T.T. Mboweni: Trends in economic growth

Address by Mr. T.T. Mboweni, Governor of the South African Reserve Bank, at the Rotary Club of Pinelands, Cape Town, 23 February 2001.

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Introduction

Ladies and gentleman, it is indeed a great honour and a privilege to be invited here to speak at this special induction meeting. I thank you for seeing fit to elect me as an Honorary Member of the Rotary Club of Pinelands. The topic I have chosen to talk about this evening is economic growth. It is a subject that affects us all, as citizens of South Africa, and it is something in which we all share; something from which we all reap the benefits.

I have noted during my recent international visits (to the US, London and Davos), that many people have become focused on South Africa's low growth rate. Over the past 40 years, the country's economic growth has declined from an average rate of 5 per cent per year in the 10 years immediately prior to the first oil crisis of 1973 to just over half of that in the latter years of the 1990s; not nearly enough to create and sustain the levels of employment we would like to see.

Economic growth since 1963

Between 1963 and 1973 growth in real GDP came to 5,0 per cent on average, and a large degree of financial stability and low inflation prevailed. The manufacturing sector expanded production, on average, by a solid 8 per cent per year over the period, although much of this was a result of the import replacement policies and protectionist measures in force at the time. The services industry was also expanding strongly at an average rate of 5,5 per cent per annum. Non-gold mining output expanded at a vibrant arithmetic mean rate of 7 per cent per annum while the gold mining sector reaped the benefits of new mine developments up to 1970 and a higher gold price thereafter.

From the expenditure side, all domestic expenditure components recorded strong growth during this period. Gross fixed capital formation was exceptionally strong, with a recorded average growth rate of 9 per cent per annum. The expansion of the capital stock was widespread and considerable attention was given to infrastructure spending.

The supply side of the economy was also boosted by the immigration of a considerable number of entrepreneurial and highly skilled people. Education and training of the whole South African population unfortunately did not receive the required attention, which came back to haunt us later on.

For the next 10 years, from 1973 to 1983, the country's real GDP growth dwindled to 2,6 per cent per annum. In the early 1970s, the semi-fixed exchange rate system, which had been in force up to that time in most parts of the world, broke down, reducing the discipline imposed on policy makers. The first oil price shock together with a substantial increase in the gold price initiated an inflation spiral and financial conditions became less stable with inflation rising to double-digit levels from 1974. Growth in manufacturing slowed to 3,4 per cent per annum, as momentum could not be sustained given the more uncertain economic environment and the shortages of highly skilled people.

Still, growth in the tertiary sectors remained relatively buoyant at 3,5 per cent per annum. Non-gold mining output expanded by 3,6 per cent per annum during this period, with coal performing well as the high price of crude oil lifted the prices of all energy-related minerals. Although gold production contracted as ore grades were reduced to prolong the lives of mines, gold mining profits remained robust because of the high gold price. The high gold price of 1979 and 1980 acted as a buffer and protected South Africa from the effects of the second oil crisis in 1979, ensuring record growth in 1980. However, this artificial boost did not last as the gold price declined from its $800 a fine ounce peak.

Fixed capital formation remained positive during 1973-83, although its average growth rate slowed down appreciably to 2,8 per cent per annum. But final consumption expenditure by general government recorded the strongest growth rate amongst the expenditure components. During this period, its growth rate averaged 5,3 per cent per year.

As South Africa became more isolated from the international arena, growth contracted. From 1983 to 1993 real GDP growth fell to a mere 1,0 per cent average per annum. Manufacturing grew at only

0,3 per cent per annum, and confidence was shaken as international pressure, sanctions and internal dissatisfaction mounted. Financial instability severely undermined the economy. Consumer price inflation peaked at 20,7 per cent in January 1986 and the prime overdraft rate rose from 14 per cent in 1983 to 25 per cent in 1984 before declining to 12 per cent at the end of 1986. The subdued gold price also impacted negatively on the economy. Only agriculture, which is an inherently volatile sector, managed to grow at a rate in excess of the 2,2 per cent per annum population growth rate. On the expenditure side, fixed capital formation fell by 3,2 per cent per annum. Household consumption growth declined while government consumption grew at an average rate of 2,9 per cent per annum and once again came to the fore as the strongest expenditure component. However, this implied a higher tax burden for the man in the street and large government dissaving, which could not be sustained.

From 1993 to 1999 (and incidentally also from 1993 to the third quarter of 2000) real GDP growth accelerated once more to some 2,6 per cent per annum. Confidence started to return, not only as sanctions were abandoned but also especially as evidence accumulated that economic policies were going to be prudent, sustainable and transparent. The improved growth rate was achieved in spite of adverse external shocks such as the East Asian markets crisis, some 3 years ago, and the floods early last year. The strongest growth over this period was recorded in the services industries, which averaged 3,3 per cent per annum. Growth in the transport and communications industry was especially vibrant, amounting to approximately 7,2 per cent per annum. A relatively strong performance of this sector, driven by technology and tourism, is likely for many years to come.

Viewed from the expenditure side, gross fixed capital formation picked up from extremely low levels, growing at a rate of 5,1 per cent per annum. Given the opening-up of the economy, reduced protection and the fact that it was highly concentrated in the private sector, this capital formation is likely to be economically productive and sustainable. The high rate of expansion in fixed capital formation was achieved in spite of the adverse shocks I have already mentioned. From 1993 to 1999 both exports and imports rose strongly as international integration proceeded.

Foreign direct investment flows into South Africa have picked up somewhat since the late 1980s and early 1990s, but have not reached healthy levels. Foreign direct investment into South Africa has averaged around 1 per cent of GDP per year since 1994. Almost certainly, the planned privatisation over the next three years will help to boost this figure.

While South Africa's depressed growth has become something of an overriding concern for many, we must not forget the sharp acceleration in growth recorded during the course of last year. Revised quarterly growth figures showed that the economy was more buoyant than had initially been forecasted by many economists and resulted in third quarter growth of 3,8 per cent, seasonally adjusted and annualised, when compared with the second quarter.

Macro-economic fundamentals

And we must not forget, too, the progress that has been made in shaping South Africa's macro-economic fundamentals to within internationally accepted standards. Economists, analysts and observers have long agreed, and I am sure that you will agree, on the successes that have been achieved over the past decade in sprucing up the country's macro-economic situation. Major economic restructuring, which was absolutely necessary in South Africa's case, often leads to a prolonged period of subdued economic activity. We have every reason to believe that the economic is now poised to maintain higher growth rates in future.

Inflation

Over the last 10 years, inflation has come down steadily from the double-digit figures of the 1980s and the early 1990s. From 1989 to 1992, consumer price inflation rates of some 14 to 15 per cent were recorded. The index then decelerated to single-digit rates from 1993, as the effects of the tight monetary policies of the preceding four years came to fruition. By the close of the millennium further progress had been made on the inflation front and in 1999 and 2000 the average consumer price inflation rate slowed down to a level of 5,2 per cent and 5,3 per cent per annum.

CPIX, the CPI index excluding mortgage costs, is the measure targeted by the Reserve Bank in its inflation-fighting strategy and is closely monitored by the Bank. According to this policy, CPIX must fall to a rate between 6 and 3 per cent by the year 2002. CPIX inflation has proved sticky over the past year and averaged 6,9 per cent in 1999 and 7,7 per cent in 2000, mainly as a result of high international oil prices. The most recent data, released on Tuesday this week, indicates CPIX was at a level of 7,7 per cent in January 2001. Most analysts B and the Reserve Bank B expect CPIX to slow down further over the course of the year, given the prudent monetary and fiscal policies that have now been put in place. Incidentally, while CPIX data is not officially available before 1997, the Reserve Bank estimates that CPIX inflation would have peaked at between 17 and 18 per cent in 1991 and 1992 - a full 10 per centage points higher than where it now stands.

Current account of the balance of payments

Progress on the current account of the balance of payments has also been evident over the past decade. The country was forced to maintain current account surpluses from the mid-1980s to 1994. This was related to the 1985 debt standstill and the international isolation of the South African government, which acted as a barrier to foreign investment and other capital flows to South Africa. With foreign debt having to be repaid, South Africa had no option but to run its affairs so that exports exceeded imports, thereby earning foreign exchange.

The political transition in 1994 set the scene for normalisation of South Africa's financial ties with the rest of the world. From 1995 South Africa ran current account deficits but kept these contained at less than 2 per cent of GDP. The deficits were easily financed through net capital inflows, which were sizeable enough not only to pay for the excess of imports over exports but also to build up South Africa's gold and foreign exchange holdings to a record level. Late last year, holdings of gold and foreign exchange exceeded the equivalent of 15 weeks' worth of imports, against the internationally accepted norm of around 12 weeks.

In spite of a low gold price, high oil prices and unfavourable conditions in certain trading partner countries in the wake of the emerging markets crisis, South Africa has managed to record very small deficits on its current account in recent quarters.

Over the past decade both exports and imports have increased relative to GDP, as can be expected as part of the process of globalisation. South Africa's authorities have added momentum to globalisation by phasing in lower import duties in terms of the World Trade Organisation agreements. This has been painful, but has enhanced South Africa's international competitiveness and ability to grow on a sustainable basis. The volume of non-gold exports has risen at an average rate of around 7 per cent a year since the early 1990s - much faster than GDP growth - which enables the country to finance imports largely needed for investment purposes.

Debt levels

During the decade we are looking at, government debt rose from 36,4 per cent of GDP in 1989 to 50,4 per cent in 1999, before receding to 48,1 per cent in 2000. Its most rapid rises were recorded when the government incurred large deficits from 1992 to 1994. However, South Africa's debt levels stayed firmly below the 60 per cent level, which is deemed by the Maastricht Treaty participants as the level beyond which fiscal health is at risk.

South Africa's foreign debt receded from 26,8 per cent of GDP in 1989 to just above 20 per cent in the early 1990s. As international borrowing was resumed from 1994, foreign debt rose significantly to 29,9 per cent of GDP in 1999. But this is still quite low in comparison with other developing countries.

The South African private sector's indebtedness to the banking system has risen over the past decade. From a level of 58 per cent of GDP in 1989, bank credit to the private sector rose to 67 per cent in 1999. This was a sign of increasing intermediation of credit and financial development in the economy - so-called financial deepening..

Budget deficits

Similar progress has been made on the government's budget deficits. The relatively low budget deficits and high government expenditure during the fiscal years of the late 1980s to the early 1990s were largely achieved through increased tax revenues. However, in the 1991/1992 fiscal year the deficit doubled to 3,7 per cent of GDP, as the recession impacted negatively on revenue while expenditure growth accelerated. There was no respite in the 1992/1993 fiscal year when the recession deepened and expenditure accelerated sharply after drought aid had been disbursed in the wake of the worst drought in half a century. This propelled the budget deficit to a record high of 7,3 per cent of GDP, a level that was clearly not sustainable. After fluctuating around 5 per cent of GDP, the deficit fell below 3 per cent of GDP after the 1997/1998 fiscal year. This was achieved through a combination of budgeting in accordance with the country's most pressing priorities, strict expenditure control and improved tax collection. With a budget deficit of below 3 per cent, South Africa's finances compare favourably with internationally acceptable levels.

Fiscal policy

Coupled with these improvements, the degree of transparency in fiscal policy was strengthened with the introduction of the three-year Medium-Term Expenditure Framework, which marked a departure from the one-year budget announcements. The three-year framework has provided certainty, a crucial factor for financial stability, and an opportunity for decisions to be informed by public debate.

Clear objectives are set out for fiscal policy, such as the elimination of government dissaving and reducing the tax burden on society. This prudent approach has kept South Africa out of a debt trap where government's deficit, government debt and the interest cost of such debt spiral out of control. The strategy has also contained government's interest costs, enabling more funds to be redirected to the priority areas where the most pressing needs have been identified. Although capital expenditure was initially a casualty of the strict control over government spending, it is now set to accelerate, given the fiscal room for maneuver that the government has created.

Although 10 years is a relatively short period in economic terms, the trends that emerge since 1993 underline the solid foundation and relative macro-economic stability that has been achieved in South Africa. The policies that are in place will ensure that this strong foundation will be strengthened further to enable the country to embrace any challenges that may arise.

While much success is evident from the side of the government concerning the country's macro-economic framework, the responses to the government's policies have at times been slow. For example, the agricultural sector has undergone immense challenges as South Africa shifted away from the excessive state regulation and intervention which characterised agricultural markets in the past. In keeping with the global trends the majority of agricultural marketing schemes and control boards have been phased out. The agricultural markets have been liberalised and access to them broadened through legislation. As a result, farming has become market-driven and not production-driven, and this naturally leads to greater agricultural price volatility. The removal of these marketing boards should create space for competition, but we are only beginning to see some encouraging signs that farmers are reacting appropriately to the new agricultural policies.

As a central bank we continue to be encouraged by what we hear from the government. In his state of the nation address earlier this month, President Thabo Mbeki indicated that the government was set to embark on a programme of action, starting with the economy. The President noted the general consensus that we have established the necessary level of macroeconomic balance and stability, and have turned away from the precarious position we found ourselves in during 1994. This, as the President said, was in spite a very volatile international environment.

President Mbeki also observed that South Africa's economic growth rate, aggregate savings and investment rates remain too low. The President went on to say, and I quote: While continuing to focus on the maintenance of the correct macroeconomic balances, we have therefore decided to pay detailed attention to the critical microeconomic issues. In particular we have decided that this year the government itself, in all its spheres, and the public sector as a whole, must make a decisive and integrated contribution towards meeting the economic challenges the country faces.

The objectives we seek to achieve are moving the economy onto a high-growth path, increasing its competitiveness and efficiency, raising employment levels and reducing poverty and persistent inequalities.

The government will draw on the advice of some of the world's top economists, lower input costs and strive to create a climate of certainty. By doing this, the government is showing its commitment to the economic well being of South Africa. We at the Reserve Bank are convinced that the micro-reforms will play an important role in boosting growth and job creation.

Concluding remarks

Ladies and gentlemen, we at the South African Reserve Bank must also do our bit. We believe, as most central banks do, that sustained high economic growth and creation of employment opportunities can only be fulfilled when stable financial conditions prevail. This is the objective of the Bank: to achieve and maintain stable financial conditions in our country. This task is spelled out in both the Constitution and in the South African Reserve Bank Act. The primary role of monetary policy, therefore, is to keep inflation in check, which is an essential ingredient in the recipe for sustainable economic growth. We aim to do this through our approach of inflation targeting. By all counts, this pillar of growth is coming into place, and our economic growth rate will be set against this more healthy background.