



EVENT REVIEW

Business Luncheon Presentation

Date : 9th September 2008

Venue : Grayston Sun Conference Centre, Sandton

Speaker : Dennis Dykes, Chief Economist, Nedbank

Topic : **How well is South Africa placed to cope with turbulent global conditions?**

On September 9th 2008, SwissCham Southern Africa – South Africa Chapter held its first membership luncheon presentation with Dennis Dykes, Chief Economist from Nedbank. Over fifty people attended the luncheon with large corporations as well as SME's represented. In the absence of our President, Jürg Schalch, our Vice-President, Thomas Hippele welcomed the guests.



Dennis Dykes joined the Nebank Group in December 1983 and was appointed Chief Economist in May 1994. He serves on a number of business and banking committees. He is a director of SACCI (formerly SACOB) and Chairman of its Economic Affairs Committee. He is also a former Chairman of Business Unity, South Africa's Standing Committee on Economic Policy and is a business representative on the Nedlac Public Finance and Monetary Policy Chamber. He is the author of many articles for in-house and external publications. In September 2003 Dennis won the Reuters Economist of the Year award. His qualifications include an honors degree from Bath University and a masters degree in economics from the London School of Economics.



In his presentation, Dennis Dykes gave a reasonably positive message of South Africa's ability to weather the storm currently raging in global financial markets and economies. South Africa's relatively favourable position is slightly counterintuitive he said, given the country's small, open nature, but both the nature of the crisis as well as the country's external position and policies have helped it to escape scrutiny so far.

Dennis first outlined how the favourable international economic and financial climate had contributed to South Africa's 5% GDP growth rate in the four years to the end of 2007. These included low global inflation and therefore interest rates, rising world economic growth and strong international liquidity. All these – to a greater or lesser extent – were functions of China's increasing dominance on the world stage. Not only has growth been strong, but it has been commodity-intensive given the rise in construction, manufacturing and infrastructure in the East. At the same time, productivity growth, driven by massive economies of scale and a relatively undervalued currency, helped keep manufactured and consumer goods price inflation very low despite rising commodity input prices. Finally, China and other trade surplus countries (such as the oil producers) were forced to recycle foreign exchange back into global financial markets. For South Africa as well as other African countries this meant an improving terms of trade (export prices rose relative to import prices), strong export demand, low inflation and access to plentiful and cheap international capital.

Unfortunately, these favourable circumstances started unraveling during 2007 and 2008 with the US subprime crisis emerging as the principal villain. As with many banking crises in the past, the origin of the problem was excessive liquidity, prompting bankers to find new and imaginative ways of lending money despite deteriorating credit quality. Given the steady upward march in house prices, mortgage lending – even to less than credit worthy clients – seemed like a safe bet, particularly when packaged into debt securities and on sold to the unsuspecting. The rise in US interest rates between 2004 and 2006 triggered large 'resets' in payments on adjustable rate mortgages and therefore large defaults among such borrowers. House price weakness in the lower price ranges soon

spilled over into other categories and soon banks were making losses on the paper they held and on securities that they had to bring back on balance sheet. They therefore started cutting back on lending and started regarding other banks' paper with suspicion, thereby exacerbating the crisis, worsening the downturn in the housing market and destroying consumer confidence. Worse still, the bets made on these securities had also been magnified by complex derivatives, making underlying losses significantly bigger than the original problem. Unfortunately, banks from other jurisdictions were involved through holding and dealing in such paper. The credit and liquidity crunch has therefore become global in nature.



Ironically though, emerging markets were not at the source of the difficulties and, in many cases, have so far escaped relatively unscathed. Although the availability of bank credit has dried up other liquidity is still very much available, with sovereign wealth funds sitting on massive piles of money. Portfolio and direct investment finance is therefore still available and many developing countries are relatively self sufficient, running fiscal and current account surpluses. South Africa is not quite as fortunate as it is running a large current account deficit and is dependent on capital inflows to support its infrastructure and capital formation programme. However, it has not been reliant on international bank credit for this and has managed to continue attracting investors. Part of the reason for this may be that the country has been able to improve its foreign exchange cushion substantially over the past four years and also has extremely low debt levels compared with peer countries. Foreign investors are also generally encouraged that the composition of imports is switching away from consumer goods towards capital goods and that the prospects for exports will improve as infrastructure improves despite a slowing global environment. Finally, the major South African banks were not involved directly or even indirectly in the subprime crisis and remain well capitalized, with the banking system operating normally.

Despite this, there are some negative features that could unfavourably differentiate the country in a risk-averse world. These include the electricity issue which, thankfully, has moved off the front page, but remains an obstacle to higher growth rates in the medium term. The uncertain political and policy environment post the changes in the ANC's leadership structures are also issues.

Dennis concluded that the potential for fallout from the global financial crisis was dependent on the country's own actions to a large extent. Positive political developments and a steady policy course would be rewarded by a relatively stable exchange rate and a declining interest rate pattern in 2009. With the oncoming Confederation Cup in 2009 and the FIFA World Cup in 2010, confidence and the economy would start lifting in the second half of 2009 and growth would get back to trend levels of around 4,5% or more in 2010.



During the presentation a superb 4-course meal was served prepared by Grayston Sun's renowned Chef, ending with dessert, tea and coffee.

SwissCham Southern Africa – South Africa Chapter thanks Dennis Dykes for his most interesting and very topical presentation.