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The role of winter in a garden

In the longer run an occasional recession is necessary for sustained economic growth. Recessions play the role of winter in a garden. Good times follow bad times, like summer follows winter. A recession eliminates economic inefficiencies and bad practices that develop in the good times and form a base for renewed upturn.

Developing countries experienced a major downturn in 1997-98 and the OECD in 2001. We are now experiencing the benefit from these periods of adjustment and are enjoying one of the strongest periods of global growth that has ever happened, despite systemic risks such as the overheated US housing market and the US current account deficit. China and India both reported annualised GDP growth rates in excess of 10 per cent in the first quarter of this year. The Japanese and European economies are growing again after a long period of stagnation. Throughout the world corporate profits are at record levels and are providing abundant liquidity to power both the economic boom and rising asset prices. It looks as if we are in the early stages of a wave of corporate mergers and acquisitions. Typically such activity characterises market peaks.

Commodity prices are high, but given the strength of the global growth, could well remain stronger for much longer. This has allowed South Africa to enjoy its greatest period of prosperity in 50 years. Initially the spending boom was concentrated on housing but now it is most visibly manifest in vehicle sales. After running at about 30,000 vehicles per month, they soared in 2004 and 2005 to reach 56,000 in March 2006. This is typical of what has happened in the economy as a whole. VAT collections, the most reliable indicator of spending, increased 17.4 per cent in 2005. Spending has slowed somewhat but is still very strong. In dollar terms imports have increased from $2.2 bn per month in 2002 to $4.6 bn last year. Foreign investment inflows, which exceeded R100 bn in the past year, have financed a growing current account deficit, now running at 4 per cent of GDP. Ultimately such a large deficit is unsustainable and will cause a significant weakening of the rand, but the favourable combination of high commodity prices and strong foreign investment could sustain the current exchange rate for a long time yet. However this does constitute a growing investment risk.

Inflation remains well within the 3 to 6 per cent target. Over the past six months the annualised growth in CPIX has been 2.5 per cent. There are few signs of secondary inflationary pressures due to high oil prices. However the Reserve Bank is becoming increasingly concerned about the rapid growth in consumer indebtedness and the impact of strong domestic demand on the current account. Accordingly it is holding interest rates steady.

The way in which high commodity prices have powered the South African boom is yet another reminder that our future is inextricably linked to global developments and the sustainability of the global boom.

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