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September 9, 1986

To: Members of the Executive Board

From: The Secretary

Subject: South Africa - Staff Report for the 1986 Article IV Consultation - Supplementary Information and Information Notice

The attached supplement to the staff report for the 1986 Article IV consultation with South Africa has been prepared on the basis of additional information.

Mr. Dell'Anno (ext. 8791) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 1986 Article IV Consultation--Supplementary Information and Information Notice

Approved by L. A. Whittome and J. T. Boorman

September 9, 1986

This supplement contains information on developments that have occurred since the issuance of the staff report for the 1986 Article IV consultation with South Africa (SM/86/185) on July 30, 1986. Most notable were a further easing of monetary conditions; substantial revisions in the balance of payments data; and the imposition of a cash deposit on imports destined for Zambia and shipped through South African territory.

As shown in the attached Table 1 and chart, the depreciation of the rand in real effective terms since the last occasion on which developments in the exchange rate of the rand were brought to the attention of the Executive Board (EBS/86/51, 3/4/86) , reached 17 1/2 percent in June 1986. This paper, therefore, also serves as an information notice.

I. Financial Policies and Developments

Economy activity remained at low levels of capacity utilization in the second quarter of 1986, owing largely to a pervasive sense of uncertainty about the future. This was reflected in a pronounced decline in the rate of growth of bank credit to the private sector, from 14 1/2 percent during the 12 months to end-March 1986 to 9.5 percent during the year to end-June. This decline was partly offset by some rise in credit extended to the public sector. With net foreign assets also falling, the rate of growth of M3 (new definition) decelerated from 11 percent during the 12 months to end-March 1986 to 10 percent during the year to end-June. Provisional estimates indicate a strengthening of this downward trend with the rate of growth of M3 declining to 7 1/2 percent in the year to end-July 1986. This continued fall in M3 growth relative to its target range of 16-20 percent was the main reason given by the South African Reserve Bank for justifying the lowering of Bank rate from 11 percent to 10.5 percent effective August 8, 1986 and to 10 percent with effect from September 5, 1986. The reductions in Bank rate were implemented although the earlier tendency for the rate of consumer price inflation to trend downward was reversed in July 1986 when prices rose at an annual rate of 18 percent in through-the-year terms (partly on account of higher food prices and housing costs), slightly above the 17 1/2 percent rate of the immediately preceding months.

The downward adjustment of Bank rate in August was followed by a reduction by about 1/2 percentage point in the prime commercial bank rate (to 14 percent) and the 90-day bankers' acceptance rate (to slightly above 10 percent). Long-term interest rates, which had proved relatively sticky, declined by about 3 percentage points in late August and early September, with the yield on long-dated government stock reaching about 14 percent. The continued increase in liquidity in the financial markets, as new real investments remained on a downward trend and the rise in the price of gold raised the cash flow of the mining houses, helps explain this development.

On the fiscal side, developments in the first four months (April to July) of the 1986/87 fiscal year (ending March) tend to confirm that the budget deficit will be higher than budgeted, broadly in line with the estimates contained in the staff report (SM/86/185). During that period expenditure was about 20 percent higher than in April-July 1985, a growth rate roughly the same as that underlying the estimates made by the staff for the year as a whole, taking into account the effects of the June fiscal package and the likely expenditure overruns during the year. At the same time, revenues increased at a somewhat faster pace (16 percent) than budgeted (13 percent), but this situation is not expected to persist for the year as a whole unless the gold price remains at its current elevated level. On balance, it is still expected that the deficit of the Central Government in 1986/87 will exceed the original budget estimate of R 4.4 billion by some R 2 billion, and therefore equal about 4 1/2 percent of GDP. The authorities have already secured most, if not all, of the additional required borrowing by overborrowing on the capital market.

II. Balance of Payments and Exchange Rate

The Annual Report of the South African Reserve Bank issued on August 26, 1986 contains revisions to the items "net services and transfers" to reflect higher interest payments abroad than estimated earlier, and to "merchandise imports" because of timing adjustments on account of imports of crude oil between the fourth quarter of 1985 and the first quarter of 1986 (Table 2). The adjustments to interest payments range from US$0.5 billion in 1983 to US$0.6 billion in 1984 and 1985. In the latter year, interest payments totaled US$2.1 billion, compared with US$2.0 billion in 1984. Previously the counterpart of these adjustments was reflected in net errors and omissions.

The current account surplus in 1985 is now estimated at US$2.6 billion (equivalent to about 5 percent of GDP), compared with the earlier estimate of US$3.1 billion (6 percent of GDP). As the revisions to the first and second quarters of 1986 leave the current surplus at US$1.3 billion for the first half of 1986, the same as estimated earlier, a revision of the current surplus for the year as a whole on that account is not warranted. However, if the price of gold remains at the present level of US$400 or more for the remainder of the year, the current surplus might well be US$1/4-1/2 billion higher than the staff estimate of US$2.0 billion contained in SM/86/185.

Table 2 also shows a continued decline in the net capital outflow in the second quarter of 1986, to US$0.4 billion from US$0.8 billion and US$1.7 billion in the first quarter of 1986 and the fourth quarter of 1985, respectively. The reduction in the outflow was particularly marked in the case of short-term capital movements (including errors and omissions), although the outflow of short-term capital continued to be affected by the perceived threats of intensified economic sanctions against South Africa and continued social unrest. On the whole, the external balance exhibited a small overall surplus in the second quarter of 1986. However, with the unplanned reduction in external liabilities of the Reserve Bank in that quarter, as mentioned in SM/86/185, official reserves fell and the exchange rate for the rand came under downward pressure as well. In June, with the reimposition of emergency measures in the face of rising social unrest, the value of the rand vis-à-vis the U.S. dollar fell back to its end-December 1985 level of US$0.38. In real effective terms, the depreciation of the exchange value of the rand reached 17.6 percent between February and June 1986. A large part of this depreciation, however, was reversed following the recent sharp increase in the price of gold under the impetus of which the exchange rate for the rand strengthened appreciably, so that in early September 1986 it was trading at about R 1 = US$0.41. Gross official reserves also rose, partly because of rising foreign exchange holdings and partly because of valuation changes, and at end-August amounted to US$1.78 billion (with gold valued at market-related prices), up from US$1.46 billion at the end of June 1986.

III. Trade Measures

On August 4, 1986, the South African authorities imposed a cash deposit requirement in rand on imports destined for Zambia that move through South African territory. The authorities base this measure upon the discovery that goods nominally destined for Zambia were in fact being diverted into the South African market. The deposit requirement applies to all goods, with the rate on goods subject to duty equal to that duty plus a 20 percent surcharge and the rate on nondutiable goods equal to 25 percent ad valorem, subject to a maximum of R 10,000. The stated objective of the measure affecting nondutiable goods, many of which are subject to import controls in South Africa, is to avoid the circumvention of such controls. The deposit, which has to be lodged when the goods are landed in South Africa, is released upon receipt of documentary evidence that the goods have been cleared by the Zambian customs authorities within two to seven days. The staff will monitor the administration of this mechanism.

Table 1. South Africa: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars 1/	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	101.1	95.6	105.8	78.7	125.4	125.1
II	97.9	90.8	107.9	72.3	130.6	130.4
III	96.3	89.0	108.2	67.7	134.0	134.3
IV	102.4	93.0	110.1	69.0	138.8	138.8
1983						
I	107.8	96.2	112.1	71.8	143.3	143.0
II	111.2	98.7	112.6	71.5	146.8	146.8
III	113.9	101.1	112.6	70.2	149.9	150.1
IV	109.7	97.2	112.9	66.3	153.8	153.7
1984						
I	106.7	94.1	113.5	63.1	157.9	157.6
II	106.2	92.4	114.9	61.0	162.8	163.3
III	92.8	79.8	116.4	49.5	168.3	168.3
IV	84.7	72.0	117.7	42.8	174.0	173.7
1985						
I	82.2	68.4	120.2	38.2	181.5	181.2
II	84.1	68.8	122.3	39.6	188.9	189.6
III	72.1	57.8	124.8	34.8	195.7	195.7
IV	59.4	46.2	128.6	29.4	204.4	204.0
1986						
I	73.1	54.4	134.5	36.3	216.4	216.0
Monthly						
1986						
Feb. 3/	74.9	55.9	134.1	37.4	215.8	215.8
Mar.	76.3	56.4	135.4	38.4	218.0	218.3
Apr.	76.4	55.7	137.2	38.0	220.9	222.2
May	70.4	51.2	137.5	35.5	221.9	222.7
June	61.7	44.6	138.3	30.8	223.9	224.4
Percentage change						
Feb.-June 1986	-17.6	-20.1	3.1	-17.6	3.7	4.0

Source: Information Notice System.

1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

Table 2. South Africa: Balance of Payments Summary

	1983	1984	1985 1/	1986 2/	1984 1/ First half	1984 1/ Second half	1985 1/ First half	1985 1/ Second half	1985 1/ Fourth quarter	1986 1/ First quarter	1986 1/ Second quarter
	(In millions of U.S. dollars)				(In billions of U.S. dollars)						
					(Seasonally adjusted, annual rates)						
Nongold exports	9,177	8,826	9,261	9,075	9.4	8.3	9.6	8.9	9.0	10.0	10.7
Gold exports	8,927	7,997	6,944	7,225	8.5	7.5	6.7	7.2	7.1	6.9	7.0
Imports	-14,262	-14,784	-10,461	-11,050	-16.3	-13.3	-11.1	-9.8	-9.4	-11.1	-11.0
Net services and transfers	-3,912	-3,632	-3,158	-3,250	-3.9	-3.5	-3.3	-3.1	-2.8	-3.8	-4.1
Current balance	-70	-1,593	2,586	2,000	-2.3	-1.0	1.9	3.2	3.9	2.0	2.6
(in percent of GDP)	(-0.1)	(-2.1)	(5.0)	(3 1/4)	(-2.7)	(-1.4)	(3.5)	(6.3)	(7.9)	(3.3)	(4.4)
					(Not seasonally adjusted, actual rates)						
Current balance	-70	-1,593	2,586	2,000	-0.9	-0.7	1.3	1.3	0.9	0.7	0.6
Long-term capital	-214	1,695	-7	...	0.7	1.0	0.3	-0.3	-0.3	-0.3	-0.2
Private sector	-1,311	553	-232	...	0.4	0.1	-a 3/	-0.2	-a 3/	-0.2	-0.1
Public sector	1,097	1,142	225	...	0.3	0.9	0.2	-0.1	-a 3/	-0.1	-0.1
Short-term capital 4/	260	-1,012	-3,880	...	-0.1	-0.9	-1.3	-2.6	-1.6	-0.5	-0.2
Private sector	179	-1,222	-3,834	...	-0.2	-1.0	-1.3	-2.6	-1.6	-0.5	-0.2
Public sector	81	210	-46	...	a 3/	0.1	-a 3/	-a 3/	-a 3/	-a 3/	-a 3/
Overall balance	-24	-910	-1,301	...	-0.3	-0.6	0.2	-1.5	-0.8	-a 3/	0.2

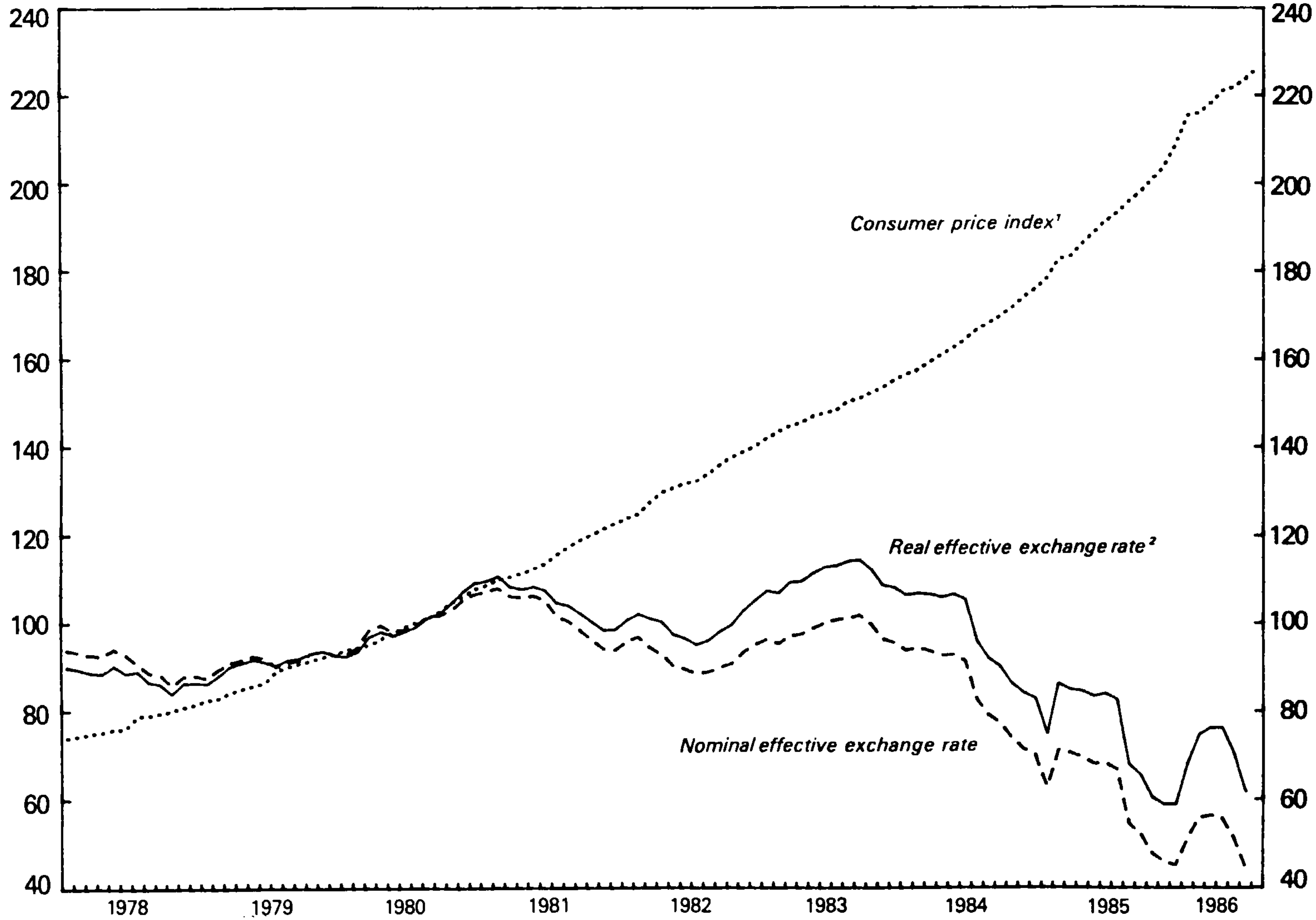
Source: South African Reserve Bank, Quarterly Bulletin and Annual Economic Report; and data provided by the South African authorities.

1/ Preliminary.
2/ Staff projections; assumes a U.S. dollar/rand exchange rate of 0.39 for the second half of 1986, which yields an average rate of R 1 = US$0.4233 for the year 1986 as a whole.
3/ Less than US$50,000.
4/ Including errors and omissions.
Note: Half-yearly data may not add due to rounding.

SOUTH AFRICA

INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE

(1980=100)



Source: Information Notice System.

[1] Seasonally adjusted.

[2] Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices, increases mean appreciation.