T T Mboweni: The implications of the global crisis for South Africa and policy responses

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, to the Road Freight Association Convention, Vanderbijlpark, 19 May 2009.

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1. Introduction

1.1 The world is in the midst of the most severe slowdown since the Great Depression of the late 1920s. We have seen negative growth rates in many countries, developing and industrialised, and world trade has declined dramatically. However, there are tentative signs that the global economy may be responding to the co-ordinated monetary and fiscal policy stimuli and that the worst of the contraction may be behind us. Nevertheless the recovery is likely to be slow and protracted. Unfortunately the integrated nature of the global economy means that South Africa has not been spared, and our future growth prospects are dependent to an important degree on global developments.

1.2 The domestic slowdown has had a direct impact on the road freight industry, which moves in excess of 80 per cent of the total load freight in South Africa. The road freight industry has grown in importance over recent years in an environment of relatively high economic growth and static rail freight tonnages. According to a recent CSIR report[1], in 2007 road transport accounted for 87 per cent of tons transported in South Africa. It goes without saying that if domestic output declines, the impact on the road freight transport sector could be significant.

2. Global economic developments

2.1 Some of the recent developments in the global economy have been quite dramatic. In the fourth quarter of 2008, the so-called advanced economies experienced a contraction of 7,5 per cent in GDP, with the United States economy contracting by 6,2 per cent (quarter-on-quarter annualised), and by 6,1 per cent in the first quarter of 2009. The UK economy contracted by 6,1 per cent and 7,4 per cent in the same quarters respectively. Our other major trading partners fared no better. In the fourth quarter of 2008, Japan contracted by 12,1 per cent, the euro area by 6,3 per cent, and within the euro area, Germany contracted by 8,2 per cent. Developing and emerging market economies were also part of the synchronised downturn, contracting by 4 per cent. While China managed to grow by 1,4 per cent in that quarter, the Indian economy experienced zero growth. Taiwan, South Korea and Thailand experienced quarter-on-quarter annualised contractions in excess of 20 per cent, while contractions were also experienced in eastern and central Europe and Latin America.

2.2 The outlook for the global economy in 2009 remains gloomy, with the IMF, the World Bank and the OECD all forecasting negative growth for the year as a whole. The discussions at the recent IMF meetings confirmed a negative outlook, although demand stimuli and natural stabilisers are expected to start having an impact later in the year, and there are tentative signs that this may be the case.

2.3 The pace of the downturn has been confounding the forecasters, and there have been continuous and large downward revisions of growth forecasts during the past few months. According to the latest IMF forecasts, the world economy, which grew by 3,2 per cent in 2008, is now expected to contract by 1,3 per cent in 2009. In January, the forecast for 2009

[1] The Fifth Annual State of Logistics Survey for South Africa, CSIR, 2008.

was for the world economy to grow by 0,5 per cent. The so-called advanced economies are expected to contract by 3,8 per cent this year, while emerging market and developing country growth is forecast to be 1,6 per cent. Africa is expected to experience growth of 2 per cent. A modest recovery is forecast for 2010: the advanced economies are expected to experience zero growth compared to emerging market and developing economies growth of 4,0 per cent.

2.4 The impact on world trade from these events has been pronounced, and the World Trade Organisation predicted that the volume of global merchandise trade would contract by 9 per cent this year, compared to an annual average growth rate in trade in excess of 6 per cent since 1990. In an environment of weak demand and lack of trade finance, international trade will continue to suffer. The motor industry has been particularly hard hit as demand continues to decline globally. Japanese motor vehicle exports declined by almost 50 per cent year-on-year in February, while global exports of motor vehicles declined by 64 per cent in that month. Not surprisingly, protectionist tendencies have emerged, with some countries providing subsidies and discriminatory procurement provisions in national stimulus packages.

2.5 Also of relevance to the South African economy has been the sharp decline in commodity prices. Fortunately, gold prices have remained relatively firm. The gold price declined from a high of around US$1000 per ounce in March 2008 to around US$712 in November, but is currently trading above US920 per ounce. However other commodities have not fared as well. From a high of US$2250 per ounce in March 2008, platinum prices declined to US$771 per ounce, before recovering to current levels of around US$1130 per ounce. Aluminium prices reached levels in excess of US$3300 per ton in July 2008, but by February 2009 the price had declined to below US$1300 per ton and currently around levels of US$1540 per ton. Similar trends are evident in the behaviour of other commodity prices. Of course, oil price developments have benefited us. Having reached levels of almost US$150 per barrel in July last year, international oil prices declined to below US$35 per barrel, and are now at levels around US$57 per barrel. Commodity prices in general are likely to remain subdued in line with global growth

2.6 The turmoil on the international financial markets has also impacted on the destination and size of capital flows. Not surprisingly, capital flows to the developing and emerging market economies have declined, with the International Institute of Finance expecting flows to emerging markets to decline from over US$900 billion in 2007 to around US$165 billion in 2009. This has implications for exchange rates and the financing of current account deficits in these countries, at a time when export markets are under pressure. Capital is in fact flowing back to the US, the source of the current crisis. We are told that this is a “flight to quality” or “risk aversion”. An irony indeed.

3. The implications for the South African economy

3.1 Given South Africa’s close trade and financial links with the global economy, it is not surprising that the South African economy would be affected by these adverse developments. After 4 years of GDP growth around or in excess of 5 per cent, the growth rate declined to 3,1 per cent in 2008, with a contraction of 1,8 per cent in the fourth quarter. Current indications are that the negative trend continued in the first quarter of this year. The high frequency data indicate that the manufacturing sector in particular remains under pressure: recent data from Statistics South Africa show that manufacturing output in the first quarter of 2009 declined by 6,8 per cent relative to the previous quarter, while mining production declined by 12,8 per cent over the same period. The utilisation of manufacturing productive capacity declined to its lowest level in ten years. Quarter-on-quarter declines were also seen in retail and wholesale trade sales, while motor vehicle domestic sales and exports also continued to contract significantly.

3.2 The impact on employment was also felt in the final quarter of 2008 when employment levels decreased for the first time in almost four year. Employment declined by 0,7 per cent, with the private sector shedding over 45,000 jobs. Most of the forward-looking confidence indices indicate that a turnaround cannot be expected until at least later in this year.

3.3 These developments are also reflected in the financial markets. In particular, house prices have been stagnant or falling, and the stock exchange has lost about a third of its value since September last year. Although exports have been affected, imports have also declined in the wake of weak demand and lower international oil prices, resulting in a moderation of the current account deficit in the fourth quarter of 2009 to 5,8 per cent of GDP. Despite lower capital inflows, we were still able to finance the deficit on the current account. In line with other emerging economies, the rand exchange rate has been relatively volatile over this turbulent period, although it has recovered significantly since the lows seen in late 2008.

3.4 While it seems clear that the first quarter of this year was also one of negative growth, the general view is that the worst is probably behind us and that things may start to improve slowly in the coming months. The latest consensus surveys indicate that growth is expected to be low but positive in the final two quarters of this year, and to recover to around 2,7 per cent next year.

4. Policy responses

4.1 There has been a multi-faceted global response to the crisis. As was noted in the G-20 London Summit Statement of 2 April 2009, “a global crisis requires a global solution”. The G-20 countries pledged “to do whatever is necessary to restore confidence, growth, and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; and fund and reform our international financial institutions to overcome this crisis and to prevent future ones” These are noble and correct sentiments, but it is the implementation that counts. A few comments on some of these themes may be in order.

4.2 Firstly, there is no doubt that for the crisis to be resolved, countries with banks exposed to the toxic assets will have to clean up their banking systems. These toxic assets will have to be taken off the balance sheets, the banks recapitalised and sufficient trust built up so that banks can start lending again. There is no easy solution for achieving this, and no simple blueprint. Countries will differ as to how they tackle this problem. But as long as banks are unwilling to lend, and demand remains subdued, the recovery cannot happen. The recent stress-tests conducted on US banks indicated that while banks still remain under pressure and some require further recapitalisation, the worst of the bad news may be behind us.

4.3 Fortunately our banking system is still allowing credit to flow, although much stricter lending criteria are being applied by banks. But unlike in Europe and the US, our interbank market is working normally, the capital adequacy ratios are strong, and no bank has had to approach the South African Reserve Bank for any extraordinary assistance. Although exchange controls irritate many, in this case the existence of these controls, in conjunction with appropriate supervision of the banks, spared us the need to have to find ways to bail out and recapitalise our banks.

4.4 Secondly, there has to be an improvement in banking regulations and supervision. Those elements of the financial system that have been able to avoid regulation must be brought into the regulatory net, and ways must be sought to ensure that regulation does not promote procyclical behaviour on the part of the banks. But we have to be mindful of the danger of over-regulation. There is always the danger that a crisis can spur excessive regulation and stifle the ability of banks to operate normally in the future. A fine balance will have to be achieved between the dangers of over-regulation and allowing banks to undertake normal lending operations. We are likely to see a return to the more traditionally type of banking for some time.

4.5 Third, there have to be appropriate policy responses to restore growth. The G-20 statement underlined the need for continued concerted and exceptional monetary and fiscal policy stimuli. With respect to monetary policy, in many countries, despite the low policy rates, banks are charging much higher spreads over the policy rates because of higher perceived risks. At the same time, households are trying to repair their balance sheets which have been adversely affected by declines in house and equity prices. In other words, the monetary transmission mechanisms are impaired, and what usually works in a relatively predicable way under normal circumstances, may not work in the same way under current abnormal circumstances. The further danger we face is that as the balance sheets of the central banks expand rapidly, down the line there may be inflationary pressures. Central banks will have to be ready to absorb this excess liquidity, but without killing off the recovery.

4.6 The G-20 recognises that even within the framework of a co-ordinated response, local conditions will shape the nature of the response of individual countries. While many countries responded with substantial interest rate reductions, these responses were carried out in the context of very low inflation in many instances, and the need to provide liquidity to ailing banking sectors. While the response of the South African Reserve Bank may appear to be less strong than in many other countries, it should be borne in mind that we started out with a relatively high inflation rate and a relatively healthy banking system. We are seeing a slowdown in the rate of inflation and, although it is relatively sticky, we still expect to be back within the target over the medium term. This has allowed for a 350 basis point reduction in the repurchase rate to date. A continuation of this slowdown of inflation, in part a result of the widening output gap, may allow for further monetary easing.

4.7 As part of stimulus packages, many countries have focused on increasing expenditure on infrastructure. This cannot happen overnight. We have been fortunate that our infrastructural expenditure programme has been accelerating for the past few years, and has therefore come on stream at a time when it is most needed. This has been most fortuitous. Anyone travelling on our national roads will have been frustrated by the inconvenience of the scale of the road upgrades, but we have to remember the positive side: that this infrastructural expenditure is helping to underpin domestic expenditure. Furthermore, such expenditure will help to increase the potential output of the economy over time, and therefore raise the sustainable long term growth rate. According to National Treasury estimates, public sector infrastructure expenditure is expected to average 9,7 percent of GDP over the coming three fiscal years, compared to 4,5 per cent in the 2005/6 fiscal year. During the current fiscal year, total expenditure by the SA National Roads Agency Ltd (SANRAL) on roads is estimated at R19,6 billion, compared to R2,2 billion in 2005/06. I am sure your truck drivers will be pleased when all this construction is completed.

4.8 It is also important to appreciate that monetary and fiscal policies have to be supplemented with other policies and structural reforms. In times of crisis, people tend to forget about longer term structural reforms and focus on the immediate crisis. But it is the structural reforms that will be important to get economies going again. For example industrial policies which can supplement other policy initiatives.

5. Conclusion

5.1 The G-20 proposals contain many important elements that will go a long way to help with the global recovery. However the proof will be in the implementation. Recovery programmes, particularly those which involve coordination between countries can take a while to implement, let alone show results. We also need to ensure that the measures undertaken to ensure the recovery do not sow the seeds of future crises. There are likely to be a number of false dawns on the long road to recovery, but hopefully we are on that road.

Thank you very much.