Statement of the Monetary Policy Committee

15 June 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 its meeting of 14 and 15 June 2000 the Monetary Policy Committee analysed recent international and domestic economic developments and reviewed the monetary policy stance. The main conclusions drawn at this meeting are summarised in this statement.

International economic developments

Since the last meeting of the Monetary Policy Committee there have been indications that economic growth in the United States of America may have slowed down. For instance, the private sector shed 116 000 jobs in May 2000, leading to an increase in the unemployment rate of 0,2 percentage points. As a result, financial markets rallied as fears of a further monetary tightening in the United States receded. It is still too early to tell whether recent data reflect a sustained trend, but it is widely anticipated that it could affect the future monetary policy stance. However, there is a possibility that higher share prices may reinforce the wealth effects that underlie much of the demand pressure in the United States.

Clearer signs of an economic recovery in Japan are emerging. Recently released data show that the real gross domestic product of Japan rose at a seasonally adjusted and annualised rate of 10 per cent in the first quarter of 2000, compared with a decline to over 6 per cent in the fourth quarter of the preceding year. Real production in the euro area increased at a weaker-than-expected growth rate of 2,8 per cent in the first quarter of 2000. However, growth is expected to be higher in the second quarter owing to strong increases in industrial production. The United Kingdom’s preliminary first quarter production figures were weaker than projected, with declining growth in manufacturing production.

The process of monetary tightening, which had generally been pursued in most of the industrial countries during 1999, continued in 2000. Interest rates were increased when it became apparent that inflation rates were rising. Sharp increases in oil prices put upward pressure on other prices, which in an environment of relatively high growth, made it necessary to apply stricter monetary discipline.

The performance of emerging-market economies improved considerably during the first months of 2000. Many of the world’s poorest countries, including some in Africa, are recording good growth rates in production. Unfortunately, the political developments in some sub-Saharan African countries impede economic growth in this region. The rate of inflation in emerging-market economies has declined, but the recent depreciation in the currencies of many of these countries, if sustained, may result in an acceleration of inflation.

Domestic real economic developments

The recently released national accounts statistics confirm that growth in the South African economy slowed down markedly in the first quarter of 2000. Adverse agricultural conditions were to a large extent responsible for the lower growth. The growth in non-agricultural production nevertheless also declined from a seasonally adjusted and annualised rate of 2½ per cent in the last two quarters of 1999 to 2 per cent in the first quarter of 2000, largely because of a levelling off in manufacturing output. This does not bode well for the already poor capacity of the economy to create employment and decrease the unemployment rate.

The growth in aggregate domestic demand weakened somewhat in the first quarter of 2000, owing to a fall in the real consumption expenditure of general government. This contributed to a further large increase in inventory accumulation. In contrast to the development in overall demand, the growth in real final consumption expenditure by households accelerated from a seasonally adjusted and annualised rate of 3 per cent in the fourth quarter of 1999 to 3½ per cent in the first quarter of 2000. However, consumers avoided financing this expenditure by excessive increases in debt. Household debt as a percentage of personal disposable income therefore declined from 59½ per cent in the first quarter of 1999 to 57 per cent in the first quarter of 2000.

Gross fixed capital formation, which had declined in 1999, rose modestly in the first quarter of 2000. The rise in fixed investment was confined to the private sector, while capital expenditure by public corporations and general government contracted further. The level of fixed investment at 14½ per cent of gross domestic product is well below the level required to support economic growth at a rate high enough to lift the employment-creating capacity of the economy.

Domestic monetary and fiscal conditions

The broadly defined money supply (M3) at the end of April 2000 was close to the value that it had reached at the end of December 1999. In fact, M3 contracted at an annualised rate of 0,2 per cent in the first four months of 2000, whereas it had increased at a rate of 18,9 per cent in the second half of 1999. Moreover, the decline in the money supply in the first four months of 2000 was mainly concentrated in short-term deposits of the non-bank private sector, i.e. in deposits reflecting the transactions demand for money. Mainly because of the statistical carry-over of strong growth in the money supply during the second half of 1999, the twelve-month growth rate in M3 amounted to a relatively high 10,8 per cent in April 2000.

Bank credit extension to the private sector expanded slowly during the first four months of 2000. The seasonally adjusted and annualised growth rate in such credit amounted to 5,7 per cent from the end of December 1999 to the end of April 2000, compared with a rate of 8,0 per cent recorded during the last six months of 1999. In April 2000 the twelve-month rate of increase in credit extension to the private sector came to 8,9 per cent.

Public finances were characterised by continued discipline in the first four months of 2000. The public-sector borrowing requirement amounted to only 1,3 per cent of gross domestic product in the fiscal year ended 31 March 2000, compared with 3,4 per cent in the preceding fiscal year. Lower capital expenditure by public corporations and a smaller national government deficit made the major contributions to this reduction.

Domestic financial markets

Financial market activity remained brisk throughout the first five months of 2000 and share prices on the whole declined up to mid-April and bond prices up to mid-May. Market sentiment then started to change. Share prices rose by 16,6 per cent from a low point on 17 April 2000 to 14 June, while long-term bond yields declined by 70 basis points from a peak value on 10 May 2000 up to 14 June.

Foreign investors remained net sellers of South African bonds up to the last week of May, but from 25 May 2000 to 14 June became net purchasers to the amount of R0,8 billion. From the beginning of the year until 14 June their net sales still totalled R15,6 billion. Non-residents have purchased R4,4 billion of equities so far this year, compared with R11,9 billion during the first five months of 1999.

In the money market the Treasury bill and bankers' acceptance rates started to rise marginally in April and showed a distinct upward trend during most of May, probably reflecting expectations that the Reserve Bank will react to the weaker rand and higher oil prices. After the beginning of June both these rates began to decline again. Other market-determined rates, such as forward rate agreements and rates on negotiable certificates of deposits, displayed similar patterns.

The recent developments in the money and capital markets were also reflected in a change in the shape of the yield curve. The yield curve flattened somewhat with the upward sloping short end reflecting the rise in shorter-term rates and the longer end of the yield curve the decline in longer-term yields.

Balance of payments and foreign exchange market

The overall balance of payments was in surplus to the amount of R3,6 billion during the first quarter of 2000. This was the combined result of a surplus of R0,5 billion on the current account and a net inflow of capital not related to reserves of R3,1 billion. After making adjustments for seasonal factors, the current account of the balance of payments was in deficit to an annualised amount of R4,7 billion, i.e. at a slightly lower value than the R5,6 billion recorded in the fourth quarter of 1999. Exports of goods continued to perform well and neutralised increases in merchandise imports and net service, income and transfer payments to non-residents.

Despite the large net sales of domestic securities by non-residents, a further although considerably smaller surplus was recorded on the financial account of the balance of payments. This was largely the result of net inward direct investment into South Africa and the proceeds obtained from an international bond issue of the government. There was also a further but smaller inflow of foreign equity portfolio capital and inflows arising from trade finance and bank deposits.

Despite the overall surplus on the balance of payments, the exchange rate of the rand came under pressure. The weighted value of the rand against a basket of currencies declined by about 7½ per cent from the end of 1999 until the middle of May 2000. This decline in the rand was probably related to the strength of the US dollar and perceptions about the effects of developments in some sub-Saharan African countries. Towards the end of May and in the first two weeks of June 2000 the US dollar weakened considerably on international foreign exchange markets, resulting in a moderate appreciation in the external value of the rand against the dollar. However, the nominal effective exchange rate of the rand declined further to a level on 14 June 2000 that was 8 per cent lower than at the beginning of the year. In view of the weakness of the rand, the Reserve Bank did not reduce its net open foreign currency position during April and May. At the end of May 2000 the net open foreign currency position of the Bank therefore remained at US$10,2 billion.

Stability in the financial sector

The additional information that has become available since the last meeting of the Monetary Policy Committee about developments in the banking sector, reaffirmed that banks are managing risks in an efficient and sound way. Gross overdues on advances have declined in absolute and relative terms. In addition, banks have made adequate provision for bad and doubtful loans. These provisions, at more than 60 per cent of total gross overdues, are currently well above the international norm of 40 per cent. However, there are signs that the profitability of the banking sector as a whole is coming under some pressure. Lower income combined with increased operating expenses, resulted in marginally lower returns on assets and equity during the first four months of 2000.

Monetary policy

Consumer and production price indices indicate that inflationary pressures are increasing in South Africa. The rate of increase in the consumer price index for metropolitan and urban areas excluding the interest costs on mortgage bonds, i.e. the CPIX which is used as the benchmark for inflation targeting, has continued to accelerate from the fourth quarter of 1999. The higher rates of consumer price inflation were mainly due to increases in the prices of energy and food. If these prices are excluded from the CPIX, the twelve-month rate of increase in this index actually declined from a peak of 7,9 per cent in March 1999 to 6,7 per cent in April 2000.

The secondary effects of recent oil and food price increases, as well as the weakness of the rand, therefore seem quite muted or simply not yet fully reflected in an acceleration in the underlying rate of price increases. Moreover, it is possible that the temporary upward pressure exerted by these external shocks may be tempered by fundamental domestic economic factors, such as the modest growth in money supply and bank credit extension; the excess production capacity in the economy; fiscal and monetary discipline; and a slowdown in the growth of nominal unit labour costs.

According to projections made by the Reserve Bank, the inflation outlook for South Africa is still positive. Given the effects of external shocks, the growth in the overall CPIX is likely to increase into the second half of 2000, but price increases may then start to slow down and the average growth in CPIX should be within the target band of 3 to 6 per cent for the year 2002.

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