South African Reserve Bank

1977

Annual Economic Report

A review of economic and financial conditions in the Republic of South Africa presented as background to the Chairman's Address to Stockholders at the Fifty-Seventh Ordinary General Meeting to be held on 23 August 1977.

Hierdie Verslag is ook in Afrikaans beskikbaar.

Contents

General observations

During the year under review* the South African authorities made considerable progress towards achieving their main policy objectives, namely to strengthen the balance of payments and to reduce the rate of inflation. By pursuing a restrictive monetary and fiscal policy, the authorities succeeded in reducing the rate of increase in domestic expenditure, as a result of which imports also declined. The lower imports, together with a sharp increase in exports, a rise in the price of gold towards the end of 1976 and a lower rate of increase in import prices than in export prices, led to a dramatic improvement of the current account of the balance of payments. The current account actually changed from a large deficit at the beginning of the year under review to a substantial surplus in the second quarter of 1977. Similarly, the basic balance switched into a surplus. Regarding the policy aim to reduce the rate of inflation, the rates of increase in consumer and wholesale prices declined further in the course of the year under review, notwithstanding the price-raising effect of an increase in indirect taxes and in a number of government-administered prices. Although the rate of inflation remained high in relation to that of most industrial countries, South Africa is one of the few countries in which the rate of price increases has been declining during recent months.

To make more rapid progress towards achieving the relevant policy objectives, the already restrictive policy stance was made more pronounced during the year under review. Following upon an increase in Bank rate and in the liquid asset requirements for banking institutions in August 1975 and the introduction of ceilings for bank lending to the private sector early in 1976, Bank rate was raised once more in July 1976 and a temporary import deposit scheme became effective from the beginning of August 1976. In April 1977 the bank credit ceilings were frozen at their March 1977 levels. In line with the tightening of monetary policy, the conservative fiscal policy stance adopted in the 1976/77 Budget was pursued further in the 1977/78 Budget. Budget proposals were aimed at a substantial reduction of the rate of increase in government expenditure. In addition, they provided for an increase in indirect taxes, the introduction of a surcharge of 15 per cent on certain imported goods, and increased prescribed investments for insurers, pension funds, building societies and banking institutions. The amended investment requirements were aimed at diverting a larger portion of domestic saving to the government in order to reduce its dependence on bank credit as a source of finance.

Apart from the improvement of the current account of the balance of payments and the lower rate of inflation, a number of other favourable developments also occurred during the year under review. Firstly, the real output of the primary sectors of the economy increased by 16 per cent and contributed materially to the attainment of a positive growth rate of about 1 per cent in the real gross domestic product, despite a deline of 1½ per cent in the real value added by the non-primary sectors. Secondly, the terms of trade started to improve from about the middle of 1976 and although the average for 1976/77 was approximately at the same level as during 1975/76, it meant that the real gross national product also recorded a positive growth rate. Thirdly, the lower rate of increase in domestic expenditure had a favourable counterpart in a substantial rise in gross domestic saving. As a result, the relative dependence on foreign funds in the financing of domestic investment decreased markedly during 1976/77. Fourthly, the use of bank credit by the central government was substantially less during the year under review than in 1975/76. The government had a large borrowing requirement, but it was successful in its programme to borrow more from the private non-banking sector. Lastly, the achievement by means of restrictive policy measures of a generally lower rate of increase in domestic demand with a view to strengthening the balance of payments, led to a reduced demand for bank credit by the private sector. Together with the decline in government borrowing from the monetary banking sector, it contributed to the markedly lower rates of increase in domestic credit extension and the money supply.

There were, however, also several unfavourable developments during the year under review. In this regard, there was a deterioration of the capital account of the balance of payments. Short-term capital movements of the private sector, including errors and unrecorded transactions, showed a large net outflow, notwithstanding the comparatively high level of interest rates in South Africa in relation to those in trading-partner countries, the restrictions on bank credit, and the low rate of increase in the money supply. A net inflow of long-term capital was recorded, but it was substantially less than during the preceding two years. Various factors contributed to the deterioration of the capital account, such as political uncertainties in Southern Africa, a repayment of certain short-term foreign debt of a compensatory nature, a decline in trade credits caused by a decrease of imports, a lower rate of fixed investment, and less attractive yields on direct investments under recessionary conditions. In order to strengthen the foreign exchange holdings, the Reserve Bank entered into more gold swap arrangements by means of which foreign exchange holdings were increased to such an extent that the gross gold and other foreign reserves increased in the second quarter of 1977. If the amount of compensatory short-term borrowing is subtracted from the gross reserves, the net gold and other foreign reserves declined by

*The year under review refers to the twelve months that ended on 30 June 1977 and is denoted as 1976/77. It represents the year for which the most up-to-date national accounts and other statistics are available. In cases where more recent information is available, the review will also cover July and part of August 1977.

R550 million during the year under review. This decrease was, nevertheless, substantially less than the corresponding figure of R808 million for the preceding year.

Although there was still a positive rate of economic growth during 1976/77, the rate of about 1 per cent was less than the already small figure of 2 per cent for 1975/76. The continued recession in the non-primary sectors of the economy, was accompanied by increased unemployment. After having increased moderately during the first two years of the current economic downswing, the number of registered unemployed Whites, Coloureds and Asians more than doubled during the year under review and at the end of June 1977 represented 1,4 per cent of the comparable labour force. Similar official statistics of unemployed Blacks are not available, but estimates indicate that Black unemployment also increased at a faster rate.

National accounts

Low rate of growth in the South African economy

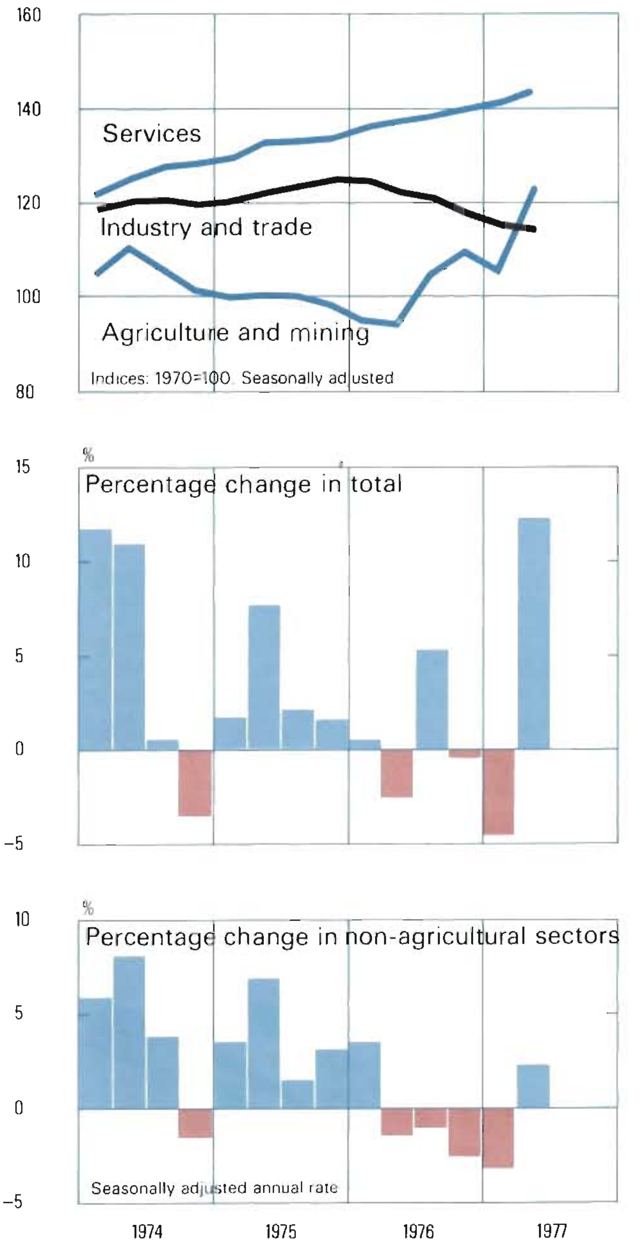
The year that ended on 30 June 1977 turned out to be one of the lowest growth years experienced by the South African economy during the post-war period. Total real gross domestic product increased by only about 1 per cent in 1976/77, following upon the already low growth rate of only 2 per cent recorded during the preceding year. The recorded growth was due entirely to a sharp increase in the output of the primary sectors. Excluding the primary sectors, the real value added by the rest of the economy declined by about 1½ per cent during 1976/77, compared with an increase of 3½ per cent during the preceding year, indicating a significant intensification of the recessionary tendencies in the non-primary sectors of the economy.

As is evident from the accompanying table, the real growth rates of the different sectors of the economy showed divergent tendencies. The real growth in agriculture and non-gold mining changed from negative rates in 1975/76 to substantial positive rates during the year under review, whereas the real value added by gold mining showed a notably smaller decline than during the preceding year. The large increase in the real income generated by the agricultural sector was due mainly to favourable weather conditions experienced during the major part of the year which resulted in exceptionally good agricultural crops, especially during the second quarter of 1977. The increase in the volume of non-gold mining production, compared with a decline during the preceding year, was related to an increase in export demand brought about by the current upswing in the economies of South Africa's main trading partners, and was promoted by the new harbour facilities which became available at Richards Bay and Saldanha Bay. In contrast to the favourable developments in the primary sectors of the economy the product contributed by manufacturing, construction and retail, wholesale and motor trade all showed negative growth rates during 1976/77 which, to a large extent, reflected the sluggishness of aggregate domestic demand and the depressed state of domestic economic conditions in general. The physical volume of manufacturing production, for example, declined by about 4½ per cent during the eleven-month period July 1976 to May 1977, compared with the corresponding period of the preceding year, and this was consistent with the behaviour of other indicators such as manufacturing sales and unfilled orders at constant prices and a decline in the utilisation of production capacity

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

	Year ended 30 June 1976	Year ended 30 June 1977
Primary sectors	−5	16
Agriculture	−8	28
Gold mining	−2	−½
Non-gold mining	−2	10½
Commerce and industry	2½	−5½
Manufacturing	2	−4½
Construction	1	−10
Wholesale, retail and motor trade	2	−7
Services sectors	4½	4
Transport, storage and communication	5	8
Financial and business services	2½	1
General government	6½	3½
Total gross domestic product	**2**	**1**
Gross national product	**−1½**	**1½**

Gross domestic product at constant 1970 prices



which declined from 88,0 per cent in the first quarter of 1976 to 83,9 per cent in the first quarter of 1977. Wholesale and retail sales at constant prices declined by about 6½ per cent and 4 per cent, respectively, during 1976/77. The number of new motor vehicles sold declined by 24 per cent during the review year. The decline in the real value added by the construction sector, following upon the already low growth rate during the preceding year, reflected the lower level of building and construction activity in both the private and public sectors, owing to the scarcity and high cost of funds, an oversupply of office and shopping accommodation, and a general cutback in government expenditure in accordance with the restrictive fiscal and monetary policy pursued by the authorities. Although the rate of increase in the real value added by the services sector was lower during the year under review than during the preceding year, the rate of increase in the real value added by communication services increased slightly. The latter increase was related to the increased production and exports of the primary sectors and a marked rise in communication services.

Although the terms of trade improved from about the middle of 1976, inter alia as a result of the higher gold price and increases in the prices of other export commodities, the average level of the terms of trade for the four quarters that ended on 30 June 1977 showed little change compared with the average for the preceding four quarters. However, because real net factor payments to the rest of the world declined during 1976/77, real gross ***national*** product increased at a slightly higher rate than the real gross domestic product during the year under review, namely by about 1½ per cent, compared with a decline of 1½ per cent during 1975/76.

The rate of increase in the gross domestic product at current prices accelerated from 12 per cent in 1975/76 to nearly 15 per cent in 1976/77, mainly as a result of a higher rate of increase in the gross operating surplus, namely 14½ per cent compared with 6½ per cent during the preceding year. This acceleration was attributable to sharp increases in agricultural income, increased profits of non-gold mining companies and higher income generated by the increased tariffs for electricity and transport services. In contrast, the gross operating surplus of other important sectors such as manufacturing, construction and wholesale, retail and motor trade in total rose by only 6 per cent during the review year, compared with 14 per cent during the preceding year. The rate of increase in the remuneration of employees declined slightly from approximately 15½ per cent in 1975/76 to about 14½ per cent in 1976/77.

The difference between the growth rates in the gross domestic product at current and constant prices implied an increase in the derived deflator from almost 10 per cent in 1975/76 to about 13½ per cent in 1976/77. This acceleration resulted primarily from rises in the average gold price and prices of other export commodities, which more than offset the slowdown in the rate of increase in agricultural producers' prices and in domestic wholesale and retail prices.

Quarterly estimates of the real gross domestic product show that positive growth rates were recorded in the third quarter of 1976 and the second quarter of 1977. However, these positive growth rates were almost entirely attributable to fluctuations in agricultural production. The real value added by the non-agricultural sectors declined for four consecutive quarters, up to the first quarter of 1977 but increased slightly during the second quarter when increases recorded by the non-gold mining and services sectors more than offset the decline registered by wholesale, retail and motor trade. The poor growth performance of commerce and industry during the past five quarters, stood in sharp contrast to the striking recovery of the primary sectors since the second quarter of 1976, as is clearly illustrated on the accompanying graph.

Substantial decline in real aggregate domestic demand

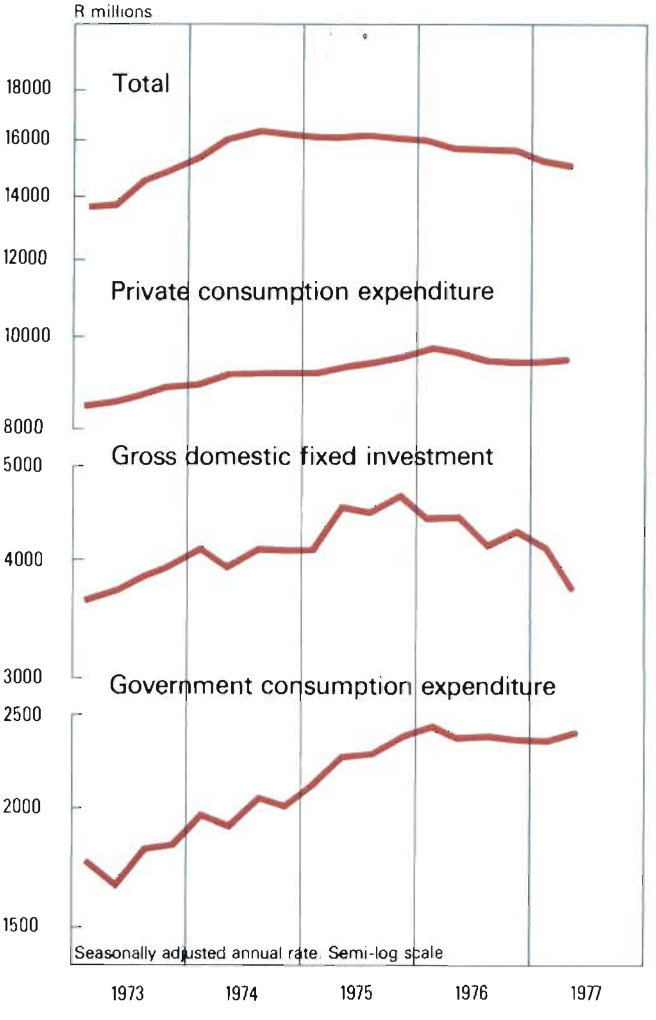
Real aggregate domestic demand, as measured by real gross domestic expenditure, started declining from about the middle of the calendar year 1974. It declined by about 1½ per cent in 1975/76 and by a further 3½ per cent during the year under review. All the components of real gross domestic expenditure, except government consumption, showed declines during the year that ended on 30 June 1977. The rate of increase in real government consumption expenditure nevertheless recorded a sharp decline.

At current prices, gross domestic expenditure exceeded gross national product by a smaller margin than during the preceding year, a development which was also reflected in a substantially smaller deficit on the balance of payments current account. This improvement in the current account during the review year was due partly to a sharp decline in the volume of merchandise imports which, in turn, was related to the decline in real gross domestic expenditure. It is clear, therefore, that the restrictive fiscal and monetary policy pursued by the authorities to attain a better balance between domestic demand and supply and, therefore, to improve the balance of payments, has met with considerable success.

Percentage change in gross domestic expenditure at constant 1970 prices

	Year ended 30 June	
	1976	1977
Private consumption expenditure	4	$-1\frac{1}{2}$
Government consumption expenditure	$12\frac{1}{2}$	1
Gross domestic fixed investment	$6\frac{1}{2}$	-8
Change in inventories (*R millions*)	-200	-400
Gross domestic expenditure	$-1\frac{1}{2}$	$-3\frac{1}{2}$

Gross domestic expenditure at constant 1970 prices



Decline in real private consumption expenditure

A substantial contribution to the sharp decline in the level of real aggregate domestic demand during the year under review was made by a decline in real private consumption expenditure, the first annual decline in this component of real domestic expenditure in the post-war period. As shown in the accompanying table, moderate increases in real outlays on non-durable goods and on services were more than offset by declines in real expenditure on durable and on semi-durable goods.

The decline in total real private consumption expenditure, and in particular on durable and semi-durable goods, was caused by various factors, some of which increased in importance during the year under review. These included the following: (1) the lower rate of increase in real disposable personal income resulting from increased personal taxation, the withholding of salary and wage scale increases, particularly in the public sector, and higher unemployment;

Percentage change in private consumption expenditure at constant 1970 prices

	Year ended 30 June 1976	1977
Durable goods	12½	−23
Furniture and household appliances	−18	−10
Personal transport equipment	− 1	−23
Other goods (including television sets)	155	−37
Semi-durable goods	3	−3½
Non-durable goods	4	3
Services	2	3
Total private consumption expenditure	4	−1½

(2) limiting of expenditure by households, partly as a result of price resistance and partly because of the channelling of a larger proportion of their current earnings into saving in view of economic and political uncertainties; (3) a continued restrictive fiscal and monetary policy pursued by the authorities which included restrictions on the extension of bank credit to the private sector; (4) increases in indirect taxes; and (5) a discontinuance of the exceptionally large expenditure on television sets in 1975/76. However, owing to the essential nature of non-durable goods and services such as food, rent, medical and transport services, real outlays on these items continued to increase moderately during the year under review.

Sharp decline in rate of increase in real government consumption expenditure

One of the outstanding features of the national accounts during the year under review was the marked slowdown in the rate of increase in the current expenditure of general government at both current and constant prices. This development could largely be ascribed to deliberate government efforts to curtail current expenditure and was noticeable for all levels of public authorities. Real salaries and wages increased by about 3½ per cent during 1976/77, compared with a rise of 6 per cent during the preceding year, but real outlays on goods and other services declined by about 5 per cent in 1976/77, mainly as a result of a reduction in real defence expenditure.

Percentage increase in government consumption expenditure

	Year ended 30 June 1975	1976	1977
At current prices			
Total expenditure	29	26	13
Non-defence expenditure	22	13	10
At constant 1970 prices			
Total expenditure	12	12½	1
Non-defence expenditure	6½	5	2

Decline in real gross domestic fixed investment

Real gross domestic fixed investment declined by about 8 per cent during the year under review, contributing significantly to the overall decline in real aggregate domestic demand. As shown by the accompanying table, the real fixed capital outlays of all the main sectors of the economy either declined or showed a lower rate of increase during 1976/77 than during the preceding year.

The sharp decline recorded in the real fixed investment by the private sector occurred mainly in manufacturing, wholesale and retail trade and residential construction. The turnabout in the fixed investment of private manufacturing was not unexpected in view of the low level of domestic demand and the existence of surplus production capacity. Notwithstanding the substantial decline in real gross fixed investment in private manufacturing, real net fixed investment was still positive, with the result that the stock of real fixed capital in private manufacturing increased by about 1½ per cent in 1976/77. This occurred at a time when the physical volume of manufacturing production declined by about 4½ per cent. Real gross fixed capital outlays on private residential buildings declined for the third consecutive year, but the stock of these assets, at constant prices, still increased on average by 3½ per cent per annum during the past three years, indicating that the net addition to existing residential accommodation continued to exceed the population growth.

Real fixed capital outlays by public corporations showed a small decline during the year under review, after having increased at high rates during the preceding two years. The sharp decline in real fixed capital expenditure caused by the completion of manufacturing installations during the preceding two years, was reversed by increased outlays on the Sasol II-project which began to gain momentum from the fourth quarter of 1976. Real fixed investment for the provision of electricity, gas and water again showed a large increase, mainly as a result of higher real outlays by Escom.

As a result of deliberate government efforts to cut back on capital expenditure, real fixed capital outlays of public authorities declined during 1976/77. The increase registered in the case of the South African Railways resulted from the purchase of new aircraft.

During the review year the total real fixed capital stock of the non-agricultural sectors increased by 5 per cent, whereas the comparable real gross domestic product declined by 1 per cent, with the result that the average amount of capital utilised per unit of non-agricultural production increased further. The relationship between the real gross domestic product of the non-agricultural sectors and the comparable economically active population, i.e. the output-labour ratio, also declined during 1976/77, after it had remained remarkably stable during the preceding three years. The lower output per worker during 1976/77 was attributable to the decline in the real gross domestic product compared with an increase in the economically active population.

The average capital-labour ratio, a measure of the capital intensiveness of the economy, increased consistently during the past six years, but the rate of increase was much lower during the year under review than during the preceding four years.

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

	Year ended 30 June 1976	1977
Real gross domestic fixed investment		
Private sector	–1	–11
Gold mining	15	7½
Non-gold mining	12	–1½
Manufacturing	3	–14
Wholesale and retail trade	–17	–15½
Private residential construction	–14	–13
Public corporations	13	–½
Manufacturing	–20	–5½
Electricity, gas and water	39	37
Public authorities	15½	–9
South African Railways	30	4½
Other business enterprises	16	–15
General departments	7	–15½
Total	**6½**	**–8**
Real fixed capital stock		
Private sector	4	2½
Manufacturing	5	1½
Private residential construction	3½	2½
Public corporations	15½	12½
Electricity, gas and water	12	16½
Public authorities	7	6
Total	**6½**	**5**

Average capital and labour ratios of non-agricultural sectors at constant 1970 prices

	Average capital-output ratio[1]	Average capital-labour ratio[2]	Average output-labour ratio[3]
	R	R	R
Year ended 30 June			
1971	2,17	4 479	2 043
1972	2,27	4 574	2 000
1973	2,34	4 733	1 989
1974	2,35	4 905	2 056
1975	2,41	5 096	2 076
1976	2,51	5 282	2 073
1977	2,67	5 404	2 005

1) Average amount of capital utilised per unit of output.
2) Average amount of capital utilised per economically active worker.
3) Average output per economically active worker.

Further sharp decline in inventory investment

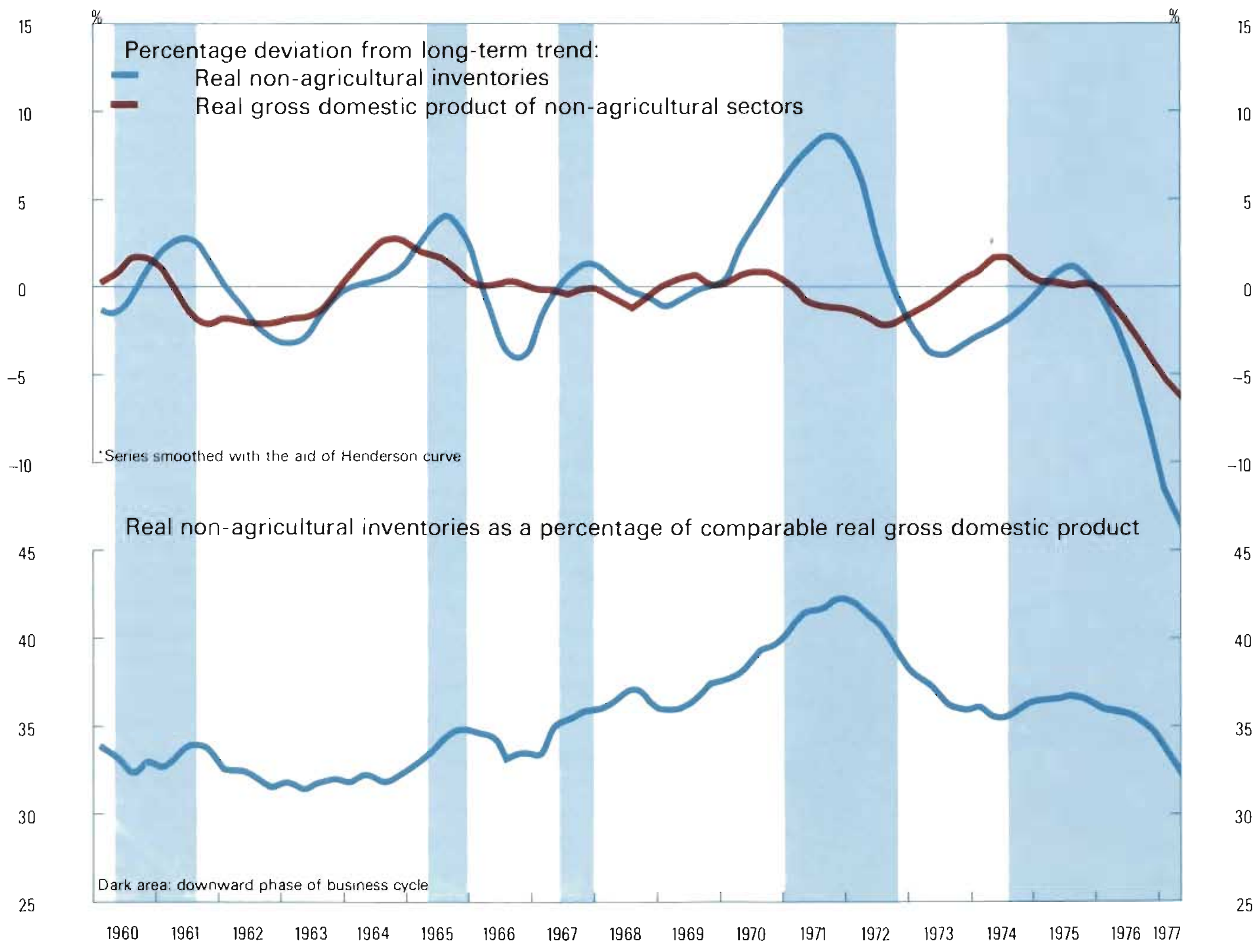
The level of total real inventories declined by about R400 million during the year under review and contributed materially to the further decline in real aggregate domestic demand and the decline in the volume of merchandise imports. Industrial and commercial inventories at constant prices, which had now declined for eight consecutive quarters, made the largest contribution to the overall decline in the review year.

As shown by the accompanying graph, the total value of inventories follows a distinct cyclical pattern, but this pattern does not coincide with the cyclical pattern of the gross domestic product or the general business cycle. In fact, the lower and upper turning points of the inventory cycle occur approximately at the middle of the upward and downward phases of the general business cycle, respectively. Judged by developments in the past, therefore, the absolute level of inventories, at constant prices, could be expected to decline further and, therefore, contribute to the expected further improvement of the balance of payments.

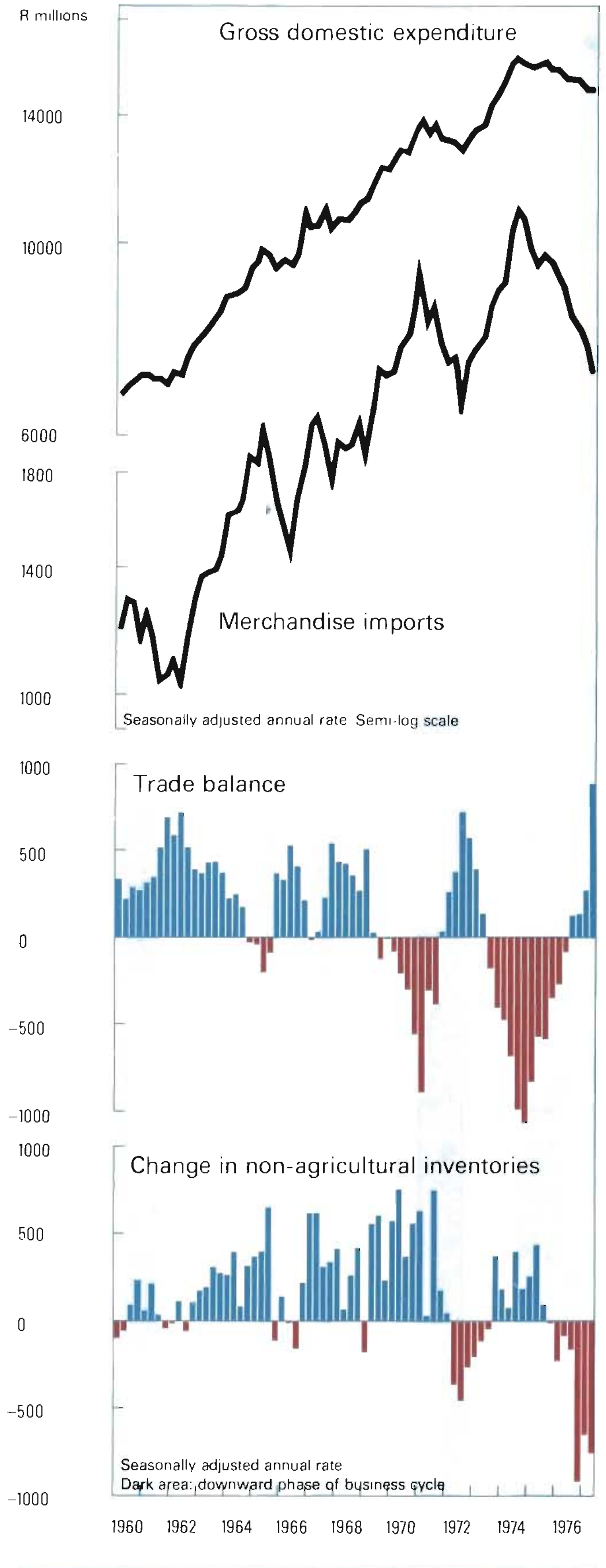
The ratio of inventories to the gross domestic product as an indicator of the adequacy of the existing level of stocks is at present much lower than the peak reached at the end of 1971, as shown by the accompanying graph. However, according to the long-term trend of this ratio and its relationship with the business cycle, the current level of inventories would appear to be relatively high and could reasonably be expected to decline further if the present downswing should continue or even if an upturn is not far off.

Changes in stockbuilding also have a profound effect on the volume of imports and therefore on the current account of the balance of payments. The volume of merchandise imports normally declines almost immediately when domestic demand starts to decline, whereas inventory accumulation still continues for some time, albeit at a lower rate. In the accompanying graph the interrelationship between

The relationship between inventories and the gross domestic product (at constant 1970 prices)



Gross domestic expenditure, imports, trade balance and change in non-agricultural inventories (at constant 1970 prices)



the real gross domestic expenditure, the volume of merchandise imports, changes in real non-agricultural inventories and the real trade balance, is clearly illustrated.

Marked improvement in gross domestic saving

Gross domestic saving showed a substantial rise during the year under review, compared with small increases in the two preceding years. Aggregate domestic saving was, nevertheless, still insufficient to finance total fixed and inventory investment, but the amount of foreign funds required to finance the shortfall amounted to only R199 million, compared with the record amount of R2 039 million employed during the preceding year. Consequently, the relative share of foreign funds used in the financing of domestic investment declined to only about 2 per cent during the year under review compared with 24½ per cent during 1975/76 and an average annual ratio of 14 per cent during the period 1970/71 to 1974/75. The improvement in domestic saving was also reflected in an increase in the ratio of domestic saving to the gross domestic product from 23 per cent in 1975/76 to 26½ per cent in 1976/77. In view of the decline in the inflow of long-term foreign capital to South Africa during 1976/77, the generation of a higher level of domestic saving is imperative for the financing of future investment.

Three of the components of gross domestic saving, namely provision for depreciation and personal and corporate saving, increased during the year under review, but the current surplus of general government declined for the third consecutive year because current expenditure increased at a faster rate than current receipts. The increase in corporate saving originated mainly in the mining, manufacturing and financial sectors and was largely due to a lower rate of increase in income tax payments and dividends declared. The sharp increase in personal saving was partly attributable to the substantial increase in net agricultural income, although the effects of precautionary saving, in view of the present cyclical downswing, also had an influence. The marked increase in the level of personal saving brought the ratio of personal saving to disposable personal income to about 14 per cent in 1976/77, compared with almost 11½ per cent during the preceding year and an average annual ratio of nearly 11 per cent during the period 1970/71 to 1974/75.

Business cycle developments, labour situation and prices

Business cycle developments

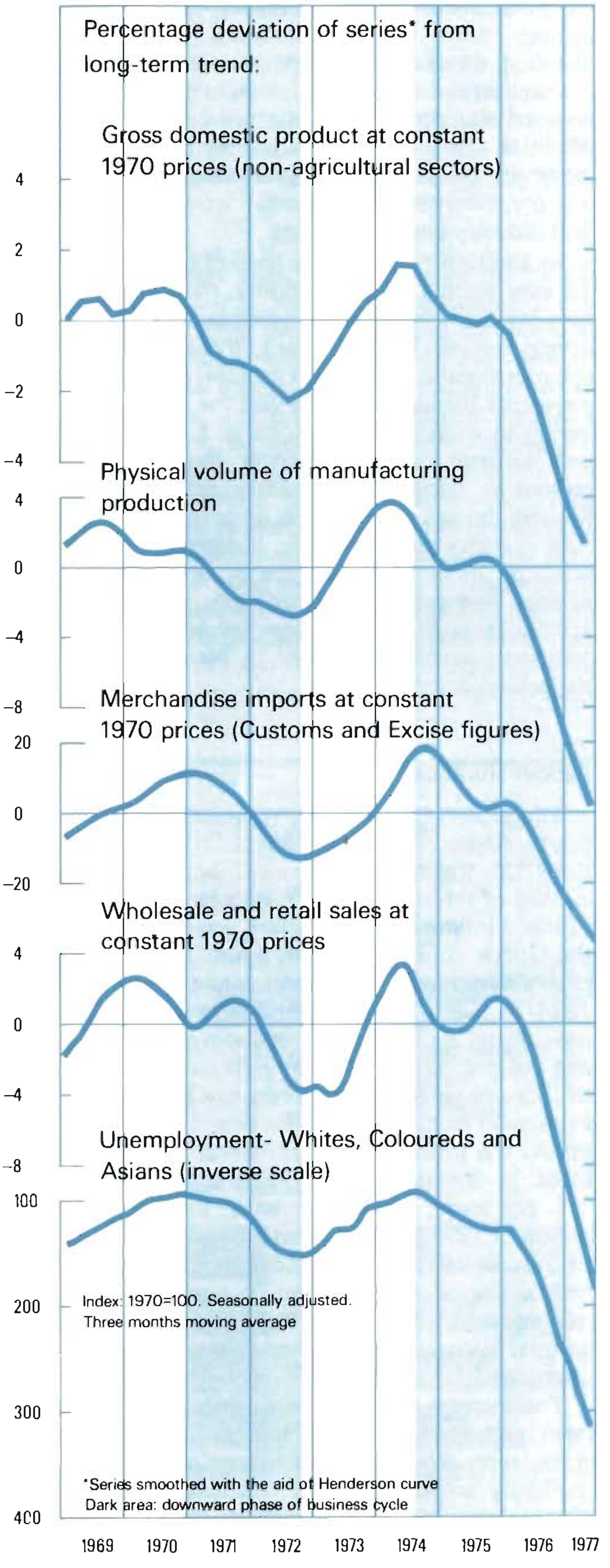
As shown by the national accounts statistics and various other economic indicators, the South African economy remained in the downward phase of the business cycle during the year under review. The current recession, which has now lasted for approximately three years, is the longest downswing experienced in South Africa during the post-war period.

The extraordinary length of the current recession resulted from a number of developments such as the severe recession experienced by the industrialised countries, political developments in Southern Africa which have affected business and consumer confidence detrimentally, the continued application of a restrictive monetary and fiscal policy to improve the balance of payments and to contain inflation, and developments in the gold market. Traditionally gold has had a stabilising influence on the economy through its effect on production, incomes and earnings of foreign exchange. During 1973 and 1974, however, the price of gold on the private market rose very sharply, but this was followed by a marked decline in 1975 and 1976. This large fluctuation in the price had a marked destabilising influence on incomes, production, exchange earnings and government revenue and expenditure and made an important contribution to the prolonged and severe recession and the balance of payments problem.

Other factors which had a destabilising influence and consequently also contributed to the intensity of the present downswing, were the introduction of television in 1975 and the subsequent drop in sales of television sets in 1976; the increase in government expenditure, particularly on defence in 1975, and the cutback in the rate of increase in government expenditure in general in 1976 and the first half of 1977; the high rate of increase in fixed investment by public corporations during 1975 and the subsequent sharp cutback; and the marked change in the distribution of income among the various sections of the labour force. Mainly because of social considerations, real wages of Black workers were raised significantly during the past years, notwithstanding increasing rates of unemployment and decreasing productivity caused by the decline in the level of economic activity. From a business point of view, this had a detrimental effect on production costs and did not promote the creation of employment opportunities but rather a greater degree of mechanisation and a higher capital-output ratio or a lower labour-output ratio.

Apart from the length of the present economic downswing, it was also more severe than preceding downward phases of the business cycle. The average annual rate of growth in the gross domestic product during the present downswing amounted to only 1,6 per cent per annum as against an increase of 3,5 per cent per year during the downward phase of the preceding cycle. Nevertheless, this low growth rate during the present recession in South Africa still compares favourably with the very low or even nega-

Business cycle indicators



tive growth rates experienced by most industrialised countries in 1973 and 1974.

In the course of the present downswing, production trends in the primary and non-primary sectors of the economy differed markedly. During the first six quarters of the downward phase economic activity of the primary sectors declined, whereas that of the non-primary sectors continued to rise, albeit at a low rate. From the second half of 1976, however, primary sectors production started to rise sharply, whereas real economic activity in commerce and industry began to decline.

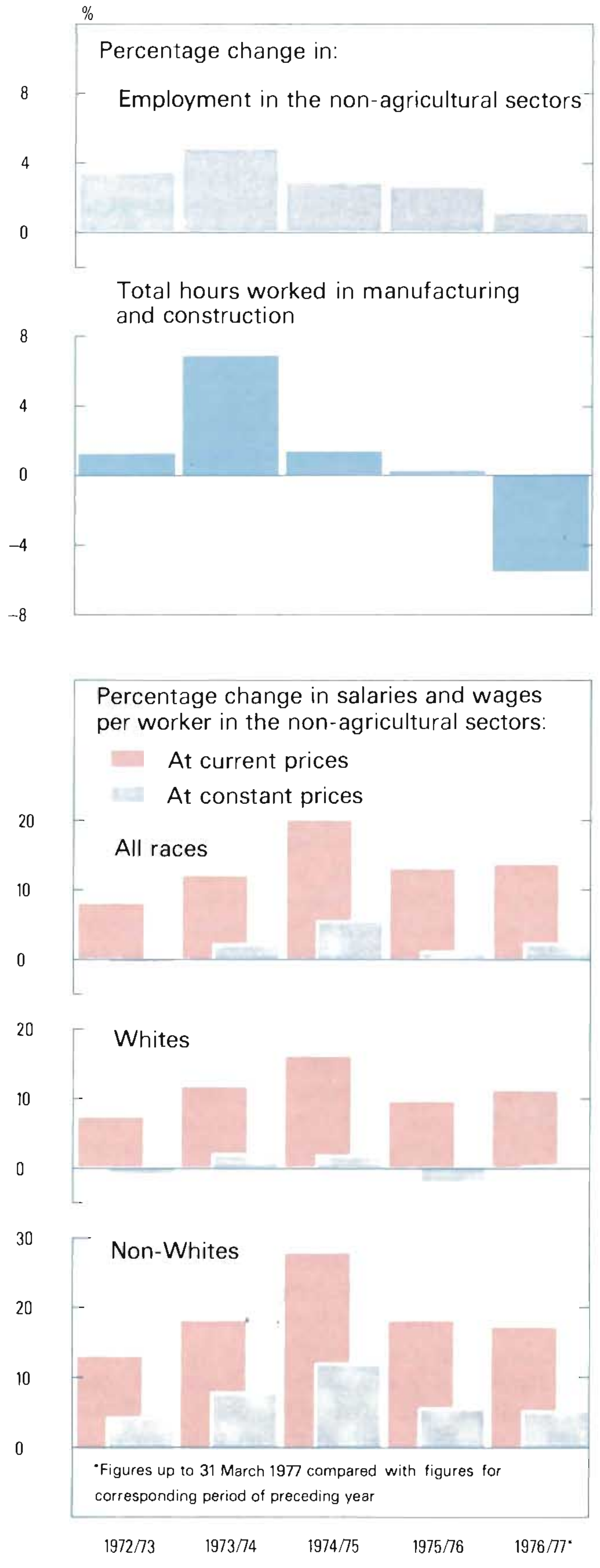
In addition to the higher level of production in the primary sectors of the economy, there were encouraging signs that a basis was being laid for a sound economic revival. In this regard, there was a dramatic improvement in the current account of the balance of payments throughout 1976 and the first half of 1977 owing to a decline in imports and a rise in exports and net gold output. Moreover, the application of a restrictive fiscal and monetary policy successfully limited the rate of increase in government expenditure and the money supply, a degree of success was achieved in curbing the rate of inflation, and real salaries and wages increased only moderately. The continuation of the economic revival in most industrialised countries is another favourable factor for an export-led domestic revival.

Labour situation

The prolonged economic recession experienced by South Africa, naturally influenced the labour situation. Up to 1974 an almost continuous shortage existed of skilled labour in particular, but as the duration and intensity of the current downswing increased, the labour situation initially eased and subsequently changed into one of increased unemployment. During 1974/75 and 1975/76, employment in the non-agricultural sectors of the economy still rose by 2,8 and 2,6 per cent, respectively. These fairly high rates of increase were attained primarily as a result of the increase in employment in the public sector. However, during the three quarters up to March 1977, employment in the non-agricultural sectors rose by only 1,1 per cent, compared with the corresponding period of 1975/76, notwithstanding a further increase of 2,9 per cent in employment in the public sector and a rise of 5,4 per cent in employment in the mining sector. The number of employees in all other sectors, consequently, either decreased or remained unchanged.

The increase in employment since 1974/75 has not been sufficient to absorb the growth in the labour force, with the result that unemployment increased markedly among all races. The seasonally adjusted number of unemployed Whites, Coloureds and Asians initially rose moderately, namely from 7 369 in August 1974 to 13 379 in June 1976, but then increased sharply further to 28 603 in June 1977. It is

Labour



estimated that the latter number represents about 1,4 per cent of the comparable labour force. An analysis of the occupational status of the unemployed indicates that a large number of artisans, operators and semi-skilled workers have registered as unemployed since the middle of 1976. Although official statistics of the number of unemployed Blacks are not available, indications are that the situation has deteriorated markedly during the past year.

In order to retain their staff, notwithstanding a decline in the volume of activity, employers resorted to shortened working weeks, forced holidays, shorter hours and sharp cut-backs in overtime worked. Total hours, i.e. ordinary and overtime hours, worked in manufacturing and construction in the first quarter of 1977 was, for example, no less than 7,0 per cent less than in the first quarter of 1976. In these circumstances, output per worker in the non-agricultural sectors declined by 1,7 per cent in the first three quarters of 1976/77, as against a small rise of 0,2 per cent in 1975/76. The volume of production per man-hour in manufacturing declined by 2,2 per cent in the first three quarters of 1976/77 after having risen by 1,6 per cent during the preceding year. The poor productivity performance reflected to a large extent the decline in the volume of production as a result of decreased demand for goods and services.

After having risen by 20 and 13 per cent in 1974/75 and 1975/76, respectively, the average remuneration of workers in the non-agricultural sectors increased by about 14 per cent in the three quarters that ended on 31 March 1977, compared with the same period in 1975/76. The latter rate of increase in average remuneration was recorded in a period of substantial unemployment, depressed economic conditions and a decline in the number of hours worked in manufacturing and construction. The growth rate in average remuneration during 1976/77 should, however, be interpreted with care because a number of factors contributed to this increase, apart from the actual rise in salaries and wages. These include the increase of 10 per cent in salary and wage scales of public service employees on 1 July 1976, compared with no adjustment during the preceding year, the change of self-employed and other professional persons to ordinary salary and wage earners, and the higher rate of increase in unemployment of lower-paid than higher-paid employees. It is interesting to note that the rate of increase in salaries and wages, at current prices, per worker in the public sector rose from 5,8 per cent in 1975/76 to 12,5 per cent in the first three quarters of 1976/77, whereas that of employees in the private sector declined slightly, i.e. from 15,8 to 14,5 per cent during the same periods, respectively.

As can be seen on the accompanying graph, the real average remuneration of Whites rose slightly during the three quarters to March 1977 as against a decline during 1975/76, whereas the real average wages and salaries of Non-Whites rose by about the same high positive rate during the nine months to March 1977 as during the corresponding period a year ago.

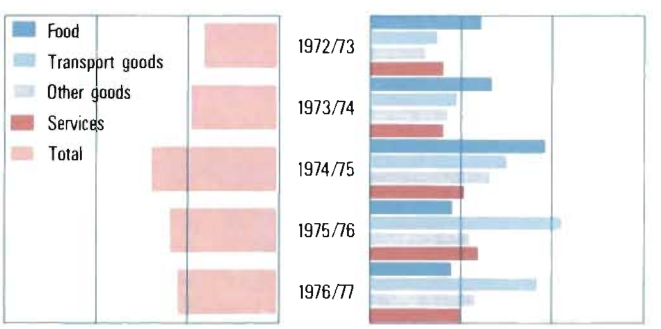
As a result of the continued high rate of increase in the remuneration and the lower output per worker in the non-agricultural sectors, the labour cost per unit of production increased sharply by 15,8 per cent in the three quarters to March 1977 after the rate of increase had slowed down to 12,5 per cent in 1975/76. This development aggravated the inflationary pressures in the economy.

Prices

During the past year the lowering of the rate of inflation and the improvement of the balance of payments remained the prime objectives of monetary and fiscal policy. However, some of the measures taken to achieve these objectives had the immediate effect of increasing prices. These included the raising of indirect taxes to avoid inflationary financing of the Exchequer deficit and a surcharge on imports to increase the revenue of the government and to accelerate the decline in imports with a view to improving the balance of payments. Notwithstanding the price-raising effects of these measures and the increase in a number of government-administered prices, the rates of increase in wholesale and retail prices were lower for the second consecutive year. Notwithstanding this favourable development, the rates of increase in both

Prices

Percentage change in consumer prices



Percentage change in wholesale prices

Prices
Annual percentage change in quarterly averages of seasonally adjusted monthly indices

	Second quarter 1976 to third quarter 1976	Third quarter 1976 to fourth quarter 1976	Fourth quarter 1976 to first quarter 1977	First quarter 1977 to second quarter 1977	1975/76 to 1976/77
Consumer prices	10,5	9,3	13,3	11,8	11,2
Goods	11,2	8,9	15,3	12,2	11,7
Services	9,1	10,3	9,1	10,6	10,0
Wholesale prices	14,2	13,9	16,0	13,3	14,8
South African goods	17,1	16,2	18,2	12,0	15,6
Imported goods	6,7	7,4	10,0	17,4	12,5

wholesale and consumer prices are still at high levels. The further lowering of the rate of inflation, therefore, remains one of the aims of economic policy, not only as a social objective to safeguard the purchasing power of, inter alia, recipients of fixed incomes, but also to maintain the country's competitiveness in international markets.

The monthly average consumer price index for the year 1976/77 rose by 11,2 per cent, compared with an increase of 11,9 per cent in the preceding year. The slightly lower rate of increase was primarily due to smaller increases in service costs. After having amounted to 12,0 per cent in 1975/76, the rate of increase in the prices of consumer services slowed down to 10,0 per cent in the year 1976/77. Service items such as rent, communication and recreation and sport contributed to the lower rate of increase, whereas costs of other services such as servants' wages and transportation, continued to rise sharply.

The rate of increase in prices of goods remained almost unchanged, i.e. 11,8 and 11,7 per cent for 1975/76 and 1976/77, respectively. During the year 1976/77, a slightly lower rate of increase in food prices and a decline in the rate of increase in prices of motor cars and other transportation goods were approximately neutralised by a higher rate of increase in prices of other goods, and more in particular of furniture. It is particularly noteworthy that the rate of increase in the prices of goods currently experiencing a sharp decline in demand, e.g. motor cars, furniture and other durable goods, either remained at a high level or increased further during the past year. This was partly attributable to the effect of higher indirect taxes, such as sales duty, and partly to unavoidable cost increases including higher unit costs resulting from the decline in demand.

The accompanying table shows that the seasonally adjusted quarterly rate of increase in consumer prices declined to a single-digit figure in the fourth quarter of 1976, but increased again to higher levels in the first two quarters of 1977. The acceleration in the first quarter was primarily attributable to the increase in indirect taxes and administered prices.

The rates of increase in the seasonally adjusted monthly consumer price indices, compared with the same month a year ago, declined markedly from 11,7 per cent to March, 11,5 per cent to April and 11,0 per cent to May as well as to June 1977.

The rate of increase in the wholesale price index of goods consumed domestically decreased for the second consecutive year, namely from 19,4 per cent in 1974/75 to 15,7 per cent in 1975/76 and to 14,8 per cent in 1976/77. The decline in the rate of increase during 1976/77 was entirely attributable to the lower rate of increase in prices of imported goods. The rate of increase in the index of all goods produced in South Africa rose to 15,6 per cent in 1976/77, after having risen to 14,4 per cent in 1975/76. This rise was mainly due to continued high rates of increase in the prices of manufactured basic metals and metal products, higher rates of increase in prices of manufactured food, textiles and clothing and exceptional increases in prices of minerals, electricity, water and gas.

As in the case of consumer prices, the seasonally adjusted quarterly rate of increase in wholesale prices declined in the second half of 1976, increased in the first quarter of 1977, but dropped again in the second quarter. The rate of increase in prices of South African produced goods remained high during the first three quarters of the year under review but was significantly lower in the second quarter of 1977. The high rate of increase during the first three quarters of 1976/77 was largely due to sharp increases in prices of minerals, electricity, gas, water and manufactured metals, metal products and food. After having risen sharply as a result of the devaluation of the rand in September 1975, the rate of increase in prices of imported goods declined markedly during 1976. During the first and second quarters of 1977, however, the rate of increase in prices of imported goods accelerated again. The increase in prices caused by the surcharge of 15 per cent on certain imported goods, which became effective from the second quarter, naturally contributed to the higher rate of increase in the second quarter of 1977.

Balance of payments

As mentioned before, economic policy during the past two years has been directed primarily at improving the balance of payments and reducing the rate of inflation. By pursuing a restrictive monetary and fiscal policy the authorities succeeded in reducing the rate of increase in gross domestic expenditure which, during the past five quarters, was reflected in a sharp improvement of the current account of the balance of payments. The improvement of the current account was further enhanced by the recovery of economic activity in most of the industrialised countries, a lower rate of increase in import than export prices, a rise in the price of gold on the private market from the fourth quarter of 1976 and a further increase in the volume of exports, particularly mining products. It is noteworthy that the significant improvement in South Africa's current account was attained during a period in which most other non-oil producing developing countries continued to experience balance of payments difficulties.

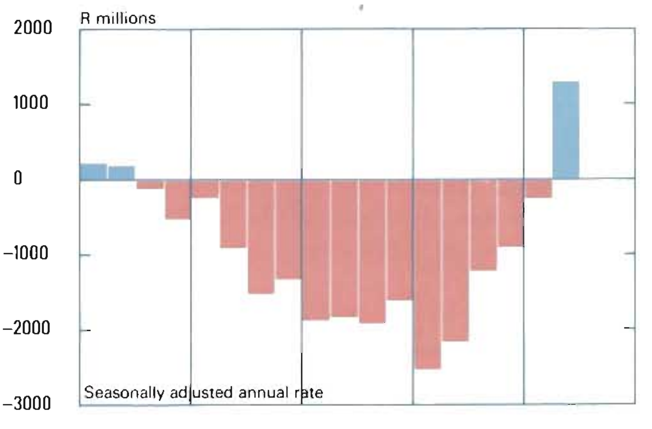
On the other hand, the capital account deteriorated during the year under review and a net outflow of capital was recorded. A number of factors contributed to the deterioriation of the capital account such as unfavourable political developments in Southern Africa, a decline in the value of merchandise imports and the lower rate of growth of gross domestic fixed investment. In particular, a substantial outflow of short-term capital, including errors and unrecorded transactions, from the private sector, caused a sharp decline in the net gold and other foreign reserves. As a result of compensatory financing obtained abroad and further gold swap agreements, the gross gold and other foreign reserves declined only moderately.

As part of the measures taken to improve the balance of payments, an import deposit scheme was introduced, effective from 2 August 1976, in terms of which a deposit of 20 per cent of the free-on-board value of all imported goods, excluding certain exempted categories, had to be made. The scheme was intented as a temporary measure and was abolished with effect from 2 February 1977. As a more direct measure to protect the balance of payments and to correct deficiencies in exchange control, certain regulations were amended from the end of March 1977. Firstly, the restriction on foreign-controlled South African resident organisations in terms of which dividends could only be declared and profits could only be transferred from income earned after 1 January 1960, was changed to apply to all income earned after 1 January 1975. Secondly, the facilities available to emigrants for the transfer of capital were made less liberal. Thirdly, legacies which were previously freely transferable abroad up to a maximum amount of R20 000 per beneficiary were made subject to the securities rand procedure. Finally, it was also announced that the administrative measures to control payments for imports, which were deficient in some respects, would also be changed later in 1977 to make control more effective. A fiscal policy measure which had a direct effect on the balance of payments was the introduction of a special revenue duty or surcharge of 15 per cent on all imported goods, except those subject to GATT-bindings or other agreements and customs conventions, goods imported by the government and certain petroleum products.

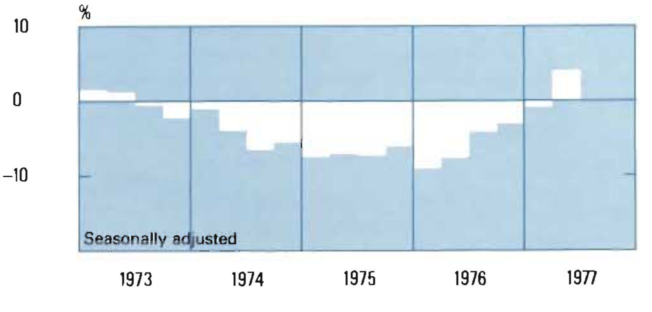
Dramatic improvement of the current account

During the five quarters that ended on 30 June 1977 there was a marked improvement of the current account of the balance of payments. In 1974 and 1975 South Africa, as an oil-importing country, experienced an increasing deficit on current account which reached a seasonally adjusted annual rate of R2 529 million in the first quarter of 1976. In subsequent quarters this deficit declined sharply and changed, to a surplus of R1 277 million at a seasonally adjusted annual rate in the second quarter of 1977. This dramatic improvement on current account from a deficit of 9,2 per cent of the gross domestic product to a surplus of 3,8 per cent over five quarters, was an outstanding achievement, especially if account is taken of the fact that most other non-oil producing developing countries continued to experience large current account deficits.

Balance on current account



Balance on current account as percentage of GDP



During 1976/77 as a whole, a deficit of R199 million was recorded on the current account, compared with deficits of R2 039 million and R1 664 million in 1975/76 and 1974/75, respectively. This substantial improvement during the year under review was the net result of a large increase in merchandise exports, declines in merchandise imports and net invisible payments to the rest of the world, and a small decline in the net gold output.

Further substantial increase in merchandise exports

For the second consecutive year merchandise exports increased substantially. During 1976/77 they rose to R5 583 million or by 33 per cent, following upon an increase of nearly 25 per cent in 1975/76. This upward trend in merchandise exports coincided approximately with the upturn in the business cycle in a number of important industrialised countries. Merchandise exports increased from a seasonally adjusted annual rate of R3 514 million in the third quarter of 1975 to R6 436 million in the second quarter of 1977, or by about 83 per cent. In contrast to the preceding year, when the increase in merchandise exports was mainly attributable to an increase in volume, price increases made the major contribution to the rise during 1976/77. A moderate increase in the volume of mining products exported, however, also contributed to the increase.

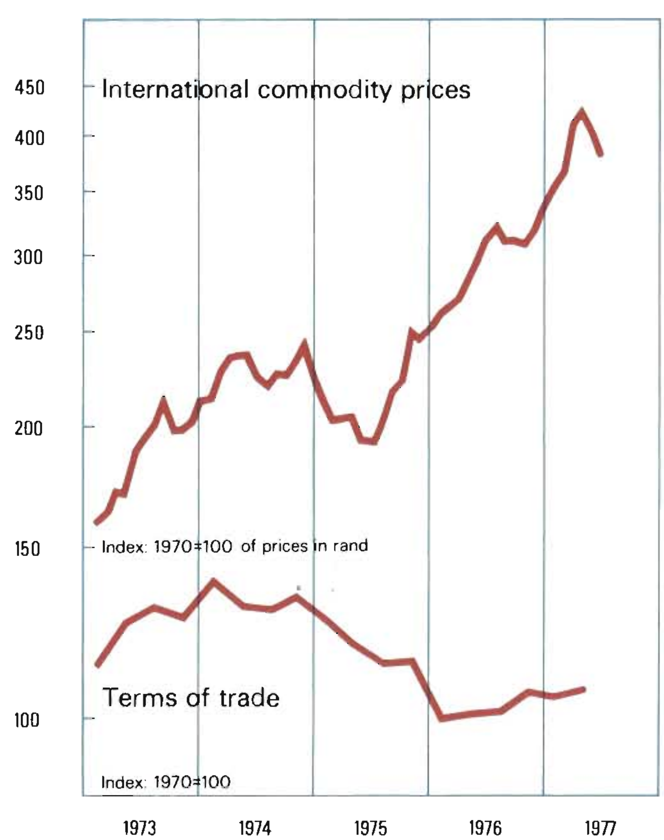
The sharp rise in the prices of South African exports was brought about by increases in the prices on international commodity markets in response to a revival in world demand. Around the middle of 1975 commodity prices in general began to rise and in the middle of 1976 approximately equalled the record prices attained in 1974. They then increased further at a rapid rate until April 1977, before declining slightly during the following two months. More recently, international commodity prices have tended to fluctuate owing inter alia to doubts about the strength of the economic revival in the main industrialised countries, while ample supplies of meat and a good grain harvest have restrained food price increases.

The increase in merchandise exports occurred over a wide range of commodities, but a particularly sharp increase in the demand for diamonds caused a substantial rise in the exports of precious stones. Price increases were mainly responsible for the good export performance of uranium and wool, whereas the increase in the exports of asbestos and copper came about as a result of price and volume increases. The commencing of exports through the Saldanha Bay and Richards Bay harbours led to a sharp rise in the volume of iron ore and coal exported, and the volume of nickel exports also increased sharply. The value of exports of manufactured goods also increased considerably during the year under review, because surplus production capacity and a low level of domestic demand induced local manufacturers to exploit export opportunities at a time when world demand was at a relatively high level. In contrast, a decline in the price of sugar resulted in a decline in the value of exports, notwithstanding a favourable crop. The value of the exports of maize also declined during the year.

Merchandise exports

Quarter ended	Value at a seasonally adjusted annual rate R millions	Percentage change
1975: September	3 514	1,1
December	4 272	21,6
1976: March	4 182	−2,1
June	4 726	13,0
September	5 067	7,2
December	5 217	3,0
1977: March	5 318	1,9
June	6 436	21,0

International commodity prices and terms of trade



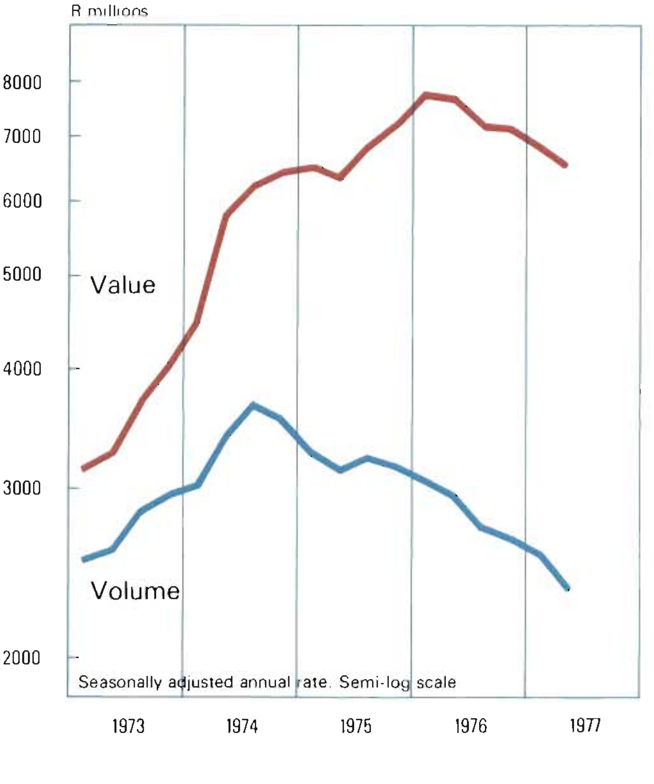
Decline in merchandise imports

After having increased substantially during the three preceding years at an average annual rate of 34 per cent, the value of merchandise imports declined from R7 369 million in 1975/76 to R6 947 million in 1976/77, or by 5,7 per cent. In fact, imports started to decline from the first quarter of 1976 when they amounted to a seasonally adjusted annual rate of R7 737 million to R6 551 million in the second quarter of 1977, or by 15,3 per cent. As a percentage of the gross domestic product, merchandise imports declined from 28,0 to 19,6 per cent over the same period.

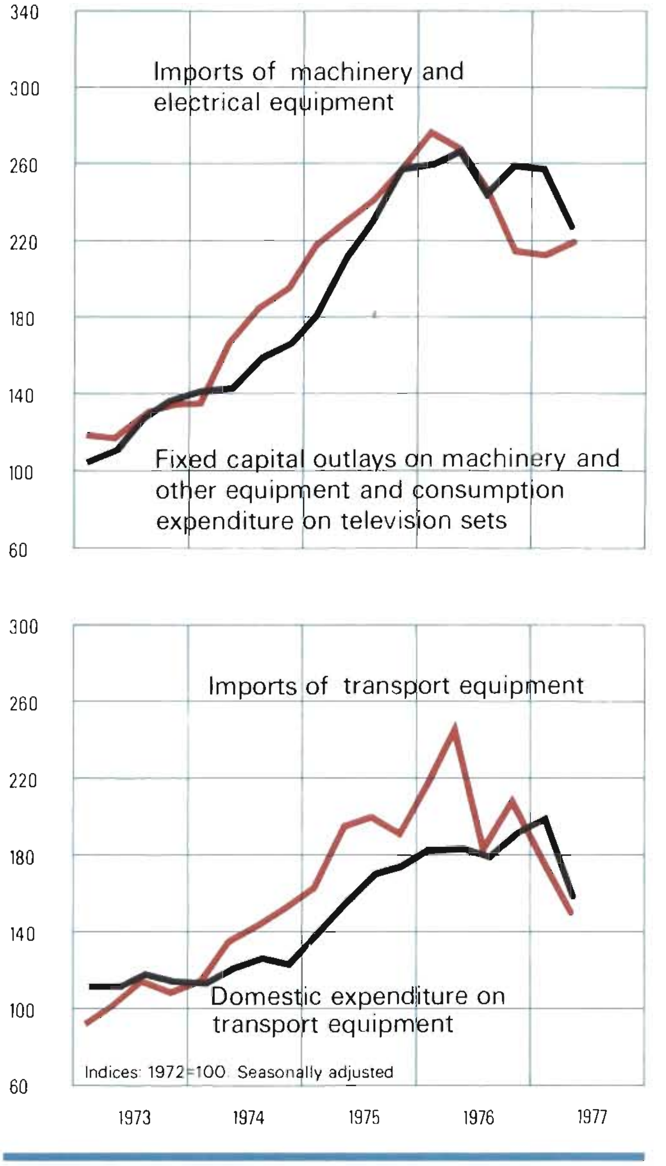
The sharp decline in imports was entirely attributable to a further decrease in the volume of goods imported which closely corresponded to the decline in the real gross domestic expenditure. As in the past, the decline in the volume of merchandise imports again coincided fairly closely with the downward phase of the business cycle and amounted to nearly one-third from the peak reached in the second quarter of 1974 to the second quarter of 1977. Although the prices of merchandise imports continued to rise during 1976/77, the rate of increase slowed down considerably in conformity with price tendencies experienced by South Africa's main trading partners.

A classification of merchandise imports according to main categories of goods, indicates that in 1976/77 a further increase in the value of oil imports was more than offset by declines in the imports of machinery and electrical equipment, transport equipment, base metals and textiles. In particular, the value of machinery and electrical equipment and transport equipment declined considerably during the year under review. As shown on the accompanying graph, a close relationship exists between the imports of machinery and electrical equipment, on the one hand, and capital outlays on machinery and other equipment and consumption expenditure on television sets, on the other hand. The levelling-off in expenditure on these assets from the beginning of 1976 was followed by a sharp reduction in the imports of machinery and electrical equipment from the second quarter of 1976. Similarly, a levelling-off

Merchandise imports



Imports of and domestic expenditure on machinery and electrical equipment and transport equipment



in domestic expenditure on transport equipment caused, with slight fluctuations, a decline in the imports of these goods. The further decline in the imports of base metals was mainly due to the effect of import substitution and has been discernible for the past three years. In this regard, organised industry and commerce initiated a drive to replace imports of goods by South African produced consumer, intermediate and capital goods.

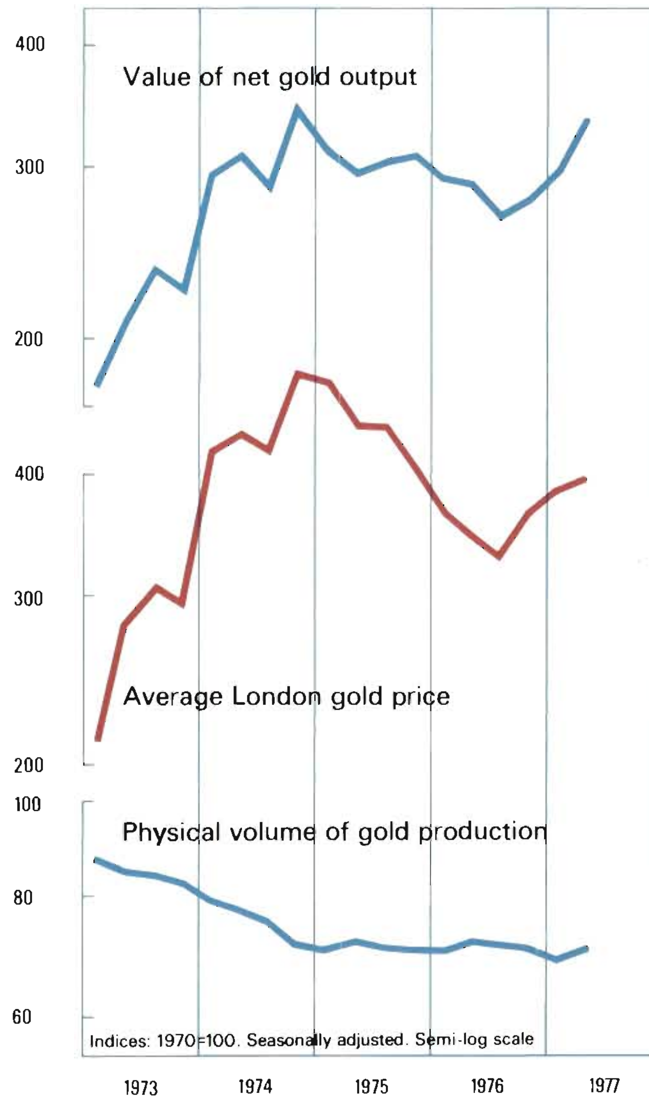
Decline in net invisible payments

After having increased at an average annual rate of 26 per cent during the preceding four years, net invisible payments to the rest of the world declined from R1 349 million in 1975/76 to R1 290 million in 1976/77, or by 4,4 per cent. This improvement on the invisibles account was brought about by an increase in service receipts and a decline in service payments. The increase in service receipts was caused mainly by an increase in the value of transport services rendered to foreigners partly offset by a slight decline in income on foreign investments. The decline in service payments was due to lower payments for international freight and merchandise insurance because of the decline in the value of merchandise imports, and to the fact that higher interest payments on foreign loans were more than offset by a decline in dividends paid to non-residents.

Small decrease in net gold output

In contrast to the other aggregates in the current account, the net gold output did not improve during the year under review as a whole and declined slightly from R2 488 million in 1975/76 to R2 455 million in 1976/77. This decline was attributable about equally to a lower average gold price and a further small decline in the volume of gold produced. However, during the course of the review year the sharply declining tendency in the gold price was reversed. After the average gold price on the London market had declined from about $180 per fine ounce at the end of 1974 to approximately $110 per fine ounce in August 1976, it improved again and rose sharply in November to just over $130 per fine ounce. Subsequently, it increased further to $149,18 per fine ounce in April 1977 before declining to $140,73 in June. As a result of these price movements, the net gold output increased from a seasonally adjusted annual figure of R2 227 million in the third quarter of 1976 to R2 800 million in the second quarter of 1977.

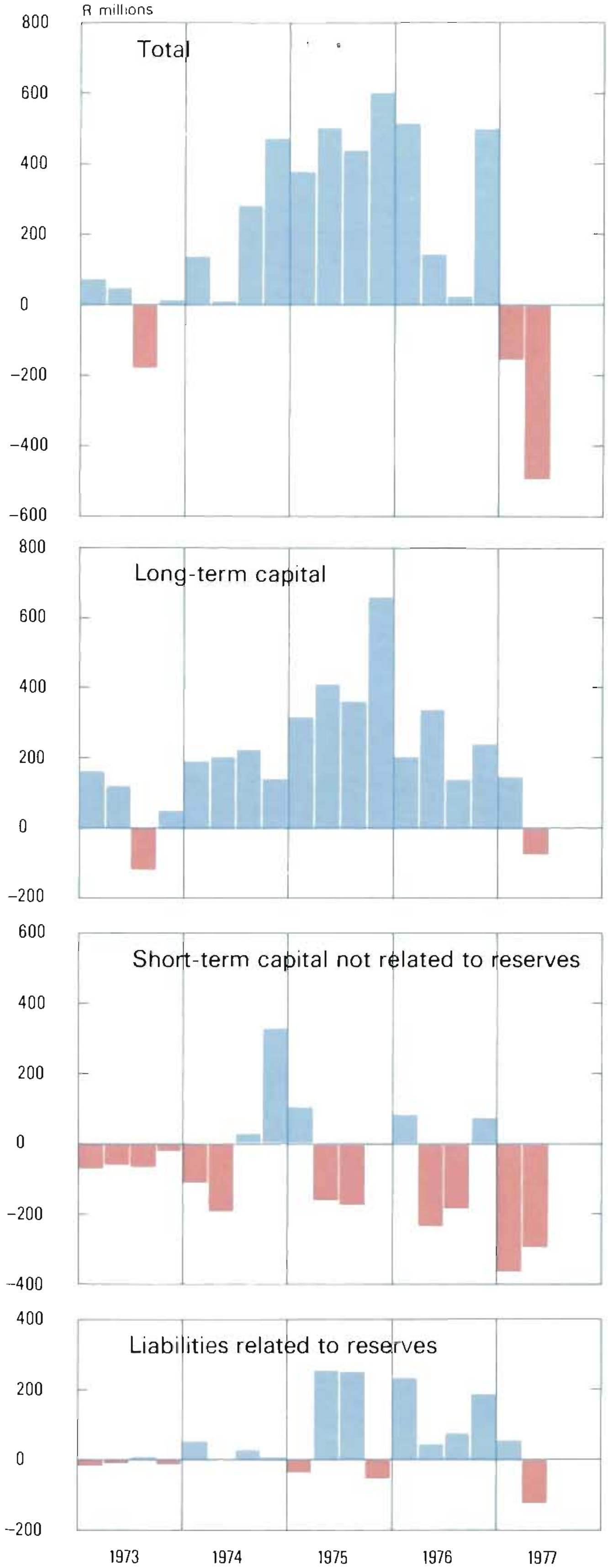
Net gold output



Net outflow of capital

Developments on the capital account of the balance of payments were less favourable during 1976/77. After a net *in*flow of foreign capital amounting to R1 635 million in 1974/75 and R1 707 million in 1975/76 had been recorded, a net ***out***flow of R121 million occurred in the period under review. Although quarterly foreign capital movements show large fluctuations, the capital account deteriorated sharply during the course of the year under review from a net inflow of R528 million in the last half of 1976, to a net outflow of R649 million during the first six months of 1977. This outflow was mainly accounted for by a substantial net outflow of short-term capital not related to reserves and net repayments of compensatory loans obtained abroad. In addition, there was also a substantial decline in the net inflow of long-term capital.

Net capital movements



Net long-term capital movements
R millions

	Year ended 30 June 1975	1976	1977
Central government and banking sector	249	258	159
Public corporations and local authorities	503	760	185
Private sector	338	543	108
Loan capital	396	536	167
Share capital	1	5	61
Other	–59	2	–120
Total long-term capital	1 090	1 561	452

Notwithstanding the relatively high levels of interest rates in South Africa compared with those of South Africa's main trading partner countries and the restrictions on bank credit to the private sector, the net outflow of short-term capital not related to reserves amounted to R767 million in 1976/77. This brought the total net outflow of short-term capital not related to reserves over the past two years to R1 097 million, which was entirely due to an outflow of short-term capital from the private sector, including errors and unrecorded transactions. Factors which contributed to this outflow of short-term funds, included the decline in the value of merchandise imports, and unfavourable political developments in Southern Africa.

The net inflow of long-term capital during the year under review amounted to R452 million, compared with a net inflow of R1 561 million during 1975/76. Notwithstanding the smaller inflow, the improvement of the current account brought about a change in the basic balance from a deficit of R478 million in 1975/76 to a surplus of R253 million in 1976/77. Although the political situation in Southern Africa probably also contributed to the decline in the long-term capital inflow, one of the main factors responsible for this development was the low rate of increase in gross domestic fixed investment at current prices. As shown in the accompanying table, the decline in the long-term capital inflow during 1976/77 related to all sectors, but particularly to public corporations and local authorities and the private sector. The net inflow of long-term capital to the private sector during the past three years consisted largely of loan capital.

The total net outflow of capital during the year under review was to some extent offset by the authorities' short-term borrowing abroad for the purpose of supporting the level of the foreign exchange holdings. Notwithstanding this compensatory borrowing, liabilities related to reserves increased by only R194 million during 1976/77, compared with a rise of R476 million in 1975/76. An amount of

R315 million was borrowed from the International Monetary Fund, which indicates that about R121 million was repaid on other short-term compensatory loans during the year under review.

Decline in the gold and other foreign reserves

If changes in short-term liabilities related to reserves are excluded, the other balance of payments transactions caused a further decline in the net gold and other foreign reserves of R514 million in 1976/77, compared with a decline of R808 million in 1975/76. Mainly as a result of compensatory loans obtained abroad and the gold swap agreements entered into in April 1977, the gross gold and other foreign reserves declined by only R84 million during 1976/77 to reach a level of R873 million on 30 June 1977. However, during the second quarter of 1977 the gross gold and other foreign reserves increased by R92 million.

As in the preceding year, gold swap agreements again caused a considerable change in the composition of the gold and other foreign reserves during the course of the year. Since the Reserve Bank's gold holdings are still valued at the statutory price of R29,55 per fine ounce, whereas in terms of the gold swap agreements the Bank sold gold spot and repurchased it forward at market-related prices, the immediate effect of these transactions was to increase the Bank's foreign exchange reserves with a larger amount than the decline in its gold holdings. The gold and other foreign reserves of other monetary banking institutions declined slightly during the year under review, whereas the foreign reserves of the central government remained at about the same level.

Monetary and banking situation

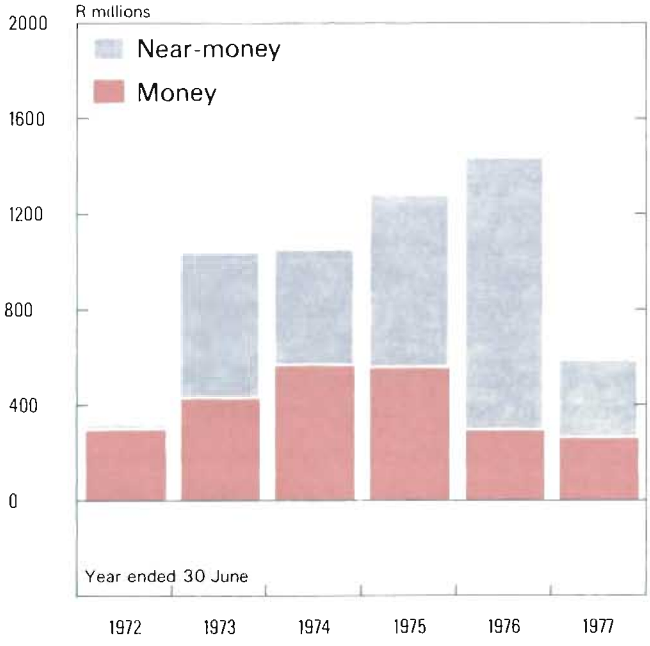
Marked and important changes occurred in the monetary and banking situation during the year 1976/77. The rate of increase in the money and near-money supply, which had mostly remained at relatively high levels during the first two years of the present economic downswing, was reduced sharply to only about 6 per cent in 1976/77. The narrowly defined money supply, which had already shown a fairly moderate rate of increase of only 7 per cent during 1975/76, slowed down somewhat further from the end of June 1976 to the end of June 1977. Similarly, the rate of increase in domestic credit in 1976/77 amounted to less than half the increase in 1975/76, namely approximately 9 per cent, which was significantly lower than the inflation rate.

Other features of the situation during the year under review included the continued restrictive stance, and some further tightening, of the authorities' monetary policy measures; relatively low levels of the excess liquidity ratios of banking institutions, in continuation of low levels of excess liquidity already apparent during most of the first half of 1976; and a downward trend of interest rates on money market instruments not representing claims on the government sector, such as negotiable certificates of deposit and bankers' acceptances.

Money and near-money

After having increased by well over R1 000 million during each of the preceding four years, the increase in the money and near-money supply from the end of June 1976 to the end of June 1977 amounted to only R586 million or 6 per cent. Indeed, for the five-month period from the end of October 1976 to the end of March 1977, the money and near-money supply actually declined at a seasonally adjusted annual rate of approximately 5 per cent.

Change in money and near-money



Changes in money and near-money

Year ended 30 June	R millions	Percentage change
1972	319	8
1973	1 039	24
1974	1 052	19
1975	1 281	20
1976	1 435	18
1977	586	6

The ratio of the quantity of money and near-money to the gross domestic product, both seasonally adjusted, decreased from 31,0 per cent in the second quarter of 1976 to 29,6 per cent in the first quarter of 1977 and to 28,2 per cent in the second quarter.

Causes of changes in money and near-money

A sharp decline of over R800 million in domestic credit expansion (i.e., the increase in the monetary banking sector's credit to the private sector and net credit to the government sector) largely accounted for the reduced increase in the money and near-money supply during 1976/77 compared with 1975/76. The effect of markedly lower rates of increase in bank credit to the private and government sectors during the year under review was, however, supported by substantial rises in long-term deposits of the private sector with the banking sector. On the other hand, the decline in the net gold and other foreign reserves during 1976/77 was markedly smaller than during 1975/76. This combination of causes of changes in the money and near-money supply during the year under review, therefore, stands in marked

Domestic credit expansion

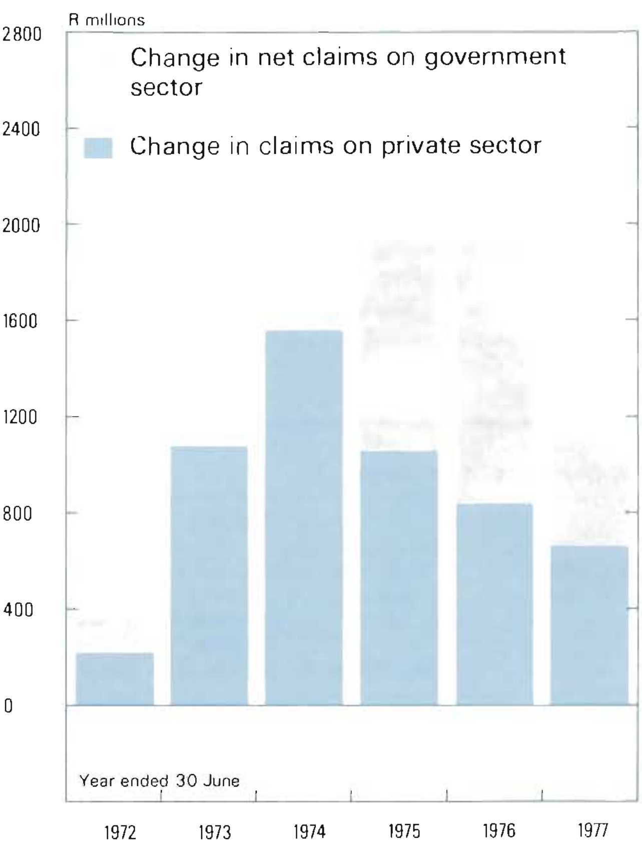
Year ended 30 June	Change in: Claims on private sector	Net claims on government sector	Total domestic credit	
	R millions	R millions	R mil.	%
1972	229	141	370	8
1973	1 086	52	1 138	23
1974	1 562	248	1 810	30
1975	1 061	902	1 962	25
1976	846	1 096	1 942	20
1977	667	442	1 109	9

Causes of changes in money and near-money
R millions

	Year 1975/1976	1976/1977 Not seasonally adjusted: 1976 Third Qtr.	1976 Fourth Qtr.	1977 First Qtr.	1977 Second Qtr.	Year 1976/1977.	1976/1977 Seasonally adjusted: 1976 Third Qtr.	1976 Fourth Qtr.	1977 First Qtr.	1977 Second Qtr.
Net gold and other foreign reserves	–756	–246	–131	–202	208	–371	–191	–211	–186	217
Claims on government sector:										
Gross claims	1 032	75	456	64	78	673	...	...	...	...
Government deposits (Increase –, decrease +)	64	–35	–409	–303	515	–231	...	...	...	...
Net claims	1 096	40	48	–239	593	442	246	–152	222	98
Claims on private sector	846	195	216	59	197	667	144	250	–12	286
Long-term private deposits (Increase –, decrease +)	–16	–95	–25	–78	–137	–335	–143	–32	–131	–20
Net other assets	265	149	4	238	–208	183	...	...	...	...
Total causes of changes	1 435	44	112	–222	653	586	135	–72	–38	556

contrast to developments during 1975/76, when the level of the domestic credit expansion was similar to that in 1974/75 and only the accelerating decline in the net foreign reserves contributed significantly to the somewhat lower rate of growth in the money supply than during the preceding year.

Domestic credit expansion



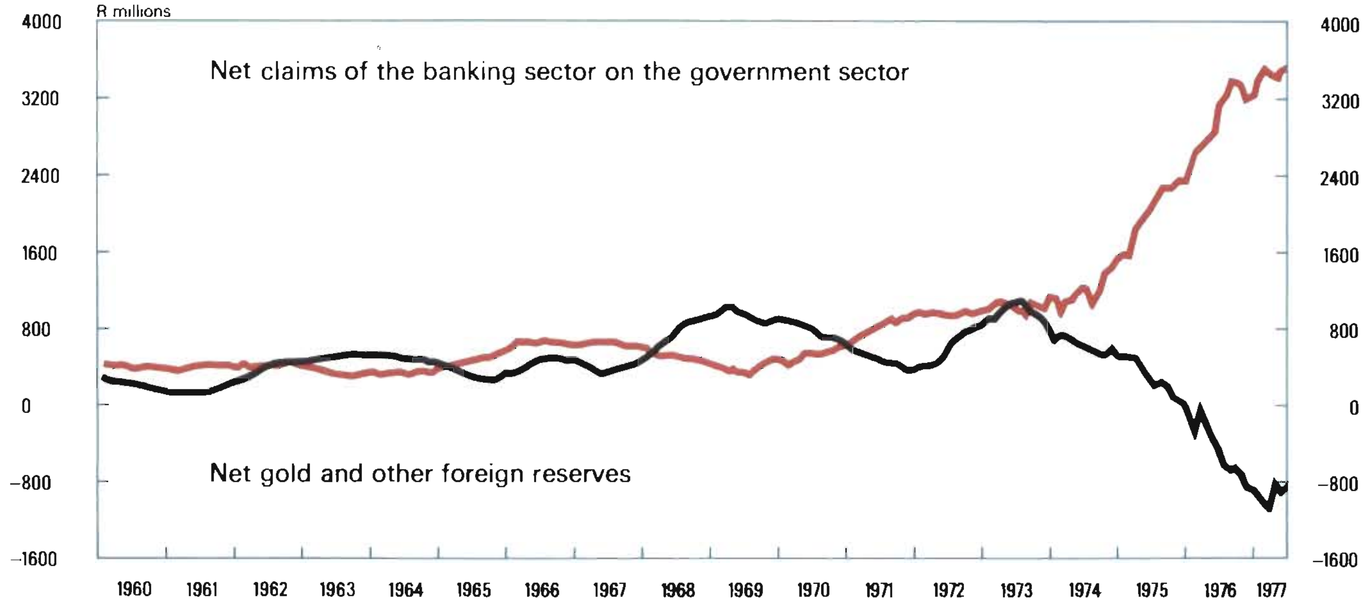
The net gold and other foreign reserves, seasonally adjusted, declined by roughly similar amounts during the first three quarters of the year under review, but rose during the second quarter of 1977. This increase reflected partly the gold swap arrangements concluded in April. Quarterly increases in the banks' net claims on the government sector, although fluctuating considerably both before and after seasonal adjustment, mostly were well below the levels recorded in 1975/76. A marked slow-down in the rate of extension of net bank credit to the government sector actually became apparent from as early as the third quarter of 1976. During the second quarter of 1977, a substantial increase was recorded, but this was largely due to seasonal factors.

A weak demand for bank credit, and other factors, caused the increase in claims on the private sector during 1976/77 to be well below the increase during the preceding year. Long-term deposits of the private sector with the banking sector, which declined during the first seven months of 1976, on balance increased by 16 per cent during the year 1976/77.

Inverse relationship between net claims on the government sector and net foreign reserves

A striking long-term inverse relationship between changes in net bank credit to the government sector and the net foreign reserves (stretching back for many years and already commented upon in the Bank's *Annual Economic Report* for 1971/72) continued to be in evidence during 1976/77. To some extent, this relationship undoubtedly represents independent cyclical behaviour of net bank credit to the government sector and the net foreign reserves,

Relationship between foreign reserves and bank credit to the government sector



respectively. To an important degree, however, the relationship also reflects causal connections running from the government's borrowing from the banking system to the net foreign reserves and from the foreign reserves to net bank credit to the government sector.

Direct links between bank financing of government expenditure and declining net foreign reserves will exist, for example, to the extent that the government itself is an importer of goods and services or when funds released by the government are used to effect foreign payments or to repay existing foreign trade debts (including such repayments as have come to be associated with the problem of "leads and lags"). Indirect links will exist to the extent that government borrowing from the banking sector and subsequent government expenditure raise the liquidity of the banking system (facilitating increased lending to the private sector), add to the money and near-money supply, and bring about a lower level of domestic interest rates than would otherwise have prevailed. An indirect link running from the net foreign reserves to bank lending to the government sector probably exists to the extent that declining net foreign reserves bring about reduced bank liquidity and a tightening of the local money and capital markets, which may contribute to the government's difficulty in raising sufficient amounts of funds from non-banking sources.

Because of the complexity of this relationship (which also has to consider, for example, non-economic influences on inflows and outflows of long-term foreign capital) no simple correlation can be expected. The fairly steady long-term rise in net claims on the government sector between the end of 1971 and the middle of 1974 was accompanied, for example, by a marked rise in the net foreign reserves from the beginning of 1972 up to July 1973, and by a decline during the remainder of this period.

Bank credit to the private sector

Claims of the monetary banking sector on the private sector increased by R667 million, or 8 per cent, during 1976/77. This lower rate of increase was a continuation of a decline during the preceding two years, namely from 31 per cent in 1973/74 to 16 per cent in 1974/75 and to 11 per cent in 1975/76. The main reason for the relatively low rate of increase in 1976/77 was the sharply reduced demand for bank credit during most of the year under review. In addition, however, the banks continued to be constrained to some extent by generally low levels of excess liquidity. Although certain banks were affected by the credit ceilings, substantial amounts of unused facilities under the ceilings existed for the banking system as a whole throughout the year.

An unusually large amount of the year's increase in bank lending to the private sector, namely R390 million seasonally adjusted, occurred during the three-month period from September to November 1976. This temporary upsurge in credit extension was probably caused by the financing of import deposits and the assistance of companies which experienced cash flow or other financing problems at that stage of the economic downswing. The effect of the import deposit scheme on credit demand was reversed, however, from the beginning of February 1977, when repayment commenced of deposits collected from the beginning of August 1976. The import deposit scheme was, in effect, replaced by the 15 per cent surcharge on certain imports announced in the 1977/78 Budget, as already referred to in the Balance of Payments Section of this Report.

As might be expected during a year of generally weak credit demand, a large part of the increase in claims on the private sector during 1976/77 consisted of increases in the banks' holdings of private sector securities (accounting for R151 million, or 23 per cent), and in cash credit advances of the Land Bank (R329 million, or 49 per cent). Discounts and advances of the commercial banks, merchant banks and monetary hire-purchase and general banks actually rose by only R211 million, representing an increase of only about 3 per cent. By far the larger part of this increase, moreover, occurred during the first half of the year under review.

Hire-purchase and leasing finance extended by the commercial banks, merchant banks and monetary hire-purchase and general banks rose by R153 million during the year. Although representing a rise of 12 per cent, this increase was, in fact, lower than in any one year since 1971/72. At the end of June 1977, hire-purchase and leasing finance accounted for 23 per cent of the banks' discounts and advances to the private sector, as compared with 13 per cent at the end of June 1972.

Liquidity situation of banking institutions

The absence of strong private sector demand for bank credit during most of 1976/77 did not result in any marked build-up of excess liquidity in the banking system during the year. With the exception of largely seasonal rises at the end of December 1976 and June 1977, the banks' excess liquidity ratios remained at a relatively low and fairly stable level throughout the year.

The average excess liquidity ratio during 1976/77 amounted to 2,3 per cent for the commercial banks and 1,7 per cent for all banks. This may be compared with ratios of 4,7 per cent and 3,4 per cent for the commercial banks and all banks, respectively, during the second half of 1975, and with ratios of 1,8 per cent and 1,2 per cent, respectively, during the first half of 1976.

High liquid asset requirements, particularly on the increase of liabilities, caused the required amount of liquid assets of the commercial banks to rise by about 9½ per cent during the year, compared with an increase of less than 8 per cent in their total liabilities to the public. Non-commercial banks, however, succeeded in substantially reducing their short-term liabilities while increasing their long-term liabilities, and thereby reduced their required liquid asset holdings by 8 per cent, although the rise in their total liabilities to the public amounted to about 4 per cent.

Relative stability in the excess liquidity of the banking system generally did not exclude certain smaller banks experiencing difficulties in meeting the liquid asset requirements during part of the year. This situation arose as the seasonal flow of funds to the government in the first few months of 1977 combined with a tendency for funds to be transferred from smaller banks to larger banks. The latter tendency, in turn, could be traced to financial problems being experienced by certain property developers and two of the smaller banking institutions. These developments caused the Reserve Bank to announce certain countervailing measures, including the arrangement of the so-called "Lifeboat" facilities referred to below.

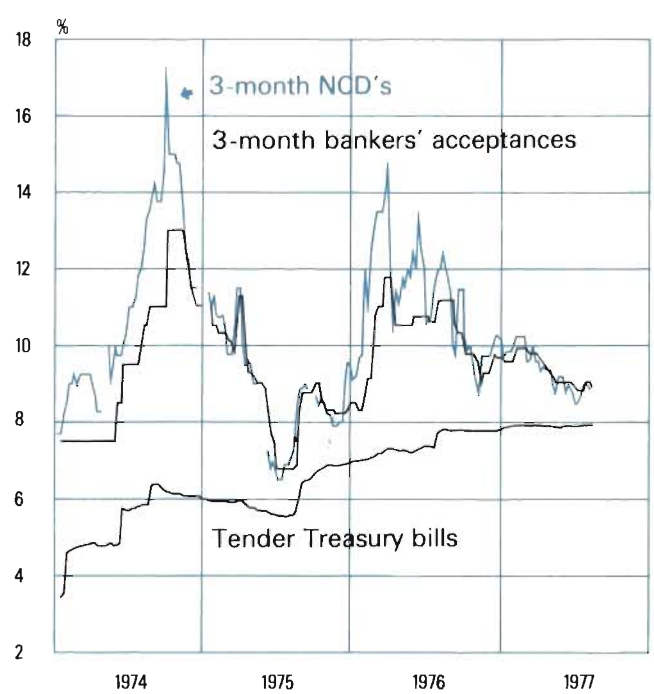
Money market conditions and interest rates

In sharp contrast to the tight money market conditions experienced during the year 1975/76, generally easier conditions prevailed during most of the year under review. After tightening during July 1976, money market conditions eased considerably

Excess liquidity ratios of banking institutions
%

	1976			1977	
	June	Sep.	Dec.	Mar.	June
Commercial banks	5,1	1,7	3,8	1,1	4,8
Other monetary banks	0,3	1,3	0,7	2,0	0,6
Non-monetary banks	–0,1	0,7	0,4	–3,0	–2,8
All banks	3,4	1,5	2,7	1,2	3,2

Money market interest rates

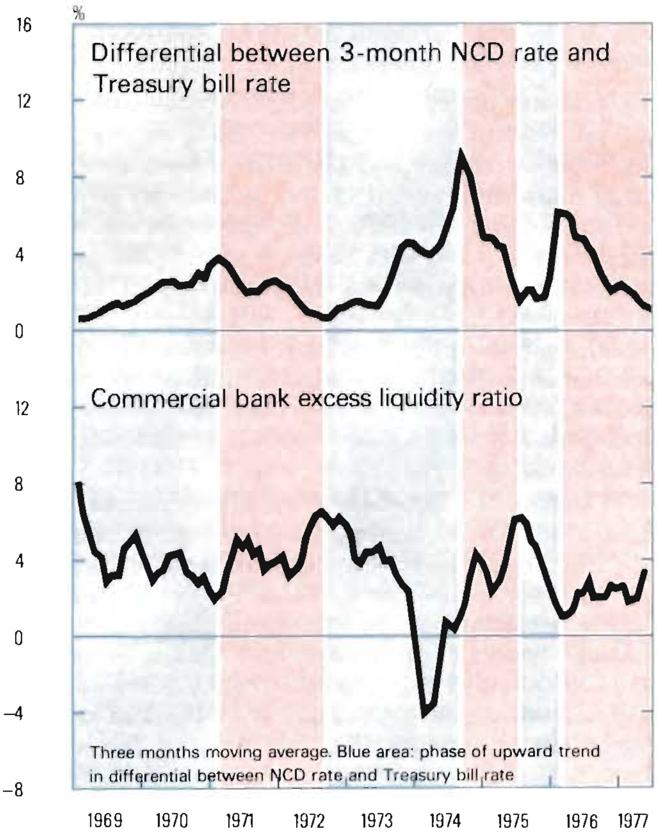


during August, September and October 1976 but then, owing mainly to the sharp increase in government deposits with the Reserve Bank and the further decline in net gold and other foreign reserves from the middle of November,. tightened somewhat during the remainder of 1976 and January and February 1977. As a result mainly of the sharp increase in the Reserve Bank's and National Finance Corporation's (NFC's) net claims on the government sector after February 1977, conditions in the money market eased considerably again during the ensuing months.

In accordance with the above changes in money market conditions, the rates on private money market instruments declined sharply during August, September and October, 1976, increased somewhat during most of the subsequent four months, and then declined sharply during the remainder of the year under review and most of July. The 3-month NCD rate, for example, declined from 12,50 per cent at the beginning of August to 8,75 per cent on 5 November 1976, increased to 10,25 per cent on 25 February 1977, and then declined to 8,50 per cent on 8 July. In contrast to the more volatile movement exhibited by the rates on instruments not ranking legally as liquid assets, the trend in the rate on tender Treasury bills, which is a prescribed liquid asset, was mainly upward during the review period, from 7,72 per cent on 23 July 1976, i.e., just after the increase in Bank rate on 22 July, to 7,88 per cent on 8 July 1977.

The apparent divergent tendencies of rates on tender Treasury bills and NCD's can, to a very large degree be explained in terms of the banks' excess liquidity positions. As the accompanying graph shows, periods of declining or low excess bank liquidity approximately coincided with periods during which the differential between the Treasury bill tender rate and NCD rate increased, and periods of rising or high excess bank liquidity with periods during which the differential decreased. The reasons for this phenomenon are many and varied. During a period of declining or low excess bank liquidity, for example, banking institutions would usually, in an effort to improve their liquidity, either aggressively issue NCD's and/or dispose of NCD's (or other instruments not ranking legally as liquid assets) from their portfolios. Both efforts would make for increasing rates on such "non-liquid" assets. Since the sale of statutory liquid assets, such as Treasury bills, would not improve bank liquidity, the rates on Treasury bills, while moving upwards, would tend to diverge from those on non-liquid assets. On the other hand, during periods in which cash reserves tend to accrue to the banks and their liquid asset positions are improving, both the NCD and Treasury bill rates would tend to decline, but the former more rapidly than the latter, until the margin between these rates would represent the intrinsic quality differences between these two types of assets. The reason for this phenomenon can be found in the fact that as the banks' liquidity position improves, the

Commercial bank excess liquidity and differential between NCD rate and Treasury bill rate



urge to add further to their liquid asset holdings diminishes, causing the banks' demand to be shifted towards non-liquid assets, such as NCD's, in view of the relatively high yields that can be earned on them.

The discount houses experienced little difficulty in recruiting funds during 1976/77, with the result that the call money rate of the houses rarely moved above the Treasury bill tender rate. Since total call deposits with the houses stood at a level of around R800 million, i.e., the maximum level allowed by the Banks Act according to the discount houses' existing capital and reserves, the banks' surplus cash balances were voluntarily placed with the National Finance Corporation (NFC) at lower call money rates. Thus the call deposits with the NFC became more volatile because it had to absorb short-term fluctuations in the banks' cash reserves. The NFC, therefore, experienced large fluctuations in deposits during the year under review and July 1977.

Except for minor adjustments (in the short-term category) at the end of October and the beginning of November, the deposit interest rates of the major banking institutions remained unchanged during the review year. Bank rate was increased on 22 July 1976 from 8½ to 9 per cent, allowing the banks, which in July 1975 untertook to maintain their prime rate at between 2½ and 3½ per cent above the ruling discount rate of the Reserve Bank, to increase their prime rate from 12 to 12½ per cent.

Monetary policy

Monetary policy during 1976/77 continued the generally restrictive stance that had gradually been developed from the end of 1973 onward and been made more pronounced in the second half of 1975 and the first half of 1976. Thus, Bank rate was raised once more (for the fifth time since the lower turning point of interest rates was reached in mid-1973) with effect from 22 July 1976. This increase, which raised the rate from 8½ to 9 per cent, was announced simultaneously with the introduction of an import deposit scheme by the Ministers of Finance and Economic Affairs on 21 July, which became effective from 2 August.

In view of the liquidity difficulties experienced by some of the smaller banks during the first few months of 1977 in particular, certain steps were announced by the Reserve Bank on 22 February 1977. These included an assurance by the Bank that the fullest possible financial accommodation would, if necessary, be extended to the smaller banks in the normal way, as well as an agreement with the five largest banks that an amount R55 million, over and above their minimum required balances, would be maintained by these banks with the National Finance Corporation, to be available for recycling to the smaller banks (the so-called "Lifeboat" facilities already referred to). These steps were accompanied by a revision of the deposit interest rate control regulations, in terms of which the amount from which individual deposits with banks and building societies (other than deposits held by banks and building societies with one another) are exempted from rate control, was lowered from R1 000 000 to R250 000, effective from 23 February 1977. In conjunction with Reserve Bank guarantees of one bank's foreign commitments, these various steps proved successful in restoring depositor confidence in the smaller banking institutions.

The ceilings on the banks' discounts and advances to the private sector and on their private sector investments, which initially had been permitted to rise monthly by ½ per cent of the respective "base" figures as at the end of December 1975, were frozen at their levels as at the end of March 1977 with effect from 1 April. This step was taken on account of the continued need to strengthen the balance of payments and to reduce the potential inflationary effects of excess liquidity in the economy, particularly in view of the then expected seasonal shift of funds from the government to the private sector.

In order to limit the use of bank credit for the financing of the Exchequer deficit, the Minister of Finance raised the minimum holdings of prescribed investments of banks, building societies, insurers and pension funds (details are given under the Capital Market Section). A part of this increase had to be in the form of government securities.

As part of its strategy to maintain local shorter-term interest rates at appropriate levels relative to overseas rates, the Reserve Bank towards the end of the year under review (i.e., during May and June 1977) embarked on intermittent sales of government securities (ex portfolio or as acquired on tap from the Treasury), on either side of the three-year maturity dividing line, to the banks, discount houses and certain institutional investors.

Government finance

During the year that ended on 30 June 1977, Exchequer issues increased at a much lower rate than during the preceding three years and this was a reflection of the government's policy to limit the growth in its expenditure. The rate of increase in Exchequer receipts was also notably smaller in 1976/77 than in preceding years. The margin between issues and receipts widened further during the year and a new record shortfall, which had to be financed by means of borrowing and the use of cash balances, was recorded. As part of the restrictive fiscal and monetary policy, the government took steps to reduce its dependence on the monetary banking sector in financing this deficit in order not to cause an undue rise in the supply of money and near-money.

The restrictive fiscal policy was pursued further in the Budget for the fiscal year 1977/78, which embodied measures to continue limiting the rate of increase in government expenditure and to reduce the shortfall of receipts in relation to issues. Measures were also taken to divert a larger portion of domestic saving to the Treasury so as to limit any further increase in the government's net indebtedness to the monetary banking sector.

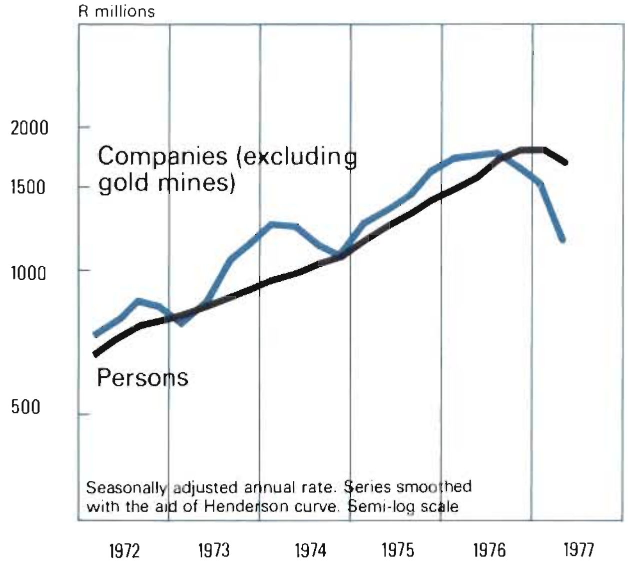
Divergent trends in revenue components

Exchequer receipts increased, relative to the preceding year, by 7,9 per cent during 1976/77, compared with 14,0 per cent in 1975/76 and an average of 20,2 per cent for the preceding five years. This relatively low rate of growth was due, firstly, to lower receipts from gold mining companies in the form of income tax and mining lease payments. Revenue from this source declined for the second consecutive year because of a decline in the average price of gold and a rise in mining costs. Secondly, income tax payments by companies other than gold mines also declined, after having risen substantially during the preceding year. As shown by the accompanying graph, which is partly based on estimates, these company tax receipts already started to decline from the beginning of 1976, mainly because of the generally lower level of economic activity and a consequent decline in company profits.

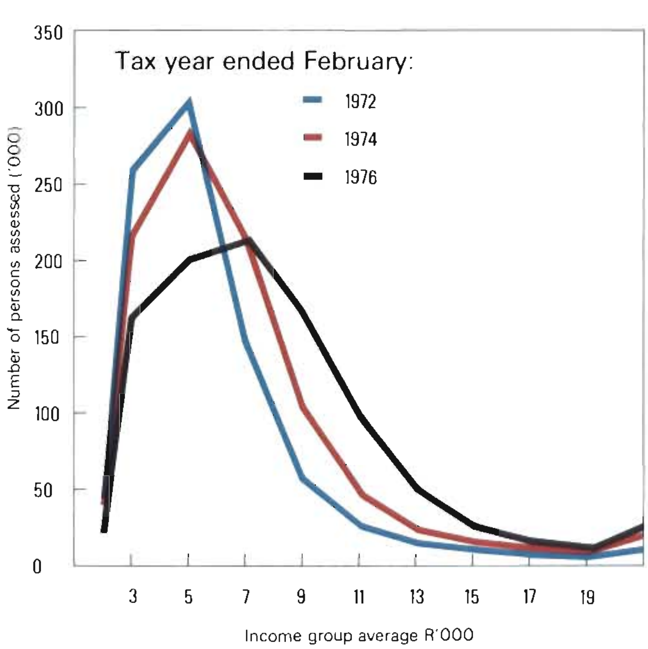
Income tax payments by individuals, on the other hand, maintained a strong upward trend during 1976/77, although a slight levelling-off was noticeable towards the end of the year. The main reasons for this strong upward trend were a general rise in taxable personal income and a simultaneous increase in tax rates. Not only did the progressive normal tax rates remain unchanged since 1971/72 during a period characterised by an inflation-induced upward adjustment of incomes, but effective rates were raised by surcharges on normal tax. The accompanying graph provides an example of the broadening of the personal income tax base that had resulted from a shift of taxpayers into higher income tax brackets because of the upward adjustment of incomes. The graph refers to married taxpayers who account for about 85 per cent of the income tax paid by individuals. The total number of taxpayers increased on average by slightly more than 3 per cent per annum since 1971/72, which was well below the average annual growth rate of about 20 per cent in the tax paid by individuals.

The "fiscal dividend" effect of higher incomes and increased progressive tax rates led to income tax pay-

Income tax paid by companies (excluding gold mines) and persons



Taxable income distribution of married persons



Principal components of government revenue

	Year ended 30 June							
	1974		1975		1976		1977	
	R mil.	% change	R mil.	% change	R mil.	% change	R mil.	% change
Customs duties	248	43,3	312	25,9	356	14,1	400	12,2
Excise duties	517	17,3	550	6,4	666	21,0	850	27,7
Sales duties	192	3,3	181	−6,1	237	31,0	278	17,4
Receipts from gold mines[1]	490	115,5	804	63,8	596	−25,8	378	−36,6
Income tax (excl. gold mines)	2 078	28,6	2 401	15,5	3 079	28,2	3 397	10,3

1) Income tax and gold mining leases.

ments by individuals exceeding for the first time in 1976/77 the income tax payments by companies other than gold mines. In his 1977/78 Budget speech, however, the Minister of Finance announced the government's intention to increase the relative importance of indirect taxes, as opposed to direct taxes, by means of the introduction of a general sales tax at the retail level.

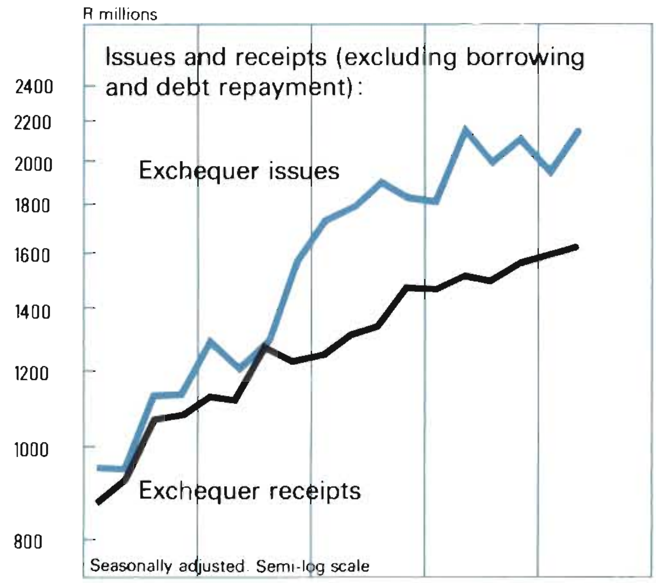
As regards other revenue components, customs duties were affected by the general decline in imports, and the rise in this source of revenue during 1976/77 was due to higher collections from April 1977, following the introduction of a 15 per cent surcharge on certain categories of imports. Receipts of excise and sales duties rose well above the preceding year's levels as a result of the increases in the rates in 1976 and early in 1977

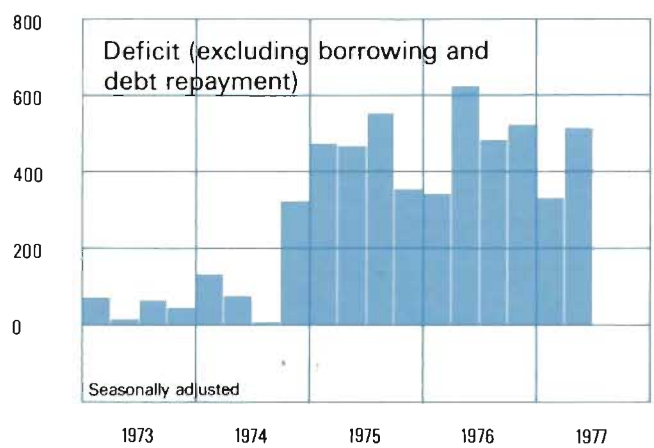
Levelling-off in Exchequer issues

Exchequer issues increased, relative to the preceding year, by 6,9 per cent during 1976/77, which was considerably less than the increase of 20,9 per cent in 1975/76 and the annual average of 21,4 per cent for the preceding five years. The lower rate of increase in issues was in accordance with the fiscal policy objective of limiting government expenditure, which was first announced in the 1976/77 Budget speech and reaffirmed in the 1977/78 Budget speech. The effect of the more restrictive fiscal policy stance became evident in the third quarter of 1976. Since then, as is shown in the accompanying graph, there has been a distinct levelling-off in Exchequer issues. The cutback in expenditure mainly affected the central government's investment expenditure which declined by 3 per cent during the year under review. However, a notably smaller rate of increase in consumption expenditure was also recorded during 1976/77.

Notwithstanding a decline also in the rate of growth of Exchequer receipts, the reduced rate of increase in issues led to the deficit on the Exchequer Account being only R62 million higher than in 1975/76. The deficit that had to be financed by means of borrowing and the use of cash balances, nevertheless, reached a new record high of

Exchequer Account





R1 851 million. In addition, debt amounting to R684 million fell due for redemption, with the result that the total borrowing requirement of the Treasury amounted to R2 535 million in 1976/77, compared with R2 461 million in the preceding year.

Further expansion of borrowing operations

In order to finance the record deficit on the Exchequer Account, the Treasury's borrowing operations had to be expanded during 1976/77. However, in line with the monetary policy objective of limiting the growth in the supply of money and near-money, borrowing from the monetary banking sector had to be restricted as far as possible. Accordingly, various steps were taken to divert a larger portion of domestic saving to the government. These measures consisted of the raising of the yield on new issues of long-term government stock in two stages from 10 to 11 per cent, the issuing of special National Defence Bonds with a relatively attractive yield, the reintroduction of a compulsory loan levy for individual taxpayers and an increase in the loan levy for companies, and with effect from the fiscal year 1977/78 an increase in the compulsory investment in government securities by financial institutions. As a result of these measures, the private non-banking sector contributed R988 million, or 53 per cent of the total, to the financing of the Exchequer deficit, compared with a contribution of 23 per cent in 1975/76. Of the amount contributed by this sector, R625 million represented an investment in government securities, including subscriptions of R135 million to National Defence Bonds, and R363 million a payment on loan levies.

The Public Debt Commissioners, with whom most public sector pension fund contributions and surplus funds are invested, also increased their contribution to the financing of the Exchequer deficit. Their net investment in government securities amounted to R295 million, or R69 million more than in 1975/76. In total, the flow of loan funds from the non-banking sector to the government amounted to R1 163 million, which left R688 million of the deficit to be financed by either foreign borrowing or net bank credit.

During 1976/77 further drawings of R315 million on the International Monetary Fund were made, largely to strengthen the country's gold and other foreign reserves. These drawings, however, also facilitated the financing of the Exchequer deficit. Other forms of foreign borrowing were fairly modest and accounted for only R50 million, or 14 per cent, of total net foreign borrowing of R365 million.

Net credit extended by the monetary banking sector to the Treasury amounted to R322 million, which was notably less than the corresponding amount of R909 million for 1975/76. The net credit figure consisted of an investment of R319 million in government securities and a decrease of R3 million in government deposits with this sector. The largest part of government deposits at the end of June 1977 represented the balance on the Stabilization Account.

Bank credit extended to the Treasury for the financing of the Exchequer deficit, represents the major part but not all of the credit extended by the monetary banking sector to the government sector as a whole, because various extra-budgetary organisations also have direct access to the monetary banking sector as a source of finance. In addition, deposits are held with the monetary banking sector by provincial administrations, the Paymaster-general and other organisations in the government sector. As quoted earlier, ***net*** bank credit to the government sector as a whole increased by R441 million during the year under review.

Restrictive fiscal policy pursued further in the 1977/78 Budget

In presenting the 1977/78 Budget to Parliament on 30 March 1977, the Minister of Finance stated that for the time being the appropriate policy package should continue to consist mainly of restrictive fiscal and monetary measures. In the short-term the main objectives of the government's financial policy were still to strengthen the country's balance of payments and to counteract inflation. The Minister emphasised that although some progress had already been made in achieving these objectives, any premature stimulation of the economy with a view to attaining more rapid economic growth, would risk sacrificing the results already achieved. Furthermore, the improve-

Exchequer Account financing
R millions

	Year ended 30 June 1974	1975	1976	1977
Deficit (excluding borrowing and repayment of debt)	457	1 188	1 789	1 851
Financed by —				
Domestic non-banking sources:				
Public Debt Commissioners	192	225	226	295
Paymaster-general	–	120	–	–120
Private sector	–45	213	415	988
Monetary banking sector	348	429	909	322
Foreign sector	–38	200	238	365
Total	**457**	**1 188**	**1 789**	**1 851**

ment of the current account of the balance of payments had to a large extent been neutralised by an outflow of foreign capital. Therefore, the Minister also pointed out that it would be prudent to accept that in the short-term the overall balance of payments, i.e. the current as well as the capital account, would have to be strengthened further before a policy of general stimulation could be pursued.

According to the Minister, it was realised that the authorities were confronted with a conflict situation in which the domestic economy was in a recessionary phase and required stimulation, whereas the balance of payments situation for the time being called for a conservative policy. The question naturally arose whether a conservative fiscal and monetary policy was indeed desirable and whether the dilemma should not rather be resolved by shifting a portion of the demand for imported goods and services to domestically produced goods and services. It was concluded, however, that the contribution of such a diversion of demand would be limited and that it would be of a short-term nature only, because once a new upswing would be in progress, a continued policy of diverting demand would suffer from the serious disadvantages that it could aggravate inflation, undermine real growth and produce new pressure on the balance of payments. Even in the existing abnormal circumstances, therefore, measures to divert import demand to the domestic economy could not serve as a substitute for conservative fiscal and monetary policy, but could only supplement such a policy.

In line with this policy stance, Budget proposals were aimed at a substantial curtailment of government expenditure, an increase in indirect taxation, and the diversion of a larger portion of domestic saving to the government in order to reduce its dependence on bank credit as a source of finance. According to Budget estimates, total expenditure in the 1977/78 fiscal year is expected to increase by only 7,8 per cent in money terms. In real terms, a significant decline in expenditure may be expected. If proposed outlays on defence are excluded, estimates of expenditure at current prices show an increase of only 5,1 per cent above the 1976/77 figures.

Total revenue is expected to increase by 16,1 per cent during 1977/78. Apart from an increase in indirect taxes on a number of goods before the Budget date, revenue proposals included the introduction of a surcharge of 15 per cent on all imported goods, excluding petroleum products, provincial and central government purchases and goods subject to GATT bindings or other agreements and customes conventions. No changes in direct taxes were proposed.

The accompanying table provides a brief summary of the Budget and shows the final Parliamentary approved estimates of expenditure from the State Revenue Account and the South West Africa Account for the 1977/78 fiscal year. The deficit of R1 598 million in the overall State Revenue Fund is estimated to be R370 million lower than the shortfall for 1976/77. No provision was made for new foreign loans, but it is expected that, on a net basis, foreign loans of R31 million will be repaid. In addition, it is anticipated that a net amount of R1 403 million will be borrowed from domestic sources. The last-mentioned figure includes a contribution of R450 million by the Public Debt Commissioners, compulsory loan levies of R462 million, issues of new National Defence Savings Bonds amounting to R160 million, and a net investment of R500 million in government securities by banking institutions, building societies, insurers and pension funds in response to the higher prescribed investment requirements announced in the Budget speech. It is expected that available cash balances, including the balance on the Stabilization Account, will decline by R226 million during 1977/78 as part of the financing of the deficit.

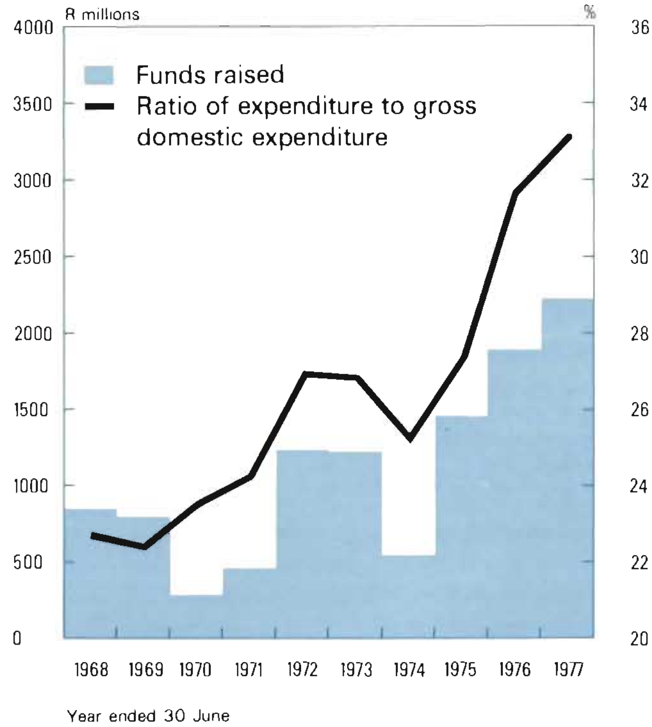
The 1977/78 central government Budget
R millions

Revenue	7 395
Expenditure	
As approved	9 193
Less proposed savings	−200
Total	8 993
Deficit (excluding borrowing and repayment of debt)	**1 598**
Repayment of debt	991
Total borrowing requirement	**2 589**
Financing:	
Foreign loans	149
Domestic borrowing:	
Public Debt Commissioners	450
New and existing Defence Bonds	240
Conversions and new stock issues	1 032
Loan levies	462
Other non-marketable issues	30
Use of available cash balances	226
Total financing	**2 589**

Capital market

Developments in the capital market during the year 1976/77 were to a large extent related to a change in the allocation of funds available in the market. The main characteristic of the flow of funds in the market was a larger allocation to the public sector and a smaller flow to the private sector. Because of the greater flow of funds to the public sector, the fixed-interest security section of the capital market, in which the public sector raises most of its loan funds, eased noticeably towards the end of the period under review notwithstanding a large demand for funds. The other sections of the capital market, namely the share, mortgage and real estate markets, however, remained depressed throughout 1976/77. The lack of investors' interest in these sections of the market facilitated a greater allocation of available funds to the fixed-interest security market. On the other hand, the diversion of a larger proportion of funds to one section of the market contributed to conditions remaining tight in the other sections. In accordance with these developments, long-term interest rates increased further in the course of 1976/77 and, with the exception only of fixed-interest security yields, remained at these peak levels until the end of the year. Most fixed-interest security yields declined slightly during the last four months of the review period.

Public sector: Expenditure and funds raised in the domestic financial market



Increased flow of funds to the public sector

The flow of funds to the public sector, which had been increasing since 1974/75, was markedly higher during 1976/77 than during 1975/76. Funds raised by the central government, local authorities and public corporations in the domestic financial market by means of new issues of marketable and non-marketable securities and short-term and long-term loans, amount to R2 238 million, compared with R1 894 million in 1975/76 and R1 458 million in 1974/75. The sharp rise in the amount of funds raised, reflected the larger financing requirements brought about by a further increase in the aggregate expenditure of public authorities and public corporations, and a greater allocation of funds to the public sector. In financing its expenditure, the public sector was able to obtain a larger share in the available pool of funds at a time when the financing requirements of the private sector were reduced by a cyclically lower rate of increase in this sector's aggregate expenditure. The increase in the amount of funds raised by the public sector since 1974/75 was, therefore, related to the cyclical increase of public sector expenditure in relation to total gross domestic expenditure and the corresponding relative decrease in private sector expenditure.

An indication of the relatively larger flow of funds to the public sector is provided by the allocation of the supply of funds originating from the intermediation by domestic financial institutions. During the year under review, 54 per cent of the funds supplied by financial intermediaries in the form of an increase in financial assets, was allocated to the public sector. As the accompanying table shows, the percentage was noticeably higher than in preceding years.

The relatively larger allocation of funds to the public sector by financial intermediaries during the last three years, led to a change in the composition of the institutions' portfolios. Claims on the public sector increased from 38 per cent of total financial assets at the end of June 1974 to 41 per cent at the end of June 1977. Included in these are claims on the central government which increased from 26 per cent to 28 per cent during the same period. At the end of June 1977, claims on the central government were the largest single financial asset of South African financial institutions. As the accompanying table shows, the decline in the relative importance of total claims on the private sector was reflected in all the individual claims on this sector.

Percentage distributions of funds supplied through intermediation by financial institutions to the public and private sectors

	Year ended 30 June 1973	1974	1975	1976	1977*
Public sector	36	18	46	48	54
Private sector	64	82	54	52	46
Total	100	100	100	100	100

* Partly estimated.

Financial assets of all financial institutions

	30 June 1974 R millions	%	30 June 1977 R millions	%
Claims on the central government:				
Securities	6 408	25,8	9 587	27,8
Other	10	–	235	0,7
Claims on local authorities:				
Securities	1 077	4,3	1 594	4,6
Other	290	1,2	323	0,9
Claims on public corporations:				
Securities	1 460	5,9	2 241	6,5
Other	134	0,5	186	0,6
Total claims on the public sector	9 379	37,7	14 166	14,1
Claims on the private sector:				
Ordinary shares	1 793	7,2	2 340	6,8
Preference shares and loan securities	844	3,4	1 062	3,1
Mortgage loans	7 185	28,9	9 530	27,7
Other loans, discounts and advances	5 663	22,8	7 341	21,3
Total claims on private sector	15 490	62,3	20 273	58,9
Total financial claims	**24 869**	**100,0**	**34 439**	**100,0**

Easing of the market for fixed-interest securities

The tight conditions in the market for fixed-interest securities at the beginning of 1976/77, continued during the next eight months but eased considerably during the last four months of the review period. The easier trend was reflected in a successful new issue of long-term government stock in April and in the over-subscription of virtually all new issues of semi-gilt-edged stock. New issues of semi-gilt-edged stock, excluding short-term Land Bank debentures, scheduled for the period March to June 1977 amounted to R300 million, but drew subscriptions of no less than R432 million.

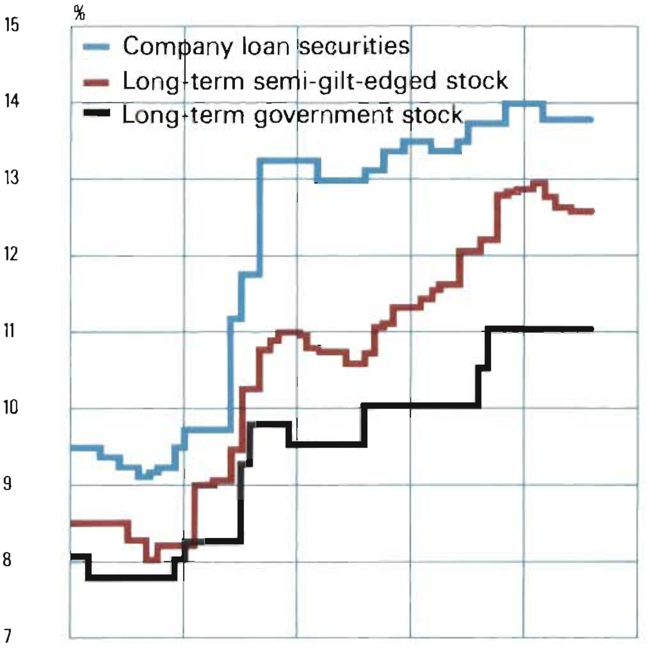
Security yields also reflected the easing of market conditions. The yield on new issues of the highest grade long-term semi-gilt-edged stock, which had increased from 12,10 per cent in June 1976 to a peak of 12,98 per cent in February 1977, declined to 12,60 per cent in June 1977. A similar course was followed by the yield on new issues of company loan securities. This yield increased from 13,5 per cent in June 1976 to 14,0 per cent in November and then remained at this level until March 1977 when it declined to 13,8 per cent. The yield on new issues of long-term government stock rose from 10,0 per cent to 10,5 per cent in August 1976 and to 11,0 per cent in September and then remained unchanged during the remainder of the period under review.

Although the yield on new issues of government stock remained unchanged when easier market conditions developed towards the end of the year under review, it became better aligned with other long-term fixed-interest security yields. Thus, the margin between gilt and semi-gilt-edged yields, which had narrowed only slightly from a historical peak of 2,10 per cent in June 1976 to 1,98 per cent in February 1977, shrank to 1,60 per cent in June. Notwithstanding the narrowing of the margin, it was still considerably larger than the average of 0,88 per cent for the preceding five years and the average of 0,67 per cent for the ten-year period 1961 to 1970.

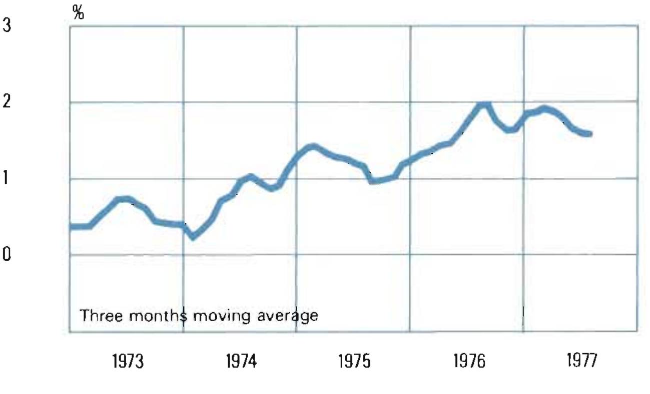
A substantial amount of new capital was raised in the fixed-interest security section of the capital market during 1976/77. Net new issues of marketable stock by the public sector, excluding the increase in the relevant borrowers' holdings of their own stock, amounted to R1 549 million which exceeded substantially the already high figure of R1 106 million for 1975/76. In addition, private sector companies listed on the stock exchange made new issues of fixed-interest securities amounting to R140 million which, however, was considerably less than the figure of R188 million for 1975/76.

The easing of market conditions, despite the large amount of funds raised in the market, was due, firstly, to the general increased allocation of funds to the public sector. Secondly, long-term fixed-interest securities became a more attractive investment outlet because investors accepted that long-term yields had peaked and that a further increase could not be expected in the short-run. Thirdly, the supply of funds was influenced favourably by the expansion of statutory investment requirements for financial institutions announced by the Minister of Finance in his March 1977 Budget speech. The amended requirements are aimed at ensuring a net investment of at least R760 million in gilt and semi-gilt-edged

Yields on fixed-interest securities



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



securities, of which at least R500 million has to consist of an investment in government securities, during the 1977/78 fiscal year.

In terms of the new requirements, banking institutions have to hold an amount equal to at least 15 per cent (previously 10 per cent) of their long-term liabilities to the public in prescribed investments which have to include government stock equal to 8,5 per cent of long-term liabilities (previously 5 per cent). The obligation of building societies to maintain prescribed investments, and not only liquid assets, which had been suspended in 1971, was re-instituted. Such prescribed investments, including liquid assets, have to amount to at least 10 per cent of their liabilities to the public and have to include, firstly, government securities and, secondly, securities of and loans to public corporations and local authorities equal to 1½ per cent and 2 per cent, respectively, of liabilities to the public. Both short-term and long-term insurers have to maintain prescribed assets equal to at least 35 per cent (previously 30 per cent plus a voluntary 2 per cent) of their liabilities, net of re-insured liabilities. Prescribed assets have to include government securities equal to 17,5 per cent (previously 15 per cent plus a voluntary 2 per cent) of net liabilities. Private pension and provident funds have to maintain a minimum of 55 per cent (previously 50 per cent plus a voluntary 2 per cent) of their assets in the form of prescribed assets which have to include government securities equal to at least 22,5 per cent (previously 20 per cent plus a voluntary 2 per cent) of total assets. Specified prescribed investments or assets other than government securities consist of cash and deposit holdings and approved semi-gilt-edged securities and loans.

All institutions have to comply with the new requirements by the end of March 1978 and to ensure that the required levels of investment will be reached by that date, the existing requirements will be increased in stages on 30 September 1977, 31 December 1977 and 31 March 1978. To facilitate the investment in government securities, government stock will be available on tap at the Public Debt Commissioners.

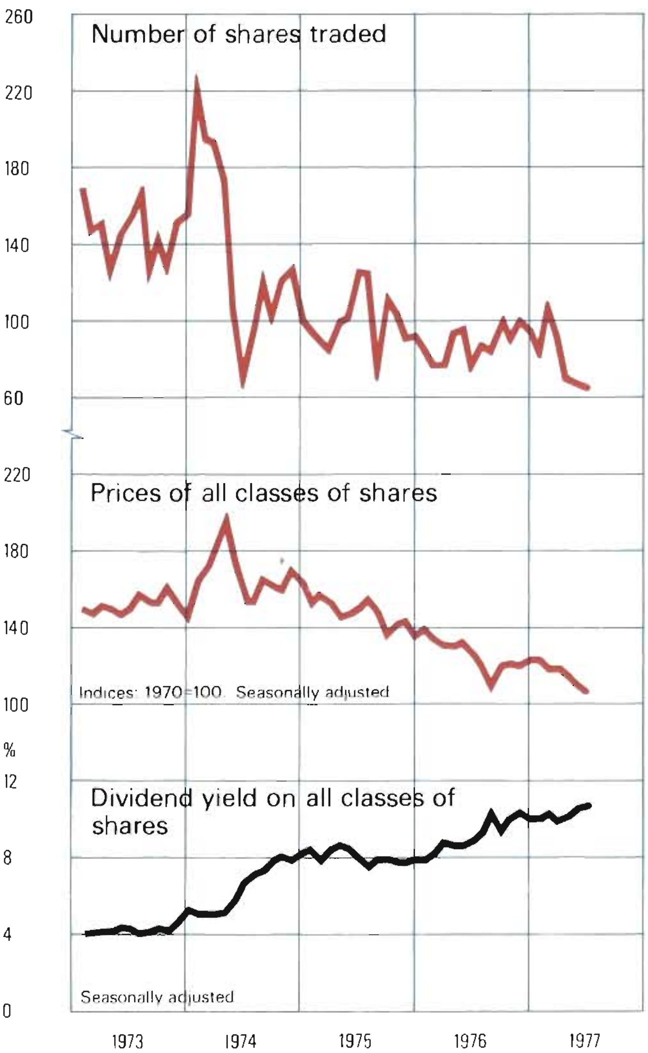
Continuing depressed conditions in the share market

Most classes of share prices continued their downward slide during 1976/77, largely because the short-term economic outlook still appeared unfavourable and foreign investors' interest in South African shares remained limited. The depressed conditions were also reflected in a lower stock exchange turnover. Turnover, in terms of the number of shares traded, was on average 6 per cent less than in 1975/76 and reached its lowest level since 1967/68.

Apart from a temporary improvement during December 1976 and January 1977, financial, industrial and commercial share prices declined almost uninterruptedly during 1976/77. In June 1977 the prices of these classes of shares were 17,12 and 18 per cent, respectively, lower than in June 1976. Gold mining share prices reacted favourably to the rise in the price of gold that had started in September 1976, and recovered noticeably during the period November 1976 to March 1977. Thereafter, during the remainder of the year under review, these prices declined again quite sharply. For the year as a whole a decrease of 27 per cent was recorded, notwithstanding an increase of 12 per cent in the price of gold. The only share prices to rise during 1976/77 were those of coal mining shares and of metal and mineral shares (excluding gold and coal mining shares). Increases of 26 per cent and 2 per cent, respectively, were recorded in these share prices.

The dividend yield on all classes of shares, excluding mining shares, increased from 8,62 per cent in June 1976 to 11,09 per cent in June 1977. The inverse yield gap between these shares and long-term government stock, which had amounted to

Stock exchange



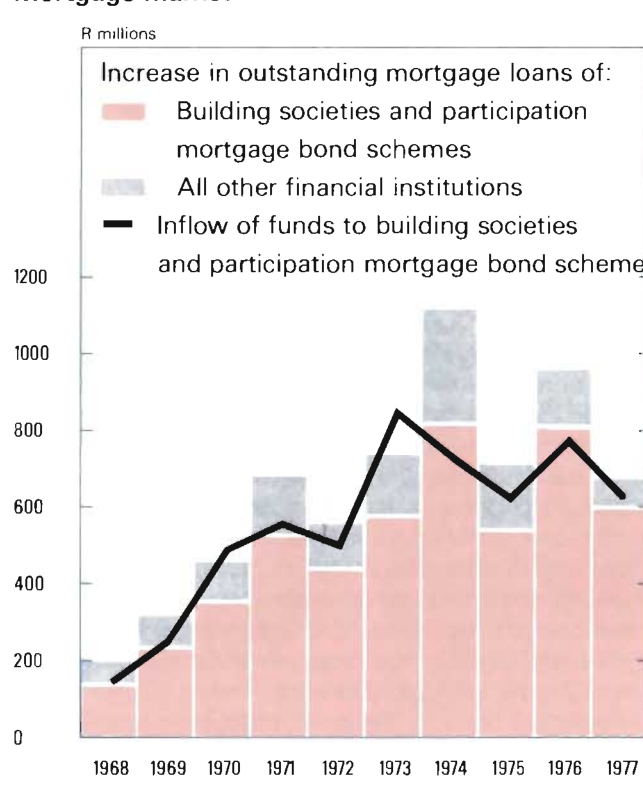
1,38 per cent in June 1976, disappeared in June 1977, as had also happened previously on a number of occasions in the course of the year under review. For the first time since an inverse yield gap had first appeared in 1964, the relevant share yield, therefore, started to exceed the long-term government stock yield during 1976/77. The disappearance of the inverse yield gap also confirmed that the easing of capital market conditions was not reflected in the share market, but was restricted to the fixed-interest security market only.

Unit trusts experienced an outflow of funds for the fifth consecutive year, but the declining trend of the outflow continued and it amounted to only R4 million during 1976/77, compared with R8 million in 1975/76 and R11 million in 1974/75. The market value of the trusts' net assets declined by R18 million during the year under review because of the general decline in share prices. The average selling price of units decreased by 8 per cent during the year and the average yield on units increased accordingly from 7,2 per cent in June 1976 to 8,3 per cent in June 1977.

Lower rate of lending in the mortgage market

The rate of mortgage lending by financial intermediaries operating in the mortgage market declined markedly during 1976/77. Their mortgage loans outstanding increased by R677 million which was not only less than the increase of R958 million in 1975/76, but also substantially lower than the average of R880 million for the preceding four years. The lower rate of mortgage lending was due, on the one hand, to a smaller inflow of funds to the intermediaries specialising almost exclusively in this type of lending, namely building societies and participation mortgage bond schemes, and, on the other hand, to less emphasis on mortgage lending by other financial institutions. In the field of industrial and commercial mortgages, the demand for loans was limited by a still existing over-supply of commercial building accommodation and by a low rate of expansion of industrial production capacity. Residential mortgage lending decreased not only because of a lower intake of funds by intermediaries, but also because of a fall-off in private residential construction and a smaller demand for building sites, both of which were largely due to a faster rise in costs than in incomes.

Mortgage market



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

	Year ended 30 June 1976		1977	
	R mil.	%	Rmil.	%
Building societies	710	51,3	610	41,3
Participation mortgage bond schemes	61	4,4	27	1,8
Banking institutions	483	34,9	606	41,1
Post Office savings facilities ...	124	9,0	229	15,5
Government savings facilities .	6	0,4	5	0,3
Total	1 384	100,0	1 477	100,0

The inflow of funds to building societies during 1976/77 amounted to R610 million which was 14 per cent lower than the corresponding figure of R710 million for 1975/76. Investments with participation mortgage bond schemes increased by only R27 million during 1976/77, compared with R61 million during 1975/76. These schemes actually experienced an outflow of R7 million during the first quarter of 1977, which was the first quarterly outflow of funds to be recorded since the movement's inception. The accompanying table shows that the smaller intake of funds by these two main groups of mortgage market intermediaries was due to an increased share of other financial institutions in the aggregate flow of non-contractual longer-term funds to financial institutions. The increase of R1 477 million during 1976/77 in longer-term funds held with deposit-receiving and related institutions was slightly more than the corresponding amount of R1 384 million for 1975/76.

During 1976/77 mortgage rates remained at the levels to which they had risen during 1975/76. The mortgage market, therefore, did not share in the easing of market conditions that occurred in the fixed-interest security market.

Low level of activity in the real estate market

The decline in mortgage lending, a sluggish demand for real estate and a limited availability of funds contributed to conditions remaining depressed in the real estate market. The declining trend in real estate transactions continued throughout 1976/77 and the value of such transactions during this period was on average 9 per cent lower than during 1975/76. Market conditions deteriorated to such an extent that a number of property development companies were liquidated during the year under review.