Statement of the Monetary Policy Committee

6 April 2000

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

The Monetary Policy Committee discussed in some detail recent international and domestic economic developments and the current monetary policy stance. The main conclusions of the committee are summarised in this statement.

International economic developments

Since the last meeting of the Monetary Policy Committee the growth prospects for the world economy have remained positive. The unexpectedly high annualised growth of around 7 per cent in the real gross domestic product of the United States in the fourth quarter of 1999 resulted in a further increase in official interest rates during March. Continued upward pressure on official interest rates is likely to remain the norm as US policy makers seek to dampen inflationary pressures.

The growth performance in the euro area has been robust and is expected to improve further over the current year. Inflationary pressures induced by higher oil prices and a weaker euro exchange rate brought about a further interest rate increase by the European Central Bank. In contrast to these developments, the Bank of England did not raise its rates in March. In Japan interest rates are being maintained at exceptionally low levels in view of the fact that the country is experiencing negative growth and deflationary tendencies. There are, however, promising signs that the Japanese economy could start recovering during the current year.

Economic growth prospects in the developing countries in Africa and Latin America remain good, but growth in Asia slowed down during the second half of 1999. Growth in the aggregate production of the developing countries in Asia is nevertheless expected to average a high rate of 6 per cent in 2000. Inflationary pressures in Africa, Latin America and in the countries in transition seem to be subsiding or remaining constant.

The pressure on world inflation induced by higher oil prices was reduced somewhat by the decision of OPEC in March to relax production quotas. This had the effect of reducing oil prices from above US$30 to around US$24 per barrel. The gold price weakened in March and averaged US$286,56 per fine ounce for the month. On 6 April the gold price stood at US$278,85.

Domestic real economic developments

Information available about economic activity in the current year indicates a continuation of the broad-based economic recovery of the second half of 1999. Export growth remained healthy and world prices of internationally traded primary commodities rose strongly in the first three months of 2000. Domestic non-gold mining output remained at a high level, manufacturing output growth maintained momentum and the rate of increase in motor car sales accelerated in the first few months of 2000.

Despite these indications of economic recovery, there were still no signs of any pick-up in the formal demand for labour by the end of 1999. According to the *Survey of Total Employment and Earnings* by Statistics South Africa, there was a loss of more than 43 000 jobs in the formal non-agricultural sectors of the economy in the last quarter of 1999. The Monetary Policy Committee is concerned about the high unemployment in South Africa, but remains convinced that the best contribution that monetary policy can make in creating an environment conducive to economic development and employment creation is bringing about and maintaining financial stability.

The underutilisation of labour resources apparently slowed down the growth in the earnings of workers during 1999. The year-on-year growth in nominal salaries and wages per worker declined sharply from 7,1 per cent in the first quarter to 3,9 per cent in the fourth quarter of that year. This decline together with productivity increases caused the change in nominal unit labour costs measured over a period of twelve months to turn around from a positive rate of 5,5 per cent in the first quarter of 1999 to a negative rate of 0,7 per cent in the fourth quarter. On average, nominal unit labour costs increased at a rate of 3,5 per cent in 1999.

Domestic monetary and financial conditions

The slowdown in the growth of labour costs has been neutralised by other price increases. Rising costs of imported crude oil, increases in the prices of transport equipment and increases in food prices partly related to the recent floods, caused an upward movement in production prices. The rate of increase in the overall consumer price index in metropolitan and other urban areas, excluding mortgage bond costs, rose from 6,5 per cent in October 1999 to 7,1 per cent in February 2000.

The twelve-month growth in the broadly defined money supply (M3) accelerated from single-digit levels during 1999 to 10,2 per cent in January and 13,9 per cent in February 2000. The latter rate was, however, influenced by an exceptionally low base value in the previous year. In contrast, the seasonally adjusted month-to-month growth in M3 was subdued in the first two months of 2000, following brisk rates of expansion in the second half of 1999.

Total domestic credit extension continued to expand firmly in the first two months of 2000. The growth rate in this aggregate measured over twelve months accelerated from 6,9 per cent in October 1999 to 11,5 per cent in February 2000. Although the growth in credit extension to the private sector weakened in February, its lack of buoyancy was countered by an increase in the net claims on the government sector by the monetary institutions.

Domestic money and capital markets

Early indications are that conditions in the real-estate market strengthened further in the first quarter of 2000, with increases in property prices and rental values being recorded. Share market turnovers also remained at a high level, but share prices declined somewhat. From an all-time high on 17 January 2000, share prices declined by 17 per cent until 13 March. Subsequently they regained some lost ground, rising by 7,5 per cent until 27 March 2000, but then declined again by 6,1 per cent until 5 April.

Bond prices were more volatile in a market with record turnovers. Yields generally shifted upwards in the first three months of 2000 because of a shift of funds away from commodity-based countries to high-tech and manufacturing-oriented economies. Moreover, sustained buoyant market conditions in the United States contributed to this shift in funds. As a consequence, non-residents were net sellers of bonds to the amount of R5,6 billion in the first three months of 2000. Money market interest rates have remained more or less unchanged since the last meeting of the Monetary Policy Committee. The stable money market rates were related to the daily liquidity requirement of banks which was managed in a way to ensure that the repo rate would remain at or around the level of 11,75 per cent. Through various operational procedures the Reserve Bank steered the daily liquidity requirement to a level of between R7 billion and R8 billion during March and the beginning of April, and continued to provide fully in the estimated liquidity requirements at the daily repo auctions.

These developments in interest rates were reflected in a change in the shape of the yield curve. The upward-sloping short end of the yield curve steepened slightly, partly as a result of a shortage of suitable liquid assets which the banks could hold for prudential purposes. The longer end of the yield curve shifted parallel upwards based on higher inflation expectations, international increases in longer-term interest rates and large net sales of South African bonds by non-residents.

Balance of payments and foreign exchange market

The good export performance in the first two months of 2000 neutralised the effect of the rise in oil prices and increases in the volume of imports. As a consequence, the trade balance in the first two months of 2000 was in surplus. The seasonally adjusted and annualised average monthly value of the surplus amounted to R23,1 billion in January and February 2000, compared with R20,0 billion in the fourth quarter of 1999. This indicates that the deficit on the current account of the balance of payments could have declined somewhat, provided there was no significant increase in net service and transfer payments to the rest of the world.

Judging by the net sales of fixed-interest securities and equities by non-residents in the domestic capital markets, there is a strong possibility that the external financial account deteriorated in the first three months of 2000. The gross gold and other foreign reserves of the Reserve Bank accordingly increased by just R3,1 billion from the end of December 1999 to the end of March 2000; in the fourth quarter of 1999 an increase of R6,2 billion was recorded. Despite this slowdown in the increase in foreign reserves, the net open foreign currency position of the Reserve Bank declined by US$1,9 billion in the first three months of 2000 to a level of US$10,3 billion at the end of March, owing largely to the proceeds of a US$750 million bond issue by the government.

The external value of the rand against both the US dollar and a basket of currencies continued to decline during March. After stabilising around R6,30 to the US dollar in February, the rand depreciated to an average level of R6,45 in March. At the beginning of April the rand along with other emerging-market currencies came under pressure and depreciated further to R6,60 against the dollar on 5 April 2000. Against a basket of currencies, the rand fell by some 3,8 per cent from the end of 1999 to 5 April 2000. International stock exchanges and exchange rates have been more volatile in recent weeks. For example, the euro depreciated to all-time low levels against the US dollar, the Australian dollar has depreciated by more against the US dollar than the rand and the NASDAQ composite index weakened by 16 per cent in just 8 days.

The recent net sales of South African securities by non-residents were accommodated in an orderly fashion. The South African markets have reacted in a mature manner to these changes, thereby avoiding large price swings while reflecting underlying market conditions.

Stability in the financial sector

Conditions in the banking sector remained stable during the first three months of 2000. Profitability was healthy, but the margin between interest rates paid on loans and advances and the funding of the banking sector declined from 3,92 percentage points in December 1999 to 3,37 percentage points in February 2000. The anticipated short-term liquidity mismatch, i.e. the difference between liabilities maturing in the next 31 days and assets maturing during the same period, decreased from 14,0 per cent of total liabilities in December 1999 to 12,6 per cent in February 2000.

Monetary policy

Recent changes in price indices continued to reflect some inflationary pressures in the South African economy. The secondary effects of oil price increases, rising food prices and a projected increase in domestic demand during 2000, are expected to result in higher inflationary pressures over the short term. The twelve-month growth in money supply also accelerated in the second half of 1999 and reached relatively high levels in the first two months of 2000. However, the high year-on-year growth of money supply in February 2000 was mainly due to technical factors. The month-on-month increases in money supply in the first two months of 2000 actually slowed down significantly. The oil and food price increases are the result of particular events that are not expected to have a permanent effect on the inflation rate. In fact, the oil price started to decline in late March because of a decision by OPEC to increase production by 1,7 million barrels per day.

Over the medium to longer term the outlook for inflation still seems to be very promising. In particular, the recent subdued movements in nominal unit labour cost should have a dampening effect on general price increases. Fiscal discipline continues to be applied, and the public-sector borrowing requirement, i.e. the deficit before borrowing of the central government, provincial governments, local authorities, non-financial public enterprises and public corporations, averaged 1,7 per cent of gross domestic product in the first nine months of fiscal 1999/2000. Prudent monetary discipline will continue to be pursued. Moreover, there is still excess production capacity in the economy. These factors should, over the medium term, contain inflationary pressures.

In view of the above circumstances the Monetary Policy Committee has decided that the current level of the repurchase rate of the Reserve Bank should be maintained.

Inflation targeting

There still seems to be uncertainty about the application of inflation targeting in South Africa despite the explanations given by the Department of Finance and the Reserve Bank. The Monetary Policy Committee therefore decided to append to this statement a more detailed explanation of the new monetary policy framework.