Statement on monetary policy

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

29 June 1995

The Reserve Bank was in recent months reluctant to increase its lending rates because of ambiguous signals emitted by financial and real economic indicators of current trends in the economy. Against the background of the slow-down in both gross domestic production and gross domestic expenditure during the first quarter of 1995, there were perhaps dubious indications that the rate of increase in domestic bank credit extension and in the money supply could follow the slow-down in the rate of expansion in total real economic activity. At the same time, the daily money market shortages recently remained fairly stable at a relatively low level of between R1 and R2 billion, indicating the presence of ample liquidity in the banking sector. There was, therefore, no undue upward pressure on interest rates.

Figures for total bank credit extension during April 1995, and for the money supply as at the end of May 1995, however, now indicate a further significant increase in these two important financial aggregates after the end of the first quarter. Over the twelve months up to April 1995, total claims of the banking sector on the domestic private sector increased by 19,5 per cent, up from 17,5 per cent in March. The rate of increase in the M3 money supply rose from 14,9 per cent in April to 15,8 per cent in May.

Both producer and consumer price inflation also increased further during recent months. Over the twelve months up to April 1995, the total producer price index rose by 11,5 per cent, and the index for consumer prices increased by 11 per cent. In May 1995, however, the twelve months' rate of increase in consumer prices receded slightly to 10,8 per cent.

Volatile changes in the net gold and foreign exchange reserves in recent months contributed to the complexity of the current financial situation. In April 1995, the total net foreign reserves of the Reserve Bank declined by R4,1 billion, followed by an increase of R5,8 billion in May. Indications are that the Reserve Bank's net foreign reserves will again increase in June, albeit by less than the R1,3 billion proceeds of the Samurai loan issued by the Government earlier this month.

Underlying inflationary pressures are undoubtedly increasing again in the South African economy, stimulated inter alia by wage increases, the depreciation of the exchange rate of the rand over the past year, the acceleration in the rates of increase in the major monetary aggregates and the growing expectation of a continuous rising rate of inflation. If left unchecked, this trend will eventually force the abortion of the welcome improvement over the past year in real economic growth, and will frustrate the objectives of the Reconstruction and Development Programme. The Reserve Bank's tolerance with the untenable large increases in bank credit extension and in the money supply, which has already been criticised very widely recently, can no longer be defended. Delaying corrective action now could risk the danger of more painful adjustment in future.

The Bank has therefore decided to raise the Bank rate and related lending rates with immediate effect by one percentage point. As from 30 June 1995, the Bank rate, that is the rate at which the Reserve Bank is prepared to make loans available to banking institutions at the discount window, will be raised from 14 to 15 per cent. The effective cost of Reserve Bank accommodation for all banking institutions is therefore increased by one percentage point. As is customary, each banking institution will decide on its own deposit and lending rates, taking account of the increase of one percentage point in the Bank rate.