Statement on the Bank rate

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

26 April 1996

From the middle of February 1996 up to today, the rand has depreciated by 18 per cent against the United States dollar, and by an estimated 17 per cent on an average weighted basis against a basket of the currencies of South Africa's major trading partners. The initial adjustment, say up to the end of March 1996, could still be defended on the basis of economic fundamentals, and particularly against the background of the appreciation of 5,1 per cent in the effective exchange rate of the rand from the end of May 1995 up to 15 February 1996. The depreciation after the end of March, that is during the past month, certainly no longer reflects underlying economic fundamentals such as inflation differentials, interest rate levels and the overall balance of payments situation. The exchange rate has therefore now reached a level where the rand can with justification be referred to as an "undervalued" currency.

The depreciation of the rand of 17 per cent from the middle of February can have serious adverse implications for the domestic financial situation. The Reserve Bank has over the past two-and-a-half months on a net basis sold foreign exchange for more than R5 billion in providing liquidity to the foreign exchange market and in its efforts to "lean against the wind" of the depreciating rand. This has drained liquidity from the domestic money market, with the result that the banks today had to borrow as much as R8,2 billion at the discount window of the Reserve Bank.

Domestic interest rates have also risen quite sharply. The yield on long-term government bonds, for example, rose from 13,3 per cent in the middle of February to over 16 per cent today. The tender rate on Treasury bills of three months rose from 13,9 per cent in the middle of February 1996 to 15,1 per cent today, to exceed the Bank rate of 15 per cent.

The depreciation of the rand will also have unavoidable effects on the rate of inflation. Prices of many imported goods can be expected to rise almost immediately, while prices of locally produced goods and services will, with some time lags, also be affected. It is important that these price rises will be constrained as far as possible, otherwise potential benefits for exporters and local manufacturers that must compete with imported goods, will be short-lived. Indeed, there is a real danger that inflation in the aftermath of the depreciation can destruct more wealth and job creation than the initial gains from the depreciation itself.

The rates of increase in both bank credit extension and in the money supply recently showed encouraging signs of levelling-out, but are still on relatively high levels. Taking account of the monetary stimulus that can flow from the depreciation of the rand, some further tightening in the monetary policy has now become essential. The Reserve Bank has therefore decided to raise the Bank rate, that is the rate at which the Bank is prepared to make loans to banking institutions, and other related interest rates of the Reserve Bank, with immediate effect by one per cent. The Bank rate is therefore increased from 15 to 16 per cent per annum as from Monday, 29 April 1996.

This step by the Reserve Bank, which is in line with current developments in the money and capital markets, may not be completely compatible with recent trends in the domestic economy. For the time being, however, it has become a first priority to restore some stability in the foreign exchange market, and to find a new stable base for the exchange rate of the rand from which the future course of monetary policy can be guided.