T T Mboweni: The challenge of stronger economic growth and development in South Africa

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, at the Fedusa Third National Congress, Gold Reef City, 15 and 16 September 2005.

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Introduction

Thank you for your invitation to speak at the Fedusa Third National Congress. A constructive dialogue between labour and the other social partners is crucial for fostering community consensus on those issues that are important for accelerating growth and improving the quality of life of all South Africans. I welcome the opportunity to be part of this dialogue.

In speaking about the challenge of stronger economic growth and development I will first briefly review where our economy currently stands, paying due attention to the statutory mandate of the South African Reserve Bank. The second part of the address will be directed at the debate on how much growth is needed for South Africa to absorb the unemployed within a reasonable timeframe, and – perhaps more importantly – what needs to be done to boost our growth and development momentum accordingly.

Recent economic developments

By this time we all know that South Africa's economic growth rate in the second quarter of 2005 amounted to 4,8 per cent, compared with 3,5 per cent in the first quarter. Most analysts forecast that real gross domestic product will increase by around 4 per cent in the full calendar year 2005, signifying an increase of more than 2½ per cent in real income per capita. What is particularly gratifying about the current growth environment is that our economy has enjoyed twenty-three quarters of uninterrupted economic expansion. This is the longest upswing in the recorded economic history of South Africa. The current recovery has the properties of a well-trained long-distance runner, rather than the characteristics of an unfit sprinter loaded with steroids performing admirably for just a fleeting moment.

The improvement in growth in the second quarter of 2005 was mainly brought about by a sharp increase in real value added in manufacturing, which reflected rising domestic final demand and stronger export demand for certain categories of goods, alongside a somewhat more competitive level of the exchange value of the rand. Real output of the agricultural sector was bolstered by a bumper maize crop which was predominantly harvested in the second quarter, while simultaneously almost all the other main sectors of the economy displayed solid growth too.

Enterprise-surveyed employment outside the agricultural sector recorded successive increases in each of the five quarters to September 2004. Private-sector job opportunities benefited most from the economic recovery, but there was also a moderate increase in public-sector employment. The pick-up in enterprise-surveyed employment was, however, not sustained in the last quarter of 2004 and the first quarter of 2005. Over the year to March 2005 enterprise-surveyed employment rose, on balance, by 111 000. The strongest increases were recorded in the community, social and personal services and trade sectors, while employment in gold mining, finance and manufacturing shrank over this one-year period.

Whereas the enterprise survey measures formal employment in the main non-agricultural sectors of the economy, results from household surveys measures all employment. Household survey data indicate that total employment in South Africa expanded by some 500 000 jobs over the year to March 2005, but roughly half of this increase was in the informal, domestic service and agricultural sectors.

Returning to the narrower data based on the enterprise surveys, it is estimated that labour productivity rose by 2,6 per cent in the year to the first quarter of 2005.

Workers engaged in more strike action in the recent past: Man-days lost to industrial action increased more than three-fold from the first half of 2004 to the first half of 2005. Nevertheless, nominal remuneration per worker rose by 8,7 per cent in the year to March 2005, noticeably slower than previously. Allowing for productivity changes, unit labour cost increased by 5,9 per cent in the year to March 2005, i.e. 1,3 percentage points lower than the average rate of increase in 2004. Wage settlements averaged 6 per cent in the first half of 2005.

These wage settlements and remuneration increases are modest compared to the high nominal increases recorded in the 1970s and 1980s. However, those distant increases were eroded by equally high inflation. After allowing for fiscal drag they did little if anything to improve the average worker's real disposable income. Currently inflation is much lower, and as a consequence there is far less money illusion and inflationary distortion which misdirect economic decisions. In July 2005 CPIX-inflation amounted to 4,2 per cent, registering its 23rd successive month within the inflation target range of 3 to 6 per cent. Although one cannot deny that it has been a difficult journey to low inflation, the benefits are apparent: More certainty regarding the future purchasing power of the money in our pockets, better planning, especially of cash-flows for those households and businesses using credit and accordingly having to make interest payments. The cash-flow improvement follows because sustained low inflation creates the scope for nominal interest rates to move to lower levels.

The achievement of sustained lower inflation made it possible for the household sector to incur more debt – largely for housing and durable consumption purposes – without a significantly heavier interest burden. Since 1999 the household-debt-to-disposable-income ratio, on balance, rose from 57 per cent to more than 60 per cent, whereas the debt-service-to-disposable-income ratio decreased from around 10 per cent to about 7 per cent.

Revealing as they are, these aggregate numbers do not show that numerous households that are already over-indebted and facing uncomfortable circumstances are included in the totals. Nor do they show that there is a further significant number of people who just make ends meet but who would be in dire straits if a fairly small interest rate increase were to take effect.

Nevertheless, with employment and real disposable income rising and the average debt-service ratio well contained, most households are still in a comfortable position and this is likely to persist, provided they continue to live within their means and allow for some cushion to shield them against unforeseen events.

The South African Reserve Bank is committed to ensuring that the hard-won gains in the fight against inflation are not forfeited. With international oil prices recently recording record-high levels, there is no shortage of factors waiting to fuel the inflation spiral. While the immediate or first-round effects of rising energy prices would have to be accepted, monetary policy will not allow this to develop into an inflationary spiral. The Bank will continue to honour its mandate as enshrined in the Constitution and the South African Reserve Bank Act and given explicit content through the adoption by the Government of a 3-to-6-per-cent target range for CPIX inflation.

Towards stronger growth and accelerated development

These promising economic conditions are clouded by the high rate of unemployment in South Africa: 26 per cent of the workforce is unemployed. Recently debate intensified regarding ways to enhance the growth capacity of South Africa in order to make meaningful inroads into unemployment, poverty and underdevelopment. A sustained real growth rate of around 6 per cent per annum is often mentioned in this context. It is worthwhile to reflect on some of the key strands in this debate and to provide a central banker's perspective on some of these.

At a G-20 conference on economic growth which was recently held in South Africa and co-organised by the Bank, it was argued that there is more to sustained and vibrant growth and development than just "good macro". In other words, prudent and consistent monetary and fiscal policies, while necessary in order to achieve sustained strong growth and development, are not sufficient.

What is needed beyond a prudent and stable macroeconomic policy arrangement is unfortunately not available in standard recipe format, but depends on the specific circumstances in each country. Allow me to discuss a handful of reforms which are likely to be crucial to enhancing the long-term health and vigour of the South African economy.

The maintenance, upgrading and expansion of infrastructure deserve a prominent position among any list of reforms needed to propel growth to a higher plane. The real fixed capital stock of South Africa rose by just 2 per cent in 2004, and by between 1 and 1½ per cent per annum in the preceding four years. A continuation of such low rates of increase in the capital stock is clearly not supportive of a real GDP growth rate of 6 per cent per annum. Assuming that the capital stock would have to increase by 4½ to 5 per cent per year to support a real growth rate of 6 per cent per annum, it would require the ratio of fixed capital formation to gross domestic product to rise from the current 17 per cent to around 22 per cent in order to achieve such growth on a sustainable basis.

Government – at all levels – and public corporations have committed themselves to ambitious capital programmes. However, implementation almost invariably seems to take longer than initially planned. Institutional capacity rather than money seems to be the problem in many instances. Much has been said about the inadequate road and rail infrastructure which hinders the efficient movement of workers between their residences and places of work, while also inhibiting the movement of goods between producers and markets. Similar concerns have been voiced regarding certain ports.

Unfortunately sweeping statements discrediting all infrastructural installations are not at all helpful. The challenge lies in identifying specific current and future bottlenecks at the microeconomic level, followed by the often thankless processes of budgeting, planning, implementation and maintenance management. In each of these processes dedication, appropriate skills and long-term commitment are required to deliver the goods. Those overseeing these processes should stay committed to each project, infrastructure creation, with lengthy gestation periods, clearly would not benefit from high turnover at management level.

Several exciting microeconomic reforms involving South Africa's infrastructure are in the pipeline. The introduction of a second fixed-line telephone operator, for example, seems set to increase competition and reduce communications costs. De-mothballing of power generating plants and the upgrading of power distribution networks, water-supply infrastructure, railway lines and rolling stock are all to be welcomed. While our main airports currently seem to cope well, projected further increases in passenger numbers and freight volumes necessitate further expansion. The cluster of industries linked to infrastructure is evidently going to experience buoyant times in the coming years. The accompanying imports of machinery and equipment might, of course, initially widen the deficit on the current account of our balance of payments. However, foreign finance usually accompanies such imports, and later on the improved infrastructure is likely to boost exports as the supply side of our economy is streamlined.

A particularly sensitive area is that of land reform. Patterns of land ownership which have evolved over time are not sustainable, and need to change. However, great care needs to be taken in this process. What South Africa cannot afford is the kind of reform where agricultural land which is being used productively is purchased with taxpayers' money, transferred, and ends up being used far less productively than before, subtracting from the country's output and destroying job opportunities. Farming is a modern business requiring specialised skills as well as financial capital. Adequate attention has to be paid to the training of newly empowered farmers, advisory services, and financial support for a limited period.

Success in improving growth and creating jobs hinges critically on appropriate skills development. This does not require throwing money at the problem, but aligning the system of education and training to the requirements of a modern economy. Agriculture's share in total value added in the economy has dwindled from 7,7 per cent in 1975 to 3,4 per cent last year, and that of mining from 11,1 per cent to 7,1 per cent over the same period. Construction's share fell from 5,1 per cent in 1975 to 2,4 per cent in 2004 (but this should, of course, rise as infrastructure spending gets underway). At the other extreme, the share of the finance, real-estate and business services sector in the economy grew from 12,5 per cent in 1975 to 20,1 per cent last year, and that of community, social and personal services from 16,1 per cent to 21,0 per cent over the same period. Product lines and production processes within the various sub-sectors have undergone revolutionary change with the introduction of sophisticated information and communications technologies. The skills requirements of a modern services-oriented economy (the tertiary sector currently generates 65 per cent of total value added in South Africa) are dramatically different from the requirements which faced entrants to the labour market 30 years ago.

In reflecting on ways to systematically improve prospects for growth, the role of the exchange rate merits some consideration. Firstly, it should be emphasised that the authorities have a target for the inflation rate and not for the exchange rate. The exchange rate is essentially determined by supply and demand in the foreign exchange market, reflecting the decisions of numerous participants – tourists, investors, importers, exporters and the like. But for various reasons the Bank cannot be blind to the exchange rate, and has a clear preference for a relatively stable and competitive level of the exchange value of the rand.

The preference for a relatively stable exchange value of the rand originates from the painful adjustment costs which accompany large movements in the exchange rate. Adjustment at the margin is a natural economic phenomenon, but large movements in the exchange rate can render entire sectors uneconomical and others extremely viable within a very short period of time. The preference for a competitive level of the exchange rate reflects the need for sustainability – for exporters to move into foreign markets and to stay there.

The preference for a relatively stable and competitive exchange value of the rand is seldom perfectly matched by economic outcomes. The foreign exchange market in South Africa is highly liquid (turnover nowadays exceeds US$13 billion per day) and powerful forces beyond our control, such as the international prices of commodities, have a considerable bearing on price formation in the foreign exchange market. Practical experience in the central bank with large-scale intervention in the foreign exchange market has been sobering. Zealous intervention in a liquid market with numerous financially strong participants can be a costly and largely futile exercise.

In practice, the Bank prefers to leave the determination of the exchange rate to market forces. The Bank disseminates data on the balance of payments, foreign exchange reserves and related matters, thereby helping to inform market participants' decisions. On rare occasions the Bank may comment on evidence pointing to possible excesses in price formation in the foreign exchange market. The best medicine for the one-way view regarding the direction of the rand's exchange value which prevailed from the early 1980s up to 2001, however, was the recovery of the rand over the past four years, which bit deeply into the pockets of rand pessimists.

The Bank may also build up or reduce its international reserves; in recent years the emphasis has been on accumulating international reserves, which naturally has had some price consequences but did not signify the adoption of a target level for the exchange rate. When abundant amounts of foreign exchange are available in the market (and the rand is comparatively strong) it presents the Bank with a good opportunity to buy more foreign exchange from the market, since its holdings of gold and foreign exchange are on the low side. On balance the Bank has increased its gross gold and foreign exchange reserves from US$8 billion at the end of 2003 to just below US$19 billion at present.

Conclusion

Despite some progress made in recent years, high levels of unemployment necessitate more ambitious steps to strengthen South Africa's growth potential. The Reserve Bank is committed to containing inflation, thereby providing a launching pad for enhanced growth and development. But this is not a sufficient condition for economic success. Enhanced infrastructural development, the implementation of education and training programmes which deliver the skills necessary for a modern economy, and careful land reform are but a handful of the key ingredients necessary for boosting economic performance. And, as with monetary policy, all of these elements need to be nurtured carefully as it takes a while before they bear fruit. They require total dedication and sustained attention to detail if they are to be successful. Success is in our hands.