# Statement of the Monetary Policy Committee

**2 March 2000**

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

The main conclusions made at the Monetary Policy Committee meeting of 1 and 2 March 2000 are summarised in this statement.

## International ecomonic developments

The positive international economic outlook reported after the end of the last meeting of the Monetary Policy Committee continues to prevail. Global growth prospects remain favourable, although there are some signs of an acceleration of inflation in industrial countries. Since the beginning of 2000 most of the member countries of the OECD, with the notable exception of Japan, have increased their official interest rates as a precautionary measure to quell rising inflationary pressures exacerbated by higher commodity prices. In the emerging-market economies, by contrast, there was no dominant trend in the path of official interest rates.

In particular, international oil prices moved up further from just below US$23 per barrel on 11 January 2000 to above US$28 per barrel from the middle of February. This upward movement was mainly attributable to the product-cut accord of the main oil producers. The gold price also gained about US$25 per fine ounce early in February primarily because a number of producers bought gold back that had previously been sold forward. On 29 February 2000 the fixing price of gold had fallen back again to about US$294 per fine ounce.

## Domestic real economic developments

The upturn in economic activity that was noted at the meeting of the Monetary Policy Committee at the beginning of January 2000, was confirmed by the recently released national accounts data. According to this information the real gross domestic product increased from quarter to quarter at rates in excess of 3 per cent in the second half of 1999. Moreover, the recovery in economic activity became more widespread and the real output of manufacturing enterprises rose at a rate of almost 7 per cent in the fourth quarter of 1999.

As could be expected under these circumstances, domestic final demand began to pick up. Consumers stepped up their current expenditure in line with lower interest payments on loans and increases in real personal disposable income, without resorting to a large increase in debt for the financing of their outlays. Total gross fixed capital formation still declined in the fourth quarter of 1999, but private-sector fixed investment rose. Real final consumption expenditure by general government continued to decline, while the growth in final demand was supplemented by an increase in total inventories at constant prices.

These production and expenditure patterns will, of course, be influenced by the recent floods that have devastated vast areas in South Africa and other parts of southern Africa.

Conditions in the labour market remained relatively depressed, with new jobs only being created in the trade, transport and communication sectors during the first nine months of 1999. Labour productivity increased by 2,7 per cent in the first three quarters of 1999 compared with the corresponding period in the preceding year, and helped to contain the growth in nominal unit labour cost to 4,7 per cent over the same period.

## Domestic monetary developments

The low rate of increase in nominal unit labour costs helped to contain the rise in the consumer price index excluding the effect of mortgage rate changes (i.e. in the CPIX in metropolitan and urban areas, which is used to measure inflation in the targets pursued by the authorities). The twelve-month growth rate in CPIX amounted to 7,0 per cent in January 2000. Some inflationary pressures have recently become discernible in the economy due to increases in international oil prices, the prices of transport equipment and, more recently, also in the cost of food.

The growth in money supply accelerated strongly in the second half of 1999. The rate of increase over twelve-month periods in the broadly defined money supply (M3) increased from a low of 5,5 per cent in August 1999 to 10,2 per cent in January 2000. Although low growth in money supply is no longer an intermediate objective of monetary policy, it remains an important indicator of financial stability and will still be monitored closely by the central bank as one of the important variables in the determination of monetary policy.

The growth in total credit extended by banks measured over a period of twelve months, which had slowed down from 17,7 per cent in January 1999 to 6,9 per cent in October, increased to 9,8 per cent in January 2000. Reflecting the strengthening in domestic economic activity, this rise in bank credit extension can mainly be attributed to funds made available to private corporations. Households remained reluctant to utilise consumer credit instruments to finance the purchase of durable goods, and banks have become more cautious in the extension of credit.

## Domestic money and capital markets

Following the decline in the repo rate of 25 basis points to 11,75 per cent on 14 January 2000, the prime overdraft rate of banks was reduced by one percentage point to 14,50 per cent. The interbank call rate also moved down from 10,25 per cent to 10 per cent on 14 January and 9,50 per cent on 21 January. The changes in other money market rates generally reflected the decline in the prime overdraft rate of the banks.

The yields on domestic bonds have moved to slightly higher levels since the last meeting of the Monetary Policy Committee, probably in response to higher short-term interest rates in the main international markets. Activity on the bond and share markets remained buoyant, but was lower in the fourth quarter of 1999 in comparison with the high figures of the preceding quarter. For the year 1999 as a whole, turnover in the secondary bond market increased to R8,8 trillion from the very high R8,5 trillion in 1998. The value of shares traded on the Johannesburg Stock Exchange came to R448 billion in 1999, or to 40 per cent more than in 1998. Share prices rallied to a new record level on 17 January 2000, before declining again by 13½ per cent until 29 February. The real-estate market continued to recover in the closing months of 1999.

## Balance of payments and foreign exchange market

The balance of payments on the current account, which had moved into a deficit from the second quarter of 1999, recorded a further deficit in the fourth quarter. This amounted to an estimated seasonally adjusted and annualised amount of approximately R5½ billion, or about ½ per cent of gross domestic product. The appearance of a deficit on the current account at this early stage of a recovery in domestic economic activity was, to a large extent, due to a deterioration in South Africa's terms of trade, relating to the substantial increase in the price of oil. In the fourth quarter of 1999 the quantity of imports also rose sharply.

The financial account of South Africa's balance of payments recorded increasingly positive inflows of capital throughout 1999. In the fourth quarter of 1999 the net inflow of capital was provisionally estimated at R14 billion, which should bring the annual net inflow to about R27 billion. This large inflow of capital consisted mainly of portfolio investments in the form of equity investments. Non-residents' net purchases of shares on the Johannesburg Stock Exchange amounted to R40,6 billion and their net purchases of bonds to R14,3 billion in 1999. These inflows were offset to some extent by a repayment on foreign loans and investments in foreign financial assets by domestic institutional investors through the asset swap mechanism. In the first two months of 2000, non-residents' net purchases of securities declined to R0,8 billion.

The overall balance of payments surplus in the fourth quarter of 1999 led to a further increase in the total gross gold and other foreign reserves from R53,9 billion at the end of September 1999 to R67,5 billion at the end of December. This increased the import cover, i.e. the value of gross international reserves expressed as a ratio of the value of imports of goods and services, to about 15 weeks at the end of 1999. In the first two months of 2000 the gross foreign reserves of the Reserve Bank rose further by R1,6 billion. The net open foreign currency position of the Reserve Bank improved by US$1,9 billion over the same period to US$11,1 billion at the end of February 2000.

The exchange rate of the rand was relatively volatile against the US dollar during the first two months of 2000. After having reached a level of R6,06 to the US dollar on 13 January, the rand depreciated sharply to a low of R6,32 at the end of January. During February the rand traded between R6,20 and R6,40 against the US dollar. The depreciation of the rand against the dollar was due to the overall strength of the US currency, as demonstrated by an appreciation of 0,6 per cent in the value of the rand against the Euro in the first two months of 2000. As a consequence the nominal effective exchange rate of the rand declined by only 0,4 per cent from the end of December 1999 to the end of February 2000.

## Stability in the financial sector

Conditions in the banking sector remained stable during the fourth quarter of 1999 and in the first two months of 2000. The gross overdues of the banking sector increased from R28,4 billion in the third quarter of 1999 to R29,4 billion in the fourth quarter. As a ratio of total loans and advances, gross overdues therefore increased slightly from 4,8 per cent to 4,9 per cent over the same period. However, total provisions as a ratio of gross overdues also improved from 53,7 per cent in the third quarter of 1999 to 57,5 per cent in the fourth quarter. This is much higher than the international norm of 40 per cent.

## Monetary policy

The Reserve Bank had deliberately eased liquidity conditions in the money market during the last four months of 1999 to allay fears arising from the millennium change. From the beginning of the new year when it became apparent that no serious Y2K problems would be experienced, the Bank began to increase the reserve dependency of banks on central bank funding. In order to drain liquidity the Bank entered into foreign exchange swaps with banks, increased the number of reverse-repurchase transactions and also issued more Reserve Bank debentures.

Although these operations were partly offset by a decline in notes and coin in circulation, the liquidity requirement of the banks increased from R2,4 billion at the end of 1999 to R7,7 billion at the end of February 2000. The Reserve Bank provided liquidity to the full extent of the private banks' needs, with the result that only limited use was made of the marginal lending facility during the first two months of 2000.

The repo rate of the Reserve Bank at the daily auction remained at a level of 11,75 per cent from 14 January 2000. This constant repo rate probably resulted from the Monetary Policy Committee's conclusion on 13 January 2000 that such a level was regarded as appropriate for South Africa under the circumstances at that time, and that the banks' daily liquidity requirement would be managed in a way which would ensure that the repo rate would remain at or around that level.

Since the last meeting of the Monetary Policy Committee, clear signs of increased inflationary pressures have become apparent in the South African economy. Increases in the prices of petrol and diesel, transport equipment and more recently food products have led to accelerated inflation. For example, the imported component of the production price index increased from a twelve-month rate of 7,1 per cent in September 1999 to 13,1 per cent in January 2000, while the rate of increase in domestically produced goods accelerated from 5,2 per cent to 6,5 per cent over the same period. The Monetary Policy Committee will be closely monitoring any second-round effects of these inflationary pressures.

Over the medium to longer term, inflation in South Africa is expected to decline again because of monetary and fiscal discipline, international competition, the projected low growth of nominal unit labour costs and excess production capacity in the economy.

Given these circumstances, and consistent with the inflation target of 3 to 6 per cent as an average in 2002 as set by the government, the Monetary Policy Committee is of the opinion that the current level of the repo rate is appropriate. In accordance with the decision taken at the previous meeting, the Reserve Bank will therefore continue to manage the banks' daily liquidity requirement in a way that will result in a repo rate at or around 11,75 per cent.