

South African Reserve Bank

1970

Annual Economic Report

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 Fiftieth Ordinary General Meeting to be held on 25th August 1970.

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During the year ended June 1970,* the South African economy achieved a very high rate of growth as reflected in an increase of well over 12 per cent in the gross domestic product at current prices, despite a shortage of labour and certain types of capital. The upswing in economic activity stemmed from a further substantial rise in total domestic demand which exceeded the domestic supply of goods and services and exerted considerable pressure on resources, particularly on the supply of skilled and semi-skilled labour. This led to price rises at a rate which may be considered unduly high for South Africa. Moreover, although a high growth rate was achieved, the distribution of resources was such that most of the increase in activity was concentrated in fixed property development and in the provision of financial and other services, while sectors responsible for the production of goods did not expand satisfactorily.

Although the high rate of growth in the gross domestic product of well over 12 per cent was accompanied by fairly rapid price rises, the gross domestic product in real terms still increased by more than 7 per cent during the year ended June 1970. It is also noteworthy that the relatively large increase of about 5 per cent in the price deflator was influenced by special factors of a random nature, such as price increases associated with the introduction of the sales duty and the premium earned on gold sales. Substantial upward adjustments to salary and wage scales in the public sector as well as significant increases in the cost of housing and in the prices of food and services also contributed to the relatively high increase in the price deflator. As the influence of some of these special factors, such as the premium on gold sales and the upward adjustment to salary and wage scales in the public sector, are not reflected in the rise in the consumer price index, the latter naturally showed a smaller increase than the price deflator, namely an increase of 4 per cent.

While the growth rate of the economy, as reflected in the rate of increase in the gross domestic product was relatively high during the past year as a whole, significant changes were noticeable in the quarterly rates of increase during the course of the year. Thus, the growth rate of general economic activity, which accelerated from the beginning of 1968 and reached exceptionally high levels in the second and third quarters of 1969, slowed down during the next two quarters and then increased again in the second quarter of 1970. Notwithstanding the fact that the latter increase was attributable mainly to an increased contribution of agriculture, production in the rest of the economy also increased faster.

The very high rate of growth in economic activity stemmed from substantial increases in all the major components of gross domestic expenditure, namely private and government consumption expenditure, capital outlays by the private and public sectors, and inventory investment. During the year ended June 1970, total monetary demand, as reflected by total gross domestic expenditure, increased even faster than the gross domestic product, namely by as much as 17 per cent. The excess of domestic demand over domestic supply of goods and services resulted in a record deficit on the current account of the balance of payments. Although all the major components of gross domestic expenditure contributed to the excess of domestic demand over domestic supply of goods and services, private and government consumption expenditure and inventory investment showed the most pronounced increases. Furthermore, the fact that the inventory accumulation was the major reason for the acceleration in the rate of increase of gross domestic expenditure from 9 per cent in 1968/69 to 17 per cent in 1969/70, is of special significance, as it represents partly an exchange of foreign reserves for goods. The extent to which this stockpiling represents an accumulation over and above the normal increase in inventories associated with higher domestic production and the extent to which it represents imported goods, will determine the possible future relief of pressure on the balance of payments and on domestic factors of production.

Another feature of changes in the components of gross domestic expenditure was the divergent trends in the fixed capital outlays of the different sectors. Fixed capital outlays by private manufacturing and the South African Railways and Harbours were sluggish, while the capital outlays by the rest of the central government, the provincial administrations, the public corporations and the private sub-sector commerce, finance and private transport increased substantially. The sub-sectors of the private sector which produce goods, therefore, did not expand their production capacity to the same extent as those providing services, including fixed property development, while a large part of fixed capital outlays was used on infra-structural development by public authorities. Private and government consumption expenditure are the other components of gross domestic expenditure which not only continued to rise at a very rapid rate, but reached high levels. Moreover, private consumption expenditure increased markedly in relation to personal disposable income thus reducing the supply of personal saving available for the financing of future economic growth.

The excessive rate of increase in total monetary demand, not only exerted pressure on the domestic factors of production which, *inter alia*, led to substantial increases in salaries and wages and to an acceleration in the rate of increase of consumer prices, but also resulted in higher imports and a large deficit on the current

* These observations were written before the 1970/71 Budget Speech was delivered on the 12th August. The main features of the Budget are, however, discussed briefly in a section included under the part of this report dealing with "Government finance".

account of the balance of payments. On the other hand, a substantial net capital inflow alleviated the effect of the deficit on the gold and foreign exchange reserves which consequently declined only moderately. During the year under review, however, the deficit on the current account increased at a progressively faster rate as a result of the rise in imports coupled with an approximately stable level of exports.

The moderate decline in the gold and foreign exchange reserves helped to reduce the rate of increase in money and near-money in relation to that of the gross domestic product, but a further substantial increase in bank credit to the private sector and, more recently, also in net bank credit to the government sector, led to a considerable further increase in the liquidity of the private non-bank sector. These developments resulted in reduced levels of surplus liquid assets of banks during most of the year under review. However, a decline in government deposits and a reduction in the liquid asset requirements in the second half of the year under review, led to increased surplus liquid assets at the end of June 1970. While money market interest rates showed little change during the past year as a whole, keen competition for deposits resulted in considerable upward pressure on deposit interest rates which were only prevented from rising above 7 per cent by a request from the Reserve Bank. The rapid rise in bank credit to the private sector was due to a strong demand which may largely be associated with the sharp increase in imports and in consumption expenditure and also the substantial build-up of inventories. The increase in net bank credit to the government sector represents a reversal of the trend over the past three years and resulted from the poor support by the private non-bank sector of the government's borrowing operations.

Conditions in the capital market changed considerably during the past year and the market was generally characterised by a depressed equity market, a buoyant property market and a very tight market for fixed-interest-bearing securities. In these circumstances, strong upward pressure developed on long-term interest rates and several upward adjustments were made to various rates, including an increase to 7 per cent in May 1970 in the yield on long-term government stock, while that on securities of public corporations and local authorities increased to about 8 per cent and that on private company debentures to about 9½ per cent. Even at these higher rates the demand for funds, especially in the public sector, could not be fully satisfied owing to a substantially reduced support from unit trusts, insurers and pension funds, and the attractiveness of investments in other spheres, such as the property market. The dividend yields of equities also increased significantly in absolute terms and in relation to the rates on fixed-interest investments and thereby improved the attractiveness of equity investments.

National accounts
and other
economic indicators

Exceptionally high rate of increase in gross domestic product

The gross domestic product at current market prices increased by well over 12 per cent during the year ended June 1970, compared with an increase of about 7½ per cent during the preceding twelve months. Although the contribution of agriculture rose substantially during the second quarter of 1970, the sectors private manufacturing, commerce, non-gold mining, and private and government services also made significant contributions to the increase in the gross domestic product in 1969/70. Production in the non-agricultural sectors of the economy still increased by just under 12 per cent in 1969/70, as against an increase of about 10 per cent during the preceding year. These very high rates of increase included, however, fairly substantial price rises. Nevertheless, the gross domestic product in real terms, i.e. excluding price changes, still increased by more than 7 per cent during the year ended June 1970, compared with an increase of about 4 per cent during the previous year. The production in the non-agricultural sectors of the economy in real terms increased by 6½ per cent in 1968/69 and by 6 per cent in 1969/70.

A comparison of the rate of increase in the real gross domestic product with that of the gross domestic product at current market prices during 1969/70, indicates a rise in the overall price levels (or in the price deflator as it is commonly called) of no less than 5 per cent, compared with a rise of about 4 per cent during the preceding year. This relatively high increase in the price deflator was partly due, however, to special factors such as price rises associated with the introduction of the sales duty in March 1969, substantial upward adjustments to salary and wage scales in the public sector, the premium realized on gold sales and significant increases in the cost of housing and in the prices of food and services, in particular medical services. As the influence of some of these factors, namely the premium on gold sales and the upward adjustment to salary and wage scales in the public sector, are not reflected in the consumer price index, the latter naturally showed a smaller increase, namely of about 4 per cent during the year ended June 1970. These special price factors with a random nature should therefore also be taken into account in assessing the price effect of the underlying inflationary pressure.

Although the rate of increase in the gross domestic product during the past year as a whole was very high, quarterly estimates reveal notable changes in the rates of increase during the course of the year. Thus, the rate of increase in the gross domestic product, which accelerated from the beginning of 1968 and reached very high levels during the second and third quarters of 1969, slowed down during the next two quarters and then increased again in the second quarter of 1970. The latter increase was attributable mainly to a rise in the

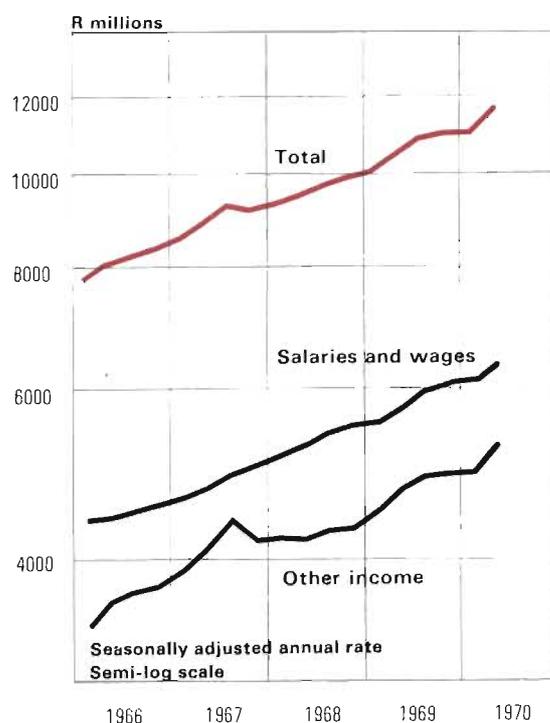
value added by agriculture, but even if the contribution of agriculture is excluded, the non-agricultural sectors still showed an increase in the rate of growth.

Over the year as a whole, "other income", i.e. profits and net interest and rent payments, contributed slightly more to the increase in gross domestic product than salaries and wages. However, while salaries and wages showed a more or less consistent and relatively rapid rise throughout the year, "other income" showed a distinct levelling-off tendency from the end of the third quarter of 1969, but increased again during the second quarter of 1970 mainly owing to the increased contribution of agriculture as a result of the above-normal maize crop. The high rate of increase in "other income" for the year as a whole was made possible, *inter alia*, by utilising surplus capacity, rationalisation, mechanisation and increased labour productivity through training.

Pronounced further increase in gross domestic expenditure

The very high rate of growth in economic activity stemmed from substantial increases in all the major components of gross domestic expenditure, namely private consumption expenditure, current and capital expenditure of the public sector, private fixed investment and inventory accumulation. During the year ended June 1970, total gross domestic expenditure increased at the extraordinarily high rate of approximately 17 per cent, which was much higher than the exceptionally high rate of

Gross domestic product



increase in the gross domestic product. As a result, the deficit which appeared on the current account of the balance of payments in the second quarter of 1969 increased to a record amount for the year 1969/70. In assessing the impact of the excess of domestic demand over domestic supply of goods and services on domestic resources and on the balance of payments, the fact that the deficit on the current account was accompanied by an equally substantial build-up of inventories should be taken into account.

Quarterly estimates of gross domestic expenditure reveal changes very similar to those of the gross domestic product. After accelerating to very high rates of increase during the

second and third quarters of 1969, the total gross domestic expenditure as well as most of the major components tended to increase at lower rates during the fourth quarter of 1969 and the first quarter of 1970, before increasing again at a faster rate during the second quarter of 1970.

Too high level and rate of increase in consumption expenditure

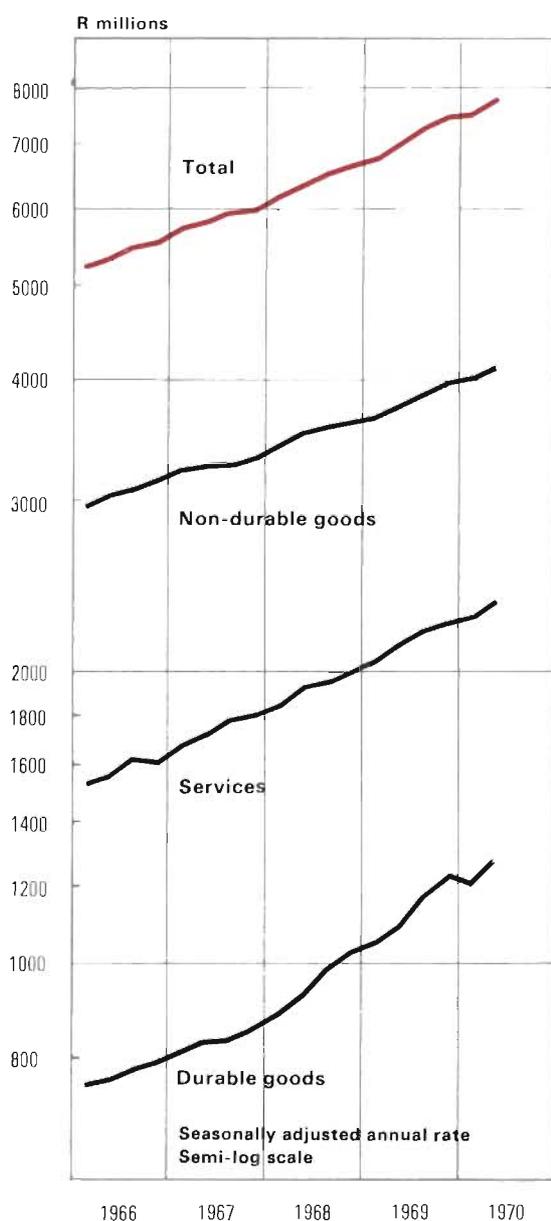
The most important contributions to the high rate of increase in gross domestic expenditure were made by private and government consumption expenditure, both of which continued to rise at very high rates. During 1969/70 private consumption expenditure increased by about 11 per cent for the second consecutive year and current government expenditure by about 14 per cent during each of the past two years. Salaries, wages and bonus payments to government employees, which accounted for about three-fifths of current government expenditure, rose by no less than 15 per cent during the year ended June 1970 and thus contributed materially to the overall increase in government consumption expenditure.

All the major components of private consumption expenditure showed substantial increases during the year ended June 1970. Expenditure on durable goods rose by about 17 per cent, that on services by about 11 per cent and that on non-durable goods by approximately 9 per cent. Exceptionally high rates of increase were recorded in expenditure on furniture and furnishings and motor cars, which increased by as much as 13 per cent and 22 per cent, respectively.

Notwithstanding the very high rate of increase in private consumption expenditure over the year ended June 1970, a noticeable decline in the rate of increase occurred during the six month period from October 1969 to March 1970. This slow-down was, however, short-lived and, as new salary and wage increases were announced, a not unexpected acceleration in the rate of increase of private consumption expenditure again became evident in the second quarter of 1970. Although the latter acceleration was noticeable in all the major categories of expenditure, it was more pronounced in expenditure on motor cars, which increased sharply in the second quarter after showing a decline during the first quarter of 1970. The higher rate of increase in expenditure on services during the second quarter was due partly to price rises, in particular in medical fees.

Private consumption expenditure did not only rise at a very high rate, but its absolute level in 1969/70 was also high compared with previous years. Thus, private consumption expenditure as a percentage of personal disposable income was 93 per cent in 1969/70, compared with 91 per cent in 1968/69 and an average of only 89 per cent for the preceding 10 years. Personal saving, accordingly, declined as a percentage of personal disposable income.

Private consumption expenditure



Further increase in fixed investment

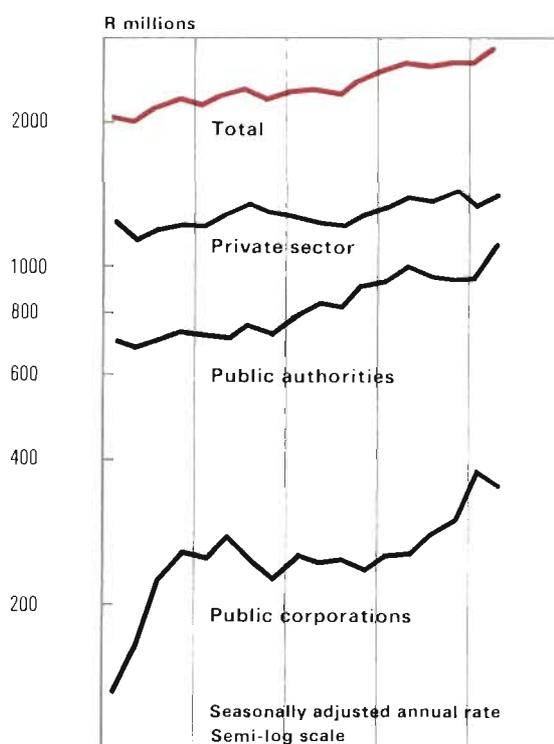
Total gross domestic fixed investment increased at a faster rate during 1969/70 than during 1968/69, namely by 10 per cent as against 7 per cent. Of the three main sectors usually distinguished, namely the private sector, public corporations and public authorities, only the fixed capital outlays of the last mentioned failed to increase at a faster rate during the past year than during the year before.

Owing mainly to a decline of 14 per cent in the fixed investment of the South African Railways and Harbours, fixed capital outlays by public authorities increased by only about 8 per cent, compared with an increase of

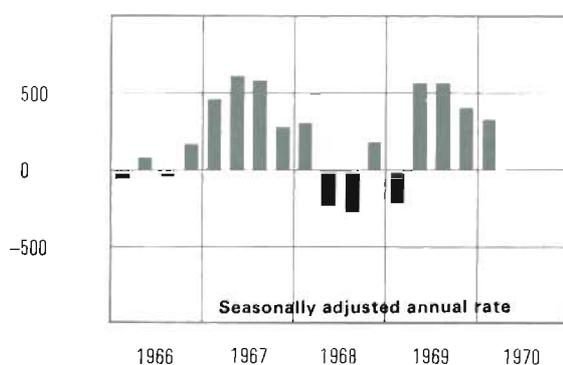
18 per cent during the preceding year. If capital outlays by the South African Railways and Harbours are excluded, however, the capital outlays of the rest of the public sector, which had risen by 21 per cent during the year 1968/69, increased by a further 14 per cent during the year under review and brought the average annual rate of increase during the past decade to more than 13 per cent. The central government, excluding the South African Railways and Harbours, contributed most to the rise in fixed investment of public authorities with an increase of no less than 25 per cent, while the capital outlays of the provincial administrations rose by 15 per cent. The capital outlays of the South African Railways and Harbours, on the other hand, declined by 14 per cent during 1969/70, after an increase of 8 per cent in 1968/69. At the same time, the demand for transport services increased markedly with the result that the imbalance between supply and demand became more pronounced. During the second quarter of 1970, however, there was a pronounced increase in the capital outlays of the South African Railways and Harbours and this represented a reversal of the downward trend which started in the first quarter of 1969.

Fixed investment by public corporations, which had shown little change during the preceding two years, revived strongly during the past year and increased by as much as 31 per cent. Moreover, this substantial increase was mainly in the form of capital outlays

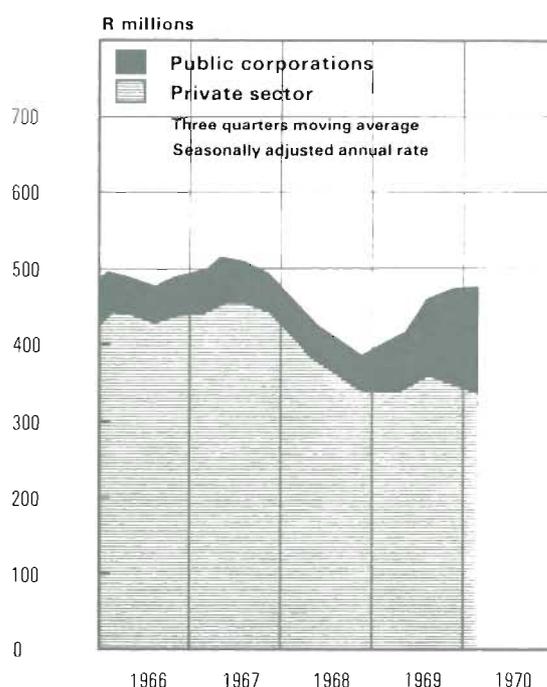
Gross fixed investment



Change in total inventories



Gross fixed investment: manufacturing



on plant, machinery and equipment on various new projects as well as extensions to and modernisation of existing establishments. Thus, this increase in outlays on plant, machinery and equipment contributed much to the increase of 13 per cent in investment in these assets by all sectors during the year under review, compared with a small decline the year before. Although public corporations' contribution to total capital outlays is relatively small (approximately 12 per cent), a large part of their activities is in the manufacturing field and their capital outlays were about 36 per cent of fixed investment in private manufacturing during 1969/70. The public corporations, therefore, contributed materially to the expansion of production capacity in total manufacturing.

After showing little change during 1968/69, private fixed investment increased by 7 per cent during 1969/70. This increase in fixed capital outlays by the private sector was, however, not evenly distributed among the different sub-sectors. Capital outlays on residential buildings increased by 6 per cent, that by the sub-sector commerce, finance and private transport by 20 per cent, while fixed investment by agriculture showed a slight increase only. On the other hand, capital outlays by manufacturing showed little change, after a substantial decline during the previous year, while those of mining declined moderately.

Sharp increase in inventory investment

Despite the strong upsurge in domestic monetary demand, a relatively large net addition of more than R450 million was made to inventories during the past year, compared with only R70 million during the preceding year. This change was also largely responsible for the *acceleration* in the rate of increase in total gross domestic expenditure from 9 per cent in 1968/69 to 17 per cent in 1969/70, and was, therefore, closely associated with the high level of imports and the deficit on the current account of the balance of payments.

A closer look at the different types of inventories reveals that, although the stockpiling of strategic materials and the increase in diamond stocks associated with the irregular diamond market contributed much to the accumulation of inventories, the largest inventory build-up occurred in industrial and commercial stocks and agricultural stocks-in-trade. Although the reasons for this stockpiling are not obvious in the light of the very buoyant domestic demand situation, it may have been associated with international uncertainties such as the pending British dock strike, possible exchange rate changes, and a misconception regarding possible import restrictions. Other factors that may have played a role are the misjudgement of the level and rate of increase in domestic demand and the influence of bottlenecks, such as insufficient transport facilities.

Insufficient domestic saving

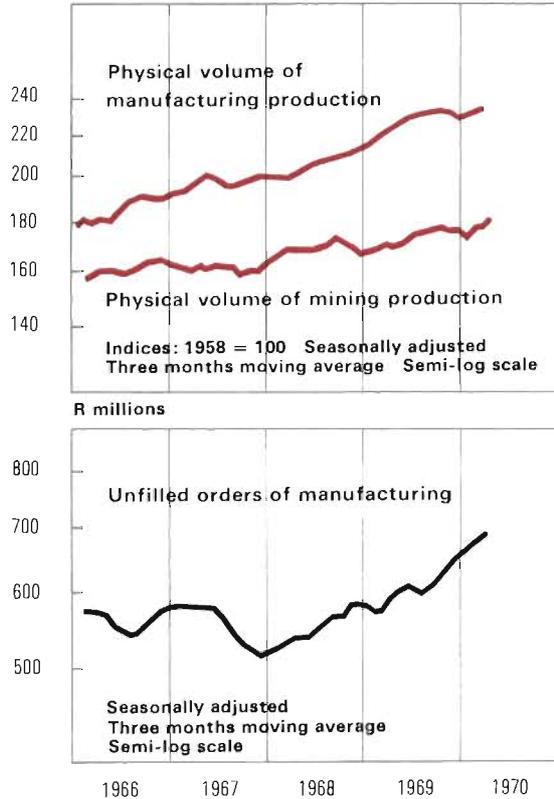
Gross domestic saving increased by only 6 per cent during the year ended June 1970, as against an increase of as much as 25 per cent in gross domestic investment. Domestic saving, therefore, was insufficient to the extent of R465 million to finance the rise in investment. This shortfall was financed by a net inflow of capital from abroad amounting to R276 million and a decline of about R189 million in the gold and foreign exchange reserves.

The relatively small increase in gross domestic saving resulted from a decline in personal saving, which partly offset the increases in corporate saving, the current surplus of general government, and depreciation allowances. Furthermore, personal saving declined significantly in relation to personal disposable income, namely from a ratio of 8 per cent in 1968/69 to 6 per cent in 1969/70. If compared with an annual average of 10 per cent during the preceding ten years, personal saving was evidently low in 1969/70.

Further substantial increase in manufacturing production and moderate rise in mining output

The physical volume of manufacturing production showed a further substantial increase during the ten months ended April 1970 and the average level of the seasonally adjusted index was 8.8 per cent higher than during the corresponding period a year ago. This increase followed upon the already high rate of increase of 8.7 per cent during the year ended June 1969. A levelling-off tendency was, however, noticeable towards the end of 1969 and the first quarter of 1970. During April the seasonally adjusted index of the physical volume of manufacturing production increased again strongly, and the possibility of a slight acceleration in manufacturing production during the second quarter is strengthened by the sustained upward movement in total hours worked and the value of unfilled orders in manufacturing. Notwithstanding the increase during April and the possible slight acceleration during the second quarter of 1970, manufacturing production showed a distinct levelling-off tendency during the period July 1969 to April 1970 as a whole, which may be ascribed partly to the fact that manufacturing production had already approached the full capacity level and partly to the shortage of labour. The main contributions to the increase in manufacturing output during the ten months ended April 1970 were made by metal products, transport equipment and textiles, clothing and footwear, while food production was the only major item which declined.

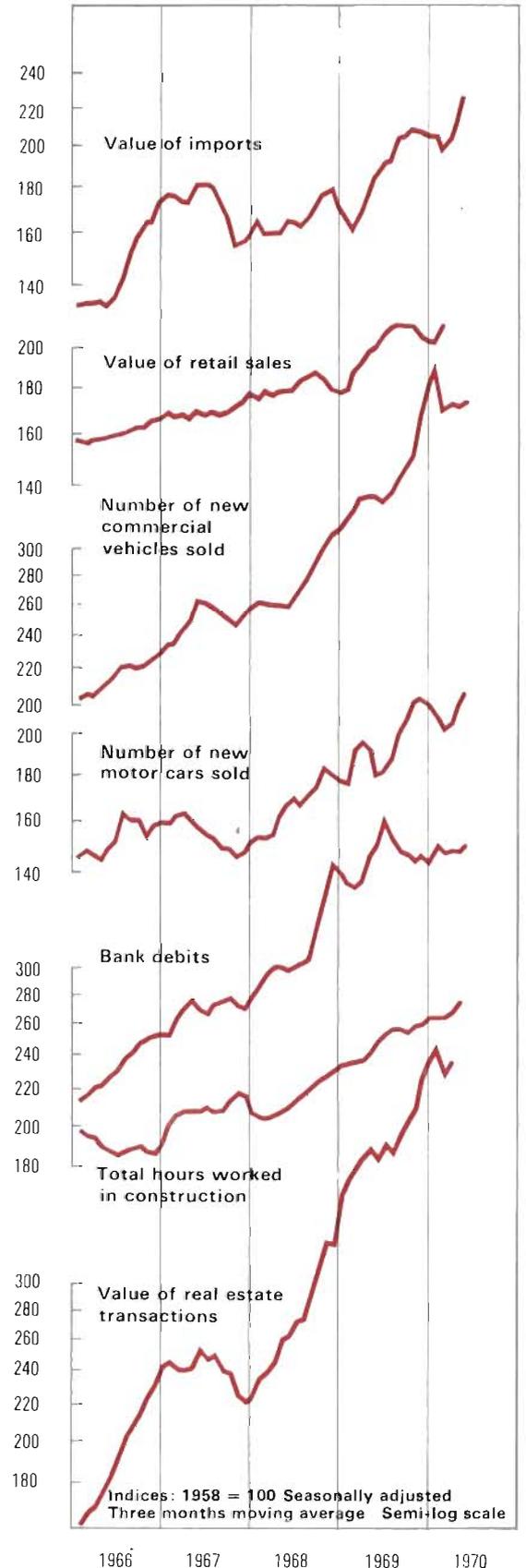
Mining production showed a moderate rise during the eleven months ended May 1970, and its average level was 4.2 per cent higher than the average level during the corresponding period a year ago. Gold mining production increased by 4.8 per cent and other mining



production by 3.6 per cent during the same period. The latter increase was mainly attributable to increases in the production of building materials, iron ore and copper, while diamond exploitation did not increase during this period. It is also significant that non-gold mining production showed a noticeable increase from about the fourth quarter of 1969.

Other general economic indicators

The general impression gained from the national accounts that the exceptionally high rate of increase in economic activity reached during the second and third quarters of 1969 slowed down during the subsequent two quarters and then tended to gain in momentum again in the second quarter of 1970, was to a large extent confirmed by the available general monthly economic indicators. A very large number of economic indicators showed a levelling-off or decline during the fourth quarter of 1969 and the first quarter of 1970, while the few indicators that are available for the second quarter tended to increase in the months after March 1970. The latter include merchandise imports, sales of motor cars, bank debits, hours worked and overtime worked in manufacturing and construction, employment in mining, manufacturing and



construction, and average salaries and wages. The property market remained buoyant throughout the period under review as reflected by the strong upward movement in the value of real estate transactions, while the equity market was depressed with low stock exchange turnovers and declining share prices.

The labour situation

Although concern about the tight labour situation was expressed on various occasions during recent years, the adaptability of the South African economy succeeded in achieving a highly satisfactory increase in real income over the last decade. Thus, the real gross domestic product of the non-agricultural sectors increased at an average annual rate of 6.4 per cent over the last decade as against an increase of 3.4 per cent per annum in employment, implying a rise of about 2.9 per cent per annum in the average real output per worker. An increase in output per worker is also

reflected in the physical volume of production per worker in the manufacturing and mining sectors, which increased by 2.6 per cent and 4.3 per cent per annum, respectively, during the last ten years. Although the figures for the individual years showed regular improvements in the output per worker, the average annual rate of increase declined somewhat towards the end of the period. The increase in output per worker may be attributable to improvements in technique, better utilization of production capacity through rationalisation and modernisation, better training and education, more overtime worked, and changes in the composition of the labour force owing to factors such as the regular and relatively high inflow of skilled immigrants and the better use made of unskilled workers.

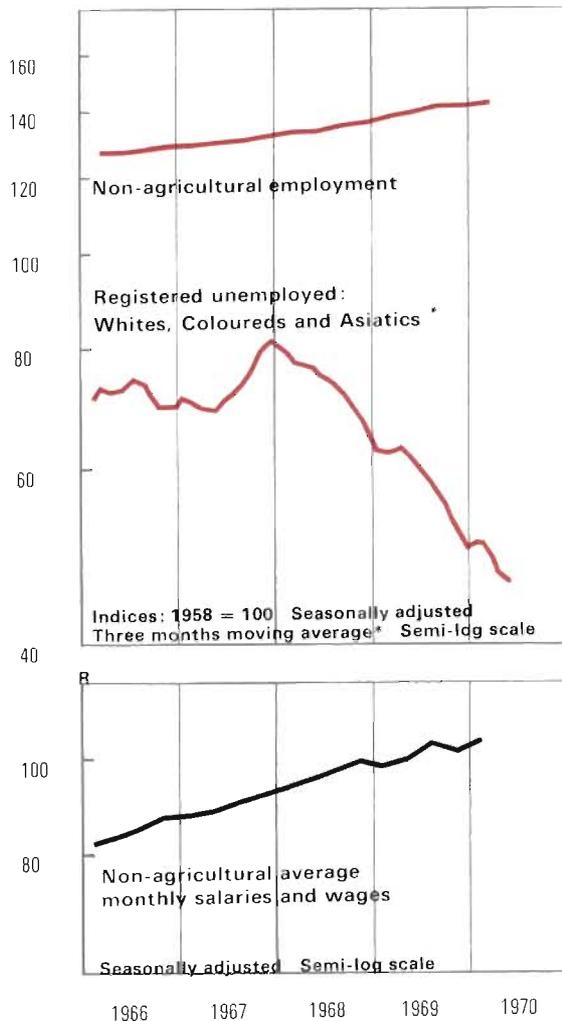
Despite these tendencies, the labour situation has become progressively more tight. Thus, the number of registered unemployed Whites, Coloureds and Asiatics declined from more than 26,000 in 1959 to less than 11,000 in 1969 and to only 8,652 at the end of May 1970. The ratio of unemployed Whites, Coloureds and Asiatics to the total employed in the non-agricultural sectors declined from 2.4 per cent in 1959 to 0.7 per cent in 1969 and to 0.6 per cent in the first quarter of 1970. Furthermore, according to the percentage of overtime worked to ordinary hours worked, a significant increase in the tightness of the labour situation probably occurred in the second quarter of 1970.

The tightness of the labour situation can also be gauged from a Department of Labour survey of manpower as at the end of April 1969. According to this survey, the White labour position was particularly critical in the case of artisans and apprentices, with vacancies in relation to the number of posts standing at 7.6 per cent for all trades and at 11.6 per cent and 8.8 per cent for the building and electrical trades, respectively. For workers other than artisans and apprentices, the labour shortage of Whites was most acute in the case of transportation, delivery and communication sector, for which a shortage of 10.4 per cent was recorded. Employee shortages of between 6 and 7 per cent were also observed in service capacities (public, personal and domestic), professional, semi-professional and technical employees, and for operators and semi-skilled workers in building and construction work.

In these circumstances, it is therefore not surprising that the average salaries and wages per worker increased markedly over the past decade and for the non-agricultural sector amounted to 5.3 per cent per annum. An acceleration in the rate of increase was also noticeable towards the end of the decade.

Further acceleration in price increases

As a result of the very high rate of increase in monetary demand, coupled with substantial increases in salaries and wages and other costs, the rate of increase in consumer prices accelerated further during the year under review. Thus the seasonally adjusted con-



Consumer prices

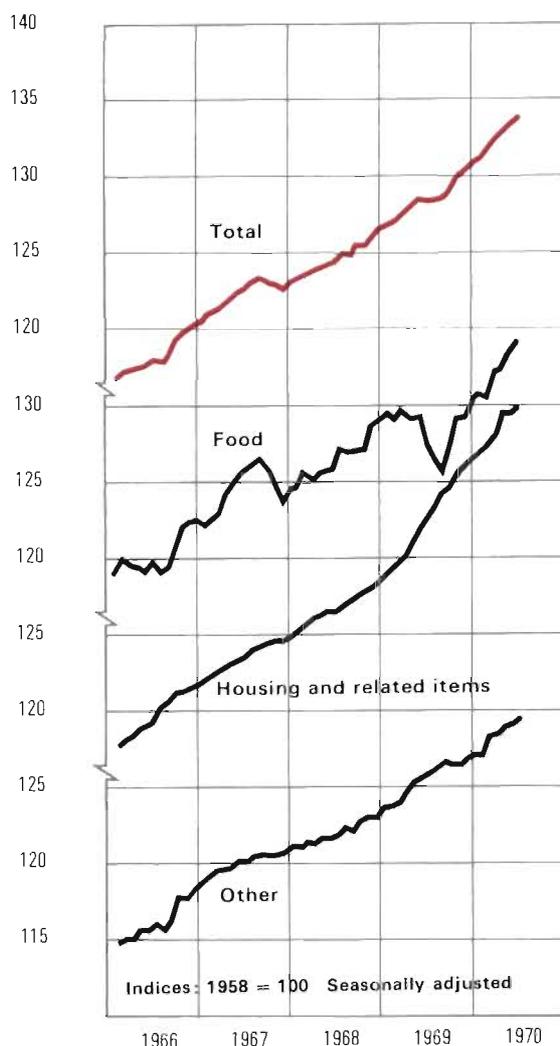
Annual percentage rate of change in seasonally adjusted index

Period	Food	Other			Total
		Housing etc.	Other	Total	
June 1967 – June 1968	0.2	2.4	1.3	1.8	1.3
June 1968 – June 1969	1.3	4.8	3.3	4.0	3.3
June 1969 – June 1970	5.1	5.4	2.8	3.8	4.1

Wholesale prices

Annual percentage rate of change in seasonally adjusted index

Period	Goods produced in South Africa			Imported goods	Total
	Agriculture, etc.	Manufacturing	Total		
June 1967 – June 1968	-2.4	1.0	0.4	0.8	0.5
June 1968 – June 1969	-0.2	3.0	2.3	1.5	2.1
June 1969 – June 1970	7.0	2.9	3.4	1.8	3.2

Consumer prices

sumer price index rose by 4.1 per cent during the year ended June 1970, compared with 3.3 per cent during the previous year. If the influence of the sales duty is excluded from these rates, the acceleration is even more pronounced, namely from 2.7 per cent during the year ended June 1969 to 4.0 per cent during the past year.

Although rises were registered in all three major components of the consumer price index, the most pronounced increases occurred in housing and related items, which rose by 5.4 per cent, and food which rose by 5.1 per cent. The individual items which made major contributions to the rise during 1969/70 were house and flat rents, medical services and vegetables and fruit.

Wholesale prices showed tendencies similar to those of consumer prices. During the year ended June 1970, the wholesale price index increased by 3.2 per cent compared with 2.1 per cent during the previous year. Without the sales duty it increased from 1.3 per cent during 1968/69 to 3.2 per cent during the past twelve months. This sharp acceleration in wholesale prices can be ascribed almost entirely to an increase of no less than 7.0 per cent in the prices of agricultural products. As the latter declined up to August 1969, the acceleration from August 1969 to June 1970 was even more pronounced.

Balance of payments

Record deficit on current account

During the year ended June 1970 a deficit of R465 million was recorded on the current account of the balance of payments. This was the largest deficit in the history of the country and followed upon surpluses of R86 million in 1967/68 and R5 million in 1968/69. This unfavourable development was the result of increases of R437 million in merchandise imports and R83 million in net service and transfer payments to the rest of the world, which were only partly offset by increases of R47 million and R3 million in net gold output and merchandise exports, respectively.

Current account of the balance of payments

R millions

	1968		1969		1970	
	2nd half	1st half	2nd half	1st half	2nd half	1st half
Actual balance	10	-5	-155	-310		
Seasonally adjusted annual rate	-24	28	-363	-577		

The accompanying table shows that the deficit on the current account, at a seasonally adjusted annual rate, increased progressively and amounted to no less than R577 million in the first half of 1970. On the same basis the deficit was even higher at R618 million during the second quarter of 1970. This further deterioration during the second quarter of 1970 was likewise due mainly to substantial increases in merchandise imports, and in interest, dividend and other invisible payments to foreigners.

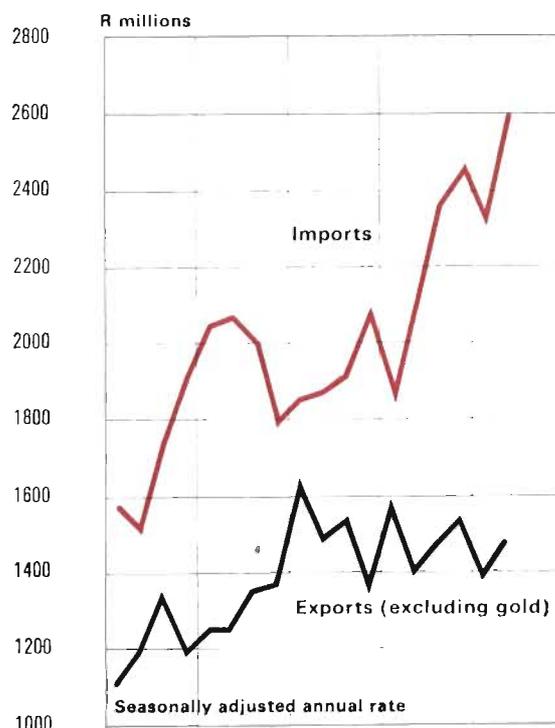
Sharp rise in merchandise imports and invisible payments

Merchandise imports increased from R1,999 million in 1968/69 to no less than R2,436 million in 1969/70, or by 22 per cent, compared with an increase of 6 per cent during the preceding twelve months. The substantial increase during the year ended June 1970 may be associated with, *inter alia*, the large increase in gross domestic expenditure, including a significant build-up of inventories.

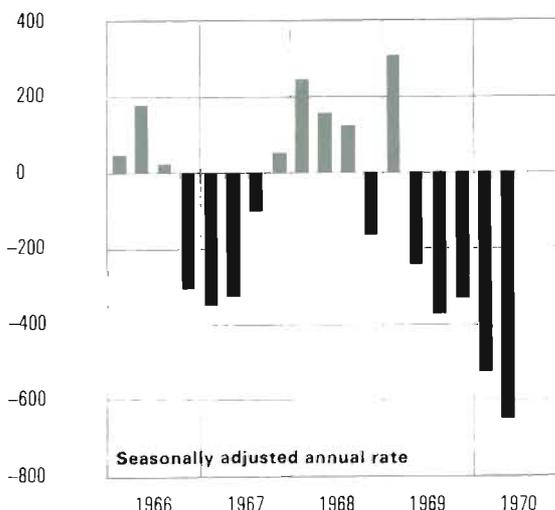
The increase in merchandise imports was spread over almost all the different classes of goods, but particularly large increases occurred in imports of textiles and textile articles, machinery and electrical equipment, and transport equipment. Poor climatic conditions resulted in a significant rise in the imports of certain types of agricultural goods.

On a quarterly basis, merchandise imports showed large fluctuations, and at a seasonally adjusted annual rate increased from a relatively low level of R1,870 million in the first quarter of 1969 to R2,456 million during the fourth quarter of 1969, before declining to R2,320 million during the first quarter of 1970. During

the second quarter of 1970 imports increased again to the very high level of R2,608 million. The high figure for the fourth quarter of 1969 followed by the decline in the first quarter of 1970 may be associated to some extent with the disappearance at the end of 1969 of uncertainty concerning the marketing of South Africa's gold and thus of a possible tightening of import control. Although the possibility of the introduction of stricter import control also became less probable, following the announce-



Balance of payments on current account



ment by the Minister of Economic Affairs on the 31st December that the Government had decided not to use import control in terms of Article XII of the General Agreement on Tariffs and Trade, there may be some uncertainty amongst importers about the implications of this decision. The sharp rise in merchandise imports during the second quarter of 1970 may be ascribed partly to stockpiling by business enterprises in anticipation of dock strikes in the United Kingdom, and could also be a reflection of a new upsurge in total domestic demand which had levelled off during the fourth quarter of 1969 and the first quarter of 1970.

Net invisible payments to the rest of the world increased by no less than R83 million or 32 per cent during the year ended June 1970, compared with an increase of 4 per cent during the preceding twelve months. This large increase was caused mainly by a substantial rise in service payments, while service receipts showed little change and net transfer receipts remained more or less constant. Although all the components of service payments increased, major contributions were made by higher freight and insurance payments, associated with increased imports, and higher interest and dividend payments, as a result of the large capital inflow experienced in recent years, and the generally higher level of interest rates.

Quarterly figures of net invisible payments showed a marked increase in the third quarter of 1969, when the seasonally adjusted annual figure rose to the relatively high amount of R356 million. After declining slightly to R309 million in the fourth quarter, it increased during the first half of 1970 to approximately the level reached in the third quarter of 1969.

Little change in merchandise exports

Merchandise exports showed almost no change over the year ended June 1970 as a whole and amounted to R1,464 million. A decline in exports of maize and other agricultural products and lower proceeds from wool exports as a result of lower world prices were mainly responsible for the poor performance of exports, as they offset the sharp rises in exports of base metals and diamonds. During the first half of 1970, however, diamond exports declined markedly when diamond merchants were left with large unsold stocks, while at the same time agricultural exports showed a notable increase. The latter increase was not, however, sufficient to offset the decline in diamond exports, with the result that total exports declined from R749 million during the second half of 1969 to R715 million during the first half of 1970.

Moderate rise in net gold output

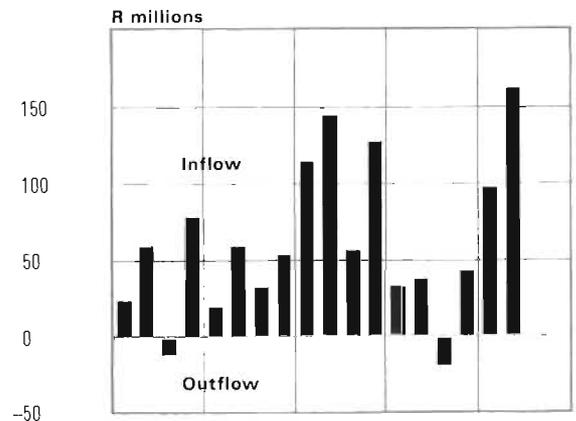
After showing little change over the years 1964/65 to 1967/68, net gold output subsequently showed a moderate upward tendency. During the year ended June 1970 it increased by 6 per cent to R847 million, com-

pared with an increase of 5 per cent in the previous year. The rise during 1969/70 can be attributed partly to an increase of about 5 per cent in the physical volume of gold production coupled with a small increase in the average prices realized on the free market. During the first half of 1970, however, the average price obtained on the free market as well as the physical volume of production declined, with the result that the value of net gold output fell from R441 million in the second half of 1969 to R406 million in the first half of 1970.

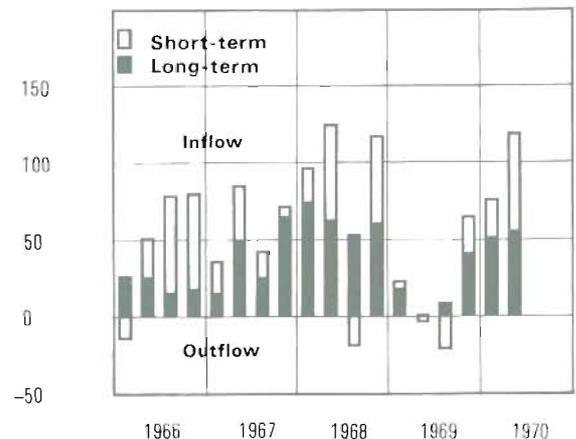
Continued large net capital inflow

A further net capital inflow of R276 million was recorded in the year ended June 1970, compared with a net inflow of R255 million during the preceding twelve months. This was the sixth consecutive year in which a net inflow of capital was recorded and it brought the total net inflow over the six-year period to no less than R1,400 million, of which about R750 million represented long-term capital and R650 million short-term capital.

Total capital movements



Private capital movements



Net movements of capital

R millions

	1968		1969		1970	
	2nd half	1st half	2nd half	1st half	2nd half	1st half
To private sector:						
Stock exchange trans- actions	37	-5	10	10		
Other long-term	77	25	40	101		
Short-term*	37	-	4	81		
Total	151	20	54	192		
To central government and banking sector	34	50	-31	61		
Total capital movements ..	185	70	23	253		

*Including net errors and unrecorded transactions.

It is, moreover, significant that the distinct downward trend in net capital inflow from the second half of 1968, was reversed during the first half of 1970. After showing a net inflow of only R23 million during the second half of 1969, it increased again to no less than R253 million in the first half of 1970. Although net capital inflow to the central government and banking sector made a significant contribution to the change in the net capital inflow during the first half of 1970, net capital inflow to the private sector also increased substantially from the fourth quarter of 1969, after it had declined during the first three quarters of 1969.

The relatively high net inflow of capital to the private sector of R246 million during the year ended June 1970 was recorded despite the high interest rate structure abroad and the disappearance of some of the general currency uncertainties. Although it may be associated partly with domestic credit control and the application of exchange control measures to domestic borrowing by foreign controlled organisations, it also reflects the confidence in South Africa's economic stability and growth. A net capital inflow of R161 million was recorded as long-term capital to the private sector during the year, notwithstanding the decline in the net purchases by foreigners of South African securities on the Johannesburg Stock Exchange, and consisted mainly of loans obtained abroad. Short-term capital to the private sector, including errors and unrecorded transactions amounted to R85 million and was mainly due to an increase in trade credits associated with the sharp rise in merchandise imports.

The fact that the central government and banking sector obtained capital from abroad amounting to R30 million during the year ended June 1970, may be ascribed partly to the tight conditions that prevailed in the domestic market for fixed-interest-bearing securities. In addition, public corporations, which are included under the private sector for balance of payments purposes, accounted for an amount of R94 million of the net inflow of capital to the private sector. As the accompanying table shows, the net inflow of capital to the central government and banking sector increased substantially during the first half of 1970 compared with the preceding six months.

The inflow during the first half of 1970 consisted of an inflow of long-term capital of R41 million and of short-term capital of R20 million. The drawing of South Africa's gold tranche on the International Monetary Fund during the first half of 1969, and the subsequent repayment thereof during the second half of 1969, contributed materially to the large fluctuations which occurred in the short-term capital movements of this sector.

Decline in gold and foreign exchange reserves

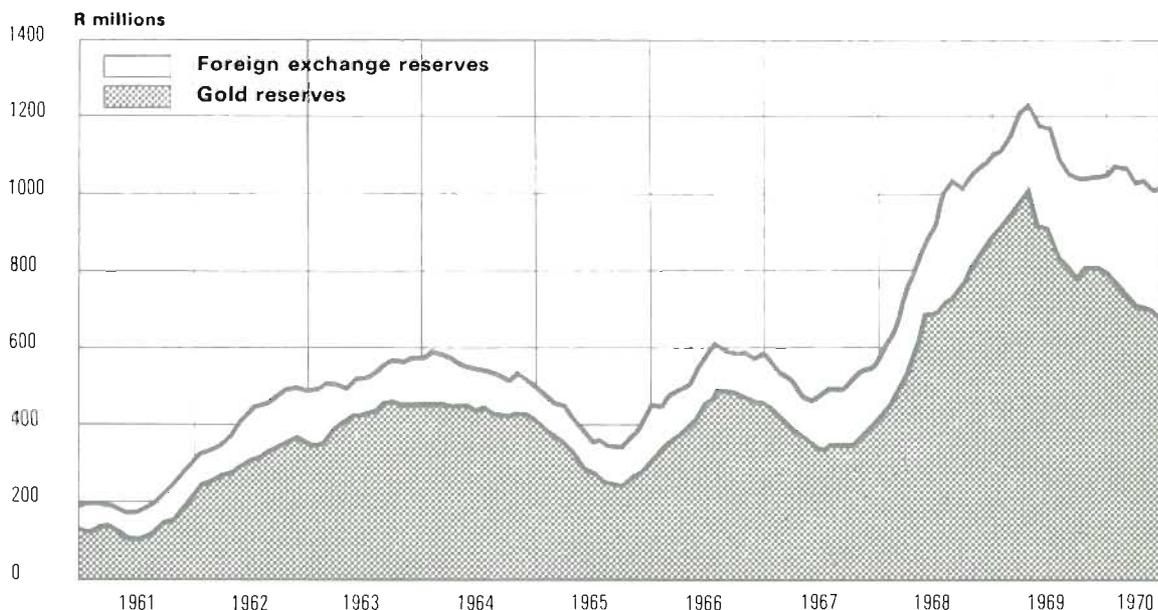
The deficit on current account of R465 million and the total net capital inflow of R276 million indicated a decline of R189 million in South Africa's gold and foreign exchange reserves. This decline does not, however, take into account an exchange profit of about R8 million as a result of the revaluation of the German Mark in October 1969, and the initial allocation of Special Drawing Rights in January 1970 amounting to R24 million. The total gold and foreign exchange reserves therefore actually declined by only R157 million.

The total gold and foreign exchange reserves declined from their peak of R1,230 million in

April 1969 to R1,035 million in September. Mainly owing to the inclusion of the above-mentioned exchange profit and allocation of Special Drawing Rights, the reserves increased to R1,071 million at the end of January 1970, but subsequently declined by R63 million to R1,008 million at the end of June 1970. A decline of only R27 million was therefore recorded in total reserves over the nine months ended June 1970. During July 1970, however, a fall of R36 million occurred in the gold and foreign exchange reserves of the Reserve Bank.

Over the year 1969/70 the composition of the gold and foreign exchange holdings of the country showed a significant change. The gold component, for example, decreased from 77.4 per cent of total reserves at the end of June 1969 to 66.8 per cent at the end of June 1970. It is also significant to note that the increase in the exchange holdings of the central government from R3 million at the end of June 1969 to R90 million at the end of April 1970, and the subsequent decline to R19 million at the end of May, was mainly the result of a corresponding increase in South Africa's super gold tranche held with the International Monetary Fund during the first period, and a subsequent drawing of R71 million on this tranche position.

Total gold and foreign exchange reserves



Monetary and banking situation

Changed monetary and banking conditions

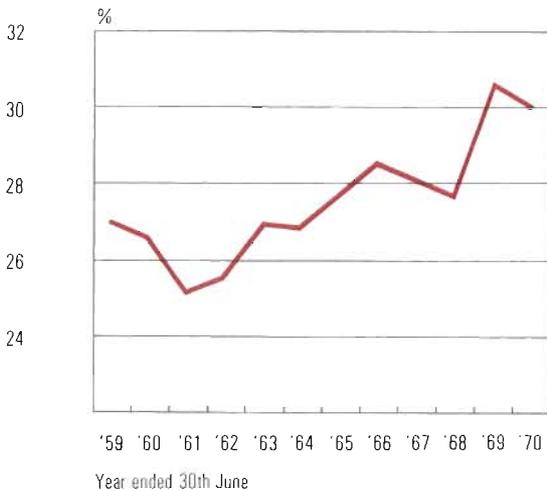
During the year ended June 1970, monetary and banking conditions were characterised by a further rapid rise in bank credit which outweighed the contractionary effect of a moderate decline in the gold and foreign exchange reserves and thus resulted in a further increase in the liquidity of the private non-bank sector. At the same time, the banks operated at considerably reduced levels of surplus liquid assets and upward pressure continued to be exerted on deposit interest rates which were, however, prevented from rising above 7 per cent on deposits by a request from the Reserve Bank. A strong demand for bank credit continued to be felt and, as several relaxations of the credit ceilings and required liquid asset ratios were made during the year under review, bank credit increased very rapidly.

Slight reduction in rate of increase of money and near-money

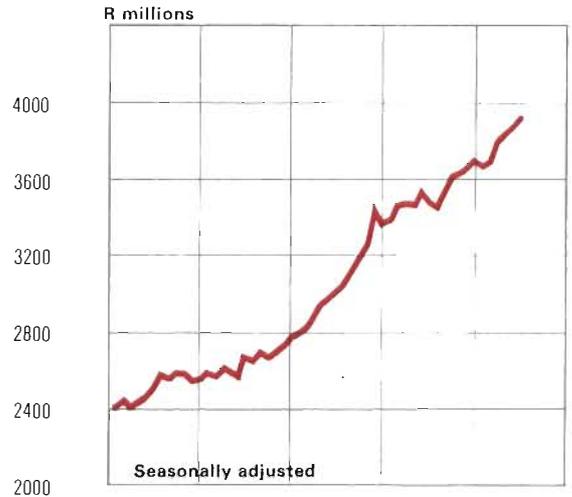
Money and near-money increased by R437 million, or about 12.5 per cent, during the year ended June 1970, compared with increases of about 13 per cent in 1967/68 and 15 per cent in 1968/69. However, as the accompanying table shows, the reduction in the rate of increase in the seasonally adjusted quantity of money and near-money during the first half of 1969 did not continue during the second half of 1969 and the first half of 1970.

The average ratio of money and near-money to the gross domestic product was 29.9 per cent for the year ended June 1970, compared with 30.6 per cent for the preceding twelve months and 28.0 per cent for the period 1961/62 to 1969/70. It is also of significance to compare the average annual rates of increase of money and near-money, bank credit to the private sector, and the gross domestic

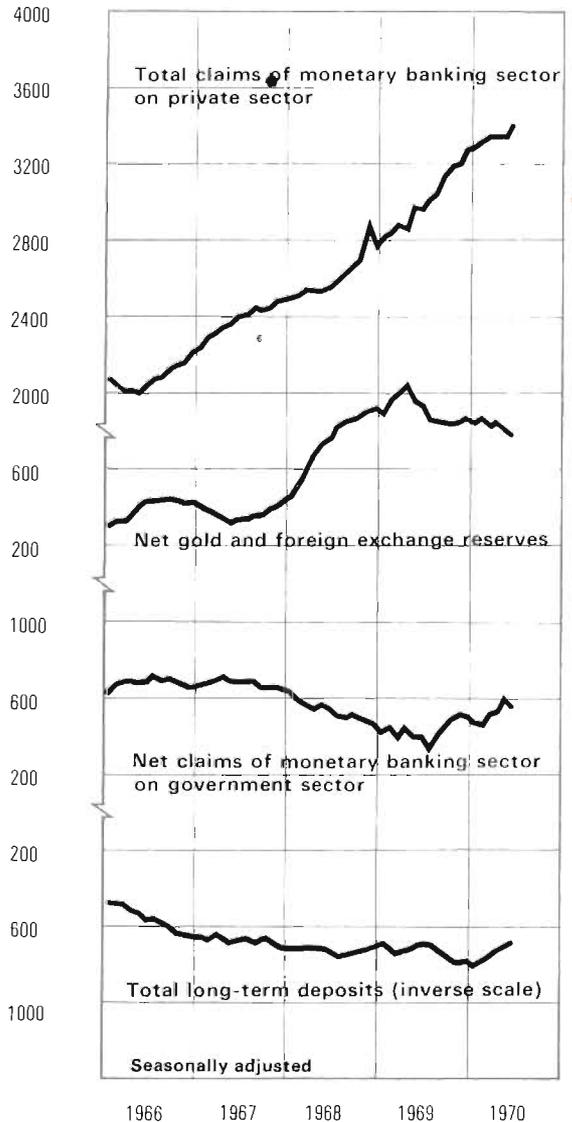
Ratio of money and near-money to gross domestic product



Money and near-money



Causes of changes in money and near-money



product over a relatively long period of time. Thus, the gross domestic product increased by 9.0 per cent per annum over the past ten years, while in the case of money and near-money and bank credit to the private sector the increases were 11.0 per cent and 11.3 per cent respectively. It is, therefore, clear that both money and near-money and bank credit to the private sector increased on average at a significantly faster rate per annum than the gross domestic product over the past ten years.

Money and near-money

	Not seasonally adjusted		Seasonally adjusted	
	Amount	Annual rate of increase	Amount	Annual rate of increase
	R m	%	R m	%
1968-2nd half	412	27.1	324	21.4
1969-1st half	49	2.8	135	8.1
2nd half	308	17.6	211	12.1
1970-1st half	129	6.8	224	12.1

Extension of bank credit main cause of increase in money and near-money

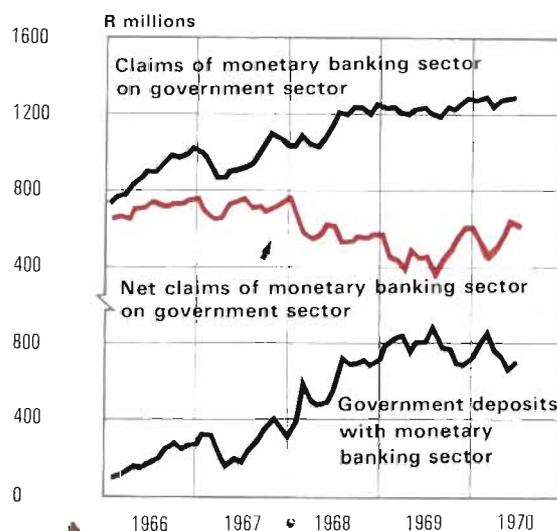
Despite a decline of R160 million in the net gold and foreign exchange reserves during the year ended June 1970, money and near-money nevertheless increased by R437 million as a result of a very large increase of R602 million in bank credit to the private and government sectors. As is shown in the accompanying table, this was quite different from developments during 1967/68 and 1968/69. In 1967/68 bank credit was a neutral factor, but a substantial increase in the gold and foreign exchange reserves caused money and near-money to rise, and in 1968/69 bank credit contributed nearly R260 million and gold and foreign exchange reserves only R183 million to the increase in money and near-money.

A major factor contributing to the acceleration in the extension of bank credit was the fact that net bank credit to the government sector, which had shown a declining tendency since 1966, increased during the twelve months ended June 1970 by no less than R167 million, compared with a decline of R160 million during the previous year, i.e.

Main causes of changes in money and near-money

R millions

	1967/68	1968/69	1969/70
Net gold and foreign exchange reserves	423	183	-160
Extension of bank credit:			
Net claims on government sector	-148	-160	167
Claims on private sector	152	417	435
Total bank credit	4	257	602
Long-term private deposits (increase-, decrease +)	-69	46	-1
Other assets and liabilities (net)	-4	-25	-4
Total change in money and near-money	354	461	437



a change of R327 million. The increase of R167 million was the result of an increase of R50 million in the monetary banks' holdings of Treasury bills and government securities and other claims on the government sector, and a decline of R118 million in government deposits with the monetary banking sector.

Bank credit to the private sector increased by 14.5 per cent during 1969/70 compared with increases of 17 per cent in 1966/67, 6 per cent in 1967/68 and 16 per cent in 1968/69. A distinct slowing down occurred, however, in the rate of increase during the course of 1969/70. Thus the seasonally adjusted annual rate of increase declined from 19.5 per cent during the second half of 1969 to 8.8 per cent during the first half of 1970. The main contributors to the changes in the claims of the monetary banking sector on the private non-bank sector were the discounts and advances of commercial banks, merchant banks and monetary hire-purchase and general banks with an increase of R278 million, and the cash credit advances of the Land Bank, which increased by R71 million.

Relaxation of credit ceilings

The substantial further increase in bank credit to the private sector during 1969/70 was made possible by several relaxations of the ceiling on discounts and advances as well as by a raising of the ceiling on certain specified investments of the banks. Thus, the former ceiling was raised from 100 to 110 per cent of its March 1965 level effective from 1st September 1969, while an additional concession of 1 per cent of its new level was made simultaneously for purposes of granting new credit to smaller business enterprises. The ceiling was raised further to 115 per cent of its March 1965 level, effective from 1st January 1970. Earlier concessions relating to agriculture, smaller business enterprises and credit for certain strategic purposes, were generally to remain outside the ceiling. Finally, a further increase to 118 per cent became effective from 1st June 1970, primarily for the expansion of production credit to the agricultural sector and bridging finance to the manufacturing sector. The ceiling on certain investments with the private sector was also raised in February 1970, from 100 to 115 per cent of its level as at 31st March 1968, to enable banks to grant more medium-term credit to manufacturing undertakings in the form of investment in debentures.

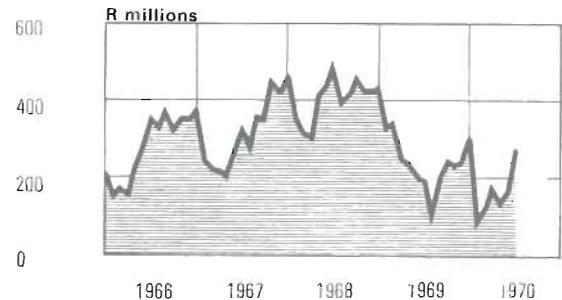
Despite requests that the additional credit should be used to assist the agricultural and manufacturing sectors, fixed investment by manufacturing remained sluggish. The additional credit extended by commercial banks and other monetary banking institutions during the 1969/70 period should, therefore, be associated with the high level of imports, rapid inventory accumulation, the sustained high level of private consumption expenditure (in particular on durables), and a continued high level of activity in fixed property development.

Apart from the increase in money and near-money and in bank credit, the so-called grey market recently became very active. Apparently pension funds and insurers are also now participating in placing money outside the banking system, while certain banks and buildings societies appear to have assisted transactions outside the banking and building society system by providing bank guarantees or, in the case of the building societies, by earmarking funds placed with them for specific borrowers. Property developers, appear to have made increasingly more use of funds obtained outside the banking system.

Lower levels of excess liquid assets of monetary banks

The excess liquid assets of the monetary banks generally were at much lower levels during the year ended June 1970 than during the preceding year. Thus the monthly average amount of excess liquid assets during 1969/70 was only about R180 million, or 3.9 per cent of the monetary banks' liabilities to the public, as against more than R340 million, or 8.4 per cent of the banks' liabilities to the public,

Surplus liquid assets of monetary banking institutions



during 1968/69. Owing mainly to short-term seasonal increases of tax collections in July 1969 and January 1970, excess liquid assets of monetary banks at the end of these two months actually amounted to less than R100 million.

The reduction in the excess liquid assets of monetary banks may be ascribed to various factors such as the substantial increase in bank credit, the decline in the net gold and foreign exchange reserves, and increases in the liquid asset requirements for all banking institutions in February, March and May 1969, which brought the required ratios in respect of short-term and medium-term liabilities to 48 per cent and 30 per cent respectively. More recently, the generally downward trend in government deposits and a reduction in liquid asset requirements in respect of short-term liabilities to 45 per cent in February, and in respect of medium-term liabilities to 28 per cent in May, have contributed to the somewhat higher level of the banks' excess liquid assets, which amounted to R264 million, or 5.3 per cent of their liabilities to the public, at the end of June 1970.

Money market conditions and interest rates

Conditions in the money market during 1969/70 tended to reflect mainly the generally downward trend of the government's balances with the Reserve Bank and the National Finance Corporation which, over the year as a whole, more than fully offset the tightening effect of the decline in the gold and foreign exchange reserves. Following upon the relatively tight conditions of July 1969 as a result, inter alia, of a seasonal peak in tax collections, the Treasury bill tender rate declined from 4.77 per cent on 8th August 1969 to 4.34 per cent at the end of November and, after another seasonal increase to 4.44 per cent in January 1970, declined again to a level of between 4.32 and 4.34 per cent in July. Other money market rates, such as the rates on bankers' acceptances and certi-

ificates of deposit, showed broadly similar but more pronounced movements.

As money market conditions eased during the second half of 1969, the total assets of the discount houses reached a record value of R400 million at the end of November. Over the remainder of the year under review they maintained the value of their asset portfolio at a remarkably stable level of between R375 and R400 million, even though the amount of call money available fluctuated substantially. As a result, the discount houses during the first half of 1970 frequently tended to borrow substantial amounts from the Reserve Bank. Their average month-end indebtedness to the Bank during the first four months of 1970 actually amounted to R120 million. At the end of June, however, the Bank's lending to the discount houses had declined to R17 million.

Contrary to the behaviour of interest rates on most money market instruments, interest rates on deposits with banking institutions showed a persistent upward trend over the year. Several factors, such as the fairly low level of excess bank liquidity over most of this period, the increase in the ceilings on monetary banks' discounts, advances and investments, the sustained rise in the banks' lending and the keen competition among the various institutions, would appear to have accounted for this development. In addition, competition for deposits became more intense as the building societies, during July and August 1969, increased their rate on fixed deposits from 6½ to 7 per cent, and their rate on fixed-period shares to 7¾ per cent, while the interest rate on tax-free building society shares was raised from 6 to 6½ per cent and the maximum permissible amount of investments in such shares was increased from R6,660 to R10,000 in August 1969.

In order to prevent the rising costs of funds to the banks and building societies from being reflected in higher bank lending and building society mortgage rates, the Reserve Bank on various occasions requested the banks and building societies to maintain a maximum rate of 7 per cent on deposits. As a result, margins between the rates on deposits of short-, medium- and long-term original maturities tended to narrow. Thus, whereas the margin between rates on six- and twelve-months' deposits at commercial banks was between 1 and 1¼ per cent in June 1969, this difference had decreased to between ½ and 1 per cent in July 1970.

On the 12th August 1970 the Reserve Bank decided to release the banking institutions and building societies from their undertaking to maintain a maximum of 7 per cent per annum on deposits.

Government finance

Exchequer's deficit financed partly by bank credit

As was pointed out earlier, one of the causes of the increase in money and near-money during the twelve months ended June 1970 was an increase of R167 million in the net claims of the monetary banking sector on the government sector including non-Exchequer accounts and bodies. This development was also reflected in the Exchequer Account, which showed an increase of R90 million in the Exchequer's net indebtedness to the monetary banking sector during the year ended June 1970, as the accompanying table shows. This increase forms a marked contrast to the decline of R204 million during the preceding twelve months and represents a reversal of the negative influence on the quantity of money and near-money exerted by the Exchequer during the preceding three years.

The main reason for the deterioration in Exchequer finance during the year ended June 1970 was the substantial reduction in the contribution of the private non-bank sector. Thus, the Exchequer reduced its net indebtedness to the private non-bank sector by R12 million, as against an increase of no less than R314 million during the year ended June 1969. All components of government borrowing from the private non-bank sector declined during the past year. Investments in government stock by this sector, which brought in a net amount of R198 million in 1968/69, declined by R22 million during 1969/70, and the net proceeds of tax bonds and tax-free Treasury bonds changed from an increase of R44 million in 1968/69 to a decline of R11 million in 1969/70. Loan levies provided only

R20 million during the past year, compared with R78 million during the preceding year. The decline in the proceeds of the loan levies was due to the consolidation of company loan levies into company tax and the reduction from 15 per cent to 5 per cent in the 1969/70 Budget of the rate paid by individuals.

The decrease in investments in government stock may be ascribed partly to substantially reduced support from unit trusts, pension funds and insurers and partly to the general shortage of capital and the resultant rises in interest rates with which the public sector found it difficult to compete. Although the yield on long-term government stock was raised from 6½ to 7 per cent on 26th May 1970, the latest issue during July revealed that even at the higher rate government borrowing met with limited success. Unit trusts reduced their holdings of government stock by R24 million during the year ended June 1970, compared with an increase of R77 million during the preceding year, as a result of a decline in the market value of their portfolios and certain concessions granted to them by the government with regard to their legally required holdings of government stock. The net investment by insurers and pension funds in government stock also declined substantially and was about R40 million less during the year ended June 1970 than during the preceding year. This was due mainly to the fact that these institutions had more or less complied with the higher statutory investment requirements introduced in 1966 and could therefore confine their investment in government stock at the existing interest rates to the amounts legally required in terms of the growth of their assets and liabilities.

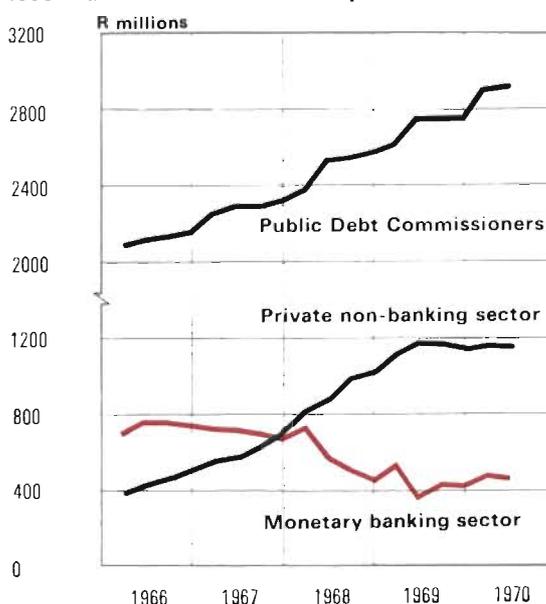
Exchequer finance

R millions

	July to June	
	1968/69	1969/70
Total net issues	2,088	2,529
Total net receipts	1,755	2,206
Total deficit (excluding borrowing)	333	324
Financing:		
Change in net indebtedness to:		
Foreign sector	16	71
Private non-bank sector	314	-12
Public Debt Commissioners	208	175
Sub-total	538	234
Monetary banking sector:		
Change in holdings of government securities	33	-42
Change in Exchequer balance*	-237	132
Sub-total	-204	90
Total financing	333	324

*After adjustment for transfers to the Stabilization Account and to the I.M.F. Deposit Account in respect of super gold tranche drawings. Increase—, decrease+.

Net indebtedness of Exchequer to



In addition to the above factors which contributed to the deterioration in the Exchequer's financing, the Public Dept Commissioners, as one of the Exchequer's major sources of funds, contributed R33 million less in 1969/70. This was due mainly to withdrawals of funds by the Defence Department.

As a result of the unsatisfactory developments in the Exchequer's domestic borrowing, it had to rely to a much greater extent on foreign borrowing than a year ago. Thus, the Exchequer's net indebtedness to the foreign sector increased by R71 million in 1969/70, compared with an increase of only R16 million during the preceding year. However, the overall deficit was R10 million less during the year ended June 1970 than during the preceding year as a result of high customs and excise and income tax receipts.

The 1970/71 Budget

When presenting his 1970/71 Budget to Parliament on 12th August 1970, the Minister of Finance gave a brief survey of economic conditions in South Africa. It was evident that the economy was essentially sound and still showed the remarkable vitality which had characterised it for most of the past decade. As in any rapidly growing economy, however, certain strains had developed, certain imbalances had to be corrected and certain sectors of the economy required particular attention. In this regard, the Minister mentioned the following problem areas to which attention had to be given: (1) Consumption had increased too rapidly and, conversely, saving too slowly; (2) There had been an imbalance in the growth of fixed investment in the sense that investment in buildings and construction received particular attention, while investment in manufacturing lagged behind; (3) The deficit on the current account of the balance of payments reached undue proportions with imports rising very rapidly and exports experiencing difficulty to increase; (4) Stresses and strains were apparent in the monetary and banking system as evidenced, *inter alia*, by the upward pressure on interest rates and increased activity in the so-called grey market; (5) The drought caused concern for the agricultural sector in certain areas; (6) The government was compelled, due to its less successful borrowing operations, to finance its deficit in an inflationary manner during the year ended June 1970; (7) The threat of inflation, which was intimately connected with many of the other problems mentioned, was very real, and the Minister stated that an increase in prices, such as had been experienced during the past year, was not satisfactory for a country in South Africa's position.

With these problems in mind, the Minister, *inter alia*, imposed a sales duty on products such as cameras, photographic equipment, and office printing, calculating and statistical machines, which were earlier exempted from sales duty for reasons connected with tariff negotiations. Most of the products previously subject to a duty of 20 per cent, mainly luxury

items, would in future also be subject to a duty of 25 per cent. The excise duty on certain motor cars was also raised and an additional 5 per cent sales duty imposed on cars with a value, for sales duty purposes, of R2,050 (representing a retail value of about R3,000) and higher.

In an endeavour to increase savings and as a measure to finance the shortfall on the Loan Account, the Minister mentioned a new savings scheme through the issue of Treasury bonds. The present 5 per cent loan levy paid by individuals would be raised to 10 per cent of normal tax, while a 2½ per cent loan levy was imposed on companies other than gold and diamond mines.

In order to improve exports, the Minister increased the existing allowance granted in respect of expenditure incurred in the development of export markets and, with a view to encouraging fixed investment in manufacturing, allowed manufacturers to deduct 15 per cent of the cost of new machinery and plant and 10 per cent of the cost of new factory buildings or additions thereto from taxable income. The allowances would apply to machinery, plant and buildings brought into use up to 30th June 1973. The Minister also announced concessions in respect of donations by companies as well as individuals to universities and other institutions for higher education and proposed increased government financial assistance to these institutions in an endeavour to alleviate the skilled manpower shortage.

Simultaneously with the Budget, the South African Reserve Bank announced that, after the usual consultation with the Treasury, it had been decided to release the banks and building societies of their undertaking to maintain a maximum interest rate of 7 per cent per year on deposits. At the same time, the yield on long-term government stock quoted by the Reserve Bank for maturities of 20 years and longer would be raised from 7 to 7¼ per cent. In his speech the Minister mentioned that certain vulnerable sections of the community should be cushioned against the effects of higher interest rates. It had, therefore, been decided to subsidise interest rates on mortgage bonds on farm property to a maximum of 1½ per cent but only to the extent necessary to reduce the interest rate after the subsidy to 7½ per cent. Similarly, a subsidy would be paid on mortgage loans granted by financial institutions to individuals for the purchase, erection or improvement of dwellings for normal occupation by borrowers. The latter subsidy would only be paid on the difference between the interest rate paid and the present rate of 8½ per cent subject to a maximum of 1 per cent and would cover mortgage loans not exceeding R12,000 where the value of the relevant property does not exceed R16,000. Subsidies amounting to 25 per cent of the cost of financing exports, would also be made available to manufacturing industries.

The tabled estimates of expenditure from Revenue Account for 1970/71 totalled R1,858 million, an increase of about 10 per cent, compared with the previous year. It was

expected that the Revenue Account would, after taking into account the Minister's various proposals, close the financial year with a surplus of about R103 million. Expenditure from Loan Account was estimated at R718 million, representing an increase of 9 per cent compared with 1969/70. Total loan requirements, i.e. including repayments of loans of R540 million, therefore amounted to R1,258 million. The Loan Account was expected to close the 1970/71 fiscal year with a deficit of R95 million which would be met from the surplus on Revenue Account, leaving an overall surplus of R8 million on the two accounts together. It was therefore expected that government operations would be financed in a non-inflationary manner. An amount of R193 million was expected to be received from loan recoveries, R200 million from the Public Debt Commissioners, R49 million from loan levies, R41 million from other non-marketable debt while external loans (including renewals of existing loans amounting to R63 million) were estimated at R163 million and internal borrowing through stock issues (including conversions of R437 million) at R517 million.

Changed conditions in the capital market

During the year ended June 1970, conditions in the capital market differed materially from those in the preceding year, the flow of funds in the market changed direction, and interest rate relationships were affected. Until May 1969 both the equity and property markets were exceptionally buoyant and most of the funds flowed to these markets in preference to fixed-interest investment outlets. Adequate support was given, however, to issues of fixed-interest securities owing to a steady institutional demand for these securities and expectations that the yields might decline in future. The adverse effects of investors' preferences for equity and property investments were felt mainly by building societies and banks which experienced a reduced inflow of funds.

After May 1969, when equity prices declined sharply, a reversal of the flow of funds occurred as the general public withdrew from the equity market (including unit trusts) in favour of deposits and shares with building societies and banks. The fixed property market remained very active, however, and continued to be favoured by investors such as insurers and pension funds seeking investment outlets with prospects of capital appreciation. The market for fixed-interest securities, in particular that for gilt-edged and semi-gilt-edged securities, which is highly dependent on support from institutional investors, did therefore not benefit much from the change in the general public's investment preferences. In fact, the attractiveness of fixed property investment, and even equities with their higher yields as a result of the decline in share prices, and the fact that a significant further investment in those securities ranking legally as prescribed or approved assets became unnecessary, resulted in a considerable tightening of the market for gilt-edged and semi-gilt-edged securities and strong upward pressure was exerted on interest rates. Under these circumstances several upward adjustments were made to interest rates quoted on these securities and expectations of further increases kept the demand for these securities limited.

Depressed conditions in the equity market

After the extraordinary upsurge in share prices from the last quarter of 1967 to the middle of May 1969, the prices of all classes of shares showed a sharp and almost uninterrupted downward movement up to the end of the period under review. Gold mining share prices increased moderately during the period February to May 1970, but nevertheless declined by 28 per cent from May 1969 to June 1970. Over the same period declines in the prices of mining financial and industrial financial shares amounted to 46 and 50 per cent, respectively, while the prices of industrial and commercial shares declined by 46 per cent. These declines brought the prices of financial, industrial and commercial shares roughly to the same level as in the first quarter of 1968, and those of gold

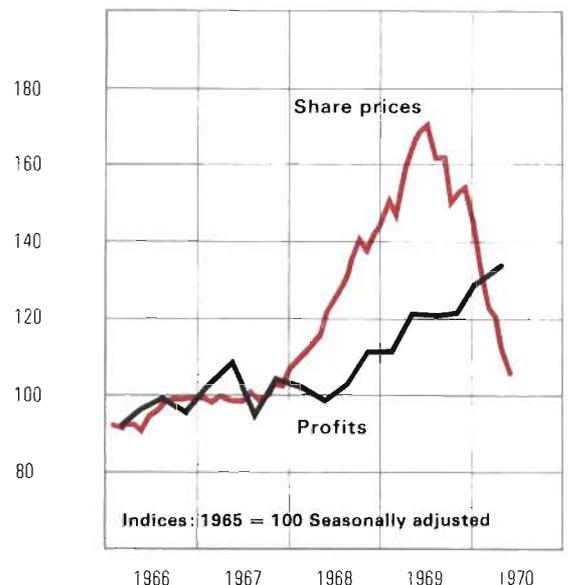
mining shares to the level at the beginning of the fourth quarter of 1967. The decline in share prices was accompanied by a decline in stock exchange turnover which fell from a peak in the second quarter of 1969 to well below the average level for 1968.

The magnitude of the unrealistic increase in share prices after the end of 1967, and the extent of the reaction that has set in since May 1969, may be judged by comparing the movements of the profits and share prices of industrial companies. During the period from 1965 to the last quarter of 1967 these two variables, which under normal circumstances should be closely related, moved in conformity with each other. However, when the Sterling devaluation triggered off the upsurge in share prices, profits were left far behind. After the reaction on the Stock Exchange in May 1969, the trends in profits and share prices converged again and actually crossed, so that the index of profits was higher than that of share prices. Under normal circumstances they may be expected to move in closer conformity.

The decline in share prices naturally resulted in noticeable increases in share yields. Compared with 3.4 per cent in May 1969, the average yield on industrial and commercial shares rose to 5.7 per cent in June 1970, the highest level in almost four years. The average yield on gold mining shares increased from 5.7 to 9.9 per cent over the same period.

The boom period on the stock exchange prior to May 1969 was accompanied by a spate of new share issues, which indeed continued up to December 1969, notwithstanding the fact that conditions for raising capital became progressively less attractive

Profits and share prices of industrial companies



after May. Issues between May and December 1969 probably represented a completion of issues planned during the period of rising share prices, as new issues fell to a very low level from December 1969 to June 1970.

From the second quarter of 1968 to the end of 1969 over R700 million was raised by means of new share issues. A break-down of this amount shows that about R50 million was raised by mining companies, R280 million by financial companies including banks and insurance companies but excluding property development companies, R125 million by property development companies, and about R260 million by industrial and commercial companies. If it is accepted that at least a part of the new issues of financial companies was eventually used by industrial and commercial companies, then the latter sector in fact obtained quite a large portion of the new capital raised and the sluggishness of their fixed investment during that period could apparently not be ascribed to their inability to raise capital.

Large outflow of funds experienced by unit trusts

Reflecting the general change of mood on the stock exchange, the flow of funds to unit trusts changed dramatically during the year ended June 1970. Whereas net sales of units reached the exceptionally high figure of R532 million during 1968/69, units amounting to R74 million were repurchased during the subsequent twelve months.

The outflow of funds, together with the substantial decline in share prices, reduced the market value of the trusts' net assets from R850 million at the end of June 1969 to R414 million at the end of June 1970. This decline had important implications for the market for gilt- and semi-gilt-edged securities as it reduced the amount that the trusts were legally required to invest in approved securities. Accordingly, the trusts sold government, municipal and public corporation stock amounting to R40 million during 1969/70, compared with a net investment of R125 million during the preceding twelve months. At the end of June 1970, the trusts' excess holdings of approved securities still amounted to R51 million, of which R35 million represented excess holdings of government stock.

Sales of approved securities were aimed at supplementing the cash resources of the trusts in order to meet possible repurchases of units. The trusts' cash and deposit holdings indeed declined from R186 million at the end of June 1969 to R52 million at the end of June 1970. The decline in the cash reserves of the trusts in the face of increasing repurchases of units led to a number of concessions by the Minister of Finance. In November 1969 the Government undertook to buy from the trusts government stock held in excess of the statutory minimum, if the cash reserves of a trust had to be supplemented for the purpose of repurchasing units. Further concessions were announced on 18th March 1970 in terms of which the statutory

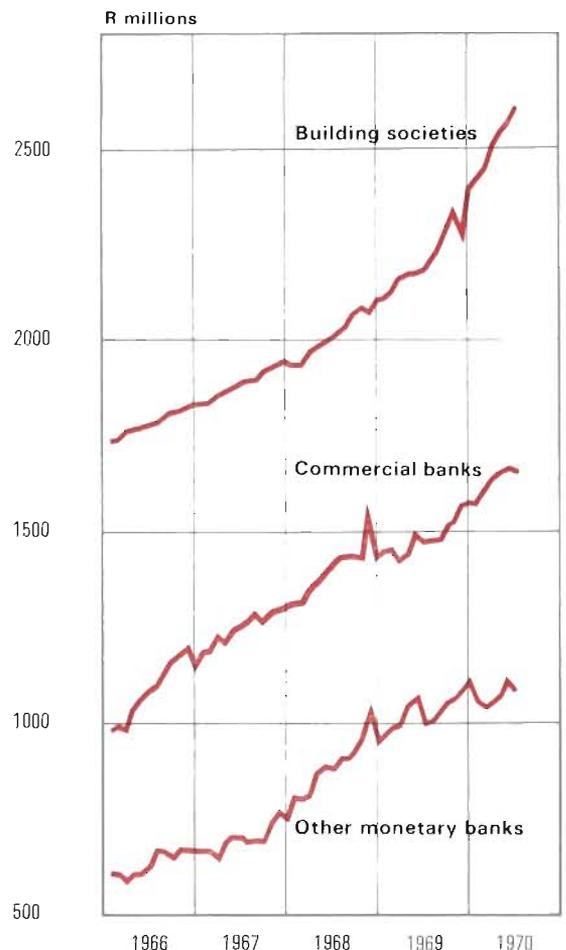
minimum investment in government stock, namely 7½ per cent of the market value of a trust's portfolio, would be suspended in certain circumstances. In addition, a management company of a trust would, if necessary, be required to build up its investment in the units of its trust to a minimum of 10 per cent of the market value of the trust's portfolio.

The index (June 1965 = 100) of selling prices of units, which is based on the market value of the trusts' net assets, declined from 282 in June 1969 to 152 in June 1970. During the corresponding period the average yield on units doubled from 1.5 to 3.0 per cent.

Record inflow of funds to building societies

The reversal of the flow of funds to the unit trusts and to the equity market in general proved to be advantageous to the building societies, which experienced a record inflow of funds of R422 million during the year ended June 1970. This was more than double the previous record amount of R203 million recorded during 1968/69. Fixed and savings deposits accounted for R137 million and R95

Interest bearing deposits and building society shares



million, respectively, of this increase in resources, while share capital contributed R190 million. Net issues of tax-free shares amounted to R84 million and an amount of R99 million was raised through net issues of a new type fixed-term paid-up share. These shares became a popular investment outlet after the rate had been raised to 7¼ per cent, fixed for the whole investment period of at least five years, or ¾ per cent above the rate for indefinite period paid-up shares, in August 1969. However, the societies discontinued issuing these shares as from 13th May 1970 in accordance with an agreement with the Reserve Bank to maintain a maximum rate of 7 per cent on shares and on deposits.

The exceptional increase in their resources provided the societies with considerable scope to expand their lending activities. New mortgage loans granted during the year ended June 1970 amounted to R725 million, compared with R475 million during 1968/69, and the societies' commitments in respect of loans granted, but not yet paid out, increased by R117 million over the relevant period to a level of R229 million at the end of June 1970. The actual amount of mortgage and other loans outstanding increased by R275 million (or 14 per cent) during 1969/70, against R220 million (or 12 per cent) during the preceding twelve months. At the same time, the societies increased their holdings of liquid assets and other prescribed investments by R135 million during the period under review, and this investment raised their excess holdings above the statutory minimum to R166 million at the end of June 1970.

Of the amount invested in liquid assets and other prescribed investments during 1969/70, only R5 million was in the form of government, municipal and public corporation stock. Instead, the societies preferred to increase their cash and deposit holdings by an amount of R130 million, a substantial part of which represented an investment in negotiable certificates of deposit.

Notwithstanding the very large increase in resources and the high level of lending, it would appear that the societies were still unable to satisfy the demand for housing loans. Rising prices of fixed property and higher construction costs gave rise to an increase in the average amount of individual housing loans and thus restricted the number of applications for housing loans that could be satisfied. Thus, there was still an inducement for the societies to keep up their competition for the available funds, but their inability to compete was limited, *inter alia*, by the Reserve Bank's request that the societies and other deposit receiving institutions should maintain rates at a maximum of 7 per cent.

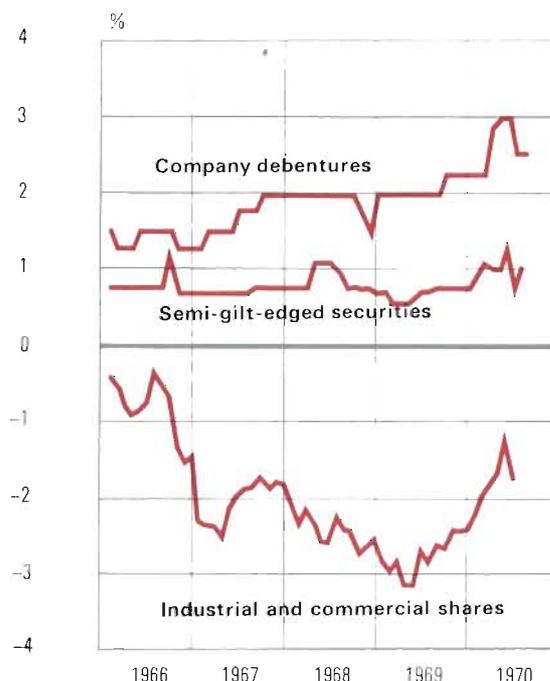
Tightening of the market for fixed-interest securities

Conditions in the market for fixed-interest securities tightened considerably during the year ended June 1970. This change was reflected in increased yields on new issues of long-term stock and debentures and also in the

inability of a number of borrowers to raise all the funds they wanted to borrow. The yield on new issues of long-term municipal and public corporation stock consequently increased at various stages during the period under review from a level of about 7.1 per cent to 8.0 per cent. At the same time the yield on most new issues of company debentures increased by roughly the same extent, namely from 8½ to 9½ per cent. The upward pressure on long-term yields was officially recognised when the Reserve Bank, after the usual consultation with the Treasury, raised the rate quoted for transactions in government stock with a maturity of 15 years and longer from 6½ to 7 per cent with effect from 26th May 1970. On 12th August the Bank announced a further upward adjustment to 7¾ per cent in the rate quoted for government securities with a maturity of 20 years and longer.

Various factors contributed to the tightening in the market for fixed-interest securities. Firstly, the decline in share prices led to reduced margins between equity yields and yields on fixed-interest investments, with the result that the inducement to switch to fixed-interest securities was diminished. A comparison of the yields on industrial and commercial shares and long-term government stock shows that the reverse yield gap

Yield gaps*



*The three yield gaps shown on the graph represent the differences between the yield on long-term government stock and the yield on company debentures, semi-gilt-edged securities and industrial and commercial shares, respectively. The latter is negative and therefore referred to as the reverse yield gap

narrowed from 3.1 per cent in May 1969 to 2.0 per cent in April 1970. Notwithstanding the increase in the yield on government stock in May 1970, the reverse yield gap was reduced even further to 1.3 per cent in June, on account of the sustained decline in share prices and the increase in company dividends. Other important yield gaps also changed during the year. Increases in the yields on semi-gilt-edged securities, prior to the adjustment of the yield on government stock, led to an increase in the gap between these two yields from 0.6 per cent in the middle of last year to 1.2 per cent in April 1970. This gap then declined to 0.7 per cent in May, but increased again to 1.0 per cent in June. The gap between yields on company debentures and long-term government stock increased from 2 per cent in the middle of 1969 to 3 per cent before the increase in the yield on government stock in May. The latter increase reduced the gap again to 2½ per cent.

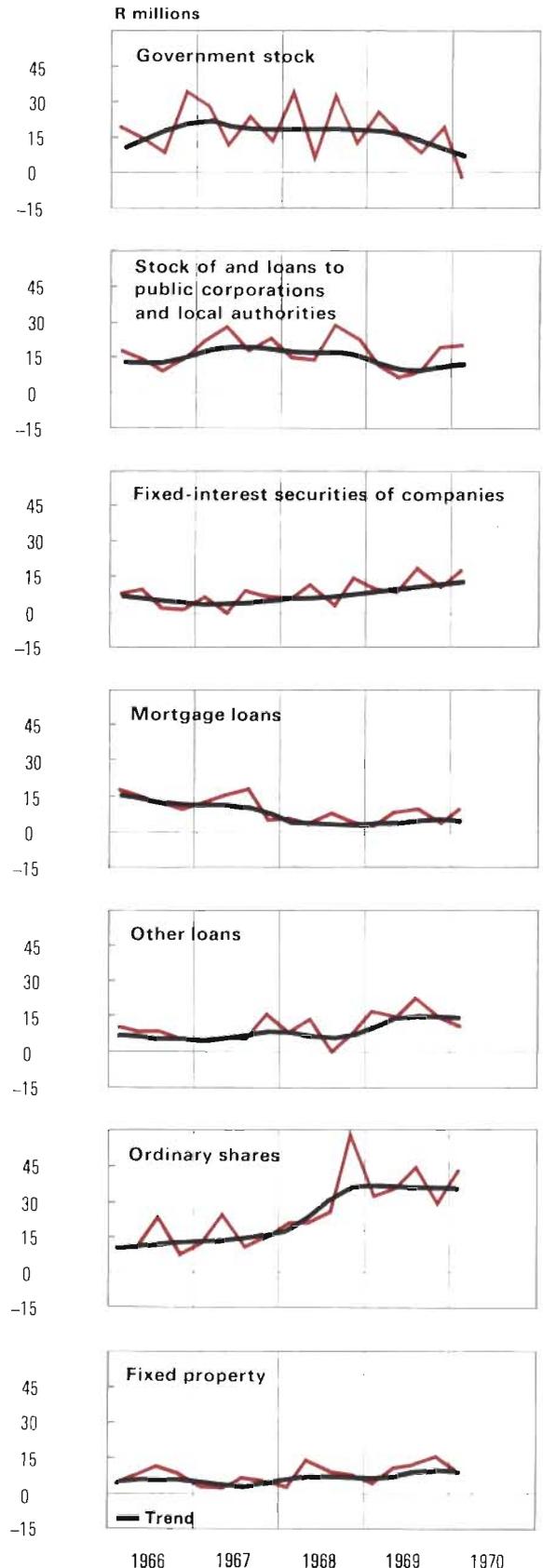
Apart from the changes in the yield gaps that may induce investors to shift their funds to particular fields of investment, a second factor which aggravated the tightening in the market for fixed-interest-bearing securities was the attractiveness of the property market, where prospects of capital appreciation and a high investment income were very good. A further factor was the change in the demand for gilt-edged and semi-gilt-edged securities by building societies, unit trusts, insurers and pension funds. During the year under review the demand for gilt- and semi-gilt-edged securities by institutions outside the monetary banking sector declined sharply. The net investment in government, municipal and public corporation stock by insurers, private pension funds, unit trusts and building societies amounted to about R40 million, compared with more than R260 million during 1968/69. The main reason for this change was that the unit trusts became net sellers of these securities during 1969/70, whereas they invested heavily during the preceding twelve months. In addition, most insurers and pension funds had already complied with the changed investment requirements introduced in 1966 and accordingly invested less in the relevant securities which rank as prescribed assets. Furthermore, as upward pressure on interest rates developed and actual adjustments were made, the expectations of further upward movements became stronger and this reduced the willingness of institutional and other investors to invest in fixed-interest securities. The investment policies of the institutional investors thus contributed to the tightening of conditions in the market for fixed-interest securities and their investment portfolios are accordingly reviewed below.

Insurers and private pension funds

During the twelve months ended 31st March 1970 the emphasis in the investment policy of insurers and private pension funds continued to fall on investments in equities and fixed property. Net investments in ordinary shares and

Insurers and private pension funds

Changes in holdings of



units of unit trusts amounted to R150 million and exceeded the relatively high figure of R134 million recorded during the preceding twelve months. Similarly, investments in fixed property increased by a record amount of R43 million, compared with R31 million during the previous year. Long-term insurers, in particular, were large investors in equities and increased their holdings appreciably during the first quarter of 1970. However, of the increase of R35 million in their equity holdings during this quarter, R14 million represented an investment in units of unit trusts. The latter increase was substantially above the average of less than R2 million for the preceding three quarters and it indicates that the long-term insurers contributed to stabilising conditions experienced by the unit trust movement during the first quarter of 1970.

As far as fixed-interest investments are concerned, the institutions showed a distinct preference for higher yielding company debentures, preference shares and direct loans. Their holdings of fixed-interest company securities and direct loans to the private sector increased by R51 million and R59 million, respectively, during the twelve months April 1969 to March 1970, compared with increases of R32 million and R33 million, respectively, during the previous year. Net investments in government, municipal and public corporation stock, and in loans to local authorities and public corporations amounted to R92 million during the period under review, but were considerably less than the R150 million invested during the previous year, when a larger investment was called for under the statutory investment requirements.

Pension funds increased their investment in mortgages by R22 million during the year ended March 1970, which was well above the figure for the comparable 1968/69 period. Long-term insurers, however, did not show any interest in the mortgage market, obviously preferring to invest directly in fixed property. As was the case in the preceding twelve months, insurers and pension funds maintained a high level of liquidity and their cash and deposit holdings increased by R43 million to R260 million during the year ended March 1970.