THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA FOURTH QUARTER 2015

The Real Economy Bulletin is a TIPS review of quarterly trends, developments and data in the real economy, with an analysis of the latest growth and employment figures from the main manufacturing industries and key data in Excel format (*available to download online).*

Production and sales

In the past quarter, agricultural output dropped sharply, by 4%, while manufacturing shrank by 0,6%. Mining, however, climbed by 0,4%. Overall, GDP growth slowed significantly compared to the previous quarter.

The quarter saw a marked slowdown in seasonally adjusted growth, with particularly poor results for agriculture and manufacturing. Growth in the GDP dropped to 0,15% in the final quarter of 2015 in seasonally adjusted terms. Manufacturing output declined 0,64% in the quarter, for annual growth of just 0,1% from 2015 to 2014. In agricultrure, the drought drove production down almost 4% for the quarter, which meant farm production dropped 8% over the year. Mining and construction both expanded output, but by less than 0,5%. That was significantly slower than their growth in the first three quarters of the year (Graph 1).

The decline in agricultural and manufacturing output meant that the share of the productive sectors in the GDP continued to decline through 2015. Taken together, their share in the economy dropped from 29% in 2014 to 28% in 2015 (Graph 2).

Within manufacturing, food and beverages continued with the stable growth seen since 2010. In seasonally adjusted terms, the auto industry also appeared to recover from a decline in sales in the previous quarter. Growth in auto was driven largely by exports, since local sales declined from 2011, according to the National Association of Automobile Manufacturers. In contrast, the metals industry continued the decline that started with the end of the commodity boom, with sales now 6% lower than they were in 2011 (Graph 3).

CONTENTS

EDITORIAL TEAM

The Real Economy Bulletin is a TIPS Publication

Editors:

Neva Makgetla

Baba Gqubule

Contributors to this edition:

Neva Makgetla

Blessing Chipanda

Baba Gqubule

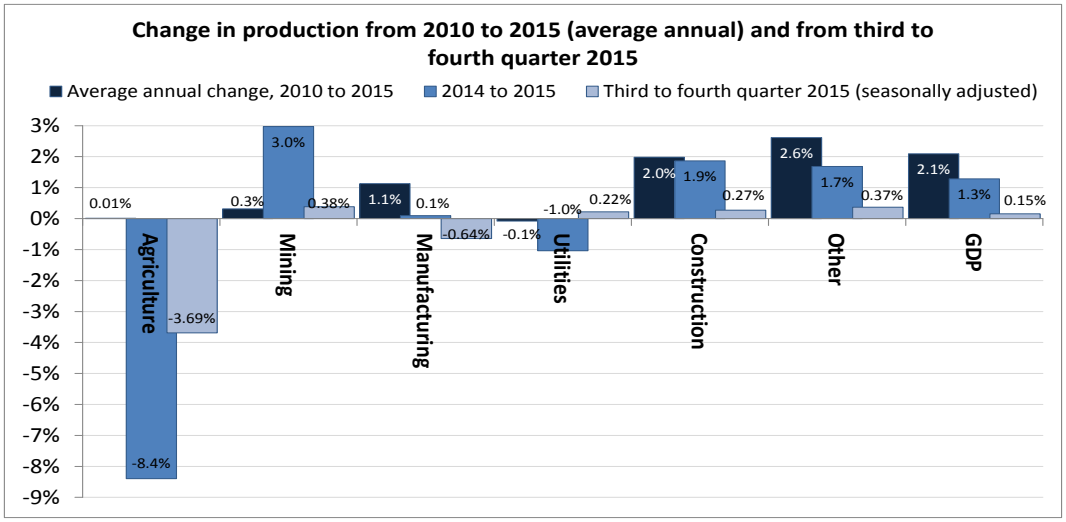
Sithembiso Mtanga

Georgina Ryan

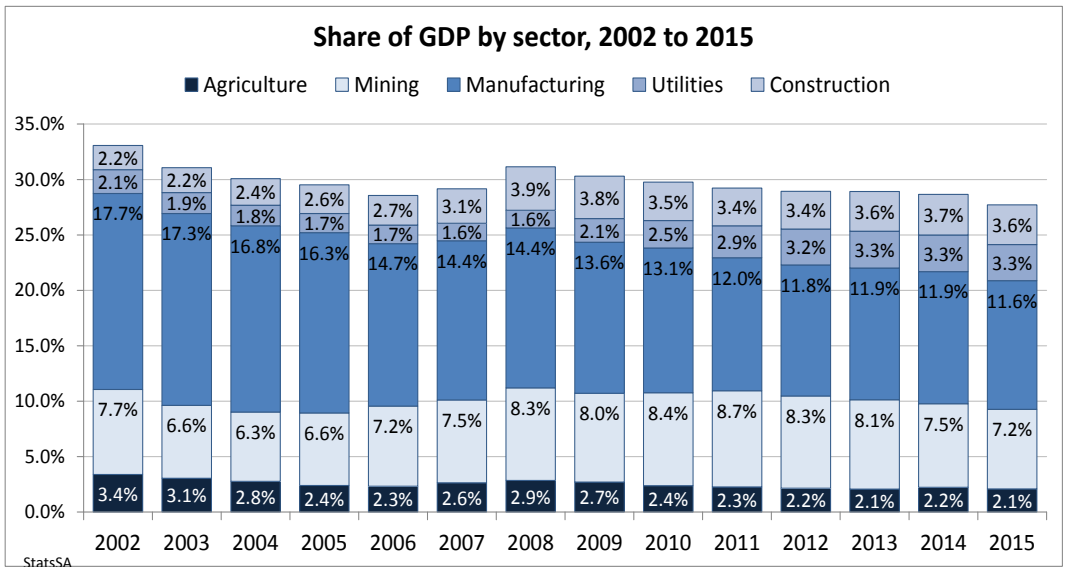
Trade & Industrial Policy Strategies

info@ tips.org.za
+27 12 433 9340
www.tips.org.za

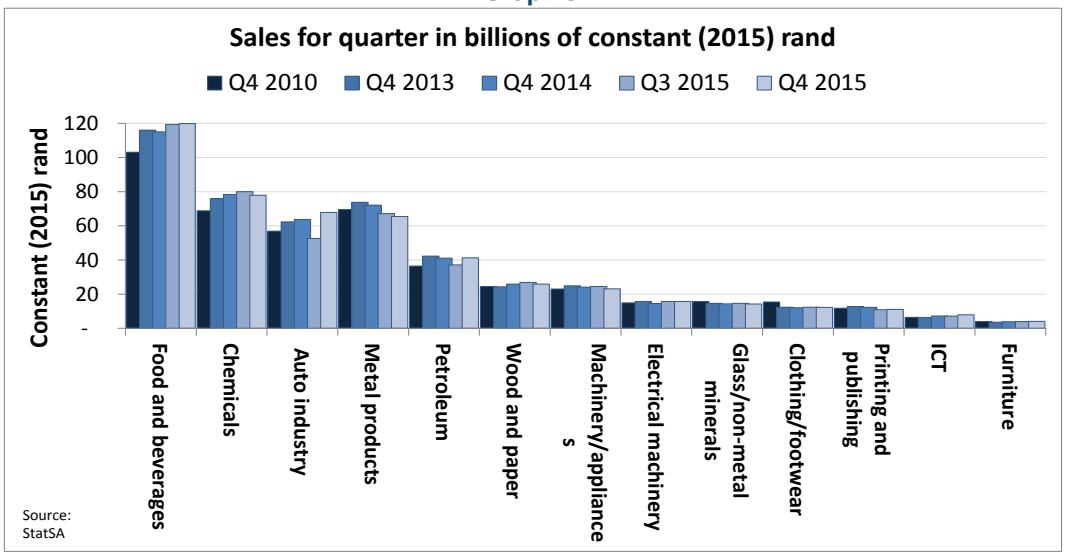
Graph 1



Graph 2



Graph 3



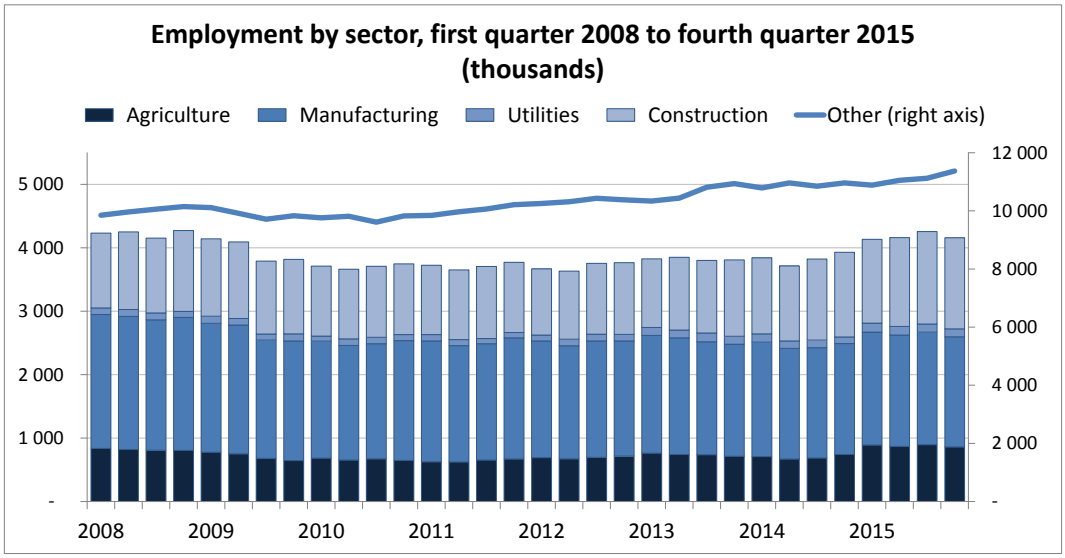
Employment

After falling fairly steadily from 2008, manufacturing employment levelled out in 2015. Total employment climbed by 700 000 over the year, with the bulk of net new jobs emerging in public, private and domestic services and retail. Still, the global slowdown, drought and pressure on mining and heavy industry led to widespread anticipation of job losses in the coming months, at least in agriculture, mining and metals production.

Employment in productive sectors account for just under a third of total employment in South Africa, with the bulk of the remaining jobs in private, public and domestic services plus retail. Statistics South Africa's Quarterly Labour Force Survey provides data for employment by sector and subsector, but the figures are not seasonally adjusted. Moreover, the survey returns for mining are not reliable for technical reasons, so figures from the Quarterly Employment Survey are used instead.

As Graph 4 shows, employment in productive sectors excluding mining dipped in 2015, even though the rest of the economy continued to show growing numbers of jobs.

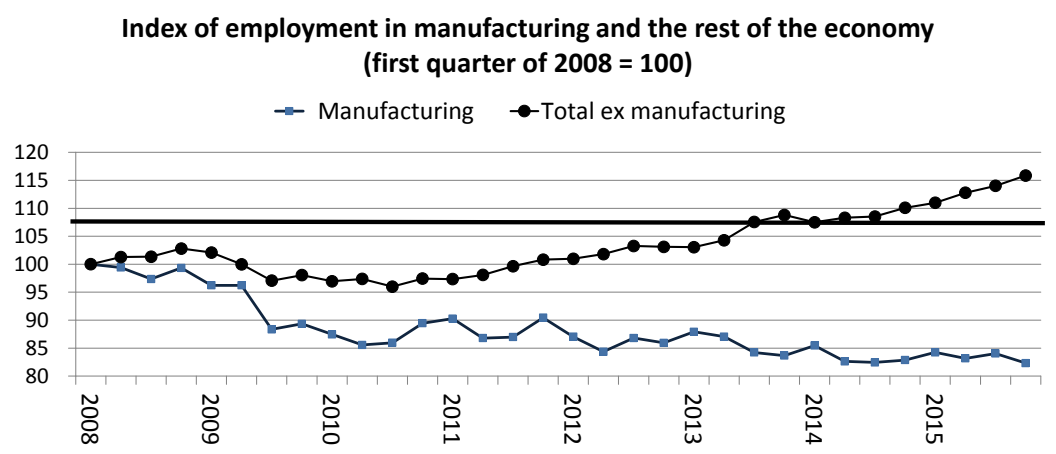
Graph 4



After increasing fairly steadily during the commodity boom from around 2002 to 2011, mining employment began to decline from 2012. It fell from a peak of 525 000 in 2012 to 477 000 in the third quarter of 2015, for a total loss of around 50 000 jobs.

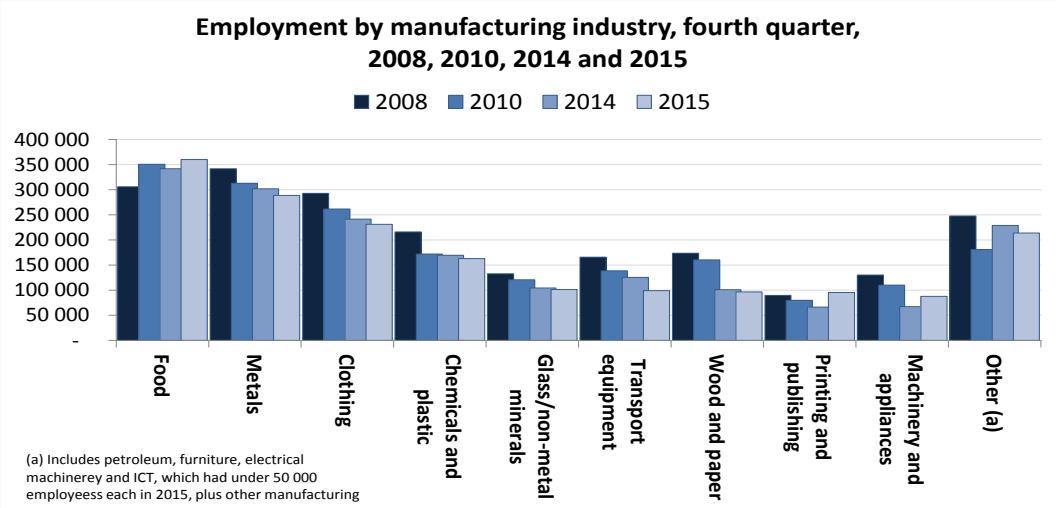
As Graph 5 shows, manufacturing employment did not reflect the recovery in job creation from 2010 following the global financial crisis. Still, it stabilised to a degree from 2014, although the last quarter showed a decline.

Graph 5



By subsector within manufacturing, substantially different trends have emerged. Food, beverages and tobacco has seen relatively strong growth since 2010, and is now the largest employer in manufacturing. Virtually every other major subsector has seen a steady decline over this period, as Graph 6 indicates.

Graph 6

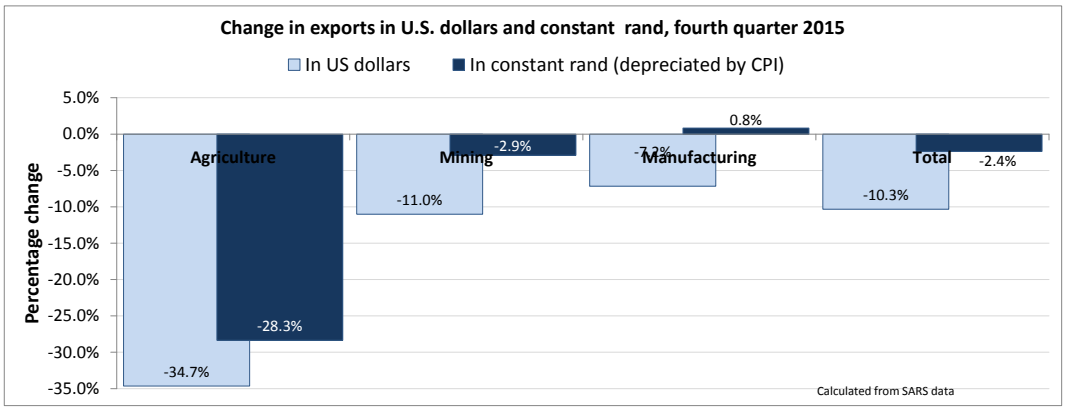


Trends in trade

Over the last quarter, a more competitive currency protected the revenues of manufacturing and mining exporters in rand terms, despite falling volumes. The falling price of petroleum in dollar terms helped relieve the burden of slowing merchandise exports on the balance of trade.

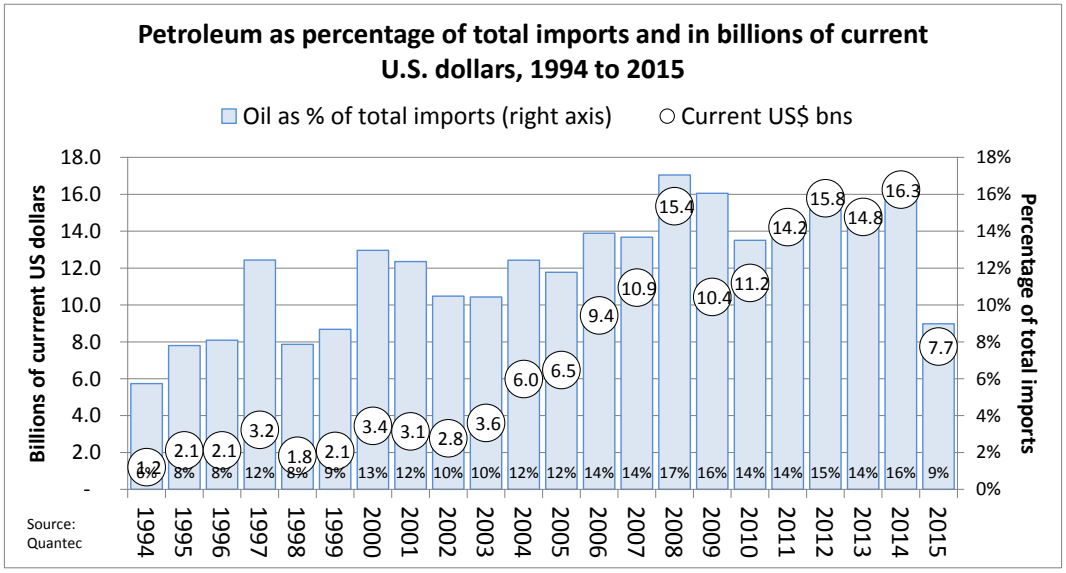
Overall, in the last quarter of 2015 the dollar value of total merchandise exports fell by 10,3%, although in rand terms they dropped only 2,4%. (The figures are not seasonally adjusted.) Manufacturing exports dropped in dollar terms but increased by almost 1% in rand. In contrast, mining exports declined in both dollars and rand terms (Graph 7).

Graph 7



2015 saw an extraordinary fall in the petroleum price, which in turn led to a sharp fall in the cost of imports. For the first time in the 21st Century, petroleum fell below 10% of total imports, while the value of imports in current dollars fell by more than half to under US$8 billion (Graph 8). The falling price of petroleum relieved some of the pressure from the fall in the prices of South African exports during the commodity bust that started, for mining products, in 2011.

Graph 8



The declining price of export commodities also led to a significant shift in South Africa's trading partners. Exports to China and Japan fell by over 40%, reflecting the predominance of commodities in South African sales to these countries. As a result, sales to these two countries together dropped from 19% of South Africa's total exports in 2011 to 14% in 2015. In contrast, imports from China increased by 36% in the same period, even though imports from the rest of the world dropped 17%. The decline in imports from Saudi Arabia and Iran accounted for a third of the total fall in imports in dollar terms, underscoring the importance of the falling price in petroleum for South African trade.

Within manufacturing, as the following table shows, over the quarter, the ***winners*** within manufacturing in terms of exports were textiles and clothing, with an increase relative to the performance of other sectors. The share of textiles and clothing in total exports, in both rand and dollar value, is 0,5%, up from 0,4% in the third quarter of 2015. In part, this gain reflects the impact of efforts by the dti to stabilise the sector.

Over the past quarter, the major ***loser*** in terms of exports was metals, which contracted both in rand and dollar terms. The major loser in terms of imports was transport equipment. The drop in imports in transport equipment, by 11% over the past quarter, reflects the slowdown in the domestic and global market.

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

		Value in Q4 2015		% change in constant ZAR to Q4 2015		% change in USD to Q4 2015	
Indicator	**Manufacturing Industry**	**Rand bns**	**USD bns**	**From Q4 2014**	**From Q3 2015**	**From Q4 2014**	**From Q3 2015**
Exports	Textiles, clothing, leather and footwear	5,7	0,5	2,7%	22,5%	-14,6%	13,1%
	Paper and publishing	5,0	0,4	18,1%	11,5%	-2,2%	2,1%
	Chemicals, rubber, plastic	20,4	1,7	-0,8%	8,4%	-17,6%	-0,1%
	Wood and wood products	1,4	0,1	9,9%	8,3%	-8,9%	-0,2%
	Food and beverages	10,8	0,9	-1,3%	7,6%	-18,2%	-1,1%
	Glass and non-metallic mineral products	1,3	0,1	5,3%	1,6%	-12,3%	-6,4%
	Machinery, appliances, AV equipment	24,9	2,1	-5,8%	-0,1%	-21,6%	-8,0%
	Transport equipment	28,8	2,4	3,2%	-4,5%	-14,2%	-11,8%
	Metal and articles of metal products	26,1	2,1	-9,1%	-5,9%	-24,5%	-13,7%
Imports	Food and beverages	7,76	0,6	8,6%	11,2%	3,3%	2,6%
	Paper and publishing	4,0	0,3	7,8%	6,5%	1,6%	-1,5%
	Machinery, appliances, AV equipment	70,0	5,8	5,8%	4,7%	-4,0%	-3,2%
	Wood and wood products	1,1	0,1	12,2%	4,5%	-5,9%	-2,9%
	Metal and articles of metal products	13,0	1,1	8,8%	2,4%	-4,0%	-5,5%
	Chemicals, rubber, plastic	36,0	3,0	2,6%	-3,7%	-9,7%	-11,0%
	Textiles, clothing, leather and footwear	13,4	1,1	13,8%	-4,6%	8,1%	-11,5%
	Glass and non-metallic mineral products	2,7	0,2	4,0%	-7,1%	-8,8%	-14,0%
	Transport equipment	39,5	3,3	1,8%	-11,3%	-18,6%	-17,9%
Balance	Food and beverages	3,1	0,3	-10,0%	-3,7%	-21,5%	-3,7%
	Textiles, clothing, leather and footwear	-7,7	-0,6	-11,1%	27,2%	-22,7%	24,6%
	Wood and wood products	0,3	0,0	-2,2%	3,9%	-2,9%	2,7%
	Chemicals, rubber, plastic	-15,6	-1,3	-3,4%	12,0%	-7,9%	10,9%
	Glass and non-metallic mineral products	-1,4	-0,1	1,4%	8,7%	-3,6%	7,6%
	Metal and articles of metal products	13,0	1,1	-17,9%	-8,3%	-20,4%	-8,2%
	Machinery, appliances, AV equipment	-45,2	-3,7	-11,6%	-4,8%	-17,6%	-4,7%
	Paper and publishing	1,0	0,1	10,3%	5,1%	-3,8%	3,5%
	Transport equipment	-10,7	-0,9	1,4%	6,8%	4,4%	6,1%

Notes: (a) Figures for change from second quarter 2015 are not seasonally adjusted. Constant change in rand calculated using CPI to deflate current figures. *Source:* South African Revenue Service (SARS) data on trade.

Profitability and investment

Profitability in manufacturing has tended to decline from 2011. Mining as a whole made a loss for the first three quarters of 2015, after making a return of 1,4% on capital in 2014. Overall, the return on capital outside of agriculture and construction dropped from around 5% in 2014 to just over 4% from the first to the third quarter of 2015.

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 third quarter of 2015. The most recent data on construction, however, appear to be faulty, so the sector is excluded here. The data are not seasonally adjusted, so quarterly fluctuations should be treated with care.

Profitability in manufacturing has tended to decline from 2011. Return on capital dropped from around 8% in 2012 and 2013 to 6,5% in 2014 and the first three quarters of 2015. Mining as a whole made a loss for the first three quarters of 2015, after making a return of 1,4% on capital in 2014. Overall, the return on capital outside of agriculture and construction dropped from around 5% in 2014 to just over 4% from the first to the third quarter of 2015.

While capital expenditure in mining has tended to decline as a percentage of assets over the past five years, it has generally increased in manufacturing and construction. For the economy as a whole outside of construction and agriculture, however, capital expenditure as a percentage of assets fell from an average of 4,1% in 2014 to 3,5% in the first three months of 2015.

Profitability and capital expenditure by sector, third quarter 2015, 2014, 2010

	Mining	Manufacturing	Utilities	Other sectors	Total excluding construction
Profitability					
Profits, Q3 2015	-R7,5 bn	R25,6 bn	R15,3 bn	R72,4 bn	R105,8 bn
Return on capital (a)					
- Q3 2015	-1,5%	5,9%	2,9%	7,2%	4,3%
- Q3 2014	2,0%	7,0%	2,4%	9,5%	6,2%
- Q3 2010	3,4%	6,5%	3,3%	5,1%	4,8%
Capital expenditure					
Capital expenditure, Q3 2015	R13,1 bn	R17,2 bn	R20,9 bn	R34,0 bn	R85,2 bn
Capital expenditure as % of assets					
- Q3 2015	2,5%	4,0%	4,0%	3,4%	3,4%
- Q3 2014	3,0%	4,2%	5,2%	3,6%	3,9%
- Q3 2010	2,5%	4,0%	4,0%	3,4%	3,4%

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

Behind the trends

The economy slowed in the last quarter primarily due to the drought combined with lower commodity prices, which in turn resulted from a global slowdown. While South Africa has not fallen into recession – in contrast to Russia and Brazil – its growth over the past five years has been more than half a percent lower than for all upper-middle-income economies excluding China. In contrast, before 2008 it grew at almost exactly the same rate as this peer group.

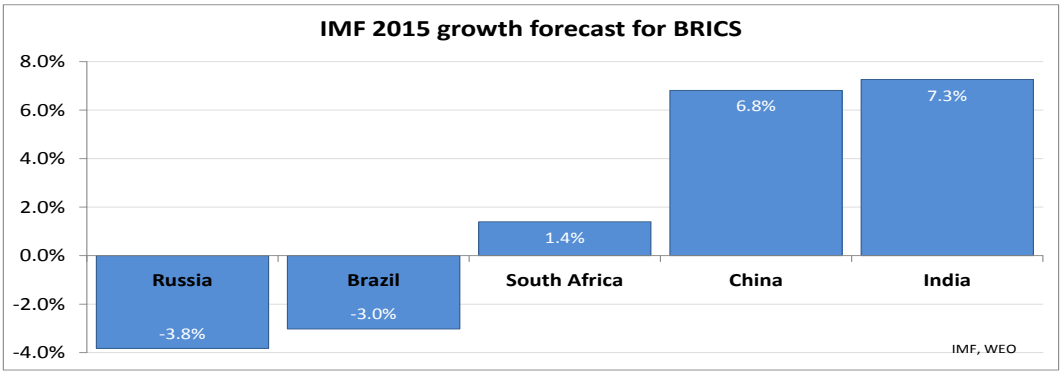
The impact of the end of the commodity boom has coincided with a major drought in Southern Africa. These two blows lie behind the slowdown in the South African economy, which worsened in the past quarter. In this context, the 6% decline in sales by the manufacturing sector largely reflected the sharp fall in metal production, especially steel and ferroalloys. Sales of metal products fell by almost 10% in real terms in the year to December 2015. The refineries have experienced both slowing export markets and rising competition from China as a result of that country's substantial over-production. Increasing electricity costs have added to their woes.

In addition, the auto industry saw a steady 13% fall in domestic sales from 2011, while exports essentially stagnated. The national automobile producers association, NAAMSA, attributed declining domestic sales to the economic slowdown, aggravated by the decline in the rand, which pushed up the cost of imported models and components.

The decline in commodity prices has mainly resulted from slower growth in Europe and China. Official growth figures for China have come under sharper scrutiny, with most observers agreeing that they are substantially and increasingly overstated.[1] Still, the trend is clear, with reported growth in China falling below 7% for the first time in a quarter century. Experts have also raised doubts about reported growth rates for India.[2]

In the event, as Graph 9 shows, South Africa's growth rates actually look rather good compared to the other commodity-dependent BRICS – that is, Brazil and Russia.

Graph 9

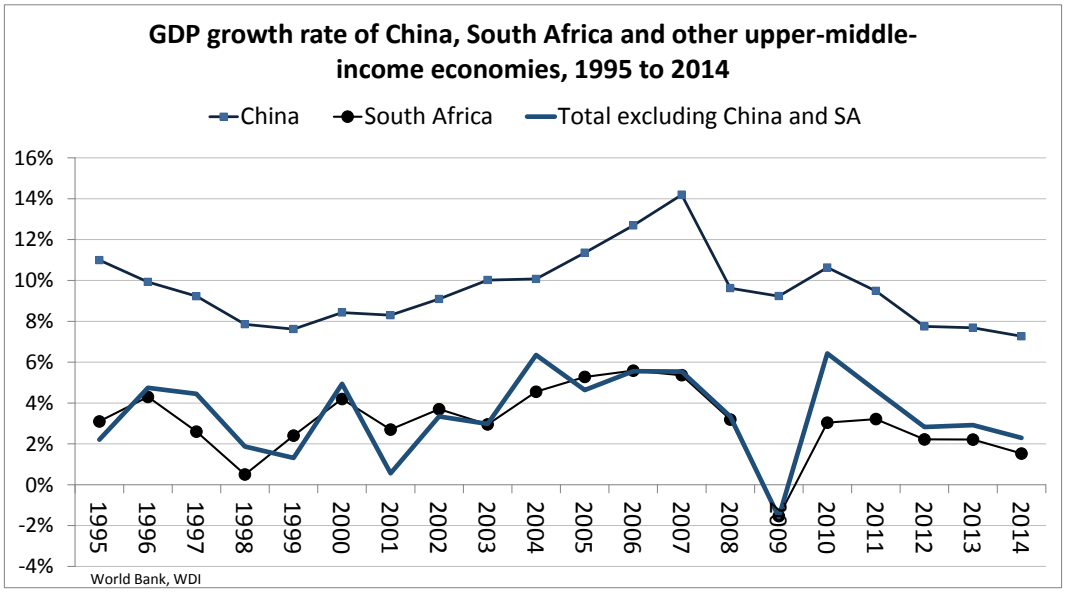


[1] See for instance, Keith Bradsher, *Inquiry in China adds to doubt over reliability of its economic data*, New York Times, 26 January 2016 (downloaded from www.nytimes.com in March 2016)

[2] See for instance, Himanshu Goenka, *India's GDP growth data: Numbers divorced from reality?* in India Business Times, 8 February 2016 (downloaded from www.ibtimes.com in March 2016)

Still, growth in South Africa is now more than half a percent lower than for all upper-middle-income economies excluding China. In contrast, before 2008 it grew at almost exactly the same rate as this peer group (Graph 10).

Graph 10



Slow growth in commodity-dependent economies, including South Africa, has generally fuelled political and social strains. To start with, many workers have seen a slowdown in pay increases, especially in the mining value chain. It is noteworthy in this context that, despite some downsizing in mining and agriculture, the available data still show fairly strong growth in South African employment, almost exclusively, however, in business, domestic and social services. At the same time, commodity economies have begun to encounter fiscal constraints, as revenues decline with their exports and growth. That in turn makes it harder to sustain redistributive programmes. In South Africa, the sharp drop in the value of the currency value has also raised a red flag in the mainstream press, together with concerns of country-risk downgrades.

A strength of the South African political economy in these circumstances remains the commitment to social dialogue as well as the depth of civil society, including business and labour. The country can draw on the long-standing practice of working together to develop shared perspectives and measures to address economic downturns. Experience suggests that while many of these commitments will not be fully implemented, the very fact of dialogue helps alleviate the divisions and tensions that inevitably arise as the economy endures a more stressed period.

In any case, despite the negative headwinds, opportunities exist for South Africa to take advantage of the low rand to diversify exports into manufacturing, agriculture, and value-adding services. Moreover, South African firms are increasingly identifying both export and investment opportunities in other African countries, which provide a fast-growing alternative to traditional trade partners.

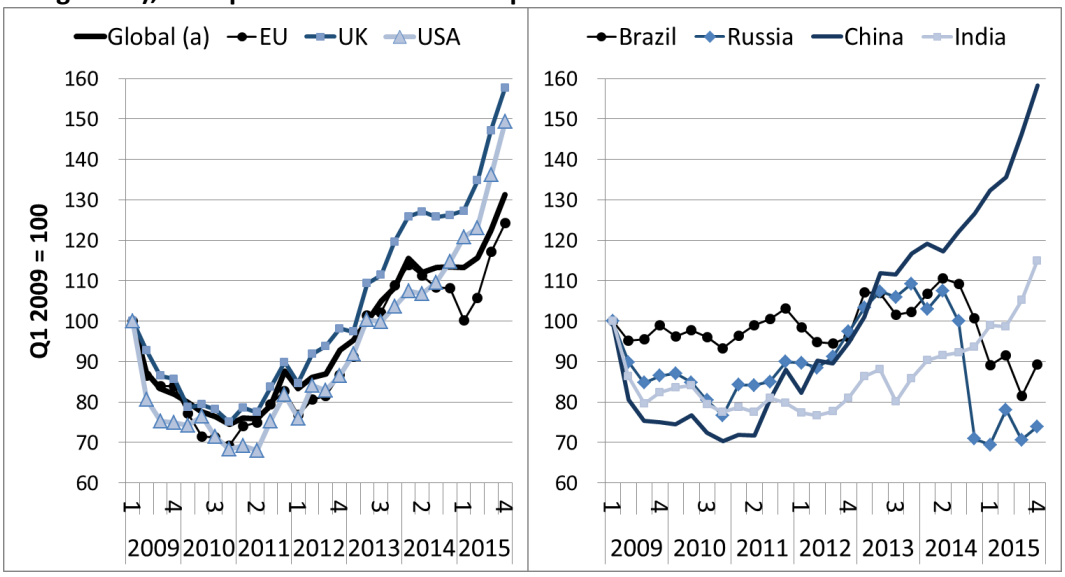
Brief: The exchange rate and the real economy

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.

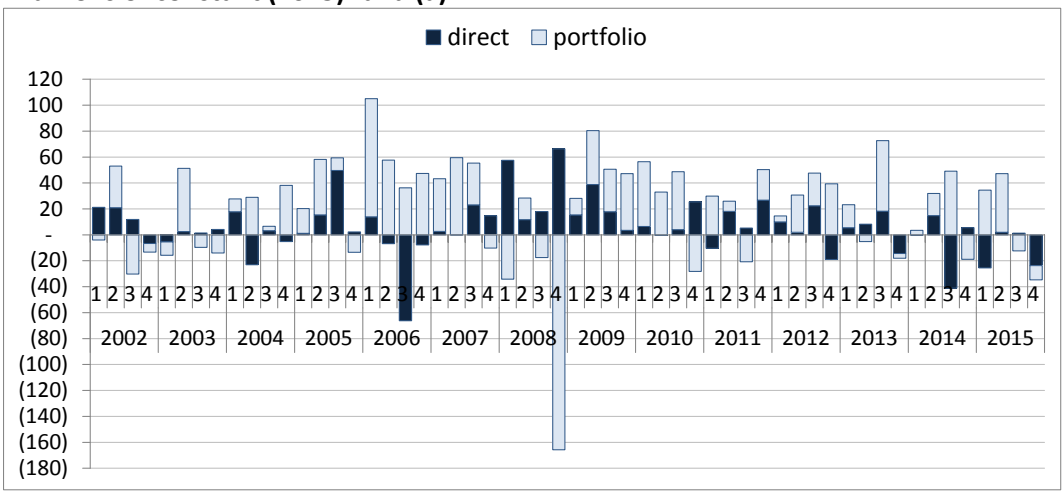
Table 1. Indices of exchange rates with major trading partners and BRICS (cents per foreign unit), first quarter 2008 to fourth quarter 2015



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.

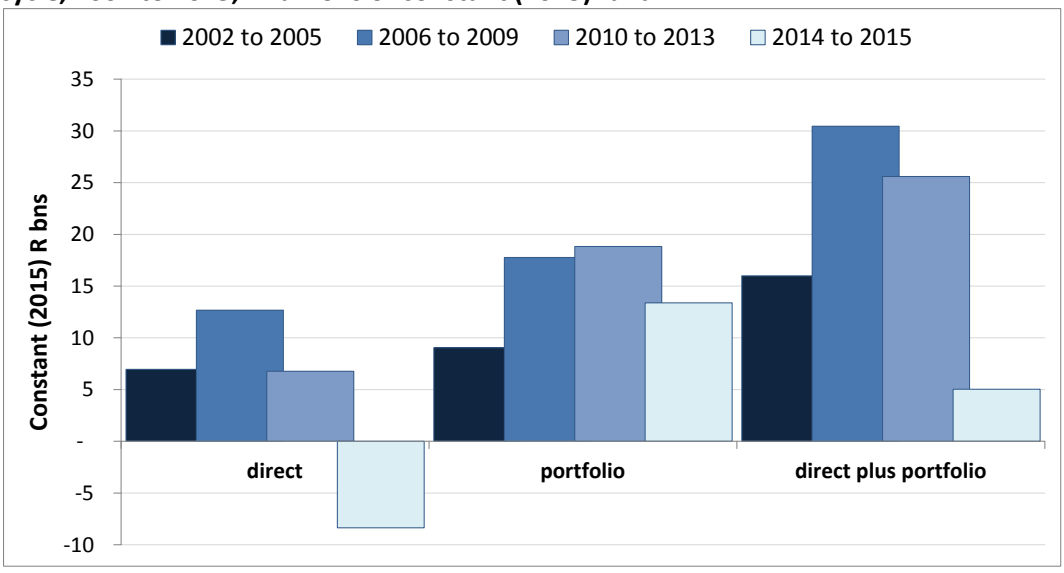
Table 2. Quarterly net direct and portfolio investment into South Africa, 2002 to 2015, in billions of constant (2015) rand (a)



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

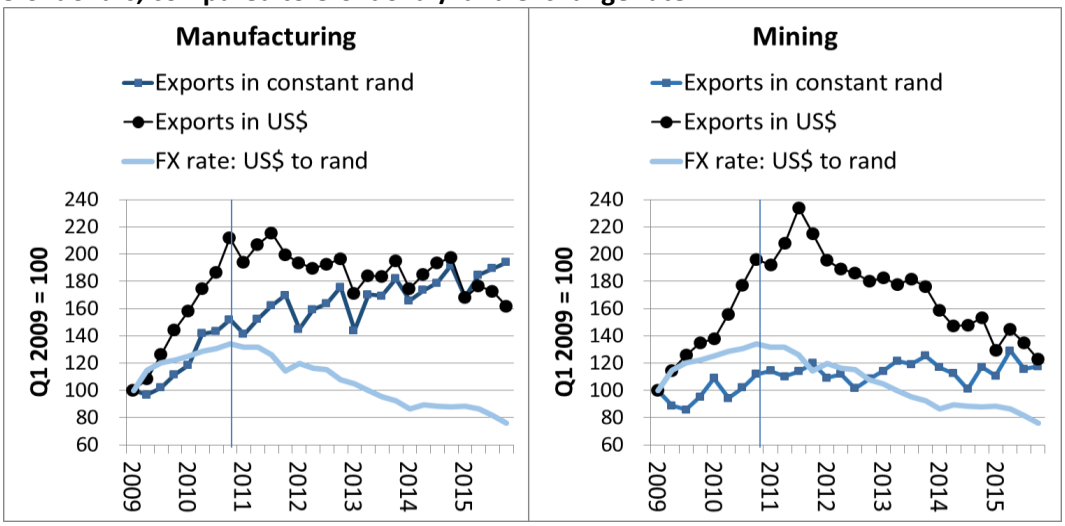


Notes: (a) Deflated using the GDP deflator. *Source:* South African Reserve Bank, interactive dataset, series on direct and portfolio investment into and out of South Africa. Downloaded from www.resbank.co.za in March 2016.

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

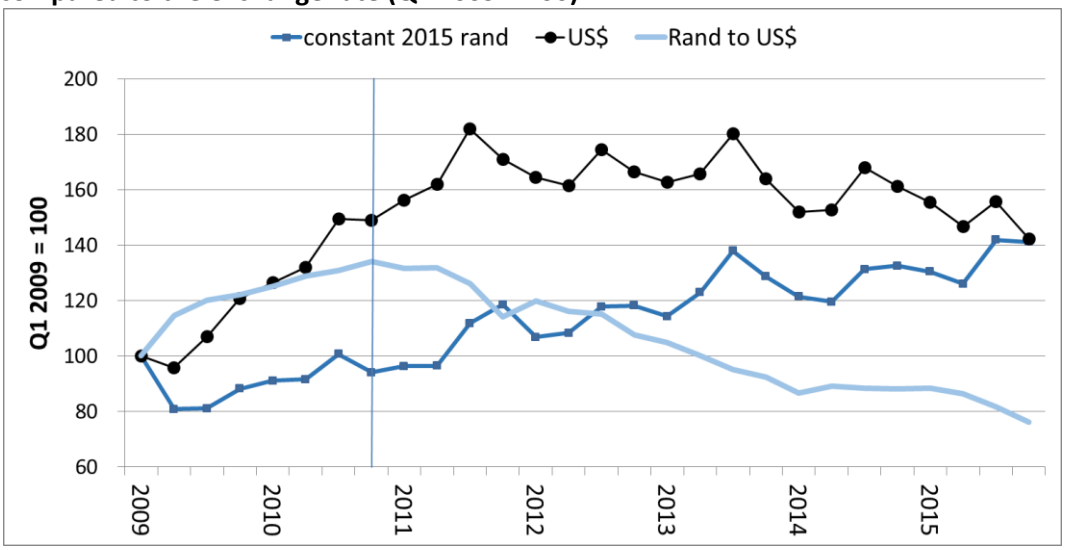


Notes: (a) Deflated with GDP deflator for relevant sector. *Source:* Export data from Quantec EasyData, HS-4 series, downloaded www.quantec.co.za in February 2016; exchange rate from South African Reserve Bank, nominal exchange rate for 20 trading partners, downloaded from www.resbank.co.za in March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

Brief: Decarbonising the economy – risk or opportunity?

The commitment made by South Africa to reduce Green House Gas (GHG) emission levels at the December 2015 COP21 negotiations will affect manufacturing and mining in various ways. A key dimension is the impact of the additional cost of electricity (due to the carbon tax) and the costs associated with improvements in the use of energy, imposed by regulatory constraints. Meeting South Africa's COP21 targets will likely require diversification away from the current dependence on mining exports, which aligns with the core objectives of the Industrial Policy Action Plan.

The commitment made by South Africa to reduce GHG emission levels at the December 2015 COP21 negotiations will affect manufacturing and mining in various ways. A key dimension is the impact of the additional cost of electricity (due to the carbon tax) and the costs associated with improvements in the use of energy, imposed by regulatory constraints.

In December 2015, the United National Framework Convention on Climate Change (UNFCCC) hosted Paris COP21[3] negotiations with the aim of negotiating internationally binding agreements on climate change. The negotiations centred on the commitment to limiting the rise in global temperatures to below 2 degrees Celsius.

The climate change governance framework has evolved over time from a top-down to a bottom-up approach that no longer imposes legally binding agreements, which enables countries to decide on their own mitigating strategies. Commitments have been made by 150 countries in the form of Intended National Determined Commitments (INDCs). They will be measured from 2020 and reported on every five years. However, there remains a gap between the promotion of climate change ambitions and the complexity of implementing climate change goals within specific contexts.

In preparation for the negotiations at COP21, South Africa committed to reducing its GHG emission levels, applying a peak, plateau and decline approach, to between 398 and 614 MtCO2e (metric tons of carbon dioxide equivalent) over the period 2025 to 2030, in a bid to demonstrate intended action towards a low carbon development path. If South Africa were to take no measures to reduce emissions and mitigate climate change, its emissions are projected to reach around 1,700 MtCO2e by 2050. If measures implemented between 2000 and 2010 are taken into account (the "with existing measures" scenario), emissions are projected to reach around 1,600MtCO2e by 2050.

South Africa's commitments in Paris would cut its projected emissions well over half. This is considered an ambitions target for such an energy-intensive economy.

The policy instruments considered for achieving the target include: a carbon tax, desired emissions reduction outcomes (DEROs) for specific sectors, company-level carbon budgets, and a variety of regulatory standards.

[3] COP stands for Conference of the Parties, which are regular meetings of the countries engaged in climate change talk.

According to a mitigation potential analysis study conducted by the Department of Environmental Affairs in 2014, the national mitigation potential (if all available measures are implemented) is estimated at 100 $MtCO_2e$ in 2020, 340 $MtCO_2e$ in 2030 and 852 $MtCO_2e$ in 2050. Two key assumptions of the mitigation potential analysis are a real growth rate of 4,2% per annum over the medium term (2015-2020) and 4,3% over the long term (2021-2050). A lower growth rate scenario of 3,8% per annum is also considered in the analysis. At the lower growth rate projection of 3,8%, emissions in 2050 would be 15% lower than under the 4.3% growth rate scenario.

The chief challenge in the transition toward a low carbon economy in South Africa is tackling the carbon lock-in driven by the Minerals Energy Complex. The mining and energy sectors represent the key sectors that contribute to the carbon intensity of the economy. In the context of a cheap and abundant supply of coal-fired electricity, these sectors have fostered a carbon-intensive industrial development path that needs to be transformed to make a significant change to the mitigation landscape of South Africa.

The potential benefits and costs of mitigation for manufacturing depend largely on the structure of each industry and consequently vary by sector. In the short term there are benefits to the industrial sector in avoiding the costs of climate change – already beginning to take a serious toll on the economy, especially in agriculture and coastal communities – as well as through unlocking opportunities in energy efficiency in particular. The direct costs of mitigation generally take the form of investment in new technologies and higher energy tariffs and taxes. A sector with substantial potential for saving is the building sector.

In the long run, deep de-carbonisation can be achieved through transforming the energy system to shift away from fossil fuels combined with reduced energy intensity in production. In manufacturing, the biggest challenges arise in the energy-intensive industries, and especially in metals and coal beneficiation. Clearly the process of reducing emissions will require tough choices in these industries, which may paradoxically be made easier by the current commodity bust. In contrast, in the rest of manufacturing energy is less of a cost driver, and mitigation – including through both efficiency gains and shifting to renewable energy sources – should be easier.

In sum, meeting South Africa's COP21 targets will likely require diversification away from the current dependence on mining exports. From this standpoint, these measures are well aligned with the Industrial Policy Action Plan (IPAP), which also aims at economic diversification.