MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

KEYNOTE ADDRESS BY THE MINISTER OF FINANCE, MR ENOCH GODONGWANA, AT THE GEPF ANNUAL THOUGHT LEADERSHIP CONFERENCE 2022, AT THE CAPE TOWN INTERNATIONAL CONFERENCE CENTRE, CAPE TOWN

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"THE IMPACT OF A CHANGING GEOPOLITICAL LANDSCAPE ON THE GLOBAL ECONOMY AND FINANCES"

Director of the Programme
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Practitioners in the Pension Fund Industry
Distinguished Ladies and Gentlemen:

1. INTRODUCTION

Thank you for the opportunity to address this year's GEPF Annual Thought Leadership Conference.

Gathered here are practitioners and stakeholders in an industry that is a vital source of economic growth, given its role as an intermediary in the investment savings channel.

This industry is also one of the most important providers of liquidity needed to ensure the smooth functioning of capital markets.

The industry provides the means for its clients to diversify their portfolios enabling them to achieve their investment goals.

Your industry also has the unique capacity to mobilise massive resources that could be used to respond to the socio-economic challenges of our time.

Ladies and Gentlemen, I have structured my input in the following manner.

Firstly, I will focus on the global economic outlook, in particular, the geopolitical environment and its impact on the global economy

I will then move to the domestic economic outlook.

Thirdly, I will deal with the challenges of climate change and its implications for pension fund investments.

Lastly, I will reflect on the role of pension funds in infrastructure finance.

2. THE GLOBAL ECONOMIC OUTLOOK: THE GEOPOLITICAL ENVIRONMENT AND ITS IMPACT ON THE GLOBAL ECONOMY

Ladies and Gentlemen, we are meeting at a time of unprecedented volatility in the world's geopolitical environment.

This is a time when regional blocs are gaining prominence, while multilateral institutions are weakening.

Ours is increasingly becoming a multi-polar world!

As a consequence, global supply chains are being re-configured leading to possible disruptions which could negatively affect established global trade patterns.

The weakening of multilateral institutions could make it difficult to build global consensus and solidarity on the challenges facing humanity.

The war between Russia and Ukraine has increased geopolitical risks.

This is happening at a time when the world economy was beginning to recover from the COVID-19 pandemic.

The war is set to deepen geopolitical fragmentation and is likely to impede global trade and cooperation.

This is in addition to the tragic loss of life and the destruction of livelihoods.

The Russia-Ukraine conflict is manifesting through a threefold crisis: access to food, energy, and finance.

The United Nations has warned of signs of a wave of economic, social, and political upheaval that will leave no country untouched.

It is important for South Africa to heed this warning.

The Russia-Ukraine conflict and subsequent sanctions against Russia have renewed the surge in global inflation, weighing on global demand.

Higher inflation is eroding purchasing power. It has also led to higher interest rates, discouraging, and delaying investment and employment creation.

Collectively, these factors are detrimental to near-term and long-term economic growth.
In its most recent forecast, the International Monetary Fund cut it's 2022 global economic growth forecast to 3.2 percent from an estimated 3.6 percent.

The global lender cited a worse-than-anticipated slowdown in China, further COVID-19 outbreaks, and lockdowns; and critically, further negative spill overs from the war in Ukraine.

Among emerging markets and developing economies, growth is projected to fall from 6.6 percent in 2021 to 3.4 percent in 2022.

This is well below the annual average of 4.8 percent over the period 2011-2019.

The negative spill- overs from the war in Ukraine will more than offset any near-term benefits from higher energy prices in some commodity exporters.

Forecasts for 2022 growth have also been revised down, in nearly 70 percent of emerging markets and developing countries.

3. THE DOMESTIC ECONOMIC OUTLOOK AND THE IMPACT OF THE GEOPOLITICAL LANDSCAPE ON SOUTH AFRICA'S ECONOMY

The Russia-Ukraine conflict is a powerful example of how our economies are integrated.

On the 23rd of February, I tabled before Parliament my inaugural budget speech.

The following morning, we woke up to the news that the Russia-Ukraine conflict has escalated.

The consequence of this escalation, including the sanctions imposed on Russia, gravely impacted our assumptions on the domestic outlook.

The conflict has created a new set of multi-dimensional risks to our economic outlook, and to fiscal and monetary policy.

It has also exacerbated the supply chain bottlenecks that emerged during the COVID-19 pandemic.

Equally, it has raised inflationary pressures through higher energy and food prices, leading to a rapid tightening of monetary policy while adding to fiscal pressures.

Between February and June, the petrol price nearly doubled, putting immense pressure on the already stretched incomes of South Africans.

Inflation has jumped to a 13-year high. Headline consumer inflation rose significantly in July 2022 to 7.8%. This compares to an average of 6.2% in the first half of 2022.

Furthermore, increasing inflationary pressures and rising interest rates have hurt disposable income and disrupted efforts to lower poverty, negatively impacting consumer spending, economic growth, employment creation, and food security.

We have already seen the impact of these developments on the latest GDP numbers.

Following a more positive real GDP outcome in the first quarter of 2022, second quarter growth shrunk by 0.7 percent. Notably, household spending also slowed.

Since February, the rand has been among the worst performing currencies against the dollar, sliding from around 14 rands to 18 rands to the U.S dollar.

This has had a major impact on the cost of our debt as well as that of our imports.

Just last week, our external account turned negative for the first time in a long while.

While commodity prices have begun to fall, the price of coal, one of our largest exports, continues to rise.

Domestic constraints namely: the poor state of our freight-rail network, as well as the inefficiency and lack of capacity at our ports, prevent our country from taking full advantage of this dynamic, driven by the decreasing gas supply from Russia to Europe.

The downside risks to the local economy are intensifying.

These include the impact of the KZN flooding, frequent periods of load shedding, rising inflationary pressures, and escalating global pressures.

In part due to the Russia-Ukraine conflict, the IMF revised downwards its GDP forecast for South Africa to 2.1 percent in 2022.

The conflict as well as other risks which are beginning to materialise will put pressure on the fiscal space in developing countries such as South Africa.

The IMF also cautions that tighter global financial conditions could induce debt distress in emerging markets and developing economies.

More aggressive interest rate hikes by major central banks have already prompted capital outflows from emerging markets, raising fears of economic contraction in the near term.

Slower growth in China's economy as well as lower global growth means lower external demand, threatening the pace of economic recovery in South Africa.

The Russia-Ukraine conflict has also highlighted the pressing need for our economic and fiscal policy to be responsive to changes in the geopolitical landscape.

4. CHALLENGES OF CLIMATE CHANGE AND THEIR IMPLICATIONS FOR PENSION FUND INVESTMENTS

As we meet at this conference, the winds of change have begun to blow within the pension fund industry.

As part of this change, the industry is charged with the enormous responsibility to ensure that capital flows towards not only economic returns, but also social impact.

This presents both opportunities and risks.

I am sure that many of these risks are well known to you.

Allow me then to focus on the opportunities that climate change presents to the industry.

Specifically, I would like to talk about the role that institutional investors can play in enabling the African continent to transition to more resilient and sustainable economies and prepare for climate-driven events and catastrophes.

In March this year, the African Development Bank estimated that South Africa would require 30 billion US dollars – that is approximately 522 billion rands – to finance the just energy transition.

This excludes the investments required for disaster management and mitigation against climate -driven events and catastrophes.

We are already seeing the impact of floods in many parts of West Africa on the Atlantic seaboard and here at home in KwaZulu-Natal and the Eastern Cape.

Once in a lifetime flooding has also recently affected India and Pakistan.

In all these cases, the infrastructure has shown itself as insufficient to withstand this new normal.
The increasing incidence of climate-related disasters means that we must channel more resources towards designing and implementing effective measures to mitigate the effects of climate change.

Pension funds can play a central role in helping us reach net-zero emissions.

Their long-term liabilities and investment profile render them particularly vulnerable to damage caused by climate change.

Pension funds can also be influential in aligning other investors towards net zero emissions.

Located at the heart of the South African economy, the financial services sector touches the life of each and every citizen.

The sector, therefore, needs to respond to geopolitical shifts, including climate change, in ways that ensure that the goal of an inclusive and sustainable economy can be achieved.

The sector needs to leverage on the work done at COP 26.

We are encouraged that there is growing consensus among governments and investors on the need to find ways to avert harmful climate change.

There is also agreement that the existential challenge of our time is to arrest global warming, re-establish respect for nature, and put the world economy on the path of sustainability.

The financial services sector has a major role to play in this regard.

This includes investing for impact in social, climate and environmentally friendly projects.

The sector needs to place itself firmly behind the agenda of a Just Transition, which must be inclusive and must leave no one behind.

5. THE ROLE OF PENSION FUNDS IN INFRASTRUCTURE FINANCE

In addition to the climate transition, there are other opportunities for pension funds to co-invest with the government, especially in the delivery of infrastructure.

Investment in South Africa, measured as gross fixed capital formation, has lagged in GDP for some years now.

This is owing to continued global and domestic uncertainty, as well as the re-emergence of pre-existing domestic growth constraints – chief among them being unreliable electricity supply.

According to the World Bank, closing sub-Saharan Africa's infrastructure quantity and quality gap has the potential to raise GDP per capita by as much as 2.6% per annum.

This is in addition to the many lives that will be uplifted in a manner that unlocks the abundant human potential of our continent.

Closing this infrastructure gap and future-proofing our communities and our economies will require resources. It will also require vision and commitment. And I see all three of these things in abundance here in this room!

Conservative estimates by the African Development Bank suggest that the continent's infrastructure needs a total of 130 to 170 billion US dollars a year. The financing shortfall is in the range of 100 billion US dollars or more.

In South Africa, the amount needed to finance both brown and greenfield infrastructure projects totalsin the region of R1 trillion over the next five years.

Put differently, South Africa needs to lift the level of fixed investment in the economy to at least 30% of GDP from the current level of around 19% of GDP.

As government we cannot close this gap alone.

We will require partnerships with the private sector, especially in the finance sector where global institutional investors including pension funds have more than 100 trillion US dollars in assets under management.

As an enabler to growth, investment in infrastructure is mutually beneficial.

A growing economy that produces jobs will spur household savings on which the pension industry thrives. And higher savings will mean more money that can be invested back into the economy.

As the government we are doing our part to create a conducive environment for the private sector to invest in the delivery of infrastructure.

We acknowledge that the problem is not merely a lack of private sector desire to invest.

The obstacle is often the insufficient supply of investible infrastructure projects.

Inadequate project design and preparation, as well as regulatory and institutional frameworks that are too difficult to navigate are not conducive to private investment.

Our PPP framework is long overdue for revision, It takes too long to get a PPP off the ground.

To address this, we aim to create a centre-of-excellence for PPPs, as well as introducing an expedited approval process for projects below a predetermined value.

This centre-of-excellence will be a direct interface with private financial institutions for investments in critical government infrastructure programmes.

In 2020 we established Infrastructure South Africa as a facility to overcome hurdles in project preparation. This will help ensure that projects are feasible and properly structured.

We have also capitalised on the Infrastructure Fund to the tune of R 100 billion, over the next five years.

6. CONCLUSION

Ladies and Gentlemen, the past two years have, once again, shown us that change is happening at an increasing rate.

We have also learnt that this rapid change comes with a number of risks, but also it comes with opportunities; opportunities to improve how we do things, as well as opportunities to prepare ourselves better for the changes that lie ahead.

All these changes are also taking place when our economy faces an urgent need to rebuild infrastructure, finance the just energy transition, and improve growth prospects.

As you engage in this Conference, I urge you to consider and propose ways that GEPF and government could work more closely to respond to these challenges.

Given that our fates are intertwined, we have a better chance of success if we work together.

I wish you a successful Conference!

Thank you.