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Speaker : **MINISTER TREVOR MANUEL**

THE STATE OF THE ECONOMY

"No one in the summer of 1929 suspected that the world economy was about to collapse. With the shares on Wall Street rising ever more dizzily, Americans believed that they had discovered the secret of permanent prosperity. As long as the United States boomed the rest of the world felt secure…In retrospect one can see that demand was being switched from production to speculation. But the worry of a few was drowned by the chorus of optimism." These words come from Keynes’s biographer, Robert Skidelsky.

Today, global financial markets are in the midst of their deepest crisis since the Great Depression of 1929. Although there are many differences between the current crisis and the Great Depression, there are also many similarities. The nineties has by and large been a decade of optimism. All over the world stock markets have boomed, capital flows have reached unprecedented levels, financial wealth increased beyond most peoples’ wildest imaginations. Indeed a little over a year ago few people wanted to believe that this was unsustainable.

This is after all the decade in which the developing world or the emerging markets (as we have all come to be known) have had access for the first time, and were the recipients of significant capital flows. In reality the virtually unchecked bull-run on the world equity and bond markets has resulted in a wave of speculative activity which is being addressed with ever-increasing interest rates.

The only instrument that continues to be used across the world to deal with economic pressures is interest rates. This is in itself telling, because the instrument is blunt. It does not take account of the structural and institutional factors which make some economies more vulnerable to crises than others. It does not differentiate sufficiently between sound and unsound economic policies. Moreover, since it takes time for changes in interest rates to change behaviour, instead of preventing the spending sprees, they tend to take effect after the spending has already taken place. Also they do not discriminate between those who have overspent, and those who have for example simply borrowed to buy a modest house. In the final analysis the pain falls disproportionately on ordinary people who have tried hard to live within their means.

History tells us that when there is no longer any relationship between the value of an asset and its price, a correction is inevitable. To quote Skidelsky again "[T]he slump was the punishment, as well as the cure, for the reckless extravagance of the previous years."

One of the salient features of this crisis has been the speed at which it has spread from one economy to the next. From Asia to Australia to Japan, to Russia, to Latin America, to North America, through Europe and, yes, to our part of the world and to our own economy. No one has been spared. And it is the developing economies that have suffered most.

We have all seen the images of thousands upon thousands of people joining the unemployment queues in Indonesia as factories close down. The queues of ordinary Russians waiting day by day in a desperate attempt to withdrawn their life-savings from the local bank. It is the plight of ordinary people and the fact that the burden of the adjustment to a new economic reality falls disproportionately on the poor and vulnerable that is of the greatest concern.

Or the crisis now faced by Brazil, where the equity market has fallen by 29% since the end of August, interest rates have gone up to 50%, and $11 billion worth of reserves have been lost.

High interest rates rapidly decrease the disposable income of ordinary people. They increase the running costs particularly of small and medium-sized businesses, increase bankruptcies and ultimately put people out of work. Economies slow down and recovery is often protracted.

No economy is ever completely insulated from external shocks. However, it is an economy's ability to withstand these shocks, and the speed at which it is able to recover the damage caused that is important. We know that this in turn depends on the strength and sustainability of economic policies, the quality of the institutions that underpin our economies, the regulatory framework and the degree of compliance, the legal framework, the commitment and courage to pursue the policies chosen, accountability and transparency, and importantly, democracy.

There are many emerging economies that have been dragged into the vortex of this storm that share most, if not all, of these characteristics, South Africa included. However, this has not insulated us. One of the reasons is that markets, and the people who populate them, have in this frenzy, lost the ability to differentiate between good and bad, or between sustainable and unsustainable policies. The markets, have temporarily we hope, forgotten how to make rational decisions. It is ironic that despite the vast amounts of information available and the increased transparency, there is a paucity of analysis and a tendency towards a 'herding instinct'. Decision-making in these circumstances is, to say the least, poor. Yet these decisions have a profound impact on many economies, and can as we have seen in this past period, trigger significant crises.

At times like this we need to stand together as a nation and find common solutions. We need to recognise that as tempting as it may be to score cheap political points, to be adversarial, to posit populist solutions, it does not help in addressing the challenges we face as a nation. These are difficult times and it is not what we had hoped for almost five years into our hard-won and cherished democracy.

Tough as things are at present, our economy has not collapsed in the face of the storm. We have of course sustained some damage, but we will recover. Our strength lies in the sustainability of the policies that we have adopted, the irreversible nature of our transformation agenda, our ability and courage to chart our own course. It is important that we are not provoked into making decisions for which we will pay dearly once the crisis has subsided.

What is the impact on the South African economy?

- The rand has depreciated by over 28% since January, and 22% has been wiped off the value of the stock market. Interest rates have increased by 5% and there is upward pressure on inflation. This despite the fact that our economy is vastly different to Russia or the Asian economies.
- We have a sound and well-capitalised banking sector; not merely by emerging market standards, but also by OECD standards. Bad debts account for 3 per cent of banks' portfolios compared to approximately 30 per cent in Japan. The banking system does not have large foreign currency exposures.
- We have continued to pursue sound fiscal policies and have effected fundamental reforms in both revenue collection and expenditure management. The government has reduced the fiscal deficit from over 10 per cent in 93/94 to a targeted 3,5% in this fiscal year.
- More importantly we continue to honour our commitment to the irreversible transformation of our economy. This is embodied in the RDP, and is supported by the macroeconomic policies set out in GEAR. There has been substantial reprioritisation of Government spending towards social delivery, and despite the slowdown in growth we do not intend to cut back on expenditures on health, education, welfare payments and housing. In other words, our Budget commitments remain unchanged.
- At times like this it is often easy to forget how much progress we have made in getting this economy on to a sound footing. Our civil servants get paid, we pay pensions and other benefits to millions of South Africans, we continue to build houses, to provide water and electricity to millions of people, and to provide services at our clinics and hospitals, and to provide schooling for our children.
- By contrast many of the countries affected by the global crisis have had to cut back radically on all these expenditures. In many, many cases the burden which is being placed on the poor is intolerable.
- We have been cautious about the deficit and it is only at times like this that we can really begin to appreciate how much this actually means. Had the deficit been 6 per cent this year, the cost of financing it at much higher interest rates would have been over R4 billion more than it is now. This would have severely hampered our ability to spend on social services, not just this year but well into the future.
- We have succeeded in bringing down inflation – the average CPI increase for the first half of 1998 was 5,5%, down from the 1997 average of 8,6%. The recent depreciation of the rand is placing upward pressure on inflation (CPI has risen to 6,6% in July 1998), but the average inflation rate for 1998 is expected to be around 7%.
- The current account deficit is expected to be 1 per cent of GDP for this year. Exports have continued to perform well both in value and volume terms. South Africa has experienced four years of strong export growth. This trend has continued through the first half of 1998. (The value of merchandise experts increased at an average annual rate of 20% during the period 1993 to 1996; rose by 12,5% in 1997 and 12,0% in the first half of 1998). The value of merchandise imports, by comparison, has flattened out during the first half of 1998. Exports as a share of GDP increased from 15% in 1994 to 19% in 1997.

- The balance of payments financing requirement is therefore relatively small. Our external debt obligations are very low by most standards (approximately 5% of total public debt) and we do not have any foreign debt redemptions until December 1999.
- Our entry into the global capital markets has also been impressive. For instance, a net capital inflow of R20,2 billion was experienced in 1997, as compared to R4,3bn in 1994.
- Of course this crisis has impacted negatively on our growth rate. Whereas at the time of the Budget 3 per cent seemed attainable, we are now looking at a growth rate of just under 1 per cent. In addition the higher interest rates will put pressure on our debt service costs.
- On the positive side the latest figures on the state of government finances which were released by the Department of Finance just yesterday, show that expenditure is broadly on target, and revenue is slightly ahead of target. This despite the economic slowdown.
- As we have said many times in this House, unemployment remains the biggest challenge that we face as a nation. The current crisis is likely to further add to the pressures. However, as our submission to the Job Summit indicates, we are committed to find both short- and long-term solutions to overcome the scourge of unemployment.

The way forward

- At a global level the nature of this crisis demands bold solutions. Amongst these solutions must surely be ways of dealing with the distortions created by speculative and unsustainable capital flows. The world clearly needs a set of 'rules of the game' that we all adhere to. This is not the same as arcane exchange controls and the building of new barriers. The time for that is gone. But we do need better regulation of the financial markets. Financial institutions whatever form they take, should for example, have to report to regulators what speculative positions they have taken, and what their capital at risk is, and they should have to provide adequately for this. Currently it is all too easy to take speculative positions without any consequences. Non-compliance costs need to be high. There is also much scope for improvement in cross-border supervision and regulation.
- But the answers clearly do not lie simply in the realm of capital regulation alone. Governments also need to examine their policies to ensure that they are sound and do not open their economies to excessive speculation. In the final analysis there are no viable alternatives to sound and sustainable economic policies. Blind adherence to populist solutions, whether these be of the rabid free-market type or of the radical left-wing type, are neither appropriate nor sustainable.
- Tax regimes also need to be considered. Many financial institutions, practices and instruments, work only because the tax regime of a particular country makes it possible.
- For South Africans, the challenge is to stay the course of the economic policies we have chosen. It is a challenge that we all need to embrace with commitment and discipline. If we stay the course through these tough times we will emerge stronger and better equipped to meet the needs of all of our people. What we need now is not pessimism. That is easy. We need the courage and the conviction to embrace the challenges that lie ahead. We to believe that when the global crisis subsides, we will be well-placed to attract the investment which is required to grow this economy and create sustainable jobs.