EBS/86/51

CONFIDENTIAL

March 4, 1986

To: Members of the Executive Board

From: The Secretary

Subject: South Africa - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the South African rand.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

SOUTH AFRICA

# Real Effective Exchange Rate - Information Notice

Prepared by the European Department and
the Exchange and Trade Relations Department

(In consultation with the Legal Department and
the Research Department)

Approved by Brian Rose and J. T. Boorman

March 3, 1986

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 December 1985 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 notification on changes in exchange arrangements and system (EBS/85/214, 9/9/85). The depreciation is estimated to have amounted to 10.4 percent in the three months to December 1985.

After appreciating strongly in both nominal and real effective terms between mid-1982 and mid-1983, the rand remained firm through late 1983. Since then the rand has been under almost uninterrupted--and at times very strong--speculative downward pressure. Its effective external value depreciated by 36 percent in nominal terms and by 29 1/2 percent in real terms in the 12 months ending December 1985, following depreciations of 26 percent and 23 percent, in nominal and real terms, respectively, in the preceding 12 months. Exchange rate developments during the more recent period have been strongly influenced by noneconomic considerations. Despite a growing current account surplus, downward pressures on the rand were quite strong in July-August 1985 when, in response to the proclamation of a state of emergency by the South African Government, nonresidents accelerated the pace of portfolio disinvestment and there were large-scale outflows of short-term capital, including outflows stemming from the decision of some foreign banks to withdraw their lines of credit to South African residents. The rand traded at an all-time low of R 1 = US$0.35 on August 27, 1985, compared with a rate of about R 1 = US$0.50 at the end of 1984 and in mid-1985. In response, the South African Government decided to close the foreign exchange market and the stock exchange. On the reopening of the markets on September 2, 1985 they announced the imposition of a standstill on the repayment of a large part of maturing external debt obligations extending to December 31, 1985 (subsequently prolonged until March 31, 1986), and the reintroduction of the dual exchange rate arrangements that had been discontinued in February 1983.

Despite the imposition of the standstill, the capital outflow remained large in October and November 1985. As a result, the rand, which had strengthened somewhat to more than R 1 = US$0.40, on average, in September, weakened again in the next two months, declining gradually to a low of R 1 = US$0.36 in early December. Much of the outflow is attributed to one-off adverse shifts in leads and lags in trade financing as foreign suppliers demanded cash payments from South Africa in the wake of the standstill. As the scope for these and other capital outflows began to diminish, the exchange rate of the commercial rand 1/ started to benefit from the effects of the continued surplus in the current account of the balance of payments. In late December 1985, the rand began to appreciate vis-à-vis all major currencies and, as the price of gold rose in January 1986, it tended to strengthen further. By the end of January the exchange rate of the rand vis-à-vis the U.S. dollar had risen to about R 1 = US$0.44, representing an appreciation of 18 percent relative to its average level against the dollar in December 1985, while the nominal effective exchange rate for the month of January 1986 was about 13 percent higher than in December 1985. Data for the real exchange rate index for January 1986 are not yet available. However, the real depreciation that had taken place in the three months to December 1985 is certain to have been more than fully reversed since then, given the significant appreciation of the rand in nominal effective terms and South Africa's continued poor price performance. In the 12 months to December 1985, the rate of consumer price inflation accelerated to 18 1/2 percent, from 16 1/2 percent in the year to September 1985, and was well above the average in trading partner countries.

South Africa's external current account is estimated to have shown a surplus of some US$3 billion (well over 5 percent of GDP) in 1985. The net capital outflow in the first nine months of 1985 amounted to about US$2 1/2 billion, compared with an outflow of only US$13 million in 1984 as a whole, and is estimated to have remained significant (about US$1 billion) in the fourth quarter of 1985. At the end of December 1985, South Africa's holdings of foreign exchange stood at US$314 million; its physical holdings of gold--which had fallen by about 30 percent during the 11 months to November 1985 largely on account of swaps of gold for foreign exchange--fell by a further 7 1/2 percent during December to 4.84 million ounces (US$1.4 billion at market-related prices).

---

1/ Transactions involving the financial rand have not been large, and in a very thin market the financial rand has been trading at a discount on the commercial rate ranging from less than 10 percent to nearly 40 percent. In late January 1986, the discount was 23 percent.

On the economic policy side, the South African authorities have eased the firm monetary policy that they had been implementing since mid-1984 and have announced a number of budgetary measures to increase employment and stimulate domestic demand. 1/ Interest rates have declined steeply, with the 90-day bankers' acceptance rate, for example, falling by 9 1/2 percentage points to 12 3/4 percent between early May 1985 and late January 1986. Although this reflected in part the weakness of activity--real GDP declined by about 0.5 percent in 1985--the monetary authorities have actively encouraged the downward movement in interest rates by lowering the official rediscount rate in several steps from 21.75 percent in early May 1985 to 12 percent in mid-January 1986. Government revenue and expenditure in the first nine months of the fiscal year ending March 1986 (i.e., April-December 1985) were 23 percent and 21 percent, respectively, higher than in the corresponding period of the preceding fiscal year and well above the annual increases of 18 3/4 percent and 13 1/2 percent provided for in the budget for 1985/86. As a result, the budget deficit in the current fiscal year is likely to be equivalent to about 3 1/2 percent of GDP, compared with a little over 3 percent of GDP in 1984/85.

1/ These programs are being financed partly with the proceeds of a new import surcharge of 10 percent, applicable on all goods not subject to GATT bindings, i.e., about 50 percent of South Africa's imports.

South Africa: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

| | Real Effective Exchange Rate 1/ 2/ | Nominal Effective Exchange Rate 1/ | Relative Consumer Prices (Local Currencies) | Exchange Rate in Terms of U.S. Dollars 1/ | Consumer Price Index (Seasonally Adjusted) | Consumer Price Index (Not Seasonally Adjusted) |
|---|---|---|---|---|---|---|
| Quarterly | | | | | | |
| 1981 | | | | | | |
| I | 109.5 | 107.1 | 102.3 | 101.0 | 109.7 | 109.4 |
| II | 107.8 | 105.7 | 102.0 | 92.9 | 112.4 | 112.1 |
| III | 103.5 | 100.1 | 103.5 | 82.8 | 117.3 | 117.7 |
| IV | 98.9 | 94.6 | 104.5 | 80.8 | 121.4 | 121.6 |
| 1982 | | | | | | |
| I | 101.1 | 95.6 | 105.8 | 78.7 | 125.4 | 125.1 |
| II | 97.9 | 90.8 | 107.9 | 72.3 | 130.6 | 130.4 |
| III | 96.3 | 89.0 | 108.2 | 67.7 | 134.0 | 134.3 |
| IV | 102..4 | 93.0 | 110.1 | 69.0 | 138.7 | 138.8 |
| 1983 | | | | | | |
| I | 107.8 | 96.2 | 112.1 | 71.8 | 143.3 | 143.0 |
| II | 111.2 | 98.7 | 112.7 | 71.5 | 146.8 | 146.8 |
| III | 113.8 | 101.1 | 112.6 | 70.2 | 149.8 | 150.1 |
| IV | 109.6 | 97.2 | 112.8 | 66.3 | 153.7 | 153.6 |
| 1984 | | | | | | |
| I | 106.7 | 94.1 | 113.5 | 63.1 | 158.0 | 157.5 |
| II | 106.2 | 92.4 | 115.0 | 61.0 | 163.0 | 163.3 |
| III | 92.8 | 79.8 | 116.3 | 49.5 | 168.1 | 168.3 |
| IV | 84.6 | 72.0 | 117.6 | 42.8 | 173.7 | 173.6 |
| 1985 | | | | | | |
| I | 82.2 | 68.4 | 120.2 | 38.2 | 181.6 | 181.2 |
| II | 84.2 | 68.8 | 122.4 | 39.6 | 189.1 | 189.6 |
| III | 72.1 | 57.8 | 124.8 | 34.8 | 195.6 | 195.7 |
| IV | 59.3 | 46.2 | 128.3 | 29.4 | 204.1 | 203.8 |
| Monthly | | | | | | |
| 1985 | | | | | | |
| Sept. 3/ | 65.5 | 52.1 | 125.8 | 31.3 | 197.8 | 198.0 |
| Oct. | 60.4 | 47.7 | 126.8 | 30.0 | 200.5 | 200.8 |
| Nov. | 58.7 | 45.9 | 128.0 | 29.3 | 203.5 | 203.3 |
| Dec. | 58.6 | 45.1 | 130.1 | 29.0 | 208.2 | 207.4 |
| Percentage change | | | | | | |
| Sept 1985-Dec. 1985 | -10.4 | -13.4 | 3.5 | -7.1 | 5.3 | |

Source: Information Notice System.

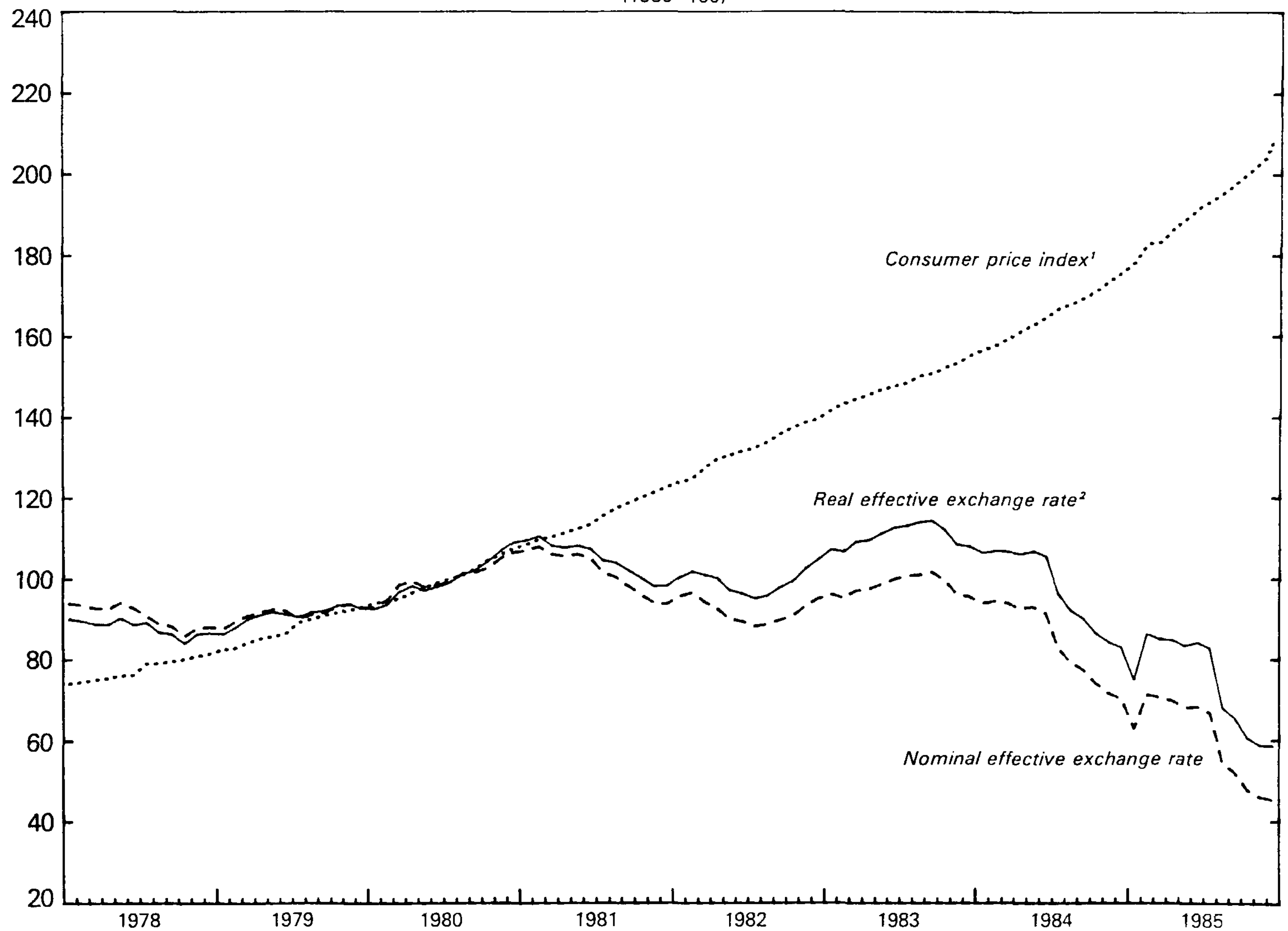
1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

CHART

SOUTH AFRICA

# INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE

(1980=100)




Source: Information Notice System.

[1]Seasonally adjusted.

[2]Trade weighted index of nominal effective exchange rate deflated by seasonally adjusted consumer prices; increase means appreciation.