

FOR
AGENDA

EBS/82/173

CONFIDENTIAL

October 4, 1982

To: Members of the Executive Board
From: The Acting Secretary
Subject: South Africa - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from South Africa for a stand-by arrangement equivalent to SDR 364 million. A draft decision appears on page 15.

This subject, together with South Africa's request for a purchase under the compensatory financing facility (EBS/82/174, 10/4/82), will be brought to the agenda for discussion on Wednesday, November 3, 1982.

Att: (1)

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Request for Stand-By Arrangement

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

(In consultation with the Legal Department, the Research
Department, and the Treasurer's Department)

Approved by L.A. Whittome and S. Mookerjee

October 4, 1982

I. Introduction

A staff team visited Pretoria during August 9-24, 1982 to discuss the possible use of Fund resources by South Africa. The staff representatives were Messrs. Knöbl (Head-EUR), Berengaut (ETR), Burton (EP-EUR), Dell'Anno (EUR), Lipschitz (EUR), Morrison (RES), Wein (EUR), and Ms. Avvakoum (EUR, secretary). The mission met with Professor Horwood, the Minister of Finance; Dr. de Kock, the Governor of the Reserve Bank; Dr. de Loor, the Director General of Finance; and other officials. Dr. Brand, Principal Resident Representative of South Africa to the IMF and IBRD, participated as an observer.

In the attached letter, the Minister of Finance of South Africa requests a stand-by arrangement for a period extending to the end of 1983, in an amount of SDR 364 million, representing about 57 per cent of South Africa's quota. In addition, South Africa is requesting a purchase under the compensatory financing facility (CFF) in an amount of SDR 636 million, equivalent to 100 per cent of quota. A waiver of the limitation of Article V, section 3 (b)(iii), in the Articles of Agreement is required.

The program in support of which the stand-by arrangement is requested is described in the memorandum annexed to the attached letter and analyzed below. Purchases under the stand-by arrangement would not exceed SDR 159 million until January 31, 1983; SDR 200 million until April 30, 1983; SDR 254 million until July 31, 1983; and SDR 308 million until October 31, 1983. The last two purchases would be subject to a mid-term review.

In 1976 and 1977 South Africa made purchases under the CFF and under two stand-by arrangements extending into the second credit tranche, totaling SDR 160 million and SDR 232 million, respectively. The Fund's holdings of South African rand were subsequently reduced, but with the purchase by South Africa of the remainder of its reserve tranche in February 1982, the Fund's holdings of rand on August 31 were equivalent to SDR 636 million (100 per cent of quota). If South Africa purchases

the full amounts proposed under the stand-by arrangement and the CFF, the Fund's holdings of South African rand would reach SDR 1,636 million (257 per cent of quota) after October 31, 1983. Further details of South Africa's relations with the Fund are provided in Appendix II.

South Africa accepted the obligations of Article VIII, sections 2, 3, and 4, of the Fund's Articles of Agreement as from September 15, 1973. South Africa maintains no restrictions on the making of payments and transfers for current international transactions. The 1982 Article IV consultation took place during February-March 1982 and the Staff Report (SM/82/76, 4/20/82) and the Recent Economic Developments paper (SM/82/89, 5/11/82) were discussed by the Executive Board on May 26, 1982.

II. Recent Economic Developments 1/

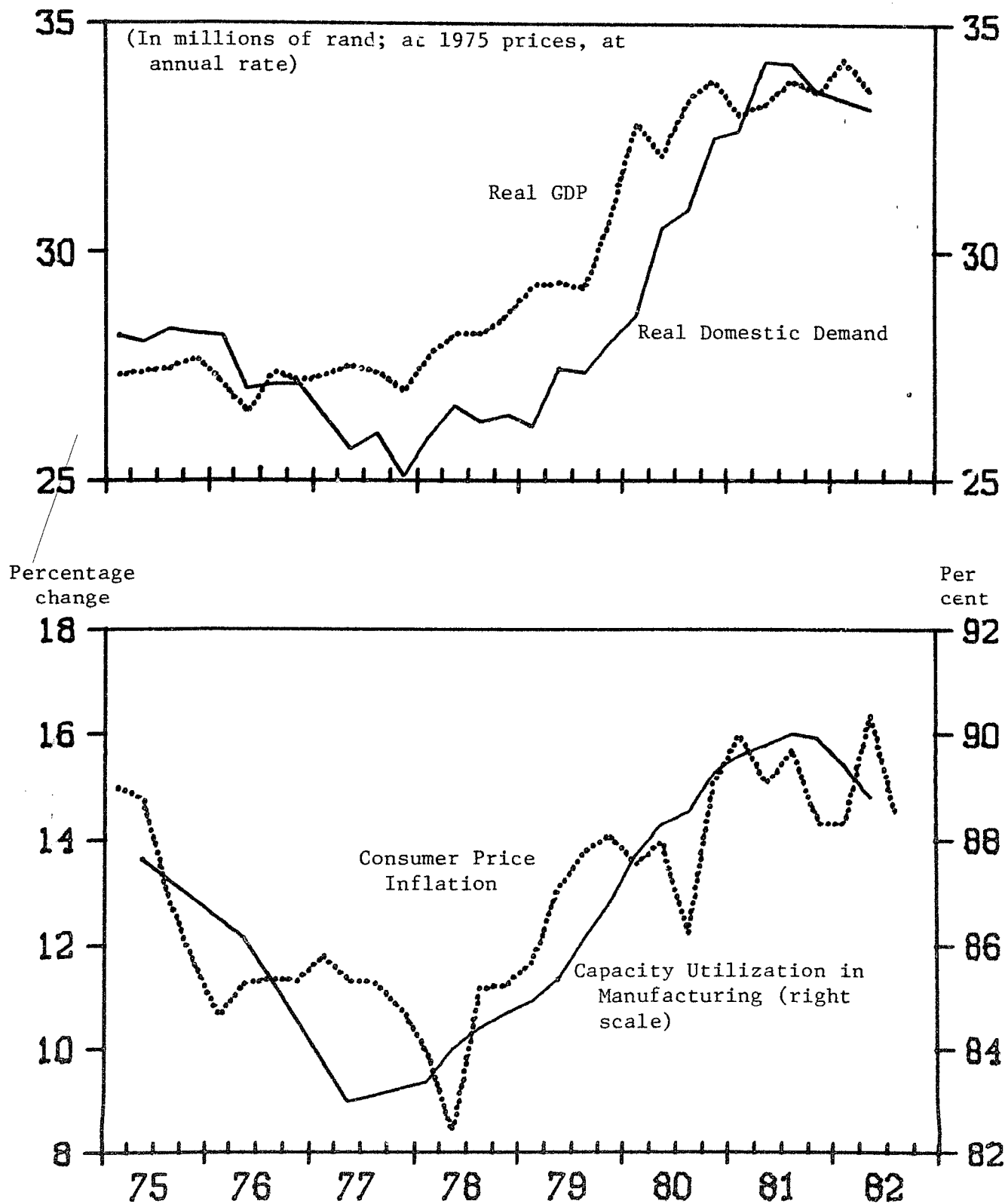
The cyclical upswing in the South African economy, which had begun in late 1977, was reinforced and sustained by the sharp rise in the gold price in 1979-80. With the emergence of a large external surplus and the balance of payments constraint effectively removed, financial policies were designed to encourage rapid growth. In contrast to the low growth prevailing in most of South Africa's trading partners, real GDP grew by 8 per cent in 1980 and real domestic demand by 13 1/4 per cent. As capacity utilization rose, supply bottlenecks developed in many areas. Notwithstanding increased immigration, shortages of skilled labor became widespread, pushing up labor costs. Inflation accelerated from 13 3/4 per cent in 1979 to 15 1/4 per cent in 1981.

In 1981 the price of gold fell (to an average of US\$460 per fine ounce from US\$613 in 1980), and South Africa's nongold exports were affected by the recession abroad. Financial policies initially sought to shield the South African economy from these influences, and real domestic demand increased by 9 3/4 per cent. However, as capacity constraints became binding, the rate of growth of real GDP slowed to below 5 per cent (Table 1 and Chart 1). Continued excess demand kept the rate of inflation high and led to a further sharp increase in imports. This, combined with the deterioration in the terms of trade of 13 1/2 per cent, contributed importantly to the turnaround in the current account of the balance of payments from a surplus of SDR 3 billion (4 3/4 per cent of GDP) in 1980 to a deficit of SDR 3.6 billion (5 1/4 per cent of GDP) in 1981 (Tables 2 and 3, and Chart 2).

The swing in the current account deficit in 1981 was not accompanied by a reversal of capital flows of a similar magnitude, as relative interest rates did not favor borrowing abroad for much of the year. The authorities initially financed the external deficit by running down reserves and short-term borrowing (amounting to SDR 1.8 billion in 1981).

1/ For a detailed discussion of developments see the Staff Report for the 1982 Article IV Consultation with South Africa (SM/82/76, 4/20/82) and Recent Economic Developments (SM/82/89, 5/11/82).

CHART 1 SOUTH AFRICA DEMAND, SUPPLY, AND INFLATION

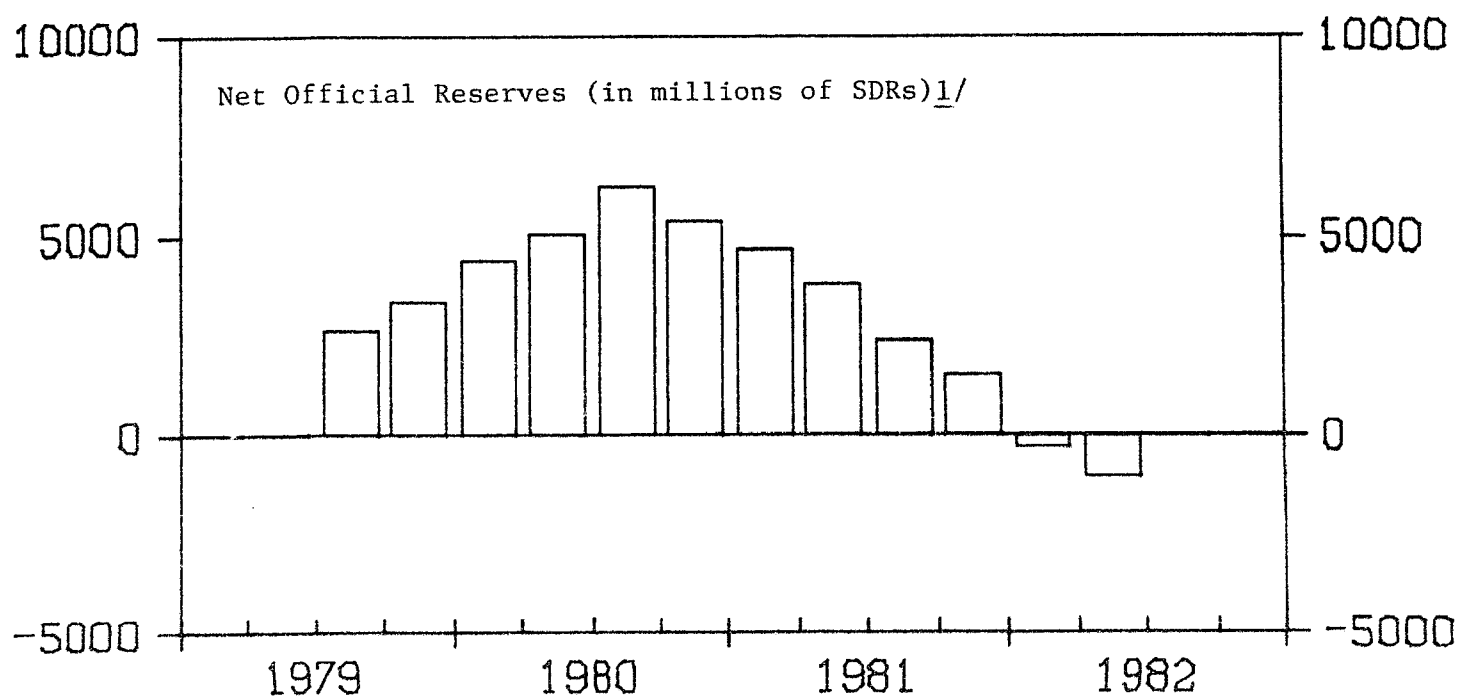
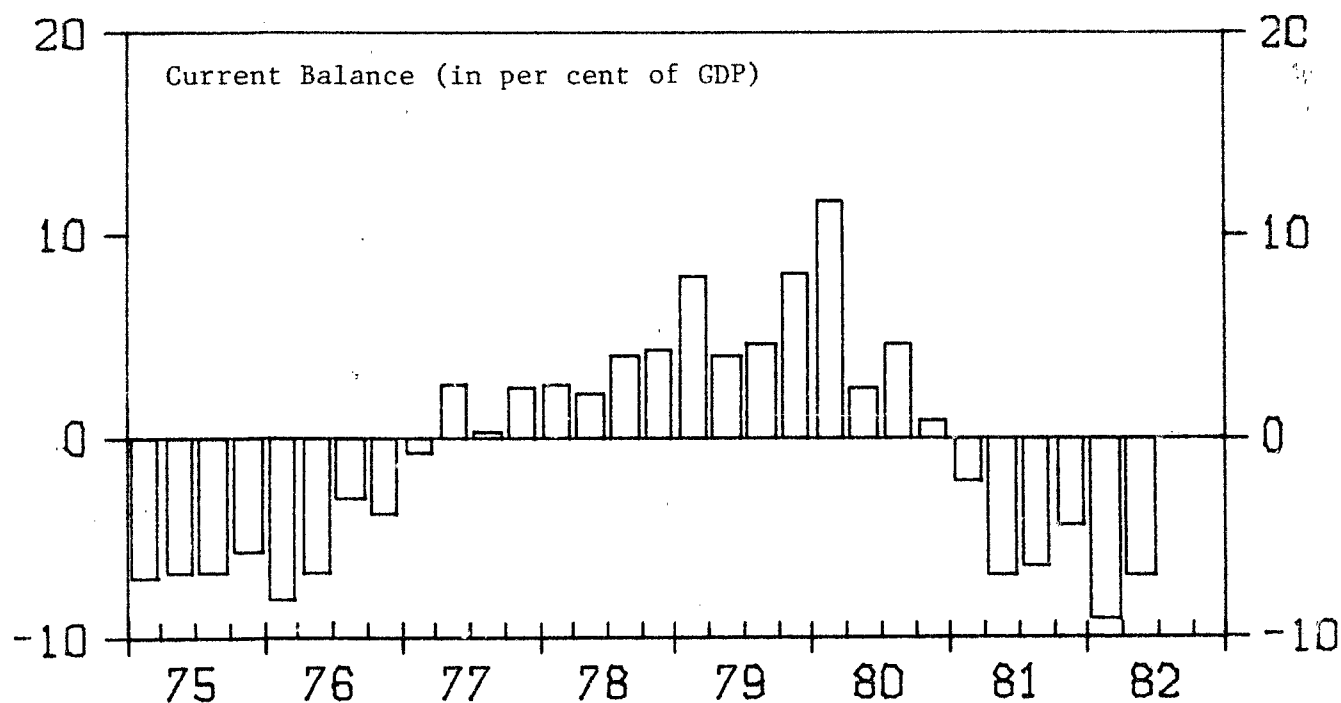


Source: South African Reserve Bank, Quarterly Bulletin.

CHART 2

SOUTH AFRICA

BALANCE OF PAYMENTS INDICATORS



Source: South African Reserve Bank, Quarterly Bulletin.

^{1/} Gold valued at market-related prices.

In late 1981 the South African Reserve Bank undertook gold swaps of about SDR 1 billion. At the end of 1981, official reserves, including gold at market-related prices, were SDR 3.4 billion (equivalent to nine weeks of merchandise imports), compared with SDR 5.7 billion at the end of 1980. During 1981 net foreign assets declined by SDR 2.8 billion, even though the rand was depreciated by 12 per cent in effective terms 1/ and by 9 per cent (Chart 3) in real (that is, price-adjusted) effective terms.

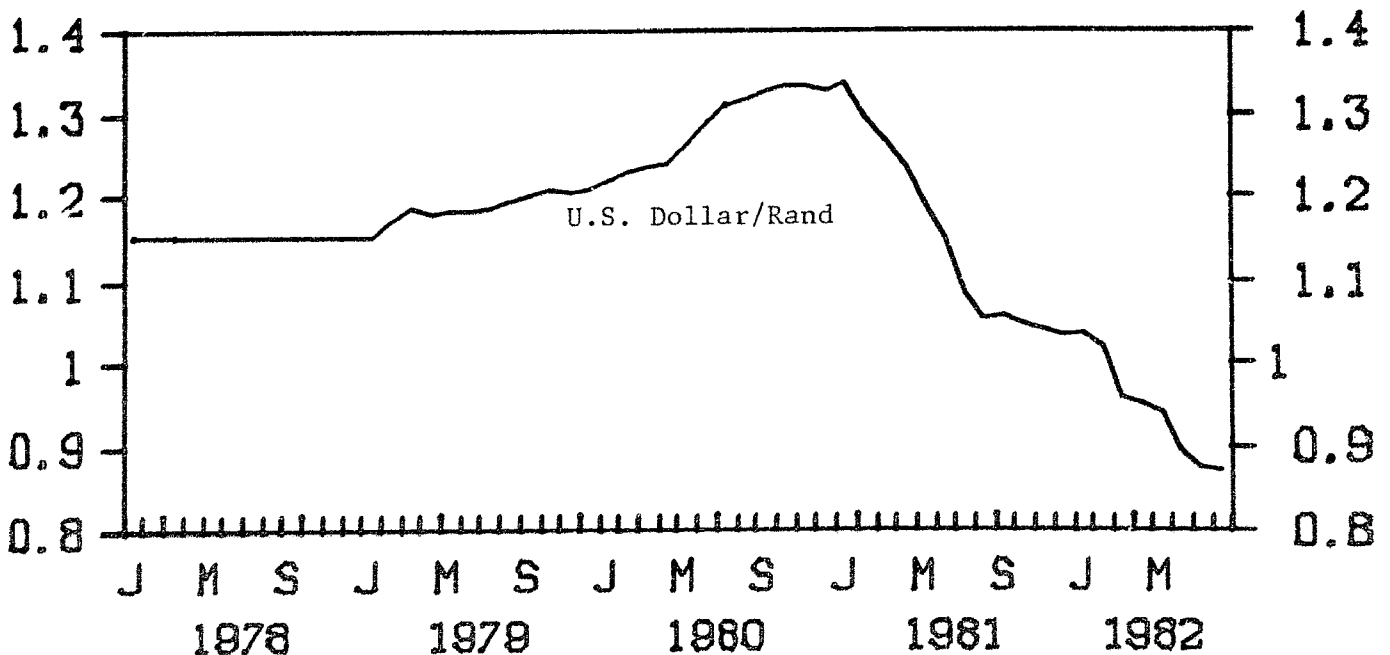
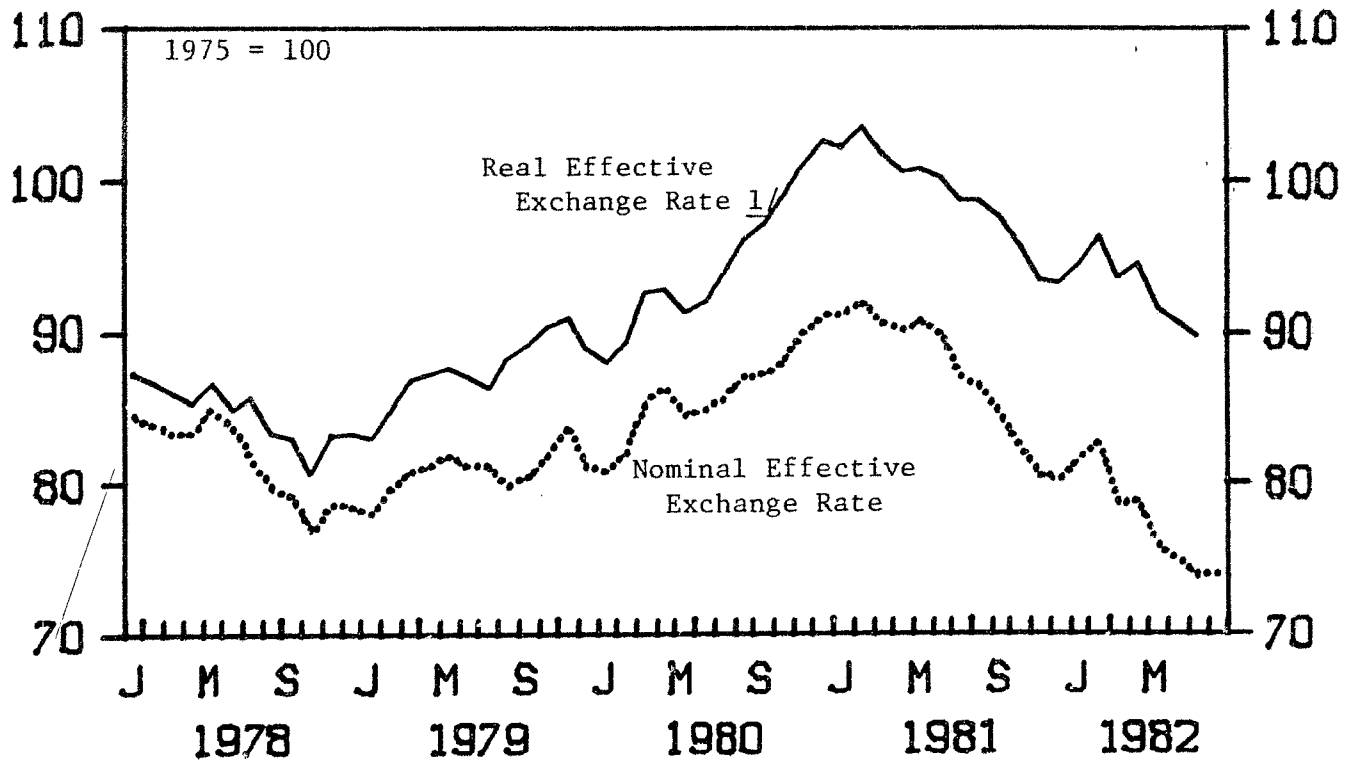
Monetary policy in 1981 was too easy, although monetary conditions were tightened in the second half of the year as the authorities became increasingly concerned about the external deficit. Interest rates were allowed to rise sharply but still remained negative in real terms until early in 1982 (Chart 4). Domestic credit increased by 38 per cent during 1981 and, despite the very large drain of liquidity resulting from the external deficit, broad money (M3) grew by 20 per cent. Some special factors complicated monetary management during 1981: first, there was a very large increase in agricultural financing at preferred rates through the Land Bank, a quasi-government institution; second, there was an unexpected shortfall in the purchases of government securities by the Public Debt Commissioners, which, because yields on government paper were not allowed to rise sufficiently to attract private subscriptions, led to additional Reserve Bank financing of the Government; and third, large bouts of disintermediation and reintermediation affected the growth rates of the monetary aggregates. In addition, large losses incurred on the provision of forward cover by the Reserve Bank were monetized. 2/

Forward cover is only provided by the Reserve Bank, and since 1980 forward rates have normally been set to reflect interest differentials. For part of the third quarter of 1981 and at times in 1982, however, the authorities set the forward exchange rate to provide a covered interest differential in favor of foreign borrowing (Chart 5); this contributed to the large imbalance in the forward book. As a consequence, the sharper-than-anticipated depreciation of the rand led to large losses on forward cover. Substantial forward losses were incurred again in the first half of 1982. In the year through June 1982, these losses amounted to R 2.2 billion, or about 30 per cent of the expansion of domestic credit over the period.

1/ The effective exchange rate index used by the South African authorities shows a somewhat larger depreciation. The difference between the two figures is accounted for by the larger weight of the U.S. dollar in the official index. The weights in the official index reflect the currency denomination of trade in certain primary commodities, that are priced in world markets in U.S. dollars, rather than the origin or the destination of trade, as in the staff index.

2/ The monetization is automatic, in the sense that, at maturity of the forward contract, the impact on the money supply is less than the rand value of the fall in foreign assets, with the difference accounted for by the forward losses. In the official statistics, such losses are included under "other items, net" on the asset side of the monetary survey. Here, however, and for the purposes of the program, they are included under total domestic credit and net credit to the Government.

CHART 3
SOUTH AFRICA
EXCHANGE RATE DEVELOPMENTS
(1975=100)



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

^{1/} Relative consumer prices adjusted for nominal exchange rate movements.

annual rate. The fall-off in domestic activity and the depreciation-related increase in import prices in rand terms led, by the second quarter of 1982, to a 12 per cent reduction in the volume of imports from the peak in the second quarter of 1981. However, the gold price fell further in the first half of 1982; ^{1/} the value of gold exports, at an annual rate of SDR 6 billion, was not much more than half that of 1980. Depressed world markets also reduced export receipts for other metals and minerals and some agricultural commodities. Export volume declined by 11 per cent on a seasonally adjusted annual basis from the second half of 1981 to the first half of 1982. As a result, the current account deficit amounted to about SDR 5 1/4 billion on a seasonally adjusted annual basis in the first half of 1982--that is, substantially larger than in 1981.

With the continued large current account deficit, the effective exchange rate was allowed to depreciate by a further 8 per cent during the first eight months of 1982. In addition, from end-March 1982, the Reserve Bank lowered the forward premium on dollars in order to favor foreign over domestic financing of trade. In the first half of 1982, liabilities related to reserves rose by SDR 2 billion and, following additional gold swaps in July 1982, the potential for further short-term borrowing and swaps was seen to be very limited. Thus, by the time of the staff visit, the freedom of maneuver in the financing of the external deficit was perceived to be extremely small.

III. The Stabilization Program and Performance Criteria

The attached memorandum on the economic policies of the Republic of South Africa describes the adjustment program that the South African authorities have embarked upon and that they intend to pursue through 1983. The objective of the program is to attain a sustainable external position in 1983, which the authorities believe would entail a reduction of the current account deficit from close to 6 per cent of GDP projected in 1982 to 2 per cent in 1983. This objective is consistent with a cautious view of the external financing possibilities available to the South African authorities in light, particularly, of the large buildup of short-term foreign debt over the last two years. The attainment of this current account objective will require a substantial reduction of domestic demand over the program period, to be achieved through financial restraint and an appropriate exchange rate policy. Demand restraint should also facilitate the containment of inflationary pressures.

In addition to the customary provisions with respect to the trade and exchange system, the performance criteria are ceilings on total domestic credit, with subceilings on net credit to government. No ceiling is placed explicitly on government and government-guaranteed external debt, as the external debt service ratio, at about 8 per cent of exports of

^{1/} To an average of US\$348 per fine ounce, compared with US\$460 in 1981.

exceed budget estimates by about R 200 million, mainly on account of higher gold-related revenues. Although gold prices in dollar terms on average so far have been lower than anticipated, mining profits have been protected by a sharper depreciation of the rand than that underlying the budget estimate. At the time of the mission, the authorities reconfirmed their resolve to hold the budget deficit to the original estimate and, to this end, the general sales tax was raised by 1 percentage point, to 6 per cent, effective September 1, 1982. ^{1/} This measure is expected to yield additional revenues of over R 300 million during the fiscal year. Together with continued restraint on total expenditures, it should facilitate the realization of the budget deficit objective, despite the phased reduction in the 10 per cent import surcharge announced on October 4, 1982. Moreover, except for seasonal borrowings, the authorities are maintaining their intention to finance the budget deficit entirely outside the domestic banking system.

The budget for the 1983/84 fiscal year has not yet been formulated in detail. Nevertheless, the Government's objective is to reduce the overall deficit further to about 2 per cent of GDP (some R 2 billion) by again cutting spending in real terms. The recent increase in the sales tax will boost revenues in 1983/84 by almost R 0.7 billion (about 3/4 per cent of GDP). The Government will take any additional tax measures that may become necessary to contain the overall deficit and will allow sufficient interest rate flexibility to finance the budget deficit entirely outside the domestic banking system. The additional tax effort necessary to attain the overall deficit objective would be significant if the price of gold were as low as assumed in the program. The authorities intend to discuss fiscal policy with a staff mission before the next budget.

The Government regards the adjustment program as a period of financial consolidation to lay the basis for sustained growth over the longer term. During past high-growth periods, such as 1980-81, infrastructural inadequacies and, even more importantly, skilled labor shortages have proved to be serious supply constraints. In this context, the authorities have determined that critical training and infrastructural programs, designed to ease these medium-term constraints on growth, should not bear the brunt of the budget cuts. On the other hand, it is envisaged that government consumption expenditures, and, in particular, the public sector wage bill, will see much slower growth in 1983/84 than over the previous two years. This view is consistent with the projection of a fall in real domestic demand, an abatement of domestic price inflation, and a softening of the labor market.

3. External policies

The objective of South Africa's exchange rate policy during the program period will be to support balance of payments adjustment. As a result of the depreciation of the rand that has already taken place, the

^{1/} It had already been raised from 4 per cent to 5 per cent in February 1982.

real effective exchange rate is considered to be broadly appropriate for safeguarding the competitive position of the exporting and import-competing sectors. The authorities intend to administer exchange rate policy flexibly in response to the requirements of South Africa's external environment.

South Africa has maintained its exchange system for current international transactions free from restrictions. During the program period, the Government will continue its commitment to an open trade and exchange system. In February 1982 a temporary 10 per cent surcharge was imposed on non-oil nongovernment imports not subject to GATT bindings. The Government recognizes that the surcharge has resulted in significant trade distortions. Accordingly, on October 4, 1982, the Government announced that effective January 1, 1983 the surcharge rate would be reduced to 7.5 per cent. In addition, the Government is committed to a complete phasing out of the surcharge during the program period.

South Africa operates a dual exchange rate system, with all equity investments by nonresidents eligible to use the financial rand. ^{1/} Income from these investments, however, can be remitted at the commercial rand exchange rate. All current international transactions take place at the commercial rand exchange rate. Since the financial rand floats freely, there can be no net capital inflow through this medium. The financial rand has traditionally been at a substantial discount vis-à-vis the commercial rand, but recently the discount has narrowed and at end-August 1982 stood at 12 per cent. The eventual aim of the authorities remains to merge the two markets, and the text of the stand-by arrangement explicitly allows for the transfer of transactions from the financial to the commercial rand market.

South Africa has followed a prudent external debt management policy, restricting its direct official borrowing to the smoothing out of short-term fluctuations in official reserves and limiting the issuance of official external debt guarantees to the financing of a small number of commercially viable projects. In the past, South Africa used the periods of balance of payments surplus to make substantial repayments of its external debt. As a result, South Africa's public debt service burden, at 8 per cent of exports of goods and services, is comparatively low, and it is expected to remain so in the future (Table 5).

4. The short-term outlook

While it is expected that higher interest rates will elicit an increased flow of domestic saving and that investment will not be cut in certain critical areas, the Government's adjustment program consists chiefly of rigorous demand management. Total real domestic expenditure is projected to fall by 2 per cent in 1982 and by 4 per cent in 1983 (Table 1).

^{1/} A limited number of other transactions also take place through the medium of the financial rand. For details, see the 1982 Recent Economic Developments for South Africa, Chapter VII (SM/82/89, 5/11/82).

In 1982 consumption is expected to continue to increase in real terms, although the growth will be much lower than in 1981. For 1982 there may still be some net positive inventory accumulation--chiefly of an involuntary nature and in response to a weakening of final demand--but the slowdown in inventory accumulation will have a substantial negative effect on real growth. Fixed investment is projected to fall after the rapid expansion of the past two years. Despite the fall in total domestic expenditure, real GDP is expected to rise slightly in 1982, owing to the substantial projected improvement in the real external balance of goods and services. While no recovery of exports of goods and services is expected, the considerable reduction in imports contributes to a positive swing in the balance that adds about 2 1/4 percentage points to GDP.

In 1983 private consumption is projected to fall by 2 per cent, stocks are likely to be reduced substantially, and fixed investment to fall even more sharply than in the current year. Despite the large improvement in the external balance on goods and services, which, in itself, contributes about 3 percentage points to the change of real GDP, a fall of about 1 per cent in real GDP is projected. The brunt of the adjustment program will be borne by imports, which traditionally consist largely of intermediate and investment goods. There is no doubt that this adjustment will constrain capacity in certain areas and have some effect on growth in the future. These negative effects, however, will be minimized by protecting critical areas in the public sector's investment program, and by allowing market-determined interest rates to mobilize additional savings and allocate investment finance to the most profitable areas.

The Government does not envisage a substantial lowering of the inflation rate during the program period. Despite the considerable abatement in demand pressures, consumer price inflation is programmed to fall by only 2 percentage points, in 1983, to 14 per cent. The continued high rate of inflation is due largely to the lagged effects of the depreciation of the rand and the adjustments in administered prices that were necessary and inevitable in order to avoid implicit subsidies, as well as the higher rate of the general sales tax.

The external current account is projected to improve mainly because of a sharp turnaround of the trade account, which is expected to swing from a deficit of about SDR 0.2 billion in 1981 and an estimated SDR 0.7 billion in 1982 to a surplus of SDR 1.5 billion in 1983 (Table 2). The projection for merchandise exports is based on an assumption that the recovery from the current recession in South Africa's major trading partners will be mild and will not commence until 1983. Accordingly, while it is estimated that the volume of merchandise exports (including gold) will change little in 1982, an increase of some 2 per cent is projected for 1983.

A steep reduction in merchandise imports is expected to contribute importantly to the improvement of the current account. Owing primarily

to restrictive domestic financial policies and the depreciation of the rand, the volume of imports is projected to decline by about 12 per cent in 1982 and a further 14 per cent in 1983. The apparently large magnitude of these import cutbacks needs to be placed in the context of South Africa's business and balance of payments cycle. Over the period 1979-81, with favorable terms of trade developments and very rapid growth of domestic demand, the volume of imports increased by about 40 per cent. This increase was due, in large part, to a substantial accumulation of inventories. For the program period, the projected import volume developments are consistent with the financial policies described above and historical experience of similar cyclical downturns.

Reflecting the fall in the gold prices in the first half of 1982, the assumed price in the second half of 1982 and for 1983, and depressed prices for most nongold exports in 1982, the terms of trade are projected to decline by 14 3/4 per cent in 1982 and by a further 2 1/2 per cent in 1983.

Based on these trends and an anticipated improvement in invisibles, the current account deficit is expected to increase slightly from SDR 3.6 billion (5 1/4 per cent of GDP) in 1981 to SDR 4.0 billion (6 per cent of GDP) in 1982, and to decline sharply to SDR 1.4 billion (2 per cent of GDP) in 1983. Taking capital inflows into account, the overall external deficit is projected to be about SDR 2 billion in 1982 and SDR 0.8 billion in 1983. Under the proposed arrangement and the CFF purchase, Fund resources provided to South Africa would amount to about SDR 0.8 billion during 1982 and 0.2 billion during 1983.

The gold price rose quite sharply, after the return of the mission, and it could well remain significantly above the level assumed for the program period. If an average gold price of US\$415 for the last four months of 1982 and for 1983 is assumed, staff calculations suggest that the current account deficit would be closer to 5 per cent of GDP in 1982, and of the order of 1/2 per cent of GDP in 1983. Even so, official reserves would remain relatively low in relation to imports. Given the credit ceilings, the higher gold price would allow a somewhat faster growth of M3 in both 1982 and 1983 than envisaged in the program. The decline in real domestic expenditure would also be slightly lower in both 1982 and 1983. Real GDP would still fall in 1983, although by somewhat less than assumed in the program.

5. Performance criteria

The program's performance criteria are ceilings on net credit to government and on total domestic credit of the banking system. These ceilings are as follows:

	Amount Outstanding				
	1982	1983			
	Dec.	March	June	Sept.	Dec.
<hr/>					
(In millions of rand; end of period)					
Net credit to government	8,050	7,500	8,200	8,100	8,500
Domestic credit	34,150	34,450	36,650	37,450	38,600
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As explained above, the definition of net credit to government is inclusive of (1) certain items in the banking system accounts that are classified by the South African authorities as "other items, net" but are for the account of the Government and (2) the Exchequer foreign borrowing. The inclusion of the latter obviates the need to impose separate limitations on the contracting or guaranteeing of new external commitments by the Government. Also, the ceilings on domestic credit of the banking system would be adjusted downward automatically if the price of gold were to decline significantly on a sustained basis.

In addition to these quantitative performance criteria, the program contains as performance clauses (1) the customary provisions on the restrictive system and (2) a review to reach further understandings with the Fund before July 31, 1983 on exchange rate policy and the removal of the import surcharge.

IV. Staff Appraisal

After exceptionally vigorous growth in 1980 and a strong balance of payments sustained by a buoyant gold market, South Africa's economic performance deteriorated significantly. Economic growth weakened, and the balance of payments swung into large deficit, financed mainly through substantial official short-term borrowing abroad. The main causes of the deterioration were the decline in the price of gold, weaker markets for other exports, and excessive domestic demand, the latter reflecting the authorities' delay in implementing adjustment policies.

It was only by early 1982 that strong adjustment measures were in place. These included a sharp increase in interest rates to positive real levels; a budget limiting the overall deficit through a decline in real spending and significant tax increases, to be financed without recourse to the banking system; and a substantial effective depreciation of the rand. Although these measures have begun to curtail the demand for imports, the balance of payments has continued to deteriorate in the first half of 1982, mainly because of the further weakening of export markets and the decline in gold prices. In view of this and the perceived

limited possibilities for further financing, the authorities are determined to strengthen their adjustment efforts to speed up the attainment of a sustainable external payments position.

In order to safeguard the stabilization efforts, the authorities are basing their policy strategy on a conservative assumption about the future price of gold, despite the recent upward movement in the price. If the higher price of gold were to be sustained, the external constraint would be less severe. However, given the extensive official borrowing over the past two years, the staff regards this safeguard for the time being as appropriate. On these assumptions, the main aim of policies is to reduce the external current account deficit from close to 6 per cent of GDP in 1982 to 2 per cent in 1983. The principal instruments for achieving this objective will be financial restraint and continued flexibility of the exchange rate. After two years of rapid growth, demand restraint will inevitably bring about a period of consolidation. Demand restraint will also be instrumental in reducing the rate of inflation, which is very high by historical standards.

A number of important monetary policy initiatives have recently been introduced to strengthen control over the monetary aggregates by means of management of the cash base and flexibility on interest rates, rather than through quantitative ceilings on bank lending. The authorities have targeted the growth of broad money (M3) to be well below the expected rate of inflation in 1982 and 1983, and the growth of domestic credit of the banking system is to be reduced sharply. Monetary restraint should help both to contain the external payments deficit and to reduce inflation. The staff believes that the monetary targets are entirely appropriate and that the recent initiatives should facilitate financial control. Market-determined interest rates should help elicit adequate domestic savings and ensure a more efficient allocation of credit. They should also help to encourage inflows of external capital on an uncovered basis.

Should the price of gold decline significantly from the level assumed in the program, more vigorous adjustment will be required in order to attain the external objective, and the authorities intend to reduce the rate of growth of domestic credit accordingly. Given the substantial buildup of official short-term external debt over the past two years and the limited remaining financing possibilities, such a safeguard is believed to be necessary. However, in view of the high rate of inflation and the danger of rekindling demand pressures, the staff agrees that no similar automatic upward adjustment of the credit ceilings would be warranted, if the price of gold were to remain at present levels or increase further.

Monetary restraint is to be supported by fiscal austerity, with the government deficit to be financed entirely outside the banking system. The budget for 1982/83 included a substantial additional tax effort, in part to compensate for reduced gold-related revenues, and a cut in real spending, with the objective of containing the deficit to about 2 3/4 per

cent of GDP. In order to offset expenditure overruns, the authorities have raised the general sales tax, and the staff welcomes this indication of their commitment not to exceed the budgeted deficit. For 1983/84 the authorities intend to reduce the budget deficit to about 2 per cent of GDP and again to finance it entirely outside the banking system. This should make an important contribution to adjustment. Total spending will again be reduced in real terms, but the authorities will ensure that critical training and infrastructural programs--designed to ease medium-term constraints on growth--are not made to bear the brunt of the budget cuts. Instead, greater restraint will be exercised with respect to current spending, in particular the government wage bill. In addition, if the price of gold is as low as is assumed in the program, a significant tax effort will be required in order to attain the budgetary objective for 1983/84. The staff supports the general stance of fiscal policy and welcomes the recently announced reduction in the import surcharge, and the intention of the Government to completely phase it out during 1983.

With the sharp effective depreciation of the rand during the past two years and the planned stance of financial policies, the current level of the real exchange rate of the rand appears to be consistent with the achievement of the external objective, though the authorities intend to continue to pursue exchange rate policy with the appropriate degree of flexibility.

In sum, the staff believes that South Africa's financial program through the end of 1983 is appropriate to the attainment of a sustainable external position and a sound basis for continued economic growth over the medium term.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Government of South Africa has requested a stand-by arrangement for a period from November ..., 1982 to December 31, 1983 in an amount equivalent to SDR 364 million.
2. The Fund approves the stand-by arrangement attached to EBS/82/173.
3. The Fund waives the limitation in Article V, section 3(b)(iii), of the Articles of Agreement.

Table 1. 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	2.5	8.9	6.6	1	-2
Public consumption	5.1	2.7	7.8	3.0	2	--
Gross fixed investment	4.0	1.9	14.8	11.4	-2 1/2	-4 1/2
Stockbuilding 1/	-0.5	0.8	2.5	2.2	-2 1/4	-1 3/4
Total domestic demand	3.2	3.4	13.2	9.7	-2	-4
Foreign balance 1/	0.6	0.9	-4.2	-4.5	2 1/4	3
GDP	3.5	4.0	7.8	4.7	1/4	-1
Prices, wages, and savings						
Consumer prices	9.6	13.1	13.8	15.2	15 3/4	14
GDP deflator	11.1	15.1	21.7	8.6	12 1/2	13 3/4
Salaries and wages per worker in nonagri- cultural 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	16.7	22.3	19.7	16 1/4	12 1/3
Savings ratio (in per cent)	9.5	8.8	7.8	5.9	5	5 1/2

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: Savings, Investment
and the Current Account

(In per cent of GDP)

	1979	1980	1981	1982 Estimated	1983 Forecast
Gross domestic saving	<u>32.2</u>	<u>34.6</u>	<u>28.9</u>	<u>24.0</u>	<u>24.7</u>
Personal saving <u>1/</u>	5.1	5.6	3.9	2.9	3.3
Corporate saving <u>1/</u>	10.6	12.2	9.3	5.2	4.2
Saving of general government <u>1/</u>	2.7	4.3	2.6	1.9	2.6
Provision for depreciation <u>2/</u>	13.9	12.5	13.1	14.0	14.6
Gross domestic investment	<u>26.0</u>	<u>29.8</u>	<u>34.2</u>	<u>30.0</u>	<u>26.7</u>
Total fixed investment	24.5	24.6	27.2	27.3	26.2
Total change in inventories	1.4	5.2	7.0	2.7	0.5
Current account balance	6.2	4.8	-5.2	-6.0	-2.0

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

1/ After provision for depreciation and inventory valuation adjustment.

2/ At replacement value.

Table 4. South Africa: Summary of the Exchequer Accounts

(In millions of rand)

	1980	1981	1982	1983	
	Actual	Actual	Actual	Budget estimate	Revised estimate
	Year ending March				
Current revenue (excluding loan levy)	9,788	13,310	14,426	15,858	16,350 1/
Of which:					
From gold mining	1,501	3,633	2,131	1,005	1,200
Other	8,287	9,677	12,295	14,853	14,850
Additional tax effort	--	--	--	300
Expenditure	-11,441	-13,595	-16,455	-18,238	-18,750
Surplus or deficit (-)	-1,653	-285	-2,029	-2,380	-2,400
(In per cent of GDP)	3.2	0.4	2.8	2.8	2.8
	(Percentage changes)				
Current revenue (excluding loan levy)	20.3	36.0	8.4	9.9	13.3 1/
Of which:					
Related to gold mining	74.2	142.0	-41.3	-52.8	-43.7
Other	13.9	16.8	27.1	20.8	23.2 1/
Expenditure	14.9	18.8	21.0	10.8	13.9

Sources: Ministry of Finance, Budget Speech, various issues; and data provided by the South African authorities.

1/ Including revenues from additional tax effort.

Table 5. South Africa: The Financial Program

(In millions of rand)

	1981		1982		1982		1983		
	Dec.	March	June	Dec.	March	June	Sept.	Dec.	
	Historic data				Program period				
Total domestic credit 1/	27,768 (38)	29,450 (37)	31,353 (32)	34,150 (23)	35,450 (20)	36,650 (17)	37,450 (15)	38,600 (13)	
Net credit to government 1/	6,022 (52)	5,642 (72)	6,933 (69)	8,050 (34)	7,500 (33)	8,200 (18)	8,100 (12)	8,500 (6)	
Private sector credit	21,746 (35)	23,808 (31)	24,420 (24)	26,100 (20)	27,950 (17)	28,450 (17)	29,350 (16)	30,100 (15)	
Other assets, net	-4,285	-3,643	-4,253	-4,750	-4,600	-4,900	-4,930	-5,050	
Net foreign assets 2/	1,654	139	-754	-1,250	-1,900	-2,350	-2,470	-2,550	
Total liquidity (M3)	25,137 (20)	25,946 (18)	26,346 (11)	28,150 (12)	28,950 (12)	29,400 (12)	30,050 (11)	31,000 (10)	

Source: Data provided by the South African authorities.

1/ Inclusive of Exchequer foreign liabilities, government-related items in transit, and exchange losses on forward cover.

2/ Exclusive of Exchequer foreign liabilities and valuation adjustments.

Note: Data refer to the end of period. The figures in parentheses are percentage changes over the corresponding date of the previous year.

Table 6. South Africa: Outstanding External Public Debt
and its Servicing, 1980-83 1/

(In millions of SDRs)

	1980	1981	1982	1983
Outstanding debt (including undis- bursed, end of period)	5,214	5,046
Amortization payments	1,558	821	867	655
Interest payments	460	476	490	608
Total payments	2,018	1,297	1,357	1,263
Exports of goods and non- factor services	21,944	20,194	17,275	18,052
Debt service ratio (in per cent)	9.2	6.4	7.9	7.0

Source: Data provided by the South African authorities.

1/ Including publicly guaranteed debt. Projections for 1982-83 are based on amounts outstanding as of March 31, 1982.

South Africa: Summary of the Financial Program

I. Target

1. The deficit on the current account of the balance of payments is to be reduced from close to 6 per cent of GDP (SDR 4 billion) projected for 1982 to 2 per cent of GDP (SDR 1.4 billion) in 1983.

II. Implications of the Program

1. It is expected that real GDP will rise slightly in 1982 and decline by about 1 per cent in 1983. Gross domestic expenditure is projected to fall by about 2 per cent in 1982 and by 4 per cent in 1983.
2. The inflation rate of consumer prices is projected to be reduced from nearly 16 per cent in 1982 to about 14 per cent in 1983.

III. Principal Elements in the Program

1. Monetary policy

a. Total domestic credit expansion is programmed to fall from 38 per cent during 1981 to 23 per cent during 1982 and then further to 13 per cent during 1983. The ceilings on domestic credit are to be adjusted downward automatically in the event of the gold price declining, on a sustained basis, by US\$10 or more below US\$300 per fine ounce--the adjustment will amount to half a per cent at an annual rate for each US\$10 decline.

b. There are also separate subceilings on net credit to government, which is defined to include Exchequer foreign borrowing and other government-related items not included in the official statistics, in particular losses on official forward exchange transactions. The growth in net credit to government is programmed to fall from 52 per cent during 1981 to 34 per cent during 1982 and then to 6 per cent during 1983.

c. Consistent with the credit ceilings, a reduction in the growth of broad money (M3) from 20 per cent during 1981 to 12 per cent during 1982 and to 10 per cent during 1983 is expected.

d. The restrictive monetary and credit policies are to be pursued through control of the monetary base rather than through quantitative controls on bank lending.

2. Fiscal policy

The budget deficit for 1982/83 is to be held to the original estimate of R 2.4 billion (2 3/4 per cent of GDP). To this end, the general

Fund Relations with South Africa
(As of August 31, 1982)

Quota	SDR 636 million.
Status	Article VIII, as from September 15, 1973.
Fund holdings of South African rand	SDR 636.0 million or 100.0 per cent of quota.
SDR position	Holdings are SDR 3.6 million or 1.6 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. Certain capital transactions take place in a separate insulated market in which the "financial" rand is traded at a freely determined exchange rate, usually at a discount over the "commercial" rate. The exchange rate of the "commercial" rand on August 31, 1982 was R 1 = US\$0.87; on the same date the discount of the "financial" rand was 12 per cent.
Last consultation	February/March 1982, completed by the Executive Board on May 26, 1982.

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 1981)	5,103,000

IMF Position (August 31, 1982)

Quota	SDR 636 million
Fund holdings of rand as per cent of quota	100.0
holdings of SDRs	SDR 3.6 million
Exchange rate	R 1 = US\$0.87 = SDR 0.80

National Accounts

	1981	1978	1979	1980	1981
	In millions of rand at current prices	Percentage change in real terms			
Private consumption	37,681	1.1	2.5	8.9	6.6
Public consumption	9,882	--	2.7	7.8	3.0
Gross fixed investment	19,343	-3.0	1.9	14.8	11.4
Change in stocks (including residual item) 1/	<u>5,295</u>	<u>1.8</u>	<u>0.8</u>	<u>2.5</u>	<u>2.2</u>
Total domestic demand	72,201	1.8	3.4	13.2	9.7
Exports of goods and services	20,725	4.5	2.3	-0.9	-5.1
Imports of goods and services	<u>21,732</u>	<u>0.7</u>	<u>-1.0</u>	<u>18.6</u>	<u>13.6</u>
Gross domestic product	71,194	2.9	4.0	7.8	4.7

State Revenue Account 2/

	1978/79	1979/80	1980/81	1981/82
	In millions of rand			
Revenue	8,138	9,788	13,310	14,426
Expenditure	-9,955	-11,441	-13,595	-16,455
Overall deficit	-1,817	-1,653	-285	-2,029

1/ Contribution to growth of GDP.

2/ Years ended March 31.

Basic Data (cont'd.)

Balance of Payments

	1978	1979	1980	1981
	In billions of rand			
Merchandise exports, f.o.b.	11.3	14.8	19.9	17.9
Net gold output	3.9	6.0	10.1	8.3
Merchandise imports, f.o.b.	-8.0	-9.7	-14.2	-18.1
Net invisibles and transfers	<u>-2.0</u>	<u>-2.1</u>	<u>-2.7</u>	<u>-3.5</u>
Current balance	1.3	3.0	3.0	-3.7
Net long-term capital	--	-1.0	-0.6	0.4
Net short-term capital (including errors and omissions)	<u>-0.8</u>	<u>-1.5</u>	<u>-1.9</u>	<u>0.5</u>
Net capital (including errors and omissions) <u>1/</u>	-0.8	-2.6	-2.5	0.9
Overall balance	0.5	0.4	0.5	-2.8
Level of reserves at end-year (in millions of SDRs, IFS definition)	667	681	994	898

Monetary Aggregates (end-period)

	1978	1979	1980	1981
	Percentage increase over previous year			
Broad money (M3)	16.5	14.7	23.5	20.2
Total net domestic credit <u>2/</u>	8.8	13.3	20.3	33.8
Of which:				
Bank credit to private sector	1.45	15.6	29.1	35.0
Bank credit (net) to government <u>2/</u>	-6.7	5.7	-12.0	27.0

Prices (annual average)

Consumer prices	10.2	13.1	13.8	15.2
Exports of goods and services	18.4	26.2	34.3	-0.2
Imports of goods and services	15.7	21.6	20.4	12.1

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.

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

	1981 Actual	1982 Estimate	1983 Program <u>1/</u>
	(Annual percentage changes unless otherwise specified)		
National income and prices			
GDP at constant prices	4.7	1/4	-1
GDP deflator	8.6	12 1/2	13 3/4
Consumer prices	15.2	15 3/4	14
External sector			
Nongold exports, f.o.b. <u>2/</u>	-3.2	-9	7
Nongold export volume	-10.0	-1/2	2 1/2
Gold exports <u>2/</u>	-18.9	-25	-1/3
Gold export volume	0.8	1	2
Imports, f.o.b. <u>2/</u>	26.2	-13 3/4	-10 1/2
Import volume	14.6	-12 1/3	-14 1/3
Terms of trade (incl. gold; deterioration, -)	-13.6	-14 3/4	-2 1/2
Nominal effective exchange rate (depreciation, -)	1.5	-12 1/2	-6 1/2
Real effective exchange rate (depreciation, -)	4.5	-6 1/2	-1
Government budget <u>3/</u>			
Revenue	8.4	13 1/3	...
Total expenditure	21.0	14	...
Money and credit <u>4/</u>			
Net domestic credit <u>5/</u>	38	21	13
Net credit to the Government <u>5/</u>	52	34	6
Credit to the private sector <u>5/</u>	35	20	15
M3	20	12	10
	(In per cent of GDP)		
Central government budget deficit (State Revenue Account) <u>3/</u>	2.8	2 3/4	2
Savings of general government	2.6	2	2 1/2
Gross domestic investment	34.2	30	26 3/4
Gross domestic savings	28.9	24	24 3/4
External current account deficit	5.2	6	2
Debt service ratio <u>6/</u>	6.4	8	7
Overall balance of payments (in millions of SDRs)	-2,762	-2,000	-800

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

1/ Based on a gold price of US\$315.

2/ In SDR terms

3/ Fiscal year ending March 31 of the following year.

4/ End period.

5/ As defined for purposes of the stand-by arrangement.

6/ In per cent of exports of goods and nonfactor services.

Stand-By Arrangement--South Africa

Attached hereto is a letter, with annexed memorandum, dated October .., 1982 from the Minister of Finance of the Republic of South Africa, requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of South Africa intend to pursue for the period of the stand-by arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from November .., 1982 to December 31, 1983, South Africa will have the right to make purchases from the Fund in an amount equivalent to SDR 364 million, subject to paragraphs 2, 3, and 4 below, without further review by the Fund.

2. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 159 million until January 31, 1982; the equivalent of SDR 200 million until April 30, 1983; the equivalent of SDR 254 million until July 31, 1983; and the equivalent of SDR 308 million until October 31, 1983. None of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund's holdings of South Africa's currency in the credit tranches beyond 25 per cent of quota.

3. South Africa will not make purchases under the stand-by arrangement that would increase the Fund's holdings of South Africa's currency in the credit tranches beyond 25 per cent of quota:

(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on domestic credit of the banking system, described in paragraph 5 and Table 1 of the memorandum annexed to the attached letter; or

(ii) the limit on net credit to the Government, described in paragraph 5 and Table 1 of the same memorandum,

are not observed; or

(b) during any period after July 31, 1983 in which understandings pursuant to the last sentence of paragraph 3 of the attached letter have not been reached, or such understandings having been reached, are not being observed; or

(c) during the entire period of this stand-by arrangement, if South Africa

- (i) imposes restrictions on payments and transfers for current international transactions; or
- (ii) introduces new or modifies existing multiple currency practices other than the transfer of transactions from the financial rand market to the commercial rand market; or
- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or
- (iv) imposes or intensifies import restrictions for balance of payments reasons.

When South Africa is prevented from purchasing under the stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and South Africa and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. South Africa's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of South Africa. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 4, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and South Africa and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund and may be made in SDRs if, on the request of South Africa, the Fund agrees to provide them at the time of the purchase.

6. South Africa shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

7. (a) South Africa shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as South Africa's balance of payments and reserve position improves.

(b) Any reductions in South Africa's currency held by the Fund shall reduce the amounts subject to repurchases under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

8. During the period of the stand-by arrangement, South Africa shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to South Africa or of representatives of South Africa to the Fund. South Africa shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of South Africa in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

9. In accordance with paragraph 4 of the attached letter, South Africa will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation, because any of the criteria in paragraph 3 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while South Africa has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning South Africa's balance of payments policies.

Pretoria,, 1982

Dear Mr. de Larosière:

1. After a period of buoyant economic growth and strong balance of payments performance sustained by an improvement in the terms of trade stemming from high gold prices, South Africa's economic performance deteriorated considerably during 1981. Economic growth weakened, owing mainly to physical constraints, and the balance of payments swung into deficit. The main causes of the deterioration were a sharp decline in the prices of gold and of other major exports, and an inordinate rise in aggregate demand emanating from an accumulation of excess liquidity during the two preceding years of balance of payments surplus. Although monetary policy initially remained too accommodating, the authorities gradually moved during 1981 to bring about adjustment through restrictive financial policies and a flexible exchange rate policy. Since early 1982 these policies have been tightened and a stabilization program is in effect to bring about a sustainable balance of payments position during 1983.
2. The attached memorandum describes the economic and financial objectives of the program in support of which the Government of South Africa requests the use of Fund resources under a 14-month stand-by arrangement in the amount of SDR 364 million. At the same time, a separate request for a purchase under the compensatory financing facility is also being submitted.
3. The principal economic objective for 1983 is to limit the external current account deficit to 2 per cent of GDP (R 1.8 billion), compared with a projected deficit of about 6 per cent of GDP (close to R 5 billion) in 1982. Taking capital flows into consideration, the overall balance of payments deficit in 1983 is projected to be about R 1 billion. To achieve this, various actions in the monetary, fiscal, trade, and exchange fields have been taken. These are reviewed in the attached memorandum, which also describes performance criteria for (a) domestic credit of the banking system and (b) net credit to government of the banking system. Before July 31, 1983 the Government of South Africa will review with the Fund the progress of the program, in order to reach further understandings on exchange rate policy and removal of the import surcharge.

4. The Government believes that the policies described in the attached memorandum are adequate to achieve the objectives of the program. However, it will take any additional measures that might become necessary for this purpose. Furthermore, South Africa will consult with the Fund in accordance with the policies of the Fund.

Sincerely yours,

/s/

O.P.F. Horwood
Minister of Finance

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431, USA

Memorandum on the Economic Policies of the Republic of South Africa

1. During 1980 the South African economy experienced unprecedented economic growth. The sharp increase in the gold price had removed the balance of payments constraint and, until the latter part of the year, domestic supply conditions did not constitute a serious constraint on output. Business and consumer confidence boosted expenditure, and economic policies were designed to accommodate demand and promote growth. However, by the end of 1980, owing to the recession in South Africa's major export markets and the weakening of the gold price, the balance of payments constraint re-emerged. At the same time, high capacity utilization rates and shortages of skilled labor contributed to an acceleration of inflation. Despite uncertainties about the duration of the recession abroad and the adverse shift in the terms of trade, and about the seriousness of domestic supply constraints, the need for adjustment was recognized. However, at that stage the excess liquidity and abnormally low interest rates inherited from the two preceding years of large balance of payments surplus provided more than enough scope for demand to rise unduly, and added to the difficulties facing the monetary authorities. It therefore took some months before the attempts of the authorities to bring about a meaningful tightening of the financial situation began to show positive results. Later in the year, and into 1982, economic policies were tightened further and strong adjustment measures have now been introduced.

2. It is clear with hindsight that, during 1981 as a whole, monetary policy was too accommodating, in part because a number of specific institutional problems weakened monetary control. Reintermediation, after the abolition of quantitative constraints on bank credit in September 1980, led to a swelling of the monetary aggregates in early 1981. Because of the record maize crop, there was an unprecedented amount of concessional credit to the agricultural sector. Easy and relatively cheap access to the Reserve Bank's discount window undermined the reserve constraint on commercial banks' credit expansion. In the latter part of the year, the Reserve Bank was forced to temporarily finance more of the government deficit than had initially been planned. In addition, large losses on official forward exchange contracts contributed importantly to monetary expansion. Fiscal policy was far more cautious, but it, too, in retrospect, did not fully respond to the need for adjustment in 1981/82. The growth of expenditure accelerated to 21 per cent, owing chiefly to substantial increases in interest payments on the public debt and in the government wage bill. On the revenue side, although receipts from the gold mines, which had contributed more than a quarter of total revenues in the previous year, fell by over 40 per cent, there was a compensating increase in other tax revenues. The deficit amounted to about 3 per cent of GDP, and although this was not high by historical standards, it did--in the context of the generally buoyant demand for credit--serve temporarily to exacerbate the difficulties of monetary control. External policies were allowed greater flexibility in 1981. In response to the worsening external position, the value of the rand was allowed to depreciate substantially and about R 3 billion of official balance of payments financing was provided.

3. In early 1982 the Government shifted the thrust of economic policy from accommodation to adjustment. Monetary policy was considerably tightened. Interest rates were allowed to rise and are now positive in real terms and better aligned with those abroad. The link between Bank rate and the prime lending rate was broken, and the prime rate, which had already risen from 9 1/2 per cent in early 1981 to 17 per cent in December of that year, increased further to 20 per cent in March 1982. Treasury bill rates were allowed to rise substantially to attract nonbank subscriptions. Strict interest rate penalties have been imposed on recourse to the Reserve Bank's discount window. In addition, the usury ceilings on bank lending up to amounts of R 100,000 have been raised, interest rates on government paper have been allowed to respond to market forces, and the concessional element in agricultural finance through the Land Bank has been greatly reduced. In response, by mid-1982 the rate of growth of the major monetary aggregates had fallen substantially, and bank deposit rates, which are market determined, had risen significantly. The need for further tightening of fiscal policy was already recognized before the end of the 1981/82 fiscal year and significant tax measures were introduced. The budget for 1982/83 went further in the direction of austerity. The overall deficit was budgeted at about 2 3/4 per cent of GDP despite a projected fall of over 50 per cent in gold-related revenues. This required substantial new revenue measures, including a loan levy on individuals, an income tax surcharge on companies, and selected increases in excise taxes on luxury goods. Together with pre-budget measures, these changes are expected to yield an amount equivalent to over 2 per cent of GDP and to increase nongold revenues by almost a quarter. Government expenditure in 1982/83 was budgeted to decline in real terms. The stricter monetary and fiscal policies have been accompanied by continued exchange rate flexibility. After a 14 per cent effective depreciation during 1981, the rand has depreciated by a further 10 per cent in the first seven months of this year. In early 1982, for the first time in its history, it was allowed to fall below parity with the U.S. dollar, and by end-August 1982 it stood at R 1 = US\$0.87. Although these measures have already begun to curtail demand, the balance of payments has deteriorated further in the first half of 1982, owing chiefly to the continued weakness of export markets and the further decline in gold prices. The Government is determined to strengthen its adjustment efforts until a sustainable external payments position is reached.

4. The objective of the stabilization program is to adjust the economy to the changed external conditions as rapidly as possible without jeopardizing the longer-term growth potential of the economy. In order to safeguard the program, the Government has based its policy planning on a conservative view of the future gold price. The current account deficit, which averaged about 2 per cent of GDP over the postwar period, is to be reduced progressively from the equivalent of about 6 per cent of GDP (close to R 5 billion) in 1982 to 2 per cent of GDP (R 1.8 billion) in 1983. Taking into account projected capital inflows, the overall payments deficit should decline from R 2 1/2 billion in 1982 to around R 1 billion in 1983. The principal instruments for achieving this objective will be

credit policies, fiscal policies, and continued flexibility of the exchange rate. A slow recovery abroad is assumed, and very little improvement in the nongold terms of trade. Because of the substantial depreciation of the rand over the past 18 months and the recent adjustments in administered prices, consumer price inflation is expected to rise from 14 per cent in 1981 to 16 per cent in 1982, before falling back to 14 per cent in 1983. After the vigorous real growth over the last two years, the demand restraint in 1982/83 will bring about a period of consolidation; real GDP is projected to remain flat in 1982 and to decline slightly in 1983. The Government will, however, continue to press ahead with infrastructural development and training programs to reduce the domestic bottlenecks that have constrained growth in the past.

5. The emphasis of monetary policy has been on curtailing demand and containing the external payments deficit and domestic costs. As noted in paragraph 3, a number of policy initiatives have recently been introduced to strengthen control over the monetary aggregates. Consistent with the real output, price, and external payments projections, the Government has targeted the growth of broad money (defined as M2 plus long-term deposits with the banking system) at about 12 per cent during 1982, and about 10 per cent during 1983. The expansion of domestic credit of the banking system is to be limited over the program period, as is the increase in net credit to Government. The ceilings for both are set out in Table 1. Should the price of gold decline significantly from the level assumed in the program, more vigorous adjustment will be required in order to attain the external objective. Accordingly, the rate of growth of domestic credit will be progressively reduced if the price of gold were to decline substantially from this level on a sustained basis. In limiting monetary growth, the Government will not rely on quantitative ceilings on commercial bank lending, but rather on management of the cash base and flexibility on interest rates. Such an interest rate policy would attract external capital and, accordingly, the Government intends to limit to exceptional circumstances the provision of incentives in the form of forward exchange rates to encourage the use of foreign credits. Market-determined interest rates will also help elicit adequate domestic savings and ensure an economically efficient allocation of credit.

6. The Government regards fiscal restraint as essential to the success of the stabilization program. As stressed in paragraph 3, the budget for 1982/83, which projects a reduction in real spending and a substantial tax effort, already represents a shift toward fiscal austerity. The budget deficit of R 2.4 billion, or about 2 3/4 per cent of GDP, will not be exceeded and will be financed entirely outside the banking system. However, the higher-than-expected rate of inflation has put pressure on spending, and the Government has raised the general sales tax, effective September 1, 1982, from 5 per cent to 6 per cent, in order to adhere to the original deficit target. This additional tax effort will also boost revenues in the next fiscal year by about 3/4 per cent of GDP. The budget for 1983/84, which has yet to be formulated in detail, will also be consistent with the financial program. It is intended to reduce total government spending again in real terms, to further reduce the

overall deficit to some 2 per cent of GDP (about R 2 billion), and to finance it entirely outside the domestic banking system. Moreover, the Government does not expect to borrow externally more than R 300 million (net) during the period of the arrangement. Over the past two years, government consumption expenditure has risen rapidly, owing chiefly to the need to maintain salaries competitive with the private sector. However, with the slowing down of the real economy and wage inflation, smaller increases in the wage bill are envisaged. Additional restraint on other current spending will permit expenditures on important infrastructural projects and on critical training programs to be continued to help ease domestic supply constraints. In addition, the Government intends to take appropriate tax measures to achieve the fiscal objective.

7. In February 1982 the Government introduced a 10 per cent surcharge on nongovernment imports that were not subject to GATT bindings. The primary purpose of this measure was to raise revenue rather than restrict imports and, at the time of its introduction, the Government indicated that it was of a temporary nature and would eventually be phased out. Revenue raised through this surcharge amounted to R 340 million during the period through end-September 1982. However, the Government recognizes that the surcharge, although an efficient means of raising revenues, also produces distortions of trade. Accordingly, on October 4, 1982, the Government announced that, effective January 1, 1983, the surcharge rate would be reduced to 7 1/2 per cent. The Government intends to phase out the surcharge completely during the program period. The date for the complete removal will be decided in conjunction with the 1983/84 budget and the mid-term review of the program.

8. The balance of payments objective of the program is to be achieved principally through an improvement in the trade account. The Government recognizes that the achievement of this goal will require the maintenance of a flexible exchange rate policy. The rand has depreciated considerably during the past 18 months. The Government considers the current level of the real effective exchange rate to be broadly appropriate for safeguarding the competitive position of the exporting and import-substituting sectors. Should external circumstances require it, the Government will pursue its exchange rate policy with the appropriate degree of flexibility.

9. The Government of South Africa has followed a prudent external debt management policy limiting its direct borrowing to the smoothing out of reversible fluctuations in official reserves and limiting the issuance of external debt guarantees to the financing of a small number of commercially viable projects. The stock of outstanding public and publicly guaranteed debt with a maturity of over one year amounted to US\$5.6 billion at the end of March 1982, while its servicing in 1982 will be equivalent to about 8 per cent of exports of goods and nonfactor services. The Government intends to continue its prudent external debt policy during the period of this arrangement, with the debt service ratio expected to remain below 10 per cent over the medium term. In addition, the Government intends to exercise restraint on its short-term borrowing abroad.

Table 1. Ceilings on Net Credit to Government and Domestic Credit
of the Banking System

(In millions of rand)

	Banking System	
	Net credit to Government	Domestic credit
Amount outstanding on June 30, 1982	6,933	31,353
Amount outstanding on December 31, 1982	8,050	34,150
Amount outstanding on March 31, 1983	7,500	35,450
Amount outstanding on June 30, 1983	8,200	36,650
Amount outstanding on September 30, 1983	8,100	37,450
Amount outstanding on December 31, 1983	8,500	38,600

Note: Net credit to Government includes Exchequer foreign borrowing and those items in the banking system accounts which are classified by the South African authorities as "other items, net" but which are for the account of the Government.

The ceilings on domestic credit of the banking system will be adjusted to reduce the growth of domestic credit by half a percentage point at an annual rate for each US\$10 that the price of gold, averaged over the three-month period ending on the date a credit ceiling is to be met, falls below US\$300 per fine ounce. Any such reduction will be applied cumulatively in respect of consecutive quarters in which an adjustment is required.