Statement on interest rate policy

Issued by Dr C.L. Stals, Governor of the South African Reserve Bank

9 October 1989

Since the Reserve Bank announced the increase in its Bank rate from 16 to 17 per cent on 5 May 1989, relatively stable conditions prevailed in both the money and capital markets, and interest rates fluctuated within relatively narrow margins.

The discount rate for three-month liquid bankers' acceptances, for example, increased from 16,70 per cent at the end of April 1989 to 17,35 per cent on 5 May 1989, and then fluctuated between 17,30 per cent and 17,60 per cent subsequently. The monthly average yield on long-term government stock reached a peak of 17,38 per cent in May 1989 and then drifted down to 16,86 per cent in September. On 9 October 1989 the yield on long-term government stock was 16,85 per cent.

Although South African interest rates may seem to be high in nominal terms, they are indeed lower than comparable rates in most of the Western industrial countries if account is taken of the rates of inflation prevailing in South Africa and in these countries. In real terms, that is after adjustment for the rate of inflation, the prime overdraft rate of commercial banks in South Africa is only 3,9 per cent, compared with 6,3 per cent in the United Kingdom and 6,6 per cent in West Germany.

The increases announced in the discount rates of a number of central banks in Western Europe and in the United Kingdom last week, *widened* the above-mentioned margins between the South African and the overseas real rates of interest. This will put additional pressure on the capital account of the South African balance of payments, on the exchange rate of the rand and eventually also on the rate of inflation in South Africa. In view of the relatively low level of South Africa's foreign reserves and existing commitments to repay foreign loans, and also taking account of the relatively low price of gold at this stage, the country can ill afford any further pressure on its balance of payments.

As far as the domestic economic situation is concerned, the latest available economic statistics confirm that the economy has turned down early in 1989, and is now technically in a consolidation period. Total gross domestic expenditure for example, which had increased by 7 per cent in real terms in 1988 and by a seasonally adjusted annual rate of 6 per cent in the first quarter of 1989, *actually* declined at a seasonally adjusted annual rate of 2 per cent in the second quarter of 1989.

In addition to the concern about the continuing capital outflow in the balance of payments, the relatively low price of gold and a further rise of 17,5 per cent in the seasonally adjusted imports from the first to the second quarter of 1989, there are also a number of reasons arising from domestic economic developments which make it important for South Africa to maintain nominal interest rates at an appropriately high level:

> *Firstly*, revised statistics for the money supply indicate that in August 1989 M3 still increased at a rate in excess of 24 per cent over twelve months. This remains well above the target-range of 14 to 18 per cent for 1989.
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> *Secondly*, the rate of inflation remains high. The consumer price index in August 1989 was 15,5 per cent above the level of a year ago, while the rate of increase in the producer price index rose to 16,1 per cent in August.
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> *Thirdly*, increases in wages and salaries in excess of the rate of inflation create more inflationary pressures in the economy, and also raise the demand for credit on the basis of an increase in the ability of salary and wage earners to service additional debt. It is necessary to counteract these effects by a more restrictive monetary policy.
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> *Fourthly*, mainly because of the lack of an inflow of capital from abroad, it remains important that South Africans at this stage spend less on consumption and save more. The country is currently obliged to finance its economic development entirely from its own resources.

Against this background, it is even more important for South Africa than for the countries in Western Europe or for the United Kingdom to apply the necessary financial disciplines, and to maintain positive real rates of interest in its fight against inflation, and for the protection of the balance of payments.

After the usual consultation with the Minister of Finance, the Reserve Bank has therefore decided to raise its Bank rate, that is the rate at which it rediscounts Treasury bills, from 17 to 18 per cent with effect from Wednesday, 11 October 1989. Other interest rates at which the Reserve Bank provides accommodation to the market will also be increased by 1 percentage point as from 11 October 1989, except rates in respect of all forms of overnight loans which will be raised by 1,25 percentage points. The rate for overnight loans covered by liquid bankers' acceptances, for example, will be increased from 20 per cent to 21,25 per cent as from 11 October 1989.

When Bank rate and other interest rates were increased in May 1989, Reserve Bank assistance was made available to the Land Bank to enable it to keep its short-term interest rates unchanged. Various schemes were also announced by the Government to assist small businesses and home-owners in the lower income groups who were adversely affected by the higher interest rates. The Government has indicated that the Land Bank and Government Departments responsible for these assistance schemes will reassess the existing facilities in the light of this further upward adjustment in interest rates. Where appropriate, further announcements in this regard will be made in due course by the responsible Ministers.

Statement regarding the interim debt arrangements with foreign creditors of South Africa

Issued by Dr C.L. Stals, Chairman of the South African Standstill Co-ordinating Committee

18 October 1989

The present Second Interim Arrangements covering the redemption of the affected amount of the foreign debt of South Africa will expire on 30 June 1990. It is estimated that on that date, approximately $8 billion will remain affected, compared with the amount of $14 billion blocked in terms of the Debt Standstill announced in September 1985.

During the past two months, members of the South African Standstill Co-ordinating Committee held extensive discussions with many of the major foreign creditors of South Africa. The progress made over the past four years in reducing the amount of the affected foreign indebtedness of South Africa and the working of the Second Interim Arrangements were reviewed. The current economic situation in South Africa was analysed and prospects for the South African balance of payments over the next four years were discussed.

In the light of the discussions it was determined that the currently applicable Second Interim Arrangements should be extended for a further period beyond June 1990.

New Third Interim Arrangements will therefore be provided for through procedures similar to those previously adopted and will take effect on 1 July 1990, that is, on the expiration of the Second Interim Arrangements. The main terms of the new Arrangements are as follows:

(i) They will extend over a period of three years and six months, that is from 1 July 1990 to 31 December 1993.

(ii) During this period, South African debtors having affected indebtedness will be permitted to repay in eight instalments a total amount equal to 20,5 per cent of the reducing balance of the affected indebtedness. The total amount of redemptions over the period will be equal to approximately $1,5 billion; that is, more than the total repayments provided for in the Second Interim Arrangements.

Redemptions will take place in terms of the following schedule:

		Per cent
1990	– December	1,5
1991	– February	2,5
	– August	3,0
1992	– February	3,0
	– August	3,0
1993	– February	3,0
	– August	3,0
	– December	1,5

The indicated percentages for capital redemption will be applied to the outstanding amounts of all affected indebtedness on each of the indicated dates.

(iii) A revised provision will be included for the conversion of short-term claims inside the net to long-term loans outside the net. Claims converted in this manner will be repayable over a ten year period as follows:

- from 1 July 1990 to 31 December 1993, payments on the reducing balance as for debt inside the net;
- from 1 January 1994 until seven and a half years after the original date of conversion, no redemption; and
- the final two and a half years, the balance redeemable in six equal half-yearly instalments.

(iv) The present provision for the conversion of restricted indebtedness into financial rand, for investment in equities, will be retained in the new Third Interim Arrangements.