NATIONAL ASSEMBLY

QUESTION FOR WRITTEN REPLY

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Mr M G Oriani-Ambrosini (IFP) to ask the Minister of Finance:

Whether he has made any contingency plans to enable the economy to weather the impact of and mitigate the direct or indirect effects of a double-dip recession in the United States of America, Europe and Japan, which is foreseen to begin at the end of the year; if not, why not; if so, what plans?

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REPLY:

The outlook for the global economy remains uncertain as the effects of fiscal and monetary stimulus and inventory restocking are beginning to wane. In June, concerns were dominated by fears of a sovereign risk meltdown in Europe; now in August, concerns have shifted to the weak pace of growth in the US and China.

Financial markets are weaker and talk of the double dip has reared its head again. In the American economy, the fiscal stimulus package is diminishing; in China, growth indicators are pointing lower as trade activity declines and recent monetary tightening measures begin to bite. In Europe, growth has been better, but driven largely by German exports – and fiscal tightening in the region will only begin to take effect in 2011.

There are also some grounds for taking a more balanced view of the global environment. First, both China and India continue to grow very rapidly, despite the need to moderate short-term inflation and property price concerns. Other Asian economies, such as South Korea and Indonesia are also performing well. In these economies, the drivers of growth are expected to continue to shift away from exports and to domestic investment and consumption, thereby providing demand for the rest of the world.

Second, whilst employment has yet to increase in the US economy, households are reducing their over-borrowed positions and corporate profitability has increased strongly. These factors suggest stronger investment, exports and consumption in coming years.

Third, the factors that usually drive recessions – inventory de-stocking, sharp declines in job growth and the shock of a retraction in bank lending – have already occurred. Finally, the space for further policy effort remains. The Federal Reserve's recent decision to maintain its quantitative easing policy suggests that monetary policy will continue to react in the event of further signs of a slowdown.

This, of course, does not mean we should be complacent. Talk of Europe and the US entering a Japanese style "lost decade" has grown – which suggests that even if a double dip is avoided, in developed economies the prospect of a long, anaemic "U" recovery is high. Such a scenario would not necessarily be an official contraction, but it may well be perceived as such, and could quickly tip into recession with a shock emanating from a sovereign risk crisis or sharply lower asset prices.

Slower growth or recession in the major developed countries has implications for the demand for South Africa's exports, since these are our major trading partners. It also raises the prospects of weaker commodity prices (although gold may remain well supported) and constrained government revenue. The risk of increased trade protectionism in the wake of a double dip would further reduce global growth and could harm our exports even more.

National Treasury has been warning for some time now of the fragility of the global recovery. This fragility is likely to be with us for some time as fundamental shifts in the structure of the global economy are underway – wide scale de-leveraging, the end of fiscal stimuli and bank balance sheet restructuring all have important implications for the sources of growth in the future.

The low growth rates in South Africa suggest we are not able to take advantage of upswings in global activity as they occur and we remain vulnerable to slower activity. As such, our contingency plan for the double dip recession is part of a broader strategy that aims to build up the resilience of the South African economy to external shocks and improve the manner in which the economy functions.

The government's efforts in this regard can be broadly categorised as:

- An emphasis on countercyclical policy, so that there is sufficient policy room in the event of a worsening of economic conditions to respond and enable the exchange rate to cushion the economy against international financial volatility. Over time we want to achieve a more competitive real exchange rate.

- The inflation targeting framework has enabled a steady reduction in domestic interest rates in line with weaker inflation outcomes, and this will lower debt service costs and support demand for credit in the economy. Recent credit aggregate outcomes reflect the accommodative monetary conditions.

- Emphasis on continuing government's infrastructure spending – particularly in energy, transport and communications, which should lower the cost of South Africans doing business and improve their connectivity, and provide a source of growth – now and in the future.

- The government already has in place a number of social support mechanisms, such as the Unemployment Insurance Fund (UIF), which helps to protect vulnerable South Africans from the income loss associated with unemployment. The Framework for addressing the global crisis, run by the IDC, also includes a means of supporting companies and workers by providing funds for training instead of resorting to layoffs.

- Efforts are also underway by the Department of Trade and Industry to facilitate South African businesses' expansion into those regions that are growing – such as Brazil, India and throughout Africa – through a renewed emphasis on promoting trade and investment. A more diversified economy broadens the sources of economic growth available to us.

The National Treasury continues to closely monitor international and domestic economic developments and will adjust policy as necessary to maintain macroeconomic stability and to support a feasible economic growth rate.