Statements on Bank rate and monetary policy

Issued by the Governor of the South African Reserve Bank, Dr Gerhard de Kock

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During recent months real output, employment and general economic activity in South Africa have not only remained high but have continued to expand strongly. As expected, the rate of **real** economic growth has declined from the exceptionally high figure of nearly 8 per cent attained in 1980 to what appears to be an annual rate of roughly 4 to 5 per cent thus far in 1981. But this reduction was mainly the inevitable result of **physical** constraints - in particular the shortage of skilled labour and the absorption during the course of 1980 of most of the surplus productive capacity which had still existed at the beginning of that year. **Monetary demand**, particularly fixed investment spending, has continued to rise strongly, thereby contributing not only to the relatively high rate of inflation - 15 per cent between May 1980 and May 1981 in terms of the consumer price index - but also to rising imports, the emergence of a moderate deficit on the current account of the balance of payments and an effective depreciation of the commercial rand against all other currencies of nearly 4 per cent since the beginning of 1981.

Until recently, this undue pressure of demand on available resources has been accompanied by an exceptionally high rate of increase of the money supply. Taken at a seasonally adjusted annual rate, the broadly defined money supply (M2) increased by 41 per cent in the third quarter of 1980, 25 per cent in the fourth quarter and 53 per cent in the first four months of 1981, reflecting mainly an abnormally large expansion of bank credit to the private sector. Although these rates of increase have been artificially inflated by so-called "re-intermediation", i.e. a return switch from "off-balance sheet financing" to "on-balance sheet financing" by the banks, they have clearly been excessive and must in no small measure have contributed to the inflation. Moreover, given the normal time lags involved, this excessive increase in the money supply will probably continue to exert an inflationary influence in the months ahead.

In these circumstances one of the main objectives of the official anti-inflationary policy has been to slow down the rates of increase of bank credit and money supply to a level high enough to promote sound economic growth but not so high as to cause or permit continued or accelerating inflation. To this end the monetary authorities have made use of public debt management, open-market operations, rediscount policy and variations in the Reserve Bank's discount on forward dollars.

Although no money supply figures are as yet available for May or June, there are now clear indications that the current monetary policy has begun to take effect. As anticipated in discussions held between the Reserve Bank and the banks earlier this year, the rapid expansion of credit to the private sector by the banks at a time when their own liquid assets were not being augmented by either the balance of payments or the government's financial operations, has reduced their excess holdings of liquid assets above the required legal minimum to such an extent that they have no option but to slow down their lending activities.

Since the demand for money and credit generated by the activity in the economy has remained high, these changes in the monetary and banking situation have understandably brought about a sharp upward movement in interest rates, particularly short-term rates. In recognition of this tendency, the Reserve Bank raised its Bank rate from 7 to 8 per cent on 3 February 1981 and from 8 to 9½ per cent on 6 May 1981.

Since the latter date, short-term rates have shown a substantial further increase, as the following examples indicate:

	Oct. 1980	Immediately after Bank rate increase of 6 May 1981	22 June 1981
	%	%	%
Discount house basic call rate	4,55	8,60	9,50
Liquid three-months' bankers acceptances	4,80	10,70	13,50
Non-liquid three months' bankers' acceptances	5,05	11,60	16,00
Effective cost of 3 months' liquid bankers' acceptance financing	±6,60	±12,50	15,20–15,50
Negotiable Certificates of Deposit (three months)	4,80	11,70	16,00–16,50
Treasury bill tender rate	4,66	8,69	9,16
Commercial banks' prime overdraft rate	9,50	13,00	13,00
Commercial banks' 6 months' fixed deposits	6,00	12,00	16,00
Yield on 3-year government securities	6,00	10,00	11,25

In line with its policy of keeping Bank rate as market-related as possible, the Reserve Bank has therefore decided, after the usual consultation with the Treasury, to increase its Bank rate from 9½ to 10½ per cent with effect from 24 June 1981. On the assumption that the clearing banks will now increase their prime overdraft rates from 13 to 14 per cent, this should result in a more appropriate alignment of short-term interest rates.

South African short-term interest rates are still relatively low by comparison with rates in the United States, the United Kingdom, Germany, Canada and many other countries. Indeed, in many cases they are still negative in real terms, i.e. after correcting for inflation. Nevertheless, the recent increases in

domestic rates, reflecting as they do the interplay between the rate of monetary expansion and the demand for money and credit, serve as an indication that the official anti-inflationary monetary policy is beginning to achieve some of the desired results.

20 July 1981

The Reserve Bank has decided to increase its Bank rate from 10½ to 12½ per cent with effect from 21 July 1981. This decision was taken after the usual consultation with the Treasury, the recent meeting of the Prime Minister's Economic Advisory Council and discussions held by the Reserve Bank with the main clearing banks today.

In terms of the existing understanding between the clearing banks and the Reserve Bank regarding the relationship between Bank rate and the banks' prime overdraft rate, the latter rate will presumably now be increased from 14 to 16 per cent. It has been decided, however, that the maximum overdraft rates as laid down under the Limitation and Disclosure of Finance Charges Act, including the maximum of 18 per cent for all loans exceeding R1 000, will remain unchanged. This means that the expected increase in overdraft rates will affect mainly the large companies enjoying the status of "prime borrowers", since most other borrowers have already been paying the higher rates for some time and will therefore not experience any further increase as a result of the latest Bank rate adjustment.

The clearing banks have also agreed to stand by their earlier undertaking to assist in financing the record maize crop by extending increased amounts of credit to the Land Bank at a rate of 11½ per cent. The interest rates charged by the Land Bank should not therefore be affected by the new Bank rate increase.

At the same time the clearing banks have indicated that they see no need at this stage to bring about any material changes in their ordinary "retail" deposit rates, which have already risen substantially in recent months. The increase in the prime overdraft rate should therefore have little, if any, effect on the competition for retail deposits between banks and building societies.

In recent weeks the combination of a lower gold price, world-wide recessionary tendencies and continued high overseas interest rates, coupled with a strong demand for credit in the still buoyant South African economy, has naturally exerted a tightening effect on domestic financial markets. The further increase in Bank rate, and therefore in the banks' prime overdraft rates, is therefore partly a technical adjustment necessitated by further increases in other short-term rates. It is, however, also a logical consequence of present monetary policy, which has begun to achieve its objective of reducing the rate of increase of bank credit and money supply as an integral part of overall anti-inflationary policy.