Statement of the Monetary Policy Committee

19 January 2001

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

At a meeting on 18 and 19 January 2001 the Monetary Policy Committee reviewed current and likely future economic developments in order to evaluate the monetary policy stance. The main conclusions of the committee are summarised in this statement.

International economic developments

Since the previous meeting of the Monetary Policy Committee international oil prices have declined markedly. After averaging more than US$32 per barrel in November 2000, the price for Brent crude declined to an average of US$25,60 in December and then fluctuated around this level during the first two weeks of January. The Organisation of Petroleum Exporting Countries (OPEC) has indicated that it will regulate output to maintain prices within a range of between US$22 and US$28 per barrel.

The downturn in economic activity in the United States appears to have intensified. The growth in real gross domestic product for the third quarter of 2000 has been revised downwards from the previous estimate of 2,7 per cent to 2,2 per cent. Various indicators point to a material slowdown of growth in the fourth quarter. These developments prompted the Federal Reserve Board to lower the US Federal Funds rate by 50 basis points to 6 per cent on 3 January 2001. Despite the slowdown, the United States labour market remains tight and record deficits continue to be reported on the current account of the balance of payments. Inflation is largely contained and the year-on-year rate of increase in the consumer price index was unchanged at 3,4 per cent in November 2000.

Economic growth in the euro area slowed down somewhat. The annualised rate of increase in the real gross domestic product of the euro area declined from 3,3 per cent in the second quarter of 2000 to 2,7 per cent in the third quarter. The euro-area inflation continued to accelerate and the increase in the overall harmonised index of consumer prices reached 2,9 per cent in November 2000, the highest rate since 1994. However, the lower oil price and the strengthening euro, which appreciated by about 12 per cent against the dollar from the end of October, are likely to moderate these inflationary pressures. In the meantime the European Central Bank has not followed the US in cutting interest rates.

In the United Kingdom economic growth moderated to 2,8 per cent in the third quarter of 2000, down from 4,1 per cent in the preceding quarter. Inflation in the United Kingdom remained below target. The Japanese recovery remains fragile with growth in real gross domestic product increasing marginally from 0,9 per cent in the second quarter of 2000 to 1,0 per cent in the third quarter. Analysts still point to problems in the banking sector, the high public debt and a rapidly ageing population as major obstacles to the achievement of sustained higher growth.

The emerging markets of Asia, Africa and Latin America are expected to be adversely affected by the downturn in the United States. Third-quarter growth rates were generally subdued in these regions, except in Korea where growth amounted to a seasonally adjusted and annualised rate of 14 per cent. The growth in the real gross domestic product in Brazil, at 4,7 per cent, was also quite healthy. Mexico is likely to be most affected by a slowdown in the United States. Concerns that Argentina's recent liquidity crisis could have negative contagion effects in Latin America have subsided somewhat following the recent rescue package of the International Monetary Fund.

Domestic real economic activity

In contrast to the general slowdown in economic activity in many parts of the world, the South African economy continued to recover in the second half of 2000. Although estimates of the national accounts for the fourth quarter of 2000 are not yet available, various indicators point to robust growth. The growth in the physical volume of manufacturing production, which had abated somewhat in the middle of 2000, rebounded strongly in November. Similarly, the reduction in the value of unfilled orders in August and September 2000 was followed by a marked increase in October and November. Capacity utilisation rates in the manufacturing sector generally moved higher in the third quarter of 2000.

In addition, a distinct upward trend is discernible in the output of the non-gold mining sector of the economy from the third quarter of 2000, notably in the mining of copper, nickel and diamonds. Non-gold mineral sales were boosted, especially by higher sales of platinum and coal.

The trade sector seemed to have experienced higher activity levels in the fourth quarter of 2000. The growth in total retail and wholesale trade accelerated in October 2000 after it had weakened somewhat in the third quarter. Furthermore, preliminary indications point to better than expected year-end retail sales. Signs of some improvement in the financial position of households and small businesses are supported by a continued decline in the number of insolvencies of individuals and partnerships in October 2000.

Contrary to these positive developments, the strong rise in new vehicle sales lost much of its momentum in the fourth quarter, signalling some weakness in households' spending on durable consumer goods. The number of real-estate transactions remained at a relatively high level, but the upward movement flattened out in the course of 2000. The strong upward momentum in the composite leading business cycle indicator abated slightly in the course of 2000.

Despite the general recovery in economic activity, the latest available labour market statistics show a continuation of the decline in regularly surveyed formal non-agricultural employment in the third quarter of 2000. The under-utilisation of labour resources remained high and no additional wage pressures were evident from the rate of growth in nominal salaries and wages in the third quarter of 2000. In combination with strong growth in labour productivity, the moderate increase in remuneration per worker gave rise to a growth in unit labour costs consistent with a future fall in inflation.

Domestic monetary and fiscal conditions

The growth in the broadly defined money supply (M3) levelled off in October and November 2000, following the brisk growth in the preceding two months. This brought the twelve-month rate of increase in M3 to 6,6 per cent in November, with even lower corresponding growth rates in the narrower monetary aggregates. The deceleration in money supply growth, however, was partly due to the high base in 1999 when the demand for money was strong because of Y2K concerns.

The twelve-month rate of increase in bank credit extension to the domestic private sector accelerated from 8,6 per cent in August 2000 to 11,8 per cent in November. Although part of this acceleration was the result of banks' holdings of investments, there were also signs of a more rapid increase in the demand for mortgage, instalment sale and leasing finance. This was to be expected, given the ongoing upswing in economic activity.

Revised estimates show a decline in the borrowing requirement of the non-financial public sector from 4,7 per cent of gross domestic product in the first half of fiscal 1999/2000 to 3,0 per cent in the corresponding period of 2000/01. This further improvement was related to the continued discipline applied in government expenditure and greater efficiency in the collection of taxes. The deficit in the current fiscal year has been financed to a considerable extent by issuing Treasury bills at a relatively low interest cost to the taxpayer.

Domestic financial markets

Capital market turnovers remained buoyant in the final months of 2000. As a result, record turnovers were registered on the JSE Securities Exchange, the Bond Exchange and the Futures Exchange during 2000.

Since the previous meeting of the Monetary Policy Committee, bond prices have continued to strengthen despite substantial net sales by non-residents. There has therefore been a downward movement in bond yields that started on 18 October 2000. These changes could reflect lower inflation expectations as well as the low demand for loanable funds by the government. The lower inflation expectations are also confirmed by a narrowing of the difference between the yield on inflation-linked bonds and ordinary government bonds of similar maturity from the beginning of November 2000.

Non-residents were net sellers of bonds to the amount of R20,3 billion in 2000, while the yield on the R150 bond moved from 13,26 per cent on 4 January 2000 to 12,03 per cent on 29 December 2000. At the same time non-residents were net buyers of South African shares to an amount of R17,4 billion during 2000, which brought the combined net sales of securities to R2,8 billion in the year as a whole. This can be compared with net purchases of securities by non-residents of R54,9 billion in 1999. Further improvements in bond yields occurred in the first two weeks of January.

On balance, share prices lost considerable ground during 2000. The all-share price index declined from a peak of 9 227 on 17 January 2000 to 8 494 on 29 December 2000. However, since the previous meeting of the Monetary Policy Committee, share prices have risen by 7,2 per cent up to 18 January 2001.

Over the same period, money-market interest rates remained generally stable, with the 91-day Treasury bill rate, for instance, fluctuating within a narrow range of between 10,15 per cent and 10,25 per cent. However, money-market interest rates with a maturity of longer than 6 months at first declined significantly, reflecting market expectations of reduced interest rates in the course of 2001. From 10 January 2001 this trend was partly reversed with the weakening in the external value of the rand.

Balance of payments and foreign exchange market

Monthly international trade data indicate that the current account of the balance of payments probably remained in deficit during the fourth quarter of 2000, and that this deficit could perhaps be even higher than the seasonally adjusted and annualised rate of R3,7 billion in the third quarter of the year because of a deterioration in the trade balance. The trade surplus decreased from a seasonally adjusted and annualised rate of R25,2 billion in the third quarter of 2000 to R15,1 billion in October and November 2000. This was largely the result of a sharp rise in imports related to the economic recovery, the high price of oil and a depreciating currency. The value of exports also declined over this period.

Measured by the change in the country's international reserves, there were deficits of R4,0 billion on the overall balance of payments in October 2000 and R0,5 billion in November 2000. This could indicate that the surplus on the financial account of the balance of payments shrank or that it may even have reverted to a deficit.

On balance, the nominal effective exchange rate of the rand declined by 12,4 per cent from the end of December 1999 to the end of December 2000. The deficit on the overall balance of payments, together with unsubstantiated market rumours about delays in the implementation of government's privatisation programme and relaxations of exchange controls, put further downward pressure on the rand in the first few days of January 2001. On 11 January the rand traded briefly at the level of R8,01 against the US dollar. Subsequently it recovered somewhat. The weighted exchange rate of the rand nevertheless fell by 3,7 per cent from the end of 2000 to 18 January 2001.

Monetary policy

From the above analysis it is apparent that many factors appear positive for the desired inflation outcome in 2002. These include apparently lower inflationary expectations, moderate rates of increase in nominal unit labour cost, surplus production capacity in manufacturing, an under-utilisation of labour, little evidence of demand pressures on prices, lower oil prices since December 2000, a slowdown in the growth of money supply and prudent fiscal and monetary policies. The likely positive effects of these factors on inflation are substantiated by the econometric projections of the Bank that show that, all things remaining the same, the average rate of increase in the CPIX will be within the target range in 2002.

However, in the course of 2000 the rate of inflation rose because of the depreciation of the rand, a steep rise in oil prices and an upward shift in food prices. In the last few months of the year lower rates of increase in food prices and in the running costs of transport equipment were the main reasons for a slowdown in inflation. As a result, the percentage change over twelve months in consumer prices excluding mortgage costs (CPIX), which had increased from 6,5 per cent in October 1999 to 8,1 per cent in September 2000, fell back to 7,7 per cent in November. Moreover, the month-on-month changes in the consumer price index in the second half of 2000 reached levels which bode well for the attainment of the inflation target in 2002.

Developments in production price inflation are unfortunately less encouraging. The rate of increase in the all-goods production price index measured over twelve-month periods rose from 6,0 per cent in October 1999 to 9,9 per cent in November 2000. This acceleration was largely due to a rise in the prices of imported goods arising from the weakness of the rand and the increase in international oil prices. The prices of domestically produced goods, however, also rose sharply over the same period. These raise concerns about the possibility that production price increases may spill over into higher consumer price inflation in the months to come, posing some threat to the attainment of the inflation target in 2002.

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