Global economic recession: effects and implications for South Africa at a time of political challenges.

Claves de la Economia Mundial

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1. Introduction:

Africa's relatively weak global linkages suggested to some that it would be spared the worst effects of the global crisis which hit many developed and emerging market economies from around September 2008 (Bakrania and Lucas: 2009). However the region as a whole has indeed been exposed to the downturn and growth estimates for the continent have been continuously lowered from 5 percent in 2008 to 1.7 percent in April 2009 (IMF, 2009). The main channel for this negative effect has been via the recession-induced slow-down in foreign financial flows of all types into Sub-Saharan African and the region's dependency on commodity based export growth.

The South African case:

2.1 South Africa and the global economy:

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Unlike most other countries on the continent, South Africa has historically been a significant player in international markets: its economy is more open than many industrialized countries. The open world economy which stimulated so much international migration in the period before the first world war found in South Africa one of its growth engines as well as one of its most contradictory crucibles of imperialism.

2.2 The global recession and South Africa: economic considerations:

Given this global engagement expectations were that South Africa would feel the effects of the global recession both quickly and deeply, and in ways which added to the economic problems created by race, inequality and the structural problems associated with the nature of its brand of capitalism. The Chilean-born, Cambridge economist Gabriel Palma speaking to a audience in Cape Town in September 2009, observed that 'unlike almost all other middle-income countries, [South Africa] had entered the crisis with a greater degree of vulnerability, namely a very large current account deficit, high interest rates and high inflation'. He argued that South Africa had to re-impose capital controls, relinquish the independence of its central bank, jettison inflation targeting and address the problem of its over-sized and unproductive financial sector, a legacy of a long period of (US-type) financialization of its economic activity. (Business Day 14 September 2009).

In contrast, top South African officials initially took a different position to the emerging crisis. Trevor Manuel, the former Finance Minister, now Minister in the Presidency in charge of the National Planning Commission, reacted to the crash in global markets in late 2008 with the view that South Africa would not be badly affected. Even when signs in the real economy were pointing to serious problems in early 2009, Trevor Manuel insisted that South Africa was not in a recession!

Part of the reason for this more optimistic picture arose from the experience of the late 1990s Asian financial and currency crisis, which South Africa weathered very well. The government attributed that earlier success to the soundness of its home-spun structural adjustment program, the Growth, Employment and Redistribution program (GEAR) which saw key macroeconomic balances fall within IMF norms quickly after the democratic elections of 1994. Since then the country experienced sustained, though far from spectacular, rates of economic growth from 1999 to 2007. Inflation fell comfortably within the inflation targeting range of 3-6 per cent between late 2003 and 2006, testing and later breaching the upper limit only from mid-2007. The budget deficit and current account deficits were both under control.

But things then begin to change after 2007 in the key macroeconomic balances and the fragility and vulnerability in the real economy that had been evident for sometime could not easily be swept away with technical talk about the macroeconomic fundamentals being right.

The country's GDP *growth rate* dropped to 1.8 percent in the last quarter of 2008, then plunged to -6.4 percent in the first quarter of 2009, and to -3.2 percent in the second quarter. So the country fell into a technical recession already at the end of the first quarter of 2009. Manufacturing output in the first quarter of 2009 declined by 6.8 per cent relative to the previous quarter, while mining production declined by 12.8 percent over the same period. Similar contractions are apparent in the retail and wholesale trade sales, with motor vehicle sales (domestic and export) in particular falling sharply. (SARB Quarterly Bulletin, various)

484 000 workers lost their jobs in the third quarter of 2009, the largest number in manufacturing (about 150 000): the total job losses were more than the combined total of the first two quarters of that year taking the official unemployment rate to 24.5 percent and total (official) job losses up to the end of the third quarter over the million mark. To these figures should be added some 1.6 million workers who are excluded from the calculations because they have ceased actively searching for work, ie the so-called discouraged workers syndrome, taking the real unemployment rate to about 32 percent! (Business Day, 30 October 2009).

Turning to macroeconomic balance indicators, *inflation* breached the outer limit of the target range (3-6 percent) and CPIX stood at an average 9.9 percent for 2008. The current account deficit as a percent of GDP arose from a very modest and manageable 1.1 percent in 2003 to a disconcerting 5.8 percent in 2008, an alarming 7 percent in the first quarter of 2009, and a further 3 per cent fall in the second quarter of 2009. Though initially this deficit was easily financed by steady foreign capital inflows (mainly portfolio investment but also some FDI) the tremors in global financial markets from around September 2008 threatened the sustainability of this key ratio, for long regarded as the ‘achilles heel’ of the modern South African economy (SARB Quarterly Bulletins, March 2009, June 2009 and September 2009).

The Reserve Bank after a long period of successive Repo (bank) rate hikes from April 2005 (which saw the rate rise from a low 7 percent to 12 percent in June 2008) began cutting its key Repo rate from the latter date, to its current low of 7 percent at end December 2009 – the lowest rate in 27 years!

The *Johannesburg Securities Exchange* all-share index fell from a high of 32 542 on 23 May 2008 to a low of 18066 on 21 November 2008, but volatility and uncertainty in the market was as worrying as the absolute fall. New listings remained subdued throughout 2009. The all-share index has since picked up, and it stood at 27 895 as of 5 January 2010 (Business Day: 5 January 2010). Depressed global conditions and lower liquidity on global financial markets also impacted on the rand-denominated bonds in the European and Japanese bonds markets in 2009. Turnover in the secondary domestic bond market fell in 2009; bond prices weakened and a much reduced level of participation by non-residents in the domestic market is detectable (SARB Quarterly Bulletin, September 2009: 43-45).

The local *property market* has weakened since late 2008, but without the devastating consequences for low-income home owners felt in the US and to some extent in the UK. (SARB Q/B September 2009). House price deflation continued in 2009, maintaining the downward trend noticeable in late 2008: this despite the serial lowering of the Repo and mortgage rate, which appear to have been off-set by commercial banks' tightening lending conditions. Activity in new home construction also slowed as demand weakened, in part a consequence of depressed conditions in the labour market and a decline in household income expectations.

However, millions of poor South Africans exist outside these formal property and real estate markets in sprawling informal settlements and slums. The Zuma government appears to be making a more concerted effort to accelerate state housing provision but slowing economic activity nationally is being felt in lower aggregate taxation and in the context of so many competing demands on the fiscus, the ambitious targets to 'eliminate' informal settlements (the language of the state) and resettle these communities in low cost houses by 2014, may be jeopardized.

Some attention has been paid in recent literature to the effects of the global economic recession on South Africa, focusing on the implications for growth, poverty and employment (see for example Marais, 2009: Jacobs, 2009)). I want to address here, two issues, banking and black economic empowerment, which have not received as much attention, but which are significant for South Africa, in the context of the economic transformation of the country after apartheid.

2. 2.1. South Africa: the banking sector.

A Financial Mail analyst observed that one reason why South Africa would weather the global turbulence better than most was its effectively regulated and well-capitalised banking and financial sector. Remaining exchange controls measures for residents and a relatively stable macroeconomic management combined to insulate South African banks from the shocks originating in the US sub-prime market, he argued. Of the country's top banks only Investec, the smallest but most aggressively internationalized bank appears to have taken somewhat of a direct knock. As early as November 2007 Investec reported a 36 million pound sub-prime hit and a sharp fall in its share price, though this exposure pales into insignificance when compared to the US and UK write-offs. (Financial Mail: 13 March 2009).

A Business Day analyst compares European banks with an average leverage (debt to equity) ratio of 35 per cent and the big global investment banks with a leverage as high as 50 to 60 percent with South Africa's big four banks with an average leverage of about 16% - in the lower quarter for leverage internationally. Former Reserve Bank Governor Tito Mboweni pointed out that South African banks had improved their capital ratios in the past year, noting that the country's banks were "strong and healthy" and that the capital adequacy ratio was increased from 11.8 percent in January 2008 to 13percent in December 2008 (Business Day: 2 March 2009).

The 2008 banking supervision annual report showed that economic stress in the household sector had an adverse effect on banking business but that banks remained sound in terms of liquidity and solvency. The report highlighted the buffers that have protected the local banking industry: including that banks had not been allowed to use hybrid structures in their capital base (like US/UK); banks had not relied on derivative structures for funding; banks were required to increase capital adequacy in good times; capital adequacy requirements were raised on home loans when banks granted more than 80 percent of the value of the property, a factor which limited banks from giving loans simply to fund high lifestyles.

The SARB's senior deputy Head of the Research Department Brian Kahn answers the question, what has protected South Africa during this period of turbulence, as follows: :

> It turns out that we were protected to some extent by prudent regulation by the Bank regulators, but more importantly, and perhaps ironically, from controls on capital movements of banks. Despite strong pressure to liberalise exchange controls completely, the Treasury has adopted a policy of gradual relaxation over the years… With respect to banks, there are restrictions in terms of the exchange control act, on the types of assets or asset classes they may get involved in (cross-border). These include leveraged products and certain hedging and derivative instruments. For example banks cannot hedge transactions that are not SA linked. Effectively it meant that our banks could not get involved in the toxic assets floating that others were scrambling into. They would have needed exchange control approval which would not have been granted, as they did not satisfy certain criteria. The regulators were often criticised for being behind the times, while others have argued that they don't understand the products, but it seems there may be advantages to that! …(2008:1).

But local banks have experienced some stresses.

The level of interest rates, other cyclical economic developments in South Africa and the turmoil experienced in international financial markets contributed to credit risk ratios deteriorating during 2008. Impaired advances increased to R87.3 billion at the end of December 2008 (January 2008: R47.6 billion). Impaired advances as a percentage of gross loans and advances deteriorated from 2.3 per cent at the end of January 2008 to 3.8 per cent at the end of December 2008. (SARB Bank Supervision Report, 2008).

Growth in credit extension slowed in September 2009 to the lowest in 43 years! Growth in credit to the private sector fell to 2.34 per cent year on year in September 2009, the weakest growth since October 1966. It all but collapsed in 2009 after peaking at 7.55 percent in September 2006, three months after the SARB started to raise rates as inflation moved towards the upper limit of the inflation target (see Business Report 1 October 2009).

Not surprisingly therefore, local banks' earnings have been under pressure. Absa confirmed interim results that earnings per share for the six months to end in June dropped 39% as it wrote down assets it bought after clients defaulted on futures contracts. "Business volumes are ... likely to show limited growth. Arrears and non-performing loans are expected to continue rising. Margins are expected to remain under pressure due to the continued higher cost of funding." Mail & Guardian (3 August 2009). Similar pressures are evident from both Standard and Nedbank.

A number of factors, including the strength of its regulatory institutions and residual exchange controls on residents, protected South Africa from the kind of full-blown banking crisis experienced in the UK, parts of Europe, and the USA. However, local banks have experienced some stresses, especially on the earnings front, as advances and credit extension fell sharply.

2. 2.2. South Africa: impact of the crisis on Black economic empowerment:

One key characteristic of post-apartheid South Africa is to be found in its program of affirmative action. In the world of South African business, this notion is expressed in the term ‘black economic empowerment’ or BEE. The imperative to transform the economy, through some form of BEE is unquestionable, entirely logical and reasonable.

However, the beneficiaries of BEE have tended to be a small elite, closely linked to the ruling ANC - some controversially being current party officials – as well as a few prominent ex-trade unionists. It is also worth mentioning that the majority of the new elite have accumulated their wealth through board-room deals, and few if any, have started large new businesses. Self-enrichment rather than broad based empowerment typifies many BEE deals. Deals are typically financed by the dividend income of the newly empowered (black) shareholders. The lack of finance in the quantum needed for

BEE deals creates not only a heavy reliance on the ‘once empowered’, the merchant bankers and others (the ‘real’ beneficiaries) who lie just below the surface of these transactions.

The financial crisis and global and local recession has had a major impact on the number and character of BEE deals.

Many companies have cut back on dividends so straining the environment for empowerment deals since the deals were often structured so that dividends would repay initial debt. “This creates the danger that the banks that funded the deals will call up the debt, forcing the black investors out of the company.” Industrial conglomerate, Barloworld, offered 10 percent of its shares to black investors at R83.31. But since the recession stock prices decreased by 60 percent and were valued at just R33! (Financial Mail, 3 April, 2009:79).

Analysts (Financial Mail Special Edition, 3 April 2009: 41) warned that many empowerment deals were “under water” because of the drop in metal prices. Empowerment outfits have borrowed cash to fund their stakes in mining firms and had been servicing this through dividend payments. Now, many companies are having to rethink dividends policy and conserve cash.

Latest figures for 2009, drawn from the research of McGregor’s “Who Owns Whom” database, shows that “BEE activity as whole….was half that of the previous year because of the global financial turmoil. And a lot of that activity was in completion of existing deals" (Mail and Guardian: 23 December 2009 to 7 January 2010. BEE supplement: 3).

South Africa's plan to transfer about 25 percent of the country's wealth to black people by 2017 is increasingly looking like a fantasy.

3. Policy responses:

Different from US and European government responses to the economic crisis which focused on financial bailouts to banks and businesses, South Africa's focus has been on spending on real physical investment: road and rail construction, new power stations, housing, health, water and sanitation systems. But it is important to recognize that the bulk of these investments and commitments predate the 2008/9 global financial and economic crisis and in part are linked to the staging of the 2010 FIFA World Cup in June-July,

Following the announcement of further job losses in the third quarter of 2009, former Finance Minister Trevor Manuel (now Minister in the National Planning Commission) acknowledged that 'the government had underestimated the seriousness of the recession. Manuel told the annual Standard Bank Africa Forum "looking back, it appears that we were rather too confident." (Mercury: 30 October 2009). Yet the South African government appears resolute in its commitment to its 'no redistribution before growth' approach, a line re-iterated in new Finance Minister Pravin Gordhan's Medium Term Expenditure Framework announced in parliament on 28 October 2009.

The National Economic Development and Labour Council (a social accord of government, labour and business) has played an important role in developing a co-ordinated response to the global economic crisis, and its framework document published in early 2009, has focused considerable attention on trying to minimize job losses and re-training and enskilling those who unavoidably had to be retrenched.

The South African Reserve Bank's response, within the limits of its current constitutional mandate, has focused on the following interventions:

- using moral suasion to get the banks to tighten their lending criteria, while letting credit to flow.
- Further improving banking regulation and supervision, while avoiding the dangers of over-regulation.
- Succesively lowering gradually the repo rate (so influencing onward lending rates (see above).

The Bank has so far resisted pressures from the ANC-aligned trade unions and the Communist Party to scrap or radically revise inflation targeting as its monetary policy anchor.

4. South Africa and the global recession: political implications:

Service delivery protests among the poor and previously disadvantaged (the ANC's core constituency) which intensified to levels amongst the highest in the world from the middle of the first decade of the 21st century, signified the crisis around housing, transport, water, electricity provision, and there is little doubt that this level of dissatisfaction was effectively used by the rising anti-Mbeki faction in the ANC to vote the President out of his ANC leadership role in late 2007 and then from his state leadership in September 2008.

Whatever the merits of these political actions, its timing, as world markets started to crash in the same month, certainly added to concerns about the country's stability and its status as an emerging economy.

In a report published by the Real Instituto Elcano, independent analyst Hein Marais reflected on these very same developments and his analysis in most respects is in line with the above introductory assessment of its economic impact. (Marais, 2009). Marais is right in his concluding argument that the impact of the crisis on the politics of the nation are hard to predict, especially, I would add, after the electoral victory in April 2009 of the left-supported Jacob Zuma administration. Where is one to go from here politically if it too fails to come to grips with poor growth, high unemployment, increasing inequality and service delivery crises? As he points out South Africa has been widely held to have one of the world's highest rates per capita of protest action, but the

ANC has been swept into power with ever rising majorities between 1994 and 2005. Further eruptions of xenophobia, perhaps exceeding in reach and degree the violence of May 2008, may (tragically) mean that the impact of the crisis may yet again fall on refugees and migrants, mainly from other African countries, seeking to escape political violence and economic collapse at home, as well as the poorest of South Africa's poor themselves.

None of the opposition parties, including the Congress of the People (COPE, a late 2008 breakaway from the ANC), nor the official opposition, the Democratic Alliance (DA), appear to have capitalized politically from the growing economic crisis, despite mounting service delivery protests and open displays of dissent within the ANC-led alliance. Neither COPE nor the DA would appear to pose an electoral threat to the dominant African National Congress, led by Jacob Zuma.

That leaves the question about how the fractions *within* the broad, multi-class ANC alliance are likely to coalesce post-2008, and whether a more radical break from what is referred to as Mbeki's 1996 class project, is likely. Academic Patrick Bond is not sanguine about the prospects for such a break, despite the convulsions at the ANC's national conference in December 2007. For him:

> Even the apparent death of South Africa's neoliberal project in September 2008, personified by former president Thabo Mbeki, whose pro-corporate managerialism was one reason for an unceremonious removal from power, is

> misleading. The 'populist' ruling party leader Jacob Zuma appears intent on not only retaining [the conservative, National Planning Minister Trevor] Manuel as long as possible but preparing a collision course with his primary internal support base, trade unionists and communists, in the run-up to the March 2009 general election. As Zuma put it to the American Chamber of Commerce in November 2008, 'We are proud of the fiscal discipline, sound macroeconomic management and general manner in which the economy has been managed. That calls for continuity ….'

5. Conclusion:

Both the continent and South Africa have been hit by the global financial and economic crisis, though in ways not predicted or expected. While the crisis did not hit the banking sector in the same degree or as deeply as in the US and Europe, banks have experienced a drop in earnings and some stress. Bank regulation has proven to have been crucial to South Africa's reaction. The major problem for South Africa has been the impact of slowing growth on employment and (through falling tax revenues) on service delivery to the poor, areas of the real economy that has been in deep crisis all through the post-1994 era. The government-supported program of Black economic empowerment, appears also to have taken some knocks.

Following three consecutive quarters of contraction, South Africa's real GDP returned to positive growth in the third quarter of 2009 (an annualized increase of 0.9 percent)

(SARB Quarterly Bulletin, December 2009). Whether this represents the beginning of a more rapid growth phase, backed by strong public investment beyond the 2010 World Cup, or the onset of a long period of low yet positive growth, remains unclear. The latter scenario will no doubt place further pressure on the government, more through stresses and tensions within the ANC-led alliance rather than electoral defeat in 2014.

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