Statement of the Monetary Policy Committee

25 April 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 25 April 2001. After taking the impact of current and likely future economic and price developments into consideration, the Committee decided to maintain the current monetary stance. This decision was based primarily on the following considerations:

International economic developments

The international economic outlook continues to be dominated by the downturn of activity in the United States and the effect that this is likely to have on the rest of the world economy. Recent information indicates that economic growth in the United States will probably remain subdued for much of the year. Although industrial production rose in March after it had declined from September 2000, other data indicate that the economy remains under pressure. These include lower retail sales, a rise in the unemployment rate, a decline in imports, lower fixed investment, the erosion in current and expected profitability and the possible negative effects that lower equity prices may have on consumption.

The full extent of the impact of the United States' downturn on the rest of the world is still unclear. The countries that will probably be most affected will be those with a strong export orientation to the United States, particularly the East Asian economies specialising in high-technology products. Sluggish conditions in Japan are likely to accentuate the overall weakness of Asian trade. The World Bank nevertheless still predicts only a modest fall in the growth rate of gross domestic product in all developing economies from 5,4 per cent in 2000 to 4,2 per cent in 2001, whereas growth in high-income countries is expected to fall from 3,7 per cent to 1,7 per cent over the same period.

As a result of the continued poor performance of the United States' economy, the Federal Reserve Board announced a further cut of 50 basis points in its targeted federal funds rate on 18 April 2001. This brought the federal funds rate to 4,5 per cent, representing a decrease of 2 percentage points since the beginning of the year. The decline in interest rates in the United States has resulted in generally lower interest rates internationally, in both developed and emerging-market economies. A notable exception in this regard is the euro area, where the European Central Bank has maintained short-term rates at the levels prevailing since October 2000. Another exception is Brazil where interest rates have been raised on two occasions in the past two months when inflation exceeded the target range.

Generally there has been little evidence of an increase in inflationary pressures internationally. In the United States, United Kingdom and the euro area, the rate of inflation is lower than the levels recorded at the end of 2000 because of declines in oil prices. The inflation rate in the euro area at 2,6 per cent in March, compared with the same month in the preceding year, was nevertheless still above the target ceiling of 2 per cent. With the exception of Asia, consumer prices in developing countries are increasing at considerably higher rates than those in advanced economies.

Domestic real economic developments

Information on real domestic economic activity for the first quarter of 2001 is still incomplete and due to conflicting signals, it is difficult to determine whether the strong growth in the last half of 2000 has been maintained. All in all, it seems that economic growth levelled off during the first three months of 2001, although activity remained at a relatively high level. This is confirmed by a downward movement in the volume of imports in the first two months of the year, a decline in the physical volume of manufacturing and non-gold mining production in January and February and a decrease in wholesale and retail sales during January from the high levels reached in December. In contrast to these developments, the quarter-to-quarter growth in new vehicle sales was substantial in the first quarter of 2001 and the value of unfilled orders in manufacturing rose to a new record level in February 2001. The volume of merchandise exports was not significantly affected by the slower international economic growth and continued to rise in the first two months of 2001.

The creation of employment opportunities for South Africa's growing population remains the major challenge facing the country. The new *Labour Force Survey* of Statistics South Africa reports an increase in the unemployment rate during 2000 because of the majority of new work seekers who were unable to find jobs. The oversupply of labour, rationalisation of production processes and increases in output contained the increase in the cost of labour per unit of output. The growth in nominal unit labour cost therefore decreased from an already low level of 2,8 per cent in 1999 to 2,3 per cent in 2000, alleviating pressures on price increases. Towards the end of 2000 there was a moderate acceleration in the growth of nominal unit labour cost when the year-on-year rate of increase rose from 1,8 per cent in the third quarter to 3,7 per cent in the fourth quarter.

Domestic monetary and fiscal conditions

The growth in the monetary aggregates continued to reflect the higher level of real economic activity and easier monetary conditions. The year-on-year rates of expansion in the broadly defined money supply (M3) accelerated from 6,0 per cent in July 2000 and 7,5 per cent in December to 9,3 per cent in February 2001. More rapid growth was also discernible in the narrower monetary aggregates, with the exception of M1A.

The relatively high level of economic activity resulted in a moderate expansion in the loans and advances of banks to the domestic non-bank private sector. The year-on-year growth in this aggregate amounted to 8,2 per cent in February 2001. The demand for instalment sale credit and mortgage finance continued to strengthen in line with brisk motor vehicle sales and better property market conditions. In contrast to these developments, other loans and advances by banks to the private sector, including bank overdrafts, declined from a high of R239,6 billion in November 2000 to R233,4 billion in February 2001.

Preliminary information about the national government's finances for the full fiscal year 2000/01 indicates that the deficit before borrowing was even smaller than had been anticipated at the time of the Budget. This deficit is now estimated at 1,9 per cent of gross domestic product, largely owing to higher revenue collections than had initially been expected as well as prudent management of the fiscus.

Domestic financial markets

In the first quarter of 2001 turnover in the secondary bond and share market slid back slightly from the record levels reached in the fourth quarter of 2000. Bond rates and share prices fluctuated considerably during the first few months of 2001. Bond yields reached a lower turning point in early March following a bull run of about ten months, but then rebounded by about half a percentage point as a result of profit taking by investors. Share prices peaked on 16 February 2001, but have declined by about 14 per cent up to 3 April 2001. Subsequently share prices have recovered again somewhat. Early indications are that property rents and real-estate prices rose less rapidly in the first quarter of 2001 than during most of the preceding year.

Money-market conditions remained relatively stable throughout the first quarter of 2001 with slight fluctuations in short-term interest rates and a liquidity requirement that fluctuated between R8 billion and R10,4 billion. Since the previous meeting of the Monetary Policy Committee on 16 March 2001, money-market rates have generally firmed. This led to a steepening of the money-market yield curve. The short end of the money-market yield curve is now higher than immediately after the 25-basis-point increase in the repo rate on 16 October 2000.

Balance of payments and foreign exchange market

South Africa's overall balance of payments position is expected to have remained sound during the first quarter of 2001. This is firstly indicated by a trade surplus, at a seasonally adjusted and annualised rate, of R23 billion in the first two months of 2001. Although this surplus was smaller than in the fourth quarter of 2000 it was brought about by a continued strong export performance. In particular, the exports of platinum and manufactured goods did well, reflecting a firm international demand and the improved price competitiveness of South African goods related to the depreciation of the rand. The improvement in exports was partly neutralised by a rise in the value of imports, largely capital and intermediate goods.

Secondly, transactions by non-residents in domestic securities indicate some improvement in South Africa's financial flows with the rest of the world. Non-residents have been net buyers on the JSE Securities Exchange to an amount of R11,4 billion since the beginning of 2001, compared with R2,6 billion in the first four months of 2000. In the bond market they were net sellers in January and February 2001, but became net buyers in March. These purchases have brought their cumulative net bond sales since the beginning of the year down to R6,5 billion.

Despite these favourable developments, the exchange rate of the rand remained under pressure in 2001, and heightened volatility was experienced in the market for foreign exchange. Since the previous meeting of the Monetary Policy Committee, the rand has declined to new record levels against the dollar and traded in a range between R8,00 and R8,20 per dollar during April. This reflected to a significant extent the strength of the US dollar. The trade-weighted value of the rand nevertheless declined by 3,0 per cent from the end of 2000 to 25 April 2001.

Monetary policy

Although the depreciation of the rand exerted upward pressure on the prices of imported goods, the overall effect on prices was counteracted by the lower international prices of oil combined with moderate inflation rates in South Africa's main trading-partner countries. As a result, the year-on-year rate of increase in the prices of imported goods moderated from 15,0 per cent in December 2000 to 12,3 per cent in March 2001. Slower rates of increase in domestic food prices further contained the inflation in production prices in 2001. The year-on-year rate of increase in the all-goods production price index consequently declined from 10,0 per cent in December 2000 to 8,9 per cent in March 2001.

The same factors were responsible for a marked slowdown in consumer price inflation during the first three months of 2001. In fact, the quarter-to-quarter seasonally adjusted and annualised rate of increase in the consumer price index excluding mortgage costs (CPIX) has declined consistently from 8,8 per cent in the second quarter of 2000 to 6,1 per cent in the first quarter of 2001. The year-on-year increase in the CPIX also decreased from a high of 8,2 per cent in August 2000 to 7,5 per cent in March 2001.

The South African Reserve Bank remains focused on achieving the inflation target. Factors mentioned in previous statements of the Monetary Policy Committee, such as surplus production capacity, no signs of excessive domestic demand, low increases in nominal unit labour cost, low growth in monetary aggregates, fiscal prudence and monetary discipline, all point to lower future domestic inflation. Projections for the year 2002 accordingly indicate that the average annual rate of increase in the CPIX should fall within the target range of 6 to 3 per cent if all other things remain the same. The main risk in this projection is the impact of the prices of imported goods on domestic prices.