

South African Reserve Bank

1974

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-Fourth Ordinary General Meeting to be held on 27 August 1974.

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General observations

The South African economy continued to grow at a high rate during the year that ended on 30 June 1974* and at the end of this period had been in an upward phase of the business cycle for about twenty months, i.e. from about the middle of the fourth quarter of 1972. The overall growth rate of the economy, as measured by the increase in the real gross domestic product, was not particularly high for the year under review, owing mainly to negative contributions by the agricultural and gold mining sectors. However, the bumper maize and other summer crops of 1974 will only be reflected in the production figures for the third quarter, with the result that for the calendar year 1974 a growth rate of about 7 per cent is expected. Furthermore, the more rapid rise in export prices than in import prices enabled South African residents to purchase a larger volume of goods and services abroad with the proceeds of the same volume of exports. Because this favourable turn in South Africa's terms of trade is taken into account in the calculation of the real gross *national* product, it is noteworthy that this measure of the economic welfare of the residents of South Africa showed an increase of 10 per cent in real terms for the year 1973/74, compared with an increase of 6 per cent during the preceding year. The different measures of economic growth, therefore, indicate that South Africa is experiencing one of its best growth periods at a time when most industrialised countries' economic growth rates are very low or even negative.

A closer look at the changes in the growth rate of the non-agricultural sectors of the economy during the course of the year under review reveals that the real gross domestic product increased during all four quarters of the year, but that the rate of increase declined from the high peak reached in the third quarter of 1973. This slowing-down in the rate of increase at a relatively high level may be associated with developments such as the influence of the oil crisis in the fourth quarter of 1973 and of flood damages in the first quarter of 1974, scarcities of certain raw materials, uncertainties in the international monetary field, and the high level of utilisation of machine capacity and of labour and capital resources. In fact, the rate of increase accelerated slightly during the second quarter of 1974 and taking into account the harvesting of the maize and other summer crops in the third quarter, should show a further increase in this quarter.

The higher growth rate of the economy stemmed not only from the benefits gained from the sharp rise in the price of gold and of certain export commodities, but

also from an acceleration in the rate of increase in domestic aggregate demand as measured by the gross domestic expenditure. All the main components of aggregate demand, i.e. private and government consumption expenditure and fixed and inventory investment, contributed during 1973/74 to the high rate of increase in the gross domestic expenditure of 25 per cent at current prices and 12 per cent at constant prices. These high rates of increase indicate that the gross domestic demand for goods and services increased at significantly faster rates than the gross domestic and the gross national product and exceeded the latter in the fourth quarter of 1973 and the first half of 1974. This development, together with the fact that the economic expansion has reached a high level of utilisation of machine capacity in most industries and of labour and capital resources, points to the existence of a situation of demand-pull inflation. Moreover, the large capital expansion programmes already commenced or announced by the public authorities as well as the expansionary effects of the salary and wage increases in the public and private sectors should also stimulate aggregate monetary demand in the near future.

The excess of the domestic demand over the supply of goods and services during a large part of the year under review was also reflected in the balance on the current account of the balance of payments, which changed from a surplus in the third quarter of 1973 to deficits during the subsequent three quarters. In addition to the natural development of a current account deficit in a period of rapid domestic economic expansion, a number of external developments affected the South African economy, and more particularly, South Africa's balance of payments. These developments include the oil crisis, the sharp rise in the price of gold and in international commodity prices, the marked increases in interest rates and in rates of inflation, and the continued international monetary uncertainties coupled with fluctuating exchange rates. During the year 1973/74 a current account deficit of R241 million was recorded. If viewed in relation to the gross domestic product this deficit was relatively small and represented only 1,2 per cent of that aggregate, compared with an average of 3 per cent for the post-war years. The exceptionally sharp rise in the prices of gold and certain export commodities were the main reasons why the larger deficit which could have been expected in a period of such rapid economic expansion did not, in fact, materialise. This is illustrated by the fact that merchandise imports rose by 46 per cent during 1973/74 to an amount of R4 473 million, exports by 14 per cent to R2 796 million and net gold output by 55 per cent to R2 215 million.

*The year that ended on 30 June 1974 will be the year under review and will also be referred to as 1973/74.

The capital account of the balance of payments also recorded a deficit taking the form of a net outflow of capital from South Africa during 1973/74, compared with a net inflow during the previous year. During the third and fourth quarters of 1973 and the second quarter of 1974 net outflows of capital occurred, whereas a net inflow was recorded during the first quarter of 1974. The outflow of capital during 1973/74 was rather unusual because in South Africa's case a deficit on the current account resulting from increased domestic demand has usually been accompanied by an inflow of capital from abroad to finance increased domestic activity. In this instance, the outflow of capital was largely attributable to the abnormally wide margin between South African and foreign interest rates, and, at one stage, towards the end of 1973, also to unfounded speculation on a possible devaluation of the rand. Another factor contributing to the outflow of capital was the marked increase in bank credit to the private sector which was partly used for the switching of trade credits and other finance from more costly foreign sources to much cheaper domestic bank credit.

The outflow of capital, together with the deficit on the current account and certain valuation adjustments to the reserves, resulted in a notable decline in the gold and other foreign reserves. The combination of expanding bank credit and declining reserves partly caused by a capital outflow was naturally not in the longer-term national interest. The authorities, therefore, decided to pursue a more cautious monetary policy and interest rates were raised on several occasions.

The marked increase in bank credit to the private sector was largely responsible for a substantial further increase in the quantity of money and near-money during the year that ended on 30 June 1974. Bank credit to the government sector increased only moderately, whereas both the net gold and other foreign reserves and the long-term deposits of the private sector with the banking sector had a negative effect on the money and near-money supply. The rapid expansion of bank credit to the private sector and the decline in the gold and other foreign reserves both contributed to the tightening of the liquidity position of banking institutions. Fluctuations in government deposits and shifts between short-term and long-term deposits with the banking sector at times also contributed to a tightening or easing of the liquidity position of the banks. By increasing credit to the private sector during 1973/74 by an amount of R1 529 million, i.e. an increase of 30 per cent, the banks drew down their excess liquid assets from a ratio to their liabilities to the public of 4,5 per cent at the end of July 1973 to 0,8 per cent at the end of June 1974. Towards the end of the period under review the banks' ability to create further credit was enhanced by Reserve Bank credit extended to the Land Bank and by a substantial shift of deposits from short-term to long-term which reduced the required minimum amount of liquid assets.

Notwithstanding the rapid rise in bank credit, the demand for credit continued to exceed the supply and with the tight liquidity and money market situation short and long-term interest rates moved upwards in stages to much higher levels than during the previous year. The Reserve Bank acknowledged this upward trend of interest rates and increased Bank Rate and the pattern of rates quoted on government stock transactions as well as the ceilings on deposit interest rates on various occasions. The higher levels of interest rates in both the money and capital markets can be attributed not only to the relative shortage of loanable funds caused by the upsurge in economic activity and the outflow of capital, but also to the exceptionally high rate of inflation.

During the past few years, one of the most pressing economic problems in South Africa and elsewhere in the world has been the unacceptably high rate of increase in prices in general. A comparison of consumer and wholesale price increases in a number of industrialised countries during the most recent twelve months, nevertheless indicates that South Africa had still one of the lowest rates of increase, despite the fact that consumer prices in the Republic rose by 11,2 per cent and wholesale prices by 18,8 per cent between June 1973 and June 1974. With these high rates of price increases and with the presence of demand inflation, the authorities pursued a more conservative monetary and fiscal policy as reflected in a statement of the Reserve Bank on 13 August and the Budget Speech on 14 August.

National accounts and other economic indicators

High rate of economic growth

The rate of increase of 22 per cent in the gross domestic product at current prices during the year that ended on 30 June 1974, was substantially higher than the 16 per cent recorded during the preceding year. This higher rate of increase was associated with increases of 15 per cent and 32 per cent, respectively, in the remuneration of employees and the operating surplus. Because of the large rise in the operating surplus, the ratio of this surplus to the gross domestic product increased to 46 per cent — the highest ratio recorded during the past fifteen years. The largest contributions to the exceptionally high rate of increase in the gross operating surplus were made by increases of 70, 42 and 40 per cent, respectively, in the operating surplus of the sectors mining, manufacturing and commerce.

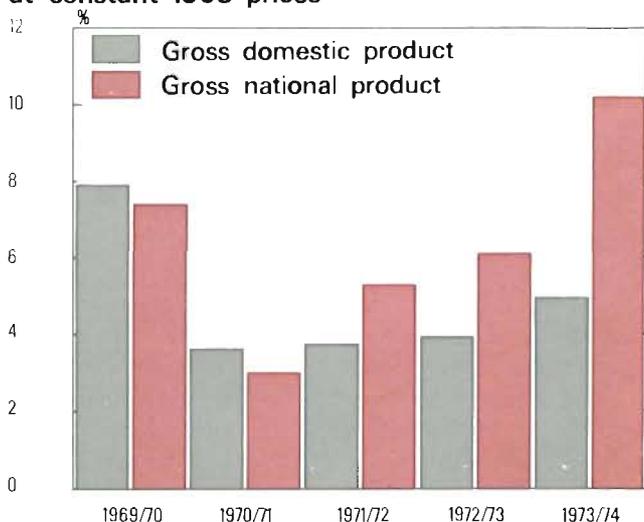
The rate of growth of the gross domestic product at current prices, however, reflected largely a high rate of increase in prices. At constant prices, the growth rate of the gross domestic product increased only moderately from 4 per cent in 1972/73 to about 5 per cent in 1973/74. The difference between this small increase and the acceleration of 6 percentage points in terms of current prices was accounted for by a higher rate of increase in the gross domestic product deflator which increased by approximately 16 per cent during the review period, compared with 12 per cent during the previous year. The sharp rise in the price of gold and in

the price of certain export commodities was a major factor contributing to the higher rate of increase in the gross domestic product deflator.

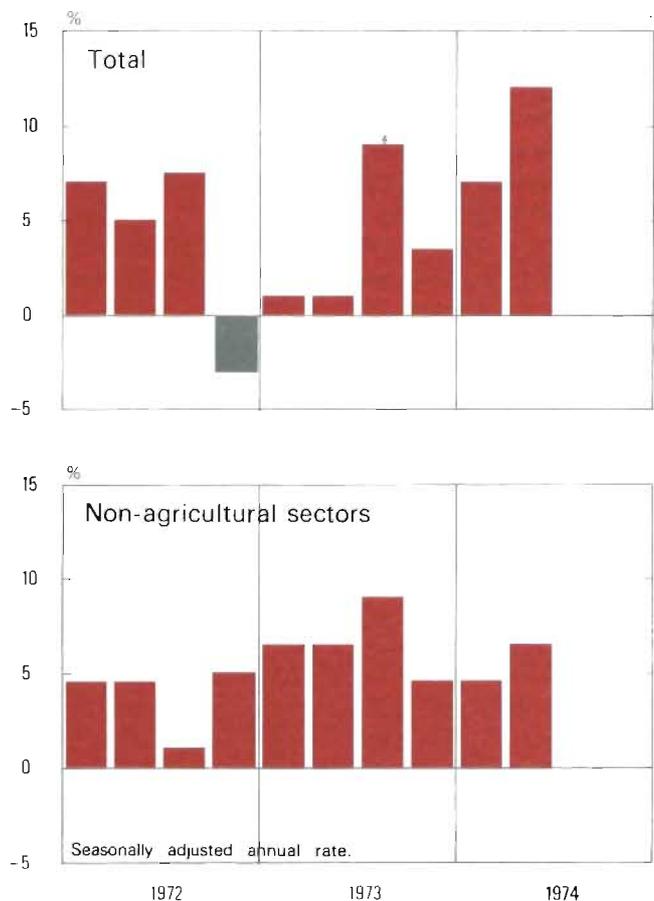
Because the prices of South African exports increased substantially faster during 1973/74 than the prices of imports, the terms of trade moved in South Africa's favour. Consequently, the real gross national product, as a measure of real purchasing power of permanent residents of South Africa, increased by as much as 10 per cent during 1973/74, compared with 6 per cent during the previous year. These increases represented a considerable increase in the welfare of South African residents during the past two years.

Indications are that the real growth rate for the calendar year 1974 will be one of the highest rates achieved in South Africa in the post-war period. This forms a sharp contrast to the situation in most industrialised countries where negative to relatively low rates of

Annual percentage change in gross domestic and gross national product at constant 1963 prices



Percentage change in gross domestic product at constant 1963 prices



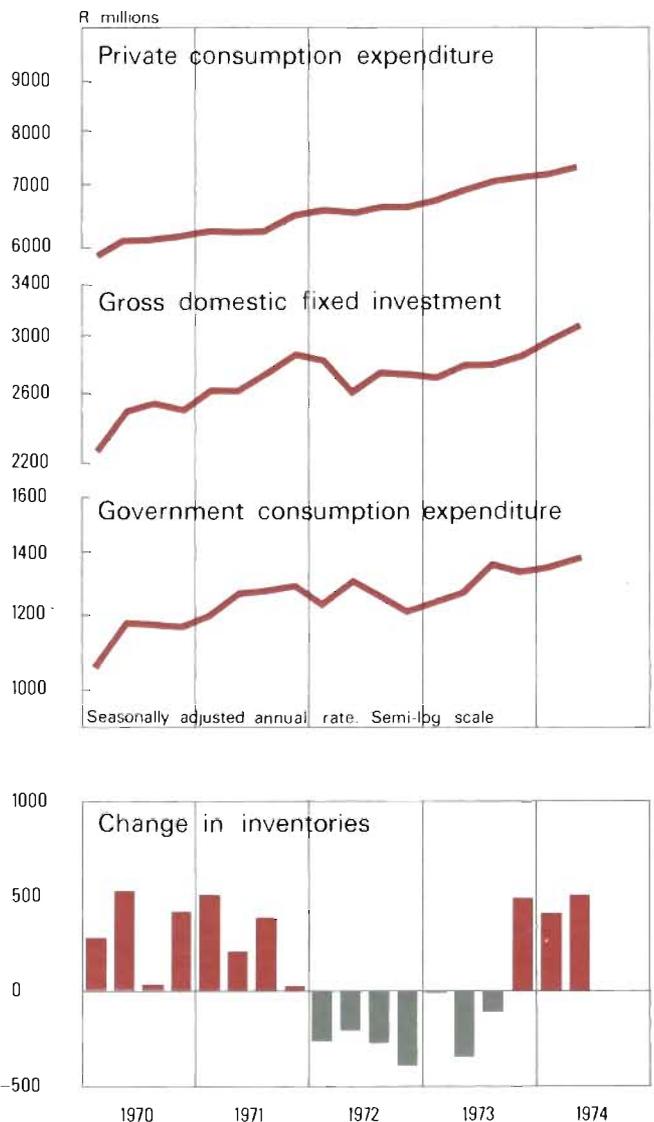
economic growth are envisaged for 1974. Both the agricultural and the non-agricultural sectors are experiencing buoyant conditions. However, South Africa's growth rate is affected markedly by fluctuations in agricultural production. For example, the major part of the maize crop, which on average accounts for about 20 per cent of the value of agricultural production, is harvested either in the second or in the third quarter of the year and is included in production as and when the actual harvesting is done. In 1974 the very large maize crop will only be harvested fairly late in the year and will therefore, lead to a sharp increase in the overall growth rate in the third quarter of 1974, but does not show up in the figures for the year under review. Consequently the overall economic growth rate measured in this way was relatively low for 1973/74. However, if the agricultural sector is excluded, the real growth rate of the non-agricultural sectors increased from about 4 per cent in 1972/73 to 6½ per cent in 1973/74. It is anticipated that for the calendar year 1974 the increase in the real gross domestic product may reach a level of 7 per cent.

Quarterly estimates of the gross domestic product at current prices show that the rate of increase accelerated further during the first half of 1974, mainly on account of substantial increases in the gross operating surplus of the sectors agriculture, mining, manufacturing and commerce. As is evident from the accompanying graph, the gross domestic product at *constant* prices increased during all four quarters of the year under review, although the rate of increase declined slightly from the high level of the third quarter of 1973. This slowing-down in the *rate of increase* in the real gross domestic product was not unexpected, in view of considerations such as the fuller utilisation of production capacity and labour and capital resources and international economic uncertainties including those related to the supply of oil and other raw materials.

Large increase in gross domestic demand

Aggregate domestic demand, as measured by gross domestic expenditure, recorded a rate of increase of 25 per cent at current prices, and 12 per cent at constant prices during the year under review. These rates of increase were substantially higher than those for previous years. All the main components of total monetary demand contributed to these high rates of increase. At constant 1963 prices, private consumption expenditure increased by 5½ per cent, government consumption expenditure by 10 per cent, fixed investment by 7 per cent, and there was an inventory investment of R325 million. Real fixed investment in machinery and equipment rose by 10 per cent and that in building and construction works by 4 per cent. The increase in real domestic expenditure has been one of the major factors responsible for the highly satisfactory growth perfor-

Gross domestic expenditure at constant 1963 prices



mance, particularly that of the non-agricultural sectors of the economy.

The trend in quarterly estimates of total monetary demand, together with indications of a high level of capacity utilisation and a tighter labour and capital situation, leave no doubt that the economy reached a situation of excess demand towards the end of the period under review. Total domestic demand increased at a noticeably faster rate than both the gross domestic and the gross national product, and exceeded the latter in the fourth quarter of 1973 and the first half of 1974. As a result of this development, the current account of the balance of payments changed from a surplus during the third quarter of 1973 to deficits during the subsequent three quarters.

Acceleration in rate of increase in private consumption expenditure

Private consumption expenditure at current prices increased by 16 per cent during the year that ended on 30 June 1974, compared with 12 per cent during each of the preceding two years. Because of a high rate of increase in the prices of consumer goods, real consumption expenditure increased by only $5\frac{1}{2}$ per cent which is higher than the rate of increase of $3\frac{1}{2}$ per cent recorded during the preceding year. The acceleration in the rate of increase in real consumption expenditure, however, was noticeably different for the various classes of consumer goods. Outlays on non-durable goods and services increased only at a moderately higher rate during 1973/74 than during the previous year. However, the rate of increase in consumer expenditure on goods of a less essential nature, such as durable and semi-durable goods, accelerated substantially.

The sharp rises of 9 per cent and 6 per cent, respectively, in the outlays on durable and semi-durable goods at constant prices were not unexpected because expenditure on these classes of goods normally tends to increase at a faster rate during periods of general economic prosperity. Expenditure on furniture and household appliances at constant prices increased very sharply during 1973/74, after it had shown almost no change during the previous year. This was to some extent due to the furnishing of the large number of new houses and flats completed during the relevant period. Expenditure in real terms on new motor cars, however, did not increase to the same extent during 1973/74 as during the previous year. The reason for this was that the upward trend in the number of new motor cars sold was affected during the last quarter of 1973 and the first quarter of 1974 by the oil crisis and government measures to economise on fuel consumption. Expenditure on semi-durable goods at constant prices recorded a rate of increase during the period under review that was double that of the previous year, with expenditure on clothing and footwear making the largest contribution, especially during the second half of 1973.

Estimated quarterly data show that the rate of increase in real private consumption expenditure declined slightly during the final quarter of 1973 and the first quarter of 1974. During the second quarter of 1974, however, it accelerated again, mainly on account of a substantial increase in outlays on motor cars.

The high rate of increase in private consumption expenditure during the last two years was facilitated to an important extent by the extensive use made of consumer credit. Because an increase in consumer credit represents negative saving, it also contributed to the lower level of personal saving during the year under review. Consumer credit outstanding is estimated to have risen from about R1 475 million at the end of June 1972 to approximately R2 110 million at the end

of December 1973 (the latest figures available) representing an increase of 43 per cent in 18 months.

Revival in private fixed investment and smaller increase in fixed investment by public corporations

Although the prices of capital goods increased substantially, gross private fixed investment at constant prices recorded a marked increase of 18 per cent during the year that ended on 30 June 1974, compared with a decline of 5 per cent during the previous year. The replacement of and addition to production capacity was induced mainly by the high rate of increase in real domestic expenditure and the low level of inventories at the beginning of the period under review. Notwithstanding the increase in real fixed investment, a high level of capacity utilisation existed in the private sector at the end of the review period.

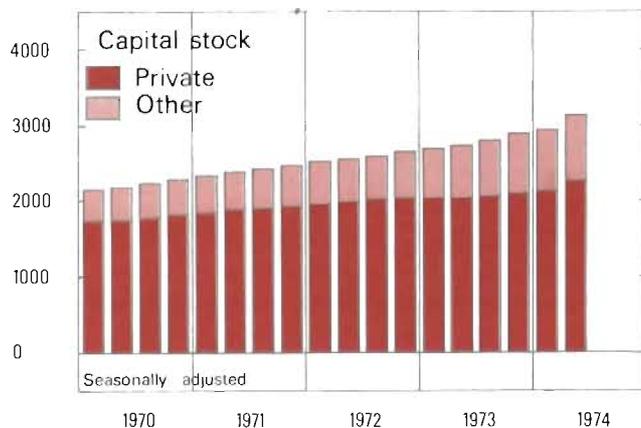
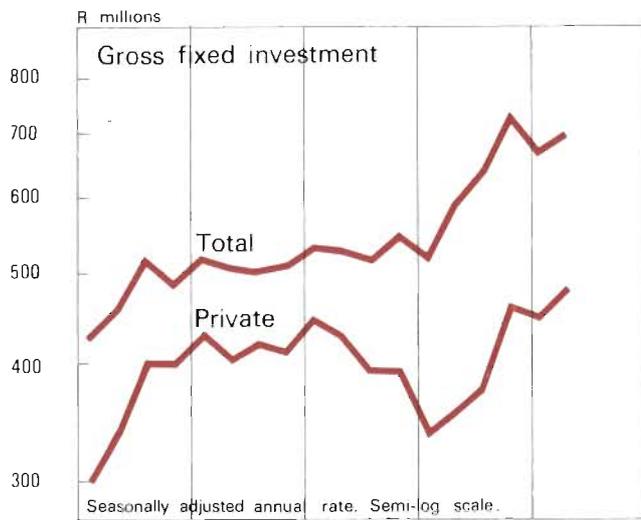
Percentage change in gross fixed investment of the private sector at constant 1963 prices

	Year ended 30 June	
	1973	1974
Private business enterprises	-5	18
Agriculture	-18	5
Mining	4	49
Manufacturing	-13	20
Private residential buildings	6	13

As shown in the accompanying table, the mining sector made the largest percentage contribution to the increase in real private fixed investment, mainly because of higher capital outlays by gold and platinum mines. A notable contribution was also made by the outlays on new residential buildings. Real fixed capital expenditure by private manufacturing, which had declined during 1972/73, increased again during 1973/74. As the accompanying graph shows, the real fixed capital stock of private manufacturing increased substantially from the third quarter of 1973. Real capital outlays by the agricultural sector also increased during the period under review, after a substantial decline during the preceding year. The main reasons for this increase were the heavy demand for planting equipment during the second half of 1973 and for harvesting equipment during the first half of 1974 to cope with the expected record agricultural crops. Real fixed investment in non-residential buildings increased only moderately during the review period mainly owing to an over supply of office and shop accommodation in the principal urban areas.

Estimated quarterly data show that the fixed investment by the private sector increased strongly in all four quarters of the period under review. The rate of increase in the fixed capital expenditure by private manufactur-

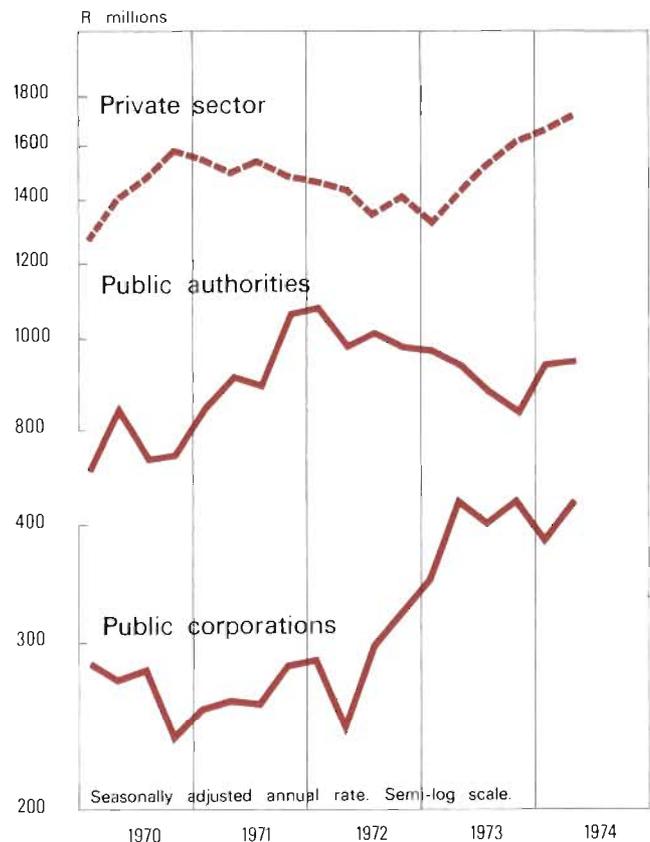
Fixed capital stock and gross fixed investment in manufacturing at constant 1963 prices



ing gained considerable momentum during the second half of 1973, continued at a slower rate during the first quarter of 1974 and accelerated again during the second quarter.

The real fixed investment of public corporations increased substantially for the second consecutive year, but the rate of increase nevertheless declined from 33 per cent in 1972/73 to 14 per cent in 1973/74. The expansion and renewal programmes of Iscor were largely responsible for the further increase in the corporations' capital outlays. On a quarterly basis, the fixed investment of public corporations showed large fluctuations, but a strong upward tendency was nevertheless maintained throughout the period under review.

Fixed investment at constant 1963 prices



Higher rate of increase in final expenditure of public authorities

The public authorities' total demand for final goods and services, excluding changes in inventories, increased by 14 per cent during the year that ended on 30 June 1974. This increase, which was more than double the percentage rise recorded in 1972/73, was almost entirely due to higher consumption expenditure, because fixed investment outlays during the year under review rose by only 4 per cent compared with 1972/73. Notwithstanding the higher rate of increase in the public authorities' consumption expenditure, the ratio of their total final expenditure to aggregate gross domestic expenditure was lower in 1973/74 than in the preceding two years. Compared with 23 per cent in 1971/72 and 22½ per cent in 1972/73, the ratio declined to 21 per cent in 1973/74.

At current prices, the consumption expenditure of public authorities registered the highest percentage increase of all the main components of gross domestic expenditure during the year under review, namely 23 per cent compared with only 5 per cent during the preceding year. The composition of the increase in current expenditure during 1973/74 was significantly different

from that in 1972/73. Whereas higher salaries and wages were entirely responsible for the rise in consumption expenditure in 1972/73, the increase in absolute terms in 1973/74 was almost equally divided between the remuneration of employees, on the one hand, and the purchase of goods and other services, on the other. In percentage terms, however, the remuneration of employees increased by 18 per cent and consumption expenditure on goods and other services by 32 per cent. In real terms, the increased expenditure on goods and other services was mainly responsible for the rise of 10 per cent during the year under review. If the various levels of government are considered, current outlays by the central government rose by 29 per cent during the review period, whereas those of provincial administrations and local authorities increased by 15 and 19 per cent, respectively.

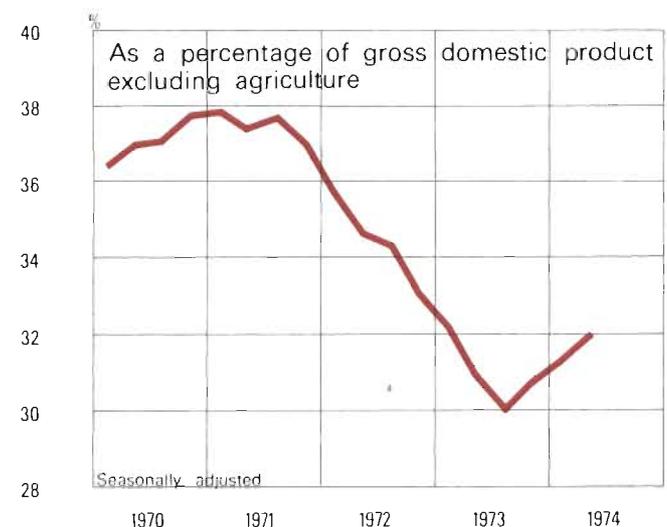
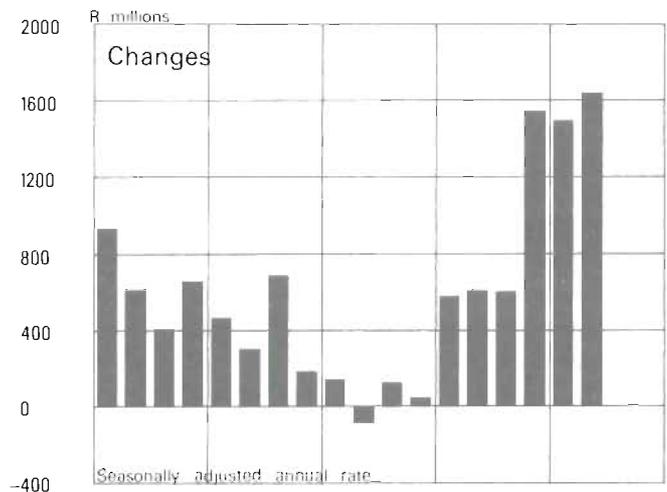
The fixed investment of public authorities at current prices showed a small increase during the year that ended on 30 June 1974, but at constant prices it declined by 9 per cent, compared with a fall of 3 per cent during 1972/73. The decline in real terms during the year under review was mainly due to decreases of about 9 per cent in the fixed capital outlays of public authorities on community and social services and of 12 per cent in the fixed investment of the South African Railways. Real fixed capital expenditure of the Department of Posts and Telecommunications, however, increased by 14 per cent during the year under review. In terms of different classes of assets, a very substantial decline of 34 per cent in the real fixed investment in transport equipment was registered. Declines were also recorded in the real fixed investment in residential and non-residential buildings and in construction works, whereas real capital outlays on machinery and other equipment did not change during the review period.

Estimated quarterly data indicate that capital outlays by the general government departments on community and social services, which had declined sharply during the second half of 1973, started to recover during the first half of 1974. The capital expenditure of the South African Railways continued to decline throughout 1973/74, whereas that of the Department of Posts and Telecommunications remained strong throughout the period under review.

Large addition to inventories

The book value of the aggregate of inventories increased by R1 200 million during the year that ended on 30 June 1974 compared with an increase of R400 million during the previous year. The manufacturing sector contributed R700 million and the sector wholesale, retail and motor trade R350 million to the 1973/74 increase. After adjusting the book value of inventories at the end of June 1974 for price increases in excess of the average price level during the relevant year, net

Total inventories excluding agricultural stocks



additions to inventories amounted to R550 million during 1973/74, compared with a running-down of inventories to an amount of R220 million during the previous year.

Quarterly estimates of inventory investment show that the book value of total inventories increased significantly from the fourth quarter of 1973, mainly owing to substantial additions to commercial and industrial inventories. The downward tendency since the beginning of 1971 of the ratio of non-agricultural stocks to the comparable gross domestic product was reversed in the fourth quarter of 1973, but the ratio is still relatively low.

Further substantial increase in gross domestic saving

For the third consecutive year, a rate of increase of more than 20 per cent was recorded in gross domestic saving and as a ratio of gross domestic product it increased from a level of 20½ per cent in 1970/71 to 26½ per cent in 1973/74 — the highest annual level attained during the past fifteen years. Notwithstanding this high rate of increase, gross domestic saving was still insufficient to finance gross domestic fixed and inventory investment and, consequently, in the absence of a net inflow of foreign capital, the gold and other foreign reserves were drawn down to supplement domestic savings.

As the accompanying table shows, the substantial increase in domestic saving during 1973/74 was almost entirely attributable to very large increases in corporate saving and the current surplus of general government, whereas personal saving showed a large decline.

Percentage change in gross domestic saving

	Year ended 30 June		
	1972	1973	1974
Personal saving	66	5	-32
Corporate saving	52	56	97
Current surplus of general government	2	93	79
Provision for depreciation	12	10	15
Gross domestic saving	32	23	25

The substantial increase in corporate saving was attributable to large increases in profits which, in turn, led to higher tax payments and therefore to the higher surplus of general government. However, it should be noted that realised net profits and net corporate saving, as calculated for national accounts purposes, provide for depreciation on fixed assets at original costs. If these calculations are based on the higher replacement cost of fixed assets, net profits and net corporate saving will be substantially lower while provision for depreciation will be correspondingly higher. Percentage changes in these components will not necessarily be affected in the same way.

The decline in personal saving caused the ratio of personal saving to disposable personal income to decline from 11½ per cent in 1972/73 to only 7 per cent in 1973/74 — one of the lowest levels recorded in the past fifteen years.

Economic activity levelling-off at a high level

General economic indicators confirm that economic activity continued to increase until the end of the second quarter of 1974, although the rate of increase declined slightly from the high level reached in the third quarter of 1973. The South African economy has now been in the upward phase of the business cycle for more than twenty months, i.e. from the fourth quarter of 1972. The levelling-off in the rate of increase in economic activity at a high level is not surprising in view of considerations such as the influence of the oil crisis, scarcities of certain raw materials, uncertainties in the international monetary field and the high level of utilisation of machine capacity and of capital and labour resources.

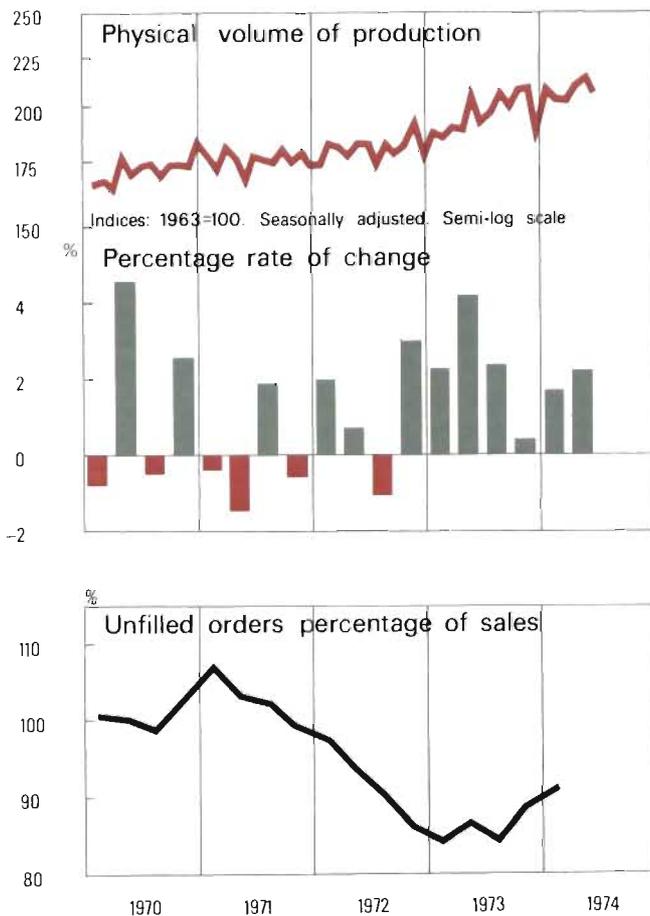
High rate of increase in manufacturing production

The year under review proved to be an outstanding growth year as far as manufacturing is concerned. Concomitant with the revival in general economic activity, manufacturing production started to increase at an accelerated rate from the fourth quarter of 1972, and during 1972/73 recorded an increase of 4,8 per cent compared with the previous year. It was only during the year under review, however, that the extent of the acceleration in the rate of increase in manufacturing production really became apparent in an increase of no less than 9,4 per cent in the physical volume of manufacturing production.

Moreover, this percentage increase could have been substantially higher had it not been for the adverse effects of exogeneous factors on manufacturing production, particularly during the closing months of 1973 and the first quarter of 1974. After increasing at a high rate up to November 1973, manufacturing production levelled off in December and the first quarter of 1974 and then increased fairly sharply in the second quarter. The levelling-off in production during the four months to March 1974, was mainly attributable to the effects of the oil crisis and a general scarcity and high rate of increase in prices of certain raw materials. Nevertheless, the average level of manufacturing production during the first six months of 1974 was still 7,9 per cent higher than during the corresponding period of the previous year.

The high rate of increase in manufacturing output during the year under review was the result of substantial increases in production by both the durable and non-durable goods industries. The main contributions to increased output during the past year came from manufacturers of transport equipment, chemicals, non-metallic mineral products, wood and furniture. Considering the pronounced increases in the value of unfilled orders in both durable and non-durable goods industries throughout 1973 and the first five months of

Manufacturing



1974, and the lengthening of delivery periods, it does not appear that lack of demand will inhibit further increases in manufacturing production during the remainder of 1974.

As may be expected in the light of developments described above and the relatively late revival in fixed investment by private manufacturing, capacity utilisation in manufacturing increased markedly during the year under review. Although large fixed capital outlays were made by public corporations on manufacturing undertakings during the year under review, the gestation period of some of these manufacturing projects is fairly long and will only extend production capacity in the future. From official and unofficial sources, therefore, it would appear that certain branches of the manufacturing sector are at present producing at approximately full capacity. Although unused production capacity may still exist, in varying degrees, in certain branches of manufacturing and additions to existing production capacity are made on a continuous basis by real net fixed investment in this sector, it should be expected that the *rate of increase* in produc-

tion will slow down somewhat during the course of 1974/75.

The acceleration in the rate of increase in manufacturing production together with the fuller utilisation of production capacity also led to a further substantial increase in production per worker. As can be seen from the accompanying table, the volume of manufacturing production increased substantially faster than the hours worked by production workers, so that production per man-hour increased further by about 3 per cent during the ten months to April 1974, compared with the same period a year ago, after it had already risen by 2.5 per cent during the previous year.

Manufacturing — Output per man-hour Percentage change

Year ended 30 June	Manufacturing production	Hours worked	Production per man-hour
1971.....	3,9	3,9	—
1972.....	2,0	1,4	0,5
1973.....	4,7	2,2	2,5
1974*.....	10,5	7,3	3,0

*Figures up to April 1974 compared with figures for corresponding period during the previous year.

During the past year, actual employment in the manufacturing sector did not increase to the same extent as the hours worked by production workers. The difference in the rates of increase was reflected in a fairly sharp increase in overtime as a percentage of ordinary hours worked, a development associated with a marked tightening in the labour situation in this sector. After tending to level off from October 1973 to February 1974, this percentage increased sharply in March and April and, together with the high level of capacity utilisation, indicates that the rate of increase in the volume of production in this sector may level off at this high level.

A significant difference in the rate of increase in employment of Whites and other population groups during recent years is also evident. The number of Whites employed in the manufacturing sector showed virtually no change during the past two years, and in fact declined by 0,7 per cent during the last ten months compared with the same period of the previous year notwithstanding the high rate of increase in production. In contrast, the rate of increase in the number of non-Whites employed, accelerated appreciably from 2,9 per cent in 1972/73 to 4,3 per cent during the ten months that ended on 30 April 1974 compared with the same period a year ago. The corresponding increases in aggregate employment in this sector were 2,3 and 3,2 per cent, respectively.

Continued prosperity for the gold mining industry

The sharp rise in the price of gold on the private market not only led to prosperity for the gold mining industry, but also materially affected domestic economic developments and the balance of payments of South Africa. After having increased from \$37,8 per fine ounce in 1970/71 to \$46,8 in 1971/72 and \$77,1 in 1972/73, the average price of gold on the London market rose further to \$130,7 in 1973/74, i.e. by no less than 69,5 per cent. Over the past three years, therefore, the average price of gold had increased by as much as 246 per cent. Although maintaining a continuing upward trend, the gold price showed large fluctuations during the past year. From an average of \$120,0 per fine ounce in June 1973, the London gold price dropped to \$94,8 in November 1973 and then increased sharply to \$172,2 in April 1974. Subsequently the price declined again to an average of \$142,6 per fine ounce in July 1974.

The direct effect of the further increase in the price of gold on the gold mining industry was a decline in the number of kilograms of gold produced. During the year under review, the volume of gold production declined by no less than 7,6 per cent. This decline occurred notwithstanding an increasing trend in the volume of gold ore milled and was exclusively attributable to a further sharp decline in the grade of ore milled, made possible by the higher price of gold. The declining trend in the grade of ore milled has now prevailed for four years, i.e. since the price of gold started to rise.

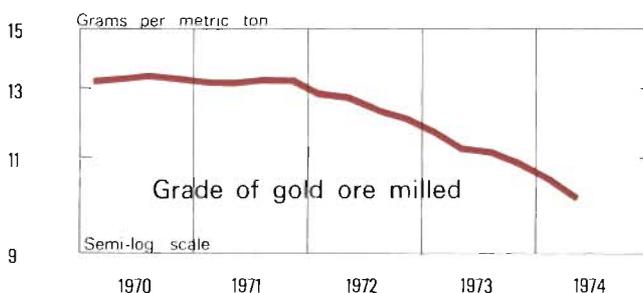
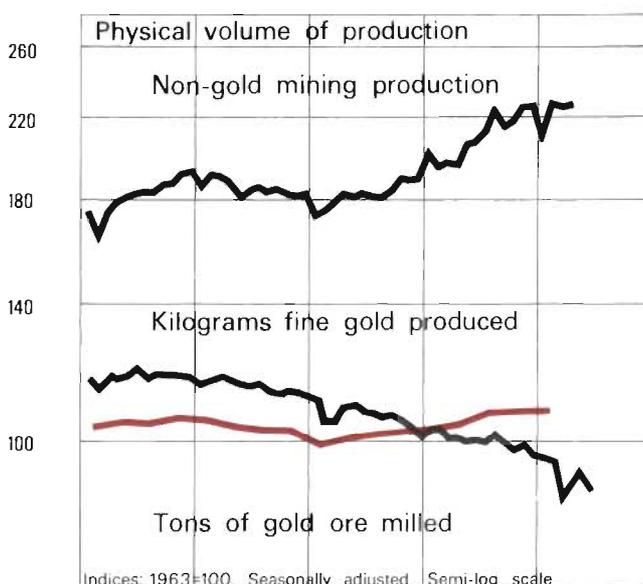
As already mentioned, secondary effects of developments in the gold mining industry are observable in almost all spheres of the economy. During the past year the contribution of gold mining to the gross domestic product at current prices increased markedly; gold mining contributed materially to the improvement in the terms of trade; net gold output made a significant contribution to the balance of payments; new capital outlays by this sector stimulated manufacturing production and construction activities; large retained balances contributed to the availability of short-term and long-term capital in the economy; higher dividend payments and increased salary and wage payments contributed to the high rate of increase in private consumption expenditure; and large increases in direct tax payments by gold mines contributed to a marked increase in government receipts and surplus of general government. Apart from past and immediate effects, plans for the development of new gold mines may lead to the further stimulation of the South African economy.

Although developments in the gold mining industry contributed markedly towards accelerated growth during the past year, the decline in the volume of gold production exerted a negative influence on the rate of growth in real gross *domestic* product. As already mentioned, however, the sharp increase in the price of

gold made a major contribution to the improved terms of trade and, therefore, to an accelerated rate of increase in real gross *national* product, which is a measure of the effective real purchasing power of permanent residents of the country.

Notwithstanding an increase in the physical volume of ore milled, employment in the gold mining industry declined throughout the period under review. The most outstanding feature regarding employment in this sector, was the sharp increase in remuneration of employees. Average salaries and wages of employees in the gold mining industry increased by no less than 32,5 per cent during the three quarters up to 31 March 1974, compared with the corresponding period a year ago after it had increased by only 10,9 per cent during 1972/73. The increases in the average remuneration of Non-White employees were substantially higher, i.e. 44,5 and 25,1 per cent during the respective periods.

Mining



Further sharp increase in non-gold mining production

Non-gold mining production increased at a high rate throughout 1972 and 1973, but tended to level off during the first four months of 1974. During the ten months to April 1974, the volume of non-gold mining output was nevertheless 16,0 per cent higher than during the corresponding period of the previous year, and registered the highest growth rate of all non-agricultural sectors during this period. The largest contributions to this highly satisfactory growth rate were made by the mines producing manganese, building materials and platinum. The levelling-off in production during the first four months of 1974 was partly due to transport problems arising from flood damages. Declines in the output of coal, iron ore and manganese, and a slower rate of growth in copper production, were largely responsible for this levelling-off tendency.

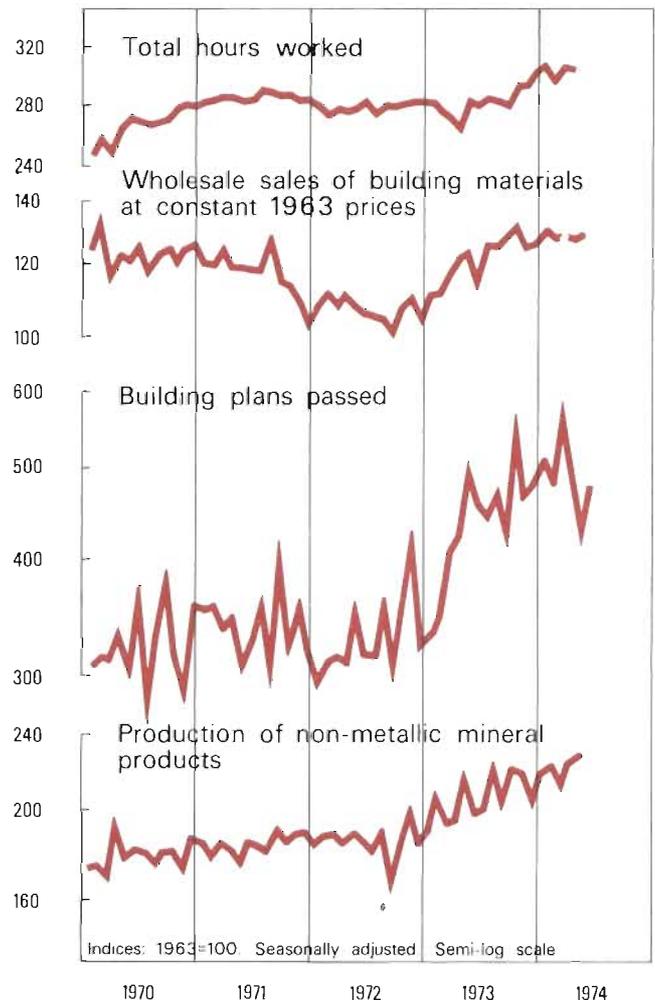
As in the case of the gold mining industry, the most important factor contributing to the buoyant conditions experienced by the non-gold mining sector was the high prices prevailing particularly on international commodity markets. Whereas the volume of production increased by about 16,3 per cent during the three quarters ended March 1974, compared with the corresponding period a year ago, the proceeds from the sale of non-gold mining products increased by no less than 29,6 per cent. Prices on commodity markets tended to increase up to the first quarter of 1974 but declined fairly sharply thereafter. The current level of metal and mineral prices, however, is still very high.

In contrast to employment trends in the gold mining sector, the number of employees in the non-gold mining sector increased fairly sharply. During the nine months that ended on 31 March 1974, the labour force rose by 13,8 per cent compared with the corresponding period during the preceding year. The same sharp rise in average wages and salaries that manifested itself in the gold mining industry, was also discernible in this sector.

High level of building and construction activity

Building and construction activity increased sharply to a high level in the first half of 1974. This was reflected in the high rates of increase registered in the physical volume of production of non-metallic mineral products (including building bricks and tiles, glass products, cement and cement products and composite boards and sheets), sales of building materials adjusted for price changes, the number of hours worked by production workers and the relative high level of overtime as a percentage of ordinary hours worked. In the last months of the review period, however, changes in the various indicators pointed to the levelling-off in total activity at a high level. This tendency, particularly evident in sales of building materials at constant prices and the number of hours worked by construction workers, was not

Construction



unexpected in view of the scarcity and high cost of long-term funds. For example, new advances by building societies for new buildings are currently at a substantially lower level than that of the third quarter of 1973.

Towards the end of 1973, a significant change occurred in residential and non-residential building and construction activity. Judged by the changes in the value of building plans approved and buildings completed, the construction of non-residential buildings was at a substantially higher level during the first half of 1974 than during the second half of 1973, whereas residential construction levelled off from the middle of 1973. The increase in non-residential construction is in line with the sharp revival in fixed investment in manufacturing, mining and agriculture, whereas the sharp increases in interest rates and the decline in funds advanced by building societies, together with the high level of prices for residential stands adversely affected

residential construction. A development that may have adverse consequences for the building and construction industry in the near future is the high rate of increase in the wholesale prices of building and construction materials. From June 1971 to June 1972 and June 1972 to June 1973 these prices increased by 4,6 and 11,3 per cent, respectively, but escalated to no less than 18,7 per cent from June 1973 to June 1974.

In sympathy with the high rate of increase in building and construction activity, particularly during the course of 1973, the number of employees in this sector increased sharply up to December 1973 but then declined somewhat during the next four months. After declining by 0,4 per cent in 1972/73, the number of employees during the ten months up to 30 April 1974 increased by 3,5 per cent compared with the corresponding period of the previous year. The number of hours worked showed similar changes during the corresponding periods, namely a decline of 1,3 and an increase of 6,7 per cent.

Sharp revival in commerce

As discussed in the section on national accounts, gross domestic expenditure at current and constant prices rose sharply throughout 1973/74. This is also reflected in the marked acceleration in the rates of increase in retail and wholesale sales at current and constant prices. The rate of increase in retail sales at constant prices rose sharply from 2,3 per cent in 1972/73 to as much as 8,8 per cent during 1973/74, whereas the corresponding figures for wholesale sales

were a decline of 1,6 per cent in 1972/73 and an increase of no less than 9,4 per cent up to May 1974. Rates of increase at current prices were substantially higher due to the high rate of price increases experienced during the past number of years.

As a result of the high rates of increase in turnover, conditions in commerce were particularly buoyant during the past year. In view of the salary and wage scale adjustments already announced by the mining sector, and by the public sector effective from 1 July 1974, and with the rest of the private sector also likely to raise salaries and wages further, prospects for a further increase in consumption expenditure seem favourable.

Tightening in labour situation

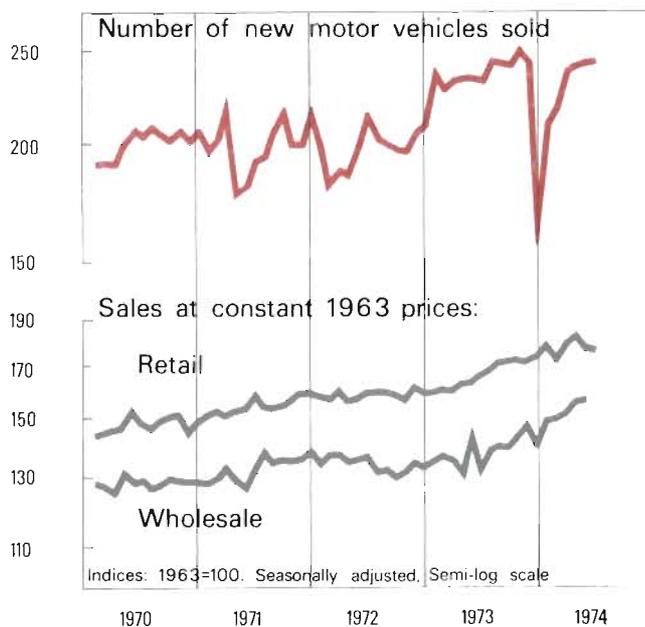
As a result of the high rate of increase in economic activity during the year that ended on 30 June 1974, the labour situation tightened appreciably. This tendency was clearly reflected in a further decline in the seasonally adjusted number of unemployed Whites, Coloureds and Asians from 10 531 in June 1973 to 7 995 in June 1974, a number that represents less than 0,5 per cent of the corresponding number of Whites, Coloureds and Asians actually employed. It is interesting to note that the number of unemployed persons at the end of June 1974 was only slightly more than the number at the upper turning point of the preceding business cycle.

During periods of rapid growth production per worker in general tends to increase because of, *inter alia*, the better utilisation of production capacity and labour. In the three quarters up to 31 March 1974 the rate of increase in the number of employees in the non-agricultural sectors of the economy, at just under 3 per cent, was substantially lower than the increase of about 6½ per cent in the volume of production, with the result that the production per worker in the non-agricultural sectors increased by about 3,4 per cent.

As a result of the tightening in the labour situation and the high rate of increase in the consumer prices during the year under review, continued upward pressure was exerted on salaries and wages. As can be seen from the accompanying table, average salaries and wages per employee in the non-agricultural sectors increased by 13,3 per cent during the first three quarters of 1973/74, compared with only 8,0 per cent during the previous year. What is even more significant is the difference between the rates of increase in the average remuneration of Whites and Non-Whites. In accordance with government policy to reduce the gap between salaries and wages paid to Whites and Non-Whites, the average remuneration of Non-Whites increased substantially faster during the past year than that of Whites.

It is also clear from the above information that, after providing for the high rate of increase in consumer prices during the past two years, the purchasing power

Commerce

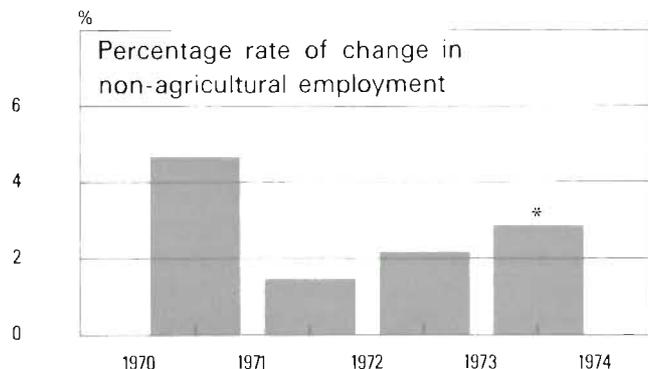
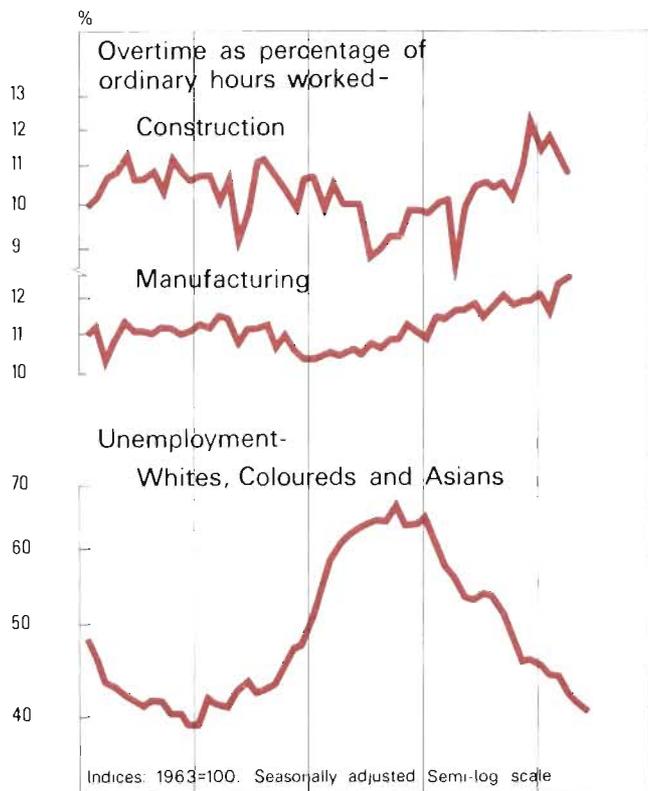


Non-agricultural sectors — Salaries and wages per employee
Percentage changes

Year ended 30 June	Whites		Non-Whites		Total	
	At current prices	At constant prices	At current prices	At constant prices	At current prices	At constant prices
1971.....	12,2	7,3	14,7	9,8	11,8	7,0
1972.....	8,7	2,1	9,1	2,5	8,8	2,3
1973.....	7,6	-0,5	11,1	2,7	8,0	-0,2
1974*.....	10,8	1,1	21,0	10,4	13,3	3,5

*Figures up to 31 March 1974 compared with figures for corresponding period during the previous year.

Labour



*Figures up to 31 March 1974 compared with figures for corresponding period during previous year.

of the average employee, as measured by the increase in real wages, on average, showed a relatively small increase during the past two years.

Continued rapid rise in prices

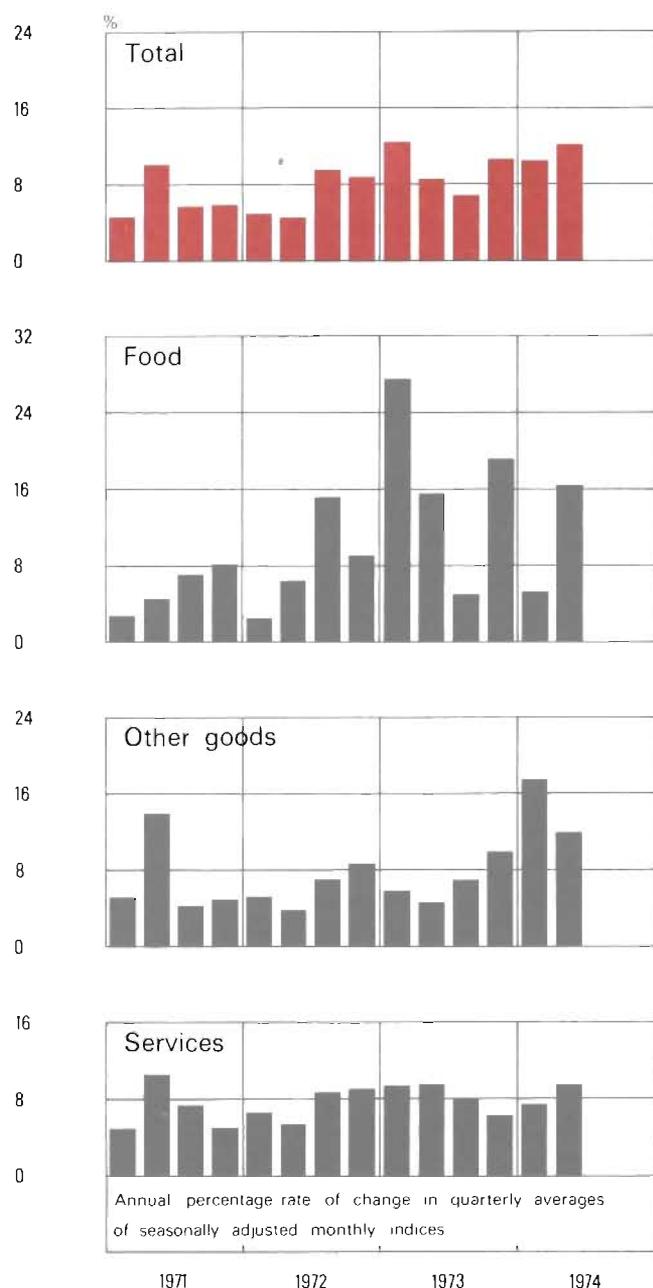
During the past two years, the most important economic problem facing the authorities in South Africa and elsewhere in the world has been the high rate of increase in prices. As was to be expected, South Africa with its relatively open economic system was unable to isolate itself from the effects of price movements in the rest of the world. During the past four years, the rates of increase in prices accelerated each year, reaching a level in 1973/74 unsurpassed during the post-war period. Although it is almost impossible to ascertain precisely the underlying causes of price increases over time, the acceleration in the rates of increase during 1971/72 and 1972/73 was mainly due to cost-push factors and imported inflation and not to the demand-pull type of inflation. During the year under review, however, the situation changed significantly. The demand for goods and services rose more rapidly and, more recently, exceeded the supply thereof, while at the same time the expansion of production led to the approximately full utilisation of the factors of production in most sectors of the economy. These developments brought the problem of an overheating of the economy to the fore and added the demand-pull type of inflation to the other types of inflation already experienced. Monetary policy measures, therefore, came to be directed at preventing an aggravation of the inflationary pressures arising from excessive demand.

The rate of increase in the *consumer price index* for South Africa accelerated appreciably over the past four years to a rate of no less than 11,2 per cent between June 1973 and June 1974, compares with 10,0 per cent during the previous year. This compares with an average annual rate of increase of 2,0 per cent during the period 1955 to 1963 and 3,6 per cent during the subsequent eight-year period 1963 to 1971.

An analysis of the main components of consumer prices responsible for this high rate of increase, reveals that food prices, with a weight of nearly 24 per cent,

rose by no less than 15 per cent from June 1973 to June 1974 and made by far the largest contribution. Prices of clothing and footwear rose by an even higher percentage, viz. 15.6, but consumer expenditure on these items accounts for only slightly less than 10 per cent of total expenditure. The rate of increase in prices of furniture and household equipment and petrol and oil also accelerated appreciably during the year under review. It is highly significant that prices of services increased at a substantially lower rate during the past year than the prices of goods.

Consumer prices



All prices increased at high rates during the year under review, but in the case of food prices the sharp rise was partly due to adverse weather conditions experienced by agriculture during 1972/73 and periodic adjustments in administered agricultural prices necessitated by rises in prices of farming requisites and higher labour costs. Furthermore, the sharp increases in the prices of goods imported and prices on international commodity markets during the past year had a pronounced effect on domestic prices. These influences were particularly apparent in price increases in petrol, oil, furniture, clothing and footwear.

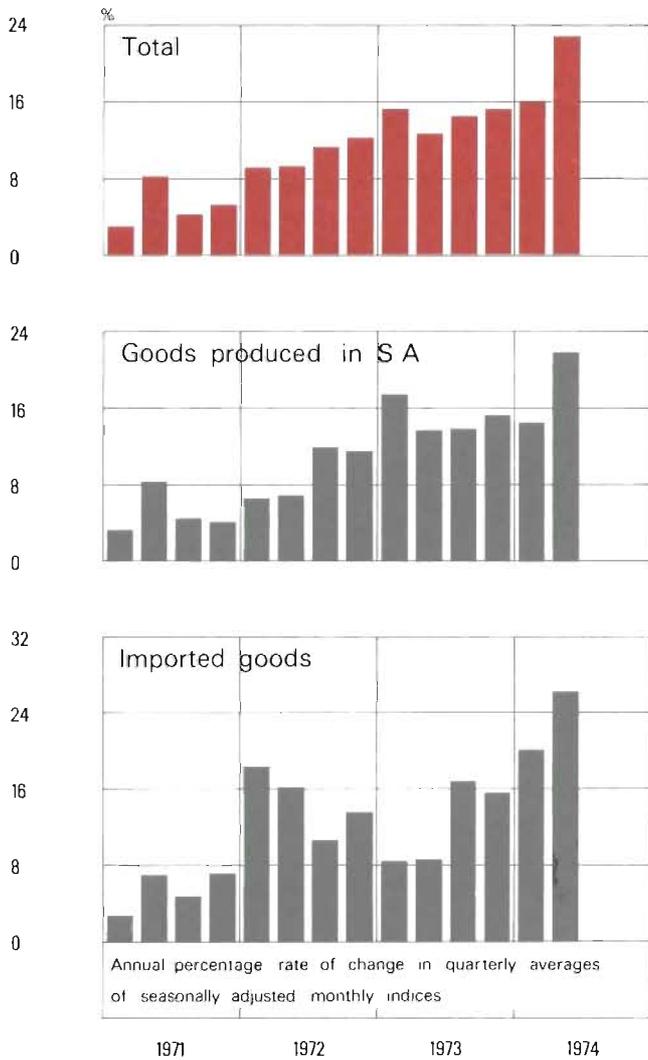
Important changes in the rates of increase in consumer prices also occurred during the course of the year. After having increased at a relatively low rate during the third quarter of 1973, the rate of increase in consumer prices rose sharply in the fourth quarter and prices continued to increase at approximately the same high rate during the first quarter of 1974. During the second quarter of 1974, the rate of increase rose further to approximately 12,3 per cent, taken at an annual rate.

Wholesale prices increased at a significantly faster rate than consumer prices during the past year. From June 1973 to June 1974, the seasonally adjusted wholesale price index rose by no less than 18,8 per cent compared with 13,1 per cent during the preceding twelve months. Although the rate of increase in prices of goods produced in South Africa accelerated appreciably, from 13,9 per cent from June 1972 to June 1973 to 18,1 per cent over the past year, by far the largest increase occurred in prices of imported goods, i.e. from 10,7 to 21,0 per cent over the comparable periods. Marked increases were registered in the prices of imported agricultural and mining products, manufactured textiles, paper and paper products, chemicals, petroleum and basic metal products, partly as the result of inflation experienced by almost all South Africa's main trading partners and partly owing to the effects of the large rises in the prices of petroleum and related products.

As mentioned above, prices of goods produced in South Africa also increased at a higher rate during the past year than during the preceding year. Particularly large increases were registered in the prices of goods produced by agriculture and mining while the most important price rises in respect of manufactured goods occurred in basic metals, textiles, footwear and food.

As shown on the accompanying graph, the annual rate of increase in the quarterly average of the monthly wholesale price index accelerated in each of the four quarters under review. In contrast, the rate of increase in the prices of goods produced in South Africa remained approximately unchanged for four consecutive quarters until the first quarter of 1974 and then accelerated during the second quarter of 1974 following a sharp rise in prices of basic metals and agricultural products.

Wholesale prices



High rates of inflation are currently also being experienced by most countries throughout the western world. In an international comparison of the degree of inflation currently experienced, South Africa ranks amongst the countries with the lowest rates of price increases. Although this fact is surely no reason for complacency, it shows the severity of the problem in South Africa in its proper perspective.

Prices: Percentage change, June 1973 to June 1974

Country	Consumer prices	Wholesale prices
South Africa	11,2	18,8
Japan	21,9	35,3
Italy	16,6	42,6 ¹
United Kingdom	16,5	24,2
Australia	14,5 ²	...
France	13,9	...
Canada	11,4	26,0 ¹
USA	11,1	14,5
West Germany	6,9	16,9 ¹

1. May 1973 to May 1974.

2. Second quarter 1973 to second quarter 1974.

Balance of payments

The relatively open economy of South Africa was again strongly influenced by external developments during the year that ended on 30 June 1974 which affected not only the balance of payments, but indirectly also the supply of goods and services in the economy, the rate of inflation and the conditions in the domestic money and capital markets. Of these developments, the most important were the sharp rise in interest and inflation rates in industrial countries, the continued international monetary uncertainties, large fluctuations in exchange rates, further substantial increases in the price of gold and in international commodity prices, and the oil crisis. During the period under review, these factors, together with the upswing in the domestic economy, were mainly responsible for the reversal in the overall balance of payments from a large surplus to a deficit.

Large overall deficit

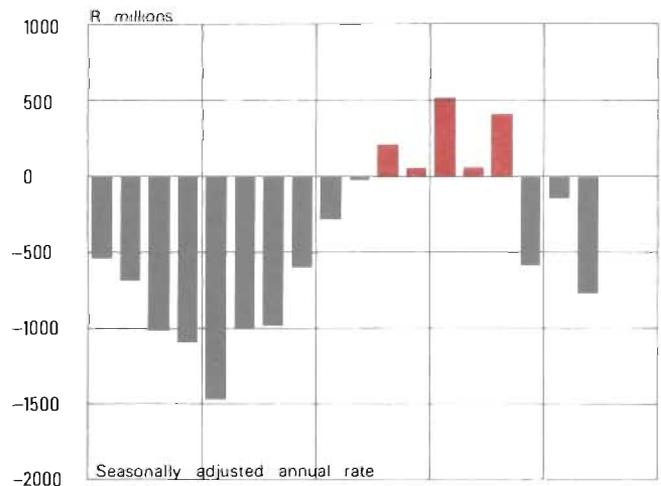
The overall balance of payments, as measured by changes in the country's gold and other foreign reserves, changed from a surplus of R503 million in 1972/73 to a deficit of R361 million during 1973/74. The deficit in 1973/74 was brought about by a deficit on both the current and capital accounts. During an economic upswing the current account of South Africa's balance of payments normally is in deficit while the capital account usually has a surplus which enables the economy to grow at a faster rate than would have been possible if it had to rely exclusively on its own financial resources. In 1973/74, however, this pattern was not followed. The marked acceleration in the economic growth rate in the non-agricultural sectors resulted in the expected increase in the demand for imported goods that exceeded the increase in the value of exports attributable to rises in the prices of gold and export commodities. However, the increase in the net inflow of capital which usually accompanies a cyclical upswing in the economy, did not materialise on this occasion. Developments such as the sharp rise in interest rates in other countries and changes in the exchange rate of the rand, induced an outflow of short-term private capital. Because of these unfavourable developments, the authorities pursued monetary and exchange rate policies directed at restraining the outflow of capital and at promoting, as far as possible, further rapid economic growth.

Deficit on current account

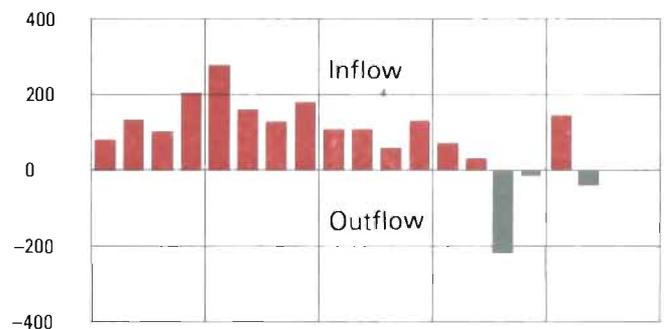
After it had shown a surplus of R200 million in 1972/73, the balance on the current account changed to a deficit of R241 million during 1973/74. Such a change may be expected in a period of cyclical upswing in the economy and the deficit as a ratio of the gross domestic product was in fact relatively small compared with the average annual ratio during the

post-war years. In the post-war period South Africa's current account deficit amounted on average to about 3 per cent of the gross domestic product at current market prices and to a much higher percentage during years of rapid economic growth, whereas the deficit in 1973/74 was only 1.2 per cent of this aggregate. It is also of interest to note that the change from a surplus to

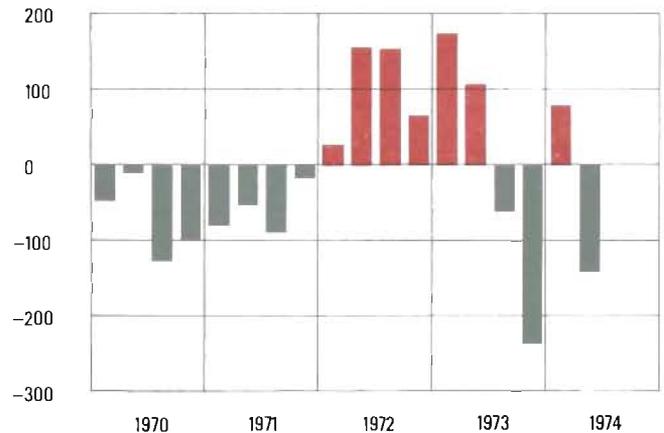
Balance on current account



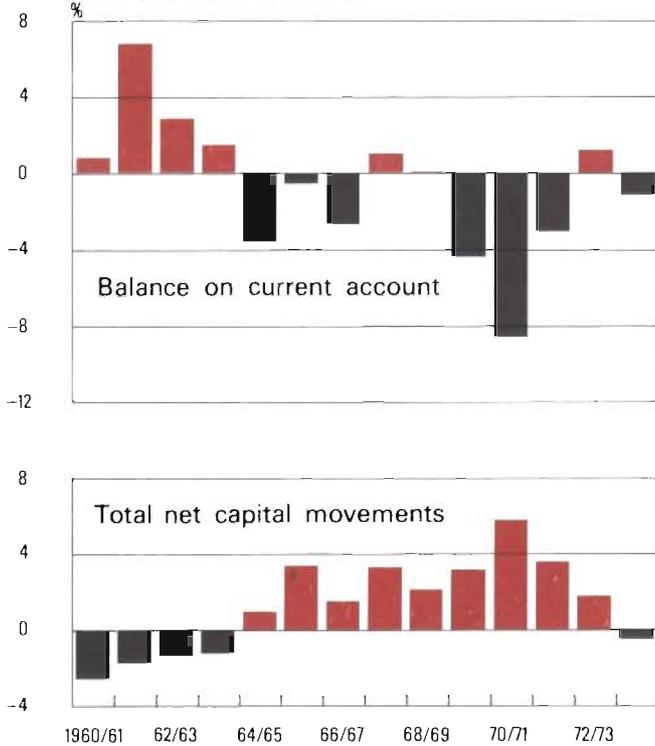
Total net capital movements



Changes in the gold and other foreign reserves as a result of balance of payments transactions



Balance on current account and total net capital movements as percentage of gross domestic product



a deficit on the current account came about at a relatively late stage in the economic upswing. The upward phase of the current business cycle began in the fourth quarter of 1972, whereas an adverse balance on current account appeared only in the fourth quarter of 1973. The time lag in the appearance of a shortfall on the current account and the relatively small size of this deficit were mainly due to sharp increases in prices ruling on the private gold market and international commodity markets. These price rises enabled current account receipts to offset higher payments for imported goods and services for an extended period.

Substantial increase in merchandise imports

The value of merchandise imports rose by no less than 46 per cent during the year that ended on 30 June 1974, compared with an increase of about 7 per cent in the previous year. Although this substantial increase in merchandise imports was brought about by an increase in both the volume and prices of imported goods, by far the larger part of the increase was due to a rise in the volume of imports as a result of the high rate of increase in domestic demand. The sharp increases in the price of oil during 1973 and at the beginning of 1974 and the high inflation rates experienced by most of South Africa's main trading partners, caused a rise of about 14 per cent in the average wholesale prices of

imported goods during the past year.

As may be expected under the relatively free import system currently in operation in South Africa and in view of the dependence of the economy on external trade, the value of merchandise imports started to rise at the beginning of the upward phase of the business cycle. In the fourth quarter of 1972 and during the first half of 1973, a steady but moderate growth was discernible in the value of imports. From the beginning of the period under review, however, the rate of increase in merchandise imports rose appreciably, reflecting the acceleration in the growth rate of the economy and the escalation of inflation rates, particularly in Western European countries and in Japan. In the second quarter of 1974, for example, merchandise imports increased by about 28 per cent to a seasonally adjusted annual level of approximately R5 700 million.

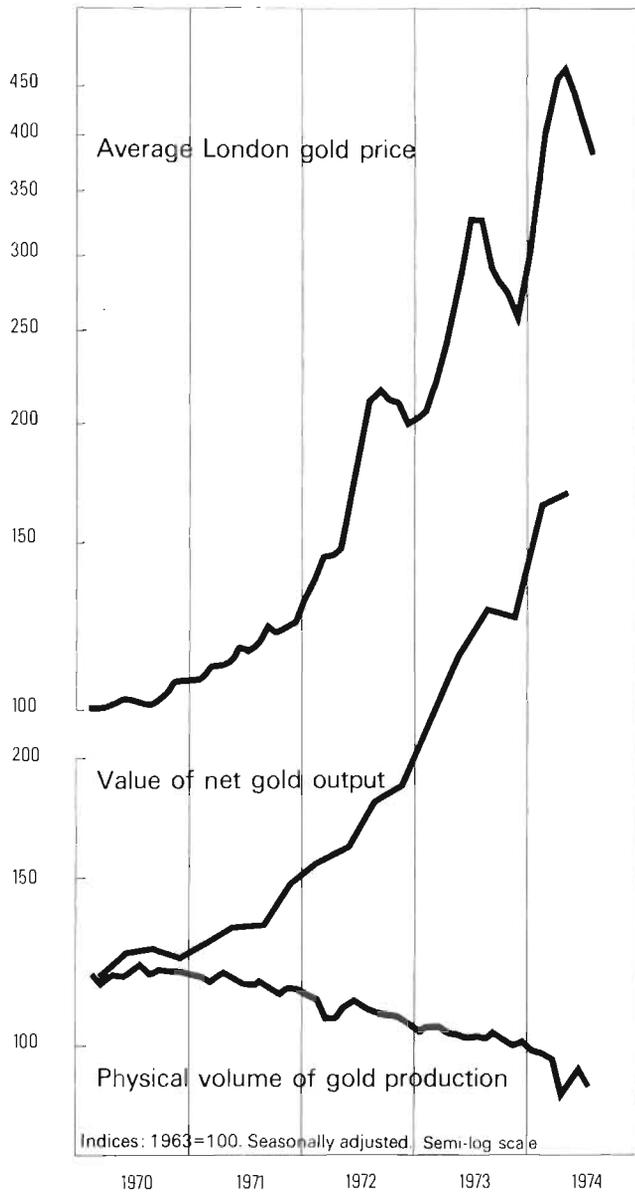
A break-down of imports by stage of use, namely capital, intermediate and consumer goods, shows increases in all three categories. At the beginning of the period under review, however, increases in imports of intermediate goods and to a lesser extent, of consumer goods, were much higher than the increase in imports of capital goods. Although all three categories of products imported increased during 1973/74, machinery and electrical and transport equipment contributed most to the rise in merchandise imports. The imports of mineral products, textiles, base metals and chemical products also increased sharply during the year under review.

Substantial rise in net gold output

For the second consecutive year an exceptionally large increase was recorded in the net gold output. After increasing from R1 015 million in 1971/72 to R1 430 million in 1972/73, i.e. by no less than 41 per cent, the net gold output again increased substantially further by R785 million to R2 215 million in 1973/74, or by 55 per cent. This phenomenal increase can entirely be attributed to a sharp rise in the price of gold on the private market, which not only contributed to a broader base in absorbing the higher value of imports in the balance of payments, but also materially affected the rest of the economy. The rising trend in the price of gold on the private market has also enabled the gold mines to mine lower grade ore, and consequently the volume of net gold output on average declined by nearly 7 per cent per year during the past three years.

International arrangements for the marketing of gold were changed during the year under review. When these arrangements were first introduced in March 1968, the leading industrial countries agreed on a two-tier system for the marketing of gold, in terms of which they were obliged to refrain from buying and selling gold on the private market. In November 1973 seven of the industrial countries decided to terminate the two-tier system of marketing gold. At the request of South Africa,

Net gold output

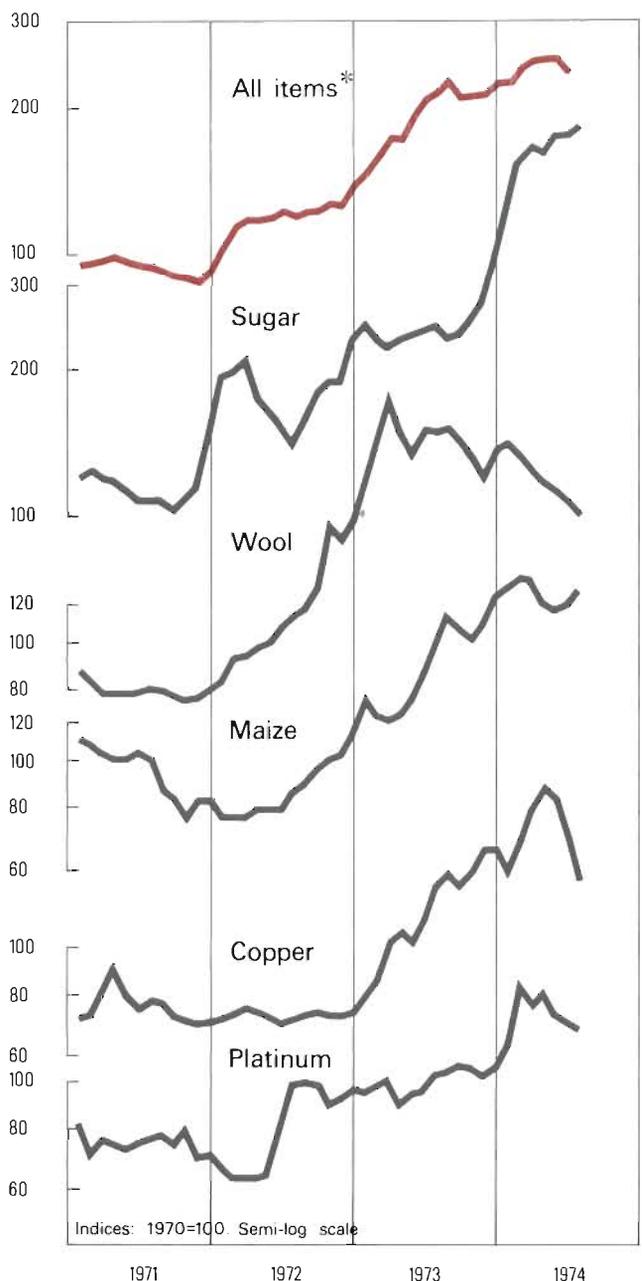


this led to the termination of South Africa's Gold Agreement with the International Monetary Fund on 7 December 1973. Owing to the sharp rise in the price of gold on the private market, the agreement had at that stage little significance. Subsequently, in June 1974, the Group of Ten agreed in Washington that gold valued at market related prices could be used as collateral for official international borrowing. As a result of increased pressure in the United States, legislation to permit private holdings of gold was passed by Congress on 31 July 1974. It was subsequently approved by the President and will become effective from the beginning of 1975.

Continued rise in merchandise exports

After having increased by more than 30 per cent per year for two consecutive years, merchandise exports increased by a further 14 per cent in 1973/74. This further rise in merchandise exports occurred notwithstanding a sharp decline in the exports of agricultural products, and was mainly due to a substantial increase in the value of exports of diamonds, base metals and mineral products. The exports of sugar, chemical products, paper and paper products, and textiles, also made fairly large contributions to the increase in the value of exports.

International commodity prices



*Economist's dollar index of all items which does not reflect the total for South African exports.

The exceptionally high increase in exports during the past three years, was largely due to sharp rises in the price of diamonds and other prices on international commodity markets, particularly during 1972/73 and 1973/74. From the beginning of 1973 no fewer than four increases in the price of diamonds were announced, which together amounted to a rise of well over 40 per cent. As shown in the accompanying graph, the prices of South Africa's main export products on international markets also increased sharply from about the beginning of 1972. The general rise in prices on international commodity markets was attributable to developments such as increased demand for raw materials in most industrialised countries during the upward phase of the business cycle in these countries during most of 1972 and during 1973, international monetary uncertainties, the continuation of hostilities in the Middle East and the oil crisis which also led to speculative purchases of raw materials.

However, from January to June 1974 world commodity prices and, therefore, also prices of South Africa's main export products showed a declining tendency. The price of wool already started to decline from March 1973 and a particularly sharp drop in the price of copper occurred during June 1974. In contrast to these movements, the international sugar price increased substantially from the end of 1973 because of increased demand and expectations of only a moderate increase in the current sugar crop. More recently from June 1974, the price of maize increased sharply as a result of an expected poor crop in the United States. Although international commodity prices generally declined from the beginning of 1974, South Africa's merchandise exports increased steadily in both the first and second quarters of the year. This was due to the fact that prices were on average still above levels in the previous quarters and to a substantial increase in exports of diamonds and maize in the second quarter.

Increase in net invisible payments

For the second consecutive year, net invisible payments to the rest of the world increased substantially. In contrast to 1972/73, during which the increase in service payments was mainly the result of a sharp rise in dividend payments to foreigners, the main contributing factors during 1973/74 were freight charges, merchandise insurance and increased interest payments on foreign loans. In this regard, higher freight rates and sharp increases in both the outstanding amount of and interest rates on foreign loans deserve special mentioning. On the receipts side of the invisibles account, dividends received on foreign investment increased considerably.

Adverse balance on capital account

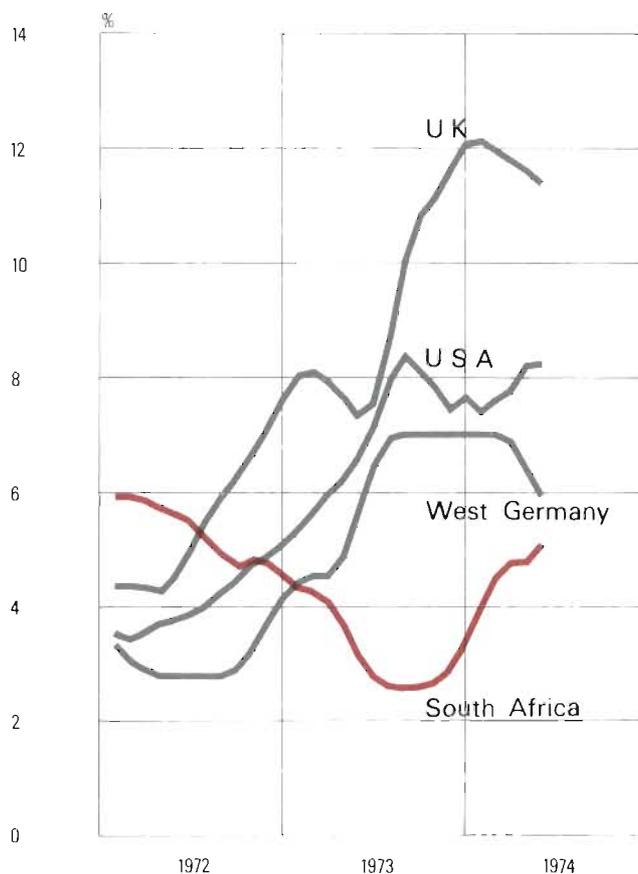
As indicated above, the sharp decline in the gold and other foreign reserves during 1973/74 was the result

of a deficit on the current account and an adverse balance on the capital account of the balance of payments. An outflow of capital amounting to R120 million was recorded during the year under review, compared with an inflow of R303 million in 1972/73. This change from an inflow to an outflow of foreign capital was recorded for the private sector as well as the central government and banking sector. In comparison, there was an inflow of foreign capital amounting to no less than R382 million during the upswing of 1969/70.

In the case of the central government and banking sector the net outflow of capital was mainly caused by an outflow of long-term funds although a small outflow of short-term capital was also recorded during this period. The outflow of long-term capital was mainly attributable to large repayments by the central government on its foreign loan commitments during the last six months of 1973. In addition, the Department of Posts and Telecommunications and the South African Railways did not borrow abroad to the same extent during the year under review as during the previous year. The net outflow of capital recorded for the private sector, excluding public corporations, was mainly the result of a substantial outflow of short-term funds and, to a lesser extent, of an outflow of long-term capital. Public corporations, however, continued to borrow considerable amounts in foreign capital markets.

The outflow of private sector capital during 1973/74 was largely attributable to the relatively low level of interest rates ruling in South Africa compared with those in other countries, but at one stage also to movements and expectations regarding changes in the exchange rate of the rand. These factors, together with ready availability of domestic bank credit during the second half of 1973, facilitated the outflow of short-term capital. The interest rate differential between South Africa and most other countries also contributed to an outflow of long-term capital.

An international comparison of treasury bill rates



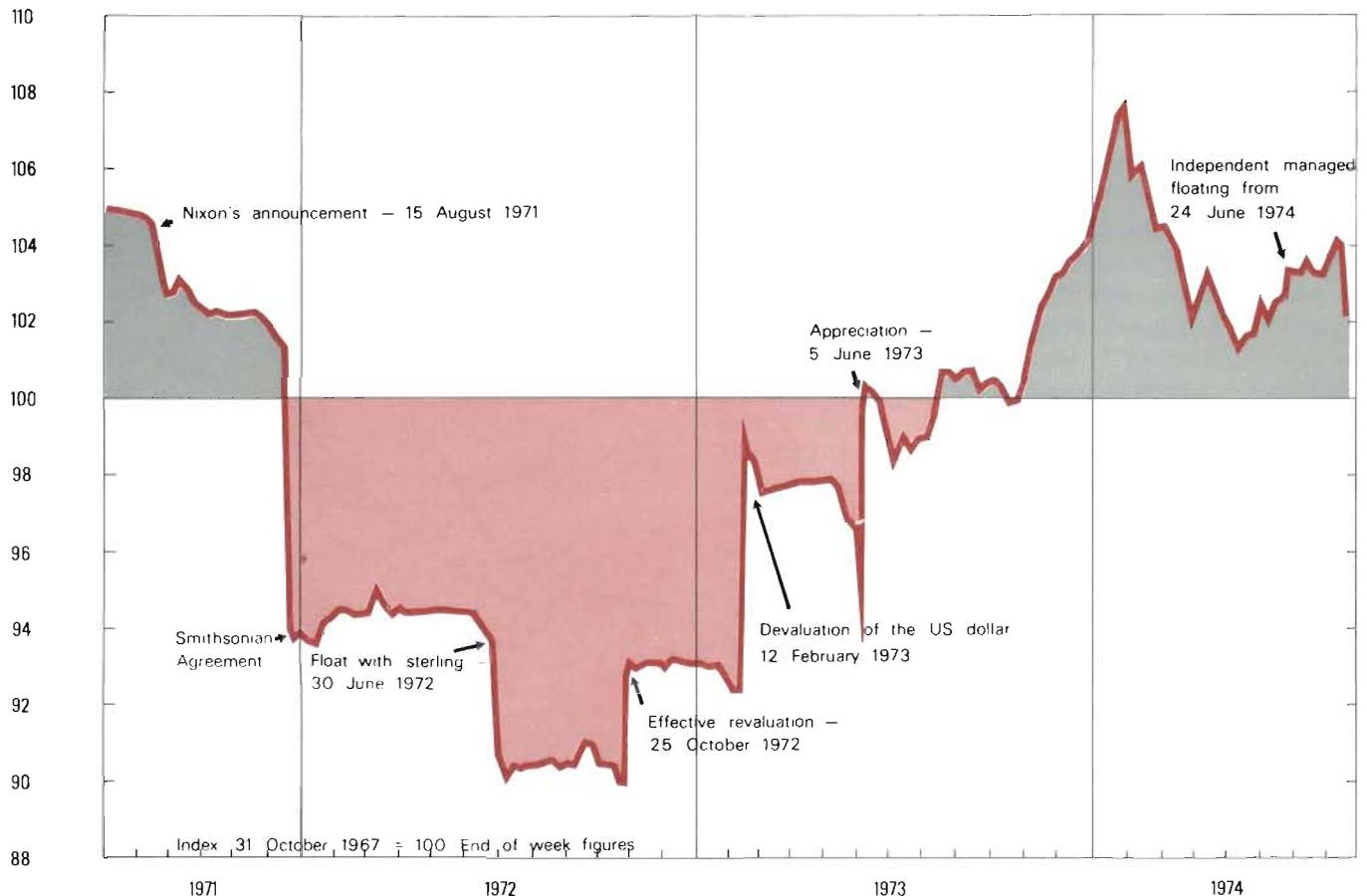
In the accompanying graph, the Treasury bill rate in South Africa is compared with the corresponding rates in three of South Africa's main trading partners. The differential between and trend in these rates are also reflected in other short-term interest rates in the countries concerned. This graph shows that short-term interest rates in South Africa were above those in the other countries in 1971/72, but the South African rates moved downwards and those in the other countries upwards during 1972/73. At the beginning of 1973/74 short-term interest rates in South Africa were at a low level relative to the rates in the other countries. Exporters accordingly endeavoured to retain their export proceeds in foreign countries as long as possible, whereas importers switched the financing of their imports from foreign to domestic sources. Although short-term interest rates in South Africa started to rise from the beginning of the period under review, they remained well below comparable rates in the United Kingdom and the United States. It is also interesting to note that the sharp rise in the South African short-term interest rates during the past few months coincided with a similar development in the United States,

Net foreign capital movements

R millions

	1972/73	1973/74
Private sector	224	-50
Net purchases by foreigners on the Johannesburg Stock Exchange	1	-46
Loans of public corporations and local authorities	284	305
Other long-term capital	89	-88
Short-term capital, including errors and unrecorded transactions	-150	-221
Central government and banking sector	79	-70
Loans of central government	204	-24
Other long-term capital	-19	-27
Short-term capital	-106	-19
Total capital movements	303	-120

Effective appreciation(+) or depreciation(−) of the rand



whereas the short-term interest rates in the United Kingdom and West Germany started to decline.

Towards the end of 1973 speculation that the rand would be devalued also contributed to the outflow of short-term capital. From July to October 1973 the effective exchange rate of the rand appreciated slightly and then increased by no less than 7,5 per cent up to 22 January 1974. Although this appreciation of the rand initially tended to favour an inflow of capital, expectations in some circles towards the end of 1973 that the authorities were going to lower the fixed buying and selling rates of the rand in terms of the dollar contributed to the outflow of capital. On this presumption importers redeemed their foreign liabilities as soon as possible and exporters retained exchange earnings abroad as long as possible. Early in January 1974, however, the authorities announced that the rand would not be devalued, but that a more conservative monetary policy would be pursued and that interest rates would be raised. This approach reduced the speculation and the outflow of short-term private capital.

Policy measures to counter the outflow of capital

The unfavourable developments on the capital account of the balance of payments, were taken into account by the authorities in the framing of monetary, fiscal and exchange rate policies during the year under review. The increases in interest rates and other monetary policy measures, especially those taken during the first half of 1974, were aimed not only at containing demand inflation, but also at encouraging a net inflow of capital and discouraging the switching from foreign to domestic sources for the financing of imports.

Effective from 24 June 1974, the practice of maintaining a fixed exchange rate between the South African rand and the United States dollar for extended periods, was discontinued and instead an exchange rate policy of independent managed floating was adopted. In accordance with this policy, the rand was effectively devalued by 2 per cent from 13 August 1974.

In addition, the Reserve Bank also announced on 6 June 1974 that it would consider favourably any

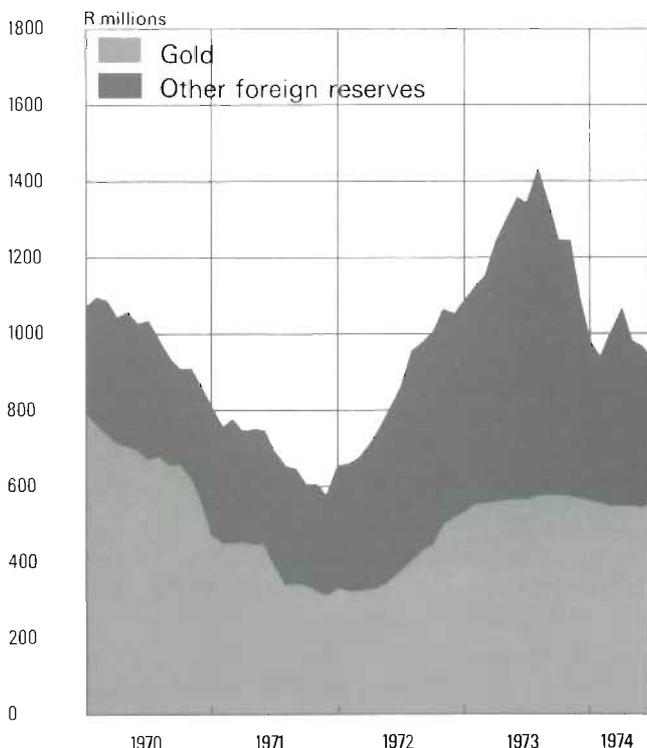
applications by local entrepreneurs to borrow funds abroad for a period of not less than one year. In August this minimum period was reduced to six months. These loans must be used for manufacturing and other productive purposes, but not for property development. This measure, therefore, allows private enterprises to borrow funds abroad for financing the expansion of production capacity, including the purchase of capital equipment abroad. At the same time, the authorities kept the liquid asset and cash requirements of banking institutions unchanged despite their relatively tight position and adjusted interest rates upwards in order to narrow the differential between interest rates in South Africa and abroad. With domestic bank credit more costly and less freely available, it is not unlikely that part of the financing of trade, production and investment will to a certain degree shift back to foreign sources.

Substantial decline in gold and other foreign reserves

The deficit on the current account and the adverse balance on the capital account of the balance of payments, together with valuation adjustments, caused a decline of R412 million in the gold and other foreign reserves of the country to a level of R929 million at the end of June 1974. From August 1973 to January 1974

this decline amounted, on average, to R80 million per month, but thereafter the reserves increased by an average of R65 million per month during February and March 1974. From April to June of this year the gold and other foreign reserves declined again on average by about R45 million per month. The gold and other foreign reserves of the Reserve Bank declined fairly sharply during the past year, whereas the foreign exchange holdings of the monetary banking institutions increased slightly and that of the central government remained on about the same level. The decline in the Reserve Bank's reserve holdings was almost entirely confined to exchange holdings and its gold reserves in fact declined by only R16 million.

Gold and other foreign reserves



Monetary and banking situation

Although various monetary aggregates, such as the quantity of money and near-money and the total of bank credit, increased during the year that ended on 30 June 1974 at roughly the same high rates as during the preceding year, the monetary and banking situation in 1973/74 differed from that in 1972/73 in several important respects. Whereas 1972/73 had been a year of rising gold and other foreign reserves, adequate bank liquidity, and declining interest rates, monetary expansion during most of 1973/74 tended to proceed under conditions of occasionally very low bank liquidity and a strong upward trend of interest rates. The emphasis of monetary policy, which had been cautiously stimulative during 1972/73, shifted towards greater conservatism, partly by maintaining the banks' liquidity requirements at their pre-existing levels in the face of marked declines in the banks' actual liquidity ratios. Similarly, the Reserve Bank extended credit under rather more restrictive conditions, apart from lender of last resort facilities to alleviate seasonal shifts of funds, whereas interest rates quoted by the official sector (including Bank rate) were raised on several occasions during the year in accordance with the marked rise in money market rates during most of the period under review.

Continuation of sharp rise in the money and near-money supply

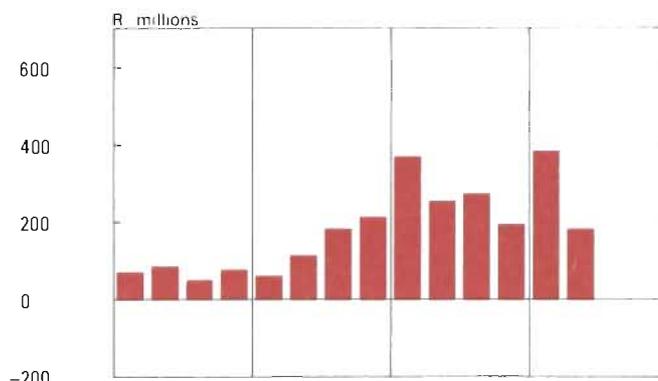
As during 1972/73, the quantity of money and near-money during 1973/74 increased by somewhat over R1 000 million, or approximately 19 per cent, as against 24 per cent during the preceding year. This compares with an average annual increase of about R250 million, or an annual rate of approximately 6 per cent, during the two years 1970/71 and 1971/72. After increasing by 23 per cent during 1973 the quantity of money and near-money increased at a seasonally adjusted annual rate of 29 per cent during the first quarter of 1974 and of about 12 per cent during the second quarter of 1974.

At these rates of increase, the rise in money and near-money was sufficiently large to cause a virtually unchanged value of the ratio of money and near-money to the gross domestic product. The average value of this ratio during 1973/74 as well as during 1972/73 amounted to 28,5 per cent.

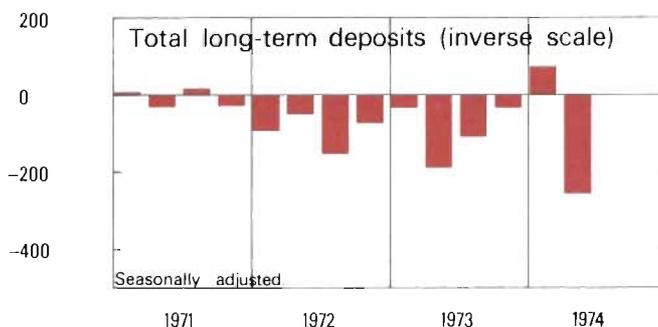
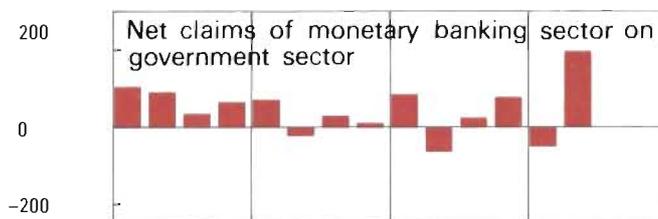
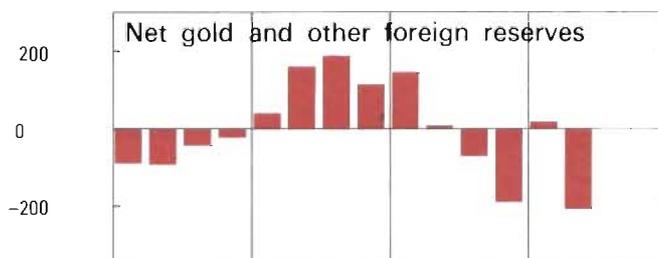
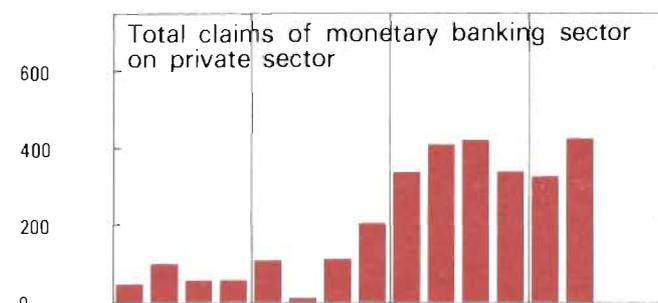
Causes of changes in money and near-money

The pattern of factors contributing to the large increase in money and near-money during 1973/74, while resembling that of 1972/73 in respect of the sustained rise in bank credit to the private sector, was nevertheless notably different in several ways from that during the preceding year. The net gold and other foreign reserves, which, as might be expected, had still been rising strongly during the earlier stages of the current economic upswing in 1972/73, declined

Changes in money and near-money



Causes of changes in money and near-money
Changes in



Seasonally adjusted

Causes of changes in money and near-money, 1973/74

R millions

	Not seasonally adjusted					Seasonally adjusted				
	1973 3rd qtr	1973 4th qtr	1974 1st qtr	1974 2nd qtr	1973/74	1973 3rd qtr	1973 4th qtr	1974 1st qtr	1974 2nd qtr	1973/74
Net gold and other foreign reserves.....	-134	-243	46	-145	-476	-71	-190	17	-210	-455
Claims on government sector:										
Gross claims.....	104	-45	42	-134	-34	...	...	...	...	...
Government deposits ¹	-78	208	-261	412	282	...	...	...	...	...
Net claims.....	26	163	-219	278	248	24	77	-50	198	248
Claims on private sector.....	480	332	355	362	1 529	425	341	333	429	1 528
Long-term private deposits ¹	-121	-17	37	-228	-329	-109	-35	72	-259	-331
Net other assets.....	52	—	-41	69	80	...	...	...	...	...
Total causes of changes.....	303	235	178	336	1 052	278	197	384	184	1 043

1. Increase —; decrease +.

markedly and fairly persistently during most of 1973/74 from the high level of R1 153 million that had been reached at the end of July 1973. Net claims of the banking sector on the government sector, the movements of which tend to some extent to be inversely related to changes in the gold and other foreign reserves, increased moderately during 1973/74 after having shown little change during the preceding year. Partly owing to a declining tendency during the middle months of the year under review, the net increase in long-term deposits of the private sector during 1973/74 was rather smaller than during 1972/73.

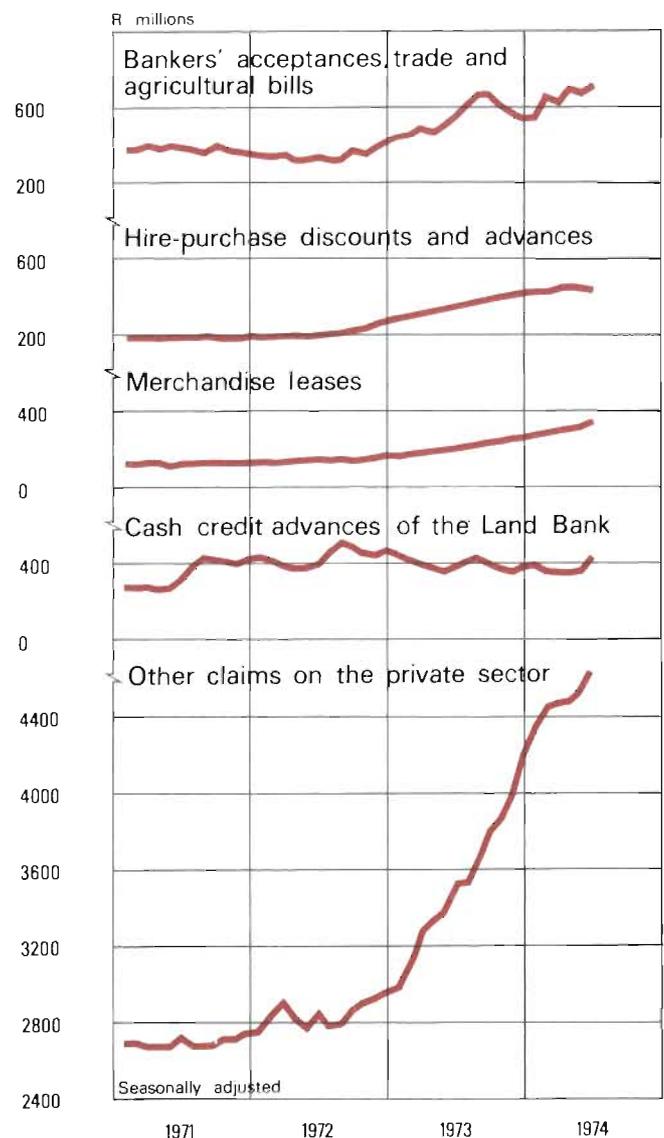
Sustained high rate of domestic credit expansion

The increase in domestic credit extended, that is, in the total of banking sector claims on the private sector and net claims on the government sector, amounted to R1 777 million, or 29 per cent, during 1973/74, as compared with R1 138 million or 23 per cent during 1972/73. The increase in the banking sector's net claims on the government sector, amounting to R248 million, was fully accounted for by a decrease in government deposits.

Monetary bank credit to the private sector increased by R1 529 million or 30 per cent, a rate which was actually still somewhat higher than the rate of approximately 28 per cent that had been recorded during 1972/73. There were, moreover, few signs during the year of a slowing-down in the rate of expansion of bank credit. In fact, the seasonally adjusted annual rate of increase accelerated from 25 per cent in the first quarter of 1974 to 31 per cent in the second quarter. In absolute terms, bank credit increased by no less than R229 million in the month of June 1974 alone. For the first six months of 1974 the rate of increase in bank credit amounted to 28 per cent at a seasonally adjusted annual rate.

An overwhelmingly large proportion of the increase in bank credit to the private sector was once more accoun-

Claims of monetary banking sector on private sector



ted for by rising discounts and advances. Contrary to developments during the preceding year, however, the rate of expansion of lending by merchant banks and monetary hire-purchase and general banks was not notably higher than that of the commercial banks.

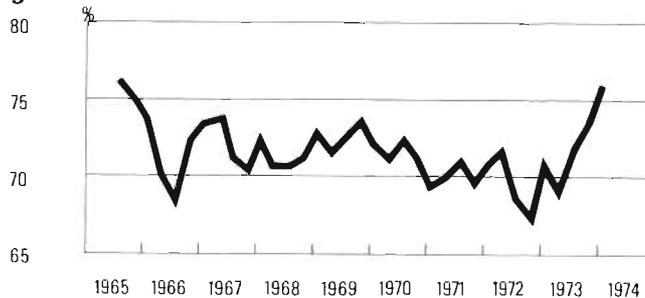
Lending by the commercial banks, the merchant banks and the monetary hire-purchase and general banks in the form of the discounting of trade bills and bankers' acceptances increased only marginally faster than the total of the banks' lending to the private sector. When the roughly unchanged holdings of bankers' acceptances of the discount houses are included, the rate of increase in acceptance financing during the year was well below that of the total of banking sector discounts and advances to the private sector. To a large extent this development undoubtedly reflected the rise in money market interest rates which caused the effective cost of acceptance financing to rise above the level of the commercial banks' prime overdraft rate. In addition, at several month-ends during the year, the banks' actual holdings of bills and acceptances ranking as liquid assets already exceeded the amount that, in terms of the limitations applying thereto, can be used to meet the minimum liquid asset requirements.

Leasing contracts held by the commercial banks, the merchant banks and the monetary hire-purchase and general banks increased by approximately R125 million or by as much as 58 per cent during the year. In contrast, the increase in all forms of hire-purchase credit extended by these banks, amounting to R81 million or 23 per cent, was at a markedly lower rate than the overall increase in all forms of discounts and advances granted, which amounted to 40 per cent. One reason for the popularity of leasing contracts as a means of credit extension may be the fact that this form of lending does not fall under the scope of the Limitation and Disclosure of Finance Charges Act.

The sustained sharp rise in bank lending to the private sector would appear to have reflected the strong demand for credit arising from the further acceleration of the economic upswing and its more recent levelling-off on a high level of activity, rising imports and the rebuilding of stocks, and larger financial requirements arising from inflationary cost increases, as well as the large interest rate differentials between South Africa and abroad which encouraged the use of local sources of credit.

At times such as the present when the demand for bank credit is strong, the banks find it difficult to control effectively the actual extension of credit because of the overdraft system of lending under which overdraft facilities granted previously may at any time be utilised by the client. From figures supplied to the Reserve Bank on a quarterly basis the amount of unused overdraft facilities with commercial banks declined during the first quarter of 1974 after having increased substantially from the second quarter of 1972 to the fourth quarter of 1973. This may indicate the banks' more recent efforts

Ratio of utilised overdraft facilities with commercial banks to total overdraft facilities granted



to keep the amount of new facilities granted below the amount of additional credit that is being taken up by clients availing themselves of existing facilities. After fluctuating on a relatively low level for a number of years, the ratio of utilised overdraft facilities to total facilities granted increased from a low level of 67 per cent in the fourth quarter of 1972 to 76 per cent in the first quarter of 1974.

Very low levels of monetary banks' excess liquidity

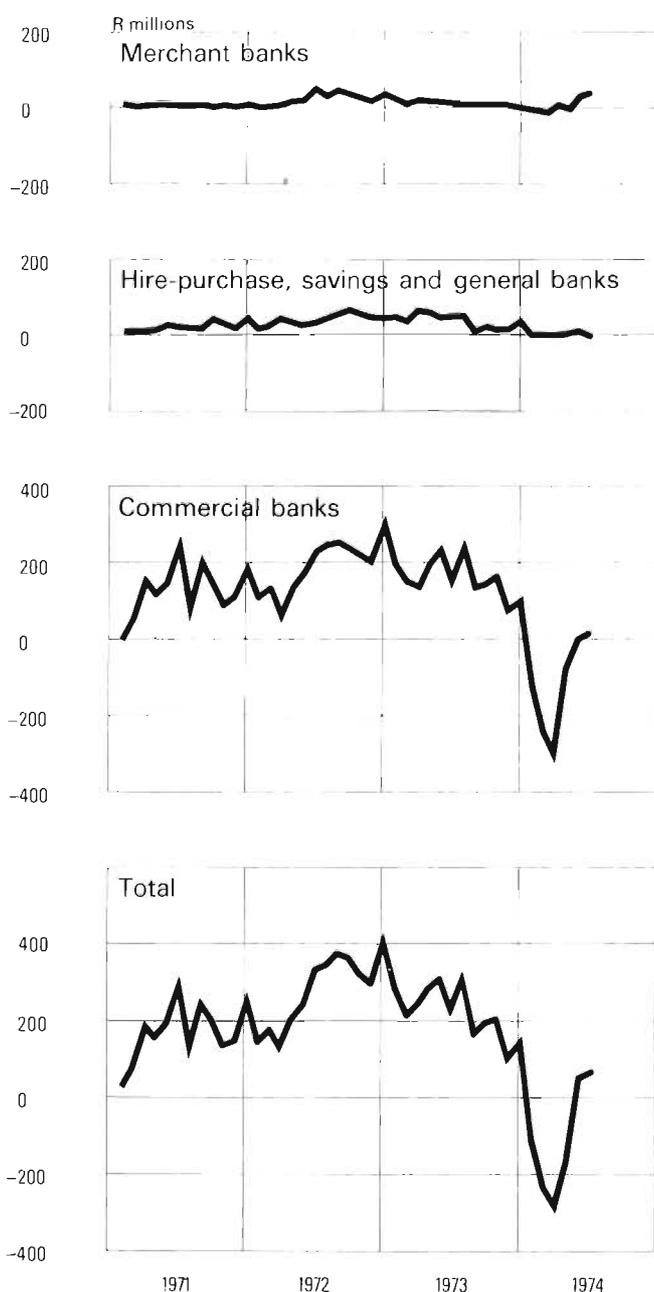
Extraordinary low levels of excess liquid asset holdings of monetary banking institutions have prevailed from approximately November 1973 onwards. The average excess liquidity ratio during 1973/74 as a whole amounted to 0,5 per cent for the commercial banks and to 0,7 per cent for all monetary banking institutions; the comparable ratios during 1972/73 had been 5,3 per cent and 5,0 per cent, respectively. Indeed, some banking institutions had shortfalls in their required liquid asset holdings during the early months of 1974, but in most cases complied again with these requirements by 21 May 1974.

Several factors contributed to these conditions. The rapid expansion of bank credit brought about a large increase in the banks' liabilities to the public which was not matched by an increase in their liquid assets. At the same time, the more or less continuous drain on the gold and other foreign reserves and periodic large increases in government deposits caused a loss of cash holdings. In addition, a shortening of the average maturity structure of the banks' liabilities occurred during the period October 1973 to February 1974, which was eventually brought to a halt by the banks' more aggressive bidding for time deposits.

A further improvement in their ability to lend resulted from their success in obtaining more long-term funds partly from outside the banking sector by using negotiable certificates of deposits as an instrument in the secondary market. This was accompanied by a reduction in the relative importance of short-term

liabilities against which they have to hold 45 per cent in liquid assets, whereas against long-term deposits this requirement is only 5 per cent. From February to June 1974 the relative share of the commercial banks' short-term liabilities to their total liabilities to the public declined from 56,3 per cent to 50,6 per cent, whereas the ratio of their long-term deposits increased from 12,7 per cent to 14,7 per cent. This enabled the commercial banks to increase their lending during the second quarter of 1974 by a large amount despite their already relatively tight liquidity position in the first quarter of 1974.

Surplus liquid assets



Furthermore, in their attempt to improve their liquid asset position while continuing to meet the demand for credit, the commercial banks, merchant banks and monetary hire-purchase and general banks increased their holdings of *liquid* bankers' acceptances and trade and agricultural bills by R133 million, or 53 per cent. At these higher levels the banks' total holdings of liquid bills and acceptances actually slightly exceeded the amount that, in terms of the 20 per cent limitation applying to such paper, could be used for complying with the liquid asset requirements.

Tight money market conditions

During 1972/73 the situation in the money market had been one of growing ease which eventually resulted in interest rates at such low levels as had not been recorded since the early 1960's. In contrast, during 1973/74 the declining gold and foreign exchange reserves, reduced bank liquidity, and inflationary expectations, caused interest rates on certain money market instruments to rise to levels that have been unparalleled in the post-war period. The Treasury bill tender rate, which had been 5,96 per cent at the end of 1971 and had reached a low point of 2,39 per cent in the middle of August 1973, returned to 5,84 per cent on 2 August 1974. More strikingly, the rates on 3-month bankers' acceptances and 91-day NCD's declined from respectively 8,5 and 8,7 per cent at the end of 1971 to 3,8 and 3,25 per cent in July 1973 — before increasing again to the record levels of 10,5 and 12,0 per cent at the end of July 1974.

Unusually tight conditions were experienced by the market towards the end of August 1973 and again in January, February and early March 1974. Both periods reflected shifts of funds to the government and other seasonal factors as well as the decline in the gold and other foreign reserves. From the middle of August 1973 to the end of that month, call loans with the discount houses decreased from R524 million to R254 million and, with the exclusion of deposits made by the Public Debt Commissioners, eventually reached a low point of only R114 million on 3 May 1974. However, since 17 May these loans have consistently exceeded R350 million.

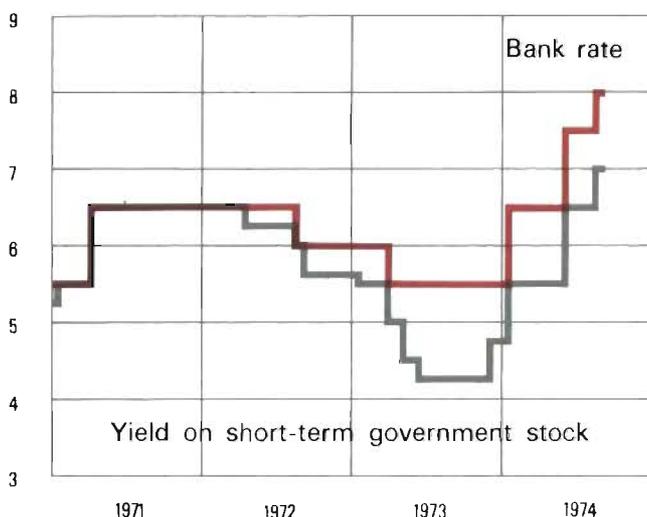
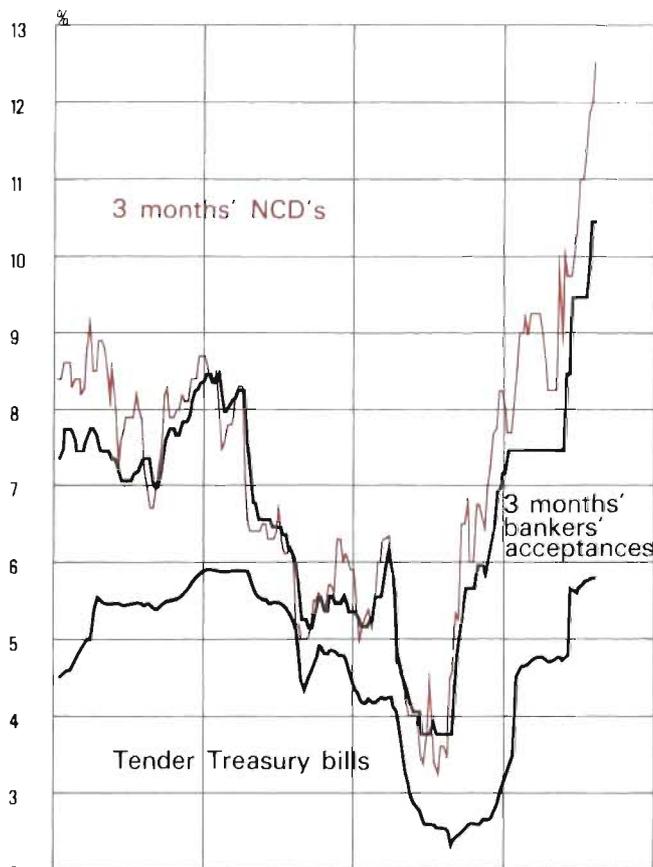
On 1 September 1973 the Reserve Bank introduced a new system for providing assistance to the discount houses by means of the discounting of Treasury bills rather than the granting of loans. Total accommodation granted by the Bank to the discount houses and the banks in the form of overnight loans, Treasury bills discounted or purchased, and lending to the banks (but excluding government securities purchased), had reached a high point of R387 million in early March 1974 but then dropped to nil in mid-June. Since then it fluctuated between R69 million and R106 million.

Although the penal rates charged by the Bank on its accommodation were at times considerably higher than

Bank rate, the Bank did take various steps to relieve the pressure on the discount houses where such pressure arose from normal seasonal or month-end developments. Thus, from October 1973 the gold premium payable to gold mines was paid out shortly before the end of each month instead of early in the next month.

In addition, the Bank for some time did not insist on strict adherence to the maximum of 40 per cent of the ratio of bankers' acceptances and trade bills to the discount houses' total assets. Finally, deposits were made with the discount houses by the Public Debt Commissioners from the end of November 1973. These deposits reached a peak of R130 million during March and the first half of April 1974, but were withdrawn entirely during May.

Money market interest rates



Record high levels of interest rates

Apart from the money market rates already referred to, other interest rates also moved strongly upwards to new record levels during the year under review. Bank rate was increased from 5,5 to 6,5 per cent on 14 January 1974, to 7,5 per cent on 1 June and to 8 per cent on 14 August. Maximum deposit interest rates, as laid down by the interest rate control regulations, were also revised on 14 January and 1 June, resulting in a maximum of 10 per cent on deposits with an original maturity of 24 months or longer. The prime overdraft rate of the commercial banks was lowered from 8 to 7,5 per cent on 16 July 1973. It was subsequently raised, however, to 8 per cent on 15 November 1973, 9 per cent on 1 February 1974, and 10 per cent on 1 June. On 1 August the lowest overdraft rate actually charged to the banks' clients was increased to 11 per cent, although the prime overdraft rate itself remained unchanged at 10 per cent. On 14 August the Reserve Bank not only increased Bank rate to 8 per cent but also raised the yield quoted on government stock by 0,5 per cent, resulting in a rate of 7 per cent for short-term stock and 9,75 per cent for long-term stock. Interest rate control on deposits of more than R250 000 per individual depositor was also abolished.

Following the increase in Bank rate, the commercial banks increased their prime overdraft rate to 10,5 per cent effective from 16 August.

In his Budget speech on 14 August, the Minister of Finance announced the substitution of a maximum finance charge of 14 per cent for the previous maximum charge of 12 per cent, as laid down by the Limitation and Disclosure of Finance Charges Act, on all money loans exceeding R400.

Government finance

Substantial increase in revenue collections

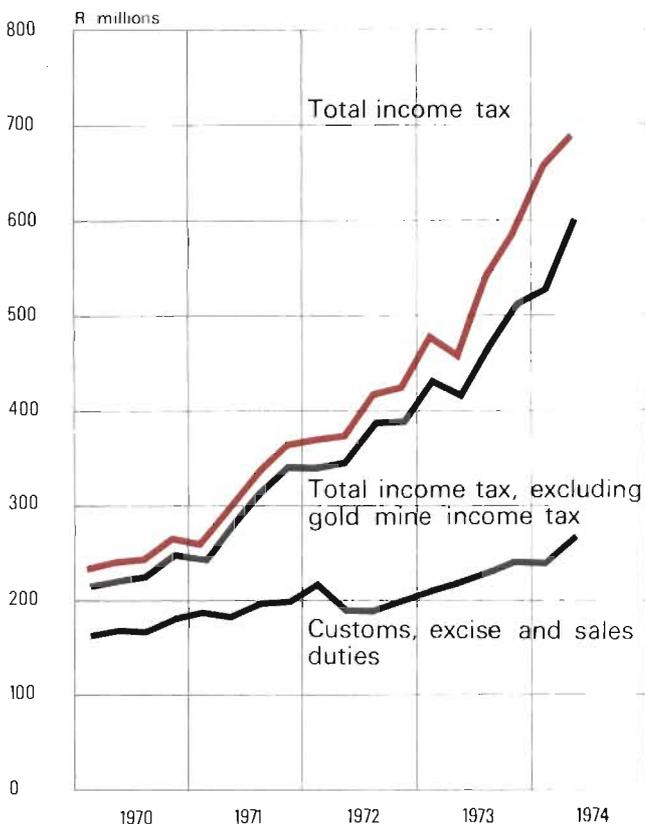
The most important development in the field of public finance during the year that ended on 30 June 1974 was the substantial increase in the current revenue collections of public authorities. Receipts of the general government departments of public authorities rose by as much as 31 per cent, which was the highest percentage increase recorded during the past ten years and also substantially higher than the increase of 17 per cent in 1972/73. Current revenue consists mostly of direct and indirect taxes, and during the year under review an increase in direct tax collections was mainly responsible for the higher rate of increase in current revenue. Consequently, South Africa's tax burden, i.e. the ratio of total tax collections to the gross domestic product, continued its gradual upward trend of the past decade. The ratio increased to 21,5 per cent in 1973/74, compared with 20,4 per cent during the preceding year. As a result of the higher current revenue, and despite the sharp increase in consumption expenditure

referred to earlier, the current surplus of the general departments of public authorities amounted to about R1 200 million in the year under review. This surplus was the highest yet recorded and exceeded the surplus in 1972/73 by almost 80 per cent.

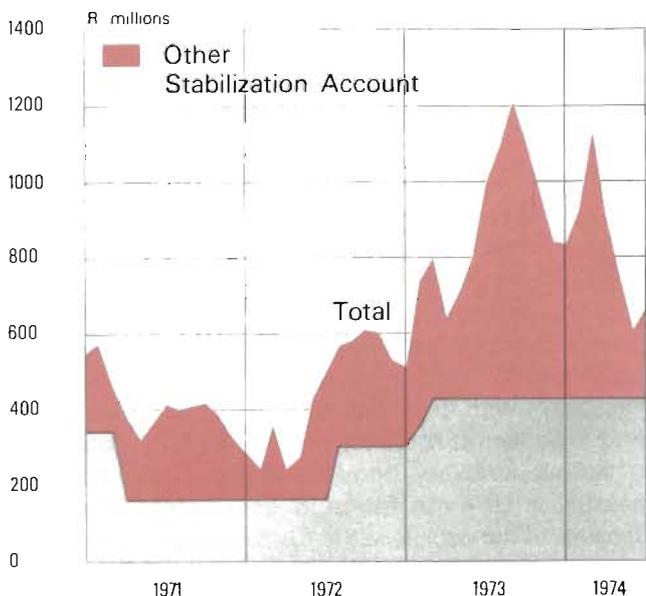
Relatively small deficit on Exchequer Account

As most of the current revenue of public authorities is collected by the central government and shown in the Exchequer Account, the substantial increase in current revenue during 1973/74 was also reflected in Exchequer receipts. Total Exchequer receipts, excluding borrowing, rose by more than R1 000 million or 31 per cent during the year under review, largely because of higher receipts from income tax and, to a lesser extent, customs and excise duties. Income tax receipts increased by R661 million, or 37 per cent, above the corresponding figure for the preceding year. The profits of gold mining companies increased substantially because of the sharp rise in the price of gold on the private market and income tax paid by these companies increased to 16 per cent of total income tax collections in the fiscal year that ended on 31 March 1974, compared with 9 per cent in the preceding year. The contribution by non-gold mining and other companies to total income tax collections declined slightly from 46 to 44 per cent from the fiscal year 1972/73 to the fiscal

Revenue collections of central government



Deposits on Exchequer and Paymaster-General Accounts



year 1973/74 and the contribution of individuals declined from 45 to 40 per cent over the same period.

As in the case of receipts, Exchequer issues also increased sharply during the year that ended on 30 June 1974, namely by almost R1 070 million or 28 per cent. Larger issues from both the Revenue and Loan Accounts contributed to this increase. Loan Account issues, in particular, increased by 29 per cent, after they had declined in 1972/73. The substantial rise in issues, however, was to a large extent offset by the equally sharp rise in receipts and the overall deficit on the Exchequer Account, therefore, was relatively small. The ratio of the deficit to total receipts was only 10 per cent, compared with 13 per cent in 1972/73 and 33 per cent in 1971/72. As a result of the sharp increase in receipts, the Exchequer deficit of R405 million for the fiscal year that ended on 31 March 1974 was substantially smaller than the R1 100 million anticipated in the original Budget estimates for the relevant fiscal year.

Deficit financed largely by a decline in Exchequer balance

The Exchequer deficit of R457 million for the year that ended on 30 June 1974 was financed only to a limited extent by means of borrowing. In view of the high level of government deposits and the progressive tightening of the capital market, the Treasury restricted its borrowing operations during the year under review and financed the Exchequer deficit by reducing the Exchequer balance. Total domestic government debt, after taking into account the repayment of loan levies of R80 million in March 1974, increased by only R105 million during the year under review. A large part of the debt increase represented issues of Treasury bills to the Public Debt Commissioners so that the marketable domestic government stock debt increased by only R7 million. The balance on the Exchequer Account declined by R378 million during the review period, but the balance on the Stabilization Account was not used, contrary to what was envisaged in the original Budget estimates.

As shown in the accompanying table, the Treasury was able to reduce its indebtedness to the foreign and the private non-banking sectors. However, the Treasury's indebtedness to the Public Debt Commissioners, including the Post Office Fund as from 1 April 1974, increased substantially by R193 million during the review period. The main reason for this increase was the investment with the Commissioners of funds issued by the Exchequer at the close of the 1973/74 fiscal year to various statutory bodies and the Commissioners' investment of these funds in government securities. Because of the decline in the Exchequer's cash balance, the net indebtedness to the monetary banking sector also increased sharply. Apart from the decline of R378 million in the Exchequer balance, the monetary banking institutions, excluding the Reserve Bank and

Exchequer finance

R millions

	Year ended 30 June		
	1972	1973	1974
Total receipts	2 810	3 342	4 381
Total net issues	3 743	3 768	4 838
Total deficit (excluding borrowing)	- 933	- 426	- 457
Financing:			
Change in net indebtedness to:			
Foreign sector	90	46	- 38
Private non-banking sector:			
Loan levies	142	- 10	- 14
Other	426	315	- 32
PDC and Post Office Fund ..	160	96	193
Sub-total	818	447	109
Monetary banking sector:			
Change in holdings of government securities held by:			
Reserve Bank and NFC ..	23	209	175
Other monetary banking institutions	224	245	- 205
Change in Exchequer balance*	- 132	- 475	378
Sub-total	115	- 21	348
Total financing	933	426	457

*Increase —, decrease +. Including net transfers to the Stabilization Account and to the IMF Deposit Account in respect of super gold tranche drawings.

the National Finance Corporation, actually reduced their holdings of government securities by an amount of R205 million. This reduction, however, was largely offset by an increase of R175 million in the government security holdings of the Reserve Bank and the National Finance Corporation. Redemptions of government stock during the year under review accounted partly for the decline in monetary banking institutions' holdings of government securities. The stock that had to be redeemed during the review period amounted to R429 million and of this amount about R200 million was repaid in cash, whereas the remainder represented conversions into new stock.

The 1974/75 Budget

In presenting the 1974/75 Budget on 14 August 1974, the Minister of Finance indicated that the prevailing and prospective economic conditions call for directing economic policy measures at four objectives, namely the maintenance of a satisfactory rate of growth, the preservation of economic stability, particularly the containing of the rate of inflation, the strengthening of the balance of payments and the alleviation of the effects of inflation on certain sections of the community.

To meet the first mentioned objective, the Minister made a number of proposals to increase production and productivity which may also contribute to the attainment of other objectives. These measures include the provision of increased funds for education and training and for the extension of the country's economic infrastructure. Tax concessions were also made in respect of mining, the training of labour, the income of married women and the income tax surcharge on individuals, whereas increases were announced in the initial and investment allowances for machinery and equipment and the loan levy on companies was reduced by half.

With a view to strengthening the balance of payments, an amount of R17 million was provided in the estimates of expenditure for the scheme launched by the Industrial Development Corporation of assisting industrialists by means of low-interest loans in establishing new productive capacity for exports. The local beneficiation of minerals will also be encouraged. The greater use of foreign loans will contribute towards an improvement in the capital account of the balance of payments and the Minister announced that sympathetic consideration will be given by the Reserve Bank to applications for loans for approved purposes with a duration as low as six months. In addition, it was felt that an extension of forward exchange transactions to cover extended credit for the importation of capital goods was justified.

To alleviate the effects of inflation, the Budget provided for a further reduction in sales duties on essential goods, increased social and civil pensions and an extension of subsidies on interest in respect of housing mortgage loans. Estimates of expenditure furthermore provided for an increase of 20 per cent in food subsidies. The Minister also proposed increases in income tax abatements and, to assist aspiring house-owners, a reduction in transfer and stamp duties payable by individuals. Moreover, the Minister, in line with present monetary policy, adopted a general conservative approach and did not employ the previous year's surplus on the Revenue Account to finance expenditure or reduce taxation. The Minister proposed that the major part of the surplus of R319 million be transferred to the Stabilization Account.

It was estimated that, on a cash basis, Revenue and Loan Account receipts together will rise by about 20 per cent to R4 869 million during the 1974/75 fiscal year, whereas expenditure will rise by nearly 23 per cent to R5 502 million. Consequently, a deficit (excluding borrowing) of R633 million is expected and, if loan redemptions are taken into account, the total borrowing requirement for the year will amount to R1 146 million. The Minister anticipated that R334 million of this amount will be financed through foreign borrowing and the remainder through domestic borrowing. The latter includes a contribution by the Public Debt Commissioners of R300 million, loan

conversions of R315 million and new loans of R100 million. Total loan levies by companies is expected to yield a further R52 million, whereas R47 million is expected to be received through the issue of a second series tax-free Premium Bonds. The issue of these bonds is aimed at fostering saving and will be made available to investors as from 15 October. It will give an average yield of 8 per cent per annum, but will be subject to a maximum investment of R20 000.

Capital market

Conditions in the capital market changed markedly during the year that ended on 30 June 1974. At the beginning of this period the market was easing and interest rates were moving downwards, but towards the end of 1973 the cyclical upswing which had started in the last quarter of 1972, was beginning to have its usual lagged effect on the capital market. Since then, market conditions have tightened and interest rates have been rising. In addition to the normal cyclical influences, three further factors reinforced the tightness of the market and the upward pressure on interest rates. Firstly, the usual net inflow of foreign capital to supplement domestic saving at a time when the economy is in an expansionary phase, was not forthcoming and an actual net outflow of capital was recorded on account of the much higher interest rates abroad. Secondly, interest rate levels had to allow for the prevailing high rate of inflation. Thirdly, expectations of a further increase in interest rates adversely affected the supply of funds.

Progressive tightening of fixed-interest security market

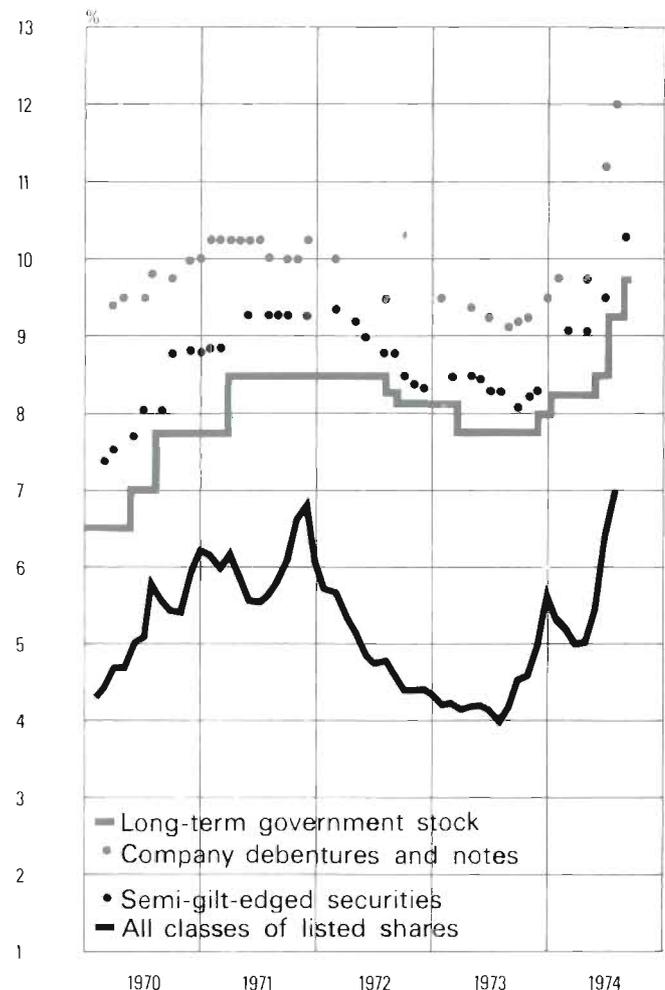
The easing of the fixed-interest security market which had begun towards the middle of 1972, continued until the third quarter of 1973. Thereafter the market tightened progressively and this was reflected in a sharp upward movement of interest rates. The yield on long-term government stock was raised in five stages, namely from 7,75 to 8,00 per cent on 3 December 1973, to 8,25 per cent on 14 January 1974, to 8,50 per cent on 1 June, to 9,25 per cent on 12 July and to 9,75 per cent on 14 August. The predominant yield on long-term semi-gilt-edged securities, which had moved downwards to about 8,1 per cent in September 1973, increased to 9,5 per cent in June 1974 and to 10,29 per cent in July. Similarly, the yield on long-term loan securities of companies rose from 9,1 per cent in August 1973 to 11,2 per cent in June 1974 and 12,0 per cent in July. Because of the uncertain investment climate brought about by the continued upward adjustment of interest rates and the high rate of inflation, a variable coupon rate linked to the prime lending rate of commercial banks was introduced for a large issue of company debentures in July 1974.

The tightening of the market occurred notwithstanding a substantial reduction in the recourse to this market by the central government. Because of a large current surplus mainly arising from a substantial increase in income tax receipts, new funds raised by the government in the form of domestic marketable stocks amounted to only R7 million during the year under review, compared with R778 million and R660 million

in 1971/72 and 1972/73, respectively. Public corporations, local authorities and companies in the private sector, however, increased their borrowing in the market. The larger company borrowing was due to some extent to companies switching their demand for new funds from a rather depressed share market to the fixed-interest security market.

Notwithstanding the sharp rise in interest rates, some of the issues towards the end of the period under review were unsuccessful and had to be cancelled or postponed. The inadequate supply of funds was due to the general scarcity of funds in financial markets, a withholding of investments because of expectations of a further increase in interest rates, high rates of interest on shorter-term investments and deposits, and compliance by institutional investors with the statutory

Interest rates and yields



requirements in terms of which a minimum investment in gilt and semi-gilt-edged securities has to be maintained. The monetary banking sector's holdings of fixed-interest securities, for example, declined during the year under review, compared with a substantial increase during 1972/73, and the private non-banking sector's holdings increased much less than during the previous year.

Large interest rate differentials between the South African and foreign capital markets, a general scarcity of funds in international financial markets and uncertainties about future exchange rate movements acted as disincentives to foreign borrowing as a means of supplementing the domestic supply of funds. The central government actually reduced its foreign indebtedness during the year under review, but public corporations had to maintain a high level of foreign borrowing because of their large capital requirements. Individual companies in the private sector eventually also had to transfer part of their borrowing operations to foreign markets.

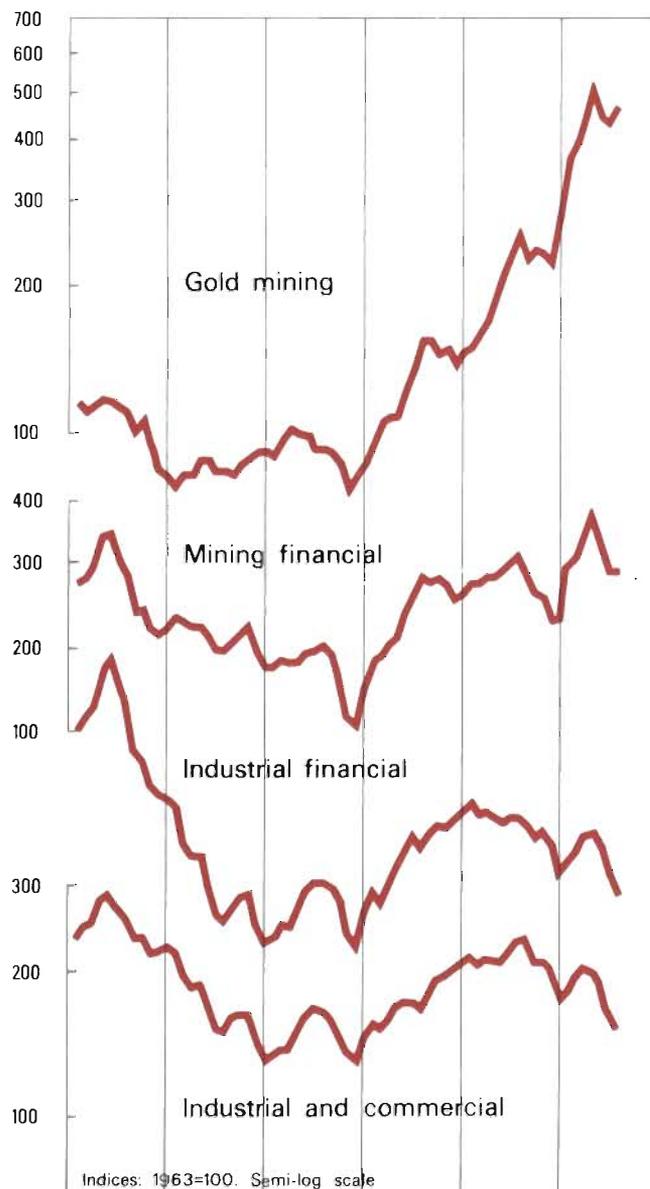
Downward movement of prices in the share market

The rising trend of share prices from the end of 1971 was reversed during the third quarter of 1973 and, except for a temporary recovery during the first four months of 1974, the prices of almost all classes of shares drifted downwards throughout 1973/74. Declines in the prices of the various classes of shares ranged from 21 to 36 per cent, except for the decline of only 3 per cent in the prices of mining financial shares. Gold and coal mining share prices, however, continued their upward trend apart from temporary downward fluctuations in gold mining share prices. A very substantial increase of 86 per cent in gold mining share prices was recorded during the year under review and this rise was a reflection of the sharp increase in the price of gold on the private market. The interest of investors, therefore, was focused on the gold mining section of the stock exchange and this contributed to the sluggishness of the prices of other classes of shares.

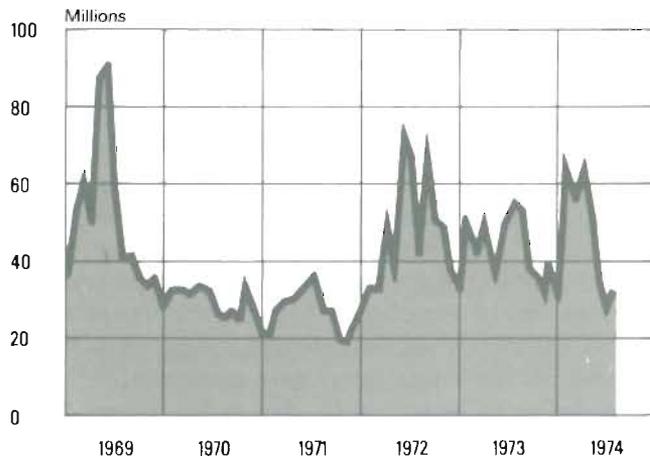
Stock exchange turnover, in terms of the number of shares traded, was on average 7 per cent lower in 1973/74 than in 1972/73, but the value of shares traded increased by 52 per cent. The increase in the value of turnover was influenced strongly by transactions in gold mining shares which accounted for 39 per cent of the total turnover. These transactions also accounted for 27 per cent of the number of shares traded.

Because of an increase in dividend payments resulting from a sharp rise in company profits, and a decline in most classes of share prices, dividend yields increased substantially during the year under review. The average dividend yield on all classes of shares increased from 4,13 per cent in June 1973 to 6,40 per

Share prices



Number of shares traded



cent in June 1974. Even the yield on gold mining shares increased during this period, namely from 4,84 to 5,23 per cent, notwithstanding the very substantial increase in prices. The strong rise in the share yield reduced the inverse yield gap between long-term government stock and shares from 3,62 per cent in June 1973 to 2,10 per cent in June 1974, even though the government stock yield had also increased markedly.

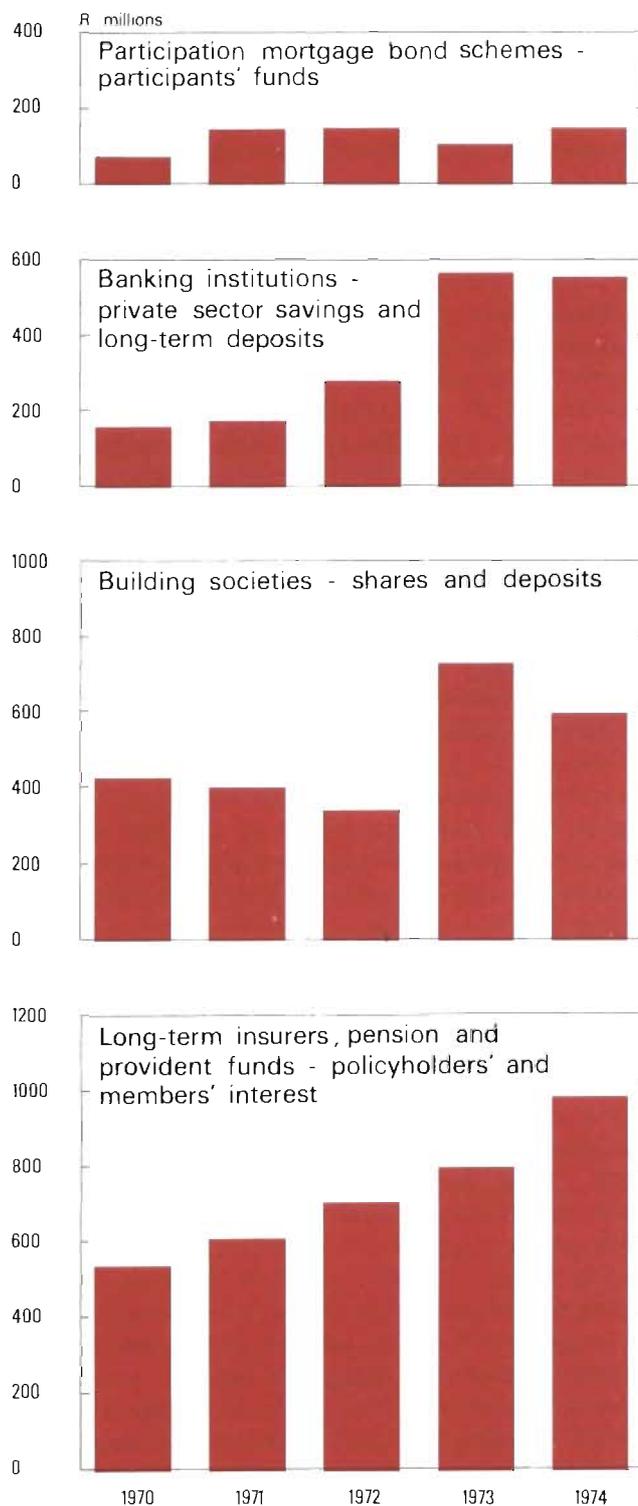
The downward movement of all non-gold mining share prices also caused a reduction in the amount of new capital raised on the stock exchange. Compared with new share issues of R175 million by listed companies in 1972/73, new issues amounted to only R89 million during 1973/74 at a time that private investment expenditure was rising. A large increase in corporate saving reduced the dependence of companies on external sources of finance, but the companies nevertheless had to supplement the amount of capital raised in the share market by larger borrowing in the fixed-interest security market and by using available bank credit facilities.

Because of the depressed share market, excluding the gold mining section, net repurchases of units by unit trusts increased from R17 million in 1972/73 to R53 million in 1973/74. The almost constant outflow of funds obliged the unit trusts to maintain a reasonable working balance in the form of cash and deposits and the outflow of funds recorded during the year under review, therefore, had to be financed entirely through net sales of securities in their portfolios. Such net sales amounted to R67 million and probably contributed to the downward movement of share prices. The market value of the trusts' net assets declined by R169 million during the review period and this was reflected in a decline of 17 per cent in the selling prices of units.

Strong competition for funds among deposit-receiving and related institutions

The flow of funds to banking institutions, building societies and participation mortgage bond schemes, in the form of an increase in savings and long-term deposits, building society shares and investments in mortgage participations, declined gradually during the year that ended on 30 June 1974 after it had increased to a very high level in the second quarter of 1973. In 1973/74 the inflow amounted to R1 311 million, compared with R1 416 million in 1972/73. The diminished flow was attributable to a decline in personal saving, a higher preference for more liquid forms of investment, an increased flow of funds outside the banking system during most of the period and a net outflow of funds to other countries. At the same time, the institutions were faced with a larger demand for funds caused by an increase in the monetary demand for goods and services and a continued large demand for mortgage loans. These developments gave rise to stronger competition among the relevant institutions to maintain or increase

Flow of funds to financial institutions



their share in the available pool of funds. The banking institutions' share in the flow of longer-term funds, as defined above, increased from 40 per cent in 1972/73 to 43 per cent in 1973/74 and that of participation mortgage bond schemes from 8 to 11 per cent, whereas the share of building societies decreased from 52 to 46 per cent. The increase in savings and long-term deposits of the private sector with banking institutions, which had remained at a relative high level during the second half of 1973 when an average quarterly figure of R152 million was recorded, reverted to a decline of R54 million during the first quarter of 1974. The decline in these deposits was due to a larger flow of funds outside the banking system, an increase in other financial intermediaries' proportionate share in deposit-type funds and a shift from longer-term to shorter-term deposits with banks. The strong demand for credit and the lack of excess liquid assets during the first quarter induced the banks to compete aggressively for funds. As a result, the increase in their savings and long-term deposits during the second quarter of 1974 of R309 million was the largest quarterly increase during the year under review. Issues of negotiable certificates of deposit trading at attractive rates of interest in the secondary market, were one of the methods used by the banks to increase their inflow of funds. Rates on these certificates in the secondary market were actually increased above those on new issues of long-term gilt and semi-gilt-edged securities and were also competitive with those on loan securities of companies. These competitive rates on marketable short-term instruments, together with expectations of further interest rate increases, had an adverse influence on the demand for fixed-interest securities during the second quarter of 1974. There was also a reduction in the flow of loanable funds outside the banking system and a decline in short-term funds with the banks during this quarter.

The increase in the deposits and shares of building societies during the year under review amounted to R596 million, compared with the record increase of R744 million during the preceding year. The downward trend of the quarterly inflow of funds to the societies during the second half of 1973 was sharply reversed during the first quarter of 1974 at a time when the flow of longer-term funds to banking institutions declined strongly. However, during the second quarter the building societies' inflow of funds dropped to the lowest quarterly level during the year under review when the banking institutions' inflow increased again.

The stronger demand for the type of mortgage loans provided by participation mortgage bond schemes, related to the higher level of fixed investment, encouraged the schemes to compete more actively for funds during the year under review than in the preceding year during which the real estate market had experienced a smaller demand for non-residential mortgages. The inflow of funds to the schemes, consequently, increased from R108 million in 1972/73 to R150 million in 1973/

74. Contractual savings institutions such as long-term insurers and pension and provident funds, had their usual even inflow of funds during the year under review because of the contractual nature of their liabilities.

Deposit interest rate control which was introduced in March 1972, had little significance until the fourth quarter of 1973. Because of the shortfall of the supply of deposit-type funds relative to the demand and the stronger competition for funds, an upward pressure developed on deposit interest rates. This was recognised by the authorities when the controlled maximum deposit interest rates for various classes of deposits and building society shares, excluding subscription and tax-free shares, were raised by 1 per cent on 14 January 1974 and further by 1.5 per cent on 1 June 1974. Rates on subscription and tax-free shares were increased by 1 per cent on 1 June 1974.

On 14 August an important further change was introduced when the deposit interest rate control was abolished for all individual deposits exceeding R250 000. The existing maximum interest rates will continue to apply to individual deposits of R250 000 and less and to all building society shares. The exemption of interbank deposits from interest rate control given in June 1974 was also extended to building societies, in other words, the maximum interest rates will in future not apply to deposits which building societies and banking institutions accept from one another. It has also been decided, with effect from 14 August 1974, to abolish interest rate control in respect of individual amounts of more than R250 000 accepted for investment in participation bonds and in debentures issued by institutions for the purpose of granting credit to the public.

Levelling-off of activity in the mortgage and real estate markets

There was a continued strong demand for mortgage loans during 1973/74. During the first ten months (for which statistics are available), the value of net registrations of new bonds, i.e. after allowing for cancellations, was 42 per cent higher than that for the corresponding period of the preceding year. Building societies, banking institutions and participation mortgage bond schemes were responsible for most of these registrations. The amount actually advanced on mortgage loans by building societies during 1973/74 was R1 200 million, compared with R872 million in 1972/73, and their mortgage loans outstanding increased by R676 million. The mortgage loans outstanding of banking institutions and participation mortgage bond schemes increased by about R290 million and R150 million, respectively, in 1973/74, compared with increases of R161 million and R105 million in 1972/73.

The declining trend in the flow of funds to building societies, however, reduced the rate at which new

mortgage loans were granted. The monthly average of new loans granted declined from R112 million during the first half of the year under review to R82 million during the second half. In addition, the societies reduced their commitments in respect of loans granted but not yet paid out, by R120 million during the last nine months of the review period.

The tightening of the mortgage market was reflected in an increase in mortgage rates. The average rate for all classes of mortgage loans, which had declined to 8,58 per cent in November 1973, subsequently increased to the latest available figure of 9,01 per cent in April. Building societies reduced their lending rate on house mortgages from 8,75 to 8,50 per cent in August and then raised this rate to 9,25 per cent and 10,50 per cent in January and June 1974, respectively. The rate on participation mortgage bonds increased from 9,0 to 9,6 per cent in January 1974 and then rose to 11,0 per cent in July 1974.

The interest subsidy scheme applicable to certain residential mortgage loans advanced by building societies was amended with effect from 1 July 1974. A borrower will qualify for a subsidy of up to 2 per cent, based on the excess of the actual mortgage rate above 8,5 per cent, on a property valued at not more than R18 000 with an outstanding mortgage of not more than R15 000. Previously the maximum subsidy was fixed at 1 per cent for properties valued at not more than R16 000 and having an outstanding mortgage of not

more than R12 000. On 14 August the maximum value of a property qualifying for the subsidy, was raised to R20 000.

The tightening of the mortgage market, together with the high levels of interest rates and the general scarcity of funds, had a dampening effect on the real estate market. Transactions in fixed property, which had been buoyant since the beginning of 1972, levelled off during the first half of 1974.

Fixed property market

