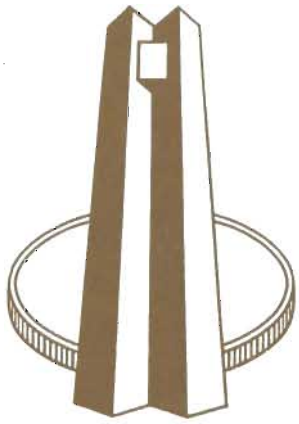
South African Reserve Bank
Annual Economic Report 1990



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 seventieth ordinary general meeting to be held on 28 August 1990

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Hierdie verslag is ook in Afrikaans beskikbaar

Introduction

The Reserve Bank's *Annual Economic Report* for 1989, released in August of that year, suggested that an upper turning-point of the South African business cycle had been reached, "at least in a technical sense", towards the very end of 1988 or in the first few months of 1989; believed that a "soft landing" would still be possible; and did not rule out the possibility of some further growth in domestic output and spending in the quarters ahead, which would be compatible with some relief for the balance of payments. The *Report*, however, also identified various "problem areas" with regard to inflation, the then prevailing relatively high rates of monetary and credit expansion, the low level of the foreign reserves, and the still relatively high level of (current) government expenditure, as well as certain other inadequately resolved problems containing elements of a more "structural" character.

Fresh policy approaches to these matters in the course of the year to mid-1990 arose from two major shifts in the authorities' broad policy orientation. Firstly, the curbing of inflation was stated by the Reserve Bank to be the prime objective of the Bank's policies early in the 1989/90 review period. In a similar vein, the Bank's Board of Directors and management in April 1990 formulated and adopted a clearly defined "mission" in terms of which the protection of the domestic and external value of the rand was accepted as the prime objective of the Bank. Specifically, the Bank would strive for a lowering of the South African inflation rates to levels that will at least not be higher than the average of inflation in the economies of South Africa's main international trading partners.

Secondly, important moves towards the normalisation of various aspects of South Africa's external relationships and the domestic socio-economic and political situation since the disturbances of the mid-1980s, have for some time now allowed more attention to be paid to structural deficiencies of the South African economy and to the formulation of medium-term or long-term economic policies and strategies. These policies seek to rectify earlier structural distortions of the economy and to establish, among other things and within the framework of market-orientated policy action, realistic values for certain "key" prices or other variables in the economy (such as the level of *real* interest rates, the real effective exchange rate, real wages, and the real burden of taxation as the price of government services). Such key variables should be mutually consistent while also being reflective of the relative scarcities of the various means of production and productive resources in general, at the disposal of the economy.

As a part of this thinking, the Reserve Bank on various occasions during the year also expressed its strong preference for interest rates that will be manifestly positive in real terms in virtually all conceivable conditions. The Bank was clearly justified in its view that its uncompromising anti-inflationary attitude – apart from seeking to address inflation as a severe socio-economic problem in its own right – would also serve the authorities' structural and growth objectives well, inasmuch as (1) international economic opinion has increasingly come to accept that the general price level is the only variable which is effectively under the control of central banks in the long run, and (2) relative price stability is conducive to stable economic growth. The establishment and preservation of relative price stability must therefore rank as the prime contribution which central banks can make to the fostering of economic growth and development.

Problem areas in the economy in the third quarter of 1989 as referred to above, the Reserve Bank's new and unyielding anti-inflation attitude and the Bank's predilection for clearly positive real interest rates, the need to deal a blow to inflation expectations, and overseas interest rate developments, provided reasons for a further Bank rate increase (from 17 to 18 per cent) in October 1989, as part of a mild further tightening of the Bank's moderately restrictive policies during the year.

A cyclical downturn of the economy has now definitively been established to have begun in March 1989. Positive growth of the real gross domestic product was maintained, however, in the economy's "consolidation" phase in the second and – as had been expected – also in the third quarter of 1989. This was followed by a mild contraction (at annualised rates of the order of 1½, 1½ and not quite 1 per cent) in the ensuing three quarters to mid-1990. A slightly negative rate of real growth was displayed by the gross domestic product over the five-quarter downswing period to mid-1990 as a whole. Slightly positive real growth (of some ½ per cent) was, however, still recorded in the four quarters to mid-1990 vis-à-vis the four quarters to mid-1989.

On the *spending* side of the economy, total real gross domestic expenditure fell back markedly in the third and the fourth quarter of 1989. It appeared, how-

ever, to have found new support in the first quarter of 1990 and actually staged a minor recovery in the second quarter. Its average level in the four quarters to mid-1990 was some 3 per cent lower than its average level in the four quarters to mid-1989.

Factors sustaining aggregate domestic demand consisted, firstly, of relative firmness of total real private consumption expenditure, which still rose mildly in the face of a modest contraction of total personal disposable income. Secondly, real government consumption expenditure, after having increased very sharply in the first quarter of 1989, was maintained at a high average level in the ensuing five quarters. Finally, only a modest rate of decline was recorded in total real gross domestic fixed investment over the five-quarter downswing period.

The "soft landing" of the economy in 1989 therefore translated eventually into a cyclical downswing that, in its first five quarters, remained characterised by its unusual mildness on both the output and the expenditure side of the economy. Apart from the relative firmness of domestic final demand, domestic production was also sustained to an important degree by continued strength of the South African merchandise export performance, especially in the first quarter of 1990, and of the "net foreign balance" (i.e. the excess of exports of goods and non-factor services over imports of such goods and services) as measured in the framework of the national accounts.

On the *balance of payments* front, the mostly well-maintained vigour of merchandise exports, a rather modest retreat of the value of merchandise imports from the first half of 1989 to the first half of 1990, and (more recently) a somewhat easier position on the services account, caused the quarterly average current account surplus (seasonally adjusted and at an annualised level) to recover from some R1,4 billion in the first half of 1989 to R4,8 billion in the second half and to R4,6 billion in the first half of 1990. Assisted by a decline in the total net outflow of capital in the four quarters to mid-1990, the reinvigorated current account surpluses permitted a modest strengthening of the *net* foreign reserves. They also contributed to a firming and subsequent increased stability of the effective exchange rate of the rand.

In the *monetary and credit* sphere, factors such as the cooling-down of the economy, the gradually spreading and intensifying effects of higher nominal and real interest rates, and the effect of shifting interest rate expectations on "liquidity preference proper", caused the annualised quarter-to-quarter rate of increase in M3 to decline further to a comparatively moderate 12,5 per cent in the second quarter of 1990 and the rate of increase in M3, as calculated for "guideline" purposes, to be brought down to (marginally) within the 11-15 per cent guideline range. Similarly, the annualised quarter-to-quarter rate of increase in monetary institutions' total claims on the private sector in the second quarter of 1990 was, at 15,3 per cent, less than half as high as the high points in this rate in 1988. The *average* of the more recent month-to-month increases in the banks' claims on the private sector has tended to adhere fairly closely to the guideline of an average of not more than 1 per cent per month which the banks have been requested to observe by the Reserve Bank since April 1989.

In the area of *inflation*, significant improvements were observed up to the second quarter of 1990 in the rates of increase in virtually all major price indices from the recent high points in these rates in the second quarter of 1989. The firming and subsequent relative stability of the exchange rate of the rand from the third quarter of 1989 onward caused the rates of increase in the prices of imported goods to fall back to low levels not seen since late 1987. This contributed to shrinkage of the annualised quarter-to-quarter rate of increase in the total production price index from nearly 18 per cent in the second quarter of 1989 to 9,2 per cent in the first quarter of 1990. However, a reacceleration of the rate of increase in the production price index (arising from more rapid *domestic* price increases) was registered in the second quarter. Also, the abatement of inflation in consumer prices generally failed to match fully the more impressive declines in the rates of increase in other price indices. From high points of 18,0 per cent and 15,7 per cent in 1989, the quarter-to-quarter and twelve-month rates of increase in the consumer price index had retreated, on balance, to 13,1 and 13,6 per cent in the second quarter of 1990 and in June 1990 respectively.

Compilation of the regular annual balance sheet of pluses and minuses in recent economic developments and in current economic conditions therefore gives cause for feeling encouraged rather than satisfied. On the positive side of the balance sheet should be recorded that a notable measure of strength was maintained on the balance of payments, and that the debt repayment obligations in terms of the standstill arrangements – which, potentially, could have been more troublesome in the second quarter of 1990 than in most earlier or subsequent quarters – were disposed of with minimal disturbance to the money and foreign exchange markets. Also clearly to be listed on the plus side are the various "movements in the right direction" of the firmness and stability of the exchange rate, the recently higher proportions of refinancing of maturing foreign loans, the slight improvement in the net foreign

reserves, the abatement of the inflation rates, and the gradual moderation of the rates of monetary and credit expansion.

On the debit side it must be recorded that these results were attained against a background of a near-stagnant and (more recently) mildly slackening economy, of continuing low and shrinking levels of aggregate domestic saving and investment, and of clearly inadequate powers of employment creation of the formal sector of the economy. Attention is also drawn in the main text of this *Report* to the ageing of the capital stock in private manufacturing industry and to the attendant risks of obsolescence and of diminishing competitiveness of South African products in the international markets. The surplus on the current account of the balance of payments in the first half of 1990 also did not reach the hoped-for annualised level of R6 billion, and the foreign reserves still need a major re-strengthening. Last but not least, the inflation rates still remained far above those of South Africa's principal international trading partners, and an arduous road may still lie ahead in bringing them down to more acceptable levels. In the South African situation, reductions of the rates of *monetary and credit expansion* are themselves dependent to a major extent on a lowering of the inflation rates.

A key role in the South African inflation is now played by inflation expectations and nominal wage developments, and by the obvious interconnections between these two. Unduly aggressive wage demands, and employers' willingness to accede to such demands, will delay and may potentially frustrate success for the authorities' anti-inflationary policies. Industrial action, organised labour protest and labour unrest raise the perceived *effective* real cost of labour. They thereby reduce the demand for labour at any given nominal wage level and will neutralise at least partly the unions' efforts to raise the real wages of their members through more effective control over the labour supply.

Secondly, increases in the *effective* real cost of labour stand in the way of structural readjustment efforts that are aimed at bringing about capital-labour ratios more suitably adapted to South Africa's relative factor endowment. Disorderly labour conditions also add to business uncertainty and to the lack of business confidence, thereby holding back private-sector investment. Such investment as still does take place, will still be inclined to embody too high a degree of capital intensity of the production techniques and processes involved. Finally, by holding back output and the growth of output, unsatisfactory labour relations eventually also limit the Government's powers to raise the community's well-being through education and training, improved housing and health care, and social upliftment in general.

In the area of *government finance*, the year under review witnessed an outcome to the 1989/90 Budget that was characterised by high discipline over government expenditure, a substantial underestimation of revenue, and a deficit before borrowing that was well below the Budget estimates and amounted to less than 2 per cent of gross domestic product during the fiscal year. The Budget for 1990/91, as presented by the Minister of Finance on 14 March 1990, provided for a fairly moderate deficit before borrowing which, nevertheless, implied a relapse into government dissaving. A *positive* (and rising) contribution to domestic saving, as calculated for national accounts purposes, was, however, made by general government in the three quarters to mid-1990, i.e. in the second half of fiscal 1989/90 and the first quarter of fiscal 1990/91.

The *capital markets* in the year to mid-1990, apart from displaying some extraordinarily high levels of trading activity, also saw a number of major regulatory, institutional and organisational developments. These included, for example, the launching of South Africa's first mortgage securitisation scheme and the start of business of the South African Futures Exchange.

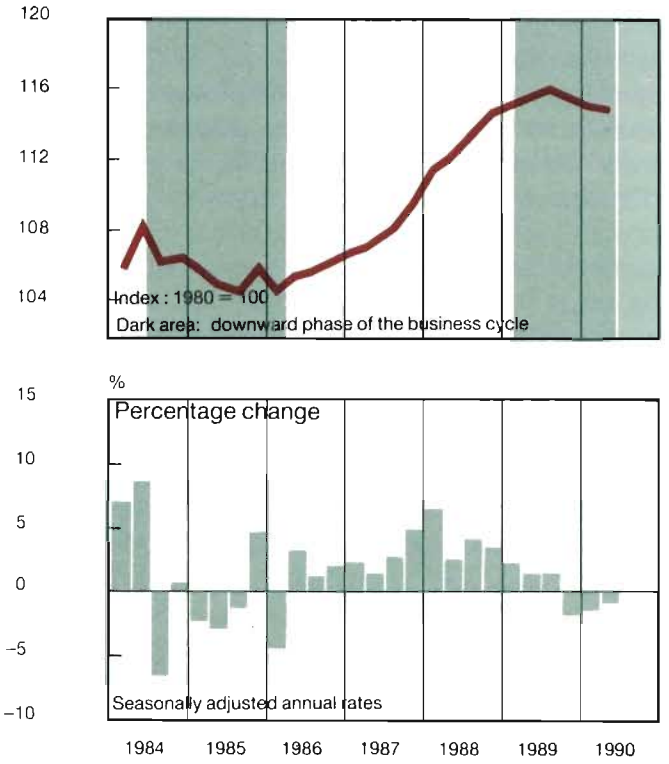
Domestic economic developments

Trends in output

A cyclically downward movement of the South African economy was suggested by the composite business cycle indicators to have started from approximately the beginning of 1989. Against this, the more definitive diffusion indices now indicate conclusively that an upper turning-point of the business cycle was reached in February 1989 and that a phase of consolidation, which has more recently hardened to a light recession, commenced in March 1989. The second quarter of 1989 therefore ranks as the first quarter of this cyclical downturn for data which are available only on a quarterly basis.

Positive growth in the real gross domestic product, at seasonally adjusted and annualised rates of some 1½ per cent, was still maintained by the economy during its consolidation phase in the second and the third quarter of 1989. *Negative* real growth, similarly at annualised rates of around 1½ per cent, was subsequently recorded in both the fourth quarter of 1989 and the first quarter of 1990. The modest contractions of aggregate real output in these two quarters could, however, still be attributed essentially to downward reactions of real value added in the primary sectors, i.e. in agriculture and in the mining industry, and be held to have left the broader economy essentially unaffected. In contrast, the mild further shrinkage of total real gross domestic product in the second quarter of 1990 (which is provisionally estimated to have reached a seasonally adjusted and annualised rate of not quite 1 per cent) involved a modest new contraction in real value added by the secondary sectors and a "downwardly biased" movement in real tertiary production, in addition to some further decline in real output by the mining industry.

Real gross domestic product

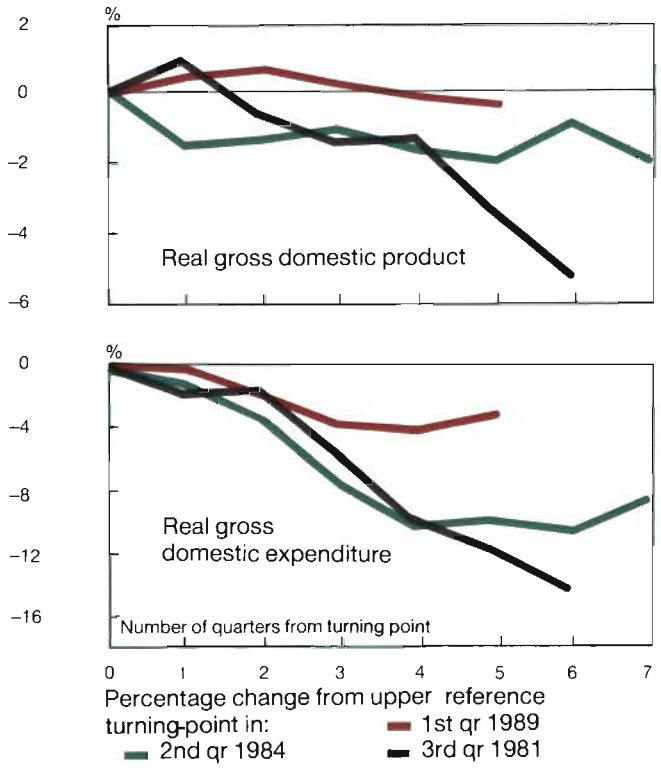


The three consecutive quarters of declines in aggregate real production from the fourth quarter of 1989 onward leave little doubt as to the recessionary character of current economic conditions in more than a purely technical sense. Developments in the first two quarters of 1990 also do not leave much hope that positive real growth may still be attained in the calendar year 1990 vis-à-vis the preceding calendar year.

Over its full five quarters to mid-1990, however, the current downswing as a cyclical phenomenon nevertheless remained characterised by its unusual mildness on both the output and the domestic expenditure side of the economy. Real gross domestic product contracted over the five-quarter period concerned at an average annualised rate of not more than approximately ½ per cent. This may be compared with annualised rates of decline of 3 per cent and 2 per cent over corresponding periods in the cyclically downward movements of the economy in 1981-83 and 1984-86 respectively. Also, positive average rates of growth in real value added were displayed in the current downswing to date by both the primary and the tertiary industries; the positive growth rates in these sectors came close to neutralising the decline in real output in the industrial sectors.

On the *spending* side of the economy, aggregate real gross domestic expenditure topped out as early as the second quarter of 1988 and fell back markedly in the third and the fourth quarter of 1989. However, total real domestic expenditure appeared to have re-

Recession phase comparisons



gained a firmer footing in the first quarter of 1990 and actually staged a minor recovery in the second quarter of the year.

The South African economy obviously differs widely from the world's major industrialised countries in virtually all its main structural features. At the same time, the pattern of cyclical developments in the South African economy over the past several years has been influenced greatly by conditions and events (such as inter-group friction and civil unrest, more turbulent labour relations and the need for accommodation of the new trade union movement, and considerable uncertainties concerning the country's future constitutional dispensation, political system and socio-economic organisation) that have had no counterparts in these mature economies. Certain elements among the various factors that have served to support the levels of activity and spending in the current downswing (and have done so more visibly than in earlier downswings) have nevertheless been akin to factors that have also helped to sustain the prolonged cyclical expansion of the leading industrialised economies from late 1982 up to the present. Such factors include, for example:

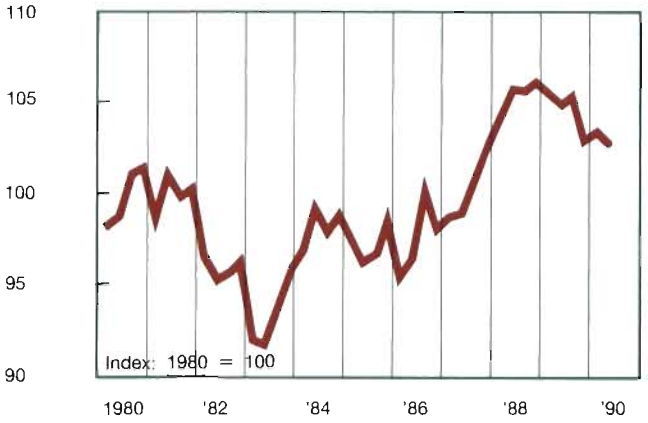
- The slowly expanding role of the services sectors (including general government services) in aggregate domestic output, and the cyclically more stable demand for the output of these sectors than for the output of the goods-manufacturing industries (which contains relatively large elements of more readily postponable expenditure on consumer durables and semi-durables and on fixed capital goods).
- Lower levels of inventories to turnover or sales, and closer management of these inventories (which allows avoidance of unintended overshoots and undershoots in inventory levels and the cyclically destabilising correction – or over-correction – of such overshoots and undershoots).
- The secularly increased share of Government in the national economy. (Even if encroachment by Government is undesirable from the point of view of optimal resource utilisation and economic growth, the cyclically insensitive or contra-cyclical character of the Government's employment and spending practices exerts a stabilising effect. This may be in addition to the effect of such "automatic stabilisers" as may have been built into the taxation and social security systems.)

In a more immediate and specific manner, however, economic activity in the current downward phase of the South African business cycle also enjoyed support from the relative strength of real merchandise exports, as reflected (in the context of the national accounts relationships) in the so-called "net foreign balance" or excess of exports of goods and non-factor services over imports of goods and non-factor services. Mainly because of a further strengthening of the merchandise export performance as a largely "exogenous" element in the prevailing business cycle situation, the real net foreign balance rose by 35 per cent to the second quarter of 1990 from the second quarter of the preceding year. The relative strength of the merchandise export performance, in turn, also served to keep up elements of domestic demand.

In contrast to the mild decline in the gross domestic product, the real gross *national* product (which provides a more appropriate measure of changes in national wealth) declined substantially from the first quarter of 1989 up to the second quarter of 1990. The annualised decline in real gross national product amounted to approximately 2 per cent over this six-quarter period. As a result, real gross national product per head of the population fell back at an annual rate of some 4½ per cent.

In a reversal of developments during most of the 1986-89 upswing, the decline in real gross national product in the five quarters to mid-1990 could be

Real gross national product



attributed, firstly, to an increase in real net factor payments to the rest of the world. Real net factor payments reached a low point in the first quarter of 1989, but rose in subsequent quarters mainly on account of increased payments of interest and (until the end of 1989) of dividends on foreign investments. Increased dividend payments at the beginning of the downward phase were a reflection of the buoyant financial results of South African companies in 1988 and the first half of 1989; higher interest payments arose from the general hardening of interest rates in South Africa as well as in the major overseas economies, and from non-resident investors' increased holdings of fixed-interest-bearing South African securities.

Secondly, the South African terms of trade, which had improved during a large part of the 1986-89 upswing in 1987 and the first half of 1988, deteriorated from the middle of 1988. This was mainly a matter of the downward trend in the dollar price of gold which had set in from the beginning of 1988; export prices generally, however, weakened relative to import prices throughout 1989. A *shrinking* of the adverse terms-of-trade adjustment subsequently became apparent in the second quarter of 1990, because of a decline in international crude oil prices and a firming in the second quarter of the world prices of certain South African export commodities.

Sectoral output performances

An analysis of output performances by sector shows that the net decline in aggregate real output during the five downswing quarters to mid-1990 as a whole was due entirely to a contraction of real value added in the *secondary* sectors: mild increases in real production were still recorded, *on balance*, both in the primary sectors and in the services industries over this five-quarter period. A slightly different outcome would have been reported, however, if the upper turning-point of the business cycle had been found to have been reached in late 1988 rather than in early 1989. Also, by the second quarter of 1990 mining production had been decreasing again for the past two quarters; aggregate real output of the services industries in this quarter was barely higher than in the first quarter of 1989.

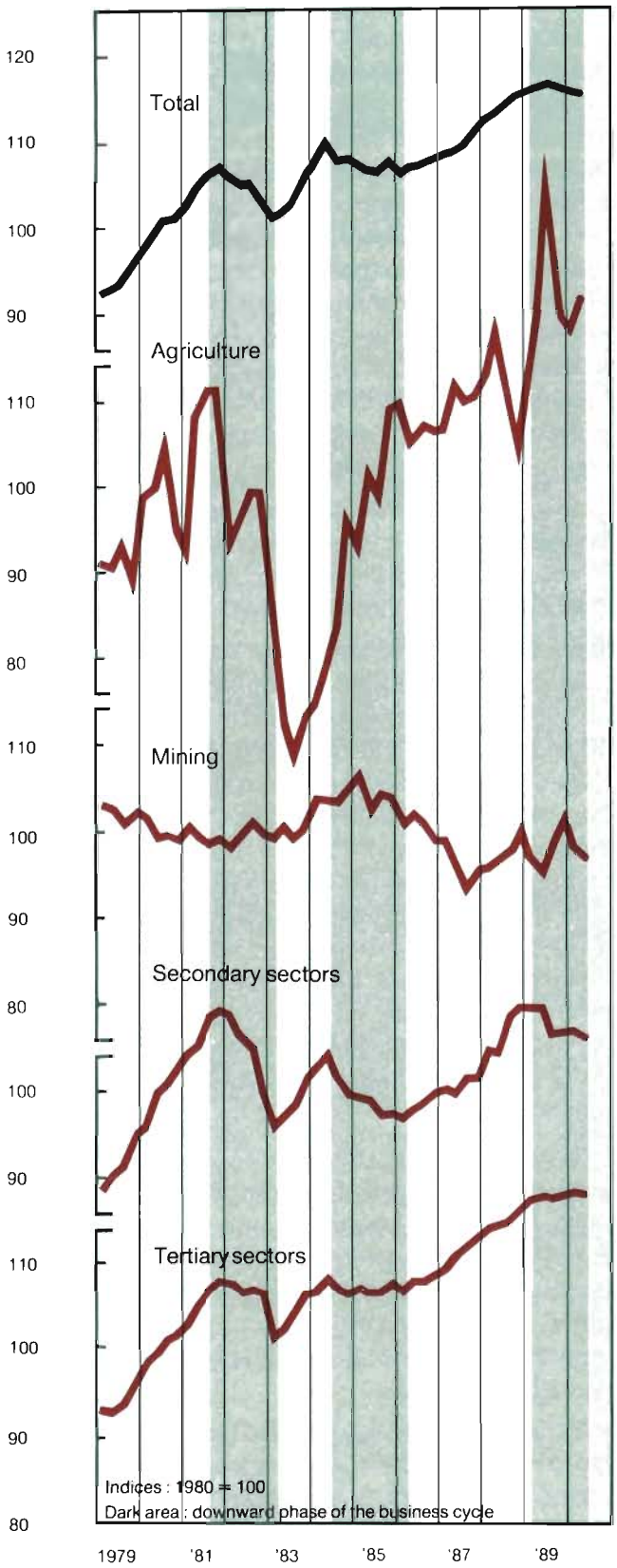
Real value added by the *primary sectors* rose, on balance, during the five quarters to mid-1990 at an annualised rate of some 2 per cent. This comprised annualised rates of increase of 6 per cent in real agricultural production and of nearly ½ per cent in real output of the mining industry.

Agricultural real output reached a new high point for the 1980s in the third quarter of 1989. This could be attributed mainly to the harvesting of the bulk of the country's second-largest maize crop ever (the 1988/89 crop of 11½ million tons) during that quarter; to increases in real gross incomes in horticulture and livestock production; and to lower rates of increase in farmers' real outlays on intermediate goods in the course of 1989. Agricultural real value added was actually some 11½ per cent *lower* in the second quarter of 1990 than at its peak in the third quarter of 1989, but was still some 3 per cent higher than at its high point in the course of the preceding upswing in the second quarter of 1988.

Real value added in the *mining sector contracted* at an annualised rate of 1½ per cent in the 1986-89 upswing, but *rose*, on balance, at an annual rate of nearly ½ per cent in the current downswing to mid-1990. This was the net result of real output increases in coal and "other" mining which slightly more than made up for production declines in the gold- and diamond-mining industries.

The decline in physical *gold* production was due to a concurrence of factors which adversely affected the gold-mining industry. Such factors included sporadic labour unrest, technical problems at certain mines, and a decline in the average grade of ore milled. In addition, the industry was affected in a steadily more acute manner by its longer-term problem of rising working costs in the face of a weakening dollar price of

Components of real gross domestic product



gold and the recently more stable exchange rate of the rand.

Increases in real value added by *coal* and *"other" mining* reached annualised rates of 3 and 2 per cent in the current downswing period. This was essentially a reflection of firm foreign demand. The rise in coal production nevertheless compared poorly with output increases in the cyclical down-swing of 1984-86. This was partly due to Eskom's earlier overestimation of the growth in the demand for electricity and its present concentration on the use of its more efficient coal-burning generators.

Aggregate real value added in the *secondary sectors* declined moderately in the current slow-down at an annualised rate of 2½ per cent. This may be compared with the fairly impressive growth rate of these sectors of 4 per cent per annum in the 1986-89 upswing, but also with annualised rates of decline of as much as 8 per cent and 4½ per cent in the downswings of 1981-83 and 1984-86 respectively. The fairly modest tempo of the contraction of industrial production in the current downswing to date may be attributed partly to the fact that real value added in the secondary sectors assumed a downward tendency only one quarter after the start of the general cyclical slow-down in the second quarter of 1989.

Within the secondary sectors, real value added in *manufacturing* declined at an annualised rate of 3½ per cent, against rates of decline of 9 and 4½ per cent in the down-swings of 1981-83 and 1984-86. Real manufacturing output in the second quarter of 1990 was thereby brought down to a level that was some 6½ per cent lower than at its historical high point in the fourth quarter of 1981.

Output in the secondary sectors in general and in manufacturing in particular was supported in the current cyclical contraction to date by the strength of merchandise exports as well as by the relative firmness of domestic final demand. Against this, however, manufacturing concerns had to contend with a heightened incidence of industrial action, unauthorised and politically motivated absenteeism, stay-aways, worker intimidation and labour unrest. Problems of this nature tended to become more severe in the first half of 1990, and in the second quarter in particular.

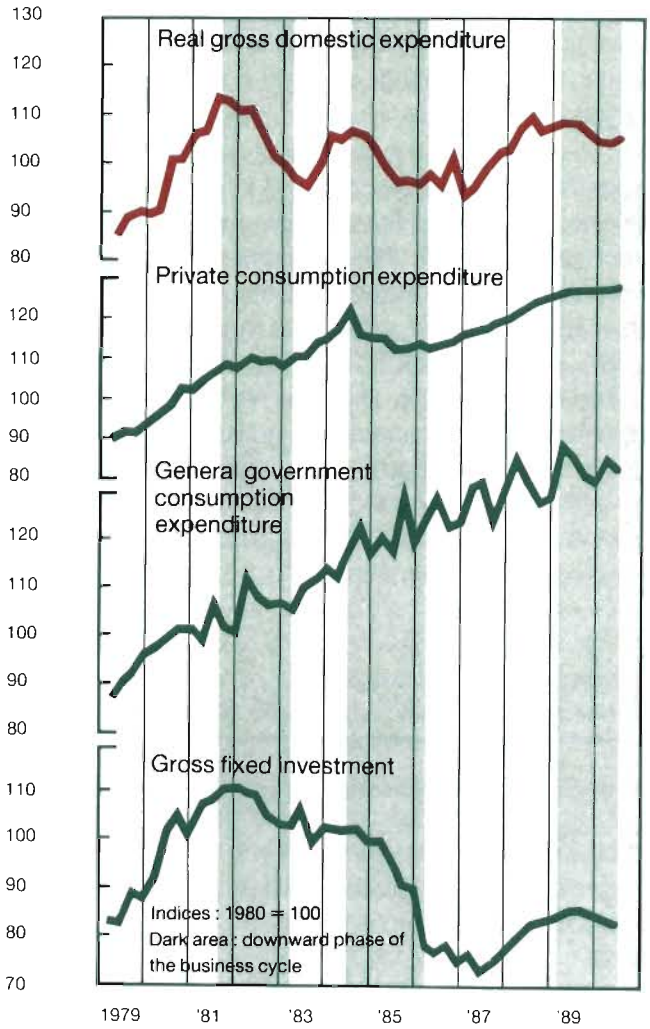
Real value added in the *tertiary sectors* continued to rise in the five quarters to mid-1990 at the annualised rate of nearly ½ per cent already referred to. This may be compared with significant output declines in the preceding two cyclical downswings. Like output in the secondary sectors, output in the services sectors was supported by the sustained, relatively high, levels of domestic final demand as well as by the major strengthening of the net foreign balance.

Real gross domestic product generated by the sectors *transport, finance* and *general government* rose during the downswing to date at annualised rates of approximately 1 per cent, whereas real output in *commerce declined* at a rate of nearly 1 per cent. Output declines in commerce were concentrated primarily in wholesale and motor trade. The motor trade was hampered by the relatively high prices of motor vehicles and relatively high interest rates, as well as by labour problems at certain manufacturing plants, irregular supplies and low inventories.

Transport, storage and communication were favoured by the "soft landing" character of the downswing throughout 1989 as well as by the buoyancy of export trade. The *financial services sector* benefited from sustained high credit demand in much of 1989, a positive investors' mood and high trading activity in various financial markets especially in late 1989 and early 1990, and the high profile given to the privatisation of Iscor.

Growth in real value added by *general government* slowed down from an annualised 3½ per cent in the 1986-89 upswing to an approximate 1 per cent, annualised, in the current downswing phase to mid-1990. Employment figures in general government were affected by the authorities' more conservative recruiting practices as well as, for some time, by a rising number of staff resignations. Significant increases were still recorded, however, in the numbers of workers employed in certain departments of the governments of the independent and self-governing national states.

Real gross domestic expenditure and its components



Trends in domestic expenditure

Total real gross domestic expenditure reached its most recent peak fairly early in the 1986-89 upswing, namely in the second quarter of 1988. It then declined in the third quarter of 1988, but strengthened again in the fourth quarter of that year and in the first quarter of 1989. The steadily spreading effects of the authorities' more restrictive monetary and fiscal policies subsequently caused total real domestic expenditure to fall back at annualised rates of some 6½ and 7½ per cent in the third and the fourth quarter of 1989 and at a rate of 1½ per cent in the first quarter of 1990. Real domestic spending recovered somewhat, however, in the second quarter of 1990, at an annualised rate provisionally estimated at 3 per cent.

In the past five quarters to mid-1990 real gross domestic expenditure retreated, on balance, at a fairly modest annualised rate of nearly 3 per cent. This may be compared with annualised rates of contraction of 9½ and 5 per cent over comparable periods in the preceding two cyclical downswings. The relative moderateness of the current decline in aggregate real spending to date derived mainly from the relative firmness of real private consumption expenditure and from the comparatively limited extent of the decline in total real gross domestic fixed investment over the five quarters concerned. Since the middle of 1989, however, the softening of domestic demand has been more broadly reflected in all principal spending categories.

Changes in the various components of total real gross domestic expenditure over the five quarters to mid-1990 ranged from an *increase* at a seasonally adjusted and annualised rate of 1 per cent in real private consumption expenditure to a *decline*, at a rate of 1½

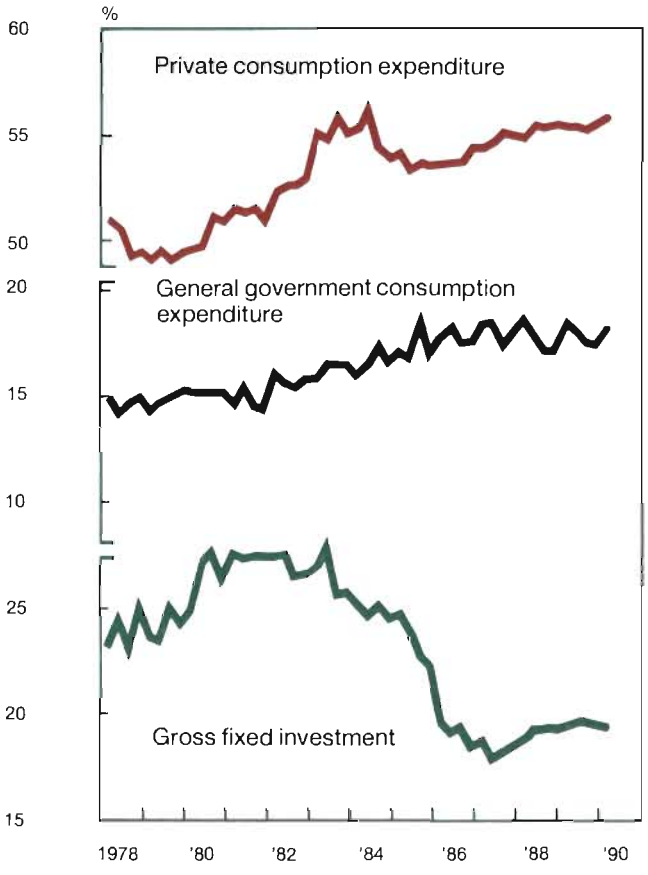
per cent, in total real gross domestic fixed investment, and to a marked contraction, at a rate of 3 per cent, in real consumption expenditure by general government. The decline in the contribution of the change in real inventories to the real gross domestic product was equal to nearly 3 per cent of the gross domestic product.

The index of total real gross domestic *final demand* reached a new high point (of 117,4; 1980 = 100) in the first quarter of the current downswing phase (i.e. in the second quarter of 1989). This new high point in domestic final demand was 1½ percentage points higher than its previous record value in the second quarter of 1984, i.e. at the peak of the 1983-84 mini-boom.

The small net gain that was recorded in total real domestic final demand over the five-year period concerned was based on a relative strengthening of real private and government consumption expenditure against a declining trend in the relative importance of real fixed capital formation. In what must be regarded as a disquieting longer-term phenomenon, South Africa has gradually developed more into a consumer society. The shares of real private and real government consumption expenditure in total real gross domestic final demand rose from some 55 and 16 per cent in the early 1980s to approximately 60 and 19 per cent towards the end of the decade. Conversely, the share of real gross domestic fixed investment retreated from some 29 per cent to approximately 21 per cent during this period. Similar tendencies are apparent from the longer-term behaviour of the ratios of private-sector and government consumption expenditure to the gross domestic product, i.e. from the private and government sectors' average "propensities to consume".

Various factors (including certain structural factors) served to support the relative strength of private-sector consumer demand in the 1986-89 upswing and in the subsequent downswing. Together with a sustained high *level* of real government consumption expenditure, the net *increase* in real private consumption expenditure in the five quarters to mid-1990 very nearly neutralised the effect on total real final demand of the decline in real fixed investment expenditure during the downswing phase to date. The South African economy's present high propensity to consume must currently rank among factors that may delay a return to a somewhat more relaxed stance of the authorities' policies.

Average propensity to consume and invest

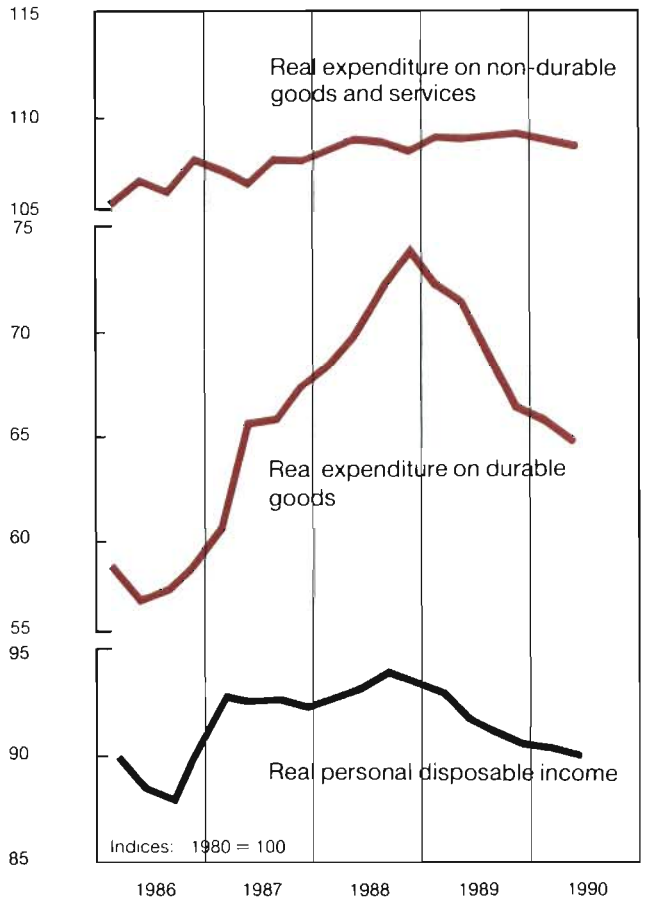


Private consumption expenditure

Total real private consumption expenditure, which had increased remarkably steadily at an average annualised rate of some 4 per cent in the 1986-89 upswing to the first quarter of 1989, rose further at an average annualised rate of 1 per cent in the five quarters to mid-1990. This rate of increase may be compared with an annualised rate of *decline* of 4½ per cent in the 1984-86 downswing period. It was based on increases in households' real spending on non-durable goods and on services at an annualised rate of 2 per cent, in conjunction with moderate contractions in households' real spending on durable and semi-durable goods.

The decline in households' real spending on consumer durables in the current cyclical downswing reached an annualised rate of 6 per cent, against a rate of no less than 28½ per cent in the previous downswing period of 1984-86. Lower rates of contraction than in this earlier period were also apparent in real spending on the major sub-categories of outlays on durables, such as spending on personal transport equipment and on furniture and household appliances. Real spending on personal transport equipment fell back at an annualised rate of 13½ per cent. This, how-

Personal disposable income and expenditure per capita



ever, was no more than one-third as fast as the decrease in such spending in the downswing from late 1984 to early 1986.

A "change of gear" in the tempo of increases in total real private consumption expenditure actually became apparent in the first quarter of 1989. The deceleration concerned therefore followed with a lag of some four quarters the start of the cyclical rise in interest rates which had begun in the closing weeks of 1987 or in the first quarter of 1988. A lag of this length is well within the range of normality in the context of timing relationships in the South African business cycle.

As was noted earlier, a variety of factors contributed to the *relative* firmness of real private consumption expenditure in the current downswing phase to date. Such factors included the sturdy increases in total real personal disposable income that had taken place in 1988, some further small increases in real disposable income in early 1989 and early 1990 (despite households' higher debt service commitments and tax payment obligations), and the very limited decline which, on balance, was recorded in total real disposable income to the first half of 1990 from the second quarter of 1989. Also, a sustained rise was recorded in real remuneration per worker in the non-agricultural sectors of the economy, and an increase was registered in the percentage share of aggregate labour income in total factor remuneration (against a decline in this share in the first six quarters of the downturn of 1984-86).

Relatively firm levels of personal income in turn supported comparatively high levels of consumer borrowing. Relatively heavy recourse was had by households to consumer credit in both the 1986-89 upswing and in the economy's consolidation phase in the middle quarters of 1989. Moreover, consumer credit was accessible at interest rates which, in *real* terms, were notably lower in 1989 and 1990 than in late 1984 and early 1985. Finally, real expenditure on consumer durables was cushioned by the pressures of replacement demand: the stock of consumer durables held by households in 1989 and 1990 was of a higher average age, of more heavily depreciated value, and significantly smaller in real terms, than in 1984.

The sustained rise in households' real expenditure on *non-durable* goods and on services reflected the more essential and non-discretionary nature of such expenditures as well as some substitution of spending on non-durables for spending on durable goods. Increases in the share of non-durable consumer outlays in the total of private consumption expenditure may also have reflected an increase in the relative importance of spending by low-income earners in the so-called informal sector of the economy.

Consumption expenditure by general government

Real consumption expenditure by general government rose very strongly (at an annualised rate of 40 per cent) to a relatively very high level in the first quarter of the calendar year 1989, but declined markedly in the ensuing three quarters. Its (net rising or net declining) behaviour in the course of the current downward phase of the business cycle to date therefore depends greatly on whether the upper turning-point of the general business cycle is determined to have been in the final quarter of 1988 or in the first quarter of 1989.

Accepting the authoritative evidence of the diffusion indices that the business cycle peaked in the first quarter of 1989, real outlays by general government on intermediate goods and services *declined* at an annualised rate of 8½ per cent during the five-quarter

downswing period to mid-1990; the real wage bill of general government (broadly representing the level of employment by public authorities) still *rose* at an annualised rate of more than ½ per cent; and total real government consumption expenditure *declined* at the annualised rate of 3 per cent to which reference was made earlier.

If the business cycle were assumed to have peaked in the fourth quarter of 1988, the resultant net *increase* in real government consumption expenditure in the *six* quarters to mid-1990 would have ensured the rising ratio of such expenditure to the real gross domestic product that has been found to be a characteristic of earlier business cycle downswings. In either case, however, the generally *high* level of real government consumption expenditure served to hold up the level of real domestic final demand in 1989 and the first half of 1990 and contributed to the high *overall* propensity to consume of the South African economy (comprising both the government sector's and the private sector's consuming proclivities) in the present downward phase of the business cycle.

The longer-term upward trend in the ratio of real government consumption expenditure to total real domestic final demand and to the real gross domestic product (from an average of 14 per cent of gross domestic product in the 1960s to nearly 15 per cent in the 1970s and more than 17 per cent in the 1980s, and to a high point of 19½ per cent in 1989) was matched by a broadly commensurate rise in the percentage ratio of the sum total of direct and indirect taxes to gross domestic product. This ratio reached a level of 26½ per cent in 1989.

Various announcements have been made since March 1990 concerning expenditures in fiscal 1990/91 in addition to those proposed in the March 1990 Budget. In the light of these announcements, the importance of continued restraint over government consumption expenditure – which may well be considered a prerequisite for a successful programme of structural re-adjustment and reform, and for short-term stabilisation purposes – must again be emphasised.

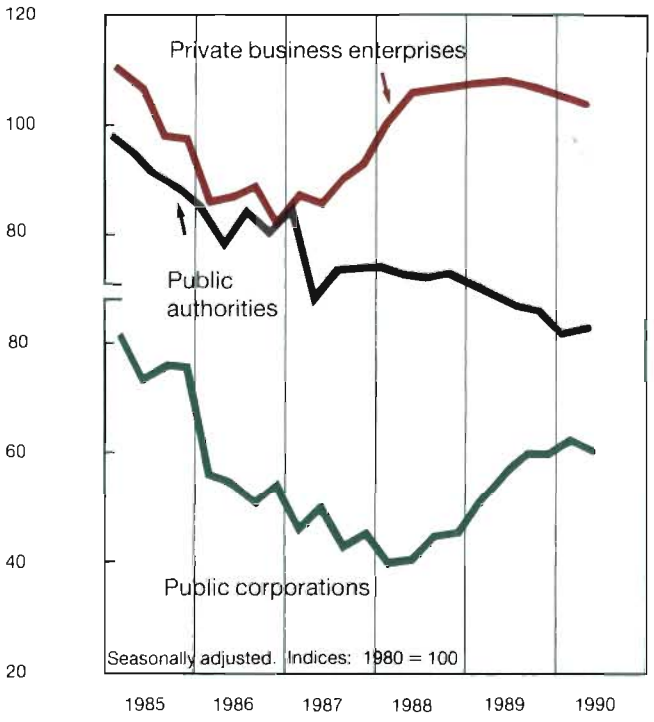
Gross domestic fixed investment

Aggregate real gross domestic fixed investment rose at a relatively modest annualised rate of 2½ per cent in the 1986-89 upswing and declined at an annualised rate of 1½ per cent in the five quarters of the current downswing to mid-1990. On a calendar year basis, the increase in total real gross domestic fixed investment of 9 per cent in 1988 was followed by a rise of only 4 per cent in 1989 and by an average annualised rate of decline of some 4½ per cent in the first half of 1990.

An analysis in institutional terms shows that a large *increase* at an annualised rate of 14 per cent in real fixed capital expenditures by *public corporations* in the five quarters to mid-1990 was more than fully neutralised by further reductions in such expenditures by *public authorities*. The larger part of the downturn in real fixed capital formation in the current downswing was, however, accounted for by a decline in real fixed investment by the private sector.

Although still benefiting from spill-overs of investment projects and contracts from the preceding cyclical expansion, *private-sector* real fixed investment decreased at an annualised rate of 3 per cent in the current downswing, after having increased at a rate of 7½ per cent in the upswing phase. Factors contributing to the scaling-down or shelving of private-sector investment plans included the generally less impressive financial results, cash flows and liquidity positions of corporations from the second half of 1989 onward; comparatively high real interest rates; a softening of world commodity markets during most of the downswing period, and the slackening of real domestic

Real gross domestic fixed investment



monetary demand; no or little prospective real growth of the South African economy in 1990; and widening margins of unused production capacity. In addition, business firms still faced considerable uncertainties which arose from unsettled issues with regard to South Africa's future socio-political dispensation and the effective real cost of labour services.

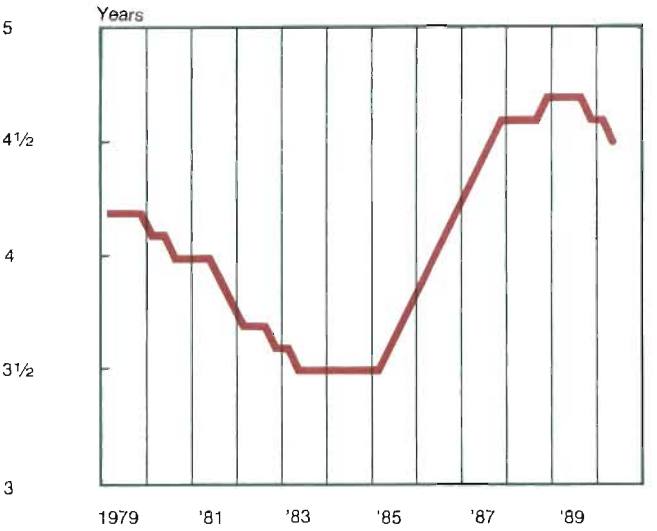
Slow-downs in real fixed capital formation in the private sector during the current downswing were recorded in agriculture, manufacturing and finance; actual declines were registered in the mining industry and in commerce during 1989 as a whole. In the first half of 1990 the more prominent fall-offs in investment were registered in agriculture and mining and in the sector finance, business services and real estate.

Real fixed investment by *public authorities* declined during the current downswing phase at an annualised rate of 9½ per cent. This meant that such investment has now been declining for more than seven years since 1983. The more recent declines in fixed investment by public authorities could be attributed to significant reductions in fixed investment spending by the *business enterprises of general government*. As such, they were a further reflection of rationalisation programmes instituted by the Department of Posts and Telecommunications and by Transnet.

Real fixed investment by *general government* fell back at an annualised rate of 23 per cent, after modest increases at rates of ½ per cent and 2½ per cent had been recorded both in the cyclical downswing of 1984-86 and in the upswing of 1986-89. Real fixed investment expenditure by *public corporations*, on the other hand, *rose* at a rate of 14 per cent (from a very low base) in the five quarters to mid-1990 after decreases had been registered in both the previous downswing and the preceding upswing. This could mainly be attributed to progress in the on-shore and off-shore development activities of Mossgas.

A breakdown of fixed investment by *type* of capital asset during the current downward phase of the business cycle shows that real outlays on all types of assets, with the exception of spending on machinery and equipment and on transport equipment, only reached upper turning-points in the fourth quarter of 1989 and the first quarter of 1990; spending on machinery and equipment and transport equipment, on the other hand, contracted from as early as the middle of 1989. Investment in machinery, equipment and transport equipment was affected, more than other forms of real fixed capital formation (such as housing), by factors such as the slackening of domestic monetary demand and the widening of the margins of excess capacity, as well as by factors such as the surcharge on imported capital goods and the higher user cost of capital in general.

Average age of machinery and equipment in the private manufacturing sector

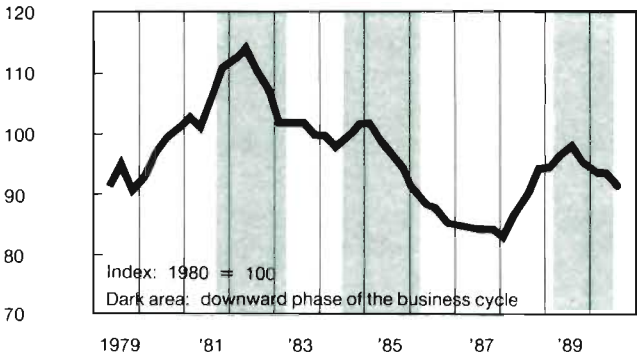


The total real capital stock in manufacturing industry rose in 1989 and the first half of 1990 for the first time since the mini-boom year 1984; this, however, was mainly due to investment activity at and on behalf of the still uncompleted Mossgas operations. Low levels of investment spending in the past several years have meant that the average age of equipment in private manufacturing has increased by nearly 30 per cent since 1984. The ageing of this equipment carries an obvious risk of increasing technological obsolescence and backwardness and, potentially, of a loss of competitiveness of South African products in the international markets.

Change in inventories

Total real inventories maintained their traditional lagged relationship to the business cycle in that they continued to rise briefly in the consolidation phase of the economy in the second quarter of 1989. Aggregate real inventories were already being reduced, however, from as early as the third quarter of 1989, when positive real growth was still being recorded in the overall economy. The change-over from real inventory accumulation to inventory decumulation in the course of the current cyclical downswing contributed 2 percentage points to the decline in real gross domestic product during this period.

Level of industrial and commercial inventories



Various factors have helped to dampen the amplitude of the inventory cycle, and therefore also its reinforcing and amplifying effect on cyclical fluctuations in general business conditions, in the past several years. Firstly, improved information systems and the use of superior techniques of inventory management have allowed manufacturers and traders to link inventories more closely and continuously to orders; this has resulted in a reduction of the levels, and in an increase in the stability, of the various ratios of inventories to sales and of real inventories to real gross domestic product. Thus, the average level of real *industrial and commercial* inventories relative to real gross domestic product in the non-agricultural sectors of the economy declined along a long-term downward trend line from 25 per cent in the downswing of 1981-83 and 22 per cent in the downswing of 1984-86, to approximately 20½ per cent in the current downswing to date.

Secondly, positive real interest costs of carrying inventories provide an incentive for economising on inventory holdings; they are likely to have done so in the advanced upswing conditions of 1988 and the beginning of 1989. Thirdly, the "soft landing" character of the cyclical slow-down during most of 1989 served to reduce the element of "surprise" in this change in the general business situation. It thereby also forestalled a major part of the overshoot in inventory holdings which typically tends to result from more abrupt cyclical fall-offs in economic activity and in monetary demand.

Net additions to real inventories of R1,9 billion in 1988 were followed by a further real inventory accumulation of R1,3 billion (seasonally adjusted and annualised) in the first half of 1989. Inventory *de*cumulations from the third quarter of 1989 onward were evident in particular in the mining sector, retail and wholesale trade and private manufacturing. Decreases were also recorded in the first half of 1990 in agricultural and diamond stocks-in-trade.

The decline in diamond stocks-in-trade reflected the buoyancy of the international diamond market. Reduced stocks of other primary (agricultural and mining) products similarly reflected high levels of exports relative to current production. Agricultural stocks were also affected downwards, however, by the poor 1989 wheat-growing season, and by the fact that the bulk of the 1989/90 maize crop will be harvested only in the second half of the present year.

Factor incomes

The increase in total nominal factor incomes *at market prices* slowed down only marginally from its high point of 19 per cent in 1988 to 18½ per cent in 1989. However, the average quarter-to-quarter rate of increase in this aggregate, in seasonally adjusted and annualised terms, amounted to only 14½ per cent in the third and the fourth quarter of 1989 and to 11½ per cent in the first two quarters of 1990.

The average quarter-to-quarter rate of increase in total *nominal labour remuneration*, seasonally adjusted and annualised, retreated from 21 per cent in the first half of 1989 to 16 per cent in the second half, and to 14½ per cent in the first half of 1990. The average *level* of total nominal labour remuneration in the first half of 1990 was, however, still 15 per cent higher than in the first half of 1989.

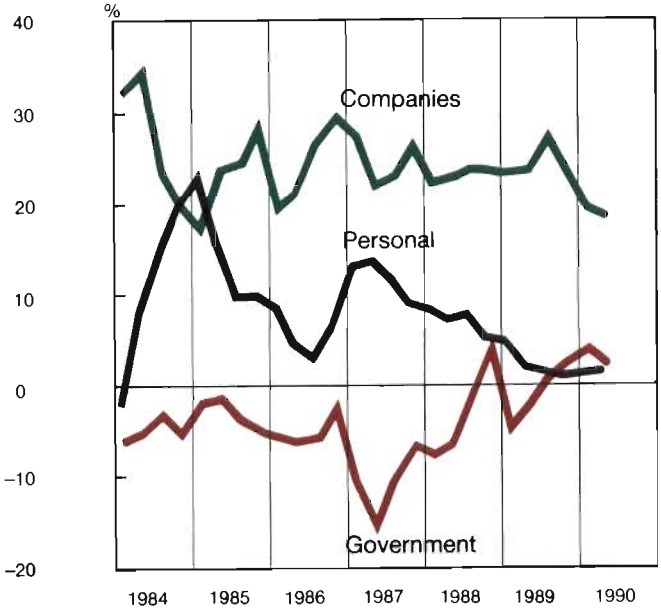
The year-on-year rise in the average nominal remuneration *per worker*, will probably not have matched fully the recent inflation rates. However, the relatively high level of this increase still reflected stubbornly high inflation expectations. It will also have incorporated the effects of the substantial wage increases that were granted to various low-wage groups of workers in the civil service from the second quarter of 1990, as well as having been influenced by occasionally successful trade union militancy.

The *operating surplus* component of total nominal factor rewards still rose substantially in the first half of 1989, but drifted downwards in the second half and levelled out in the first half of 1990. The generally weaker performance of the total gross operating surplus since mid-1989 stemmed mainly from the rise in firms' labour costs in the face of the slackening increase in monetary final demand. It was also influenced by, among other things, the effect of the weaker dollar price of gold, the relatively stable exchange rate, and

rising working costs, on the mining sector and auxiliary industries, in the second quarter of 1990 in particular.

The weakening of the gross operating surplus caused a decline in the share of the surplus in gross domestic product, as is typical of the closing stages of cyclical upswings and the initial stages of cyclical downswings. Conversely, the share of the aggregate remuneration of employees rose from its recent low point of 56½ per cent in the third quarter of 1988 to an average of 59 per cent in the first two quarters of 1990.

Components of savings as percentage of gross domestic saving



Domestic saving

The ratio of gross domestic saving to gross domestic product declined in the current downswing to mid-1990 to an average level of 22½ per cent. This may be compared with historical savings ratios in the South African economy which amounted, on average, to 24 per cent in the 1960s, 26 per cent in the 1970s and nearly 25 per cent in the 1980s. In the second half of the recession year 1985, however, the savings ratio declined to 23½ per cent.

Weakening of the domestic savings ratio in the current downward phase of the business cycle was the net result of lower contributions to gross domestic saving from the personal and corporate sectors, on the one hand, and of the newly positive and rising contributions to domestic saving from the general government sector, on the other hand.

The reduced savings contribution from the *personal sector* (which in the first half of 1990 resulted in an average ratio of personal saving to personal disposable income of about ½ per cent) was the counterpart of the relative firmness of total real private consumption expenditure in the current downswing to mid-1990. Involved in the explanation of this decline were therefore: (1) various elements of "structural" redistributions of income and expenditure, as, for example, of real income to lower-income groups and of real expenditure to workers in the informal sector; (2) elements of cyclical income redistribution, as from the gross operating surplus to labour remuneration; (3) consumption expenditure out of habit persistence, or in defence of a customary life-style, in the face of lower personal disposable income *per capita*; and (4) the pressures of replacement demand, arising from households' declining real stock of consumer durables.

The softer trend in *net corporate saving* since the middle of 1989 could be attributed to an increase in the average effective corporate tax rate (brought about by, among other things, the phasing-out of tax concessions for capital investment); to the rise in dividend pay-outs after company profits had peaked in the second half of 1988 and early 1989; and to the subsequent slowing-down of growth in the gross operating surplus of the corporate sector after the middle of 1989.

The change-over from net dissaving to net saving by *general government* from the third quarter of 1989 arose from the fact that current revenue in the fiscal year 1989/90 increased by a substantially larger amount than had been foreseen in the March 1989 Budget. Current government expenditure, on the other hand, exceeded the Budget estimates to a considerably more modest extent.

Government's higher income in fiscal 1989/90 primarily reflected sharply higher tax receipts. Increased tax receipts, in turn, sprang from the sustained high level of economic activity in early 1989 and from the very gradual slowing-down of the economy during most of the current downswing to date; from high import surcharge receipts; from the effects of fiscal drag; and from the more stringent measures that have been introduced for the more efficient collection of general sales tax dues and income tax arrears.

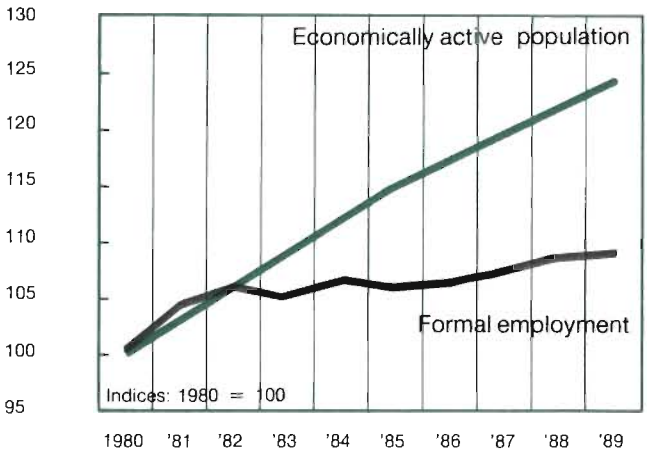
Employment

Total recorded employment in the non-agricultural sectors of the economy contracted by 0,7 per cent in the recession year 1985, but rose at relatively unimpressive rates of 0,4, 0,9 and 1,2 per cent in the three upswing years 1986-88. Employment growth, excluding the retail trade sector, then slowed down to 0,4 per cent in the consolidation year 1989.

In the first quarter of 1990 non-agricultural employment increased at an annualised rate of 1,8 per cent. This, however, was largely a "correction" of employment decreases in the fourth quarter of 1989: large variations in numbers employed during these two quarters were observed, for example, in the South African Transport Services. Total employment in the first quarter of 1990 was 0,4 per cent higher than in the first quarter of 1989.

Growth in formal non-agricultural employment in the upswing period 1986-1988 was noted in the *Annual Economic Report* for 1989 to have compared unfavourably with employment increases in earlier business cycle upswings, and also to have fallen significantly short of the rate of growth of the economically active population. An overview of the past twenty years shows that employment increases declined from an average of 2,5 per cent per annum in the decade of the 1970s (1970-1979) to an annual average of only 1,1 per cent in the 1980s; in contrast, the annual average growth rate of the economically active population during the 1980s amounted to 2,5 per cent. The year-to-year percentage increases in the annual average level of non-agricultural employment still broadly matched the rate of increase in the labour force in the early years of the decade from 1980 to 1982, but failed to do so from 1983 onward. The "gap" between the economically active population and formal non-agricultural employment as in 1989 is estimated at approximately 5,4 million people.

Economically active population versus formal non-agricultural employment



Failure of the formal economy to generate an adequate number of new job opportunities during the upswing of 1986-89 was attributed in the 1989 *Annual Economic Report* to only moderately rapid economic growth even in the course of that cyclical expansion; to low levels of *net* real fixed investment and the resultant low rate of increase in the economy's real fixed capital stock; and to the relatively low employment-providing powers *of* the real fixed capital stock (and of net additions to the capital stock), on account of the utilisation of unduly capital-intensive production techniques in large segments of the formal economy and of the economy's resultant high capital-labour ratios.

Inadequate employment-creating capabilities of the formal sector, and this sector's tendency towards undue capital intensity of its production processes, have been recognised for some time now as major structural weaknesses of the South African economy. They have been attributed, in part, to businesses' long drawn-out responses to structural distortions in relative factor prices, and specifically to the relative "cheapness" of capital and the relative "expensiveness" of labour, that were allowed to arise and persist in the economy during large parts of the 1970s and 1980s. The Reserve Bank's present policy stance and the Bank's insistence on positive real interest rates in virtually all conceivable conditions, are based, in part, on the perceived need for a rectification of these long-term factor price distortions and related structural deficiencies.

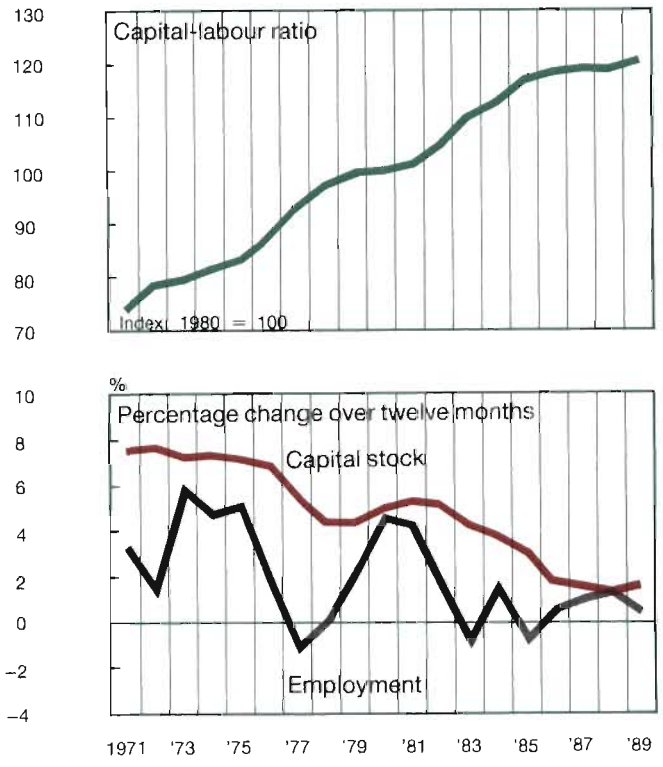
As shown by the accompanying graph, the declining rate of growth of the capital stock of the non-agricultural business sector, and the rising rate of growth of the labour force employed by that sector, have been moving closer to each other since 1985. This must necessarily have been reflected in a levelling-out of the capital-labour ratio. A flattening-out of the capital-labour ratio from 1986 onward was, in fact, noted to have taken place in the Reserve Bank's *Annual Economic Report* for 1989. Superficially, this might be taken to suggest some early success for the authorities' policies of structural adjustment and reform.

Positive real long-term and short-term interest rates have, however, most recently been in evidence again only since late 1987 and early 1988 respectively. (Other factors bearing on the user cost of capital should, of course, also be taken into consideration.) At the same time, some not inconsiderable periods of

time will almost certainly be needed to affect significantly (through appropriate changes in the technological character of net new and replacement investment) the labour-absorbing qualities of the aggregate real fixed capital stock.

The flattening-out of the capital-labour ratio since 1986 therefore seems unlikely to have represented, already, a predominantly *structural* phenomenon. Instead, it should be seen *primarily* as a result of the mild cyclical reacceleration of employment increases in the 1986-89 upswing in conjunction with the relatively low levels of net fixed capital formation during this period: accelerated employment increases in the face of a stagnant or only slowly expanding real fixed capital stock (which will result in enhanced degrees of capacity utilisation) will obviously also result in a decline in the measured capital-labour ratio. This will be true however *capital-intensive* the prevailing *technologies* – as embodied in both net new fixed investment and the existing capital stock – may still be. An affiliated question then remains, however, to what extent changes – i.e. increases – in the user cost of capital may have contributed to the declining levels of real fixed investment of the past several years.

Capital and labour in non-agricultural sectors



The interpretation of the levelling-out of the capital-labour ratio since 1986 as being due (essentially) to (1) the mild cyclical acceleration of non-agricultural employment increases, and (2) low recent rates of expansion of the real fixed capital stock – rather than to a structural shift towards more appropriately labour-intensive production processes – is also supported by recent increases in the "effective" real cost of labour as represented by (1) increases in the real wage per worker, and (2) increases in the so-called "hassle factor" of providing employment. Generally speaking, increases in the "effective" real cost of labour will, of course, militate against the adoption of more labour-intensive production techniques.

The "hassle" element in the cost of providing employment comprises the loss of output on account of worker intimidation and unauthorised absenteeism, and of work stoppages, strikes, stay-aways and other forms of trade union or organised labour action; the management costs of dealing with these and related phenomena; and the loss of goodwill on account of strained labour/management relationships. Some impression of the presumed behaviour of these "hassle" costs as perceived by business enterprises in recent years, can probably be gained from changes in the annual number of work stoppages and strikes; this number rose from only 207 in 1980 to as high as 1 148 in 1987 before declining to 942 in 1989. The number of *man-days lost* on account of strikes and work stoppages rose from less than 0,2 million in 1980 to 5,8 million in 1987, but retreated to 0,9 million in 1988 and to 1,5 million in 1989. The number of man-days lost in the *first half* of 1990, which, according to unofficial sources, reached a record level of approximately 1,2 million, was, however, close to three times as high as in the *first half* of 1989.

The ratios of *overtime hours to normal hours worked* in manufacturing and construction fluctuated in close correspondence with the general business cycle in both the 1970s and the 1980s. These ratios attained their most recent high points in 1988. They then retreated, in agreement with the cooling-down of the economy, in 1989 and the first quarter of 1990.

In manufacturing the overtime ratio declined from 12,1 per cent in 1988 to 10,6 per cent in the first quarter of 1990; in the construction industry this ratio fell back from 8,1 per cent to only 6,6 per cent over the same period. The general level of these ratios in the course of the 1986-89 upswing was noted in the *Annual Economic Report* of 1989 to have been consistently lower than during comparable stages in the cyclical expansion that began in the first quarter of 1978. This

was held to be another symptom of the reduced labour intensity/increased capital intensity of production in the 1986-89 upswing as compared with earlier upswing periods.

In the first quarter of 1990, labour's increased reluctance to work overtime apparently caused employment increases in manufacturing and construction to be *substituted* to some extent for overtime work. This implied a weakening of the more usual relationship in terms of which cyclical rises/declines in employment tend to be preceded or accompanied by cyclical rises/declines in the overtime ratio. Employment increases on account of this development may help to explain some apparent anomalies of strengthening employment opportunities in a softening economy. They also contributed to downward pressure on the observed capital-labour ratios for reasons other than the more desirable "structural" ones.

Total employment in the non-agricultural *private* sector of the economy declined marginally in the first year of the 1986-89 cyclical upswing, but rose at rates of 0,6 and 1,1 per cent in 1987 and 1988. Private-sector employment (excluding retail trade) then showed little further change from 1988 to 1989. In comparison, total employment by public authorities *rose* at a rate of 1,7 per cent in 1986 and continued to do so at rates of 1,9 and 1,5 per cent in 1987 and 1988; this rate of increase then declined to 1,1 per cent in 1989. The cyclical slow-down in employment increases by public authorities set in earlier than the slow-down in employment increases in the private sector. The general level of the year-to-year rates of increase in the annual average of employment in the private sector was, however, significantly lower than the level of these rates among public authorities.

From 1980 to 1989 the rate of increase in private-sector employment exceeded the rate of increase in employment by public authorities only in the decade's opening years, i.e. in 1980 and 1981. Total employment by public authorities and in the non-agricultural private sector rose from 1,3 and 3,4 million in 1980 to 1,6 and 3,9 million in 1989.

Registered unemployment – which had declined significantly more slowly during the upswing up to 1988 than during earlier expansion phases and had taken on a more structural character – remained relatively stable during 1989. During parts of that year it actually declined in apparent contradiction to the cooling-down of the economy. The relative stability of registered unemployment in 1989 testified to the initial mildness of the cyclical slow-down as well as – presumably – to the labour-absorbing powers of economic activities in the informal sector. More pronounced increases in registered unemployment were, however, recorded in the first several months of 1990.

The seasonally adjusted number of registered unemployed workers in the White, Coloured and Asian population groups declined from a high point of 82 300 in September 1986 to a low point of 45 400 in January 1989. After a brief increase, it then declined further to only 42 000 in December 1989, but rose to 53 600 in May 1990. The seasonally adjusted *total* number of unemployed workers declined from a high point of 136 300 in September 1987 to a low point of 108 900 in January 1989. After having risen to 125 700 in December, it fell back once again to 113 000 in February 1990, but increased to 138 900 in May.

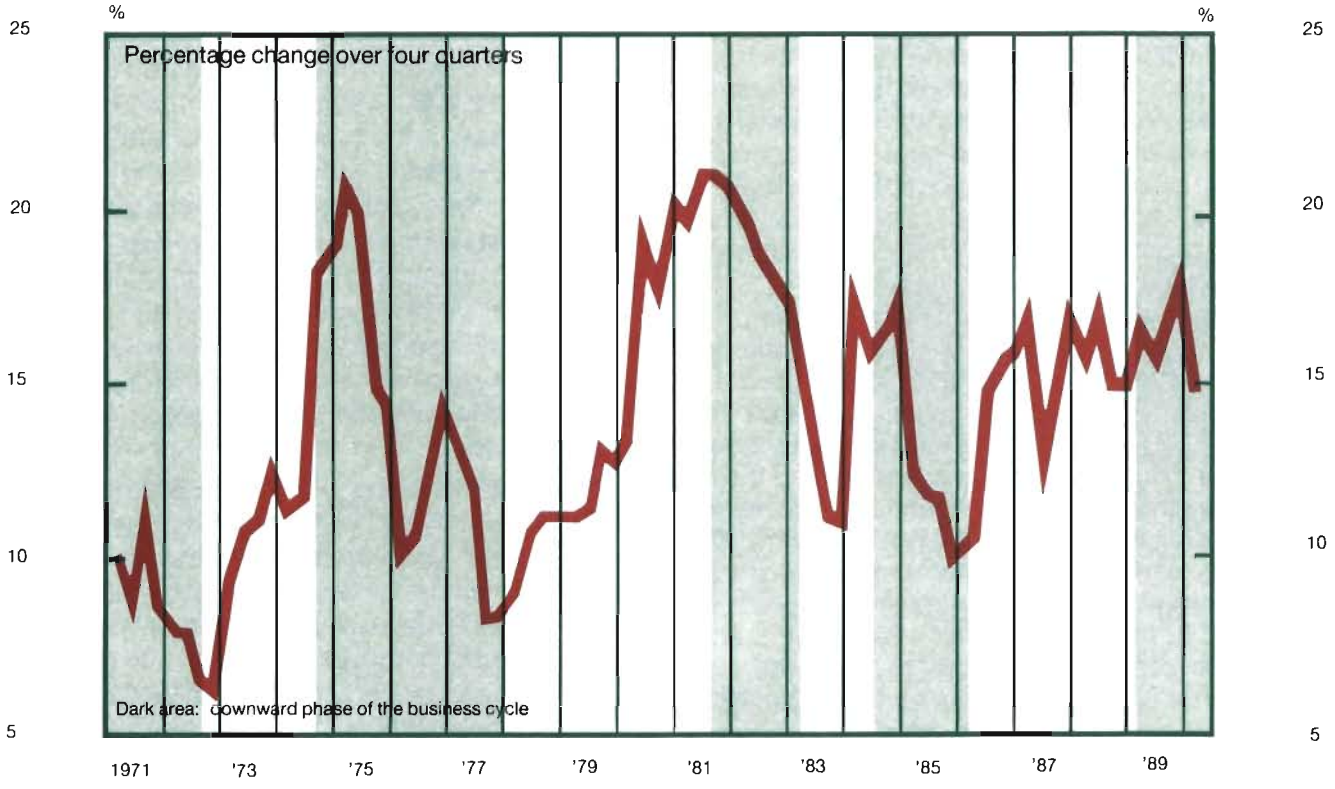
The number of unemployed Black workers, as measured by the Current Population Survey, declined from a high point of 1 180 000 in July 1986 to low points of 734 000 and 719 000 in April and December 1989 respectively, but rose to 750 000 in March 1990.

Labour costs and productivity

The year-to-year rate of increase in the annual average amount of nominal wages and salaries per worker in the non-agricultural sectors of the economy accelerated from 11,4 per cent in the recession year 1985 to 16,9 per cent in the consolidation year 1989. Data for the first quarter of 1990, however, point to some recent moderation of the tempo of nominal wage increases from its 1989 levels. In the light of the comparatively high levels of trade union militancy, industrial action and labour unrest in the first several months of 1990, this slow-down in nominal wage increases in the first quarter of 1990 probably provided evidence of businesses' growing resistance to such increases in a less buoyant business environment.

Unusual significance attached to the behaviour of nominal wages in the closing months of 1989 and the first half of 1990 in the light of, among other things, the monetary authorities' interest in preserving "structurally sound" levels of real labour remuneration, their recently stepped-up endeavours towards restoring relative price stability in the South African economy, the largely expectations-driven nature of the current South African inflation, the role of inflation expectations (in conjunction with trade union action and unemployment) in the determination of nominal wage increases, and the role of indexation or "quasi-indexation" in the setting of nominal wage increments. The accompanying graph shows that mild further accelerations of nominal wage increases in the early stages of cyclical slow-downs have not been unusual in the context of post-war South African business cycle developments.

Average remuneration per worker in non-agricultural sectors



The graph also shows an unmistakably upward long-term trend in the percentage rates of nominal wage increases from the mid-1970s onward; very great caution should obviously be exercised, however, in distinguishing between accelerating wage increases that have been *results* of, and those that have played *causative* roles in, inflationary developments. Finally, the level of the year-on-year rates of nominal non-agricultural wage increases in early 1989 will be noted to have been higher than at any other time in the past twenty years, with the exception of the gold-price boom years 1974 and 1980-1981.

From 1985 to 1988, the year-to-year rates of increase in the nominal wage per worker in the non-agricultural private sector exceeded the rates of wage increases among workers employed by public authorities. This situation was, however, reversed in 1989, when the nominal wage per worker employed by public authorities rose by as much as 20,4 per cent; the average nominal wage increase for private-sector workers in 1989 amounted to 14,8 per cent. The total nominal amount of salaries and wages lost on account of trade union action (strikes, lock-outs and work stoppages) rose from less than R0,1 million in 1976 to a peak of R111 million in 1987, but fell back to R53 million in 1989.

The *real* wage per non-agricultural worker advanced, on balance, from 1970 onward to a high point in 1984. It then declined in the recession year 1985 and in the early upswing years 1986 and 1987, but rose relatively strongly (by 2,5 and 1,9 per cent) in 1988 and 1989. Peak rates of increase in the real wage per worker (of 4,6 per cent) were recorded in 1981 and 1984; the average annual percentage increase in the real wage per worker in the 1980s up to 1989, at 0,9 per cent, was, however, lower than the average annual increase of 1,3 per cent from 1970 to 1979.

Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural sectors of the economy, weakened by 0,8 per cent in the recession year 1985 and – unusually – by 0,6 per cent in the early upswing year 1986. It then strengthened by 0,9 per cent in 1987 and by a relatively impressive 2,7 per cent in 1988.

In 1989 the rate of increase in labour productivity slowed down (as is common in a slackening economy, showing cyclically lower output levels) to 1,3 per cent.

A part of the slow-down in 1989 was explained, however, by the intensifying aggressiveness of trade union behaviour and the rising incidence of strikes and labour unrest. The number of man-days lost on account of strikes and work stoppages was noted earlier to have increased from 0,9 million in 1988 to 1,5 million in 1989; in manufacturing industry (which accounted for some three-quarters of total man-days lost on account of industrial action) real labour productivity declined in 1989 for the first time since 1985. In the first quarter of 1990 non-agricultural labour productivity declined, year-on-year, by 0,7 per cent.

Strengthening of the gains in physical labour productivity in the upswing years 1987 and 1988 caused the year-to-year rise in *nominal unit labour costs* to contract from 14,9 per cent in 1986 to 14,3 per cent in 1987 and to 12,6 per cent in 1988, despite the accelerating rise in nominal wages per worker during these years. Conversely, the disturbingly high rate of increase (of 17,1 per cent) in nominal unit labour costs in 1989 reflected the effect of a further acceleration of nominal wage increases in the face of a slackening of productivity gains. In the first quarter of 1990 nominal unit labour costs rose, year-on-year, by 15,1 per cent.

Real unit labour costs declined from 1985 to 1988. In 1989, however, the relatively rapid rise in the real wage per worker in conjunction with a lower rate of increase in physical labour productivity, caused real unit labour costs to rise by 2,0 per cent vis-à-vis the preceding year.

Prices

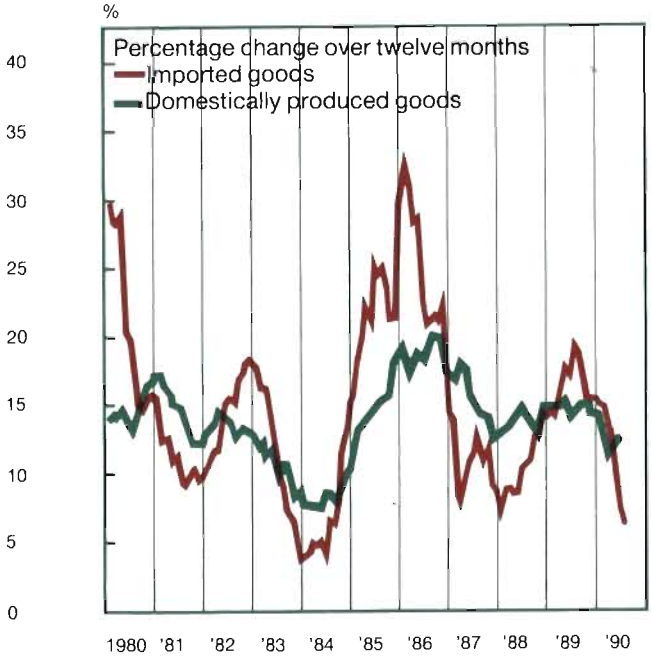
In April 1990, the top management and the Board of Directors of the Bank adopted a "mission" statement for the Bank in terms of which the protection of the domestic and external value of the rand has been accepted as the prime objective of the Bank's policies. The curbing of inflation, and its eventual reduction to levels that will at least not be higher than the average rate of price increases in South Africa's principal international trading partner countries, therefore now enjoys unqualified priority in the monetary authorities' policy actions. It also ranks as a prime element in the rectification of structural deficiencies that have been identified in the South African economy.

Inflation, as measured by the behaviour of the principal price indices on a quarter-to-quarter basis or over twelve-month periods, reached its most recent high point in the second quarter or towards the middle of 1989 and, in most cases, improved significantly thereafter. The year-to-year rates of increase in the *annual averages* of the various price indices were, however, still higher in 1989 than in the preceding year.

The Reserve Bank's econometric analyses suggest that pressures on the domestic means of production, as measured by the economy's actual output/potential output ratio, reached their cyclical high point early in 1989 and abated mildly in the ensuing quarters. Improvements in the inflation rates from mid-1989 onward were also assisted by the firmer tone of the rand in the foreign exchange markets in the third quarter of 1989, the significant strengthening of the exchange value of the rand in the fourth quarter of 1989, and the fairly moderate decline in the effective exchange rate in the first half of 1990. Inflation in South Africa in its present form and at current levels therefore appears as an essentially domestic phenomenon that is "driven", to a probably preponderant degree, by inflation *expectations*; inflation *expectations* are embodied in, among many other things, the annual wage claims of organised labour and in business firms' willingness to accede to these demands.

Inflation expectations affect wage demands (or, more generally, income augmentation claims) in both the "defensive" and "aggressive" versions of these claims or demands. A lowering of the expected rate of price increases obviously reduces the nominal wage increase (or the increase in other nominal factor rewards) that is perceived as being required "defensively" for maintaining a given real income position. It also tempers "aggressive" wage demands by increasing the perceived risk of a loss of employment, and strength-

Production prices



ens employers' resistance to such demands by reducing firms' perceived powers of "passing on" cost increases in price increases without a loss of sales, a decline in market share, and diminishing operating surpluses.

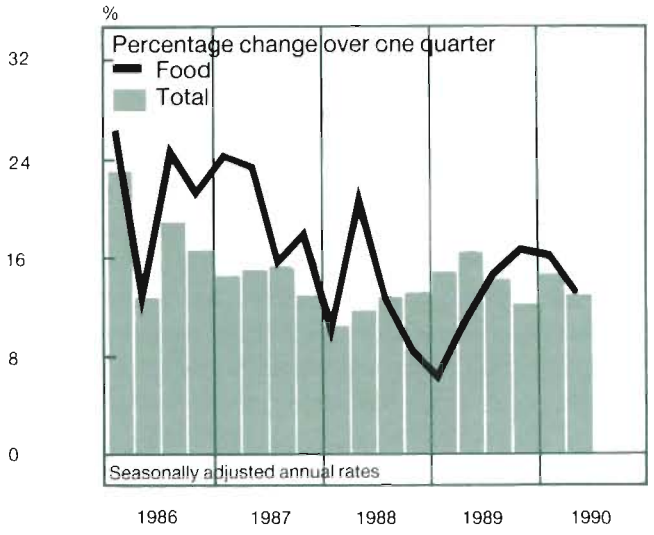
A lowering of inflation expectations may, however, require a fairly dramatic decline in the observed inflation rates as a demonstration of the authorities' ability to pursue effective anti-inflationary policies. "Unsatisfactory wages" as a factor triggering trade union action accounted for 63,5 per cent of the approximate number of 1,2 million man-days lost through work stoppages and strikes in the first half of 1990. Claims for higher minimum wages and for general salary increases during this period ranged from 20 per cent to an exceptional (and unique) 500 per cent. Wage increases eventually agreed on between unions and major employers in both the public and the private sector mostly ranged, however, from 10 to 20 per cent.

Strengthening of the exchange rate of the rand caused the year-to-year rate of increase in the prices of *imported goods* to fall back from 23,6 per cent in 1985 to only 9,7 per cent in 1987; the rand's weakening in 1988, and increases in the import surcharges initially imposed in August 1988, subsequently caused this rate to rise again to 11,0 and 16,3 per cent in 1988 and 1989. The generally firmer appearance of the rand in the foreign exchange markets from the third quarter of 1989, and reductions of the import surcharges from mid-March 1989, nevertheless caused the *quarter-to-quarter* rate of increase in these prices, in seasonally adjusted and annualised terms, to fall from 26,8 per cent in the second quarter of 1989 to only 6,6, 7,5 and 2,9 per cent in the fourth quarter of 1989 and in the first and second quarter of 1990. The average *year-on-year* rate of change (or rate of change over four quarters) in these prices in the first two quarters of 1990 amounted to 10,5 per cent.

The rate of increase in the prices of *domestically produced goods* retreated from 18,7 per cent in 1986 to 13,8 per cent in 1988, but reaccelerated to 14,8 per cent in 1989. The quarter-to-quarter rate of increase in this index, seasonally adjusted and annualised, fell back from 18,1 per cent in the first quarter of 1989 to a single-digit level (9,7 per cent) in the first quarter of 1990, but rose to 14,2 per cent in the second quarter. The average year-on-year increase in the prices of domestically produced goods in the first two quarters of 1990 also stayed in double digits at a level of 12,4 per cent.

The year-to-year rate of increase in the total *production price index*, which incorporates the movements in the price indices of both imported and domestically produced goods, declined from its high point of 19,6 per cent in 1986 to 13,2 per cent in 1988, but climbed back to 15,2 per cent in 1989. The general improvement in inflation rates from approximately mid-1989 caused the seasonally adjusted and annualised quarter-to-quarter increase in this index to fall back fairly dramatically from 17,9 per cent in the second quarter of 1989 to 11,1 per cent in the fourth quarter, and to 9,2 and 11,8 per cent in the first two quarters of 1990. The average year-on-year increase in this index in the first two quarters of 1990 amounted to 12,1 per cent.

Consumer prices



The year-to-year increase in the *consumer price index* declined from 18,6 per cent in 1986 to 12,9 per cent in 1988, but reaccelerated to 14,7 per cent in 1989. The quarter-to-quarter rate of increase in this index, seasonally adjusted and annualised, amounted to 18,0 per cent in the second quarter of 1989 and to 13,3 per cent, a disappointing 14,9 per cent, and 13,1 per cent, in the fourth quarter of 1989 and in the first two quarters of 1990 respectively. The retreat of the inflation rate in consumer prices from the middle of 1989 onward therefore failed to match fully the more convincing declines in other inflation rates during this period. The average year-on-year increase in the consumer price index in the first two quarters of 1990 still amounted to 14,5 per cent.

The rate of increase in the prices of consumer *goods* exceeded the rate of increase in the cost of consumer *services* in every year from 1985 to 1989. This situation was, however, reversed temporarily (for the first time

since early 1989) in the first *quarter* of 1990, when the annualised rate of increase in the cost of consumer services advanced to 16,1 per cent (from 11,0 per cent in the preceding three months). In the second quarter of 1990, however, the tempo of increases in consumer goods prices again exceeded the rise in the cost of consumer services.

A major role in the recent behaviour of the rate of inflation in consumer prices was played by fluctuations in the rate of change in the prices of foodstuffs. The rate of inflation in food prices declined from a high point of 22,6 per cent in 1987 to only 11,0 per cent in 1989. On a shorter-term basis, however, the quarter-to-quarter rate of increase in food prices, seasonally adjusted and annualised, advanced steadily from only 6,8 per cent in the first quarter of 1989 to 18,5 per cent in the first quarter of 1990. Truly exceptional increases (at annualised rates of more than 80 and more than 90 per cent respectively) were recorded in the prices of vegetables in the fourth quarter of 1989 and the first quarter of 1990. In the second quarter of 1990, however, these prices *declined* at an annualised rate of more than 30 per cent.

In the second quarter of 1990, the annualised quarter-to-quarter rate of increase in food prices generally, receded to 10,5 per cent. Food price movements in this quarter thereby actually assisted the mild retreat of the inflation in consumer prices from its annualised quarter-to-quarter rate of 14,9 per cent in the first quarter of 1990 to 13,1 per cent in the ensuing three months.

Foreign trade and payments

Record period of uninterrupted current account surpluses

Relatively restrictive monetary and fiscal policies – imposed on the authorities partly by factors beyond their control – and a generally healthy international economy contributed to surpluses being maintained on the current account of the South African balance of payments during an unbroken period from the first quarter of 1985 to the second quarter of 1990, i.e. for 22 consecutive calendar quarters. This was easily the longest uninterrupted series of such surpluses ever recorded; its closest rival in the annals of the post-war South African economy is a fifteen-quarter series of current account surpluses in the closing stages of the 1974-77 downswing and in the subsequent gold-boom years from 1978 to 1980.

During the 5½ years from the beginning of 1985 to mid-1990 the cumulative current account surplus amounted to R26,3 billion or to an average of more than R1,1 billion per quarter. Relative to the concurrent gross domestic product in the quarters concerned, these surpluses reached an average of nearly 3 per cent. This may be compared with a similar average surplus-to-gross domestic product ratio during the years from 1977 to 1980.

Unusually, by far the greater part of the 1985-90 current account surpluses was recorded during a period of cyclical expansion. Moreover, more than half of the 22 quarterly surpluses concerned fell within a period of a generally downward trend in the dollar price of gold. In notching up current account surpluses during the years from 1985 to 1989, South Africa also stood out as remarkable among the world's developing countries: with the exception of the newly industrialising economies of East and South East Asia, large current account *deficits* were sustained during this period by all classes and regions of countries that are classified as "developing" countries by the International Monetary Fund. These deficits reached a total of US$34 billion for African developing countries and amounted to US$49 billion for the developing economies in the Western hemisphere.

Not surprisingly, however, the South African current account surpluses were significantly smaller (on average, but in both relative and absolute terms) during the six quarters to mid-1989 than during the preceding six quarters to the end of 1987. As was explained in some detail in the Reserve Bank's *Annual Economic Report* for 1989, shrinkage of the current account surplus in the advanced upswing and early consolidation periods from the start of 1988 to the middle of 1989 was primarily a matter of a strong cyclical expansion of merchandise imports and of increased net service and transfer payments to non-residents.

By the first half of 1989 the average quarterly current account surplus, seasonally adjusted and annualised, had contracted to R1,4 billion. Partly because of the moderate further cooling-down of the domestic economy, however, the average quarterly current account surplus subsequently recovered to an annualised level of R4,8 billion in the second half of 1989 and of R4,6 billion in the first half of 1990. Incorporated in this

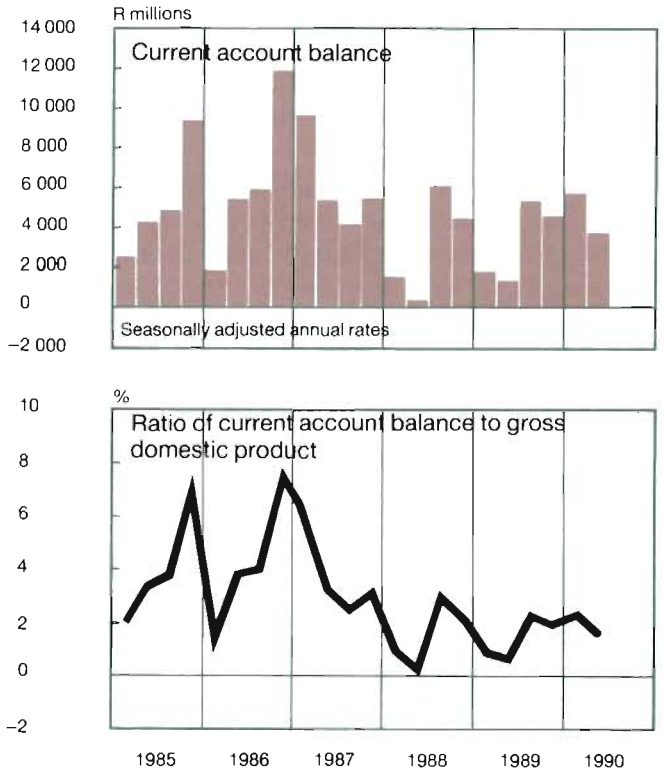
Balance of payments on current account

Seasonally adjusted annual rates

R millions

	1989					1990	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	34 842	42 866	39 986	38 646	39 085	41 660	39 527
Net gold exports	18 970	18 150	19 670	20 122	19 228	17 793	18 500
Merchandise imports	–41 519	–48 560	–44 841	–42 368	–44 322	–43 577	–44 140
Net service and transfer payments	–10 640	–11 293	–9 628	–11 971	–10 883	–10 299	–10 264
Balance on current account	1 653	1 163	5 187	4 429	3 108	5 577	3 623

Balance of payments



welcome reinvigoration of the surplus were the effects of a further strengthening of the South African merchandise export performance, a rather modest retreat of the value of merchandise imports from the first half of 1989 to the first half of 1990, and a mildly easier position on the services and transfers account. The current account surplus did, however, fall back to an annualised level of only R3,6 billion in the second *quarter* of 1990, on account of a modest reversal of these cyclical tendencies in both merchandise exports and imports.

Although *merchandise imports* topped out and receded slightly in real terms after the third quarter of 1988, they remained surprisingly strong in the first five to six quarters of the current cyclical downswing up to mid-1990. The *value* of merchandise imports actually *rose* slightly from an annualised level of R43,6 billion in the second half of 1989 to R43,9 billion in the first half of 1990, and to an annualised level of R44,1 billion in the second *quarter* of 1990.

This relative strength of merchandise imports could be explained only partly from the comparative mildness of the cyclical slow-down of the economy during most of the sixteen months from March 1989 to mid-1990: a more important contributory factor was that the import "penetration ratio" (i.e. the ratio of real imports, or import volumes, to real gross domestic expenditure) failed to decline strongly in its customary cyclical manner (as it still did in 1984-86). At its level of some 22,4 per cent, this ratio was, in fact, no lower in the first quarter of 1990 than in the first and the second quarter of the upswing year 1988.

Various factors are likely to have played a part in holding up import volumes in the course of the current downswing phase to date. Firstly, imports of capital equipment have remained at a relatively high level in the present cyclical consolidation phase and the present downswing in comparison with the level of these imports in the preceding cyclical expansion. This would appear to have its foundations in the relatively low absolute level, and the commensurately reduced cyclical responsiveness and variability, of real fixed capital formation in the economy over the past several years. Also, new mechanisation programmes have been embarked upon by (among others) the mining industry, in response to an increasingly unsettled and troublesome labour situation.

Secondly, the increased stability and slight appreciation of the real effective exchange rate of the rand from approximately the second half of 1988 gave rise to a relative cheapening of imported goods vis-à-vis their South African-made equivalents or substitutes from approximately mid-1989 onward. The accompanying graph shows a distinct measure of (lagged) responsiveness of South African non-oil import volumes to changes in the real effective exchange rate of the rand and to the associated changes in the relative expensiveness/inexpensiveness of imported goods. The reduction of the surcharges on imports, as announced in the Central Government's Budget for 1990/91, have recently also provided a stimulus for higher import quantities. Finally, a stimulative effect on real imports may have been exerted by the growth of countertrade, which has developed partly in reaction to international sanctions against South African trade in selected import and export goods.

South African *merchandise exports* – which, in both value and volume terms, displayed a remarkably strong upward trend from the third quarter of 1988 – nevertheless fell back in the third and the fourth quarter of 1989 and, after another strong showing in the first quarter of 1990, again in the second quarter of 1990. They thereby contributed greatly to the second-quarter narrowing of the current account surplus.

Export *volumes* fell back in the third and the fourth quarter of 1989, but recovered markedly in the first

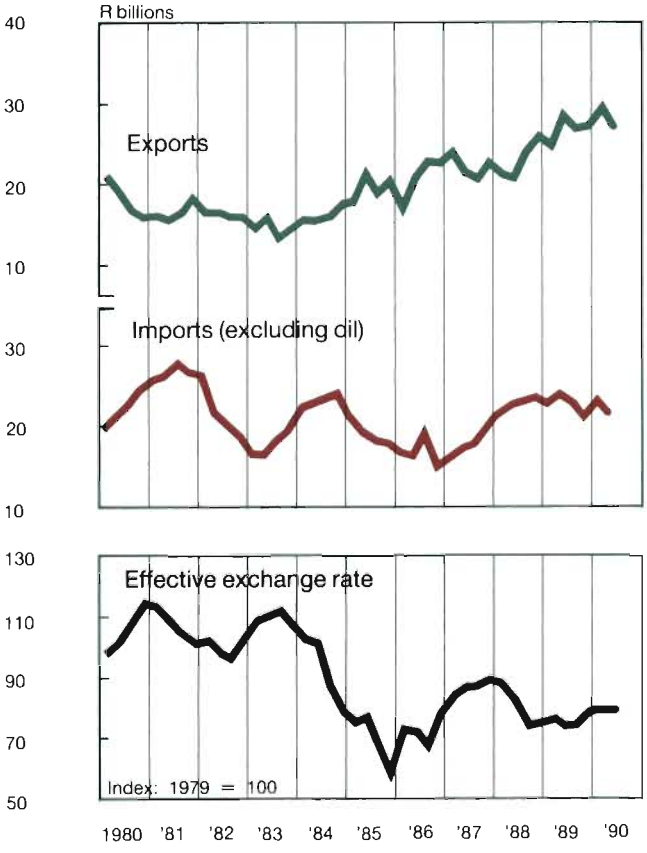
quarter of 1990 before declining once more in the second quarter. Export *prices* declined in the third and the fourth quarter of 1989, thereby reinforcing the effect of lower export volumes on aggregate export earnings. The average level of export prices subsequently showed little change in the first quarter of 1990, but, owing to a revival of international commodity prices, rose by some 3 per cent in the second quarter. On balance, export volumes, export prices and the total value of merchandise exports in the four quarters to mid-1990 exceeded their counterparts in the preceding four quarters by 6,8, 1,3 and 8,0 per cent.

Net gold exports, by value in terms of rand, were some 1½ per cent *lower* in the four quarters to mid-1990 than in the preceding four quarters to mid-1989. This was the result of a relatively low volume of physical gold production in the first half of 1990. For the full four-quarter period to mid-1990 the physical production of gold (at 596 tons) was some 2½ per cent lower than in the preceding four quarters (611 tons).

From the first to the second *quarter* of 1990, a recovery in the physical volume of gold exports, and depreciation of the rand against the dollar, more than made up for a marked decline in the average dollar price of gold during that period. The rand value of the net gold exports rose accordingly by some 4 per cent between these two quarters, thereby preventing a more drastic shrinking of the current account surplus in the second quarter.

Net service and transfer payments to non-residents were 2,8 per cent higher in the four quarters to mid-1990 than in the preceding four quarters, despite further cooling of the economy. Mainly because of sharply higher payments of interest to non-residents, total net service and transfer payments rose to an uncommonly high level (in seasonally adjusted and annualised terms) of close to R12,0 billion in the fourth quarter of 1989. They retreated, however, to a quarterly average of some R10,3 billion in the first and the second quarter of 1990. A further note on recent developments on the services and transfers account is provided in a subsequent section.

Real exports, imports and effective exchange rate of the rand



Structural changes in visible exports and imports

The Reserve Bank's *Annual Economic Report* for 1989 examined in some detail the forces behind the sustained South African current account surpluses from 1985 to mid-1989. The principal factor in generating these surpluses was found to have been the remarkable vigour of the South African merchandise export performance: the growing strength of the country's export achievements was noted to have outweighed both the slow retrogression of South Africa's net gold exports in real terms and the effect of depreciation of the rand on import prices. Depreciation of the rand was observed to have been of major importance, both in holding *down* import *volumes* and in holding *up* the international competitiveness of South African export goods.

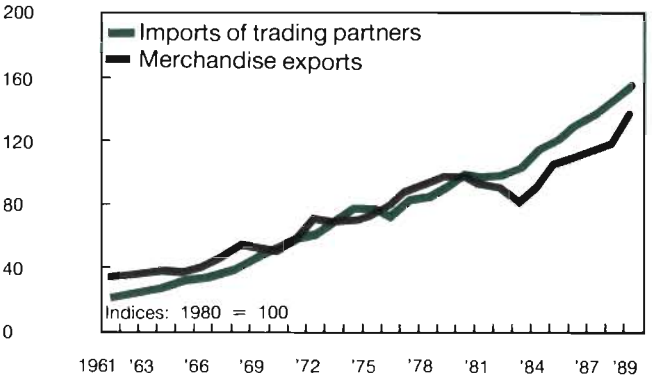
Concentration on the current account *surplus* (as the difference between earnings or receipts on the one hand, and payment obligations incurred on the other hand, that arise from current foreign transactions over any given period) may cause scant attention to be paid, firstly, to changes in the *levels* of these earnings and obligations over time and, secondly, to shifts in the *composition* of the exports and imports of goods and services from which these earnings and payment obligations arise. Important developments in either area may cut across developments in the overall current account surplus or deficit position and be quasi-inde-

pendent of cyclical phenomena; the starting points and terminal dates of such developments would also not necessarily bear any relationship to the emergence or disappearance of surpluses or deficits on the current account as a whole. The next few paragraphs note in outline certain broad "structural" changes in the patterns of South African visible exports and imports as they have manifested themselves over the past number of years.

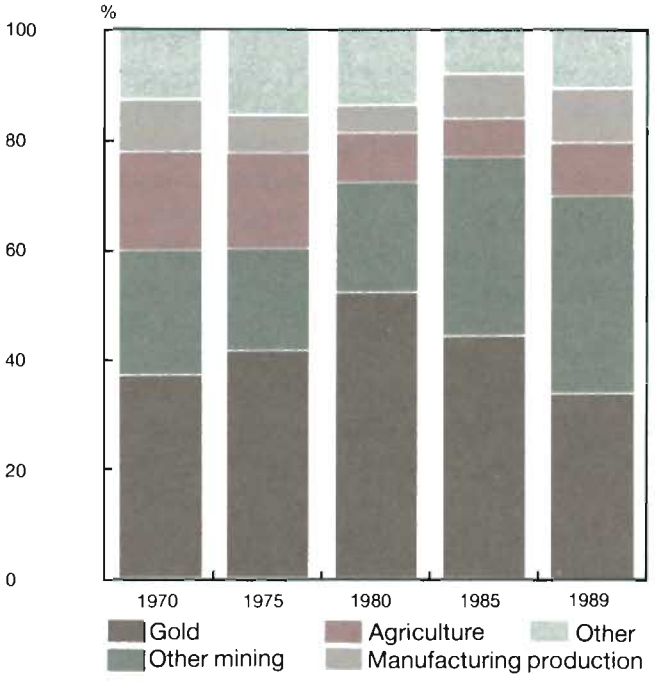
In 1970 gold exports accounted for a fairly typical 36,6 per cent of total visible exports. Doubling of the average dollar price of gold from US$307 per fine ounce in 1979 to US$613 in 1980 caused the share of net gold exports in total visible exports to expand abruptly from some two-fifths (40,5 per cent) in 1979 to more than half (51,6 per cent) in 1980.

Two major effects flowed from this gold price rise. Firstly, the South African economy was enabled to show healthy current account surpluses even in the advanced stages of the then prevailing cyclical upswing. Secondly, the relative significance of all non-gold exports necessarily declined to "make room for" the increased importance of gold. Higher international prices of non-gold precious metals (which had risen in sympathy with the higher gold price) allowed "other mining" exports more or less to maintain their relative position. The share of agricultural exports in total visible exports, on the other hand, declined, on balance, to 9,1 per cent in 1980 from 18,1 per cent in 1970. The share of "manufactured" exports[1] fell from 9,5 to 5,0 per cent over the same period.

Real South African exports versus real imports of trading partner countries



Categories of total exports



Overvaluation of the rand exchange rate as a result of the high gold price (a case of the so-called Dutch disease) caused South Africa's non-gold exports to lose market share internationally from 1980 to 1983. The ensuing combination of an overvalued exchange rate and a declining dollar price of gold (in conjunction with a cyclical downswing in the industrialised economies and a decline in world commodity prices) from late 1980 up to the beginning of 1982, caused the current account to sink rapidly into deficit from the first quarter of 1981. Deficits were experienced up to the third quarter of 1982.

The effective exchange rate of the rand began to decline steeply from late 1983. This caused the South African non-gold exports to regain their international competitiveness; the volumes of non-gold exports responded energetically. Surpluses were restored to the current account in most of 1983 and (after the 1983-1984 mini-boom interlude) were maintained continuously from the start of 1985. In the new surplus situation of 1985, however, the share of net gold exports in total visible exports had retreated to 43,6 per cent (against these exports' 1980 share of 51,6 per cent); with the exception of agricultural exports, other export

[1] Defined, for present purposes, as the sum total of the following export categories: chemical products; textiles; plastic materials; machinery and electrical equipment; vehicles and parts; paper and paper products; and "other" manufactured products.

categories had strengthened their relative positions accordingly. "Other mining" exports were assisted by the revival of the world economy from late 1982 or early 1983. They also benefited substantially, however, from the completion of the Richards Bay coal export facility, the Sishen-Saldanha iron ore export project and the opening-up of a new lead, copper and zinc mine in the North-Western Cape.

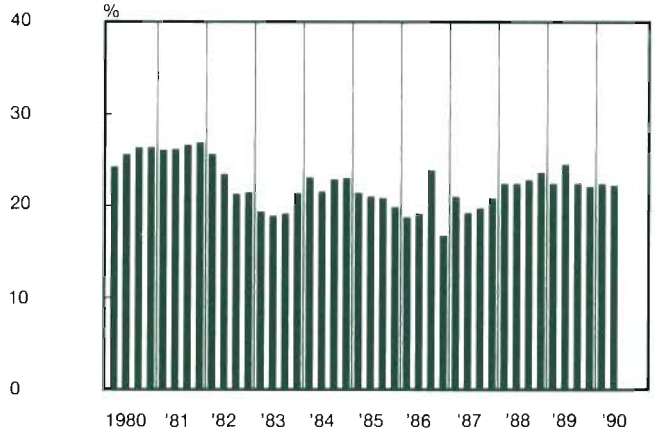
Strengthening of the real effective exchange rate of the rand from its record low point at the end of 1985 and the introduction of international trading sanctions against selected South African export products did not prevent a further surge in the volume of non-gold exports. This surge was interrupted temporarily in 1987 and the first half of 1988; new record levels of non-gold export volumes were, however, attained in 1989 and the first half of 1990. The volume of merchandise exports rose by a major 16½ per cent from 1988 to 1989. In the first half of 1990 it was another 5 per cent higher than its average level in the preceding year.

This vigorous expansion of merchandise exports caused the share of net gold exports in total visible exports to be pressed back further to 33,0 per cent in 1989, its lowest level since 1977. The shares of other export categories naturally again increased accordingly. By 1989 the relative share of manufactured exports had returned to the level it had reached in the pre-gold-boom period. The void left by the shrinking share of the net gold exports was therefore filled by agricultural exports (in the then prevailing good agricultural conditions) and, in a more durable and "structural" way, by non-gold mining exports.

In absolute figures, South Africa's *total visible* export earnings *in US dollar terms* retreated from a peak of $25,2 billion in the gold-boom year 1980 to only $15,9 billion in 1985, but recovered to $22,2 billion in 1989. Gold export earnings included in these amounts fell back from $13,0 billion in 1980 to hardly more than half that figure ($7,3 billion) in 1989. As another reflection of the strengthening of merchandise exports, the ratio of real merchandise exports to the real gross domestic product advanced quite impressively from only 12,6 per cent in 1983 to 20,4 per cent in 1989 and to 22,0 per cent in the first half of 1990.

In contrast with this increased internationalisation of South African *production*, South African domestic *expenditure* became more domestically orientated. The import penetration ratio declined from an average of more than 30 per cent in the early 1970s to a low point of 19,6 per cent in 1986 before increasing again to 22,5 per cent in 1989 and the first half of 1990. To some extent, the generally downward tendency of this ratio could be attributed to the coming on stream of import substitution industries, such as the new Sasols.

Real merchandise imports as percentage of gross domestic expenditure



More important, however, was the downward trend in real gross domestic fixed investment after 1982.

Machinery and electrical equipment, and transport equipment nevertheless remained South Africa's largest import categories. Collectively these two classes of imports accounted for 44,7 per cent of total merchandise imports in 1982 and for 46,1 per cent in 1989. Agricultural imports retreated from a peak of 8,5 per cent of total imports in the drought year 1984 to a fairly typical 5,4 per cent in 1989. Completion of the successive oil-from-coal projects also caused the share of mineral imports to decline substantially.

As a result of these various structural changes since 1980, the value of merchandise exports increased – despite the weakening of the terms of trade from mid-1988 – from an average of 59 per cent of the value of merchandise imports in the four-year period 1980-83 to more than 90 per cent in 1989 and the first half of 1990.

Diverse views – not to be discussed here in detail – may, of course, be taken of these developments. Granted that the increase (in fact, the doubling) of the aggregate volume of merchandise exports since 1983 has been impressive, it may be noted that this was only possible under the impact of a generally healthy world economic environment and of a frequently slack, or at least less than fully stretched, domestic economy which has not succeeded in generating acceptable levels of formal employment and has mostly failed to display satisfactory growth. Doubts may also be expressed (debatably) about the desirability of continued relatively heavy reliance on non-manufacturing

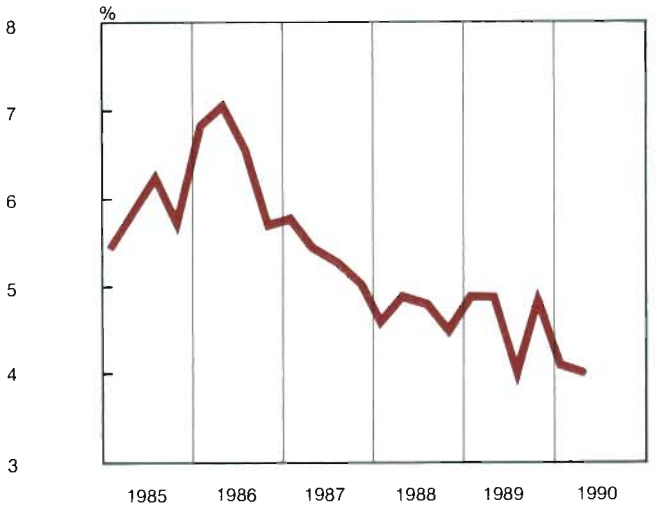
exports from the point of view of future development needs.

In a more positive vein, the growth of non-gold exports may be seen as proof of the adaptability of the South African economy even in the face of sanctions and international antagonism and without the benefit – as yet – of more thoroughgoing domestic economic structural reforms, and as evidence of South African goods being able to hold their own in world markets given appropriate exchange rate policies. Realistically, it should be noted that a 90 per cent cover of merchandise imports by merchandise exports still leaves 10 per cent of these imports, *plus* the negative balance on the services account, capital outflows, and the need for a strengthening of the foreign reserves, to be "provided for" by the currently hard-pressed gold-mining industry.

A note on the improvement in the services account

Net service and transfer payments to non-residents as a current account item declined from a high point of 6½ per cent of the gross domestic product in 1986 to 4½ per cent in 1989 and the first half of 1990. As in other developing countries, these net payments tend to be high in South Africa mainly because of payments of interest and dividends on foreign investments and payments of freight and insurance, especially on the importation of capital goods.

Net services and transfer payments as percentage of gross domestic product



The decline since 1986 in the relative importance of net service and transfer payments was due to a relative *decline* in gross service and transfer payments rather than to an increase in gross *receipts*. The diminishing relative significance of total gross payments was, in turn, largely a reflection of lower payments of interest which accompanied or followed the repayment of large amounts of foreign debt.

Being denominated in rand, dividend payments also did not increase in rand terms as a result of the depreciation of the rand over the past several years. In addition, the relative decline in merchandise imports (in proportion to the gross domestic product and related macro-economic variables, as discussed earlier) gave rise to a levelling-off of the relative importance of freight and merchandise insurance payments on imported goods.

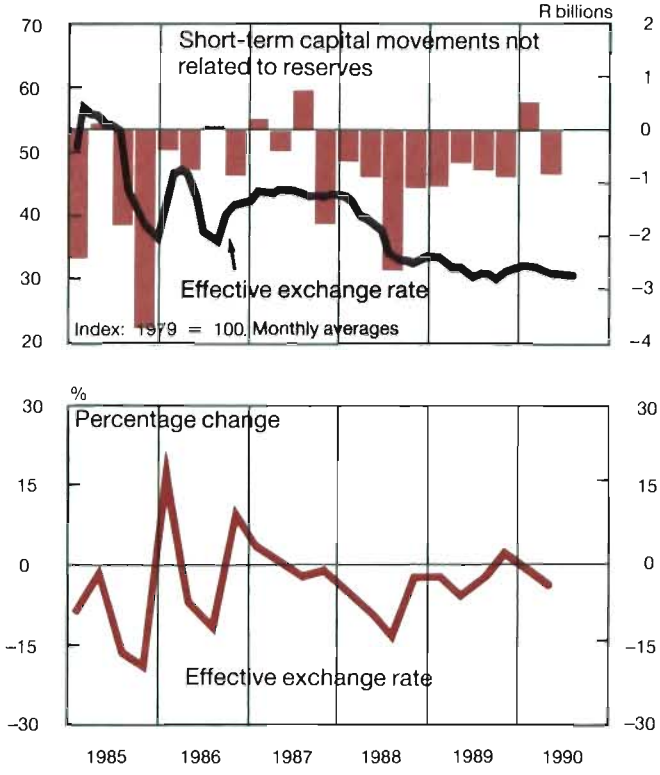
During the first half of 1990 the services account benefited from a substantial upturn in foreign travel expenditure in South Africa. This contributed materially to the shrinkage of total net service and transfer payments from their unusually high level of R12,0 billion (seasonally adjusted and annualised) in the fourth quarter of 1989 to R10,3 billion in both the first and the second quarter of 1990.

Lower aggregate outflow of capital

The total outflow of *short-term* capital not related to reserves (but including unrecorded transactions) shrank dramatically to R3,4 billion in the six quarters to mid-1990 from R6,0 billion in the preceding six quarters. A major break in the earlier pattern of these outflows occurred in the first quarter of 1990: an *outflow* of R0,8 billion in the fourth quarter of 1989 was followed by an *inflow* of R0,5 billion in the ensuing three months.

As is shown by the accompanying graph, movements of short-term capital have been associated in a broadly positive manner with contemporaneous exchange rate movements: mainly because of activation of so-called leads and lags in foreign payments and receipts, *out*flows of short-term capital have tended to increase in periods of exchange rate *weakness* and of expected exchange rate declines. Strengthening of the effective exchange rate of the rand from October 1989, and the rand's relative stability in 1990 to date, accordingly played a major part in the transformation of the short-term capital outflows of 1989 into inflows in the first quarter of 1990. This transformation was also assisted by relatively high real South African short-term interest rates, which led South African importers to switch from domestic to foreign sources of trade finance.

Short-term capital movements and effective exchange rate of the rand



Contrary to developments in short-term capital movements, the outflow of *long-term* capital rose from R2,3 billion in the six quarters to the end of 1988, to R3,3 billion in the ensuing six quarters to mid-1990. This increase consisted mainly of increases in non-residents' sales of securities listed on the Johannesburg Stock Exchange, but also included increases in obligatory repayments on foreign debt in accordance with the debt standstill arrangements with foreign creditor banks, as well as increases in other redemptions of foreign debt. In terms of the standstill arrangements and because of the maturity structure of the affected debt, very large amounts of debt fell due for repayment in the first half of 1990 and in the second quarter of 1990 in particular. Of the total amount of approximately US$2,2 billion that is to be repaid (both "inside" and "outside" the standstill net) in 1990, relatively demanding amounts of $1,2 billion and $1,6 billion fell due for repayment in the second quarter and in the first half of the year respectively.

The total net outflow of long-term capital and of short-term capital not related to reserves in the six quarters to mid-1990 amounted to R6,7 billion. This may be compared with a total net outflow of R8,3 billion in the preceding six quarters.

Financing of large debt repayments

Satisfactory strength of the current account in the second half of 1989 and the first quarter of 1990, and the improved situation on the capital account, caused the South African total *net* gold and other foreign re-

Net capital movements not related to reserves
R millions

	1988		1989		1990
	Year	1st half	2nd half	Year	1st half
Long-term capital					
Public authorities	–440	–456	–190	–646	–879
Public corporations	–636	440	–4	436	438
Private sector	–97	–1 112	92	–1 020	–1 673
Total long-term capital	–1 173	–1 128	–102	–1 230	–2 114
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	–5 035	–1 575	–1 540	–3 115	–234
Total capital movements excluding liabilities related to reserves	**–6 208**	**–2 703**	**–1 642**	**–4 345**	**–2 348**

serves to rise by R2,3 billion during this three-quarter period. This increase was mainly represented by reductions of nearly R1,2 billion in reserve-related foreign liabilities. Most of the overseas credit lines concerned were, however, held open; they were therefore available to help bridge the very large debt repayment obligations in the second quarter.

In the event, the second quarter of 1990 witnessed a renewed increase in reserve-related liabilities of only R68 million. The total net foreign reserves declined by R1,1 billion during this period. In July 1990, the net gold and other foreign reserves of the *Reserve Bank* increased again by R848 million.

The South African total *gross* gold and other foreign reserves rose by R0,9 billion in the first quarter of 1990, but fell back, by R1,4 billion, to R6,4 billion at the end of the second quarter. The remaining reserves were equal to some 1,2 months' total imports of goods and services. In July 1990, the *Reserve Bank's* gross gold and other foreign reserves strengthened moderately by R277 million to R5,4 billion at the end of the month.

The Reserve Bank's *gold* reserves rose from 3,1 million fine ounces at the end of December 1989 to 3,6 million fine ounces at the end of April 1990, but retreated to 3,4 million fine ounces at the end of June. However, because of the declining dollar price of gold, the dollar value of the Bank's gold stock declined more steeply from $1,3 billion at the end of February 1990 to $1,1 billion at the end of June.

Further improvement in foreign debt position

Reflecting continued foreign debt repayments both inside and outside the standstill net, South Africa's total foreign debt declined from US$21,2 billion at the end of 1988 to $20,6 billion at the end of 1989. From the introduction of the first standstill arrangements at the end of August 1985 to the end of 1989, South Africa's foreign debt declined by $3,1 billion or by 13 per cent. Valued in constant US dollars at the dollar's exchange rates vis-à-vis other currencies as on 31 August 1985, total debt repayments amounted to $5,5 billion, or 23 per cent of the total foreign debt, over a period of somewhat more than four years. In rand terms South Africa's total foreign debt declined from R65,8 billion at the end of August 1985 to R52,5 billion at the end of 1989.

South Africa's ratio of debt to export earnings declined from 128 per cent to 79 per cent, and its ratio of debt to gross domestic product from 43 per cent to 23 per cent, from 1985 to the end of 1989. The more recent debt ratios put South Africa among developing countries with some of the lowest relative foreign debt burdens in the world. Among the various groups of developing countries listed by the International Monetary Fund, foreign debt ratios lower than South Africa's have recently been reported only by the four newly industrialising East and South East Asian economies.

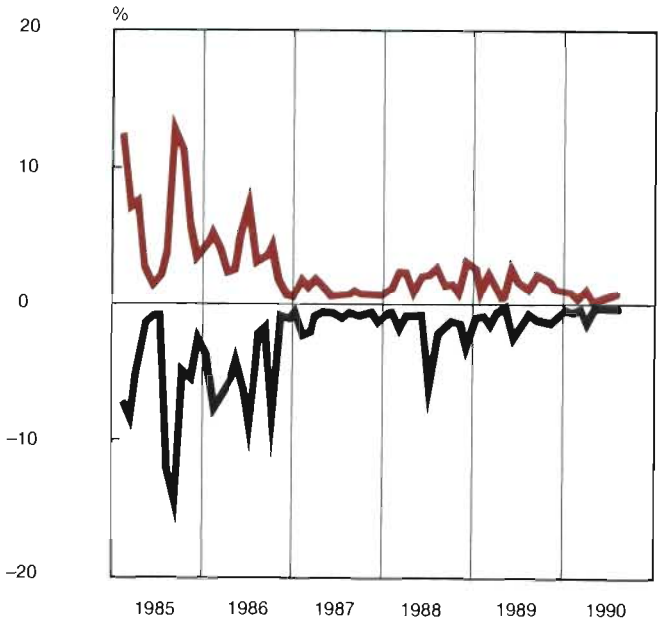
The improvement in South Africa's foreign debt situation was also reflected in the country's credit rating as computed by an international investors' journal. Before the debt standstill South Africa took 29th position in a world ranking of all borrowing countries; its credit rating was 57,1 per cent. After the debt standstill, South Africa's international ranking fell back to 57th position, at a credit rating of 31,3 per cent. By March 1990 its ranking had, however, recovered to 51st position, at a credit rating of 34,0 per cent. The improvement in the country's credit rating in the six months to March 1990 was the sixth largest such increase in the world during that period. South Africa's standing as an international borrower stands to be raised further when repayment of the full amount of US$2,2 billion due in 1990, as referred to earlier, will have been completed by the end of the year.

More stable exchange rate of the rand

Largely because of relatively high interest rates in the American money market at the time, the effective exchange rate of the US dollar rose by 11½ per cent from the beginning of 1989 up to June of that year. Strength of the US dollar in the world's foreign exchange markets was therefore a major factor in causing the rand to decline, on 15 June 1989, to its lowest value in terms of the dollar ever recorded, at a level of R2,8743 per dollar or US$0,3479 per rand.

Apart from this unexpected vigour of the American dollar, the rand was also affected adversely in the first 8½ months of 1989 by the narrowing of the surplus on the South African current account in the first two quarters of 1989, by large debt repayment obligations in June 1989, and by the decline in the dollar price of gold to a low point for the year of US$358 per fine ounce on 15 September. Having strengthened, on balance, by 2 per cent in 1987 and weakened by 22,5 per cent in 1988, the effective exchange rate of the rand accordingly weakened further, on balance, by 10,9 per cent from 1 January 1989 to its lowest value ever recorded on 18 September 1989. This further decline in the exchange value of the rand comprised depreciations against all major currencies, but most prominently against the US dollar. From 1 January to 18 Sep-

Largest positive and negative deviations from average effective exchange rate of the rand



Changes in the exchange rates of the rand
%

	30 Dec 1988 to 18 Sep 1989	18 Sep 1989 to 31 Jul 1990
Weighted average	–10,9	1,8
US dollar	–15,9	8,8
British pound	–3,7	–7,8
German mark	–7,7	–10,8
Swiss franc	–5,9	–12,5
Japanese yen	–2,3	9,8
French franc	–8,7	–11,4
Financial rand	–5,2	4,5

tember 1989, the index value of the effective exchange rate of the rand (1979 = 100) fluctuated downwards from 34,1 to 30,1.

Weakening of the US dollar, the more impressive South African current account surpluses of the third and the fourth quarter of 1989, and strengthening of the dollar price of gold, subsequently caused the effective exchange rate of the rand to appreciate by 7,3 per cent up to 5 January 1990. Downward pressure on the exchange rate was exerted again, however, by sharp setbacks to the dollar price of gold in late March and in late May and early June 1990, and by heavy debt repayment obligations in the second quarter of 1990. Fluctuations in the index value of the effective exchange rate of the rand from 18 September 1989 to August 1990 nevertheless did not stray beyond lower and upper limits of 30,1 and 32,3 respectively. Even greater stability was displayed by the exchange rate from the beginning of April 1990 up to early August, when the range of fluctuations in the exchange rate index extended only from 30,4 to 31,3.

At the end of July 1990 the effective exchange rate of the rand was still 1,8 per cent above its low point of 18 September 1989. This reflected appreciations of the rand against the yen and the dollar which outweighed depreciations against all other major currencies.

The *real* effective exchange rate of the rand declined, on average, by 5,3 per cent from 1988 to 1989, mainly in sympathy with the decline in the *nominal* effective exchange rate. However, the average real effective exchange rate then appreciated again by a similar percentage in the first six months of 1990 vis-à-vis its average level in 1989, as a reflection of the relative stability of the nominal exchange rate during this period in the face of sustained large differences between the South African inflation rates and inflation in the country's principal international trading partners.

The *financial* rand remained at relatively depressed levels during the larger parts of both 1989 and the first half of 1990. During most of these eighteen months, the financial rand's discount vis-à-vis the commercial rand did not decline to less than 30 per cent, and occasionally even moved close to 40 per cent. This generally weak performance of the financial rand was temporarily interrupted, however, by the markets' positive response to the State President's address at the opening of Parliament on 2 February 1990.

By 6 February 1990 the financial rand had firmed to R3,13 per dollar and to a discount against the commercial rand of 19,2 per cent. Changing assessments of the socio-political situation and the continuation of violence in certain parts of the country subsequently caused the financial rand to return to levels of around R4,00 to the dollar and to its earlier discount of more than 30 per cent.

Monetary and financial developments

Anti-inflation stance and structural reorientation of monetary policy

The curbing of inflation was explicitly stated by the Reserve Bank to be the prime objective of its monetary policies early in the 1989/90 review period. In a similar vein, the Bank's "mission", as formulated and adopted by the Bank's Board of Directors and management in April 1990, was declared to consist of the protection of the domestic and external value of the rand. On the basis of this broad policy orientation, a fairly restrictive stance of the Bank's policies – which were actually tightened somewhat further from the posture they had been made to assume in preceding quarters – was maintained by the Bank in the year to August 1990. Bank rate was raised from 17 to 18 per cent with effect from 11 October 1989. This was the seventh increase in Bank rate since the Bank's adoption of a "less accommodative" policy stance in the closing weeks of 1987, and the sixth such increase since the first Bank rate increase in the most recent series from 9,5 to 10,5 per cent on 9 March 1988.

Reasons for adhering to a fairly restrictive stance of policy could be found in continuing double-digit or high single-digit levels of inflation as measured by the major price indices, in wage developments as in 1989 in particular, in sustained relatively high rates of expansion of the monetary and credit aggregates, in the need for maintaining surpluses on the balance of payments on current account, and in the relatively low level of the foreign reserves. These various considerations were reinforced by the generally upward drift of interest rates in some of South Africa's principal trading partner countries and by the disappointing behaviour of the dollar price of gold during large parts of the 1989/90 review period. In its various public statements during the year, the Reserve Bank – while acknowledging that the economy was cooling down cyclically and while expressing its satisfaction with the direction in which various aggregates (notably in the realm of the balance of payments, the exchange rate, the foreign reserves, and the foreign debt situation) had already been moving – did not yet consider the progress made in the economy's various problem areas sufficiently impressive, well-established or convincing to justify contemplation of an early relaxation of its policies.

Also with regard to its broad policy orientation, the Bank during the past twelve months made clear its strong preference for interest rates that would be positive in real terms (although not necessarily, of course, to an unchangeable degree) in virtually all conceivable conditions. In turn, the Bank's commitment to positive real interest rates – which, among several other things, serves as an acknowledgement of the relative scarcity of capital as a productive resource in the South African economy – implied constraints on the extent to which the authorities would be willing to wield the interest rate weapon for the purposes of a contra-cyclical policy.

The immediate occasion for the Bank rate increase of 11 October 1989 was provided by increases in the discount rates of certain important central banks in Western Europe and in the United Kingdom. Following these rate increases, real interest rates in several of the countries concerned had come to exceed their South African counterparts by substantial margins. The increase by one percentage point in the Reserve Bank's rediscount rates at the discount window was accompanied by an across-the-board increase of 1,25 percentage points in the rates on the Bank's overnight loan facilities, as a further disincentive to banking institutions to make use of this kind of accommodation.

Also within the framework of its stern anti-inflationary policy attitude, the Reserve Bank lowered its 14-18 per cent target range for growth in M3 in the targeting year 1989 to a "guideline" range of 11 to 15 per cent in the money-management year 1990. The change in terminology from "targets" to "guidelines" served to make clear that the propounded limits to monetary growth were an indication of what *should* happen to the money supply in 1990, rather than an authoritative forecast of, or a binding commitment to, a predetermined rate of monetary expansion. A more flexible and relaxed approach to monetary targeting must, however, usually also be a logical concomitant of policies in which the authorities are bound to observe certain constraints with regard to the level of real and nominal interest rates.

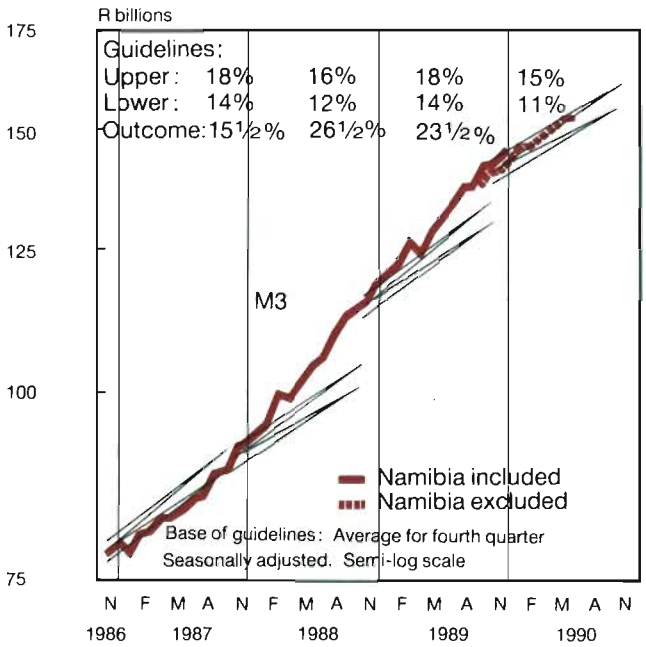
In keeping with the authorities' intention to reduce the rates of monetary and credit growth further, money market conditions were kept relatively tight throughout the 1989/90 period under review. This was done partly, and where circumstances so required, through the sterilisation of flows of liquidity into the market that arose from increases in the Reserve Bank's net gold and other foreign reserves.

Deceleration of growth in the money supply

Rates of increase in the broadly defined money supply, M3, which had peaked at very high levels in the third quarter of 1988, receded significantly thereafter. The twelve-month rate of growth in M3 reached a high point of 27,5 per cent in August 1988 before retreating gradually to 17,2 per cent in June 1990. The quarter-to-quarter increases in the quarterly average of M3, in seasonally adjusted and annualised terms, touched a high point of 28,5 per cent in the third quarter of 1988, but declined to 19,0 per cent in the first quarter of 1990 and to only 12,5 per cent in the second quarter.

Growth in the quarterly average of M3 from the fourth quarter of 1988 to the fourth quarter of 1989 – i.e. growth in M3, as measured for targeting purposes, in the 1989 targeting year – amounted to 23,5 per cent. M3 therefore exceeded the upper boundary of the 14-18 per cent 1989 target range by a considerable margin of some 4,7 per cent. The extent of this overshoot, however, was notably smaller than the overshoot of 1988, when growth in M3 of 26,5 per cent as measured for targeting purposes had caused the upper limit of the 12-16 per cent target range to be breached by more than 9 per cent.

Guidelines for growth in M3



New guidelines for the rate of increase in the quarterly average of M3 of 11 to 15 per cent from the fourth quarter of 1989 to the fourth quarter of 1990 were announced by the Governor of the Reserve Bank on 23 March 1990. The lowering by three percentage points of the 1990 guideline range as compared with its 1989 target counterpart was meant to convey to the public an impression of the authorities' anti-inflationary resolve as well as the official expectation of somewhat lower inflation in 1990 than in the preceding year. The guidelines at their reduced levels were believed to be reconcilable with projected growth in the real gross domestic product in the calendar year 1990 of up to 1 per cent, a surplus on the current account of the balance of payments of at least R6 billion, and a gradual rise in the official gold and other foreign reserves.

Growth in M3 in the first half of 1990 generally declined further along its growth rates' fluctuating downward paths. The rate of increase in M3 over twelve-month periods receded from 22,4 per cent in December 1989 and 23,5 per cent in January 1990 to the level of 17,2 per cent in June 1990 already referred to. The seasonally adjusted and annualised rate of increase in M3 from the beginning of the 1990 guideline year (mid-November 1989) to the end of June 1990 amounted to 14,6 per cent. It was, therefore, marginally below the 15 per cent upper boundary of the 1990 guideline range.

Continuing declines in the growth rates of M3 in the first half of 1990 may be assumed to have been a reflection primarily of the slowing-down of the growth in private-sector parties' needs for nominal money balances for transaction purposes, on account of the recent mild declines in real gross domestic product and expenditure and of significant moderations of most inflation rates after the middle of 1989. In addition, reintermediation phenomena had probably almost run their full course by the first quarter of 1990. The margin between banks' average lending and average deposit interest rates (which tends to narrow in conditions of money market tightness, heavy credit demand and fierce inter-institutional competition for deposits, thereby encouraging reintermediation) would appear to have reached a minimum level in the final quarter of 1989 and to have widened somewhat in the ensuing quarters: the ratio of banks' interest received to interest paid (which is held to be indicative of the lending rate/deposit rate margin) reached a low point (of 1,17) in the fourth quarter of 1989.

Finally, by the second quarter of 1990 market participants' expectations were increasingly turning away from the possibility of another Bank rate increase and had begun anticipating a possible Bank rate decline. Considerations of "liquidity preference proper", there-

fore, by themselves and by that time no longer suggested a need for a deliberate building-up of highly liquid balances.

Considerable volatility was displayed by the monetary growth rates over shorter periods. Transitory events (such as the extension of bank credit and the creation of bank deposits that preceded the Iscor share issue in October 1989, and round-tripping in the tight money market conditions at the end of January 1990) were reflected in sharp but short-lived reaccelerations of money growth.

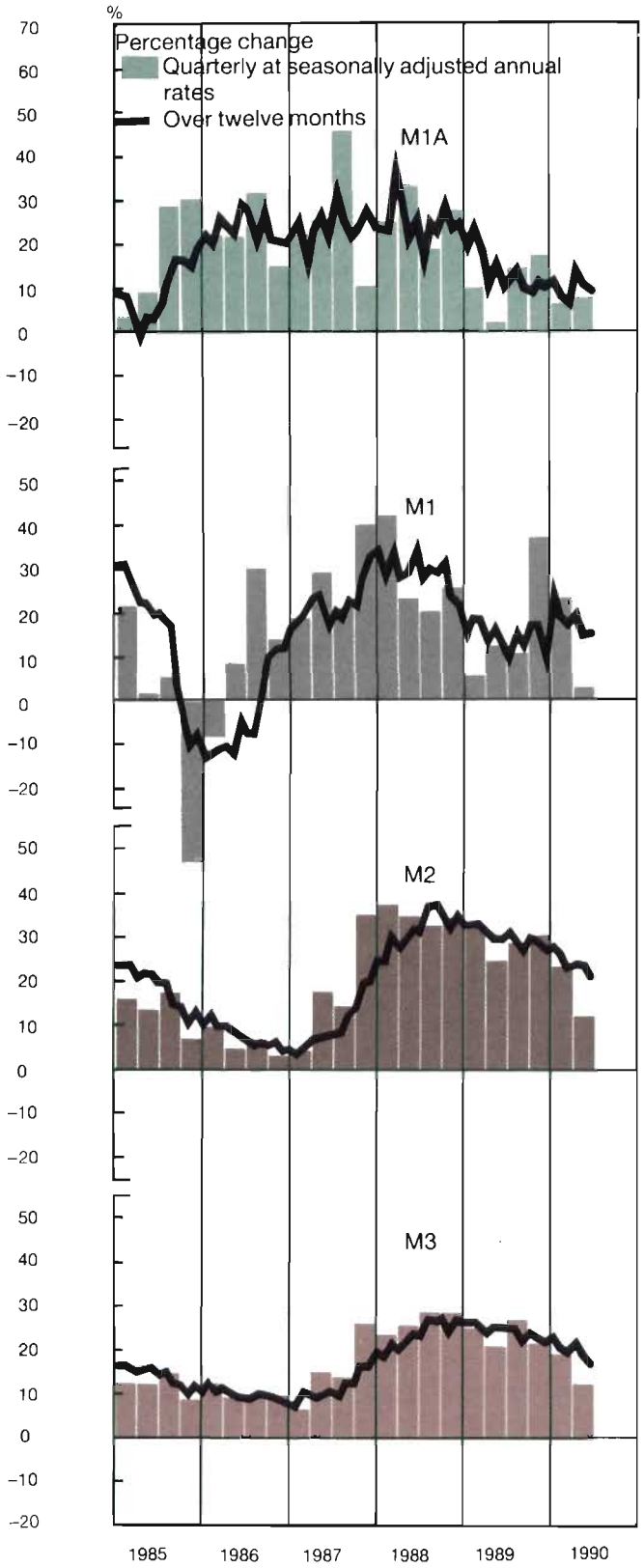
Reserve Bank action with regard to repurchase agreements

Measures for bringing banking institutions' commitments on account of repurchase agreements onto these institutions' balance sheets, were announced by the Reserve Bank on 24 April 1990, partly so as to allow these commitments to be made subject to cash reserve and liquid asset requirements. (Cash reserve and liquid asset requirements were, in fact, made to apply – with effect from the date of the banks' submission of their monthly returns for May 1990 – to the amounts of the banks' commitments as at month-ends *in excess of* the level of these commitments at the end of February 1990). The objective of these measures, which anticipated the introduction of pertinent provisions in the proposed Deposit-Taking Institutions Act, was to prevent a further erosion of banks' prudential provisionings, in the interest of the soundness of banks and the health of the banking system. These measures did not, therefore, signify a deliberate tightening of the Reserve Bank's monetary policy stance.

Changes in the composition of the M3 money supply

The comparative rates of increase in M1A, M1, M2 and M3 during the twelve months to the end of June 1990 amounted to 9,8 per cent, 15,5 per cent, 21,1 per cent and 17,2 per cent. Relatively slow growth in M1A (comprising notes and coin in circulation and cheque and transmission deposits, i.e. "transaction" moneys) was a reflection of generally less buoyant economic activity, moderation of most inflation rates, and economic agents' economising on their holdings of non- or low-interest-earning forms of money in a high interest rate environment. In the first half of 1990 the annualised growth rate of M1A amounted to less than 2 per cent.

Monetary aggregates



Increases in components of M3, end of June 1989 to end of June 1990

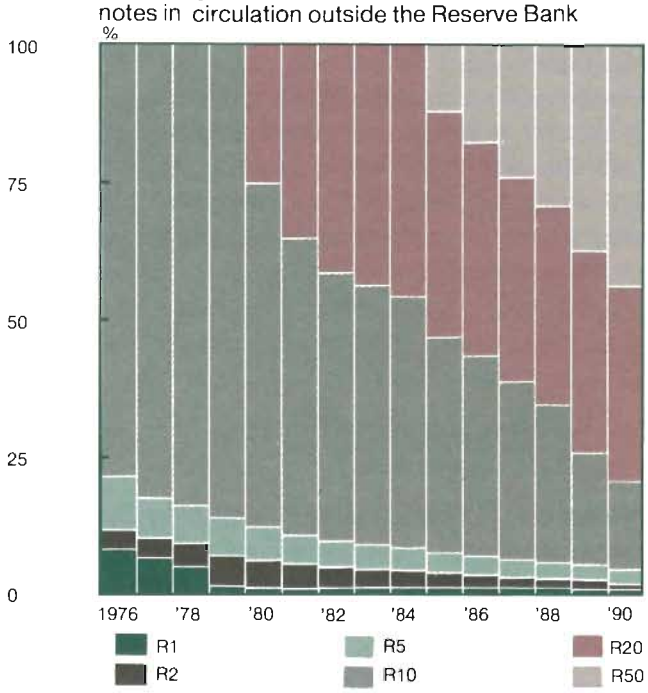
%

Banknotes and coin in circulation	13,0
Cheque and transmission deposits	8,4
M1A	9,8
Other demand deposits	22,1
M1	15,5
Other short- and medium-term deposits	25,2
M2	21,1
Long-term deposits	3,1
M3	17,2

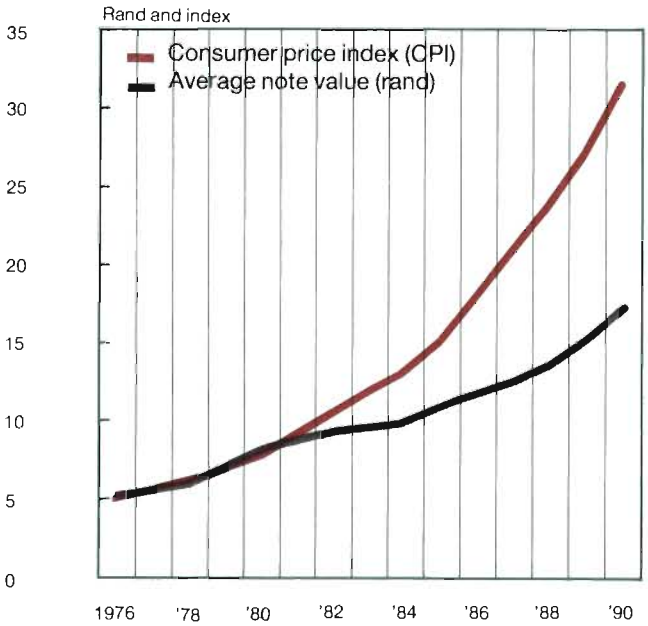
Growth in "other demand" deposits still accelerated from 1988/89 to 1989/90 as a whole. This was a reflection of relatively high overnight money rates in generally tight money market conditions. Growth in "other short"- and medium-term deposits, on the other hand, declined substantially from 1988/89 to 1989/90, essentially because of very slow growth in these deposits in the first half of 1990. This reflected a waning of the forces making for reintermediation and for "liquidity preference proper", as the markets turned away increasingly from rising interest rate expectations. As the counterpart of this development, long-term deposits rose markedly again (at an annualised rate of 27,4 per cent) in the first half of 1990, after having *declined* in the preceding six months. In the full twelve months to mid-1990, however, growth in these deposits was still substantially slower than in the preceding year.

Composition by denomination of notes in circulation

Percentage composition of the total rand value of notes in circulation outside the Reserve Bank



The value of the "average" note in circulation and consumer prices



The CPI was rebased in such a way that its base value in March 1976 of 5,16 coincides with the value of the average note in circulation in March 1976 (R5,16)

Prolonged double-digit inflation in South Africa has been at the root of major changes in the composition of the stock of *banknotes and coin* in use by the general public and by monetary institutions. As was to be expected, steadily rising prices have created a demand for larger-denomination banknotes which has had to be satisfied periodically by the authorities. Also, the high tempo of cancellation of R2 notes eventually (from October 1989) warranted their replacement by R2 coins as a cost-reducing measure.

Increasing use has been made over the past 15 years of cheques, credit cards and other non-cash forms of payments, especially by households for their more highly priced purchases. As is shown by the accompanying graph, the result of this recourse to non-cash payment facilities has been that the "size" or denomination of the "average" note in circulation outside the Reserve Bank has not kept pace with the average price, or expensiveness in money terms, of consumer goods and services as measured by the consumer price index.

Income velocity of circulation of the monetary aggregates

Gross domestic product at current prices in the second quarter of 1990 was some 11,6 per cent higher than in the second quarter of 1989. Growth in the quarterly average of M3 amounted to 19,8 per cent over this four-quarter period. M3's velocity of circulation accordingly declined by approximately 6,9 per cent during the year concerned. This followed similar declines in the preceding two years.

Growth in M3 in excess of growth in the nominal gross domestic product during 1989/90 could still be attributed, partly, to the forces of reintermediation and investors' enhanced liquidity preference proper, which had been associated with rising interest rates and rising interest rate expectations especially in the earlier parts of the year. The levelling-out of interest rates in the first 7½ months of 1990, and accompanying changes in interest rate expectations, are now, however, likely to have removed these upward pressures on the growth rate of the money supply.

The public's economising on low- or non-interest-bearing forms of money holdings caused the income velocity of M1A to accelerate marginally during the year. The velocities of M1 and M2, like that of M3, still declined. M2's velocity of circulation, in fact, still declined somewhat more markedly than that of M3.

Domestic credit extension

The quarter-to-quarter rate of increase in monetary institutions' claims on the private sector, which had reached its cyclical high point of 33,2 per cent (seasonally adjusted and annualised) in the fourth quarter of 1988, decelerated significantly in the course of 1989 and the first half of 1990. This rate amounted to 23,9 per cent, 12,6 per cent, 25,4 per cent and 22,8 per cent in the four successive quarters of 1989, and to 16,0 per cent – or to less than half as much as at its peak in 1988 – in the first two quarters of 1990.

Broadly speaking, the subsidence of the rate of monetary institutions' extension of credit to the private sector was a reflection of the moderate cyclical slackening of business conditions, cyclical declines in fixed and inventory investment and in durable goods purchases, the moderation of the inflation rates, and the associated slow-down of the growth in credit demand. In addition, however, the first quarter of 1990 is also likely to have witnessed some change-overs by South African importers and exporters from domestic to foreign sources of trade finance. Such change-overs will have been included on the balance of payments in the first-quarter inflow of short-term capital.

Monetary institutions' claims on the domestic private sector

	June 1989 Rm	June 1990 Rm	Percentage change
Investments	2 138	3 000	40,3
Bills discounted	6 336	10 039	58,4
Hire-purchase credit	14 143	16 593	17,3
Leasing finance	7 808	9 839	26,0
Mortgage finance	50 545	58 398	15,5
Other loans and advances	46 936	53 710	14,4
Total claims	127 906	151 579	18,5

During the year to mid-1990 the growth in total claims of monetary institutions on the private sector amounted to 18,5 per cent, against 25,9 per cent in the year to mid-1989. An analysis by type of credit shows that *bills discounted* (which had already increased by 29,3 per cent in 1988/89) rose by as much as 58,4 per cent in 1989/90. Private monetary institutions built up their holdings of liquid bills both to be able to comply with the statutory liquid asset requirements and to avoid having to approach the Reserve Bank's discount window with non-liquid instruments, which would mean being subjected to penal rates on overnight loan accommodation.

Monetary institutions' holdings of *investments* in private-sector securities rose by 40,3 per cent in the twelve months to mid-1990 after having declined by some 25,7 per cent in the preceding twelve months. To an important extent, however, the decline in these holdings in the year to mid-1989 is likely to have reflected large increases in certain banks' commitments under repurchase agreements (i.e. increases in these banks' off-balance sheet operations) in the first half of 1989 in particular; like bills discounted (and government securities), certain private-sector securities may be used conveniently as the underlying instruments in buy-back transactions. The new rules governing repurchase agreements referred to earlier caused a levelling-off in repurchase agreements and contributed to a resumption of growth in monetary institutions' "measured" investments.

Leasing finance still expanded relatively strongly during the 1989/90 review period. A general cooling-down of the economy was more obviously apparent, however, in declines in the tempo of growth in monetary institutions' hire-purchase credit extended,

mortgage advances and "other" loans and advances, from some 32,6 per cent, 25,8 per cent and 26,2 per cent in the twelve months to the end of June 1989 to more moderate rates of increase of 17,3, 15,5 and 14,4 per cent in the twelve months to the end of June 1990.

The seasonally adjusted increase in the total of *hire-purchase credit and leasing finance*, which correlates well with sales of durable consumer and investment goods, fell back from around R1,4 billion in each of the first three quarters of 1989 to amounts of R1,0 billion, R0,9 billion and R1,1 billion in the final quarter of 1989 and in the first and the second quarter of 1990. Increases in the monetary institutions' holdings of *mortgage finance* slowed down similarly from R2,6 billion and R2,4 billion in the first two quarters of 1989 to R1,8 billion and R1,9 billion in the ensuing two quarters, but reaccelerated to R2,1 billion and approximately R2,0 billion in the first and the second quarter of 1990.

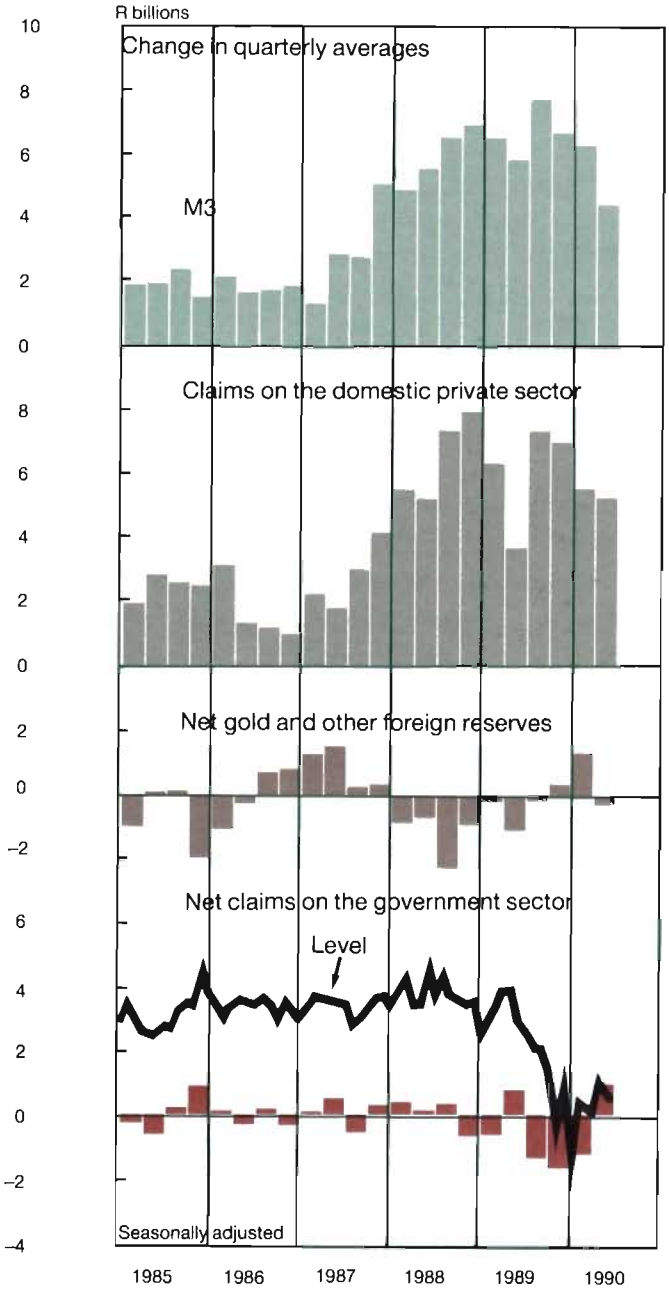
In the statistical or accounting sense, the R22,3 billion increase in M3 during the twelve months to mid-1990 was more than fully explained by the increase of R23,3 billion in the monetary system's claims on the domestic non-bank private sector. As is also brought out by the accompanying graph, the money-creating system's extension of credit to the private sector "accounted for" virtually all of the very large monetary expansion that was observed in the course of the 1986-89 cyclical upswing and in the current downswing phase to date. In 1989/90, however, the monetary system's net gold and other foreign reserve holdings also rose by R0,7 billion, whereas monetary institutions' net claims on the government sector *declined* by R2,2 billion. Declines in monetary institutions' net claims on the government sector (essentially reflecting large temporary build-ups of government deposits with the Reserve Bank) caused these net claims to become *negative* at the end of November 1989; they reached a peak *negative* amount of as much as R2,4 billion at the end of January 1990.

"Net other assets" of the money-creating sector, which include the Reserve Bank's claims on the Treasury on account of shortfalls experienced by the Bank in its provision of forward foreign exchange cover, rose slightly (by R0,5 billion) in the twelve months to the end of June 1990, after having increased by R5,3 billion in the preceding twelve months. This was partly a matter of the increased strength of the rand in the foreign exchange markets which during the fourth quarter of 1989 and the first quarter of 1990 allowed the Bank to register surpluses in its provision of forward cover. To a more important extent, however, it reflected the Treasury's payment of R1 billion to the Reserve Bank to reduce the accumulated balance on the Bank's Gold and Foreign Exchange Contingency Reserve Account.

Wealth and credit-demand effects of increased property values

In South Africa as in other countries, households' willingness and ability to borrow may be influenced greatly by increases (or decreases) in the market prices or money values of their owner-occupied homes and other

Changes in M3 and its statistical counterparts

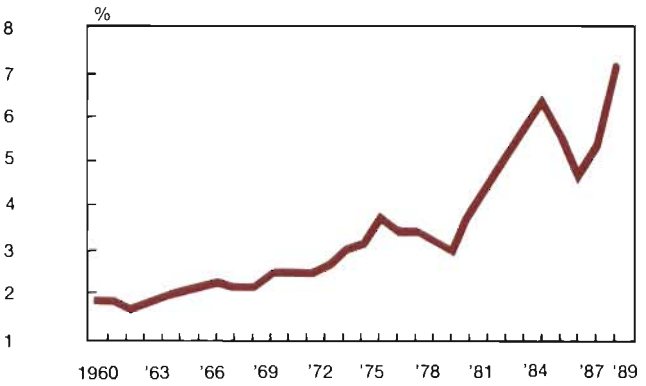


privately owned residential buildings. During the past three decades the vast majority of homeowners in South Africa experienced considerable appreciations of the market values of their properties. Relative to the market values of these properties, the outstanding amounts of the mortgage loans on these properties typically tend to decline markedly in inflationary periods.

Other things being equal, the homeowner's growing "equity" interest in his own home, in both real and nominal terms, means an increase in his net real personal *wealth*, which may be encouraging to consumption expenditure even in the absence of growth in his current real personal disposable *income*. It also provides collateral that can be borrowed against. Homeowners' increased borrowing against the equity in their own homes may therefore also be used, at least for some time, to support a certain style or standard of living and to keep up real personal consumption expenditure at earlier or "habitual" levels when real personal income per capita declines.

Although the available data do not permit firm or accurately quantified conclusions, increases in property values in the increasingly inflationary 1970s apparently caused the ratio of outstanding mortgage loans to the estimated replacement value (as an approximation of the market value) of privately owned residences to decline from more than 60 per cent in the 1960s to less than 50 per cent in the early 1980s. Stepped-up borrowing in the form of mortgage loans (to which the banks' entry into the mortgage lending field is also likely to have contributed) subsequently caused this ratio to rise again to more than 55 per cent in the second half of the 1980s. The ratio of total mortgage loans relative to the *market* value of privately owned residences may well have risen to levels higher than in the early 1960s.

Interest paid on mortgage loans as a percentage of personal disposable income



The counterpart of the rapid expansion of mortgage loans outstanding, in conjunction with higher (and sometimes sharply fluctuating) nominal mortgage interest rates, was a sharp rise in mortgagors' interest payment obligations. Declining interest rates in 1979-80 and 1986-87 caused the upward trend in these payments to be interrupted temporarily. As a percentage of total nominal personal disposable income, interest payments on mortgage loans nevertheless rose, on balance, from less than 2 per cent in the 1960s to more than 7 per cent in 1989.

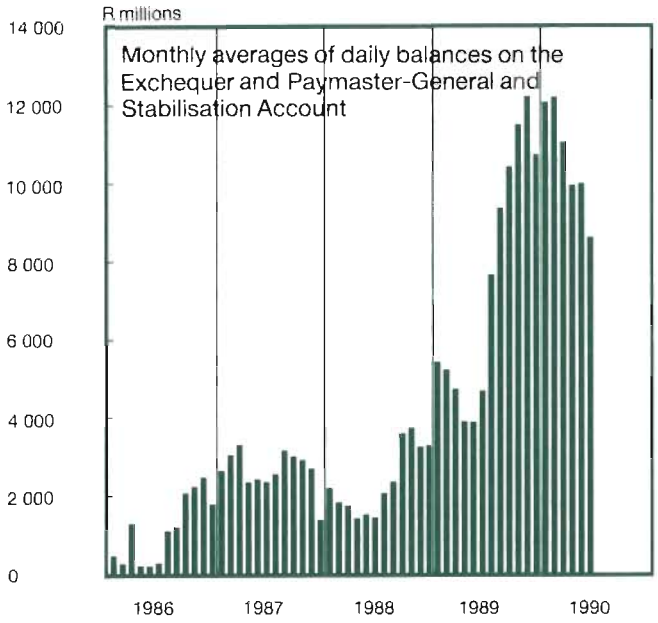
Reserve Bank operations in the money market

Money market conditions, as measured by the market's need for Reserve Bank accommodation, remained tight from mid-1989 to mid-1990. This was in accordance with the Bank's declared restrictive monetary policy stance. The average daily level of the Bank's accommodation of the market at the discount window amounted to R1,8 billion in the first half of 1989, but rose to R3,5 billion and R3,6 billion in the second half of 1989 and in the first half of 1990 respectively. However, after having registered a record monthly average level (in nominal terms) of R4,8 billion in January 1990, average accommodation at the window eased somewhat during the ensuing five months. It amounted to R2,6 billion in June 1990 before rebounding to R3,4 billion in July.

The *month-end* amount of accommodation at the discount window reached an all-time high (in nominal terms) of R5,5 billion at the end of January 1990. The overnight loan component of discount window accommodation amounted to R1,0 billion at the end of January, to R1,4 billion at the end of February, and to a record R2,7 billion at the end of March, but had fallen back sharply at the month-ends of April, May, June and July.

In the accounting sense, a major part of the sharp increase in and subsequent high levels of the money market shortage in the second half of 1989 and the first few months of 1990 was explained by movements in government deposits. During the first half of 1989 the average of the daily totals of government deposits in the Exchequer and Paymaster-General Account with the Reserve Bank amounted to R4,6 billion. An uncommonly large build-up of government deposits, which largely neutralised the expansionary effect on money market liquidity of the considerable shortfalls experienced by the Reserve Bank in its provision of forward foreign exchange cover up to September 1989, was recorded during the second half of 1989. From 1 Sep-

Government deposits with the Reserve Bank



tember 1989 the proceeds from a part of the sale of government stock were deposited in a stabilisation account.

The average of the daily totals of the balance on the Exchequer Account, the Paymaster-General Account and the Stabilisation Account amounted to R10,3 billion and R10,6 billion in the second half of 1989 and the first half of 1990 respectively. On a monthly basis, however, these totals fell back from averages of daily figures of as much as approximately R12,1 billion in both January and February 1990 to R8,6 billion in June and R10,1 billion in July. The balance on the Stabilisation Account amounted to R2,1 billion at the end of July 1990.

Tighter money market conditions during the year under review could also be attributed, in the accounting sense, to an increase in the daily average of the amount of banknotes in circulation. This amount rose from R7,0 billion in the first half of 1989 to R8,0 billion in the second half (including a daily average of R9,4 billion in December), and to R8,2 billion in the first half of 1990.

Easing effects on market conditions were exerted in the course of the 1989/90 review period by slower growth in the money supply, by the rising level of the net gold and other foreign reserves, and by a smaller outflow of capital on the balance of payments. On balance, the second and third of these factors also lent support to the exchange rate of the rand, thereby enabling the Reserve Bank to recoup a part of the shortfalls it had experienced earlier in its provision of forward foreign exchange cover.

Undue easing of the market was, however, counteracted by the Bank partly through the Bank's introduction of dollar swap arrangements with major banks from 23 February 1990. In terms of these arrangements, dollars sold by the Reserve Bank to the banks as foreign exchange dealers are re-deposited by the banks (denominated in dollars) with the Reserve Bank. The dollars are subsequently repurchased by the Reserve Bank at predetermined exchange rates which ensure the banks concerned of a market-related interest rate. The effect of these transactions therefore is a temporary "destruction" of cash reserve balances in the hands of banking institutions. The amount of the temporarily bank-held dollar deposits with the Reserve Bank peaked at a level of R1,7 billion in the middle of May.

Other actions by the Reserve Bank to influence money market conditions included, *inter alia* the issuance, in May 1989, of an amount of R0,8 billion of specially dated tax-Treasury bills, which matured at the end of August 1989. This served as a partial offset to the flow of tax payments to the Exchequer over the August month-end.

The privatisation of Iscor and the listing of the Iscor share issue on the Johannesburg Stock Exchange on 8 November 1989 resulted in a transfer of more than R2,9 billion to the Exchequer. This caused government deposits with the Reserve Bank to rise briefly to a peak amount of R13,5 billion on 27 November. Countervailing action by the Reserve Bank (operating partly through the Corporation for Public Deposits and the Public Investment Commissioners) for mitigating the potential shock effect of this transfer on money market conditions included the purchase of R1 500 million in promissory notes issued by the Land Bank, R88 million of project bills issued by Eskom, and R15 million of "cycle bills" issued by the South African Transport Services. All these bills had matured by mid-February 1990.

The amount of 91-day Treasury bills offered at the weekly tender was reduced from R100 million on 28 July 1989 to nil on 4 August 1989. The tender was resumed on 11 August. The amount of bills on offer was increased gradually again from R20 million on 11 August 1989 to R100 million from 15 June 1990.

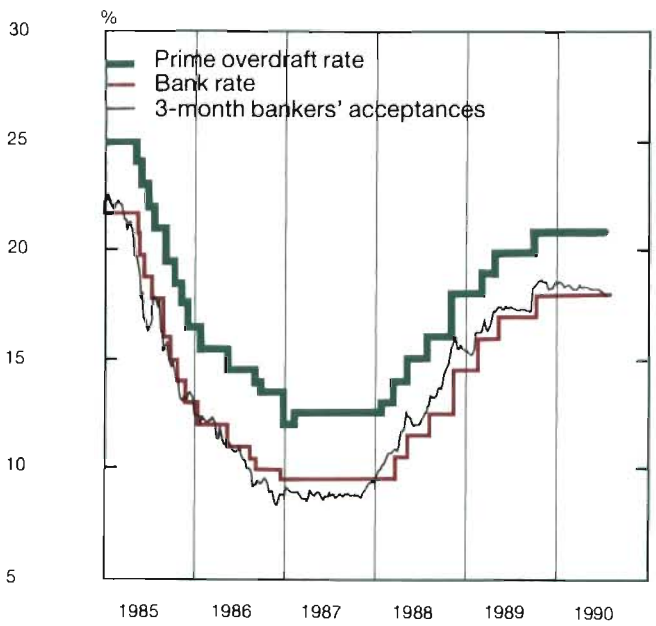
Net open-market sales of government stock by the Reserve Bank declined from R10,1 billion in the fiscal year 1988/89 to R8,4 billion in fiscal 1989/90. Sales in the period from April to July 1990 amounted to R4,6 billion, against R4,2 billion in the same four-month period in 1989.

Money market interest rates

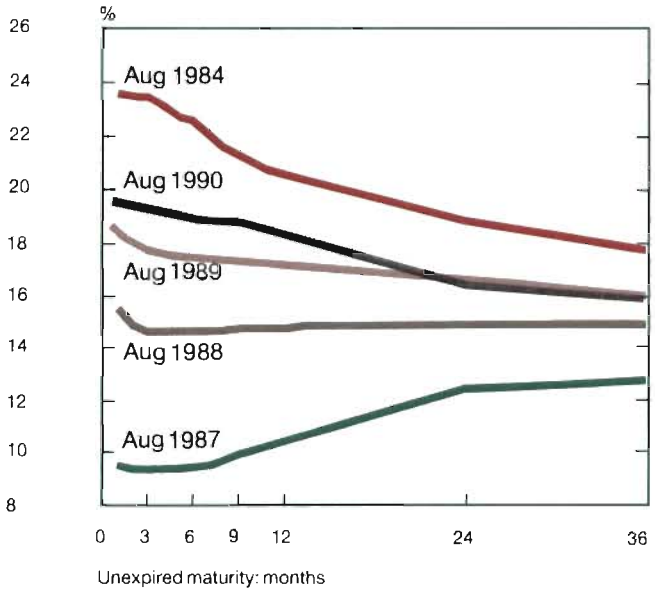
Within the framework of the authorities' gradually tightening policy stance, Bank rate was raised (from its initial level of 9,5 per cent) on four occasions in 1988, and on a further two occasions (eventually to 17 per cent) in the first half of 1989. As noted earlier, it was then raised further, to 18 per cent, on 11 October 1989. Following this most recent Bank rate increase, the clearing banks raised their prime overdraft rates from 20 to 21 per cent.

After having adjusted to the Bank rate increase of 11 October 1989, the market rates on money market instruments generally moved sideways during the remainder of 1989 and the first 6½ months of 1990. The rate on three-month liquid bankers' acceptances, which had fluctuated between 17,30 and 17,60 per cent after the Bank rate increase (to 17 per cent) of 8 May 1989, shifted to fluctuations within a range from 18,25 to 18,80 per cent in the period from 11 October 1989 to mid-July 1990. From mid-July 1990 the market's growing conviction that a Bank rate reduction was to be expected within the next one to three months, caused the liquid bankers' acceptances rate to retreat from 18,20 per cent on 14 July to 18,05 per cent by the end of July. The Treasury bill tender rate eased similarly from 18,00 per cent on 22 June 1990 to 17,75 per cent – i.e. to 0,25 percentage points *less* than the ruling Bank rate – on 27 July.

Short-term interest rates



Yield curves for negotiable certificates of deposit



The severe liquidity shortages that were experienced in the market from the second half of 1989 tended to result in considerable swings in call rates in the course of any "typical" month. The discount houses' call rate reached a high point of 21,25 per cent over the month-ends from October 1989 to January 1990 and again over the month-end of June 1990, thereby calling forth round-tripping on a substantial scale. The mid-month levels of the call rate during this period were generally in the region of 18,25 to 19 per cent. In the extremely tight conditions of January 1990, however, this rate did not decline to less than 19,50 per cent.

Official action resulting in steadily higher money market interest rates from December 1987, also caused the shape of the yield curve on short- to medium-term market instruments to change over from upward-sloping to downward-sloping (or "inverse") from mid-July 1988 onward, as may be illustrated with reference to the yields on negotiable certificates of deposit of various maturities. However, as is shown by the accompanying graph, the gradient or degree of "downward-slopingness" of the yield curve as in August 1990 at the very short end of the maturity spectrum, fell significantly short of the "downward-slopingness" displayed by the yield curve in August 1984. This suggested that the market as in August 1990, while expecting future rate reductions, did not anticipate *dramatic* nominal rate declines within the next twelve months or so.

Capital market developments

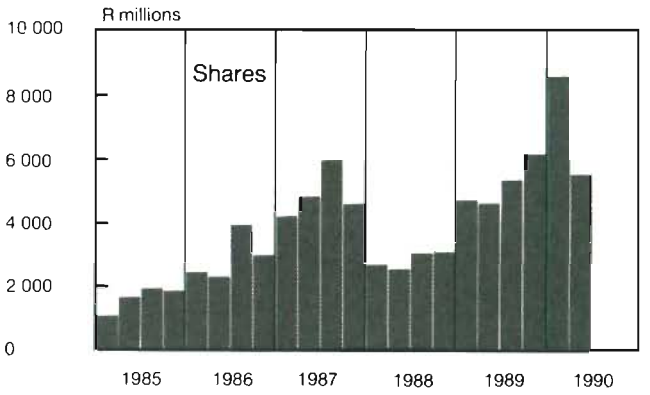
The capital markets in the period from mid-1989 to mid-1990 witnessed increased levels of trading activity in addition to certain major regulatory, institutional and organisational innovations. In the area of trading activity, new record levels were registered in the turnovers of public-sector stock, company shares and real estate. New records were also established during the year in the level of share prices on the stock exchange.

In the regulatory area, the markets experienced the effects of the institutional investors' new freedom of portfolio selection. This freedom resulted from the abolition, announced on 5 May 1989 and promulgated on 1 October 1989, of the prescribed investment requirements for these institutions and the replacement of these requirements by certain limitations on these institutions' various asset holdings.

Innovatory developments included the launching of South Africa's first mortgage securitisation scheme in November 1989, the successful flotation of a major privatisation share issue (the Iscor share issue) also in November 1989, and the partial privatisation of the investment management of designated amounts of the pension fund monies of certain government employees, which had hitherto been administered solely by the Public Investment Commissioners.

Institutional developments included the start of business of the South African Futures Exchange (SAFEX) on 30 April 1990. Progress was also made with preparations for the establishment of a formalised gilts market under the auspices of the Bond Market Association, and for the establishment of a traded options market. In addition, investigations were set afoot for identifying measures that will serve to improve the marketability and tradability of government stock.

Stock exchange transactions



The secondary markets

Following the "crash" of October 1987, the total value of shares traded on the Johannesburg Stock Exchange declined by 42 per cent in 1988 from its 1987 levels. The value of shares traded subsequently rose, however, from R11,2 billion in 1988 to R20,7 billion in 1989 (i.e. by 85 per cent), and reached a record quarterly amount of R8,6 billion in the first quarter of 1990. Turnover then retreated to R5,5 billion in the second quarter of 1990.

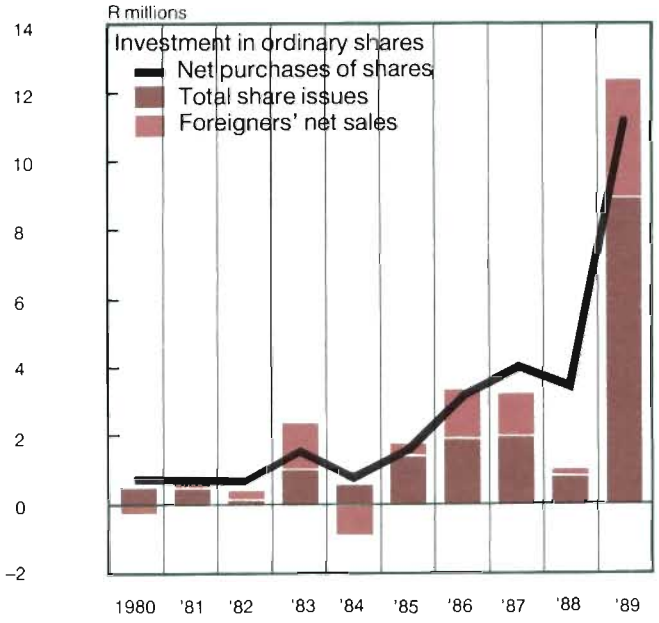
Trading activity in the share market in 1989 and early 1990 was stimulated greatly by the increased freedom of investment action of the institutional investors (i.e. insurers and pension funds) referred to above. These institutions, in fact, more than doubled their net purchases of listed shares from R3,4 billion in 1988 to R11,3 billion in 1989; the total of these two annual amounts, of almost R15 billion, actually exceeded by more than R1 billion the aggregate amount of net new issues of listed shares *plus* non-residents' net sales of shares on the Johannesburg Stock Exchange during the two-year period concerned.

Overall share trading activity was also boosted significantly by the buying and selling operations of non-residents. Purchases of listed equities by non-resident investors rose from R2,0 billion in 1988 to R5,1 billion in 1989 and to R3,4 billion in the first *half* of 1990. Sales by non-residents, on the other hand, rose from a similar amount of R2,0 billion in 1988 to R8,5 billion in 1989, and to no less than R7,1 billion in the first *half* of 1990.

The monthly average *price* level of all classes of shares touched bottom in February 1988 after the price collapse of October 1987 and recovered only modestly (by 6 per cent) from December 1987 to December 1988. It then rose sharply, however (by 38 per cent) from December 1988 to December 1989, and continued to strengthen in January-February 1990. Price gains among the various classes of shares during the calendar year 1989 ranged from 25 per cent in respect of industrial and commercial shares to 56 and 60 per cent with regard to "all mining" and gold-mining shares respectively. Gold-mining shares in particular, however, had to stage this price recovery from a low 1988 base.

Modest further increases (of 4,8 and 0,5 per cent) in the overall average of share prices were registered in January and February 1990. New record levels of

Insurers and private pension funds

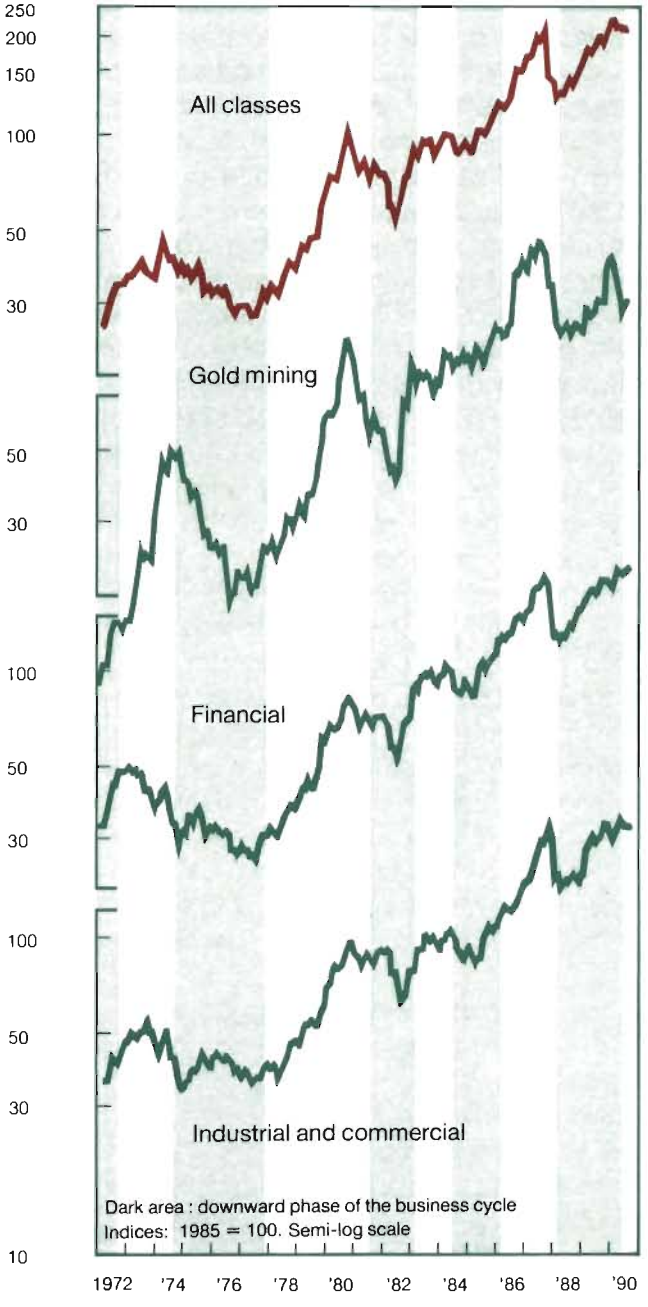


prices were posted in February 1990 by all classes of shares except gold-mining shares, and shares of real estate companies; the average price level of "all classes" of shares as in February 1990 exceeded its earlier record level of September 1987 by 3 per cent.

More hesitant and generally weaker tendencies in share price behaviour became apparent from approximately March 1990 onward. From March to June 1990 the average price level of "all classes" of shares receded, on balance, by 8 per cent. Price falls ranged from 3 per cent in the case of "all financial" shares to 31 per cent in the case of gold-mining shares.

Factors fostering buying interest and resulting in the second major post-1985 share price revival during most of 1989 and early 1990 included, firstly, the increased freedom of asset choice of the institutional investors already referred to and the large shifts in the composition of these institutions' incremental investment asset holdings in favour of equities and at the expense of cash and deposits and public-sector securities. This factor was supported by a relatively limited net new borrowing requirement of the public sector in general and of the central government in particular. It was also aided by the usual scarcity of good-quality equities relative to the institutional investors' large net current intake of investible funds. The last-mentioned factor, to be sure, had not sufficed to prevent the share price drop of late 1987 and share price weakness in 1988; during the 1989/90 review period its significance was reduced by non-residents' net sales of shares in early 1990 in particular, and by an extraordinarily large amount of new share issues in the course of 1989.

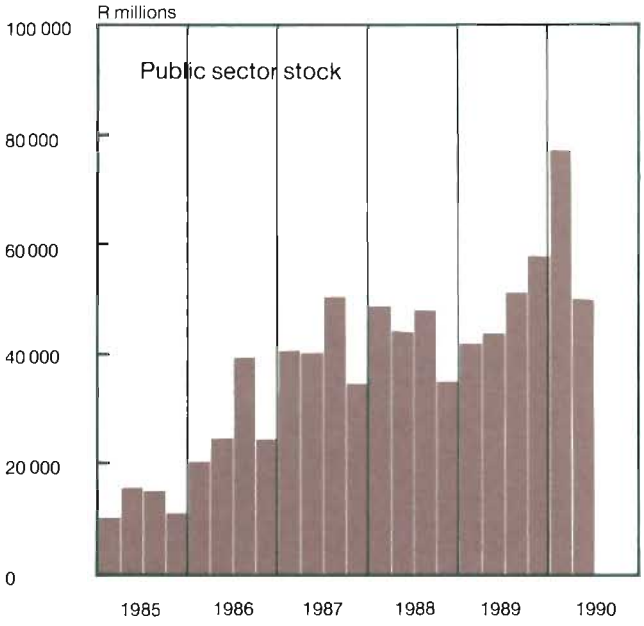
Share prices



Secondly, share prices, having been boosted in 1988 and the first half of 1989 by the increasingly impressive financial results of companies, were favoured in late 1989 and early 1990 by further improvements in investor sentiment. Market bullishness during this period was fostered by factors such as the strengthening of the dollar price of gold and of the exchange rate of the rand, a softer tendency in long-term interest rates and more encouraging prospects for inflation, and more confident views concerning the possibility of a peaceful settlement of South Africa's socio-political problems and a satisfactory outcome to its future constitutional development. A final fillip to this general optimism in the socio-political area was provided on 2 February 1990 by the State President's announcement of various political reform initiatives.

Conversely, the more hesitant and weaker tendency in share prices from March 1990 onward could be attributed to re-emerging concerns about the potential nature of the country's future socio-political and economic dispensation, the general slackening of the economy and notably less impressive financial results of companies, a mild hardening of long-term interest rates from February 1990, and a sharp setback to the dollar price and the rand price of gold in late March, followed by further gold price declines in late May and early June.

Stock exchange transactions



The value of *public-sector stock* traded on the stock exchange rose by 11 per cent from R175,8 billion in 1988 to R195,3 billion in 1989. On a quarterly basis the volume of transactions in public-sector stock rose very sharply from R51,5 billion in the third quarter of 1989 and R58,1 billion in the fourth quarter to R77,3 billion in the first quarter of 1990. This was followed, however, by a decline to R49,4 billion in the second quarter. The very sharp rise in trading volumes in the period from November 1989 to January 1990 in particular, took place against a background of a marked drop in long-term interest rates.

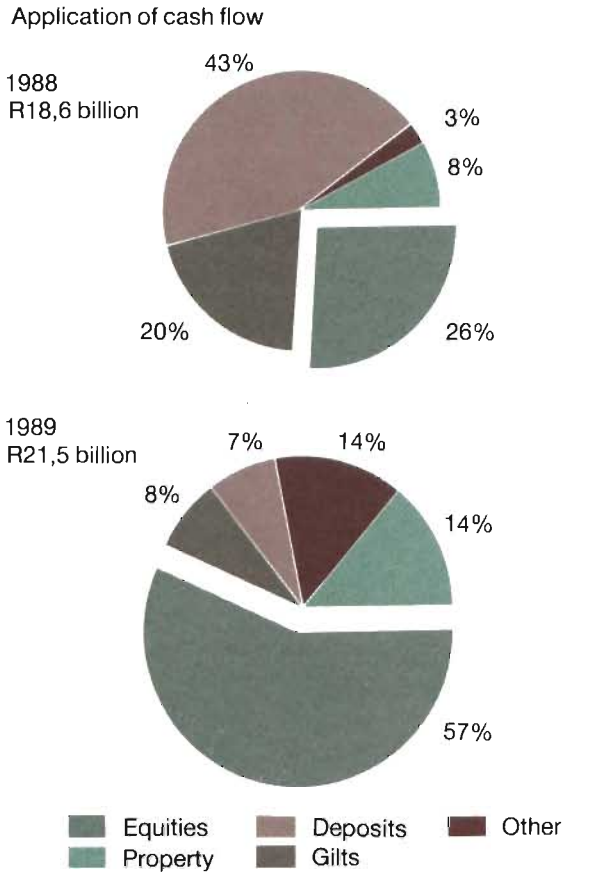
The well-sustained and mostly rising levels of trading activity in public-sector stock in 1989 and early 1990 were due to a significant extent to non-resident investors' switching from equities to higher-yielding public-sector stock issues, as well as to insurers' and pension funds' shifts from public-sector securities into private-sector securities and into equities. Non-residents' large-scale change-overs into interest-bearing securities were, in fact, credited with having caused a decline of more than 1 percentage point in the yields on long-term government and Eskom stock.

Insurers and pension funds responded in their securities transactions to the new maximum investment limits announced on 5 May 1989, already referred to above; a more complete description of these limits was provided in the Reserve Bank's *Annual Economic Review* for 1989. As a reflection of the institutional investors' reconstitutioning of their portfolios, an amount of only 8 per cent of these institutions' net current income receipts in 1989 was invested in public-sector securities, against 20 per cent in 1988. Conversely, proportions of 57 and 14 per cent of the net current income receipts of these institutions in 1989 found their way into equities and into property investments respectively, against 26 per cent and 8 per cent in 1988.

The *South African Futures Exchange* (SAFEX), which was established in terms of the Financial Markets Control Act, 1989 (Act No. 55 of 1989), formally commenced business on 30 April 1990 under the auspices of the South African Futures Exchange Clearing Company (SAFCOM). Members of the Futures Exchange handle transactions in financial futures contracts that are based on the JSE-Actuaries' all-share index, all-gold index and industrial index, in interest rate futures (three-month bankers' acceptances), in notional-bond futures, and in dollar-gold futures. As regards the notional-bond futures, the initial notional medium-debt bond futures have recently been replaced by long-dated bond futures.

SAFEX is governed by rules approved by the Registrar of Financial Markets and by provisions laid down

Insurers and private pension funds



by the Financial Markets Control Act. The monthly total value of daily deals in futures contracts amounted to R2 289 million, R2 301 million and R1 975 million in May, June and July 1990 respectively.

The primary markets

In the *primary capital markets*, more receptive market conditions during much of the 1989/90 review period were a contributory factor in causing the amount of net new issues of *public-sector stock* to be raised from R4,9 billion in the calendar year 1988 to R7,0 billion in the calendar year 1989. Favourable market conditions – as reflected in the downward drift of long-term interest rates during most of the period under review – resulted partly from market participants' more sanguine interest rate expectations. These could be traced, in turn, to the market's perception of the fairly limited borrowing needs of the public sector, which arose from the unexpectedly high level of current government revenue and from the rationalisation of other public-sector borrowing programmes. Under these circumstances, the Exchequer – partly in support of the monetary policies of the Reserve Bank – borrowed extensively in excess of its budgetary borrowing requirements. A part of the proceeds of this borrowing was used to fund a proportion of the accumulated shortfalls on the Foreign Currency Contingency Reserve Account in the Reserve Bank's books.

Relatively buoyant stock market conditions, gradually less impressive corporate cash flows and less bounteous corporate liquidity, companies' continuing fixed investment activities, and corporate financial restructuring, caused the amount of net new issues of *fixed-interest securities* by *private-sector companies* listed on the stock exchange to be raised from R222 million in 1988 to R823 million in 1989. A further amount of R75 million was raised in the first half of 1990. Included in the total of these issues in 1989 was an issue in November 1989 of R250 million of fully secured, compulsorily redeemable, mortgage-backed floating-rate debentures due in 2009. This represented the South African capital markets' first "securitisation" issue of mortgage-backed securities. The debentures concerned subsequently received a listing on the stock exchange in February 1990. The greater part (70 per cent) of these debentures is currently held by insurers and pension funds. Smaller proportions (of 21 and 9 per cent) are held by banks and nominee companies and by non-residents respectively.

Favourable market conditions and private firms' fixed investment activities also provided reasons for an increase in listed companies' new issues of ordinary *share capital* from only R0,9 billion in 1988 to a record amount of R9,0 billion in 1989. A further amount of R1,7 billion of share capital was raised in the first six months of 1990. The amount of new share issues in 1989 was also greatly boosted, however, by Iscor's privatisation issue, to an amount of R3,1 billion, in November 1989.

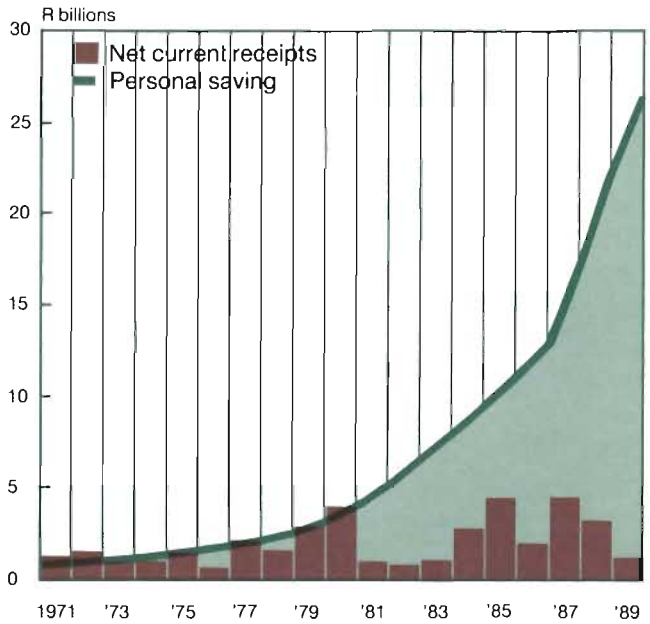
Relatively rapid increases in deposit interest rates in the first quarter of 1989, the fading-away of rising interest rate expectations, and more favourable prospects for the inflation rate, contributed to an investment climate in the 1989/90 review period that was more congenial to certain classes of financial intermediaries as collectors of the public's longer-term funds than had been the case in 1988. Included in the total *flow of longer-term funds to intermediaries* in the primary capital market are the net premium and net (i.e. after-tax) investment incomes of long-term insurers,

the net contributions to and net investment incomes of private pension funds, the net sales of units by unit trusts, and the net flow of longer-term deposits to banks, building societies, participation mortgage bond schemes, the Post Office Savings Bank and other government savings facilities. The year-to-year increase in the *total* of these flows rose substantially from 13 per cent in 1988 to 22 per cent in 1989.

Market conditions in 1989 and the first half of 1990, as outlined above, tended to strengthen the competitive attractions of savings facilities offered by deposit-receiving institutions as compared with those provided by the so-called contractual savings intermediaries (insurers and pension funds). In preceding years, the competitive strength of the contractual savings intermediaries had been raised greatly by the tax advantages and inflation resistance of their savings facilities offered, and by the high performance of their investment strategies in an inflationary environment.

As a result of this shift in the investment climate, the flow of longer-term funds to the deposit-receiving institutions, which had *decreased* by 25 per cent in 1988, *rose* by 37 per cent in 1989. In contrast, the year-to-year increase in the flow of longer-term funds to insurers and pension funds fell back from 30 per cent in 1988 to 19 per cent in 1989. As displayed in the accompanying graph, the sum total of the insurers' and pension funds' net premium income, net contribution receipts and net investment incomes in 1989 nevertheless still exceeded greatly and to a rising degree the total of net personal saving in South Africa, as calculated for purposes of the national income and product accounts.

Net current receipts* of insurers and pension funds versus personal saving



*Net premium income, net contribution receipts and net investment income of insurers and private and state pension funds

Among the various kinds of deposit-receiving institutions, banks appeared as the prime beneficiaries of the relative shift in investor preferences: the banks' intake of longer-term funds – i.e. savings deposits and long-term deposits, after adjustment for the effect of mergers of building societies and banks in the course of the year, i.e. by statistically undoing these mergers – was approximately six times larger in 1989 than the (very low) intake of 1988. A marginal *decrease* (of 2 per cent) in the intake of longer-term funds was, however, experienced by the building societies (after similar adjustment). Inflows of longer-term funds also rose substantially (by 35 per cent) in the case of the unit trusts, but only slightly (i.e. by 5 per cent) in the case of the participation mortgage bond schemes. Actual *outflows* of funds were still experienced by the Post Office Savings Bank and other government savings facilities.

The *mortgage market* in the 1989/90 review period witnessed the introduction of the first mortgage securitisation scheme referred to earlier. Other features of the home loan market during the period under review included banking institutions' continuing success in capturing and handling a major part of this market; further shrinkage of the building societies' relative role in this market, even when the effect of certain building societies' mergers with banks is taken into account; and relatively high aggregate amounts of new mortgage lending, despite the diminishing significance of the building societies in the intermediation of longer-term funds. An ever-widening gap was apparent between the value of real estate transactions and the increase in banks' and building societies' aggregate holdings of mortgage bonds. This gap rose to 76 per cent in the first quarter of 1990, from 43 per cent in the third quarter of 1988.

After allowance has been made for the effect of mergers of certain building societies with banks, the total net inflow of longer-term funds to building societies and participation mortgage bond schemes was 1 per cent *smaller* in 1989 than in 1988; this compares with a small *rise* in this inflow in the preceding year. The aggregate amount of new *mortgage loans paid out* by these two groups of institutions, which had increased by 11 per cent (to R10,3 billion) in 1988, declined by some 7 per cent (to R9,6 billion) in 1989. It amounted to R3,9 billion in the first half of 1990.

Despite the generally lower level of mortgage loan pay-outs by the building societies in 1989/90, these

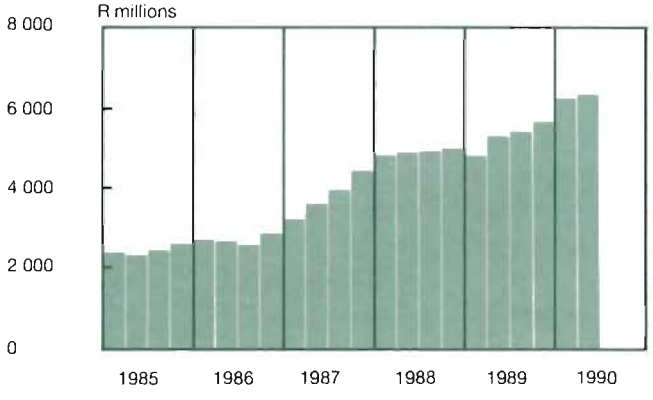
pay-outs still exceeded significantly the societies' total net inflow of depositors' funds. As in preceding quarters, this was made possible by mortgagors' substantially increased repayments on existing mortgage loans. Apart from regular monthly redemptions, these large repayments also continued to reflect mortgagors' change-overs from borrowing from the building societies to borrowing from the banks.

The decline in outpayments on new mortgage loans and the relatively high level of capital redemptions caused the annual "transactions" increase in the building societies' *holdings* of mortgage loans (i.e. the change in these holdings after removal of the effect of bank and building society mergers) to decline from R3,5 billion in 1988 to R3,3 billion in 1989; during the first half of 1990 the societies' holdings of mortgage loans rose by another R1,9 billion. In comparison, the "transactions" increase in the nine major *banks'* holdings of mortgage loans, which had reached an exceptionally high level of R5,9 billion in 1988, retreated to R3,9 billion in 1989.

At the end of 1989, the banks' and the building societies' total holdings of mortgage loans amounted to R22,8 billion and to R24,4 billion respectively. However, the banks' holdings of such loans were R8,5 billion higher, and the building societies' holdings were R8,5 billion lower, than they would otherwise have been on account of bank and building society mergers in the course of 1989. The increase in the banks' and the building societies' combined holdings of mortgage loans of R7,2 billion in 1989 was 24 per cent smaller than in the preceding year.

Relative buoyancy continued to prevail in the *fixed property market*, despite banks' diminishing interest in new mortgage lending and the declining increases in banks' and building societies' mortgage holdings in both 1988 and in 1989 and the first half of 1990. This could be attributed partly to accelerated increases in the property portfolios of insurers and pension funds. The *number* of fixed property transactions nevertheless declined by 8 per cent in 1989, after having increased by 9 per cent in 1988; the number of these transactions in the first four months of 1990 was, however, 10 per cent higher than in the first four months of the preceding year. The average *value* of property transactions per transaction rose by 17 per cent (to R106 700) in 1989, and by another 6 per cent (to R113 000) in the first four months of 1990.

Real estate transactions



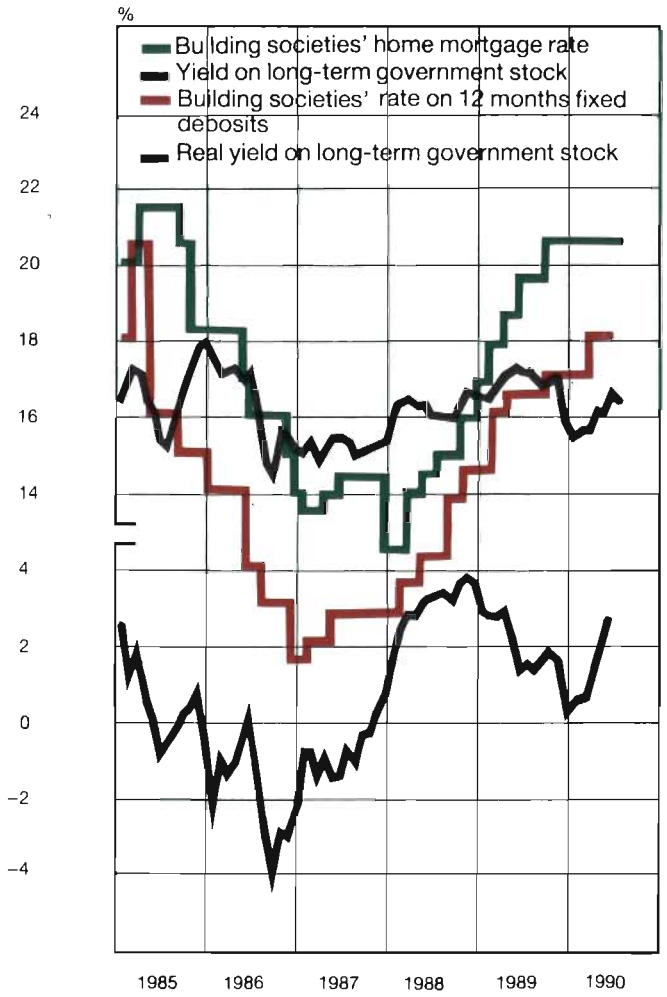
Capital market yields and interest rates

Capital market yields and interest rates, which had shown a mildly upward trend from the third quarter of 1987 onward, reached a high point in May 1989. The monthly average yield on long-term government stock subsequently eased very gradually from 17,4 per cent in May 1989 to 16,9 per cent in November; it then fell back rather more steeply to 15,8 per cent in December 1989 and to 15,5 per cent in January 1990. This rate then returned to 16,7 per cent in June 1990 before easing slightly to 16,4 per cent in July.

The upward drift of nominal long-term interest rates in 1988 and early 1989 was attributed in the Bank's *Annual Economic Report* for 1989 to factors such as the major rise in short-term interest rates during that period, the disappointing behaviour of the dollar price of gold, the market's intermittent doubts about the realisability of the Central Government's Budget proposals for fiscal 1988/89 and 1989/90, and the then worsening prospects for the inflation rate.

Conversely, the decline in the long rates in late 1989 and early 1990 in particular, was helped along by the initially stronger gold price and rand exchange rate, the Government's early completion of its budgetary borrowing programme for fiscal 1989/90, the more favourable outlook for the inflation rate, generally positive foreign and domestic views of South Africa's prospective socio-political developments, and non-resident investors' buying interest in South African public-sector securities. The more recent mild reversal of this downward rate movement from February to June 1990 could be attributed *inter alia* to the disappointing behaviour of the dollar price and the rand price of gold in March, May and June 1990 and to re-emerging concerns about the current and prospective socio-political situation.

Capital market rates and yields



The maximum permissible *finance charges rates*, as determined in terms of the Usury Act, were raised in October 1989 from 28 to 30 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 (but not exceeding R500 000), and from 31 to 33 per cent in respect of transactions for up to R6 000. The new top rates of 30 and 33 per cent respectively equalled and exceeded the earlier record rates of 30 and 32 per cent that had been in force from the end of 1984 up to January 1986. Both the new maximum rates were, however, reduced, for technical reasons, by 1 percentage point with effect from 27 July 1990.

Following the increase in Bank rate of 11 October 1989, the building societies' *home mortgage lending rate*, which had been raised in eight steps from its low point of 12,50 per cent in February 1988 to 19,75 per cent in June 1989, was raised further to 20,75 per cent. Banks raised their bond rates to 21,00 per cent in December 1989, but reduced them to 20,75 per cent again in March 1990.

The rapid rise in share prices from mid-1989 caused the *dividend yield* on all classes of shares to decline from its high point of 5,7 per cent in May 1989 to 5,1 per cent in October. However, this rate returned to 5,7 per cent in December 1989 before easing marginally again to 5,6 per cent in both June and July 1990.

The predominant rate on *twelve-month deposits* with banks and building societies, which is regarded as indicative of deposit rates in general, was raised broadly simultaneously with the several increases in the predominant home mortgage lending rate from early 1988 through late 1989. In April 1990, however, this rate was raised from 17,0 to 18,0 per cent without an accompanying increase in the bond rate. Banks subsequently lowered this rate again to 17,5 per cent in June 1990 – the first reduction of this rate since December 1986.

The rates on *tax-free investments* with building societies, the Post Office Savings Bank and the Treasury were raised by 0,5 per cent in December 1989 and by 1,5 per cent in March 1990. The last-mentioned of these increases was effected partly by way of compensation for the first step in the phasing-out (by 20 per cent per year over a five-year period) of the tax-free status of the interest income earned on these investments. The current interest rate of 11,5 per cent on Post Office Savings Certificates and on tax-free deposits with, and subscription shares in, building societies compares with a rate of 9,5 per cent in November 1989.

Government finance

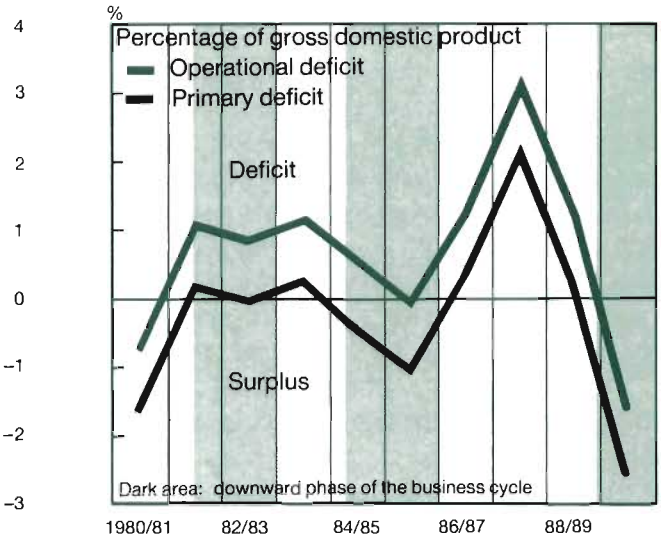
Continued "less expansionary" stance of fiscal policy and broadening of fiscal policy objectives

The Central Government's Budget for the fiscal year 1987/88, as presented in June 1987, was still intended to exploit more fully the "room for growth" which, at that stage, was considered still present in the economy. In contrast, a less expansionary stance of fiscal policy was adopted in the Budget for 1988/89 as submitted to Parliament in March 1988. This shift in policy posture was effected in the light of the strengthening of economic activity in 1987, the prospects for a further firming of growth and of domestic expenditure in 1988, and growing awareness of the potential effects of this rising level of buoyancy on the balance of payments and inflation. It also served to co-ordinate fiscal policy with the less accommodative stance of monetary policy that had already been adopted by the Reserve Bank in the closing weeks of 1987. Further fiscal and other policy measures of a demand-restraining nature were introduced in May and August 1988.

The Central Government's Budget for 1989/90, as submitted to Parliament on 15 March 1989, represented a continuation of the Government's less expansionary policy stance, with a view to tempering the marked strengthening of domestic spending that had already taken place in 1988. Supplementary measures to restrain domestic demand were subsequently introduced in April and May 1989. The measures of April 1989 included, among other things, an increase in fringe benefit taxation on company cars and on employers' loans to employees at below-market interest rates. The May package contained, similarly among other things, the imposition of a loan levy on companies to an amount of 10 per cent of income tax paid, and the abolition, with very few remaining exceptions, of exemptions of the surcharge payable on imports of capital goods; the *level* of this surcharge was, however, reduced from 20 to 15 per cent. The eventual short-term impact of the 1989/90 Budget was, however, appreciably more "de-stimulative" than had been envisaged in March 1989. Judged by its outcome, the Budget could, in fact, be described as restrictive in terms of the Government's so-called "primary" as well as "operational" budgetary deficit.

The Central Government's Budget for 1990/91, as submitted on 14 March 1990, represented a further prolongation of the Government's aim to maintain financial discipline in support of the monetary authorities' restrictive monetary policies. As was stated explicitly by the Minister of Finance, this Budget was *not* meant to provide for an early or short-term restimulation of the economy; more pertinently than on earlier occasions, however, the Budget speech spelled out a role for fiscal policy in effecting certain structural reforms in the South African economy in addition to the use of fiscal measures for the purpose of short-term stabilisation.

Primary and operational deficit



Primary deficit: government revenue *minus* government expenditure excluding interest payments on government debt
Operational deficit: government revenue *minus* government expenditure that includes only a real component of interest on government debt

With regard to the Budget's "broad twofold aim" of, firstly, maximum encouragement of stable long-term economic growth and, secondly, the alleviation of poverty and deprivation, the Minister stated that the developed or "formal" sector of the economy would have to be strengthened to the highest possible degree in its powers of creating new and better opportunities for the developing or "informal" sector. To this end, the *revenue* side of the Budget was to be regarded – not least through a lightening of the burden of personal income tax in particular – as the most appropriate area for promoting saving, investment and entrepreneurship. In contrast, little scope remained for a further alleviation of the tax burden on the less privileged sections of the South African population. For these population groups, therefore, maximum possible provision was to be made in the Budget's *expenditure* plans.

Roles for fiscal policy in the areas of both structural reform and short-term stabilisation were laid down by the Minister in his statement that the 1990/91 Budget, like the Budgets for the next few years, would have to comply with three different "considerations" of policy. Firstly, structural changes should be effected in the South African economy with a view to raising materially the standard of living of the entire South African population. In this restructuring process, the private sector ought to be recognised as the most important source of economic growth and of income and employment creation. Special attention would, however, also have to be paid to the curbing of inflation and to the alleviation of shortages of skilled manpower and capital. Major attention was, therefore, to be focused on the "supply" or production side of the economy and on making the public sector smaller and more efficient.

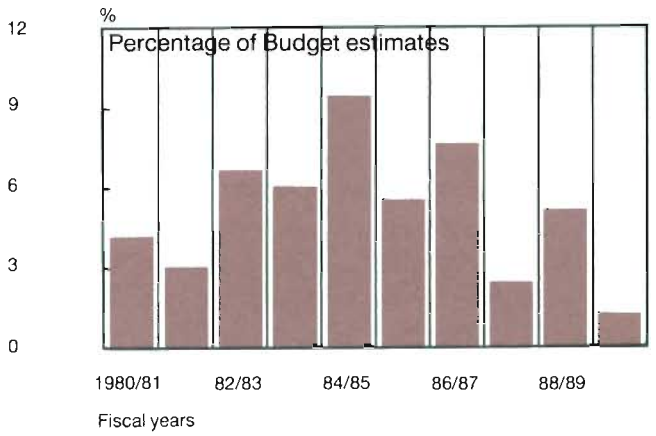
Secondly, higher priorities than before would have to be accorded to the pressing socio-economic problems of poverty and of "backlogs" in education and training, housing, literacy, basic health needs, and other factors that impeded the raising of living standards of, and more active participation in the economy by, large segments of the population. Fiscal discipline would, however, have to be maintained in the execution of these processes, through the rearrangement of priorities and through greater cost-effectiveness of government expenditures.

Thirdly, macro-economic fiscal policy in its shorter-term aspects should continue to be aimed at the stabilisation of economic activity in the course of the business cycle. The emphasis in such an active stabilisation policy would, however, be placed to an increased extent on the Government's debt and borrowing operations. Adjustments in government *revenue* and *expenditure* should be made to serve to an enhanced degree the longer-term objectives of economic restructuring and of socio-economic development.

Outcome of Central Government Budget for fiscal 1989/90

Notable features of the actual outcome of the Central Government's Budget for the fiscal year 1989/90 included, firstly, the high degree of discipline that was exercised by the authorities over their expenditure during the year. This resulted in actual total expenditure in the fiscal year that was remarkably close to the original Budget estimates. In the light of the overspending experience of earlier years, this outcome was valuable in helping to restore the credibility of the Budget as a statement of the Government's fiscal intentions.

Overspending of Central Government



A second notable characteristic of the outcome of the 1989/90 Budget was the uncommonly high degree of underestimation of government revenue during the fiscal year. In conjunction with the effect of actual expenditure being close to budgeted expenditure, the result of this feature was an actual deficit before borrowing and debt repayment for fiscal 1989/90 as a whole that was considerably smaller than had been envisaged in the Budget speech of March 1989.

Actual nominal Central Government *expenditure* in fiscal 1989/90 amounted to R65,8 billion. This represented an increase of 16,2 per cent over actual expenditure in fiscal 1988/89, against the increase of 15,0 per cent that had been budgeted for.

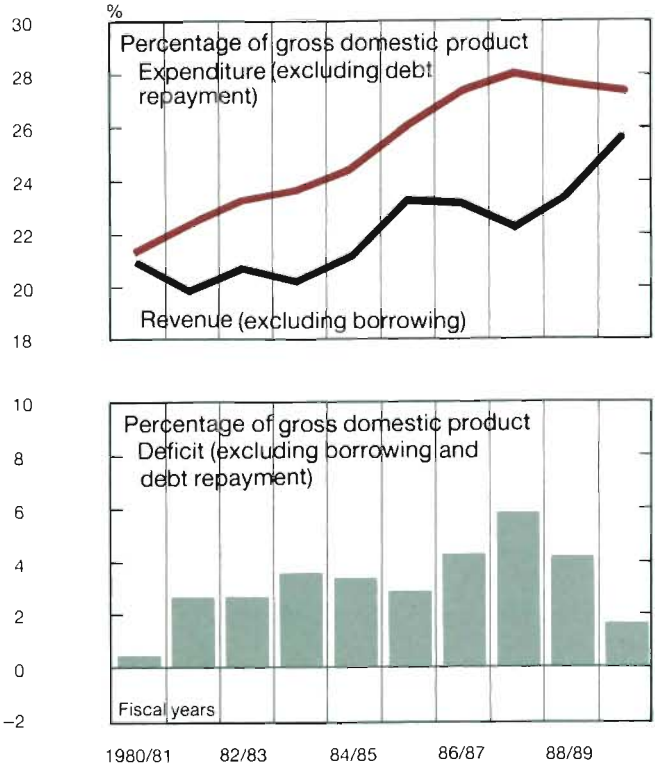
At its level of R65,8 billion, actual government expenditure in 1989/90 exceeded the original Budget estimates by only 1,2 per cent (after inclusion in the spending estimates of the additional amount of R1,0 billion that had been provided for in respect of unforeseen spending needs). The extent of this overspending could be compared with over-runs to an aggregate amount of 5,1 per cent of originally budgeted expenditure in fiscal 1988/89, and with an average "overspending ratio" of 6,0 per cent in the five fiscal years from 1984/85 to 1988/89.

In *real* terms Central Government expenditure rose by 1,1 per cent from fiscal 1988/89 to fiscal 1989/90. The ratio of government expenditure to the gross domestic product accordingly contracted mildly from 27,7 per cent in fiscal 1988/89 to 27,4 per cent in fiscal 1989/90. Even at this slightly lower figure, however, the value of this ratio in 1989/90 was still markedly higher than its average level of 24,8 per cent in the ten fiscal years from 1979/80 to 1988/89.

A functional classification of government expenditures in fiscal 1989/90 shows above-average rates of increase of 25 per cent in expenditures on state domestic administration, 22 per cent in expenditures on social services (such as housing, health and education services, and welfare promotion), and 19 per cent in expenditures on protection services. Expenditure on "public" services (such as constitutional and regional development) and on economic services (for example, in agriculture, on transport, and on energy and power) rose by 6 and 5 per cent respectively. Costs of administering the public debt (comprising interest and management charges) rose by 22 per cent in fiscal 1989/90, against an increase of 27 per cent in fiscal 1988/89; budgetary outlays in this category thereby came to amount to 15 per cent of total government expenditure in fiscal 1989/90, against 14 per cent in the preceding fiscal year.

Total government *revenue* receipts in fiscal 1989/90 amounted to R61,8 billion (not including R3,0 billion in Exchequer receipts from the proceeds of the privatisation of Iscor and the South African Mint). This exceeded the original Budget estimates by a very large amount of R6,7 billion, or by 12,2 per cent.

Exchequer Account



Revenue receipts in fiscal 1989/90 also exceeded revenue in the preceding fiscal year by an unprecedented 28,2 per cent. This may be compared with the increase in revenue of 16,0 per cent that had been budgeted for in the March 1989 Budget estimates. In *real* terms revenue receipts in fiscal 1989/90 were higher than in fiscal 1988/89 by a very large 11,5 per cent. The ratio of government revenue to the gross domestic product accordingly rose from 23,6 per cent in 1988/89 to a new historically high level (for South Africa) of 25,8 per cent in 1989/90. Following an increase of 12,5 per cent in 1988/89, the 11,5 per cent rise in total real revenue receipts in 1989/90 also served to underscore the need for certain structural reforms in the South African economy, and of certain aspects of the country's tax system in particular.

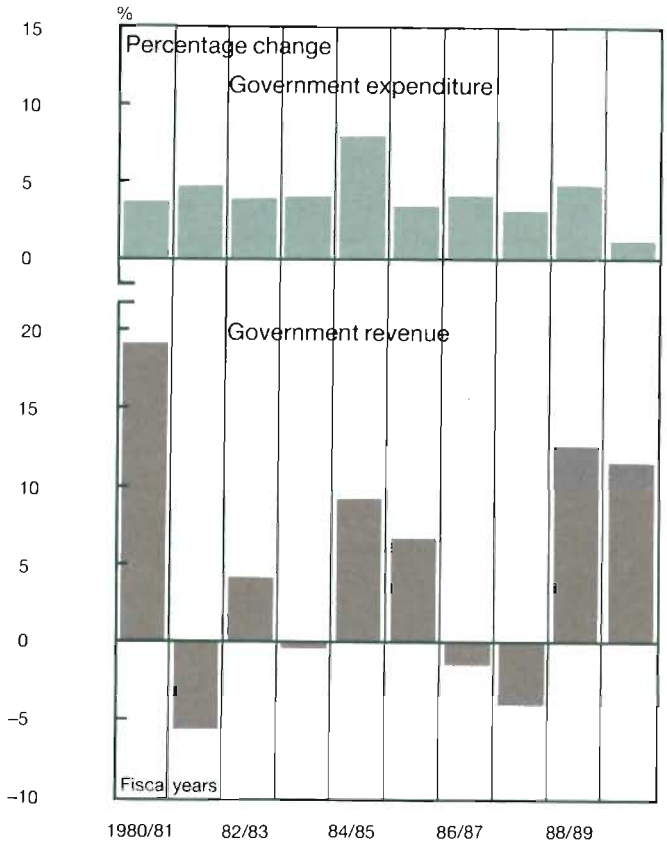
Actual revenue receipts in 1989/90 exceeded substantially the Budget estimates under both the two broad headings of customs and excise duties and inland revenue. *Customs and excise duties* were 25,4 per cent higher than in the preceding year. This was mainly due to larger than expected receipts from the fuel levy, the surcharge on imports and customs duties. Receipts from excise duties, on the other hand, fell slightly short of the Budget estimates.

Receipts from *inland revenue* in 1989/90 were 28,7 per cent higher than in 1988/89 and exceeded the Budget estimates by no less than R5,3 billion, or by some 11,1 per cent. Increases were recorded in revenue from all sources, with the exception of the gold-mining industry. Income tax receipts from individuals and from non-mining companies proved to have been underestimated in the Budget by as much as R2,6 billion and R1,7 billion, or by 15,7 and 17,7 per cent.

The general make-up of government revenue in terms of its various sources in fiscal 1989/90 did not depart greatly from trends that had been established in the preceding few fiscal years. The well-known difficulties of the gold-mining industry caused the relative contribution to total revenue of the total mining sector to slip down further to 4 per cent; at its peak in 1980/81 this contribution had amounted to 29 per cent. The relative share in total revenue of income tax from non-mining companies, on the other hand, rose further from its lower turning-point in 1986/87, reflecting the improved financial results of businesses in the advanced upswing period.

The relative share of revenue from individuals, which had retreated mildly (to 30 per cent) in fiscal 1988/89, recovered slightly (to 31 per cent) in fiscal 1989/90. No change of any importance was recorded in the relative share (of 27 per cent) of general sales tax proceeds.

Real changes in government expenditure and revenue



The relative contribution of customs and excise duties, which had increased sharply (from 9 per cent to 15 per cent) in fiscal 1988/89, receded to 14 per cent in fiscal 1989/90. *Total* indirect taxation as a percentage of total tax receipts in fiscal 1989/90 maintained its level of 47 per cent reached in fiscal 1988/89, compared with a ratio of 36 per cent in fiscal 1980/81.

The *deficit before borrowing* and debt repayment in the fiscal year 1989/90 (in which the proceeds from privatisation actions and the discount on new issues of government stock have *not* been taken into account) amounted to R3 996 million. This was a very substantial R5 953 million less than the deficit of R9 949 million that had been budgeted for in the original Budget estimates. Relative to the nominal gross domestic product, the actual deficit amounted to only 1,7 per cent; the deficit as originally foreseen would have amounted to 4,1 per cent of gross domestic product as projected for the fiscal year as a whole at the time of the Budget's presentation to Parliament.

Financing of the deficit of R3 996 million, plus the discount of R4 331 million on new issues of government stock (for a total of R8 327 million), was provided from the following sources:

	R millions
Public Investment Commissioners	4 111
Non-bank private sector	6 204
Banking sector:	
Corporation for Public Deposits	1 886
Other banks	–6 868
Foreign sector	19
Proceeds from privatisations	2 975
Total	8 327

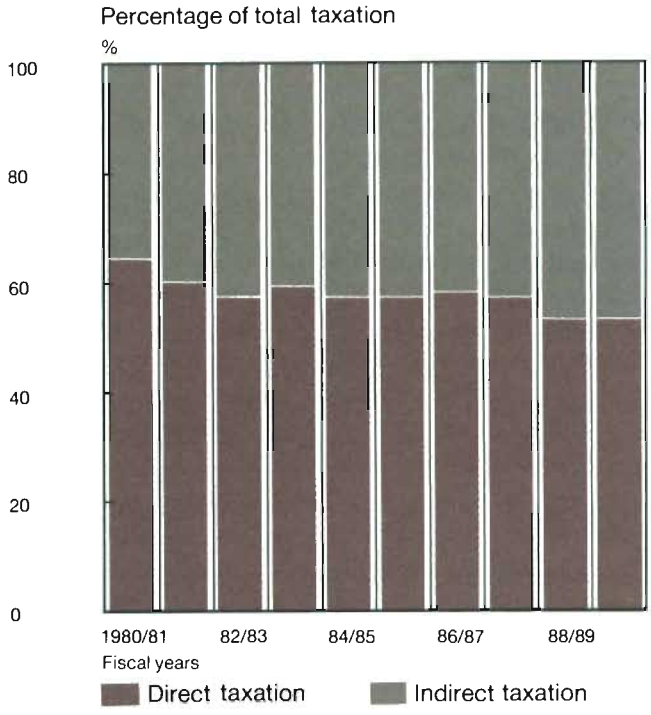
The borrowing instruments and other ways of raising funds utilised in the financing of the deficit were as follows:

	R millions
Government stock	10 165
Treasury bills	3 326
Loan levy	692
Non-marketable securities	–890
Foreign loans	–174
Total gross financing	13 119
Plus: Privatisation proceeds	2 975
Less: Discount on new stock issues ..	4 331
Less: Transfers to stabilisation and other accounts	3 416
Less: Increase in available cash balances	4 351
Total net financing (= deficit before borrowing)	3 996

The most prominent feature of the Government's deficit financing operations in the fiscal year 1989/90 was the unusually high degree of *over-financing* of the deficit. As is brought out by the above table, this excess of financing resulted, *inter alia*, in an increase of close to R4,4 billion in the Government's available cash balances. Deliberate borrowing by the Government in excess of its budgetary borrowing requirement served to support the restrictive stance of the authorities' monetary policies, by forestalling an undue easing of the financial markets through the sale of additional government stock and Treasury bills.

Other distinguishing traits of the 1989/90 deficit financing pattern were the reduced relative contribution of the Public Investment Commissioners (PIC) and the increased contribution of the non-bank private sector. This was a reflection of, among other things, the

Direct and indirect taxation



transfer of R1,0 billion of Government pension fund monies formerly held with the Public Investment Commissioners, to portfolio managers (insurers and banks) in the private sector, as a preliminary step in the privatisation of the state pension fund.

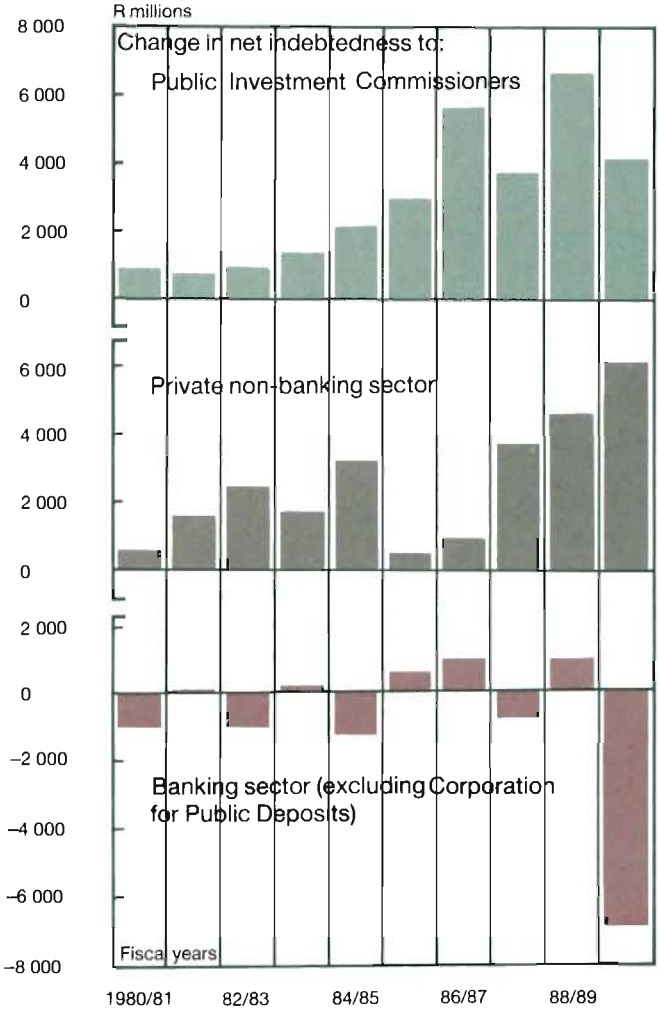
The substantial *negative* contribution of the banking sector to financing of the 1989/90 deficit was mainly a result of the large increase in the Government's cash balances with institutions (primarily the Reserve Bank) in this sector. As noted in an earlier section of this *Report*, this build-up of government deposits actually resulted in negative *net* claims of the banking system on the government sector at certain month-ends during the review period.

The fiscal deficit in 1989/90 was smaller than in 1988/89. The Government's overborrowing, and the marked rise in the discount on new issues of government stock, nevertheless caused the ratio of the total of the Central Government's outstanding debt to the gross domestic product to advance from 33,6 per cent at the end of March 1989 to 34,2 per cent at the end of March 1990. When the Government's debt is also made to include the Government's commitment in respect of the accumulated shortfall that has been sustained by the Reserve Bank in the Bank's provision of forward foreign exchange cover, the increase in the debt/gross domestic product ratio rises to 40,0 per cent in 1989/90, from 39,1 per cent in the preceding year.

As in the previous three fiscal years, the increase in the Central Government's debt in fiscal 1989/90 (from R68,7 billion at the end of March 1989 to R81,9 billion at the end of March 1990) was entirely the result of borrowing in the domestic markets. Debt obligations to non-residents (excluding *domestic* securities held by foreigners) declined further from R2,2 billion (3,2 per cent of the total debt) at the end of March 1989 to R2,1 billion (2,6 per cent of the total debt) at the end of March 1990.

The average maturity of the Central Government's domestic marketable stock debt lengthened – for the first time since 1984/85 – from 114 months in 1988/89 to 117 months in 1989/90. This, however, was a result

Financing of Exchequer Account deficit



of the process of consolidating a part of the debt, rather than of a change in investors' preferences.

The Central Government Budget for fiscal 1990/91

In explaining the specifics of the Government's proposed tax and spending measures in his 1990/91 Budget, the Minister of Finance reiterated the Government's commitment to a reduction of taxation on individuals and companies; to the promotion of effective utilisation of labour and capital through the introduction of appropriate tax reforms; to a lowering of the Budget deficit to levels not exceeding 3 per cent of the gross domestic product and, eventually, to levels that would eliminate government dissaving; to a reduction of the share of government expenditure in the overall economy; to increased emphasis on socio-economic development; and to the promotion of "corporatisation, privatisation and deregulation". In the pursuit of these various aims and objectives, the Budget for fiscal 1990/91 was to be regarded as the first step in a five-year programme of fiscal reform.

Against the background of these policy intentions, the Minister budgeted for total government *expenditure* in fiscal 1990/91 of R72,9 billion. Included in this amount, as in the previous fiscal year, was a "contingency reserve" for unforeseen expenditures of R1,0 billion; *not* included in this amount were any prospective expenditures out of a special capital fund (which was to amount to R2,0 billion, and was assigned to the Independent Development Trust) that was to be created out of the Government's borrowing surplus in the fiscal year 1989/90 for the specific purpose of making good "backlogs" among the country's various population groups with regard to their socio-economic conditions and development. The intended establishment of this fund was announced by the Minister of Finance in his Budget speech; specifics regarding its purposes, management and manner of operation were, however, announced subsequently by the State President on 16 March. In this statement the State President also announced that a further R1,0 billion would be made available to the fund out of the prospective proceeds of the privatisation of business enterprises of the General Government that would be found suitable for privatisation.

On the *revenue* side of the Budget, the Minister provided for total revenue receipts in fiscal 1990/91 of R64,9 billion, representing an increase vis-à-vis expected revenue in fiscal 1989/90 of only R3,6 billion, or 5,8 per cent. Being substantially less than the anticipated inflation rate, this relatively small percentage increase meant a major reduction in total revenue in real terms.

The more important tax proposals of the 1990/91 Budget comprised an increase in customs and excise duties on liquor and tobacco products; abolition of the ad valorem customs and excise duties on jewellery; reductions of the rates of the surcharge on imports by one-third or one-quarter (namely from 60, 20, 15 and 10 per cent to 40, 15, 10 and 7,5 per cent) as a first step towards the eventual phasing-out of these surcharges; an increase in the taxation of fringe benefits with regard to the use of company cars and of employers' subsidised loans to employees; the exemption from normal income tax of a further R1 000 in earnings of interest and of building society dividends by individuals; the exemption from normal income tax of all other dividends received by individuals and closed corporations; additional allowances for the elderly; further steps towards the separate taxation of married women; and a substantial reduction of personal income tax, mainly through increases in the primary income tax rebates for married male and unmarried taxpayers, reductions in the average tax rates payable by the lower and middle income groups, and a lowering of the maximum marginal personal income tax rate from 45 to 44 per cent. The new tax scales involved in the last-mentioned of these proposals were structured in such a way as to eliminate most of the "bracket creep" that would otherwise have been experienced in fiscal 1990/91; the lowering of the maximum marginal tax rate to 44 per cent was to be seen as the first step in bringing this rate down to 40 per cent over a five-year period.

Other tax proposals contained in the Budget included a revised implicit specification of the concept of capital gains, through introduction of a "safe haven" notion, so as to exclude from the incurrence of income tax any profits made from the sale of shares that had been held for a period of more than ten years; the phasing-out of certain so-called "tax expenditures", such as tax concessions with regard to the cost of training of employees; changes in the definition of business firms' stocks-in-trade with regard to consumable stores and spare parts, and with regard to work in progress in the construction industry; and a partial suspension of the reserves that had originated from the LIFO method of valuation of inventories.

The deficit before borrowing and debt repayment as envisaged by the Minister for the fiscal year 1990/91 amounted to R7 994 million, or to approximately 2,8 per cent of the prospective gross domestic product in the new fiscal year. Given proposed capital expenditure of R5 113 million, the anticipated size of this deficit implied a return to dissaving by the Central

Government (on a full-fiscal-year basis) to an amount of R2 881 million. Revenue, expenditure and the deficit as budgeted for, and the proposed manner of financing of the deficit, are summarised in the accompanying table.

	R millions
Revenue	64 938
Expenditure	72 932
Deficit (before borrowing and debt repayment)	7 994
Financing (net of debt repayment):	
Government stock issues (net)	8 021
Non-marketable securities (net)	–175
Debt standstill and foreign funds (net)	174
Available balances[1]	–26
Total	7 994

[1] Increase–; decrease+.

The first quarter of fiscal 1990/91

In the first quarter of fiscal 1990/91 (i.e. the June quarter of 1990) Exchequer *issues* (after the usual adjustment for changes in the balance on the Paymaster-General Account) were 12,6 per cent higher than in the corresponding quarter of fiscal 1989/90. This could be compared with the budgeted increase in issues of 11,9 per cent for the fiscal year as a whole. The ratio of first-quarter issues to total budgeted expenditure for fiscal 1990/91 as a whole, at 25,8 per cent, did not differ significantly from the average ratio of 25,9 per cent in the preceding five fiscal years.

Exchequer *receipts* in the first quarter of fiscal 1990/91 were 19,1 per cent higher than in the first quarter of fiscal 1989/90. This increase was therefore substantially larger than the budgeted increase in revenue of 5,8 per cent for the fiscal year as a whole. The large size of the actual increase could be attributed to an increase of 22,0 per cent in income tax receipts from companies and individuals. The ratio of first-quarter receipts to total budgeted revenue for fiscal 1990/91, at 22,1 per cent, was substantially higher than the average ratio of 20,2 per cent for the preceding five fiscal years.

The *deficit before borrowing* in the first quarter of fiscal 1990/91 amounted to R4 448 million. This was some 4 per cent less than the deficit in the first quarter of fiscal 1989/90. The deficit of R4 448 million, plus the discount on new government stock issues of R1 311 million, was financed by the banking sector (to an amount of R2 949 million), the non-bank private sector (R3 182 million) and the foreign sector (R16 million). Exchequer indebtedness to the Public Investment Commissioners decreased by R388 million.

New government stock issued for financing the June-quarter deficit amounted to 38 per cent of the total of anticipated stock issues during the fiscal year, against 30 per cent in the June quarter of 1989/90. Temporary financing of the June-quarter deficit by means of Treasury bills amounted to R0,4 billion, against a major R4,0 billion in the June quarter of the preceding year.