Mr. Stals asks whether the East Asian financial crisis can be repeated in South Africa Address by the Governor of the Reserve Bank of South Africa, Mr. C. Stals, at a breakfast meeting organised by Life Line West Rand in Krugersdorp on 29/4/98.

1. Background to the East Asian crisis

It is now history that the economies of a number of East Asian countries collapsed in the second half of 1997 and created disruptive turmoil in financial markets around the world. The countries most affected were Indonesia, the Republic of Korea, Malaysia, the Philippines and Thailand.

A number of reasons were provided for this collapse which shocked the world economy, particularly because it occurred in those countries that were the most successful in achieving their economic development objectives during the past thirty years. The main reasons included:

- a substantial build-up of foreign liabilities -- particularly of a short-term nature -- took place over the protracted period of rapid economic growth;

- the financial sectors were not properly supervised and regulated, with the result that banking institutions accumulated large amounts of non-performing loans, not provided for in capital and reserves;

- there were unjustified governmental interventions in the normal working of the financial markets. Financial institutions were, for example, instructed to make loans to preferred clients at low interest rates;

- governance within private sector institutions, public corporations and government departments was of low quality and, in the case of some countries, undermined by corruption;
- macroeconomic policies did not adjust to the changing environment; markets were liberalised without concurrent adjustment in internal economic structures; money supply and bank credit extension increased almost unchecked; interest rates were kept artificially low, and exchange rates were not allowed to adjust in accordance with changes in the overall balance of payments situation.

The final collapse was triggered first in Thailand, when foreign investors lost confidence in the economy and started to withdraw part of their more liquid investments from the country. The authorities were very slow to react to the threatening crisis. As became evident at a later stage, important information on the deteriorating economic situation was withheld from the markets and vital statistics were, in some cases, deliberately not released.

In the end, the International Monetary Fund, the World Bank, a number of the governments of industrial countries, and the international investment community, had to provide a massive amount of financial support -- more than US $120 billion -- to assist these countries. The countries themselves also had to implement painful corrective measures that will, over time, restore equilibrium in their economies. These programmes inter alia provide for:

- relatively restrictive monetary policies that must prevent further depreciation of the currencies to protect domestic institutions with outstanding foreign liabilities from further losses, and must eventually reduce inflation;

- the restructuring of the financial sectors through predetermined reform agendas in each country. Public sector rescue operations must be supported by cost sharing sacrifices from the private sector, and prudential regulations for financial institutions must be tightened;

- improvements in public and corporate governance and a strengthening of transparency and accountability;

- a reduction in the dependence of public sector budgets on external funds, and fiscal provision for the costs of restructuring and recapitalising banking systems.

The devastating effects of the crises can be illustrated by a few statistics from some of the affected countries. According to a recent World Bank report, prices of key commodities, such as rice, increased by 25 per cent or more in Indonesia, leading to food riots and major demonstrations against the Government. Unemployment is rising sharply and will increase the number of people living below the poverty line from 23 million to 40 million during the course of 1998.

In Korea, bankruptcies and unemployment are on the rise. Eight of the thirty biggest conglomerates (chaebol) have filed for liquidation. Unemployment is expected to increase from 500,000 last year to 1.2 million workers soon.

In Thailand, the slump in industry is severe. Monthly sales of motor vehicles, steel, consumer electronic goods and durable consumer goods are now running at levels of 35 to 75 per cent down on last year. Industrial output growth is expected to decline by about 50 per cent.

In terms of the latest World Economic Outlook of the International Monetary Fund, the global economic growth rate for 1998 will be reduced by the East Asian crisis from a previous forecast of 3½ per cent to not more than 3 per cent in 1998. This will have an adverse effect on world trade, and also on the export prospects for countries such as South Africa. It further deteriorates the outlook for an early economic recovery in Japan, and also holds adverse effects for many emerging market economies.

2. The South African situation

The South African economy was so far relatively little affected by the East Asian crisis. The foreign exchange market, and particularly the exchange rate of the rand, came under pressure for only a few weeks in October last year. Prices on the Johannesburg Stock Exchange were more directly affected, although the declines registered at that time were wiped out by a strong bull run over the past three months.

Some other emerging markets, for example Brazil, were affected much more severely than South Africa. The question is often asked why was South Africa left almost unimpaired by the East Asian crisis? There are a number of reasons for this:

> Firstly, it must be remembered that South Africa had its own mini-crisis in 1996 when sudden capital outflows from the country forced a depreciation of the rand of more than 20 per cent, and the introduction of restrictive fiscal and monetary policies that reduced the growth rate in total domestic expenditure from 5.0 per cent in 1995 to 2.7 per cent in 1996, and 1.4 per cent in 1997. At the time of the East Asian crisis, South Africa had just gone through a very painful downward economic adjustment

period that satisfied foreign investors of our resolve to apply acceptable macroeconomic disciplines.

Secondly, the South African problems of 1996 were created by a cyclical disequilibrium, following from excessive rates of growth in total domestic expenditure, and this situation could be corrected fairly easily with the right kind of monetary and fiscal policies. In most of the East Asian countries, the fundamental problems are more of a structural nature and will require longer and more painful adjustments to restore growth to previous levels.

There are, nevertheless, a number of lessons to be learned by South Africa from the East Asian crisis. Our country is also being integrated more and more into the global markets of the world and, as in the case of those countries, developments in South Africa are also subject to the very critical surveillance of the international investors' community. At this stage, their critical monitors are being focused on:

- the health and soundness of the domestic financial sector;
- the openness and efficiency of the money and capital markets, and the market in foreign exchange;
- the transparency, both of policies and of macroeconomic data made available by the authorities;
- the quality of governance in both the public and the private sectors of the economy;
- the macroeconomic policies followed in the country by the monetary and fiscal authorities, and in respect of labour and commodity markets;
- the overall balance of payments situation, including developments in the current and in the capital accounts; and
- the total outstanding foreign liabilities, with special reference to the vulnerability of the country for sudden outflows of capital.

In recent months, foreign investors showed their satisfaction with the South African situation by continuing to increase their investments in South Africa. Over the first four months of this year, non-residents increased their holdings of South African equities and bonds by no less than R34 billion. This enabled South Africa to continue with the programme of gradually relaxing exchange controls, and also helped the Reserve Bank to increase its net foreign reserves by R4.9 billion during the first quarter of this year.

South Africa can continue to hold the confidence of foreign investors, provided we are also prepared to continue to apply the sound monetary and fiscal policies of the past year. If not, foreign market sentiment towards the country can change very quickly, and we can easily be forced into a new financial market crisis of our own.

With his latest Budget, the Minister of Finance reconfirmed the Government's determination to maintain the necessary disciplines in fiscal policy. The Reserve Bank is known for its conservative approach towards monetary policy, and is equally determined to maintain strict disciplines in the management of the money and banking systems of the country. In this way, South Africa will continue to benefit from being part of the global financial system, and to make use of the savings of other countries to help finance growth and development.

In summary, it depends on us and on the economic policies we apply, whether an East Asian crisis will also develop in South Africa. Foreign investors nodded their approval of the policies of the past year. We should therefore not deviate unnecessarily from the course of the existing policies.