

South Africa and the global economy: next three years

GDP projections, trade and investment

I turn now to our projections for the three-year period ahead, in preparation for the 2010 Budget.

Against the background of the global economic decline, the outlook for the South African economy is significantly weaker than projected in February.

- Real GDP is expected to be 1.9 per cent lower this year than in 2008, and growth of 1.5 per cent is projected for 2010, rising to 2.7 per cent in 2011 and 3.2 per cent in 2012;
- Exports and imports have both declined by about 20 per cent in volume terms this year, reflecting the sharp downturn in world trade. We expect a recovery in trade of about 4 per cent next year, accelerating moderately in subsequent years;
- Gross fixed capital formation is expected to average 6 per cent growth over the period ahead, supported by continued public sector infrastructure spending and a recovery in private investment.

There is considerable uncertainty in these numbers – a faster global recovery could improve prospects for next year. But South Africa's recovery lags behind global trends to some extent, mainly because households carry a substantial overhang of debt, which holds back more robust consumption expenditure.

Balance of payments and the exchange rate

Partly because of large imported equipment requirements of our transport and power generation investment projects, South Africa imports considerably more than we export. Payments to non-resident investors have also remained high.

The deficit on the current account of the balance of payments will be about 5 per cent of GDP this year, rising somewhat over the medium term.

We therefore rely on capital inflows from abroad, which have continued to exceed the current account shortfall. The exchange rate has strengthened in recent months as a result of these inflows. This is a matter of concern, as it impacts negatively on South African business. The Treasury will support the ongoing accumulation of foreign exchange reserves by the Reserve Bank, which assists in moderating the appreciation of the rand. Official reserves have reached US\$40 billion, equivalent to over 12 per cent of GDP.

Inflation and monetary policy

For the last two years, consumer price inflation has exceeded the target range of 3 to 6 per cent. We expect CPI inflation to average 6.3 per cent next year and 6 per cent in 2011.

Members of the House will be aware that the moderation in consumer price inflation over the past year has enabled the Reserve Bank to lower interest rates by 5 percentage points.

Our inflation targeting framework is an important element in macroeconomic coordination. It has assisted in lowering inflation expectations, and in preventing inflation from undermining our competitiveness. Monetary policy has to take account of the lag of some 18-24 months between interest rate changes and their effect on demand, and a range of external influences on inflation that cannot be directly controlled.

We recognise that alongside inflation reduction and financial stability, we must seek faster development and employment creation. I welcome public debate on this issue, and have agreed with the Governor of the Reserve Bank, and the Governor-designate, that monetary policy should also support our aim of balanced and sustainable growth.

Governor Mboweni has steered the Reserve Bank's supervision of our monetary system with great wisdom – Members of the House will join me, I know, in thanking him for a decade of sound monetary leadership. We look forward to a constructive partnership with his successor, Ms Gill Marcus.

Exchange control reforms

The economic crisis has exposed risks embedded in the global financial system, and the failure of regulators to work together in supervising multi-national financial institutions. Under the guidance of the multilateral Financial Stability Board and the G-20, various countries are now implementing macro-prudential approaches to financial regulation, reviewing capital adequacy requirements of banks and adopting more stringent standards of disclosure and governance.

South Africa's financial system proved to be highly resilient during the global financial crisis, partly because of the phasing in of prudential regulation of foreign exposure over previous years. This approach is in line with international practice, and government is in a position to announce further reforms to lower the cost of doing business, while managing risks in a volatile international environment.

Proposed changes include

- increases in the rand thresholds applicable to outward investments by South African companies;
- removal of various restrictions on rand conversion of export proceeds and advance payments for imports, and
- increases in foreign capital allowances for resident individuals.

Details will be released by the Reserve Bank. In support of regional economic integration, we are further relaxing the approvals required for investing in Southern African Development Community (SADC) countries. The current exchange control regulatory framework for approving inward investment in

South Africa is also in need of review – I intend to table proposals for modernisation early next year, after appropriate consultations.