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-third Ordinary General Meeting to be held on 14th August, 1963.

HIERDIE VERSLAG IS OOK IN AFRIKAANS BESKIKBAAR

PREFACE

In accordance with the policy inaugurated in 1961, the Bank has pleasure in issuing its third annual report on economic conditions in South Africa which, it is hoped, will be found both useful and interesting.

The Chairman will make his customary comments and observations on current and prospective conditions in the country at the Annual General Meeting of Stockholders on 14th August, but the more detailed information contained in this analysis will serve as a background to his remarks.

GERARD RISSIK, Governor, South African Reserve Bank. August, 1963.

CONTENTS

THE SOUTH AFRICAN ECONOMY IN 1962/63 **A SUMMARY**

The South African economy put up a most satisfactory performance during the year ended 30th June, 1963. The upswing in real income, employment and general economic activity which had begun from about the middle of 1961 but had remained sluggish during 1961/62, gained considerable momentum during the past year and brought the economy closer to a position of full employment of its available human and other resources than it had been for some time.

The main expansionary factors responsible for this further improvement were substantial increases in private consumption, current Government expenditure and inventory investment, supplemented by moderate increases in the gold output and fixed capital outlays by both private and public enterprises. Merchandise exports declined sharply during the second half of 1962, but recovered noticeably during the first half of 1963.

A particularly gratifying feature of the economic situation during the past year was the way in which the substantial increase in the demand for both consumer and capital goods was met by increases in local production and imports, with the result that general demand inflation did not arise. Indeed, the marked acceleration in the rate of growth of the economy was accompanied by only slight increases in consumer and wholesale prices.

In addition, the balance of payments position remained strong in the circumstances. Thus, despite a sharp rise in imports as a result mainly of the further increase in total economic activity, the current account still showed a large enough surplus to permit a relaxation of exchange control and a considerable outflow of foreign capital without the gold and foreign exchange reserves suffering a decline. On the contrary, the reserves showed a considerable further increase during the past year.

The acceleration in the rate of investment and consumer spending was facilitated and encouraged by a favourable monetary and banking environment. Money and near-money increased further, although at a slower rate in relation to the gross national product than during the previous year; bank credit not only remained readily available but, in fact, increased substantially; and interest rates remained relatively low. At one stage the monetary and fiscal authorities even found it necessary to take certain steps to reduce excess liquidity, prevent undue disturbances in the financial structure and achieve a more orderly downward movement in money rates. Throughout the period under review, however, the authorities recognised the need to assist the economic upswing as far as possible and, to this end, applied various expansionist measures.

Mainly owing to the relaxation of exchange control and an appreciable number of new issues in both the public and private sectors, a better relationship between supply and demand gradually developed in the capital market during the course of the past year, so that the downward movement in long-term interest rates and yields on ordinary shares tended to level off.

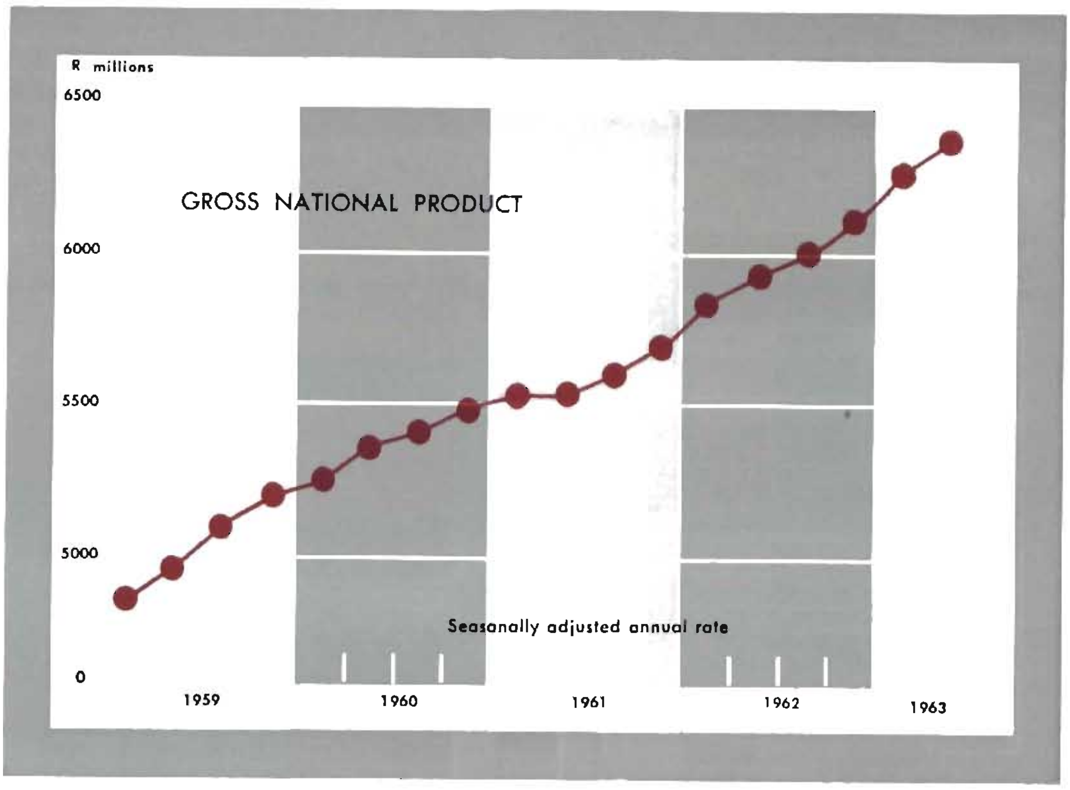
INTERNAL ECONOMIC CONDITIONS

Continued Upswing in Economic Activity

The South African economy has now been in an expansion phase of the business cycle for approximately two years. This upward movement began from a relatively low level and took some time to get into its stride. At one stage, during the second and third quarters of 1962, it even tended to lose momentum. But from the fourth quarter of 1962 it began to show new vigour and during the first half of 1963 developed into a relatively strong upswing.

Acceleration in Rate of Increase of Gross National Product

These short-term tendencies are well indicated by the recent behaviour of the gross national product. Thus, after slowing down during the second and third quarters of 1962, the seasonally adjusted gross national product again began to rise at a faster rate from the fourth quarter and accelerated further during the first half of 1963.



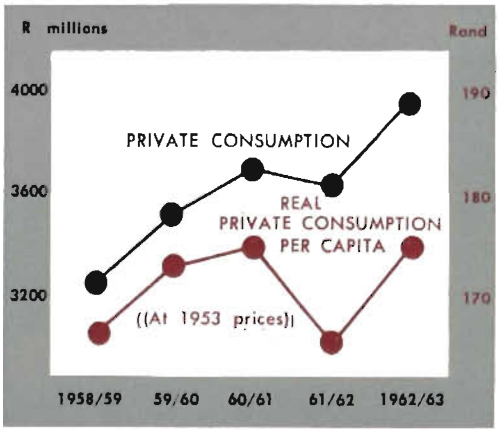
As a result of this acceleration, the year ended 30th June, 1963, turned out to be a very good "growth year" for the South African economy. During these twelve months the gross national product is provisionally estimated to have amounted to about R6,180 million, which is about 7½ per cent higher than the figure for the preceding year, compared with an increase of 5 per cent between 1960/61 and 1961/62. If allowance is made for price increases, the *real* gross national product increased between 1961/62 and 1962/63 by about 6 per cent, compared with a rise of 3 to 4 per cent during the previous year. Since the annual rate of population growth is about 2.3 per cent, the real gross national product *per head,* which had risen by only 1 per cent between 1960/61 and 1961/62, increased by approximately 4 per cent during the past year. Even taking into account the fact that 1961/62 had not been a particularly good year for the internal economy, this represented a very satisfactory rate of increase.

Strong Recovery in Private Consumption

The main reason why the sluggish revival of 1961/62 changed into a more vigorous upswing during the past year, was the strong further recovery in private consumption. The revival in consumer spending had actually begun from about the fourth quarter of 1961, after a low point had been reached during the third quarter of that year, but it took some time to gain its stride and it was only during the first quarter of 1963 that *real* consumption *per head of the population* again began to approximate the previous peak attained during the third quarter of 1960. Nevertheless, the recovery was strong enough to raise consumption to a level of about R3,960 million for the year 1962/63 as a whole, which exceeded that of the previous year by R330 million or approximately 9 per cent.

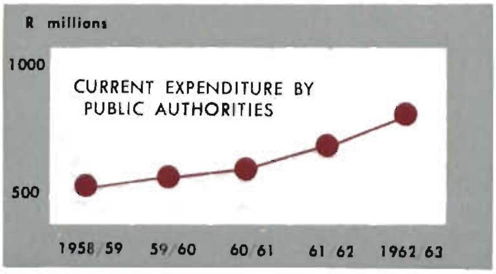
This increase occurred mainly in the field of durable consumer goods. Expenditure on motor cars, for example, which had shown a noticeable decline during 1961/62, increased by about 30 per cent in 1962/63, while outlays on furniture and furnishings increased by approximately 13 per cent.

The significance of this revival of consumer spending stems not only from the direct stimulating influence it exercised on both retail and wholesale trade, but also from the fact that it helped to absorb much of the surplus capacity which still existed in secondary industry and other sectors of the economy at the time. In so doing, it tended to provide a new incentive to certain classes of private enterprises to expand their fixed capital outlays.



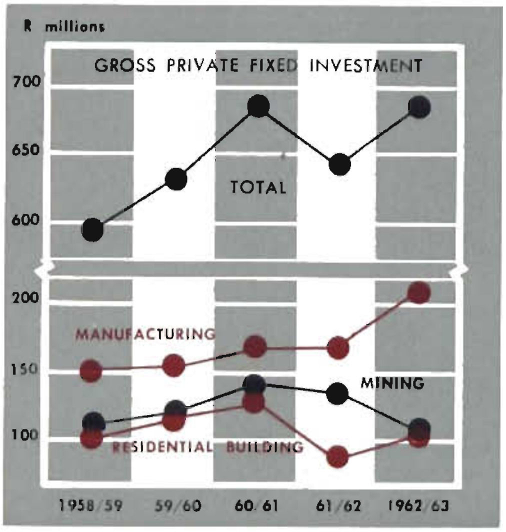
Considerable Further Increase in Current Expenditure by Public Authorities

The expansionary effect of the recovery in private consumption was strongly reinforced by a continuation of the marked upward tendency in the current expenditure of the Government and other public authorities. This component of total spending increased by a further R112 million or 16 per cent between 1961/62 and 1962/63, compared with R87 million or 14 per cent during the previous year. A higher rate of spending on locally produced as well as imported defence equipment was again responsible for a major share of this increase, although the normal expansion of governmental activities also made a significant contribution.



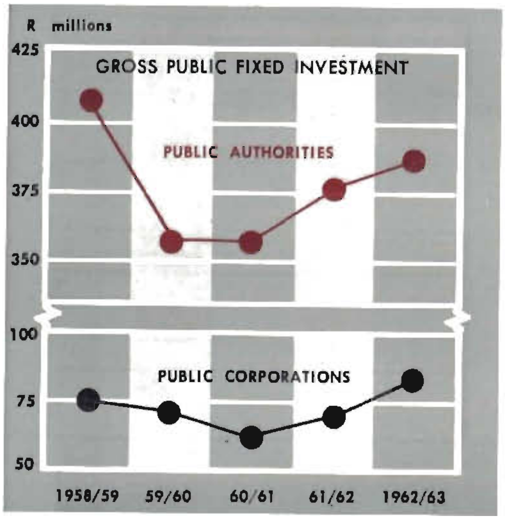
Revival of Private Fixed Investment

As the general state of confidence improved and surplus capacity declined, fixed capital outlays by private enterprises, which had declined noticeably during the course of 1961/62, gradually recovered and during 1962/63 as a whole amounted to about 6½ per cent more than during the previous year. Fixed investment in mining continued to decline and that in commerce and agriculture showed little change, but expenditure on residential buildings and outlays by private manufacturing enterprises on plant, equipment and construction moved upwards throughout the past year.



Moderate Increase in Public Fixed Investment

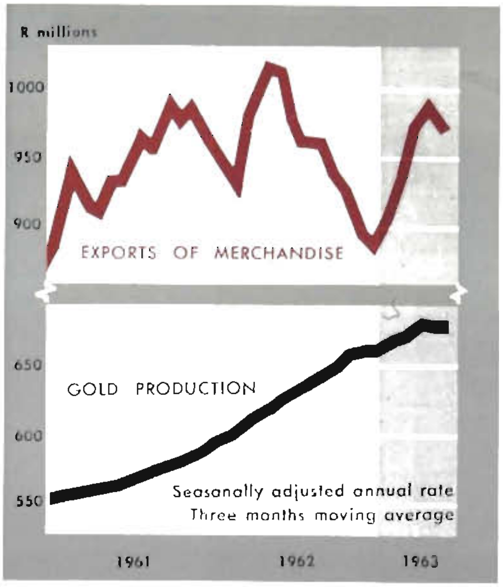
Although fixed investment by public *authorities* increased only slightly during 1962/63, public *corporations* slowly but surely expanded their fixed capital outlays and thereby contributed to the further upward movement in the economy. Nevertheless, having regard to the size of the public projects which have been announced, the effect on total economic activity of these additional expenditures was still relatively small during the period under review.



Increase in Inventories

The increases in private consumption, current Government outlays and total fixed investment during the past year were accompanied by an increase of about R108 million in total stocks of goods, mainly owing to a rise in commercial and industrial inventories. Although this stocking-up process was to some extent associated with a sharp upward movement in imports, it probably also involved substantial purchases of locally produced goods and thus tended to operate as an additional factor stimulating economic activity.

Decline in Exports Followed by Recovery



The increases in the various components of gross domestic expenditure set out above came at an opportune time as the value of merchandise exports, which together with the rising gold output had played an important part in the earlier stages of the recovery, declined sharply during the second half of 1962, as the world economic situation temporarily tended to weaken and world commodity prices moved downwards.

From the beginning of 1963, however, as the economic outlook abroad improved and world commodity prices firmed, the downward drift in exports was sharply reversed, mainly owing to increased exports of maize, diamonds, sugar and copper. Since the gold output continued to move upwards, this meant that during the first half of 1963 all the main components of total spending on the domestic product were rising simultaneously, which explains the new vigour shown by the upswing during this period.

Little Change in Total Saving

Gross domestic saving during 1962/63 showed little change compared with the previous year. Public "saving", i.e. the current surplus of the Government and other public authorities, increased substantially, partly owing to the introduction of the P.A.Y.E. system of income tax collection with effect from the 1st March, 1963. But this increase, as well as the more or less automatic rise in depreciation allowances resulting from the increase in the stock of capital goods, was offset by decreases in net company and personal saving. The latter decline largely represented the counterpart of the increase in private consumption.

More Rapid Expansion in Income Generated by Mining, Manufacturing, Commerce and Transport

With the exception of agriculture, where conditions remained more or less stationary, all the main branches of economic activity contributing to the domestic product advanced at a substantially faster rate during 1962/63 than during the previous year.

The income generated by manufacturing, for example, increased by about 11 per cent between 1961/62 and 1962/63, compared with 6 per cent during the previous year. In the case of commerce, the acceleration in the rate of increase was even more marked, namely from 4 per cent to about 9½ per cent, which is understandable in view of the recovery in consumer spending.

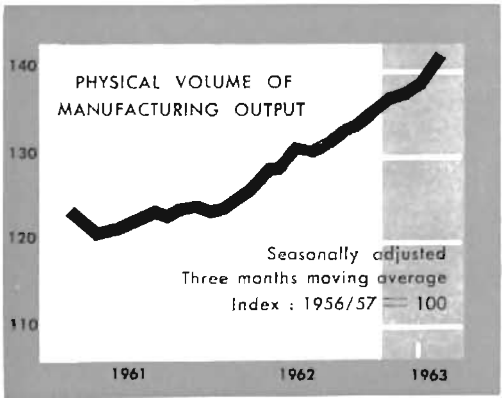
The contribution of mining as a whole increased by approximately 5 per cent between 1961/62 and 1962/63, as against 2½ per cent during the previous year. In the case of *gold* mining, the rate of increase was even higher, namely about 7 per cent.

Finally, the income generated by transport rose by roughly 9 per cent, compared with 2½ per cent during the previous year. This was largely attributable to the increase in the contribution of the South African Railways and Harbours.

Substantial Increase in Manufacturing Output

After almost levelling off during 1961, the seasonally adjusted index of the physical volume of manufacturing output increased noticeably during 1962 and gained further momentum during the first six months of 1963. During 1962/63 as a whole, it was on average about 9 per cent higher than in 1961/62. The branches of secondary industry responsible for the largest contributions to this increase were metal products, the basic metal industry, chemicals and chemical products, and electrical machinery.

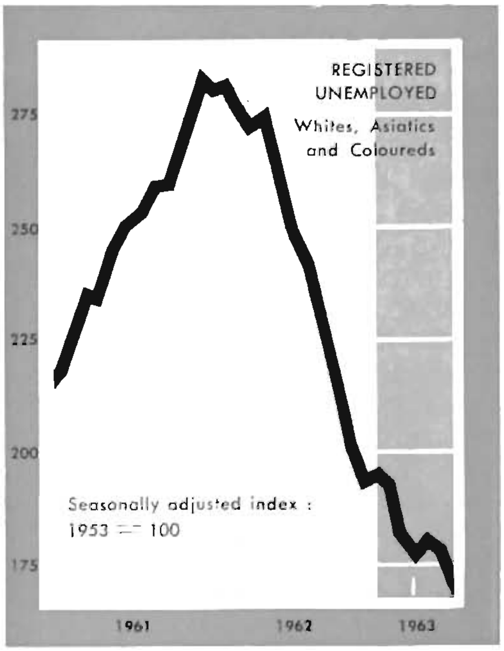
Moreover, since the average index of manufacturing employment for 1962/63 only exceeded that for the previous year by about 4½ per cent, it would appear that an increase must have occurred in the average output per person employed, even if allowance is made for the downward bias shown in the past by the employment index.



Sharp Decline in Unemployment

Although comprehensive unemployment data are not yet available, the seasonally adjusted index of registered unemployed Whites, Coloureds and Asiatics, which had already begun to decrease from the peak reached in November, 1961, continued to decline during the past year to a level which may be regarded as normal. At the end of June, 1963, the number of registered unemployed persons in these groups amounted to only about 21,600 or 1.4 per cent of the labour force comprising these groups, compared with about 2 per cent at the end of June, 1962.

From the available employment indices it further appears that the increase in total employment during 1962/63 was largely attributable to increases in manufacturing employment and employment by public authorities, including the South African Railways and Harbours.



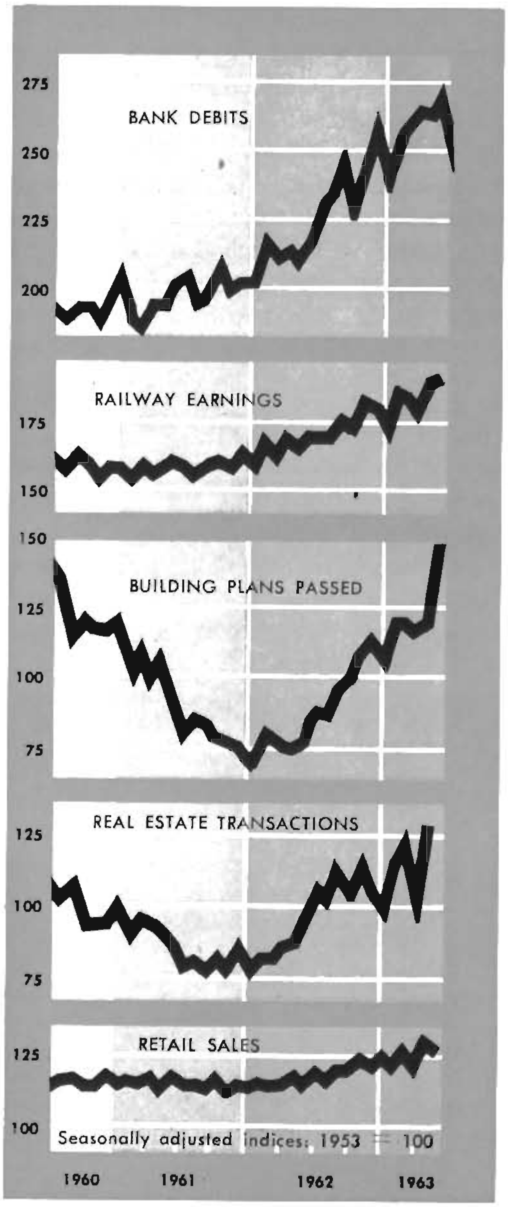
Relative Stability of Prices

Despite the marked increase in total spending, both wholesale and consumer prices edged only slightly upwards during the second half of 1962 and remained more or less constant during the first half of 1963. The wholesale price index (1953 = 100) increased from 110.7 in June, 1962, to 112.6 in December of that year, then declined slightly before rising again to the latter figure in June, 1963, while the consumer price index moved from 121.2 in June of last year to 121.8 in December and 122.0 in June, 1963. Food and clothing prices actually declined slightly during the first half of 1963.

Although bottlenecks in respect of certain types of skilled labour began to emerge as the economy gradually approached full employment of its productive resources, there was no indication at any stage during the past year of general demand inflation, i.e. of *total* demand pressing unduly upon available resources and pulling prices upwards. On the contrary, the increase in demand would appear to have been well met by increases in local production and imports, which were made possible, respectively, by the slack which still existed in the economy and the scope provided by the favourable balance of payments and relatively high gold and foreign exchange reserves.

The slight rise in the price level which did occur during the second half of 1962 would appear to have been largely attributable to such factors as increases in import tariffs, railway rates and wage and salary rates. In other words, such moderate "inflation" as may have arisen, would appear to have been more of the "cost-push" than the "demand-pull" variety.

Other Economic Indicators



As the accompanying graphs indicate, the behaviour of such other economic indicators as bank debits, railway earnings, building plans passed, real estate transactions and retail sales, confirm that, after a lower turning point of the business cycle was reached about the middle of 1961, a new upswing began which has so far lasted about two years and has become stronger during the past year.

BALANCE OF PAYMENTS

Smaller Surplus on Current Account

In accordance with expectations, the further upswing in internal economic activity during the past year was accompanied by a marked decline in the surplus on the current account of the balance of payments. As the accompanying table indicates, if allowance is made for seasonal movements, the current surplus declined sharply during the third and fourth quarters of 1962, then remained unchanged during the first quarter of 1963, before declining slightly further in the second quarter. For the year ended 30th June, 1963, it eventually yielded a surplus of R175 million which, although only about half the record surplus of R368 million attained during the previous year, was still remarkably high in view of the internal economic expansion.

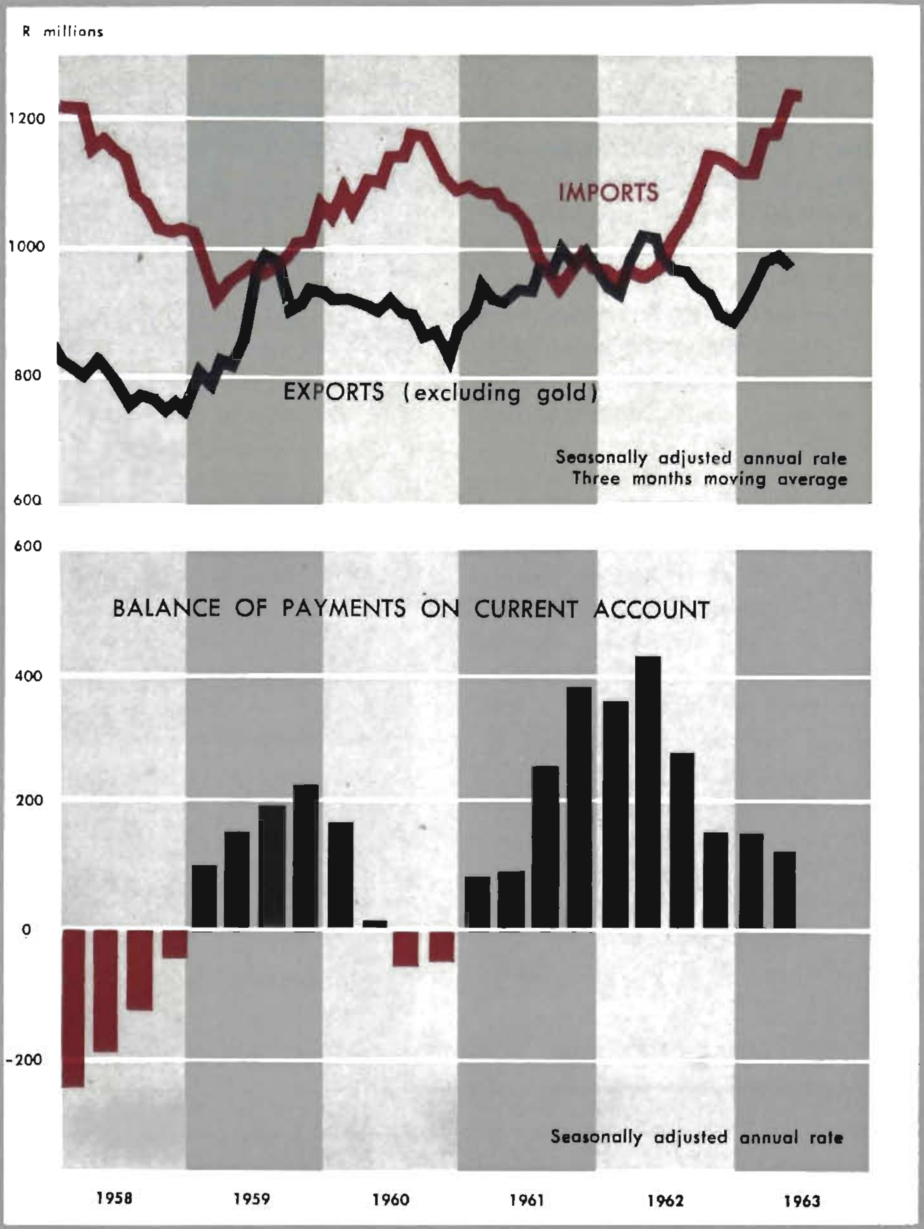
The main reason for the reduction in the current surplus was the sharp recovery in imports as a result of the increase in aggregate demand. With the exception of the last few months of 1962, when a somewhat paradoxical relapse occurred, seasonally adjusted imports moved strongly upwards throughout the past year and for the twelve months ended 30th June, 1963, showed an increase of R203 million or 21 per cent over the previous year. Of this increase, Government imports accounted for R43 million, while the categories of private imports which registered the major increases were textiles and clothing, metals, metal manufactures, machinery and vehicles.

Merchandise exports, as mentioned earlier, showed a definite downward tendency during the second half of 1962, but then moved upwards again during the first half of 1963. But despite this recovery, they were still R33 million lower during the year 1962/63 as a whole than during the previous twelve months, the main declines being registered by ferro-alloys, pig and ingot iron, other metals and metal manufactures, uranium and groundnuts.

As far as the other items in the current account are concerned, the net gold output continued to rise throughout the past year and in the end showed an increase of about R54 million over the high figure of the previous year, while net invisible payments to the rest of the world increased by R11 million over the year. Increased freight and insurance payments as a result of the higher import bill were partly offset by a decrease in the outflow of emigrants' funds.

Balance of Payments on Current Account (R millions)

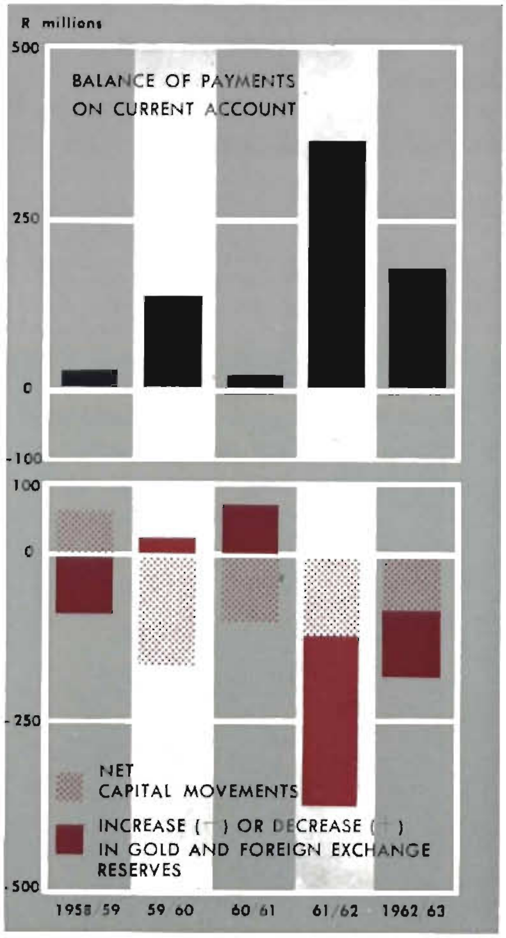
	1961				1962				1963	
	1st Qtr.	2nd Qtr	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
Actual Surplus	14	13	60	116	82	110	63	52	25	35
Seasonally Adjusted Annual Rate	84	92	256	380	360	432	280	156	156	128


R millions
1200
1000
800
600
IMPORTS
EXPORTS (excluding gold)
Seasonally adjusted annual rate
Three months moving average
600
400
200
0
-200
BALANCE OF PAYMENTS ON CURRENT ACCOUNT
Seasonally adjusted annual rate
1958
1959
1960
1961
1962
1963

Surplus on Current Account over Last Five Years

The current surplus of R175 million attained during 1962/63 brought the accumulated surplus on the balance of payments on current account for the past five years up to the substantial amount of R739 million. Moreover, as the accompanying graph indicates, South Africa achieved a current surplus during each of these years, although the amounts varied from R24 milion in 1960/61 to R368 million in 1961/62.

This huge surplus of R739 million was, in effect, used partly to reduce South Africa's net indebtedness to the rest of the world, i.e. to finance an outflow of capital, and partly to build up the country's gold and foreign exchange reserves. The former use absorbed R399 million of the total and the latter the remaining R340 million.



Substantial Net Outflow of Private Capital

Mainly owing to the operation of certain measures of exchange control relaxation, which will be discussed in more detail later on, the net outflow of private capital increased considerably during the past year, as indicated in the accompanying table. For the twelve months ended June, 1963, this outflow amounted to about R124 million, which was slightly larger than the net outward movement of R119 million registered during 1960/61, the year before the tightening of exchange control, and much larger than the outflow of R28 million during 1961/62, the first year after the tightening.

Net Movements of Private Capital
(R millions)

1961				1962				1963	
1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
-36	-19	-11	1	-3	-15	-26	-31	-36	-31

Of the total net private outflow of R124 million, R32 million represented *resident* funds invested abroad, so that the net outflow of *foreign* funds amounted to R92 million. The latter amount is, however, only the *net* figure. In actual fact a variety of long and short-term capital inflows as well as outflows occurred.

The most important single form of outflow was net purchases by South African residents from foreigners of listed South African securities to an amount of approximately R75 million. Not all of this money left the country, however. About R13 million of it was invested in the Government's special "blocked rand bonds" and again appears elsewhere in the balance of payments, namely as an inflow of official and banking capital. This leaves roughly R62 million which was either transferred abroad under the exchange control regulations or was still eligible for transfer after the 30th June, 1963.

It is also known that substantial contractual repayments on uranium, Escom and other foreign loans were made during this period.

On the other hand, while these amounts were leaving the country, foreign capital was also flowing in. It is known, for example, that foreign direct investment in private enterprises in South Africa during the past year was fairly substantial.

Small Net Inflow of Official and Banking Capital

The effect of the large net outflow of private capital during the past year was to a small extent offset by a net inflow of official and banking capital of about R20 million, which contrasted sharply with the large net outflow of the previous year, when substantial loan repayments had been made. Further repayments of official loans were made during the past year, but these were more than neutralised by an inflow of short-term capital resulting from Government trade transactions, as well as by the investment of R13 million in blocked rand bonds referred to earlier.

Net Movements of Official and Banking Capital (R millions)

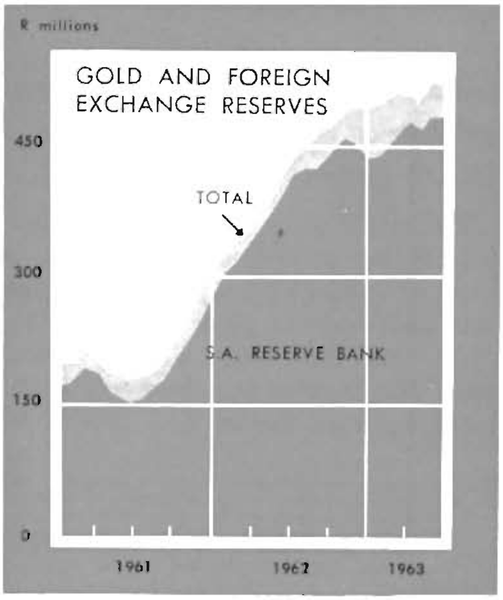
1961				1962				1963	
1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
29	-12	-11	-19	-34	-20	1	-2	17	4

Gradual Levelling-Off in Total Gold and Foreign Exchange Reserves

Despite the decline in the surplus on current account and the increase in the net outflow of capital, the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government still increased from R427 million at the end of June, 1962, to R522 million at the end of June, 1963, of which R427 million was held in the form of gold. This increase of R95 million was, however, considerably smaller than that of R249 million attained during the previous year. Moreover, as can be seen from the accompanying graph, the total reserves tended to level off during the fourth quarter of last year and the first half of this year.

The Reserve Bank's gold and foreign exchange reserves behaved somewhat differently. After rising to a peak in October, 1962, they declined noticeably until the end of the year, and then increased sharply during the first quarter of 1963, before tending to level off during the second quarter. The decline after October was largely attributable to a policy of allowing the commercial banks to invest limited amounts abroad under cover of special forward exchange agreements with the Reserve Bank — the so-called "swop arrangements", to which reference will again be made. At one time, the commercial banks held nearly R43 million in this form, in addition to their normal foreign exchange holdings. During the first quarter of 1963, however, about R12 million of this money was repatriated, followed by another R5 million during the second quarter, which contributed to the rise in the Bank's reserves during this period.

The fact that, notwithstanding the sharp increase in imports and a net total capital outflow of R104 million, the country still could show a substantial further increase in its gold and foreign exchange reserves during the past year, is a clear indication of the current strength and soundness of the South African economy. In the circumstances, it would have been understandable if the reserves had shown a downward tendency, particularly during the first half of 1963. In the past, similar upswings in total spending and activity have often brought about temporary declines in the reserves. But during the first half of 1963 the South African economy succeeded in reconciling rapid internal growth with both price and external stability.



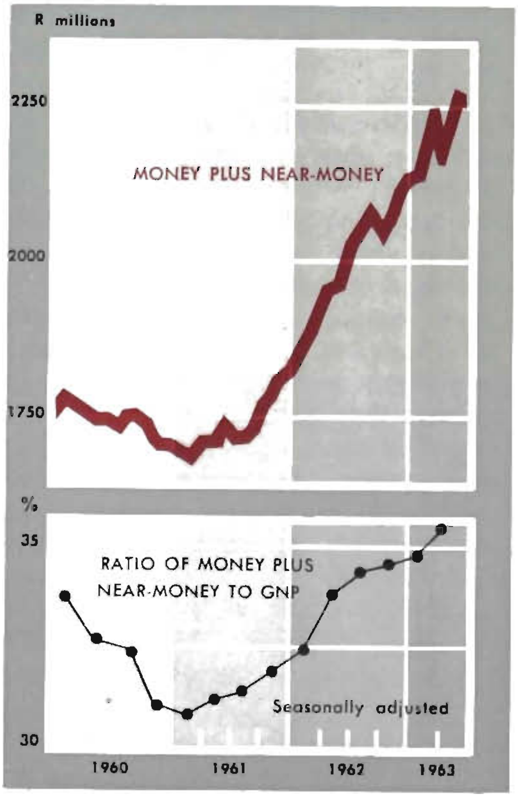
MONETARY AND FINANCIAL DEVELOPMENTS

Economic Upswing Facilitated by Favourable Monetary and Banking Environment

During the past year the general monetary and banking situation remained one of exceptional ease. Money remained in plentiful supply, bank credit readily available and interest rates relatively low. While these factors were probably not in themselves basic causes of the increased vigour shown by the upswing in economic activity during this period, they would appear to have facilitated and encouraged the acceleration in the rate of investment and consumer spending and thus to have played an important part in the more rapid advance of the economy.

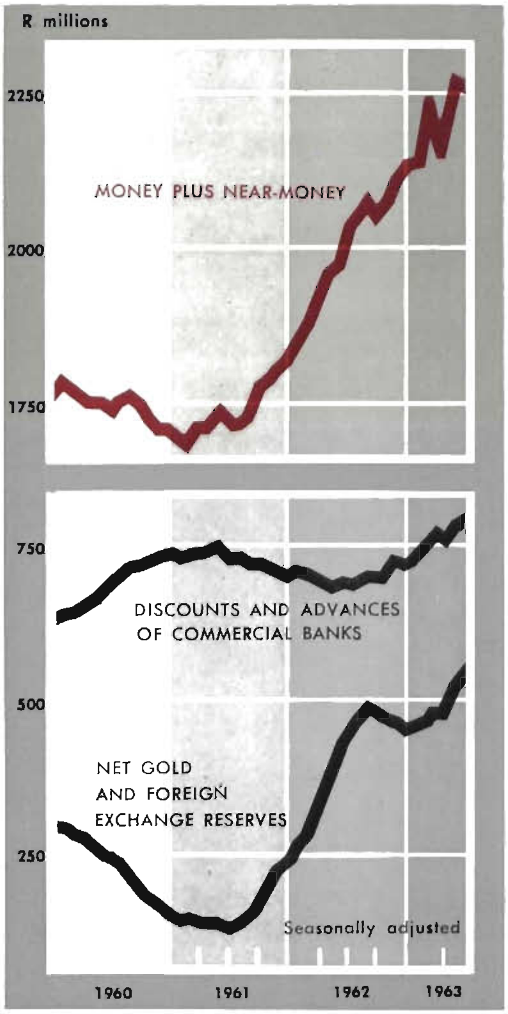
Levelling-Off Tendency Shown by Money and Near-Money in Relation to Gross National Product

The supply of money and near-money[1] held by the private sector continued to show an upward tendency during the past year and increased by R229 million between 30th June, 1962, and 30th June, 1963. This increase was, however, significantly less than that of R322 million recorded during the previous year. Moreover, during the course of the past year, as the economic upswing proceeded, the ratio of money and near-money to the gross national product increased at a slower rate, i.e. the "income velocity of circulation" of money and near-money declined less rapidly.



(1) Near-money includes interest-bearing deposits held with the "banking sector", as well as Treasury bills, short-term Government stock and tax redemption certificates outside the banking sector. "Banking sector" includes the Reserve Bank, commercial banks, National Finance Corporation, discount houses and part of the Land Bank.

Change in "Causes" of Increase in Money and Near-Money



The increase in money and near-money during the past year was no longer mainly a reflection of a large surplus in the overall balance of payments, as had been the case during 1961/62, but was to a considerable extent the result of an increase in bank credit to the private sector. The latter increase, in turn, was related to the acceleration of the rate of total spending.

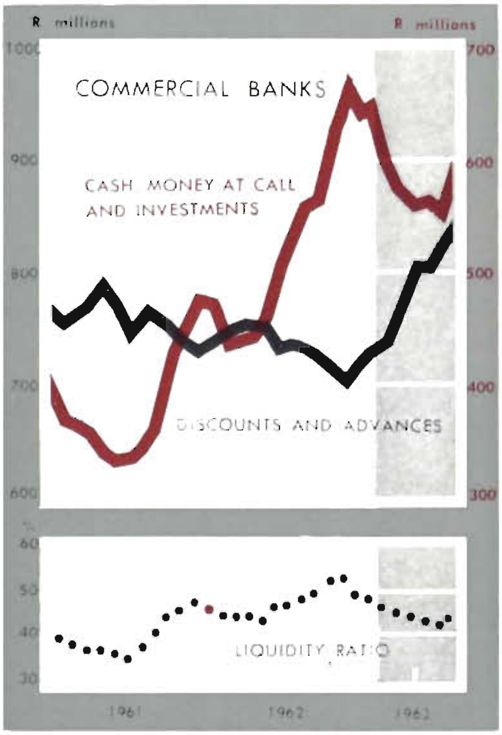
Reversal of Commercial Banking Trends

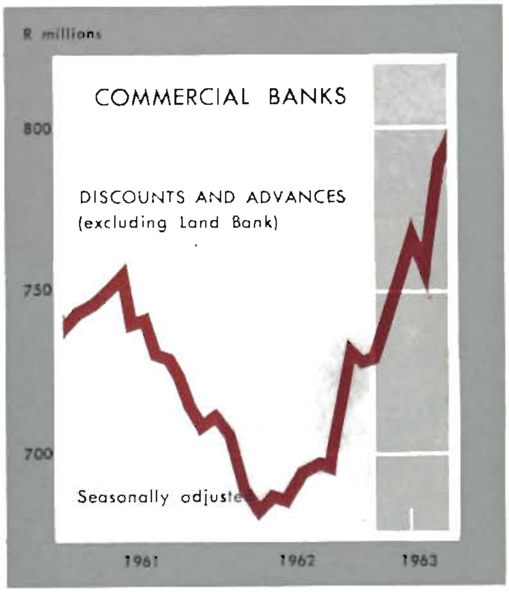
These various changes naturally also affected the position of the commercial banks. During 1961/62 the banks' discounts and advances had edged downwards, whereas their cash, money at call and investments had increased substantially owing to the extremely favourable balance of payments. The result was that the ratio of their liquid assets to their liabilities to the public had increased considerably.

From the end of October, 1962, however, an important reversal of commercial banking trends occurred. On the one hand, as the economic upswing gained new vigour, the banks' discounts and advances increased much more than seasonally. Indeed, as the accompanying graph indicates, if advances to the Land Bank are excluded and seasonal fluctuations eliminated, the commercial banks' discounts and advances showed a strong upward tendency throughout the past year and by the end of June, 1963, had reached a level well above the previous peak attained in May, 1961.

On the other hand, although the total gold and foreign exchange reserves still showed a slight upward tendency, the banks' cash, money at call and investments in South Africa declined sharply after October, 1962. This was largely attributable to two factors, namely (1) a considerably more than seasonal shift of tax and loan funds from the private to the public sector and (2) the temporary investment of funds abroad by the banks under the "swop arrangements" with the Reserve Bank referred to earlier.

The result of this "scissors movement" was that the banks' liquidity ratio declined sharply from a peak of 53.3 per cent at the

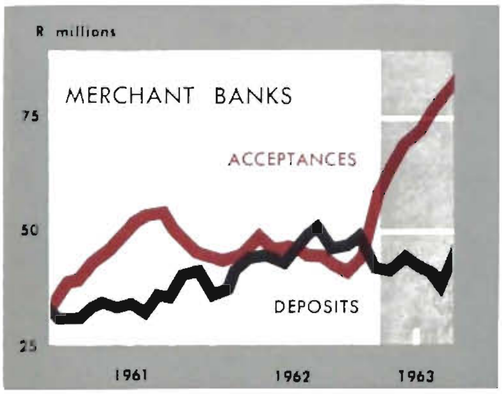




end of October, 1962, to 45.3 per cent at the end of June, 1963. Even at this level, however, the ratio was still relatively high, so that the money-creating potential of the commercial banking system remained considerable.

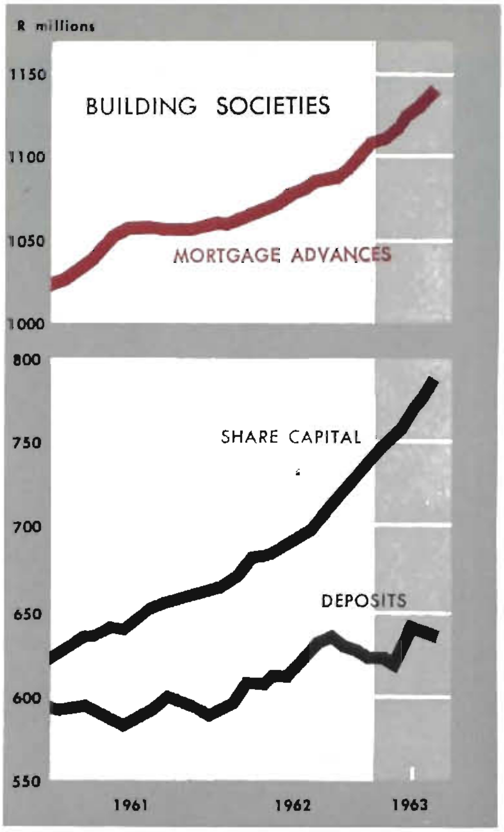
Increase in Acceptances of Merchant Banks

The experience of the merchant banks during the past year also reflected the further upswing in economic activity and the increased demand for short-term credit which accompanied it. Thus their acceptances, which had shown a declining tendency during the previous year, increased sharply from a low point of R44 million at the end of October, 1962, to R86 million at the end of June, 1963. Furthermore, as the relative liquidity of the private sector tended to level off, the deposits held with merchant banks not only ceased to rise, but after attaining a peak of R53 million in August, 1962, moved slowly downwards to R47 million at the end of June, 1963.



Further Growth of Building Societies

After rebuilding their liquidity and consolidating their general position during 1961/62, the building societies started the year 1962/63 in a favourable position to meet any increase in the demand for urban mortgage loans. Moreover, during the course of the past year the funds placed with them again rose substantially, particularly their share capital. Between June, 1962, and May, 1963, the building societies' share capital increased by R100 million to a total of R789 million, while their deposits rose by R27 million to a total of R639 million.

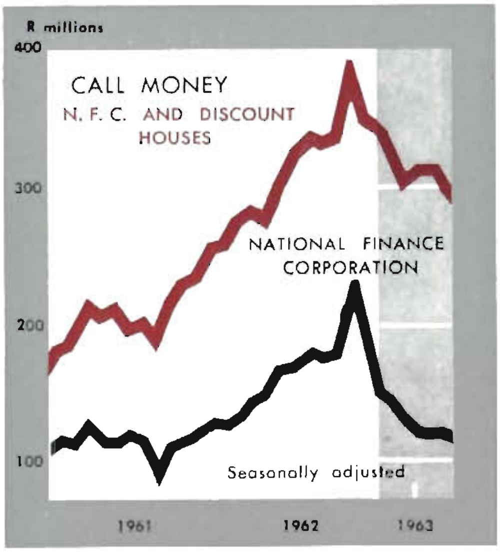


As building activity and real estate transactions increased, the building societies did in fact experience a marked revival in the demand for their loans, and their mortgages outstanding actually rose by R63 million between June, 1962, and May, 1963, to a record level of R1,142 million. But throughout this period, the total funds at their disposal proved to be more than sufficient to meet the increased demand, so that their cash, money at call and investments moved upwards by R58 million. During recent months, however, a better balance between the inflow of funds and new loans appears to have been achieved.

Sharp Decline in Call Money with National Finance Corporation and Discount Houses

Mainly as a result of the considerably more than seasonal shift of funds from the private to the public sector and the temporary investments made abroad by the commercial banks, the total amount of call money with the National Finance Corporation and the discount houses declined sharply from a peak of R408 million at the end of October, 1962, to R291 million at the end of June, 1963. Even after the elimination of seasonal movements, this decline was still considerable, as indicated in the accompanying graph.

The National Finance Corporation suffered the bulk of these withdrawals, just as it had, as a matter of policy, absorbed most of the increase in call money during the first ten months of 1962, when the discount houses had not been able to find sufficient investment outlets for all their funds.

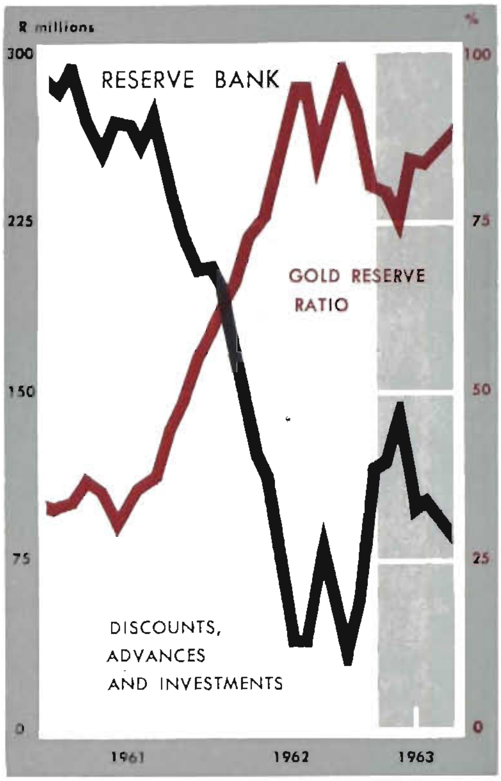


A further feature of money market operations during recent months was the decline in the Treasury bill holdings of the discount houses from a month-end peak of R94 million at the end of 1962 to R47 million at the end of June, 1963, and the increase in their holdings of bankers' acceptances from R35 million at the end of November, 1962, to R75 million at the end of June, 1963. In other words, as the demand for short-term credit expanded and the merchant banks accepted more bills, the discount houses allowed their Treasury bill holdings to run down in order to help provide the funds to discount these acceptances.

Increase in Reserve Bank Credit

The main change in the Reserve Bank's asset structure during the past year was the increase in its total discounts, advances and investments from the low level of R33 million to which it had declined by the end of October, 1962, to R145 million at the end of February, 1963. This increase was mainly attributable to credit extended to the National Finance Corporation and the discount houses to assist them in meeting the large withdrawal of call money referred to above. The main form which this accommodation took, was that of rediscounts of bills and repurchases of medium and long-term Government securities which had earlier been sold to these institutions for limited periods at prices based on short-term money rates. Subsequently, however, as the position of the Corporation and the discount houses eased somewhat, the Reserve Bank's discounts, advances and investments declined again to R79 million at the end of June, 1963.

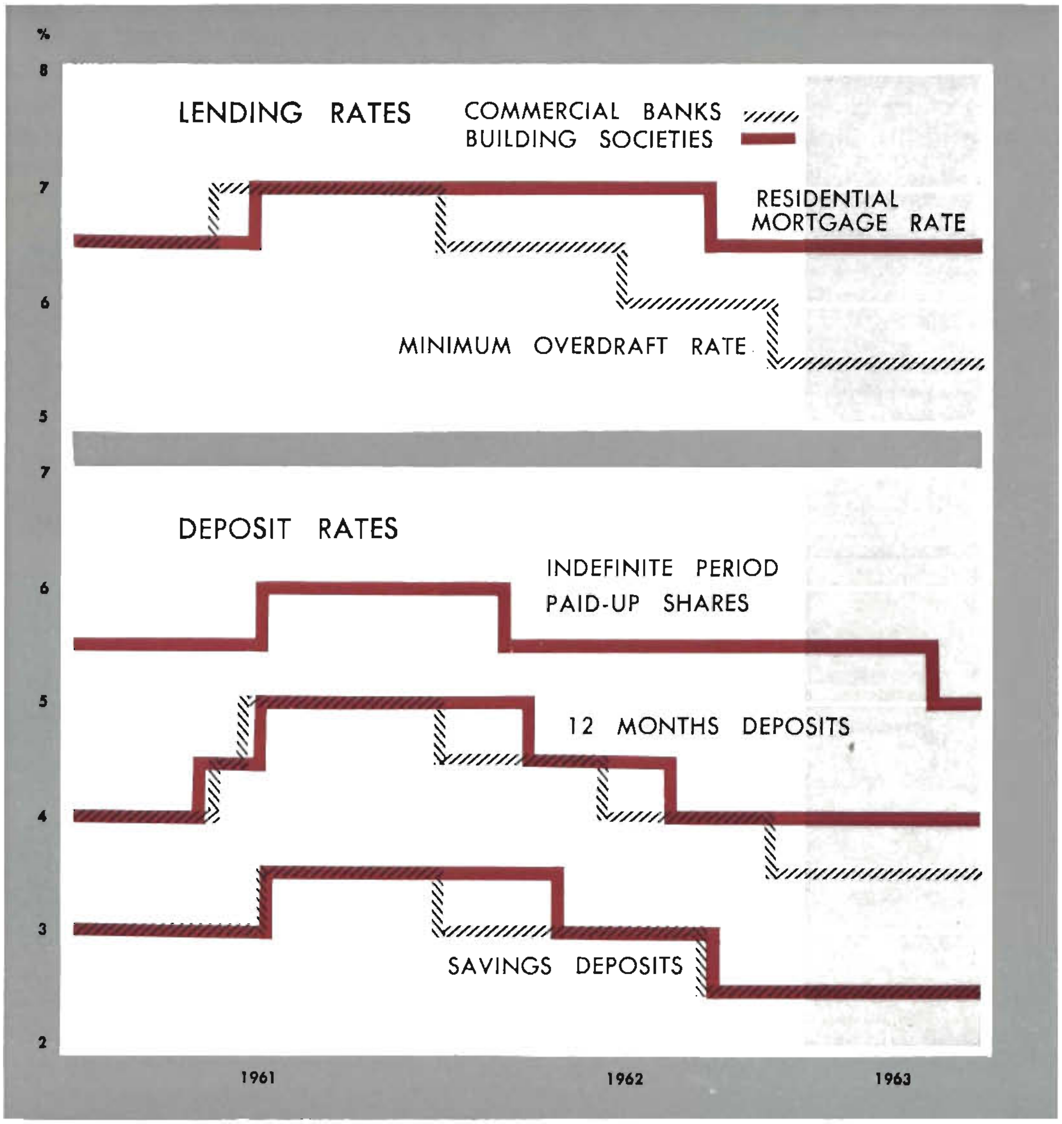
At that date the Reserve Bank's legal reserve ratio amounted to 87 per cent which, although lower than the peak of 97 per cent attained at the end of October, 1962, was still very high and, together with the ample liquidity of the various classes of banking institutions in the country, served as an indication of the substantial money and near-money creating potential still left in the banking system as a whole.



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

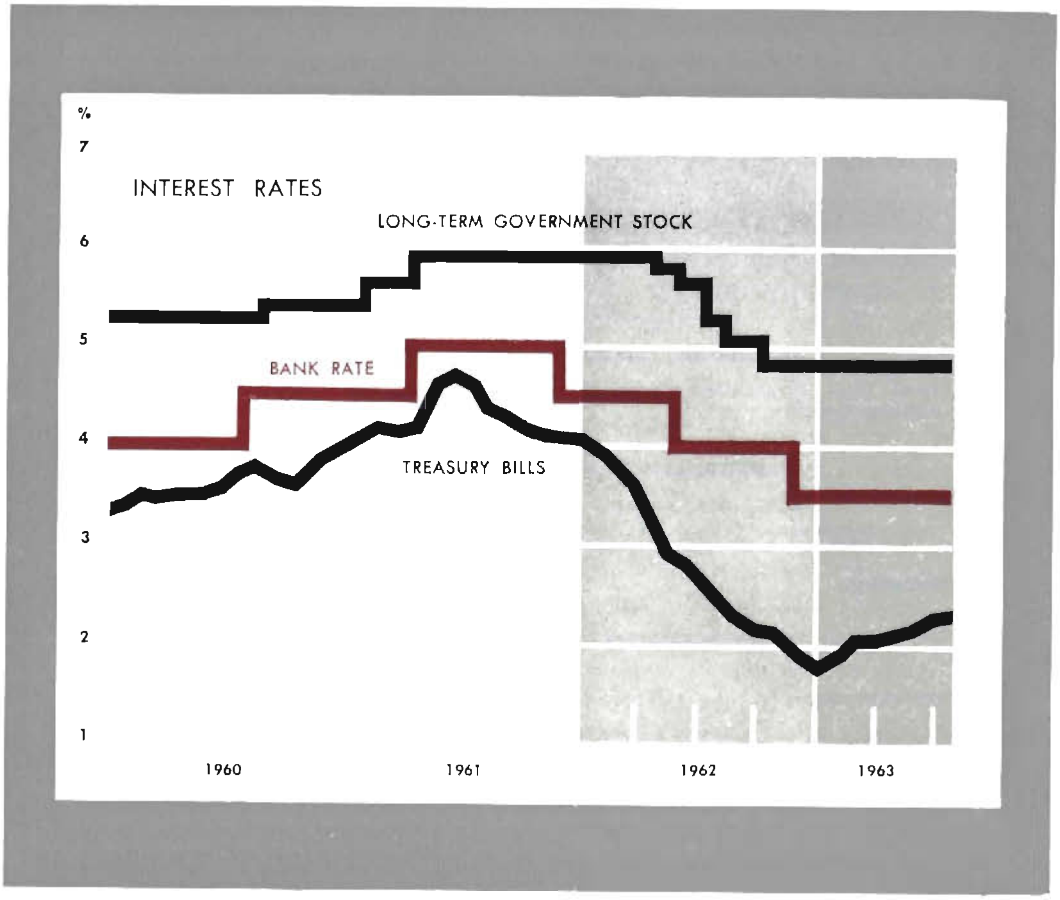
Despite the increased vigour shown by the upswing in economic activity from about the fourth quarter of 1962, the Reserve Bank did not at any stage during the period under review deem it necessary to apply restrictive credit measures of any kind. This was because the monetary authorities judged that, in view of the slack which still existed in the internal economy and the scope provided by the favourable balance of payments and high reserves, the expected increase in the aggregate demand for goods and services would be well met by increased local production and imports and would not, therefore, give rise to either demand inflation or external economic disequilibrium. Indeed, the authorities remained of the opinion that it was still necessary and desirable to assist the recovery in economic activity by stimulating both investment and consumption outlays.

In the prevailing circumstances, it was not, of course, necessary for the Reserve Bank to take the initiative in creating a favourable monetary environment by, for example, buying securities in the open market, since such an environment already existed as a result of the large and sustained balance of payments surplus. As indicated earlier, the supply of money and near-money increased further in relation to the gross national product, the banking system remained extremely liquid and most forms of credit continued to be readily available. Moreover, supply and demand conditions in the money market during the second half of 1962 were such that the Treasury bill tender rate and related short-term interest rates continued to drift downwards. In addition, during the months following the Bank Rate reduction of June, 1962, various downward adjustments were made in the deposit and lending rates of the commercial banks and building societies, as indicated in the accompanying graph.



The Reserve Bank did, however, take the step of further reducing Bank Rate on the 27th November, namely from 4 to $3\frac{1}{2}$ per cent. This was the third lowering of Bank Rate in a period of eleven months and brought it down to the lowest level in more than ten years. The Reserve Bank stated at the time that this action was taken "not only in recognition of the changes which have occurred in the monetary and banking situation during recent months, but also to reduce the cost of short-term financing and to indicate to the business community and the general public that the way appears to be clear for the continuation of the current economic revival and for a further acceleration of the rate of economic growth".

The commercial banks followed this lead by lowering their lending and deposit rates by $\frac{1}{2}$ per cent, with the exception of their rate for six months notice deposits, which was reduced by only $\frac{1}{4}$ per cent, and their savings deposit rate, which remained unaltered at $2\frac{1}{2}$ per cent. This brought their minimum overdraft rate down to $5\frac{1}{2}$ per cent and their twelve months deposit rate to $3\frac{1}{2}$ per cent.



But while recognising the need to assist the economic upswing as far as possible, the monetary authorities did at one stage adopt certain measures to reduce excess liquidity, prevent undue disturbances in the financial structure and achieve a more orderly downward movement in the Treasury bill and related money market rates. In the first place, the Treasury continued to issue Treasury bills at a rate of about R16 million per week and to borrow internally in other ways, even though it did not require the funds. For this and other reasons, which will be discussed in more detail later, an abnormal build-up of Government deposits with the Reserve Bank occurred, namely from R58 million at the end of June, 1962, to R145 million at the end of June, 1963, which naturally reduced the liquidity of both the private sector and the banks. Indeed, the shift of funds from the private to the public sector went so far that from the beginning of March, 1963, the authorities began transferring a part of the Government's deposits from the Reserve Bank to the money market in order to relieve the strain.

A second policy measure which influenced the situation during the past year was that of allowing the commercial banks to invest limited amounts abroad under cover of "swop arrangements" with the Reserve Bank. While these transactions did not affect the *total* gold and foreign exchange reserves of the country or directly influence the amount of money and near-money in the hands of the private sector, they nevertheless had a tightening effect on local money market conditions. This "swop arrangement" became operative in June, 1962, and by the middle of December a total of nearly R43 million had been invested overseas in this manner. Thereafter, as local monetary conditions tightened, some of these funds were returned and on the 26th July, 1963, an amount of R24 million was still outstanding.

Finally, although they were not originally introduced for this purpose, the various schemes of exchange control relaxation, which will be discussed more fully later on, did much to relieve the pressure of liquidity by allowing substantial amounts of funds to leave the country.

As a result of these measures and the underlying economic tendencies referred to earlier, the decline in the Treasury bill rate and related short-term interest rates, which had continued more or less without interruption for about eighteen months, was finally reversed. After declining to 1.80 per cent early in December, the lowest rate ever reached in the case of 91-day or 3-months bills, the Treasury bill rate gradually moved upwards again, and by the 26th July had already risen to 2.21 per cent.

Better Balance between Supply and Demand in Capital Market

Although conditions in the capital market during the past twelve months continued to be dominated by an abundance of funds seeking avenues of investment, supply-demand relationships in the different sections of this market gradually began to change as the year progressed.

At first, during the second half of 1962, as the rate of domestic saving remained high and the liquidity of both the private and banking sectors increased further, the demand for securities continued to rise. On the other hand, despite the improvement in internal economic conditions and the exchange control relaxations referred to earlier, the supply of scrip for the time being remained limited. The result was that most security prices showed substantial further increases and yields in general continued to decline.

In the gilt-edged market, for example, the pressure of funds induced the Reserve Bank to reduce its pattern of rates for Government stock by $\frac{3}{8}$ per cent in July, by a further $\frac{1}{4}$ per cent in August (0.275 per cent in the case of stocks with maturities between 3 and 11 years) and by another $\frac{1}{4}$ per cent on the 1st November. This brought the rate for stock with a maturity exceeding 11 years down to $4\frac{3}{4}$ per cent. At that stage, the Reserve Bank had only about R9 million worth of Government and other securities in its portfolio, compared with the peak of R182 million attained at the end of May, 1961. By the end of 1962 this amount had dwindled to R7 million.

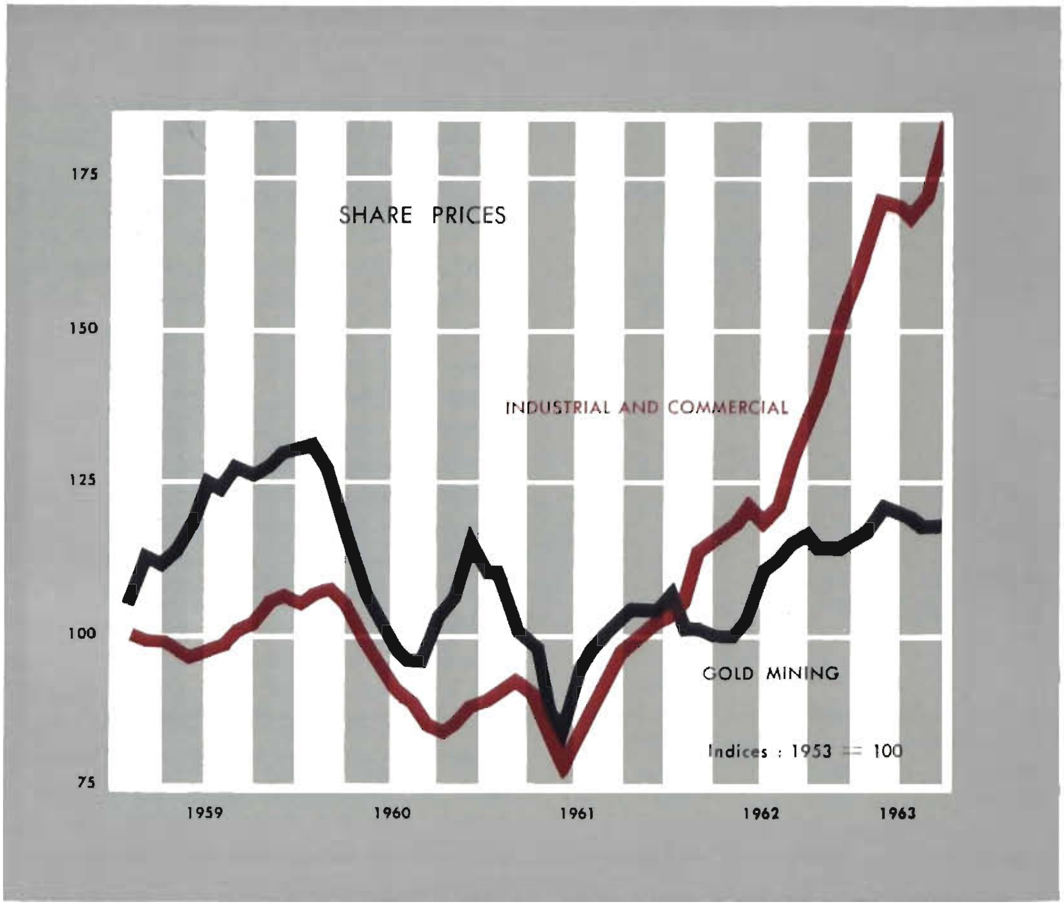
The index of gold mining share prices (1953 = 100) likewise continued to rise during the third quarter of 1962, then tended to level off during the last quarter, but renewed its upward movement during the first two months of 1963 and reached a peak of 120 in February. The index of industrial and commercial share prices rose unabatedly to a fifteen-year peak of 171 in February, 1963.

In due course, however, a better balance between supply and demand developed in the capital market. Although this was partly the result of the relaxation of exchange control, which helped to increase the supply of scrip, it would appear to have been mainly attributable to the further expansion of economic activity and the spate of new issues by both the public and private sectors which accompanied it.

The internal stock debt of the Government, for example, increased by R168 million between June, 1962, and June, 1963, as will be indicated in more detail later on. In addition, during the 12 months ended June, 1963, seven municipalities floated public issues to a total amount of R62 million, compared with only R37 million during the previous year, while Escom, the Rand Water Board, the Land Bank and the Industrial Development Corporation made public issues amounting to R94 million, which was slightly higher than the amount issued in 1961/62.

As a result of these developments, the Reserve Bank was only called upon to make moderate sales and purchases of Government securities during the first half of 1963, i.e. apart from the special repurchases from the National Finance Corporation and the discount houses referred to earlier. Gilt-edged rates accordingly remained stable throughout this period at the relatively low level to which they had declined by the fourth quarter of last year.

The changed supply-demand relationship during the first half of 1963 was also evident in the case of gold mining and industrial and commercial share prices. As indicated in the accompanying graph, the prices of gold mining shares declined slightly after February of this year, while those of industrial and commercial shares temporarily tended to level off before increasing further. At the same time, the decline in yields appears to have come to a halt. According to calculations of the Bureau of Statistics, the annual average yields on about 250 listed industrial and commercial shares, for example, after rising to a peak of 8.3 per cent in 1960/61, declined to 6.8 per cent in 1961/62 and about 5.3 per cent in 1962/63, but tended to level out at around 5.1 per cent after January, 1963. The yields on gold mining shares followed a largely similar pattern, as indicated by the annual averages of 9.0 per cent for 1960/61, 8.2 per cent for 1961/62 and 7.6 per cent for 1962/63, and a tendency to rise slightly during the first half of 1963.



Important Developments in Government Finance

As already indicated, certain developments in the field of Government finance exercised an important influence on monetary and financial conditions during the past year. These developments were reflected in a substantial increase in the total deposits of the Government, namely from R59 million at the end of June, 1962, to R170 million at the end of June, 1963. The main reasons for this exceptional increase were (1) a decline in the excess of exchequer issues over receipts (excluding borrowing) from R133 million in 1961/62 to R53 million during 1962/63 and (2) an increase in the Government's net borrowing from R147 million in the former year to R162 million in the latter.

The decline in the excess of issues over receipts occurred despite a substantial rise in defence expenditure and was mainly attributable to higher income tax collections. The increase in the latter partly resulted from the change-over to the P.A.Y.E. system of collection, which greatly reduced the seasonal decline in income tax receipts during the second quarter of the year.

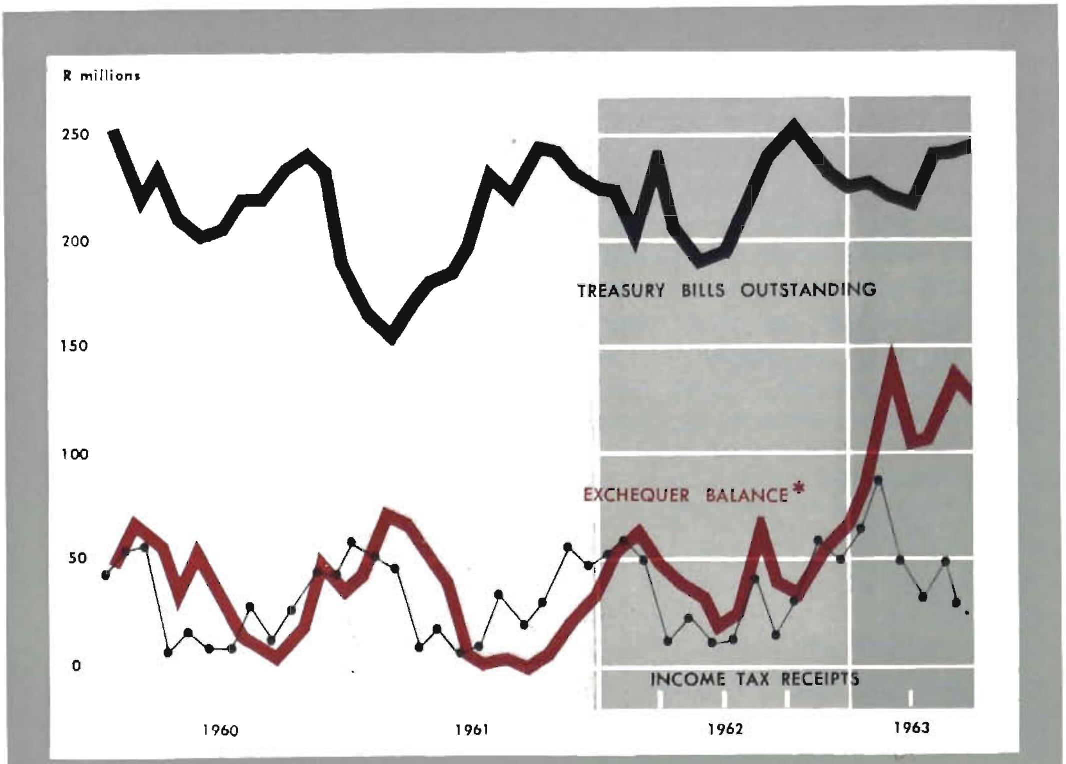
It follows from the above that the Government's net borrowing of R162 million during the past year was considerably more than was necessary from the point of view of its own cash requirements. As pointed out earlier, however, there were other important considerations, such as the need to provide investment outlets for the money market and the Public Debt Commissioners, and to mop up surplus liquidity.

In actual fact, as the accompanying table shows, the Government borrowed more than R162 million from the domestic market, namely R188 million, as its foreign debt decreased by an amount of R26 million during the year. Its internal stock debt increased by R168 million and its Treasury bills outstanding by R53 million, while it repaid loan levies and other floating debt to an amount of R33 million. As in former years, the Public Debt Commissioners again absorbed a major share of the increase in the Government's internal stock debt, namely R135 million.

Government Debt (R millions)

	Outstanding Debt as at: 30th June, 1962	30th June, 1963	Net Borrowing during Year
Treasury Bills	194	246	+ 53
Other Floating Debt	75	42	— 33
Internal Government Stock:			
Marketable Stock held by:			
Public Debt Commissioners	1,208	1,343	+ 135
Banking Sector	340	348	+ 7
Building Societies	54	67	+ 13
Other Deposit-receiving Institutions	22	29	+ 7
Insurers and Pension Funds	107	111	+ 4
Other Businesses	81	77	— 4
Other	51	55	+ 4
Total	1,862	2,029	+ 167
Non-marketable Stock	369	370	+ 1
Total Internal Government Stock	2,232	2,400	+ 168
External Government Stock	189	162	— 26
Total Government Debt	2,689	2,850	+ 162

As a result of the official policy of providing additional investment outlets, the usual pattern of the Government's short-term borrowing through the issue of Treasury bills showed a noticeable change during the past year, as indicated in the accompanying graph. In former years, the amount of Treasury bills outstanding used to decline considerably when the exchequer balance increased. During the past year, however, the outstanding Treasury bills were maintained at a high level despite the substantial increase in the Government's deposits. Moreover, the legal limit on the Government's borrowing powers over and above the amount voted on loan account (less credits to that account) was increased recently from R30 million to R60 million with a view *inter alia* to affording the Treasury more scope to perform this type of operation in the future.



* Including R49 million uninvested funds of the Public Debt Commissioners on the 31st March, 1963.

Expansionist Fiscal Policy

The 1963/64 Budget introduced by the Minister of Finance in March of this year was an expansionist one aimed at assisting the upswing in economic activity and attaining a higher rate of growth in the economy. On the one hand, a substantial increase in the proposed expenditure on both the Revenue Account and the Loan Account was announced and, on the other, measures were introduced to stimulate consumption, private fixed investment and exports.

The measures to encourage consumption included a discount of 5 per cent on income tax for individuals, increased benefits to social and civil pensioners, larger deductions from taxable income in respect of contributions to pension funds and retirement annuity funds, increased rebates on insurance premiums and a reduction of the customs and excise duties on petrol and on diesoline used for road transport by 1 cent per gallon. The Minister of Finance envisaged that these concessions, together with the tax-free period of eight months from July, 1962, to February, 1963, resulting from the introduction of the P.A.Y.E. system of income tax collection as from the beginning of March, 1963, would stimulate total consumer spending.

In order to encourage private fixed investment, the investment allowances introduced earlier were extended to 28th February, 1966, in respect of equipment and machinery, and to 28th February, 1967, in respect of buildings.

The concessions to exporters were extended so that all exporters would be entitled to deduct from their taxable income 125 per cent of allowable expenses incurred in the development of export markets, irrespective of whether or not they succeeded in increasing their exports.

Despite these changes, the Minister did not have to budget for a deficit in the Revenue Account, partly owing to the transfer from this account to the Loan Account of R26 million under the vote "Defence" and the R25 million grant to the South African Native Trust Fund.

Further Relaxation of Exchange Control

The continued strength shown by the balance of payments on current account during the past year and the further increase in the country's gold and foreign exchange reserves made it possible for the authorities not only to maintain the relaxations of exchange control announced during the previous year, but also to introduce further liberalisation measures. The main methods of relaxation in operation during the past year were the following:

Firstly, non-residents continued to be permitted to utilise blocked funds to subscribe to a special issue of five-year non-negotiable Government bonds, bearing interest at 5 per cent per annum and repayable in five equal annual instalments, and freely transferable in foreign currency on the expiry of each instalment. Moreover, this facility, which had previously also been available to emigrants who had relinquished South African domicile prior to the introduction of sterling control in May, 1958, was extended to all emigrants on the 28th August, 1962, at the same time as an increase in the emigration or "settling-in" allowances was announced. While there is no limitation on the amount for which non-residents may apply, an emigrant subscription is limited to R30,000 per family unit. By the end of July, 1963, R18.1 million had been invested in these special bonds, and recently the first instalments on the first subscriptions of just over a year ago were repaid. A significant variation of this method of relaxation was introduced on the 25th July of this year, when the Treasury announced that it was replacing the 5 per cent five-year blocked rand bonds with new 3¼ per cent three-year bonds.

Secondly, the so-called *permit* scheme which had been announced by the Minister of Finance in his Budget Speech of March, 1962, remained in operation. The main purposes of this scheme were to alleviate the shortage of scrip on the local market; to furnish additional scope for the overseas investor to realise his investments in South African shares; to provide for a controlled repatriation of South African securities and thus a reduction in the country's foreign liabilities in respect of portfolio investments; to narrow the "gap" between the foreign and local prices of South African shares; and to confer some financial benefit on the State and thus on the country as a whole. In terms of this scheme, stockbrokers can apply to the Reserve Bank, on behalf of approved clients, for permisison to buy shares abroad if the local broker is unable to satisfy the order by purchases in South Africa. The differences between the Johannesburg and foreign security prices, less the costs involved, are credited to a Defence Special Equipment Account.

Thirdly, in order to supplement the *permit* scheme, another plan for the purchase of South African shares abroad was put into operation from September, 1962, namely the *arbitrage* scheme. In terms of this scheme, the Reserve Bank makes periodic allocations of sterling through the Johannesburg Stock Exchange to finance one-way arbitrage transactions in South African securities between the local and foreign stock exchanges. The price differential between the local and overseas markets is established at the time each allocation is made and the broking firms concerned are informed what percentage of the amount involved, in terms of South African currency, must be paid into the Defence Special Equipment Account.

The results of these two share purchase schemes have thus far not been insignificant. As at the 26th July, 1963, sterling remittances effected in payment of scrip delivered under the permit scheme amounted to R25 million, while the fate of permits to the value of about R11 million was unknown as yet. Under the arbitrage scheme, total allocations up to that date amounted to R34 million, of which R28 million had been remitted. The total contribution to the Defence Special Equipment Account at that stage was R4.0 million.

Apart from helping to relieve the pressure of liquidity, as mentioned earlier, these transactions also contributed to the narrowing of the gap between local and overseas prices of South African shares. Indeed, during March and April of this year, this gap, which had originally exceeded 20 per cent, narrowed to about 7 per cent, although it subsequently increased again to well over 10 per cent.

Finally, with a view to stimulating new investment and broadening the investment opportunities available to holders of blocked rand, the Minister of Finance announced on the 28th August, 1962, that the authorities would, in consultation with the appropriate Government Departments, be prepared to consider favourably applications by or on behalf of non-residents for permission to utilise their blocked rand balances for direct investment in the equity or loan capital of manufacturing enterprises. Such investments were to be restricted to new industries not directly competitive with existing industries and, provided the investment had continued uninterrupted for a minimum period of five years, the repatriation of the proceeds on realisation would be freely permitted. Investment in "Border Areas" would be viewed with particular favour and cognizance would also be taken of the opportunities offered to South African interests to participate in the investments.

Relaxation of Import Control

In addition to the further liberalisation of exchange control, import control was relaxed in certain respects during the past year. Firstly, in August, 1962, additional allocations were made in respect of consumer goods and textile piece goods. This was followed by an announcement in November that allocations for 1963 would be increased by 10 per cent in the case of Group A consumer goods (goods which are not available in substantial quantities from local sources) and 12½ per cent in the case of consumer goods in Group B (goods which in general are freely available from local sources of production). These increases were confirmed in May, 1963, when the second round allocations were made. In addition, importers were allowed to use the first R5,000 of their quotas to import goods on the restricted list at a conversion rate of R1 for R1, compared with an amount of R3,000 during the previous year.

In the case of raw materials and capital goods, the policy of granting importers their full reasonable requirements continued to be applied, although applications for import permits were still scrutinised with a view to ascertaining to what extent such goods were available locally or could be manufactured economically in South Africa.

The flexibility allowed by South Africa's system of import control was again illustrated during the past year by the fact that, notwithstanding the various import restrictions, total imports rose by as much as R203 million or 21 per cent over the relatively low level of the previous year. Although this increase was, no doubt, to some extent associated with the relaxations mentioned above, it would appear to have been mainly attributable to the increase in total demand flowing from the continuation of the economic upswing, just as the relatively low level of imports during the previous year had been largely the result of the slack conditions which still existed in the economy at that stage.