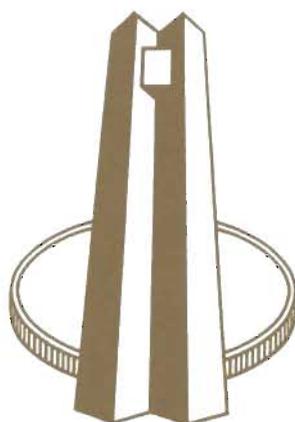


South African Reserve Bank Annual Economic Report

1991



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 seventy-first ordinary general meeting to be held on 27 August 1991

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Introduction

In the *Annual Economic Report* for 1990 it was noted that the authorities had adopted a "fresh approach" in economic policy, placing more emphasis on structural deficiencies in the economy and concentrating on formulating medium-term and long-term economic strategies. Within a framework of a market-orientated system these strategies seek to eliminate structural distortions and to establish realistic relative prices reflecting the scarcities of the various means of production and productive resources. In order to realise these objectives, a restrictive monetary and fiscal policy is *inter alia* essential. The Reserve Bank therefore gradually reduced the guideline range for the growth in money supply and allowed the prime overdraft rate of banking institutions to rise from 12½ per cent at the end of 1987 to 21 per cent in October 1989. Similarly, the Exchequer deficit before borrowing and debt repayment relative to the gross domestic product was decreased from 5,6 per cent in 1987/88 to 0,6 per cent in 1989/90.

Recently a slightly more expansionary fiscal policy stance was adopted by the authorities in the Budget for 1991/92, which seemed justified in the light of the relatively depressed economic conditions and the pressing need for certain social expenditures. The stimulatory impact of the Budget was raised further by off-budget expenditures out of the financial surpluses of previous fiscal years and the announcement by the State President that a further R1 billion would be spent on socio-economic upliftment in disadvantaged communities.

Monetary discipline was maintained by the authorities to create a stable financial environment that will be conducive to sustainable economic growth. In accordance with this approach the Reserve Bank has maintained relatively stable nominal and high real interest rates in South Africa throughout 1990 and the first half of 1991, and Bank rate was adjusted downwards by only one percentage point from 18 to 17 per cent from 11 March 1991. This was justified in view of the progress made in restricting the rate of monetary expansion. Considerable success was achieved over the past eighteen months in bringing the rates of increase in the money supply and in bank credit down to lower levels. Recently the statistical measure of the growth rates in these aggregates has been distorted by reintermediation, following the implementation of the Deposit-taking Institutions Act in February 1991.

However, monetary policy was not applied in an excessively restrictive manner and real positive interest rates in South Africa were maintained at a level considerably lower than in many other countries pursuing similar policies. This policy stance in conjunction with a

continued strong international demand for South African goods, supported economic activity and contributed to a relatively mild but nevertheless extended downturn in economic activity over the past nearly 2½ years. Real gross domestic product accordingly contracted at an annual rate of only approximately ½ per cent from the first quarter of 1989 to the second quarter of 1991 – i.e. at a substantially lower rate than the decreases of 3 per cent and 2 per cent in the previous two economic downswings.

In addition to the continued strong growth in merchandise exports, the mildness of the current economic downswing was further supported by a firm demand for consumer goods and services and a relatively small contraction in real fixed capital expenditure. In contrast to these developments, a considerable destocking took place which brought inventories down to new record-low levels. In the first half of 1991 the downturn in economic activity deepened considerably when the rate of decrease in fixed investment accelerated and consumer demand tapered off, leading to a decline in real private consumption expenditure in the second quarter of the year.

The downturn in economic activity was also accompanied by a marked decrease in the standard of living of the nation as measured by changes in the real gross national income. In particular, a considerable deterioration in the terms of trade was responsible for decreases in gross national income per capita at rates of 3 per cent in 1989, 4 per cent in 1990 and 2½ per cent in the first half of 1991 (compared with the corresponding period in the preceding year).

The decreases in fixed capital formation and in inventories kept the volume of imports at a low level, while the volume of exports continued to increase vigorously. Despite the deterioration in the country's terms of trade because of the poor performance of the gold price and international commodity prices, further substantial surpluses were recorded on the current account of the balance of payments. Although these surpluses were somewhat distorted by the events in the Middle East, they averaged about R5,1 billion per quarter or 2 per cent of gross domestic product from the beginning of 1990 up to the middle of 1991.

These surpluses on the current account facilitated further repayments on South Africa's foreign debt. This reduced the outstanding foreign debt of the country to \$19,4 billion at the end of 1990, of which only \$6,6 billion represented debt under the standstill net. Despite these repayments, the net outflow of capital from the country decreased from R6,2 billion in 1988 to R4,3 billion in 1989 and R2,9 billion in 1990. Moreover, for the twelve months ended 30 June 1991

the total net outflow of capital not related to reserves amounted to only R1,4 billion. The largest part of this improvement on capital account consisted of short-term capital movements which made the country's capital account more prone to fluctuations. The improvement in the overall balance of payments position enabled the monetary authorities to reduce their reserve-related liabilities and at the beginning of 1991 the Reserve Bank had only a small amount of foreign loans still outstanding. Nevertheless, the gross gold and other foreign reserves increased by R1,8 billion in the eighteen months up to the end of June 1991. Although still at a relatively low level, the foreign reserves of the country are now considerably better placed to accommodate an economic upswing because they now represent "earned" and not "borrowed" reserves.

The favourable balance of payments position also made a relatively stable effective exchange rate of the rand possible. Substantial changes occurred, however, in the exchange rates of the rand against certain individual currencies. Relative stability also existed in the money market, partly owing to Reserve Bank operations to limit the extent of short-term fluctuations. On the whole, money market conditions eased gradually over the past eighteen months. At the same time the activity on the primary and secondary capital markets continued to rise and share prices, with the exception of gold-mining shares, reached new record levels in the first half of 1991. Capital market yields and interest rates also remained relatively stable from the beginning of 1990 up to the middle of 1991. Despite these considerable achievements in the country's external relations and in the financial environment, there are still a number of serious problems in the economy which must be resolved. Particularly disconcerting in this regard is the formal economy's inability to create adequate employment opportunities. This is clearly illustrated by the decrease in the labour absorption capacity of the economy - i.e. the average annual increase in employment in the formal sectors (excluding agriculture and self-employed persons) relative to the average annual increase in the labour force - which has declined from 72 per cent in the 1970s to only 22 per cent in the 1980s and as low as 7 per cent in the period 1985-90. This implies that on average only 7 new employment opportunities are created in the formal sectors of the economy for every 100 new entrants to the labour market.

This poor performance in the labour market was related to a major change that has taken place in the production structure of the economy. Over the past two decades capital has been increasingly used as a substitute for labour in view of factors such as the low user costs of capital reflecting low and often negative real interest rates; the over-valuation of the exchange rate of the rand in the early 1980s; tariff policies protecting local industries against foreign competition;

and a number of tax expenditure schemes to encourage capital formation in the manufacturing sector.

Although the low labour absorption capacity has led to a substantial rise in unemployment, wage costs continued to increase at high rates. Wage costs therefore did not reflect the underlying supply and demand conditions in the labour market. This can to a large extent be attributed to the fact that the labour market became more politicised and normal market forces were interfered with in many ways. Attempts to close wage differentials based on race and sex also contributed to sharply rising wage costs. At the same time labour productivity increases did not keep up with real wage increases and the number of man-days lost because of strikes and work stoppages increased at disturbingly high rates during 1989 and 1990. These developments caused real unit labour costs to rise at an average annual rate of nearly 2 per cent, after having decreased from 1985 to 1988.

The rising labour costs in the economy have been an important contributing factor to the continuing unacceptably high rates of inflation since the middle of the 1970s. During the past few years high inflation rates have become more and more a domestic phenomenon related to the entrenchment of inflationary expectations in the economy. Expected high price increases became embodied in wage settlements leading to higher production costs which are passed on to the consumer. In the second half of 1990 the crisis in the Persian Gulf region and higher food prices interrupted the slowing-down of domestic price increases and fostered inflationary expectations further.

Another important problem that needs attention is the decline that has occurred in the domestic savings ratio (the ratio of gross domestic saving to gross domestic product), viz from 24½ per cent in 1985 to 21½ per cent in 1990. In the past few years this was brought about particularly by the dissaving of the government, but in 1990 net private saving (i.e. corporate and personal saving) also declined sharply. One of the important barriers in the way of a meaningful rise in household saving has been the negative real after-tax rates of return on depository types of savings. The average real negative after-tax rate of return in 1990 amounted to slightly more than 2½ per cent.

Although much still needs to be done to change the production structure of the economy, the underlying economic situation in South Africa has been improved considerably and is now more conducive to sustainable economic growth than in any period during the 1980s. The restrictive fiscal and monetary policies pursued in the past three years made a major contribution towards achieving a healthier balance of payments and foreign reserve position, towards reducing the country's outstanding foreign debt and towards creating a more stable internal financial situation.

At the same time many developments have taken place in the political arena and the country is moving to

a situation where normal economic relations could be re-established with most other countries in the world. Under these circumstances and taking the relatively favourable short-term prospects for the world economy into account, an export-led upturn in economic activity seems more than a remote possibility for South Africa. Indeed, the composite leading business cycle index has already increased during the first three months of 1991, indicating that a lower turning-point of the business cycle may be reached in the second half of the year or early in 1992. Although the economy may at first grow at a relatively modest rate, the growth rate could strengthen if the international relations of the country improve further.

Domestic economic developments

Mild downturn of economic activity

The economy has now been in a downward phase of the business cycle for nearly two and a half years, which is much longer than the average duration of cyclical downturns in the post-war period. Despite the length of the current downturn, the decline in economic activity has been considerably less severe than in the two previous downward phases of the business cycle. For example, real gross domestic product contracted at an annual rate of approximately ½ per cent from the first quarter of 1989 to the second quarter of 1991, which is substantially less than the decreases of 3 per cent and 2 per cent per year recorded in the downward phases of 1981-83 and 1984-86 respectively. Moreover, total real gross domestic expenditure contracted at an annual rate of about 2 per cent in the current downswing, compared with declines of 9½ and 5 per cent per annum during the previous two downswings.

The relative mildness of the current downturn in economic activity can mainly be attributed to the following factors:

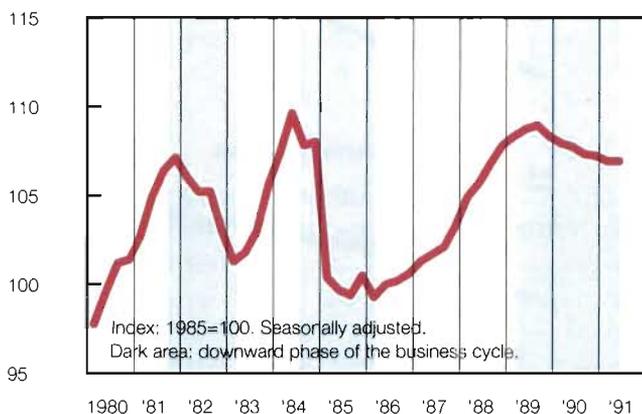
- continued strong growth in the volume of merchandise exports, related largely to a sharp expansion in world trade from the beginning of 1983 and the depreciation of the rand during the 1980s;
- a relatively buoyant demand for consumer goods and services due to real wage increases, a redistribution of income to lower-income households with a high propensity to consume and the unwillingness

- of consumers in the higher-income groups to accept lower living standards; and
- a relatively small contraction in real fixed capital expenditure because of a fairly high level of domestic expenditure, the replacement demand for certain capital goods and large investments in the Mossgas project.

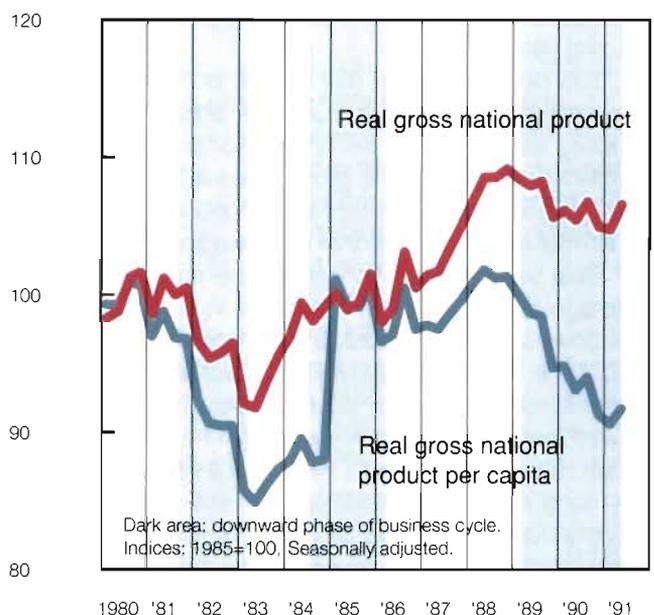
The downturn of economic activity was at first fairly concentrated in a few sectors, but later became more widely dispersed and it deepened during the first half of 1991. In particular the rising trend in real expenditure on consumer goods and services began to taper off from the beginning of 1991 and in the second quarter of the year real private consumption expenditure actually declined. The rate of decrease in real gross domestic fixed investment also accelerated considerably in the second quarter of 1991. Nevertheless a strong demand for South African goods continued to exist in the industrial countries, and this supported domestic production.

The mild decline in economic activity was accompanied by a sharper decrease in the standard of living as measured by the real gross national product. After still increasing by 5 per cent in 1988, the real gross nation-

Real gross domestic product



Real gross national product and gross national product per capita



al product contracted at an annual rate of 1 per cent in the current downswing, largely owing to a considerable deterioration in South Africa's terms of trade. The rate of decline in the real gross national product nevertheless compares favourably with the annual rates of decrease of 4 per cent and 2½ per cent in the 1981-83 and the 1984-86 economic downswing. However, the rate of decrease in real gross national product *per capita* accelerated sharply from almost 3 per cent in 1989 to 4 per cent in 1990 and 2½ per cent in the first half of 1991 (compared with the corresponding period in the preceding year).

Fortunately, the first signs of a potential revival in economic growth have already appeared: the composite leading business cycle indicator increased during the first three months of 1991, after having declined almost without interruption from the middle of 1987. Normally, an upturn in this indicator is followed by a recovery in economic activity after about six to twelve months. From these developments it therefore seems likely that the lower turning-point of the current business cycle will probably be reached in the second half of 1991 or early in 1992.

Small decrease in domestic production

The downturn in economic activity as from March 1989 was followed two quarters later by a continuous decrease in real gross domestic product, at an averaged annual rate of about 1 per cent from the fourth quarter of 1989 up to the second quarter of 1991. On an annual basis the rate of increase in real gross domestic product decelerated from 4 per cent in 1988 to 2 per cent in 1989, and then real output decreased by 1 per cent in 1990 as well as in the first half of 1991 (compared with the corresponding period in the preceding year).

The deterioration in real output occurred largely in the primary sectors, but the value added by the secondary sectors also declined moderately from the beginning of 1990. The gross value added by the tertiary sectors, on the other hand, continued to increase in almost all nine quarters of the downturn.

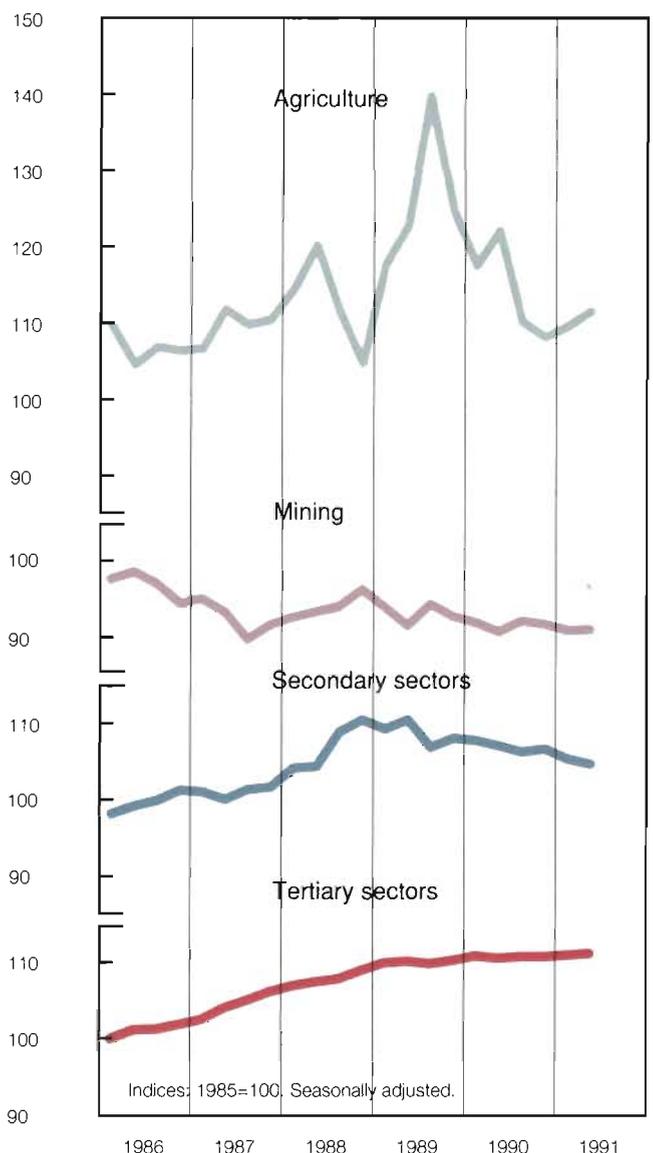
Real value added by agriculture contracted at an average annual rate of 2½ per cent in the current cyclical downturn. This contraction can primarily be attributed to a marked decrease in wheat and maize harvested because of adverse weather conditions. Maize output fell from a peak of 11½ million tons in 1989 to 8½ million tons in 1990 and a projected 6½ million tons in 1991. In addition, farmers' expenditure on intermediate goods and services continued to rise at a fairly rapid rate in the current cyclical downswing.

Real output by the mining sector began to decline from the fourth quarter of 1989, initially mainly because of lower gold production. Several factors continued to impede the production of gold, including rising operat-

ing costs combined with a relatively stable rand price of gold; the termination or curtailment of underground operations at some of the older mines as part of rationalisation programmes aimed at minimising unprofitable operations; and a fall in the throughput of ore. From the middle of 1990, however, gold output started to increase moderately as a result of the mining of higher-grade ore. This rise in gold production was neutralised by a decrease in the output of other mining products from the second quarter of 1990 as a result of a downturn in economic activity in certain of the major industrial countries.

The mild decline in real output of the secondary

Components of real gross domestic product



sectors occurred mainly in the physical volume of manufacturing production, which declined at an annual rate of ½ per cent in the current downward phase of the business cycle; the output of the other two sub-sectors (construction and electricity, gas and water) essentially moved sideways. Although lower domestic demand was mainly responsible for the lower production of manufactured goods, the production of these goods was also adversely affected by sporadic unrest, industrial action by trade unions and stay-aways – especially during the first nine months of 1990.

Apart from transport, storage and communication, all the other sub-sectors of the tertiary sector recorded increases in the real value added during the current cyclical downswing. The level of the gross value added by enterprises involved in transport, storage and communication activities moved virtually sideways over this period of nine quarters, because the decline in the real value added by Transnet was neutralised by increases in the value added by the Department of Posts and Telecommunications and by private transport undertakings.

The moderate increase in real output recorded by commerce stemmed mainly from an increase in the real value added by the retail and wholesale sectors, which more than offset a pronounced decline in value added in the motor trade. The latter was adversely affected by rising debt-servicing costs. From the beginning of 1991 the value added by the commerce sector as a whole began to decline as the downturn gained more momentum.

The high level of real activity in the sector finance,

insurance, real estate and business services throughout the current downswing could be associated with the good performance of exports, continued high turnovers in the commercial sector, buoyant conditions on the stock exchange market and the continuing strength of the fixed property market. The value added by general government also remained positive in the downswing, but rationalisation programmes were mainly responsible for a considerable decrease in the rate of growth in government's contribution to gross domestic product.

Contraction in real domestic expenditure

Real gross domestic expenditure began to decrease even before the downturn in economic activity started, and contracted during four consecutive quarters from the second quarter of 1989 to the first quarter of 1990. It then increased at annual rates of 3 and 4 per cent in the second and the third quarter of 1990, before fluctuating sharply in the next two quarters from a large negative to a large positive rate of change reflecting equally volatile movements in inventories. In the second quarter of 1991 real gross domestic expenditure decreased again at an annual rate of about 3 per cent.

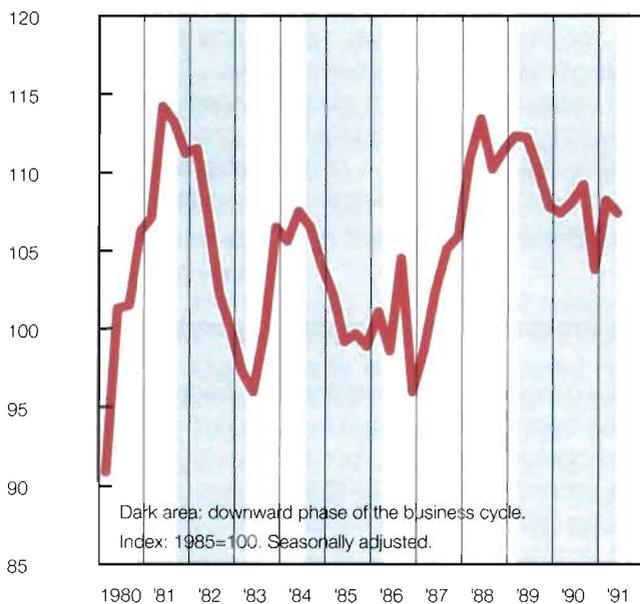
Despite these fluctuations in aggregate real gross domestic expenditure, its overall decline in the current downward phase of the business cycle has been relatively mild. As already indicated, this mildness was mainly related to a firm demand for consumer goods and services, combined with a relatively small decline in

Changes in levels of real aggregate demand

Annualised percentage changes in seasonally adjusted quarterly data

	Downward phases of the business cycle		
	From fourth quarter of 1981 to first quarter of 1983 (6 quarters)	From third quarter of 1984 to first quarter of 1986 (7 quarters)	From second quarter of 1989
Private consumption expenditure.....	1	-4½	1
Consumption expenditure by general government	2½	2½	4
Gross fixed investment.....	-4½	-14	-2
Gross domestic expenditure	-9½	-5	-2
Exports of goods and non-factor services.....	-3½	1	5
Imports of goods and non-factor services.....	-24½	-10 ½	2
Gross domestic product.....	-3	-2	-½

Real gross domestic expenditure



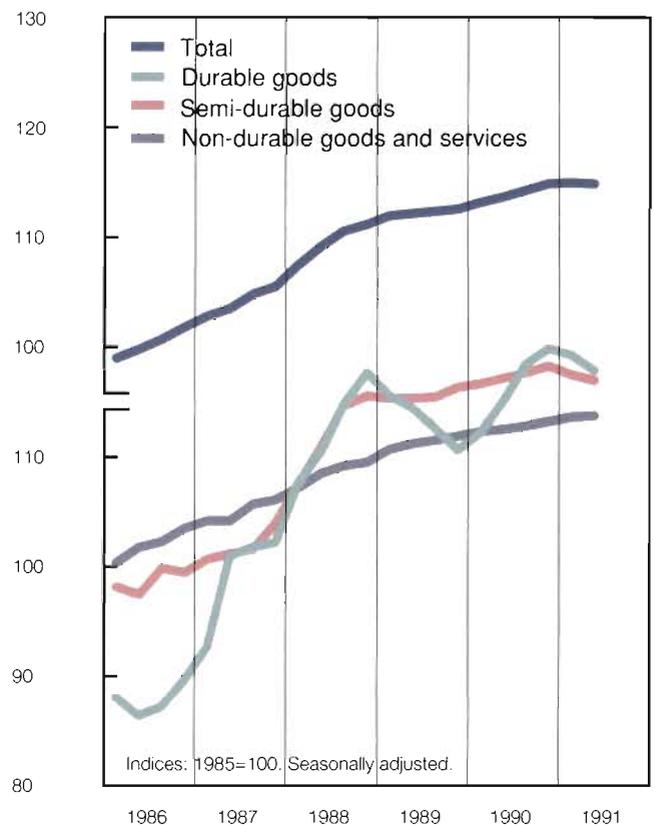
real fixed investment. These relatively positive developments were partly offset by a continuing decrease in inventories.

Firm household demand for consumer goods and services levelling out in 1991

The relatively firm performance of real expenditure by households in the current downswing is clearly illustrated by annual growth rates of around 2 per cent in all four quarters of 1990. This sustained increase in private consumption expenditure could be attributed to continued rises in all the major sub-components of real consumer outlays. In particular it stemmed from a sharp rise in real outlays on consumer durables – notably expenditure on furniture and household appliances, which more than offset a decline in expenditure on transport equipment. Real expenditure on semi-durable goods and on non-durable goods and services also rose at annual rates of about 1½ per cent in 1990; however, these rates were considerably lower than the growth rates of 3 and 2½ per cent, respectively, attained in 1989.

As noted above, various factors contributed to the firm demand for consumer goods and services. In particular, real personal disposable income continued to rise from the middle of 1989 throughout 1990, after having increased at very high rates during 1987 and 1988. The increase in real personal disposable income was accompanied by a contraction in real income from

Components of real private consumption expenditure



property and can mainly be ascribed to large wage adjustments in both the private and the government sector. Moreover, lower-paid categories of workers with a higher propensity to consume, generally received larger proportional adjustments than higher-paid workers with a higher propensity to save.

The sharp rise in expenditure on furniture and household appliances also reflected a pent-up replacement demand for consumer durables because of earlier postponement of purchases. The increase in this type of expenditure in 1990 was financed to a large extent by a sustained increase in hire-purchase finance which may have been aided by the relaxation of hire-purchase restrictions in March 1990. The further increase in households' real expenditure on non-durable consumer goods and services reflects the more essential and non-discretionary nature of spending on items in these categories, which normally rises with the growth in population.

From the beginning of 1991, however, a contraction in expenditure on durable and semi-durable goods and services at first resulted in a considerably lower growth (at an annual rate of ½ per cent in the first quarter) in

real private consumption expenditure. In the second quarter real outlays on consumer goods and services *decreased* at an annual rate of ½ per cent. This turnaround in real consumption expenditure took place in conjunction with a marked levelling-off in real personal disposable income. Other factors, such as the continued cooling-down of the economy and the considerable retrenchment of labour, could also have led to a more conservative attitude on the part of consumers.

Sharp acceleration in government consumption expenditure

Real consumption expenditure by general government remained on a high level during the current downswing of economic activity, but the rate of growth in this aggregate slowed down from 3½ per cent in 1989 to only 1 per cent in 1990. This was the lowest year-to-year percentage increase in government consumption expenditure since 1978 and may be compared with an average annual growth rate of 4 per cent in the 1980s. However, real consumption expenditure by general government started to accelerate towards the end of 1990; it increased at an annual rate of no less than 16 per cent in the fourth quarter of 1990, followed by growth rates of 19½ and 12 per cent in the first two quarters of 1991. Over the twelve months ending June 1991, the real government consumption expenditure was therefore 5 per cent higher than in the previous twelve months.

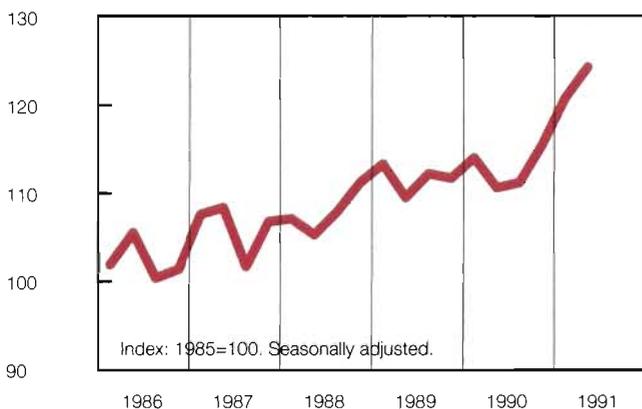
The sustained rise in consumption expenditure by general government at a rate exceeding aggregate income growth, gave rise to an increase in government’s claim on national disposable income. The ratio

of consumption expenditure by general government to gross national disposable income rose from an average of 14 per cent in the 1970s to an average of more than 17 per cent in the 1980s. In 1990 this ratio amounted to 19½ per cent, and then rose even higher to no less than 21 per cent in the first half of 1991.

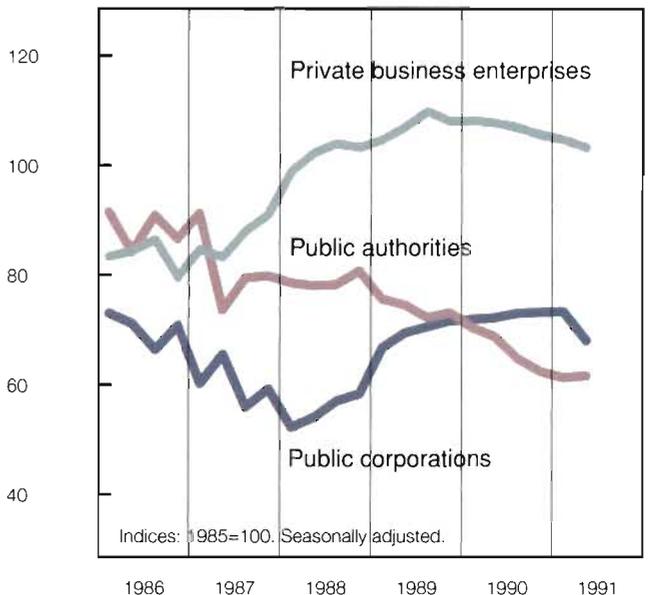
Relatively small contraction in gross domestic fixed investment

Aggregate real gross domestic fixed investment contracted at an average annual rate of 2 per cent during the nine quarters of the current downswing up to the end of June 1991. This moderate rate of decrease can be compared with annual rates of decrease amounting to 4½ per cent and 14 per cent in the 1981-83 and 1984-86 economic downswings; but in the current downswing fixed investment, of course, decreased from an already relatively low level. As a percentage of gross domestic product, gross domestic fixed investment decreased from a high point of 27 per cent in 1982 to 19 per cent in 1988 and then rose marginally to 19½ per cent in 1990. The rise in this ratio occurred mainly in the early stages of the cyclical downswing because total real fixed investment started to decline only from the fourth quarter of 1989; this rate of decrease then accelerated to annual rates of approximately 5 per cent in the second half of 1990 and in the first half of 1991.

Real government consumption expenditure



Real gross domestic fixed investment



The downturn in real outlays on aggregate gross domestic fixed investment in the current downswing was firstly the result of a continued contraction in real fixed capital formation by public authorities, which has decreased almost uninterruptedly from 1983 onwards. The share of public authorities' investment came down from 25 per cent of gross domestic fixed investment in 1982 to 16½ per cent in the first half of 1991. This could be ascribed to significant reductions in real fixed investment by both the services departments and the business enterprises of general government. In the case of business enterprises the decline in fixed investment formed part of the rationalisation programmes instituted especially by the Department of Posts and Telecommunications and by Transnet to improve their cost-effectiveness and to become more responsive to market forces.

Secondly, the downturn in real fixed investment was brought about by a downward trend in the investment of the private sector. In 1990 real fixed investment by the private sector contracted by ½ per cent, followed by a further decrease at an annual rate of 4½ per cent in the first half of 1991. Nevertheless the level of real fixed capital outlays by the private sector in the second quarter of 1991 was only about 1½ per cent lower than the level attained at the peak of the business cycle in the first quarter of 1989.

The decrease in the private sector's real fixed investment in the current economic downswing occurred mainly in the sectors agriculture, mining, commerce and finance, which neutralised an increase in the capital formation of the manufacturing sector. Adverse weather conditions, mounting levels of farm debt, high interest rates and political uncertainties were mainly responsible for a downward movement in the fixed investment of agriculture during 1990 and the first half of 1991. In addition, farmers' ability to invest in capital goods was also eroded by the deterioration in the terms of trade in agriculture – i.e. by increases in output prices not fully matching increases in input costs.

Real fixed capital formation in the mining sector was discouraged during most of the current downswing by, *inter alia*, a rationalisation in the gold-mining industry owing to the weak performance of the gold price combined with rising operating costs. The weaker performance of certain international base metal prices from the middle of 1988 was also an important disincentive over the short-term to enhance the production capacity of other mining enterprises. Considerable rationalisation programmes to increase the profitability of financial institutions and a decline in the demand for equipment financed through leasing contracts led to a decrease in fixed investment by this sector. Finally, the decrease in fixed investment could also be attributed to factors such as the low and decreasing level of economic activity, internal unrest and a fair amount of disharmony in management-labour relations.

On the other hand, aggregate real fixed investment by the private manufacturing industry improved notably dur-

ing 1990 and the first half of 1991. This reflected an expansion of the production capacity in a number of sub-sectors, such as paper and printing, the chemical industry and base metal working. The rise in fixed investment by private manufacturing enterprises during an economic downswing was probably caused by the strong export performance of manufactured goods, discussed in more detail below. It could possibly also be attributed to the fact that certain industries have replaced obsolete capital equipment or have upgraded plants to manufacture products for a still relatively buoyant local market.

In contrast to the general lack of investment activity by the private sector and public authorities, real capital outlays by public corporations increased substantially. After it had reached a low point in the first quarter of 1988, it rose almost uninterruptedly to record an annual growth rate of more than 4 per cent in the current economic downswing up to the first quarter of 1991. This reflected a continued increase in real capital expenditure by public corporations involved in the manufacturing sector, which more than offset a decline in fixed investment by Eskom. A decline in the capital spending of Eskom was also responsible for a considerably slower rate of increase in the fixed investment by public corporations from the beginning of 1990. All in all, however, public corporation investment expenditure was dominated during the past 2½ years by the on-shore and off-shore development activities of Mossgas. A decline in the capital outlays on this project was mainly responsible for a decrease in the capital formation of public corporations in the second quarter of 1991.

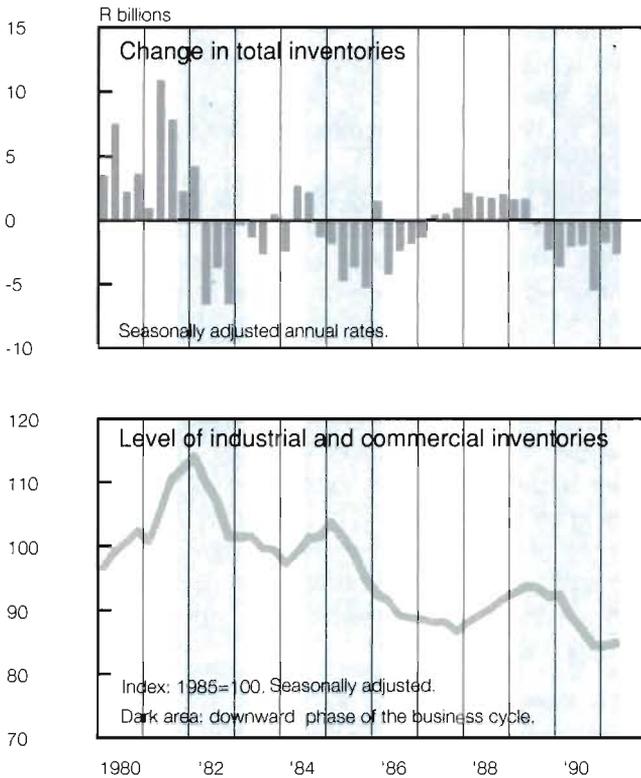
An analysis of total real gross domestic fixed investment by type of asset during the current downswing shows that with the exception of non-residential buildings, real outlays on all types of other assets decreased. The continued strong investment in non-residential buildings could, among other things, probably have arisen in view of the fact that in an environment of high inflation, institutions will rather tend to hedge themselves against the negative effects of inflation than investing in more risky type of projects.

Record low level of inventories

In accordance with its normal cyclical behaviour, the decumulation of aggregate real inventories lagged behind the downturn in the business cycle. Inventory accumulation only became negative in the third quarter of 1989. Destocking continued in the ensuing seven quarters up to the middle of 1991. As a percentage of gross domestic product, total inventories declined by approximately 3 per cent during the current downswing. This was more than the 1 per cent recorded in the 1984-86 downswing, but substantially less than the 6½ per cent decrease during the 1981-83 downturn.

In general, inventory investment still plays an important role in the path and amplitude of the business

Inventories



cycle, as the variance in the changes in inventory investment is normally larger than the variance in changes in any other component of gross domestic expenditure. Better control by business enterprises of their inventories and the resultant lower level of inventories relative to gross domestic product helped to cushion the amplitude of the inventory cycle, and therefore also its effect on cyclical fluctuations in general business conditions over the past several years.

The destocking during the current downswing has resulted in further declines in the ratio of non-strategic non-agricultural stocks to real gross domestic product of the non-agricultural sectors. The value of this ratio declined from an average of 33½ per cent in the early 1980s to approximately 29 per cent in 1989-90. The ratio of commercial and industrial inventories to the non-agricultural gross domestic product also decreased from a recent high in the second quarter of 1989 of 21 per cent to a new low of 18½ per cent in the first half of 1991.

Slower growth in factor income

The rate of increase in aggregate nominal factor income slowed down from 17½ per cent in calendar

1989 to 13 per cent in 1990. This deceleration became more pronounced in the second half of 1990, when the annual rate of increase in factor income receded to 12½ per cent; this was followed by an even lower rate of 11 per cent in the first half of 1991. The slowdown in the growth of factor income was primarily accounted for by slower growth in gross operating surpluses, but the rate of increase in the remuneration of employees also became somewhat more moderate from the second half of 1990.

The rate of increase in the gross operating surplus decelerated from 13½ per cent in 1989 to 9½ per cent in 1990 and to an annualised rate of 10 per cent in the first half of 1991. The downturn in the growth of the operating surplus was particularly evident in the primary sectors and, to a lesser extent, also in the secondary sectors. From the first half of 1991 the lower growth in the gross operating surplus became more dispersed and occurred also in most sub-sectors of tertiary economic activities.

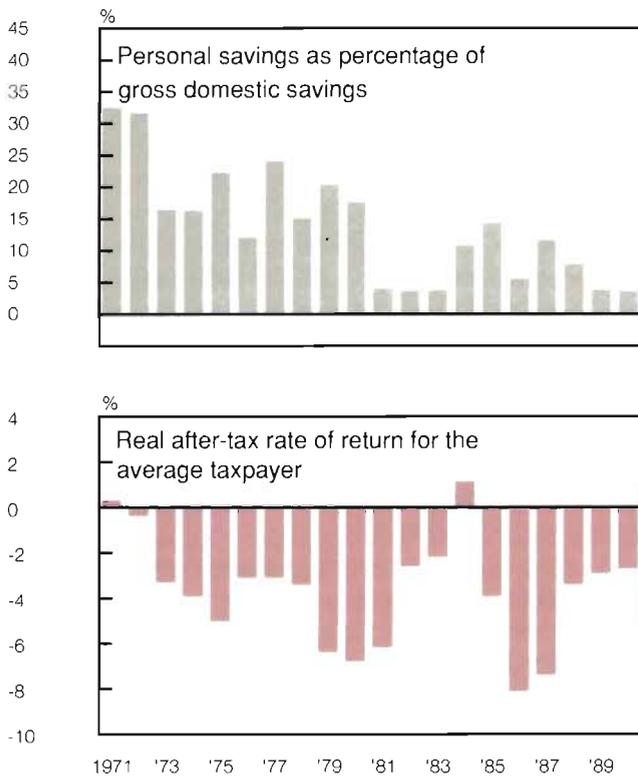
Following annualised increases of 18 and 23 per cent in the first two quarters of 1990, the growth rate in the remuneration of employees tapered off in the second half of 1990 and the first half of 1991 to annualised increases that varied between 14½ and 15 per cent. These lower, but still relatively strong, increases in the remuneration of employees included salary adjustments in the civil service and other general improvements in the conditions of service of government employees. It also reflected the strong and more sophisticated bargaining power of labour unions, and increases in the salary and wage payments by companies necessitated by the employment of temporary workers during strike actions as well as by retrenchment provisions and improved severance allowances.

Decline in domestic savings ratio

The ratio of gross domestic saving to gross domestic product continued to decrease from an upper turning-point of 24½ per cent in 1985 to 22½ per cent in 1989 and 21½ per cent in 1990. In the first half of 1991 this ratio amounted to only 19½ per cent. These ratios can be compared with an average domestic savings ratio of slightly more than 26 per cent in the 1970s. The further recent decline in the domestic savings ratio during 1990 and the first half of 1991 was due in particular to a decrease in private saving. This lower level of private-sector saving resulted from a reduction in the saving by corporate entities owing mainly to:

- the lower growth of companies' earnings (notably companies in the primary sectors);
- the rising number of company liquidations;
- the maintenance of dividend payments in spite of

Personal savings and real after-tax rate of return



lower profits, because of the exemption of dividends from normal income tax as from the fiscal year 1990/91; and

- a change in the investment climate under the prevailing socio-economic and political conditions, which discouraged companies to plough back large amounts of surplus funds.

Similarly, the ratio of net personal savings to personal disposable income decreased further from an average level of 3 per cent in 1988 to 1½ per cent in 1990 and to approximately 2 per cent in the first half of 1991. This was substantially lower than the average saving rates of 10 per cent during the 1960s and of 8½ per cent during the 1970s.

One of the most important barriers in the way of a meaningful improvement in households' saving performance in recent years, and more particularly since 1985, has been the negative real after-tax rates of return on depository types of savings. An analysis of real after-tax rates of return for the years 1971 through 1990 shows that negative rates were recorded in all but two years, namely 1971 and 1984, when these rates amounted to less than ½ per cent and slightly more than 1 per cent respectively. The lowest real

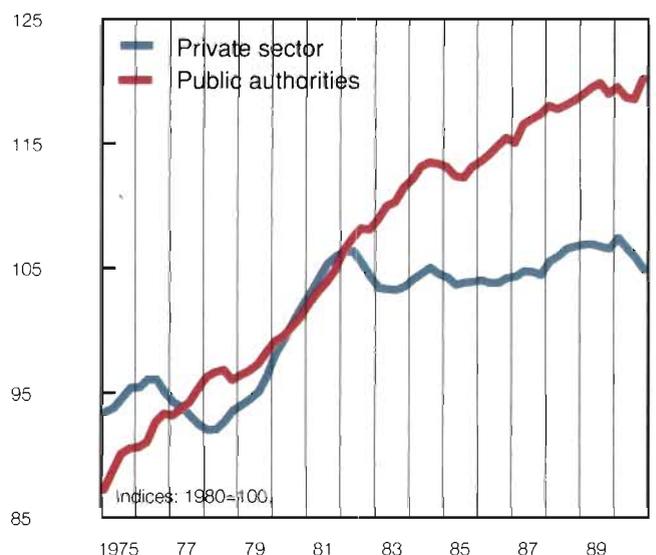
after-tax rates of return during the period under review were registered in 1986 and 1987, when they were *negative* to the extent of slightly more than 8 per cent and almost 7½ per cent. Real after-tax rates of return have remained consistently negative in subsequent years, averaging minus 3 per cent during the period 1988 to 1990 and approximately minus 2½ per cent in the year 1990.

Gross domestic saving by general government also slowed down considerably in the second half of the 1980s. The gross savings ratio of general government contracted to an average of 7½ per cent in the period 1985-90, against a longer-term ratio of 12½ per cent in the period 1975-90. Moreover, from 1984 to 1989 general government was consistently a net dissaver, because its current expenditure exceeded its current revenue. In calendar 1990, however, general government recorded positive savings in all four quarters, adding up to a net saving of almost R1,7 billion. In the first half of 1991 the government's saving turned negative again because of a decrease in direct tax receipts and a substantial acceleration in government consumption expenditure.

Low labour absorption capacity of economy

After the growth rate in total *non-agricultural employment* had accelerated moderately during the 1986-89 upward phase of the business cycle to 1,5 per cent in 1988, it slowed down to 0,7 per cent in 1989 and turned negative to the extent of 0,4 per cent in 1990.

Employment in the non-agricultural sectors



Data available for the first quarter of 1991 indicate a continuation of this trend, with further declines in employment in manufacturing, construction, electricity generation and the financial sector. Like total non-agricultural employment, employment in the private sector and by public authorities also contracted in 1990, viz by 0,6 and 0,1 per cent respectively. However, employment by public authorities increased fairly sharply in the fourth quarter of 1990 and the first quarter of 1991.

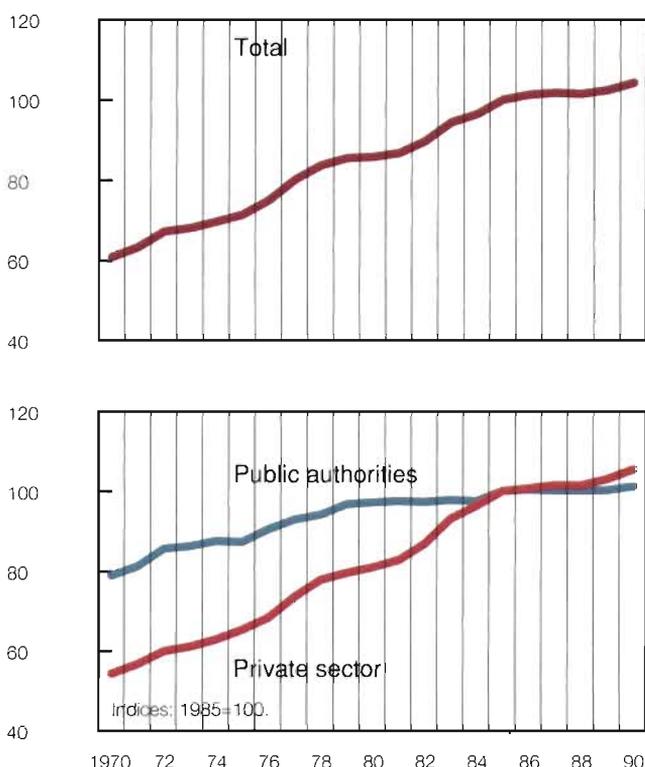
Taking a longer-term view of changes in employment, it is obvious that the ability of the formal economy to create additional employment opportunities has deteriorated markedly. This is clearly reflected in the deceleration in the average annual rate of increase in employment from nearly 4 per cent in the 1960s to 2½ per cent in the 1970s and to slightly more than 1 per cent in the 1980s. It was even more noticeable in the later part of the 1980s: the average annual growth rate contracted from 1,2 per cent in the period 1980-85 to only 0,6 per cent in the period 1985-90. Even more disconcerting is the fact that the growth that still occurred in employment during the 1980s was concentrated in the public sector, while employment in the non-agricultural private sector fluctuated around a flat trend.

The inability of the formal sectors of the economy to provide sufficient employment opportunities to a rapidly growing labour force is confirmed by changes in the *labour absorption capacity* of the economy - i.e. the average annual increase in employment in the formal sectors (excluding agriculture and self-employed persons) as a ratio of the average annual increase in the labour force. The labour absorption capacity decreased from an average of 97 per cent in the 1960s to 72 per cent in the 1970s and to only 22 per cent in the 1980s. The decline in this ratio was even much more pronounced during the period 1985-90, when it contracted to an average of only 7 per cent. This means that on average only 7 new employment opportunities are created in the formal sectors of the economy for every 100 new entrants to the labour market.

This poor performance was related to a major change that took place in the production structure of the economy. In the past two decades capital was increasingly used as a substitute for labour in production processes, as is confirmed by the fairly steep rise in the *capital-labour ratio*. The move away from labour in favour of capital was much stronger in the private sector; a marked flattening-out occurred in the capital-labour ratio of the public authorities.

Various factors were probably responsible for this substitution of capital for labour. In particular, distortions in relative factor prices made a very important contribution. During the 1970s and in the early and middle 1980s user costs of capital were relatively low because of prolonged periods of low and often negative real interest rates; the unrealistically high average

Capital-labour ratio in non-agricultural sectors



value of the exchange rate of the rand, especially in the early 1980s; tariff policies protecting local industries against foreign competition; and a number of tax expenditure schemes specifically designed to encourage capital formation in the manufacturing sector. At the same time labour became more expensive; real wages showed a sharply rising trend because wage settlements generally failed to adequately recognise the relative abundance of less-skilled labour. Unionisation, political actions in the trade union movement, protest actions, strikes and unrest added to the non-wage cost of labour.

However, in the period 1986 to 1988 the capital-labour ratio of not only the public authorities but also that of the private sector flattened out markedly. As pointed out in the 1990 *Annual Economic Report* this was not a "predominantly structural phenomenon", but was mainly related to a mild cyclical acceleration in employment in conjunction with low levels of net fixed capital formation. This statement has been substantiated by the resumption of a fairly sharp increase in the capital-labour ratio during 1989 and 1990 when real economic activities tapered down.

Total employment in the non-agricultural sectors of the economy reached its most recent cyclical upper turning-point of 5,45 million people in the second quar-

ter of 1989. It then declined on balance to a level of 5,38 million in the fourth quarter of 1990. The extent of this decrease in employment is not excessive and also compares favourably with the downward phases of 1981-83 and 1984-86. The duration of the current decline in total non-agricultural employment of six quarters is, however, significantly longer than the average duration of the decline of three quarters in the two preceding cyclical downswings.

As could be expected under these circumstances, the total number of registered *unemployed workers* increased from 109 600 in January 1989 to 274 600 in April 1991. A sharp rise in the official number of unemployed workers occurred especially since the middle of 1990. However, as has been indicated in reviews in the *Quarterly Bulletin* of the Reserve Bank, these statistics have been affected by the adoption of a new method of measuring the number of registered unemployed workers as from July 1990.

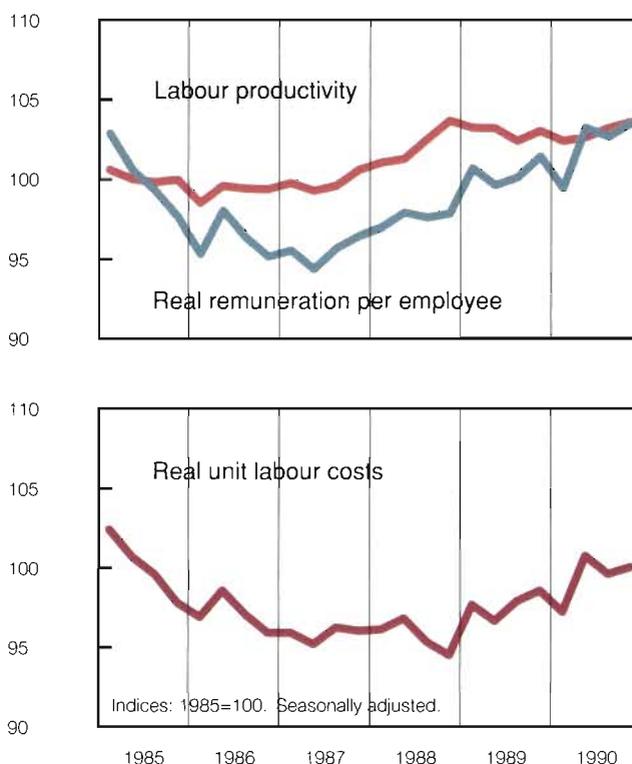
Although the exact extent of unemployment is difficult to determine in South Africa, the government is acutely aware of the seriousness of the unemployment situation and has undertaken various measures to alleviate it, including:

- The active promotion of the small business sector by way of the Small Business Development Corporation (SBDC). Since its inception in 1981, the SBDC has contributed to the creation of about 249 000 employment opportunities at a relatively low cost. In 1990 about 37 000 new employment opportunities were made possible by the SBDC.
- Special employment and training programmes were introduced in 1985. A total of 1,3 million unemployed persons were trained at a cost of R460 million, of whom about 30 per cent have been able to find permanent employment. In addition, R719 million was spent on the creation of employment opportunities.
- Considerable amounts were spent by the government on the development of housing projects, which contributed to new employment opportunities in the construction sector.
- In 1990, a total of 111 000 job seekers were placed in posts by the Department of Manpower.

Increased labour costs and lower productivity

The year-to-year rate of increase in the average *nominal value* of salaries and wages per worker in the non-agricultural sectors of the economy accelerated uninterruptedly from 11,4 per cent in 1985 to 18,0 per cent in 1989, before declining slightly to 16,7 per cent in 1990. Similarly, the year-to-year rate of increase in the nominal salaries and wages of private sector work-

Non-agricultural labour productivity, remuneration and unit costs



ers also declined marginally from 16,6 per cent in 1988 to 16,1 per cent in 1990, while the rate of increase in the average wage cost per worker employed by public authorities rose from 12,4 per cent in 1988 to 21,9 per cent in 1989 and 18,0 per cent in 1990. Moreover, data available for the first quarter of 1991 indicate that further large wage increases were granted in certain industries during this period.

These continued high rates of increase in nominal wages in spite of the low labour absorption capacity and high unemployment in the economy, clearly indicate that the functioning of the labour market has become increasingly distorted. In contrast to most industrial countries, which have been able to contain wage increases within reasonable limits by decentralising the determination of salary and wage increases, the wage negotiating process in South Africa has become more and more centralised, leading to unrealistically high wage settlements. Labour unions have mainly been concerned with broader social and political issues, which are not always work-related and are often aimed at maximising short-term benefits for the unions' members, but disregard the long-term effects of such actions on labour and unemployment.

Attempts to close wage differentials based on race and sex also did not take underlying supply and demand conditions into consideration. The labour market thus became more politicised and normal market forces were interfered with in many ways. It is therefore not surprising that a considerable substitution of capital for labour took place.

The increases in wage costs during the past three years exceeded the rate of increase in consumer prices, with the result that the *real wage* per non-agricultural worker rose at an average annual rate of 2,5 per cent in the period 1987-89 and by 2,0 per cent in 1990. However, the average annual rate of increase in the real wage per worker has at least decelerated marginally from 1½ per cent in the 1970s to 1 per cent in the period 1980-90.

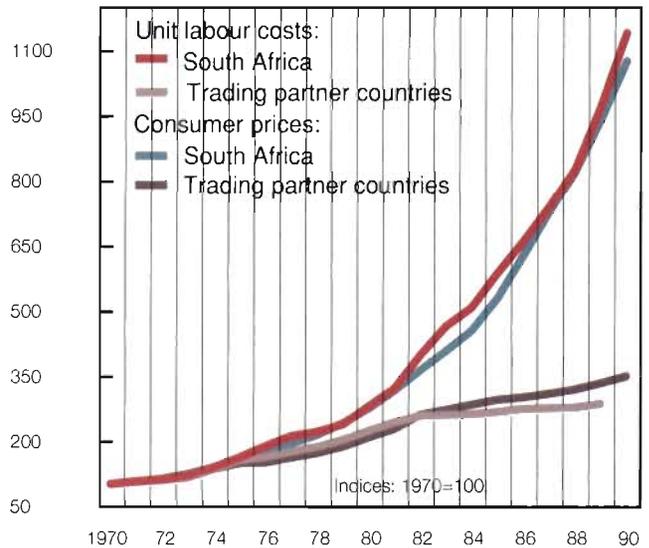
Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural sectors of the economy, increased at rates of 0,6 and 2,3 per cent in the two cyclical upswing years 1987 and 1988. The rate of increase then slowed down to 0,8 per cent in 1989, before labour productivity declined marginally in 1990. The initial slowdown and subsequent deterioration of labour productivity was partly due to an increase in the number of man-days lost in production because of strikes and work stoppages, which rose from 0,9 million in 1988 to 1,5 million in 1989 and to 2,0 million in 1990.

As could be expected, the recent high rates of increase in nominal salaries and wages per worker and the concurrent relatively poor performance of labour productivity exerted upward pressure on nominal labour costs per unit of physical output. The year-to-year rate of increase in *nominal unit labour costs* accordingly accelerated from 12,6 per cent in 1988 to 17,2 per cent in 1989; it then receded slightly to 16,3 per cent in 1990. This caused *real unit labour costs* to rise again by 2,1 per cent in 1989 and by 1,7 per cent in 1990, after having decreased from 1985 to 1988.

From the accompanying graph it is also apparent that nominal labour costs per unit of physical output in South Africa's manufacturing sector have, on average, increased much more rapidly than in South Africa's main trading partner countries since about the middle of the 1970s. This increasing trend clearly had an important bearing on the competitiveness of South African manufactured goods on international markets which was at times offset by a depreciation of the exchange rate of the rand. Such depreciations of the rand provide only temporary relief to manufacturers of exports because of the impact they have on the inflation rate of the country. In order to maintain a sustained competitive position, it is of the utmost importance to restrict wage cost increases and to improve productivity.

The close correlation between increases in nominal unit labour costs and the rate of increase in consumer prices, both in South Africa and in its trading partner

Unit labour costs in manufacturing



countries, is also clearly illustrated in the graph. Very disconcerting is the fact that the rate of increase in nominal unit labour costs in South Africa has tended to remain consistently above the rate of inflation in consumer prices from 1974 onwards and especially since 1981. This is in sharp contrast with the experience in South Africa's main trading partner countries, where the growth in nominal unit labour costs has, on average, been consistently lower than the inflation rate in the 1980s.

Continuing unacceptably high rates of inflation

The rates of increase in most of South Africa's main price indices in 1990 declined to slightly lower but still unacceptably high levels. For example, the year-to-year rate of increase in the prices of domestically produced goods accelerated from 13,8 per cent in 1988 to 14,8 per cent in 1989, before declining somewhat to a rate of 12,8 per cent in 1990. The year-to-year rate of increase in the prices of imported goods also accelerated from 9,7 per cent in 1987 to 16,3 per cent in 1989, and then improved considerably to 10,2 per cent in 1990. In a pattern similar to those of the two main components of the production price index, the year-to-year rate of increase in the consumer price index accelerated from 12,9 per cent in 1988 to 14,7 per cent in 1989, but then receded marginally to 14,4 per cent in 1990.

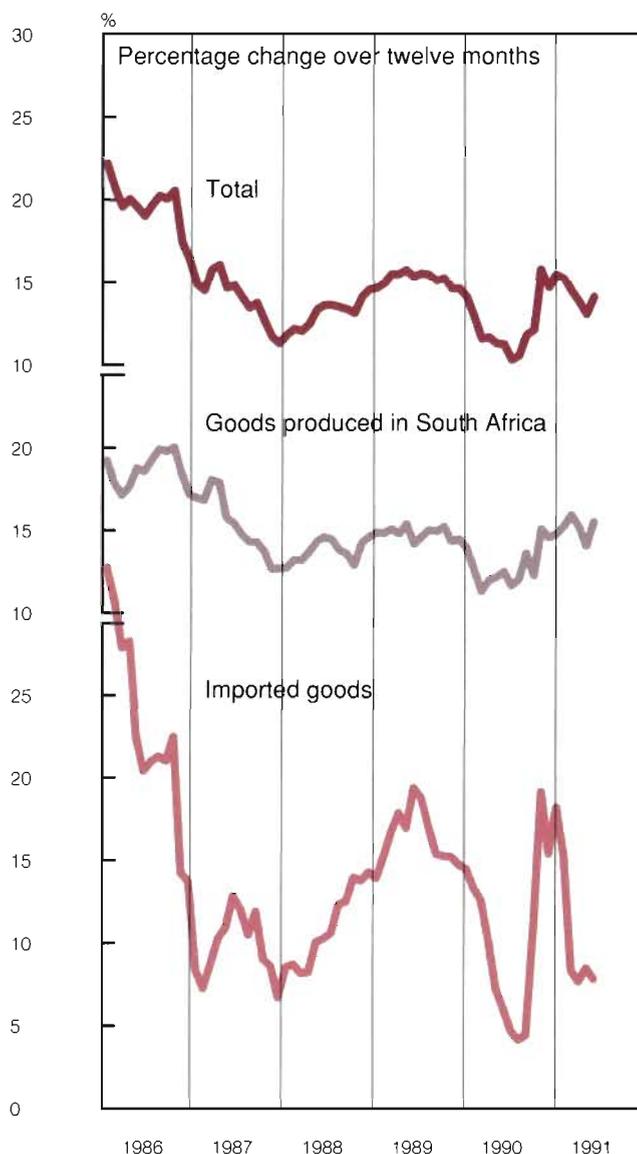
In the past six years the rate of increase in the consumer price index has averaged slightly more than 15

per cent, compared with about 13 per cent in the period 1974-84 and about 4 per cent in the period 1960-73. The *underlying causes* of the higher inflation rate in recent years differ markedly from those before 1984. The Commission of Inquiry into the Monetary System and Monetary Policy in South Africa identified excessive domestic monetary demand as the main source of inflation in South Africa during the period 1960-84. However, the Commission also pointed out that the excessive domestic demand should be viewed against the background of inflationary tendencies generated by structural and cost-push factors, such as autonomous increases in salaries and wages, administered price increases, rising prices of imported goods and insufficient competition.

From the beginning of 1985 the relatively high rate of inflation was at first essentially caused by the depreciation of the rand, which particularly during 1985-86 and again in 1988 made a major contribution to price increases. During the final years of the 1980s the continuing unacceptably high inflation rates became more and more a domestic phenomenon related to the entrenchment of inflationary expectations in the economy. These inflationary expectations became embodied in wage negotiations, making business enterprises more willing to concede to wage demands by labour unions; the increased production costs were passed on to the consumer. At the same time, the economy's productivity continued to be adversely influenced by socio-political conditions. The poor productivity performance, as reflected *inter alia* in high rates of increase in nominal and real labour costs per unit of production, was also passed on to consumers. More recently, the seeming inability of restrictive monetary and fiscal policy measures effectively to lower the rate of inflation could also be ascribed to the impact of the war in the Persian Gulf on oil prices and to the impact of adverse weather conditions during 1990 on food prices.

The effect of the higher oil prices in the last half of 1990 is clearly illustrated by the reversal of the declining tendency in *import prices*. Measured over a period of twelve months, the rate of increase in these prices came down from 19,3 per cent in June 1989 to only 4,1 per cent in August 1990, but then increased substantially to 19,1 per cent in November. When international crude oil prices returned to the levels that had prevailed before August 1990, the rate of increase in import prices at first fluctuated around a slightly lower level of about 15 per cent until February 1991, before receding substantially to 7,8 per cent in June 1991. The *quarter-to-quarter* rate of increase in the prices of imported goods also declined substantially from a seasonally adjusted and annualised rate of 25,3 per cent in the second quarter of 1989 to only 0,1 per cent in the third quarter of 1990, mainly as a result of the strengthening of the exchange rate of the rand and the lowering of import surcharges in the 1990/91 Budget. The third

Production prices



international oil crisis then caused this rate of increase to reaccelerate to 59,4 per cent in the fourth quarter of 1990, before it subsided again to 4,4 per cent in the first quarter and to minus 19,0 per cent in the second quarter of 1991. Measured over a period of twelve months, the rates of increase in the production prices of *domestically produced goods* accelerated from a lower turning-point of 11,3 per cent in March 1990 to 15,1 per cent in November, and then continued to fluctuate around this level until June 1991. The *quarter-to-quarter* rate of increase in the prices of domestically produced goods also accelerated from its lowest level in twenty-one quarters of 9,2 per cent (seasonally adjusted and annualised) in the first quarter of 1990 to

19,0 per cent in the fourth quarter. Thereafter it declined to 14,3 per cent in the first quarter of 1991 and to 11,7 per cent in the second quarter.

Reflecting these movements in its two main components, the rate of increase in the *total production price index over periods of twelve months* also accelerated from 10,3 per cent in July 1990 to 15,8 per cent in November, but then fluctuated downwards to 14,1 per cent in June 1991. The *quarter-to-quarter* rate of increase in the total production price index similarly rose sharply from a seasonally adjusted and annualised rate of 9,6 per cent in the first quarter of 1990 to 25,4 per cent in the fourth quarter, before falling back to 13,0 per cent in the first quarter of 1991 and to 4,8 per cent in the second quarter.

In contrast to the resumption of the downward trend in producer prices, the rate of increase in *consumer prices* remained stubbornly high throughout the first six months of 1991. Measured over a *period of twelve months*, the rate of increase in consumer prices accelerated on balance from 13,3 per cent in July 1990 to 15,3 per cent in November 1990 and then fluctuated around this level to 15,2 per cent in June 1991. The *quarter-to-quarter* rate of increase in the consumer price index accelerated from seasonally adjusted and annualised rates of 13,5 per cent in both the second and third quarter of 1990 to 16,8 per cent in the fourth quarter. It then declined to 14,1 per cent in the first quarter of 1991, but moved upwards again to 15,0 per cent in the second quarter.

Continued high rates of inflation in consumer prices occurred mainly in the prices of food, alcoholic beverages and tobacco, new vehicles and transport services. From the second quarter of 1990 to the second quarter of 1991 the rates of increase in the prices of these items (excluding food prices, which have displayed a very erratic pattern) have not only been consistently higher than the rates of increase in the overall consumer price index, but have been higher than or close to 20 per cent. The high rates of increase in the prices of consumer goods were offset to some extent by slower rates of increase in the prices of consumer services.

Foreign trade and payments

Sustained but fluctuating surpluses on current account

In what is probably a record for a developing country which is also mainly an exporter of primary commodities, surpluses have now been recorded on the current account of South Africa's balance of payments for twenty-six consecutive quarters. From the beginning of 1985 up to the middle of 1991, the total cumulative current account surplus amounted to no less than R31 billion, or to 3 per cent of gross domestic product. As already explained in some detail in previous issues of the *Annual Economic Report* and the *Quarterly Bulletin*, the maintenance of these surpluses was essential in view of the constraints imposed by financial and other sanctions on the country. During the first half of 1991 a gradual lifting of some of these measures began to take place, and this movement may accelerate after the United States' decision on 10 July 1991 to remove all sanctions in terms of the Comprehensive Anti-Apartheid Act.

Although continued surpluses were recorded on the current account of the balance of payments, the size of the surpluses fluctuated considerably during the past eighteen months, especially towards the end of 1990 and in the beginning of 1991. The surplus on the current account of the balance of payments, which had reached a seasonally adjusted and annualised rate of R5,6 billion in the first quarter of 1990, fluctuated downwards to R4,2 billion in the third quarter before shooting up to R9,7 billion in the fourth quarter of 1990. In the first quarter of 1991 this surplus dropped substantially to R1,5 billion and then bounced back again to a level of R6,2 billion in the second quarter of 1991 - i.e. to a level higher than the quarterly average of R5,8 billion in 1990. These sharp fluctuations in the current account transactions were mainly related to developments caused by the crisis in the Persian Gulf area.

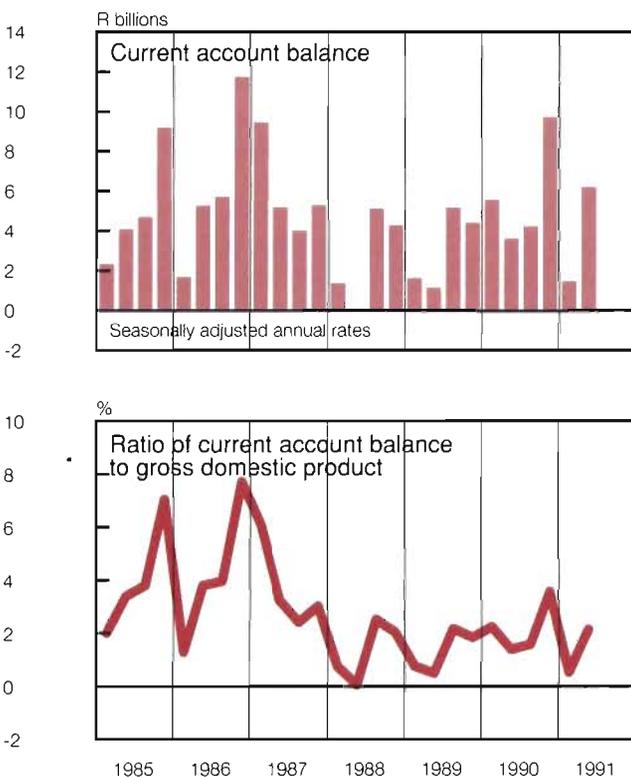
Effects of crisis in Middle East on South Africa's balance of payments

The invasion of Kuwait by Iraq on 2 August 1990 immediately resulted in a sharp increase in oil prices. The price of Brent crude oil roughly doubled from a monthly average of US\$17 per barrel in July 1990 to \$26 in August and \$35 in October. A peak price of \$40,90 per barrel was reached on 28 September 1990. As soon as it became apparent that the threat to Saudi Arabian oilfields was ruled out by actions of the allied forces and that world oil supplies would not be disrupted seriously, the oil price fell back again to a monthly average of \$23,36 per barrel in January 1991 and to \$18,52 in June 1991.

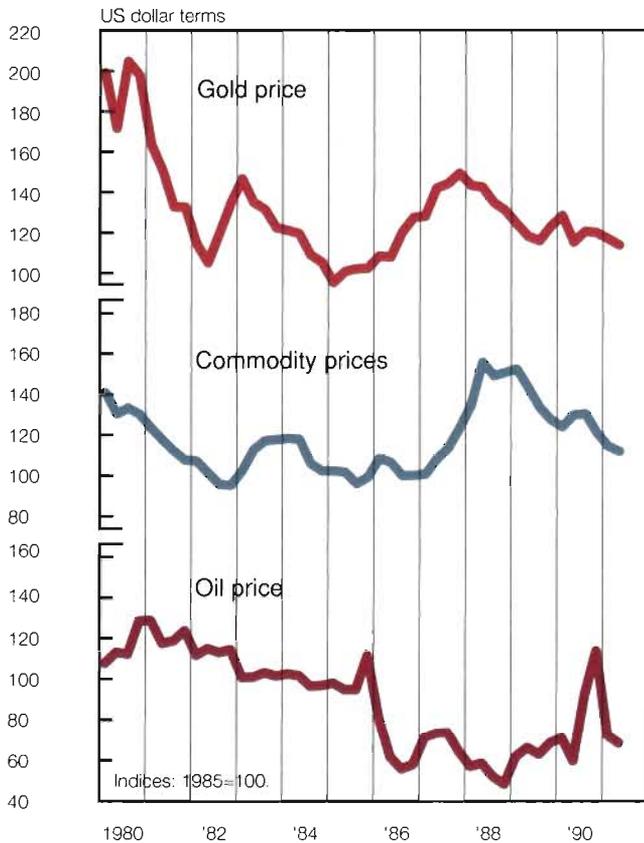
As in the case of the two previous oil price shocks, the gold price rose in tandem with the oil price but not nearly to the same extent. The monthly average fixing price of gold strengthened from \$362 per fine ounce in July 1990 to approximately \$395 in August 1990, but fell back to about \$381 in October 1990 and then further to more or less the same levels as before the crisis. In contrast to the previous two oil crises, the prices of certain other oil-substitute commodities, such as uranium and coal, did not increase during the latest crisis, but remained depressed. Other international commodity prices also rose initially, but then declined again when it became clear that the Middle East crisis was less serious than originally expected.

The net effect of all these price movements and changes in the rand's exchange rate, was an increase in South Africa's terms of trade of 2,9 per cent from the second to the third quarter of 1990; it then declined again sharply by 7½ per cent up to the first quarter of

Balance of payments



Gold, commodity and oil prices



1991 before it recovered by 5½ per cent in the second quarter. These movements may be compared with increases in the terms of trade in the previous two oil shocks of nearly 30 per cent from 1972 to 1974 and approximately 17 per cent from 1978 to 1980. It is therefore obvious that the price effects of the recent crisis in the Middle East on South Africa's balance of payments were minimal and very short-lived. As indicated above, however, the situation in the Persian Gulf area interrupted the downward movement of the domestic price increases and prolonged the relatively high rates of inflation in the country.

The developments in the Middle East also caused substantial fluctuations in the country's balance of payments in the fourth quarter of 1990 and the first quarter of 1991. The very high level of the surplus in the fourth quarter was largely the result of a substantial decrease of 14½ per cent in the volume of merchandise imports, which was related to the drawing-down of inventories of mineral products; in the first quarter of 1991 the volume of merchandise imports increased again by 10 per cent, mainly because of increased imports of mineral products. Although the volume of South Africa's merchandise exports continued to rise in the second half of

1990, the Persian Gulf conflict seriously affected world growth and world trade. The uncertainties associated with the crisis in the Middle East led to a sharp drop in business confidence and a contraction in spending by consumers and businesses internationally, which probably also restricted the growth in South African exports.

The volatility of international oil prices also gave rise to fluctuations in net service and transfer payments over these two quarters. The high average oil price resulted in substantially higher travel and transport payments to non-residents in the fourth quarter, followed by a decline in these service payments when oil prices dropped again. It particularly affected freight charges on all merchandise transported, the cost of air travel, and bunker oil and air fuel prices. Foreign tourism to South Africa was also adversely affected by widespread cancellations of tourist and business travel.

Substantial growth in merchandise exports

The main driving force behind South Africa's exceptional current account performance since the beginning of 1985 has been a substantial growth in merchandise exports. From 1984 to 1990 the value of merchandise exports continued to advance strongly from R12,8 billion to R42,4 billion, or at an average annual rate of 22½ per cent. Even more significantly, the volume of merchandise exports rose by 10 per cent per year over the same period.

This export growth was achieved despite the introduction of sanctions and trade embargoes by a large number of countries on several categories of export products, and can largely be attributed to:

- a sharp decline in the real effective exchange rate of the rand, particularly during 1984 to 1985 and 1988, to an average level in 1990 which was 13 per cent lower than the average index value of 1984 and 26 per cent lower than the average index value of 1983;
- relatively high and rising levels of real economic activity in the main industrial countries of the world and a growth in the volume of world trade which averaged 5 per cent per year during the period 1984 to 1990 and which at times reached exceptionally high growth rates, such as 9 per cent in 1988; and
- the relatively low level of domestic economic activity and excess production capacity which existed during the larger part of this period and which encouraged domestic producers to find other outlets for their products.

Quite significantly, the volume of merchandise exports continued to rise in 1990 and the first half of 1991, despite a reversal in some of the factors favouring

exports. Economic growth in the industrial countries, for instance, slowed down considerably from the beginning of 1990 and this led to a deceleration in the rate of increase in world trade to 4 per cent from slightly more than 7 per cent in the preceding year. From the middle of 1989 the real effective exchange rate of the rand also appreciated fairly sharply. The continued growth in the volume of exports is probably a reflection of the fact that exporters have remained competitive in international markets and that the rand is still undervalued in relation to the currencies of South Africa's main competitors.

An analysis of exports in terms of main type of economic activity shows that the sharp rise in the value of merchandise exports occurred over a wide range of goods. A high average annual growth rate of 21½ per cent was recorded in the value of mining products exported from 1984 to 1990, owing to substantial increases in the exports of products such as platinum, diamonds and coal. Agricultural exports increased at an average annual rate of 21 per cent during this period, but this rate of increase was measured from a relatively low base year owing to the droughts experienced in the early years of the 1980s. Even more encouraging is the growth in the exports of manufactured goods*, which averaged 25 per cent per year from 1984 to 1990. As a percentage of total merchandise exports, manufacturing exports rose from 14 per cent in 1984 to 16½ per cent in 1990. Particularly large increases were recorded in the categories chemical products, textiles and transport equipment.

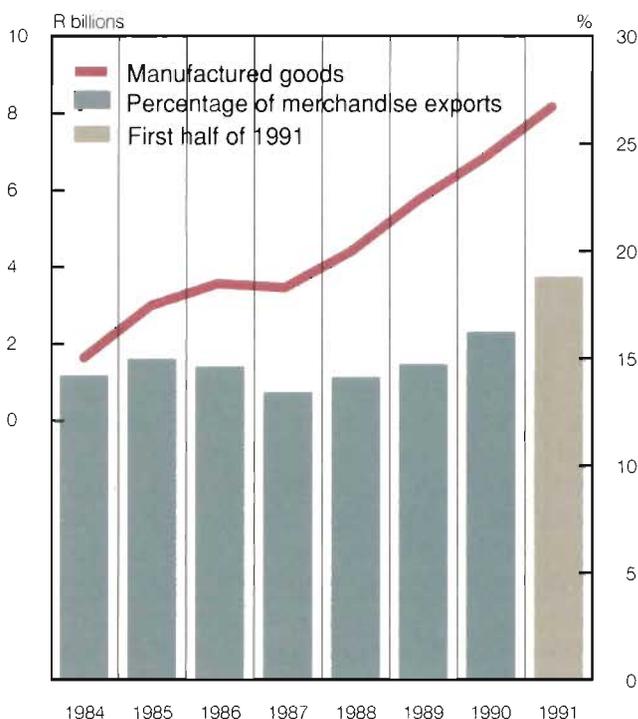
Developments in other current account transactions

The current account surpluses registered from the beginning of 1985 were, on balance, also the result of hardly any growth in the volume of *merchandise imports*. The low level of real economic activity held down real gross domestic fixed investment and inventory accumulation, both of which have a relatively high import content. The import penetration ratio (i.e. real merchandise imports as a percentage of real gross domestic expenditure) therefore fluctuated between 20 and 23 per cent in the period 1985 to 1990, compared with levels of more than 30 per cent in the early 1970s.

The share of capital goods in total merchandise imports, however, remained relatively high. This ratio rose from 40 per cent in 1987 to slightly more than 44 per cent in 1988, before declining moderately again to 41½ per cent in 1990. On the other hand, the share of intermediate goods in total merchandise imports declined sharply from 48 per cent in 1980 and 45 per cent in 1985 to 38 per cent in 1990. Imports of interme-

* Defined for purpose of this analysis as the sum total of the following export categories: chemical products, textiles, plastic materials, machinery and electrical equipment, vehicles and spare parts, paper and paper products, and "other" manufactured products.

Export of manufactured goods

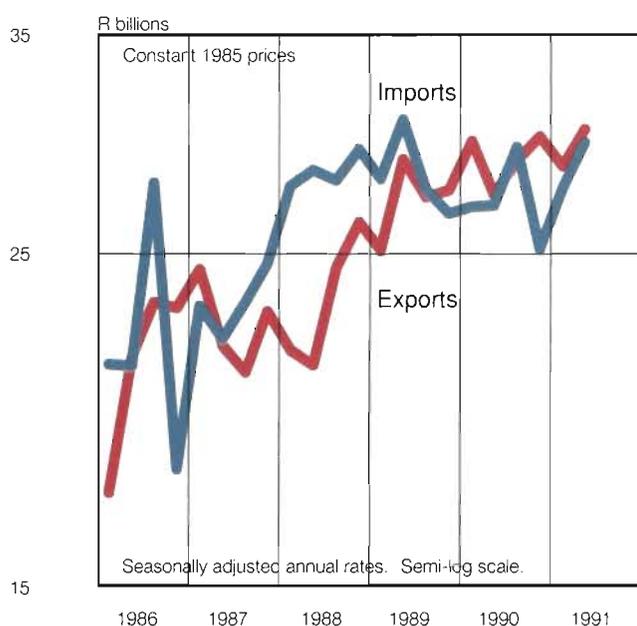


mediate goods were particularly high during the beginning of the 1980s when drought conditions necessitated the importation of agricultural products. In addition, the decline in this ratio was also the result of South Africa's decreasing dependence on imported crude oil after the construction of the new Sasol plants. The imports of consumer products as a ratio of total merchandise imports fluctuated around 15 per cent over this period, depending largely on changes in domestic demand.

In 1990 sharp decreases in the absolute volumes of both capital and consumer goods were mainly responsible for a decrease of 4 per cent in the total volume of merchandise imports. However, the prices of imported goods rose by 3½ per cent, with the result that the nominal value of merchandise imports declined by only ½ per cent in 1990. A substantial rise in the value and volume of imports of intermediate goods, related mainly to the replenishment of the inventories of mineral products referred to above, caused the seasonally adjusted value and volume of merchandise imports to rise in the first half of 1991 by 10½ and 5½ per cent respectively.

In contrast to these positive contributions made by the volumes of merchandise imports and exports to the sustained surpluses on the current account of the balance of payments, *net gold exports* performed relatively poorly. South Africa's total gold production declined from 682 tons in 1984 to 603 tons in 1989 and to 593 tons in 1990. This substantial contraction in gold output

Real merchandise imports and exports



was mainly due to a decline in the grade of ore milled from 6,43 grams per ton in 1984 to 4,99 grams per ton in 1989, before it rose again to 5,06 grams per ton in 1990. The decline in South Africa's gold production, however, levelled off during the first six months of 1991 when 297 tons of gold were produced, i.e. equal to the production in the corresponding period of 1990. This was achieved despite retrenchments of more than 30 000 employees in 1990 and about 20 000 employees in

the first half of 1991, and was mainly brought about by a further increase in the gold content of ore milled to 5,22 grams per ton.

In addition, the dollar price of gold has increased, on balance, only moderately since 1984. The annual average gold price rose relatively sharply at first from US\$360 per fine ounce in 1984 to \$447 in 1987, but then declined again to \$382 in 1989 and \$384 in 1990. During the beginning of 1991 the dollar price of gold decreased further to \$370 per fine ounce in the first quarter and to \$360 in the second quarter.

Various factors contributed to the poor performance of the gold price in the past few years. In particular, the supply of gold to the market showed a sharp upward movement owing to increased production in countries such as the USA, Canada, Australia and Brazil, and to a considerable increase in forward sales by producers. Economic problems brought about by certain reforms in the USSR also led to considerable increases in Soviet gold sales. More recently, the crisis in the Middle East triggered an increase in gold sales by Arabian countries. On the demand side of the market, certain structural changes in the major industrial countries, such as the maintenance of positive real interest rates and relatively low increases in international consumer prices, depressed the more speculative demand for investment gold.

Lastly, as far as the current account is concerned, lower relative *net service and transfer payments* to non-residents also contributed to the sustained surpluses on the current account since 1985. As a ratio of gross domestic product, net service and transfer payments declined from 6 per cent in 1985 to 4 per cent in 1990 and 3½ per cent in the first half of 1991. Recently it has even started to decline in absolute terms from R10,9 billion in 1989 to R10,6 billion in 1990 and R9,8 billion (at a seasonally adjusted and annualised rate) in the

Net capital movements (not related to reserves)

R millions

	1989		1990		1991
	Year	1st half	2nd half	Year	1st half
Long-term capital					
Public authorities	-646	-879	-281	-1 160	-51
Public corporations	436	438	452	890	533
Private sector	-1 020	-1 686	11	-1 675	-1 391
Total long-term capital	-1 230	-2 127	182	-1 945	-909
Short-term capital, including unrecorded transactions, but excluding reserve-related liabilities	-3 115	-469	-460	-929	-379
Total capital movements, excluding liabilities related to reserves	-4 345	-2 596	-278	-2 874	-1 288

first half of 1991. Lower interest payments to foreigners, reflecting the decline in South Africa's foreign debt, were mainly responsible for this declining trend since 1985. Dividend payments to non-residents also contracted in the past eighteen months because of large disinvestments of equity capital and the lower profitability of the gold-mining industry.

Further improvement in the capital account

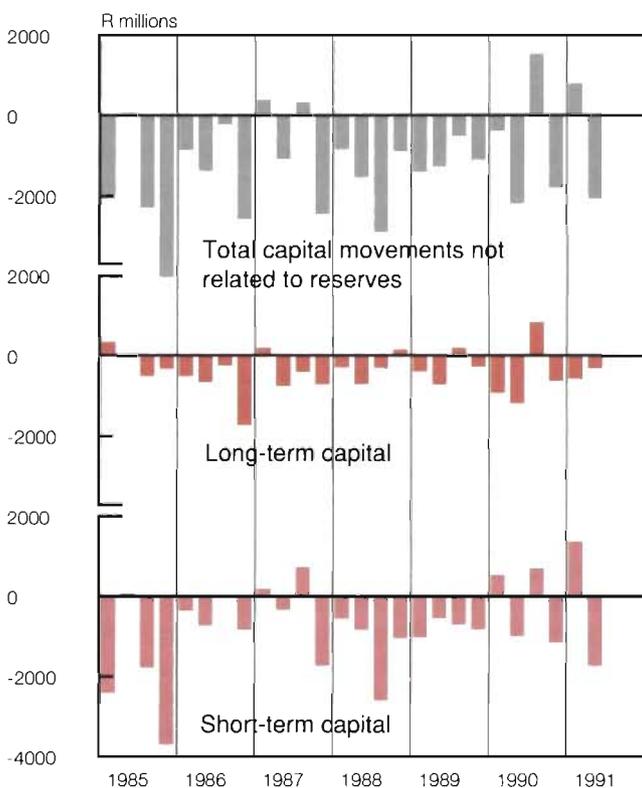
Over the past few years the capital account of the balance of payments improved dramatically. The net outflow of capital not related to reserves decreased from R6,2 billion in 1988 to R4,3 billion in 1989 and further to R2,9 billion in 1990. Moreover, during the twelve months ended 30 June 1991 the total outflow of capital not related to reserves amounted to only R1,6 billion. On a half-yearly basis the improvement on the capital account was even more remarkable: the capital outflow decreased from R2,6 billion in the first half of 1990 to R0,3 billion in the second half of 1990, but then increased again to R1,3 billion in the first half of 1991.

A significant feature of the improvement on the capital account during the past eighteen months was that it occurred during a time when large amounts of foreign debt inside and outside the standstill net fell due for

repayment. During 1990 and the first half of 1991 a total amount of about US\$2,8 billion (R7,3 billion) of total debt inside and outside the standstill net fell due. The smaller actual outflow of capital than the debt maturing, confirms that the more favourable foreign political and economic perceptions regarding South Africa led to a substantial refinancing of debt or that new funds were made available to South African borrowers. It is estimated that approximately 40 per cent of maturing bearer bonds and notes were rolled over or replaced by new loans during this period.

This improvement in the capital account of the balance of payments to a large extent took the form of short-term capital movements. A net outflow of short-term capital not related to reserves of R3,1 billion in 1989 decreased to R0,9 billion in 1990 and R0,4 billion in the first six months of 1991. These positive developments in short-term capital movements were mainly the result of increased availability of trade finance to South African enterprises from abroad, coupled with relatively favourable forward cover rates. However, the trade related capital flows also brought about large fluctuations in quarterly capital movements because of volatile rand-dollar exchange rates as well as in dollar exchange rates against third currencies. Largely in accordance with these actual and expected exchange rate changes, the net short-term capital movements varied from an inflow of R0,7 billion in the third quarter of 1990 to an outflow of R1,2 billion in the fourth quarter, followed again by an inflow of R1,4 billion in the first quarter of 1991 and an outflow of R1,7 billion in the second quarter. The net outflow of long-term capital of R2,1 billion in the first half of 1990 was also transformed into an inflow of capital of R0,2 billion in the second half of the year because of a substantial increase in project financing; in the first half of 1991 a net outflow of long-term capital of R0,9 billion was recorded again. Repayments by public authorities on foreign long-term debt during the past eighteen months were neutralised to a large extent by new long-term foreign borrowing by public corporations. From the fourth quarter of 1988 to the second quarter of 1991 the net inflow of long-term capital to public corporations totalled no less than R2,0 billion. Except for a small net inflow of capital in the third quarter of 1990, the private sector continued to make net repayments on foreign debt in the other quarters during the past eighteen months.

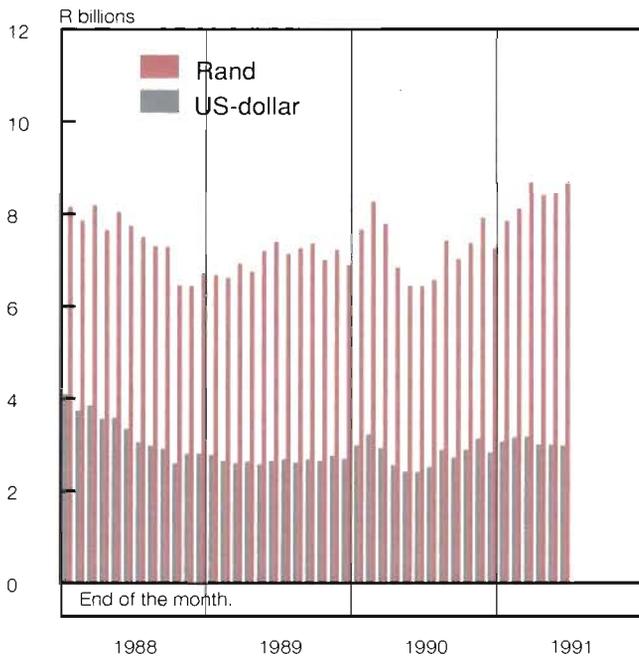
Net capital movements



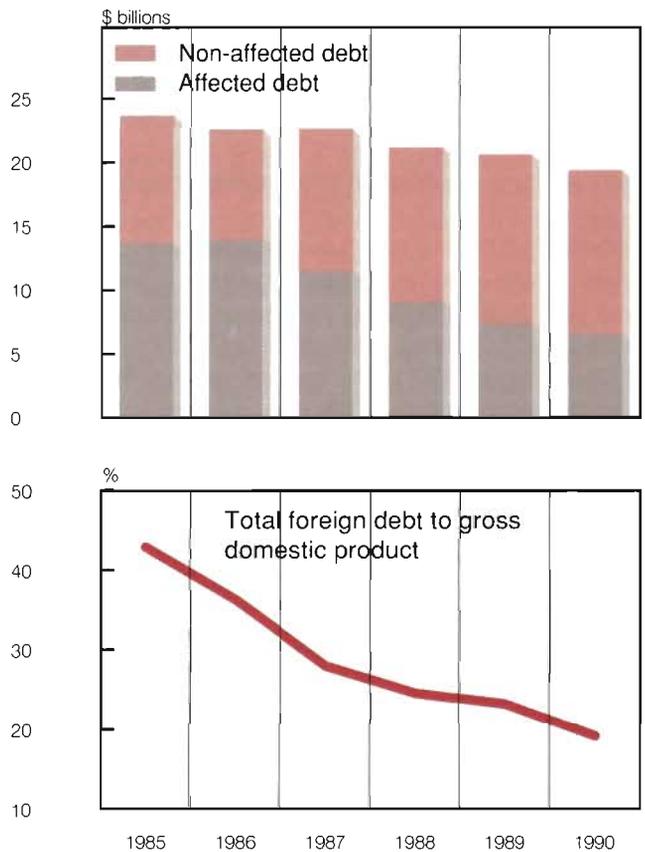
Substantially higher foreign reserves

As a net result of the sustained surpluses on current account and the smaller net outflow of capital not related to reserves, South Africa's total net gold and other foreign reserves increased by no less than R2,9 billion in 1990 and by a further R1,0 billion in the first half of 1991. The improvement in the overall balance of payments position enabled the monetary authorities to

Gross gold and other foreign reserves



Total foreign debt at current exchange rates



reduce their reserve-related liabilities by R1,6 billion during the six quarters from the beginning of 1990. The Reserve Bank has now redeemed virtually all its reserve-related foreign liabilities, with the result that the gross reserves of the Bank now represent "earned" and not "borrowed" reserves.

After allowing for valuation adjustments, the total gross gold and other foreign reserves of the country increased by R0,4 billion in 1990 and a further R1,4 billion in the first half of 1991. At R8,7 billion at the end of June 1991 the gross gold and other foreign reserves still represented only about seven weeks' imports of goods and services; with a substantial amount of unused credit facilities available to the Reserve Bank, however, the total potential reserves are now considerably better placed to accommodate an economic upswing.

From a low point of 3,1 million fine ounces at the end of December 1989 the total gold reserves of the Reserve Bank increased by 67,7 per cent to 5,2 million fine ounces at the end of June 1991.

Substantial reduction in foreign debt

South Africa's total outstanding foreign debt was reduced further by US\$1,2 billion (R2,8 billion) in 1990 from \$20,6 billion at the end of 1989 to \$19,4 billion at the end of 1990. Since the declaration of a partial debt standstill in September 1985, the country's for-

ign debt (denominated in US dollars) has decreased at an average rate of 3½ per cent per year. The reduction in South Africa's foreign debt over this period is in sharp contrast with the growth that occurred throughout the 1970s and early 1980s from \$3,7 billion at the end of 1970 to \$23,7 billion on 31 August 1985, or at an average annual rate of 13 per cent. The foreign debt of South Africa increased particularly sharply during the 1970s, namely at an average rate of 16 per cent per year. It then rose more moderately by 7 per cent per annum to 31 August 1985. However, during the early 1980s short-term debt grew at an annual rate of 22 per cent, while long-term debt actually decreased.

South Africa's foreign debt in terms of rand decreased from R65,8 billion at the end of August 1985 to R52,5 billion at the end of 1989 and R49,7 billion at the end of 1990, despite the substantial weakening in the exchange rates of the rand over this period. Valued at constant US dollars at the dollar's exchange rates against other currencies as on 31 August 1985, the total outstanding debt amounted to \$16,4 billion on 31 December 1990, implying that \$7,3

billion or nearly a third of the outstanding debt as on 31 August 1985 has been redeemed.

Debt not payable in terms of the interim debt arrangements with foreign creditor banks also continued to decline and amounted to \$6,6 billion (R17,0 billion) at the end of 1990. Valued at the exchange rates of 31 August 1985, this so-called affected debt amounted to \$5,9 billion, compared with \$6,7 billion at the end of 1989 and \$13,6 billion at the end of August 1985. As a ratio of the total foreign debt, the affected debt has decreased from 57½ per cent at the end of August 1985 to 34 per cent at the end of 1990.

A large part of the reduction in affected debt from the beginning of the standstill arrangements was due to conversions of this debt into longer-term loans falling outside the standstill net and debt-equity swaps, both made in terms of the interim debt arrangements with foreign creditor banks. Affected debt to the amount of no less than \$4,7 billion (R12,1 billion) had already been converted into long-term loans at the end of 1990, while debt-equity swaps amounted to \$0,7 billion (R1,8 billion). In addition to these conversions, South Africa also made considerable repayments on affected debt in accordance with the three interim debt arrangements with foreign creditor banks, amounting to \$2,9 billion (R7,4 billion) until the end of 1990. It has been agreed that further repayments of \$1,4 billion will be made on the affected debt in the three years 1991 to 1993.

Largely as a result of the conversion of debt inside the standstill net, total outstanding debt outside the net increased from \$10,1 billion (R28,0 billion) at the end of August 1985 to \$12,8 billion (R32,8 billion) at the end of 1990, or \$10,5 billion if valued at August 1985 exchange rates. Included in the total repayments of debt outside the standstill net of about \$4 billion since August 1985 was the redemption of \$0,9 billion raised on a loan from the IMF in 1982, large repayments on maturing bearer bonds and notes and repayments on foreign loans of the Reserve Bank.

Not only has South Africa's outstanding foreign debt been reduced sharply since the declaration of the debt standstill, but the maturity structure of this debt has also been improved substantially. At the end of August 1985, short-term debt comprised 57 per cent of the outstanding foreign debt of the country. At the end of 1990, debt falling due in the ensuing twelve months amounted to only about 25 per cent of the outstanding foreign debt. This substantially lower proportion of short-term debt was mainly the result of the interim debt arrangements concluded with foreign creditor banks, which extended the repayment of a large part of debt overdue until the end of 1993. In addition, the affected debt converted into longer-term loans outside the net also made a major contribution to the improvement in the maturity profile of the foreign debt.

On the date when the debt standstill was introduced, South Africa's debt ratios amounted to 43 and

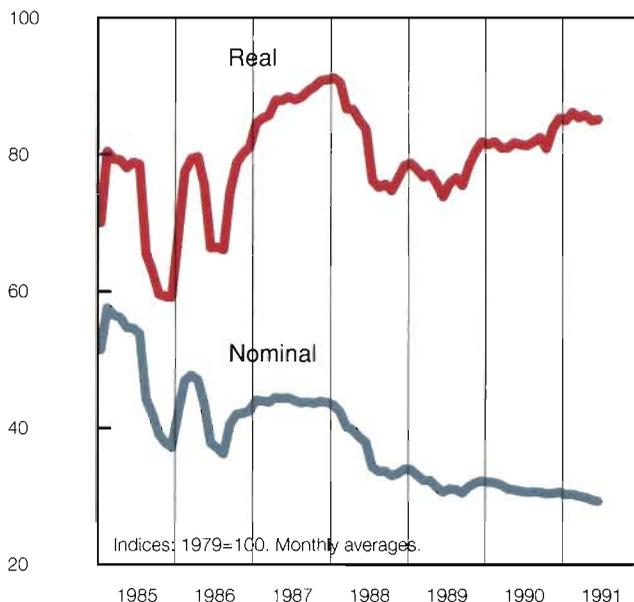
128 per cent of gross domestic product and total export proceeds respectively, compared with ratios of 45 and 293 per cent respectively for Western Hemisphere developing countries - an indication that South Africa was by no means overborrowed in 1985. Reflecting the sharp decline in South Africa's foreign debt since 1985, its debt ratios also improved dramatically to only 19 and 70 per cent of gross domestic product and export proceeds respectively at the end of 1990. Of all the developing countries only the newly industrialised Asian economies had lower debt ratios, while certain industrial countries, such as Australia and Canada, had considerably higher ratios.

Continued stability of effective exchange rate of the rand

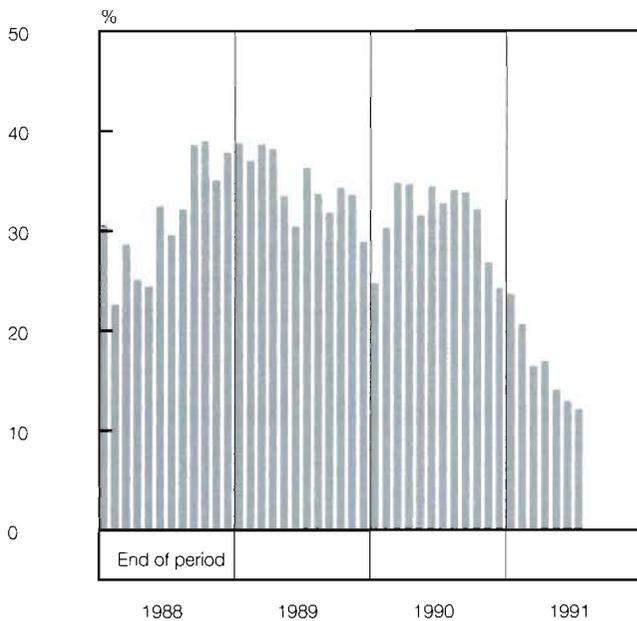
Although the *nominal effective exchange rate* of the rand declined moderately over the past nineteen months up to July 1991 this decline occurred in a very stable and orderly manner. The deviation of the monthly changes from the average monthly index value of the effective exchange rate during this period never exceeded 1½ per cent, and the depreciation averaged only ½ per cent per month. This relative stability of the rand was, of course, only possible because of a healthy overall balance of payments position.

After the *effective exchange rate* of the rand had increased by 7½ per cent from a low point on 18

Effective exchange rate of the rand



Financial rand discount



September 1989 to a peak on 5 January 1990, it declined steadily by 6½ per cent throughout 1990 until 12 February 1991. During this period the rand-dollar exchange rate remained fairly stable, and the rand, on balance, appreciated by about ½ per cent against the dollar. The depreciation of the rand vis-à-vis all the other main currencies, however, varied between 10½ and 19 ½ per cent.

From 12 February 1991 until the end of July the rand depreciated by 12 per cent against the dollar and by 5 per cent against the yen; at the same time it appreciat-

ed against all the other main currencies. The effective exchange rate of the rand accordingly decreased by 4 per cent over this period. At the end of July 1991 the nominal effective exchange rate of the rand was approximately 3½ per cent below its previous trough on 18 September 1989.

The *real effective exchange rate* also remained very stable during the first ten months of 1990, and during this period the index fluctuated between an average monthly low of 80,8 and a high of 82,4. In October 1990 the real effective exchange rate was 1,1 per cent below its level in December 1989. In November and December 1990, however, the effects of the higher world oil price on South Africa's production prices pushed the real effective exchange rate to higher levels, before it stabilised again at these levels in the first half of 1991. In June 1991 the real effective exchange rate was therefore 4 per cent above the level at the end of 1989.

The *financial rand* continued to fluctuate considerably from the beginning of 1990. After the financial rand's discount vis-à-vis the commercial rand had shrunk to only 19,2 per cent on 6 February 1990 in the wake of the State President's address at the opening of Parliament, it returned to rates of more than 30 per cent until the end of October 1990. The financial rand rate subsequently strengthened sharply from R3,74 per dollar at the end of October 1990 to R3,33 per dollar at the end of January 1991, and the financial rand discount narrowed to slightly less than 24 per cent. In a repeat performance of the previous year, it then strengthened again significantly after the opening of Parliament to R3,07 per dollar on 6 February 1991, or to a financial rand discount vis-à-vis the commercial rand of slightly less than 18 per cent. Thereafter, the financial rand weakened again slightly to levels between R3,20 and R3,30 per US dollar. The depreciation of the financial rand, however, was smaller than the depreciation of the commercial rand. As a result, the financial rand discount

Changes in exchange rates of the rand

%

	18 Sept '89 to 5 Jan '90	5 Jan '90 to 12 Feb '91	12 Feb '91 to 31 Jul '91	18 Sept '89 to 31 Jul '91
Weighted average.....	7,5	-6,6	-4,0	-3,7
US dollar.....	11,5	0,6	-12,0	-1,2
British pound.....	6,8	-17,6	4,3	-8,1
German mark.....	-4,2	-13,6	6,2	-12,1
Swiss franc.....	1,7	-19,3	8,4	-11,0
Japanese yen.....	9,8	-10,7	-5,0	-6,9
French franc.....	-2,9	-13,8	5,9	-11,4
Financial rand.....	12,3	13,3	-2,6	24,0

narrowed to 13,0 per cent at the end of June 1991. During the first six months of 1991 the average financial rand discount amounted to about 18 per cent, compared with 31½ per cent in 1990.

After the announcement that the United States Federal Government was prepared to lift most of its sanctions against South Africa, the financial rand strengthened further to R3,14 per dollar on 12 July. The financial rand's discount vis-à-vis the commercial rand narrowed to an all-time low of approximately 7½ per cent on that same day, but subsequently widened again to 12 per cent by the end of July.

Financial markets

Continued monetary discipline

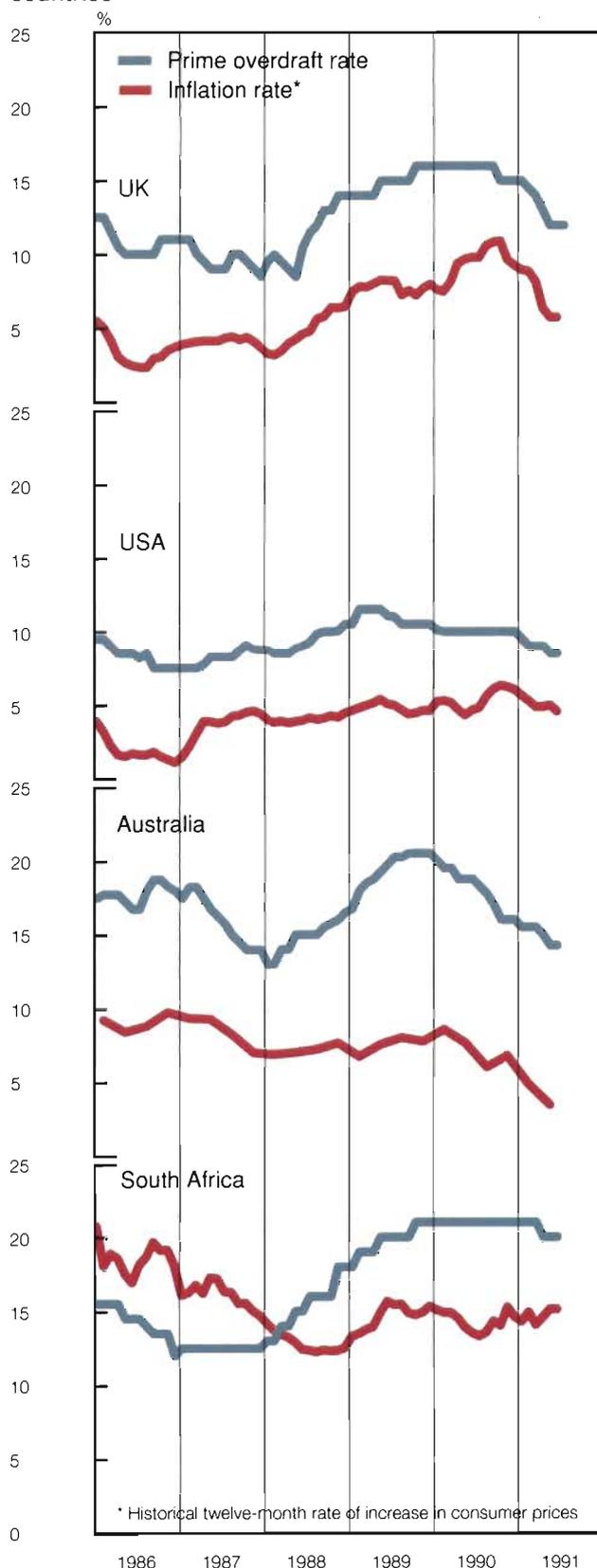
The prime objective of monetary policy in South Africa is to protect the internal and external value of the rand. By applying a monetary policy stance aimed at combating inflation, the monetary authorities believe they are making the best contribution to support sustainable long-term economic growth. An easy monetary policy would at best lead to higher growth over a short time span, thereafter leaving the economy in a worse position than before the change in policy. An acceptably low rate of growth in the money supply and relatively stable interest rates, which in real terms are about on par with those in trading partner countries, should therefore be recognised as in the interest of stability and sustainable economic growth in the longer term.

In order to bring the inflation rate down and to maintain financial stability, the monetary authorities have adopted a progressively more restrictive monetary policy stance since about the end of 1987. The guidelines for an acceptable rate of increase in the money supply were reduced, and this took the predominant prime overdraft rate from 12½ per cent at the end of 1987 to 21 per cent in October 1989. Thereafter, the restrictive stance was maintained in view of the fact that a considerable time lag exists between a decline in the growth rate of money supply and increases in interest rates, and in achieving a reduction in the rate of inflation. It was recognised that a medium-term approach had to be followed in the application of monetary policy to bring the inflation rate down to more acceptable levels, rather than conducting policy in a contra-cyclical manner.

Experience in a number of other countries tends to support the view that it may take roughly two years or longer for a decline in the growth rate of money supply and significantly higher interest rates to have a dampening effect on inflation. As illustrated in the accompanying graph, interest rate increases in major industrial economies in the second half of the 1980s initially coincided with even higher rates of inflation. Success in bringing inflation rates down only followed upward movements in interest rates after a considerable lapse of time. In all the countries concerned the downturn in inflation was temporarily interrupted by the fuel price increases in the second half of 1990 during the Persian Gulf crisis. It is also important to point out that these positive results on the inflation front in the countries concerned could not be attributed to monetary policy only: fiscal policy was also tightened in most of these industrial countries. At the same time, the rate of increase in non-oil commodity prices contracted sharply from the middle of 1988.

Increases in nominal interest rates in certain industrial countries where inflation accelerated only restored their real interest rates to levels which had prevailed before the acceleration in inflation. In contrast to the

Prime overdraft and inflation rates in selected countries



experience in these countries, the upward phase in South African interest rates started early in 1988 from a point where the prime overdraft rate was significantly below the rate of inflation in consumer prices. The prime rate started to exceed the rate of inflation by a significant margin of more than three percentage points only from about the middle of 1988. However, even at that stage it was probably barely higher than the *expected* rate of inflation. Interest rates only became unambiguously positive in real terms from the end of 1988, but the positive real rates were still then lower than those of many other countries.

Reacting to these monetary and other restrictive policy measures, the rate of inflation started to subside slowly during 1990. This process was - as in other countries - upset by the fuel price increases due to the Gulf crisis. However, in contrast to most other countries where inflation decelerated again when oil prices declined, the rate of increase in the consumer price index in South Africa continued to move sideways throughout the first half of 1991. In view of the relatively unbalanced conditions at the start of the reorientation of monetary policy, it could be expected that it would take some time before the tightening of the policy stance would reduce inflation to more acceptable levels. Had the South African authorities not implemented and maintained monetary discipline at the time, it is highly likely that the inflationary shocks of the Gulf crisis could have ignited escalating inflation which could have undermined stability, confidence and economic growth.

In accordance with this viewpoint, the monetary authorities maintained relatively high nominal and real interest rates throughout 1990 and the first half of 1991. In recognition of the progress made in redressing the rate of monetary expansion and in replenishing the foreign reserves of the country, Bank rate was lowered from 18 to 17 per cent from 11 March 1991; this resulted in corresponding reductions in most overdraft, mortgage and deposit rates. In explaining the reduction in Bank rate, the Governor of the Reserve Bank stated that it would not be necessary to depress the financial situation further, but only to retain the lower and more acceptable underlying rates of increase in the various financial aggregates; these would, with the normal time lags involved, lead to a further easing of the underlying inflationary pressures in the economy.

Changes in the regulatory framework

Important regulatory changes were implemented during the past twelve months in order to promote financial stability. The most important development in this respect was the implementation of the Deposit-taking Institutions Act as from 1 February 1991. At the same time, the phasing-in of capital requirements continued with a view to strengthening these institutions' solvency ratios and to obtain a healthier risk

position. The Deposit-taking Institutions Act, Act No. 94 of 1990, consolidated, revised and broadened the Banks Act of 1965 and the Building Societies Act of 1986. The basic objectives of the new Act are to protect the interests of depositors and to maintain the integrity of the financial intermediation function of deposit-taking institutions. Together with the regulations under the Act, it emphasises the promotion of sound risk management by deposit-taking institutions; the intention is not to involve the regulatory authorities in the management of risks, but rather to act as a catalyst in order to enhance the standard of risk management being applied by the board of directors and management of each institution.

In terms of the new Act and regulations, the increasingly artificial distinction between discount houses, banks and building societies was discontinued and the "playing fields levelled", in that all these institutions were denoted deposit-taking institutions, subject to the same regulations and requirements. However, the former discount houses were granted a temporary concession in that call money lodged with them by deposit-taking institutions will still be regarded as a liquid asset for the deposit-taking institutions up to the end of January 1993.

Under the previous regulations, banks and building societies had to keep cash reserves equal to 5 per cent of their short-term liabilities and 2 per cent of their medium-term liabilities to the public. The new regulations provide only for a 4 per cent requirement against short-term liabilities to the public. Similarly, the previous liquid asset requirements - which provided for a minimum of 20 per cent of short-term liabilities, 15 per cent of medium-term liabilities and 5 per cent of long-term liabilities to the public to be held in the form of liquid assets - were replaced by a 20 per cent requirement against short-term liabilities only. At the same time, however, the definition of liabilities to the public for purposes of these requirements was broadened to include all foreign liabilities and liabilities arising from certain types of repurchase agreements.

On balance, these changes caused a reduction in the deposit-taking institutions' required cash reserves and liquid assets. In order to smooth the transition, the new requirements were phased in over four months, ending on 21 June 1991. At the end of February 1991 - when the cash reserve and liquid asset holdings were still based on January balance sheet information under the old regulations - the total deposits on monetary institutions' reserve accounts with the Reserve Bank amounted to R2,1 billion; the corresponding total at the end of June was R1,1 billion. Total liquid assets held by these institutions similarly declined from R22,2 billion to R19,9 billion over the same period.

Of more importance, as far as the analysis of monetary and credit aggregates is concerned, are the effects that the new regulations regarding repurchase agreements and various types of off-balance-sheet

transactions have had on these aggregates. Whereas from May 1990 to January 1991 only the *increases* in the amounts of deposit-taking institutions' holdings of repurchase agreements above the level of these holdings as at the end of February 1990 were subjected to cash reserve and liquid asset requirements, from February 1991 the total amount of deposit-taking institutions' holdings of such agreements (excluding their holdings of repurchase agreements with readily marketable gilts or semi-gilts as the underlying asset) became subject to cash reserve and liquid asset requirements. Most repurchase agreements therefore lost their attractiveness to the deposit-taking institutions as a funding mechanism for deposit-taking institutions which did not attract reserve requirements. The conversion of repurchase agreements (which are not included in the monetary aggregates) into conventional deposits (which are included in the monetary aggregates) started in the final months of 1990. In February 1991 alone, such conversions amounted to approximately R3,6 billion, which contributed to a sharp increase in the statistically measured money supply data. Similar increases were recorded on the asset side of the monetary institutions' balance sheets, because assets which were previously sold to other parties under repurchase agreements reappeared as conventional assets. The level of measured credit extension accordingly rose steeply, especially in February 1991.

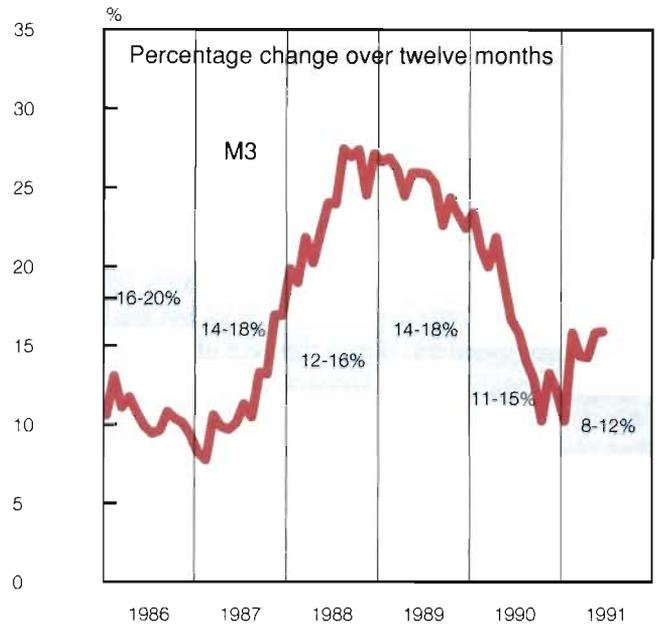
Similar increases in the money supply and in credit extension, estimated at around R1,5 billion, were recorded in May, following a further tightening of the regulations. These regulations *inter alia* stipulated that deposit-taking institutions have to keep reserves against promissory notes and other debt instruments issued by clients wishing to borrow funds and sold to surplus units by the deposit-taking institution on behalf of the client (which may imply the deposit-taking institution's endorsement of the paper). Deposit-taking institutions therefore converted such instruments into conventional deposits and advances on a significant scale.

Levelling-off in the growth rates of the broadly defined money supply

The growth in the quarterly average value of the broadly defined money supply (M3) from the fourth quarter of 1989 to the fourth quarter of 1990 amounted to 12 per cent; this was well within the guideline range of 11 to 15 per cent. After having exceeded the target ranges in the two preceding targeting years and in the first five months of the 1990 guideline year, the value of M3 moved back to within the guideline cone from June 1990 and remained within this range for the rest of the year.

Measured over a period of twelve months, the rate

Guidelines for growth in M3



of increase in M3 dropped from a peak of 27,5 per cent in August 1988 to only 10,2 per cent in October 1990, before edging up slightly to 12 per cent at the end of 1990. This pronounced reduction in money supply growth was mainly a reflection of the cyclical slowdown in economic activity and spending, and of sustained high and relatively stable interest rates. For both cyclical and structural reasons, deposit-taking institutions began to look more closely at the quality of their assets and generally to put less emphasis on quantitative balance sheet expansion. Their drive to contain costs and to rationalise services led to a number of mergers. In addition, somewhat wider lending rate/deposit rate margins slowed down the process of reintermediation, which had been a significant force in the rapid monetary growth in the two preceding years.

The lowering of the *guideline range* to 8 to 12 per cent for the period from the fourth quarter in 1990 to the fourth quarter of 1991, announced by the Reserve Bank on 8 March 1991, was indicative of the Bank's determination to retain the downward pressure on inflation. At the same time the guideline range also allowed for a modest growth in real economic activity and for some further increases in the country's net foreign reserves. Mainly because of technical factors related to the implementation of the Deposit-taking Institutions Act, the growth in money supply accelerated sharply to a rate exceeding the upper boundary of the new guideline ranges from February 1991. The twelve-month rate of increase in M3, for instance, accelerated to 15,8 per cent in February 1991, and

then fluctuated between 14 and 16 per cent up to the end of June 1991.

With the financial system in the process of settling down to the new regulations applicable to deposit-taking institutions, the movements in the statistically measured M3 in the first half of 1991 could clearly not be regarded as indicative of developments in the real economy. When allowance is made for the effect of these regulatory changes, the estimated underlying rate of increase in M3 remained fairly subdued. The transition to the new regulations can also be discounted to some extent if the growth in M3 is measured from February 1991 - the month in which the new Act came into operation. From the end of February to the end of June 1991 the seasonally adjusted and annualised rate of growth in M3 amounted to 11,7 per cent; this clearly did not signify unduly expansionary monetary conditions.

In a statistical or accounting sense the growth in M3 during the twelve months to the end of June 1991 was largely due to an increase in monetary institutions' claims on the domestic private sector, which to a large extent reflected the regulatory changes. Increases in the net gold and other foreign reserves and net claims on the government sector also contributed to this growth. However, "net other assets" of the monetary institutions declined substantially, reflecting:

- a transfer of R3 billion from the Treasury's Exchequer Account to the Gold and Foreign Exchange Contingency Reserve Account on 24 December 1990;
- surpluses recorded during the year in the provision of forward exchange cover by the Reserve Bank; and
- substantial increases in the deposit-taking institutions' capital and reserves in preparation for the phasing-in of more stringent capital requirements.

The effect of the deceleration of reintermediation was clearly reflected in the changes in the *income velocity* of M3. After having declined from an upper turning point of 1,96 in the third quarter of 1987 to 1,70 in the first quarter of 1990, it levelled out at approximately 1,74 in the last three quarters of 1990. The statistical distortions caused by the regulatory changes, however, resulted in a decrease in income velocity of 3 per cent to 1,69 in the first quarter of 1991. In the second quarter, income velocity declined by a further 0,7 per cent.

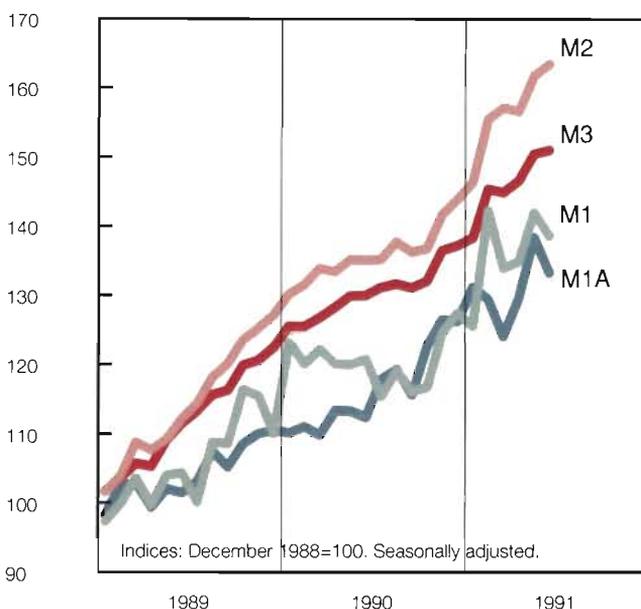
Developments in narrower monetary aggregates

With the exception of M1A, the growth in the other, narrower, monetary aggregates broadly followed the

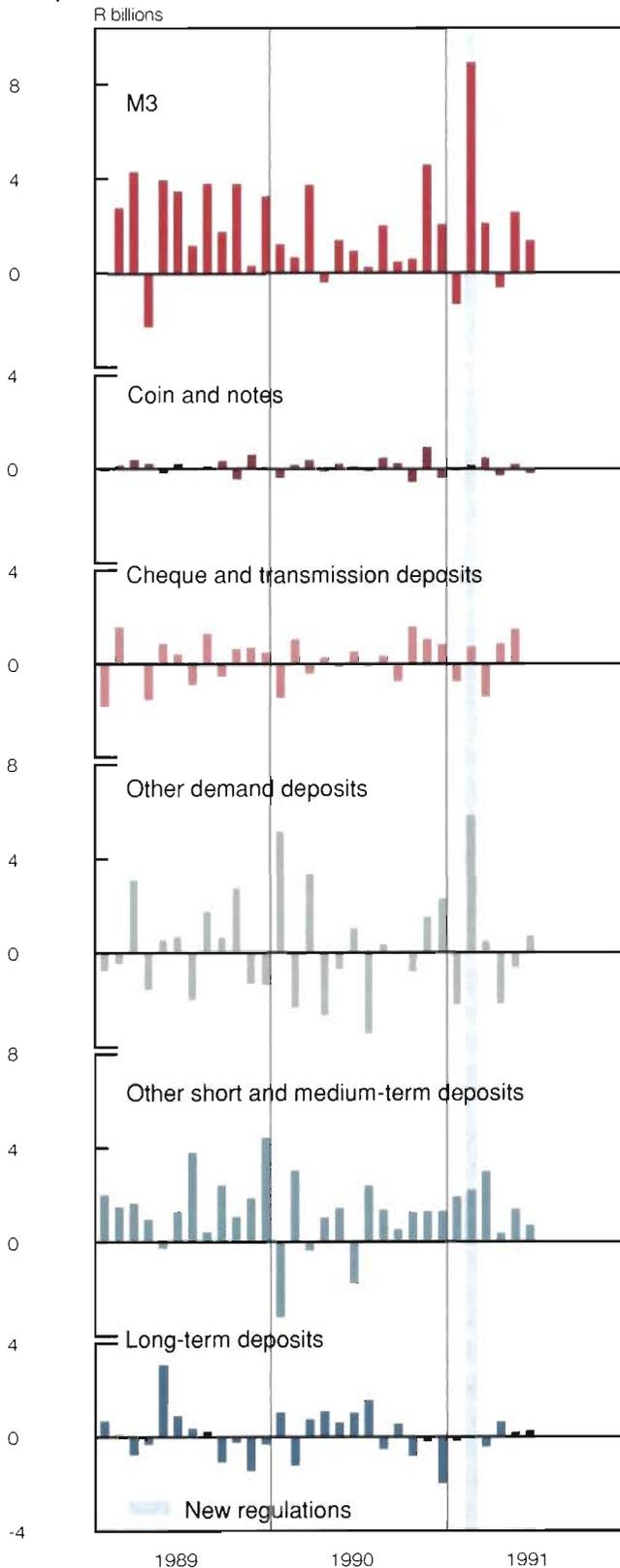
same pattern as that of M3. Measured over a period of twelve months, the rate of increase in M2 declined from a peak of 37,6 per cent in October 1988 to 13,1 per cent in December 1990. It then moved to a substantially higher level of 17,6 per cent in February 1991 and, on balance, rose somewhat further to 20,5 per cent in June 1991. The twelve-month *growth rate in M1* also came down sharply during 1989, but then rose to higher levels during the first seven months of 1990 because of attractive returns offered on call deposits. It then declined again in the second half of 1990 to a low of 0,3 per cent in October as expectations regarding interest rate movements became more bullish and investors shifted into deposits of a somewhat longer maturity. The regulatory changes then had a substantial effect on call and overnight deposits (excluding cheque and transmission deposits), leading to an acceleration in the twelve-month growth rate of M1 to 18,1 per cent in February 1991 and 15,1 per cent in June.

The twelve-month growth rate of the more *transaction-related money supply M1A* already started to decline from a peak of 38,9 per cent in March 1988, to a low point of only 6,9 per cent in March 1990. It subsequently fluctuated sharply upwards to a peak of 19,5 per cent in January 1991, before contracting again to 17,2 per cent in June 1991. The upward trend in M1A during 1990 occurred mainly in cheque and transmission deposits and was probably related to the relatively high level of gross domestic expenditure. M1A

Monetary aggregates



Monthly changes in M3 and its underlying components

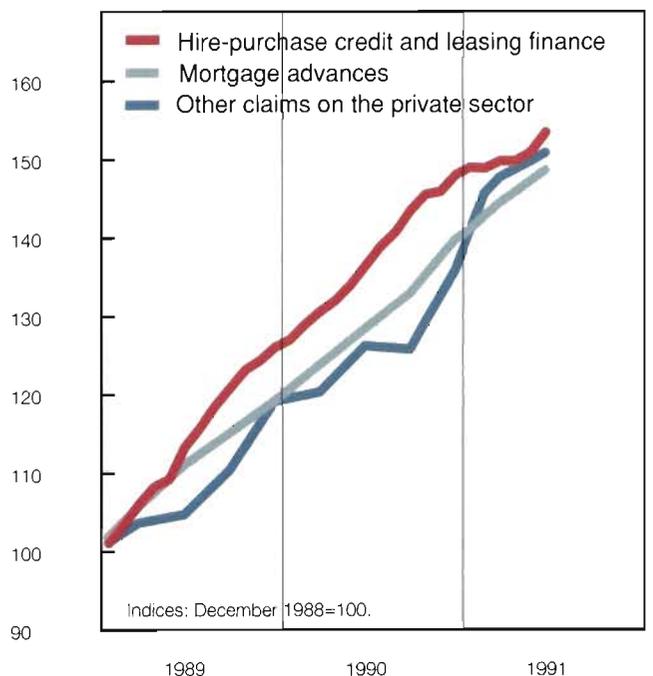


was also influenced marginally by the regulatory changes related to the implementation of the Deposit-taking Institutions Act. The relationship between M1A and economic activity consequently remained much more stable than that of the more broadly defined monetary aggregates, as indicated by a change of less than 2 per cent in the income velocity of M1A from the fourth quarter of 1989 to the first quarter of 1991. In real terms, M1A declined by 0,3 per cent from December 1989 to December 1990 and increased only marginally by 1,7 per cent from June 1990 to June 1991.

Slower growth of credit extension by monetary institutions

Measured over a period of twelve months, the growth rate of monetary institutions' claims on the domestic private sector receded from a peak of 30,2 per cent in October 1988 to 12,9 per cent in January 1991. Mainly as a result of the bringing onto the balance sheet of assets previously treated as off-balance-sheet items (referred to above), this rate accelerated to 19,0 per cent in February and stayed above 16 per cent in the next four months. Similarly, the seasonally adjusted and annualised rate of increase in the quarterly average of monetary institutions' claims on the domes-

Claims on the domestic private sector



tic private sector rose from only 6,7 per cent in the fourth quarter of 1990 to 24,4 per cent in the first quarter of 1991, and then fell back to 22,0 per cent in the second quarter.

An analysis of credit extended to the private sector by type of claim, shows that the acceleration in monetary institutions' credit extension during the first half of 1991 occurred mainly in *investments* and *general non-mortgage advances*, and were brought about mainly by regulatory changes. Mortgage advances extended by monetary institutions increased relatively sharply. This rise in mortgage lending was supported by factors such as the increase in the amount of government employees' mortgage loans qualifying for interest subsidisation from R50 000 to R70 000 as from 1 January 1991, the active promotion of highly flexible mortgage loans by certain monetary institutions, and the slower repayment of capital by customers experiencing cash flow problems. In each of the six quarters up to the June quarter of 1991, monetary institutions' mortgage holdings rose by between R2 billion and R3 billion; the demand for and supply of this type of credit were therefore very stable.

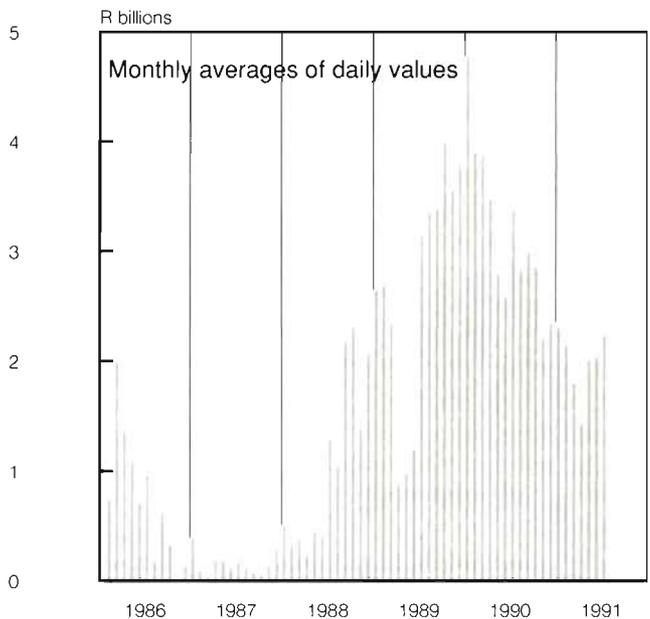
In contrast to these developments, monetary institutions' *bills discounted* declined somewhat in the first half of 1991, *inter alia* as a result of the lower liquid asset requirements. A considerably lower rate of increase was also recorded in hire-purchase credit and leasing finance than in the institutions' overall claims on the private sector. *Hire-purchase credit* and *leasing finance* rose by only R0,2 billion per month in the first half of 1991, while it increased by some R0,4 billion per month during 1990. In view of the correlation between this type of financing and spending on consumer durables and capital goods, this clearly indicates that real expenditure in the economy remained under downward pressure, in spite of the apparently brisk pace of expansion recorded by overall credit extension. The slower growth in hire-purchase credit and leasing finance may also have been exacerbated by the withdrawal from 1 March 1991 of certain tax benefits previously enjoyed by institutions extending such credit.

Money market conditions and Reserve Bank operations in the money market

Money market conditions gradually eased during the past eighteen months from the exceptional tightness that had been experienced in early 1990. In accordance with the Reserve Bank's anti-inflationary objective, various methods were applied by the Bank to limit the extent of fluctuations in the amount of discount window accommodation, and to prevent this amount from temporarily declining to levels which could engender expectations of rapidly declining money market interest rates.

The average daily level of *accommodation* at the

Accommodation at the discount window



Reserve Bank's discount window declined from a high point of R4,8 billion in January 1990 and R3,6 billion in the first half of 1990 to R2,8 billion in the second half of 1990 and R1,9 billion in the first half of 1991. A low point in this monthly average of only R1,4 billion was recorded in April 1991. This easing in the money market was mainly due to a decline in *government deposits* with the Reserve Bank, an improved overall balance of payments position, and a decline in the liquid assets and cash reserve requirements for banking institutions in terms of the new Deposit-taking Institutions Act.

The average of the daily balances on the Exchequer, Paymaster-General and Stabilisation Accounts declined from R10,6 billion in the first half of 1990 to R10,0 billion in the second half, and to only R7,3 billion in the first half of 1991, *inter alia* due to the transfer of Exchequer funds to the Gold and Foreign Exchange Contingency Reserve Account (which, of course, did not affect the money market liquidity). At times decreases in government deposits with the Reserve Bank had a substantial easing effect on the money market, especially during the first half of 1991. On a monthly basis, the average daily balance reached its lowest value of only R5,7 billion in April 1991, following relatively high Exchequer issues during that month.

At times, the effect on the money market of substantial withdrawals of government deposits also had to be countered by Reserve Bank operations, to avoid serious disruptions. For example, on 16 July 1990 an amount of R2,0 billion was transferred from the

Exchequer Account to the newly established Independent Development Trust. The potential impact on money market conditions of this large and sudden release of funds from the government's accounts was, however, neutralised through the sale of government and public-corporation paper by the Reserve Bank and the Public Investment Commissioners to the Development Trust.

The easing of the money market was to a considerable extent also due to a substantial increase in the *net gold and other foreign reserves* holdings of the Reserve Bank. In the twelve months to June 1991 the Bank's net foreign reserves rose by no less than R5 billion. Apart from its expansionary money market effects, this strengthening of the reserves contributed to the Bank's decision to reduce the preferential margin for forward foreign exchange cover in respect of new foreign finance, from 2 per cent to 1 per cent below that for ordinary cover transactions, with effect from 22 November 1990.

A further noteworthy cause of the easing of the money market included the lower *cash reserve requirements* for deposit-taking institutions, which were phased in over a four-month period ending on 21 June 1991. From the second quarter of 1991, deficits were also again recorded by the Bank in its provision of forward foreign exchange cover, mainly as a result of the strengthening of the US dollar in international foreign exchange markets.

On the other hand, the average daily level of *notes in circulation* outside the Reserve Bank rose from R8,2 billion in the first half of 1990 to R9,1 billion in the second half, and to R9,3 billion in the first half of 1991; the resulting reduction in liquidity was, however, overshadowed by the other factors mentioned.

The easier conditions on the money market were partly counteracted by the Reserve Bank through short-term foreign-exchange intervention swaps, the issuing of special short-term Treasury bills, and reverse repurchase agreements. The usual tightening of the money market over month-ends made it unnecessary to continue with these countermeasures over month-ends up to April 1991. Over the next three month-ends, however, the underlying liquidity increased to such an extent that sustained Reserve Bank intervention became necessary again. The value of these measures reached a peak of R3,7 billion on 24 June 1991.

Net sales of government stock declined moderately from R8,4 billion in the fiscal year 1989/90 to R7,6 billion in fiscal 1990/91. Sales in the second quarter of 1991 amounted to R2,8 billion, against R3,8 billion in the corresponding quarter of 1990. However, the Bank's *gross* transactions in government stock amounted to as much as R15,6 billion in the first six months of 1991 - a threefold increase compared with the R5,2 billion recorded in the first half of 1990, which clearly reflected the Bank's efforts to increase the mar-

ketability of government stock.

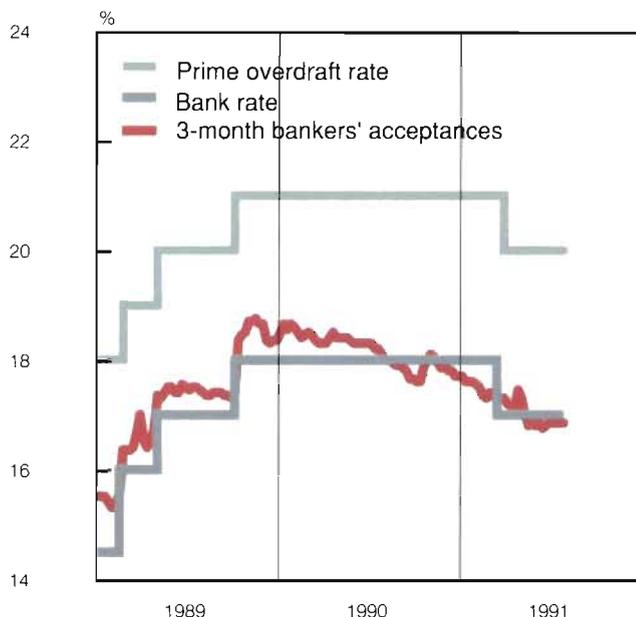
In a related move, the Reserve Bank continued to step up its activities in the government-stock *options market*. The average monthly amount of traded-options contracts to which the Bank was a party, was increased from R0,3 billion in the first half of 1990 to R1,1 billion in the second half, and amounted to R1,4 billion in the first half of 1991.

The amount of *Treasury bills* offered at the weekly tender was increased from R70 million up to 8 June 1990 to R100 million from 15 June and to R120 million from 24 August 1990. It was reduced to R100 million from 21 December 1990, but was increased again to R130 million from 5 April and to R150 million from 30 May 1991.

Softening of money market interest rates

The money market rates softened somewhat through most of 1990, although the Reserve Bank kept its Bank rate unchanged at 18 per cent and the clearing banks held their predominant prime overdraft rate unchanged at 21 per cent. The softening of rates arose from market expectations engendered by the cooling-down of the economy, the slackening of monetary expansion and credit growth, the strengthening balance of payments position, and declining inflation rates up to July 1990. The market rates on money market instruments then hardened abruptly in the final

Short-term interest rates



two weeks of October on the basis of gloomier views of the Middle East crisis and higher inflation. Market rates quickly resumed their downward course, however, as the effect of the Persian Gulf confrontation on the prices of petroleum products appeared to be well contained and as further evidence of the slackening of the domestic economy accumulated.

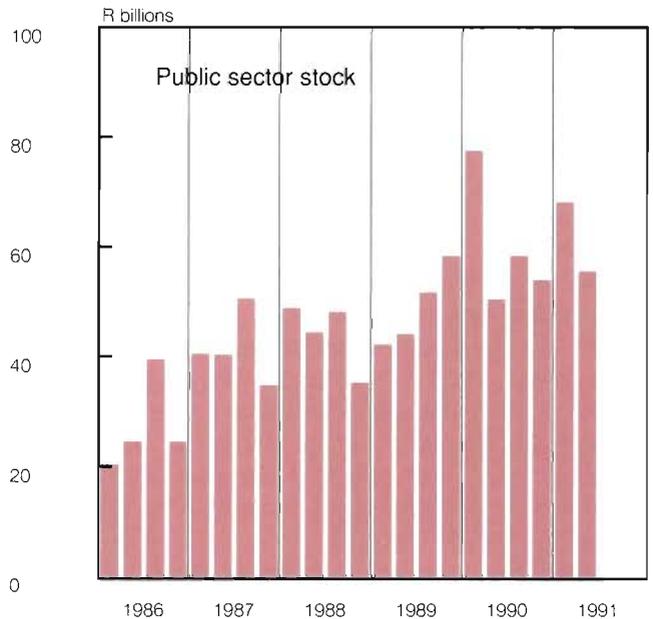
The market rate on three-month *liquid bankers' acceptances*, which had declined from 18,4 per cent at the beginning of 1990 to a low point of 17,6 per cent on 3 October 1990, firmed to 18,2 per cent at the end of October. This rate then receded to 17,25 per cent on 25 February 1991 as expectations of an imminent Bank rate reduction grew. However, the bankers' acceptance rate rose again to 17,4 per cent by the end of February and remained on that level during the first ten days of March. From the end of December 1990 the bankers' acceptance rate was more than half a percentage point below the Reserve Bank's rediscount rate for bankers' acceptances of 18,30 per cent, and by 25 February a reduction in the Reserve Bank's rediscount rates of one percentage point was already being fully discounted by the market.

After the Bank rate reduction of one percentage point as from 11 March 1991, the predominant prime overdraft rate of the clearing banks was lowered from 21 to 20 per cent from 2 April. The liquid bankers' acceptance rate continued to soften and slipped to below 17 per cent by the middle of May. Similarly, most short-term deposit rates, variable lending rates and even the relatively stable term-lending base rate, declined significantly from March or April on the basis of these developments and related expectations. Given the underlying high level of liquidity in the money market already referred to above, even the usual month-end hardening of call rates was hardly noticeable from May 1991; whereas in June 1990, for example, the rate on interbank funds fluctuated between 18,25 per cent in the middle of the month and 21 per cent over the month-end, in June 1991 it moved within a range from 16,75 to 17,25 per cent.

Secondary capital market developments

The value of *public-sector stock traded* on the Johannesburg Stock Exchange rose by 23 per cent from R195 billion in 1989 to R239 billion in 1990. However, during the course of 1990 trading activity in these securities fell back significantly from its high levels at the beginning of the year. After the value of these transactions had recovered markedly from R35 billion in the fourth quarter of 1988 to an exceptionally high level of R77 billion in the first quarter of 1990, it decreased to an average value of R54 billion per quarter in the rest of the year. In the first quarter of 1991 the value of public-sector stock traded rose again to R68 billion; this was followed by a decline to R55 bil-

Stock exchange transactions



lion in the second quarter.

The rising levels of trading activity in public-sector stock in 1989 and early 1990 were partly due to portfolio adjustments by insurers and pension funds, following increases in short-term interest rates and a marked drop in long-term interest rates in the second half of 1989 up to March 1990. These portfolio adjustments were also boosted by the abolition of the prescribed investment requirements for institutional investors effective from 1 October 1989 and by the replacement of these requirements by new maximum limits on institutional investors' holdings of various kind of assets.

Trading activity slackened throughout the remainder of 1990, as Bank rate remained unchanged and long-term interest rates (after firming slightly in the second quarter) moved marginally lower. This softening of rates led to a renewed pick-up in trading activity in the first quarter of 1991. However, trading fell back again in the second quarter of 1991, following the decrease in short-term interest rates and the firming of long-term interest rates. These interest rate movements led to a flat and "neutral" yield curve in July 1991.

Trading in public-sector stock was also influenced throughout the past eighteen months by non-residents' transactions in gilts. Although they account for only a small share of overall transactions in public-sector stock, these transactions have a significant impact on market sentiment. The high levels of gilt trading at the end of 1989 and in the beginning of 1990 were influenced significantly by the increased buying and selling

activities of non-residents. The slackening of activity from the second quarter of 1990 onwards, was accompanied by a marked decline in non-residents' activities in the gilts market which was influenced, among other factors, by the significant hardening of real yields on gilt-edged and other long-term instruments in some of the major industrial economies and by the weakening of the financial rand. The revival in trading activity in the first half of 1991 was also partly due to a switching by non-residents from holdings of shares to gilts, the easing of yields internationally and a marked strengthening of the financial rand.

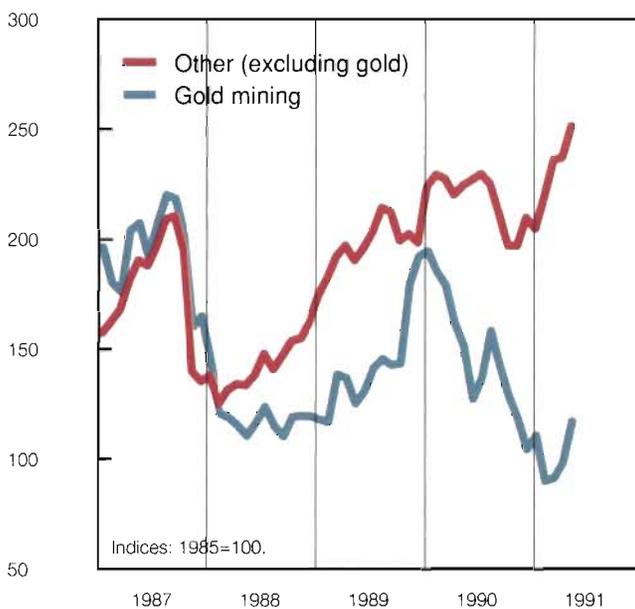
The value of *shares traded* on the Johannesburg Stock Exchange, which had increased by 85 per cent in 1989, rose moderately further by 15 per cent to R23,9 billion in 1990. Concomitant with the trading in public-sector stock, trading activity in the share market also reached an all-time high of R8,6 billion in the first quarter of 1990. It then fluctuated downwards to only R3,5 billion in the fourth quarter of 1990, before increasing again to R6,0 billion in the second quarter of 1991.

Transactions by non-residents followed closely the fluctuations in shares traded, with peak sales of R4,9 billion and purchases of R2,1 billion coinciding with the record value of transactions in the first quarter of 1990. From March 1990 onwards there was a close relationship between share market activity and a sharply lower gold price, and the market was also influenced by an increased sense of uncertainty about unsettled issues concerning South Africa's future socio-political and

economic dispensation. The increased activity during the first half of 1991 occurred mainly in industrial and non-gold-mining shares, probably as a result of a strong demand for shares which are expected to perform well in the next economic upswing, and increasing optimism generated by the gradual lifting of sanctions.

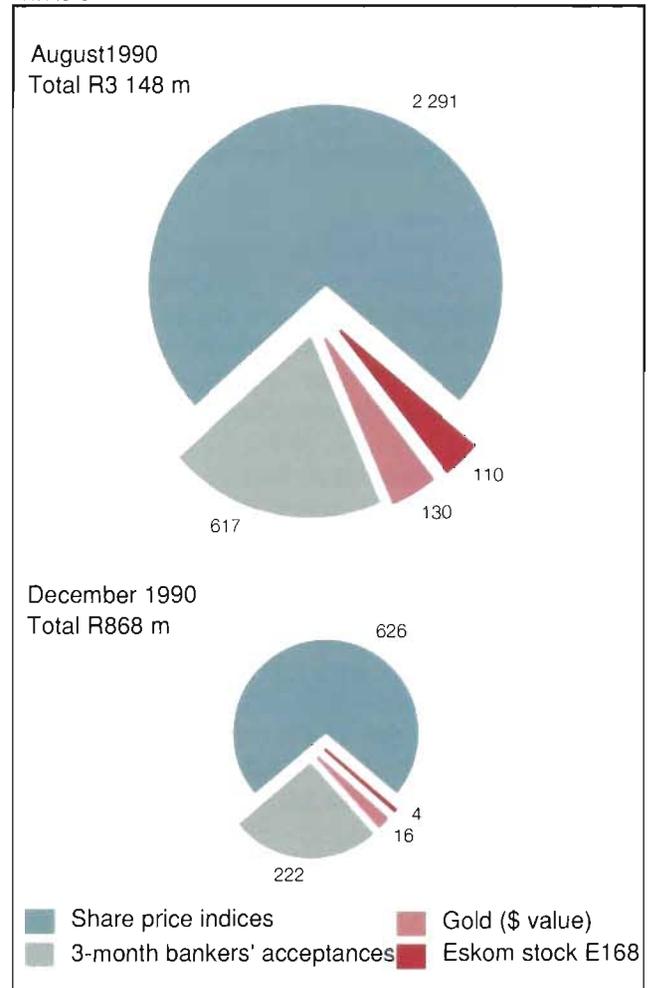
The average level of *share prices* increased, on balance, by 75,2 per cent from February 1988 to a new record level in February 1990, despite the rising trend in short-term interest rates and the downward movement in the dollar price of gold. The average share price level then shed 19 per cent to reach a new low in November 1990; the largest price decline since the crash of October 1987, amounting to 14 per cent was recorded over a two-month period in September-October 1990. The prices of all classes of shares fell significantly during this period, apparently because of the inability of the dollar price of gold to break through the \$400 barrier after the Iraqi invasion of Kuwait, and

Share prices



South African Futures Exchange deals

R millions



because of an increase in long-term interest rates.

Share prices in all the main categories, with the exception of gold-mining shares, set off on an upward course from December 1990, largely because of the softening of long-term interest rates, the lowering of Bank rate, generally unfavourable inflationary expectations, and the lack of alternative investment opportunities which could serve as a hedge against inflation. The share market was also influenced positively in this period by socio-economic developments, the possibility of the lifting of sanctions and a demand for equities based on expectations that economic activity could reach a lower turning-point by the end of 1991. Gold-mining share prices, on the other hand, weakened further in view of the generally lower profitability of the gold-mining industry which resulted from a relatively stable rand price of gold combined with sharply rising production costs.

The *South African Futures Exchange (SAFEX)* formally started business on 30 April 1990. Trading activity was fairly buoyant, rising to a record amount of transactions of R3,1 billion in August 1990. Thereafter, activity contracted rapidly to a low level of R0,9 billion in December 1990, before stabilising in the first half of 1991 at levels slightly below the average of 1990. In terms of value most of the deals in 1990 were concluded in share indices, while deals in bankers' acceptances became more prevalent in the beginning of 1991.

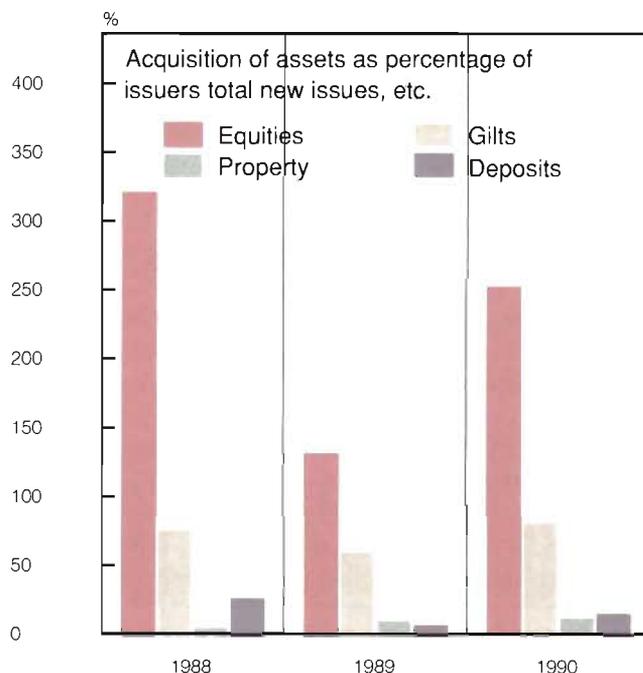
Primary capital market developments

The amount of new issues of *public-sector stock* increased from R7,1 billion in 1989 to R9,2 billion in 1990. Net new borrowing by the public sector through issues of fixed-interest securities peaked at R5,2 billion in the second quarter of 1990 and then fell back to R1,3 billion in the first quarter of 1991. As in the two preceding years, this kind of borrowing rose substantially again in the beginning of the fiscal year to R3,6 billion in the second quarter of 1991.

The low level of economic activity was mainly responsible for a declining trend in the funds raised by *private-sector companies* during 1990 and the first half of 1991. New issues of fixed-interest securities of the private sector decreased from R823 million in 1989 to R722 million in 1990; they then declined further to R106 million in the first half of 1991. The value of new issues of ordinary shares by listed private-sector companies was halved from R9,0 billion in 1989 to R4,5 billion in 1990. An amount of R3,3 billion in new capital

* The "primary balance" is government revenue minus government expenditure, excluding interest payments on government debt. The "operational balance" is government revenue minus government expenditure that includes only a real component of interest on government debt.

Insurers and pension funds



was raised in the first six months of 1991 through issues of ordinary shares.

The *flow of longer-term funds* to financial intermediaries continued to rise in 1990 and the early part of 1991 at the high rate attained in 1989; this growth rate even increased slightly from 25,7 per cent in 1989 to 26,0 per cent in 1990, compared with only 8,3 per cent in 1988. These longer-term funds include the net premium and (after-tax) investment income of long-term insurers, net contributions to all pension funds, net unit sales by unit trusts, and the net flow of longer-term deposits (i.e. savings and deposits) to banks, building societies, participation mortgage bond schemes, the Post Office Savings Bank and other government savings facilities.

For the second consecutive year the *growth* in the flow of longer-term funds to deposit-taking institutions (33 per cent) in 1990 was again more vigorous than that in the flow of institutional investors (24 per cent). Among the deposit-taking institutions, banks and building societies again showed the greatest intake of longer-term funds, while substantial outflows of funds were reported by the Post Office Savings Bank and other government savings facilities. Inflows of longer-term funds to unit trusts more than doubled in 1990 and there was also an increase of 80 per cent in the flow of funds to participation mortgage bond schemes.

Despite the further more moderate growth in institutional investors' longer-term funds, the bulk of all

longer-term financing – including the ultimate financing of domestic investment – is still provided by insurers and pension funds. The overall aggregate flow to contractual savings institutions is currently four times as large as that of the flow of longer-term funds to deposit-taking institutions, as against only two and half times in 1985. This substantial flow of longer-term funds to contractual savings institutions arises from the fact that membership of a pension or provident fund is mostly compulsory for employees and contributions are paid and adjusted automatically, thereby ensuring the inflow. As almost two-thirds of the business of long-term insurers is concerned with retirement provisions, this also applies to them. In addition, long-term insurers also enjoy a relatively favourable tax position and have, until recently, been well placed to absorb and neutralise the effects of inflation on income and asset growth.

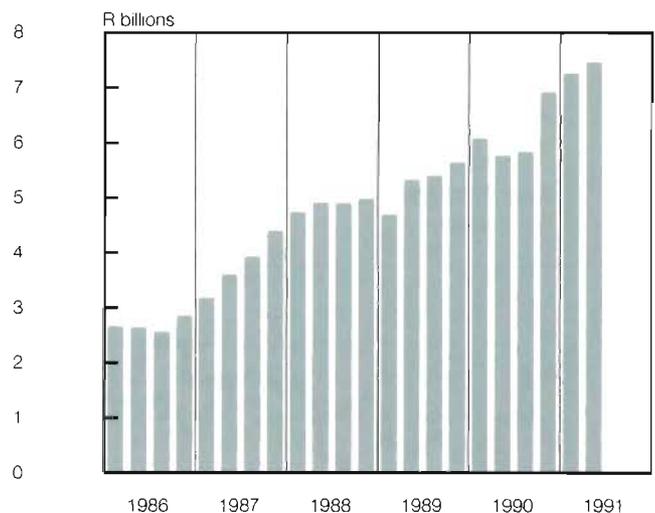
In investing these substantial cash flows, insurers and pension funds fulfil a major intermediary role in the economy. In 1990 these receipts were mainly used to acquire gilts (26 per cent), equities (35 per cent), property (21 per cent) and cash holdings (11 per cent). Gilts totalling R8,5 billion purchased by insurers and pension funds (including the state employees' funds through the Public Investment Commissioners) in 1990, represented 82 per cent of the total net new issues of stock by the public sector, considerably higher than the 61 per cent in 1989. Similarly, the net acquisition of equities totalling R11,4 billion in 1990, was equal to 253 per cent of the total new issues by companies listed on the stock exchange. Not only did such acquisitions of equities in 1990 thus exceed the new issues, they also absorbed an amount in excess of non-residents' net sales of R4,5 billion.

In the *mortgage market* the amount of loans paid out by building societies recovered from the low of R1,4 billion in the third quarter of 1989 to R2,3 billion in the first quarter of 1991. The amount of mortgage loans paid out by participation mortgage bond schemes rose by 57 per cent to R1,2 billion in 1990, after having increased by only 15 per cent in 1989. A further amount of R457 million was paid out by participation mortgage bond schemes in the first half of 1991.

The *increase* in the banks' and the building societies' holdings of mortgage loans rose slightly from R7,2 billion in 1989 to R7,4 billion in 1990. The *total holdings* of mortgages of building societies, participation mortgage bond schemes and the nine major banks increased from R50,8 billion in December 1989 to R60,8 billion in March 1991.

The fixed-property market remained buoyant and the *value of real estate transactions* increased by 16 per cent from R21,1 billion in 1989 to a record level of R24,6 billion in 1990. The value of these transactions increased, on balance, from R5,7 billion in the fourth quarter of 1989 to R7,5 billion in the second quarter of

Real estate transactions



1991. The *number* of fixed property transactions increased by 5 per cent in 1990, after having declined by 8 per cent in 1989. The *average value* of property transactions rose by 10 per cent from about R107 000 in 1989 to R118 000 in 1990.

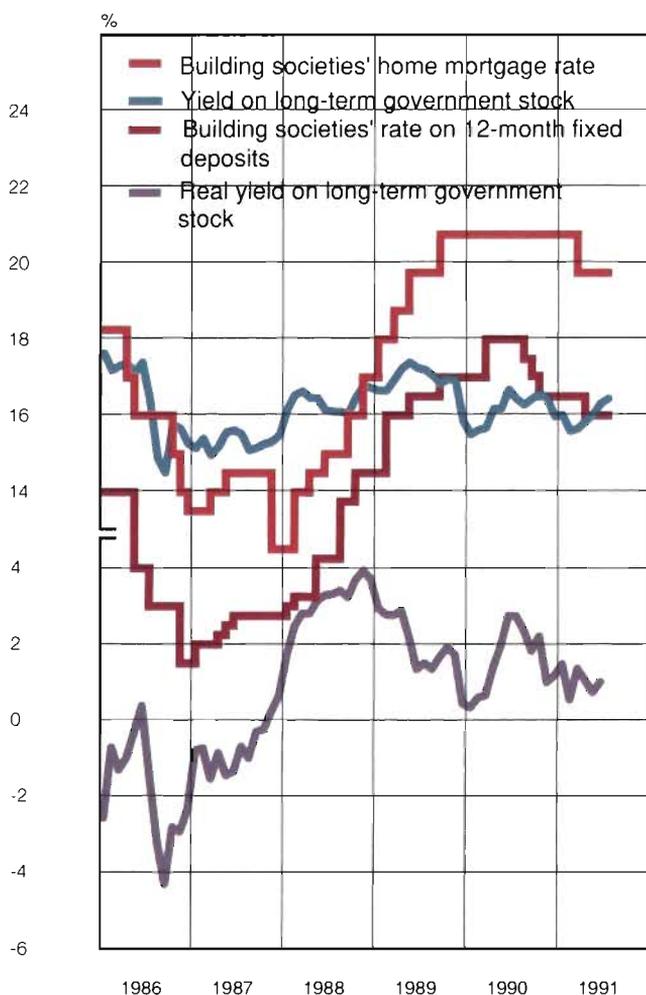
Relatively stable capital market yields and interest rates

The monthly *average yield on long-term government stock* increased gradually from a low of 15,5 per cent in January 1990 to 16,7 per cent in June 1990; it then fell back to 16,0 per cent in December 1990 and January 1991 and even further to 15,6 per cent in February and March, before firming significantly to 16,4 per cent in July 1991.

The relative stability of nominal long-term interest rates from the second half of 1989 to early 1991 could be attributed to continued inflationary expectations and to the stability of short-term interest rates during that period. After short-term rates had been adjusted downwards in March and April 1991, long-term interest rates firmed somewhat, reflecting market uncertainties such as concern about potential longer-run socio-political and economic developments as well as changes in the actual and expected inflation rates.

The *real yield on long-term government stock* (i.e. the nominal rate after adjustment for the prevailing year-on-year inflation rate), remained positive from November 1987 onwards. This real yield increased from a low of 0,3 per cent in January 1990 to its most recent high of 2,7 per cent in June 1990, subsequently declined to 0,5 per cent in February 1991 and amount-

Capital market interest rates and yields



ed to 1,0 per cent in June 1991. The decline from June 1990 onwards was a reflection of the oil-price-induced reacceleration of the inflation rate and the downward trend, within a narrow channel, in the nominal yield on long-term government stock.

The building societies' *home mortgage lending rate* – which had been raised in nine steps from its low point of 12,50 per cent in February 1988 to 20,75 per cent in October 1989 – remained unchanged up to February 1991. After the reduction in Bank rate from 11 March, this rate was lowered to 19,75 per cent in March 1991. Banks only reduced their mortgage bond rates from 20,75 to 19,75 per cent in April 1991.

The decline in share prices from their high point in February 1990 to a low in November 1990 and the recovery of these prices from February 1991 onwards, caused the *dividend yield* on all classes of shares to increase from 5,3 per cent in March 1990 to 6,3 per cent in November 1990, before easing to 5,9 per cent in March 1991. Financial results, which improved markedly in mid-1990 before falling back during the rest of 1990 and in early 1991, were instrumental in initially keeping up the level of the dividend yield.

The *earnings yield* on all classes of listed shares (excluding gold-mining shares) declined to 14,1 per cent in March 1990 before regaining the December 1989 level of 15,4 per cent in October 1990; it then decreased sharply to 14,0 per cent in December before recovering again from January 1991 onwards. This reflected the effect, as from the third quarter of 1990, of higher share prices.

The predominant rate on *twelve-month deposits* with banks and building societies, which is regarded as indicative of deposit rates in general, was raised from 17,0 per cent to 18,0 per cent in April 1990, without an accompanying increase in the building societies' bond rate. This rate was subsequently lowered again to 17,0 per cent in August 1990, and even further to 16,5 per cent in October 1990. In reaction to the decrease in the bond rate in March-April 1991, the deposit rate was reduced to 16,0 per cent in April 1991, in an endeavour to restore somewhat more comfortable interest-rate margins in an easier credit-demand situation.

In contrast to the general declining trend in long-term deposit rates, the rates on partially *tax-free investments* with building societies, the Post Office Savings Bank and the Treasury were raised by 0,5 per cent in December 1989. The increases in these rates of 1,5 per cent in March 1990 and of 0,5 per cent in March 1991 were effected to compensate for 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 12,0 per cent on these partially tax-free investments compares with a rate of 9,5 per cent in November 1989.

The maximum permissible *finance charge 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 maximum 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. These maximum rates were reduced for technical reasons by 1 percentage point with effect from 27 July 1990.

Government finance

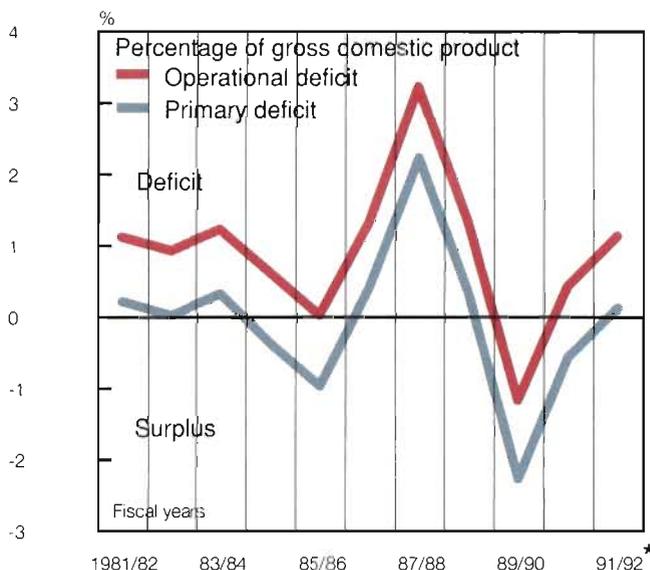
More expansionary fiscal policy stance

After a less expansionary fiscal policy had been pursued by the authorities from the beginning of 1988, a slightly more expansionary stance was adopted in the Budget for 1991/92. In concurrence with monetary policy, more restrictive fiscal policy measures were introduced in fiscal 1988/89 because of the limits placed on the growth potential of the South African economy by the high rate of inflation and the continued outflow of capital. The government persisted with this policy in the next three years. Although the eventual outcome of the Budget for 1990/91 together with the impact of certain "off-budget" expenditure was more expansionary than originally intended, the fiscal policy stance remained fairly restrictive.

In presenting his Budget for 1991/92 on 20 March 1991, the Minister of Finance again stressed the importance of maintaining fiscal discipline as a precondition for reaching the goals of economic growth and lower inflation. Nevertheless, a slightly more expansionary Budget was presented to Parliament which seemed justified in the light of the relatively depressed economic conditions and the pressing need for certain social expenditures. The anticipated stimulatory impact of the Budget was enhanced with further "off-budget" expenditures arising from the planned spending of the Exchequer surplus of 1990/91 and the announcement by the State President in April 1991 that a further R1 billion would be spent on socio-economic upliftment in disadvantaged communities.

The expected slight stimulatory effect of the Budget is clearly illustrated in the accompanying graph by both the so-called "primary" and "operational" balances of the Central Government*. As percentages of nominal gross domestic product, both these balances are expected to move from surpluses in fiscal 1989/90 to deficits in fiscal 1991/92. For example, after inclusion of "off-budget" expenditures, the operational *deficit* as a percentage of gross domestic product is expected to amount to 1,1 per cent in fiscal 1991/92, against 0,4 per cent in 1990/91 and a *surplus* of 1,2 per cent in 1989/90. Excluding the "off-budget" expenditures, an operational deficit of 0,2 per cent of gross domestic product is still estimated for 1991/92. However, from the graph it is also apparent that the ratios of the operational and primary deficits to gross domestic product in fiscal 1991/92 are still expected to be considerably

Primary and operational deficit



* Estimate for 1991/92 includes "off-budget" expenditures.
 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.

smaller than in 1987/88, when a much more stimulatory fiscal policy was pursued by the authorities.

In addition to these short-term objectives directed at the stabilisation of economic activity, the Minister reaffirmed the Government's commitment to the proposed role of fiscal policy in the process of structural reforms in the South African economy, which had been spelled out in some detail in the 1990/91 Budget. Further progress was also made in implementing some of these structural reforms of government finance in the 1991/92 Budget, including:

- a higher priority for expenditure on socio-economic development;
- a broadening of the tax base by the introduction of value added tax;
- a reduction of the tax rate on companies; and
- a further lowering of the maximum marginal tax rate on individuals.

Unfortunately, some of these structural reforms led

* The "primary balance" is government revenue minus government expenditure, excluding interest payments on government debt. The "operational balance" is government revenue minus government expenditure that includes only a real component of interest on government debt.

to considerably higher pressures on government finance, with the result that the government was forced in the Budget for 1991/92 to depart in certain other ways from its programme of fiscal reform, including:

- an increase, instead of a planned decrease, in government expenditure as a ratio of gross domestic product;
- an increase in the Budget deficit before borrowing and debt repayment to a level exceeding 3 per cent of gross domestic product;
- an increase instead of a decrease in the tax burden of individuals;
- a decrease instead of an increase in the ratio of indirect taxation to total taxation; and
- an expected dissaving by the Central Government, as reflected by the fact that capital expenditure is expected to be smaller than the projected deficit before borrowing.

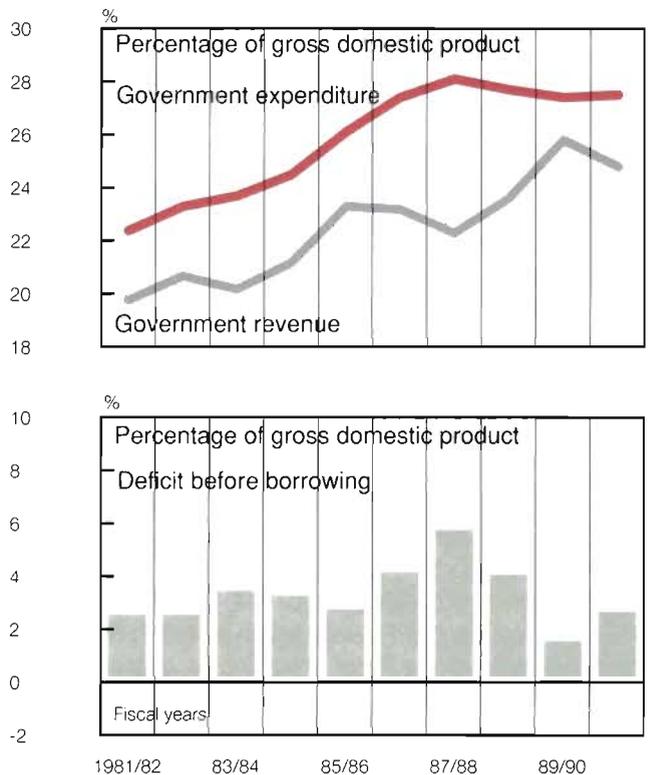
Outcome of the Budget for fiscal 1990/91

The actual outcome of the Central Government's Budget for the fiscal year 1990/91 was characterised by three main features. Firstly, the authorities continued to exercise a high degree of discipline over their expenditure. This control over expenditure obviously contributed to the restoration of the credibility of the Budget as a declaration of the fiscal authorities' intentions. Secondly, government revenue markedly exceeded the original Budget estimates, but to a much smaller extent than in the preceding two fiscal years. Lastly, the deficit before borrowing came very close to the original Budget estimates.

The degree of discipline maintained on government expenditure is clearly indicated by the fact that the year-to-year increase in actual Exchequer issues amounted to 13,1 per cent in fiscal 1990/91, compared with the Budget estimate of 11,9 per cent after taking into account the amount of R1,0 billion that had been set aside for unforeseen spending needs. The extent of overspending by the Central Government came to only 2,0 per cent of the original Budget estimate, compared with the low figure of 1,2 per cent in fiscal 1989/90 and an average overspending ratio of 5,1 per cent in the ten fiscal years from 1980/81 to 1989/90.

In real or inflation-adjusted terms, Central Government expenditure decreased by about 1,0 per cent in fiscal 1990/91. However, the nominal value of Central Government expenditure of R74,4 billion was nevertheless still equal to 27,5 per cent of gross domestic product in 1990/91, or marginally higher than the ratio of 27,4 per cent in fiscal 1989/90. The aver-

Exchequer Account



age ratio of government expenditure to the gross domestic product was 19,1 per cent in the 1960s, 24,4 per cent in the 1970s and 25,5 per cent in the 1980s.

An economic classification of Central Government expenditure indicates that current expenditure accounted for nearly 79 per cent of total expenditure (excluding additional expenditure) in 1990/91; the share of capital expenditure was almost 5 per cent, and that of transfers and loans to other general government institutions and funds approximately 16 per cent. The main component of current expenditure was still the remuneration of employees, which amounted to about 33 per cent of total expenditure in fiscal 1990/91. The share of interest paid on government debt to total Central Government expenditure increased further in 1990/91 to 15,7 per cent, compared with an average ratio of 13,1 per cent in the 1980s.

The cost of administering the public debt also showed the highest rate of increase in a functional classification of government expenditure in 1990/91, and rose by 19 per cent. This may be compared with rates of increase of 7 per cent in expenditure on protection services, 15 per cent in expenditure on social services (such as housing, health, education and the promotion of welfare) and 14 per cent in expenditure

on economic services (for example, transport and communication, mining, export promotion, manufacturing, water schemes, and fuel and energy).

Total Central Government revenue in fiscal 1990/91 amounted to R67,1 billion. This exceeded the original Budget estimates by R2,2 billion or 3,4 per cent; in fiscal 1989/90 actual government revenue was 12,2 per cent higher than the Budget figure and the average underestimation of government revenue in the ten fiscal years from 1980/81 to 1989/90 amounted to 7,3 per cent. The actual year-to-year rate of increase in government revenue amounted to 8,6 per cent in fiscal 1990/91, compared with the increase in these revenues of 5,8 per cent provided for in the March 1990 Budget estimates.

The higher-than-budgeted increase in government revenue in 1990/91 was mainly the result of higher income tax collections from individuals and non-gold-mining companies than had been foreseen in the Budget, because of higher-than-expected wage increases and company profits as well as more effective collection procedures. Collections of customs and excise duties also exceeded the Budget estimates, despite lower-than-budgeted collections from the fuel levy. In contrast to these developments, lower-than-budgeted increases in revenue were recorded in tax

collected from gold mines and from general sales tax. These lower collections could mainly be attributed to a lower actual gold price and a lower level of domestic economic activity than had been allowed for in the original Budget estimates.

As a result of this relatively low rise in nominal Central Government revenue, the ratio of government revenue to gross domestic product declined from its historically high level of 25,7 per cent in fiscal 1989/90 to 24,8 per cent in fiscal 1990/91. The average level of government revenue to gross domestic product was 16,2 per cent in the 1960s, 20,0 per cent in the 1970s and 22,2 per cent in the 1980s. In real terms government revenue decreased by 4,9 per cent in fiscal 1990/91.

The general rising trend in government revenue as a ratio of gross domestic product during the ten fiscal years from 1981/82 to 1990/91 was accompanied by a decline in the relative share of revenue collections from mining companies and a rise in the relative contributions from individuals. The contribution of mining companies to total government revenue declined from 16 per cent in fiscal 1981/82 to only 4 per cent in fiscal 1990/91, owing to a decline in the relative share of tax from gold-mining companies from 15 to 1 per cent over the same period. The relative contribution of income tax collections from individuals to total government revenue, on the other hand, increased from 22 per cent in fiscal 1981/82 to 34 per cent in fiscal 1990/91, mainly because of the effect of bracket creeping.

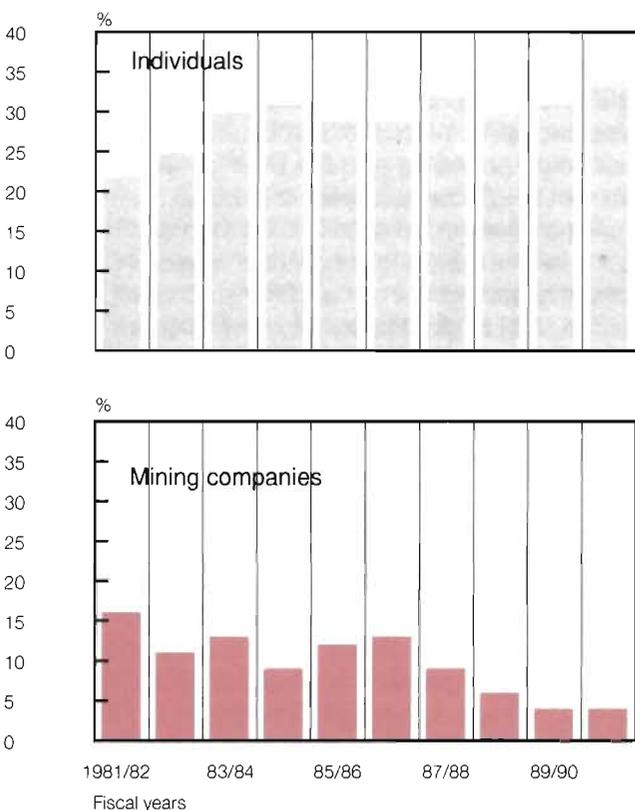
Other compositional changes in revenue collections in the 1980s included:

- The declining trend in the ratio of receipts from non-mining companies to total revenue was reversed in fiscal 1987/88. It has increased gradually from 15 per cent in 1986/87 to 18 per cent in fiscal 1990/91.
- The contribution of general sales tax to total revenue, which had increased substantially to 27 per cent in fiscal 1985/86, remained at that level in the following five fiscal years.
- The relative contribution of customs and excise duties, which had reached a peak of 15 per cent in fiscal 1988/89, receded to 13 per cent in fiscal 1990/91 with the phasing-out of the surcharge on imports and a lower rate of increase in the fuel levy.

The *deficit before borrowing* and debt repayment in fiscal 1990/91 amounted to R7 267 million, or about 2,7 per cent of the gross domestic product. This compared favourably with the deficit of R7 994 million, or 2,8 per cent of the gross domestic product, that had been envisaged in the original Budget estimates. The

Government revenue

Contribution to Central Government's revenue



average ratio of the deficit to the gross domestic product in the ten fiscal years from 1980/81 to 1989/90 amounted to about 3,3 per cent.

The financing of the deficit of R7 267 million, plus the discount of R2 966 million on new issues on government stock (for a total of R10 233 million), was provided from the following sources:

	R millions
Public Investment Commissioners.....	4 201
Non-bank private sector	5 938
Banking sector:	
Corporation for Public Deposits	571
Other banks	7 441
Foreign sector	-79
	18 072
Less payments to:	
Independent Development Trust (social upliftment).....	2 000
South African Reserve Bank (forward-cover deficits)	3 000
Government pension funds (additional funding)..	1 000
Development Bank of Southern Africa ...	216
Less transfers to the Stabilisation Account ...	1 623
	10 233

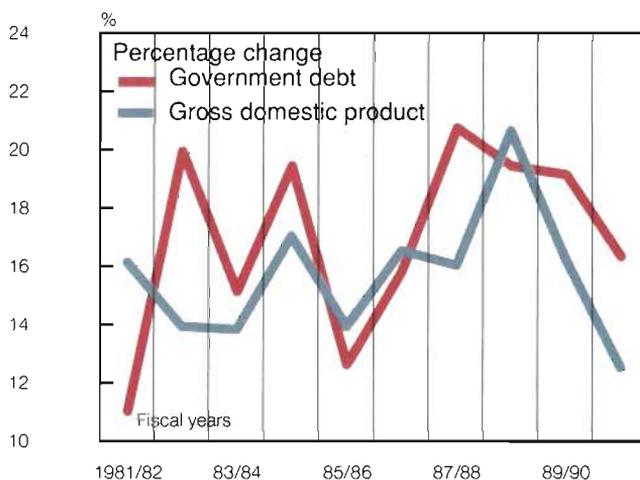
The following instruments were used to finance the deficit before borrowing:

	R millions
Government stock	11 800
Treasury bills	2 848
Non-marketable debentures	-146
Foreign loans	-318
Decrease in available cash balances	3 888
Total gross financing	18 072
Less: transfers and payments	7 839
Less: discount on new stock issues	2 966
	7 267

The most outstanding feature of the financing operations of the Central Government's deficit in fiscal 1990/91 was the large contribution of more than R8 billion made by the banking sector. This large share of the banking sector was mainly related to the utilisation of available cash balances held with the Reserve Bank, which had originated from the surplus financing of the Government's deficits in 1990/91 and previous fiscal years.

Fortunately, this utilisation of the surplus financing of fiscal 1990/91 did not have a corresponding expansionary effect on the money market during 1990/91.

Government debt and gross domestic product

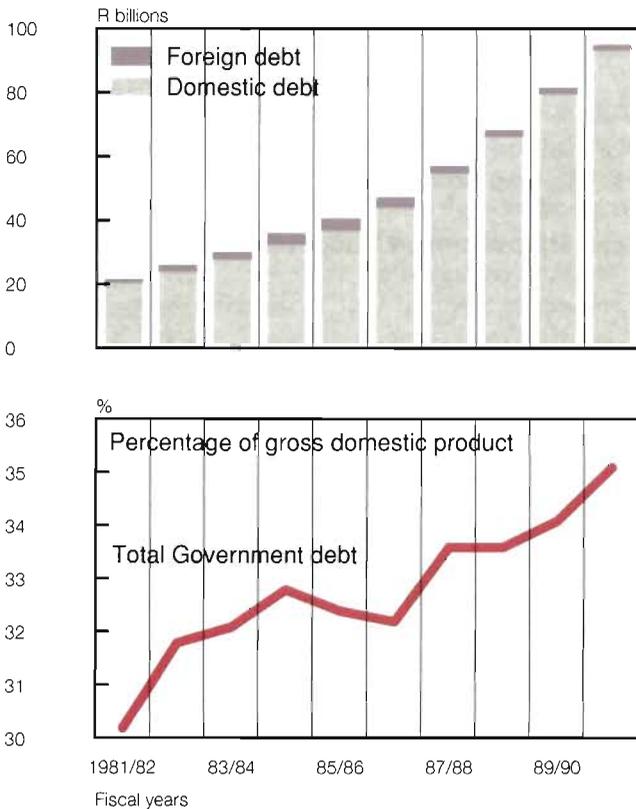


The payment of R3,0 billion to the Reserve Bank as a partial redemption of the Government's liability in respect of the accumulated shortfall on forward exchange cover affected liquidity at the time that the shortfall was incurred. In addition, the transfer of R1,6 billion to the Stabilisation Account at the Reserve Bank was made to support the restrictive monetary policy stance of the authorities. The transfer of R1 billion to the government pension funds administered by the Public Investment Commissioners also did not have an expansionary effect on the money market in 1990/91. Only R2,2 billion of the surplus financing therefore led to increased liquidity, and this was done in close co-ordination with the Reserve Bank in such a way that its effect was largely neutralised.

The size of the deficit before borrowing and the discount on new government stock issues, as well as some overborrowing in fiscal 1990/91, caused the ratio of total *debt* of the Central Government to the gross domestic product to increase from 34,1 per cent in fiscal 1989/90 to 35,1 per cent in 1990/91. The average level of this ratio amounted to 45,7 per cent in the 1960s, 40,0 per cent in the 1970s and 32,4 per cent in the 1980s. However, from fiscal 1982/83 this ratio has shown a sharply increasing trend, which casts doubt on the sustainability of current developments in government finance. A criterion often used to judge the sustainability of fiscal policy is a nominal growth rate of the economy in excess of the growth rate in the Central Government's debt. From fiscal 1982/83 to fiscal 1990/91 the average annual growth rate in the Central Government's debt amounted to 17,4 per cent; the average annual growth rate in the nominal gross domestic product was 15,8 per cent.

The rise in the total debt of the Central Government

Central Government Debt



from R81,9 billion at the end of March 1990 to R95,3 billion at the end of March 1991 was entirely the result of net borrowing in the domestic market. Total foreign debt, in fact, declined in 1990/91 for the fifth consecutive fiscal year from R2,1 billion at the end of March 1990 to R1,8 billion at the end of March 1991, or from 2,6 to 1,9 per cent of total debt. This development is obviously closely related to the disinvestment campaign against South Africa. In the domestic market the distribution between marketable and non-marketable debt in fiscal 1990/91 did not deviate much from the previous fiscal year, with the share of marketable debt at about 91 per cent and that of non-marketable debt at 9 per cent.

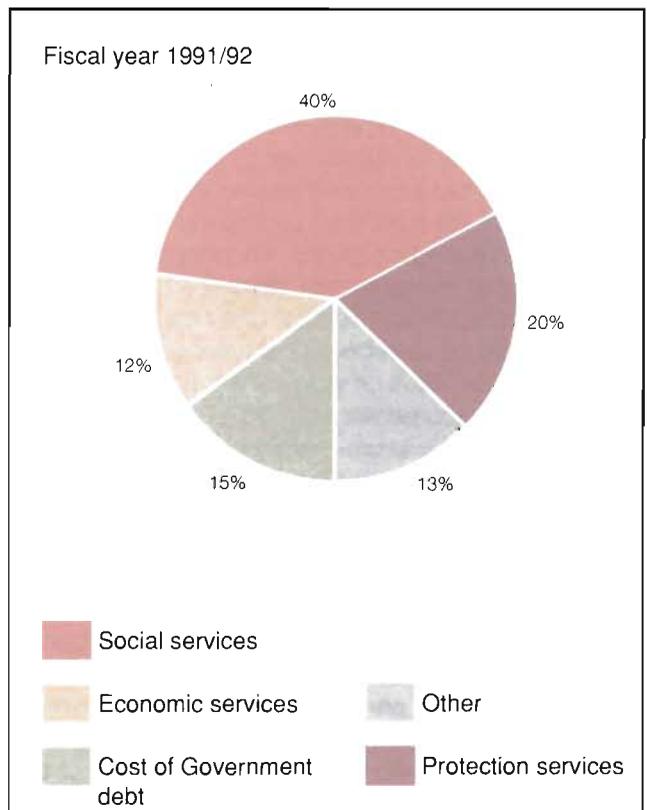
The declining tendency during the 1980s in the average maturity of domestic stock debt of the Central Government was reversed in fiscal 1989/90, when it increased to 117 months from 114 months in the previous fiscal year. In fiscal 1990/91 the average maturity of these debts increased further to 129 months. This was, however, not indicative of a turnabout in investors' preferences, but should rather be ascribed to the process of consolidating part of the Government's stock, which had the effect of increasing the average maturity of the domestic stock.

Central Government Budget for fiscal 1991/92

In his Budget speech in Parliament on 20 March 1991, the Minister of Finance identified the disparity in development and income between people and between communities as one of the "most daunting" socio-economic issues in South Africa. He indicated that South Africa now has one of the most unequal distributions of income in the world; but even more disturbing were the millions of South Africans who have pitifully low incomes. In order to address the goal of justice for all in the economic field, the Minister stated that the theme of the Budget for 1991/92 was "equity through growth and stability". The Minister described "equity" as actions conducted by the Government on the revenue side in the fairest possible manner, and on the expenditure side to give those in real need a chance to survive. The crucial issue in the Budget was to ensure a proper balance between the pressing needs for welfare augmentation and the no less urgent need for more rapid economic growth.

The Minister also noted that the Budget would help create a climate for growth and increased employment by reinforcing the downward trend in inflation, maintaining the relatively stable exchange rate of the rand, promoting a climate conducive to investment, providing

Composition of government expenditure



support to institutions that are contributing to job creation, and promoting small business. The Budget was also intended to create a climate for stability through increases in social spending, provision for the strengthening of the Police Force, and the maintenance of fiscal discipline.

The Budget allowed scant room for expansion on the revenue as well as the expenditure side and strict priorities had to be applied. In accordance with the pressing needs of a growing part of the population, a large part of government funds was allocated to expand the share of social services in total government expenditure from 38,7 per cent in fiscal 1990/91 to 39,3 per cent in fiscal 1991/92. The announcement by the State President in April 1991 that the Government was to reduce its strategic stockpiles to raise a further R1 billion for socio-economic upliftment in disadvantaged communities, raised this ratio to 40,5 per cent.

The Minister announced in the Budget considerable increases in expenditure on education, especially Black education, and on social-assistance allowances. Relatively small increases in spending on housing and health care were explained by the Minister as being made possible by large expenditure on housing by the Independent Development Trust and by increasing private-sector expenditure on curative health services for that portion of the population who can afford to pay cost-related tariffs. Considerable cuts in expenditure on defence were announced in the Budget, a large part of which had to be devoted to the maintenance of internal law and order. The Minister also provided for a significant increase in the remuneration of civil-service employees.

On the *revenue* side of the Budget, the main feature was the announcement that value added tax (VAT) would be introduced from 30 September 1991 at a rate of 12 per cent to replace the existing general sales tax of 13 per cent. Other tax proposals for fiscal 1991/92 included increased excise duties, a further phasing-out of the surcharge on imports of particularly capital and intermediate goods, an increase in the fuel levy, reductions in marketable securities tax rates and the stamp duty, the introduction of a new tax on interest received by deposit-taking institutions, a revised tax formula to lower taxes on gold mines, the reduction of the tax rate on companies from 50 to 48 per cent, the reduction of the maximum marginal tax rate for individuals from 44 to 43 per cent, a lowering of the primary tax rebate for individuals, the final phasing-in of the taxable housing benefit, separate taxation of married women's investment income, and an increase in the SITE ceiling to R50 000.

Government expenditure, including a contingency reserve of R1,2 billion, was budgeted to increase in fiscal 1991/92 by 13,7 per cent and government revenue by 11,1 per cent. Identified capital expenditure was estimated at R5,4 billion or about 1,8 per cent of the projected gross domestic product, reflecting the bud-

geted dissaving of about R4,7 billion by the Central Government. In view of the more rapid rise in expenditure than in revenue, the *deficit before borrowing* was projected to increase from R7 267 million in fiscal 1990/91 to R10 118 million in fiscal 1991/92, or from 2,7 to 3,4 per cent of the prospective gross domestic product. It was further proposed that the deficit be financed mainly by the issue of new government stock and the use of available cash balances.

Central Government Budget for 1991/92

	R millions
Revenue	74 866
Expenditure	84 984
Deficit (before borrowing)	<u>10 118</u>
Financing (net of debt repayment):	
New government stock issues	9 181
Non-marketable securities	-185
Foreign loans.....	3
Sale of assets	950
Use of available cash balances	<u>2 003</u>
	11 952
Less: Transfers and payments	<u>1 834</u>
Total net financing	<u>10 118</u>

Cash balances to the amount of R1,8 billion were also set aside for transfers and payments, including, among others, the partial redemption of the Maize Board's debt of R350 million, a further transfer of R1,0 billion to the Government Service Pension Fund, and a transfer of R450 million to the Export Credit Reinsurance Fund. These expenditure items were not included in the Budget estimates. If they are included in government expenditure, and if the additional R1 billion for socio-economic upliftment is also included without providing for compensatory declines in other expenditure or increases in income, the deficit before borrowing would be raised to a point where it could exert pressure on the money and capital market.

Other fiscal measures related to the revenue side of the Budget and which could affect these estimates, were announced after the Budget Speech on 20 March 1991. The Income Tax Amendment Bill was passed in Parliament on 17 June 1991 and *inter alia* provides for the replacement of the previous system of valuing company cars used by individuals by a new system according to which the fringe benefit of company cars is deemed to be 1,2 per cent per month of the total original cost of the vehicle. This Act also provides for the abolition, with effect from 1 March 1992, of current tax exemptions for educational bursaries granted to company employees and/or their dependants. In the Taxation Laws Amendment Bill, tabled in Parliament on 14 June 1991, tax deductions for capital goods and property used in the beneficiation of

base minerals are to be extended as part of the Government's initiative to boost exports of processed minerals and intermediate products.

The first quarter of fiscal 1991/92

In the June quarter of 1991 (i.e. the first quarter of fiscal 1991/92), Exchequer *issues* (after the usual adjustment for changes in the balance on the Paymaster-General Account) were 11,9 per cent higher than in the corresponding quarter of fiscal 1990/91. The increase in these issues was lower than the budgeted increase in government expenditure of 13,7 per cent for the fiscal year as a whole. The ratio of first-quarter issues to total budgeted expenditure for fiscal 1991/92 as a whole was, at 24,7 per cent, also below the average ratio of 25,4 per cent in the preceding three fiscal years.

Exchequer *receipts* in the first quarter of fiscal 1991/92 increased by only 2,1 per cent compared with the corresponding quarter of fiscal 1990/91. This increase was markedly lower than the budgeted increase in government revenue of 11,1 per cent for the fiscal year as a whole, which could be attributed to lower-than-expected increases in excise duties, the fuel levy and income tax receipts from individuals and companies. The ratio of first-quarter receipts to total budgeted government revenue for fiscal 1991/92, at 19,5 per cent, was also substantially lower than the average ratio of 21,3 per cent for the preceding three fiscal years.

The deficit before borrowing in the first quarter of fiscal 1991/92 amounted to R6 376 million, or about 43 per cent more than the deficit in the first quarter of fiscal 1990/91. The deficit of R6 376 million, plus the discount of R1 213 million on new government stock issues, was financed from funds obtained from the Public Investment Commissioners (R3 303 million), the non-bank private sector (R169 million), the banking sector (R4 059 million), and the foreign sector (R58 million).

In terms of the financing of the deficit by means of various financial instruments, new government stock issues during the June quarter amounted to 41 per cent of the total anticipated stock issues for the fiscal year as a whole, against 38 per cent in the same period of fiscal 1990/91. The temporary financing of the deficit by means of Treasury bills amounted to R1,2 billion in the first quarter of 1991/92, compared with only R0,4 billion during the first quarter of 1990/91. The available cash balances of the Government at the Reserve Bank, including the proceeds of Treasury bill issues, increased by about R0,5 billion during this period.