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CONFIDENTIAL

March 28, 1985

To: Members of the Executive Board

From: The Acting Secretary

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

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

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

Att: (1)

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 other departments)

Approved by L. A. Whittome and J. T. Boorman

March 27, 1985

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 January 1985 the South African rand has depreciated in real effective terms by more than 10 percent since the last occasion on which South Africa's exchange rate developments were brought to the attention of the Executive Board--an information notice in October 1984. The depreciation is estimated to have amounted to 13.0 percent. 1/

Since the issuance of the last information notice, which covered exchange rate developments up to August 1984, the South African rand has continued to be under downward pressure in foreign exchange markets. As mentioned in that information notice, in August 1984 the authorities raised interest rates to record high levels, both in nominal and in real terms, tightened the terms of hire purchase transactions, and made an effort to avoid further overspending by government departments. These measures, in combination with earlier sizable increases in direct and indirect taxation and worsening business and consumer confidence, brought to an end the vigorous expansion of real domestic demand that South Africa had experienced from mid-1983 to mid-1984, which itself had been an important source of pressure on the exchange rate of the rand. In response, real GDP declined, unemployment began to rise, and the external current account strengthened, moving back into surplus in the last quarter of 1984.

Even so, the exchange rate of the rand continued to weaken. As the U.S. dollar continued to strengthen in the foreign exchange markets, the average price of gold--South Africa's most important foreign exchange

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1/ The South African authorities do not maintain margins in respect of exchange transactions. A dual exchange rate system, under which the "financial" rand was traded at a freely determined exchange rate (usually at a discount over the "commercial" rate), was unified as of February 7, 1983. A further deregulation of the foreign exchange market came into effect on September 5, 1983, establishing a system of managed floating.

earner--fell further (by over US$46 per fine ounce to about US$302 between August 1984 and January 1985). The effect of this development on expectations, together with the acceleration of inflation in South Africa reflecting inter alia the persistence of excess liquidity conditions, triggered large outflows of short-term capital in the form of leads and lags. This speculative outflow of capital and the downward pressure on the rand were very strong in late 1984 and the first three weeks of January 1985.

Between August 1984 and January 1985, the rand depreciated by over 27 percent vis-à-vis the U.S. dollar, reaching a low of about R 1 = US$0.42 on January 21, 1985 and averaging R 1 = US$0.46 in the month of January. It also lost ground against all other major currencies over the five months to January 1985, falling by over 23 1/2 percent against the Japanese yen, by 20 percent against the deutsche mark, and by 15 1/4 percent against sterling. During the same period, the year-on-year rate of increase of the consumer price index accelerated from 11 3/4 percent to 14 percent. All told, between September 1983--when the rand reached its most recent high--and January 1985, the real effective depreciation of the rand amounted to 34 percent, more than offsetting the real appreciation of 17 percent that had occurred in the year to September 1983.

Since the latter part of January 1985, the rand has staged a modest recovery and its value vis-à-vis the U.S. dollar has been fluctuating around R 1 = US$0.50. The strengthing of the rand in recent weeks reflects to an extent a perception by the market participants that its earlier fall may have been excessive and the realization that the outlook for the current account of the balance of payments had improved materially, in part as a result of the success of the August 1984 measures in curbing domestic demand. The rand was further supported by the introduction on January 30, 1985 of supplementary measures to alleviate pressures on the spot exchange rate, including a tightening of the Reserve Bank's arrangements for accommodation to the banks.

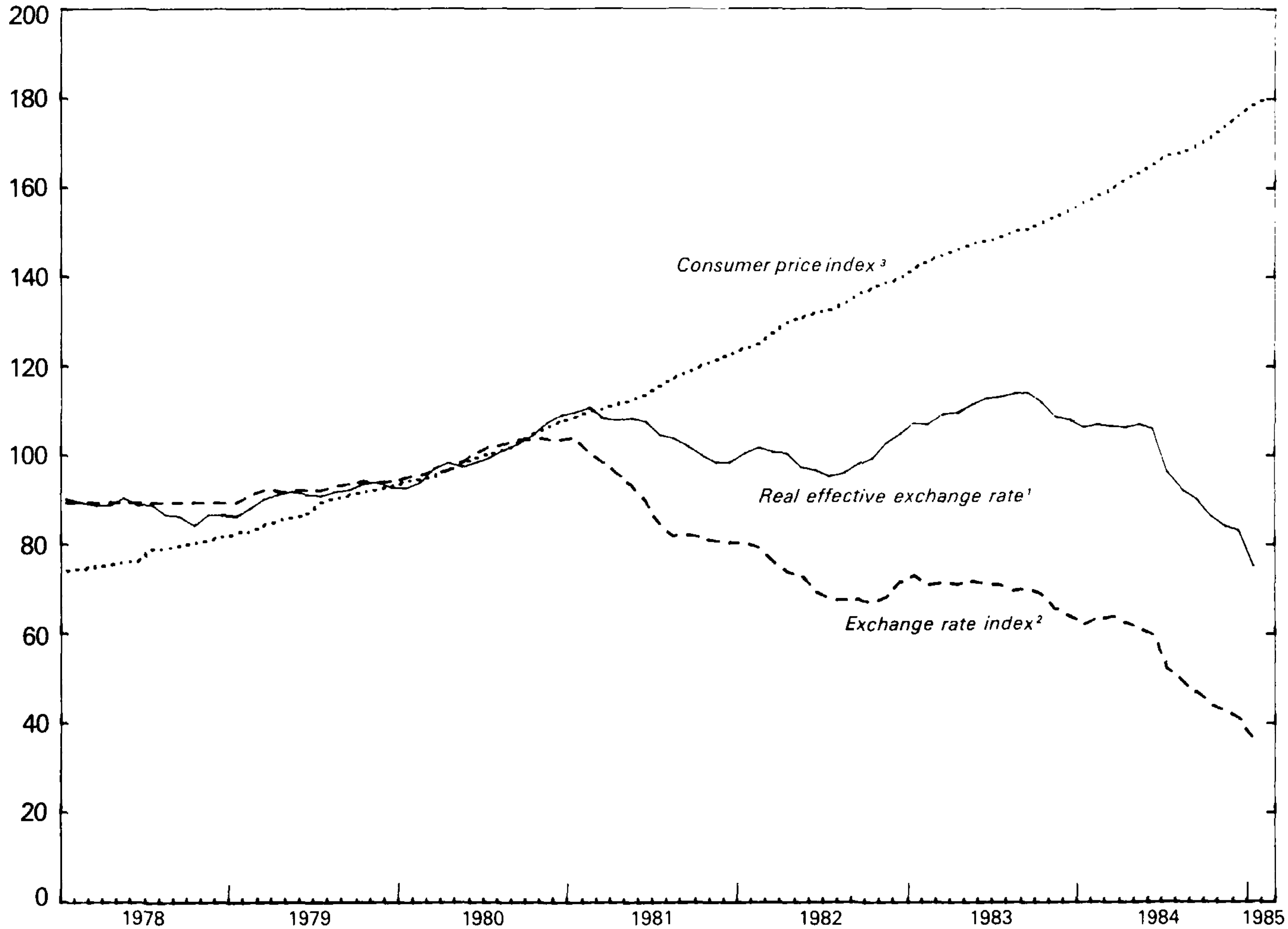
Article IV consultation discussions were recently held in South Africa. The staff report for the consultation, which is expected to be circulated to the Board by the end of April 1985, will include a detailed review of recent developments in the exchange rate of the rand and an appraisal of their policy implications.

CHART

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.
[3] Seasonally adjusted. The figures for December 1984 and January 1985 are staff estimates.

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

(Indexes: 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						
1979						
I	88.2	89.4	98.7	90.9	83.3	83.0
II	91.4	92.1	99.2	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	94.4	95.4	98.9	95.5	94.6	94.4
II	97.8	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	107.1	102.3	101.0	109.7	109.4
II	107.8	105.7	102.0	92.9	112.5	112.1
III	103.6	100.1	103.5	82.8	117.3	117.7
IV	98.8	94.6	104.5	80.8	121.3	121.6
1982						
I	101.1	95.6	105.8	78.7	125.3	125.1
II	98.0	90.8	108.0	72.3	130.7	130.4
III	96.3	89.0	108.2	67.7	134.0	134.3
IV	102.3	93.0	110.0	69.0	138.5	138.8
1983						
I	107.7	96.2	112.0	71.8	143.4	143.0
II	111.3	98.7	112.8	71.5	147.1	146.8
III	113.8	101.1	112.6	70.2	149.8	150.1
IV	109.5	97.2	112.7	66.3	153.4	153.7
1984						
I	106.6	94.1	113.4	63.1	157.9	157.5
II	106.4	92.4	115.2	61.0	163.5	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	173.9
Monthly						
1984						
Oct. 3/	86.3	74.0	116.6	44.1	171.2	171.9
Nov.	84.3	71.6	117.6	43.2	173.8	173.9
Dec.	83.0	70.3	118.1	41.2	175.8	175.5
1985						
Jan.	75.0	63.0	119.0	36.1	178.2	177.1
Percentage change						
Oct. 1984–Jan. 1985	-13.0	-14.8	2.2	-18.2	4.2	3.1

Source: Information Notice System.

1/ Increase means appreciation.
2/ Using seasonally adjusted consumer price indexes.
3/ Date of latest consideration by Executive Board.