South Africa Finance Minister Warns of Great Depression

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Drawing a rather gloomy picture of what the world's economies can look forward to, Finance Minister Trevor Manuel on Wednesday said recession on Anglo-Saxon markets has truly taken grip.

"The global economy is experiencing a sharp downturn, spreading from developed to developing countries. Its origins lie in macroeconomic imbalances of an unprecedented scale.

"In a very short period…what started off as a financial crisis may well become a second great depression [mirrored on the Wall Street crash of 1929]," the finance minister told Parliament, delivering his 2009 Budget Speech.

In mid-2008, banks and financial institutions in the United States over-extended credit to people who were not credit worthy.

When the time came for banks to call in mortgages and consumers were unable to repay, a massive liquidity crisis erupted in banks in the United States, at first, which then quickly spread to European banks.

All major world banks relied on an availability of credit from other banks in order to lend money to ordinary consumers, but once banks were not sure whether they would still be able to recoup those funds from other banks then lending between financial institutions drew to an abrupt halt.

The result was a drying up of funds or liquidity crisis on the markets of the world's most advanced and developed economies.

The finance minister explained that if the balance sheet of a bank shrinks, its ability to lend to consumers is then eroded.

"If its lending is curtailed, businesses and households have to reduce their spending. If demand falls in Birmingham, factories close in Beijing. If production lines in China slow, demand for commodities from Africa dries up.

"The vegetable shop next to the mine closes, and drivers of the delivery vehicles are asked to work short time, on half pay, and if the driver cannot pay his mortgage, the bank forecloses on its bond, and the bank writes down its balance sheets again," the minister said.

The problem being, however, is that when global car manufacturers scale down the size of their orders for new cars, production firms producing catalytic converters, such as the one in the Eastern Cape are now affected.

The mine producing the platinum that goes into the catalytic converter is near Rustenburg, so the factory worker in Uitenhage and Rustenburg are now without work, he said.

In the United States alone last year, 2.6 million people lost their jobs, while that figure is expected to double in 2009.

Likewise in China, 20 million migrant workers who went home for the Chinese New Year will not return to the cities as those jobs no longer exist he said.

The International Monetary Fund (IMF) has continually revised its forecasts for global growth downwards in 2009, going from 3.8 percent in April 2008 to current estimates of just half a percent.

While the downgraded reductions were initially focused on developed countries, the Gross Domestic Product (GDP) growth of developing countries has also now been halved from 6.6 percent in April to 3.3 percent at present.

The US economy has been in recession since the last quarter of 2007 and its economy is expected to shrink by a further 1.6 percent in 2009, the minister said, adding growth in Europe is also expected to shrink by 2 percent this year.

"China's GDP growth fell to 6.8 percent in the final quarter of 2008 and will slow this year to its lowest level since 1990… [while] India's growth will fall by almost half.

"Sub-Saharan Africa is feeling the effects of the commodity price plunge and declining investor confidence, [and growth is expected to] slow to 3.5 percent in 2009 from 5.4 percent in 2008," Mr Manuel told Parliamentarians.

International investors, who had money invested in developing economies like South Africa, Botswana, Namibia and Angola, among others, are in an ironic twist practicing emerging market risk aversion and withdrawing their funds from what is perceived to be riskier markets.

Capital is then leaving emerging markets and flowing into currencies such as the US dollar and the Euro, who are, in fact, responsible for the markets collapse in the first place.

Many governments this year will be borrowing heavily in an attempt to finance their financial bailout plans and budget deficits, which may well be necessary, Mr Manuel said, noting though that the build up of debt will have to be paid back with interest by future generations and governments.

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