Statement on Bank rate and monetary policy

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

2 February 1981

After the usual consultation with the Treasury, the Reserve Bank has decided to increase its Bank rate from 7 to 8 per cent with effect from 3 February 1981. Since the clearing banks have an understanding with the Reserve Bank that their prime overdraft rates will normally be maintained within a range of 2½ and 3½ per cent above Bank rate, these rates can now be expected to rise from their present level of 10 per cent to between 10½ and 11½ per cent. Other money market rates, including the rates on Treasury bills, bankers' acceptances, trade bills, call money and fixed and savings deposits, have already increased considerably in recent months in response to changes in supply and demand, and will, no doubt, continue to reflect market forces.

The increase in Bank rate signifies both official recognition of the recent upward tendency in domestic interest rates and the determination of the monetary authorities to act with all due speed to reduce the rate of increase of the money supply.

That 1980 was one of the best years ever for the South African economy is self-evident. It was a year of continued cyclical upswing during which real gross domestic product increased by about 8 per cent and trade, employment and general economic activity expanded substantially. It was a period of prosperity and rising living standards for most South Africans and of increased confidence in the economic future of the country, as shown by the substantial increases in real fixed investment and consumption in the private sector. Moreover, despite the increase of about 47 per cent in imports which accompanied this upward surge in total outlays, the current account of the balance of payments still showed a surplus of between R2½ and R3 billion for 1980 as a whole, largely reflecting the virtual doubling of the average gold price for the year in comparison with 1979.

What was disturbing, however, was the increase of over 28 per cent in the broad money supply (money plus near-money) between November 1979 and November 1980. This rate of increase was more than double the broad guideline of 10 to 12 per cent indicated by the Minister of Finance early in the year. Moreover, the seasonally adjusted annual rate of increase accelerated from 13,7 per cent in the first quarter of 1980 to 17,5 per cent in the second quarter and 48,6 per cent in the third quarter, before declining slightly to about 40 per cent for October and November.

Although the government sector's financing operations contributed substantially to the increase in the money supply during the second quarter of 1980 and again in October and November, they exerted a net contractionary monetary influence over the first eleven months of the year as a whole, and present indications are that this will also be true of the fiscal year ending in March 1981. The main reasons for the excessive rise in the money supply during the first eleven months of 1980 were the overall balance of payments surplus during the third quarter of 1980, and an increase in bank credit to the private sector made possible by excess bank liquidity.

The inflationary potential of the excessive increase in the money supply needs no underlining. At the beginning of 1980 the inflation in South Africa had still been largely of the cost-push kind and, particularly in view of the tight curbs on government spending and the scope for rising imports provided by the balance of payments surplus, the emergence of **general** demand inflation had not seemed inevitable. But as the year progressed, the excessive increase in the money supply and the accompanying relatively low level of interest rates made the general financial situation increasingly conducive to general demand inflation, despite the continued restraints on government spending and the marked increase in tax receipts.

During this period there was also a progressive acceleration of the rate of inflation. The seasonally adjusted annual rate of increase of the consumer price index rose from 8,6 per cent in the first quarter of 1980 to 13,3 per cent in the second quarter, 16,3 per cent in the third quarter and 22,3 per cent in the fourth quarter, resulting in an increase of 15,7 per cent between December 1979 and December 1980.

In these circumstances, and particularly now that most of the surplus capacity in the economy has been absorbed and the effects of the acute shortage of skilled labour are increasingly being felt, the threat of accelerating demand inflation is real indeed. To avert this threat it is imperative that the monetary authorities regain effective control over the money supply and add monetary discipline to the existing fiscal discipline. The first steps in pursuit of this objective have already been taken and further measures will be applied to the full extent required.