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EBS/83/100

CONFIDENTIAL

May 20, 1983

To: *Members of the Executive Board*

From: The Secretary

Subject: South Africa - Staff Report for the 1983 Article IV Consultation and Review Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with South Africa and the review under the stand-by arrangement for South Africa. A draft decision appears on page 21.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Vittas, ext. 76546.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 1983 Article IV Consultation and Review under the Stand-By Arrangement

Prepared by the European Department and the Exchange and Trade Relations Department

(In consultation with the Legal and Treasurer's Departments)

Approved by L. A. Whittome and Subimal Mookerjee

May 19, 1983

I. Introduction

A staff team, consisting of Messrs. Vittas (EUR), Berengaut (ETR), Dell'Anno (EUR), Lipschitz (EUR), and Mrs. Evans (EUR, as secretary), held Article IV consultation discussions in Johannesburg, Pretoria, and Cape Town from February 25 to March 11, 1983. At the same time, the mission reviewed performance under the stand-by arrangement. The staff representatives met with the Minister of Finance, Prof. O. Horwood; the Governor of the Reserve Bank, Dr. G. de Kock; the Director General of Finance, Dr. J. de Loor; other government and Reserve Bank officials; and representatives from the private sector. Dr. D. Brand, Principal Resident Representative of South Africa to the IMF and the World Bank, attended the meetings as an observer. South Africa accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Articles of Agreement as of September 15, 1973.

The stand-by arrangement with South Africa, approved by the Executive Board on November 3, 1982 (EBS/82/173, 10/4/82), was for an amount of SDR 364 million (equivalent to 57 per cent of quota) and for the period through December 1983. On November 8, 1982 South Africa purchased SDR 159 million under the stand-by arrangement and, at the same time, purchased SDR 636 million (100 per cent of quota) under the compensatory financing facility. These transactions raised the Fund's holdings of rand to the equivalent of SDR 1,431 million (225 per cent of quota). Although South Africa has remained fully in compliance with the performance criteria of the stand-by arrangement, it has not made any further purchases under the arrangement because of the improvement in its external position, and the Fund's holdings of rand have remained at 225 per cent of quota. South Africa has consented to the increase in its quota, under the Eighth General Review from SDR 636 million to SDR 915.7 million. Further details of the Fund's relations with South Africa are provided in Appendix I.

As part of the midterm review of the stand-by arrangement, understandings are required to be reached with the South African authorities by July 31, 1983 on exchange rate policy for the remaining period of the stand-by arrangement and on the removal of the import surcharge. The authorities' intentions on exchange rate policy, which are consistent with the original government Memorandum on Economic Policies, are described in sections IV and V. The import surcharge which came into effect in February 1982 at a rate of 10 per cent was reduced to 7 1/2 per cent in December 1982 and to 5 per cent in February 1983. The Government, which has committed itself to eliminating the surcharge before the end of 1983, is expected to communicate the schedule for its removal to the Fund, prior to the Board consideration of this report. In light of the substantial improvement in South Africa's external payments position, the authorities have indicated that they do not intend to request further purchases under the stand-by arrangement at the present time.

II. Economic Background

During 1979-80 external circumstances and domestic financial policies combined to initiate an unprecedented surge in domestic expenditure in South Africa (Chart 1). Between 1978 and 1980, the price of gold in terms of SDRs trebled and this added some SDR 6 1/2 billion to South Africa's annual export earnings from gold. The rise in gold receipts tended to mask the current account effects of an adverse shift in the nongold terms of trade over the period and the deterioration in nongold trade performance from the latter part of 1979. The current account surplus rose from SDR 1 1/4 billion in 1978 to SDR 3 billion in 1980. In view of widespread controls on capital outflows, part of the large current account surplus in 1980 was bottled up in the domestic economy and, with monetary policy aimed at sustaining the rapid growth in demand, the rate of growth of broad money (M3) accelerated from 15 per cent in 1979 to almost 24 per cent in 1980. Nominal interest rates also fell for much of the period and were far below those on similar assets in the major overseas capital markets. Over the same period, the rate of increase in consumer prices was relatively high and rising, so that real rates of interest remained substantially negative. While fiscal policy looked relatively austere by conventional measures--the deficit in the financial year 1980/81 1/ fell to less than 1/2 per cent of GDP from 3 1/4 per cent in 1979/80--this was due mainly to a large increase in tax and lease revenues from gold mining companies that was less than fully offset by tax concessions. The contraction of the budget deficit was insufficient to counter the expansionary thrust from monetary policy and external payments developments.

In 1981 the external situation deteriorated rapidly. The gold price fell to US$460 per fine ounce from US$608 in 1980 and, owing partly to the recession abroad, the volume of South Africa's nongold exports declined by 10 per cent. Although the rand was allowed to depreciate in

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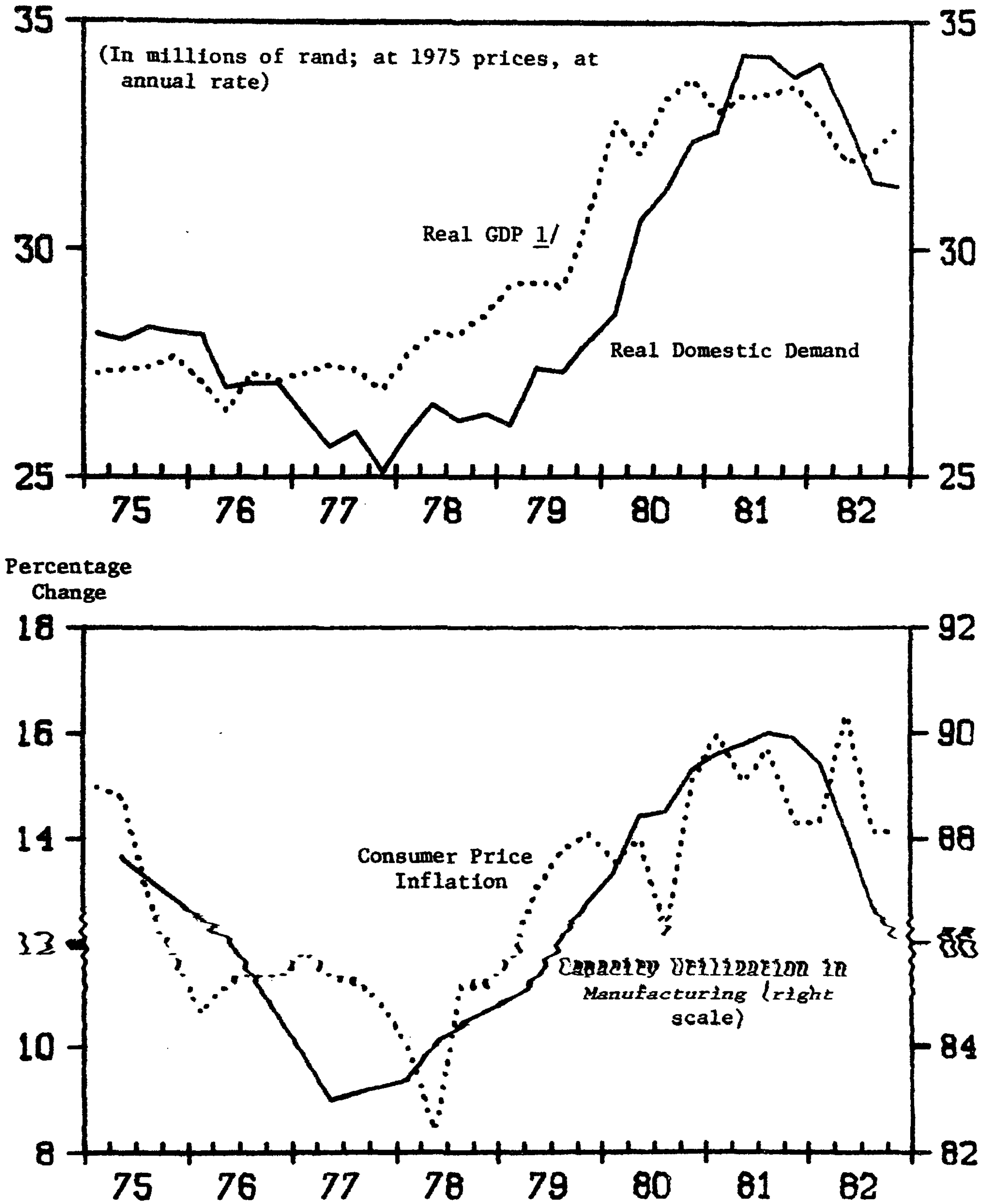
1/ The financial year runs from April to March.

CHART 1

SOUTH AFRICA

DEMAND, SUPPLY, AND INFLATION



Source: South African Reserve Bank, Quarterly Bulletin.

1/ Adjusted for changes in the terms of trade.

effective terms during the year, financial policies initially sought to shelter the domestic economy from these influences. Real domestic demand rose by a further 10 per cent in 1981, so that over the two-year period 1980-81 it increased by about a quarter, with a corresponding surge of about 40 per cent in import volume. By 1981, however, as capital and skilled labor constraints became binding, the growth in demand could only partly be met by increased domestic production. Inflationary pressures intensified and the balance of payments weakened precipitously. The rate of growth of real GDP fell from 8 per cent in 1980 to 5 per cent in 1981, and consumer price inflation accelerated from 12 per cent in the third quarter of 1980 to 16 per cent in the first quarter of 1981. The external current account swung from a surplus equivalent to almost 5 per cent of GDP in 1980 to a deficit of similar proportion in 1981, with the turnaround amounting to about SDR 6 1/2 billion (Chart 2). Increased capital inflows were far from sufficient to offset these current account developments and the overall payments position weakened by some SDR 3 billion.

From the latter part of 1981, the Government set about altering the stance of policy from accommodation to adjustment. In its attempt to tighten monetary policy, however, it faced a number of impediments. First, there were constraints on interest rate policies. The Government, aware of the sensitivity of important sectors such as agriculture and residential construction to interest rates, was loathe to allow too rapid a rise in certain key interest rates. There was a reluctance to allow yields on government securities to rise to a level sufficient to attract private subscriptions. As a result, purchases of these securities by the nonbank public (including nonbank financial intermediaries) in 1981 were substantially lower than had been anticipated in the budget, and the shortfall was made up by increased direct Reserve Bank financing of government operations. Second, the banking sector had easy access to official rediscounting facilities. Third, large bouts of disintermediation and reintermediation had affected the growth rates of the various monetary aggregates and had led to uncertainties in interpreting these data. Finally, the Reserve Bank had at times set forward exchange rates calculated to encourage short-term capital inflows. This had contributed to a substantial imbalance in the forward exchange book of the Reserve Bank and to large losses on forward exchange transactions that had automatically been monetized.

Although some progress was made in tightening demand management in late 1981, these impediments to monetary policy limited the success of the adjustment effort. Interest rates were raised, but most rates remained negative in real terms throughout the year (Chart 3). Domestic credit increased by almost 40 per cent and, despite the contractionary effects of the external payments deficit, broad money rose by 20 per cent. Fiscal policy in 1981/82 was also unduly accommodating. The budget deficit rose sevenfold to 2 3/4 per cent of GDP, largely as a result of lower gold mining tax and lease revenues.

By early 1982, around the time of the Article IV consultation discussions, the need for urgent measures to stabilize the economy became widely accepted. On the monetary front, the authorities commenced a series of actions designed to increase interest rate flexibility and improve monetary control. For the first time, government bonds were sold by tender at market-determined yields and Treasury bill rates were allowed to rise in response to market forces to the point where they were attractive to nonbank subscribers. The traditional link between the banks' prime overdraft rate and the Bank rate was broken and the prime rate rose sharply, reaching 20 per cent in March 1982. Both rediscounting operations and collateralized overnight loans from the Reserve Bank were discouraged by punitive interest rate penalties. Usury ceilings on lending rates were raised substantially. In midyear, rates on Land Bank lending to the agricultural sector were increased and the concessional element in these rates was substantially reduced. The Reserve Bank also moved away from its policy of using forward exchange rates to influence short-term capital movements, and, in the latter half of the year, adopted a neutral policy (setting forward rates to reflect interest rate differentials) in an attempt to achieve a more balanced forward book. These changes greatly improved the scope for effective control of monetary developments.

Even before the end of the 1981/82 fiscal year, it had also become apparent that additional budgetary restraint was required. To meet this need, in February 1982 the authorities raised the general sales tax from 4 to 5 per cent and imposed a 10 per cent surcharge on imports not subject to GATT bindings. The budget for 1982/83 continued the movement toward greater restraint and better coordination between fiscal and monetary policy. The Government undertook to finance the budget deficit entirely from nonbank sources so as to facilitate monetary control. Tax measures in the budget, together with the measures that were introduced shortly before the budget, were calculated to increase nongold revenues by the equivalent of more than 2 per cent of GDP. Additional measures were put in place in the third quarter of 1982. In September, prior to the request for use of Fund resources, the Government raised the general sales tax by an additional percentage point to 6 per cent. Shortly thereafter, in October, it was announced that the import surcharge, which had been regarded as a temporary revenue-raising measure, would be reduced by 2 1/2 percentage points in January 1983. 1/

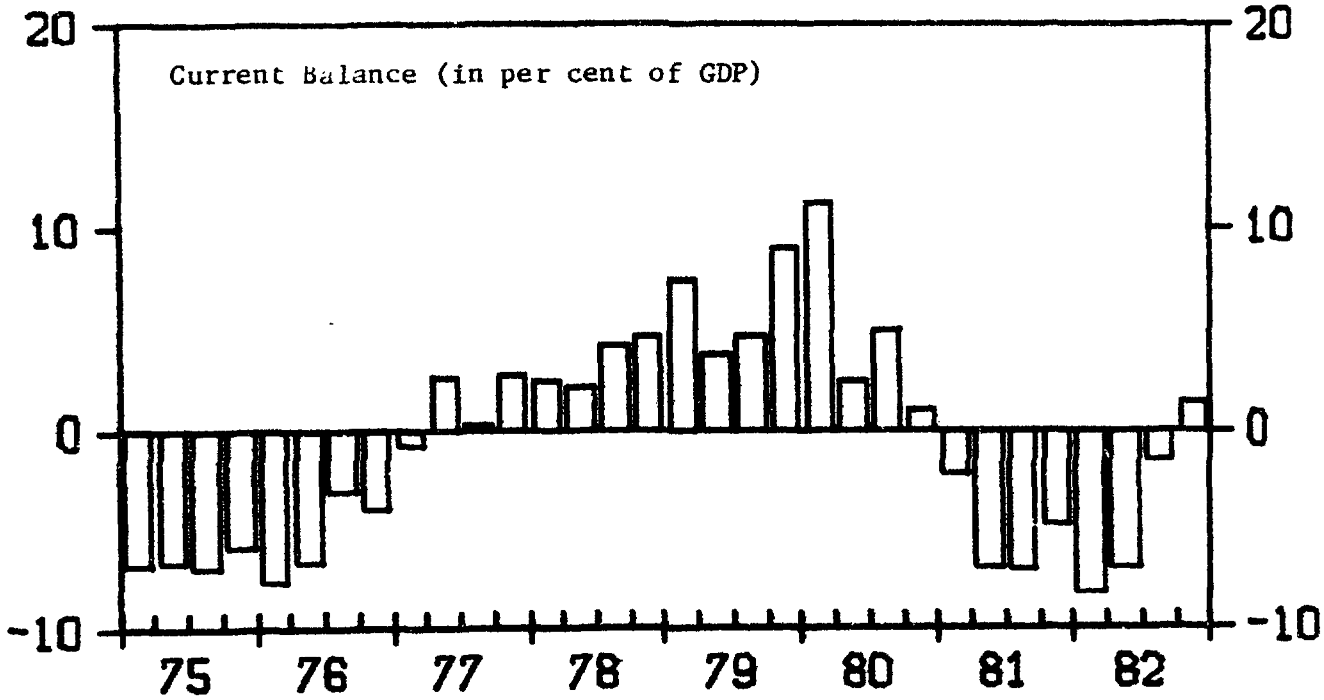
By the third quarter of 1982, it was clear that the South African authorities had embarked on a determined stabilization program. The groundwork had been carefully prepared: the substantial deregulation of interest rates and the enhanced monetary and fiscal control facilitated the effort to adjust the economy rapidly to the deterioration in the external circumstances. Fiscal and monetary policies were supported by continued exchange rate flexibility. From December 1981 through September 1982, the rand depreciated by some 17 per cent against the U.S. dollar, and by almost 6 per cent in effective terms (Chart 4).

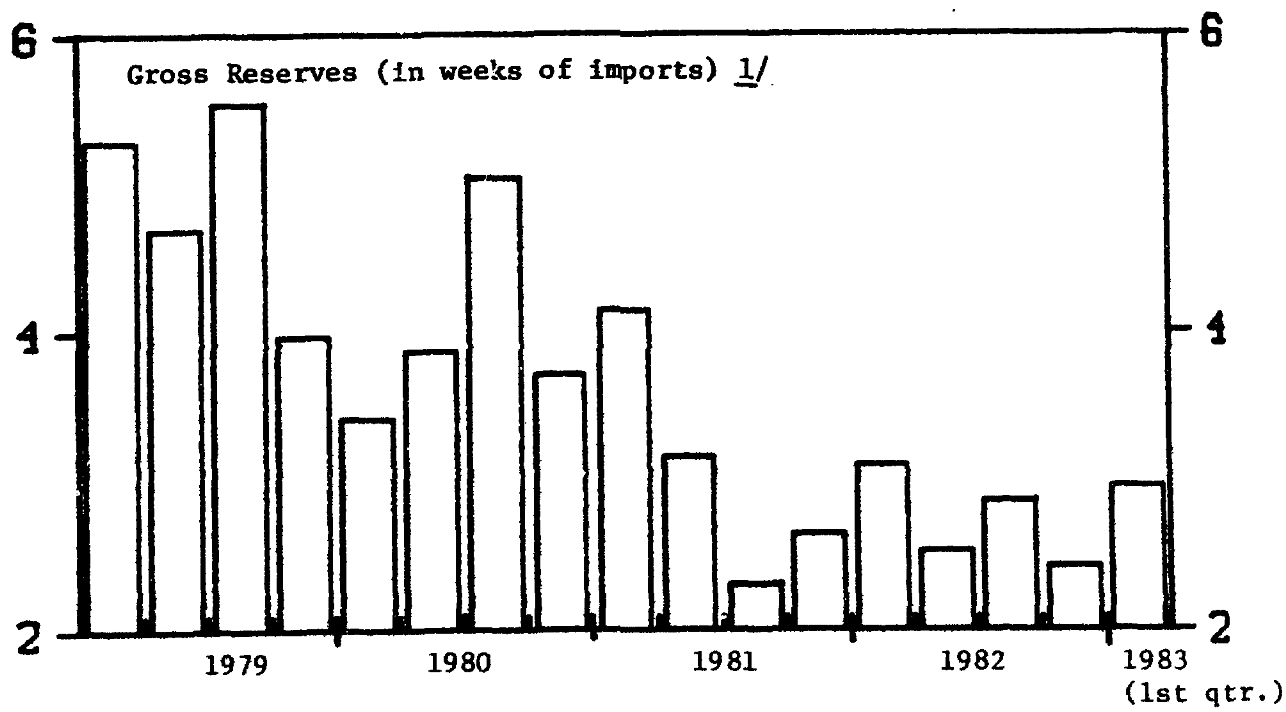
1/ The reduction was subsequently brought forward to December 1982.

CHART 2

SOUTH AFRICA

BALANCE OF PAYMENTS INDICATORS





Sources: South African Reserve Bank, Quarterly Bulletin; and IMF, International Financial Statistics.

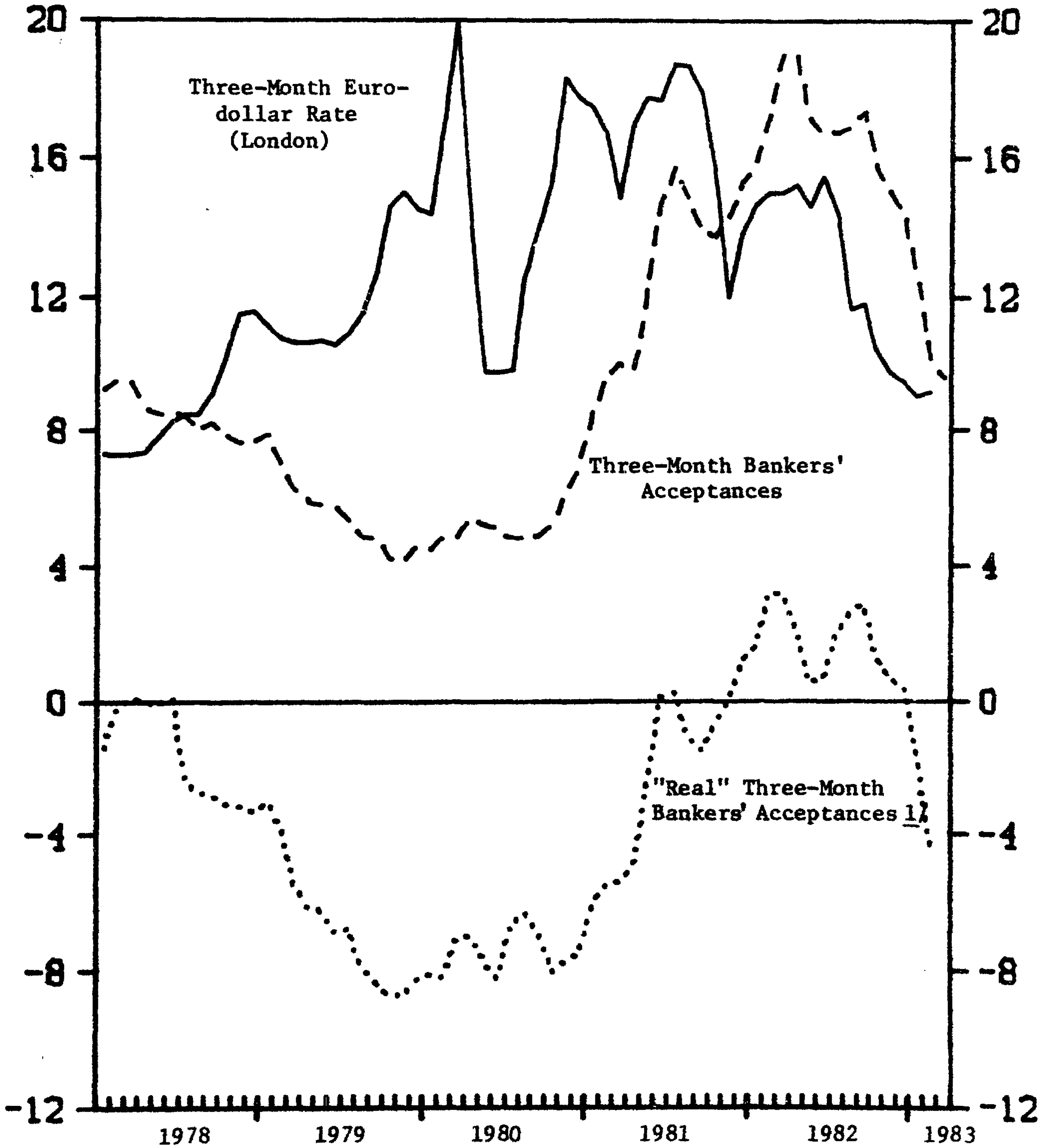
1/ Gold valued at SDR 35 per fine ounce.

CHART 3

SOUTH AFRICA

INTEREST RATE DEVELOPMENTS

(Per cent per annum)



Sources: South African Reserve Bank, Quarterly Bulletin; and IMF, International Financial Statistics.

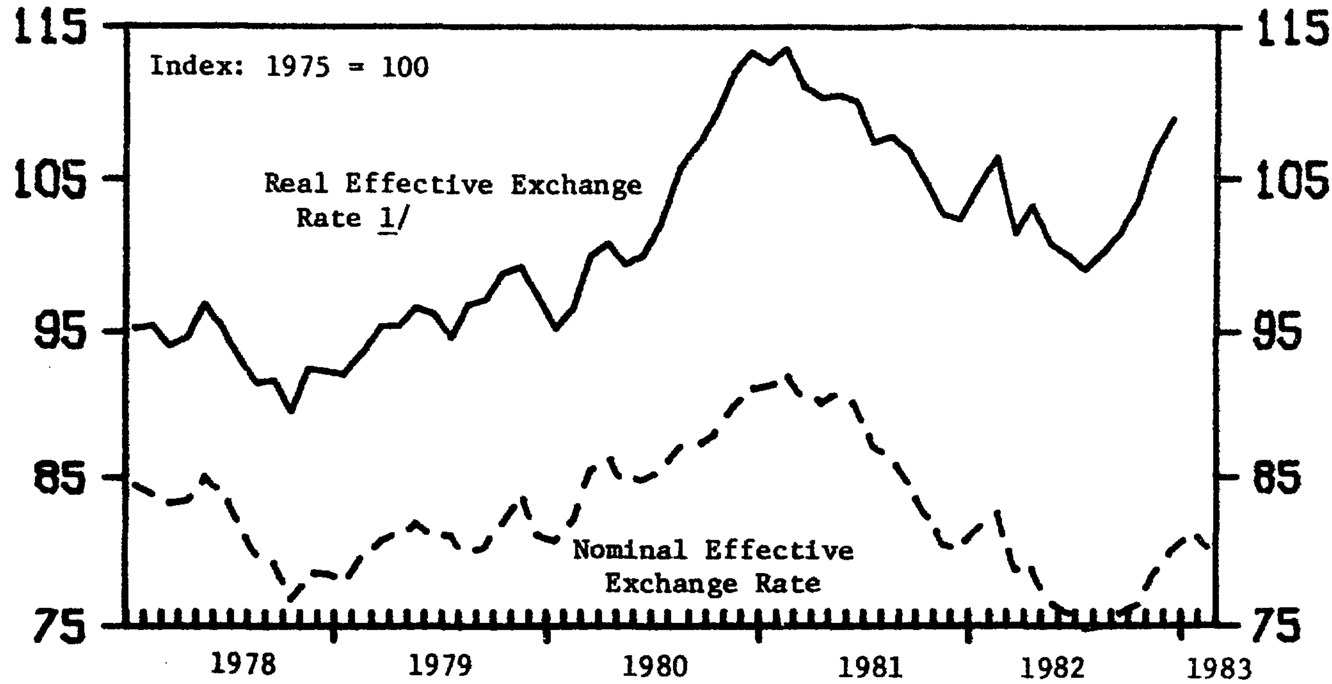
1/ Deflated by the consumer price index.

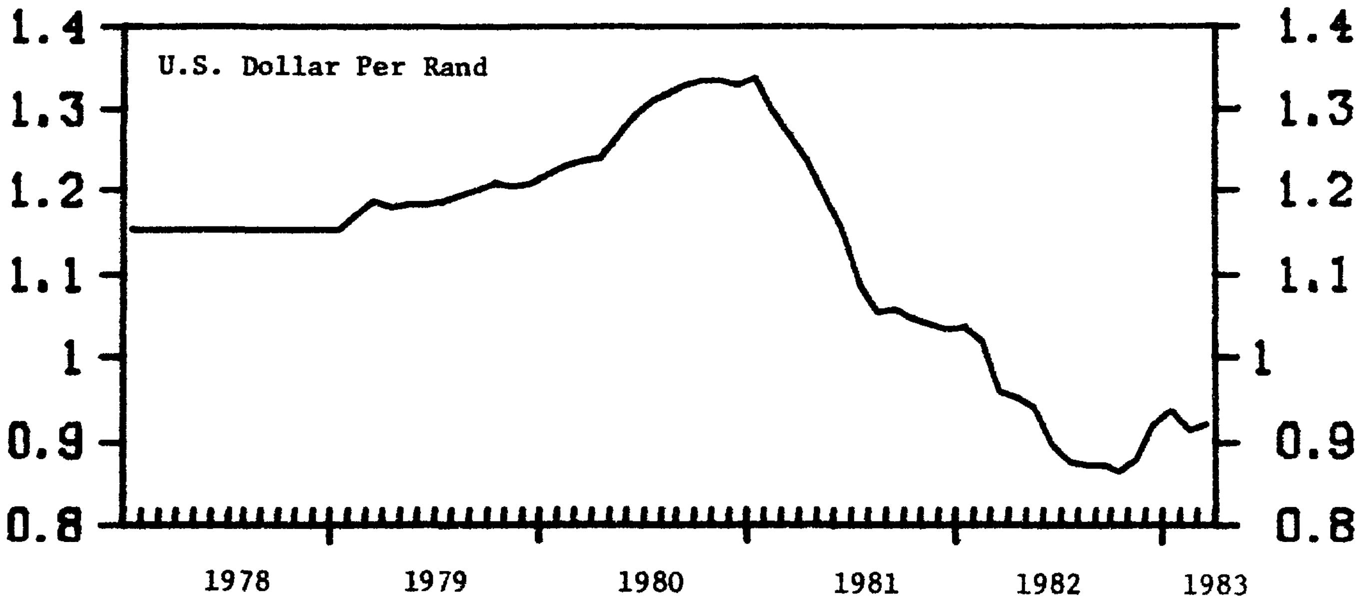
CHART 4

SOUTH AFRICA

EXCHANGE RATE DEVELOPMENTS

(1975 = 100)





Sources: IMF, International Financial Statistics; and staff calculations.

1/ Wholesale prices in South Africa relative to those of major trade partners, adjusted for exchange rate changes.

The stabilization program was put in place against the backdrop of an extremely unfavorable external environment. In the first half of 1982, the price of gold continued to decline and prices of most other major exports remained weak. Despite a decline in the volume of imports and some strengthening of the capital account, the large external deficit persisted, forcing the authorities to increase their foreign borrowing. By mid-1982 official short-term foreign liabilities had risen to SDR 1.8 billion from practically zero 18 months earlier, and all foreign loan facilities available to the Reserve Bank had been fully utilized. Over the same 18-month period, gross official reserves had fallen by SDR 258 million, despite substantial recourse to gold swaps, and the net foreign asset position of the commercial banks had worsened by almost SDR 2 billion. By mid-1982 gross official reserves (with gold valued at SDR 35 per ounce) amounted to SDR 736 million, that is, about two and a half weeks of merchandise imports. On a market valuation of gold, reserves stood at SDR 2.7 billion, equivalent to nine weeks of imports. The rapid buildup of short-term foreign debt, coupled with a persistent weakness of the gold market, severely undermined South Africa's ability to raise additional loans abroad.

III. The Financial Program and Performance Under the Stand-By Arrangement

1. The financial program

The program in support of which the stand-by arrangement was approved was designed to ensure the attainment of a viable balance of payments position in 1983, even if the unfavorable external circumstances were to persist. For this reason, the staff suggested that it should deliberately be based on a conservative assumption regarding the price of gold, that is, US$315 per ounce, which was the average price in June 1982. The program provided for: (a) a marked deceleration in the pace of domestic credit expansion from 38 per cent during 1981 to 23 per cent during 1982 and 13 per cent during 1983; (b) a decline in the rate of growth of net credit to government from 52 per cent during 1981 to 34 per cent during 1982 and 6 per cent during 1983; (c) a containment of the budget deficit to R 2.4 billion (or some 2 3/4 per cent of GDP) in 1982/83 and to about R 2 billion (around 2 per cent of GDP) in 1983/84; (d) the phasing out during the program period of the import surcharge and the avoidance of any new restrictions on trade or payments for current international transactions; and (e) sufficient flexibility in exchange rate policy to respond to changes in the external environment.

At the time that the program was formulated, the external current account deficit for 1982 was projected at about 6 per cent of GDP on the basis of the program assumptions and in light of the fact that in the first half of the year the deficit exceeded 7 1/2 per cent of GDP; the objective of the program was to reduce this deficit to the equivalent of 2 per cent of GDP in 1983. The attainment of this objective was sought chiefly by traditional demand management--that is, the pursuit of tight monetary and fiscal policies--which was also expected to dampen the rate of inflation. Nevertheless, owing partly to required adjustments in administered prices, consumer prices were projected to rise by 15 3/4 per cent and 14 per cent in 1982 and 1983, respectively.

Given the external payments projections, the growth of broad money was projected to fall from 20 per cent in 1981 to 12 per cent in 1982 and further to 10 per cent in 1983. It was understood that monetary and credit control would be attained by means of the conventional instruments to limit the growth of the monetary base and not by quantitative restrictions on the lending of commercial banks, which had, in the past, led to widespread distortions in financial flows. In formulating the financial program, two items which the program sought to constrain were defined as components of net credit to government. Forward exchange losses incurred by the Reserve Bank on behalf of the Government were included under the subceiling on net credit to government, and account was taken only of those losses resulting from existing contracts. Exchequer foreign borrowing was also included under the subceiling to preclude the possibility that the financial constraint on fiscal policy be undermined by excessive government borrowing abroad to finance domestic expenditure. The arrangement placed no ceiling explicitly on government and government-guaranteed external debt, as external debt service, projected at about 8 per cent of exports of goods and services, was comparatively low. However, foreign borrowing of only R 300 million was allowed for under the subceiling on net credit to government. No recourse by the Government to the banking system for ordinary budgetary finance was allowed for in the program. In addition to the undertakings related to government borrowing and the overall budget deficit, the authorities intended to limit the growth of government expenditure to 14 per cent in 1982/83--that is, a projected reduction in real terms--and to further reduce expenditure in real terms in 1983/84.

Until recently, South Africa operated a dual exchange rate system with equity investment by nonresidents eligible to use the discounted financial rand exchange rate while current transactions took place at the commercial rand exchange rate. The text of the stand-by arrangement explicitly allowed for the transfer of transactions from the financial to the commercial rand market in the hope that the external position would strengthen sufficiently to allow the authorities to progress toward a unified exchange rate system during the stand-by period. In addition, the arrangement included the customary provisions with respect to the trade and exchange system and provided for a review of the progress of the program before July 31, 1983.

2. Performance under the stand-by arrangement

The external payments objectives of the stabilization program have been realized much more quickly than was expected at the time of the stand-by negotiations. This has been due principally to a higher price of gold than had been assumed, but also to a better performance on the nongold trade and services accounts. The current account deficit in

1982 amounted to SDR 2 1/2 billion as against the SDR 4 billion projected (Table 1). Larger earnings from gold accounted for about SDR 1.1 billion of the discrepancy, with lower imports and a smaller negative balance on services, each accounting for about SDR 200 million. The turnaround in trade volumes during the year was dramatic (Chart 5): nongold export volume was flat in the second half of 1982 after a fall of almost 6 per cent at a seasonally adjusted rate in the first half; import volume, after falling at a rate of almost 4 per cent in the first half, fell further at a rate of over 21 per cent in the second half. On a seasonally adjusted basis, the current account swung from a deficit equivalent to 7 1/2 per cent of GDP in the first half of the year to a position of near balance in the second half.

The capital account also strengthened markedly in the latter half of the year. In particular, after the sharp depreciation of the rand and the rise in interest rates, there were large inflows of short-term capital on an uncovered basis in response to the favorable interest rate differential and widely held expectations of an appreciation of the rand. The capital account surplus rose from under SDR 0.5 billion in the first half to over SDR 1.6 billion in the second half. However, part of the improvement in net short-term capital inflows (which saw a turnaround of almost SDR 1.4 billion from the first to the second half) was due to a switching from below-the-line covered foreign borrowing by banks to above-the-line borrowing through the banks by the nonbank private sector.

Overall, the balance of payments swung from a deficit of SDR 2 billion in the first half of 1982 to a surplus of some SDR 1 1/2 billion in the second half of the year. The surplus remained large in the first two months of 1983. The authorities were thus able to repay nearly all of their outstanding foreign short-term liabilities (which had exceeded the equivalent of SDR 1.5 billion in mid-1982) and to rebuild gross reserves from a low of SDR 503 million in October 1982 to SDR 1,307 million (five weeks of imports) in February 1983. In March, however, reserves fell sharply, reflecting a substantial worsening of the capital account, though they rose again in April to SDR 949 million.

The virtual collapse of imports in the second half of the year reflected the weakening of aggregate demand in the economy in response to the program of financial austerity (Table 2). Real domestic expenditure fell in 1982 by almost 4 per cent, about twice as much as had been projected in the stabilization program, and GDP declined by 1 per cent. The rate of growth of private consumption was reduced from 6 1/2 per cent in 1981 to 2 per cent in 1982. Fixed investment fell by 2 1/2 per cent in 1982 and the turnaround in the inventory cycle, in itself, reduced domestic demand by about 6 1/2 per cent. Capacity utilization in manufacturing fell sharply and unemployment increased.

Despite the weakening of demand, shortages of skilled labor did not ease substantially and wage-cost performance was unsatisfactory. The rise in unit labor costs in manufacturing accelerated from 16 per cent in 1981 to 21 1/2 per cent in 1982, owing partly to a slower rate of increase in productivity. Consumer prices, however, rose by 14 3/4 per cent in 1982, about 1 percentage point less than projected at the time of the stand-by negotiations. The rate of increase of administered prices, which account for about 25 per cent of the consumer price index, was much higher, at 16 1/2 per cent. In addition, the two 1 percentage point increases in the general sales tax in 1982 each added about 3/4 per cent to the index. The production price index rose by less than 14 per cent. Given weak demand conditions, higher unit labor costs served chiefly to lower profit margins rather than to raise output prices. Also, with the depreciation of the rand, prices of imported goods rose more rapidly than those of domestically produced goods; this reversed the pattern of the previous year and was consistent with the resource allocation objectives inherent in the program.

Domestic credit expansion during 1982 and the first quarter of 1983 was well below the ceilings set in the program (Table 3). Credit to the private sector grew at about the rate projected, but the rate of growth of net credit to the Government, programmed to decline from 52 per cent in 1981 to 34 per cent in 1982, in fact fell to only 5 per cent in the latter year. During the fiscal year 1982/83, net credit to the Government as defined in the stand-by fell by R 259 million (4 1/2 per cent); within this total, forward exchange losses on the government account increased by R 1,278 million, and Exchequer foreign borrowing amounted to R 129 million. Net bank credit to government in the conventional sense, therefore, was reduced by R 1,666 million during the fiscal year. Developments in credit to the Government reflected substantial overfunding of the government deficit, in an attempt to absorb liquidity, and contributed to limiting the growth of total domestic credit to only 12 per cent as against the 20 per cent allowed for under the ceiling. Nevertheless, the considerable unanticipated improvement of the net foreign asset position of the banking system led to a faster-than-projected expansion of the monetary aggregates. Broad money grew by 14 1/2 per cent during 1983 and accelerated to 16 per cent in the year to March, compared with projected growth rates of 12 and 11 1/2 per cent, respectively. The authorities evinced concern at these monetary growth rates and the perennial problem of maintaining monetary control in the face of large unanticipated swings in the external position was a principal focus of the policy discussions.

The budget deficit in 1982/83 turned out much as expected at R 2.3 billion (2.8 per cent of GDP). Both revenue and expenditure rose more rapidly than projected in the stand-by arrangement (Table 4). Total government revenues rose by 19 per cent as against the 13 1/2 per cent projected in the stand-by paper. Of the discrepancy of R 0.8 billion, about R 450 million was due to higher tax and lease receipts from gold mining companies and the remainder mainly to more buoyant personal income taxes than had been expected.

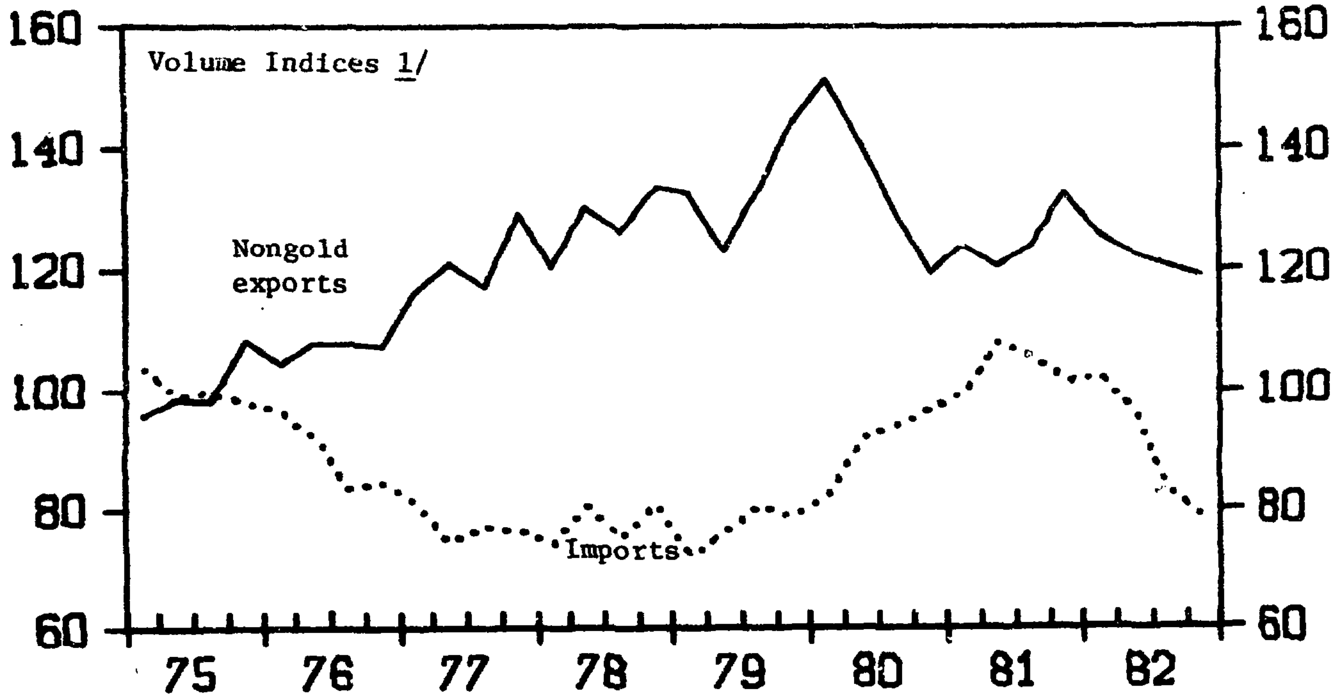
Expenditure exceeded the stand-by estimate by R 740 million. Of this, some R 230 million represented a transfer to the Special Defense Account; about R 80 million was on account of drought relief to farmers, suffering the worst drought in 20 years; and another R 80 million was

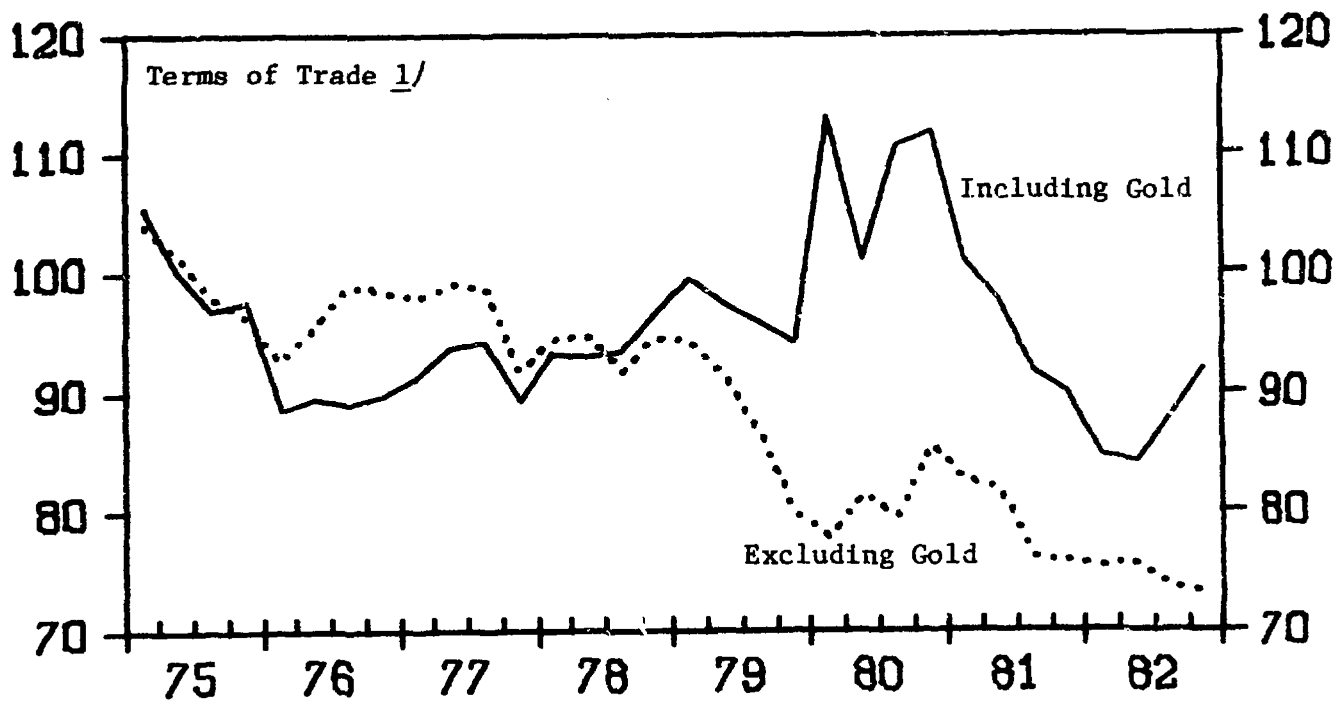
CHART 5

SOUTH AFRICA

EXPORT AND IMPORT PERFORMANCE

(Indices 1975 = 100)





Source: South African Reserve Bank, Quarterly Bulletin.

1/ Based on National Accounts Statistics.

due to the additional interest payments related to overfunding the government deficit for monetary control purposes. Subsidies on basic transport services for Blacks were higher by R 46 million and aid to Black homelands by R 45 million. Other factors included underestimates of the public sector wage bill (R 84 million), 1/ subsidies on state-assisted housing for civil servants (R 28 million), and a host of other minor items.

The interest cost of servicing the public debt was some R 270 million higher than budgeted, although most of this had been anticipated in the stand-by estimates. Much of it was due to the overfunding of the budget deficit which had been undertaken in order to facilitate monetary control. Toward the end of the fiscal year, there was a virtual halt in this overfunding, owing, in part, to a fear that continued debt sales would raise expenditure in 1983/84 and frustrate the realization of the fiscal objectives of the stabilization program. This lull in debt sales contributed to an acceleration of monetary growth and a steep fall in interest rates. 2/ The mission took the view that, insofar as higher debt service costs were due entirely to actions related to monetary control, they constituted a transfer rather than a drawing on the resources of the country and ought not to be limited by the conventional concerns about government spending. 3/

With respect to external policies, the authorities have taken further action to promote their longer-term objective of allowing the exchange rate of the rand to be determined flexibly in response to market conditions. In particular, in the light of the improvement in South Africa's external financial position, it proved possible to abolish exchange controls on nonresidents much earlier than previously expected, and thus to unify the dual exchange market in February 1983. At the same time, exchange controls on residents were eased. After a brief period of uncertainty, these measures had the welcome side effect of arresting the upward pressure on the rand in the exchange markets and, together with resumption of open market operations by the authorities, they have contributed to some firming of interest rates in March-April 1983.

The progress made to date in reducing the import surcharge has been more rapid than envisaged at the time of the stand-by arrangement discussions. There have been no other changes in South Africa's trade policies. In particular, there has been no recourse to quantitative restrictions in order to limit imports, and at present only about 10 per cent of total imports are subject to the specific license requirement. The authorities

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1/ The overrun on the public sector wage bill reflected greater success than had been expected in filling existing vacancies.

2/ By early March 1983, the prime overdraft rate had fallen to 14 per cent and the 90-day bankers' acceptance rate to below 10 per cent.

3/ It is worth noting that higher debt service costs, to the extent that they result from efforts to neutralize the liquidity effects of the external surplus, tend to be offset by the increased earnings on foreign reserves, though the latter initially accrue to the Reserve Bank rather than the Exchequer.

also noted that the EC had imposed quotas on South African exports of steel and certain agricultural products, but the impact of these measures was not thought to be very significant.

Since the mid-1970s, South Africa has followed a prudent external debt management policy aimed at restricting its direct official borrowing abroad and limiting the issuance of official external debt guarantees to the financing of infrastructural projects by public sector entities. For 1982 South Africa's debt service burden (including interest on short-term debt) amounted to about 7 1/2 per cent of goods and nonfactor services. Given the substantial repayment of official short-term debt and the declining trend in international interest rates, the debt service ratio is expected to fall in 1983 (Table 5).

IV. Policy Discussions and the Short-Term Economic Outlook

Despite the improvement in South Africa's external circumstances and the prospect that further purchases under the stand-by arrangement might be unnecessary, the authorities held the view that continued financial restraint was essential in order to help dampen domestic cost and price pressures and build a sound basis for a resumption of growth. They therefore reaffirmed their resolve to pursue policies consistent with their intentions at the time of the stand-by arrangement. The authorities recognized that the recovery in the price of gold, which had contributed importantly to the rapid turnaround in the balance of payments position, had eased the external constraint to growth. Nevertheless, they took the view that financial planning for the year ahead should continue to be based on conservative assumptions about the external environment. The need for a cautious approach in framing policies was underscored at the beginning of the mission, when the gold price fell to US$408 from US$509 per fine ounce two weeks earlier (Chart 6).

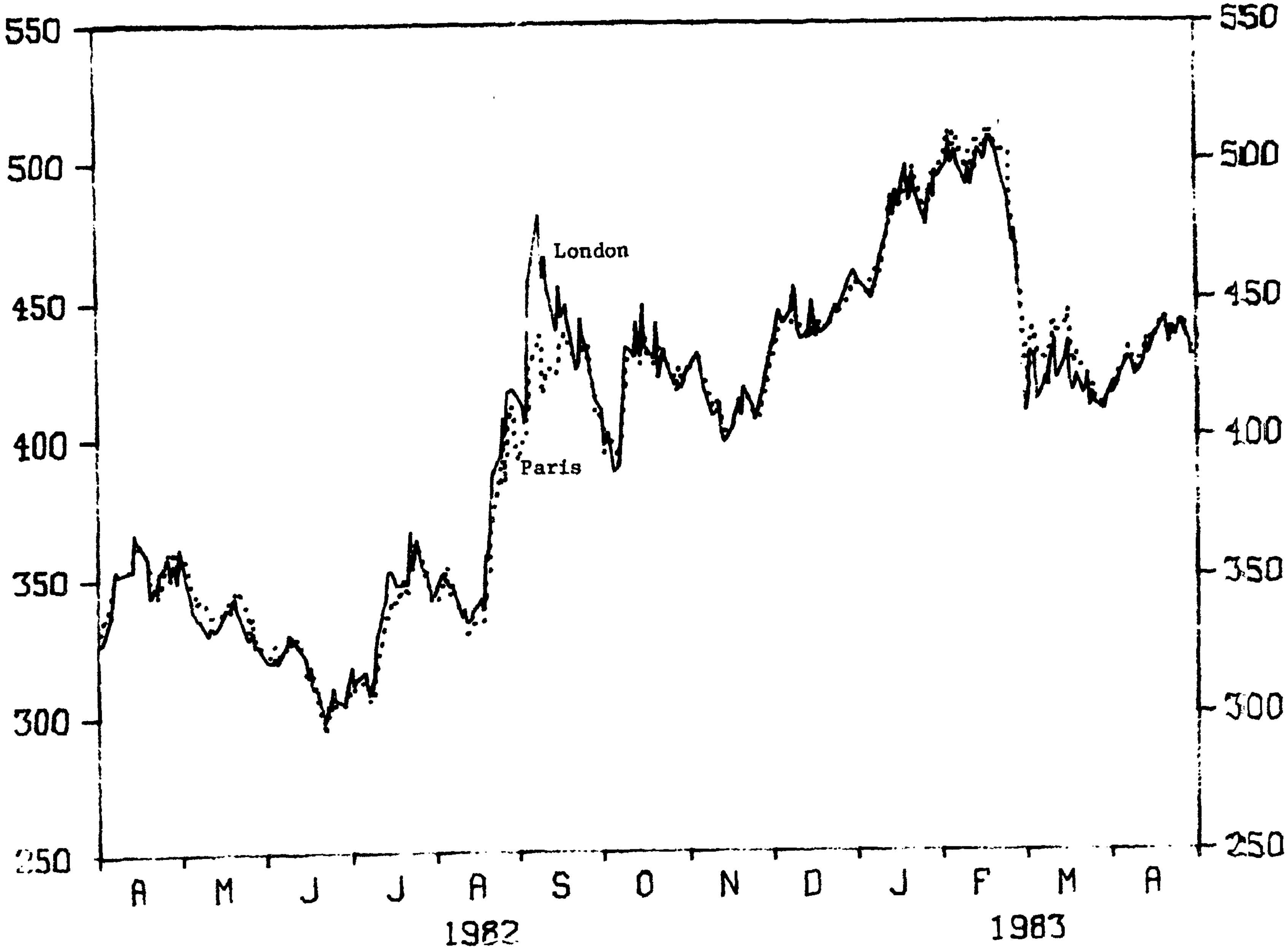
The rapid progress in strengthening the external payments position had itself created new dilemmas for the conduct of policies in 1983. First, although the rand had depreciated in nominal effective terms by 10 1/2 per cent in 1982, in real terms--that is adjusted for relative wholesale price inflation--it had fallen by only 5 per cent. Moreover, in both real and nominal terms the rand had appreciated sharply during the second half of the year and in the first few weeks of 1983. Clearly, this appreciation had contributed to a decline in the competitive position of nongold industry and could hinder the diversification of the production base over the medium term. At the same time, the large external surplus had compounded the problem of maintaining control over the growth of the monetary aggregates; this problem could not be effectively resolved without a substantial degree of flexibility in the management of the exchange rate. Second, with the external constraint visibly eased, there were pressures to move to a more reflationary fiscal stance. Given the relatively high rate of inflation that persisted, however, the Government's view was that the initial objectives set out in the stand-by paper remained broadly appropriate. Third, with somewhat brighter prospects

CHART 6

GOLD PRICES IN LONDON AND PARIS

April 1982-April 1983

(In U.S. dollars per fine ounce)



for the world economy and the possibility of a resumption of growth, increased attention had to be paid, within the overall policy of restraint, to the longer-term problems of alleviating the principal domestic supply constraints. These three problem areas constituted the principal themes of the policy discussions.

1. External policies

With the rapid transformation of the balance of payments outlook, the authorities have moved to reorient their short-term external policies. In a general way, the focus of policies has shifted from enforcing balance of payments adjustment--by means of financial austerity and a depreciating rand--to dealing with the problem of curbing the growth in domestic liquidity generated by large inflows from abroad. This shift was reflected in the recent appreciation of the rand (to about 6 per cent, in trade-weighted terms, between September 1982 and February 1983) and the abolition of capital controls for nonresidents together with some relaxation of controls for residents.

The authorities shared the mission's view that a flexible exchange rate policy was necessary for effective control of the money supply which, in turn, was essential to reducing price and cost inflation. For as long as the price of gold was strong and expected to rise, exchange rate flexibility was likely to imply further upward pressure on the rand. This prospect was viewed with some concern, particularly in the light of South Africa's poor cost and price performance relative to its main trade partners, as it tended to undermine the competitive position of the non-gold sector. Nevertheless, the authorities believed that a sustainable improvement in competitiveness could not be achieved by maintaining the rate at a level that was perceived to be artificially low, since this would generate additional inflationary pressures by swelling the domestic money supply. The problem of competitiveness in these circumstances could only be resolved over time through the pursuit of restrictive financial policies designed to curb domestic cost and price increases. However, steps could be taken to improve further the functioning of the exchange market with a view to dampening the wide fluctuations in the exchange rate stemming from the variability in the external terms of trade.

In this context, the authorities noted that, although the decision to lift exchange control on nonresidents and unify the exchange system for the rand was not viewed as a short-term stabilization measure, it had broadened the scope for equilibrating capital flows. It was therefore hoped that it would ease the upward pressure on the rand. Initially this hope did not materialize, but after the decline in the price of gold in late February evidence of considerable outflows of capital by nonresidents began to accumulate and the tendency of the rand to appreciate stopped. This had eased the conflict between competitiveness and monetary restraint, though the problem could re-emerge. The authorities were therefore exploring the scope for further steps to broaden the exchange market. In particular, they were reviewing the feasibility of the Reserve Bank's withdrawal from the market for the purposes of routine gold-related transactions, by paying gold mines directly in U.S. dollars, and of reducing the Reserve Bank's involvement in the forward market by encouraging the banking sector to undertake the required transactions themselves. The improved functioning of the exchange market could help reduce the fluctuations in the exchange rate emanating from the instability in the terms of trade. In addition, the authorities noted that the high marginal rates of taxation of gold mines, coupled with the policy of overfunding the budgetary deficit at times of high gold prices and freezing the proceeds in a stabilization account at the Reserve Bank, provided an appropriate mechanism for, at least partial, insulation of the domestic economy. The authorities recognized that this mechanism could be strengthened and emphasized in this connection that a review of gold mines' taxation was being undertaken.

The authorities stressed that, with the replacement of administrative capital controls by indirect market-related instruments, there was a need for a higher level of foreign reserves to deal with the increased volatility of capital flows. In this connection, the present reserve position was regarded as relatively low. The authorities also indicated that they intended to continue their gold marketing policy of selling the full gold production, but not necessarily over a short period of time.

2. Monetary policy

With the recent improvement in the mechanics of monetary control, the authorities were able to implement short-run demand management policies in an integrated fashion, placing special emphasis on coordinating monetary policy with exchange rate and fiscal policies. In 1982 this increased coordination had been exemplified in the strategy of overfunding the budget deficit, allowing the exchange rate to respond flexibly to market forces, and controlling bank liquidity through changes in interest rates designed to discourage banks from seeking recourse to the Reserve Bank. A similar mix of policies would be applied in 1983 with attention focused on the need to reduce inflation; it was essential that an unambiguous signal be sent to the private sector that inflationary wage demands would not be accommodated by financial policy. While credit expansion would probably be contained well within the ceilings specified for total domestic credit and net credit to government, monetary growth might exceed the 10 per cent rate projected for broad money, as the recovery in the price of gold had led to an increase in the demand for liquid balances. It was intended, however, to ensure that the growth in the broad monetary aggregates be contained within the 10-14 per cent range which was thought to be consistent with downward pressure on inflation.

It was clear that open market sales of government debt, even if carried out to the full extent of the Government's ability to sell paper, could not alone ensure monetary control. As indicated by the short-term capital flows and interest rate movements around the turn of the year, it was not feasible to follow an interest rate policy independent of that in major trading partner countries unless exchange rates were free to move accordingly. While the rand was perceived to be undervalued, it had been impossible to offset the monetary effects of short-term interest-rate-induced capital inflows. Only when the rand had reached a level where there was perceived to be some risk of depreciation, were the authorities able to pursue domestic interest rate policies that were not completely dependent on external developments. Even then, however, the degree of autonomy was limited given the interdependence of exchange rates and interest rates and the volatility of exchange rate expectations, which were very sensitive to changes in the direction of movement of the price of gold.

3. Fiscal policy

The memorandum on economic policy attached to the stand-by paper set out three objectives for fiscal policy in 1983/84: government spending should decline in real terms, the budget deficit should be limited to about R 2 billion, and this deficit should be financed entirely by non-bank borrowing. On the basis of the gold price assumption underlying the financial program, it was thought that further tax measures might be necessary to achieve these objectives. At the time of the review mission, in view of the continuing high rate of inflation, the South African authorities believed that these objectives remained broadly appropriate and, moreover, that the intentions expressed in the earlier memorandum provided a useful constraint on fiscal policy. They pointed out, however, that domestic demand had fallen much more rapidly than had been expected and that the balance of payments constraint had become less binding. For these reasons, they thought that further increases in taxation in 1983/84 would no longer be appropriate.

The budget for 1983/84, presented to Parliament shortly after departure of the mission, projected a deficit of R 2.1 billion (some 2 1/4 per cent of GDP) to be financed without any net recourse to borrowing from the banking system (Chart 7). No allowance was made in the initial budget estimates for the removal of the import surcharge. The budget included no substantial additional tax measures, although some rationalization of the tax system was proposed and the Minister abolished the 5 per cent loan levy on personal income taxpayers. Also, it was announced that, starting in the 1984/85 tax year, Black taxpayers would be taxed on the same basis as other taxpayers.

Total revenues were budgeted to increase by about 11 1/4 per cent. Tax and lease revenues from gold mines were projected to rise by 9.5 per cent, suggesting that the budget had assumed a price of gold slightly in excess of US$400 per fine ounce. The increase in these revenues accounts for only about 8 per cent of the overall budgeted increase in revenues. Notably, the estimates for personal income taxes reflect an assumption of much less buoyancy than experienced during the last two years.

Expenditure was budgeted to increase at a rate of about 8 3/4 per cent over the revised estimates for 1982/83--implying a significant reduction both in real terms and in proportion to GDP. While the Government is determined to resist pressures for increased spending, past experience suggests that some additional appropriations will be made before the end of the fiscal year. In addition, about R 0.9 billion of the borrowing in excess of requirements in 1982/83 was transferred to the stabilization account with the Reserve Bank. Funds in this account may be drawn upon during the fiscal year to finance stockpiling of imported strategic materials, but may not be used for any other purpose without specific Parliamentary appropriation. Such stockpiling represents a substitution of assets and should not exacerbate inflation insofar as it draws on foreign reserves rather than domestic resources. In any event, owing partly to a dearth of additional storage capacity, it is believed that very little stockpiling is likely in 1983/84.

Within the aggregate of government spending, expenditure on education and manpower training was budgeted to increase faster than the average--that is, by about 11 1/4 per cent. Another welcome element on the expenditure side was the commitment to freezing salary scales for government employees. In addition to its direct effects, the authorities hope that this will provide a signal for wage moderation in the private sector.

4. Labor market policies as a constraint on growth 1/

While demand restraint might be able to contain labor cost increases in the short run, shortages of skilled labor constitute a medium-term constraint on potential growth that is unlikely to be eased without substantial changes in policy. It is notable that, whereas, according to official estimates, a 5 per cent rate of growth is required to keep unemployment from rising, only about a 4 per cent rate of growth is viewed as attainable with the projected availability of skilled labor. Clearly, there is a serious problem in the skill structure of the supply of labor. This problem derives from the long-standing labor market policies and practices that constitute impediments to mobility in the labor market and the optimal use of labor resources.

Until recently, a number of job reservation regulations based on race impeded vertical mobility in the labor market, acted as a disincentive to the acquisition of skills by Black workers, and distorted the occupational allocation of labor. In meetings with the government representatives, opposition groups, and private industry, the mission found broadly based acknowledgement that these legal impediments to vertical labor mobility had been virtually eliminated. Only one relatively unimportant job reservation determination remained in the mining industry, but exemptions to it were readily granted, and the Government intended that it should be phased out as soon as agreement could be reached among

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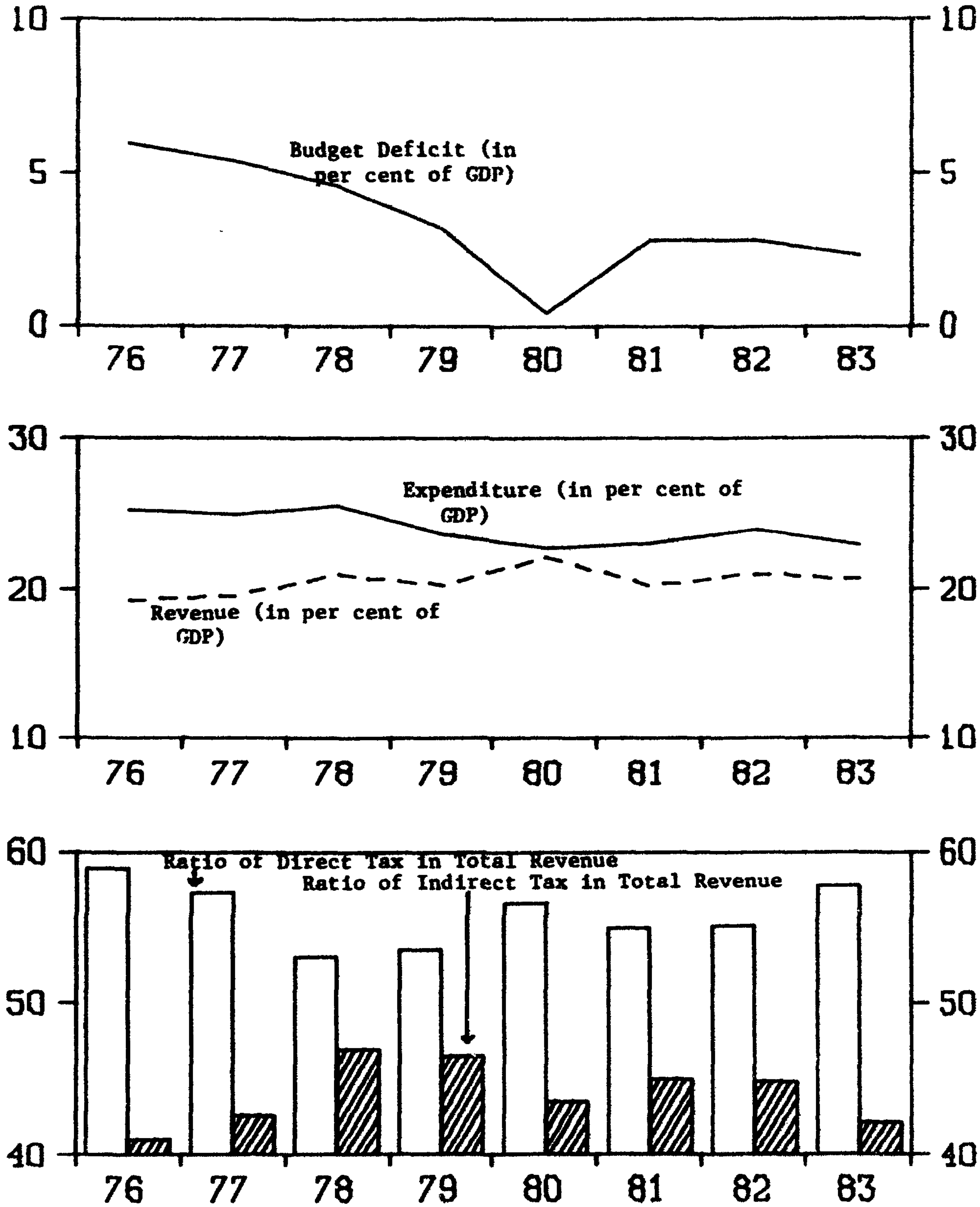
1/ An appendix to the recent economic developments paper for the 1983 Article IV consultation discussions examines the question of labor market policies and practices in greater detail.

CHART 7

SOUTH AFRICA

BUDGET INDICATORS 1/



Source: Ministry of Finance, Budget Speeches.

1/ Years beginning April; the data for 1983 are budget estimates.

all the concerned parties. The mission also found widespread agreement that substantial improvements had been made in allowing Black workers full union rights and access to the machinery for settlement of industrial disputes.

In practice, the movement to a more racially diverse skilled labor force has proceeded more rapidly in private industry than in public service. A major impediment to progress on this front is the large discrepancy in skills and in government expenditure on education and training between race groups. While this discrepancy in educational expenditure may have narrowed somewhat in recent years, estimates of per capita expenditure on school education by race group in 1979/80, published by the nongovernment Institute of Race Relations, show a ratio of almost 13:1 between expenditure on White school children and on Black school children, with other race groups falling between the two. There were also, reportedly, large discrepancies between race groups in terms of access to technical and vocational training. The authorities were aware of and concerned about these problems and they acknowledged that more expenditure on training and education for non-White race groups was important to the objective of easing the skilled labor constraint. In recent years they have increased expenditure on education for Blacks more rapidly than that for Whites and have provided attractive fiscal incentives to private sector employers for on-the-job training. Nevertheless, on present trends, the discrepancy in the distribution of skills is likely to persist over the long run.

Another serious problem exists with respect to impediments to the geographical mobility of Black workers. There are restrictions on the movement of Blacks from the rural to the urban areas and limitations on the mobility of urban Blacks between urban areas. These restrictions impede the normal working of the labor market, lead to large pay differentials between areas, and add to inflationary pressures in labor shortage areas and unemployment in labor surplus areas. Moreover, the system of short-term migrant labor contracts, whereby Black workers have to be returned to their point of recruitment on the expiration of the contract, militates against continuity of employment and consequently against on-the-job training. The question of geographical mobility is a subject of intense debate within official circles in South Africa, and a variety of proposals for changes in the regulations render it difficult to analyze the direction and nature of potential change. It is generally acknowledged that the present system involves economic costs, but the mission's discussions did not indicate any clear prospect of improvement in this area. The regulatory system might serve some sectoral economic interests but in general its maintenance is based on noneconomic considerations.

In general, labor market regulations in South Africa are clearly not consistent with the realization of the country's full growth potential. By contrast, their effects on short-term fluctuations in the external position are unlikely to be significant, and any easing of labor market restrictions would have virtually no effect within the relatively short time horizon of the current stabilization program. It is also worth noting that a full utilization of the resources of the economy would require that the relaxation of restrictions on labor mobility be coupled with a reordering of spending priorities that allowed for an enormous increase in education and training and thus in public sector expenditures.

Until April 1982 industrial development in the so-called national states and Black homelands and in adjacent areas was encouraged through a package of fiscal incentives but the results achieved were generally poor. If anything, in the decade to 1980 the proportion of new investment in manufacturing in areas other than the established industrial centers declined slightly and the geographical distribution of industrial employment remained extremely uneven. From April 1982, a new package of incentives for development of a broader set of designated "industrial development points and deconcentration points" became effective. In general, this new package substituted cash incentives for tax concessions and it is intended that the regional pattern of transport and industrial infrastructural development will be integrated with this scheme. Discussions with officials indicated that increased emphasis will be placed on the promotion of agriculture, services, and labor-intensive industry in these areas, although it was recognized that even so the expenditure required to develop the necessary infrastructure would be very large.

5. The short-term economic outlook

As usual, the external environment is the principal source of uncertainty in evaluating the short-term prospects of the South African economy. The recent World Economic Outlook exercise projected an increase of almost 4 per cent in the weighted average of partner countries' non-oil import volumes in 1983. However, while the South African economy will obviously benefit from a recovery in major trading partner countries, it is extremely sensitive to prices of a few major primary commodities that do not necessarily move up in pace with aggregate demand. In addition, the normal difficulty of projecting capital flows has been made more hazardous by recent policy changes.

For 1983 a current account surplus of almost SDR 1 1/2 billion (equivalent to 2 per cent of GDP) is projected. Nongold export volume is expected to rise by 2 per cent after falling by 3 per cent in 1982. The increase is constrained in part by drought-related weakness of some agricultural exports, and the margin of error is widened by the difficulty of projecting the demand for coal and some other primary mineral products in the wake of the fall in oil prices. No appreciable change is expected in the volume of gold output but the SDR price of gold is assumed to rise, on average, by 16 per cent in 1983. Import volume is projected to fall by 16 per cent, following a 15 per cent decline last year, owing to continuing weakness in total domestic demand and, particularly, in investment, which has a relatively high imported component. The nongold terms of trade are expected to improve by some 4 per cent, partly reversing the sustained deterioration over the last few years, and the terms of trade, including gold, by 9 per cent. The trade surplus is projected at almost SDR 4 1/2 billion and the deficit on services is expected to be slightly more than SDR 3 billion.

The elimination of exchange controls on nonresidents and the unification of the exchange market render projections of capital flows even more difficult than usual. It was thought at the time of the unification that there would be a strong incentive for nonresidents to sell South African shares that had been purchased at a substantial discount through the financial exchange rate and to repatriate their capital at the new unified exchange rate. This did not occur immediately, partly, perhaps, because there were widespread expectations of a further appreciation of the rand. However, a large capital outflow occurred after the steep decline in the price of gold in late February, which increased the likelihood of a depreciation of the rand. At the time of the discussions, the authorities envisaged a net capital inflow of about SDR 1 1/2 billion; subsequent developments, however, suggest that it might turn out to be smaller.

The real economy is expected to remain weak for the year as a whole, although a pickup in demand is expected in the latter part of the year. Total domestic demand is projected to fall by about 4 per cent, led by a 7 per cent reduction in fixed investment and a further substantial rundown in inventories. The effect of this fall in demand on output is expected to be moderated by some strengthening of the foreign balance, in constant price terms, so that GDP is projected to decline by about 1/2 per cent. Implicit in this projection is a substantial further reduction in value added in agriculture owing largely to the drought. The projections for the real economy imply a substantial further worsening of unemployment.

At the time of the mission, the rate of increase in consumer prices was expected to fall to about 10-11 per cent from 14 3/4 per cent in 1982. These projections now seem slightly optimistic given the effects of the drought on prices of agricultural goods and the cessation of the upward trend in the exchange rate of the rand. Nevertheless, some reduction in consumer price inflation to about 12 per cent still seems likely. A much sharper reduction is expected in unit labor cost inflation, given the softening of the private labor market and budgetary control over government wages and salaries.

V. Staff Appraisal

South Africa's financial and economic position has turned around much more sharply than anticipated at the time of the stand-by negotiations, with the increase in the price of gold reinforcing the effects (especially on imports) of the vigorous stabilization policies which the authorities pursued during 1982. On a seasonally adjusted basis, the current account of the balance of payments had moved into a surplus of some 1 1/2 per cent of GDP already in the fourth quarter of 1982, as against a deficit of 7 1/2 per cent of GDP in the first half of the year. The capital account has also strengthened markedly since mid-1982. In particular, there were large inflows of short-term capital, on an uncovered basis, induced both by comparatively high nominal interest rates in South Africa and widely held expectations of an appreciation of the rand. Overall, the balance of payments swung from a deficit of SDR 2 billion in the first half of 1982 to a surplus of some SDR 1 1/2 billion in the second half of the year, and the surplus remained large in the first two months of 1983. The authorities were able to repay nearly all of their outstanding foreign short-term liabilities (which in mid-1982 had exceeded the equivalent of SDR 1.5 billion) and to rebuild gross official reserves from a low of SDR 0.5 billion in October 1982 to SDR 1.3 billion in February 1983. In March 1983, however, substantial capital outflows appear to have taken place in response to the weakening of the gold market and the lifting of exchange controls on nonresidents.

On the domestic front, the economy has cooled off rapidly. In real terms, domestic expenditure fell in 1982 by 4 per cent, about twice as much as had been projected under the stabilization program, and GDP declined by 1 per cent. Capacity utilization in manufacturing fell sharply and unemployment increased, although shortages of skilled labor did not ease much. Price performance was also slightly better than had been foreseen under the stabilization program. However, the rate of inflation (CPI), at 14 3/4 per cent, remained disturbingly high, reflecting mainly strong wage pressures, and the differential against trading partners widened further.

Despite a disquieting increase in real government spending, the budget deficit in the 1982/83 fiscal year was contained within the initial budget projection of 2 3/4 per cent of GDP, owing largely to the unexpected buoyancy of revenue from gold mining. In addition, the deficit was more than fully funded outside the banking system, so that net bank credit to the Government was sharply reduced; this helped to counter the liquidity effects of the external surplus. Nevertheless, although the growth in total domestic credit in the period through March 1983 has remained well within the ceilings set under the stand-by arrangement, the monetary aggregates have grown faster than projected owing to a stronger-than-expected external payments position. In the opening months of 1983, the authorities called a virtual halt to their efforts to mop up excess liquidity by means of sales of new government debt to the public. This lull in debt sales occurred because of a fear that overfunding, undertaken for monetary control rather than budgetary finance, could undermine the government expenditure and fiscal deficit objectives for 1983/84, and it contributed to a worrisome acceleration of monetary growth and fall in interest rates in the first quarter in 1983. In order to moderate these tendencies, the strengthening of the external position was allowed to be reflected in part in an appreciation of the rand, at the expense of a worsening in cost competitiveness. Also, in line with the Government's stated long-term objective, exchange control on nonresidents was abolished on February 5, 1983 in the hope that it would have the beneficial side effect of dampening or reversing the net inflow of capital.

The staff believes that, in view of the strength of the external position and the prospect of a resumption of growth in the second half of 1983, policies in the period ahead should focus on reducing inflation.

To this end, credit expansion should remain well within the ceilings set under the stand-by arrangement and interest rates as well as rediscounting penalties should be raised to contain the expansion of credit to the private sector and reduce the growth in the monetary aggregates. The staff agrees with the authorities that monetary control should be pursued even at the risk of its leading to some further appreciation of the rand, and would urge the authorities to pursue aggressive debt management policies even if this requires some increase in government expenditure on servicing the public debt. The staff acknowledges the possibility of a conflict arising between the objectives of monetary control and the maintenance of the external competitiveness of the manufacturing sector in the event of a continued improvement in the external payments position. Should such a conflict arise, the staff agrees with the authorities that efforts to control the nominal exchange rate at the expense of a loss of monetary control would not be beneficial to the external competitiveness of the economy over the medium term and would not facilitate the medium-term objective of diversifying the production and export base of the economy. Such a situation would, however, present an opportunity for the authorities to make further progress toward their objective of easing capital controls on residents and this, in turn, should help resolve the conflict between monetary control and short-term competitiveness.

Fiscal policy for 1983/84 reflects the authorities' commitment to restraint. The containment of the budget deficit to about R 2 billion (equivalent to 2 1/4 per cent of GDP), despite the effects of overfunding and drought relief on government expenditure and strong pressures for a more expansionary fiscal policy in light of the substantially eased balance of payments constraint, is evidence of the authorities' fiscal resolve. Moreover, the undertaking to finance the budget deficit from nonbank sources should facilitate monetary control. The projected 11 1/4 per cent increase in government revenue is predicated on conservative assumptions regarding the gold price. The staff concurs with the view that no major tax initiative was warranted in present circumstances and welcomes the elimination of the compulsory loan levy on income taxpayers, which constitutes a further step in the liberalization of domestic financial markets. Within the increase of about 9 per cent in total government expenditure, both the larger allocation to training and education and the freezing of government salary scales are steps in the right direction, given the current conditions of high wage-cost inflation and a continuing underlying shortage of skilled labor.

At the time of the presentation of the budget to Parliament, no action was taken on the removal of the remaining 5 per cent surcharge on imports, although the authorities reaffirmed their commitment to eliminate the surcharge completely before the end of 1983. The authorities acknowledge that the elimination of the surcharge might be beneficial to their inflation objective and that there is no balance of payments reason for the retention of the surcharge. The delay in completing the phasing out of the surcharge reflects rather the authorities' conservative assumptions about government revenue and their desire to contain the budget deficit. The staff believes that the authorities should accelerate the phasing out of the surcharge even if this were to be possible only at the expense of a larger budget deficit than envisaged at present.

Finally, for the South African economy to realize its full potential over the medium term, in terms of both overall growth and diversification of the production base, the staff believes that it is important that more efficient use be made of the country's manpower resources. In this connection, the progress made to date in eliminating regulatory impediments to vertical labor mobility is welcome, but the efforts that are currently in progress to upgrade the skills of a large part of South Africa's population can hardly be regarded as adequate. Moreover, there are still significant restrictions on the geographical mobility of labor, which create inflationary pressures in labor shortage areas, while adding to unemployment in labor surplus areas. The system of short-term migrant labor contracts encouraged by these restrictions leads to high labor turnover and acts as a disincentive to investment in on-the-job training. These restrictions are maintained despite widespread official acknowledgement of the persistent shortages of skilled labor and their inconsistency with the general free market thrust of economic policy. In the view of the staff, therefore, in order to avoid serious imbalances in the economy over the medium term, it is essential that the impediments and restrictions governing the labor market be eased and that the allocations of government expenditure to certain areas of education and manpower training, that to date have been inadequately funded, be stepped up sharply.

In recent years the Government has shown evidence of cautious external debt management policies. The debt service ratio is low by the standards of many developing countries and is projected to fall to 7 per cent in 1983. In view also of the present and prospective strength of the external current account position, it seems unlikely that South Africa will experience any debt servicing difficulties in the foreseeable future. The staff also welcomes the decision to refrain from further purchases under the stand-by at the present time.

It is recommended that the next Article IV consultation with South Africa be held on the standard 12-month cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board upon completion of the review of the stand-by arrangement for South Africa:

South Africa has consulted with the Fund in accordance with paragraph 3(b) of the stand-by arrangement for South Africa (EBS/82/173, Sup. 1, 11/8/82) and paragraph 3 of the letter dated October 4, 1982, attached hereto. No new understandings with the Fund are necessary regarding the circumstances in which further purchases may be made by South Africa under the stand-by arrangement.

Table 1. South Africa: Balance of Payments, 1979-83

(In millions of SDRs)

	1979	1980	1981	1982		1983	
				Stand-by projections	Preliminary outturn	Stand-by projections	Revised projections
Merchandise exports, f.o.b. 1/	8,103	9,645	9,334	8,500	8,469	9,100	9,070
Percentage change in value	18.4	19.0	-3.2	-9	-9 1/2	7	7
Percentage change in volume	5.0	-0.8	-10.0	-1/2	-3	2 1/2	2
Percentage change in unit price	12.8	20.0	7.6	-8 1/2	-6 1/2	4 1/2	5
Net gold output	5,519	10,015	8,126	6,100	7,211	6,080	8,350
Percentage change in value	55.5	81.5	-18.9	-25	-11	-1/3	16
Percentage change in volume	-2.7	-6.8	0.8	1	1/2	2	--
Gold price in SDRs	238	471	390	290	342	284	396 2/
Merchandise imports, f.o.b.	-8,954	-13,983	-17,647	-15,320	-15,128	-13,700	-12,835
Percentage change in value	21.6	56.2	26.2	-13 1/4	-14 1/2	-10 1/2	-15
Percentage change in volume	-0.5	21.6	14.6	-12 1/3	-15	-14 1/3	-16
Percentage change in unit value	22.2	28.5	10.1	-1	1	4 1/3	1
Trade balance	4,668	5,677	-187	-720	552	1,480	4,585
Nonfactor services, credit	1,754	2,283	2,734	2,670	2,649	2,850	2,890
Nonfactor services, debit	-1,966	-2,765	-3,528	-3,420	-3,224	-3,160	-2,736
Other services and transfers	-1,725	-2,235	-2,625	-2,500	-2,516	-2,570	-3,281
Current balance	2,731	2,960	-3,606	-3,970	-2,539	-1,400	1,458
(In per cent of GDP)	(6.2)	(4.8)	(-5.2)	(-6.0)	(-3.8)	(-2.0)	(2.0)
Capital movements	-2,347	-2,436	844	1,970	2,185	600	...
Exchequer	...	...	155	433	387	228	...
Other 3/	...	...	689	1,537	1,798	372	...
Overall balance	384	524	-2,762	-2,000	-354	-800	...
Financing (increase in assets -)	-384	-524	2,762	2,000	354	800	...
Net use of Fund credit	-237	-77	--	800	800	200	...
Other financing	-147	-447	2,762	1,200	-446	600	...
Terms of trade	8	23	-13.6	-14 3/4	-10	-2 1/2	9
Gross official reserves, end of period 4/							
In millions of SDRs	3,708	5,670	3,441	2,890 5/	3,916	...	...
In months of merchandise imports	5.0	4.9	2.3	2.3 5/	3.1	...	...
SDR/rand exchange rate (averages)	0.9194	0.9876	0.9744	0.8172	0.8359	0.7604	0.8453 2/

Sources: South African Reserve Bank, Quarterly Bulletin; and data provided by the South African authorities.

1/ Excluding gold.
2/ Actual data for January-March 1983 and projected at the March 1983 level for the rest of 1983.
3/ Including errors and omissions.
4/ Gold valued at market-related prices.
5/ End-August 1982.

Table 2. South Africa: Domestic Developments and Forecasts

(Changes, in per cent, from previous year)

	1969-79 Average	1979	1980	1981	1982 Estimates	1983 Forecast
Demand and output (in constant prices)						
Private consumption	3.6	2.9	9.0	6.4	1.9	-1 1/2
Public consumption	5.1	2.7	9.0	2.5	3.7	3
Gross fixed investment	4.0	2.2	14.6	11.5	-2.6	-7
Stockbuilding 1/	-0.5	0.6	2.2	2.7	-4.7	-1 1/2
Total domestic demand	3.2	3.4	13.2	10.1	-3.8	-4
Foreign balance 1/	0.6	0.9	-4.2	-4.5	2.9	3 1/2
GDP	3.5	4.1	7.8	5.1	-0.9	-1/2
Prices, wages, and savings						
Consumer prices	9.6	13.1	13.8	15.2	14.7	11 1/2
GDP deflator	11.1	14.3	20.8	8.4	13.8	12 1/2
Salaries and wages per worker in nonagricultural sector (in constant prices)						
Whites	-0.5	-1.0	3.3	5.7	...	
Nonwhites	5.5	0.5	4.3	2.9	...	
All population groups	1.7	-0.9	3.5	4.6	3	
Personal disposable income	13.5	18.5	23.2	17.9	13.6	
Savings ratio (in per cent)	9.5	10.4	10.0	6.7	4.6	

Sources: South African Reserve Bank, Quarterly Bulletin; and data provided by the South African authorities.

1/ Contribution to growth of GDP; the contribution by stockbuilding includes statistical discrepancies.

Table 3. South Africa: The Financial Program 1/

(In millions of rand)

	1981	1982					1983				
	Dec.	Mar.	June	Sept.	Dec.		Mar.		June	Sept.	Dec.
		Historical data			Program	Actual	Program	Actual			
Total domestic credit 2/3/	27,768	29,450	31,343	32,011	34,150	32,492	35,450	33,064	36,650	37,450	38,600
	(38)	(37)	(32)	(25)	(23)	(17)	(20)	(12)	(17)	(15)	(13)
Net credit to Government 2/3/	6,022	5,642	6,930	6,487	8,050	6,328	7,500	5,383	8,200	8,100	8,500
	(52)	(72)	(69)	(38)	(34)	(5)	(33)	(-5)	(18)	(12)	(6)
Private sector credit	21,746	23,808	24,413	25,524	26,100	26,164	27,950	27,681	28,450	29,350	30,100
	(35)	(31)	(24)	(22)	(20)	(20)	(17)	(16)	(17)	(16)	(15)
Other assets, net	-4,285	-3,643	-4,153	-3,918	-4,750	-4,563	-4,600	-4,055	-4,900	-4,930	-5,050
Net foreign assets 4/	1,654	139	-824	-198	-1,250	844	-1,900	1,096	-2,350	-2,470	-2,550
Total liquidity (M3)	25,137	25,946	26,366	27,895	28,150	28,773	28,950	30,105	29,400	30,050	31,000
	(20)	(18)	(11)	(18)	(12)	(14)	(12)	(16)	(12)	(11)	(10)

Source: Data provided by the South African authorities.

1/ Data refer to the end of period. The figures in partentheses are percentage changes over the corresponding date of the previous year.
2/ Inclusive of Exchequer foreign liabilities, government-related items in transit, and exchange losses on forward cover.
3/ Program ceilings are performance criteria.
4/ Exclusive of Exchequer foreign liabilities and valuation adjustments.

Table 4. South Africa: Summary of the Exchequer Accounts 1/

(In millions of rand)

	1980/81	1981/82	1982/83			1983/84
	Actual	Actual	Budget estimate	Stand-by estimate	Actual	Budget estimate
Revenue	13,130	14,146	15,858	16,350 2/	17,148	19,094
Of which:						
Gold-mining related	3,633	2,131	1,005	1,200	1,652	1,810
Other	9,677	12,285	14,853	15,150 2/	15,496	17,284
Expenditure	-13,595	-16,438	-18,238	-18,750	-19,489	-21,176
Of which:						
Education	-2,147	-2,813	-3,372	-3,372	...	-3,752
Defense	-2,270	-2,662	-2,668	-2,895	-3,128	-3,092
Interest on public debt	-1,403	-1,973	-2,230	-2,419	-2,499	-2,850
Capital expenditure	-2,594	-2,731	-2,750	-2,750	-2,795	-2,850
Surplus or deficit (-)	-285	-2,022	-2,380	-2,400	-2,341	-2,082
(In per cent of GDP)	0.4	2.8	2.8	2.8	2.8	2.3
			(Percentage changes)			
Memorandum items:						
Revenue 3/	36.0	8.3	10.0	13.4	19.0	11.3
Expenditure	18.8	20.9	11.0	14.1	18.6	8.7
Education	27.9	31.0	19.9	19.9	...	11.3
Defense	28.7	17.3	0.2	8.7	17.5	-1.2
Interest on public debt	8.0	10.6	13.0	22.6	26.7	14.0
Capital expenditure	...	5.3	0.7	0.7	2.3	2.0

Source: Data provided by the South African authorities.

1/ Years ending March 31.
2/ Including R 300 million from additional tax effort.
3/ Excluding loan levy.

Table 5. South Africa: Outstanding External Debt and its Servicing, 1980-83

(In millions of SDRs)

	1980	1981	1982	1983 1/
Outstanding public and publicly guaranteed debt 2/	4,551	5,046	5,473 3/	...
Amortization payments	1,422	692	867	655
Interest payments	487	681	435	608
Total payments	1,909	1,373	1,302	1,263
Exports of goods and nonfactor services	21,944	20,194	17,920	18,052
Debt service ratio (in per cent)	8.7	6.8	7.3	7.0
Memorandum items:				
Outstanding debt by lender				
Financial institutions	3,506	4,132	4,713 3/	...
Suppliers' credits, bonds, etc.	1,045	914	760 3/	...
Outstanding debt by lender				
Central government	...	1,591	2,098	...
Public corporations	...	3,388	3,317	...
Local authorities	...	67	58	...
Short-term debt 4/	5,005	...	...	...

Source: Data provided by the South African authorities.

1/ Projections for 1982-83 are based on amounts outstanding as of March 31, 1982.
2/ Debt (including undisbursed) with original maturity of one year or longer, at end of period.
3/ Outstanding amount as of September 30, 1982.
4/ Including domestic banking system and private sector.

Fund Relations with South Africa
(As of April 29, 1983)

Quota	SDR 636 million.
Proposed quota	SDR 915.7 million
Status	Article VIII, as from September 15, 1973.
Fund holdings of South African rand	SDR 1,431.0 million or 225.0 per cent of quota.
SDR position	Holdings are SDR 69.9 million or 31.7 per cent of net cumulative allocation of SDR 220.4 million.
Gold distribution	273,865 fine ounces.
Exchange system	The South African authorities do not maintain margins in respect of exchange transactions. The dual exchange rate system, under which certain capital transactions took place in a separate insulated market in which the "financial" rand was traded at a freely determined exchange rate (usually at a discount over the "commercial" rate), was unified as of February 7, 1983. The exchange rate of the rand on April 29, 1983 was R 1 = US$0.92, compared with R 1 = US$0.93 on February 4, 1983.
Last consultation	February/March 1982, completed by the Executive Board on May 26, 1982.
Purchases under the stand-by arrangement	
Effected	SDR 159 million (November 8, 1982)
Scheduled	SDR 41 million after January 31, 1983 SDR 54 million after April 30, 1983 SDR 54 million after July 30, 1983 SDR 56 million after October 31, 1983

South Africa--Basic Data

Area and Population

Area	1,182,345 sq. km.
Population (at June 1981)	30,130,000
Employment in nonagricultural sector (as at December 1982)	5,111,000

IMF Position (April 29, 1983)

Quota	SDR 636 million
Fund holdings of rand as per cent of quota	225.0
Holdings of SDRs	SDR 69.9 million
Exchange rate	R 1 = US$0.92 = SDR 0.8499

National Accounts

	1982	1973-80	1980	1981	1982
	In millions of rand at current prices	Percentage change in real terms			
Private consumption	43,882	3.8	9.0	6.4	1.9
Public consumption	11,982	5.8	9.0	2.5	3.7
Gross fixed investment	21,723	3.0	14.6	11.5	-2.6
Change in stocks (including residual item) 1/	1,855	2.6	2.3	2.7	-4.6
Total domestic demand	79,442	4.1	13.2	10.1	-3.8
Exports of goods and services	21,929	1.4	-0.9	-5.1	-1.5
Imports of goods and services	-21,956	2.6	18.6	13.6	-13.2
Gross domestic product	79,415	3.7	7.8	5.1	-0.9

State Revenue Account 2/	1979/80	1980/81	1981/82	1982/83
	In millions of rand			
Revenue	9,788	13,310	14,416	17,420
Expenditure	-11,441	-13,595	-16,438	-19,205
Overall deficit	-1,653	-285	-2,022	-1,785

1/ Contribution to growth of GDP.
2/ Years ended March 31.

Basic Data (cont'd.)

Balance of Payments	1979	1980	1981	1982
	In billions of rand			
Merchandise exports, f.o.b.	14.8	19.9	17.9	18.8
Net gold output	6.0	10.1	8.3	8.6
Merchandise imports, f.o.b.	-9.7	-14.2	-18.1	-18.1
Net invisibles and transfers	-2.1	-2.7	-3.5	-3.7
Current balance	3.0	3.0	-3.7	-3.0
Net long-term capital	-1.0	-0.5	0.5	1.9
Net short-term capital (including errors and omissions)	-1.5	-2.0	0.4	0.7
Net capital (including errors and omissions) 1/	-2.5	-2.5	0.9	2.6
Overall balance	0.5	0.5	-2.8	-0.4
Level of reserves at end-year (in millions of SDRs, IFS definition)	681	994	898	705

Monetary Aggregates	1979	1980	1981	1982
	Percentage increase over previous year			
Broad money (M3)	14.7	23.5	20.2	14.5
Total net domestic credit 2/	13.1	20.4	33.1	10.2
Of which:				
Bank credit to private sector	15.6	29.1	34.9	21.0
Bank credit (net) to government 2/	5.7	-12.0	23.5	-52.2

Prices, Wages, and Unit Labor Costs (annual average)

Consumer prices	13.1	13.8	15.2	14.7
Exports of goods and services	26.2	34.1	-1.7	7.5
Imports of goods and services	21.6	20.4	2.8	16.5
Real remuneration per worker 3/				
Whites	-1.0	3.2	5.7	2.5
Nonwhites	0.5	4.3	2.9	5.6
Unit labor costs in manufacturing	7.7	11.8	15.8	21.4

1/ Excluding short-term liabilities related to reserves.

2/ These data are on the official definition rather than the definition employed for purposes of the stand-by arrangement.

3/ In the nonagricultural sector.

South Africa: Selected Economic and Financial Indicators, 1981-83

	1981	1982		1983	
	Actual	Stand-by estimate	Preliminary outturns	Stand-by program 1/	Review mission
	(Annual percentage changes unless otherwise specified)				
National income and prices					
GDP at constant prices	5.1	1/4	-1	-1	-1/2
GDP deflator	8.4	12 1/2	13 3/4	13 3/4	12 1/2
Consumer prices	15.2	15 3/4	14 3/4	14	11 1/2
External sector					
Nongold export value, f.o.b. 2/	-3.2	-9	-9 1/2	7	7
Nongold export volume	-10.0	-1/2	-3	2 1/2	2
Gold exports 2/	-18.9	-25	-11	-1/3	16 3/
Gold export volume	0.8	1	1/2	2	--
Import value, f.o.b. 2/	26.2	-13 3/4	-14 1/2	-10 1/2	-15
Import volume	14.6	-12 1/3	-15	-14 1/3	-16
Terms of trade (including gold, deterioration, -)	-13.6	-14 3/4	-10	-2 1/2	9
Nominal effective exchange rate (depreciation, -)	1.5	...	-10.6	...	...
Real effective exchange rate (depreciation, -)	4.7	...	-5.0	...	...
Government budget 4/					
Revenue	8.3	13 1/3	20 3/4	...	9 1/2
Total expenditure	20.9	14	16 3/4	...	10 1/4
Money and credit 5/					
Net domestic credit 6/	38	23	17	13	13
Net credit to the Government 6/	52	34	5 1/4	6	6
Credit to the private sector 6/	35	20	20 1/2	15	15
M3	20	12	14 1/2	10	12-14
Velocity of M3 (ratio of GDP to M3)	3.02	2.96	2.96	3.00	...
Interest rate (90-day bankers' acceptance)	15.25	...	14.25	...	...
	(In per cent of GDP)				
Central government budget deficit (State Revenue Account) 4/	-2.8	-2 3/4	-2 1/4	-2	-2 1/4
Gross domestic investment	34.2	30	27	26 3/4	24 1/2
Gross domestic savings	28.9	24	23 1/4	24 3/4	26 1/2
External current account deficit	-5.2	-6	-3 3/4	-2	2
Debt service ratio 7/	6.8	8	7	7	7
External debt	7.6	...	8 1/2	...	...
Overall balance of payments (in millions of SDRs)	-2,762	-2,000	-354	-800	...
Gross official external reserves (in millions of SDRs) 8/	3,441	...	3,916	...	...

Sources: IMF, International Financial Statistics; and data provided by the South African authorities.

1/ Based on a gold price of US$315 per fine ounce.
2/ In SDR terms.
3/ Based on a gold price of US$431 per fine ounce.
4/ Fiscal year beginning April.
5/ End period.
6/ As defined for purposes of the stand-by arrangement. Based on program ceilings for 1983.
7/ In per cent of exports of goods and nonfactor services.
8/ Gold valued at market-related price.