BUSINESS CYCLE ANALYTICS

BUSINESS CYCLE: 2007 TO 2013

The Great Recession and the SA business cycle, 2007-2013

SA has a small and open economy, being closely integrated with the rest of the world via both trade and financing channels. It follows that the business cycle is closely influenced by the world economy. The bankruptcy (September 2007) of a large investment house in the USA, Lehman Brothers, ended the record sub-prime driven housing boom during the 2000s in that country. This triggered a global financial crisis (GFC), which, in turn, sparked a US and world-wide recession. The depth and reach of the recession reminded of the Great Depression of the 1930s and became known as the Great Recession.

Macro-economic stimulus measures, including the advent of Quantitative Easing (QE) in November 2008 in the major industrial countries, acquired unprecedented levels. Including China's debt-drive infrastructure spending drive, this assisted financial markets and real economic activity levels to rebound. However, the level of real-world economic growth trended lower post-2009.

The SA economy did not suffer a major *financial* impact from the GFC. The country witnessed some capital flight and the rand exchange rate came under some pressure, but the broader financial conditions remained largely unaffected. The main impact arrived via the *trade channel* as all its trading partner economies suffered recessionary impacts, which caused the demand for SA's exports to shrink. SA's export volumes contracted by more than a fifth. Commodity prices also tumbled temporarily; however, the big commodity price collapse only happened later when China's economic growth slowed down (2011-15).

The *real economic impact* was therefore more meaningful, including a contraction in real GDP (by 2.7 percentage points from peak-to-trough) and, more seriously, steep net job losses (measuring more than a million formal jobs by the end of 2010, or a contraction of 4.5 percentage points). However, in an historical context, the contraction in real GDP (and even jobs) was not excessive. The main feature of the 2007-13 business cycle, was the poor recovery phase. The economy rebounded after the 2009 recession, with real GDP growth reaching 3% in 2010-11 (in line with its post-apartheid performance during the first decade).

However, the revival of business confidence fell flat, fixed investment remained lacklustre (even when compared to business cycle expansions from the mid-1970s) and growth tapered to a 1.3% annual tempo (2012-19). *The aftermath of the Great Recession and the change in political leadership (2007 and 2009) left an indelible mark on the economy*.

Economic downturn: December 2007 to August 2009

The 2008-09 domestic recession will be remembered for the fact that it embodied an abrupt end to the record economic expansion between the end of 1999 and the end of 2007. Domestic business confidence began tapering off two years ahead of the onset of the recession. The RMB/BER business confidence index peaked at a level of 86 early 2006 and then tapered to 67 by the end of 2007 with the onset of the recession. While this indicated weaker growth to follow on the robust growth performance of the 2004-2007 period, the recession was externally induced being triggered by the GFC.

This impact is best reflected in the 23½% drop in the level of goods and non-factor services exports between 2007Q4 and 2009Q3 coinciding with the full length of the domestic recession. The shock impact on the export side is reflected in a close to 15% drop in the export-oriented manufacturing sector real value added and a 14½% drop in mining real value added and explains (with a three-quarter time lag) the bulk of the 4½% decline in non-agricultural formal sector employment, which then spilled over to the household consumer spending, which also began contracting in 2008Q3, i.e. three quarters after the onset of the recession. Real household consumption expenditure contracted by 2.4% (peak-to-trough).

Tel: +27(0) 21 851 3285 Mobile: +27(0) 83 414 0260 Email: p.laubscher@mweb.co.za
Address: 1A Gabbro Place, Boskloof, Somerset West, 7130
Owner & Economist: P Laubscher

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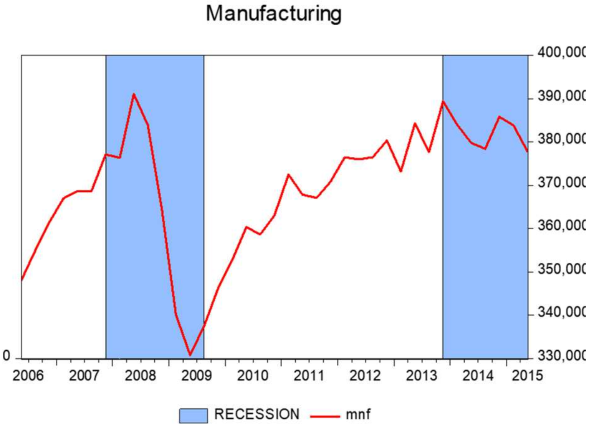
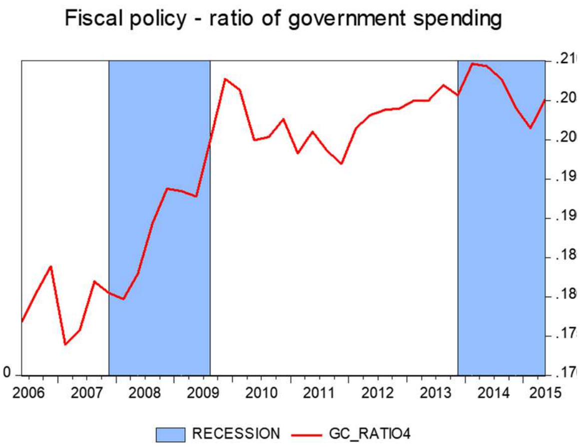


Source: SA Reserve Bank

In the domestic market, the impact was most visible in the 11½% contraction of fixed investment spending. The downturn in fixed investment spending was driven by the collapse in business confidence (62 points in all peak-to-trough, 44 points from the onset of the recession); in turn, mainly a result of intense uncertainty in the wake of the GFC, but also due to falling production capacity utilization as the demand conditions in particularly the export sectors waned.

The decline in fixed investment spending mainly comprised machinery and equipment spending (including transport equipment) as the construction sector was boosted by the infrastructure spending associated with the World Soccer Cup event in 2010; in fact, the construction sector avoided absolute contraction during the full period of the recession – it was only towards the end of 2009 when most of the mega construction projects linked to the Soccer World Cup began tapering off that the sector registered contractions in the level of real value add, i.e. 1.3% in all during 2010.

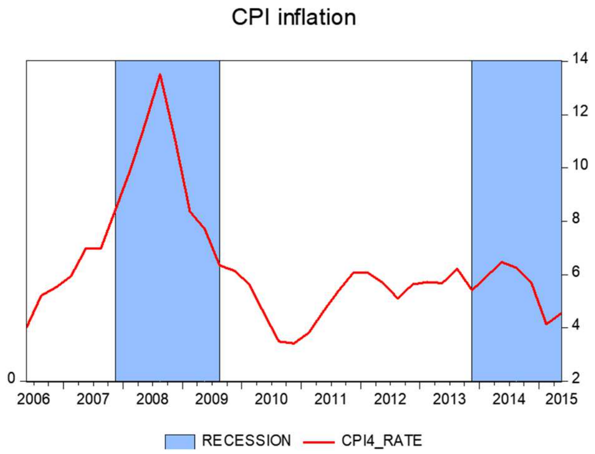


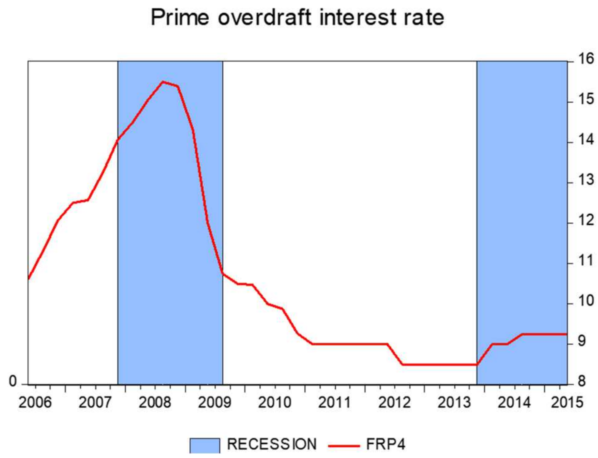
Source: SA Reserve Bank

The domestic market impact of the global recession was countered by strong anti-cyclical fiscal policy as real government consumption expenditure continued to grow (by 10.1%) over the course of the 18-month recession. This also softened the adverse impact on aggregate employment and household income. Real gross domestic expenditure contracted by 3% (peak-to-trough) and real GDP by 2.7%. The sharp fall in exports was countered by an equally sharp 22% drop in real import volumes, causing net exports to trend sideways during the recession.

Economic expansion: September 2009 to November 2013

Each business cycle has its peculiarities. SA's third post-apartheid business cycle is no exception. The recovery from the Great Recession displayed a number of unprecedented features. Furthermore, business cycles are often composed of different phases. Closer inspection of the 2009-13 expansion, which lasted 51 months (peaking in November 2013), also reveals *an inflection point* around the middle of 2011, i.e. seven to eight quarters from the onset of the economic recovery.





Source: Statistics SA/ SARB

The initial period, 2010/11, when real GDP growth averaged 3.2% per annum, was characterized by a rebound in business confidence and economic activity from the recessionary slump in 2008-09. Thereafter, economic growth slowed down and business confidence oscillated around weak levels. Two factors contributed to the growth phase. *Firstly*, continued growth in China and India, throughout the recession and its immediate aftermath, drove an immediate recovery in commodity prices, extending the commodity (super) cycle to 2011. This supported SA's export earnings, both from a demand and price perspective.

Secondly, on the domestic front, strong counter-cyclical fiscal policy throughout the recession and after (chart above), witnessed sharp increases in public sector employment and real wage rates – the latter also spilling over to the private sector. This, combined with lower inflation in 2010, a boom in unsecured lending (2010/11) and the recovery on the JSE and higher property prices, boosted household consumption expenditure. Hence, the expansion may be classified as being consumption-driven. The expansion phase was characterised by low and declining interest rates, which was a global phenomenon.

The export recovery was hampered by the sovereign debt crisis in SA's largest trading partner, the EU, which experienced a second leg of the Great Recession (2010-12). Economic growth in the other major advanced economies was also problematic in the wake of the global financial crisis. Lower productivity growth, ageing populations, high indebtedness, poor business sentiment and fixed investment were all characteristic of economic growth in the advanced economies of the world in the aftermath of the Great Recession.

Furthermore, influenced by the economic sluggishness and uncertainty abroad over this period, domestic business confidence oscillated around a weak level from 2011, also impacted by domestic supply-side constraints. This brings us to the onset of the demise of the 2009-13 expansion.

From 2011 onwards growth decelerated notably *"… as the weak global economy, domestic structural constraints and later also slowing domestic consumer demand all contributed to the demise of the upward phase in the business cycle"* (Venter, 2016: 110). With the typical overheating elements (read: high inflation) largely absent, the economy drifted into a downturn.

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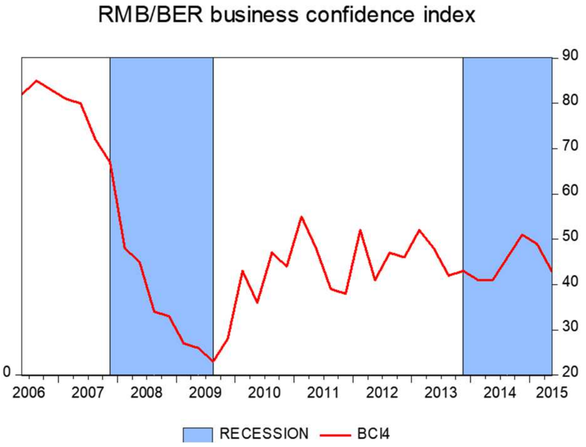
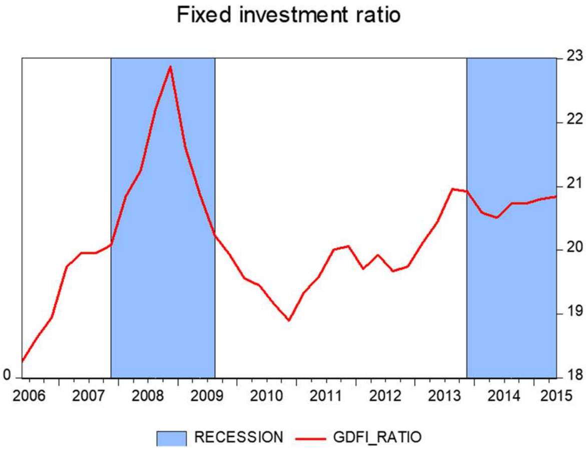
Real GDP growth averaged only 2.3% per annum, 2012-13. In November 2013, real economic growth dipped below its estimated trend rate, marking the onset of the economic downturn. The main factors, driving the economic slowdown, were, firstly, the slowdown in the (rebalancing) Chinese economy, sparking a collapse in commodity prices (2011-15) and a deterioration in SA's terms of trade over the period mid-2011 to end-2013. For the remainder, the global backdrop also remained *"unfavourable and turbulent"* (SARB, 2016: 107).





Source: Statistics SA

Secondly, the expansionary fiscal stance produced budget deficits measuring above 5% of GDP in 2012/13 and 2013/14, inducing fiscal consolidation from 2012 onwards. Static overall employment growth, lower real wage growth and higher inflation caused downward pressure on disposable income growth and household expenditure. Furthermore, business confidence and private fixed investment remained weak, which failed to boost employment growth and therefore rendered the consumption-driven economic expansion unsustainable.

Furthermore, the unsecured credit boom reversed from mid-2011 and other household credit extension remained lackluster (following the introduction of the NCA in 2007). This also meant that a key propagating factor in SA's economic recovery was missing, namely private sector credit extension. Only the higher-income consumers benefited.

International investors' search for yield (linked to the period of unconventional monetary policies in the major advanced economies) drove domestic asset prices higher and allowed an accommodative monetary policy stance by the SARB (see chart above). However, even new car sales peaked by mid-2013. Weak business confidence and fixed investment and the poor performance of the goods-producing sectors throughout the expansion were notable features. This, in turn, was linked to the global factors noted above and the domestic supply-side constraints.

The latter included the series of electricity outages from 2011, other infrastructure bottlenecks, the labour strife in the mining and manufacturing sectors (including the Marikana event in August 2012) and general economic policy uncertainty, which impacted these sectors more directly. The accompanying charts depict the near absence of the typical driver of SA's business cycles, i.e. fixed investment spending, also being accompanied by poor business confidence.

The result was that the economy drifted into recession. The typical economic flashpoints – or endogenous business cycle factors – sparking the upper turning point in the cycle were absent. No overcapacity, no undue wage inflationary pressures, no credit over-extension, etc. While the current account deficit reached a shocking 6% of GDP mid-2013, this was handsomely financed; furthermore, the deficit was a direct result of the deteriorating terms of trade and a high import intensity (in turn, linked to a deteriorated manufacturing performance).

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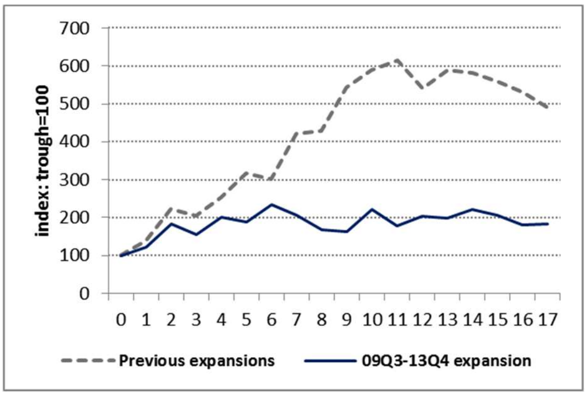
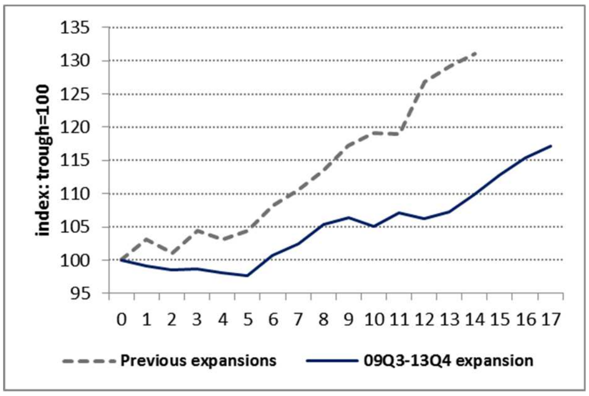
Figure 1: Tendency in business confidence



Source: BER

Figure 2: Tendency in real fixed investment spending



Source: SA Reserve Bank