Gill Marcus: Challenges for young professionals in South Africa

Address by Ms Gill Marcus, Governor of the South African Reserve Bank, to the Black Management Forum Young Professionals, Sandton, 27 September 2013.

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Thank you for the opportunity to address you this evening. As young professionals you are the future of this country. Some among you may well be the first in your family to have attained this level of professional education or earning potential. As professionals you are in a particularly privileged position at a time when the global economy is still trying to recover from the financial crisis that began in 2007. While millions of people around the world lost their jobs, and many have lost hope of ever getting a job again, a global skills shortage exists. This shortage is even more severe in South Africa, and without appropriate skills in the country, and without a strong and sustained global recovery from the crisis, the domestic economy will struggle to grow sufficiently to make appreciable inroads into our persistent unemployment problem.

As has been well documented, the global crisis hit different countries in different ways, and how countries were affected was determined in part by policy responses as well as by different structural features.

Whereas the recession in South Africa was relatively brief and shallow, in line with most emerging market economies, the recovery has lagged that of our peers. Furthermore, we were an outlier in terms of the number of jobs lost during the crisis, with almost one million jobs lost. Five years later we are barely back to the levels of employment achieved before the crisis. The official unemployment rate stands at 25,6 per cent, while youth unemployment is 52,8 per cent. It is probably true to say that the longer a young person stays unemployed after leaving school, the lower their chances are of ever getting a job and they get deskilled, demotivated and disaffected, leading to social hardships and a drain on society. It is also probably the case that if people over the age of 50 lose their jobs they are unlikely to ever work again.

Most of you here this evening, as young professionals, are university graduates. You are among the fortunate ones who have been relatively protected from the fallout of the crisis. And where skills shortages are more severe, the more protected are graduates as they command a premium in the labour market. A lot will clearly depend on the type of skills and qualification, and the quality of that qualification. But globally, there appear to be mixed experiences regarding the impact of the crisis on graduate employment. There have been a number of anecdotal reports of the challenges facing graduates in finding employment. This has certainly been the case in Europe and the UK, with reports of graduates having to take on temporary and relatively menial jobs. This not only affects their lifetime earnings, but also causes a ripple effect by depriving less skilled workers of access to these jobs. According to a recent survey conducted by the Trendence Institute in Berlin, the number of applications European business school graduates expect to send out before they get their first job has increased from 28,5 in 2002 to 38; and, on average, European graduates now expect to spend almost six months looking for a job. But in Greece and Spain, where unemployment is above 25 per cent and youth unemployment double that, the expectation is ten months.

There are indications that, while the crisis has no doubt had a devastating effect on unskilled and even semi-skilled workers, South African graduates appear to have fared better than their European counterparts. Recent research suggests that South African university graduates are relatively better off, but perhaps not surprisingly so. According to research conducted by Hendrik van Broekhuizen and Servaas van der Berg at Stellenbosch University, and published by the Center for Development Enterprise, the stock of South African university graduates more than doubled to about 1,1 million between 1995 and 2012, but the broad unemployment rate of graduates has remained below 6 per cent. At the same

time the labour force participation rate for graduates is around 90 per cent, compared with 59 per cent for people with only a school education.

However, these figures hide a racial disparity. While the number of black graduates employed has trebled over this period, the unemployment rate of black graduates has been consistently higher than that of whites, although the gap has narrowed significantly over time. The above-mentioned study shows that in 2012 the unemployment rate of black graduates was 8,6 per cent, compared with 3,0 per cent for white graduates. This is still a significant difference, and I am sure we would find this compounded by gender bias if this was to be analysed.

It is perhaps also worth noting that their research distinguishes between university graduates and other tertiary education. In the latter category, the experience of graduates has not been as positive, and may well reflect the state of the economy as well as some quality constraints. They show a general tendency for unemployment of graduates, irrespective of race, to follow the business cycle, but worsening economic conditions seem to have less of an impact on graduate unemployment than on people without degrees.

There is no doubt that education matters for employment prospects. According to the Quarterly Labour Force Survey, in the second quarter of 2013 the unemployment rate was 5,2 per cent for university graduates; 12,6 per cent for those with other tertiary education; 27,0 per cent for those with matric and 30,3 per cent for those with less than matric.

This relatively favourable trend of graduate employment is consistent with results of the Professional Provident Society of South Africa (PPS) Professional Confidence Index Survey, which shows that graduate professionals are relatively confident about the future. The most recent survey revealed a 70 per cent confidence level when respondents were asked about the future of their profession over the next five years. However, the results show that professionals are increasingly concerned about the outlook for the local economy, with only 55 per cent feeling confident. Nevertheless, 77 per cent of respondents were confident about remaining in the country for the foreseeable future.

Because the outlook for the domestic economy is intricately tied to the global prospects, it is appropriate to consider whether or not we are out of the crisis yet. There is little doubt that the global financial crisis is still with us, although it has continued to mutate. While the general global outlook seems to be a bit more positive, we appear to have moved into a new phase, which is no less risky or uncertain than previous phases. And even if things don't get worse, they will take a long time to get better.

How has the crisis mutated? What started off as a banking crisis, spurred by questionable banking practices in the advanced economies in particular, a failure of regulation in some jurisdictions and excessive household borrowing, developed into a synchronised global recession. World trade, commodity prices and asset prices collapsed, and millions of people around the globe lost their jobs. Fortunately, policy makers in the advanced economies had learned from the mistakes of their predecessors during the Great Depression of the early 1930s, and a repeat of that era was avoided. So, although things were bad enough, they could have been much worse.

But the path to recovery has not been easy. Expansionary fiscal policies were soon constrained as government debt ratios became unsustainable and the crisis mutated into a sovereign debt crisis, particularly in a number of European economies, which threatened the existence of the Eurozone as a single currency area. Increasing reliance was placed on monetary policy and, as interest rates reached their zero lower bound in a number of the advanced economies, a range of unconventional policies were introduced, including quantitative easing, which is a process whereby the central bank injects money into the economy by buying government bonds or other assets. The subsequent combination of high liquidity and low interest rates led to a global search for yield, and consequently reinforced strong capital flows into emerging market economies, which had generally recovered from the recession by late 2009. Emerging markets, led by China, were seen to be the new engine

for global growth, and this development was seen as a tectonic shift in the balance of economic power around the globe.

However, these capital inflows created challenges for emerging market economies, as the resulting exchange rate appreciation undermined competitiveness. Some emerging markets complained about "currency wars" and various policies were implemented to stem these inflows, with very mixed success. But at the same time, stronger exchange rates did help to constrain inflationary pressures, allowing monetary policy more freedom to focus on providing some stimulus to the hesitant growth recovery.

A notable structural change in the nature of these capital flows was the predominance of flows into domestic currency bond markets in emerging market economies, with non-residents holding increasing proportions of domestic bonds. South Africa's experience was no different. In the pre-crisis period, the bulk of portfolio flows to South Africa were to the equity market. Since 2009 until recently, bond flows predominated and non-resident ownership of the outstanding stock of bonds increased from around 12 per cent in 2007 to around 38 per cent currently. This change in the pattern of flows reinforced the downward pressure on long term bond yields. Although this did not have the positive effect on private sector investment that one would generally have expected, it did have a significant effect on the cost of borrowing by government at a time when the counter-cyclical fiscal policy of National Treasury was relatively expansionary. These flows also helped to finance the widening current account of the balance of payments.

So what has changed? We now appear to be entering a new but still highly uncertain phase of the crisis. Growth in the emerging market economies, including China, has been declining, and earlier optimism that emerging markets could decouple from the advanced economies has faded somewhat. At the same time, there are some signs of recovery in the US, which prompted the US Fed to begin to consider slowing the pace of extraordinary monetary policy accommodation it has been providing. This does not mean an imminent tightening of policy by raising short term interest rates, but rather beginning to cut back on the pace of asset purchases, currently at US$85 billion per month.

The reaction to the announcement by the Fed in May that tapering would begin relatively soon took many analysts and market participants by surprise, and underlined just how nervous markets are, and how elevated the uncertainty is. What was meant to be an orderly adjustment threatened to become precisely the opposite, despite the assurances by the Fed that tapering would be done in a responsible manner. Long-term bond yields and mortgage rates in the US increased by about 100 basis points. The spillover effect on emerging markets was intense, with bond yields generally increasing by more than in the US, as bond flows reversed sharply – since May about US$20 billion has flowed out of emerging bond markets, with R17 billion net sales by non-residents in the domestic bond market between 22 May and the end of August; and emerging market currencies, including the rand, depreciated markedly across the board.

Although there was a general expectation that tapering of quantitative easing would begin in September, there was a great deal of uncertainty around the pace and timing, and the period between the May and the September FOMC meeting was highly volatile. In the event, the Fed refrained from tapering in September, out of concern about the slow pace of recovery in the US labour market; the unresolved fiscal issues in the US which could lead to further fiscal contraction when the debt ceiling is reached, possibly in mid-October; and the negative impact of tight financial conditions and higher long term interest rates on the nascent housing market recovery in the US.

The reaction of the markets to this surprise was dramatic, with strong recoveries in bond and equity markets, while the dollar weakened across the board. However, it is inevitable that the Fed will have to begin tapering at some stage, and markets are likely to react or over-react to any data coming out of the US that is likely to have a bearing on US monetary policy decisions. We have been given a taste of what is to come, and we are in for a difficult and

volatile period ahead. This is unchartered territory, and whatever the US does is going to have spillover effects onto the rest of the world. This is why we pay such close attention to developments in the US, including who will replace Ben Bernanke when his term expires at the end of January 2014.

While the news from the US appears relatively positive, the same cannot be said about the prospects for the Eurozone, where the outlook for growth is poor, despite the fact that the region as a whole emerged from recession in the second quarter of this year. A number of European countries are still experiencing negative growth and, even where growth is positive, it remains very weak. The July World Economic Outlook (WEO) update of the IMF forecasts growth of –0,6 per cent in 2013 and 0,9 per cent in 2014, with the risks still seen to be on the downside. One of the constraints facing these countries is the weak state of their banking sectors, which have not recovered sufficiently to resume lending on a large scale, and there is still very slow progress towards a banking union in the region. At the same time, fiscal consolidation continues to be quite severe in some countries and the debt ratios are still deteriorating in the peripheral countries, for example, the debt to GDP ratio in Greece now stands at around 160 per cent, and that of Italy at around 130 per cent.

From a South African perspective, given our trade and investment links, this is not good news, and implies that the crisis will be with us for some time. Europe is still our major trading partner, despite accounting for a declining share of our manufacturing exports, from around 38 per cent to 25 per cent between 2007 and 2012. The importance of Europe to South Africa is further underlined by its weight as a source of foreign investment into South Africa. According to the Census of Foreign Transaction, Liabilities and Assets, published by the South African Reserve Bank earlier this month, European countries and the UK are the main sources of foreign capital to the South African economy, with the relative share unchanged at around two-thirds since 2001. However, the share of the UK has declined from 45,5 per cent in 2001 to 37,6 per cent in 2011.

The recent July WEO downgraded its global growth forecasts for emerging markets, and unfortunately the BRICS countries featured strongly in this downgrade. The 2013 growth forecast for China was reduced from 7,8 per cent to 7,5 per cent; Russia from 3,4 per cent to 2,5 per cent; and Brazil from 3,0 per cent to 2,5 per cent. Although China is not an important destination for our manufacturing exports, it remains our main trading partner, mainly as a destination for our commodities. China also has an important impact on global commodity price trends, and the recent weakness in a number of commodity prices has been ascribed to the slowdown in that country.

While the crisis has curtailed domestic growth, it is not the only contributory factor. After all, our emerging market peers have faced the same challenging environment and yet outperformed South Africa in the post-crisis period. The World Economic Forum (WEF) Global Competitiveness report paints a mixed picture of how South Africa stands up to international comparison. It shows that, with respect to the financial sector, we are up there with the best. South Africa was ranked first out of 148 countries for regulation of securities exchanges; first for strength of auditing and reporting standards; first for efficacy of corporate boards and the protection of minority shareholders' interests; second for financing through local equity markets; and third for overall financial market development. This reflects well on the sector, and also on the quality of the professionals that make up that sector, including accountants, economists, etc. Many of you here this evening are part of that sector. What is important to bear in mind is that, while there is recognition of the excellence of South Africa's financial sector, and it is a critically important asset for the country and our future development, it must serve the needs of the real economy.

South Africa cannot simply aspire to be a world leader in the financial sector. We need to encourage more productive real sector investment and employment and, crucially, encourage exports, given our dependence on imports of capital goods. Unfortunately, according to the WEF, we are have slipped in the overall competitiveness ranking from 40th

to 53rd, and we have been surpassed by Mauritius as the most competitive country in Africa. For years we have been somewhat complacent about being the biggest economy in Africa. With the current growth rates, we could be overtaken by Nigeria within a decade. We fare even worse when it comes to labour relations where we are ranked worst in the survey of 148 countries.

This declining competitiveness is reflected in South Africa's widening current account deficit at 6,5 per cent of GDP in the second quarter of this year, driven to an important degree by a weak export performance, which can only be partly explained by weak demand growth. Our exports have also suffered due to widespread strikes: not only do current export volumes decline, whether commodities or manufactured goods such as motor vehicles, but South Africa's attractiveness as an investment destination suffers, and this has the potential to undermine future investment in the economy. South Africa is part of the global manufacturing supply chain, and reliability of supply is key to maintaining and improving our position in this chain. South Africa's competitiveness is further undermined by unit labour costs rising relative to competitor countries, and a weaker exchange rate only helps improve competitiveness if not offset by wage and price increases.

In order to improve our growth prospects we need a sustained increase in fixed capital formation. Having reached a peak of around 24 per cent of GDP in 2008, the ratio of gross fixed capital formation to GDP has now declined to around 19 per cent. This is well short of the 25 per cent ratio that is generally seen to be the minimum to sustain the growth rates that we require to make inroads on unemployment, and even further away from the 30 per cent aspired to in the National Development Plan. The decline in the investment ratio has been mainly a result of a collapse in investment expenditure by the private sector which, at the height of the crisis, was faced with relatively low levels of capacity utilisation and uncertainty about the future. Growth in gross fixed capital formation remains weak, at 2,7 per cent in the second quarter of 2013.

Since the crisis, infrastructure expenditure by the state-owned enterprises has been the main driver of fixed investment. The emphasis on infrastructure investment is appropriate as it is likely to contribute to improved economic efficiencies and helps with the alleviation of existing bottlenecks in the economy. But the focus on infrastructure is not new, and the plans must come to fruition.

But it is not only the government and state-owned enterprises that need to invest. In his book "The Next Convergence" Michael Spence, the respected growth theorist, has shown that countries which have sustained growth rates of around 7 per cent or more for 25 years generally have government and public sector investment ratios of between 5 and 7 per cent of GDP, and total investment rates of at least 25 per cent of GDP. A consistent growth rate of 7 per cent will allow for a doubling of income every 10 years, whereas a growth rate of 3 per cent will take 24 years to double incomes. Currently our problem is that private sector investment is weak, which may partly reflect excess capacity in some sectors, but also a lack of general business confidence. There are indications that private sector fixed capital formation has begun to improve, but this appears to be gradual and tentative. In the second quarter of 2013, growth of 4,4 per cent was recorded.

Michael Spence sums it up appropriately as follows: "Put bluntly, growth requires investment, and that means present sacrifice for future gain. The job of leaders is in part to get everyone on board, to build a consensus behind a forward-looking vision, underpinned by a growth and development strategy that is credible. Multiple classes of participants and organised stakeholders need to be willing participants. These include labour, unions, businesses and entrepreneurs, civil society organisations, and households at various levels in the income distribution." Unfortunately, while there is a common view that we need investment, there is no consensus around how this should be achieved, and how the sacrifices should be shared.

This brings us back to where I began this evening, and that is the need for education or investment in human capital. I have on numerous occasions in the past stressed the need to

improve the quality of education in South Africa and to fix the parlous state of many of our dysfunctional schools. We need to value education and, thereby, knowledge, and not simply the certificate of qualification. But we also need to ensure that the education we do receive is of value. The CDE report referred to earlier suggests that, while not perfect, the university system is turning out appropriate and good quality skills. But we also need to focus on other technical skills that are not taught in universities but are no less important to the economy. Not only does an undertrained and undereducated workforce constrain economic growth, it reinforces the cycle of unemployment and widening inequalities. As Michael Spence has noted, in a world in which knowledge and connectivity are increasingly the basis for value creation, failures in the educational system are the surest form of exclusion there is.

In conclusion, the crisis is still with us, and South Africa faces a challenging future. However, the doom and gloom associated with the emerging markets is probably overstated: whereas there will be global adjustments in response to normalisation of monetary policy in the advanced economies, and this means volatility in emerging market financial markets, it is hard to see a recovery of global demand or demand from the advanced economies as being anything but good news in the medium to long term. This is what we have been waiting for. But we have to ensure that we are well-positioned to take advantage of the global recovery and minimise the impact of the uncertainty and volatility that will surely accompany such a recovery.

And as professionals, all of you here this evening have an important role to play.

With your personal achievements comes responsibility – to your immediate families, to those who have supported you throughout your studies, to your communities and to society as a whole. You have dreams, ambitions, and visions of the future South Africa we are all striving to build. So where is your voice, your passion, your purpose in the vibrant debate that rages as we work to build our common future? We all have the ability to exercise both reason and choice. The future will be what you make it.

I wish you all well in your personal and professional lives.