent in the number of transactions and of 5 per cent in the average value per transaction. With inflation and building costs increasing at much higher rates, recourse could have been taken to smaller units. On a quarterly basis the value of real estate transactions peaked at R7,5 billion in the second quarter of 1991, and then contracted slightly to R7,1 billion in the fourth quarter. The introduction of value added tax did not appear to have a tangible effect on the market for real estate.

In the *mortgage market* the increase in deposit-taking institutions' and mutual building societies' holdings of mortgage loans decelerated marginally from R2,7 billion in the third quarter of 1991 to R2,6 billion in the fourth quarter.

Recent developments in the *derivatives markets* included the opening of these markets to non-resident investors as from 2 December 1991 and the introduction of the Traded Options Market on 24 January 1992.

The *Traded Options Market* is an extension of investment in the underlying equity market, with the Johannesburg Stock Exchange listing options on certain company shares and share indices. The main advantage of the options market is that it reduces exposure and promotes interest in the underlying securities, and in this way enhances liquidity. This new market set off to a slow start with only nine contracts with a premium of R13 430 and an underlying value of R250 400 on the first day of business. Activity increased to 127 contracts with a premium of R42 790 and an underlying value of R1,2 million in the last week of January 1992.

Divergent views in response to the buoyant share market resulted in a wide variety of positions being taken on the *South African Futures Exchange* by participants during 1991. The value of deals in futures contracts accordingly expanded markedly from R4,6 billion in the first quarter of 1991 to a new record of R7,7 billion in the third quarter; in the fourth quarter it receded again to R4,9 billion. In January 1992 the level of these transactions amounted to a substantial R2,9 billion.

Capital market interest rates and yields

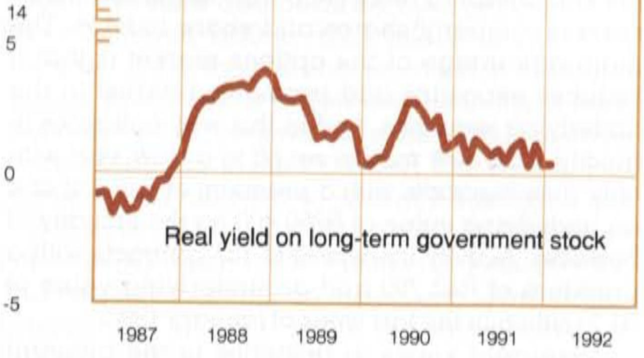
The monthly average *yield on long-term government stock* increased from a low of 15,6 per cent in February and March 1991 to 17,2 per cent in October, reflecting expected higher inflation rates and upward pressure exerted by substantial public-sector borrowing in the primary market. This yield then declined to 16,6 per cent in January 1992, but daily yields tended to increase again towards the end of January. In accordance with these movements and changes in the consumer price index, the monthly average real yield on long-term government stock increased from a low of 0,5 per cent in July 1991 to 1,3 per cent in September, and then eased again to 0,4 per cent in December 1991.

The deposit-taking institutions' *predominant home mortgage bond rate*, which had been maintained at 19,75 per cent since April 1991, was raised by 0,25 percentage points to 20,00 per cent in October 1991. This increase was made in reaction to the taxation introduced on financial institutions in lieu of value added tax. In an attempt to pre-empt a cut in Bank rate, most of the larger deposit-taking institutions announced late in January 1992 that home loan rates would be reduced by 1,0 percentage point to 19,0 per cent with effect from 2 March 1992.

The taxation on financial institutions referred to above, also led to a reduction in the *twelve-month deposit rate* of deposit-taking institutions. This rate, which is regarded as indicative of deposit rates in general, was lowered by 0,50 percentage points in October 1991 to 15,5 per cent to alleviate the pressure on interest rate margins between lending and deposit rates.

Concurrent with the surge in the average level of share prices, the *dividend yield* contracted from 4,29 per cent in January 1991 to 3,23 per cent in July and to 3,13 per cent in January 1992. The *earnings yield* on all classes of shares, excluding gold-mining shares, also decreased from 11,33 per cent in January 1991 to 8,0 per cent in August and to 7,58 per cent in January 1992 because of higher share prices as well as lower company profits.

Capital market yields



Government Finance

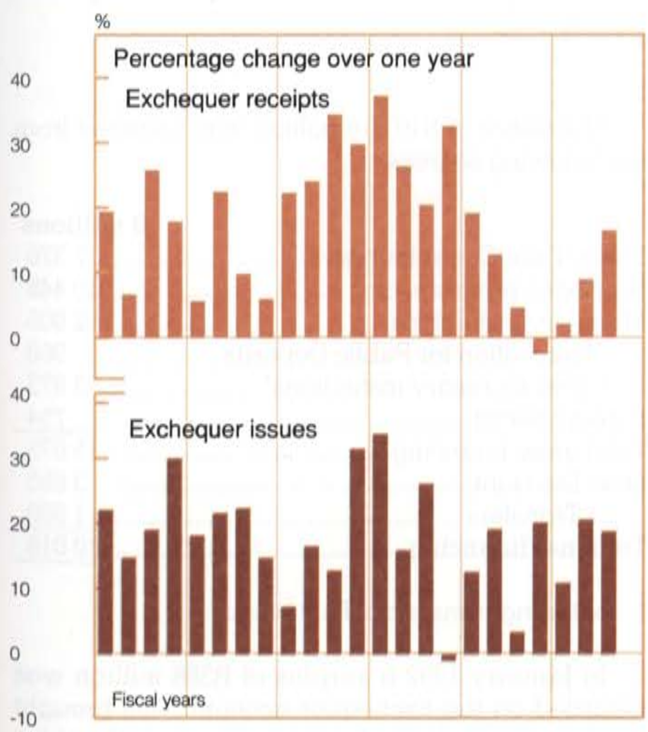
Exchequer issues

The *year-on-year rate of increase* in Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account), which had accelerated markedly from 10,9 per cent in the June quarter (the first quarter of fiscal 1991/92) to 20,6 per cent in the September quarter, declined moderately to 18,8 per cent in the December quarter. In January 1992 the growth in government expenditure accelerated again, with the result that the rate of increase over twelve months in Exchequer issues in the first ten months of fiscal 1991/92 amounted to 17,9 per cent. This rate of expansion was substantially higher than the 13,7 per cent increase envisaged in the Budget in March 1991 for the fiscal year as a whole, and was also well above the rate of inflation.

Exchequer issues to government departments for the first *ten months* of fiscal 1991/92 were equal to 80,4 per cent of the total budgeted expenditure for the year as a whole; this percentage share exceeded the ratio of 79,6 per cent in the corresponding period of fiscal 1990/91, but was below the ratio of 82,4 per cent for the first ten months in the preceding five years. As envisaged in the Budget, this sharp growth in Exchequer issues took place in current expenditure, especially on goods and services, while the growth in capital expenditure was insignificant.

In addition, *transfers* to the amount of R1,8 billion were made out of the Exchequer Account during the first ten months of fiscal 1991/92. These expenditures were not included in the Exchequer issues as reported by government departments because they were funded from the Exchequer's financing surplus of fiscal 1990/91. These transfers included R450 million paid over to the Reinsurance Fund for Export Credit and Foreign Investment, R1 000 million to the Government Service Pension Fund and R350 million to the Maize Board. If total Exchequer issues in the first ten months of fiscal 1991/92 are compared with the budgeted and off-budget Exchequer issues of the corresponding period of the previous fiscal year, the rate of increase in these issues amounted to only 7,9 per cent.

Exchequer receipts and issues



Exchequer receipts

The *year-on-year rate of increase* in Exchequer receipts accelerated sharply from 2,1 per cent in the June quarter of fiscal 1991/92 to 9,0 per cent in the September quarter and to 16,5 per cent in the December quarter. The high rate of increase in the December quarter could be attributed to the following factors:

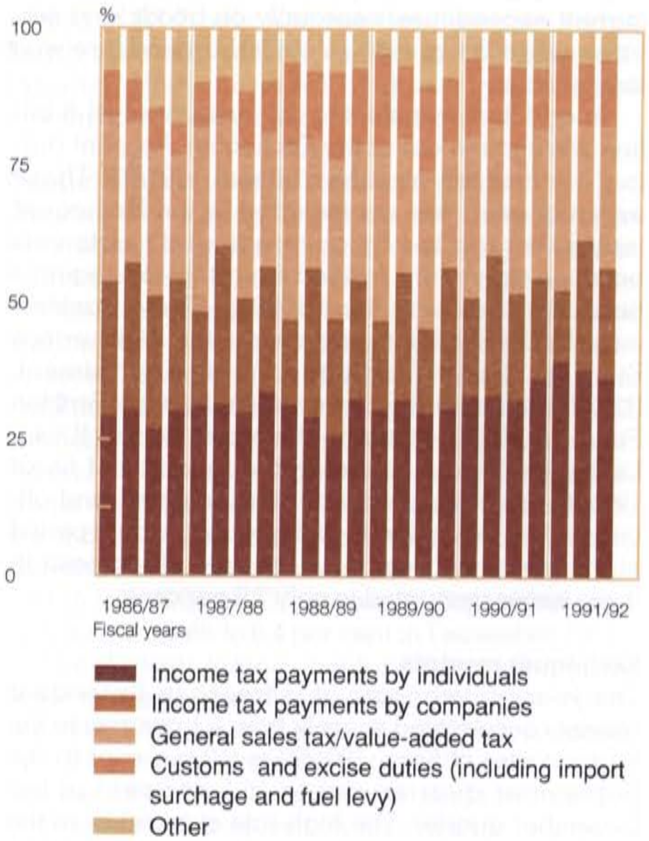
- the amount of provisional tax due on 31 December but which ran over into January, was much lower in fiscal 1991/92 than in fiscal 1990/91, with the result that total tax on income and profits increased at a year-on-year rate of 23,6 per cent in the December quarter of 1991;

- income from the fuel levy rose over a period of twelve months at a rate of 58,8 per cent in the December quarter of 1991; and

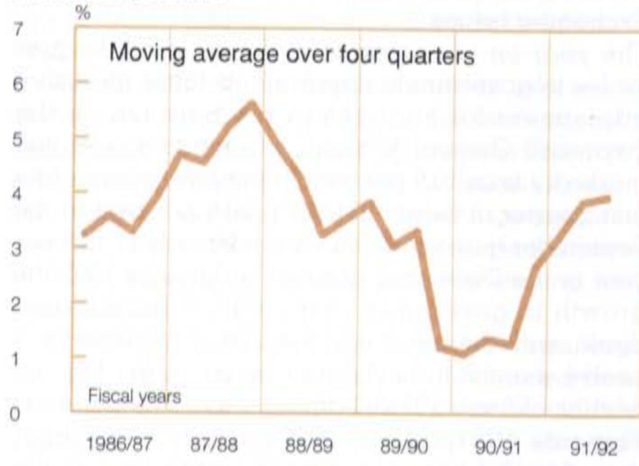
- the income derived from general sales tax and value-added tax during the December quarter of 1991 was 11,1 per cent higher than the income collected from general sales tax during the corresponding period of the preceding year.

In January 1992 the year-on-year rate of increase in Exchequer receipts declined again sharply. This brought the rate of increase in these receipts during the first *ten months* of fiscal 1991/92 to 8,8 per cent as against the corresponding period in the preceding year; this rate of increase was still well below the budgeted rise of 11,1 per cent. Exchequer receipts in the first ten months of fiscal 1991/92 were equal to 79,8 per cent of total budget-

Government revenue



Deficit before borrowing as percentage of gross domestic product



ed revenue for the fiscal year as a whole, compared with a ratio of 85,7 per cent in fiscal 1990/91 and an average ratio of 84,7 per cent in the preceding five fiscal years. The lower-than-expected Exchequer receipts were mainly the result of relatively low proceeds from general sales tax/value added tax, income tax on companies and excise duty; the low proceeds on these types of taxes, in turn, is again related mainly to the slack conditions in the domestic economy.

Deficit before borrowing

The deficit before borrowing and debt repayment in the first *nine months* of fiscal 1991/92 came to R10 018 million, or to approximately 99 per cent of the budgeted deficit of R10 118 million for the fiscal year as a whole. The deficit for the corresponding period of fiscal 1990/91 was equivalent to 66 per cent of the budgeted deficit for that year. Relative to the gross domestic product, the deficit from April to December 1991 was equal to 4,4 per cent; the original Budget provided for a ratio of 3,4 per cent of gross domestic product for the fiscal year as a whole.

The deficit of R10 018 million was *financed* from the following sources:

	R millions
Public Debt Commissioners	7 376
Non-bank private sector	10 448
Monetary institutions:	-2 905
Corporation for Public Deposits	968
Other monetary institutions*	-3 873
Foreign sector	754
Total gross financing	15 673
Less: Discount	3 855
Transfers	1 800
Total net financing	**10 018**

* Including transfers of R1,8 billion

In January 1992 a *surplus* of R388 million was recorded on the Exchequer account. This brought the cumulative deficit for the first ten months of fiscal 1991/92 to R9 630 million. This deficit, plus the discount of R4 017 million on new government stock issues and the transfers of R1 800 million, was financed by means of the following *debt instruments:*

	R millions
Government stock (including discount)	18 452
Treasury bills	1 111
Foreign loans	539
Non-marketable securities	-67
Increase in available cash balances	-4 588
Total financing of Exchequer deficit	15 447
Less transfers 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	4 017
Total net financing	9 630