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PORTFOLIO INFLOWS:

NEVA MAKGETLA: Addiction to hot money retards growth, fuels inequality

It exposes SA fully to the emerging global asset bubble, which can only end in tears

BL PREMIUM
12 September 2017 - 06:59 Neva Makgetla

Picture: ISTOCK

Many things start out fun: sugar, shopping and binge drinking, for instance. The next day you wake up broke, unsatisfied and a kilo heavier.

SA's addiction to global financial markets falls into this category. We have attracted huge amounts of short-term holdings in stocks and bonds (portfolio inflows), but at the cost of depressing foreign direct investment, while aggravating inequality. World Bank figures show how much of an outlier SA is when it comes to global financial markets. They provide information on capital inflows for 32 upper middle-income economies. Of these, in 2015, SA ranked fourth in terms of the dollar value of portfolio investments, but 31st for foreign direct investment.

In the decade to 2015, portfolio investment into SA equalled 2.7% of GDP, while direct investment came to just 0.8%. That reversed the ratio for the other 31 countries in the sample. Excluding China, portfolio investments for these countries came to 0.7% of GDP, while foreign direct investment was 1.7%. For China, portfolio investment equalled just 0.1% of GDP and direct investment, 2.6%.

Facilitating short-term investments has made some people a lot of money. It also props up the stock market, where high levels of portfolio investment increased foreign institutional investment from about 2% of ownership in 1994 to more than 25% today.

But the effects on broader economic development are suboptimal. In SA, portfolio and direct investment have an inverse relationship. Yet direct investment brings far more benefits, in the form of access to more advanced technologies and markets.

The divergence between direct and portfolio investment has grown. According to the Reserve Bank, in constant 2016 rand (using years to the first quarter) from 2012 to 2017 an average of R1.2bn in direct investment left the country. From 2015 to 2017, more foreign direct investment left than came in. Portfolio inflows were stable at an annual average of R140bn.

For other middle-income economies, portfolio and direct investment generally track each other. From 2008 to 2013, portfolio investment relative to GDP climbed for the countries in the World Bank sample. They then saw a sharp fall in portfolio investment, while foreign direct investment picked up.

Various factors explain the divergence between direct and portfolio inflows in SA. When times are uncertain, investors typically shift to short-term investments. With the end of the mining boom in 2012, international mining companies shed SA assets. In addition, portfolio investments can reduce competitiveness. They sustain a stronger rand, which depresses exports and encourages imports. Institutional ownership puts pressure on companies to maximise share prices and dividends in the short run. That can come at the cost of longer-term investments.

It's not as if the financial sector itself creates jobs. In 2016, it employed about 420,000 people, 3% of all jobs in SA. While total employment climbed 14%, from 2010 to 2016, the financial sector grew just 10%.

The industry is still far from representative. In 2015, about a third of financial sector employees were white, compared with a seventh for the rest of the economy.

After a short hiatus following the 2008-09 global financial crisis, SA has again fallen back into bad habits around global financial markets. That in itself can constrain domestic growth and job creation. And it exposes SA fully to the emerging global asset bubble, which can only end in tears.

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