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What do the surveys reveal about the impact of the global crisis on the South African economy?

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Abstract

The global crisis originated in the US and European banking sectors. In contrast, banks continued to operate normally in South Africa. However, the fall in the international demand for and price of commodities, the reversal of foreign portfolio investment and the spreading of fear transmitted the crisis to South Africa. The unexpected huge change for the worse in the outlook forced business people and consumers to adjust quickly. Many of the business tendency and consumer survey time series consequently dropped to their lowest levels in their more than a quarter of a century's existence. The survey data also reveals the progression of the adjustment, from the fall in sales volumes to the slashing of expectations, run down of inventories, halt in production, reduction in working hours, abandonment of fixed investment plans, fall in price increases, cut back in employment and easing of constraints.

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Introduction

The severity of the impact of the global crisis on South Africa is surprising given that the country was one of only a few that escaped a banking crisis. Pinpointing the impact of the crisis is complicated by the fact that the crisis hit the country while it was already experiencing a cyclical downturn.

The cyclical downturn resulted primarily from a higher nominal interest and inflation rate. Economic growth slowed down and various cyclical indicators already pointed down by the time the financial market instability skyrocketed and became more widespread after the bankruptcy of the US investment bank, Lehman Brothers, during 08Q3.

Between June 2006 and June 2008 the South African Reserve Bank (SARB) increased its policy rate by 4.5 percentage points as inflation rose to above the 6% upper limit of its inflation target. CPIX (i.e. the consumer price index excluding the mortgage bond rate) inflation accelerated from a low rate of 3.1% in February 2005 to a high 13.0% in July 2008.

Real quarter-on-quarter GDP growth slowed down from 1.3% during 07Q4 to 0.4% during 08Q1. After an electricity supply crisis stifled economic growth during 08Q1, it temporarily bounced back to 1.2% during 08Q2. However, economic growth weakened once more thereafter, slowing to zero in 08Q3 and contracting by 0.5% in 08Q4, as – among other things - higher inflation eroded real incomes and an increased interest rate constrained activity.

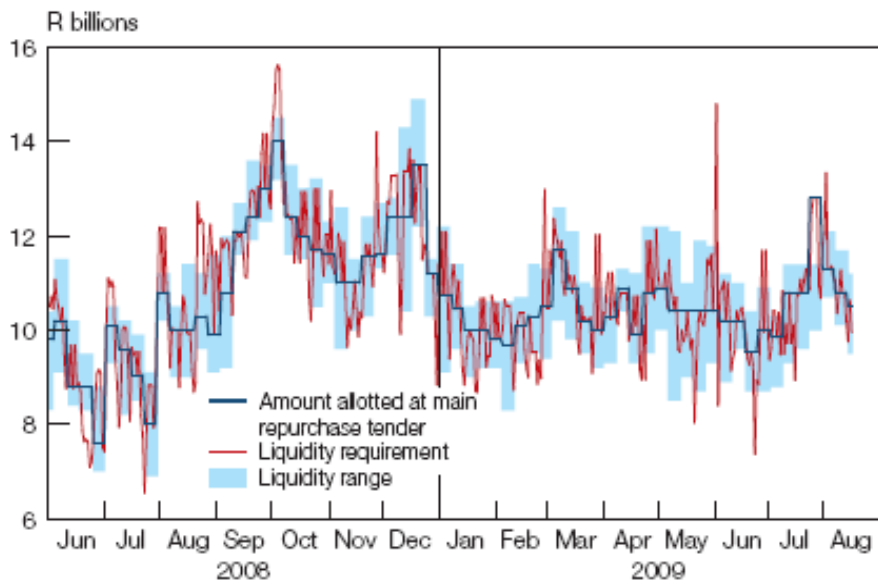
The BER's business confidence index² moved sideways for the most part between 04Q4 (87) and 07Q2 (80). It dropped from 67 in 07Q4 to 23 in 09Q3. The 08Q1 and 08Q3 falls of 19 and 12 index points respectively were particularly large. Such big falls typically indicate the start of a cyclical downturn. In September 2009 the SARB dated the start of the downward phase in the business cycle as December 2007.

South Africa escaped a banking crisis

Unlike many other countries, no banking crisis occurred in South Africa. The liquidity requirements of banks did not surge (see Figure 1). The interbank market continued to operate normally (see Figure 2). In contrast to other countries, the South African central bank did not have to provide emergency liquidity (see Figure 3). The spread between the policy and market interest rate also did not widen in South Africa as in many other countries (see Figure 4).

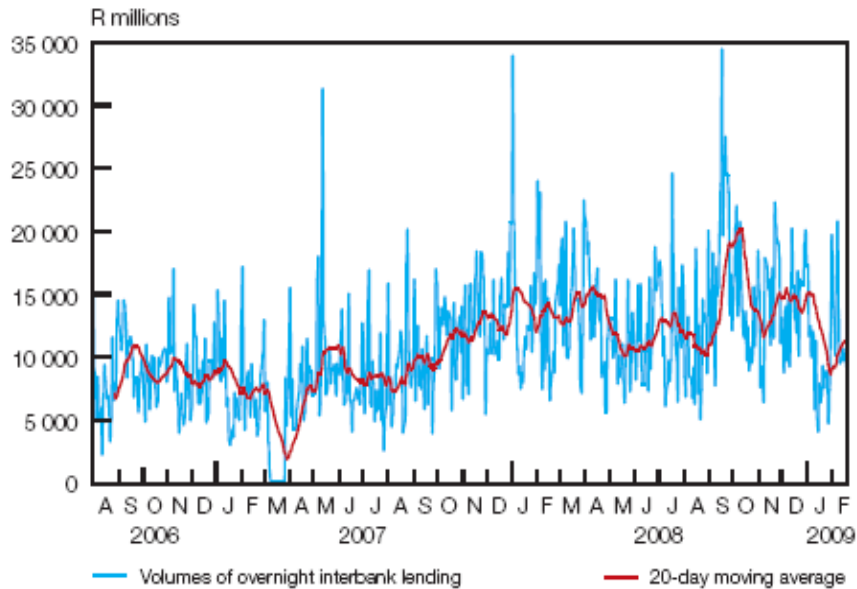
² The BCI is a composite business cycle and GDP indicator and can vary between zero and 100.

Figure 1 Liquidity requirement, range and amount allotted



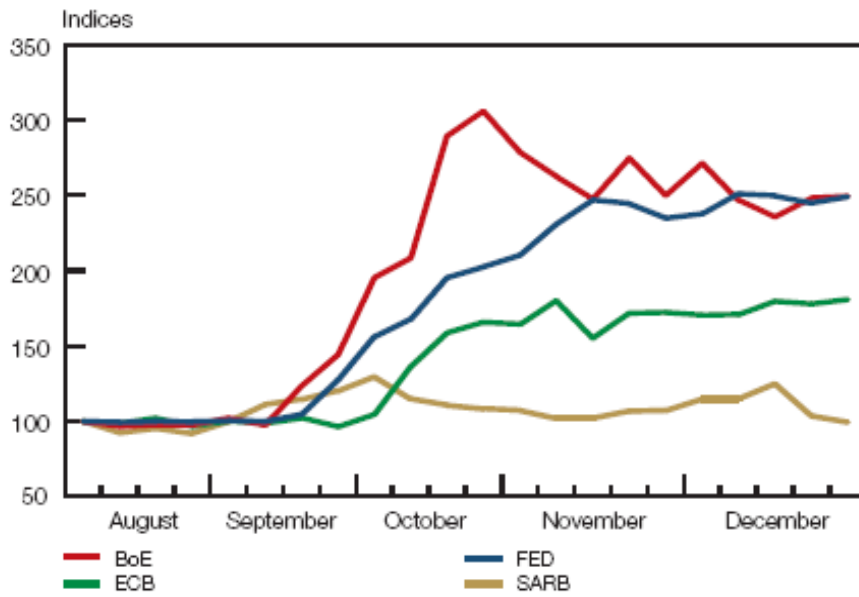
Source: SARB Quarterly Bulletin, Sep. 2009, p. 40

Figure 2 Volumes of overnight interbank lending in South Africa



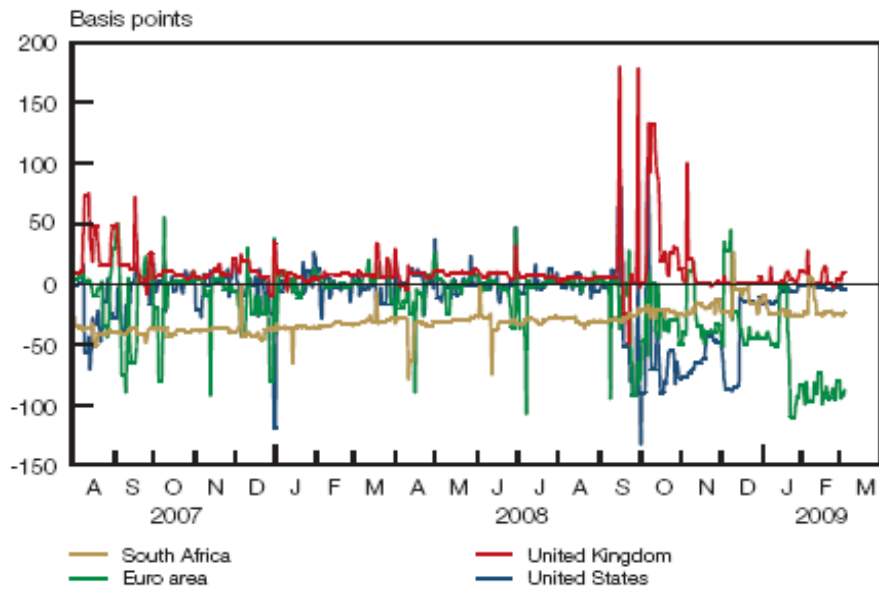
Source: Brink, SARB Financial Stability Review, Mar 2009, p. 44

Figure 3 Liquidity provided by central banks: Aug to Dec 2008



Source: Brink, SARF Financial Stability Review, Mar 2009, p. 42

Figure 4 Spreads between policy and market overnight rates



Source: Brink, SARF Financial Stability Review, Mar 2009, p. 44

Transmission of the global crisis to South Africa

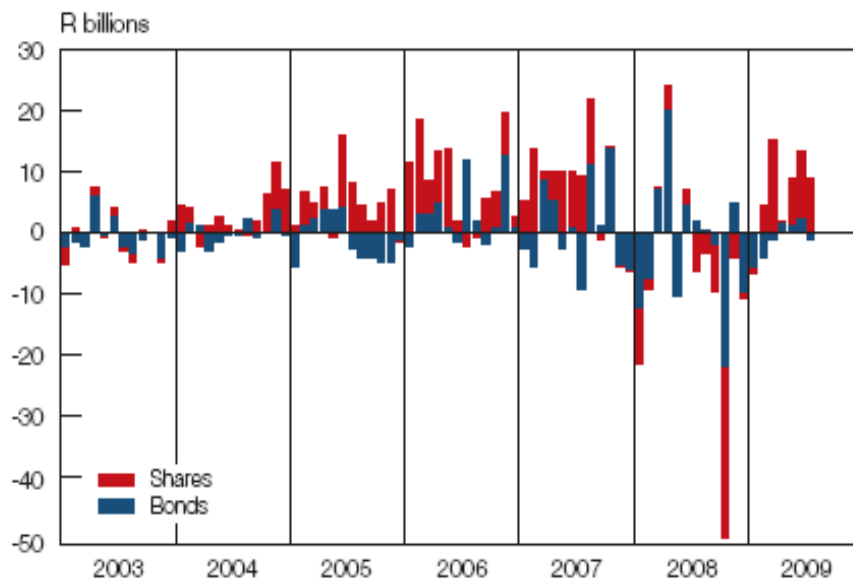
Africa

The global crisis was transmitted to South Africa via the financial markets, international trade and tightening of bank lending standards.

1. Financial markets

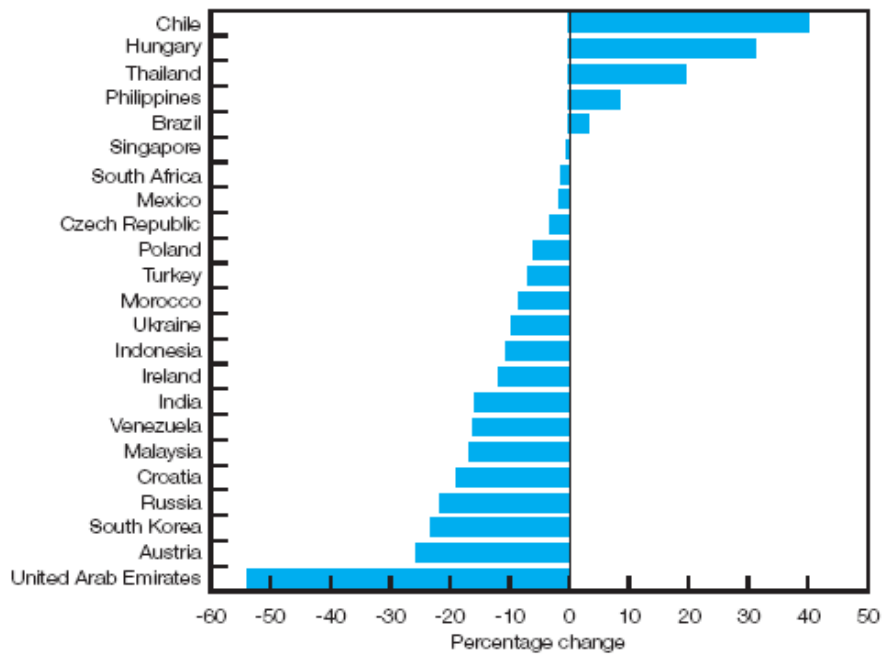
Risk aversion soared during the global crisis. Foreign portfolio investment flows to emerging countries, such as South Africa, reversed (see Figure 5). However, South Africa's gross reserves did not decline as in the case of most other emerging countries (see Figure 6). After dropping sharply in September 2008, the rand exchange rate recovered and returned to pre-crisis levels by May 2009 (see Figure 7). Similarly, share prices on the stock exchange recovered after plunging during 08Q3 (see Figure 8). The spread of South African bonds widened at the height of the financial market crisis, but have narrowed in the meantime (see Figure 9).

Figure 5 Net purchases of shares and bonds by non-residents



Source: SARB Quarterly Bulletin, Sep. 2009, p. 42

Figure 6 Change in gross reserves: Feb 2008 to Feb 2009



Source: Brink, SARB Financial Stability Review, Mar 2009, p. 48

Figure 7 Nominal effective exchange rate of the rand



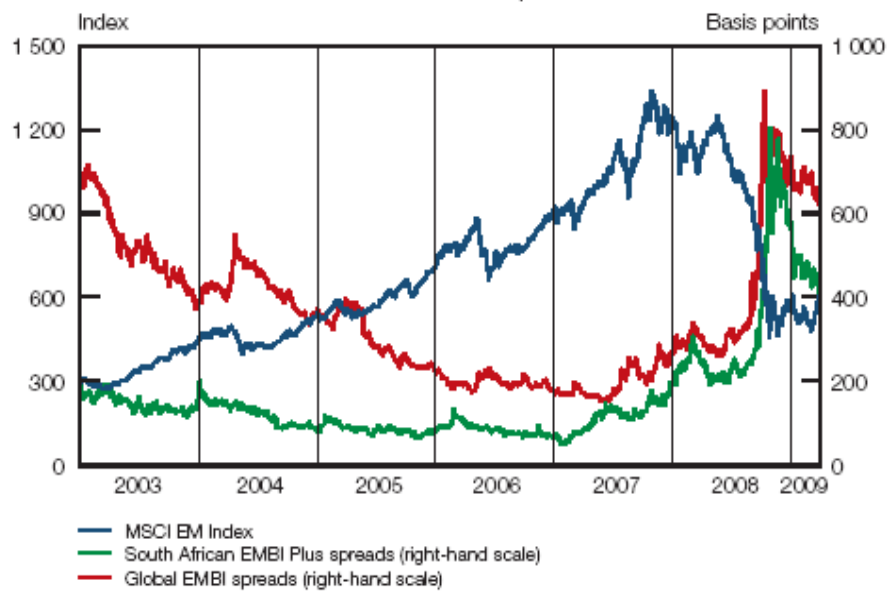
Source: SARB Financial Stability Review, Mar 2009, p. 31

Figure 8 Share prices



Source: SARB Quarterly Bulletin, Sep. 2009, p. 44

Figure 9 MSCI EM Index, EMBI global spreads and South African EMBI Plus spreads



Source: SARB Financial Stability Review, Mar 2009, p. 9

2. International trade:

Manufacturing made up 79% of total merchandise exports in 2008. Mining accounted for 18% and agriculture for 4% of South Africa's exports. Transport equipment, basic metals (iron, steel, gold, platinum and aluminium), chemicals and machinery were together responsible for 76% of manufacturing exports in 2008 (see Table 1).

Table 1 Manufacturing exports, output and employment in South Africa, per cent

	Exports	Output	Employment
Transport equipment	27.5	17.8	11.2
Basic metals	23.4	9.7	5.9
Chemicals	13.7	14.9	5.4
Machinery & equipment	11.4	3.5	8.9
Furniture & other	7.4	6.6	7.3
Electrical machinery	3.0	4.6	4.7
Food	2.9	14.6	12.7
Paper	2.7	5.1	3.0
Metal products	2.2	4.8	9.4
Beverages	1.8	3.7	4.2
Plastic	1.0	2.5	2.8
Non-metal minerals	0.7	3.1	5.1
Wood	0.7	1.9	4.4
Rubber	0.5	0.8	1.1
Leather	0.4	0.5	0.6
Textiles	0.3	1.6	3.6
Printing & publishing	0.2	2.3	4.1
Clothing / Wearing apparel	0.1	1.6	4.9
Footwear	0.0	0.4	0.8
Total	100.0	100.0	100.0

Data source: Quantec Research

International trade plunged during the global crisis. South African exports of goods (see Figure 10) and services (such as foreign visitors) fell sharply as a result. The drop in the international demand for vehicles and non-food commodities (industrial raw materials) hit South Africa particularly hard, because these items dominate the country's exports.

Figure 10 Volume of merchandise exports



Source: SARB Quarterly Bulletin, Mar. 2009, p. 24

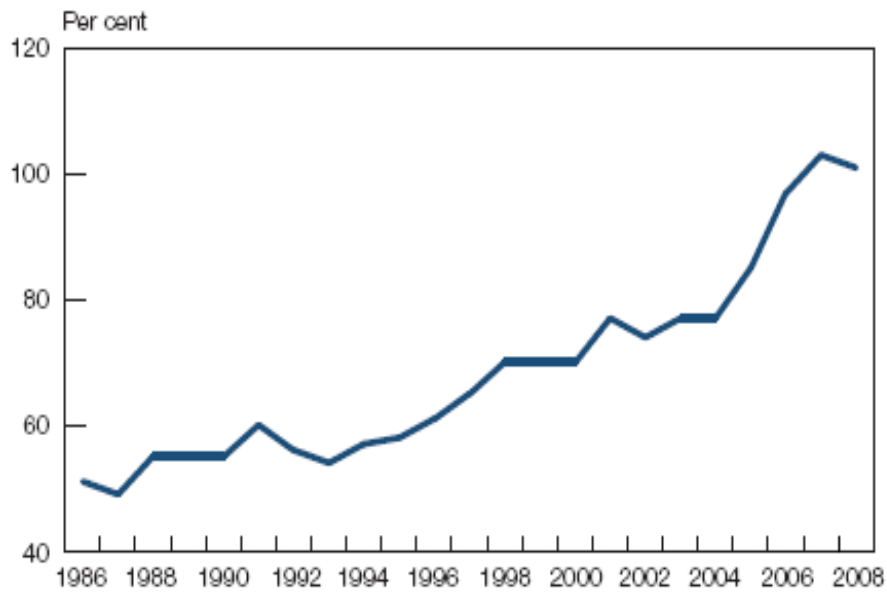
3. Tightening of bank lending standards

Although lower compared to some other countries, the use of credit has risen sharply in South Africa, particularly during the period 2004-2006 (see Figure 11). The upsurge in credit can mainly be attributed to a sharp rise in the price of houses (see Figure 12) and credit providers' push to extend as much credit to as many individuals as possible before a new more restrictive consumer credit act became effective in mid-2007. Household debt as a percentage of disposable income spiralled. Income gearing increased as well, but is still lower compared to previous peaks owing to a lower nominal interest rate (see Figure 13).

Banks already started tightening credit standards in South Africa before the onset of the global crisis (see Table 2). The tighter credit standards stemmed from the new national credit act (NCA) in 2007, switch to Basel 2 accounting standards and capital requirements in 2008 and rising non-performing loans (credit impairments).

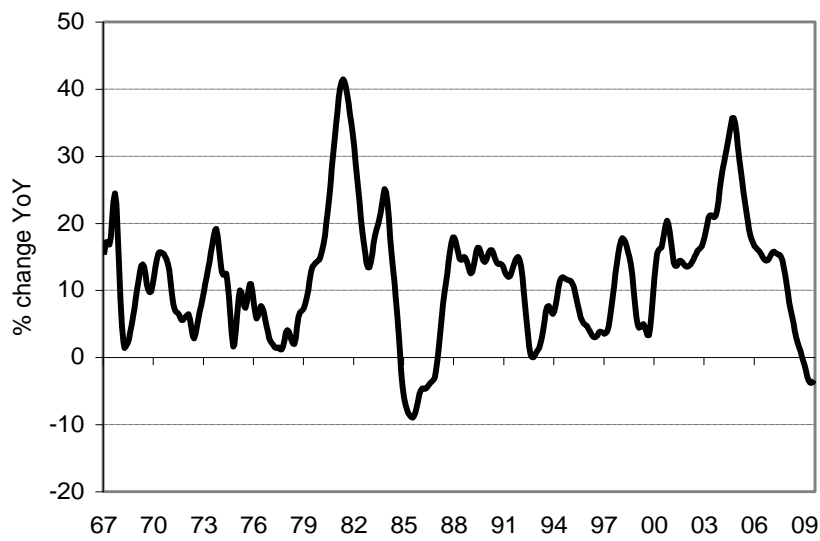
However, South African banks tightened credit standards further in reaction to what happened to banks overseas during the global crisis. This set a vicious circle in motion. The cut back in credit provision amplified the decline in house prices, slowdown in consumer spending and cut back in fixed and inventory investment. These developments, in turn, sped up business closures and retrenchments, which led to a further tightening of credit standards. Retail and investment banks have never before in the survey's seven year history tightened credit standards by as much as they did after the global financial market instability climaxed during 08Q3 (see Table 2).

Figure 11 Credit as a percentage of nominal GDP in South Africa



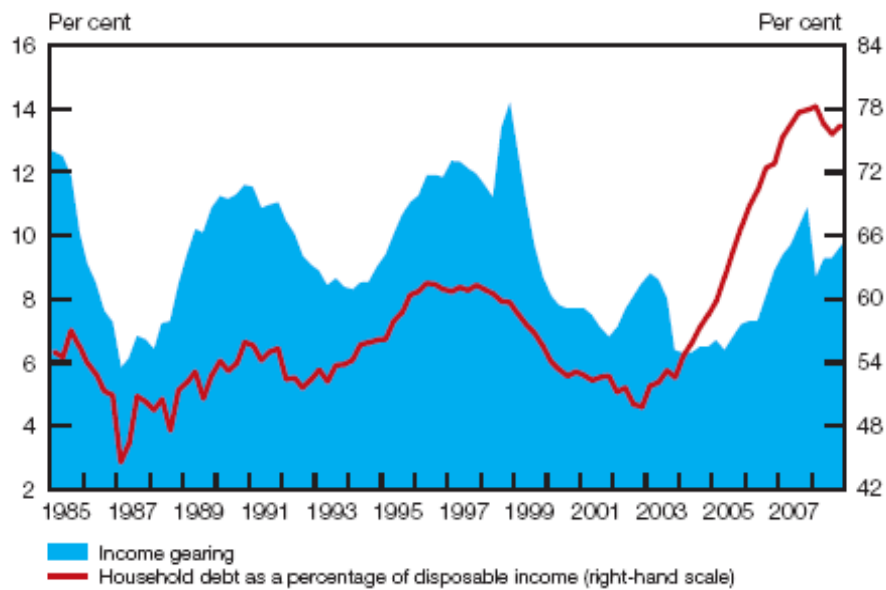
Source: Brink, SARB Financial Stability Review, Mar 2009, p. 45

Figure 12 House prices



Source of data: ABSA

Figure 13 Ratio of household debt to disposable income and income gearing



Source: SARB Financial Stability Review, Mar 2009, p. 24

Evidence from the surveys on the direct impact of the global crisis on the real economy

Consumer confidence

During the first half of 2008, consumer confidence registered its steepest fall over a short time period since 1984. The consumer confidence index (CCI) fell by 28 index points - from +22 during 07Q4 to -6 during 08Q2. This fall can mainly be attributed to the cumulative impact of several lending rate increases, the reduced availability of credit and the rise in inflation (particularly fuel and food prices), which eroded households' purchasing power. Although consumer confidence came off its previous record high level, it was at -6 still much higher compared the record low level of -33 registered during 85Q2 at the height of the political unrest (see Table 2).

Somewhat more (on a net basis) consumers rated the present as an inappropriate time to buy durable goods when the global financial market turmoil reached its peak during 08Q3. However, both the change in and level of the time to buy durable goods sub-index were respectively not large and high by historical standards.

Except for the rating of the present time to buy durable goods, the global crisis did not have much of a direct impact on consumer confidence in South Africa. The fact that banks

continued to operate normally and confidence already fell sharply prior to the crisis probably caused the global crisis to have little effect on consumer confidence.

New vehicle trade

Rising debt service costs, declining availability of credit and consumers' unwillingness to buy durable goods already led to a contraction in sales of durable goods (i.e. vehicles, furniture, appliances, entertainment goods and jewellery) before the financial market turmoil reached a zenith during 08Q3. The additional tightening of bank lending standards and consumers' increased unwillingness to buy durable goods after the crisis curtailed spending on durable goods further. Never before in the survey's 23 years' existence have new vehicle sales fallen at such a brisk tempo as during the three quarters following the crisis in 08Q3 (see Table 2). This episode was worse than the previous record recorded during the 1992 recession.

Retail trade

Retail sales weakened after the crisis, but the sector continued doing well relative to the other sectors and some previous episodes. However, things changed for the worse during 09Q2 – three quarters after the crisis – as massive worker lay-offs following the crisis hit sales. In the survey's 23 year history retail sales have not contracted at such a high rate as during 09Q2 (see Table 2). This episode was worse than the 1992 recession. The retreat in sales initially did not hurt retailers' bottom lines by much due to their strong pricing power, but profitability plummeted at a record magnitude when they lost that power and rising costs caught up with them in 09Q2.

Manufacturing

The manufacturing sector was hit from all sides after the crisis. Domestic sales contracted at the highest rate in 35 years as retailers and wholesalers placed nearly no new orders to reduce their inventories (see Table 2). Likewise, export sales plummeted at an unprecedented fast tempo, as the demand for South Africa's main export goods – motor vehicles, basic metals, chemicals, machinery and equipment – evaporated. Manufacturers cut production at the same 35 year record high rate as domestic sales to prevent stocks from rising. This episode was worse than at the time of the Southeast Asian crisis in 1998.

When it became clear that the weakness in demand would continue for some time, manufacturers shifted from shortening working hours to retrenching workers and abolishing fixed investment to curb costs. Never before – not even at the height of the Southeast Asian crisis in 1998 – were the workforce and fixed investment reduced at such a high rate in the manufacturing sector.

Building and construction

Building activity contracted at its fastest pace since 2001³. Similar to the new vehicle trade, the additional tightening of bank lending standards and consumers' increased unwillingness to buy durable goods after the crisis exacerbated the fall in building activity. However, the major cause of the drop off in building activity is not the global crisis, but most likely the prior over investment in property following the surge in the price of houses between 2003 and 2006.

Sources

Brink, N. (2009) Note on the global financial market turmoil and central bank intervention – a South African perspective. In SARB, *Financial Stability Review*, March 2009

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³ The BER has been conducting a building survey since 1970, but the question on building activity has been posed in this format only since 2001.

Table 2 BER Survey Results – 2008Q2 until 2009Q3

	Unit	Start	Min / Max	Date	08Q2	08Q3	08Q4	09Q1	09Q2	09Q3
Retail banks										
Total income	Net %	02Q1	42	02Q3	72	50	25	40	0	-24
Credit standards	Net %	02Q1	71*	02Q3	50	50	75	87	85	44
Investment banks										
Total income	Net %	02Q1	-11	02Q3	67	37	6	0	-14	-63
Credit standards	Net %	02Q1	64*	02Q1	71	92	100	100	47	-26
Consumer confiden										
Total	Net %	08Q2	-33	85Q2	-6	-1	-4	1	4	1
Economic perform	Net %	08Q2	-38	85Q2	-14	2	-5	4	17	11
Financial perform	Net %	08Q2	-22	85Q2	5	13	9	15	17	15
Time to buy durables	Net %	08Q2	-42	84Q2	-9	-17	-16	-15	-21	-23
High income group	Net %	95Q1	-29	98Q4	-5	4	-3	2	1	5
Low income group	Net %	95Q1	-25	00Q4	-7	-5	-5	0	7	-4
Business confidence										
	%	75Q1	10	85Q3	45	34	33	27	26	23
Retail trade										
Confidence	%	86Q1	0	92Q3	53	49	49	52	47	35
Sales volume	Net %	86Q1	-38	92Q2	-1	3	-13	-19	-44	-21
Employment	Net %	86Q1	-40	02Q1	14	3	7	-4	-26	-27
Selling prices	Net %	01Q2	-36	04Q1	74	76	61	35	17	-18
Profitability	Net %	01Q2	-46	01Q2	-14	-33	-45	-37	-60	-64
Stocks	Net %	86Q1	60*	88Q4	18	28	17	20	18	11
New vehicle trade										
Confidence	%	86Q1	8	92Q1	38	15	0	5	12	19
Sales	Net %	86Q1	-85	92Q3	-75	-80	-88	-94	-96	-55
Manufacturing										
Confidence	%	74Q2	11	98Q3	37	30	31	16	11	22
Domestic sales	Net %	74Q2	-48	99Q1	-19	-28	-34	-65	-65	-47
Export sales	Net %	92Q1	-47	05Q1	-42	-20	-23	-54	-64	-47
Production	Net %	74Q2	-41	85Q3	-12	-18	-39	-63	-62	-47
Stocks	Net %	95Q3	51	98Q4	34	34	45	47	44	35
Dom selling prices	Net %	87Q3	-5	03Q4	56	48	35	29	-8	0
Exp selling prices	Net %	92Q1	-38	05Q2	20	45	27	10	-21	-18
Employment	Net %	70Q1	-59	98Q3	-24	-28	-37	-43	-63	-44
Investment	Net %	92Q2	-17	99Q2	-12	10	13	-23	-25	-23
Building contractors										
Confidence	%	75Q1	1	85Q1	47	41	42	33	23	24
Building activity	Net %	01Q2	-60	99Q1	-56	-65	-68	-77	-83	-77
Employment	Net %	01Q2	-46	01Q4	-27	-51	-47	-60	-67	-59
Profitability	Net %	01Q2	-53	01Q3	-51	-59	-56	-77	-83	-78
Tendering competition	Net %	70Q4	96	76Q4	52	53	55	61	51	60

The third quarter is highlighted orange to set apart the severe financial market instability following the bankruptcy of Lehman Brothers.

Unit = unit of measurement, % can vary between zero and 100, net % can vary between -100 and 100

Start = date when electronic data series starts

Min = minimum, new minima are highlighted grey

Date = when minimum was registered

* Maximum