Statement on monetary policy

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It is customary for the Reserve Bank at the beginning of every year to announce guidelines for a plausible growth rate in the M3 money supply for the calendar year. These guidelines are normally only made known in March when final figures for money supply and estimates for the national accounts for the previous calendar year become available, and when more complete information on the Budget and the financing requirements of the government for the new fiscal year is on hand.

There is at present considerable interest in monetary policy owing to the recent developments in financial aggregates, particularly because of the decline in the inflation rate to a level below 10 per cent over the twelve months from December 1991 to December 1992. As an exception to the general rule, this statement is therefore made much earlier than would usually be the case, and the statistical information referred to is still incomplete and in some cases based on preliminary estimates.

The decisions on monetary policy now announced have been taken after due consideration of recent developments in financial conditions. The following factors were especially important in this regard:

1.1 Balance of payments and foreign reserves

The strong balance of payments position of the previous three years weakened considerably during the past year. The surplus on the current account declined from R7,4 billion in 1991 to an estimated R4,4 billion in 1992, mainly on account of the effects of the drought, and consequential poor agricultural crops, on imports and exports.

The net outflow of capital, which were practically non-existent in the first quarter of 1992, increased again gradually to an estimated R3,5 billion in the fourth quarter. For the year 1992 as a whole, the total net capital outflow is preliminary estimated at R6,5 billion. The decline in the level of domestic interest rates, together with the depressed economic situation and political developments, probably contributed to the increase in the outflow of capital.

The net gold and other foreign reserves therefore declined by about R2,2 billion in 1992. The decline in the net reserves in the fourth quarter amounted to R3,0 billion. The gross reserves of the Reserve Bank decreased by as much as R2,3 billion in December 1992, and for the first time over a long period the Reserve Bank had to make a drawing of R0,8 billion on a foreign loan to support the level of the gross reserves. In contrast to previous years when an increase in reserves on a net basis was usually recorded in January, the Bank's reserves declined by a further R316 million in January 1993, after an amount of R116 million was repaid on the foreign loans.

These developments in the balance of payments aggregates urge a cautionary monetary policy.

1.2 The money supply and domestic credit extension

According to preliminary figures, the M3 money supply increased by 8,6 per cent over the twelve months from December 1991 to December 1992. The average level of M3 in the fourth quarter of 1992 was only 8,9 per cent higher than the average level in the fourth quarter of 1991, which means that the growth in the money supply in the past year remained within the limits of the prescribed guidelines of 7 to 10 per cent.

It is, however, important to note that the growth rates in the narrower money supply aggregates have been substantially higher. During the twelve months from November 1991 to November 1992 M1A increased by 17,6 per cent, M1 by 15,7 per cent and M2 by 10,5 per cent.

Total credit extension by all monetary institutions to the private sector likewise slowed down substantially in 1992. Compared with an increase of 14,5 per cent in 1991, claims of the monetary institutions against the private sector increased by only 7 per cent during the twelve months ending in November 1992.

1.3 The rate of inflation

The production price index for all classes of goods, as measured over consecutive periods of twelve months, has since November 1991 remained consistently below the level of 10 per cent, and in November 1992 was only 7,5 per cent higher than in November 1991. It is particularly encouraging that the production prices of domestically produced goods have also of late risen at a slower rate and increased by only 8,2 per cent over the twelve months to November 1992.

Although consumer prices continued to rise reasonably sharply during the greater part of 1992, particularly as a result of sharp increases in food prices, the rate of inflation measured as the change in the consumer price index also declined considerably over the last few months of 1992. In December 1992 the consumer price index was therefore only 9,6 per cent higher than in December 1991 and the rate of inflation measured over a twelve months period declined to below 10 per cent for the first time since June 1978.

1.4 Government finance

There was an unfavourable development in the Budget of the government over the past year. Total Exchequer issues increased by 16,5 per cent in the first three quarters of the 1992/93 fiscal year compared with the corresponding period of the preceding year. This was more or less in accordance with the estimates provided for in the Budget for 1992/93.

Total Exchequer revenue, however, increased by only 4,5 per cent over the first three quarters of the fiscal year 1992/93 compared with the corresponding period in the preceding year. This rate of increase was considerably lower than the estimated 15,7 per cent which was envisaged in the Budget for 1992/93.

The deficit before borrowing of the central government for the current fiscal year will therefore be much larger than the budgeted R16 billion and could, according to estimates, even exceed 8 per cent of gross domestic product. Such a deficit would not be sustainable once real expenditure by the private sector increases again.

1.5 Domestic liquidity conditions and short- and long-term interest rates

Against this background, domestic liquidity conditions towards the end of 1992 remained tight. The average daily amount of accommodation provided by the Reserve Bank to banking institutions increased from R2,7 billion in November 1992 to R3,2 billion in December 1992 and to R3,5 billion in January 1993.

Short-term interest rates initially declined after the lowering of Bank rate on 18 November 1992, but towards the end of December 1992 returned to more or less earlier levels as a result of the tighter conditions in the money market. The rate on three-months liquid bankers acceptances, for example, declined from 12,50 per cent on 17 November 1992 to 12,00 per cent on 18 November and 11,90 per cent on 20 November 1992, but firmed again to 12,40 per cent towards the end of December. These rates again started to move downwards in January 1993 and amounted to 12,05 per cent on 8 February 1993, which was still higher than the level pertaining after the previous Bank rate reduction in November 1992.

Long-term interest rates hardly responded to the previous lowering of Bank rate. However, these rates did reflect a firmer tendency during the fourth quarter. The yield on long-term government stock, for instance, increased from a low point of 13,81 per cent on 13 October 1992 to 15,17 per cent on 13 December 1992. Subsequently, as a result of the lower than expected rate of inflation, it declined again to 14,25 per cent on 3 February 1993.

2. Money supply guidelines for 1993

In determining the money supply guidelines for 1993 it is necessary to keep in mind the Reserve Bank's main objective, namely to continue to depress the rate of inflation further, but at the same time also to take account of the needs for an increase in the money supply in order to support a rise in the real gross domestic product in 1993.

In view of the relatively large increases in the money supply in the past five years when real gross domestic product increased little or even declined, the income velocity of the existing money supply is at present very low. There is therefore room for an increase in real economic activity without any significant further additions to the money supply.

The Reserve Bank is determined to persist with its policy of financial stability and prefer, as in the past, to apply this policy continuously in a moderately restrictive but sustainable way. Taking into account developments in the major financial aggregates during the past year, the Reserve Bank therefore decided to set guidelines for an acceptable growth rate for the M3 money supply of 6 to 9 per cent from the fourth quarter of 1992 to the fourth quarter of 1993.

3. Bank rate of the Reserve Bank

Although developments in the balance of payments, and particularly in the capital account, as well as the increasing deficit on the Budget of the government, call for caution, the Reserve Bank believes that there is scope for a further lowering of Bank rate at this stage. The lower inflation rate has recently indeed led to a considerable increase in real interest rates in South Africa. Based on the assumption that expectations regarding future developments in the inflation rate will adjust in a realistic manner to these lower rates of price increases, nominal interest rates can be reduced without signifying any fundamental easing in monetary policy. Such lower interest rates are under current conditions also reconcilable with the lower guidelines for the increase in the money supply in 1993.

Against this background the Reserve Bank has decided to reduce the rate at which it is willing to rediscount Treasury bills for deposit-taking institutions with one percentage point from 14 to 13 per cent as from Tuesday, 9 February 1993. Other interest rates used by the Reserve Bank in providing accommodation to deposit-taking institutions will likewise also be reduced with one percentage point from 9 February 1993.

Banks and other financial institutions of course make their own decisions regarding their deposit and loan rates and are not necessarily obliged to adjust their interest rates with every change in Bank rate. In view of current general economic conditions, particularly the depressed demand for bank credit at this stage, it can, however, be expected that various other interest rates will in practice follow the downward adjustment in Bank rate.

The decline in the country's gold and other foreign reserves of more than R3 billion over the past four months already had a restrictive influence on the availability of domestic liquidity. If this declining tendency should continue, it will militate against further reductions in interest rates, irrespective of what the inflation rate may do in future. In fact, a continuing overall deficit on the balance of payments may in due course again lead to higher interest rates which the Reserve Bank should not try to neutralise by the creation of more money.