FOR AGENDA

SM/85/120

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May 1, 1985

To: Members of the Executive Board

From: The Secretary

Subject: South Africa - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with South Africa, which will be brought to the agenda for discussion on a date to be announced.

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

Att: (1)

Other Distribution:
Department Heads

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INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Article IV Consultation with South Africa

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

April 30, 1985

I. Introduction

Article IV consultation discussions were held in Pretoria and Cape Town from February 15 to March 4, 1985. The staff team, which consisted of Messrs. H. Vittas, U. Dell'Anno, Y. Horiguchi, S. Kashiwagi, G. Thumann, and Miss L. Pike (all EUR), met with Mr. B. du Plessis, Minister of Finance, Dr. G. de Kock, Governor of the South African Reserve Bank, and with senior officials from various government departments, the South African Reserve Bank, and the Development Bank of Southern Africa. Discussions were also held with representatives of several private sector and semipublic entities. Mr. Peacey, South Africa's Principal Resident Representative to the Fund and the IBRD, attended the meetings. South Africa accepted the obligations of Article VIII, Sections 2, 3, and 4, as of September 15, 1973.

II. Background

The external difficulties that had led to a substantial use of Fund resources in November 1982 were temporarily overcome by the early part of 1983, owing to a strong--albeit short-lived--increase in the price of gold and a sharp fall in the volume of imports. However, as Executive Directors noted with concern at the conclusion of the 1984 Article IV consultation with South Africa (SUR/84/52, 6/8/84), financial policies and conditions were allowed to ease markedly thereafter, setting off an unsustainable upswing in domestic demand that contributed to renewed weakness in the external current account position, downward pressure on the rand, and a rekindling of inflationary pressures. Directors considered that the measures of adjustment that had been taken to deal with these problems had not been adequate. Accordingly, they called on the authorities to tighten both their fiscal and monetary policies and, in particular, to curb the growth in overall government outlays.

Subsequent developments have tended to confirm the validity of the concerns that Directors had expressed. The most striking feature has been the almost uninterrupted, and at times precipitous, fall in the exchange rate of the rand against all major currencies. Between June

1984 and January 1985 the rand depreciated by close to 40 percent against the U.S. dollar, 30 percent against the deutsche mark, and 26 percent against the pound sterling. Over the same period, the effective exchange rate index of the rand fell by 31 percent in nominal terms and by 29 percent in real terms (Chart 1). 1/ A large part of the effective depreciation of the rand occurred during two crises in the foreign exchange markets, the first in July 1984 and the second in December 1984-January 1985. 2/ In both instances, the slide of the rand was to some extent the counterpart of the strengthening of the U.S. dollar and an associated decline in the price of gold, South Africa's principal export commodity (Chart 2). It is clear, however, that lax financial policies also played an important role. Soaring government outlays and a high pace of credit and monetary expansion led to a sharp acceleration in the growth of nominal demand which, in turn, contributed to the persistence (up to the third quarter of 1984) of a sizable deficit in the current account of the balance of payments and an aggravation of inflationary pressures. Pessimistic exchange rate expectations generated by these developments resulted in a sustained outflow of short-term capital, which was reinforced, at times, by industrial unrest and by noneconomic factors. This outflow of capital assumed alarming proportions in late 1984 and the first three weeks of 1985 and was facilitated by the lack of effective control over domestic credit expansion.

In the wake of the July crisis in the exchange market the authorities raised sharply the rates at which the central bank provides assistance to the banking system. This action prompted a steep upward adjustment in the whole spectrum of short-term interest rates, with the prime overdraft rate rising from 21 percent in mid-July to 25 percent in early August, some 13 percentage points above the prevailing rate of inflation. Long-term rates also moved up but much less markedly (Chart 3). In addition, the authorities tightened the terms of hire purchase transactions and renewed their efforts at improving control over government expenditure. These measures, in combination with a large increase in indirect taxation that became effective in mid-1984, helped curb the growth in real domestic demand. Nevertheless, they failed to stabilize the exchange rate.

The response of the authorities to the more recent crisis in the foreign exchange market did not entail any further tightening of financial

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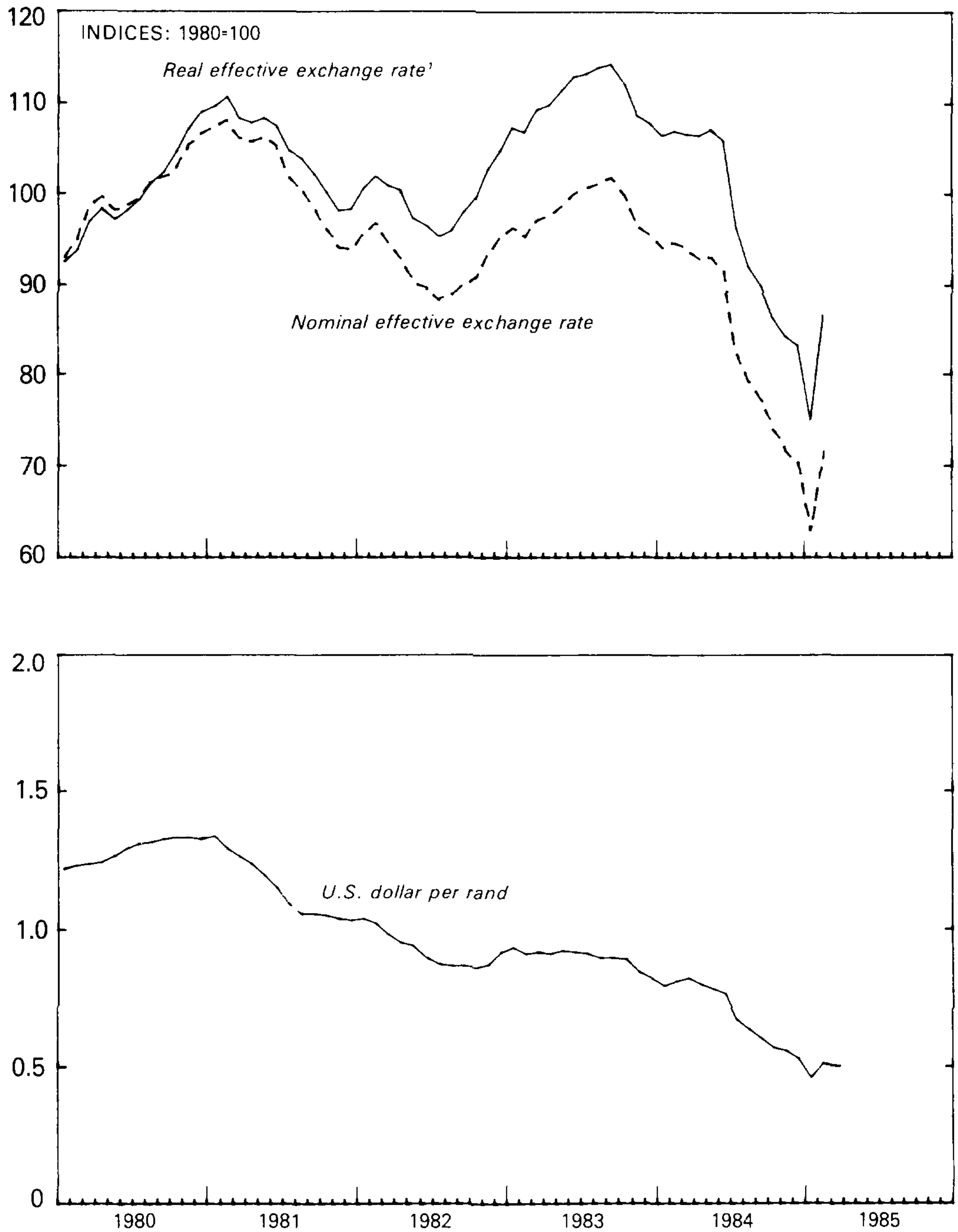
1/ The figures that are quoted in the text refer to the nominal and real depreciation of the rand relative to the currencies of a large number of partner countries, as calculated for purposes of the information notice system. The nominal and real effective depreciation of the rand relative to the currencies of the main industrial countries over the seven months to January 1985 is estimated at 33 percent and 29 percent, respectively.

2/ These developments were brought to the attention of the Executive Board through the issuance of information notices (see EBS/84/216, 10/6/84, and EBS/85/78, 3/28/85).

CHART 1

SOUTH AFRICA

EXCHANGE RATE DEVELOPMENTS



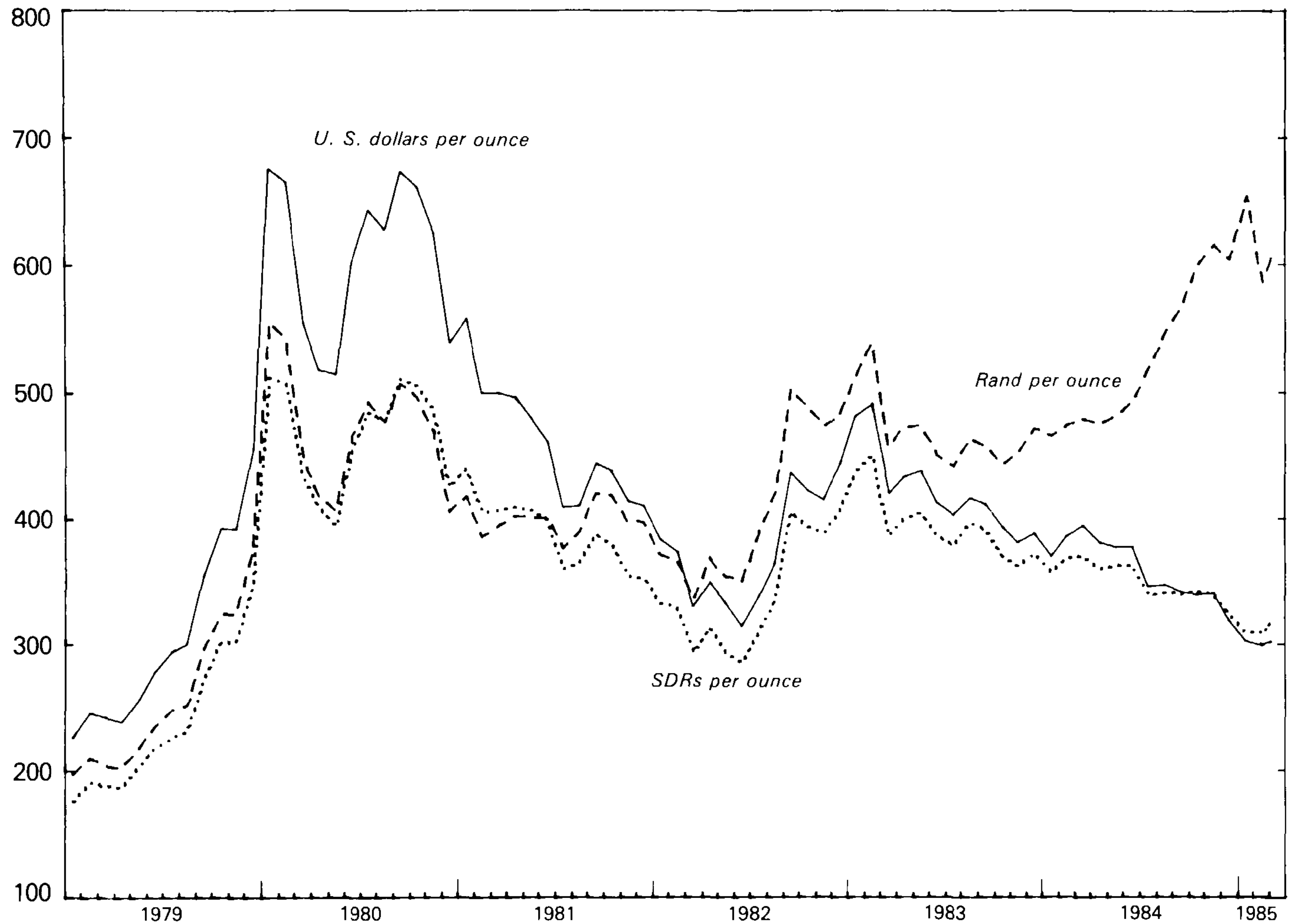
Source: IMF, *International Financial Statistics*, and staff calculations.

[1]Consumer prices in South Africa relative to those of it's 36 main trading partners, adjusted for exchange rate changes

CHART 2

SOUTH AFRICA

DEVELOPMENTS IN THE PRICE OF GOLD



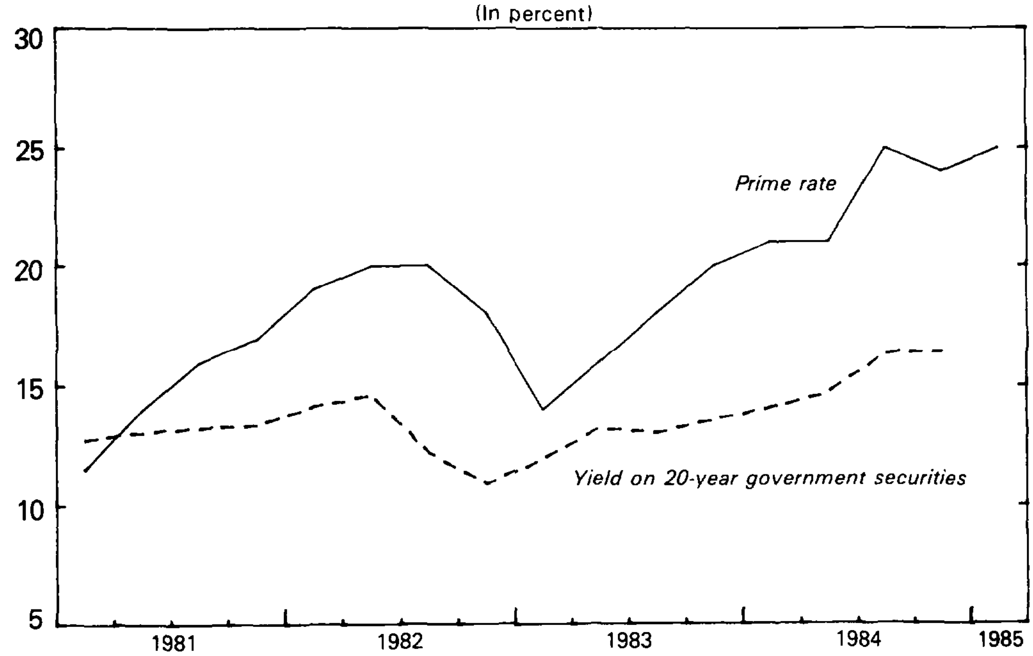
Source: IMF, *International Financial Statistics*.

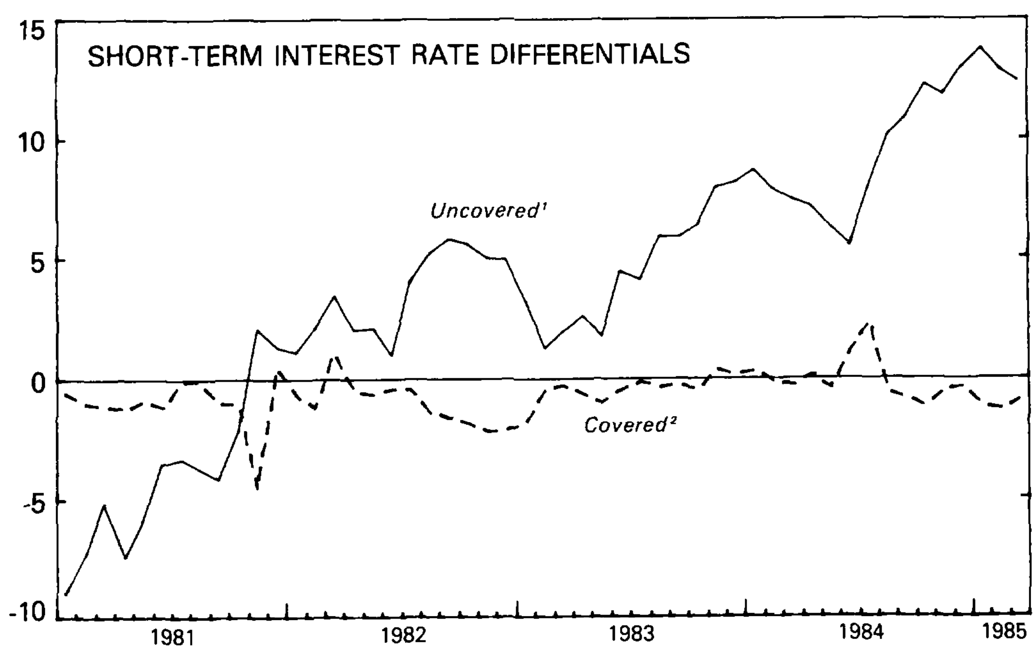
CHART 3

SOUTH AFRICA

INTEREST RATE DEVELOPMENTS

(In percent)





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

[1] Three-month bankers' acceptances, corrected for ordinary bank charges, minus three month Eurodollar rate

[2] Three-month bankers' acceptances, corrected for ordinary bank charges, minus three-month Eurodollar rate minus three-month forward premium on the U.S. dollar vis-a-vis the rand.

policies. 1/ In part this reflected the judgment that a sound underlying payments position had been restored and that the short-term capital outflow would eventually reverse itself. More importantly, however, the Government was unwilling to see any further increase in interest rates. Attempts to defend the rand in the exchange market therefore relied on intervention in the spot and forward markets which appears to have had only limited effects. The rand remained under downward pressure until the market concluded that its depreciation had overshot the correction warranted by its underlying weakness. Following a period of volatility, the rand then staged a strong recovery and in February 1985 its real effective exchange rate was 15 1/2 percent higher than in January, i.e. the end of the period covered in the Information Notice issued on March 28, 1985.

The economic upswing which had been under way since April 1983 came to an abrupt end around the middle of 1984 and output has since been on a flat trend (Chart 4). Nevertheless, for 1984 as a whole, real GDP increased by 4.7 percent, reversing its cumulative fall in the preceding two years (Table 1). The strong recovery in output in the period up to the first half of 1984 was propelled by an upsurge in public consumption and a modest increase in private consumption. In real terms, gross fixed investment fell in 1984 for the third year in a row to 13 percent below its peak in 1981, while the contribution of the foreign balance was strongly negative.

Nonagricultural employment increased modestly in 1984, but the increase fell well short of the growth in the labor force which is estimated at about 2 1/2 percent per annum. The rate of unemployment, especially among unskilled workers, is therefore likely to have increased further and, according to some independent estimates, it may now be in excess of 20 percent. Nevertheless, average remuneration in the nonagricultural sector increased sharply (Chart 5) and there was a significant increase in industrial disputes and in the number of man-days lost through pay-related and other strikes. Despite a strong cyclical upturn in productivity, the rate of increase in unit labor costs remained well into double digits (Table 1).

With the weakening of demand from mid-1984, the current account of the balance of payments began to improve and showed a small surplus in the last quarter of 1984 (Chart 6). For the entire year, however, there was a deficit of SDR 0.8 billion (about 1 percent of GDP), compared with a small surplus in 1983. The volume of merchandise (nongold) exports benefited from the broadening of the recovery in industrial countries and rose by 12 percent in 1984, after a fall of 10 percent in 1983 (Chart 7). There was, in addition, a small improvement in the terms of trade in 1984 despite the decline in the price of gold and the sharp depreciation of the rand. These developments, however, were more than

1/ In late January 1985, after the rand had begun to recover in the exchange markets, the authorities introduced some minor adjustments to their techniques of intervention in the money and foreign exchange markets. For details, see the recent economic developments paper.

offset by a 20 1/2 percent increase in the volume of imports which reflected for the most part the excessive growth in domestic demand in the period through mid-1984, though large imports of agricultural products, necessitated by drought, also played a role. There was a sizable inflow of long-term capital in 1984, including an inflow of funds by nonresidents for investment in South African gold mining and other shares. However, this inflow was swamped by a SDR 1.8 billion outflow of short-term capital (including unrecorded transactions). All in all, there was an overall deficit of SDR 0.9 billion in 1984, compared with approximate balance in 1983 (Table 2). Gross official nongold reserves declined by more than SDR 500 million during 1984 to SDR 247 million, though they recovered somewhat to SDR 329 million by end-March 1985. Gold holdings also fell from 7.8 million ounces at end-1983 to 6.2 million ounces (less than SDR 2 billion) at end-March 1985, reflecting gold swap transactions.

Although demand pressures on prices have recently eased considerably, the rate of inflation has accelerated as the effects of the depreciation of the rand and of overdue adjustments in administered prices began to assert themselves. By February 1985, the year-on-year rate of increase in the CPI had risen to 16 percent, from a low point of 10 percent 12 months earlier. As a result, South Africa's adverse inflation differential relative to the average rate in the industrial countries widened to nearly 12 percentage points, from 5 percentage points in early 1984.

III. Economic Policies

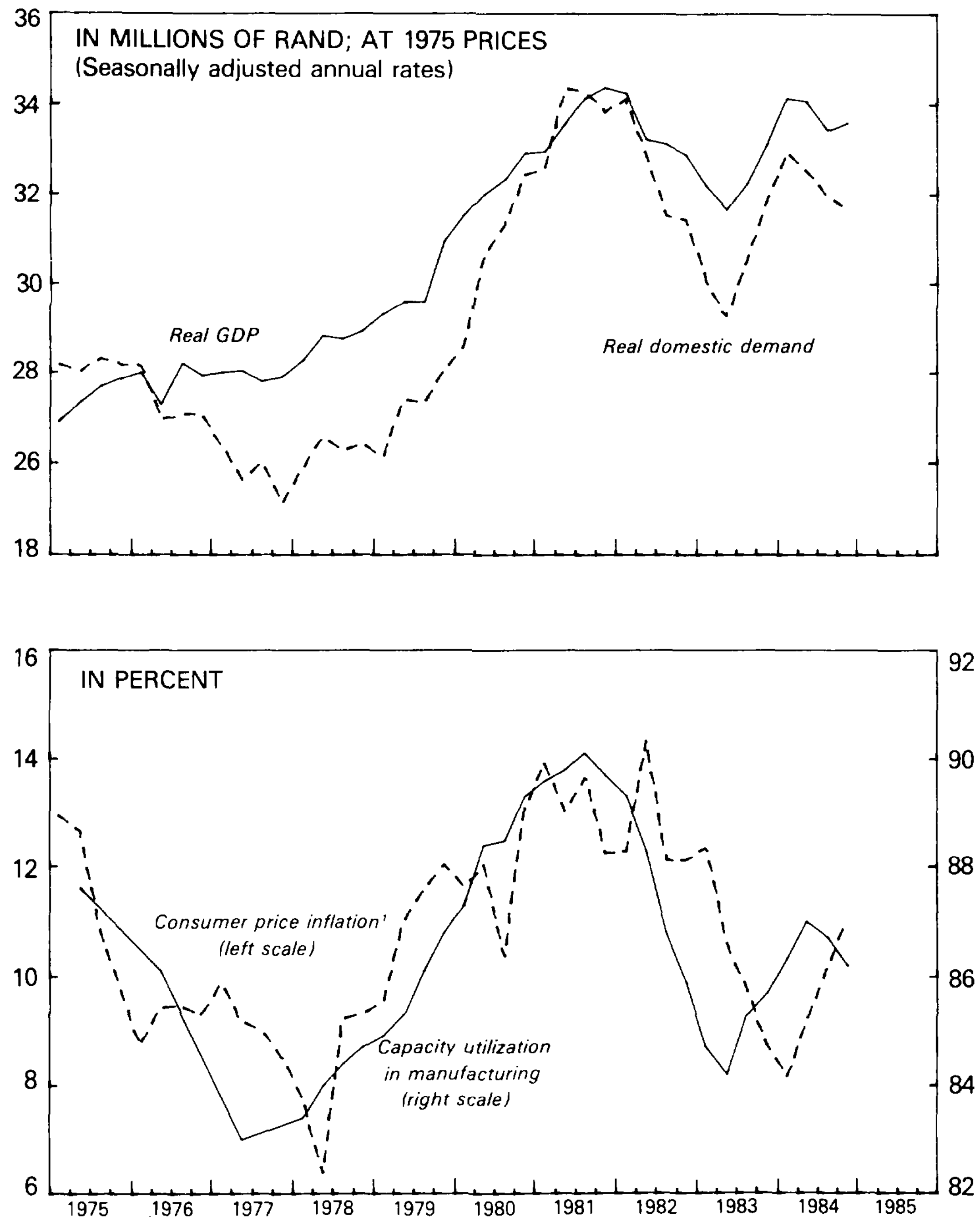
In recent years, the authorities have stated frequently their intention to pursue a coordinated macroeconomic strategy aimed at the reduction of inflation and the maintenance of a sound external position. However, the financial policies put in place have not generally been consistent with the attainment of these objectives. Since the beginning of the 1980s, government spending has tended to exceed announced targets by a wide margin, rising strongly in real terms and pre-empting a growing share of available resources (Chart 8). Although the overall burden of taxation has increased, the savings performance of the government sector has deteriorated and its overall borrowing requirements have grown rapidly. In addition, the authorities have not been able to establish and maintain adequate control over the money supply and the growth in aggregate demand. As a result, strong inflationary pressures have persisted and recurrent balance of payments difficulties have been experienced, with the pattern of economic growth being highly volatile. Meanwhile, the cumulative effects of the misallocation of resources stemming from extensive government interference with the functioning of the labor and other markets have become more onerous, contributing to a deceleration in the trend rate of economic growth and large-scale underutilization of manpower resources.

In the light of these developments, business and consumer confidence have deteriorated, and there has also been an erosion of support for some modest financial and exchange market reforms which the authorities had

CHART 4

SOUTH AFRICA

DEMAND, SUPPLY, AND INFLATION



Source: South African Reserve Bank, *Quarterly Bulletin*

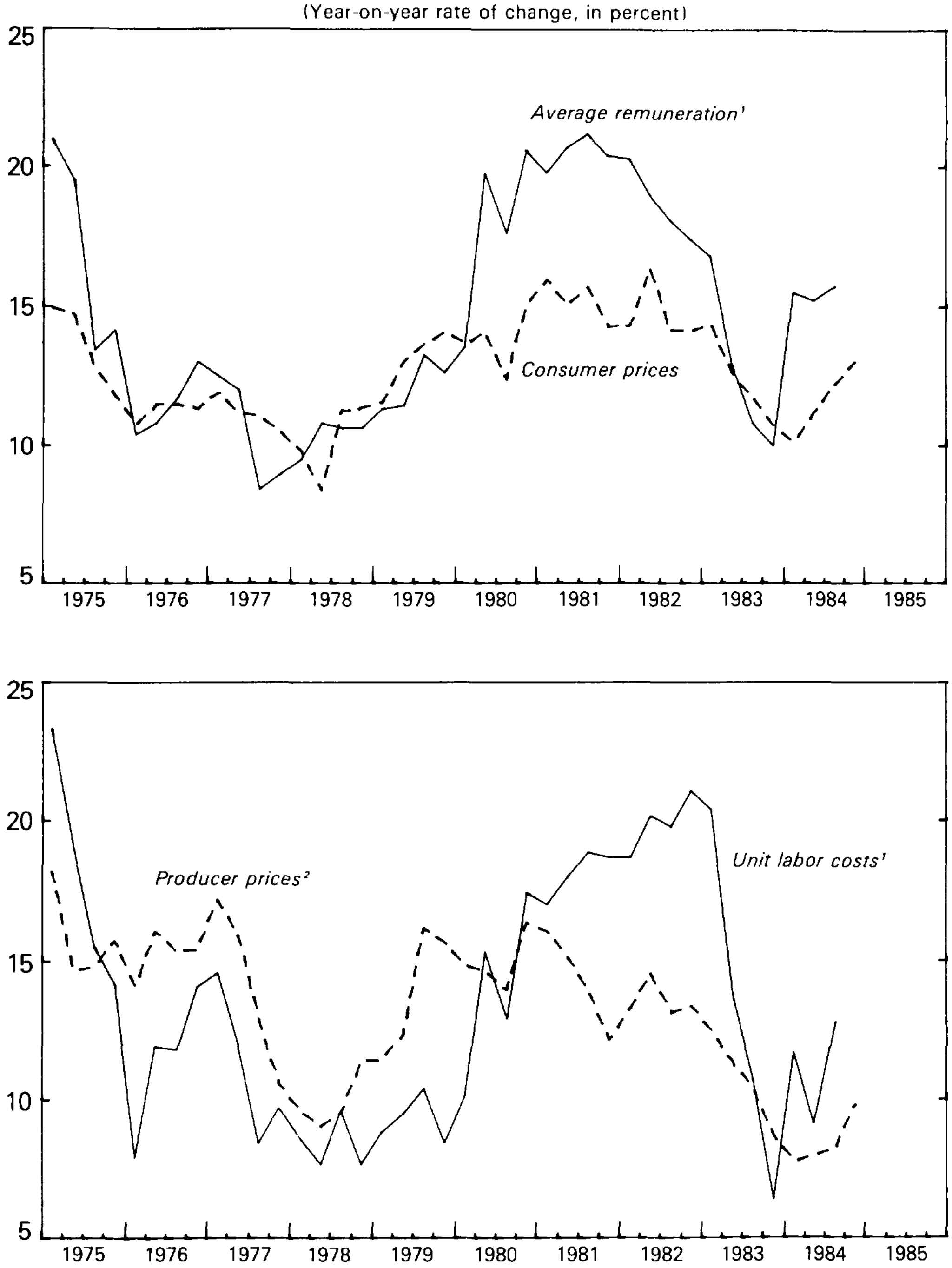
[1] Rate of change over corresponding quarter in preceding year

CHART 5

SOUTH AFRICA

LABOR EARNINGS, LABOR COSTS, AND PRICES

(Year-on-year rate of change, in percent)



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

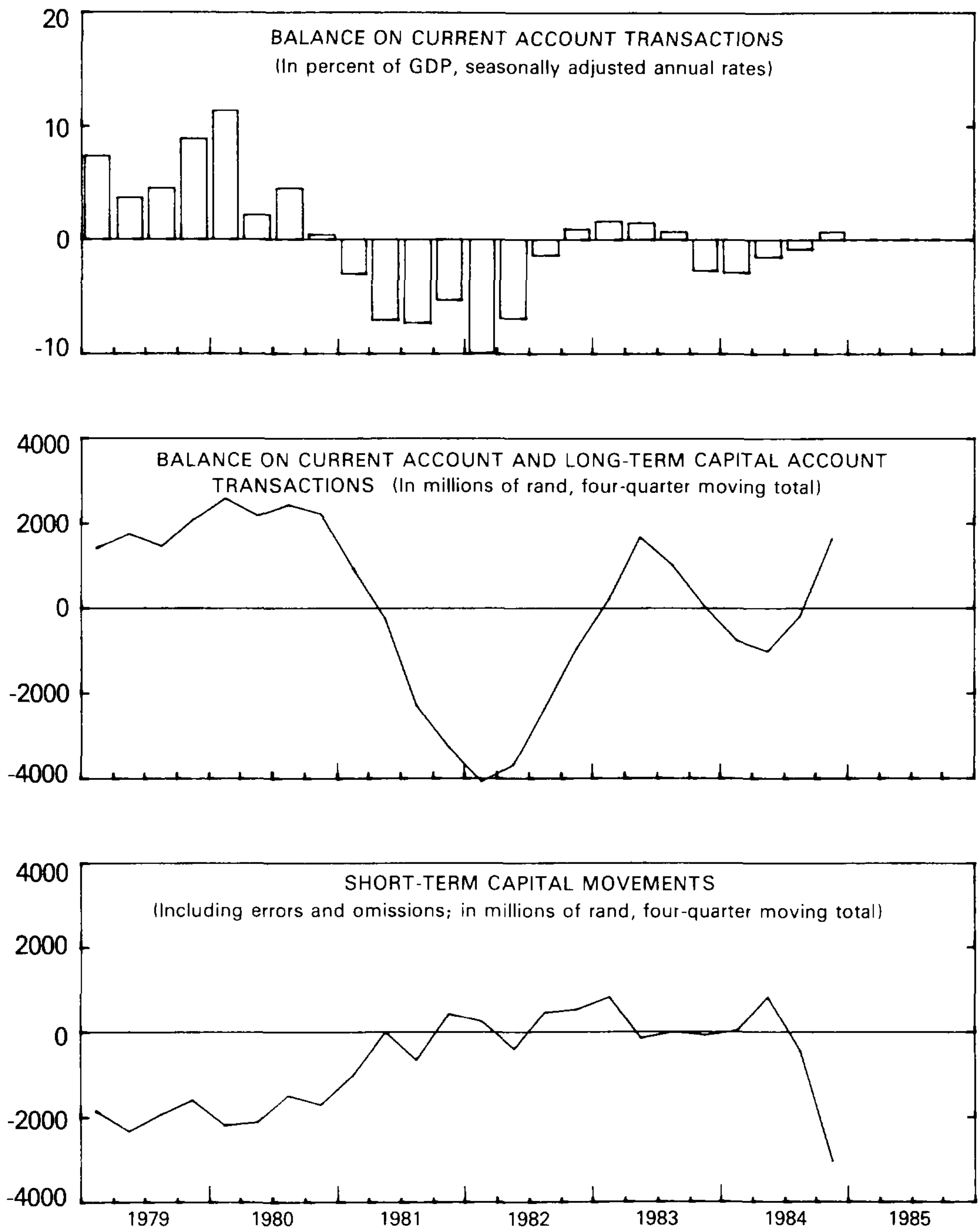
[1]In the nonagricultural sector.

[2]Wholesale prices of goods produced in South Africa.

CHART 6

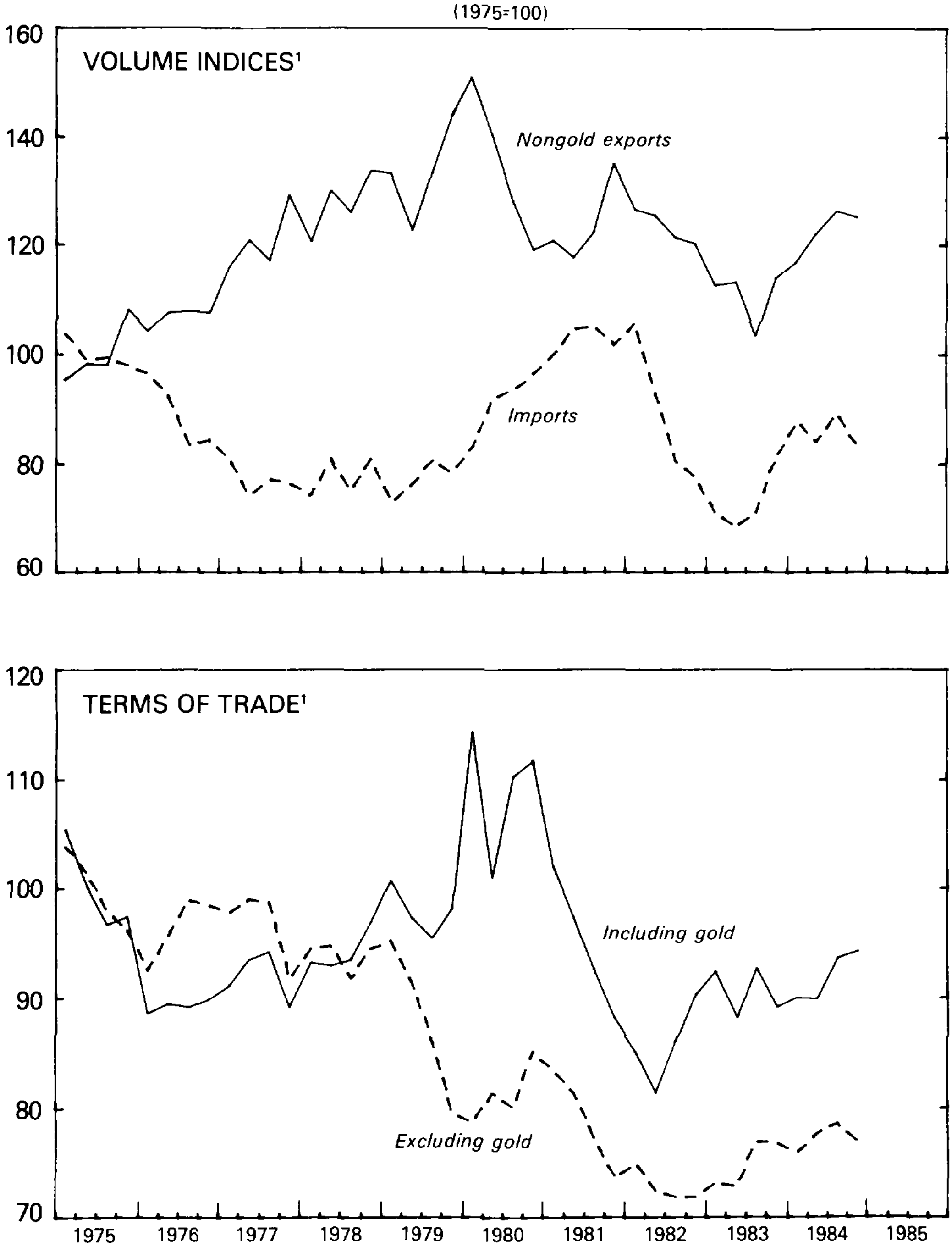
SOUTH AFRICA

BALANCE OF PAYMENTS DEVELOPMENTS



Source South African Reserve Bank, *Quarterly Bulletin*.

CHART 7
SOUTH AFRICA
EXPORT PERFORMANCE AND TERMS OF TRADE
(1975=100)



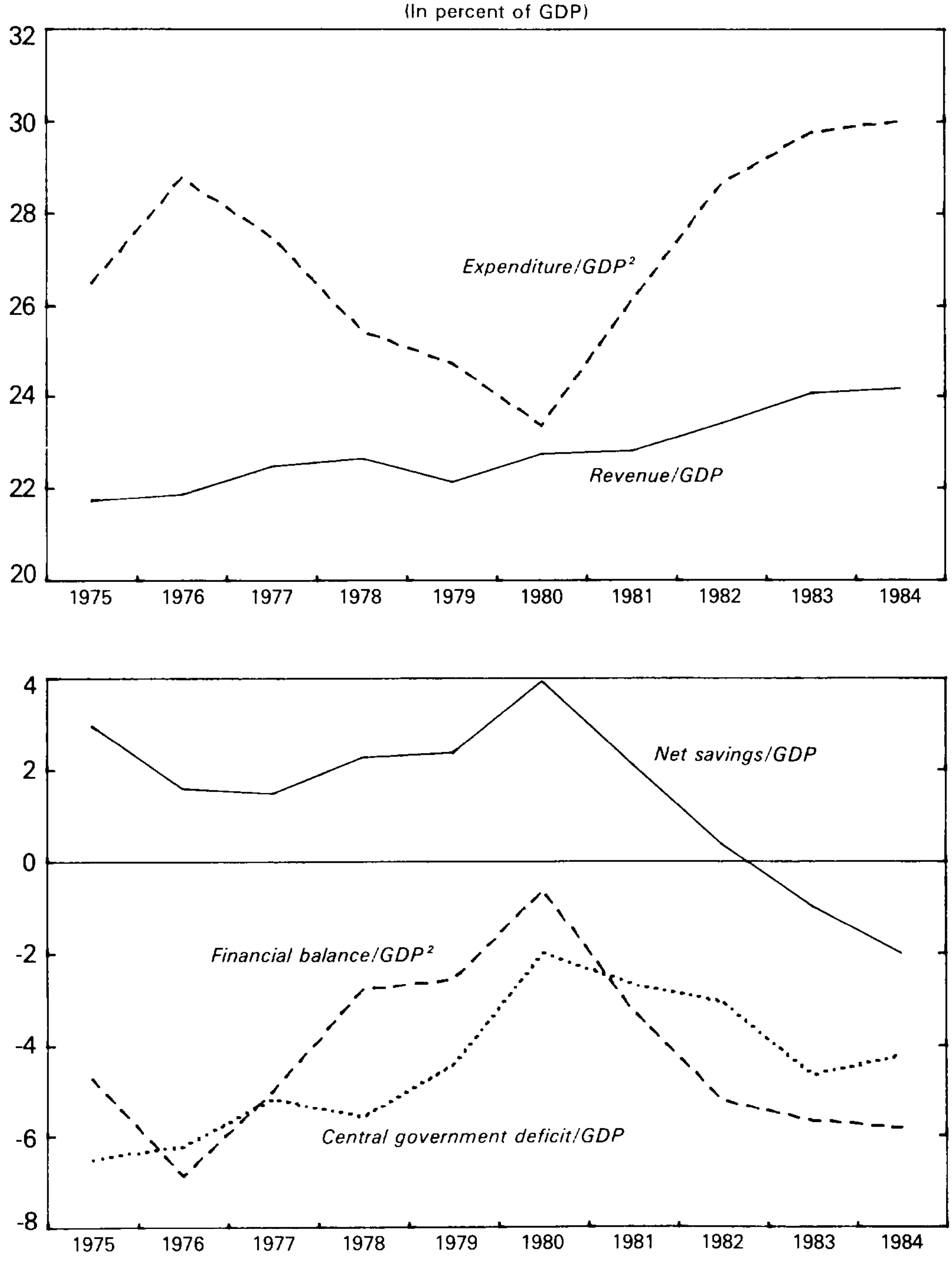
Source: South African Reserve Bank, *Quarterly Bulletin.*
[1]Exports and imports of goods and nonfactor services, based on national account statistics.

CHART 8

SOUTH AFRICA

SELECTED INDICATORS OF FISCAL DEVELOPMENTS[1]

(In percent of GDP)



Source Minister of Finance, *Budget Speeches* South African Reserve Bank, Quarterly Bulletin, and data provided by the South African authorities.

[1] General government on a national accounts basis, unless indicated otherwise.

[2] Expenditure covers consumption expenditure by general government plus gross investment by public authorities; the financial balance is the difference between general government revenue and expenditure as defined.

begun to implement since the beginning of the 1980s. The South African representatives agreed that one of the main tasks for the period ahead was to restore the credibility of government policies and belief in the advantages of a market-oriented approach to managing the economy. They were concerned that unless their policies produced early tangible results--including a significant reduction in the rate of inflation and the level of interest rates--it would become very difficult to keep in check pressures for protectionism and even greater direct government regulation of economic and financial activity.

1. Fiscal policy

The budget for the 1984/85 financial year 1/ presented in March 1984 was intended to help curb inflation and ease the upward pressure on interest rates. It provided for an 11.7 percent increase in expenditure. a 15.4 percent growth in revenue, and a lowering of the deficit to about 3 percent of GDP from 3.5 percent of GDP in 1983/84. In the event, expenditure rose by no less than 21.9 percent, or by 7.4 percent in real terms, with the rate of increase being very large for the Government's total pay bill and for interest payments (Table 3). Much of the apparent overruns reflected the fact that in the initial estimates expected expenditure, e.g., for drought relief and defense, was understated. In addition, there were unexpected increases in spending in such areas as food and transportation subsidies, housing, incentives for regional development, etc. Revenue rose by nearly 25 percent, boosted by a post-budget decision to raise the rate of the general sales tax (GST) from 7 percent to 10 percent and by the unexpected buoyancy of domestic incomes and spending. Thus the deficit turned out to be only slightly higher than envisaged. As in the preceding three years, the deficit was funded without recourse to bank credit but this required increased real interest rates for government securities.

At the time of the discussions, the authorities were still in the process of finalizing the budget for 1985/86. However, they had already decided that the budget should be framed so as to satisfy three criteria: (a) the growth of expenditure should be contained to below the rate of inflation; (b) the deficit should not exceed 3 percent of GDP; and (c) no borrowing should be undertaken in order to finance current, as opposed to capital, spending. In pursuit of these objectives, the authorities had lowered markedly the original spending plans of the various departments and had announced that there would be no increase during 1985/86 in the general pay scales for government employees and that bonus payments to these employees would be reduced from 8 1/3 percent to 5 1/2 percent of annual salary. The South African representatives noted, however, that in the absence of further measures the deficit would be above 3 percent of GDP. The dilemma that the authorities were facing was whether to raise taxes or allow borrowing to rise to a level that was judged to be inconsistent with the aim of lowering inflationary pressures and interest rates. The mission suggested that a preferred alternative would be to trim spending further.

1/ The financial year runs from April 1 to March 31.

The 1985/86 budget was introduced soon after the return of the mission to Washington. It incorporated tax measures designed to raise revenue by the equivalent of more than 1.5 percent of GDP, the main measure being a further increase in the GST from 10 percent to 12 percent. Total revenue was projected to rise by 18.8 percent and total expenditure by 12.9 percent, 1/ implying a deficit of R 3 billion or 2 1/2 percent of GDP. For the first time, provision was made in the budget for setting aside a small reserve (R 400 million) to cover unforeseen expenditure (or revenue shortfalls). This was supplemented by a new early-warning system to identify deviations from planned expenditure so as to enable the authorities to take corrective or compensatory steps and keep overruns to a minimum.

The significance of the budget deficit as an indicator of fiscal developments and their impact on the economy has declined in recent years as a result of decisions to take certain items of expenditure out of the budget and to allow various extrabudgetary funds to borrow on their own account. The South African representatives said that it was the intention of the authorities to increase the transparency of the budgetary accounts by gradually bringing back all extrabudgetary funds into the budget. Some steps to this end were indeed announced in the 1985/86 budget (for details, see the recent economic developments paper). The South African representatives added that, for the time being, reliable and consistent estimates of the borrowing requirements of the general government or the broader public sector are not available. The staff has made some tentative estimates on the basis of national accounts data. These estimates therefore exclude net lending by the general government and also the borrowing requirements of the public corporations. The estimates suggest that both the level and the recent deterioration of the financial position of the general government have been more significant than suggested by the central government budget deficit (Chart 6).

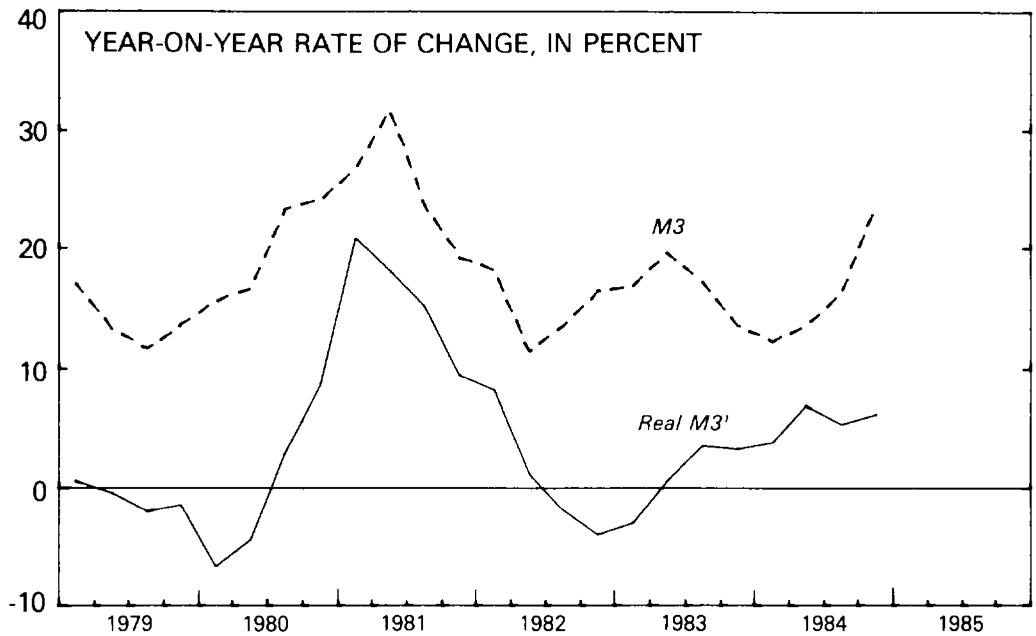
During the 1984 consultation, the Executive Board had encouraged the authorities to correct deficiencies in the tax system and broaden the tax base. The South African representatives informed the mission that it had been decided that fringe benefits would become subject to income tax with effect from the 1985/86 financial year. In addition, a Commission of Inquiry had recently been set up with the task of making a thorough investigation of the tax system and submitting recommendations regarding desirable changes in its structure. The Commission had been asked to complete its task by July 1986 and it was possible that it would submit interim reports on matters that required early attention.

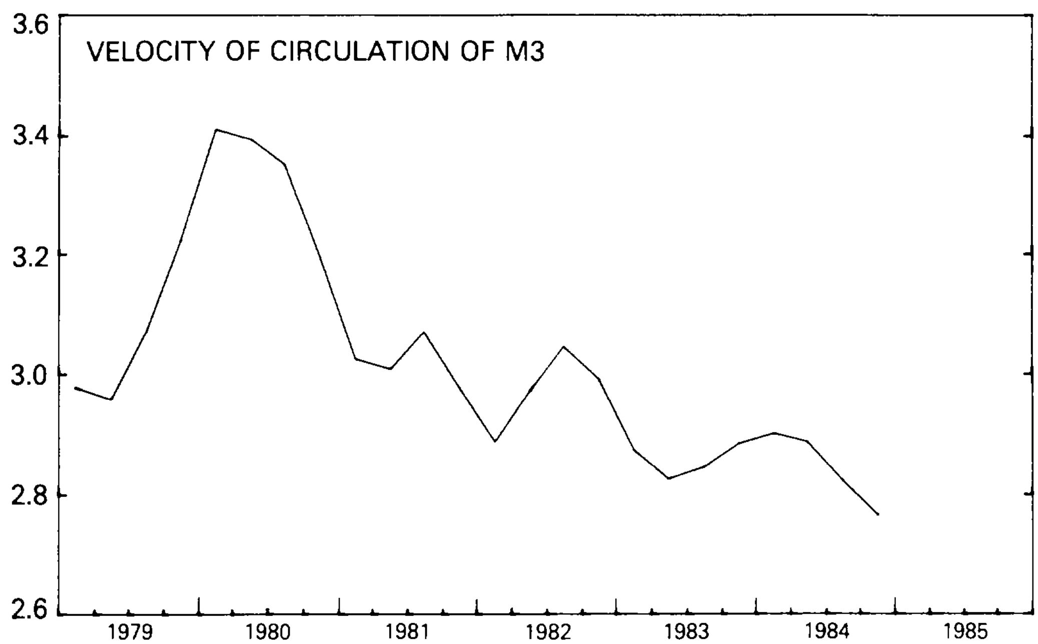
2. Monetary policy

Since 1980 the authorities have begun a process of deregulation of the financial system designed to increase its efficiency and to enable monetary policy to be conducted by means of market-oriented instruments rather than direct controls. Quantitative credit ceilings have been abolished, the administrative regulation of deposit and lending rates

1/ See footnote 2 in Table 3.

CHART 9
SOUTH AFRICA
MONETARY DEVELOPMENTS





Source: IMF, *International Financial Statistics;* South African Reserve Bank *Quarterly Bulletin;* and staff estimates
[1]Derived using the GDP deflator

has been markedly reduced, the yields on government securities have been raised to competitive levels, and the range of instruments available to the authorities for influencing conditions in the money and capital markets has been broadened. The scope for effective monetary control was further enhanced in February 1983 with the adoption of a system of a floating exchange rate for the rand. Exchange control on nonresidents was dismantled at the same time.

In spite of the more flexible framework for monetary policy, the authorities have not been successful in keeping the pace of credit and monetary expansion under control. After slowing from 22 percent in mid-1983 to 14 percent in mid-1984, the rate of growth of M3 (measured over a 12-month period) reaccelerated and reached 24 1/2 percent in November. It eased back somewhat in the subsequent two months, perhaps in lagged response to the record high interest rates prevailing since August 1984. The South African representatives were of the view that the rapid increase in the money supply reflected to a large extent the reintermediation of financial flows occasioned by the deregulation of the financial system and gave a misleading impression of the policy stance in recent months. They thought that a sharp fall in the velocity of circulation of M3 (and of the other monetary aggregates) since 1980 (Chart 9) lent support to this view. They also drew attention to the fact that interest rates were very high, in real terms, and noted that real domestic demand was falling.

While agreeing that these arguments had much validity, the mission noted that in practice the authorities had often shown more concern about holding down the level of interest rates than about curbing the growth in the monetary aggregates. This was illustrated by experience in the recent past when official reluctance to accept any firming of interest rates, together with the easy access of the banking system to the Reserve Bank discount window, had tended to facilitate the extension of bank credit for the financing of capital outflows. It was against this background that the growth of bank credit to the private sector accelerated during the latter part of 1984, reaching an annual rate of 28 percent in December. While net bank credit to the Government (as conventionally defined) has continued to contract during 1984, the large official losses on maturing forward contracts have also contributed significantly to the excessive rate of domestic credit expansion and the associated weakness of the external position (Table 4).

The South African representatives advised the mission that the authorities were considering the introduction of publicly announced targets for the growth in the money supply as a way to facilitate the pursuit of restrained monetary policy. Monetary targets would be chosen mainly with a view to achieving a deceleration in the growth of nominal spending and thus, over time, in the rate of inflation. In the light of uncertainties regarding the behavior of the velocity of money, the authorities were inclined to adopt not a rigid monetary rule but rather a low-profile, pragmatic approach to monetary targeting. In taking policy decisions, attention would also be paid to other indicators such as, in particular, the behavior of the exchange rate. As regards the choice of aggregates to be targeted, at present, the authorities favored the broader aggregates mainly because they were judged to be less distorted than the narrow ones by financial innovation, deregulation, and changes in the structure of interest rates. However, the definition of broad money would probably be revised, e.g., to include building society deposits which had become very close substitutes for bank deposits. In addition, steps would be taken to shorten publication lags and improve the reliability of the monetary statistics. The South African representatives questioned the feasibility of targeting directly the growth in nominal GDP, rather than the money supply, noting that data on GDP became available with a considerable lag and were subject to significant revisions.

3. External policies

The authorities reaffirmed their intention to continue to pursue a flexible exchange rate policy. They noted that, while in principle the rand could be pegged to a single major currency or a basket of currencies, in practice, it would be extremely difficult to defend the peg, given the size and potential volatility of capital flows. The authorities stressed that they did not have any predetermined exchange rate target and believed that the rate should essentially be a reflection or concomitant result of domestic financial policies and their interplay with external conditions. They were, nevertheless, by no means indifferent to the behavior of the exchange rate in the market. On the contrary, as their actions in August 1984 had demonstrated, they were prepared to adjust the stance of their financial policy markedly so as to influence the exchange rate whenever this was deemed desirable. The authorities, moreover, believed that intervention in the exchange market had a role to play not only in ironing out minor fluctuations in the rate but also in dampening down larger swings that were judged to be excessive and essentially temporary. They recognized, however, that intervention was constrained by the paucity of foreign exchange reserves.

The authorities accepted that the large depreciation of the rand had resulted, at least in part, from inadequately restrictive monetary and fiscal policies and was bound to have harmful inflationary consequences. They noted, however, that the depreciation has also had, and will continue to have, favorable effects on the economy. For one thing, it has allowed profitability in the gold mining sector to be maintained in the face of a declining price of gold in world markets and it has also strengthened incentives for inflows of long-term equity capital. Most importantly, the depreciation has resulted in a significant improvement in the competitive position of the nongold traded goods sector, more than offsetting the losses that had been experienced in 1981-83 (Chart 1). The authorities realized that this improvement could be eroded quickly in the absence of a marked moderation in the rate of domestic cost and price inflation. In this context, they hoped that the tight public sector pay policy that they had adopted for the current financial year would have a beneficial demonstration effect on pay settlements in the private sector.

The South African representatives said that, with the decline in the external value of the rand, the pressure for import protection had abated. The process of dismantling quantitative import controls would continue, and it was anticipated that a substantial number of items would be released from permit control in the foreseeable future. This would still leave about 20 percent of total imports under licensing requirements. Consideration was being given to the possibility of extending the domestic content program that provided protection to the motor vehicle industry so as to cover apart from passenger cars all commercial vehicles. A similar program was contemplated for television sets. In addition, the longstanding practice of according preferential treatment to domestic producers in granting government contracts continued, though the Board of Trade and Industries was investigating the issue with a view to stimulating competition.

The authorities believe that the private market for forward exchange is not yet well developed. Accordingly, the Reserve Bank continues to provide a forward cover facility to authorized foreign exchange dealers (banks) up to specified quotas which, at present total US$6.6 billion. 1/ However, the quotas are to be reduced to US$3.3 billion in September 1985 and to be phased out a year later. In early 1984, use of these facilities by the banks was relatively small on a net basis, and the Reserve Bank's forward book was therefore well balanced. The situation has since changed markedly, and by early 1985 the oversold forward position of the Reserve Bank had risen to over US$3 billion. In addition, forward cover has continued to be provided directly to public corporations, with the Reserve Bank's forward sales reaching over US$8 billion by the beginning of 1985, compared to US$7.5 billion in early 1984.

The mission expressed serious concern about these developments, stressing that, apart from the risk of significant losses that they could entail (and the attendant effects on the fiscal position and money creation), the large outstanding forward commitments of the Reserve Bank also posed a threat to the stability of the exchange rate in the future. The authorities shared this concern and noted that some changes in banking legislation that were likely to foster the development of an efficient private forward exchange market had been proposed in a bill recently submitted to Parliament. Changes in the terms under which foward cover was provided to public corporations were also under study, with the intention of reducing the cost of such cover to the Exchequer.

In U.S. dollar terms, South Africa's total gross external debt is estimated by the staff to have increased modestly during 1984 but because of large valuation changes its ratio to GDP rose sharply to 48 percent from 32 percent at the end of 1983. The maturity structure of the debt remains unfavorable; short-term debt accounts for some 50 percent of the

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1/ In general, the Reserve Bank sets the forward premium on the basis of the differential between domestic interest rates and comparable rates abroad. It incurs a loss when, as was the case during 1984, the spot rate of the rand falls more rapidly than is implied by interest rate differentials.

total and a large proportion of the remainder falls due within the next three to four years. Nevertheless, the debt service ratio (18 percent in 1984) is not very high as the currency composition of the debt is biased toward the currencies of countries with low inflation and interest rates.

The authorities said that, while there had been no difficulty in rolling over maturing debt and renewing existing credit lines, a significant increase in the amount of these credit lines would probably entail a worsening of the terms of borrowing. Accordingly, their policy was to avoid any substantial increase in the foreign indebtedness of the public sector and to focus on lengthening to the extent possible the maturity profile of the debt, while also supporting efforts of the private sector to restructure its debt. In the official medium-term projections, the maintenance of approximate balance in the external current account is treated as an important policy objective. The staff's illustrative medium-term debt scenarios tend to indicate that this objective should be attainable if the authorities succeeded in preserving a large part of the recent gains in external competitiveness. The debt simulations also show, however, that the results are very sensitive to the assumptions made, especially as regards the price of gold and the terms of new borrowing (see Appendix II).

4. Manpower policies

The functioning of the labor market continues to be hampered by impediments to the geographical and occupational mobility of the majority of the work force. These have a detrimental effect on the rate of growth of the supply capacity of the economy and also tend to encourage an increase in the capital intensity of production, thereby reducing the rate at which employment opportunities are being created. Labor market rigidities thus go a long way toward explaining why the recurrent shortages of skilled labor coexist with a high and rising rate of unemployment of semiskilled and unskilled manpower, and why the economy is characterized by the perpetuation of strong upward pressures on costs and vast geographical, occupational, and racial wage differentials. The maintenance of restrictions on labor mobility also augments government expenditure in a variety of ways and affects adversely the economy's price and balance of payments performance, in part by increasing the costs of stabilization policies, and thereby discouraging the authorities from adhering to such policies.

In a recent research paper, 1/ it was estimated that the rate of growth of potential output declined from 5 1/2 percent per annum in the period 1967-74 to slightly above 3 percent per annum in the period 1974-83. The paper attributed this decline to the limited availability of highly skilled labor, which tended to reduce the average rate of productivity growth, as well as to adverse changes in the terms of

1/ See B. L. de Jager and M. M. Smal, "The Potential Gross Domestic Product of South Africa." South African Reserve Bank, Quarterly Bulletin, December 1984.

trade related in particular to the increases in international oil prices. Looking ahead, the paper forecast that the growth of potential output would not exceed 3 1/2 percent to 4 percent per year, even if the net domestic savings rate were to rise well above historical levels. It suggested that an obvious approach would be to concentrate on a program of improved productivity growth through increasing the number of skilled workers. In a recent update of its medium-term projections that had been prepared in the context of the official Economic Development Program, the Central Economic Advisory Service estimated that, on present trends and policies, the annual rate of growth of output in the period to 1990 would average 3.5 percent. This would be well below the rate of 4 1/2 percent that is estimated to be required to absorb the rapid increase in the labor force. The Central Economic Advisory Service concluded that it was imperative that further measures be taken to increase the growth and employment-creating capacity of the economy.

The administrative restrictions on the geographical mobility of labor are the most significant constraints on the allocation of manpower. Recently, the authorities announced their intention to take some steps that would allow black people with residential rights outside the so-called homelands to move freely between metropolitan centers. However, the timetable for the implementation of these steps remains unclear. Controls over the movement of black people who reside in the homelands remain in force; they are perceived by the authorities as an instrument for "orderly" urbanization. Considerable sums of public money are spent for the construction of new housing near areas designated as decentralization points in the context of the official regional development program. The authorities believe that regional development will create more favorable conditions for the phasing out of the administrative regulation of geographical mobility. However, for the time being regional disparities in income, wealth, and new job opportunities appear to have continued to widen. There are suggestions that the regional development incentives, which are very generous, are at times being abused notwithstanding the authorities' efforts to appraise carefully the viability of proposed projects. The incentives are also believed to have made it more difficult for some neighboring countries to attract foreign investment in pursuit of their own development efforts.

As mentioned in previous staff reports, legal impediments to occupational mobility have for the most part been removed. However, in the mining industry several job categories are still reserved for certain race groups by virtue of the definition of "scheduled person" under the Mine and Work Act of 1956. The Government has not taken any initiative to amend the law, even though negotiations between employers and trade unions that started in 1981 have not led to any agreement. The South African representatives nevertheless expressed confidence that progress would be made within a reasonable time toward the resolution of this issue.

In the area of industrial relations, the Labor Relations Amendment Act of 1981 for the first time defined the black worker as an employee, thereby extending trade union rights to all races. At present, there are 21 black and 78 multiracial unions as well as 57 white and 43 colored unions; the percent of black workers who are unionized remains well below the national average. The range of training facilities open to all workers has increased as a result of recent rationalization and streamlining of the industrial training system under new legislation that emphasizes the provision of manpower training on a nondiscriminatory basis. Since 1980 an increasing number of black apprentices have been trained to qualify as certified skilled artisans, despite the continuing negative attitude of white artisan labor unions toward the training of blacks. However, in relation to the size of the black labor force, the number of black apprentices remains small. One important constraint to progress in this area is the lack of applicants with the required eight years of schooling.

Wide disparities in average levels of education among the various population groups have indeed tended to reinforce the pattern of employment fostered by statutory restrictions on mobility. There are large differences in per capita government expenditure on the education of various race groups. Official data show that in 1984 education expenditure per student was R 1,184 for whites compared to R 235 for blacks. The Government has stated that its long-term aim is to provide each pupil with equal educational opportunities irrespective of race. However, given present trends and the existing disparities, the attainment of such a goal could not be expected for a long time. Furthermore, in complying with the aim of separate development of each population group, the Government plans to maintain what amounts to four separate and distinct educational systems, each serving one of these groups, with possible implications, at least for a time, for the quality of education that members of some groups receive.

5. Statistical issues

The South African statistical apparatus is reasonably well-developed and the reporting of data to the Fund has, in general, been timely. The official statistics, however, are deficient in several respects. One of the main shortcomings is that most statistics refer to South Africa and Namibia rather than to South Africa alone. The South African representatives said that the Administration of Namibia had begun collecting national accounts, balance of payments, and other macroeconomic statistics pertaining to Namibia alone. These statistics were regularly published in a Statistical Survey. However, they could not be used to net out Namibia from South African statistics because there was at present no systematic and reliable information regarding bilateral trade flows between the two countries.

Another problem of significance is that there is a large discrepancy between the liabilities of South African banks to nonresident banks as derived from national sources and the data which nonresident banks report as claims on South African banks. The South African representatives agreed that it was likely that the discrepancy reflected funds borrowed abroad by South African banks for on-lending purposes, but this could not be confirmed as the Reserve Bank did not yet possess adequate information on the contingent liabilities of the banks. However, this gap was expected to be closed soon as a by-product of improved arrangements that had been set up recently to ensure close monitoring and supervision of the international activities of all South African banks.

6. The economic outlook

The official projections were prepared prior to the introduction of the budget for 1985/86, but were based on assumptions about the stance of fiscal policy that are closely in line with the budget decisions. The projections envisage a continuation of the slowdown in economic activity that began in mid-1984. In volume terms, domestic demand is expected to fall by 4 percent in 1985, but the net foreign balance is projected to improve sharply, leaving total GDP roughly unchanged compared to its average level in 1984. This picture is broadly the same as the one that emerged from the staff's forecast in the context of the latest WEO exercise.

The projected fall in real domestic demand reflects expected reductions in private consumption expenditure and gross domestic fixed investment, as well as a sizable negative contribution from stockbuilding. Consumer spending declined in the second half of 1984, in part as a reaction to the abnormally rapid growth in the first half of the year and is expected to remain weak throughout 1985. The main factor constraining consumer spending is the projected decline in real wages, though its impact on personal income is likely to be moderated by a marked recovery in farm incomes. Gross fixed investment will continue to be adversely affected by persistent high interest rates, poor growth prospects, and a deterioration in the overall profit position of private industry, as the increase in profits in exporting industries resulting from the depreciation of the rand is expected to be more than offset by the decline in profits in other industries. A fairly large reduction in inventories is projected, reflecting in part some depletion of strategic fuel stocks and the likely liquidation of an involuntary buildup of stocks by the business sector in the latter part of 1984.

The current account of the balance of payments is projected by both the South African authorities and the staff to record a surplus of about SDR 1 billion in 1985. This is predicated on the assumption that the price of gold will average US$300 per fine ounce. With a slowdown in economic growth in a number of major export markets, the growth in the volume of nongold exports is expected to be slower than in 1984, despite the improvement in price competitiveness, which should be reflected in some gains in market shares, especially for manufactured goods, coal, and citrus fruit exports. Nevertheless, the trade balance is projected to improve as the volume of imports is likely to fall markedly in absolute terms in response to the decline in domestic demand, the delayed effect of the depreciation of the rand, and the termination of the large exceptional imports of agricultural products which drought conditions had caused in 1984.

On the assumption that the nominal exchange rate index remains at its average level in early February 1985, the authorities expect the rate of inflation, as measured in consumer prices, to increase from 11.6 percent in 1984 to 15 percent in 1985. The pressure on prices is expected to be especially strong in the first half of 1985 as the effects of the depreciation of the rand come through. In addition, increases in certain administered prices, such as motor fuel prices, rail fares, and postal tariffs, are expected to further push up the rate of increase in prices. The rate of increase of administered prices, which have a weight of about 20 percent in the consumer price index, is expected to go up from 8 percent in 1984 to about 20 percent in 1985. Even with the same exchange rate assumption as the authorities, the staff projects the rate of inflation to rise above 16 percent in 1985, with the difference reflecting mainly a less optimistic assessment of the prospects for pay restraint in 1985 than is embodied in the official forecast.

IV. Staff Appraisal

The performance of the South African economy over the past several years has not been satisfactory. Despite a massive increase in nominal spending, economic activity has expanded at a slow pace; per capita income has stagnated; both measured and disguised unemployment have increased markedly; double-digit inflation has persisted; and the balance of payments position has remained fragile. While the volatility of the external environment has complicated the task of managing the economy, it is clear that the authorities' efforts to promote financial stability and address long-standing structural weaknesses in the goods and labor markets have not produced any visible results. Strong policies to foster adjustment and financial discipline have on occasion been introduced, but only after crisis conditions had been allowed to develop. Moreover, these policies have tended to be reversed as soon as the crises appeared to have been overcome, with attention shifting to the pursuit of other objectives. Inevitably, the impression has been created that economic policy has drifted without a clear order of priorities and its credibility has been eroded.

Developments over the last year or so have followed a broadly similar pattern. Soaring government spending helped to prolong somewhat the consumption-led upswing in activity that a relaxation of policies had set in train in early 1983. However, the adverse consequences for the fiscal position, the exchange rate, inflation, and the medium-term growth prospects have been grave. Adjustment policies were introduced belatedly when the fall in the exchange value of the rand was moving at an alarming pace; even then action to curb the growth in government expenditure was postponed and the effectiveness of the measures taken was compromised to some extent by the authorities' unwillingness to allow adequate flexibility in the determination of interest rates and the exchange rate of the rand in the spot and forward markets. With official operations in the money and exchange markets apparently acting at cross purposes, credit and monetary expansion continued at an unduly rapid rate; the financing of capital outflows became easier and perhaps more attractive; net external reserves fell markedly; and the authorities accummulated large uncovered commitments in the forward exchange market.

The economy is now delicately poised. With the budget for 1985/86 reinforcing the effects of earlier stabilization measures, some degree of financial restraint has been achieved and the growth in domestic demand has moderated. In response, the prospects for the current account of the balance of payments have improved. Nevertheless, the overall payments position remains vulnerable, especially in view of the low level of foreign exchange reserves, the unfavorable maturity structure of the external debt, and the severe imbalance in the official forward exchange book. Moreover, the outlook for inflation is worrisome. In this situation, it is crucially important for the authorities to follow, and above all to stick to, tight financial policies over the medium term so as to allow the adjustment process to run its full course. A sustained and progressive reduction in the rate of inflation, in the context of a firm multiyear financial strategy, is a key requirement for the restoration of credibility in economic policies and the recovery of business and consumer confidence. However, if it is to succeed in enhancing prospects for growth on a durable basis, a strategy that aims to lower inflation needs to be supplemented by far-reaching structural reforms designed to ease or remove artificial constraints on the allocation of resources.

The budget for 1985/86 envisages a not inconsiderable reduction in the fiscal deficit, with the help of a restrictive pay policy for government employees but also a further sizable increase in taxation. While the planned reduction in the deficit, if it materializes, would represent a significant step toward the necessary consolidation of the public finances, more restraint on the spending side would have been preferable. The ratio of central government expenditure to GDP has increased by some 5 percentage points since 1980, and efforts to contain the deficit have entailed a sharp rise in the overall tax burden. The authorities now need to set clear objectives regarding the path and composition of government spending over the medium term and the means by which such spending is to be financed, with due regard to the paramount importance of upgrading the educational and skill qualifications of the low-income population groups. While issues related to the reform of the tax system deserve to be studied carefully, decisions in this area should not be delayed for too long, given the urgency of broadening the tax base. Last but not least, it is important to proceed speedily with the compilation and publication of reliable data for the entire public sector so as to allow more informed judgments to be made about the stance and effect of fiscal policy.

The behavior of the monetary aggregates in the recent past may have been distorted by the ongoing process of financial deregulation and to that extent it may have understated the extent to which monetary policy has been tightened. However, the concern of the authorities to prevent interest rates from rising has also contributed to the rapid growth in the money supply. There is now evidence that the rate of expansion of nominal demand has begun to abate. The key issue facing the monetary authorities at this juncture is how to maintain over the medium term a course of policy that is consistent with the progressive reduction in the growth of nominal spending to levels compatible with much lower rates of increase in prices. The introduction of publicly announced monetary targets, which the authorities are at present considering, could help them in this task but, until inflationary expectations have clearly been dampened, it will be necessary for policy to err on the side of too much rather than too little restraint and to avoid the stop-and-go pattern of the past.

With the large depreciation of the rand over the recent past, the competitive position of the tradable goods sector appears to have strengthened markedly. However, the competitive gains are likely to be dissipated quickly in the absence of noticeable progress in narrowing the large gap between cost increases in South Africa and those in the main trading partners. Financial restraint is indispensable in this respect, but it needs to be supplemented by action to increase competition in the goods and labor market, including action to reduce reliance on direct import controls. While the continuation of a flexible exchange rate policy is in general appropriate, some weight also has to be given to the need to run down official short-term foreign liabilities and rebuild external reserves. It is desirable for the Reserve Bank to reduce markedly and speedily its involvement in the forward market, as such involvement has caused large losses to the Exchequer and has been a significant source of monetary expansion.

As the authorities have come to recognize, the long-standing rigidities in the labor market have had deleterious effects on the growth performance of the economy, while also contributing to the secular rise in unemployment, the perpetuation of large wage differentials across population groups, and the persistence of strong cost-push inflationary pressures. Despite some changes in recent years, there remain important legal and other impediments to the occupational, and especially the geographical, mobility of labor. The elimination or significant reduction of these impediments will clearly improve over time the efficiency of resource allocation and allow income inequalities to be reduced in a noninflationary manner. It may also facilitate the task of shifting government expenditure in favor of outlays for the development of the country's manpower resources.

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

Table 1. South Africa: Domestic Developments and Forecasts

(Changes in percent from previous year)

	1969-79 Average 1/	1980-84 Average 1/	1981	1982	1983	1984 2/	1985 Forecast 3/
Demand and output (in constant prices)							
Private consumption	4.3	4.3	6.5	2.4	1.1	2.5	-2 1/2
Public consumption	5.7	5.5	2.9	4.3	0.9	9.4	1/2
Gross fixed investment	5.2	2.1	9.3	-2.4	-8.9	-2.4	-3 1/2
Stockbuilding 4/	-0.6	1.4	2.9	-6.2	-3.1	3.4	-1 1/2
Total domestic demand	4.2	3.6	9.9	-4.9	-5.0	6.1	-4
Exports of goods and services	2.6	-1.1	-5.8	-0.1	-7.3	9.3	6
Imports of goods and services	2.3	2.2	12.8	-15.2	-16.5	17.7	-12 1/2
Real GDP	4.0	2.5	4.9	-1.2	-3.2	4.7	--
Nominal GDP	16.3	17.2	17.3	10.0	11.8	17.4	11 1/2
Prices, wages, and costs							
Consumer prices	9.6	13.5	15.2	14.7	12.3	11.7	15
GDP deflator	11.8	14.3	11.8	11.3	15.5	12.1	11 1/2
Salaries and wages per worker in nonagricultural sector (in constant prices)	1.7	3.2	4.7	3.5	--	4.3	...
Productivity 5/	...	1.6	2.1	-0.9	-0.3	3.6	...
Unit labor costs 6/	...	15.2	18.0	19.9	12.8	11.5	...
Personal disposable income	13.5	16.0	14.6	14.3	12.6	15.0	...
Personal savings ratio (in percent)	9.5	5.4	5.6	3.5	3.0	3.3	...

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

1/ Compound annual averages, except for productivity, unit labor costs, and the personal savings ratio.
2/ Preliminary.
3/ As provided by the South African authorities.
4/ Including errors and omissions; first differences are expressed as a percentage of GDP in the previous period.
5/ Output per person employed in nonagricultural sector.
6/ In nonagricultural sector.

Table 2. South Africa: Balance of Payments

(In millions of SDRs)

	1981	1982	1983	1984 1/	1985 Forecast 2/
Merchandise exports, f.o.b. 3/	9,334	8,465	8,588	8,726	9,600
Net gold output	8,126	7,172	8,357	7,793	6,700
Merchandise imports, f.o.b.	-17,647	-15,058	-13,346	-14,310	-12,500
Trade balance	-187	579	3,599	2,209	3,800
Services, credit	2,999	2,928	2,998	2,881	2,875
Services, debit	-7,044	-6,514	-6,632	-6,097	-5,900
Transfers, net	360	283	305	228	200
Current balance	-3,872	-2,724	270	-779	975
(In percent of GDP)	(-5.2)	(-4.1)	(0.3)	(-1.0)	(1 1/2)
Capital movements	831	2,620	-288	-115	...
Long term	527	2,032	-219	1,733	...
Private	-283	580	-1,217	651	...
Public	810	1,452	998	1,082	...
Short term 4/	304	588	-69	-1,848	...
Overall balance	-3,041	-104	-18	-894	...
Official reserves, end of period 5/					
Gross:					
In millions of SDRs	3,441	3,227	3,327	2,326	...
In months of merchandise imports	2.3	2.6	3.0	2.0	...
Net (in millions of SDRs)	2,293	2,743	2,122	1,092	...
Memorandum items:					
Changes in the volume of trade					
Exports other than gold	-10.0	-0.6	-10.2	12.2	10 1/2
Imports	14.4	-17.6	-18.3	20.5	-15
Terms of trade (in SDRs)					
Excluding gold	-2.5	-12.0	4.0	2.0	...
Including gold	-16.8	-13.4	5.2	0.8	...
Gold price in SDRs	390	340	397	351	...
SDR/rand exchange rate					
(End of period)	0.8981	0.8423	0.7818	0.5140	...
(Average)	0.9723	0.8350	0.8408	0.6762	...

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

1/ Preliminary.
2/ As provided by the South African authorities.
3/ Excluding gold.
4/ Including errors and omissions.
5/ With gold valued at market-related prices.

Table 3. South Africa: Central Government Budget 1/

	1984/85		1985/86	1982/83	1983/84	1984/85	1985/86
	Budget estimate	Revised estimates	Budget estimates				
	In millions of rand			Percentage changes			
Central Government							
Revenue	21,977	23,835	28,322	19.1	11.2	24.9	18.8
Personal income tax	7,311	7,840	9,100	35.5	32.3	38.2	16.1
Gold mining related	1,845	2,025	2,340	-22.8	35.0	-8.8	15.6
Other corporate income tax	3,627	4,075	4,780	-19.7	-11.7	19.6	17.3
General sales tax	5,020	5,895	8,220	50.4	21.8	52.0	39.4
Other	3,882	4,000	3,882	10.6	-8.2	2.4	-3.0
Expenditure 2/	24,945	27,194	31,292	16.7	16.3	21.9	15.1 2/
Of which:							
Education and training	4,225	4,248	5,194	12.0	13.5	19.6	22.3
Interest on public debt	3,421	4,011	4,475	22.7	25.2	32.2	11.6
Defense	3,755	4,098	4,374	12.1	8.1	20.7	6.7
Social security and welfare	1,200	1,304	1,489	21.3	14.6	13.0	14.2
Agricultural subsidies and financing	323	612	...	28.2	62.0	-10.6	...
(Wage bill)	(4,915)	(5,120)	(5,550)	(...)	(24.7)	(28.2)	(8.4)
Surplus or deficit (-)	-2,968	-3,359	-2,970	--	--	--	--
				(In percent of GDP)			
Memorandum items:							
Surplus or deficit (-)				-2.5	-3.5	-3.1	-2.5
Revenue				20.9	20.6	22.1	23.5
Expenditure				-23.4	-24.1	-25.2	-26.0 2/
Education and training				-3.8	-3.8	-3.9	-4.4
Interest on public debt				-3.0	-3.3	-3.7	-3.8
Defense				-3.8	-3.7	-3.8	-3.7

Sources: Department of Finance, Budget Speech; Department of Finance, Statistical/Economic Review; and data provided by the South African authorities.

1/ Years ending March 31.

2/ The expenditure figures exclude discounts (the difference between the face value and the sale value of government securities). The expenditure figures for 1985/86 include transfers of R 400 million to the Tax Reserve Account to finance additional expenditure that may become necessary and R 599 million for expenditures that in previous years were made off-budget (including allocations to the Atomic Energy Corporation, the National Housing Fund, certain defense expenditure, etc.). Excluding the latter amount, the rate of growth of expenditure in 1985/86 is 12.9 percent.

Table 4. South Africa: Monetary Survey

	1984 Dec.	1982 Dec.	1983 Dec.	1984 Mar.	1984 June	1984 Sept.	1984 Dec.
	In millions of rand	Percentage changes from previous year					
Foreign assets (net)	1,029	-13.3	-1.1	-26.8	-9.2	-26.0	-57.7
Credit to private sector	40,355	20.5	17.8	19.4	22.1	21.4	28.4
Credit to Government (net) 1/	7,349	-5.6	40.1	34.4	14.7	20.3	9.2
Other items (net)	-6,595	4.4	36.0	42.7	52.6	22.1	3.1
M3	42,138	14.4	16.9	14.5	14.2	17.6	23.2
		(Contribution to M3 growth)					
Foreign assets (net)		-1.5	-0.1	-2.3	-0.7	-1.9	-4.1
Credit to private sector		17.8	16.2	17.6	19.9	19.7	26.1
Credit to Government (net) 1/		-1.1	6.6	4.9	2.5	3.4	1.8
Excluding forward cover losses		-8.3	5.0	2.7	0.2	-0.9	-3.0
Including forward cover losses 1/		-1.1	6.6	4.9	2.5	3.4	1.8
Other items (net)		-0.8	-5.8	-5.7	-7.5	-3.6	-0.6

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

1/ Including credit from the Reserve Bank to cover losses incurred on forward exchange cover transactions.

Table 5. South Africa: Illustrative Medium-Term Debt Projection, 1983-90

	1983 1/	1984 2/	1987	1990
		(In billions of U.S. dollars)		
Current account balance	0.2	-0.6	-- 3/	-- 3/
Total external debt	23.6	25.0	25.6	30.5
Of which:				
Medium- and long-term debt	11.0	12.5	12.1	15.1
Short-term debt	12.6	12.5	13.5	15.4
Interest payments	1.1	0.9	1.8	1.9
Amortization payments	2.2	2.1	2.4	3.8
		(In percent of GDP)		
Current account balance	0.3	-1.1	-- 3/	-- 3/
Total external debt	32.3	48.0	30.1	29.2
Of which:				
Medium- and long-term debt	15.1	23.6	14.2	14.5
Short-term debt	17.2	24.4	15.9	14.7
		(In percent)		
Debt service ratio 4/	15.5	18.0	19.1	22.7
Interest payments ratio	5.3	6.2	8.2	7.5

Sources: Data for 1983 and 1984 provided by the South African authorities; data for 1987 and 1990 are staff estimates.

1/ Official estimates.
2/ Preliminary staff estimates.
3/ Average for 1986-90.
4/ Interest payments plus repayments of medium- and long-term debt in percent of exports of goods and services.

Fund Relations with South Africa
(As of end of March 1985)

I. Membership Status

South Africa is an original member of the Fund. The obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement have been accepted as from September 15, 1973.

(A) Financial Relations

II. General Department

(a) Quota	SDR 915.7 million		
(b) Total Fund holdings of South African rand	SDR 1,590.7 million or 173.7 percent of quota		
		Amount	Percent of quota
(c) Fund credit	CFF	SDR 636.0 million	69.5
	Credit tranche (ordinary)	SDR 109.0 million	11.9
	Total	SDR 745.0 million	81.4
(d) Reserve tranche position	SDR 70.0 million		
(e) Current operational budget	No use of the rand is planned in the current budget.		
(f) Lending to Fund	None.		

III. Current Stand-By or Extended Arrangement and Special Facilities

(a) Current: None.

(b) Previous: In November 1982, the Fund approved a 14-month stand-by arrangement for an amount equivalent to SDR 364 million (57 percent of the then-quota) and a purchase equivalent to SDR 636 million (100 percent of the then-quota) under the CFF. South Africa drew SDR 159 million under the stand-by arrangement but made no further drawings afterwards. On August 31, 1983 the authorities made an early repurchase of SDR 50 million.

In September 1975 South Africa purchased SDR 80 million under the gold tranche and four months later a further SDR 80 million under a stand-by arrangement in the first credit tranche. The Fund approved a new stand-by arrangement in August 1976 under which SDR 75 million was purchased immediately, SDR 39 million in January 1977, and SDR 38 million in May 1977. In November 1976, South Africa purchased SDR 160 million under the CFF.

IV. SDR Department

(a) Net cumulative allocation: SDR 220.4 million

(b) Holdings: SDR 1.8 million or 0.8 percent of net cumulative allocation.

(c) Current designation plan: The rand is not included in the current plan.

V. Administered Accounts: Not applicable.

VI. Overdue Obligations to the Fund: None.

B. Nonfinancial Relations

VII. Exchange system: The South African authorities do not maintain margins in respect of exchange transactions. The dual exchange rate system, under 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. A further deregulation of the foreign exchange market came into effect on September 5, 1983, establishing a system of managed floating. The exchange rate of the rand in March 1985 was R1 = US$0.50222, compared with R1 = US$0.8225 in March 1984.

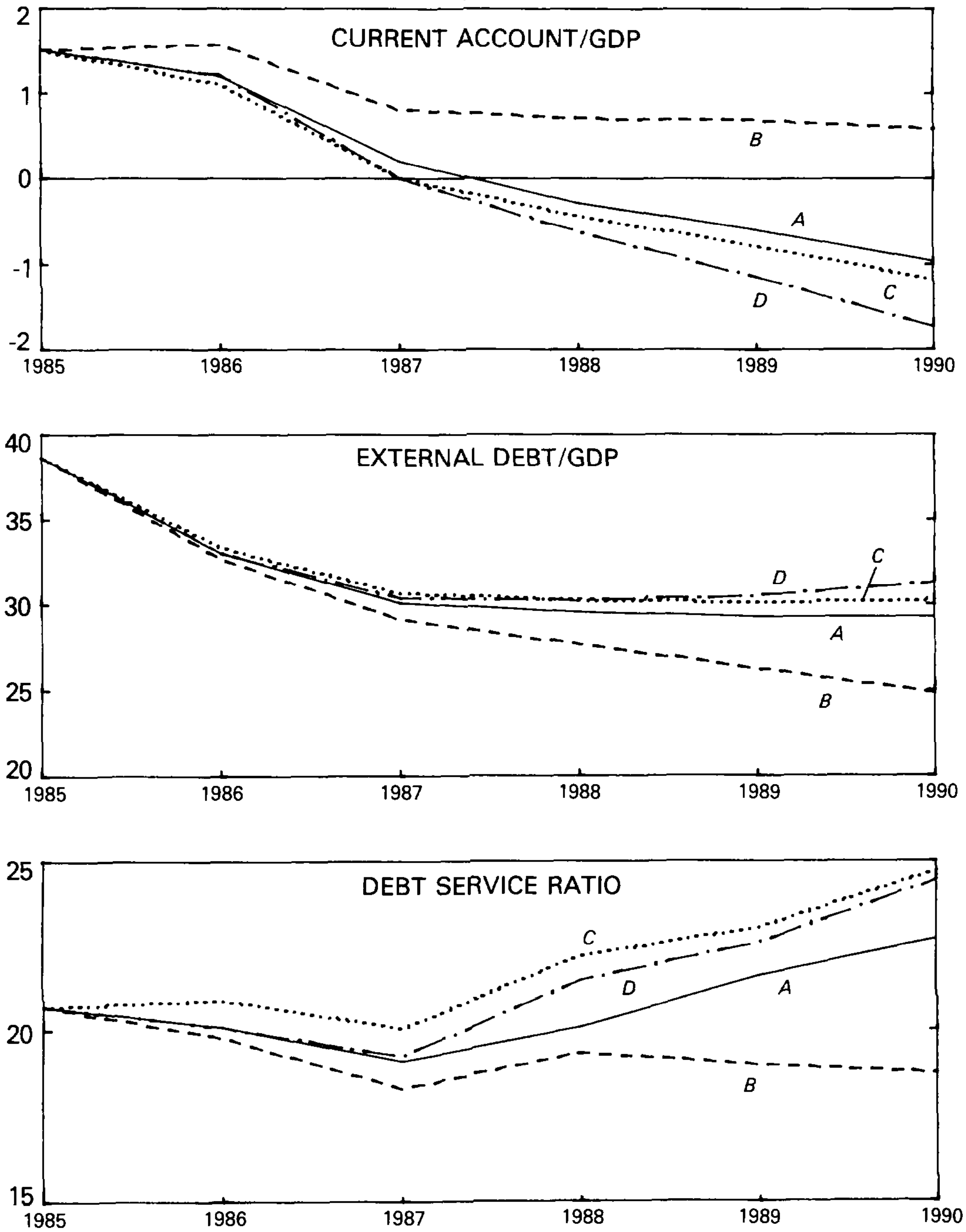
VIII. The Last Article IV consultation took place in February/March 1984, and was completed by the Executive Board on June 8, 1984.

CHART 10

SOUTH AFRICA

MEDIUM-TERM EXTERNAL DEBT SCENARIOS[1]

(In percent)



Source: Staff estimates.

[1] A=baseline scenario; B=price of gold constant in real terms; C=interest rates 1 percentage point higher than in scenario A; and D=nongold export volume growth 1 percentage point lower than in scenario A.

Illustrative Medium-Term Debt Projections

The simulation period for the medium-term debt projections is 1986-90; the 1985 figures are in line with the forecasts given in Table 1. A baseline simulation (central scenario) is presented together with three alternative scenarios.

The main assumptions underlying the central scenario are as follows: Industrial countries' output is assumed to increase by 3 percent per annum and their GDP deflator to rise by 4 1/2 percent per annum. Domestic demand in South Africa is assumed to grow at an average annual rate of 3 1/2 percent. The terms of trade (excluding gold) are assumed to remain constant, while the price of gold is kept unchanged at US$300 per fine ounce. The volume of gold exports is projected to remain constant at the 1985 level. 1/ It is assumed that about half of the recent fall in the real effective exchange rate will be reversed by 1987. Thereafter, the real effective exchange rate is assumed to remain constant. All new medium- and long-term borrowings are assumed to be repayable within five years without any period of grace and international interest rates are assumed to decline slowly as in the latest WEO exercise. The results of the central scenario are summarized in Table 5.

The sensitivity of the simulation results to some of the key underlying assumptions is indicated in Chart 10. Against the central scenario, this chart illustrates the effects in 1986-1990 of changes in the assumptions with respect to (1) the price of gold (constant in real rather than nominal terms), (2) the interest rates (1 percentage point higher than in the central scenario throughout 1986-90), and (3) nongold export growth (2 percent instead of 3 percent per annum from 1987 to 1990). In each of the three cases, only the assumption indicated has been changed, while all other assumptions remain the same. Therefore, the differences between the central scenario and the three variants shown in the chart provide no more than a rough indication of the significance of the individual change in each assumption. In reality, a higher gold price, for example, would have implications for some other assumptions underlying the central scenario, including the assumption about the exchange rate; similarly, a worsening of the terms of borrowing would probably have some implications, inter alia, for the stance of domestic financial policies and thus for the rate of growth of domestic demand.

1/ Gold output is expected by the mining industry to remain close to present levels through the end of the decade. It would probably decline thereafter, though the prospects could change depending on the results of significant exploration activities that are currently under way.

South Africa: Selected Economic and Financial Indicators, 1981-84

	1981	1982	1983	1984
	(Annual percentage changes, unless otherwise specified)			
Demand, output, and prices				
Real domestic demand	9.9	-4.9	-5.0	6.1
Real output at factor cost	4.7	-1.1	-3.1	4.7
Agriculture	0.5	-7.7	-22.0	13.7
Mining	-1.0	-1.5	-1.9	2.6
Manufacturing	6.7	-2.9	-6.9	3.1
Government services	1.7	2.8	4.9	4.5
GDP deflator	11.8	11.3	15.5	12.1
Consumer prices	15.2	14.7	12.3	11.7
External sector				
Nongold exports value, f.o.b. 1/	-3.2	-9.3	1.5	1.6
Nongold export volume	-10.0	-0.6	-10.2	12.2
Gold export value 1/	-18.9	-11.7	16.5	-6.7
Gold export volume	0.8	0.7	--	4.9
Imports value, f.o.b. 1/	26.2	-14.7	-11.4	7.2
Import volume	14.4	-17.6	-18.3	20.5
Terms of trade (including gold; deterioration -) 1/	-16.8	-13.4	5.2	0.8
Nominal effective exchange rate (average depreciation -)	1.9	-9.6	6.7	-14.0
Real effective exchange rate (average depreciation -)	4.9	-5.2	11.2	-11.7
Government budget 2/				
Revenue	8.3	19.1	11.2	24.9
Total expenditure	21.5	16.7	16.3	21.9
Money and credit 3/				
Net credit to Government 4/	62.0	-5.6	40.1	9.2
Credit to private sector	34.4	20.5	17.8	28.4
Broad money (M3)	19.4	14.4	16.9	23.2
	(In percent of GDP)			
Central government budget deficit (State Revenue Account) 2/	-3.1	-2.5	-3.5	-3.1
Savings of general government	2.1	0.3	-1.0	-2.0
Gross domestic savings	28.3	22.8	25.2	22.8
Gross domestic investment	34.5	27.0	24.9	23.8
External current account balance	-5.2	-4.1	0.3	-1.0
Debt service ratio 5/	...	...	15.5	18.0
Overall balance of payments (in millions of SDRs)	-3,041	-104	-18	-894

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

1/ In SDR terms.
2/ Fiscal year beginning April.
3/ In through-the-year terms.
4/ Including credit from the Reserve Bank to finance losses incurred on account of forward exchange contracts.
5/ Interest and amortization payments on total foreign debt. In percent of exports of goods and nonfactor services.

South Africa--Basic Data

Area and Population

Area	1,182,345 sq. km.
Population (at June 1983)	30,800,000
Employment in nonagricultural sector (September 1984)	5,100,000

IMF Position (March 31, 1985)

Quota (in millions of SDRs)	915.7
Fund holdings of rand as percent of quota	173.7
Holdings of SDRs (in millions)	1.8
Exchange rate	R 1 = US$0.50222 = SDR 0.52962

National Accounts

	1984	1982	1983	1984
	In millions of rand at current prices	Percentage change in real terms		
Private consumption	57,244	2.4	1.1	2.5
Public consumption	17,987	4.3	0.9	9.4
Gross fixed investment	24,652	-2.4	-8.9	-2.4
Change in stocks (including residual item)	2,296	-6.2 1/	-3.1 1/	3.4 1/
Total domestic demand	102,179	-4.9	-5.0	6.1
Exports of goods and services	28,319	-0.1	-7.3	9.3
Imports of goods and services	-25,733	-15.2	-16.5	17.7
Gross domestic product	104,765	-1.2	-3.2	4.7

State Revenue Account 2/

	1982/83	1983/84	1984/85
	In millions of rand		
Revenue	17,173	19,088	23,835
Expenditure	-19,183	-22,317	-27,194
Overall deficit	-2,010	-3,229	-3,359

Balance of Payments

	1982	1983	1984
	In billions of rand		
Merchandise exports, f.o.b.	18.8	20.1	24.8
Net gold output	8.6	9.9	11.7
Merchandise imports, f.o.b.	-18.0	-15.9	-21.3
Net invisibles and transfers	-4.0	-3.9	-4.5
Current balance	-3.2	0.3	-1.0
Net long-term capital	2.4	-0.2	2.7
Net short-term capital (including errors and omissions)	0.7	-0.1	-3.1
Net capital (including errors and omissions) 3/	3.1	-0.3	-0.4
Overall balance	-0.1	--	-1.4
Level of reserves at end-year (in millions of SDRs, IFS definition)	705	1,059	504

Monetary Aggregates (end of period)

	1981	1982	1983
	Percentage increase over previous year		
Broad money (M3)	14.4	16.9	23.2
Bank credit to private sector	20.5	17.8	28.4
Bank credit (net) to Government 4/	-5.6	40.1	4.2

Prices and Wages (annual average)

Consumer prices	14.7	12.3	11.7
Price deflators			
Exports of goods and services	6.2	14.5	11.8
Imports of goods and services	19.0	7.1	12.1
Real remuneration per worker 5/	3.5	--	4.3
Whites	2.0	-1.5	4.0
Nonwhites	5.4	0.6	4.6

1/ Contributions to growth of GDP.
2/ Years ended March 31.
3/ Excluding short-term liabilities related to reserves.
4/ Includes credit from the Reserve Bank to finance losses on account of forward exchange contracts.
5/ In the nonagricultural sector.