SOUTH AFRICAN RESERVE BANK

1968

ANNUAL ECONOMIC REPORT

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A review of economic and financial conditions in the Republic of South Africa presented as background to the Chairman's Address to Stockholders at the Forty-eighth Ordinary General Meeting to be held on 27th August 1968.

HIERDIE VERSLAG IS OOK IN AFRIKAANS BESKIKBAAR

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INTERNAL ECONOMIC CONDITIONS

Better balance between demand and supply

The slowing down in the rate of increase in monetary demand which became evident towards the middle of last year continued into 1968 and, although individual indicators would seem to suggest that some acceleration took place during the first half of this year, aggregate demand and supply appeared to be in good balance with little evidence of general demand inflation. Over the year ended June 1968 price levels rose only moderately, a surplus emerged on the current account of the balance of payments and the undue pressure upon scarce resources, which was a feature of the inflationary upswing in 1966 and the early part of 1967, was relieved to an appreciable extent. These favourable developments were due in large measure to the official policy of curbing inflation by means of monetary, fiscal and other measures.

However, towards the end of the period under review this approximate balance reached between total demand and supply was threatened from various quarters. Chief among these was the continued gold speculation resulting from international currency uncertainties initiated by the devaluation of the British pound in November 1967. This led to a large and persistent capital inflow which, in turn, not only produced sharp rises in share prices and turnover on the Johannesburg Stock Exchange but also considerably increased the liquidity of the private and banking sectors of the economy.

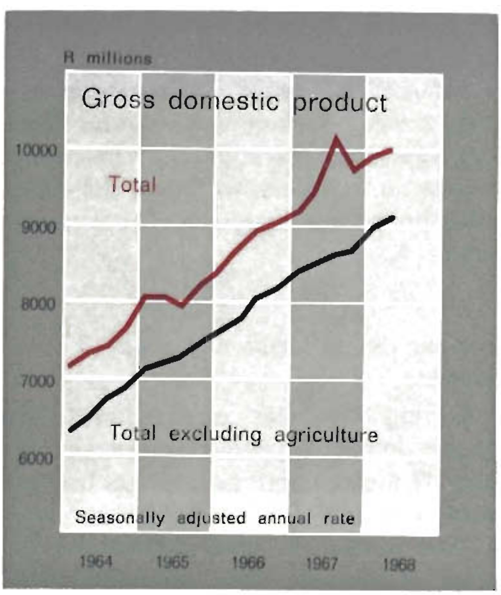
Thus, notwithstanding the existence of a better balance between demand and supply, a general monetary environment developed which was potentially conducive to inflation. Under these circumstances the authorities deemed it advisable to persist with their main disinflationary monetary and fiscal measures.

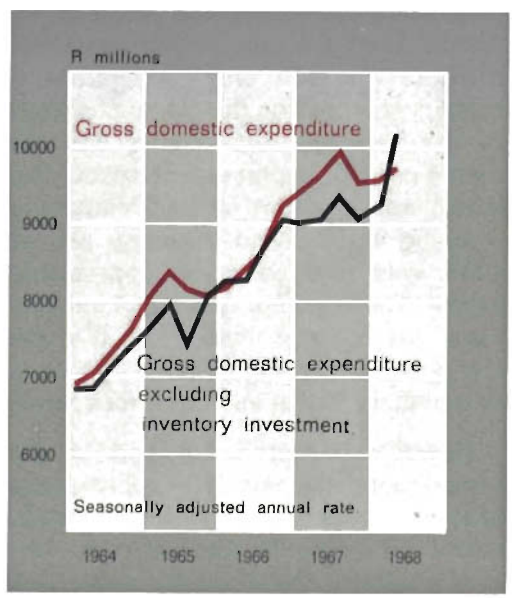
Further rise in gross domestic product

During the year ended June 1968 gross domestic product increased by slightly more than 8 per cent at current market prices and by about 6 per cent in real terms, i.e. after adjustment for price increases. This relatively high rate of increase was, however, to a large extent attributable to an increase of no less than 23 per cent in the value added by agriculture. Likewise, the trend in gross domestic product during the course of the year 1967/68 was strongly influenced by fluctuations in the contribution of agriculture. After rising sharply during the second and especially the third quarter of 1967, gross domestic product declined noticeably during the fourth quarter due mainly to fluçtuations in the value added by agriculture. Although the contribution of agriculture declined further during the first half of 1968, total gross domestic product resumed its upward trend as a result of the faster rate of increase in the value added by other sectors of the economy, in particular commerce, manufacturing and mining other than gold.

Slower rate of increase in gross domestic expenditure

Sharp increases in the gross domestic expenditure in the second and third quarters of 1967 were followed by a decline in the fourth quarter, a levelling out in the first quarter of 1968, and a moderate rise in the second quarter. The slow rate of increase in gross domestic expenditure during the first half of 1968 could be ascribed almost entirely to a sharp decline in inventory investment as the total of the other components of gross domestic expenditure, i.e. personal consumption, current government expenditure and fixed capital outlays, increased further at an annual rate of about 13 per cent from the fourth quarter of 1967 to the second quarter of 1968.

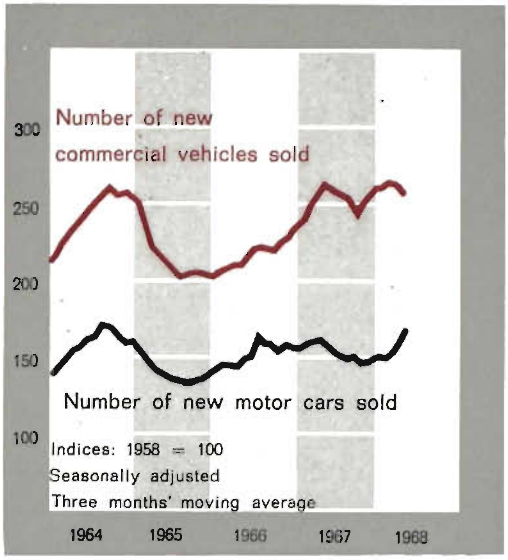


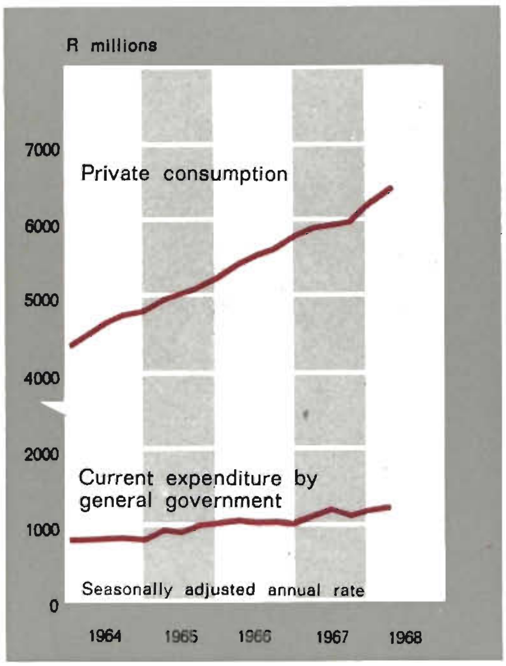


Private consumption and current government expenditure

Although private consumption increased at an annual rate of only $7\frac{1}{2}$ per cent during the year 1967/68, compared with an average of $8\frac{1}{2}$ per cent during the preceding six years, its rate of increase changed significantly during the course of the year. In the second half of 1967 it tended to level off and increased at an annual rate of only about $4\frac{1}{2}$ per cent compared with the first half. But during the first half of 1968 its annual rate of increase accelerated appreciably to no less than $12\frac{1}{2}$ per cent compared with the second half of 1967. Although this higher rate during the first half of 1968 partly reflected a slightly faster rise in consumer prices, it mainly represented an increase in real consumption expenditure, especially on durable consumer goods.

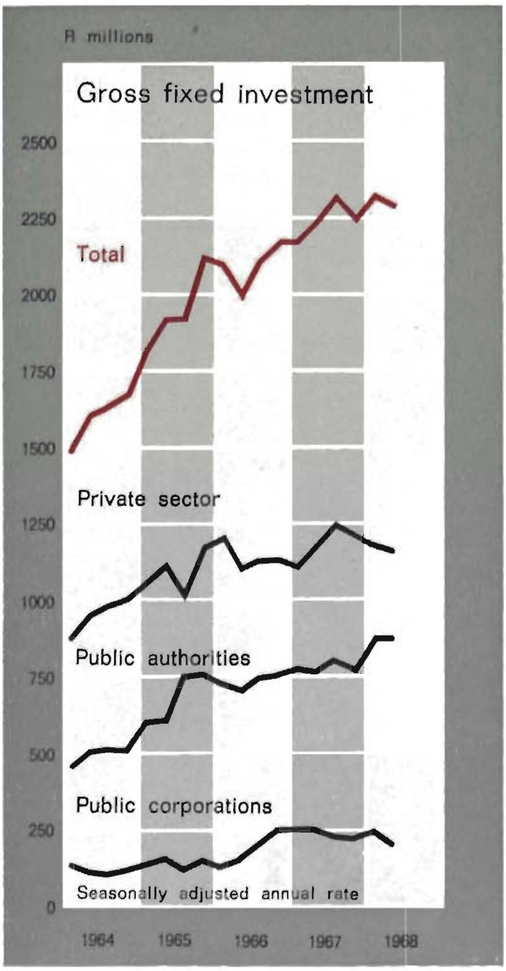
After remaining at approximately the same level from the second quarter of 1966 to the first quarter of 1967, current government expenditure resumed a strong upward trend, except for a temporary decline during the fourth quarter of 1967. During the year ended June 1968 current expenditure by general government increased by about $10\frac{1}{2}$ per cent, compared with only 7 per cent during the previous year and an average annual rate of more than 12 per cent during the six years to June 1967.





Divergent trends in fixed investment

While total gross domestic fixed investment showed an increase of only $5\frac{1}{2}$ per cent during the year ended June 1968, compared with 7 per cent during the previous year, it accelerated sharply from the second quarter of 1966 to the third quarter of 1967, before levelling off during the next three quarters. However, the components of total fixed investment revealed divergent trends, as set out below.



After increasing sharply during the second and third quarters of 1967, gross fixed investment by private enterprises declined continuously during the next three quarters. During the year 1967/68 it rose by only about $5\frac{1}{2}$ per cent due mainly to increases of about 18 per cent in investment in residential buildings and approximately 13 per cent in mining, while fixed capital outlays in agriculture, manufacturing and commerce showed little change.

Fixed investment by public authorities, including the South African Railways and Harbours, which increased only moderately during the course of 1967, showed a sharp rise during the first half of 1968. For the year ended June 1968 it was about 9 per cent higher than the figure for the preceding year. Fixed investment by public corporations showed a downward tendency during the course of the year 1967/68 and amounted to about 7 per cent less for this period compared with the previous year.

Sharp decline in inventory investment

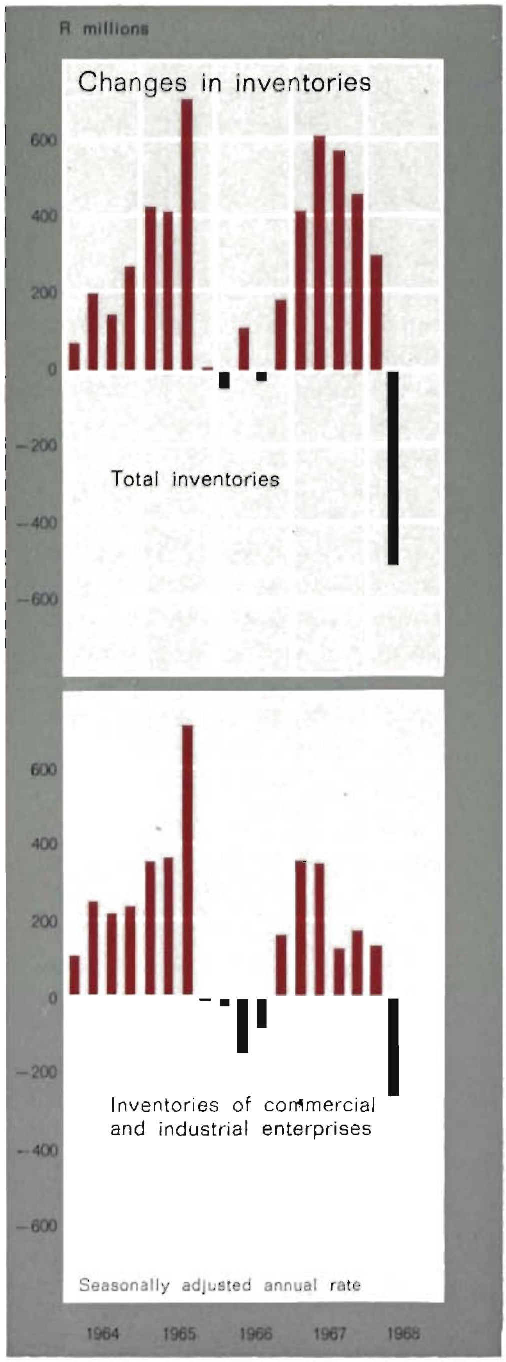
After rising very sharply from the third quarter of 1966 to the second quarter of 1967, partly as the result of an increase in agricultural stocks, total inventory investment declined during the next four quarters to a substantial negative figure during the second quarter of 1968. Similar tendencies obtained, however, if changes in agricultural stocks are excluded. For the year ended June 1968 total inventory investment nevertheless still amounted to about R210 million, compared with about R300 million during the previous year. Had it not been for this substantial decline in inventory investment during the first half of 1968, gross domestic expenditure would have shown a much higher rate of increase during this period.

Rise in exports and decline in imports

One of the most outstanding features of the national accounts during the year 1967/68 was the sustained growth in the value of exports (goods and non-factor services), including the net gold output. With the exception of the fourth quarter of 1967, exports increased continuously from the fourth quarter of 1966 to the first quarter of 1968, before levelling off during the second quarter. In the second quarter of 1968 total exports were 15 per cent above the level of a year earlier.

Imports behaved less buoyantly and declined markedly during the third and fourth quarters of 1967 before again increasing somewhat during the first and second quarters of 1968. The level attained in the second quarter of 1968 was, however, still far below that reached in the second quarter of 1967.

The result of these two divergent tendencies is reflected in the improve-



ment in the current account of the balance of payments, which will be referred to later on.

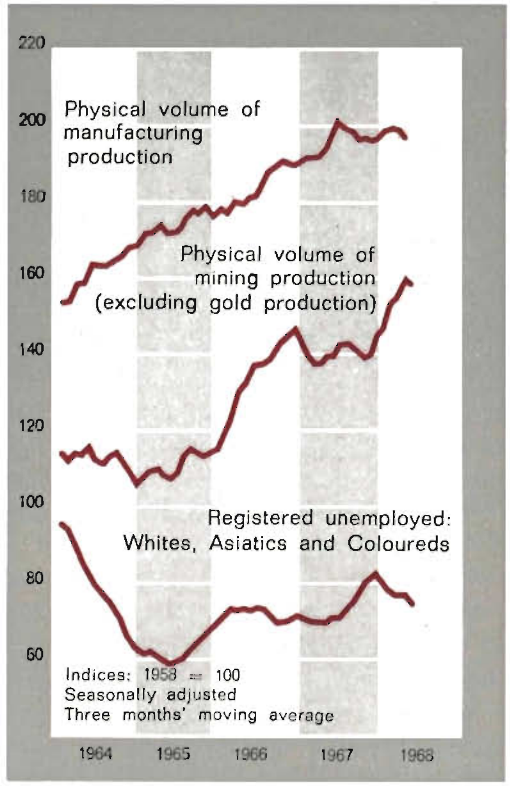
Marked increase in domestic saving

Gross domestic saving increased sharply during the first three quarters of 1967, largely as a result of the high personal saving which was related to the proceeds of the exceptionally good agricultural crops received in the second and third quarters of 1967. During the fourth quarter of 1967 and the first quarter of 1968, however, gross domestic saving receded to a slightly lower level owing to smaller personal and corporate saving, and during the second and third quarters of 1967. Durstantially, owing mainly to declines in corporate saving and in the current surplus of general government.

For the year ended June 1968 gross domestic saving is estimated to have increased by about 17 per cent over the previous year, mainly as a result of an exceptionally large increase in personal saving. The current surplus of general government and provision for depreciation also increased during the year, while corporate saving declined substantially.

Levelling-off in manufacturing output

After showing a marked upward tendency until the second quarter of 1967,



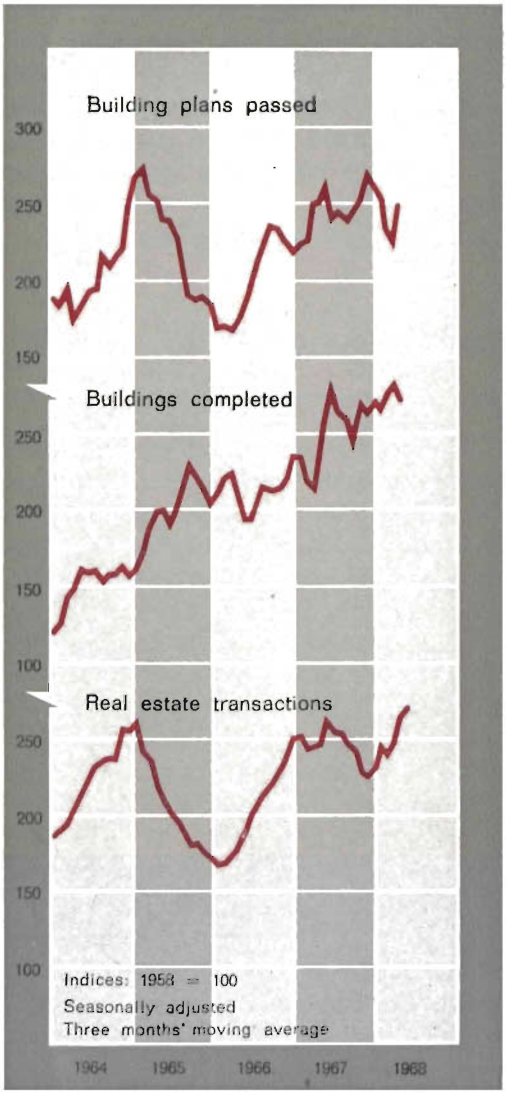
the seasonally adjusted index of the physical volume of manufacturing output more or less maintained its level between June 1967 and April 1968. For the period July 1967 to April 1968 the index was on average only 3.6 per cent higher than during the corresponding period a year earlier. The biggest contributions to this increase were made by metal and chemical products.

New upturn in mining output

Mining output, which levelled off during 1967, increased fairly sharply during the first six months of 1968, and was on average about 4 per cent higher than the figure for the corresponding period of 1967. After a moderate decline throughout 1967, gold output increased again during the first six months of 1968 and was on average 2.3 per cent higher compared with the corresponding half-year of 1967, while other mining output likewise increased during the first six months of 1968 and amounted to about 11 per cent more than during the corresponding period of the previous year.

Levelling-off in construction and real estate transactions

The tendency for economic activity to level off during the past year was also reflected in the field of construction. Both the value of building plans passed and the value of buildings completed, for example, fluctuated around a more or less horizontal line during most of this period. New advances granted by building societies, however, actually declined towards the end of 1967 before increasing substantially during the second quarter of 1968, while the value of real estate transactions showed similar tendencies.



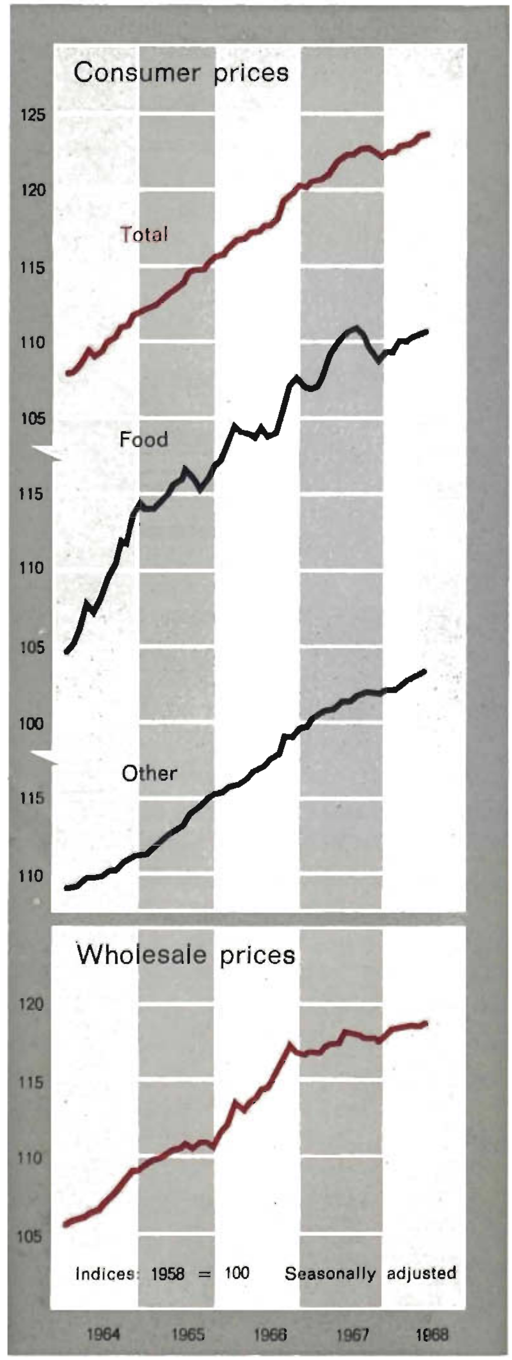
Labour market

During the past year conditions in the labour market showed little change and the seasonally adjusted index of registered unemployed Whites, Coloureds and Asiatics increased from 70.5 in June 1967 to 82.4 in December of that year, before declining again to 72.1 in June 1968. The number of unemployed remained small, however, and registered only 13,802 in June 1968.

Earnings per employee continued to rise during 1967/68. In mining, for example, average earnings per White employee were 12 per cent higher during the 11 months July 1967 to May 1968 than during the corresponding 1966/67 period, while in manufacturing it was more than 5 per cent higher in the 10 months July 1967 to April 1968 compared with a year earlier.

Relative stability in prices

During the second half of 1967 there was a marked decline in the rate of increase in prices. After rising at an average annual rate of 3.5 per cent between December 1964 and June 1967, the seasonally adjusted consumer price index advanced at an annual rate of only 0.3 per cent from June to December 1967. This decline in the rate of increase was to a large extent attributable to a reversal in the trend of food prices, viz., from an increase at an average annual rate of 3.6 per cent during the former period to a decline at a rate of 1.6 per cent during the latter period. The rate of increase for other consumer prices also declined sharply between the two periods, namely from 3.5 per cent to 1.2 per cent. During the first half of 1968, consumer prices again increased at a somewhat higher rate, namely 2.0 per cent per annum compared with 0.3 per cent during the latter half of 1967. Food prices, for example, increased at an annual rate of 1.9 per cent, while other consumer prices increased at a rate of 1.8 per cent during this period.



Consumer price index — seasonally adjusted

Annual percentage rate of change

Period	Food	Other	Total
December 1964 — June 1967	3.6	3.5	3.5
June 1967 — June 1968	0.2	1.5	1.1
June 1967 — December 1967	-1.6	1.2	0.3
December 1967 — June 1968	1.9	1.8	2.0

The seasonally adjusted wholesale price index fluctuated broadly in sympathy with the consumer price index. While wholesale prices rose rapidly at an average annual rate of 3.2 per cent between December 1964 and June 1967, it actually declined at a rate of 0.3 per cent between June and December 1967. Although the rate of increase was significantly lower for all components of the index, the change was particularly evident in the case of agricultural prices, which registered an increase of 5.2 per cent per annum in the former period and then a decline of 10.6 per cent per year in the latter. During the first half of 1968, however, wholesale prices again increased at a rate of 1.4 per cent per year. This reversal in the trend of wholesale prices was, however, entirely due to the behaviour of agricultural prices which increased at an annual rate of 6.7 per cent during the first half of 1968, following upon the decline of 10.6 per cent during the latter half of 1967.

Wholesale price index — seasonally adjusted

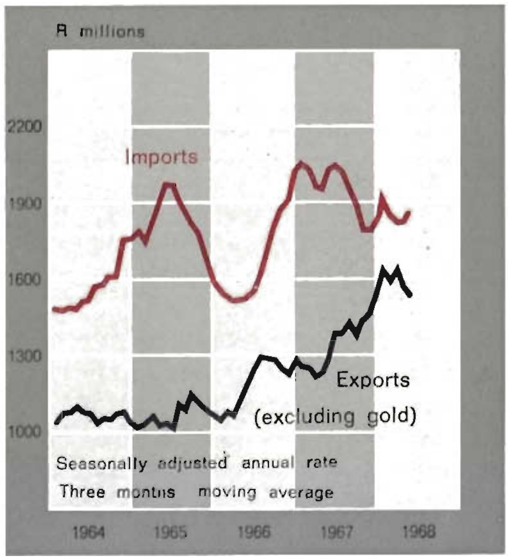
Annual percentage rate of change

Period	Goods produced in South Africa			Imported goods	Total
	Agriculture, etc.	Manufacturing	Total		
December 1964 — June 1967	5.2	3.2	3.6	2.2	3.2
June 1967 — June 1968	-2.4	1.0	0.4	0.8	0.5
June 1967 — December 1967	-10.6	1.4	-0.8	1.0	-0.3
December 1967 — June 1968	6.7	0.7	1.7	0.5	1.4

Substantial surplus on current account

Merchandise imports decreased from a seasonally adjusted annual rate of more than R2,000 million during the first half of 1967 to about R1,800 million towards the end of that year, before increasing again to about R1,900 million during the second quarter of 1968. For the twelve months ended June 1968 total imports were about R52 million less than during the preceding twelve months.

This downward trend in imports occurred notwithstanding the progressive relaxation of import contrcl since December 1966, which thus supports the view that the excess demand in the economy was substantially reduced. Mainly with an eye to the increasing liquidity in the internal economy, which will be referred to again later on, the Minister of Economic Affairs on 1st August of this year authorised further import allocations on a selective basis in respect of capital and consumer goods.



Merchandise exports, on the other hand, after reaching a level of approximately R1,200 million during the first half of 1967, increased to a seasonally adjusted annual rate of nearly R1,400 million during the second half of 1967 and to R1,560 million in the first half of 1968. During the year ended June 1968 exports showed an improvement of about R234 million, or 19 per cent, mainly as a result of a substantial increase in exports of agricultural products, although certain classes of manufactured goods also registered rises. The country's net gold output, as defined for balance of payments purposes, decreased by about R13 million during the year ended June 1968.

South Africa's net payments to the rest of the world for services and transfers decreased by about R85 million during the year. Although a number of service and transfer items contributed towards this improvement, the major contribution came from an increase of about R52 million in receipts for other transportation, which include dock dues, harbour fees and sales of bunker fuel and ship's stores. This increase was the direct result of the Middle East crisis of June 1967 and the subsequent closure of the Suez Canal, which forced many ships to follow the route around the Cape.

As a result of the above movements, South Africa's balance of payments on current account changed from a deficit of R257 million during the year 1966/67 to a surplus of R101 million during the year 1967/68. The quarterly fluctuations in the balance of payments on current account over this period are set out in the accompanying table.

Exceptionally large net capital inflow

In addition to the current surplus, South Africa also received a substantial amount of capital from abroad during the year 1967/68. Total private and official capital movements showed a net inflow of R339 million during the twelve months ended June 1968, to bring the cumulative net inflow of capital in all forms during the past four years to R837 million.

A significant change occurred during the past twelve months in the net inflow of private capital through the Johannesburg Stock Exchange. During each of the four quarters of 1967/68 purchases of South African securities by foreigners exceeded their sales. The successive figures were R11 million, R18 million, R36 million and R25 million, compared with an average of only R3 million per quarter during the preceding six quarters.

Private long-term capital in other forms showed a net inflow of R120 million during the year 1967/68, compared with R90 million during the preceding year, while the net inflow of private short-term capital, including errors and unrecorded transactions, decreased from R130 million in 1966/67 to a net inflow of R119 million in 1967/

Balance of payments on current account
R millions

	1966				1967				1968	
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
Actual balance	5	37	22	-77	-106	-96	-6	22	44	41
Seasonally adjusted annual rate	41	168	112	-373	-409	-364	15	14	207	189

68. The total net private capital inflow was especially large during the first half of 1968, when it amounted to no less than R226 million, compared with R103 million during the last half of 1967.

Total government and banking capital showed a net inflow of only R10 million during the year 1967/68, consisting of a net inflow of R14 million in the form of long-term capital and a net outflow of R4 million in the form of short-term capital.

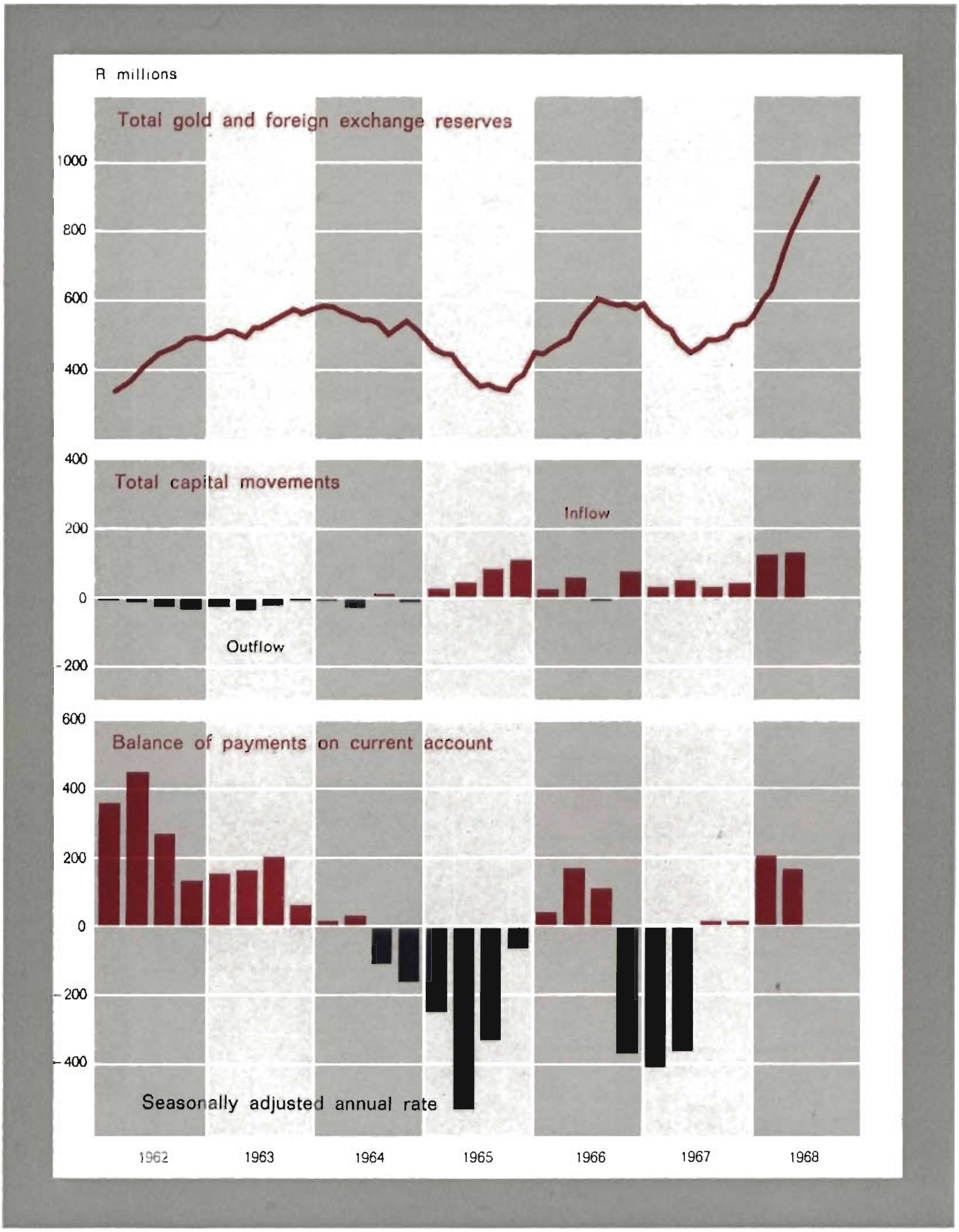
Substantial increase in gold and foreign exchange reserves

As a result of the current surplus of R101 million and the total net capital inflow of R339 million, South Africa's total gold and foreign exchange reserves increased by R440 million during the year 1967/68, compared with a decrease of R106 million during the preceding year. At the end of June 1968 the total gold and foreign exchange reserves held by the Reserve Bank, the Government and other monetary banking institutions amounted to R904 million, compared with the previous highest level of R604 million at the end of July 1966.

The increase in the total reserves was especially large during the first half of 1968 when the current account yielded a comfortable surplus and a substantial amount of capital flowed into the country. Between the end of December 1967 and the end of June 1968 the total reserves increased by R347 million or at an average rate of R58 million per month.

Net movements of private and official capital
R millions

	1966				1967				1968	
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
PRIVATE:										
Stock Exchange transactions	4	5	3	1	1	3	11	18	36	25
Other long-term	23	21	13	17	14	46	15	47	33	25
Short-term (including errors and unrecorded transactions)	-14	25	—	62	31	37	16	-4	39	68
Total private	13	51	16	80	46	86	42	61	108	118
OFFICIAL	11	8	-28	-2	-15	-32	-9	-17	19	17
TOTAL	24	59	-12	78	31	54	33	44	127	135



R millions
Total gold and foreign exchange reserves
1000
800
600
400
Total capital movements
Inflow
Outflow
200
0
-200
Balance of payments on current account
600
400
200
0
-200
-400
Seasonally adjusted annual rate
1962
1963
1964
1965
1966
1967
1968

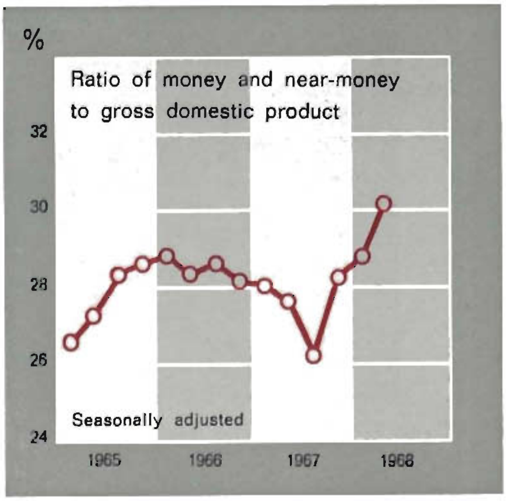
Sharp rise in money and near-money

After having levelled off during the year 1966/67, the quantity of money and near-money increased sharply during the twelve months ended June 1968. Indeed, the seasonally adjusted quarterly data show that the increase actually tended to gain in strength, as is apparent from the accompanying table.

Increase in money and near-money
Seasonally adjusted
R millions

1967 —	3rd Quarter	11
	4th Quarter	87
1968 —	1st Quarter	146
	2nd Quarter	148
	Total	392

During the year 1967/68 the increase in total money and near-money was, in fact, close to 15 per cent, compared with just over 6 per cent for the year 1966/67. As a result of these developments, which brought the total of money and near-money at the end of June 1968 to a level of well over R3,000 million, the seasonally adjusted ratio of money and near-money to gross domestic product increased from a low point of approximately 26 per cent during the third quarter of 1967 to about 30 per cent during the second quarter of 1968, compared with the level of somewhat over 29 per cent which had been reached during the first quarter of 1966.



Shifts in causes of changes in money and near-money

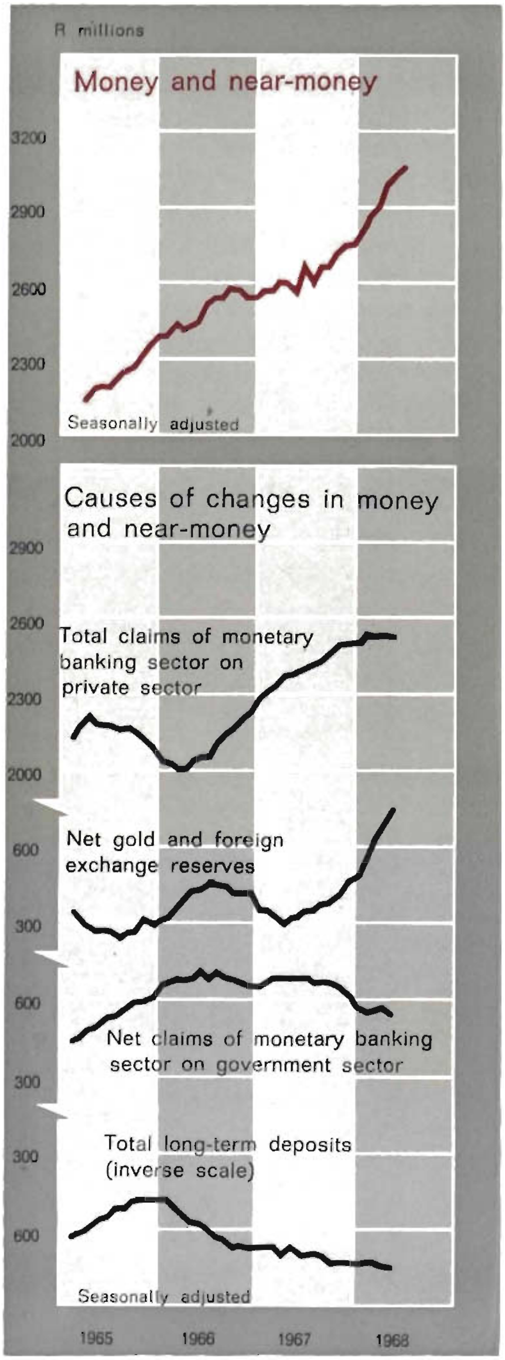
As shown in the accompanying table, by far the most important single "cause" of the relatively large increase in money and near-money during the twelve-month period under review was the rapid rise in the net gold and foreign exchange reserves, which amounted to no less than R430 million. The data also show other important changes in the relative significance of the various factors explaining the rise in money and near-money. Thus, whereas during 1966/67 the increase in bank credit to the private sector as the principal expansionary factor was partly offset by the decline in the gold and foreign exchange reserves, during most of 1967/68 the sharp rise in the foreign reserves was to some extent supported by a further increase in bank credit to the private sector. As against this, however, the change in net claims of monetary banking institutions on the government, which had contributed notably to private sector liquidity during 1965/66 but had become an almost "neutral" factor during the following year, actually tended to reduce private sector liquidity in 1967/68, mainly as a result of the accumulation of deposits of the central and provincial governments with the monetary banking sector.

Causes of changes in money and near-money

(Changes in consolidated assets and liabilities of the monetary banking sector)

R millions

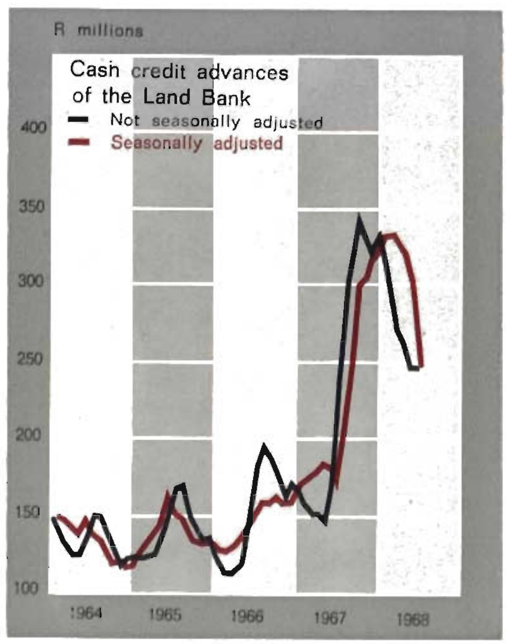
	Year 1966/67	Year 1967/68
Changes in money and near-money:		
Money	65	155
Near-money	95	238
Total	160	393
Causes of changes:		
Net gold and foreign exchange reserves	-102	430
Claims on government sector	5	225
Government deposits (increase —, decrease +)	4	-380
Net claims on government sector	9	-155
Claims on private sector	345	152
Long-term deposits (increase —, decrease +)	-99	-84
Other assets and liabilities	7	50
Total	160	393



Reasons for increase in bank credit to the private sector

As discussed in more detail below, the authorities throughout 1967/68 continued to apply a policy of direct limitation to the total discounts and advances of monetary banking institutions to the private sector. Moreover, as from September 1967 the relevant credit maxima were actually enforced on a month-by-month basis. At first sight, it may therefore appear surprising that the total claims of the banking sector on the private sector between June 1967 and June 1968 should still have increased by as much as R152 million.

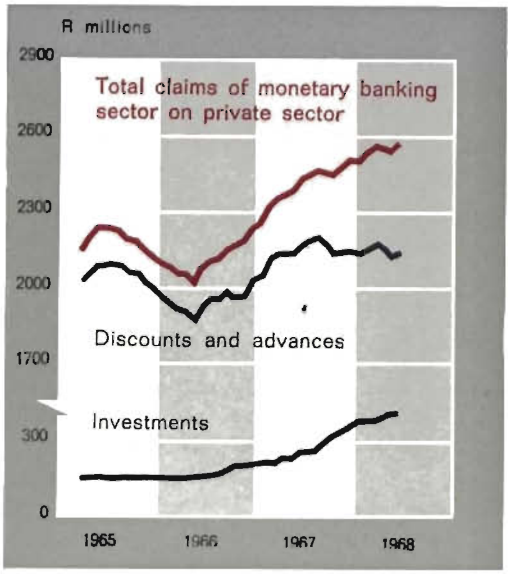
An analysis of the *types* of credit extended shows that there were two main reasons for this increase. Firstly,



as a result of the large maize and other agricultural crops during the 1967 season, cash credit advances of the Land Bank increased from their seasonally low point at the end of May 1967, when they amounted to R148 million, to a peak of R345 million at the end of September 1967, and subsequently declined to R248 million at the end of June 1968. Between the end of June 1967 and June 1968 the Land Bank contributed slightly less than R78 million to the increase in claims of the banking sector on the private sector. In fact, if this increase in Land Bank cash credits is disregarded, the total discounts and advances of monetary banking institutions to the private sector actually declined by R115 million over this period.

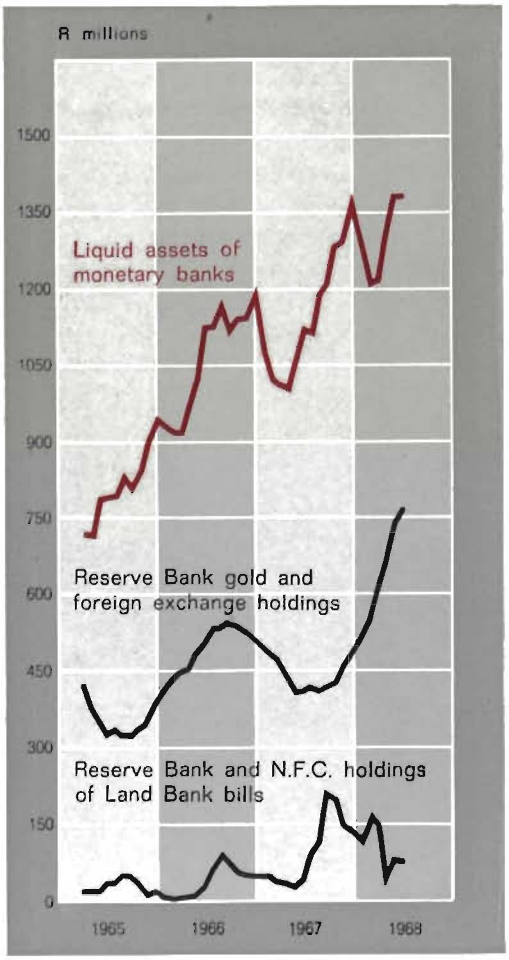
Secondly, as the monetary banks reduced their discounts and advances to within the "ceiling" set by the Reserve Bank's directives and subsequently maintained the total of these forms of credit at levels that did not exceed the permissible maxima, they significantly increased their investments with the private sector. Thus, whereas such investments had already increased relatively rapidly by R62 million during the year 1966/67, they increased by R167 million during 1967/68. Close to half of this increase occurred during the fourth quarter of 1967 alone. It should be noted, however, that approximately three-fifths of this increase in the monetary banks' private investments consisted of increased holdings of stocks and debentures of local authorities, the Land Bank and other public corporations.

It was apparent that this form of credit extension held considerable possibilities of reducing the effectiveness of the Reserve Bank's credit control. In consequence the Bank in May 1968 instructed all monetary banks to ensure that from the end of that month the total of their investments with the private sector, other than their holdings of stocks, debentures and bills of local authorities, the Land Bank and other public corporations, would not exceed the amount of such investments as at the end of March 1968, unless any such excess had been authorised by the Reserve Bank. However, when these instructions were promulgated, most of the banks were already heavily committed to take up further investments, and substantial concessions had to be granted to exceed the specified investments as at 31st March.

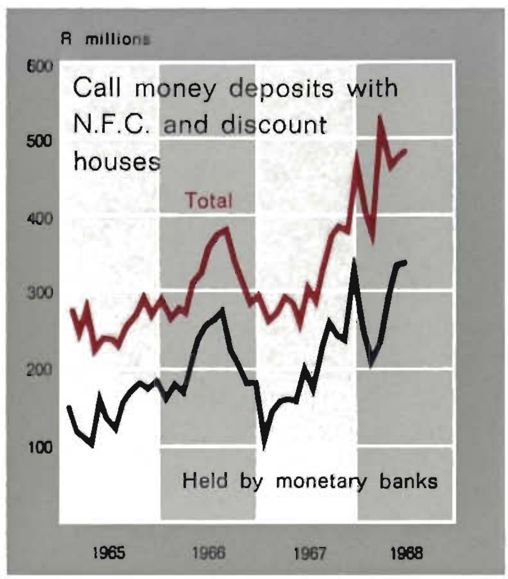


High level of bank liquidity

Excess liquidity of monetary and other banking institutions (i.e. the amount of liquid assets held in excess of the legal requirements), which had tended to decline during 1966/67 mainly as a result of the deficit on the balance of payments, remained at relatively high and generally rising levels during the period from June 1967 to June 1968. Thus, the excess liquidity ratio of the commercial banks, which had amounted to only 3.3 per cent at the end of April 1967, reached a level of 14.8 per cent at the end of December. After declining seasonally during the first quarter of 1968, the commercial banks' excess liquidity ratio rose again during the second quarter. At the end of June 1968 it amounted to 12.6 per cent, compared with 6.9 per cent at the end of June 1967.



Various factors accounted for this change in the banks' liquidity position. Thus, the fact that the Reserve Bank in the course of the year was called upon to provide substantial accommodation to the Land Bank was important, in particular during the third quarter of 1967, when the Bank's holdings of Land Bank bills at one stage



amounted to R200 million. Obviously, however, the main factor contributing to the banks' excess liquidity was the sustained rise in the Reserve Bank's gold and foreign exchange reserves, which, notwithstanding the neutralising effect of certain sterilising operations of the monetary authorities such as the sterilisation at the Reserve Bank of funds withdrawn by the Government from the private non-bank sector, resulted in an addition to the excess liquid assets of the banks, given the existing restraint on the banks' lending.

As might be expected in view of the highly liquid state of the banking system and the relatively high degree of liquidity in the economy in general, large amounts of call money were held with the discount houses and the National Finance Corporation over most of the period under review. Thus, call money with the discount houses and the National Finance Corporation increased from a level of just over R300 million at the end of June 1967 to R484 million at the end of June 1968.

Short-term interest rates

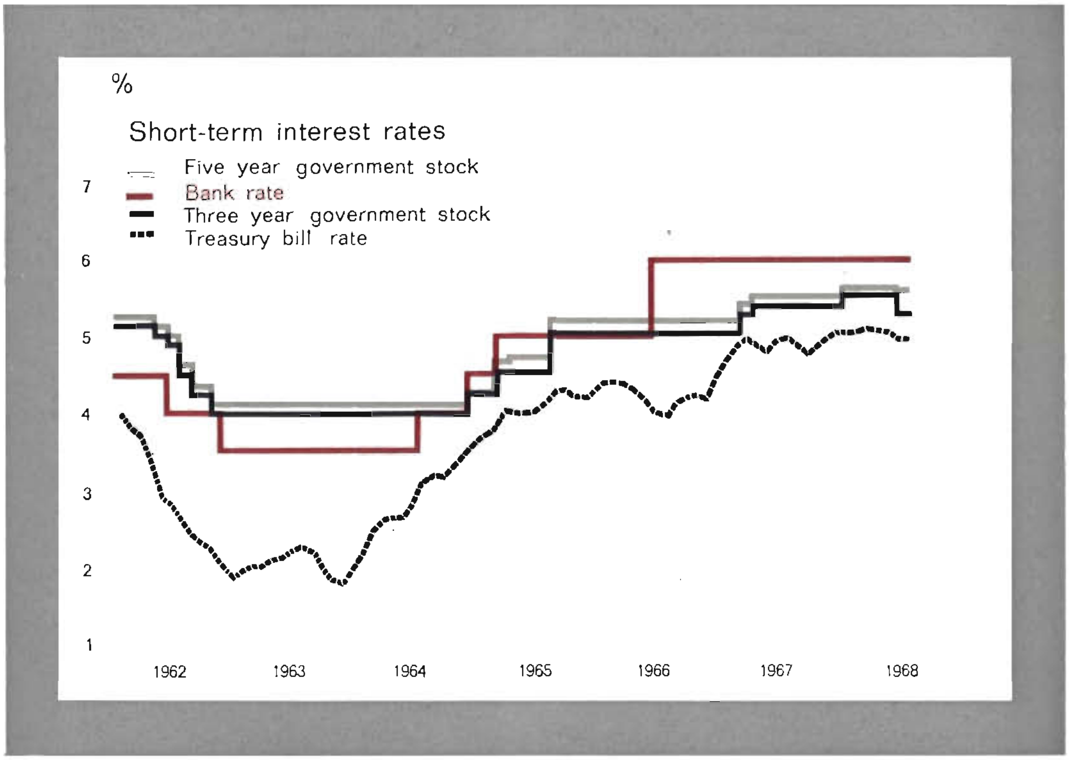
Despite the strong easing influence on the money market of the large increase in the gold and foreign exchange reserves referred to above, the monetary authorities succeeded in maintaining short-term interest rates at a relatively high level as from April 1967. Thus, the Treasury bill tender rate, except for temporary declines to 4.75 per cent in May and 4.70 per cent in September 1967, fluctuated around 5 per cent from the end of March 1967. Other money market rates also remained relatively high.

The high level of short-term interest rates during this period was the result of official policy to neutralise as far as possible the easing influences in the market and to provide the market with investment outlets. The fact that the gold and foreign exchange reserves of the Reserve Bank increased by R487 million to R901 million from the 15th September 1967 to the 2nd August 1968, of course made this operation much more difficult.

The Treasury and the Reserve Bank therefore used various methods to cope with the flood of liquidity caused by this increase in the gold and foreign exchange reserves. The Treasury, at times, issued more Treasury bills (through the weekly tender as well as on tap) to discount houses, banks and other institutions and sterilised the proceeds with the Reserve Bank. In addition short-term as well as long-term government stock were issued in excess of the needs of the Treasury. Thus, the total amount of Treasury bills and short-term government stock held by the discount houses, commercial banks, merchant and other monetary banks increased by R259 million from a relatively low level of R512 million at the end of April 1967 to R771 million on the 2nd August 1968. Naturally this had the effect of preventing short-term interest rates from declining to any significant extent.

The provision of investment outlets to the money market by the Government contributed to the large increase of R521 million in government deposits with the Reserve Bank and the National Finance Corporation between the 22nd December 1967 and the 2nd August 1968. This increase exceeded the amount by which the discount houses, commercial banks and merchant and other monetary banks increased their holdings of Treasury bills and short-term government stock, as the Government also withdrew funds from the private non-bank sector in the form of taxes, loan levies and other types of borrowing. In this regard special mention should be made of the unqualified success of the 6 per cent tax-free Treasury bonds issued to private individuals as from 15th September 1967, which yielded no less than R127 million to the Treasury up to the 31st July 1968.

In order to assist the Treasury in the provision of investment outlets to the money market, the Reserve Bank during the past year for the first time sold Land Bank bills to the discount houses on a special re-purchase basis. The total amount of such bills held by the



discount houses reached a maximum of R83 million during April 1968. The Reserve Bank also encouraged commercial banks to invest more short-term funds abroad under the so-called "swop" arrangements and thereby helped to relieve the downward pressure on short-term interest rates.

After March 1968 this downward pressure on short-term interest rates was strengthened when government deposits began to decline seasonally, while the gold and foreign exchange reserves of the Reserve Bank were still rising strongly. In order to counteract this tendency the Reserve Bank towards the end of April instructed all monetary banks to maintain with it from the end of May not only the normal minimum reserve balance equal to 8 per cent of their short-term liabilities to the public, but also an additional balance equal to 12 per cent of the increase in these liabilities after the end of March 1968. Furthermore, special deposits equal to 20 per cent of any such increase had to be placed with the National Finance Corporation.

Although these various official actions achieved their objective to a considerable extent, the Treasury bill tender rate did begin to decline slowly from the 17th May and reached 4.92 per cent on the 5th July. Subsequently it increased again to 5.00 per cent on the 2nd August. Various other short-term interest rates, including the deposit rates of banking institutions, showed similar tendencies.

In conformity with the downward trend in short-term interest rates, the Reserve Bank decided to decrease as from the 28th June 1968 its pattern rate for government stocks with maturities of 3 to $3\frac{1}{2}$ years by $\frac{1}{4}$ per cent to $5\frac{1}{4}$ per cent, and to adjust the rates for stocks with maturities of up to $6\frac{1}{2}$ years on a sliding scale, while retaining the other longer term rates, including the maximum of $6\frac{1}{2}$ per cent for stocks with a maturity of 25 years or more. During July the Treasury issued three new stocks for 3, 5 and 25 years at $5\frac{1}{4}$, $5\frac{5}{8}$ and $6\frac{1}{2}$ per cent, respectively, and succeeded in withdrawing funds to a net amount of R35 million from the private non-bank sector, while, in addition, providing non-liquid investment outlets to the banking sector amounting to R40 million.

Relaxation of exchange and import controls

The continued increase in the country's total gold and foreign exchange reserves, which reached the record level of approximately R960 million at the end of July, was a factor which influenced the Government in relaxing exchange control selectively and to authorise certain further import allocations on a selective basis in respect of capital and consumer goods with a view to assisting in the removal of the surplus banking and private sector liquidity. Thus, on the 31st July the Minister of Finance announced that, with due regard to the level of the total foreign exchange reserves, more sympathetic consideration would be given to the following applications for foreign exchange: transfers abroad in foreign currency of the local proceeds of the sale of direct long-term investments in the equity of South African enterprises controlled by non-residents; approved direct investments abroad by South African residents; and redemptions prior to due date of loans owed to foreigners by South African residents. The Minister also indicated that if these concessions should not have the desired effect of reducing excess liquidity, further exchange control steps would be considered.

Continued improvement in Exchequer finance 1967/68

The various fiscal measures to contain inflationary pressures announced by the Minister of Finance in the March 1967 Budget, made a major contribution to the pronounced "disinflationary" effect of central government finance upon the liquidity of the private sector during the fiscal year ended March 1968.

As shown in the accompanying table, the Exchequer succeeded during this period not only in reducing its net indebtedness to the foreign sector by R48 million, compared with a reduction of R15 million in 1966/67, but also in restricting the increase in its net indebtedness to the monetary banking

Exchequer finance
R millions

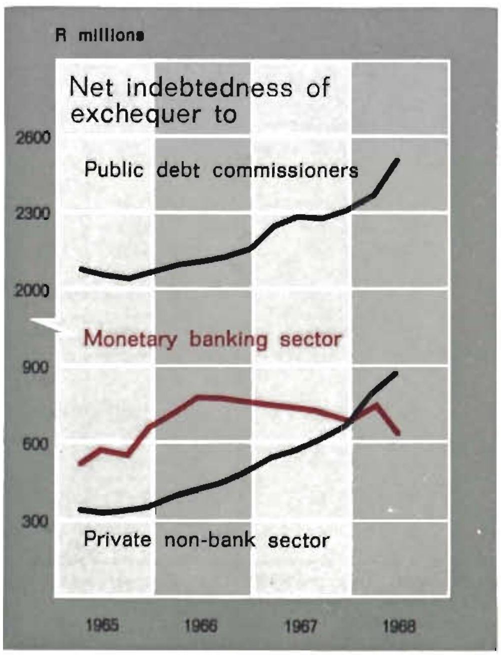
	Financial years ended March		1967/68					1968
	1965/66	1966/67	Apr.— Jun.	Jul.— Sept.	Oct.— Dec.	Jan.— Mar.	Total	Apr.— Jun.
Total deficit (excluding borrowing)	277	340	41	10	56	224	331	103
Financing.								
Change in net indebtedness to:								
Foreign sector	-11	-15	-23	-9	-1*	-15*	-48*	12*
Private non-bank sector	65	167	18	56	55	128	257	71
Public Debt Commissioners	16	165	38	-2	29*	56*	121	136
Paymaster-General and social security funds	-6	-1	20	-20	—	—	—	—
Sub-total	64	316	53	25	83	169	330	219
Monetary banking sector:								
Change in holdings of government securities	115	60	25	103	-22	14	120	87
Change in Exchequer balance (increase —, decrease +)	98	-36	-37	-118	-5*	41*†	-119*†	-203*†
Sub-total	213	24	-12	-15	-27	55	1	-116
Total financing	277	340	41	10	56	224	331	103

* After adjustment for foreign loans invested abroad and for investments with the Public Debt Commissioners.

† These figures include, apart from the normal Exchequer balance with the Reserve Bank and various investments, transfers to a special Stabilization Account with the Reserve Bank as provided for by the General Loans Act.

sector to less than R1 million. This constituted a continuation of the trend already apparent in 1966/67, when the increase of R24 million in the Exchequer's net indebtedness to the banking sector was R189 million less than the comparable figure for 1965/66.

The banking sector's holdings of government stock (mainly short-term) and Treasury bills actually increased by R120 million over the 1967/68 financial year, but this was almost completely offset by an increase of R119 million in the Exchequer balance. Both these changes reflected the official money market policy of providing short-term investment outlets to banking institutions.



Net contribution of Public Debt Commissioners

If the operations of the Public Debt Commissioners are fully taken into account, however, central government finance had a much greater contractionary effect upon private sector liquidity than the above figures suggest. This is because the Exchequer, in order not to exceed its legal borrowing powers, refrained from accepting from the Public Debt Commissioners all the funds the latter had available for investment during the fiscal year 1967/68. The result was that at the end of March 1968 the Commissioners had R117 million on deposit with the National Finance Corporation and R29 million with the Reserve Bank, all of which would normally have been in the Exchequer account. Had these funds been invested in the normal way, the Exchequer's indebtedness to the Public Debt Commissioners would have increased by R267 million instead of only R121 million, while its net indebtedness to the banking sector would have shown a decline of R145 million during 1967/68, instead of an increase of R1 million.

Smaller budget deficit

This favourable overall result was attributable to two main factors. In the first place, despite extra appropriations totalling R85 million in the Supplementary Budget of February 1968, the total budget deficit (excluding borrowing) amounted to only R331 million for the full fiscal year 1967/68, compared with R340 million during the previous year.

This was the direct result of, on the one hand, restraints on government expenditure and, on the other, increases in both direct and indirect taxes announced in the Budget of March 1967.

Increased contribution by private non-bank sector

Secondly, owing to such factors as an increase in loan levies, the issuing of tax-free Savings and Treasury bonds to personal savers, realistic interest rates on government stock and legislative changes in 1966 to force insurers, pension funds and unit trusts to invest a larger proportion of their funds in government stock, the Exchequer succeeded in borrowing a net amount of R257 million from the private non-bank sector during the 1967/68 fiscal year, compared with R167 million during the previous year and R65 million during 1965/66. Loan levies provided R76 million and the 6 per cent tax-free Treasury bonds R92 million, while insurers and pension funds increased their holdings of government stock by R67 million.

The 1968/69 Budget

No fundamental changes in fiscal policy were announced by the Minister of Finance when he presented his Budget to Parliament on the 27th March 1968. Although concessions were made to pensioners, civil servants and marginal gold mines, tax rates remained practically unchanged and loan levy rates were maintained at the levels to which they had been raised in the preceding budget.

As shown in the accompanying summary of the budget on a cash basis, total expenditure on Revenue and Loan Account was expected to rise by about 8 per cent to R2,099 million and total revenue (excluding borrowing) by about 3 per cent to R1,670 million. It was anticipated that the resultant deficit of R429 million would be financed in a way which would not have a significant expansionary effect upon the liquidity of the private sector.

Favourable developments in the first quarter 1968/69

During the period April to June 1968 most of the funds held by the Public Debt Commissioners with the National Finance Corporation and the Reserve Bank at the end of March were invested with the Exchequer. These investments resulted in an increase of R136 million in the Exchequer's net indebtedness to the Public Debt Commissioners and helped to reduce its net indebtedness to the monetary banking sector by R116 million. This substantial decline was the net result of an increase of R87 million in the banking sector's holdings of government securities and an increase of no less than R203 million in the Exchequer balance.

Net indebtedness to the foreign sector increased by R12 million and to the private non-bank sector by about R71 million during the quarter. Of the latter, R17 million was received by way of loan levies and R25 million through the issue of tax-free Treasury bonds.

Cash budget

R millions

	1967/68 Provisional results*	1968/69 Budget
EXPENDITURE		
Revenue Account	1,410.4	1,533.0
Loan Account	541.4	565.5
Total	1,951.8	2,098.5
REVENUE (excluding borrowing)		
Customs and excise	388.1	411.0
Inland revenue	961.6	977.3
Posts, telegraphs and telephones	142.1	149.8
Loan recoveries and other credits	132.5	131.4
Total	1,624.3	1,669.5
TOTAL DEFICIT (excluding borrowing)	327.5	429.0
Plus redemptions:		
Domestic	253.6	167.2
Foreign	52.1	38.1
Sundry items	21.3	27.3
TOTAL BORROWING REQUIREMENTS	654.5	661.6
FINANCING		
Foreign loans (conversions plus new loans)	21.4	84.5
Domestic conversions	253.6	167.2
Domestic new loans — P.D.C.	196.1	225.0
Stock	115.5	55.5
Non-marketable debt	192.1	134.5
Treasury bills	5.3	—
Change in cash balance (increase —, decrease +)	-129.5†	-5.1
TOTAL FINANCING	654.5	661.6

* The 1967/68 figures are not strictly comparable with those for the 1968/69 Budget.

† Including, inter alia, transfers of R83.3 million to the Stabilization Account with the South African Reserve Bank.

CAPITAL MARKET

Improved balance disturbed by developments in the share market

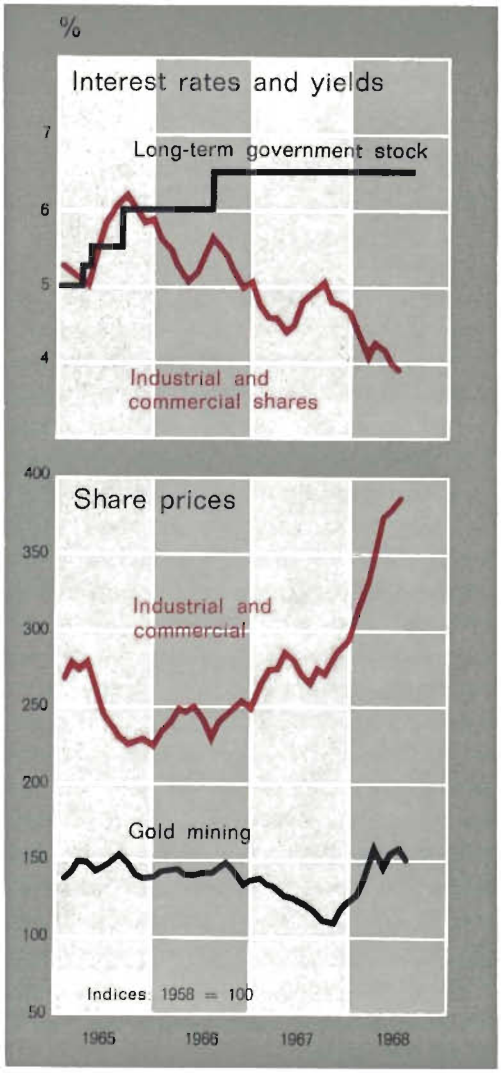
The levelling-off in economic activity after the middle of 1967 would appear to have produced a better balance between demand and supply in some sections of the capital market. Rates and yields on most classes of fixed-interest investments, such as the yields on long-term government and local authority stock and the principal mortgage rates, remained unchanged during 1967/68, and although the yields on long-term public corporation stock and company debentures and notes were adjusted upwards during the third quarter of 1967, they remained at these levels during the remainder of the period under review. The yield on new long-term public corporation stock was raised to about $7\frac{1}{4}$ per cent whereby the margin between yields on these stocks and on local authority stock was eliminated, while the yield on newly issued company debentures increased to $8\frac{1}{2}$ per cent.

Initially, the improved balance between demand and supply was also reflected in the share market and during the first four months of 1967/68 the prices of almost all classes of shares fluctuated around a horizontal level or even tended to decline somewhat. But from November onwards, an exceptionally heavy demand for equities began to dominate the capital market. In view of the slowing down in the rate of increase of aggregate monetary demand, this development would not appear to have been related to new inflationary pressures in the internal economy, but to have been based upon the international currency uncertainty and gold price speculation which followed the devaluation of sterling in November 1967 and produced increased expectations of capital gains on South African shares. This increased tendency on the part of investors to favour equities and other "growth" investments naturally tended to upset such balance between demand and supply as had developed in certain sections of the market for fixed-interest investments.

Substantial changes in stock exchange turnover and in share prices and yields

Reflecting the heavy demand for equities, the average monthly turnover on the Johannesburg Stock Exchange during the period November 1967 to June 1968 was more than double the average monthly figure for the preceding ten months, and share prices in general soared to new record levels during this period, Between October 1967 (the month before the devaluation of sterling) and June 1968 the indices of gold mining and of industrial and commercial share prices increased by 44 and 38 per cent, respectively, while the corresponding increase in the case of the different financial shares ranged from 30 to 46 per cent.

In these circumstances, share yields declined to levels which were very low in relation to not only previous experience but also rates on fixed-interest investments. The average yield on gold mining shares was reduced to 6.6 per cent in June 1968, compared with 10.0 per cent in June 1967, while the average yield on industrial and commercial shares declined from 4.8 to 3.9 per cent during this period. When the latter figure is compared, for example, with the yield on long-term government stock which remained at 6.5 per cent throughout the year, the reverse yield gap thus amounted to 2.6 per cent as at the end of June 1968.



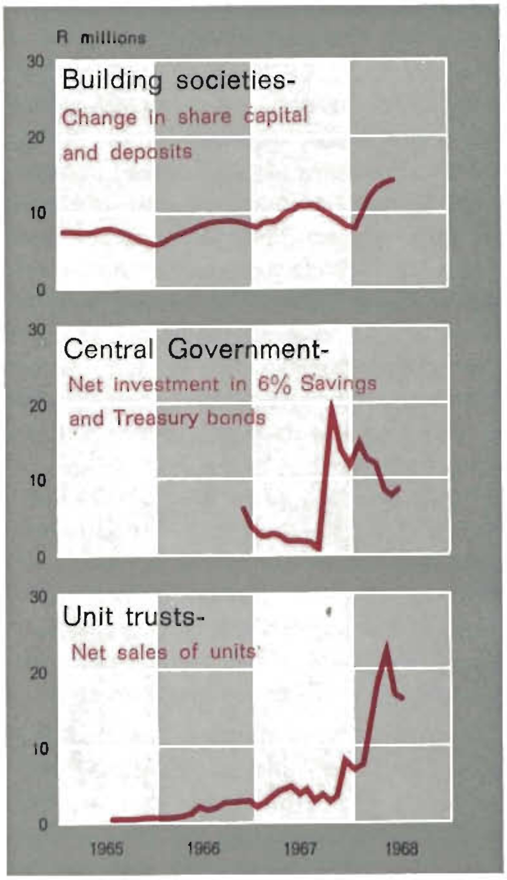
Exceptionally rapid growth of unit trusts

The growth of the unit trust movement during 1967/68 was closely associated with the developments in the share market. During the four months July to October 1967, net sales of units slowed down to an average of R2.9 million per month, compared with a corresponding figure of R3.7 million during the first six months of 1967. The market value of their net assets also increased only slightly more than this net inflow of funds to them, reflecting the modest increase in share prices during this period. However, from November onwards the boom on the Johannesburg Stock Exchange led to an exceptionally rapid expansion of the trusts. Not only did total net sales of units during the period November 1967 to June 1968 increase by R108 million, or by an average monthly figure of R13.5 million, but owing to the sharp increase in share prices the market value of their net assets increased by substantially more than this amount, namely by R148 million. During 1967/68 as a whole, total net sales of units amounted to R120 million as against R36 million during 1966/67, while the market value of net assets increased from R47 million at the end of June 1967 to R209 million at the end of June 1968.

These tendencies were also reflected in the selling prices of units and the combined index (June 1965=100) rose from 125 in June 1967 to 183 in June of this year. The average yield on units was accordingly reduced to 2.4 per cent in June 1968, compared with 3.6 per cent in June of the previous year.

Building societies

Notwithstanding the preference of investors for equity and other "growth" investments, the building societies maintained their interest rates on shares and deposits at the relatively high levels reached in March 1967 and succeeded in attracting funds to an amount of R128 million during the year ended 30th June 1968, compared with R107 million during the preceding twelve months. Their fixed and savings



deposits increased by R108 million, while their share capital showed an increase of R20 million. The latter increase represented a marked change from the decline of R19 million registered during the year ended 30th June 1967.

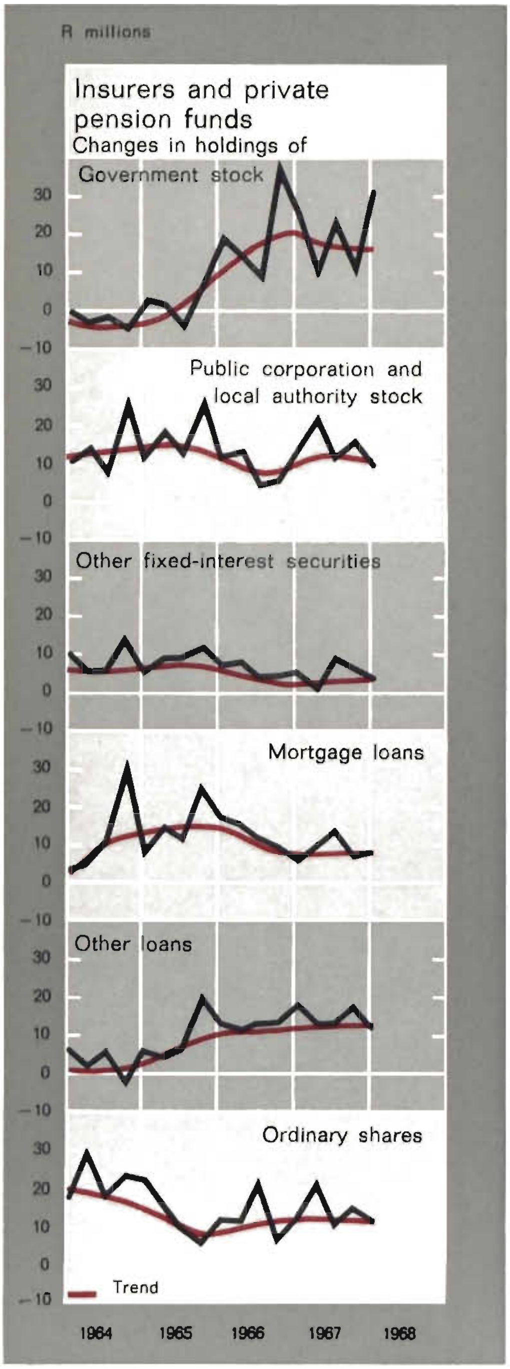
This change in the popularity of building society shares was the result of a special concession granted to building societies by the Minister of Finance in February this year, in terms of which they were permitted to issue to individuals a special class of permanent share, the interest on which would be $6\frac{1}{2}$ per cent tax-free up to a maximum of R400 per taxpayer per year. This new type of share proved to be popular with investors and during the four months from March to June 1968 the total amount invested in these shares amounted to R161 million, of which R43 million represented new cash investments, R98 million conversions of other shares and R20 million transfers from deposit accounts. In addition to this concession granted by the Minister to alleviate the effect of a more than seasonal decline in the net inflow of funds to building societies from December 1967 to February 1968, the Government also advanced to the societies an amount of R16 million which was roughly the equivalent of the amount guaranteed by it under the 100 per cent housing scheme for public servants.

In these circumstances, the building societies were able to increase their mortgage and other loans outstanding by R122 million during the year ended 30th June 1968, compared with an increase of R96 million during the previous twelve months. At the same time, they also increased their holdings of liquid assets and other prescribed investments by R20 million which raised the excess of these assets over the statutory minimum to R102 million at the end of June 1968.

Insurers and private pension funds

As large institutional investors, insurers and private pension funds apparently took a fairly cautious view of the recent developments in the share market which led to high prices and low yields. Their net investment in ordinary shares amounted to R14 million during the last quarter of 1967 and only R12 million during the first quarter of 1968, compared with an average of R14 million for the first three quarters of 1967. Nevertheless, their holdings of ordinary shares increased by R57 million during the year ended 31st March 1968, as against R49 million during the preceding twelve months.

The main emphasis in their investment policy during this period was placed, as during the preceding year, on the allocation of funds to prescribed investments so as to comply with the changed statutory investment requirements introduced in 1966 and to take advantage of the relatively high yields on these investments. Their holdings of government stock, for example, increased by R75 million during the period April 1967 to March 1968, which was R10 million lower than the corres-



ponding increase during the preceding twelve months. But, whereas the increased investment in government stock during the latter period had been accompanied by a decline in the amount of new funds invested in local authority and public corporation stock and loans, their new investments in these securities and loans returned to a more normal level during the period under review. The net figure for this period amounted to R73 million as against R54 million during the preceding twelve months.

Mortgage and other loans continued to be a popular alternative form of fixed-interest investment for these institutions and an amount of R76 million, which roughly equalled the amount invested during the preceding twelve months, was directed to this investment outlet during the year ended 31st March 1968. The amount of investment funds allocated to fixed property and fixed-interest securities of the private sector during this period, however, declined when compared to the preceding twelve-month period.

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