Statement of the Monetary Policy Committee

13 January 2000

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

The Monetary Policy Committee, meeting over two days on 12 and 13 January 2000, made a detailed assessment of changes in general economic conditions since its last meeting on 24 November 1999. The main conclusions of the Committee are summarised in this statement.

International economic developments

International economic indicators that have become available since the last meeting of the Monetary Policy Committee generally confirm the improved world economic conditions perceived at that time. The latest projections of the OECD have been revised sharply upward. In the OECD Economic Outlook for December 1999 the growth in world output is projected to accelerate from 3 per cent in 1999 to around 3½ per cent in both 2000 and 2001. Growth expectations for Africa, Asia and Latin America have also improved.

Although the higher global economic growth is expected to take place under relatively stable economic conditions, consumer price inflation has accelerated somewhat as a result of higher oil and other international commodity prices. Mainly because of supply-side constraints, oil prices increased to an average level of US$25,50 per barrel in December 1999, compared with just above US$10 a year ago. Concerns about inflationary pressures arising from this and other developments caused the monetary authorities of industrial countries to tighten monetary policy in the last half of 1999. However, rates in emerging markets have generally been flat or trended downwards.

Domestic real economic developments

Recently released economic data confirm the previously noted improvement in domestic economic activity. In particular, the composite coincident business cycle indicator (an index derived from a range of statistics showing the present state of the business cycle) displayed a sharp rise in the three-month period from June to August 1999. Other economic indicators showing improved conditions include an increase in mining production during September and October 1999, a rising trend in manufacturing output in the second half of 1999, an increase in electricity generated from June 1999, a sharp rise in the value of total unfilled orders from July to October 1999 and a distinctly increasing trend in retail and wholesale sales from the beginning of the year.

The recovery in economic activity took place from a relatively low level and has not yet brought about any improvement in reported formal-sector employment. In fact, the available data indicate that the number of people employed in the non-agricultural sectors of the economy declined by about 80 000 in the first nine months of 1999. Decreases in employment were recorded in the mining, manufacturing and construction sectors. Despite the rise in unemployment, the average year-on-year rate of increase in nominal salaries and wages per employee rose from 7,1 per cent in the first quarter of 1999 to 8,8 per cent in the third quarter. This acceleration was mainly due to wage increases in the public sector from a low base. Growth in the average nominal remuneration per worker in the private sector continued to rise at high levels of between 8 and 9 per cent during this period. The increase in wages per worker was countered to some extent by the acceleration in the growth of labour productivity from a year-on-year rate of 1,9 per cent in the first quarter of 1999 to 3,6 per cent in the third quarter. As a result, nominal unit labour costs rose by only 5,0 per cent from the third quarter of 1998 to the third quarter of 1999.

Domestic monetary developments

The relatively small increase in nominal unit labour costs was an important contributing factor to a moderation in consumer price inflation to a year-on-year rate of 1,7 per cent in October 1999. The downward movement in consumer price increases was, however, mainly the result of a fall in mortgage bond rates. The year-on-year rate of increase in the consumer price index rose marginally to 1,9 per cent in November 1999 because of increases in the prices of food, medical care and transport services.

Sharp increases in petrol and diesel prices kept core inflation at a level of 8,1 per cent in November and the year-on-year increase in the production price index at 6,3 per cent in the same month. Moreover, if the effects of reductions in interest rates are not taken into account, there was a moderate increasing trend in inflation during 1999.

The growth in broad money supply (M3) measured over a period of twelve months remained firmly below 10 per cent from February 1999 and amounted to 8,5 per cent in November. However, an annualised increase of 24 per cent was recorded in the seasonally adjusted value of M3 over the three months from the end of August to the end of November 1999. This sharp growth in M3 was concentrated in notes and coin, and cheque and call deposits.

The value of total credit extended by the monetary institutions contracted from approximately R558 billion at the end of September 1999 to R555 billion at the end of November, largely owing to a reduction in banks' claims on the government sector. The twelve-month growth rate in credit extended to the private sector receded from 11,5 per cent in September 1999 to 8,2 per cent in November.

Domestic money and capital markets

In order to alleviate possible Y2K problems, the Reserve Bank has actively engineered a sharp decline in the banks' liquidity requirement since the last meeting of the Monetary Policy Committee. The liquidity requirement of banks consequently declined by R3,8 billion from R6,2 billion on 25 November 1999 to R2,4 billion on 31 December, despite an increase of R6,7 billion in notes and coin in circulation. At R32,7 billion at the end of 1999 the level of notes and coin in circulation was well below the market's expectations.

Money market interest rates eased slightly further from 25 November to 31 December 1999, while yields on government bonds decreased by approximately ½ percentage point over this period. In the first week of the new year there was a rally in the bond market, which brought yields to a level below 13 per cent. Activity on the bond and share markets remained buoyant and the value of real-estate transactions rebounded from deeply depressed levels at the beginning of 1999 to more normal levels in August. From the beginning of October to the end of December 1999 share prices rose by no less than 23 per cent, bringing the total increase from their lower turning point in September 1998 to 65 per cent. The most recent increase in the all-share price index was mainly the result of gains recorded by financial and industrial shares.

Non-residents played an important part in these price developments, increasing their holdings of South African bonds and equities further by R3,3 billion and R0,8 billion, respectively, during December 1999. For the calendar year as a whole, non-residents increased their holdings of domestic bonds by R14,3 billion and their equity holdings by R40,6 billion. The corresponding figures for 1998 were net sales of bonds to the amount of R9,8 billion and net purchases of equities to the value of R42,3 billion.

Balance of payments and foreign exchange market

Trade figures for the first two months of the fourth quarter of 1999 indicate that the deficit on the current account of the balance of payments probably deteriorated further in the fourth quarter of 1999. The trade surplus declined from an average monthly value of R1,6 billion in the third quarter of 1999 to an average of only R0,4 billion in October and November 1999. The weaker trade surplus was the result of an increase in the value of merchandise imports, which outweighed increases in the value of the exports of gold and other goods.

The financial account of South Africa with the rest of the world was probably characterised by a substantial increase in the inflow of capital, as indicated by a rise of R6,2 billion in the gross foreign reserves of the Reserve Bank during the fourth quarter to a level of R45,4 billion at the end of December. From 25 November 1999 the net open position in foreign currency declined further to a level of US$13 billion at the end of the year, i.e. close to pre-crisis levels. This was consistent with the Bank's intention to continue reducing the net open position in foreign exchange.

During December 1999 the rand traded in a narrow range of R6,12 to R6,17 per dollar and remained strong against most major currencies. The nominal effective exchange rate of the rand increased by 0,3 per cent in this month. Over the year as a whole, the nominal effective exchange rate of the rand rose by 0,6 per cent. However, the average level of the rand decreased by 8½ per cent in 1999. In the first week of January 2000 the rand strengthened marginally.

Stability in the financial sector

The banking sector's thorough preparations to avoid the possible effects of the transition to the year 2000, proved to be very effective. With the exception of a few minor disruptions which generally were not Y2K related, normal operations were reported by the banks during the first week of the new millennium. The positive spin-offs of large-scale technology renewal, the systematic rationalisation of systems and processes, the improvement of human resources and closer co-operation in the sector, can significantly enhance efficiency.

The way that the banks and corporates managed the millennium date change has been commendable. The Monetary Policy Committee expresses its appreciation to the management of these institutions for their actions that ensured that South Africa coped well with the transition to the new millennium. In addition, the Committee commends the members of the public for their mature and responsible behaviour over the year-end.

The latest available statistical information suggests that conditions in the banking sector remained stable and profitability improved during October and November 1999. Although some of the smaller banks at times experienced a temporary liquidity squeeze due to the reduction of wholesale deposits, these problems were dealt with quickly and efficiently. A noticeable change was also reported in the anticipated short-term liquidity mismatch of banks which, measured as a percentage of their total funding, decreased from a level of approximately 12 per cent in the four months June to September 1999 to about 9 per cent in October and just slightly above 10 per cent in November.

Monetary policy

In accordance with the decisions taken at the Monetary Policy Committee Meeting on 24 November 1999, the rate on repurchase transactions was kept fixed at 12,00 per cent in the ensuing period and full liquidity was provided to banks at the daily auctions of the Reserve Bank. This resulted in relatively stable money market interest rates and yields over the past six weeks.

As already indicated, the inflation rate has started to increase somewhat, primarily due to the substantial rise in international oil prices. Wage increases could also contribute to a moderate increase in the inflation rate over the next few months if they are not neutralised by productivity gains. However, over the more medium to longer term the inflation outlook is still promising and this has been enhanced by the recent further restructuring of the trade regime. Most projections indicate that the average inflation rate is expected to decline over the next two years. The projections of the Reserve Bank show a similar trend provided that the exchange rate of the rand remains relatively stable, the growth in money supply and bank credit extension are contained and that positive real interest rates are maintained.

The Monetary Policy Committee in its deliberations expressed concern about the continued shedding of jobs in South Africa. Unemployment is a structural problem that requires significant supply-side adjustments in the economy.

After careful consideration of international and domestic economic developments and the successful transition to the new millennium, the Monetary Policy Committee of the Reserve Bank decided to discontinue the temporary measure of fixing the repo rate at 12 per cent. The Bank will again apply a variable-rate auction in accordance with the agreed signalling procedures from Friday, 14 January 2000. Although the repo rate will be determined at the daily auctions of the Bank, the Monetary Policy Committee believes that recent changes in short-term interest rates warrant an immediate reduction to 11,75 per cent in the rate at the first auction on Friday. This reduction should allow the banks to reduce their prime overdraft rate with immediate effect by 100 basis points. The Monetary Policy Committee is of the opinion that the daily liquidity requirement of the banks must then be managed in such a way that short-term money market rates remain at or around this level, as the Committee is of the considered view that current and projected conditions do not at present warrant a further reduction in interest rates.