Statement of the Monetary Policy Committee

10 September 2003

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

Introduction

The Monetary Policy Committee (MPC) of the South African Reserve Bank has held a special meeting on Wednesday, 10 September. The impetus for this meeting came from the regular Governors' Committee meeting where, amongst other things, recent economic developments are reviewed as part of the Bank's continuous assessment of economic and financial conditions. Although the monetary policy stance is generally set at the MPC meetings that are scheduled on alternate months, there is in fact a continuous process of keeping the monetary stance under review, taking account of any new information or developments.

In the interest of transparency and to keep the market informed, the decision to hold an extra MPC meeting today (10 September) was announced last Friday (5 September).

Recent economic developments

There are signs that the international economy is beginning to recover from its extended period of low growth, although the process is proving to be slow and protracted. Second quarter growth in the United States was revised to above 3 per cent, and the prospects for the Asian economies, including Japan, have improved. The outlook for the major European economies however remains less certain. Despite the nascent recovery, its sustainability is not yet assured and there remain significant downside risks. Against this background, world inflation is not expected to be a cause for concern in the near future.

Domestically, growth performance has been weak during the first half of the year. Growth in gross domestic product moderated from 1½ per cent in the first quarter to 1 per cent in the second quarter. Although there are signs of a revival of output growth following the 3 per cent increase in manufacturing production and the 11½ per cent increase in mining production in July 2003, manufacturing production over the 3 months to July declined by 0,9 per cent compared to the previous 3 months. On a year-on-year basis, manufacturing output declined by 1½ per cent. The increasing gap between actual output growth and potential growth was further illustrated by the decline in capacity utilisation in manufacturing to 79 per cent in the second quarter of 2003. Domestic expenditure, on the other hand, appears to have held up well so far: for example, the demand for new motor vehicles recorded month-on-month increases of 8½ per cent in July and 5½ per cent in August.

Statistics on South Africa's international trade indicate an improvement in merchandise export earnings, probably reflecting the improved international environment, whereas merchandise imports remained broadly unchanged from June to July. The seasonally adjusted trade surplus improved significantly in July. South Africa's total gold and other foreign exchange reserves rose further from US$18,5 billion (R138,9 billion) at the end of June 2003 to US$19,0 billion (R141,6 billion) at the end of July.

The exchange rate of the rand has continued to display greater stability, despite the recent variability in the major currencies. The nominal effective exchange rate stood at 55,1 on 14 August and rose to 57,4 on 4 September, before receding to 54,5 on 9 September 2003.

Year-on-year growth in M3 money supply remained below 10 per cent in July 2003. In fact, the seasonally adjusted level of money supply declined by 0,6 per cent from the end of June to the end of July. Bank loans and advances to the domestic private sector recorded a seasonally adjusted increase of only 0,1 per cent in July, bringing the twelve-month growth rate to 13 per cent.

During the second quarter of 2003 non-residents were net purchasers of both bonds and shares on the South African exchanges. But in July and August they reduced their holdings by a combined total of R7,6 billion. There was also a reduction in non-residents' foreign-currency deposits with South African banks in July.

Fairly buoyant conditions continued to prevail in the real-estate market, while equity prices continued to recover. Share prices have risen by more than 6 per cent from 14 August to date. House prices increased by more than 18 per cent in the year to August 2003.

Data on national government finances during the first four months of the current fiscal year indicate an increase of 3,7 per cent in government revenue and an increase of 10,1 per cent in expenditure compared with the corresponding period of the previous year.

Inflation and inflation expectations

CPIX inflation, measured over periods of twelve months, picked up slightly from 6,4 per cent in June to 6,6 per cent in July 2003. The increase from month to month picked up from minus 0,3 per cent in June to 0,8 per cent in July, mainly on account of an increase in municipal rates and taxes. Despite this slight increase, the previous downward trend is expected to resume. Production price inflation continues to indicate further future declines in CPIX inflation with the twelve-month rate of production price inflation decelerating from 2,3 per cent in June to 1,5 per cent in July, while the month-on-month increase in July was 0,6 per cent.

In the bond market, long yields continue to reflect declining inflation expectations. Consistent with that, CPIX inflation expectations as measured by the Bureau for Economic Research quarterly survey declined across the board for the coming three years, and the levels of CPIX inflation expectations are below those of the same time last year.

The monetary policy stance

Against this background the MPC discussed underlying trends in both the international and the domestic economies.

There is growing evidence that the recovery in the international economy is proceeding. It is becoming clearer, too, that the pace of activity in the domestic economy is slowing. Helped by the recovery in the rand, prospects for lower inflation remain encouraging: there is continued evidence of declining inflationary expectations and CPIX inflation should fall within the target range of 3 – 6 per cent.

Going forward, the Bank's most recent forecasts show that, all things remaining the same, the inflation target should be achieved for the forecast period.

Taking all these factors into account the Monetary Policy Committee has decided to lower the repo rate by 100 basis points to a level of 10 per cent effective from 11 September 2003. This reduction should not be interpreted as a move to a more aggressive lowering of interest rates. Should the inflation outlook deteriorate in the near future, the Committee will not hesitate to take the appropriate action.