South African Reserve Bank

1971

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 Fifty-first Ordinary General Meeting to be held on 24th August 1971.

Hierdie Verslag is ook in Afrikaans beskikbaar.

Contents

General observations

After attaining an exceptionally high growth rate in the year ended June 1970, the South African economy slowed down during the year ended June 1971 and showed a more moderate rate of growth. This was reflected in a change from an increase of about 12 per cent in the gross domestic product at current prices in 1969/70 to a rise of 9 per cent in 1970/71. Reduced contributions by the primary sectors mining and agriculture were mainly responsible for this decline. The lower rate of growth was not unexpected as the economy had already been virtually fully extended during 1969/70 when considerable pressure was exerted on the factors of production, particularly on the supply of certain types of labour and capital. Apart from limitations imposed on the growth rate by natural factors in an economy operating close to full capacity, the authorities applied measures to curtail excessive monetary demand and this inevitably contributed to the reduced rate of increase in economic activity.

Notwithstanding a decline in the rate of increase of gross domestic expenditure, a large imbalance still existed between the domestic demand for and supply of goods and services. This excess demand situation was accompanied by pressure on the available capital and labour supply, on prices and on the balance of payments. Pressure on resources, in turn, was reflected in higher interest rates, a substantial increase in labour costs and a large deficit on the current account of the balance of payments. The rate of increase of prices remained relatively constant during the second half of 1970 and the first quarter of 1971 and then increased substantially further during the second quarter of 1971. This acceleration was mainly the result of higher sales duties and other indirect taxes and the concentration in this particular quarter of periodic upward adjustments to the prices of certain goods and services provided by the government and prices controlled by the government. In addition to these special factors, upward adjustments were also made to the salary and wage scales of public authorities. In view of the above-mentioned price adjustments, and the rise in the price level in general, the gross domestic product at constant prices increased by about 4 per cent in 1970/71.

The strong monetary demand which caused the imbalance between the domestic demand for and supply of goods and services stemmed from all the major components of gross domestic expenditure, namely private and government consumption expenditure, capital outlays by the private sector and public authorities, and inventory accumulation. Excessive spending by the public authorities and the private sector on consumption goods and on capital projects of a less productive nature may be singled out as major contributors to the imbalance in the economy. A gratifying development was the marked increase in fixed investment by the private manufacturing sector resulting in a more balanced distribution of capital expenditure among different sectors and types of assets.

Although the economy still experienced inflationary pressures there were definite signs that the situation improved in 1971, particularly during the second quarter. Total monetary demand not only ceased to increase faster than the production of goods and services, but actually increased at a lower rate than production during the second quarter of 1971. The adjustment process has thus started and a considerable improvement was also noticeable in the current account of the balance of payments. With a sustained substantial capital inflow, the large deficit on the current account was not fully reflected in the movements of the gold and foreign reserves which are still at a comfortable level. Taking into account the relatively high level of inventories and the fact that consumption expenditure, particularly in real terms and on durable goods, has shown a levelling-of tendency, the adjustment process is likely to continue under present circumstances.

The substantial decline in the gold and foreign reserves and the restrictive credit measures of the authorities, which limited the increase in bank credit, led to tighter money and banking conditions, with the Reserve Bank in firmer control of the situation. The liquidity of private enterprises and individuals increased considerably less during the past year than during each of the preceding three years and the excess liquidity of the banking sector was on average on a lower level than before. Under these tighter money market conditions, short-term interest rates moved upwards to high levels before tending to ease during the second quarter of 1971. The central government was not able to finance its entire deficit from sources outside the banking sector, and this resulted in the drawing down of its deposits with the Reserve Bank and consequently in a marked acceleration in the private sector's liquidity during the first half of 1971. Under these circumstances, the authorities continued to follow a restrictive monetary policy and adjusted official interest rates to market tendencies during the year under review.

Although the demand for funds in the capital market still exceeded the supply and interest rates consequently moved upwards, more normal conditions prevailed in the equity and fixed property markets and a slight easing was noticeable in the fixed-interest security market during the second quarter of 1971. Building societies, however, experienced a smaller inflow of funds during the second quarter of 1971. This followed upon an exceptionally large inflow during 1970.

National accounts and other economic indicators

Lower economic growth rate

After increasing at the exceptionally high rate of about 12 per cent during 1969/70, the gross domestic product at current market prices rose further by about 9 per cent during the year ended June 1971. Poor performances by the primary sectors of the economy, namely agriculture and more particularly mining, were responsible for the lower growth rate attained during the past year. The decline in wool prices and sales during the fourth quarter of 1970 and the first quarter of 1971, neutralised the increase in maize output during the second quarter of 1971, while weaker markets for diamonds, platinum and copper caused the value added by the mining sector to show an actual decline. The secondary and tertiary sectors of the economy did not grow fast enough to compensate for the poor performance of the primary sectors, with the result that the total gross domestic product increased significantly less than a year before. If the value added by the primary sectors is excluded, the growth rate of the rest of the economy declined only marginally from nearly 13 per cent in 1969/70 to slightly more than 12 per cent in 1970/71.

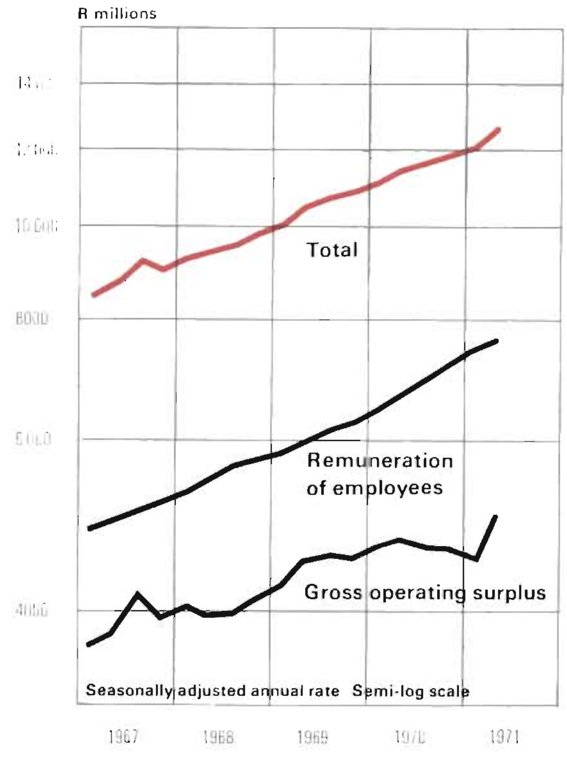
It is also significant to note that the rate of increase in the value added by the manufacturing sector, the sector "finance, insurance, real estate and business services" and the sector "community, social and personal services" accelerated during the year under review.

In real terms, i.e. if price rises are excluded, the gross domestic product increased by about 4 per cent during the year ended June 1971, compared with approximately 7 per cent during the preceding year. If the value added by the primary sectors is excluded, the real growth rate of the rest of the economy was just more than 4 per cent during 1970/71.

Nearly the entire growth of the gross domestic product during 1970/71 stemmed from higher remuneration of employees, which rose by almost 15 per cent, while gross operating surplus (profits, provision for depreciation and net interest payments) showed only a small increase. Moreover, this was the fourth consecutive year in which remuneration of employees increased at a progressively faster rate and it was brought to a level in 1970/71 representing 61 per cent of gross domestic product, compared with an annual average ratio of less than 57 per cent during the preceding ten years. During 1970/71 salary and wage increases by public authorities, including the S.A. Railways and Post Office, and by the manufacturing sector were mainly responsible for the sharp increase in remuneration of employees.

Quarterly estimates of gross domestic product show that, after increasing at about the same relatively low rate during the second half of 1970 and the first quarter of 1971, total gross domestic product increased markedly during the second quarter of 1971, mainly as a result of a larger gross operating surplus in the sectors agriculture, non-gold mining and transport, storage and communication. This development was related to the good maize crop, improvements in the profits of diamond and other non-gold mining companies and the higher railway and postal rates.

Gross domestic product

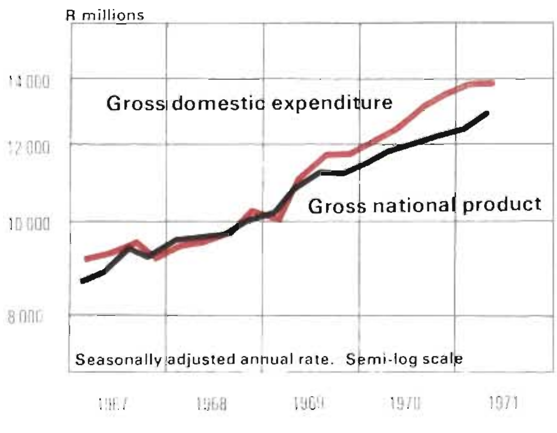


High level of domestic expenditure, but lower rate of increase

Although gross domestic expenditure showed a further substantial increase of more than 13 per cent during 1970/71, it rose by appreciably less than the 17 per cent in 1969/70. Despite the lower rate of increase, gross domestic expenditure still exceeded gross national product as was reflected in a record deficit on the current account of the balance of payments. Additions to inventories contributed much to the overspending during the past two years, but during 1970/71 the sum of the other components of domestic expenditure, namely private and government consumption expenditure and gross fixed investment by both the private and public sectors, also exceeded gross national product. Outlays on these components showed progressively larger percentage increases during the past four years and reached rates of between 12 and 13 per cent during the past two years from which it is clear that the country is living beyond its means.

According to the quarterly national accounts estimates, the efforts of the authorities to restore a better balance between the domestic supply of and demand for goods and services have already shown signs of success. Gross domestic expenditure, which rose faster than gross national product during the second half of 1970, increased at about the same rate during the first quarter of 1971 but at a lower rate than gross national product during the second quarter. This represents a significant change in trend and was reflected in a substantially smaller deficit on the current account of the balance of payments during the second quarter of 1971.

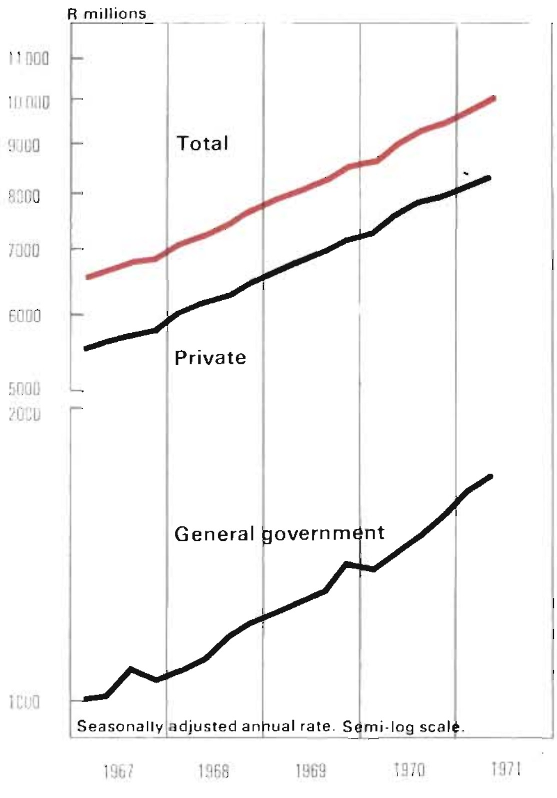
Gross national product and domestic expenditure



Pronounced further increase in consumption expenditure

Both private and government consumption expenditure rose at excessively high rates during the past number of years and contributed materially to the overspending and the resultant imbalance between the domestic demand for and supply of goods and services. Private consumption expenditure, which is by far the largest component of gross domestic expenditure, rose by about 11 per cent during each of the past three years, while government consumption expenditure increased by about 17 per cent during 1970/71, following upon increases of between 12 and 13 per cent during each of the preceding two years. This brought the average annual rate of increase in government consumption expenditure during the past 10 years to more than 12 per cent and this increased its relative share in the gross domestic product from 9 per cent in 1960/61 to more than 12 per cent in 1970/71. The rate of increase in government consumption expenditure during 1970/71 was, except for 1965/66, the highest increase in ten years, and stemmed mainly from upward adjustments to salary and wage scales.

Consumption expenditure



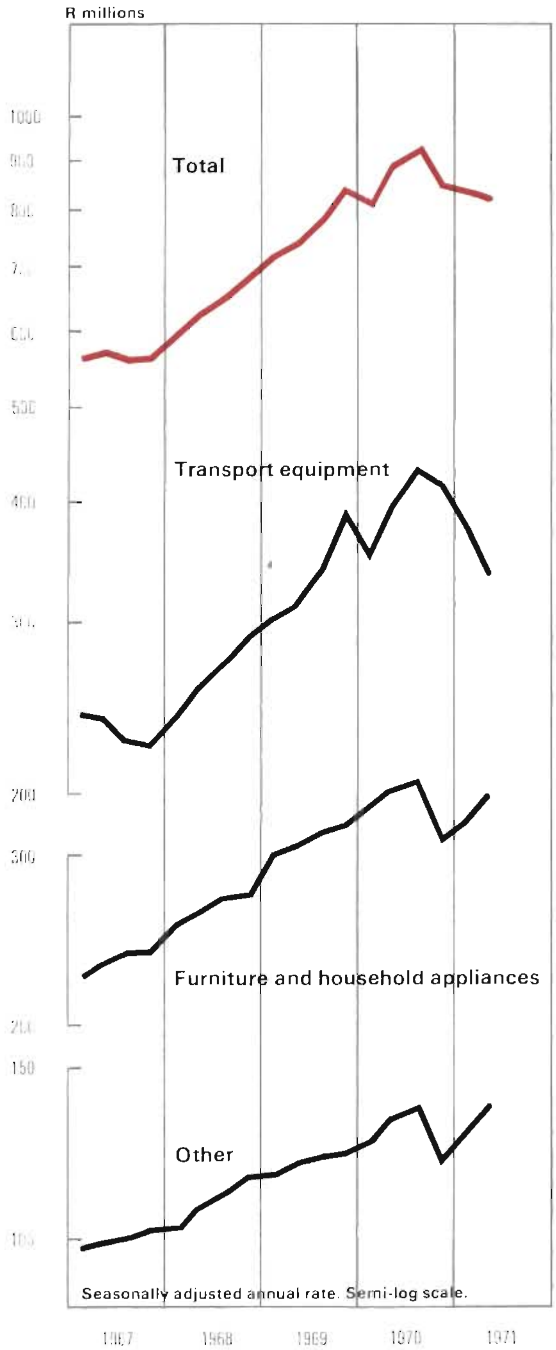
Private consumption expenditure, in turn, rose faster than disposable personal income during each of the past three years and thus brought the ratio of private consumption to disposable personal income up to more than 91 per cent, as against an annual average of 88 per cent during the past decade. The extensive use of consumer credit played an important role in facilitating consumer spending and at the same time reduced personal saving as such credit represents negative saving. According to estimates, consumer credit increased from about R1 025 million at the end of 1967 to about R1 400 million at the end of 1970, i.e. by R375 million or at an average annual rate of about 11 per cent. Other factors contributing to the high rate of consumer spending, were the substantial increases in salaries and wages and, therefore, in disposable personal income, and the general inflation psychosis which led the public to spend rather than save.

In an endeavour to curb the excessive rise in consumer spending, the authorities increased personal income tax to reduce disposable personal income, increased sales duties and other indirect taxes to discourage spending through higher prices, restricted hire-purchase and other types of consumer credit to reduce negative saving, increased loan levies and raised official interest rates and allowed other interest rates in general to rise in order to encourage saving. Although the rate of increase in private consumption expenditure was still very high in 1970/71, a considerable measure of success in curbing the rapid rise is evident from the movements in the quarterly estimates of expenditure on the different components of consumption, especially if the substantial increases in prices are excluded.

Part of the rise in private consumption expenditure in money terms during 1970/71 was a reflection of the increase in prices resulting from government policy measures to curb the excessive rise in consumption. Increased indirect taxes, such as sales and excise duties were intended to discourage consumption expenditure (apart from their role as a source of revenue to the government) and should, therefore, not be included in the increase in consumption expenditure at current prices when judging the success of these measures to curtail the rate of increase in spending. It is, therefore, gratifying to observe that in real terms private consumption expenditure increased at a lower rate during the past year than during the preceding year, namely by less than 6 per cent during 1970/71 as against 7 per cent during 1969/70.

Expenditure on durable goods, which showed an excessive increase of between 18 and 19 per cent during 1968/69 and 1969/70, and at which most of the measures to curb consumer spending were directed, rose by only about 2 per cent during the past year. After declining sharply in the fourth quarter of 1970 and recovering again in 1971, expenditure on furniture and household appliances showed a decline of 1 per cent

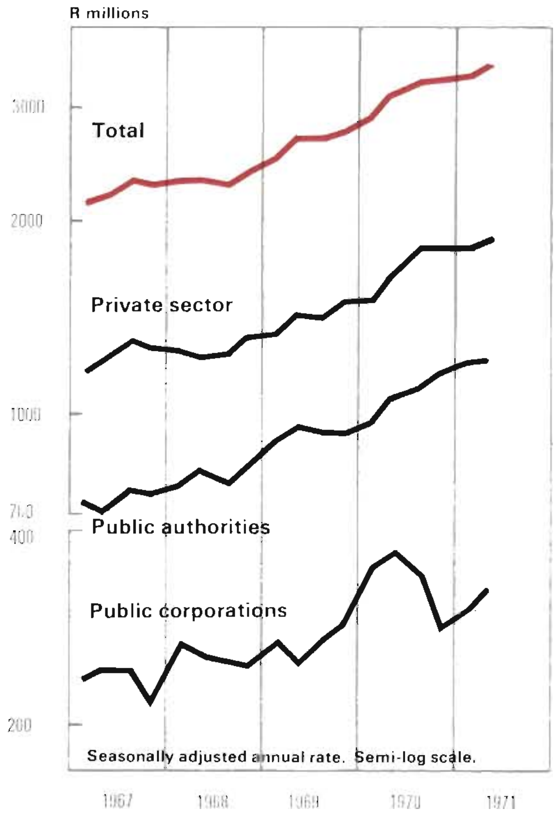
Private consumption expenditure on durable goods



for the year ended June 1971, compared with a rise of almost 16 per cent during the preceding year. Similarly, the rate of increase of consumer expenditure on new motor cars, mini-buses and light commercial vehicles declined from 28 per cent in 1969/70 to 6 per cent in 1970/71.

Outlays on semi-durable goods increased at about the same rate as during the preceding year, namely by 12 per cent, while the rise in expenditure on non-durable goods was about 12 per cent in 1970/71, compared with 8 per cent during the preceding year, mainly as a result of higher prices of food, alcoholic beverages, tobacco and petroleum. Despite the substantial increase in the prices of certain services, such as postal and transport services, the rate of increase of expenditure on services at current prices remained about the same as during the year before, namely about 11 per cent, indicating that in real terms, the demand for services increased at a lower rate.

Gross fixed investment



Further increase in fixed investment

Total gross domestic fixed investment increased by about the same rate during the year ended June 1971 as during 1969/70, namely by about 16 per cent. The main contributors to this increase were public authorities and private enterprises, while capital outlays by public corporations declined slightly as a result of the completion of important capital projects.

Classified according to types of asset, outlays on building and construction rose by about 14 per cent, while expenditure on machinery and transport and other equipment increased by 20 per cent. During the preceding two years, outlays on machinery and equipment rose at a lower rate than investment in building and construction and the change in the allocation of capital investment during the year under review is to be welcomed, because it contributed materially to the creation of additional capacity for the future production of goods.

The sector "transport, storage and communication" showed a larger percentage increase than any of the other eight sectors distinguished according to kind of economic activity. A rise of 30 per cent in the fixed capital outlays by the S.A. Railways was mainly responsible for the increase in fixed investments of this sector and is generally welcomed as adequate transport facilities are essential for the smooth functioning of the economy. Capital outlays by the sector providing community, social and personal services increased by 14 per cent during the year ended June 1971, owing to increases in fixed investment by provincial administrations (17 per cent), local authorities (16 per cent) and the central government (12 per cent). Important contributors to the increase in total fixed investment were the sectors "wholesale, retail, restaurants and hotels" and "finance, insurance, real estate and business services". Expenditure on private residential building, showing an increase of 30 per cent, was mainly responsible for the rise in the latter sector's fixed investment. During the past decade, fixed investment in private residential building has increased at an average annual rate of more than 12 per cent which is higher than the average increase of capital outlays in private manufacturing and, for the last two years, actually exceeded the amount invested in private manufacturing. With the limited capital and other resources available to South Africa, the allocation of a larger portion of our resources to residential building than to the creation of additional production capacity may not be in the interest of future growth and stability.

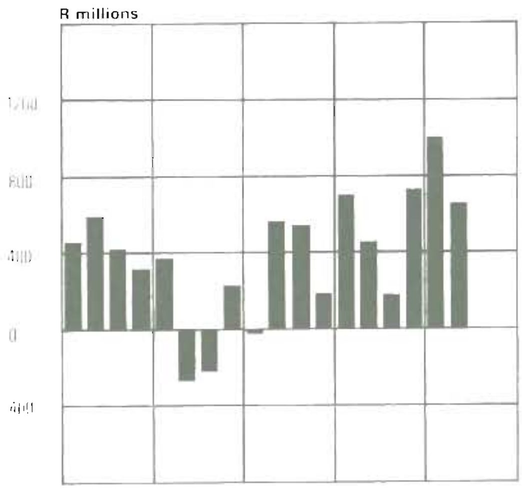
Fixed investment in the manufacturing sector rose by more than 21 per cent during the past year, compared with an increase of 23 per cent during 1969/70. This decline in the rate of increase of investment was due to marked fluctuations in the capital outlays by public corporations, which more than doubled during 1969/70 and then declined in 1970/71 as a result of the completion of certain big projects. Fixed capital investment by private manufacturing concerns showed a welcome revival and, after declines during the three years 1966/67, 1967/68 and 1968/69 and a moderate rise of 5 per cent in 1969/70, increased substantially by nearly 35 per cent during the year ended June 1971. In real terms, this increase still amounted to about 29 per cent, which represents a significant addition to production capacity. Net real fixed investment by private manufacturing concerns, i.e. after provision for depreciation, rose by an even higher percentage.

Quarterly estimates showed that total gross fixed investment continued to rise at a rapid rate until the third quarter of 1970 and then increased at a lower rate during the next three quarters. Capital outlays by the private sector and public corporations were responsible for this lower rate of increase, while fixed investment by public authorities continued to increase at a rapid rate during the first half of 1971. The slow-down in the rate of increase in capital expenditure of the private sector was a reflection of the tendency in fixed capital outlays by private manufacturing concerns. After rising to a high level in the third quarter of 1970, fixed investment in private manufacturing declined moderately during the subsequent two quarters, before increasing again during the second quarter of 1971.

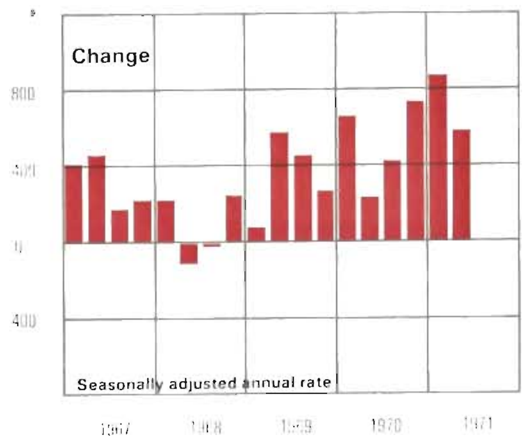
Continued inventory build-up

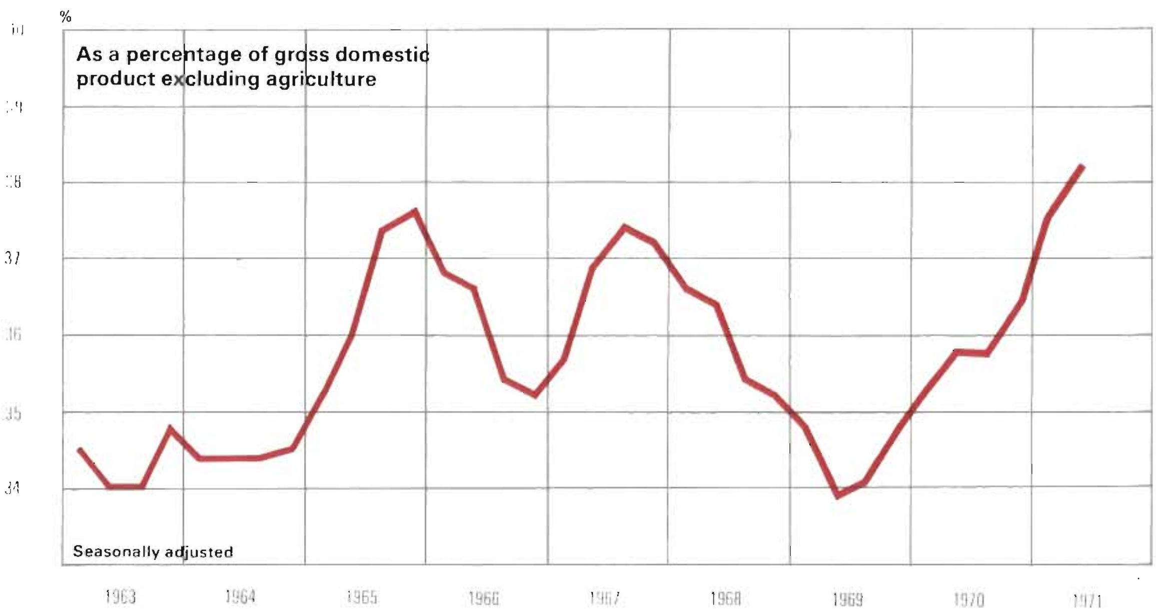
An important feature of economic developments during the past two years was the large and sustained inventory build-up amounting to between R600 and R700 million per year at book value. Although additions to almost all types of inventories occurred, the largest increases were recorded by industrial and commercial stocks which increased by about R400 million in 1969/70 and by about R500 million in 1970/71. Agricultural stocks fluctuated on a quarterly basis but also increased during the past two years.

As a result of the inventory build-up, the total non-agricultural inventories as a percentage of the comparable gross domestic product rose to a very high level in the second quarter of 1971. The ratio increased uninterruptedly from the third quarter of 1969 and was higher in the second quarter of 1971 than at any time since 1958. In 1958, however, the ratio was on a downward trend from the abnormally high figure reached immediately after the second World War, Change in total inventories



Total inventories
excluding agricultural stocks





while, since the early sixties, the trend has flattened out. Although there may be factors, such as the build-up of strategic inventories, which in recent years may have led to an upward shift in the level of inventories, the historical trends suggest that the level of inventories in relation to the gross domestic product cannot be expected to increase much further in the near future. The fact that the actual accumulation during the second quarter of 1971 was significantly lower than during the first quarter, also supports this view.

Low level of domestic saving

In contrast to the substantial increase in total gross domestic investment (i.e. fixed investment and inventory accumulation), gross domestic saving declined by 2 per cent during 1970/71. This was associated with a substantially higher shortfall of domestic funds to finance total investment in 1970/71, namely an amount of R1 084 million, which was financed by a net capital inflow from abroad of R725 million and the utilisation of gold and foreign reserves to the extent of R359 million.

The poor performance of domestic saving is also reflected in the decline in the ratio of saving to the domestic product to a level of 21 per cent in 1970/71, compared with an average annual ratio of more than 24 per cent during the preceding ten years. The decline in domestic saving during the year under review was the net result of substantial declines in personal saving and the current surplus of general government, while depreciation allowances showed their normal increase and corporate saving remained almost unchanged. Personal saving has now declined for three consecutive years and was slightly less than 8 per cent of disposable personal income in 1970/71, compared with 9 per cent in 1969/70, more than 10 per cent in 1968/69, and an average of more than 11 per cent for the preceding eight years. In order to restore a better balance between the demand for and supply of funds in the next year or two, it is necessary to reduce the percentage of disposable personal income utilised for consumption and thereby to increase personal saving, regardless of whether income or production increases at a faster rate.

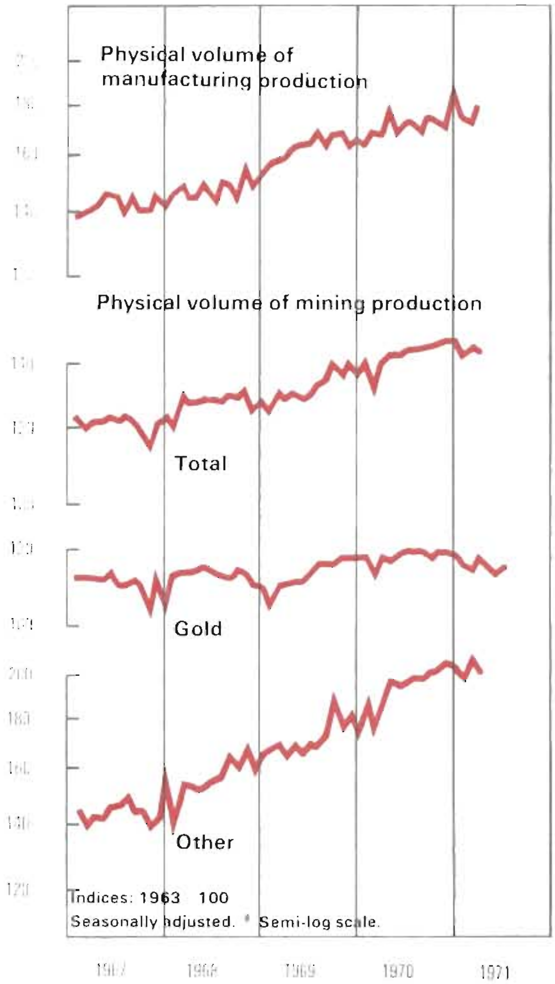
Moderate rise in manufacturing production and further increase in mining output

After increasing at a relatively high rate during 1969 and the first half of 1970, the volume of manufacturing production levelled off and increased at a significantly lower rate until the first quarter of 1971 (the latest period for which figures are available). Thus, the average level of the index of the physical volume of manufacturing production was 5,1 per cent higher during the three quarters ended March 1971 than during the corresponding period a year before, compared with increases of 7,9 and 8,1 per cent during 1968/69 and 1969/70, respectively. The main contributors to the rise in manufacturing output were metal products, machinery and food products, while the production of transport equipment declined somewhat.

The physical volume of production of durable goods began to level off at an earlier stage than that of non-durable goods, i.e. in the fourth quarter of 1969, and then increased at a lower rate until the first quarter of 1971. At the same time, consumption expenditure on durable goods and fixed investment increased at a high rate throughout 1969 and the first three quarters of 1970, which indicated that, apart from the rise in prices, the increase in spending was to a large extent on imported durable and capital goods.

As a result of a distinct levelling-off tendency after the middle of 1970, the volume of gold production was slightly lower in 1970/71 than in 1969/70. Other mining production continued its rapid rise from 1968 to November 1970, and then declined slightly to March 1971, but was on average still 13,1 per cent higher during the nine months ended March 1971 than during the corresponding period a year before.

Manufacturing and mining production



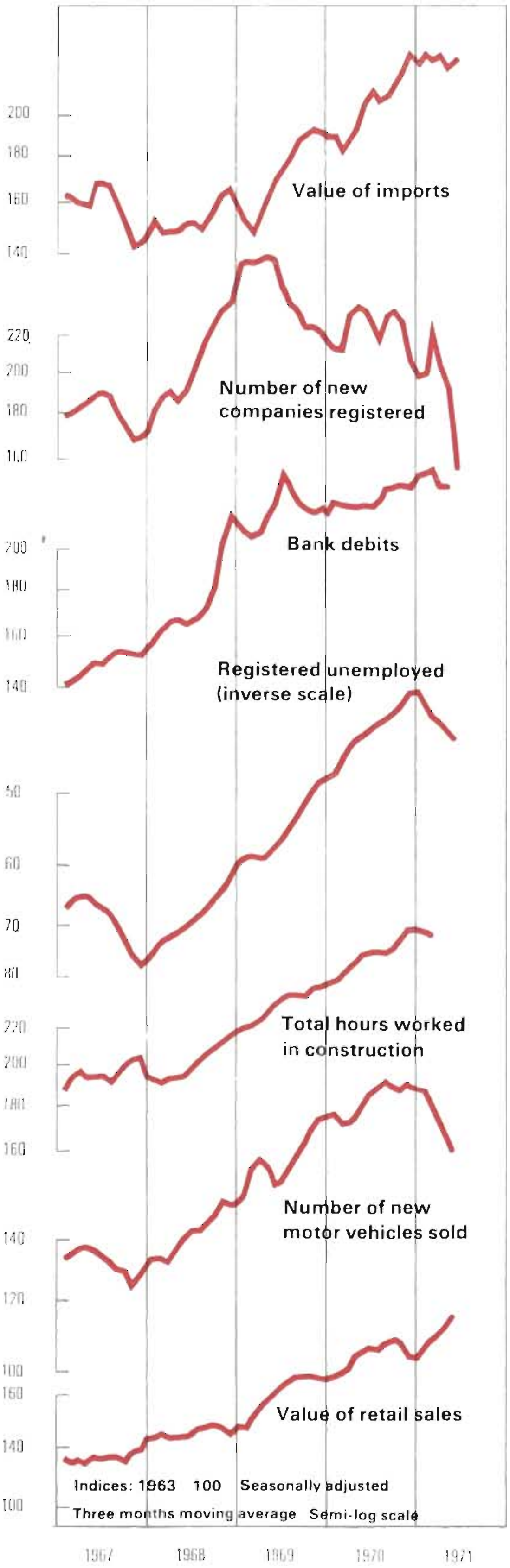
Building and construction activity

Judged by the substantial increases in the indices of the value of buildings completed and hours worked, the strong upsurge of activity in the building and construction industry, which started in 1968, continued throughout 1970. However, a levelling-off in building and construction activity early in 1971 is indicated by indices such as the value of building plans approved, new advances granted by building societies, cement production, the value of buildings completed and hours worked.

Levelling-off in other economic indicators

Various indicators of economic activity levelled off or declined during the course of the year under review and confirmed the impression gained from the national accounts that the economy became less overheated

General economic indicators



during the course of 1970/71. After increasing very rapidly to a high level in July 1970, the number of new motor cars sold declined sharply until April 1971, before rising again in May and June 1971. The sales of new commercial vehicles, which are not subject to the hire-purchase restrictions and higher sales duty, continued to increase throughout 1970, then declined during the first four months of 1971 before rising again in May and June. The value of retail sales declined in the fourth quarter of 1970 but recovered again in 1971, while imports, which rose uninterruptedly during 1969 and 1970, levelled off during the first half of 1971. New companies registered, which levelled off during 1970, declined during the first half of 1971, while bank debits levelled off after the middle of 1970.

Tight labour situation

Although tight labour conditions, which have characterised the South African economy throughout the past decade, continued to exist during the year under review, a slight easing of the position would appear to have occurred during the first half of 1971. This easing of the labour situation may be associated with the slow-down in economic activity revealed by a number of economic indicators. This was reflected, for example, in a decline during the first half of 1971 in the number of persons employed in the mining sector, while most other sectors of the economy did not increase their employment at the same rate as before. A change in the labour position is also evident from the behaviour of the number of registered unemployed Whites, Coloureds and Asians, which declined sharply from the end of 1967 to the end of 1970 and then rose moderately during the first half of 1971 to reach a figure of about 8 900 in June 1971. Despite the slight increase in unemployment, the figure is still very small and represents only about $\frac{1}{2}$ per cent of the comparable number of persons employed.

Under these circumstances of virtually full employment, it is not surprising that substantial upward adjustments were made to salaries and wages. Thus, the average salary and wage per non-agricultural worker increased by 11 per cent during the nine months ended March 1971, compared with increases of 6,3 in 1968/69 and 6,6 per cent in 1969/70. This escalation of wages did not coincide with a corresponding rise in productivity as is shown by the rise in labour costs per unit of output. In the manufacturing sector, labour costs per unit of output rose by 11,6 per cent during the nine months to March 1971, compared with an increase of 3,2 per cent in 1969/70, while in the mining sector it deteriorated from a decline of 0,8 per cent in 1969/70 to an increase of 3,0 per cent.

Notwithstanding the significant addition to production capacity by capital outlays on plant, machinery and equipment, the average real output per worker in the non-agricultural sectors declined during the year under review. Total employment in the non-agricultural sectors of the economy increased by nearly 5 per cent, while the real gross domestic product contributed by these sectors rose by only about 4 per cent, implying a decline in output per worker. During the preceding two years a significant improvement in the output per worker was achieved. From the available information, it would appear that output per worker in both the mining and manufacturing sectors decreased during the year under review.

Exceptional increase in consumer prices

According to the seasonally adjusted index, consumer prices continued to rise at an annual rate of just over 4 per cent during 1970 and the first quarter of 1971, but the rate of increase accelerated considerably during the second quarter of 1971 because of special factors and brought the increase from June 1970 to June 1971 to 6,1 per cent. As the accompanying table shows, the prices of services increased at a faster rate then those of goods during the year ended June 1971.

Higher rents and postal and railway rates were mainly responsible for the rise of 6,7 per cent in the prices of all services. Under the goods category, important price increases were recorded in respect of vehicles, furniture and equipment, milk and milk products and meat. Clothing and footwear showed the lowest price rise, namely 2,1 per cent.

Consumer prices

Annual percentage rates of change in seasonally adjusted indices

	March 1970 to March 1971	June 1970 to June 1971
Services:	5,0	6,7
Housing	5,0	5,9
Other	5,1	8,1
Goods:	3,5	5,7
Food	3,7	4,7
Furniture and equipment	3,9	5,4
Clothing and footwear	1,6	2,1
Purchase of vehicles	6,0	7,8
Other	3,0	8,2
Total	4,1	6,1

The rapid acceleration of the increase in consumer prices during the second quarter of 1971, can largely be ascribed to special factors such as increased sales duties and other indirect taxes and upward adjustments to various prices and rates controlled by the government. Sales duties on various products were introduced or increased in August 1970 and again in February 1971, and other indirect taxes were raised in March 1971, all as part of the anti-inflation-

Consumer prices

ary fiscal measures introduced by the Minister of Finance. During the second quarter of 1971 postal and railway rates and prices controlled by the government, such as those of petrol, and milk and milk products were increased. However, a rise in the consumer price index as a result of the direct actions of the government to curb inflation should not be interpreted as an indication of a general rise in the price level or of the degree of inflation, but should be identified separately.

The actions of the government which led to increases in the consumer price index during 1970/71 may be divided into three categories, namely (i) increases in indirect taxes such as sales and excise duties, (ii) increases in the prices and rates of goods and services provided by public authorities and corporations such as steel and postal and railway services, and (iii) increases in the prices of goods and services provided by private enterprises and controlled by the government. The increase in indirect taxes and of prices and rates of goods and services provided by the authorities serves a dual purpose, namely (1) to discourage consumption expenditure on these goods and services as part of the anti-inflationary campaign and (2) to serve as an additional source of revenue to public authorities to assist them in the sound financing of infrastructural and other essential services. The additional revenue accruing to the government, the Post Office and the S.A. Railways will assist the authorities in financing their expenditure in a less inflationary manner by not making more use of bank credit, which would, of course, be highly inflationary under present conditions.

The prices and rates of goods and services provided by public authorities as well as the prices of goods and services provided by private enterprises and controlled by the government, which are sometimes collectively referred to as "administered" prices, are increased only periodically as a result of increases in other prices and costs. It was to a certain extent a coincidence that so many of these prices were adjusted during the first half of 1971 and it should be taken into consideration that these price rises are not based on increases in costs only during the year in which such prices are adjusted, but during the whole period over which they have been kept constant while other prices and costs have been moving upwards. Thus, for example, most postal rates were kept constant for more than 10 years before they were adjusted upwards in 1970/71, while railway rates and the prices of milk, butter, cheese, petrol and certain other products were all kept constant between 1966 and 1970. Sufficient data are unfortunately not available to identify and distribute the periodic adjustments to the prices of these products more evenly over the appropriate period, but an estimate was made of the direct effects of such changes on the total consumer price index. It is also difficult to identify the effects of the sales duty and other indirect taxes on the consumer price index accurately, as these are all levied at the manufacturer and importer stage and not at the final consumer level. Estimates were made, however, to exclude the ascertainable effects of changes in these indirect taxes as well as of changes in administered prices.

From the accompanying table it appears that, if the estimated effects of indirect taxes and administered prices are excluded from the consumer price index, the rate of increase in all other prices contained in the index did not accelerate between 1969/70 and 1970/71. In fact, the rate declined slightly from a rise of 4,0 per cent between June 1969 and June 1970 to 3,8 per cent between June 1970 and June 1971.

Wholesale prices increased at a seasonally adjusted annual rate of 5,3 per cent between June 1970 and June 1971, with beverages and tobacco, basic metals and metal products and machinery and transport equipment the items mainly responsible for the acceleration in the rate of increase. Prices of imported goods also increased at a much faster rate from the second half of 1970.

Consumer prices

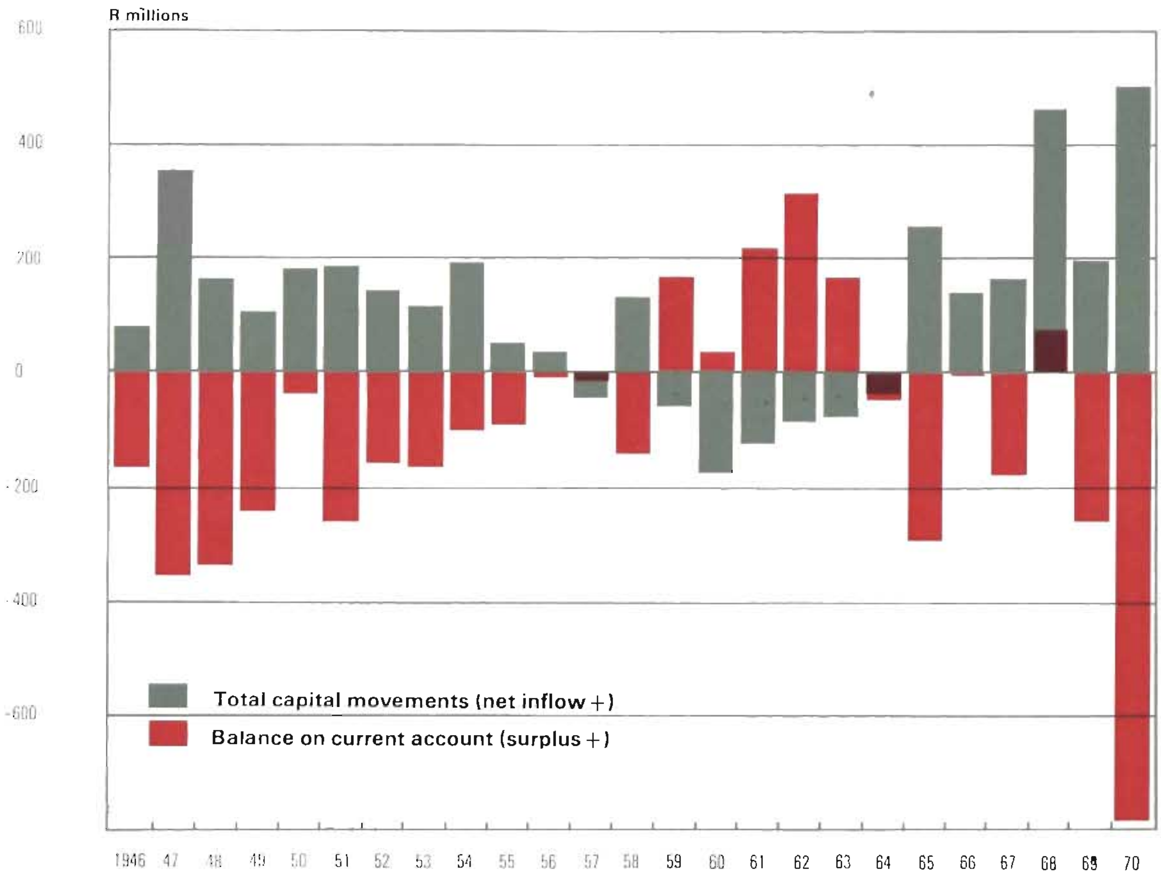
Percentage changes in seasonally adjusted indices

Index	Jun. 64 to Jun. 65	Jun. 65 to Jun. 66	Jun. 66 to Jun. 67	Jun. 67 to Jun. 68	Jun. 68 to Jun. 69	Jun. 69 to Jun. 70	Jun. 70 to Jun. 71
Total	4,2	3,3	4,1	1,6	3,4	4,1	6,1
Total excluding administered prices	3,9	2,5	3,3	1,7	3,2	4,0	5,2
Total excluding indirect taxes	4,1	3,2	3,9	1,5	3,0	4,0	4,9
Total excluding both administered prices and indirect taxes	3,9	2,5	3,0	1,6	2,7	4,0	3,8

Balance of payments

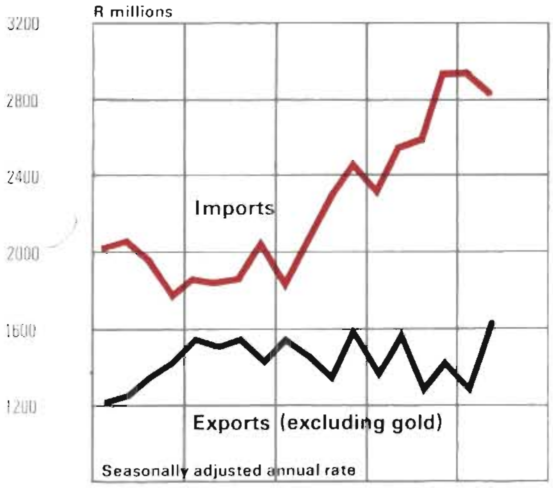
South Africa's balance of payments data for the post-war period show that, as in many other developing countries, a deficit on the current account is usually accompanied by a surplus on the capital account (i.e. a net inflow of capital), while a surplus on the current account normally coincides with a net capital outflow. This phenomenon may be explained largely by the fact that under normal circumstances both the current account and the capital account of the balance of payments are strongly influenced by domestic economic developments. Abnormal events, such as political disturbances, devaluations, speculations, etc., sometimes upset this relationship, particularly the movement of capital. Normally, however, when an upswing in domestic demand for goods and services and consequently in general business activity occurs, local production will not be able to satisfy the increased demand with the result that more goods will be imported and a smaller proportion of the local production will be available for exports. This will result in a deterioration of the current account of the balance of payments. At the same time, a higher level of domestic economic activity usually results in higher investment income which is attractive to foreign investors. An expansion of economic activity also tends to lead to increased domestic demand for finance, which may have to be supplemented from abroad, depending on interest rate differentials and the availability of local funds. These forces, therefore, tend to promote an inflow of capital from abroad at a time when a deficit develops on the current account.

Balance on current account and net total capital movements

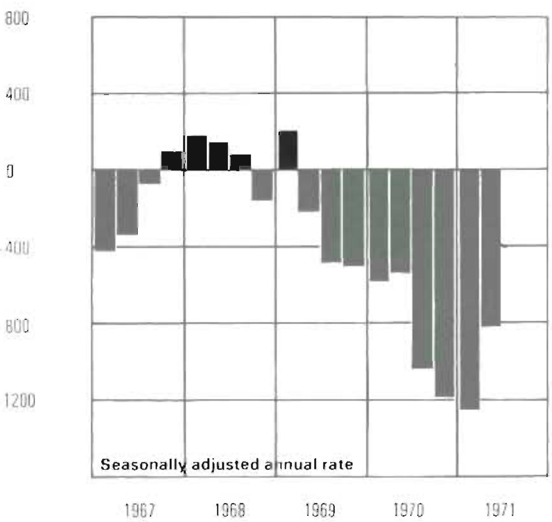


In view of the exceptionally high rate of increase in domestic demand in South Africa in 1969 and 1970, it is, therefore, not surprising that a huge deficit developed on the current account of the balance of payments while, at the same time, a net capital inflow, which grew progressively bigger, was recorded. The historically high deficit of R1 084 million, which was recorded for the year ended June 1971, was thus prevented from exerting its full impact on the country's gold and foreign reserves by an all-time record net inflow of capital from abroad amounting to R725 million. Nevertheless, R359 million of the gold and foreign reserves still had to be used to finance the overall deficit on the balance of payments during the year ended June 1971.

Current account of the balance of payments



Balance on current account



Decline in deficit on current account

After showing a small surplus of R3 million during 1968/69, the current account of the balance of payments subsequently deteriorated substantially and showed deficits of R531 million during 1969/70 and as much as R1 084 million during the year ended June 1971. As in the preceding year, the deterioration in the current account during 1970/71 was the net result of a substantial increase in merchandise imports associated with the rapid rise in domestic demand for goods and services, a sharp increase in net investment income and other service payments to the rest of the world and a decline in merchandise exports.

Developments during the course of the year ended June 1971 revealed, however, that a notable improvement occurred in the current account in the first half of 1971. Thus, the seasonally adjusted deficit taken at an annual rate declined from R1 122 million in the last half of 1970 to R1 037 million in the first half of 1971. The comparable figure for the second quarter of 1971 was R820 million, which, although still very high, represents a substantial improvement on the deficit of R1 254 million for the first quarter of 1971. This considerable improvement was the net result of a decline in merchandise imports and substantial increases in merchandise exports and net gold output, which outweighed the rise in net service payments.

Sharp rise in merchandise imports, but favourable change in trend

During 1969 and 1970 merchandise imports increased almost uninterruptedly at rates of 14 per cent and 20 per cent, respectively. From the fourth quarter of 1970 to the second quarter of 1971, however, a decline of R117 million was recorded, if taken at a seasonally adjusted annual rate.

Merchandise imports

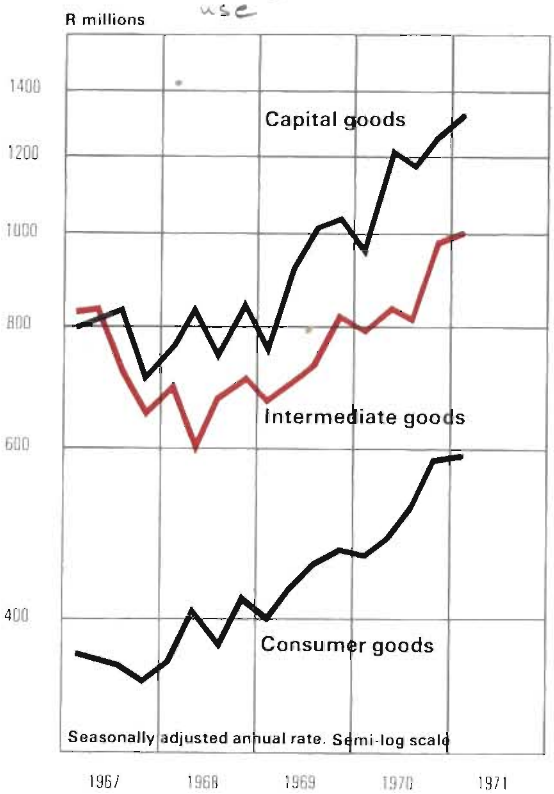
Seasonally adjusted annual rate
R millions

		Total	Increase (+) or decrease (−)
1969	1st qtr.	1 824	−192
	2nd qtr.	2 056	+232
	3rd qtr.	2 272	+216
	4th qtr.	2 440	+168
1970	1st qtr.	2 302	−138
	2nd qtr.	2 530	+228
	3rd qtr.	2 567	+ 37
	4th qtr.	2 917	+350
1971	1st qtr.	2 917	—
	2nd qtr.	2 800	−117

The trend, therefore, changed significantly and this development is likely to continue during the second half of 1971. The decline in imports during the first half of 1971 may be ascribed to the lower rate of increase in total domestic demand as a result of the anti-inflationary fiscal and monetary policy of the authorities. It might even have declined more rapidly, if unwarranted fears of a possible tightening of import control and general uncertainties in respect of international currency changes had not induced importers to build up large inventories.

In analysing imports according to stage of use, it is gratifying to note that capital goods, which constitute about 45 per cent of total imports, contributed most to the rise in imports although intermediate goods (approximately 35 per cent of total imports) and consumer goods (20 per cent of total imports) also rose strongly. Capital goods consist mainly of machinery and equipment and thus add to the domestic production capacity. The individual categories of goods imported which showed the most pronounced rises during the period under review, were machinery and electrical equipment, transport equipment, base metals (including steel), and mineral and chemical products.

Imports according to stage of use



Rise in net invisible payments

Net invisible payments to the rest of the world increased from R460 million in 1969/70 to R559 million in 1970/71, i.e. by about 22 per cent. This sharp rise may largely be ascribed to a substantial increase in service payments owing mainly to the larger volume of imports, upward adjustments to freight rates, a significant increase in the number of South Africans visiting foreign countries, and the higher cost of servicing the increased foreign investment in South Africa. Service receipts, on the other hand, showed a moderate increase only, while net transfer receipts did not change much.

Decline in merchandise exports

Notwithstanding South Africa's policy to promote exports, *inter alia*, through interest subsidies and tax incentives, merchandise exports performed poorly during the past two years and declines of 2 per cent and 4 per cent were recorded for the years 1969/70 and 1970/71, respectively. During the latter year merchandise exports amounted to only R1 415 million. If exports are classified by stage of production, it is encouraging to note, however, that manufactured goods, which on average represented about 18 per cent of total exports during the last three years, showed a rising trend during the year under review. Exports of raw materials and semi-manufactured goods were mainly responsible for the decline in total exports. In particular, decreases in exports of diamonds, wool and fresh and preserved fruit were the most pronounced and their collective relative importance in total exports declined from an average of 30 per cent during the period 1967/68 to 1969/70 to only 24 per cent in 1970/71. During the second quarter of 1971, merchandise exports showed a welcome and highly satisfactory upsurge owing mainly to higher maize and diamond exports. At a seasonally adjusted annual rate exports rose from R1 300 million in the first quarter of 1971 to R1 636 million in the second quarter of 1971, reflecting indeed a marked improvement.

The promotion of exports remains an important objective of official policy and various incentives for exporters were introduced during the past year. In October 1970 a 25 per cent subsidy on interest charges on new and expanded exports of manufactured goods became effective. Further income tax concessions in respect of expanded exports were also announced by the Minister of Finance in his Budget speech in August 1970. The intention of the government to promote exports is further illus-

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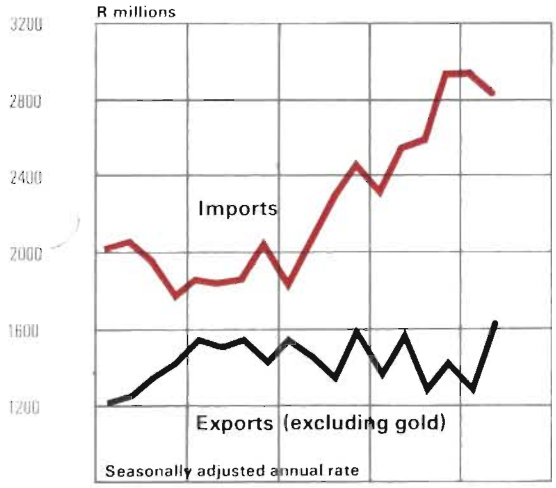
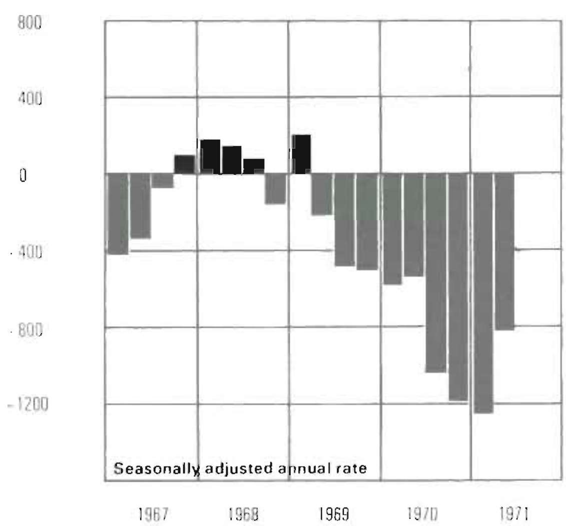


Balance on current account



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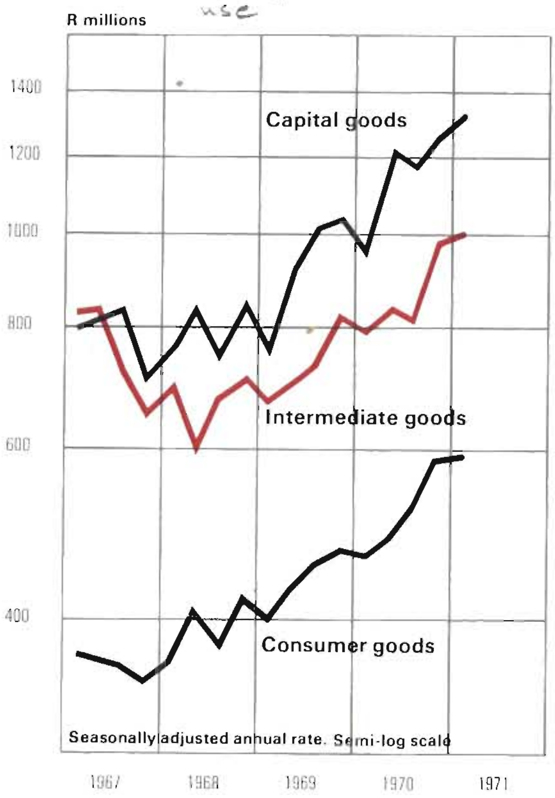

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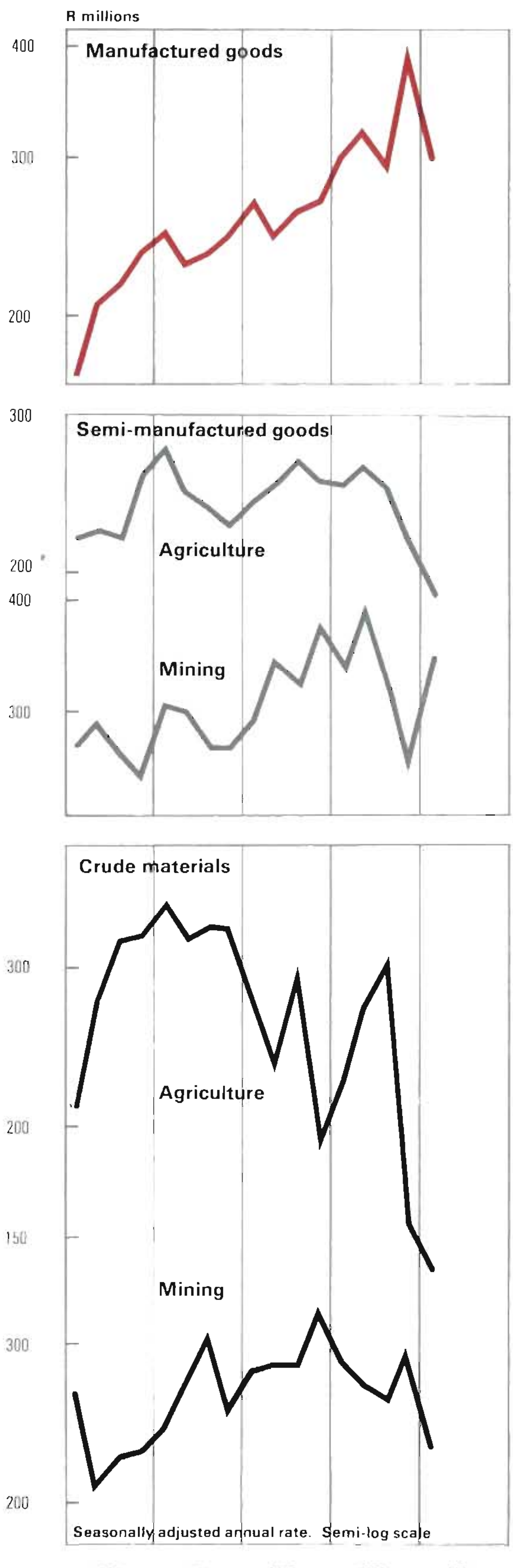
Exports according to stage of manufacturing



trated by the announcement in January 1971 that the Export Promotion Council will be replaced by an Export Advisory Council through which the private sector will be able to play a more active role in the promotion of exports. In August 1971 the government also appointed a commission of inquiry to investigate export promotion.

Slight increase in net gold output

After rising by 5 per cent in 1968/69 and by 6 per cent in 1969/70, net gold output rose by only 2 per cent to R863 million in 1970/71. This increase in net gold output occurred despite a small decline in the physical volume of gold production and was the result of a higher average price obtained for gold sales on the private market.

Record net capital inflow

During 1970/71 South Africa not only had a record deficit on the current account of the balance of payments, but also the highest net inflow of capital ever experienced, namely R725 million. This inflow was much higher than the inflow of R374 million registered during 1969/70 and R224 million during 1968/69 and was the seventh consecutive year in which an inflow was recorded. During this whole period a net amount of R2 150 million, of which about R1 250 million or 58 per cent represented long-term capital, was received from abroad.

The accompanying table shows that the total net capital inflow increased progressively during the course of the past two years. During the year ended June 1971, net capital inflow to the private sector made the largest contribution and amounted to R617 million of which R147 million was received by public corporations. Of the total inflow to the private sector, 61 per cent represented long-term capital and was, therefore, of a more permanent nature. The general international currency uncertainties and the narrowing of the margin between the prices of South African securities quoted on the Johannesburg and London stock exchanges resulted in an increase in the net purchases by foreigners of South African securities from R25 million in 1969/70 to R90 million in 1970/71. The large net inflow of other long-term capital may be associated with the relatively high domestic interest rates and returns on investments, the tight conditions on the local capital market and the exchange control restrictions on domestic borrowing by foreign controlled enterprises. Exchange control applied to the inflow of loan capital to the private sector, however, restricted the inflow of such capital.

Net capital inflow
R millions

	1969	1970		1971
	2nd half	1st half	2nd half	1st half
To the private sector:				
Stock exchange transactions	12	13	37	53
Other long-term	104	124	152	133
Short-term	54	31	96	146
Total private	170	168	285	332
To central government and banking sector	−13	49	55	53
Total net capital inflow	157	217	340	385

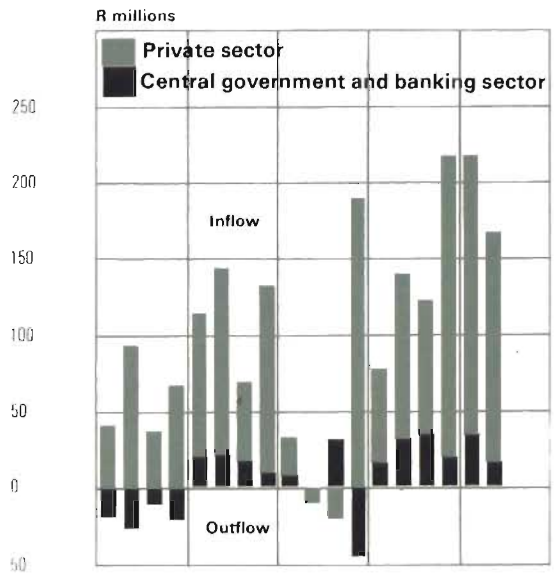
The sustained increase in short-term capital to the private sector (including errors and unrecorded transactions), mainly in the form of trade credits may be ascribed to the high level of imports and the fact that, in accordance with the authorities' restrictive monetary policy, domestic credit for imports were difficult to obtain from the banks. Importers were accordingly induced to obtain additional credit from exporters abroad or other foreign sources.

The net capital inflow to the central government and banking sector also increased from R36 million in 1969/70 to R108 million in 1970/71. Limited success of the government in attracting loan capital from the domestic private non-banking sector led to increased use of foreign loans. Total drawings on foreign loans by the government during 1970/71 were as high as R220 million of which R102 million, in turn, was used to repay foreign loans which fell due for redemption. A net outflow of other capital from the central government and banking sector of R10 million brought the total net inflow to R108 million.

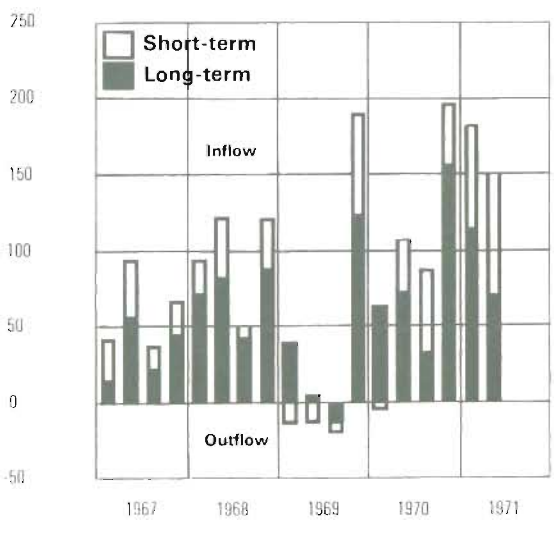
Fall in gold and foreign reserves

The record deficit on the current account exceeded the very large inflow of capital and R359 million of South Africa's gold and foreign reserves was used to finance this overall deficit on the balance of payments for 1970/71. The foreign reserves were supplemented, however, by the second allocation of Special Drawing Rights amounting to R15 million and an exchange profit of about R2 million on the revaluation of the Swiss franc and Austrian schilling so that the total decline amounted to R342 million. This decline brought South Africa's total gold and foreign reserves to a still comfortable level of R691 million at the end of June 1971.

Total capital movements

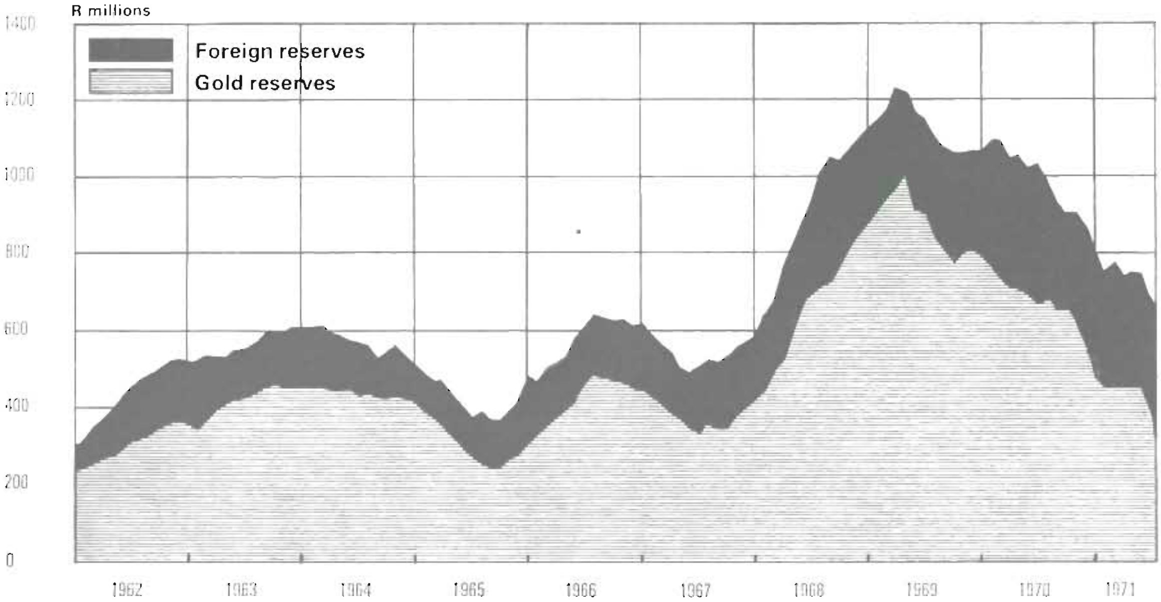


Private capital movements



During July the gold and foreign reserves of the Reserve Bank declined by a further R51 million. On 15th July South Africa's quota in the IMF was increased by R86 million to R229 million, and a quarter of the increase was paid in gold. As South Africa's gold tranche position increased as a result of the higher quota, the payment of the gold portion of the quota did not affect the total gold and foreign reserves.

Gold and foreign reserves



Monetary and banking situation

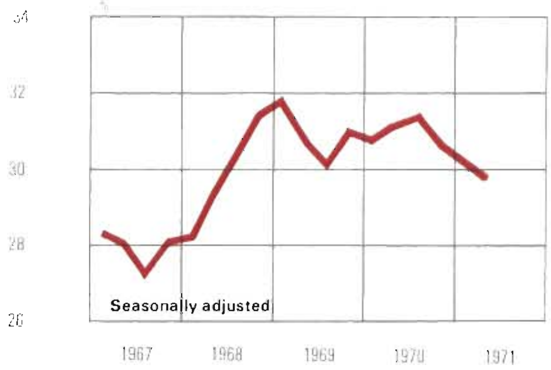
Tighter monetary conditions

The main features of monetary and banking conditions during the year ended June 1971 were a lower rate of increase in the quantity of money and near-money in the hands of the private sector, relatively tight conditions in the money market with upward adjustments to interest rates, and lower excess liquidity of banking institutions. In view of the pronounced inflationary tendencies, monetary policy continued to be aimed at regulating the extension of bank credit to the private sector and moderating the increase in the liquidity of the private non-banking sector (i.e. of private businesses and individuals).

Lower rate of increase in money and near-money

Money and near-money in the hands of the private non-banking sector rose by only R185 million, or by less than 5 per cent, during the year ended June 1971. This increase is considerably smaller than the increases of between 12 and 15 per cent recorded during the preceding three years. In view of the prevailing inflationary conditions, this lower rate of increase in the liquidity of private businesses and individuals during 1970/71 was a favourable development from a monetary policy point of view. The slow-down did not, however, occur evenly throughout the year under review, but was the net result of a decline in money and near-money during the last five months of 1970 followed by an appreciable increase during the first half of 1971. Thus, the seasonally adjusted total quantity of money and near-money declined at an annual rate of about 1,5 per cent during the second half of 1970 and rose at an annual rate of about 11 per cent during the first half of 1971. A significant change in the trend, therefore, occurred during the year which is not revealed by the lower rate of increase for the year as a whole. Taking into account this uneven change in the quantity of money and near-money in the course of the year, the *average* monthly level of the quantity of money and near-money was 7,9 per cent higher during 1970/71 than during 1969/70. Measured in this way, the rate of increase in private sector liquidity was, however, still somewhat lower than the rate of growth of the gross domestic product. As a result the ratio of money and near-money to the gross domestic product decreased slightly from 30,6 to 30,3 per cent between 1969/70 and 1970/71.

Ratio of money and near-money to gross domestic product



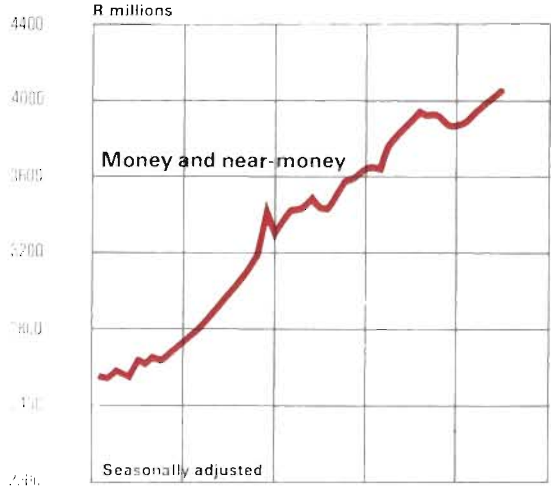
Causes of changes in money and near-money

The decline in the seasonally adjusted quantity of money and near-money during the second half of 1970 may be attributed to the fact that the very large decrease in the gold and foreign reserves and a substantial increase in long-term deposits placed by the private sector with the banking sector, following the freeing of deposit interest rates in August 1970, more than compensated for the continued rise in domestic credit extended to the private sector and the more moderate rise in net credit to the government sector (the result of both a decline in government deposits and a rise in the banking sector's holding of government paper and advances to government bodies). By contrast, during the first half of 1971 the sharp increase in domestic credit extended to the government outweighed the effect of the slightly more moderate decline in the gold and foreign reserves, a much reduced increase in long-term deposits of the private sector and a lower rate of increase in domestic credit extended to the private sector.

Further rise in domestic credit extended

Total domestic credit extended by the monetary banking sector to the private and government sectors increased by R584 mil-

Monetary analysis



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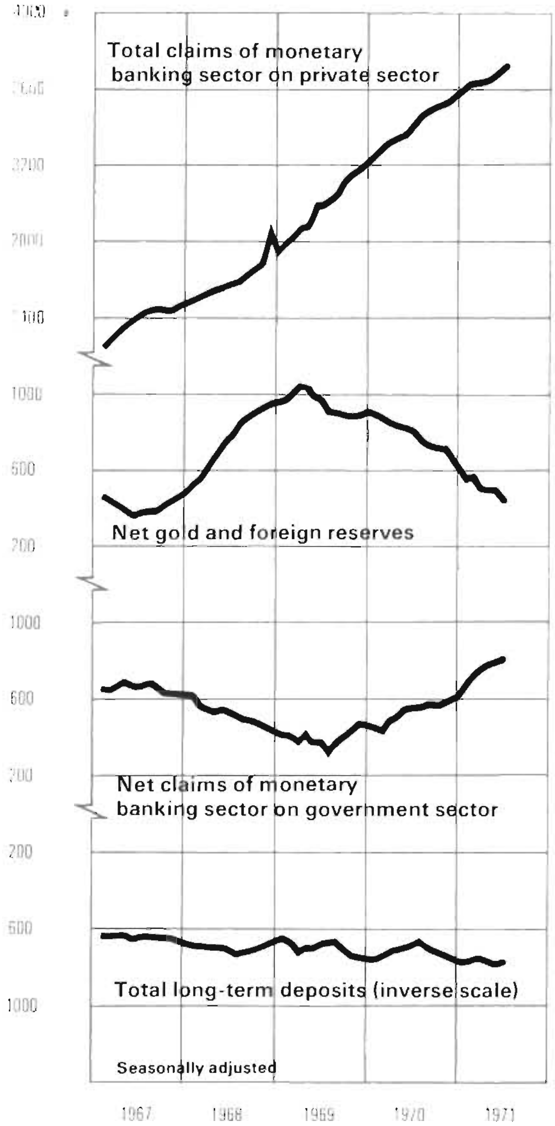
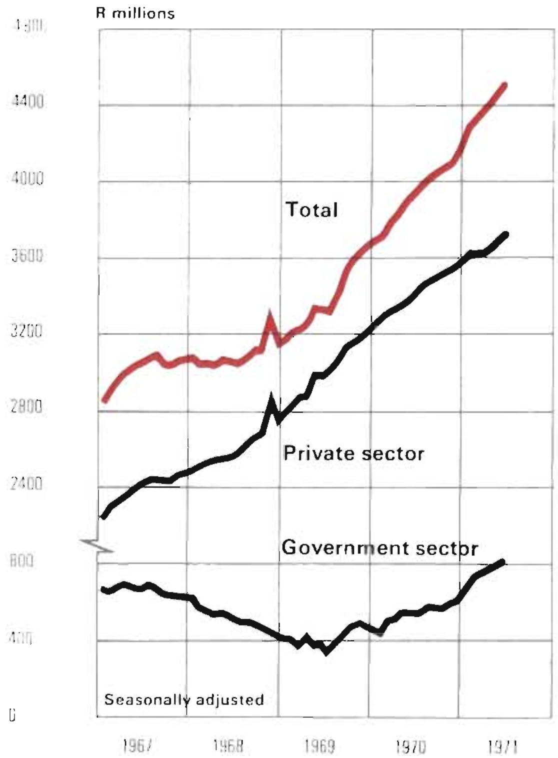


lion, or 15 per cent, during the year ended June 1971. This increase followed upon increases of 18 per cent in 1969/70 and 8 per cent in 1968/69. During 1970/71 almost one-half of the increase in total domestic credit extended was accounted for by the government sector, while credit to the private sector was largely responsible for the expansion of credit during the preceding two years. In fact, the net claims of the monetary banking sector on the government sector (i.e. mainly the monetary banking sector's holdings of government paper plus advances to government bodies less total government deposits, or net bank credit to the government sector) declined during the years 1967/68 and 1968/69 but started an upward movement from about the middle of 1969 which accelerated substantially during the year under review, especially during the first half of 1971.

The sharp increase of R270 million in the net claims of the monetary banking sector on the government sector during the year ended June 1971 was accounted for mainly by a large reduction of about R200 million in central government deposits with the Reserve Bank. The monetary banking sector's holdings of government paper showed almost no change, while Reserve Bank credit to

Domestic credit extended



Changes in domestic credit extended by the monetary banking sector
R millions

Year ended June	To the private sector	To the government sector			Total	
		Claims	Deposits[1]	Net claims		%
1966	−143	263	−65	198	55	2,1
1967	348	−1	6	5	353	12,8
1968	148	189	−336	−147	—	—
1969	414	93	−254	−161	253	8,2
1970	432	15	167	182	614	18,3
1971	314	78	192	270	584	14,7

1) Increase −, decrease +.

government bodies increased by R69 million. Government deposits with the banking sector began their downward movement from the peak of almost R800 million reached at the end of July 1969 and declined by R222 million until June 1970. During 1970/71 these deposits declined further by a roughly similar amount, namely by R192 million, reaching a level of R384 million at the end of June 1971. Thus the government reduced its balances between July 1969 and June 1971 by no less than R414 million, while the monetary banking sector's holdings of government paper and advances to government bodies increased by R137 million over this period.

In contrast to the increasingly rapid rise in net bank credit to the government sector, the increase of R314 million in bank credit to the private sector (i.e. claims of the monetary banking sector on the private sector) during 1970/71 was substantially smaller than the increases recorded during 1968/69 and 1969/70. In fact, the rate of increase declined from 16 per cent in 1968/69 and 15 per cent in 1969/70 to about 9 per cent in 1970/71. A slight deceleration in the rate of increase was also noticeable in the course of 1970/71. The seasonally adjusted annual rate of increase in the banks' claims on the private sector declined from approximately 10 per cent during the second half of 1970 to about 8 per cent during the first half of 1971.

The composition of the increase in bank credit to the private sector also changed during 1970/71 in comparison with the preceding year. Thus, whereas the commercial banks were the main contributors to the rise in bank credit during 1969/70, they contributed only slightly more than one-third (R113 million) of the total increase in 1970/71. During the first half of 1971 commercial banks actually reduced their discounts and advances by R39 million. The banks' private sector investments rose, however, by R31 million over this period, largely as a result of their purchases of Land Bank debentures. The relatively high level of domestic interest rates, as compared with rates obtaining abroad, may have encouraged a shift from domestic to foreign sources of credit for the purpose of financing the sustained high level of imports and inventory accumulation. Together with the enforcement of the credit ceilings by the Reserve Bank, this factor may have helped to reduce the rate of increase in domestic credit extension to the private sector.

Low levels of excess liquid assets during most of the year

During the year under review the excess liquid assets of monetary banking institutions largely tended to reflect the opposing forces of the sustained and rapid decline in the gold and foreign reserves and the decline in government deposits. In addition, the banks were subject to the usual shorter-term declines in actual liquid asset holdings as a result of seasonal movements of tax and loan funds to the government, in particular during July 1970 and January 1971. From March to the middle of June 1971 the decline in government deposits with the Reserve Bank was substantially larger than the decline in the gold and foreign reserves, leading to a rise in the banks' excess liquid assets during the second quarter of the year.

The average month-end excess liquid assets of commercial banks, merchant banks and monetary hire-purchase and general banks amounted to about R160 million, or 3,2 per cent of their liabilities to the public, during 1970/71, compared with 4,0 per cent in 1969/70. From January to June 1971 the excess liquid assets of monetary banks increased fairly substantially from less than 1 per cent to 5,4 per cent of their liabilities to the public.

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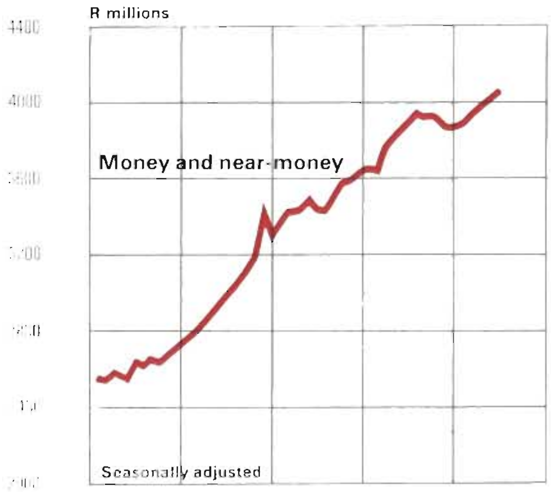
The composition of the increase in bank credit to the private sector also changed during 1970/71 in comparison with the preceding year. Thus, whereas the commercial banks were the main contributors to the rise in bank credit during 1969/70, they contributed only slightly more than one-third (R113 million) of the total increase in 1970/71. During the first half of 1971 commercial banks actually reduced their discounts and advances by R39 million. The banks' private sector investments rose, however, by R31 million over this period, largely as a result of their purchases of Land Bank debentures. The relatively high level of domestic interest rates, as compared with rates obtaining abroad, may have encouraged a shift from domestic to foreign sources of credit for the purpose of financing the sustained high level of imports and inventory accumulation. Together with the enforcement of the credit ceilings by the Reserve Bank, this factor may have helped to reduce the rate of increase in domestic credit extension to the private sector.

Low levels of excess liquid assets during most of the year

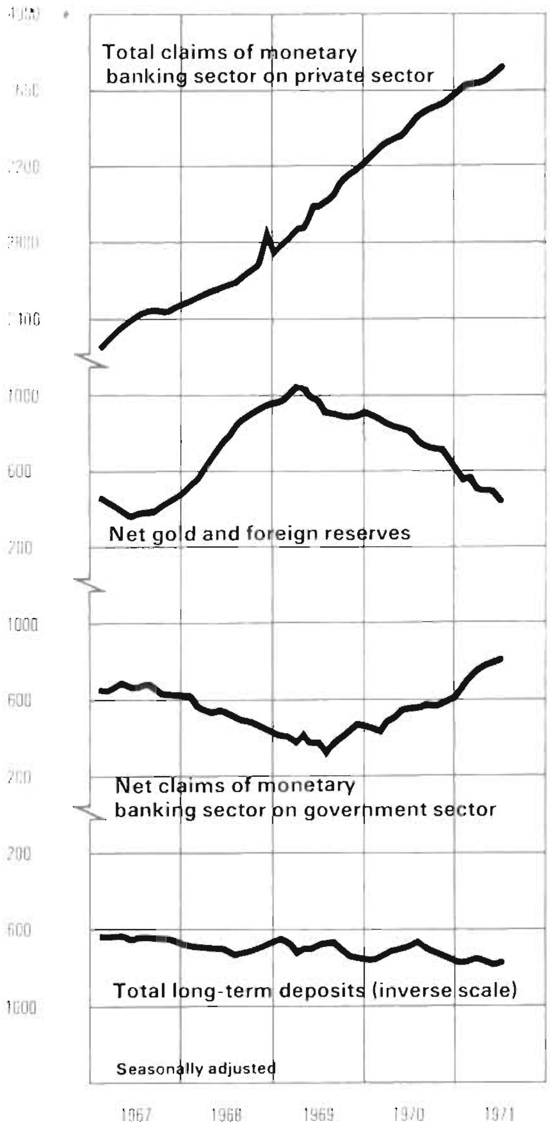
During the year under review the excess liquid assets of monetary banking institutions largely tended to reflect the opposing forces of the sustained and rapid decline in the gold and foreign reserves and the decline in government deposits. In addition, the banks were subject to the usual shorter-term declines in actual liquid asset holdings as a result of seasonal movements of tax and loan funds to the government, in particular during July 1970 and January 1971. From March to the middle of June 1971 the decline in government deposits with the Reserve Bank was substantially larger than the decline in the gold and foreign reserves, leading to a rise in the banks' excess liquid assets during the second quarter of the year.

The average month-end excess liquid assets of commercial banks, merchant banks and monetary hire-purchase and general banks amounted to about R160 million, or 3,2 per cent of their liabilities to the public, during 1970/71, compared with 4,0 per cent in 1969/70. From January to June 1971 the excess liquid assets of monetary banks increased fairly substantially from less than 1 per cent to 5,4 per cent of their liabilities to the public.

Monetary analysis



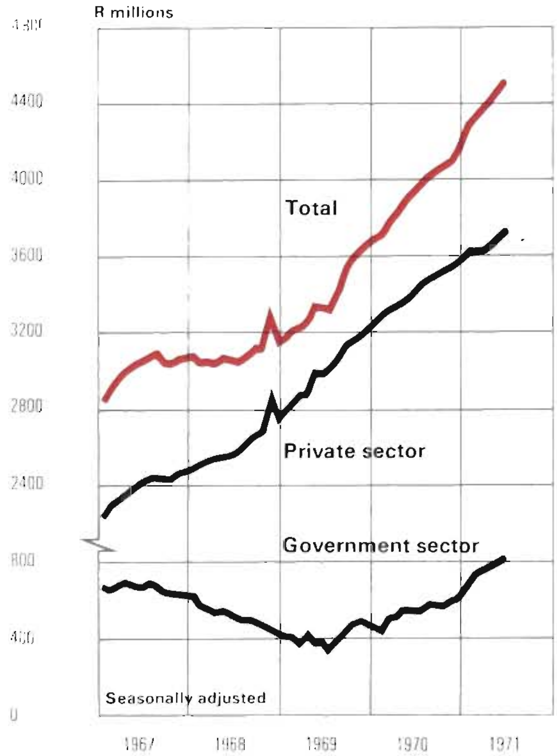
Causes of changes in money and near-money



lion, or 15 per cent, during the year ended June 1971. This increase followed upon increases of 18 per cent in 1969/70 and 8 per cent in 1968/69. During 1970/71 almost one-half of the increase in total domestic credit extended was accounted for by the government sector, while credit to the private sector was largely responsible for the expansion of credit during the preceding two years. In fact, the net claims of the monetary banking sector on the government sector (i.e. mainly the monetary banking sector's holdings of government paper plus advances to government bodies less total government deposits, or net bank credit to the government sector) declined during the years 1967/68 and 1968/69 but started an upward movement from about the middle of 1969 which accelerated substantially during the year under review, especially during the first half of 1971.

The sharp increase of R270 million in the net claims of the monetary banking sector on the government sector during the year ended June 1971 was accounted for mainly by a large reduction of about R200 million in central government deposits with the Reserve Bank. The monetary banking sector's holdings of government paper showed almost no change, while Reserve Bank credit to

Domestic credit extended



Changes in domestic credit extended by the monetary banking sector
R millions

Year ended June	To the private sector	To the government sector			Total	
		Claims	Deposits[1]	Net claims		%
1966	−143	263	−65	198	55	2,1
1967	348	−1	6	5	353	12,8
1968	148	189	−336	−147	—	—
1969	414	93	−254	−161	253	8,2
1970	432	15	167	182	614	18,3
1971	314	78	192	270	584	14,7

1) Increase —, decrease .

government bodies increased by R69 million. Government deposits with the banking sector began their downward movement from the peak of almost R800 million reached at the end of July 1969 and declined by R222 million until June 1970. During 1970/71 these deposits declined further by a roughly similar amount, namely by R192 million, reaching a level of R384 million at the end of June 1971. Thus the government reduced its balances between July 1969 and June 1971 by no less than R414 million, while the monetary banking sector's holdings of government paper and advances to government bodies increased by R137 million over this period.

In contrast to the increasingly rapid rise in net bank credit to the government sector, the increase of R314 million in bank credit to the private sector (i.e. claims of the monetary banking sector on the private sector) during 1970/71 was substantially smaller than the increases recorded during 1968/69 and 1969/70. In fact, the rate of increase declined from 16 per cent in 1968/69 and 15 per cent in 1969/70 to about 9 per cent in 1970/71. A slight deceleration in the rate of increase was also noticeable in the course of 1970/71. The seasonally adjusted annual rate of increase in the banks' claims on the private sector declined from approximately 10 per cent during the second half of 1970 to about 8 per cent during the first half of 1971.

The composition of the increase in bank credit to the private sector also changed during 1970/71 in comparison with the preceding year. Thus, whereas the commercial banks were the main contributors to the rise in bank credit during 1969/70, they contributed only slightly more than one-third (R113 million) of the total increase in 1970/71. During the first half of 1971 commercial banks actually reduced their discounts and advances by R39 million. The banks' private sector investments rose, however, by R31 million over this period, largely as a result of their purchases of Land Bank debentures. The relatively high level of domestic interest rates, as compared with rates obtaining abroad, may have encouraged a shift from domestic to foreign sources of credit for the purpose of financing the sustained high level of imports and inventory accumulation. Together with the enforcement of the credit ceilings by the Reserve Bank, this factor may have helped to reduce the rate of increase in domestic credit extension to the private sector.

Low levels of excess liquid assets during most of the year

During the year under review the excess liquid assets of monetary banking institutions largely tended to reflect the opposing forces of the sustained and rapid decline in the gold and foreign reserves and the decline in government deposits. In addition, the banks were subject to the usual shorter-term declines in actual liquid asset holdings as a result of seasonal movements of tax and loan funds to the government, in particular during July 1970 and January 1971. From March to the middle of June 1971 the decline in government deposits with the Reserve Bank was substantially larger than the decline in the gold and foreign reserves, leading to a rise in the banks' excess liquid assets during the second quarter of the year.

The average month-end excess liquid assets of commercial banks, merchant banks and monetary hire-purchase and general banks amounted to about R160 million, or 3,2 per cent of their liabilities to the public, during 1970/71, compared with 4,0 per cent in 1969/70. From January to June 1971 the excess liquid assets of monetary banks increased fairly substantially from less than 1 per cent to 5,4 per cent of their liabilities to the public.

Tight money market conditions and higher interest rates

Corresponding to the excess liquidity position of banks, money market conditions were influenced by the decline in the foreign reserves which generally outweighed the easing effects of declines in government deposits. Seasonal increases in government deposits in July 1970 and especially in January 1971 resulted in relatively tight conditions in the money market. Apart from these fluctuations, the discount houses were net borrowers from the Reserve Bank for most of the period under review. Their average month-end indebtedness to the Bank amounted to over R100 million during the year ended June 1971 and to a substantially higher amount during the period July 1970 to January 1971. To discourage excessive use of central bank credit, the Reserve Bank from July 1970 applied progressively higher penalty rates to discount house borrowing, which reached a level of 2 per cent above Bank rate in September 1970. In October and November they succeeded in substantially reducing their indebtedness to the Reserve Bank.

The Treasury bill tender rate increased slowly from 4,32 per cent in early July 1970 to 4,64 per cent in early February 1971 before rising more rapidly to 5,04 per cent immediately before Bank rate was increased from $5\frac{1}{2}$ to $6\frac{1}{2}$ per cent on 31st March 1971. Since the increase in Bank rate the tender rate has been fluctuating around 5,5 per cent.

Despite considerable fluctuations, other money market rates also moved upwards during the year under review. Relatively high levels were reached in January and March 1971. A substantial easing of money market conditions was apparent, however, during the second quarter of 1971. The basic call rate quoted by the discount houses exceeded the Treasury bill tender rate for more than half the year under review (30 weeks), and rose to as much as 1,36 per cent above the tender rate at the end of January 1971. During the second quarter money market rates declined as the accompanying table shows.

Rates on money market instruments

	End of June 1970	End of January 1971	End of June 1971
	%	%	%
3 months' bankers' acceptances	6,10	7,80	7,10
90-day NCD's	6,90	8,60	7,85
180-day NCD's	7,10	9,10	8,20

Deposit interest rates also tended to move to higher levels during the year. Following upon the release, on 12th August 1970, of banks and building societies from their undertaking to maintain a maximum of 7 per cent for interest rates on deposits of 12 months and longer, this long-term deposit interest rate was subsequently raised by $\frac{1}{2}$ per cent to $7\frac{1}{2}$ per cent and some upward adjustments were also made to other deposit interest rates. As in the case of money market interest rates, exceptionally high deposit interest rates were occasionally quoted during the year, especially towards the end of January 1971.

The commercial banks' prime lending rate was raised twice during the past year, namely from 8 to $8\frac{1}{2}$ per cent effective from 15th September and from $8\frac{1}{2}$ to 9 per cent from 1st May 1971. In announcing the latter increase, the banks made it clear that this increase was forced upon them by rising costs rather than representing a delayed response to the technical adjustment of the Bank rate on 31st March. They also mentioned that the idea was not to increase their deposit rates.

Monetary policy measures during 1970/71

On account of the sustained inflationary pressures and the still relatively high level of liquidity of the private non-banking sector referred to above, no relaxations of the banks' required liquid asset ratios or general increases in the credit ceilings were granted during the year under review. Indeed, in order to put the competition between different banking institutions on a more equitable basis, and also to reduce the probability of a disorderly interest rate war following upon the freeing of deposit interest rates, it was decided in August 1970 that the discounts, advances and certain private sector investments of non-monetary banking institutions should also be brought under the credit ceilings. However, in February 1971 a concession of 2 per cent of the banks' ceilings on discounts and advances for the purpose of extending additional credit to the agricultural sector in view of the favourable maize and other crops was granted. The Reserve Bank also made known that penalties, in the form of additional cash requirements, would be applied to banks that exceeded their credit ceilings.

To supplement the various fiscal measures incorporated in the 1971/72 Budget, the Reserve Bank on Budget day (i.e., on 31st March 1971) raised the Bank rate from $5\frac{1}{2}$ to $6\frac{1}{2}$ per cent and made further upward adjustments to its pattern of rates on government stocks. Thus, the yield on short-term stocks was raised by 1 per cent to $6\frac{1}{2}$ per cent, while the yield on long-term stocks was increased by $\frac{3}{4}$ per cent to the all-time record level of $8\frac{1}{2}$ per cent. These adjustments served to bring the official interest rates more in line with rates quoted by the private sector.

Viewed in conjunction with the banks' and building societies' release, in August 1970, from their undertaking to maintain a maximum interest rate of 7 per cent on long-term deposits, these increases also gave further confirmation of the authorities' willingness to allow interest rates to rise in an orderly manner to somewhat higher levels, as appeared to be required by the prevailing demand and supply conditions in the financial markets. However, to mitigate the possibly unfavourable effects of higher costs of financing on housing, exports and agriculture, the freeing of deposit rates was accompanied by the introduction of a government scheme for subsidising interest costs to certain borrowers in these categories, as announced by the Minister of Finance in his 1970/71 Budget speech in August 1970. For similar reasons, the increase in Bank rate in March 1971 was accompanied by the lowering of the supplementary cash reserve requirement as applied to monetary banking institutions since 1968, this step being intended to provide additional relief from pressure exerted by rising costs on the banks' lending rates.

Longer-term view of monetary policy since 1964

The continued application during 1970/71 of fairly strict monetary measures and the fact that similar measures have been in use over the past six or seven years, may have led to the impression that the instruments of monetary policy that have been applied since the middle sixties have as yet been unsuccessful in curbing inflation. Any such impression would be false. Indeed the facts show clearly that monetary policy supplemented by fiscal measures has in fact contributed importantly to economic stability over this period.

Inflationary pressures, resulting from general overspending facilitated by a rapid rise in bank credit, became increasingly apparent from approximately the second half of 1964. To counteract these tendencies, the authorities during 1964 and 1965 took several steps (including, in October 1965, the imposition of the ceiling on bank credit) that were intended to bring about a more moderate increase in bank lending to the private sector and to protect the declining gold and foreign reserves. A more decisive application of some of these measures, supplemented by a tighter fiscal policy and accompanied by a relaxation of import control, was contained in the four-point attack on inflation announced by the authorities in July 1966.

The success of these measures became very apparent in the course of 1967. Indeed, over as long a period as from the third quarter of 1967 to the first quarter of 1969 an approximate balance was achieved between the domestic demand for and supply of goods and services, i.e. in the real sphere of the South African economy. Throughout this period, gross domestic expenditure did not greatly exceed, and mostly remained significantly below, the level of the gross national product, resulting in a small surplus on the current account of the balance of payments. At the same time, a considerable measure of stability was attained in the general price level, the consumer price index moving upward at an average annual rate of only 2,4 per cent. It is true that certain imbalances did develop in the composition of fixed investment in terms of its distribution among sectors and types of assets. Thus, private fixed capital outlays were mainly directed to residential and other building and construction in the non-manufacturing sectors, while fixed investment in manufacturing was sluggish. But these were the only blemishes in the real sphere of the economy which in most other respects was close to ideal.

In 1968 international exchange uncertainties following upon the devaluation of sterling gave rise to a large inflow of foreign capital into the South African economy. Coupled with the initial difficulties experienced in the marketing of gold under the two-tier system instituted in March 1968, this development resulted in an excessive expansion of domestic liquidity which found expression in speculative purchases of shares and fixed property transactions. Monetary and fiscal measures since 1968 have accordingly been aimed at restoring financial balance. To this end, quantitative restrictions on the banks' lending have been maintained while relaxations of the credit ceilings have mostly been allowed on a selective basis only. At the same time the government during 1968 and early 1969 absorbed and sterilised substantial amounts of funds from the private sector. In addition, the authorities, by means of further relaxations of import and exchange control and by permitting a rapid rise in imports, also allowed the gold and foreign reserves to decline substantially from the record level attained in May 1969.

These measures proved effective during 1970 and early 1971. The Reserve Bank re-established relatively firm control over bank and private sector liquidity and monetary conditions generally, while activity in the financial and fixed property markets returned to more normal levels. In the process of effecting a return to sounder domestic liquidity conditions, the authorities, by raising Bank rate and the pattern of yields on government stock, and by the removal of the ceiling on deposit interest rates in August 1970, also showed themselves willing to allow a higher interest rate structure.

In the meantime a new imbalance between the domestic demand for and supply of goods and services had developed from approximately the middle of 1969 and considerable pressure was exerted by the excessive demand on the limited supply of certain types of labour and capital with the resultant rapid rises in salaries and wages and prices. Under these circumstances, monetary and fiscal policies were aimed at restoring balance by curbing demand and encouraging saving through higher direct and indirect taxes and restrictive hire-purchase and other credit measures. As set out in the earlier part of this *Report*, information relating to 1971 now suggests that the fairly restrictive monetary and fiscal measures applied from 1969 onwards have once again, as in 1967, begun to restore balance between domestic expenditure and output.

Government finance

Increased contribution to overall demand by public authorities

During the year ended June 1971 public authorities, i.e. the central, provincial and local governments, contributed materially to the rise in expenditure on the gross domestic product. Consumption and fixed investment expenditure of the general departments of public authorities, together with the fixed investment expenditure of the business enterprises of these authorities, amounted to about R2 770 million, or 21 per cent of total gross domestic product, compared with about R2 360 million or 20 per cent of gross domestic product in the preceding year. The relevant expenditure increased by 17 per cent during 1970/71, against an increase of 9 per cent in total gross domestic product.

Of the total amount of R2 770 million, R1 600 million represented current expenditure of general government on goods and services, while the gross fixed investment expenditure of general government and autonomous government enterprises amounted to R625 million and R545 million, respectively. It is evident, therefore, that a substantial portion of the expenditure by public authorities related to expenditure on infrastructural development and other capital goods. During the period under review the investment component of the authorities' expenditure actually increased at a faster rate than its consumption expenditure component, namely by 19 per cent compared with 17 per cent. Both components, however, increased faster than private consumption and capital expenditure.

Expansionary impact of public authority expenditure

Apart from the public authorities' overall demand for goods and services, transfer payments to households and subsidies increased fairly substantially for the third consecutive year and amounted to about R335 million and R153 million, respectively, during the review period. In total these payments showed an increase of 19 per cent during 1970/71, compared with increases of 11 per cent and 17 per cent recorded during the preceding two years. Proceeds from direct and indirect taxation were about R1 380 million and R1 070 million, respectively, during 1970/71 and, taking into account income from property, interest on public debt, subsidies and net transfers to households and the rest of the world, total net current revenue of the general departments of public authorities amounted to about R2 050 million. This fell short of total expenditure on goods and services by public authorities by no less than R720 million, or 82 per cent more than in 1969/70. Consequently, it may be concluded that the demand for goods and services by public authorities exerted a direct expansionary effect on the economy during the period under review, apart from the indirect effect of net transfers to other sectors of the economy. The main reason for the substantial increase in the shortfall of the public authorities' net current revenue in relation to their overall demand for goods and services, was that direct and indirect tax receipts, the main sources of current revenue, increased by only 8 per cent against the increase of 17 per cent in expenditure on goods and services.

During the year under review direct taxes rose by 9 per cent and indirect taxes by 8 per cent. The tax reform introduced in the fiscal year 1969/70 had a distinct influence on the division of tax receipts between the direct and indirect categories. In terms of this reform, the indirect tax base was broadened by the introduction of a selective sales duty, levied at the importer and manufacturer level, and at the same time direct tax rates for individuals, particularly in the middle and higher income groups, were reduced. Direct taxes as a percentage of gross domestic product declined from 11,3 per cent in the year ended June 1969 to 10,6 per cent in the year ended June 1971. The ratio of indirect taxes to gross domestic product showed an increase over the corresponding period, namely from 7,4 per cent to 8,2 per cent. Total tax receipts as a ratio of gross domestic product rose only marginally from 18,7 per cent to 18,8 per cent over the same period.

The full expansionary impact of public authority expenditure in relation to current revenue is, however, also dependent upon the manner in which the borrowing requirements of the authorities are financed. With the exception of local authorities, the borrowing requirements of public authorities are channelled through the Treasury, so that the financing of the Exchequer deficit is also of prime importance in assessing the impact of government finance on the economy.

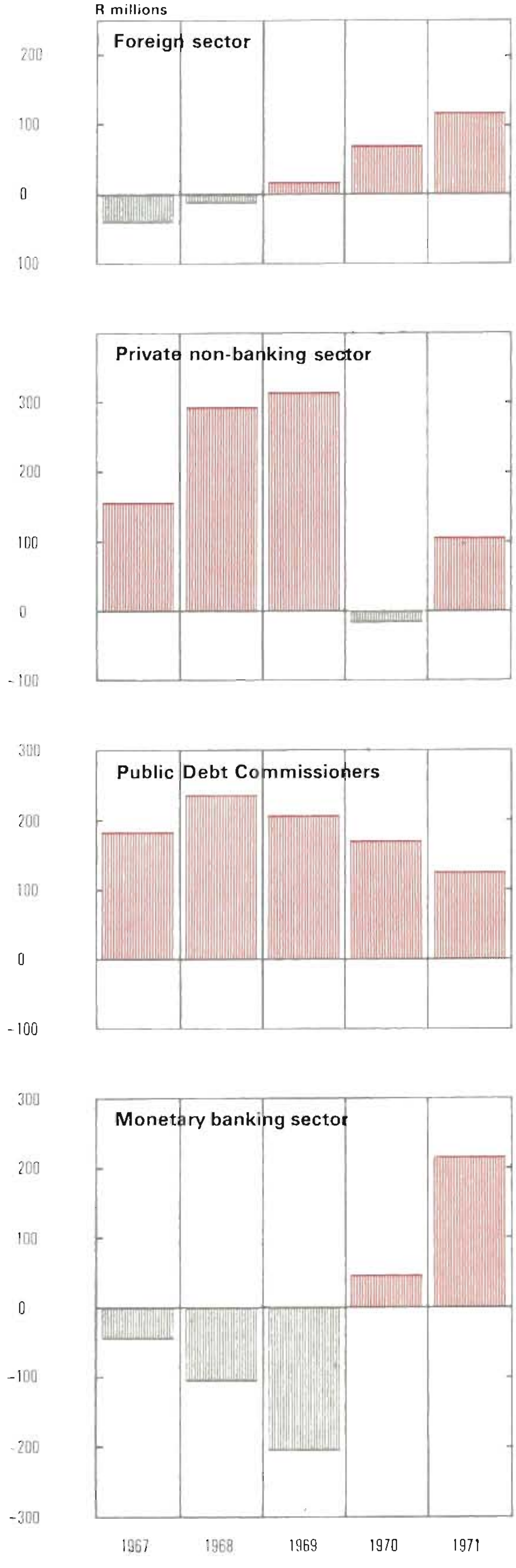
Substantial decline in cash balances to finance Exchequer deficit

The deficit on the Exchequer Account for the year ended June 1971 amounted to R563 million and exceeded the deficit of R369 million for the preceding year by a considerable margin. Exchequer issues increased by R329 million, or 13 per cent, during the period under review and accounted for the increased deficit, as Exchequer receipts showed a rise of only R135 million, or 6 per cent. Included in the receipts for the last quarter of the period under review are tax receipts which had previously been transferred to provincial administrations, while issues also included the higher subsidy payments to the administrations as from 1st April 1971.

In financing the deficit on the Exchequer Account, the Treasury was faced with a very tight domestic capital market and had to divert a substantial part of its borrowing operations to foreign capital markets. Net borrowing from the foreign sector amounted to R114 million, compared with R70 million during 1969/70, and this left an amount of R449 million to be raised in the domestic market. Traditionally the Public Debt Commissioners have been the Treasury's main source of funds, but during the period under review the Commissioners were able to contribute only R125 million, or 22 per cent, to the financing of total borrowing requirements, against R170 million in 1969/70 and an annual average of 50 per cent during the five years to June 1970. Capital raised in the private non-banking sector increased significantly during the year under review and amounted to R116 million, of which the proceeds of loan levies accounted for R63 million and increased holdings of government securities for R53 million. During 1969/70 the private non-banking sector's holdings of government securities declined by R37 million, while the proceeds of loan levies amounted to only R20 million, resulting in a decline of R17 million in the Exchequer's indebtedness to this sector.

Foreign and domestic non-banking sources provided R355 million for the financing of the Exchequer deficit and the Treasury was obliged to finance the remaining 37 per cent of its borrowing requirements through an increase of R208 million in the Exchequer's net indebtedness to the monetary banking sector. Holdings of government securities of the monetary banking sector increased by R3 million and the increase in the Exchequer's

Exchequer financing: change in net indebtedness to



net indebtedness to this sector was, accordingly, largely accounted for by a decline of R205 million in its cash balances. The Treasury was, therefore, unable to finance the deficit on the Exchequer Account in a non-inflationary manner and the increase in the Exchequer's net indebtedness to the monetary banking sector accounted largely for the rise of R270 million in this sector's net claims on the government sector as a whole. As was pointed out earlier, this increase in net claims on the government sector was one of the principal expansionary causes of the increase in the quantity of money and near-money.

During the second quarter of 1971, however, conditions in the market for fixed-interest securities improved at the higher levels of interest rates effective from the end of March. More support was given to the government's stock issues floated on 17th May and subscriptions were also received as from 15th June on the issue of new tax-free Premium Bonds. Subscriptions to the $6\frac{1}{2}$ per cent three-year issue amounted to R146 million, including R10 million subscribed by the Public Debt Commissioners and a similar amount subscribed by the private non-banking sector, while an amount of R129 million, of which the Public Debt Commissioners contributed R100 million and the private non-banking sector R25 million, was subscribed to the $8\frac{1}{2}$ per cent long-term issue. At the end of June investments in the Premium Bonds amounted to R8 million. Although the amount borrowed from the private non-banking sector was still very small, it nevertheless represented a considerable improvement compared with the total lack of support for the previous issues in October 1970.

The 1971/72 Budget

In the 1971/72 Budget, presented on 31st March, the emphasis was placed on curbing private consumption expenditure, encouraging saving and strengthening the infrastructure of the country. To curtail the increase in private consumption expenditure, both direct and indirect taxes were increased. Direct taxes were raised by increasing the surcharge on personal income tax from 5 to 10 per cent, the increased percentage being applied to a broader tax base including income and personal taxes levied previously by provincial administrations. Indirect taxes raised were excise duties on petrol, alcoholic beverages, cigarettes and tobacco. Except for minor adjustments, sales duties were not increased in the Budget, but had been raised on 10th February to forestall increased expenditure in anticipation of the announcement of higher sales duties in the Budget. These increased sales duties were estimated to yield R47 million during the 1971/72 fiscal year. The total revenue to be derived from all these tax increases was estimated at R156 million, or 2,0 per cent of private consumption expenditure in 1970/71.

In addition to these tax measures, loan levies on individuals and companies were also raised with a view to assist in the curbing of private consumption expenditure and in financing the expenditure on Loan Account. The levy of 10 per cent on individual taxpayers was increased on a sliding scale to a maximum of 20 per cent. Moreover, the $2\frac{1}{2}$ per cent loan levy on companies other than gold and diamond mining companies was raised to $7\frac{1}{2}$ per cent and a further loan levy amounting to $7\frac{1}{2}$ per cent of the dividend receipts of companies was introduced. Additional receipts from the increased and new loan levies were estimated at R79 million.

The Budget also embodied a number of recommendations by commissions of inquiry. The most important of these was the recommendation of the Commission of Inquiry into Fiscal and Monetary Policy in South Africa that provincial income and personal taxes be consolidated with the income tax of the central government. In accordance with the basic requirements set forth by the Commission of Inquiry into the Financial Relations between the Central Government and the Provinces, provinces would from 1st April be compensated for this loss of revenue by a subsidy based on the difference between their expenditure and their capacity to pay from sources of revenue other than income and personal taxes.

As a result of the consolidation of all income and personal taxes, the Budget estimates were not strictly comparable with the data for the 1970/71 fiscal year. The indications were, however, that receipts on the Revenue and Loan Accounts would increase by 12 per cent and expenditure from these accounts by 18 per cent. Based on information quoted by the Minister in Parliament, about 48 per cent of the expenditure in the Budget was intended for the improvement of the country's infrastructure. Because of the unequal increase in receipts and expenditure, the deficit for the fiscal year was expected to rise from R421 million in 1970/71 to R671 million in 1971/72. Taking into account redemptions of domestic and foreign loans, amounting to R320 million, the Government's borrowing requirements were estimated at R991 million.

In addition to the increase in loan levies, a new savings instrument was introduced to increase the contribution of the private non-banking sector to the financing of the

Government's borrowing requirements. It was announced that a new tax-free seven-year Premium Bond, yielding an average 7,1 per cent per year if held to maturity, would be available for subscription by individuals. It was anticipated that R80 million would be raised through issues of Premium Bonds, which together with an estimated total income of R152 million from loan levies and net issues of non-resident bonds of R6 million, would bring the amount to be raised in the form of an increase in non-marketable debt to R238 million.

The yield on long-term government stock was raised from $7\frac{3}{4}$ to $8\frac{1}{2}$ per cent on Budget day and the Budget provided for an amount of R90 million to be raised through new stock issues. The Public Debt Commissioners were expected to contribute R200 million to the financing of the deficit and new foreign loans of R150 million were anticipated, apart from conversions of foreign loans to the amount of R72 million. Together with conversions of domestic loans amounting to R209 million, all these sources of finance were expected to yield an amount of R958 million, leaving a deficit of R33 million to be covered by available cash balances.

Capital market

Noticeable change in capital market conditions

Notable changes occurred during the year ended June 1971 in the different sections of the domestic capital market, namely the equity market, the fixed property market and the market for fixed-interest securities, and also in the channelling of funds to fixed-interest-bearing deposits and building society shares.

Activity and prices in the equity market continued to decline until the end of 1970 from the peak reached in May 1969, and then improved noticeably during the first half of 1971, while activity in the fixed property market, which remained buoyant after prices and turnover in the equity market had commenced their downward movement, levelled off towards the middle of 1970. Conditions in the market for fixed-interest securities (gilt- and semi-gilt-edged securities and company debentures) continued to be very tight during the second half of 1970 and the first quarter of 1971, but tended to ease somewhat during the second quarter of 1971. Interest rates in this market, accordingly, continued to rise during the first part of the period under review, but the pressure on these rates eased considerably after further upward adjustments at the end of March and in April 1971.

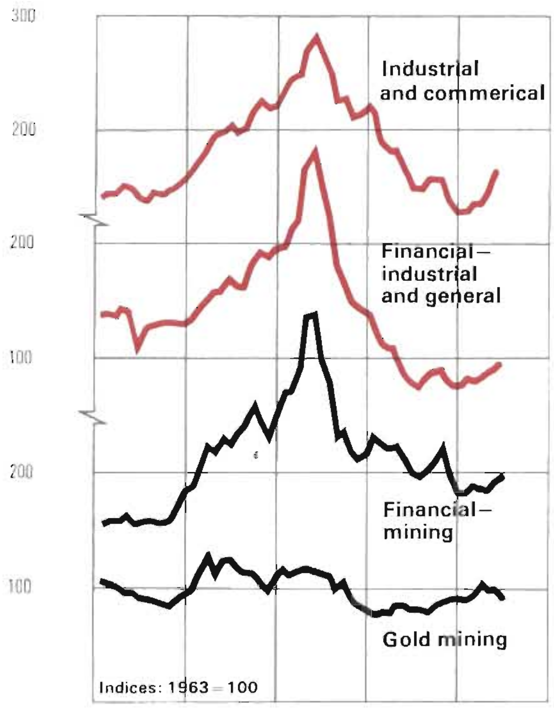
In contrast to the tight conditions in the market for fixed-interest securities during the larger part of the year under review, a steady and substantial inflow of funds in the form of interest-bearing deposits and building society shares was experienced by building societies and banks during the first three quarters of this period. During the second quarter of 1971, however, this inflow of funds, and in particular that to building societies, declined considerably.

Reversal of downward trend in equity market

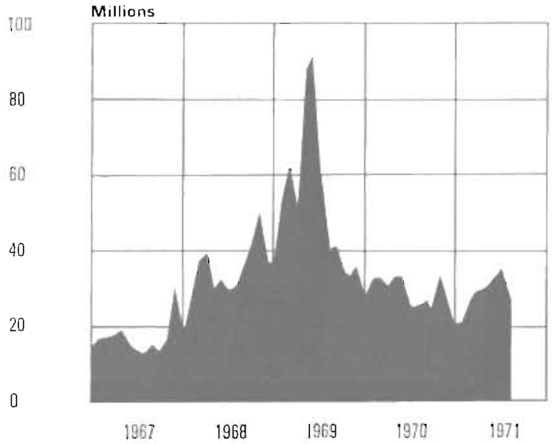
Share prices in general continued to drift downwards during the second half of 1970, but recovered noticeably during the first half of 1971. The prices of gold mining shares, however, showed a different trend and rose uninterruptedly until the end of the first quarter of 1971, before declining slightly during the second quarter of 1971. These changes in the prices of gold mining shares could to some extent be associated with international currency uncertainties and changes in the price of gold on the private market.

One of the factors that sparked off the recovery of share prices during the first quarter of 1971, was the substantial pur-

Share prices



Number of shares traded on the Johannesburg Stock Exchange



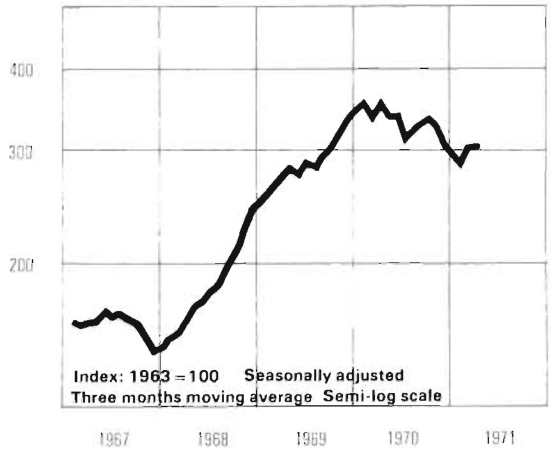
chases by foreigners of shares listed on the Johannesburg Stock Exchange. Gross purchases by foreigners amounted to R63 million, or 41 per cent of the value of all shares traded on the stock exchange during the first quarter. During the second quarter of 1971, however, the value of shares purchased by foreigners dropped substantially but the revival of stock exchange activity nevertheless continued. The stock exchange was, therefore, not only supported by foreigners, but on a much broader front. This was also confirmed by the renewed interest shown in equities by institutional investors, such as insurers and pension funds, and by the smaller increase in the general public's investments with deposit-receiving institutions.

Another factor contributing to the firmer trend of share prices was the limited amount of new scrip offered in the market. New share issues amounted to only R47 million in 1970/71, compared with R246 million in 1969/70. Companies preferred to raise capital through new issues of fixed-interest securities and these issues amounted to R121 million during the year under review, as against R73 million during the preceding year.

The increased activity in the equity market brought the prices of most classes of shares at the end of June 1971 to higher levels than a year before. Although dividend yields were generally lower in June 1971 than at the end of 1970, they nevertheless showed a marginal rise during the year under review, largely on account of higher dividend payments. With the upward adjustments of yields on fixed-interest securities, the reverse yield gap between the yield on industrial and commercial shares (5,3 per cent in June 1971) and that on long-term government stock (8,5 per cent) increased from 1,9 per cent in June 1970 to 3,2 per cent in June 1971.

The improvement of share prices during the first half of 1971 led to a decline in the outflow of funds from unit trusts and net repurchases of units fell from R30 million during the second half of 1970 to R14 million during the first half of 1971. In addition to the decline in their cash and security holdings for the purpose of financing the net outflow of funds, the market value of the unit trusts' fixed-interest security holdings also declined on account of the increase in yields. These two factors outweighed the effect of the increase in share prices and a decline of R33 million was recorded in the market value of trusts' net assets, bringing the total to R382 million at the end of June 1971. The index of selling prices of units declined only slightly from 135 in June 1970 to 134 in June 1971 and the dividend yield increased from 3,25 to 3,68 per cent over the relevant period.

Value of real estate transactions



More stable conditions in the fixed property market

In contrast to the sharp decline in prices and turnover in the equity market from May 1969 to the end of 1970, the fixed property market remained buoyant throughout 1969 and the earlier part of 1970. In this regard, the Commission of Inquiry into the Occurrence of Ruling High Selling Prices of Vacant Residential Sites and Unplanned Land found that, whereas the prices of erven increased annually by about 20 per cent during the five years prior to 1968, the subsequent increase during 1968 and 1969 was approximately 50 per cent per year. Although reliable statistics are not available to analyse the fixed property market, it would appear that conditions in this market tended to moderate towards the middle of 1970. The value of real estate transactions, which had risen sharply during 1968 and 1969, did not continue its upward course and levelled off as from the second half of 1970. This development was apparently due to a stabilisation of prices and also of the volume of transactions.

Slight easing of tight conditions in the market for fixed-interest securities

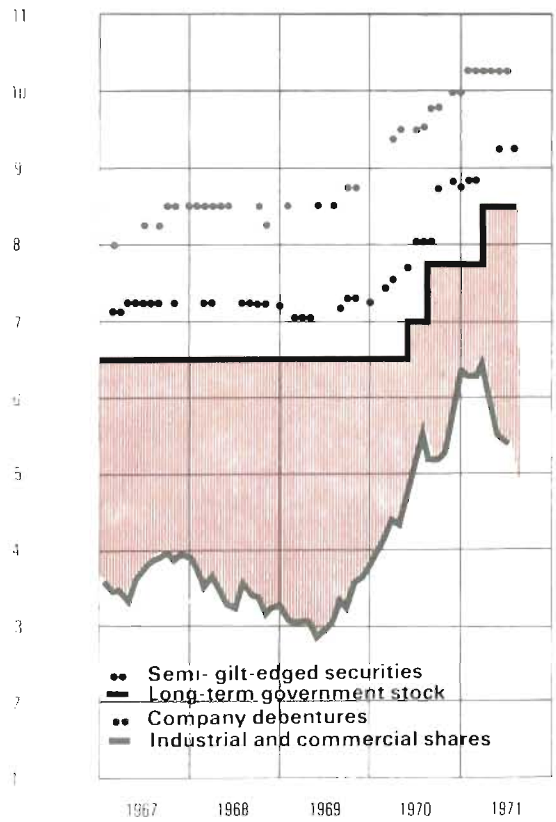
The demands made on the market for fixed-interest securities increased considerably during the year ended June 1971. Net new issues of marketable securities during this period amounted to R571 million, compared with R295 million during the preceding twelve months. The public sector raised a net amount of R450 million, or R228 million more than in 1969/70, while the private sector's net new issues amounted to R121 million, or R48 million more than in 1969/70. An interesting development was that smaller local authorities also entered the market instead of negotiating loans directly with investors, and during the period under review five new local authorities made issues of marketable stock. In addition to the demands made on the domestic market, the public sector diverted a part of its borrowing operations to foreign markets. Net foreign loans of R262 million were raised by this sector, against R136 million in 1969/70. These foreign borrowing operations, therefore, relieved the pressure on the domestic capital market to a considerable extent.

In the domestic market, the private non-banking sector contributed R136 million, the monetary banking sector R22 million, the redemption and other funds of public corporations and local authorities R59 million, and the Public Debt Commissioners R233 million, to the net amount raised by the public sector through issues of marketable stock. During 1969/70 almost the entire amount raised by the public sector in the market for fixed-interest securities was accounted for by an increase in indebtedness to the Public Debt Commissioners and other investors in the public sector.

During the review period the yield on long-term government stock was raised in two stages, from 7 per cent to $7\frac{3}{4}$ per cent on 13th August 1970 and to $8\frac{1}{2}$ per cent on 31st March 1971. The predominant yield on new issues of long-term stock by public corporations and the five largest municipalities increased from 8,0 per cent to 9,3 per cent over the corresponding period. In the case of new company debentures and notes, the representative yield rose from 9,50 per cent to 10,25-10,50 per cent. These interest rate adjustments led to a change in yield relationships. The margin between the yields on long-term semi-gilt- and gilt-edged securities narrowed from 1,0 per cent in June 1970 to 0,8 per cent in June 1971, while the yield gap between company debentures and gilt-edged or government stock was reduced from 2,5 per cent to 1,75-2,00 per cent over the same period. The fact that yield margins were not restored to previous levels after the last increase in the long-term government stock yield, appeared to reflect market opinion that the relevant yields had reached a maximum.

It would appear that at the new high yields a better balance developed between the demand for and the supply of funds in the market. New issues of semi-gilt-edged securities since April this year were slightly oversubscribed, while the issue of long-term government stock floated in May also

Interest rates and yields



proved to be more successful than the previous issue during October 1970.

Building societies

During the year ended June 1971 the flow of new funds to building societies in the form of an increase in deposits and share capital amounted to R410 million (or an increase of 15 per cent) and just fell short of the record inflow of R422 million (representing an increase of 19 per cent) during 1969/70. These rates of growth were also considerably above the average annual rate of growth of 10 per cent in building society funds during the ten-year period between 1960/61 and 1970/71. Of the net amount invested with building societies during the period under review, R364 million was received during the first nine months and R45 million during the last three months. The rate of inflow, therefore, decreased significantly after having reached a very high level from about the middle of 1969. This decline in the rate of inflow of funds during the second quarter of 1971 was also immediately reflected in the amount of new advances granted. The figure for the second quarter amounted to R150 million, compared with a quarterly average of R173 million during the first three quarters of the period under review.

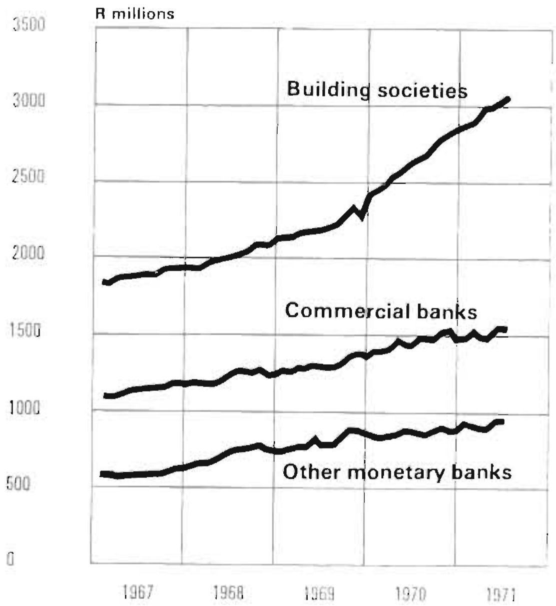
The smaller inflow of funds to building societies was probably related to the increased activity on the stock exchange and the stronger competition for funds by the monetary banks and other investment outlets such as participation mortgage bonds and the Premium Bonds issue by the Treasury. Savings and time deposits of the private sector (excluding monetary banks and building societies) with monetary banks, for example, increased on average by R30 million during the first three quarters of the twelve-month period under review and by as much as R84 million during the last quarter of the relevant period. The main reason for this diversion of funds to the monetary banks was that these banks, with a wider margin between their borrowing and lending rates and a greater flexibility in the adjustment of their lending rates, were able to raise their borrowing rates above those of the building societies. Borrowing and lending rates of the societies have remained unchanged since August/September last year, when an upward adjustment of $\frac{1}{2}$ to $\frac{3}{4}$ per cent in deposit and lending rates was made.

The inflow of funds to building societies together with capital repayments on existing mortgages enabled the societies to grant new mortgage loans of R669 million during 1970/71, compared with R725 million during the preceding twelve months. However, their commitments in respect of mortgage loans granted but not yet paid out, declined by R64 million during the period under review against an increase of R117 million during the preceding year. Consequently, an amount of R733 million was actually paid-out on new mortgage loans during 1970/71, compared with R608 million during the previous year.

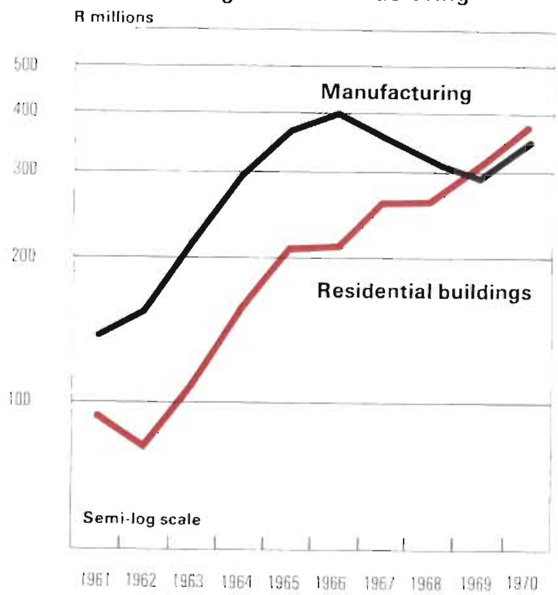
Notwithstanding the substantial amounts advanced by building societies, they were still unable to satisfy the demand for mortgage loans stemming from the housing needs of the middle and higher income groups of the population. The very high demand for housing was also reflected in an average annual growth rate of 12,3 per cent for gross fixed investment in private residential buildings during the ten-year period 1961 to 1970, compared, for example, with a corresponding growth rate of 10,8 per cent for gross fixed investment in the private manufacturing industry. In terms of absolute figures, the gross fixed investment in private residential buildings amounted to R367 million in 1970, against R350 million in the private manufacturing industry.

In view of the very large payments on new mortgage loans, the actual amount of these loans outstanding increased by R374 million or 17 per cent during the review period, against an increase of R288 million or 15 per cent during the previous year. Loans against shares and deposits also showed a

Savings and time deposits and building societies' shares



Private gross fixed investment: residential buildings and manufacturing



net increase of R14 million, after a decline of R13 million during 1969/70. The decline in the societies' commitments in respect of mortgage loans not yet paid out led to a comparatively small net investment in liquid assets and other prescribed investments, which increased by R16 million, against an increase of R134 million during the preceding twelve months. Compared with their outstanding commitments of R166 million at the end of June 1971, the societies' excess holdings of prescribed investments, i.e. the amount held in excess of the statutory minimum, amounted to R139 million.

Preference of insurers and pension funds for higher yielding fixed-interest securities

Figures for insurers and private pension funds are only available up to March 1971 and indicate that during the year ended March 1971 a distinct shift of emphasis in the investment policies of these institutions occurred in relation to the preceding year. Whereas the emphasis had fallen on equity and fixed property investments during the twelve months to March 1970, the institutions showed a preference for higher yielding fixed-interest securities during the subsequent twelve months and at the same time maintained a fairly substantial investment in fixed properties.

During the period under review the investments of these institutions in semi-gilt-edged securities and company debentures amounted to R183 million, compared with about half that amount during the preceding year. Investments in equities, including units in unit trusts, for the corresponding two periods amounted to R32 million and R169 million, respectively. The allocation of funds to government stock also increased slightly relative to 1969/70, while the allocation to direct loans, mortgage bonds and cash and deposits holdings declined.

Changes in assets of insurers and pension funds
R millions

	Year ended March	
	1970	1971
Government stock	43	46
Public corporation and municipal stock	42	65
Company debentures	48	118
Mortgage loans	35	16
Loans to public corporations and local authorities	13	13
Other loans	68	29
Ordinary shares	144	27
Units in unit and property trusts	25	5
Fixed property	40	40
Cash and deposits	46	39

The investment pattern of the institutions concerned, however, changed during the course of the year ended March 1971. These investors showed little interest in equities during the first half of this period, but their equity investments were higher during the last quarter of 1970 and increased still further during the first quarter of 1971. This increased institutional demand for equities probably also contributed to the improvement of share prices from the beginning of 1971. The institutions' investment in fixed properties followed a broadly similar pattern. At the time when equity and fixed property investments were kept at a low level, investments in the higher yielding fixed-interest securities were stepped up. As the increase in the institutions' assets was larger in the second half of the period under review, the allocation of funds to fixed-interest investments did not show a compensating decline when equity and fixed property investments were increased. Cash and deposit holdings, which had shown a substantial increase during the first half of the period under review, remained more or less unchanged during the second half.