Statement of the Monetary Policy Committee

16 March 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 reviewed current and likely future economic developments at a meeting on 15 and 16 March 2001 to evaluate the monetary policy stance. The main conclusions of the committee are summarised in this statement.

International economic developments

After the world economy had registered strong growth during the first half of 2000, it slowed down during the rest of the year. Particularly notable was the slowdown in the growth of the gross domestic product of the United States from a seasonally adjusted and annualised rate of 5½ per cent in the second quarter of 2000 to only 1 per cent in the fourth quarter. Economic activity in the United Kingdom and the euro area also became less robust, while Japan's aggregate production remained weak. There is as yet no clear picture of the impact of this slowdown on the emerging-market economies of Latin America, Asia and Africa. A severe downturn in the world economy could negatively affect international commodity prices and the exports of these countries.

A more benign inflationary environment is generally expected after oil prices settled at levels of between US$23 to US$28 per barrel in recent weeks. Oil price developments and a stronger euro brought down the rate of increase in the overall harmonised index of consumer prices in the euro area from 2,9 per cent in November 2000 to 2,4 per cent in January. Japan is still experiencing deflationary conditions, while the inflation rate in the United Kingdom of 1,8 per cent in January 2001 continued to be well below the target rate of 2,5 per cent. In the United States there were signs of increased inflationary pressures with the year-on-year change in the all-goods consumer price index rising from 3,4 per cent in November 2000 to 3,7 per cent in January 2001. In the same month of the preceding year, the corresponding rate of increase was still only 2,7 per cent.

The marked slowdown in economic activity in the United States resulted in a 100-basis-point reduction in the Federal Funds rate in two steps during January, from 6,5 per cent at the beginning of the month to 5,5 per cent at the end of the month. This led to a general decline in the interest rates in a number of advanced as well as emerging-market economies. A notable exception in this regard was the euro area, where the European Central Bank maintained its official rate at a level of 4,75 per cent.

The gold price has moved somewhat from its low of US$256 per fine ounce on 16 February 2001. A sharp rise in gold lease rates helped to underpin the firmer gold price, probably because central banks have shifted their gold deposits out towards longer-dated deposits to achieve a higher return on their assets. As a result, gold has traded between US$260 and US$275 per fine ounce in the past two weeks. However, the prices of palladium and platinum have moved down to lower levels.

Domestic real economic developments

Economic activity in South Africa remained buoyant despite the slower growth experienced in industrialised countries. In fact, the annualised rate of increase in real gross domestic product amounted to 4 per cent in the third quarter of 2001, before decreasing slightly to 3 per cent in the fourth quarter. This lower growth rate had more to do with a moderation in the increase in agricultural output following an exceptionally strong rise in the preceding quarter, than with any general weakness in output. Strong growth continued in the manufacturing and tertiary sectors, and real value added by the mining sector picked up despite a further fall in the output of gold mines.

Aggregate domestic final demand and exports remained strong throughout the second half of 2000. This was the combined result of a sharp rise in real consumption expenditure and gross fixed capital formation. Growth in spending on durable consumer goods slowed down somewhat in the fourth quarter of 2000, but this was mostly caused by prospective buyers of new motorcars delaying their purchases until after the year end. The recorded increases in new car sales in January and February 2001, seem to confirm that strong demand conditions might have persisted in the first two months of 2001.

The increase in domestic final demand was countered to some extent by a more subdued accumulation of inventories in the fourth quarter of 2001. Together with the increase in exports, the slower rate of increase in inventories contributed to an improvement in South Africa's transactions in goods and services with the rest of the world.

The growth in unit labour cost was contained to a year-on-year rate of about 1,5 per cent in the first three quarters of 2000 (the latest period for which this information is available). This was largely brought about by a further decline in the demand for labour. The consequent under-utilisation of labour resources contributed to a significant moderation of nominal wage growth and a substantial improvement in productivity.

Domestic monetary and fiscal conditions

The monetary aggregates started to reflect the stronger real economic activity and easier monetary conditions from the fourth quarter of 2000. The seasonally adjusted and annualised rate of increase in M3, for instance, accelerated from 4,7 per cent in the third quarter of 2000 to 14,7 per cent in the fourth quarter and to 23,5 per cent in January 2001. The twelve-month growth in M3 amounted to 9,1 per cent in January 2001. Such high growth rates in money supply, if sustained, are not conducive to low and stable inflation.

Banks' loans and advances to the domestic private sector expanded at a firm pace from the middle of 2000. This aggregate, which includes instalment sale credit, leasing finance, mortgage and other loans and advances, recorded an annualised rate of increase of 9,6 per cent over the six months up to January 2001, i.e. at a pace considerably in excess of the overall inflation rate.

The easier monetary conditions were accompanied by continued fiscal prudence reflected in a low borrowing requirement during the current fiscal year. The latest Budget indicates that government intends maintaining fiscal discipline in the coming year, while at the same time stimulating the domestic economy by lowering the tax rates for especially the lower and middle-income groups and increasing expenditure on social and infrastructural development. The relatively small projected budget deficit will mainly be financed by the expected proceeds from the restructuring of state assets and by making use of foreign financing.

Domestic financial markets

Capital market turnovers remained high in the first 2½ months of 2001, following the record levels reached in 2000. Interest in this market was supported by a further increase in bond prices and a corresponding decline in yields. Nominal bond yields have receded considerably since early November 2000. On 5 March 2001 the R150 - yield briefly broke the 11 per cent level, reflecting receding inflation fears and the conservative deficit financing of government. These changes in longer-term bond yields resulted in both a flattening and a downward shift of the yield curve.

Other asset prices have generally also recorded increases during the second half of 2000 and the beginning of 2001. Share prices rose in early 2001 to a new record level on 16 February and then receded up to 15 March 2001. On this date they were nevertheless 28 per cent above their lower turning point on 17 April 2000. Starting from a low base, housing prices were rising at year-on-year rates of around 20 per cent towards the end of 2000.

The money market was characterised by continued stability with relatively stable rates and the liquidity requirement fluctuating between R8,3 billion and R10,2 billion since the previous meeting of the Monetary Policy Committee. However, forward rates continued to reflect market expectations of moderate decreases in interest rates in the course of 2001.

Balance of payments and foreign exchange market

A favourable export performance in the last quarter of 2000 counteracted the effects of high crude oil prices and increases in the volume of imports. As a result, the seasonally adjusted and annualised deficit on the current account of the balance of payments of R6,3 billion in the third quarter of 2000 turned into a surplus of R2,5 billion in the fourth quarter of 2000. This change occurred despite a further worsening in the deficit on the services and income account. In January 2001 the three-month centred moving average trade surplus fell from R37,0 billion (seasonally adjusted and annualised) from October to December 2000 to R31,9 billion in the three months from November to January 2001.

The financial account of the balance of payments was in deficit to the amount of R1,0 billion in the fourth quarter of 2000, following a surplus of R10,9 billion in the third quarter. Judging by the net sales of securities by non-residents on the South African financial markets, the financial account remained fairly weak in the early months of 2001. However, prospects seem favourable for a strong inward movement of capital later in the year with the planned external borrowing programme of the government and the restructuring of state assets. Optimism was buoyed even further by the proposed restructuring of stockholdings in the De Beers diamond company which is expected to precipitate an inward movement of foreign capital of roughly R22 billion.

The net result of the balance of payments movements was a small addition to the country's overall holdings of international reserves since the end of September 2000. The net oversold position in foreign currency nevertheless remained unchanged at US$9,5 billion.

In tandem with international currency markets, the nominal effective exchange rate of the rand continues to be characterised by great volatility. The trade-weighted value of the rand nevertheless has declined by 1,5 per cent from the end of 2000 up to 15 March 2001. This brought the total decline from the beginning of 2000 to as much as 13,7 per cent. This reflects the strength of the US dollar as reflected by substantial depreciations of other currencies such as those of Australia and New Zealand.

Monetary policy

The depreciation of the rand exerted upward pressure on the prices of imported intermediate and final goods. Other upward pressure arose from high international oil prices. The effect of these factors was countered to some extent by the low growth in unit labour costs, and by cost absorption in industry and commerce, which is not uncommon in the early stages of an upturn in economic activity. The twelve-month rate of increase in the production price index nevertheless picked up from 8,6 per cent in July 2000 to 10,0 per cent in December and declined to 9,2 per cent in January 2001. Measured from quarter to quarter, production price inflation accelerated from 7,4 per cent in the third quarter of 2000 to 10,6 per cent in the fourth quarter.

The targeted CPIX inflation (i.e. the overall consumer price inflation for metropolitan and other urban areas, excluding changes in mortgage bond rates) slowed down from a twelve-month rate of increase of 8,2 per cent in August 2000 to 7,6 per cent in December and 7,7 per cent in January 2001. The rate of increase in the quarter-to-quarter seasonally adjusted CPIX also declined from 8,8 per cent in the second quarter of 2000 to 6,2 per cent in the fourth quarter.

These changes show that the normal long-established relationship between movements in production and consumer prices has apparently broken down. In the past, changes in production prices usually led changes in consumer prices by two or three months. The breakdown of the relationship between production and consumer prices was mainly due to the fact that oil price changes had a more serious impact on production prices than on consumer prices. Another factor was that the rate of increase in retail food prices had slowed down in the last half of 2000, whereas the inflation rate of food prices in the production price index remained virtually unchanged.

The baseline forecast for CPIX inflation falls within the target range, although close to the upper limit. The inflation expectations survey of the Bureau for Economic Research of the University of Stellenbosch showed that inflation expectations have improved slightly from the fourth quarter of 2000 to the first quarter of 2001.

In view of the above considerations, the Monetary Policy Committee has decided to keep the monetary policy stance unchanged.