

**1978**

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## 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-Eighth Ordinary General Meeting to be held on 22 August 1978.

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# Summary and general observations

Following a period of cyclical downswing lasting about forty months, the South African economy began to recover towards the end of 1977. During the first half of 1978 the real gross domestic product increased moderately, after having declined slightly during the second half of 1977. For the year under review\* as a whole, a small negative rate of growth was recorded. A feature of the recovery during the first six months of 1978 was that an increase in real economic activity in manufacturing and trade became an expansionary force, after declines in the real value added by these sectors had contributed to the progressively decreasing rates of economic growth during 1976 and 1977. Part of the increased activity during the second quarter of 1978, however, reflected the unusual rise in consumer expenditure prior to the introduction of a general sales tax on 3 July. The upturn in real economic activity was accompanied by a slight increase in non-agricultural employment during the first quarter of 1978, the latest period for which statistics are available. This improvement was confirmed by a decline in the number of registered unemployed Whites, Coloureds and Asians during the first half of 1978 and in the number of unemployed Blacks during the period October 1977 to February 1978.

The rise in the real gross domestic product during the first half of 1978 originated not only in an increase in the volume of exports and net gold output, but also in a recovery of real aggregate domestic demand which had been declining during the second half of 1977. This change in real demand was accounted for by increases in private and government consumption expenditure and in fixed investment by the central government and public corporations, which were partly offset by further declines in private fixed investment and inventories. Increases in government consumption expenditure and fixed capital expenditure by the central government reflected the official policy of mildly stimulating the economy. The rise in private consumption expenditure from the beginning of 1978 gained considerable momentum during the second quarter when extensive consumer buying ahead of the introduction of the general sales tax occurred. This unusual increase in consumption expenditure may have the effect of lowering private consumption outlays in the third quarter of 1978. On the other hand, the accompanying decline in inventories during the second quarter, together with a decrease during the first three quarters of the year under review, resulted in low inventory levels in the second quarter, and a replenishment of inventories may add to overall demand during the second half of 1978.

Reflecting the increase in real aggregate domestic demand, the volume of merchandise imports started to rise from the beginning of 1978. This was counter-balanced, however, by a rise in the volume of exports and net gold output. For the year 1977/78 as a whole, the volume of merchandise imports still showed a

decline, whereas the volume of exports and net gold output increased. The result was that the current account of the balance of payments improved markedly further in 1977/78, and a sizeable surplus was recorded on this account. A contribution to this improvement was also made by slightly better terms of trade, which came about largely as a result of a strong rise in the price of gold. The capital account of the balance of payments, on the other hand, deteriorated and the net capital outflow during 1977/78 actually exceeded the current account surplus. Included in the net capital outflow, however, were repayments on foreign loans which had been raised previously to support the level of the country's foreign exchange holdings.

Distinct progress was made during 1977/78 towards reducing the rate of inflation. The rates of increase in wholesale and retail prices declined progressively in the course of the year, except for a slight temporary acceleration in the first quarter of 1978. Notwithstanding these lower rates of increase, the general level of inflation in South Africa remains high. Moreover, it is possible that the introduction of the general sales tax will have an escalating effect on price increases during the third quarter.

Monetary and credit aggregates changed only moderately during 1977/78. The money and near-money supply increased at a rate which was only slightly higher than in the preceding year, and the narrowly defined money supply actually rose at a substantially lower rate than in 1976/77. The rate of growth in credit extended by the monetary banking sector declined for the fourth consecutive year, the lower rate of increase during 1977/78 being the result of a considerable decline in net bank credit extended to the government sector. A more general demand for bank credit to the private sector, however, became apparent during the first half of 1978, reflecting the mild expansion of the economy since the end of 1977. During the second quarter of 1978 the growth rate of the money supply and of bank credit to the private sector accelerated markedly. Figures for this period were, however, distorted by the upsurge in consumer spending prior to the introduction of the general sales tax, and it would appear that this increased spending was financed partly by means of newly created bank credit. The effect of the accelerated extension of new bank credit during the first half of 1978 was apparent in a decline in the banks' unused facilities under the ceilings on bank credit to the private sector, notwithstanding an additional increase in the ceilings in May.

Conditions in the money market remained fairly easy during most of 1977/78 and the interest rates on money market instruments other than Treasury bills continued to show a moderately downward trend. This decline in short-term interest rates, at a time when similar interest rates in the United States of America and in the United Kingdom were moving upwards, had the effect of reducing the effective cost of trade financing in terms of rand to a level that was lower than the comparable cost of financing in terms of US dollars or Euro-dollars.

Notwithstanding a higher rate of increase in central government expenditure during 1977/78, the government's net indebtedness to the monetary banking sector declined during this period, the first such decrease for a twelve-month period since 1972/73. Successful borrow-

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\* The year under review refers to the twelve-month period that ended on 30 June 1978 and is denoted as 1977/78. It represents the period for which the most up-to-date national accounts and other statistics are available. In cases where more recent information is available, the review also covers July and part of August.

ing from the domestic private non-banking sector, together with a substantial net new investment in government securities by the Public Debt Commissioners, enabled the government to achieve this reduction. Borrowing from the private non-banking sector was facilitated by a further easing of the fixed-interest security section of the capital market in which not only the central government, but also local authorities and public corporations, could raise substantial amounts of new capital at decreasing rates of interest during 1977/78. Buoyant conditions were also experienced in the share market where share prices and stock exchange turnover increased notably during the year under review. Activity in the mortgage and real estate markets remained generally at a low level but signs of recovery in these markets began to emerge during the first half of 1978.

Economic policy was modified in 1977/78 when it became apparent that considerable progress had been made towards achieving the more urgent policy objectives of strengthening the balance of payments and eliminating demand-pressure causes of inflation. It was felt that further deflation of the economy might only prove detrimental to economic growth and increase the already high level of unemployment without either improving the balance of payments or reducing the rate of inflation. In view of these considerations, it was decided in November 1977 that monetary and fiscal restraint would be maintained as the key element in economic policy strategy, but that stimulation would be directed to those sectors of the economy which had been most affected by the economic recession. Selective stimulatory measures were accordingly announced on 10 November.

This shift of emphasis in economic policy was more explicitly pursued in the 1978/79 Budget which was presented in March 1978. In the Budget, policy objectives were formulated in terms of a mild general stimulation of the economy within the framework of financial discipline. To achieve these objectives, certain categories of expenditure were increased without an undue rise in overall government expenditure. This was supplemented by a reduction of sales duties, of the surcharge on imports, and of personal and company income tax rates. In accordance with this approach, monetary policy was eased slightly in May 1978 when concessions were made in respect of the ceilings on bank credit to the private sector.

# National accounts

## Acceleration of economic growth during first half of 1978

Real gross domestic product declined by approximately ¼ per cent in 1977/78, which reflects the extent to which real economic activity slowed down during the final phase of the cyclical downswing that lasted until late 1977. This small negative rate was preceded by positive rates of growth which had decreased consistently from 7½ per cent in 1973/74 to 4½ per cent in 1974/75, 2½ per cent in 1975/76 and 1½ per cent in 1976/77. However, the pattern of growth changed significantly in the course of the year under review. Whereas the seasonally adjusted real gross domestic product still declined at an annual rate of about ½ per cent from the first to the second half of 1977, it increased at an annual rate of approximately 3½ per cent from the second half of 1977 to the first half of 1978.

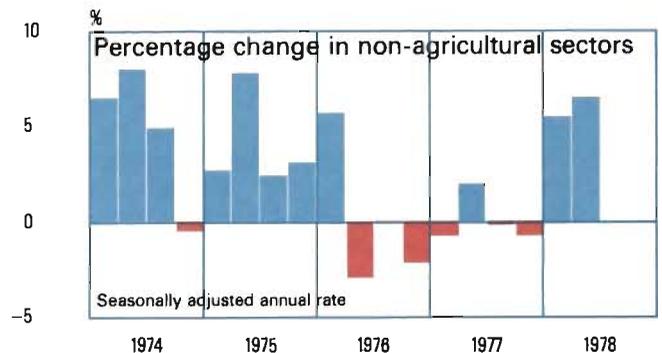
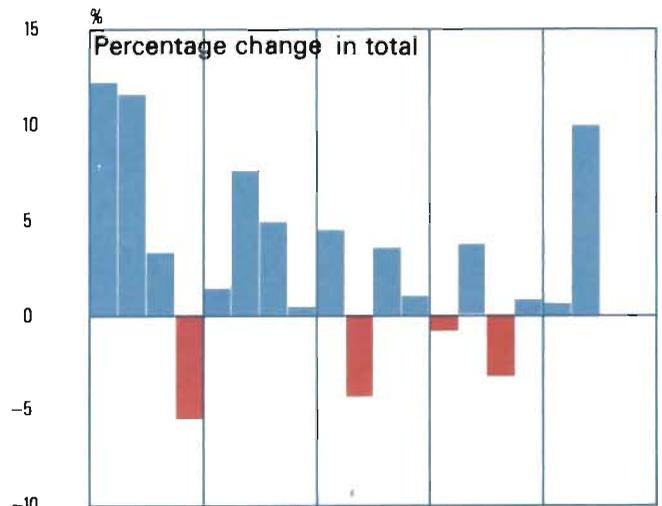
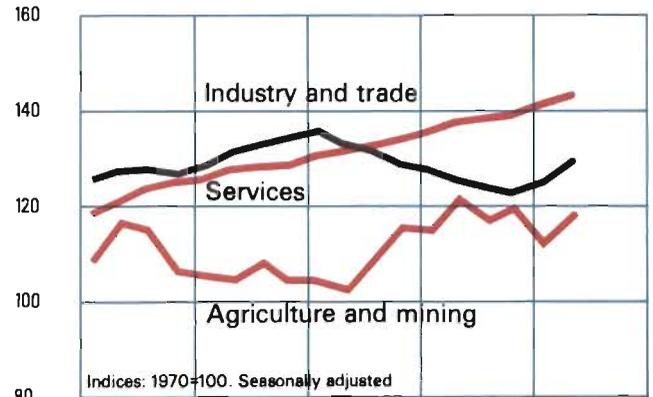
The accompanying table shows that the decline in real gross domestic product in 1977/78 was accounted for by decreases in the real value added by agriculture, manufacturing, construction and trade, and offsetting increases in the real value added by mining, the electricity, gas and water sector, and the services sectors. Notwithstanding generally favourable weather conditions during the year under review, several major agricultural crops failed to reach the high levels of the preceding year, and the real value added by the agricultural sector decreased. This decrease was also related to shifts in the periods during which crops were harvested in 1976/77 and in 1977/78. Although the real value added by manufacturing, construction and trade decreased during 1977/78 as a whole, the declining trends were reversed during the second half of the review period. Comparing the first half of 1978 with the second half of 1977, the volume of manufacturing production increased at a seasonally adjusted annual rate of 7½ per cent, and the volume of wholesale and retail sales, including new motor vehicle sales, at a seasonally adjusted annual rate of 2 per cent.

These changes contributed materially to the economic expansion during the first half of 1978. In addition, the expansion reflected the higher rate of growth in the real value added by the gold mining and services sectors. Non-gold mining production and construction activity, however, fell in relation to the level of output during the preceding six months.

South Africa's terms of trade improved slightly during 1977/78 because of a higher rate of increase in the price of gold than in the prices of imported goods. However, this improvement in the terms of trade was counterbalanced by an increase in real net factor payments to the rest of the world. Consequently, the real gross *national* product showed the same small decline in 1977/78 as the gross *domestic* product.

The rate of increase in the gross domestic product at current market prices fell from 14 per cent in 1976/77 to about 12 per cent in 1977/78. This decrease was entirely due to a decline in the rate of increase in the remuneration of employees from 14 per cent in 1976/77 to 9 per cent in 1977/78, reflecting slower increases in virtually all sectors of the economy except the mining industry. The rate of increase of 14 per cent in the gross

## Gross domestic product at constant 1970 prices



operating surplus in 1977/78 approximately equalled that in 1976/77. Sharp rises in the operating surpluses of mining and of the sectors electricity, gas and water, and transport, storage and communication were partly neutralised by decreases recorded by agriculture and trade.

The difference in the rates of growth in the gross domestic product at current and at constant prices during 1977/78 implies an increase of about 12 per cent in the gross domestic product deflator, which was equal to the rate of increase in 1976/77. The unchanged rate

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

	Year ended 30 June		1st half of 1977 to 2nd half of 1977*	2nd half of 1977 to 1st half of 1978*
	1977	1978		
<b>Primary sectors</b> . . . . .	16	-3	-½	-6
Agriculture . . . . .	25	-9	-8	-8
Gold mining . . . . .	-½	½	1	3
Non-gold mining . . . . .	12	7	15	-8
<b>Commerce and industry</b> . . . . .	-4½	-3	-4½	5½
Manufacturing . . . . .	-4½	-2	-4	7½
Electricity, gas and water . . . . .	1½	5	7	5
Construction . . . . .	-10	-8½	-8½	-4
Wholesale, retail and motor trade . . . . .	-3½	-4½	-6	2
<b>Services sectors</b> . . . . .	4	4	3½	5
Transport, storage and communication . . . . .	6½	7	7	8
Financial and business services . . . . .	½	1½	1	3
General government . . . . .	5	4	4	4
<b>Total gross domestic product</b> . . . . .	<b>1½</b>	<b>-½</b>	<b>-½</b>	<b>3½</b>
<b>Gross national product</b> . . . . .	<b>1½</b>	<b>-½</b>	<b>-</b>	<b>5</b>

\* Seasonally adjusted annual rates.

of increase reflected the net effect of a rise in the price of gold, almost unchanged prices of other exports, and lower rates of increase in domestic wholesale and retail prices.

#### Significant increase in domestic demand during first half of 1978

Although real gross domestic expenditure declined by about 3½ per cent in 1977/78, a significant change occurred in the course of the year. Following an annual rate of decline of 2½ per cent from the first to the second half of 1977, the seasonally adjusted real gross domestic expenditure increased at an annual rate of approximately 4½ per cent from the second half of 1977 to the first half of 1978. This change was accounted for by increases in private and government consumption expenditure, which were only partly offset by further declines in real fixed and inventory investment. Apart from a higher volume of exports, the increase in

real gross domestic product during the first half of 1978, therefore, stemmed from a rise in real consumption expenditure.

Gross domestic expenditure at current prices not only increased at a lower rate than the gross national product during 1977/78, but was also exceeded in absolute terms by the gross national product for the first time since 1972/73. This difference was reflected in a fairly substantial surplus on the current account of the balance of payments.

#### Moderate increase in private and government consumption expenditure

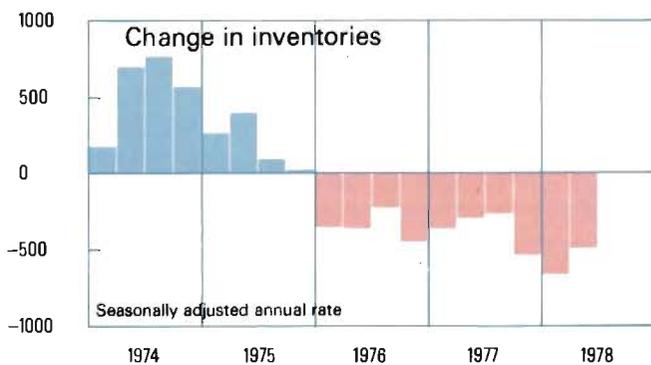
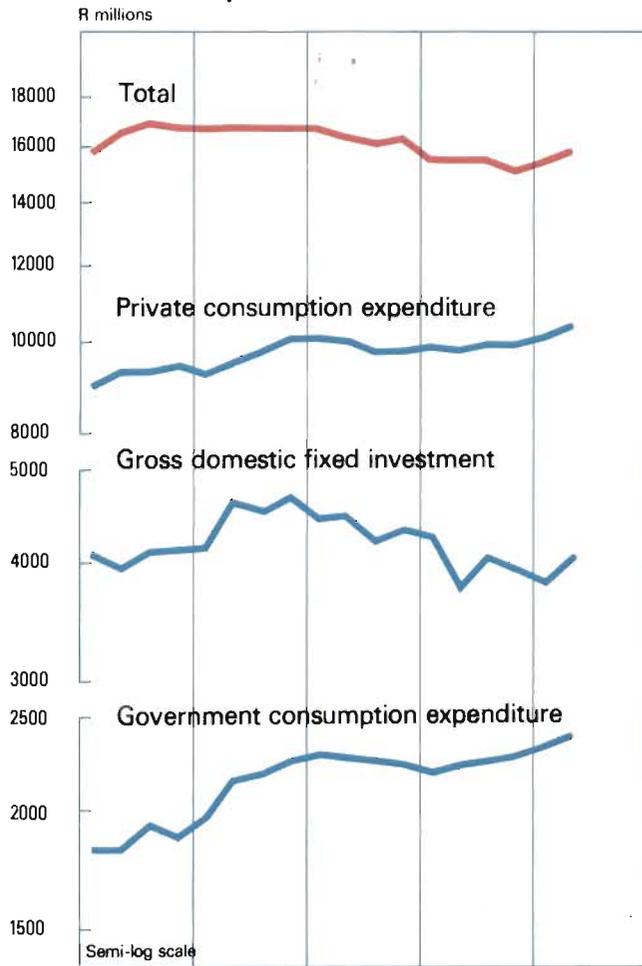
Following a slight decline during 1976/77, real private consumption expenditure increased moderately during 1977/78. A break-down of this expenditure shows that outlays on durable and non-durable goods and on services increased during the period under review, whereas outlays on semi-durable goods decreased. The

### Percentage change in gross domestic expenditure at constant 1970 prices

	Year ended 30 June		1st half of 1977 to 2nd half of 1977*	2nd half of 1977 to 1st half of 1978*
	1977	1978		
Private consumption expenditure . . . . .	-1½	2½	2	4
Government consumption expenditure . . . . .	1	3½	5	6
Gross domestic fixed investment . . . . .	-8½	-5	-1½	-2½
Change in inventories ( <i>R millions</i> ) . . . . .	-389	-500	-450	-550
<b>Gross domestic expenditure</b> . . . . .	<b>-3½</b>	<b>-3½</b>	<b>-2½</b>	<b>4½</b>

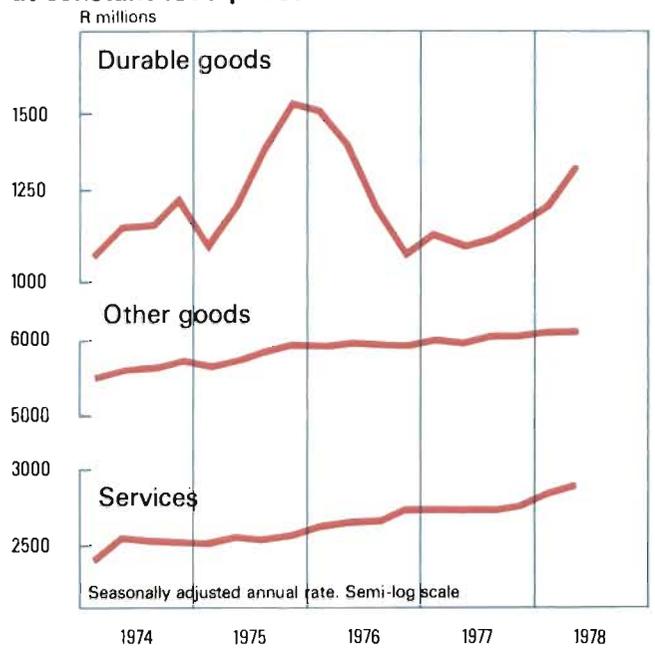
\* Seasonally adjusted annual rates.

### Gross domestic expenditure at constant 1970 prices



most significant change occurred in the case of real expenditure on durable goods. As the accompanying table shows, the substantial decline in 1976/77 was followed by a significant rise in 1977/78, largely because of a marked increase in expenditure on personal transport equipment (mainly new motor cars). Owing to the increase in durable consumption outlays and the absence of any substantial increase in real disposable personal income, real expenditure on semi-durable goods continued to decline. The essential nature of

### Private consumption expenditure at constant 1970 prices



non-durable goods ensured that the average rate of increase in this type of expenditure was maintained during 1977/78.

The increase in real private consumption expenditure was heavily concentrated in the second quarter of 1978 when goods were bought ahead of the introduction of a general sales tax on 3 July. A stronger consumer demand, however, was already apparent earlier in the year under review. The increase in consumer outlays during the first half of 1978 may have been related to other factors such as an actual and anticipated increase in real disposable personal income, the termination of many hire-purchase commitments in respect of television set purchases, a greater availability of consumer credit, an extension of the periods allowed for hire-purchase repayments on motor vehicles, and the introduction of a wide range of new motor car models.

### Percentage change in private consumption expenditure at constant 1970 prices

	Year ended 30 June	
	1977	1978
Durable goods . . . . .	-22	5
Furniture and household appliances . . . . .	-13	5
Personal transport equipment . . . . .	-23	15
Other goods . . . . .	-41	-2
Semi-durable goods . . . . .	-2	-2
Non-durable goods . . . . .	2½	3½
Services . . . . .	4	3
<b>Total private consumption expenditure . . . . .</b>	<b>-1½</b>	<b>2½</b>

Real government consumption expenditure, which had increased only slightly in 1976/77, rose at a somewhat higher rate in 1977/78, reflecting official government policy of mildly stimulating the economy. In terms of expenditure components, real salaries and wages increased more or less at the same rate as in 1976/77, but a more pronounced change occurred in real outlays on goods and other services (including defence expenditure). Compared with a fairly substantial decline in 1976/77, these outlays increased moderately in 1977/78. The increase in aggregate real government consumption expenditure was entirely attributable to the central government, with provincial administrations and local authorities recording declines in their real consumption outlays.

#### Percentage change in real government consumption expenditure

	Year ended 30 June	
	1977	1978
Government consumption expenditure . . . . .	1	3½
Salaries and wages . . . . .	5	4
Goods and other services . . . . .	-6	2

#### Continued decline in fixed investment

Real gross domestic fixed investment decreased by about 5 per cent during 1977/78, compared with a decline of 8½ per cent in 1976/77. Significant changes occurred in the composition of gross domestic fixed investment by type of organisation during 1977/78. The real fixed capital expenditure of the private sector showed a much smaller decline than in 1976/77, that of public authorities a considerably larger decrease, and that of public corporations a substantial increase as against a small decline in the preceding year.

In the private sector the lower fixed capital expenditure by gold mining, non-gold mining and manufacturing, and on residential construction were partly offset by higher fixed capital outlays by the agricultural and transport sectors. The nearly threefold increase in fixed capital expenditure by the private transport sector was entirely attributable to the acquisition of ships for the containerisation programme and the export of iron ore.

The increase in real fixed investment by public corporations during 1977/78 was accounted for by further outlays on Sasol's second oil-from-coal project and Escom's nuclear power station. This increase was partly offset by a substantial decline in the public corporations' real fixed capital outlays on mining and transport projects, following the completion of the Sishen-Saldanha scheme for transporting and exporting iron ore. The real fixed capital expenditure of public authorities declined sharply further during 1977/78 because of government policy to cut back on capital projects and also because of the completion of the South African Railways Administration's programme of acquiring new

#### Percentage change in real gross domestic fixed investment and real fixed capital stock

	Year ended 30 June	
	1977	1978
<b>Real gross domestic fixed investment</b>		
Private sector . . . . .	-11	-2
Agriculture . . . . .	-13	3
Gold mining . . . . .	-10	-9
Non-gold mining . . . . .	-7	-10
Manufacturing . . . . .	-12	-8
Transport . . . . .	-25	195
Private residential construction . . . . .	-12	-15
Public corporations . . . . .	-1	13
Manufacturing . . . . .	-	45
Electricity, gas and water . . . . .	31	30
Other (mining, transport, etc.) . . . . .	-38	-58
Public authorities . . . . .	-8	-19
S.A. Railways Administration . . . . .	3	-43
Other business enterprises . . . . .	-15	-5
General departments . . . . .	-12	-5
Central government . . . . .	-11	-
Provincial administrations . . . . .	-13	-11
Local authorities . . . . .	-12	-9
<b>Total gross domestic fixed investment</b>	<b>-8½</b>	<b>-5</b>
<b>Real fixed capital stock</b>		
Private sector . . . . .	2½	2
Manufacturing . . . . .	1½	-
Public corporations . . . . .	13	13
Manufacturing . . . . .	8	13
Electricity, gas and water . . . . .	16	18
Public authorities . . . . .	6	4½
<b>Total real fixed capital stock</b>	<b>5</b>	<b>4</b>
Non-agricultural sectors . . . . .	5½	4½

aircraft. However, during the first half of 1978 the declining trend in the fixed capital expenditure of the central government was reversed when the capital outlays on housing projects started to increase in accordance with the government's programme of selective stimulation.

Notwithstanding the further decline in real *gross* domestic fixed investment during 1977/78, real *net* domestic investment continued to increase, enlarging the real fixed capital stock of the non-agricultural sectors of the economy by about 4½ per cent, compared with 5½ per cent in 1976/77. Because of an increase of only 1 per cent in the real gross domestic product of these sectors during 1977/78, the average amount of capital utilised per unit of non-agricultural output rose further during this period. This ratio of capital to output had been increasing since the beginning of the nineteen-seventies, but the rising trend levelled off during the first half of 1978. The average output-labour ratio declined further during 1977/78 as a result of a higher rate of increase in the economically active population in the non-agricultural sectors of the economy than in the real gross domestic product of these

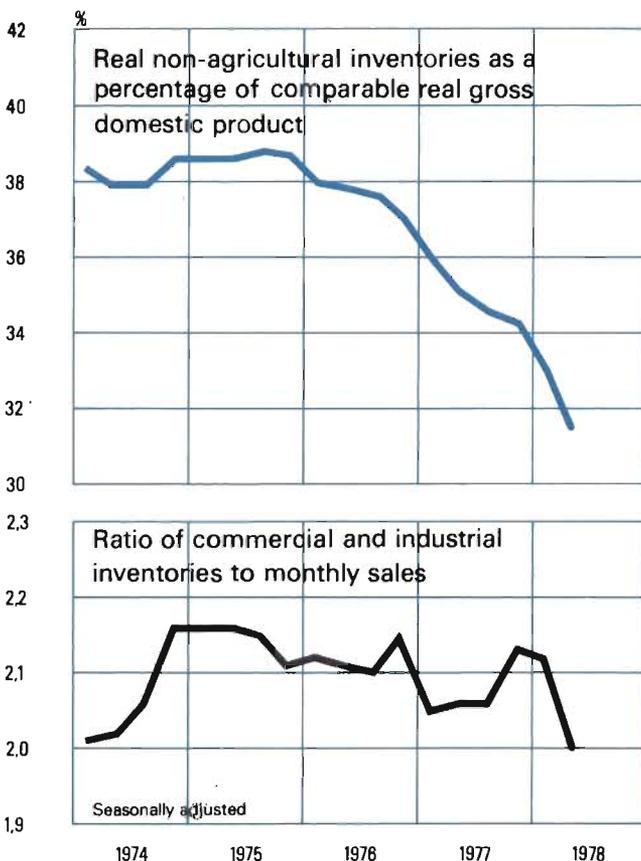
sectors. Because of a higher rate of increase in the stock of real fixed capital than in the economically active population, the average capital-labour ratio, a measure of the capital intensiveness of production in the economy, rose slightly further during the year under review.

### Sharp decline in inventory investment

The level of total inventories at constant 1970 prices declined by about R500 million during 1977/78, compared with R389 million during the preceding year, and contributed significantly to the further decline in the level of aggregate real domestic expenditure during the period under review. Real industrial and commercial inventories and real diamond stocks decreased substantially during 1977/78, but the volume of agricultural stocks in trade did not change to any significant extent.

Most of the decline in real industrial and commercial inventories occurred during the first half of 1978 when an increase in the volume of sales exceeded the rise in real production and imports. The ratio of real non-agricultural inventories to the real gross domestic product of the non-agricultural sectors fell to 31,4 per cent in the second quarter of 1978, compared with 33,1 per cent in the first quarter and the most recent peak of 38,8 per cent in the third quarter of 1975.

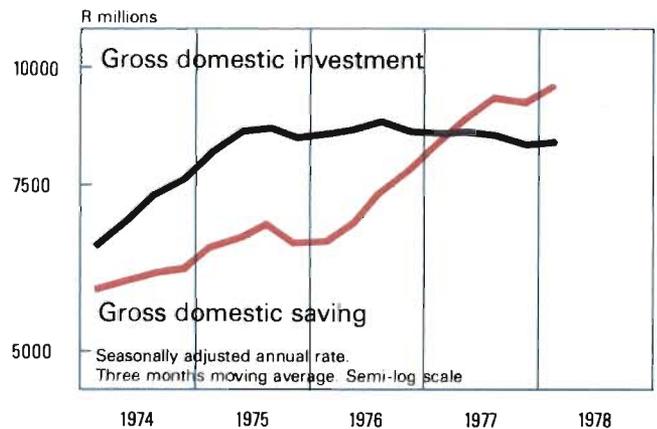
### Inventory ratios



### Further increase in gross domestic saving

Gross domestic saving rose by 12 per cent during 1977/78 as against increases of 9 per cent and 23 per cent during 1975/76 and 1976/77, respectively. For the first time in five years, gross domestic saving exceeded the amount required to finance total investment, and the resulting surplus of R984 million was used to reduce the country's net indebtedness to the rest of the world. Three of the main components of gross domestic saving, namely corporate saving, the current surplus of general government and the provision for depreciation, increased during 1977/78, but personal saving declined markedly. However, this decline reflected a change from the high level of personal saving in 1976/77, part of which was accounted for by a substantial increase in net agricultural income. Other factors contributing to the decline were the increase in private consumption expenditure during the first half of 1978 and the relatively small rise in disposable personal income during the year under review.

### Financing of gross domestic investment



The current surplus of general government increased as a result of a lower rate of increase in current expenditure than in current receipts, especially direct and indirect tax receipts. The fairly large increase in corporate saving originated mainly in the mining and financial sectors, and reflected a sharp rise in net corporate profits and lower dividend payments, the effect of which was partly neutralised by higher payments of direct taxes.

# Business cycle developments, labour situation and prices

## Lower turning point in business cycle

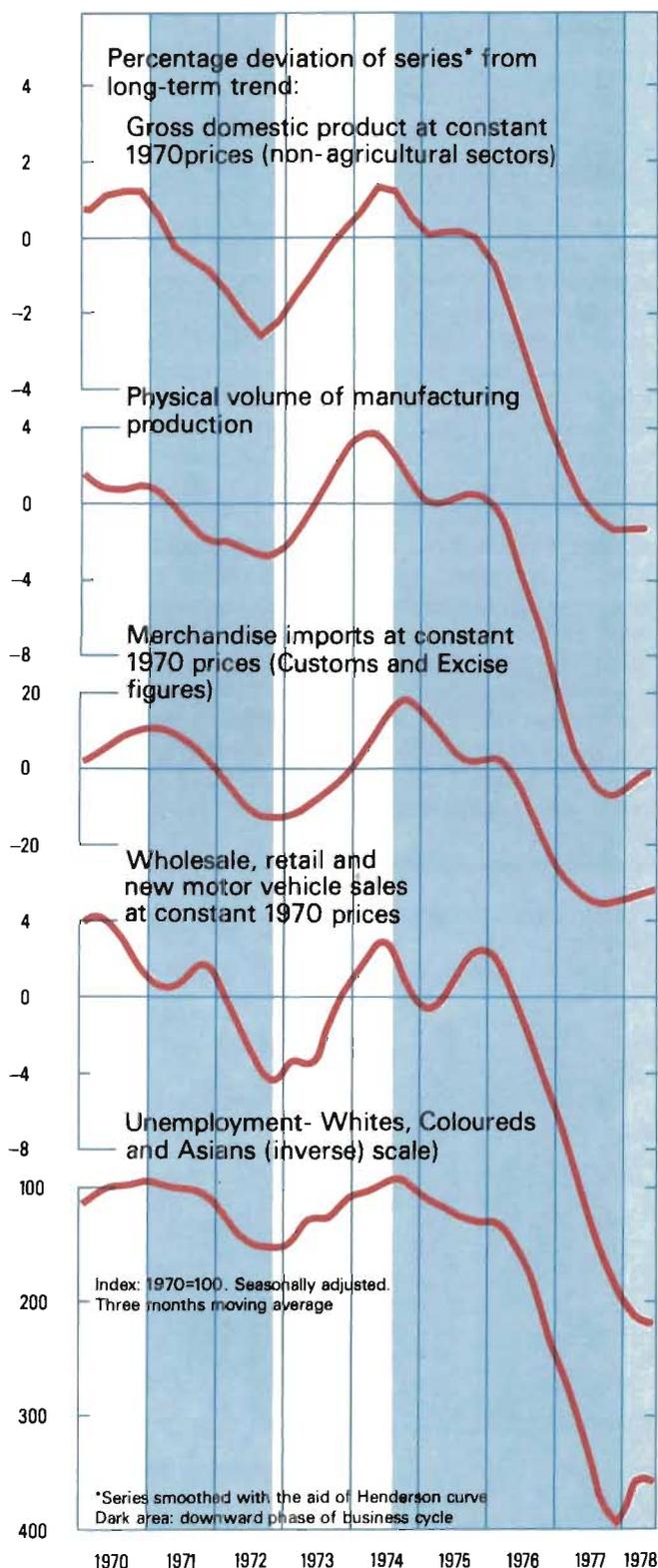
National accounts statistics and other economic indicators show that the business cycle reached a lower turning point towards the end of 1977. By that time the downward phase of the business cycle had lasted for 40 months, the longest downswing experienced during the post-war period. The most important reason for the long duration of the cyclical downswing was the severe balance of payments problem which, until recently, required a lowering of the rate of increase in real aggregate domestic demand and precluded general stimulatory policy measures. Apart from measures aimed at restricting the growth in demand, private consumption expenditure was affected adversely by the erosion of real personal income as a result of the continuing high rate of inflation. Investment activity, in turn, was constrained by high levels of inventories, the existence of surplus production capacity, the high cost of new fixed capital assets, high interest rates, and a general lack of business confidence. The balance of payments problem, in turn, was caused by the length and severity of the recession in trading-partner countries and the subsequent relatively slow economic recovery in most of these countries; steep rises in the prices of oil and other imports, which affected the terms of trade adversely and kept the value of imports at a high level even after the volume of imports had begun to decline; a sharp decline in the price of gold from early 1975 to about August 1976; the limited response of the demand for imports to a reduction in the rate of growth in aggregate domestic demand; and a decline in the net inflow of foreign capital, which eventually turned into a net outflow.

Owing to the length of the downswing, the rate of growth in economic activity declined to well below its long-term potential. The average annual rate of growth in the real gross domestic product of the non-agricultural sectors of the economy amounted to 1,2 per cent during the downward phase of the business cycle, as against 5,9 per cent for the period 1960 to 1974.

Various economic indicators confirm that a moderate economic recovery occurred during the first half of 1978. In addition to the expansionary effect of the increase in exports and the net gold output, economic growth during this period originated in higher consumer spending. An increase in consumer spending was encouraged by an upward adjustment of salary and wage scales in the public and private sectors early in 1978 and the forthcoming reduction of personal income tax announced in the 1978/79 Budget. Wholesale and retail sales at constant prices, and especially sales of new motor vehicles, reflected the increase in consumer spending, and this increase in trade was accompanied by a rise in the volume of manufacturing production and in manufacturing sales. Towards the end of the year under review, however, increased sales also resulted from heavy consumer spending ahead of the introduction of a general sales tax on 3 July 1978. The higher level of sales lowered inventory levels, and this raises the prospect that a replenishment of inventories may contribute to further economic growth.

Economic expansion continues to be constrained by the need to maintain, firstly, a surplus on the current account of the balance of payments and, secondly, a

## Business cycle indicators



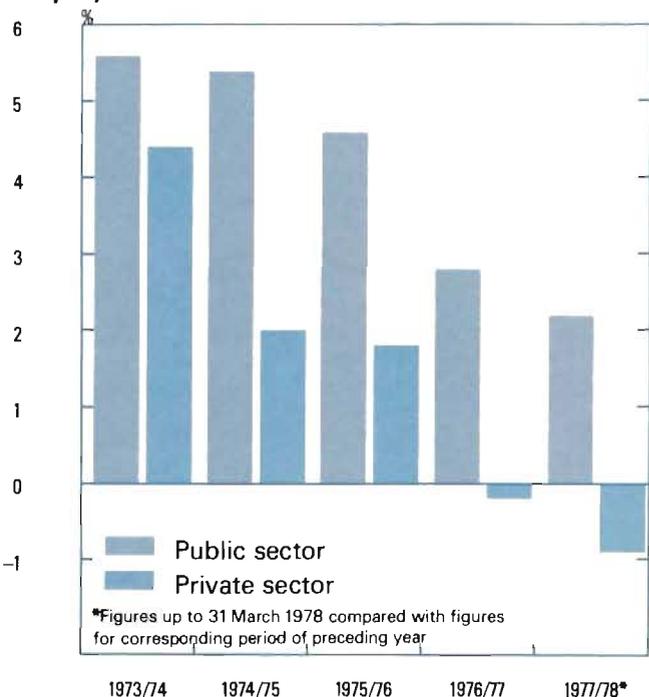
generally high level of interest rates aimed at discouraging an outflow of capital. Further limiting factors are the still existing high rate of inflation and its effect on real personal incomes and on the cost of new capital expenditure; the fact that the current utilisation of production capacity does not yet warrant any substantial new investment expenditure; and the slowdown in world trade which is expected to continue for some time.

### Labour situation

The average level of employment in the non-agricultural sectors of the economy during the first three quarters of 1977/78 was 0,1 per cent lower than during the corresponding period of 1976/77. This small decrease in employment was preceded by declining, but still positive rates of increase during the preceding three years, reflecting the cyclical downswing in real economic activity. Employment in the private sector decreased by 0,2 per cent in 1976/77 and by 0,9 per cent during the first nine months of 1977/78. The rate of increase in public sector employment, which had declined from 5,3 per cent in 1974/75 to 2,9 per cent in 1976/77, decreased further to 2,3 per cent during the first three quarters of 1977/78. Private sector employment in the first three quarters of 1977/78 declined, notwithstanding employment increases of 4,5 per cent in mining and 0,2 per cent in wholesale and retail trade. The number of employees in all other sectors decreased during the three quarters ended March 1978.

The slack demand for labour, especially in the private sector, was reflected in the number of hours worked in

### Percentage change in non-agricultural employment



manufacturing and construction, which decreased by 2,0 and 9,5 per cent, respectively, during 1976/77, and declined further by 1,5 and 7,1 per cent, respectively, during the ensuing period of seven months. Production per worker in the non-agricultural sectors of the economy increased by about 0,5 per cent in the first three quarters of 1977/78, compared with a decline of 0,7 per cent in 1976/77. This improvement was largely due to the fact that the decline in labour inputs exceeded that in the volume of output.

Preliminary figures for the first quarter of 1978 indicate a slight increase in non-agricultural employment, in accordance with the higher level of real economic activity. The seasonally adjusted number of employees in the non-agricultural sectors increased by 0,5 per cent during this quarter because of higher employment in the public as well as the private sector. This improvement was confirmed by a slight decline in unemployment among all population groups. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians decreased from 34 641 in December 1977 to 29 752 in March, before increasing slightly to 31 170 in June 1978. According to a survey conducted by the Department of Statistics, the number of unemployed Blacks decreased from about 633 000 in October 1977 to approximately 569 000 in February 1978.

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

	1974	Year ended 30 June			1978*
		1975	1976	1977	
Whites:					
At current prices . . .	11,6	15,9	9,6	10,6	7,0
At constant prices . .	1,7	1,6	-1,7	-0,7	-3,2
Non-Whites:					
At current prices . . .	18,1	27,7	17,6	14,6	10,8
At constant prices . .	7,7	11,9	5,5	2,9	0,4
All population groups:					
At current prices . . .	11,9	20,0	12,7	12,5	8,8
At constant prices . .	2,0	5,2	1,1	1,0	-1,5

\* Figures up to 31 March 1978 compared with figures for the corresponding period of the preceding year.

The average remuneration per worker in the non-agricultural sectors of the economy, which had increased by 12,7 per cent in 1975/76 and 12,5 per cent in 1976/77, was 8,8 per cent higher in the first three quarters of 1977/78 than in the corresponding period of 1976/77. However, if the effect of increasing prices on purchasing power is taken into account, the average real remuneration per worker declined by 1,5 per cent during the first three quarters of 1977/78, compared with increases of 1,1 per cent in 1975/76 and 1,0 per cent in 1976/77. As shown in the accompanying table, the average real remuneration of White workers, which had declined during 1975/76 and 1976/77, continued to decrease in the first three quarters of 1977/78. The average real remuneration of Non-White workers showed a small rise during this period, after having increased fairly substantially during preceding years.

### Slightly lower rate of price increases

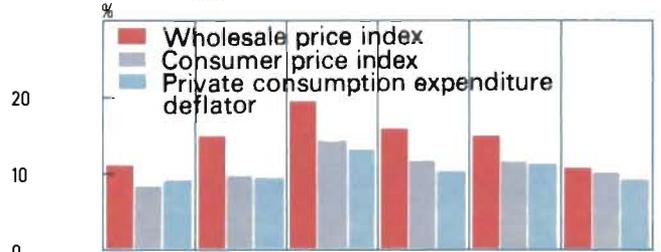
Various measures of price increases, such as the private consumption expenditure deflator and the consumer and wholesale price indices, show that the rate of inflation declined during 1977/78. In the absence of demand pressure and any excessive increase in the money and near-money supply, this decline was largely caused by the lower rates of increase in most cost variables, in particular unit labour costs and the costs of domestically produced and imported production inputs such as basic metals and metal products, machinery and transport equipment, building and construction materials, petroleum and diesel oil. Although the rates of increase in costs were lower than before, cost levels remained high, accounting for the still existing high level of the rate of inflation.

The new consumer price index of the Department of Statistics, which incorporates changed weights and coverage and is based on the 1975 expenditure patterns of households in different income categories, shows that for all income groups the rate of increase in consumer prices declined from 11,5 per cent in 1975/76 to 11,4 per cent in 1976/77 and then decreased further to 10,0 per cent in 1977/78. A lower rate of increase was recorded during 1977/78 despite accelerated increases in food prices and in the costs of certain services, such as servants' wages and medical and transport costs. Lower rates of increase in the prices of all other goods and of housing services contributed to the decline in the rate of inflation.

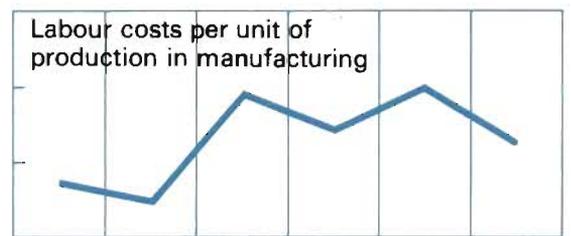
Consumer price indices for different income groups have recently been introduced by the Department of Statistics. During 1977/78 consumer prices increased by 9,8 per cent for households with an income of less than R2 000 in the base year 1975, by 10,0 per cent for households with an income ranging from R2 000 to R5 999 in 1975, and by 10,1 per cent for households with an income of R6 000 or more in the base year. The higher rate of increase recorded for the upper income groups was due mainly to the greater weights of service costs in the indices for these groups and the more rapid rise of these costs during the year under review.

In the course of 1977/78 the rate of increase in the consumer price index for all income groups declined significantly. The seasonally adjusted annual rate of increase in consumer prices fell from 10,6 per cent in the second quarter of 1977 to 8,3 per cent in the last quarter of 1977, rose to 9,1 per cent in the first quarter of 1978, and then declined to 5,1 per cent in the second quarter. The acceleration during the first quarter was due to a sharp rise in food prices and higher rates of increase in the prices of motor cars and furniture, and in housing costs, whereas the sharp deceleration during the second quarter reflected lower price increases for all goods and for services other than housing and transport. The lower rate of increase in the prices of goods was probably related to the reduction in March of sales duties and the surcharge on imports, and price competition aimed at promoting consumer purchases before the introduction of the general sales tax. Compared with the same month in the preceding year, consumer prices rose by 9,1 per cent in March, 8,6 per cent in April, 8,4 per cent in May and 8,2 per cent in June 1978. It is expected that a higher rate of increase

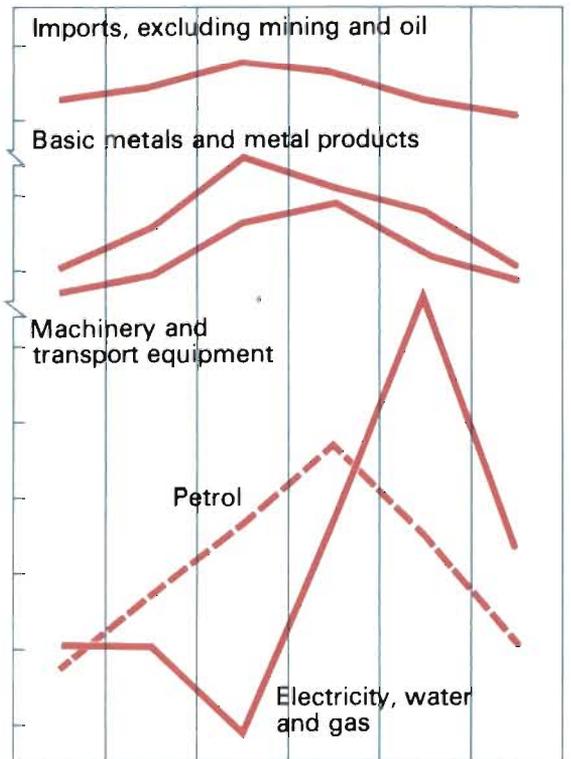
### Percentage change in prices, labour and transport costs



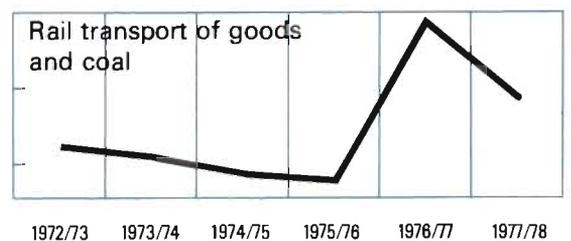
### Labour costs



### Wholesale prices



### Transport costs



## Prices

Annual percentage change in quarterly averages of seasonally adjusted monthly indices

	2nd qtr. 1977 to 3rd qtr. 1977	3rd qtr. 1977 to 4th qtr. 1977	4th qtr. 1977 to 1st qtr. 1978	1st qtr. 1978 to 2nd qtr. 1978	1976/ 1977 to 1977/ 1978
<b>Consumer prices</b> .....	11,3	8,3	9,1	5,1	10,0
Goods .....	10,5	9,8	9,2	4,3	10,1
Services .....	12,1	7,6	6,5	8,9	9,5
<b>Wholesale prices</b> .....	6,9	6,5	13,8	9,6	10,5
S.A. produced goods .....	6,1	7,3	14,1	9,4	10,7
Imported goods .....	9,2	4,2	13,0	10,2	9,9

will be recorded in July because of the effect of the general sales tax. The escalating effect of the sales tax may, however, be partly neutralised by the abolition of sales duties and the levying of excise tax at lower rates on less essential high-rated goods which were previously subject to sales duties.

As in the case of consumer prices, wholesale prices of goods for domestic use rose at progressively lower rates during the past three years. The monthly average wholesale price index, which had risen by 19,4 per cent in 1974/75, increased by 15,7 per cent in 1975/76, 14,8 per cent in 1976/77 and 10,5 per cent in 1977/78. Both domestically produced and imported goods showed significantly lower rates of price increase in 1977/78. Prices of goods produced in South Africa rose by 15,6 per cent in 1976/77, but the rate of increase declined to 10,7 per cent in 1977/78. All major items included in the index for domestically produced goods showed lower rates of price increases. The rate of increase in the prices of imported goods declined from 12,5 per cent in 1976/77 to 9,9 per cent in 1977/78.

On a quarterly basis, the seasonally adjusted wholesale price index rose at annual rates of 6,9 per cent and 6,5 per cent in the third and fourth quarters of 1977, respectively. However, because of a faster rise in electricity tariffs and higher rates of increase in the prices of coal, locally produced metals and metal products, food, and imported goods, the rate of increase in wholesale prices accelerated to 13,8 per cent in the first quarter of 1978, before declining again to 9,6 per cent in the second quarter. During the first half of 1978 relatively low or declining rates of increase were recorded in the prices of domestically produced agricultural products, beverages, tobacco, textiles and clothing. Compared with the same month in the preceding year, wholesale prices increased by 9,7 per cent in April, 9,3 per cent in May and 8,5 per cent in June 1978.

# Balance of payments

The high priority in economic policy assigned to the strengthening of the balance of payments in recent years started having its effect towards the middle of 1976, and during the past two years the current account of the balance of payments improved markedly. A stronger current account made it possible to accommodate a net outflow of capital during 1977/78, and also allowed repayments on foreign loans. Because of the improved current account, the emphasis in economic policy could be shifted towards mild stimulation of the economy. As a result of the net outflow of capital, however, the balance of payments remained an important policy consideration.

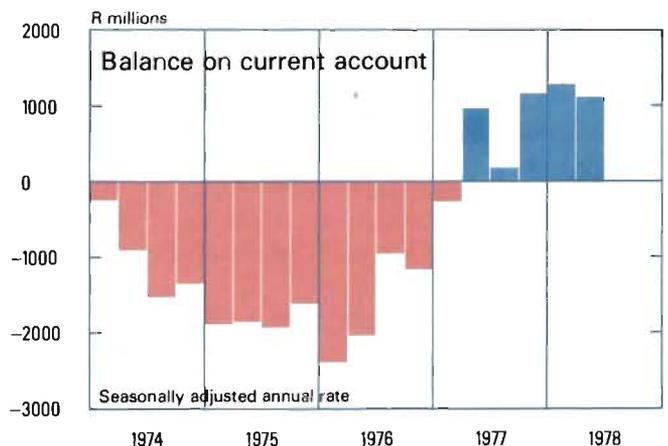
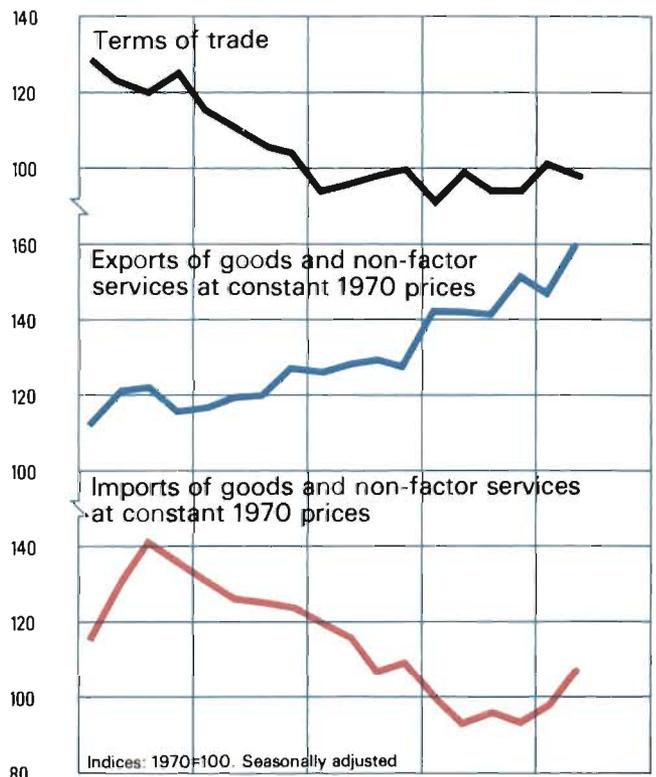
Various further measures affecting the balance of payments were introduced during 1977/78. Firstly, the 1978/79 Budget provided for increased expenditure on export promotion. Secondly, the free transfer abroad at the official exchange rate of the redemption proceeds of government and semi-gilt-edged stock acquired by non-residents with security rand was terminated on 30 March 1978. Since then, non-residents have been allowed to invest in 6 per cent Security Rand Bonds with a maturity of 7 years. These bonds are not transferable, but the redemption proceeds may be transferred abroad on maturity. Thirdly, in order not to induce excessive dividend transfers, the cut-off date of 1 January 1975 from which dividends out of the profits of foreign-controlled companies could be freely transferred abroad, was not advanced to 1 January 1976 as originally announced. In addition to these measures, the official gold reserves have been valued at market-related prices, with effect from 11 April 1978.

## Further improvement of the current account

The improvement of the current account of the balance of payments, which had begun in the second quarter of 1976, continued during 1977/78. Following a decline in the deficit on the current account from R1 996 million in 1975/76 to R353 million in 1976/77, a surplus of R984 million was recorded during 1977/78. As a percentage of the gross domestic product, the balance on the current account changed from a deficit of 7,2 per cent in 1975/76 to a surplus of 2,7 per cent in 1977/78. Quarterly figures show an even more dramatic improvement. At a seasonally adjusted annual rate, the balance on the current account changed from a deficit of R2 545 million in the first quarter of 1976 to a surplus of R1 256 million in the first quarter of 1978, followed by a somewhat smaller surplus of R1 098 million during the second quarter of 1978.

The success achieved in improving the current account of the balance of payments was reflected in a decline in the volume of imports, which coincided with an increase in the volume of exports of goods and non-factor services. A contribution to the current account surplus in 1977/78 was also made by a slight improvement in the terms of trade arising from a substantial increase in the price of gold and a decline in the rate of increase in import prices. The result of these price and volume changes was a sharp rise in the value of merchandise exports and in the net gold output, which outweighed a moderate increase in the value of merchandise imports and in net invisible payments to the rest of the world.

## Balance of payments current account



## Continuation of upward trend in merchandise exports

Merchandise exports, which had risen by 27 per cent in 1975/76 and 34 per cent in 1976/77, increased further by 20 per cent in 1977/78 to reach a level of R6 795 million. At a seasonally adjusted annual rate, the value of merchandise exports amounted to as much as R7 461 million in the second quarter of 1978. In contrast to the preceding two years, export prices rose very little during 1977/78 and the higher value of exports was almost entirely accounted for by an increase in volume, which was higher than in the preceding two years. The relatively rapid growth in real exports was promoted by the

## Merchandise exports

Year ended 30 June	Percentage change in:		
	Value	Volume	Price
1976 .....	26,7	14,7	10,5
1977 .....	33,6	10,2	21,2
1978 .....	20,2	17,5	2,3

completion of new harbours at Richards Bay and Saldanha Bay, and it is estimated that the increased exports of coal and iron ore through these harbours contributed about 2,6 percentage points to the rise in volume of exports during 1977/78. Other contributions were made by exports of primary commodities such as maize, fruit, diamonds and uranium, and of manufactured products of the iron and steel and chemical industries.

The small increase in export prices during 1977/78 was related to international commodity price movements. *The Economist's* dollar-based index of commodity prices reached a level in April 1977 that was nearly 40 per cent above the peak reached in May 1974, but then declined by almost 20 per cent to October 1977. Subsequently, with the depreciation of the US dollar, prices started to increase again, but in June 1978 they were still about 9 per cent lower than the April 1977 peak. For 1977/78 as a whole, international commodity prices increased by only 2,2 per cent.

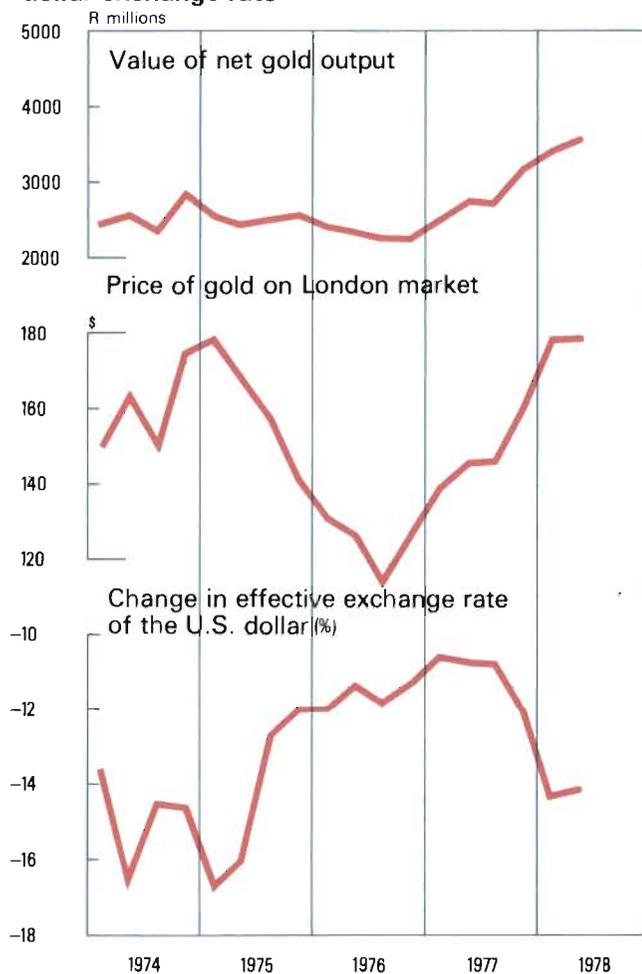
Widely divergent movements in the prices of individual South African export products occurred during 1977/78. Diamond prices, for example, were raised fairly substantially, and a surcharge was introduced to counter speculative purchases. The surcharge ranged from 40 per cent in March 1978 to 10 per cent in July. In addition, the prices of platinum and uranium rose sharply. The price of sugar, however, declined markedly as a result of the new international sugar agreement, which came into effect at the beginning of 1978.

## Substantially higher net gold output

A substantial increase in the net gold output during 1977/78 contributed materially to the current account surplus. After having declined during the preceding two years, the net gold output increased by 31 per cent from R2 455 million in 1976/77 to R3 218 million in 1977/78. This large rise was almost entirely due to a higher price of gold because the volume of the net gold output remained approximately the same as in the preceding year. The average price of gold increased from \$131,3 per fine ounce in 1976/77 to \$165,8 in 1977/78, or by 26 per cent, reaching its highest level during the year under review on 8 March 1978 when it amounted to \$190,0 per fine ounce. Subsequently, the price rose above the \$200 level to \$207,5 at the morning fixing in London on 1 August 1978.

The price of gold in the open market is strongly influenced by changes or expected changes in the exchange rate of the US dollar. As shown on the accompanying graph, an inverse correlation between the price of gold and the effective exchange rate of the dollar

## Net gold output, gold price and dollar exchange rate



existed from 1974 to the beginning of 1976. From early 1976 to the middle of 1977 this relationship was disturbed by the announcement of forthcoming gold auctions by the International Monetary Fund, widespread speculative selling, and expectations of large gold sales by the Soviet Union to replenish its foreign exchange reserves. In response to an anticipated over-supply on the market, the price of gold fell sharply until the end of August 1976. By then it was realised that demand was sufficiently strong to absorb a larger supply and the price started to recover, even though the effective dollar exchange rate was still moving upwards. By the middle of 1977 the inverse relationship between the price of gold and the dollar exchange rate had re-established itself and the sharp depreciation of the dollar since then has been accompanied by a rise in the price of gold.

## Moderate increase in merchandise imports

A rise in the prices of imported goods caused the value of merchandise imports to increase moderately by 5,9 per cent to a level of R7 360 million in 1977/78. Although the effect of the increase in prices exceeded

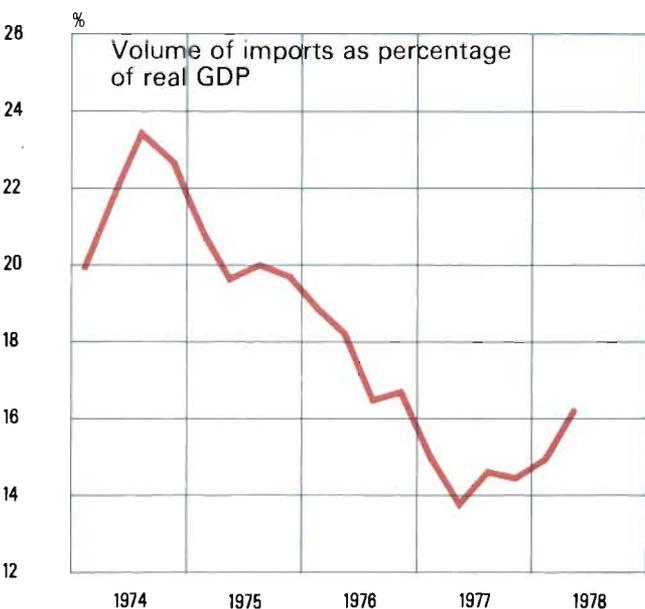
that of a further decline in the volume of imports, the rate of increase in import prices declined markedly during the past two years and in 1977/78 it was less than one-third of the rate in 1975/76. This lower rate reflected the phasing-out of the initial price effect of the September 1975 devaluation of the rand, but was also due to a sharp decline in the rate of inflation in most trading-partner countries.

Continuing its declining trend from about the fourth quarter of 1974, the volume of merchandise imports decreased until the end of 1977. Over this period merchandise imports at constant prices declined by as much as 37 per cent. In the fourth quarter of 1977 imports amounted to only 14 per cent of the real gross domestic product, which was the lowest level of this

ratio since the early nineteen-sixties and well below the average of 19 per cent for the post-war period. Coinciding with the upturn in real economic activity from the beginning of 1978, merchandise imports at constant prices started to increase in absolute terms and also as a ratio of real gross domestic product. This increase, together with a rise in import prices, resulted in the value of imports increasing, at a seasonally adjusted annual rate, from R6 942 million in the fourth quarter of 1977 to R8 204 million in the second quarter of 1978.

A breakdown of imports by commodity shows a considerable change in the composition of imports during 1977/78. Imports of oil, machinery and electrical equipment, and chemical products increased sharply, whereas imports of textiles declined substantially and those of defence equipment more moderately. In addition, the import figure for 1977/78 was inflated by purchases of new container and other ships.

### Merchandise imports



### Increase in net invisible payments

Net invisible payments to the rest of the world amounted to R1 669 million in 1977/78, compared with R1 512 million in the preceding year. A substantial increase in service payments to foreigners outweighed a fairly sharp rise in service receipts, whereas net transfer receipts from foreigners declined slightly. The higher service payments were caused by increases in dividend payments, the remuneration of migrant labourers, and payments for international freight and insurance. Interest payments on foreign loans, which had risen considerably during the preceding two years, increased only slightly during 1977/78. The larger service receipts were attributable to increases in transportation services rendered, stores sold to foreign vessels, and tourist receipts. In contrast, dividend receipts on foreign investments declined substantially. The invisible account was also affected in 1977/78 by a sharp increase in transfers abroad of emigrants' funds.

### Substantial net outflow of capital

A substantial net outflow of capital of R1 064 million, exceeding the surplus on the current account, was recorded in 1977/78, compared with net inflows of R33 million in 1976/77 and R1 664 million in 1975/76. Both the private sector and the central government and banking sector contributed to this net capital outflow, the relevant amounts being R811 million and R605 million, respectively. Against this outflow, a net inflow of R352 million was reported for public corporations and local authorities. The net outflow of capital consisted of short-term as well as long-term capital. Notwithstanding the net outflow of long-term capital, the basic balance surplus increased from R185 million in 1976/77 to R982 million in 1977/78 because of the substantial improvement of the current account.

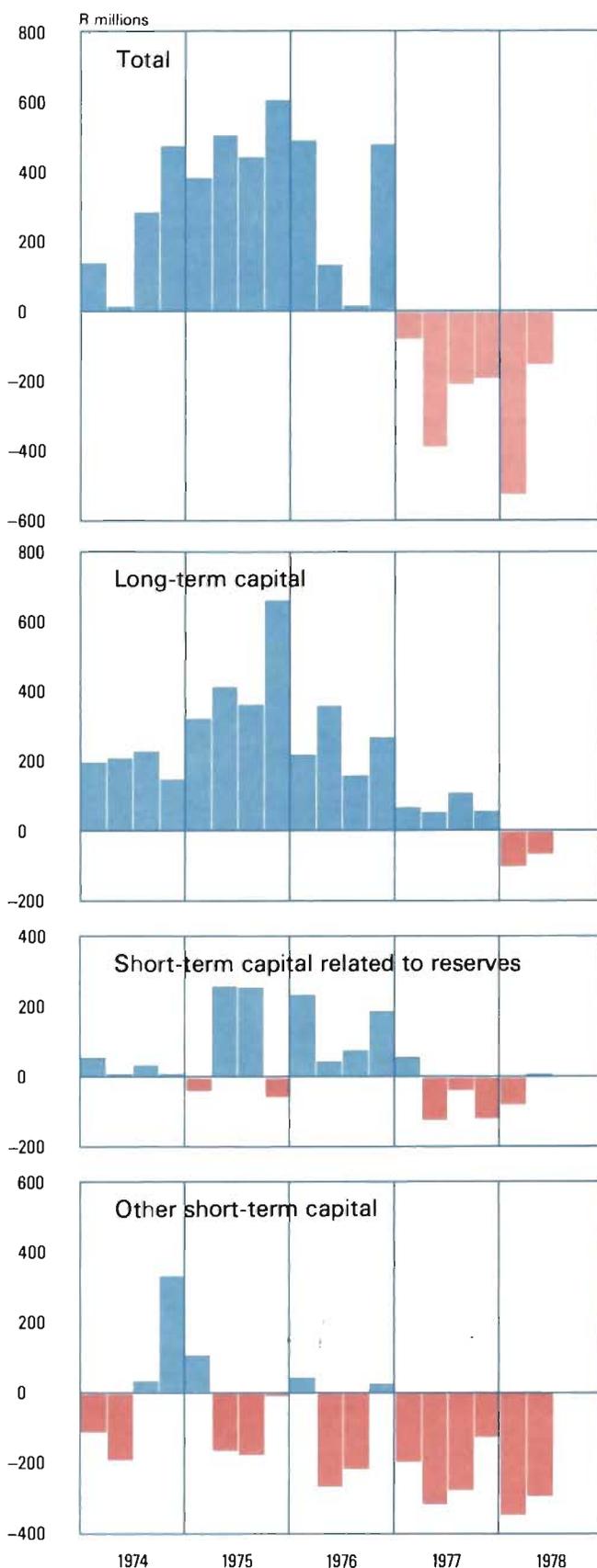
Long-term capital movements during the past four years reflected the normal course of events during a period of cyclical downswing, but during the more recent part of this period they were also influenced strongly by political uncertainties in Southern Africa. As regards cyclical changes, an inflow of long-term capital may still be expected during the early phase of

the downswing because the current account of the balance of payments is normally in deficit, all investment projects started during the preceding upswing are not yet completed and still require financing, and the domestic capital market is usually still characterised by an excess of demand over the supply of funds. As demand in general and investment expenditure in particular level off during the subsequent phases of the downswing, less foreign capital is required, and an improvement of the current account may facilitate the actual repayment of foreign debt. The inflow of long-term capital may, therefore, continue to decline or even become negative until a new cyclical upswing is well under way. In accordance with this cyclical pattern, the net inflow of long-term capital continued to increase to a peak of R660 million in the fourth quarter of 1975, despite the commencement of the cyclical downswing in real economic activity in the third quarter of 1974. Thereafter, the decline in economic activity, together with political uncertainties, caused a decrease in the net inflow of long-term capital, which changed to an actual net outflow of R161 million during the first half of 1978.

A net outflow of long-term capital from the central government and banking sector had already begun in the second quarter of 1977, but was offset until the end of 1977 by a net inflow of long-term capital to the private sector and to public corporations and local authorities. This outflow, which consisted largely of repayments on foreign loans, was related to the improvement of the current account of the balance of payments, the government's successful borrowing in the domestic capital market, and the high cost of foreign loans. The further, although smaller, net inflow of capital to public corporations and local authorities was largely accounted for by development finance for Sasol's second oil-from-coal project and Escom's nuclear power station. The private sector's net inflow of capital consisted largely of loans for the development of uranium production and other mining projects and the containerisation programme.

The net capital outflow during 1977/78 was mostly in the form of short-term capital. A significant part of the

## Net capital movements



### Net capital movements

R millions

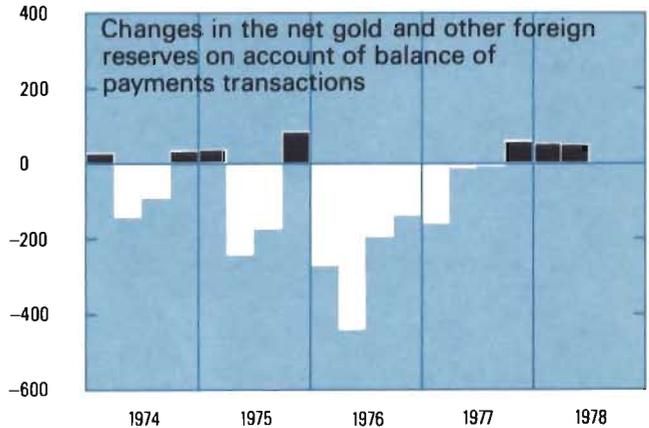
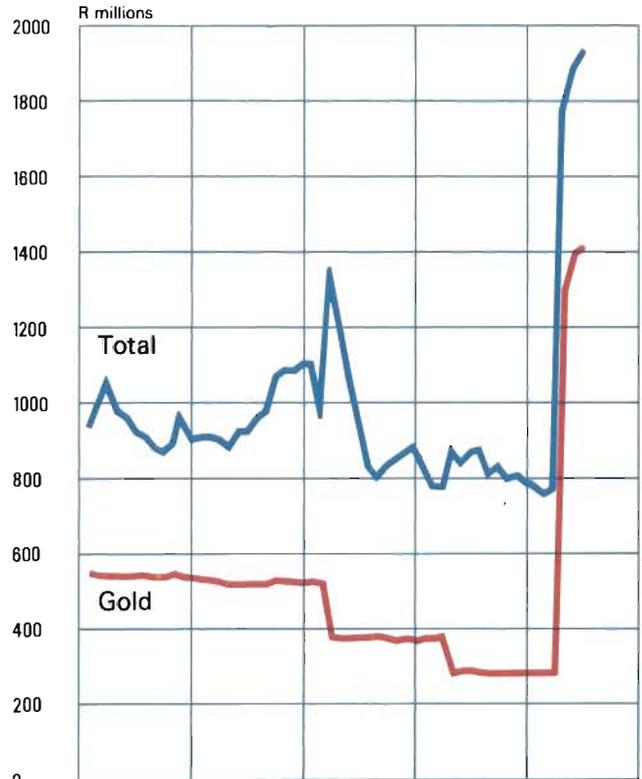
	Year ended 30 June		
	1976	1977	1978
Long-term capital			
Central government and banking sector . . . . .	258	173	-410
Public corporations and local authorities . . . . .	760	264	185
Private sector . . . . .	572	101	223
<b>Total . . . . .</b>	<b>1 590</b>	<b>538</b>	<b>-2</b>
Short-term liabilities related to reserves . . . . .	476	194	-229
Other short-term capital, including unrecorded transactions . . . . .	-402	-699	-833
<b>Total . . . . .</b>	<b>1 664</b>	<b>33</b>	<b>-1 064</b>

short-term capital outflow represented a reduction of short-term liabilities related to reserves, namely repayments on foreign loans raised previously to support the level of the country's foreign exchange holdings. However, by far the largest part of the short-term capital outflow, which also includes unrecorded transactions, was related to a decline in the foreign financing of imports and political uncertainty in Southern Africa. The increase in the value of imports in the course of the first six months of 1978 resulted in a fairly substantial decrease in the net outflow of short-term capital from the private sector during the second quarter of 1978. This smaller net outflow occurred notwithstanding the inducement to switch from foreign to domestic sources of finance that was provided by the fact that the effective cost of trade financing in terms of US dollars or Euro-dollars had come to exceed the cost of financing in terms of rand. Compared with a quarterly average of R282 million during the first three quarters of 1977/78, the net outflow of capital from the private sector, including unrecorded transactions, amounted to R188 million in the last quarter of the year under review.

**Increase in gold and other foreign reserves because of revaluation of gold reserves**

The gross gold and other foreign reserves increased by R1 056 million during the year under review to a level of R1 929 million at the end of June 1978. This increase was almost entirely due to the revaluation of the official gold reserves at market-related prices, after the new valuation procedure had come into effect on 11 April 1978. If only balance of payments transactions are taken into account, the gross reserves declined by R80 million during 1977/78. Because of the revaluation of the gold component of the foreign reserves, the composition of these reserves showed a material change. Whereas gold had accounted for only about one-third of the foreign reserves at the end of June 1977, it represented approximately three-quarters of reserves at the end of June 1978. If valuation adjustments and changes in short-term liabilities related to reserves are excluded, the increase in the net gold and other foreign reserves during 1977/78 amounted to R149 million, compared with decreases of R514 million in 1976/77 and R808 million in 1975/76.

**Gold and other foreign reserves**



# Monetary and banking situation

Only moderate changes occurred in the principal monetary and credit aggregates during 1977/78\*. The money and near-money supply increased at a rate which was slightly higher than in the preceding year, the narrowly defined money supply expanded at a substantially lower rate than in 1976/77, and the rate of increase in credit extended by the monetary banking sector declined for the fourth consecutive year to reach a relatively low level. A sharply higher increase in bank lending to the private sector became evident, however, during the first half of 1978 and was based partly on a more general demand for bank credit, related to the mildly expansionary tendencies in the economy since late 1977. During the last quarter of the year under review a marked acceleration in the growth of the money and near-money supply and of bank credit to the private sector occurred. An unusual increase in consumer spending prior to the introduction of the general sales tax on 3 July, partly financed by bank credit, accounted for an important part of the change during this period.

A generally restrictive stance of monetary policy was maintained during 1977/78. Significant concessions were made, however, in respect of the ceilings on the banks' discounts and advances to the private sector and on investments in private sector securities in the course of the year, in accordance with the government's announced policy of moderately stimulating the economy. Other features of the monetary and banking situation during the year under review were continued low levels of excess liquidity of banking institutions; a continuation of the generally downward trend of short-term interest rates, as is consistent with the normal behaviour of interest rates during the initial stages of an economic recovery; and fairly easy money market conditions, barring various periods of mostly seasonal tightness in the course of the year.

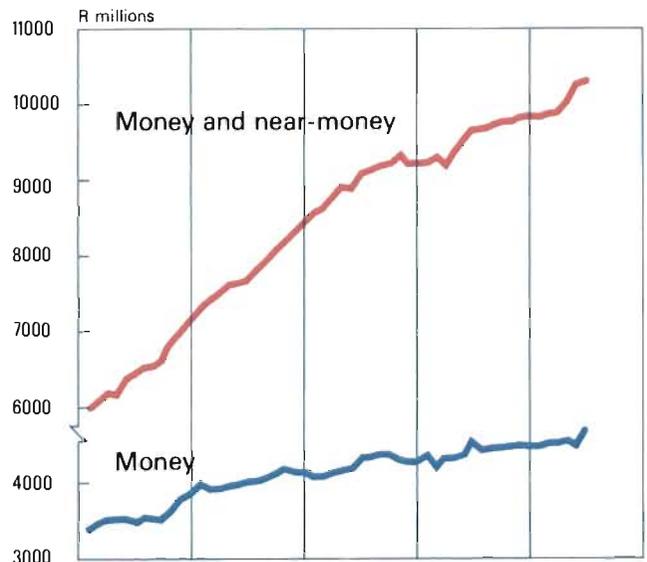
## Moderate changes in monetary aggregates

The money and near-money supply increased by R656 million, or approximately 7 per cent, during 1977/78. This rate of increase compares with a slightly lower rate of 6 per cent in 1976/77 and an average annual rate of increase of approximately 19 per cent during the three years from the end of June 1973 to the end of June 1976. Seasonally adjusted annual rates of increase during the four quarters of 1977/78 amounted to 6 per cent, 2 per cent, 2 per cent and 18 per cent, respectively. The narrowly defined money supply, which had increased at roughly the same rate as the money and near-money supply during 1976/77, rose only slightly by R102 million, or 2 per cent, during 1977/78.

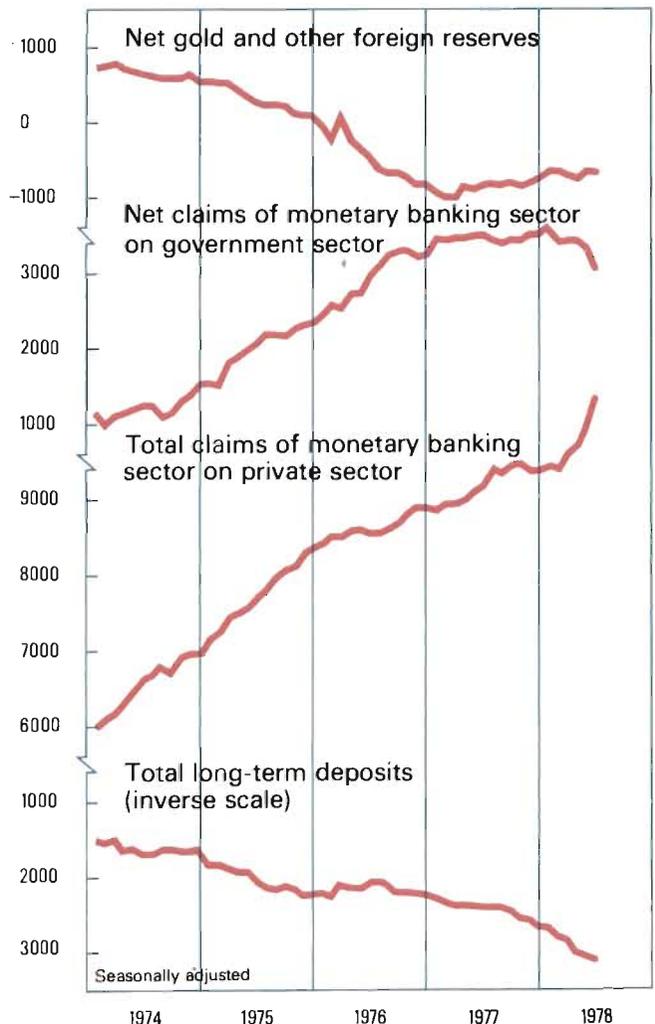
The ratio of the quantity of money and near-money to the gross domestic product, which had decreased from 30,2 per cent in the second quarter of 1976 to 28,0

\*) Data relating to the Reserve Bank's monetary analysis and to monetary banking institutions generally have been affected by the merger between a non-monetary general bank and a monetary general bank in April 1978. To preserve comparability of data, the estimated effect of this inclusion of an additional bank in the monetary banking sector has been eliminated in this review from all figures concerned.

## Monetary analysis



## Causes of changes in money and near-money



## Causes of changes in money and near-money

R millions

	Not seasonally adjusted					Seasonally adjusted				
	Year 1976/1977	1977 Third Qtr.	1977 Fourth Qtr.	1978 First Qtr.	1978 Second Qtr.	Year 1977/1978	1977 Third Qtr.	1977 Fourth Qtr.	1978 First Qtr.	1978 Second Qtr.
Net gold and other foreign reserves . . . . .	-391	-6	80	45	55	174	20	63	57	34
Claims on government sector:										
Gross claims . . . . .	673	348	57	-46	223	582	..	..	..	..
Government deposits (increase-, decrease+) . . . . .	-113	-732	61	-306	-68	-1 045	..	..	..	..
Net claims . . . . .	560	-384	118	-352	155	-463	-71	71	-65	-384
Claims on private sector . . . . .	666	322	-51	215	622	1 108	247	-60	204	721
Long-term private deposits (increase-, decrease+) . . . . .	-335	-12	-196	-128	-354	-690	-61	-187	-186	-251
Net other assets . . . . .	87	134	207	81	105	527	..	..	..	..
<b>Total causes of changes . . . . .</b>	<b>587</b>	<b>54</b>	<b>158</b>	<b>-139</b>	<b>583</b>	<b>656</b>	<b>140</b>	<b>50</b>	<b>48</b>	<b>408</b>

per cent in the second quarter of 1977, declined further to only 26,9 per cent in the first quarter of 1978, its lowest level since 1966. It recovered marginally to 27,0 per cent in the second quarter.

## Causes of changes in money and near-money supply

A marked further decline in domestic credit expansion, i.e. in the increase in monetary bank credit to the private sector and in net credit to the government sector, contributed significantly to keeping the rate of increase in the money and near-money supply at relatively low levels during most of the year under review. Largely because of a substantial increase of R1 045 million in government deposits, net claims of monetary banking institutions on the government sector decreased by as much as R463 million during the year, the first annual decrease since 1968/69. As claims on the private sector increased by R1 108 million, the overall net increase in domestic credit amounted to R645 million, or to 5 per cent.

The latter increase may be compared with an increase of well over R1 200 million, or approximately 11 per cent, during 1976/77, and with annual increases ranging from approximately R1 800 million to more than R1 900 million during the preceding three years from 1973/74 to 1975/76.

A sustained rapid increase in long-term deposits held by the private sector with monetary banking institutions was the most important single factor in maintaining the growth rate of the money and near-money supply at a fairly moderate level during most of 1977/78. For the year as a whole, long-term deposits increased by as much as R690 million, or 28 per cent. This increase was considerably larger than in any previous year and actually exceeded the increase in the money and near-money supply for the first time since 1964/65. The main reasons for this phenomenon were the continuing relatively high level of personal saving during the year; a persistent lack of interest of investors in certain other financial and real assets, such as ordinary shares and fixed property; some increase in the relative attractive-

ness of the interest rates on the longer-term deposit-type forms of financial investment in a climate of generally decreasing yields and interest rates and a declining rate of inflation; and the continuing high levels of the liquid asset requirements for banking institutions against increases in their short-term and medium-term liabilities to the public.

The effect of the net gold and other foreign reserves of the monetary banking sector on the rate of increase in the money and near-money supply during 1977/78 was markedly different from that in the preceding year. Reflecting the marked improvement in the current account of the balance of payments, the net foreign reserves of monetary banking institutions, which had declined by more than R1 600 million from the end of July 1973 to the end of June 1976 and by a further R391 million during the year 1976/77, rose by R174 million during 1977/78. A decline of R240 million in short-term foreign liabilities, representing mainly repayments on foreign loans, was partly offset by a decrease of R66 million in gross reserves (excluding changes due to the monthly revaluations of the Reserve Bank's gold holdings from April 1978). The apparently inverse relationship between movements in the monetary banks' net claims on the government sector and in

## Domestic credit extension by the monetary banking sector

Year ended 30 June	Change in					
	Net claims on government sector		Claims on private sector		Total domestic credit	
	R mil.	%	R mil.	%	R mil.	%
1973 . . . . .	52	5	1 086	28	1 138	23
1974 . . . . .	248	24	1 562	31	1 810	30
1975 . . . . .	860	67	1 061	16	1 920	24
1976 . . . . .	1 020	48	846	11	1 865	19
1977 . . . . .	560	18	666	8	1 226	11
1978 . . . . .	-463	-12	1 108	12	645	5

the net gold and other foreign reserves of the monetary banking sector (extensively commented upon in the Bank's *Annual Economic Report* for 1977), continued to be a striking feature of developments during 1977/78.

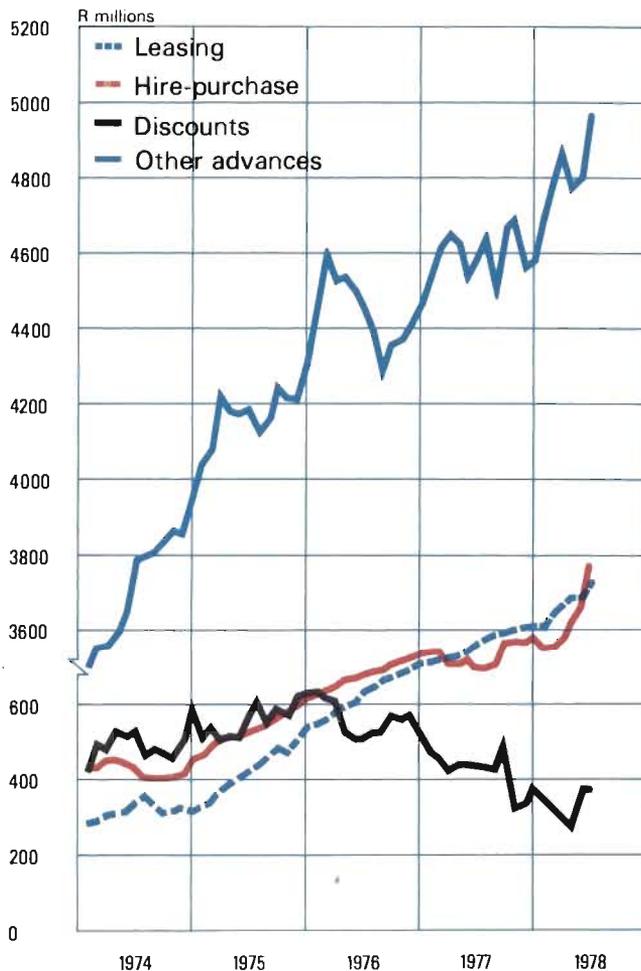
#### Acceleration of rate of increase in bank credit to the private sector

The rate of increase in the claims of the monetary banking sector on the private sector, which had declined sharply during the preceding three years from 31 per cent in the boom year 1973/74 to 8 per cent in 1976/77, accelerated significantly to 12 per cent during 1977/78. The absolute increase in these claims during 1977/78 amounted to R1108 million, compared with R666 million during 1976/77. Bank credit extension to the private sector accelerated notably in the course of the year. Whereas the seasonally adjusted annual rate of increase amounted to only about 4 per cent during the second half of 1977, it reached a level of approximately 21 per cent during the first half of 1978 and of almost 34 per cent during the second quarter of 1978.

The relatively low rate of growth in the monetary banks' credit extension to the private sector during the second half of 1977 was largely due to a continued slack demand for credit. An increased demand for bank credit, however, became apparent during the first half of 1978, reflecting the moderate economic expansion since late 1977. The acceleration in bank credit extension caused some banks, in particular the larger banking groups, to find themselves constrained in their lending operations by the ceilings on their discounts and advances to the private sector and their investments in private sector securities. In May additional scope for credit extension was created by the raising of the ceilings by an additional 4 per cent of their respective December 1975 base figures. The substantial increase in bank credit to the private sector during May and June, notably in hire-purchase financing, was related to an important extent to sharply stepped-up consumer expenditure ahead of the introduction of the general sales tax. By the end of the second quarter, a large portion of the newly created facilities under the ceilings had already been utilised.

Significant shifts in the composition of new bank credit extended occurred in the course of 1977/78. Total discounts and advances of the commercial banks, merchant banks and monetary hire-purchase and general banks increased by R756 million, or about 12 per cent, compared with R211 million, or 3 per cent, during 1976/77. This increase was heavily concentrated in the first half of 1978, and more particularly in the second quarter. If hire-purchase credit and leasing finance are excluded, the remaining discounts and advances of the banking institutions concerned declined marginally during the second half of 1977 before rising strongly during the first half of 1978. Hire-purchase and leasing finance rose rapidly throughout the year under review, recording increases of R270 million, or 38 per cent, and R174 million, or 23 per cent, respectively. The rate of extension of those two forms of credit, moreover, also showed a sharp acceleration during the first half of 1978. Reflecting these substantial increases, the outstanding amount of hire-purchase and leasing credit of

#### Commercial banks, merchant banks and monetary hire-purchase and general banks – discounts and advances



commercial banks, merchant banks and monetary hire-purchase and general banks increased from about 15 per cent of their total discounts, loans and advances at the end of June 1974 to approximately 26 per cent at the end of June 1978. Bills discounted by monetary banking institutions other than the Reserve Bank and the National Finance Corporation dropped sharply by R187 million to only R514 million from the end of June 1977 to the end of February 1978, but recovered slightly to R544 million during the remainder of the year under review.

Generally slack demand for bank credit during the first half of the year under review probably contributed to a marked increase in the monetary banking sector's holdings of private sector securities. For the year as a whole, monetary banks' investments in such securities rose by R246 million, or 19 per cent, against an increase of 13 per cent during 1976/77.

Cash credit advances by the Land Bank rose by 10 per cent during 1977/78, compared with an increase of as much as 44 per cent during 1976/77 and an average rate of increase of 31 per cent during the four-year period

from 1973/74 to 1976/77. Late harvesting of crops accounted for most of this development.

During 1977/78 the authorised ceilings on the banks' discounts and advances were increased by R693 million. Ceiling facilities utilised increased by R793 million, causing the unused portions of these facilities to decline by R100 million. The effect of the accelerated extension of new bank credit during the second half of the year under review was mainly apparent in a sharp decline in the average month-end amount of the unutilised ceiling facilities of the four largest banking groups from the second half of 1977 to the first half of 1978, despite the additional four per cent increase in the ceilings announced in May. The authorised ceilings on the banks' investments in private sector securities increased by R46 million during the year. Facilities utilised rose by R33 million, causing the unused portion to increase by R13 million.

### Liquidity situation of banking institutions

Although at relatively low levels, excess liquidity of banking institutions during most of 1977/78 was somewhat higher than during 1976/77. This was consistent with a further narrowing of the average differential between the rates on non-liquid money market instruments, such as 90-day negotiable certificates of deposit, and the Treasury bill tender rate during the year. The average month-end excess liquidity ratio of commercial banks amounted to 3,6 per cent during the second half of 1977, compared with 1,8 per cent during the second half of 1976. Low excess liquidity in June 1978 (reflecting, among other things, a marked increase in government deposits and the accelerated extension of bank credit), however, caused the average month-end ratio to be reduced to only 2,2 per cent during the first half of 1978, compared with 2,5 per cent during the first half of 1977. For all banking institutions, these average ratios amounted to 2,3 per cent during the second half of 1977, against 1,2 per cent during the second half of 1976, and to 1,4 per cent during the first half of 1978, against 1,7 per cent during the first half of 1977.

For banking institutions other than commercial banks, an increase of slightly more than 9 per cent in total liabilities to the public during 1977/78 was accompanied by a decline in required minimum liquid assets holdings of approximately 1½ per cent. This development clearly reflected a marked shift in the term structure of their deposit and other liabilities from the short and medium-term towards the long-term category. Commercial banks, on the other hand, experienced an

increase in their required liquid asset holdings of R325 million, or nearly 12 per cent, accompanying a roughly similar increase in their total liabilities to the public of about 13 per cent. As the commercial banks also showed a slight increase in the relative importance of their long-term liabilities, the reasons for this roughly proportionate increase in their minimum liquid asset holdings were to be found in a substantial rise in their medium-term liabilities to the public and in the relatively high level of the liquidity requirements pertaining to *increases* in their short-term and medium-term liabilities.

### Money market conditions and interest rates

Conditions in the money market remained fairly easy during most of 1977/78. As the slightly higher average level of excess bank liquidity during the year permitted some further shrinkage of the differentials between the rates on non-liquid and liquid assets, the interest rates on most money market instruments (other than Treasury bills) continued to show a mildly downward trend. Periods of seasonal tightness, due mainly to shifts of tax and loan funds to and from the government sector, however, occurred over the month-ends of July and August 1977, during September 1977, and during the first few months of 1978, as well as during the closing days of June and in early July 1978. Reflecting these periods of seasonal tightness, total call loans to the discount houses, which for most of the time remained within fairly narrow limits of approximately R770 million and R870 million, declined to R640 million in early September 1977, R593 million in early March 1978, R658 million at the end of June 1978, and only R584 million on 5 July. The year's peak in call loans to the discount houses, amounting to R912 million, was reached on 26 June 1978, reflecting a sustained inflow of funds into the money market (due mostly to declines in government deposits with the Reserve Bank) from early March 1978 through April, May and most of the first three weeks of June.

Moving inversely to the availability of call money in the market, Reserve Bank accommodation to the discount houses reached peaks of over R200 million at the end of September 1977 and February 1978 and of as much as R343 million at the end of June, the latter figure subsequently rising somewhat further to R371 million on 5 July. Banking institutions' free balances with the National Finance Corporation, which moved at somewhat lower average levels than in 1976/77, were virtually depleted at various stages and for varying periods in September-October 1977, January-March 1978, and June 1978.

Interest rates on money market instruments showed fairly mild fluctuations in accordance with this pattern of tightening and easing of the market in the course of the year. The rate on 90-day negotiable certificates of deposit, for example, which was quoted at 8,5 per cent at the beginning of July 1977, reached a peak of 9,2 per cent in September. After having declined to a level of 8,7 per cent which prevailed during most of November and December, this rate increased to peaks of 9,75 per cent in February and March 1978 before fluctuating downwards to 8,6 per cent at the end of June and 8,45

### Excess liquidity ratios of banking institutions

	1977			1978	
	Jun	Sept.	Dec.	Mar.	Jun.
Commercial banks . . . . .	4,8	2,2	4,7	1,3	2,6
Other monetary banks . . . . .	0,5	0,6	0,9	1,3	1,0
Other banks . . . . .	-2,9	-2,3	-1,1	-1,3	-0,4
All banks . . . . .	3,2	1,5	3,3	1,2	2,0

per cent on 21 July. The rate on 3-month bankers' acceptances closely followed these movements. Amounting to 8,8 per cent at the beginning of the year under review, this rate peaked at 9,5 per cent in February and early March 1978 but then declined again to 8,5 per cent at the end of June 1978 and to 8,4 per cent on 21 July. In contrast to the somewhat more volatile behaviour of these various interest rates, the Treasury bill tender rate moved slightly upwards during most of 1977/78. Having opened the year at 7,88 per cent on 1 July 1977, it reached a level of 8,00 per cent at the end of March

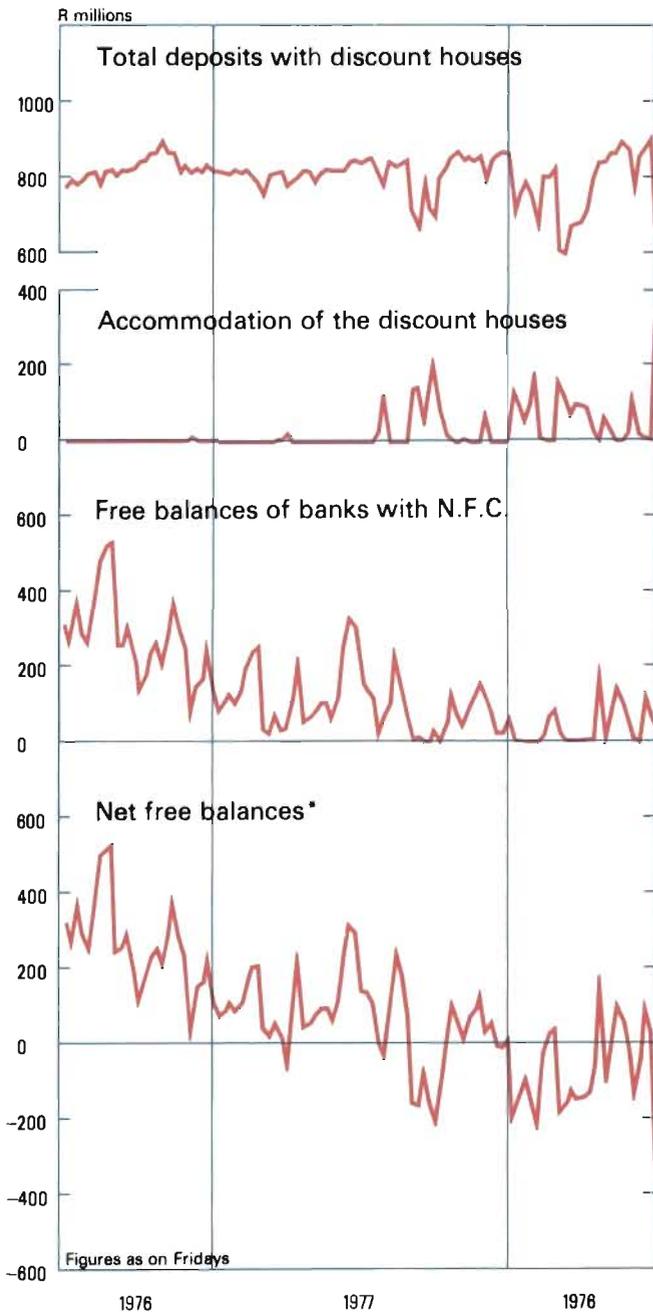
and again at the end of June 1978. It then eased marginally to 7,98 per cent on 21 July.

The weighted average call rate quoted by the discount houses rose significantly above the Treasury bill tender rate (i.e. by margins of up to 0,55 per cent) during the two periods of relatively severe money market stringency in September 1977 and February-March 1978.

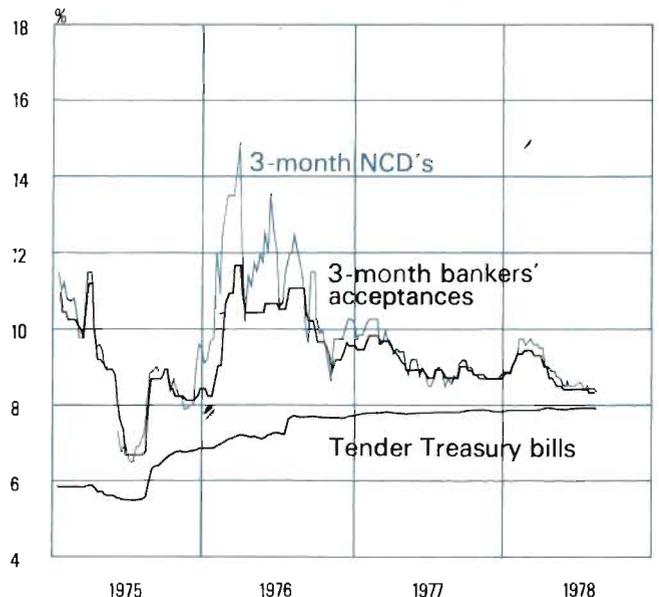
The net free balances of monetary banking institutions with the Reserve Bank and the National Finance Corporation (i.e. monetary banks' total deposits with the Reserve Bank and the National Finance Corporation, less the amount of their required balances and the amount of Reserve Bank accommodation to the banks and the discount houses) continued to show a downward trend during most of 1977/78. To an important extent this reflected a further shift by banking institutions out of call deposits with the National Finance Corporation and into increased holdings of short-term government securities and other liquid assets, a tendency which was probably encouraged by expectations of further declines in interest rates. The commercial banks, for example, reduced their free balances with the National Finance Corporation from R315 million at the end of June 1976 to R107 million at the end of June 1977 and to only R11 million at the end of June 1978. At the same time, however, these banks increased their holdings of short-term government stock from R716 million in June 1976 to R1 062 million in June 1977 and R1 494 million in June 1978. It may be observed that the reduced average level of banks' free balances with the National Finance Corporation also meant that an increased proportion of the seasonal fluctuations in the availability of call money once again had to be absorbed by the discount houses rather than the Corporation.

Apart from the Reserve Bank's sales of government

### Selected indicators of money market conditions



### Money market interest rates



securities in the open market referred to below, three changes in policy affecting the money market were made by the authorities during the year. Firstly, in order to stimulate interest in the Treasury bill tender, the differential between the Treasury bill tender rate and the NFC's rate for call deposits was increased from 0,15 to 0,25 per cent with effect from 26 August 1977, as announced by the Governor of the Reserve Bank in his Chairman's Address for 1976/77. Secondly, the Governor in his Address indicated the Bank's willingness to provide accommodation to the discount houses by rediscounting bankers' acceptances. After consultations between the Bank and the discount houses, this new method of providing assistance to the market was introduced on 1 January 1978. The amount of bankers' acceptances rediscounted by the Bank reached a peak on R109 million on 5 and 6 July 1978. Thirdly, as a consequence of the abolition of the official gold price on 1 April 1978, the system whereby the Reserve Bank purchased gold from the mines at the official price and resold it at the ruling market price, was terminated from 11 April 1978. The Bank now purchases gold from the mines at a market-related price. In terms of the new arrangement, the mines from April 1978 no longer received payment of a separate gold "premium". From October 1973, this premium had been paid shortly before the end of each month (rather than early in the next month, as had been the case previously) in order to counter the effect on the money market resulting from the regular month-end increases in the amount of notes in circulation.

### Monetary policy measures

Although a generally restrictive stance of monetary policy was maintained during the year under review, significant concessions were made in respect of the ceilings on bank credit to the private sector, in order to lend support to the authorities' proposed moderate stimulation of the economy. The regular monthly increases in the ceilings of  $\frac{1}{2}$  per cent of the December 1975 base figures, which had been suspended as a temporary measure in March 1977, were reintroduced with effect from 1 September 1977, as announced by the Governor of the Reserve Bank in his Chairman's Address in August last year. Smaller banking institutions of which the combined ceiling figure in respect of discounts and advances and investments did not exceed R10 million, were exempted from the ceiling requirements from the same date. A raising of the ceilings by an additional 4 per cent of their respective base figures, effective retroactively from 1 May 1978, was announced by the Governor of the Reserve Bank on 17 May. At the same time it was announced that the amount of credit granted to the private sector (as defined for purposes of the ceilings) which a banking institution may not exceed without becoming subject to the ceiling requirements, was increased from R10 million to R15 million.

The prescribed investment requirement applying to banking institutions (as well as those applying to building societies, insurers and private pension funds) was reduced with effect from 9 June 1978. Initially amounting to 10 per cent of banking institutions' long-term liabilities to the public (5 per cent of which was to be

held in the form of long-term government securities), this requirement had been raised to 15 per cent (8½ per cent to be held in government securities) in June 1977 in order to assist the government and other public and semi-public bodies and organisations in their domestic borrowing programmes. Banks, however, were allowed up to the end of March 1978 to comply fully with the increased level of these requirements. As from June 1978, the prescribed investment requirement for banking institutions was lowered to 13 per cent of the banks' long-term liabilities to the public, 6½ per cent of which is to be held in the form of long-term government securities. Because of limited unused facilities under the ceilings on the banks' investment in private sector securities, the immediate effect of this reduction of the prescribed investment requirement is likely to be a further increase in the excess holdings of prescribed investments.

During a substantial part of the year, the authorities' desire to ease monetary conditions to some extent had to be reconciled with a need to maintain domestic interest rates at appropriate levels *vis-à-vis* the level of rates prevailing overseas. With this in view, the Reserve Bank, among other things, from time to time embarked upon open-market sales of both short-term and long-term government securities to the discount houses, banking institutions and institutional investors. *Net* sales of such securities amounted to nearly R266 million during the year, of which net sales to the discount houses and banking institutions accounted for R210 million or approximately 82 per cent. The bulk of these net sales were made during periods of relative ease in the money market, i.e. in November to December 1977 and in the period from March to June 1978.

# Government finance

The rate of growth in central government expenditure accelerated notably during 1977/78, after a relatively low rate of increase had been recorded during the preceding year. In order to improve the balance of payments and lower the rate of inflation, the government succeeded in reducing the rate of increase in aggregate domestic demand during 1975/76 and 1976/77 by increasing taxes and lowering the rate of growth in its own expenditure. In addition, attempts were made to reduce as far as possible the government's use of bank credit as a source of finance, so as to contain the rate of growth in the money and near-money supply. The restraint on government expenditure continued into the first half of 1977/78, but towards the end of 1977 Exchequer issues began to increase faster and this trend became even more pronounced during the first half of 1978. The acceleration in expenditure was accompanied, however, by a higher rate of increase in revenue collections. In addition, funds borrowed from the domestic non-banking sector more than covered the Exchequer Account deficit in 1977/78.

To some extent the higher rate of increase in central government expenditure from the fourth quarter of 1977 reflected a shift of emphasis in economic policy, which was set out more explicitly in the 1978/79 Budget. The Budget was aimed at a mild general stimulation of the economy, without sacrificing economic stability, by removing those restraints on economic expansion which no longer served the purpose of either improving the balance of payments or reducing the rate of inflation. A strong balance of payments and a lower rate of inflation, nevertheless, remain prime objectives of fiscal policy.

## Higher rate of increase in Exchequer issues

Exchequer issues, which largely reflect central government expenditure, increased by R1 286 million, or 15 per cent, during 1977/78, compared with 7 per cent in 1976/77. This substantially higher rate of increase was partly due to shifts in the seasonal pattern of Exchequer issues during recent years, affecting the amounts included in the figures for the different years. Issues during March 1978, for example, were much higher than during March 1977.

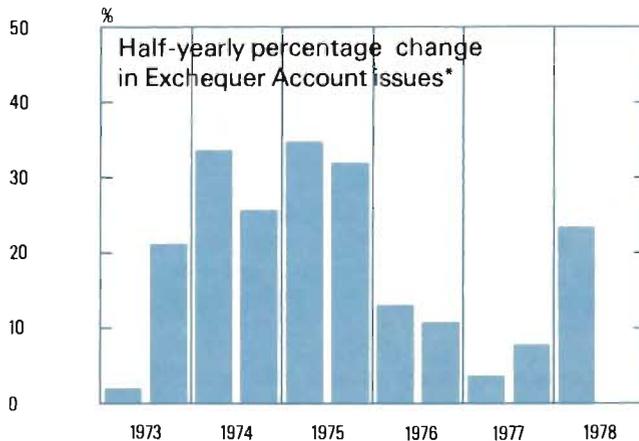
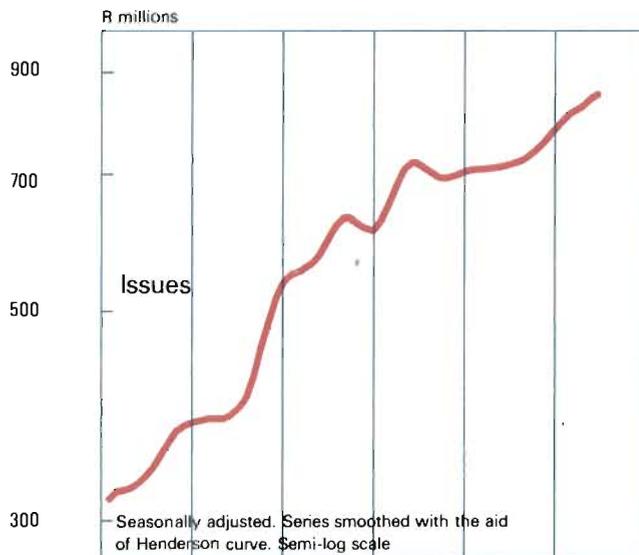
The central government's Budgets for 1976/77 and 1977/78 were aimed primarily at reducing the rate of increase in government expenditure. The effect of this policy, as shown on the accompanying graph, was a substantial decline in the rate of increase in Exchequer issues, which had reached unprecedentedly high levels during the first three quarters of 1975. A decline in the growth rate of government expenditure continued during most of 1977 and Exchequer issues during the first nine months of that year were only 3 per cent higher than during the corresponding period of 1976. During the last quarter of 1977, however, the rate of increase in issues began to accelerate and this trend continued during the first half of 1978. As a result, issues during the nine months to June 1978 actually exceeded those during the corresponding period of 1976/77 by almost 20 per cent.

## Improvement in Exchequer receipts

Exchequer receipts during 1977/78 amounted to R7 514 million, or 16 per cent more than during the preceding year. In contrast to 1976/77, when an actual decline in receipts from gold mining companies contributed to a relatively low rate of growth in overall receipts, a substantial increase in revenue collections from those companies occurred during 1977/78. Receipts in the form of income tax and mining lease payments rose by about R102 million, or 27 per cent, as against a decline of R218 million, or 37 per cent, in 1976/77. This reversal of the downward trend started in the second half of 1977 and was largely due to higher profits resulting from the rise in the price of gold from about the middle of 1976. Other current revenue increased by about 16 per cent during the year under review, which was slightly higher than the rate of increase recorded in 1976/77.

The various categories of tax collections showed divergent trends during the review period. Collections of customs duties, for example, were as much as 72 per

## Exchequer Account



\* Compared with same period of preceding year

## Revenue collections — State Revenue Fund

R millions

	Year ended 30 June			
	1975	1976	1977	1978
<b>Customs, excise and sales duties<sup>1</sup></b>				
Customs duties . . . . .	312	356	400	689
Excise duties . . . . .	550	666	850	895
Sales duties . . . . .	181	237	278	343
<b>Total . . . . .</b>	<b>1 043</b>	<b>1 259</b>	<b>1 528</b>	<b>1 927</b>
<b>Inland revenue</b>				
Income tax (excluding payments by gold mines) . . . . .	2 401	3 080	3 397	3 839
Payments by gold mines <sup>2</sup> . . . . .	804	596	378	480
Other <sup>3</sup> . . . . .	954	1 060	1 186	1 329
<b>Total . . . . .</b>	<b>4 159</b>	<b>4 736</b>	<b>4 961</b>	<b>5 648</b>
<b>Total revenue collections<sup>1</sup> . . . . .</b>	<b>5 202</b>	<b>5 994</b>	<b>6 488</b>	<b>7 575</b>

1) Including collections in respect of payments to neighbouring countries in terms of customs and excise agreements.

2) Comprising income tax and gold mining lease payments.

3) To preserve comparability, this item includes interest received from the S.A. Railways Administration but excludes receipts of interest and redemption payments from provincial administrations.

cent higher than in 1976/77, largely because of the imposition of a 15 per cent surcharge on imports in March 1977. Sales duty receipts increased by 23 per cent, mainly as a result of higher rates introduced early in March last year. Collections of excise duties, on the other hand, which represent the government's main source of indirect taxation, rose by only 5 per cent. This relatively low rate of increase reflected the slow growth in the demand for goods that are subject to excise duties, most of which are goods of a semi-luxury nature. Duties collected on petroleum products rose markedly, following the increase in rates in 1977. The largest part of these collections, however, is not available as government revenue, but is transferred to a separate State Oil Fund, *inter alia* for the financing of the second oil-from-coal project. The aggregate amount of customs, excise and sales duty collections increased by 26 per cent to R1 927 million during 1977/78, compared with an increase of 21 per cent in 1976/77. Part of these collections is transferred to neighbouring countries in terms of customs and excise agreements. These transfers amounted to R183 million in 1977/78.

Income tax receipts from individuals and companies other than gold mines rose by 13 per cent during 1977/78, compared with 10 per cent during 1976/77. A detailed breakdown of income tax receipts by source is not available for the period under review. Such data as are available, however, suggest that the rate of increase in tax payments by individuals was lower and that by companies higher than in the preceding year.

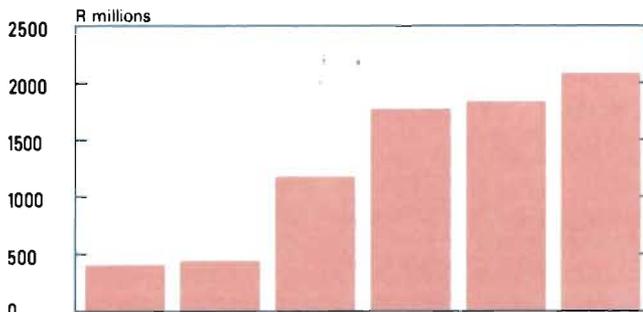
### Exchequer Account deficit financed from domestic non-banking sources

The deficit on the Exchequer Account, excluding borrowing and loan redemptions, reached a record level of R2 089 million in 1977/78, which was R238 million

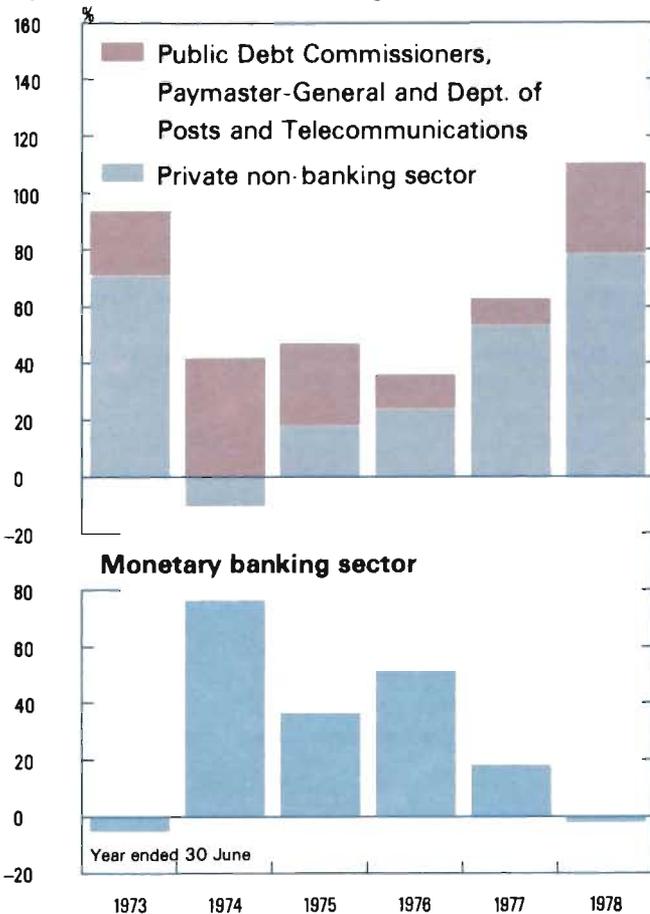
more than in the preceding year. As shown on the accompanying graph, the relative importance of the private non-banking sector as a source of funds for financing the deficit continued to increase during the year under review. No less than 79 per cent, or R1 645 million, of the deficit was financed by net borrowing from this sector, compared with 53 per cent in 1976/77. The substantial amount of funds raised in the private non-banking sector was due, not only to the retention of compulsory loan levies, but also to this sector's favourable response to issues of marketable stock and non-marketable bonds. Subscriptions to stock issues were influenced by expectations of a decline in long-term interest rates and the higher prescribed investment requirements for financial institutions that had been announced in March 1977; these requirements were, however, reduced again in June 1978. The largest contribution to Exchequer financing by investors in the private non-banking sector was made by insurers and private pension funds, which increased their holdings of government securities by R510 million. A substantial portion of this increase reflected purchases in the secondary market for government stock. Applications by the private non-banking sector for non-marketable securities, such as Treasury Bonds, Defence Bonus Bonds (both of which are available to individuals only) and National Defence Bonds, rose from R400 million in 1976/77 to R685 million in 1977/78. Net receipts of compulsory loan levies amounted to R384 million.

The Public Debt Commissioners also further increased their contribution to the financing of the Exchequer Account deficit. During 1977/78 their net new investment in government securities amounted to R678 million, compared with R295 million in the preceding year. The Commissioners experienced a substantial inflow of funds during the year, mainly from public

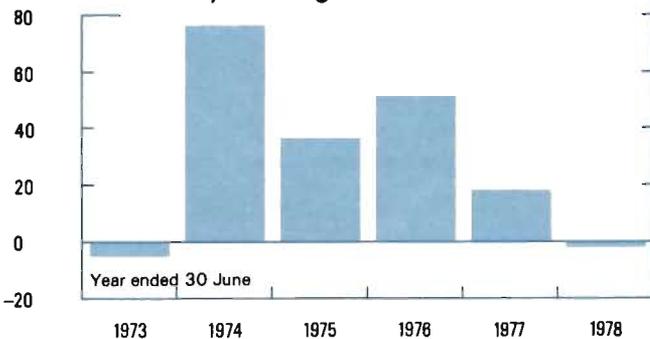
## Exchequer Account deficit



## Percentage of Exchequer Account deficit financed by: Domestic non-banking sector



## Monetary banking sector



pension funds, the South African Railways Administration and other government bodies. In fact, since December 1977 not all funds available to the Commissioners were invested in government securities and large amounts were deposited by them with the National Finance Corporation and, in March 1978, with the discount houses. The Public Debt Commissioners' contribution, therefore, would have been higher if an amount of R270 million had not been invested by them with the National Finance Corporation at the end of June 1978.

The substantial net new investments of R2 323

million in government securities by the domestic non-banking sector more than covered the shortfall on the Exchequer Account and enabled the Treasury not only to reduce its net indebtedness to the foreign sector, but also to make substantially less use of the monetary banking sector as a source of finance than in previous years. Net repayments of foreign debt by the Treasury during 1977/78 amounted to R190 million, compared with net borrowings (including drawings on the International Monetary Fund) of R365 million during 1976/77. The monetary banking sector increased its holdings of government securities by R621 million during the year. However, Exchequer deposits with the banking sector rose by about R665 million, with the result that net indebtedness to the banking sector, for the first time since 1972/73, declined by R44 million, compared with an increase of R322 million in 1976/77 and as much as R910 million in 1975/76.

## Less restrictive 1978/79 Budget

In view of the success which had been achieved since 1977 in improving the country's balance of payments, the central government Budget for the fiscal year 1978/79 was aimed at encouraging economic growth within the framework of financial discipline. The need for a shift of emphasis in economic policy had already been pointed out by the Minister of Finance in the second half of 1977 and certain steps had been taken in this regard. The Budget aimed at providing further momentum to this new approach.

Although the policy of financial restraint in expenditure, adopted in 1977/78, was maintained in the Budget, expenditure on export promotion, housing, public works, and the new oil-from-coal project was increased. Pension and social benefits were also raised significantly.

## The 1978/79 Budget

	R millions	Percentage change
Expenditure . . . . .	10 114	9,7
Revenue . . . . .	7 943	9,9
Deficit (excluding borrowing and debt repayment) . . . . .	2 171	8,9
Debt repayment:		
Domestic . . . . .	1 522	
Foreign . . . . .	232	
<b>Total borrowing requirement . . . . .</b>	<b>3 925</b>	
Financing:		
Domestic loans:		
Public Debt Commissioners . . . . .	650	
Re-investment of maturing stock . . . . .	1 230	
New stock issues . . . . .	750	
Non-marketable debt . . . . .	795	
Foreign loans . . . . .	75	
Use of available cash balances . . . . .	425	
<b>Total financing . . . . .</b>	<b>3 925</b>	

Total expenditure in the fiscal year 1978/79 is expected to rise by about 10 per cent, or approximately 2 percentage points less than in the preceding year. This moderate increase, which implies a marginal reduction in real expenditure, mainly reflects the effect of an actual decline of almost 6 per cent in the proposed expenditure on the Defence Vote. Excluding defence expenditure, aggregate central government expenditure is expected to increase by 13 per cent during 1978/79, compared with 9 per cent in 1977/78. The purpose of maintaining restraint in government spending is to provide more scope for economic activity in the private sector.

In addition to these short-term economic policy measures, the Budget also embodied elements of structural tax reform in the form of the introduction of a new general sales tax at the retail level. This tax was introduced in order to provide a broader base for indirect taxation with a built-in growth potential based on increases in consumption expenditure, to spread the tax burden more evenly, and to provide a more effective economic regulator. The new tax, which is levied at a rate of 4 per cent, became operative on 3 July 1978. When presenting the Budget to Parliament, the Minister reduced the existing sales duties. On 1 July 1978, he announced the abolition of the sales duties on certain goods, as well as the reduction, and the conversion to excise duties, of the sales duties on the remaining less essential goods that were subject to relatively high rates of sales duty. Because of the need for additional income, the temporary 15 per cent surcharge on imports, imposed in March 1977, was not abolished; it was, however, reduced to 12½ per cent. The Minister also stated his intention to reduce the surcharge further, indicating that it will be phased out as and when fiscal circumstances permit. In order to reduce the impact of the new general sales tax on those in the lower income groups, R20 million was provided to help stabilise the prices of basic foodstuffs, and the fixed per capita tax on Black taxpayers was abolished. Various other concessions were also made in the Budget, including the reduction by 2½ percentage points of the surcharge on company tax and the abolition of the 10 per cent surcharge on personal income tax. This was done, not only to reduce the maximum marginal income tax rate on individuals from 66 to 60 per cent, but also to provide some stimulus to the economy. The compulsory loan levy payable by individuals and companies was maintained at existing rates. However, in order to improve taxpayers' cash flows, and to mitigate the effect of the introduction of the general sales tax, the repayment of the 1972 loan levy was advanced from February 1979 to July 1978.

As shown in the accompanying table, which also includes data for the South West Africa Account, expenditure and revenue in 1978/79 are estimated to rise by approximately 10 per cent above their 1977/78 levels. The deficit before borrowing is estimated at R2 171 million, or about R180 million more than the estimated shortfall for 1977/78. Taking loan repayments of R1 754 million into account, the government's total borrowing requirement is estimated at R3 925 million. It is expected that R3 425 million, or about 87 per cent, of this amount will be financed by domestic borrowing,

while available cash balances will be employed to the extent of R425 million. New foreign borrowing during the fiscal year 1978/79 is estimated at only R75 million, and it is anticipated that the government's indebtedness to the foreign sector will be reduced by R157 million.

### Changes in tax structure

The introduction of the general sales tax from 3 July 1978 once again focused attention on the relative importance of direct and indirect taxes as sources of revenue to the central government. This matter achieved prominence in the late nineteen-sixties, following the report of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa which recommended an increase in the relative importance of indirect taxes. The introduction, in the fiscal year 1969/70, of sales duties at the manufacturing or importer level helped to raise the share of indirect taxes in total tax revenue from 35 per cent in the fiscal year 1968/69 to 41 per cent in 1971/72. During the next three years, however, there was a continuous decline in the share of indirect taxes to only 30 per cent in 1974/75, reflecting, among other things, inflation-induced increases in the direct taxable incomes of individuals and the consequent shift of such incomes into higher income tax brackets; increases in direct tax collections because of the imposition of surcharges on normal income tax payable by companies and individuals; and the upsurge during these years in income tax payments by gold mines, following increases in the free market price of gold.

Since the fiscal year 1974/75 an upward tendency in the share of indirect taxes has been observed again, largely as a result of increases in recent years in the rates of customs, excise and sales duties and because of the imposition of a 15 per cent surcharge on imports in 1977/78. Budget data indicate that slightly more than 38 per cent of the total tax revenue of the central government will consist of indirect taxes during the fiscal year 1978/79.

### Direct and indirect taxes as percentage of total central government tax revenue

	Fiscal year ended March				
	1969	1972	1975	1978	1979*
Direct taxes . . . . .	65	59	70	64	62
Indirect taxes . . . . .	35	41	30	36	38
	100	100	100	100	100

\* Based on Budget estimates.

# Capital market

The further increase in domestic saving during 1977/78 led to a significantly improved supply of funds in the financial market in general and in the capital market in particular. The greater availability of funds in the capital market was reflected in a decline in yields in the fixed-interest security market, notwithstanding a substantial increase in the amount of new funds raised in this market; an increase in stock exchange turnover and share prices; a notably larger flow of funds to savings institutions; and, towards the end of the period under review, also a small increase in mortgage lending and in real estate transactions. In contrast to more buoyant conditions in the fixed-interest security and share markets, activity in the mortgage and real estate markets remained at low levels during most of the year under review. During the second quarter of 1978, however, a recovery became evident in these markets.

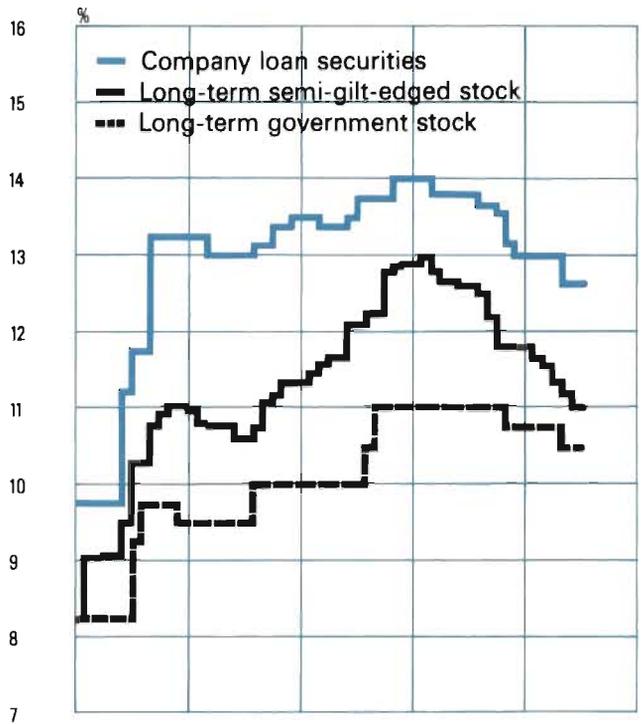
## Increased activity and lower yields in the fixed-interest security market

The easing of the market for fixed-interest securities from March 1977 gained further momentum during 1977/78, notwithstanding a substantial increase in the amount of new funds raised in this market. The yield on new issues of long-term government stock was adjusted downwards in three stages, namely from 11,00 per cent in September 1976 to 10,75 per cent in November 1977, 10,625 per cent in May and 10,50 per cent in June 1978. A more pronounced decline occurred in the case of the yield on new long-term issues of the highest grade semi-gilt-edged stock, namely from 12,6 per cent in June 1977 to 11,0 per cent in June 1978. The yield on new issues of loan securities by companies listed on the Johannesburg Stock Exchange declined from 13,8 per cent in March 1977 to 12,7 per cent in June 1978. Because of these yield changes, the margin between the long-term yield on semi-gilt-edged and gilt-edged stock narrowed from 1,6 per cent in June 1977 to 0,5 per cent in June 1978. This margin is characteristically small during the initial stages of a cyclical upswing. During the last quarter of 1972, when the economy was last in a similar phase of the business cycle, the margin declined to as little as 0,3 per cent.

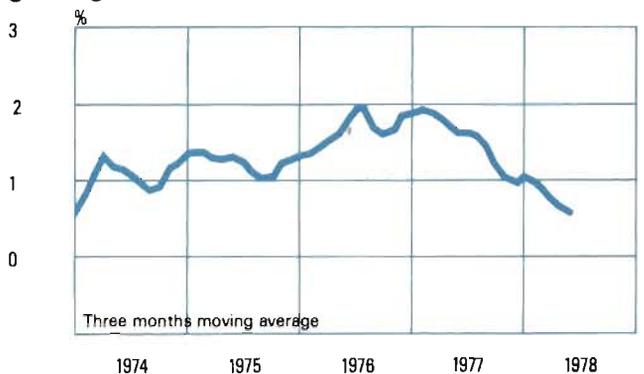
New funds raised in the fixed-interest security market during 1977/78 by means of new issues of gilt-edged and semi-gilt-edged securities, excluding the increase in the borrowers' holdings of their own securities, amounted to R2 471 million, or R852 million more than the already high figure of R1 619 million in 1976/77. Net new issues of loan securities by companies listed on the stock exchange increased from R139 million in 1976/77 to R189 million during 1977/78.

The demand for government and semi-gilt-edged stock during 1977/78 was strengthened by the higher statutory investment requirements for financial institutions announced in March 1977, investors' expectations of a decline in security yields, and limited investment opportunities in the private sector. Because of the favourable market conditions, the central government raised a substantial amount of new funds, and local authorities and public corporations were able to acquire more funds than provided for in their initial borrowing plans. As shown in the accompanying table, new issues

**Yields on fixed-interest securities**



**Yield margin between long-term semi-gilt and gilt-edged stock**



were concentrated more heavily in the second half of the year under review.

Because of the ease with which the central government could satisfy its borrowing requirements and the need to increase the supply of funds to the private sector, in accordance with government policy to create a climate conducive to economic recovery, the investment requirements for financial institutions were lowered in June 1978. In terms of this amendment, the requirements in respect of holdings of government stock as well as the total prescribed asset requirements for banking institutions, insurers and private pension funds were reduced by 2 percentage points. In the case of building societies, the requirement in respect of holdings of government stock was lowered by  $\frac{1}{4}$  of a percentage point.

### Net new issues of marketable fixed-interest securities

(Excluding increase in public sector borrowers' holdings of their own securities)

R millions

Sector	Year ended 30 June						
	1974	1975	1976	1977	1978		Total*
					1st half	2nd half*	
Central government . . . . .	-97	498	789	965	746	706	1 452
Public corporations . . . . .	224	145	154	386	325	492	817
Local authorities . . . . .	149	171	161	268	111	91	202
<b>Total, public sector . . . . .</b>	<b>276</b>	<b>814</b>	<b>1 104</b>	<b>1 619</b>	<b>1 182</b>	<b>1 289</b>	<b>2 471</b>
Private sector . . . . .	117	124	189	139	102	87	189
<b>Total . . . . .</b>	<b>393</b>	<b>938</b>	<b>1 293</b>	<b>1 758</b>	<b>1 284</b>	<b>1 376</b>	<b>2 660</b>

\* Preliminary data.

The growing net new investment in public sector securities and a correspondingly more limited net new investment in other securities from the second half of 1974, resulted in a considerable change in the composition of the financial assets of financial institutions over the past four years. The relative importance of claims on the public sector increased during this period, whereas that of claims on the private sector showed a corresponding decline. This was reflected in virtually all individual types of claims of financial institutions on the private sector. The allocation of investment funds by financial institutions between the public and private sector during 1977/78, which favoured a substantial further investment in public sector securities, tended to emphasize the shift in the composition of financial assets during recent years.

### Recovery of share market

Share prices, which had fluctuated downwards for a period of about three years, recovered significantly from the beginning of 1977/78. In June 1978 share prices, on average, were approximately 30 per cent higher than in June 1977. This rise in share prices coincided with an increase in turnover, with the average number and average value of shares traded increasing by 25 per cent and 107 per cent, respectively, from 1976/77 to 1977/78. Because of the rising trend in gold mining share prices, associated with the increase in the price of gold, and also in the prices of other classes of shares, foreign investors once again began to show some interest in South African shares. This interest was apparently also related to the withdrawal by the authorities in the

### Financial assets of financial institutions

	30 June 1974		30 June 1978	
	R millions	%	R millions	%
Claims on the public sector:				
Government securities . . . . .	7 175	27,1	12 816	30,4
Local authority securities . . . . .	1 091	4,1	1 926	4,5
Public corporation securities . . . . .	1 182	4,5	2 435	5,8
<b>Total public sector securities . . . . .</b>	<b>9 448</b>	<b>35,7</b>	<b>17 177</b>	<b>40,7</b>
Other claims on the public sector . . . . .	426	1,6	1 153	2,7
<b>Total claims on the public sector . . . . .</b>	<b>9 874</b>	<b>37,3</b>	<b>18 330</b>	<b>43,4</b>
Claims on the private sector:				
Ordinary shares . . . . .	1 798	6,8	2 659	6,3
Preference shares and loan securities . . . . .	844	3,2	1 129	2,7
Mortgage loans . . . . .	7 139	27,0	10 101	23,9
Other loans, discounts and advances . . . . .	6 794	25,7	9 995	23,7
<b>Total claims on the private sector . . . . .</b>	<b>16 575</b>	<b>62,7</b>	<b>23 884</b>	<b>56,6</b>
<b>Total financial claims . . . . .</b>	<b>26 449</b>	<b>100,0</b>	<b>42 214</b>	<b>100,0</b>

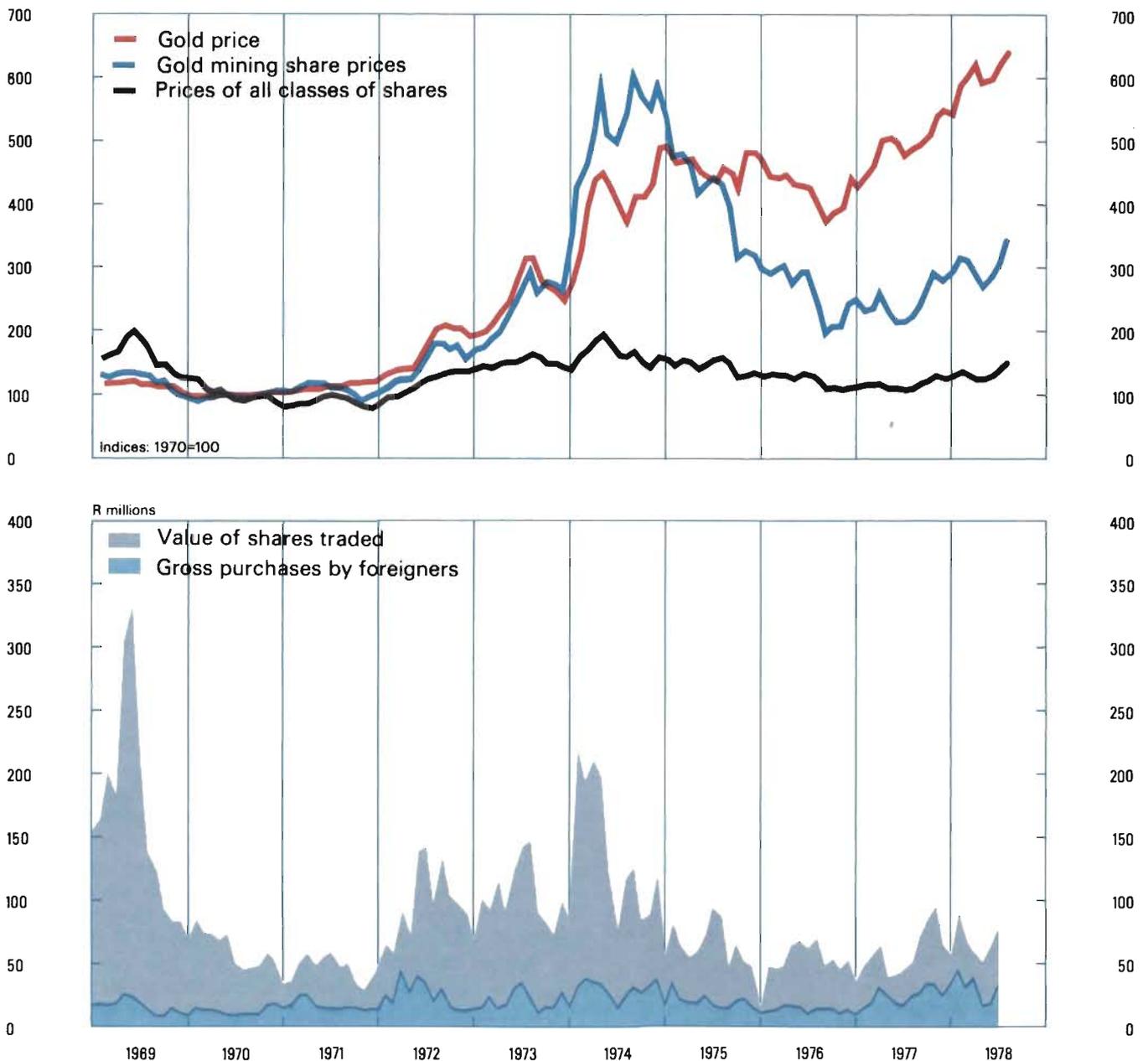
United Kingdom in December 1977 of the requirement that twenty-five per cent of the sales proceeds of foreign securities be converted into sterling through the official foreign exchange market. For the first time since the first quarter of 1973, foreigners were net purchasers of South African securities during the first quarter of 1978. During the second quarter, however, net sales of securities were recorded again.

The increase in share prices applied to all classes of shares and ranged from 13,6 per cent and 18,2 per cent in the case of coal mining and industrial and commercial shares, respectively, to 28,7 per cent, 33,7 per cent and 43,2 per cent in the case of financial, other metal and

mineral, and gold mining shares, respectively. These share price movements were reflected in share yields, and the dividend yield on all classes of shares declined from 9,6 per cent in June 1977 to 7,0 per cent in June 1978. The inverse yield gap between ordinary shares and long-term government stock widened from 1,4 per cent to 3,5 per cent over the year 1977/78.

Unit trusts recorded a further and slightly higher net outflow of funds, amounting to R9 million, during 1977/78, compared with R4 million during 1976/77. However, as a result of the general rise in share prices, the market value of the trusts' net assets increased by R80 million to reach a level of R352 million at the end

### Stock exchange



### Percentage change in share prices

Year ended 30 June	Mining shares				Financial shares			Industrial shares	Commercial shares	All classes of shares
	Gold	Coal	Other metals & minerals	Mining	Industrial and general	Real estate	Banking and insurance			
1977.....	-26,6	26,2	2,2	-18,4	-9,9	-33,3	-14,5	-12,9	-18,7	-17,3
1978.....	43,2	13,6	33,7	31,0	22,0	6,8	47,5	20,5	20,7	30,0

of June 1978. The average selling price of units rose by 30,0 per cent during the year under review, whereas the average yield on units declined from 8,3 per cent in June 1977 to 6,5 per cent in June 1978.

A relatively small amount of new capital was raised during 1977/78 by companies listed on the stock exchange. New share issues amounted to R104 million, compared with R411 million in 1976/77. The high level of corporate saving and the relatively low level of investment by the corporate sector accounted for this limited demand for new funds.

### Further decline in the rate of mortgage lending

As during 1976/77, the rate of mortgage lending by financial intermediaries operating in the mortgage market, declined during 1977/78, reflecting the sluggish conditions in the real estate market and the construction sector. These institutions' mortgage loans outstanding rose by R643 million, or 7 per cent, during the year that ended on 31 March 1978, compared with increases of 9 per cent and 12 per cent in corresponding years that ended in 1977 and 1976, respectively. This lower rate of increase in mortgage lending occurred notwithstanding a generally larger inflow of funds to the institutions concerned, and was probably due to a continuing slow growth in the demand for mortgage loans, which caused the institutions to channel more of their funds to other investment outlets.

The inflow of funds to building societies, for example, increased during the year under review, but their mortgage lending declined. The amount actually paid

out as mortgage advances by building societies was R944 million, or R136 million less than during 1976/77. Apart from a slack demand for housing loans, a reason for this decline was that building societies had to increase their holdings of prescribed investments other than liquid assets, after their formerly suspended prescribed investment requirements had been reinstated in March 1977. Mortgage loans extended by participation mortgage bond schemes declined because of a further decrease in their inflow of funds.

The large inflow of funds to building societies reflected the more general increase in the flow of non-contractual longer-term funds to deposit-receiving and related institutions. This inflow amounted to R2 175 million in 1977/78, or to 45 per cent more than the corresponding figure of R1 498 million in 1976/77. As during the preceding year, banking institutions were the largest recipients of longer-term funds during the year under review, followed by the building societies. A new series of tax-free Treasury bonds proved to be very popular and a substantial amount was invested in these securities, raising the proportionate share of the inflow of funds to government savings facilities quite markedly. As in the case of participation mortgage bond schemes, the net new investment in the Post Office Savings Bank (including National Savings Certificates) declined during 1977/78.

Mortgage loans granted by building societies increased during the second half of the period under review when the inflow of funds became somewhat larger than during the first half of 1977/78. In June 1978 the limits on mortgage loans in excess of R18 000 and the proportion of aggregate loans that may be advanced on flats and commercial and business buildings, were abolished. This step was taken on the understanding that building societies would continue to apply the generally accepted principle that a mortgage loan be restricted to an amount on which the monthly instalment does not exceed 25 per cent of the borrower's monthly income; that they would not give preference to more lucrative loans to the detriment of applications for smaller loans; and that second mortgage bonds would only be allowed by way of exception in deserving cases. Furthermore, despite the formal abolition of the 3 per cent limit on loans advanced on buildings for commercial and business purposes, building societies were requested to continue observing this limit as far as possible.

Mortgage rates generally remained unchanged at their 1975/76 levels during the year under review, notwithstanding the slack demand for mortgage loans and a

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

	Year ended 30 June			
	1977		1978	
	R mil.	%	R mil.	%
Banking institutions.....	627	41,9	1 079	49,6
Building societies.....	610	40,7	660	30,4
Participation mortgage bond schemes.....	27	1,8	5	0,2
Post Office Savings Bank and National Savings Certificates....	229	15,3	202	9,3
Other government savings facilities.....	5	0,3	229	10,5
<b>Total.....</b>	<b>1 498</b>	<b>100,0</b>	<b>2 175</b>	<b>100,0</b>

larger inflow of funds to mortgage market intermediaries.

### Smaller decline in real estate transactions

Although the value of real estate transactions declined further by 7 per cent during 1977/78, the decrease was nevertheless smaller than the 12 per cent in 1976/77. Moreover, a recovery of market activity became evident in the second quarter of 1978. This improvement coincided with the higher demand for housing loans and the moderate acceleration of the rate of mortgage lending by building societies during the first half of 1978.

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### Fixed property market

