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Annual Economic Report 1980

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 Sixtieth Ordinary General Meeting to be held on 26 August 1980.

South African Reserve Bank

Hierdie Verslag is ook in Afrikaans beskikbaar.

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Summary and general observations

The current upswing in the South African economy entered a more advanced stage during the year under review.* In the second half of 1979 economic activity recovered also in those sectors in which conditions had remained sluggish during the earlier part of the upswing. Reflecting a stronger and more broadly based recovery, the rate of economic growth accelerated further in the second half of 1979 and gained more momentum in the first half of 1980, averaging 6½ per cent for the year as a whole. Higher rates of growth were recorded in the non-agricultural sectors of the economy and an almost equally strong rise occurred in the real output of the agricultural sector. The higher level of economic activity in 1979/80 was reflected in a more rapid rise in employment and unemployment decreased moderately during the year under review.

The higher rate of growth from about the middle of 1979 was based on a considerable further improvement in real aggregate domestic demand, which was accounted for mostly by a strong rise in real private consumption expenditure and a sharp reversal of the declining trend in real fixed investment. In contrast with the early stages of the recovery phase, exports made a relatively smaller contribution to real economic growth in the year under review. The initial export-led economic recovery was, therefore, superseded in 1979/80 by an upswing that derived its momentum largely from a strong increase in domestic demand. This increase reflected, among other things, more consumer confidence, an increase in real personal disposable income, a favourable investment climate, and an ample availability of funds. More generally, the increase in demand was both encouraged and facilitated by the substantial build-up of liquidity in the economy and the accompanying relatively low levels of interest rates.

In the last quarter of the year under review the rate of economic growth in the non-agricultural sectors of the economy reached a level of approximately 7 per cent per annum and signs were beginning to emerge that the economy was approaching capacity limits in certain sectors. Shortages of certain classes of skilled labour were generally experienced, stronger demands for higher salaries and wages were made, certain intermediate goods and final consumer goods were running into short supply, and the rates of increase in wholesale and consumer prices showed renewed acceleration. Of these developments, the more rapid rise in prices may be singled out as a cause for concern. In June 1980, for example, wholesale and consumer prices were 15,9 per cent and 14,6 per cent, respectively, higher than in June 1979, and in 1979/80 as a whole the rates of increase in these prices were only marginally below the peak levels of 1974/75.

By attaining a high rate of growth in 1979/80, one of the main objectives of economic policy in recent years had been achieved. From the end of 1977 the policy objective of higher economic growth had been awarded high priority. Fiscal policy had been aimed at promoting growth, not by means of increased government expenditure, but rather through encouraging private consumption and investment expenditure. In the year under review the tax concessions granted to individuals and companies in the March 1979 Budget showed an expansionary effect on the economy. Further measures consisting of the early repayment of loan levies, increased social security benefits, and larger food and transport subsidies, were introduced in the fourth quarter of 1979. In the subsequent Budget in March 1980 the objective of promoting economic growth retained high priority. Large further tax concessions were granted to individuals and companies in order to increase personal disposable income and to enhance the financial capacity of companies to expand their fixed and inventory investment. These Budget measures will have their effect from the second half of 1980.

From 1978 monetary policy had been aimed at accommodating a higher rate of economic growth by means of allowing additional scope for bank credit extension to the private sector. During 1979/80 special increases in the ceilings on bank credit to the private sector were made in August 1979 and again in March 1980, apart from the regular increases of ½ per cent per month of the base figures as at the end of December 1975. With effect from about 21 April 1980, the cash reserve and liquid asset requirements for banking institutions were changed significantly as a first step towards placing more emphasis on cash reserve requirements and supporting open-market operations as instruments of credit control. This was done with a view to the eventual abolition of the credit ceilings on banking institutions' credit extension to the private sector.

Much of the scope for more rapid economic growth in 1979/80 was provided by a substantial surplus on the current account of the balance of payments and a marked increase in the revenue of the central government, both of which were directly related to the strong rise in the price of gold. The record annual surplus on the current account was predominantly the result of a very large increase in the value of the net gold output. Merchandise exports continued to rise, but the rate of increase was substantially lower than that in merchandise imports. In the second quarter of 1980 merchandise exports actually declined, while merchandise imports rose at a higher rate than during the preceding three quarters of the year under review. The surplus on the current account in 1979/80 was exceeded by a net outflow of capital, causing the gross gold and other foreign reserves of the country to decline on account of balance of payments transactions. The net reserves,

*The year under review refers to the twelve-month period from July 1979 to June 1980 and is denoted as 1979/80.

however, increased further because of repayments on loans obtained previously by the government and the Reserve Bank for the purpose of supplementing the country's foreign exchange holdings. If valuation adjustments, including the revaluation of the gold reserves at market-related prices, are taken into account, the gross gold and other foreign reserves increased by a large amount during 1979/80, mainly because of a substantial rise in the price of gold during the year.

The net outflow of capital during 1979/80 was increased substantially by the large-scale switching of trade financing from foreign to domestic sources in response to wide margins between short-term interest rates in South Africa and those in other countries. During the first quarter of 1980 the net outflow of short-term capital was deliberately encouraged by the authorities as a means of draining excess liquidity from the economy. From the middle of March to the middle of April, however, this capital outflow resulted in substantial foreign exchange losses and a severe tightening of the money market. After having made arrangements to control the domestic liquidity situation more effectively through its open-market operations, the Reserve Bank in April raised the discount on US dollars in forward exchange transactions in order to discourage an unduly large financing of trade in South Africa. By raising this discount, the difference between the effective cost of financing trade, covered by forward exchange contracts, in rand and in US dollars was largely eliminated.

Exchequer receipts increased at a high rate in the year under review, not only because of a near-doubling of income tax and mining lease payments by gold mining companies, but also as a result of the favourable effects of the high level of exports and the increase in domestic economic activity on income tax receipts from other companies and on general sales tax and customs duty receipts. The anticipation of substantial increases in government revenue allowed tax concessions to be granted in the 1979/80 as well as in the 1980/81 Budget as a means of promoting economic growth. Although Exchequer issues rose at a higher rate than in the preceding year, the sharp rise in receipts in 1979/80 prevented the deficit before borrowing from increasing by more than a relatively small amount above the figure for 1978/79. In contrast with the preceding year, however, less was borrowed from the Public Debt Commissioners and the private non-banking sector during 1979/80, and an increase occurred in the Treasury's net indebtedness to the monetary banking sector. This increased net indebtedness was one of the causes of a sharp rise in the money and near-money supply during the year under review.

The quantity of money and near-money increased at an exceptionally high rate of 21 per cent during 1979/80. An even higher rate of increase of 27 per cent occurred in the narrowly defined money supply. If banking institutions' short-dated and medium-dated re-

purchase agreements with the private non-banking sector, which are close substitutes for money and near-money deposits, are taken into account, the monetary expansion was even more pronounced. Including these agreements, the money and near-money supply increased by as much as 32 per cent during 1979/80. The more advanced stage of the upswing in the economy was reflected in a shift in the pattern of the causes of changes in the money and near-money supply. The extension of net domestic credit accelerated substantially during 1979/80, the increase in the monetary banking sector's net gold and other foreign reserves was markedly smaller than during the preceding year, and a sharp reduction occurred in the increase in long-term deposits as a negative cause of change in the money and near-money supply.

Total bank credit extension increased by 17 per cent during 1979/80, consisting of an appreciable increase in the monetary banking sector's net claims on the government sector as well as a sharp rise in claims on the private sector. Bank credit to the private sector in the form of hire-purchase credit and leasing finance increased sharply in accordance with the more rapid rise in consumer expenditure and private fixed investment. The general industrial and commercial demand for bank credit, on the other hand, rose only moderately because of the high level of corporate saving and the increased availability of funds on favourable terms outside the banking system.

Periods of rapidly rising liquidity were present in the money market in the course of the year under review. Market conditions were generally very easy, except for regular tightenings over most month-ends and fairly severe tightenings on a number of other occasions during the year. Money market interest rates continued to decline to the end of November and early December 1979, increased during the subsequent four to five months, and declined again during the ensuing period. The Reserve Bank's open-market sales of securities were stepped up substantially during the year under review in order to provide the highly liquid market with adequate investment outlets. During the first half of the year these operations were aimed at ensuring an orderly downward adjustment of interest rates, but during the second half of the year more emphasis was placed on a policy of stabilising short-term interest rates. The amount of paper sold by the Bank in the market during 1979/80 was nearly R2,3 milliard. In its dealings, the Bank made use of various new instruments and techniques. Open-market sales of securities included sales of special tap Treasury bills which matured on major tax-payment dates. In addition, repurchase agreements were concluded with banking institutions, in terms of which the securities sold by the Bank are to be repurchased on future dates. The Bank also commenced issuing its own debentures as a further means of absorbing excess cash in the market.

The substantial build-up of liquidity in the economy

gave rise to a marked increase in transactions in the capital market during the year under review. Secondary market transactions in fixed-interest securities, shares and fixed property soared to very high levels and mortgage and other lending rose strongly. The amount of new funds raised in the fixed-interest security and share markets by the private sector was relatively small, reflecting the high level of corporate saving, increased intercompany borrowing, and a preference for direct loans on favourable terms from financial institutions. Capital market yields generally declined during the first eight months of 1979/80. Towards the end of March, however, expectations of an increase in long-term yields became widespread, resulting in a slight rise in such yields during the remaining part of the year under review.

National accounts

Substantially higher rate of economic growth

After a prolonged period of slow economic expansion, the rate of economic growth increased substantially in the year under review. The real gross domestic product rose at a substantially higher rate of 6½ per cent in 1979/80, compared with 2½ per cent in the preceding year. A marked acceleration in the rate of growth occurred in the course of 1979/80. In the first half of the year the real gross domestic product was only 4½ per cent higher than in the first half of 1978/79, but in the second half the increase in relation to the second half of 1978/79 amounted to as much as 8 per cent.

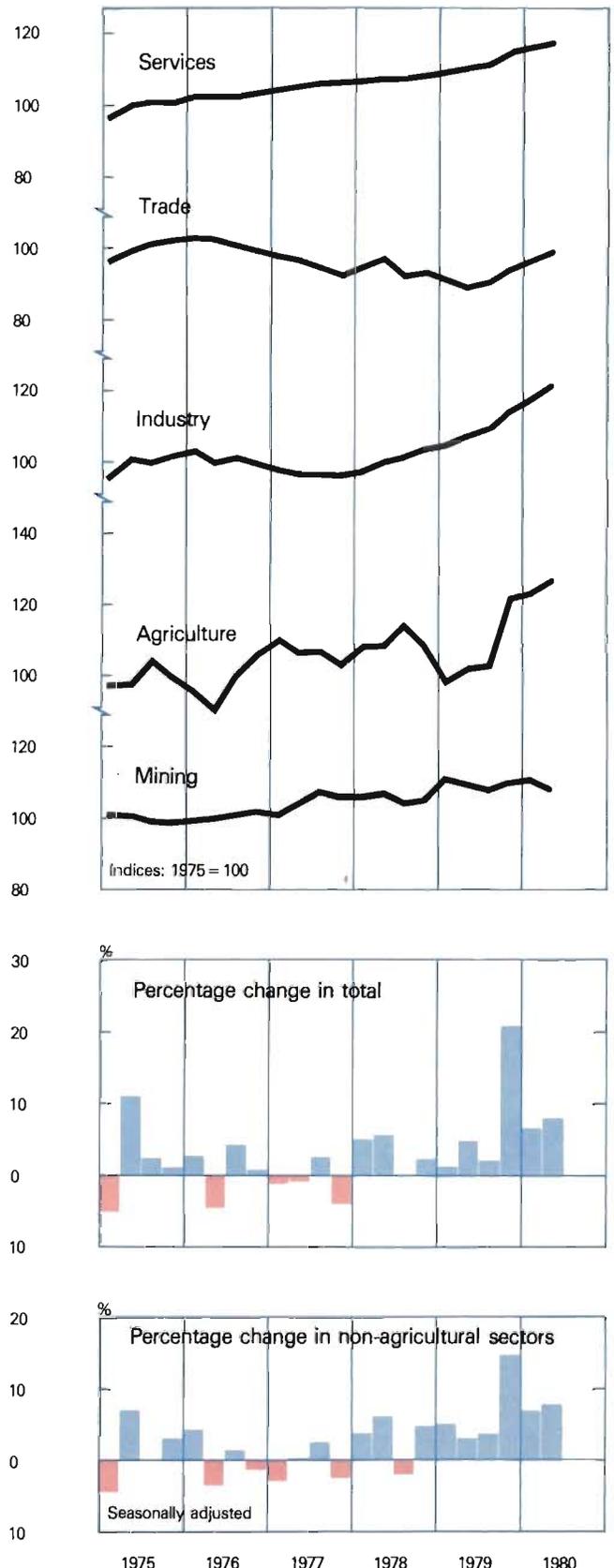
As is shown in the accompanying table, higher rates of growth were recorded in almost all sectors of the economy in 1979/80, the most important exception being the decline in the real product of the gold mining sector. Although the tonnage of ore milled increased, the volume of gold produced declined as a result of the mining of lower-grade ore in response to the sharp rise in the price of gold. The real product of the primary sector as a whole nevertheless rose strongly as a result of marked increases in agricultural and non-gold mining production. The higher real product of agriculture reflected larger summer and winter crops and that of non-gold mining was due to a continued strong demand for metals and minerals.

The higher rate of increase in the real product of the secondary sector was accounted for mainly by manufacturing and to a lesser extent by construction. A slightly lower rate of increase was recorded in the real product of the sector electricity, gas and water. The increase in the real value added by manufacturing, which had started in the fourth quarter of 1977, gained considerable momentum in the year under review. The percentage rise in 1979/80 was the highest annual increase during the past ten years and reflected largely the strong revival in real consumer and fixed investment demand during 1979/80.

A notable development during the year under review was the turnabout in the real value added by commerce. The real product of this sector, which had declined at an average annual rate of about 3½ per cent from 1975/76 to 1978/79, started to rise from the third quarter of 1979 and reached a level in the second quarter of 1980 that was 10 per cent higher than in the corresponding period of 1979. In the year 1979/80 as a whole an increase of 3½ per cent was recorded. The real value added by the wholesale trade and by the motor trade both rose by about 1½ per cent, com-

*Real national accounts figures are now expressed at constant 1975 prices instead of the previous constant 1970 prices. Because of structural changes in the economy between 1970 and 1975, the recalculation of constant-price figures relating to the new base year has necessarily resulted in changes in national accounts series. Formerly observed rates of change in these series may, therefore, not correspond entirely with those in the newly calculated series.

Gross domestic product at constant 1975 prices



Percentage change in gross domestic and national product at constant 1975 prices

	Year ended 30 June		
	1978	1979	1980
Primary sector	-1	1½	5
Agriculture	-7	2	10½
Gold mining	—	—	-2½
Non-gold mining	11½	2	8
Secondary sector	-1	6½	11
Manufacturing	—	8	12
Electricity, gas and water	5½	5½	4½
Construction	-10	-1	8
Tertiary sector	1	1	5
Commerce	-3½	-3½	3½
Services	3	2½	5
Transport, storage and communication	4	6	9
General government	4	3	4
Financial and other	1½	—	3½
Total gross domestic product	—	2½	6½
Non-agricultural sectors	1	2½	6½
Non-primary sectors	½	3	7
Gross national product	—	4½	8

pared with decreases of the same order in 1978/79. A dramatic turnabout from a decline of 6½ per cent in 1978/79 to an increase of 5½ per cent in 1979/80 occurred, however, in the real value added by the retail trade as a result of an upsurge in consumer expenditure. The real value added by the services sector continued to rise strongly, mainly because of a substantial increase in the product of the sector transport, storage and communication, which was related to the higher level of domestic production and demand and an increase in the volume of exports and imports.

South Africa's terms of trade improved further in 1979/80, reflecting a higher rate of increase in export prices (including the price of gold) than in import prices. In addition, real net factor payments to the rest of the world declined in this period. Consequently, the real gross *national* product increased at a higher rate than the real gross *domestic* product, namely by about 8 per cent, compared with 4½ per cent in 1978/79.

At current prices, the rate of increase in the gross domestic product accelerated from 18 per cent in 1978/79 to 26 per cent in 1979/80. Total remuneration of employees rose by 16½ per cent, compared with 13 per cent in 1978/79, reflecting mainly higher rates of increase in the case of mining, manufacturing, the financial sector, and general government. The total gross operating surplus increased by 39 per cent in 1979/80, as against 24 per cent in the preceding year, largely as a result of higher rates of increase in surpluses in agriculture, gold mining, non-gold mining, manufacturing and the wholesale and retail trade. Be-

cause the rate of increase in the total gross operating surplus during the past three years was higher than that in the total remuneration of employees, the ratio of the gross operating surplus to the gross domestic product rose to 50 per cent in 1979/80, compared with 42 per cent in 1976/77 and the most recent peak of 46 per cent in 1973/74. After provision for depreciation at the higher replacement cost of fixed assets, the share of the *net* operating surplus in the gross domestic product increased from 27½ per cent in 1976/77 to 35½ per cent in 1979/80, as against the preceding peak of 35 per cent in 1973/74.

The difference between the growth rates in the gross domestic product at current and at constant prices implied an increase of about 18 per cent in the derived gross domestic product deflator in 1979/80, compared with a rise of 15 per cent in 1978/79. The higher rate of increase in 1979/80 reflected the combined effect of sharp increases in export prices (including the price of gold) and domestic prices.

Marked increase in real gross domestic expenditure

Although real aggregate domestic demand started to increase from about the first quarter of 1978, it remained sluggish during 1978 and gathered momentum only from the beginning of 1979. In 1979/80 real gross domestic expenditure increased by 8 per cent, compared with a moderate rise of only 1½ per cent in the preceding year. The comparatively high rate of increase in 1979/80 was accounted for mostly by real private consumption expenditure and real fixed investment. Real government consumption expenditure and real inventories increased only slightly. The higher real aggregate domestic demand was largely responsible for the rise in the real gross domestic product in 1979/80, but a contribution was also made by the further increase in the volume of exports. At current prices, the increase in gross domestic expenditure was exceeded by the rise in the gross national product, resulting in a substantially larger surplus on the current account of the balance of payments in 1979/80 than in 1978/79.

Percentage change in gross domestic expenditure at constant 1975 prices

	Year ended 30 June		
	1978	1979	1980
Private consumption expenditure	3½	¼	6
Government consumption expenditure	2½	-1	1
Gross domestic fixed investment	-6	-½	7½
Change in inventories (R millions) ..	-659	4	35
Total gross domestic expenditure	-3	1½	8

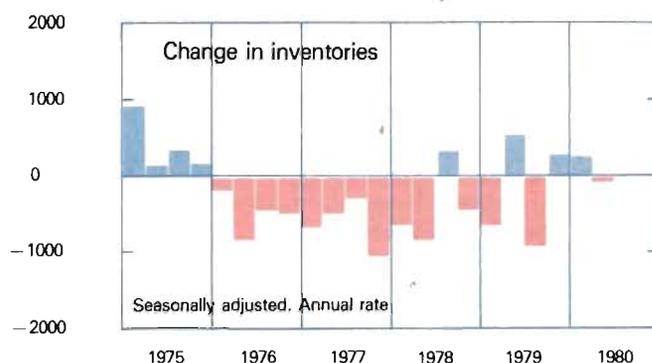
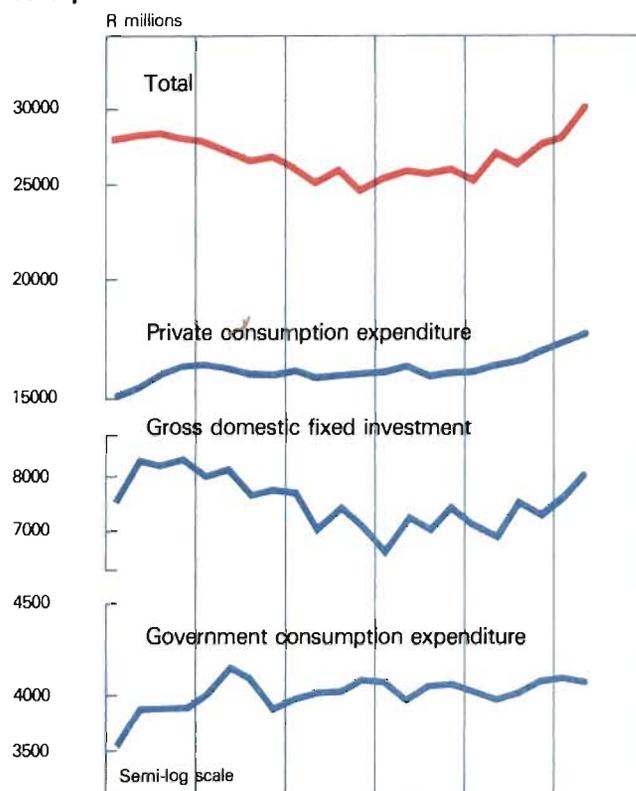
Strong rise in real private consumption expenditure

The most important reason for the rapid economic growth in 1979/80 was the strong revival in real private consumption expenditure. Consumer demand remained subdued during the first five quarters of the present economic upswing, mainly as a result of the low rate of increase in real personal disposable income. This low rate was caused, on the one hand, by the high rate of inflation which had the effect of reducing the rate of increase in real incomes and, on the other hand, by the fact that unchanged progressive income tax rates continued to apply to incomes that had been adjusted upwards in response to the prevailing high rate of inflation, the so-called "fiscal drag". Real consumer expenditure started to increase strongly, however, from about the second quarter of 1979 when measures aimed at stimulating consumer demand, such as the tax concessions granted in the 1979/80 Budget, increased social security benefits and the early repayment of loan levies, were beginning to take effect. These measures were supplemented in the 1980/81 Budget by large further tax concessions and the abolition of the loan levy, but the benefits of these further measures will accrue to consumers only in the second half of 1980.

Percentage change in private consumption expenditure at constant 1975 prices

	Year ended 30 June		
	1978	1979	1980
Durable goods	5	-3½	20
Furniture and household appliances	2	-6	20
Motor cars and other transport equipment	14	2	20
Other durable goods	1	-6	19
Semi-durable goods	-1	-3	7½
Clothing and footwear	-1	-5	9½
Motor car tyres, parts and accessories	1	1	-11
Other semi-durable goods	-2	-3	11
Non-durable goods	2	2½	3½
Food, beverages and tobacco	1½	3	4
Petroleum products	1	1	-11
Other non-durable goods	4½	—	6
Services	-2½	—	3
Rent of dwellings	2	2	2
Household services	-8	-9	-9
Transport and communication	2½	2½	6
Recreational and entertainment services	-1½	6	4
Other services	-9	-2½	6½
Total real private consumption expenditure	3½	¼	6

Gross domestic expenditure at constant 1975 prices



Apart from the effect of the increase in real personal disposable income, private consumption expenditure was also stimulated by the build-up of liquidity and availability of credit in the economy. Consumer credit already started to increase in 1978 and the rate of increase accelerated appreciably during 1979 and the first half of 1980.

Real expenditure on all major classes of consumer goods, namely durable, semi-durable, and non-durable goods, as well as on consumer services, increased more rapidly in 1979/80, the largest rise being recorded in the durable goods category. Within these main classes, however, declines were recorded in real outlays on petroleum products and on motor car tyres, tubes, parts and accessories, reflecting the effect of

the fuel conservation measures and the sharp rise in the prices of petroleum products. Real expenditure on household services also decreased, probably as a result of the decline in real incomes during recent years.

Small increase in government consumption expenditure

The policy of limiting the growth in government expenditure continued during the year under review and real government consumption expenditure rose only slightly above its 1978/79 level. An increase in the real remuneration of employees was partly offset by a decline in real expenditure on goods and other services.

Reversal of decline in real gross domestic fixed investment

A major reason for the higher rate of economic growth in 1979/80 was the reversal of the downward trend in real gross domestic fixed investment during the preceding three years. The appreciable rise that occurred in the year under review was the net result of substantial increases in the real fixed capital expenditure of public corporations and of the private sector, and a slight decline in the real fixed capital outlays of public authorities.

The downward trend in the private sector's real fixed capital outlays since the first quarter of 1976, was reversed in the second quarter of 1979. A climate

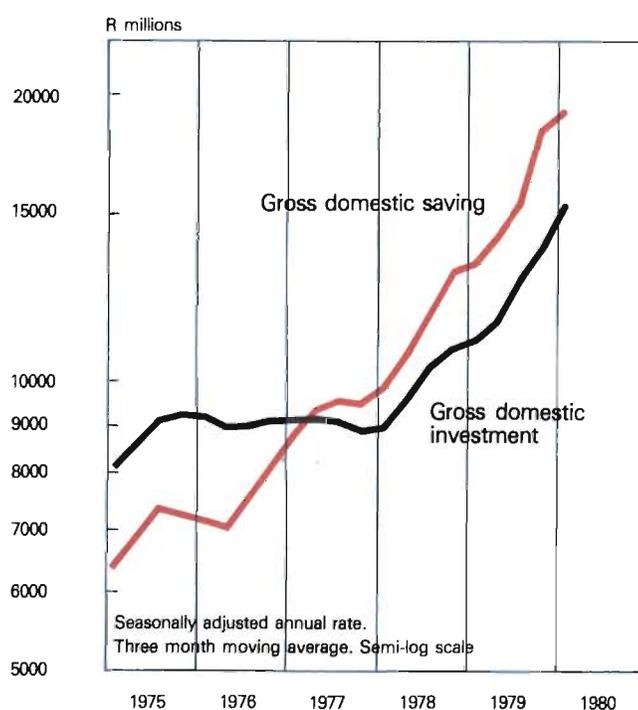
more conducive to new fixed investment was created by the continuing large demand for exports, a revival in consumer expenditure, tax concessions, a substantially higher level of corporate saving, and, more generally, a build-up of liquidity and accompanying relatively low levels of interest rates in the economy. In the year under review, sharp increases were recorded in the real fixed investment of the mining, manufacturing and financial sectors, as well as in real investment in private residential buildings. A sharp turnabout also occurred in the real fixed capital outlays of the agricultural sector. In the mining sector, production capacity was expanded at several gold mines, uranium plants were constructed, and additional production capacity was created in other mining with a view to meeting the higher domestic and foreign demand. In manufacturing, new capital outlays were necessitated by the decline in excess production capacity that resulted from an increase in manufacturing production in response to the higher consumer demand. The utilisation of production capacity in manufacturing, for example, increased from 84,9 per cent in February 1979 to 88,4 per cent in May 1980. In the finance sector, a strong rise in the leasing of new capital equipment gave rise to an increase in real fixed investment. Private residential construction increased sharply, reflecting boom conditions in the real estate market, and was facilitated by the ready availability of funds for mortgage lending.

Real fixed investment by public corporations, which

Percentage change in gross domestic fixed investment at constant 1975 prices

	Year ended 30 June		
	1978	1979	1980
Private business enterprises	-1	-7	13
Agriculture	-1	-7	6
Gold mining	-3	23	39
Non-gold mining	-7	-6	27
Manufacturing	-3	-9	27
Personal residential construction	-22	-8	12
Finance (including leasing)	10	2	15
Other (transport and commerce)	15	-14	6
Public corporations	4	20	10
Manufacturing	45	27	17
Electricity, gas and water	11	20	5
Mining	-53	-2	50
Public authorities	-19	-4	-3
S.A. Railways Administration	-42	-6½	3
Residential construction	-20	44	12
Other business enterprises	—	-4	-9
General government	-7	-6½	-7
Total real gross domestic fixed investment	-6	-½	7½

Financing of gross domestic investment



had increased at an average annual rate of 14 per cent from 1970/71 to 1978/79, rose further by 10 per cent in 1979/80. The fixed capital outlays of Escom increased only moderately, but those of Sasol and Iscor rose substantially.

Public authorities' real fixed investment declined slightly in 1979/80. The fixed capital outlays of the South African Railways Administration, which had declined in the preceding two years, increased moderately in 1979/80. As in 1978/79, real outlays on residential construction financed by the government showed a marked increase in accordance with government policy to provide more low-cost housing. These increases were neutralised, however, by declines in the fixed capital outlays of other business enterprises and the general departments of public authorities, as part of the general policy of restraining the increase in overall government expenditure.

In real terms, *net* fixed investment, i.e. gross fixed investment less provision for depreciation, increased by a larger amount than in 1978/79. The stock of real fixed capital in the non-agricultural sectors of the economy was 5½ per cent higher at the end of June 1980 than at the end of June 1979, compared with a rise of 4 per cent during the preceding year. Because the real gross domestic product of the non-agricultural sectors increased somewhat faster than their real fixed capital stock, the amount of capital utilised per unit of production, or the capital-output ratio, declined slightly from 2,87 in 1978/79 to 2,83 in 1979/80, after it had increased sharply from 1973/74 to 1978/79. The capital-labour ratio in the non-agricultural sectors, a measure of capital intensiveness in the economy, increased further from R10 024 in 1978/79 to R10 306 in 1979/80.

Small increase in real inventories

The value of total inventories at constant 1975 prices increased slightly by about R35 million in 1979/80, compared with almost no change in 1978/79. The increase in real inventories during 1979/80 was the result of increases in mining inventories, industrial inventories of the private sector, and agricultural stocks-in-trade, which were partly offset by decreases in diamond stocks, commercial inventories, industrial inventories of public corporations, and livestock inventories.

Real non-agricultural inventories decreased almost uninterruptedly from the first quarter of 1976 to the third quarter of 1979. The main reasons for this persistent decline were (1) the abnormally high level of inventories in 1975 and a lack of business confidence during the early part of the period concerned, (2) the continuing high cost of carrying large stocks, (3) shorter delivery periods, resulting from better transport and communication facilities, and (4) the tendency towards the centralisation of inventories and improved methods of inventory control. It would appear, however, that the

long downward phase in the inventory cycle came to an end in the year under review. Increases in the fourth quarter of 1979 and the first quarter of 1980 were followed by only a small decline in the second quarter of 1980. Real industrial inventories of the private sector already started to increase in the first quarter of 1979, but real commercial inventories continued to decrease uninterruptedly from the beginning of 1976 to the second quarter of 1980. The increase in real private industrial inventories during the past six quarters was related to the rise in manufacturing production and the further decline in real commercial inventories during 1979/80 reflected the sharp increase in wholesale, retail and motor sales in this period.

In relation to the real gross domestic product of the non-agricultural sectors, real non-agricultural inventories reached an all-time low of 29,6 per cent in the second quarter of 1980. This ratio compared with 31,9 per cent in the second quarter of 1979 and the most recent peak of 39,7 per cent in the third quarter of 1975. Apart from being consistent with its long-term trend, the behaviour of this ratio also reflected cyclical influences, in so far as the real gross domestic product usually increases more rapidly than real inventory investment during the initial and even more advanced stages of an economic upswing.

Substantial further increase in gross domestic saving

Gross domestic saving rose by R4 444 million, or 32½ per cent, in 1979/80, after a substantial increase of R4 288 million, or 45 per cent, had been recorded in 1978/79. The ratio of gross domestic saving to gross domestic product increased further from 31,2 per cent in 1978/79 to 32,8 per cent in 1979/80. As total gross domestic saving in 1979/80 amounted to R18 148 million and only R14 526 million was required for the financing of fixed and inventory investment, an amount of R3 622 million was available for the reduction of South Africa's net indebtedness to the rest of the world.

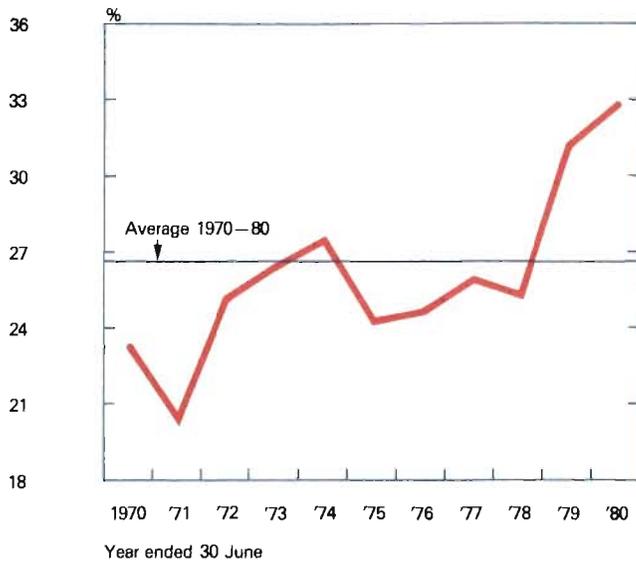
As is indicated in the accompanying table, corporate saving, the saving of general government, and pro-

Changes in gross domestic saving

R millions

	Year ended 30 June		
	1978	1979	1980
Personal saving	-1 087	1 741	-79
Corporate saving	800	1 054	2 964
Saving of general government	427	651	451
Net domestic saving	140	3 446	3 336
Provision for depreciation	660	842	1 108
Gross domestic saving	800	4 288	4 444

Gross domestic saving as percentage of gross domestic product



vision for depreciation increased further during 1979/80, but personal saving declined slightly. This decline occurred because the increase in private consumption expenditure, facilitated by the rise in consumer credit (representing negative saving), exceeded the rise in personal disposable income, notwithstanding a lower rate of increase in personal income tax payments and the sharp increases in salaries and wages and in net agricultural income. The largest contributions to the further substantial increase in corporate saving were made by the mining and financial sectors. The high level of corporate saving was one of the main reasons for the increased availability of funds in the economy. The increase in the saving of general government which was lower than in the preceding year, occurred despite lower rates of increase in direct personal tax (reflecting the concessions granted in the 1979/80 Budget) as well as in indirect taxes, and resulted mainly from a further sharp rise in company tax receipts. The provision for depreciation increased at a higher rate in 1979/80 because of a more rapid rise in prices and larger investment at current prices.

The composition of net domestic saving changed considerably during the past three years. A marked increase occurred in the share of corporate saving in total net saving, namely from an annual average of 24 per cent during the period 1969/70 to 1976/77 to 60 per cent in 1979/80. The share of personal saving showed more or less the opposite trend, declining from an annual average of 54 per cent during the period 1969/70 to 1976/77 to 22 per cent in 1979/80. The share of the saving of general government declined slightly from an annual average of 22 per cent during the period 1969/70 to 1976/77 to 18 per cent in 1979/80.

Employment* and prices

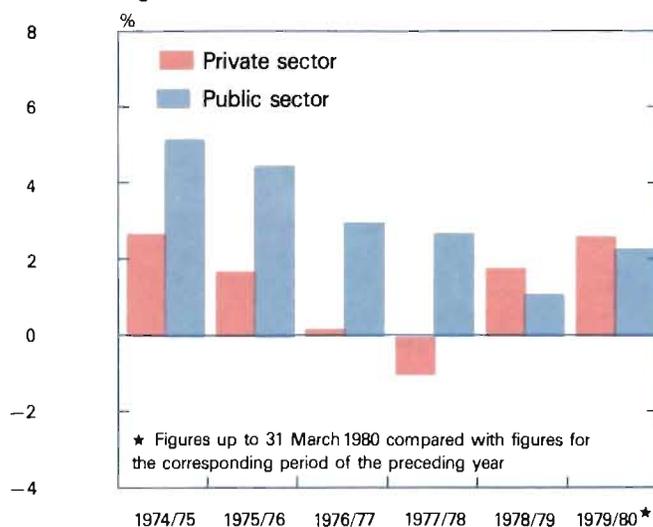
Higher rate of increase in employment and labour productivity

The higher rate of increase in economic activity in 1979/80 was reflected in a more rapid rise in employment and an accompanying decline in unemployment. Non-agricultural employment, which had increased by only 0,1 per cent in 1977/78 and by 1,6 per cent in 1978/79, was 2,5 per cent higher in the first three quarters of 1979/80 than in the corresponding period of the preceding year. A significantly higher rate of increase became evident in the fourth quarter of 1979. At a seasonally adjusted annual rate, non-agricultural employment increased successively by 1,9, 1,1 and 1,5 per cent in the first three quarters of 1979, before rising by 5,6 per cent in the fourth quarter and 4,2 per cent in the first quarter of 1980. As a result of this acceleration, shortages of certain classes of skilled labour were beginning to emerge towards the end of the year under review.

The more rapid increase in employment was observed in the private as well as the public sector. Private-sector employment was 2,6 per cent higher in the first three quarters of 1979/80 than in the corresponding period of the preceding year, compared with an increase of 1,8 per cent in 1978/79. The corresponding increases in public-sector employment amounted to 2,3 per cent and 1,1 per cent, respectively. The higher rate of increase in employment applied to virtually all sections of the private sector and to the more important sections of the public sector. In the private sector,

*Statistics relating to employment and the remuneration of labour are available only up to the end of March 1980.

Percentage change in employment in the non-agricultural sectors

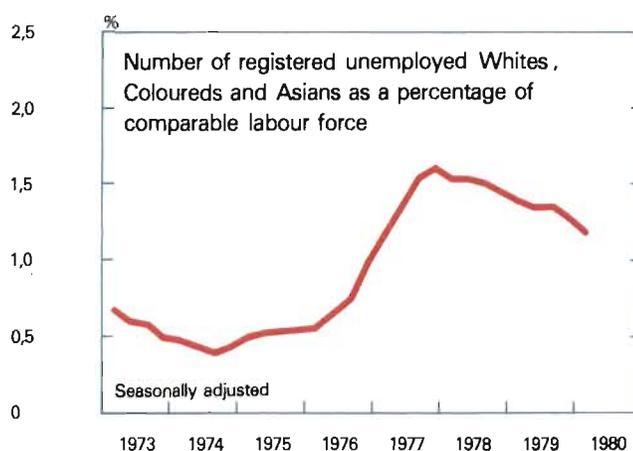


appreciable increases in employment were recorded in mining, manufacturing and the financial sector. In the public sector, employment by the central government, provincial administrations, and the sector electricity, gas and water increased significantly, whereas employment by local authorities, the South African Railways Administration and agricultural control boards declined.

The rate of increase in employment was only slightly higher than the estimated rate of growth of 2,3 per cent in the economically active population. As a result, only a moderate decline in unemployment was recorded. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians decreased from 28 200 in June 1979 to 22 375 in June 1980. As a ratio of the corresponding labour force, it declined from 1,4 per cent in the first quarter of 1979 to 1,2 per cent in the first quarter of 1980. The latter figure compares unfavourably with the corresponding ratio of 0,5 per cent in the more advanced stage of the preceding cyclical upswing in 1973/74. The ratio of unemployed Blacks to the economically active Black population decreased from 9,2 per cent in May 1979 to 8,8 per cent in May 1980.

Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural sectors of the economy, was 2,4 per cent higher in the first three quarters of 1979/80 than in the corresponding period of the preceding year, as against an increase of 1,3 per cent in 1978/79. In manufacturing, for which more detailed statistics are available, production per man-hour increased by 4,1 per cent in the first ten months of 1979/80, compared with the same period of the preceding year, as against 2,5 per cent in 1978/79. Mainly as a result of the increase in productivity in this sector, unit labour cost rose at a lower rate of 8,5 per cent in the ten months to April 1980, compared with

Unemployment



the same period of the preceding year, as against 9,4 per cent in 1978/79 and an average annual rate of increase of 16,8 per cent during the period 1974/75 to 1977/78.

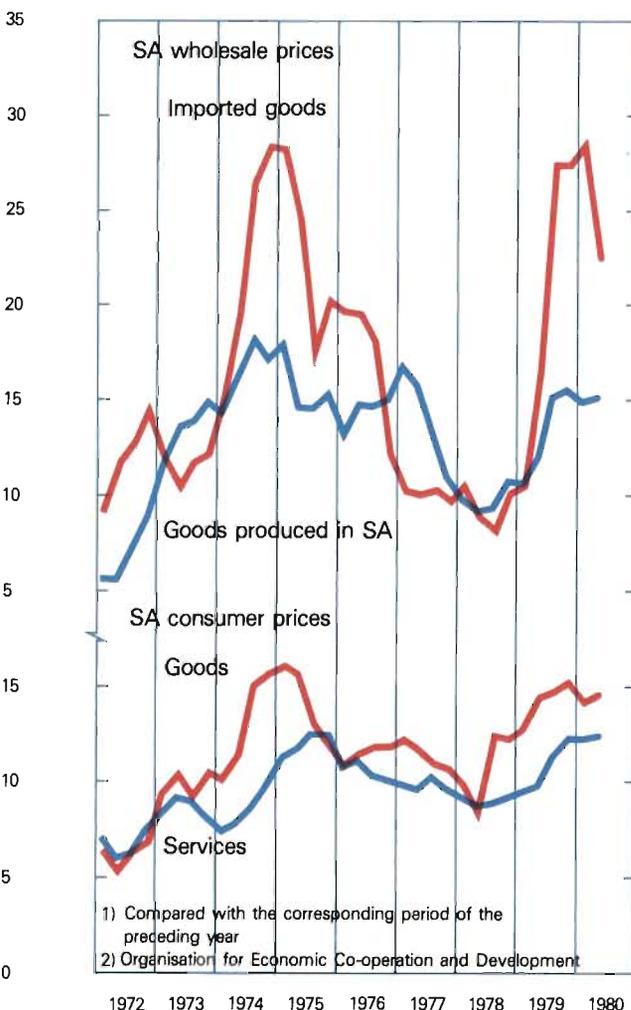
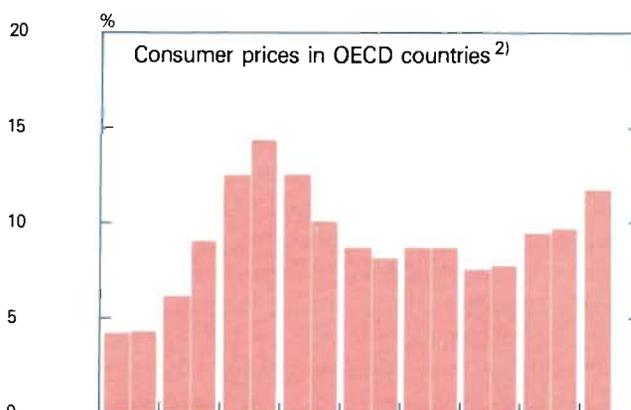
Remuneration of labour

The rate of increase in the average remuneration per worker in the non-agricultural sectors of the economy amounted to 13,6 per cent in the first three quarters of 1979/80, as against 11,4 per cent in 1978/79. Mainly as a result of a higher rate of increase in prices, the average real remuneration per worker remained approximately unchanged in the first three quarters of 1979/80 compared with the corresponding period of the preceding year, after small declines had been recorded in 1977/78 and 1978/79. The average real remuneration per White worker which had declined for four consecutive years, remained unchanged in the first three quarters of the year under review. The average real remuneration per non-White worker, on the other hand, showed progressively smaller increases from 1975/76 to 1978/79 and rose only marginally in the first three quarters of 1979/80. Considerable salary and wage increases were granted to employees in the public sector and certain sections of the private sector in the second quarter of 1980, but statistical information on these increases is not yet available. It is likely, therefore, that the rates of increase in the real remuneration of labour in the full year to June 1980 will be much higher than the figures quoted above.

Higher rate of inflation

The rate of increase in consumer prices, which had declined to slightly less than 10 per cent in 1977/78, reverted to a higher level of 11,8 per cent in 1978/79 and accelerated further to 13,8 per cent in 1979/80, reaching a level that was only marginally lower than the peak of 14,0 per cent in 1974/75. The acceleration in the rate of increase in the past two years was to a large extent the result of special circumstances. In 1978/79, the more rapid rise in consumer prices was caused mostly by the introduction in July 1978 of the general sales tax. Excluding the effect of this tax, consumer prices increased at an appreciably lower rate of 8,4 per cent. In 1979/80, an exceptionally sharp rise of 60,9 per cent in the prices of petroleum products contributed 2,5 percentage points to the rate of increase in consumer prices. Apart from this direct effect, the higher prices of petroleum products had a wide-ranging indirect effect on consumer prices. In contrast with the preceding year, when accelerating increases in the prices of consumer goods were widespread, more rapid price rises in 1979/80 were confined to a limited range of goods, such as petroleum products, meat, vegetables and footwear. The rate of increase in the prices of most other consumer goods nevertheless re-

Percentage change in prices¹⁾



mained at high levels. The cost of most consumer services increased at appreciably higher rates than in 1978/79.

As is shown in the accompanying table, an upward surge in consumer prices occurred in the third quarter of 1979 when the substantial increase in the prices of

Prices

Annual rate of change in quarterly averages of seasonally adjusted monthly indices

	2nd qtr. 1979	3rd qtr. 1979	4th qtr. 1979	1st qtr. 1980	1978/ 1979
	to 3rd qtr. 1979	to 4th qtr. 1979	to 1st qtr. 1980	to 2nd qtr. 1980	to 1979/ 1980
Consumer prices .	23,5	11,3	8,6	13,3	13,8
Goods	27,4	11,0	7,5	13,9	14,8
Services	18,0	12,2	9,1	10,5	12,1
Wholesale prices .	28,1	14,6	12,0	14,3	18,1
SA produced goods	20,8	14,4	9,5	16,0	15,1
Imported goods .	50,4	15,1	19,0	9,9	26,4

hand, rose at a substantially lower rate in the second quarter of 1980 than in the preceding three quarters, partly as a result of the abolition of the surcharge on imports in March. From June 1979 to June 1980, wholesale prices increased by 15,9 per cent.

petroleum products came into effect. In the subsequent two quarters the rate of increase slowed down considerably, before accelerating again in the second quarter of 1980. This acceleration was due to upward adjustments in several administered prices, such as coal, maize, bread and sugar prices and railway and other transport tariffs. In addition, sharp rises occurred in the prices of meat, vegetables, footwear, reading matter and vehicles, and of educational, dry-cleaning and certain personal services. From June 1979 to June 1980, consumer prices increased by 14,6 per cent.

Wholesale prices rose sharply by 18,1 per cent in 1979/80, compared with 11,0 per cent in 1978/79 and 10,5 per cent in 1977/78. The substantially higher rate of increase in the year under review resulted from a more rapid rise in the prices of domestically produced as well as imported goods. Lower rates of increase than in the preceding year occurred in the wholesale prices of domestically produced minerals, transport equipment, beverages and tobacco as well as in electricity tariffs. The prices of all other goods produced in South Africa increased at higher rates than in 1978/79. The exceptionally sharp rise in the prices of imported goods in 1979/80 notwithstanding the moderating effect of the appreciation of the rand, was accounted for mainly by the substantial increase in the price of crude oil in July 1979.

The seasonally adjusted quarterly figures in the accompanying table show that wholesale prices increased sharply in the third quarter of 1979, but rose at lower rates in the subsequent two quarters before increasing again at higher rates in the second quarter of 1980. The acceleration in the latter quarter was due to a higher rate of increase in the prices of domestically produced goods, reflecting higher prices of agricultural products, processed food, footwear and transport equipment. The prices of imported goods, on the other

Balance of payments

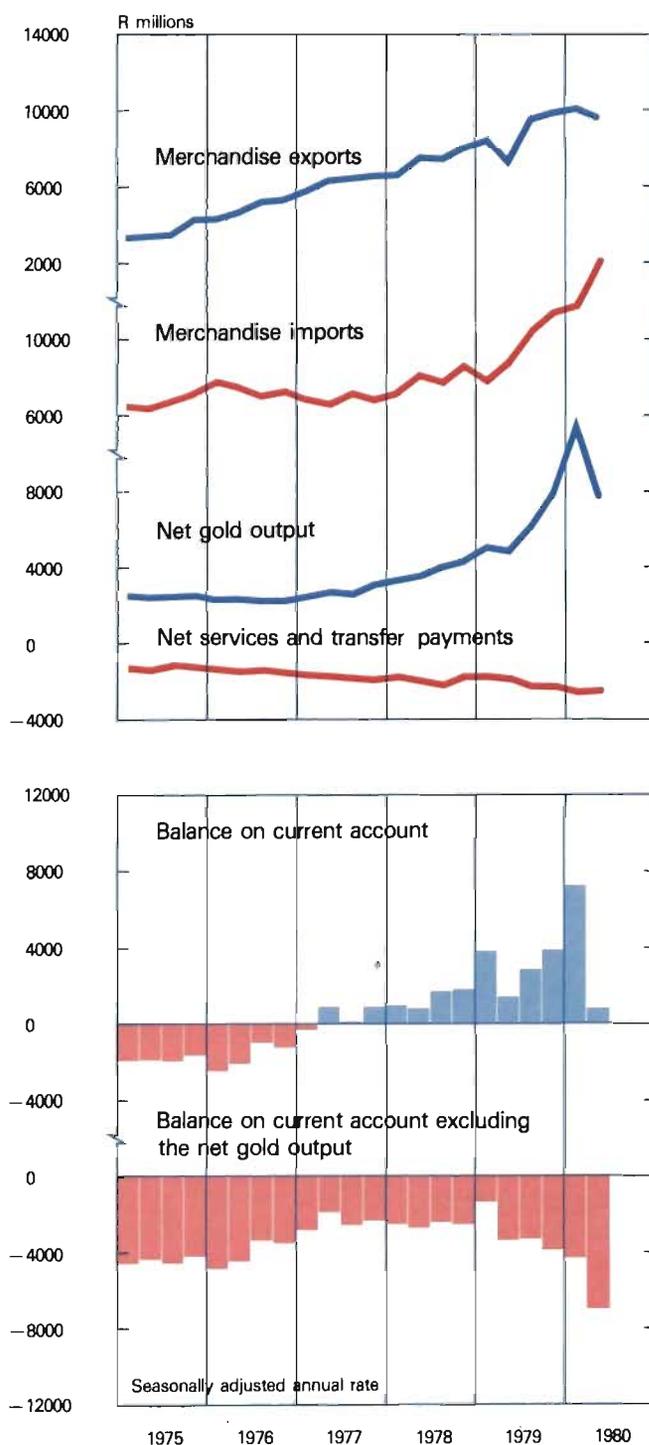
Substantially larger surplus on current account

As in the preceding two years, a surplus was recorded on the current account of the balance of payments in 1979/80. The surplus of R3 622 million was substantially larger than the R2 298 million of 1978/79 and the R790 million of 1977/78, and it amounted to no less than 6,5 per cent of the gross domestic product. Since the beginning of the present economic upswing the current account has been in surplus for ten consecutive quarters, an achievement that has been surpassed only by the eleven successive quarterly surpluses during the cyclical upswing from September 1961 to April 1965.

The sustained current account surplus during a period of cyclical upswing did not conform to the historical cyclical pattern, according to which surpluses emerge during the advanced stages of cyclical downturns and disappear relatively early during the subsequent upswings. During the current upward phase of the business cycle, moreover, the surplus tended to increase rather than decrease. At a seasonally adjusted annual rate, the current account surplus increased, for example, from R910 million in the fourth quarter of 1977 to R3 986 million in the fourth quarter of 1979 before rising strongly to R7 210 million in the first quarter of 1980. It then declined dramatically, however, to R770 million in the second quarter of 1980.

The progressively larger surpluses up to the first quarter of 1980 were predominantly the result of an exceptionally strong rise in the price of gold and consequently also in the value of the net gold output. The rise in the net gold output, together with a considerable increase in the value of merchandise exports, outweighed a sharp increase in the value of merchandise imports and in net service and transfer payments to the rest of the world. If the net gold output is excluded from the current account for the purpose of illustrating its important contribution to the sustained surplus on this account, there has been a sharply rising deficit from the second quarter of 1979. This deficit increased, for example, from R2 316 million in 1978/79 to R4 664 million in 1979/80. The strong rise in the value of merchandise imports accounted for most of the deterioration in the current account balance, excluding the net gold output, during the year under review. In contrast with the usual cyclical pattern, the volume of imports increased at a low rate during the first three quarters of 1979/80. The increasingly higher value of imports during the period was due, therefore, to an increase in import prices. In the second quarter of 1980, however, a substantial increase occurred also in the volume of merchandise imports. This increase, together with a further rise in import prices, contributed considerably to the marked decline in the current account surplus in the second quarter.

Balance of payments current account



Record increase in net gold output

The value of the net gold output increased by 79,6 per cent to a record amount of R8 286 million in 1979/80. This increase was attributable exclusively to an exceptionally strong rise in the price of gold, namely from an average of US\$ 228,29 per fine ounce on the London

market in 1978/79 to US\$ 476,56 per fine ounce in 1979/80. The volume of gold production, on the other hand, declined during the year under review, mainly because the mining of lower-grade ore had been made more profitable by the higher price of gold.

The various factors that contributed to the substantial rise in the price of gold included declines on various occasions in the effective exchange rate of the US dollar, expectations of and actual further increases in the price of oil, higher rates of inflation internationally, the termination of gold auctions by the International Monetary Fund, the fact that no gold has been sold by the United States since November 1979, smaller sales of gold by South Africa and the Soviet Union, unfavourable international political developments, and the conversion of some dollar holdings into gold. The upward movement in the gold price was, however, subject to sharp fluctuations. The price per fine ounce on the London market, for example, rose from US\$ 277,50 at the end of June 1979 to US\$ 437,00 on 2 October before declining to US\$ 372,80 on 2 November. Subsequently, it rose to US\$ 850,00 on 21 January 1980, then declined to US\$ 490,00 on 1 May, and thereafter increased to US\$ 653,50 on 30 June. These fluctuations were reflected in the quarterly value of the net gold output which, at a seasonally adjusted annual rate, amounted successively to R6 136 million, R7 852 million, R11 480 million, and R7 780 million in the four quarters of 1979/80. At the end of July 1980 the price of gold on the London market stood at US\$ 614,25 per fine ounce.

Good export performance

Merchandise exports increased from R7 976 million in 1978/79 to R9 771 million in 1979/80, or by 22,5 per cent, the fifth sharp increase in consecutive twelve-month periods. The average annual rate of increase during the five-year period from 1974/75 to 1979/80 amounted to as much as 24,0 per cent. In the course of the year under review, however, the increase in exports levelled off and an actual slight decline in exports occurred in the second quarter of 1980. At a seasonally adjusted annual rate, merchandise exports rose from R7 376 million in the second quarter of 1979 to R10 130 million in the first quarter of 1980 before declining to R9 670 million in the second quarter.

The rise in the value of exports in 1979/80 was the result of an increase in export prices as well as in the volume of exports. Particularly sharp increases were recorded in the export prices of platinum, copper, nickel, uranium, sugar and maize. In addition, moderate rises occurred in the prices of diamonds, coal, wool and iron ore. The rate of increase in export prices, however, declined in the course of 1979/80, notwithstanding a more rapid rise in international commodity prices generally. This was attributable mainly to the appreciation of the rand, not only against the US dollar, but also

against other major currencies. The rate of increase in export prices fell from 13,0 per cent in 1978/79 to 9,8 per cent in 1979/80.

The volume of exports rose by 11,6 per cent in 1979/80 as a result of a continuing strong foreign demand during most of this period, increased railway facilities for transporting export commodities, and additions to total mining production by new mines. Substantial increases were recorded in the volume of exports of coal, iron ore, ferro-chrome, platinum and sugar. These increases were partly offset by declines in the volume of diamonds, uranium, copper, and maize exported. The increase in the volume of exports was limited, however, to the first nine months of the year under review. A sharp decline was experienced in the second quarter of 1980.

Sharp rise in merchandise imports

Merchandise imports rose from R8 351 million in 1978/79 to R12 013 million in 1979/80, or by 43,9 per cent, owing mainly to a further strong rise of 31,2 per cent in import prices, but also to an appreciable increase of 9,7 per cent in the volume of imports. The rate of increase in the value of merchandise imports accelerated notably in the second quarter of 1980, when a sharp rise was recorded in the volume of imports. At a seasonally adjusted annual rate, imports rose from R8 942 million in the second quarter of 1979 to R11 830 million in the first quarter of 1980 and to R14 210 million in the second quarter.

Despite the considerable increase towards the end of the year under review, the volume of imports remained at a relatively low level, amounting to 18,4 per cent of the real gross domestic product in the second quarter of 1980. In the third quarter of 1974, i.e. at the beginning of the economic downswing from 1974 to 1977, this ratio was at an unusually high level of 28,5 per cent. Subsequently, it declined to 17,4 per cent in the second quarter of 1977 and fluctuated around this level before increasing in the second quarter of 1980.

The increase in the value of merchandise imports in 1979/80 occurred over a wide range of commodities. As expected, the substantial rise in the price of oil during the first half of 1979 resulted in a sharp rise in the value of imports of mineral products (including petroleum products). Significant increases were, however, also recorded in the import categories machinery and electrical equipment, chemical products and artificial resins and plastic materials, and, towards the end of the year under review, transport equipment.

Substantial increase in net service and transfer payments

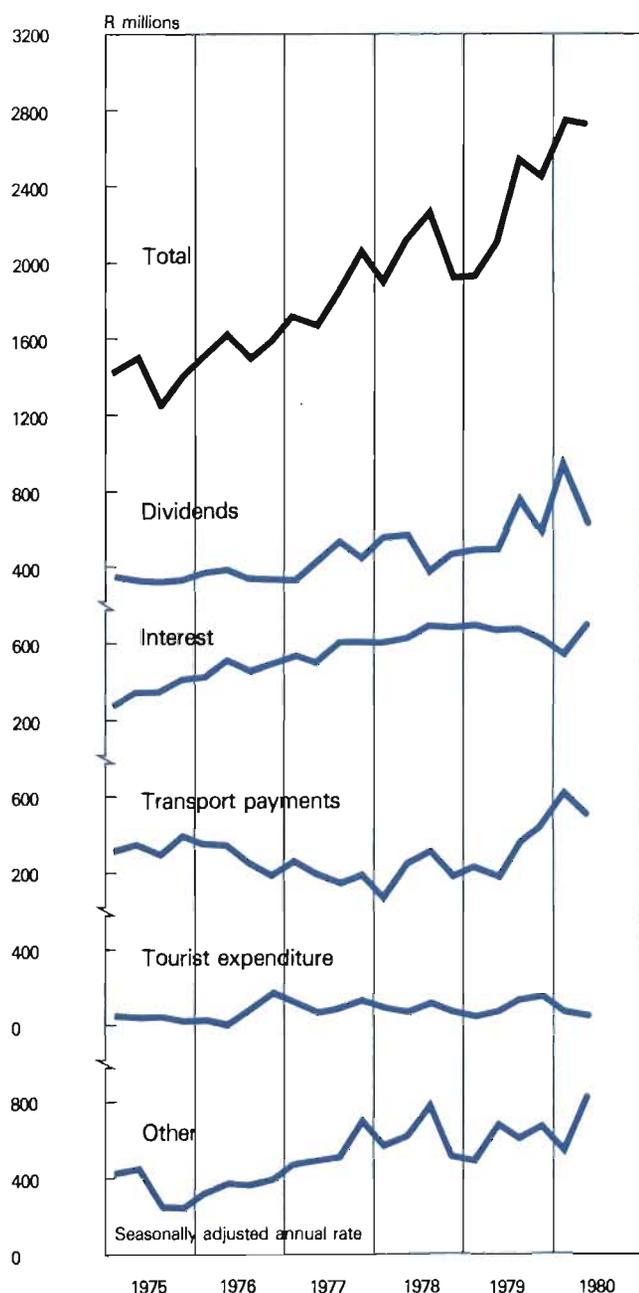
Net service and transfer payments to the rest of the world increased substantially from R1 941 million in 1978/79 to R2 422 million in 1979/80, or by 24,8 per

cent. This represented a marked acceleration of the sharp upward trend that had been in evidence since 1970/71. During the ten years to June 1980 these net payments rose at an average annual rate of 17,2 per cent. The increase was most pronounced in net interest and dividend payments to foreigners as well as in salary and wage payments to foreign migrant workers, reflecting South Africa's position as a traditional importer of labour and capital. Other major items on the invisibles account of the balance of payments, such as net tourist expenditure and net transport payments, did not show a clear trend during the ten-year period

concerned. Net transport payments tended to follow a cyclical pattern, declining during the downward phase and rising during the upward phase of the business cycle.

In the year under review, net dividend payments to foreigners rose particularly sharply to R709 million, compared with R488 million in 1978/79, largely because of the higher profits of gold and other mining companies. Higher salary and wage payments to foreign migrant workers and net transport payments also made important contributions to the increase in net service and transfer payments in 1979/80. Net interest payments to foreigners, however, declined during this period, despite higher interest rate levels in most foreign countries. This decline reflected mainly the substantial reduction in foreign loan liabilities during recent years.

Net service payments



Large further net outflow of capital

A substantial net outflow of capital, amounting to as much as R3 812 million, was recorded in 1979/80. This was preceded by net outflows of R2 142 million in 1978/79 and R872 million in 1977/78. In contrast with the preceding two years, when the net outflow represented mostly an outflow of short-term capital, about 42 per cent of the net outflow during the year under review consisted of long-term capital. For the first time a large net outflow of long-term capital from the private sector occurred, comprising repayments on foreign loans as well as an increase in long-term foreign assets. Repayments on foreign loans were encouraged by the high rates of interest abroad and the ample availability of funds in the domestic capital market. These considerations also prompted repay-

Net capital movements

R millions

	Year ended 30 June		
	1978	1979	1980
Long-term capital			
Central government and banking sector	-397	-183	-267
Public corporations and local authorities	198	108	-220
Private sector	120	168	-1 129
Total long-term	-79	93	-1 616
Short-term capital			
Liabilities related to reserves	-226	-500	-346
Other, including unrecorded transactions ¹⁾	-567	-1 735	-1 850
Total short-term	-793	-2 235	-2 196
Total net capital movements	-872	-2 142	-3 812

1) I.e. errors and omissions relating to the current as well as the capital account of the balance of payments.

ments on foreign loans by the central government and public corporations. Net repayments on long-term foreign debt by the central government, for example, amounted to R605 million during the past three years.

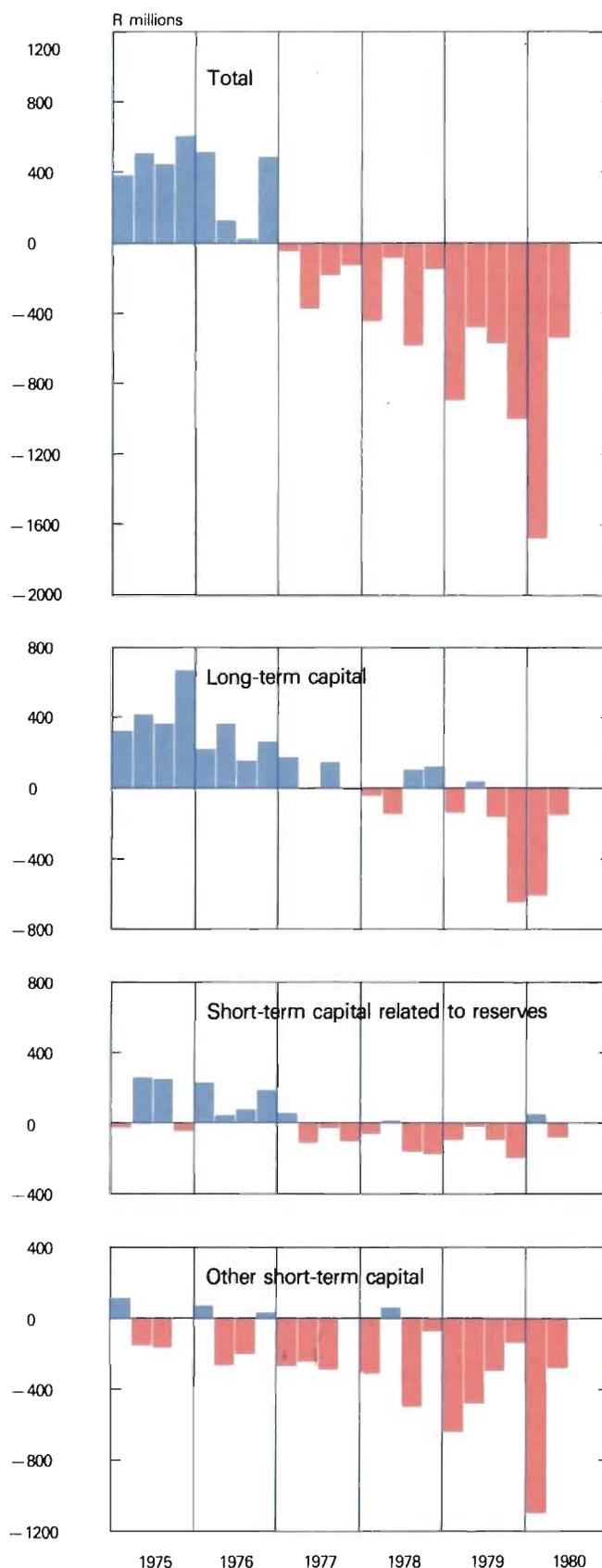
The net outflow of short-term capital amounted to R2 196 million in 1979/80 and was only slightly lower than the figure of R2 235 million in 1978/79. Repayments on loans obtained previously for the purpose of supplementing the country's foreign exchange holdings, were notably smaller in 1979/80 than in the preceding year because the outstanding balance of these so-called "liabilities related to reserves" that could be redeemed in the course of the year, was much smaller than in the preceding year. At the end of June 1980 the entire foreign debt of the Reserve Bank and all drawings by the government on the International Monetary Fund had been repaid. During the past three years liabilities related to reserves were reduced by R1 072 million.

Excluding the decrease in reserve-related liabilities, the net outflow of short-term capital increased further in 1979/80 to reach a figure of R1 850 million. To an important extent, this outflow was brought about by the switching of trade financing from foreign to domestic credit sources in response to wide margins between short-term interest rates in South Africa and those in other countries. The rate on three-month bankers' acceptances in the United States, for example, rose from 9,8 per cent at the beginning of the year under review to 19,0 per cent at the end of March 1980. During the same period, the corresponding rate in South Africa declined from 5,7 to 4,9 per cent, widening the margin from 4,1 to 14,1 per cent.

The outflow of short-term capital also resulted from certain relaxations of exchange control measures. As from December 1979, bills which are directly related to foreign trade transactions between a South African company and a foreign concern, could be discounted in the domestic money market and these discounts were exempted from the restriction on domestic borrowing by foreign-controlled companies. Subsequently, from February 1980, the maximum period for which South African exporters are allowed to provide credit to foreign importers, was extended from 6 to 12 months and forward cover facilities were provided for the longer credit period.

In response to these changes, the net outflow of short-term capital from the private sector, including errors and omissions on both the capital and current accounts of the balance of payments, increased from R375 million in the second quarter of 1979 to R1 088 million in the first quarter of 1980. The larger capital outflow during the latter period was encouraged initially by the authorities as a means of draining excess liquidity from the economy. From the middle of March to the middle of April, however, the capital outflow assumed such proportions that substantial foreign exchange losses and a severe tightening of the money

Net capital movements



market were experienced. After having made arrangements to control the domestic liquidity situation more effectively through its open-market operations, the Reserve bank on 18 April raised the discount on forward exchange transactions in US dollars from 2,5 to 12 per cent per annum in order to discourage an unduly large domestic financing of foreign trade. This was replaced on 23 April by a graduated discount on forward dollars to allow for differences in the maturities of forward exchange contracts. Since then, the discounts have been adjusted regularly in accordance with changes in domestic and foreign short-term interest rates. On 30 June 1980 discounts of 4,25, 4 and 3,5 per cent were applicable to forward exchange contracts with maturities of up to 121 days, 122 to 243 days, and 244 to 365 days, respectively.

During the second quarter of 1980 the discounts were fixed at such levels as to make it slightly more attractive to use foreign instead of domestic credit in the short-term financing of trade covered by forward exchange contracts. As a result, the outflow of short-term capital from the private sector decreased substantially to R381 million in the second quarter of 1980. From the beginning of July, however, the discounts were fixed at levels which marginally favoured the use of domestic credit in trade financing. The fixing of the discounts in this way was intended to assist the authorities once again in the management of excess liquidity in the money market. The outflow of long-term capital from the private sector, which had increased from R173 million in the third quarter of 1979 to R623 million in the first quarter of 1980, also declined in the second quarter, namely to R162 million.

Increase in foreign reserves

The surplus on the current account of the balance of payments in 1979/80 was sufficiently large to absorb the substantial net capital outflow, but added an amount of only R156 million to the country's net gold and other foreign reserves. The reduction of R346 million in liabilities related to reserves, however, caused the gross reserves to decline by R190 million on account of actual balance of payments transactions. If valuation adjustments, especially the revaluation of the gold reserves at a higher market-related price, and the allocation of special drawing rights by the International Monetary Fund are taken into account, the gross reserves increased by R3 019 million during 1979/80 to a level of R5 826 million at the end of June 1980.

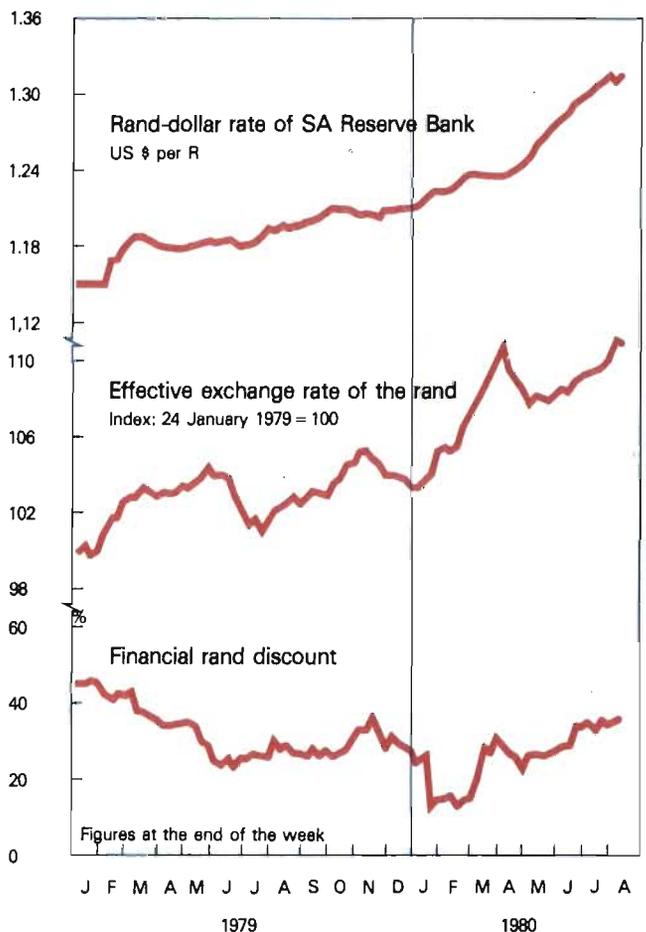
As a result of the sharp rise in the price of gold and the method followed in valuing the gold reserves at market-related prices, these reserves increased substantially from R2 070 million at the end of June 1979 to R4 928 million at the end of June 1980. Even the volume of the gold reserves, which had declined during the preceding five years, increased from 9,67

million fine ounces to 11,34 million fine ounces during the year under review. The foreign exchange component of the reserves increased by R161 million during 1979/80 to R898 million at the end of June 1980. During July 1980 the gross gold and other foreign reserves of the Reserve Bank rose by R403 million, of which R42 million represented the effect of the revaluation of the gold reserves at a higher price. The increase in the Bank's reserves also included a rise of 447 thousand fine ounces in the gold reserves.

Appreciation of the rand

The weighted average value of the rand in terms of major currencies continued to rise during 1979/80 and at the end of June 1980 the effective exchange rate of the rand was 7,1 per cent higher than at the end of June 1979. Considerable fluctuations in the effective exchange rate of the rand occurred in the course of the year under review. The weighted average value of the rand at first continued to increase up to the end of October 1979, but declined sharply during the remainder of 1979. The appreciation of the US dollar on international exchange markets early in 1980 and the simul-

Exchange rates



taneous appreciation of the rand against the dollar caused the effective exchange rate of the rand to rise sharply up to 8 April 1980. During the remainder of the year under review the rand continued to appreciate against the US dollar, but the depreciation of the dollar against other major currencies had the effect of limiting the rise in the effective exchange rate of the rand. Despite a strong appreciation of the dollar at the end of July, the rand appreciated by 1,0 per cent against the dollar during this month and by 1,5 per cent against all currencies.

The rate of appreciation of the rand against individual currencies varied appreciably during 1979/80. The rand appreciated, for example, by 10,0 per cent against the US dollar, 11,0 per cent against the Japanese yen, 7,9 per cent against the Swiss franc, 5,3 per cent against the French franc, and 5,1 per cent against the German mark. Because of the relatively strong position of the British pound on international exchange markets, however, the rand's appreciation against the pound during the year under review amounted to only 1,4 per cent.

In contrast with the relatively strong and stable commercial rand, the exchange rate of the financial rand fluctuated considerably in the course of 1979/80. After the introduction of the new exchange rate system in January 1979, the financial rand discount declined from 44,6 per cent on 24 January 1979 to 23,7 per cent on 18 July, mainly because the new system extended the scope of financial rand investments. Subsequently, the discount increased to 35,4 per cent on 16 November before declining sharply to 14,9 per cent at the end of February 1980 as a result of the sharp rise in the price of gold and an increase in the demand for financial rand by foreigners for the purpose of investing on the Johannesburg Stock Exchange. This upsurge in demand for financial rand, however, subsided rapidly and the discount increased again to 31,2 per cent on 1 April. Thereafter, it fluctuated between 22 and 35 per cent during the ensuing four months, amounting to 31,6 per cent at the end of June and 34,7 per cent at the end of July.

Monetary and banking situation

High rate of monetary expansion

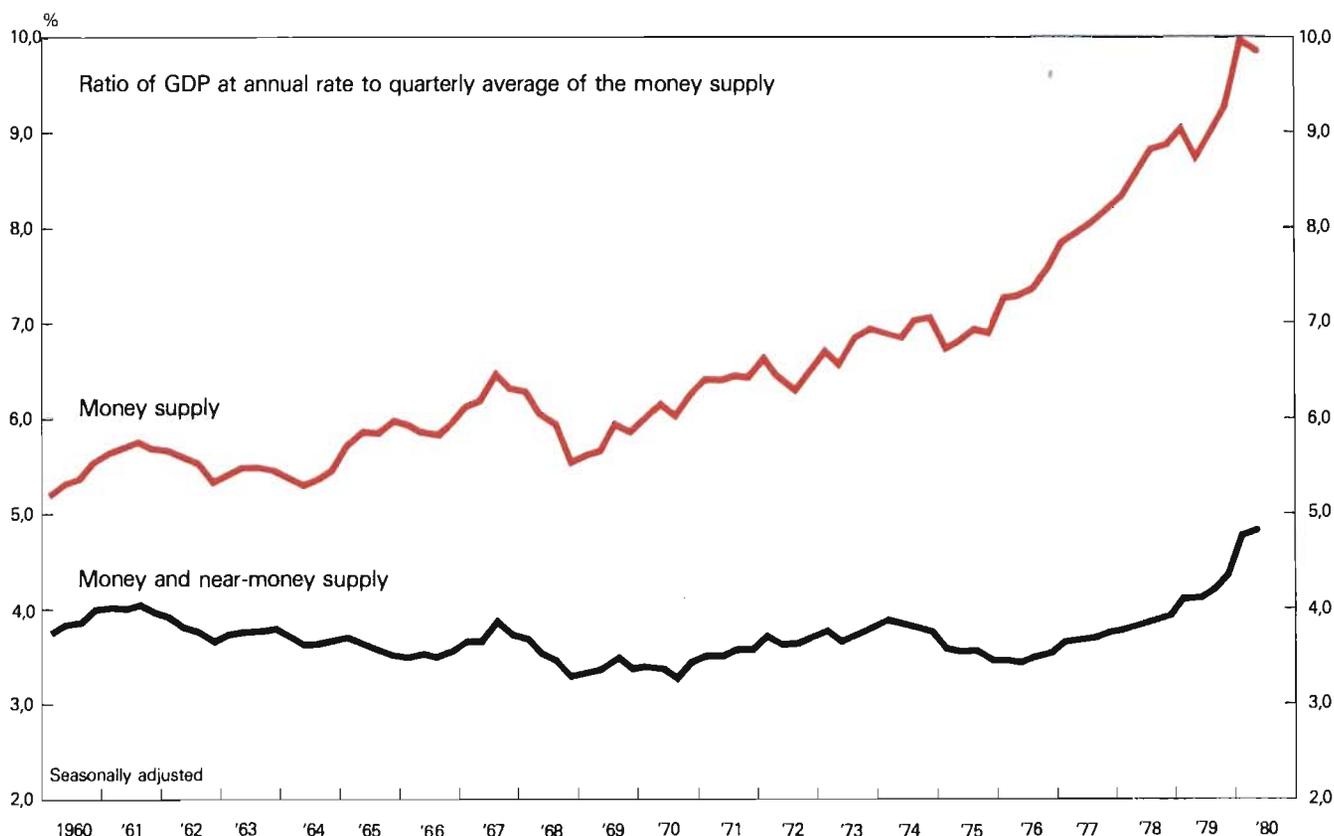
After three years of moderate growth in the monetary aggregates, a strong monetary expansion occurred in the South African economy during 1979/80. The quantity of money and near-money increased by a record amount of R2 374 million, or 21 per cent, as against a rise of only 7 per cent during 1978/79 and an average annual rate of increase of slightly less than 7 per cent during the three-year period from the end of June 1976 to the end of June 1979. The narrowly defined money supply, which had expanded by approximately 14 per cent during 1978/79, rose by the record amount of R1 453 million or 27 per cent during 1979/80.

Marked short-term fluctuations in the rates of increase of the monetary aggregates were apparent in the course of the year under review. During the second half of 1979 the money and near-money supply rose at a seasonally adjusted annual rate of 27 per cent, but at a rate of only 15 per cent during the first half of 1980. The narrowly defined money supply increased, at a seasonally adjusted annual rate, by 11 per cent during the third quarter of 1979, by no less than 42 per cent during the period October 1979 to March 1980, and then by 16 per cent during the second quarter of 1980.

The significance and comparability of the monetary aggregates, as conventionally measured, were affected greatly by the practice adopted by the banks from July 1979 of selling assets under repurchase agreements. Generally speaking, there is little doubt that short- and medium-dated repurchase agreements held by the private non-banking sector retain a close affiliation with bank deposits, are close substitutes for such deposits, and should therefore probably be included in appropriate measures of the money supply and the money and near-money supply. In the United States such agreements are, in fact, now included in the Federal Reserve Board's recently redefined monetary aggregates.

According to data submitted by the banks, short- and medium-dated repurchase agreements entered into by monetary banking institutions with the private non-banking sector amounted to R1 271 million at the end of June 1980. Inclusion of this amount in the money and near-money supply raises the increase in the quantity of money and near-money during 1979/80 from 21 to 32 per cent. Similarly, inclusion of the so-called "continuous contracts" and "overnight buy-backs" in the narrowly defined money supply causes its increase during the year to rise from 27 to 39 per cent.

Velocity of circulation of monetary aggregates



In an alternative approach, the banks' introduction of repurchase agreements may be viewed as one of several developments that have contributed in recent years to an acceleration in the long-term upward trend in the velocity of circulation of the narrowly defined money supply, and to the increase in the velocity of circulation of the money and near-money supply since the third quarter of 1976. From the second quarter of 1976 to the second quarter of 1980, the increase in the velocity of circulation of the narrowly defined and the broadly defined money supply, measured by the ratio of the gross domestic product at current market prices to these aggregates, amounted to average annual rates of 7,9 per cent and 8,9 per cent, respectively. From the second quarter of 1979 to the second quarter of 1980, however, these increases amounted to no less than 13,1 and 17,1 per cent, respectively.

The velocity of circulation of the narrowly and the broadly defined money supply increased by 36 per cent and 41 per cent, respectively, from the second quarter of 1976 to the second quarter of 1980, compared with increases of 53 per cent and 47 per cent in the quarterly averages of the money supply and the money and near-money supply during this four-year period. Rising velocity and the quantitative increase in the monetary aggregates have, therefore, in recent years made contributions of a comparable order of magnitude to the increase in the money value of the gross domestic product at current prices, which amounted to approximately 107 per cent during the four-year period concerned.

Although increases in velocity have been common in many countries recently, such accelerations have mostly tended to accompany restrictive monetary policies and rising interest rates. In contrast, the increases in the velocity of circulation of the money supply in both its broad and narrow sense in the South African economy since 1976 have, by and large, taken

place against a background of rising domestic liquidity and declining interest rates. Explanations of this phenomenon must include long-term institutional and other developments (including the introduction of repurchase agreements referred to earlier), as well as elements of a more cyclical nature. As regards the latter, declining short-term interest rates, interest rate expectations, and shifts in relative interest rates, have among other things, until recently encouraged a relative shift by investors to long-term deposits not included in the money and near-money supply, as well as very substantial non-bank holdings of money market instruments that serve as substitutes for interest-bearing deposits with the banking system.

Causes of changes in the money and near-money supply

The pattern of the causes of changes in the money and near-money supply during 1979/80 differed considerably from that in the preceding year. These shifts could be associated with the more advanced stage of the upswing in the economy, modified by the effect of the high price of gold on the balance of payments, the domestic liquidity situation, and interest rates. Specifically, the extension of net domestic credit accelerated substantially from 1978/79, the increase in the monetary banking sector's net gold and other foreign reserves was markedly smaller than during the preceding year, and there was a sharp reduction in the increase in long-term deposits as a negative cause of change in the money and near-money supply.

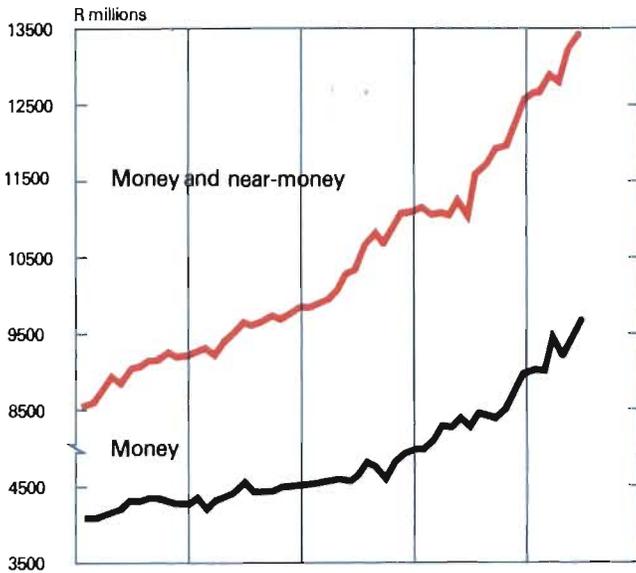
The increase in the net gold and other foreign reserves of the monetary banking sector amounted to R384 million during 1979/80, compared with R655 million during 1978/79. Marked fluctuations occurred in the quarterly changes in the net foreign reserves during the year. In broad terms, the fairly substantial in-

Causes of changes in money and near-money

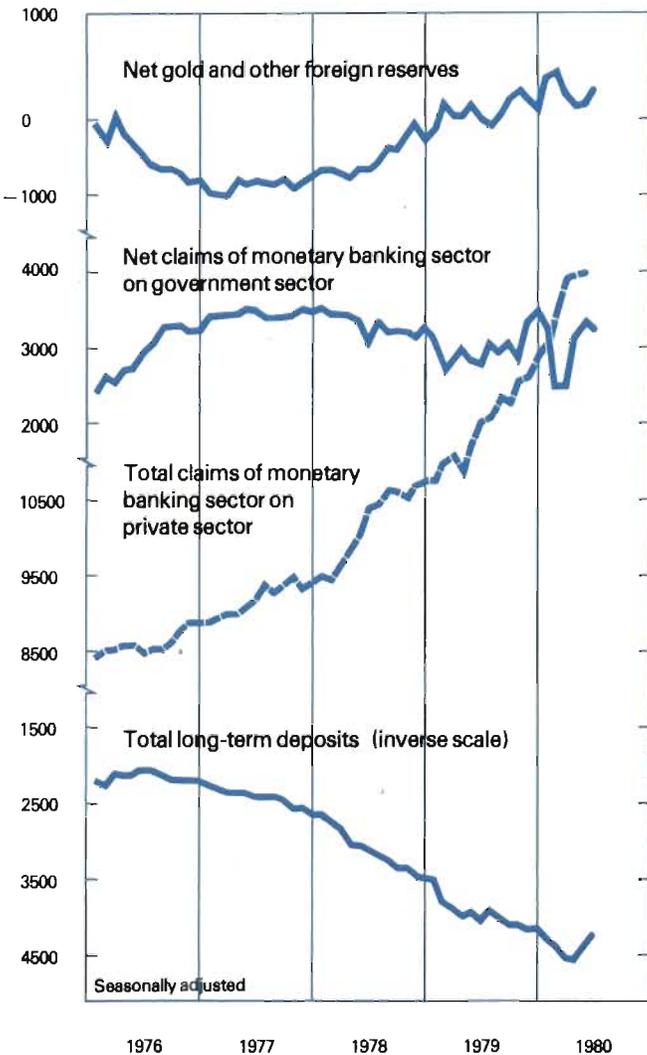
R millions

	Year 1978/ 1979	Not seasonally adjusted				Year 1979/ 1980	Seasonally adjusted			
		1979 3rd qtr	1979 4th qtr	1980 1st qtr	1980 2nd qtr		1979 3rd qtr	1979 4th qtr	1980 1st qtr	1980 2nd qtr
Net gold and other foreign reserves	655	259	-96	157	64	384	247	-85	133	79
Claims on government sector:										
Gross claims	-515	-71	454	-490	347	240	—	—	—	—
Government deposits (increase-, decrease+)	191	98	-7	-733	833	191	—	—	—	—
Net claims	-324	27	447	-1 223	1 180	431	221	330	-902	767
Claims on private sector	1 151	377	572	709	357	2 015	293	664	838	196
Long-term deposits (increase-, decrease+)	-947	-13	-27	-333	166	-207	-82	-103	-334	316
Net other assets	199	-5	-18	653	-879	-249	—	—	—	—
Total causes of changes	734	645	878	-37	888	2 374	662	733	407	532

Monetary analysis



Causes of changes in money and near-money



crease in the net reserves during the second half of 1979 was accounted for by the fact that the decline in the short-term foreign liabilities of the banking sector (partly reflecting continuing repayments on official foreign loans) substantially exceeded the decline in the banking sector's gross foreign reserve holdings. The small increase in the net reserves during the first half of 1980, on the other hand, was due to the fact that the increase in the gross foreign reserves during this period somewhat exceeded the increase in short-term foreign liabilities. Reflecting the high price of gold, the gross foreign reserves rose strongly during January and February in particular; short-term foreign liabilities rose sharply in March as a result of renewed official borrowing in response to the sharply increased outflow of private capital.

Contrary to their usual inverse relationship, net claims of the monetary banking sector on the government sector rose substantially by R431 million during 1979/80, notwithstanding the continuing moderate increase in the net gold and other foreign reserves. In contrast, these net claims declined by R780 million during the preceding two-year period. Exceptionally sharp month-to-month changes in net bank credit to the government sector were in evidence on various occasions during the year, reflecting mostly the uneven flow of tax funds to the government. Net claims of the banking sector on the government sector, seasonally adjusted, declined, for example, by over R730 million during February 1980. During April, however, these claims rose again by more than R650 million.

Added to a markedly higher increase of R2 015 million, or 17 per cent, in monetary banks' claims on the private sector (not including repurchase agreements), the renewed rise in net bank credit to the government sector contributed significantly to a marked acceleration in the expansion of overall domestic credit, namely from R827 million, or 6 per cent, in 1978/79 to R2 446 million, or 17 per cent, in 1979/80. It represented a significant acceleration from the average rate of increase in domestic credit of less than 8 per cent per annum during the earlier stages of the current economic upswing from the end of December 1977 to the end of June 1979. In addition, the apparent increase in domestic credit, like the increases in the monetary aggregates, was affected significantly during the year under review by the banks' introduction of repurchase agreements with the non-bank private sector, and more particularly by repurchase agreements in credit instruments representing claims on the private sector.

Long-term deposits of the private non-banking sector with monetary banking institutions, which had been on a rising trend since the third quarter of 1976 and had increased at progressively higher rates during 1978 and the first quarter of 1979, rose more slowly during 1979/80. The increase in these deposits

amounted to R207 million, or 5 per cent, during the year under review, compared with R947 million, or 30 per cent, during the preceding year. Long-term deposits tend to increase most rapidly, in relative terms, when interest rates are declining most rapidly, a state of affairs that generally occurs during the more advanced stages of cyclical downswings or the earlier stages of upswings. The slowdown in the rate of increase in these deposits during 1979/80 may therefore be associated with the deceleration and partial reversal of the decline in interest rates during the year and accompanying changes in interest rate expectations.

Higher rates of increase in bank credit to the private sector

The monetary banking sector's claims on the private sector increased by R2 015 million, or 17 per cent, during 1979/80, compared with R1 151 million, or 11 per cent, during the preceding year. If the monetary banks' repurchase agreements in private-sector credit instruments (such as bankers' acceptances and promissory notes) with the private non-banking sector, amounting to R971 million at the end of June 1980, are included, the aggregate increase in bank credit to the private sector during 1979/80 amounted to as much as 25 per cent.

Considering a somewhat longer period, the extension of bank credit to the private sector during the current economic upswing has not yet reached the very high growth rates which were recorded in 1973 and 1974. Not including banks' repurchase agreements in private-sector credit instruments, the increase in the monetary banks' claims on the private sector from the end of December 1977 to the end of June 1980 amounted to 44 per cent, representing an average annual growth rate of 16 per cent. If repurchase agreements in private-sector paper are included, the increase amounted to 54 per cent, or to an average rate of 19 per cent per annum. In contrast, the monetary banks' total claims on the private sector during the upswing from November 1972 to July 1974 rose at the much higher average annual rate of 31 per cent.

All components of bank credit to the private sector increased during 1979/80. The relative growth rates of the various types of credit differed, however, from those in the preceding year, reflecting a more advanced stage of the current economic upswing and the termination of the declining trend in interest rates. The rate of increase in the monetary banks' investments in private-sector securities, for example, accelerated slightly from 14 per cent in 1978/79 to 15 per cent, or R271 million, in 1979/80. Cash credit advances by the Land Bank, showing their normal seasonal fluctuations, rose on balance by R260 million during 1979/80, against R150 million during the preceding year. Monetary banks' holdings of bills discounted increased by R248 million, or 37 per cent, after a small

decline had been recorded in 1978/79. The loans and advances of commercial, merchant and monetary general banks rose by R1 135 million, or 15 per cent, during the year under review, against 9 per cent in 1978.

A breakdown of the loans and advances of commercial, merchant and monetary general banks shows that hire-purchase credit and leasing finance extended by these institutions continued to rise strongly during 1979/80, namely by 26 per cent and 28 per cent, respectively. The sharp rise in hire-purchase credit reflected the substantial increase in consumer expenditure, notably on durable goods. As the banks' hire-purchase credit and leasing finance since the beginning of the present upward phase of the business cycle have consistently increased more rapidly than bank lending generally, the share of these forms of credit in the banks' total loans and advances to the private sector rose from less than 26 per cent at the end of 1977 to more than 36 per cent at the end of June 1980. Other loans and advances, which are more indicative of the general industrial and commercial demand for credit, rose by 9 per cent during 1979/80. Although still well below the current rate of inflation, this rate of increase represented a marked acceleration from the rate of growth of less than 1 per cent during 1978/79. In addition, this rate, which incorporates the growth in ordinary commercial bank lending on overdraft, has probably been held down in recent years by large companies' increasing recourse to inter-company borrowing and to borrowing on short-term paper in the money markets outside the banking system.

The authorised ceilings on the banks' discounts, loans and advances to the private sector were raised by R1 055 million during 1979/80, of which R671 million represented additional increases over and above the usual monthly increase of ½ per cent of the base figures as at the end of 1975. These ceilings, as well as those on the banks' investments in private-sector securities, were raised in August 1979 by an additional 4 per cent and in March 1980 by a further 6 per cent of the base figures. Unused facilities under the ceilings on discounts, loans and advances declined by R230 million and those under the ceilings on investments increased by R19 million during the year under review.

Increase in bank liquidity

The excess liquidity of banking institutions was on average appreciably higher during 1979/80 than during the preceding year. The average month-end excess liquidity ratio of all banking institutions rose from 2,9 per cent in 1978/79 to 3,5 per cent in 1979/80. A pronounced change from the first to the second half of the year under review was evident in the excess liquidity of commercial banks. After the excess liquidity ratio of these banks had risen from 3,9 per

cent at the end of June 1979 to 7,0 per cent at the end of October and 6,3 per cent at the end of December, it declined to 1,7 per cent at the end of February 1980 before recovering to 5,8 per cent at the end of June. Most of the sharp decline during January and February was due to a decrease in the banks' actual holdings of liquid assets as a result of unusually large tax payments to the government at the end of February. The reduction was accompanied by some widening of the differentials between the yields on non-liquid and liquid money market instruments from the end of 1979 to late April 1980.

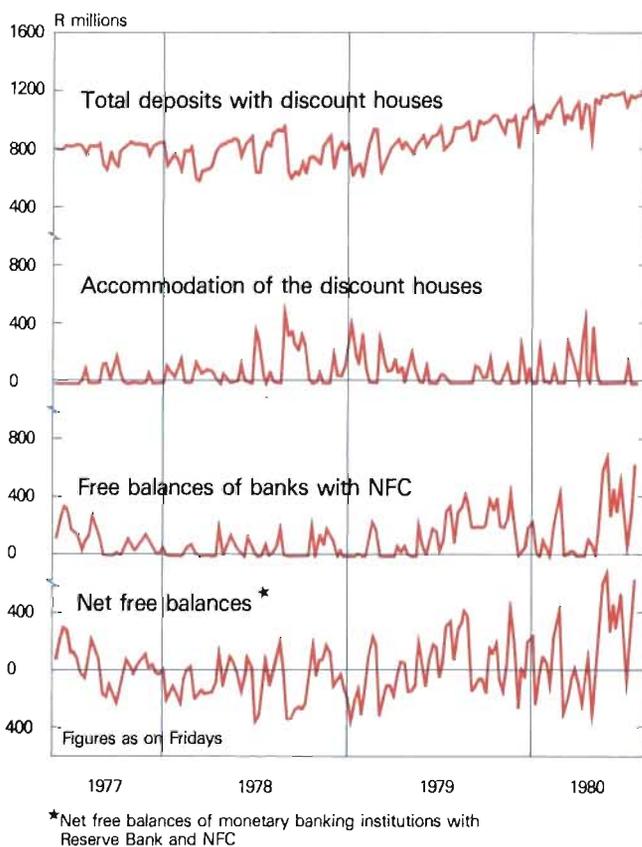
From the end of June 1979 to the end of June 1980, the banks' required holdings of liquid assets increased by R1 100 million or 24 per cent, compared with an approximately commensurate increase in their total liabilities to the public of 21 per cent. Although the cash reserve and liquid asset requirements for banking institutions were changed significantly with effect from about 21 April 1980, this had little effect on the total of the banks' required minimum holdings of liquid assets. The banks' actual liquid asset holdings rose by R1 459 million, or 29 per cent, during the year, compared with an average annual rate of increase of only 7 per cent during the three-year period from June 1976 to June 1979 and of as much as 24 per cent during the period from June 1973 to June 1976. The larger part of the rise during 1979/80 was accounted for by increased contributions of the foreign sector and the government sector to the banks' liquidity base.

Significant shifts in the composition of the banks' liquid asset portfolios again occurred during the year under review and were probably related partly to uncertainty about future interest rate movements and changing interest rate expectations. In the case of the commercial banks, for example, the average share of short-term government stock in their aggregate liquid asset portfolio as at month-ends was reduced from 42 per cent during 1978/79 to only 30 per cent during 1979/80. The share of call money and Treasury bills, on the other hand, was raised from 18 per cent to 27 per cent. Treasury bills accounted on average for nearly 7 per cent of the commercial banks' liquid asset holdings, against less than 1 per cent as recently as 1977/78.

Money market conditions and interest rates

A steady upward trend in the availability of call money was one of the main characteristics of the money market during the year under review. This resulted from a sharp rise in banking institutions' liquid asset holdings, partly originating in the rising level of the Reserve Bank's net gold and other foreign reserves, during the second half of 1979, and the relative shift towards call deposits in the banks' liquid asset portfolios throughout 1979/80. The average amount of call loans to the discount houses (as on Fridays) rose from

Selected indicators of money market conditions



R975 million during the second half of 1979 to R1 090 million during the first half of 1980. The average amount of R1 032 million during 1979/80 as a whole was approximately 28 per cent higher than the figure for 1978/79.

Banking institutions' free balances with the National Finance Corporation were depleted regularly over month-ends and for a more extended period from the end of February up to early April 1980. However, as the discount houses were occasionally unable to accept further call loans because of the capital constraint on their total call liabilities, substantial accumulations of banks' free balances with the Corporation occurred at various stages during the year. The average amount of such balances during 1979/80 was R173 million, compared with only R55 million in 1978/79.

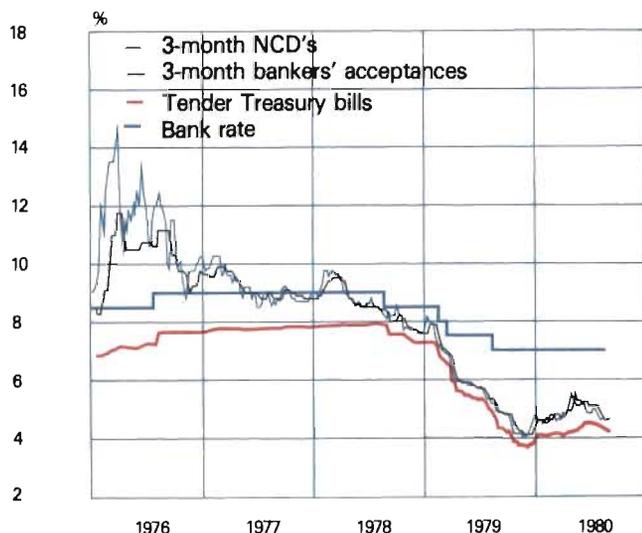
Month-end and other short-term tightenings of the market of above-average severity were experienced at the end of August 1979 and again at the end of February and March 1980 and during the fourth week of April 1980. The withdrawal of call deposits from the money market institutions at the end of August 1979 and at the end of February 1980 was caused mainly by heavy tax payments to the government, especially by gold mining companies. The tightening of the market over the March month-end resulted mainly from a sharp decline in the net gold and other foreign re-

serves of the Reserve Bank. Relatively tight conditions during the latter part of April, which continued to be felt during the first week of May, mainly reflected the increase in the cash reserve requirements for banking institutions (which took effect from approximately 21 April), as well as a large increase in the amount of banknotes in circulation outside the banking system.

Large free balances of banking institutions with the National Finance Corporation proved adequate to absorb the loss of cash reserves to the banking system over the month-ends of July 1979 and May 1980 and significantly reduced the need for the discount houses to seek accommodation from the Reserve Bank on other occasions, notably over the month-ends of August 1979 and February 1980 and in early July 1980. Accommodation by the Reserve Bank to the discount houses was, however, provided for fairly extensive periods in September 1979 and in March and April 1980. On 31 March it reached a peak of R562 million, including deposits of R217 million by the Public Debt Commissioners and overnight loans of R62 million. The average amount of accommodation granted to the discount houses during 1979/80 only slightly exceeded that during the preceding year.

Rising average levels of the banks' free balances with the National Finance Corporation also accounted for a resumption of the upward tendency in monetary banks' so-called net free reserve balances with the Reserve Bank and the Corporation during the later stages of 1979/80. As shown by the accompanying graph, a lower turning point in these reserve balances, which had shown a downward trend during the period of declining money market interest rates from approximately the second quarter of 1976, apparently was reached in early 1979.

Money market interest rates



During the first four-and-a-half months of 1979/80, money market interest rates continued the downward movement that had commenced in the second quarter of 1976 and had accelerated sharply after the first quarter of 1978. A lower turning point was reached, however, in the second half of November to early December 1979. From this turning point, interest rates rose moderately up to the end of April 1980, but declined again during the subsequent three months. The rate on three-months bankers' acceptances, for example, declined from 5,70 per cent at the end of June 1979 to 4,10 per cent on 7 December, rose to 5,40 per cent on 25 April 1980, and decreased to 4,65 per cent on 8 August. The rate on 90-day negotiable certificates of deposit similarly declined from 5,75 per cent on 29 June 1979 to 4,10 per cent on 7 December, rose to 5,50 per cent on 25 April 1980, but fell back to 4,65 per cent on 8 August. The Treasury bill tender rate declined from 5,34 per cent on 29 June 1979 to 3,81 per cent on 23 November and rose to 4,66 per cent on 30 May 1980 before declining to 4,36 per cent on 8 August. The differential between this rate and the rate on 90-day certificates of deposit widened from only 0,17 percentage points in early December 1979 to 1,15 percentage points at the end of April 1980 in accordance with the marked decline in banking institutions' excess liquidity, but narrowed again to 0,35 percentage points at the end of July.

Substantially larger open-market operations by the Reserve Bank

The Reserve Bank's open-market operations were stepped up substantially during the year under review and in its dealings the Bank made use of new instruments and techniques. In view of the increased availability of funds in the money market and the Bank's interest rate objectives, no purchases of securities were effected in the market during the year. The aggregate amount of paper made available by the Bank to the market (not including the National Finance Corporation) was nearly R2,3 milliard, of which approximately 75 per cent consisted of short-term instruments of less than three years' unexpired maturity. Sales of government securities amounted to slightly over R1 000 million, of which R565 million was in the short-term category. An amount of R690 million of government securities was sold by the Bank during the three months of rapidly rising bank and money market liquidity and declining short-term interest rates from August to October 1979.

Reserve Bank sales of Treasury bills during the year amounted to R1 061 million. These included sales during the period October 1979 to January 1980 of R350 million of "special" or tax-anticipation tap Treasury bills that matured on 29 February 1980, and sales in May and June 1980 of R500 million of such bills that will mature at the end of August 1980.

Repurchase agreements were concluded by the Reserve Bank with various banking institutions during June 1980. In terms of these agreements, an aggregate amount of R135 million of government securities sold by the Bank is to be repurchased on 29 August 1980 and 27 February 1981. Finally, the Bank commenced issuing its own securities during the year under review. An amount of R100 million was sold in the market during June 1980, of which R20 million will mature on 29 August 1980 and R80 million on 27 February 1981, in order to alleviate the shortage of funds in the market that normally arises over these month-ends.

Government finance

Shift in the seasonal pattern of Exchequer issues

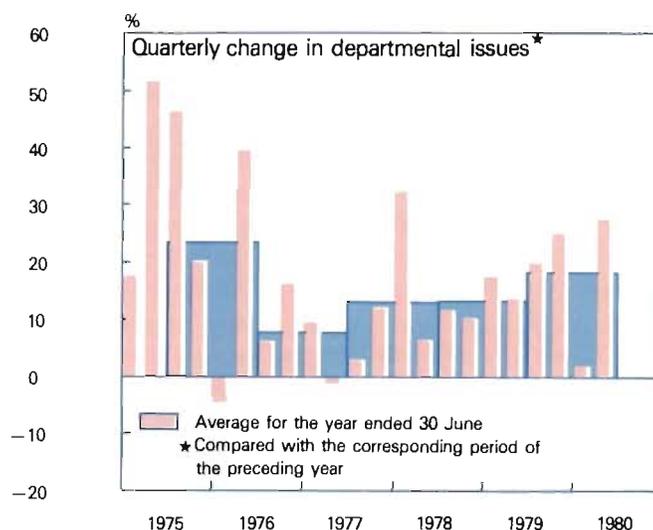
As during the preceding three years, a policy of restraining the growth in government expenditure was pursued during 1979/80. Exchequer issues to government departments nevertheless increased at a notably higher rate than in the immediately preceding years, namely by 18 per cent. During the three-year period from July 1976 to June 1979, Exchequer issues rose on average by 11 per cent per year and showed virtually no change in real terms. The relatively high rate of increase in issues in 1979/80 did not, however, reflect a departure from the existing policy, but rather a shift in the seasonal pattern of quarterly issues. In contrast with the usual seasonal pattern in preceding years, Exchequer issues increased in the third quarter of 1979 and in the second quarter of 1980. Issues during these two quarters, for example, exceeded those in the corresponding quarters of 1978/79 by 20 per cent and 27 per cent, respectively. The effect of these substantial rises on the rate of increase in Exchequer issues in 1979/80 as a whole, was only partly offset by a less than seasonal increase of 2 per cent in the first quarter of 1980.

The relatively low rate of increase in government expenditure during recent years resulted in an appreciable decline in the relative contribution of the central government to the gross domestic product. In 1975/76, for example, the consumption and investment outlays of the central government amounted to 15½ per cent of the gross domestic product, but this ratio declined to 12 per cent in 1979/80. The policy of restraining the growth in expenditure also applied to provincial administrations and local authorities, and the ratio of the consumption and investment outlays of all public authorities to the gross domestic product likewise decreased from 25 per cent in 1975/76 to 18 per cent in 1979/80.

Strong rise in Exchequer receipts

Receipts on the Exchequer Account rose strongly during the year under review and the increase of 21 per cent even exceeded the high rate of increase of 19 per cent in 1978/79. In both these years the high rate of growth in receipts was attributable to substantially larger receipts from gold mining companies, reflecting the sharp rise in the price of gold and in gold mining profits. Income tax and mining lease payments by gold mining companies rose from R480 million in 1977/78 to R901 million in 1978/79 and to R1 752 million in the year under review. If this revenue is excluded, Exchequer receipts increased at an average annual rate of only 13 per cent during the past two years. The substantial increase in receipts from gold mining companies raised the ratio of these receipts to total revenue from 7 per cent in 1977/78 to 17 per cent in 1979/80.

State Revenue Fund



Notable increases occurred also in most of the other revenue items. Income tax receipts from non-mining companies, which had declined by 8 per cent in 1978/79, rose by 16 per cent in 1979/80, reflecting the substantial increase in company profits. The profitability of mining companies other than gold and diamond mining companies was affected favourably by the domestic economic upswing as well as buoyant export markets. Indirect taxes which showed substantial increases in 1979/80, were the general sales tax and

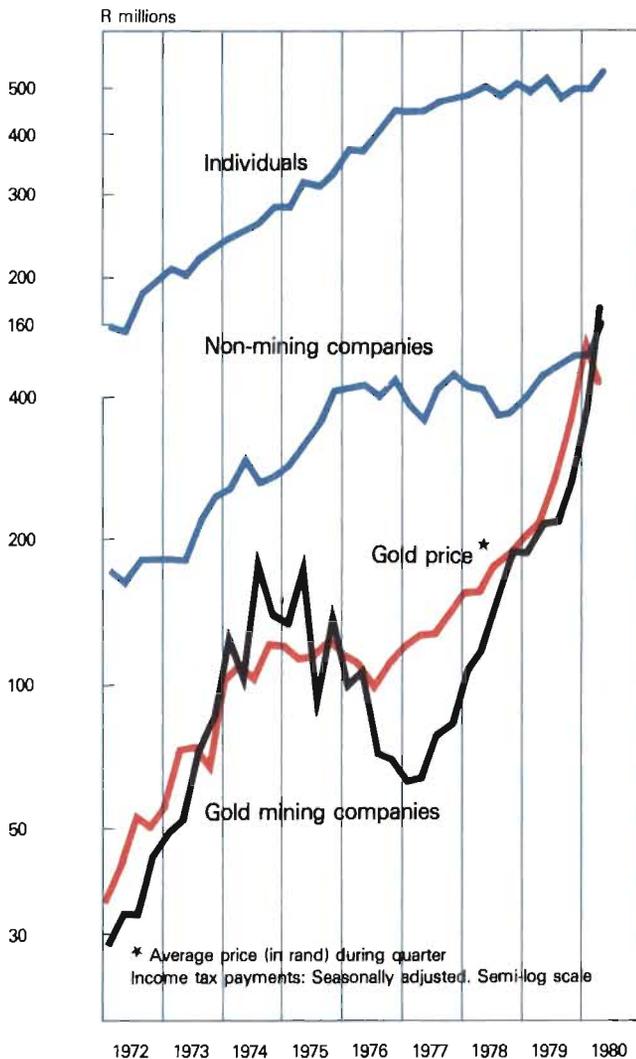
State Revenue Account — Revenue collections

R millions

	Year ended June		
	1978	1979	1980
Indirect taxes			
Import duties	316	388	493
Surcharge on imports	373	330	190
Excise duties	895	1 003	1 075
Sales duty	343	46	1
General sales tax	—	928	1 343
Sub-total	1 926	2 694	3 102
Less: Transfers to SWA Account and neighbouring countries ¹⁾	229	363	471
Sub-total	1 697	2 332	2 632
Income tax and other revenue			
Income tax and lease payments by gold mines	480	901	1 752
Other income tax	3 775	3 828	4 107
Other revenue	1 236	1 489	1 755
Total	7 189	8 550	10 246

1) In terms of Custom Union agreements

Income tax payments

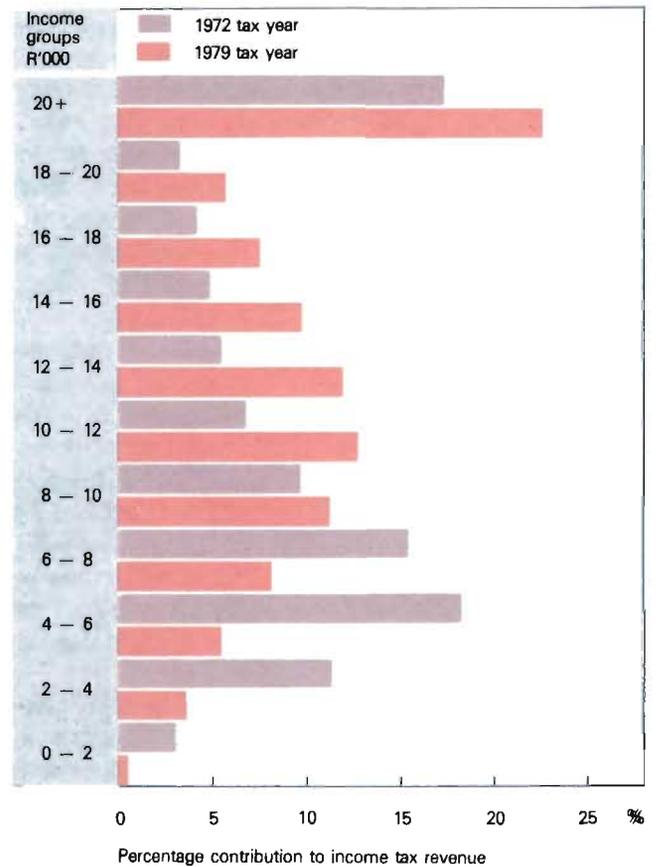


customs duties. As a result of the sharp rise in consumer expenditure, general sales tax receipts increased by 45 per cent and accounted for 44 per cent of total indirect taxes in 1979/80. Customs duties rose by 27 per cent in accordance with the more rapid increase in imports during the year under review.

In contrast with the strong rise in Exchequer receipts generally, personal income tax receipts declined slightly in 1979/80. This resulted from the lowering of personal income tax rates as part of the government's policy to promote more rapid economic growth through an increase in consumer demand, and also to adjust the tax structure in order to place more emphasis on indirect taxes as a source of revenue. The decline in personal income tax receipts was preceded by strong rises from 1971/72 to 1977/78 and a moderate increase in 1978/79. During this eight-year period basic personal income tax rates remained unchanged and were supplemented from time to time by surcharges

Personal income tax

Contribution to total income tax revenue by taxpayers in different income groups



on the basic or normal tax. At the same time, an inflation-induced upward adjustment of personal incomes resulted in a shift of taxpayers into higher income tax brackets, which meant that tax had to be paid at progressively higher rates. The unfavourable effect of the "fiscal drag" on personal disposable income was alleviated by a lowering of marginal tax rates and an increase in income abatements in the 1979/80 Budget. This was followed by a further adjustment of tax rates, including a reduction in marginal tax rates and a substitution of tax rebates for income abatements, in the 1980/81 Budget.

The process of tax reform, which started with the introduction of the general sales tax in July 1978 and continued with the lowering of personal income tax rates in 1979 and in 1980, was directed towards an increase in the share of indirect taxes in total government revenue. The effect of these structural tax changes was obscured, however, by the sharp rise in income tax receipts from gold mining companies, and by the reduction in March 1979 and eventual abolition in March 1980 of the surcharge on imports which had been imposed in March 1977 largely as a temporary measure of supplementing government revenue. The ratio of indirect taxes to total revenue increased from

25 per cent in 1977/78 to 30 per cent in 1978/79, but declined slightly to 29 per cent in 1979/80. If the proceeds of the surcharge on imports and tax receipts from gold mining companies are excluded, however, the ratio increased from 23 per cent in 1977/78 to 30 per cent in 1978/79 and to 33 per cent in 1979/80.

Greater reliance on banking sector as a source of finance

The deficit on the Exchequer Account, excluding borrowing and debt repayment, amounted to R2 014 million in 1979/80. This figure was equal to 16 per cent of total Exchequer issues during this period, meaning that only a relatively small proportion of issues was not covered by current revenue but had to be financed by means of borrowing or the utilisation of cash balances. Because of the sharp rise in Exchequer receipts in the year under review, the deficit was only R137 million larger than in 1978/79, despite the more rapid increase in issues. In 1979/80, however, the pattern of Exchequer financing differed from that in the preceding year. Less was borrowed from the domestic non-banking sector and an increase occurred in the Treasury's net indebtedness to the monetary banking sector.

Borrowing from the domestic non-banking sector, which had exceeded the amount of the deficit in 1977/78 and 1978/79, covered only 82 per cent of the deficit in the year under review. The contributions of

both the private non-banking sector and the Public Debt Commissioners to the financing of the Exchequer deficit declined during 1979/80. Although the private non-banking sector's holdings of marketable government stock increased by R466 million, or R154 million more than in the preceding year, its net investment in non-marketable government securities decreased from R492 million in 1978/79 to R321 million in 1979/80. Net receipts of compulsory loan levies, however, amounted to R270 million, compared with R252 million in 1978/79.

Borrowing from the private non-banking sector during the year under review was affected by a change in investors' expectations of prospective interest rate movements. During the second half of 1979/80, in particular, expectations of an increase in long-term interest rates inhibited new investment in long-term securities. As a result, the issues of long-term stock in April and also in July 1980 met with little support from investors in the private sector. The amount of new funds raised in the private non-banking sector during 1979/80 was also affected by the Treasury's procedure of redeeming maturing stock without necessarily offering investors the usual option of reinvesting in new stock. Although maturing stock issues were repaid on six occasions during the year, only two new coinciding public issues were made. As a result, the private non-banking sector's holdings of government stock were increased mainly by means of purchases in the secondary market.

Although the Public Debt Commissioners' inflow of funds during 1979/80 was only slightly smaller than in the preceding year, their net new investment in government securities decreased from R1 096 million in 1978/79 to R562 million in 1979/80. The Commissioners, however, substantially increased their net investment in securities of public corporations.

The Treasury's net indebtedness to the monetary banking sector, which had declined during 1978/79, rose by R446 million during 1979/80. This was accounted for by an increase in monetary banks' holdings of government securities as well as to a decline in Exchequer Account balances with the banking sector. In the course of the year the Reserve Bank and the National Finance Corporation were important subscribers to public issues of government stock. These subscriptions were made by the Reserve Bank in order to expand its portfolio of securities for the purpose of conducting open-market operations and by the National Finance Corporation as an investment outlet for the increased amount of call deposits received during the year under review. Large sales of government securities were, however, made by these institutions during 1979/80 and in particular towards the end of the year, resulting in a decline of R286 million in the government security holdings of the Bank and the Corporation.

As during the preceding two years, the Treasury re-

Exchequer Account financing

R millions

	Year ended June		
	1978	1979	1980
Deficit	2 123	1 877	2 014
Financing:			
Foreign sector	-190	-257	-82
Domestic non-banking sector:			
Public Debt Commissioners	681	1 096	562
Private non-banking sector	1 638	1 099	1 087
Total	2 319	2 195	1 649
Monetary banking sector:			
Change in holdings of government securities:			
Reserve Bank and National Finance Corporation	180	-506	-286
Other banks	441	209	492
Total	621	-297	206
Change in Exchequer Account balance*	-627	236	240
Total	-6	-61	446
Total financing	2 123	1 877	2 014

*Increase-, decrease+

duced its net indebtedness to the foreign sector during 1979/80. The decline of R82 million included further repayments of drawings on the International Monetary Fund and by the end of June 1980 these drawings had been fully repaid.

Outline of the 1980/81 Budget

In his presentation of the 1980/81 Budget, the Minister of Finance stated that the government's broad economic policy in the period ahead would remain one of "disciplined growth from a position of basic strength". According to the Minister, developments during the preceding fiscal year, which had caused fiscal policy to be more conservative and less expansionary than originally planned, together with the favourable effects of the authorities' broad financial policy, had increased not only the basic strength of the economy but also the scope for more rapid growth. Fiscal policy was aimed, therefore, at utilising the growth potential of the economy more fully. It was stated, however, that the continued emphasis on growth would be accompanied by an equally strong emphasis on continued financial discipline. The growth in government expenditure would be limited so as to provide the private sector with both the scope and the incentive for more rapid economic expansion without over-extending available resources. Moreover, the revenue shortfall would be financed without adding to the money supply.

In addition to promoting production, employment and investment, another major objective of official economic policy in 1980/81 would be to curb the rate of inflation. In the Minister's view, the existing inflation was mainly of the cost-push kind which could not be combated effectively by depressing aggregate demand. It was recognised that shortages of skilled labour and other bottlenecks were likely to create upward pressures on labour and certain other costs in the year ahead, but it was concluded that this problem could also not be solved by restricting demand. Inflation would, therefore, be countered by other means, namely (1) effective control over government expenditure and the increase in the money supply in order to prevent the emergence of demand inflation; (2) stimulation of supply through greater emphasis on the training and better utilisation of labour resources, increased imports, and the prevention of monopolistic practices; (3) a further appreciation of the rand against other currencies, if warranted by supply and demand conditions in the foreign exchange market; (4) strict discipline in respect of increases in administered prices; and (5) tax proposals aimed at lowering certain costs or at least slowing down their rate of increase.

To give effect to this policy, the Budget proposals were aimed at supporting the recovery in private consumption and investment by increasing the real disposable incomes of individuals and by enhancing the

financial capacity of companies to expand fixed and inventory investment, and at contributing to the fight against inflation. This contribution would involve limiting the growth in government expenditure, financing the "deficit before borrowing" without resort to money creation, abolishing the import surcharge, providing additional funds for training and education, and increasing subsidies on food, transport and housing. In addition, the Budget proposals were aimed at continuing the process of structural tax reform which had been initiated previously.

Structural tax changes and tax relief measures consisted of, firstly, the introduction of a single basic income tax rate for both married and unmarried persons and the substitution of a new and comprehensive system of tax rebates for one of income abatements. Differentiation between married and unmarried taxpayers would be achieved by allowing a smaller rebate to unmarried persons and increasing their tax liability by means of a 20 per cent surcharge. Secondly, the progression of the basic marginal rates of normal income tax would be adjusted to reach a maximum of 50 per cent (previously 55 per cent) at a taxable income of R40 000 (previously R30 000) in the case of married persons and at an income of R28 000 (previously R22 000) in the case of unmarried persons. Thirdly, the compulsory loan levy on individuals and companies was abolished. Fourthly, concessions were granted in respect of transfer duty, estate duty, tax-free lump-sum payments by pension and retirement annuity funds, the tax-free portion of the income of married women, and taxes paid by Blacks.

Taking into account estimated tax concessions of R909 million, total revenue in 1980/81 was expected to amount to R10 856 million, representing an increase of about 11 per cent. Total expenditure, including provisions for higher salaries and wages in the public service, increased social and civil pensions, additional funds for training and education, and increased subsidies, was estimated at R13 083 million in 1980/81, or 14 per cent more than in the preceding fiscal year. The "deficit before borrowing" was expected to amount to R2 227 million. This figure, together with loan repayments of R1 430 million, would result in an estimated financing requirement of R3 657 million. It was envisaged that this amount would be financed mainly by borrowing from the Public Debt Commissioners and the private non-banking sector, and that foreign loans and the utilisation of Exchequer balances would contribute only relatively small amounts.

Capital market

Fixed-interest security market affected by change in investors' expectations

Conditions in the market for fixed-interest securities remained fairly easy during the first eight months of the year under review. In March 1980, however, a tightening of the market became evident. Support for new issues of long-term stock by the public sector weakened and long-term yields began edging upwards. This change in market conditions bore little relation to the demand for new funds and the availability of loanable funds, and was largely caused by investors' expectations of a prospective increase in long-term yields and a concomitant hesitancy on the part of investors to acquire long-term securities.

These changes in market conditions were reflected in movements of secondary-market yields on fixed-interest securities. The yield on long-term government stock declined from 9,49 per cent in July 1979 to 9,24 per cent in January 1980, remained at this level until about the middle of March, and thereafter increased to 9,54 per cent in June and 9,85 per cent in July. Like-

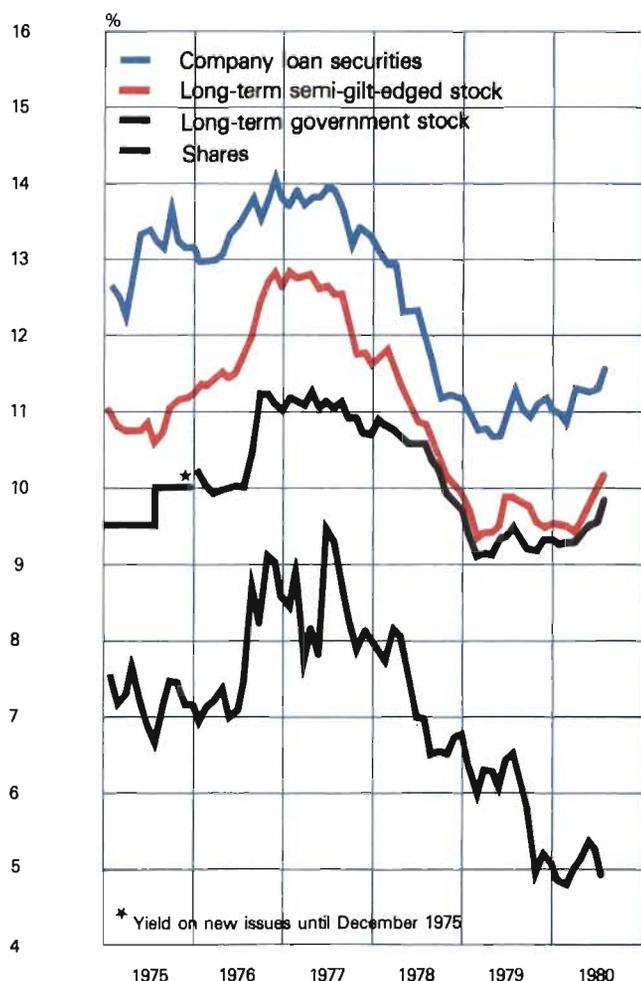
wise, the long-term yield on the highest grade semi-gilt-edged stock declined from 9,89 per cent in July 1979 to 9,42 per cent in March 1980, before rising to 10,01 per cent in June and 10,21 per cent in July. The yield on long-term loan securities of companies declined from 11,31 per cent in July 1979 to 10,97 per cent in December, and started to rise in March to reach levels of 11,28 per cent in June and 11,59 per cent in July.

Compared with the potential supply of loanable funds by capital market intermediaries, a comparatively small amount of new funds was raised in the fixed-interest security market during 1979/80. Net new issues of marketable public sector stock, excluding the increase in the borrowers' holdings of their own stock, amounted to about R1 065 million, compared with R960 million in 1978/79 and R2 570 million in 1977/78. The amount of new funds raised by the central government by means of net issues of marketable stock to the private sector, which had been insignificant in 1978/79, amounted to R174 million in the year under review. Public corporations and local authorities raised R777 million and R114 million, respectively, in the market, compared with R826 million and R103 million, respectively, in 1978/79. New issues of fixed-interest securities by private-sector companies which are listed on the stock exchange, amounted to R458 million, or R225 million more than in 1978/79.

In contrast with the rather limited activity in the primary market, secondary-market transactions in stock of the public sector increased substantially further in the year under review. The nominal value of stock traded, which had risen from R259 million in 1977/78 to R1 417 million in 1978/79, increased to R4 125 million in 1979/80. In order to handle this large volume of transactions, the stock exchange in July 1980 instituted separate facilities for trading in gilt-edged and semi-gilt-edged stock. Apart from adjusting their portfolios of public-sector stock by means of secondary-market transactions, institutional investors during 1979/80 used mainly the secondary market for the purpose of supplementing their holdings of such stock. The increase in holdings of government stock by insurers and private pension funds alone, for example, exceeded the amount of new funds raised by the central government in the private sector.

The relatively small net investment in public-sector securities by the various groups of institutional investors during the past two years, lowered the relative importance of these securities in the investment portfolios of the institutions concerned. In addition, more attractive alternative investment opportunities in the share and property markets, as well as an increased demand for loan funds by the private sector, contributed to a significant change in the composition of the financial asset portfolios of these institutions. As shown in the accompanying table, the relative importance of the institutions' claims on the public sector de-

Secondary market security yields



Composition of financial asset portfolios of financial institutions¹⁾

	Year ended 30 June					
	1978		1979		1980 ²⁾	
	R mil.	%	R mil.	%	R mil.	%
Claims on public sector:						
Government securities	6 817	19,3	7 086	17,9	7 588	16,6
Local authority securities	1 555	4,4	1 696	4,3	1 959	4,3
Public corporation securities	1 927	5,5	2 477	6,3	3 165	6,9
Total public sector securities	10 299	29,2	11 259	28,5	12 712	27,8
Other claims	622	1,8	700	1,8	775	1,7
Total	10 921	31,0	11 959	30,3	13 487	29,5
Claims on private sector:						
Ordinary shares	2 801	7,9	3 390	8,6	4 279	9,4
Preference shares and loan securities	1 165	3,3	1 487	3,8	1 804	3,9
Mortgage loans	10 147	28,8	10 865	27,5	12 284	26,9
Other loans, discounts and advances	10 217	29,0	11 779	29,8	13 884	30,3
Total claims	24 330	69,0	27 521	69,7	32 251	70,5
Total financial claims.....	35 251	100,0	39 480	100,0	45 738	100,0

1) Banks, building societies, insurers, private pension funds, unit trusts, participation mortgage bond schemes and finance companies.

2) Preliminary.

clined notably from 1977/78 to 1979/80. The corresponding increase in the relative importance of claims on the private sector was more or less evenly distributed among the various classes of such claims.

Buoyant conditions in the share market

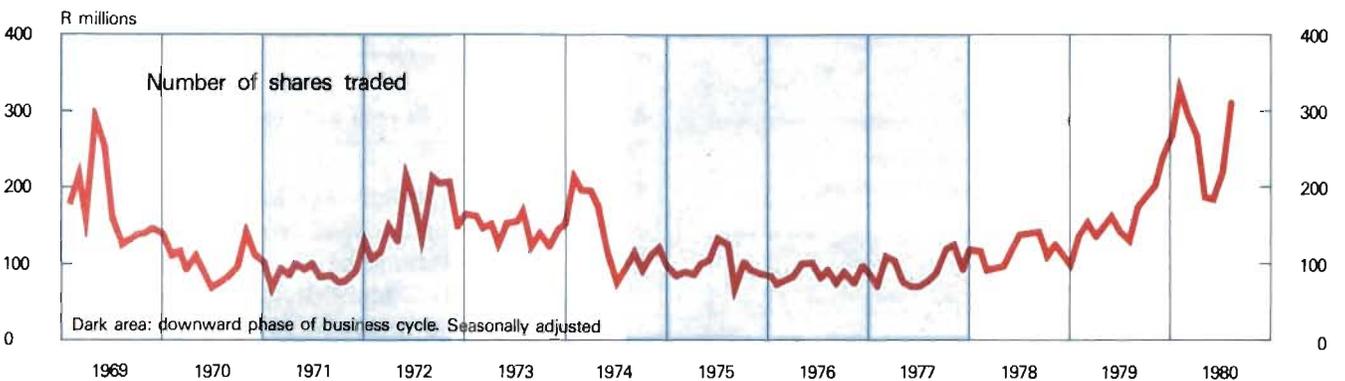
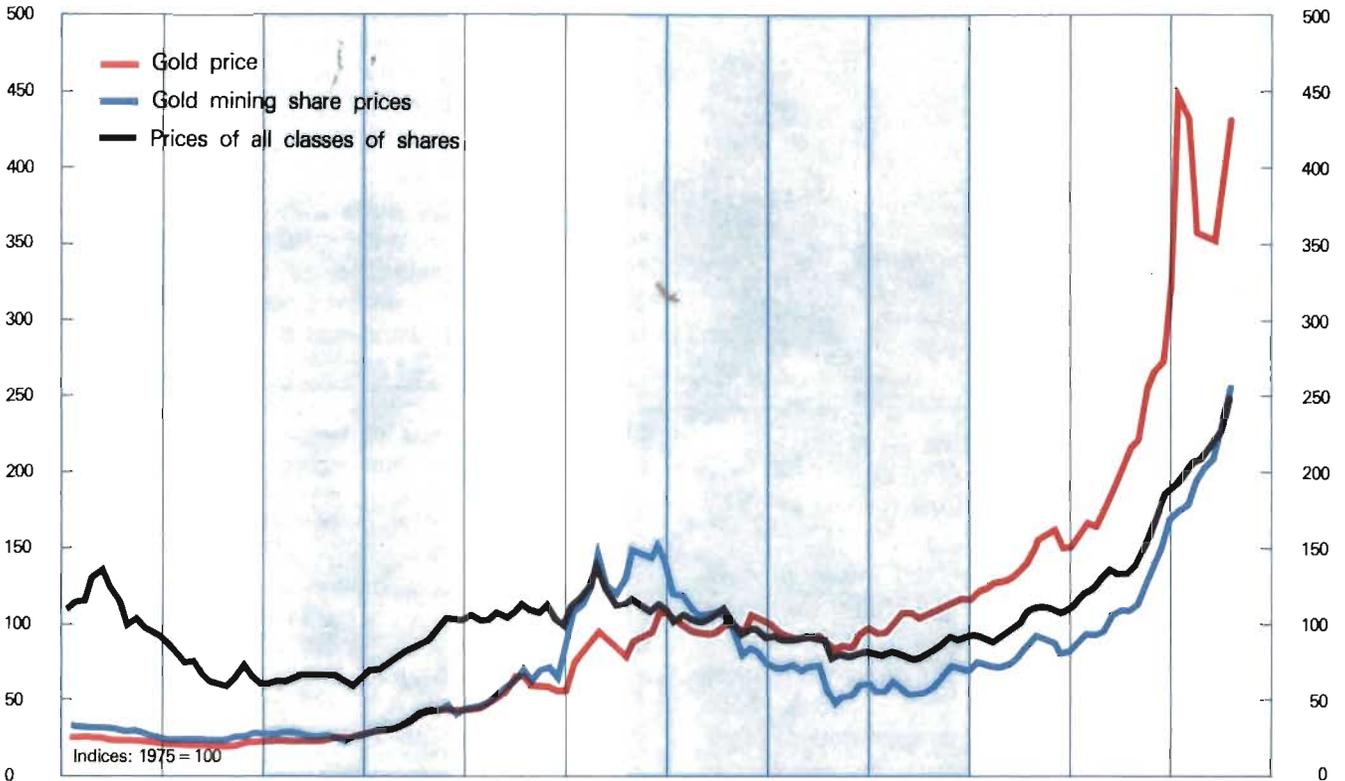
The sharp increase in stock exchange turnover and share prices during 1978/79 gained further momentum during the year under review. Following an increase of 27 per cent in 1978/79, the number of shares traded on the stock exchange rose by 65 per cent in 1979/80. Share prices were on average 55 per cent higher in 1979/80 than in the preceding year, compared with an increase of 32 per cent in 1978/79. The further sharp upward trend in share prices was maintained almost uninterruptedly, except for a temporary decline during March and April 1980, a period during which decreases were evident in most security prices. Thereafter, share prices increased sharply further and in June 1980 the comprehensive share price index, covering all classes of shares, was 71 per cent higher than in June 1979. During this period the prices of mining shares rose by 92 per cent, those of industrial and commercial shares by 55 per cent, and those of financial shares also by 55 per cent. The increase in mining share prices included a rise of 112 per cent in gold mining share prices. From June to July the comprehensive share price index increased by a further 10 per cent.

The average dividend yield on all classes of shares followed roughly the same course as the yields on fixed-interest securities, declining from 6,51 per cent in July 1979 to 4,75 per cent in February 1980 and increasing afterwards to 5,24 per cent in June. In July,

however, it declined to 4,90 per cent. During March and April the increase in share yields was caused mostly by the decline in share prices, but during May and June these yields continued to rise notwithstanding the increase in share prices. This further increase reflected higher dividend payments, stemming from an increase in company profits, in particular the profits of gold mining companies. Although changes in share yields followed broadly the same pattern as those in fixed-interest security yields, yield differentials nevertheless changed appreciably during 1979/80. The yield margin between long-term government stock and shares, for example, widened from 2,98 per cent in July 1979 to 4,30 per cent in June 1980. In July the margin widened even further to 4,95 per cent because of a notable rise in the yield on long-term government stock and an accompanying decline in the dividend yield.

The amount of new funds raised in the share market increased from only R25 million in 1978/79 to R472 million in 1979/80. The latter figure includes the large share issue by the newly formed holding company of Sasol. An amount of R280 million was raised in the market by means of this issue and additional amounts of R147 million and R98 million are scheduled to be raised in July 1980 and January 1981, respectively. Excluding the Sasol issue, the amount of new share capital raised in the market was substantially larger than in the preceding year, but still small in comparison with earlier years. The main reasons for the corporate sector's limited recourse to the share market were the relatively low level of fixed investment activity until fairly late in the year under review, the high level of corporate saving, increased inter-company borrowing, and

Stock exchange



the preference for loan capital at the prevailing low rates of interest.

Buoyant conditions in the share market did not prevent a further net outflow of funds from the unit trusts. The net outflow of R29 million during 1979/80 was somewhat larger than that of R20 million in 1978/79. The market value of the trusts' net assets nevertheless increased, in accordance with the sharp rise in share prices, by as much as R248 million during the year under review to a level of R667 million at the end of June 1980. Reflecting the increase in the market value of net assets, the average selling prices of units increased by 62 per cent and the average yield on units

declined from 5,6 per cent in June 1979 to 4,5 per cent in June 1980.

Sustained large increase in holdings of longer-term funds with deposit-receiving and other savings institutions

In contrast with the usual cyclical pattern, holdings of longer-term funds with deposit-receiving and other savings institutions continued to increase, even though the economy had moved well into the upward phase of the upswing. These holdings of longer-term funds rose by R2 112 million during 1977/78, R3 111 million during 1978/79 and R3 220 million during 1979/80. The substantial rise during the year under review was probably due, among other things, to an increase in domestic saving, the prevailing relative interest rate levels and expectations regarding interest rate movements, and shifts among the various deposit liabilities of banking institutions. Judging by the smaller seasonally adjusted increase in holdings of longer-term funds during the second quarter of 1980, however, the increase apparently started to level off towards the end of the year under review.

As during the preceding year, the inflow of new funds to building societies during 1979/80 exceeded the increase in savings and long-term deposits with banking institutions. In addition to a sharp increase in deposits of individuals with building societies, there was a significant increase in the investments of other financial institutions, mostly private pension funds, with the societies. The intake of new funds by participation mortgage bond schemes started to increase

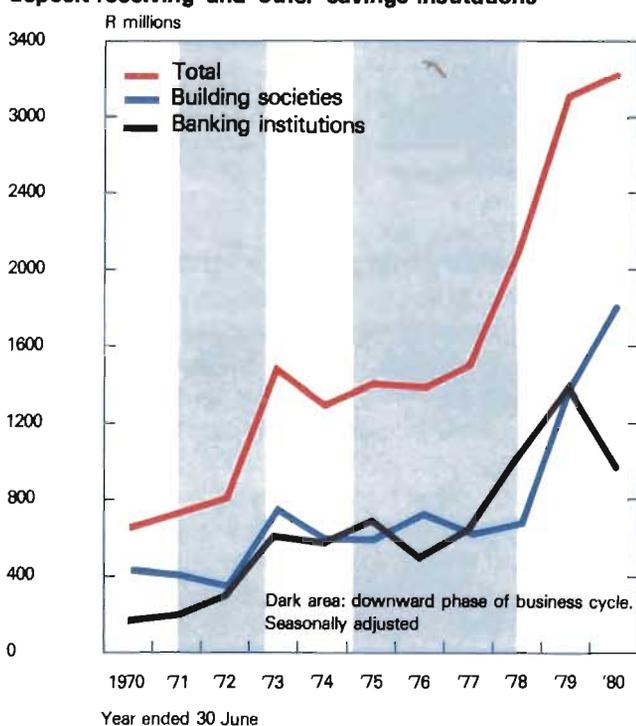
from the fourth quarter of 1979, indicating a somewhat greater interest in this type of mortgage financing. Investments in government savings schemes also reflected the generally higher rate of increase in holdings of longer-term funds with savings institutions.

After deposit and related interest rates had been lowered in September 1978 and in February and April 1979, most deposit interest rates were reduced further by ½ per cent in August 1979. In June 1980, however, the rates on fixed deposits for periods of 12 months and longer were increased by ½ to 1½ per cent, depending on the maturity of the deposits. At the same time, the rate on fixed-period paid-up shares of building societies was raised by ½ per cent.

Changes in holdings of longer-term funds with deposit-receiving and other savings institutions

	1978/79		1979/80	
	R mil.	%	R mil.	%
Banking institutions.....	1 365	43,9	954	29,6
Building societies.....	1 376	44,2	1 813	56,3
Participation mortgage bond schemes.....	-23	-0,7	5	0,1
Government savings schemes.....	393	12,6	448	14,0
Total.....	3 111	100,0	3 220	100,0

Increase in holdings of longer-term funds with deposit-receiving and other savings institutions

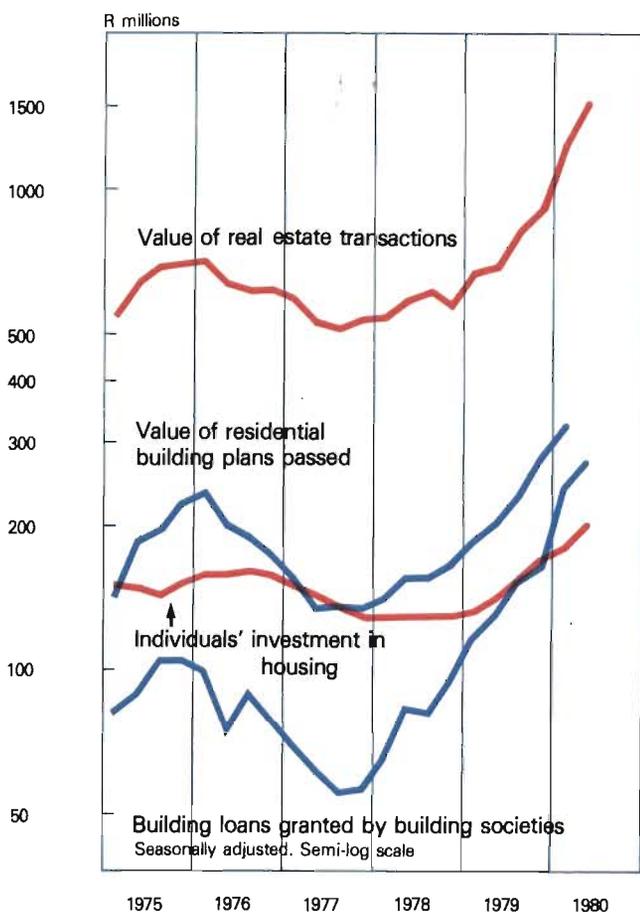


Marked increase in real estate and mortgage market activity

The real estate and mortgage markets, which had recovered slightly during 1978/79, became very buoyant during the year under review. The value of real estate transactions almost doubled from R2 550 million in 1978/79 to R4 500 million in 1979/80. This high turnover reflected not only a dramatic recovery in the residential property market from the sharp downturn during 1976 and 1977, but also a renewed interest in non-residential fixed property by long-term institutional investors, such as insurers and private pension funds. Net new mortgage loans granted by building societies, predominantly on residential property, increased by 100 per cent in 1979/80 and the net new investment in fixed property by insurers and private pension funds amounted to R210 million in the twelve months to March 1979 and R175 million in the twelve months to March 1980. Increased turnover in the secondary real estate market was accompanied by a rise in construction activity. The value of building plans passed increased, for example, from R1 100 million in 1978/79 to R1 800 million in 1979/80.

The increase in the value of real estate transactions and building plans passed also reflected a strong rise in property prices and building costs. It is estimated that

Fixed property market



Further evidence of a higher rate of lending was provided by the increase in the societies' commitments in respect of mortgage loans granted but not yet paid out, namely from R603 million at the end of June 1979 to R1 036 million at the end of February 1980 and R1 500 million at the end of June.

Mortgage rates were reduced further in the year under review. Home mortgage rates of building societies, which had been lowered by ½ per cent in October 1978 and again in April 1979, were reduced by another ½ per cent in February 1980, bringing the range of rates to 9,0—11,0 per cent. A similar decline occurred in the societies' mortgage rates on commercial properties, and since February 1980 the societies have been quoting rates of 10,5 to 11,5 per cent. The mortgage rates of insurers and private pension funds declined from 11,5—12,0 per cent in June 1979 to 11,0—11,5 per cent in June 1980, and those of participation mortgage bond schemes from 9,7 to 9,1 per cent over the same period.

building costs, for example, increased by 17½ per cent in the year under review. A further indication of price rises was provided by the increase in the average amount of gross home mortgage loans granted by building societies, namely from R19 500 in 1978/79 to R21 550 in 1979/80.

The rapid increase in real estate transactions was facilitated by the ample availability of funds to building societies for mortgage lending. The intake of new funds by the societies, together with capital repayments on existing mortgages, rose from R2 100 million during 1978/79 to R3 300 million during 1979/80, or by 60 per cent. A corresponding increase occurred in new mortgage loans paid out by the societies, namely from R1 475 million to R2 843 million. The excess of available funds over the amount of new mortgage lending was used mostly to increase the societies' holdings of prescribed investments. Excess holdings of prescribed investments over and above the legally required minimum reached a peak of 10,5 per cent of liabilities to the public at the end of February 1980. Subsequently, this ratio declined slightly to 9,8 per cent of liabilities to the public at the end of June, reflecting an increased tempo of mortgage lending.