

## Economic discipline has its reward

Over the past three years South African inflation and interest rates have declined dramatically and its economy is booming. This is the consequence of becoming a full participant in the global economy since 1993.

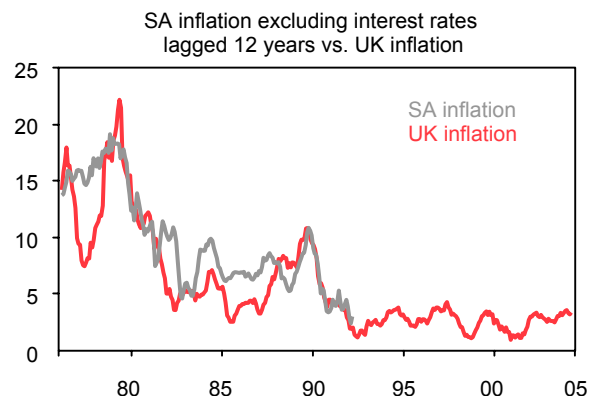
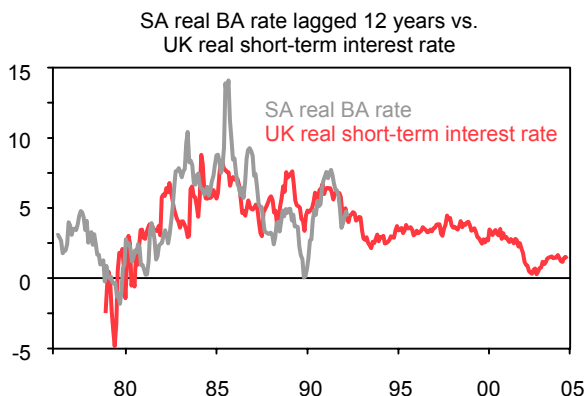
During the 1970's the world was plagued by high levels of inflation, which was brought under control by an economic revolution, the most prominent proponents of which were the US administration of Ronald Reagan and the UK government of Margaret Thatcher. The mix of policies, which largely eliminated inflation and ultimately gave rise to the boom of the 1990's included:

- Setting interest rates significantly higher than inflation so that it was no longer possible to make money out of inflation
- Increasing competition both domestically and through international trade
- Reducing taxes

The concept of free markets operating within a stable monetary and fiscal framework has become the so called Washington consensus of the IMF and World Bank, and is now widely regarded as the most certain formula for economic success.

The introduction of these policy reforms was accompanied by acrimonious debate about whether they would work. In order to make the costs more palatable, their proponents promised fairly immediate benefits that in fact took a decade to materialise. However without exception, wherever these policies have been adopted, in time inflation has been tamed, which has allowed a substantial cut in interest rates and created an economic boom. The global prosperity of the 1990's was a direct consequence of initiatives taken in the 1980's. One of the biggest risks facing investors today is the abandonment of sound monetary and fiscal policies in many countries, most notably the United States, which could rekindle inflation.

South Africa, trapped within its fortress economy, was largely excluded from this process until 1993, when under the new political dispensation it was able to open its economy to global competition, while imposing monetary and fiscal discipline. It is 12 years behind the United Kingdom and 9 years behind Australia in this process. What is remarkable is the similarity of the outcome. The graphs show inflation and real interest rates in South Africa compared with those in the UK with a lag of 12 years. Both countries started with similar inflation and interest rates, which then declined over a decade. The comparison between South Africa and Australia is almost identical. We have followed the same path and have now arrived at the point the UK reached in 1993 and Australia in 1996. Their subsequent experience gives a sense of what inflation and interest rates could be if the South African government maintains macro-economic discipline and market freedom. Shocks such as a significant devaluation of the Rand can divert us temporarily from this path but in time we should gravitate towards the inflation rates of our trading partners. It is important to recognise that our current boom is typical of what other countries have experienced once inflation was largely eliminated. This was what the proponents of the GEAR strategy (Growth, Employment and Redistribution) promised when it was implemented in 1996. GEAR has worked, except, as elsewhere it took longer than initially expected to deliver the promised results.



Our current prosperity is proof yet again that the laws of economics work inexorably and everywhere. Good economic policy is ultimately rewarded with prosperity.

*Commentary by Sandy McGregor, Director, Allan Gray Limited*