

## **Forex reserves at new high**

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Ever since South Africa's advent to a democratic order in 1994, structural change to various key economic variables have become evident, particularly in the areas of price stability and the public finances.

Testimony to this is the fact that inflation is well within the SA Reserve Bank's target range of between 3% and 6% and the regular announcements of overruns of budgeted fiscal revenues.

The latter was well publicised during the last week of October, when Finance Minister Trevor Manuel presented his so-called "mini-budget" to Parliament, which is essentially a mid-fiscal year report-back on progress with the current national budget targets.

### *Tax bonanza*

It must have been a pleasant exercise, considering the sheer size of the latest revenue overrun. After announcing that the National Treasury was stuck with R30 billion of funds that were not budgeted for, the Finance Minister's popularity stakes are probably at an all-time high.

One glaringly obvious caveat to this apparent rosy scenario is the concern over government's capacity to spend money in areas that are considered conducive to the stimulation of economic growth over the longer term. The mid-year fiscal review reports a budget deficit/GDP ratio that is merely 1% - effectively changing the 2005/6 national budget from a pro-growth budget into one that acts as a growth constraint.

A much less publicised area of positive structural change is the sterling performance of the country's balance of payments over the past decade. Although a return to international financial stability was on the cards as a result of the abolition of sanctions and the lifting of the global debt moratorium on South Africa, the magnitude of the reversal of fortunes of the balance of payments is quite impressive. Two indicators that confirm the growing sophistication of the nature of foreign export earnings are:

- Between 1994 and mid-2005, gold's contribution to total export earnings declined from 21.5% to merely 6.9%
- Over the same period, the share of service and income receipts increased from 15.2% to 18.7 %

### *New record*

The most impressive performance, however, has come from the sharp increase in the country's foreign exchange reserves. At the end of the second quarter of 2005, the ratio between gross gold and foreign exchange reserves and GDP recorded a new all-time high, namely 15.8%.

The previous record was achieved in 2001 (15%). This ratio has now increased more than five-fold from its 1994 level and signals the need for both the Minister of Finance and the Governor of the Reserve Bank to urgently seek more growth-orientated policy interventions.

A business analogy to the strong balance of payments position may be found in a financially healthy company that is experiencing consistent increases in the demand for its products or services, whilst simultaneously building up cash reserves.

Furthermore, demand growth is starting to threaten output capacity, so the obvious remedy would be to utilise its cash surplus to expand productive capacity and facilitate higher future output growth from a higher economic capital base.

Not so in the case of macroeconomic policy in South Africa. Consumers have already received a thinly veiled threat of higher interest rates and the Exchequer does not seem to be able to channel substantial excess revenues to fairly innocuous job creation projects such as fixing potholes and making roads safer for both motorists and pedestrians.

Fortunately, CPIX inflation figures released at the end of October showed a marginal decline to 4.7%, which should prevent an unwelcome pre-Christmas rise in interest rates. Furthermore, the Minister of Finance has acknowledged that skills shortages constitute a threat to the quest for a higher economic growth rate.

Hopefully, the long-standing rhetoric on this issue will soon become manifested in an official international recruitment drive for appropriate skills. Such a short-term solution should be supplemented by an expansion of the higher education sector's delivery of graduates.

