

THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

SECOND QUARTER 2016

The Real Economy Bulletin is a TIPS review of quarterly trends, developments and data in the real economy, together with a comprehensive analysis of the latest from the main manufacturing industries and key data in Excel format.*

Quarterly GDP growth

South Africa's GDP grew by 0,8% in the second quarter of 2016, in a marked recovery from the 0,3% contraction in the first quarter of the year. Mining and manufacturing made the largest sectoral contributions to growth. Mining grew (quarter on quarter) by 2,8%, while manufacturing grew by 2,0%. Agriculture continued to decline as the drought persisted, utilities fell by 0,4%, and construction remained unchanged.

The figures used in this bulletin are the seasonally adjusted quarterly figures for growth. In contrast, the Press generally reports growth in terms of the annualised rates. That is, they indicate how much the economy would grow if the quarterly rate persisted for the full year. In these annualised terms, the economy shrank at the rate of -1,2% in the first quarter and grew at 3,3% in the second.

In volume terms, compared with a year ago, manufacturing is the only sector that has performed better than last year. Both mining and agricultural production are down significantly from last year's levels. Graph 1 shows year-on-year changes in GDP.

In current rand terms, the share of the real economy in the GDP recovered significantly in the past quarter, as Graph 2 shows. Much of the increase was due to the regular seasonal acceleration in agricultural value added, but mining and construction also increased their shares in the GDP. In contrast, at 12,9% of the GDP, manufacturing showed no significant growth over the second quarter in previous years back to 2011.

*Available to download at www.tips.org.za/realeconomy_bulletin

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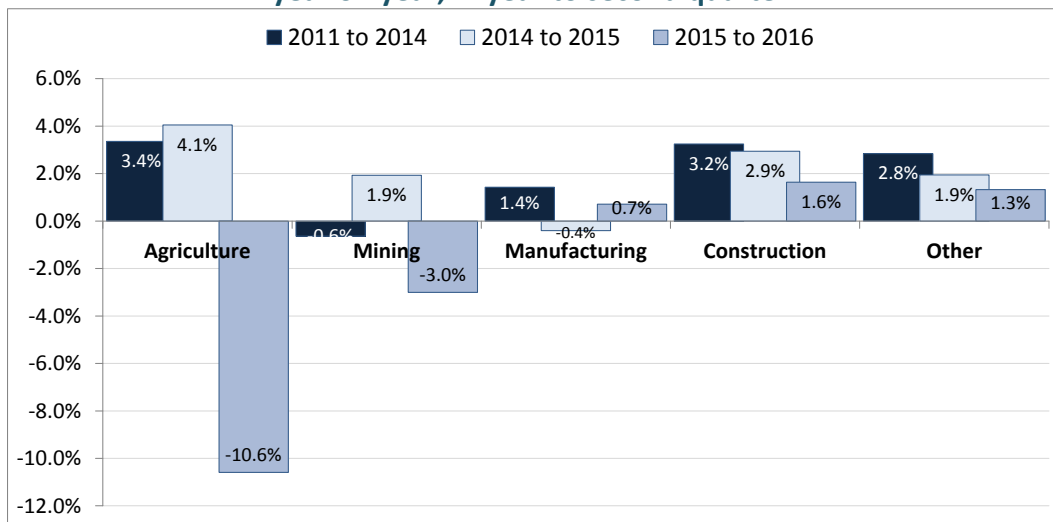
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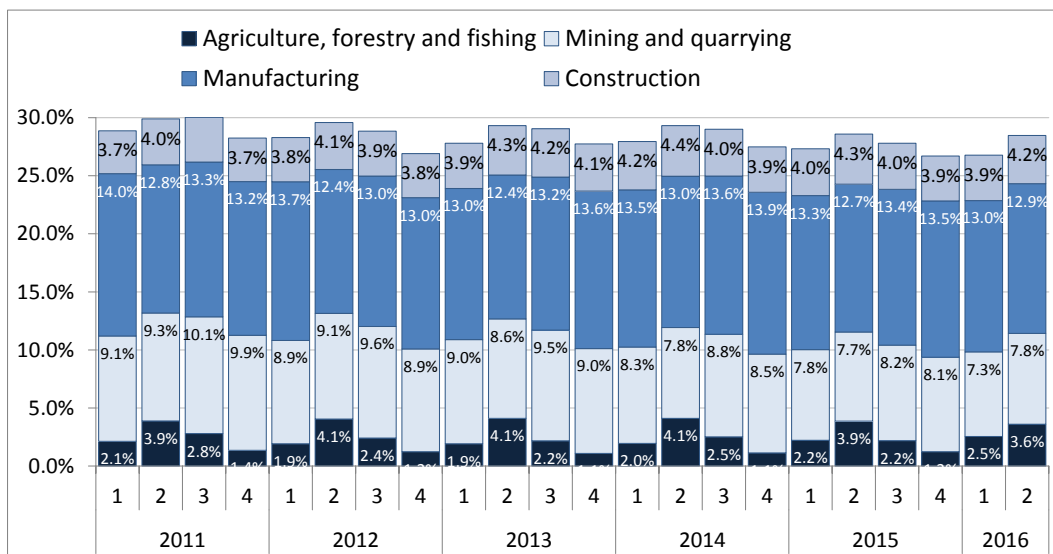
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Graph 1: Change in GDP by sector in volume terms, year on year, in year to second quarter



Note: Calculated on the basis of the sum of four quarters of each year to the second quarter. Source: Calculated from Statistics South Africa. Electronic database. Series on Gross Domestic Product growth. Downloaded from www.statssa.gov.za in September 2016.

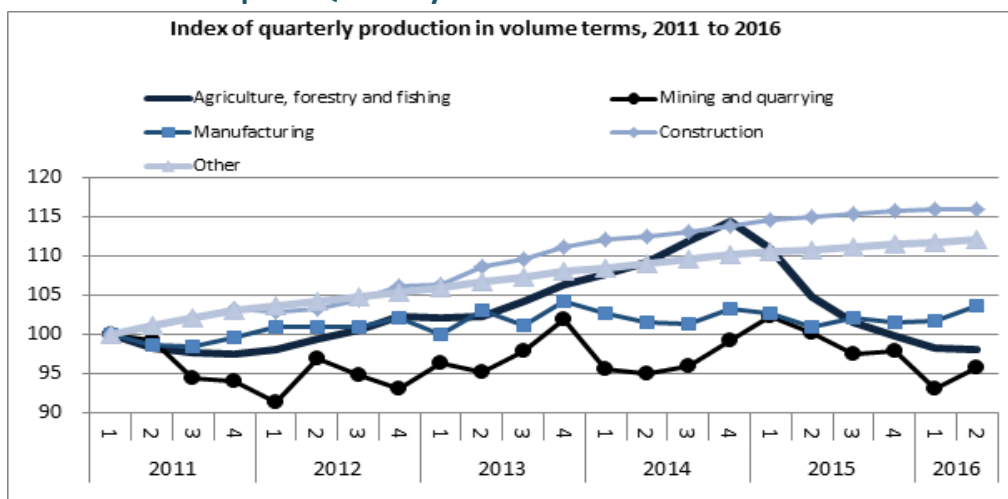
Graph 2: Share of the real economy in the GDP, in current terms, not seasonally adjusted



Source: Own compilation based on Statistics South Africa. Electronic database. Series on GDP growth. Downloaded from www.statssa.gov.za in September 2016.

Accounting for seasonal adjustments, agricultural production dipped once again (Graph 3), though at a slower pace, while mining and manufacturing production improved from last quarter, contributing to higher growth. The decline in agriculture from 2015 mainly reflects the drought. Mining also remains well below its peak in the first quarter of 2015 in terms of volume of production.

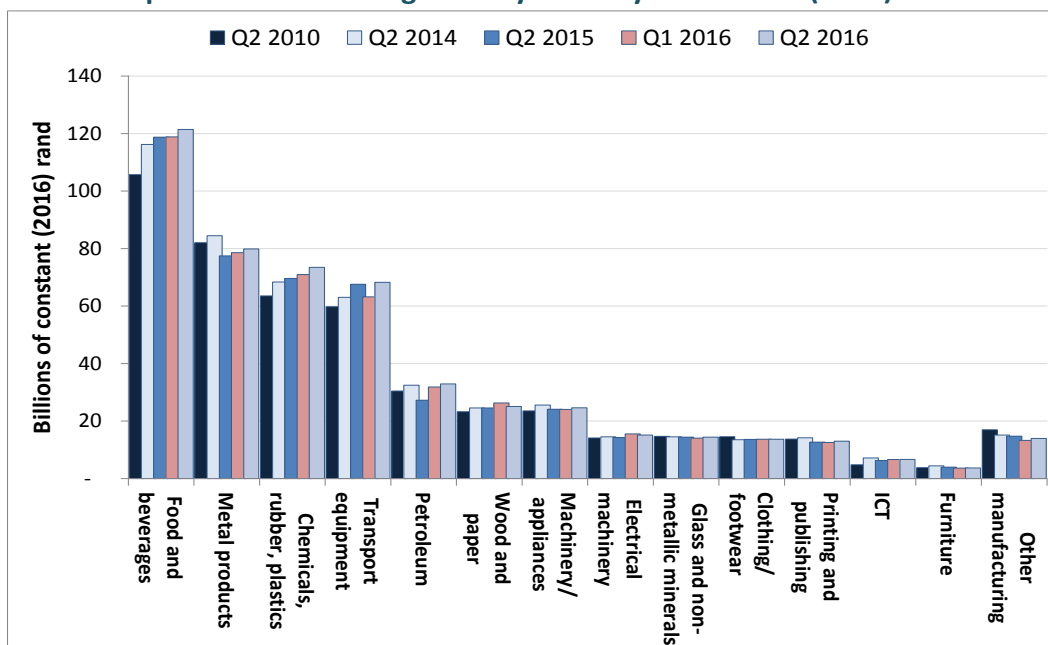
Graph 3: Quarterly Production Volumes 2011-2016



Source: Calculated from Statistics South Africa. Gross Domestic Product (Quarterly)(2016Q2). Excel spreadsheet downloaded in September 2016.

Within manufacturing, sales of ICT equipment, electrical machinery and chemicals showed the most rapid growth in the past year (Graph 4). Food and beverages continued fairly steadily, and metal products showed signs of recovery. Auto industry production fell in the first quarter of 2016, but recovered in the second quarter. Auto export sales grew substantially in this period, but domestic sales levelled out due to a combination of slowing overall growth and price hikes as a result of depreciation of the rand.

Graph 4: Manufacturing sales by industry in constant (2016) rand



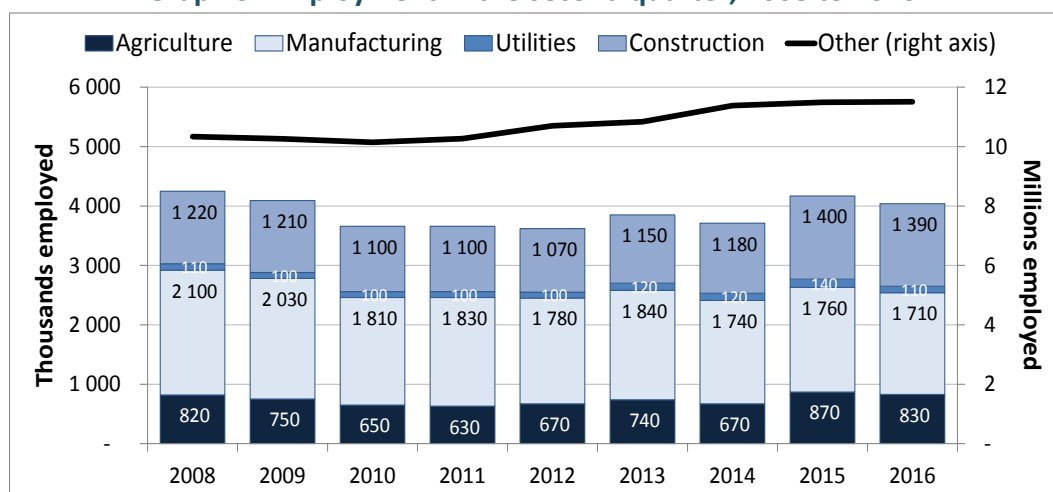
Note: Average of monthly figures for each quarter, deflated with CPI. Source: Calculated from StatSA, Manufacturing: Production and Sales. Excel spreadsheet. Downloaded from www.statssa.gov.za in September 2016.

Employment

Despite the relatively rapid growth in GDP in the second quarter of 2016, according to the official data employment in the economy as a whole fell by 130 000, or around 0,8% in the second quarter of 2016 compared to the first quarter, and around 0,7% when compared to the previous year. In contrast, the data show gains in manufacturing and construction. Agriculture usually loses jobs in the second quarter compared to the first, but in 2016 the shrinkage was higher than usual. In mining, using the employer survey (which is considered more reliable for this sector), employment dropped by 4 000 in the first quarter of 2016, or just under 1%. The end of the commodity boom has seen major losses in mining, and some 15% of miners have lost their jobs since 2012.

Graph 5 shows the change in employment by sector from the second quarter of 2008 to the second quarter of 2016. Employment in the real economy remains lower than it was before the 2008/2009 crisis because of persistent job losses in manufacturing, although employment overall recovered in 2013.

Graph 5: Employment in the second quarter, 2008 to 2016

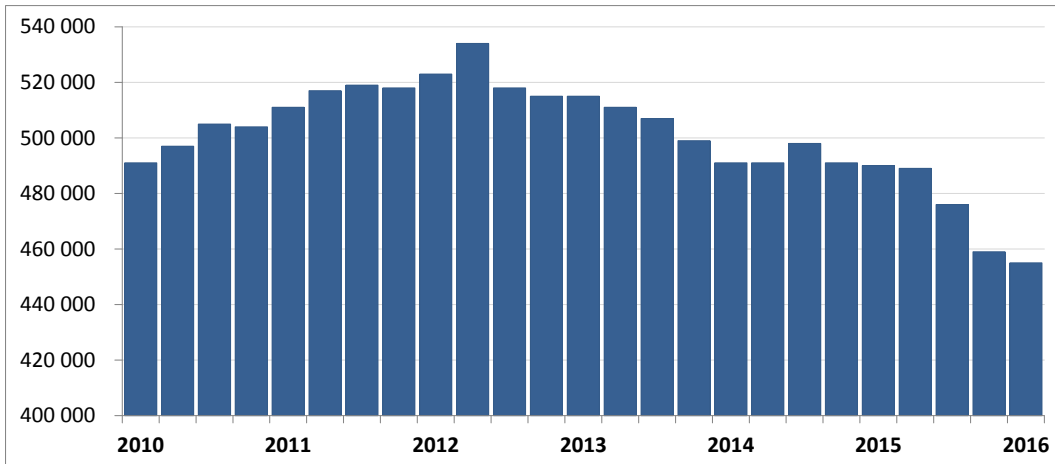


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in September 2016.

Agricultural employment declined by 44 000, or 5,0%, in the second quarter of 2016. The second quarter typically shows a seasonal fall in farm employment. From 2008 to 2015, however, the average drop was 2,9%, so the fall in 2016 was much higher than normal.

Job losses in mining started around a year after metals prices began a precipitous decline in 2012 (Graph 6). Since the peak in the second quarter of 2012, around one in seven miners has been retrenched. These job losses affect communities that depend on mining in the North West, Limpopo, the Northern Cape and Mpumalanga.

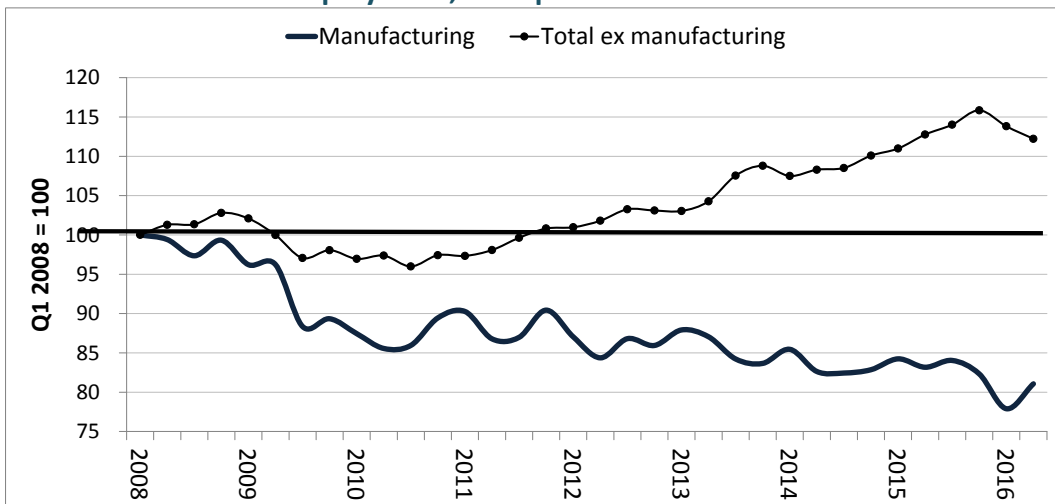
Graph 6: Employment in mining, 2010 to 2016



Source: Statistics South Africa. Quarterly Employment Survey. March 2014 and March 2016.

In contrast to mining, the official data show job gains in manufacturing after a sharp fall in the previous two quarters. Manufacturing reportedly gained 67 000 jobs, or 4,1%, in the second quarter of 2016 – a quarter in which the sector usually loses employment. It is not clear if the figures reflected a longer-term reversal of the five-year trend of job losses in manufacturing, which is shown in Graph 7. Manufacturing employment was still almost 50 000 lower than in the second quarter of 2015, and almost 400 000 below the second quarter of 2008, before the crisis hit.

Graph 7: Index of manufacturing and other employment, first quarter 2008 = 100

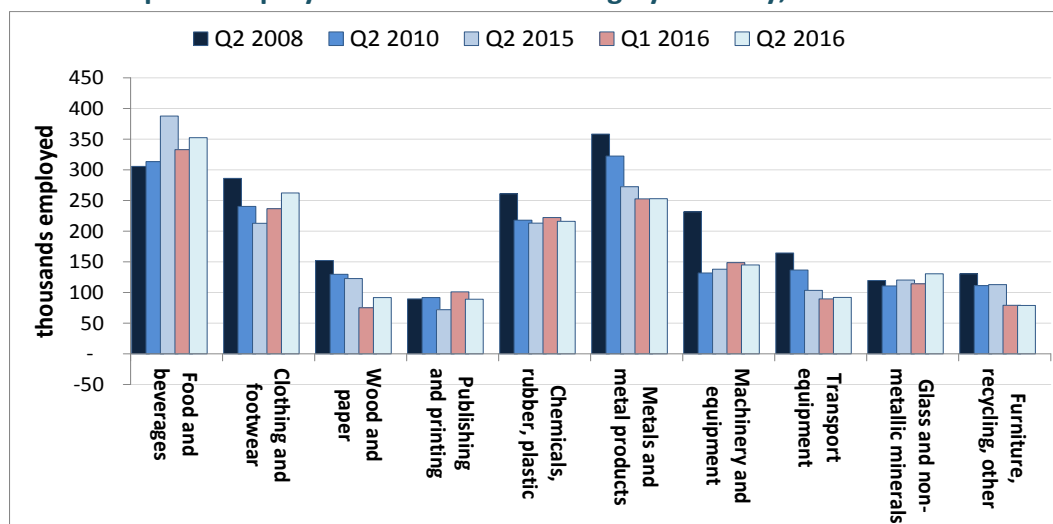


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in September 2016.

The figures on the change in employment by industry within manufacturing suggest the need to be cautious about long-term trends. Because the samples at this level are small, the quarterly changes are typically not reliable.

Still, the data indicate that virtually all job creation occurred in just four industries – food and beverages, clothing, glass and non-metallic minerals (mostly used in construction) and wood and paper – that together account for around half of total manufacturing employment. In contrast, metals, machinery and chemicals saw virtually no growth in jobs over the past quarter (Graph 8).

Graph 8: Employment in manufacturing by industry, 2008 to 2016



Note: Includes all reported employees, not just those aged 15 to 64. Source: Calculated from Statistics South Africa. Quarterly Labour Force Survey for relevant quarter. Electronic database. Series on industry.

Trends in trade

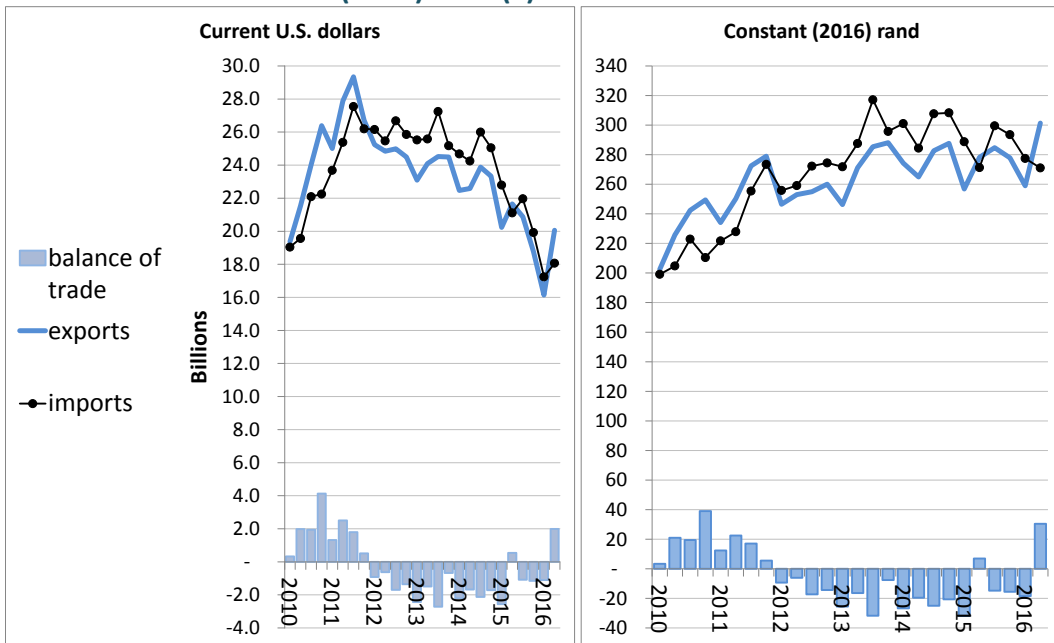
The second quarter of 2016 saw a strong uptick in exports combined with falling imports, mostly due to the falling price of petrol. The resulting improvement in the balance of trade boosted GDP growth. While both manufacturing and mining exports fell in dollar terms, they expanded in constant rand, with manufacturing exports rising by 8.6% and mining by 5.1%. Agricultural exports also performed exceptionally during the quarter, but that partly reflects seasonal factors.

As Graph 9 shows, in constant rand exports rose sharply in the last quarter, while imports declined. The value of exports fell with the end of the commodity boom in 2011, recovered somewhat in 2013, but since then stagnated until the second quarter of 2016. In contrast, imports continued to grow through 2013, but then began to fall.

The trends in trade since 2010 suggest that the economy has begun gradually to adjust to the new realities of lower metals prices. In particular, the emergence of a relatively competitive rand seems to have fostered more diversified exports while making local products more competitive on the domestic market.

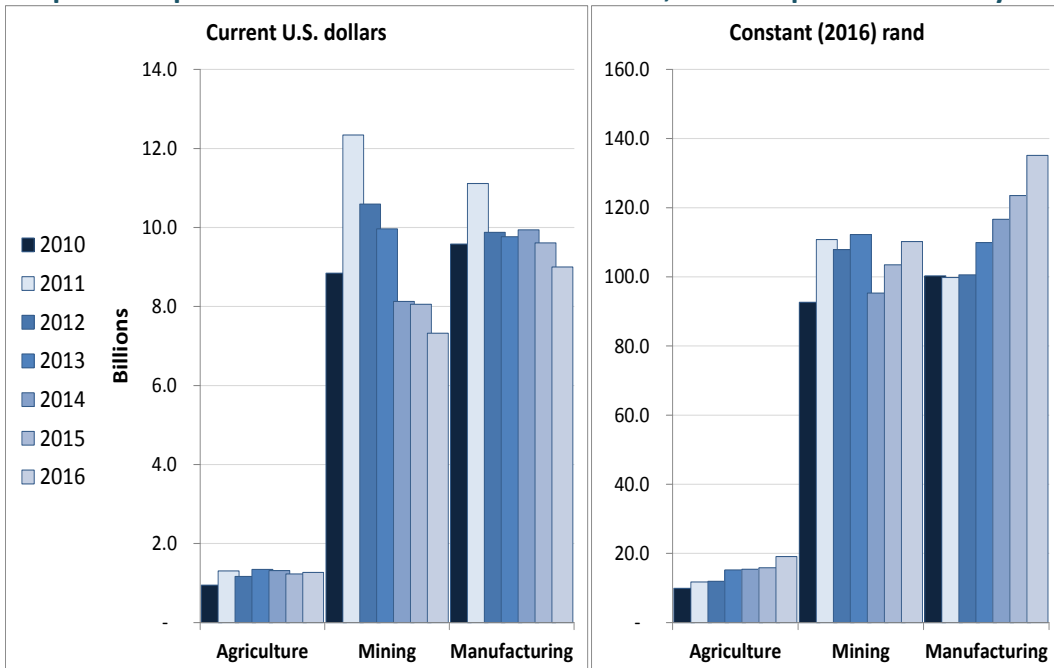
In rand terms, both manufacturing and mining have seen some recovery in exports over the past three years to the second quarter, despite a decline in US dollar revenues (Graph 10).

Graph 9: Exports, imports and the balance of trade in constant (2016) rand (a) and current US dollars



Note: (a) deflated with CPI rebased to June 2016. Source: Calculated from SARS. Trade Balance Graph for 2010-2016 (including and excluding BLNS). Excel spreadsheet. Downloaded from www.sars.gov.za in September 2016.

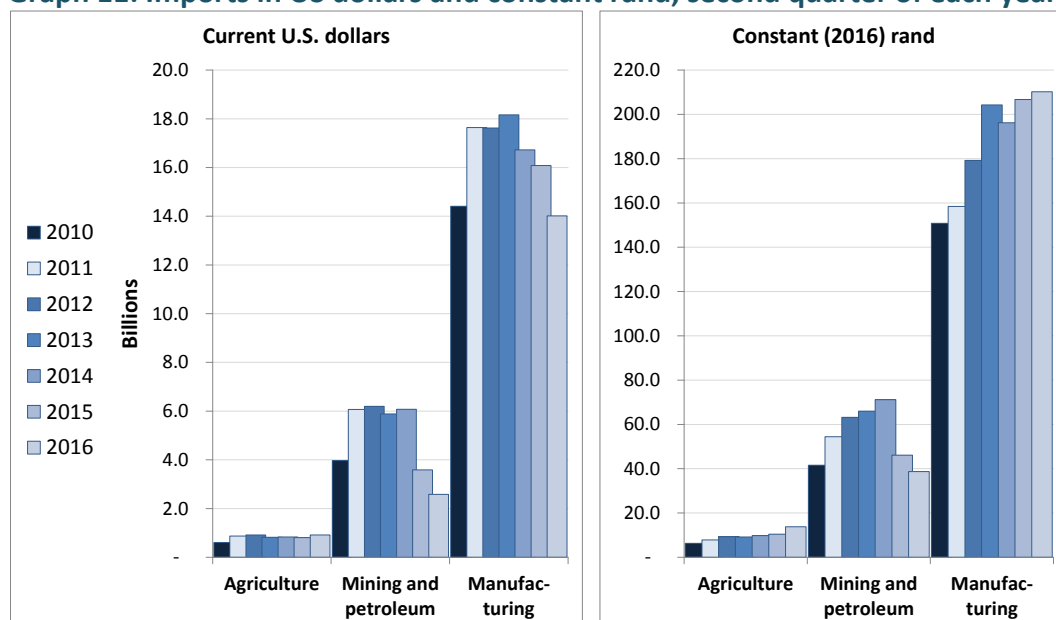
Graph 10: Exports in US dollars and constant rand, second quarter of each year



Note: Excludes trade within SACU. Rand figures deflated with CPI. Source: Calculated from SARS data on monthly exports, downloaded in September 2016.

The fall in imports was driven by the declining price of petrol. Imports of petroleum remained fairly constant in volume from 2014, but the value in dollar terms dropped from US\$4,2 billion in the second quarter of 2014 to US\$1,6 billion in the second quarter of 2016. In current rand terms, the value of petrol imports dropped from R44 billion to R24 billion in the same period.¹ In contrast, imports of manufactures continued to rise in rand terms (Graph 11).

Graph 11: Imports in US dollars and constant rand, second quarter of each year



Note: Excludes trade within SACU. Rand figures deflated with CPI. Source: Calculated from SARS data on monthly exports, downloaded in September 2016.

Within manufacturing, exports (excluding the Southern African Customs Union – SACU) were driven by transport equipment (which includes automobiles), with healthy growth also in wood and wood products, food and beverages, and machinery and appliances.

In rand terms, exports of transport equipment grew just under 30% in the second quarter, up from 20% in the previous quarter. The acceleration is even sharper in dollar terms. Clothing and footwear saw some growth in rand terms, and stabilised in dollars. Food and beverage exports increased by 19% from quarter one, wood products exports grew by 22% and metal exports grew by 11% while chemicals, rubber and plastic ticked up by 13%. However dollar exports declined in almost every manufacturing industry, except paper and auto, when compared to 2015. Table 1 provides more detail on exports by sector.

¹ Data from TradeMap. Electronic database. Series on petroleum oils in rand, dollar and quantity terms. Downloaded from www.trademap.org in September 2016.

Table 1: Trade in manufactures to second quarter 2016 in current US dollars and constant (2016) rand

Industry	Value (billions)		% change from Q2 2015		Change in millions	
	USD	Rand	USD	Rand	USD	Rand
Exports						
Food and beverages	0.63	8.3	-2.0%	14.5%	-13	1 210
Clothing and footwear	0.26	3.7	-11.7%	3.2%	-34	120
Wood and paper	0.41	5.3	-0.5%	16.5%	-2	880
Chemicals, plastics, rubber	1.22	20.1	-22.1%	-8.9%	-345	-1 780
Glass/non-metallic minerals	0.08	1.1	1.4%	17.9%	1	190
Metals and metal products	2.19	30.8	-8.5%	6.9%	-203	2 140
Machinery and equipment	1.61	22.2	-6.9%	8.8%	-119	1 950
Transport equipment	2.49	30.6	4.9%	22.4%	117	6 850
Other manufactures	0.10	1.5	-10.8%	3.9%	-13	60
Imports						
Food and beverages	0.45	6.1	-4.8%	11.1%	-23	680
Clothing and footwear	0.86	11.6	-4.7%	11.2%	-42	1 310
Wood and paper	0.33	4.8	-10.5%	4.6%	-39	220
Chemicals, plastics, rubber	2.57	36.9	-10.2%	4.8%	-294	1 780
Glass/non-metallic minerals	0.23	3.1	-2.9%	13.5%	-7	420
Metals and metal products	0.96	15.2	-19.2%	-5.7%	-227	-860
Machinery and equipment	4.99	76.8	-16.4%	-2.5%	-982	-1 900
Transport equipment	3.31	47.8	-11.1%	3.8%	-414	1 820
Other manufactures	0.30	4.4	-12.4%	2.3%	-43	100

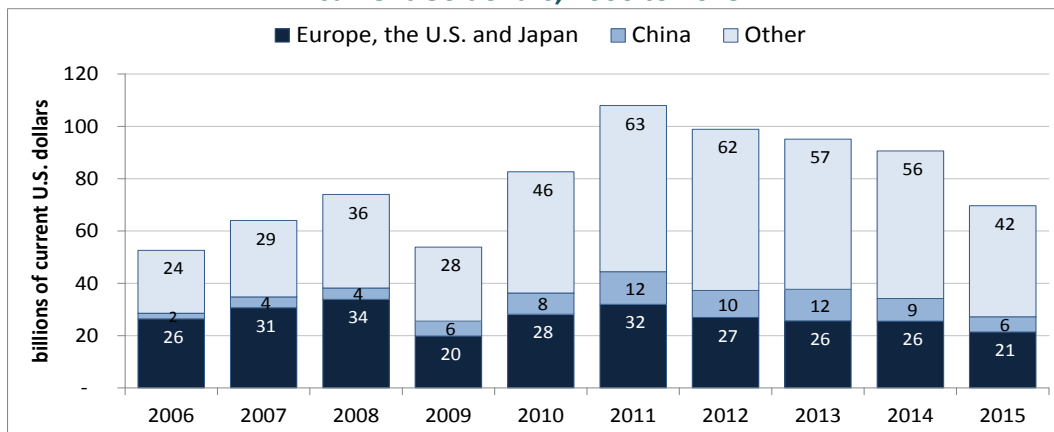
Notes: Excludes BLNS. Deflated with CPI. Source: SARS data on trade.

In terms of manufactured imports, the sharpest fall in dollar terms was in machinery and equipment. This trend resulted in part from depreciation, which generally discouraged imports, but it also reflected the slowdown in investment that is outlined in the following section.

Graph 12 shows exports in dollars in the longer term by trading partner. It demonstrates the impact of the global slowdown through 2015, although the trend appears to have reversed in the first half of 2016, as noted in Graph 9 (page 7).

In nominal dollars, South African exports dropped by 16% from 2011 to 2014, then plummeted a further 23% in 2015. The depreciation that accompanied the fall in exports boosted export revenues in rand, but they nonetheless fell 10% in 2015. Exports to the global North did not fully recover from the downturn in 2008/2009, while sales to China dropped sharply from 2013.

Graph 12: Exports to major trading partners in current US dollars, 2006 to 2015



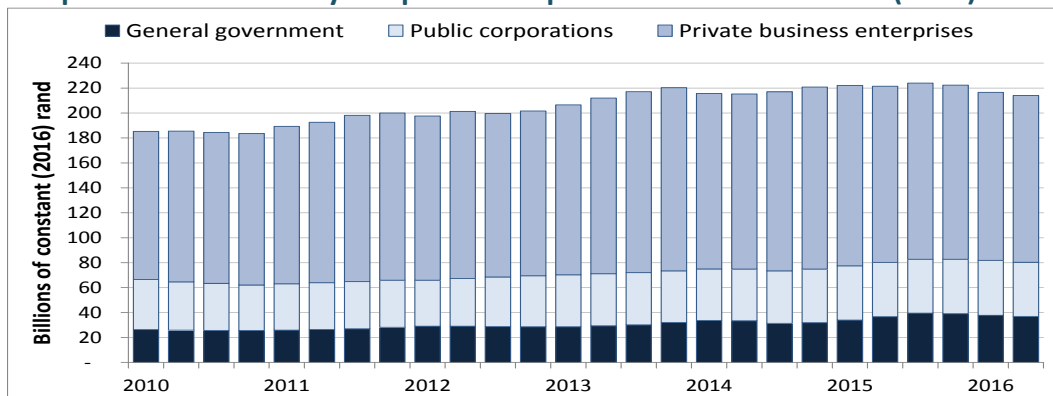
Source: Calculated from TradeMap. Electronic database. Series on export data for South Africa by country. Downloaded from www.trademap.org in August 2016.

Investment and profitability²

A decline in investment, particularly by the state, was the biggest drag on GDP growth in the second quarter of 2016. Profitability across the economy declined in the first quarter of 2016 compared to the first quarter of 2015, with worsening losses in mining. In contrast, manufacturing and construction enjoyed a higher profit rate for the quarter compared to the previous year.

As Graph 13 shows, total investment has fallen for three quarters in real terms. As a result, in the first half of 2016 it declined to below 20% of the GDP for the first time since 2013. The sharpest fall in this period was in government investment, which dropped by 6,5%. Private investment fell 5,4%, but state-owned enterprise increased their investment by 0,5%.

Graph 13: Investment by the public and private sector in constant (2016) rand



Source: Calculated from, Statistics South Africa. GDP P0441 - Q2 2016. Excel spreadsheet. Downloaded from www.statssa.gov.za in September 2016

² Quarterly data on profits and investment by sector can be calculated using Statistics South Africa's Quarterly Financial Statistics for the productive sectors outside of manufacturing. Data are, however, only available through the first quarter of 2016.

The fall in public investment likely results from the slowdown in state spending over the past two years. When fiscal policy turns contractionary, state investment tends to decline because it is project based and therefore easier to cut than on-going programmes.

In terms of profitability, according to Statistics South Africa's Quarterly Financial Statistics (see Table 2):

- The return on capital for the economy as a whole (excluding agriculture) dropped from 4,2% in the first quarter of 2015 to 3,2% a year later.
- The return on capital in mining fell to -1,8% in the first quarter of 2016 from -0,6% in the first quarter of the previous year. In contrast, in the first quarter of 2011 – the last year of the commodity boom – the return on capital in mining was 3,5%. Mining investment dropped from R69 billion in the year to the second quarter of 2012 to R56 billion³ in the year to the second quarter of 2015.
- In contrast, manufacturing profits increased for most of the year to mid-2015, recovering from a sharp fall in the third quarter of 2013. Moreover, investment in manufacturing remained positive at around R23 billion for the first quarter of the year, continuing a trend from 2015 when manufacturing investment averaged just over R21 billion.
- The construction sector posted considerable profits. The 12,3% first quarter figure was one of the most profitable quarters since 2011.

Table 2: Profitability and capital expenditure by sector, first quarter 2016

	Mining	Manufacturing	Construction	Utilities	Other sectors	Total
Profitability						
Profits in R bns, Q1 2016	-8,6	26,3	5,5	-3,2	65,1	85,1
Return on capital, Q1 2016	-1,8%	5,5%	12,3%	-0,5%	5,9%	3,2%
Return on capital Q1 2015	-0,6%	5,1%	9,5%	-0,4%	8,8%	4,2%
Return on capital Q1 2011	3,5%	6,4%	2,1%	1,4%	6,2%	4,8%
Capital expenditure (CAPEX)						
Capex in Rbns, Q1 2016	9,0	22,6	2,1	25,8	35,2	94,6
Capex as % of assets, Q1 2016	1,9%	4,7%	4,8%	4,4%	3,2%	3,5%
Capex as % of assets, Q1 2015	2,3%	5,4%	6,6%	3,5%	3,3%	3,5%
Capex as % of assets, Q1 2011	2,3%	2,9%	8,0%	7,6%	2,9%	8,9%

Note: 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.

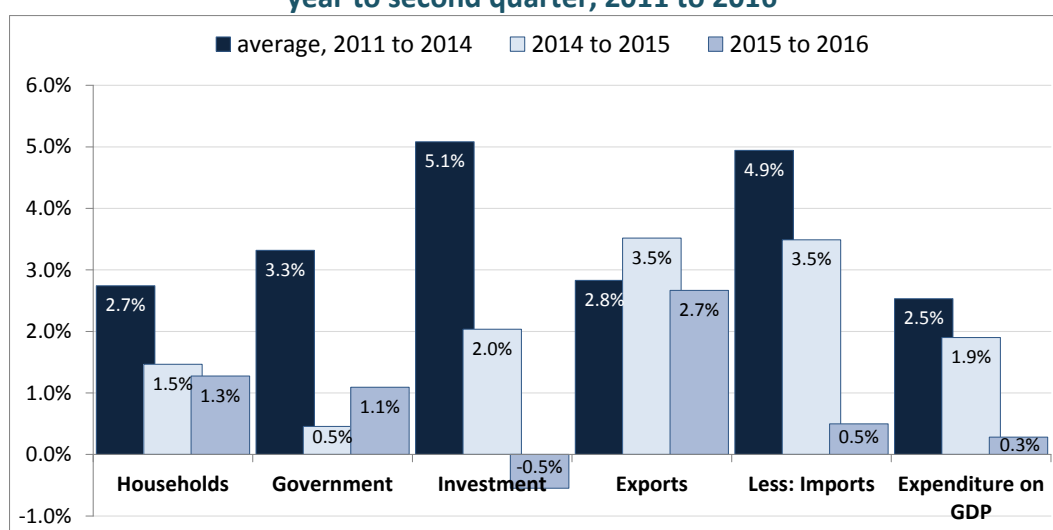
³ In Constant 2010 ZAR

Behind the trends

Exports were the main driver of the surge in growth in the GDP in the second quarter of 2016, largely thanks to the auto industry. Critical for export growth was the persistence of relatively competitive exchange rates as well as some recovery in the U.S. and Europe in the past year. While welcome, these developments emerged in the context of fairly gloomy prospects for growth in the medium term.

The main driver of growth in the past quarter was the recovery in the balance of trade on the back of a rapid increase in exports and a slowdown in imports. In contrast, investment declined and government spending remained virtually unchanged. These developments reflected the trends over the past two years, as Graph 14 shows.

Graph 14: Change in components of expenditure on the GDP, year to second quarter, 2011 to 2016

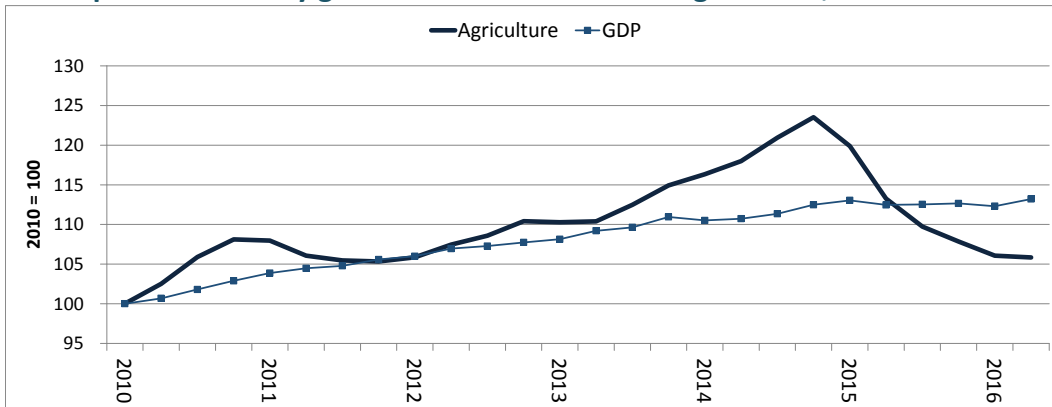


Source: Calculated from Statistics South Africa. *GDP P0441 - Q2 2016. Worksheet QRU. Excel spreadsheet.* Downloaded from www.statssa.gov.za in September 2016

Despite the relatively strong growth in the rest of the economy in the second quarter, agriculture posted its sixth consecutive quarter of economic decline. Statistics South Africa reported that in seasonally adjusted terms agriculture contracted by almost 15% from R78 billion in the fourth quarter of 2014 to R66 billion in the second quarter of 2016 (Graph 15).

A more detailed assessment of the impact of the drought and strategies to address it can be found in the briefing note on page 19.

Graph 15: Quarterly growth in total GDP and in agriculture, 2014 to 2016

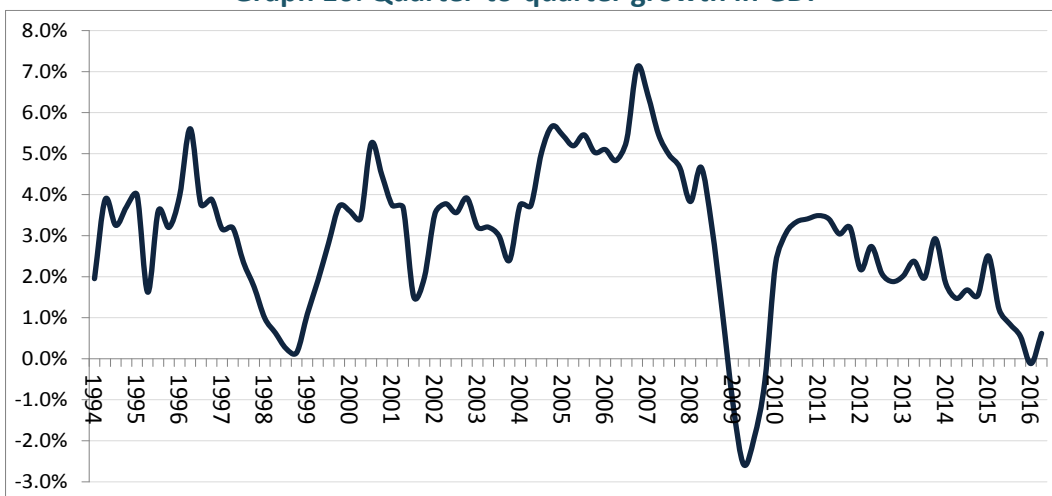


Source: Calculated from Statistics South Africa. Gross Domestic Product (Quarterly)(2016Q2). Excel spreadsheet downloaded in September 2016.

Despite the second quarter's growth, South Africa now finds itself in the most prolonged slowdown since 1994, as Graph 16 shows.

The sharp fall in growth since around 2013 mirrors international trends, especially in the upper-middle-income economies. From this standpoint, the question is whether the current uptick reflects a stabilisation in the slowdown, as producers adapt to the new realities with the end of the commodity boom, or a short-term improvement that does not herald a sustained recovery.

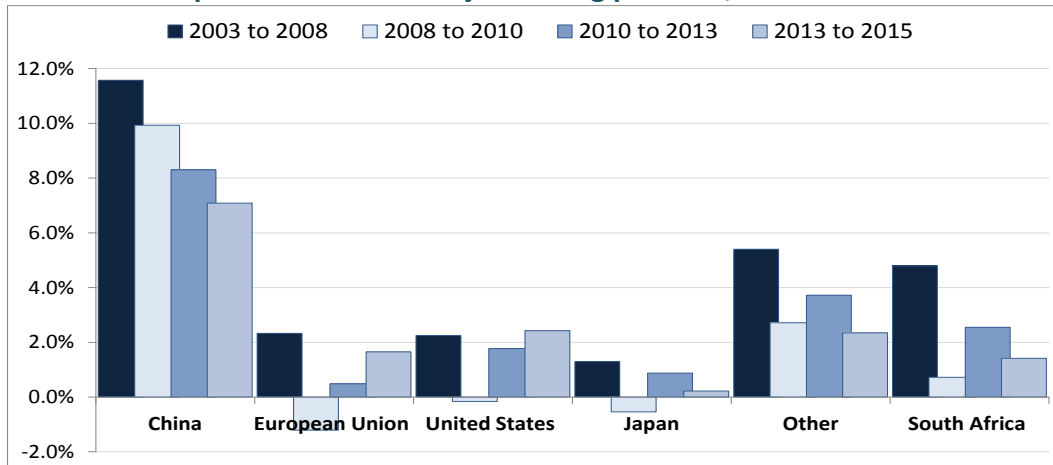
Graph 16: Quarter-to-quarter growth in GDP



Source: Statistics South Africa. Electronic database. Series on GDP growth. Downloaded from www.statssa.gov.za in September 2016.

South Africa's growth has mainly followed global trends, with a sharp slowdown in China from 2011 on top of sluggish growth in the global North since the 2008/2009 financial crisis. In Graph 17, the figures for China likely overstate the level of growth, but the trends are generally considered reliable.

Graph 17: Growth in major trading partners, 2003 to 2015



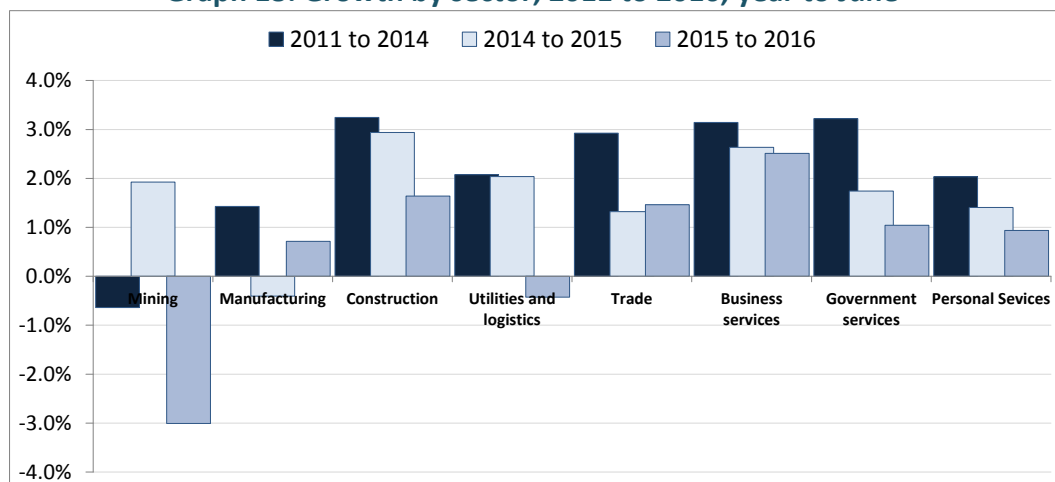
Source: Calculated from World Bank. World Development Indicators. Electronic database. Series on GDP growth. Downloaded from www.worldbank.org in August 2016.

In broad terms, the impact of the global and national slowdown can be summarised as follows:

- The mining value chain is most sharply affected. Besides the mines, which have seen falling employment and investment, this affects the makers of iron and steel and the ferro alloys and aluminium refineries as well as producers of capital equipment. These industries also depend heavily on electricity, so from 2008 they suffered more than the rest of the economy from the rapid increase in the electricity price combined with its rationing.
- Construction and government services expanded relatively rapidly from 2010, reflecting in large part efforts to sustain public spending, especially on infrastructure, after the global financial crisis. If the slowdown in public investment in the past year persists, construction growth will likely decline, while government services have already seen a slowdown.
- Within manufacturing, auto sales grew relatively rapidly, thanks in part to tax subsidies that attracted substantial new investments as well as the effects of the currency depreciation. Consumer goods and services excluding clothing also saw relatively robust growth. The chemicals value chain expanded too, presumably in part thanks to the fall in petroleum and coal prices.

Graph 18 shows growth by sector outside of agriculture in the year to June. Every sector has seen slower growth in the past two years, although manufacturing output improved in the year to June compared to the previous year. In contrast, mining and logistics shrank. Growth in government services slowed sharply as fiscal policy became more restrictive.

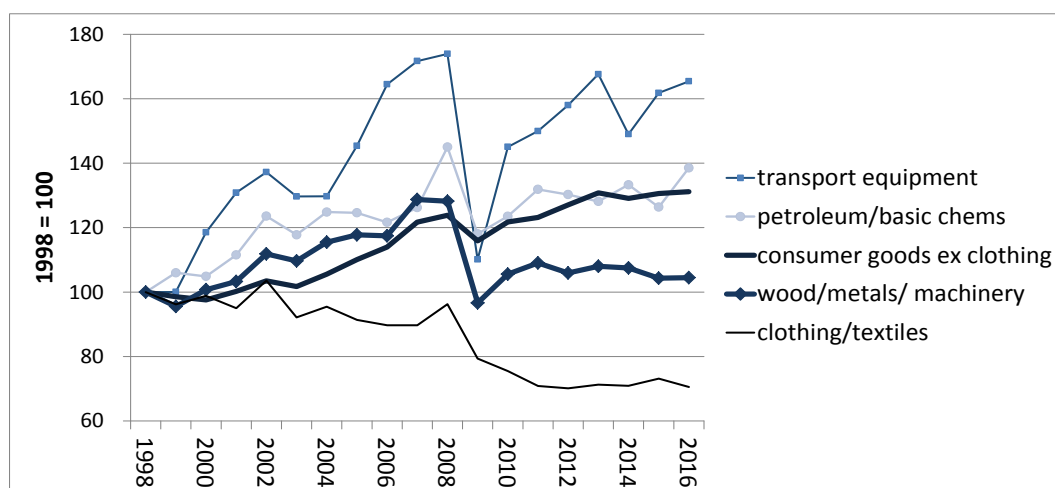
Graph 18: Growth by sector, 2011 to 2016, year to June



Source: Calculated from, Statistics South Africa. Gross Domestic Product (Quarterly)(2016Q2). Series on GDP in constant rand. Downloaded from www.statssa.gov.za in September 2016.

Within manufacturing, growth rates diverged for capital and consumer goods (Graph 19).

Graph 19: Growth in volume of production in manufacturing, 1998 to 2016 (1998=2016)



Note: Growth rates calculated using average change in volume of production from March to May for each year. Indices for volume of production for industries within groupings weighted by share in sales of the grouping in the relevant year. Source: Calculated from Statistics South Africa. Manufacturing production and sales from 1998. Excel spreadsheet. Series on actual sales and volume of production. Downloaded from www.statssa.gov.za in August 2016.

The relative resilience of the consumer goods and services industries can be attributed to a variety of factors.

- First, these industries generally see net benefits from currency depreciation since they use more local inputs rather than imports. As a result, the decline in the value of the rand would make them more competitive on both domestic and foreign markets.

- Second, government spending has tended to favour lower income households, in turn increasing their consumption over time. This group is more likely to buy local if the exchange rate is competitive. In contrast, the richest decile of households, which accounts for around half of domestic consumption, is more likely to acquire imported luxuries for which there are no local substitutes, including cars, electronics and luxury brands.
- Third, although growth in the region has slowed compared to the period before 2008/2009, it remains stronger than in much of the world. Southern Africa accounts for over half of South Africa's exports of consumer goods, but only a small share of commodity exports.

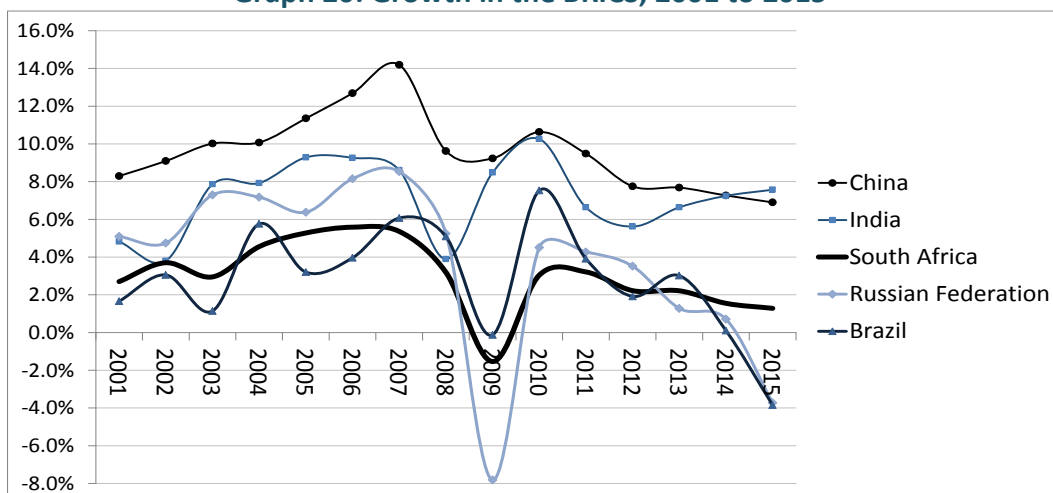
Growth in the BRICS

Divergent developments in the BRICS in the past five years illustrate the extraordinary impact of the slowdown in Chinese growth on middle-income economies. They also show how this kind of sharply slower growth can play out in greater political contestation and uncertainty.

As the following chart shows, the BRICS economies followed divergent trajectories following the 2008/2009 global financial crisis. We can identify three phases: the recovery from the downturn in 2009/2010; the tail end of the commodity boom from 2010 to 2013; and the relatively sharp slowdown in the past two years.

In response to the 2008/2009 downturn, China, Russia and Brazil undertook major fiscal and infrastructure stimulus initiatives, leading to a rapid recovery in 2010. In contrast, South Africa's stimulus was relatively small, with a correspondingly limited recovery. As Graph 20 shows, GDP growth in Brazil reached 7,5% in 2010, and 4,5% in Russia, while it was just 3,0% in South Africa. The Chinese data may exaggerate the level of growth, but the trend appears reasonably reliable. Concerns have also been raised in recent years about the Indian statistics.

Graph 20: Growth in the BRICS, 2001 to 2015

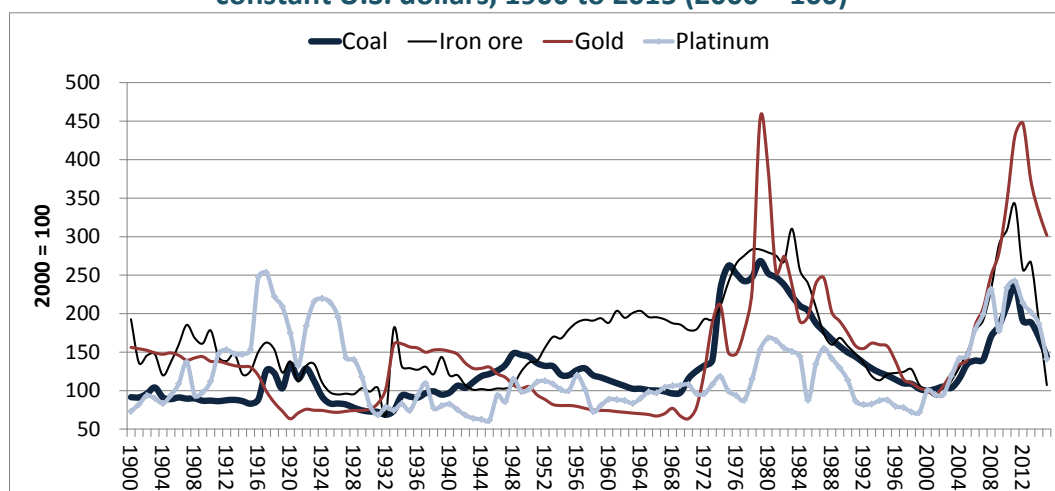


Source: World Bank. World Development Indicators. Electronic database. Downloaded from www.worldbank.org in September 2016.

The Chinese stimulus package mainly took the form of investment in infrastructure and housing, financed largely by provincial debt. In some provinces, investment reached half of the economy. As a rule, if investment exceeds 30% of the GDP, it will likely lead to high levels of inefficiency. The construction boom in China boosted real and speculative demand for metals and energy, which proved a windfall for the extractive economies in the BRICS – that is, Brazil, Russia and South Africa.

As Graph 21 shows, the resulting metals price boom was only matched 30 years earlier in real terms, around 1980. The high prices fuelled overinvestment especially in iron ore production in Brazil, Australia and to a lesser extent South Africa, and in energy worldwide, including in Russia.

Graph 21: Indices of prices for main South African commodity exports in constant U.S. dollars, 1900 to 2015 (2000 = 100)



Source: Calculated from David S. Jacks. Chartbook for "From Boom to Bust: A Typology of Real Commodity Prices in the Long Run." National Bureau of Economic Research Working Paper 18874. Downloaded from <http://www.sfu.ca/~djacks/data/boombust/index.html> in August 2016

The investment-intensive growth path in China proved unsustainable in recent years. The result was a significant slowdown in Chinese growth and crashing metals prices. While South African GDP growth slowed to under 1,5% in 2015, both the Brazilian and Russian economies shrank by almost 4%.

India remained somewhat immune to these developments. On the one hand, it is not dependent on metals exports and has weaker trade ties with China. On the other, its large domestic market makes it less vulnerable to global trends. That said, concerns have been raised about the extent to which growth has been driven by asset bubbles and financial speculation.

Declining growth rates have been associated with significant political uncertainty in Brazil and Russia as well as in South Africa. In Brazil, the elected President was recently impeached, while Russia has seen increasingly authoritarian tendencies and is currently engaged in two wars.

Growth in the SADC

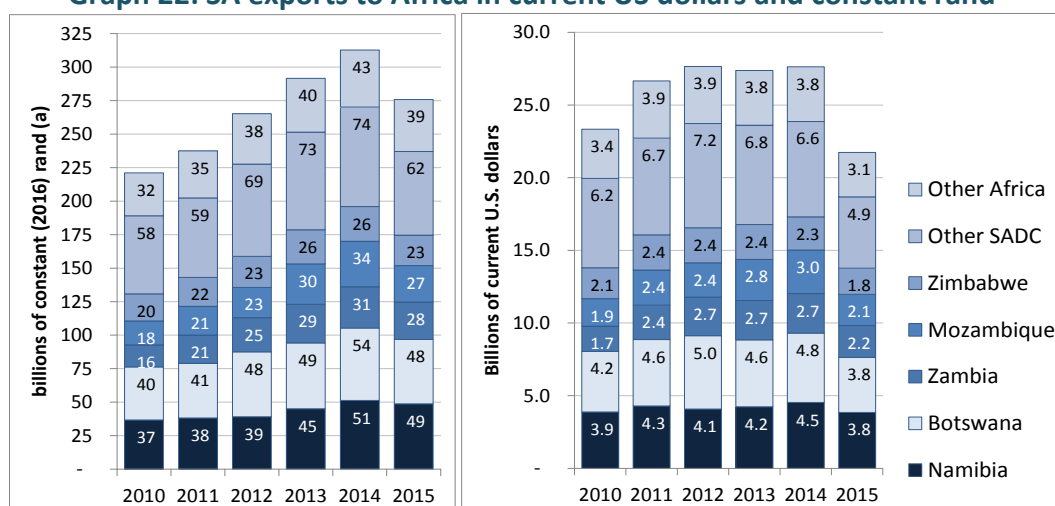
The rest of Africa now represents around 30% of South Africa's export market, up slightly from 2010. The bulk of South African exports to the rest of the continent go to Namibia, Botswana, Mozambique, Zambia and Zimbabwe. Because the region is growing rapidly compared to most of the world, despite the end of the commodity boom, it represents a significant opportunity.

From 2010 to 2015, the share of other African countries in South African exports climbed from 28% to 31%. Before 2010, South African data did not distinguish the Southern African Customs Union (SACU) members, so trade with the rest of Africa was systematically understated.

The lion's share of South Africa's trade with the rest of Africa is within SACU, with Botswana and Namibia as its largest African trading partners (see Graph 22).

Other Southern African Development Country (SADC) members, especially Zambia, Mozambique and Zimbabwe, account for most of South Africa's remaining trade with the rest of Africa.

Graph 22: SA exports to Africa in current US dollars and constant rand



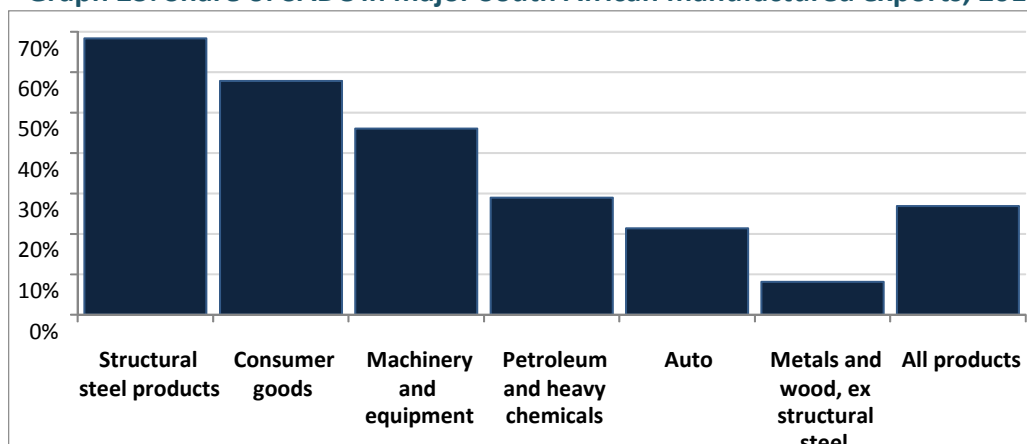
Source: Calculated from TradeMap electronic database. Downloaded in September 2016.

The relatively rapid growth in demand for South African manufactures in other African countries has helped to counter slower expansion in South Africa's other partners.

In Southern and East Africa, Ethiopia, Angola, Mozambique, Tanzania and Zambia have all recorded high annual GDP growth rates of 5% to 10% for most of the past 10 years. Smaller countries such as Namibia, Botswana, Lesotho and Malawi have had more erratic growth, although high on average. In contrast, South Africa, Swaziland and Zimbabwe have generally performed poorly in terms of growth.

South Africa's exports to the rest of Africa are primarily value-added manufactured products including structural steel, consumer goods and machinery and equipment. As a result, SADC in particular accounts for a disproportionately large share of South Africa's manufactured exports (see Graph 23).

Graph 23: Share of SADC in major South African manufactured exports, 2015



Source: Calculated from TradeMap electronic database. Downloaded in September 2016.

Imports from Africa accounted for 11% of South Africa’s total imports, comprising mostly crude oil from Nigeria and Angola and other mineral imports, mainly from SADC.

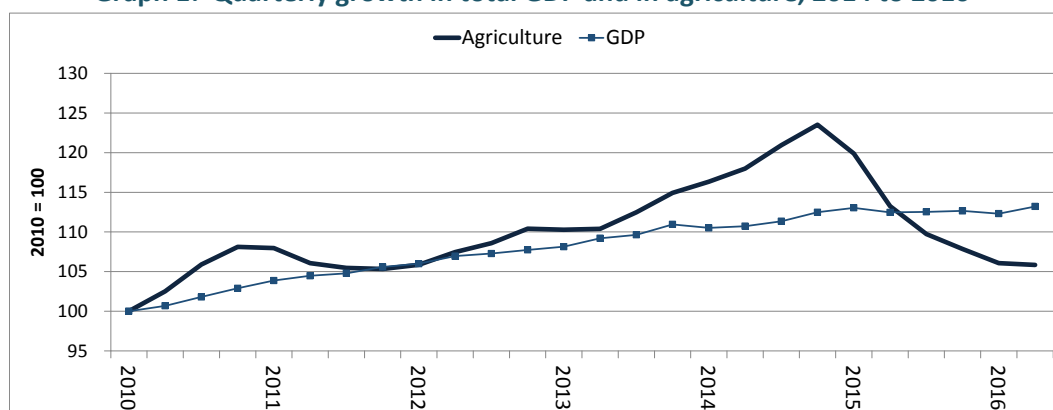
Deeper regional integration is crucial for South Africa’s growth but hurdles to trade and investment will need to be overcome. Specifically joint infrastructure development projects need to be implemented and mutually beneficial regional value chains supported. The increased trade expected from the Trilateral Free Trade Area and the Continental Free Trade Area encompassing virtually the entire continent will be a boon for expanding market development, as stronger regional markets will be crucial for the drive towards sustainable industrialisation.

Briefing note: Impacts of the drought

By Mbongeni Michael Ndlovu

Despite the relatively strong growth in the rest of the economy in the second quarter, agriculture posted its sixth consecutive quarter of economic decline (Graph 1). Stats SA reported that, in seasonally adjusted terms, agriculture contracted by almost 15% from R78 billion in the fourth quarter of 2014 to R66 billion in the second quarter of 2016.

Graph 1: Quarterly growth in total GDP and in agriculture, 2014 to 2016



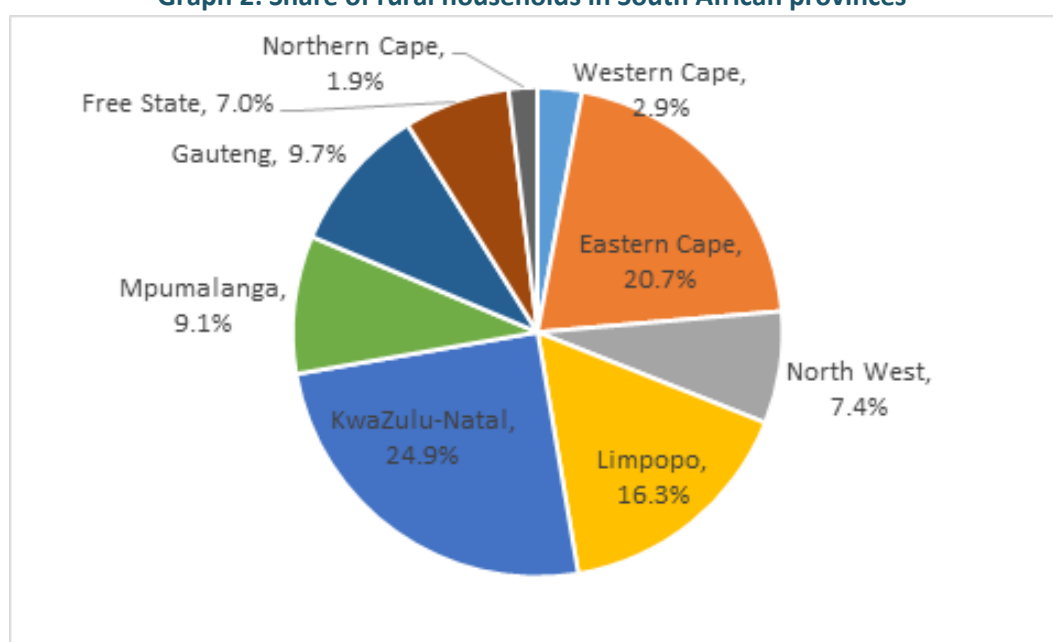
Calculated from Statistics South Africa, GDP (Quarterly) 2016 Q2. Data accessed in September 2016.

The cause is the worst drought in living memory. The effects of the drought were particularly felt in the KwaZulu-Natal, Free State and the North West provinces, with sugar and maize production being the most compromised.

The agricultural sector's contribution to the economy has been in a declining trend, falling from a contribution of 4,2% to GDP in 1996 to only 2,3% in 2015. The drought, however, has clearly demonstrated its centrality to development and its linkages to the rest of the economy.

Agriculture is important for employment in South Africa, particularly in poor rural areas. Despite rapid rural-to-urban migration, South Africa's rural population is still around a third of the total population (Graph 2), and it is estimated that the agricultural sector employs around 800 000 workers in commercial farming nationally.

Graph 2: Share of rural households in South African provinces



Source: Statistics South Africa, Census (2011)

Maize is a staple diet in the country and a significant input into the poultry and beef industry. The 2015 maize crop, at just under 10-million tonnes, was the lowest in South Africa since 2007, when it fell to seven-million tonnes. Reports suggest that as a result, around 2,7-million households will be food insecure this year. Moreover, South Africa will have to import around 3,8-million tonnes of maize. The weaker rand-dollar rate will likely push prices up, with food prices overall rising by around 10% this year.

The drought was caused by the cyclical El Niño weather pattern and the country has always had variable rainfall, but the effects of climate change mean the country will continue to experience water scarcity. Without denigrating private humanitarian initiatives such as #OperationHydrate, the experience of the drought should spur more structural reforms to respond to climate change and protect the agricultural sector.

The success of the renewable energy projects demonstrated that the country can attract rapid investment in new technologies, if the incentives and institutions are structured appropriately. Policymakers should apply the same models for encouraging new technologies to save and recycle water.

The following three strategies can mitigate the impact of climate change on agriculture.

Climate resistant agricultural practices

The effects of climate change are expected to make South Africa's rainfall patterns more unpredictable, with rainfall becoming less frequent but more intense. This puts pressure on the agricultural sector to start adopting more sustainable farming practices. Climate resistant agricultural practices involve the use of drought resistant seeds and/or adopting farming and irrigation practices that minimise water use.

The need for more water-saving farming techniques has long been recognised. The challenge is to diffuse relevant technologies beyond a few pilot projects. That in turn requires appropriate extension services that can promote new approaches as well as stronger incentives to save water, especially in the commercial farming sector.

Investing in new water recycling technologies

Water recycling technologies such as desalination offer some opportunities for increasing access to water. Desalination is the process of removing salts from water to produce fresh water. South Africa is well suited to this technology as the country has around 3 000 kilometres of coastline. The country has already started investing in this technology, with the largest seawater desalination plant in the country currently operating in Mossel Bay, Western Cape.

The most significant argument against desalination is the high energy use it requires. However, South Africa is growing capacity in renewable energy so this presents an opportunity to accelerate progress in the use of this technology. The high cost of energy will, however, raise the cost of water, as well as enforcing the need to be even more water efficient.

Investing in water preservation infrastructure

A number of water and sanitation projects are part of the government's 18 Strategic Infrastructure Projects (SIPs) initiative. This is encouraging, but most of the large water projects seem to be directed towards supporting mining activities, with some spill-overs to communities. Government should prioritise developing reticulation networks in the communities surrounding dams developed as part of the SIPs. Dams and water-sparing projects should also be developed to support more agricultural production.

In addition to building mega-infrastructure projects, there should be a shift in view about the importance and benefits of rain-water harvesting, not necessarily as a substitute for providing fresh water but as a complementary system. Similarly, water recycling at the household level should be encouraged.