Statement of the Monetary Policy Committee

13 October 1999

Released by the South African Reserve Bank after the deliberations at the first meeting of the Bank's Monetary Policy Committee (MPC) in Pretoria

In the Governor's address to shareholders at the annual general meeting of the South African Reserve Bank held on Tuesday, 24 August 1999, it was announced that a Monetary Policy Committee (MPC) would be established for the formulation of monetary policy. It was explained that the creation of this Committee formed part of ensuring a well-organised decision-making process in the Bank as an important factor in the conduct of monetary policy. The Monetary Policy Implementation Committee is tasked with the implementation of the decisions of the MPC, but may also bring issues to the attention of either the Governor or the MPC.

The Governor also explained in his address that the MPC will consist of the Governor and deputy governors as voting members and senior officials of the Bank as non-voting members, although the final decision-making power on monetary policy matters will nevertheless still vest in the Governor and deputy governors, in accordance with the current legal framework. In addition, it is envisaged that specialists from outside the Bank might in due course be co-opted to serve on the MPC, although an amendment to the South African Reserve Bank Act will be necessary beforehand.

The Bank's new Monetary Policy Committee met for the first time for the whole of today. Its current composition is:

Voting members

Mr T T Mboweni	(Governor and Chairperson)
Mr J H Cross	(Senior Deputy Governor)
Mr T T Thahane	(Deputy Governor)
Ms G Marcus	(Deputy Governor)

Non-voting members

Dr E J van der Merwe	(Chief Economist and Head of Research)
Mr C F Wiese	(Banking Supervision)
Mr L van Zyl	(International Banking)
Mr B L de Jager	(Economic Reviews and Statistics)
Dr R M du Plooy	(Money and Capital Markets)
Dr X P Guma	(International Economic Research)
Dr M M Smal	(Econometric Modelling)
Dr M Mnyande	(National Economy)
Dr J P van den Heever	(Financial Analysis and Public Finance)
Ms T T Ngcobo	(Organisation Development and Transformation)
Mr B Kahn	(Monetary Policy Research)

The secretary of the committee is Mr J J Rossouw, who is also the Secretary of the Reserve Bank.

In reviewing the state of the economy today, specific note was taken by the MPC of the following developments:

International economic developments

Global economic and financial conditions have improved markedly during 1999. Financial and economic conditions in the African and other emerging-market economies have generally become much more stable and the outlook for economic growth seems to be favourable. The sharp changes that were discernible in the money and capital market interest rates of emerging-market economies in 1998, stabilised considerably during the course of 1999. At present the level of real interest rates in South Africa is more or less in the middle of the range of interest rates in other emerging-market economies.

With the exception of Japan, the economic growth prospects of the more advanced economies have improved significantly. The economic performance of the United States, with strong growth, falling unemployment and low inflation, has been remarkable, even though indications are that there will be a slight slowdown in the period ahead. The economic growth in the European Union, which had lost some momentum in the second half of 1998, showed signs of recovery in the first half of 1999. Although the International Monetary Fund is projecting negative growth for Japan in 1999, the rate of increase in real gross domestic product is expected to become positive in the year 2000. The inflation rate in the advanced economies has edged up slightly during 1999, and interest rates in the United States and Europe are tending to rise. There is evidence of a tightening monetary policy.

Real economic conditions in South Africa

Quarterly growth of real gross domestic product in South Africa at an annualised rate accelerated from 0,6 per cent in the first quarter of 1999 to 1,7 per cent in the second quarter. Aggregate real domestic expenditure increased at a seasonally adjusted and annualised rate of 6 per cent in the second quarter of 1999. This increase could mainly be ascribed to an accumulation of inventories, which more than outweighed a further contraction in gross fixed capital formation and the consumption expenditure of general government. The final consumption expenditure by households showed almost no change. The existing excess production capacity should not present any upward demand pressures on inflation.

The year-on-year rise in the cost of labour per unit of output moderated to 6,4 per cent in the first quarter of 1999 and even further to 4,8 per cent in the second quarter because of a deceleration in nominal wage growth. Consumer price inflation continued to slow down. However, mainly due to the exclusion of changes in mortgage bond rates, the core inflation rate gradually crept higher from a year-on-year level of 6,9 per cent in March 1998 to 8,2 per cent in July 1999, but then declined to 7,9 per cent in August. The change in the production price index, measured over periods of twelve months, continued to rise during 1999 largely due to an increase in the prices of imported goods. It is generally expected in South Africa that core consumer price inflation may, on balance, decline further from current levels.

Domestic monetary developments

The growth in money supply has expanded relatively slowly during the first seven months of 1999. The year-on-year growth in the M3 money supply remained in the lower half of the 6 to 10 per cent guideline range of the Bank, before declining to 5,3 per cent in August. The growth in M3 was partly held back by a rise in the income velocity of circulation of this broad money supply.

The growth over twelve months in total domestic credit extended by the monetary sector slowed down from a recent peak of 21,7 per cent in August 1998 to 10,5 per cent in August 1999. This decline could be attributed to factors such as the weak spending of households on durable consumer goods, a decline in the private sector's fixed capital formation, a weak demand for working capital by the corporate sector and a shift in trade finance from domestic to offshore sources of credit.

Domestic money and capital markets

After liquidity in the money market had tightened considerably during the first eight months of 1999, conditions have eased somewhat in September. Declining overall consumer price inflation and more stable conditions in financial markets were conducive to declining money market interest rates.

Activity on the bond and share market remained buoyant and the value of real estate transactions has improved during 1999 from the very low levels at the end of the previous year. Bond yields generally showed a steadily rising trend from the beginning of the second quarter of 1999 in response to changes in international interest rates, and perceived domestic inflationary tendencies. Share prices behaved more positively and increased until June 1999 before declining somewhat in line with developments in international share markets. With the sharp increase in the gold price during September, share prices again recovered markedly from about the middle of the month.

Balance of payments and the foreign exchange market

The current account of the balance of payments (seasonally adjusted and annualised) changed from a surplus of R4,9 billion in the first quarter of 1999 to a deficit of R3,4 billion in the second quarter. From preliminary trade figures for July and August, it seems as if a further and perhaps somewhat larger deficit will be recorded in the third quarter of 1999. However, no difficulties are anticipated in the financing of the deficit on the current account, but the type of financial flows into the economy is easily reversible.

As a result of the relatively favourable overall balance of payments position of the country, the total gross gold and other foreign reserves increased from R42,2 billion at the end of December 1998 to R51,7 billion at the end of August 1999. In September 1999 the gross foreign reserves of the Reserve Bank rose by R1,9 billion to R39,2 billion at the end of the month and the net open position in foreign exchange of the Reserve Bank also improved further.

The outlook for international commodity prices has generally improved in response to a recovery in demand from Asia. The prices of South Africa's main commodity exports appeared to have reached a lower turning point in the first half of 1999. An announcement by European central banks that they would limit gold sales and the lending of gold reserves impacted positively on the gold price.

The nominal effective exchange rate of the rand decreased by 0,4 per cent from the end of December 1998 to 12 October 1999. The rand traded in a relatively stable range against the US dollar in the first nine months of 1999. From December 1998 to August 1999 the real effective exchange rate of the rand has risen by 3,4 per cent.

Stability in the financial sector

In contrast to many other emerging-market economies, the South African banking sector proved to be remarkably resilient in the global financial turmoil and its impact on domestic economic conditions. Although the non-performing loans of banks have increased during 1999, they also increased their provisions for bad and doubtful debts. The banks in South Africa are well capitalised and other sound banking supervision principles are being applied.

Considerable resources have also been applied to all phases of the Y2K compliance projects. After visits to and consultations with banks, they generally seemed well prepared for any problems that could arise. However, cognisance was taken of the possible effect of Y2K developments on financial conditions.

Monetary policy developments

Evidence that the emerging-market crisis was abating and other improvements in domestic economic conditions allowed a persistent decline in the repurchase rate of the Reserve Bank from 21,85 per cent early in October 1998 to 12,31 per cent on 13 October 1999, or by 9,54 percentage points. Over the same period, the prime overdraft rate of the banks was reduced from 25,5 per cent to 15,5 per cent or by 10 percentage points. Monetary policy has therefore been relaxed considerably during the course of 1999.

From 23 September 1999 (the date on which the banks announced a 1 percentage point cut in their prime lending rates) the repurchase rate has declined further by 44 basis points. The repurchase rate at first dropped sharply immediately after the prime rate was reduced, but from the end of September this decline has become more subdued.

After careful consideration of all these developments, the MPC of the Reserve Bank decided to maintain the current monetary policy stance. However, the committee noted potentially unfavourable domestic and international factors which may necessitate a reconsideration of the monetary policy stance.

The MPC will meet approximately every six weeks, and the next meeting will be held on Wednesday, 24 November 1999. A statement will be issued after each meeting of the Committee.