

THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

FIRST QUARTER 2017

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.*

GDP growth

South Africa entered a technical recession with a second quarter of contraction in a row. Investment emerges as the primary drag on economy growth, as confirmed by the decrease in mining production and the sectoral slowdown in utilities and construction. While manufacturing returned to growth over the past year, sales were still depressed, showing a slight decline.

Based on seasonally adjusted data, South Africa's GDP contracted for the second quarter in the row, putting the country in technical recession (Graph 1). Over the first quarter of 2017, GDP decreased by 0.17%, essentially due to the trade, catering and accommodation sector (-1.5%) and manufacturing (-0.9%). Mining (+3%) and agriculture (+5.1%) returned to growth over the quarter, stimulated by the end of the drought, rising international metals prices, and stronger demand.

Importantly, the recent credit rating downgrades (which occurred in April and June 2017) did not affect the developments covered in this Real Economy Bulletin, which is based on data up to March 2017. The downgrades should be understood as a response to the trends discussed, rather than the cause of them (see Briefing Note on page 14 for more details).

*Available to download at www.tips.org.za/publications/the-real-economy-bulletin

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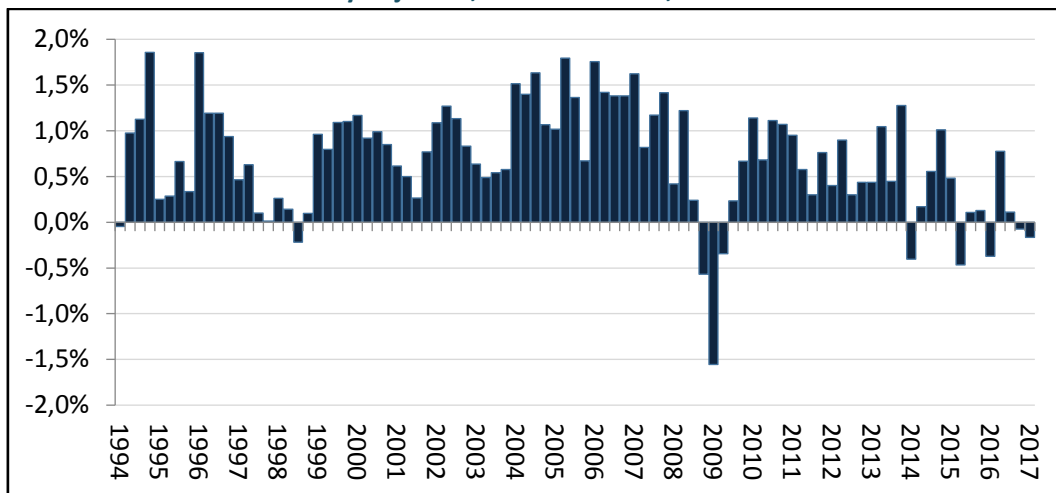


TRADE & INDUSTRIAL POLICY STRATEGIES

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Graph 1. GDP growth, quarter to quarter in constant 2010 prices, seasonally adjusted, not annualised, 1994 to 2017

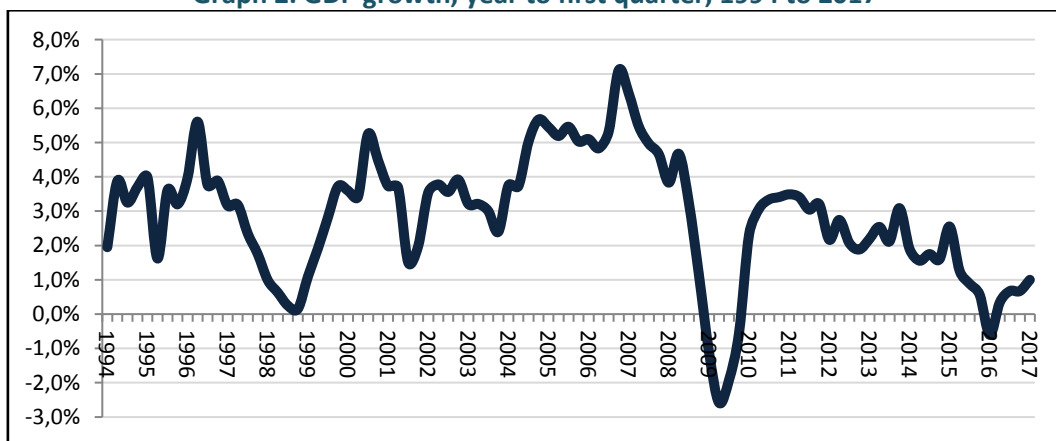


Source: Statistics South Africa GDP data.

Strong growth in the second quarter of 2016 meant that growth in the year to March 2017 was around 1% (Graph 2). In the absence of a robust recovery in the next few months, however, year-on-year growth rates will also decline.

The prospects for growth are uncertain. The World Bank in June cut its forecast for South Africa's GDP growth by 0.5 percentage points to 0.6% for 2017 and by 0.7 percentage points to 1.1% for 2018. The World Bank reduced its forecast for many commodity exporters, largely due to weaker than envisioned recovery in mining-based sectors. In stark contrast, in May, the International Monetary Fund (IMF) raised its growth prediction for South Africa for 2017 from 0.8% to 1%, expecting the end of the drought to lift agricultural production and rising commodity prices to boost the mining sector.

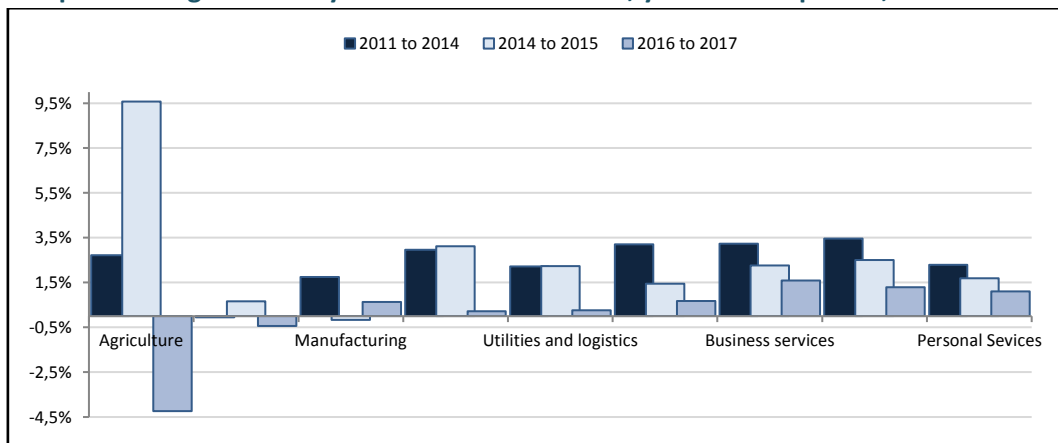
Graph 2. GDP growth, year to first quarter, 1994 to 2017



Source: Statistics South Africa GDP data.

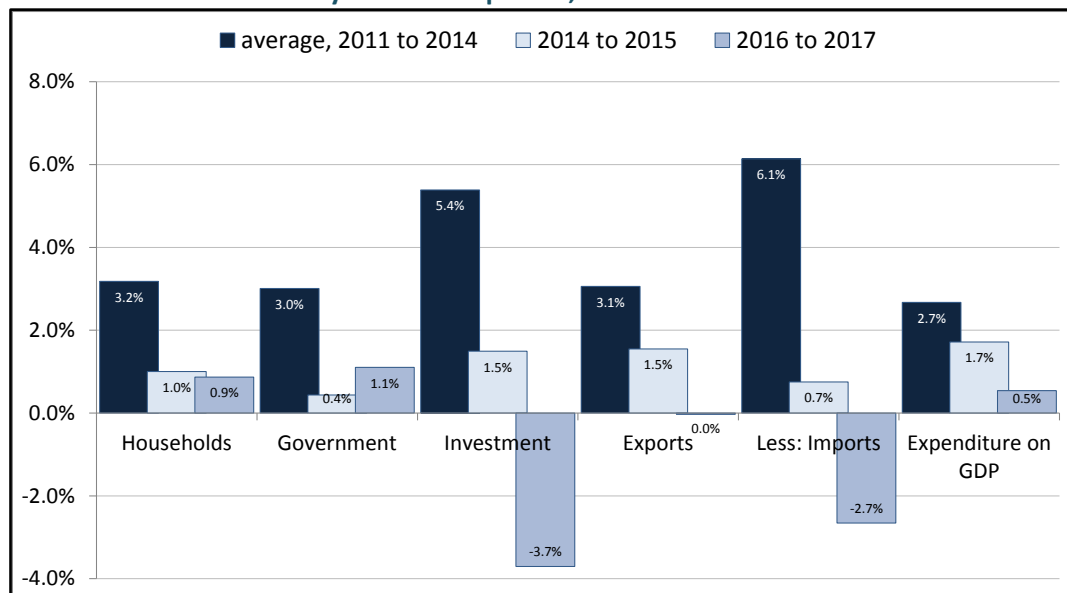
At the sectoral level, in the year to March 2017, utilities and construction experienced a drastic slowdown, after years of rapid growth (Graph 3). Mining declined by 0.4% while manufacturing returned to growth, progressing by 0.6%. Government services continued their gradual slowdown, in line with the ongoing fiscal consolidation (see the previous Real Economy Bulletin for more details on the impact of the fiscal consolidation on South Africa's GDP growth). The GDP share of the real economy remained largely stable, with manufacturing accounting for 13%. The share of mining declined to 7%, in line with seasonal variations. As shown in Graph 4, GDP growth was primarily impacted by the severe decline in investment (see section on investment and profitability for more details).

Graph 3. Change in GDP by sector in volume terms, year to first quarter, 2011 to 2017



Note: Calculated on the basis of the sum of four quarters of each year to the first quarter. Source: Calculated from Statistics South Africa. Electronic database. Series on Gross Domestic Product growth. Downloaded from www.statssa.gov.za in June 2017.

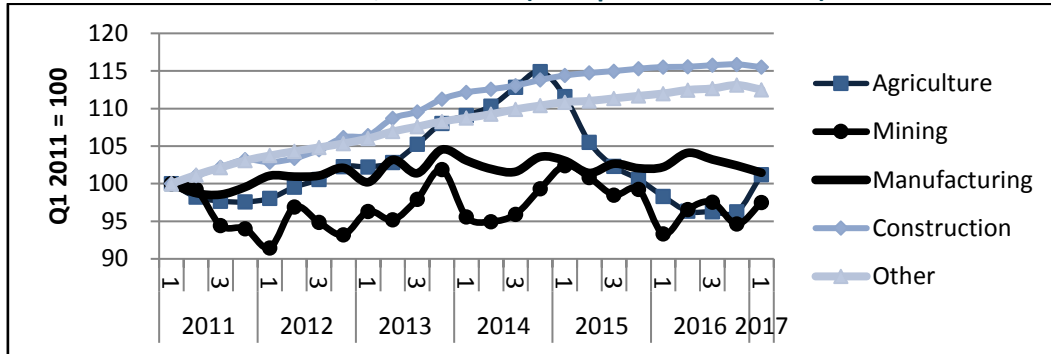
Graph 4. Change in components of expenditure on the GDP, year to first quarter, 2011 to 2017



Source: Calculated from Statistics South Africa. GDP Excel spreadsheet. Downloaded from www.statssa.gov.za in June 2017.

Production volumes in manufacturing further declined in the beginning of 2017, while construction levelled off, decreasing slightly. The end of the drought helped agricultural production volumes pick up for the first time since the 2014 peak. Mining production also improved in volume, although it has been remarkably volatile in the past few years (Graph 5).

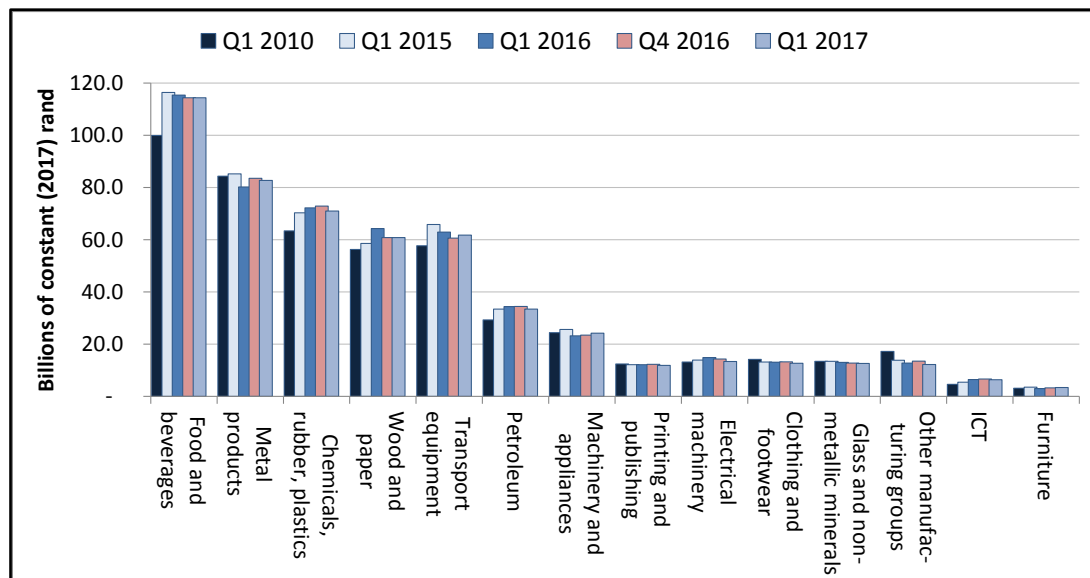
Graph 5. Index of volume of production by sector, quarterly, seasonally adjusted and annualised, 2010-2017 (first quarter 2011 = 100)



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

In line with production volumes, manufacturing sales experienced a 2% decline in the year to the first quarter of 2017 (Graph 6). The electrical machinery (-10%) and the wood and paper (-5%) industries experienced the largest decrease. In contrast, furniture sales grew by close to 13%. Sales of machinery/appliances and metals products increased respectively by more than 4% and 3% on a year-on-year basis. Other sectors experienced slight declines (from 1% to 3% depending the industry).

Graph 6. Manufacturing sales by industry in constant (2017) rand, 2010 to 2017



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 May 2017.

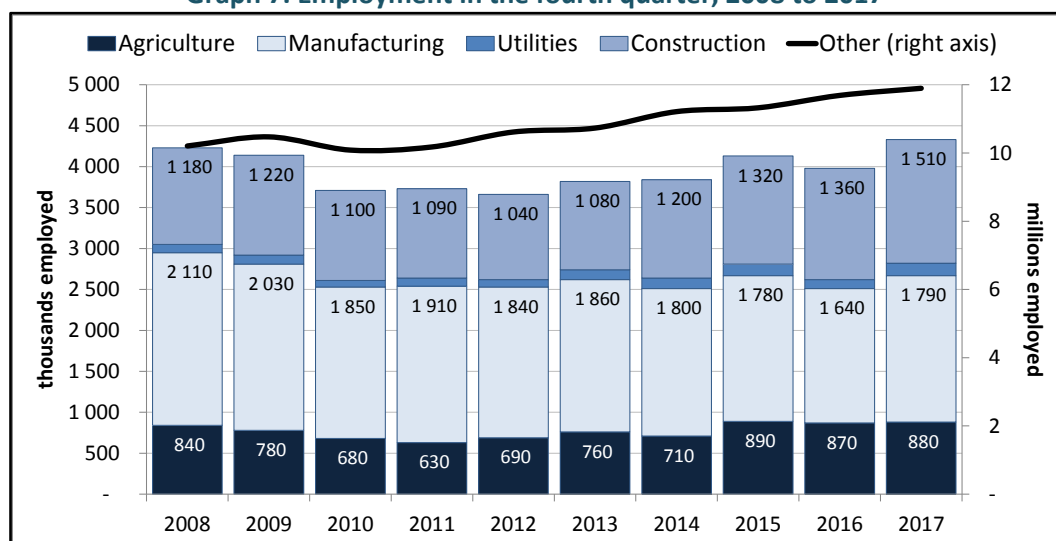
Employment

Employment reportedly climbed 500 000 in the year to the first quarter of 2017, reaching 16.2 million. Business services, manufacturing (primarily wood and paper, and food and beverages) and construction drove the growth on a year-on-year basis. Mining employment stagnated while the metals industry returned to growth.

Total employment reportedly progressed for the third quarter in a row to 16.2 million, pushing the labour absorption rate (i.e. the percentage of the working-age population employed) to 43.7%. At the same time, the unemployment rate increased to 27.7%, the highest level in the past 14 years.

As illustrated in Graph 7, on a year-on-year basis, employment grew by more than 500 000 jobs (or 3%), carried by good performance in business services (more than 150 000 jobs). Manufacturing and construction reported a similar increase in employment (about 150 000 each), while agriculture remained stagnant. The food and beverage sector led the growth in the manufacturing sector. As discussed in the Briefing Note on the employment data on page 20, however, there is a disjuncture between the employment data and the decline in the GDP, which may indicate problems with the data.

Graph 7. Employment in the fourth quarter, 2008 to 2017

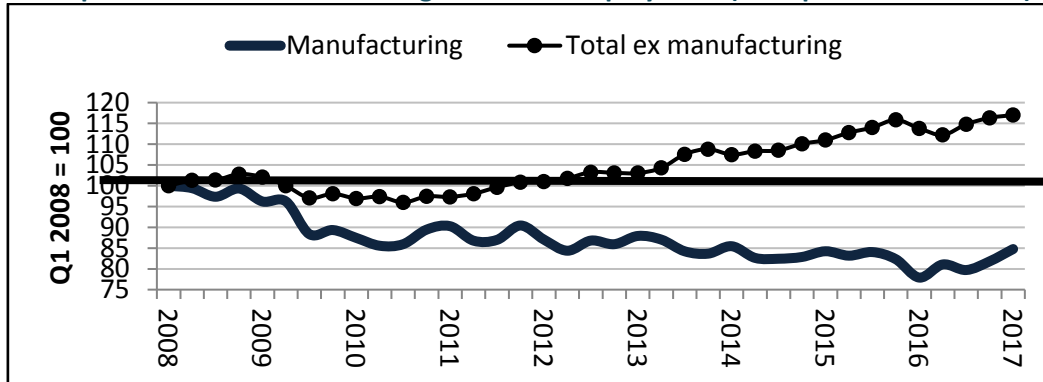


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in June 2017.

After a long period of decoupling, in which manufacturing shed jobs while employment in the country grew, manufacturing employment appeared back in line with the rest of the economy (Graph 8).

Manufacturing employment confirmed the uptake started in the second half of last year, increasing by 60 000 jobs in the first quarter of 2017. Manufacturing employment remains nonetheless far below levels reached in 2008, with 1.65 million jobs compared to 1.93 million a decade ago.

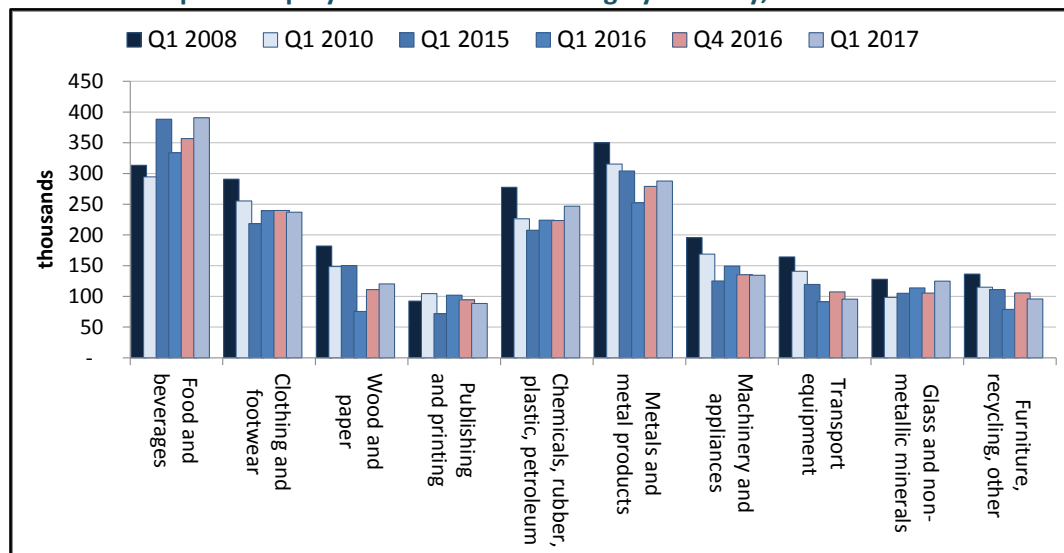
Graph 8. Index of manufacturing and other employment (first quarter 2008 = 100)



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

Within manufacturing, although employment grew by 4% in the last quarter, industries faced diverse fortunes (Graph 9). The food and beverage industry maintained its continual growth trend in the first quarter of 2017, accounting more than half of manufacturing employment gains. In part, these gains reflect a recovery from slow growth in 2015/2016 due to the drought. Agro-processing is the only industry that now employs more workers than in 2008. Some other industries also returned to employment growth in the last quarter, primarily glass and non-metallic minerals (+19%) and chemicals and petroleum (+11%). On a year-on-year basis, manufacturing employment increased by 10%, driven by the wood and paper industry which registered the fastest employment growth (+60%), although off a fairly small base. The food and beverage sector and the metals industry also grew at a steady pace (17% and 14% respectively).

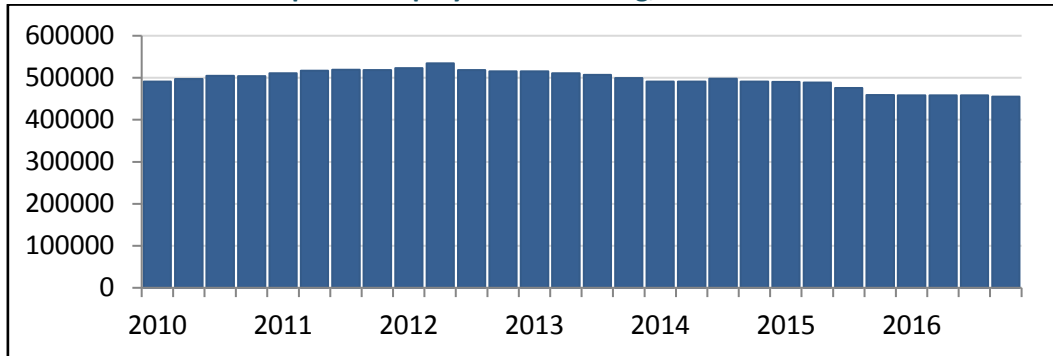
Graph 9. Employment in manufacturing by industry, 2008 to 2017



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.

Employment in mining, as reported by the Chamber of Mines, has remained virtually constant since the fourth quarter of 2015. A slight decline of 3 000 jobs was experienced in the last quarter of 2016, bringing mining employment to 455 000 jobs and the fall from the 2012 peak to almost 80 000 jobs (Graph 10).

Graph 10. Employment in mining, 2010 to 2017



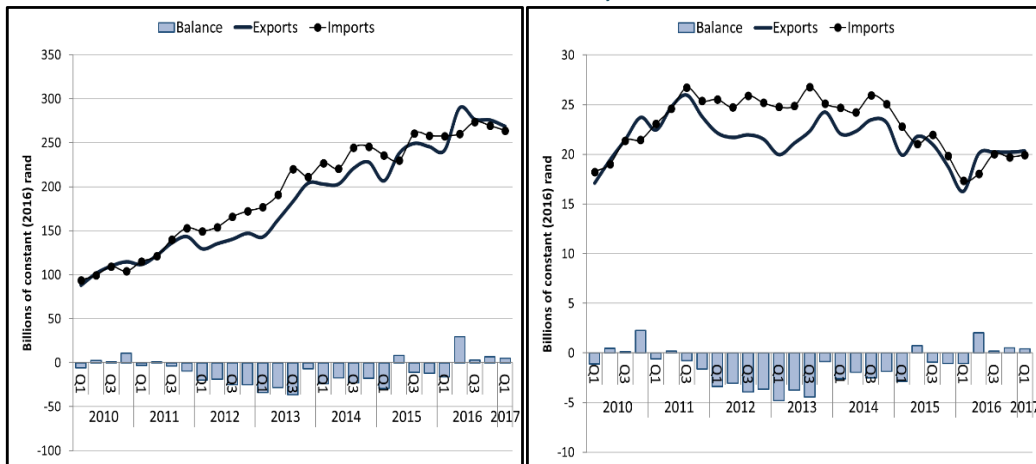
Source: Statistics South Africa. Quarterly Employment Survey. May 2017

Trade

South Africa confirmed its positive trade performance in the first quarter of 2017, running its fourth trade surplus in a row. The further strengthening of the rand over the first three months of the year led to both imports and exports decreasing in rand terms but increasing in dollar terms. Notably, mining exports picked up sharply over the last year. Exports from manufacturing, supported by chemical and metal products, also performed well over the last year.

As illustrated in Graph 11, South Africa’s balance of trade in the first quarter of 2017 was modestly positive in both rand and dollar terms. This is the fourth positive quarter in a row, after five years of ongoing deficits. It is also the first time in the 2010s that South Africa experienced a positive first quarter. Both imports and exports declined in rand terms compared to the previous quarter but increased on a year-on-year basis. In dollar terms, supported by the further appreciation of the rand, imports and exports saw a notable increase on a year-on-year basis (and a marginal expansion compared to the last quarter of 2016).

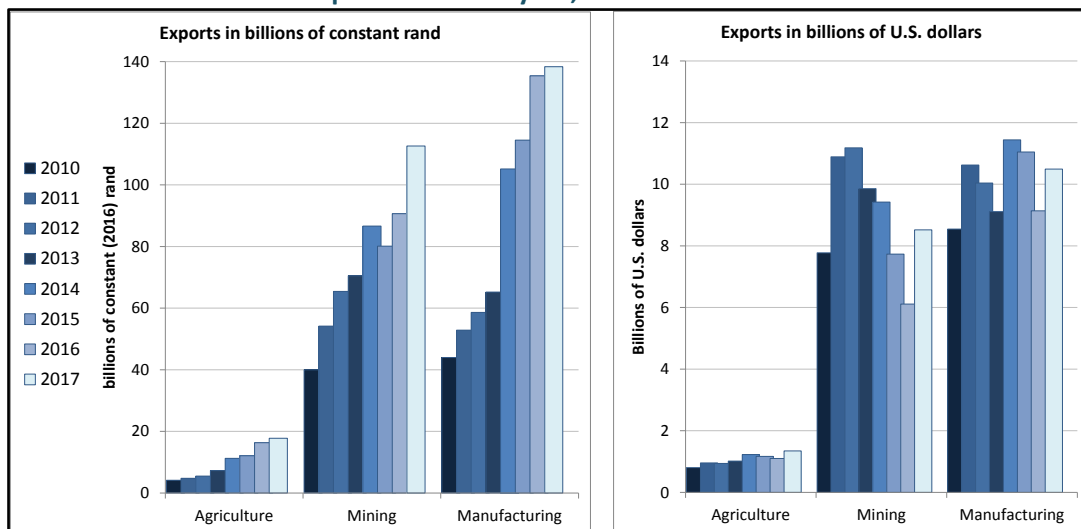
Graph 11. Exports, imports and the balance of trade in constant (2016) rand and current US dollars, 2010 to 2017



Note: Rand amounts are deflated with CPI, rebased to January 2017. Source: Calculated from SARS. "Trade Balance Graph for 2010-2016 (including and excluding BLNS)". Excel spreadsheet. Downloaded from www.sars.gov.za in April 2017.

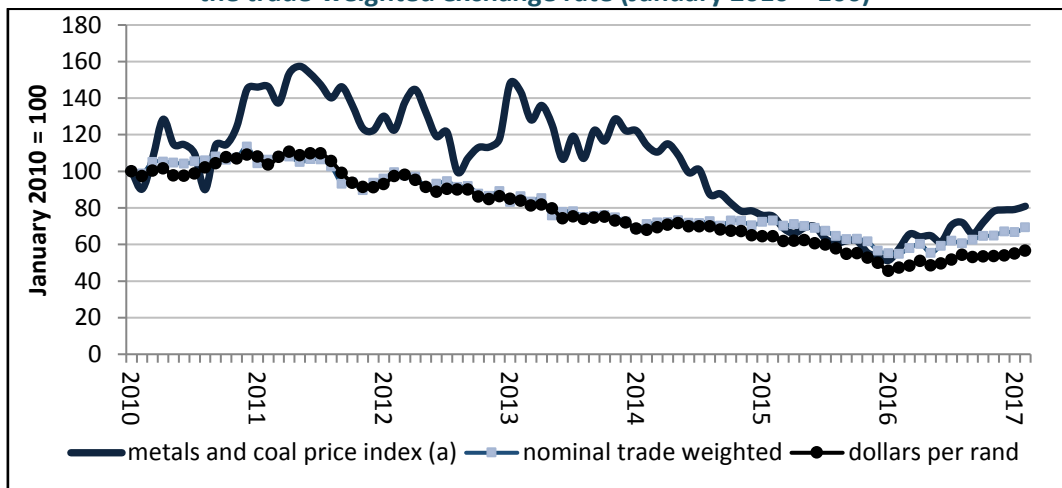
Exports increased across the board in the past year to March 2017 (Graph 12). Despite the strengthening of the rand (Graph 13), they gained in both constant rand and dollar terms. Although manufacturing exports declined compared to the previous quarter, they picked up on a year-on-year basis, particularly in dollar terms (+15%). Agricultural exports in dollar terms progressed by 22% on a year-on-year, driven by the end of the drought and bullish food prices. Supported by rising commodity prices over the beginning of the year, mining exports confirmed their recovery, with a second quarter of growth in dollar terms (and a third one in constant rand terms). They progressed sharply compared to the same period last year, increasing by close to 40% in dollar terms (24% in rand terms).

Graph 12. South African exports in constant (2017) rand and current US dollars, first quarter of each year, 2010 to 2017



Source: Calculated from SARS monthly trade data.

Graph 13. Indices of the dollar price of metals and coal, U.S. dollars to the rand and the trade-weighted exchange rate (January 2010 = 100)



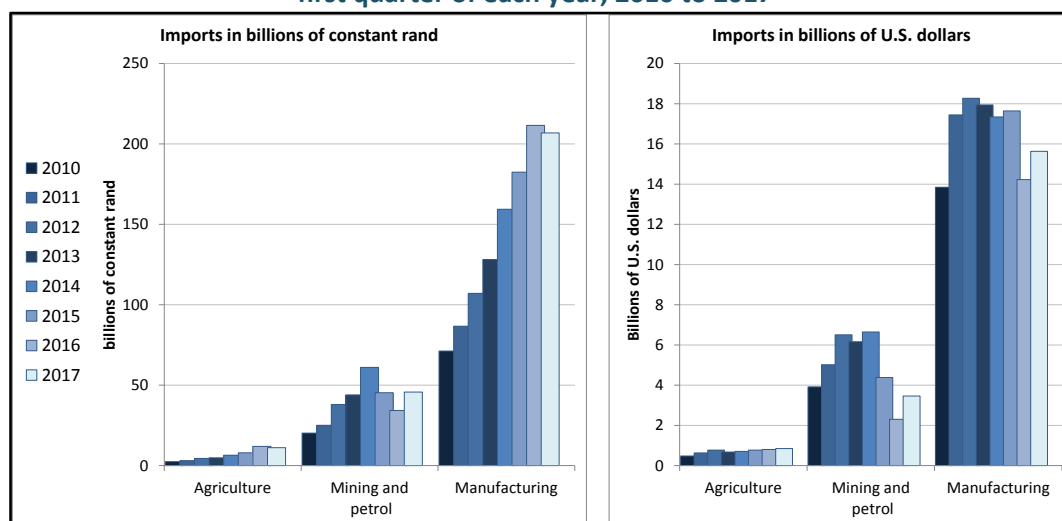
Source: Exchange rates: SARB. Interactive data. Downloaded in June 2017. Metals and coal prices: Kitco and IMF data, weighted by export shares.

Manufacturing imports have declined sharply in constant rand terms on a quarter-to-quarter basis, while the decrease has been much smaller in dollar terms (Graph 14). Compared to the first quarter in 2016, manufacturing imports have risen materially in dollar terms (+10%), while imports decreased in constant rand terms (-2%).

Mining imports, which are mostly petroleum, increased by 8% in dollar terms and 5% in constant rand terms, in progression for the fourth quarter in a row (in both currencies). On a year-on-year basis, this corresponds to an increase of 50% in dollar terms and 34% in rand terms.

Agricultural imports slightly increased from the previous quarter. In constant rand terms, they remain lower than agricultural imports in the same quarter of 2016, but have increased in dollar terms.

Graph 14. South African imports in constant (2017) rand and current US dollars, first quarter of each year, 2010 to 2017



Source: Calculated from SARS monthly trade data.

Chemical and metal products accounted for the bulk of the growth in manufacturing exports (Table 1).

In terms of manufacturing imports, the decline in imports of machinery and transport equipment, as well as clothing explain the decrease in imports in rand terms. In dollar terms, manufacturing imports have risen materially, driven by chemical products, transport equipment and foodstuffs.

Table 1. Value of and change in trade in manufactures to first quarter 2017, nominal US dollars and constant rand

Industry	Value (billions)		% change from Q1 2016		Change in millions	
	USD	Rand	USD	Rand	USD	Rand
Exports						
Food and beverages	0,82	10,8	8%	-4%	63,2	-407
Clothing and footwear	0,43	5,6	20%	7%	70,2	347
Wood products	0,13	1,7	26%	12%	26,2	178
Paper and publishing	0,43	5,6	10%	-2%	38,7	-124
Chemicals, rubber, plastic	1,70	22,5	27%	13%	367,0	2 666
Glass and non-metallic mineral products	0,09	1,2	-25%	-33%	-30,4	-596
Metals and metal products	2,50	33,0	18%	5%	383,4	1 627
Machinery and appliances	1,78	23,5	5%	-7%	79,0	-1 776
Transport equipment	2,22	29,2	11%	-1%	225,2	-253
Imports						
Food and beverages	0,63	12,0	43%	27%	271,0	2 573
Clothing and footwear	1,08	14,2	0%	-11%	-4,8	-1 829
Wood products	0,10	1,3	4%	-7%	3,9	-106
Paper and publishing	0,28	3,8	2%	-9%	6,3	-373
Chemicals, rubber, plastic	2,47	39,7	22%	8%	533,4	3 050
Glass and non-metallic mineral products	0,22	3,0	0%	-11%	-0,2	-370
Metals and metal products	1,01	14,8	11%	-2%	106,6	-242
Machinery and appliances	4,89	66,5	3%	-9%	139,4	-6 190
Transport equipment	3,20	46,6	10%	-2%	330,7	-917

Notes: Constant change in rand deflated with CPI.

Source: SARS data on trade.

Investment and profitability

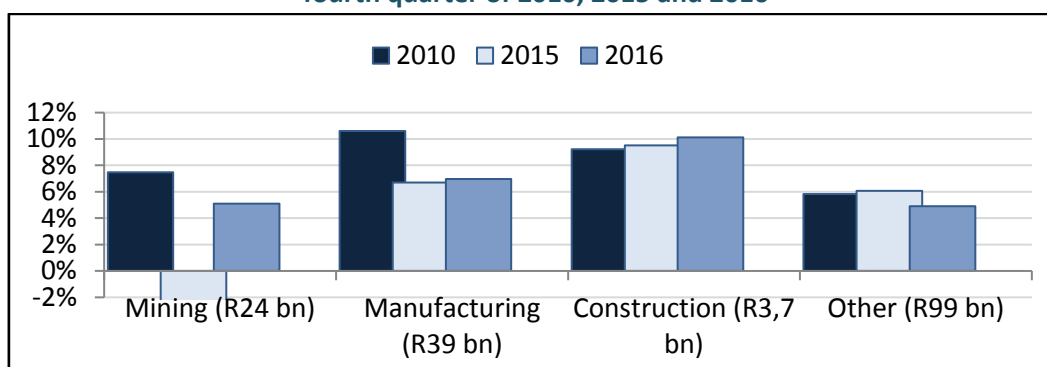
The past year saw an improvement in profitability in the real economy. Nonetheless, total investment decreased sharply in 2016, primarily in the private sector. State investment stagnated largely due to the onset of fiscal consolidation.

Profitability in the fourth quarter of 2016, calculated as pre-tax profits relative to assets, was strong in the real economy (Graph 15). Return on assets in mining confirmed its recovery from 2015, rising from R14 billion to R24 billion from the third to the fourth quarter. This situation resulted from a combination of higher global prices, although still far off 2011 peaks, and the closure of less profitable activities in the interim.

Profitability in the manufacturing sector remained stagnant compared to last year, with a sharp decline when compared to the previous quarter. After a disappointing performance in the previous quarter, the construction sector returned to strong profits, in line with 2015 results.

The rest of the economy showed satisfactory returns, although in decline both on a quarter-to-quarter and year-on-year basis.

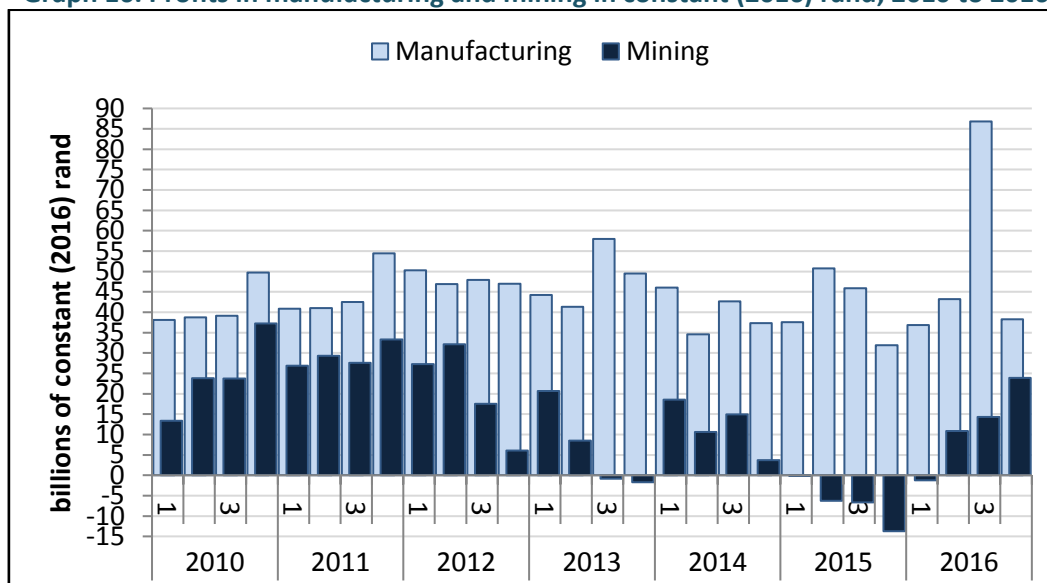
Graph 15. Return on assets (profit before tax as % of asset value) in the fourth quarter of 2010, 2015 and 2016



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

In constant rand, profits in the manufacturing sector returned to conventional levels after the spike reported in the previous quarter, which resulted from a major merger in the beverages industry (Graph 16). While the recovery of the mining sector remained fragile, the sector confirmed its return to profitability with a third quarter of improvement, returning to 2010 levels.

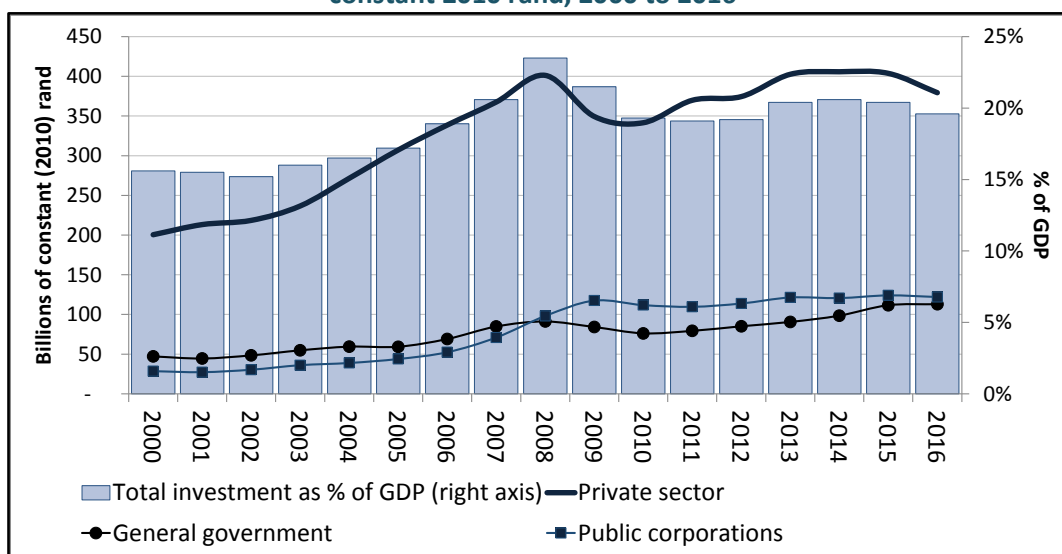
Graph 16. Profits in manufacturing and mining in constant (2016) rand, 2010 to 2016



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

Despite this recovery in profits, total investment decreased in 2016, for the first time since 2009 and the financial crisis (Graph 17). Private sector investment in particular dropped by some 6% after a couple of flat years. After five years of steady growth, state-led investment did not compensate for the decline in the private sector and levelled out (0.3%) in 2016, in line with the fiscal consolidation trend. Investment by state-owned enterprises declined by about 1.5% while government investment grew marginally by 1%. As a result, investment as a percentage of GDP further weakened in 2016, reaching 19.6%, far from the 2008 peak at 23.5%.

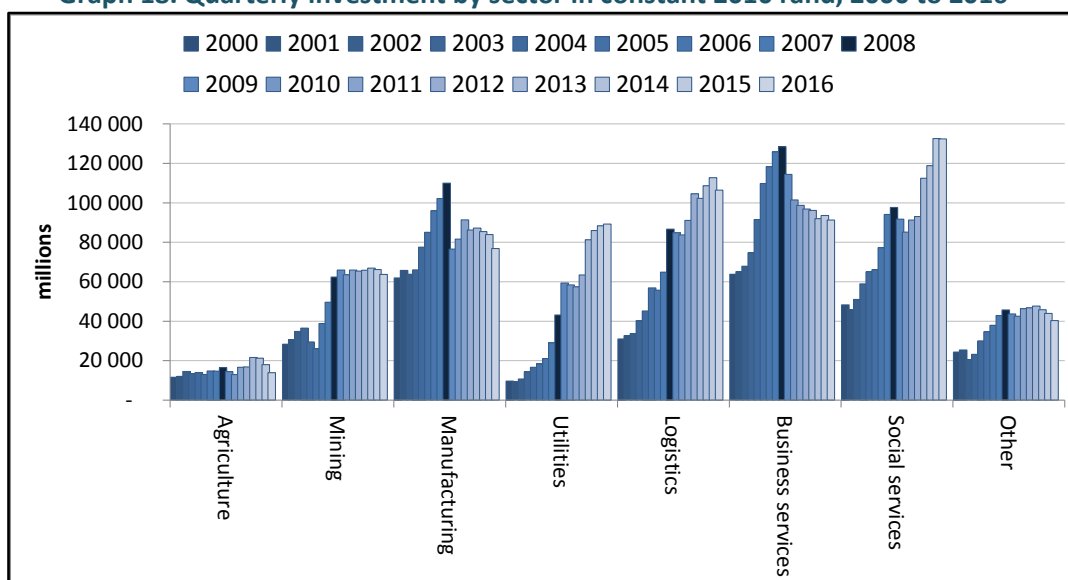
Graph 17. Yearly investment by type of organisation in constant 2010 rand, 2000 to 2016



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

At the sectoral level, investment materially declined in all sectors of the real economy with the exception of utilities and social services, which essentially stagnated (Graph 18). Affected by the drought, the agriculture sector continued its sharp fall initiated in 2014, with investment in decline of 23%. Manufacturing investment also severely decreased by more than 8% in 2016, reaching a level last seen in 2009. Investment in mining and logistics respectively declined by 4% and 6% in 2016, as a result of depressed commodity prices and weak economic activity.

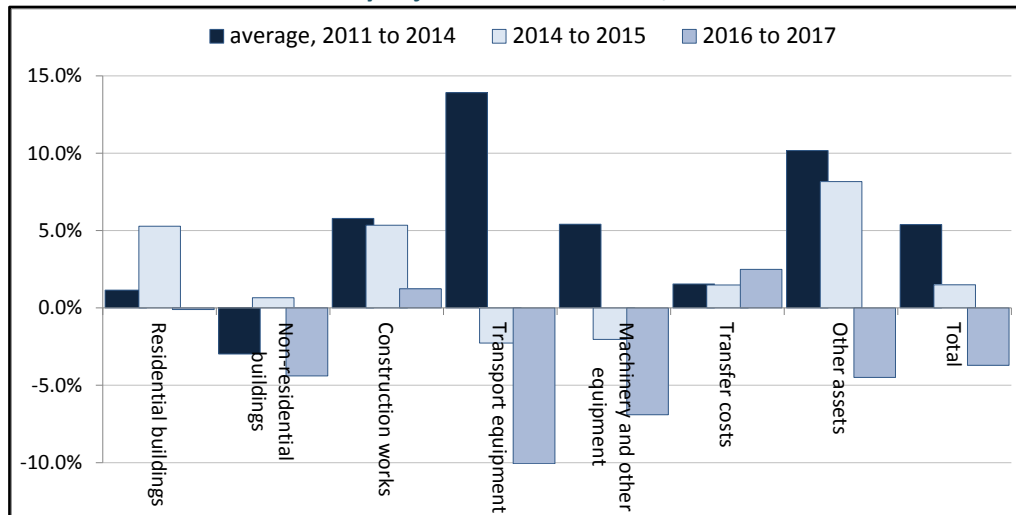
Graph 18. Quarterly investment by sector in constant 2010 rand, 2000 to 2016



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

From an asset perspective (Graph 19), infrastructure-related investment considerably slowed down in the last year, dragged by a 3% decline in investment in building and subdued growth in construction works. Investment in capital equipment plunged by 9% in 2016, in line with the decline in manufacturing and mining investment.

Graph 19. Yearly investment by type of assets in constant 2010 rand, not seasonally adjusted or annualised, 2000 to 2016



Source: Calculated from Statistics South Africa. GDP Excel spreadsheet. Downloaded from www.statssa.gov.za in June 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.

Luxembourg-headquartered Czech company PEGAS, an established global producer of nonwoven textiles, announced plans to invest R1,3 billion over a period of two years in a new textiles manufacturing plant in Atlantis in the Western Cape. Operations are expected to begin at the end of 2018, creating 200 direct jobs. The company, which will receive incentives from Wesgro, the Western Cape’s investment agency, and the Western Cape government, is committed to sourcing building and raw materials from local suppliers and to training local staff.

Confirming the attractiveness of the Automotive Production and Development Programme (APDP), South Africa’s sectoral development programme for the automotive industry, Mercedes Benz and BMW announced new investment in the first quarter of 2017. Mercedes Benz will be adding three new AMG models to its East London production line. The AMG engines will be imported, while the rest of the components will be locally manufactured. BMW will be constructing a state-of-the-art regional parts distribution centre in Midrand in Gauteng. The project will include a training centre and offices for its IT operations hub. R200 million will spent on fitting out the distribution centre once complete.

In contrast, General Motors announced in May it would be exiting South Africa. The move, triggered by a global restructuring and the difficulties of the American firm on the local market (which failed to reach the necessary production volumes to fully benefit from the APDP), is consistent with the international restructuring and consolidation occurring in the automotive industry. The Struandale vehicle assembly plant in Port Elizabeth will be sold to Japanese commercial vehicle manufacturer Isuzu.

In March 2017, Australian firm iSelect Limited - which specialises in online insurance, utilities and personal finance comparison - launched a new call centre in Cape Town, in the Western Cape, valued at R320 million. The company partnered with South African business process outsourcing company Merchant, which will manage the facility. The centre hosts 140 employees, with plans to create 500-1 000 over the next five years.

On the acquisition side, the Chevron Corporation (known as Caltex), involved in the refining and distribution of petroleum products in South Africa through 15 depots, 845 retail outlets and 21 terminals countrywide, actioned a three-year divestment programme announced in 2014. The company sold 75% of its local asset to the China Petroleum & Chemical Corporation (a subsidiary of the Sinopec Group, China's state-owned oil, gas and petrochemical producer) for an estimated R11.3 billion. A consortium of black economic (BEE) partners and an employee trust jointly hold ownership of the remaining 25% of the business.

Briefing note:

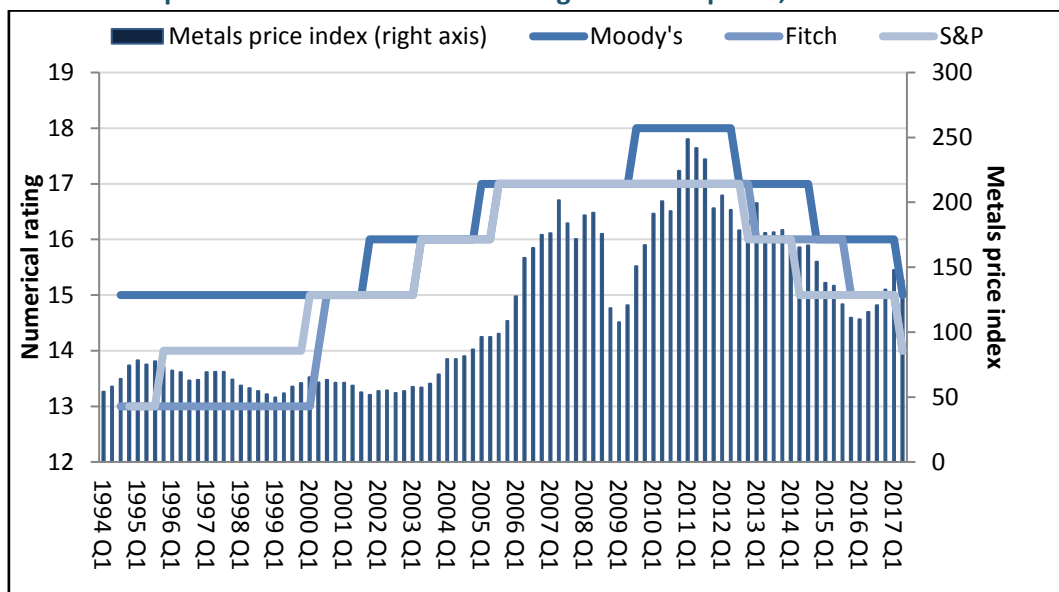
South Africa's credit downgrade – A commodity story

Generating much debate about the state and performance of the South African economy, leading credit ratings agencies recently downgraded South Africa's grade. Fitch and Standard and Poor's downgraded South Africa's long-term sovereign ratings by one notch in April 2017 from BBB- to BB+ while Moody's decreased the country's grade from Baa2 to Baa3 in June 2017. But the downgrades did not affect any of the developments covered in this Real Economy Bulletin, which is based on data up to March 2017.

According to the agencies' statements, the move was primarily driven by the political uncertainty following the Cabinet reshuffle and the perception that the fiscal consolidation stance (notably a rise in contingent liabilities of state-owned enterprises) will, as a result, be undermined by the pursuit of the nuclear power plant programme and efforts to spur radical economic transformation.

While not negating the role of internal political turmoil, South Africa's credit rating history seems, however, to provide other important angles of analysis. The country's credit ratings have been mainly determined by GDP growth, in turn underpinned by global commodity prices. Indeed, considering South Africa's rating in the light of commodity prices, (Graph 20) shows that South Africa's credit rating has been closely linked to international dynamics.

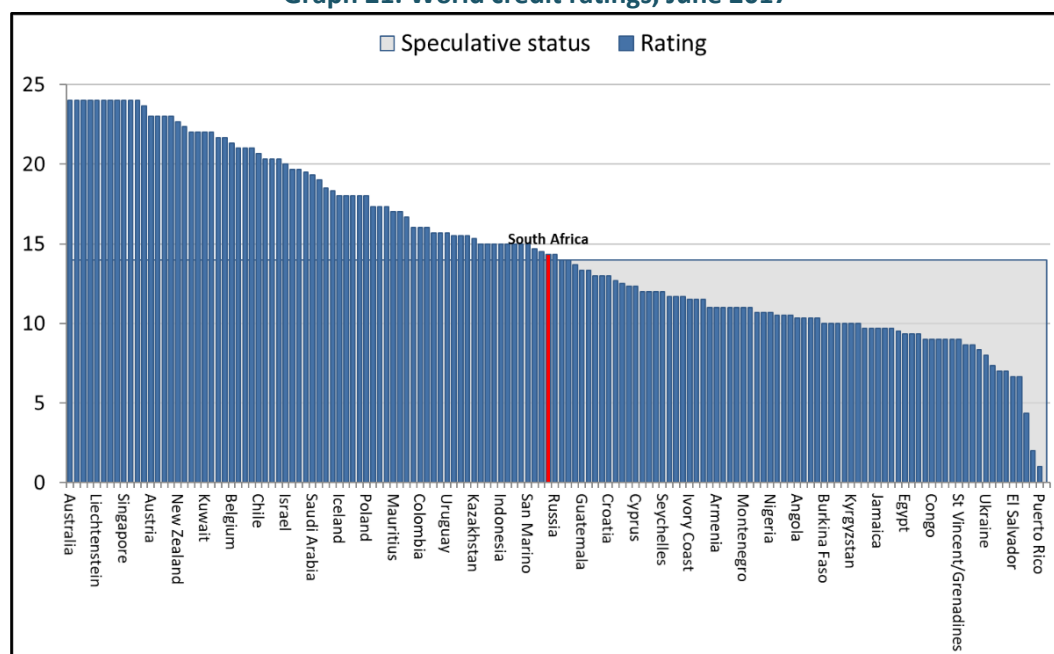
Graph 20. South Africa's credit rating and metal prices, 1994 to 2017



Source: credit ratings converted to numerical scale (0-24). Credit ratings downloaded from Trading Economics. Metals price index: IMF data

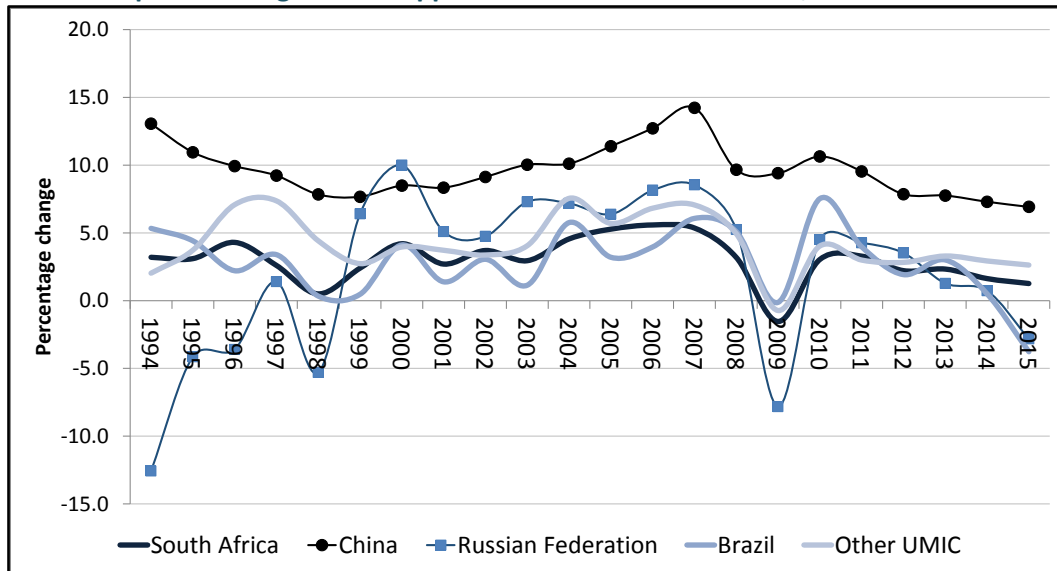
South Africa's ratings should also be put into perspective on a global scale. Based on an average of the three main agencies, South Africa is ranked 72nd out of 146 countries which have a credit rating (Graph 21). South Africa's ratings remain on par with India, Russia, Brazil and even Portugal. The country's weak economic growth performance (the main determinants of credit ratings) moreover appears in line with other upper-middle income economies (with the exception of China), as shown in Graph 22.

Graph 21. World credit ratings, June 2017



Note: The grey area indicates speculative status. Source: credit ratings converted to numerical scale (0-24). Credit ratings downloaded from Trading Economics.

Graph 22. GDP growth in upper-middle income economies, 1994 to 2015



Source: World Bank data

While South Africa undoubtedly displays some domestic weaknesses, worsened by the political noise, global dynamics seem to largely explain the downgrade spiral. Importantly, these trends determined the country's rating, and not the other way around. Indeed, ratings which, as a reminder, are tools to help investors evaluate the risks of a country defaulting on its debts, respond mostly to economic trends.

Undoubtedly, the downgrade will have some noticeable impact on the country, negatively affecting the sentiment on the domestic economy. The acceleration of capital outflows (already triggered by the fall in commodity prices) will ultimately increase the cost of capital, reducing the ability of both the public and private sector to invest. In addition, larger capital outflows are likely to push the value of the rand down, with the known positive effect on exports but negative impact on imports (particularly petroleum). However, in the long run, the impacts on the real economy are expected to be fairly muted and the current credit rating is unlikely to markedly affect South Africa's performance, compared to global demand and commodity prices.

Briefing note:

Industrial policy and the locomotive procurement – Corruption undermines industrial development

The procurement by Transnet of 1 064 locomotives was hailed as a boon for industrial policy. Transnet consolidated several years of procurement and sent the market signal that there was sufficient demand in South Africa for a major investment by locomotive producers and their suppliers. It also promised to stimulate local manufacturing firms to become suppliers into this global industry and support an export base in these products.

The firms bidding for the locomotive procurement were required to commit to localising their production, investing in local firms and building a competitive local supplier base.

Four firms were awarded the contracts, including China South Rail and China North Rail, which subsequently merged. Yet, research commissioned from the Centre for Competition, Regulation and Economic Development (CCRED) by TIPS under the Industrial Policy Research Programme¹ showed that China South Rail undertook virtually no localisation of production.

The recent leak of emails showing that the Transnet procurement process was hi-jacked helps explain this situation. They reveal that China South Rail paid a staggering 20% of the R50 million paid for each locomotive – some R10 million apiece - in “fees” to an intermediary company that facilitated its bid.² In total, it paid over R5 billion for the 500+ locomotives that Transnet will be buying from China South Rail.

TIPS commissioned research found that, to date, not one of the China South Rail locomotives has been assembled in South Africa; all have been manufactured in China. It appears that Transnet gave China South Rail “exemptions” on the number of locomotives that needed to be produced in South Africa, even though the procurement programme aimed explicitly to simulate local industry and industrial development.

The findings are verified in scrutinising the import bill for locomotives, which has grown significantly. The imports were less than \$50 million per year through 2013, but then climbed to US\$100 million in 2014 and US\$550 million in 2015.³ The remaining suppliers to Transnet under this procurement process have lived up to their obligations; they have invested, developed suppliers and are exporting components to the region and globally. Transnet Engineering has also built its own capabilities to produce locomotives, which is a positive signal.

With the slowing economy, the effects of high-level corruption can now be explicitly felt. Where government policies designed to stimulate industrialisation have been captured, the result is not only corruption and money-laundering, but also weaker foreign direct investment and slower industrialisation.

The state has few tools available to stimulate industrialisation, and the localisation of its procurement is one of its most important levers. Moral outrage aside, when corruption results in the importation of these items, it is a double blow to the economy – South Africa pays more for public investment and also loses the hoped-for stimulus to industry with the jobs and domestic manufacturing opportunities that would have been created.

As a minimum, the remaining locomotives that Transnet will get in 2018 must be locally manufactured, and the cost of each locomotive must be reviewed to ensure they do not incorporate corrupt payments.

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¹ A recent presentation at a TIPS Development Dialogue is available on the TIPS Website www.tips.org.za or [online here](#); the full report is Crompton R., Fessehaie, J., Lauralyn Kaziboni L. and Tatenda Zengeni T. 2017. *Railway Locomotives and Transnet: A Case Study*. CCRED Working Paper 9/2017. CCRED. University of Johannesburg, available on www.competition.org.za.

² AmaBhungane. 2017. *#Guptaleaks: Guptas and Associates Score R5.3bn in Locomotives Kickbacks*. Downloaded from www.amabhungane.co.za in June 2017.

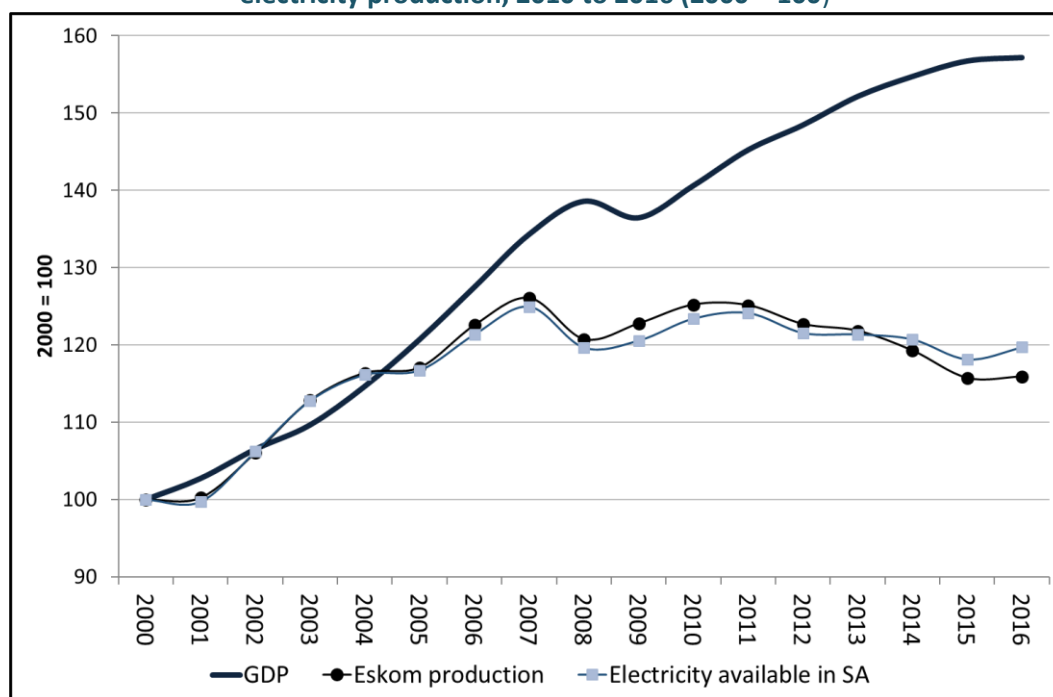
³ Crompton R., et al. 2017. *Railway Locomotives and Transnet: A Case Study*. CCRED Working Paper 9/2017. CCRED. University of Johannesburg.

Briefing note: The electricity oversupply – Implications for economic policy

Since 2011, Eskom has experienced a sharp decline in demand, while the electricity-intensity of the South African economy fell by a quarter from 2005 to 2017. A TIPS briefing note (available at [Responses to the electricity supply](#)) analyses the factors behind the fall in demand and, on that basis, a range of strategic responses.

As the Graph 23 shows, electricity production is now substantially lower than in 2008, despite continued growth in the GDP.

Graph 23. Indices of the GDP in volume terms and annual electricity production, 2010 to 2016 (2000 = 100)

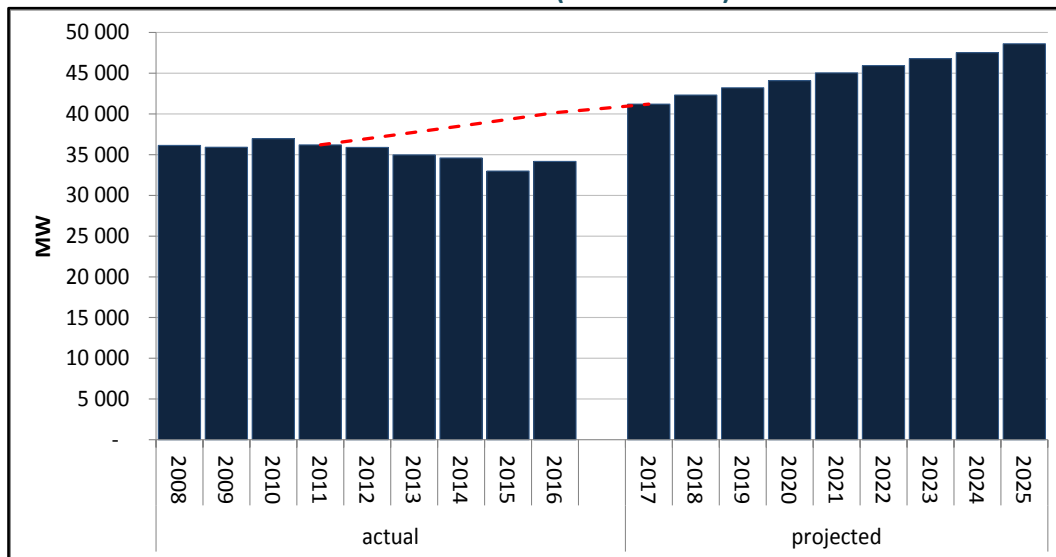


Source: For GDP, calculated from South African Reserve Bank. Interactive dataset. Series on GDP in constant rand. Downloaded from www.resbank.co.za in May 2017. For electricity, calculated from Statistics South Africa. Electricity generated and available for distribution. 201703. Excel spreadsheet. Series on monthly electricity generated and available for distribution, not seasonally adjusted. Downloaded from www.statssa.gov.za in May 2017.

Despite these trends, both Eskom and the regulator assume that demand will pick up in the near future. That belief ignores both the likelihood of slow growth in metals exports at least for the next few years as well as the strength of national and business strategies to reduce energy intensity. The risk is that it could lead to substantial overinvestment in generation in the next few years.

Graph 24 shows that NERSA’s projections for electricity demand have not been corrected to take into account the realities of the past nine years.

Graph 24. NERSA’s projections for peak demand (2017 to 2025) vs actual demand (2008 to 2016)



Source: NERSA. “System Adequacy Outlook.” Issue 12. 4 January 2017. Pp 2-3.

The TIPS briefing note concludes that it would be unsustainable in economic, environmental and social terms to fall back on the historic solution of boosting demand by subsidising new investment in metal and coal refineries.

Instead, Eskom has to develop a new business model that takes into account current realities - in particular the decline in metals refining due to higher electricity costs and the end of the commodity boom, as well as efforts to reduce greenhouse gas emissions. These realities mean Eskom will have to adapt to more or less stagnant electricity demand for the foreseeable future. To achieve that end, it should adopt smaller-scale and more flexible generation technologies.

Promoting future growth also requires that electricity supply be far more closely aligned with industrial policy. That would entail substantial modifications in current processes for determining tariffs and the allocation of electricity. The aim would be to prioritise projects that support industrial deepening and inclusive growth, which in turn would sustain Eskom over the longer run.

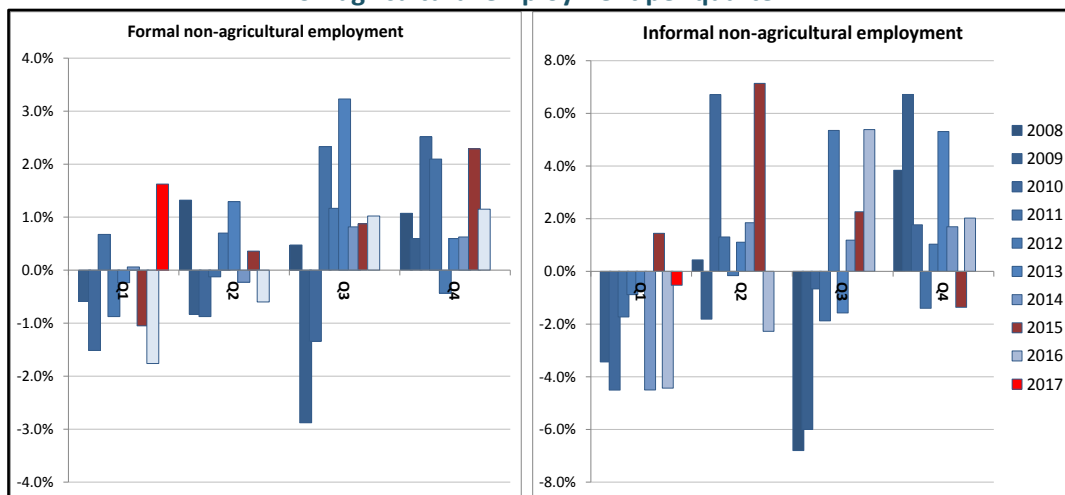
Briefing note:

What's going on with the employment data?

As Graph 25 shows, the Quarterly Labour Force Survey (QLFS) reported a markedly strong increase in formal non-agricultural employment in the first quarter for the first time since the survey was initiated nine years ago. Informal employment accounts for around 17% of all jobs and is more volatile.

The survey found that, on average, informal employment declined by 2,2% in the first quarter of the year, each year from 2010 to 2016. For the first quarter of 2017, in contrast, it reported that informal employment dropped just 0,5%.

Graph 25. Reported percentage change in formal and informal non-agricultural employment per quarter

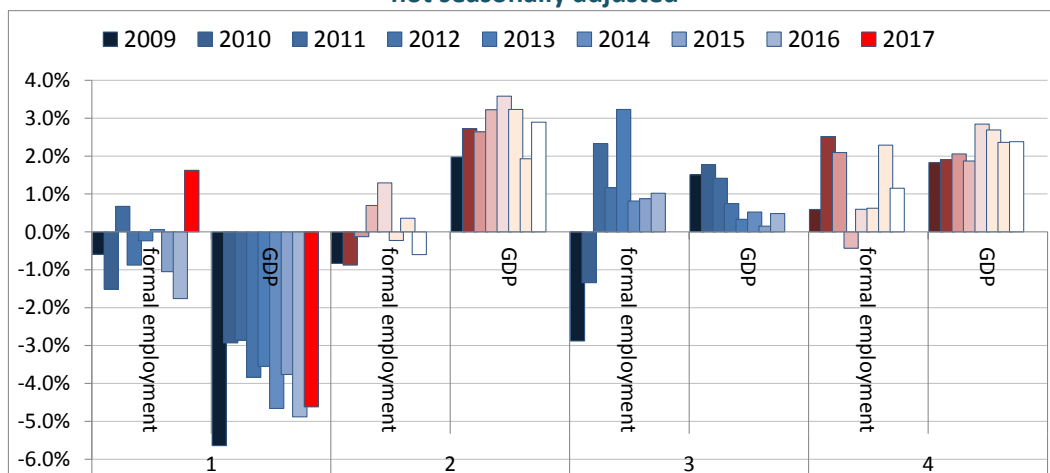


Source: Calculated from Statistics South Africa. Quarterly Labour Force Surveys for relevant year. Databases in SPSS. Downloaded from Nesstar facility at www.statssa.gov.za

If the economy were booming, this kind of jobs growth would not be exceptional. GDP growth has slowed, so the findings appear anomalous.

As Graph 26 shows, if the seasonal adjustment for GDP data is removed, employment and the GDP usually decline together in the first quarter each year, as a result of the holidays.

Graph 26. Percentage change in GDP and employment per quarter, not seasonally adjusted



Source: Calculated from Statistics South Africa. Quarterly Labour Force Surveys for relevant year. Databases in SPSS. Downloaded from Nesstar facility at www.statssa.gov.za; and GDP data in excel format, series on GDP in constant rand without seasonal adjustment. Downloaded from www.statssa.gov.za in June 2017.

Manufacturing alone accounted for 43% of the reported increase in formal employment, although it contributes just 14% of all formal jobs.

Food, beverages and the forestry value chain accounted for half the reported growth in manufacturing employment. This could in part reflect the recovery from the drought. The other main reported contributors were chemicals and non-metallic minerals, which is more difficult to explain in terms of their economic trends. In the past quarter, both of these industries reported a small decline in sales in constant terms.

In sum, the increase in employment reported for the past quarter seems at least as likely to result from data problems as from a real increase in job creation. If the QLFS results continue to diverge from other economic trends in the next few quarters, it might be useful if Statistics South Africa undertook a review of the survey's methodology.