Globalisation and deglobalisation

South African Reserve Bank

Abstract

South Africa is a small open economy characterised by increasing trade and financial integration since the advent of democracy in 1994. The country's business cycle has been strongly synchronised with the rest of world, with large common shocks accounting for much of the increased synchronisation. South Africa's major trading partners are China, Germany, India, Japan, the United Kingdom and the United States. Exports are dominated by commodities and imports by oil and manufactured goods. Globalisation has added to the economy's productive capacity through increased choice and cheaper inputs for production, thus relieving bottlenecks and supply side pressures on price formation. But exposure to global markets has not been entirely smooth, with some industries, such as the motor production industry, benefiting, and others, such as clothing and textile industry, suffering. The globalisation of the economy has also been characterised by a rise in immigration and emigration flows.

Keywords: Imports, exports, trade, globalisation, immigration, protectionism.

JEL classification: E31, F15, F31, F32, F40, F62.

Introduction

Very low global interest rates following the Great Financial Crisis (GFC) have helped to revive capital flows to emerging market economies (EMEs). However, post-crisis, global growth has become less trade-intensive and cross-border bank lending has also retreated somewhat. In addition, the benefits of globalisation and multilateralism are being questioned, at a time when a strengthening of international institutions and intensification of economic cooperation is needed to ensure sustainable growth. The evolving cycle of globalisation, as well as the challenges and benefits this brings to EMEs, warrant special attention in policy circles.

South Africa is a small open economy characterised by increasing trade and financial integration since the advent of democracy in April 1994. The globalisation of the economy has also been attended by a rise in both immigration and emigration flows. This note provides an overview of these trends, with a focus on trade and some observations on financial and population flows.

South Africa's international trade and population flows

South Africa's trade openness ratio, measured as the sum of exports and imports to gross domestic product (GDP) in nominal terms, increased from 37% in 1992 to approximately 60% in 2016 (Annex Graph 1). There has also been a significant rise in the country's financial openness over the last three decades, as is evident from the ratio of foreign owned assets and liabilities to GDP increasing from 50% in 1992 to just over 250% in 2016 (Annex Graph 2). Import volumes (export volumes) have grown at an average rate of 5.7% (3.3%) per year since the mid-1990s.

While the trade balance was largely positive up to 2003, it was negative from 2004 until 2008 and again from 2012 until 2015. Effectively, because of the import content of domestic demand, accelerations in the latter have tended to drive the trade balance into deficit, unless accompanied by strong terms of trade gains. Exports are dominated by commodities, (such as mineral products, precious metals and products of iron and steel), vehicles and transport equipment, machinery and electrical equipment, which all accounted for 59% of total exports in 2016.[1] Similarly, the main imported goods include machinery, petroleum, chemicals, vehicles and equipment components (Annex Graphs 3 and 4). These products accounted for almost two thirds of total imports in 2016.

South Africa's major trading partners are China, Germany, India, Japan, the United Kingdom and the United States.[2] Domestic export performance is heavily reliant on demand in advanced countries.[3] However, in recent years there has been a shift towards greater trade with Africa, with the continent accounting for 18.4% of South Africa's exports in 2016 compared with 13.4% in 2000.[4] Asia's importance as an export destination has also increased over time. This has been largely due to Chinese demand for commodities.[5] However, recent efforts by China to restructure its economy towards consumption-led growth has caused demand for commodity imports to taper off somewhat. By contrast, the pick-up in global economic activity has favoured growth in sub-Saharan Africa, which has resulted in increased demand for South African exports, specifically from the Southern African Development Community (SADC) (see Annex Graphs 5 and 6).

Export growth has also been impacted by domestic factors on the supply side. These include skills shortages, increased costs and bottlenecks in electricity supply and declining labour productivity in the mining sector.[6] The agricultural sector

1 Motor vehicle exports have also played a significant role in South Africa's export mix and accounted for 12% of total exports in 2016.

2 These countries accounted for 50% of total merchandise trade with South Africa in 2013.

3 The United States, Germany, Japan and United Kingdom accounted for an average of 30% of demand for South African exports over the period 2000–16.

4 These figures are for exports to Africa excluding Botswana, Lesotho, Namibia and Swaziland as statistics for this group of countries has only been collected since 2010. In 2016, including these countries, South African exports to Africa account for 28.9% of total exports.

5 South Africa's exports to China grew by 28% per annum on average over the past 15 years.

6 Electricity constraints have adversely impacted productivity levels in many South African industries. For example, the mining sector consumes approximately 15% of the total electricity supply and this sector was severely affected by energy shortages. In addition, the mining sector has experienced challenges with productivity – labour productivity in particular. For example, platinum output per worker declined by 49% between 1999 and 2014, while real labour costs increased by 309% during the same period. In addition, declining ore grades, ageing mines and production disruptions (strikes, community disruptions, illegal mining) have also added to the woes of the mining sector.

meanwhile has been negatively affected by climatic conditions.[7] In addition, rigid product and labour markets have also adversely impacted the competitiveness of South African producers.

South Africa's exposure to global value chains (GVCs) is limited. Participation in GVCs has been largely through the provision of raw or less-transformed commodities at the lower end of the value chain. Given the recent sharp slowdown in the expansion of GVCs – which, some have argued, may be related to the threats of increased protectionism – this lack of integration has been a buffer against a decline in trade activity. Equally, South Africa does not have the kind of large trade surpluses with advanced economies (for example, the United States) that have triggered calls for protectionist measures, or reviews of existing trade agreements. The large degree of overlap in the commodities produced in the Southern African region may explain why regional GVCs have not developed. In addition, barriers to trade (eg taxes and border inefficiencies) and insufficient development and integration of the regional trade network (eg transport, communication, finance, and payment systems) have also been contributing factors.

After the collapse of apartheid, immigration has been largely the result of political, social and economic developments in other parts of Africa, with most immigrants arriving from the SADC region.[8] A significant pull factor is that South Africa is the most advanced economy on the continent, offering higher wages than most countries in the region. It is no surprise then that many migrants come from the SADC to work in mining, construction, agriculture, hospitality and domestic work, all seen as semi-skilled and low-skilled sectors. South Africa also experiences robust inflows of asylum seekers. An increase in the population inflow from neighbouring countries over time has been associated with an emergence of xenophobic behaviour amid perceptions that foreigners have been getting, inter alia, easier access to housing benefits, and have been taking jobs away from locals in a number of sectors.

Emigrant flows, meanwhile, have primarily been to English-speaking advanced economies such as Australia, the United Kingdom and the United States. As is the case in many developing countries, these outflows have been dominated by skilled professionals.[9]

7 The threats to the agricultural sector include changes in rain patterns, increased evaporation rates, higher temperatures, increased pests and diseases and pest distribution ranges, reduced yields and spatial shifts in optimum growing regions. Some analysts have argued that these threaten South Africa's status as a net food exporter as well as the very important seasonal employment for unskilled workers provided by this sector

8 Department of Home Affairs, "White paper on international migration", 2017, www.dha.gov.za/WhitePaper-Gazette_z.pdf.

9 For example, in 2011, 63% of South Africans in Australia were employed in either a skilled managerial, professional or trade occupation, https://businesstech.co.za/news/business/130998/these-are-the-skills-south-africans-are-taking-to-australia/ (accessed 26 November 2017).

Macroeconomic and distributional effects of globalisation

Increased financial integration has been found to have an uneven effect on global business cycle integration, resulting in lower business cycle co-movement during tranquil times and greater business cycle co-movement during crises.[10] In the past decade, sizeable cross-border capital flows have allowed the persistence of large current account deficits or surpluses in some countries, resulting in threats to global financial stability. More recently, these large imbalances have shrunk quite significantly in some cases, but unfortunately for countries that still run structural current account deficits, such as South Africa, the financing of these deficits may pose a problem in future.

In South Africa's case, the business cycle has been strongly synchronised with the rest of world, with large common shocks accounting for much of the increased synchronisation.[11] The variation in South Africa's industrial production due to spill-overs from trading partners and common shocks averaged 38% over the past 25 years and reached a peak of 62% over the 2009–13 period, due mainly to the global financial crisis.[12]

Annex Graph 7 shows the recent decoupling of South Africa's GDP growth from world economic growth and shows a slowdown relative to both advanced economies and emerging market and developing economies. Evidence suggests that the breakdown of this relationship may be due to declining commodity prices and confidence levels.[13] However, decoupling over the recent past is also due to policy uncertainties, declining productivity levels, lack of fixed investment, tax hikes and inefficiencies in public expenditures.

With increased globalisation, South Africa's current account has been predominantly negative. From 1994 until 2003 it was quite stable, averaging –0.62% of GDP, but as the trade balance turned negative, further pressure resulted in more frequent current account deficit periods, of a higher magnitude from 2004 until 2011 the average balance on the current account was –3.5% of GDP. More recently, the ratio of the current account to GDP improved to –1.7% in the fourth quarter of 2016 (up from –6.7% in Q3 2013), before deteriorating marginally to –2.0% in the third quarter of 2017. In the main, changes in the trade balance, and, as a result, in the current account balance, have been driven since 2004 by movements in commodity exports, and imports of oil and machinery.[14] In addition, the recovery from the 2013 low was hampered by a significant rise in maize imports, as a result of the drought in major agricultural areas of the country. To date, the current account deficit has been

10 E Monnet and D Puy, "Has globalization really increased business cycle synchronization?", *IMF Working Papers*, no 16/54, 2016.

11 I Botha, "A comparative analysis of the synchronisation of business cycles for developed and developing economies with the world business cycle", *ERSA Working Papers*, no 132, 2009.

12 F Ruch, "The impact of international spillovers on the South African economy", *SARB Working Papers*, WP/13/02, 2013.

13 T Janse van Rensburg and E Visser, "Decoupling from global growth – Is confidence becoming a scarce commodity?", *SARB Occasional Bulletin of Economic Notes*, OBEN/17/03, 2017.

14 R Walter and D Fowkes, "Current account rebalancing: an exploration of the trade data", *SARB Occasional Economic Notes*, OBEN/17/01, 2016.

adequately financed through capital inflows – albeit portfolio flows which, by their nature, are subject to considerable volatility, something of particular relevance to South Africa given the recent sovereign credit rating downgrades.

Trade is unequivocally beneficial for South Africa, as is evident from the strong positive correlation between trade openness and growth (see Graph 8). The benefits were observed in the trade patterns of the country during high growth periods such as in 2006, when real GDP grew by 5.6%. At the time, export volumes from South Africa grew by 7.5%, far quicker than the growth rate of 1.8% recorded in 2016, alongside real GDP growth of 0.3% over the period. Import volumes, on the other hand, grew by 18.3% in 2006, compared with a contraction of 0.4% in 2016. This highlights the importance of trade, both outward and inward (especially imports of intermediate goods used in the domestic production process), for domestic economic performance.

Additionally, at an aggregate level, we find that there is a positive correlation between globalisation and growth and, linked to this, a positive correlation between globalisation and employment, with the link being much stronger in the case of trade openness than of financial openness (see Graph 8). However, it is worth noting that South Africa's Gini coefficient increased from 59.3% in 1993 to 65% in 2014 – one of the highest inequality rates in the world – resulting in a weak positive correlation between growth in real GDP per capita and trade openness.

Globalisation has also positively impacted inflation trends in South Africa. On aggregate, inflation declined from an average of 8.1% (1994 to 1998) to 5.8% (1999 to the second half of 2017). Globalisation has added to the productive capacity of the economy through increased choice and cheaper inputs into different levels of production, thus favourably impacting bottlenecks and supply-side pressures on price formation. It is worth noting, however, that this inflation effect also coincided with the adoption of inflation targeting, which has favourably impacted inflation expectations and outcomes in South Africa.[15]

Policy implications

Globalisation has had an impact on the autonomy of monetary policy; for example, capital flows driven by global factors have influenced domestic monetary policy formulation. In such cases, the more stable domestic inflation expectations are, and the less durable the disruption caused by swings in capital flows are likely to be, the greater will be the latitude for the domestic central bank to focus on the domestic drivers of inflation.

As a small open economy with deep and liquid financial markets, South Africa is sensitive to external shocks. The exchange rate channel, which has an impact on the competitiveness of domestic producers, has been particularly important in this regard. The country's free-floating currency has served as a shock absorber. However,

[15] M Reid, "The sensitivity of South African inflation expectations to surprises", *ERSA Working Papers*, WP131, 2009.

the exchange rate can at times also be a source of shocks, as seen in episodes of large rand volatility, which at times are unrelated to domestic economic fundamentals.

As mentioned earlier, the globalisation of the South African economy has been associated with lower inflation. Estimates show that the long-run rate of exchange rate pass-through has been around 20% under inflation targeting, significantly lower than in the pre-inflation targeting period.[16] More recent estimates suggest that the rate of pass-through is currently around 15%.[17] Increased competition (as a result of globalisation), coupled with an inflation target as the nominal anchor for monetary policy, has resulted in a more muted pricing response than before, despite the weakness and higher volatility of the exchange rate.

One of the key objectives of economic policy is to contribute to macroeconomic stability, something that is of particular significance for small open economies given their vulnerability to changes in global economic conditions. In this respect, South Africa's flexible exchange rate policy, inflation targeting regime and commitment to prudent fiscal policies have provided a platform for investment and a buffer against global volatility. However, more recently, the policy landscape has become complicated, with South Africa's local currency bonds now downgraded to sub-investment grade by two ratings agencies (Fitch and S&P). This is even more problematic considering that the country currently runs both current account and fiscal deficits, with the latter being revised upward frequentlythus requiring more external financing. The policy challenge remains to attract capital flows to fund the current account deficit and fixed investment to place the economy on a sustainable growth path.

More recently, the Monetary Policy Committee has attempted to manage inflation expectations from current levels, which are closer to the top of the 3–6% inflation targeting range, towards the mid-point of the target range. In addition, the general approach adopted by the MPC is to assess the nature of shocks confronting the economy and to respond only to those deemed to be permanent. Currently, the exchange rate and its potential long-term impact on prices and wages are seen as an important upside risk to inflation outcomes. That said, the continued low growth in investment and consumption has resulted in muted import demand growth, exerting less pressure on the rand than would be the case in a higher demand scenario. While this decreases the external current account funding needs, subdued growth, export and job creation performance are less likely to attract capital inflows (especially FDI), with adverse implications for the country's growth potential.

There have been a number of targeted policy efforts to boost export industries that have been identified as important for economic growth. For example, government support for the automotive manufacturing sector, in the form of the Motor Industry Development Plan (MIDP) and its replacement, the Automotive Production and Development Programme (APDP), have successfully influenced export production in this sector. These programmes focus on offering import credits and other incentives for the purposes of encouraging investment. In the clothing and textile sector, the Clothing and Textile Competitiveness Programme (CTCP) is directed

16 A Kabundi and A Mbelu, "Has the exchange rate pass-through changed in South Africa?", *ERSA Working Papers*, no 649, 2016. More recent estimates by the SARB indicate that the pass-through fell to a low of 10% just after the financial crisis.

17 SARB, *Monetary Policy Review*, April 2017.

at stabilising employment and improving overall competitiveness in the sector. This programme provides assistance for the upgrade of processes, products and skills, and also aims at developing domestic value chains.

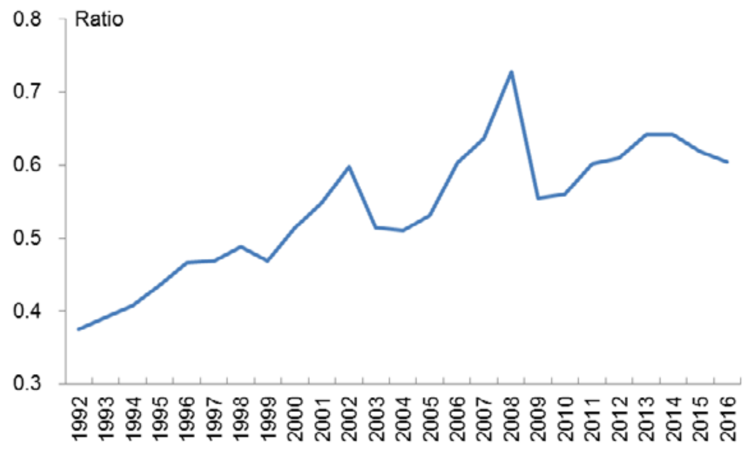
The African continent presents great potential for South African producers. Many South African businesses have ventured abroad into the continent. In addition, the development of the regional payment system SIRESS (SADC Integrated Regional Electronic Settlement System) has lowered the costs of trade transactions and facilitated cross-border settlements in real time. This, coupled with the growth in regional value chains payments, will facilitate trade growth in the region.

Conclusion

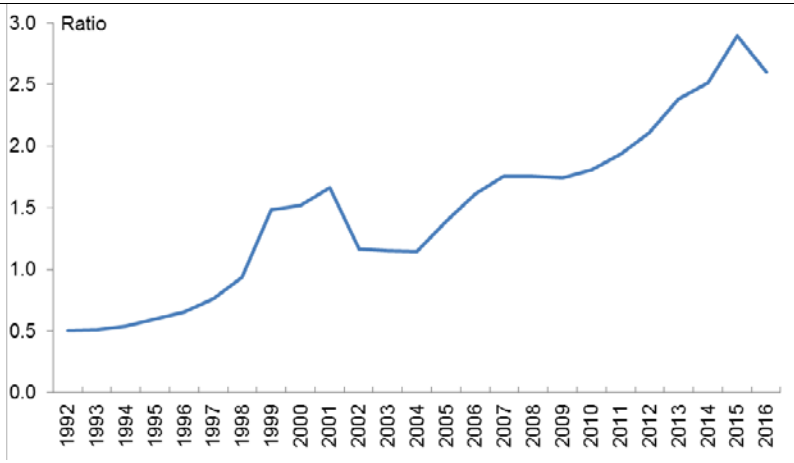
Exposure to global markets has not been entirely smooth for South Africa, with some industries, such as the motor production industry, benefiting and others, such as clothing and textile industry, suffering. However, alongside sound macroeconomic policies, globalisation has generally been good for South Africa. Access to global markets has, inter alia, facilitated technology transfers, export growth and investment flows – developments which have all been growth-positive for South Africa.

Appendix

South Africa trade openness — Graph 1



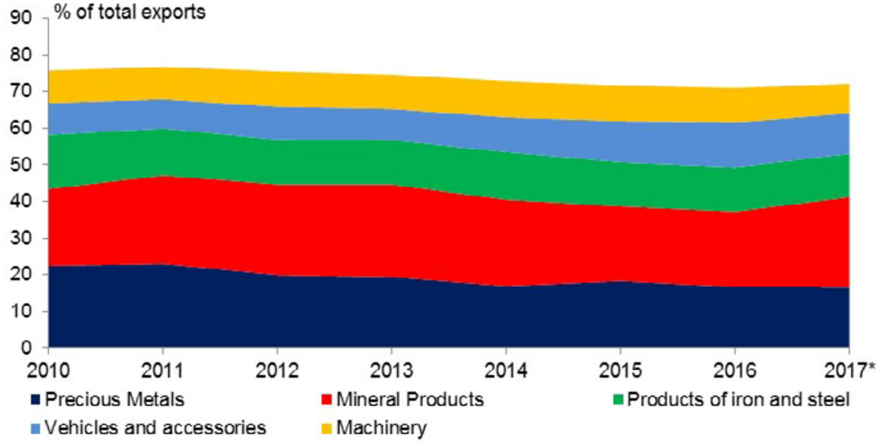
South Africa financial openness — Graph 2



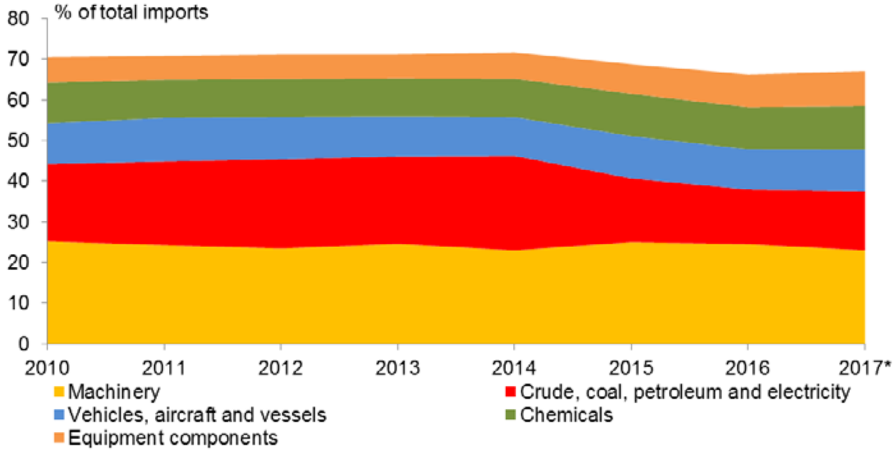
[1] Exports and imports as ratio of GDP. [2] Foreign assets and liabilities as ratio of GDP (stock positions).

Source: South African Reserve Bank.

Composition of exports Graph 3



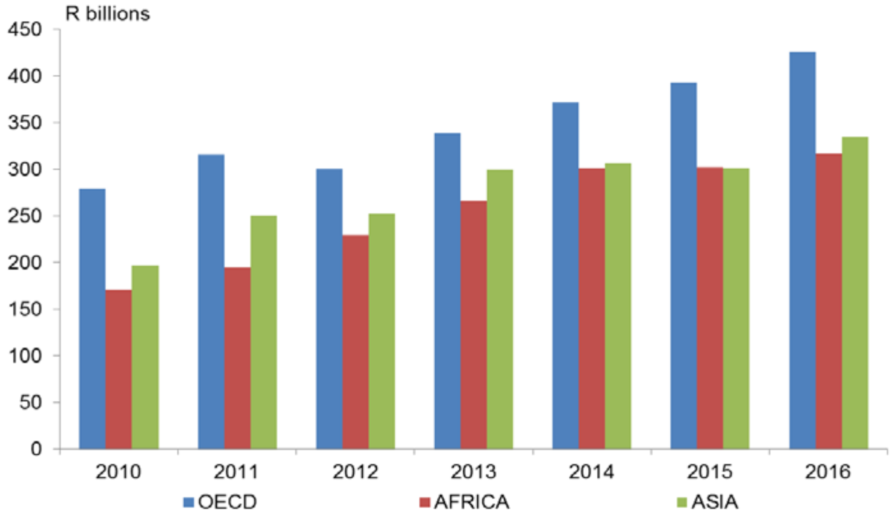
Composition of imports Graph 4



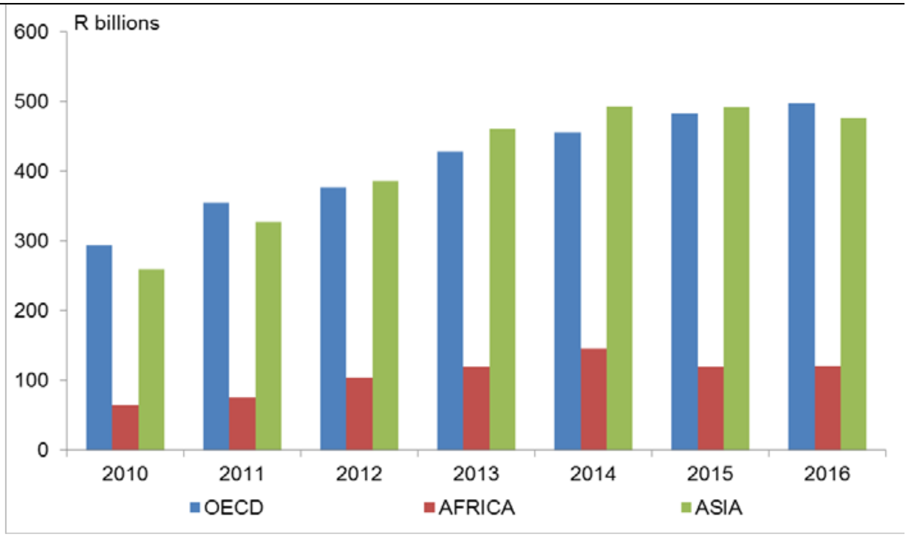
* Data for 2017 to October.

Source: South African Revenue Services.

Primary South Africa's export destinations Graph 5



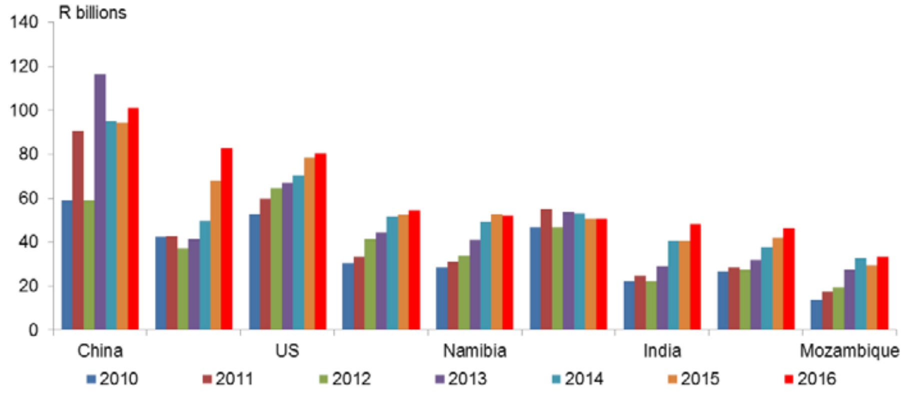
Primary origins of South Africa's imports Graph 6



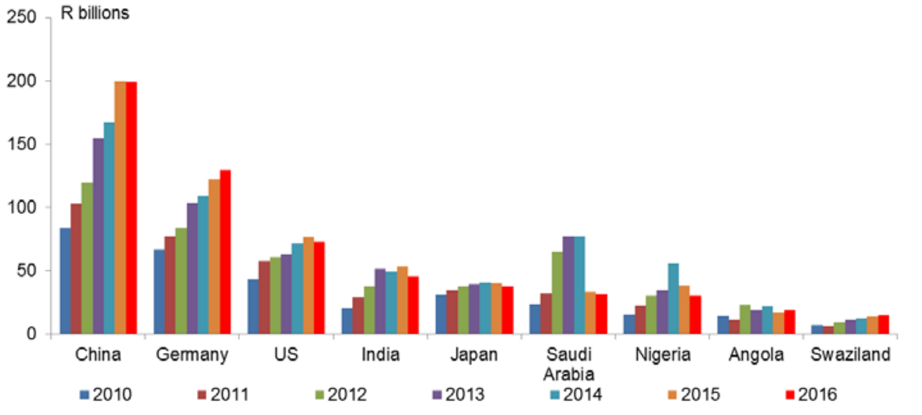
* Data for 2017 to October.

Source: South African Revenue Services.

Export destinations (countries) Graph 5a



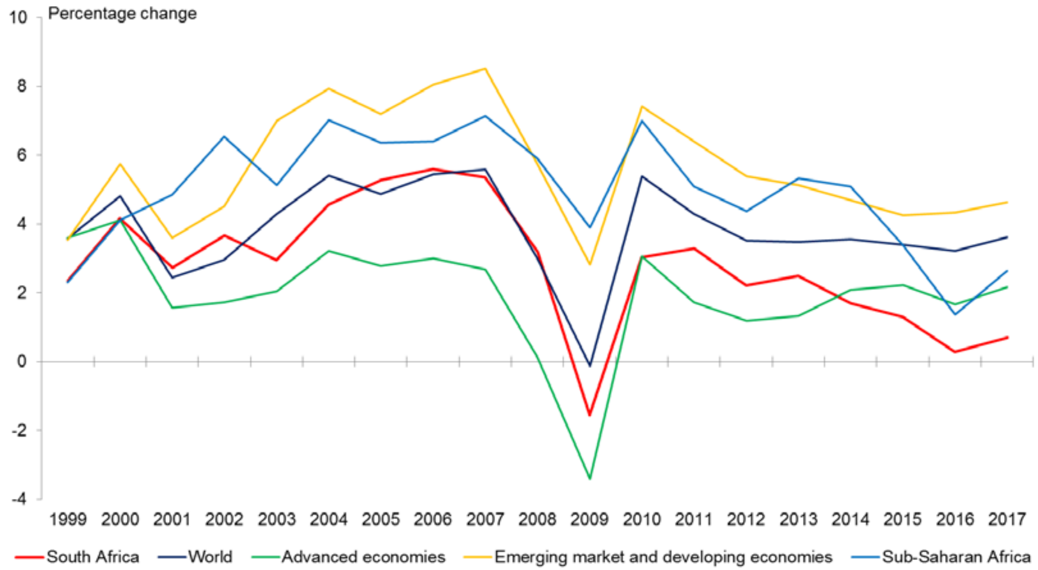
Import origins (countries) Graph 6a



Source: South African Revenue Services; author calculations

South Africa's growth vis-à-vis the rest of the world

Graph 7



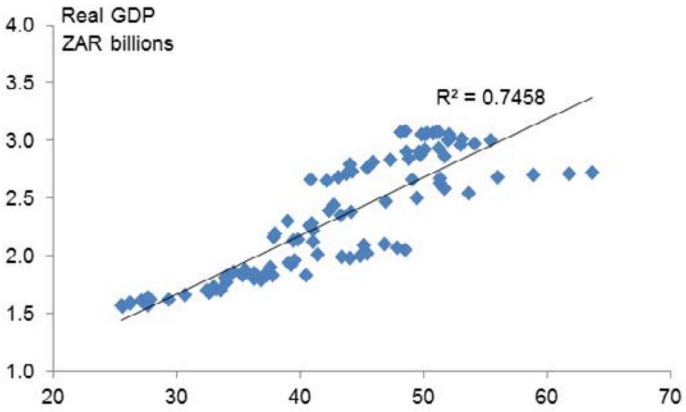
Source: IMF, WEO database, October 2017.

The correlation of trade and financial openness with real GDP and employment

Graph 8

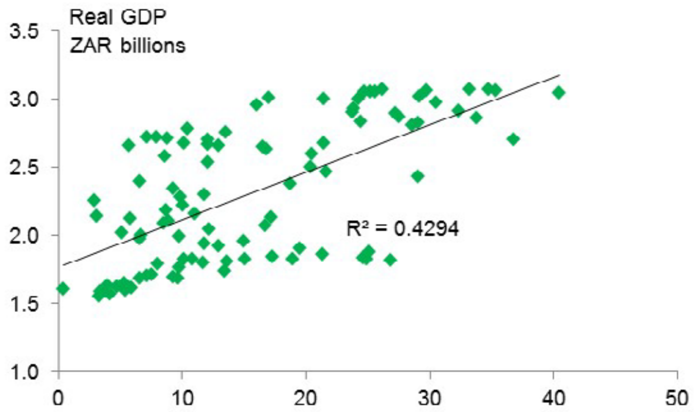
Trade openness and real GDP

Graph 8.1



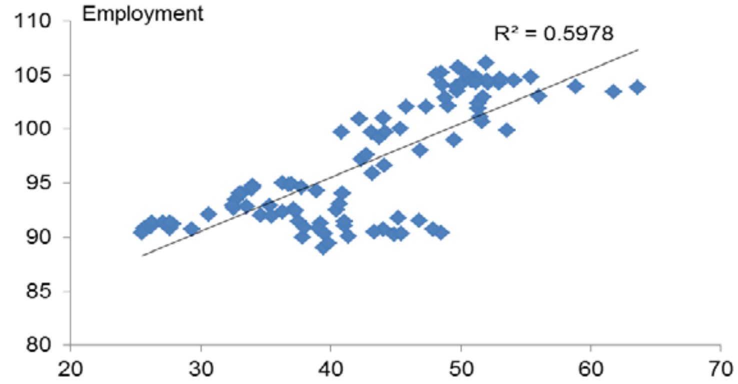
Financial openness and real GDP

Graph 8.2



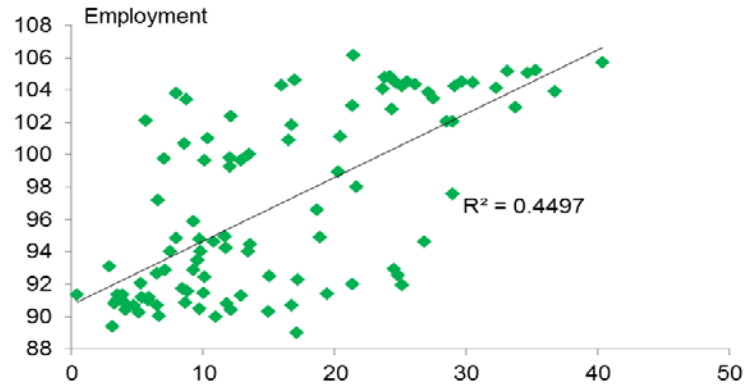
Trade openness and employment

Graph 8.3



Financial openness and employment

Graph 8.4



Sources: South African Revenue Services; South African Reserve Bank; author calculations