THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

FOURTH 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 (www.tips.org.za/realeconomy bulletin).

Quarterly GDP growth

South Africa's GDP fell by 0.08% over the past quarter, driven mostly by a decline in the real economy, above all mining. Mining contracted by 3,0%, manufacturing by 0,8%, and agriculture by 0.1%.These trends contributed to the continued slowdown in growth, which came to just 0,3% for 2016 as a whole.

Year on year, manufacturing showed a return to growth in 2016, but mining saw a decline. Agriculture shrank for the second year in a row, largely due to the persistent effects of the drought. In contrast, construction and the rest of the economy continued to expand, but at a slower rate than in 2015 (see Graph 1).

In the longer term, as Graph 2 shows:

- Mining output often fluctuates on a quarterly basis, but has shown a secular downward trend mainly due to the decline in gold output, which has persisted over the past 20 years or so;
- Agricultural output flattened out in the past six months as the drought has ended; and
- Manufacturing production has seen very little growth since the global financial crisis in 2008, mostly as a result of the challenges in the metals industry.

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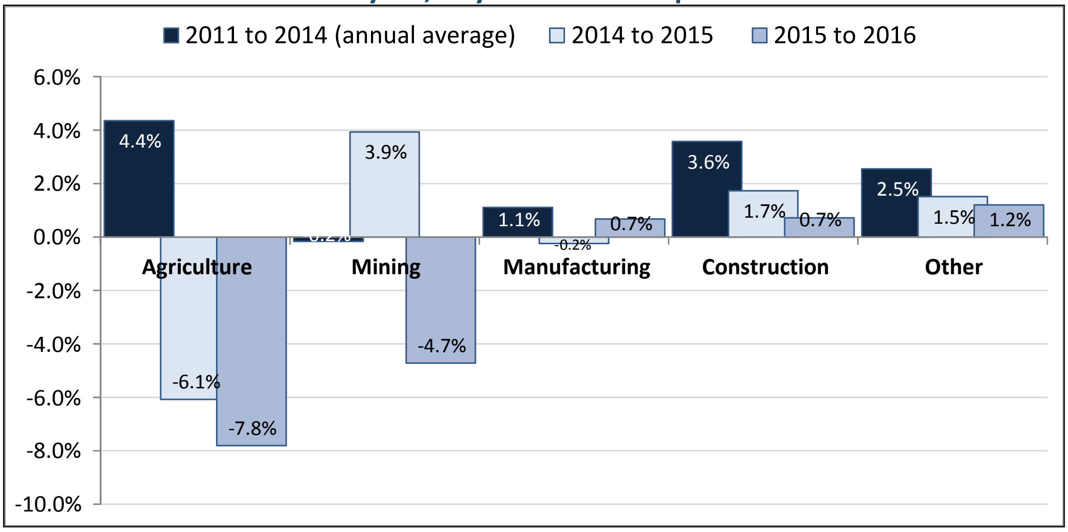
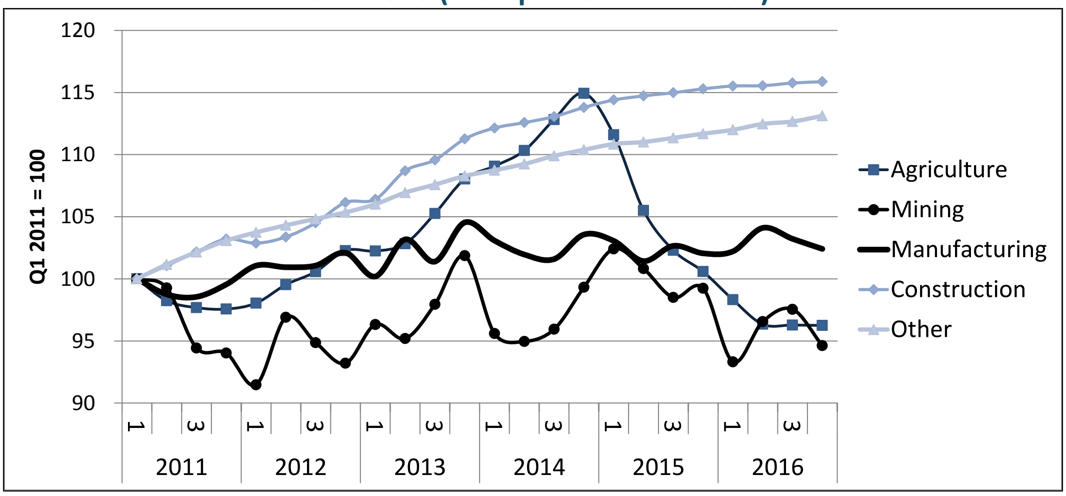
Graph 1. Change in GDP by sector in volume terms, year on year, in year to fourth quarter



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 March 2017.

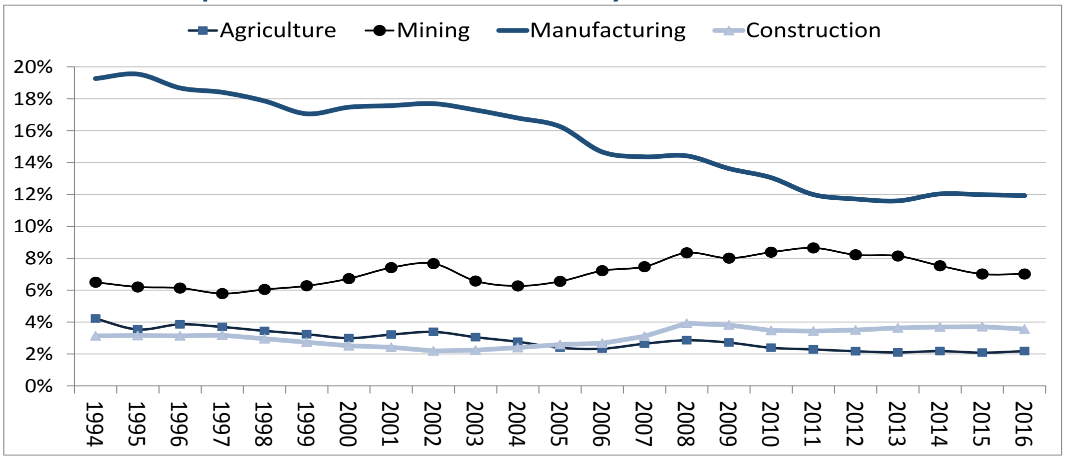
Graph 2. Index of volume of production by sector, quarterly, 2011-2016 (first quarter 2011 = 100)



Source: Calculated from Statistics South Africa. Gross Domestic Product (Quarterly) (2016Q4). Excel spreadsheet downloaded in March 2017.

2016 saw a continued decline in the share of the real economy in the GDP, which has fallen from 29,5% in 2008 to 24,7% in 2016. The share of construction declined after a growing from 2010 to 2015, while the share of manufacturing remains stable but substantially lower than before its sharp fall in the 2008 global financial crisis. The adaptation of mining to the end of the commodity boom emerges in its overall growth relative to GDP over 2016, despite the significant drop in the past quarter (see Graph 3).

Graph 3. Share of the real economy in GDP in current terms

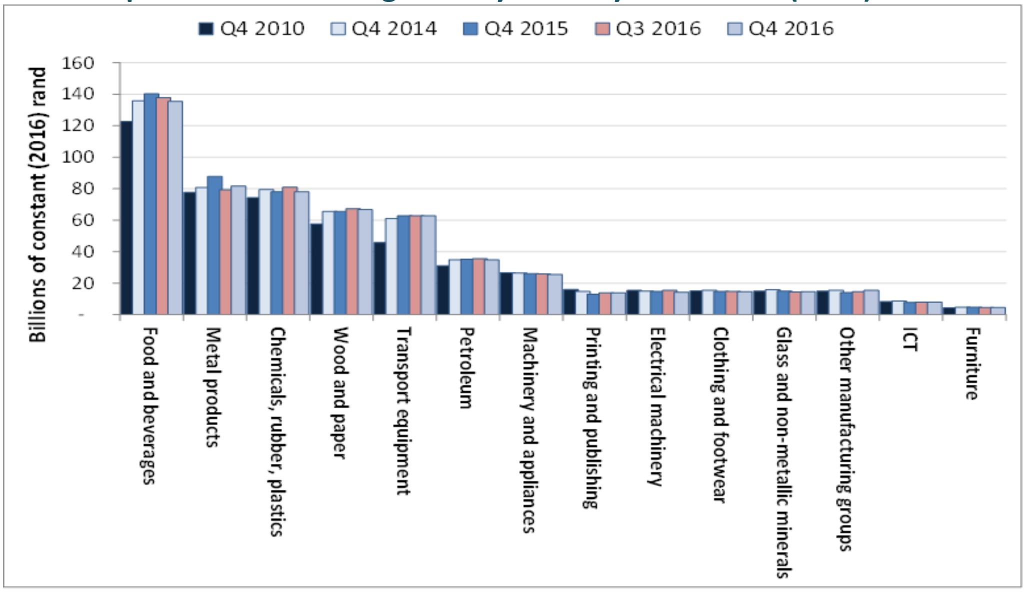


Source: Calculated from on Statistics South Africa. Electronic database. Series on GDP growth. Downloaded from www.statssa.gov.za in March 2017.

Sales across manufacturing contracted in the year to the fourth quarter of 2016 (see Graph 4).

Food and beverages accounted for most of the fall, driven mainly by the drought. No manufacturing industry saw a significant improvement in sales. The quarterly sales figures in Graph 4 are not seasonally adjusted.

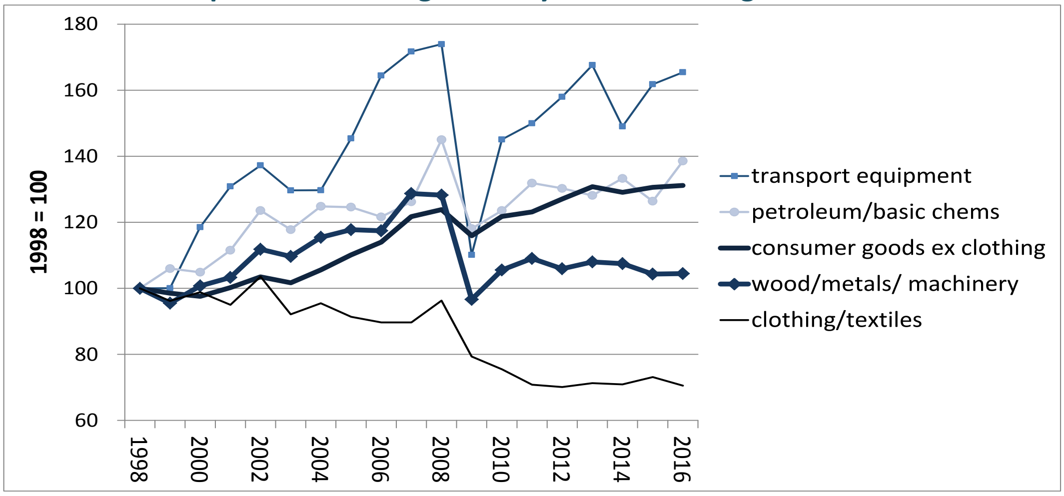
Graph 4. Manufacturing sales by industry in constant (2016) rand



Note: Average of monthly figures for each quarter. Source: Calculated from StatsSA, Manufacturing: Production and Sales. Excel spreadsheet. Downloaded from www.statssa.gov.za *in February 2017.*

In volume terms, transport equipment experienced a sharp rebound in the past two years, although growth in 2016 was slower than 2015. Consumer goods outside of clothing maintained stable growth, and the decline slowed in wood and metals. In contrast, clothing production contracted by some 3,5% over the past year (see Graph 5).

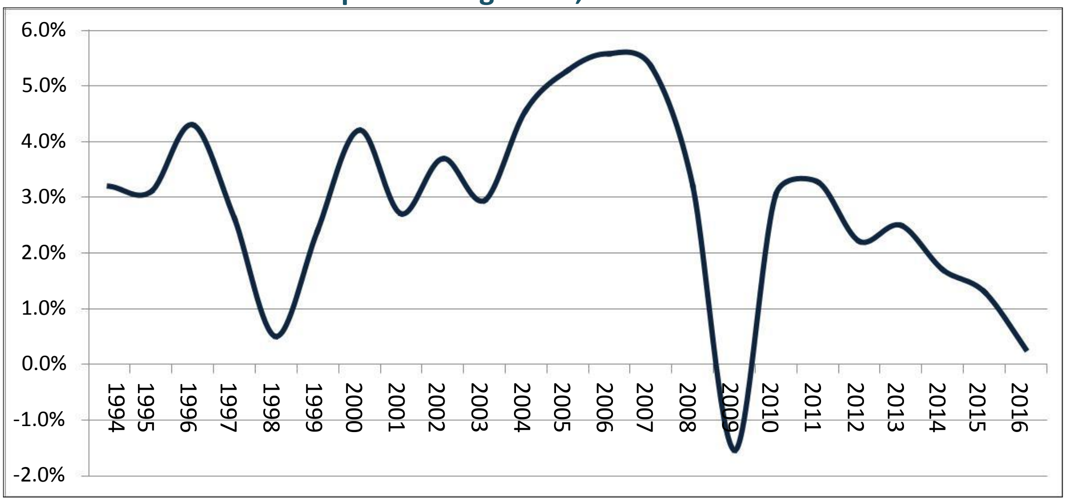
Graph 5. Indices of growth by manufacturing industries



Source: Calculated from Statistics South Africa. Gross Domestic Product (Quarterly) (2016Q4). Series on GDP in constant rand. Downloaded from www.statssa.gov.za in February 2017.

As Graph 6 shows, growth in 2016 was the third lowest since 1994. Even more worrying, it forms part of a five-year trend of slowing growth, starting with the fall in commodity prices in 2011.

Graph 6. GDP growth, 1994 to 2016

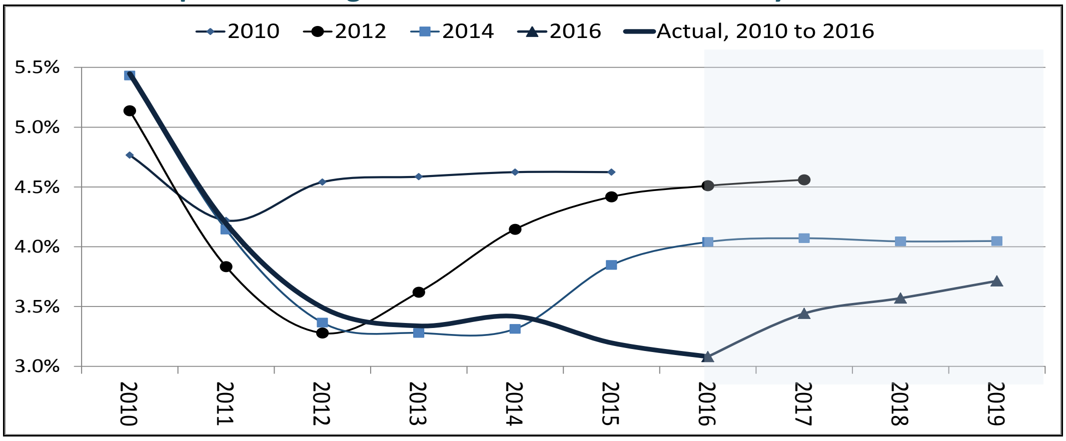


Source: Statistics South Africa GDP data.

As discussed in the *Briefing Note: The 2017/8 budget and industrialisation* (see page 15), a decline in government spending in real terms surely contributed to the slowdown in GDP growth in 2016. Still, the main cause of the slowdown lies in continued weak growth internationally. China and Europe, in particular, have experienced limited expansion, while growth in the US has been steady but unspectacular. In this context, since 2010 the International Monetary Fund (IMF) has persistently forecast higher growth than in fact occurred, mainly because China consistently underperforms expectations.

Graph 7 compares the IMF forecasts every two years from 2010 with the realities of international growth.

Graph 7. Global growth: IMF forecasts and reality from 2010



Source: IMF. World Economic Outlook for relevant years (October).

The unpredictability of the global scene makes economic analysis much harder. In particular, as discussed in the *Briefing Note: Scenarios for US protection* (see page 13) the Trump Administration may pursue protectionist policies and aggressive international ventures generally. Moreover, Brexit could affect growth in both the European Union and the UK, which still collectively dominate South African exports.

While global growth remains slow, the recent uptick in metals prices has been sufficient to increase the exchange rate. That in turn makes South African manufacturing less competitive internationally, although global markets overall remain relatively slow.

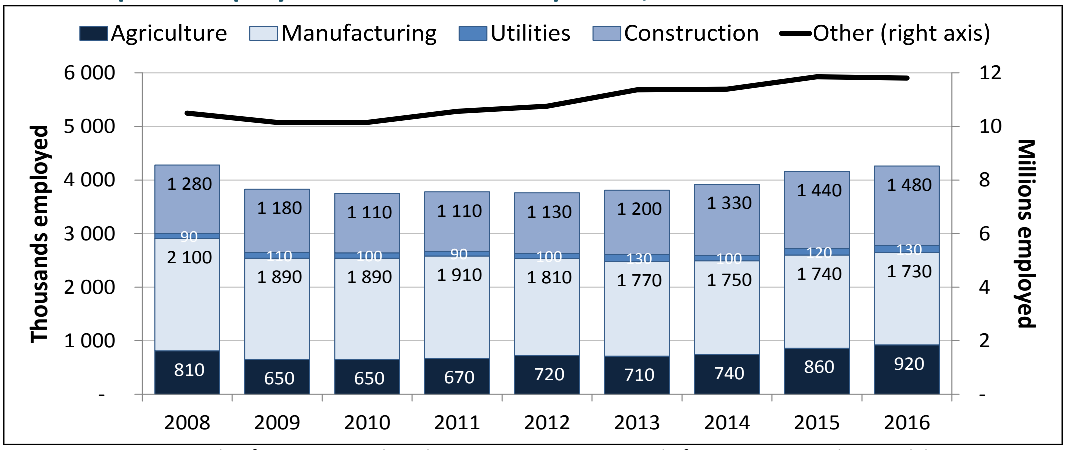
In these circumstances, two immediate factors may affect growth in South Africa. On the one hand, the US central bank is expected to increase interest rates in the near future, possibly even in March 2017. That in turn could pull investors out of South African stocks and bonds, leading to renewed depreciation. On the other, the US stock market is widely considered to be overvalued. A significant correction could affect growth both there and in Europe.

Employment

Employment showed the typical seasonal bump from the third to the fourth quarter, growing 250 000 overall. Year-on-year figures, which compensate for seasonal fluctuations, show more modest growth, at 50 000. That indicates that employment growth is slowing with the GDP, although it has levelled out in mining after substantial declines. Manufacturing employment has remained virtually unchanged since 2013, although the rest of the economy has seen significant jobs growth.

Agriculture and construction were the main drivers of job creation from the fourth quarter of 2015 to the fourth quarter of 2016 (see Graph 8). Figures for agriculture reflect in part the recovery from the drought, but they are also generally more variable than for other sectors. In contrast, manufacturing employment remained essentially stagnant while retail and government services declined.

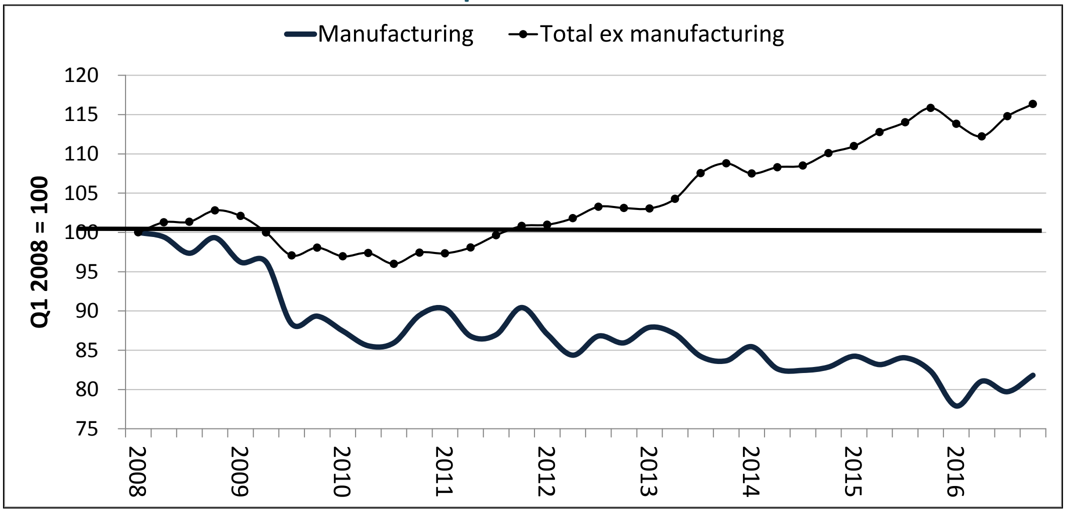
Graph 8. Employment in the fourth quarter, 2008 to 2016



Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in February 2017.

Like the rest of the economy, manufacturing showed some improvement in employment from June through the end of 2016, after declining in the first half of the year (see Graph 9). Still, manufacturing employment in the fourth quarter of 2016 remained 370 000 lower than it was in 2008, representing a fall of almost 20%.

Graph 9. Index of manufacturing and other employment, first quarter 2008 = 100

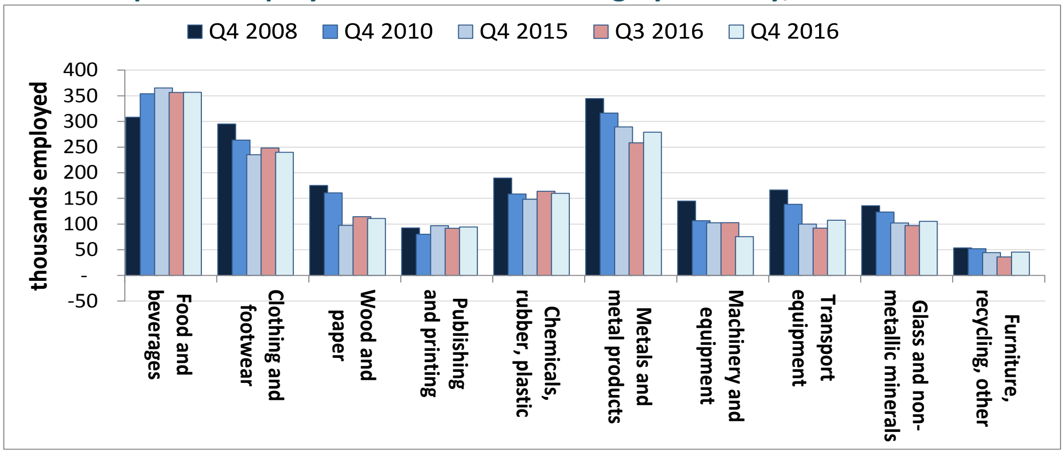


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in February 2017.

Data at the level of individual industries in manufacturing are not reliable in the short run because samples are relatively small, although long-term trends appear more meaningful. Moreover, the employment data are not seasonally adjusted, so quarter on quarter figures may be misleading.

Of the manufacturing industries, only food and beverages has seen significant growth since 2008, but it also levelled out as the drought cut into production in 2015/6. Most other industries saw little or no jobs growth over the past year. Machinery and equipment saw a fall in employment (see Graph 10).

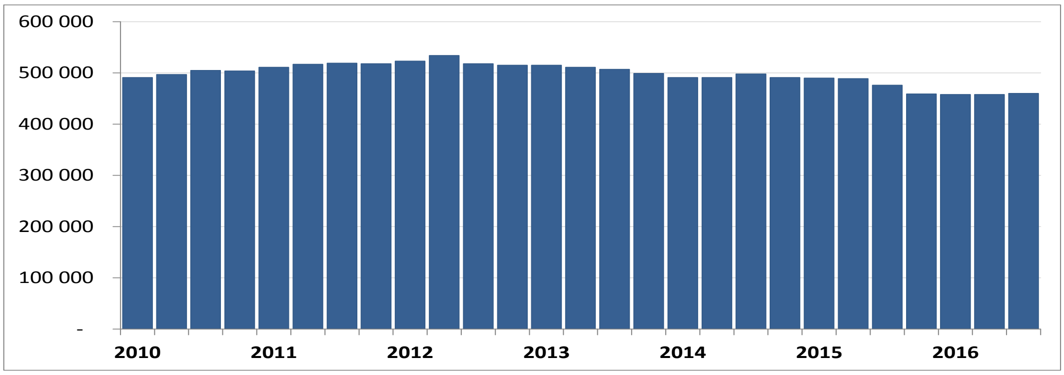
Graph 10. Employment in manufacturing by industry, 2008 to 2016



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.

Graph 11 shows mining employment as reported by the Chamber of Mines, which contributed to the employer-based Quarterly Employment Survey. Because of sampling issues, these figures are more reliable for the industry than the household-based data provided for other industries. The data are only available to the third quarter of 2016. They show that after a steady decline as metal prices fell from 2011 with the end of the commodity boom, employment in mining appears to have stabilised. It remains more than 50 000 lower than in 2012, however.

Graph 11. Employment in Mining, 2010 to 2016



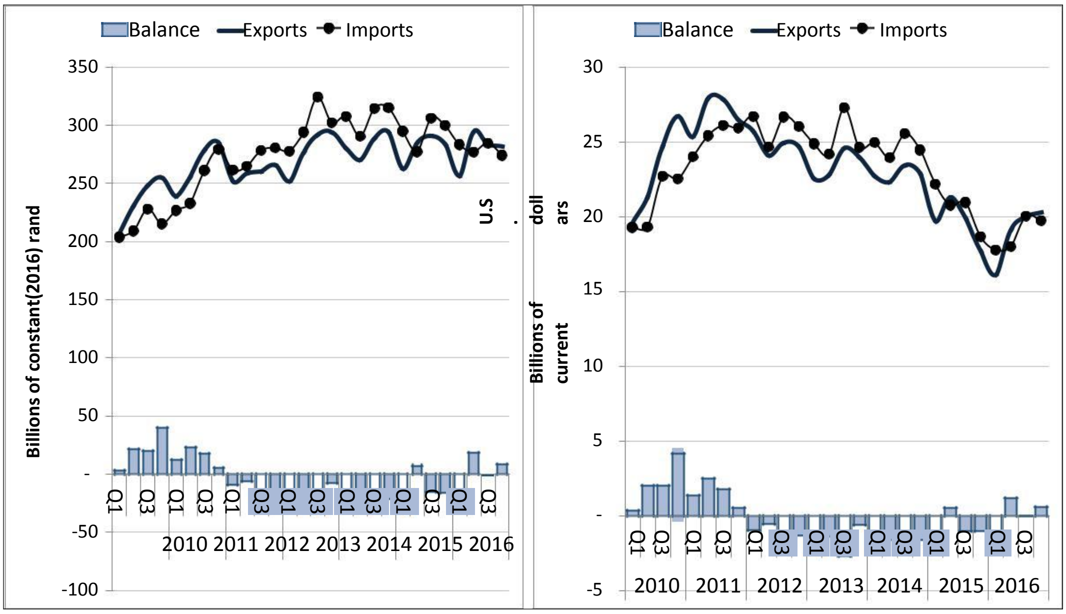
Source: Statistics South Africa. Quarterly Employment Survey. February 2017

Trade

The strengthening of the rand over 2016 reduced export revenues and made imports more competitive with local producers. As a result, despite growing manufactured exports in dollar terms, in rand revenues from exports dropped. Still, overall South Africa ended the year with a surplus on the balance of payments, after running trade deficits from the end of the commodity boom through 2012.

As Graph 12 shows, the trade surplus picked up in the final quarter of the year. The appreciation of the rand meant that the trends diverged in dollar and constant rand terms. Both imports and exports increased in dollars, although more slowly than at the start of the year; in constant rand, imports dropped while exports flattened out.

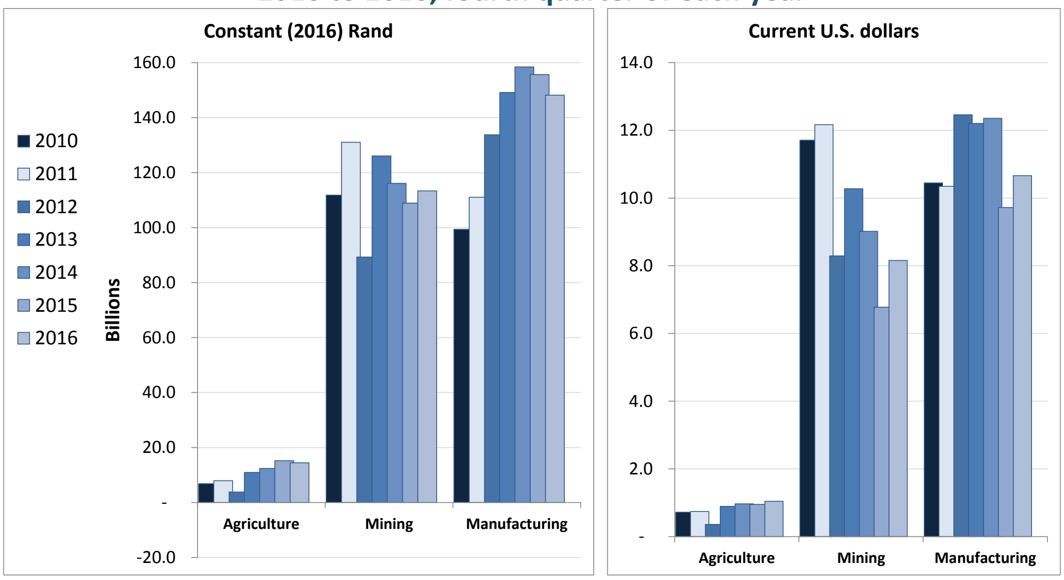
Graph 12. Exports, imports and the balance of trade in constant (2016) rand (a) and current US dollars



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 March 2017.

As Graph 13 shows, export revenues for manufacturing climbed by 10% in dollar terms in 2016, because the rand appreciated by almost 20% over the year. However, in rand terms, manufactured exports declined. Agriculture showed a similar trend. In contrast, the partial recovery in metals and coal prices meant mining exports rose some 20% in dollar terms, and 4% in rand.

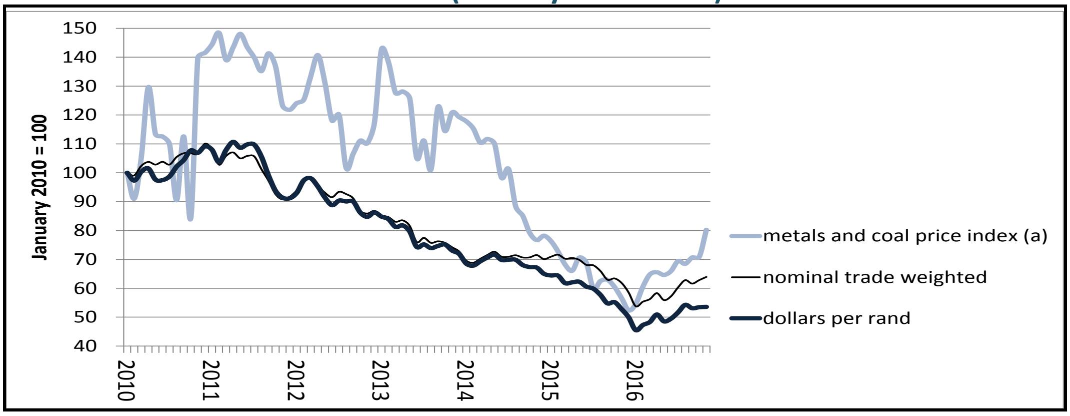
Graph 13. South African exports in constant (2016) rand and current US dollars, 2010 to 2016, fourth quarter of each year



Source: Calculated from SARS monthly trade data.

Graph 14 shows the appreciation in the rand against the US dollar and major trading partners from the start of 2016, compared to a trade-weighted average of major mining exports. The less competitive currency largely reflected somewhat stronger metals prices, which recovered from the very low levels of 2015. It seems unlikely, however, that they will return to the historically unprecedented levels seen in 2011. Indeed, despite a 40% average price increase in South Africa's main mining exports – platinum, iron ore, gold and coal – they remained almost 50% below their 2011 peaks. In any case, in the next few months the expected increase in interest rates in the US is likely to reverse the recent appreciation in the exchange rate.

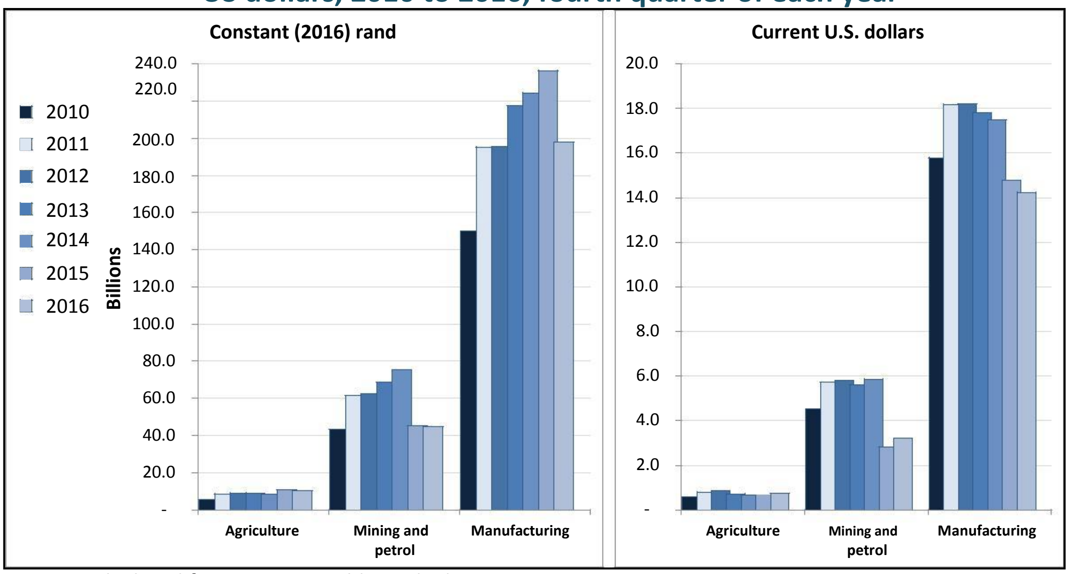
Graph 14. Indices of U.S. dollars to the rand and trade-weighted exchange rate (January 2010 = 100)



Source: Exchange rates: SARB. Interactive data. Downloaded in March 2017.Metals and coal prices: Kitco and IMF data, weighted by export shares.

Manufacturing imports declined in dollar terms in 2016, which the stronger currency translated into an even larger decline in rand terms (see Graph 15). Crude petroleum constitutes the bulk of mining-based imports. An uptick in the oil price in dollar terms was offset by appreciation of the rand.

Graph 15. South African imports in constant (2016) rand and current US dollars, 2010 to 2016, fourth quarter of each year



Source: Calculated from SARS monthly trade data.

The increase in manufacturing exports was mostly due to higher revenues from metals, mainly as a result of increased prices. Ferro-alloys showed a significant recovery in sales after several years of stagnation. In terms of manufactured imports, autos and capital machinery accounted for almost all the decline. That in turn mainly reflected the overall slowdown in the economy.

Table 1. Value of and change in trade in manufactures to fourth quarter 2016, nominal US dollars and constant rand (a)

Industry	Value (billions)		% change from Q4 2015		Change in millions	
	USD	Rand	USD	Rand	USD	Rand
Exports						
Food and beverages	0.92	12.8	3%	-5%	26.4	-720
Clothing and footwear	0.49	6.8	4%	-4%	19.2	-296
Wood products	0.14	1.9	14%	5%	16.9	90
Paper and publishing	0.39	5.4	-7%	-15%	-27.9	-911
Chemicals, rubber, plastic	1.72	23.9	2%	-6%	38.6	-1 500
Glass and non-metallic mineral products	0.11	1.5	1%	-7%	1.4	-108
Metals and metal products	2.38	33.0	11%	2%	230.7	606
Machinery and appliances	1.93	26.9	-6%	-13%	-118.6	-4 065
Transport equipment	2.52	35.0	6%	-2%	137.8	-859
Imports						
Food and beverages	0.73	10.1	13%	4%	85.3	432
Clothing and footwear	1.01	14.1	-9%	-16%	-100.6	-2 607
Wood products	0.09	1.2	-5%	-12%	-5.2	-173
Paper and publishing	0.31	4.3	-7%	-14%	-24.6	-718
Chemicals, rubber, plastic	2.95	41.0	-1%	-9%	-31.7	-3 819
Glass and non-metallic mineral products	0.22	3.0	-4%	-11%	-10.1	-391
Metals and metal products	0.99	13.7	-8%	-15%	-91.2	489
Machinery and appliances	5.39	75.0	-7%	-14%	-396.9	-12 094
Transport equipment	2.61	32.1	-20%	-35%	-667.7	-17 030

Notes: (a) Constant change in rand deflated with CPI. Source: SARS data on trade.

Investment and profitability[1]

Manufacturing saw a sharp rise in reported profits in the year to the third quarter 2016, but it mainly results from a once-off restructuring in beverages. In contrast, the return to profitability in mining appears to represent a turnaround from the end of the commodity boom. Nonetheless, the first three quarters of 2016 saw falling investment in both the public and private sector.

Graph 16 shows trends in the return on assets – measured as pre-tax profits relative to assets – in the real economy in the third quarter of 2010, 2015 and 2016. Profitability appears reasonably robust in manufacturing, and improved significantly in mining as metal prices rose and the shake-out that followed the commodity bust took effect. In contrast, construction showed falling profitability over the past year.

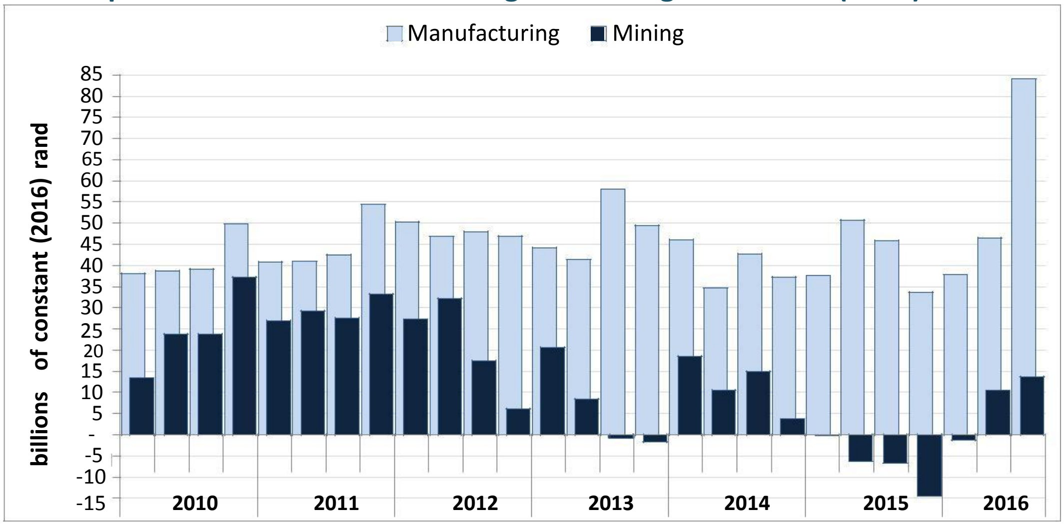
[1] Quarterly data on profits and investment by sector can be calculated using Statistics South Africa's Quarterly Financial Statistics for the productive sectors outside of manufacturing. Data are however only available through the third quarter of 2016.

Graph 16. Return on assets (profit before tax as % of asset value) in the third quarter of 2010, 2015 and 2016

Source: Statistics South Africa. Quarterly Financial Statistics, third quarter of relevant years.

In constant rand, mining profits remain far below their peak at the end of the commodity boom, despite some improvement in mid-2016. Manufacturing was less affected by falling metal prices, but has seen substantial volatility and overall lower profits until the extraordinary, but likely once-off, improvement in the last reported quarter (see Graph 17).

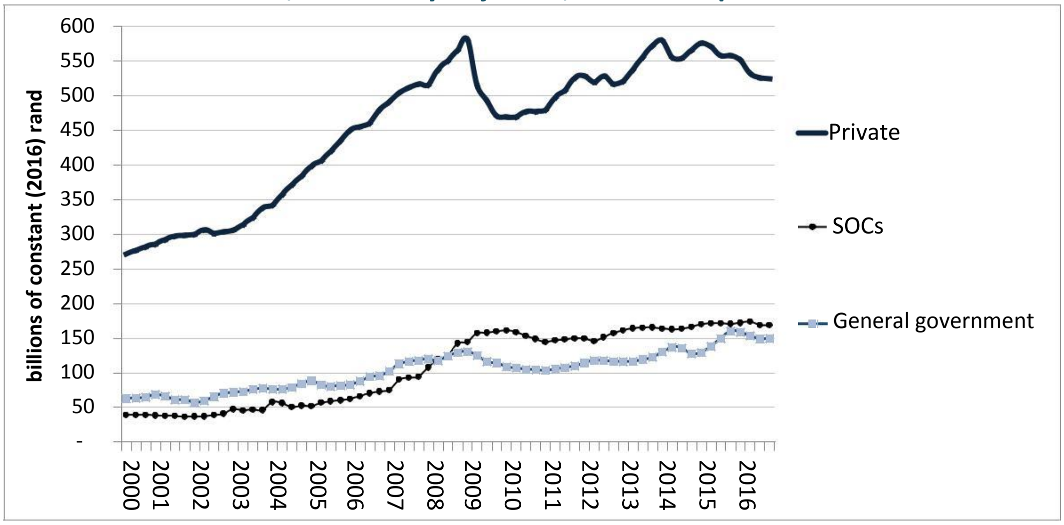
Graph 17. Profits in manufacturing and mining in constant (2016) rand



Source: Statistics South Africa. Quarterly Financial Statistics, relevant years.

Both private and public investment tended to decline in real terms for most of 2016 (the latest available figures are for the third quarter) (see Graph 18). While private investment started falling in 2014, the decline in government and state-owned corporation (SOC) investment began only in the course of 2016. As a result of these trends, the national investment rate – that is, investment as a percentage of GDP – has fallen to around 19%, from a high of 25% in 2008. As a rule, investment at 20% to 25% of the GDP is required for sustained growth.

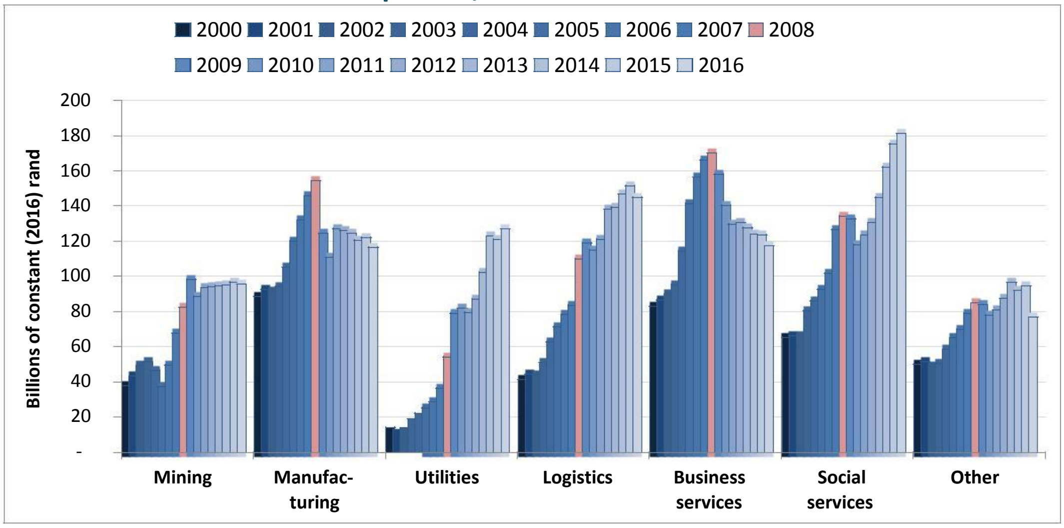
Graph 18. Quarterly investment by type of organisation in constant 2016 rand, seasonally adjusted, 2000 to September 2016



Source: Reserve Bank. Interactive data set. Downloaded in March 2017.

Manufacturing investment has been rather more subdued that other private investment. The fastest investment growth in recent years has been in utilities, logistics and social services, driven largely by the national build programme (see Graph 19).

Graph 19. Investment by sector in constant rand, year to third quarter, 2000 to 2016



Source: Calculated from, South African Reserve Bank. Downloaded from www.resbank.co.za in March 2017.

Major new projects

This section summarises major new foreign direct investment (FDI) projects, drawing on a new TIPS database, as well as domestic initiatives in the real economy.

Two new FDI projects were confirmed in the final quarter of 2016, for a combined total investment value of R1,57 billion with almost 500 permanent jobs.

The projects were Cipla's new Biotech manufacturing plant and an expansion of the 3M's Maple Park Plant in Kempton Park. Both were notable because of their advanced technology as well as their link to long-standing investors in South Africa.

The Indian pharmaceuticals company Cipla is investing R1,3 billion in a biosimilars manufacturing plant, with construction starting in early 2017 for completion by the third quarter of 2018. The plant aims to create 300 jobs, most of which will be high-skilled engineering. The plant will be in the Dube Trade Port Special Economic Zone, with the investor citing a memorandum of understanding with Dube Trade Port as its key engagement with government. Initial plans are to target the domestic market, but the plant does have the potential for export in the future.

The US company 3M is involved in South Africa mostly in chemicals, automotive components, healthcare, and other industrial and commercial products. Its R120 million investment will upgrade its existing complex in Kempton Park, and aims to create 75 new jobs.

Notable real-economy domestic investment projects in 2016 included developing a nickel beneficiation plant project in the North West by Thakadu Battery Materials and Lonmin, valued at R15 million and expected to create 60 jobs.

In the public sector, Gauteng launched a new agri-park in the West Rand. The agri-park aims to assist small farmers in joint storage and marketing of their products.

Briefing note: Scenarios for US protectionism

The election of the first explicitly protectionist American president in decades has injected a deep sense of uncertainty into a global trading system already mired by paralysis in the World Trade Organization (WTO) and fractures in the EU.

This has the potential to affect South Africa directly. The US is South Africa's second largest export market, accounting for around 7% of total foreign sales worth US$5 billion. Around a fifth of the total is platinum, and another fifth is autos. A further 10% is steel.

The Trump administration moved quickly to make clear that its anti-trade stance is not mere rhetoric. In its first days in office, it withdrew from the Trans-Pacific Partnership, a mega-regional trading bloc in Asia-Pacific that had been largely driven by the US. It has questioned whether the US should remain in the WTO, consistently threatened Mexico with border taxes of some kind, and explicitly targeted US companies that considered moving production overseas.

Most concerning is that this programme of protectionism does not seem to follow any sustainable, developmental plan or logic. The threat against Mexico, for example, apparently arose out of a dispute between President Donald Trump and the Mexican leadership. Engagements with major companies depend on Trump's personal pressure rather than any systematic policy guidelines.

Trade policy that is driven by hurt feelings and unclear impulses can be extremely dangerous for maintaining any sort of stability in the global trading system.

Three possible scenarios appear possible for South Africa and the broader African region.

First would be the cancellation of the African Growth and Opportunity Act (AGOA). AGOA is a unilateral US concession that gives imports from African countries preferential access to its market. The new administration has already expressed deep scepticism of the policy, asking the State department: "Most of AGOA imports are petroleum products, with the benefits going to national oil companies, why do we support that massive benefit to corrupt regimes?"

Historically, AGOA enjoyed widespread Congressional support, having passed the Senate 91-1 and the House 397-32 (with four abstentions). Revoking it would require an act of Congress, which might complicate efforts to roll it back. That said, the Republican-controlled Congress has shown very little appetite for standing up to Trump.

As of now, there is little evidence to suggest the deal is high on the new administration's agenda. But with South Africa's inclusion in AGOA only barely secured through last-minute negotiations, and with a regime that might be looking for an easy win in closing US borders, AGOA could once again be under threat.

Second would be a broad but unpredictable bout of overall protectionism. This could involve the US raising tariffs on an ad hoc basis, with the administration's self-declared nemeses – China and Mexico – perhaps bearing the brunt of the damage.

This kind of programme would be much more difficult to implement than the administration suggests. For one thing, it flies in the face of Republican orthodoxy, and Congress might balk.

If tariffs were to make their way past Congress, they would do serious damage to US consumers, since the US economy relies on Mexico and China for almost 35% of its imports. Strategic targeting of certain imports is possible, but the most likely targets — notably steel and rubber – were already protected under the Obama administration.

Also, if the US were to unilaterally impose tariffs, WTO rules would allow partner countries to block US exports.

On balance, the new administration leading an assault on global trade seems unlikely, but with such a radically unpredictable governing style anything is possible. And moves in that direction, even if incomplete, could still result in the world's erstwhile driver of global economic growth being cut off from the global trading system.

Third, the uncertainties around overt trade measures mean that the largest impact on trade could come from another area: taxes. In particular, the Republicans' proposed Destination-Based Cash-Flow (DBCF) tax could have serious trade implications.

The DBCF would effectively replace taxes on corporate profits with a form of Value Added Tax.

The impact on trade from the proposed tax occurs because US firms would pay the tax when they sell their goods in the US, but not when they export. Moreover, importers would have to add the tax to the sales price of foreign goods. Because of a system of deductions tied to the tax, exporters would in effect receive tax credits for exporting.

The net result of the tax, then, would be to effectively subsidise exports by US firms; to slash the effective tax rate for virtually all US companies; and to increase the tax on imports without actually imposing a tariff.

The tax changes are, by most accounts, illegal under WTO rules, but are a cornerstone reform advanced by the Republicans in Congress, since they need to boost revenues in order to pay for their proposed sharp cuts in company income tax. By extension, it is this domestic tax proposal that is most likely to pass in the relatively near future.

Whatever the specific outcome, the protectionist and unilateral approach apparently preferred by the Trump Administration poses a threat to global trade and in that context to South African and African interests. This situation makes efforts to diversify trading partners in the region and across the global South even more important.

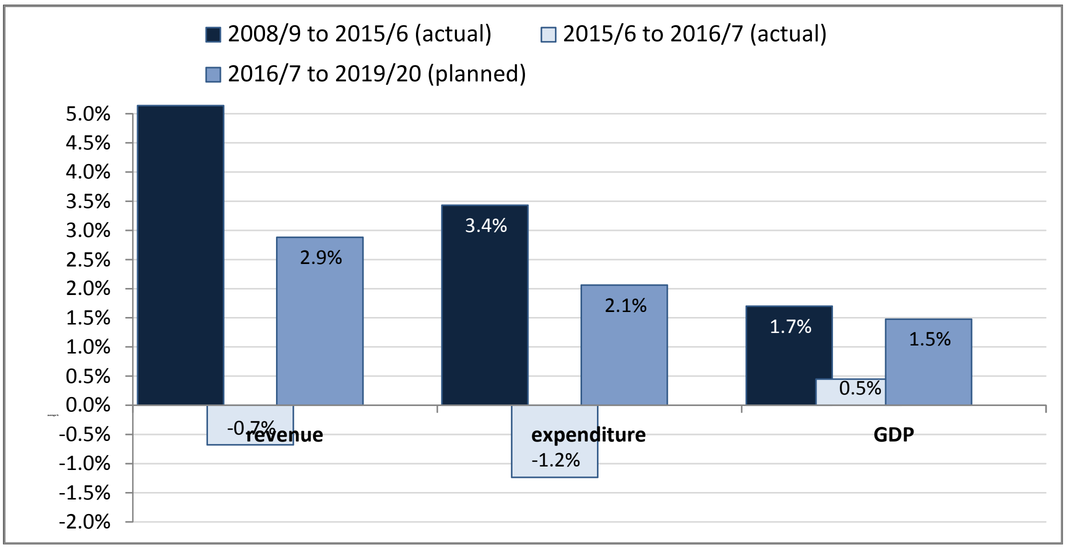
Briefing note: The 2017/8 budget and industrialisation

The 2017/8 budget, announced in March, reflects the commitment to fiscal consolidation, which in turn seems likely to slow overall growth. In this context, it imposes real cuts on the budget of the Department of Trade and Industry (the dti) in the coming three years, especially on incentive programmes.

In the past financial year, both government revenue and expenditure declined in real terms, which contributed to the slowdown in the GDP. In the coming year, expenditure is still expected to rise around a third of a percent below the population growth, although revenues should recover to 2,7%. Slow growth in spending goes hand in hand with a low forecast for growth over the fiscal year.

As usual in these situations, both the budget and growth are forecast to recover in the outer two years of the expenditure framework (see Graph 20).

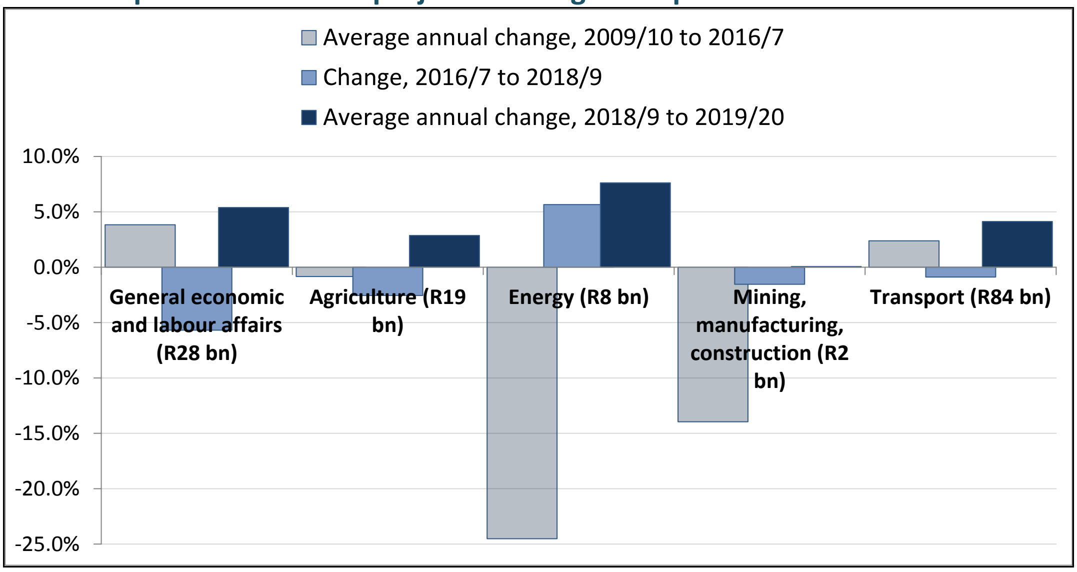
Graph 20. Growth in revenues, expenditure and the GDP



Source: National Treasury. 2017 and 2013 Budget Reviews.

The impact of slower spending is distributed differently across the functions of the state. Economic services are the hardest hit, with a decline in spending in real terms in 2017/8. This function includes the dti and other economics departments in the national government but is dominated by transport. The figures are somewhat distorted by very large fluctuations in the energy and fuel budget across the period (see Graph 21).

Graph 21. Actual and projected change in expenditure on activities

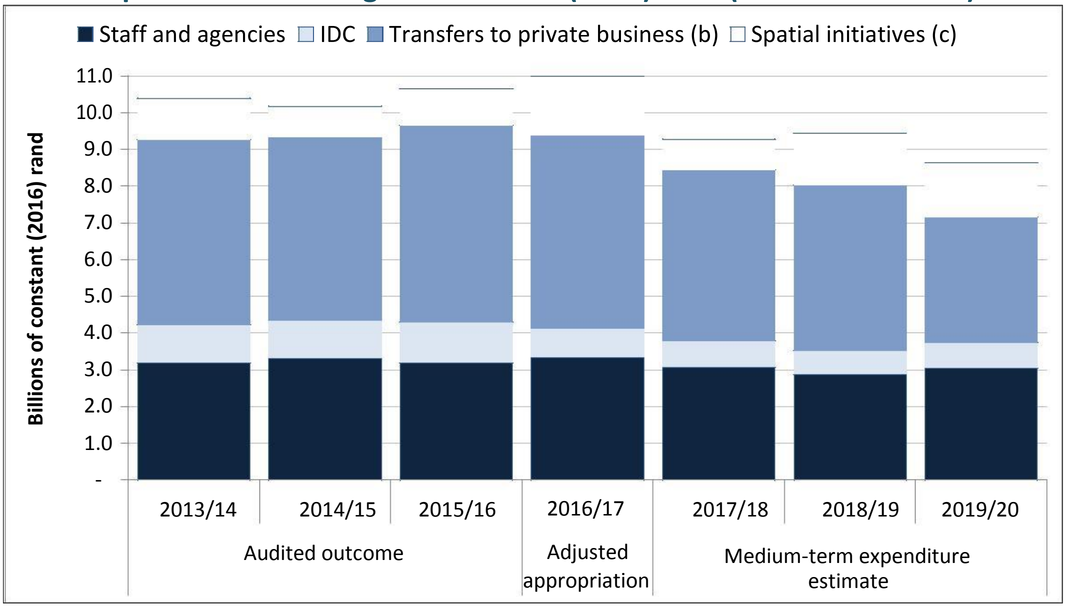


Source: National Treasury. 2017 and 2013 Budget Reviews

In this context, the dti's budget is expected to decline in real terms over the coming three years (see Graph 22).

Most of the shrinkage will occur in various incentive programmes that are designed to boost manufacturing investment. These transfers to private business will decline, in 2017/8 rand, from a peak of R5,4 billion in 2015/6 to R3,4 billion in 2019/20. These figures do not, however, include the largest support programme, which goes to the auto industry, since it takes the form of tax relief rather than on-budget spending.

Graph 22. The dti budget in constant (2016) rand (deflated with CPI)



Source: National Treasury. Estimates of National Expenditure 2017/8.