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Pre-Budget Brief: Global and South African economic outlook for 2024

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Director: Dr Dumisani Jantjies

Author: Dr Seeraj Mohamed
Enquiries: smohamed@parliament.gov.za

To obtain additional copies of this document, please contact:
Parliamentary Budget Office
4th Floor Parliament Towers
103-107 Plein Street
Parliament of the Republic of South Africa
Tel: +27 021 403 2360
Email: pboinfo@parliament.gov.za

1. Global economic outlook

1.1. Developed economies

The world continues to face serious interrelated risks and crises during 2024, including concerns about escalating geopolitical and domestic conflict and the risk of financial and debt crises. At the same time, the intensified impact of global climate change remains a crisis while the possibility of epidemics and pandemics remain risks. The context for these risks is a global economy that has been reshaped by globalisation and financial crises since the 1980s. The role of the financial sector has significantly grown as has their influence over governments and policy since the global financial crisis of 2008 (GFC).

Economic globalisation and the rapid rise of the East Asian countries and China over the past few decades led to a shift in global production eastwards, particularly from the USA and a few developed and developing countries. Developed countries such as Japan and Germany maintained their productive bases and continued to pursue export orientation. The outcome was a massive global imbalance between the USA, which ran up a massive trade deficit with countries such as Japan, Germany, China and South Korea. This trade deficit led to a large financial imbalance because the trade surplus countries would have to transfer large amounts of finance to the USA (by buying US Treasury bonds and other financial assets) to help them with their balance of payments. As a result, there was global contagion caused by the subprime crisis in the USA that grew into a GFC and caused the Great Recession.

The use of quantitative easing after the GFC created a large increase in financial liquidity in developed countries that did not support the recovery of their productive sectors but fuelled the growth of finance and speculative flows into real estate and financial assets across the globe. It also contributed to the increases in sovereign debt levels across the developing countries, particularly to finance responses and recovery to the COVID-19 pandemic. The size and potential risks to the global economy after the GFC, where finance has further become delinked from the real sector, are clear when one considers that global financial assets now amount to more than five times the global GDP.

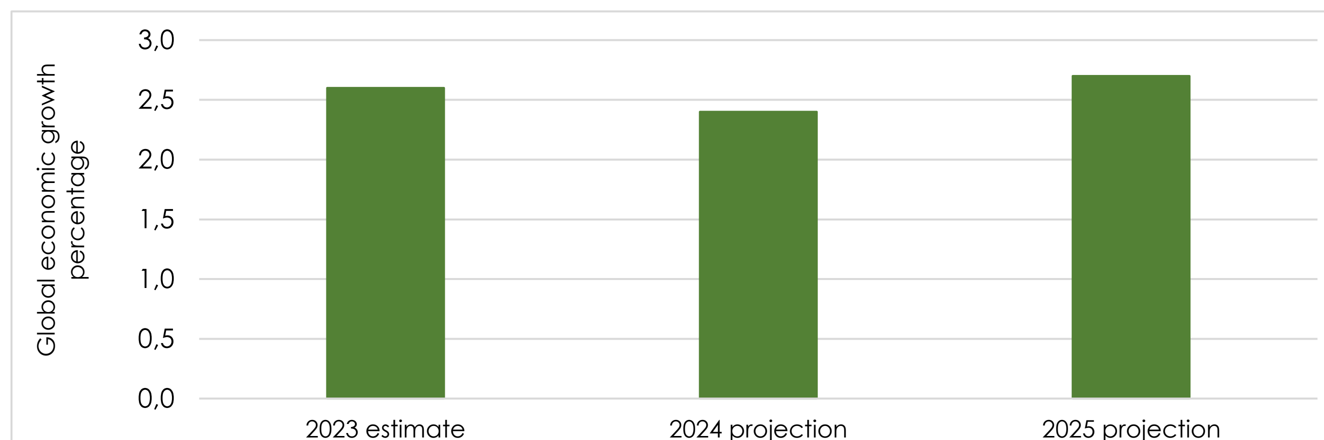
Global inequality increased during the pandemic as the returns to the financial sectors grew. The Guardian Newspaper reported in 2022 that the wealth of the 5 richest men more than doubled during the pandemic. They report that the poorest 60 per cent of the world's population lost money during the same period. The misallocation of finance, the declines in productive activity and unemployment will continue to affect the performance of the global economy, particularly of developing countries even if some developed countries have managed to resume growth and unemployment levels above what they were in the 1990s.

The interrelated geopolitical risks related to the Russian invasion of Ukraine, the escalating tensions between the USA and China over Taiwan, and more recently the Israeli government's genocidal response to the Hamas 7 October 2023 attack, have not only disrupted global supply chains. These geopolitical tensions have been causing the dismantling and rebuilding of these supply chains taking into account current alliances and power relations.

The situation today is one where global trade has declined and the USA is introducing industrial and other policies, including expansionary fiscal policies, to recover from the Covid-19 pandemic and to rebuild their domestic industrial capacity. European countries have chosen to maintain austerity so have not been able to support domestic recovery. They also have lower growth because of lower levels of international demand for their exports.

The impact of the USA's use of industrial policy and rebuilding their industrial base will have a long-run, severe impact, on countries that have chosen to build their economies by exporting. Large trade surplus countries, such as Germany and China, have followed a low-wage growth path to support the competitiveness of their exported goods. As a result, one would not expect domestic demand to offset the decline in international trade in their economies. Most countries' economic performances will continue to suffer (over several more years) the poor choice by central banks to respond to inflation caused by the pandemic, breakdowns in global supply chains, geopolitical strife, and profiteering by large corporations with the blunt, incorrect tool of raising interest rates.

Figure 1: World Bank & International Monetary Fund projections for real global economic growth



Source: International Monetary Fund and World Bank

The forecast by the IMF and World Bank for global economic growth for 2024 is below 2.5 per cent, which is conventionally recognised as a recession. They project global growth to of 2.7 per cent in 2025. Elections in 40 countries, including 12 in Africa and the presidential elections in the USA will be a test for global democracy and further increased uncertainty about global economic performance.

1.2. Developing and emerging economies

Mainstream economists' promises that all countries would benefit from market liberalisation and greater integration into global trade and financial markets turned out to be false. There was much pressure on developing countries to abide by the Washington Consensus in the 1980s and many African and Latin American countries were forced to do so as a result of the imposition of structural adjustment programmes by the World Bank during the 1980s. Developing countries were led to believe that they would have more access to finance and markets that would enable them to catch up with developed countries. Instead, Washington Consensus policies reversed the progress they had made towards development during the post-World War Two period. The limits imposed on government spending meant deterioration in health and education outcomes. Trade liberalisation led to deindustrialisation and exacerbated reliance on primary commodity sectors.

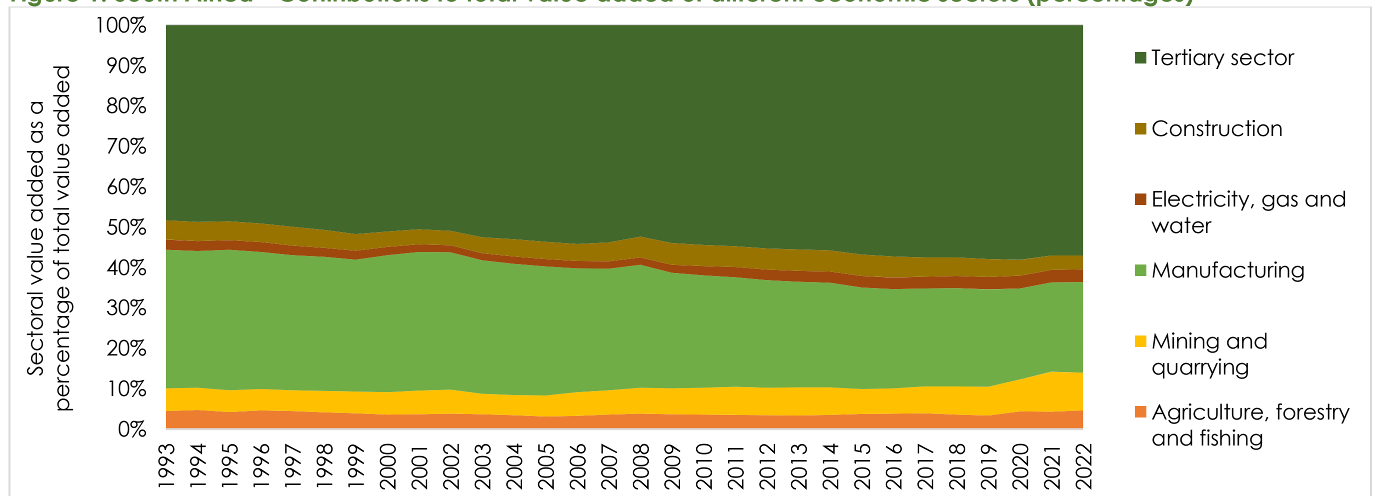
Certain developing countries, such as those in East Asia and China, that chose not to follow the Washington Consensus maintained tighter regulation of their financial systems and controls over cross-border financial transactions. They used active industrial policy to industrialise and improve their global competitiveness in downstream manufacturing. The welfare of their people was enhanced by access to employment and growing real wages. Government spending in those countries grew but more employment and economic growth meant that government spending as a percentage of GDP remained relatively low. Most of these countries also had relatively low levels of inequality and poverty (while China managed to eliminate poverty).

Countries, such as South Africa and several African and Latin American countries, that liberalised their trade and financial markets became more dependent on commodity exports, deindustrialised, and had higher levels of inequality. The overall impact of globalisation since the 1980s was increased inequality within and between countries in an environment with increased financial risks. As a result, the Asian developing countries that managed their integration into global markets entered the post-2008 GFC era and the pandemic with more developed, diversified economies and greater resilience to the interrelated crises that they would face. While South Africa and many African and Latin American countries remain reliant on commodity price cycles, have higher poverty and inequality levels, and have less resilience to crises. They also have impatient wealthy elites and large corporations more inclined to move their capital abroad in search of high, short-term returns than patience to make long-term investments in domestic productive assets.

The overall outcome of globalisation since the 1980s was increased dominance in market and global value chains of large multinational corporations and levels of concentration. The concentration and dominance have been particularly high in global financial markets where shadow banking has become even larger since the global financial crisis of 2008. Large financial corporations have become extremely influential over government economic policy with their views on the credibility of policies creating the constraints within which government finances operate. They pressure governments to forsake fiscal policy as an important instrument for managing economic cycles. This development has left monetary policy, essentially adjusting interest rates, as their only major tool of macroeconomic policy.

2. South African economic outlook

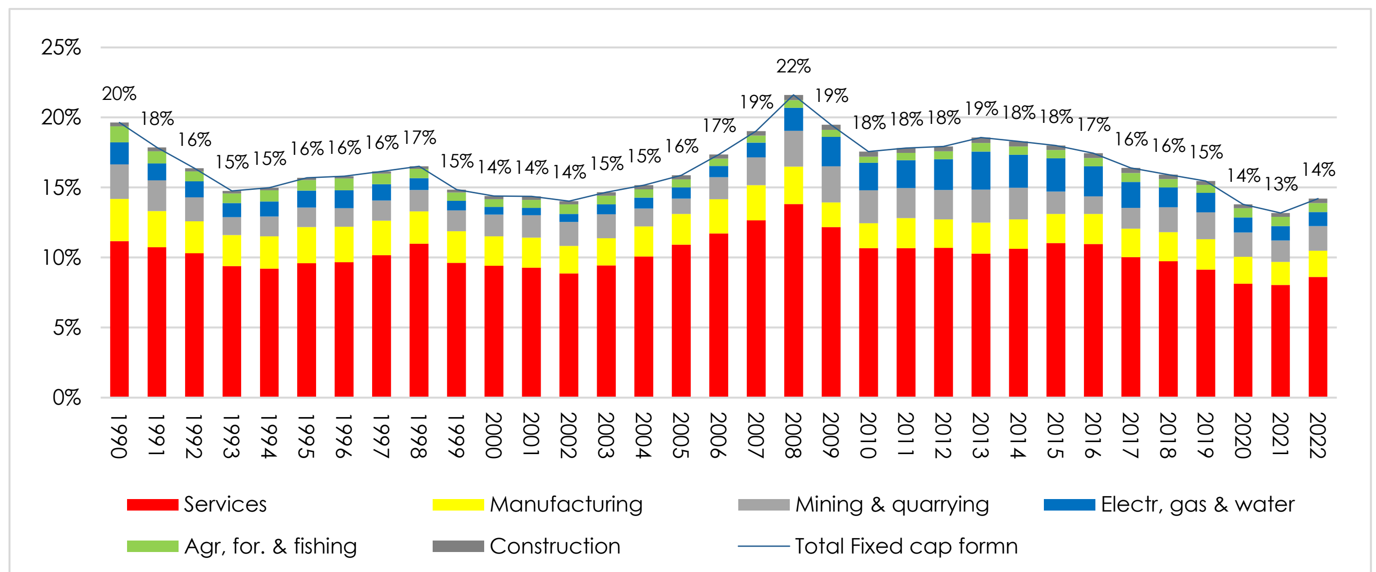
Figure 1: South Africa - Contributions to total value added of different economic sectors (percentages)



Source: Authors' calculations on Quantec's South African Industry Indicators

The impact of surges in financial liquidity, including increased inflows of foreign hot money, on the South African economy during the period from 2002 until the GFC in 2008 is generally overlooked by many mainstream economists. The increase in investment and GDP growth in this pre-GFC period is often attributed to the rise in commodity prices and the commodity super cycle, which is generally accepted to have been from 2003 to 2007. An examination of the SA value added data (see figure 2) shows that the larger growth in value added was in the service sectors whose share of total value added grew from 50.9 per cent in 2002 to 53.8 per cent in 2007. The share of value added by mining as a percentage of total value added was 5.9% in 2002, declining to 5.0% in 2003 and 2004 and recovering to 6.0% by 2007 (Real value added for mining and quarrying was R230 bn in 2023 and peaked at R236 bn in 2007).

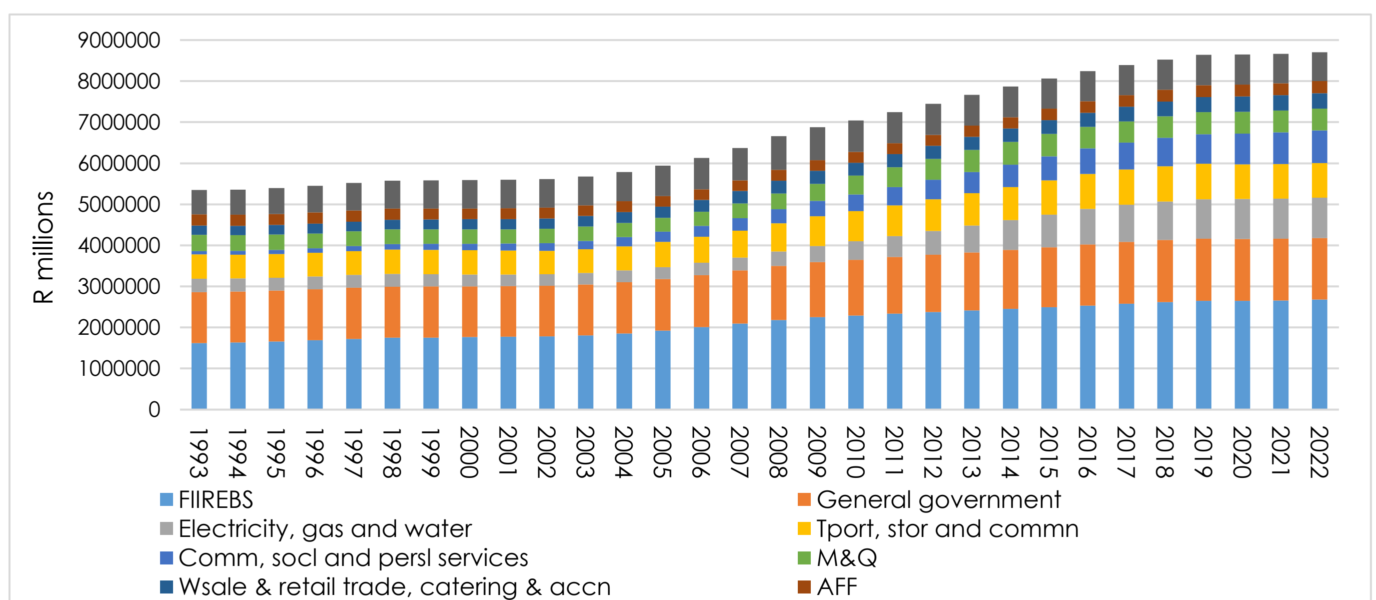
Figure 2: Gross fixed capital formation by sector as percentages of GDP



Source: Authors' calculations on Quantec's South African Industry Indicators

Figure 3 shows that the South African level of investment as a percentage of GDP was low throughout the 1990s before load shedding when the government proudly proclaimed that the country had the second lowest electricity tariff levels (after New Zealand). It is conventionally accepted that developing countries should invest levels should close to 30 per cent of GDP to support economic development and growth. A calculation using the World Bank's Development Indicators shows that from 1990 to 2021 investment as a percentage of GDP for the world was 24.2%, 27.3% for middle-income countries, and 27.7 per cent for upper middle-income countries. However, productive sectors, particularly manufacturing, are seen as the engines of economic development and growth. The future performance of the economy depends not only on the level of investment but also in which sectors that investment occurs. In South Africa, the largest share of investment since 1990 was in services with very low levels in manufacturing and other productive sectors.

Figure 3: Capital stock for different economic sectors (Rmillions, 2015=100)



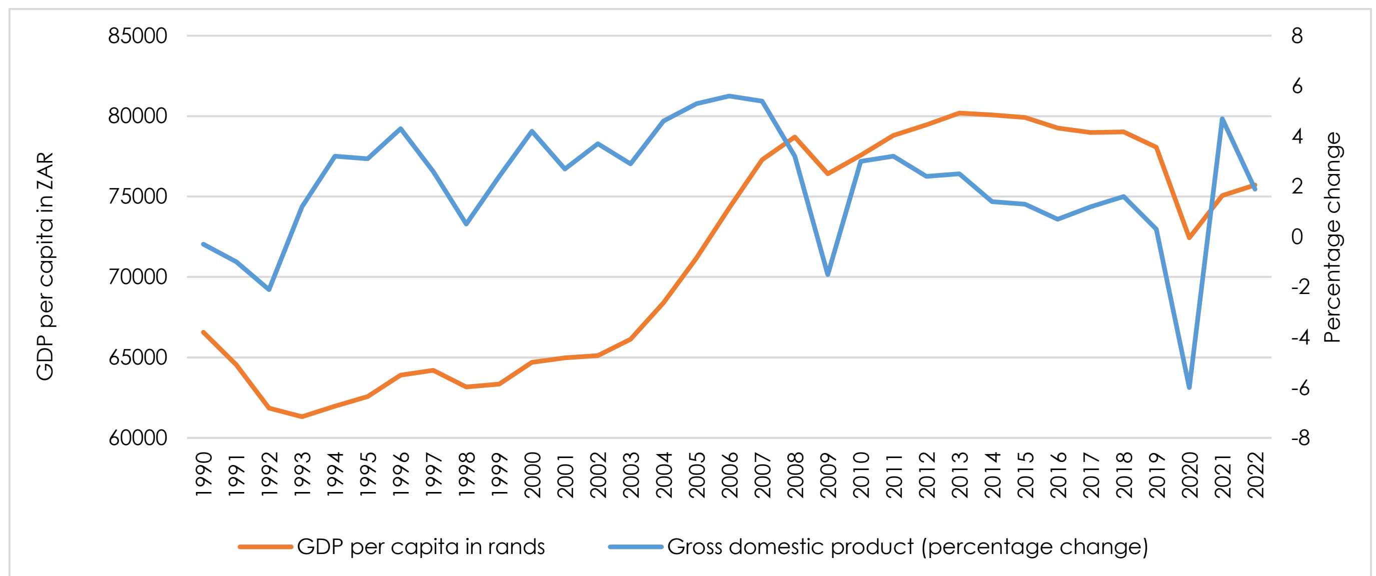
Source: Authors' calculations on Quantec's South African Industry Indicators

An examination of capital stock provides one with a sense of the economic structure of the economy. Economies are path-dependent and the extent to which capital stock is built up within an economy over time provides an indication of where to expect future economic activity to take place. Figure 4 shows how the evolution of capital stock for different sectors of the economy. The capital stock of the public sector can be gauged from changes in the real values of the capital stock of general government and the electricity, gas and water. The real capital stock of the general government sector grew by only R260 billion over the 3 decades from 1993 to 2022. On the other hand, the financial intermediation, insurance, real estate and business services sector's capital stock grew by over R1 trillion. By far the largest component of the FIIREBS capital was the real estate activities subsector, which was around 75 per cent of total FIIREBS capital stock for the entire period. The change in capital stock in the manufacturing sector over the three decades was only R116 billion. The share of the increase in capital stock for the entire manufacturing sector as a percentage of the increase in total capital stock was a small 3.4 per cent. This indicates the overall poor performance of the South African economy over the last 3 decades and points to its poor capacity to grow and industrialise on its existing manufacturing base.

The growth in GDP of around 5 per cent per annum during the 2004 to 2007 period was largely due to value added in service sectors, associated with debt-driven household consumption and growth in activities and speculation in real estate and financial asset markets. However, the GFC led to a reversal in short-term foreign capital inflows and large reductions in credit extension. Therefore, this relatively high level of economic growth was not sustainable and the overall trajectory of growth, investment and employment has been negative since the GFC. The main impact of the downturn was on non-services sectors, particularly the manufacturing sector. The choice to pursue fiscal consolidation a few years after the GFC did not help recovery but instead further constrained economic growth, investment and employment.

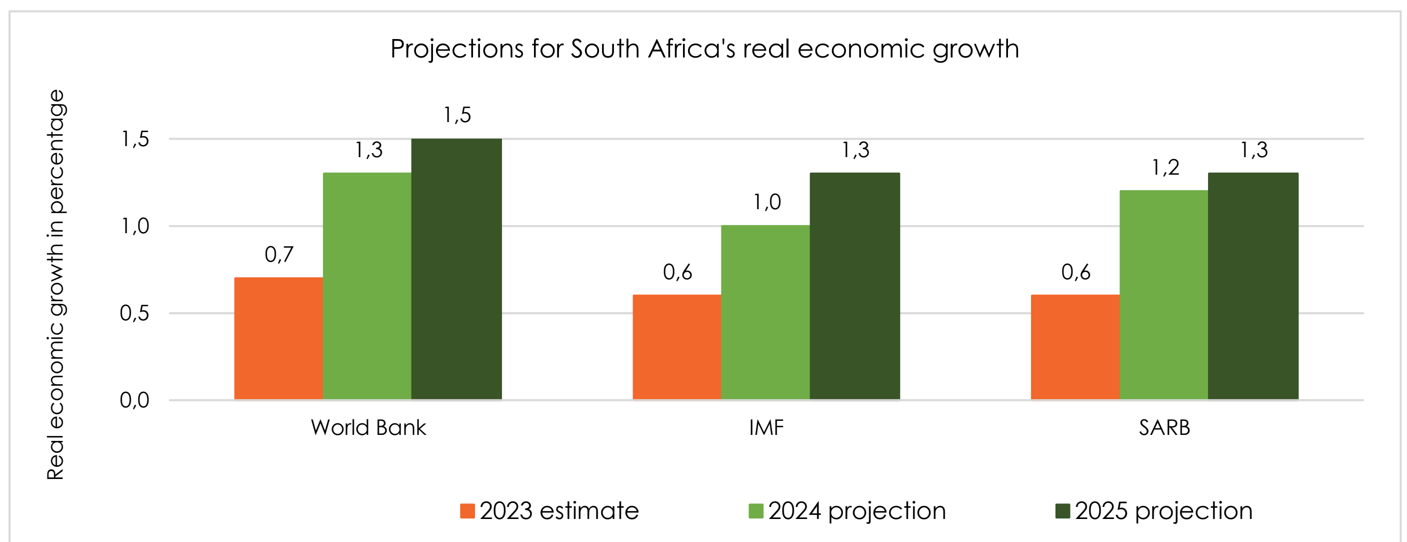
The global experience with fiscal consolidation shows that it does not lead to growth but instead constrains growth. Since fiscal consolidation constrains growth it also causes the debt-to-GDP ratio to increase. And, as the government has tried to reduce debt through limiting expenditure they have caused the ratio to increase further. The government has then pointed to the growth in debt to GDP and debt service costs to GDP as reasons for even more drastic expenditure cuts. Therefore, it is unsurprising that the impact of fiscal consolidation has been negative real per capita economic growth after 2013. By 2019 (before the pandemic) real per capita GDP was down to the level it had been in 2008. The government argues that economic growth is required to solve their perceived fiscal problems but they pursue a fiscal policy framework that has proven to constrain and reverse economic growth across the world.

Figure 4: Real GDP per capita in rands and percentage change in real GDP



Source: SARB

Figure 5: Projections for South Africa's real economic growth



Sources: IMF, World Bank and SARB

The January 2024 Projections of South African real economic growth for 2024 are low with the IMF projecting 1.0 per cent growth, the SARB 1.2 per cent and the World Bank 1.3 per cent. The projections for 2025 are equally dismal with the highest projection from the World Bank at 1.5 per cent. We can therefore expect 2024 to mark a decade of real GDP per capita shrinking in South Africa (since 2014). With the outlook projected to remain poor in 2025 and very likely over the next few years.