THE KINGDOM OF SWAZILAND

RECENT ECONOMIC DEVELOPMENTS

PAPER PREPARED BY

THE CENTRAL BANK OF SWAZILAND

RESEARCH DEPARTMENT

REAL GDP

The expansion in economic activity is projected to slow down in 2004 after growth of 2.6% in 2003. Official estimates put real GDP growth at 2.1% in 2004. Given the estimated population growth rate of 2.9%, the unimpressive economic growth fails to achieve the upliftment of the well-being of the average Swazi and implies a deterioration of the standard of living as measured by per capita income.

The downward trend in economic performance in 2004 is a reflection of the low growth rate in foreign direct investment, weaker performance of the manufacturing sector and low agricultural productivity particularly on Swazi Nation Land (SNL). The slump in agricultural production was a result of three consecutive drought seasons in the region, which resulted in a serious food shortage throughout the country. This development exacerbated the already severe problem of high unemployment, income inequality and poverty.

Growth in manufacturing output slowed down in 2004 following the closing of some major companies and weaker performance of the manufacturing sector emanating from the sustained strength of the exchange rate. The sharp appreciation of the rand/lilangeni exchange rate against the US dollar and other trading partners' currencies during 2004 reduced emalangeni value of exports destined to markets outside the Common Monetary Area. The overvalued rand/lilangeni exchange rate against a basket of its trading partners' currencies implies that the competitiveness of locally produced goods in the international markets deteriorated during 2004. Also, the strong local currency impacted negatively on overseas tourists inflow by reducing their purchasing power, thereby making domestic goods expensive.

A downturn in foreign direct investment (FDI) inflows notably in the textile industry contributed to the slowdown in manufacturing growth in 2004. As a small open economy, Swaziland faces external shocks that are not of its own making. Swaziland's clothing and textile industry, which significantly increased its exports and created thousands of jobs under the African Growth and Opportunity Act (AGOA), is now being threatened with the Agreement on Textiles and Clothing (ATC). The ATC's final implementation came into effect in January this year, lifting all quota restrictions on clothing and textile exports and paving the way for more cost-effective producers, such as China and India, to increase their exports to global markets. The textile and apparel sector is now guided by a multilateral system of trade rules under the General Agreement on Tariffs and Trade. A multilateral trade regime aims at improved trade fairness and treats all countries equally. In the advent of these changes, garments and apparels from Swaziland are increasingly becoming price competitive, something that will cause factory closures in the country. This sector is gradually seeing buyers particularly from the USA moving orders to the East. The closure of the factories and the resulting loss of jobs are serious threats to continued economic growth.

The above not notwithstanding, the moderate growth in manufacturing output was spurred by positive performance of some export commodities including sugar-based products and soft drink concentrates. Overall growth in 2004 also benefited from increased construction activities due to ongoing road and housing projects. Further, the good economic performance by South Africa in 2004 boosted Swaziland's export demand since over 50% of country's exports are sold in South Africa.

EMPLOYMENT

Employment projections for 2004 indicate a contraction in formal employment, which is in line with the projected economic growth during the same period. The labour market continues to be characterized by excess supply as the current economic activities fail to generate the much needed job opportunities. The decline in formal sector employment is attributed to a reduction in private sector employment resulting from the shedding of jobs by the textile sector during the review period. Employment opportunities were further undermined by limited investment in other labour-intensive industries as well as factory closures particularly in the textile industry in recent years. In addition, existing companies continue to shed some workers and to outsource non-core activities in a drive to remain competitive and profitable. It remains therefore government's responsibility to support the efforts of SIPA to lure foreign investors by, among other things, implementing a corrective plan to restore investor confidence in the country and remove the growing threats to the country's preferential markets.

Informal sector employment in Swaziland has gained prominence in recent years following the restructuring of most companies in the 1990s. A significant number of employees who lost their jobs joined this sector. Hence, the encouragement of informal sector activities and the promotion of Swazi-owned businesses remain crucial for stemming the unemployment rate. This is very important in view of the results of the 2001/02 Household Income and Expenditure survey, which put the unemployment rate at 29%, up 6.2% from the 22.8% estimated by a similar survey undertaken in 1997/98.

Work opportunities outside the country, especially in the South African mines, on the other hand, continue to be important in terms of income and foreign exchange earnings. However, current estimates indicate that mining labour, which constitutes the bulk of migrant labour for Swaziland, has continued to decline in recent years following a peak of 20,041 in 1993. Swazi migrant workers in South African mines declined from 7,885 in 2003 to 7,445 in 2004. A number of factors, including increased mechanisation and relatively high mine wages that now attract large numbers of South Africans, have undermined the job prospects for Swazi workers on South African mines.

The high prevalence of HIV/AIDS continues to pose a threat on the labour market as it is estimated to be more prevalent among the most productive age groups i.e. 15-49 years. Statistics also show an increase in the number of orphans being taken care of by the elderly people as well as an increase in the number of elderly people with no support mechanisms. The efforts by government through the National Emergency Response Committee on HIV and AIDS in coordinating a national strategy against the pandemic and the drive to provide free education for the increasing orphans and vulnerable children are commendable. The establishment of HIV/AIDS programmes at the work place will go a long way in educating workers about the pandemic whilst the provision of anti-retroviral drugs to the critically ill through the Global Fund will give workers more productive years.

Employment prospects for 2005 remain bleak largely as a result of the negative impact of uncertainties surrounding AGOA extension, as well as the implementation of the Agreement on Textiles and Clothing and hence the removal of quotas on clothing and textile exports on international markets. Although there have been no large disinvestments from Swaziland, some clothing and textile firms have closed down since the beginning of 2005, with more expected to follow suit during the course of the year. These closures are expected to reduce employment significantly in the manufacturing sector. The sugar industry is also expected to shed a significant number of jobs during the course of 2005 as a result of unfavourable developments in the international sugar markets.

PRICES

The overall consumer inflation rate for all income groups was 3.2 percent year-on-year in January, unchanged from December and November. The average annual inflation rate was 3.4 percent in 2004 and 7.4 percent in 2003. This is in line with low inflation of 1.4 percent in 2004 in South Africa, Swaziland's main trading partner. In January, food inflation rose to 8.1 percent year-on-year from 5.7 percent in December. Annual food inflation was 6.9 percent in 2004, well below the 2003 average of 12.6 percent. Almost one-quarter of the consumer basket (24.5 percent) of goods and services is made up of food items.

Housing prices (with a weight of 15.9 percent in the consumer basket) increased by 5.1 percent year-on-year in January, unchanged from December. Housing prices increased by an annual average of 4.6 percent in 2004 compared to 7.3 percent in 2003. Clothing and footwear prices (10.9 percent weight in the consumer basket) increased by 1.1 percent year-on-year in January from 0.7 percent in December. Clothing and footwear prices rose an annual average of 1.6 percent in 2004 compared to 4.9 percent in 2003. Furniture and appliances prices fell by 1.7 percent year-on-year in January and by 0.7 percent in December. The annual average inflation rate for this group was 0.2 percent in 2004 compared to 4.8 percent in 2003.

MONETARY SECTOR

During the two months ended January – February 2005, the Central Bank of Swaziland maintained a stable monetary policy stance with its policy (discount) rate unchanged at 7.5 percent. This was mainly a result of subdued inflationary pressures mainly emanating from the resilient appreciation of the rand/lilangeni exchange rate. Commercial banks' interest rates also remained unchanged with the prime-lending rate at 11 percent.

Net foreign assets of the banking system reflected an increase of 14.8 percent over the two months period to reach E2, 225.4 million at the end of February 2005. The net foreign assets were enough to cover 2.3 months of estimated imports, slightly higher than the 2 months' cover recorded in December 2004. Contributing to the increase in net foreign assets were the usual quarterly customs revenue inflows during the month of January 2005. Compared year-on-year, the net foreign assets grew by 9.9 percent. Net official reserves alone increased by 27.4 percent to E1, 845.7 million while net external assets of commercial banks declined by 22.6 percent to E379.7 million. Measured in Special Drawing Rights (SDRs), the level of net foreign assets depicted a bi-monthly rise of 13.6 percent to SDR251 million.

Over the two months ended February 2005, net domestic credit fell by 20.7 percent to E1, 919.1million; largely attributed to a decline in private sector credit combined with an increase in government net balances with the banking system. Total credit extension to the private sector exhibited a decline of 2.5 percent to reach E2, 948.6 million; mainly reflected in credit extended to the household sector. Net government balances with the banking sector, however, rose substantially by 71 percent to E1, 029.5 million over the two months to February 2005.

Broadly defined money supply (M2) constituting currency in circulation and other domestic deposits depicted a bi-monthly decline of 3.2 percent to close at E3, 172 million in February 2005. The fall in M2 was mainly attributed to the deceleration in private sector credit as well as the leveling-off in domestic expenditure recorded during the festive season. A notable decline was depicted in corporate sector deposits which fell by 19 percent to E1, 535.6 million whilst household sector deposits increased by 11.2 percent to reach E1, 025 million.

EXTERNAL SECTOR

Swaziland's preliminary balance of payments depicts an improved overall deficit of E128.5 million in 2003 against a deficit of E307.3 million recorded the year before. Contributing to this movement are surpluses in the trade account and current transfers account, coupled with a reduced deficit in the services account.

The current account moved from a surplus of E565.9 million, 24.3 percent lower than that recorded the previous year, mainly as a result of a 2.1 percent contraction in the trade surplus to E1,373.5 million in 2003. Other contributors to the worsened current account are a deficit in the services account, which stood at E1,074.3 million, and the income account which for the first time in many years deteriorated to a net outflow of E83.9 million.

Revised 2003 data indicate that exports (f.o.b.) increased by 8 percent to reach E12,797 million. Exports of soft drink concentrates continued to soar in 2003, as Swaziland became the biggest supplier in Africa, although its earnings dropped as a result of the exchange rate losses. Sugar export earnings on the other hand rose by 10.6 percent to E762.2 million. The establishment of more textile factories and the textile sector's improving efficiency cushioned the negative impact of the closure of three textile factories during 2003. By December, export proceeds under AGOA had increased by 68.1 percent to E122.2 million.

Lack of demand in world markets combined with low production volumes saw wood pulp export earnings plummet by 41.3 percent to E421.3 million during the review period. Revenue earnings from canned fruits and citrus declined to E117.4 million and E57.3 million, respectively. The fall in canned fruit export revenue is a product of low prices in the word market and unfavourable rand/lilangeni exchange rate; whilst citrus export revenue was undermined by a poor crop yield due to reduced area cultivated. Export receipts from unprocessed cottonseed declined by 78 percent to E48 million in 2003.

Revised data reflect that imports (f.o.b.) recorded a 20.2 percent growth during 2003 as Swaziland recorded a significant increase in goods imported for repairs during the period under review. The coming on stream of new Cut-Make-Trim factories also contributed positively to the hike as they imported more input fabrics from the Far East. In addition, there was a general upward movement in imports into the manufacturing sector coupled with a rise in imports of machinery and equipment for both government and the private sector. The hike in oil prices also contributed to the increase in the importation of minerals, fuels and lubricants.

The services account recorded a net outflow of E1,074.3 million in 2003, compared to a net outflow of E1,304.8 million recorded in 2002. Services inflows increased by 20.4 percent to E912.7 million in 2003 whilst services outflows decreased by 3.7 percent to E1,987 million during the same period. Explaining the growth in services inflows was a hike in income earned by the transport sector as some foreign exporters utilized domestic roads, railway, and freight companies to ship goods into Swaziland. Earnings by the country's passenger airliner, which operated more flights and at higher occupancy levels with non-resident leisure and business tourists, also account for the growth in services inflows during 2003. By end of the year, income from transportation services had risen by 18 percent to E158.9 million. Other services inflows also grew by 21 percent to E753.8 million during the review year, and was aided by a notable growth of E268.7 million in tourism income as holidaymakers and business tourists considered the country an ideal tourist destination.

Services outflows declined due to a deceleration in expenditures of the country's Embassies and High Commissions. Transportation services outflows grew slightly by 8.5 percent to E383.7 million, with most sugar-based processors using specialized foreign tankers to export to South Africa.

For the first time in many years, the income account registered a deficit in 2003, swinging from a net inflow of E47.9 million in 2002 to a net outflow of E83.9 million. This was due to a 31.5 percent decline in income inflows to E1,038.8 million; income outflows contracted by 23.6 percent to E1,122.6 million during the same period. Due to an upward adjustment in average wages of Swazi nationals employed in the South African mines, compensation of employees soared by 3 percent to E664 million in 2003.

Inflows of equity to the private sector grew by 44.1 percent to E51.3 million during 2003 following an increase in dividend earnings from offshore investments. On the other hand, outflows on equity income declined by 29 percent to E390 million, mainly reflecting reduced reinvested earnings. Income inflows, largely consisting of interest and investment income earnings, fell due to low interest rates and the relatively stronger lilangeni as interest earnings by both the private and the official sectors declined. This occurred despite the persistent increase in outflows of pension and other employee retirement funds invested with fund managers in South Africa.

The current transfers account declined by 46.8 percent to a net inflow of E350.5 million during 2003. The contraction was mainly a result of current transfer outflows that grew by 51.5 percent to E2,170.8 million. The growth in current transfers outflows resulted from duties collected and remitted by Swaziland to the SACU revenue pool managed by South Africa. On the other hand, current transfers inflows benefited from non-duty SACU receipts, which rose by 9.4 percent to E1,951.8 million in 2003.

There were no movements in the capital account in 2003. The financial account recorded a net outflow of E296 million, 56.5 percent lower than the level registered the year before. Influencing this development was a turnaround in other investment from a net inflow of E1,586.3 million to net outflow of E191.7 million; combined with a decline in portfolio investment to a net inflow of E14.3 million against a net inflow of E20 million. FDI swung from a net inflow of E886.5 million to a net outflow of 502.1 million. This is due to a turnaround in inward FDI from an inflow of E822.7 million to an outflow of E540.2 million: a sign of disinvestments. During the review year, long-term loans extended to Swazi companies by head offices, equity capital, reinvested earnings and short-term capital fell by 2.8 percent, 6.5 percent and 37.9 percent, respectively.

Portfolio investment also declined by 28.5 percent to E14.3 million in 2003 as a result of portfolio investment liabilities, which declined 41.7 percent to a negligible outflow of E0.5 million. Portfolio investment assets contracted by 64.1 percent to E14.8 million as a result of one local company's disinvestments from public sector bonds abroad during the review year.

Other investment assets, comprising mostly of pension funds and life assurance funds invested mostly in South Africa, registered an inflow of E316.9 million against an outflow of E1,155 million seen in 2002, thus resembling reduction in assets held abroad. Other investment liabilities declined mainly due to other sector's short-term liabilities, which fell by 71 percent to an outflow of E125.1 million during the review year.

FISCAL SECTOR

Government budgetary operations worsened in 2004/05. The estimated outturn shows a deficit of 3.6% of GDP, an increase from an actual outturn deficit of 2.9% of GDP recorded the previous fiscal year. The deterioration in the country's fiscal position continued in spite of an improved performance and efficiency in revenue collection and an unexpected increase in SACU receipts. Government revenue including grants is projected to rise by 30% to E5.1 billion in 2004/05. The improvement in SACU receipts should however be viewed as a windfall and cannot be expected in future years. To sustain this position, government is committed to undertake economic reforms that were identified in previous budgets. The aim of these programs is to address the cash flow problems by exploring revenue enhancement as well as expenditure control. These include the implementation of VAT in 2007/08, merging the major revenue collecting departments under one Revenue Authority, strengthening the legal framework on public finances, privatisation of public enterprises and reorientation of government expenditures with the downsizing of the civil service being the first priority.

At the current level, the country's deficit is unsustainable as the internationally acceptable level for a small open economy is 3% of GDP. There is therefore an urgent need for the country to maintain the maximum sustainable level of its deficit in the range of 1-2% of GDP. Even though government revenues are projected to rise, the gravity of the problem is that the revenue base is not rising rapidly enough to match the expenditure. Hence, the greatest efforts to reduce the deficit must be on controlling expenditure.

Appropriated recurrent expenditure is estimated to increase by 25.2% to E4.4 billion in 2004/05 and is 25.5% of GDP during the same period. Like in previous budgets, the major contributors to the high recurrent expenditure included personnel costs, clearing of outstanding commitments, transfers to parastatals and social sectors (education, health and drought relief programs). On the other hand, the ratio of revenue to GDP is estimated to have improved to 29.8% in 2004/05 compared to 26.4% recorded in 2003/04. The revenue/GDP ratio is still below the 30% ratio recorded in the 1980s. In this regard, there is need for the government to come up with revenue enhancing measures.

Meanwhile, expenditure in public investments is estimated to increase by 31.2% in 2004/05 and the programme included infrastructural development (road networks and new hospitals), water supply to communities and other government projects (Millennium Projects).

Government projects a higher deficit of E746 million which translates to 4.5% of GDP in 2005/06, a position which is totally unsustainable, more so with the current projections of future revenue growth decline. The increased deficit is mainly a result of increased recurrent expenditure, mainly due to completion of the salary review exercise resulting in a substantial increase in the wage bill, accounting for about 63% of recurrent expenditure. Other contributing factors include a general increase in spending on goods and services, scholarships, bursaries for orphans and vulnerable children, grants to the elderly, completion of ongoing projects and maintaining existing infrastructure.

EXTERNAL DEBT

Swaziland's external indebtedness in Emalangeni terms worsened in 2004. At the end of December 2004, total external debt stock including private sector non-guaranteed debt stood at E3.22 billion, denoting an increase of 17.5% from E2.74 billion recorded in December 2003. The increase in the stock of debt was due to the start of disbursements of huge government projects such as the Komati Downstream Development Project and the Mbabane-Oshoek Road Phase II Project. The deterioration in the country's external indebtedness occurred in spite of the resilient strength of the rand/lilangeni against the world's largest currencies during 2004.

The country's external debt structure did not change over the year 2004 with the dominating share still being that of central government at 77.3%. The official debt is expected to increase in the near future as huge government projects start disbursing. These include among others the Lower Usuthu Smallholder Irrigation Project estimated to cost over E1 billion and the ongoing upgrading and construction of the country's road network.