Further details of the new arrangements will be conveyed to all South Africa's foreign creditors shortly and the arrangements will also be applied to all foreign non-bank creditors holding part of the affected indebtedness.

Foreign indebtedness of South Africa falling outside the net of affected indebtedness will remain, as at present, unaffected, that is, not subject to these arrangements. It is estimated that such debt currently amounts to approximately $12 billion.

Money supply guidelines for 1990

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

23 March 1990

The monetary target announced on 7 March 1989 provided for a rate of increase in the broad money supply (M3) of 14 to 18 per cent between the fourth quarter of 1988 and the fourth quarter of 1989. The actual increase in the quarterly average of M3 over this period amounted to 23,5 per cent, which substantially exceeded the upper target limit. The main "cause" of this increase remained the rapid expansion in monetary institutions' credit extension to the domestic private sector of 21,2 per cent, mainly granted to companies for various purposes, and to individuals for purchases of durable goods. In order to curb this credit creation, Bank rate was increased in three steps from 14,5 to 18 per cent during the targeting year. Although the rate of credit extension still remains at an unacceptably high level it is abating, reflecting the influence of higher interest rates and a lower level of economic activity.

The increases in Bank rate were followed by corresponding rises in the prime overdraft rates of banks. Intense competition between financial institutions, and a relatively high responsiveness of deposit rates to tighter monetary conditions, led to a narrowing of the differential between these institutions' average lending and deposit rates. These changes were accompanied by a renewed process of reintermediation which contributed to the higher growth rate of the money supply. This was reinforced by an increase in the public's liquidity preference proper, related to the attractiveness of depository investments at higher interest rates and uncertainties regarding other financial investments. The reintermediation and the higher level of liquidity preference were reflected in a further substantial decline in the income velocity of M3. Had it not been for the increase in the liquidity preference of the holders of cash balances, the inflationary impact of the increases in M3 could have been more serious. The higher money holdings of the private sector nevertheless hold the danger of increasing overall monetary demand for real goods and services, should the current preference for liquid assets over less liquid assets weaken in the face of a decline in nominal interest rates relative to current inflationary expectations.

In view of the above circumstances and the persistent high rate of inflation, continued compulsory repayments on foreign debt and the relatively low level of the gold and other foreign reserves, it is clear that monetary policy should remain restrictive. The Reserve Bank has, therefore, after the usual consultation with the Minister of Finance, set new "guidelines" for the rate of increase in M3 of 11 to 15 per cent between the fourth quarter of 1989 and the fourth quarter of 1990. These targets represent a range of increase for the money supply during 1990 that conforms with the Reserve Bank's objectives for overall monetary policy at this juncture. They should, accordingly, not be seen as Reserve Bank forecasts of changes in M3 during 1990. Their function is to communicate to the public and the Government what range of change in M3 is regarded by the Reserve Bank as appropriate in the present circumstances and in view of the Bank's objectives to stabilise the value of the currency. Deviations from such a published guideline are, accordingly, an important criterion, among others, that influence decisions by the Bank in its application of monetary policy.

The lowering of the target range by three percentage points signals the determination of the monetary authorities to make a contribution to the combating of inflation by reducing the rate of increase in the money supply. The lower guidelines are believed to be reconcilable with projected growth in real gross domestic product in 1990 of up to 1 per cent, a surplus on the current account of the balance of payments of at least R6 billion and a gradual rise in the official gold and other foreign reserves. At the same time the lowering of the limits for the guidelines reflects the authorities' view that a number of factors are already in place –

notably an improved situation on both the current and the capital account of the balance of payments as reflected in the stronger exchange rate of the rand, fiscal moderation and the cumulative effects of two years of relatively restrictive monetary policy – which will almost certainly act to bring inflation down during 1990.

The pursuit of targets of 11 to 15 per cent for the increase in M3 in 1990 has important implications for the extension of credit to the private sector by all monetary institutions. Taking account of expected changes in the country's net gold and other foreign reserves and in government finances, it restricts the tolerable rate of growth in the overall amount of bank credit to be extended to the private sector on average to only about 1 per cent per month. The Reserve Bank therefore repeats the request it made to each banking institution in March 1989, namely to ensure that the monthly increase in each bank's credit extended to the private sector shall on average not exceed this 1 per cent limit. Not many banks complied with this request during the past year and discussions will be held with representatives of the banks shortly to explore ways and means for making this request more effective.

The Reserve Bank will continue to apply these guidelines with flexibility and a "low profile". In deciding on the monetary policy stance, the Reserve Bank will pay attention not only to the behaviour of M3, but also to developments in other variables. In particular changes in other monetary and credit aggregates, the exchange rate, the nominal and real gross domestic expenditure and product, prices and other general economic indicators will be monitored closely.

The lower guidelines for M3 growth in 1990 form part of a broader, co-ordinated medium-term economic strategy involving conventional monetary and fiscal measures as well as industrial and other structural policies. One of the major objectives of this medium-term strategy is to reduce the rate of inflation in order to improve the growth potential of the country. This implies, among other things, that positive real interest rates must be maintained. However, this obviously does not mean that nominal interest rates will not change; they may well move in accordance with changes in the rate of inflation. To ensure continuous downward pressure on the inflation rate, a further reduction of the guidelines for M3 growth may be called for in 1991.

Notes to tables

Monetary analysis – Table S-28

The format in which the monetary analysis is presented is revised as from this issue of the *Quarterly Bulletin*. Owing to recent amalgamations and takeovers involving banks and building societies, as well as the fading of demarcation lines between the business of the various classes of monetary institutions, the distinction between banking institutions and other monetary institutions in the calculation of the statistical counterparts to M3 is no longer meaningful. The analysis which will henceforth be published therefore comprises the consolidated assets and liabilities of all monetary institutions (banking institutions, building societies and the Post Office Savings Bank) without further subdivision. The table was also expanded to show the balances underlying the analysis, before and after seasonal adjustment, on a monthly basis.

Effective exchange rate – Table S-81

Revised information on the nominal effective exchange rate of the rand is published in Table S-81 of this issue of the *Quarterly Bulletin*. The new time series is based on changes in the exchange rates of the currencies of only *six* of South Africa's most important trading partner countries, instead of the twenty-four currencies used previously. This change was made to avoid distortions caused by substantial deviations from the base figures in certain minor currencies which have occurred from time to time. The base used in the calculations has also been changed from 24 January 1979 to the average for the calendar year 1979.

In addition, a new column has been added to this table providing information on the *real* effective exchange rate of the rand, i.e. the nominal effective rate adjusted for inflation differentials as based on the South African production price index and similar indices for the other countries included in the calculation of the index.