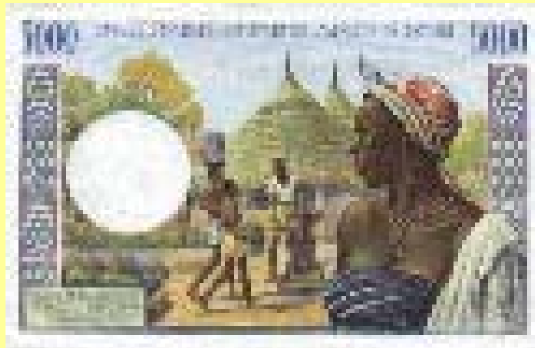
NQF Level: 4 **US No: 7468**

Assessment Guide

Primary Agriculture

Investigate and monitor the financial aspects of issues.



Assessor: . . . .

Workplace / Company: . . . .

Commodity: . . . . Date: . . . .

The availability of this product is due to the financial support of the National Department of Agriculture and the AgriSETA.

agriculture
Department: Agriculture
REPUBLIC OF SOUTH AFRICA

AgriSETA

Before we start…

This assessment guide contains all necessary activities and instructions that will enable the assessor and learner to gather evidence of the learner's competence as required by the unit standard. This guide was designed to be used by a trained and accredited assessor whom is registered to assess this specific unit standard as per the requirements of the AgriSETA ETQA.

Prior to the delivery of the program the facilitator and assessor must familiarise themselves with content of this guide, as well as the content of the relevant Learner Workbook.

Please Note:

This Unit Standard **7468** Assessment Guide must be read in conjunction with the generic Assessor Guide as prescribed and published by the AgriSETA.

The assessor, facilitator and learner must plan the assessment process together, in order to offer the learner the maximum support, and the opportunity to reflect competence.

The policies and procedures that are required during the application of this assessment are available on the website of the AgriSETA and should be strictly adhered to. The assessor must familiarise him/herself with this document before proceeding.

This guide provides step-by-step instructions for the assessment process of:

Title:	Use mathematics to investigate and monitor the financial aspects of personal, business, national and international issues.				
US No:	***7468***	**NQF Level:**	4	**Credits:**	2

T
his unit standard is one of the building blocks in the qualification listed below. Please mark the qualification you are currently assessing, because that will be determined by the context of application:

Title	ID Number	NQF Level	Credits	Mark
National Certificate in Animal Production	48979	4	120	❒
National Certificate in Plant Production	49009	4	120	❒

Please mark the learning program you are enrolled in:

Are you enrolled in a:	Y	N
Learnership?	❒	❒
Skills Program?	❒	❒
Short Course?	❒	❒

Note to Assessor:

If you are assessing this module as part of a full qualification or learnership, please ensure that you have familiarized yourself with the content of the qualification.

Activity Answers

1

SO 1

Instructions to learner:

Answer the following questions

Learner Guide: Page 14 Facilitator Guide: Page 11

a. Define a budget. (3)

Model Answer(s):
A budget is a financial or quantitative statement, prepared in advance of a period of time, reflecting the agreed policies and strategies necessary to meet objectives.

b. What are the steps to be followed for company budgetary control? (8)

Model Answer(s):

1. *Definition of objectives*
2. *Allocation of responsibilities for achievement of objectives*
3. *Statement of policies and strategies necessary to achieve the objectives*
4. *Budget preparation – calculation of likely results*
5. *Budget approval*
6. *Implementation of policies and strategies*
7. *Measurement of progress – actual performance versus budget*
8. *Revision of policy to reflect actual conditions and new circumstances.*

c. Why is it advisable to start with a sales-, then a production- and then a capital expenditure forecast in the budgeting process? (3)

Model Answer(s):
A sales budget indicates how much money will be coming into the business. When you know this amount you can then plan how much product to manufacture as well as what equipment you will need to buy to produce the product.

d. What is the difference between assurance and insurance? (2)

Model Answer(s):
Assurance
A term interchangeable with insurance, but generally used in connection with life business as assurance implies the certainty of an event and insurance the probability. The term "assurance" is used more commonly in the in Great Britain and South Africa. Assurance (insurance) is a contract whereby one party, the assurer/insurer, in return for a consideration, called the premium, agrees to pay to the other party, called the assured/insured, a sum of money or its equivalent in kind upon the happening of a specified event that is contrary to the interest of the insured. More simply, assurance is a contract to pay a specified amount on the happening of a specified event.
Insurance
A contract whereby one party, the insurer, in return for a consideration, the premium, undertakes to pay the other party, the insured, a sum of money or its equivalent in kind upon the happening of a specified event that is contrary to the interest of the insured (contingency). A means whereby the losses of the 'few' are distributed among the 'many'.

e. What is an annuity? (2)

Model Answer(s):

An annuity is a contract that provides a regular payment – typically monthly – during the lifetime of the annuitant – or a fixed period if less. If the payments start at the outset of the contract, it is an immediate annuity. If they start at some point in the future, it is a deferred annuity. The annuity can be on more than one life and the amount payable may increase.

f. What is a bond? (2)

Model Answer(s):

Also known as Gilts. An investment usually issued by the government, which offer fixed half-yearly payments for a specific number of years, and a predetermined capital payment at the end of that period. Bonds are bought and sold in the bond market. Bond prices vary with the interest rate.

g. What is inflation? (2)

Model Answer(s):

Inflation is the average rate at which prices (of products and services) increase over time. It gradually reduces the value of money for example, a loaf of bread, which cost 50c ten years ago, today costs R3. Increase in the general price level of goods and services generally measured by the consumer price index CPIX.

My Notes ...

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Activity Answers

2

SO 2

Instructions to learner:

Calculate

Learner Guide: Page 20 Facilitator Guide: Page 13

Calculate the (i) interest and (ii) the final amount for each of the principals for the stated simple interest rate and time period:

a. R500; 7%; 1 year (1)

Model Answer(s):

Information	*Calculation*
I = ? *P = R500* *r = 7% = 7/100 = 0,07* *n = 1 yr*	*I = Prn* *= 500 x 0,07 x 1* *= R35* *A = P + I* *= R500 + R35* *= R535*

b. R500; 24%; 3 months (1)

Model Answer(s):

Information	*Calculation*
I = ? *P = R500* *r = 24% per year = 0,24* *n = 3 months = ¼ year*	*I = Prn* *= R500 x 0,24 x ¼* *= R30* *A = P + I* *= R500 + R30* *= R530_*

c. R1000; 8%; 1 year (1)

Model Answer(s):

Information	*Calculation*
I = ? *P = R1000* *r = 8% = 0,08* *n = 1yr*	*I = Prn_* *= 1000 x 0,08 x 1_* *= R80* *A = P + I_* *= R1000 + R80_* *= R1080*

d. R200; 12%, 18 months (1)

Model Answer(s):

Information	*Calculation*
I = ? *P = R200* *r = 12% = 0,12* *n = 18 months = 1,5 years*	*I = Prn* *= 200 x 0,12 x 1,5* *= R36* *A = P+I* *= R200 + R36* *= R236*

e. How many months will it take until the interest on R900 at 12% will be R135? (2)

Model Answer(s):

Information	*Calculation*
I = R135 *P = R900* *r = 12% = 0,12* *n = ?*	*I = Prn* *n = I ÷Pr* *n = R135 ÷(900 x 0,12)* *= 1¼ years* *= 15 months*

f. A credit card holder has owed the credit card company R200 for a month and receives an account containing an interest charge of R3. Find the interest rate. (3)

Model Answer(s):

Information	*Calculation*
I = ________________________ *P =* ________________________ *r =* ________________________ *n =* ________________________	*Assume that none of the principal will be paid back. Over 1 year R36 will have been paid back.* *Interest rate = 36/200 = 18%*

g. Find the future value at the stated nominal interest rate compounded annually (once a year).

i. R200; 20 years; 5% (2)

Model Answer(s):

Information	*Calculation*
A = ? *P = R200* *r = 5% = 0,05* *n = 20 years*	$A = P(1+r)^n$ $= P(1+0,05)^{20}$ $= 200(1,05)^{20}$ *= R530.66*

ii. R300; 10 years; 6% (2)

Model Answer(s):

Information	*Calculation*
$A = ?$ $P = R300$ $r = 6\% = 0,06$ $n = 10$ years	$A = P(1+r)^n$ $= 300\ (1+0,06)^{10}$ $= 300\ (1,06)^{10}$ $= R537.25$

iii. How many years will it take at 7% compounded annually for R5000 to amount to R20000? (2)

Model Answer(s):

Information	*Calculation*
$A = R20\ 000$ $P = R5\ 000$ $r = 7\% = 0,07$ $n = ?$	$A = P(1 + r)^n$ $20000 = 5000(1 + 0.07)^n$ $4 = 1.07^n$ $n = 20.49$ years

iv. How many years will it take for a sum of money to double at 10% compounded annually? (Hint: let P = x. Then A = <u>2x</u>) (3)

Model Answer(s):

Information	*Calculation*
$A = 2x$ $P = x$ $r = 10\% = 0,1$ $n = ?$	$A = P(1 + r)^n$ $2x = x(1 + 0.1)^n$ $2 = 1.1^n$ $n = 7.273$ years

v. Find the rate of interest compounded annually at which a sum of money will double in 20 years. (3)

Model Answer(s):

Information	*Calculation*
$A = 2x$ $P = x$ $r = ?$ $n = 20$ years	$A = P(1 + r)^n$ $2x = x(1 + r)^{20}$ $2 = (1 + r)^{20}$ $r = 3.526\%$

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Activity Answers

3

SO 2

Instructions to learner:

Find the value

Learner Guide: Page 28 **Facilitator Guide: Page 13**

Find the present value of the following ordinary annuities:

a. R400 every 3 months for 5 years at 8% compounded quarterly (3)

Model Answer(s):

Information	***Calculation***
F = ______ *r* = ______ *n* = ______ ______ *R* = ______	$F = R\left[\frac{(1+r)^n - 1}{r}\right]$ $F = 400\ \frac{(1+.02)^{20} - 1}{0.02}$ $= 400(24.29736982)$ $= R9718.95$

b. R1000 per month for 3 years at 12% compounded monthly. (3)

Model Answer(s):

Information	***Calculation***
F = ______ *r* = ______ *n* = ______ ______ *R* = ______	$F = R\left[\frac{(1+r)^n - 1}{r}\right]$ $F = 1000\ \frac{(1+.01)^{36} - 1}{0.01}$ $= 1000(43.07687836)$ $= R\ 43\ 076.88$

c. R1000 every year for 40 years at 6% compounded annually. (3)

Model Answer(s):

Information	***Calculation***
F = ______ *r* = ______ ______ *n* = ______ ______ *R* = ______	$F = R\left[\frac{(1+r)^n - 1}{r}\right]$ $F = 1000\ \frac{(1+.06)^{40} - 1}{0.06}$ $= 1000(154.7619656)$ $= R\ 154\ 761.97$

My Notes ...

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Activity Answers

4

SO 2

Instructions to learner:

Find the amount

Learner Guide: Page 30 Facilitator Guide: Page 13

a. Lerato successfully completed her studies and found a job as a IT technician. She wanted to buy new Chevrolet Aveo. She needed to obtain financing from the bank to the value of R90 000 to buy the vehicle. The monthly compounded interest rate is 12%. She will amortize the loan by monthly payments over a period of 4 years.

i. Find the amount of each payment. (2)

Model Answer(s):

Information	*Calculation*
F = ______ r = ______ n = ______ ______ R = ______	$R = P\left[\frac{r}{1-(1+r)^{-n}}\right]$ $R = 90{,}000\left[\frac{0.12/12}{1-(1+.12/12)^{-48}}\right]$ $= 90{,}000(0.026333835)$ $= R2370.05$

ii. Find the total amount that Lerato will pay. (2)

Model Answer(s):

*Total amount = 2370.05 * 48 = R113762.17*

b. A R370, 000 townhouse is to be purchased by paying R100,000 in cash and a R270,000 mortgage for 20 years at 12 percent compounded monthly.

a. Find the monthly payment on the mortgage.

Model Answer(s):

Information	*Calculation*
F = ______ r = ______ n = ______ ______ R = ______	$R = P\left[\frac{r}{1-(1+r)^{-n}}\right]$ $R = 370{,}000\left[\frac{0.12/12}{1-(1+.12/12)^{-240}}\right]$ $= 370{,}000(0.011010861)$ $= R4074.02$

b. What will be the total amount of interest paid?

Model Answer(s):
*Total amount = 4074.02 * 240 = 977764.80*
Interest paid = 977764.80 - 370 000 = 607764.80

c. How much should be deposited in a sinking fund at the end of each quarter for 4 years to accumulate R40, 000 if the fund earns 6% compounded quarterly?

Model Answer(s):

Information	***Calculation***
F = ______ r = ______ n = ______ ______ R = ______	$R = F\left[\frac{r}{(1+r)^n - 1}\right]$ $R = 40000\left[\frac{0.015}{(1+0.015)^{16} - 1}\right]$ $= 40,000(0.055765078)$ $= R\ 2230.60$

My Notes ...

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Activity Answers

5

SO 2

Instructions to learner:

Calculate

Learner Guide: Page 33 Facilitator Guide: Page 13

You decided to speculate in white maize and on 1 June 2004 and bought one white maize futures contract. On that date the following information was applicable:

White maize price (per ton) = R890

Futures trading date = 1June 2004

Futures trading date = 1 November 2004

Short-term rate (cost of borrowing) = 14% p.a.

Contract size = 1 ton of white maize

Calculate the fair value (theoretical price) of the white maize futures contract.

Model Answer(s):

FVF = R890 (1 + 0,14)$^{153/365}$ = R940.25

My Notes ...

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Activity Answers

6

SO 4

Instructions to learner:

Read and answer

Learner Guide: Page 58 **Facilitator Guide: Page 15**

Read the following article:

2004-11-18: MONETARY POLICY AND INFLATION: THE NEXT DECADE, Address by Mr TT Mboweni, Governor of the South African Reserve Bank at the Conference of the Bureau for Economic Research, Stellenbosch, 18 November 2004

1. Introduction

Chairperson, ladies and gentleman, I have been asked to share my views with you today on what will happen with monetary policy in the next ten years. Looking into the future is always a hazardous undertaking. It requires a careful analysis of what has changed already and what likely changes will occur in the coming years. Such an analysis cannot only concentrate on what has happened in South Africa, but must also take into account the structural changes in the rest of the world and how these developments could perhaps affect South Africa. This is indeed a formidable task. In the next thirty minutes I will do my best to give you my view on these matters.

2. Structural changes in the world's financial sector

World War I and the great depression of the 1930's left the world with highly regulated capital markets and a disintegrated international financial system. The highest priority was therefore attached to restoring multilateral payments and current account convertibility towards the end of World War II, which led to the Bretton Woods Agreement and the General Agreement on Tariffs and Trade. In the period after the war, the emphasis shifted to the liberalisation of trade and payments. Progress with these reforms was relatively slow and at first concentrated on the currency convertibility of current account transactions. In the 1980's the authorities of the industrialised countries began liberalising financial systems, which were later followed by a number of emerging-market economies. The convertibility of the capital account of the balance of payments gained further momentum with the negotiations in the World Trade Organisation to liberalise transactions in financial services.

This financial liberalisation was accompanied by a process of globalisation, i.e. a growing economic interdependence of countries became discernible through the increasing volume and variety of cross-border transactions and through the rapid and widespread diffusion off technology. New technological advances reduced transportation, telecommunication and computation costs, thus greatly increasing the ease with which national markets may be integrated at the global level.

The liberalisation and globalisation resulted in a growing interdependence of national financial markets. Although these markets still do not form a single global market, the degree of interdependence is already strong enough to have altered the environment in which monetary policy is conducted. In particular, it has affected the volume of international financial transactions. International transactions in goods

and services have become considerably less important than financial transactions. The closely linked financial markets have changed the monetary transmission mechanism, and shocks that occur in one country can easily have an impact on other countries.

As a transition phase of or perhaps as an alternative to globalisation, considerable emphasis has been placed on closer international co-operation, convergence and integration since the end of World War II. Many regional economic co-operation arrangements have been formed or are under consideration. The aim of these regional arrangements is to free international trade and financial transactions between a group of countries. But many of them also want to encourage the movement of labour across domestic frontiers and the eventual attainment of political unions. The establishment of the European Union is, of course, the best example in this regard. This regional arrangement has created the largest government bond market in the world and led to the development of the euro into a major international currency.

Another important structural change in the world's financial market has been the achievement of greater price stability. Over the past twenty years the rate of inflation has declined dramatically in most countries of the world. The disinflation process was at first mainly concentrated in the industrialised countries. According to the International Monetary Fund the average annual inflation rate in the major advanced countries already started to decline from the early 1980s from 12,3 per cent in 1980 to 1,7 per cent in 2003. By contrast, the average inflation in emerging-market and developing countries continued to increase from 25,0 per cent in 1980 to 107,7 per cent in 1992, before declining sharply to 6,1 per cent in 2003. These developments brought the average rate of inflation in the world as a whole down to only 3,7 per cent in 2003.

This disinflation process has been so strong that some countries even experienced declines in their average price indices. Consumer prices have actually been declining in Japan and Hong Kong for quite a while, while some other countries such as China recorded decreases for a short period. As could be expected, disinflation to low positive values has been accompanied by a corresponding decrease in short-term interest rates to low levels.

Finally the financial sector, just like all other activities in the world, has been severely influenced by the revolution experienced in information technology and telecommunication. In central banking the advances made in information technology and telecommunication have particularly led to a more efficient payment system catering for real-time gross interbank settlement. New developments in commercial banking include automated teller machines, credit and debit cards, telephone and inter-net banking, intelligent cards and card reading devices. In the 1990s a further advance in technology made it possible to store monetary value on a silicon chip embedded in a plastic card or in a personal computer. This was the first step in the development of electronic money or e-money. Initially it was believed that this development would lead to a quick and dramatic change in the way that payments are made. Such a change would have required large investments in infrastructure and the general acceptance of this new payments method by the public. It is thus

not surprising that it did not take off in the way predicted by some analysts. However, initial setbacks to new innovations are a common experience and it is quite possible that the public could eventually be more willing to accept this new innovation.

3. Effects on South Africa's financial structure

These changes in the rest of the world did not affect South Africa's financial sector to any great extent during the 1980s, i.e. in a period in which the country became increasingly isolated from the rest of the world as a result of trade boycotts, embargoes and financial sanctions. The subsequent transition to a new political dispensation and the normalisation of the country's international relations completely changed this situation. These circumstances forced the South African financial sector to move from a relatively isolated position to a world that had changed in many ways from the time when our financial institutions were still actively involved internationally.

To cope with the challenges faced in this new environment it was important to improve the functioning of the domestic financial markets and to reintegrate them in the world economy in an orderly way. Great efforts were accordingly made to bring the rules and regulations applying to financial institutions in line with international norms and standards. The re-entry of South Africa in an integrated financial community also made it important to reconsider the strict exchange control rules applicable at that time. The country's limited foreign exchange reserves prevented the immediate removal of all exchange control measures, which caused the authorities to opt for a policy of a gradual relaxation of capital account transactions.

From 1994 South African financial institutions started operating on an increasing scale in major international financial centres and opened branches or subsidiaries in other African countries. At the same time foreign financial institutions were encouraged to conduct business in South Africa by the creation of a level playing field between local and foreign service providers. In addition, the regulatory authorities actively encouraged the development of appropriate clearing, settlement, ownership-transfer and market information systems, and proper intra-market and cross-market risk management systems.

This restructuring led to a sharp increase in the involvement of foreign banks and other non-residents in domestic financial markets. In particular their transactions on the Bond Exchange and the Johannesburg Stock Exchange increased considerably. This participation of non-residents contributed to the increase in the turnover of these two markets. It also caused more volatility in long-term interest rates because investors quickly altered their positions with changes in domestic and international conditions, while prices on the Johannesburg Stock Exchange became even more susceptible to changes in the prices on the stock exchanges of major financial centres.

Moreover, the normalisation of relations with the rest of the world led to a turnaround in the international financial flows of South Africa from a net outflow of about R45 billion in the period from 1985 to 1993 to a net inflow of nearly R204 billion since 1994. At the same time the volatility in these financial flows increased.

Although the country generally experienced an inflow of capital from the rest of the world, the magnitude of these inflows varied considerably from year to year. For example, a net financial inflow of about R29 billion in 1998 was followed by inflows of just more than R7 billion in each of the next two years, before these inflows increased again to about R30 billion in 2002 and R63 billion in 2003.

Most emerging-market economies now seem to experience large and volatile capital movements. Despite considerable efforts to make South Africa a more investor-friendly country, it can safely be assumed that fluctuations in capital movements will continue to be a feature of our economy in the future. This volatility will not only be influenced by domestic developments, but also by events in the rest of the world.

The volatile capital movements brought about large swings in the exchange rate of the rand not only against individual currencies but also on a trade weighted basis. For instance, in 2000 and 2001 the nominal effective exchange rate of the rand declined by 13 percent and 39 per cent, respectively, before it increased again by 24 per cent in 2002 and by 44 per cent in 2003. These fluctuations have complicated the implementation of monetary policy. In particular, monetary policy was dominated in 2002 by inflationary pressures arising from the substantial depreciation in the external value of the rand in late 2001, combined with a sharp rise in international oil prices as well as in domestic food prices. These external shocks were responsible for a surge in the twelve-month rate of increase in the CPIX from a low of 5,8 per cent in September 2001 to a peak of 11,3 per cent in October 2002. Subsequently, the appreciation of the rand from the beginning of 2002 again had to be carefully taken into consideration in the formulation of monetary policy.

The fluctuations in the exchange rate of the rand clearly illustrated the need for structural adjustments in the foreign exchange market in South Africa. The Reserve Bank accordingly concentrated on eliminating its negative net open foreign reserve position and its oversold forward book. With the success achieved with these objectives, the focus of the Bank has now shifted to a gradual strengthening of the official foreign exchange reserves. Since the end of 2002 the official foreign exchange reserves of the country have increased from US$7,6 billion to US$13,0 billion at the end of October 2004. The higher foreign exchange holdings should help to stabilise the external value of the rand.

4. Implications for monetary policy

Taking these changes in the world and more specifically in South Africa into consideration, we now come to the crucial question on how will monetary policy be affected or what will happen to monetary policy in the next ten years. More in particular I want to concentrate on three questions in this regard, namely:

(1) Will monetary policy still be effective?
(2) What should the primary objective of monetary policy be?
(3) What monetary policy framework should be applied?

4.1 The effectiveness of monetary policy

As in the rest of the world, e-money has not really taken off in South Africa. Although several potential products have been evaluated by the Reserve Bank, no

roll-out on a significant basis has yet occurred. The failure of e-money to meet expectations can possibly be ascribed to the fact that cash remains a trusted and very convenient payment mechanism, debit and credit cards are widely used and e-money products generally do not allow for person-to-person payments. However, it is conceivable that this could change in the future and that e-money could to an increasing extent become a substitute for banknotes and coin. As Benjamin M. Friedman (1999) has pointed out it is possible, albeit at present highly unlikely, that e-money could be used as a means of payment as well as settlement and therefore erode the role of currency and reduce banknotes and coin in circulation.

Friedman also stated that the size of base money (currency in circulation plus the balances of banks at the central bank) could decline in future because of the declining role of banks in advancing credit to the non-bank private sector. If bank credit extension to the private sector decreases, less deposits are created. The reserves that banks are required to hold at the central bank are then smaller, which reduces base money.

Securitisation and the liberalisation and globalisation of South Africa's financial markets have led to a declining role of banks in the advancement of credit to the non-bank private sector. As already indicated, South African organisations are now more easily able to obtain financing from abroad than they were before 1994. Many private sector companies have also started to make increasing use of the bond market to raise funds for development purposes. Although this disintermediation has not led to a decline in reserve requirements of banks, it has affected the growth of base money.

Friedman further indicated that private bank clearing mechanisms could be developed that would further reduce base money. Mervyn King (1999) also pointed out that there is a possibility that the demand for settlement balances could eventually be eliminated by the development of electronic networks allowing payments to be settled without the involvement of the central bank.

These arguments led Friedman to the conclusion that the central bank in the future will become "an army with only a signal corps". Central banks will only be able to indicate to the private sector how they believe monetary conditions should develop, but will be unable to do anything about this if the private sector has a different view.

It nevertheless seems highly unlikely that the effectiveness of monetary policy will decline in South Africa in the next ten years because of the increased use of e-money, the liberalisation and globalisation of our financial markets or the development of private banking clearing mechanisms. At most these factors should only have a limited impact on the effectiveness of monetary policy. As Woodford (2000) stated, the effectiveness of monetary policy is not dependent "upon a mechanical connection between the monetary base and the volume of nominal spending, which is then presumably dependent upon a need to use base money as a means of payment". In fact, in South Africa the supply of money is endogenously determined. The repo rate is the operational variable of the Reserve Bank and this rate is not affected by the size of base money.

4.2 The primary objective of monetary policy

Having determined that monetary policy should remain effective in the coming ten years, what should the primary objective of monetary policy be in South Africa?

It is now generally accepted all over the world that the central bank's responsibility is to ensure price stability. As already indicated, considerable success has been achieved with the attainment of this objective and in the advanced countries of the world price stability has been maintained for a relatively long period. As a consequence, many of the central banks of these countries seem to have become less engrossed with combating inflation and have again moved somewhat in the direction of fine tuning economic growth. Many economists are of the opinion that this is the right approach. For example, in a recent article of Carl Walsh (2003) he states that modern central banks must "recognise that achieving and maintaining low inflation cannot be their only objective. Monetary policy has important short-run effects on real economic activity and there is, therefore, a role for monetary policy to play in conducting stabilisation policy". The danger of such an approach is, of course, that central banks could concentrate too much on expansionary policies at the cost of maintaining price stability.

Despite the fact that South Africa has only been able to maintain low inflation over a relatively short period, it can be argued that the Reserve Bank should now give more attention to the promotion of economic growth. It is true that short-term interest rates do have some affect on long-term interest rates which, in turn, is an important determinant of the growth in investment and production. However, it must be realised that reductions in short-term interest rates do not always lead to a reduction in the cost of capital. If it is generally expected that lower levels of short-term interest rates will lead to higher inflation, long-term interest rates are bound to rise. Monetary policy may therefore be less effective in having the desired impact on real economic activity over the short term than generally believed. At the same time it must be admitted that the actions of central banks do have some affect on the growth of domestic product over the short term.

Although monetary policy measures affect real economic activity over the short term, long-term economic growth can only be achieved if production capacity and productivity increases. Besides increases in employment, the expansion in production capacity requires additions to capital stock in the form of net fixed investment. Productivity refers to the efficiency with which labour, capital and other inputs are combined and used to produce goods and services of a specific quality in order to satisfy the needs of the market. Technological progress, improving the quality of the labour force and the more productive utilisation of resources are among the factors needed to increase productivity.

Monetary policy measures cannot directly influence the factors on which long-term economic growth depend. Monetary policy has the most control over changes in the overall price level and therefore on the long-run impact of inflation on economic growth. But it should at least not discourage and preferably rather encourage domestic saving, investment and the inflow of foreign capital to promote economic growth. Monetary policy should also not stand in the way of the optimal allocation of resources and the most efficient utilisation of these resources in business

enterprises, because this could lower the potential growth in output. All in all, monetary policy should therefore not add to the risks that normally confront private business or dampen technological innovations.

The South African Reserve Bank believes that the best way that monetary policy can contribute to the important objective of sustained economic growth is to achieve and maintain price stability. The maintenance of price stability should continue to be a major objective of monetary policy particularly now that we have achieved some success in bringing the inflation rate down within our inflation targets. If we are unable to do this, the credibility of monetary policy will be questioned, which could have a severe affect on the effectiveness of monetary policy measures in the future. As Carl Walsh (2003) has indicated "the three most important ingredients to a successful monetary policy are credibility, credibility and credibility".

There are many convincing arguments why price stability should be regarded as a prerequisite for sustainable economic growth. All modern market-orientated economies are based on the extensive use of money as a unit of account, as a means of exchange and as a store of value. Money that deteriorates in value all the time cannot fulfil these functions effectively. High inflation discourages savings and foreign investment, on which economic growth is highly dependent.

Not only is the supply of funds for investment reduced by high inflation, but the flow of existing saving to risk capital is distorted. The finance that do become available is invested in such a manner where they can provide the best protection against inflation, and not necessary where they could be the most productive and lead to employment creation. In the past when we experienced high inflation, large amounts of investment in South Africa were made in the construction of office blocks, shopping centres and expensive housing, which cannot be regarded as the most productive forms of investment and which probably lowered the growth potential of the economy. Inflation accordingly undermines the efficiency of the pricing system and does not lead to the optimum allocation of production resources.

4.3 The monetary policy framework

In the pursuit of price stability the South African Reserve Bank and the central banks in many other parts of the world have found that the inflation targeting monetary policy framework has proved to be highly effective. In particular, inflation targeting has led to a better co-ordination between monetary policy and other economic policies than with other monetary measures applied in the past. This is largely owing to the fact that the Government is responsible for the determination of the inflation target in South Africa in co-operation with the Reserve Bank. This target is therefore determined in a structured manner, and taking into consideration the other economic objectives of government. After the determination of the target it is the Reserve Bank's responsibility to see that it is achieved, i.e. the Reserve Bank has instrumental independence but not goal independence. It is therefore surprising that the Bank is sometimes criticised of being over obsessed with the attainment of the target at the detriment of economic growth. Since the target is established in a co-ordinated way, it should in theory form part of the government's objectives for economic growth and employment creation. Even more importantly, after the target has been established, it is the Reserve Bank's task to see that it is achieved.

Inflation targeting has the further advantage that it provides a nominal anchor to inflation expectations if monetary policy is perceived to be credible. This facilitates a reduction in inflation and should form the basis for future price and wage setting. It is a transparent policy framework, because the target is publicly announced. This announced target provides the basis of accountability of the central bank. This disciplines the actions of the central bank and leads to a better understanding among the public why monetary policy decisions are made.

In view of these advantages of inflation targeting in comparison with other monetary policy frameworks, there seem to be little reason to start applying a new framework. The authorities will accordingly continue to apply inflation targeting as the monetary policy framework of South Africa in the next ten years and at most probably only refine the system further to ensure that it continues to function efficiently.

5. Conclusion

My general conclusion is therefore that the recent major structural changes in the world and in South Africa will have little effect on the determination and implementation off monetary policy in the coming years. It is true that vast developments have taken place in information technology and telecommunication and that we could probably expect further significant changes in the next ten years which will have a major impact on our lives. The process of liberalisation, globalisation and integration is also bound to change our lives even further. It seems unlikely however, that these changes will affect the efficiency of monetary policy. In this expected changed world the South African Reserve Bank will continue in its quest for the achievement and maintenance of price stability by applying an inflation targeting monetary policy framework.

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Summarise the address of the Governor of the South African Reserve Bank made on 18 November 2004. (Min 1 A4, max 2 A4 pages.)

Model Answer(s):
The assessor must check the following:
Does the learner understand the concepts?
Did the learner use his/her own words for the summary?
Is the summary the correct length?

Activity Answers

7

SO 4

Instructions to learner:

Debate

Learner Guide: Page 66 **Facilitator Guide: Page 15**

You have to debate aspects of the national and global economy. There are a number of articles that were obtained from Reuters, Business Day, Sanlam, and Old Mutual on 19 November 2004. Use them to prepare for a debate. Record your notes of your preparation in the space provided at the end of the articles.

Resurgent oil jumps ahead of northern winter

By Neil Chatterjee (Reuters – 19 Nov 2004)

LONDON (Reuters) - Oil prices leaped more than a dollar on Friday on renewed concern over tight supplies of distillate fuels in Europe and the United States ahead of the northern hemisphere winter.

U.S. light, sweet crude gained $1.53 to $47.75 a barrel, stemming a decline that has dragged prices down $8 from record highs since late October. London IPE Brent jumped $1.48 or three percent to $44.20 a barrel.

Friday's jump renewed a rally that has added 45 percent to prices this year as rising world fuel demand strains supplies of refined products such as gasoline, diesel fuel and heating oil.

Dealers are concerned about the adequacy of heating oil inventories, which are significantly below last year's levels in the top markets of the United States, Germany and Japan. U.S. supplies are 16 percent less than year-ago figures.

London IPE gas oil, used as a basis to price distillates such as heating oil, added $23.25 or over five percent from the previous day's settlement to $447.00 a tonne.

Gas oil has gained $47 a tonne -- more than 11 percent -- in the last four trading sessions, dragging up refining profits and spurring physical oil buying to staunch a three and a half week slide on crude futures.

"It's because we've had such an explosive rise in heating oil prices -- I don't think we've ever seen such a dramatic increase in the spread between heating oil and crude," said Kevin Norrish of Barclays Capital.

The rally comes after prices plunged nearly 17 percent from record highs in late October, as signs of building crude supplies and slowing demand growth drove investors out of energy and into financial or equity markets.

WINTER WEATHER WORRIES

An early or severe winter could cause a price spike with household demand for heating. Continued mild weather, however, would give refiners more time to replenish stocks, providing a cushion against future cold snaps.

The U.S. National Oceanic and Atmospheric Administration said on Thursday in a revised forecast that winter would be likely to bring warmer-than-normal conditions in the West and colder temperatures in the East, including the heavy-consuming Northeast.

Demand for oil products on physical markets has been strong this week. Traders said China, the world's second-largest energy user, had boosted diesel imports to their highest levels since early 1999 to make sure supplies do not run short as in 2003.

Chinese oil importers have booked at least 450,000 tonnes of diesel for November -- more than four times October's estimated volume -- hoping to avoid the kind of supply crunch that forced hundreds of gas stations to ration sales a year ago.

Oversupply on crude markets has also focused attention on the OPEC producers cartel, which has been pumping near flat out at near 30 million barrels per day since the late summer.

Venezuelan Energy Minister Rafael Ramirez said late on Thursday his country would support a cut in oil production by oil cartel OPEC when the producers' group next meets on December 10.

The minister said OPEC member Iran had already made a proposal to cut production at the upcoming meeting. Some producing nations are concerned that a potential build-up in crude stocks over the next few months could depress oil prices.

On Thursday the OPEC cartel revised down its expectations of oil demand growth for next year and projected a rare big winter stockbuild if the group keeps producing at current levels.

Europe gold surges as dlr wanes on Greenspan

LONDON (Reuters) - Gold surged to its highest in more than 16 years for the sixth session in a row on Friday in Europe after comments by U.S. Federal Reserve Chairman Alan Greenspan reinforced the euro's rally against the dollar.

The dollar slumped across the board after Greenspan said appetite for dollar investments could eventually wane. A weaker U.S. currency makes dollar-priced gold cheaper for non-U.S. investors.

Spot gold surged to close in Europe at $446.75/447.50 -- its highest since July 1988 -- and up compared with $442.95/443.70 quoted late in New York on Thursday. The metal was fixed on Friday afternoon at $445.60.

"The dollar weakened again and gold took off just before the fix, mainly on fund buying," a dealer said.

Gold has now gained more than seven percent since the beginning of this year.

LIQUIDATION THREAT

Analysts said gold's bull run would probably continue while the dollar remained weak, but raised the possibility of a sell off due to high speculative exposure.

"The dollar is looking really, really weak and with all the comments that we've seen from Greenspan -- this points to the dollar getting even weaker and that will lift the gold price," UBS Investment Bank analyst John Reade said.

Reade said the market's bullish glow would fade at some point however, as speculators became increasingly overexposed on New York's COMEX gold futures market.

"You don't stand in the way of the falling dollar, but there will be a shakeout at some stage," he said, adding that gold was unlikely to outperform the euro if the dollar continued to weaken substantially.

The euro was last at $1.3025, off its all-time high of $1.3074 on Thursday.

Analysts said gold was still within sight of its next upside target of $450 -- last seen in June 1988.

Traders have also attributed gold's recent bullish streak to hype generated by the launch of a new U.S. investment product on Thursday.

StreetTRACKS Gold Shares, a bullion-backed exchange-traded fund, debuted on the New York Stock Exchange on Thursday, with the aim of broadening investor access to the market.

San Francisco-based Barclays Global Investors also filed a registration with the Securities and Exchange Commission for iShares COMEX Gold Trust, which will mimic the price of COMEX gold futures.

Silver was seen broadly consolidating, tracking gold and currency moves. Spot silver was quoted at $7.57/7.60, up from New York's $7.52/7.55.

Platinum weakened to $852.00/857.00 from New York's previous $857.50/862.50.

Palladium was at $214.00/218.00 from $214.50/220.50.

South African stocks end soft, pause after gains

JOHANNESBURG (Reuters) - South African stocks retreated on Friday led by resource stocks with Anglo American Platinum down nearly five percent on a firmer rand, but mobile operator MTN jumped on strong earnings.

"It's jitters over the rand, a softer rand didn't happen and no one wants to stay long if the rand is at these levels. Some profit-taking took place in resources," a trader said.

Angloplat, the world's number one platinum producer, shed 3.91 percent to stand at 220 rand after the rand rose to 6.03 from 6.04 late on Thursday and was likely to strengthen, back to the 5.94/dollar four-month peak reached this week. Platinum prices also eased.

Angloplat cut its expansion target last year due to a strong raned and analysts fear current rand levels could hurt profits and force another cutback.

Impala Platinum Holdings Ltd (Implats), the world's second biggest platinum producer, lost 2.67 percent to 510 rand.

The JSE top 40 index of blue chips eased 0.24 percent to 11,169.90 points, while the all share index fell 0.13 percent to 12,337.10 points.

Gold miners also tumbled, with AngloGold Ashanti weakening by 2.11 percent to 243.49 rand. Hostile takeover predator, Harmony Gold shed 1.86 percent to 68.65 rand.

Harmony's takeover target Gold Fields edged down 0.69 percent to close at 89.08 rand while the gold mining index slipped by 1.3 percent.

Luxury house Richemont, which makes Cartier watches and Lancel handbags, reversed the previous day's gains, losing 1.06 percent to 18.75 rand on profit-taking. Its share had surged after it lifted first-half profits.

British property firm Liberty International was down 1.53 percent to 96.20 rand, and First Rand dipped 1.43 percent to 12.40 rand.

The bank index shed 0.42 percent, with most other bank shares steady, and Absa, a takeover target of British banking giant Barclays ticked up 0.29 percent to 69.60 rand ahead of its half-year results on Monday.

Africa's biggest mobile operator, MTN, was the biggest gainer on the day, charging up 3.57 percent to 34.50 rand, after unveiling a 34 percent jump in first-half profit on Thursday. It attributed its profits to solid subscriber growth in Nigeria and cost cuts in South Africa, promising further expansion abroad.

Leading South African insurer Old Mutual Plc surged 1.65 percent to 14.18 rand after posting solid second half earnings, which it said would last into 2005.

Steinhoff, South Africa's largest household goods maker bounced up 1.39 percent to 11.70 rand. Last week, Steinhoff bought a 44 percent stake in transport group Unitrans for about 935 million rand from construction firm Murray & Roberts.

South Africa's rand firmer on dlr, waits for G20 signals

JOHANNESBURG (Reuters) - South Africa's rand nosed stronger in quiet trade on Friday as the dollar slipped, but traders said volatility was possible after the weekend's G20 meeting in Berlin.

The dollar fell after Federal Reserve chief Alan Greenspan said the U.S. current account could not continue to widen indefinitely at its current pace, and given the size of the trade gap, investor appetite for U.S. assets would likely cool.

Traders say comments over the weekend from finance ministers and officials at the G20 industrialised and developing nations meeting could provide the impetus for the rand to break through 5.94/dollar, a 4-month peak reached on Thursday.

That would put it on target to test 5.87 to the dollar -- last scaled on July 19, taking the rand to its best levels since January 1999. Its gains this week were driven mainly by the dollar's dive to a record low of 1.3074 to the euro.

The euro was trading at $1.3046 at 1500 GMT, and the rand was at 6.0175/dollar versus 6.04 late on Thursday.

"If the dollar breaks through its lows this weekend then the rand could also go through its levels," the trader said.

Profit taking cut back the rand's rally on Thursday. The strong rand is making life difficult for South Africa's exporters, particularly the crucial mining sector.

Traders said the market would keep a close eye on inflation data due next week for clues to the outlook for interest rates, with speculation mounting of another cut in December given the positive impact the rand's strength will have on inflation.

The targeted CPIX index is seen to have risen by an annual rate of 4.1 percent in October, well up from a low of 3.7 percent in the previous two months but still well inside its official target range.

The anticipated rise is a result of higher oil prices during the month, but as these have dropped sharply there is scope for inflation to follow suit in the coming months, analysts say.

Traders said a rally in South African bonds looked like calming down, as the market had already priced in a 50 basis point interest rate cut at the Reserve Bank's December Monetary Policy Committee meeting.

The yield on the benchmark 153 due 2010 was down three basis points at 8.29 percent having hit a record low of 8.25 percent on Thursday. The yield on the 194 due 2008 was up five basis points at 7.87 percent.

"We've priced the cuts in and there's a bit of resistance at this level," said a trader.

Exporters not feeling rising rand's bite yet

(Business Day , 19 Nov 2004)

EXPORTERS said they were not yet feeling the pinch from the rand's rise to a four-month high this week, with expectations of an interest rate cut likely to ease concerns in the struggling sector.

The rand maintained its strength for the second day in a row yesterday, trading at R5,96 against the dollar for most of the day, before moving back up to the R6 level.

Exporters said yesterday that although they were not feeling the effect of a stronger currency yet, a rand trading between R6,50 and R7 against the dollar would help them to be more competitive.

A cut in interest rates at the Reserve Bank's monetary policy committee meeting next month would help ease the burden on exporters, but companies should not rely on a weaker currency to boost profits, analysts said yesterday.

The latest Reserve Bank quarterly bulletin shows a deficit of R5,5bn in the trade account in the second quarter the first time in 22 years that imports have totalled more than exports.

A strong rand does not bode well for exporters' bottom line, since they make their revenue in dollars, but cover their costs in rand.

"One has to start expecting this (strong rand) could be a long-term phenomenon driven by external factors beyond our control," Absa treasury economist Chris Hart said.

Econometrix Treasury Management analyst Michael Keenan said exporters could not rely "on a currency to keep your shop open".

"Adjusting to a strong rand will make local firms more efficient, and more sustainably competitive globally," Keenan said.

Gold mining company Harmony said yesterday that the higher dollar price of gold, which has been trading at a 16-year high of about 440/oz, had helped to partially offset the gains in the rand.

"Fortunately, the higher dollar price of gold has to an extent negated the impact of a stronger rand. We are now receiving a higher price in rand per kilogram than we were in the last quarter," Harmony marketing director Ferdi Dippenaar said. He said a rand at about R6,50 against the dollar would be "a lot easier" on exporters.

Keenan said the strong gold price would also help limit job losses in the mining sector.

Manufacturers may struggle, though, and the only way for them to respond would be to reduce costs.

"A cut in interest rates would help to take out some of the sting," Hart said.

Capital equipment manufacturer Bell said a rand of between R7,50 and R8 against the dollar would be more competitive. Doug Rhind, Bell's financial director, said the strong rand would hurt its exports, and increase competition from European imports.

Fiscal policy, virtuous circle set to sustain growth

Business Day 19 Nov 2004

STRONGER economic growth in SA was sustainable in coming years, boosted by a more expansionary fiscal deficit and low interest rates, leading economists said yesterday.

Gross domestic product growth was set to top 4% next year, driven by strong spending and investment , according to the University of Stellenbosch's Bureau for Economic Research (BER).

Economist Mike Schussler forecasts that growth will rise above 4% over the next two years, with the record growth in economic activity likely to continue until 2010, when SA hosts the Soccer World Cup.

Schussler said that SA's economic upswing was sustainable since it was not based on low or negative real interest rates or on a fiscal stimulus as in Europe.

Instead stronger growth in SA was based on a virtuous circle of higher labour productivity leading to lower inflation, which lowered the cost of capital. This in turn lead to firms investing more in capital equipment, which improved labour productivity, he said.

Although growth would be higher next year compared with this year's expected 2,9%, exports would remain sluggish next year because of the rand's strength, said the BER.

The bureau said yesterday that consumer spending would slow next year to around 3,7% from 4,1% this year, while investment was set to accelerate to 9% next year from 8,4% this year.

The rand was expected to weaken to around R7,50-R8 against the dollar next year, given SA's widening current account deficit, said the university's bureau.

Old Mutual Market Watch – 1 October 2004

The August CPIX inflation rate of 3.7% was again lower than market expectations. Excluding the impact of petrol prices, CPIX inflation was only 3.5%. Clearly the benefits of the strong rand and lower food prices are still being felt. The high oil price is a concern for inflation, although the rand is helping to blunt the impact on petrol prices to some extent. We expect inflation to remain relatively subdued over the next several months and it should easily remain within the 3% to 6% target range throughout next year.

Local demand growth remains strong, with recent car and retail sales data confirming booming consumer spending. Consumer finances remain very healthy, with strong disposable income growth, low interest rates and resultant low debt servicing levels. In addition, the production side of the economy has responded nicely to strong demand growth. The prospects for growth into 2005 remain very favourable, with firm foreign demand, low local interest rates and expansionary fiscal policy.

The Reserve Bank could decide to cut interest rates again, given the recent performance of inflation, the still positive outlook for future inflation, the strong rand and the fact that the underlying (i.e. excluding airplanes, the corvette and extra oil imports) current account deficit in the second quarter was not as bad as the headline number of a 3.8% of GDP suggested. In addition, the current account deficit is still easily financed. However, the high oil price and strong demand growth (together with the resultant booming conditions in credit extension) could counter the reasons for such a rate cut. All told, it is a tough call as to whether rates will be cut or not and the decision could depend heavily on the rand and oil price.

Sanlam Economic Report – November 2004

<u>Inflation</u>

The annual percentage change in the CPIX, which is the Consumer Price Index excluding the interest rate on mortgage bonds, for the historical metropolitan and

other urban areas is 3,7% at September 2004 (i.e. the CPIX at September 2004 compared with that at September 2003).

This rate is the same as the corresponding annual rate of 3,7% at August 2004. From August 2004 to September 2004 the CPIX for the historical metropolitan and other urban areas increased by 0,3% and the seasonally adjusted index increased by 0,4%.

The latest inflation figures have again been lower than expected. This now brings the number of inflation releases below expectations to seven and economists now forecast a strong possibility of a further rate cut at the Monetary Policy Committee's (MPC's) monetary policy meeting in December if the oil price reverts back to normal levels in the mean time. The MPC decided to leave rates unchanged at 7.5% at its meeting this month.

The Rand and the Economy

The Rand appreciated to its best level (R6.06/$) since 23 July but eased slightly to R6.14 at month-end. The strong Rand has protected the economy from inflationary pressures and aided GDP growth especially from the manufacturing sector. This manufacturing growth should translate into more jobs and increased economic growth over the next few quarters.

The South African economy has shown positive growth for a record 61 straight months and economists have indicated that this record can be extended further. The one obvious threat to this position is the effect of another terrorist attack on the fragile oil price.

The Association of Collective Investments data shows that investments in foreign currency denominated equity funds attracted R2.1 billion, which was double the second quarter net inflow. Although the bulk of this increase is from institutional clients, it seems South-Africans are once again testing the international waters.

The Gold price had a somewhat volatile month dropping from $418 to $411 in the first week of the month, but staged a healthy recovery reaching a high of $428 per ounce near month-end.

The Local Equity Market

The JSE All Share Index reached an all-time high of 12115 points in the first week of October, but the subsequent strong Rand and its impact on exporters halted the last quarter's phenomenal growth.

The Index ended the month almost two percent down taking direction this time from the Rand and international markets that succumbed to high oil prices.

The JSE All Share Index was dragged down by the Resources sector, which makes up roughly 30% of the index. Resources ended the month almost 10% down because most of the companies receive their income in US dollars. It is interesting to see that most of the dual-listed stocks were up on the foreign exchanges, which

suggests that the stronger local currency was primarily to blame for the lower All Share Index.

The Financial sector has continued its run of six consecutive positive months and the Industrial sector is following closely with 4 positive months to place the index up 19% year-on-year.

Local stocks continue to be supported by low, stable inflation and firm commodity prices. The question on everyone's lips is how long can the good times last. This will depend on the oil price, the currency and the MPC's December interest rate decision.

The Global Economy

The oil price has once again taken the limelight and hit an all-time high of $51.38 per barrel of Brent Crude in the last week of October when US data releases suggested an increase in yearly deficits of heating oil inventories. A cold Northern Hemisphere winter could drive the price further up if demand doesn't decrease elsewhere. US Federal Reserve Chairman, Alan Greenspan, commented that current levels would have an economic impact, but this should not be as detrimental to growth and inflation as the oil price spikes in the seventies.

This month's sharp increase was driven by double-digit demand growth in China and the effect on supply of strike action in Nigeria.

The United States

Non-farm payroll employment increased by 337,000 in October, and the unemployment rate was about unchanged at 5.5 percent according to the Bureau of Labour Statistics of the U.S. Department of Labour. Construction employment rose sharply over the month, and several service-providing industries also added jobs. These higher-than-expected figures could indicate that the recent slowdown is over, but the real test will come once the hurricane effect fades.

The US economy grew at an annualised pace of 3.7% in the third quarter, 0.4% higher than in the second quarter, but marginally lower than predicted. Growth in GDP was aided by strong consumer spending but could not overcome the drag of disappointing inventories by businesses and the large trade deficit.

The markets were down for the first half of the month, but a recovery in the insurance and technology sectors helped the major indices end the month in the black. Investors were anxiously awaiting the outcome of the presidential elections in the last week of October.

China

China's emergence as a budding economic superpower and its insatiable demand for raw materials has benefited commodity exporting economies, but has also placed increased pressure on the oil price. The People's Bank of China raised interest rates for the first time since 1995 to 5.58% in an effort to cool down an economy that has experienced nominal growth of more than 9% per annum in the year thus far. Analysts say that another increase early next year is likely.

Japan & The Far East

Japan's Nikkei 225 was the only major international equity market that could not overcome pre-US election jitters and ended the month 1.95% down. The boom in China is fuelling the growth in the rest of Asia and the regional markets are thus taking direction from the world's second largest economy.

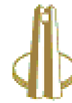
The UK & Europe

Central banks in Europe and the UK all left interest rates unchanged after monetary policy meetings this month.

The Bank of England based the decision on the cooling housing market and slowing domestic demand. The interest rate in the Eurozone is still considered uncomfortably low at 2% but economic growth is continuing to show signs of deterioration. The Euro's strength could become a threat to export competitiveness, but is also helping offset potential inflation from high oil prices.

No. 233 - September 2004

Quarterly Bulletin



South African Reserve Bank

Introduction

During the first half of 2004 the world economy continued along its stronger expansion path which started around mid-2003. This occurred despite disappointing growth in Japan in the second quarter of 2004 and tentative signs that the steps taken by the Chinese authorities to rein in growth were successful. Nevertheless, overall activity levels rose further and with international trade volumes expanding briskly, commodity prices remained high.

In the third quarter of 2004 the price of crude oil reached levels previously observed 14 years earlier around the time of the Gulf War. Strong world demand for petroleum and petroleum products was complemented by fears of supply disruptions. Against the background of fairly accommodative monetary and fiscal policies in most parts of the world, this contributed to an acceleration in inflation – quite modest in most instances, but more noticeable in a number of Asian economies. In the SADC region inflationary pressures are expected to subside somewhat on account of sustained policy discipline and improved food supply conditions in most parts of the subcontinent.

While levels of short-term interest rates generally remained fairly low, a number of central banks pre-emptively started raising interest rates from late 2003 in order to contain future inflation. Having maintained the federal funds target rate at 1 per cent since 2003, the Federal Open Market Committee in the United States raised the target policy rate by 25 basis points in June 2004 and by a further 25 basis points in August.

Economic activity in South Africa picked up further in the second quarter of 2004, with the real gross domestic product expanding for the twenty-third consecutive quarter – the longest period of uninterrupted quarter-to-quarter growth since quarterly data became available in 1960. Supported by lower interest rates, a moderately higher budget deficit and favourable international terms of trade, the annualised pace of growth accelerated to 4 per cent in the second quarter of 2004 from an upwardly revised 3½ per cent in the first quarter. The growth trajectory has steepened noticeably since the second quarter of 2003, with each quarter's growth rate being higher than the one preceding it.

The improvement in the economic growth rate in the second quarter of 2004 was broadly based. Growth in the primary sector accelerated on account of an improvement in agricultural output, while higher growth in production in the secondary sector was led by manufacturing. In the tertiary sector growth was maintained at a brisk pace, with real output originating in the transport and communication subsector rising most noticeably. As in the first quarter, all sectors and subsectors registered increases in real output in the second quarter of 2004.

The pace of expansion in real gross domestic expenditure was more than three times as fast as that of gross domestic production in the second quarter of 2004. A sharp acceleration in inventory accumulation in the second quarter contributed to this divergence; an important element in this build-up was the exceptionally high quantity of crude oil which was imported and added to inventories.

Growth in domestic final demand, while remaining brisk, decelerated somewhat in the second quarter of 2004. Real gross fixed capital formation, while losing some momentum following the very high purchases of capital equipment by public corporations during the first quarter, still rose at a rate of more than 10 per cent in the second quarter. Growth in real final household consumption decelerated marginally as expenditure on semi-durable and durable goods lost some of its earlier momentum. Another corvette – the third in as many quarters – was acquired by the South African Navy during the second quarter of 2004, but growth in real government consumption expenditure moderated slightly.

South Africa's export volumes rose considerably in the second quarter of 2004, following a protracted lull since mid-2001 when the world economy moved into growth recession. Growth in mining exports was led by platinum and coal, while the volume of manufacturing exports also recorded a sizeable increase as foreign demand strengthened and producers started to come to terms with the recovery in the exchange rate. Import volumes increased even more briskly than exports as a

number of aircraft, the abovementioned corvette and exceptionally large quantities of crude oil were imported. Accordingly, despite the favourable terms of trade, South Africa recorded the first trade-account deficit in 22 years and a current-account deficit of nearly 4 per cent of gross domestic product during the second quarter of 2004.

The deficit was again comfortably financed by capital inflows, enabling the Reserve Bank to continue its accumulation of foreign exchange reserves. The effective exchange rate of the rand continued its upward trend, resulting in further year-on-year declines in the rand prices of imported goods at the production level. Together with prudent financial policies this resulted in CPIX inflation remaining within the target range; July 2004 was the eleventh consecutive month in which the rate of CPIX inflation fell within the 3-to-6-per-cent target range. The latest available data on unit labour cost also display rates of increase marginally below 6 per cent.

Inflation outcomes so far in 2004 were generally lower than expected, feeding back into lower expectations of future inflation. Having maintained an unchanged level of the repurchase rate for a period of eight months, at its August 2004 meeting the Monetary Policy Committee reviewed prospects for inflation and concluded that a further reduction of 50 basis points in the repurchase rate would be consistent with projected CPIX inflation remaining in the target range. When this reduction was announced, the exchange rate of the rand immediately depreciated; this was in contrast to the experience in 2003 when the exchange rate appeared to be oblivious to interest rate reductions. The narrower margin between interest rates in South Africa and in the rest of the world might have contributed to this greater sensitivity of exchange rate changes to interest rate movements.

There was a deceleration in growth across the spectrum of the monetary aggregates in the second quarter of 2004, after a sharp increase in the preceding quarter. This deceleration in part reflected a reversal of the exceptionally high increase in money balances at the end of February caused by coupon interest payments on government bonds and the redemption of a maturing government bond. Measured over twelve months, growth in M3 receded somewhat to levels of around 12 per cent in the period April to July 2004.

The stimulus to consumer and business sentiment induced by lower interest rates, rising house prices and rising real income was reflected in brisk expenditure growth which in turn was partly financed through rising credit extension by the banking system. Growth in asset-backed loans and advances accelerated further during the first seven months of 2004, from already high levels. The modest level of overdue loans encouraged banks to accommodate the higher demand for mortgage, instalment sale and leasing advances. The demand for other loans and advances – often seen as a sign of corporate distress borrowing – tended downward in recent months as lower interest rates and the use of non-bank funding mechanisms made themselves felt.

Higher mortgage lending by the banking sector in turn supported residential

property prices whose yearly rates of increase in the first eight months of 2004 were without precedent. Nevertheless, the monthly increases in house prices have lately decelerated somewhat.

Bond yields reached a peak in June 2004 and fluctuated around a declining trend in the ensuing period as the domestic inflation outlook improved. A mild softening in global bond yields reinforced the decline in domestic yields as markets apparently discounted less buoyant global economic conditions against the backdrop of high oil prices. South African share prices, which were rather lacklustre from March 2004, picked up from mid-August in response to the decline in the exchange value of the rand.

The authorities continued to pursue a cautiously expansionary fiscal policy. While the twelve-month growth in government revenue from taxes on income and profits in April – July 2004 was below the projected growth for the full 2004/05 fiscal year, the budget deficit remained well-contained and easily financed. Although the bulk of the deficit was financed through issues of conventional bonds in the domestic capital market, a foreign bond was also launched as well as a government bond series for retail investors. The latter bond series became available on 24 May 2004, and more than R600 million was raised by the end of August.

Model Answer(s):
The assessor must judge whether the preparation has been thorough and whether the learner has used correct terminology.

My Notes ...

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Summative Test and Attitude & Attribute Evaluation

Before the knowledge test is undertaken, the learner must be reminded of what is expected from him / her in terms of summative and reflexive competence. Read and explain to the learner, the **Preparation for Your Final Assessment** section in the learner workbook. Learners and assessor should sign off this section to acknowledge that this step was completed.

Please set up a knowledge test from the questions given as a guideline to learners and supply each learner with a test sheet.

Supply each report with the following heading:

Unit Standard:	7468	**NQF Level:**	4
Learner Name:			

Questions	**Model Answers**

Assessment Feedback Form

Comments / Remarks	
Feedback to learner on assessment and / or overall recommendations and action plan for competence:	
Feedback from learner to assessor:	
Assessment Judgement You have been found: ❍ Competent ❍ Not yet competent in this unit standard	Actions to follow: ❍ Assessor report to ETQA ❍ Learner results and attendance certification issued
Learner's Signature:	**Date:**
Assessor's Signature:	**Date:**
Moderator's Signature:	**Date:**