

May 25, 1982 - 82/73

Statement by Mr. Brand on South Africa
Executive Board Meeting 82/72
May 26, 1982

1. As is evident from study of the staff report for the 1982 Article IV consultation with South Africa as well as from the latest report on recent economic developments, the economic scenario in South Africa has changed quite considerably since the previous consultation two years ago. The implications of these changed conditions for internal and external adjustment, unfortunately, are serious and therefore require carefully considered and strictly executed coordinated plans of action. In view of the urgent need to foster adjustment, the present consultation with South Africa came at a very opportune time.
2. In this regard I wish at the outset to place on record my authorities' appreciation and gratitude to the management and staff for the most efficient and constructive way in which the consultations with them have once again been conducted. My authorities agree with the broad thrust of the analysis and with the description of the developments and policies contained in the staff papers.
3. The changed conditions to which I have referred relate to (1) the substantial decline in the price of gold and in world demand for South Africa's primary exports and (2) a massive worsening of the external current account of the balance of payments which the South African economy faced in the course of 1981. In addition to this, the economy has also been plagued by considerable inflationary pressures.
4. There is no doubt that in particular the monetary policies followed by my authorities up to late 1981 retarded the adjustment process. In retrospect coordinated measures taken at an early stage to foster adjustment would to some extent have lessened the worsening of the balance of payments, requiring lesser adjustment effort now to redress the position. In this regard it is, of course, always easier with hindsight, to express an opinion on what should have been done. Apart from the uncertainties which existed at that time about the duration of the unfavorable external conditions and the seriousness of supply constraints, judgments about the timing and scope of adjustment efforts are particularly difficult in South Africa because of the extreme difficulty of foreseeing developments in the gold market. Such developments, of course, play a pivotal role in the economy.
5. As it became clear that the world recession would last longer than initially expected and as the downward trend in the price of gold continued, the financial policy stance in 1981 gradually shifted from one of accommodation to one designed to bring about adjustment. At the time when the budget for the 1982/83 financial year had to be framed, my authorities had to consider several very difficult factors. On the internal side, the fact that the rate of unemployment among the lesser skilled sections of the

population did decrease initially, but stabilized at too early a stage, coexisted with an unacceptably high rate of inflation. For domestic reasons and in line with my authorities' desire to improve the economic well-being of all the population groups of the country, it was considered imperative on the one hand that the employment position should not be allowed to deteriorate. On the other hand, it was considered equally important for continued emphasis to be placed on containing demand pressures as far as possible. The choice of instruments to be employed in this precarious balancing act therefore required careful consideration so as to prevent as far as possible one priority from being undermined by the pursuit of another.

6. Any attempt to stimulate for employment purposes the economic activity through the budget would have been counterproductive. It would not have encouraged growth and thus employment in the longer run. On the contrary, inflationary pressures would most likely have been rekindled with detrimental consequences for the international competitiveness of the economy, prolonging unnecessarily the present balance of payments problems. It is hoped that the approach of consolidation and adjustment which was decided upon eventually, would restrict to a minimum any sacrifices that would temporarily be required on the employment side in order to promote inter alia, price stability and external adjustment in the economy.

7. With regard to the external side, policies have been designed to facilitate adjustment of the balance of payments. Interest rates have during the course of 1981 been allowed to rise very considerably and are now for the first time in several years, positive in real terms. However, my authorities would like to avoid overkill in the management of money and credit. The broad objective of policy is to hold growth of money slightly below the rate of inflation. In March 1982 broad money (M2 and M3) still was higher (24 and 18 1/2 per cent, respectively) than a year earlier. Although some special factors had distorted the money stock upward in March, my authorities regard such a monetary expansion clearly as excessive. They feel that, as the rise in interest rates affects the demand for credit, monetary growth should diminish in the near future; in April the cash base was only about 12 per cent above the level of a year earlier.

8. In general it may be noted that fiscal policy has shifted decisively toward restraint. The intention is to restrict government spending during the current year as much as possible without disrupting the provision of essential services. In this regard the latest budget provides for an increase in expenditure of 11.5 per cent. The medium-term objective of my authorities is to increase the share of resources available to the private sector. In line with this objective, between 1976/77 and 1980/81 public spending as a proportion of GDP has been reduced from 27 1/2 per cent to 23 per cent. No backtracking of this progress is envisaged for 1982/83. It may also be mentioned that the Minister of Finance is adamant that the financing of the budget deficit will not require any recourse to

bank credit this year. The deficit before borrowing is budgeted to amount to about R2.3 billion--that is, about 2 3/4 per cent of GDP. This is not considered excessive in terms of the level of domestic saving, the growth potential of the South African economy and the need to contain unemployment. This percentage is also unchanged from the 1981/82 percentage. It is further pertinent to note that during the first five weeks of the 1982/83 financial year, the Treasury and the Reserve Bank have through a primary issue and tap sales of government stock already raised virtually the full amount of nonbank financing provided for in the budget statement from nonbank sources. The monetary authorities are furthermore continuing these efforts in an attempt to provide a further cushion to any possible adverse developments in both revenue receipts and expenditure.

9. The exchange rate policy pursued by my authorities has remained flexible to promote adjustment of the external payments position and also to help mitigate the potential conflict between the objectives of adjustment and growth. My authorities do not intend to change the basic liberal approach to import control that had been followed during the past few years, and they regard the import surcharge as a temporary revenue raising measure, to be removed when circumstances permit.

10. At this stage, it is still too early to make conclusive deductions on the basis of available statistics about the progress made with the adjustment of the South African economy, particularly in the light of the fiscal measures introduced in the budget in March. It is expected, however, that these measures will start to affect in earnest domestic production and expenditure in the second half of 1982. The following developments would, on the one hand, seem to confirm that a shift from expansion to adjustment is taking place:

- (i) some decline in the utilization of production capacity occurred in the first quarter of 1982;
- (ii) retail sales at constant prices declined by 1.6 per cent from March 1982 to April 1982;
- (iii) wholesale sales at constant prices declined by 4.3 per cent from February 1982 to March 1982 (a decline was also registered on a 12-month basis both for wholesale and retail sales at constant prices);
- (iv) the number of new motor vehicles sold in April 1982 declined by 13.7 per cent compared with March 1982 and by 1.4 per cent compared with April 1981. On the other hand, the balance of payments remained weak during the first quarter of 1982. Export markets remained depressed, the price of gold fell further, and though imports declined somewhat in real terms, their level remained high. My authorities remain convinced, however, that as soon as the effects of the budgetary measures as well as the monetary and exchange rate policies fully take hold,

substantial downward pressure would be exerted on demand in general, and imports in particular, thereby reducing the pressure on the balance of payments.

11. My authorities concur with the staff's view that the prospects for growth in the South African economy during 1982 are not good, especially relative to the past two years. They also share the staff's view that although the balance of payments could be expected to improve later in the year, the inflationary picture is unlikely to show much improvement in the short run. However, after a period of consolidation and adjustment my authorities are confident that our economy will be able to share in an eventual recovery in world demand from a more balanced position.