T T Mboweni: Observations on recent economic developments

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, to the Southern African-German Chamber of Commerce and Industry, Cape Town, 13 July 2001.

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1. Introduction

Good afternoon ladies and gentlemen. I thank you for inviting me here to address you today. I stand before you at a rather uncertain global economic time. But despite the world economic slowdown and the question marks over future growth prospects, trade between South Africa and Europe has been on the increase. The Euro area has been less affected by the global slowdown, and South Africa, with its close ties to the region, has also been somewhat cushioned.

South African imports from Europe rose by 20 per cent in April 2001 compared with April 2000. South Africa's exports to Europe rose by 34 per cent over the same period. Likewise, South African-German economic relations have prospered over the past year. In 2000, trade between South Africa and Germany reached an all time high with combined trade amounting to DM13,4 billion, or R50 billion at the current exchange rate. South Africa's imports from Germany increased by 19,9 per cent and South Africa's exports to Germany rose by 23,2 per cent last year. This was the fifth consecutive year where South African exports showed double-digit increases. Semi-finished and chemical products were among the South African exports that showed significant increases. The biggest growing import items were manufactured products such as vehicles and transport equipment as well as machinery and electric equipment. Clearly, Germany remains one of South Africa's significant trading partners and German companies continue to invest substantially in this country. Chambers of Commerce and Industry undoubtedly enhance the strong bilateral and trade relations between the two countries, such as yourselves.

I see that over the past four years you have extended your activities to the neighboring countries in the Southern African Development Community to include Botswana, Malawi, Namibia, Seychelles, Tanzania and Zambia, to name just a few. By viewing the region as a whole, you share our broader vision of closer regional ties. SADC, as a region, strives to achieve economic growth and development through sound economic policies and cooperation. Within this the South African Reserve Bank plays a pivotal role. It chairs the Committee of Central Bank Governors in SADC. This Committee focuses on issues of financial policy and investment, development finance and macro-economic policies – important to boost the economic integration of the region. Regional integration will give the region a stronger platform from which to participate in the global economy.

For the remainder of my time with you, I am going to give you some observations on the recent economic developments in South Africa. This may give you an indication as to what the short-term holds. But first let me return to the trends in the global economy. Forecasts of slowing growth abound. In the IMF's world economic outlook published in April this year, it noted that prospects for global growth had weakened significantly since 2000. However, of some comfort is that the IMF expects the slowdown to be short-lived. The second half of the year should see a pick up in US economic activity, growth in Europe is expected to remain "reasonably robust", and recovery in Japan is forecast to resume next year. Japan faces the challenge of addressing structural weaknesses, especially in its financial and corporate sectors.

This global slowdown is bound to affect emerging market economies. And with this in mind, we must be vigilant. In this environment, commodity prices, upon which so many developing countries depend, are expected to weaken. Indeed, the IMF notes, that prospects in these developing markets, like South Africa, depend on maintaining investor confidence. However, the IMF acknowledges that these markets have made significant progress in reducing their external and financial sector weaknesses. Many of them have moved towards sustainable exchange rate regimes and prudent debt and reserve management policies.

Against this backdrop of slowing world economic activity, the Reserve Bank's composite leading business cycle indicator regained some momentum in the three months ending February. Similarly the composite coincident business cycle indicator was on a definite upward trend from May 2000 to February 2001. Preliminary indications are that this upward momentum persisted in the following months. However, by the end of the first quarter it became clear to us at the Reserve Bank that South

Africa could not escape the world economic downturn as weaker international demand affected export volumes in the first quarter.

2. Domestic output and domestic expenditure

The decline in export volumes contributed to a decline in economic growth. From 4 per cent in the third quarter of last year, growth slowed to 3 per cent in the fourth quarter. Growth fell further to 2 per cent in the first quarter of this year. The slowing growth was largely restricted to the agricultural sector in the fourth quarter of 2000. However, by the first quarter of this year, the weakness reached other sectors of the economy.

Agricultural output dropped at an annualised rate of 6 per cent in the first quarter, coming off a high base. Although mining output rose slightly, this was not near the levels seen at the beginning of 2000. Demand for platinum and coal remained firm but diamond stockpiling continued in the face of weaker demand. Of some worry is that the sector that bore the brunt of the slowdown was the manufacturing sector. The growth rate in this sector slowed down from an annualised 4,5 per cent in the fourth quarter to a mere 1 per cent in the first quarter. This is somewhat puzzling because there appears to be strong demand for manufactured goods.

Domestic demand remained strong in the first quarter with household and government consumption expenditure rising. However, the growth in real fixed capital formation and inventory investment accelerated. However, it was net inventory investment which slowed down the growth in aggregate spending in the fourth quarter of 2000. An acceleration in inventory levels followed in the first quarter of 2001. This suggests that producers are positive about South Africa’s future growth prospects and anticipate an increase in domestic demand.

Household spending was still holding firm in the first quarter of 2001. Real final consumption expenditure by households increased at a quarter-on-quarter seasonally adjusted and annualised rate of 3 per cent in the first quarter, slightly lower than the 3,5 per cent recorded for the fourth quarter of 2000. The weakness was mainly due to a slowdown in spending on services other than communications services. A rise of 28% in the purchase of cellular telephones over the past year was not enough to cushion this.

The real gross fixed capital formation accelerated steadily in the 12 months to the first quarter. The private and general government sector registered high fixed capital formation but there was a decline in the public corporations sector. The private sector continued to expand communication infrastructure. General government also increased their outlays on infrastructure spending, although from a very low base. Total fixed capital formation amounted to approximately 15,5 per cent of GDP in the first quarter.

3. Employment and labour remuneration

South Africa is labouring under a scenario of low growth that appears insufficient to create the levels of employment we would like to see. However, it must be remembered that a drop in formal unemployment does not necessarily imply an equal rise in the number of the unemployed. Often those who are no longer employed in the formal sectors of the economy enter the informal sectors or become self-employed.

From 1999 to 2000, employment fell in the formal private and public non-agricultural sector. On average, public sector employment fell by 4,1 per cent in 2000. Non-agricultural private sector employment fell by 2,0 per cent from 1999 to 2000. The findings of the September 2000 Labour Force Survey, which measures total employment and unemployment and tracks the trends in the labour market, concluded that 25,8 per cent of the economically active population was unemployed.

Wage growth presents a mixed picture. Nominal wage growth in the private sector amounted to 8,8 per cent in 2000. This is the lowest rate of increase in the past 30 years. However, public sector pay increases outstripped the private sector. On average, public sector employees earned 9,4 per cent more in 2000 than in 1999.

But, on the positive side, labour productivity has been rising in the formal non-agricultural sectors. This is partly due to efficiencies gained from new technologies. On average labour productivity growth reached 6,0 per cent in 2000 – the highest rate of increase in thirty years. As a result of the robust growth in labour productivity and moderate increases in remuneration per worker, the growth in nominal unit labour costs in the manufacturing sector slowed down to a year-on-year rate of just 0,8 per cent in 2000. This has important positive implications for price stability and inflation.

4. Prices

The South African Reserve Bank introduced inflation targeting last year. Within this framework, we target CPIX inflation, which is headline consumer inflation excluding mortgage costs. This measure of inflation must fall between 6 and 3 per cent on average in 2002. In assessing the inflation outlook, we look at many aspects. These include global oil prices, which has been a main driver of inflation recently, the exchange rate of the rand, private sector demand and nominal unit labour costs, among other factors. During last year there was a significant rise in prices because of pressure from food and energy prices.

At our Monetary Policy Committee meeting in the middle of June we reduced the repo rate by 100 basis points. This caused the commercial banks, in turn, to drop their consumer interest rates. The repo rate decision was based on a number of factors. Among these were clear indications that consumer and production price inflation was slowing. Measured from quarter to quarter, seasonally adjusted and annualised, CPIX inflation came down from 8,8 per cent in the second quarter of 2000 to 6,1 per cent in the first quarter of 2001. The moderation in price increases was mainly the result of more moderate rises in food and energy prices, which had shown exceptionally large increases in 2000. More fundamentally, the slowdown in inflation was related to the moderate rise in unit labour costs over the past two years. In our Monetary Policy Committee statement we noted that with continued fiscal and monetary discipline, the target range of inflation in the year 2002 was achievable.

The rate of imported inflation in production prices has declined from 15 per cent year-on-year in December to 11,8 per cent in May. Inflation in domestically produced goods slowed from a year-on-year rate of 8 per cent in November 2000 to 7,5 per cent in May. This was largely because of declining food prices which had a positive impact.

Similarly, the headline CPI accelerated from 1,7 per cent in October 1999 to 7,8 per cent in February 2001 but declined to 6,4 per cent year on year in May.

Although we remain reasonably confident of meeting our inflation target, we nonetheless remain vigilant. There are some forces at work that may obstruct the gradual decline we have witnessed up until now. These include the faster growth in aggregate demand over output, uncertainties about the stability of the oil price, and possible delayed second-round effects from the rand's depreciation of last year.

Although the rand depreciated by 1,3 per cent during the first quarter of this year, it appreciated by 1,2 per cent against the basket of currencies during the second quarter. Against the dollar the rand depreciated by 5,9 per cent in the first quarter. However, during the second quarter, the rand depreciated against the dollar by only 0,6 per cent.

5. Exchange rate of the rand

Having declined from a level of about R7,50 against the US dollar early in January 2001 to levels around R8,00 at the end of May, the rand seemed to stabilise against the US dollar in June. The monthly average exchange rate of the rand against the dollar in June 2001 was R8,05. However, from 3 July 2001 the rand weakened against the US dollar to a level of R8,2403 on 9 July reaching an all time low of R8,2456 in intra-day trading. Subsequently the rand declined further to a level of R8,34 on 11 July 2001.

Since the beginning of the year, the rand has depreciated by about 9,5 per cent against the US dollar. This is in line with a weaker performance of most currencies against the dollar in the first half of the year. The general weakness of currencies against the US dollar is demonstrated by comparable depreciations of almost 8,7 per cent for the euro, 5,7 per cent for pound sterling and 8,6 per cent for the Australian dollar. On a trade-weighted basis, the rand is weaker by 3,6 per cent since the beginning of the year.

A factor which has recently cast a shadow over the rand has been a general increase in risk-aversion by international investors. The increase in risk aversion is partly explained by weaker stock markets, a deterioration in the global economy and by developments in specific emerging markets such as in Argentina and Turkey. South Africa is certainly not the only emerging market to be impacted negatively. In particular, the currencies of Brazil, Turkey and Indonesia have been affected much more, and have declined by 28, 92½ and 18½ per cent respectively since the beginning for the year.

6. Foreign trade and payments

South Africa's surplus on the current account of the balance of payments widened from R2,5 billion in the fourth quarter of 2000 to R6,9 billion or 0,7 per cent of GDP in the first quarter of 2001. This was mainly because of the slight improvement in the trade surplus and a more substantial improvement in the services account.

South Africa's trade performance has been nothing short of stellar. The surplus on the trade account increased slightly in the first quarter from R37 billion in the fourth quarter of 2000. This goes some way to fulfilling our hopes of an export-led recovery for the South African economy. However, weaker global demand has caused the physical quantity of exported goods to decline by about 0,5 per cent in the first quarter of 2001 compared with the fourth quarter of 2000. But export prices in rand terms increased by 3,4 per cent over the same period.

The country's gold and foreign exchange reserves are on an upward trend, having risen from R69,1 billion at the end of December 1999 to R87,8 billion at the end of the first quarter this year. This is equal to 16 week's worth of imports. The Reserve Bank's net open forward position in foreign currency has been declining. We expect to see continued improvements in this position and we reiterate our commitment to reduce this position to zero, as and when circumstances permit. From US$13 billion at the end of December 1999 the NOFP fell to US$9 billion at the end of April. Our latest figures show the NOFP at just over half of that, US$5,3 billion, at the end of June.

Of course, with foreign portfolio investment into South Africa remaining fairly volatile, we are obliged to rely on more permanent inflows. Foreign portfolio investment into South Africa changed from an outflow of R1,8 billion in the fourth quarter of 2000 to an inflow of R3,5 billion in the first quarter of 2001. The acquisition of portfolio assets by South African residents, i.e. an outflow of capital, declined from R3,1 billion to an estimated R0,2 billion over the same period.

The growth in broad money supply has been on an accelerating trend since November last year. From year-on-year growth of 7,5 per cent in December, growth in money supply increased to 13,5 per cent in May. The low base for year-on-year calculations in 2000 explains the return to double-digit rates. Credit extension to the private sector, which forms the bulk of money supply in this country, registered rises of more than 11 per cent in the last three months of 2000. However, in the first five months of this year, credit extended to the private sector slowed to below 10 per cent.

7. Government finances

The government's revenues have been on the increase recently, mainly because of improved revenue collection. The result of the higher-than-budgeted revenue and close-to-budgeted expenditure for the 2000/2001 fiscal year was a deficit before borrowing and debt repayment equal to 2 per cent of GDP. This marked an improvement on the 2,3 per cent recorded in the previous fiscal year.

The reduction in the deficit to below 3 per cent of GDP coupled with government debt below the 60 per cent level, which is deemed by the Maastricht Treaty participants as the level beyond which fiscal health is at risk, paint a robust picture. National government debt has decreased from 48,1 per cent of GDP at the end of March 2000 to 46,5 per cent at the end of March 2001.

8. Conclusion

I will conclude by saying that within this economic picture, we at the Reserve Bank play a prominent part. By maintaining financial and price stability, through inflation targeting, we contribute towards the goals of sustained higher economic growth and the creation of employment opportunities. The primary role of monetary policy is to keep inflation in check, which is an essential ingredient in the recipe for sustainable economic growth.

There is some reason for optimism about the prospects of economic growth. As we noted in our Quarterly Bulletin of June 2001 the economy has been in recovery mode since the third quarter of 1999 and yet it has not exhibited some of the imbalances typical of previous expansionary periods.

Inflation is on a declining trend and unit labour costs are contributing to this. The household sector is in a financially healthier position and individual bankruptcies have fallen by 62% from April 2000 to April 2001. Bank balance sheets are sound. And the deficit on the current account of the balance of payments has turned into a surplus driven by the expansion in export earnings.

I am convinced that the Southern African-German Chamber of Commerce and Industry can likewise make a contribution. By fostering trade and business ties between Southern Africa and Germany, and specifically targeting small and medium enterprises, which must be the job creators in this economy, you are contributing to putting this country and region onto a higher growth path.

Africa is now part of the global economy, which brings its own pressures. Often these pressures are ones that we have no control over. We have a much more open economy, some trade barriers have come down and we are no longer politically isolated. With the transition to a democratic South Africa, confidence has begun to return with the mounting evidence that economic policies are prudent and transparent. It is on these foundations that we will continue to build upon. We count on you as our valued partners.

Danke. Rea leboga.