Annual Economic Report 1982

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 Sixty-Second Ordinary General Meeting to be held on 24 August 1982.

South African Reserve Bank

Hierdie Verslag is ook in Afrikaans beskikbaar.

Contents

Summary and general comments

After the South African economy had been in a cyclical upswing for almost four years, it entered a downward phase of the business cycle in the third quarter of 1981. By the middle of 1982 there were clear signs that the economy was in the process of cooling down. As an aftermath of the preceding boom, however, important strains remained present. In all, the adjustment during the first three quarters of the downswing was fairly mild and did not show the characteristics of a full-scale recession.

Real gross domestic product decreased slightly from the second half of 1981 to the first half of 1982 and this was accompanied by a levelling-off in employment and a moderate rise in unemployment. Real gross domestic expenditure reversed its strong upward movement in the fourth quarter of 1981 and declined slightly further during the first half of 1982. Apart from a marginal decrease in private consumption expenditure, this decline was due to lower fixed and inventory investment in both the private and public sectors.

The rates of increase in consumer and production prices both accelerated in the first half of 1982. Excess demand pressures of the immediately preceding boom period continued to exert their influence on costs and prices, and their effect was reinforced by inevitable upward adjustments in administered prices, increases in indirect taxes, and a rise in import prices resulting in part from the depreciation of the rand and the surcharge imposed on imports in February 1982.

The balance of payments reflected the continuing strain in the economy. During the first half of 1982 the current account remained substantially in deficit, mainly because of the weak performance of the gold price and the value of other exports, coupled with the sustained high level of nominal domestic demand and the large import content of fixed and inventory investment expenditure. However, the growing current account deficit appeared to have reached a turning-point in the first quarter of 1982, when it amounted to 9 per cent of gross domestic product. As the downward movement in the volume of exports levelled off while the volume of imports continued to decline, the current account balance showed a slight improvement in the second quarter.

Mainly owing to a moderate decline in the net credit extended by the banking sector to the government sector, a continuing drain on domestic liquidity through the balance of payments, as reflected in a decline in net foreign reserves, and a reduced rate of increase in bank credit to the private sector, the money supply rose at a slower rate during the first half of 1982. The increase in M2, for example, decelerated from 25 per cent in 1981 to a seasonally adjusted annual rate of 21 per cent in the first half of 1982.

Despite the economic downturn, interest rates continued to rise during the first half of 1982, reflecting continuing tight conditions in the financial markets. In a broad sense, this was due to an imbalance between the domestic demand and supply of funds, which meant that foreign funds had to be employed extensively to supplement domestic saving, not only during 1981 but also during the first half of 1982. The sharp rise in interest rates during this eighteen-month period was accompanied by significant changes in the structure and flexibility of interest rates. Short-term interest rates moved to higher levels than long-term rates; interest rates and yields on government and other public-sector securities (including Land Bank securities) adjusted to market-related levels that were more in line with the rates on private-sector securities; the Treasury bill tender rate was allowed to exceed Bank rate; a tender system for issuing new government stock was introduced and bank advances to the Land Bank were converted into bills and debentures at market-related interest rates and yields.

A general slow-down of financial activity and shifts of activity among the different markets were also observed as part of the cyclical change in the economy. The decrease in activity was particularly evident in the share and mortgage markets during 1981 and the first half of 1982. This was accompanied by a relative shift of activity to the fixed property market, which remained buoyant throughout 1981 and most of the first half of 1982. Only towards the middle of 1982 did investors' interest in real estate begin to diminish and did this interest shift to fixed-interest securities as an investment outlet.

Short-term prospects for the South African economy should be viewed against the background of the developments which gave rise to the economic downturn from the third quarter of last year. The downturn had its origin in earlier unfavourable external developments. Already from the second half of 1980 the recession in the industrial countries had been reflected in a decline in merchandise exports. The effect of lower export proceeds on domestic income and the balance of payments was subsequently reinforced by the sharp decline in the price of gold from the fourth quarter of 1980. The domestic economy was slow to adjust to these adverse external changes, partly because it was shielded from these changes by a sharp depreciation of the rand from the beginning of 1981, and partly because of a fuelling of monetary demand by a strong expansion of the money supply. As a result, several strains began to develop in the economy in the course of 1981. Among other things, the current account of the balance of payments moved sharply into deficit, the further growth of real domestic output became constrained by capacity limits and skilled labour shortages, and financial markets tightened considerably with an accompanying sharp rise in interest rates.

In order to relieve these strains, and more specifically to assist in the adjustment of aggregate monetary demand to a more sustainable level, a moderately restrictive monetary and fiscal policy stance was adopted in early 1981 and maintained throughout the rest of that year and the first half of 1982. In monetary policy the emphasis was on allowing, and officially endorsing, the sharp rise in interest rates produced by market forces, and on gradually bringing the excessive monetary expansion under control. Emphasis in fiscal policy was on restraining the growth in government expenditure and on keeping the deficit before borrowing in the Budget within appropriate limits, in order not to contribute unduly to the already high level of domestic expenditure.

In the actual implementation of their policies, however, the monetary authorities were hampered during 1981 and early 1982 by the Land Bank's exceptionally large demand for bank credit for the purpose of financing agricultural production and crops. The financing of the Land Bank created additional liquid assets for the banks, on the basis of which they were able to extend a substantial further amount of credit and to contribute in this way to an increase in the money supply. In addition, a large temporary use of bank credit by the Government in the fourth quarter of 1981 had the effect of increasing the money supply directly and, at the same time, expanding the cash and liquidity base and credit-creating ability of the banks. These developments temporarily weakened the control of the authorities over the money supply and made monetary and fiscal policy more accommodating and less restrictive than had been intended.

Most of the initial causes of the downturn are still in operation. The duration of the recession in the industrial countries has turned out to be longer than had been anticipated originally. Contrary to earlier expectations, it now appears that the anticipated economic upswing in most of these countries will not materialise during the second half of 1982 but only in 1983, and will be milder than previously expected. As in the past, any new economic upswing in South Africa will be heavily dependent on economic recovery in the industrial countries and will only follow with a certain time lag.

In the short-term, therefore, the rate of real economic growth is likely to decline further, and in 1982 as a whole it might fall below 1 per cent. In the longer-term, however, South Africa is well placed to benefit from economic recovery in the industrial countries because of its large raw-material and labour resources and its substantially increased real capital stock.

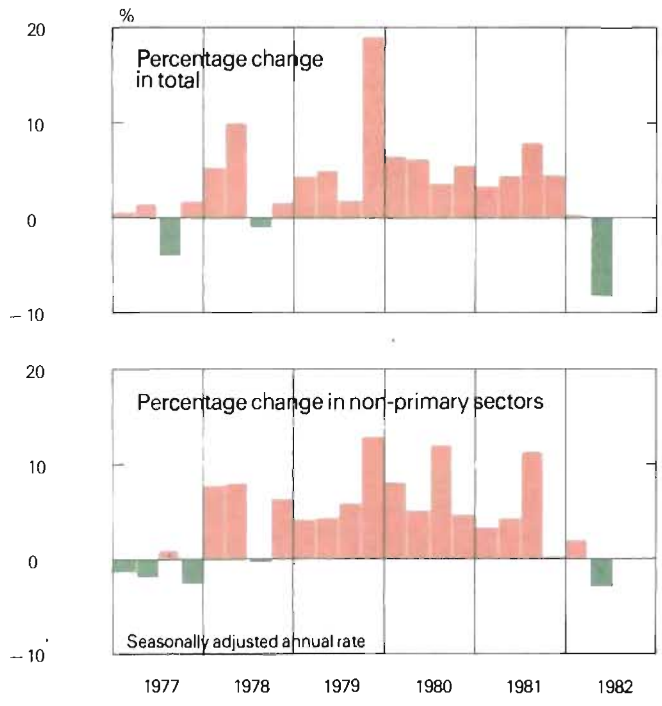
National accounts *

Slight decline in real domestic output in first half of 1982

The cyclical upswing in the South African economy from the end of 1977 reached an upper turning point in the third quarter of 1981. Real gross domestic product rose marginally further in the fourth quarter, but showed a small decline from the second half of 1981 to the first half of 1982. Compared with the first half of 1981, however, real gross domestic product still grew by 1½ per cent in the first half of 1982. For the year as a whole the real economic growth rate might fall below 1 per cent, compared with about 4½ per cent in 1981. Real gross *national* product, which had increased by only about 1 per cent in 1981, declined notably faster than real gross *domestic* product from the second half of 1981 to the first half of 1982. This was caused by a sustained deterioration of South Africa's terms of trade, mainly as a result of a further sharp decline in the price of gold.

The decline in real output from the beginning of 1982 was fairly widespread in the economy. In the primary sectors a sharp decrease occurred in real agricultural output owing to adverse weather conditions; the volume of gold production continued to fall, mainly because of the mining of lower-grade ore; and a considerable decline in the real output of non-gold mining reflected a sustained weak demand for metals and minerals. As shown in the accompanying table, the combined real output of the secondary sectors of the economy still showed a small rise, while that of the tertiary sectors remained at an unchanged level in the first half of 1982. However, within these categories not all of the individual sectors maintained increasing or unchanged real output levels. In particular, declines were recorded in the real value added by the construction and the commercial sector. On the other hand, the growth in the real product of the electricity, gas and water sector and of the services sectors held up quite well in the face of a general economic downswing.

Real gross domestic product



Percentage change in real gross domestic and national product[1]

	1980	1981	1982[2] 1st half
Primary sectors	4½	1	-7
Agriculture, forestry and fishing	12½	4	-9
Gold mining	-4½	-2½	-1
Non-gold mining	4½	—	-10
Secondary sectors	10½	6½	½
Manufacturing	11	6	½
Electricity, gas and water	8½	11	5½
Construction	8	8	-3
Tertiary sectors	6½	5	—
Commerce and accommodation	10	7½	-7½
Services	5½	4	3
Total gross domestic product	8	4½	-1½
Non-agricultural sectors	6½	4½	-½
Non-primary sectors	8	5½	½
Gross national product	11	1	-4

1. Rounded to nearest half per cent.
2. Change from preceding half year at a seasonally adjusted annual rate.

Lower rates of increase in domestic factor incomes

The slow-down of the increase in nominal gross domestic product at factor cost in 1981 continued in the first half of 1982. In 1981, the slower growth was caused by a substantially lower rate of increase in the overall

* Quarterly and half-yearly changes are based on seasonally adjusted data.

gross operating surplus. The increase in total remuneration of employees, on the other hand, accelerated in 1981. From the second half of 1981 to the first half of 1982 gross operating surplus actually declined, while remuneration of employees rose at a lower rate than in 1981. The decline in gross operating surplus largely reflected a sharp drop in agricultural income owing to smaller crops, and lower mining profits resulting from a general decline in metal and mineral prices and in mining output, coupled with a sharp increase in mining costs.

Cyclical decline in real gross domestic expenditure

The upswing which ended in the third quarter of 1981 was characterised by an exceptionally sharp rise in gross domestic expenditure. In 1980 and 1981 real gross domestic expenditure increased by 13 per cent and 10 per cent, respectively. Both these rates were considerably in excess of the corresponding growth rates in real gross domestic product. In nominal terms, gross domestic expenditure began to exceed gross national product from the beginning of 1981 and since then the gap has widened substantially. Per definition, this meant that the current account of the balance of payments moved into deficit in early 1981 and that the deficit has become substantially larger during the ensuing period.

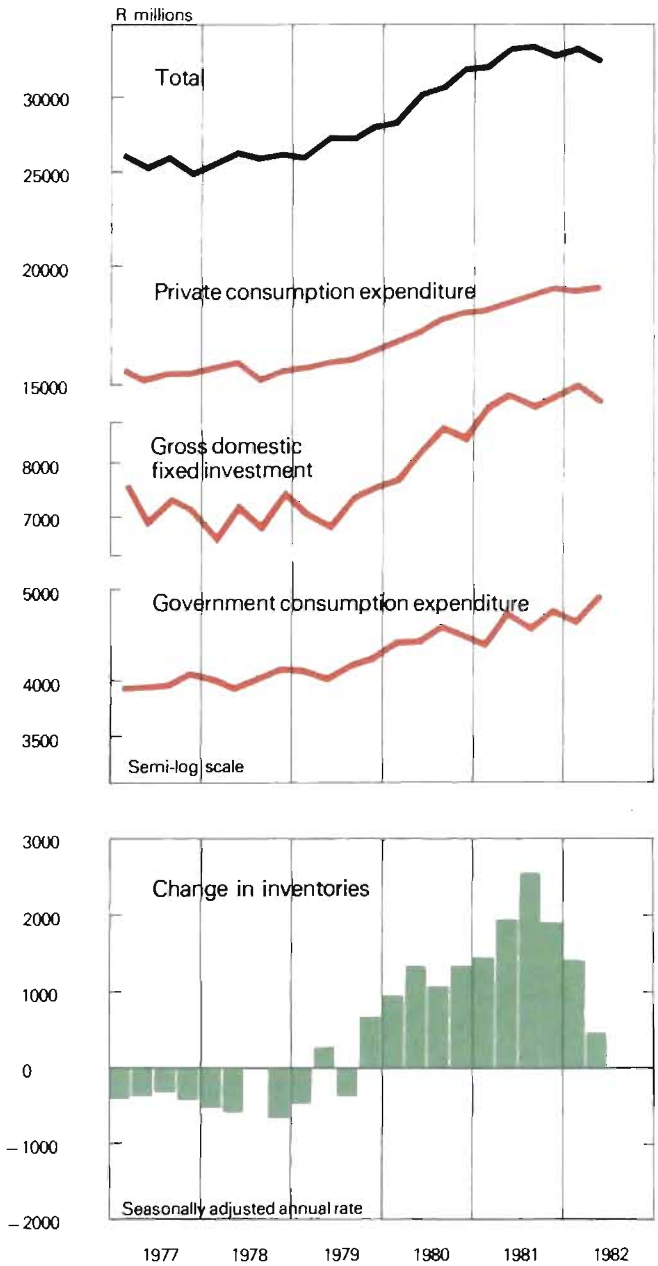
The strong upward trend in real gross domestic expenditure, which was particularly evident in private consumption expenditure and in fixed and inventory investment, continued until the third quarter of 1981. In the fourth quarter, however, it was reversed and by the second quarter of 1982 the downward movement had become more pronounced. It is probable that this downturn will gain momentum during the second half of 1982 and that a decline of about 1½ per cent will be recorded for the year as a whole.

Percentage change in real gross domestic expenditure[1]

	1980	1981	1982[2] 1st half
Private consumption expenditure	9	6½	-½
Private gross fixed investment	13	15½	2
Change in private-sector inventories (1975 R millions)	978	1 322	1 200
Government consumption expenditure	7½	3	5
Public authorities' gross fixed investment	1	14	8
Public corporations' gross fixed investment	14	—	2
Change in public-sector inventories (1975 R millions)	207	638	-250
Total gross domestic expenditure	**13**	**10**	**-½**

1. Rounded to nearest half per cent.
2. Change from preceding half year at a seasonally adjusted annual rate.

Gross domestic expenditure at constant 1975 prices



Marginally lower real private consumption expenditure

Reflecting the general economic downswing, real private consumption expenditure started to decline in the first quarter of 1982, after it had risen substantially in the preceding two years. The marked increases in 1980 and 1981 of 9 and 6½ per cent, respectively, resulted mainly from a strong rise in real personal disposable income and the extensive use of consumer credit. In the first half of 1982, however, real disposable income declined owing to a lower rate of increase in the remuneration of employees, a decline in income from property, and the effects on income of fiscal drag and the persistently high rate of inflation. At the same time, monetary policy measures that were aimed at curbing excess domestic expenditure, had the effect of reducing the availability and raising the cost of consumer credit. All of these developments contributed to a reversal of the upward trend in real private consumption expenditure.

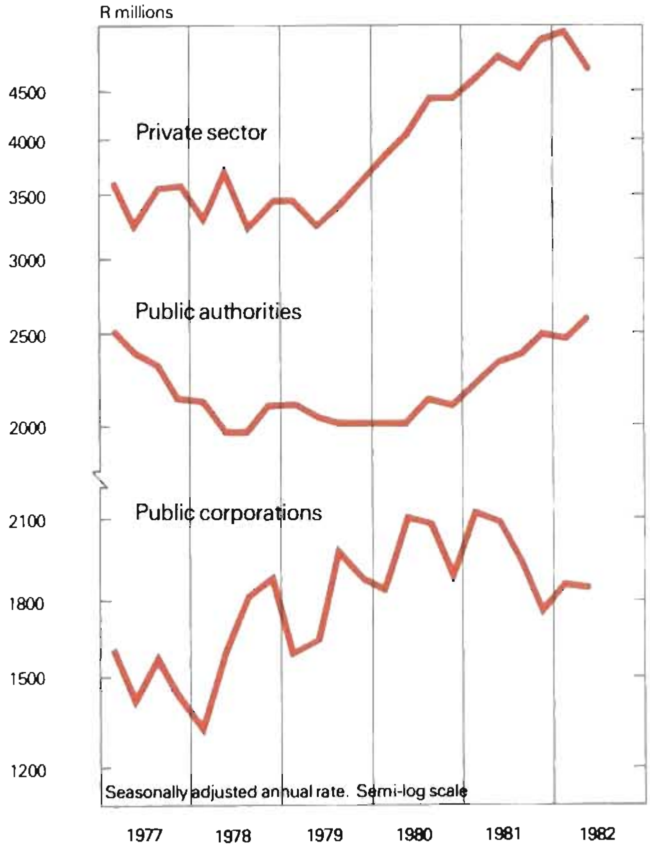
Expenditure on durable and semi-durable goods, such as motor vehicles, furniture, clothing and footwear, was affected most by the cyclical change and declined in the first half of 1982. On the other hand, expenditure on more essential goods and services, such as food, beverages, housing and medical care, continued to rise moderately.

Upper turning point in real private fixed investment cycle

The upswing in real private fixed investment from the second half of 1979 gained momentum during 1980 and the first half of 1981, but began to slow down during the second half. An increase of 15½ per cent was nevertheless recorded in 1981, compared with a rise of as much as 23 per cent in 1980. The upswing came to an end in the first quarter of 1982. By that time several of the fixed capital expansion programmes, which had been initiated during the earlier part of the upward phase of the investment cycle, had been completed and new investment had become constrained by the re-emergence of some excess production capacity and by the relative scarcity and higher cost of funds. In the second quarter real private fixed investment declined over a broad front.

From the middle of 1979 to the second quarter of 1982 the real fixed capital stock of private manufacturing, a measure of production capacity, increased by almost 19½ per cent. This increase, together with a slow-down in production from the fourth quarter of 1981, contributed to a decline in the utilisation of production capacity in total manufacturing, namely from a peak of 90 per cent in the third quarter of 1981 to 88 per cent in the second quarter of 1982.

Gross domestic fixed investment at constant 1975 prices

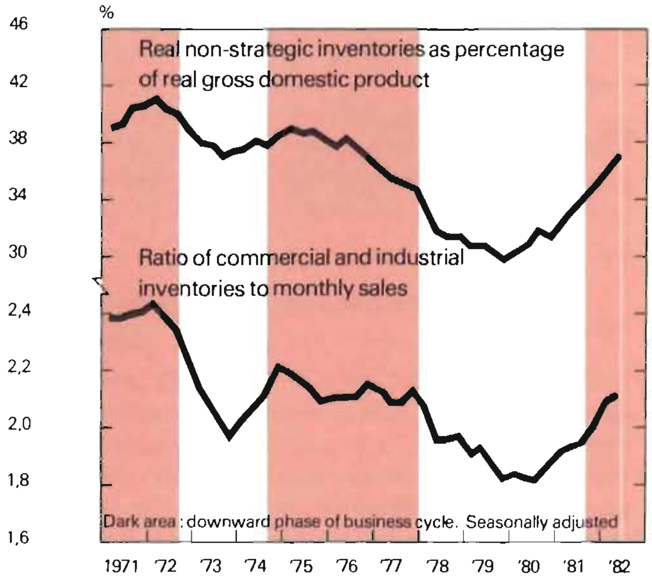


Slow-down in real inventory investment

Despite the economic downturn in the third quarter of 1981, real inventories continued to increase during the fourth quarter and the first half of 1982. However, the increase of R950 million in the first half of 1982 was considerably smaller than that of R2 250 million in the second half of 1981. This change contributed significantly to the lower level of real gross domestic expenditure and, because of the high import content of inventories, also to a decline in the volume of merchandise imports in the first half of 1982.

The ratio of real inventories (excluding strategic inventories) to the real gross domestic product of the non-agricultural sectors rose from a trough of 30 per cent in the fourth quarter of 1979 to 37 per cent in the second quarter of 1982. The ratio of industrial and commercial inventories to monthly sales showed a similar trend. The continued build-up of inventories during the initial stages of the present economic downswing was consistent with past experience. Usually, during this phase of the business cycle, there is to some extent an involuntary addition to inventories. Changes in demand cannot be anticipated correctly and, in addition, domestic production and imports do not adjust immediately to a slow-down in demand.

Non-agricultural sectors : inventory ratios



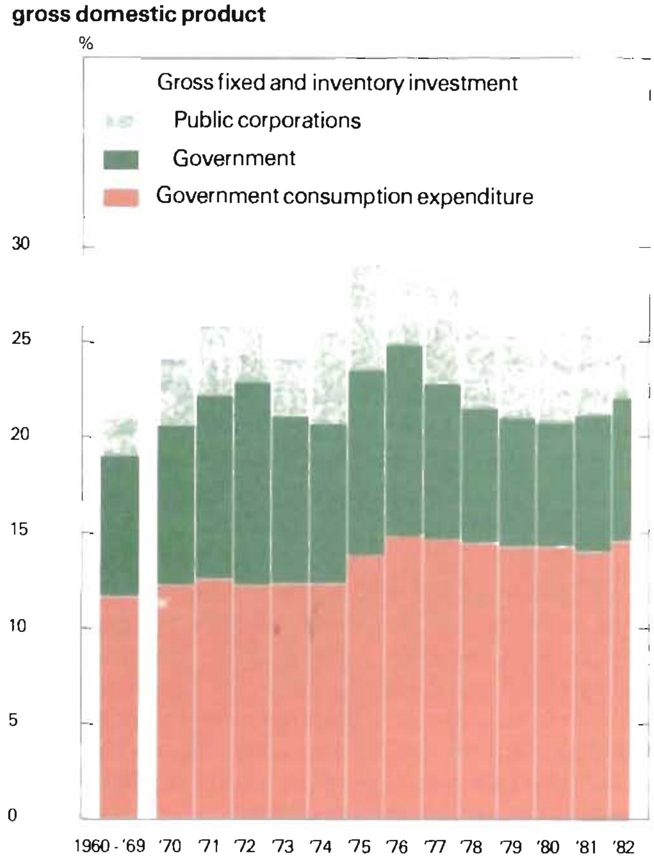
In the past, the inventory cycle reached upper turning points more or less in the middle of the downward phases of the business cycle. Under present conditions of high nominal interest rates, the higher cost of carrying stocks may hasten this turnabout. Indications are that the present levels of industrial and commercial inventories are considered to be relatively high. This may give rise to deliberate stock reductions which will help easing demand pressures and balance of payments strains.

Marked decrease in real public sector* expenditure

Total real public sector expenditure, consisting of government consumption expenditure and of fixed and inventory investment of public authorities and public corporations, increased at very high rates of 11 per cent and 9½ per cent in 1980 and 1981, respectively, but declined markedly from the second half of 1981 to the first half of 1982. The increase during 1980 and 1981, which raised the ratio of public sector expenditure to gross domestic product from 27 per cent in 1979 to 29 per cent in 1981, was evident in all major expenditure components. Higher government consumption expenditure reflected not only increased defence spending, but also larger outlays on other government services during a period of rapid economic expansion. The increase in real investment expenditure by public authorities was mainly due to several large expansion programmes, including outlays on lower-cost housing and the acquisition of new rolling stock and aircraft by the South African Transport Services. The exceptionally large increase in real fixed and inventory investment by public corporations consisted mainly of large outlays on Sasol's synthetic oil projects, expansion programmes of Iscor and Escom, and the stockpiling of strategic goods.

By the end of 1981 and in early 1982 most of the large expansion programmes of the public corporations had been completed. Consequently, the real investment expenditure of public corporations, which often shows large short-term fluctuations, declined markedly from the second half of 1981 to the first half of 1982. On the other hand, real government consumption expenditure and real fixed investment by public authorities increased moderately further. The net result was that total real public sector expenditure declined sharply in the first half of 1982, contributing substantially to the decline in aggregate domestic expenditure in this period.

Real public sector expenditure in relation to gross domestic product



*In the national accounts, the public sector refers to the general departments of the Central Government, provincial administrations, the South West African Administration, local authorities and other independent and self-governing states within the Rand Monetary Area (excluding Lesotho and Swaziland); extra-budgetary organisations and institutions; public enterprises such as the South African Transport Services and the Department of Posts and Telecommunications; and all public corporations.

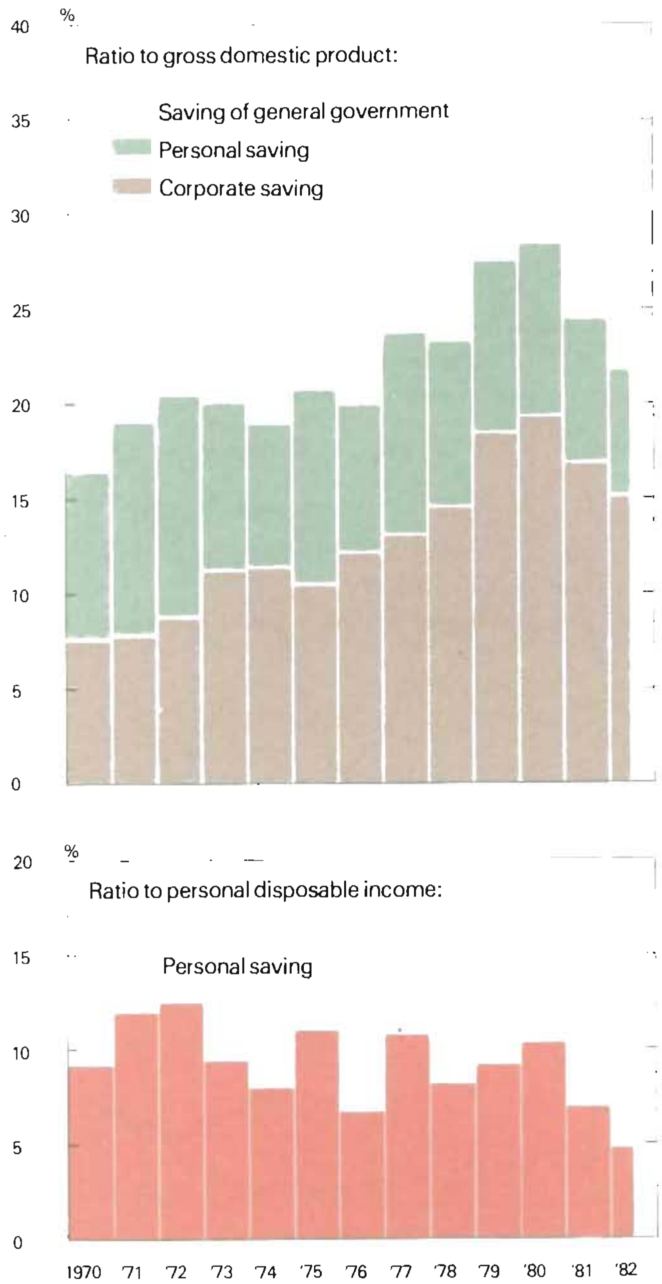
Substantial domestic savings shortfall

The sharp increase in gross domestic fixed and inventory investment from about the middle of 1979 resulted in a substantial financing requirement. Up to the end of 1980 this requirement could be satisfied from domestic saving. Gross domestic saving almost doubled between 1978 and 1980 and as a ratio of gross domestic product, it rose from 28 per cent in 1978 to 34½ per cent in 1980. During this two-year period the sharp rise in the price of gold and in other export prices not only caused higher income and saving in the gold mining and other export industries, but also had a secondary expansionary effect on domestic income and saving in general. Gross domestic saving actually exceeded gross domestic investment by a considerable margin during this period.

From 1981, however the situation changed considerably. Corporate saving in the gold mining and other export industries was affected adversely by the recession in trading-partner countries, falling prices on international markets, and sharply rising production costs. As a ratio of gross domestic product, corporate saving declined from 19½ per cent in 1980 to 15 per cent in the first half of 1982. At the same time, personal saving decreased markedly because of the upsurge in consumer expenditure which was financed to a large extent by an increase in consumer credit (representing negative saving). The ratio of personal saving to gross domestic product declined slightly from 9 per cent in 1980 to 6½ per cent in the first half of 1982. As a ratio of personal disposable income, the decline in net personal saving was more pronounced, namely from 10 per cent to an all-time low of 4½ per cent. Government saving likewise decreased from 6 per cent of gross domestic product in 1980 to 3 per cent in the first half of 1982.

The decline in domestic saving occurred at a time when domestic fixed and inventory investment was still rising rapidly. Inevitably, this gave rise to a substantial savings shortfall which had to be financed by means of foreign funds and the use of foreign reserves. During the eighteen months to June 1982 this savings shortfall amounted to almost R6 444 million.

Gross domestic saving



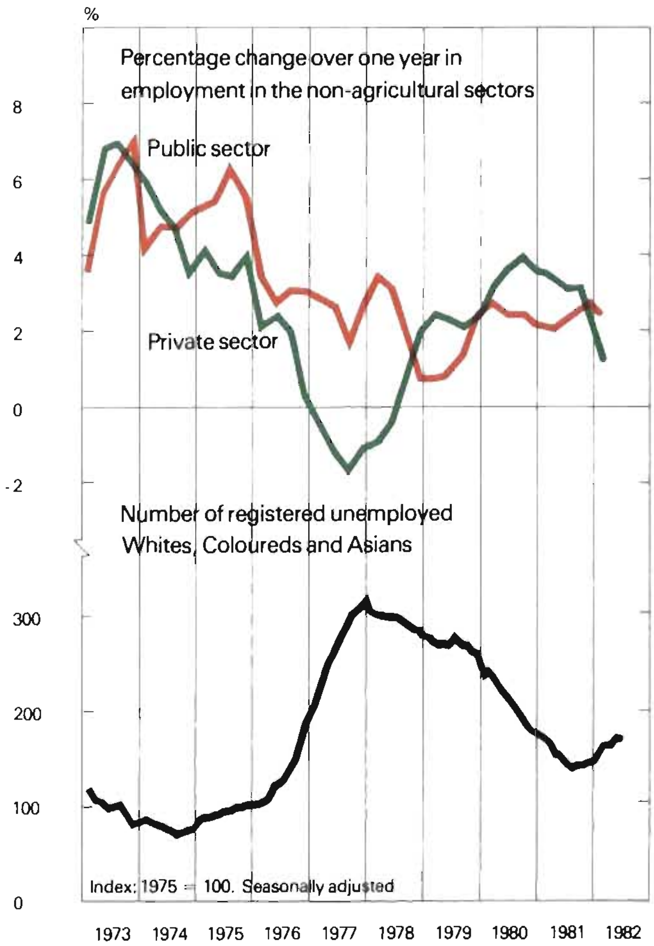
Employment and prices

Easing of labour market conditions*

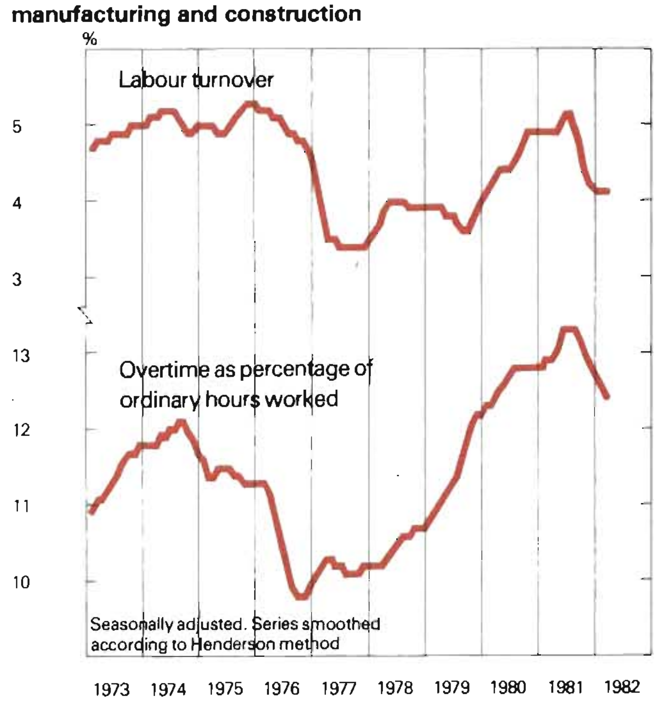
The continued economic expansion during the greater part of 1981 resulted in a further increase of 2,9 per cent in employment in the non-agricultural sectors of the economy for the year as a whole. A distinctly lower annual rate of growth in employment of only 1,2 per cent was recorded in the fourth quarter of 1981, and during the first quarter of 1982 the level of employment remained unchanged, reflecting the general slow-down in economic activity from the fourth quarter of last year. Employment in the private sector actually declined at a seasonally adjusted annual rate of 1,1 per cent in the first quarter of 1982, mainly as a result of a reduction in the manufacturing and non-gold mining labour force, while the rate of increase in public sector employment slowed down to 1,7 per cent.

Further indications of the easing of labour market conditions were provided by the substantially smaller labour turnover, the decline in the number of overtime hours worked in manufacturing and construction, and the increase in unemployment. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians increased from 14 643 in August to 15 336 in December 1981 and then further to 18 123 in June 1982, resulting in an increase in the unemployment rate. The unemployment rate among Blacks, however, declined throughout 1981 to a level of 7,1 per cent at the end of the year and then remained unchanged up to February.

Employment and unemployment



Labour turnover and overtime hours worked in manufacturing and construction



Slower increase in labour productivity and more rapid rise in unit labour costs

Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural sectors of the economy, rose by 1,8 per cent in 1981, compared with a 3,4 per cent gain in 1980. Available information points to a further deceleration of the increase in productivity in the first quarter of 1982. The

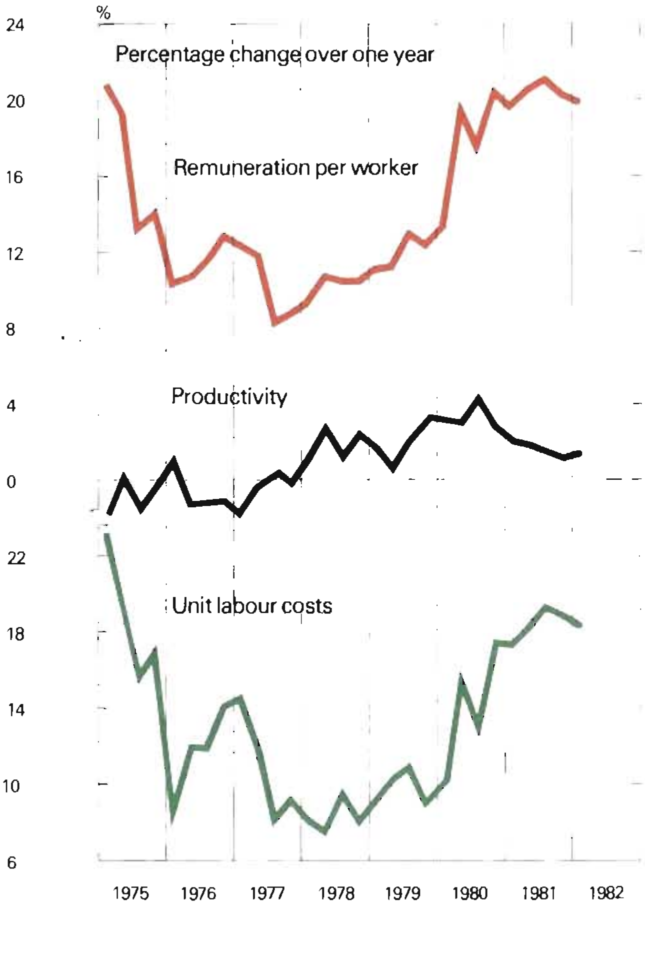
*Statistics relating to employment and remuneration of labour are only available up to the first quarter of 1982.

slow-down of the rise in productivity was in agreement with changes in manufacturing production. In the manufacturing sector the rate of increase in the volume of production per man-hour slowed down from 4,6 per cent in 1980 to 3,4 per cent in 1981. In the first quarter of 1982 the output per man-hour declined to a level that was 0,4 per cent below the peak reached in the third quarter of 1981. The initial deceleration of the increase in labour productivity was mainly due to strains which had developed in the labour market, especially shortages of skilled workers and a high labour turnover. During recent months, however, productivity growth was inhibited by the more pronounced slow-down of the growth in production than of the increase in employment.

As production resources became more fully utilised during 1981, the active competition for skilled workers in the private and public sectors and the inflation-related upward adjustments in salaries and wages led to a continued sharp rise in the average remuneration per worker in all non-agricultural sectors. In nominal terms, the average remuneration per worker rose by no less than 20,5 per cent in 1981, following an almost equally sharp rise of 18,0 per cent in 1980. In the first quarter of 1982 the increase amounted to 20,1 per cent, compared with the same period in the preceding year. As these rates outstripped the increases in the consumer price index, the average real remuneration per worker increased by 4,6 per cent in 1981, compared with 3,7 per cent in 1980. In the first quarter of 1982 real remuneration was no less than 5,0 per cent higher than in the corresponding period of 1981.

This simultaneous sharp rise in remuneration and slower growth of labour productivity naturally led to increased labour costs per unit of non-agricultural production. The rise in average unit labour costs accelerated from 14,1 per cent in 1980 to 18,4 per cent in 1981 and the increase over a one-year interval amounted to 18,3 per cent in the first quarter of 1982. In manufacturing, the increases amounted to 11,8 per cent in 1980, 15,8 per cent in 1981 and 17,1 per cent on a year-on-year basis in the first quarter of 1982. Since labour costs represent a relatively important part of total costs and, consequently, also of the final prices of goods and services, the sharp rise in the unit labour costs contributed materially to the higher rate of increase in domestic prices.

Productivity, remuneration and labour costs in the non-agricultural sectors



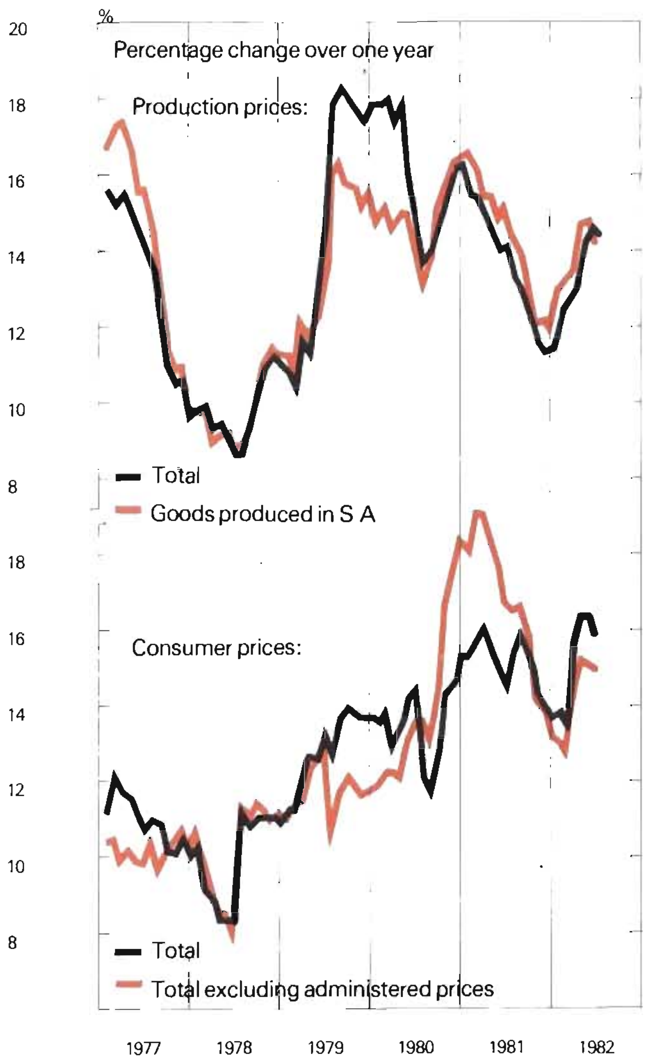
Inflation rate remains at high level

As a result mainly of the continuing influence of excess demand pressures and the accompanying cost rises (in particular the increase in unit labour costs), the inflation rate remained high and even accelerated during the first half of 1982. At the same time, upward adjustments in administered prices, increases in indirect taxes and the effect of the considerable depreciation of the rand on import prices also contributed to the sharp rise in prices.

Compared with the same period in the preceding year, the average level of the consumer price index was 15,4 per cent higher in the first six months of 1982 and 16,0 per cent higher in June 1982. Following somewhat lower seasonally adjusted annual rates of increase in consumer prices in the first half of 1981, the rate rose sharply to 16,2 per cent in the third quarter, came down somewhat to 14,6 and 14,4 per cent in the following two quarters, but again rose sharply to 20,3 per cent in the second quarter of 1982. The increase in the general sales tax rate from 4 to 5 per cent as from 1 March, various increases in administered prices in April — in particular petrol prices, postal tariffs, railway tariffs and air fares — as well as higher rates of increase in the prices of food, furniture and personal services, were responsible for the sharp rise in the second quarter.

The rate of increase in production prices accelerated considerably during the past twelve months as a result of increases in the prices of both imported and domestically produced goods. The seasonally adjusted production price index rose at annual rates of 11,5 per cent in the third quarter and 13,7 per cent in the fourth quarter of 1981, before accelerating further to rates of 16,8

Prices



per cent and 16,5 per cent in the following two quarters. Compared with the same period in 1981, the average level of the production price index recorded a rise of 13,7 per cent in the first six months of 1982. From June 1981 to June 1982 production prices rose by 14,6 per cent.

As a result of increased demand for domestically produced goods, higher labour and other costs and upward adjustments in administered prices, the production price index of domestically produced goods rose sharply from the second half of 1981. In the twelve months to June 1982 producer prices of domestically produced goods rose on average by 14,3 per cent.

After having contributed to the slower increase in production prices in 1980 and the first half of 1981, the rise in the prices of imported goods accelerated in the subsequent period. In June 1982, import prices were on average 15,6 per cent higher than in June 1981.

These variations in the rates of increase were caused mainly by the initial appreciation and subsequent sharp depreciation of the rand and the introduction of a 10 per cent surcharge on imports in February 1982.

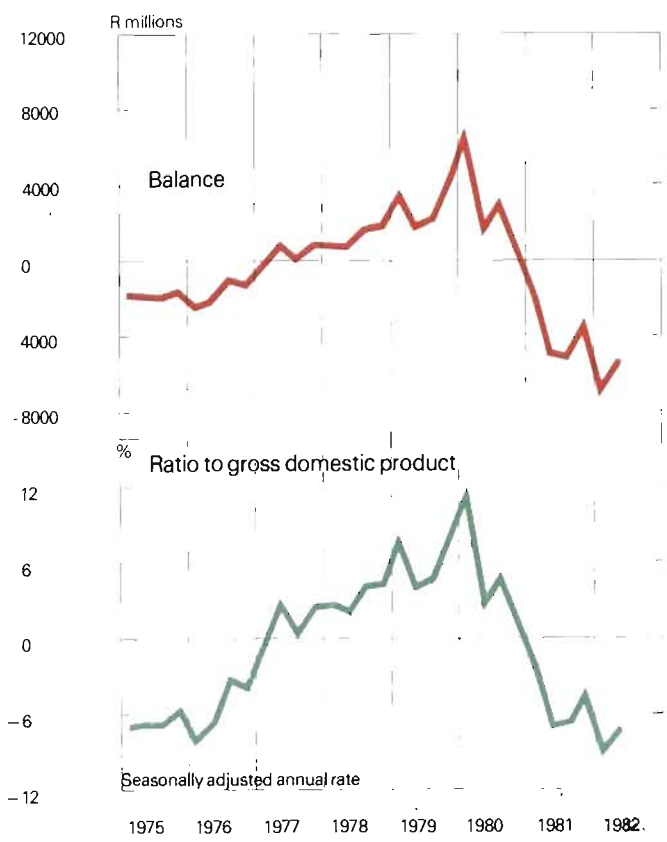
Balance of payments

Substantial deficit on current account

After the current account of the balance of payments had been in surplus for four years, it moved sharply into deficit in 1981. For the year as a whole, the deficit amounted to R3 701 million, a swing of R6 699 million from the surplus of R2 998 million in 1980.

The set of circumstances responsible for this large swing to a large extent continued to prevail during the first half of 1982. Export volumes continued to decline because of the persistent recession in the industrial countries, and the gold price and most other export prices decreased further on international markets. The only change was that, whereas the *value* of imports expressed in terms of rand remained high, the *volume* of imports declined appreciably during this period in line with the slowing down of real aggregate domestic expenditure. At a seasonally adjusted annual rate, the current account deficit increased to R6 890 million (9 per cent of gross domestic product) in the first quarter of 1982, before declining to R5 400 million (7 per cent of gross domestic product) in the second quarter.

Balance on current account

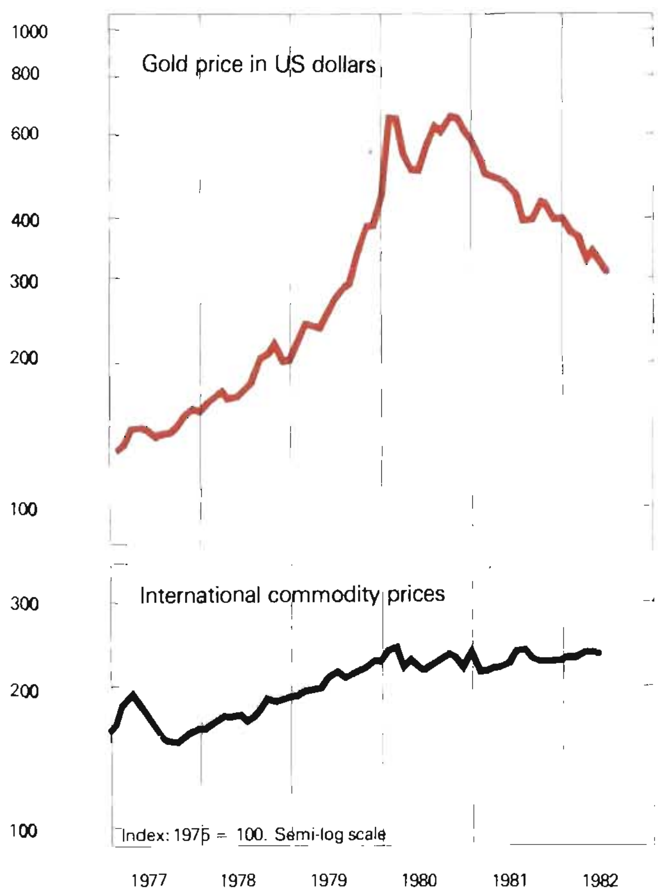


Substantial decline in gold price

One of the main causes of the large current account deficit in 1981 and the first half of 1982 was the substantial decline in the gold price from the fourth quarter of 1980. Compared with an average of US $613 in 1980, the gold price per fine ounce decreased to an average of US $460 in 1981 and to an average of US $348 in the first half of 1982. In the second quarter of 1982 the dollar price of gold was 49 per cent below its peak average in the third quarter of 1980.

The sharp fall in the price of gold was the result of considerable changes in demand and supply conditions in the international gold markets. The demand for gold, consisting of investment as well as industrial demand, was affected adversely by, among other things, high levels of international interest rates, actual and expected further declines in the inflation rates of the industrial countries to which lower oil prices made a sig-

Export prices



nificant contribution, the strengthening of the US dollar, and the recession in the industrial countries. In the face of a weaker demand for gold, increased sales by the Soviet Union and some of the oil-producing countries also contributed to the decline in the gold price.

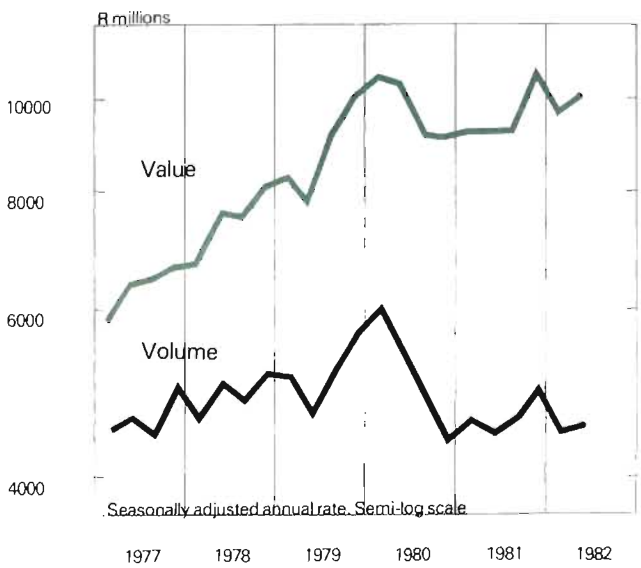
Because of the depreciation of the rand, the decline in the rand price of gold was more moderate. From the third quarter of 1980 to the second quarter of 1982 the rand price decreased by 27 per cent, against the fall of 49 per cent in the dollar price. The volume of the net gold output declined slightly in 1981 and also in the first half of 1982. Reflecting the decline in price, the value of the net gold output decreased from R10 141 million in 1980 to R8 340 million in 1981 and, at a seasonally adjusted annual rate, to R7 025 million in the first half of 1982. This represented a decline of R3 116 million, or 31 per cent, from 1980 to the first half of 1982. The dollar value of the net gold output decreased from US $13 033 million in 1980 to US $6 806 million (at a seasonally adjusted rate) in the first half of 1982, or by 48 per cent.

Value of merchandise exports underpinned by depreciating rand

Merchandise exports were also affected severely by the recession in the industrial countries. The volume of exports started to decline from the beginning of 1980 and this downward trend continued during 1981 and, although levelling-off, also during the first half of 1982. The weaker demand for South African exports was accompanied by a general decline in commodity prices. According to the index of international commodity prices published in *The Economist*, prices declined on average by 27 per cent from the end of 1980 to the end of June 1982. However, the depreciation of the rand caused export prices in terms of rand to rise by 9 per cent in 1981 and by a further 3 per cent from the fourth quarter of 1981 to the second quarter of 1982. This rise also reflected an increase in international market prices of some South African exports, in particular coal, uranium and maize prices.

Although the volume of merchandise exports declined by 10 per cent in 1981, the value of exports declined by only 2 per cent, namely from R9 766 million in 1980 to R9 579 million in 1981. Despite a further decline in volume, the rise in export prices in terms of rand caused the value of exports, at a seasonally adjusted annual rate, to increase to R9 850 million in the first half of 1982.

Merchandise exports



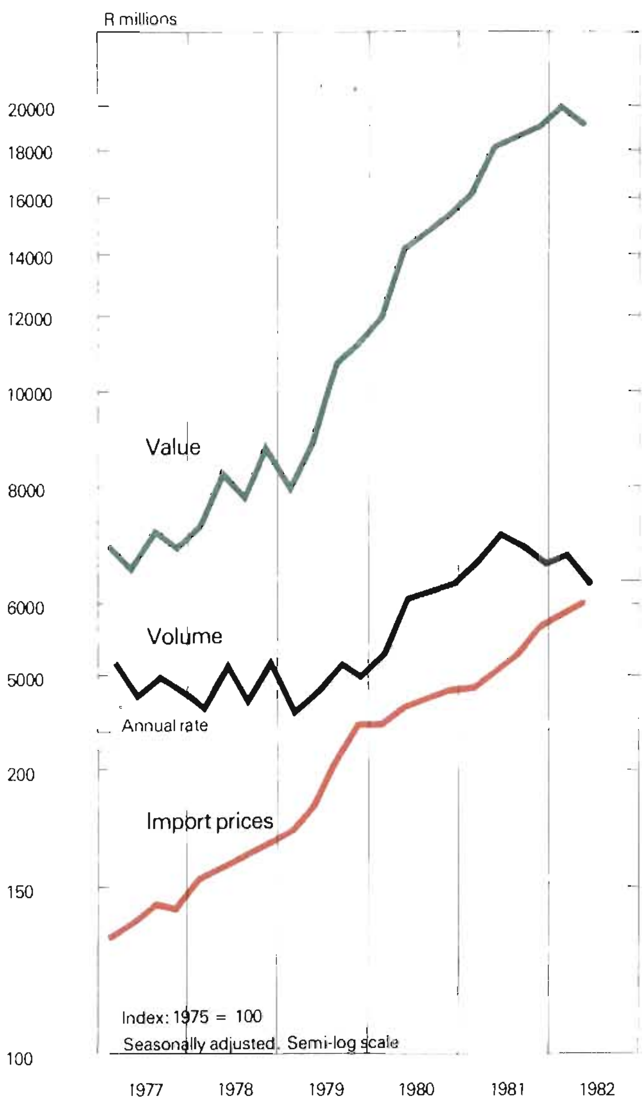
Sharp rise in imports

Another major factor contributing to the large swing in the current account balance from 1980 to 1981, and to the increased current account deficit in the first half of 1982, was the sharp rise in the value of imports. Total imports increased from R14 159 million in 1980 to R18 111 million in 1981, or by 28 per cent. At a seasonally adjusted annual rate, the value of imports rose by a further 8½ per cent to R19 670 million in the first half of 1982. The surge in imports during 1981 was mainly caused by the strong expansion of gross domestic expenditure during this period. However, it also reflected sharply rising import prices which, in turn, were largely the result of the depreciation of the rand. Fixed and inventory investment, both of which have a high import content, showed particularly large increases in 1981 and started to taper off only in the first half of 1982.

Coinciding with the beginning of the general downturn of economic activity, the *volume* of imports started to decline from the fourth quarter of 1981. In the second quarter of 1982 the import volume was 11½ per cent lower than the peak in the second quarter of last year. Apart from the effect of the general economic slow-down, imports were to some extent discouraged by the increase in import prices resulting from the sharp depreciation of the rand during 1981 and the first half of 1982, as well as by the high cost of trade financing, and the introduction of an import surcharge of 10 per cent in February 1982.

Import prices rose sharply by 11½ per cent in 1981 and further by 6 per cent from the fourth quarter of 1981 to the second quarter of 1982. To a large extent these high rates of price increases reflected the depreciation of the rand and, after February 1982, also the surcharge on imports. The increase in consumer prices in trading-partner countries actually slowed down during this period. Exhibiting the so-called J-curve effect, the immediate result of the sharp depreciation of the rand from the beginning of 1981 was an increase in import prices, the value of imports and the deficit on the cur-

Merchandise imports



rent account of the balance of payments. The beneficial effect of the depreciation, in the form of a contribution to the lowering of the import volume, became evident only towards the end of 1981 and in the first half of 1982.

Change in the composition of service payments

Net service and transfer payments to foreigners increased from R2 750 million in 1980 to R3 509 million in 1981, or by 28 per cent. In the first half of 1982, however, these net payments, at a seasonally adjusted annual rate, declined slightly to R3 350 million, but they nevertheless continued to make a significant contribution to the current account deficit. Freight, merchandise insurance and dividend payments to foreigners started to decline in the second half of 1981 owing to a decrease in the volume of imports and lower gold and other mining profits. Interest payments to foreigners, however, increased sharply because the current account deficit was financed mainly by means of foreign borrowing at high interest rates.

Financing of the current account deficit

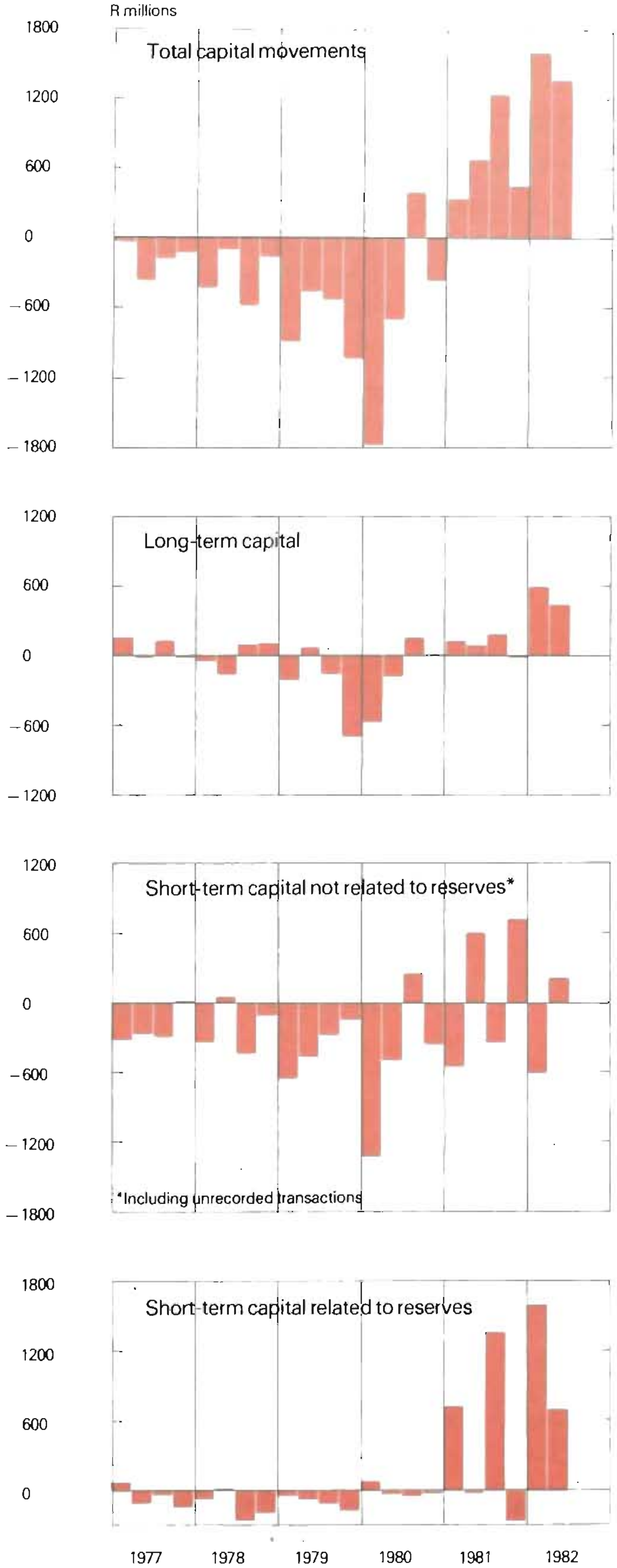
The cumulative deficit on the current account of the balance of payments during the eighteen months to June 1982 amounted to R6 444 million. A net inflow of capital, not related to reserves, of R1 510 million occurred during this period. However, the larger part of the deficit was financed by means of short-term foreign borrowing by the Reserve Bank and other banking institutions. In total, short-term foreign liabilities related to reserves increased by R4 131 million during these eighteen months. The remainder of the deficit, namely R803 million, was financed from gold and other foreign reserves. The use of gold reserves for this purpose was facilitated by the Reserve Bank's gold swaps with foreign financial institutions, in terms of which gold was sold spot at market-related prices and repurchased forward.

As shown in the accompanying table, the net inflow of capital not related to reserves during the eighteen-month period concerned consisted of long-term capital to the amount of R1 443 million and short-term capital (including errors and omissions) to the amount of R67 million. Long-term capital, in turn, consisted almost entirely of loan capital, the larger part of which represented net foreign borrowing by the Central Government and public corporations. New equity investment

Financing of current account deficit
R millions

	1981	1982 1st half
Net inflow of long-term capital		
Loan capital		
Central government and banking sector	149	532
Public corporations and local authorities	598	161
Private sector	-35	219
Total	712	912
Other long-term capital	-300	119
Total	412	1 031
Net inflow of short-term capital (including errors and omissions)	454	-387
Increase in liabilities related to reserves	1 830	2 301
Decline in gold and other foreign reserves (excluding valuation adjustments)	1 005	-202
Total financing	**3 701**	**2 743**

Net capital movements



by foreigners in South Africa in forms other than quoted securities was made through the medium of financial rand, which stood at an appreciable, but variable, discount to the commercial rand during the eighteen months to June 1982. While this resulted in a favourable reallocation of the foreign funds invested in South Africa, in the sense that direct investments in plant, equipment and construction were substituted for portfolio investments in quoted securities, these investments did not, of course, result in a net inflow of funds, because the required financial rand could only be obtained from other foreigners. With a view to financing the current acccunt deficit, the Reserve Bank from March 1982 encouraged the inward movement of short-term capital by quoting substantially reduced premiums on forward dollars. This led to a shift from domestic to foreign sources of trade financing.

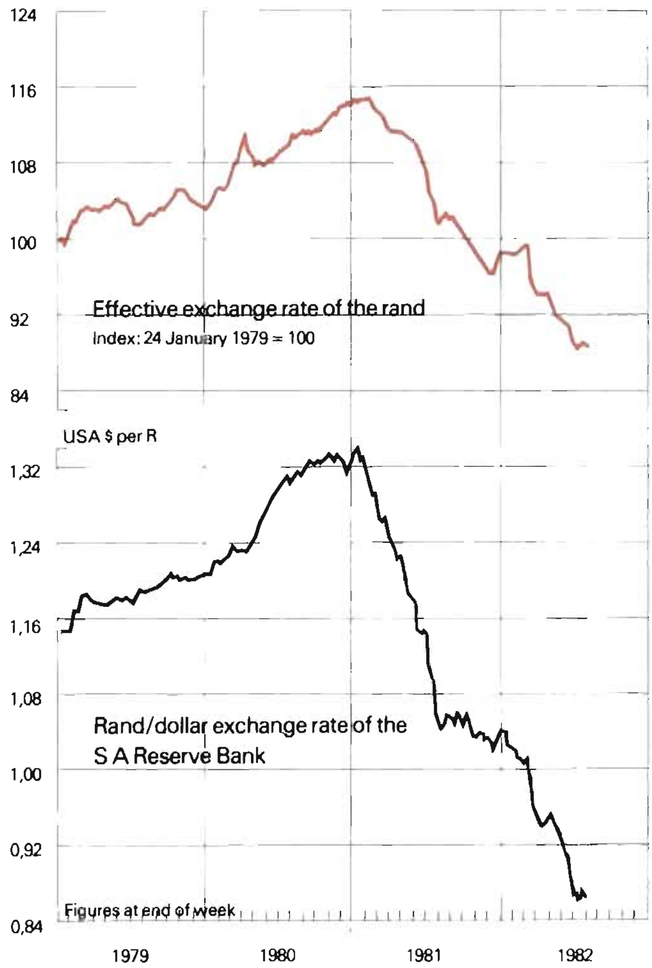
The financing of the current account deficit, together with negative valuation adjustments resulting from the decline in the price of gold and the depreciation of the rand, caused the gross gold and other foreign reserves to decline by R1 955 million during the eighteen months to the end of June 1982. At that date the foreign reserves stood at R3 838 million. Gold reserves decreased from 12,15 million fine ounces at the end of 1980 to 9,03 million fine ounces at the end of June 1982, largely reflecting further gold swap transactions.

Sharp depreciation of the rand

The growing deficit on the current account of the balance of payments gave rise to a sharp depreciation of the rand. To an important extent, the depreciation of the rand shielded the domestic economy from the adverse external developments by raising the rand prices of gold and other export commodities. The effective exchange rate of the commercial rand declined by 14 per cent during 1981 and by a further 10 per cent during the first seven months of 1982. During this nineteen-month period the rand depreciated by 35,1 per cent against the US dollar, 23,3 per cent against the Swiss franc, 18,6 per cent against the German mark, 18,2 per cent against the Japanese yen and 10,5 per cent against the pound sterling.

The financial rand depreciated by 15,6 per cent against the US dollar from the end of 1980 to the end of July 1982. Since this depreciation was much smaller than the depreciation of the commercial rand against the US dollar, the financial rand discount narrowed from 30 per cent to 9 per cent during this period.

Exchange rates



Money and banking

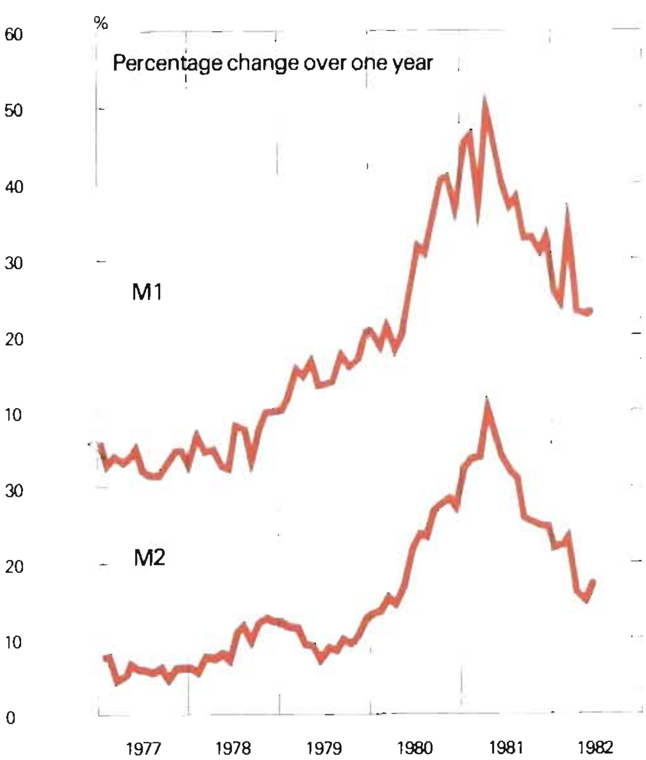
Slow-down of growth in money supply

After a period of rapid growth in the money supply from about the middle of 1979 to the middle of 1981, the rate of increase began to slow down from the third quarter of last year. Following upon an increase of 27 per cent in M2 during 1980, the seasonally adjusted annual rate of increase in this aggregate accelerated to 37 per cent during the first half of 1981, but decelerated to 15 per cent during the second half, before advancing again to 21 per cent during the first half of 1982 — 41 per cent during the first quarter and 3 per cent during the second quarter. The growth in M1, however, showed a continuous slow-down. An increase of 36 per cent during 1980 was followed by seasonally adjusted annual rates of increase of 39 per cent in the first half of 1981, 30 per cent in the second half and 19 per cent in the first half of 1982. The excessive monetary expansion of the past three years was, therefore, gradually reduced to significantly smaller proportions.

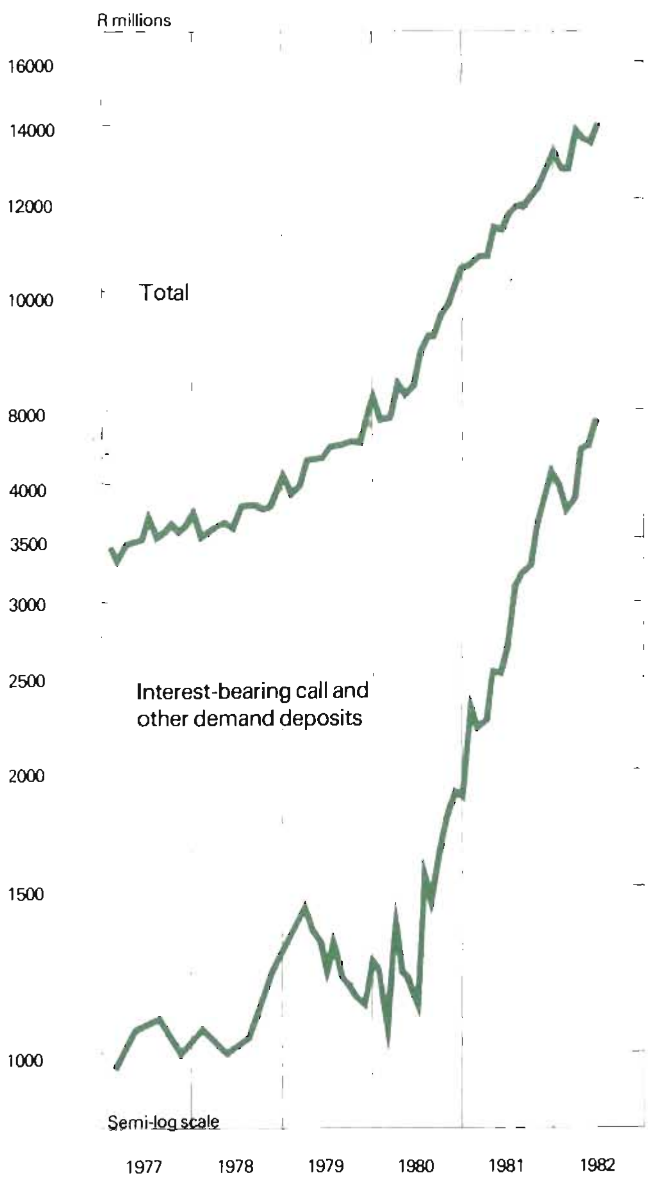
Large short-term fluctuations in money supply

Despite the slow-down of the growth in the money supply, monetary aggregates showed large short-term fluctuations, even after seasonal variations had been eliminated. For example, at a seasonally adjusted annual rate, quarterly increases in M2 during 1981 and the first half of 1982 ranged from 3 to 46 per cent. These fluctuations were caused not only by external influences of varying intensity, which had an uneven effect on the money supply through changes in net foreign reserves, but also by irregular patterns in government spending and in the use of government cash balances. Equally important, however, were the effects of "disintermedi-

Growth of monetary aggregates



Narrowly defined money supply (M1)



ation" and "re-intermediation" which, in turn, were to a large extent related to innovations in bank practices and market reactions to actual and expected changes in interest rates and interest rate margins.

One bank innovation, which is related to the banks' obligation to meet cash reserve and liquid asset requirements at specified dates and to investors' desire to economise on the use of non-interest-bearing cash balances, is the practice of selling assets under repurchase agreements to the non-bank private sector. This practice has the effect of reducing bank deposits and the measured money supply when bank assets are sold and, conversely, of inflating the money supply when repurchases are made. From 1980 these forms of disintermediation and re-intermediation occurred on a large scale. For example, if the banks' short and medium-dated repurchase agreements are included in the money supply, the rise in M2 during 1980 changes from 27 to 34 per cent, the increase during 1981 falls from 25 to 22 per cent, and the seasonally adjusted annual rate of increase during the first half of 1982 diminishes from 21 to 16 per cent.

A second bank innovation is the so-called "cash management" arrangement, according to which banks automatically transfer that part of clients' non-interest-bearing demand deposit balances which is in excess of agreed minima, to interest-bearing call deposits. This arrangement not only changes the composition of M1, which consists of non-interest-bearing demand deposits as well as interest-bearing call and other demand deposits, but also encourages a shift from medium-term deposits to M1-type of deposits. The inducement for such a shift is strengthened by an interest rate structure, such as the one prevailing at present in South Africa, in which short-term interest rates are higher than long-term rates and also by expectations of an absolute or relative prospective rise in long-term interest rates. Since the latter part of 1980 the interest-bearing part of M1 has in fact been rising at a substantially higher rate than the non-interest-bearing component. At the end of June 1982 the former component accounted for 39 per cent of total M1, compared with 22 per cent at the end of 1980. Most of the increase in M1 during this eighteen-month period, therefore, represented an increase in interest-bearing call and other demand deposits.

At times during the past two-and-a-half years the measured money supply was also distorted by other types of market reactions to prevailing and expected future interest rate levels and margins. In 1980, for example, large-scale disintermediation occurred in the form of borrowing and lending outside the banking system, including credit arranged by banks off their balance sheets. Overdraft rates that were considerably higher than the rates on bankers' acceptances and other money market paper, provided the inducement for this kind of intermediation. This was followed by extensive re-intermediation during the first half of 1981 when the rates on money market paper moved into line with overdraft rates. Similar disintermediation and re-intermediation, but of lesser significance, recurred respectively in the third quarter of 1981 and the first quarter of 1982, contributing to wide short-term fluctuations in the money supply. Fluctuations were also caused, notably during July 1981 and the first quarter of 1982, by so-called "round-tripping", i.e. the practice of borrowing on overdraft from banks and investing these funds at rates higher than the prevailing overdraft rates, mostly in call deposits and negotiable certificates of deposit.

Causes of changes in M2

An *ex post* analysis of the "causes" of changes in M2 is presented in the accompanying table. Throughout 1981 and the first half of 1982 a strong contractionary influence was exerted on M2 by the overall balance of payments deficit as reflected in a decline in the monetary banking sector's net gold and other foreign reserves. During the first half of 1981 this negative influence on M2 was supplemented by a seasonally adjusted increase in long-term deposits of the private sector with monetary banking institutions, but this contrac-

Causes of changes in M2
R millions

	Not seasonally adjusted			Seasonally adjusted		
	Year 1980	Year 1981	1st half 1982	1st half 1981	2nd half 1981	1st half 1982
Net gold and other foreign reserves	531	-2 835	-2 098	-986	-2 010	-1 732
Net claims on government sector	-407	809	-707	152	571	-386
Claims on private sector	3 629	5 632	2 674	3 398	2 256	2 362
Long-term deposits (increase-, decrease +)	-468	-133	158	-338	200	429
Net other assets	221	617	1 340	...	...	...
Total causes of changes in: M2	**3 506**	**4 090**	**1 367**	**2 651**	**1 336**	**1 949**
M1	2 220	2 876	684	1 436	1 324	962

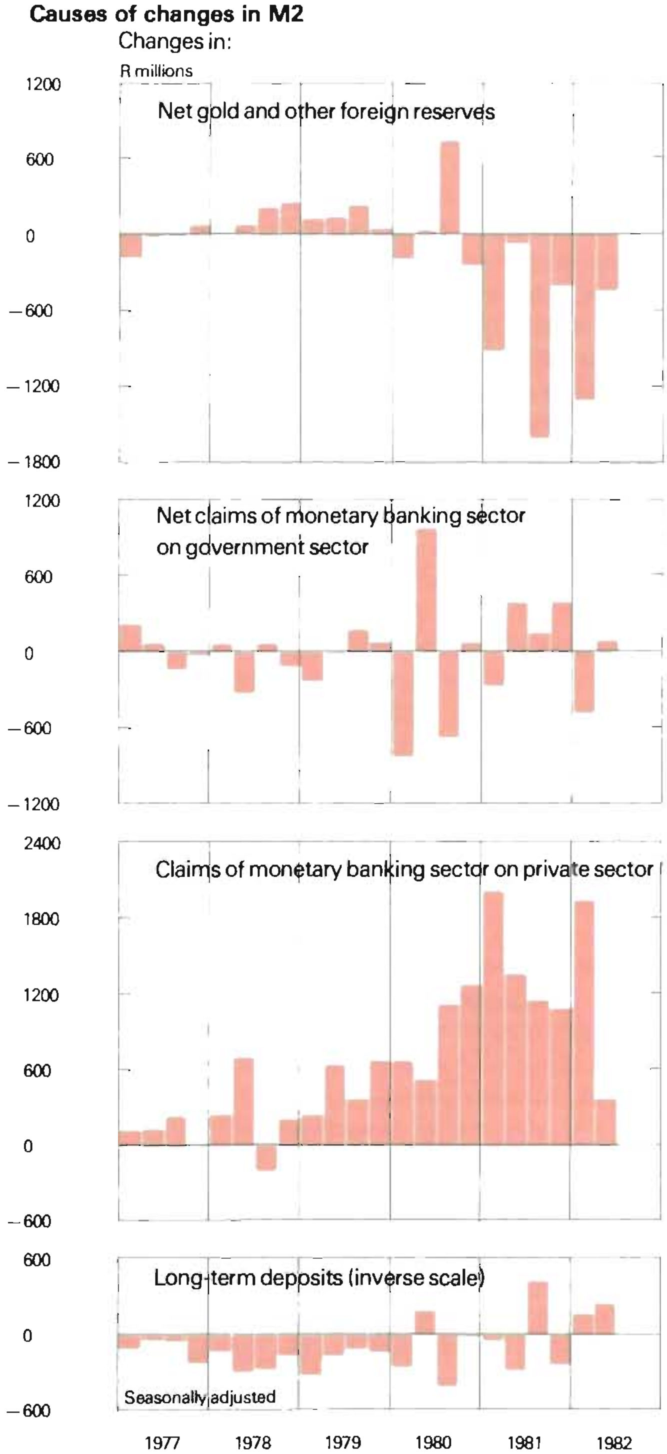
tionary effect was reversed during the second half of 1981 and the first half of 1982, when these deposits declined moderately.

The major "cause" of the increase in M2 during the eighteen months to June 1982 was a sharp rise in total credit extended by the monetary banking sector. During 1981 this increase in credit amounted to 34 per cent, but during the first half of 1982 it slowed down to a seasonally adjusted annual rate of 16 per cent. Looking at the two main components of bank credit, net credit to the government sector increased considerably during 1981, but actually declined during the first half of 1982. The second component, namely bank credit to the private sector rose by 35 per cent during 1981 and continued its upward trend during the first half of 1982. The increase during the latter period, however, slowed down to a seasonally adjusted annual rate of 23 per cent, mainly because of a marked decline in the rate of increase during the second quarter.

Judging from the latest information, it appears that there was a significant moderation in the private sector's demand for credit. This was particularly evident in the loans and advances of the commercial, merchant and monetary general banks, other than hire-purchase credit. The apparently weaker credit demand reflected the general slow-down of economic activity which had been in progress from the third quarter of 1981 and the high cost of borrowed funds.

Another "cause" of the increase in M2 during 1981 and the first half of 1982 was a considerable increase in the net "other" assets of the monetary banking sector. Although a complete breakdown of this increase is not available, a major part of it consisted of larger exchange losses incurred by the Reserve Bank on forward exchange contracts. These losses are for the account of the Government and could be considered as claims on the government sector.

Causes of changes in M2

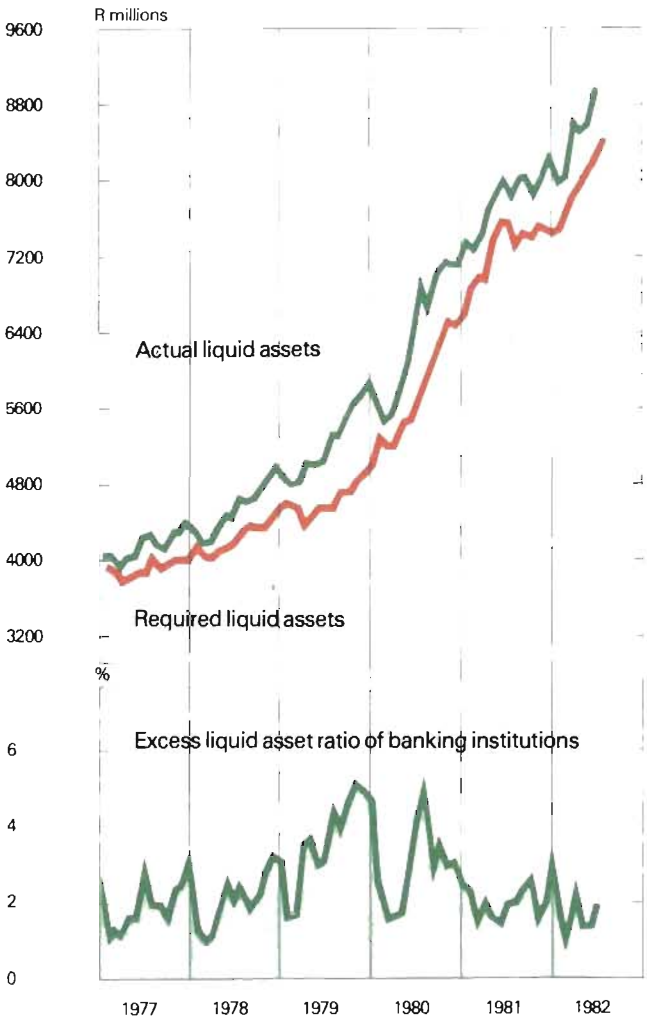


Low level of excess bank liquidity

Excess holdings of liquid assets by banks over and above the legally required minimum started to decline from about the middle of 1980 at a time when bank credit to the private sector began to increase more rapidly. During 1981 excess bank liquidity generally remained at a low level and it declined slightly further during the first half of 1982. Compared with an average of 2,1 per cent in 1981, the excess liquid asset ratio declined to an average of 1,6 per cent in the first half of 1982 and amounted to 2,0 per cent at the end of June. The decline in excess bank liquidity during the eighteen months to June 1982 occurred despite a marked increase in the banks' liquidity base, or holdings of liquid assets. This was the result of a relatively larger rise in required liquid assets than in actual holdings of such assets.

The increase in the banks' holdings of liquid assets, which influences their capacity to create additional bank credit, amounted to R1 168 million during 1981 and to R1 644 million during the first half of 1982. The large expansion of the banks' liquidity base during 1981 was mainly due to increases in credit extended by banking institutions to the Land Bank, Reserve Bank credit to the government sector, and net "other" assets of the Reserve Bank (including exchange losses on forward contracts). The effect of these increases was partly

Bank liquidity



offset by a considerable decline in the Reserve Bank's net gold and other foreign reserves and smaller bank holdings of short-term government debt. During the first half of 1982 the banks' liquidity base was expanded mainly by an increase in the Reserve Bank's net "other" assets and larger bank holdings of liquid bankers' acceptances. A contractionary influence on the base was exerted by a further decline in the Reserve Bank's net foreign reserves and in its credit to the government sector.

The amount of required liquid assets rose substantially during the eighteen months to June 1982, mainly because of the rapid rise in liabilities resulting from the extension of credit by the banks. Required liquid assets rose by R851 million during 1981 and by a further R985 million during the first half of 1982.

Tight money market conditions

Money market conditions, which had tightened markedly during the last quarter of 1980, generally remained tight throughout 1981 and the first seven months of 1982. However, periods of relative ease were experienced from early April 1981 to about the middle of May, from the middle of December to early January 1982, and during April, May and early June 1982. On the other hand, the general tightness of the market during 1981 at times became more severe, especially over the month-ends of January, February, May, July and August and almost continuously during the period from early September to the middle of December. In 1982, the market tightened substantially over the January month-end, remained severely short of funds during February and most of March and again showed a considerable tightening over the June month-end.

Apart from seasonal increases in banknotes in circulation, peaks in the flow of tax funds to the Government and occasional subscriptions to government loans, the most important cause of the sustained tightness of the market was the continuous decline in the net gold and other foreign reserves of the Reserve Bank. The periods of relative ease, on the other hand, were largely due to increased government spending and an accompanying decline in government deposits, and short-term foreign borrowing by banks. Apart from the normal rediscounting facilities, special accommodation provided by the Reserve Bank eased the seasonal tightening of the market over the month-ends of February and August 1981 and February 1982, when large tax payments were made to the Government.

In order to alleviate the persistently tight market situation and to reduce the upward pressure on the banks' prime overdraft rates, the Reserve Bank on 30 March lowered the supplementary minimum cash reserves which banks are required to hold against their liabilities to the public. At the same time, the Reserve Bank started quoting substantially reduced premiums on forward dollars in order to encourage the increased use of foreign credits by banks and their clients. These measures resulted in easier market conditions which continued until early June.

As a result of the tighter conditions in the money market during 1981 and the first half of 1982, Reserve Bank accommodation to the discount houses remained at fairly high levels for longer periods at a time. Varying amounts of accommodation were provided to the discount houses over all month-ends during this period. Accommodation increased to an all-time peak of R1 021 million on 5 March 1982, but the measures introduced on 30 March served to reduce the amount of accommodation from R983 million on 26 March to R428 million at the end of that month and to maintain subsequent month-end accommodation generally at a lower level.

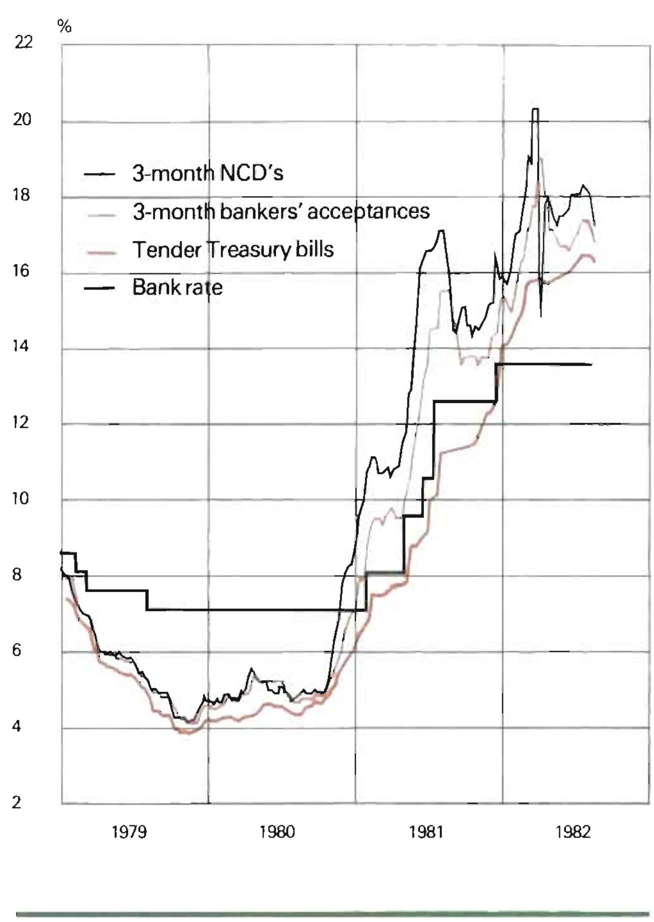
Sharp rise in short-term interest rates

Money market interest rates increased sharply during 1981 and the first seven months of 1982 in response to the sustained tight conditions in the market. The rate quoted by the discount houses on three-month bankers' acceptances rose from 7,00 per cent on 24 December 1980 to 15,25 per cent on 31 December 1981 and to 16,70 per cent on 6 August 1982. The Treasury bill tender rate on these dates amounted to 6,04 per cent, 14,04 per cent and 16,24 per cent, respectively. In December 1981 this rate, for the first time since the introduction of the tender system for issuing new Treasury bills, rose above Bank rate. In order to create a broader and more active market in Treasury bills, the margin between the Treasury bill tender rate and the call deposit rate of the National Finance Corporation was raised to 0,75 per cent on 23 October 1981 and further to 1 per cent and 1½ per cent on 18 December 1981 and 15 February 1982, respectively.

In recognition of the tightening of financial markets and the general increase in interest rates, and also as part of a restrictive monetary policy stance, the Reserve Bank's rediscount rate, or Bank rate, was raised in five steps during 1981, namely from 7,0 to 13,5 per cent. As part of the Reserve Bank's rediscount policy, however, the discount houses and banks were, and still are, accommodated at flexibly determined rates well in excess of Bank rate. The increase in Bank rate permitted the commercial banks to increase their prime overdraft rates from 9,5 to 17,0 per cent during 1981. On 16 February 1982 the direct link between Bank rate and the banks' prime overdraft rate was abolished. Previously, in terms of an understanding between the Reserve Bank and the clearing banks, prime overdraft rates had to be maintained within a range of between 2½ and 3½ per cent above Bank rate. Banks were, therefore, given freedom to determine their own prime overdraft rates in response to market forces, subject only to the influence of broad monetary policy and the maximum rates laid down under the Limitation and Disclosure of Finance Charges Act (Ladofca). Following this change, the banks' prime overdraft rate was raised immediately to 18 per cent and subsequently to 20 per cent in early March. Subsequently, maximum "Ladofca" rates were increased by 2 per cent on 25 June 1982.

The various deposit rates of banking institutions were raised on a number of occasions during 1981 and the first half of 1982. Details of these changes are provided in the capital market section of this review.

Short-term interest rates



Extensive open-market operations

Open-market operations by the Reserve Bank during the first quarter of 1981 were mostly accommodating, but from the second quarter, operations were aimed at ironing out short-term variations in money market conditions and at curbing the growth in the money supply. Open-market purchases and sales of government securities during the first quarter of 1981 amounted to R253 million and R45 million, respectively. During the last three quarters of 1981 the corresponding amounts were R473 million and R1 095 million, respectively. Most of the purchases during the latter period consisted of the buying in of government stock prior to dates of maturity on 1 October and 1 December. Open-market sales during 1981 included sales of long-term government stock to the amount of R723 million. The larger part of the stock sold in the market was obtained on tap from the Treasury or purchased from the Public Debt Commissioners. The Bank's sales were mainly intended to reduce liquidity and to assist the Treasury in raising the loan funds provided for in the Budget.

From the beginning of 1982 up to the first week of August the Reserve Bank's open-market purchases and sales amounted to R90 million and R842 million, respectively. Stock obtained by the Bank on tap from the Treasury and through subscription to new issues, together with stock purchased from the Public Debt Commissioners, totalled R1 059 million during this period.

In addition to government stock sales, the Bank sold special Treasury bills to an amount of R142 million in late December 1981 and early 1982. These bills matured on 27 February, and the timing of the maturity was aimed at alleviating the usual seasonal shortage of funds in the money market over the February month-end, when large tax payments are made to the Government. For the same reason, special Treasury bills amounting to R222 million, which will mature at the end of August 1982, were sold in the market during April, June and early August.

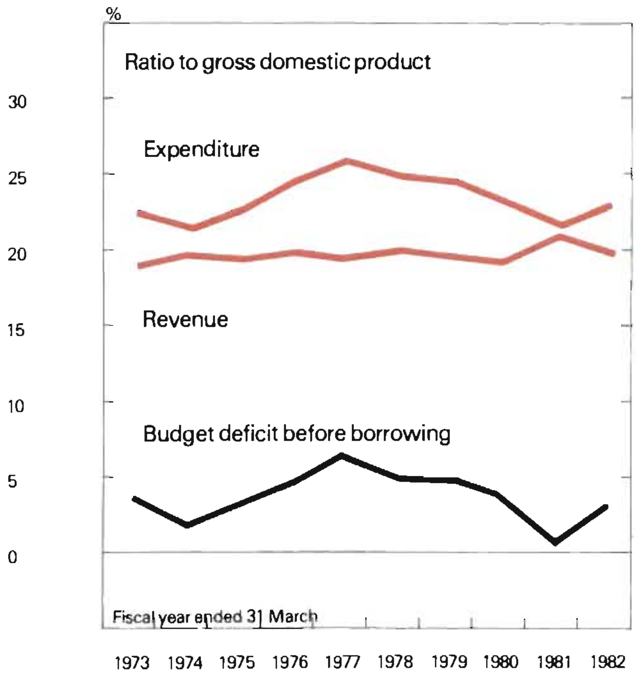
Government finance

Longer-term overview

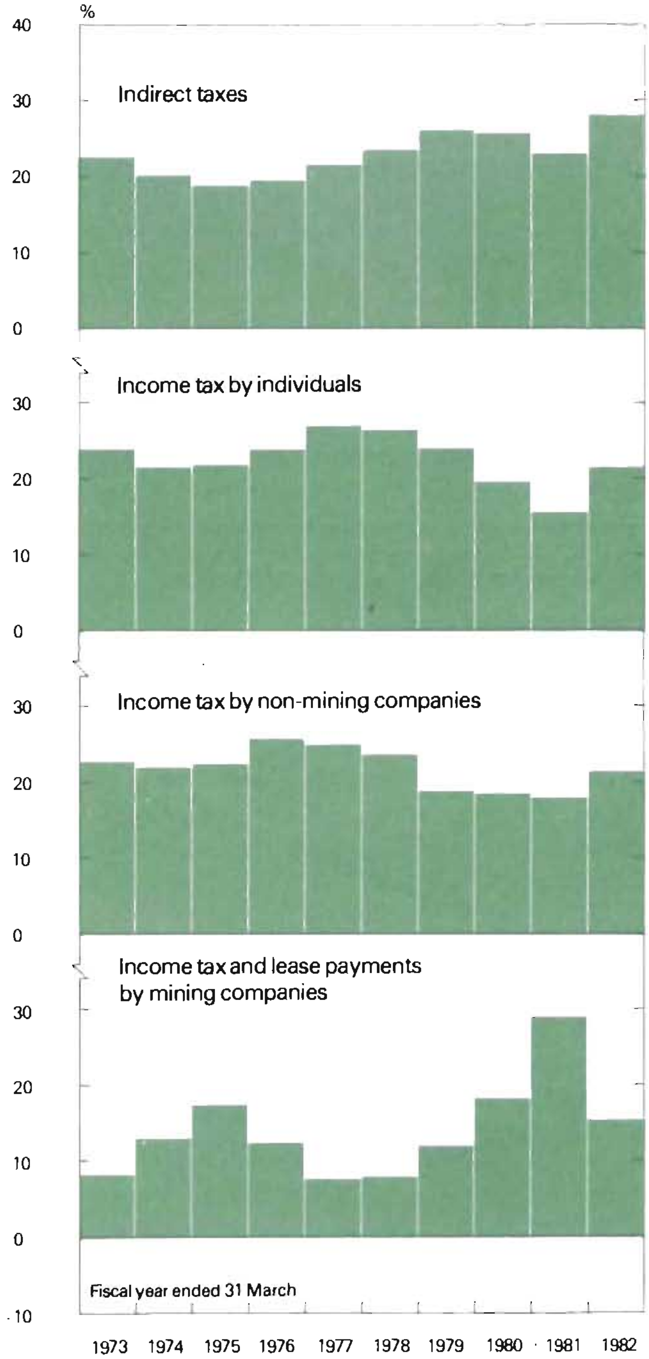
From the 1977/78 fiscal year, the Government has been pursuing a policy of restraining the growth in its expenditure in order to leave more scope for expansion in the private sector and the rest of the public sector and, at the same time, to avoid the use of bank credit in the financing of its budget deficits. During the five fiscal years to 1981/82 central government expenditure, as reflected in issues on the Exchequer Account*, increased at an average annual rate of 15 per cent, compared with an average annual rate of growth of 18 per cent in nominal gross domestic product. Because of this restraint, the ratio of central government expenditure, as defined above, to gross domestic product declined from 26 per cent in 1976/77 to 23 per cent in 1981/82.

The ratio of central government revenue to gross domestic product varied within a narrow range of between 19 and 21 per cent during the five years to 1981/82. Personal income tax rates were reduced in the 1979/80 and 1980/81 Budgets, but the effect of this on total government revenue was offset by a more rapid growth in personal and corporate incomes and tax payments during this period. Not only was there a sharp

Central Government



Composition of Central Government revenue



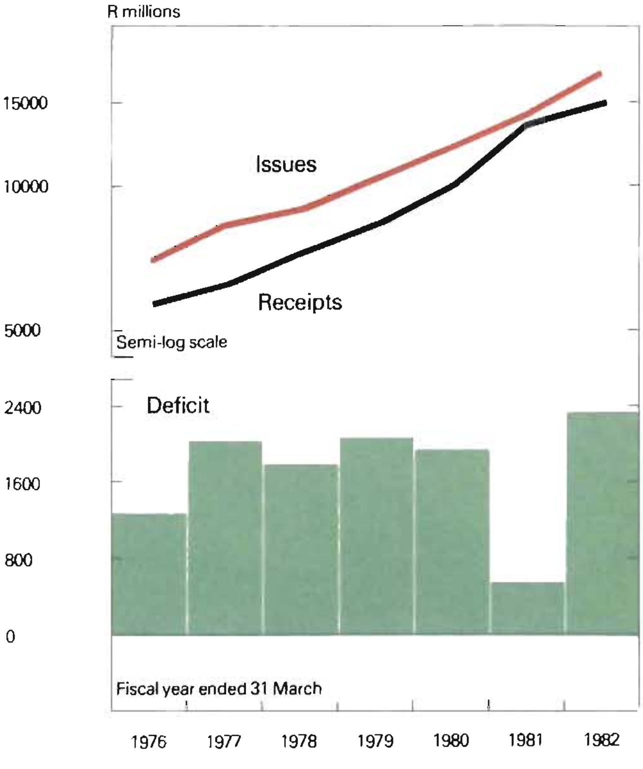
*In this review, the Exchequer Account is adjusted to take account of changes in cash balances on, and the net borrowing from, the Paymaster-General Account and to incorporate the Stabilization Account. Some figures, therefore, do not correspond exactly with those presented in Central Government budgets.

rise in the price of gold and in other export prices, but higher nominal incomes also reflected the general economic upswing and the prevailing high rate of inflation at the time. In addition, the introduction of the general sales tax and the buoyancy of the economy resulted in a higher rate of increase in indirect taxes.

Reflecting these changes, the composition of government revenue changed notably from 1976/77 to 1981/82. In the former fiscal year, indirect taxes accounted for 22 per cent of total revenue, while the relative shares of personal income tax and revenue from companies (income tax and mining lease payments) amounted to 27 per cent and 33 per cent, respectively. In 1981/82, 28 per cent of total revenue consisted of indirect taxes, 22 per cent of personal income tax, and 37 per cent of revenue from companies. The ratio of revenue from gold mining companies to total revenue rose from 7 per cent in 1976/77 to 27 per cent in 1980/81, before declining to 15 per cent in 1981/82. These fluctuations were largely due to the strong increase in the rand price of gold from about the middle of 1976 to the first quarter of 1980 and its subsequent decline.

As a ratio of gross domestic product, the Government's deficit, before borrowing and debt repayment, declined from over 6 per cent in 1976/77 to 3 per cent in 1981/82. In 1980/81 it fell to less than 1 per cent owing to an exceptionally sharp rise in revenue from gold mining companies. During the five-year period to 1981/82, the Government was able to finance its budget deficits without recourse to bank credit. Net indebtedness to the monetary banking sector actually declined by R908 million during this period.

Exchequer Account



Main developments during the 1981/82 fiscal year

In the 1981/82 fiscal year, the Government found it more difficult to adhere to its policy of restraint. Expenditure increased by 21 per cent, the highest fiscal-year increase since 1976/77. The original 1981/82 Budget provided for an expenditure increase of 17 per cent, but additional expenditure was approved by Parliament in early 1982. Expenditure items such as salaries and wages, interest on public debt, and defence showed particularly large increases.

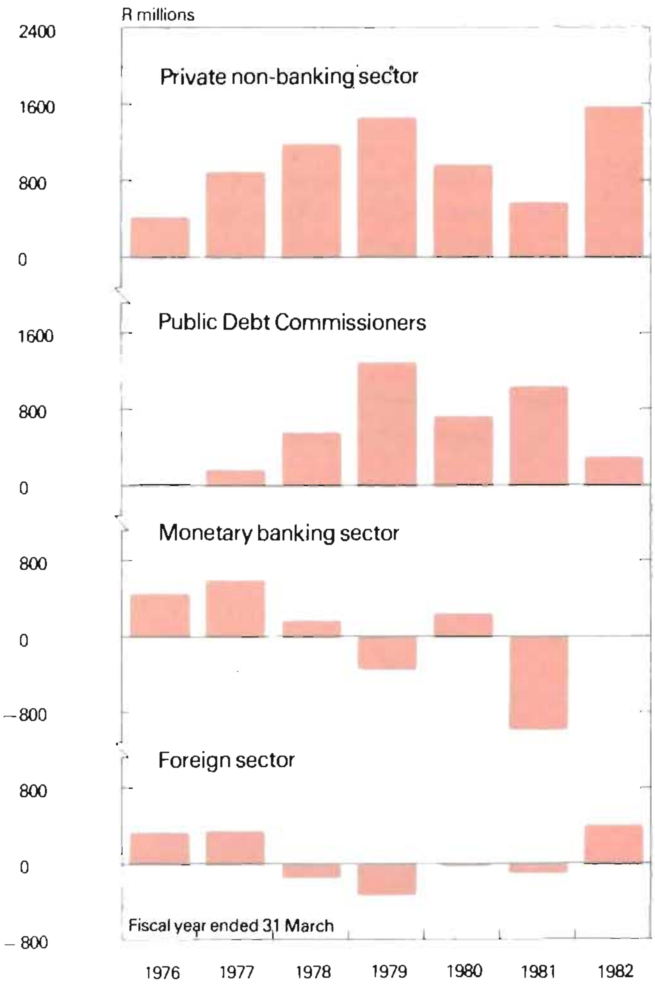
Government revenue in 1981/82 was also well above the Budget estimate. Instead of an estimated decline of 1 per cent, revenue actually increased by 8 per cent. This result was achieved despite a substantial decline in revenue collected from gold and other mining companies, attributable to the combined effect on mining income of a fall in metal and mineral prices and a rise in mining costs. The Government's gold mining revenue alone decreased by R1 502 million, or by 41 per cent, compared with 1980/81. This revenue loss, was, however, more than compensated for by a considerable increase in other revenue. Reflecting the further sharp rise in domestic expenditure, imports, salaries and wages, and non-mining company profits, there was an increase of 32 per cent in indirect taxes and of 35 per cent in income tax receipts (excluding gold mining tax) in 1981/82. Both these increases were markedly higher than original Budget estimates. Most dramatic was the effect of sharp increases in nominal salaries and wages and of fiscal drag on personal income tax receipts. At unchanged tax rates, personal income tax collections rose by 51 per cent in 1981/82.

The higher than expected revenue more than offset the increased expenditure provided for in the Additional Budget for 1981/82. Consequently, the deficit before borrowing of R2 342 million was notably smaller than the original Budget figure of R2 707 million. The Government was able to finance this deficit without recourse to bank credit because of its successful borrowing from the non-bank private sector. This borrowing, supplemented by considerable open-market sales of government stock by the Reserve Bank, was facilitated by the pitching of new issue yields at prevailing market levels. Nevertheless, at times long-term borrowing was complicated by the variability of interest rates and accompanying shifts in interest rate expectations. To overcome this problem, the Treasury in February 1982 introduced a tender system for new issues of government stock.

Increased borrowing from the non-bank private sector during 1981/82 also served to supplement the smaller amount of funds received from the Public Debt Com-

Financing of Exchequer Account deficit

Change in net indebtedness to:



missioners and raised through net issues of non-marketable debt instruments. Net investment in government securities by the Public Debt Commissioners was substantially below the Budget estimate because they had to face unexpectedly large withdrawals of funds administered by them. Holdings of non-marketable government debt actually declined during 1981/82 owing to relatively unattractive yields on the various instruments concerned.

In total, the contribution of the non-bank private sector to the financing of the deficit in 1981/82 amounted to R1 588 million. The Public Debt Commissioners' net contribution came to R329 million, the smallest figure since the 1976/77 fiscal year. The Commissioners' gross new investment in government securities amounted to R1 199 million, but a substantial part of this amount represented the reinvestment of the proceeds of stock sold in the market. Net foreign borrowing amounted to R425 million, of which R130 million consisted of a drawing on the International Monetary Fund. As mentioned earlier, the Treasury's net indebtedness to the monetary banking sector remained unchanged during the fiscal year as a whole.

Large deficit in the first quarter of 1982/83 fiscal year

In the first quarter of the 1982/83 fiscal year, i.e. the period April to June 1982, Exchequer issues showed a large seasonal increase. Compared with the corresponding quarter of 1981, issues rose by 17 per cent. This percentage was well above the Budget estimate of 11,5 per cent for 1982/83 as a whole.

Government revenue in the first quarter of 1982/83 was also 21 per cent higher than in the corresponding quarter of 1981/82, despite a substantial decline in revenue received from gold mining companies. In the Budget the rate of increase in revenue for the fiscal year as a whole was estimated at 11 per cent. Part of the revenue increase was accounted for by the imposition in February 1982 of a 10 per cent surcharge on certain classes of imported goods and a simultaneous increase in the general sales tax from 4 to 5 per cent. Despite the sharp rise in revenue, the Exchequer Account recorded a large deficit of R1 492 million in the first quarter of 1982/83. In financing this deficit, an amount of R902 million was raised in the non-bank private sector, while the Government's net indebtedness to the monetary banking sector increased by R268 million. In addition, net borrowing from the Public Debt Commissioners and the foreign sector amounted to R180 million and R142 million, respectively.

On two occasions during the first quarter of 1982/83 new government stock was offered on a tender basis for public subscription. Subscriptions were well in excess of the amounts offered. In addition, new government stock was issued on tap to the Reserve Bank and the Public Debt Commissioners. The amount raised by the Treasury by means of new issues of marketable stock during the first quarter of 1982/83 totalled R1 620 million. Owing to the Treasury's successful borrowing operations, new stock issues were not made to refinance government stock debt of R166 million that matured on 15 August.

The 1982/83 Budget

The 1982/83 Budget, which was presented to Parliament on 24 March, aimed at promoting consolidation in the South African economy and at ensuring that fiscal policy would play its proper part in bringing about the necessary balance of payments adjustment. In his presentation of the Budget, the Minister of Finance stated that while he was fully aware that the economy had entered the downward phase of the business cycle and that the rate of real economic growth would almost certainly be lower in the coming fiscal year, the decline in the gold price and other adverse external developments of recent months ruled out any possibility of "reflation" or "stimulation" of the economy at that time.

On the contrary, the balance of payments adjustment process needed strong support from fiscal and monetary policies, even if this meant restraining demand at a time of slower real growth. The existing economic situation, therefore, called for firm control over government spending, the liquidity base of the banking system and the money supply.

The Minister was of the opinion that in recent months adjustments to the adverse external developments had come about largely via inflation and currency depreciation, on the one hand, and increases in interest rates on the other. He stated that the Government considered it essential that fiscal policy should play its proper part in assisting the economy to make the necessary further adjustments. Recognition needed to be given to the "trade-off" which existed in the prevailing situation between higher interest rates, higher tax rates (or lower government spending) and exchange rate depreciation. In framing the Budget proposals, therefore, due consideration had been given to the need to achieve the optimal combination of tax rates, interest rates and spot and forward exchange rates required for dealing with the existing economic situation.

Against this background, the Budget sought to comply with three minimum requirements. Firstly, the increase in government spending would be restricted as much as possible without disrupting the provision of essential services. Secondly, in order to curb monetary demand and to prevent undue upward pressure on interest rates, the "deficit before borrowing" as a percentage of gross domestic product would be reduced to well below its average of 3,4 per cent over the past 22 years. Thirdly, this deficit would be financed in such a manner that not only the Exchequer, but also the government sector as a whole, would be able to avoid a net recourse to bank credit.

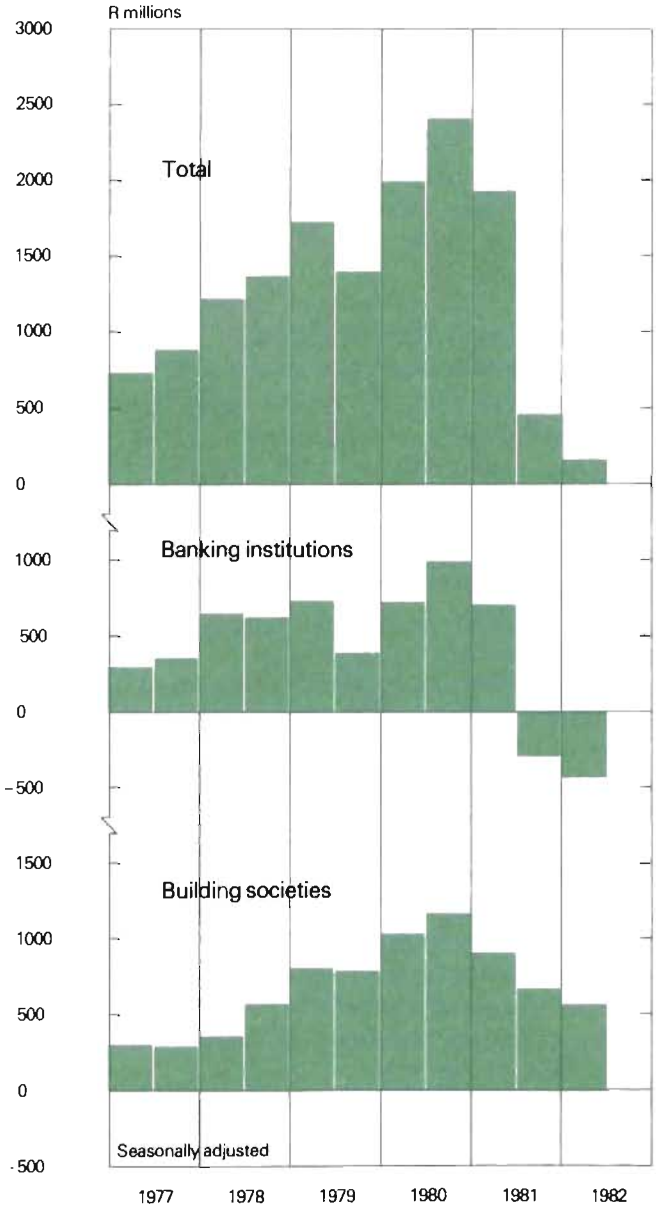
Aggregate expenditure during the 1982/83 fiscal year was estimated at R18 238 million, or 11,5 per cent more than the revised estimates of expenditure in 1981/82. Total revenue in 1982/83 was estimated at R15 858 million, an increase of 11 per cent in comparison with expected revenue receipts in 1981/82. Tax proposals for 1982/83 included the incorporation of the existing surcharge of 5 per cent on company tax into the basic rate of 40 per cent and the introduction of a surcharge of 10 per cent on the new basic rate of 42 per cent. The surcharge on income tax payable by gold and diamond mining companies was raised from 5 to 15 per cent. In addition, a 5 per cent compulsory loan levy, based on personal income tax, was imposed on individual taxpayers. The deficit before borrowing in 1982/83 was estimated at R2 380 million, or 2,8 per cent of gross domestic product. Together with loan redemptions of R1 246 million, the total financing requirement came to R3 626 million.

Capital market

Smaller increase in holdings of longer-term funds with non-contractual savings institutions

Financial markets tightened considerably during 1981 and the first half of 1982. In broad terms, these tight conditions reflected the imbalance between domestic saving and investment during this period. As discussed in the national accounts section of this review, the inadequacy of domestic saving to finance domestic investment was mainly due to a decline in corporate and personal saving as well as to a sharp rise in investment in 1981 and the first half of 1982. These declines were clearly reflected in a substantially smaller increase in holdings of longer-term non-contractual savings with financial institutions. In addition, an increased preference for more liquid investments, reflecting changes in interest rate expectations and differentials, caused a shift from longer-term to short-term deposits.

Change in holdings of longer-term funds with financial institutions



The increase in holdings of longer-term funds with banking institutions, building societies, participation mortgage bond schemes and government savings schemes decelerated considerably during 1981 and the first half of 1982. Compared with R4 400 million in 1980, the increase at a seasonally adjusted annual rate slowed down progressively to R3 676 million in the first half of 1981, R1 108 million in the second half and only R284 million in the first half of 1982. Except for participation mortgage bond schemes, which recorded a higher intake of new funds during the eighteen months to June 1982, the other groups of institutions had to face a diminishing growth in longer-term funds invested with them. Holdings of longer-term funds with banking institutions and government savings schemes actually declined during the first half of 1982. Building societies managed to maintain a net inflow of longer-term funds (after adjustment for seasonal variations) during the latter period, but this inflow was substantially smaller than during the preceding six months.

Selected interest rates[1]
%

	1980 31 Dec.	1981 31 Dec.	1982 31 Jul.
Ordinary savings deposits	3,50	4,00	4,00
Special savings deposits	5,50[2]	8,25[3]	11,75[3]
Fixed deposits:			
12 months	8,50	11,50	16,00
24 months	9,50	13,50	15,50
36 months	9,50	13,25	14,00
60 months	9,50	14,00	14,00
Building society shares:			
Indefinite period paid-up	8,00	11,50	14,00
Tax-free shares	7,00	8,75	9,50
Post Office Savings Bank Certificates	7,00	8,75	9,50
National Savings Certificates[4]	7,50	9,00	9,75
Tax-free Treasury Bonds	7,00	8,75	9,50

1. Predominant rates.
2. Deposits of less than R20 000.
3. Deposits of up to R15 000.
4. Average rate over full period of investment.

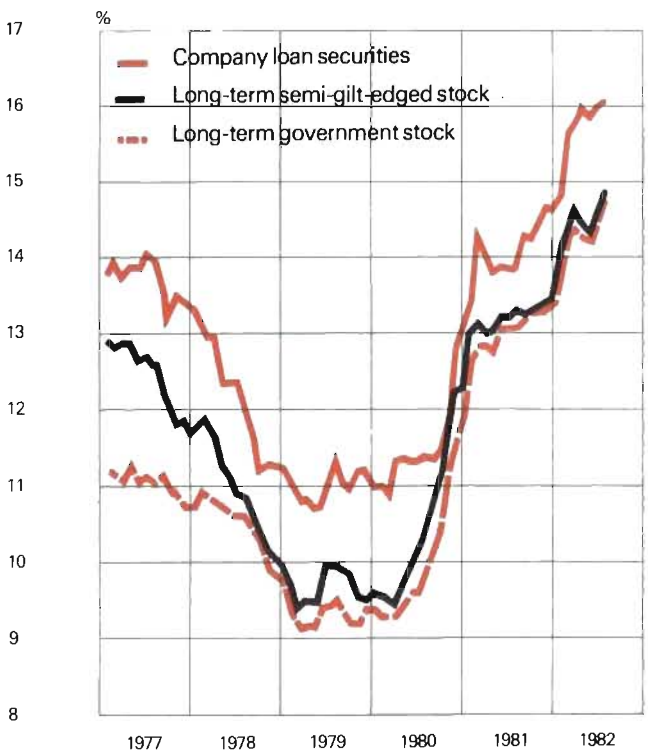
The scarcity of funds and a continuing strong demand for bank credit and housing loans during most of the eighteen months to June 1982 resulted in active competition for funds and a sharp rise in deposit and related interest rates. As shown in the accompanying table, increases ranged from 0,5 per cent to 7,5 per cent during this nineteen-month period.

More active fixed-interest security market

Owing to a higher borrowing requirement of the Central Government and other borrowers in the public sector, the amount of new funds raised in the fixed-interest security market increased considerably during 1981 and the first half of 1982. The public sector's net borrowing in this market increased from R1 448 million in 1980 to R2 470 million in 1981 and R2 200 million in the first half of 1982. The private corporate sector, on the other hand, raised a relatively small amount in this market during the eighteen months to June 1982.

Most of the new funds raised by the public sector during 1981 and the first half of 1982 came from the non-bank private sector, in particular from insurers and pension funds. The non-bank private sector's holdings of public-sector stock rose by R2 600 million during 1981 and by a further R1 600 million during the first half of 1982. Holdings of public-sector stock by the monetary banking sector declined by R275 million during 1981, but increased by R475 million during the first half of 1982.

Secondary market yields



Increased activity in the fixed-interest security market was not confined to the raising of a larger amount of new funds. The rise in holdings of public-sector stock was accompanied by extensive secondary-market transactions. Turnover in public-sector stock rose from R4 219 million in 1980 to R5 100 million in 1981 and amounted to R4 715 million in the first half of 1982. In these transactions the non-bank private sector participated actively as part of the process of increasing its holdings of public-sector stock and adjusting its stock portfolios.

In accordance with the generally tight situation in the financial markets, long-term fixed-interest security yields increased throughout 1981 and the first seven months of 1982. The monthly average yield on long-term government stock rose from 11,81 per cent in December 1980 to 13,33 per cent in December 1981 and further to 14,70 per cent in July 1982. Likewise, the monthly average yield on long-term semi-gilt-edged stock of the highest grade increased from 12,20 per cent to 13,41 per cent during 1981 and to 14,78 per cent during the first seven months of 1982. The corresponding increase in the yield on corporate loan securities was from 13,03 per cent to 14,58 per cent and 16,00 per cent.

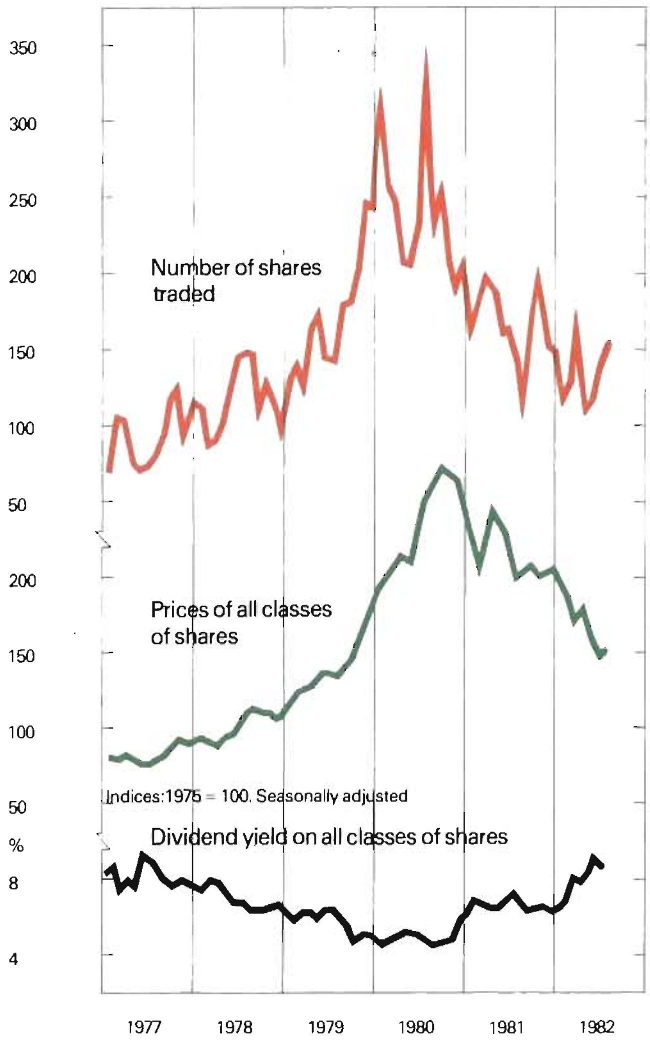
Because of the difficulty of determining accurate market-related yields on new issues of government stock in an environment of rising interest rates and varying interest rate expectations, the Treasury in February 1982 resorted to a system of offering new stock for subscription on a tender basis. The February issue was followed by further tender issues in April and June.

Decline in share market activity and prices

After a five-month decline in turnover and prices from a peak in September 1980, the share market showed remarkable resilience during the remainder of 1981. However, a sharply downward trend in share turnover and prices commenced in early 1982. Share prices in 1981 were underpinned by sustained institutional investment in shares and by optimistic expectations that the downturn in the South African economy, which was widely anticipated at the time, would be fairly mild and of short duration. The deepening of the recession in most industrial countries, the further decline in the gold price and more generally the further deterioration of the balance of payments on current account, and the restrictive monetary and fiscal policy stance and an accompanying sharp rise in interest rates, among other things, contributed to a change in market sentiment in early 1982.

From the second half of 1981 to the first half of 1982 the number of shares traded on the stock exchange declined by 18 per cent. On average, share prices declined by 26 per cent from September 1980 to February

Stock exchange



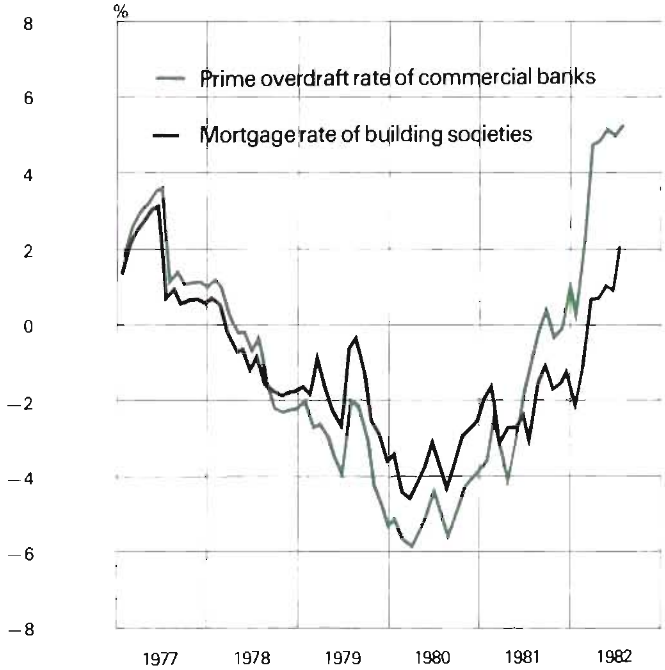
1981 and by less than 2 per cent up to December 1981. Subsequently, they declined by 34 per cent to June 1982. The decrease in share prices during the first half of 1982 was led by mining shares, followed closely by industrial and commercial shares and lastly by financial shares. As share prices declined, the average dividend yield on all classes of shares increased from 4,75 per cent in September 1980 to 6,54 per cent in December 1981 and 9,37 per cent in June 1982. Despite this increase, the level of share yields remained considerably below that of fixed-interest security yields. In June 1982 the yield gap between long-term government stock and shares still amounted to 5,12 per cent, although a narrowing of 1,67 per cent had occurred from December 1981.

Mortgage market constrained by shortage of funds

Judging by the lending operations of building societies, which are by far the largest group of financial intermediaries in the mortgage market, activity in this market during 1981 and the first half of 1982 was severely constrained by a shortage of funds. Owing to a substantially smaller inflow of new funds, the building societies reduced the amount of new mortgage loans granted from a monthly average of R383 million in 1980 to R142 million in 1981 and R162 million in the first half of 1982. At the end of 1980 the societies' commitments in the form of loans granted but not yet paid out amounted to R1 635 million. In order to reduce these commitments to a level more compatible with the smaller inflow of funds, the societies maintained the amount of new loans paid out at a fairly high level during 1981. This had the effect of lowering loan commitments to R513 million at the end of 1981, before they increased again slightly to R551 million at the end of June 1982. This policy left little scope for the societies to increase their holdings of prescribed securities. These holdings actually declined by R27 million during 1981, but showed a seasonally adjusted increase of R47 million during the first half of 1982.

In line with the increase in their own deposit rates and in interest rates in general, the societies raised their mortgage rates in three steps by a total of 3¼ per cent during 1981. This was followed by two further increases of 1 per cent each in February and July 1982. These increases raised the rate on new home mortgages from a range of 9,00 — 11,00 per cent at the end of 1980 to a range of 14,25 — 16,25 per cent in July 1982. At these higher levels, some of the mortgage rates were barely positive in real terms and even at the

Real interest rates



higher end of the range, real mortgage rates were considerably lower than, for example, the real prime overdraft rates of commercial banks.

Buoyant real estate market

Despite the general scarcity of funds in the economy, and more particularly the lower level of mortgage lending by the building societies, the real estate market remained buoyant during 1981 and the first half of 1982. The monthly average value of real estate transactions rose by 6 per cent in 1981 and by a further 13 per cent in the first half of 1982. A decline in residential property transactions during this eighteen-month period was more than compensated for by an increase in non-residential property transactions. The continued buoyancy of the real estate market, at a time when activity in other sections of the capital market tended to decline, was apparently due to an increase in the fixed property investments of insurers and pension funds.

Fixed property market