Statement of the Monetary Policy Committee

21 September 2000

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

At a meeting on 20 and 21 September 2000 the Monetary Policy Committee reviewed international and domestic economic conditions and the monetary policy stance. The main conclusions of the committee are summarised in this statement.

International economic developments

A significant development on the international economic scene has been the continued increase in the oil price. At the time of the previous Monetary Policy Committee meeting, the oil price had responded to the Organisation of Petroleum Exporting Countries' (OPEC) announcement of output increases by falling from a level above US$30 to below US$26 per barrel. Since then the oil price has moved upwards again to US$37 per barrel in early September. After a decision by OPEC to increase output further, the price has fluctuated between US$30 to US$35 per barrel. In view of the lack of additional refining capacity, the low American oil stocks, a continued increase in world economic growth and with the onset of winter in the northern hemisphere, there is a likelihood of continued pressure on oil prices over the short term.

As could be expected, the increase in the oil price has contributed to a rise in inflation in most oil-importing countries. For instance, in the United States the year-on-year rate of increase in the all-goods consumer price index has accelerated from levels of around 1,5 per cent at the beginning of 1999 to 3,4 per cent in August 2000. Similarly, the year-on-year rate of increase in consumer prices in the euro area accelerated from 0,8 per cent to 2,3 per cent over the same period. In contrast to these developments, Japan continued to experience deflationary conditions in the first seven months of 2000.

Up to now, the increase in the crude oil price seems to have had little effect on global economic growth. The second-quarter real growth in the United States, seasonally adjusted and annualised, amounted to 5,3 per cent. However, indications are that the growth rate in the United States is moderating. Growth in consumer spending is slowing down and the labour market is less tight than it had been, a marginal increase in the unemployment rate having been recorded in the second quarter of 2000. Productivity growth amounted to a seasonally adjusted and annualised rate of 5,7 per cent in the second quarter of 2000, resulting in a decline in unit labour costs and reduced pressure on inflation.

Economic growth in the euro area is expected to remain robust, despite an increase of 25 basis points in interest rates announced by the European Central Bank at the end of August. According to preliminary official estimates the real gross domestic product of the United Kingdom grew at a seasonally adjusted and annualised rate of 3,6 per cent in the second quarter of 2000, following an increase of 2,0 per cent in the first quarter of this year. The recovery in Japan has also been stronger than expected at a seasonally adjusted annualised growth rate of 4,2 per cent in the second quarter of 2000. However, consumer spending remains weak in Japan and leading indicators show a mixed picture.

Growth in the emerging markets of Asia has moderated somewhat in the second quarter of 2000, and some increased inflationary pressure has been observed in Indonesia and Korea mainly as a result of higher oil prices. Growth in most Latin American countries has slowed down.

Domestic real economic developments

From available information it is difficult to determine whether the acceleration in the growth rate of real gross domestic product from a seasonally adjusted and annualised rate of about 1 per cent in the first quarter of 2000 to 1½ per cent in the second quarter, continued in the third quarter. Some indicators point to an improvement in economic activity while others indicate declining output volumes, making it difficult to interpret the overall change in the economy.

The monthly index of manufacturing production apparently resumed its upward movement towards the end of the second quarter of 2000. Moreover, manufacturing capacity utilisation picked up slightly, electricity generation was rising solidly, real wholesale sales showed strong growth, buildings completed and new building plans approved continued to recover, and new vehicle sales remained firm. Higher and more sustainable economic expansion was also reflected in increases in new company registrations, and declines in company liquidations and insolvencies of individuals and partnerships.

Contrary to these developments, signs of a deceleration in economic activity were given by a decline in mining output and a levelling off in the rate of increase in transactions in the real-estate market. Taking into account an expected increase in agricultural production due to the harvesting of summer crops in the third quarter, conditions seem to indicate continued moderate growth in the third quarter of 2000.

Domestic monetary and fiscal conditions

The level of the broadly defined M3 money supply has declined somewhat since the end of 1999. Over the seven-month period to the end of July 2000, M3 recorded an annualised rate of decline of 1,4 per cent. This reflected fairly subdued economic activity, lower absolute and relative returns on deposits, some disintermediation, and in July in particular, a build-up of government deposits with the banking sector.

Credit extension to the private sector recorded an annualised rate of increase of 8,3 per cent over the seven months to the end of July 2000. In July it grew at a high annualised rate of almost 22 per cent. However, a large part of this sudden increase resulted from changes in accounting practices.

The public-sector borrowing requirement amounted to R7,7 billion in the April-June quarter of 2000, against R10,6 billion in the corresponding quarter of 1999. The cumulative budget deficit for the current fiscal year is well contained and closely follows the typical seasonal pattern. Treasury bills and foreign loans have so far been the main instruments used to finance the deficit.

Domestic financial markets

Turnover in the bond market, share market and futures market picked up in August 2000, having not been quite as brisk in July and during most of the second quarter of the year.

Bond rates were relatively volatile during the third quarter of 2000. At first they generally drifted lower during July and August and declined markedly towards the end of August, probably owing to the reinvestment in bonds of the larger part of the coupon interest of R10,1 billion paid on government debt at month-end. Subsequently, yields rose somewhat due to the increase in the oil price and a stronger dollar. At the same time non-residents became net sellers of bonds, after they had purchased bonds on a net basis of R2,8 billion in July and August.

Share prices continued to recover during the third quarter of 2000. These prices have now increased by 25 per cent from their recent trough on 17 April 2000 to 19 September 2000. Non-residents contributed to this recovery, having been net buyers of South African shares since April 2000. Their total net purchases of shares from the beginning of April 2000 up to 19 September 2000 amounted to R13,0 billion.

Money-market interest rates continued to move sideways in the third quarter of 2000. There were, however, slight increases in the rates on forward agreements and shorter-term negotiable certificates of deposit towards the end of August.

The tendency displayed by the yield curve to flatten at the short end and to shift downwards at the long end, was reversed recently. Since the previous meeting of the Monetary Policy Committee, the short end of the yield curve has become steeper and the longer end of the curve has shifted upwards parallel to the previous position. This probably reflected the market's uncertainty of the possible impact of the high oil price on inflation and interest rates.

Balance of payments and foreign exchange market

The trade account registered a further but considerably smaller surplus in July 2000. This decline in the trade surplus was mainly due to a decrease of nearly 10 per cent in the seasonally adjusted value of merchandise exports. This decrease could be seen in nearly all the main categories of export goods. More particularly, a sharp decrease was recorded in the exports of base metals, agricultural products, chemicals, and machinery and electrical equipment. Despite this decline in merchandise exports during July, the three-month moving average value of exports continued to rise.

The seasonally adjusted value of merchandise imports declined by about 3 per cent in July. A sharp increase in the imports of petroleum products was offset by declines in the value of manufactured goods imported. The three-month moving average value of imports increased further, probably in line with signs of economic recovery.

The gross gold and other foreign reserves of the Reserve Bank increased by R1,1 billion in July and August to a level of R52,1 billion at the end of August. Over the same period the net oversold forward position in foreign currency of the Reserve Bank was reduced by US$0,2 billion to US$9,7 billion at the end of August 2000.

After the external value of the rand had strengthened markedly from the end of May until the end of August 2000, it started to come under pressure early in September. The recent weakness of the rand was mainly a reflection of the strength of the US dollar. Since the beginning of the year, the rand has depreciated by about 19 per cent against the dollar. The general weakness of currencies against the dollar is demonstrated by depreciations of 21 per cent for the euro, 16 per cent for pound sterling and 22 per cent for the Australian dollar over the same period. The nominal effective exchange rate of the rand has therefore declined by only 6 per cent from the end of 1999 up to 20 September 2000.

Stability in the financial sector

Conditions in the banking sector remained stable during July. Growth in total assets improved marginally, while capital and reserves rose strongly. Although the profitability of banks declined in July, liquidity improved. The anticipated short-term liquidity mismatch as a percentage of total funding declined significantly, whereas wholesale deposits as a percentage of total funding declined slightly.

Monetary policy

The increase in the oil price and the damage to agricultural crops caused by adverse weather conditions were the major factors responsible for the continued rise of consumer price inflation in metropolitan and other urban areas, excluding mortgage interest cost (CPIX). The year-on-year increase in the CPIX has accelerated from 6,5 per cent in October 1999 to 8,2 per cent in August 2000. If fuel and food prices are excluded, CPIX inflation declined slightly from 6,8 per cent to 6,6 per cent over the same period.

For the same reasons as those stated for the acceleration in consumer price inflation, the year-on-year increase in production prices also accelerated from 5,7 per cent in September 1999 to 10,1 per cent in April 2000, before declining to 8,6 per cent in July. However, if energy and food prices are omitted, the year-on-year increase in production prices has continued to accelerate from a low of 3,2 per cent in November 1999 to 4,8 per cent in July 2000. This upward trend was mainly due to increases in the prices of imported goods, while domestically generated inflation has remained low and has shown a downward tendency from April 2000.

The domestic fundamental factors for containing inflation remain favourable. These include low growth in nominal unit labour costs, surplus production capacity in the economy, no signs of excessive growth in demand, sluggish growth in money supply and bank credit extension, prudent fiscal and monetary policies and increased competition arising from tariff reforms. On top of this, the rate of increase in food prices seems to be levelling off.

In view of these circumstances the Monetary Policy Committee has decided to maintain the current monetary policy stance. However, the Monetary Policy Committee will continue to closely monitor the possible second-round effects of the depreciation in the exchange rate and continued high prices of petroleum.