The Impact of the Financial Crisis on South Africa

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Outline

- The Economic Background
- Recent Developments
- Challenges
- Prospects
South Africa has achieved respectable GDP growth and maintained macro stability:

- Annual GDP growth averaged 5.1% over 2004-07, up from 3.6% over 2000-03. This was driven by
  - HH consumption and private and public fixed investment on the demand side
  - Financial and business services, construction, and wholesale and retail trade on the supply side.
- Export growth amidst an appreciating real effective exchange rate;
- Prudent macroeconomic management resulted in a budget surplus since 2006. Low public debt, high revenue collection and single digit inflation;
- Rising capital inflows attracted by good economic prospects, resulting in historically high foreign exchange reserves even as CA deficit rose sharply;
- Deep, well-regulated, liquid financial sector able to borrow in Rand.
The Economic Background

- Vulnerabilities bubbled to surface:
  - Extremely high unemployment;
  - Huge inequality, widespread poverty, high crime and HIV/AIDS incidence
  - Underperforming agriculture and mining sectors as well as a struggling manufacturing sector
  - A widening current account deficit
  - High and fast-rising household debt as proportion of GDP. Mortgage loan exposure a concern for banks
  - Growing energy shortages
  - Political developments breeding uncertainty
Recent developments

- When the global economic storm struck, it found an economy going through a period of internal correction.
  - Tightening monetary policy since 2006 to contain consumer demand and escalating inflation
  - The National Credit Act came into effect in 2006 to reduce household debt
  - Skyrocketing commodity prices (food and oil) raised inflation expectations and led to tighter monetary policy
Challenges

- The current account deficit is the main source of macroeconomic vulnerability

  But we were not looking at any imminent macro crisis as the economy is robust enough to withstand shocks
Challenges

- The growing current account deficit is financed by the financial account.
- Sustainability of the current account is of concern, in respect of the sudden stop of capital inflows – typical in developing countries during hard times.
  - Purchase of stocks and bonds by non-resident South Africans moved to negative territory in September and October.
  - Equity inflows have declined.
  - FDI fell to negligible levels in September.
  - The trade deficit increases despite a weaker rand.
The trade deficit continues to widen despite a weaker rand
The rand – like other commodity currencies, has been under increased pressure
JSE down about 40% after record-levels in early 2008 and remains volatile
Challenges

- The combination of domestic and international developments has taken a toll on the real economy.

- Emerging signs of weakness:
  - A sharp drop in house prices,
  - Declining domestic vehicle sales,
  - Manufacturing production in the year to September slowed to 3.3%, from 4.4% in 2007
  - The mining sector continues to achieve negative growth, as gold and platinum prices fall and demand in global demand falters
  - Retrenchments are on the increase
Management of the large CA deficit will remain the main challenge

- Lower net exports, limited and costly financing options. CA expected to deteriorate to 9% of GDP.
- Falling commodity prices will reduce FOREX earnings.
- Rand depreciation not expected to counter lower demand.
- FDI is low and fell to negligible levels during 2008Q2.
- Net purchase of stocks and bonds by non-residents is now negative and expected to decline.
- Capital inflows have been sufficient to finance CA deficit, but now investors are deleveraging. The major risk is associated with sudden stops of capital flows.

But in a floating ER regime, no real insolvency issues. Risk is large currency depreciation to adjust CA deficit.
Prospects

- The risk is more severe for the real economy.
  - For the 3 year period ahead, GDP growth is expected to significantly slow.
  - Risky proposition for a country with high unemployment and inequality, and growing political uncertainty.

- Sound fiscal position and low debt will allow some cushioning of the economic slowdown.
  - Revenue growth will slow while spending will increase.
  - In particular, revenue from corporate taxes and value added tax is expected to come under pressure.
  - Social assistance programs are planned to increase.
  - Net effect of countercyclical spending = Negative Budget balance (-1.6%), after 2 years of surplus.
Thank you!