

## **Wits Student Business Society**

**23 September 2004**

### **Economic growth prospects in a strong rand environment**

I have just returned from a series of meetings in London.

I tell you this not so that you feel sorry for me for having to travel so much or to such dreary places, but to let you know how the entire world continues to watch our progress, marvelling at how far we have come as a nation in ten short years of democracy.

The international community has come to recognise the strength of our nation and there is optimism about the ability of our young people to forge a new future for South Africa, building shared wealth and prosperity.

It is to the people in this room that we turn to fulfil this promise.

We all have a role to play.

As government, we can facilitate, nurture, guide, even cajole.

But, above all, we can provide a platform of predictable policy.

In parlance that you are more familiar with – these are necessary conditions for sustainable growth and development.

But, not sufficient conditions.

For this, we look to you. So, look at the person next to you and ask:

What will set us apart from the rest?

What can we do to ensure ongoing wealth creation in South Africa?

I implore you to devour every last vestige of knowledge that is offered, both here and in everyday life.

I encourage you to analyse and to question, not to be swayed this way and that by fickle headlines and banners. But to develop a deeper understanding of our economy, our nation, your future business.

When I was invited to talk to you, I was asked to talk about economic growth prospects in a strong rand environment.

Indeed the large fluctuations of the rand over the past three years or so make this a very sensible question for future business leaders to be asking.

It is also very topical, especially as we begin to see results reported in the newspapers of economic performance over the course of 2003.

Some of the choice ones include:

'Rand chips away at Concor results' [Business Day 21/9/2004]

'SA loses lustre as 'cheap' holiday venue' [Business Day 21/9/2004]

'Mines groan, banks smile as rand gains ground.' [Business report 21/09/2004]

'KVV defends market share as strong rand tears into earnings.' [Business report 21/09/2004]

'Relyant Retail's earnings a share rocket by 140%.' [Business report 07/09/2004]

'Quarterly retail sales rocket 8,9%.' [Business report 10/09/2004]

Then, as policymakers we read:

'Can a weaker rand be reconciled with economic growth aims?' [Business day 06 July 2004]

'Rands odyssey key to fending off inflation.' [Business day 29/07/2004]

So, what is one to make of all the hurly burly?

We are constantly faced with a series of questions:

What is the right price for the rand?

Is this a 'fair value'?

Why does it move so much?

Should government not intervene? If so, how? Or, more aptly, in whose interest?

The currency is merely a price, broadly, reflecting the value of our goods and services in international markets.

But, as South Africans, we have an intense interest in this single price in the economy.

In fact, every half hour, you can turn on any radio station and be updated on the value of the currency.

During 2001, the nominal effective exchange rate of the rand declined by 34,4 per cent, the bulk of which occurred in the second half of the year. Against the US dollar, the rand depreciated by 37,4 per cent.

Since the end of 2001, as you will know, the exchange rate of the rand appreciated by almost 50 per cent on a trade-weighted basis. And almost 85 per cent against the US dollar over the same period.

But, South Africa has not been alone in experiencing large shifts in the value of its currency!

Over the same period against the US dollar...

- ...the Aussie dollar appreciated 36,9 per cent
- ...the British pound appreciated by 22,8 per cent
- ...the Euro appreciated by 36,6 per cent

So what is the fair value of the currency?

My staff at the National Treasury recently shared with me a review of what the private sector economists think the fair value of the rand should be.

These 'estimates' ranged from R6.30 per USD to a high of over R8.00 per USD. A 27% range from highly-trained individuals, using deeply intellectual theory and sophisticated statistical models.

Still, please no pity for the policymaker.

Some very clever people have tried to dig deeper still and understand the equilibrium value of the currency.

One can identify a range of factors that could determine the equilibrium value, or the value that will maintain macroeconomic balance.

A very interesting paper by Ronald McDonald and Luca Ricci of the IMF sought to apply econometric techniques to identify the factors that determine the real equilibrium value of the rand.

They came up with a lot of things that are quite intuitive to savvy businesspeople like yourselves, including:

- The difference in interest rates in South Africa versus those in other countries.
- The difference in economic growth rates between us and other countries.
- Changes in commodity prices.
- The fiscal balance in South Africa and
- The value of net foreign assets.

Over the short term, the rand will deviate from this equilibrium as the value is driven by market information, rumours and speculation.

Poor information flows in these highly liquid and flexible markets may lead to the rand overshooting or undershooting the equilibrium value.

So, the fair price is that one that just traded. Yes, the one you just heard on the news, the one just agreed to between a willing buyer and a willing seller.

With over R10 billion traded every day, South Africa remains a price taker, unable to alter the value of the currency for long, without causing other economic difficulties.

It is clear, as the range of news articles I referred to earlier indicate, that the movements in the currency over the past two years have created shifts in economic resources across the economy.

Certainly, the strong rand creates both winners and losers, not all of whom have equal voice in the public discourse.

Over the course of 2003, the data shows that the manufacturing, agriculture and tourism sectors were to varying degrees adversely affected by the rapid appreciation of the currency, as was the mining sector, though rising commodity prices ameliorated the impact of this.

Clearly, as input costs are, to put it mildly, less flexible than the currency, margins were tightened for manufacturers and miners.

The flip side is in the retail sector, where the costs of key inputs fell and margins widened.

And, of course the banks did well, as South Africans felt wealthier when the international value of their assets rose.

Then there are the obvious benefits to every South African, from the overpaid chief executive to the underpaid worker, to the unemployed job seeker desperately eking out a living.

I am obviously referring to the positive effect on inflation from the stronger currency, especially in this time of severe dislocation of international oil prices.

I mentioned earlier what Government can and cannot do for you as you think about your future business career.

We cannot guarantee you a profit.

Only hard work will bring that.

We cannot guarantee you an easy ride.

No one can.

We can guarantee you policy consistency and certainty.

We are already beginning to see the benefits of 10 years of policy consistency.

Our businesses are more resilient, recovering much more quickly, seeking new opportunity in the face of adversity.

As we are digesting what happened in 2003, we are beginning to see the manufacturing sector recover a new momentum, recording quarterly growth of 4,6 per cent and 5,3 per cent over the first two quarters of this year.

This was driven by the strength of domestic demand and a renewed energy to find international opportunities in less traditional markets and sectors.

The strength of this optimism is clearly reflected in the ongoing commitment to investing in manufacturing and mining, taking advantage of the rand's strength to install capacity for future growth and development.

In sum, there is reason to be optimistic about the near-term prospects for the economy.

Against this backdrop, it is important for Government to take a long-term view of the rand and not be swayed from current policy by the short-term movements in the currency.

Monetary policy in South Africa remains firmly anchored in the inflation-targeting framework to guide the Reserve bank to meet its constitutional objective of preserving the value of the currency, in the interests of balanced and sustainable growth.

The framework has already delivered precious gains in terms of focusing pricing decisions, and aiding the SARB to deepen its policy credibility.

The Governor assures us that in the deliberations of the monetary policy committee, the exchange rate gets its rightful attention amongst the host of factors that influence its interest rate decisions over the business cycle.

The recent stability in the exchange rate, supported by the SARB's increasing reserves and underpinned by the stability of the inflation targeting framework, will also help to lower the risk of doing business in South Africa.

As an economy, we cannot rely on increasing competitiveness on the basis of a depreciating rand.

Competitiveness should not be driven by the nominal exchange rate, but rather through real efficiency gains.

These real efficiency gains will come through a renewed commitment to revitalise our economic infrastructure, making it easy for you to conduct your businesses.

It comes through the intellectual power, innovation and creativity of the individuals sitting in this room who will be able to ensure that in the decade ahead we will transcend to a higher growth plane.

It is my hope that every one of you sitting here today, will take this lesson to heart and when you are at the helm of business in years to come, make the decisions based on the fundamentals of economics and with the best interest of the whole of South Africa in mind.

I thank you.