

1976

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-Sixth Ordinary General Meeting to be held on 24 August 1976.

Contents

General observations	5
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National accounts	7
Economic growth rate	7
Little change in real gross domestic expenditure	9
Further increase in real private consumption expenditure	10
Sharp increase in government consumption expenditure	10
Small rise in real gross domestic fixed investment	11
Decline in real inventory investment	12
Insufficient domestic saving	12

Business cycle trends, labour situation and prices	15
Business cycle trends	15
Labour situation	15
Prices	17

Balance of payments	19
Further large deficit on current account	19
Further rise in the value of merchandise imports	21
Small decline in the net gold output	21
Increase in net invisible payments to the rest of the world	22
Further substantial rise in the value of merchandise exports	22
Further large net inflow of capital	23
Decline in gold and other foreign reserves	23
Balance of payments and economic policy	24

Monetary and banking situation	27
Money and near-money	27
Causes of changes in money and near-money	28
Bank credit to the private sector	28
Cyclical behaviour of bank credit to the private sector	29
Marked swings in excess liquidity of banking institutions	30
Money market conditions and interest rates	30
Monetary policy	31

Government finance	33
Changed pattern of Exchequer issues	33
Smaller contribution of gold mines to Exchequer receipts	34
Increase in Treasury borrowing	34
Increase in monetary banking sector's net claims on the non-Exchequer part of the government sector	35
Tightening of fiscal policy in the 1976/77 Budget	36

Capital market	37
Tighter conditions in the capital market	37
Large demand for funds in the market for fixed-interest securities	37
Depressed conditions in the share market	38
Declining flow of longer-term funds to deposit-receiving and related institutions	39
High level of lending maintained in the mortgage market	40
Real estate market affected by a lesser availability of funds	41

General observations

During the year under review* the South African economy experienced a relatively low growth rate, an unfavourable balance of payments situation and a still too high rate of inflation. Although the economy has now been in the downward phase of the business cycle for about two years, it has in certain important respects not yet reacted in accordance with the normal pattern expected at an advanced stage of a cyclical downswing. These include the fact that real gross domestic expenditure and imports did not decline to the same extent as during previous downswings, bank credit to the private sector at times increased without a corresponding increase in the demand for credit for domestic expansion, short-term interest rates increased and long-term interest rates remained high or increased slightly. In these circumstances, a policy of restricting bank credit to the private sector had to be pursued despite the relatively low level of domestic economic activity.

The real gross domestic product increased by 2½ per cent during the year under review, compared with 4 per cent during the preceding year. Although low for South Africa by historical standards, the growth rate would have been lower if it were not for the primary and secondary expansionary influences of the high rate of increase in public sector expenditure. This, together with an increase in certain other components of gross domestic expenditure, all of which have a relatively high import content, contributed to the unfavourable balance of payments situation.

In accordance with the usual cyclical pattern, the current account of the balance of payments normally shows a moderate improvement during the early stage of the downward phase of the business cycle because domestic demand and imports start to decline, and a more pronounced improvement later in the downswing when exports start to rise in response to economic expansion abroad. For a number of reasons this normal adjustment process has not yet occurred in the present downswing and the deficit on South Africa's balance of payments on current account increased further during the year under review. The continued high level of real gross domestic expenditure contributed materially to the further deterioration of the current account of the balance of payments. Certain components of domestic expenditure were not immediately affected by the downswing but increased independently. These include a substantial increase in public sector current expendi-

ture, particularly on defence equipment and stockpiling of strategic materials, a building-up of inventories in the first quarter of 1976 in anticipation of a possible tightening of import control or a further depreciation of the rand, high initial outlays on television sets, and further outlays on large capital projects of public authorities and public corporations. All these expenditure items have a high import content, with the result that the volume of imports, although declining, was kept well above the level that could be expected in the second year of the downswing. At the same time, the length and severity of the recent recession in the main industrialised countries understandably caused a delay in the improvement of South Africa's current account through increased exports.

A related reason for the further increase in the balance of payments current account deficit during 1975/76 was the continued deterioration of South Africa's terms of trade. The long and severe recession abroad led to a decline in the volume of international trade and a fall in international commodity prices. In addition, the dollar price of gold started declining sharply from the beginning of 1975 and the devaluations of the rand, although they increased the rand proceeds of exports and helped to compensate for the decline in export prices on overseas markets, increased import prices in terms of rand. Consequently, considering also the further rise in prices abroad, there was a more rapid increase in import prices than in export prices. This deterioration in the terms of trade caused the real **national** product to decline slightly, compared with the small positive growth rate in the real **domestic** product.

Although the capital account of the balance of payments showed a large net inflow for the year as a whole, the deficit on the current account still exceeded this inflow, with the result that the gold and other foreign reserves declined after exclusion of the effect of the gold swap transactions. The large inflow of capital during the year under review consisted largely of loan funds obtained abroad by public authorities and, particularly, by public corporations to finance infra-structural investment, but also included substantial short-term borrowing of a compensatory nature by the authorities. Short-term capital to the private sector fluctuated widely as a result of uncertainties of an economic and political nature and showed a substantial outflow during the review year. At times, expectations regarding a possible devaluation of the rand led to unfavourable leads and lags in foreign payments and receipts and a weakening of the capital account.

In these circumstances, the highest priorities of economic policy remained the strengthening of the balance of payments and the reduction of the rate of

*The year under review refers to the twelve months that ended on 30 June 1976 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 a part of August 1976.

inflation, while at the same time efforts to improve productivity and to attain a better utilisation of productive resources continued. Various measures were introduced during the review year to improve the balance of payments situation and to contain inflation. From the second half of 1975 a more stringent credit policy was pursued and the exchange rate and exchange control policies were adjusted from time to time. To assist in correcting the balance of payments deficit, and, in particular, to stem the short-term capital outflows, the authorities depreciated the rand in terms of the US dollar by 4,8 per cent in June 1975, and again by 17,9 per cent in September 1975. In August 1975 credit policy was tightened further through the raising of the liquid asset requirements of banks and key interest rates, and a number of changes were made to exchange control regulations to encourage capital inflows and discourage outflows. The liquid asset requirements were increased further in September 1975 to an exceptionally high level, and in February 1976 fairly drastic quantitative limits were imposed on bank credit to the private sector. Furthermore, a conservative Budget for the fiscal year 1976/77 was introduced in March 1976. Although provision was made for a substantial increase in defence expenditure, the budgeted rise in total central government expenditure was kept to approximately the anticipated inflation rate, i.e., no increase in expenditure in real terms was allowed for. In addition, substantial increases were announced in several taxes and duties. Owing largely to an abnormally high level of drawings on the Exchequer Account in the opening months of the new fiscal year (chiefly due to the unusually low level of cash balances in most public sector accounts at the beginning of the fiscal year and the fact that most of the direct tax increases became effective only in July 1976), the Budget has not as yet exerted its intended corrective effect on the economy. However, its impact, in conjunction with that of the present stringent monetary policy, should be considerable during the remainder of the fiscal year. In order to accelerate the expected decline in imports, the authorities in July 1976 introduced an import deposit scheme and at the same time the Reserve Bank raised Bank rate from 8½ per cent to 9 per cent.

In accordance with the change towards a more restrictive monetary policy, the rate of growth in the quantity of money and near-money, and particularly in bank credit to the private sector, declined during the second half of the year under review. However, the most notable feature of the monetary and banking situation was the substantial increase in **net** bank credit to the government sector, which was the main single cause of the increase in the quantity of money and near-money during 1975/76. At times during the first part of the year under review, the increase in bank credit to the private sector was not related to domestic economic activity, but was linked to the exceptionally large purchases of foreign exchange from the Reserve Bank

and this also induced the authorities to pursue a more stringent monetary policy. The tighter monetary and banking situation was also reflected in a marked reduction in the excess liquidity of banks from a high level in July 1975 to low levels during most of the year under review, and in substantial increases in short-term interest rates.

Capital market conditions also became tighter during the review period notwithstanding the fact that an easier situation could have been expected in the second year of a downswing in domestic economic activity. However, a continuing large demand for long-term funds, particularly by the public sector, and the restrictive economic policy aimed at improving the unfavourable balance of payments and curbing the high rate of inflation, precluded an easing of market conditions. The tighter situation was widely diffused throughout the capital market and was reflected in higher rates on fixed-interest securities, lower share prices and higher yields and a reduction in the flow of funds to financial intermediaries and to the mortgage and real estate markets.

The stringent monetary and fiscal policy measures outlined above were not only aimed at strengthening the balance of payments but also at curbing the rate of inflation. Although still unacceptably high, the rate of increase in consumer and wholesale prices declined significantly after the third quarter of 1974 until the first quarter of 1976, but accelerated slightly during the second quarter of 1976 mainly because of a number of unavoidable increases in government-administered prices of certain goods and services. In order to assist the general economic policy measures in containing inflation, a voluntary price and wage restraint campaign was agreed upon in October 1975 by the private and public sectors in the Anti-inflation Manifesto. This anti-inflation campaign has been extended on two occasions and will now be continued until the end of November 1976.

National accounts

Economic growth rate

The real gross domestic product increased by about 2½ per cent during the year that ended on 30 June 1976, compared with an increase of 4 per cent in the preceding year. These growth rates are below the long-term growth rate trend and reflect the fact that the South African economy has now been in a downward phase of the business cycle for two consecutive years. The growth rates were, nevertheless, still positive and in this respect they compare favourably with the negative growth experienced by many countries during 1974 and 1975.

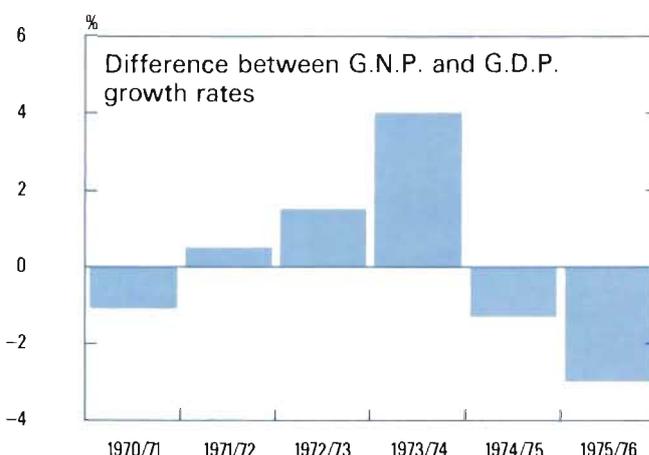
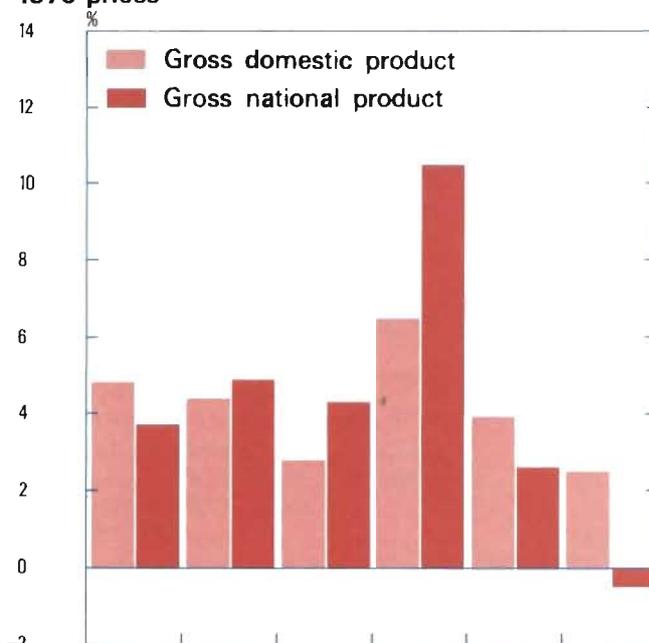
As is evident from the accompanying table, most sectors either recorded lower positive growth rates or showed declines during the year under review. Notable exceptions were gold mining, which showed a substantially smaller negative growth rate, general government services (mainly salaries and wages) which increased more rapidly and manufacturing which increased at a slightly higher rate. The main contributions to the decline in the overall growth rate during 1975/76 were made by agriculture, non-gold mining, construction, and the sector transport, storage and communication. The negative growth rate recorded by agriculture was mainly due to less favourable weather conditions whereas the sharp decline in the rate of increase in the volume of non-gold mining production was due to the relatively low level of domestic and export demand. However, it is expected that the non-gold mining sector will make a significant contribution to domestic growth in the near future, because of an anticipated increase in export

Percentage change in gross domestic product at constant 1970 prices

	Year ended 30 June		
	1974	1975	1976
Agriculture	-1	4½	-4
Gold mining	-8	-11	-2
Other mining	15½	7½	1
Manufacturing	9½	2½	3
Construction	6½	1½	-4½
Wholesale, retail and motor trade	9	4	4
Transport, storage and communication	4½	11	4
General government services	7½	6	7½
Other sectors	6½	4	3
Gross domestic product	6½	4	2½
Non-agricultural sectors	7½	4	3
Non-agricultural and non-mining sectors	8	4½	3½
Gross national product	10½	2½	-½

demand as a result of the current upswing in the economic activities of South Africa's main trading partners. The negative contribution to growth by the construction sector, following upon the already poor performance during the preceding year, to a large extent reflected the scarcity and high cost of finance and the generally lower level of real domestic economic activity during the past two years. The lower rate of increase in the real activity of the sector providing transport, storage and communication services was also directly related to the lower level of economic activity and more particularly to the de-

Percentage change in gross domestic and gross national product at constant 1970 prices



cline in agricultural production, the small increase in the volume of non-gold mining production and the decline in real activity in the construction sector. As far as the commercial sector is concerned, retail sales at constant prices increased by 3,9 per cent and wholesale sales at constant prices by 4,9 per cent, whereas the number of new motor vehicles sold declined by 0,7 per cent during the year under review.

The rate of increase in the physical volume of manufacturing production increased slightly from

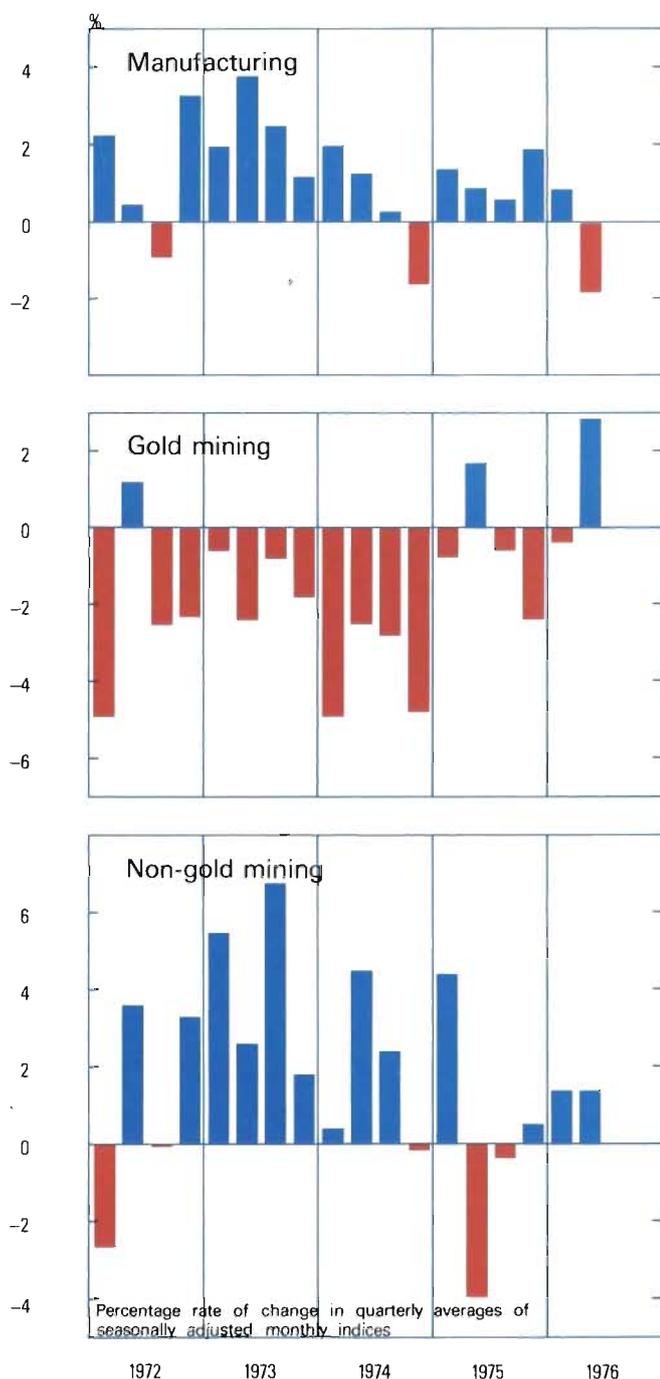
2,4 per cent in 1974/75 to 3,1 per cent in 1975/76. It would appear that the main reasons for this slightly higher rate of increase during the past year were the large number of television sets produced, the high rate of increase in real government consumption expenditure, the substantial increase in the real earnings of and the consequent higher expenditure by the Non-white population, and the continuation of expenditure on a number of large capital projects of the public corporations and public business enterprises.

During 1975/76 South Africa's terms of trade deteriorated markedly because the prices of imported goods rose faster than the prices of South African export goods and gold, with the result that the real gross national product declined slightly, compared with the small but positive rate of growth in the real gross domestic product. The substantial differences in the real growth rates of the gross domestic and national product, owing mainly to changes in the terms of trade during the past five years, are clearly illustrated by the accompanying graph.

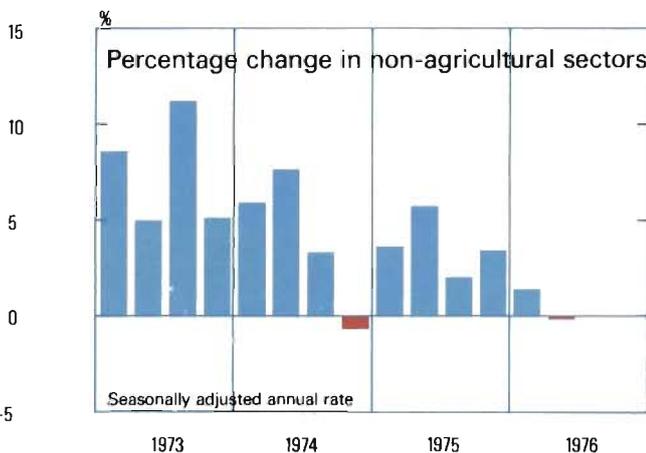
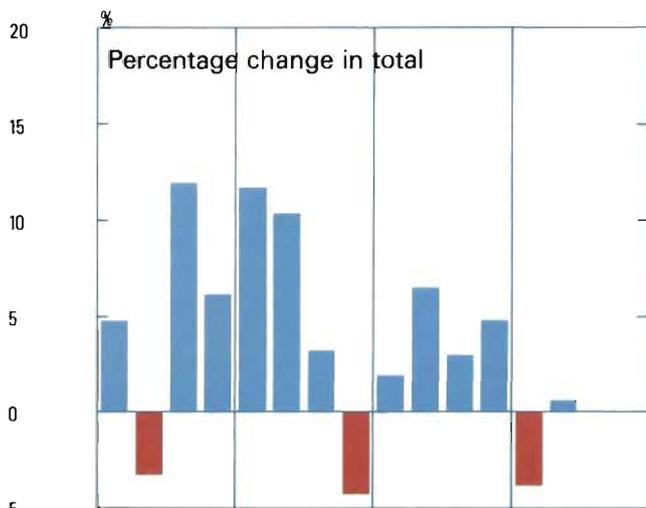
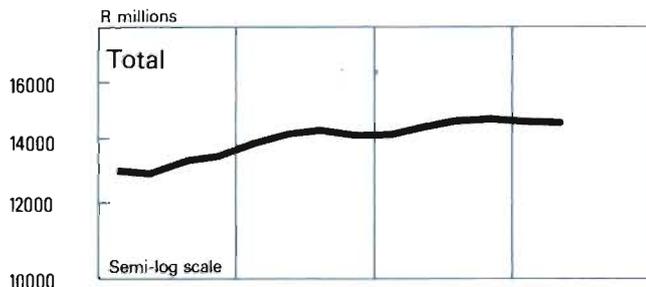
At current market prices, the gross domestic product increased by 12 per cent during the year that ended on 30 June 1976, compared with rises of 15 per cent and 23½ per cent during 1974/75 and 1973/74, respectively. Although the rate of increase in the remuneration of employees also declined from 21 per cent in the preceding year to 15 per cent in 1975/76, the lower rate of increase in gross domestic product at current prices was attributable mainly to an increase of only 6 per cent in the gross operating surplus (gross profits and net interest payments), compared with a rise of 9½ per cent during the preceding year. In fact, the low rates of growth in the gross operating surplus during the past two years brought the ratio of the operating surplus to gross domestic product at factor cost down from 45 per cent in 1973/74, and an average annual ratio of 42½ per cent during the sixteen years 1960 to 1975, to only 40½ per cent in 1975/76. This very low rate of increase in the operating surplus recorded in 1975/76 was largely accounted for by sharp declines in the operating surpluses of gold mining and agriculture. The main contributions to the increase of 15 per cent in the remuneration of employees were made by manufacturing, wholesale and retail trade, and mining.

The gross domestic product deflator, derived from estimates of the gross domestic product at current and constant prices, rose by 9 per cent in 1975/76, compared with nearly 11 per cent during the preceding year. Lower rates of increase in the domestic wholesale, retail and agricultural producers' prices and in the prices of gold and export commodities were responsible for the smaller rise in the gross domestic product deflator.

Physical volume of production



Gross domestic product at constant 1970 prices



Quarterly estimates of the real gross domestic product show that, after increasing at relatively low but positive rates during 1975, it declined during the first half of 1976.

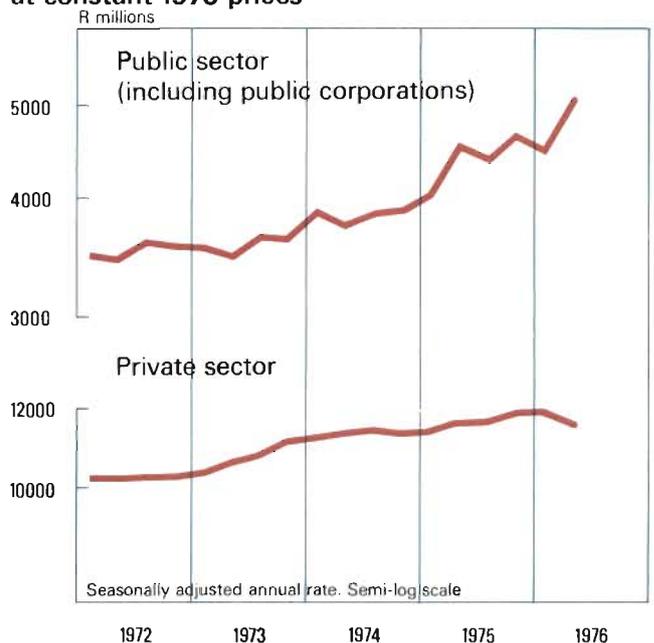
Little change in real gross domestic expenditure

As the accompanying table shows, real gross domestic expenditure showed little change during 1975/76, compared with substantial increases during the preceding two years. It is also clear that the main expansionary force in the economy during the past year was government consumption expenditure, although the rate of increase in certain other components of gross domestic expenditure may also have been too high in relation to the growth rate in the gross national product. The rate of increase in private consumption expenditure remained unchanged whereas that of gross domestic fixed investment declined and inventory levels at constant prices were run down during the year under review. However, the rate of increase in government consumption expenditure accelerated further in 1975/76 from the already high level in the preceding year. At current

Percentage change in gross domestic expenditure at constant 1970 prices

	Year ended 30 June		
	1974	1975	1976
Private consumption expenditure	6	3½	3½
Government consumption expenditure	9½	11	15½
Gross domestic fixed investment	7	5	2½
Change in inventories (R millions)	287	533	-250
Gross domestic expenditure	13	7	—

Total of consumption expenditure and gross domestic fixed investment at constant 1970 prices



prices, gross domestic expenditure in 1975/76 exceeded gross national product by a substantially larger amount than during the preceding year and this was reflected in a sharp increase in the deficit on the current account of the balance of payments.

Further increase in real private consumption expenditure

After amounting to 6 per cent in 1973/74, the rate of increase in real private consumption expenditure slowed down to 3½ per cent in 1974/75 and remained at that level in 1975/76. However, the various components of consumption expenditure showed divergent tendencies during the year under review. The most notable feature during 1975/76 arose from the introduction of television which led to such a substantial outlay on television sets that the real expenditure on **total** durable goods at constant prices increased by 8 per cent in 1975/76, compared with 1 per cent in the preceding year. Real outlays on durable goods other than television sets, declined by 10 per cent during 1975/76. With real disposable income of a major part of the population declining, a considerable substitution within consumer spending occurred, as is evidenced by the decline of 18 per cent in real expenditure on furniture and household appliances during 1975/76, compared with a decline of only 2 per cent during the preceding year. The

market for furniture and other major household appliances was not only affected adversely by the introduction of the television service, but also by the marked decline of 15 per cent in residential construction at constant prices, which contributed to the decline in expenditure on these items.

Real outlays on semi-durable goods in 1975/76 showed the same percentage increase as during the preceding year, namely 3 per cent. The rate of increase in real outlays on non-durable goods and on services declined slightly.

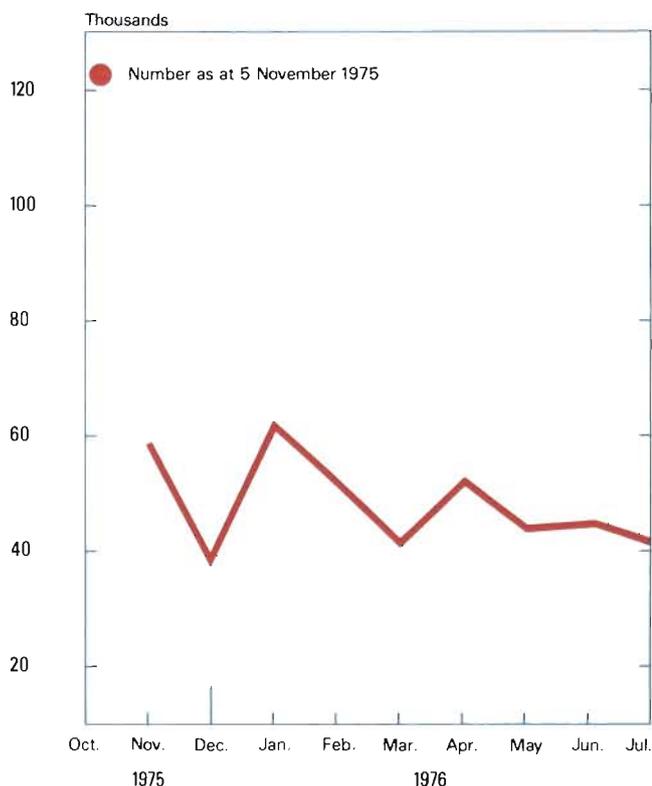
Quarterly estimates of real private consumption expenditure indicate a deceleration in the rate of increase, especially during the first half of 1976. During the second quarter of 1976 almost all components of consumption expenditure showed a slower rate of increase and real outlays on durable consumer goods declined. It would appear that real outlays on television sets, which kept expenditure on durable goods at constant prices at a high level throughout the year under review, levelled off during the second quarter of 1976.

Sharp increase in government consumption expenditure

As the accompanying table shows, government consumption expenditure at both constant and current prices increased at a much more rapid rate during the past three years than during the preceding years. This acceleration was almost entirely accounted for by the increase in defence spending. In fact, the rate of increase in non-defence spending at current prices declined during 1975/76 and in real terms rose only slightly to 7 per cent, compared with an increase from 11 per cent to 15½ per cent in **total** real government consumption expenditure.

The high rate of increase in real government consumption expenditure, particularly during the past three years, increased the relative importance of this component of aggregate expenditure in the economy. Real government consumption expenditure as a percentage of total gross domestic expenditure rose from 13 per cent in 1974/75 to 15 per cent during the year that ended on 30 June 1976, compared with

Number of television sets licensed



Percentage increases in government consumption expenditure

	At current prices		At constant prices	
	Non-defence	Total	Non-defence	Total
1971/72.....	16	13	8½	6
1972/73.....	9	6	3½	—
1973/74.....	20	23	7	9½
1974/75.....	22	29	6½	11
1975/76.....	14	30	7	15½

an average annual ratio of about 12 per cent during the nineteen-sixties and early nineteen-seventies.

Quarterly estimates of real government consumption expenditure show that the increase for the year resulted from higher expenditure during all four quarters of the year, but more so from expenditure during the first and second quarters of 1976. The central government was mainly responsible for this increase in 1975/76, because the real consumption expenditure of provincial administrations and local authorities showed only moderate increases.

Small rise in real gross domestic fixed investment

Compared with increases of 7 per cent in 1973/74 and 5 per cent in 1974/75, real gross domestic fixed investment rose by only 2½ per cent during the year that ended on 30 June 1976. As the accompanying table indicates, the moderate increase during the year under review was largely the result of substantial increases in real fixed capital outlays by the South African Railways and the Electricity Supply Commission, partly neutralised by declines in fixed investment by wholesale and retail trade and on residential buildings. All the other subsectors showed either small increases or small declines. The low rate of increase in real fixed investment by private manufacturing in 1975/76 was not unexpected in view of the low level of domestic demand, the existence of surplus production capacity and the decline in the value of unfilled orders at constant prices. The sharp decline, for the second consecutive year, in real fixed capital outlays on private residential buildings was caused mainly by the escalation of building costs, the current high cost of building stands, the scarcity of funds for residential construction, and the decline in the real disposable income of the White population.

After reaching a relatively high level in the second half of 1975, quarterly estimates of real fixed investment showed a declining tendency up to the second quarter of 1976. Real fixed capital outlays of the private sector and of public corporations declined during the second quarter of 1976, but those of public authorities increased sharply mainly owing to higher fixed capital outlays by the South African Railways.

The different rates of increase registered during the past twenty-five years in the real gross domestic fixed investment of the different organisations and major industrial sections, resulted in some structural changes in the composition of South Africa's real fixed capital stock. As shown by the accompanying table, which gives the percentage distribution of the real fixed capital stock by kind of organisation, the relative share of public corporations increased markedly during the past twenty-five years with a concomitant decline in the relative importance of the private sector. The relative share of public authorities remained remarkably stable over the past fifteen-year period.

Percentage distribution of real fixed capital stock by type of organisation

Period	Public authorities	Public corporations	Total public sector	Private sector	Total
Average annual:					
1950-1959....	42.3	4.9	47.2	52.8	100.0
1960-1969....	45.1	5.8	50.9	49.1	100.0
As at 30 June:					
1970.....	44.0	6.8	50.8	49.2	100.0
1971.....	43.9	7.0	50.9	49.1	100.0
1972.....	44.4	7.1	51.5	48.5	100.0
1973.....	44.7	7.6	52.3	47.7	100.0
1974.....	44.6	8.1	52.7	47.3	100.0
1975.....	44.5	8.7	53.2	46.8	100.0
1976.....	44.6	9.4	54.0	46.0	100.0

Percentage change in real gross domestic fixed investment

	Year ended 30 June		
	1974	1975	1976
Private sector	14	2	-5
Gold mining.....	43	42½	10½
Non-gold mining.....	34	-6	9
Manufacturing.....	15½	7	-3½
Wholesale and retail trade.....	3½	3	-24
Private residential construction..	12	-5	-15
Public corporations	17	14	12
Manufacturing.....	18	-23	-31
Electricity, gas and water.....	-13	31	51
Public authorities	-7½	6	10
South African Railways.....	-16	5½	27
Other business enterprises.....	-6	-	10
General departments.....	-6½	7	3½
Total	7	5	2½

As the accompanying table shows, the relationship between real fixed capital stock and real gross domestic product, i.e. the capital-output ratio, on average remained relatively stable during the period 1950 to 1969, notwithstanding cyclical variations in the degree of utilisation of the real fixed capital stock. However, it would appear that the average amount of capital utilised per unit of output tended to increase continuously, albeit moderately, over the past seven years.

Although factors such as improved technology and better utilisation of the labour force are also important determinants of economic growth, capital accumulation remains an important prerequisite for economic expansion. In view of the increasing capital-output ratio, it is important in the long term either to maintain or even to increase the current

Average capital-output ratio

	Ratio
Average annual ratio:	
1950-1959.....	2,21
1960-1969.....	2,21
Year ended 30 June	
1970.....	2,30
1971.....	2,37
1972.....	2,44
1973.....	2,53
1974.....	2,53
1975.....	2,59
1976.....	2,70
Average 1970-1976.....	2,56

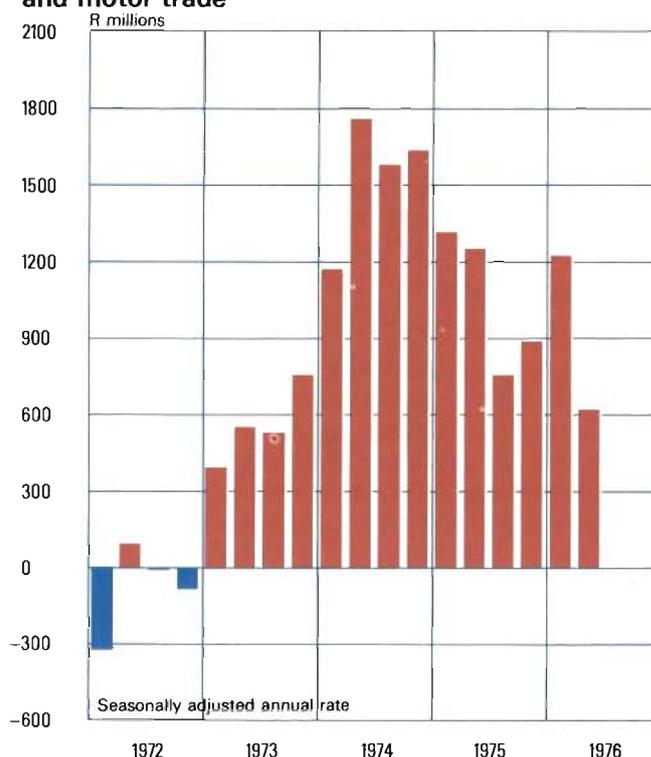
level of fixed investment or to employ the existing capital stock more productively if a relatively high rate of growth is to be attained in the future.

Decline in real inventory investment

Net additions to inventories fluctuated markedly over the past two years. After increasing by more than R2 000 million during the preceding year, the book value of total inventories increased by only about half that amount, namely R1 100 million, during the year under review. At constant 1970 prices the change was even more noticeable, namely from an inventory build-up of R533 million during 1974/75 to a depletion of approximately R250 million during 1975/76. The level of industrial and commercial inventories at constant 1970 prices declined by about R150 million, whereas real agricultural stocks in trade declined by about R40 million.

Quarterly estimates of real inventory investment indicate that, with the exception of the first quarter of 1976, industrial and commercial inventories were run down during the other three quarters of the year under review. Special factors, such as expectations regarding a possible adjustment in the exchange rate of the rand and the introduction of more stringent import control measures, were responsible for the build-up of inventories in the first quarter of 1976. In view of these expectations, wholesalers and retailers were induced to stockpile imported goods during the first quarter of 1976. The higher imports and accumulation of inventories were facilitated by the extension of domestic bank credit. During the second quarter of 1976, however, there was a general decline in real inventories. The rising trend in the ratio of non-agricultural stocks to the comparable gross domestic product was arrested and declined slightly from 37,7 per cent in the first quarter to 37,3 per cent in the second quarter.

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



Insufficient domestic saving

During the year that ended on 30 June 1976, gross domestic saving declined slightly compared with the level reached during the preceding year. However, total investment demand at current prices increased moderately, with the result that the shortfall of domestic saving to finance domestic investment increased further from the already high level reached during the preceding year. Consequently, the share of foreign funds employed to finance domestic investment increased from 21 per cent in 1974/75 to 25 per cent in 1975/76. The declining ratio of gross domestic saving to gross domestic investment and gross domestic product during recent years is reflected in the accompanying table.

Although gross domestic saving declined only slightly, net domestic saving, i.e. excluding provision for depreciation, declined by approximately R450 million during the current year. This decrease in net domestic saving stemmed mainly from sharp declines in personal saving and the current surplus of general government, with corporate saving remaining almost unchanged. The decline in personal saving was attributable to a lower rate of growth in disposable personal income and the increased use made of consumer credit to finance part of private consumption expenditure. Outstanding personal loans, hire-purchase and other forms of consumer credit

Gross domestic saving as a percentage of gross domestic investment and product

Year ended 30 June	Gross- domestic investment	Gross domestic product
Average annual ratio:		
1966 to 1975	90,3	25,3
1971	70,8	20,6
1972	89,0	24,9
1973	103,5	26,1
1974	95,4	27,3
1975	79,3	25,2
1976	75,3	22,1

are estimated to have risen by R400 million between December 1974 and December 1975 (the latest figures available). Being negative saving, the increase in consumer credit outstanding also reduced the level of personal saving. This decline brought the ratio of personal saving to disposable personal income to a level of about 10½ per cent during 1975/76, compared with an average annual ratio of 12 per cent during the preceding ten years.

Notwithstanding a lower rate of increase in corporate profits, corporate saving approximately remained at its 1974/75 level, because both income tax payments and dividends declared also increased at lower rates than during the preceding year. During 1975/76 current revenue of general government rose by 16 per cent, whereas the total current expenditure, i.e. consumption expenditure and current transfer payments, rose by as much as 28 per cent. The result was that the current surplus of general government declined sharply from R1 035 million in 1974/75 to about R700 million in 1975/76.

Business cycle trends, labour situation and prices

Business cycle trends

It is apparent from an analysis of the national accounts and other economic indicators that the South African economy is still in a downward phase of the business cycle. After reaching an upper turning point early in the third quarter of 1974, the rate of growth of economic activity slowed down noticeably up to the end of the first quarter of 1975. During the subsequent three quarters the downswing was temporarily arrested and economic activity showed a moderate recovery, mainly because of the expansionary effect of the high rate of increase in government expenditure, the stimulating influence of the introduction of the television service, the sharp increase in the real purchasing power of the Non-White population, and the continuation of expenditure on large capital projects of public authorities and public corporations. The effect of these stimulating influences was clearly reflected in series such as the real gross domestic product, the number of workers employed in the non-agricultural sectors, the physical volume of durable goods produced, the utilisation of production capacity in manufacturing, and the number of hours worked in manufacturing and construction.

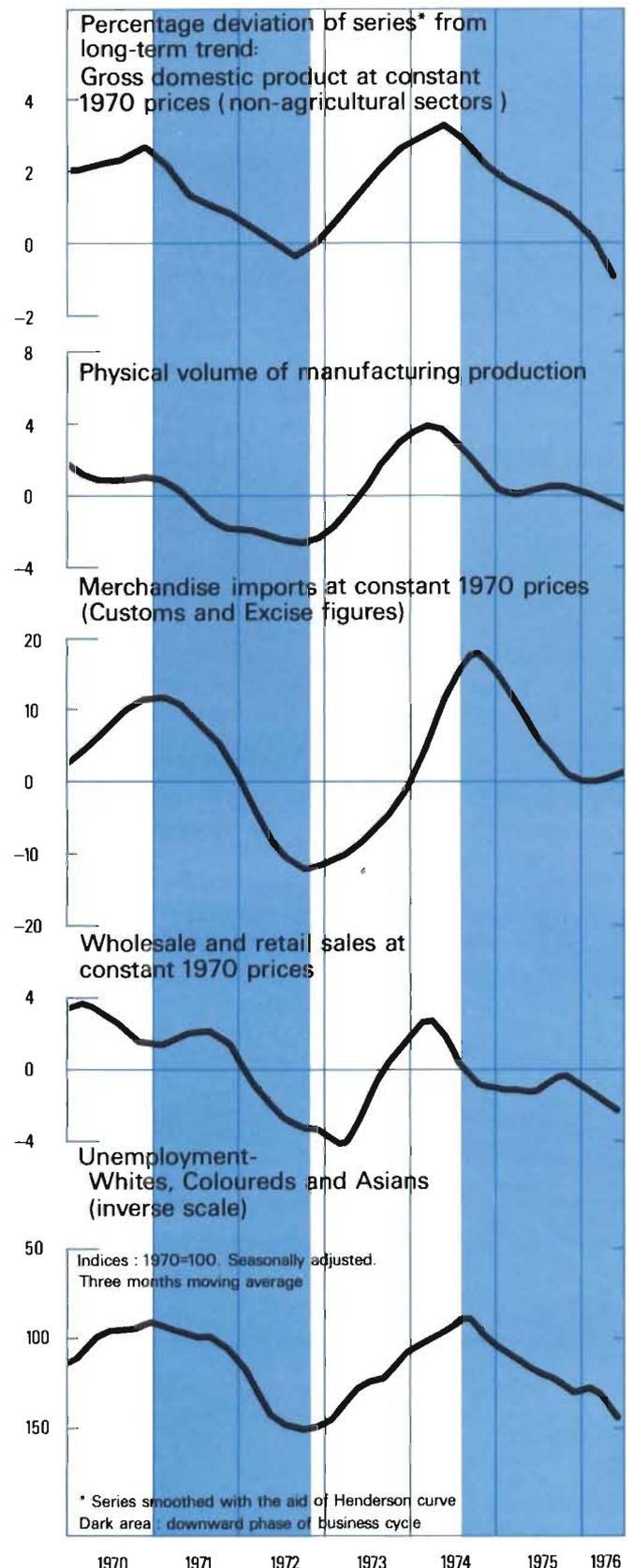
As and when the effects of the expansionary influences began to diminish, however, economic activity declined during the first half of 1976. This development is reflected by the tendencies in indicators such as the real gross domestic product, the utilisation of production capacity, the physical volume of manufacturing production, overtime hours worked in manufacturing and construction, employment and hours worked in construction, unfilled orders at constant prices in manufacturing, the number of new motor vehicles sold and the number of company liquidations. With minor exceptions, the slow-down in domestic economic activity up to the middle of 1976 was widely diffused throughout the economy.

As shown by the accompanying graph, the current slow-down has lasted for approximately two years. However, the length of the downswing is not surprising if the length and the intensity of the recession in most industrialised countries during the period 1973 to 1975 are taken into account.

Labour situation

As a result of the relatively low rate of increase in overall economic activity during the past two years, the labour situation eased further during the year under review. This development was clearly evidenced by the sharp increase in the number of registered unemployed Whites, Coloureds and Asians, a series which in the past has been a very sensitive business cycle indicator. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians namely increased from 7 243 in August 1974 to 11 492 in December 1975 and further to 13 368 in

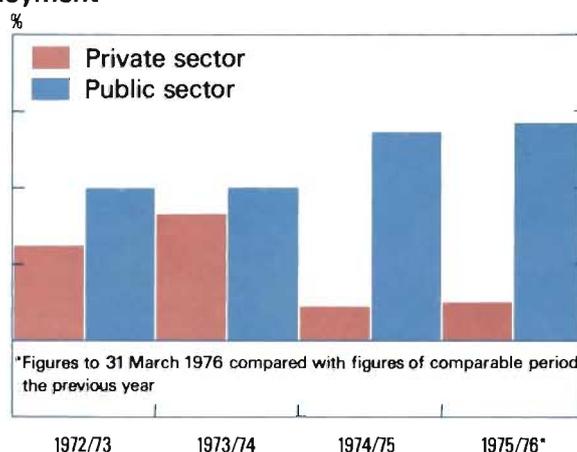
Business cycle indicators



June 1976. The number of Bantu registered as unemployed by the Bantu Affairs Administration Boards (which excludes unemployed Bantu in Bantu Homelands) increased by 9,4 per cent between the first quarter of 1975 and the comparable quarter of 1976 and amounted to 123 000 in March 1976. Other indications of the easing of the labour situation were the decline in the relevant importance assigned to the shortage of labour as a contributing factor to the degree of under-utilisation of manufacturing production capacity, the decline in the number of overtime hours as a ratio of ordinary hours worked in manufacturing and construction, and the lower rate of increase in employment in the non-agricultural sectors of the economy.

The rate of increase in employment in the non-agricultural sectors of the economy declined from 3,6 per cent in 1973/74 to 2,2 per cent in 1974/75. For the three quarters that ended on 31 March 1976, compared with the same period of the preceding year, total employment increased by 2,3 per cent, and was the net result of a rise of 2,2 per cent in the number of Blacks employed and an increase of 2,4 per cent in the number of Whites, Coloureds and Asians employed. During the same period the number of people employed in the public sector rose sharply by 5,7 per cent, compared with an increase of 1,1 per cent for the private sector. The small rise in employment in the private sector was partly due to the levelling-off in the number of workers employed in construction and the decline in employment in the non-gold mining and private services sectors. However, the employment in gold mining increased substantially during the past year. After declining until the first quarter of 1975, the number of persons employed in gold mining increased until the second quarter of 1976 and for the year 1975/76 it was on average 3,4 per cent higher than for the preceding year. Employment in wholesale and retail trade rose by about 1 per cent during the three quarters that ended on 31 March 1976, compared with the same period of the preceding year.

Percentage rate of change in non-agricultural employment



Notwithstanding a levelling-off in employment and the number of overtime hours worked in manufacturing, the output per manhour increased by 2,2 per cent for the three quarters that ended on 31 March 1976, compared with the corresponding period in 1975. During 1974/75 the increase was 2,0 per cent.

The average remuneration of all employees in the non-agricultural sectors of the economy increased by 19,9 per cent in 1974/75 and then by 13,8 per cent during the three quarters that ended on 31 March 1976. If the reduced purchasing power of the rand as a result of the increase in the cost of living is taken into account, the real average salaries and wages per worker rose by only 1,5 per cent during the three quarters to March 1976. As shown in the accompanying table, the real wages of Non-White workers have increased substantially during the past number of years, notwithstanding the lower rate of increase in economic activity. In contrast, the real remuneration of White workers rose by only slightly

Percentage rate of change in salaries and wages per worker in the non-agricultural sectors

	Year ended 30 June				
	1972	1973	1974	1975	1976*
Whites:					
At current prices	7,6	7,3	11,8	15,8	10,3
At constant prices	1,2	-0,8	1,9	1,7	-1,6
Non-Whites:					
At current prices	10,9	12,0	18,2	26,9	19,5
At constant prices	4,3	3,5	7,7	11,4	6,6
All races:					
At current prices	8,5	7,6	12,6	19,9	13,8
At constant prices	2,1	-0,6	2,6	5,3	1,5

* Figures up to 31 March 1976 compared with figures for the corresponding period of the preceding year.

more than 2 per cent over the past five years taken together. If the higher direct tax payments are also taken into account, the real disposable income of Whites declined noticeably during this period.

Prices

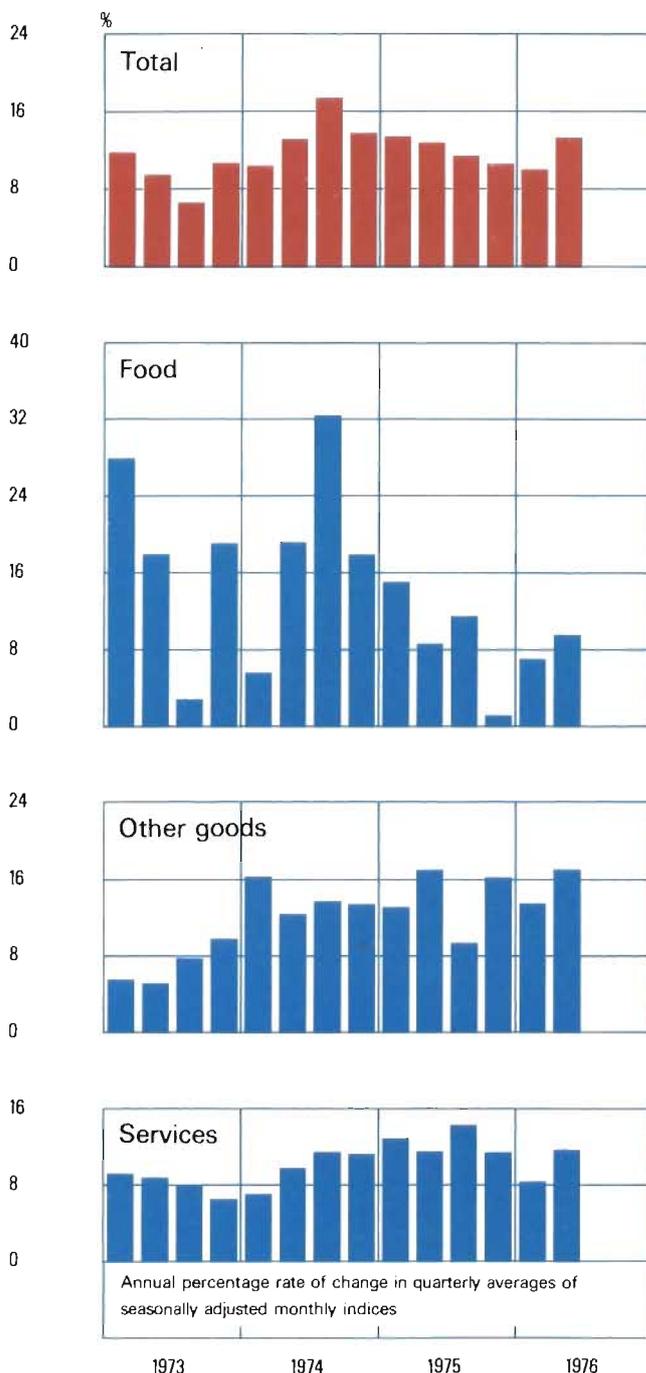
The declining tendency in the rates of increase in both consumer and wholesale prices from the fourth quarter of 1974 continued up to the first quarter of 1976 but accelerated again in the second quarter. The lower rate of increase was brought about by the deflationary impact of the current recession, the lower rates of inflation experienced by South Africa's main trading partners and the voluntary wage and price constraint agreed upon by both the public and private sectors in terms of the Anti-inflation Manifesto. The influence of these factors was partly neutralised, however, by the price-raising effects of the devaluation of the rand, unavoidable upward adjustments of administered prices, increases in indirect taxes, and further substantial increases in salaries and wages.

The average seasonally adjusted consumer price index was 11,9 per cent higher during the year that ended on 30 June 1976 than during the preceding year, compared with an increase of 13,9 per cent during 1974/75. From June 1975 to June 1976, consumer prices rose by 11,1 per cent, compared with an increase of 14,1 per cent during the preceding year. The latter decline in the rate of increase was primarily attributable to lower rates of increase in prices of food, furniture, flat rent and communication costs. The favourable influence of these factors were partly neutralised, however, by a more rapid rise in prices of vehicles and services such as servants' wages, home-owners' and transportation costs.

After reaching a peak in the third quarter of 1974, the rate of increase in the seasonally adjusted consumer price index declined continuously up to the first quarter of 1976. From an annual rate of increase of 17,5 per cent in the third quarter of 1974 the rate declined to 11,4 per cent in the third quarter of 1975 and then, notwithstanding the price-raising effect of the devaluation of the rand in September 1975, declined further to 10,6 per cent in the fourth quarter of 1975 and to 10,1 per cent in the first quarter of 1976. As a result of marked upward adjustments of administered prices such as rail tariffs, electricity rates, prices of maize and maize products, milk, vegetable oils and products thereof, cement and steel, and increases in indirect taxes announced in the Budget, the rate of increase in consumer prices accelerated to an annual rate of 13,3 per cent in the second quarter of 1976.

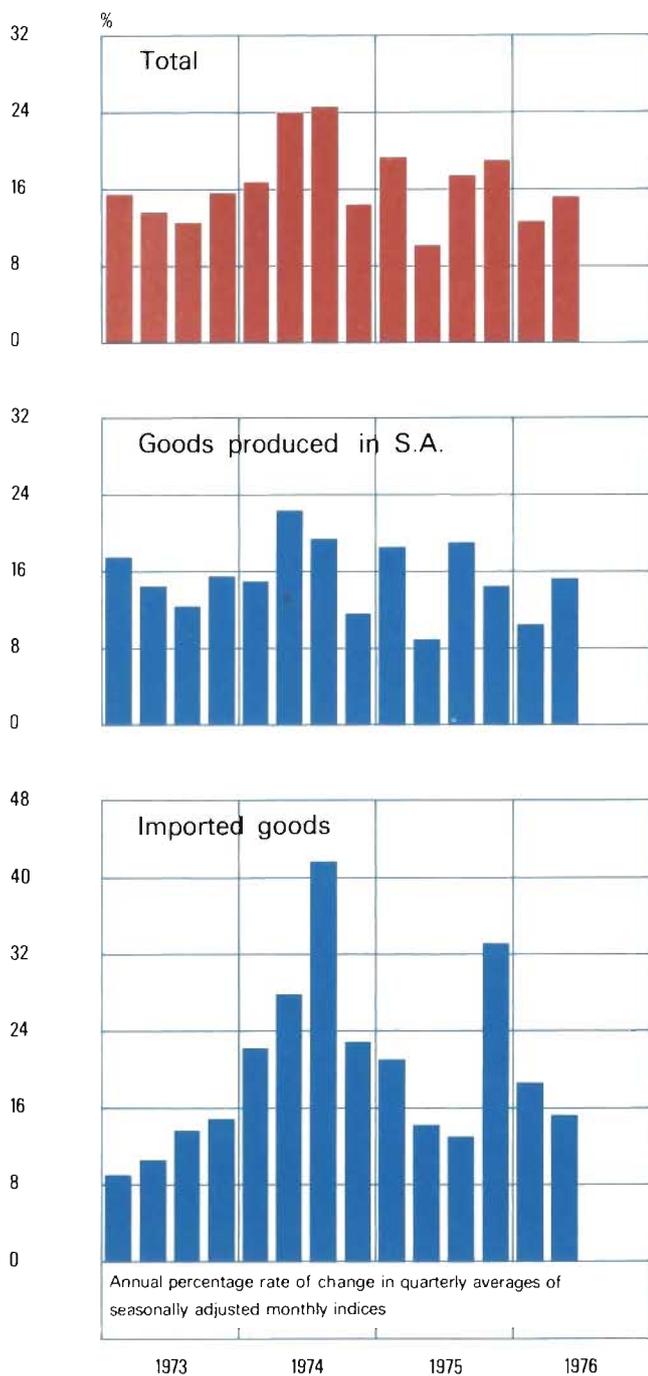
The average seasonally adjusted wholesale price index was 15,7 per cent higher in 1975/76 than in the preceding year, compared with an increase of 19,4 per cent in 1974/75. From June 1975 to June 1976 the index rose by 16,2 per cent, compared with an increase of 15,5 per cent during the preceding

Consumer prices



twelve months. Important changes occurred in the rate of increase during the course of the past two years. Although the rate of increase in wholesale prices fluctuated from quarter to quarter, a general downward tendency was noticeable from the peak reached in the third quarter of 1974. In the latter quarter, the seasonally adjusted annual rate of increase was 24,6 per cent, compared with 12,7 per cent in the first quarter of 1976, and a rate of 15,3 per cent in the second quarter of 1976.

Wholesale prices



prices accelerated to an annual rate of 15,3 per cent following the increases in prices of domestically produced beverages, tobacco, basic metals and metal products. Mainly owing to the price-raising effect of the devaluation of the rand in September 1975, the seasonally adjusted annual rate of increase of prices of imported goods rose to 33,2 per cent in the fourth quarter of 1975, but slowed down to 18,8 and 15,3 per cent in the subsequent two quarters, respectively.

The rates of increase in wholesale prices of both domestically produced and imported goods showed similar tendencies to those of the index for all goods. After amounting to 19,1 per cent in the third quarter of 1975, the annual rate of increase in prices of goods produced in South Africa decreased to 14,5 per cent in the fourth quarter of 1975 and to 10,4 per cent in the first quarter of 1976. During the second quarter, however, the rate of increase in

Balance of payments

During 1975/76 the balance of payments was characterised by a substantial deficit on current account, which exceeded the large inflow of foreign capital and consequently resulted in a sharp decline in the gold and other foreign reserves owing to transactions with the rest of the world. The large deficit on current account was caused by a number of developments such as the decline in the gold price and a further marked deterioration in the terms of trade in general, the continued high level of gross domestic expenditure, including a large increase in the book value of inventories, the relatively slow economic revival in the rest of the world after the most severe recession since the nineteen-thirties with the resultant adverse effects on South Africa's exports, a sharp increase in the value of imports of oil and defence equipment, and a further small decline in the volume of gold production.

The net inflow of capital during the year under review consisted largely of loan capital obtained abroad by public authorities and, particularly, by public corporations to finance infra-structural investment, but also included substantial amounts of short-term borrowing of a compensatory nature by the Reserve Bank. In addition, there was a further substantial inflow of long-term funds to the rest of the private sector. Sharp fluctuations also occurred from time to time in short-term private capital movements which, together with the continued large deficit on current account, placed a considerable strain on the gold and other foreign reserves. To sustain the level of the gold and other foreign reserves and to improve the balance of payments situation in general, various policy measures were taken.

Further large deficit on current account

From the accompanying graph it is clear that in the past the balance on the current account has shown a distinct cyclical pattern. Apart from the fact that almost all economic variables are subject to domestic cyclical fluctuations, the balance on current account is to a large extent also influenced by cyclical fluctuations in the rest of the world. Statistics show that business cycles in South Africa normally lag behind those in the United States and Western Europe. It often happens that at a time when the South African economy is still in a downward phase of the business cycle, the United States and Western Europe are already in an upward phase. As the rate of increase in economic activity gains momentum in those countries, their demand for South Africa's imports decline because of the lower level of domestic demand, with the result that the balance on current account usually shows an improvement from the beginning of the downward phase of the business cycle and, later in the downswing, a more pronounced improvement when exports also start to rise.

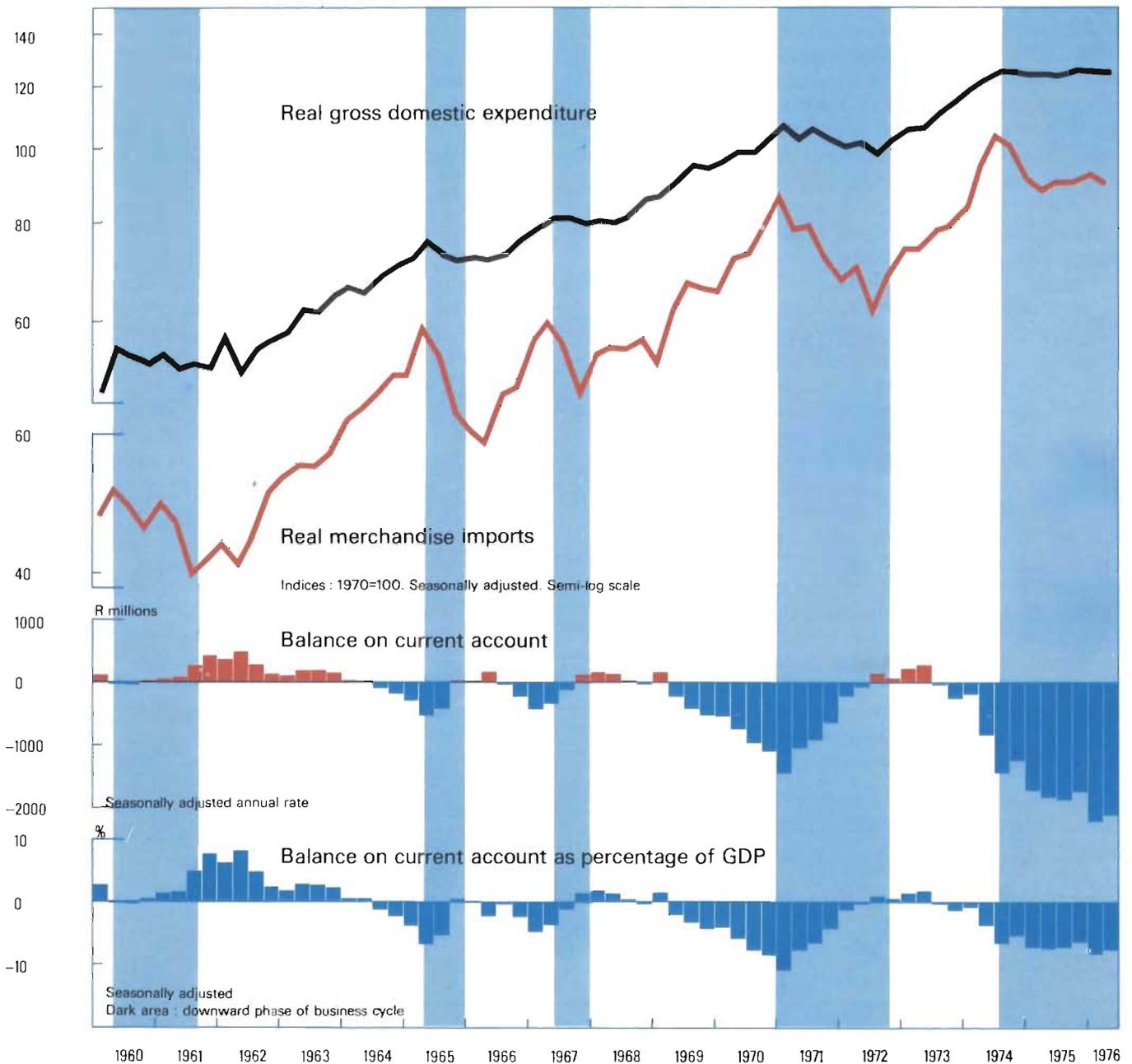
Subsequently, the process is normally reversed. In the upward phase of the business cycle in South Africa, imports of goods and services usually increase

sharply mainly as a result of the dependence of the economy on foreign capital and intermediary goods. In the later stages of the upswing, when imports are still increasing sharply, exports begin to decline as most of our trading-partner countries have then already passed the upper-turning point of their business cycle and their imports are declining. Consequently, in the stages immediately before and after the upper-turning point of the business cycle, there is usually a substantial deficit on the current account of the balance of payments. As the rate of real economic growth subsequently declines, the rate of increase in expenditure on consumption and fixed investment declines, inventory investment may even be negative and imports will, therefore, decline noticeably. At this stage, exports usually start to rise because of increased economic activity abroad, with the result that the deficit is reduced considerably and may even be converted into a temporary surplus.

Because of the abnormal length and intensity of the recent recession in the main industrialised countries, and for other reasons which can readily be identified, the normal cyclical improvement in the deficit on the current account during the current South African downswing has understandably been delayed. Notwithstanding the fact that the South African economy has now been in a downward phase of the business cycle for about two years, the deficit on current account increased further from R1 592 million in 1974/75 to R1 953 million in 1975/76. As a percentage of the gross domestic product, the deficit on current account also increased slightly from about 6,6 per cent to 7,2 per cent over the same period. Although the quarterly deficit on current account fluctuated sharply during the past two years, it remained at a relatively high level. However, as a percentage of the gross domestic product, the deficit on current account during the past two years was still below the ratios recorded in the downswing of 1971–1972.

One of the causes of the substantial further increase in the deficit on current account during 1975/76 was the continued deterioration of South Africa's terms of trade. The long and severe recession experienced by the Western World during the period 1973 to 1975 eventually led to a decline in the volume of international trade and a fall in international commodity prices. Furthermore, the dollar price of gold started to decline sharply from the beginning of 1975. Although the devaluation of the rand in terms of the US dollar in June and September 1975 increased the rand proceeds of exports to such an extent during the year under review that the effects of the decline in the prices of commodities and gold denominated in foreign currencies were approximately neutralised, it also had an immediate and large adverse effect on import prices which, together with a further moderate rise in inflation rates abroad, contributed to a more rapid increase in import prices than in export prices.

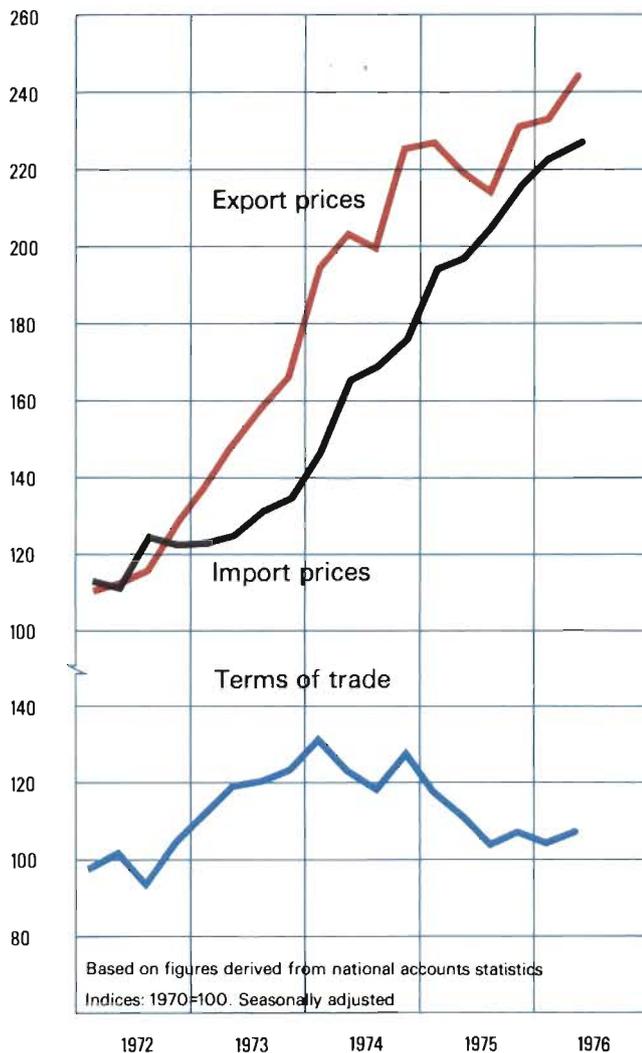
Gross domestic expenditure, merchandise imports and balance on current account



Apart from the deterioration of the terms of trade, the continued high level of real gross domestic expenditure also contributed to the large deficit on current account during 1975/76. Increased government expenditure, particularly on defence equipment, stockpiling of strategic materials, high initial outlays on television sets and further outlays on large capital projects of public authorities and public corporations, resulted in a level of real imports well above that which could otherwise have been expected

in the second year of the downward phase of the business cycle. Furthermore, towards the end of 1975 and early in 1976, expectations regarding possible changes in the exchange rate and fear of a tightening of import control also contributed to a higher level of real imports. A further decline also occurred in the physical volume of gold production and in the receipts from foreigners for non-factor services at constant prices. These adverse effects outweighed an increase in the demand for diamonds on the world

Terms of trade



market and an increase in the volume of agricultural products exported. The deterioration of the deficit on current account during the past year, therefore, was the net result of a sharp increase in the value of merchandise imports and net invisible payments to the rest of the world and a slight decline in the net gold output, which more than neutralised a substantial increase in the value of merchandise exports.

Further rise in the value of merchandise imports

After increasing at rates exceeding 40 per cent in each of the two preceding years, merchandise imports in value terms rose by a further 14,6 per cent to R7 344 million in 1975/76. This was due entirely to price increases resulting from the depreciation of the rand and a further moderate rise in the domestic

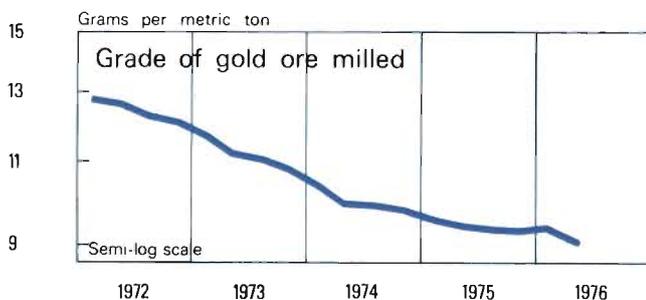
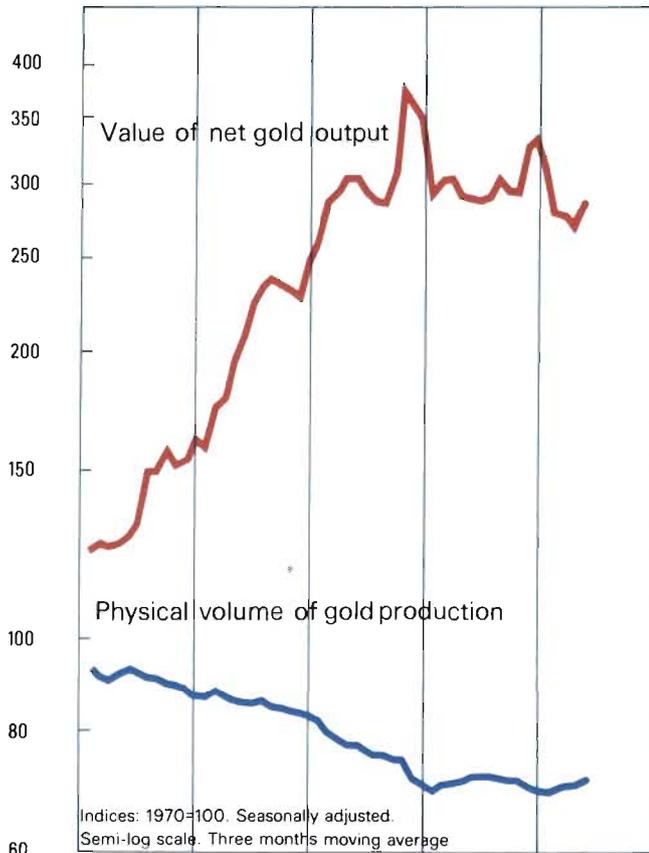
prices of South Africa's main trading partners during the year. The volume of total imports actually declined by about 5,0 per cent. A classification of imports according to main commodity groups shows that large increases were recorded during 1975/76 in the value of imports of machinery and electrical equipment, transport equipment, mineral products and defence equipment, whereas the value of imports of base metals, paper and paper products and chemicals declined significantly.

Contrary to what could have been expected at that stage of the business cycle, the value of imports remained at a relatively high level and even increased temporarily again during the second half of 1975. The accompanying graph shows that in the past a close relationship existed between real gross domestic expenditure and the volume of imports and that they usually declined together in the downward phase of the business cycle. However, such a decline did not occur during the present downward phase. Real gross domestic expenditure has thus far shown virtually no decline but has in fact maintained its high level. If real gross domestic expenditure had declined as in the past in the downward phase of the business cycle, the level of real imports would have been substantially lower, with a corresponding improvement in the current account of the balance of payments. The high level of real imports, and, consequently, the relative weakness of the current account at this stage must, therefore, be attributed primarily to the continued high level of real gross domestic expenditure. As mentioned earlier, the prime reasons for this development were the high rate of increase in real government consumption expenditure, particularly on defence equipment, stockpiling of strategic materials, the initial large outlay on television sets during 1975/76 and the continued high level of expenditure on large capital projects of public authorities and public corporations, all of which have a high import content. Real domestic expenditure was also boosted by the further sharp rise in the real earnings of the Non-white population, which proportionally contributed much more to consumption than to saving. In these circumstances, official measures were directed at lowering real gross domestic expenditure and, thereby, also at a more rapid decline in the volume of imports and an improvement in the current account of the balance of payments.

Small decline in the net gold output

In contrast to the years before 1971, the proceeds from gold sales has subsequently been less stable and this instability had a marked influence on the cyclical pattern of South Africa's balance of payments. In former years, when the price of gold remained at a relatively low but stable level, South Africa always depended on fairly stable foreign exchange earnings from the gold mining industry. When the gold price started to increase rapidly from the beginning of 1972, the

Net gold output



foreign exchange earning capacity of the country expanded substantially. This development enabled the country to increase its growth rate considerably, because the balance of payments took a longer time to become a restraining factor in the expansion of economic activity. The delayed cyclical increase in the deficit on current account during the upswing in 1973 and the first half of 1974 was mainly due to the sharp rise in the gold price at that time.

After the economy had reached its upper turning point in the third quarter of 1974, the price of gold started to decline from the beginning of 1975. This decline, together with a small decrease of 2,2 per cent in the volume of gold production caused by a further reduction of 4,2 per cent in the grade of

ore milled in the year under review, resulted in a moderate decline of 3,3 per cent, to R2 488 million, in the net gold output during 1975/76. In the current downswing of economic activity, the decline in the price of gold was, therefore, a principal contributing factor to the larger deficit on current account. Only a small decline occurred in the rand price of gold because the devaluation of the rand in September 1975 almost neutralised the drop of 16,7 per cent in the average dollar price of gold on the private market in 1975/76, compared with the price in the preceding year.

Increase in net invisible payments to the rest of the world

A further sharp increase in net invisible payments to the rest of the world also contributed to a deterioration of the deficit on current account during 1975/76. After increasing substantially during the three preceding years, net invisible payments to the rest of the world showed a further increase of about 15 per cent to an amount of R1 198 million in 1975/76. This increase occurred notwithstanding a considerably lower rate of increase in total service payments to foreigners. The latter decline in the rate of increase of service payments occurred despite a substantial increase in interest payments owing to increased foreign borrowing. The decline in the rate of increase was largely attributable to a decrease in the payments to foreigners for international freight and insurance on goods and other transportation costs, and a levelling-off in dividend payments on foreign investment as a consequence of the business cycle downswing. The decline in international freight and insurance payments, in turn, was entirely attributable to a decline in the volume of imports as international freight rates were increased further during the year under review.

Service receipts from foreigners remained at approximately the same level during 1975/76 as in the preceding year and net transfer receipts actually declined slightly. Lower dividend yields on investments in other countries and the re-opening of the Suez Canal in July 1975 were largely responsible for the small change in service receipts.

Further substantial rise in the value of merchandise exports

The value of merchandise exports increased from R3 279 million in 1974/75 to R4 101 million in 1975/76, or by about 25 per cent. Both volume and price increases contributed to the higher value of exports. The larger volume of exports was attributable to good agricultural crops, with a correspondingly larger volume of agricultural products exported, and a substantial increase in the demand for diamonds. The devaluation of the rand made an important contribution to the increase in export

prices in rand, particularly during the first half of the year under review. During that period, the index of the dollar prices of all commodities traded on international markets remained at a relatively low level, whereas the corresponding rand price index showed a sharply increasing trend. In the earlier part of 1976, most countries discontinued the deliberate reduction of inventory levels and in a few countries the rebuilding of inventories commenced. This resulted in a sharp increase in the prices of most commodities traded on international markets. At present the United States, Germany and, to a lesser extent, also Canada, are in the process of building up inventories. In most of the other industrialised countries, however, the level of inventories is currently considered to be relatively high, whereas inventory levels in Japan have recently declined markedly owing to a sharp increase in final demand. The prospects for further increases in international commodity prices, therefore, appear to be favourable because it is expected that the economic revival in the industrialised countries will gain momentum and lead to increased production and imports of raw materials and, consequently, also to rises in commodity prices.

A classification of exports according to main commodity groups indicates that the increase in the value of merchandise exports during 1975/76 was largely accounted for by increases in the exports of precious and semi-precious stones, mineral products, textiles, and base metals, whereas a sharp decline was recorded in the exports of prepared food. More in particular, the further rise in exports was attributable to a sharp increase in the demand for diamonds, a strong rise in the price of wool from about the middle of 1975 coupled with a substantial increase in the volume of wool exported, a higher average level of export prices for platinum and, from the beginning of 1976, a sharp increase in the price of copper. A further relatively good maize crop also ensured that the high level of the volume of maize exports registered during 1974/75, could be maintained during 1975/76. The decline in the value of exports of prepared foodstuffs during the year under review was mainly due to a noticeable decline in the price of sugar from the record levels attained at the end of 1974.

Further large net inflow of capital

During 1975/76 a large net inflow of foreign capital of R1 619 million was recorded. This brought the total net inflow over the past two years to about R3 200 million. In 1975/76 the inflow of capital was nearly equally divided between the private sector and the central government and banking sector and consisted largely of loan capital obtained abroad. Foreign net long-term loans of public corporations amounted to R804 million and were used mainly to finance infra-structural investment. Public authorities borrowed R322 million in the form of

long-term capital. If public corporations are excluded from the private sector, other private organisations and persons nevertheless obtained R278 million net long-term capital from abroad. However, the short-term capital of the private sector, including errors and unrecorded transactions, changed from a net inflow of R507 million in 1974/75 to an outflow of R326 million in 1975/76. Expectations regarding possible movements in the exchange rate of the rand contributed to wide fluctuations in private short-term capital movements in the review period. These movements at times placed a strain on the gold and other foreign reserves and led to compensatory short-term borrowing by the Reserve Bank and also contributed to the need for a more conservative monetary and fiscal policy pursued during 1975/76.

Net foreign capital movements

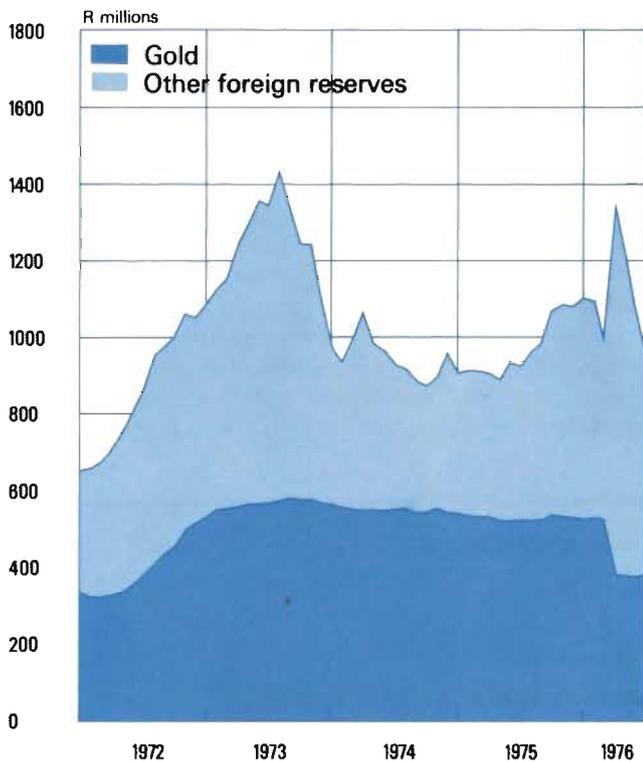
	Year ended 30 June	
	1975	1976
Private sector	1 194	756
Foreign long-term loans of public corporations	482	804
Net purchases by foreigners of shares quoted on the Johannesburg Stock Exchange	-28	-51
Other long-term capital	233	329
Short-term capital including errors and unrecorded transactions	507	-326
Central government and banking sector	386	863
Foreign long-term loans of the central government	261	322
Other long-term capital	-10	-63
Short-term capital	135	604
Total net inflow	1 580	1 619

Decline in gold and other foreign reserves

As a result of the large deficit on current account and the substantially smaller net inflow of capital, the gross gold and other foreign reserves declined by R334 million during 1975/76. However, if valuation adjustments and the effect of the gold swap agreements are taken into account, the gross gold and other foreign reserves increased by R24 million during the year under review to a level of R951 million at the end of June. During the first nine months of 1975/76, the gross gold and other foreign reserves increased, but then declined by R395 million in the second quarter of 1976. Apart from temporary increases, the net gold and other foreign reserves declined during the year under review.

The gold swap agreements and the drawing of South Africa's gold tranche with the International Monetary Fund had a profound effect on the composition of South Africa's gold and other foreign reserves. In terms of the gold swap agreements, South Africa sold gold at spot and repurchased it forward,

Gold and other foreign reserves



with the result that the gold reserves dropped and the foreign exchange holdings of the Reserve Bank increased during 1975/76. The drawing of South Africa's gold tranche with the International Monetary Fund caused a sharp decline in the foreign reserves of the central government, whereas the gold and other foreign reserves of the rest of the monetary banking sector showed little change during the period under review.

Balance of payments and economic policy

During the past year, balance of payments developments had an important influence on economic policy in general. The large deficit on current account together with leads and lags in foreign payments and receipts, at times caused sharp decreases in the gold and other foreign reserves. Various measures were, from time to time, introduced to improve the overall balance of payments position and, more in particular, to prevent short-term capital outflows. On 27 June 1975 the authorities changed their policy of independent managed floating because the strengthening of the dollar and the weakening of sterling encouraged unfavourable leads and lags in foreign payments and receipts. From then on changes would only be made in the exchange rate of the rand if they were considered essential in view of basic changes in the domestic or international

economic situation. At the same time, the fixed rand-dollar rate was depreciated by 4,76 per cent to allow for the expected effective appreciation of the rand as a result of a further appreciation of the dollar and a weakening of sterling.

Subsequently, the rand appreciated markedly with the US dollar, and this led to expectations that the value of the rand would be depreciated again and, therefore, also to speculative capital outflows. In these circumstances, the Minister announced on 11 August 1975 that various changes would be made to the exchange control regulations, namely:

- (1) more sympathetic consideration would be given to foreign borrowing by local entrepreneurs provided that this would be for periods longer than six months and not intended for property development, speculation or consumer credit;
- (2) authorised dealers in foreign exchange would be allowed to raise funds abroad in their own names for the financing of South African foreign trade and for other approved purposes;
- (3) local borrowing by foreign-controlled South African organisations would be further restricted by including in the definition of local borrowing certain leasing, factoring and hire-purchase facilities and lease back arrangements; and
- (4) blocked rand would be made directly transferable between non-residents.

In addition, forward exchange cover would be extended for longer periods and would also be granted to authorised dealers for foreign loans in their own name provided that these loans were approved by the authorities. The Reserve Bank also announced on the same date that a more conservative monetary policy would be pursued to discourage banks from extending local bank credit for the switching from foreign to domestic financing of international trade. Bank rate was increased from 8 to 8½ per cent and the minimum liquid asset requirements were adjusted upwards for the first time since 1973.

From the end of August 1975, however, a further sharp decline in the gold price again caused substantial short-term capital outflows, and in view of the overall change in economic circumstances, the government decided to devalue the rand by 17,9 per cent in terms of the US dollar, with effect from 22 September 1975. The liquid asset requirements were also increased further to prevent an undue expansion of bank credit to the private sector. These measures proved to be successful and contributed to the change from an outflow of R115 million of short-term capital in the third quarter of 1975 to an inflow of R108 million in the fourth quarter. In the last week of December 1975 abnormally high net purchases of foreign exchange indicated the reappearance of unfavourable leads and lags in the foreign payments and receipts at a time when the deficit on the current account of the balance of payments was still very high. In view of these develop-

ments and the relatively high rate of inflation that still prevailed in South Africa at the time, the authorities on 17 February 1976 decided to impose quantitative restrictions on bank credit to the private sector. This decision was taken after it had become evident that a clear link had existed between the excessive increase in bank credit to the private sector and the high level of net purchases of foreign exchange from the Reserve Bank during the period preceding the announcement.

The high priority assigned to the improvement of the balance of payments was a major reason for curtailing the rate of increase in government expenditure and imposing higher taxes and a loan levy in the March 1976 Budget. In the same month a further change was introduced to the exchange control regulations to shorten the period during which export proceeds must be repatriated to South Africa from 30 days to 7 days. It was also reiterated that prepayments on imports could only be made with the prior approval of the exchange control authorities.

For reasons discussed elsewhere in this Report, including the fact that the government's financial operations during the second quarter of 1976 were still very expansionary and did not yet reflect the influence of the new Budget, the current account deficit remained unduly high and the net inflow of capital declined during the second quarter of 1976. This resulted in a considerable decline in the gold and other foreign reserves. Because the authorities expected the corrective influence of the Budget to become effective only from the third quarter of 1976 onwards they realised that the gold and other foreign reserves would still remain under pressure for some months after the introduction of the Budget, owing *inter alia* to the repayment of official foreign loans during the second quarter of 1976. Consequently, they decided to introduce an additional measure to accelerate the improvement of the balance of payments and on 21 July 1976 announced that a temporary import deposit scheme would come into effect on 2 August. The Reserve Bank also increased the Bank rate from 8½ to 9 per cent from 21 July 1976. In terms of the provisions of the import deposit scheme, a deposit of 20 per cent of the free-on-board value of all goods imported into South Africa, except for certain exempted categories, must be made with the Controller of Customs and Excise. The exempted categories include mineral oil products, government stores, essential capital goods with a value of more than R10 000 for development projects, goods imported for re-export in their original form, and goods of which the value does not exceed R100. No interest will be paid on the deposits, and they will be refunded to the importer by the Reserve Bank after a period of six months. To assist importers in the financing of the required import deposit, the Reserve Bank in early August 1976 decided that banks could approve the

raising of overseas loans for this purpose without prior reference to the Reserve Bank subject to certain conditions.

Monetary and banking situation

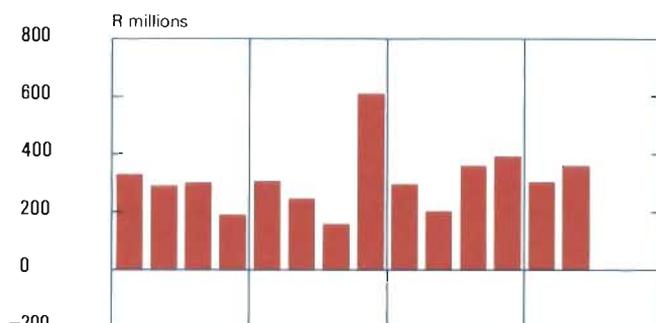
During a large part of the year that ended on 30 June 1976, the causes of changes in private sector liquidity did not correspond to the causes normally expected during an advanced stage of the business cycle downswing such as that experienced during the year. The net gold and other foreign reserves of the banking sector, for example, showed another very large decrease, which was accompanied by further relatively substantial increases in bank credit to the private sector and large increases in net claims of the banking sector on the government sector. These developments were interrelated in various ways. The continuing drain on the net foreign reserves, for example, undoubtedly contributed to the government's difficulty in raising sufficient amounts of funds from non-banking sources, while the substantial increase in government spending and the way in which it was financed had considerable primary and secondary expansionary effects on total spending and imports and thus accounted for a large part of the continuing large deficits on the balance of payments on current account. At the same time, increases in the government's net indebtedness to the banking system caused the banks' holdings of liquid assets to be maintained at higher levels than would otherwise have prevailed. Relatively high levels of **excess** bank liquidity during the first few months after June 1975, in turn, encouraged resort to local sources of credit for financing imports and, at times, facilitated shifts in the leads and lags in international payments and receipts.

Notable features of the money and banking situation during the year under review included a change towards decisively restrictive monetary policy measures, marked shifts in excess bank liquidity from a relatively high level in July 1975 to very low levels during most of the first half of 1976, a sharp rise in interest rates from August 1975 to approximately March 1976, a continued high level of bank credit extension to the government sector, a sharp decline in the rate of extension of bank credit to the private sector from the first to the second half of the year under review, and a fairly pronounced deceleration in the rate of growth of private sector liquidity, as measured by changes in the money and near-money supply, between these two periods.

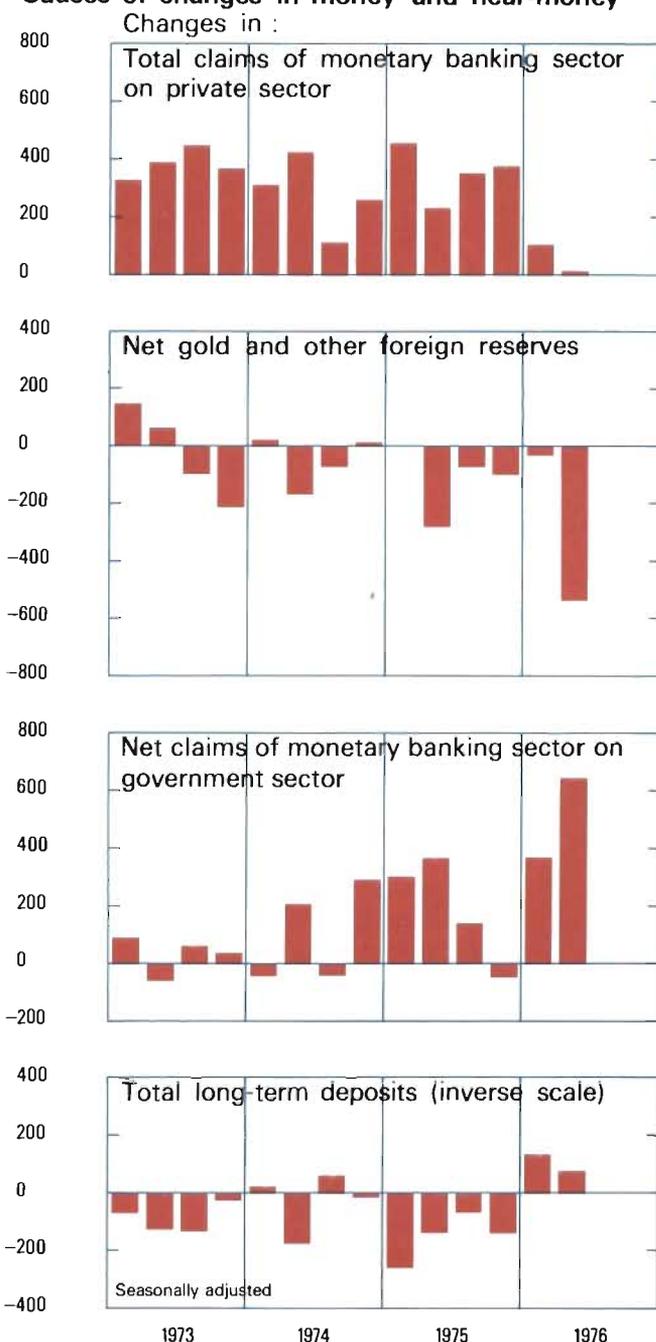
Money and near-money

The money and near-money supply increased by approximately 18 per cent during 1975/76, compared with increases of 24 and 19 per cent during 1972/73 and 1973/74, respectively, the two years of economic upswing, and 20 per cent during the downswing year 1974/75. Although still at a relatively high level for the year as a whole, the rate of increase in money and near-money was markedly lower during the second half of the year under review (16 per cent at a seasonally adjusted annual rate) than during the first half (21 per cent). It is noteworthy that a very large divergence occurred between the growth rates of money and near-money

Changes in money and near-money



Causes of changes in money and near-money



Causes of changes in money and near-money, 1975/76

R millions

	Not seasonally adjusted					Seasonally adjusted					
	Year 1974/ 1975	1975 Third Quarter	1975 Fourth Quarter	1976 First Quarter	1976 Second Quarter	Year 1975/ 1976	1975 Third Quarter	1975 Fourth Quarter	1976 First Quarter	1976 Second Quarter	Year 1975/ 1976
Net gold and other foreign reserves . . .	-349	-111	-109	-68	-464	-752	-75	-103	-37	-541	-756
Claims on the government sector:											
Gross claims	901	178	373	244	236	1 031	...	...	...	...	...
Government deposits (increase —, decrease +)	1	-123	-143	-248	579	65	...	...	...	...	...
Net claims	902	55	230	-4	815	1 096	135	-53	368	638	1 088
Claims on the private sector	1 061	396	305	191	-38	854	355	376	106	13	850
Long-term private deposits (increase —, decrease +)	-379	-24	-119	154	-28	-17	-70	-142	128	74	-10
Net other assets	46	48	143	-121	184	254	...	...	...	...	...
Total causes of changes	1 281	364	450	152	469	1 435	360	395	305	361	1 421

and of the narrowly defined money supply, respectively. The latter increased by 7 per cent during the year and actually declined during the fourth quarter of 1975 and the first quarter of 1976. The ratio of the quarterly average money and near-money supply to the gross domestic product, both seasonally adjusted, rose from 29,7 per cent in the second quarter of 1975 to 32,3 per cent in the second quarter of 1976.

Causes of changes in money and near-money

As during 1973/74 and 1974/75, the increase in the money and near-money supply during 1975/76 was mainly the result of a large increase in domestic bank credit to the government and private sectors, which was only partly offset by large declines in the net gold and other foreign reserves and some increase in long-term deposits of the private sector. However, the decline in the net gold and other foreign reserves was very much larger than during any of the preceding years and amounted to R752 million during 1975/76. The accelerating decrease in the foreign reserves was, in fact, the main single development accounting for the slightly lower rate of growth of the money and near-money supply during 1975/76 than during 1974/75 and also contributed greatly to the further slowdown in the rate of monetary expansion from the second half of 1975 to the first half of 1976.

Domestic bank credit, consisting of the monetary banks' claims on the private sector and their net claims on the government sector, increased by R1 950 million, or by 20 per cent, during 1975/76. The sharply accelerated rate of increase in the extension of net bank credit to the government sector during the first half of 1976 more than compensated for the marked decline in the rate of bank lending to the private sector during this period.

Despite obvious incentives for the banks to attract longer-term deposits from the public (in view of the relatively low liquidity requirements against their long-term liabilities), private sector long-term deposits with the banking sector increased by only R17 million during 1975/76 and actually decreased substantially during the first quarter of 1976.

Bank credit to the private sector

Total claims of the monetary banking sector on the private sector increased by R854 million or 11 per cent during 1975/76. Although this rate was not markedly lower than the rate recorded during 1974/75, a marked deceleration occurred during the course of the year under review. Indeed, after having accelerated from less than 14 per cent during the first half of calendar year 1975 to somewhat over 20 per cent during the second half, the seasonally adjusted annual rate of increase in bank lending to the private sector dropped sharply to less than 3 per cent during the first half of 1976.

Several factors accounted for the behaviour of bank credit during the course of the year under review. Firstly, the banks still held substantial amounts of excess liquid assets during the first part of this period, but by January 1976 most of this excess liquidity had been absorbed by the increased liquidity requirements or by the increase in credit extended. From the middle of February the imposition of credit ceilings also forced down the level of credit expansion. Secondly, borrowing from the banks was initially stimulated by special factors such as: (1) shifts in the leads and lags in international payments and receipts, notably during September and December 1975 and January 1976; (2) relatively low interest rates at the beginning of the year under review, which encouraged resort to local sources of finance; and (3) the high level of sales of television sets,

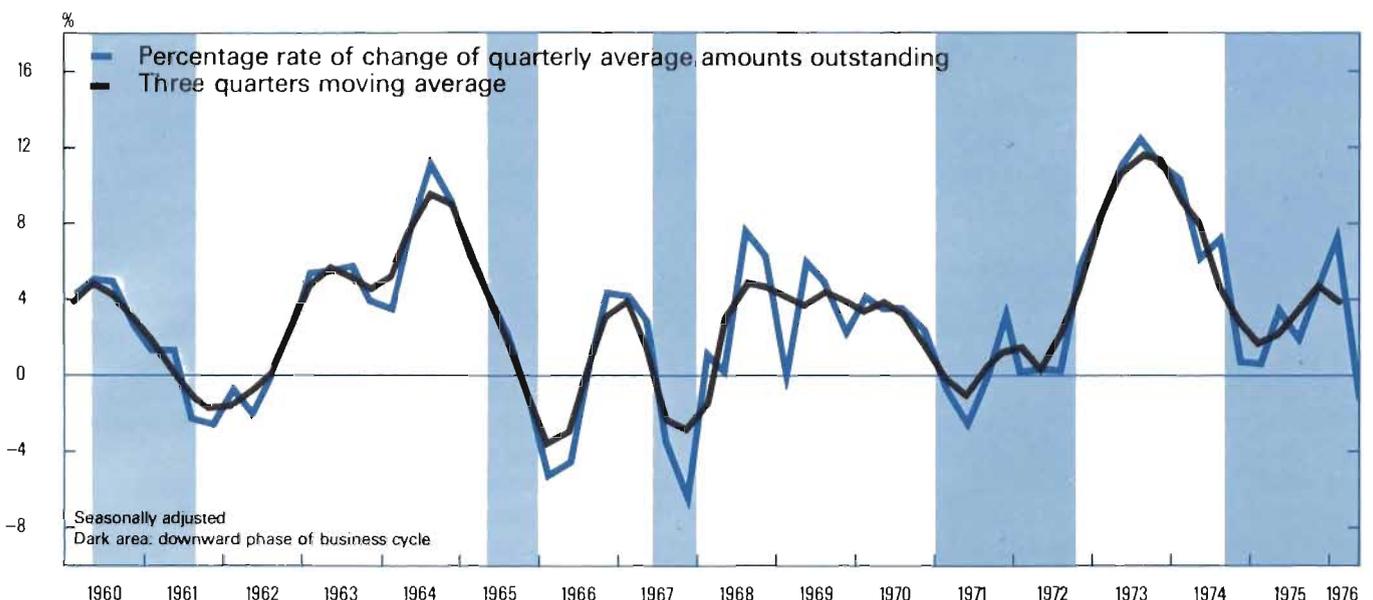
accounting for a major part of the marked rise in hire-purchase and leasing finance extended by the banks. The slackening in the demand for bank credit from approximately March 1976 may be attributed, among other things, to the deepening of the recessionary tendencies in the economy in recent months.

As regards various types of credit, leasing finance and hire-purchase credit extended by the commercial banks, merchant banks and monetary hire-purchase and general banks increased by as much as 48 and 28 per cent, respectively, during 1975/76 as a whole. However, both types of lending slowed down appreciably in the first half of 1976, after a rapid increase during the second half of 1975. Trade bills and bankers' acceptances held by the banking sector rose moderately during the second half of 1975 but declined in the first half of 1976, showing a decrease during the review year as a whole. The discounts and advances of the commercial banks (excluding advances to the Land Bank), decreased at a seasonally adjusted annual rate of over 10 per cent after the end of February 1976, after having increased at a rate of 27 per cent during the first eight months of the year under review. This decline from February 1976 was caused by the low bank liquidity, the credit ceilings and reduced demand for bank credit.

Cyclical behaviour of bank credit to the private sector

As shown by the accompanying graph, changes in the rate of increase in commercial bank discounts and advances are closely associated with the business cycle. While peak rates of increase in bank credit are reached in the course of the upswing phases of the business cycle, troughs in the rate of increase in bank lending occur during or shortly after the downswing phases. It is clear from this graph that the fairly pronounced renewed acceleration in the rate of increase of commercial bank lending in the second half of 1975 and early 1976 represents a deviation from the normal cyclical pattern. This temporary increase in the rate of expansion of commercial bank credit during the downswing phase of the business cycle was attributable mainly to: (1) high excess liquidity of the banks towards the middle of 1975 caused by a substantial increase in bank credit to the government sector during the immediately preceding three quarters; and (2) leads and lags in international payments and receipts, which contributed to increased demand for bank credit in the third and fourth quarters of 1975 and in January 1976.

Commercial bank discounts and advances (excluding advances to the Land Bank)

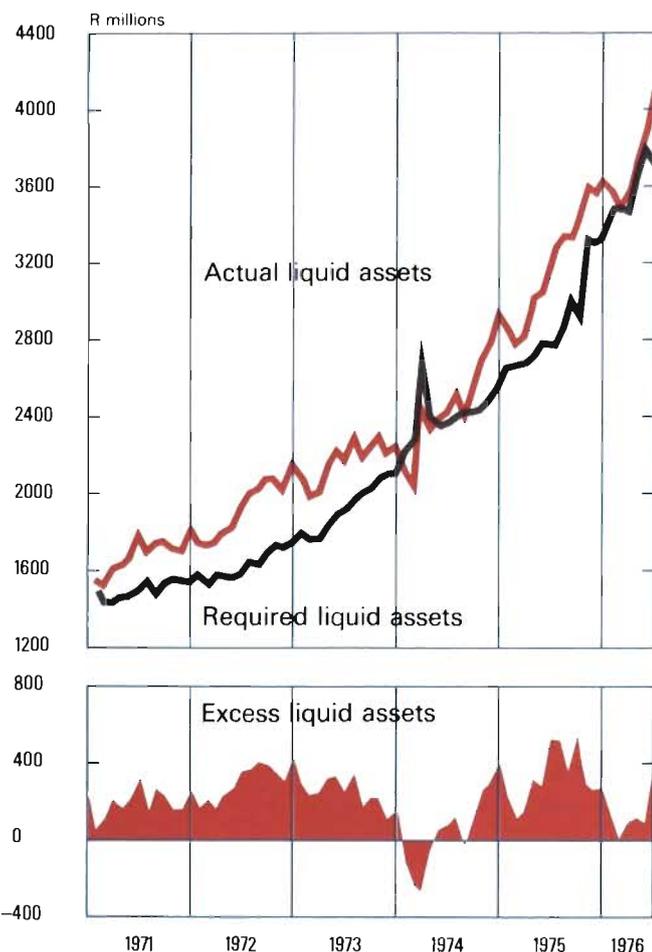


Marked swings in excess liquidity of banking institutions

Excess liquidity of banking institutions, which was high at the end of June 1975 at a level of 7,1 per cent of liabilities to the public for the commercial banks and 4,9 per cent for all banks, was reduced markedly to about half these levels at the end of 1975. During the first few months of 1976, normal seasonal flows of funds to the government and large declines in the net foreign reserves reduced excess liquidity even further to only 0,1 per cent for all banks at the end of February. After having remained tight during the ensuing three months, excess liquidity of the commercial banks rose again in June 1976. The average excess liquidity ratio for all banks during the year amounted to 2,3 per cent, against 2,4 per cent during 1974/75.

The main reason for the marked tightening of the banks' excess liquidity position from the first to most of the second half of the review year was the substantial increases in the banks' liquid asset requirements in August, October and November 1975.

Liquid asset position of banking institutions



Excess liquidity ratios of banking institutions

	1975			1976	
	June	Sept.	Dec.	March	June
Commercial banks	7,1	6,4	3,3	1,8	5,1
Other monetary banks	0,9	1,9	1,2	-1,2	0,3
Non-monetary banks	2,4	2,7	0,7	0,4	-0,1
All banks	4,9	4,8	2,5	0,8	3,4

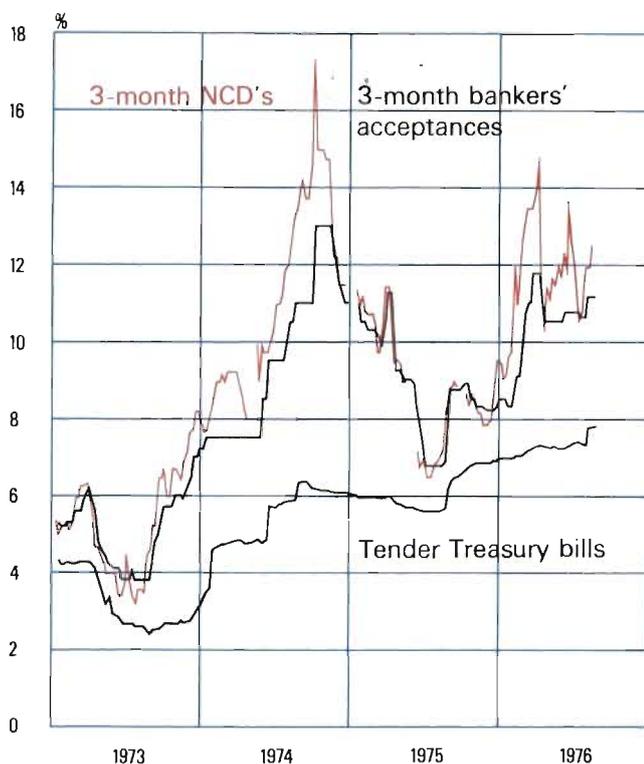
Largely as a result of these increases, the minimum amount of liquid assets to be held by all banks increased by 34 per cent from June 1975 to June 1976. The banks' total liabilities to the public, in contrast, rose by only 13 per cent from June 1975 to June 1976. (The effect of the higher requirements was, however, very slightly offset by a relative shift in the term structure of the banks' liabilities towards medium-term unexpired maturities.) The banks' **actual** liquid asset holdings increased by approximately 18 per cent (R833 million) during the year. This increase occurred in spite of the large decrease in the net gold and other foreign reserves and largely reflected the government sector's resort to net borrowing from the banking system. In June 1976 alone, the government's net borrowing from the banks (including an increase in the net claims of the Reserve Bank and the National Finance Corporation on the government sector of approximately R200 million), caused the banks' liquid asset holdings to rise by over R250 million.

Money market conditions and interest rates

In contrast to the easy conditions experienced during most of the year 1974/75, a tight money market situation prevailed during most of the year under review. Initially, owing mainly to the increase in the net claims on the government sector, supported by an increase in the net gold and other foreign reserves during the fourth quarter of 1975, money market conditions were relatively easy. However, mainly as a result of the continuing sharp decline in the net gold and other foreign reserves, conditions tightened considerably from the end of the fourth quarter of 1975. This was especially the case over the January and February 1976 month-ends when the net claims on the government sector declined rather sharply, resulting in large-scale resort to the Reserve Bank.

Call loans with the discount houses, after having increased steadily during most of the second half of 1975, declined sharply during January and February 1976, but subsequently increased to an all-time high of R842 million on 26 May 1976. On a number of occasions during the period after the end of February the discount houses were prevented by the capital

Money market interest rates



constraint of the Banks Act from accepting additional deposits. At such times the banks substantially increased their call loans, in excess of requirements, with the National Finance Corporation. Although such a situation is normally indicative of easy money market conditions, it reflected instead a rather strong demand for liquid assets by the banks in the face of the high liquid asset requirements.

Money market interest rates, which had increased sharply after the increase in Bank rate on 11 August 1975, tended to move downwards during most of the fourth quarter of 1975, but subsequently increased markedly until the end of March 1976. Thereafter rates fluctuated around a high level. The 90-day NCD rate, for example, declined from 9,0 per cent on 5 September to 7,90 per cent on 21 November 1975 and then increased almost uninterruptedly to 14,75 per cent on 26 March 1976. After declining to 10,3 per cent on 9 April, the 90-day NCD rate increased to 13,5 per cent on 11 June, but subsequently declined somewhat and then increased again to 12 per cent on 23 July. As against the marked fluctuations in the rates on non-liquid money market instruments, the Treasury bill tender rate increased less dramatically during the year under review from 5,54 per cent on 11 July 1975 to 7,72 per cent immediately following the increase in Bank rate on 22 July 1976.

Interest rates on deposits with banking institutions were reduced at the beginning of July 1975 from the maxima as allowed by the interest rate control regulations (long-term deposits by 0,5 per cent and short-term deposits by 1 per cent, in most cases). The rates were increased in some cases at the beginning of October, following the further increase in the banks' liquid asset requirements, announced on 30 September 1975, and then further, in respect of certain short-term categories, at the beginning of February 1976.

Monetary policy

After a shift towards a more conservative stance during the first three quarters of 1974, monetary policy was made somewhat more accommodative towards the end of that year and during the first few months of 1975. During the year under review, however, balance of payments and anti-inflation considerations forced more decisive restraint, resulting in the adoption of a set of progressively more restrictive measures. Firstly, to counteract the then prevailing unfavourable leads and lags situation, encourage the inflow of foreign capital, reduce excess liquidity in the economy, and support the firming of interest rates, several measures were announced on 11 August 1975. These included an increase in Bank rate from 8 to 8½ per cent and an increase in the liquidity requirements against the short-term liabilities of banking institutions from 45 to 49 per cent for the commercial banks and from 45 to 47 per cent for all other banks except the discount houses. These new ratios became effective from approximately 21 August.

Secondly, the banks' liquid asset ratios were raised once more on 30 September 1975 to become effective from approximately 21 October. In terms of this measure, which was taken in conjunction with the devaluation of the rand on 22 September, the liquidity ratios against the banks' short-term and medium-term liabilities were increased from 49 and 28 per cent, respectively, to 55 and 30 per cent for the commercial banks, and from 47 and 28 per cent, respectively, to 50 and 29 per cent for all other banks except the discount houses. In addition, supplementary liquid assets equal to at least 20 per cent of the **increase** in short-term liabilities and 10 per cent of the **increase** in medium-term liabilities since the end of September, were required to be held by all banks concerned from approximately 21 November.

Thirdly, in view of the recurrence of unfavourable leads and lags in international payments and receipts in January and February 1976 and the resulting high levels of purchases of foreign exchange from the Reserve Bank, the obvious link between these purchases and the continued high rate of bank lending to the private sector and the expected seasonal increase in government expenditure during the second quarter of 1976, the Reserve Bank in February 1976 imposed quantitative limits on bank credit to

the private sector. Taking the end of December 1975 as a base, the discounts, loans and advances to the private sector of each banking institution were limited to an increase of 3½ per cent up to the end of March 1976, and to ½ per cent per month thereafter. The increase in the investments in specified private sector securities of each banking institution was limited to 1½ per cent up to the end of March 1976, and to ½ per cent per month thereafter.

Finally, Bank rate was raised once more, from 8½ to 9 per cent, effective from 22 July 1976, allowing the commercial banks to increase their prime overdraft rate to a maximum of 12½ per cent. This step was announced by the Reserve Bank in conjunction with a joint announcement by the Ministers of Finance and Economic Affairs on the same date, regarding the temporary imposition of an import-deposit scheme.

Government finance

During the year that ended on 30 June 1976 Exchequer issues increased substantially. The high rate of increase in issues was due to higher government spending at still sharply rising prices and an unusual concentration of issues in the second quarter of 1976, i.e. the first quarter of the current fiscal year. Exchequer issues include the transfer of loan funds to government business enterprises, some public corporations and provincial administrations, as well as funds required for the financing of the investment expenditure of not only the central government departments but also of various extra-budgetary bodies and organisations. Current receipts on the Exchequer Account are insufficient to cover all these expenditures so that part of Exchequer issues is customarily financed through borrowing. Exchequer receipts other than borrowing proceeds, however, increased at a lower rate than issues and a larger deficit than in the preceding year had to be financed by means of loans. Considering the tight capital market conditions during the year under review, the central government was remarkably successful in raising loan funds. However, because of the limited capacity of the domestic market and higher capital requirements of other borrowers in the market, the Treasury was obliged to increase its foreign indebtedness as well as its net indebtedness to the monetary banking sector. In accordance with the economic policy objectives of improving the balance of payments and reducing the rate of inflation, the 1976/77 Budget provided for a tightening of fiscal policy aimed, *inter alia*, at reducing the government's reliance on the monetary banking sector as a source of finance. However, it is expected that the tighter policy will start having its effect only from the third quarter of 1976.

Changed pattern of Exchequer issues

Exchequer issues during the year that ended on 30 June 1976 were 22 per cent higher than in 1974/

75. This percentage increase was nevertheless lower than the 31 per cent rise in issues during 1974/75 and in fact the lowest since 1972/73.

From the beginning of the fiscal year 1975/76 issues deviated noticeably from the seasonal pattern established in the immediately preceding fiscal years. During the first half of the 1975/76 fiscal year, i.e. the six months from April to September 1975, Exchequer issues were 48 per cent higher than during the corresponding period of 1974 because of the earlier withdrawal of funds by government departments. Because government expenditure is limited to the amount appropriated by Parliament, and the 1975/76 Budget did not provide for an increase of this magnitude, issues could increase only modestly during the second half of the relevant fiscal year. Contrary to the usual seasonal trend, issues actually increased by only 3 per cent during these six months, especially because of a relatively low level of issues during the last quarter of the fiscal year.

During the first quarter of the 1976/77 fiscal year, issues increased by 43 per cent in relation to those in the corresponding period of the preceding fiscal year. This increase again represented a marked deviation from the previously established seasonal pattern. As fiscal policy is at present aimed at a substantial reduction of the rate of increase in government expenditure during the current fiscal year and Parliamentary appropriations had been determined accordingly, Exchequer issues are expected to increase only moderately during the remaining three quarters of the fiscal year. The main reason for the contra-seasonal increase in issues during the first quarter of the current fiscal year was that public sector bodies and organisations, dependent on the Treasury for part or all of their funds, had made abnormally large drawings on their balances with the Public Debt Commissioners during the fiscal year 1975/76 and had to requisition through the responsible government departments more of their appropriated funds early in the new fiscal year. In

Quarterly distribution of Exchequer issues in percentages

Fiscal years	April-June	July-September	October-December	January-March	Year
1971/72.....	18,7	27,1	25,2	29,0	100,0
1972/73.....	22,8	25,3	22,7	29,2	100,0
1973/74.....	17,7	25,0	23,5	33,7	100,0
1974/75.....	18,1	22,6	26,0	33,3	100,0
1975/76.....	22,4	27,3	25,4	24,9	100,0
1976/77.....	27,7*	...	...	...	...

* Percentage of comparable Budget figure

Exchequer receipts

	Year ended 30 June									
	1972		1973		1974		1975		1976	
	R millions	% change	R millions	% change	R millions	% change	R millions	% change	R millions	% change
Receipts from gold mines	136	19,2	228	68,0	490	115,5	804	63,9	596	-25,8
Customs, excise and sales duties	775	10,5	801	3,4	959	19,8	1 041	8,6	1 244	19,5
Other receipts	1 900	24,5	2 314	21,8	2 932	26,7	3 296	12,4	4 095	22,1
Total	2 810	20,0	3 342	18,9	4 381	31,1	5 141	17,4	5 935	15,4

addition, some government departments had to meet commitments that had been extended to the first quarter of the 1976/77 fiscal year. The changes in the seasonal pattern of Exchequer issues are shown in the accompanying table.

Smaller contribution of gold mines to Exchequer receipts

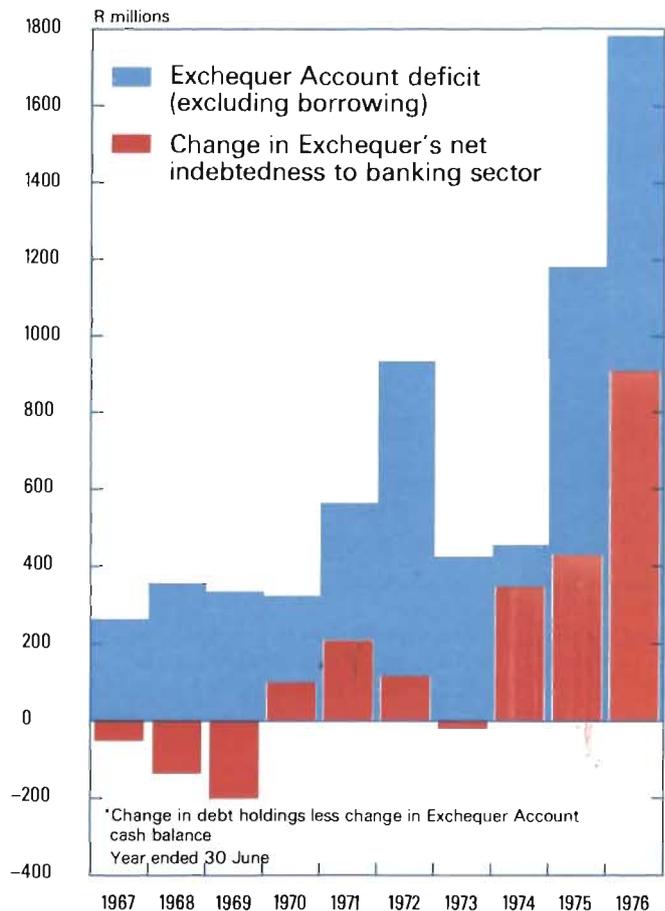
During the year that ended on 30 June 1976, net receipts on the Exchequer Account rose by 15 per cent compared with 1974/75, or 2 percentage points less than in the latter year. This lower rate of increase was caused by a drop of more than 25 per cent (or more than R200 million) in receipts from gold mines in the form of income tax and lease payments. This decline was in sharp contrast to developments during the preceding three years when receipts from this source were favourably influenced by a substantial increase in the price of gold. Because of the subsequent decline in the price of gold, the rapid rise in costs and consequently the decline in profits of gold mining companies, the percentage contribution of gold mines to Exchequer receipts declined from the record level of 16 per cent in 1974/75 to only 10 per cent in 1975/76 or approximately the same average level as during the preceding five years. As is shown in the accompanying table, customs, excise and sales duties as well as other receipts, consisting mainly of income tax payments by persons and non-gold mining companies, increased at substantially higher rates than during the preceding year. The lower receipts from gold mines, therefore, were to a large extent neutralised by increases in other revenue items. The 1976/77 Budget provided for an increase in direct as well as indirect tax rates, but the increased taxation will only be reflected in Exchequer receipts as from the third quarter of 1976.

Increase in Treasury borrowing

The changed seasonal pattern of Exchequer issues, in conjunction with the normal seasonal flow of Exchequer receipts, led to the largest quarterly

deficit being recorded during the second quarter of 1976, instead of as usual during the first quarter of the year. The absolute amount of the deficit during the second quarter contributed materially to an increased Exchequer deficit for the year that ended on 30 June 1976, and consequently larger borrowing requirements. A deficit of R1 787 million was recorded, compared with a deficit of R1 187 million in 1974/75. In accordance with the tightening of

Banking sector financing* of Exchequer Account deficit



economic policy in the second half of 1975, the Treasury's borrowing operations were aimed at raising funds in the private non-banking sector so as to avoid as far as possible an increase in net indebtedness to the monetary banking sector. Thus, the yield on new issues of long-term government stock was increased from 9,5 per cent to a historically high rate of 10,0 per cent. In addition, an appeal was made to insurers and private pension funds to increase their holdings of government stock above their legally required minima, and building societies and banking institutions were requested to support government stock issues.

In a tight market characterised by an imbalance between the demand for and supply of funds, the Treasury was able to borrow a net amount of R414 million from the private non-banking sector during the year under review. The Public Debt Commissioners, who were faced with large withdrawals of funds, especially during the first quarter of 1976, were able to invest R226 million in government securities during the review period, largely because of a strong inflow of funds during the second quarter of 1976. Notwithstanding these contributions by the private non-banking sector and the Public Debt Commissioners, a substantial Exchequer deficit of R1 147 million remained to be financed through other forms of borrowing or by utilising available cash balances. Foreign borrowing amounted in total to R238 million, of which R155 million represented drawings

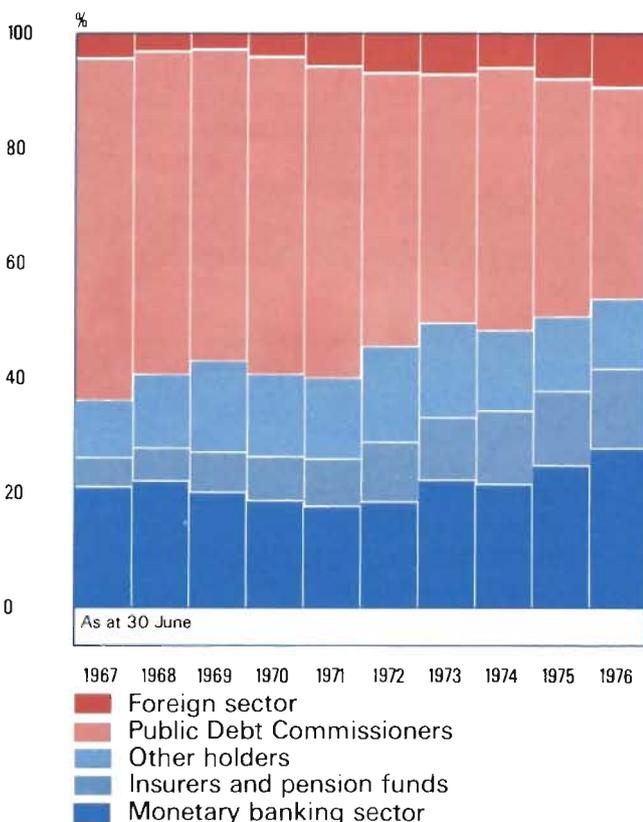
of South Africa's gold and first credit tranches from the International Monetary Fund. The residual deficit of R909 million was financed by means of an increase in net indebtedness to the monetary banking sector. This sector's holdings of government securities increased by R752 million and, in addition, Exchequer balances declined by R157 million.

Because of the relatively large amount borrowed from the monetary banking sector, the proportion of the total central government debt held by this sector increased to 28 per cent at the end of June 1976, after having risen since 1972. As is shown in the accompanying graph, the relative importance of insurers and pension funds and the foreign sector as holders of central government debt also continued to increase and amounted to 14 per cent and 9 per cent, respectively, at the end of June 1976. The relative shares of the debt held by the rest of the private sector and the Public Debt Commissioners showed a corresponding decline and amounted to 12 per cent and 37 per cent, respectively, at the end of June 1976. The Public Debt Commissioners, nevertheless, remained the principal holder of total central government debt.

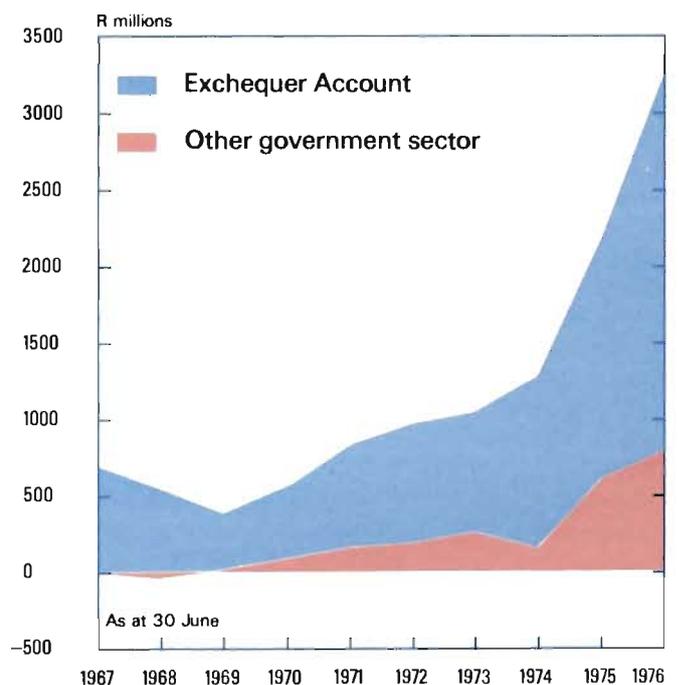
Increase in monetary banking sector's net claims on the non-Exchequer part of the government sector

Although the monetary banking sector's claims on the government sector, which are one of the factors affecting the supply of money and near-money,

Ownership distribution of total public debt



Net claims of banking sector on government sector



relate mostly to the Exchequer Account, they also include credit extension to other bodies and organisations in the government sector. Thus, in addition to appropriations from the Exchequer Account, some of these bodies and organisations, mainly extra-budgetary organisations, have direct access to the monetary banking sector as a source of finance. Their indebtedness to the monetary banking sector is also affected by a change in their deposits with this sector. During the past seven years the monetary banking sector's net claims on the non-Exchequer part of the government sector increased and, as is shown by the accompanying graph, these claims rose quite substantially during 1974/75 and 1975/76. To a large extent the increase during the past two years was due to a building up of strategic inventories.

Tightening of fiscal policy in the 1976/77 Budget

In contrast to the 1975/76 central government Budget, which had as its objective a moderate stimulation of the economy, the 1976/77 Budget presented to Parliament by the Minister of Finance on 31 March 1976, was aimed at tightening fiscal policy. It was stated that, although the government continued to attach the highest importance to the long-term growth of the economy, there were several factors that necessitated a greater measure of financial discipline. Firstly, there were uncertainties regarding the duration of the unfavourable external factors which had been influencing the economy and in particular the balance of payments. Because it might take some time before more favourable external conditions would benefit the South African economy, it was necessary to maintain strict control over aggregate demand in order not to expose the balance of payments to undue strain. Secondly, the campaign against inflation also required restraint in fiscal policy. It was believed that cost-push, rather than demand-pull, factors were mainly responsible for the existing inflation, but it was nevertheless important that adequate control should be maintained over the money supply. This was necessary to avoid an increase in inflationary pressures, caused by excessive monetary demand, once the economic growth rate started to increase. Monetary and credit policy was already directed towards that objective, but it was essential that these monetary measures should be reinforced by fiscal policy. However, balance of perspective in the application of fiscal policy had to be maintained and it would be inadvisable to apply so restrictive a financial policy as to stultify economic growth. Due regard also had to be paid to social priorities.

Although the Budget proposed a substantial increase in defence expenditure the policy approach was not to increase aggregate government expenditure in real terms. It was, therefore, necessary to apply stricter economies to the expenditure of other

government departments. After taking into account proposals by the Minister to increase social and civil pensions, total expenditure on the State Revenue Account was estimated at R7 832 million for the 1976/77 fiscal year, or 11 per cent above the estimated comparable expenditure for 1975/76. On the then existing basis of taxation, the Treasury would be left with a substantial deficit which, contrary to the policy adopted in the Budget, would require too heavy a reliance on bank credit as a source of finance. Consequently, both indirect and direct tax rates were increased. The former included increases in sales duties and in customs and excise duty on beer, fortified and sparkling wines, spirits, tobacco and petroleum products, and these were expected to yield an additional R275 million during the fiscal year. Higher direct taxes, expected to raise an additional R148 million, included a further 5 per cent surcharge on basic taxes payable by individuals and companies (excluding diamond mining companies) and increases in the rates of non-resident shareholders' tax and undistributed profits tax. The Minister also introduced a loan levy equal to 10 per cent of tax payable by individuals and increased the loan levy payable by companies from 5 per cent to 15 per cent.

After taking into account the various tax proposals, the State Revenue Account was expected to close the year with a deficit (excluding borrowing and the repayment of debt) of R1 463 million. The Minister anticipated that R1 051 million of this amount could be borrowed from domestic sources. This included an anticipated investment of R300 million by the Public Debt Commissioners, loan levy proceeds of R394 million, and amounts of R120 million and R250 million to be raised by means of issues of National Defence Bonds and new government stock, respectively. Net foreign borrowing was estimated at R120 million, leaving a balance of R292 million to be financed by the use of available cash balances. Of the latter figure, R240 million would be drawn from the Stabilization Account. The Minister was also empowered by Parliament to raise or lower the loan levy by a maximum of 10 per cent between Budget dates.

Since the introduction of the Budget, various supplementary estimates of expenditure were sanctioned by Parliament, including the increase in wages and salaries of civil servants as from 1 July 1976. Taking these additional amounts into account, it is estimated that total expenditure for the fiscal year 1976/77 will increase by 13 per cent above the preceding year's level, leaving a deficit of R1 670 million in the overall State Revenue Fund.

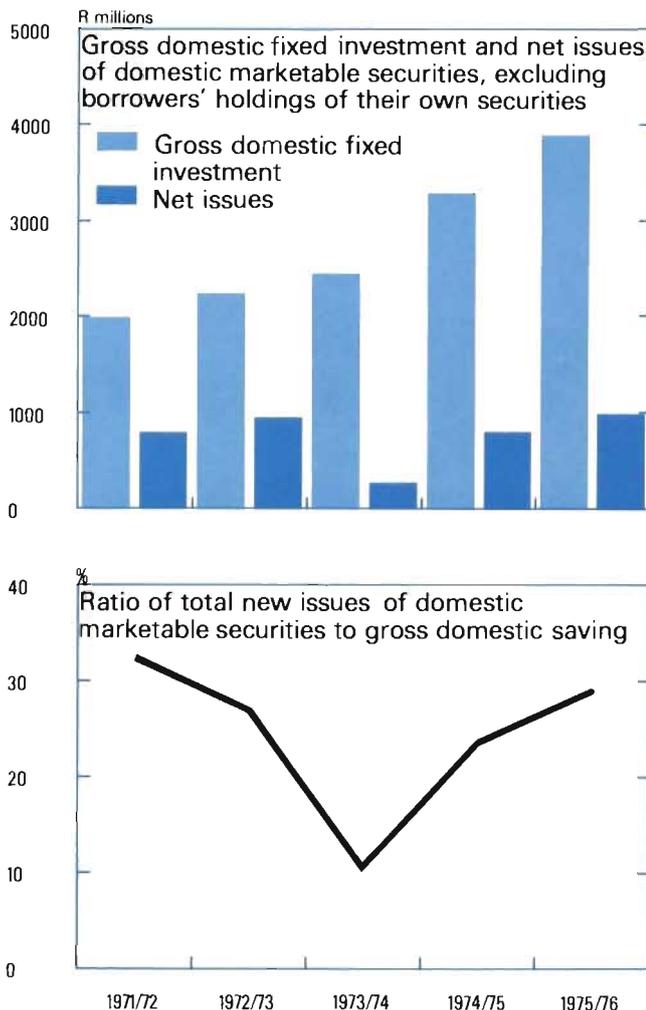
As proposed in the Budget, National Defence Bonds were offered for investment as from 1 July 1976. Interest will be paid half-yearly at a rate of 9,5 per cent per annum with a 3 per cent bonus interest at maturity after 5 years. Investments may be redeemed at par prior to maturity, for estates at any time after six months and in all cases any time after 12 months. During July, R52 million of these bonds were issued.

Capital market

Tighter conditions in the capital market

The slight easing of capital market conditions during the first half of 1975 did not continue during the year that ended on 30 June 1976. Market conditions actually became tighter during the year under review, a period during which the economy continued to be in a downward phase of the business cycle. In accordance with normal cyclical behaviour, it could be expected that market conditions would become easier and long-term interest rates would tend to decline from about the middle of 1975. However, a continuing large demand for funds, especially by the public sector, and a restrictive economic policy aimed at improving an unfavourable balance of payments and curbing a high rate of inflation, precluded a further easing of market conditions.

Public authorities and public corporations



These developments were experienced in all sections of the capital market. In the market for fixed-interest securities an imbalance between the demand for and supply of funds was reflected in an under-subscription of many new issues, and interest rates moved to higher levels. In the share market prices drifted downwards because of a growing realisation that short-term economic policy was restrictive and that an upturn in domestic economic activity would take longer to materialise than expected initially. The leveling-off of corporate saving and the erosion of personal saving by a lower rate of growth in disposable personal income, the high rate of inflation, and the greater use of consumer credit to finance part of consumption expenditure, led to a gradual fall-off in non-contractual savings with financial intermediaries, reducing the flow of funds to the mortgage and real estate markets, especially during the second half of the year under review.

Large demand for funds in the market for fixed-interest securities

The market for fixed-interest securities closely reflected developments in the broader capital market. The slightly easier market trend towards the middle of 1975 was reversed during the second half of 1975, i.e. the first half of the year under review, and market conditions tended to become even tighter towards the end of the review period. A continuing large demand for funds was the main reason for the tightness of the market and the maintenance of interest rates at high levels. The private sector diverted a larger proportion of its demand for funds to the fixed-interest security market because of the unfavourable conditions for raising capital in the share market. Thus, new issues of company loan securities amounted to R188 million in 1975/76, compared with R124 million in 1974/75. In the public sector, investment at current prices increased substantially and this led to a large demand for loan funds in the domestic market in addition to increased foreign borrowing. Net issues of marketable stock by the public sector excluding the increase in public sector borrowers' holdings of their own securities, amounted to R991 million during the year under review, compared with R812 million in 1974/75 and R276 million in 1973/74.

The tightening of market conditions was reflected in higher yields. Thus, the yield on long-term government stock increased from 9,5 to 10,0 per cent in August 1975 and then remained at this level during the rest of the review period. The representative yield on new issues of the highest grade semi-gilt-edged stock rose from 10,75 per cent in June 1975 to 12,10 per cent in June 1976. Notwithstanding a

steady upward adjustment of semi-gilt-edged yields, many new issues during the year under review were undersubscribed. The scarcity of funds and the high cost of borrowing also induced some borrowers to scale down or postpone scheduled new issues. The yield on new issues of company loan securities remained within the range of 13,25 to 13,50 per cent throughout the review period, but moved to a higher level during July 1976.

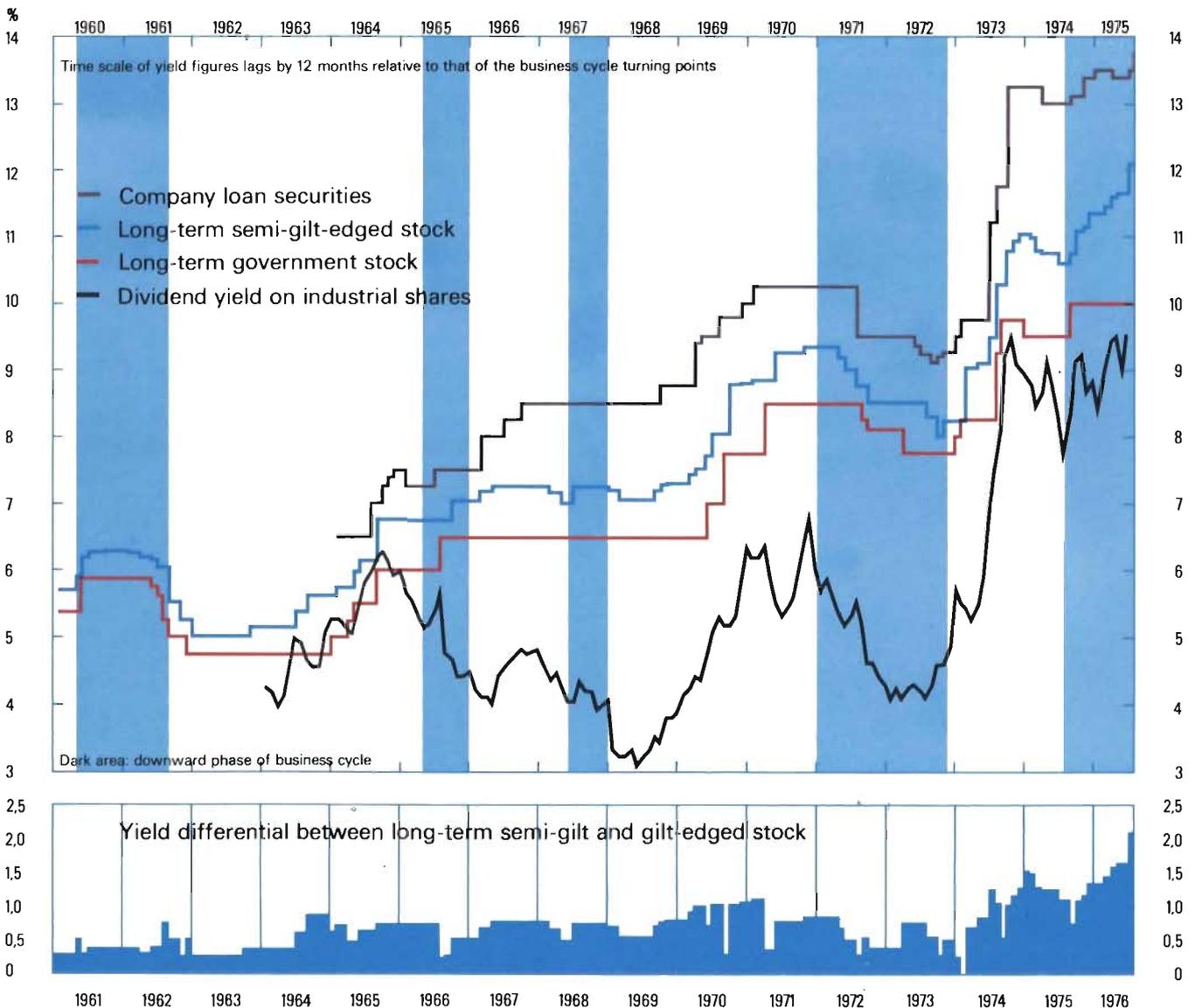
The ability of public sector borrowers, other than the central government, to raise their required funds in the market was affected not only by the tight market conditions but also by the central government's drive to increase its borrowing from the private non-banking sector. As a result, there was a marked change in the yield differential between

gilt and semi-gilt-edged stock. Whereas the differential amounted to 1,25 per cent at the end of June 1975, it widened to 2,10 per cent in June 1976.

Depressed conditions in the share market

The noticeable improvement of most classes of share prices during the first seven months of 1975 was not maintained during the last five months of 1975 and the first six months of 1976. In general, share prices declined quite sharply during the period August to October 1975 and then fluctuated around this lower level during the rest of the year under review. In addition to the effect of an unfavourable short-term economic outlook, the stock exchange mood was affected adversely by the persistent decline

Cyclical behaviour of security yields



in gold mining share prices since August 1974, reinforced by the sharp drop in the price of gold, and the dwindling interest of foreign investors in South African shares. Gold mining share prices fell by 34 per cent during the year under review. The prices of all classes of financial shares decreased by 16 per cent and those of industrial and commercial shares declined by 2 per cent.

The depressed share market conditions were also reflected in a lower turnover. Thus, the number of shares traded was 13 per cent lower in 1975/76 than in 1974/75 and 27 per cent lower than the average level during the immediately preceding five years. The fall in the value of shares traded was even more pronounced. During 1975/76 it was 35 per cent lower than in 1974/75 and 37 per cent less than the average for the five preceding years.

Notwithstanding the generally depressed state of the market, signs of recovery of some classes of share prices emerged towards the end of the period under review. Coal mining share prices increased strongly in anticipation of a rise in the price of coal and an improvement in metal and mineral prices on international markets led to higher prices of metal and mineral shares, other than gold and coal mining shares. In addition, the decline in industrial and commercial share prices appears to have bottomed out and a fairly stable price level was maintained during the first half of 1976.

The average dividend yield on all classes of shares, excluding mining shares, increased by 1,35 percentage points to 8,62 per cent during the year under review. The inverse yield gap between these shares and long-term government stock narrowed from 2,2 per cent in June 1975 to 1,4 per cent in June 1976. The differential between the relevant share yield and the yield on long-term semi-gilt-edged securities amounted to 3,5 per cent in June 1976 and was exactly equal to the differential in June 1975, indicating that these yields had risen equally during the year under review.

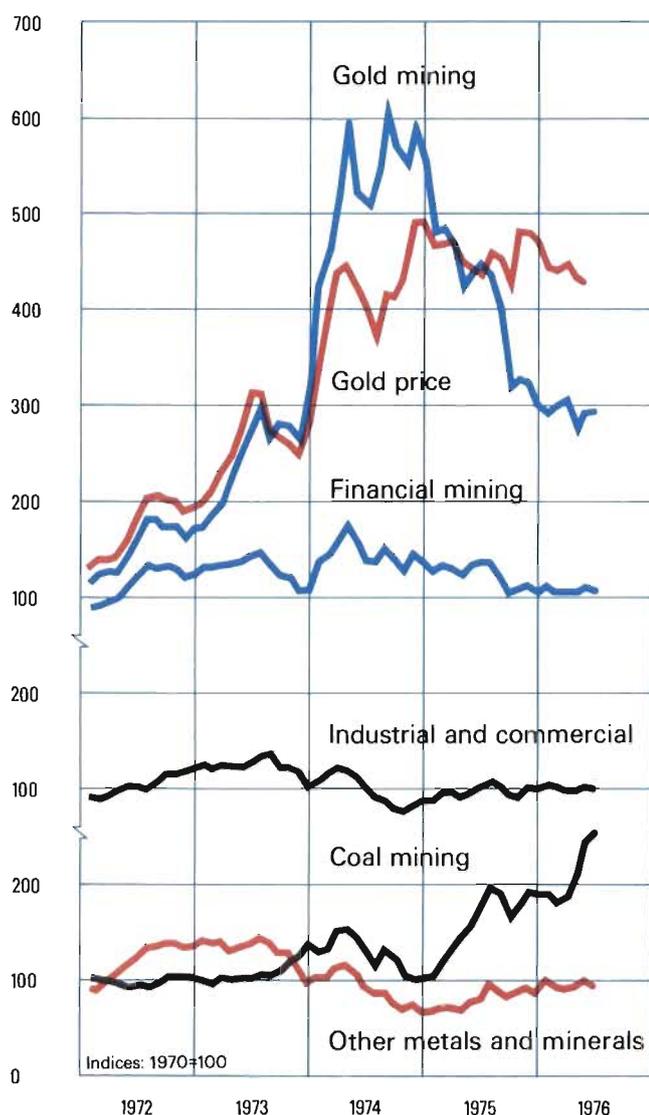
Unit trusts continued to experience an outflow of funds during the review period, but the amount of the outflow, namely R8 million, was smaller than the corresponding figure of R11 million for 1974/75. Because of this outflow and generally lower share prices, the market value of their net assets declined by R60 million to R290 million during the year under review.

Declining 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 and Post Office and other government savings facilities during the year under review as a whole was only slightly less than the corresponding figure for the preceding year. However, in the course of the review period, a marked decline occurred in this inflow of funds. Thus, the relevant institutions' inflow of longer-term funds, seasonally adjusted, amounted to R339 million during the first half of 1976, compared with R1 052 million during the second half of 1975.

Participation mortgage bond schemes and the government savings facilities actually had a slightly larger inflow of funds during the second half relative to the first half of the year under review. Building societies, however, had a markedly lower inflow of funds during the first six months of 1976 than during the preceding six months. The most pronounced decline in the inflow of funds was experienced by banking institutions. Moreover, there were no indications that the small increase in savings and long-term fixed deposits with banking institutions during the first six months of 1976 was caused by a shift to demand and other short-term deposits.

Gold price and share prices



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

R millions

	Year ended 30 June						
	1972	1973	1974	1975	1976 ¹⁾		
					1st half	2nd half	Year
Banking institutions	281	596	559	678	518	-30	487
Building societies	350	743	594	591	461	253	710
Participation mortgage bond schemes	154	106	134	29	22	37	61
Government savings facilities ²⁾	20	24	4	103	51	79	130
Total	805	1 469	1 291	1 401	1 052	339	1 388

1) Half-yearly figures are seasonally adjusted.

2) Post Office Savings Bank, National Savings Certificates and Treasury Savings and Premium Bonds.

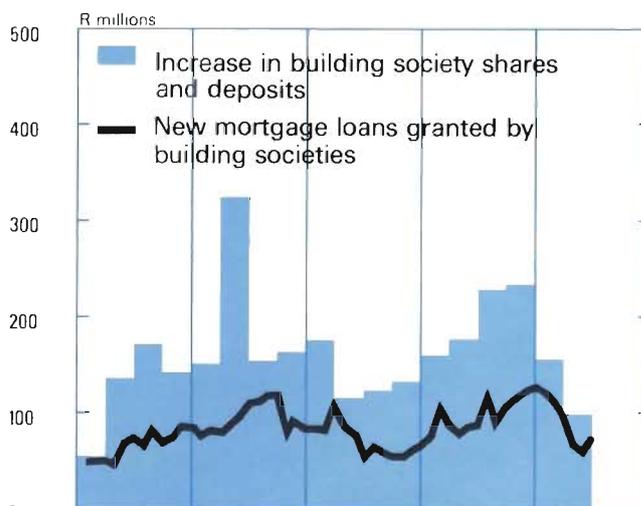
The declining rate in the inflow of funds to banking institutions and building societies, was part of the deceleration in the rate of growth of private sector liquidity in general and reflected also the lower level of personal saving.

In order to enable the building societies to compete more effectively for deposits and to counter the decline in their net intake of funds, the prescribed maximum interest rates which building societies and banking institutions may pay on deposits, were made applicable with effect from 15 June 1976 to all individual deposits of R1 million or less, instead of only to individual deposits of R250 000 or less. On the same date the maximum allowable rate of interest on the special tax-free building society shares was increased from 7½ to 8 per cent per annum. In July 1976 it was announced that with effect from 1 March 1976 the maximum tax-free investment per person in Post Office Savings Bank certificates would be raised from R6 800 to R10 000.

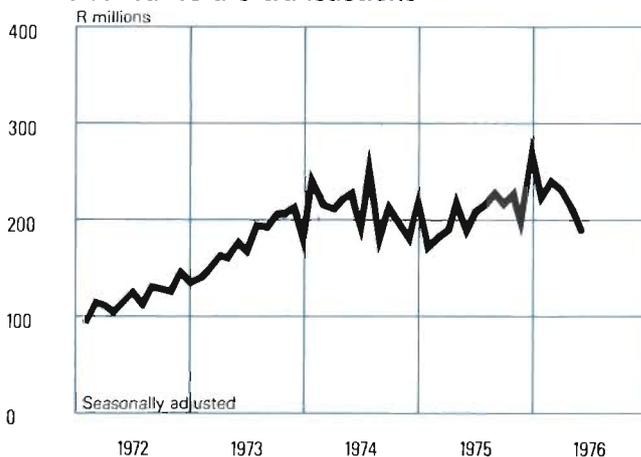
High level of lending maintained in the mortgage market

Although the building societies' intake of new funds declined sharply during the second half of the year under review, the very substantial inflow during the first half of this period enabled them to increase their mortgage lending during 1975/76. Mortgage loans actually paid out during 1975/76 amounted to R1 276 million, compared with R956 million in 1974/75 and R1 200 million in 1973/74. The smaller net intake of funds during the first half of 1976, however, led to a marked reduction in new mortgage loans granted. During this six-month period new loans granted were on average 28 per cent lower than during the second half of 1975. At the same time, the societies reduced their commitments in respect of new loans granted but not yet paid out by more than R100 million between the end of December 1975 and the end of June 1976.

Mortgage and real estate markets



Value of real estate transactions



Outstanding mortgage loans of financial institutions

	1971		1972		End of 1973		1974		1975	
	R millions	%	R millions	%	R millions	%	R millions	%	R millions	%
Building societies.....	2 720	55	3 076	56	3 706	57	4 286	58	4 878	60
Participation mortgage bond schemes.....	686	14	803	15	933	14	1 026	14	1 049	13
Banking institutions.....	437	9	506	9	746	11	852	12	995	12
Land Bank.....	393	8	417	7	434	7	470	6	516	6
Insurers.....	439	9	419	8	399	6	408	6	407	5
Private pension funds.....	254	5	272	5	293	5	301	4	334	4
Total.....	4 929	100	5 493	100	6 511	100	7 343	100	8 179	100

New mortgage loans granted by participation mortgage bond schemes amounted to R163 million in 1975/76 and were considerably higher than the R31 million granted during the preceding year. Likewise, new mortgage loans paid out during 1975/76 amounted to R160 million, compared with an amount of R107 million for 1974/75.

The high level of mortgage lending by the building societies, especially during the second half of 1975, gave rise to a further increase in their steadily growing share in holdings of mortgage debt. At the end of 1975, 60 per cent of the outstanding mortgage loans advanced by financial institutions operating in the mortgage market represented building society loans. As is shown in the accompanying table, the shares of the other financial institutions were much smaller and in the case of such large institutional investors as insurers and pension funds, the relevant shares had declined to comparatively low levels.

Notwithstanding the general rise in capital market rates, most mortgage rates remained unchanged during the year under review. The rate on new mortgages of participation mortgage bond schemes remained at 11,35 per cent and the mortgage rate of insurers and private pension funds was maintained at 13,50 per cent. In the case of the building societies' home mortgage rate, however, a new system of differential rates was introduced in September 1975. Instead of the former uniform rate of 10,5 per cent, the rate on existing as well as new mortgage loans from then on ranged between 10,5 and 12,0 per cent, depending on the amount of the loan and the valuation of the mortgaged property.

Real estate market affected by a lesser availability of funds

Developments in the real estate market corresponded closely to those in the mortgage market. Real estate transactions, which had shown a rising trend from the beginning of 1975, continued to increase during the second half of 1975. However, the lesser availability of funds in the capital market also affected the real estate market, and transactions declined during the first half of 1976. During this period the value of real estate transactions was on average 14 per cent lower than during the second half of 1975. For the review period as a whole, the value of transactions was on average 7 per cent higher than during 1974/75.