

**UNIVERSITY OF KWAZULU-NATAL**

**DISILLUSIONMENT WITH THE MARKET DRIVEN ECONOMIC SYSTEM IN A  
PERIOD OF GLOBAL ECONOMIC DOWNTURN**

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## DECLARATION

I, Maphelo Malgas declare that

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## **ABSTRACT**

This study also showed how inter-connected the world is because the global financial crisis started in one part of the world but affected every country worldwide.

The global financial crisis made it necessary to revisit the writings of the British economist John Maynard Keynes who is considered one of the most influential economists of the 20th century and one of the fathers of modern macroeconomics. He advocated an interventionist form of government policy, believing markets left to their own devices could be destructive, leading to cycles of recessions, depressions and booms. That is what the world witnessed during the global financial crisis.

Keynes ideas helped rebuild economies after World War II, until the 1970s when his ideas were abandoned for freer market systems. What then happened was regulation began to weaken as the world economies started to recover. This scenario is likely to repeat itself even when the financial crisis is over. Market capitalism is still going to dominate the world economies because in as much as transaction will be regulated but the behaviour of finance institutions will be difficult to regulate.

During the period under review, the South African financial sector and the mining industry felt the impact of the global financial crisis as shown in this study. Despite signs of a turnaround in economic activity in South Africa, financial systems are still vulnerable to risk and a renewed loss of confidence. The adverse feedback effects from the real economy, therefore, remain a concern and present new challenges for safeguarding the stability of the global financial system.

The global economic crisis offers an opportunity for South Africa to act and provide long term solutions. Strict regulation should be applied not only to the financial sector but to smaller business entities as well.

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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 BACKGROUND TO THE RESEARCH**

The 2009 global financial crisis hit the global economy very badly and South Africa has been gravely affected since the country has entered recession after experiencing growth for more than a decade.

In the United States (US) alone 3.7 million jobs have lost since the 1<sup>st</sup> quarter of 2009. The US had a housing boom which was followed by a bust and in turn led to financial crisis which spread to other countries. South Africa's Gross Domestic Product (GDP) declined by 1.8% in the final quarter of 2008. In Zambia the copper industry, which makes up 90% of the country's export dropped from \$9,000/ton in 2008 to just over \$3,000/ton in 2009. In Nigeria and Angola petroleum producers have been the hardest hit as oil prices fell by over 60% in 2009 from their peak in 2008 (internet 12).

This thesis, therefore, analyses the impact of the global economic downturn on the South African economy. The South African economy is heavily dependent on commodities such as diamonds, gold and other industrial materials and there has been a drop in demand for these commodities during the financial crisis. The closure of mines resulted in a loss of employment for thousands of employees.

In addition the automotive sector has seen retrenchment figures skyrocketing. The situation is similar in the financial services sector with most banks cutting down on overheads. In South Africa Agriculture, Mining, Manufacturing, Retail and Financial services contribute 2.2%, 5.2%, 14.9%, 12% and 21.4% to the country's GDP respectively (internet 9).

There is a sense in which bankers more especially in the United States are to blame for this crisis since it is the financial systems that actually failed. If the lower interest rates that were provided by the United States banks were used to finance entrepreneurs, the United States economy would have then had a sustainable growth.



## **1.2 MOTIVATION FOR THE STUDY**

The study was motivated by the economic debates around the financial crisis. The writer wanted to explore the real causes of the global financial crisis. Also, being aware that South Africa is not immune to the crisis, the researcher wished to investigate the impact the global financial crisis on the South African economy.

The study will assist South African government to understand the impact of the crisis; furthermore the government will benefit from the study as it reflects on what has happened and formulates responses to the crisis. Economies of the world move in cycles: there are periods of growth and periods of recession and this thesis provides some insight into the impact of the global economic downturn on South African industries as the country enters a stage of recession.

The South African economy has made gains in the past five years; however this recession threatens to reverse those gains. A 2008 study undertaken by an international panel on growth chaired by Hausmann noted that in South Africa, "Since 2004, growth has accelerated to close to 3 percent in per capita terms annually. Employment has expanded, and the unemployment rate has begun to decline from its peak in 2002 of close to 30 percent to a level close to 25 percent in 2007 in spite of a very rapid increase in the number of South Africans searching for jobs. Inflation has in general remained very close to the targeted levels (3-6%) in spite of the increase in the international price of energy and raw materials. Consumer confidence has been strong, buoyed by an emerging black middle class. Investment has risen from about 16 percent of GDP in 2000-2002, to over 18 percent of GDP in 2005-2007".

## **1.3 FOCUS OF THE STUDY**

The study interrogates the factors that gave rise to the global economic crisis and considers how the financial instruments failed under the market driven economic system. In addition the study investigates the impact of the crisis on South African industry.

## **1.4 PROBLEM STATEMENT**

Even though the global economic crisis was slow it reached South Africa in the 1<sup>st</sup> quarter of 2009, it was expected that the impact would be severe. This thesis represents an undertaking to analyse the severity of this impact and evaluate how best to respond to the global economic crisis. Other countries have already suggested stimulus packages for affected sectors while South Africa is lagging behind. Suggestions have now been made to investigate if there are any real substitutes to the market driven economic system. The point of this thesis is that South African authorities need to be prepared to respond to a financial crisis as it strikes the economy in all sectors. In addition, this thesis seeks to stimulate a public debate on this subject just so that as a country South Africa does not rely on economic prescriptions by some international bodies such as the World Bank.

## **1.5 OBJECTIVES OF THE STUDY**

- To analyse the impact of global economic downturns on South African economy.
- To investigate the measures that could assist South Africa to prevent any major impact of an economic downturn.
- To investigate the real cause of the current global economic downturn.

## **1.6 RESEARCH METHODOLOGY**

The study relies on large amount of quantitative data collected by the Index of Economic Freedom, ABSA Capital Economic Research, CDH research, the South African Reserve Bank, Nedbank Group Economic Research, South African government website, Statistics South Africa, Johannesburg Securities Exchange, Standard Bank, International Monetary Fund, World Bank. In some cases it is better to rely on secondary data as an alternative to collecting new data. Secondary data has its advantages since it allows student an access to good quality data available from the abovementioned research institutions. The institutions mentioned above sampling procedures that are rigorous, in most cases resulting in samples that are close to being representative as one would likely to achieve. These organizations

may suffer from the same problems of survey non-response but they have well established procedures in place for following up non-respondents and thereby keeping this problem at minimum levels. Their samples are often national or at cover the better part of South Africa.

## **1.7 LIMITATIONS OF THE STUDY**

Limitations of this study are the extent to which the sample is representative of the population as the study relies on secondary data. The study is confined to two sectors of the economy and this was done due to time constraints. Thus, whether the findings and recommendations are generalisable to the entire economy is questionable and further research to determine this becomes essential. Also the study excludes the impact of the economic crisis on the South African Labour market.

## **1.8 STRUCTURE OF THE STUDY**

**Chapter one** is the introductory chapter: this chapter covers the background information. The problem statement is discussed and those who will benefit from the findings are mentioned. The advantages of the study and its limitations are discussed in this chapter. This chapter also provides an outline of what the study aimed to achieve and the value of the proposed research.

**Chapter two** comprises a literature review which examines the global economic crisis, government regulation and role of global institutions. The chapter also provides the Keynesian viewpoint as another school of thought in economic theory which is fundamental to prevent future occurrences of an economic crisis. The chapter then interrogates the role of government intervention in the functioning of an economy. Thereafter the chapter considers the role of global institutions in the economies of the world and the impact of this on individual countries. Finally in this chapter global economic integration is reviewed in the current format.

**Chapter three** informs readers about the research methodology that has been used in this work. The chapter considers the advantages and disadvantages of

quantitative research. The chapter also discusses the criticisms levelled against quantitative research as a research methodology. Subsequently the chapter looks at the aims and objectives of the study and the methods of data selection. Finally the chapter evaluates issues of the reliability and validity of the study.

**Chapter four** contains the presentation and interpretation of research results. This chapter outlines the impact of the global economic downturn on certain South African industries such as the financial services sector and the resources sector.

**Chapter five** represents the conclusion and the recommendations of the thesis. This chapter discusses South Africa's economic outlook and prospects after the global economic downturn. The chapter interrogates the need to rethink the international financial systems and also looks at the role of global institutions as the financial crisis unfolds. Thereafter in this chapter South Africa is considered as it undergoes recession and recommends how best to respond to the latter. Lastly the chapter also makes recommendations regarding how South Africa should respond to the global financial crisis.

## **1.9 CONCLUSION**

This chapter examined the motivation for the study, the objectives and the problem statement. The limitations are also identified and the structure of the study examined. The next chapter furnishes a literature review of the economic theories and the architects of those theories, in the light of the global economic downturn.

The next chapter is the literature review to explore the global financial crisis.

## **CHAPTER TWO**

### **Literature Review**

#### **2.1 INTRODUCTION**

The Global financial crisis hit the global economy very severely even though it has been slow to reach South Africa. The effects of this financial crisis are felt by all starting from the developed countries to the underdeveloped countries. South Africa has also not been spared from this financial crisis. There is a sense in which South Africa has not been badly affected as other African countries because of the nature of its banking sector. This thesis therefore analysis the impact of the global financial crisis on the economy of South Africa by analysing two sectors during the period of the crisis. These sectors are the mining sector and the financial services sector. From the investment point of view these two sectors are known for their correlation in terms of their performance. Very often when the financial services are on the decline the mining sector is on the incline and vice versa. So it becomes very important to analyse these two sectors and evaluate how they have performed during the time of the global financial crisis.

#### **2.2 BACKGROUND OF THE CRISIS**

The financial crisis started in US largely due to the lack of regulation of the financial system by the government. The US financial institutions gave credit to non-creditworthy clients. The US economy then had a boom which was largely driven by residential property market mortgage bubble. Cogman & Dobbs (2008: 1) said "Financial crises occur with surprising frequency, in every decade in the past century there has been at least one big shock to a major economy's financial system". When the clients could not repay their debts the US financial institutions had write-off those credits and they had amounted to about \$1 trillion. As a result of these write-offs the US Federal Reserve bank had put intervention measures in place as almost 9000

financial institutions were going into bankruptcy and the country's economy was experiencing deflation (internet 1).

This background shows that the economic crisis started in the US but because of the nature of global financial institutions the impact of the crisis had an un-imaginable impact worldwide, including South Africa (SA). The main cause of this crisis being a malpractice by the financial institutions in the US which took place over a very long period of time, seemingly unregulated or regulators failing to act. There are no easy solutions to this economic downturn but there are major lessons to be learnt. Among those is the desire to review the free market reforms or to enforce government regulation. There seems to be a need to overhaul the regulatory industry more especially for the finance sector. This regulation may be that of the behaviour of financial institutions or regulating transaction themselves.

According to the South African Reserve Bank "South Africa could not escape the negative consequences of the international financial turmoil, despite the fact that its domestic financial institutions had virtually no direct exposure to the troubled assets that were central to the deterioration of credit markets" (internet 8).

The 2009 Global financial crisis was not the first crisis in the past two decades. There was a mini crisis in Russia back in 1998 which actual shock the US market a bit but because Russia barely reaches 2% of the global gross domestic products, the effect of their mini crisis were minimal. The Russian mini crisis was preceded by the financial crisis which broke out in Japan in 1997. Another mini crisis broke out in Brazil in 1999 (Castro 2002). These were all signs of the imperfections of the global financial markets.

According to Castro (2002, p.84) "this time, the inevitable happened: the crisis began in the US almost imperceptibly at first".

Most countries will probably have to redesign their financial regulation in order to prevent another crisis from happening since the 2009 crisis started in US and affected all nations. This regulation may have to be inclusive of large companies other than the financial institutions. In South Africa, enforcing the King 3 report on

corporate governance will be good start or making sure that the King 3 is incorporated into the Companies Act just so that it can be enforceable.

## **2.2 CHALLENGES OF MAROECONOMIC POLICY IN THE TIME OF FINANCIAL CRISIS**

Due to the nature of the integration of global financial markets, each nation will have to review its policies on international investments and exposure.

The current governor of the US Federal Reserve, Bernanke (2006: 1) said “economic and technological changes are likely to shrink effective distances still further in coming years, creating the potential for continued improvements in productivity and living standards and for a reduction in global poverty. However, the effort is well worth making, as the potential benefits of increased global economic integration are large indeed”.

There is no evidence suggesting a failure of global financial systems but the failure is with the regulation of financial systems by the countries in their individual capacities more especially the US. Since the financial crisis began, the South African government has played an important role to support the businesses strained by this financial crisis, most notably the government mandate to Independent Development Corporation (IDC) to create a fund in order to assist ailing companies. The bigger the economies of countries, the more they have been affected by this crisis. South Africa needs to revisit its options for long term growth due to this economic crisis. South Africa cannot continue to rely on foreign direct investment while the country has a flourishing tourism sector.

However, South Africa cannot afford to operate in isolation because of the integration of the world economy. There is a need to sustain the integrated global economic arrangement because it benefits both the developed nations and the developing nations. This point emphasized by Frieden (2006: 7), where he noted that “over the past thirty years, the world economy has become increasingly integrated. The world economy was, despite many problems and periodic crises, characterised by generalised growth and macroeconomic stability”.

Developed economies were seen as if they are doing well as their citizens were benefiting from the economic boom cycles of their economies. These economies did not foresee the downturn and when it happened they were unprepared for it. These economies such as the US, China and other European countries are largely driven by market capitalism. Since the US is a financial hub, what happens in their financial markets is felt by all the countries. Market Capitalism was credited for the boom cycles in many nations and it ought to be discredited even during this bust period. Hence the view is also to interrogate mixed economy as an alternative to market capitalism.

Keynes helped to lay a foundation for the mixed economy as we know it today (Mohr and Fourie 2004). According to Froyen (2009, p. 68) “Keynesian economics developed against the backdrop of the Great Depression of the 1930’s. The unemployment rate rose from 3.2% of the labour force in 1929 to 25.2% in 1933, the low point for economic activity during the Depression. Real gross national product fell by 30% between 1929 and 1933, and did not reach the same level until 1939”.

The latest global financial crisis makes it necessary to revisit Keynes theories on money supply and aggregate demand because of this financial crisis. There is a sense in which that the other element of this crisis was a creation of non-existent money where bonds were sold from person to person or institution to institution without checking the actual value of the asset that was being sold. Froyen (2009, p. 2) said “we might ask to what degree government policies were to blame for the massive unemployment during the Great Depression of the 1930’s or for the simultaneously high unemployment and inflation of the 1970’s”.

Currently, market Capitalism is functioning in many economies around the world. But for it to properly work it needs to be coupled with functioning governments with high levels of economic order. This also has to happen at a global scale as market capitalism is also on a global scale. Also economic bloc such as Southern Africa Development Community (SADC) need to make sure that their members has functioning democracies and good governance both political and business. Similarly Frieden (2006: 25), argued, “Supporters of an open international economy need to work together to build an effective and stable governance structure for international economic interactions. This might include consultation among affected social groups, compensation for those asked to sacrifice, targeted interventions to smooth



transitions and political stability necessary for national political economies to reap the fruits of international economic integration”. These arguments by Keynes are very relevant today when we are facing a global economic downturn. Since the great depression there has been a change on how businesses are owned and managed. It is no longer the owner who manages the business. Global insurance companies own businesses and also pension funds own businesses. In South Africa for example the government pension fund is the biggest investor on the Johannesburg Stock Exchange as depicted in Table 2.1.

**Table 2.1**

<b>Shareholding of PIC on JSE listed companies as at 31 March 2009</b>	
<b>Company name</b>	<b>(% of company held)</b>
1 Alexander Forbes Group	22.85
2 Lewis Group - Limited Lewis	19.25
3 Sasol Limited	18.43
4 New Clicks Group	17.16
5 Investec Limited	16.24
6 Imperial Holdings Limited	15.89
7 Network Healthcare Holdings	15.7
8 Remgro Limited	15.41
9 Mondi Ltd	15.37
10 The Bidvest Group Limited	15.08
11 Metropolitan Holdings Limited	14.78
12 Tiger Brands Limited	14.69
13 Telkom SA Limited	14.57
14 Super Group Limited	14.25
15 Steinhoff International Holdings	14.13
16 Woolworths Holdings Limited	13.96
17 Aveng Limited	13.79
18 AECI Limited	13.77
19 Murray & Roberts Holdings	13.76
20 Brait SA	13.7
21 Spar Group Limited	13.6
22 JD Group Limited	13.24
23 Barloworld Limited	12.96
24 Sanlam Limited	12.96
25 Adcock Ingram Holdings	12.92
26 Shoprite Holdings Limited	12.32
27 JSE Limited	12.22
28 Standard Bank Group	12.06
29 Truworths International Limited	11.87
30 Allied Electronics	11.86
31 Purple Capital Limited	11.76
32 Sentula Mining Limited	11.68
33 MTN Group Limited	11.68
34 Massmart	11.35
35 Business Connexion Group	11.31
36 Eqstra Holdings Ltd	11.3
37 Reunert Limited	11.2
38 Astral Foods Limited	11.12
39 Austro Group Ltd	10.37
40 Naspers	10.22

Source: [www.pic.gov.za](http://www.pic.gov.za)

There is a sense in which the owners of capital drive the working class to buy more and more expensive goods by credit. This is done by use of vigorous marketing and employing technology until the debt of the working class becomes unbearable. The unpaid debt will lead to bankruptcy of banks which will have to be nationalized by the State. South Africa has been saved from this eventuality by the National Credit Act which protects consumers from themselves and from the sellers of credit. But, even though South Africa did not escape the side effects of the global financial turmoil, its financial institutions had minimal exposure to the global credit market. This was largely caused by the limitations of offshore investments by a single investor. Therefore, how South Africa faces these macroeconomic challenges during the time of global economic crisis becomes very important.

## **2.3 THE ROLE OF GLOBAL INSTITUTIONS**

The International Monetary Fund (IMF) and the World Bank also known as Bretton Woods Institutions were created to provide capital in the global financial system and to monitor the usage of those funds by those who borrowed from these institutions. Most countries who experienced shortages in their balance of payments borrowed funds from the IMF to close the gaps. IMF is also charged with monitoring the global economic environment and that of the individual countries.

In the words of Stiglitz (2002, p. XII) “the International Monetary Fund (IMF) policies, in part based on the presumption that markets, by themselves, lead to efficient outcomes, failed to allow for desirable government interventions in the market, measures which can guide economic growth and make everyone better off”.

Because of the global nature of this financial crisis, it becomes imperative to seek solutions that are global and it is necessary for global institutions to assist in this regard. This crisis also threatens the millennium development goals such as reducing poverty drastically by 2015. Due to this crisis levels of poverty are likely to rise globally and unemployment rate is likely to rise. During the current global financial crisis the role of the IMF and the World Bank have come under scrutiny and on the main questions about their relevance have been raised. This is due to the failure by IMF to warn its members about a possible outbreak of financial crisis

despite the fact that there has been crisis in Japan, Brazil and Russia just in the past fifteen years.

According to Stiglitz (2002, p. 14) “the IMF was supposed to limit itself to matters of macroeconomics in dealing with a country, to the government budget deficit, its borrowing from abroad; its monetary policy, its inflation, its trade deficit”.

There is a sense that IMF has failed on its global mandate because of the global financial crisis which the world experienced. Also the World Bank has failed on its mandate to be a watchdog of nations on how their government spend the budget and also monitoring each country’s financial institutions. Countries with little foreign exchange are likely to suffer more during this period of economic meltdown and they will be looking up to IMF for assistance. So the IMF should create a macroeconomic environment in order to help distressed nations deal with the financial crisis.

Therefore, IMF was unable to perform its task hence the questions around its relevance and because of the crisis it also needed to assist countries who had severely been affected by the crisis. Most of those countries needed to rebuild their economies and revive their labour markets because people lost their jobs during the crisis but IMF also failed on this task.

This current global economic crisis should make nations to relook the fundamentals of their economic development as sovereign states. IMF should in this regard be able to play an advisory role for nations to develop policy frameworks that will assist nations regain control of this financial crisis. There is a need for global institution to play a pivotal role on how nations are governed as a preventative measure because failing to do so is too ghastly to contemplate. The reason being that failed states normally would seek for funding from global institutions but these states fail in front of these very same institutions. This can be done without compromising the sovereignty of these states.

The G20 looked at the following matters in relation to the global economic crisis:

- Stabilising the global financial system,
- Countering the economic downturn,

- Ensuring resources and means of preventing a collapse in developing economies, and
- Securing an open and fair trade and finance system for the long-term (Manuel, 2009).

The most urgent task for nations was stabilising the global financial systems to curb the impact of the crisis. Countries needed to put intervention measures in place even if they are short term then each country also needed to have counter strategies around the future reoccurrence of economic downturn crisis. The US government took large shareholding of that country's major banks, while South Africa engaged with the Independent Development Corporation to assist the struggling small business to avoid retrenching staff and closing down. Key to South Africa's strategy was savings jobs and skilling the citizens (internet 21).

The G20 has also discussed the need to:

- Broaden effective regulation to all systemically important institutions,
- Ensure the registration and regulation of hedge funds,
- Call for registration and compliance with relevant codes of all Credit Rating Agencies whose ratings are used for regulatory purposes,
- Reinforce macro-prudential oversight,
- Enhance the counter-cyclical effects of financial regulation, and
- Strengthen international regulatory cooperation" (internet 2).

If the G20 does apply the above measures, global financial institutions will surely be stronger than before. The issue with the G20 is commitment of other nations who are outside the G20 who should perhaps should discuss this particular crisis at the forums such as the African Union or even within the trade blocs such SADC or ECOWAS (internet 6).

Some of the key role players in implementing some of the recommendation by the G20 are the reserve banks of nations. Among other things the South African Reserve Bank has committed to do is:

- "Identify systemic threats at an early stage;
- Promote measures to reduce these threats;

- Develop and test contingency plans and crisis preparedness; and in extreme cases, implement safety net measures to support systemically important financial institutions, maintain confidence in financial markets and restore the efficient functioning of markets” (internet 3).

The South African Reserve Bank has a capacity to identify these threats and reduce them at an early stage. But the reserve bank also needs to work with commercial banks in putting safety measures to protect the financial institutions of South Africa. Because of the crisis South Africa went into recession which made it difficult for commercial banks to lend to households and firms. Corporate South Africa reported losses and some firms for the first time in many years. The results of those losses were weaker commodity, property and equity markets (internet 8).

Nations of the world need to work together in order to save the global economy from this financial crisis and put measures in place to prevent future occurrences of a financial meltdown. If countries do that at the global level, they may be able to save jobs in their sovereign states. Therefore national and regional financial authorities and institutions should make contributions to the global regulatory reform and South Africa as a member of the G-20 should be taking the lead on behalf of Africa as a whole (internet 6).

Given the changing landscape of the world economy and the failure of today's multi-lateral institutions to provide a collective response to the crisis, a rethink of the global financial system is required. The global financial system need to be reformed from policymaking to implementation (internet 6).

## 2.4 GOVERNMENT INTERVENTION

Like other nations in the world South Africa is also facing a challenge of dealing with the global financial crisis and the country needs to revisit its macroeconomic policy stance both the fiscal and monetary policies. Also South Africa should review its banking sector structure (even though this sector proved to be strong during this financial crisis) and its regulatory systems. Nonetheless, the view is not to over regulate such that it becomes too difficult to do business in South Africa because that too will slow down the economy as Adam Smith once observed (internet 18).

Buchholz (1999, p. 40) "Adam Smith generally believed in a limited national government, fewer social welfare programs, less government price regulation, and less federal intervention in and aid for local government affairs; the free market would provide most of what citizens require in life". But Keynes had a different viewpoint on this matter. Cited by Schiller (2007, p. 255), Keynes commented that the "private economy was inherently unstable. The inherent instability of the marketplace required government intervention".

So the fiscal policy and monetary policy are some of the tools which government can use to manage or regulate the economy of any nation. In this respect Schiller (2007, p. 288) asserted: "the threat of inflation suggests that fiscal restraint may be an appropriate policy strategy at times. If excessive aggregate demand is causing prices to rise, the goal of fiscal policy will be to reduce aggregate demand, not to stimulate it". In South Africa the reserve bank controls the interest rate as it has an inflation targeting policy.

In addition, Schiller (2007, p. 290) stated that "the policy goal is to match aggregate demand with the full employment potential of the economy. The tools of doing so are (1) changes in government spending and (2) changes in tax rates".

In the face of recession, the government has reasons both to cut taxes and to increase its own spending. By reducing tax revenues and increasing expenditures simultaneously. South Africa, in this instance should carry on with its infrastructure

development programme but, that does not suggest that these programme should be funded by debt sourced from outside. A monetary stance becomes necessary where government could make use of government bonds to fundraise but also look at reducing the tax bracket for middle income earners while also dropping interest rate to stimulate business growth.

As Schiller (2007, pp. 362-363) suggests, “Modern Keynesians acknowledge that monetary policy might also help during recession. Specifically, increases in the money supply may lower interest rates and give investment spending a further boost”.

In order to revive the economy during recession government has to cut taxes and increase its spending and through the South African Reserve Bank the government could also increase the money supply and these measures could boost consumer confidence and raise investor expectations (Schiller, 2007). Froyen (2009, p. 321) stated that “monetary policy is completely ineffective if the exchange rate is fixed, and fiscal policy is completely ineffective if the exchange rate is flexible”.

The role of every government though is to look after the citizens of its country by making sure the poor is lifted out of poverty and people are encouraged to have saving accounts. The South African government should also create an entrepreneurial spirit among the citizens therefore government policies should be aimed at enhancing this viewpoint. Government policy should permit or support global economic integration and South Africa should also work hard at promoting regional economic integration in order for Southern Africa Development Community (SADC) to have common standards for financial market development and be able to remove cross border trading barriers within SADC nations. South Africa has also entered into recession for the first time in 10 years (internet 2)

## 2.5 THE IMPACT OF THE CRISIS GLOBALY

The global financial crisis was deeply rooted on the fact that globalisation of businesses meant that what happened in the United States is felt all over the globe. Also, the imbalances of global economies such as trade balances, asset prices and exchange rate fluctuations exacerbated the problem in some economies more than the others (internet 4).

The financial crisis was characterized by:

- “Severe dysfunction in the banking sectors including interbank lending;
- Disruption of world credit markets;
- Reduction in residential mortgage financing, which is causing downward pressure on already weak housing prices;
- Collateral damage to commercial real estate and other asset classes;
- The deterioration of capital flows and financing conditions for emerging economies” (internet 4).

The good thing out of this crisis is that it has managed to force a review of the global financial systems as far as regulation is concerned. Also it has managed to make people question the role of the fundamental global financial institutions such the International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO). The United States and United Kingdom which are among the wealthiest nations started to put up bail out plans for their economies which meant that the companies who were actually responsible for the crisis would get funding from the state in order to function. They did that because not doing so would have meant that more jobs would continue to be lost. As mentioned earlier that in South Africa then only plan government did put in place was the re-skilling programme of workers who are about to be retrenched hoping that when the economy turns around those workers would find themselves back to the job market. In as much this plan may assist South Africa in the long term view as the country has skills shortage but it is not what business is looking for in the short term as business is currently struggling now (internet 6).



## **2.6 LESSONS FROM THE CRISIS**

This global financial crisis has highlighted the importance of regulating the financial sector in order to make sure it remains stable. The crisis has also increased the resolve that central banks need to have more input and understanding of the financial sector more especially the banking sector. This was not the first financial crisis as Castro (2002) illustrates but the earlier ones were ignored.

The US has benefited a lot from globalisation but this benefit was not as a result of production. The capitalist society changed the industry focus from production and trade to stocks and bonds which actually involved a lot of speculation. Lessons from the great depression of 1939 in US were all forgotten (Castro, 2002).

Castro (2002, p. 83), noted that “Every day \$3 trillion were involved in speculative operations including currencies and stocks. Stock prices on US exchanges were rising, often with no relation whatsoever to the actual profits and revenue of companies. Nobody seemed to realise that any apparently insignificant occurrence in the economy of one region of the world could shake the entire structure of the world economy”.

In the 1<sup>st</sup> quarter of 2009 what happened in the US did shake the economies of the World. Therefore, in view of what happened, governments globally need to review their economies whether at policy level or by way of intervention. In the US many of the banks are still functioning due to massive financial bailout packages provided by the state and invertible by tax payers. Therefore, governments of nations need to have a policy in place to make sure that these bankers are in line with the view of government at least at policy level, and this calls for compliance on the part of the banks. Perhaps, it is vital to look at the three broad schools of macro-economic theory (internet 6).

### **2.7.1 The Keynesian Theory of Monetary and Fiscal Policies**

A Keynesian macroeconomic model argues that the economy would rarely operate at full employment and that to achieve and maintain full employment, active help from fiscal and monetary policy is required (internet 21).

**Transaction Demand:** Money is a medium of exchange, and individuals hold money for use in transactions. Money bridges the gap between the receipt of income and expenditure. The amount of money held for transactions would vary positively with the volume of transactions in which the individual engaged. Income is assumed to be a good measure of the volume of transactions, and thus the transactions demand for money is assumed to depend positively on income.

Money received in one transaction can be used to buy bonds, which can then be sold to obtain money again when the time comes for expenditure. The gain from doing so is the interest earned for the time the bonds were held. Brokerage fees involved in buying bonds and the inconveniences of a great number of such transactions would make it unprofitable to purchase bonds for small amounts to be held for short periods. Keynes did not emphasize the interest rate when discussing the transactions motive for holding money, but it has proved to be important, especially for the business sector. Firms with a high volume of transactions can, by cash management practices, reduce their average money holdings. The incentive to make the expenditures required for cash management depends on the rate of interest (Froyen, 2009).

**Speculative Demand:** Keynes began by asking why an individual would hold any money above that needed for transactions and precautionary motives when bonds pay interest and money does not. Such an additional demand for money did exist, Keynes believed, because of the uncertainty about the future interest rate and the relationship between changes in the interest rate and the price of bonds. If interest rates were expected to move in such a way as to cause capital losses on bonds, it was possible that these expected losses would outweigh the interest earnings on the bonds and cause an investor to hold money instead. Such money would be held by those speculating on future changes in the interest rates (Froyen, 2009).

**Monetary Policy:** The defining feature of real business cycle models is that real, not monetary, factors are responsible for fluctuations in output and employment. In such a model, the role of money is to determine the price level, much the same as in the original classical model. Changes in the quantity of money result in proportionate changes in the price level with no alteration in output or employment. It follows, then, that monetary policy should focus on controlling the price level. A desirable monetary policy would result in slow, steady growth in the money supply and thus stable prices, or at least a low rate of inflation. When fiscal policy is considered, however, there an alternative view of the optimal conduct of monetary policy emerges from the real business cycle theory. In any case, there is certainly no role for activist monetary stabilisation policy of a Keynesian type. Monetary policy cannot affect output and employment, and even if it could, it would be suboptimal to try to eliminate the business (Froyen, 2009).

**Fiscal Policy:** From the Keynes viewpoint it can be concluded that Keynes believed that fiscal policy plays a major role in economic activities of the country. Be that as it may, monetary policy is also a vital tool in the economy, more especially for short measurements, because the monetary policy tools can be adjusted on a monthly basis or bi-monthly in the case of South Africa, therefore, monetary policy has strong effects. In South African the role of monetary policy has been questioned by Labour movement and the left more especially their tool i.e. inflation targeting (Buchholz, 1999).

### **2.7.2 The Classical View & Monetarist View**

Classical economists believe that the economy is self-regulating and always at full employment. The classical school of thought views business cycles fluctuations as efficient responses of a well-functioning market economy that is bombarded by shocks that arise from the uneven technological change. This technological change having the most influence on both aggregate demand and aggregate supply curve. This technological change also lengthening the useful life of existing capital decreases the demand for new capital, which decreases aggregate demand. The money wage rate that lies behind the short-run aggregate supply curve is instantly and completely flexible. The money wage rate adjust so quickly to maintain

equilibrium in labour market that real GDP always adjust to equal potential GDP. Therefore, the classical viewpoint emphasizes the potential for taxes to stunt incentives and create inefficiency. By minimising the distinctive effects of taxes, employment, investment, and technological advance are at their efficient levels and the economy expands at an appropriate and rapid pace (internet 21).

Monetarist viewpoint believes that the economy is self-regulating and that it will normally operate at full employment, provided that monetary policy is not erratic and that the pace of money growth is kept steady. In the monetary view, the quantity of money is the most significant influence on aggregate demand. In the monetarist viewpoint all recessions result from inappropriate monetary policy (internet 21).

For South Africa to have a sustainable and balanced growth, it needs to investigate policies that that will allow the country to achieve faster growth with more job creation. Those policies among other things should look at reducing the costs of doing business in South Africa an investigating a way of relaxing the stringent labour laws put in place by the South African government. Therefore, the role of monetary policy is vital in supporting sustainable growth by making sure that a low and stable inflation rate will manage to reduce the long term costs of borrowing (internet 4).

## **2.7 SUMMARY**

This literature review actually shows that if the structure of financial markets is left unregulated or unmonitored, there will be other financial downturns even if they are not that severe. There is clearly a need for government intervention and monitoring in order to prevent another economic downturn. Also it has become clear that there is no backup plan to deal with a financial crisis because most nations were found wanting during this period of economic meltdown. The other recent financial crises were not seen as important because they did not have an effect to the rich nations.

Keynes sought to explain how a deficiency of demand could arise in a market economy and then show how and why government had to intervene. He was convinced that government intervention was necessary to achieve our macro-economic goals, particularly full employment. To that end, Keynes advocated

aggressive use of fiscal policy, that is, deployment of government tax and spending powers to alter macro-economic outcomes.

There is a sense in which banks more especially in the US have been making up profits where they had losses by overvaluing their assets and when this caught up with them, an economic decline started. But regulating only the banking sector will not solve future occurrences of financial meltdown even though the blame for this particular financial crisis should be put squarely on the banking sector. Regulation need to be expanded to include other large corporations just so that they don't borrow recklessly.

This chapter also showed that the 2009 global financial crisis is different from the other financial crisis that happened in Brazil, Japan and Russia in the past 15 years as it is global in nature. This crisis also warranted intervention from the state in many nations including South Africa.

It is also clear that the main cause of the 2009 global financial crisis was the reckless lending coupled with careless borrowing which started in the United States and affected all the nations of the world. Also this chapter showed that the IMF and the World Bank need to change their approach or these institutions must be transformed and their mandate relooked.

# **CHAPTER THREE**

## **RESEARCH METHODOLOGY**

### **3.1 INTRODUCTION**

This chapter considers the research methodology to be used to study the impact of the global financial crisis on South African economy. The research methodology is discussed by considering the research design, data requirements, data collection procedures and proposed analysis of the study. The purpose of this study is to provide outlook of on the South African Financial and Mining sector during the period of the global economic downturn. The focus falls on these two sectors because they are among the sectors that drive economic growth in South Africa.

### **3.2 RESEARCH DESIGN**

Research designs contain assumptions at their core, and all have certain requirements in order to work well. Because of this, research designs have their limitations and are better suited to some types of problems than others (Hofste, (2006). Cited by Bryman & Bell (2007, p. 28), Layder pointed out that “many writers on methodological issues find it helpful to distinguish between quantitative and qualitative research. The status of this distinction is ambiguous, because it is almost simultaneously regarded by others as no longer very useful or simple as false”.

The distinction between quantitative research and qualitative research is a very fundamental one and important to be able to know why a particular approach was adopted for a study. This relates to the type of research methodology employed for a particular study and the study indicates a process followed mainly the data collection, interpretation of that data and the writing of a thesis which leads to quantitative research (Bryman & Bell, 2007). Thus, this study will represent a quantitative research.

### **3.3 QUANTITATIVE RESEARCH**

Page & Meyer (2000, p. 17) said “Quantitative approach places greater value upon information that can be numerically manipulated in a meaningful way, and this is the traditional scientific approach to research”.

Bryman & Bell (2007, p. 28) identified the following characteristics of quantitative research:

- Entails a deductive approach to the relationship between theory and research, in which the accent is placed on the testing of theories.
- Has incorporated the practices and norms of the natural scientific model and of positivism in particular.
- Embodies a view of social reality as an external, objective reality.

In some cases researchers find themselves not involved with their subject because of the nature of the work being researched. The research may require respondents to post their responses and mainly happens in qualitative research (Bryman & Bell, 2007).

Bryman & Bell (2007, p. 425) indicate that “Sometimes, this lack of a relationship with the subjects of an investigation is regarded as desirable by quantitative researchers, because they feel that their objectivity might be compromised if they become too involved with the people they study. The qualitative researcher seeks close involvement with the people being investigated, so that he or she can genuinely understand the world through their eyes”.

#### **3.3.1 Criticisms of Quantitative Research**

Bryman & Bell (2007, p. 174) made the following critique of quantitative research: Quantitative researchers fail to distinguish people and social institutions from the world of nature.

- The measurement process possesses an artificial spurious sense of precision and accuracy.
- The reliance on instruments and procedures hinders the connection between research and everyday life.

- The analysis of relationships between variables creates a static view of social life that is independent of people's.

A researcher may be able to predict or explain certain matters using a deductive process or hypothesis and theories tested to develop generalisations. In this instance concept, variables, and hypotheses get to be known before the study begins and remains like that for the duration of data collection and analysis (Given & Olson, 2003).

### **3.4 METHOD OF DATA COLLECTION**

This study identified the period of the global economic downturn as an abnormal period in the economic activities of South Africa and analyses the developments during that period. The impact of the global economic meltdown in South African markets requires accurate data that is constantly monitored. This study had to rely on credible and reliable sources of information. Secondary data has been gathered from the websites and used in this study.

The “big four” banks in South Africa (ABSA, Standard Bank, First National Bank and Nedbank) produce and analyse data on a weekly, monthly, quarterly and annual basis. They acquire some of the data from the South African Reserve Bank, Statistics South Africa and Johannesburg Stock Exchange. These institutions also create their own data and provide economic forecasts based on the data they have collected from their own clients on a daily basis. These institutions store this data because they have a vested interest in this information as the money which they loan from the South African Reserve Bank is securitized by the mortgages on the home loans which they grant.

The South African Reserve Bank (SARB) is seeking to increase its emphasis on the macro prudential aspects of the financial system as a whole, and to formalise structures and resources devoted to this task. A Financial Stability Committee was established with a mandate to enhance financial stability by continuously assessing the stability and efficiency of the financial system, formulating and reviewing



appropriate policies for intervention and crisis resolution, and strengthening the key components of the financial system. (Internet 8).

Statistics South Africa provide an indispensable element in the information system of a democratic society, serving the Government, the economy and the public with data about the economic, demographic, social and environmental situation. To this end, official statistics that meet the test of practical utility are to be compiled and made available on an impartial basis to honor citizens' entitlement to public information. To retain trust in official statistics, Stats SA decides, according to strictly professional considerations, including scientific principles and professional ethics, on the methods and procedures for the collection, processing, storage and presentation of statistical data. To facilitate the correct interpretation of data, Stats SA will present information according to scientific standards on the sources, methods and procedures of statistics. Data for statistical purposes may be drawn from all types of sources, be they statistical surveys or administrative records. Stats SA will choose the source with regard to quality, timeliness, costs and the burden on respondents (internet 9).

### **3.5 DATA SELECTION**

The need for accuracy of the data is the reason why secondary data are preferred to primary data. Secondary data are also preferred due to the comprehensiveness they offer, as they comprise all trading data in South Africa for a particular period. Primary data with the same comprehensiveness as secondary data are not available due to lack of resources on the part of the individual researcher. This makes the collection of primary data at the required level of completeness and accuracy impractical (Kalipershad, 2007).

Sampling the resources sector and financial services sector from the total population of sectors that constitute the gross domestic product (GDP) of South African economy led to representative data as two sectors are major contributors in the GDP of South Africa. In this research the population is composed by all the sectors that contribute to the GDP of South African economy as these sectors are relevant population for this study. A sample representing elements of the population in order to draw conclusions about the entire population is welcomed in research since the

population is too large to target. Since this research attempts to find out the impact of the global economic crisis on the South African economy it would be only natural to target the sectors that constitute the South African economy. The study aimed to provide the most accurate analysis to ensure that its results are credible. Therefore, in the light of the above statement, only credible secondary data sources were chosen.

Research data collected from the sample were analysed and deductions have been made in order to address the issues researched. A deductive approach for this research has thus been used.

### **3.6 ISSUES OF RELIABILITY AND VALIDITY**

Bryman and Bell (2007, p.162) maintain that validity in qualitative research refers to the fact that the observer is observing, identifying, or 'measuring' what they say they are. These authors also refer to internal and external validity. They maintain that internal validity refers to whether or not there is a good match between researchers' observations and the theoretical ideas they develop, while external validity refers to the degree to which findings can be generalized across social settings.

Bryman and Bell (2007, p.176), also point to the importance of internal and external reliability in discourse analysis. External reliability refers to the degree to which a study can be replicated, which is a difficult criterion to meet in qualitative research, and internal reliability which refers to whether or not, when there is more than one observer, members of the research team agree about what they see and hear.

There is a concern regarding the validity and reliability of the findings in the study in that, although the author's findings may have relevance, according to ([www.ischool.utexas.edu](http://www.ischool.utexas.edu)) discourse analysis always remains a matter of interpretation. As no hard data is provided through discourse analysis, the reliability and the validity of one's research/findings depends on the force and logic of one's arguments. Even the best constructed arguments are subject to their own deconstructive reading and counter-interpretations. The validity of critical analysis is, therefore, dependent on the quality of the rhetoric. Despite this fact, well-founded

arguments remain authoritative over time and have concrete applications (Internet 10).

### **3.7 CONCLUSION**

The data requirements for this study have been assimilated by considering data sources that are relevant and credible. Also issues of validity and reliability of the have been assessed. Secondary data has been used on this study mostly from internet sources and research documents of institutions.

This chapter provided an introduction to the principles of scientific research such as population and sampling, method available for the chosen study and validity and reliability of the sources and data. Chapter Four represents the analysis of the impact of the global financial crisis on South African economy.

## **CHAPTER FOUR**

### **PRESENTATION AND INTERPRETATION OF RESULTS**

#### **4.1 INTRODUCTION**

The global financial crisis affected deeply the South African economy and the country also finds itself getting into recession during this same period of the financial crisis. This financial crisis started at the US and found its way to all the countries due to the nature of global financial institutions. In South Africa the effects of the crisis have been felt by all the sectors of the South African economy including the labour sector. During this period of the crisis there has been a decline in consumption and savings and credit became scarce, business investments declined, unemployment increased and stock market fell. The South African economy is mainly driven by the agricultural sector, the resources sector, the manufacturing sector and lately the services sector.

The Reserve Bank financial stability review states that “the impact of the global economic slowdown on real economic activity in South Africa is also evident in the retrenchments and business closures particularly in mining and manufacturing. In the motor industry, for example, the drop in domestic and especially export demand and the resulting production cuts are a reflection of a sales slump in the rest of the world” (internet 8).

South Africa’s banking sector, in particular, is considered to be the eighth most developed among world economies with populations in excess of 20 million individuals. With a substantial footprint in Africa and increasing access to emerging markets, domestic banks boast of a sound foundation in business and banking acumen. This sector is highly regulated in South Africa using the following means:

- The Financial Sector Charter (FSC) reviews performance of all relevant institutions toward the targets set by the charter. The purpose of the initial review was to establish the transformation status of the industry and to assess progress in implementing the charter.

- The Financial Advisory and Intermediary Services (FAIS) Act, which came into effect in October 2004 and focuses on the skills and competence of those involved in the financial sector.
- National Credit Act (NCA), which came into effect on 1 June 2007 and brings about major changes in credit granting processes. The NCA not only reflects the minimum legal requirements for an efficient and responsible credit lending industry but is enacted to impose greater consumer protection while contributing to improved accessibility to the credit market. The NCA applies to every credit agreement granted as of 1 June 2007, and plays a key part in assisting and informing consumers on how to borrow responsibly. The credit lending institutions in turn will also now be more accountable for the decisions made in credit lending. While the new lending criteria may stem overall credit growth, they may lead to changes in market share by opening new markets or opportunities for banks.
- the new Basel Accord (Basel II), which was implemented on 1<sup>st</sup> January 2008, sets new recommendations for measuring the adequacy of the banks' capital. (internet 8).

The housing market was to a certain extent protected by the NCA because the act protected the consumer not to borrow more than they can afford. Unlike in the US where people could for example take a second bond of \$250 000 on a house worth \$180 000. Then people will use the extra cash on luxuries that were not income generating. When they could not afford to make repayments in large numbers, then the bubble burst because money that did not exist was created in the economy and it was used.

## **4.2 OVERVIEW OF THE SOUTH AFRICAN ECONOMY**

The mineral industry is a well-established and resourceful sector of the economy, has a high degree of technical expertise and the ability to mobilize capital for new development. Mining is South Africa's largest industry in the primary economic sector, followed by agriculture. Other sectors that contribute significantly to the country's economy are: manufacturing, electricity, building and construction. The

wholesale, retail, tourism, financial services, information and communications sectors also continue to show significant growth (internet 4).

## 4.2.1 The Inflation and Interest Rates

Figure 4.1

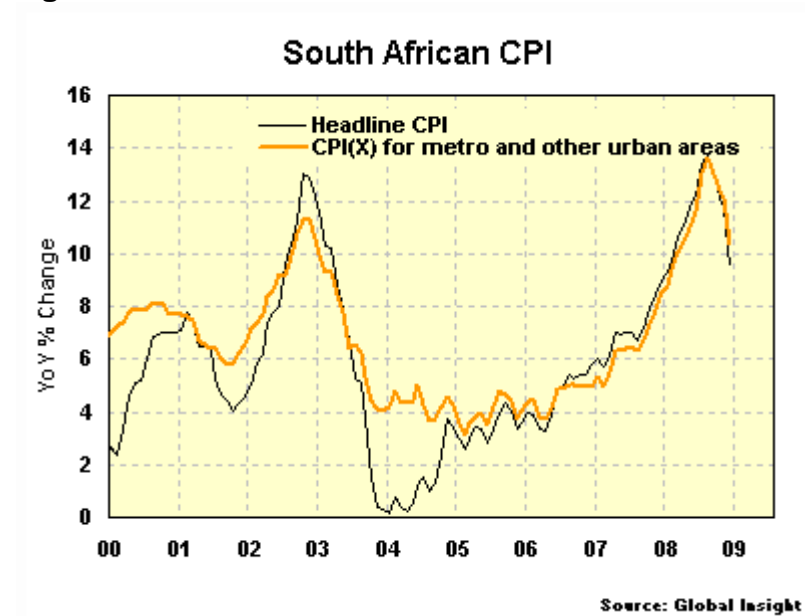


Figure 4.1 shows that in year 2000 the headline inflation of 7% and in the 2<sup>nd</sup> half of 2002 the CPI moved to just below 6%. In the last quarter 2004 it reached 4% and also in the 4<sup>th</sup> quarter of 2006. From there it rose to a high of 13.8 % by mid 2008 (for the first time in a decade) and ended at 10.2% at the beginning of 2009.

The effect of dropping gasoline (petrol) prices in December 2008 compared with rising fuel prices in December 2009 pushed the inflation rate to above the upper target of the inflation-targeting band i.e. (3%-6%). Improved growth prospects both globally and locally along with effects following electricity tariff increases in the economy are expected to exert upward pressure on prices towards the end of 2010 (internet 13).

## 4.2.2 The Rand

Figure 4.2

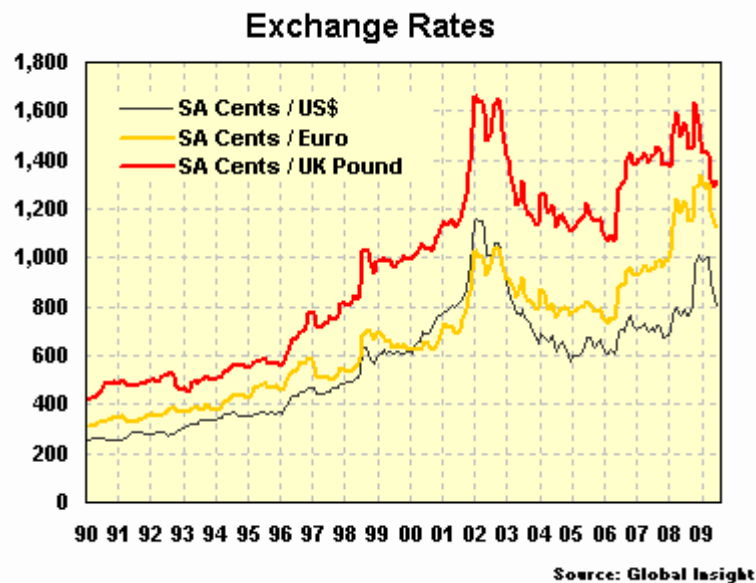


Figure 4.2 shows that in the 1990's the rand/dollar exchange of R4 to the dollar. Then it rose R6 in 1996 and in 1999 it reached R10. In year 2002 it reached the highest ever in the decade (R16.20) and that necessitated an investigation by government through the Myburgh commission (internet 22). Thereafter it kept on dropping back to R10.40 by year 2006. The rand has been extremely volatile since the start of the 2009 establishing a general trading range of between R14.00/USD and R12.00/USD.

However, towards the end of March 2009 and during much of April 2009 the rand recovered lost ground as risk aversion retreated on growing hopes that the worst of the global banking crisis could be over and that the trough in real economic activity may be near. Despite this, the rand is likely to remain volatile and face periods of renewed weakness during periods of increased risk aversion caused by the reactions to the economic downturn. Due to its high reliance on portfolio inflows, the already large current account deficit placed the economy in a vulnerable position (internet 13).

## 4.2.3 The Foreign Trade

**Table 4.1 South Africa's imports and exports (2006)**

Exporters	Trade Indicators	
	Imported 2006, USD thousand	Share in South Africa's imports, %
World	69,184,820	100
	Trade Indicators	
Importers	Exported value 2006, USD thousand	Share in South Africa's exports, %
World	53,169,880	100
NET Trade Value	-16,014,940	

Source: [www.trademap.org](http://www.trademap.org)

**Table 4.2 South Africa's imports and exports (2009)**

	Exports in value (USD)	Imports in value (USD)	Net trade in value (USD)
<a href="#">All industries</a>	53,861,918	63,767,900	-9,905,982

Source: [www.trademap.org](http://www.trademap.org)

In order for South Africa to enter a higher economic growth on a sustainable basis, growth in net exports is an imperative vehicle to fundamentally alter the economy's growth rate. Global economic growth will play a material role in this regard, particularly in respect of South Africa's major global trade counterparts and regional counterparts. In this regard South Africa's net trade was -\$16 billion in year 2006 (as shown in table 4.1) and this figure was reduced to -\$9.9 billion in year 2009. Tables 4.1 and 4.2 show that the main cause for the reduction was the fact that South Africa's imports to the world were reduced by \$5 billion between year 2006 and 2009 while the exports slightly increased from &\$53.1 billion in 2006 to \$53.8 billion in 2009.

The strengthening of current and exploration of new, trade relations will continue to dominate government's export oriented trade agenda. Import volumes and prices fell sharply in response to weaker domestic demand and the collapse in global oil prices, while export volumes and prices declined on the back of weak global demand and sharply lower international commodity prices. The economy lost momentum in the second half of 2008, hampered by a deteriorating external environment and high



interest rates. Although the country has escaped the direct effects of the global banking crisis, the collapse in commodity prices and increased risk aversion have affected exports as well as capital flows and financial market.

The global recession exerted opposing forces on the current account deficit. Import and export prices and volumes declined.

### **4.3 RECESSION IN SOUTH AFRICA**

South Africa's economy is intertwined to the global economy and although the country has low levels of external debt, a flexible exchange rate and sound fiscal and monetary policies afforded it some protection in the initial phases of the global financial crisis, it was inevitable that it would ultimately be affected. South Africa has contracted for the first time in 10 years with GDP declining by 1.8 % in the final quarter of 2008. Gold production dipped 13.6% to the lowest level since 1922 (internet 12).

The labour market has been affected by the crisis as businesses close down when feeling the impact of the global financial crisis. Nonetheless South Africa is one of the countries that proved to have strong financial institutions and regulations that provided a much needed cushion during this financial crisis but that was not enough to prevent S.A. getting into recession as the following figure depicts.

In South Africa, the real seasonally adjusted GDP grew at an annualised 3.2% in the fourth quarter of 2009, compared with growth of 0.9% in the third quarter of 2009. The seasonally adjusted real value added excluding agricultural industries for the third quarter of 2009 increased by 3.8% following an increase of 1.8% during the third quarter of 2009. On an annual basis, real GDP contracted by 1.6% year-on-year (y/y) from a contraction of 2.6% y/y in the previous quarter. For the year as a whole, real GDP growth dropped by 1.8% following the previous year's growth of 3.7% (internet 9).

**Table 4.3****Real gross domestic product**

	2007	2008		2009	
Sectors					
	Year	1 <sup>st</sup> half	2 <sup>nd</sup> half	1 <sup>st</sup> half	2 <sup>nd</sup> half
Primary Sector	0.8	-2.17	5	0.9	-11.8
Agriculture	2.9	20.4	23.9	18.8	-2.3
Mining	0.0	-11.4	-0.2	-6.5	-16.8
Secondary Sector	6.1	5.8	-3.5	2.9	-12.7
Manufacturing	4.5	5.4	-7.4	1.2	-19.4
Electricity, gas & Water	3.0	-3.6	0.3	-1.2	-5.0
Construction	17.1	13.6	12.4	13.9	13.1
Tertiary Sector	5.4	3.4	1.9	3.5	-0.1
Commerce	5.2	1.5	-4.5	0.5	-2.4
Transport & Communication	5.6	3.7	3.8	4.0	-0.7
Financial & other Services	6.8	4.1	3.2	5.0	-1.0
Non-Agricultural Sector	5.2	3.1	0.4	2.8	-4.2
TOTAL	5.1	3.5	0.9	3.1	-4.5

**Source:** <http://www.reservebank.co.za>

After a long period of uninterrupted economic growth, South Africa's real gross domestic product declined at a seasonally adjusted and annualised rate of 1,8 per cent in the fourth quarter of 2008 (as shown in table 4.3). Also, Table 4.3 shows that in the second half of 2009 real gross domestic product contracted further at an annualised rate of 4,5 per cent. This could be attributed to the sharp and synchronised decline in global economic activity during the second half of 2008, which continued into the first half of 2009. South Africa experienced its first recession since 1992. Real growth ran out of steam in the first three quarters of 2008, falling below trend and signalling the onset of a downswing, which intensified as growth subsequently turned negative.

The construction sector showed positive contributions to real GDP in the first half of 2009. Investors' fears around the impact of the credit crisis led to capital outflows, especially from emerging markets.

Table 4.3 shows that the contraction in real value added by the mining sector proceeded at an annual rate of 6,5 per cent in 2008, but became more pronounced as it shrank at an annualised rate of 16,8 per cent in the first half of 2009, mainly on account of a decline in output volumes of the non-gold segment of the industry. The

buoyant foreign demand for basic metal and mineral products, still evident in the early part of 2008, reversed rather quickly from the middle of 2008 when the global financial crisis led to a recession in many countries. These demand constraints, coupled with the sharp decline in commodity prices, subsequently prompted the South African mining industry to scale down output. The SA economy will most likely recover in Q1.10, due both to the earlier resumption of global economic growth and the boost received from preparations for the soccer world cup (internet 8).

Table 4.3 reflects how South Africa's is clearly taking strain as its GDP started shrink in the last two quarters of 2008 and the 1<sup>st</sup> quarter of 2009. The real GDP slowed to 3% as the S.A entered recession and the slowdown clearly deepened in 2009. The shrinkage of the economy will be larger if the government does not focus on infrastructure spending and therefore making sure that consumers feel at least some relief from lower inflation and interest rates. The contraction in real GDP in the first quarter of 2009 formally confirmed that the South African economy is in recession. Thus far, short-term indicators show that the second quarter will still be negative.

The SARB shifted their concern from stimulating growth back to inflation-targeting and pointed out (in the May 2009 meeting) that the easing cycle is over. The Repo rate is therefore expected to remain on hold for the rest of the year. On account of slower economic activity, the current account deficit will narrow. Portfolio inflows are increasing in line with the improving global risk appetite, making the financing of the deficit less problematic. As a commodity currency, the rand will benefit from a combination of commodity price rebound and global economic recovery, and is expected to remain strong. Conventional bonds have seen their good times and currently cannot offer more than they already have. Returns on inflation-linked bonds will decelerate as inflation starts trending down. Equity markets are still volatile but given the view that economic growth will recover in 2010, equities are likely to outperform bonds and cash (internet 8).

**Table 4.4**

Macro-economic forecasts							
Year	2008	2009	2010	2011	2012	2013	2014
GDP (%)	3.1	-2.6	1.5	3.9	4.7	5.0	4.9

**Source:** [http://www.investec.com/en\\_za/#home/research/latest\\_reports.html](http://www.investec.com/en_za/#home/research/latest_reports.html)

For South Africa, our own economic recovery may take a little longer, and be somewhat less pronounced. In part this is because our decline, roughly 3% of GDP from peak to trough (see table 4.4), is modest as compared the very sharp contractions suffered elsewhere. South Africa's policy stimulus, though not labelled as such, has also come later in the global cycle. Despite a significant response from monetary and fiscal policy, it looks very much like South Africa's growth recovery will come later than most and that it will be largely up to the global recovery to lift South Africa's fortunes (internet 14).

Real economic activity declined in most sectors as the ongoing economic recession and increases in unemployment put a damper on household expenditure. Credit impairments of banks rose and, combined with a slowdown in loan growth, profitability was affected negatively.

## **4.4 FINANCIAL SERVICES SECTOR**

### **4.4.1 Introduction**

South Africa has a large and sophisticated banking infrastructure that is as good as that of first world countries. This infrastructure is backed by a regulatory and legal framework which provides a full range of services i.e. commercial, retail and merchant banking, mortgage lending, insurance and investment. Foreign banks are well represented in South Africa and electronic banking facilities are extensive, with a nationwide network of automatic teller machines (ATMs) and internet banking facilities available. The Financial Services Board (FSB) oversees the regulation of financial markets and institutions, including insurers, fund managers and broking operations but excluding banks, which fall under the South African Reserve Bank (internet 8).

#### **4.4.2 South Africa's banking system**

The South African banking system is well developed and effectively regulated, comprising a central bank, a few large, financially strong banks and investment institutions, and a number of smaller banks. The National Payment System Act of 1998 was introduced to bring the South African financial settlement system in line with international practice on settlement systems and systematic risk management procedures. The Act confers greater powers and duties on the SA Reserve Bank in respect of providing clearing and settlement facilities (internet 8).

South African banks have been largely protected against the direct effects of the global financial crisis. Domestic banks have not invested as heavily in high-risk securities or complex instruments; have maintained a mostly traditional and relatively conservative banking model; have maintained relatively high lending standards; have enjoyed high profitability for a number of years and have maintained high capital levels; have low levels of foreign funding; and have limited activity outside the African continent. Banks have primarily felt the impact of the global financial crisis indirectly through higher funding costs and increased impairments due to retrenchments and the negative impact of lower real economic activity on corporate borrowers. The magnitude of the indirect impact is reflected in part in the sharp decline in the share prices of banks increased signs of pressure build-up in the banking sector were evident in the second half of 2008. In January 2009 impaired advances had increased by 118 per cent compared with a year earlier, and have increased by 47 per cent since July 2008 (internet 8).

However, the South Africa banking system held up very well during the time of the financial crisis and credit should be given to South Africa's regulatory framework such as the National Credit Act. Investment and merchant banking remains the most competitive front in the industry, while the country's "big four" banks i.e. Absa, First National Bank, Standard Bank and Nedbank, continue to consolidate their grip on the retail market (Lunsche, 2009).

**Table 4.5****Size of the South African private banking sector**

	June 2008		June 2009	
	number of institutions	Total assets R billion	Number of institutions	Total assets R billions
Locally controlled banks	13	2 035	13	2 128
Foreign controlled banks	6	683	6	706
Mutual banks	2	1	2	1
South African branches of foreign banks	14	227	14	185
Total registered banks	35	2 946	35	3 020

**Source: South African reserve bank**

Table 4.5 shows that locally controlled banks remained the same at 13 from June 2008 to June 2009. The total assets controlled by the locally controlled banks grow from R2 035 billion to R2 128 billion over the same period. While the foreign controlled banks total assets grew from R683 billion to R706 billion and the number of those institutions remained at 6. The major negative change though was the total assets of South African branches of foreign banks as they decreased from R227 billion to R185 billion while the number of institutions remained at 14 (as shown in table 4.5). This shows that those institutions suffered in their original banking homes and ripple effects affects their operations in South Africa while South African institutions showed a growth in assets.

South African banks have been largely protected against the direct effects of the global financial crisis. They did not invest heavily in high-risk securities and they maintained high lending standards. They have enjoyed high profitability for a number of years and have maintained high capital levels; have low levels of foreign funding; and have limited activity outside the African continent. South African Banks have primarily felt the impact of the global financial crisis indirectly through higher funding costs and increased impairments due to retrenchments and the negative impact of lower real economic activity on corporate borrowers (internet 8).

**Table 4.6****Financial Services Index and its components**

	2007	2008			
	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr
Financial Services Index	98	84	70	58	50
Retail banking confidence index	95	78	57	43	53
Investment banking and specialised finance confidence index	100	79	79	81	46
Investment management confidence index	97	77	81	57	49
Life insurance confidence index	100	100	63	51	53

Sources: Bureau for Economic Research and Ernst & Young

Table 4.6 shows that the retail banking confidence index decreased from 98 in the 4<sup>th</sup> qtr of 2007 to 50 in the 4<sup>th</sup> qtr of 2008. While the confidence in the investment banking also decreased from 95 to 53 in the same period.

Life insurance confidence decreased from 100 in the 4<sup>th</sup> qtr of 2007 to 53 in the 4<sup>th</sup> qtr of 2008 (as shown in table 4.6).

In the fourth quarter of 2008 confidence in the financial sector, as measured by the Ernst & Young Financial Services Index, 23 dropped to its lowest level since the index's inception. The drop, which largely stemmed from a worsening level of confidence in the areas of investment banking and specialised finance, was largely ascribed to the impact of the global liquidity crisis. The confidence level of investment managers also declined. Volatile global capital markets and a weak investment banking environment pushed business volumes lower, which affected fee income negatively. Investment income also dropped due to the poor performance of the equity markets (internet 15).

Following a large drop in the third quarter of 2008, the retail banking confidence level rose in the fourth quarter of the same year. However, it is still low compared to historical levels. The increase was recorded despite declining interest income resulting from declining growth in credit extension on the back of tight lending standards. Falling income and rising expenditure led to a contraction in net profit of retail banks. The confidence level of life insurers was supported by rising premium income, although this is expected to slow due to adjustments made following a new commission payment method with effect from January 2009 (internet 15).

**Table 4.7****Selected indicators of the South African banking sector**

	2009					
	Jan	Feb	Mar	Apr	May	Jun
Market share (top four banks)	84,11	84,39	84,09	84,66	84,36	84,79
Gini concentration index	83,96	83,99	83,95	84,07	83,95	84,14
Herfindahl index of concentration (H-index)	0,188	0,190	0,188	0,190	0,189	0,190
Banks' share prices (year-on-year percentage change)	-14,85	-22,35	-23,95	-13,98	-5,40	7,79
Capital adequacy						
Capital-adequacy ratio	13,01	12,98	13,29	13,54	13,51	13,69
Regulatory Tier 1 capital to risk-weighted assets	10,23	10,20	10,37	10,49	10,50	10,67
Credit risk						
Gross loans and advances (R billions)	2 338	2 316	2 329	2 268	2 257	2 258
Impaired advances (R billions)	97,97	106,14	110,59	115,13	121,46	124,89
Impaired advances to gross loans and advances	4,19	4,58	4,75	5,08	5,38	5,53
Specific credit						
impairments (R billions)	29,64	31,30	32,37	34,06	35,49	36,69
Specific credit impairments to impaired advances	30,25	29,49	29,27	29,58	29,22	29,38
Specific credit impairments to gross loans and advances	1,27	1,35	1,39	1,50	1,57	1,63
Profitability						
Return on assets (smoothed)	1,15	1,09	1,01	0,99	0,96	0,99
Return on equity (smoothed)	20,70	19,59	18,10	17,87	17,19	17,54
Interest margin to gross income (smoothed)	50,81	50,10	50,83	50,57	50,43	51,15
Operating expenses to gross income (smoothed)	49,00	49,10	49,46	49,78	50,02	49,35
Liquidity						
Liquid assets to total assets (liquid-asset ratio)	4,94	4,93	5,04	5,27	5,27	5,27
Liquid assets to short-term						
Liabilities	10,17	10,16	10,01	10,52	10,25	10,16
Effective net open foreign-currency position to qualifying capital and reserve funds	0,13	1,02	0,66	0,44	0,58	0,70

Source: South African Reserve Bank

Table 4.7 shows that the market share of the “top four” (ABSA, FNB, Standard Bank, Nedbank) banks in South Africa increased slightly 84.11 in January 2008 to 84.79 in June 2009. While the banks share prices move from a negative growth of 14.85 to a positive growth of 7.79 over the same period.



The banks gross loans and advances increased from 4.19 in January 2008 to 5.53 in June 2009 (as shown in table 4.7). The same table also shows that the banks income rose slightly from 49 to 49.35 over the same period. The liquidity of the banks also rose from 4.94 to 5.27 from January 2008 to June 2009. South African banks maintained high levels of capital during the economic crisis and they showed to be profitable but their assets quality weakened.

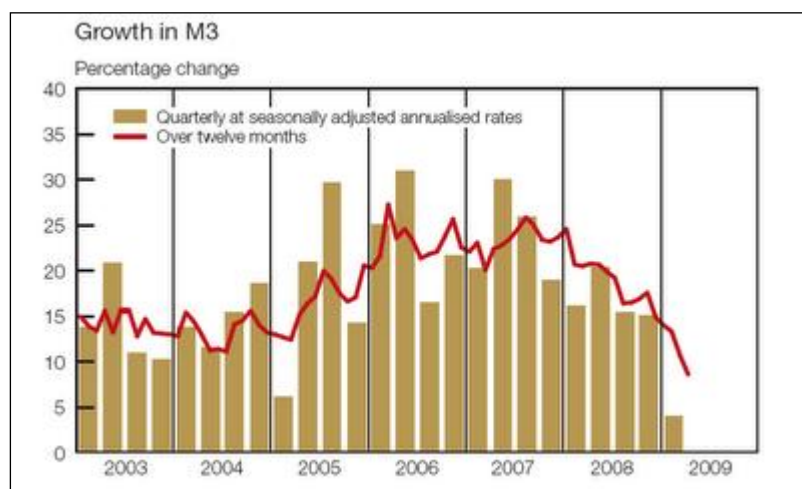
Conditions are likely to improve gradually in an environment of relatively less tight monetary policy combined with a bottoming out of the economic downturn. The overall capital ratio remained well above the minimum regulatory requirements 7 per cent. Despite the decline in profitability, South African banks remained efficient as their share prices gradually recovered during the first half of 2009. The structure, composition and concentration in the banking sector remained almost unchanged during the first half of 2009, with the big four banks still accounting for almost 85 per cent of the total assets of the sector (internet 8).

South Africa's well-developed financial system continues to grow. The financial sector has evolved into one of the largest and most deregulated within the emerging markets, accounting for 20 percent of GDP. Under the Banking is dominated by five large banks that account for over 80 percent of operations and offer a full spectrum of services. Consolidation has reduced the number of domestic banks by 40 since 2001. Capital markets are well developed and centered around the Johannesburg Securities Exchange, which is one of the world's 20 largest in terms of market capitalization (internet 17).

The financial sector was one of the hard hit sectors during this crisis and it could be the fact that this is the sector where the crisis began even though it was in the US. But because of the nature of regulation on offshore investments, the financial crisis impact was limited in the South African financial sector.

**Figure 4.3**

**Growths in Money Supply (M3)**



Source: <http://globaleconomydoesmatter.blogspot.com/2009/08/south-africa-recession-continues-even.html> - accessed 20/08/2009

In 2008 South Africa saw monetary policy tightening by the Monetary Policy Committee (MPC). On a quarter-to-quarter basis, M3 growth amounted to 4,1 per cent in the first quarter of 2009; down from 15,1 per cent in the fourth quarter of 2008. Comparing this year's first half with that of last year, the economy is down only 2%. The financial sector also contracted again, by about 2.5%.

South African banks have primarily felt the impact of the global financial crisis indirectly. The South African banking sector was further shielded from developments in global financial markets by its limited exposure to foreign currency denominated assets as this is regulated by the South African Reserve Bank. Nonetheless, conditions in the South African financial markets and banking sector have deteriorated in recent months. Share prices on the JSE Limited have declined, foreign portfolio investment flows reversed and impaired advances of banks increased as the profitability of financial institutions declined somewhat (internet 17).

Financial markets remained weak and very volatile in the final quarter of 2008. Overall, the FTSE/JSE all-share index lost a further 9,8% of its value in the fourth quarter of 2008, after plunging a massive 21,6% in the third quarter. The all-share index ended 2008 13,8% weaker. Resources took the hardest beating as relatively high prices adjusted to reflect the impact of global recession and collapsing

commodity prices on earnings growth. Resources fell by a further 13,6% in the fourth quarter, after dropping by an alarming 40,2% in the second quarter. Industrials also took strain, but the decline was much less dramatic (internet 17).

As the global financial crisis intensified and started to dampen economic growth in the second half of 2008, the domestic equity market continued its downward trend. Accelerated deleveraging, failures and near-failures of large financial institutions in the industrial countries, coupled with the weakening of global economic fundamentals, have resulted in falling asset prices and difficult financial conditions (internet 17).

The total number of listed companies on all boards of the JSE decreased from 424 in July 2008 to 415 in July 2009, with those on the main and development/venture capital boards respectively decreasing by 7 and 2, while new and delistings on AltX netted out. However, turnover on AltX as a percentage of total turnover on the JSE declined from 0,22 per cent in June 2008 to 0,06 per cent in July 2009. The value of turnover on the JSE as a whole increased by 9 per cent from 2007 to R3,3 trillion in 2008. Turnover peaked at R346,3 billion in October 2008 and, as the international financial crisis unfolded, it fell to an average of R220,9 billion per month in the first seven months of 2009. Declining share prices contributed to the sharp fall in the market capitalisation of the JSE of 16 per cent from an all-time high of R6,3 trillion in May 2008 to R5,2 trillion in July 2009. The trends in market capitalisation and turnover caused the annualised liquidity ratio<sup>12</sup> to recede from a peak of 94 per cent in October 2008 to 54 per cent in July 2009, close to monthly levels of the past two years” (internet 18).

Global financial and real economic developments impacted non-resident investor sentiment and led to heightened aversion to risk and uninterrupted monthly net purchases of shares by non-residents on the JSE. Financial markets have been weak and very volatile in early 2009. The FTSE/JSE all-share fell in the first three months of 2009 (internet 17).

#### **4.4.5 Summary**

There has been a shift in the economic structure of the country towards higher growth in and spending on services. This sector is sensitive to changes in monetary policy. Even though financial conditions have turned less optimistic of late, this sector is assured of firm growth as its roots stretch across all sectors of the economy. Overall, financial services are expected to continue to grow, although there will be some divergence across different types of services. Growth in the financial services sector will remain robust, particularly as ongoing financial innovation, strong growth in new business startups, and a sophisticated financial industry continue to lure foreign investors. Growth in financial services may be limited in the short term on account of demand for credit easing off a very high base and of stricter lending requirements. In the long run, an expanding middle class and increased emphasis on empowerment policies will remain underlying drivers in this sector, with increasing emphasis also placed on integrating the previously deprived into the broader finance sector.

### **4.5 MINERAL RESOURCES SECTOR**

#### **4.5.1 Introduction**

South Africa's mineral industry, largely supported by gold, diamond, coal and platinum group metals production, has made an important contribution to the national economy. It has provided the impetus for the development of an extensive and efficient physical infrastructure and has contributed greatly to the establishment of the country's secondary industries (internet 4).

The exchange rate of the rand plays a key role in the growth equation of the mining sector. Despite high dollar commodity prices, mining production, especially of gold, has been hampered by the relative strength of the rand and higher cost structures owing to the greater cost associated with deeper mines, which has reduced profitability. The mining sector is very responsive to boom and bust cycles throughout the world (internet 17)

However, the global financial crisis that defined the latter half of 2008 affected the mining sector very badly due to the nature of import/export reliance of that sector. As commodity prices came off their record highs, many organizations found themselves saddled with unsustainable production costs and high capital commitments. Surprised by the speed of the commodity price bust and the liquidity crisis, they were over-reliant on external financing, which dried up overnight. Despite the impact of the economic crisis, underlying industry fundamentals remain largely unchanged. As stockpiles fall, global demand may still outstrip supply. Mining companies continue to contend with the rising costs of regulatory compliance and sustainable development (internet 19).

#### **4.5.2      Impact of the Global Financial Crisis on Mining Sector**

Perhaps the best way of illustrating the role that mining plays in the economy is to temporarily “remove” the mining sector from the economy and then to reflect on the actual economic contribution. With mining temporarily removed, the economy would lose:

- about 18% of GDP
- over 50% of merchandise exports
- about 1 million jobs
- about 18% of gross investment (9% directly)
- approximately 30% of capital inflows into the
- economy via the financial account of the balance  
of payments
- about 35% of the market capitalisation of the Johannesburg Securities Exchange (JSE) 93% of the country’s electricity generating capacity
- about 30% of the country’s liquid fuel supply (internet 20).

**Table 4.8**

<b>Quarterly gold production: January - March 2009</b>		
<b>(1) Producing Chamber member gold mines and gold-uranium mines</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
January - March 2009	1 309 199	40 720.6
	(1 412 735)	(43 941,0)
October - December 2008	1 455 644	45 275.6
	(1 706 537)	(53 079,2)
<i>Decrease</i>	146 445	4 555.0
<b>(2) Other Producers</b>		
<b>(a) Chamber Members</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
January - March 2009	97 174	3 022.4
	(39 710)	(1 235,1)
October - December 2008	107 406	3340.7
	(59 849)	(1 861,5)
<i>Decrease</i>	10 232	318.3
<b>(b) Non-Chamber Members</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
January - March 2009	246 542	7 668.4
	(226 734)	(7 052,2)
October - December 2008	226 636	7 049.2
	(221 982)	(6 904,5)
<i>Increase</i>	19 906	619.2
<b>Total (1 + 2)</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
January - March 2009	1 652 915	51 411.4
	(1 679 179)	(52 228,3)
October - December 2008	1 789 686	55 665.5
	(1 988 368)	(61 845,2)
<i>Decrease</i>	136 771	4 254.1

Source: <http://www.bullion.org.za/>

The total mining production for the three months ended March 2009, after seasonal adjustment, decreased by 4 254.1 kg's compared with the previous three months (Oct-Dec 2008), see table 4.8.

**Table 4.9**

Quarterly gold production: April - June 2009		
<b>(1) Producing Chamber member gold mines and gold-uranium mines</b>		
Quarter	Ounces	Kilograms
April - June 2009	1 372 030	42 674.9
	(1 521 688)	(47 329.8)
January - March 2009	1 309 199	40 720.6
	(1 412 735)	(43 941.0)
<i>Increase</i>	62 831	1 954.3
<b>(2) Other Producers</b>		
(a) Chamber Members		
Quarter	Ounces	Kilograms
April - June 2009	108 509	3 375
	(116 374)	(3 619.7)
January - March 2009	97 174	3 022.4
	(39 710)	(1 235.1)
<i>Increase</i>	11 335	352.6
<b>(b) Non-Chamber Members</b>		
Quarter	Ounces	Kilograms
April - June 2009	179 545	5 584.5
	(192 359)	(5 983.0)
January - March 2009	246 542	7 668.4
	(226 734)	(7 052.2)
<i>Decrease</i>	66 997	2 083.9
<b>Total (1 + 2)</b>		
Quarter	Ounces	Kilograms
April - June 2009	1 660 084	51 634.4
	(1 830 421)	(56 932.5)
January - March 2009	1 652 915	51 411.4
	(1 679 179)	(52 228.3)
<i>Increase</i>	7 169	223.0
( ) Figures in parenthesis indicate corresponding totals for the same period of the previous year		

Source: <http://www.bullion.org.za/>

The total mining production for the three months ended June 2009, after seasonal adjustment, increased by 223.0 kg's compared with the previous three months (Jan-March 2009), see table 4.9.

**Table 4.10**

<b>Quarterly gold production: July - September 2009</b>		
<b>(1) Producing Chamber member gold mines and gold-uranium mines</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
July - September 2009	1 419 162	44 140.9
	(1 477 115)	(45 943.4)
April - June 2009	1 372 030	42 674.9
	(1 521 688)	(47 329.8)
<i>Increase</i>	47 132	1 466.0
<b>(2) Other Producers</b>		
<b>(a) Chamber Members</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
July - September 2009	118 868	3 697.2
	(99 994)	(3 110.2)
April - June 2009	108 509	3 375
	(116 374)	(3 619.7)
<i>Increase</i>	10 359	322.2
<b>(b) Non-Chamber Members</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
July - September 2009	201 673	6 272.8
	(214 490)	(6 671.4)
April - June 2009	179 545	5 584.5
	(192 359)	(5 983.0)
<i>Increase</i>	22 128	688.3
<b>Total (1 + 2)</b>		
<b>Quarter</b>	<b>Ounces</b>	<b>Kilograms</b>
July - September 2009	1 739 703	54 110.9
	(1 791 599)	(55 725.0)
April - June 2009	1 660 084	51 634.4
	(1 830 421)	(56 932.5)
<i>Increase</i>	79 619	2 476.5

Source: <http://www.bullion.org.za/>

In the third quarter of 2009, South Africa's gold production increased by 4.8% to 54 110.9 kilograms when compared to the 51 634.4 kilograms produced in the second quarter (see table 4.10). On a year-on-year basis gold production was down by 2.9% in the third quarter of 2009.



The total mining production for the three months ended September 2009, after seasonal adjustment, increased by 2 476.5 kg's compared with the previous three months (April-June 2009), see Table 4.8.

**Table 4.11**

**Value of Sales for Mineral groups and minerals**

Mineral groups and minerals	% contribution to total mineral sales during January to November 2008	Value of sales for January to November 2008	Value of sales for January to November 2009	% change between January to November 2008 and January to November 2009	Contribution to the % change in the total value of mineral sales 2/	Difference in sales between January to November 2008 and January to November 2009
		R million	R million		% points	R million
Gold	14.8	41 437.5	44 481.0	7.3	1.1	3 043.5
Iron ore	7.1	19 932.1	25 212.9	26.5	1.9	5 280.8
Chromium ore	1.9	5 268,6	2 952,0	-44,0	-0,8	-2 316,6
Copper	1,9	5 390,3	3 387,3	-37,2	-0,7	-2 003,0
Manganese ore	5,9	16 416,7	4 713,1	-71,3	-4,2	-11 703,6
PGMs	31.2	87 422,6	52 158,0	-40,3	-12,6	-35 264,6
Nickel	1,8	5 142,1	3 808,6	-25,9	-0,5	-1 333,5
Other metallic minerals	1,9	5 315,5	3 818,5	-28,2	-0,5	-1 497,0
Coal	23,7	66 566,6	51 667,4	-22,4	-5,3	-14 899,2
Building materials	2.3	6 461,5	6 498,2	0,6	0,0	36,7
Other non-metallic minerals	7,5	21 101,4	13 004,2	-38,4	-2,9	-8 097,2
Total	<b>100.0</b>	<b>280 455,0</b>	<b>211 701,9</b>	<b>-24,5</b>	<b>-24,5</b>	<b>-68 753,1</b>

Source: [www.statssa.gov.za](http://www.statssa.gov.za)

The major contributors to the annual sales decrease of 24.5% in 2009 were Platinum group metals (PGM's) (contributing -40.3 percentage points) and manganese ore (contributing -71,3 percentage point). However, iron ore sales increased by 26.5% in 2009 and contributed positively with 1.1 of a percentage point. The total mining sales for 2009, after seasonal adjustment, decreased by 24.5% compared to 2008. Coal sales dropped 22.4% with a negative contribution of 5.3 percentage points.

### **4.5.3 Summary**

The mining sector experienced a sharp 32.4% drop in GDP in the first quarter of 2009. By the second quarter of 2009, the recession started to moderate. The impact of the crisis on the South African mining sector has been profound. Both demand and process fell sharply in late 2008. The drop in demand for most minerals has been substantial. The effect on the South African economy has been severe as two thirds of the country's minerals are traditionally exported to the advanced economies which are all in recession.

The global credit freeze has also reduced the amount of finance available to fund capital investment and trade. The local mining industry was already declining before the global crisis occurred. Despite large increases in fixed investment in mining in 2006/07, mining output declined by 7% in 2008 and by 9.1% in the first six months of 2009. A combination of domestic factors, including the electricity crisis, regulatory red tape, infrastructure constraints, safety related closure of mines, rapidly rising costs and volatility in the rand/US dollar exchange rate, all affected the ability of the sector to increase output in that period. To survive the global economic crisis, companies had to review all expenditure, cut back on capital plans, pressurise suppliers to reduce costs and focus on restructuring.

## **4. 6 Conclusion**

The global financial crisis has, to date, not resulted in severe instability of the domestic financial system in South Africa. The economy contracted sharply in the first half of 2009 as exports remained under pressure and consumers stayed cautious in the face of rising unemployment and restricted disposable income.

While some of the biggest world economies were facing a severe slowdown as a result of the global financial crisis, South Africa's outlook remained positive in the short-term. The country's minerals and mining industry was negatively affected, with silver production remaining stagnant, particularly from gold mines.

In dealing with the financial crisis, the South African the government only announced plans of re-skilling employees that are supposed to be retrenched by affected companies. In the meantime it's only the mining sector that is currently showing

signs of improvement. Globally countries are carrying out structural adjustment programmes of their financial services sectors, South Africa should not be left behind.

The next chapter undertakes a discussion of recommendation based on the analysis of the data.

# **CHAPTER FIVE**

## **CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 INTRODUCTION**

The investment community worldwide is still grappling with the effects of the global economic crisis even though some economies are showing signs of recovery. The world over entered a period that called for greater risk awareness, more regulatory oversight and a better balance between responsible investment and profitability.

This study showed that South Africa is not immune to the risks inherent in the investment environment, therefore the country's strategy should be perhaps better able to withstand the vagaries of economic and market changes than strategies driven by shorter-term objectives. This was clearly demonstrated in the 2008/09 financial year South Africa was certainly affected by the economic downturn that took hold from October 2008 onwards. However, the questions then arise on how best South Africa should deal with the current crisis and mitigate future impacts of global financial downturns? The objectives set out at the beginning of this study were to establish:

- the impact of global economic downturns on South African economy
- the measures that could assist South Africa to prevent any major impact of an economic downturn
- the real cause of the current global economic downturn

### **5.2 OBJECTIVES OF THE STUDY**

Objective One:

To analyse the impact of global economic downturns on South African economy.

South Africa is ranked in the top 20 economies by size; the country's economy is relatively small and accounts for less than 1% of global GDP. Because South Africa's economy is dependent on foreign trade and attracting foreign savings to prop up domestic investment, it is not immune to the global economic downturn. Slower economic growth and recessions in key export markets, combined with lower

commodity prices and a slowdown in capital flows to developing countries, have impacted on the country's economy, especially in the financial, automotive, mining and retail sectors.

Although South Africa's is a small and open economy, it is intricately connected to the global economy and initially weathered the global storm relatively well. But eventually the effects of the crisis fed through, placing severe pressure on certain key export sectors like mining and manufacturing. The local economy entered negative growth territory in the fourth quarter of 2008 with a 1.8% decline in GDP, but after a 6.4% decline in GDP in the first quarter of 2009 the country was confirmed as being in recession.

### Objective Two

To investigate the measures that could assist South Africa to prevent any major impact of an economic downturn.

This study demonstrates the severity of the impact of the financial global financial crisis on South African industries. Even though during this crisis a more aggressive government intervention is required but once the crisis period is over the intervention would have to be reduced drastically. South Africa needs to consider longer-term structural, regulatory adjustments in the financial sector. In the meantime, macroeconomic volatility and international financial contagion emanating from advanced economies will present serious problems for the developing world.

Effective market discipline needs to be encouraged through greater transparency and disclosure and reform of governance in financial institutions.

International collaboration and coordination need to be improved to adequately cope with the challenges posed by cross-border institutions. To avoid a similar crisis, there is a need not just for enhanced regulation and effective supervision using proper risk management processes.

### Objective Three

To investigate the real cause of the current global economic downturn.

The causes of the global financial crisis are multidimensional. There were defaults on US subprime mortgages, and weak risk analysis and management systems within banks mainly in the US. The banks in the US shifted credit risk away from the

originators of loans and created new business models that resulted to the banks being exposed to high impact risks. There is sense in which that the failures of corporate governance; weakening lending standards were also among the causes. In the US there was an intense competitive pressure in traditional banking business. Bank's internal remuneration structures created a bias towards excess risk-taking behaviour and the failure of supervisors to act on identified concerns and to act against excessive risk-taking by banks. The dominant views of deregulation and financial liberalisation of influenced bankers, market participants.

Writing the foreword to the JSE 1<sup>st</sup> Quarter of 2009 magazine Russell Loubser argued, "the roots of this financial crisis can be found in three interlinking factors: The modern tendency to rely on computerised models as opposed to good judgement; insatiable greed where products were launched without a thought as to the consequences, as long as they were profitable and legal, and a buyer could be found; and finally the fact that old-fashioned values such as honesty and ethical business dealings were deemed irrelevant. These three factors, combined with the speed and scale of globalisation, created this lethal cocktail for world markets".

### **5.3 RECOMMENDATIONS AND THE WAY FORWARD**

On the short-term South Africa should:

- Reduce both the individual taxes and company taxes more especially on basic food items in order to stimulate the economy
- Continue with the spending on the expanded public programme and 2010 soccer world cup related infrastructure development
- Continue with the trend of reducing interest rates
- Amend the companies Act to make sure that Board of Directors in businesses pay close attention to risk management and legislative compliance.
- Pay more focus on private banks bank's liquidity requirements through the mandate of the South African Reserve Bank also enhance transparency and information disclosure with respect to both bank's balance-sheet position and the structure and characteristics of financial instruments.

On the long-term South Africa should:

- Review the financial regulatory framework more especially the banking sector to make sure that foreign debt exposure is limited because an effective regulatory infrastructure is integral to the smooth functioning of a financial system
- Strengthen the regulatory structures and framework and make sure that those who are put in positions of regulation regulate properly and they do not have any conflict of interest.
- Stimulate the economy by creating conducive conditions for entrepreneurs to prosper through National Empowerment Fund and Independent Development Corporation
- Create more programmes to encourage South African citizens to save perhaps through the issuing of government bonds.
- Attract foreign investors to come in South Africa and build new factories and not simply take shareholding in existing business as it the case in ABSA/Barclays deal.
- Creating skilling programmes for the citizens and investing more on the education of the country's youth.

Joseph Stiglitz also provides the following recommendation “failures in financial markets have come about because of poorly designed incentive structures, inadequate competition, and inadequate transparency. Part of this is because larger institutions have been resistant to changes that would actually create more healthy competition. Better regulation is required to rein in the financial markets and bring back trust in the system” (internet 6).

## **5.4 SUGGESTIONS FOR FUTURE STUDY**

There is a need to investigate whether regional economic integration is not the solution for Africa and South Africa in particular. The continent can make a better of the multilateral agreements something which the European Union has done very well. There should also be an investigation of the cross border infrastructure for many of the African countries including South Africa.

Africa also needs to look at the issue effective public service and competitiveness and do the continent measure against the rest of the world. A more pressing work need to be done in the area of regulatory studies to see how they can benefit countries if regulation is done properly.

Research needs to be conducted into how South Africa can undertake aggressive adjustments of the entire economy to make it more diversified and resilient to the global financial shocks. The solution to do this will come from South Africa. It is indeed therefore very important that vigorous research be undertaken on this subject exhaustively by all thinkers in South Africa because in the past we seem to have relied on the likes of Harvard group recommendations sanctioned by our own government through the national treasury.

There needs to be a better understanding of what can provide financial stability, how cross-border cooperation can help to provide the public good of international financial rules and systems, and what the most appropriate rules are with respect to development.

## **5.5 CONCLUSION**

South Africa has been negatively affected by the global economic downturn, but even as the banking sector exhibits few of the problems witnessed elsewhere, financial markets have moved quickly to price in a front-loaded rate cutting cycle. The financial services sector in South Africa felt the global financial crisis through increases funding costs. This sector had some form shield from the crisis to make the impact not be too severe. That shield was the limited exposure to foreign currency assets.

The global credit crisis and mounting evidence of world recession kept the world and domestic markets under pressure. The impact of the global economic slowdown on real economic activity in South Africa is also evident in the retrenchments and business closures, particularly in mining and manufacturing.



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11 MAY 2009

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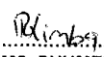
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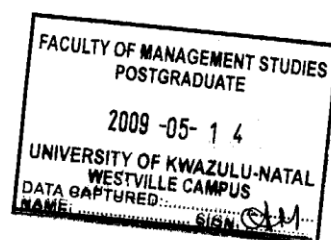
*"Disillusionment with the market driven economic system in a period of Global Economic Downturn"*

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