

# THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

FIRST QUARTER 2016

The Real Economy Bulletin is a review of quarterly trends, developments and data in the real economy, with notes on related developments and key data in Excel format\*.

## Production and sales

*The first quarter of 2016 was marked by a contraction in GDP, with the economy reported as shrinking by 0,3%, or 1,2% on an annualised basis. The immediate cause of the downturn was a 4,9% quarterly decline (equal to 18% in annualised terms) in mining and a 1,7% fall (or 6,5% at an annual rate) in agriculture. These contractions had a particularly sharp impact on overall growth because of a longer-term slowdown in growth in manufacturing and, to a lesser extent, the rest of the economy, which dates back to around 2013.*

As Graph 1 shows, both mining and manufacturing production fell in the year to March for 2015 and 2016. Agriculture climbed sharply in the year to March 2015, but in the following year fell by almost 9% due to the drought. Construction and the rest of the economy – essentially logistics and utilities, retail, and public and private services – grew over the past two years, but at a slower rate than before.

Mining production has been highly volatile, with significant declines in 2012 and 2014. But in those years the rest of the economy was relatively robust, so the overall growth rate did not dip below zero (Graph 2).

From the fourth quarter of 2015 to the first quarter of 2016, the contribution of electricity and transport to the GDP dropped by 0,7%. It seems likely that this largely resulted from the contraction in mining and refining, which contribute a substantial share of demand for both Eskom and Transnet. The gradual slowdown in manufacturing production in volume terms from 2013 largely reflects a marked fall in output in the metals value chain, driven in part by the end of the commodity boom and in part by rising competition from China (see briefing on the steel industry). In the past quarter, these trends were aggravated by a sharp fall in food and beverages production, presumably triggered by the drought. The food and beverages industry was a mainstay of growth in manufacturing for most of the past five years (Graph 3).

\*Available to download at [www.tips.org.za/publications/the-real-economy-bulletin](http://www.tips.org.za/publications/the-real-economy-bulletin).

## CONTENTS

Production and sales

Employment

Trends in trade

Productivity and investment

Behind the trends

Fiscal pressure on industrial policy programmes

Briefing note: The crisis in the steel industry

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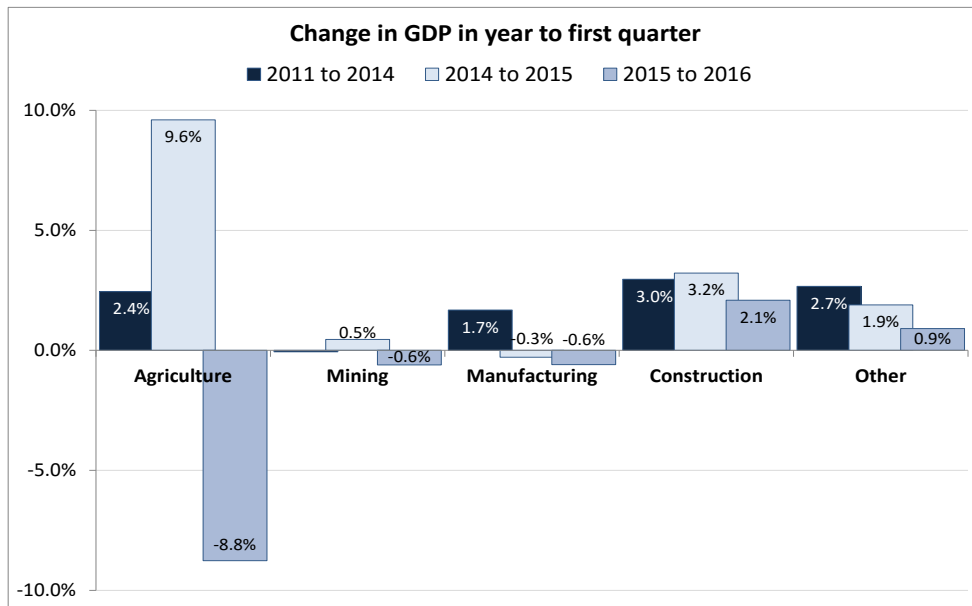
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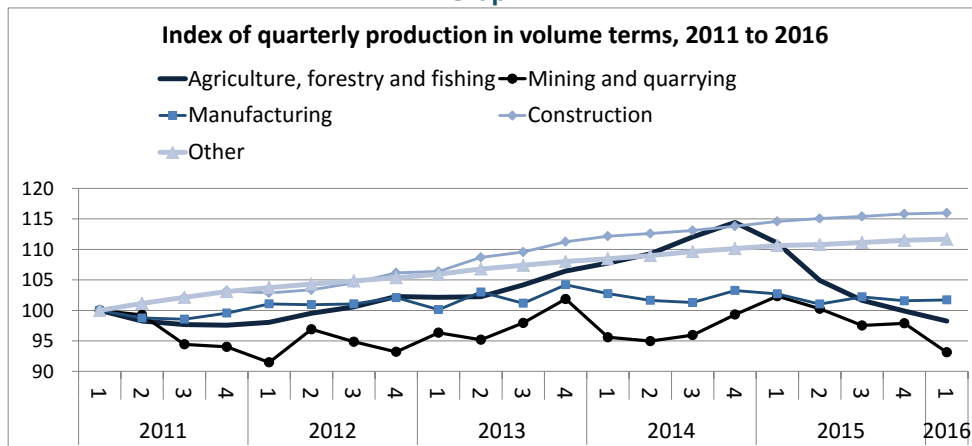
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**Graph 1**



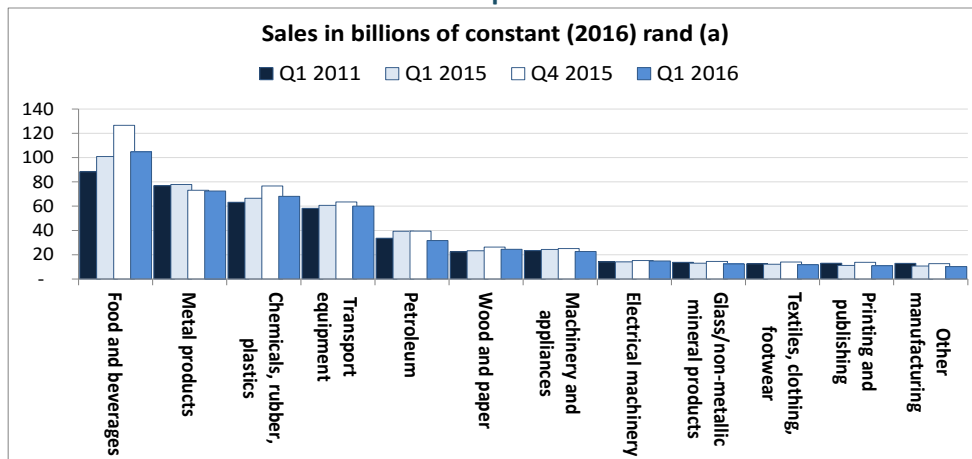
Source: Calculated from Statistics South Africa. GDP (Quarterly) (2016Q1). Excel database. Series on GDP in constant rand. Downloaded from www.statssa.gov.za in June 2016.

**Graph 2**



Source: Calculated from Statistics South Africa. GDP (Quarterly) (2016Q1). Excel database. Series on GDP in constant rand, seasonally adjusted. Downloaded from www.statssa.gov.za in June 2016.

**Graph 3**



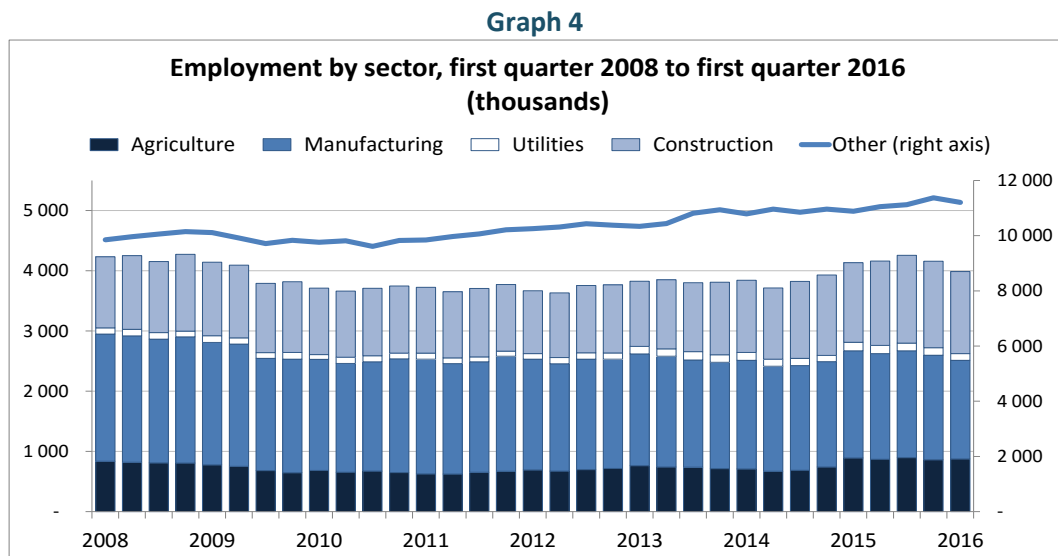
Notes: (a) Deflated with CPI. Source: Statistics South Africa. Manufacturing production and sales. Series on actual sales. Excel database downloaded from www.statssa.gov.za in June 2016.

## Employment

**NOTE:** Due to changes to the master sample used in the QLFS, employment data for the first quarter may include some temporary distortions. While the general direction of employment (jobs losses) is likely accurate, the exact figures may not be as accurate as other quarters. For more information, see TIPS Policy Brief: *The jobs bloodbath that wasn't – What happened to employment in the first quarter of 2016* (available at [www.tips.org.za](http://www.tips.org.za)). For this reason, we only give data for the year-on-year change in employment by sector, which seems more reliable than the figures for the latest quarterly change.

*In year-on-year terms, employment in the real economy contracted by 2,6%. In agriculture it reportedly shrunk by 1,7% and in manufacturing by 7,9%, while construction saw an increase of 3%. In the rest of the economy, employment expanded by 3%. In mining, using the employer survey (which is considered more reliable for this sector), employment fell by 5.9% from the last quarter of 2014 to the last quarter of 2015.*

Graph 4 shows the change in employment year on year from the first quarter of 2008 to the first quarter of 2016.

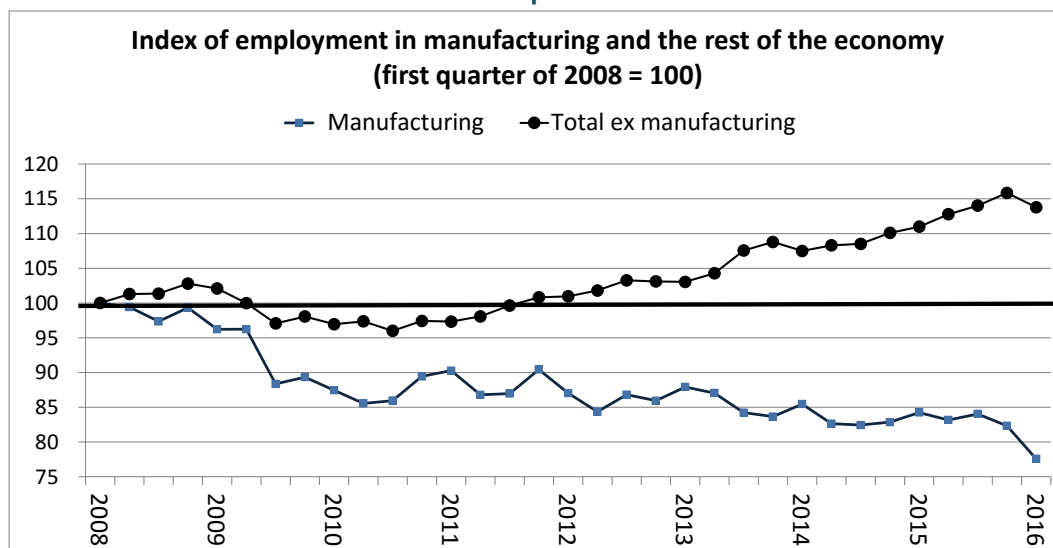


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in June 2016.

The data indicate continued job losses in manufacturing, continuing a long-term trend from 2008 (Graph 5).

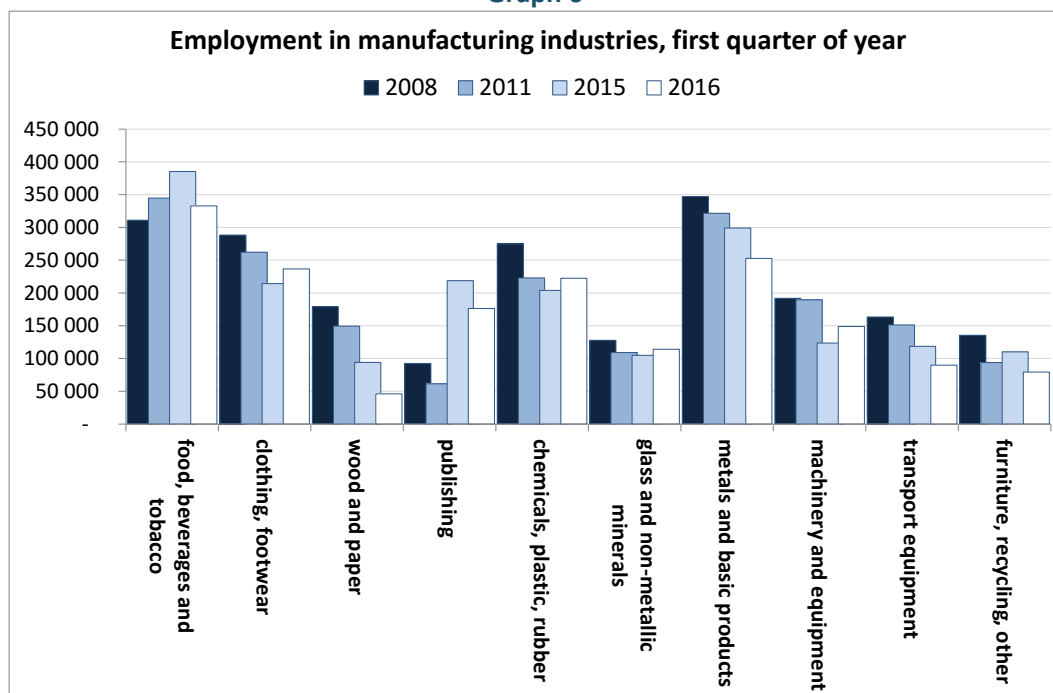
By subsector within manufacturing, machinery and equipment reportedly experienced the strongest year-on-year employment growth, closely followed by clothing and footwear. In contrast, the metals and basic metals products sector reportedly shed 46 000 jobs over the course of the year to date, reflecting the combination of lower export prices for refineries and the challenges in the steel industry. Furthermore, food, beverages and tobacco lost over 50 000 jobs. The sector has been the largest employment generator in manufacturing in recent years, but it suffered a significant slowdown in the past quarter, presumably due to the drought (Graph 6).

Graph 5



Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in June 2016.

Graph 6



Source: Calculated from Statistics South Africa. Quarterly Labour Force Survey for relevant quarter. Electronic database. Series on industry.

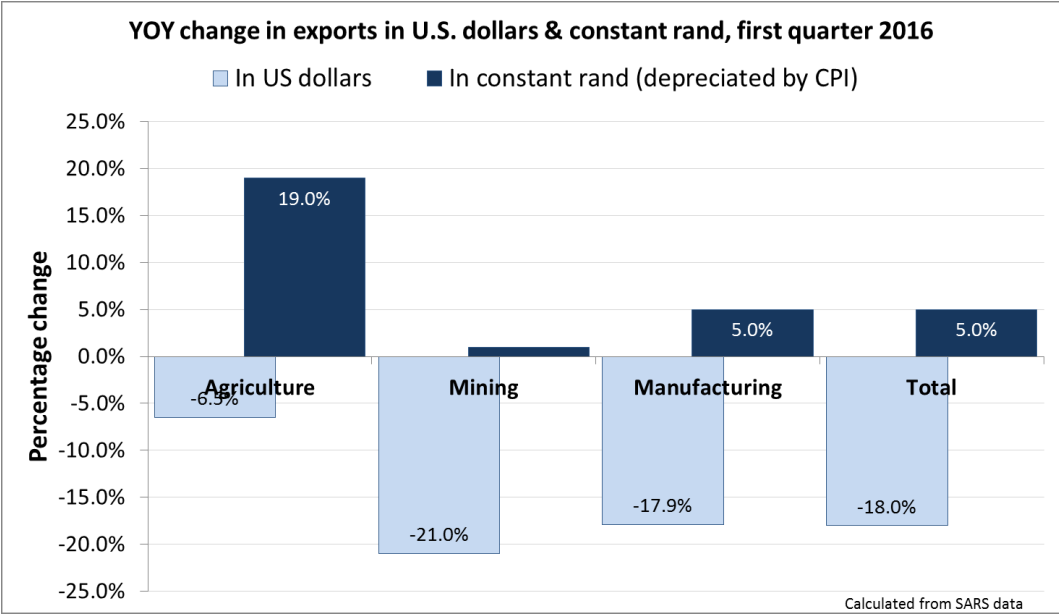
## Trends in trade

The year to the first quarter of 2016 saw a continued contraction in exports for both manufacturing and mining in dollar terms. In contrast, in constant rand both sectors saw growth, with manufacturing expanding by 4,6% and mining by 0,9%. Despite the drought, agriculture witnessed only a relatively mild dollar contraction of 6,5% and strong rand-denominated growth of 19%.

The year to the first quarter of 2016 saw a continued contraction in exports in dollar terms. Still, it again demonstrated the importance of continued protection from the weaker rand, which saw all the productive sectors posting increases in rand exports.

Manufacturing continued its recent export growth in rand terms, posting a 5% expansion. The growth came in spite of a continued decline in the metals industry, manufacturing’s largest export sector, which saw dollar declines of 19,5% softened to marginal rand growth of 2,9% Graph 7).

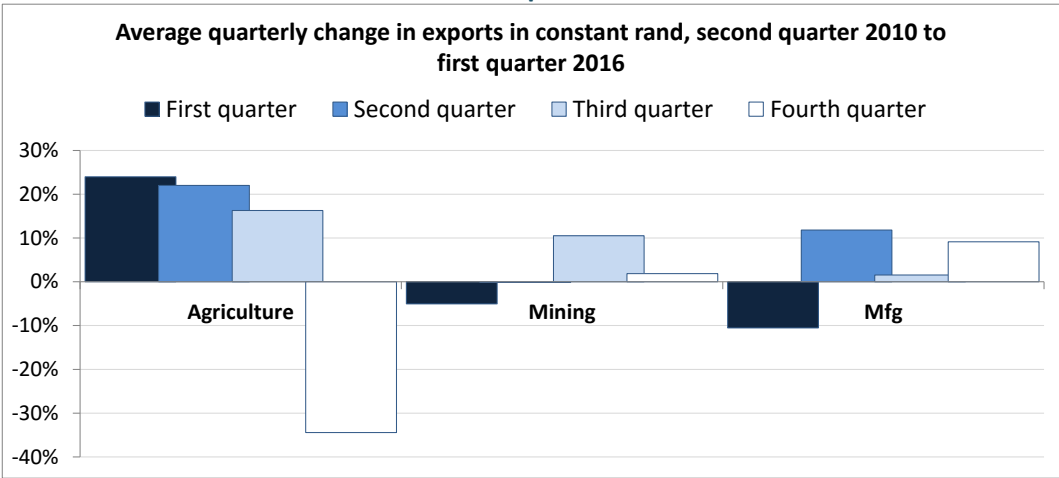
**Graph 7**



Source: South African Revenue Service, Merchandise Trade Statistics for relevant periods

Quarterly changes in exports should be treated with caution, since they fluctuate substantially for both seasonal and other reasons. As Graph 8 shows, agricultural exports show significant seasonal trends, with a drop in volume terms in the fourth quarter of each year. Manufacturing and mining show a consistent fall in exports in the first quarter of each year since 2010, although exports in the other quarters fluctuated significantly.

**Graph 8**



Source: South African Revenue Service, Merchandise Trade Statistics for relevant periods

## Value of and change in trade by manufacturing industry to fourth quarter 2015

Indicator	Manufacturing Industry	Value in Q1 2016		% change in constant ZAR to Q1 2016		% change in USD to Q1 2016	
		ZAR bns	USD bns	From Q1 2015	from Q4 2015	from Q1 2015	from Q4 2015
Exports	Food and beverages	9.4	0.7	14.1%	-13.1%	-10.6%	-20.4%
	Textiles, clothing, leather and footwear	4.7	0.2	5.5%	-17.1%	-43.3%	-47.9%
	Wood and wood products	1.3	0.1	-1.9%	-7.2%	-23.1%	-14.8%
	Chemicals, rubber, plastic	17.7	1.3	0.5%	-13.1%	-21.2%	-20.3%
	Glass and non-metallic mineral products	1.6	0.1	49.6%	21.0%	17.6%	10.8%
	Metal and articles of metal products	28.0	2.1	2.9%	7.5%	-19.5%	-1.6%
	Machinery, appliances, AV equipment	22.6	1.7	2.1%	-9.1%	-19.9%	-16.9%
	Paper and publishing	5.1	0.4	32.2%	1.7%	3.5%	-6.6%
	Transport equipment	26.4	2.0	2.6%	-8.5%	-19.1%	-16.0%
	Imports	Food and beverages	6.7	0.5	-3.7%	-14.2%	-24.8%
Textiles, clothing, leather and footwear		14.4	1.1	12.6%	6.9%	-12.2%	-3.1%
Wood and wood products		1.3	0.1	10.9%	12.7%	-13.6%	1.9%
Chemicals, rubber, plastic		32.8	2.5	2.5%	-8.9%	-20.1%	-17.1%
Glass and non-metallic mineral products		3.0	0.2	7.5%	9.0%	-16.2%	-1.2%
Metal and articles of metal products		13.5	1.0	-2.4%	3.1%	-23.9%	-6.3%
Machinery, appliances, AV equipment		65.0	4.9	6.2%	-7.1%	-17.1%	-15.6%
Paper and publishing		3.8	0.3	17.4%	-7.0%	-8.4%	-15.4%
Transport equipment		42.5	3.2	-3.9%	7.4%	-24.9%	-2.5%
Balance		Food and beverages	2.8	0.2	17.8%	1.1%	14.2%
	Textiles, clothing, leather and footwear	-9.6	-0.8	-7.1%	-24.0%	-31.0%	-44.8%
	Wood and wood products	0.1	0.0	-12.8%	-19.8%	-9.4%	-16.7%
	Chemicals, rubber, plastic	15.1	-1.1	-1.9%	-4.1%	-1.1%	-3.2%
	Glass and non-metallic mineral products	-1.4	-0.1	42.1%	12.0%	33.8%	11.9%
	Metal and articles of metal products	14.6	1.1	5.2%	4.4%	4.4%	4.7%
	Machinery, appliances, AV equipment	42.4	-3.2	-4.2%	-2.0%	-2.8%	-1.3%
	Paper and publishing	1.4	0.1	14.8%	8.7%	11.8%	8.8%
	Transport equipment	16.1	-1.2	6.6%	-15.9%	5.8%	-13.5%

Notes: (a) Figures for change from the final quarter of 2015 are not seasonally adjusted. Constant change in rand calculated using CPI to deflate current figures. Source: SARS data on trade.

## Profitability and investment

Profitability among all sectors of the economy declined in the final quarter of 2015. The mining sector continued to post losses, as it did throughout 2015, with fourth quarter losses almost doubling over the previous quarter. While manufacturing remained profitable overall, its profits also continued to decline, following a negative path that began in 2011. For the economy as a whole, the investment rate dropped sharply, but it rose slightly in manufacturing.

Statistics South Africa's Quarterly Financial Statistics provides information on trends in profitability and capital expenditure in the formal sector outside of agriculture, with information currently available through the fourth quarter of 2015.

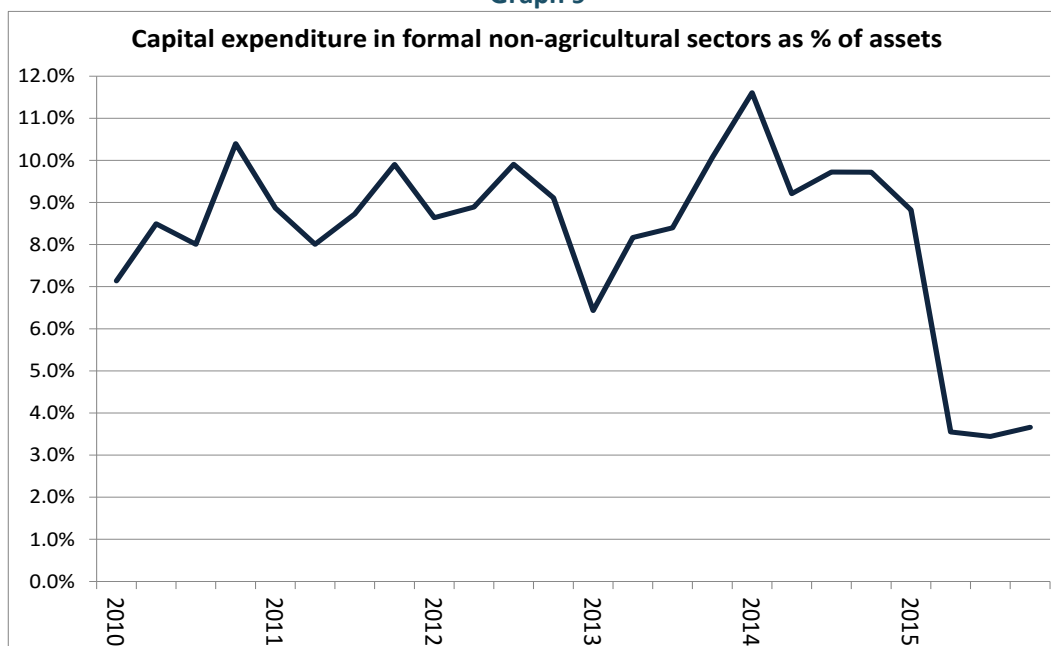
### Profitability and capital expenditure by sector, Q4 2015, 2014 and 2010

	Mining	Manufacturing	Construction	Utilities	Other sectors	Total
<b>Profitability</b>						
Profits, Q4 2015	-R15,2 bn	R19,9 bn	R5,9 bn	R1,1 bn	R79,8 bn	R91,5 bn
Return on capital (a)						
Q4 2015	-3.1%	4.4%	13.0%	0.2%	7.3%	3.5%
Q4 2014	0.0%	5.9%	2.8%	-0.6%	10.2%	4.8%
Q4 2010	5.9%	8.0%	6.6%	-0.3%	6.0%	5.5%
<b>Capital expenditure</b>						
Capital expenditure, Q4 2015	R12,3 bn	R24,6 bn	R2,4 bn	R17,3 bn	R40,1 bn	R96,8 bn
Capital expenditure as % of assets						
Q4 2015	2.5%	5.5%	5.2%	3.1%	3.7%	3.7%
Q4 2014	3.3%	5.3%	6.2%	3.7%	3.8%	9.7%
Q4 2010	3.8%	5.0%	6.6%	5.9%	3.3%	10.4%

Notes: (a) Return Is capital calculated as profits less tax divided by the carrying value of assets. Source: Calculated from Statistics South Africa, Quarterly Financial Statistics, relevant quarters.

Despite lower profits, manufacturing investment increased in the past year, reaching around R25 billion or 5,5% of the value of assets in the sector. Still, formal non-agricultural capital expenditure as a percentage of assets hit a low point in the past year, with a decline in investment relative to the GDP as well (Graph 9).

Graph 9



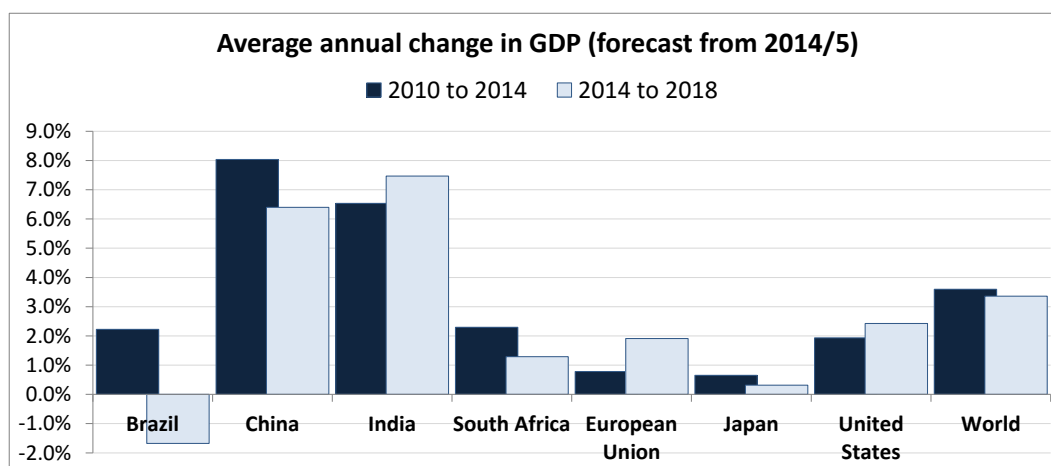
Source: Calculated from Statistics South Africa, Quarterly Financial Statistics, relevant quarters.

## Behind the trends

A number of long-term factors continued to act as a drag on the South Africa economy, key among them being the depressed global economy, weak commodity prices, and the impact of the drought. These factors have been aggravated by pro-cyclical fiscal and monetary policies.

The global economy remains in a precarious state. China's reported growth slowed from 6,8% in the final quarter of 2015 to 6,7% in the first quarter of 2016 (the official figures are now generally considered exaggerated, but the trends appear to be reliable). For their part, both the US and the European Union saw an expansion of only 0,5% in the first quarter of the year. The IMF forecasts continued slow growth in key South African markets, with the exception of India. To date, its forecasts have tended to be overly optimistic (Graph 10).

Graph 10



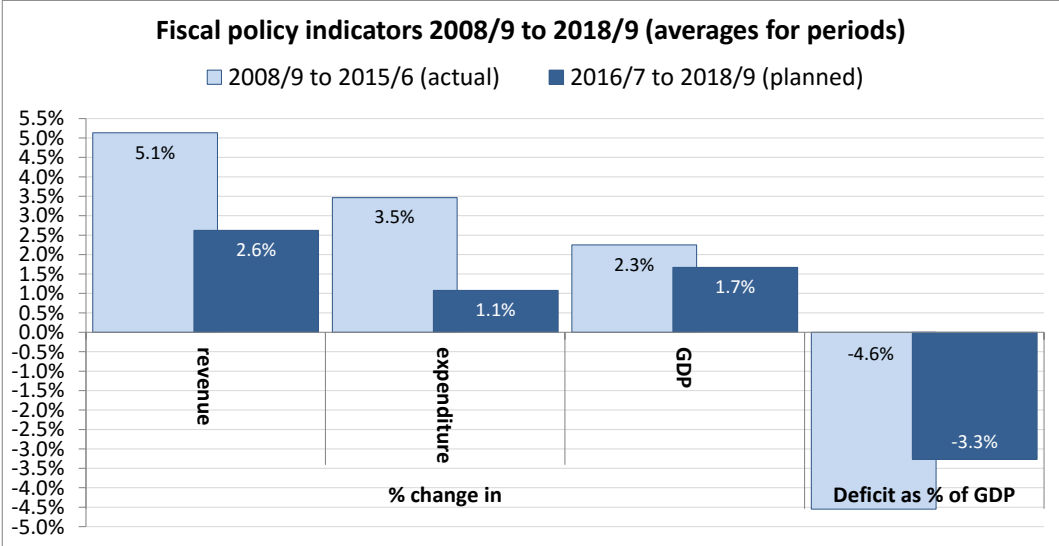
Source: Calculated from, IMF. World Economic Outlook. April 2016. Electronic database. Series on GDP growth in constant national currency. Downloaded from www.imf.org in June 2016.



South Africa has faced slower global growth while grappling with fiscal constraints and Reserve Bank concerns about inflation. These factors mean that macro-economic policy has been effectively pro-cyclical, with a slowdown in state spending and higher interest rates coming into play just as the global economy began to slow down.

As Graph 11 shows, state spending is expected to be substantially slower than GDP growth from 2016/17 to 2018/19. As a result, state spending per person is predicted to fall over this period.

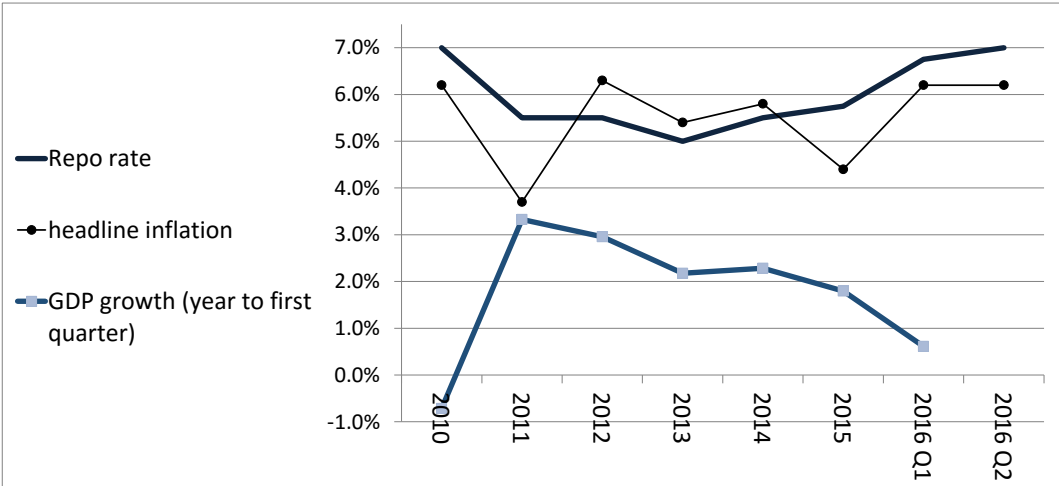
**Graph 11**



Source: Calculated from Budget Review. Statistics in excel format. Relevant series. Downloaded from [www.treasury.gov.za](http://www.treasury.gov.za) in June 2016.

Furthermore, the Reserve Bank began to increase the repo rate just as economic growth began to decline, as Graph 12 shows. In large part, it sought to subdue inflation, which seemed likely to follow from rapid depreciation as export markets narrowed. But the effect was to aggravate the overall slowdown.

**Graph 12**



Source: Repo rate from SARB. Interactive data set. Series on the repo rate. Downloaded in June 2016. GDP growth calculated from Statistics South Africa. GDP data from 2003. Electronic database. Series on GDP in constant terms. Downloaded from [www.statssa.gov.za](http://www.statssa.gov.za) in June 2016. CPI for March from Statistics South Africa. CPI History: 1960 Onwards. Downloaded from [www.statssa.gov.za](http://www.statssa.gov.za) in June 2016.

While budget constraints are real, the risk is that the current combination of tightening fiscal and monetary stances will aggravate the threats of slow growth, unemployment and inequality. In these circumstances, South Africa should explore more innovative and creative levers to stimulate aggregate demand, going beyond the budget and the repo rate. Viable measures include the following:

- A two-year holiday on UIF contributions would effectively increase incomes for both workers and employers. It would take advantage of the current UIF surplus of over R100 billion, which is far in excess of the amount required to maintain spending even under current proposals to improve benefits. In addition, ways to invest the UIF surplus to generate more sustainable growth and more competitive industries should also be considered.
- A revised policy guideline to the Reserve Bank should ensure that interest rates do not increase as long as inflation is moderate by historical standards – below, say, 10% - and growth is under 1% a year.
- More vigorous action should be taken to monitor and where appropriate restrain regulated prices and to improve productivity by state-owned enterprises, public-sector schools and hospitals, and municipalities, most of which have increased their tariffs faster than inflation.
- Cabinet should impose a six-month freeze on amending regulations and laws to stabilise the policy environment and reduce compliance burdens. The only exception should be when Cabinet specifically approves a change on the grounds that it has nationally important and urgent aims. During the temporary freeze, government should engage with stakeholders on its legislative programme so as to ensure a higher degree of agreement on priorities and to establish processes to avoid unintended consequences.
- State agencies should be required to do more to ensure local procurement, especially for consumables, where the price differential is not excessive, in order to maximise the stimulus effects of government spending by reducing import leakages.
- Government should identify additional levers to encourage private companies also to buy local.

### **Fiscal pressure on industrial policy programmes**

The 2016/17-2018/19 Medium Term Expenditure Framework (MTEF) is the product of a difficult economic climate. As a slowing global economy and depressed commodity prices put pressure on the budget, key government departments will have to grapple with the dual challenge of constrained fiscal conditions and the ever more pressing need to boost economic growth. One result is a cut in the Department of Trade and Industry's (the dti's) budget in nominal terms, with a particularly sharp impact on incentives for business and funds for Industrial Development Corporation (IDC) programmes.

The dti plays a crucial role in facilitating and supporting economic activity and employment in South Africa. Key departmental functions include increased investment facilitation, manufacturing incentives, supporting exports and industrial spatial development. Of the MTEF budgeted expenditure, the dti has been allocated just over R28 billion over the medium term (to 2018/19). That means the dti's budget will

decrease by an estimated 3,1% annually for the next three years (versus overall budgetary growth of 7,5% p.a.) from R10,3 billion in 2016 to R8,6 billion in 2018.

The cuts will mostly affect three key programme areas of the dti: support to industrial development programmes, trade and exports, and incentives.

Two dti branches support manufacturing and industrial development directly – the Industrial Development Division (IDD) and the Incentive Development and Administration Division (IDAD).

IDAD is responsible for facilitating the development of sustainable and competitive firms through the provision of effective and accessible manufacturing (and services) incentives such as the Manufacturing Competitiveness Enhancement Programme (MCEP), Automotive Investment Scheme (AIS), Critical Infrastructure Programme (CIP), Export Marketing and Investment Assistance (EMIA) and industrial infrastructure support to Special Economic Zones (SEZs)

IDAD will suffer the most drastic budget reductions of all the dti divisions. It receives 63% of the dti's budget, amounting to R17,8 billion over the MTEF. According to the latest MTEF, it will decline in nominal rand by an annual average of 4,4% from R6,9 billion in 2016 to just over R5 billion in 2018. Manufacturing and services investment incentives will be most affected. The manufacturing incentive budget will decrease from R4,5 billion in 2016 to R2,7 billion in 2018 (averaging just under 12% decline per annum).

IDD houses the Industrial Competitiveness and Customised Sector Programmes, which promote policies and strategies to create jobs, increase value addition and improve firm competitiveness. A significant portion of the funds in this division aim to strengthen technical regulatory and research capabilities, through transfers to agencies such as the South African Bureau of Standards (SABS), the Council for Scientific and Industrial Research (CSIR) and the National Regulator of Consumer Specifications (NRCS). However, the bulk (over R750 million – which represents 43% of the division's budget), is a transfer to the IDC. In nominal terms, this transfer will decrease by over 7% to just under R700 million by 2018.

Two strategic themes emerge.

- First, there is a clear move away from generic incentives such as MCEP to more sector-specific programmes in priority (and distressed) sectors.
- Second, the evolution of incentives is premised on the need for the dti to focus on job creation and other conditions for incentive programmes. These developments have implications for industrial development and growth in South Africa especially around productivity growth, competitiveness improvement, and investment leveraging and crowding in, especially given the end of MCEP.

Given the stress on the budget, it will be incumbent on both the dti and the private sector to demonstrate the importance of industrial policy interventions – and the associated resources – for achieving a more dynamic and inclusive economy. Otherwise incentives and transfers to boost industrialisation may look like an easy target for fiscal authorities anxious to find programmes that are relatively easy to cut because their funds are not tied up in existing projects and employment contracts.

## Briefing note summary: The crisis in the steel industry

The crisis in the steel industry is evident through a number of measures. Steel production declined by 15% from 2010 to 2015, for a total fall of 33% from 2008. In dollar terms, steel exports fell by 32% from 2010 to 2015, and ferro-alloys dropped by 24%. Profitability in the steel value chain shrank quickly from 2010 to 2014, with basic iron and steel posting losses for most of the past five years. The losses sparked a run of closures, with the number of foundries in South Africa declining from 140 in 2009 to 95 in 2014, and key ferro-alloy producers Evraz Highveld and Samancor forced into major restructuring. Iron and steel refining shed 30 000 jobs between 2011 and 2015, with ferro-alloy producers applying for a further 3 000 retrenchments in the first quarter of 2016 alone.

The root of the crisis is the global steel glut, which saw unit prices for South African exports of flat rolled steel fall 32% between 2011 and 2015. Overproduction results largely from the rapid expansion of global steel supply from around 2003, fuelled almost exclusively by a tenfold increase in Chinese production between 2000 and 2014.

As the Chinese economy cooled from around 2010 and the state undertook to shift towards domestic consumption, Chinese steel exporters turned to foreign markets. Chinese exports of rolled steel globally climbed 2,5 times from 2010 to 2015, and they multiplied six times to South Africa. Even though the (dollar) unit price fell by 25%, the value of South African imports of all iron and steel products rose from US\$206 million in 2010 to US\$474 million in 2015. In the same period, South African producers of steel and steel products faced stagnant domestic demand from the end of the commodity boom, with slowing growth in infrastructure investment.

The South African steel industry has strong comparative and competitive advantages that mean it can once again become a valuable asset for national development, should it survive the current glut. The industry can draw on unusually high quality iron and ferroalloy ores, supported by very efficient dedicated transport networks (thanks to Transnet). It boasts a number of world-class steel and ferro-alloy producers and fabricators.

But government support is needed to see the industry through the current downturn. That support cannot be reduced to a bailout or measures to protect the domestic market through tariffs and local procurement policies, although these measures have to form part of the mix. Rather, it must improve the industry's overall long-term competitiveness. That means targeting key cost drivers, such as inadequate investment in modernised facilities, especially in the refineries; surging electricity costs; poorly designed transport costs that burden steel production and exports while benefiting iron ore exports; regulatory challenges; and export-parity pricing by iron-ore producers and scrap-metal recyclers.

A full copy of the *Briefing Note: A strategic response to the crisis in the steel industry* is available to download at [www.tips.org.za/publications/the-real-economy-bulletin](http://www.tips.org.za/publications/the-real-economy-bulletin).