Looking forward in 1991, economists were forecasting growth of Gross Domestic Product (GDP) for the South African economy for 1992 of between 1 and 2.5%, with an inflation rate of between 12 and 15%. These forecasts were underpinned by predictions that there would be a strong revival to 2.8% per annum in the growth of world output, and that world trade would expand at the rapid rate of 5% per annum. The expectation that the international business cycle would move into a strongly expansionary phase led to the prediction of a rapid growth in South African exports, and improving terms of trade (as commodity prices were predicted to improve on world markets). On the investment front there were prospects of positive growth.

The recovery in 1992 in the economies of the industrialised nations was far below expectation, with economic growth in these economies now forecast at 1.8% for the year of 1992. As a consequence of this poor economic performance, merchandise exports of the South African economy have grown more slowly than was predicted. The sideways movement of the world price of gold, and the effect of the drought on agricultural exports have also blunted the stimulus to economic growth in 1992 which was expected from foreign trade.

With the failure of stimulus from the world economy, the onset of severe drought conditions and the stalled progress towards constitutional reform, the South African economy has dropped into the worst recession which it has experienced this century. The recession intensified in the third quarter of 1992 with a drastic fall in agricultural activity which led to real annualised GDP declining by 5.7%. Figure 1 demonstrates the negative rates of growth which have been experienced in all sectors of the economy and the non-agricultural sectors. The real GDP for 1992 is now expected to fall by at least -2.5%, taking GDP back in real terms to below its 1988 level. In per capita terms, in constant purchasing power, the decline of the 1980s and the collapse in the current recession has taken South African incomes back to the level of the mid-1960s.

Understandably, the falling level of GDP has coincided with collapsing levels of domestic expenditure. Real gross domestic expenditure has been on a declining trend since the onset of the recession in 1989, and in the second quarter of 1992 it declined at a seasonally adjusted annual rate of 6.5%. Household consumption expenditure as shown in Figure 2, has been severely depressed by: the effect of the recession; declining real disposable income (between 9-15 million people are now estimated to be living in poverty); the increases in the number of unemployed people (an estimated 200 000 jobs have been lost in the past three years); the fall in levels of personal wealth; the lack of job security and the burden of consumer debt. These trends are dramatically reflected in the HSRC consumer confidence index which has plummeted from a pessimistic value of 23 in April 1992 to 16 in July 1992, when measured on a scale where 100 represents the most optimistic view.

On the business front there has also been a slump in expectations after the mild optimism of 1991. The political uncertainty and escalating violence has put a brake on planned foreign direct investment, and the financial rand has weakened in the second half of 1992 in response to decreasing investor confidence on the part of foreigners and nationals. Falling demand, weaker export growth and the fragile state of business confidence has caused an almost complete collapse of investment activity. The level of real gross domestic investment has declined by almost 19% since its cyclical high in 1989 (see Figure 3) until the second quarter of 1992, and over this time period the share of fixed investment has contracted from 21 to only 16.5% of GDP. The rate of fixed investment is now only slightly higher than is required to keep the existing capital stock intact.

![Figure 1: Real gross domestic product](image-url)
Other unfavourable consequences have followed from the nature of recession and drought conditions being experienced. The prices of agricultural goods have continued with their upward spiral over the year of 1992, with the most recent increase for September being an annualised 30.3%, bringing the poor and unemployed under intense economic pressure. Falling incomes have also caused a drop in the expected collections of the fiscal authorities and the deficit which was planned for 4.5% of GDP is now expected to exceed 7%. Taxes have however not been raised as yet with easily obtainable loan finance being used to make up the shortfall in revenue collection.

There have however been some developments with positive prospects for economic recovery. One of these has been the steady deceleration in the inflation rate as measured by the consumer price index (CPI). In September 1992 the annualised, seasonally adjusted inflation rate decreased by 0.8 to 13.5%. Even though food price increases were running, in September, at an annualised rate of 30.3%, the annualised non-food component of the CPI (regarded as a measure of core inflation) fell below 10% per annum. Another positive development relates to the growth of the money supply (M3), which has declined from a range around 15% per annum during 1991 to within the guideline range of 7-10% for 1992. However, the cause of the falling growth of money supply does not lie in greater control being exercised by the Reserve Bank, but rather from the falling demand for liquidity which is associated with the severe state of the economy. The trend of interest rates has reflected the falling demand for money, and over the course of 1992 there was a marked downward trend in short- and long-term interest rates. On the positive side too is the sustained surplus which has continued into 1992 in the current account of the balance of payments, although as a percentage of GDP the surplus on the current account amounted to 1.6 and 1.9% in the first and second quarters respectively compared with 2.5% in 1991.

Prospect

The speed of recovery in the South African economy is contingent on an upswing in world demand in 1993. Predictions for economic growth in the OECD industrial economies for 1993 have been sharply revised downward to 2.1% from an earlier 3.0%, and as a result the prospect of a strong export-led upsurge in South Africa’s economic performance has receded. Consumer and business confidence levels in South Africa are also unlikely to recover given the present political uncertainty. On the business side, a recent survey of confidence of small businesses conducted by Sacob and the Small Business Development Corporation reported that the majority of respondents in all regions of the country are pessimistic about prospects for business in the next 12 months (Sunday Tribune Finance, 13 September 1992). Only 24% of respondents expected to increase their level of investment within the next 12 months, while 25% of the firms surveyed expected to have to further reduce levels of employment. Only when political events have run their course can we expect a strong upsurge in private investment.

Falling levels of interest rates will not act as a stimulus to new investment until confidence levels return. Private investment spending may stabilise and possibly increase slightly in 1993 if export prospects continue to improve, but it seems very improbable that private investment (and private consumption expenditure) will lead to any upswing, or indeed respond vigorously to an upswing while political questions remain unresolved.
A return to more normal weather patterns in 1993 is likely to boost agricultural production, and this alone will add substantially to the growth of GDP. In 1992 the drought is estimated to have cut GDP by 1.5%. Government is desperately trying to hold the line on the growth of current expenditure. If it is successful a base will be laid for sustained economic growth in later years, but the stimulus to upswing in the 1993 year will be more muted as a result of government prudence in expenditure policies.

Thus the forecasters are predicting a turnabout in 1993 after the continued decline in 1992, but the forecasts for 1993 are for low positive GDP growth of between 1-2%. The downward trend in the inflation rate is expected to continue in 1993, with an inflation rate of around 10%. On these growth and inflation assumptions, short-term interest rates are expected to continue on a downward trend into 1993.

Economics of Transition

The eighties were a decade of reform and change for the South African economy. Many of the strictures which were placed on the markets for labour, capital and goods were relaxed or abolished as apartheid was phased out. One exception was the balance of payments with the necessity of running a surplus on the current account to finance the capital outflow of the period. Exchange controls and the dual exchange rate continued to buttress the market for foreign exchange.

As South Africa moved into the period of enlightenment under President de Klerk, plans to restructure the economy have abounded. The adding of Finance Minister Keys’ plan to the many other provides a difference in that he may have the clout to try and make it work. Preliminary indications are that the plan will address the following issues.

First and foremost on his agenda is the lowering of the rate of inflation to levels experienced by our trading partners. Although fiscal policy has not been restrictive, both the exchange rate and monetary policy have been directed at inflation in the recent past. Inflationary expectations will have been tempered by the sobering experience of the ongoing recession and are only being sustained by the ongoing fiscal deficit and memories of Reserve Bank action when the economy has recovered. In any process of structural adjustment attaining macro-economic stability is a sine qua non for setting the foundation for future sustainable growth.

Keys also supports the notion that the corporate rate of tax in South Africa is too high. This is a contentious issue particularly in the light of comparative figures which demonstrate that the effective rate of corporate tax is not particularly high, nor that levels of tax have been influential in determining investment decisions. It could also be argued that due to the oligopolistic structure of industry in South Africa the burden of corporate tax has fallen to a large degree upon consumers.

In his plan Keys stresses the need to increase savings both private and public in order to finance investment. Recent research by the World Bank shows that private household savings have not been influenced by interest rates but rather by the rate of growth in the economy. It therefore follows that high positive real interest rates may well stifle savings through their depressing effects on growth. Mr Keys may well be advised to proceed cautiously on this front. However, his attempts to contain government expenditure are to be lauded, particularly when unmatched by revenue. In the past the financing of deficits has all too often led to the relaxation of monetary policy with ensuing inflationary pressures.

Keys also favours the maintenance of exchange rate stability, a prescription which has been attacked by the international institutions. Of course a real depreciation has been shown to be an integral part of any liberalisation or stabilisation programme. However, if inflation is contained and the nominal exchange rate has already depreciated, then the maintenance of nominal stability will also ensure real stability of the exchange rate and competitiveness will not be impaired. Presently, the exchange rate has been directed at nominal stability and given the higher rate of inflation this would imply a real appreciation, impairing the competitiveness of exporters.

An essential ingredient to Keys’ plan is the implementation of selectivity on all fronts in his industrial strategy. This selectivity applies across a broad front of policy instruments such as differential interest rates, tariffs, tax and export incentives - much the same type of intervention which has occurred in the Far Eastern NICs. It remains to be seen whether South Africa will be able to successfully implement such a policy without the costs of excessive rent-seeking on the part of industrialists and expensive errors in picking winners on the part of policymakers.

Through the National Economic Forum, increases in labour costs may be contained to within the bounds of increases in productivity, and unit labour costs may be reduced by increasing productivity. Of course it may prove as difficult to restrain Labour as it will be to govern Business, for the aim of big Labour is to increase their share of the economic pie.

The question which immediately comes to mind is whether Keys’ plan is an improvement on present policy. In our view the dangers of increased government failure from the degree of intervention suggested in the plan are likely to spillover into a long-term malaise in the economy. Furthermore, the success of any plan will be contingent on the attaining of some political certainty in South Africa. Any reform will be discounted by decisionmakers as long as the cloud of political uncertainty prevails, and hence the Keys reforms are not likely to impact on the economy during 1993.