SOUTH AFRICAN RESERVE BANK

ANNUAL ECONOMIC REPORT

A Review of Economic and Financial Conditions in the Republic of South Africa to be Presented to Stockholders at the Forty-second Ordinary General Meeting to be held on 15th August, 1962.

HIERDIE VERSLAG IS OOK IN AFRIKAANS BESKIKBAAR

PREFACE

The innovation introduced last year of issuing, in conjuction with the Bank's Annual Accounts and the Reports of the Board and the Auditors, a relatively detailed analysis of economic conditions in South Africa, met with a favourable reception. This has encouraged the Bank to issue its second Annual Economic Report covering the period 1961/62 which, it is hoped, will prove to be of equal interest.

As mentioned in the Directors' Report for the past financial year, the offices of Governor of the Bank and Chairman of the Board have, for the time being, been separated. In consequence, the observations and comments on current economic conditions and prospects, which the Governor formerly made to Stockholders at the Annual General Meeting and to which this Report serves as a background, will be delivered by the Chairman.

GERARD RISSIK, Governor
South African Reserve Bank

August, 1962

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THE SOUTH AFRICAN ECONOMY IN 1961/62 A SUMMARY

The year ended 30th June, 1962, was an exceptionally good one for the South African economy in many important respects. The net outflow of private capital declined considerably; the total value of the gold output and merchandise exports continued to show a strong upward tendency; the balance of payments on current account yielded a record surplus; the gold and foreign exchange reserves showed the sharpest and most sustained increase ever recorded in South Africa; the Reserve Bank's legal reserve ratio increased to the highest level in its history; the supply of money and "near-money" attained new record levels; the situation in both the money and capital markets was transformed from one of serious stringency to one of exceptional ease, liquidity and ready availability of funds; virtually all short and long-term interest rates declined; and the prices of gold mining, industrial, commercial and financial shares increased substantially.

The result of these various changes was that an environment came into being which, unlike that of a year and a half ago, was highly favourable to a new acceleration of the rate of growth of the South African economy. Such an acceleration did, in fact, occur from about the third quarter of 1961 and was reflected in the faster rate at which the gross national product increased throughout the year under review. Most other economic indicators also pointed to a continuing improvement in internal economic conditions during this period.

But taking into account the extremely favourable monetary and financial developments already referred to and the income generating effects of the higher gold output and merchandise exports, the acceleration of the tempo of general economic expansion did not proceed as far or as rapidly as was desired and the growth rate of the gross national product would appear to have remained below that of which the South African economy is potentially capable. Fixed capital outlays tended to decrease, while private consumption declined temporarily before resuming an upward movement from about the fourth quarter of 1961. These changes in spending were also reflected in the behaviour of commercial and industrial inventories which, despite the tightening of import control, did not decline over the year as a whole.

In these circumstances, the authorities followed an expansionist short-term economic policy. Apart from a marked increase in current Government expenditures, positive measures to stimulate fixed investment and exports were announced in the Budget. The Reserve Bank, on its part, welcomed the increase in liquidity and the easing of the situation in the money and capital markets, and reduced Bank Rate in two stages, namely from 5 to 4½ per cent in December, 1961, and to 4 per cent in June, 1962. It also effected a substantial reduction, in three stages, in its pattern of rates for Government stock.

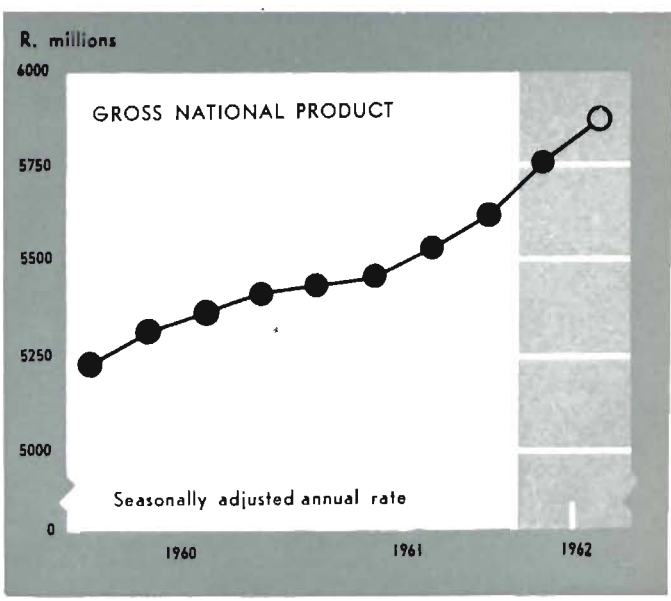
In taking these measures the monetary authorities were influenced by the fact that, in view of the remarkable improvement in the balance of payments and in general financial conditions, a situation had developed which afforded considerable *scope* for a faster rate of economic development in the sense that the rate of increase of total spending could accelerate further without causing either a deficit in the balance of payments on current account or internal demand inflation.

Acceleration of Rate of Economic Growth

After declining noticeably during the second half of 1960 and the first half of 1961, the rate of economic growth in South Africa gradually began to increase again from about the third quarter of 1961. At that stage, it now appears, the economy began to edge into a new expansion phase of the business cycle. Although this acceleration was relatively moderate, the faster economic tempo was maintained throughout the year ended 30th June, 1962. During recent months, conditions have become highly favourable to a further acceleration of the rate of economic development, while there have been distinct signs of continuing improvement in several important sectors of the economy.

Recovery of Rate of Increase of Gross National Product

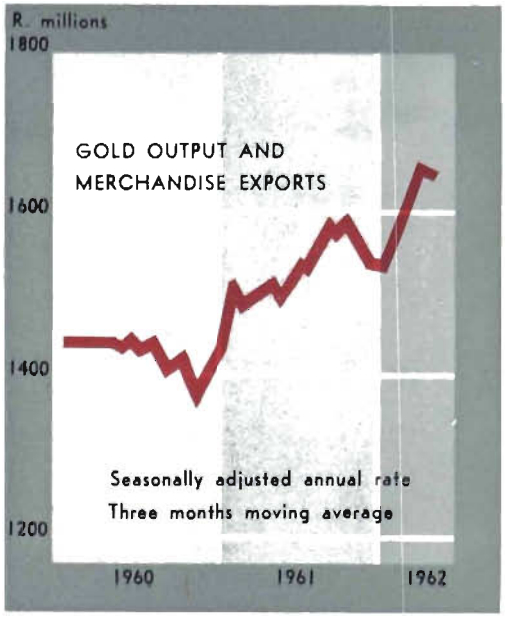
These short-term tendencies are indicated by the preliminary quarterly estimates of the gross national product, provisionally adjusted for seasonal changes on the basis of the limited information at present available. Thus, after almost levelling off during the first half of 1961, the gross national product again began to increase at a somewhat faster rate from about the third quarter of that year. Furthermore, this higher rate appears to have been maintained during the rest of 1961 and the first half of 1962. For the year ended 30th June, 1962, the gross national product is provisionally estimated to have amounted to about R5,690 million, which is about 5.3 per cent higher than the figure for the preceding year, compared with an increase of 4.2 per cent between 1959/60 and 1960/61. Allowing for an increase in the retail price level of about 1.9 per cent, it would appear, therefore, that for the twelve months as a whole, the *real* gross national product showed an increase of roughly 3.4 per cent, compared with an increase in the population of about 2.3 per cent.



Substantial Further Increase in Gold Output and Merchandise Exports

During the year 1961/62, the total value of the gold output and merchandise exports continued to show a strong upward tendency. The main categories of merchandise exports which registered important increases were maize, wool, fruit, pig-iron and manufactured products, while uranium exports, on the other hand, showed a substantial decline. Whereas exports to the sterling and dollar areas decreased slightly, those to Western Europe and Japan showed marked increases.

In former years, an increase of this magnitude in the total value of the gold output and merchandise exports was usually accompanied by substantial increases in other forms of expenditure on the gross national product. Thus, the increased incomes directly generated by the former factor tended to induce increased expenditures on consumer goods and services, which, in turn, tended to stimulate capital outlays by business enterprises. The result was that in years of relatively high gold output and merchandise exports, the rate of increase of the real gross national product was usually *considerably higher* than its long-term average growth rate. During the years 1950/51, 1956/57, and 1959/60, for example, the *real* gross national product increased by as much as 11.2, 7.7 and 6.6 per cent, respectively, compared with its average annual post-war growth rate of about 4.5 per cent. During the year ended 30th June, 1962, however, as the sections below indicate, the *secondary* stimulating effects of the increase in gold output and merchandise exports were not as much in evidence as in the past.



Continued Sluggishness of Private Fixed Investment

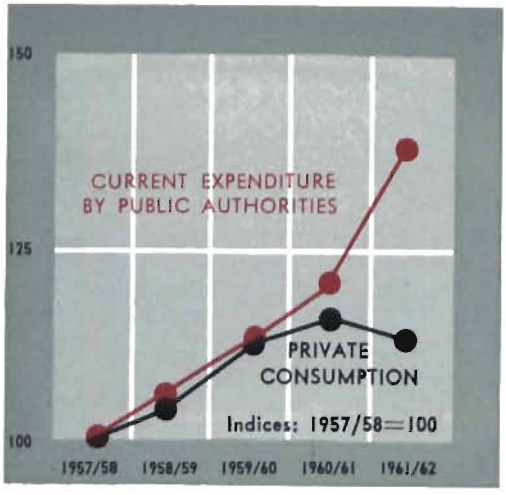
In the first place, private enterprises remained reluctant to expand their capital outlays on plant, equipment and construction. Despite a further increase in *replacement* investment, i.e. in outlays to replace worn-out or obsolete capital goods, gross fixed investment in the private sector is estimated to have been somewhat lower during the year 1961/62 as a whole, than during the preceding twelve months. It follows, therefore, that *net* private fixed investment, i.e. the net addition to the fixed capital stock of the private sector, must have shown a larger decrease.

Moderate Increase in Public Fixed Investment

Secondly, partly owing to a substantial decline in the fixed capital outlays of the Railways, total gross fixed investment by public authorities was only slightly higher during 1961/62 than during the preceding twelve months. Similarly, fixed investment by public corporations showed little change.

Decline in Private Consumption

Thirdly, private consumption, after adjustment for seasonal changes, declined during the second and third quarters of 1961, before resuming an upward course and increasing steadily again during the fourth quarter of 1961 and the first half of 1962. Despite this renewed increase, however, private consumption is still estimated to have been about R60 million less during the year ended June, 1962, than during the preceding twelve months.



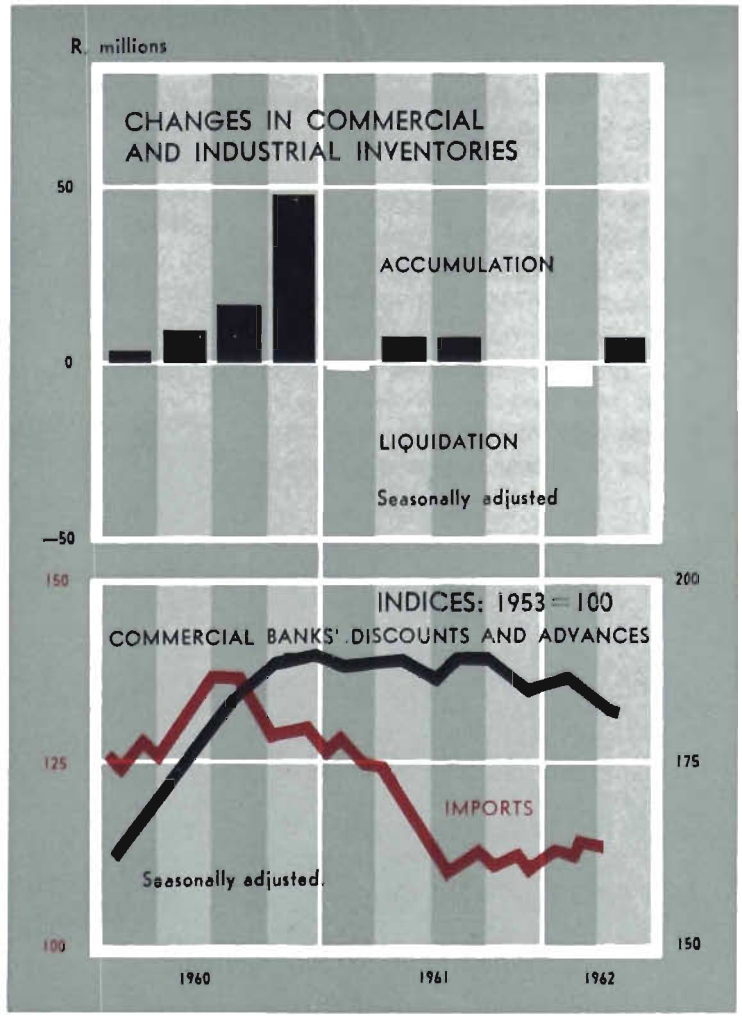
Preliminary indications suggest that this decline took the form mainly, if not entirely, of a reduction in outlays on *durable* consumer goods. It is known, for example, that sales of new and used motor vehicles were considerably lower during the past year than during the previous twelve months, while the statistics of retail sales compiled by the Census Bureau furthermore reveal a decline between these two periods in the sales of "Furniture Dealers" and "Dealers in Electrical Appliances".

This temporary decrease in private consumption helps to explain the continued reluctance of private enterprises to expand their fixed capital outlays and, as will be indicated later, also had important effects on the balance of payments and the internal monetary and banking situation.

Considerable Increase in Current Expenditure by Public Authorities

The main single component of the total expenditure on the gross national product, other than gold output and merchandise exports, which did increase substantially between 1960/61 and 1961/62, was the current expenditure of the Government and other public authorities, which rose by as much as R103 million, compared with an average annual increase of about R33 million during the preceding four years. This increase, which partly reflected a higher rate of spending on defence, occurred mainly during the first half of 1962 and would appear to have been an important factor in the improvement in general internal economic conditions during this period.

Commercial and Industrial Inventory Position a Reflection of Slack Internal Demand



Both the relatively slow tempo of general economic development during the middle quarters of 1961 and the acceleration during the year 1961/62 are reflected in the behaviour of commercial and industrial inventories during this period. It will be recalled that, after allowance for the usual seasonal changes, such inventories had shown a strong upward tendency during 1960, but had ceased to grow during the first quarter of 1961. Moreover, following the further tightening of import control in May, 1961, it had been expected that stocks would be run down to some extent. In actual fact, however, commercial and industrial inventories tended to increase during both the second and third quarters of 1961. While some substitution of locally produced for imported inventories probably occurred, this increase was, no doubt, largely a reflection of the consumption tendencies already discussed. In particular, it would appear that the actual spending by the general public weakened to such an extent during these two quarters that, despite tighter import control and increased exports, stocks of unused or unsold goods tended to accumulate.

From about the fourth quarter of 1961, however, as private consumption began to increase again while imports remained relatively low, commercial and industrial stocks first ceased to rise and then, during the first quarter of 1962, actually declined. In general, however, the inventory position of the country remained satisfactory. Indeed, provisional estimates point to a new increase in commercial and industrial stocks during the second quarter of this year.

Continued Expansion in Agriculture, Mining, Manufacturing and Commerce

A broad analysis of the contribution made to the domestic product by the different branches of economic activity reveals that the four main productive sectors in South Africa, namely agriculture, mining, manufacturing and commerce, all continued to advance during 1961/62. Both agriculture and mining registered increases of about 3 per cent over the previous year. But while, in the case of agriculture, this rate was similar to that of the previous year, it represented a decline in the case of mining, largely owing to a reduced rate of increase of salaries and wages in the *gold* mining industry.

Although manufacturing profits apparently suffered a temporary setback during the early part of the period, the total income generated by manufacturing during 1961/62 is estimated to have been about 6.4 per cent above that of the previous year, as compared with an increase of 6.2 per cent between 1959/60 and 1960/61.

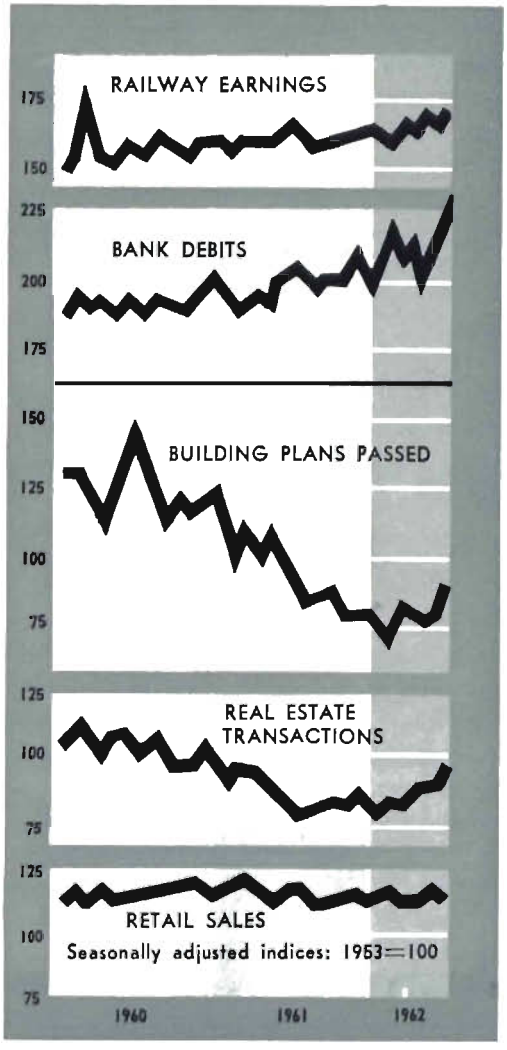
Despite the temporary decline in consumption, the income generated by commerce would still appear to have shown an increase over the figure for the previous year.

Other Economic Indicators

The behaviour of various other economic indicators also illustrates the acceleration in the rate of increase of economic activity from about the third quarter of last year. Bank debits and railway earnings, for example, after tending to level off during the early part of 1961, showed a new upward trend during the rest of that year and the first half of 1962. Similarly, building plans and real estate transactions, which had declined considerably during 1960 and the first three quarters of 1961, both reached lower turning points before the end of last year.

As regards the employment situation, it is still not possible to obtain an accurate picture of recent tendencies, particularly in respect of Bantu employment. But it is known that the number of registered unemployed Whites, Coloureds and Asiatics, which had increased from about 24,000 at the end of 1960 to a peak of about 34,000 at the end of February, 1962, declined again to about 31,000 at the end of June, 1962. From the available employment indices, it also appears that, although manufacturing employment showed little change and mining employment declined slightly from about February, 1962, employment in private construction increased noticeably after the third quarter of 1961. It is probable, moreover, that the manufacturing index tends to underestimate the increase in employment, while the slight decline in mining employment appears to have been largely the result of increased mechanisation.

Although a comprehensive, up-to-date index of industrial production does not yet exist in the Republic, the available in-



formation in this field suggests that manufacturing output increased during the past year at a relatively slow rate. This tends to confirm the view that the improvement in the rate of growth of the economy since the middle of last year has so far been largely attributable to the increase in gold output and agricultural and mineral exports and not, in the first place, to an acceleration of the rate of domestic spending. There are, however, signs that manufacturing output may now be increasing more rapidly, particularly in the engineering industry and in firms manufacturing products such as electrical cables, machinery and farm implements. The Opinion Survey of the Stellenbosch Bureau for Economic Research also clearly indicates that most industrialists are either already experiencing better conditions or confidently expecting a significant improvement soon. Indeed, a feature of the industrial scene in recent months has been the more optimistic outlook which has prevailed in many directions.

Record Increase in Gold and Foreign Exchange Reserves

If the performance of the internal economy during the past year has not been satisfactory in all respects, there can be little doubt that the recovery in the balance of payments during this period has exceeded the most optimistic expectations. This remarkable improvement was reflected in the gold and foreign exchange holdings of the Reserve Bank, which increased from a low point of R142 million on the 16th June, 1961, to R407 million at the end of June, 1962, and R424 million on the 27th July. Not only did the latter figure represent the highest point attained in fourteen years, but the increase from June last year to July this year has been the *sharpest and most sustained ever recorded* in South Africa, even exceeding the abnormal post-devaluation rise of late 1949 and 1950.

Some observers have attributed this improvement almost entirely to the extension and tightening of exchange and import control during May and June of last year, and have therefore considered it "artificial". This is true only to a limited extent. While the extended exchange control played an important part in reducing the net outflow of private capital, which had been the basic cause of the balance of payments difficulties during 1960 and the first half of 1961, the main reason for the improvement during the past year was clearly the large surplus attained on *current* account. This, in turn, as will be indicated below, was largely the result of, on the one hand, the substantial increase in gold output and merchandise exports and, on the other, the relatively slow tempo of expansion in the internal economy, and was only partly attributable to import control. There can be little doubt that, even without any import control, the current account would have shown a large surplus during the past year and the reserves would have increased considerably. The implications which this had for monetary policy will be referred to later.

Decline in Net Outflow of Private Capital

Taking the capital account first, it is clear that a substantial decline occurred during the past year in the net outflow of private capital, as indicated in the accompanying table. This decline, in turn, was largely the result of the cessation of the outflow of funds through the Stock Exchange, following the extension of exchange control, in June, 1961, to dealings in South African securities between Johannesburg, London and other foreign centres. At the same time there was a decrease in the net outflow of capital in such other forms as repayments by local foreign-controlled subsidiaries of foreign loans.

Net Movements of Private Capital
(R millions)

1960				1961				1962	
1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
-43	-45	-39	-25	-36	-19	-11	1	—	-12

It is furthermore significant that of the total net outflow of private capital of R22 million during the year ended June, 1962, R12 million represented *resident* capital, so that the net outflow of *foreign* capital amounted to only R10 million, compared with R97 million during the previous year.

The fact that during the year ended 30th June, 1962, there was still a small *net* outflow of foreign funds does not, of course, mean that no foreign capital was invested in the Republic during this period. On the contrary, it is known that considerable amounts of foreign funds entered the country during the past year in the form of direct investment capital, as well as in other ways. But against this inflow has to be set substantial contractual repayments of uranium and other private loans, as well as other forms of long and short-term private capital outflow.

Net Outflow of Official and Banking Capital

In contrast to the net inward movement of official and banking capital during 1960 and the first quarter of 1961, net outflows were recorded during the second, third and fourth quarters of 1961 and again during both the first and second quarters of 1962. The total net outflow of R95 million during the past five quarters was mainly the result of substantial repayments of official loans, including the repayment of a drawing on the International Monetary Fund of about R27 million and the repayment of R21 million of the revolving credit received from a group of American banks. These outward movements more than offset such new borrowings as the loan of R7 million obtained by the Government from a group of Italian banks in October, 1961, and the two loans of a like amount extended to it by individual German banks in December, 1961, and April, 1962, respectively.

Net Movements of Official and Banking Capital
(R millions)

1960				1961				1962	
1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
-2	5	17	-8	29	-12	-11	-19	-34	-19

This net outflow of official funds naturally had the effect of moderating the increase in the reserves during the past year, just as the earlier net inflow of such funds had served to cushion the adverse effect on the reserves of the large outflow of private capital. In other words, if it had not been for these partially offsetting official capital movements, the reserves would first have suffered an even more serious decline and then increased by an even greater amount than was actually the case.

Record Surplus on Current Account

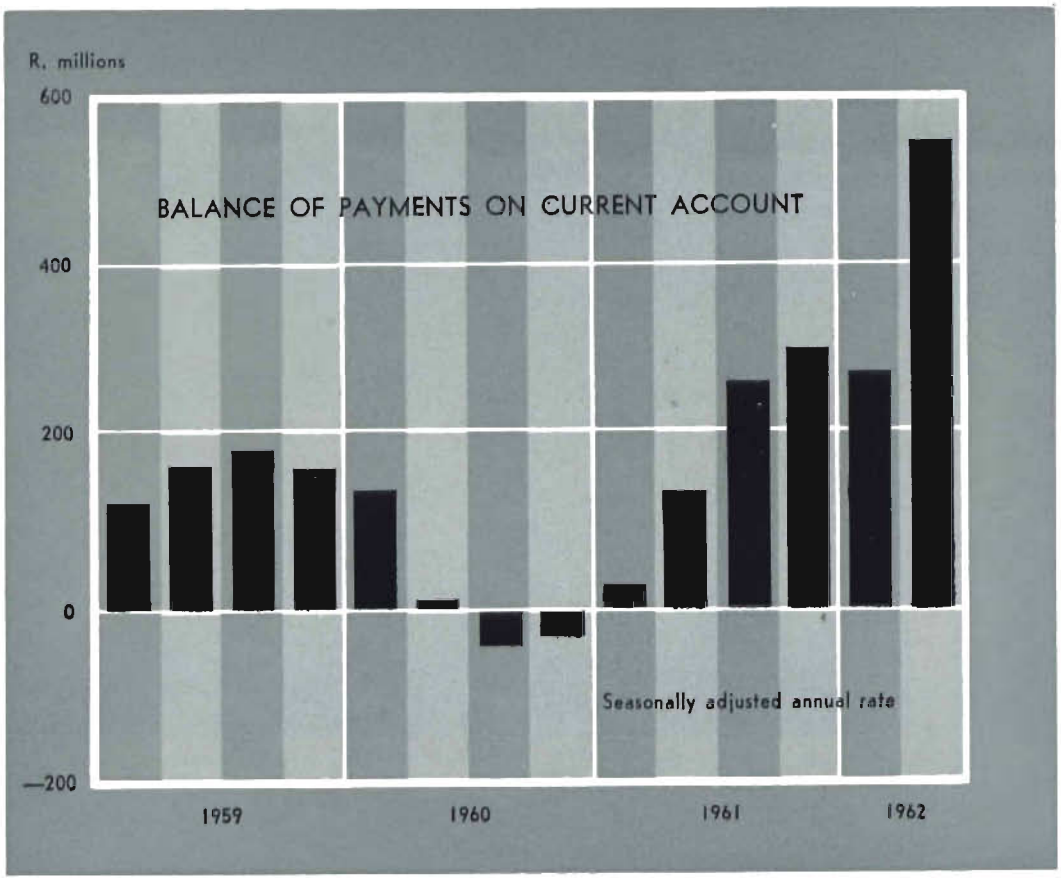
On current account, the Republic's balance of payments broke all previous records during the past year. As the accompanying graph shows, after making such corrections for seasonal movements as are possible at this stage, the current account began to improve strongly from about the fourth quarter of 1960 and continued to develop favourably throughout 1961 and the first half of 1962. For the year ended 30th June, 1962, it eventually yielded a current surplus of no less than R353 million.

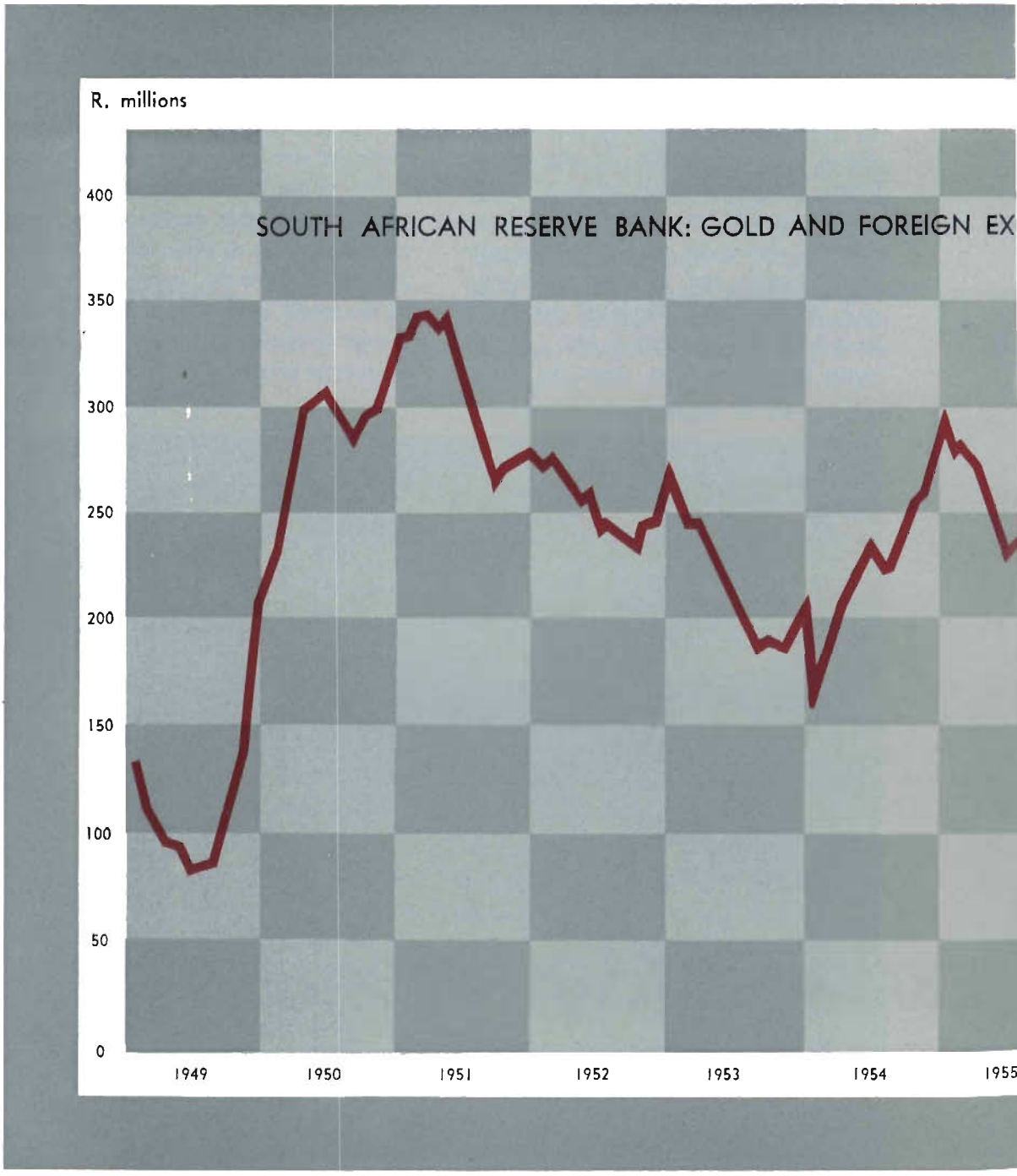
Four main factors contributed to this remarkable showing. In the first place, the already high gold output continued to increase. Secondly, as already indicated, seasonally adjusted merchandise exports showed a strong upward tendency during 1961 and the first half of 1962.

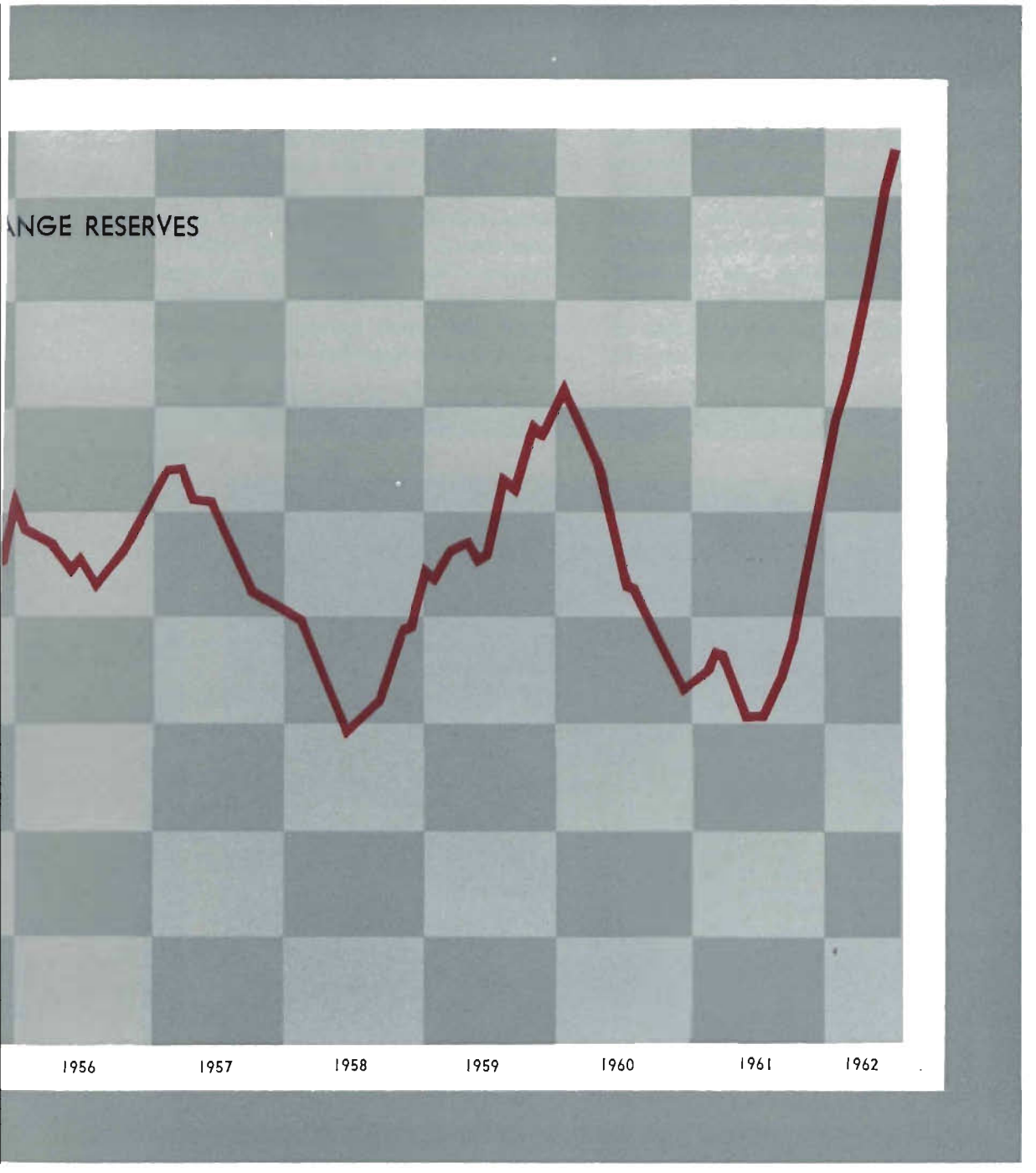
Thirdly, seasonally adjusted imports continued to show a pronounced decline during the first seven months of 1961, before levelling off during the rest of that year and the first half of 1962. Comparing 1961/62 with the previous year, most classes of imports showed a decline, but the main decreases occurred in the categories metals, machinery and vehicles, and textiles. This behaviour of imports would appear to have been largely the result of the relatively low level of private consumption and fixed investment, and only partly attributable to the tightening of import control. In this regard, it is interesting to note that seasonally adjusted imports had already begun

to decline from about August, 1960, i.e. soon after the rate of economic expansion had begun to slow down and about three months before import control was first tightened in November, 1960. Moreover, if import control had been the main causal factor, commercial and industrial stocks would probably have been run down considerably during the period when imports were declining. But, as already indicated, such stocks actually increased during the second and third quarters of 1961 and only began to decline from about the fourth quarter of that year. From that stage onwards, however, with the total spending of the economy again increasing at a somewhat faster rate, it seems probable that import control gradually began to exercise a more restrictive effect on total imports.

The fourth factor contributing towards the current account surplus was a decline, after the middle of 1961, in the Republic's net current "invisible" payments to the rest of the world, mainly as a result of lower foreign payments in respect of dividends, freight and insurance.

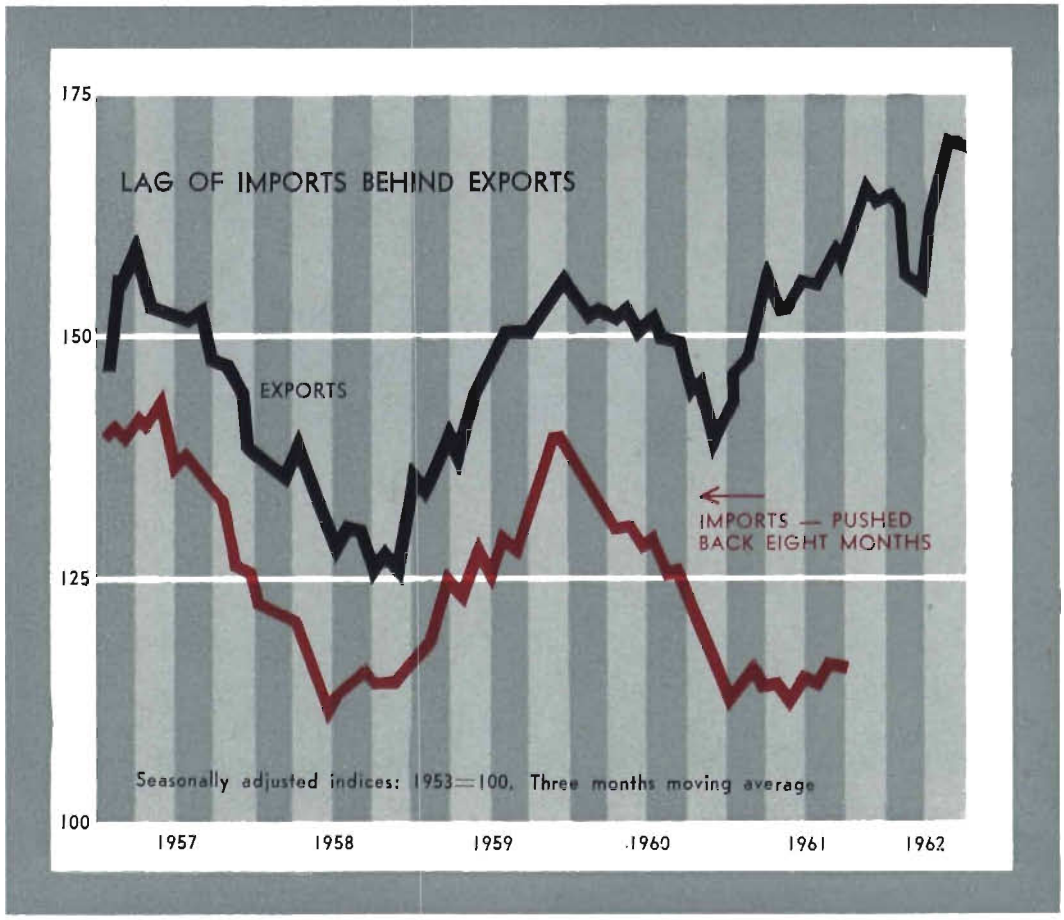



R. millions
SOUTH AFRICAN RESERVE BANK: GOLD AND FOREIGN EX
400
350
300
250
200
150
100
50
0
1949
1950
1951
1952
1953
1954
1955


ANGE RESERVES
1956
1957
1958
1959
1960
1961
1962

Lag of Imports behind Exports

In last year's *Annual Economic Report* a graph was presented which illustrated the reasonably close correlation which normally exists between export earnings and imports with a lag of about eight months. Without attaching an unduly mechanistic interpretation to this phenomenon, it was concluded that, broadly speaking, the increased spending power generated by the additional exports normally takes in the vicinity of eight months to work through to imports. During recent months, however, for the first time in years, this correlation has failed to hold. Imports have not followed exports upwards, not even with the usual lag. The main reasons for this have already been discussed, namely (1) the reluctance of private consumption and fixed capital outlays to respond in the normal manner of the past to the stimulus provided by the higher gold output and export earnings, and (2) the gradually increasing effect of import control.



Spectacular Improvement in Monetary and Banking Situation

During the past year, as the gold and foreign exchange reserves continued to increase substantially, monetary and banking conditions in the Republic changed from one extreme to the other. Within a relatively short spell of time, the position was radically transformed from one of serious stringency to one of exceptional ease and liquidity. The result was that a monetary and banking environment came into being which, unlike that of early 1961, was highly conducive to an acceleration of the rate of real economic expansion.

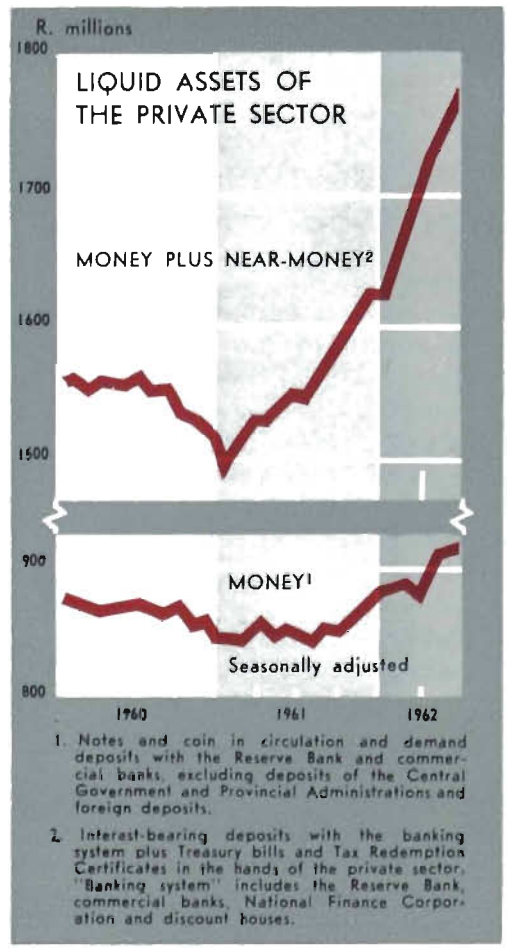
Substantial Increase in Supply of Money and "Near-Money"

The remarkable changes in this sphere were clearly reflected in the movements of the total supply of money and "near-money", i.e. other liquid assets held by the private sector with the banking sector (in the form of interest-bearing deposits) and with the Government sector (in the form of Treasury bills and Tax Redemption Certificates). It will be recalled that during the preceding period when, as a result of the capital outflow, total foreign payments had exceeded receipts, the supply of money and near-money had only been prevented from declining more sharply than it actually did by a considerable compensatory increase in the amount of credit extended by the banking sector as a whole to the private sector. With the subsequent improvement in the balance of payments, however, the supply of money and near-money increased considerably and quickly attained record levels. At the same time, the private sector's indebtedness to the banking sector was greatly reduced, which naturally exercised a moderating effect on the increase in money and near-money.

Implications for Monetary Analysis of Recent Developments in Banking Sphere

It is interesting to note from the accompanying graph that the movements of the money supply as such, narrowly defined as notes, coin and demand deposits with commercial banks and the Reserve Bank, do not reflect the sweeping changes which have taken place in the general liquidity situation during the past two or three years nearly as well as the fluctuations in the supply of money and near-money taken together. This again indicates that, under present conditions in the Republic, with a variety of evolving deposit-taking institutions competing keenly with one another for demand and other short-term deposits, it is no longer adequate to work only with the old, narrow concept of money as defined above. As has been recognised for some time, it is clearly more realistic and useful for purposes of monetary analysis and policy to place the emphasis on the broader concept of "liquid assets in the hands of the private sector", i.e. money plus near-money.

Indeed, the question arises whether the definition of near-money employed in the accompanying graph is broad enough. The "banking sector" is here taken to include only the Reserve Bank, the commercial banks, the National Finance Corporation and the discount houses, so that the only deposits included under near-money are interest-bearing deposits with these institutions. In recent years, however, other institutions, such as the building societies, hire-purchase finance companies and merchant banks have also operated on a substantial and increasing scale with funds deposited with them at call, very short notice or for longer periods on the assumption that the funds may nonetheless be withdrawn on demand in case of need. These deposits are held not only by individuals but also, to some extent, by companies and other forms of business enterprise, and in many cases have a much higher velocity of circulation than that usually associated



1. Notes and coin in circulation and demand deposits with the Reserve Bank and commercial banks, excluding deposits of the Central Government and Provincial Administrations and foreign deposits.

2. Interest-bearing deposits with the banking system plus Treasury bills and Tax Redemption Certificates in the hands of the private sector. "Banking system" includes the Reserve Bank, commercial banks, National Finance Corporation and discount houses.

with genuine savings held in deposit form. Some of these institutions have even devised ways and means of providing depositors with transfer facilities and other services specifically designed to compensate for the lack of cheque facilities. Since these deposits are clearly looked upon by their holders as close substitutes for money and can be monetised conveniently, speedily, without loss and *en masse*, there is much to be said for including them also in the definition of near-money.

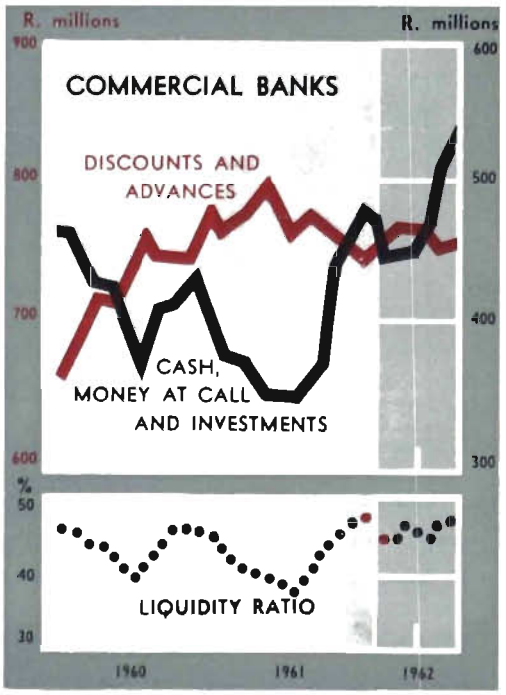
The problem is, of course, where to draw the line. It would obviously be over-stepping the mark to include *all* deposits with these other institutions under near-money, as the major part probably represents genuine long-term personal savings and is, no doubt, very inactive. On the other hand, by *ex*cluding all deposits with these institutions, the total liquidity of the private sector is probably underestimated.

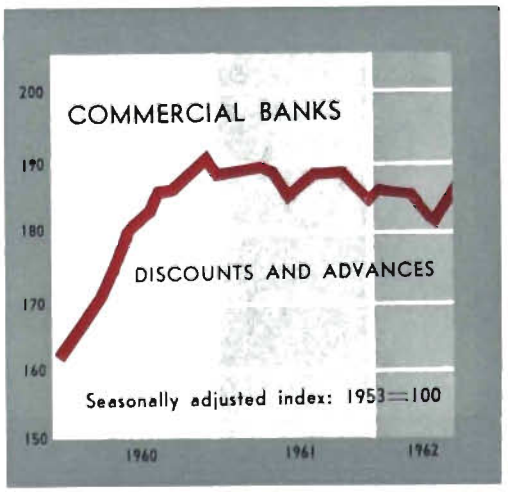
This is not a problem which interests only the economic statistician. It is also of considerable importance from the point of view of both monetary policy and banking legislation. For this reason, the problem raised by the intensive competition between the different classes of deposit-taking institutions are at present being investigated by a Technical Committee appointed by the Minister of Finance. When these problems are eventually solved in one way or another, the task of defining money and near-money will probably also be easier and it should then be possible to obtain a more satisfactory picture of what is happening at any time in the monetary sphere.

Reversal of Commercial Banking Trends

The transformation from monetary stringency to monetary ease was also clearly reflected in the changing position of the commercial banks as such. During 1960, it may be recalled, they had increased their discounts and advances at a time when the balance of payments deficit was tending to drain their cash reserves. This was rendered possible by the fact that they had been relatively liquid at the end of 1959 and could, therefore, fall back upon the Reserve Bank for accommodation by such means as rediscounts of Treasury and trade bills and sales of Government stock. During the past year, this process was reversed. On the one hand, their discounts and advances tended to decline somewhat, while, on the other, as a result of the favourable balance of payments, there was a substantial increase in their cash, money at call and investments. The result was that the ratio of their liquid assets to their liabilities to the public increased considerably, although the inclusion of South West Africa in the published statistics since January, 1962, precludes a direct comparison of recent figures with those of a year earlier.

A closer look at the commercial banks' discounts and advances reveals that, if seasonal movements are excluded, they have been showing a slight downward movement since the beginning of 1961. At the same time, it is known that the banks' advances to the Land Bank have been running at much higher levels during the past year than during 1960/61, when their tight position had forced the Land Bank to obtain a larger proportion of its require-



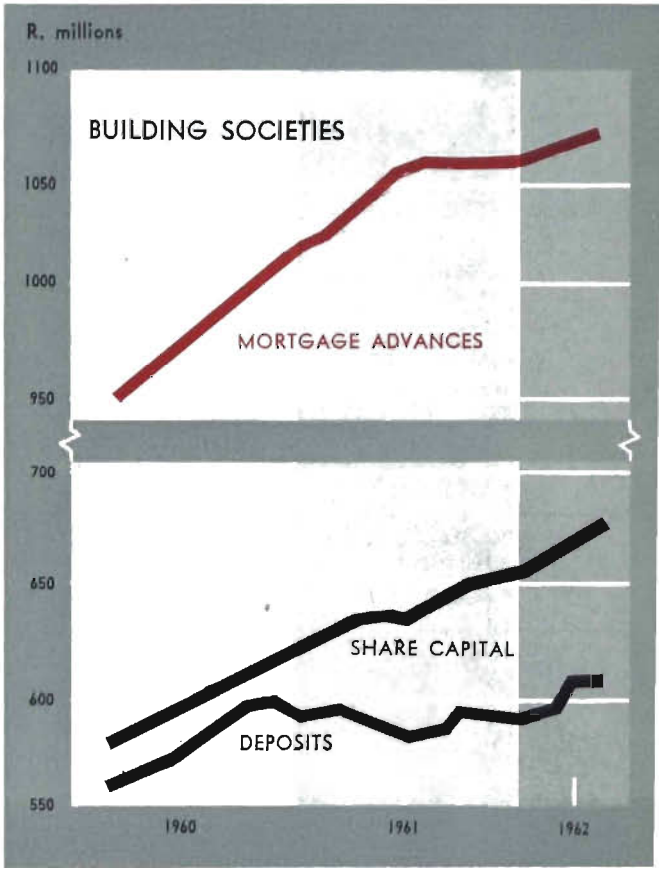


ments from the Reserve Bank through discounts of Land Bank bills. Moreover, the banks' loans to individuals showed an increasing tendency during 1961 (the latest period for which such figures are available). It follows, therefore, that the banks' credit to commercial and industrial enterprises must have shown an even more marked downward tendency. The fact that, despite the continued improvement in their liquidity position and, therefore, in their credit creating ability, the banks' discounts and advances continued to edge downwards throughout 1961/62, was another reflection of the decline in the demand for bank credit owing to the relatively moderate tempo of economic expansion during this period and particularly the relatively low level of imports.

Improvement in Position of Building Societies

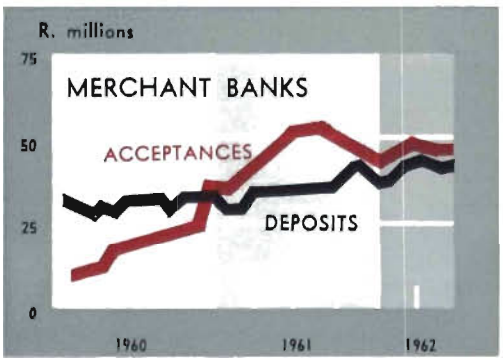
Like the commercial banks, the building societies also found their position improving as the country's gold and foreign exchange reserves continued to rise. Looking back, their most difficult period would appear to have been in May of last year, when the new funds flowing to them, together with repayments of existing loans, were not sufficient to cover withdrawals, so that they were forced not only to curtail their lending sharply but also to convert some of their liquid assets and other investments into cash, *inter alia* by selling Government stock at a loss to the Reserve Bank as the market of last resort. Fortunately, as the balance of payments tide turned soon afterwards, their deposits began to move upwards again, while their share capital increased at a faster rate.

At the same time, there was a substantial decline in their new mortgage lending, so that their total mortgage advances outstanding remained more or less constant throughout the rest of 1961 and only increased moderately during the first half of 1962. In this way, they succeeded in building up their liquidity and consolidating their general position. For some time now they have again been able to meet all reasonable demands made on them for housing loans.



Decline in Merchant Banks' Acceptances

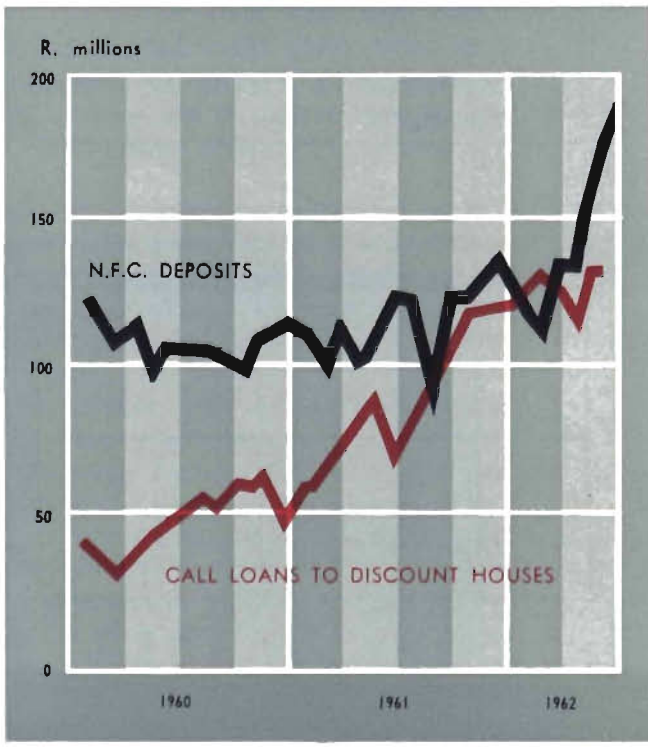
The experience of the merchant banks during the past year also fits well into this general picture. Thus, if account is taken of seasonal movements, their deposits showed a noticeable upward tendency, while a marked decline occurred in their acceptances. The fact that more use was not made of the merchant banks' acceptance facilities, at a time, moreover, when the discount houses were keen to invest in acceptances as an outlet for their increasing funds, also indicates that it was the *demand* for short-term credit which was flagging and not the supply.



Increase in Call Money with National Finance Corporation and Discount Houses

As a result of the increase in general liquidity, it is not surprising to find that deposits with the National Finance Corporation and call loans to discount houses also increased substantially during the past year. The call loans made to discount houses by commercial banks and building societies alone increased from R29 million at the end of June, 1961, to R105 million at the end of June this year.

During 1961 the discount houses, whose total resources had been growing at a steady rate during the previous years, finally managed to overtake the National Finance Corporation, whose deposits had since the beginning of 1960, been fluctuating around a more or less horizontal trend line. But during the first half of 1962, as the supply of money and near-money continued to grow and the liquidity of banking and other financial institutions continued to increase, deposits with the National Finance Corporation increased rapidly, while call loans



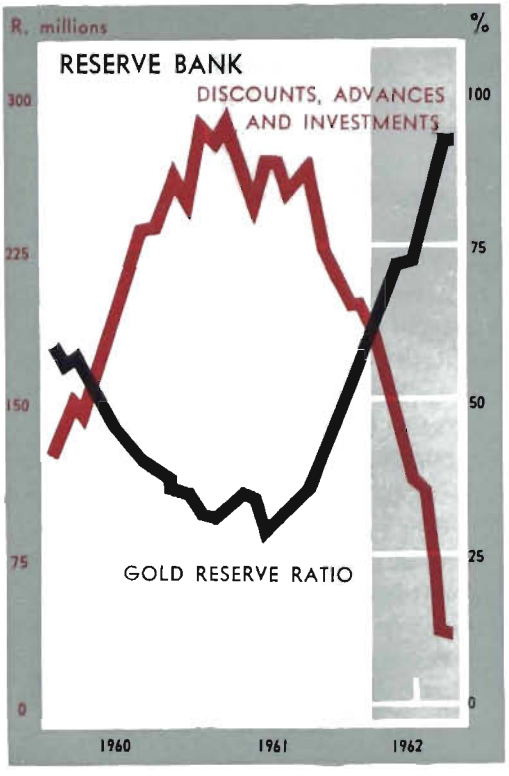
to discount houses levelled off. The main explanation for this was that the discount houses could no longer find sufficient investment outlets for all their funds and were accordingly forced to discourage the placing of further call money with them by quoting unattractive rates, whereas the National Finance Corporation, as a matter of policy, continued to accept deposits at its current rate, even though this at times had the effect of leaving it underinvested.

Complete Reversal of Reserve Bank's Position

Finally, the transformation from monetary stringency to extreme liquidity was reflected in the complete reversal which occurred in the Reserve Bank's own position. Thus, as internal liquidity continued to build up, the commercial banks, the Land Bank, the National Finance Corporation, the discount houses and other institutions were not only enabled to repay all the advances which they had obtained from the Reserve Bank during the previous year and to buy back the bills and securities which they had been forced to sell to it, but also acquired additional bills and securities from it. The Bank's discounts, advances and investments accordingly declined substantially and rapidly, and by the end of July amounted to only R37 million, which was the lowest for the end of any July since 1947. Some months earlier the Bank had already found its holdings of Treasury bills, Land Bank bills and short-term Government stock virtually exhausted, and in order to ease the pressure on short-term paper, it entered into repurchase agreements with the discount houses and the National Finance Corporation whereby longer-term Government securities were sold to them for limited periods at prices based on short-term money rates.

A further factor which contributed to the sharp decline in Reserve Bank credit was the increased use made by the Land Bank of commercial bank overdrafts as the banks became more liquid, which meant that, since the total amount of credit which the Land Bank required from the banking system as a whole did not change significantly, fewer Land Bank bills were in the hands of the Reserve Bank and the National Finance Corporation.

Since this sharp decline in the Reserve Bank's discounts, advances and investments was accompanied by a considerable and



sustained increase in its gold holdings, while its total liabilities to the public showed little change, the Bank's legal reserve ratio increased from the month-end low point of 29.6 per cent to which it had sunk by May, 1961, to no less than 95·1 per cent at the end of July. This represented the highest month-end figure in the history of the Bank.

Reserve Bank's Credit Policy and Short-term Interest Rates

Although the monetary authorities had certain difficult decisions to make in framing credit policy during the past year, they were, in general, not confronted by as complex a set of problems as during the previous twelve months. During 1960/61, it will be recalled, they had been faced by the dilemma that the internal situation called for an expansionist monetary policy at a time when, owing to the large net outflow of private capital, the external situation clearly required restraint, particularly as it was then still the official policy to try to avoid any major extension of exchange control in a way which might affect non-residents. But during the past year, after the decision to apply exchange control on a broader front had been taken in June, 1961, and as the internal and external position developed along the lines already indicated, the problems facing the monetary authorities in regard to credit policy gradually became more tractable.

On the one hand, the rapid and substantial improvement in the balance of payments and the reserves gave the authorities much more *scope* to allow an expansionist monetary and banking environment to develop, and even to apply deliberate expansionist measures, without jeopardizing the external value of the Rand. On the other hand, as the acceleration of the tempo of general economic activity did not proceed as far or as rapidly as was anticipated and the growth rate of the gross national product remained below that of which the South African economy is potentially capable, the *need* for an expansionist monetary policy became more clearly defined.

It is, of course, true that in the conditions which had developed by the second quarter of 1961, the authorities had had no alternative but to give a high priority to the achievement and maintenance of a large surplus on current account. Moreover, since there was a definite limit to the rate at which output could be expected to increase in the short run, this at the time necessarily implied some slowing down in the overall rate of internal economic expansion. Indeed, if the rate of increase of total spending had not declined largely of its own accord, the authorities would have been forced to take steps to restrain it. But, as events turned out, this slowing down lasted longer than was necessary, so that the need for measures to stimulate the economy became progressively clearer.

In these circumstances, the Reserve Bank welcomed both the increase in general liquidity during 1961/62 and the downward pressure which this exerted on the Treasury bill tender rate and other short-term interest rates. Admittedly, the already discussed cancellation of Reserve Bank credit had the effect of moderating the liquidity increase and thereby reducing the downward pressure on interest rates, but at no stage did the Bank consider it necessary to apply deliberate disinflationary measures, such as the imposition of supplementary reserve requirements on the commercial banks. In different circumstances an increase of this

magnitude in the supply of money and near-money and in the credit-creating ability of the banking system might well have contributed to demand inflation, but in view of the slackness in the economy, it was not in this case considered likely to have such an effect.

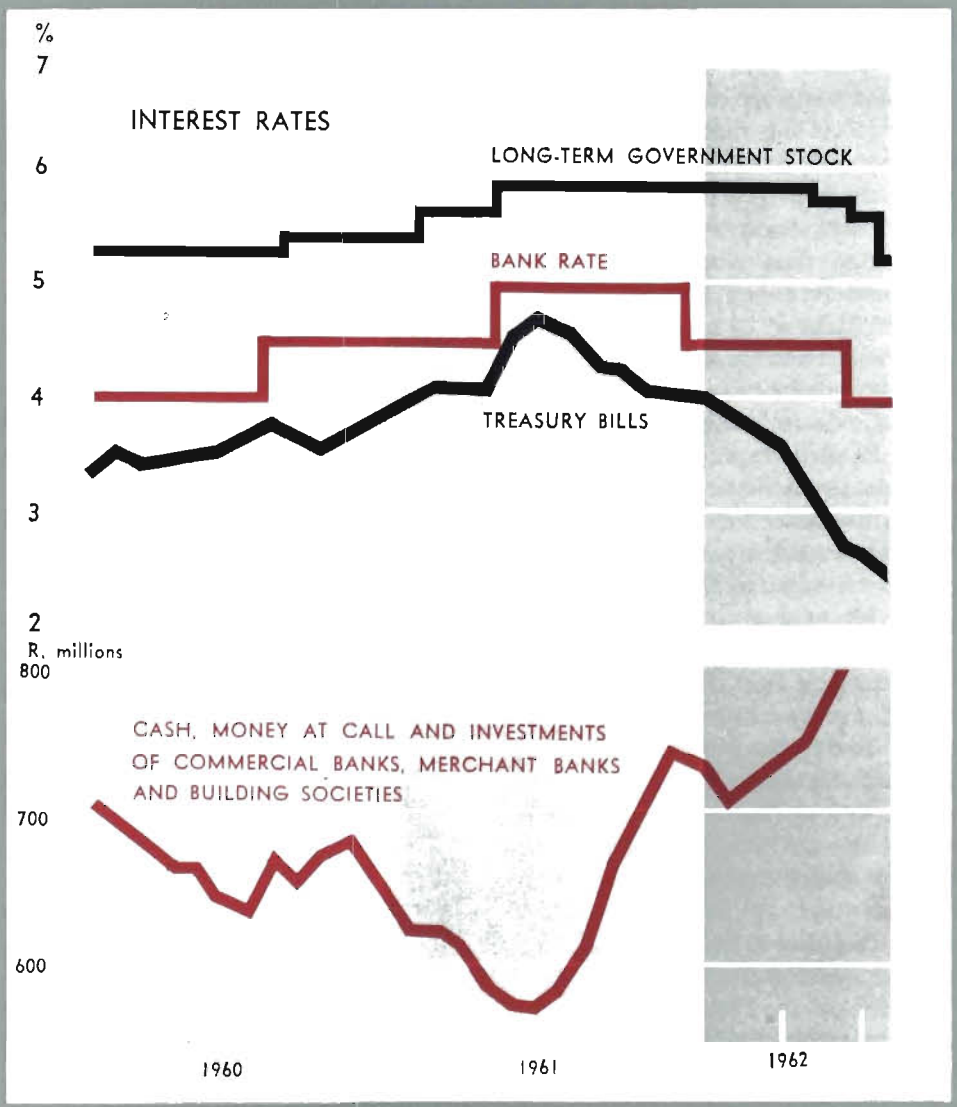
Indeed, as early as the 7th December, 1961, Bank Rate was reduced from 5 to 4½ per cent, not only as a sign to the business community and the general public that the authorities were reasonably satisfied with the results of their financial and other measures and the significant improvement in both the balance of payments and the monetary and banking situation, but also to stimulate activity in so far as this could be done by reducing the cost of short-term financing. By that stage, the Treasury bill rate had already declined to 4.07 per cent, and this downward movement continued after the lowering of Bank Rate. As usual, it was accompanied by downward adjustments in call money and related interest rates.

The lowering of Bank Rate set in motion a train of events which served to focus fresh attention on the problems caused by the intense competition for funds existing among the various classes of deposit-taking institutions in the South African credit market, to which reference was made earlier. As usual, the commercial banks made the first move by announcing that they would lower their overdraft rates as well as their rates for new deposits fixed for 3, 6 and 12 months and their savings deposit rate by ½ per cent as from the 1st January, 1962.

In making these changes, the commercial banks, no doubt, hoped that their competitors in the deposit-taking field, particularly the building societies, would also effect corresponding reductions in their deposit rates. But for some time most of these other institutions, whose methods of operation do not always permit of the same flexibility in adjusting interest rates as those of the commercial banks, refrained from changing their rates. This naturally created problems for the commercial banks, which could not afford to raise their deposit rates again in order to compete more effectively for funds, without also increasing their overdraft and discount rates, particularly since some of them were still paying as much as 5½ per cent on fixed deposits accepted at an earlier stage when money was fairly tight and rates higher.

Subsequently, however, after discussions with the Reserve Bank, the Association of Building Societies announced on the 6th March that it had recommended to its members a reduction of ½ per cent in their rates for new fixed deposits from the 1st April and in their savings deposit rate from the 1st May, as well as in the rate on new shares. At that stage, no reduction was effected in the Societies' rate for mortgage advances, but the Association did indicate that such a decrease would be considered at a later stage, as soon as the savings resulting from the reduction in the deposit and dividend rates warranted such action.

In the meantime, the continued increase in internal liquidity had brought about a considerable further decline in the Treasury bill tender rate and certain related money market rates. Moreover, during the following weeks this downward movement continued, and by the 4th May the Treasury bill rate had declined to 2.80 per cent, which meant that it was as much as 1.70 per cent below Bank Rate. After consultation with the Treasury, the National Finance


%
7
INTEREST RATES
6
LONG-TERM GOVERNMENT STOCK
BANK RATE
5
4
TREASURY BILLS
3
2
R. millions
800
CASH, MONEY AT CALL AND INVESTMENTS
OF COMMERCIAL BANKS, MERCHANT BANKS
AND BUILDING SOCIETIES
700
600
1960
1961
1962

Corporation and the commercial banks, the Reserve Bank announced, however, on the 10th May, that it had decided not to make a further reduction in Bank Rate at that stage, but, instead, to quote a separate discount rate for Treasury bills at ½ per cent above the current average tender rate for such bills. In other words, the Bank reverted to the practice which it had followed prior to May, 1960, when it quoted a special rate for the discount of Treasury bills, which was directly related to the current rate at which such bills were being issued.

There were two main considerations which played a part in this decision of the Bank to wait and see how things would develop before reducing Bank Rate further. The first was the expectation that the tempo of economic expansion would accelerate further and more rapidly and bring about a greater increase in imports, at a time when the economy was in any event approaching its seasonally leanest period for exports, which also coincided with the period of substantial dividend payments to foreign shareholders as well as of foreign loan repayments. The second was the already mentioned complex institutional problems caused by the keen competition between the commercial banks, building societies and certain other deposit-taking institutions. In view of the difficulties experienced in this regard after the previous Bank Rate reduction, the Bank was hesitant to cause new problems for some of these institutions by again lowering Bank Rate until it was quite satisfied that the situation demanded such action on its part and until conditions developed which made it easier for the various institutions to follow its lead.

It was not long, however, before two things became clear. The first was that the favourable trend in the balance of payments was continuing, even during the seasonally lean period. The second was that, despite the high degree of internal liquidity and the ready availability of short as well as long-term credit, the *actual investment and consumption spending* of the economy was still not increasing as rapidly as was desirable from both the short and long-term points of view. In other words, it became evident that the economy, in sharp contrast to the position a year earlier, now had considerable *scope* for a faster rate of development, in the sense that *the rate of increase of total spending could comfortably accelerate without causing either a deficit in the balance of payments on current account or internal demand inflation.*

The Reserve Bank accordingly lowered Bank Rate by another ½ per cent to 4 per cent on the 13th June, 1962. The commercial banks, whose position had in the meantime become even more liquid, followed this lead and reduced their fixed deposit rates, as from the 18th June, and their minimum overdraft rate, as from the 1st July, by ½ per cent, leaving their savings deposit rate unchanged. The building societies, whose position had also continued to improve, thereupon announced that they would reduce their mortgage advance rates by ½ per cent from the 1st October, but would keep their deposit and dividend rates unchanged for the time being.

More recently, as the liquidity of the economy in general and of financial institutions in particular has continued to increase, the Treasury bill tender rate has moved further downwards and by the 3rd August had fallen to 2·43 per cent, which was the lowest level attained since the introduction of the tender system in June, 1958.

Transformation in Capital Market Conditions

As in the money market, a transformation from conditions of extreme stringency, induced by the special circumstances of 1960/61, to ready availability of funds occurred in the capital market during the past year. This was reflected in rising security prices and declining yields in the markets for gilt-edged securities, gold mining shares and industrial and commercial shares.

In the gilt-edged market, the Reserve Bank at first maintained its pattern of rates for open-market operations in Government stock at the relatively high level decided upon in May, 1961, when the Bank Rate was increased to 5 per cent. Even after the Bank Rate reduction in December, 1961, this pattern remained unchanged, as the Reserve Bank felt at the time that, although the upward pressure on rates had disappeared, the existing level reflected a state of approximate balance between supply and demand in the gilt-edged market.

From the beginning of March, however, the Bank began to quote selling prices to buyers of Government stock on a yield basis of $\frac{1}{8}$ per cent below its pattern of rates for maturities exceeding 3 years. Subsequently, in May, it went a step further and actually lowered its pattern in respect of both buying and selling rates by $\frac{1}{8}$ per cent throughout for such stock, which brought the rate for stock with a maturity of over 11 years down to $5\frac{3}{4}$ per cent. In arriving at this decision, the Bank was influenced by the fact that loans issued some weeks before by the municipalities and public utility undertakings had been heavily oversubscribed, even on a lower yield basis than during the previous year, and that the Government's conversion and cash loans on the existing pattern during the previous month had yielded appreciably more than had been anticipated.

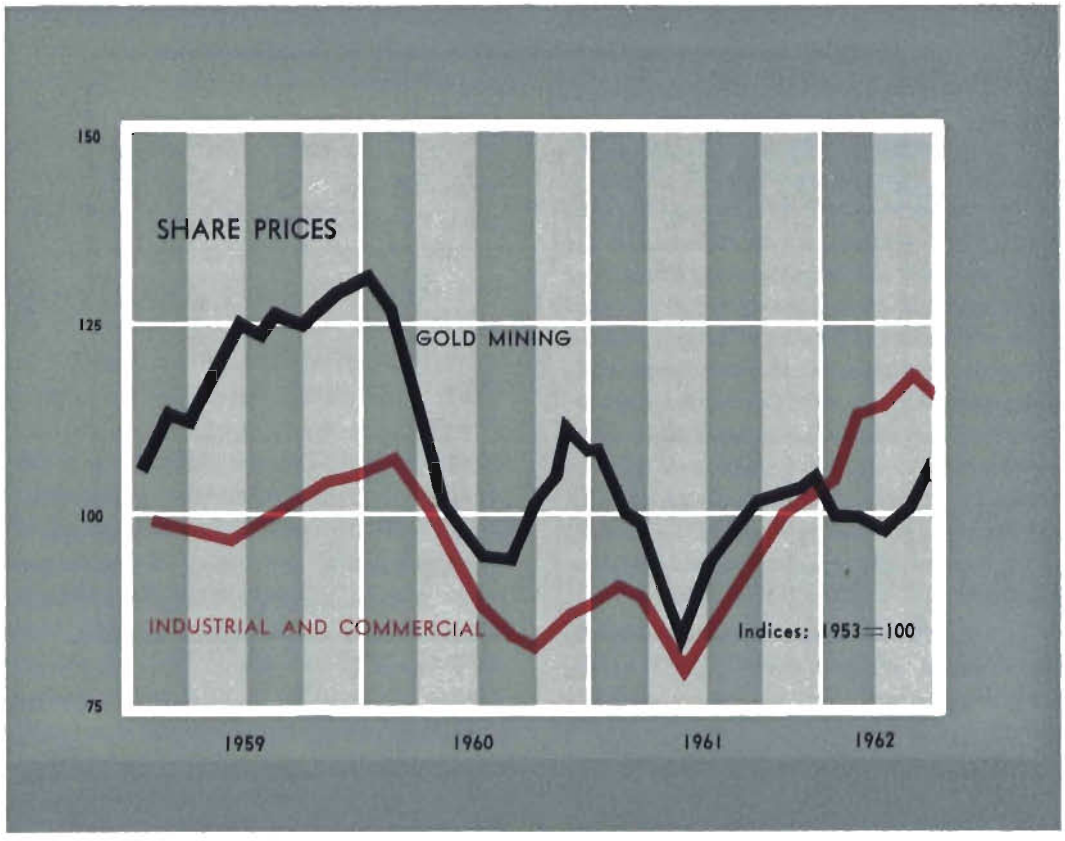
At the time of the second Bank Rate reduction in June, 1962, the Reserve Bank again lowered its pattern of rates for Government stock by $\frac{1}{8}$ per cent, which brought the rate for stock with a maturity of over 11 years down to $5\frac{5}{8}$ per cent. Subsequently, the gilt-edged market continued to ease and although the Bank began to quote selling prices for Government stock on a yield basis of $\frac{1}{4}$ per cent below its pattern of rates, it still found itself selling substantial amounts of such stock. On the 24th July, it therefore announced a further reduction, this time one of $\frac{3}{8}$ per cent, in its pattern, which brought the rate for stock with a maturity exceeding 11 years down to $5\frac{1}{4}$ per cent, the level at which it had stood prior to the large capital outflow of 1960 and the first half of 1961. At the time of this reduction, the Bank had only R13 million worth of Government stock left in its portfolio, compared with R158 million at the end of June, 1961. By the 3rd August, 1962, this amount had dwindled to R11·4 million.

These declines in gilt-edged yields occurred despite the fact that during 1961/62 there was a net increase in the internal Government stock debt of R173 million, compared with an increase of only R50 million during the previous year. But of this increase, the Public Debt Commissioners absorbed R114 million, leaving only R59 million for the banking sector, other financial institutions, other business concerns and individuals.

The yields and prices of ordinary shares showed even more marked fluctuations

than those of gilt-edged securities during the past two-and-a-half years. As the accompanying graph shows, the prices of gold-mining shares, for example, which had risen to a peak in January, 1960, first declined to a low point in August of that year, then, largely owing to speculation about a possible increase in the price of gold, recovered moderately to a relatively low peak in November, before declining again to a trough in May, 1961. But then, following the extension of exchange control to stock exchange transactions, which had the effect of severing the link between the Johannesburg Stock Exchange and the London and Bulawayo Stock Exchanges, a new upward movement began almost immediately, which lasted until the end of last year. During the early months of this year a moderate decline occurred, but from April a new, relatively sharp increase was registered.

Following the severing of the link between the Johannesburg and London Stock Exchanges, a discrepancy of about 20 to 25 per cent developed between the Johannesburg and London prices of South African gold-mining shares, which lasted for some time. More recently, however, as the external position of the South African economy has continued to strengthen, while new speculation has arisen about a possible



gold price increase, this discrepancy has been somewhat smaller.

Although the Johannesburg prices of South African industrial and commercial shares were not subject to quite the same trends as gold-mining shares, they nevertheless fluctuated broadly in sympathy with the latter. One important difference was that, after the extension of exchange control in June last year, industrial and commercial share prices showed a more marked increase than the prices of gold-mining shares. Furthermore, this rise was recorded during a period when the trend of industrial share prices in the United Kingdom was generally downward, while severe fluctuations were experienced in share prices in the United States.

These share price increases in the Republic's capital market during the past year and the accompanying decline in yields reflected a relative scarcity of first-class ordinary shares, which was largely attributable to two related sets of factors. On the one hand, the continuance of a high rate of domestic saving, coupled with the substantial increase in the liquidity of the economy, ensured a strong *demand* for scrip, particularly from the side of financial institutions. On the other hand, the *supply* of scrip on the local market was limited not only by exchange control, which discouraged foreign selling in Johannesburg, but also as a result of the relatively small amount of new issues.

The conclusion which, therefore, suggests itself is that, although there might possibly have been certain "gaps" and other imperfections in the financial structure which prevented loanable funds from flowing into desirable forms of fixed investment, conditions in both the money and capital markets were, in general, highly conducive to an acceleration of the rate of economic development. It was not a lack of money, credit or capital which kept the growth rate of the South African economy below the desired and attainable level; it was an insufficient rate of *actual investment and consumption spending*.

Expansionist Fiscal Policy

Fiscal policy in South Africa remained expansionist during the past year. Thus, with a view to stimulating private capital outlays, the investment allowances included in the previous Budget were again extended in the 1962 Budget, namely to June, 1965, in respect of equipment and machinery, and to June, 1966, in respect of buildings. Furthermore, in order to encourage exports, it was announced that exporters who increased their export turnover would be given a special income tax allowance based on the amount of their additional expenditure (other than capital outlays) on the development of export markets. At the same time, R500,000 was voted for the provision of machinery to assist exporters generally.

The Budget further provided for a substantial increase in current expenditure, particularly on defence. In order to finance these additional outlays, a large part of which was to be spent in the Republic, the discounts of 10 per cent to individual income tax payers and 3 per cent on the income tax payable by all companies other than gold and diamond mining companies, which had been granted in the previous Budget, were abolished. Increased duties were also levied on liquor, gramophone

records, petrol and diesel oil, and a number of smaller items.

More recently, in June, the Minister of Finance announced that the Government had decided to introduce the P.A.Y.E. ("pay as you earn") system for the payment of income tax and that a Bill would be presented to Parliament early in 1963 in order that the scheme might be brought into operation with effect from the 1st March, 1963. This scheme will entail a tax-free period of eight months for some individuals and a partially tax-free period for others, while companies will also enjoy a measure of tax relief. It follows that to the extent that persons or business enterprises make provision for their tax liability by buying Tax Redemption Certificates or creating other tax reserves, they will, during the partially tax-free period, retain a greater proportion of their current income than is normally the case. This should act as a stimulant to demand.

Modifications in Exchange Control

In view of the improvement in the balance of payments position and outlook, various modifications and relaxations in exchange control were introduced during the past twelve months. These were mainly designed to lessen the severity of the control measures and to iron out practical difficulties encountered in their application. Thus, for example, South African stockbrokers were allowed to engage in arbitrage transactions in securities, subject to certain conditions imposed by the authorities to prevent any net outflow of foreign exchange; permission was granted in July, 1961, to place blocked funds at call or on deposit for a maximum period of 90 days, and later, in November, this restriction as to time was abolished altogether; and, more recently, travel allowances were reinstated to their former generous level.

In addition, two methods of relaxing the control on the transfer of the proceeds of South African securities sold in South Africa by non-residents were announced by the Minister of Finance in his Budget Speech in March. Firstly, non-residents were permitted to utilise blocked funds to subscribe to a special issue of five-year non-negotiable Government bonds, bearing interest at the rate of 5 per cent per annum and repayable in five annual instalments, and freely transferable in foreign currency on the expiry of each instalment. Such subscriptions could be made from the 12th to the 20th of each month, beginning in June, and were to be limited to R20 million during 1962/63, with an ultimate limit of R50 million.

Secondly, in order to alleviate the shortage of scrip available to South African investors, and at the same time to widen the scope for sales by non-residents, approved financial institutions in South Africa could apply to the Reserve Bank for permission to buy South African shares in the London market. The differences between the Johannesburg and London security prices were to be credited to a Defence Special Equipment Account, while a limit of R20 million to R30 million on the amount involved was envisaged at the time.

The response to both these schemes has so far been limited, suggesting that the pressure by non-residents to withdraw funds is abating.

Import Control Policy

During the year ended 30th June, 1962, there were no major changes in import control policy. Applications for import permits for raw materials and capital goods continued to be scrutinised with a view to ascertaining to what extent such goods were available locally; the basis on which general merchandise permits were issued, remained the same; textile piece goods stayed under quota; and a variety of consumer goods which were either regarded as luxuries or produced locally in substantial quantity, remained on the restricted list.

A more generous basis for the issue of bonus import permits for the motor industry was, however, introduced, while the restricted list was amended and the number of items on it reduced. In addition, merchant importers of both general merchandise and raw materials were granted the concession that the first R3,000 of their quotas could be used to import goods on the restricted list on a basis of R1 for R1, while the previous conversion rate of R3 for R1 was reduced for 1962 to R2 for R1.

In the light of the internal economic tendencies discussed earlier, it would appear that import control has not yet had the adverse effects predicted by some observers. When the control was tightened in November, 1960, and again in May, 1961, the fear was expressed that, by depleting inventories unduly and diverting demand from imported to locally produced goods, import control would exert inflationary pressure on costs and prices to the detriment of the gold mines and the all important export drive and, at the same time, lead to the development of uneconomic industries and the misallocation of scarce capital, skilled labour and other resources, so that in the end the Republic would have a lower standard of living and a slower rate of real economic growth than would otherwise have been the case. It is true that if demand had increased more rapidly, import control might well have had these adverse effects. But in view of the temporary decline in consumption and the relatively moderate rate at which total demand increased, there has been little evidence of such consequences to date. Although some further upward adjustments of administered wages and prices were effected and the consumer price index continued to move moderately upwards, aggregate demand would not appear to have exerted inflationary pressure on resources during the past year.