

**The SA economy:**

**What has  
gone so  
badly  
wrong?**

OUR OBJECTIVE IS TO ADVANCE SOCIO-ECONOMIC AND ENVIRONMENTAL JUSTICE BY DEVELOPING CRITICAL KNOWLEDGE ABOUT, FOR AND IN DIALOGUE WITH CIVIL SOCIETY THROUGH TEACHING, RESEARCH AND PUBLISHING.

**CENTRE FOR  
CIVIL SOCIETY**

**Patrick Bond**

University of KwaZulu-Natal  
School of Development Studies and  
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presented to the  
**Nelson Mandela  
Inaugural Colloquium**  
organised by the  
**iKwezi Institute at the  
Nelson Mandela Foundation**  
**26 November 2009**

***I am sure that Cecil John Rhodes would have given his approval to this effort to make the South African economy of the early 21st century appropriate and fit for its time.”***

**- Nelson Mandela, launching the Mandela Rhodes Foundation, 25 August 2003**

***“We are on a completely disastrous path... We're calling for total overhaul of the economy of South Africa ... We've inherited an economy that was designed to serve the interests of a small minority. We have not developed an industrial strategy.”***

# **A critique of South African macroeconomic management during world's worst-ever capitalist crisis**

- *Why interest rates should be lower, and 'inflation targeting' scrapped*
  - *Why fiscal stimulus should be higher and better directed*
- *Why exchange controls and a debt audit are needed to solve SA's international financial vulnerability*



the dti

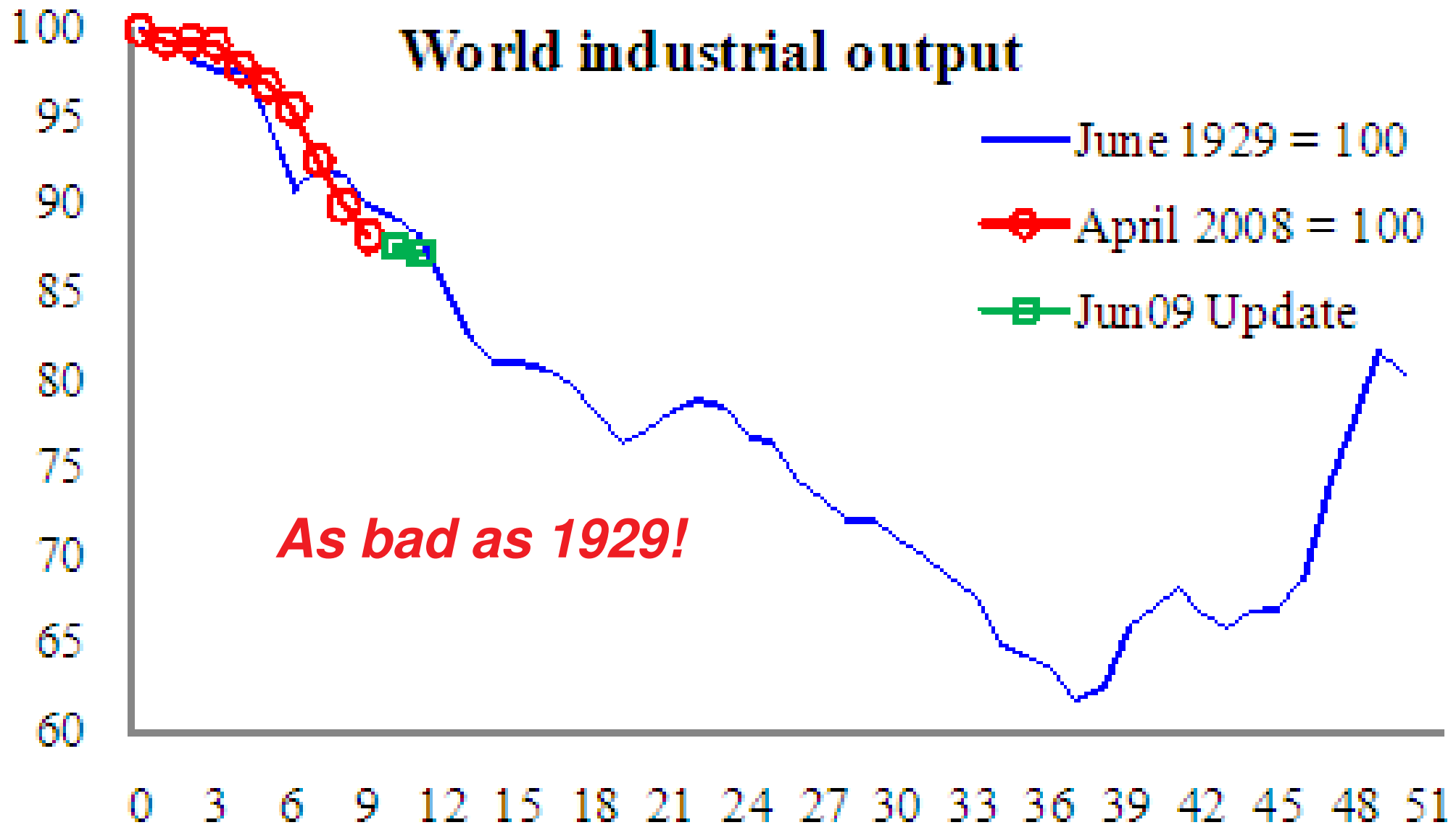
Department of  
Trade and Industry  
REPUBLIC OF SOUTH AFRICA

## *Even government admits:* **OVERVIEW OF THE ECONOMY**

2009 - 2012 MTSF

- ➔ The current economic environment is shaped overwhelmingly by the prevailing global economic crisis.
- ➔ While the crisis first appeared in the financial sector, it has now become a deep real economy and jobs crisis, which threatens to severely damage economies in the developed and developing world
- ➔ Domestic economy is in recession GDP contracted by 6.4% in Q1 2009
- ➔ The crisis threatens South Africa's industrial base:
  - Manufacturing production decreased by 11,7% in March '09
  - 23 of 39 industrial subsectors experienced output declines including in basic steel products (-24,1%) autos (-26.8%)

# Production crash in historical terms



Source: Eichengreen and O'Rourke *Months into the crisis*

# Trade crash in historical terms



Source: Eichengreen and O'Rourke *Months into the crisis*

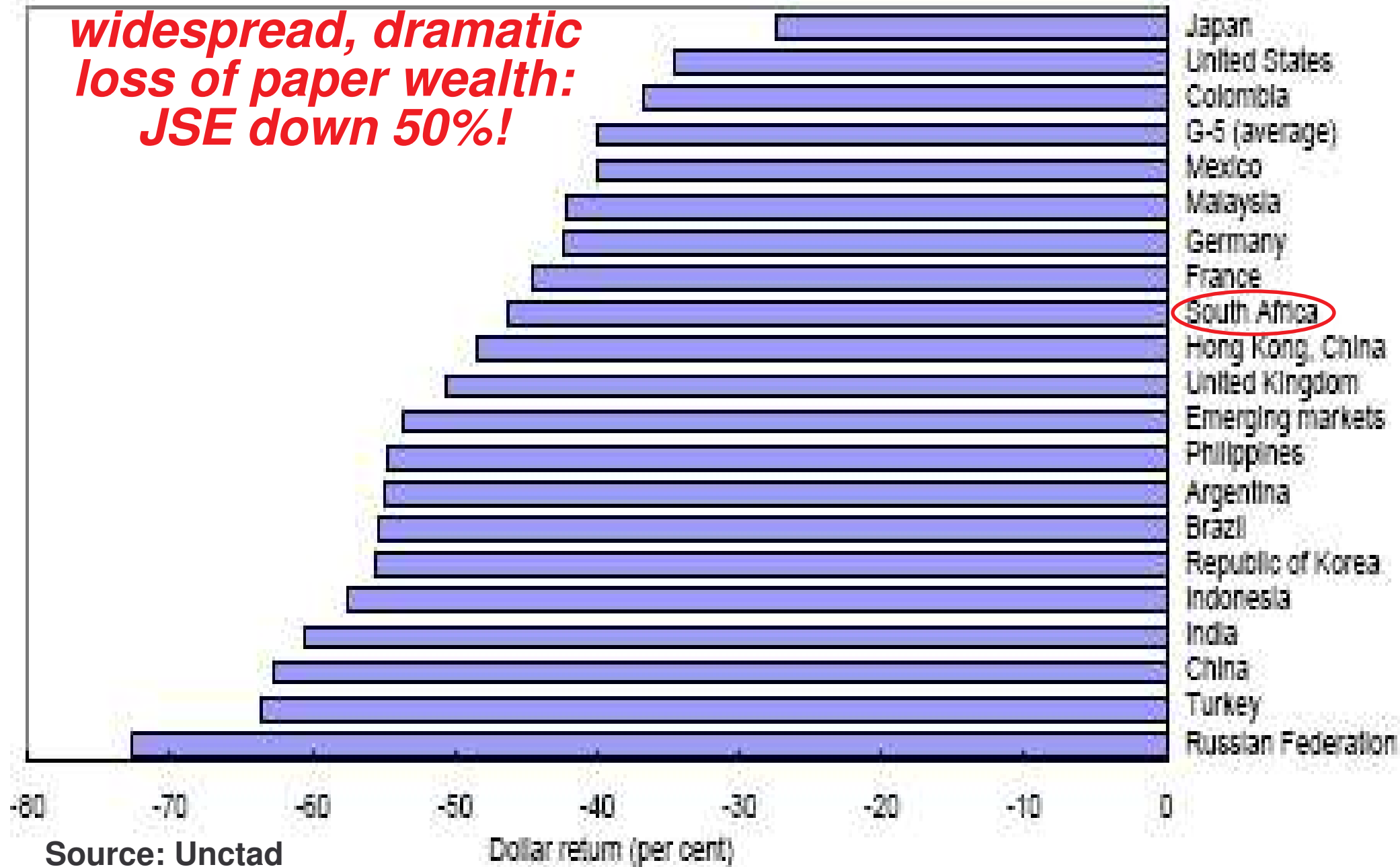
# Stock market crash in historical terms



Source: Eichengreen and O'Rourke *Months into the crisis*

# Stock market volatility in 2008

*widespread, dramatic  
loss of paper wealth:  
JSE down 50%!*

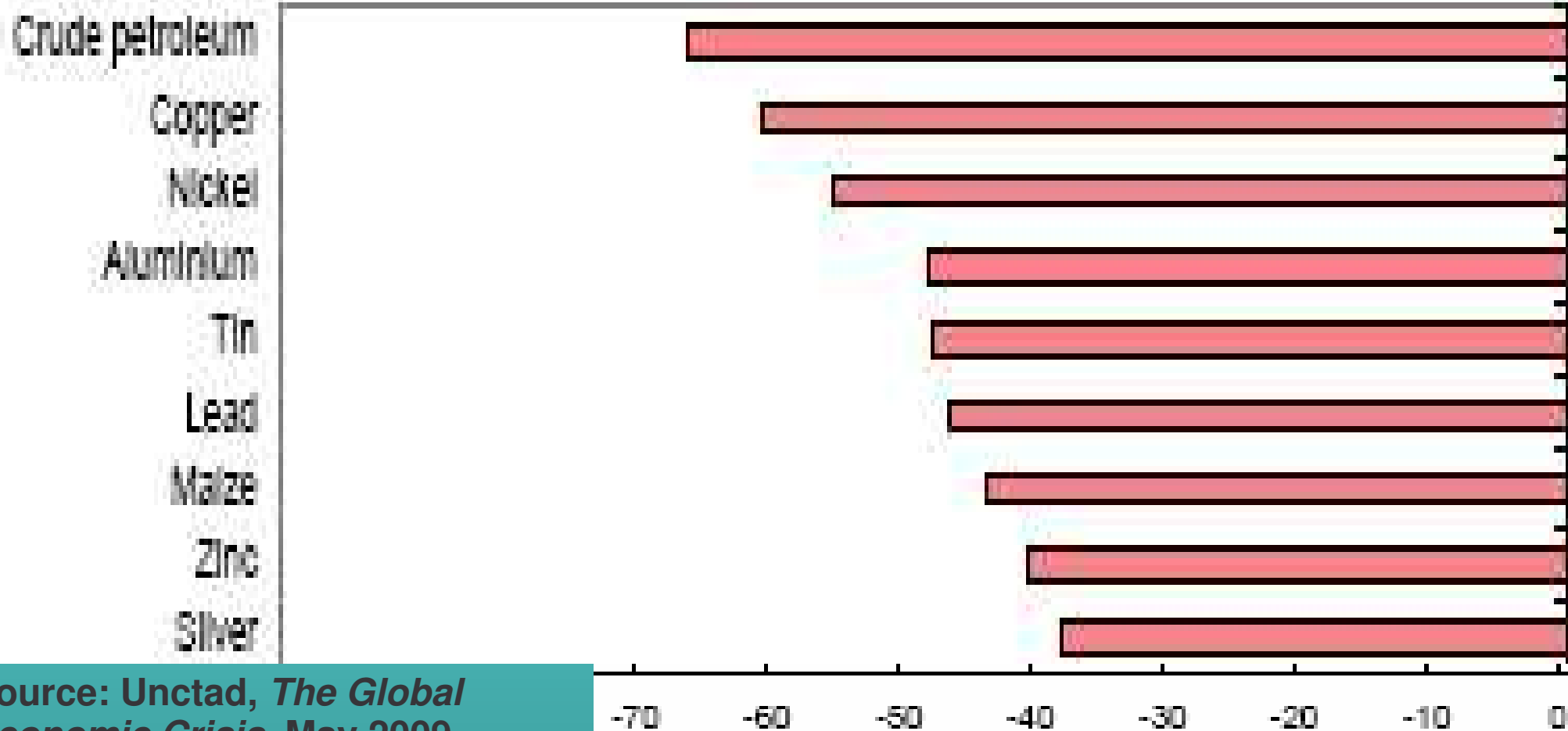




# Commodity devaluations:

Change in prices, July – December 2008

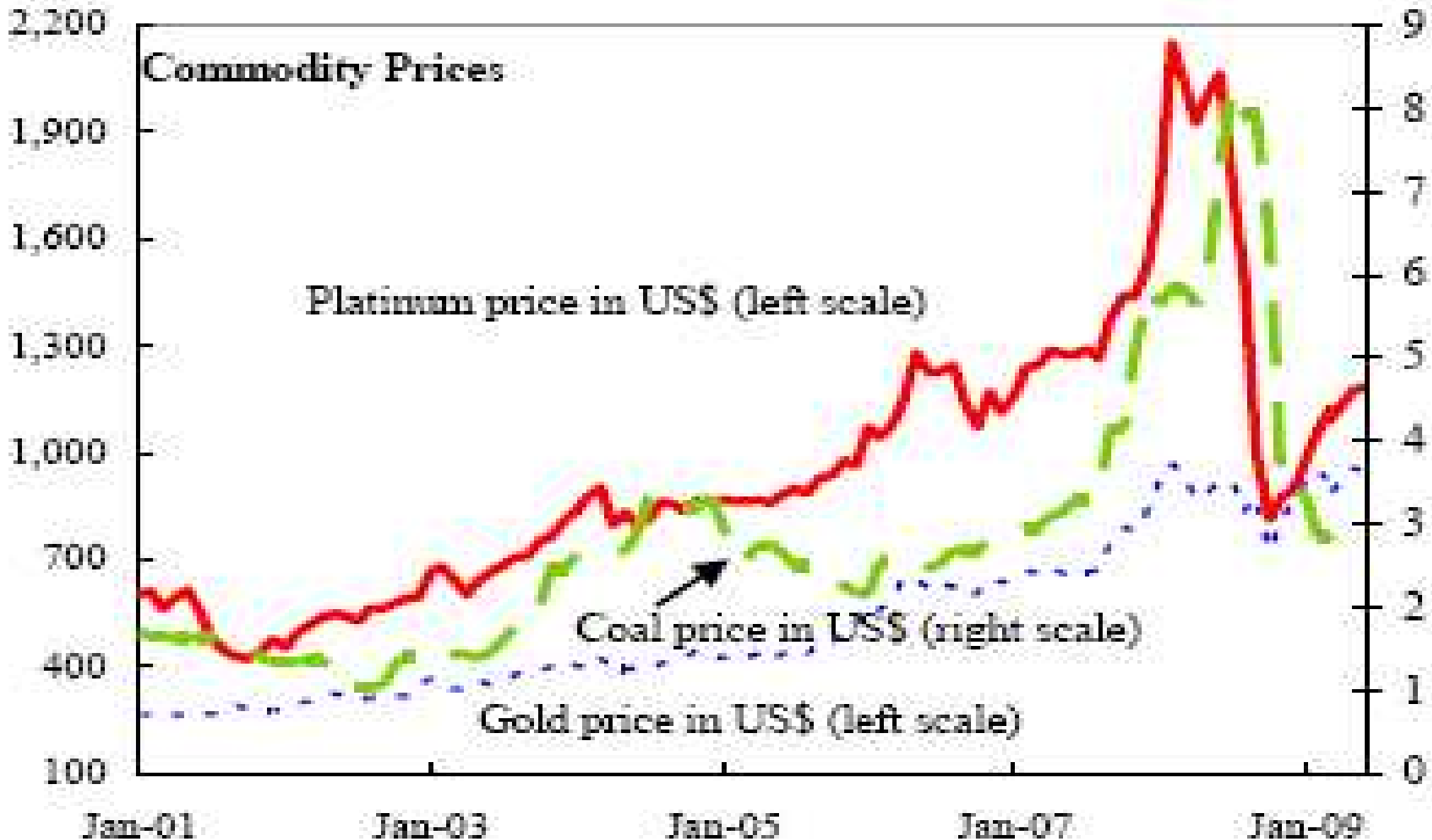
*...particularly devastating for African countries addicted to export-led extractive-industry 'growth'...*



Source: Unctad, *The Global Economic Crisis*, May 2009

# Huge swings in platinum and coal prices

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009



# Manufacturing, Mining Production and Retail Sales all decline

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

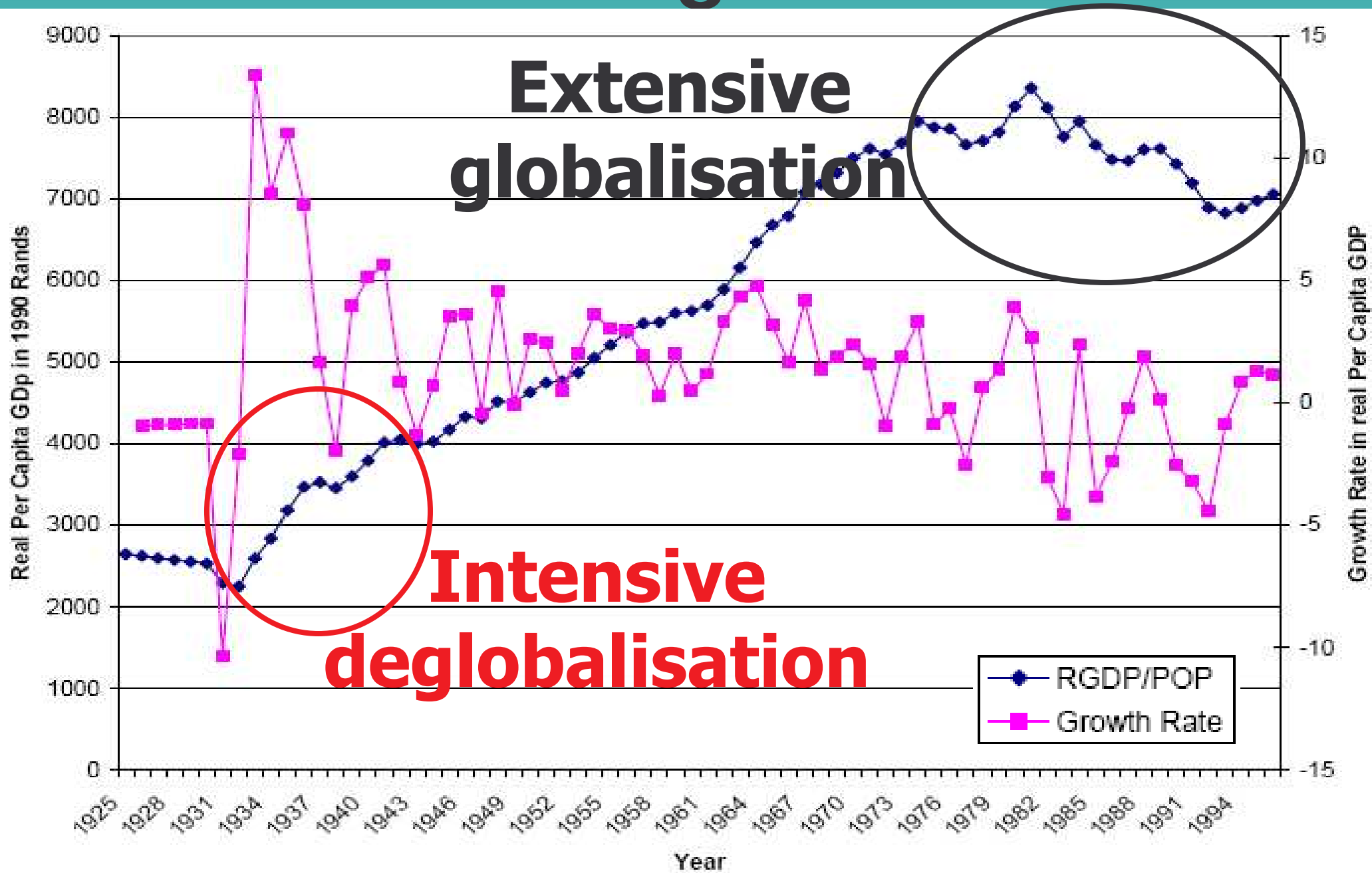


# How did SA become so **vulnerable** to world economic crisis?

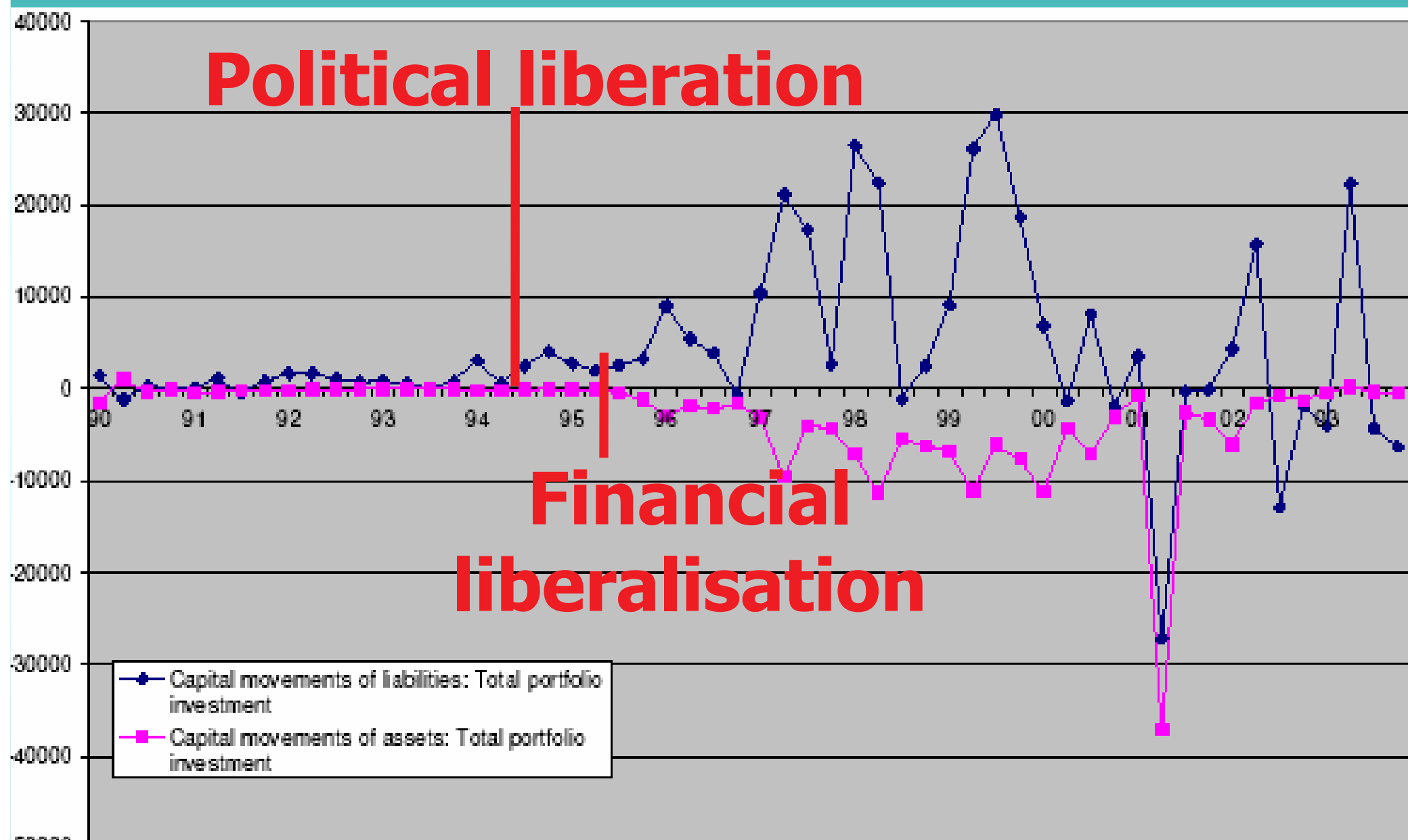
## Two sources

- **Trade liberalisation**
  - WTO from 1994
  - East Asian import surge from 2000
- **Financial liberalisation**
  - 1995 exchange control liberalisation
  - 2000s relistings of major SA firms abroad

# South African growth/decline

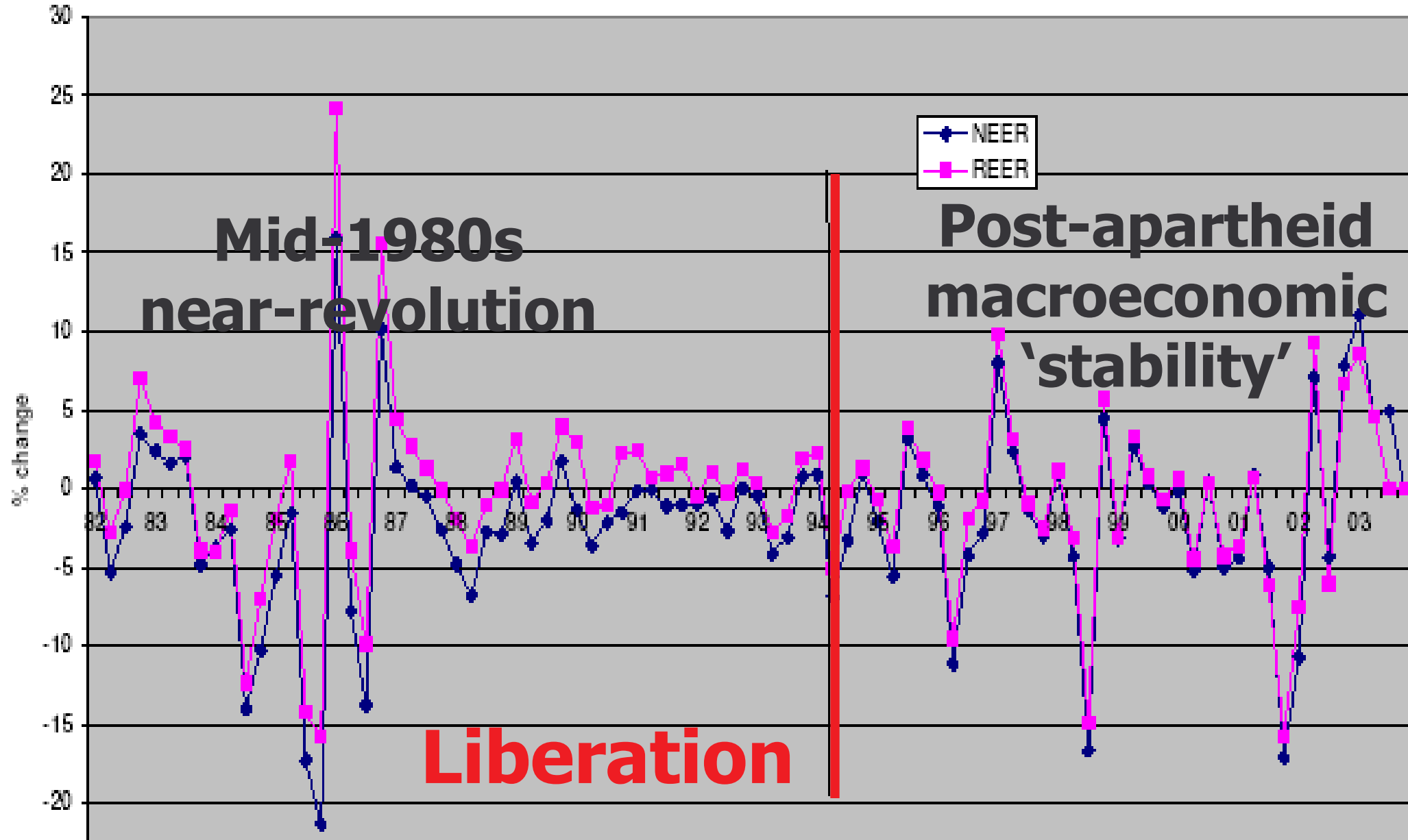


# SA financial volatility and capital flows

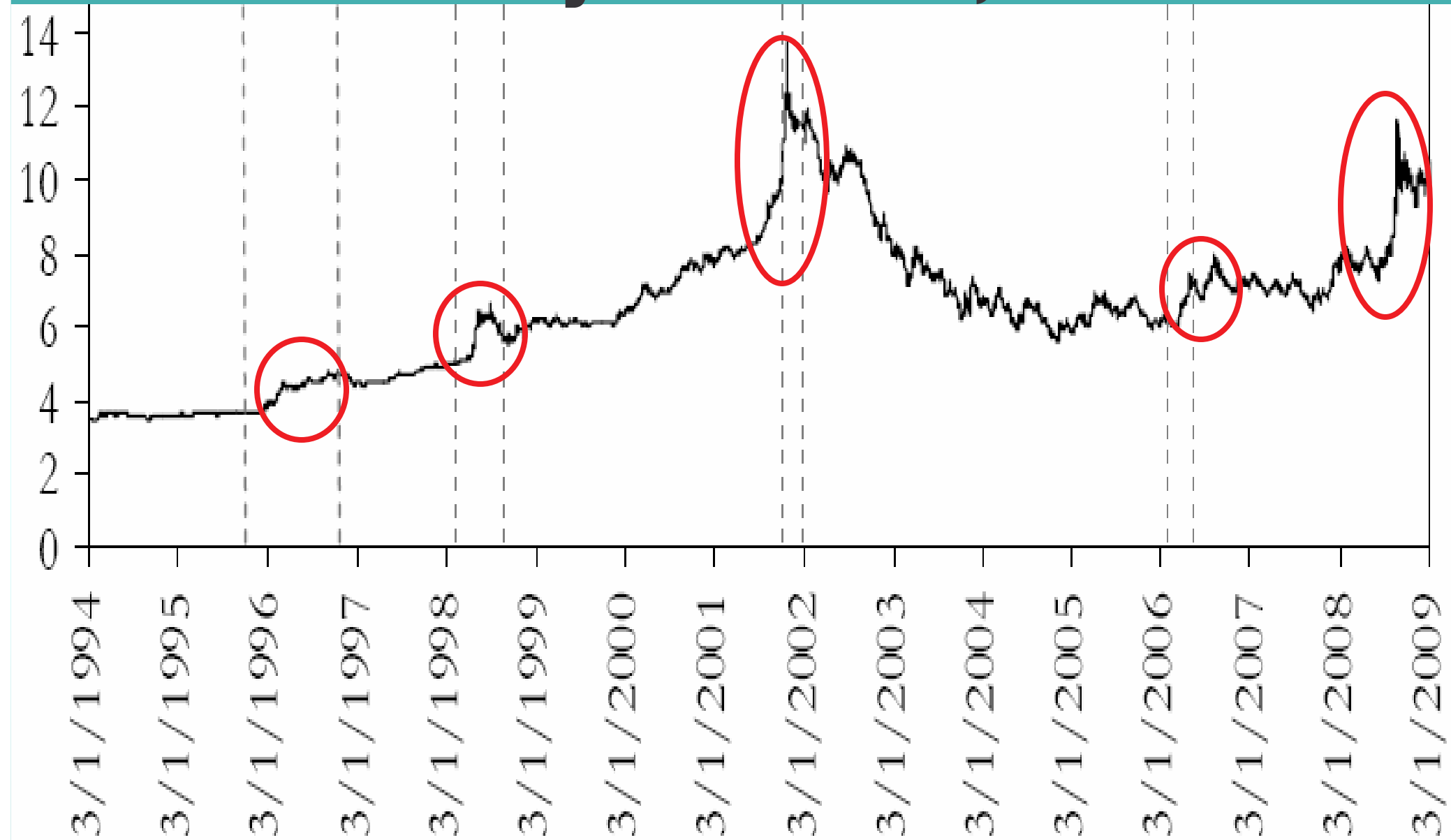


# Currency volatility

Source: Stephen Gelb, Edge Institute



# Five currency crashes, 1996-2008

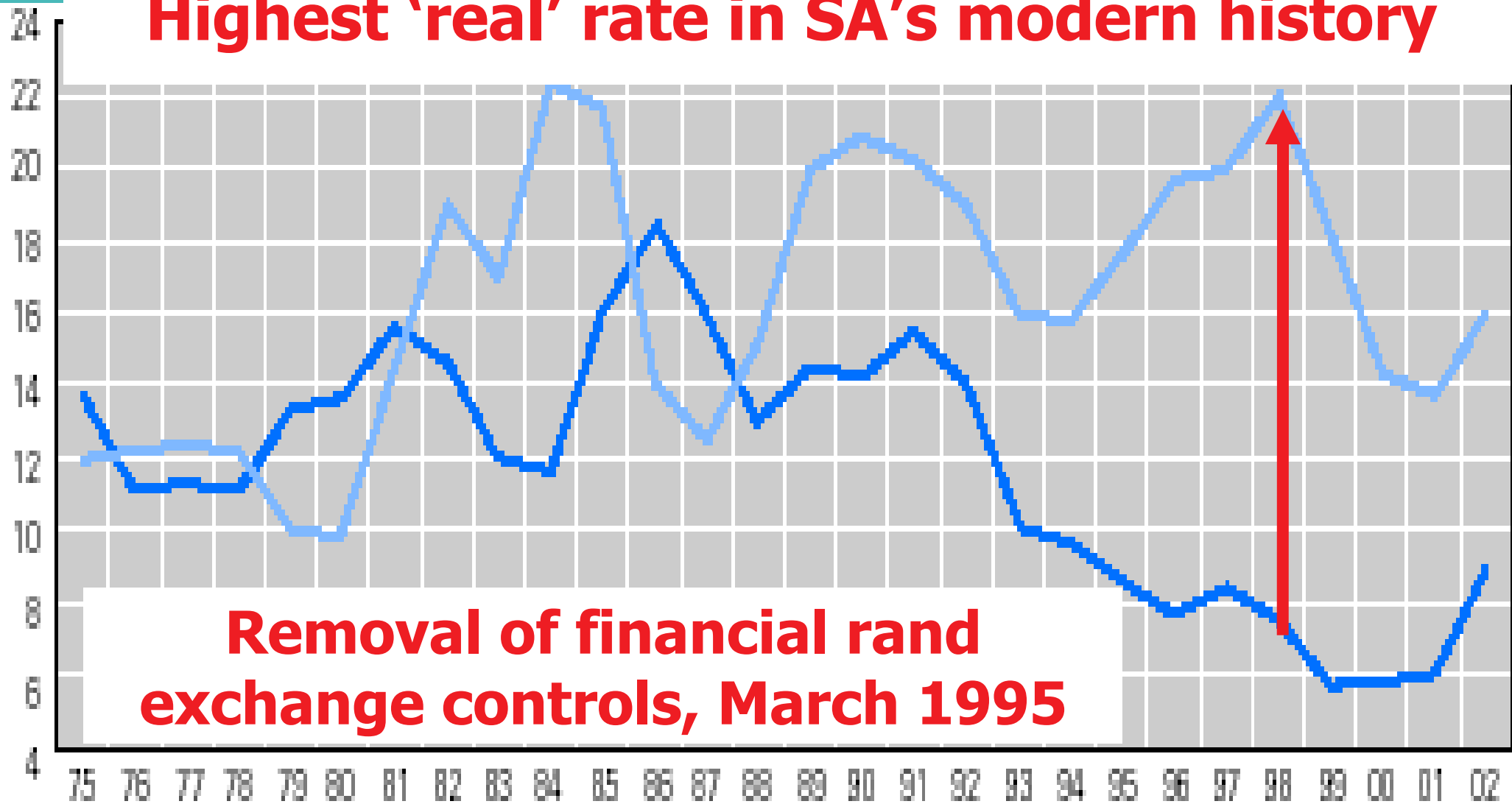


Source: I-Net Bridge



# Interest rate reactions

**Highest 'real' rate in SA's modern history**



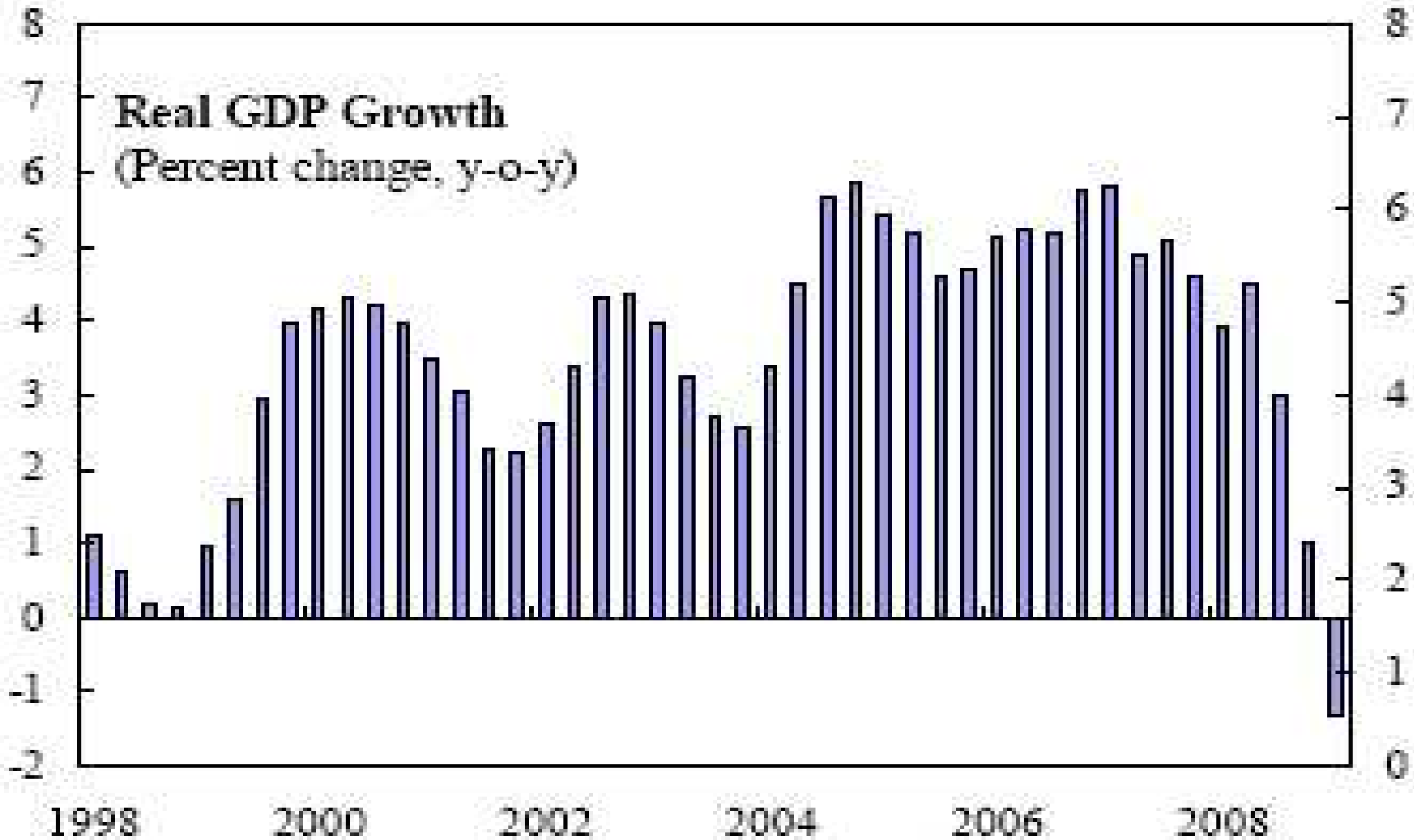
**Removal of financial rand exchange controls, March 1995**

— CPI inflation rate

— Prime rate

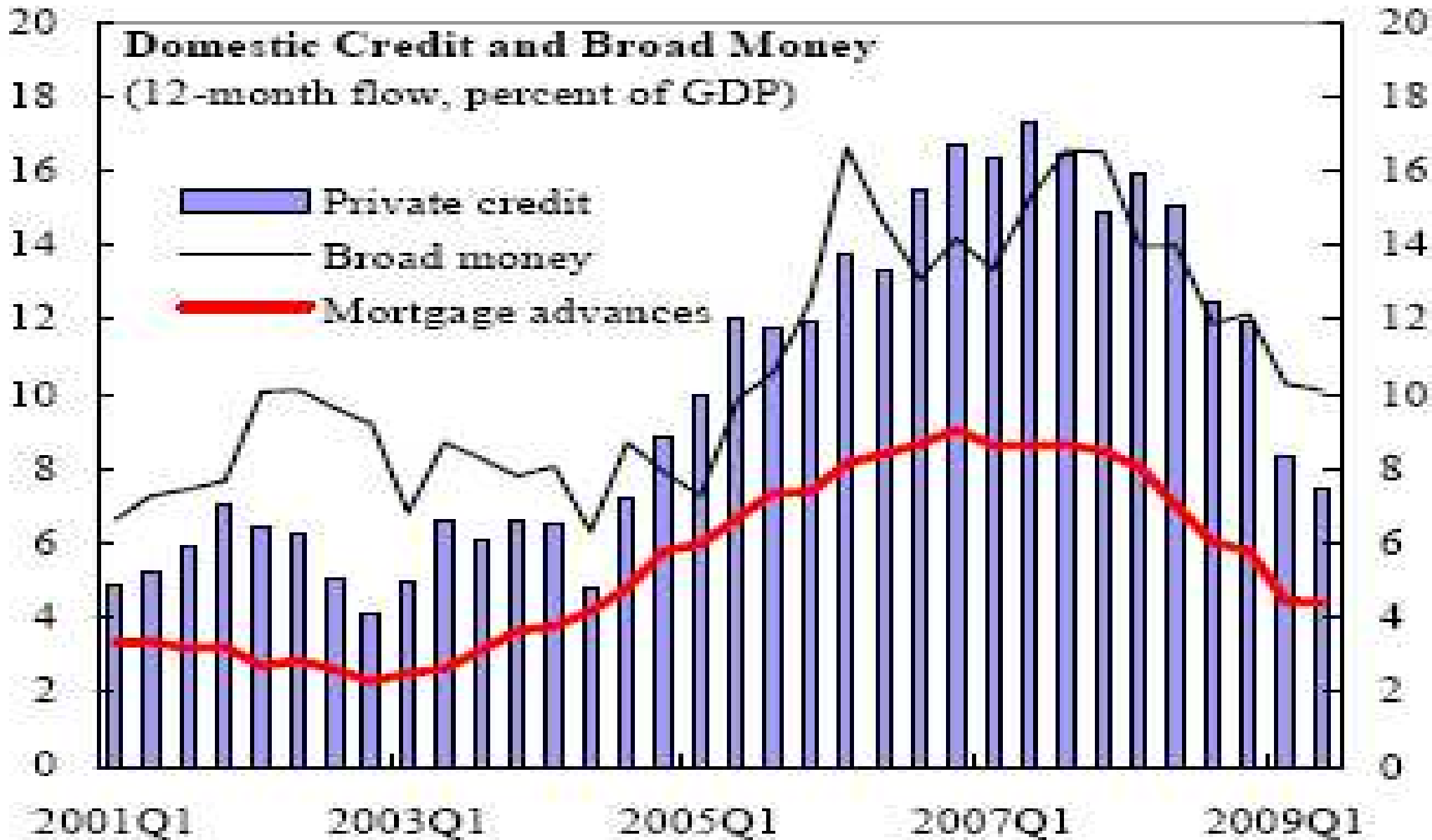
# GDP Growth, 1998-2009

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

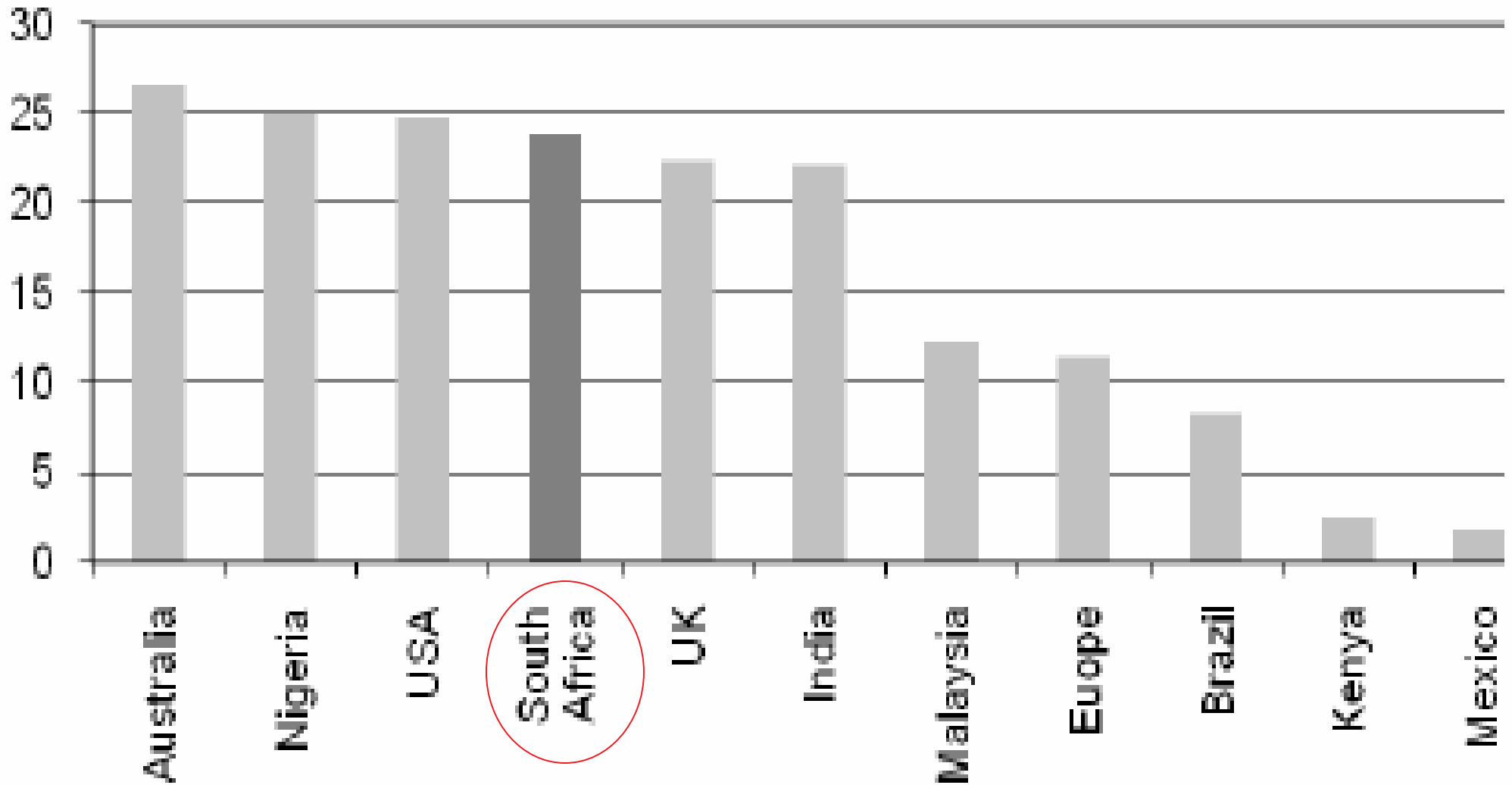


# Debt-driven economy during 2003-08

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

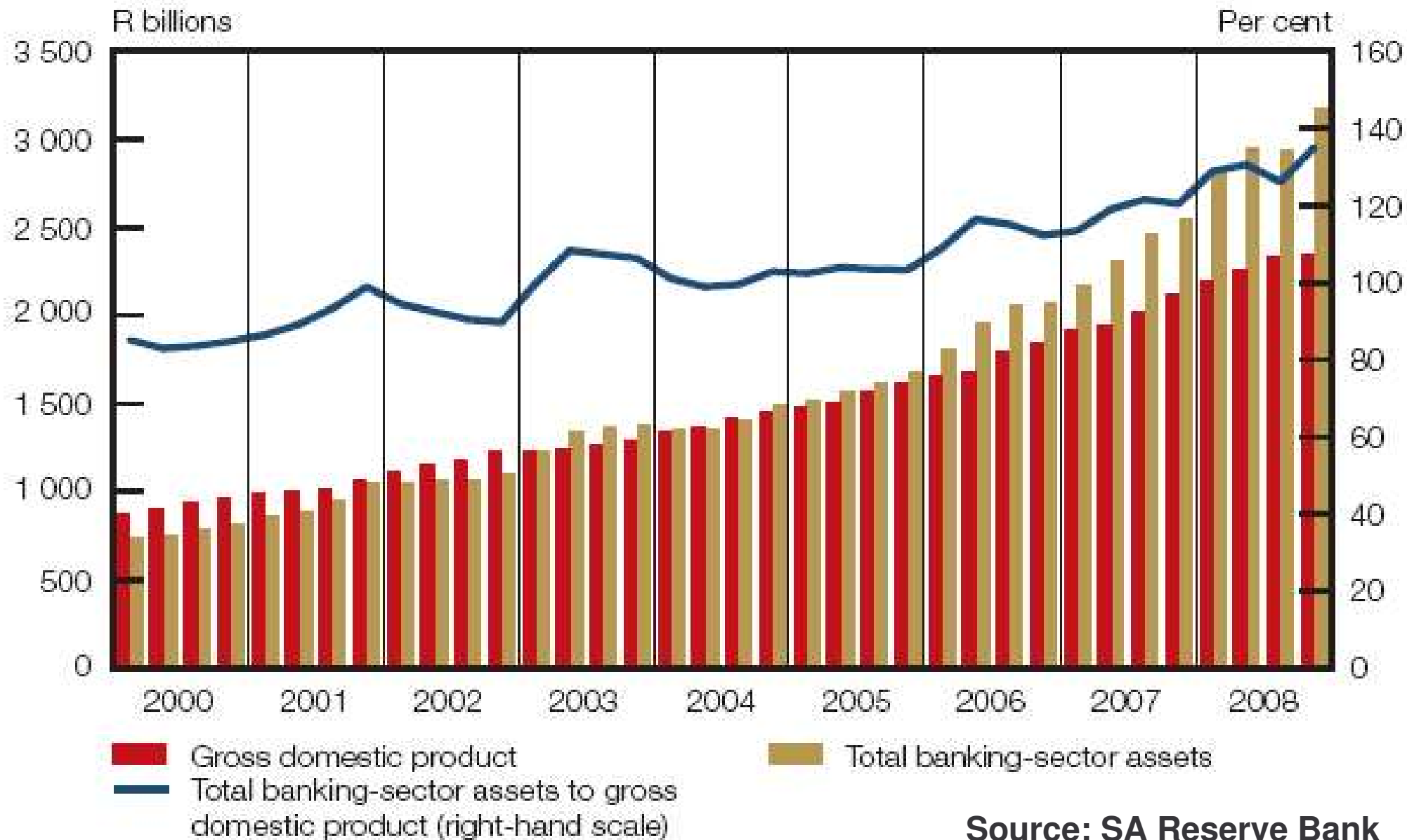


# SA banking profits amongst world's highest (return on equity, 1996-2005)



Source: ABSA Bank testimony to Competition Commission

# During 2006-08, SA bank lending soared from 100-135% of GDP



Source: SA Reserve Bank

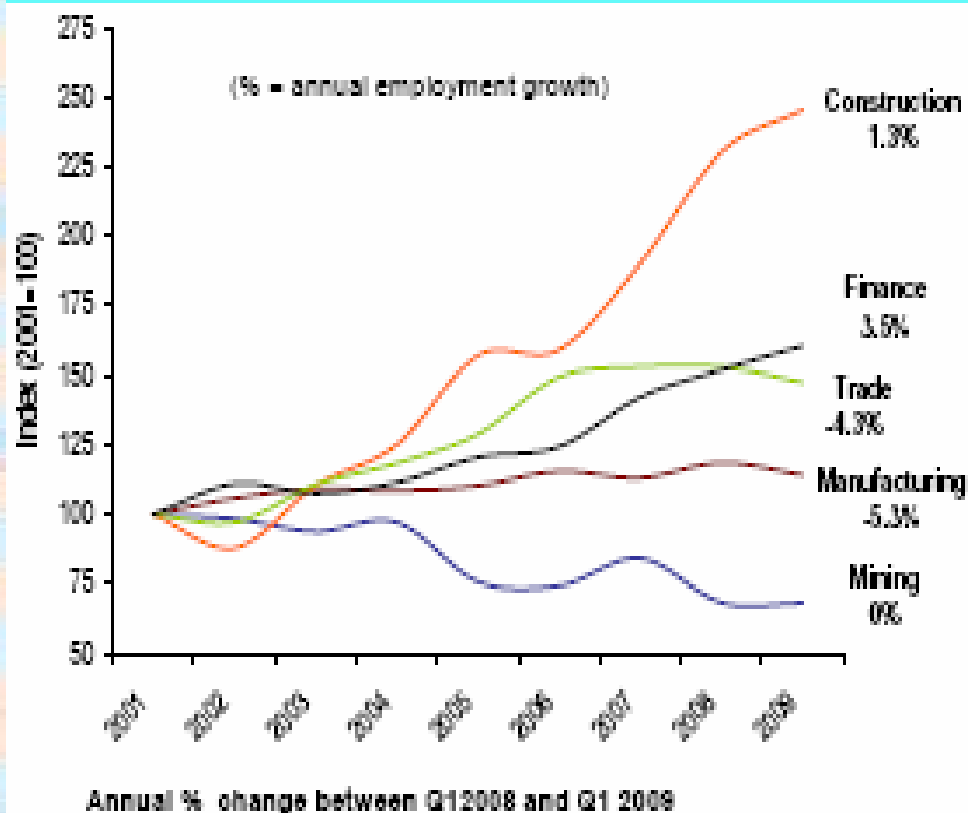
## The Economist's house-price indicators

% change

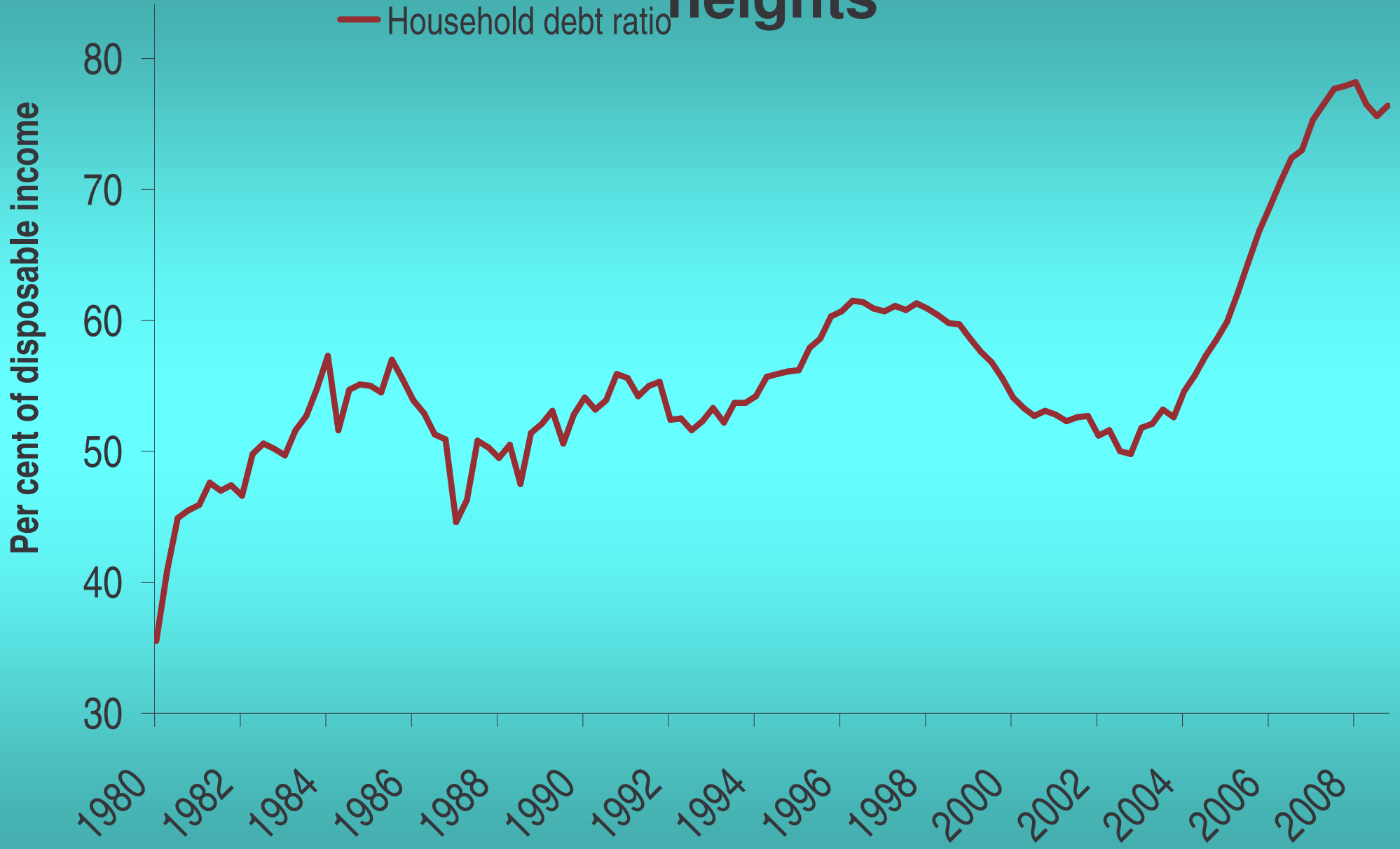
	Latest on a year earlier	Q4 2007 on a year earlier	1997 2008
Switzerland	3.7	2.0	24
Italy	1.1	5.1	104
France	0.8	5.7	152
China	-0.9	10.2	na
South Africa	-1.3	12.2	389
Sweden	-1.6	11.3	145
Japan	-1.8	-2.8	-33
Canada	-1.9	5.9	66
Germany	-2.5	-4.2	na
Spain	-3.2	4.8	184
Australia	-3.3	14.0	163
United States (OFHEO)	-4.5	0.6	84
Singapore	-4.7	31.2	na
Denmark	-4.9	1.2	119
Netherlands	-5.2	2.8	90
New Zealand	-8.9	8.0	102
Ireland	-9.8	-6.0	193
Hong Kong	-14.0	21.4	-35
Britain	-17.6	7.1	150
United States (Case-Shiller national index)	-18.2	-8.7	66
United States (Case-Shiller ten-city index)	-19.2	-8.3	102

World's biggest  
**property bubble:**  
389% increase, 1997-2008

Responsible for  
construction and finance  
(motor of economy, jobs)

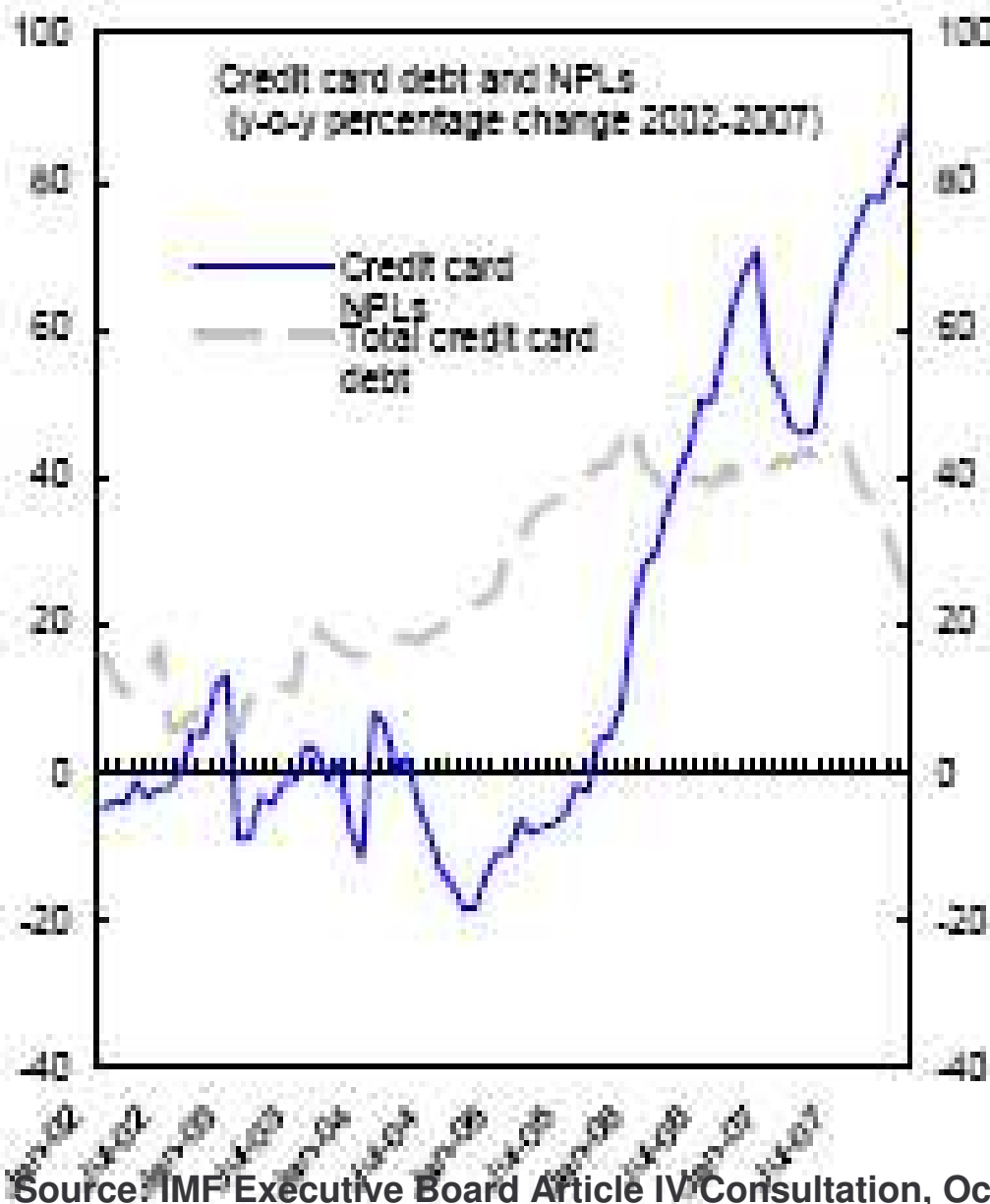


# Consumer debt reaches unprecedented heights



Source: SA Treasury

# But credit card and home mortgage bond **'non-performing loans'** soared since 2007

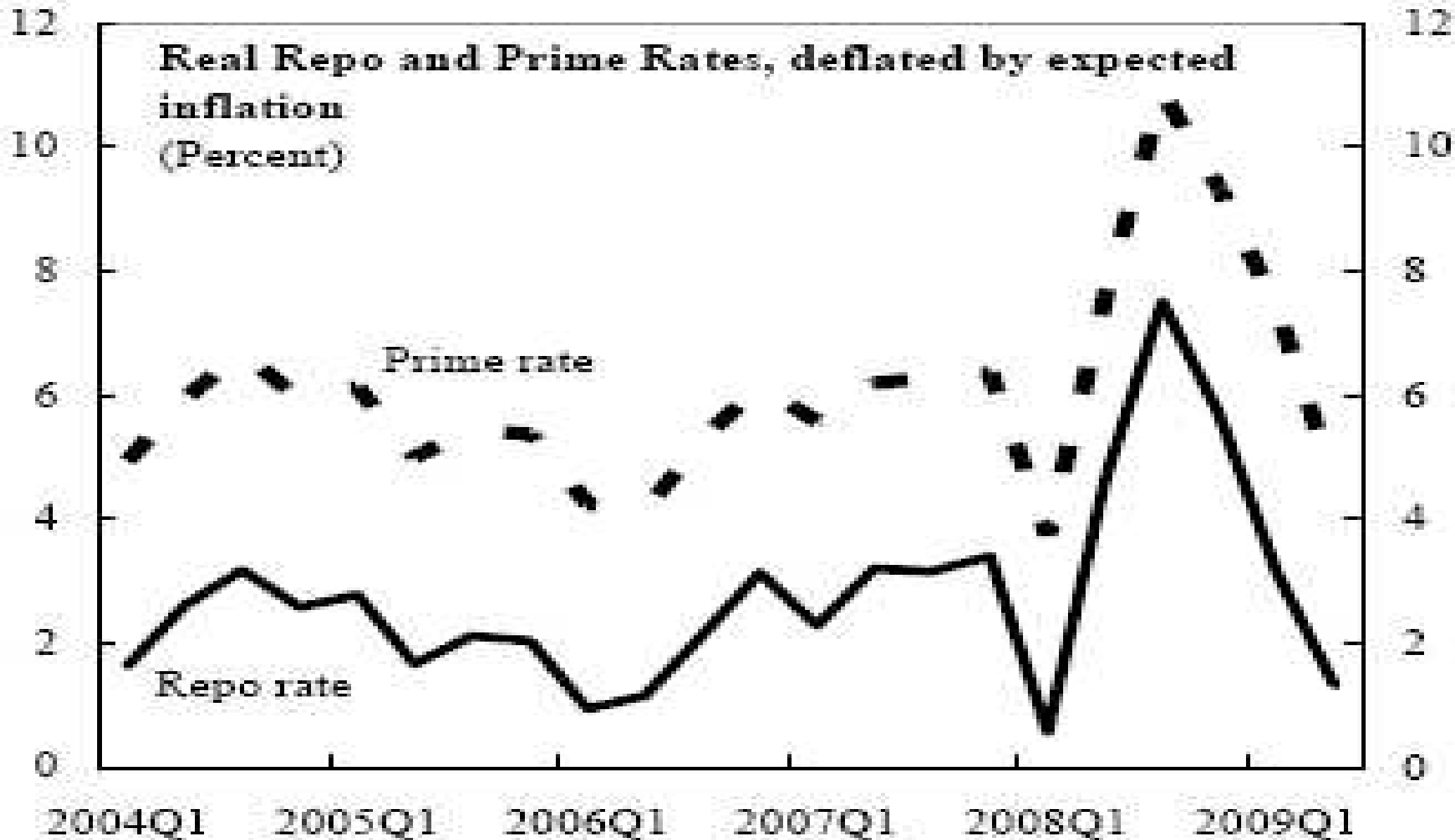


Source: IMF Executive Board Article IV Consultation, October 2008

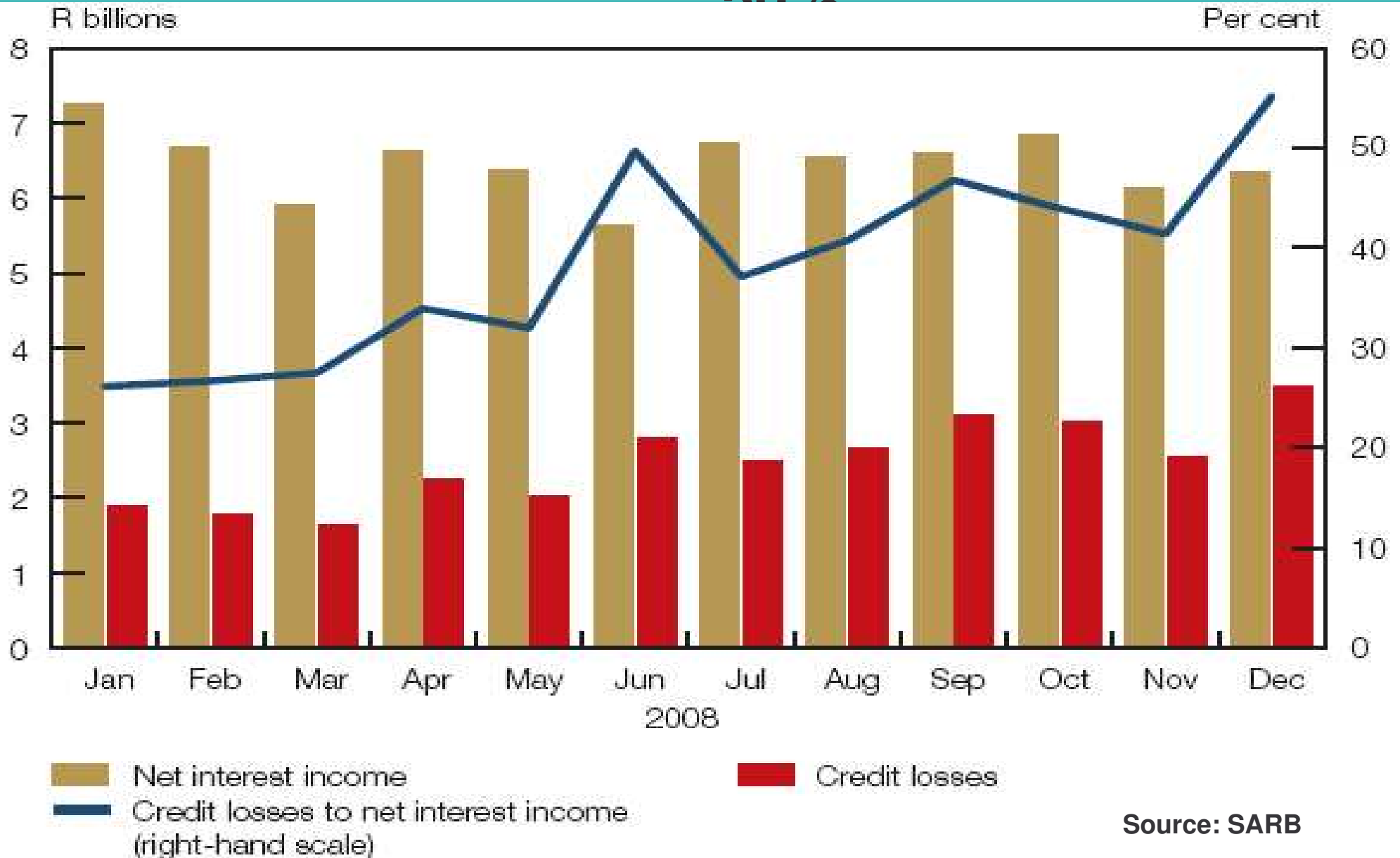


# Real interest rates extremely high in 2008

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

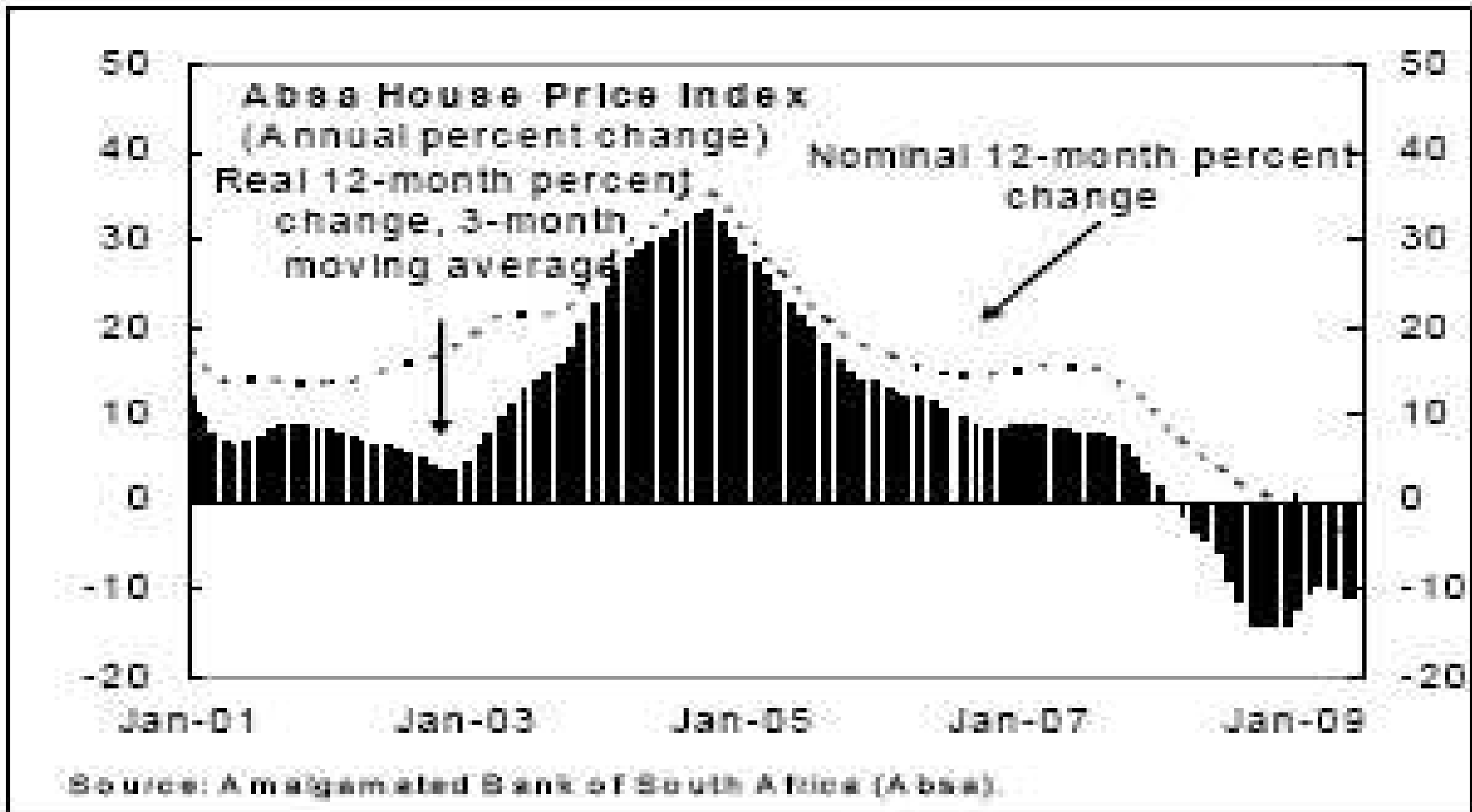


# Doubling of default rates during 2008, from less than 30% of net interest income to over 50%



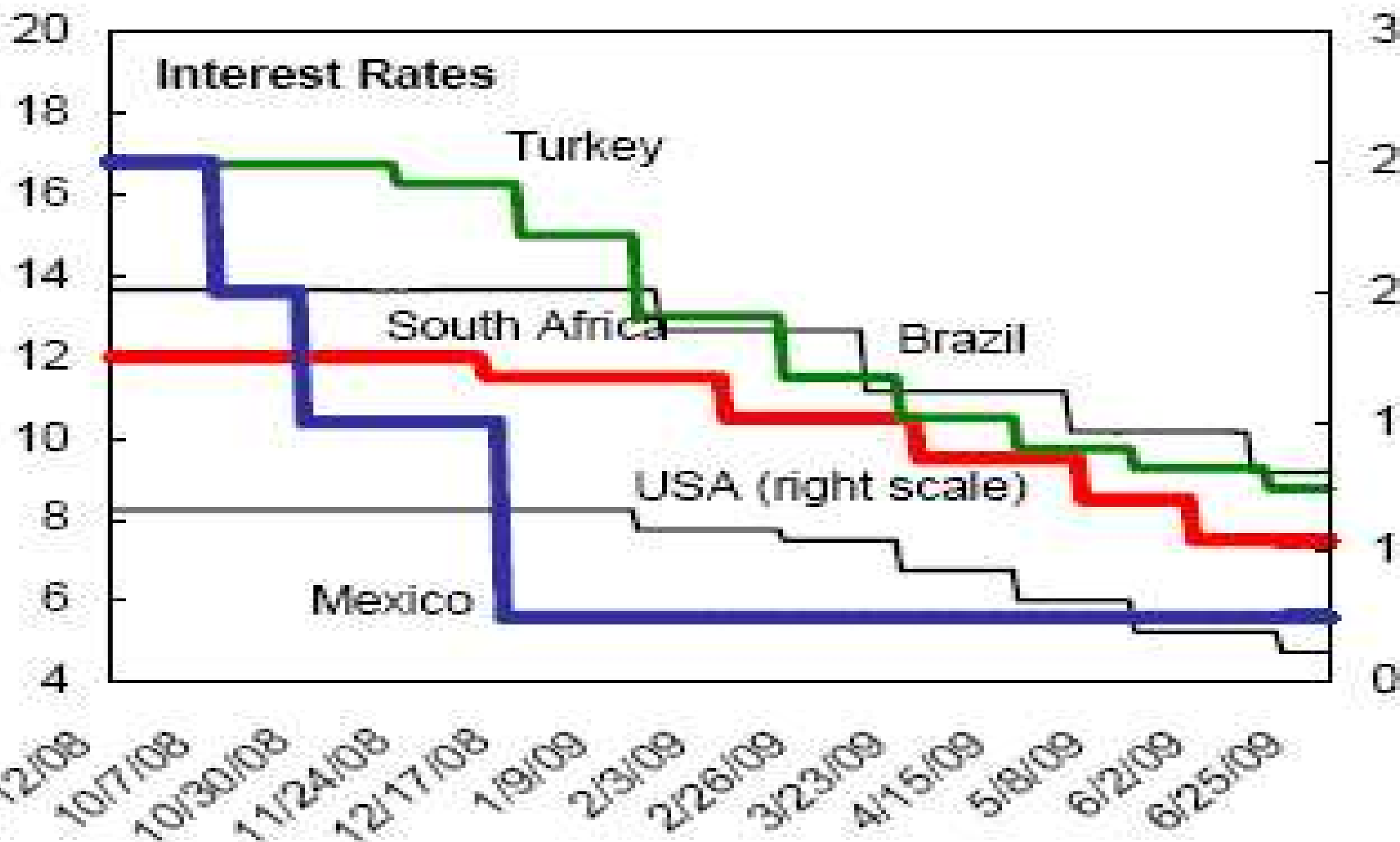
# Housing price decline

Source: International Monetary Fund Article 4 Consultation, Staff Report, Sept 2009



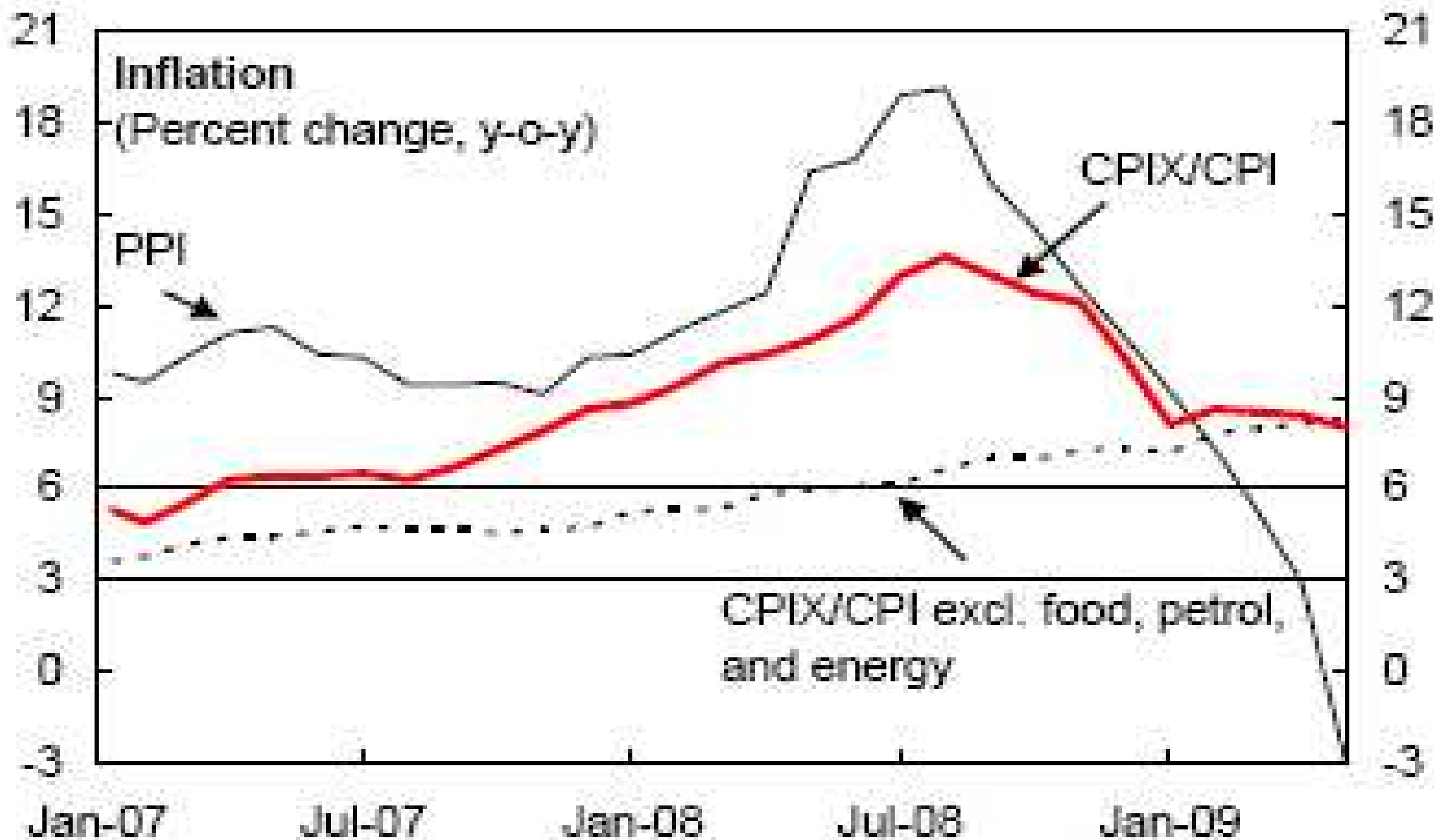
# SA's interest rate cuts amongst mildest

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009



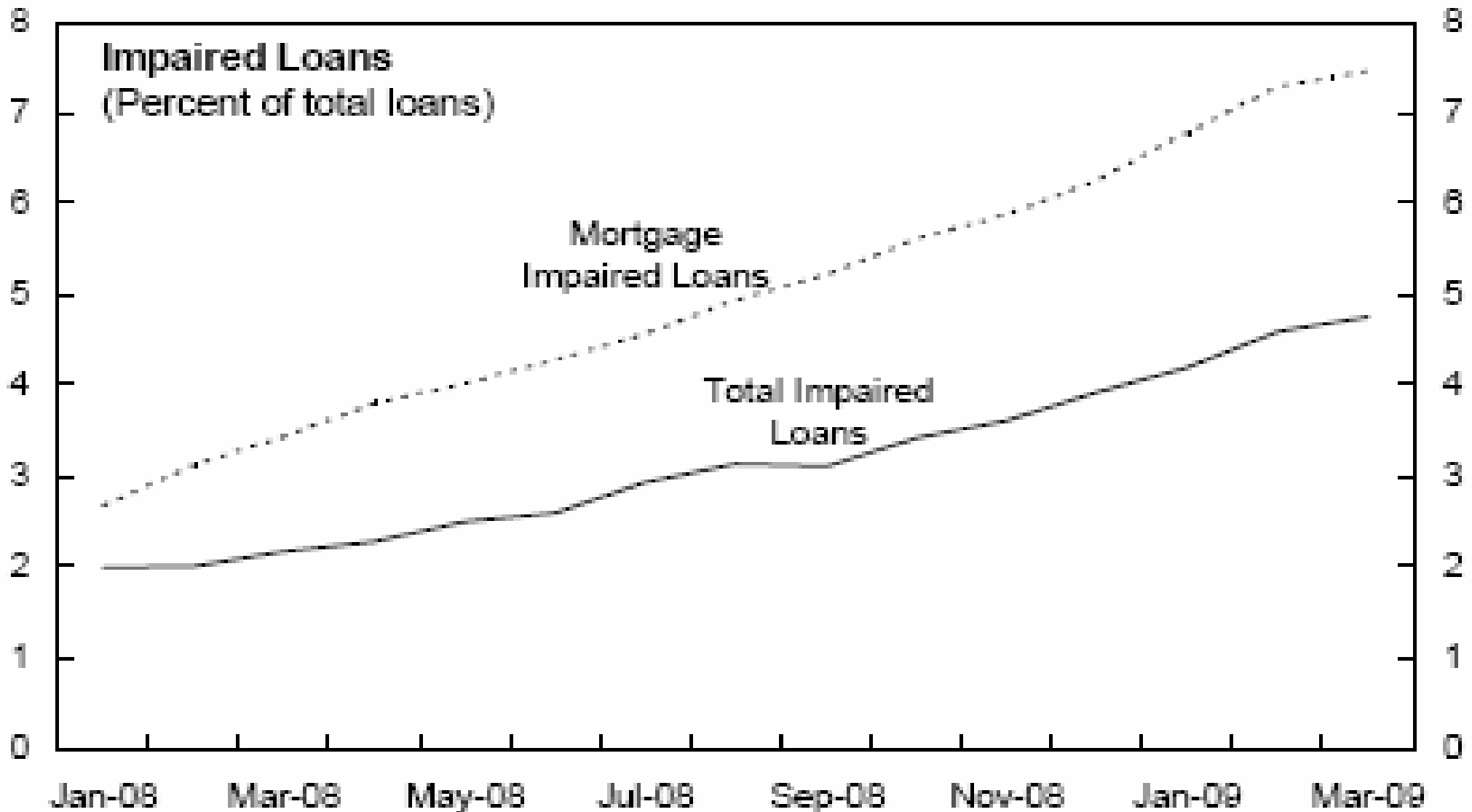
# SA's interest rate cuts amongst mildest

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009



# Quick rise in 'impaired loans', 2008-09

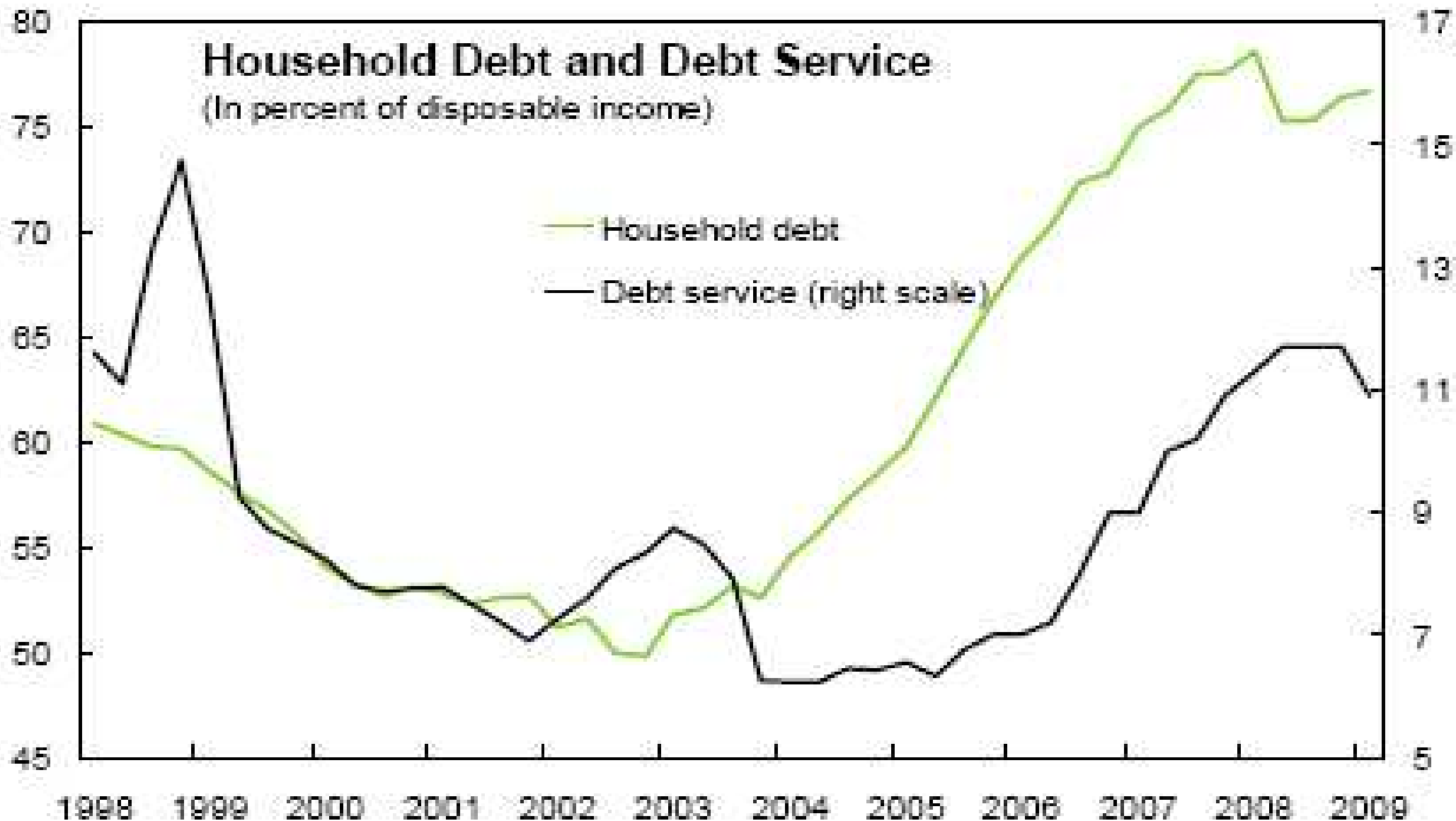
Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009



Source: South African Reserve Bank.

# Big problems with consumer debt service

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009



Source: South African Reserve Bank

# Inequality indices worsen, 1993-2006

## Both Theil and Gini measures rose



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gini coefficient	0.672	0.665	0.674	0.678	0.674	0.683	0.685	0.682	0.685	0.670	0.686	0.678	0.683	0.685
Theil: total value	0.899	0.880	0.899	0.918	0.906	0.937	0.938	0.935	0.937	0.921	1.013	0.967	1.012	1.030

1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006



# Comparative inequality: SA #1

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

## Income Distribution, latest year

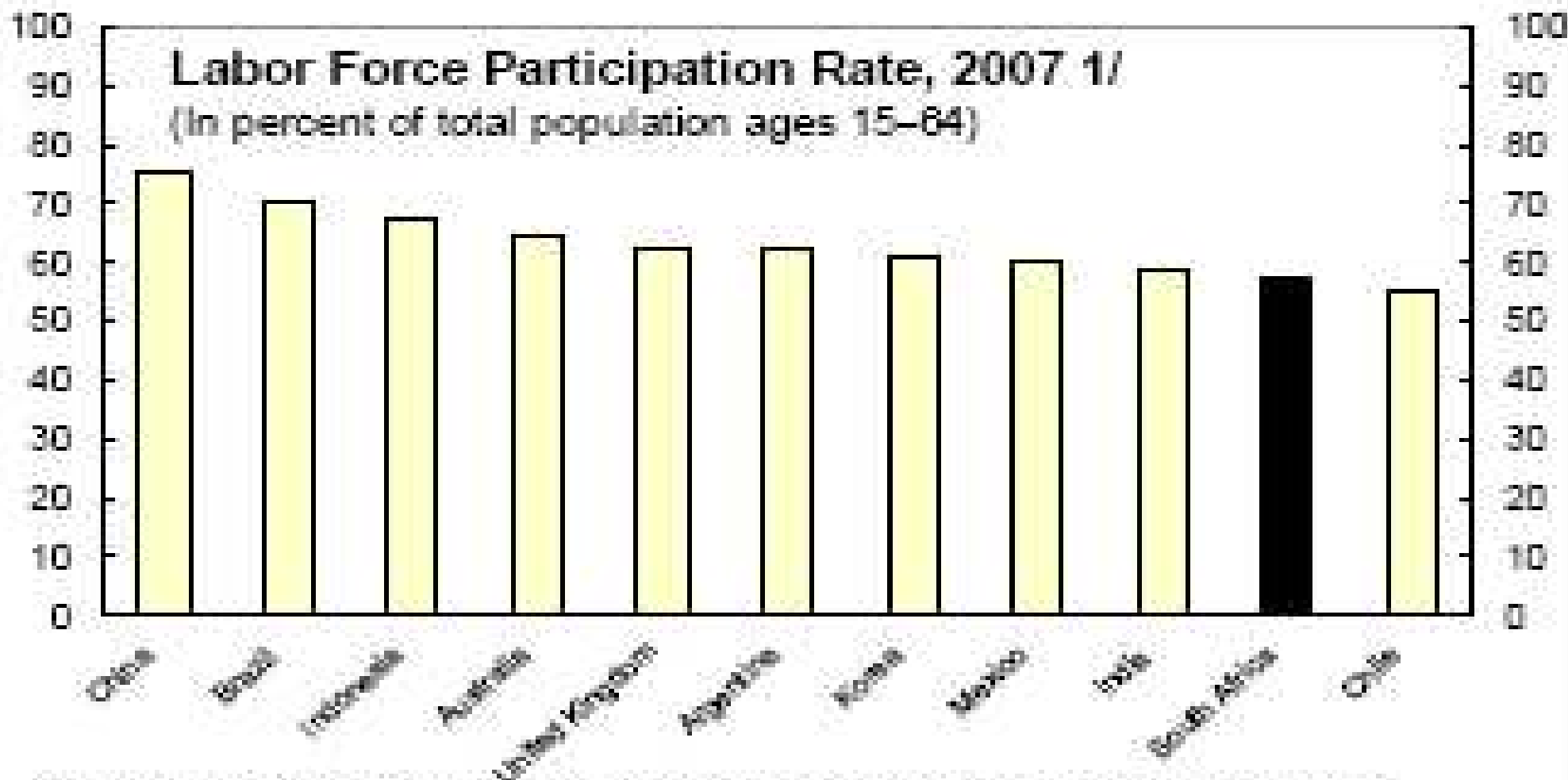
	Gini Index 1/	Share of Income Held By:	
		Top 20 %	Bottom 20 %
South Africa	58	62.7	3.1
Brazil	55	60.8	3.0
Chile	52	60.0	4.1
Argentina	50	55.4	3.4
Mexico	48	53.3	3.9
China	42	51.9	5.7
Indonesia	39	47.3	7.1
India	37	45.3	8.1
United Kingdom	36	44.0	6.1
Australia	35	41.3	5.9
Korea	32	37.5	7.9

Source: World Bank, World Development Indicators.

1/ A measure of distribution of income or consumption, where 0 represents perfect equality and 100 represents perfect inequality.

# Labour force participation rate low

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

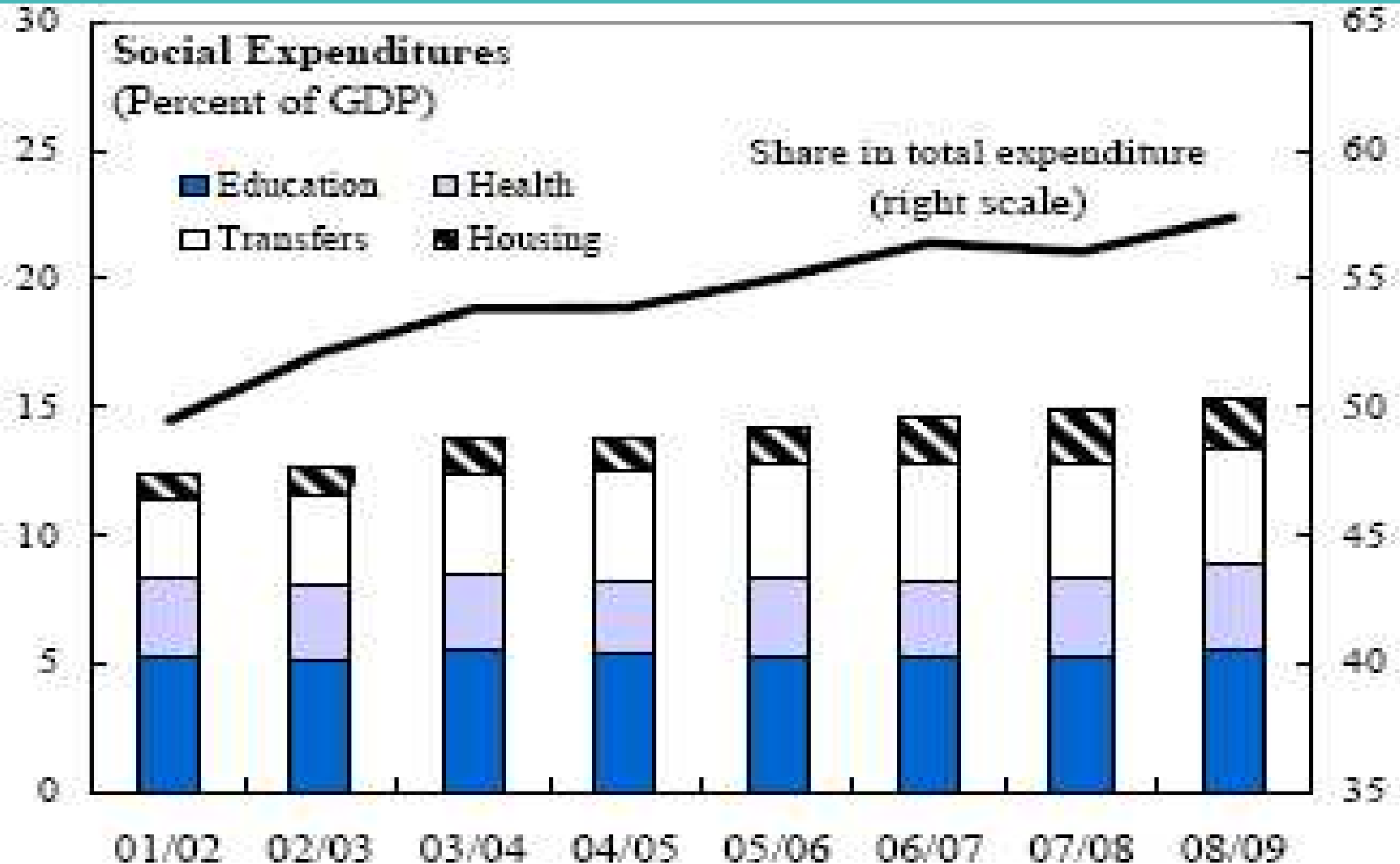


Sources: World Bank, World Development Indicators; and Statistics South Africa.

1/ For South Africa, data represents 2009Q1.

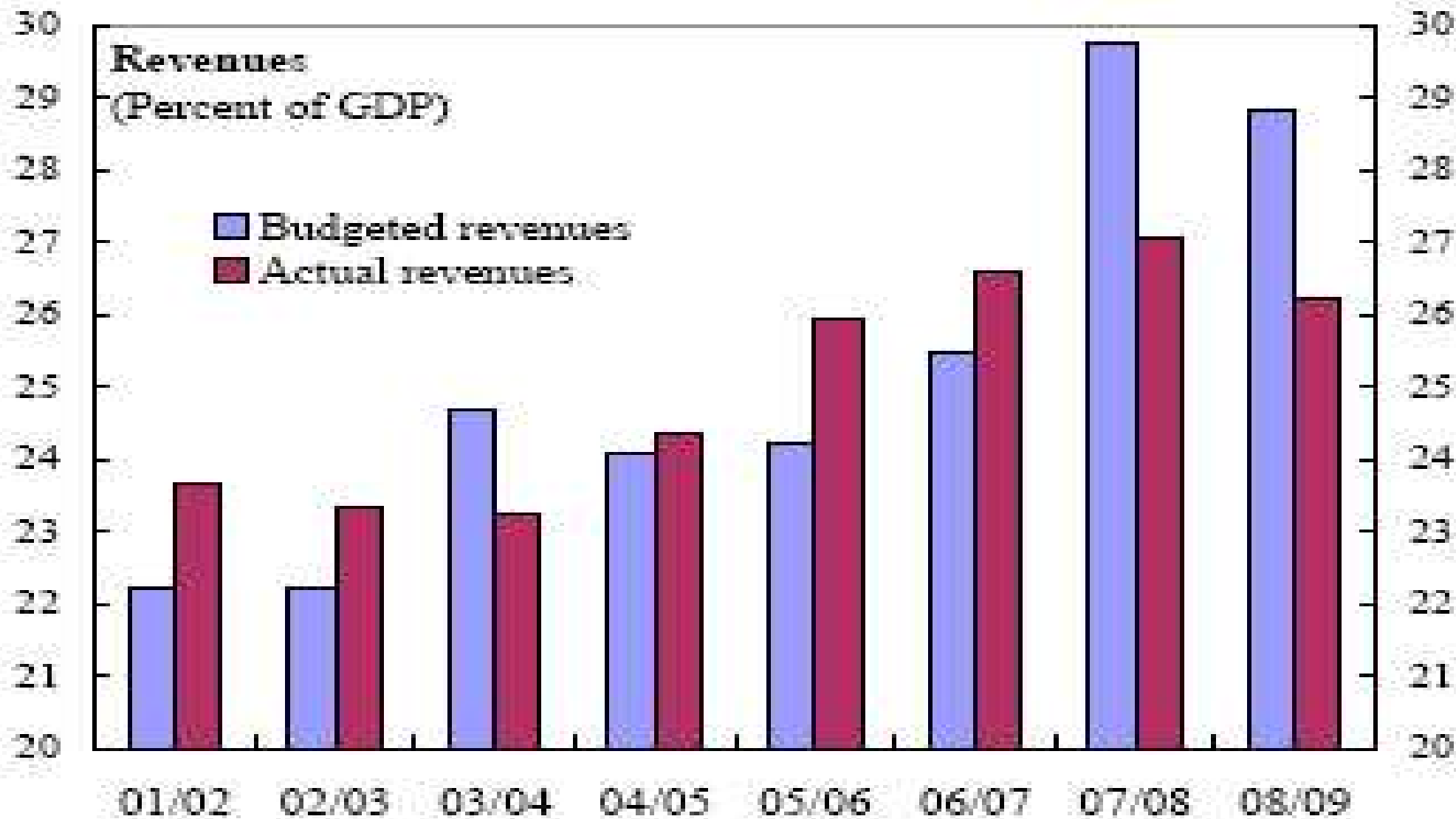
# Slight increase in social spending

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

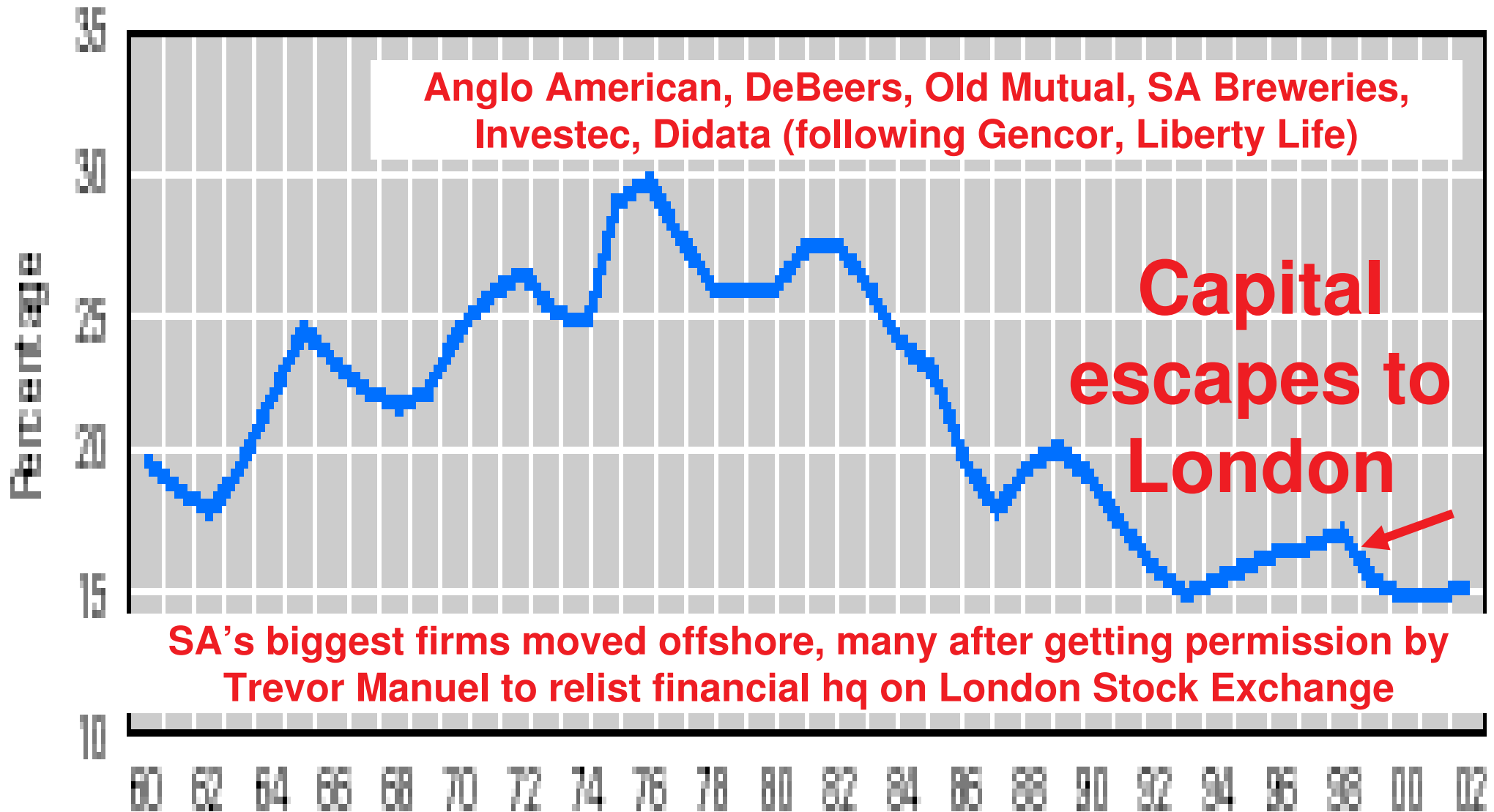


# Rising budget deficit not due to higher spending but, instead, lower revenues

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

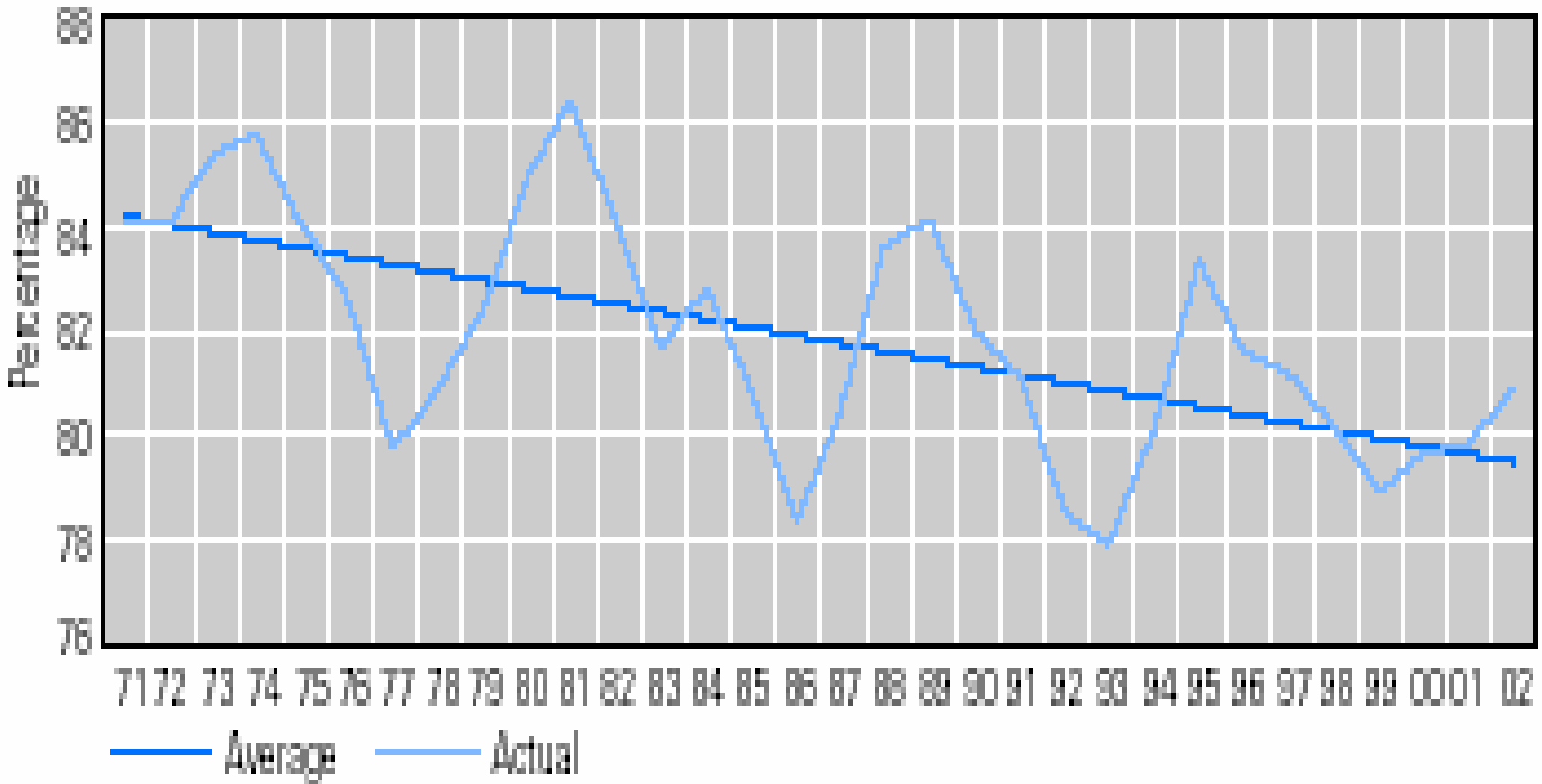


# Investment during 2000s: **capital strike**



Source: South African Reserve Bank

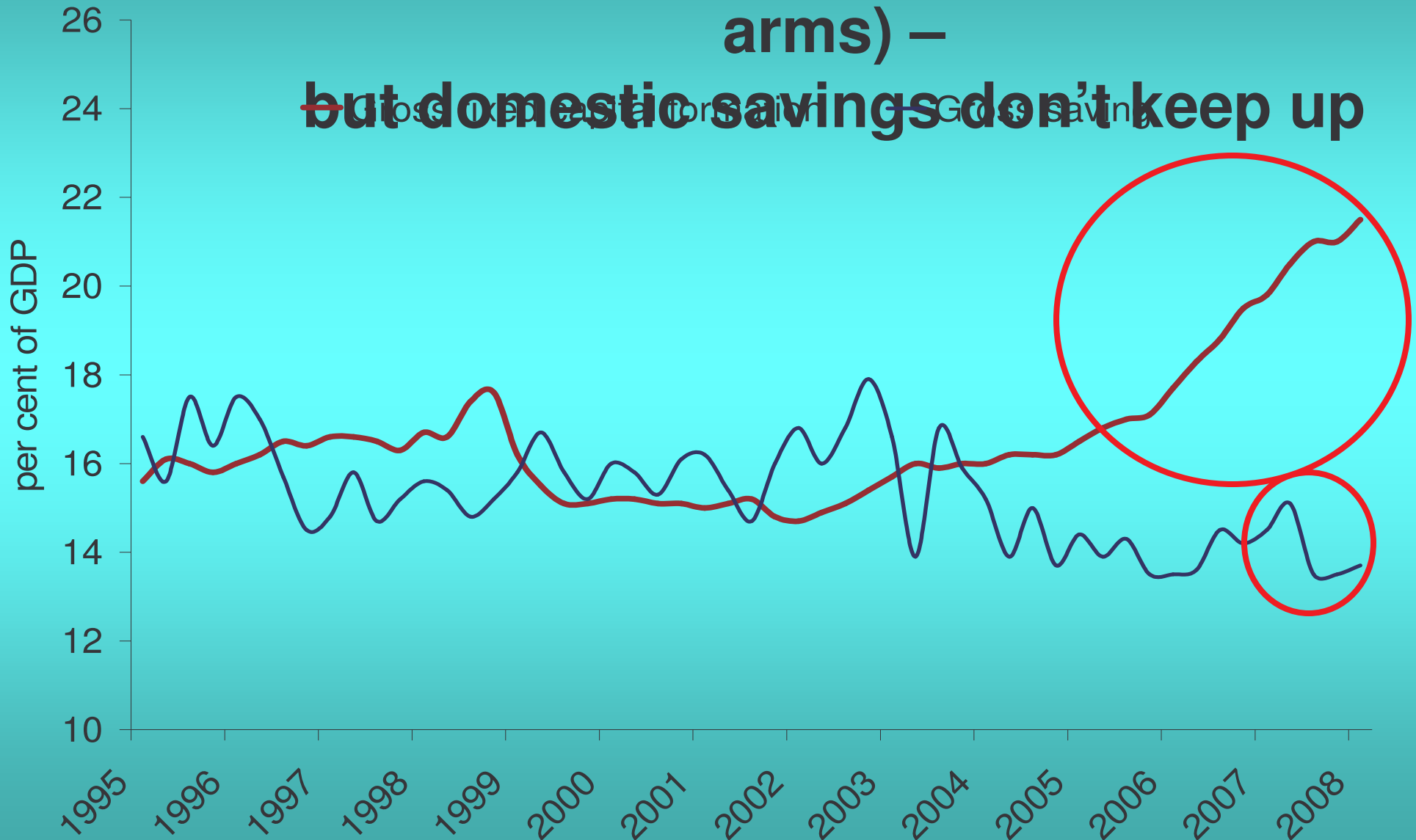
# Key factor: **overproduction** (proxy: manufacturing capacity utilisation)



Source: Reserve Bank Database

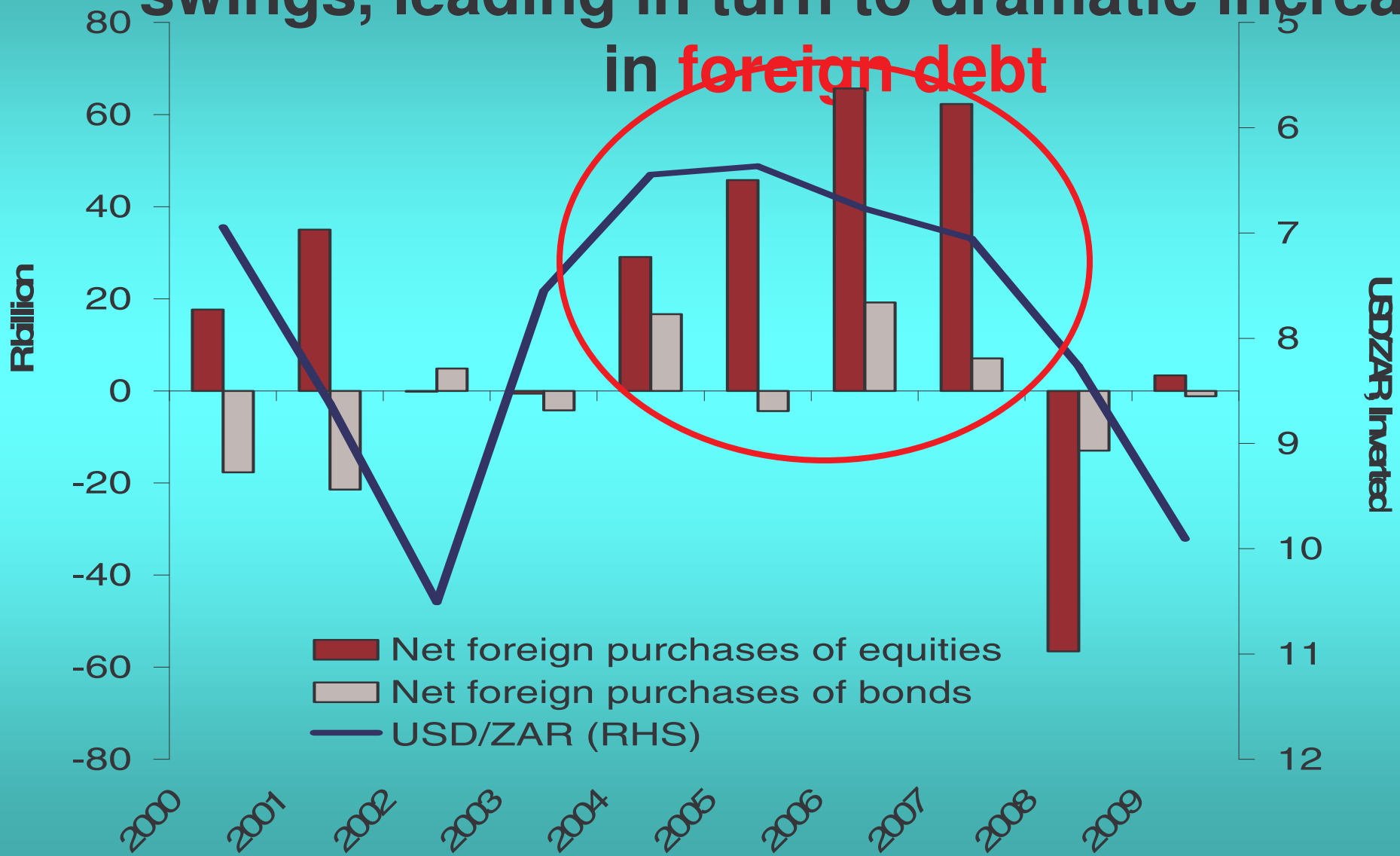
# megaprojects (e.g. stadia, Gautrain, Medupi, Coega, SAA, arms) –

**but domestic savings don't keep up**



Source: SA Treasury

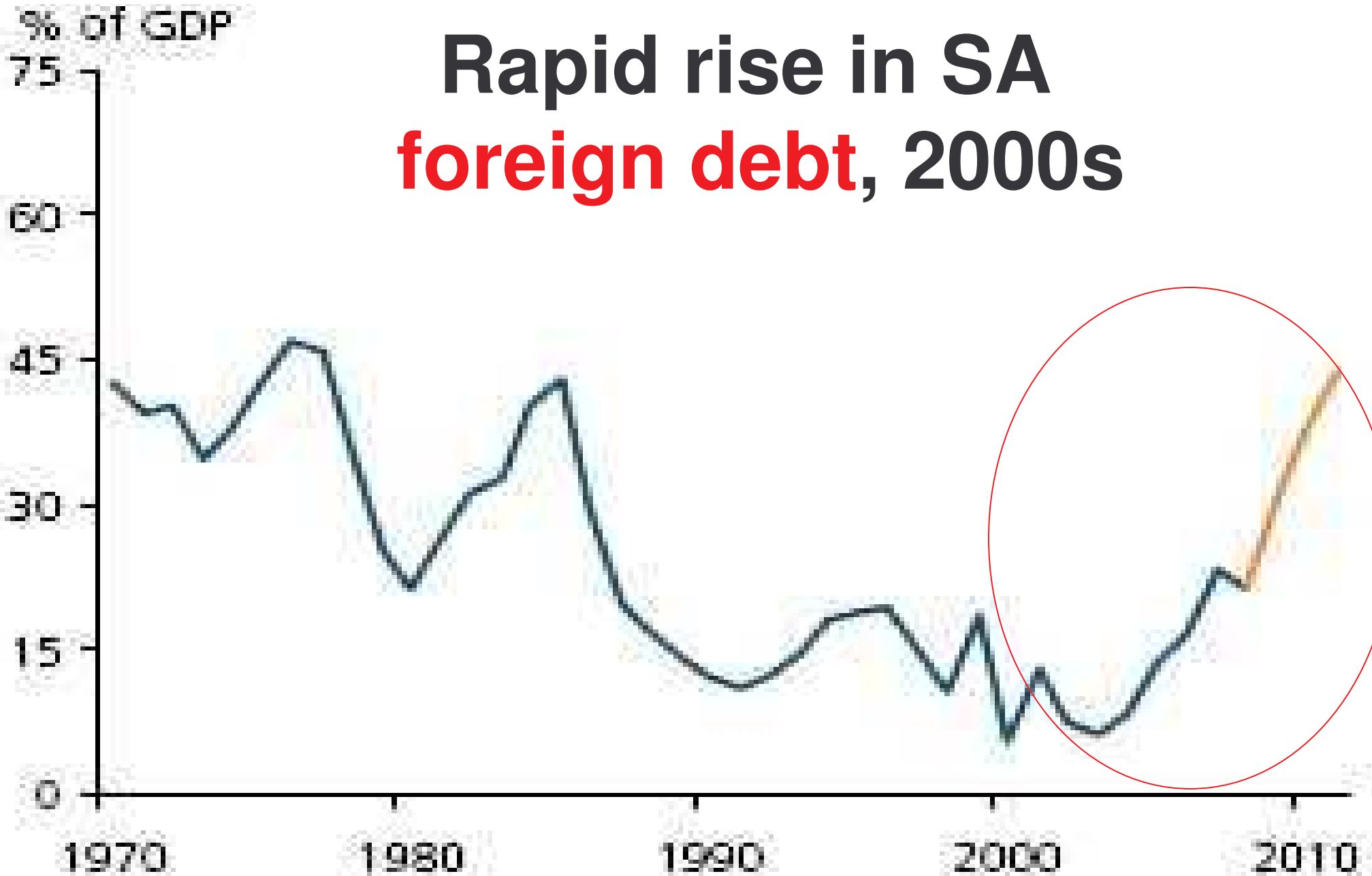
Hence the need to attract more **foreign savings**, making SA vulnerable to rapid swings, leading in turn to dramatic increases **in foreign debt**



Source: SA Treasury



# Rapid rise in SA foreign debt, 2000s



Source: SARB, RMB FM Research

# Another source of foreign debt: **bank borrowing**



Source: SA Treasury

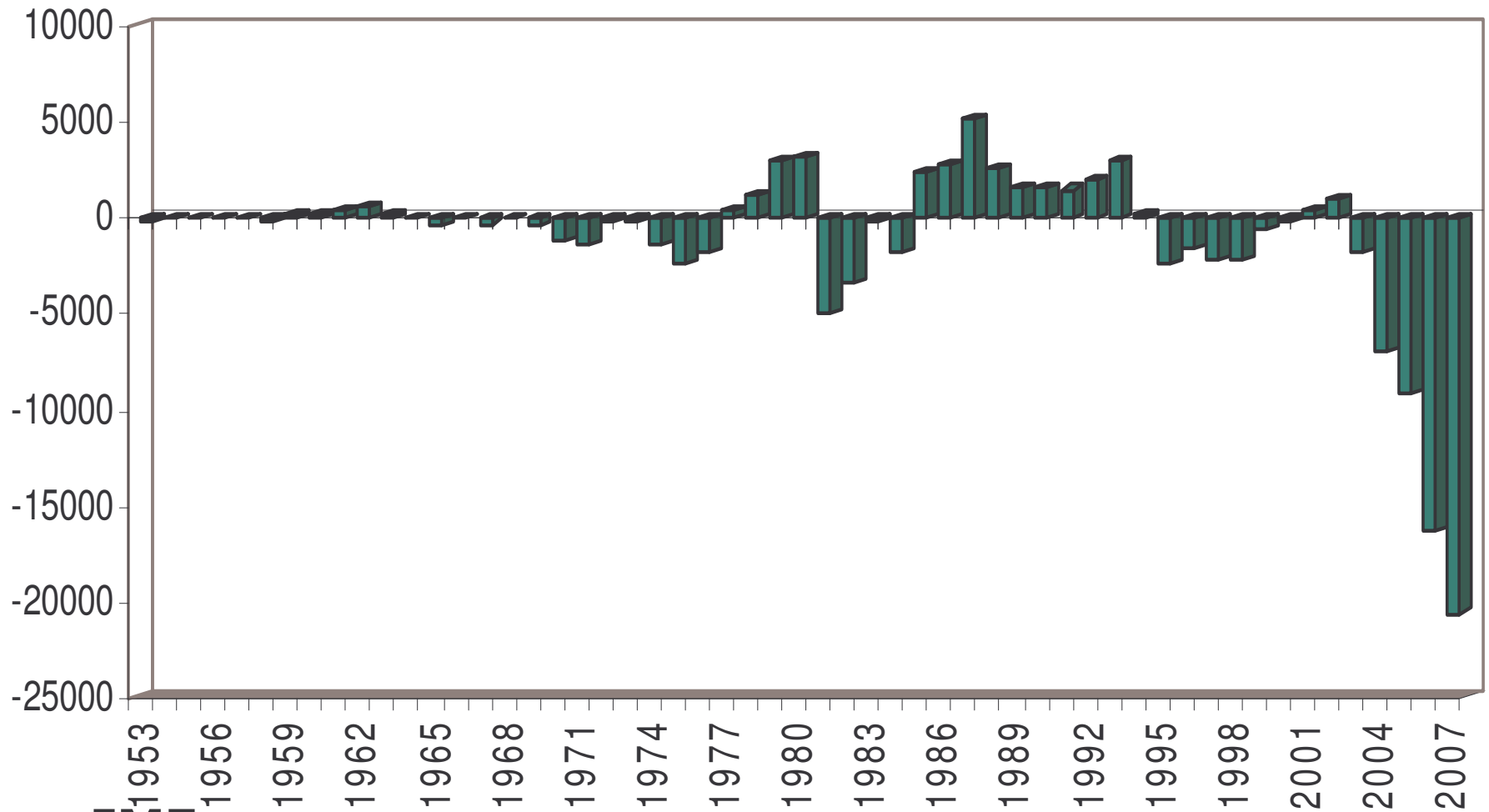
**borrowing** is main reason for SA foreign debt explosion, peaking at **\$78 billion** in Sept

	30-Sep-98
<b>1 Public Authorities</b>	<b>18,388</b>
Short-term 1)	0
Long-term	18,388
Bonds and notes	14,820
Loans	3,576
<b>2 Public Corporations</b>	<b>4,238</b>
Short-term 1)	300
Long-term	3,938
Bonds and notes	1,840
Loans	2,096
<b>3 Monetary Authorities</b>	<b>1,180</b>
Short-term 1)	1,180
Loans	840
Currency and deposits	340
Long-term	0
Loans	0
<b>4 Banking Sector</b>	<b>26,088</b>
Short-term 1)	21,822
Money market instruments	421
Loans	8,874
Currency and deposits	12,027
Long-term	3,778
Bonds and notes	1,631
Loans	2,145
<b>5 Other Sectors</b>	<b>18,088</b>
Short-term 1)	6,178
Loans and trade credits	5,176
Long-term	10,822
Bonds and notes	5,178
Loans	5,744
<b>6 Direct Investment 2)</b>	<b>12,617</b>
<b>Gross External Debt</b>	<b>77,626</b>

In May 1994, SA's total foreign debt was only \$25 billion

# Current account deficit out of control

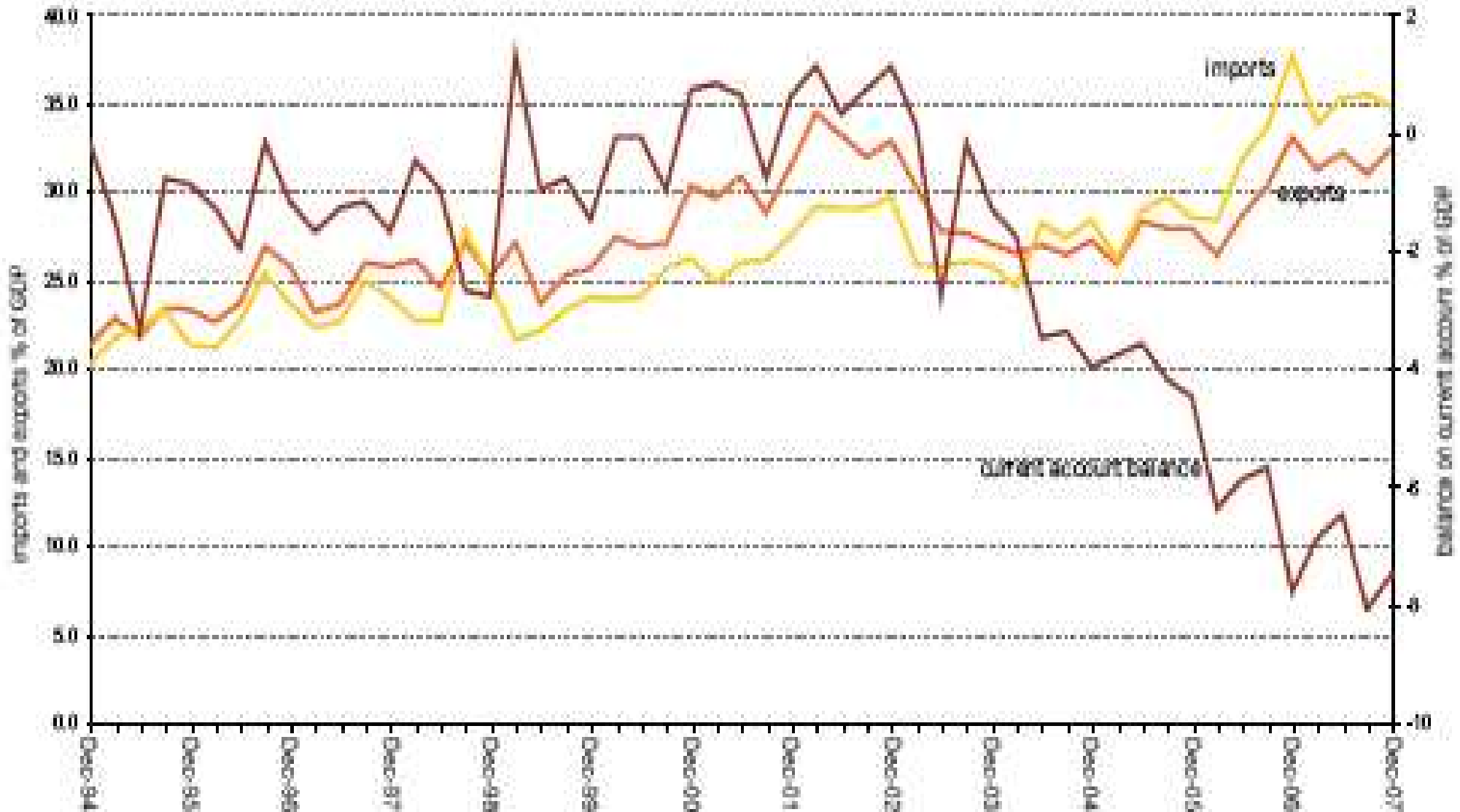
South African Current Account Balance, US\$



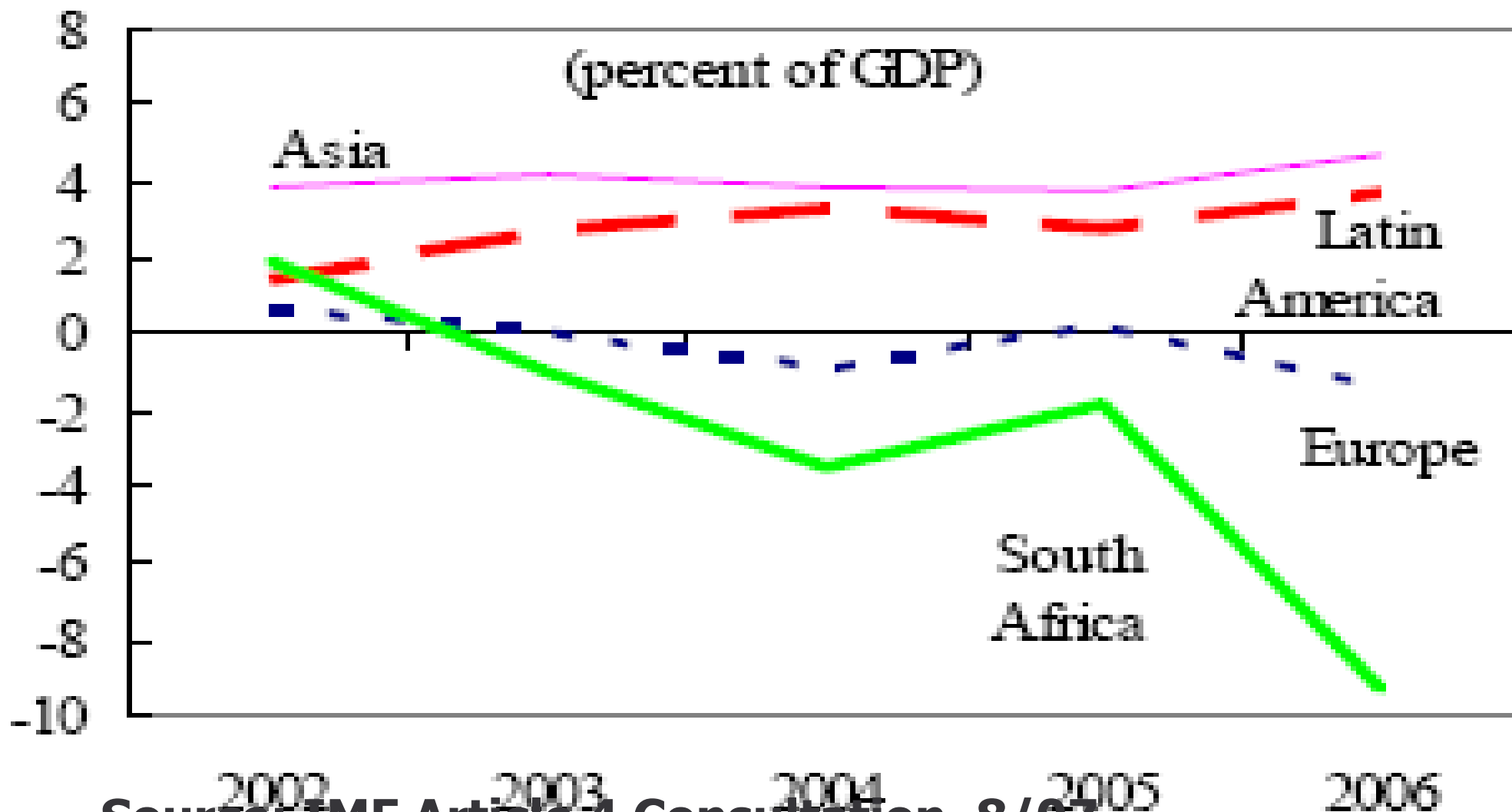
Source: IMF

# Current account deficit mainly due to dividend/profit/interest outflows

## FOREIGN TRADE AND PAYMENTS



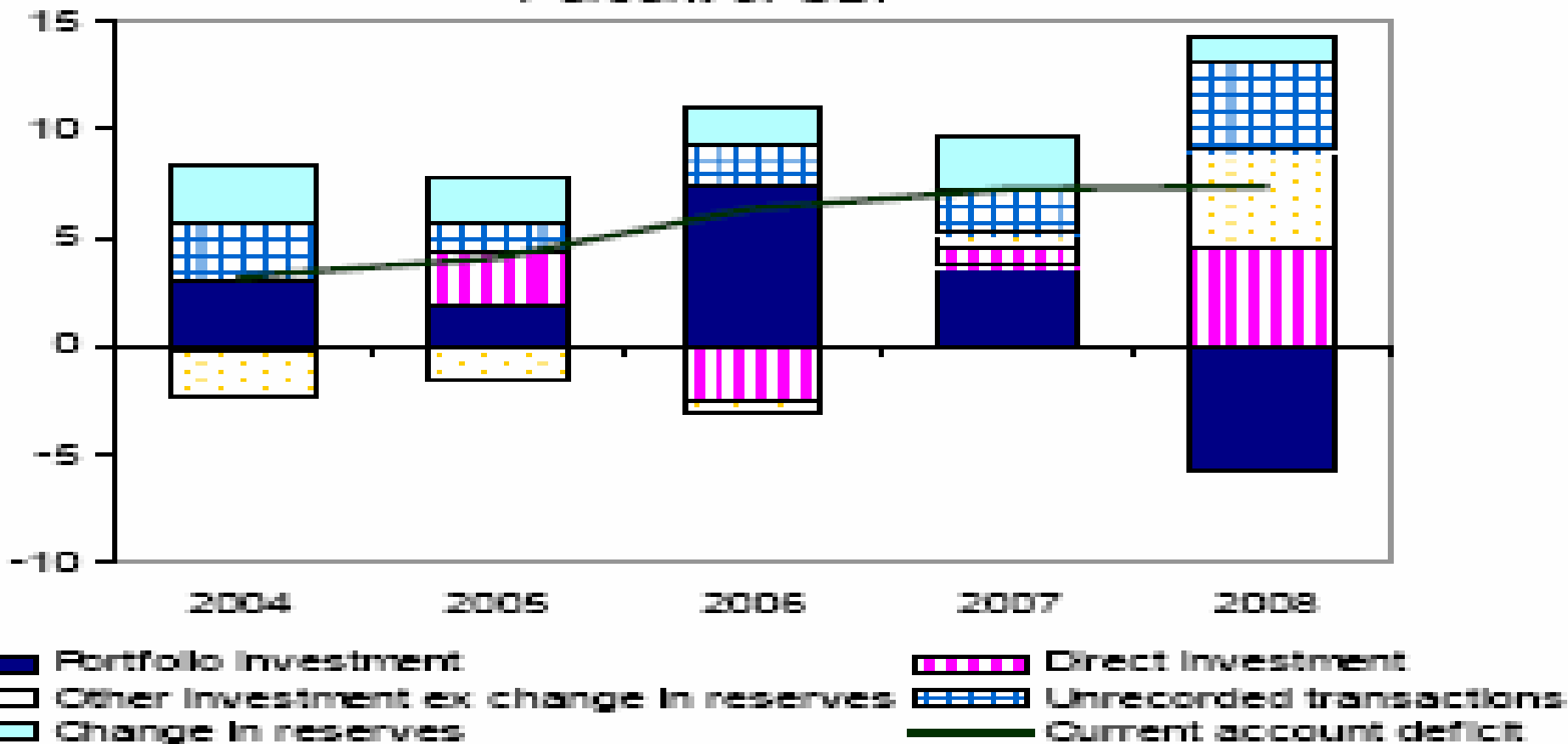
**With high interest rates and high currency, current account deficit now getting serious (emerging markets current account/GDP)**



# Current account deficit: unsustainable financing strategies

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

South Africa: Financing the Current Account Deficit  
Percent of GDP



Source: South Africa Reserve Bank Quarterly Bulletin, June 2009

# Financing SA's current account deficit depends upon attracting hot money

Source: International Monetary Fund Article 4 Consultation, Staff Report, September 2009

## Volatility of Capital Account Inflows 1995-2008 As a Percent of GDP Standard Deviation

	Total Inflows	Portfolio Inflows	o/w debt securities	o/w equity securities
Thailand	6.71	1.60	0.85	1.18
Hungary	3.86	3.51	3.09	1.46
Chile	3.57	1.03	1.02	0.77
<i>South Africa</i>	<i>3.43</i>	<i>3.92</i>	<i>1.73</i>	<i>2.72</i>
Poland	3.11	1.58	1.50	0.44
Turkey	3.07	1.28	1.08	0.36
Brazil	2.01	1.10	0.94	0.52
Colombia	2.89	0.25	...	0.25
Mexico	1.09	1.49	1.36	0.38

Source: IMF World Economic Outlook, April 2009.



# World's most risky emerging market

Country	Current-account as % of GDP*	Short-term debt as % of reserves*	Banks' loan/ deposit ratio	Overall risk ranking†
South Africa	-10.4	81	1.09	17
Hungary	-4.3	79	1.30	16
Poland	-8.0	38	1.03	14 =
South Korea	1.3	102	1.30	14 =
Mexico	-2.5	39	0.93	12 =
Pakistan	-7.8	27	0.99	12 =
Brazil	-1.5	22	1.36	10 =
Turkey	-2.3	70	0.83	10 =
Russia	1.5	28	1.51	9
Argentina	0.2	63	0.74	8
Venezuela	0.8	58	0.75	7
Indonesia	1.2	88	0.62	6
Thailand	0.3	17	0.88	5
India	-2.4	9	0.74	4
Taiwan	7.9	26	0.87	3
Malaysia	11.3	15	0.72	2
China	5.2	7	0.68	1

Sources: HSBC; Economist Intelligence Unit

\* 2009 forecasts; † The Economist, 25 Feb 2009

- # Two major reasons to change policy:
- **anger from below** (protests, demand for 'service delivery' and redistribution);
  - **world economic crisis from above**

Figure 1: Total Peaceful and Unrest Related Gatherings

