Statement on monetary policy

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

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After consultation with the Minister of Finance the Reserve Bank has decided to tighten monetary policy further in order to reduce the rates of increase of bank credit and the money supply.

To this end the Bank will curb its own net domestic credit creation in the form of both discount window accommodation and open-market operations. This is the key to better control over the money supply, since under present conditions it is the Reserve Bank's credit extension that provides the banks with the cash reserves they require to support increases in their discounts, loans, advances and investments.

Given the high level of economic activity and the resultant strong demand for credit that still exists, the planned reduction in the Reserve Bank's provision of cash reserves to the banks is likely to lead to at least a temporary further rise in some short-term interest rates, including prime overdraft rates. This is an inevitable *consequence* of the less accommodative monetary policy stance now being adopted.

In line with this expected rise in short-term interest rates the Reserve Bank has decided to raise its rediscount rates for Treasury bills, Land Bank bills and bankers' acceptances for all banking institutions other than discount houses from 15,0 per cent, 15,15 per cent and 15,30 per cent to 16,0 per cent, 16,15 and 16,30 per cent, respectively, i.e. by 1 percentage point in each case. Corresponding increases will be effected in the Bank's interest rates on overnight loans to banks. The new rates will take effect from 23 February 1989.

At the same time the Reserve Bank has decided to abolish the preferential margin of ½ per cent previously extended to discount houses on its various refinancing rates. In future the Bank will therefore have only one set of refinancing rates applicable to both banks and discount houses. This is basically a technical adjustment made in recognition of the evolutionary changes that have occurred in recent years in the functions of discount houses and, in particular, of the fact that they no longer serve as the main conduit through which banks obtain accommodation from the Reserve Bank. For some time now the Reserve Bank's key rediscount rates have, in fact, been the rates that apply to banks and not the rates charged to discount houses.

The term "Bank Rate", which in the past referred to the preferential rate at which the Reserve Bank rediscounted Treasury bills *for discount houses,* will in future therefore refer to the Reserve Bank's uniform rediscount rate for Treasury bills *for both banks and discount houses.* In practice this means that from 23 February 1989 Bank Rate will be 16,0 per cent instead of 14,50 per cent as previously.

A consequential change is that the traditional maximum margin between "Bank Rate" and the banks' prime overdraft rate now becomes 3 percentage points instead of 3½ percentage points as before.

It is expected that the planned reduction in Reserve Bank accommodation to the banks will result in increases of up to 1 per cent in the prime overdraft rates of at least some banks and in certain other short-term lending and deposit rates. This will bring these rates into alignment with those money market rates that have already moved up in recent weeks, such as the rates on Treasury bills, Land Bank bills and bankers' acceptances. It goes without saying that there is no compulsion on any bank or building society to increase any of its lending rates if it does not deem it necessary to do so.

Whether long-term interest rates, including home mortgage rates and the yields on Government stock and semi-gilt-edged securities, will be materially affected by the expected increases in short-term rates, will, of course, depend on supply and demand conditions in the capital market. At present it is not self-evident that these long-term rates will rise to any significant extent.

The need to tighten monetary policy at this stage was mainly brought about by three developments:

(1) The decline in the gold price from an average of US$437 per ounce in 1988 to well below US$400 per ounce in recent weeks. Taken over a full year a decline in the gold price of $50 per ounce would mean a decline of roughly $1 billion or nearly R2,5 billion (at the present rand-dollar exchange rate) in the value of South Africa's annual gold output.

(2) The further rise during recent months in interest rates in Europe and the United States to levels that in real terms greatly exceed those in South Africa.

(3) The further excessive rise in the money supply during January 1989 to a level 28 per cent higher than that of a year ago, which provided further proof that both the vigour and the duration of the upswing in the domestic economy had been consistently underestimated during 1988.

There are indications that the upswing in total spending and general economic activity is levelling-off and that, in a technical sense, an upper turning-point of the business cycle has either already been passed or is about to be reached. But for the time being it remains the objective of monetary policy to reduce the rates of increase of the money supply and total spending in order to counter inflation and to strengthen the balance of payments.