T T Mboweni: A review of economic and financial developments in South Africa during 2002

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, at the dinner for Heads of Foreign Missions, Pretoria, 10 December 2002.

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Mr El-Herfi, Acting Dean of the Diplomatic Corps,
Ambassadors,
High Commissioners,
Heads of International organisations,
Senior management of the Department of Foreign Affairs,
Senior management of the Reserve Bank
and honoured guests, all protocol observed

1. Introduction

Integrating dinner with discussions of finance is not unfamiliar to central bankers. The key ingredients are good food and brevity and relevance of the discussion. I will do my best to adhere to the latter two ingredients. The former is out of my hands.

2. The global economy in 2002

The developed countries were already experiencing a slowdown in economic activity in 2001 when the events of 11 September shocked the world. Transport and tourism in particular were hit very hard, with some fallout continuing to this day. World growth in 2002 has been subdued and for the full year is expected to amount to around 2,8 per cent, slightly better than the 2,2 per cent recorded in 2001 but still way below the 4,7 per cent recorded in 2000.

Alongside the uninspiring growth performance, however, inflation has been very low. In Japan prices are in fact falling, while in the Euro area the latest average inflation rate is 2,2 per cent. In the United States, inflation is running at 2,0 per cent.

Beyond the lacklustre world growth and low inflation, there were a number of key events in 2002. Argentina's one-to-one peg of the peso to the American dollar, that had led to a significantly overvalued peso, collapsed. Against the one-to-one rate at the end of last year, the current exchange rate is 3,54 peso per dollar. The Argentinian economy has been contracting, while their inflation rate has accelerated to more than 40 per cent.

Brazil experienced some problems, partly related to the country's high government debt and its linkages with troubled Argentina. IMF funding is helping to soften the adjustment process.

In the Northern reaches of the American continent, the demise of Enron led to disillusionment with corporate governance and accounting practices. This has led to a greater awareness of the need for sound structures and practices, revised codes of conduct and a sharpening of regulation.

And, closer to home, there were unfavourable climatic conditions in large parts of Southern Africa together with policies in some of our neighbouring countries which disrupted food production. As a result, the region is becoming dependent on large-scale imports of food.

3. The South African economy in 2002

The exchange rate of the rand has been at the centre of most discussions of economic developments this year. Against a basket of currencies the rand lost 34 per cent of its value during 2001 - mostly in the final two months of the year. Its gyrations were the topic of an official enquiry led by Judge Myburgh. Not surprisingly, it was found that quite a number of factors could have contributed to its sharp depreciation. Some of these factors reinforced each other, causing an exceptional overshooting of the exchange rate. At one stage importers speeded up payment for imports, afraid that they would otherwise have to pay even more rand for their import consignments, while at the same time exporters delayed repatriating their export proceeds, expecting that by doing so they would be able to exchange their foreign earnings for even more rand later on. Of course, this could not last indefinitely. With imports becoming horrendously expensive and with South African exports extremely price-competitive, supply and demand fundamentals came to the fore and the exchange rate had to turn around. From the beginning of 2002 to date the rand has appreciated by 24 per cent against a basket of currencies.

To illustrate what happened to the rand's international purchasing power, in terms which may be diplomatically familiar: a 25 pound dinner in a London restaurant would have set a South African diplomat back R280 at the beginning of 2001. Just before Christmas 2001, it would have cost the diplomat R500. Today, the same meal's bill will amount to R360.

Looking back at 2002, the competitiveness gained by the South African economy on account of the (overdone) exchange rate depreciation helped to smooth domestic production and income during a period of general weakness in the world economy. Import substitution progressed and South African exports penetrated various markets quite successfully. This was helped along by improved market access. In this regard, the Africa Growth and Opportunity Act of the United States should be mentioned, along with the European Union Free Trade Agreement and the Southern African Development Community Free Trade Agreement. Most importantly, numerous South African companies are reorienting their strategies, aiming to structurally raise their share of output flowing to the export market. In the process, upcoming markets such as China and India are also receiving due attention.

Tourism is also doing well in spite of, and perhaps even because of, the unease following the September 11 attacks. South Africa is a pleasant destination. The number of non-residents visiting South Africa rose from 4,8 million in the first 10 months of 2001 to 5,3 million in the same period of 2002. Visitor numbers from virtually all countries have increased significantly, with the exception of Argentina - the worsening of the exchange rate in that instance caused a decrease from 13 000 persons in the ten months to October last year to 4 000 this year.

Under these circumstances, South Africa maintained a healthy growth rate in the first three quarters of 2002. It seems likely that growth in real gross domestic product this year will amount to around 3 per cent, compared to 2,8 per cent in 2001. It is also heartening that the growth is spread across virtually all sectors of the economy.

A further gratifying aspect of the economy's current performance is the acceleration in real fixed capital formation, so necessary to boost the future production potential of the economy. From a contraction in 1999, real fixed capital formation reversed to 0,8 per cent growth in 2000, 3,6 per cent growth in 2001 and 7,6 per cent year-on-year growth in the third quarter of 2002. Once again, the acceleration is fairly widely spread over the various sectors of the economy.

The accusation is often heard that South Africa grows, but without creating jobs for the huge number of unemployed people. However, in the second quarter of 2002 our quarterly surveyed non-agricultural employment series picked up, rising by about 0,6 per cent. This may be early days, but it stands in welcome contrast to the declining trend in such employment recorded since 1989.

Sadly, the 2001 fall in the external value of the rand caused a strong surge in inflation in 2002. This was first and foremost visible in production prices, which accelerated from a twelve-month rate of increase of 7,8 per cent in September 2001 to double-digit rates right from January 2002, peaking at 15,4 per cent in both August and September. In October it abated somewhat to 14,6 per cent.

Consumer price inflation took longer to pick up. Twelve-month CPIX inflation accelerated from 5,8 per cent in September 2001 to double-digit levels from August 2002, reaching 12,5 per cent in October. Both at the production and consumer level, food price inflation picked up dramatically, reaching maximum year-on-year levels of 30 and 20 per cent respectively. This was related to the exchange rate depreciation coupled with the need to import grain into the Southern African region.

In the face of these inflationary forces, and given the imperative to work inflation down again to the 6 to 3 per cent target range, the South African Reserve Bank responded by tightening monetary policy. On each occasion, in January, March, June and September 2002, the Reserve Bank's repurchase rate was raised by one percentage point, leading to corresponding increases in the interest rates charged by commercial banks. The banks' prime overdraft rate for instance rose from 13 per cent at the beginning at the year to 17 per cent at present. At that level, the public is clearly feeling the impact of monetary policy. Our assessment is that this will be sufficient to bring inflation down in a fairly dramatic fashion during the course of next year. But dishing out this medicine doesn't make the Bank very popular.

Partly in reaction to the tighter monetary conditions, growth in credit extension has come down from a twelve-month rate of 15,6 per cent in January 2002 to 8,8 per cent in October. Growth in M3 has been more sticky, receding from 19,7 per cent to 17,8 per cent over the same period. This still doesn't leave any room for complacency, but calls for ongoing scrutiny of all available information about our economy.

An extremely positive element of our financial situation is the reduction in the Reserve Bank's exposure to foreign exchange rate risk, as captured in the decrease in the our net open foreign currency position (NOFP). This has receded from US$23,2 billion in September 1998 to $4,8 billion at the end of 2001 and $1,7 billion at present. At the same time, South Africa's foreign exchange reserve level is quite strong at around 20 weeks' worth of imports, double as much as 5 years ago.

It is my pleasant duty to also point out that South Africa's government finances are in a healthy shape, with tax revenue again exceeding earlier projections and the deficit before borrowing for 2002/03 now projected to amount to only 1,6 per cent of GDP.

Less pleasant to point out are the setbacks to our banking system in early 2002. One troubled bank's business was eventually sold off to other institutions, while a second medium-sized bank was acquired by one of the big four banks. This episode tested numerous depositors' and bankers' nerves to the extreme; many elderly investors now choose to keep their deposits with more than one institution, which is a wise move.

4. Financial markets

South Africa's financial markets are robust, liquid and well-developed. Turnovers remained brisk in 2002 to date. In the bond market, for example, the value of turnover in a single month is approximately equal to South Africa's annual gross domestic product of one trillion rand. Non-residents also take a keen interest in these markets. In an average month non-residents buy more than a R100 billion in bonds and R18 billion in shares on our bourses. They of course usually sell bonds and shares of a roughly equal amount, but some net inflow or outflow is recorded from month to month. During the first half of 2002 nonresidents bought a net amount of R13 billion in shares and bonds on the South African formal exchanges, but sold R17 billion during the third quarter. Further net sales in October were followed by net purchases in November. Predicting foreign portfolio capital flows is clearly dangerous, only to be surpassed by bargaining on net inflows from that source.

South African share prices performed well up to May 2002, but then fell back sharply, partly in sympathy with foreign bourses as Enronitis took hold. In rand terms, the JSE overall price index is currently 10 per cent down on its value at the end of last year. Nonresidents, because of the 24 per cent stronger exchange rate of the rand, nevertheless made substantial profits on the JSE in foreign currency terms. Those who had invested in South African bonds or real estate in early 2002 of course recorded even better returns, since in contrast to shares those asset prices also rose handsomely in rand terms.

But beyond these events on the formalised exchanges involving portfolio capital flows, South Africa has an important role to play in the area of foreign direct investment. In particular, numerous direct investment projects into other parts of Africa are being undertaken, fitting in under the broad NEPAD initiative. South Africa's involvement ranges from the Mozal smelter in Mozambique to SAA's participation in Tanzania, and includes hotels, factories, cellphone operators and shops in numerous countries on the African continent. South Africa's investments in Africa at the end of 2000 exceeded R24 billion.

Other continents are also attracting the attention of South African companies that are leaders in their respective fields and some of these companies have sought listings on foreign exchanges. Companies like the resources giants Anglo American and Billiton, the financial services companies Investec and Old Mutual, the brewer SABMiller and Sappi, the pulp and paper company now have global reach and are making their presence felt beyond their home market.

5. Conclusion

In short, then, the South African economy is in fairly good shape, with the exception of the inflationary consequences of the 2001 exchange rate depreciation. And the four interest rate increases as well as the notable appreciation of the rand in 2002 will in due course brake the inflation spiral decisively.

While my address tonight focused on broad macroeconomic trends, it is worthwhile to stress that the macroeconomy is built up from the microeconomic decisions and actions of millions of participants. Real life happens at the microeconomic level. As diplomats you will know that it is your individual encounter with the businessperson or potential tourist that counts - where interest in South Africa or in your country is either nurtured, or nipped in the bud. A sparkling, enthusiastic, well-informed diplomat is a catalyst forging friendship and economic ties across borders. Indifference or ignorance sabotages these linkages.

Accordingly, I would like to challenge you to continue deepening your knowledge of our country, its people, its economy, its incentives, rules and regulations, its magnificent places. True expert knowledge takes many years to build up, plus a lifetime of ongoing study to maintain. But it enables one to sparkle, to catch the attention of the key investor or potential tourist, to make things happen. I wish you well in 2003 and beyond in sparkling for your fraternal countries, forging links that are crucial to our mutual economic success and our ability to understand and appreciate one another.

Once again it is our honour and privilege to host you at this function which has become one of the highlights of the calendar of the South African Reserve Bank. May the friendships between South Africa and your countries continue to go from strength to strength.

Thank you.