Statement of the Monetary Policy Committee

20 September 2001

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 evaluated the monetary policy stance at a meeting on 20 September 2001. After carefully analysing the current and likely future economic and price developments, the Committee decided to lower the repurchase rate by 50 basis points to 9,5 per cent effective from 21 September 2001. This decision was based on the following considerations:

International economic developments

The international economic outlook has been overshadowed by the tragic events of 11 September 2001 in the United States. Although it is still too early to tell what the longer-term impact will be, it is expected to have a negative effect on consumer confidence in the United States over the short term, that will intensify the economic slowdown and delay its recovery. The current extent of the slowdown in economic activity was underlined by the revised growth figure of just 0,2 per cent in the gross domestic product of the United States in the second quarter of 2001. In addition, employment figures for August showed that unemployment in the United States had risen to its highest level in four years. Macroeconomic data for Europe and Japan also remained disappointing, while economic strains in Argentina, Brazil and Turkey adversely affected sentiment towards emerging-market economies.

The downward movement of global interest rates has continued since the previous meeting of the Monetary Policy Committee. Official interest rates were reduced in the United States, Japan, the United Kingdom, the euro area, Denmark, Canada and Australia. The emerging-market economies that relaxed monetary policy included South Korea, Taiwan and Poland. The negative growth outlook for the world economy is likely to reinforce or prolong this trend. It is also expected that the major central banks will provide sufficient liquidity to financial markets to alleviate any systemic pressures which may arise from the impact of the abovementioned tragic events. In reaction, the Federal Open Market Committee decided to reduce the federal funds rate by a further 50 basis points to 3 per cent on 17 September 2001. This was followed by downward adjustments in interest rates by the European Central Bank and a number of other central banks.

International oil prices, which had already begun to rise since the previous meeting of the Monetary Policy Committee, rose sharply in the wake of the events in the United States. Subsequently, they fell back somewhat after assurances from OPEC that it is committed to ensuring stable oil supplies to the market. However, the oil price is expected to remain relatively firm following the OPEC supply cut in early September and the onset of winter in the northern hemisphere. World inflation rates nevertheless still seem to be contained.

The atrocity in the United States also led to increased pressure on exchange rates in a number of economies, including South Africa. The rand immediately depreciated against all the major currencies. As a result, the trade-weighted value of the rand on 20 September 2001 was 11,5 per cent below its level at the beginning of the year.

Real domestic economic developments

Despite the deepening of the slowdown in the world economy, the growth in real gross domestic product in South Africa rose from 2 per cent in the first quarter of 2001 to 2½ per cent in the second quarter. Moreover, a better growth performance was discernible in most of the main economic sectors, with the exception of electricity generation and financial services. A further, albeit smaller, decline in agricultural output was recorded in the second quarter, while output growth in mining, manufacturing, construction and commerce improved somewhat.

In contrast to these developments in production, real gross domestic expenditure declined by 2 per cent in the second quarter of 2001. In the first quarter of 2001 it had still increased by 2½ per cent. The decline in total domestic spending was caused by a reduction in inventories. Aggregate real final demand remained relatively buoyant, even though growth in consumption expenditure and fixed capital formation declined slightly.

Despite continued weakness in the employment numbers of the formal non-agricultural sectors, the incidence of strikes and work stoppages rose markedly in the second and third quarters of 2001. These actions led to relatively higher wage settlements which could detrimentally affect nominal unit labour cost if they are not countered by continued high productivity gains.

Domestic monetary and fiscal conditions

The broadly defined money supply (M3) accelerated considerably from a year-on-year increase of 9,2 per cent in January 2001 to 17,8 per cent in July. Quarter-to-quarter growth in M3 has also been strong since the last quarter of 2000, amounting to successive annualised figures of 14,7 per cent, 19,2 per cent and 16,5 per cent in the three quarters respectively. This rise in the broad money supply can mainly be attributed to an increase in the demand for longer-term deposits by the private sector which is normally not associated with an acceleration in domestic spending. Growth over twelve months in the narrower monetary aggregate M1A, however, started to pick up from a negative 1,1 per cent in March 2001 to 6,7 per cent in June and 15,9 per cent in July.

Growth in total domestic credit extension over twelve-month periods slowed down from 10,1 per cent in March 2001 to 7,0 per cent in June and 8,3 per cent in July. This slowdown in total domestic credit extension was essentially caused by a decline in the net use of bank credit by the government sector and the increased foreign financing of the fiscal deficit. Growth in bank credit extension to the private sector remained below 10 per cent in the first seven months of 2001, with twelve-month growth in both June and July amounting to 9,5 per cent. Instalment sale credit, leasing finance and mortgage advances gained momentum over this period, reflecting the relative strength of private households' demand for durable goods and supporting the solid performance of the property market.

Government finance remained sound and continued to support monetary policy. Government revenue in the first four months of fiscal 2001/02 was 16,9 per cent more than in the corresponding period of fiscal 2000/01. This higher-than-expected increase in revenue can be ascribed to greater administrative efficiency and higher collections of taxes on international trade and transactions. Revenue growth exceeded the growth in government expenditure. As a result, the public-sector borrowing requirement narrowed from R6,7 billion in the first quarter of fiscal 2000/01 to R2,2 billion in the first quarter of fiscal 2001/02.

Domestic financial markets

Lively trading conditions prevailed in the bond market in the first eight months of 2001. The seasonally adjusted monthly value of turnover in the secondary bond market increased by 39 per cent from a recent low in May 2001 to an all-time high in June 2001, before declining by 12 per cent to a still relatively high level in August. Non-residents, on balance, were net sellers of domestic bonds. The cumulative net sales of bonds by non-residents in 2001 amounted to R15,6 billion on 19 September 2001.

The yield on long-term government bonds declined from a monthly average of 12,1 per cent in April 2001 to 10,7 per cent in August – its lowest level since 1983. Profit taking, mounting concerns about macroeconomic stability in some emerging-market economies and unfounded negative perceptions of unlawful threats to property rights in the country, introduced some volatility in the market at times.

Turnover in the secondary share market remained high. This can be attributed to volatile price movements throughout the first eight months of 2001 and the takeover of the De Beers mining company by Anglo American. Despite the volatility in the market, the average monthly all-share price index rose by 8 per cent from December 2000 to August 2001. The tragedy in the United States brought the all-share price index sharply down in September. This was consistent with most other markets. Non-residents stepped up their acquisition of shares to the amount of R21,2 billion from the end of 2000 to 19 September 2001.

The liquidity requirement in the money market has hovered around the R10 billion mark since June 2001. Money-market interest rates have remained relatively stable since the previous meeting of the Monetary Policy Committee and increased only moderately for a few days following the events in the United States. The repurchase rate was reduced by one percentage point on 5 September 2001 to administratively narrow the margin between this rate and the interbank call rate.

Balance of payments

The current-account of the balance of payments, which had moved to a surplus in the fourth quarter of 2000, continued to perform well in the first half of 2001. The depreciation of the rand dampened the demand for imports while stimulating exports. These developments, together with a decline in domestic expenditure and a decline in the price of imported crude oil, contributed to an increase in the trade balance during the second quarter of 2001. This increase, however, was offset by a widening of the deficit on the services and income account because of higher net dividend payments to the rest of the world. As a result, the surplus on the current-account of the balance of payments declined slightly from a seasonally adjusted and annualised value of R6,9 billion in the first quarter of 2001 to R6,3 billion in the second quarter.

A deficit of R3,8 billion on the financial account of the balance of payments in the first quarter of 2001 was turned into a surplus of R5,6 billion in the second quarter. This change in the second quarter was mainly brought about by the restructuring of the shareholding in the De Beers mining company. This transaction resulted in a large net inflow of direct investment capital, which was partly neutralised by an outflow of portfolio and other investments.

The joint effect of the surpluses on the current and financial accounts of the balance of payments was an increase of R8,0 billion in the gross gold and other foreign reserves of the country in the second quarter of 2001. These strong inflows of capital and the government's bond issue in the Samurai market in July, allowed the Reserve Bank to reduce its net oversold position in foreign currency further from US$9,4 billion at the end of March 2001 to US$4,8 billion at the end of July 2001. Further increases in the country's gross international reserves during August can be attributed to the proceeds of the US$1,5 billion syndicated loan of the Reserve Bank and National Treasury, the proceeds of which were delivered in the foreign-exchange market. This led to a reduction in the Bank's oversold forward book. Should the National Treasury decide to assume the role of borrower of this facility, the Bank's net oversold position in foreign currency will decrease further.

Monetary policy

South Africa has been able to withstand the inflationary consequences of rising international oil prices and a sharp depreciation in the external value of the rand. Despite these developments, inflation in consumer prices moderated meaningfully in the first half of 2001. The year-on-year rate of increase in the consumer price index for metropolitan and other urban areas excluding mortgage cost (CPIX) declined from 8,2 per cent in August 2000 to 6,0 per cent in August 2001. This favourable outcome was largely related to low increases in unit labour cost, no signs of excess aggregate demand, surplus production capacity in the economy, fiscal prudence, moderate credit growth, sound monetary discipline and recent declines in petrol prices.

In contrast to the moderation in consumer price inflation, production price inflation has accelerated in recent months and remains stubbornly high. The year-on-year rate of increase in the all-goods production price index rose from a recent low of 8,1 per cent in April 2001 to 8,6 per cent in May, June and July. When omitting the moderating effect of relatively low rises in food prices, other production prices increased by 8,9 per cent in the year to July 2001. The year-on-year growth in the prices of imported goods slowed down from 15,0 per cent in December 2000 to 9,2 per cent in July 2001. The acceleration in production prices was therefore due to a rise in the prices of domestically produced goods from a year-on-year rate of 6,9 per cent in April 2001 to 8,2 per cent in July 2001.

An acceleration in domestic production prices could lead, after a while, to a more rapid increase in consumer prices if these prices are not neutralised by lower import prices or tighter retail margins. The recent attacks on the United States and the further depreciation of the rand seem to suggest that it is highly unlikely that import price inflation will continue to slow down. As already indicated, it is generally feared that international oil prices will remain firm in the coming months, which could place pressure on import prices. Despite the fact that the Reserve Bank's projections indicate that the rate of increase in the CPIX should fall within the target range of 3 to 6 per cent if all other things remain the same, there are also other important risks for inflation. These include an acceleration in the growth of money supply, continued high rates of increase in administered prices, and greater pressure from the trade union movement for wage increases in excess of the current inflation rate.