



The state of the SA economy: On the one hand...

Executive Summary

A number of standard, conventional economic variables are analysed from both a positive and negative perspective to illustrate how context can influence analysts' interpretation of reality.

Introduction

The present health of the South African economy and the recent performance of a wide range of headline economic and socio-economic variables have led to a growing sense of despondency amongst consumers, producers and workers. This feeling has been amplified by frequent reports of labour-related incidents of violence, bureaucratic ineptitude, corruption, policy uncertainty and apparent investor disillusionment (as reflected in credit risk downgrades).

It is not the intention to refute or invalidate the fact that all is not well in the domestic economy. An attempt will, however, be made to show how one figure/statistic may be interpreted in at least two – often diametrically opposite – ways. Differences in interpretation are normally a function of different contextual vantage points held by analysts. Included are the following:

- *Time context.* A published figure may be disappointing compared to, say, a year ago, but may compare more favourably with the situation, say, 10 years earlier.
- *Space context.* A statistic may be below the world average, but better than a regional average (or *vice versa*).
- *Ideological/political context.* A figure may assume different meanings for different people as a result of differing ideological or political biases.
- *Inward/outward looking context.* A figure may be analysed from an introspective, personal point of view, or from a more general, societal point of view.

The current state of the SA economy: A 'two-handed' interpretation

- **Economic growth: Currently between 2.5% and 3.0%.**

Positive interpretation

- Economic growth has, with the exception of 2009, been positive since 1993.
- The current rate of growth is at least double the average in the advanced economies.

Negative interpretation

- The current growth rate is barely half the level required to meaningfully reduce unemployment.
- The growth rate is significantly lower than the sub-Saharan Africa average (5%+).
- The growth rate is lower than the generally accepted long-term potential rate of 3.5% per annum; this implies an output gap.
- **Inflation: Currently just below 6%.**

Positive interpretation

- The CPI inflation rate is within the target rates.
- The average inflation rate since 1993 has been 7%, compared to the average of 14% recorded during the

two decades prior to 1993.

- The current inflation rate is significantly lower than the 14% recorded during the second half of 2008.

Negative interpretation

- The inflation rate is threatening to breach the upper end of the inflation target range, with pressure being exerted by rising fuel costs, the weaker rand exchange rate, and rising costs of labour.
- The lowering of the inflation rate over time has been achieved, *inter alia*, through a tight monetary policy stance (ie, fairly high interest rates).
- **Unemployment: The official (narrowly-defined) unemployment rate is just below 25%.**

Positive interpretation

- The unemployment rate is lower than the almost 30% recorded a decade ago.
- The number of people in employment today is almost 1.5m more than in 2003.

Negative interpretation

- Despite solid economic growth over the last 15 years the unemployment rate remains stubbornly high; indeed, one of the highest in the world.
- The number of new jobs created each year is lower than the number of new job-seekers entering the market each year.
- Unemployment is caused by a structural mismatch between the nature of economic activity (shift towards services) and the skills level of job-seekers. There is, therefore, no 'quick fix' for unemployment.
- **Balance of payments: The country's gross gold and foreign exchange reserves amount to approximately \$51b (SARB).**

Positive interpretation

- The foreign exchange reserves are now sufficient to cover 20 weeks of imports, compared to only 8 weeks in 2003.
- Net financial inflows over the last 15 years have averaged R59b per annum (SARB).

Negative interpretation

- A significant proportion of the financial net inflows has served to 'finance' large current account deficits.
- Foreign direct inward investment tends to be sporadic and opportunistic. Most of the inflows are to purchase stocks and bonds (portfolio inflows). This creates an important balance of payments vulnerability as a large inflow can be reversed in accordance with the whims of nervous investors.
- **Exchange rate: The rand has been one of the worst performing currencies this year.**

Positive interpretation

- Until recently the exchange rate of the rand was probably over-valued; in terms of purchasing power parity it is now arguably correctly valued.
- The weaker exchange rate could boost the country's export performance (and therefore economic growth and job creation) and curb imports, thereby helping to narrow the current account deficit.

Negative interpretation

- The weakening of the rand has been sharp; the economy will take a while to adjust to it.
- Almost 30% of goods consumed by South Africans are imported; these prices have risen sharply.
- The weaker rand has seen the petrol price rising to historical highs.
- Exports will only benefit from a weaker currency if the country has something to export!
- A weaker rand merely masks a lack of competitiveness and does not address the root causes of poor competitiveness.

6. Real disposable income: Real disposable income per capita of households was R24 761 in 2012 (SARB).

Positive interpretation

- The 2012 level was 43% higher than in 1993. In the 13 years prior to 1993 real disposable income fell by 7.5%.

Negative interpretation

- Although most South Africans have enjoyed an increase in income over the last 15 years, the rate of increase for those at the lower end of the income scale has been slower than for those at the upper end. Thus, although there are more middle-income households than ever before, the income gap in SA remains one of the largest in the world.

7. Poverty: The income poverty rate is 32%.

Positive interpretation

- The income poverty rate has fallen from above 50% at the turn of the century.

Negative interpretation

- One in every three South Africans (ie, some 17m) has to try to survive on less than R20 a day.
- There is a poverty bias toward women, children and the black African population group.

8. Gross fixed capital formation (fixed investment): Investment in capital goods amounted to R395b in 2012 (SARB).

Positive interpretation

- After having stagnated in the decade or so before 1994, real fixed investment spending has subsequently risen by 182%. This generally points toward growing confidence in the future health of the economy since investment essentially implies taking a bet that there will be a future sustained demand for goods and services.

Negative interpretation

- At 19%, the gross fixed capital formation-to-GDP ratio is considerably lower than the 25% to 30% required to sustain a 6% growth path. Moreover, the ratio of gross savings to GDP has fallen to 13%. Thus, even at the disappointingly low level of investment there is a savings deficit, which, in effect, is being financed by foreign financial inflows. The latter, as mentioned earlier, are fickle and vulnerable to the vagaries of perceptions.

9. Interest rates: The prime overdraft rate is currently 8.5%.

Positive interpretation

- The prime rate is at its lowest level in some four decades, and 7 percentage points lower than in mid-2008. As a consequence, households' debt servicing costs (as a share of disposable income) have virtually halved over the last five years. This has, to some extent, cushioned the effect of the recent historically high ratio of household debt to disposable income.
- Despite the rapid decline in nominal interest rates, real rates remain positive; this is indicative of a still overall conservative monetary policy stance.

Negative interpretation

- All other things being equal, lower interest rates contribute to a weaker exchange rate of the rand.
- Low interest rates disincentivise personal savings.
- For those who rely heavily on interest-bearing assets as their major source of income, buying power has virtually halved over the last five years.
- There is evidence that growth in the demand for credit is accelerating, thereby reducing the likelihood of any further interest rate declines.

10. Fiscal policy: The recent budget speech confirms a relatively conservative fiscal policy stance over the next few years.

Positive interpretation

- Thanks to years of fiscal stringency, it was possible to adopt a more lenient policy approach at the onset of the slowdown in 2009, without entirely abandoning fiscal rectitude.
- The government debt-to-GDP ratio remains below 45% (compare USA and Europe at 100%+).

Negative interpretation

- Annual budget deficits have averaged 4.8% of GDP since 2009. This, together with the large current account deficits, has highlighted the country's reliance on foreign capital.

11. Social grants: Some 15m South Africans receive a social grant.

Positive interpretation

- SA has one of the most redistributive societies in the world (but see below).
- There is evidence that the social grants have contributed to the (moderate) alleviation of poverty and (slight) narrowing of the income gap.

Negative interpretation

- SA has one of the most redistributive societies in the world (but see above).
- The costs of the system are high: almost 4% of GDP; second highest budget item after education; a high burden of taxation on a relatively small number of effective taxpayers.

Concluding remarks

Amidst what seems to be a disappointing performance, it is possible to distill a more positive interpretation of the figures – at least when compared with the situation in the early-1990s. However, there can be no denying, the fact that the positive trajectory has stalled, if not regressed, over the last five years. While some of the reasons for the current stagnation are exogenous (eg, the 'Great Recession'), there is growing evidence of a number of self-imposed constraints to growth and development. And although this document has focused on conventional economic variables, it is important to note that some of the economic outcomes might be influenced by non-economic factors, decisions or policies. The education *problematique*, for instance, has a direct bearing on unemployment, productivity, competitiveness and therefore also on growth, human development, poverty and the income gap. In a similar vein, the mismanagement of public funds compromises, *inter alia*, the meaningful and effective expansion of the country's capital stock – a necessary condition for growth and development. Looking ahead, these are the kind of structural obstacles that need to be resolved, before we will be able to interpret economic data in a single-minded, unequivocally positive fashion.

In the meantime, two-handed economists will prevail!

References

SA Reserve Bank (SARB). *Online statistics*. [online] URL: <http://www.resbank.co.za>.

This publication is confidential and for distribution to IFR Associates only.