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EBS/84/216

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October 17, 1984

To: Members of the Executive Board
From: The Acting Secretary
Subject: South Africa - Real Effective Exchange Rate -
Information Notice

The attached information notice on the real effective exchange rate of the South African rand is circulated for the information of the Executive Directors.

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. G. G. Johnson (ext. (5)8671).

Att: (1)



INTERNATIONAL MONETARY FUND

SOUTH AFRICA

Real Effective Exchange Rate - Information Notice

Prepared by the European and Exchange and
Trade Relations Departments

(In consultation with other departments)

Approved by L. A. Whittome and S. Mookerjee

October 16, 1984

The recent evolution of South Africa's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of August 1984 the South African rand had depreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss South Africa's exchange rate policy--the 1984 Article IV consultation in June 1984. The depreciation is estimated to have amounted to 13.3 percent.

Since the fixed rate regime was replaced by one of managed floating in January 1979, ^{1/} the external value of the rand has fluctuated markedly, partly in response to large swings in the price of gold. After appreciating strongly in both nominal and real effective terms between mid-1982 and early 1983, the rand remained firm in the period through September 1983. Since then, however, there has been a nominal effective depreciation of 22 percent. After declining from a peak of 16.5 percent in mid-1982 to 10 percent in early 1984, the rate of increase of the consumer price index measured over a 12-month period has risen slightly, to reach 11.8 percent in August 1984. As this was close to 3 percent higher than the weighted average rate of inflation in South Africa's trading partners, the real effective depreciation over the last year has amounted to about 20 percent, more than reversing the real effective appreciation that had occurred since mid-1982.

Since September 1983, expansionary financial policies--especially fiscal policy--have combined with adverse external developments, including a declining price of gold, to bring about a marked deterioration in the balance of payments position. On a seasonally adjusted basis, the current account of the balance of payments moved from a surplus equivalent to

^{1/} Between June 1975 and January 1979, the commercial rand was pegged to the U.S. dollar. In 1983 the authorities took major steps to improve the functioning of the exchange market, including the abolition of the separate market for the financial rand and the channelling of U.S. dollar proceeds from gold sales through the market.

1.4 percent of GDP in the first three quarters of 1983 to a deficit equivalent to 2.3 percent of GDP in the subsequent three quarters. Although much of the current deficit in the latter period was offset by capital inflows, net foreign reserves fell by R 493 million (about US\$400 million).

In July 1984 a sharp decline in the price of gold (from an average of over US\$377 per fine ounce in June to an average of US\$346 per ounce), associated with a further surge in the U.S. dollar, triggered a fall of 22 percent in the U.S. dollar rate for the rand. During that month, the rand also lost ground against virtually all other major currencies, as exchange rate expectations gave rise to unfavorable leads and lags in foreign payments and encouraged also other forms of capital outflows. During July, the South African Reserve Bank at times intervened actively in the foreign exchange market, and its net foreign reserves fell by R 465 million (about US\$300 million).

In early August, the Reserve Bank raised its rediscount rates by 3 percentage points, following a small increase in July, and tightened the terms of hire-purchase transactions. In response to these measures, the clearing banks raised their minimum overdraft rate to 25 percent from 22 percent in July and 21 percent in March 1984. In September 1984 the authorities announced some cuts in public expenditure which, together with the increase in the general sales tax rate by 3 percentage points (to 10 percent) in effect since July 1984, are expected to contain the budget deficit in fiscal 1984/85 (year ending March) to 3.6 percent of GDP, slightly below the 1983/84 deficit of 3.8 percent of GDP.

Staff Appraisal

South Africa's exchange rate policy continues to be conducted in the flexible manner that Executive Directors, at the conclusion of the 1984 Article IV consultation on June 8, 1984, regarded as appropriate. The sharp depreciation of the rand over the last year reflects a combination of adverse external developments, particularly the decline in the price of gold, and continuing domestic demand pressures that have kept the rate of inflation high. In recent months, the authorities have taken strong measures with a view to dampening the growth in domestic demand. Together with the depreciation of the rand, these measures are likely to lead in the near term to an improvement in the balance of payments position on both current and capital account transactions. Nevertheless, the continuing large deficit in the budgetary accounts is a source of concern. Significant further reductions in government spending are needed in order to ease pressure on interest rates--which are at present very high in real terms--and allow a resumption of growth without the re-emergence of external difficulties.

Table. South Africa: Real Effective Exchange Rate and Related Series

(Indexes: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in terms of U.S. dollars	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
<u>Quarterly</u>						
1979						
I	88.2	89.4	98.7	90.9	83.3	83.0
II	91.4	92.1	99.3	92.0	85.9	85.5
III	91.5	91.0	100.6	92.9	90.1	90.5
IV	93.3	93.3	100.0	93.9	92.3	92.5
1980						
I	94.3	95.4	98.9	95.5	94.6	94.4
II	97.9	98.7	99.2	98.4	97.9	97.5
III	100.9	100.9	100.0	102.5	101.3	101.7
IV	106.9	104.9	101.9	103.6	106.2	106.4
1981						
I	109.5	107.2	102.2	101.1	109.6	109.4
II	107.8	105.7	102.1	92.8	112.5	112.1
III	103.5	100.0	103.6	82.8	117.3	117.7
IV	98.8	94.6	104.5	80.8	121.3	121.6
1982						
I	100.3	94.9	105.7	78.2	125.3	125.1
II	98.0	90.8	108.0	72.3	130.7	130.4
III	96.4	89.0	108.3	67.7	134.0	134.3
IV	102.3	93.1	109.9	69.0	138.5	138.8
1983						
I	107.7	96.2	112.0	71.8	143.3	143.0
II	111.4	98.7	112.9	71.5	147.1	146.8
III	113.8	101.1	112.6	70.2	149.8	150.1
IV	109.4	97.2	112.6	66.3	153.5	153.7
1984						
I	106.6	94.1	113.3	63.1	157.8	157.5
II	106.5	92.4	115.3	61.0	163.5	163.3
<u>Monthly</u>						
1984						
June <u>3/</u>	106.0	91.5	116.0	59.6	165.4	164.8
July	96.4	82.7	116.6	52.1	167.3	167.0
August	91.9	79.2	116.1	49.5	167.9	168.0
Percentage change June 1984- August 1984	-13.3	-13.4	0.1	-16.9	1.5	1.9

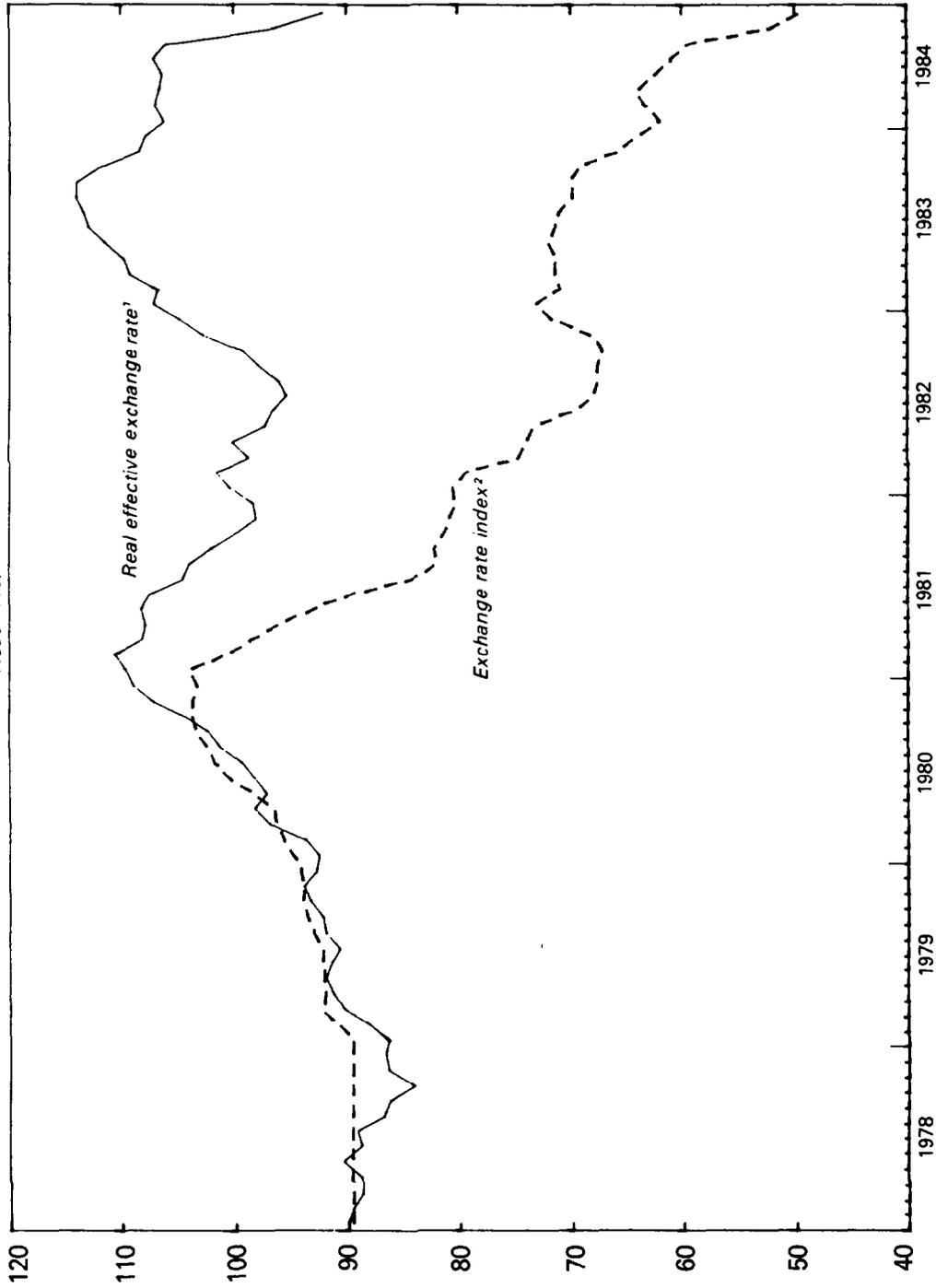
1/ Increases mean appreciation.

2/ Using seasonally adjusted price indexes.

3/ Date of latest consideration by Executive Board.



SOUTH AFRICA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980=100)



¹ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

² U.S. dollars per South African rand.

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