BUSINESS CYCLE ANALYTICS

BUSINESS CYCLES

The overall 1981-1989 business cycle

Officially, SA witnessed two peak-to-peak business cycles over the 1981 to 1989 period. The first recession unfolded when the gold price declined (1981-82) from the dizzying heights achieved during 1980, leaving the SA economy exposed, also having to contend with the impact of a global recession and the Third World debt crisis and the associated capital outflows from risky national capital markets. The country suffered a painful recession during the early 1980s, which, in reality, was 'interrupted' by an 'artificial' economic recovery between April 1983 and June 1984. A premature easing of monetary policy for political reasons (the so-called 'Primrose prime') 'ended' the economic downturn[1]; however, the hiking cycle resumed, triggering the second leg of the recession, 1984-86. Viewed this way, the early 1980s economic downturn only troughed in 1986. These years must count as the darkest period, economically speaking, of the old apartheid political order.

While these two cycles will be discussed separately, attention also focuses on the complete period as one business cycle, i.e. a protracted economic downturn between September 1981 and August 1986 (witness the trajectory of gross domestic fixed investment in the accompanying chart), followed by an economic recovery, which peaked again early-1989.

Economic downturn: September 1981 to March 1983

As noted, the early-1980s deep world economic downturn (G7 countries industrial production declined by 7½% between the first quarter of 1980 and end-1982), characterized by the onset of the third world debt crisis, sparked major domestic capital flow reversals and balance of payments pressures. The deficit on the current account increased sharply due to the high growth in the economy during 1980 and the sharp fall in the gold price in the subsequent years (1981-82). Domestic interest rates were hiked by more than ten percentage points in a matter of 18 months, with the first hike leading the ensuing economic downturn by 9 months. Interest rates did decline by 6 percentage points during the final months of 1982 and early 1983; however, the hiking cycle resumed, triggering the second leg of the economic downturn, 1984-86.

The first leg of the 1981-86 economic downturn was externally induced. Real exports declined by 21% from peak to trough (1981-83) and mining real value added drifted lower by close to 5% over the 1979-81 period. The second leg of the economic downturn had domestic origins – real exports only shrunk by 7% over this time period, while real gross domestic expenditure (GDE) shrunk by no less than 7.8%. The almost 8% contraction in real GDE followed on a close to 12% contraction over the first leg of the recession. The contraction of the domestic market is explained by the knock-on effects of the global recession, the impact of a serious and protracted drought in agriculture and the sharp subsequent tightening of interest rates in response to balance of payments and inflation pressures. Combined with a precipitous fall in the terms of trade (in line with the gold price), the current account deficit measuring close to 15% in the first quarter of 1980 had to be addressed. The 1981-83 contraction in GDP (5.3%) was of a short duration, but the deepest in the post war period (see Van der Walt, 1988: 36). This contraction was followed by a further contraction in real GDP of 3.2% (1984-86) - see below[2].

Two important events accompanying the economic downturn, were the peak (1980) and subsequent decline of the international gold price and the peak and decline in the SA housing market. Both these developments evolved into long-term trends contrary to general expectations. The housing market only recovered in the 1990s and the gold price in the 2000s. The SA economy also entered its darkest period before the demise of the

[1] The prime overdraft interest rate was cut by no less than six percentage points between October 1982 and March 1983 in a development which became known as the 'Primrose prime', with the then President of the country, PW Botha, intervening in the decision due to a by-election at the time in the Primrose constituency.

[2] The RMB/BER business confidence index plunged by 65 points between September 1980 and December 1982, recovered by 26 points up to mid-1984, where-after it plunged another 36 index points to a low level of 10 points reached during the third quarter of 1985 at the time of the Rubicon speech impact.

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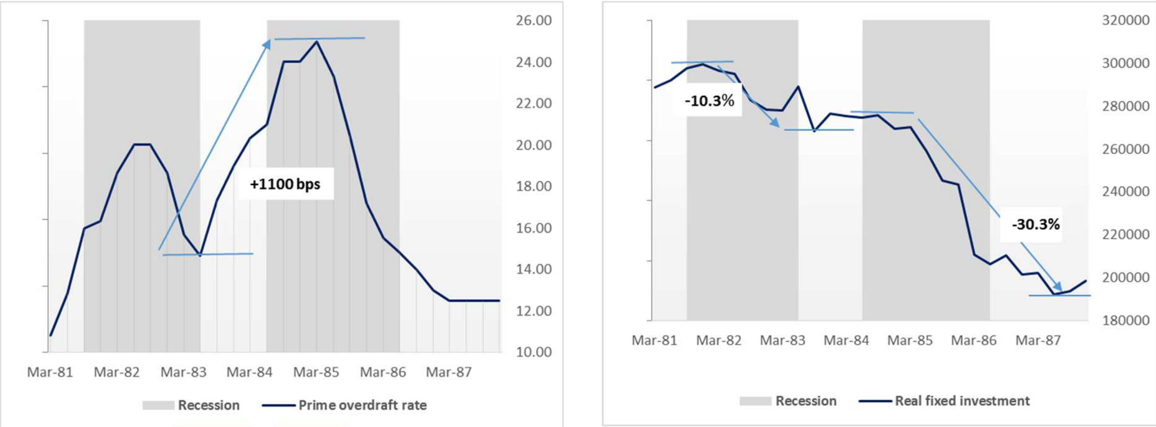
Figure 1: Interest rates & real fixed investment spending: The 1981-83 & 1984-86 recessions

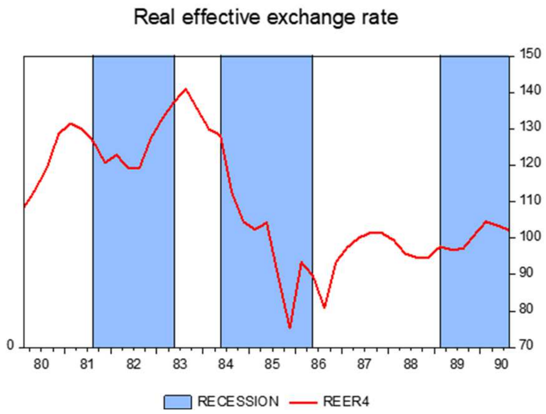


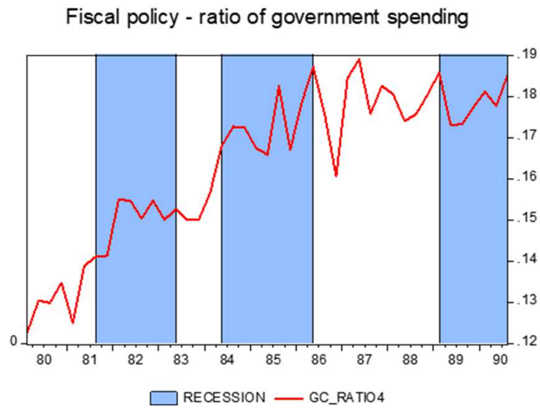
Source: SA Reserve Bank

apartheid political system. The period 1985-93 recorded real GDP growth averaging 0.5% per annum, suffered sharp capital outflows in the wake of the debt standstill and restructuring and witnessed intensifying socio-political conflict. The intervening period, 1983-84, did witness a brief expansion in economic activity; however, as noted, this was mainly related to political expediency.

Brief expansion: April 1983 to June 1984

The 1983-84 recovery was wholly consumption driven, with real household consumption spiking by no less than 13% between the middle of 1983 and mid-1984 and being accompanied by strong expansionary fiscal policy, reflected in real government consumption growth of 17% over the expansion period (and the ratio of government spending to GDP rising by 6½ percentage points over the complete period of the downturn between 1981 and 1986 - see the accompanying chart). Whereas an economic recovery ensued from the second quarter of 1983, this did not last long and never diffused throughout the economy, notably gross domestic fixed investment. Van der Walt (1988: 34) notes that the SARB's diffusion index indicated that only 60% of the time series' growth rates exceeded the long-term average towards the end of 1983 compared to more than 80% doing so during the previous economic upturn, i.e. between 1978 and 1981. Real fixed investment hardly expanded over this period (2.7%) and contracted sharply thereafter, driving the second leg of the 1981-86 economic downturn.





Source: SARB

The politically-inspired ease in interest rates (by 6 percentage points between October 1982 and March 1983) was supported by external factors. The gold price increased to above $440/oz during the second half of 1982 due to the lingering uncertainties generated by the Third World Debt crisis. Furthermore, the advanced economies of the world began exiting their respective recessions, which supported demand for SA's exports. Unfortunately, consumption-related imports surged, countering the export growth and the increase in real domestic expenditure. Overall real GDP expanded by a modest 8.1% during this brief, but intense, economic upturn. The recovery was intense as it occurred over a short time period; the speed of adjustment for this economic recovery is calculated at 6.4% (i.e. the annualised real GDP growth rate), which was fast in the context of economic performance during the post-WWII period.

Economic downturn: July 1984 to March 1986

The consumption-led recovery was unsustainable. Combined with an abrupt reversal of the 1982 increase in the gold price early during 1983, the current account pressures re-exerted themselves, including pressure on the rand exchange rate, which in turn, generated inflationary pressures. Monetary policy was tightened sharply in successive stages from March 1983 (with prime lending rates poised at 14%) to 25% in August 1984. Apart from these cyclical considerations, adverse socio-political developments (culminating in the notorious Rubicon speech in August 1985 by the then Prime Minister, PW Botha) deepened the economic downturn as apartheid SA was cut-off from international capital markets. The sharp increase in interest rates, combined with the business confidence shock, induced a precipitous decline in real fixed investment spending (by more than 30% from peak to trough, 1984-86), which propagated a renewed recessionary spiral in the economy. Judging by the behaviour of fixed investment spending, the economic downturn actually continued throughout 1981-86 (see the charts above).

The rand exchange rate fell sharply following the introduction of a floating exchange rate in January 1979 and the subsequent balance of payments pressures noted above and, thereafter, the socio-political developments leading up to the debt-standstill agreement. The real effective rand depreciated by close to 50% between the third quarter of 1983 and the end of 1985 (see the accompanying chart). Both these factors countered the recessionary forces in the economy, however, the business confidence shock and consequent contraction in inventory and fixed investment overshadowed their impact. Business confidence dropped from 91 index points in the third quarter of 1980 to 26 in by the end of 1982, recovered somewhat and then declined further to a mere 10 index points during the third quarter of 1985, i.e. at the time of the infamous Rubicon speech.

The abrupt reversal of the sharp growth in (consumption-driven) real domestic expenditure over the 1983-84 period represents the first phase of the 1984-86 economic downturn (see Van der Walt, 1988: 38). During this period real domestic expenditure fell just as sharply as it grew during the brief 83-84 economic upswing. During the second phase of this downturn, growth stabilised as favourable external factors (renewed G7-country growth and a more competitive rand exchange rate) stimulated the export sectors. This led to the monetary authorities easing interest rates during the second half of 1985, which helped stabilising growth. These supportive factors could not compensate for the confidence shocks related to the prevailing socio-political environment, including the announcement of a state of emergency (July 1985), the withdrawal of SA's international credit facilities, general socio-political unrest, etc. The contraction in real fixed investment and real household consumption resumed, which effectively represented the third phase of the 1984-86 economic downturn.

Economic expansion: April 1986 to February 1989

Following a prolonged recessionary period between 1981 and 1986[3], the SA economy recovered hesitantly from the second quarter of 1986, impacted by major uncertainty, the imposition of trade and financial sanctions and socio-political unrest. A defining characteristic of this recovery was its slow start, its shallowness and slow speed. This was despite a notable recovery in business confidence levels (the RMB/BER business confidence

[3] The recessionary nature of the general economic conditions over this period are best reflected in the fact that the level of real GDP during the first quarter of 1986 was still below that of end-1981, despite the intervening temporary measured economic recovery (1983-84).

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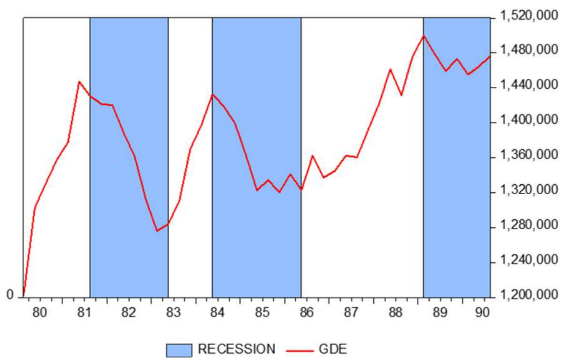
index recovered from a low of 10 index points during the third quarter of 1985 to levels exceeding 80 by the middle of 1988). The recovery speed did develop more momentum during 1987-88.

It appears, real government and household consumption expenditure led the economic recovery, with its onset characterized by deep negative real interest rates (inflation peaked around 18% following the rand exchange rate fallout in 1985 and nominal rates were cut at five occasions through 1986). Furthermore, the export sector benefited from improving growth in SA's main trading partner economies – real G7-country GDP expanded by more than 12% over the 1986-89 domestic upswing phase of the business cycle; SA's real exports recovered by 20-30% over the corresponding period. In time, these demand factors boosted fixed and inventory investment, which assisted the recovery from late 1986. Fiscal policy was also loosened in 1986 and early-1987.

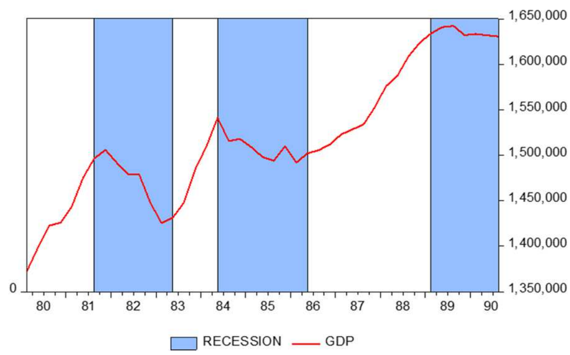
Whereas growth dispersed wider in the economy, with most expenditure components and sectors contributing (even agriculture following the end of the early 1980s drought), the pace and durability of the upswing ended up weak. The speed of adjustment over the 12 quarter recovery period measured a relatively mild 2.8%[4].

Macro-economic policies were tightened during the course of 1988 (the ratio of government consumption spending to GDP moved sideways and interest rates were tightened to address the inflation bias and manage balance of payments instability in the wake of the Debt Standstill Agreement). In this way, the SA economy was prevented fully benefiting from the growth in its trading partner economies. A degree of sanctions busting could not change this fact. Socio-political instability acted as an additional constraint.

Gross domestic expenditure (GDE)



Gross domestic product (GDP)



Source: SARB

In all, a key feature of the 1981-1989 business cycle(s) was the wild swings in a number of key variables. The 1970s already announced greater business cycle volatility compared to the period of stable and high growth during the 1950s and 1960s. The amplitude of the business cycle swings – to become known as the stop-go cycles of the 1970 and 1980s – deepened in the latter decade. Whereas external drivers triggered the 1981-83 economic downturn, domestic political factors played a role in propagating the fall in investment driving the second leg of the downturn, i.e. 1984-86. The intervening period reflected a pure policy mistake, resulting in a temporary consumption boost, which had to be aborted in view of the overall balance of payments condition and the currency-induced inflation spiral. Increased economic volatility was not the only defining feature of SA's economic performance during the 1980s. Structural factors (and exogenous influences) impacted on top of the cyclical dynamics in constraining growth. This aspect is amplified considering the historic downturn (1989-93) is included in the analysis.

4 SA's economic recovery growth rate between the mid-1970s and the end of 2013 averaged 4%. The average length of economic recoveries over this period is estimated at 19 quarters. Bar the brief 1983-84 expansion, the 1986-89 recovery was the shortest on record over this period. Only around 65% of economic activity growth exceeded the long-term average (compared with 80% during the 1978-81 expansion), suggesting weak dispersion (see Van der Walt & Pistorius, 1995: 31).

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