Statement on monetary policy

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

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During the past six months, the rate of increase in some of the more important financial aggregates used by the Reserve Bank as indicators of developments in underlying inflationary pressures, accelerated to levels that cannot be permitted indefinitely. The monetary authorities cannot delay corrective action for too long, as the eventual adjustment to restore stability becomes more painful the further the financial markets move away from equilibrium.

Over the twelve months up to July 1994, the M3 money supply increased by 16,9 per cent which exceeds by a substantial margin the guidelines of 6 to 9 per cent announced at the beginning of this year as an acceptable rate of increase in M3 for 1994. Over the same twelve-months period, total bank credit extended to both the public and private sectors increased by no less than 23 per cent. Claims of the banking sector on the private sector rose by 14 per cent, that is, well in excess of the current rate of inflation.

There is increasing evidence that the higher level of the money supply is beginning to contribute to the inflationary effects of the depreciation of the rand earlier this year, the continuing relatively high rates of increase in wages and salaries and a rapidly rising level of total gross domestic expenditure. It is important that all these emergent inflationary pressures should not be accommodated by an ever-increasing amount of money, created through excessive increases in total bank lending.

A further danger signal that cannot be ignored any longer comes from the unexpectedly large increase in total imports of merchandise. On a seasonally adjusted annual rate basis, total imports in August 1994 amounted to almost R90 billion, which was only R5 billion less than the total value of merchandise exports and the net gold production. With an annual net deficit of about R15 billion for South Africa's service payments to the rest of the world, the current account of the balance of payments has now moved into a distinct deficit.

Both production and consumer price inflation also moved up quite strongly in recent months. Over the twelve months up to July 1994, average consumer prices rose by 8,2 per cent, up from a rate of increase of only 7,1 per cent over the twelve months' period up to April 1994. The rate of increase in production prices likewise rose from 6,2 per cent over the twelve months ending in April 1994, to 9,0 per cent for the period ending July 1994.

Certain market interest rates increased quite sharply in recent months. The yield on long-term government stock, for example, rose from 11,8 per cent on 31 December 1993 to 17 per cent on 12 September 1994, before declining again to 16,25 per cent on 23 September. Money market interest rates, on the other hand, increased by a smaller margin. The yield on 91-day Treasury bills rose from 10,2 per cent at the end of 1993 to 10,9 per cent on 23 September 1994.

Money market conditions remain relatively liquid, mainly because of a welcome rise in the country's net foreign reserves. Taking account of the need to increase the foreign reserves further, steps will have to be taken to sterilise the expansionary effect of further increases in the reserves on domestic liquidity, particularly against the background of increasing inflationary pressures.

Recent changes in the yield to redemption curve to a much steeper upward slope at the short end, indicate a rising expectation of higher inflation in future. If not checked in time, the expectations could become self-fulfilling.

In the circumstances, the Reserve Bank has decided to raise the Bank rate, that is the interest rate at which the Reserve Bank extends loans to banking institutions at the discount window, from 12 per cent to 13 per cent per annum. The new rate of 13 per cent will become effective on Monday, 26 September 1994. All other related interest rates of the Reserve Bank will also be raised by 1 percentage point from present levels.

This decision does not only reflect the resolve of the monetary authorities to continue to apply measures consistent with the Reserve Bank's responsibility to protect the value of the rand, but also serves as a clear indication of a more restrictive monetary policy stance, necessitated by recent changes in underlying market conditions. If necessary, supplementary measures will be introduced to ensure that the current excessive rate of increase in the money supply will be curtailed.