Statement of the Monetary Policy Committee

11 August 2000

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 10 and 11 August 2000 the Monetary Policy Committee reviewed economic conditions and the monetary policy stance. The main conclusions of the Committee are summarised in this statement.

International economic developments

Global economic conditions remain favourable. In the United States the growth in real gross domestic product improved from a seasonally adjusted and annualised rate of 4,8 per cent in the first quarter of 2000 to 5,2 per cent in the second quarter. This strong growth was fuelled primarily by business investment and federal government spending. Over the same period, the inflation rate rose further largely due to increases in energy and food prices.

Growth in the euro area is robust and is expected to average more than 3 per cent in 2000. However, the euro remains under pressure, and the weaker currency together with higher oil prices led to an inflation rate of 2,4 per cent in June 2000. This is considerably above the inflation reference rate of 2,0 per cent. In the United Kingdom, real gross domestic product grew by a stronger than expected 3,6 per cent in the second quarter of 2000. Inflationary pressures also arose because of increases in the price of petrol and oil.

The Japanese economy has recovered somewhat since the beginning of 2000, despite the weak consumer demand. The Policy Board of the Bank of Japan is of the opinion that the downward pressure on prices stemming from insufficient demand is abating. The Board has decided at its recent meeting to terminate its zero interest rate policy.

Growth in the emerging markets of Asia and Latin America is still strong with no signs of undue inflationary pressures. The performance of African economies has varied considerably, with some parts of sub-Saharan Africa being affected by political and social developments. Some corrective measures are being put in place, as demonstrated by the recent devaluation of the Zimbabwean dollar by about 24 per cent against the United States dollar in order to improve the price competitiveness of Zimbabwe’s export sector.

In recent weeks the oil price has declined from levels above US$30 per barrel to between US$26 to US$28 following a decision by OPEC to increase production. If these lower levels are sustained, inflationary pressures will be reduced internationally.

Domestic real economic developments

Economic activity in South Africa expanded during the first half of 2000, but at a considerably slower pace than in the second half of 1999. From preliminary information it appears that the more subdued economic growth was mostly concentrated in the primary and secondary sectors of the economy. This was reflected in considerable underutilisation of production capacity in manufacturing. The real value added by the services sectors seems to have grown at a solid rate in the first six months of 2000, led by growth in the trade, transport and communication sectors.

Preliminary estimates indicate that aggregate final demand continued to expand during the first six months of 2000. In particular, growth in real final consumption expenditure by households remained firm, largely because of increased expenditure on durable and semi-durable goods. However, inventory accumulation was cut back, partly in response to some involuntary inventory build-up in previous quarters, causing a decline in real gross domestic expenditure in the second quarter of 2000.

Labour absorption in the formal non-agricultural sectors of the economy remained weak in the first three months of 2000. The latest information about the labour market is nonetheless more positive, showing that unemployment declined from 25 per cent of the economically active population in October 1998 to 23 per cent in October 1999. Total employment increased over this period, not least owing to strong growth in informal-sector employment. Another positive factor in the labour market is the low year-on-year increase in the cost of labour per unit of real output, rising by only 0,5 per cent in the first quarter of 2000.

Domestic monetary and fiscal conditions

Reflecting the subdued growth in economic activity, the level of the broadly defined money supply (M3) at the end of June 2000 was virtually the same as at the end of 1999. In fact, the seasonally adjusted quarterly average value of M3 declined slightly from the first to the second quarter of the year. Measured over a period of twelve months, M3 increased by 8,8 per cent in June 2000.

Bank credit extension to the private sector increased at an average annualised rate of 4,9 per cent in the first six months of 2000. Private-sector businesses were increasingly prepared to satisfy part of their financing needs through non-bank mechanisms, such as issuing share capital or debt securities. This had a dampening effect on credit intermediated via the banking system and on the growth of money supply. By contrast, credit extended to households showed signs of recovery after a period of consolidation.

The fiscal situation remained sound in the April-June quarter of fiscal 2000/01, with government revenue increasing more rapidly than government expenditure. The accumulated budget deficit for the current fiscal year developed closely in accordance with its typical seasonal pattern.

Domestic financial markets

Lively trading conditions prevailed in the bond market during the second quarter of 2000, but turnovers declined somewhat from the levels attained in the first quarter. The domestic bond market has been in a strong recovery phase since the last Monetary Policy Committee meeting in June. The yield on the R150 bond strengthened from just above 14 per cent to 12,75 per cent on 10 August 2000. As a consequence, the yield curve became flatter over this period. The difference between the nominal yield on long-term government bonds and the real yield on the inflation-linked government bond has declined significantly since May, tentatively signalling that inflation expectations have moderated.

Foreign investors became net buyers of South African bonds in July to an amount of R2,2 billion. However, the net sales by non-residents still totalled R13,1 billion in the first seven months of 2000.

Turnover on the secondary equity market remained high in the first six months of 2000, but share prices were relatively depressed. The all-share price index, on balance, declined from a peak of 9 227 on 17 January 2000 to 8 066 on 10 August 2000, or by 12,6 per cent. Non-residents purchased equities to the amount of R6,8 billion in the first seven months of 2000, compared with R24,7 billion in the same period of the preceding year. August 2000 to date has demonstrated a considerable improvement in net purchases by non-residents of both bonds and equities amounting to R3,1 billion.

In the money market, the interest rates which respond to changes in the Reserve Bank's repo rate, i.e. the interbank overnight rate, prime overdraft rate and mortgage rates, have remained broadly unchanged since the last meeting of the Monetary Policy Committee. Some of the other rates, such as those on Treasury bills and bankers' acceptances, declined only marginally. By contrast, the rates on forward rate agreements displayed significant downward movements from 15 June to 10 August 2000.

Balance of payments and foreign exchange market

Despite a large oil import bill, the current account of the balance of payments changed from a deficit in the first quarter of 2000 to a healthy surplus in the second quarter. This was the combined result of a decrease in the value and volume of merchandise imports, and a further substantial increase in the value of merchandise exports. The exports of mining and manufactured goods have performed remarkably well during the first six months of 2000, reflecting the weaker external value of the rand and strong international demand.

Investor sentiment deteriorated in the second quarter, leading to a net outflow of capital from South Africa. To a large extent this consisted of a net outflow of portfolio investments, but some South African companies also sought to diversify their operations into other parts of the world.

With the surplus on the current account of the balance of payments falling short of the deficit on the financial account, the overall balance of payments showed a small deficit in the second quarter of 2000. The net international reserve position of the country consequently deteriorated somewhat, and the Reserve Bank was able to reduce its net open foreign currency position only marginally to US$10,1 billion at the end of the second quarter. At the end of July the net open foreign currency position was reduced further to US$9,9 billion.

As could be expected with an overall deficit on the balance of payments, the nominal effective exchange rate of the rand declined by 2,7 per cent from the end of March 2000 to the end of June 2000. Following the improvement in the transactions of securities by non-residents in July and August, the weighted value of the rand rose by 1,4 per cent in this period. On 11 August the nominal effective exchange rate of the rand was approximately 5,0 per cent below its level at the beginning of the year.

Stability in the financial sector

The overall efficiency in the banking sector improved somewhat in June 2000. Not only did growth in capital and reserves remain strong, but the capital adequacy ratio also rose from 12 per cent in the first quarter of 2000 to 12,5 per cent in the second quarter. Liquidity pressures eased somewhat because of a lower dependency on short-term wholesale deposits for funding. An increase in the anticipated liquidity mismatch appeared to be partly of a structural nature and partly a result of some banks' views on future interest-rate movements. Although overdue accounts increased slightly in the quarter ended June 2000, both general and specific provisions increased accordingly.

Monetary policy

The increase in overall consumer prices excluding the interest costs on mortgage bonds for metropolitan and other urban areas (the CPIX) accelerated from 6,5 per cent in October 1999 to 7,9 per cent in June 2000. When omitting the effects of the rise in domestic prices of energy and food (as related to flood damage), the twelve-month rate of increase in the CPIX remained unchanged at 6,9 per cent over the same period.

For policy purposes the price increases arising from exogenous shocks cannot, of course, be ignored. It is, however, important to note that inflation in South Africa over the past nine months was largely related to supply-side shocks on which monetary policy has little effect over the short run. However, some important counter-inflationary forces were also present in the economy. Unit labour costs, money supply and credit aggregates grew at low rates, the rate of increase in aggregate domestic demand was low and the economy operated well below production capacity.

From projections made by the Reserve Bank it appears that inflation is near an upper turning point. This is supported by the recent slower rate of increase in production prices, which usually precedes inflation-rate changes in consumer prices. All things remaining the same, the projections of the Bank show that the increase in CPIX should slow down over the next two years and that the average annual rate of increase in the year 2002 should be within the target range of 3 to 6 per cent. The spill-over effect of external inflationary pressures on domestic prices will nevertheless be carefully monitored to ensure that appropriate steps are taken so that the inflation target range is met.

Taking all the above circumstances into account, the Monetary Policy Committee has decided to maintain the current monetary policy stance.