

1975

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-Fifth Ordinary General Meeting to be held on 26 August 1975.

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General observations

An analysis of the most important monthly and quarterly economic indicators reveals that an upper turning point in the South African business cycle was reached at the beginning of the third quarter of 1974, and that the downward phase of the business cycle continued throughout the rest of the year under review*. In interpreting the present economic situation, it is important to note that this downward phase of the business cycle did not represent an actual decline in economic activity, but a reduction in the growth rate to a level below that of the long-term trend. It is also noteworthy that the year under review coincided almost entirely with the downward phase of the business cycle, whereas the preceding year, with which the current year is customarily compared, had been in the upward phase of the business cycle. This means that although a meaningful comparison can be made between 1974/75 and 1973/74, exceptionally marked changes in growth rates and other statistics were recorded between these two years. Significant changes in certain economic variables and policy measures also occurred in the course of the year under review.

The rate of increase in the real gross domestic product declined from about 5½ per cent in 1973/74 to approximately 3 per cent in 1974/75 and from 7 per cent to 3 per cent if the contribution of agriculture is excluded. Although this represents a sharp decline in the growth rate of the economy to a level which is low by South African standards, this growth rate still compares favourably with the very low and even negative rates recorded in most industrialised countries during 1974 and the first half of 1975. It is gratifying to note that the latest information in respect of business conditions in the United States and a number of other countries indicates that a revival of economic activity may have started already towards the middle of 1975. More buoyant economic conditions in these important trading partners of South Africa will naturally in due course have a stimulatory effect on the South African economy.

In South Africa there are also a number of factors which should help to sustain economic activity at a reasonable level and contribute to the next upturn of the business cycle. These include the current good agricultural season, additional demand and activity that will be created by the large capital projects of the public sector, a new source of demand following upon the introduction of television during 1975 and 1976,

prospects for a lower but still satisfactory increase in non-gold mining production and the expected smaller decline in the volume of gold production. To these expansionary factors may be added that the labour situation is still relatively easy and, therefore, conducive to domestic economic expansion.

Prices continued to increase at a high rate, notwithstanding a relatively easy labour situation, increased unused production capacity in manufacturing and a lack of sufficient demand, as reflected in a marked decline in the growth rate of real gross domestic expenditure. The high rate of inflation was, therefore, not in the first instance due to excess demand exerting pressure on domestic production resources, but was associated with such factors as the high rate of increase in the prices of imported goods, the upward adjustments to government-administered prices and the large increases in the average salaries and wages of certain sections of the labour force. It is noteworthy, however, that a distinct slowdown occurred in the rate of increase in both consumer and wholesale prices from about the third quarter of 1974 up to the second quarter of 1975. After reaching an annual rate of increase of 18,2 per cent in the third quarter of 1974, the change in the seasonally adjusted consumer price index declined to a rate of increase of 13,8 per cent in both the fourth quarter of 1974 and the first quarter of 1975 and further to 12,4 per cent during the second quarter of 1975. An even more marked decline in the rate of increase of wholesale prices occurred during the same period.

Taking the year 1974/75 as a whole, South Africa's balance of payments was characterised by a large deficit on current account and an almost equally large net inflow of capital from abroad, with the result that the total gold and other foreign reserves declined only slightly. There were a number of reasons why the current account of the balance of payments did not improve in conformity with the slowdown in domestic activity and demand. These included the high rate of increase in the prices of imported goods, including oil and defence equipment; a lower rate of increase in the gold price; a decline in international commodity prices; a sharp increase in international freight rates and other transport costs; a substantial rise in interest and dividend payments to foreigners; and a sharper decline in the volume of gold production.

During the course of the year under review, both imports and exports showed a levelling-off tendency. The deficit on the current account, at a seasonally adjusted annual rate, amounted to about R1 300 million during the second half of 1974, but then increased to R1 710 million during the first half of 1975. The further deterioration in the current account of the

*The year under review refers to the twelve months ended on 30 June 1975 and represents the year for which the most up-to-date national accounts and other data are available. In cases where more recent information is available, the review will also cover July and part of August 1975.

balance of payments during the first half of 1975 was mainly due to a decline in the net gold output and a substantial increase in service payments to foreigners.

The main feature of the capital account of the balance of payments was that although a large total net inflow of capital was recorded for the year under review (R1 499 million), short-term capital movements fluctuated markedly. During the second quarter of 1975, for example, expectations regarding changes in the exchange rate of the rand caused the so-called "leads and lags" to turn against South Africa, i.e. importers paid for their imports more promptly, exporters retained their export proceeds abroad as long as possible and the inflow of certain other forms of capital was delayed. Moreover, local bank credit was used to a significant extent to finance an outflow of capital. Domestic monetary, exchange rate and exchange control policies were, therefore, changed to influence capital movements between South Africa and foreign countries.

The strengthening of the US dollar from March 1975 and the substantial weakening of sterling beginning in April 1975 created expectations that the rand would be adjusted downwards against the dollar in a series of small steps. This caused a sharp outflow of private short-term capital, which is not apparent from the figures for the year under review as a whole, and this led to increased borrowing by the central government and banking sector for balance of payments purposes. The authorities, therefore, changed their exchange rate policy as from 27 June 1975. In terms of the new policy, the Reserve Bank intends to keep the rand-dollar rate constant for longer periods and will only effect an adjustment if this is considered essential in view of basic changes in the domestic or international economic situation.

The new policy was based upon a middle rand-dollar rate of \$1,40 per rand, which at the time represented a depreciation of the rand in terms of the dollar of 4,76 per cent. This depreciation was a precautionary move to prevent an undue appreciation of the rand in the period ahead as a result of movements in other currencies. Subsequently, on 31 July, the Minister of Finance reaffirmed that the rand would not be devalued in terms of the dollar merely because the dollar had in the meantime appreciated in overseas exchange markets. He also stated that further steps would be taken to limit the magnitude of leads and lags, and to encourage the inflow of foreign capital in general. These steps were announced on 11 August and included the following:

- (1) Exchange control was relaxed in respect of foreign borrowing by local entrepreneurs;
- (2) Authorised dealers in foreign exchange will be allowed to raise funds abroad in their own names for the financing of South African foreign trade and for other approved purposes;
- (3) Blocked rand will be made directly transferable

between non-residents;

- (4) Forward exchange cover was extended for longer periods and also to authorised dealers in respect of foreign loans raised in their own names and approved by the authorities. Forward cover need also no longer be arranged within seven days after the foreign transaction was concluded;
- (5) The Bank rate was increased from 8 to 8½ per cent;
- (6) The minimum liquid asset requirement of commercial banks was increased by 4 per cent and that of other banks by 2 per cent of their short-term liabilities to the public;
- (7) Appropriate adjustments will be made in the Reserve Bank's transactions in government securities and interest rate policy in general.

In conformity with the lower levels of real economic activity and reduced rates of growth during the year under review, the money and banking situation also changed markedly and the authorities assumed a different attitude in regard to monetary policy. As during most of 1973/74, the monetary authorities at first followed a conservative monetary policy aimed at increasing interest rates to levels more in line with those prevailing abroad, and at lowering the rate of growth in the money supply. However, as the slackening of the pace of economic activity became more apparent in the course of the second half of 1974, the authorities did not actively resist a downward movement in interest rates. More recently, however, when domestic bank credit was again used to assist in the switching from foreign to domestic financing of international trade because of expectations of importers and exporters that the rand would again be devalued against the dollar, the monetary authorities reverted to a more stringent monetary policy.

These changes in monetary policy were accompanied by marked fluctuations in monetary aggregates. During 1973/74, interest rates increased uninterruptedly and continued to rise until the third quarter of 1974, while at the same time the rate of increase in the supply of money and near-money was reduced during the first three quarters of 1974. Subsequently, money and near-money at first increased at a more rapid rate and short-term interest rates declined substantially, but during the first half of 1975 the annual rate of increase slowed down substantially to 11,4 per cent. Contrary to developments during 1973/74 when the increase in the money and near-money supply did not cause a significant change in the ratio of money and near-money to the gross domestic product, the increase during 1974/75 led to a rise in this ratio from 28 per cent during the second quarter of 1974 to more than 30 per cent during the second quarter of 1975.

The causes of changes in the money and near-money supply during 1974/75 were generally such as might have been expected during the downward phase of the business cycle. The net gold and other foreign

reserves, for example, declined less than during the preceding year and bank credit to the private sector increased at a much lower rate as a result of a lack of demand. Credit to the private sector, in fact, increased by only 13 per cent during 1974/75, as against a rise of 31 per cent during 1973/74. The most important single cause of the growth in the money and near-money supply during 1974/75 was the large increase of R885 million in the net claims of the banking sector on the government sector (i.e. bank credit to the government), compared with R248 million during 1973/74. The high rate of increase in government expenditure, coupled with a lower rate of increase in revenue, led to a substantial increase in the Exchequer's overall deficit, which increased the borrowing requirements of the Government to such an extent that the Government was forced to make use of bank credit.

During recent months, bank credit to the private sector, notably in the form of merchandise leases and bankers' acceptances, also increased more rapidly, despite the lack of demand for purposes of domestic economic expansion. It would appear, therefore, that these forms of credit were used to assist in the switching from foreign to domestic financing of international trade and thus facilitated the outflow of short-term capital. As pointed out above, monetary measures were therefore taken to reduce the ability of banking institutions to extend credit for this purpose.

Short-term interest rates rose for more than a year to record levels at the beginning of the third quarter of 1974, before declining markedly up to July 1975. The rate on 90-day NCD's, for example, which had increased from 3,25 per cent in July 1973 to 17,25 per cent on 27 September 1974, declined to 6,50 per cent on 4 July 1975. Similarly, the discount rate on 3-month bankers' acceptances increased from 3,80 per cent in July 1973 to 13,0 per cent in September 1974, but then declined to 6,75 per cent on 4 July 1975. The Treasury bill tender rate also showed similar tendencies, although less marked, and the authorities acknowledged this downward movement by reducing the pattern of rates quoted on government securities in December 1974, before abolishing this pattern altogether in February 1975. Deposit rates quoted by banks and building societies and lending rates of banks also declined during the first half of 1975.

The liquidity position of banking institutions, particularly that of certain commercial banks, increased markedly during May and June 1975 and enabled them to extend further bank credit to the private sector. Subsequently, the minimum liquid asset requirements of all banking institutions were increased as part of the monetary policy measures announced on 11 August 1975, referred to above.

In the field of government finance, the main developments during the year under review were a substantial increase in government expenditure, a lower rate of increase in government revenue and a record deficit,

financed partly by bank credit, already referred to. The Minister of Finance, when presenting his 1975/76 Budget, stated that priority would be given to expenditure for infrastructural development and defence, and that the general influence of the Budget should be moderately stimulatory. He stressed that with the inflation rate still unacceptably high, the expansionary effect should be moderate so as to prevent an early return to a situation of demand inflation and balance of payments disequilibrium.

The capital market situation, which had tightened considerably until the third quarter of 1974 in conformity with the strong demand for capital to finance the buoyant economic conditions, eased somewhat towards the end of 1974 and early in 1975 and then remained unchanged during the remaining part of the year under review. Reflecting the easing of the market, yields on fixed-interest securities declined to slightly lower levels and most classes of share prices recovered noticeably. From the first quarter of 1975, the amount of funds advanced in the mortgage market increased because of a larger flow of funds to the building societies. Activity in the real estate market, which had started to level off during 1973/74, actually declined during the fourth quarter of 1974 and the first quarter of 1975. During the second quarter, however, the real estate market showed signs of a revival.

National accounts

Lower rate of increase in real gross domestic product

It is now generally agreed that the upper turning point of the business cycle in South Africa was reached in the beginning of the third quarter of 1974. The period under review, i.e. the year that ended on 30 June 1975, consequently coincided almost entirely with the downward phase of the business cycle, whereas the preceding year, with which the current year is customarily compared in this review, had been a period of high economic growth and fell in the upward phase of the business cycle. The rates of increase in almost all national accounts aggregates in 1974/75 were, therefore, substantially lower than those of the preceding year. However, the declines in growth rates do not imply an absolute decline in economic activity, but merely that lower rates of increase in activity were recorded.

In conformity with the general economic situation in South Africa during the past four quarters, the rate of increase in the real gross domestic product declined markedly from about 5½ per cent in 1973/74 to approximately 3 per cent in 1974/75 and from 7 per cent to 3 per cent if the contribution of agriculture is excluded. Although the growth rate for 1974/75 was relatively low by South African standards, it still compared favourably with growth rates recorded recently in most Western countries. In a number of countries even negative growth rates were experienced in 1974 and the first half of 1975.

As the accompanying table shows, the slowdown in economic activity was fairly general throughout the economy, but the most pronounced decline in the rate of increase occurred in manufacturing production. The latter was not only affected by a lower rate of increase in domestic demand during the review period, but also by the high levels of stocks held by wholesale and retail traders at the beginning of the downward phase of the business cycle.

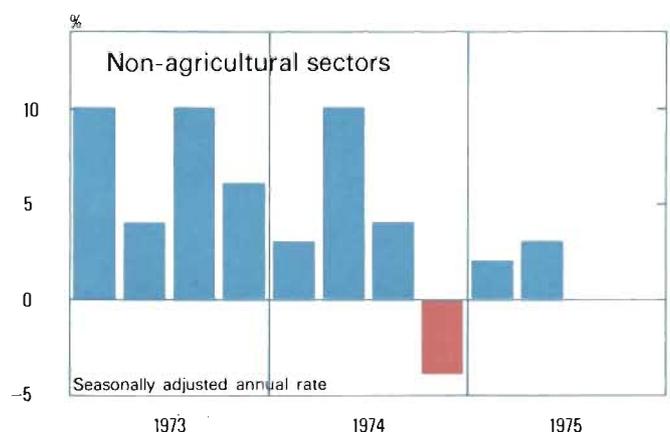
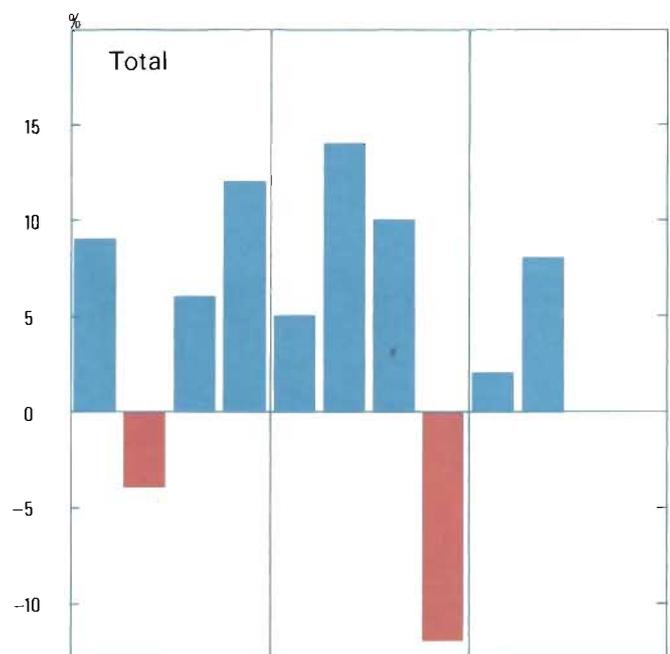
Rate of increase in real gross domestic product

	Year ended 30 June		
	1973	1974	1975
Agriculture.....	2	-5	2
Gold mining.....	-7	-8	-11
Non-gold mining.....	6	15½	7½
Manufacturing.....	4½	10	2
Construction.....	3	1	1
Commerce.....	2	9½	4
Transport, storage and communication.....	6	4½	8½
Other services.....	5	6	4
Gross domestic product.....	3½	5½	3

In contrast to the preceding year, during which export prices increased substantially faster than import prices, prices of imports and exports rose at approximately the same rate during 1974/75. The rate of increase in the real gross *national* product consequently declined more than that of the gross *domestic* product, namely from about 9 per cent in 1973/74 to only about 2 per cent in 1974/75.

Quarterly estimates of the real gross domestic product indicate that after a substantial decline in the fourth quarter of 1974, the real gross domestic product increased moderately during the first quarter but increased sharply during the second quarter of 1975

Percentage change in gross domestic product at constant 1970 prices



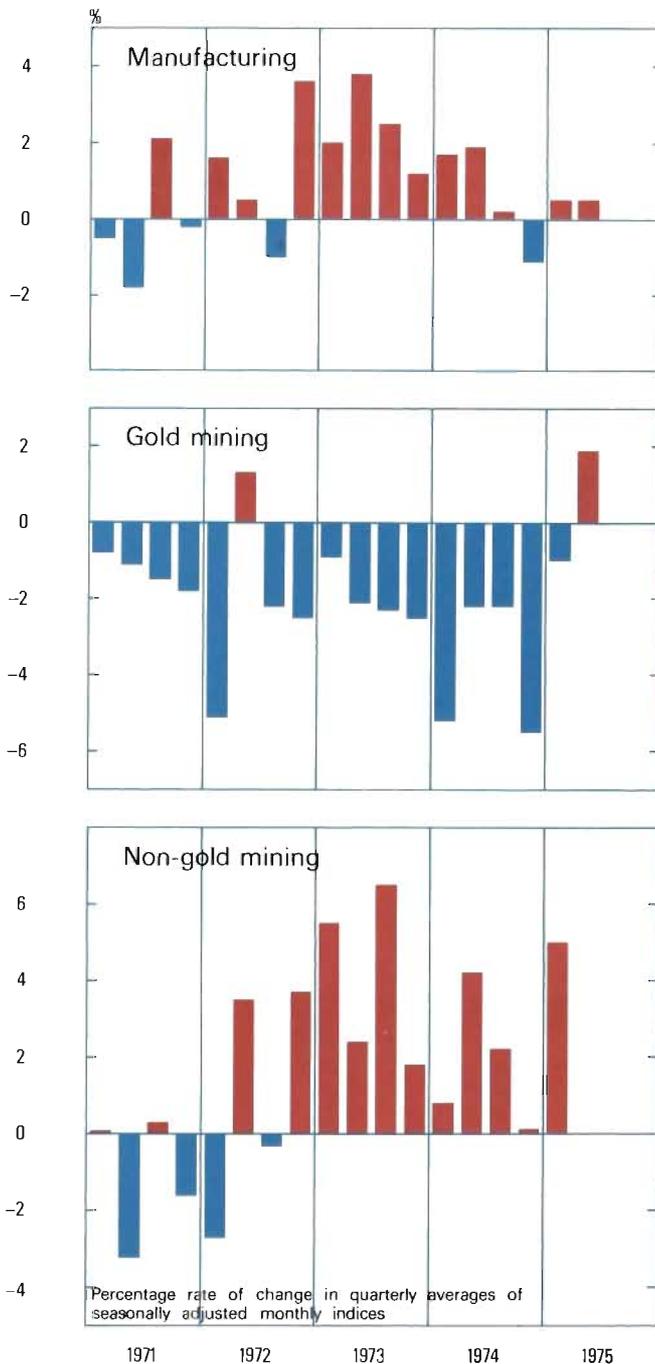
mainly on account of agriculture's contribution. The real growth in the non-agricultural sectors increased moderately only during the first half of 1975. The accompanying graph shows the general slowdown, and, in some quarters, declines in economic activity in the major sectors of the economy. The manufacturing sector is currently experiencing insufficient demand and a relatively high level of unused production capacity. As a result of a scarcity and the high cost

of finance, as well as the high rate of increase in building costs, building and construction activity also tended to slow down during the three quarters that ended on 30 June 1975. In contrast to the above-mentioned two sectors, gold mining production declined fairly sharply up to the first quarter of 1975, but then increased in the second quarter. This increase was mainly attributable to an increase in the volume of ore milled owing to an improvement in the labour situation on the gold mines. Although the rate of increase of non-gold mining production slowed down somewhat during the third and fourth quarters of 1974, as a result of the decline in the domestic growth rate and the recessionary tendencies in the economies of most of South Africa's main trading partners, it increased fairly sharply again in the first quarter of 1975.

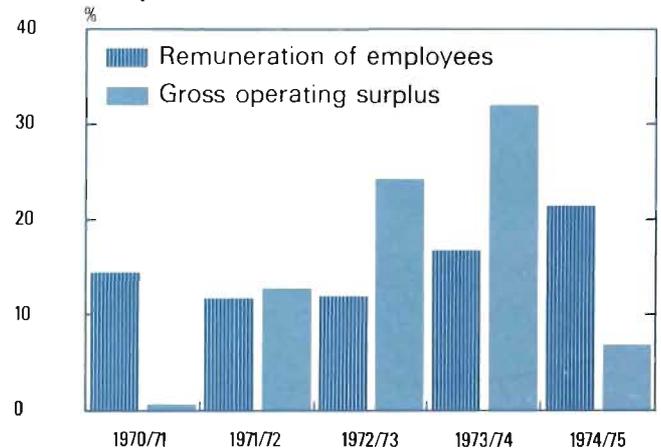
At current prices, the rate of increase in the gross domestic product declined from 23 per cent in 1973/74 to 14 per cent in 1974/75. The difference in the growth rates at current and constant prices during the past two years indicates a slowdown in the rate of increase in the gross domestic product deflator from about 16½ per cent in 1973/74 to only 11 per cent in 1974/75.

During the year under review a significant change occurred in the growth rates of the operating surplus and the remuneration of employees. The operating surplus (mainly profits), which increased by 32 per cent in 1973/74, rose by only 7 per cent in 1974/75, whereas the rate of increase in remuneration of employees accelerated from 17 per cent in 1973/74 to 21½ per cent in 1974/75. The lower rate of increase in the operating surplus was mainly accounted for by the sectors non-gold mining, and wholesale and retail trade, although almost all other sectors recorded smaller increases than during the previous year. During 1974/75 the remuneration of employees of the sectors manufacturing, general government, mining and transport, storage and communication, increased markedly.

Physical volume of production



Annual percentage change in gross domestic product



Marked decline in growth rate of real gross domestic expenditure

The rate of increase in real gross domestic expenditure declined substantially from 11½ per cent in 1973/74 to only 6 per cent in 1974/75, but was nevertheless still substantially higher than the growth rate in the real gross domestic product. As shown in the accompanying table, the lower rate of increase was attributable to a slowdown in the rates of increase in private consumption and gross domestic fixed investment. Real government consumption expenditure, in contrast, increased at a faster rate than during the preceding year.

Percentage change in gross domestic expenditure at constant 1970 prices

	Year ended 30 June		
	1973	1974	1975
Private consumption expenditure	4	5½	3½
Government consumption expenditure	½	9	12
Gross domestic fixed investment	1½	6	1
Change in inventories (Rm)	-316	302	310
Total	1	11	6

At current prices, gross domestic expenditure exceeded gross national product by R1 597 million or 7 per cent and this was naturally reflected in a large deficit on the current account of the balance of payments.

Lower rate of increase in real private consumption expenditure

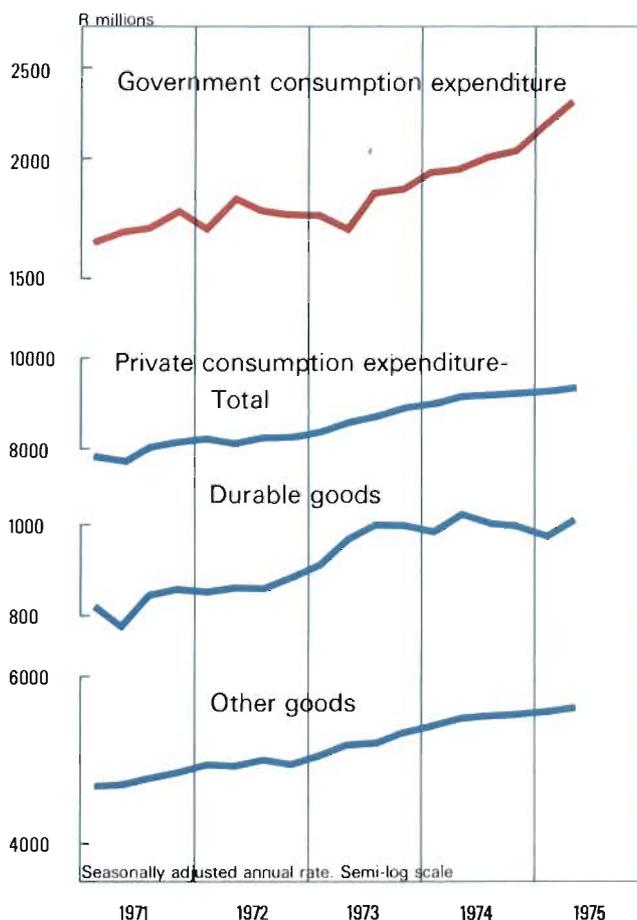
The lower rate of increase in domestic economic activity during the year under review was also reflected in a lower rate of increase in real private consumption expenditure of only 3½ per cent, compared with a rise of 5½ per cent during the preceding year. The lower rate of increase in real private consumption expenditure was also reflected in retail sales at constant prices (which represent a major part of private consumption expenditure), which increased by 2½ per cent during the year under review compared with 9 per cent during the preceding year. As the accompanying table indicates, this slowdown in the rate of increase was almost entirely attributable to a decline in real outlays on durable goods and a lower rate of increase in real expenditure on semi-durable goods. Real expenditure on non-durable goods and on services showed a normal rate of increase.

Real consumer outlays on furniture and household appliances during 1974/75 were affected adversely by the lower level of residential construction. The sluggishness of consumer purchases of new motor cars can partly be ascribed to such factors as uncer-

tainties regarding oil supplies, higher prices of motor cars and a general increase in motoring costs. However, sales of new motor cars increased sharply during the second quarter of 1975 from a relatively low level in the preceding quarter. During the year as a whole, sales of new motor cars decreased by 2 per cent. Real outlays on goods of a recreational and entertainment nature also showed an increase during the second quarter, mainly owing to sales of television sets after the introduction of television test programmes from May 1975. The overall result was that real expenditure on durable goods, after having declined for three consecutive quarters, increased again during the second quarter of 1975. Mainly as a result of this increase, the rate of increase in total real private consumption expenditure accelerated during the second quarter of 1975, notwithstanding lower rates of increase in outlays on semi-durable goods and services.

At current prices, private consumption expenditure increased by the same percentage during 1974/75 as during the preceding year, namely by about 18 per cent. Since disposable personal income increased by

Consumption expenditure at constant 1970 prices



Percentage change in private consumption expenditure at constant 1970 prices

	Year ended 30 June		
	1973	1974	1975
Durable goods.....	7	10	-1
Furniture, etc.....	3	12	-1
Transport equipment.....	13	9	-2
Semi-durable goods.....	3	7	3
Clothing and footwear.....	3½	7	4
Non-durable goods.....	4	4½	4
Services.....	3	4	4
Total.....	4	5½	3½

about 16 per cent, the ratio of personal saving to disposable personal income declined to 9 per cent, which was well below the average savings ratio of 11 per cent recorded for the preceding ten years. During 1974, however, consumers did not make use of consumer credit to the same extent as during 1973. It is estimated that consumer credit outstanding increased by about R200 million between December 1973 and December 1974 (the latest estimate available), compared with an increase of approximately R450 million from December 1972 to December 1973. The accompanying table reflects the slowdown in the rate of increase, compared with the preceding quarter, in consumer credit outstanding at the end of each quarter since the second quarter of 1973.

Percentage change in consumer credit outstanding

Quarter ended	Seasonally adjusted annual rate of change
1973: March.....	29
June.....	39
September.....	23
December.....	21
1974: March.....	16
June.....	16
September.....	3
December.....	4

Sharp increase in real government consumption expenditure

In contrast to the deceleration in the rate of increase in real private consumption expenditure, real government consumption expenditure continued to increase at a very high rate. After rising by slightly more than 9 per cent in 1973/74, real consumption expenditure

by the general departments of public authorities rose by a further 12 per cent during the year that ended on 30 June 1975. This increase was largely accounted for by higher real outlays on goods and services other than the remuneration of employees. Whereas remuneration of employees at constant prices rose by only 6 per cent during the year under review, expenditure on goods and other services increased by no less than 20 per cent in real terms. Higher defence expenditure was largely responsible for this increase. Quarterly estimates of real government consumption expenditure showed an upward trend during all four quarters under review.

Small increase in real gross domestic fixed investment

Gross domestic fixed investment at constant prices increased only slightly during the year that ended on 30 June 1975. As the accompanying table indicates, this development was largely attributable to a decline in fixed capital outlays by the private sector.

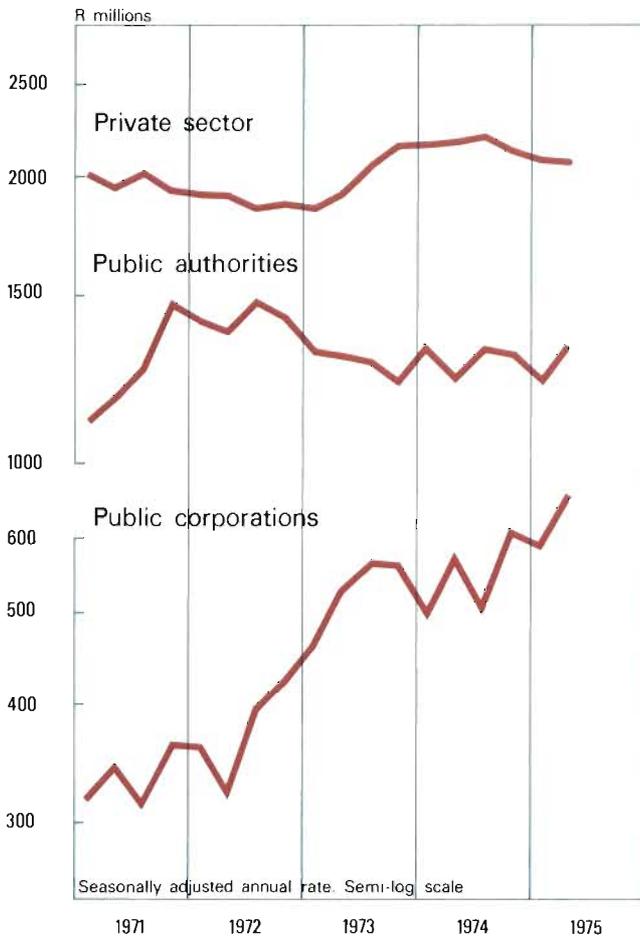
Real fixed investment of the private sector remained at a relatively high level during the second half of 1974, but showed a downward tendency during the first half of 1975. Consequently, real capital outlays by the private sector during 1974/75 were 1½ per cent lower than during the preceding year. Except for gold mining and manufacturing, declines in real fixed outlays were registered by the rest of the private sector.

A further sharp increase in real fixed investment by the gold mining industry resulted from a continuation of expansion programmes to exploit the benefits derived from the higher gold price. However, quarterly estimates indicate that real outlays by gold mines also tended to level off during the first half of 1975.

Percentage change in gross domestic fixed investment at constant 1970 prices

	Year ended 30 June		
	1973	1974	1975
Private sector.....	-3	14	-1½
Gold mining.....	-15	46	37
Non-gold mining.....	25	62	-3
Manufacturing.....	-13	14	4½
Private residential construction.....	4½	14	-12
Public corporations.....	37	17	9
Manufacturing.....	116	18	-22
Electricity.....	-7	-13	17
Public authorities.....	-1	-8	2
South African Railways.....	14½	-16	3
Other business organisations..	-4	-5	-3
General departments.....	-7½	-5	5
Total.....	1½	6	1

Fixed investment at constant 1970 prices



The decline in real fixed capital expenditure by non-gold mines resulted mainly from curtailing expansion programmes owing to lower metal and mineral prices on international commodity markets and the lower demand caused by the recessionary tendencies experienced by most of South Africa's main trading partners. The main reasons for the lower rate of increase in real fixed investment by private manufacturing were the lower level of domestic demand, coupled with the high level of unused production capacity experienced during the first half of 1975. The sharp decline in real fixed outlays on private residential buildings, which made the largest contribution to the decline in total private sector real capital expenditure, was primarily caused by the high rate of increase in building costs and a general scarcity of funds for residential construction.

Quarterly real fixed capital outlays by public corporations fluctuated during the period under review but nevertheless increased by 9 per cent during 1974/75, compared with a rise of 17 per cent during the preceding year. Real outlays by public corporations

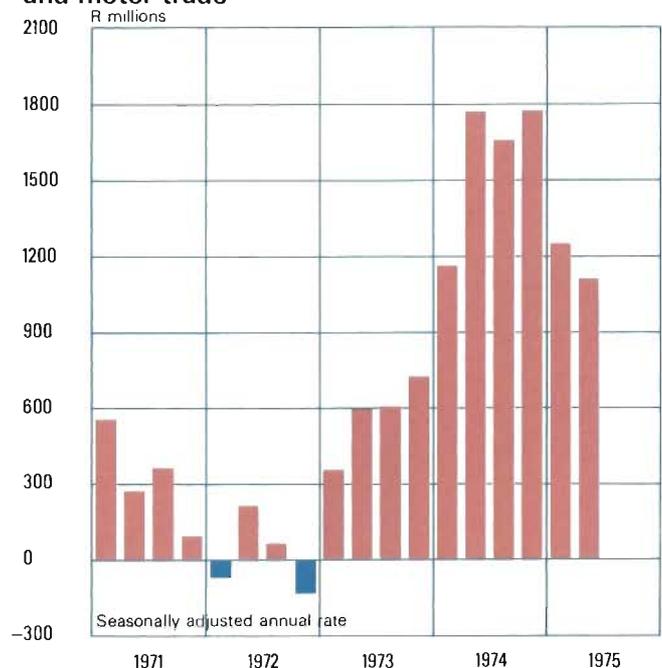
classified as manufacturing concerns declined substantially during 1974/75, whereas Iscor's outlays on the Sishen-Saldanha project and Escom's capital expenditure on electricity supply works rose substantially.

After declining during both the preceding two years, real fixed investment by public authorities showed a small increase during the year that ended on 30 June 1975. Increased real outlays by the general departments of public authorities and the South African Railways were partly neutralised by lower real outlays by other business organisations. Quarterly estimates indicate that public authorities' real fixed investment fluctuated around an approximately horizontal trend during the four quarters under review.

Further substantial addition to inventories

After increasing by approximately R1 320 million during the preceding year, the book value of total inventories (excluding livestock) rose by a further R1 670 million during the year that ended on 30 June 1975. This further substantial addition to inventories was mainly accounted for by industrial and commercial inventories which increased by approximately R1 450 million during the period under review. If increased costs to replace the same volume of stocks are taken into account (i.e. valued at constant 1970 prices), real inventories increased by approximately

Change in book value of inventories of total manufacturing and wholesale, retail and motor trade



R310 million during 1974/75. It would appear, however, that the major part of the stockpiling occurred during the second half of 1974. The lower rate of domestic production, coupled with a decline in real imports since the third quarter of 1974, resulted in a discontinuation of the build-up of inventories in real terms during the first half of 1975.

Decline in gross domestic saving

Gross domestic saving declined by 4 per cent during the year that ended on 30 June 1975 after increasing by 29 per cent during 1973/74. This decline was largely due to a substantial decrease in corporate saving, because gross profits remained at approximately the same level and provision for depreciation as well as dividend and income tax payments increased substantially. Personal saving showed little change but the current surplus of general government recorded a decrease, whereas provision for depreciation showed its normal rise. Because gross domestic saving was insufficient to finance total fixed and inventory investment, foreign funds were extensively employed to supplement domestic saving. The inadequacy of domestic saving during the year under review was also reflected in the ratio of domestic saving to gross domestic investment which declined to 78,5 per cent in 1974/75, compared with an average annual ratio of 96,5 per cent during the preceding three years.

For national accounting purposes, provision for depreciation is calculated on the basis of the original cost of the capital assets. If provision for depreciation were to be made on the basis of the replacement in stead of original cost of the assets, the size of gross domestic saving would not be changed, but its composition would change materially. On the basis of replacement cost, provision for depreciation would naturally be substantially higher, whereas the *net* saving of corporate and non-corporate enterprises would show a corresponding decline.

Business cycle analysis, labour situation and prices

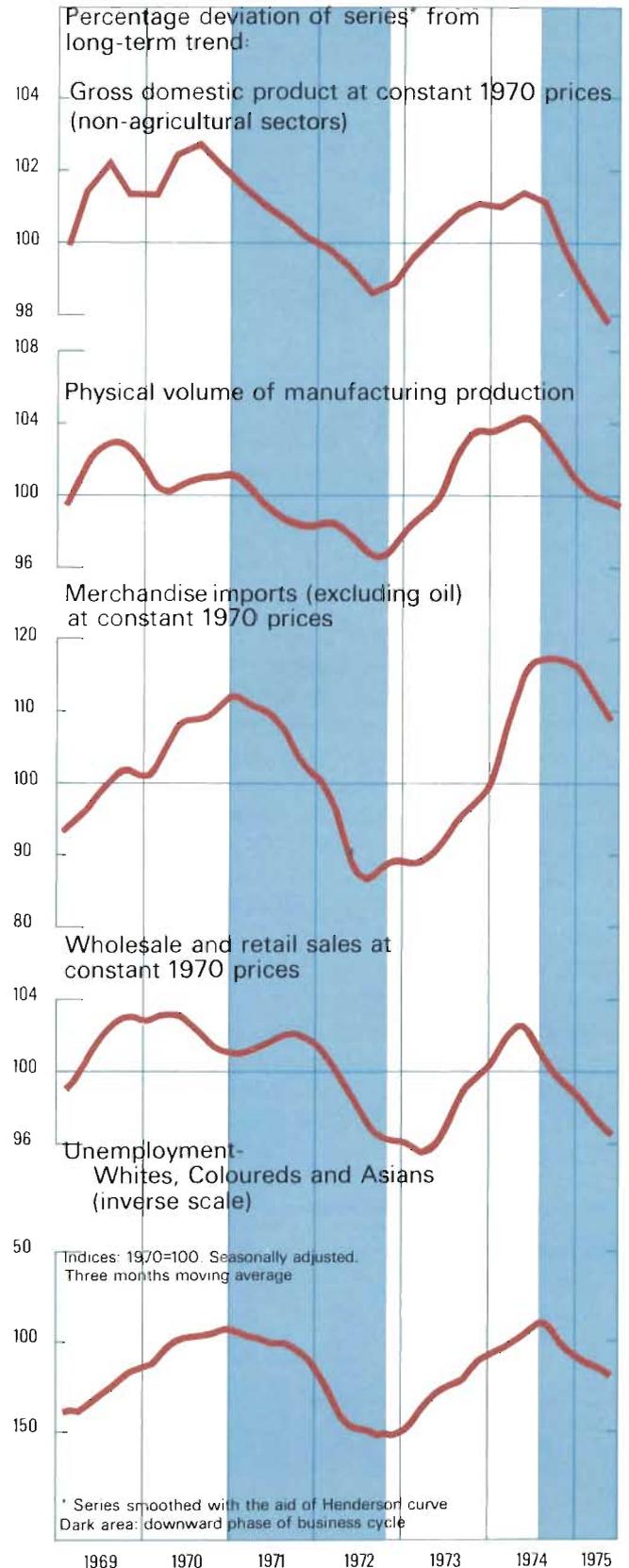
The South African economy in the downward phase of the business cycle

From national accounts data it is evident that the South African economy has been growing at a relatively low rate from the fourth quarter of 1974. This diagnosis is confirmed by an analysis of most of the important monthly economic indicators from a business cycle point of view. These monthly series indicate that an upper turning point in the business cycle was reached at the beginning of the third quarter of 1974 and that the downward phase of the business cycle has continued up to the end of the period under review. In the accompanying graph, the cyclical movements of a number of series are shown after the elimination of seasonal and irregular fluctuations as well as the long-term trend. In interpreting the movements in these series it should be noted that the declining phase of the business cycle does not necessarily represent a decline in activity but a reduction in the growth rate to a level below that of the long-term trend. The graph clearly shows that the South African economy has now been in the downward phase of the business cycle for about twelve months and that the lower turning point has not yet been reached.

From an analysis of the national accounts data and a large number of time series which reflect changes in real economic activity, such as employment, the number of registered unemployed Whites, Coloureds and Asians, the number of ordinary and overtime hours worked by production workers in manufacturing and construction, the volume of production and the rate of capacity utilisation in manufacturing, the retail and wholesale sales at constant prices, the number of new companies registered, the number of mortgages registered and the number of companies liquidated, it would appear that the slowdown in activity is widely spread throughout the economy.

However, in contrast with the situation in a large number of Western countries, which experienced the most severe and prolonged downturn in economic activity since the early thirties, the current recessionary phase in South Africa may be regarded as relatively mild and not unusual after a period of rapid economic growth. Whereas some overseas countries experienced actual declines in their real gross domestic product and registered high percentage rates of unemployment, South Africa's real gross domestic product continued to increase, albeit at a substantially lower rate than in the preceding year, and unemployment remained at a very low level. Positive indications of an upturn in economic activity in the United States of America became evident towards the end of the second quarter of 1975 and an improvement is expected during the second half of the year in the economic conditions experienced at present by South Africa's

Business cycle indicators



other major trading partners. With stocks of raw materials in those countries at present at very low levels, any significant revival abroad should affect the South African economy without undue delay.

Apart from the influence of a revival of economic activity in foreign countries on the South African economy, a number of internal forces also exist which should not only contribute to the maintenance of a positive growth rate during the remainder of 1975 but also to the next upturn of the business cycle. At present the most important of these factors are the large number of capital projects of public authorities and public corporations, the creation of a new type of consumer demand through the introduction of television, the availability of production capacity in manufacturing, and easier labour conditions.

Easier labour conditions

In conformity with lower rates of increase in economic activity employment in the non-agricultural sectors rose fairly sharply up to the third quarter of 1974, but tended to level off during the next two quarters (figures for the second quarter of 1975 are not yet available). Whereas employment in the private sector levelled off, and even declined in certain sectors, employment in the public sector increased throughout the period under review. For the first three quarters of 1974/75, total employment in the non-agricultural sectors nevertheless still increased by 2.2 per cent, compared with an increase of 3.6 per cent in 1973/74. In this easier labour situation, the seasonally adjusted number of registered unemployed Whites, Coloureds and Asians rose from a low point of 7 150 in August 1974 to 10 431 in June 1975. Notwithstanding this increase the registered unemployed still represented only about 0,5 per cent of the relevant labour force.

The easing in labour conditions was particularly evident in manufacturing, where the number of hours worked by production workers increased up

to the third quarter of 1974 and then declined in both the fourth quarter of 1974 and the first quarter of 1975. The number of hours worked in the construction sector also declined substantially during the fourth quarter of 1974. The ratio of overtime to ordinary hours worked in manufacturing increased up to the second quarter, and that of construction up to the third quarter of 1974, but then declined.

As could be expected, the decline in the volume of production, coupled with an increase in unused production capacity, adversely affected output per worker and output per man-hour. During the three quarters that ended on 31 March 1975, output per man-hour in manufacturing increased by 1,2 per cent, compared with an increase of 2,7 per cent in 1973/74. For the non-agricultural sectors of the economy as a whole, real output per worker rose by only 1,0 per cent for the three quarters that ended on 31 March 1975, compared with the corresponding period of the previous year, as against a rise of no less than 3,0 per cent for the year that ended on 30 June 1974.

Notwithstanding the lower rate of growth and the easing of labour conditions experienced during the past year, average salaries and wages continued to increase at high rates in most sectors of the economy. From the accompanying graph it can be seen that during the past four years the percentage increase in average salaries and wages for Non-Whites was substantially higher than that of Whites. Of particular interest is the substantial increases in wages of Non-Whites on gold mines during the past three years, which was made possible by the sharp increase in the price of gold on the private market. Current minimum wages for Non-Whites on gold mines are no less than four times the minimum wages in force prior to May 1973.

As a result of the sharp decline in the purchasing power of the rand during the last number of years, real salaries and wages increased by moderate percentages only as can be seen from the graph. During the nine months that ended on 31 March

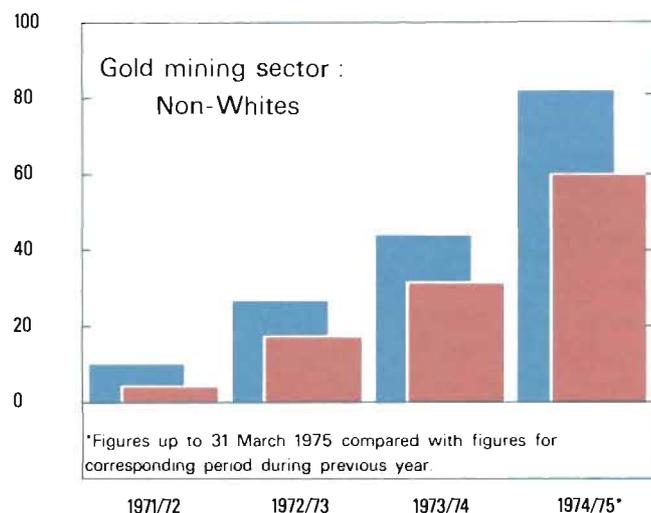
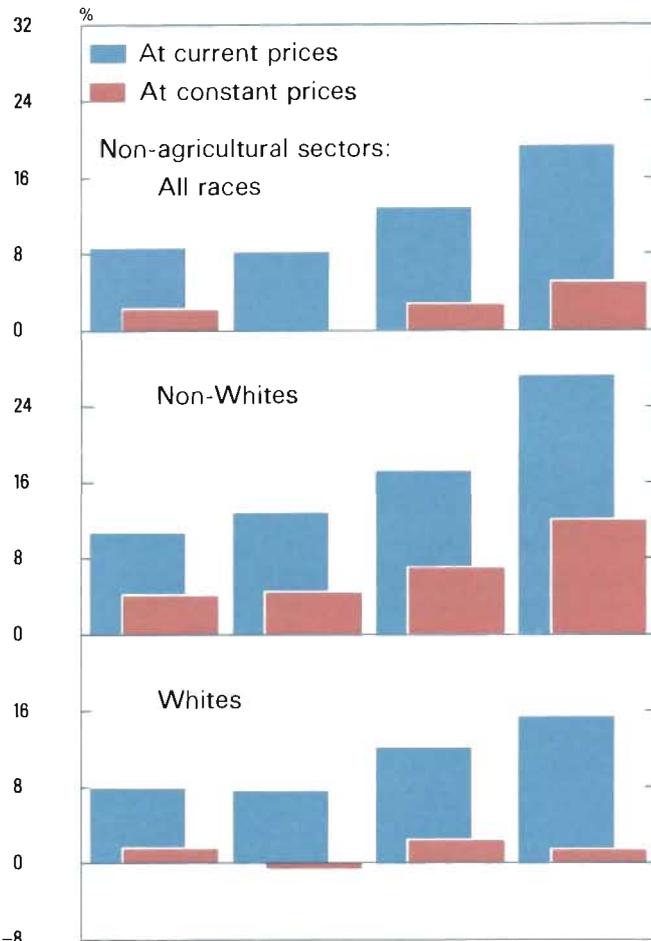
Percentage rate of change in hours worked and overtime as percentage of ordinary hours worked

Quarter	Manufacturing		Construction	
	Hours worked by production workers	Overtime as % of ordinary hours	Hours worked by production workers	Overtime as % of ordinary hours
1973: 3rd qtr.....	2.0	0.9	2.5	10.3
4th qtr.....	1.4	0.8	4.1	3.7
1974: 1st qtr.....	1.9	0.8	3.2	1.8
2nd qtr.....	1.1	1.7	1.7	0.9
3rd qtr.....	0.4	-0.8	2.5	2.6
4th qtr.....	-2.5	-1.7	-4.4	-0.9
1975: 1st qtr.....	-1.4	-3.4	0.1	-10.3

1975, the salaries and wages in real terms of Whites were on average 1,3 per cent higher than during the comparable period a year ago. In the case of Non-Whites the increase was 11,9 per cent. Comparable

figures for 1973/74 were 2,3 per cent for Whites and 6,9 per cent for Non-Whites, respectively. Notwithstanding the high rates of increase in prices, workers on average still shared in the prosperity of the country over the past four years in the form of a moderately higher real standard of living.

Percentage rate of change in salaries and wages per worker

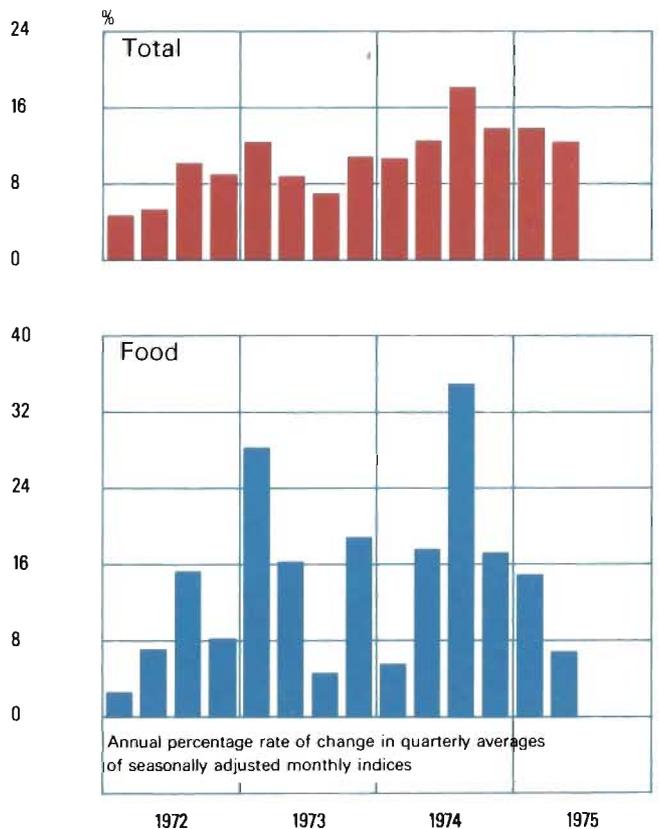


Decline in rate of increase in prices

An unacceptably high rate of inflation has been one of the main economic problems confronting the authorities in almost all Western countries during recent years. As a result of the international slowdown in economic activity during the past approximately eighteen months, the rate of increase in consumer as well as wholesale prices declined in almost all countries over the past six to nine months. Although the rates of increase in different prices are still unacceptably high in South Africa, a significant slowdown in the rate of increase in prices occurred over the past nine months.

Consumer prices were on average 13,9 per cent higher in 1974/75 than in 1973/74, against an increase of 9,7 per cent in 1973/74 compared with 1972/73. Increases in the prices of food (19,1 per cent), clo-

Consumer prices



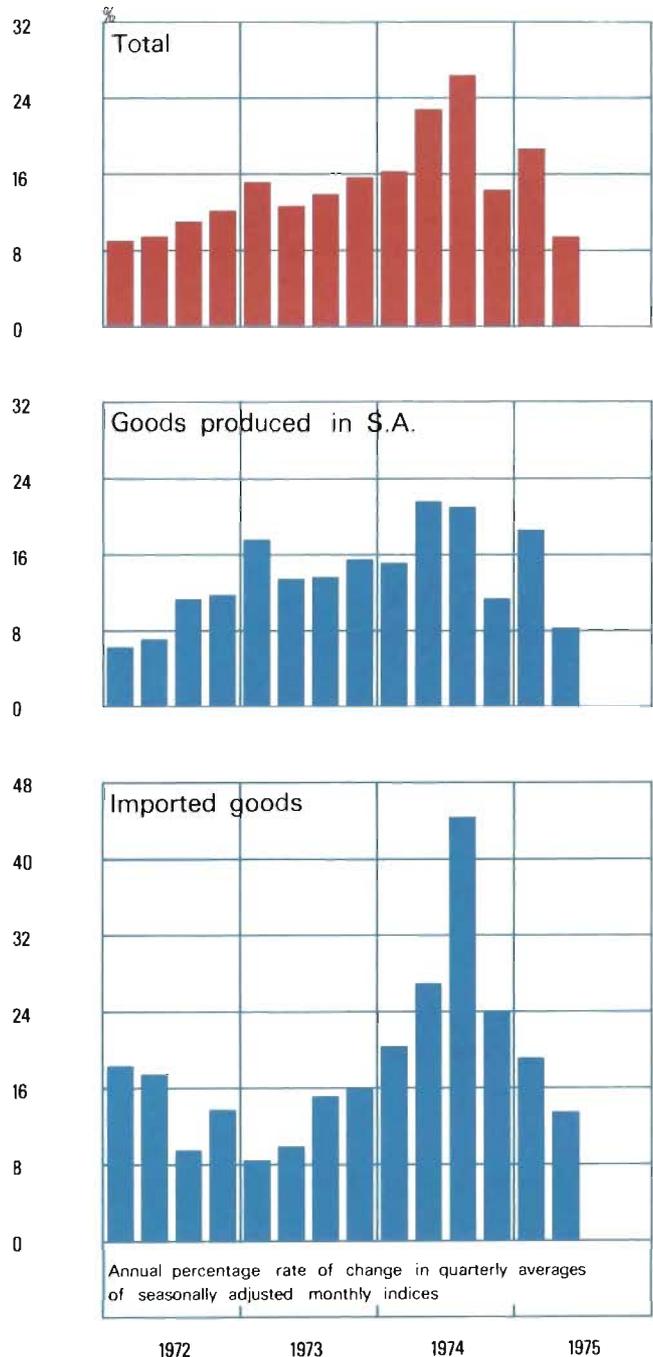
thing and footwear (14,0 per cent) and a further substantial increase in the prices of imported goods, including oil, contributed to the sharp increase in prices during the year under review.

After increasing at an annual rate of no less than 18,2 per cent in the third quarter of 1974, the rate of increase in the seasonally adjusted consumer price index declined to 13,8 per cent in both the fourth quarter of 1974 and the first quarter of 1975 and further to 12,4 per cent during the second quarter of 1975. The further slowdown in the rate of increase during the second quarter is even more significant in view of the rises in government-administered prices and higher customs and excise duties on certain goods and services which became effective in this quarter. The lower rates of increase in the prices of clothing and footwear, furniture and certain food items, such as meat, sugar and allied products, contributed to the lower overall rate of increase in prices during the three quarters that ended on 30 June 1975. In contrast, prices of motor cars, which rose at moderate rates up to June 1974, increased sharply in each of the following four quarters. Prices of medical services, recreation, amusement and sport, personal services and laundry and dry-cleaning services also rose sharply during the first half of 1975.

The monthly average wholesale price index of goods for domestic use increased by 19,3 per cent in 1974/75, as against an increase of 14,9 per cent in 1973/74. The higher rate of increase was mainly due to sharp increases in prices of imported goods (27 per cent), locally manufactured basic metals and metal products (25 per cent), and machinery and transport equipment (16 per cent). From June 1974 to June 1975, the seasonally adjusted wholesale price index increased by 15,4 per cent.

As can be seen from the accompanying graph, the decline in the rate of increase in wholesale prices was even more marked than that of consumer prices. The most significant decline occurred in respect of the prices of imported goods, which decelerated from a seasonally adjusted annual rate of 44,2 per cent in the third quarter of 1974 to 13,4 per cent in the second quarter of 1975. The rate of increase in the prices of goods produced in South Africa also declined significantly over the year to an annual rate of only 8,2 per cent during the second quarter. Lower price increases in the case of South African produced agricultural products and manufactured textiles, clothing and food contributed to the slowdown in the rate of increase in prices of goods produced in South Africa, whereas lower price increases of agricultural products and manufactured food, leather, rubber and plastic products, basic metals and electrical machinery were mainly responsible for the slower increases in prices of imported goods.

Wholesale prices



Balance of payments

The balance of payments for the year that ended on 30 June 1975 was characterised by a large deficit on current account and an almost equally large net inflow of foreign capital, with the result that the total gold and other foreign reserves declined only slightly during the relevant period. The substantial increase in the deficit on current account occurred notwithstanding a lower rate of increase in the volume of imports caused by the slowdown in the rate of increase of domestic economic activity and demand, and a rise in the value of exports. External factors, which contributed to the deterioration on the current account, included the high level and rate of increase in the prices of oil and other imported goods, a lower rate of increase in the gold price, a decline in export commodity prices, and a sharp increase in international freight rates and other transport costs. In addition, certain domestic factors such as a further decline in the volume of gold production and a sharp increase in dividend payments and interest payments on foreign loans also contributed to the deterioration on the current account.

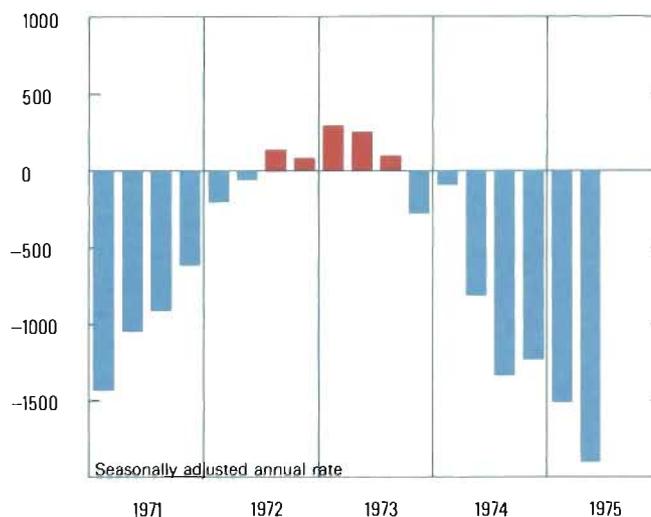
In order to strengthen the capital account, the authorities pursued a policy of encouraging foreign investment in South Africa in the form of permanent investment, loan capital and short-term trade credits. A substantial net inflow of foreign capital was recorded during 1974/75, although at times during the course of the year the interest rate differentials and speculation regarding changes in the exchange rate of the rand caused the "leads and lags" to turn against South Africa. Domestic interest rate and exchange rate policies were accordingly changed to avoid a continuation of this situation which adversely affected the capital account, particularly short-term capital flows to the private sector.

Large deficit on current account

Notwithstanding a slowdown in the rate of increase in domestic economic activity, the deficit on current account increased from R212 million in 1973/74 to as much as R1 507 million in 1974/75. This substantially larger deficit on current account during the past year was the net result of sharp rises in the value of merchandise imports and net invisible payments to the rest of the world, on the one hand, and a lower rate of increase in the value of the net gold output, on the other hand. These negative factors were, however, partly counteracted by a marked increase in the value of merchandise exports.

An increase in the deficit on current account early in the downward phase of the business cycle, as experienced by the South African economy during the past year, is not unusual, but on this occasion

Balance of payments current account



it was aggravated by unstable world economic conditions. During the past three years, the rates of increase in domestic and export prices of almost all South Africa's main trading partners were exceptionally high. The upsurge in international commodity prices and in the price of gold delayed the appearance of a deficit on the current account of the South African balance of payments during the upward phase of the business cycle to as late as the fourth quarter of 1973. Subsequently the increase in commodity prices levelled off, but increased oil prices and excessive wage demands generated further substantial price rises in most industrialised countries. For South Africa these developments brought about a sharp increase in the cost of imported goods and services during 1974/75, whereas the rate of increase in prices of South African merchandise exports and gold declined. Although a deficit on the current account of the balance of payments was expected in the current phase of the business cycle, the developments mentioned above contributed substantially to its relatively large size, particularly during the first two quarters of 1975. As a percentage of gross domestic product, however, the quarterly deficits on the current account during the past year ranged from 5 to 8 per cent, which is still well below the deficits recorded for the four quarters of the year 1970/71 when the range was from 7 to 11 per cent.

The deficit on the current account, at a seasonally adjusted annual rate, amounted to about R1 300 million during the second half of 1974, but then increased to R1 710 million in the first half of 1975.

The further deterioration on the current account during the first half of 1975 was mainly due to a decline in the net gold output and a substantial increase in service payments to foreigners.

Substantial further increase in merchandise imports

After increasing by slightly more than 42 per cent in 1973/74, the value of merchandise imports rose further by no less than 44 per cent to a level of R6 386 million in 1974/75. It is significant, however, that whereas volume increases made the largest contribution to the increase in the value of merchandise imports during 1973/74, price rises were largely responsible for the increase during 1974/75. All the main categories of imports showed increases, but particularly large rises were recorded in the imports of mineral products, machinery and electrical equipment, chemical products, base metals and transport equipment, whereas the imports of textiles declined sharply.

Although the value of merchandise imports continued to increase up to the first quarter of 1975, the volume of imports declined uninterruptedly from the third quarter of 1974 to the second quarter of 1975.

The decline in the volume of imports was the direct result of the slowdown in the rate of increase in domestic demand during the past year. From the accompanying graph it is clear that in South Africa's case fluctuations in the volume of imports around its trend line closely coincide with the business cycle. In the past, changes in the *value* of imports were usually also closely related to the movements of the business cycle, but during the most recent downturn of the business cycle at the beginning of the third quarter of 1974, imports continued to increase, albeit at a much lower rate than before. The reason for the alteration in the relationship between changes in the value of imports and domestic economic conditions is the exceptionally high rates of inflation experienced abroad. This development is clearly illustrated in the graph by the widening of the gap between the value and volume of imports.

Moderate further rise in net gold output

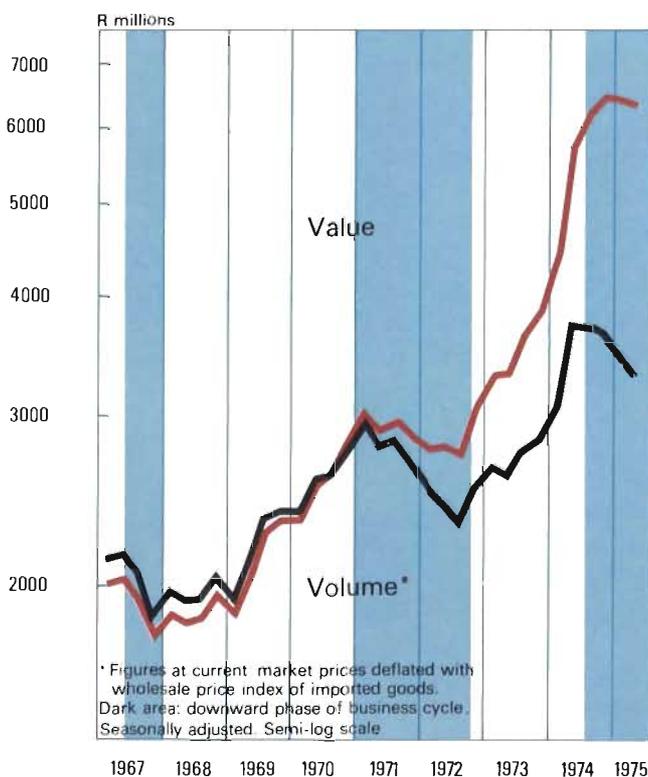
After increasing by 41 per cent in 1972/73 and 55 per cent in 1973/74, net gold output rose by only 16 per cent in 1974/75, as the result of a lower rate of increase in the price of gold and a larger decline in the volume of gold production than during the preceding two years. In 1974/75 the average price of gold on the London market increased by 28 per cent, compared with increases of 70 per cent, 65 per cent and 24 per cent in 1973/74, 1972/73 and 1971/72, respectively. During the year under review the price of gold showed marked fluctuations. From about the middle of 1974, it increased markedly to an average of \$183,34 per fine ounce in December and then declined to an average level of approximately \$164 per fine ounce during June 1975.

The sharp increase of 343 per cent in the gold price over the past four years enabled the mines to process lower grade ore, with the result that the volume of gold production declined by 28 per cent during this period. In contrast to the two preceding years, the tonnage of gold ore milled declined during 1974/75 and also contributed to the decrease in production. The decline in ore milled may partly be ascribed to labour shortages experienced by gold mines during the major part of the year under review. The kilograms of gold produced during 1974/75 declined by 10,8 per cent, compared with a decline of 7,6 per cent during the preceding year.

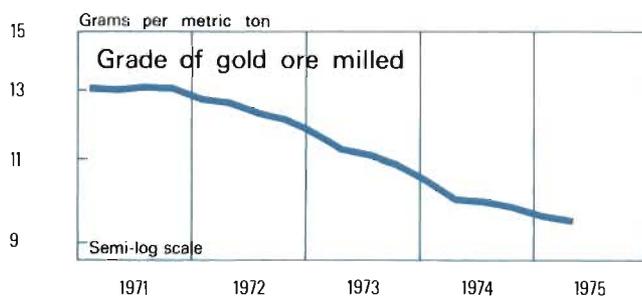
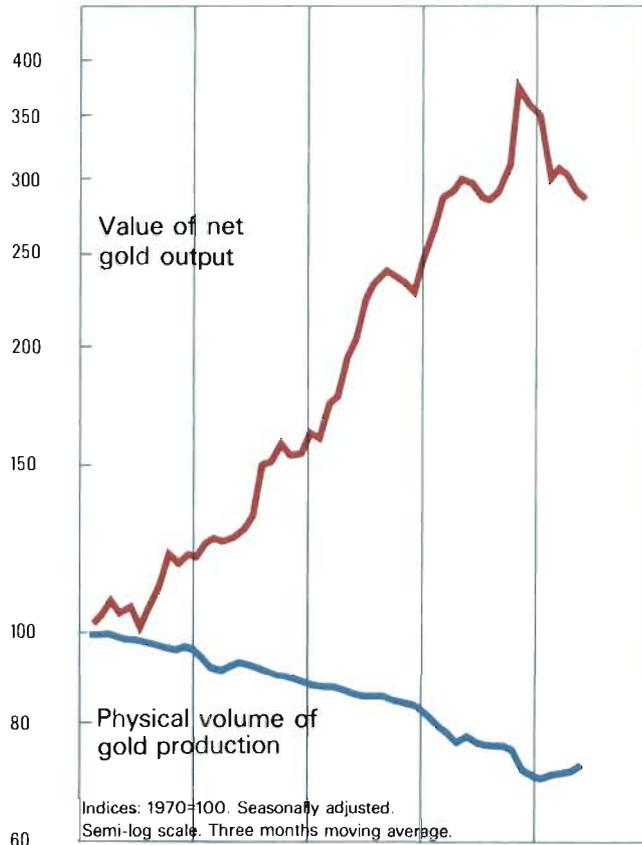
Sharp rise in net invisible payments

For the third consecutive year, net invisible payments to the rest of the world increased sharply. During 1974/75 marked rises occurred in the payments for international freight and transport, interest payments on foreign loans and dividend payments to foreigners. The increase in freight and transport payments was

Merchandise imports



Net gold output



closely related to higher oil prices which caused a rise in freight rates and in the cost of transport in general, whereas the higher interest payments on foreign loans, in turn, were due to a sharp rise in the outstanding balance on foreign loans.

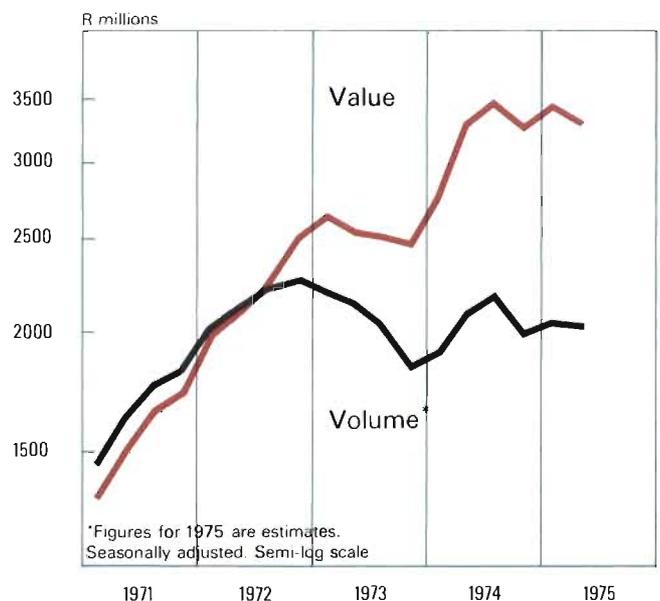
Levelling-off in merchandise exports

During 1974/75 the value of merchandise exports rose further by 20 per cent to a level of R3 375 million, compared with an increase of 13 per cent in 1973/74. This brought the percentage increase in merchandise exports over the past four years to an aggregate of

no less than 135 per cent. As in the case of imports and the net gold output, the sharply rising trend in the value of exports during the preceding three years was mainly attributable to marked rises in the prices of goods exported. The volume of exports fluctuated widely during the year under review, but was, nevertheless, on average 3.0 per cent higher than in the preceding year. From the accompanying graph it is apparent that the sharply rising trend in merchandise exports up to the middle of 1974 subsequently levelled off.

Although world commodity prices in general reached a peak in April 1974, the price pattern of South Africa's main export products showed substantial differences. The price of wool, for example, began to decline sharply from as early as March 1973, whereas the price of maize reached an upper turning point towards the end of 1974 and that of sugar at the beginning of 1975. In accordance with these movements, large increases were recorded in the proceeds from the exports of maize and sugar during 1974/75, whereas the value of wool exports declined sharply. Largely as a result of the recessionary tendencies experienced by the United States of America and other Western countries, a decrease also occurred in the exports of diamonds, and the value of exports of mineral products and base metals reached a peak towards the end of 1974. From a classification of exports according to stage of fabrication, it is noteworthy that the exports of manufactured goods had shown a continuous upward trend from 1971 until the first quarter of 1975.

Merchandise exports (excluding gold)



Large favourable balance on capital account

The capital account changed significantly from an adverse balance of R150 million in 1973/74 to a surplus of R1 499 million in 1974/75. Of this total, the private sector, including public corporations, received R1 189 million in the period under review and the remaining R310 million accrued to the central government and banking sector.

Particularly during the earlier part of 1974, the authorities pursued a conservative monetary policy in terms of which domestic interest rates were adjusted upwards to narrow the differential between rates in South Africa and abroad, and domestic bank credit was kept relatively tight. The purpose of these measures was to contain demand inflation and at the same time to induce importers to switch back from domestic to foreign financing of imports. In addition, towards the middle of 1974 the Minister of Finance also announced that the exchange control authorities would consider favourably any applications by local entrepreneurs to borrow funds abroad for a period of not less than six months, provided that these funds were used for the financing of the expansion of production capacity, including the purchase of capital equipment abroad. The authorities also decided to include extended credit transactions for the importation of capital goods in the forward exchange scheme, under which organisations can cover the exchange risk at a nominal rate. Furthermore, the Minister of Finance announced in his Budget speech in August 1974 that exemption from the non-resident's tax on interest would be considered in the case of foreign loans for deserving projects.

These measures were aimed mainly at encouraging and facilitating foreign long-term borrowing and at attaining an inflow of foreign short-term capital. From the accompanying table it is apparent that these measures were successful. Not only did the amount of net long-term loans obtained abroad increase nearly threefold, but short-term capital movements of the private sector also changed from a large net outflow to a large net

inflow during the year under review. Both the private and public sectors obtained substantial amounts of long-term loans abroad. During the course of 1974/75, however, private short-term capital flows, including errors and unrecorded transactions, fluctuated considerably. In the third quarter of 1974 a moderate inflow of R33 million was recorded, followed by substantial net inflows of R342 million during the fourth quarter and R223 million in the first quarter of 1975. From the beginning of the second quarter of 1975 expectations regarding possible changes in the exchange rate caused a considerable decline in the private short-term capital inflow to only R28 million during the second quarter. In order to counteract the unfavourable leads and lags situation and to strengthen the balance of payments in general, the authorities announced on 11 August 1975 that a more conservative monetary policy would be pursued and that exchange control would be relaxed. These measures were aimed at encouraging capital inflows and reducing the ability of banks to extend local credit to replace foreign trade financing.

Slight decline in total gold and other foreign reserves

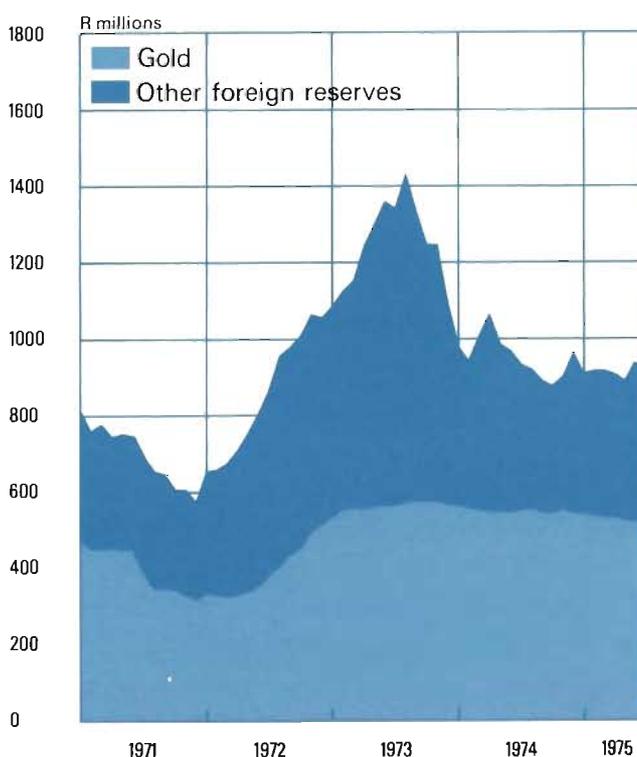
All the balance of payments transactions together resulted in a moderate decline in the gold and other foreign reserves. If currency valuation adjustments are

Net foreign capital movements

R millions

	Year ended 30 June	
	1973/74	1974/75
Long-term loans obtained abroad by:		
Central government and banking sector	-14	277
Public corporations	328	472
Other private organisations	39	257
Total	353	1 006
Private short-term capital, including errors and unrecorded transactions ..	-497	626
Other identified capital movements	-6	-133
Total net inflow (+) or outflow (-)	-150	1 499

Gold and other foreign reserves



taken into account, the total gold and other foreign reserves of the country declined by R2 million during 1974/75 to a level of R927 million on 30 June 1975. During the first half of 1975 the total gold and other foreign reserves increased by only R18 million. The gold and other foreign reserves of the Reserve Bank showed a larger decline during the past year, but this was offset by an increase in the exchange holdings of monetary banking institutions. From 30 June until 8 August 1975 the gold and other foreign reserves of the Reserve Bank increased by R47 million to a level of R767 million.

Changes in South Africa's exchange rate policy

In retrospect, South Africa's exchange rate policy has been adjusted from time to time during the past four years in accordance with changes in the domestic and international economic situation. After the announcement on 15 August 1971 that the United States was no longer prepared to convert officially held dollars into gold or other reserve assets and the decision of the major industrial countries to let their currencies float, the rand at first floated moderately downwards with the US dollar until the general realignment of currencies under the Smithsonian Agreement of December 1971. At that stage South Africa's gold and other foreign reserves had declined fairly sharply, domestic economic activity was sluggish and an expansionary economic policy was called for. As part of the general realignment in December 1971 the rand was devalued by 12 per cent and subsequently floated downwards with sterling. The effective exchange rate of the rand depreciated by slightly more than 4 per cent from 22 December 1971 to 24 October 1972.

From 25 October 1972 the exchange rate policy of the authorities was directed at an effective appreciation of the value of the rand. This change in policy was considered desirable because the gold and other foreign reserves had reached a relatively high level, the domestic economic revival was already well under way and the combating of the high rate of inflation was given a high policy priority. Subsequently, the rand appreciated with slight fluctuations by no less than 23,6 per cent from 24 October 1972 to 24 January 1974. Although this appreciation of the rand initially tended to favour an inflow of capital, expectations towards the end of 1973 that the authorities would depreciate the rand contributed to a speculative outflow of capital. Early in January 1974, the authorities announced that the fixed buying and selling rates of the rand in terms of the US dollar would not be changed, but that a more conservative monetary policy would be pursued and that interest rates would be raised. This policy, together with the subsequent depreciation of the rand with the dollar as a result of market exchange rate movements, effectively curbed the speculation.

On 21 June 1974 the authorities announced that a policy of independent managed floating would be pursued according to which smaller but more frequent adjustments would be made to the fixed middle market rate of exchange with the dollar. By making seven upward and four downward adjustments to the rand-dollar rate during the period of independent managed floating from 21 June 1974 to 26 June 1975, the authorities kept the effective exchange rate of the rand against all currencies fairly stable. During the period as a whole the value of the rand depreciated only slightly against the US dollar, but this policy, together with exchange rate movements in other countries, resulted in a considerable depreciation of the rand *vis-à-vis* the French franc and the Swiss franc, and a fairly large depreciation against the Dutch guilder and German mark. On the other hand, the exchange rate of the rand *vis-à-vis* the UK pound and Japanese yen appreciated moderately.

The policy of independent managed floating worked reasonably well up to March 1975, but the strengthening of the US dollar from March and the substantial weakening of sterling beginning in April created expectations that the value of the rand would be adjusted downwards against the dollar in a series of small steps. This encouraged importers to pay for their imports more promptly, exporters tended to retain their export proceeds abroad for longer periods and the inflow of foreign private capital in certain other forms was delayed. The authorities, therefore, decided to change their exchange rate policy as from 27 June 1975. In accordance with the new policy, the Reserve Bank intends to keep the rand-dollar rate constant for longer periods and will only effect an adjustment if this is considered essential in terms of basic changes in the domestic or international economic situation. The new policy was based on a middle rand-dollar rate of \$1,40 per rand and this at the same time represented a depreciation of the rand in terms of the dollar of 4,76 per cent. This change restored the rand-dollar relationship to that which had existed for many years before the Smithsonian realignment of exchange rates in December 1971. It was expected that the modified exchange rate arrangements would assist materially in reversing the unfavourable leads and lags and improving the net inflow of capital to South Africa.

From 27 June 1975 the dollar continued to strengthen substantially and the effective exchange rate of the rand against all other currencies accordingly appreciated steadily by about 3½ per cent from 27 June to 11 August 1975. This marked appreciation of the rand caused private enterprises to expect that the value of the rand would again be depreciated, in spite of the fact that the Minister of Finance indicated that the depreciation on 27 June 1975 was in fact partly a precautionary measure against an expected strengthening of the dollar. The Minister in July again confirmed that the authorities did not intend to make any down-

ward adjustment to the value of the rand and on 11 August 1975 announced the following measures to prevent an outflow of capital:

- (1) Exchange control was relaxed in various respects, namely:
 - (i) More sympathetic consideration will be given in respect of foreign borrowing by local entrepreneurs;
 - (ii) Authorised dealers in foreign exchange will be allowed to raise funds abroad in their own names for the financing of South African foreign trade and for other approved purposes; and
 - (iii) Blocked rand will be made directly transferable between non-residents.
- (2) Forward exchange cover was extended for longer periods and also to authorised dealers in respect of foreign loans raised in their own names and approved by the authorities. Forward cover need also no longer be arranged within seven days after the foreign transaction was concluded.

In addition, the Reserve Bank also announced that a more conservative monetary policy will be followed to discourage banks to extend local bank credit for the switching of foreign to domestic financing of international trade. In this regard the following measures were announced:

- (i) The Bank rate was increased from 8 to $8\frac{1}{2}$ per cent;
- (ii) The minimum liquid asset requirement of commercial banks was increased by 4 per cent and that of other banks by 2 per cent of their short-term liabilities to the public;
- (iii) Appropriate adjustments will be made in the Reserve Bank's transactions in government securities and interest rate policy in general.

Monetary and banking situation

Marked changes in the rate of increase in the money and near-money supply*

In conformity with the more stringent monetary policy that was still being pursued during the earlier part of 1974, when the economy experienced excess demand and higher domestic interest rates would have been more in line with levels of rates prevailing overseas, the rate of increase in the money and near-money supply dropped substantially from 24 per cent in the first quarter of 1974 to 14 per cent in the second quarter and to 11 per cent in the third quarter. However, as the slackening of the pace of economic activity became more apparent towards the end of 1974, the authorities did not actively resist a more rapid rise in the money and near-money supply and a downward movement in interest rates from their peaks reached in September 1974. After an unusually rapid rise during the fourth quarter of 1974, the quantity of money and near-money increased at markedly lower rates during the subsequent two quarters. The rate of increase for the year 1974/75 was about 19 per cent, which equalled that of the preceding year.

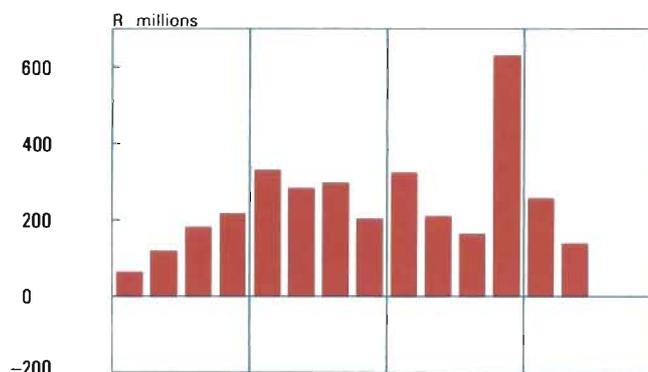
Contrary to developments during 1973/74, when the increase in the money and near-money supply did not cause a significant change in the ratio of money and near-money to the gross domestic product, the increase during 1974/75 led to a rise in this ratio from 28 per cent during the second quarter of 1974 to nearly 31 per cent during the first quarter of 1975 before declining to somewhat over 30 per cent during the second quarter of 1975.

Causes of changes in money and near-money

During 1973/74, the pattern of the causes of changes in the money and near-money supply was broadly speaking such as may be associated with economic conditions during the advanced stages of an economic upswing. By comparison, the pattern of causes during 1974/75 by and large reflected developments that may be expected during the earlier stages of a downward movement of the business cycle. Thus, whereas the net gold and other foreign reserves of the banking sector decreased by R331 million during 1974/75 (mostly during the second quarter of 1975), this decrease was still markedly smaller than the decline of R476 million during 1973/74. Similarly, bank credit to the private sector normally increases at a lower rate during the downswing, when there is lack of demand, than during the upswing when

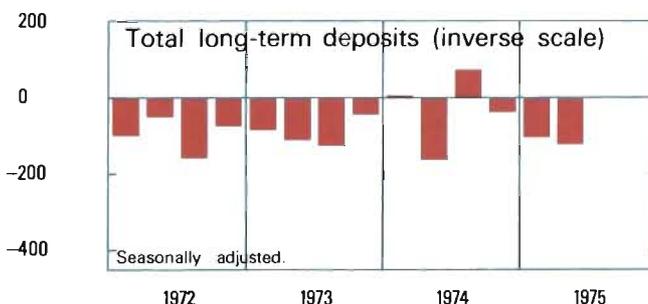
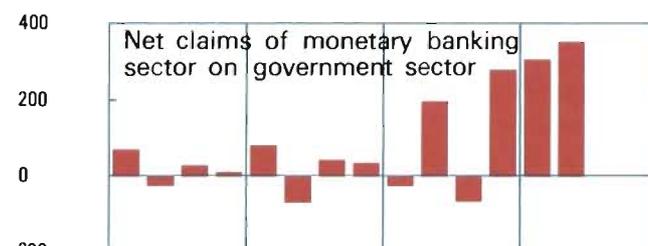
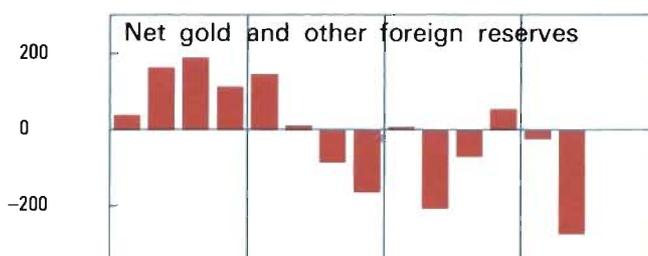
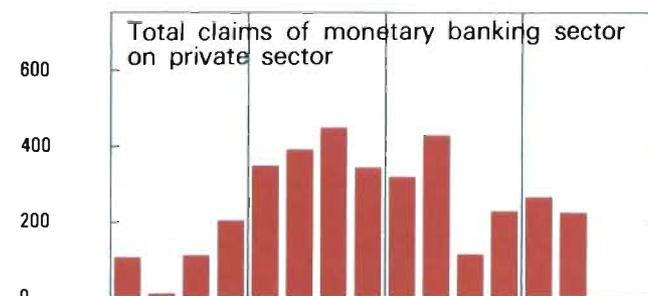
*A fairly substantial annual revision of the institutional coverage of the banking sector was made in January 1975. For purposes of comparison, all amounts concerning changes in the consolidated liabilities and assets of the monetary banking sector in this and following sections of this Report have been recalculated to eliminate the effects of this revision.

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, 1974/75

R millions

	Not seasonally adjusted						Seasonally adjusted				
	Year 1973/ 1974	1974 3rd qtr.	1974 4th qtr.	1975 1st qtr.	1975 2nd qtr.	Year 1974/ 1975	1974 3rd qtr.	1974 4th qtr.	1975 1st qtr.	1975 2nd qtr.	Year 1974/ 1975
Net gold and other foreign reserves...	-476	-98	-9	11	-235	-331	-72	53	-25	-272	-316
Claims on the government sector:											
Gross claims;.....	-33	72	266	237	310	885	...	...	...	...	...
Government deposits (increase — decrease +).....	281	-159	195	-211	175	-	...	...	...	...	...
Net claims.....	248	-87	461	26	485	885	-65	280	312	354	881
Claims on the private sector.....	1 562	146	206	314	187	853	119	232	269	231	851
Long-term private deposits (increase —, decrease +).....	-338	83	-2	-50	-226	-195	74	-37	-100	-121	-184
Net other assets.....	56	116	4	-205	86	1	...	...	...	...	...
Total causes of changes.....	1 052	160	660	96	297	1 213	164	631	258	145	1 199

demand for bank credit is strong. It is, therefore, not surprising that bank credit to the private sector (i.e. claims of the banking sector on the private sector) increased by only R853 million, or by 13 per cent, during 1974/75, as against an increase of as much as R1 562 million, or 31 per cent, during the preceding year. In addition, a fairly large proportion of the increase in bank credit to the private sector during 1974/75 was accounted for by the increased level of short-term advances of the Land Bank.

As the accompanying table shows, a further notable feature of the year under review was the very large increase in net claims of the banking sector on the government sector of R885 million, of which well over R600 million (seasonally adjusted) was recorded during the first half of 1975.

As regards long-term deposits of the private sector with the banking sector, interest rate considerations may have accounted for their relatively small increase of R195 million, as compared with an increase of R338 million during 1973/74. However, when short-term interest rates declined more rapidly than longer-term rates during the second quarter of 1975, long-term deposits with the banking sector rose sharply.

Marked slowdown in rate of increase in bank credit to the private sector

After still having been very high during the second quarter of 1974, the rate of increase in bank lending to the private sector dropped to sharply lower levels during the second half of the year and rose only slightly again during the first two quarters of 1975. At a seasonally adjusted annual rate, total claims of the monetary banking sector on the private sector rose by 11 per cent during the second half of 1974 and by 15 per cent during the first half of 1975, compared with 27 per cent during the first half of

1974. The rate of increase of 13 per cent for 1974/75 compares with increases of 31 per cent and 27 per cent during 1973/74 and 1972/73, respectively.

Other information also confirms the impression of a marked decline in the demand for bank credit in conformity with the slowdown in economic activity from the third quarter of 1974. Firstly, increased short-term advances of the Land Bank accounted for a relatively high proportion (26 per cent) of the total increase in claims on the private sector; commercial banks, merchant banks and monetary hire-purchase and general banks, on the other hand, contributed only 65 per cent of this increase, as against 96 per cent in 1973/74. Secondly, whereas the investments in private sector securities by the commercial banks, merchant banks and monetary hire-purchase and general banks increased by 17 per cent during 1974/75, their discounts and advances increased by only 8 per cent.

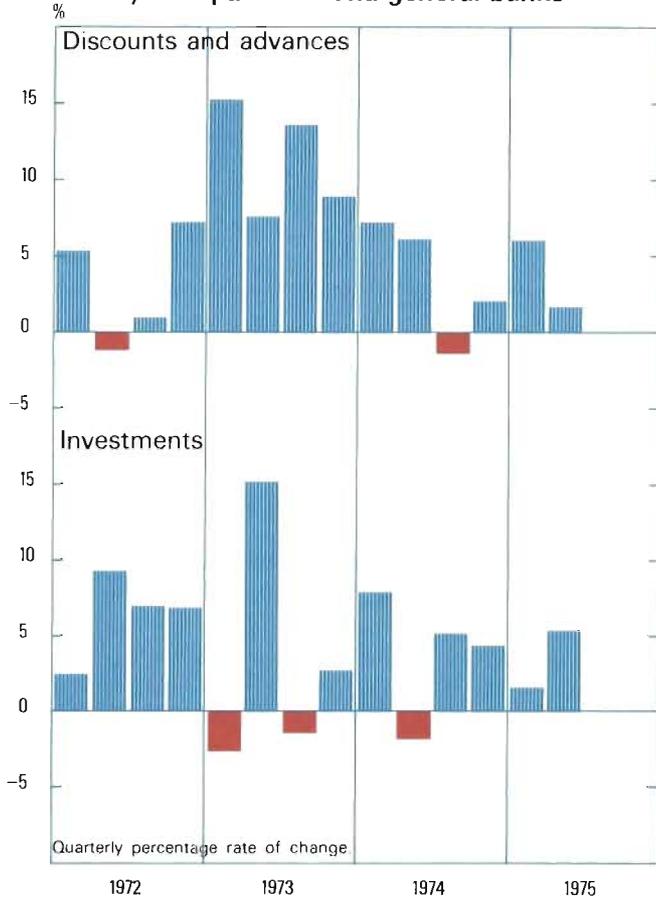
With regard to particular forms of bank credit to the private sector, it is noteworthy that leasing finance extended by monetary banking institutions increased

Increases in bank credit to the private sector

R millions

	1973/74	1974/75
Discount houses.....	-4	64
Commercial banks.....	1 078	333
Merchant banks.....	179	22
Monetary hire-purchase and general banks.....	246	203
Land Bank.....	51	218
Other.....	11	14
Total increase in claims on private sector.....	1 562	853

Discounts and advances, and investments, of commercial banks, merchant banks and monetary hire-purchase and general banks



the first few months of the year under review encouraged resort to foreign sources of credit for the financing of imports and long-term capital requirements. However, as noted above, this switching of credit was to a certain extent reversed during the first six months of 1975.

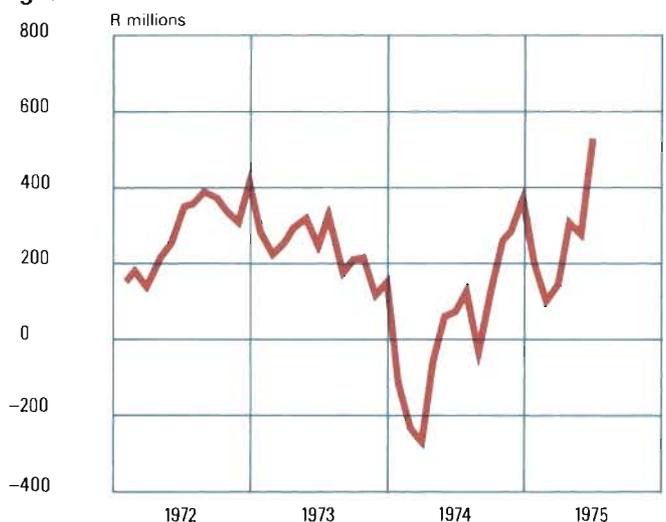
Improvement in excess liquidity position of banking institutions

After experiencing unusually tight liquidity conditions during most of 1973/74, the excess liquid asset holdings of monetary banking institutions were gradually restored to higher levels during most of 1974/75. During 1974/75 as a whole the average excess liquidity ratio of all monetary banking institutions amounted to 2,4 per cent, compared with the very low average level of 0,5 per cent during 1973/74 and a level of 5,3 per cent during 1972/73. A marked improvement in the commercial banks' liquidity positions occurred during the fourth quarter of 1974 and the second quarter of 1975. Factors contributing to the substantial increase in the monetary banks' liquid asset holdings during the first half of the year under review *inter alia* included the marked rise in the Reserve Bank's and National Finance Corporation's holdings of Land Bank bills during the third and early fourth quarters of 1974, the rising level of the Reserve Bank's gold and foreign exchange holdings during most of the fourth quarter of 1974, and the substantial decline in government deposits with the Reserve Bank from the relatively high level reached at the end of August last year. In addition, the banks' liquidity was, of course, affected by the slowdown

at a well-above-average rate of 32 per cent during the year. Monetary banks' (including the discount houses') holdings of bankers' acceptances and trade bills declined up to September 1974, but increased markedly since then, as the sharp decline in interest rates in the South African money market reduced the cost of this form of credit compared with the cost of borrowing on overdraft and as compared with the cost of foreign sources of credit. During June 1975 alone, monetary banks' holdings of trade bills and bankers' acceptances increased by R71 million or approximately 10 per cent. This indicates that importers may have used bankers' acceptances to switch from foreign to domestic sources of financing of imports.

Apart from the cyclical downturn in the demand for bank credit, certain other factors also helped to explain the marked deceleration in the extension of new bank credit to the private sector during the year under review. During most of calendar year 1974, severely limited bank liquidity caused the banks to adopt restrictive policies in the granting of new credit facilities. In addition, high local interest rates during

Surplus liquid assets of commercial banks, merchant banks and monetary hire-purchase and general banks



Excess or deficit liquidity ratios of monetary banking institutions

%

	1974			1975	
	June	Sep.	Dec.	Mar.	June
Commercial banks.....	0,4	1,8	5,7	2,4	7,1
Merchant banks.....	4,0	0,6	0,6	0,9	1,1
Monetary hire-purchase and general banks.....	0,2	0,6	0,3	-0,6	0,7
All above monetary banks:					
Ratio (%).....	0,8	1,4	4,1	1,5	5,0
Amount (R millions)	69	121	370	147	521

in the rate of their lending to the private sector which became apparent after the middle of 1974. The unfavourable effect on the banks' liquidity exerted by the largely seasonal movement of tax and other funds to the Government during the first few months of 1975 was reversed from the middle of March. During June, substantial purchases of Treasury bills and short-term government securities by certain major banks contributed to an increase in the commercial banks' holdings of excess liquid assets of somewhat over R200 million.

The liquid asset *requirements*, which had remained unchanged during the year, were subsequently raised (in terms of the Reserve Bank's policy announcement of 11 August 1975) by 4 per cent of their short-term liabilities to the public for the commercial banks and by 2 per cent of these liabilities for all other banks, effective from the day of the banks' certification of their monthly returns for July.

Easier money market conditions and sharp turn-around of interest rates

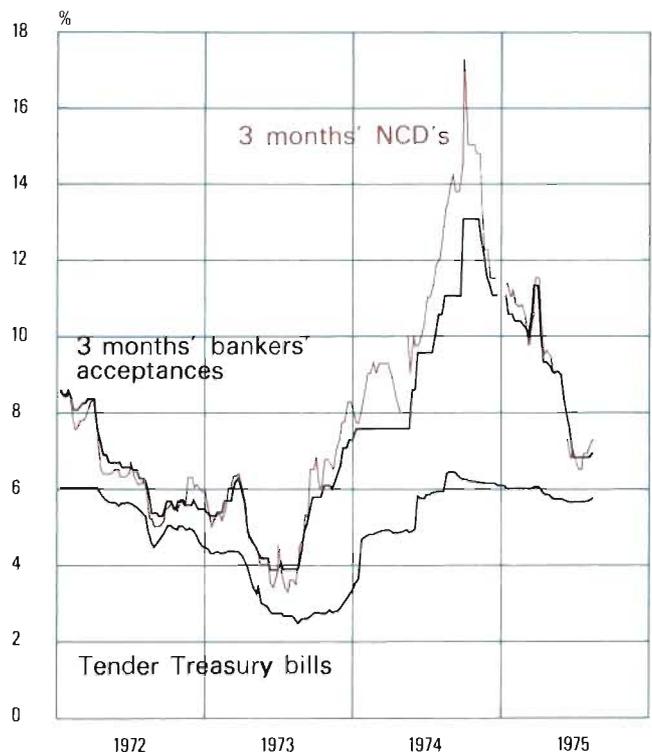
In contrast to the year 1973/74, during which money market conditions tightened considerably, the period 1974/75 was one of increasing ease. Initially, this was the result of a sharp decline in government deposits, strengthened by a modest rise in the gold and other foreign reserves of the Reserve Bank during the fourth quarter of 1974. During the first half of 1975 the main contributing factor was the increase in the net claims of the Reserve Bank and NFC on the government sector, especially during the second quarter of 1975. As might be expected, however, the market did tighten briefly at the end of August 1974 and over the February 1975 month-end, owing mainly to the seasonal flow of funds to the Treasury. Under these conditions, Reserve Bank accommodation, in the form of overdrafts and loans to banks plus the discounting of Treasury bills for the discount houses, amounted to R207 million at the end of August 1974 and to R176 million on 1 March 1975, but was negligible during the rest of the year.

Call loans with the discount houses, which had

been increasing steadily from a low point of R114 million (excluding deposits made by the Public Debt Commissioners) on 3 May 1974, increased sharply during 1974/75 and exceeded R650 million at the end of June 1975. During this period the discount houses regularly turned away deposits in favour of the NFC, partly because of the constraint imposed on them by the capital requirements of the Banks Act.

In sharp contrast to the year 1973/74, during which short-term interest rates increased to unprecedented levels, the larger part of the year 1974/75 witnessed a dramatic decline in short-term interest rates. For example, the rate on 90-day NCD's, which had increased from 3,25 per cent in July 1973 to

Money market interest rates



17,25 per cent on 27 September 1974, declined to 6,50 per cent on 4 July 1975. Similarly, the discount rate on 3-month bankers' acceptances increased from 3,80 per cent in July 1973 to 13,0 per cent in September 1974 but then declined to 6,75 per cent on 4 July 1975. The Treasury bill tender rate, which had increased from 2,39 per cent in August 1973 to 6,36 per cent on 23 August 1974, declined to 5,55 per cent on 4 July 1975. This downward movement in interest rates was acknowledged by the monetary authorities when, on 18 December 1974, the Reserve Bank adjusted its pattern of rates quoted on government securities downward by $\frac{1}{4}$ per cent. This pattern was abolished altogether on 19 February 1975.

In accordance with the general decline in short-term interest rates, the effective minimum rate (or "best" rate) charged by the commercial banks for overdrafts, which had been raised to 11 per cent in August 1974 and further to 12 per cent in October 1974, was reduced by 1 per cent during June/July 1975. Because of the confusion relating thereto, this rate will henceforth be referred to as the prime rate and will be set at between $2\frac{1}{2}$ per cent and $3\frac{1}{2}$ per cent above Bank rate, in order to allow the individual banks freedom to vary their lending rates in competition with one another.

Towards the end of the year under review, interest rates on deposits with most of the larger banking institutions were reduced from the maxima as allowed by the interest control regulations of 14 August 1974. While the rate on short-term deposits declined by 1 per cent in most cases, the rate on longer-term deposits declined by 0,5 per cent, bringing the rate on deposits of 12 months' original maturity down to 9,0 per cent. The rate on call deposits, which had been moving downwards from as early as February 1975, declined by 2, $2\frac{1}{2}$ or 3 per cent from its earlier maximum of 8 per cent to a level of 6, $5\frac{1}{2}$ or 5 per cent.

For reasons discussed earlier, the generally downward trend of interest rates during the year under review and the period immediately afterwards was interrupted when, as announced in the Reserve Bank's statement of 11 August 1975, Bank rate was raised as from that date from 8 to $8\frac{1}{2}$ per cent. This was followed immediately by an increase in the prime rate on overdrafts as quoted by the major commercial banks from 11 to $11\frac{1}{2}$ per cent, and by an increase in the discount houses' discount rate for bankers' acceptances. It was also stated by the Reserve Bank that its increase of Bank rate and allied monetary measures would be accompanied by appropriate adjustments in its transactions in government securities and its interest rate policy in general.

Government finance

The main developments in the field of government finance during the year that ended on 30 June 1975, were a substantial increase in government expenditure, a lower rate of increase in government revenue and a record deficit (excluding borrowing) on the Exchequer Account — the account in which all expenditure, revenue and loan transactions of the central government are recorded. The higher rate of growth in government expenditure not only related to the direct expenditure of the central government itself, but also to an increased appropriation of funds to government business enterprises and other extra-budgetary institutions contributing to the maintenance and expansion of the country's infrastructure and defence. A higher rate of increase in government expenditure coinciding with a lower rate of increase in government revenue, naturally resulted in a larger deficit which, in fact, reached a new record of R1 188 million. Notwithstanding increased borrowing from the domestic non-banking sectors and foreign sources, the government had to increase its borrowing from the monetary banking sector quite substantially.

Substantial increase in Exchequer issues

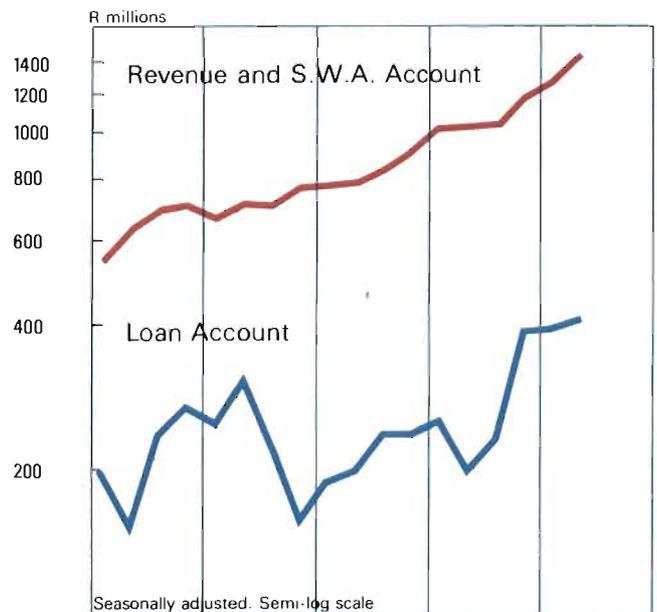
Government expenditure, as reflected in Exchequer issues, amounted to R6 329 million in the year that ended on 30 June 1975 and was R1 491 million, or 31 per cent, higher than in the preceding year. This percentage increase in expenditure exceeded the 28 per cent recorded in the preceding year.

Issues recorded in the Revenue and South West Africa Accounts, reflecting mainly government current expenditure, increased by 28 per cent compared with the preceding year, after it had risen by 26 per cent in 1973/74. A large proportion of the increased issues represented higher salary and wage payments that followed upon the adjustment of salary and wage scales of government employees in the second half of 1974 and higher appropriations to the Department of Defence. In real terms, issues on the relevant two accounts increased by 13 per cent in 1974/75, compared with 11 per cent in 1973/74. In both these years the increases were substantially higher than the rate of growth in the real gross domestic product and also above the average rate of increase in recent years.

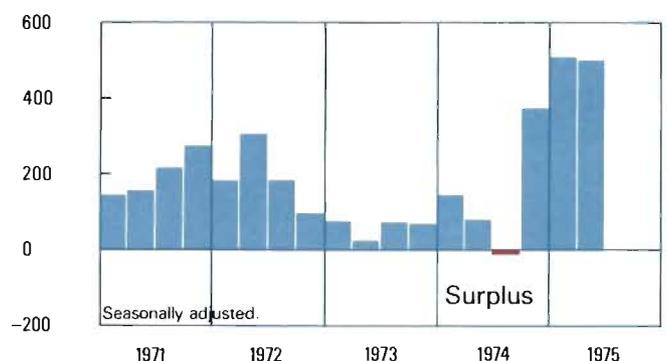
Loan Account issues reflect mostly capital expenditure, transfers of funds borrowed on behalf of government business enterprises and other extra-budgetary institutions contributing to the maintenance and expansion of the country's infrastructure, and capital for public corporations. During the year under review Loan Account issues rose by 36 per cent compared

with the preceding year, and amounted in total to R1 363 million. Of this amount, almost R447 million represented transfers of funds to the South African Railways and Harbours, the Department of Posts and Telecommunications, the National Housing Fund and the Community Development Fund. In addition, an amount of R281 million was used for acquiring shares in or providing loans to public corporations. As far as direct capital expenditure by government departments is concerned, notable increases occurred in funds employed in the development of Bantu areas, irrigation schemes and government buildings.

Issues from Exchequer Account



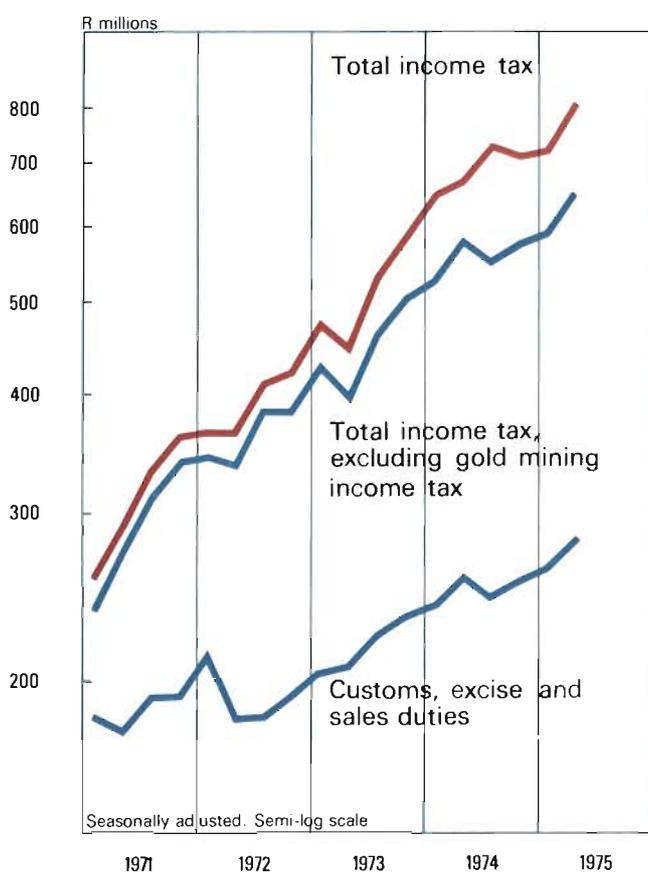
Exchequer Account deficit



Lower rate of increase in Exchequer receipts

In contrast to the relatively high rate of increase in Exchequer issues, central government revenue in 1974/75, as reflected in non-loan Exchequer receipts, rose by 17 per cent compared with the preceding year. This increase was the smallest recorded during the past four years, and was well below the increase of 31 per cent in 1973/74. The lower rate of growth in government revenue was largely accounted for by the rise of only 14 per cent, as against an increase of 28 per cent during the preceding year, in the principal revenue component, namely income tax receipts other than income tax paid by gold mining companies. Smaller increases in income tax paid by persons and companies were more or less equally responsible for the slower growth of the relevant income tax revenue. Income tax and lease payments by gold mining companies during 1974/75 amounted to R804 million and was R313 million more than in the preceding year. As a result, the contribution of gold mining companies to total central government revenue increased to 16 per cent, compared with 11 and 7 per cent in 1973/74 and 1972/73, respectively.

Revenue collections of central government



Customs, excise and sales duty proceeds increased by 9 per cent during the year under review and the relative importance of these duties as a source of revenue declined further. Whereas these duties contributed 32 per cent of total revenue in 1969/70, when sales duties were first levied to broaden the tax base, this contribution declined to 21 per cent in 1974/75.

Change in pattern of Exchequer financing

The higher rate of growth in Exchequer issues, and the lower rate of increase in government revenue resulted in a substantially increased deficit of R1 188 million on the Exchequer Account during the year under review. The deficit was R730 million more than in 1973/74. In contrast to the pattern in the preceding year, when about three-quarters of the deficit was covered by a reduction in Exchequer balances, the largest part of the 1974/75 deficit was financed by means of foreign and domestic non-banking borrowing. The proceeds of these loans were nevertheless insufficient to cover the revenue shortfall and the government had to borrow an amount of R429 million, or 36 per cent of the deficit, from the

Exchequer finance

R millions

	Year ended 30 June		
	1973	1974	1975
Total net receipts.....	3 342	4 381	5 141
Total net issues.....	3 769	4 838	6 329
Total deficit (excluding borrowing).....	426	457	1 188
Financing:			
Change in net indebtedness to:			
Foreign sector.....	47	-38	200
Private non-banking sector:			
Loan levies.....	-10	-14	66
Other.....	315	-32	147
PDC and Dept. of Posts and Telecommunications..	97	192	225
Paymaster-General.....	—	—	120
Sub-total.....	448	109	758
Monetary banking sector:			
Change in holdings of government securities held by:			
Reserve Bank and NFC....	209	175	94
Other monetary banking institutions.....	245	-205	473
Change in Exchequer balance*	-475	378	-138
Sub-total.....	-21	348	429
Total financing.....	426	457	1 188

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

monetary banking sector. This sector's holdings of government securities actually increased by R567 million, but the Exchequer balance with this sector rose by R138 million. The composition of the increase in the net indebtedness to the monetary banking sector during 1974/75 differed from that in the preceding year in that this sector's holdings of government securities then decreased by R30 million and, at the same time, the Exchequer balance with this sector declined by R378 million.

Non-bank borrowing during the year under review consisted of net foreign borrowing of R200 million, an increase in the government's indebtedness to the private non-banking sector and the Public Debt Commissioners of R213 million and R225 million, respectively, and a temporary transfer of R120 million from surplus balances on the Paymaster-General Account. Apparently, this transfer was made in order not to withdraw funds invested by the Treasury or to utilise the funds in the Stabilization Account.

During the year under review government stock of R518 million fell due for redemption. These stocks were largely held by monetary banking institutions which converted R136 million into new stocks. Three new issues, offering simultaneously short-term and long-term stock for subscription, were made during the year. In addition, two stock issues were made available only to the Public Debt Commissioners. Cash subscriptions, that is excluding conversions, to all these issues amounted to R770 million, of which R458 million came from the Public Debt Commissioners, R141 million from the monetary banking sector and the remaining R171 million from the private non-banking sector, representing mainly subscriptions by insurers and pension funds.

The 1975/76 Budget

In assessing the economic situation and prospects as background to the 1975/76 central government Budget presented on 26 March 1975, the Minister of Finance stated that although the immediate balance of payments prospects appeared to be promising, the country was faced with a phase of slower economic growth and, at the same time, an unacceptably high rate of inflation. As far as short-term fiscal policy was concerned, the objective of stimulating economic growth had to be reconciled with the objective of reducing the rate of inflation. From an analysis of the basic causes of the inflationary situation it was concluded that the basic causes of inflation were such that an excessively restrictive fiscal and monetary policy would not assist materially in tempering the rate of inflation. In this regard, a more expansionist short-term monetary policy had already been implemented and the Minister was of the opinion that the Budget should, notwithstanding the inflation, be moderately stimulatory. It was stressed, however,

that the expansionary effect should be moderate so as to prevent an early return to a situation of demand inflation and balance of payments disequilibrium.

Aggregate expenditure during the 1975/76 fiscal year from the Revenue and Loan Accounts was estimated to increase to R6 562 million, or by 18,5 per cent, compared with the preceding year. This percentage increase in expenditure was well below the increase of 24 per cent during the 1974/75 fiscal year. In real terms, it is expected that the increase in government expenditure will exceed the expected rise of between 3 and 4 per cent in the real gross domestic product. The composition of the expenditure indicated the priority given to defence and the provision of basic economic infrastructure, in particular through the supply of loan funds from the Loan Account to extra-budgetary enterprises and bodies.

To alleviate the effects of inflation, various civil pensions were increased and tax concessions granted. The latter included tax relief for aged persons and married women and concessions in respect of retirement benefits, contributions to pension and retirement annuity funds, and estate duty. In order to stimulate investment and economic development, concessions were granted in respect of investment allowances. Firstly, the expiry of the allowances on 30 June 1978 was extended for a further year. Secondly, existing allowances were increased, which meant that a manufacturer would be permitted, over and above initial and wear-and-tear allowances, to write off, over the lifetime of the asset, 120 per cent of the cost of factory buildings and 130 per cent of the cost of machinery. These percentages could be increased to 145 and 165 per cent, respectively, in economic development areas. Thirdly, an investment allowance, apart from those granted to all manufacturers, was introduced as an incentive for the local beneficiation of minerals. In addition to the investment allowance concessions, the plough-back allowed on undistributed profits of public companies was increased.

To supplement the estimated revenue on the existing basis of taxation and to reduce financing from potentially inflationary sources with a view to achieving only a moderately expansionary Budget effect, various indirect taxes were increased, such as those on petrol, beer, wines, spirits, tobacco and mineral water. The increased duty on petrol would accrue to the Strategic Oil Fund from which the erection of a second oil-from-coal plant would, *inter alia*, be financed. The loan levy on companies other than diamond mining companies was also increased.

Aggregate current revenue for 1975/76 was estimated at R5 437 million, or about 12 per cent more than in 1974/75, and fell short of the estimated expenditure on the Revenue and Loan Accounts by R1 125 million. Together with debt repayments, totalling R827 million, the total borrowing requirement for

the year was estimated at R1 952 million. The Minister proposed to finance this amount by foreign borrowing of R309 million and domestic borrowing of R1 389 million. The latter would include borrowing of R400 million from the Public Debt Commissioners, R655 million by way of the conversion of stock falling due for redemption during the year, R232 million in new issues to the local market, and R102 million in the form of compulsory loan levies. Available cash balances would be employed to the extent of R254 million, of which R29 million would represent a transfer from the Stabilization Account.

Capital market

At the beginning of the period under review, conditions in the capital market tightened progressively, but towards the end of 1974 an easing in some sections of the market, notably the fixed-interest security and share markets, became evident. Yields on fixed-interest securities declined to slightly lower levels and most classes of share prices recovered noticeably. From the first quarter of 1975, the amount of funds advanced in the mortgage market increased slightly because of a larger flow of funds to mortgage market intermediaries. Activity in the real estate market, which had started to level off during 1973/74, actually declined in the fourth quarter of 1974, remained at this low level during the first quarter of 1975 and then showed signs of a revival in the second quarter of 1975. Although the tightening of capital market conditions did not continue during the second half of the period under review, the demand for funds, nevertheless, remained high compared with the supply and most new issues in both the fixed-interest security and share markets were not fully subscribed. In addition, borrowers in the public sector had to transfer a considerable part of their borrowing operations to foreign capital markets.

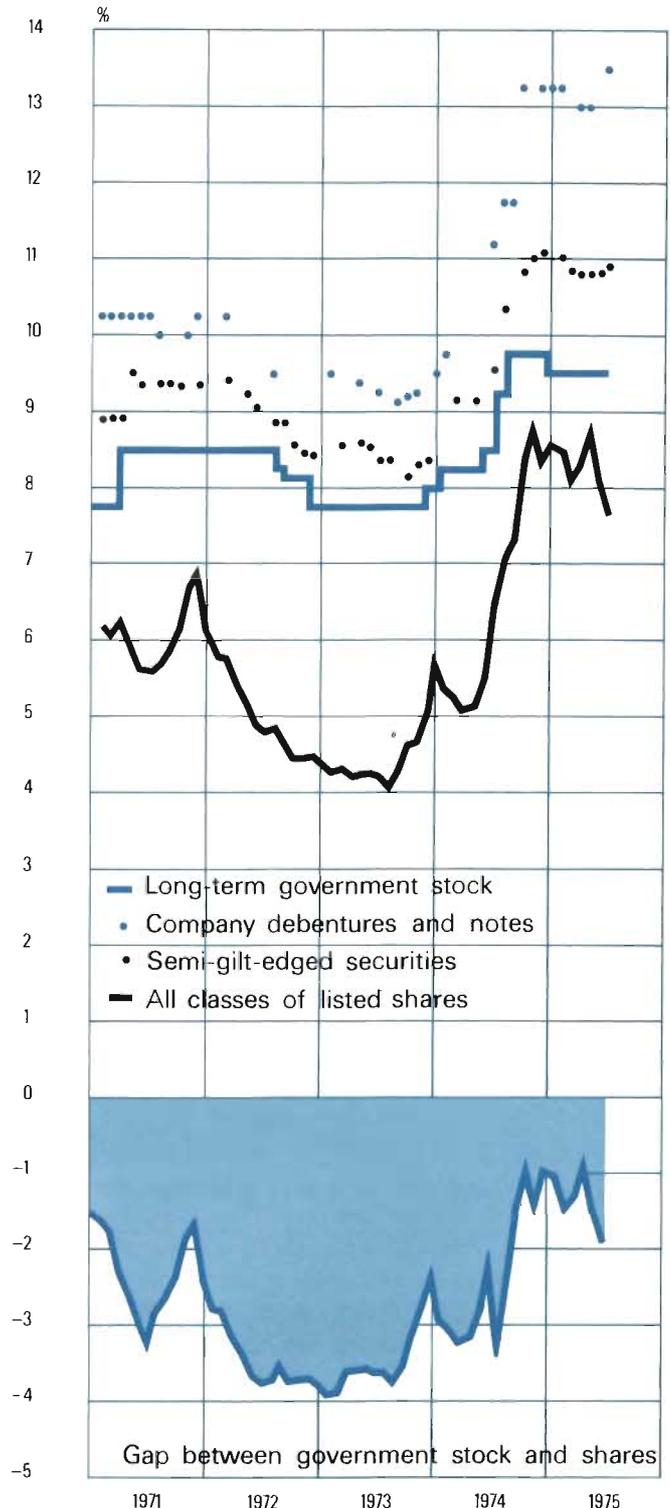
Slightly easier conditions in the fixed-interest security market

The progressive tightening of the market for fixed-interest securities from the third quarter of 1973 continued into the early part of the year that ended on 30 June 1975. Towards the end of 1974, however, the tightening of market conditions apparently came to a halt, but although yields moved to slightly lower levels, the market situation did not ease to any significant extent and under-subscriptions of a number of new issues occurred, especially during the period March to May 1975.

The aggregate proceeds of net new issues of marketable fixed-interest securities, excluding the increase in public sector borrowers' holdings of their own securities, amounted to R918 million and were more than double the amount of R394 million raised in 1973/74, especially because of the substantial increase in the net borrowing of the central government. If the increase in government stock held within the central government sector is excluded, the government's borrowing in the form of marketable stock changed from a net repayment of debt to the amount of R97 million in 1973/74 to a net increase in debt amounting to R496 million in 1974/75. The recourse to the market by borrowers would have been even higher, had the central government and the public corporations not transferred part of their borrowing to foreign markets. Their net long-term foreign

borrowing amounted to R749 million, compared with R314 million in 1973/74.

Yields



Developments in the fixed-interest security market were reflected in the movement of market yields. The yields on new issues of long-term gilt and semi-gilt-edged stock and company loan securities rose from 8,50, 9,50 and 11,20 per cent, respectively, at the end of June 1974 to 9,75, 11,00 and 13,25 per cent, respectively, during the subsequent five months. Thereafter, during the period December 1974 to March 1975, the relevant yields declined to 9,50, 10,75 and 13,00 per cent, respectively, and remained more or less at these levels during the remaining part of the year under review. Secondary market yields on semi-gilt-edged and company loan securities declined more than yields on new issues and although they rose again during the period March to May 1975 they were in June still slightly lower than the new issue yields. Rising yields during the first half of the period under review had to be supplemented by innovations such as variable coupon rates and options of partial or full redemption before maturity, in order to attract investors' interest.

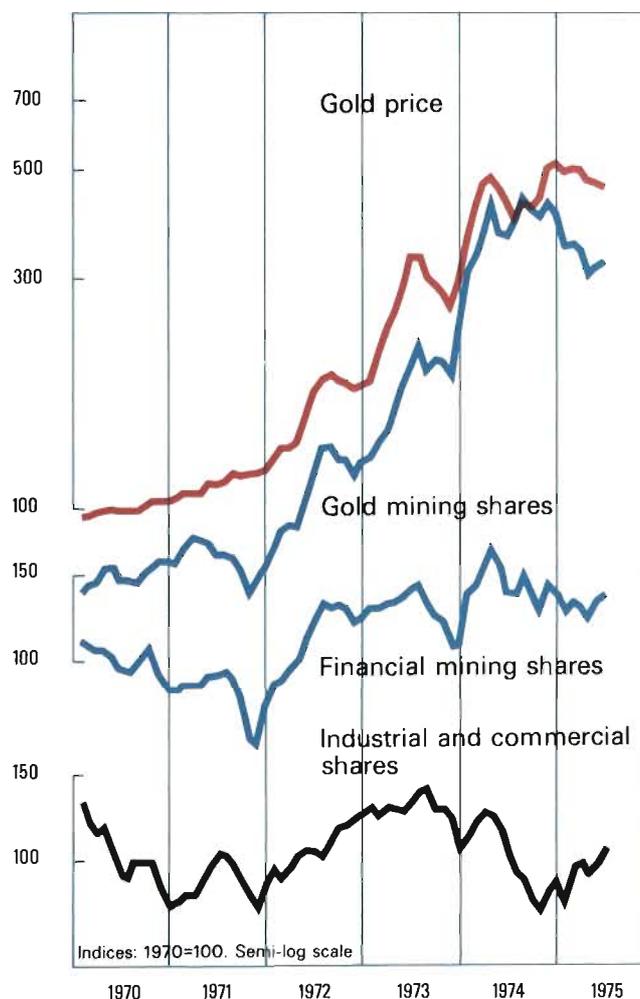
On 19 February 1975 the Reserve Bank abolished the system of quoting a pattern of rates for transactions in government stock. Yields on new issues of government stock, which had previously been related to those quoted for corresponding maturities in the Bank's pattern of rates, have been determined subsequently in accordance with prevailing market conditions. Since that date, the Reserve Bank's dealings in stock have been effected at market-related prices, with due regard, however, to the broad monetary policy objectives pursued at the time of the transactions.

Recovery of most classes of share prices

With the exception of gold mining shares, the prices of all classes of shares continued their downward course during the initial part of the year that ended on 30 June 1975, and fell to their lowest levels since the end of 1971. However, during the fourth quarter of 1974 this movement was reversed and the various classes of share prices, with the exception of mining financial shares, showed a noticeable improvement. The shift of investors' interest from the gold and mining financial sections to other sections of the market, an increase in the liquidity of the private sector and the slight easing of capital market conditions contributed to these share price rises. The decline in share prices, other than those of gold mining and mining financial shares to their lowest levels within the first half of the review period ranged from 23 to 31 per cent for the different classes of shares, whereas subsequent increases during the remainder of the period were between 21 to 56 per cent, apart from an increase of 73 per cent in coal mining shares.

Gold mining share prices, which had risen very

Gold price and share prices



strongly from the end of 1971, reached a peak in August 1974 and thereafter fluctuated downwards in accordance with the weakening of the price of gold on the private market. Towards the end of the year under review these prices recovered moderately again. The decrease in gold mining share prices was also reflected in the prices of mining financial shares. From August 1974 to June 1975, the prices of gold mining and mining financial shares declined by 27 and 11 per cent, respectively.

The declining interest in gold mining and mining financial shares and the limited interest in other classes of shares during the first half of the period under review were reflected in a lower share turnover on the stock exchange. The number and value of shares traded were on average 31 and 37 per cent, respectively, lower in 1974/75 than in 1973/74. Because of the improved stock exchange conditions, new share issues by listed companies increased

considerably during the first half of 1975. For the year 1974/75 these companies' new share issues amounted to about R200 million (of which about R160 million represented issues during the first six months of 1975), as against issues of R89 million during 1973/74.

Although most classes of share prices were at higher levels in June 1975 than in June 1974, the average dividend yield for all classes of shares increased from 6,4 per cent in June 1974 to 7,6 per cent in June 1975 because of higher dividend rates. The inverse yield gap between shares and long-term government stock narrowed only slightly from 2,1 per cent in June 1974 to 1,9 per cent in June 1975.

During the year under review, the outflow of funds experienced by unit trusts in the form of net repurchases of units, decreased to R11 million as against a figure of R53 million for 1973/74. Whereas the outflow of funds in 1973/74 necessitated net sales of securities amounting to R67 million, such sales declined to only R10 million in 1974/75 and contributed to more stable conditions on the stock exchange. The market value of the trusts' net assets at the end of June 1975 was more or less equal to that at the end of June 1974, so that the average selling price of units remained almost unchanged. The yield on units, however, increased from 4,8 per cent to 6,0 per cent during the review period.

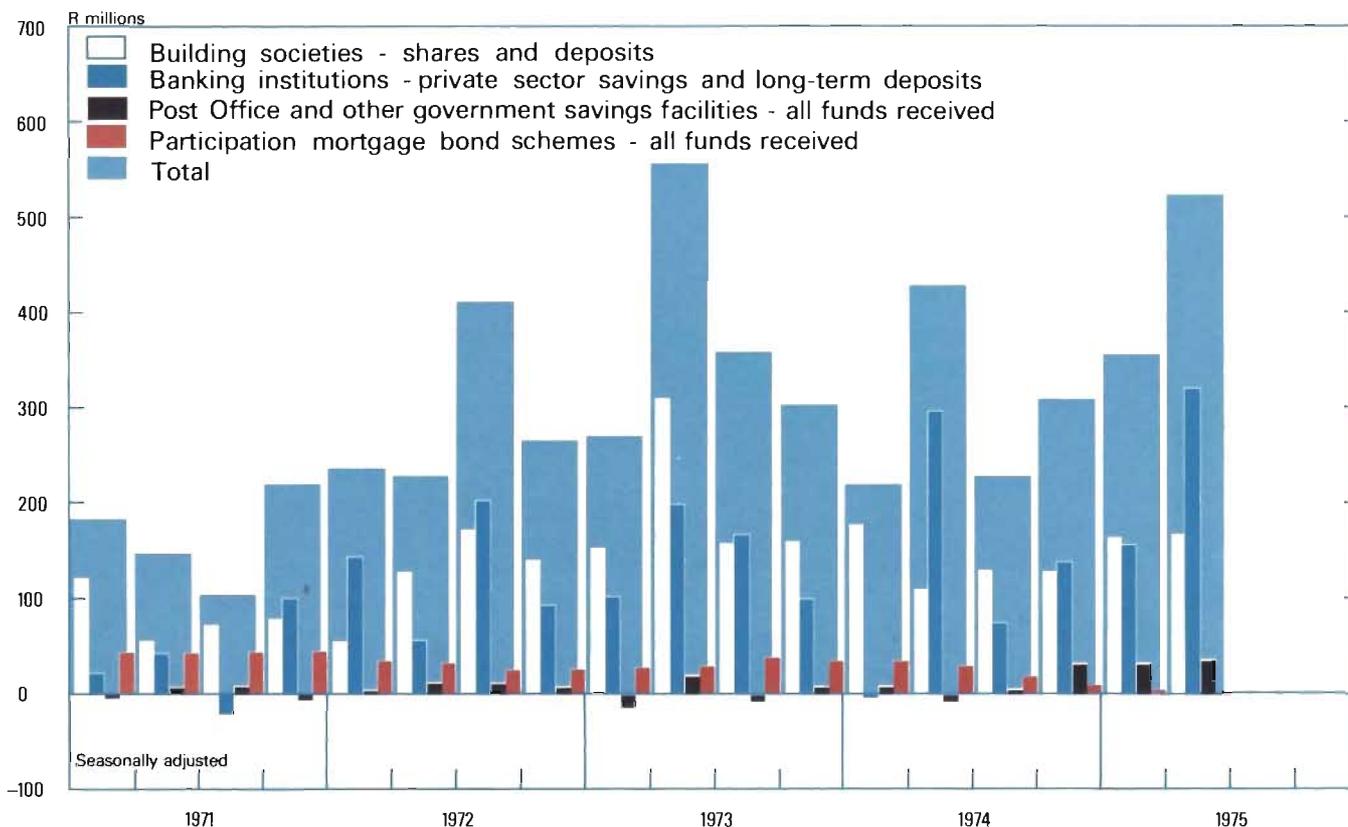
Increased flow of longer-term funds to deposit-receiving and related institutions

The flow of longer-term funds to banking institutions, building societies, participation mortgage bond schemes, Treasury savings bonds and the savings schemes of the Department of Posts and Telecommunications was at a higher level in the year that ended on 30 June 1975 than in the preceding year. The two major groups of deposit-receiving institutions, namely banking institutions and building societies, more or less maintained their combined share in the total inflow of new funds during 1974/75, compared with the preceding year. However, because of a sharp decline in the flow of funds to participation mortgage bond schemes, the share of these schemes in the inflow of

Flow of longer-term funds to deposit-receiving and related institutions

	1972/73		1973/74		1974/75	
	R m	%	R m	%	R m	%
Building societies: shares and deposits.....	735	49	600	46	597	42
Banking institutions: savings and long-term deposits....	629	42	559	43	688	48
Participation mortgage bond schemes.....	108	7	141	11	28	2
Post Office and other government savings facilities.....	24	2	4	—	104	8
Total.....	1 496	100	1 304	100	1 417	100

Flow of funds to financial institutions



new funds declined from 11 per cent in 1973/74 to only 2 per cent in 1974/75, whereas new funds invested in the Post Office Savings Bank and other government savings facilities increased from virtually nothing to 8 per cent during the respective periods.

Although the flow of funds to the relevant institutions declined during the first half of the year under review compared with the preceding year, there was a reversal of the declining trend in the inflow of new funds during the course of 1974/75. During the second half of the year under review, for example, the inflow amounted to R857 million, compared with R560 million during the first half. This change applied to building societies whose inflow of funds, if seasonal influences are disregarded, already started to increase in the last quarter of 1974. Banking institutions also achieved a greater inflow during the latter half of the year under review. Recognition of more favourable conditions came when the societies and the banks reduced the rate on deposits of two years and longer by $\frac{1}{2}$ per cent to $9\frac{1}{2}$ per cent in July 1975.

Lower level of activity in the mortgage and real estate markets

Activity in the mortgage and real estate markets was at a lower level in 1974/75 than in the preceding year. Thus, the value of net registrations of new bonds, that is after allowing for cancellations, was about 30 per cent lower during the first ten months of 1974/75 (for which figures are available) than during the corresponding period of 1973/74. The value of real estate transactions, which had started to level off during 1973/74, actually decline during the fourth quarter of 1974 and the first quarter of 1975. Preliminary information indicates that the decline in real estate activity did not continue during the second quarter of 1975, mainly because of an improvement in the general availability of funds, a decline in interest rates and a desire of investors to hedge against the effect of the still existing high rate of inflation.

Mortgage market conditions also improved during the second half of the period under review, mainly because of an increased flow of funds to financial intermediaries operating actively in this market. The amount of new mortgage loans granted by building

societies, for example, was on average 32 per cent higher during the first half of 1975 than during the second half of 1974. Similarly, banking institutions' mortgage loans outstanding increased at a faster rate during the first half of 1975 than during the preceding six months. Only in the case of insurers and private pension funds, which are no longer operating actively in the mortgage market, and in the case of participation mortgage bond schemes, which were faced with a much smaller inflow of funds, did mortgage loans outstanding not increase at a faster rate during the second half of the year under review.

Notwithstanding the easing of the mortgage market during the first half of 1975, mortgage rates remained unchanged at the levels to which they had risen in 1974. The relevant increases during 1974 included an increase in the building societies' rate for housing bonds from 9,25 to 10,50 per cent in June, an increase of 0,75 per cent to 12,00 per cent in the building societies' rates for other classes of mortgages in October, an overall increase of 0,45 per cent to 11,35 per cent in the rate for new mortgages of participation mortgage bond schemes, and an increase from 11,0 to 13,0 per cent in the mortgage rate of insurers and

private pension funds in September. Apart from these increases in rates on new mortgages, the average rate on all mortgages, except those extended by the Land Bank, increased from 9,1 per cent in June 1974 to 10,4 per cent in April 1975, the latest available figure.

Fixed property market

