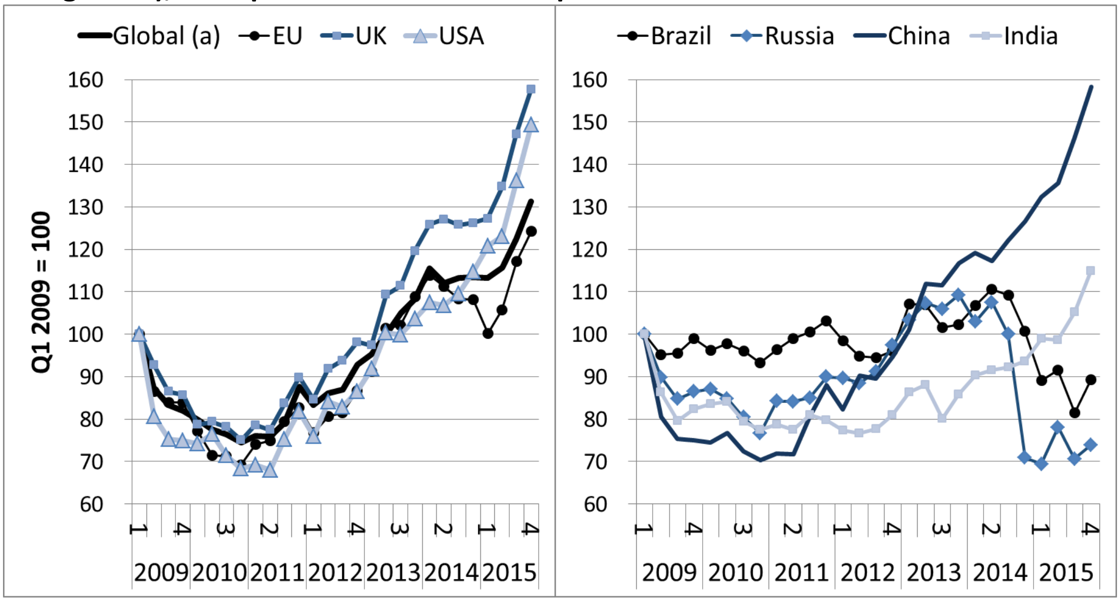
Brief: The exchange rate and the real economy

The depreciation of the rand has made manufacturing more competitive. Without it, more mines would have to close down. It results in part from the end of the commodity boom, and in part from an outflow of investment over the past two years.

There is an ongoing debate on whether the recent depreciation of the rand has improved the competitiveness of South Africa's goods and services in the global market. The available data suggest that the more competitive rand has supported South African manufacturing exports and proven crucial for the continued viability of mining.

Since 2010, the rand has depreciated by 45%. The rand fell most sharply against the currencies of its major trading partners – China, the US and Europe. In contrast, it stabilised or strengthened somewhat against other major commodity producers, such as Brazil and Russia.

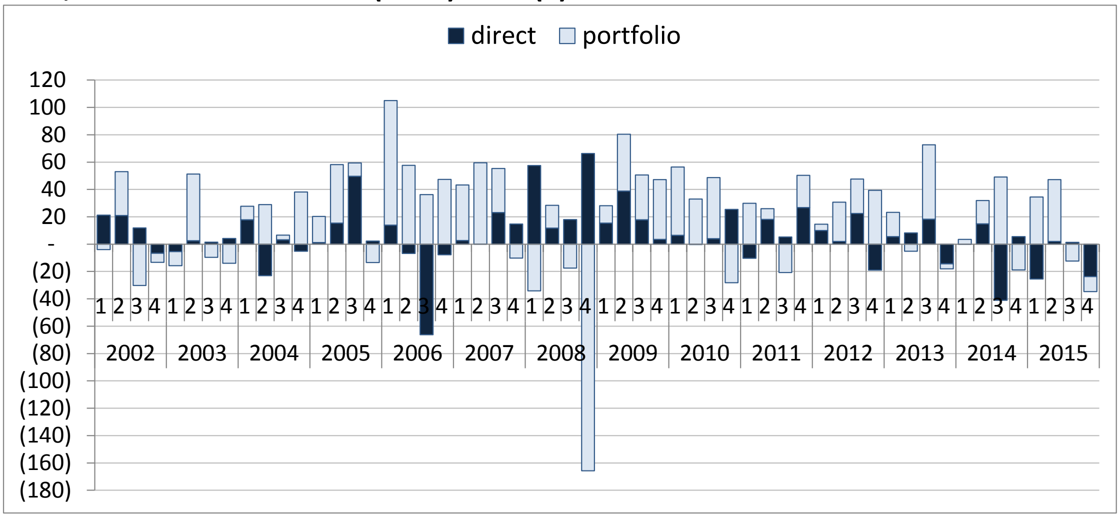
Table 1. Indices of exchange rates with major trading partners and BRICS (cents per foreign unit), first quarter 2008 to fourth quarter 2015



Notes: (a) Trade-weighted average of 20 countries. *Source:* South African Reserve Bank, interactive data set, series on foreign exchange rates. Downloaded from www.resbank.co.za in March 2016.

Depreciation in the rand was driven in part by the decline in exports in dollar terms, largely resulting from the global economic slowdown and the sharp decline in commodity prices from 2011 (details of which are available in the previous issue of the Real Economy Bulletin). The fall in export revenues was aggravated by slower capital inflows from 2010, as shown in Table 2.

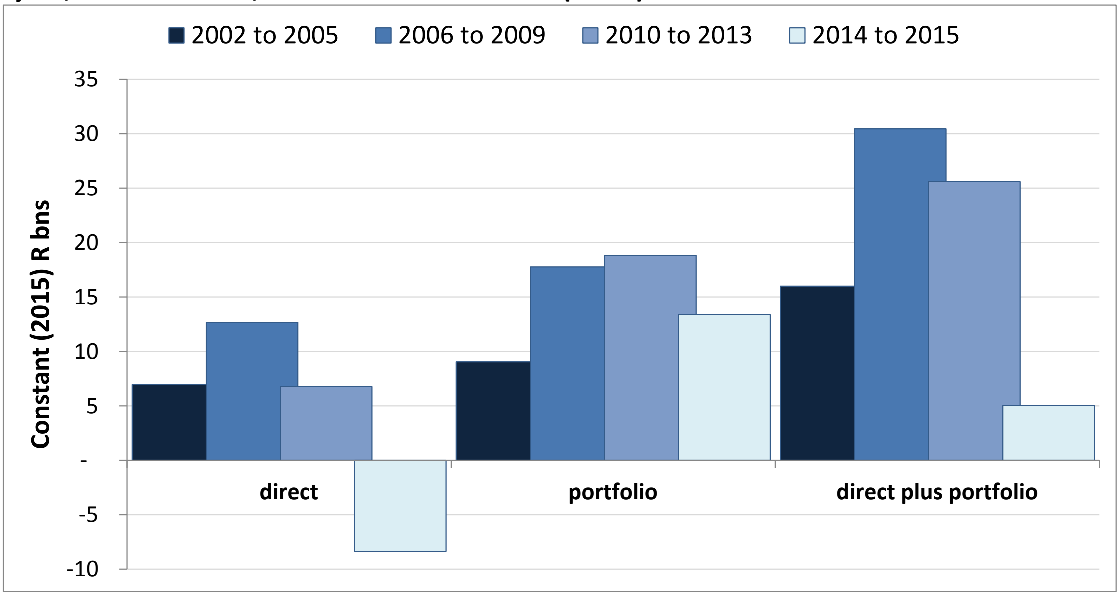
Table 2. Quarterly net direct and portfolio investment into South Africa, 2002 to 2015, in billions of constant (2015) rand (a)



Notes: (a) Deflated using the GDP deflator. *Source:* South African Reserve Bank, interactive dataset, series on direct and portfolio investment into and out of South Africa. Downloaded from www.resbank.co.za in March 2016.

The sharpest decline emerged in direct investment, apparently because opportunities opened by the commodity boom began to dry up. Direct investment dropped from an inflow over R10 billion a quarter, on average, in 2015 rand, from 2006 to 2009, to net outflows of almost equal size in the past two years. In contrast, while portfolio inflows have become increasingly volatile, they declined much less, dropping from around R17 billion a quarter from 2006 to 2013 to R13 billion a quarter in 2014 and 2015.

Table 3. Average quarterly net direct and portfolio investment over the commodity cycle, 2002 to 2015, in billions of constant (2015) rand

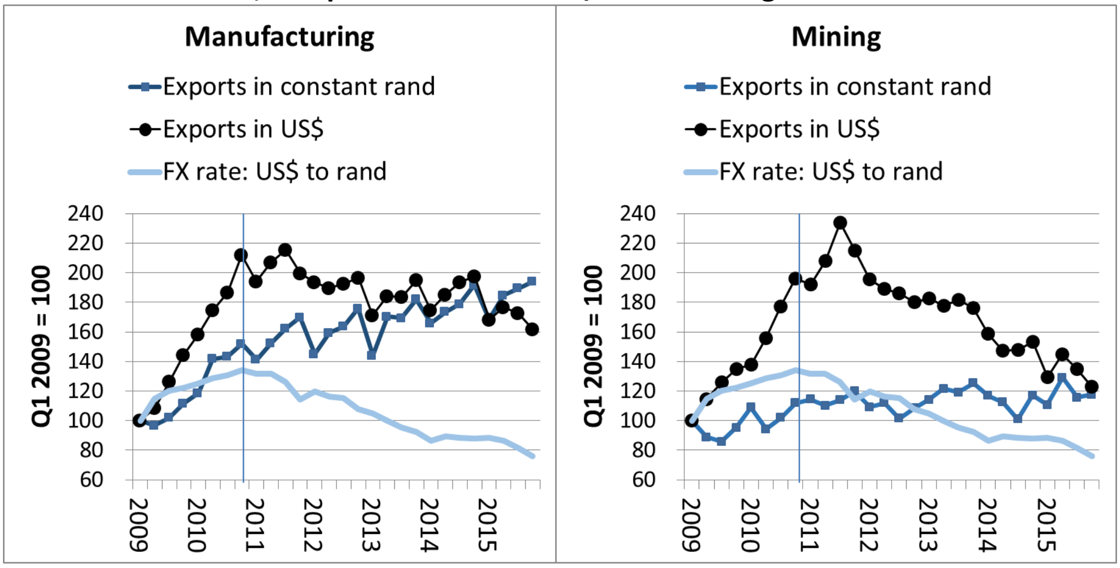


Notes: (a) Deflated using the GDP deflator. *Source:* South African Reserve Bank, interactive dataset, series on direct and portfolio investment into and out of South Africa. Downloaded from www.resbank.co.za in March 2016.

An analysis of trade and production statistics of South Africa's main economic sectors suggests that the depreciation of the rand in the past six years opened significant opportunities for manufacturing. Moreover, the more competitive rand sustained exporters which saw falling sales as global growth slowed, especially as commodity prices crashed from 2011.

- Since 2010, manufacturing exports have grown substantially faster than mining exports in constant rand, and fallen more slowly in dollar terms. From the start of 2011 to the end of 2015, manufacturing exports climbed 37% in constant rand, while declining 17% in dollars. (All constant figures are deflated using the GDP deflator for the sector.) In contrast, in the same period mining exports rose just 3% in rand and dropped 36% in dollars.

Table 4. Indices of manufacturing and mining exports in constant rand (a) and current U.S. dollars, compared to U.S. dollar/rand exchange rate

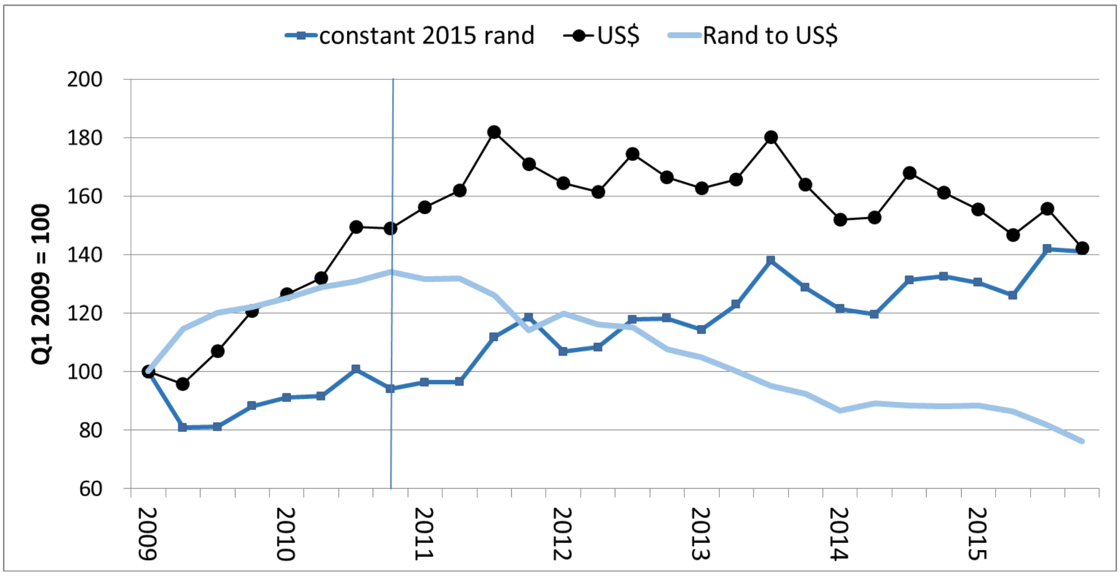


Notes: (a) Deflated with GDP deflator for relevant sector. *Source:* Export data from Quantec EasyData, HS-4 series, downloaded www.quantec.co.za in February 2016; exchange rate from South African Reserve Bank, nominal exchange rate for 20 trading partners, downloaded from www.resbank.co.za in March 2016; deflator calculated from Statistics South Africa, spreadsheet of GDP tables, downloaded from www.statssa.gov.za in March 2016.

- The export value of manufactured goods has continued to increase as production slowed down, again pointing to the impact of the more competitive rand.
- More advanced industries within manufacturing accounted for 50% of the total increase in manufactured exports in rand terms. As a result, these industries increased their share in total manufacturing exports from under 40% in 2009 to 44% in 2015. Auto alone accounted for 30% of the growth in manufactured exports, and the industry's share in total manufacturing output climbed from 18% in 2009 to 24% in 2015.
- In contrast, resource-based industries saw a declining share in both exports and production. In particular, steel products accounted for 16% of the growth in total exports, and their share in manufacturing exports fell sharply from 32% in 2009 to 23% in 2015.
- Production in the mining sector has surpassed exports, suggesting a stockpiling of minerals as commodity prices have fallen. Still, given the sharp fall in dollar prices since 2011, without the fall in the exchange rate many more mines and mining jobs would be under threat.

- In terms of imports, the picture is more ambiguous. Imports initially climbed in both dollar and rand terms, despite the depreciation, from early 2010. From mid-2011, however, both total imports and the balance of trade in manufactures have declined in dollars and, in rand, essentially levelled out.

Table 5. Indices of manufacturing imports in constant rand and current US dollars compared to the exchange rate (Q1 2009 = 100)



While the more competitive rand has supported merchandise exports in general, and especially in manufacturing, volatility remains a concern. Exchange rate volatility becomes a challenge for productive sectors because it makes it difficult for them to maintain stable prices on exports while making the cost of imported intermediate goods more unpredictable.