THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

SECOND 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 main manufacturing industries and key data in Excel format.*

GDP growth

South Africa's recovery in the second quarter of 2017 continued an emerging pattern of sharp quarterly fluctuations in growth. In this case, expansion was driven principally by agriculture and mining, with only a modest improvement in manufacturing and a decline in construction. On the expenditure side, household consumption underpinned the recovery, with a continued slowdown in government spending and a further fall in investment, especially by the private sector and parastatals.

South Africa's seasonally adjusted quarterly GDP grew 0,6% in the second quarter of 2017 (2,5% at an annualised rate), recovering from the 0,2% contraction in the first quarter of the year. Graph 1 indicates that the recovery fits an emerging trend of unusually strong fluctuations in quarterly growth rates since 2014. Five quarters in this period saw a declining GDP – the same number of quarters as in all of the 20 previous years.

In the two years to mid-2017, the standard deviation for quarterly GDP growth (seasonally adjusted) was at its highest relative to average growth than at any period since the global financial crisis in 2008/9 (Table 1). Quarterly growth has been characterised by not only falling average growth rates but by lower maximum growth rates and more pronounced negative variability.

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

CONTENTS

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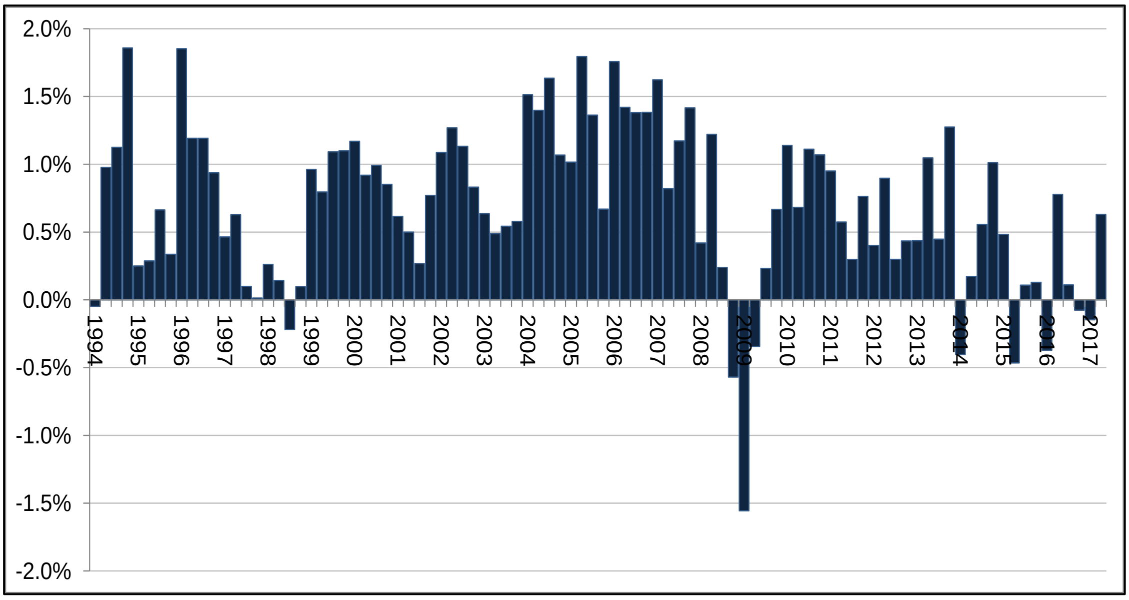
Graph 1. GDP growth, quarter to quarter in constant 2010 prices, seasonally adjusted, not annualised, 1994 to 2017



Source: Calculated from Statistics South Africa. Electronic database. Series on Gross Domestic Product in constant 2010 rand. Downloaded from www.statssa.gov.za in September 2017.

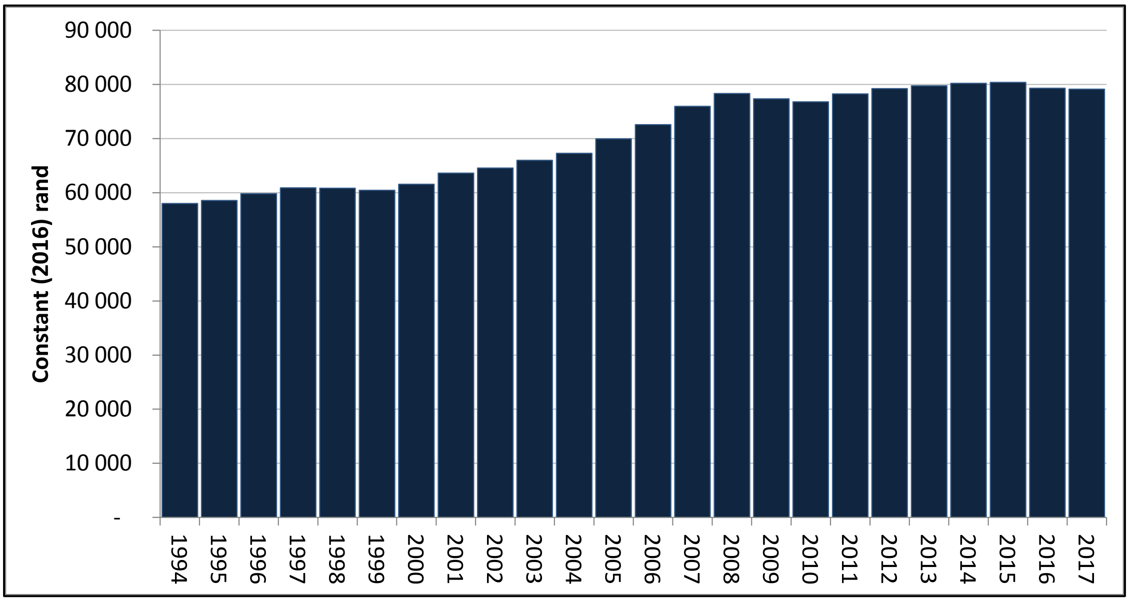
Table 1. Descriptive statistics for quarterly GDP growth rate trends from mid-1994 to mid-2017 (data for two years to second quarter)

Two years to June	ratio of standard deviation to average growth	average growth	minimum growth	maximum growth	standard deviation
1995	1.52	0.4%	0.2%	1.9%	0.7%
1997	0.60	0.8%	0.3%	1.9%	0.5%
1999	1.57	0.3%	-0.2%	1.0%	0.4%
2001	0.31	0.8%	0.5%	1.2%	0.2%
2003	0.44	0.8%	0.3%	1.3%	0.3%
2005	0.42	1.1%	0.5%	1.8%	0.5%
2007	0.33	1.1%	0.7%	1.8%	0.4%
2009	10.38	0.1%	-1.6%	1.4%	1.0%
2011	0.41	0.8%	0.2%	1.1%	0.3%
2013	0.54	0.5%	0.3%	1.0%	0.3%
2015	1.87	0.3%	-0.5%	1.3%	0.6%
2017	2.94	0.1%	-0.4%	0.8%	0.4%

Source: Calculated from Statistics South Africa. Electronic database. Series on Gross Domestic Product in constant 2010 rand, seasonally adjusted and annualised. Downloaded from www.statssa.gov.za *in September 2017.*

For the past two years, moreover, growth has lagged population growth, meaning that GDP per person has declined in real terms (Graph 2). This is only the third time since 1994 that GDP per person has declined. The fall since mid-2015 has come to 1,5%; that was exceeded only during the global financial crisis, when the GDP per capita dropped 2% over two years.

Graph 2. GDP per capita in constant 2016 rand, year to second quarter

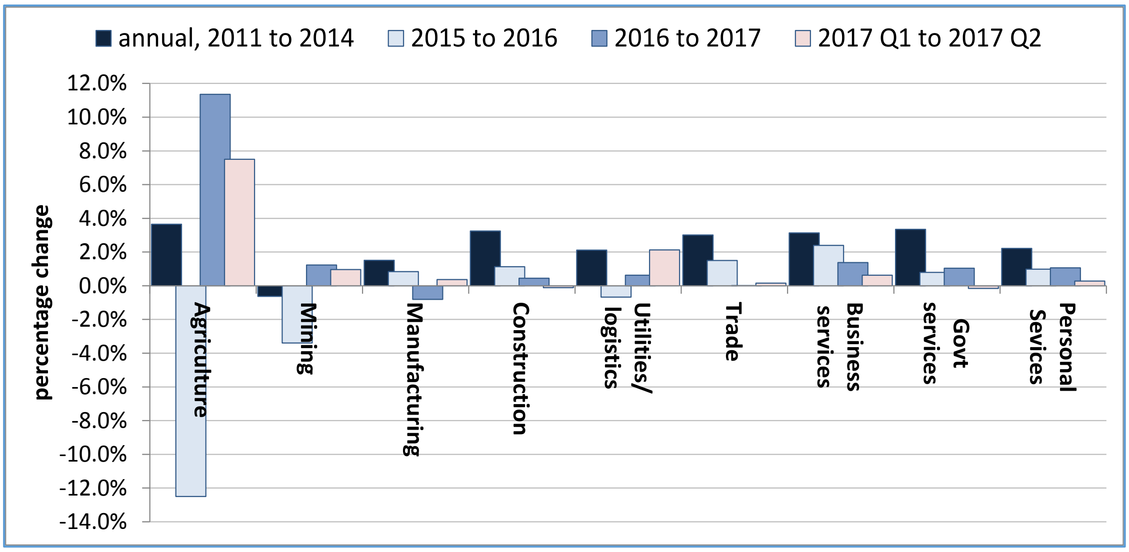


Source: Calculated from Statistics South Africa. Electronic database. Series on Gross Domestic Product in constant 2010 rand and in current rand. Downloaded from www.statssa.gov.za in September 2017. Population data for 1994 to 2016 from World Bank, World Development Indicators, downloaded from worldbank.org in September 2017, and for 2017 from Statistics South Africa, Mid-Year Population Estimates, downloaded in September 2017.

At the sector level, growth in the year to June 2017 varied sharply between sectors (see Graph 3).

- Agriculture played a disproportionate role in overall growth as it rebounded from the 2015/6 drought. Although the sector accounted for only 2,5% of the GDP, it contributed a third of GDP growth in the second quarter of 2017.
- In contrast, manufacturing declined in the year to June 2017, although in the second quarter alone it grew by 0,4%.
- Mining had a modest recovery over the year, despite substantial quarterly fluctuations. The shakeout from the end of the commodity boom in 2012 appears to be coming to an end, aided by some improvement in metals prices – although they are still far below the peak prices of 2012.
- Construction and government services saw the persistence of relatively slow growth as fiscal consolidation affected state spending. The sharp fall in their expansion contributed significantly to the overall slowdown from 2016.

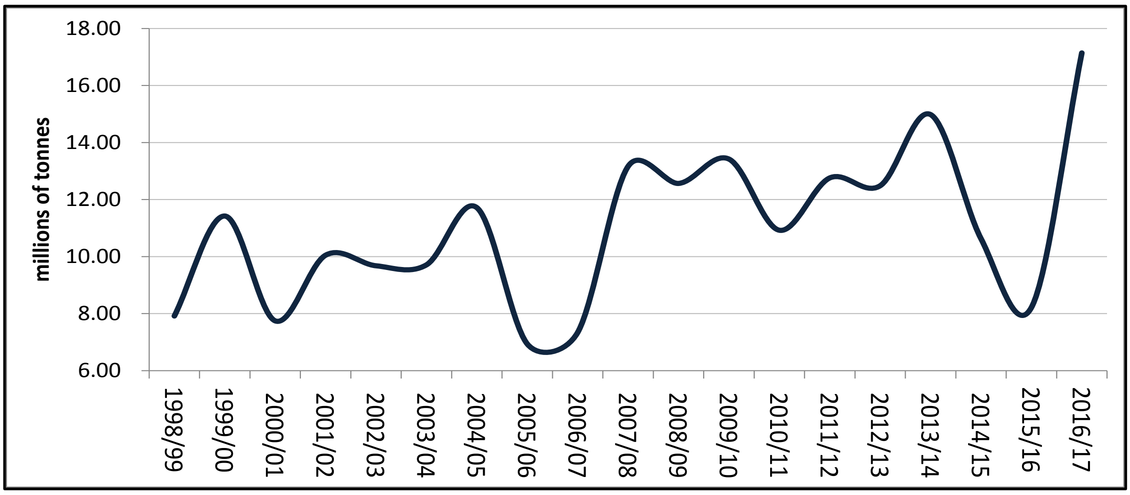
Graph 3. Change in GDP by sector in volume terms, year to second quarter, 2011 to 2017



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 in constant 2010 rand. Downloaded from www.statssa.gov.za in September 2017.

The growth in agriculture resulted from record harvests in grains and oilseeds, particularly in maize after good summer rainfall and an increase in area planted. The Crop Estimates Committee of the Department of Agriculture, Forestry and Fisheries forecast a 2017 production of 22 million tons in major grains and oil seeds (17 million tons of which is maize[1]) (Graph 4) This is expected to be an 88% increase in harvests (109% increase of maize) from the 12 million tonnes harvested last year. That said, the maize increase was only 14% above the 2013 peak before the drought.

Graph 4. Maize production, 1998 to 2016

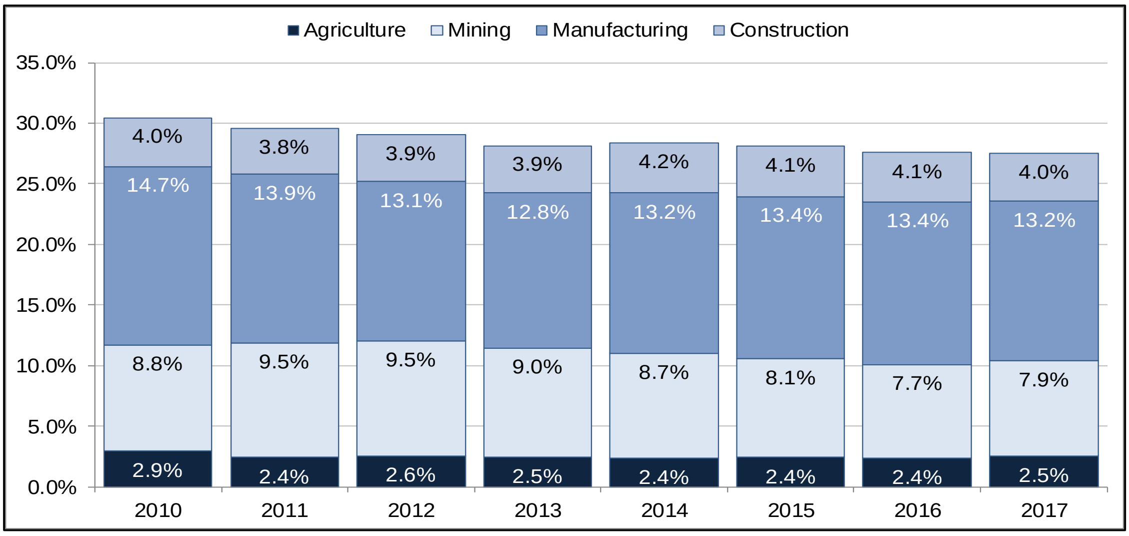


Source: Calculated from Crop Estimates Committee (2017) Summer Crops – Area Planted and Seventh Production Forecast: 2017. Downloaded: http://www.sagis.org.za/historicalhectares&production.html in September 2017.

[1] Maize forecast includes both commercial and non-commercial area planted.

Taken together, the sectoral trends stabilised the share of the real economy in the GDP in the year to the second quarter of 2017. The primary sectors slightly increased their shares, offsetting a small fall in the share of manufacturing and construction (Graph 5).

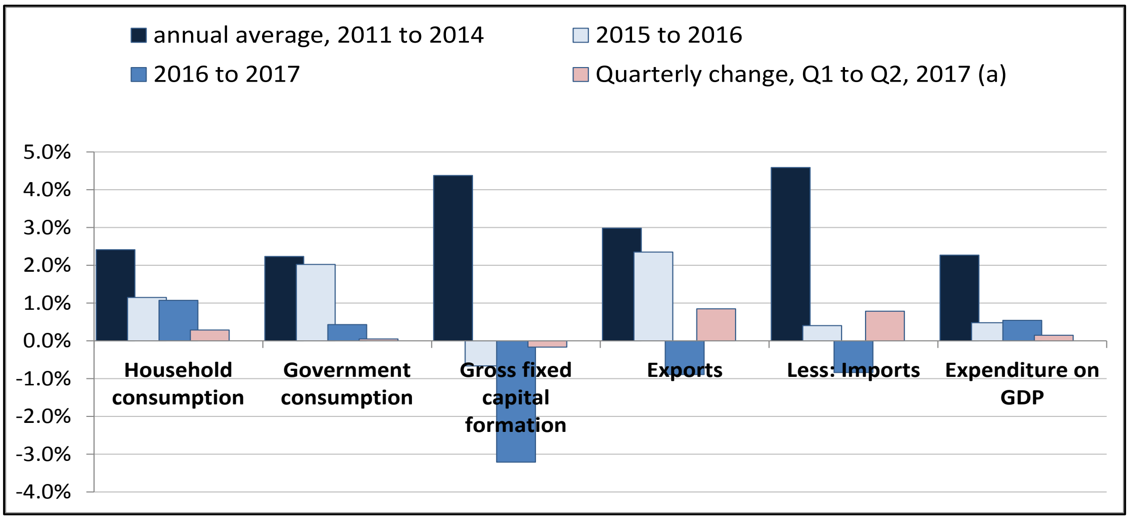
Graph 5. Share of the real economy in the GDP, 2010 to 2017 (year to second quarter)



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 in current rand. Downloaded from www.statssa.gov.za in September 2017.

On the expenditure size, household consumption drove growth over the past two years, while investment declined and the expansion in government consumption slowed sharply (Graph 6). Statistics South Africa found that household consumption was the anchor of the recovery in the past quarter, reversing a sharp fall in the previous quarter. It also found that the decline in investment slowed over the year to June 2017.

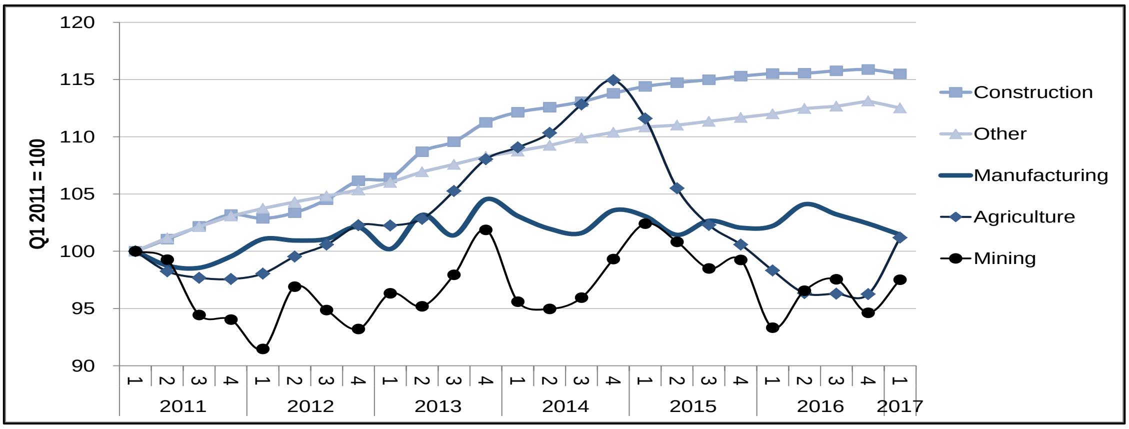
Graph 6. Change in expenditure on the GDP, year to second quarter, 2011 to 2017



Source: Calculated from Statistics South Africa. GDP Excel spreadsheet. Series on expenditure on GDP in constant 2010 prices; for quarterly change, seasonally adjusted. Downloaded from www.statssa.gov.za in June 2017.

Graph 7 shows the strength of the recovery in agriculture, although production remains below the 2014 peak. In contrast, while manufacturing showed some improvement in the past quarter, it remained well below levels a year ago, and has not increased production significantly since late 2013. Similarly, the recovery in mining over the past two quarters is still below 2015 production levels.

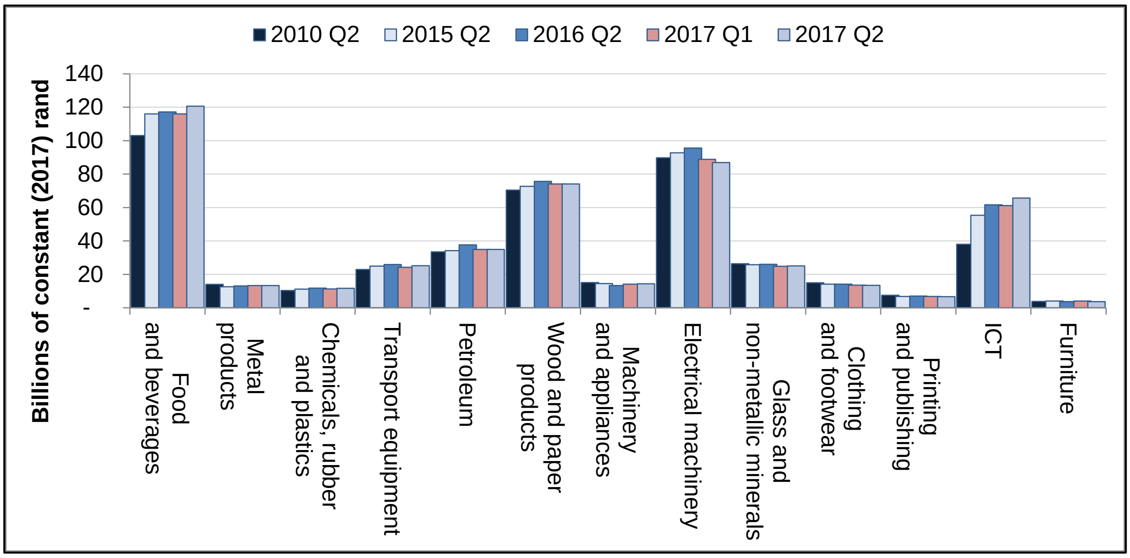
Graph 7. Index of volume of production by sector, quarterly, seasonally adjusted and annualised, 2010-2017 (first quarter 2011 = 100)



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

Within manufacturing, sales of electrical machinery, ICT equipment and furniture showed the most rapid growth over the past year (Graph 8). Food and beverages, machinery and appliances and chemical products continued to grow fairly steadily. Sales of transport equipment (mostly cars) grew in the second quarter of 2017, but declined in year-on-year terms.

Graph 8. Index of volume of production by sector, quarterly, seasonally adjusted and annualised, 2010-2017 (first quarter 2011 = 100)



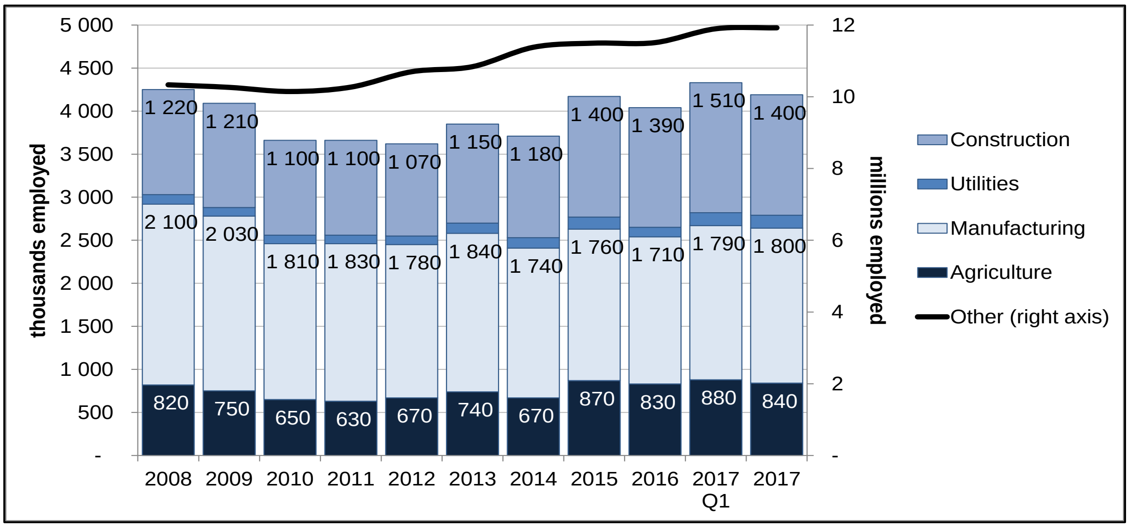
Note: Average of monthly figures for each quarter are weighted by production volumes data and deflated with CPI. Source: Calculated from Stats SA, Manufacturing: Production and Sales. Excel spreadsheet. Downloaded from www.statssa.gov.za in September 2017.

Employment

As a contrast to growth in GDP, according to the official data, employment in the economy as a whole declined by 113 000 or around -0.7% in the second quarter of 2017 compared to the first quarter. Jobs grew around 4%, however, when compared to the same quarter of the previous year. The data show slight gains in manufacturing. Agriculture created jobs in line with the rebound in the sector. In mining, using the employer survey (which is considered more reliable for this sector), employment increased by 8 000 in the first quarter of 2017, or about 2%. This signals some stabilisation as the industry adapts to the new realities of lower metals prices.

Graph 9 shows the change in employment by sector from the second quarter of 2008 to the second quarter of 2017. At 4,2 million, employment in the real economy was still marginally lower than it was before the 2008/9 crisis, most because of persistent job losses in manufacturing. In contrast, employment overall recovered from the 2008/9 downturn in 2013. Moreover, since 2015 there has been virtually no growth in employment in the real economy, while the rest of the economy has gained around 400 000 jobs.

Graph 9: Employment by sector in the second quarter, 2008 to 2017

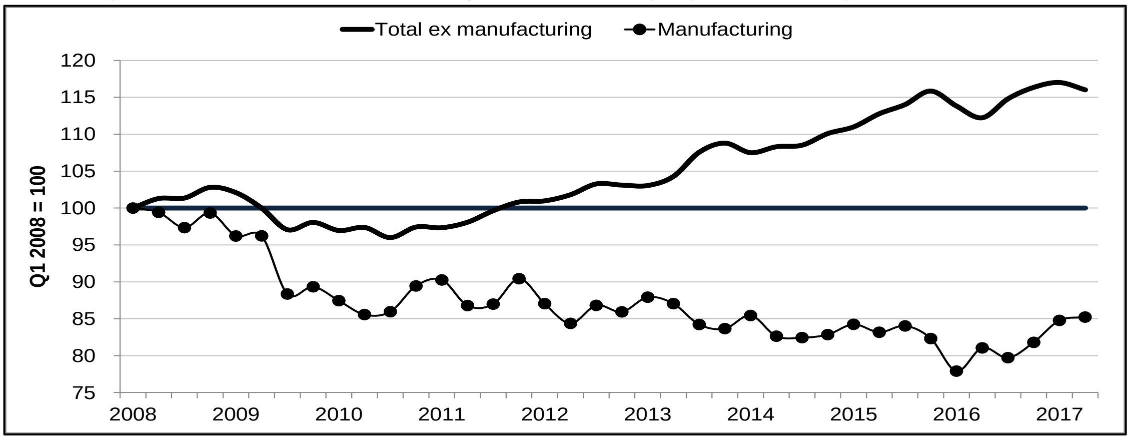


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in July 2017.

Agricultural employment reportedly increased by 10 000, or 1%, in the second quarter of 2017. The figures are not seasonally adjusted, but the second quarter typically shows a seasonal fall in farm employment. The increase in 2017 thus points to recovery from the drought.

Manufacturing employment in the second quarter of 2017 grew some 90 000 above the second quarter of 2016 (or a 5% increase). However, manufacturing employment is still 300 000 below the second quarter of 2008, before the crisis hit (Graph 10).

Graph 10: Index of manufacturing and other employment, first quarter 2008 = 100

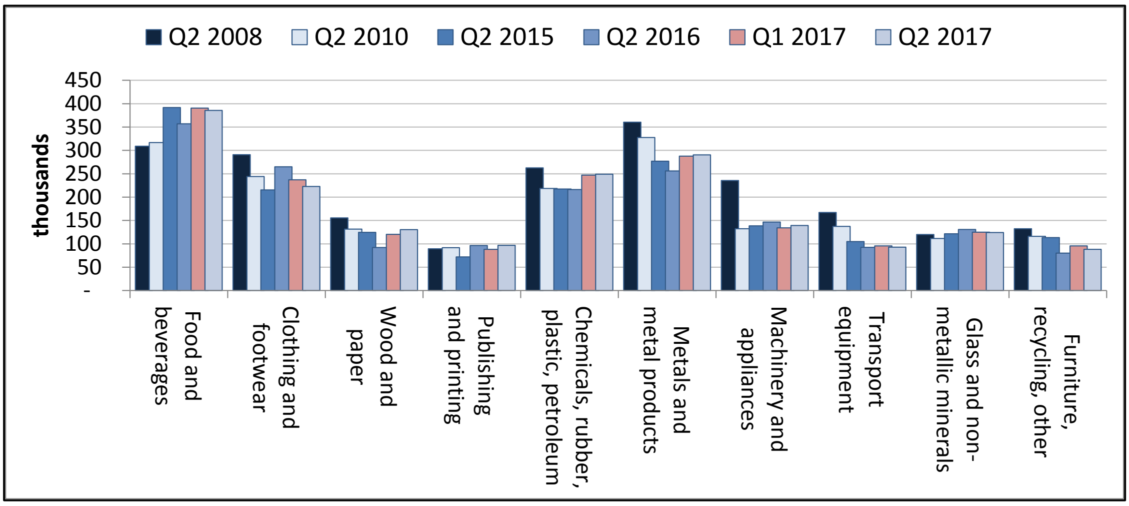


Source: Statistics South Africa. Quarterly Labour Force Survey. Trends from 2008. Excel spreadsheet. Downloaded in August 2017.

The available data suggest that while the bulk of jobs lost in 2008/9 in manufacturing were in heavy industry, especially metals production, employment creation since then has emerged principally in consumer goods, although both metals and chemicals saw renewed growth over the past year. That said, the figures on the change in employment by industry within manufacturing only indicate long-term trends. Because the samples at this level are small and not seasonally adjusted, the quarterly changes are typically not reliable.

Graph 11 indicates that the three fastest growing manufacturing subsectors for job creation in the past quarter alone were wood and paper, printing and publishing, and machinery and appliances. Wood and paper expanded employment by 40% on a year-on-year basis, although it represents only 7% of manufacturing employment and is recovering from a low employment base in 2016. Food and beverages saw a decline in employment over the quarter but has grown 8% on a year-on-year basis. Similarly, metal products and chemicals saw modest growth rates in jobs over the past quarter but grew 13% and 15% respectively over the year. Clothing and footwear and furniture reportedly experienced the most significant job losses during this quarter as well as over the year.

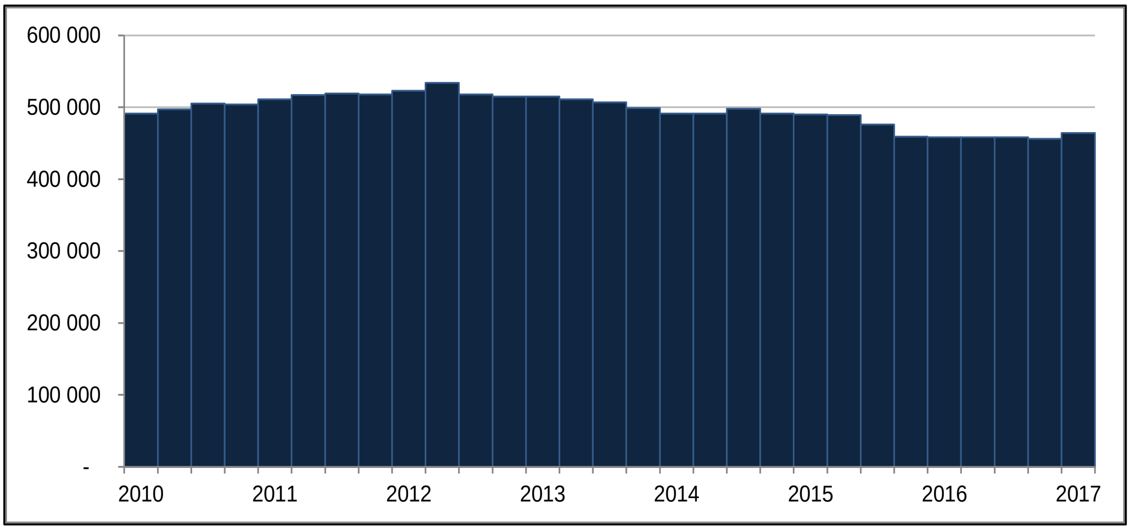
Graph 11: Employment in manufacturing by industry, 2008 to 2017



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. August 2017.

Employment in mining, as reported by the Chamber of Mines, experienced its first increase in jobs since 2014 in the first quarter of 2017, the latest data available (Graph 12). The sector saw growth of 8 000 jobs during the last quarter, equivalent to 2% growth. This is a recovery from the job losses in 2016 but is still some distance from the 70 000 jobs cumulatively lost since 2012.

Graph 12: Employment in mining, 2010 to 2017



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

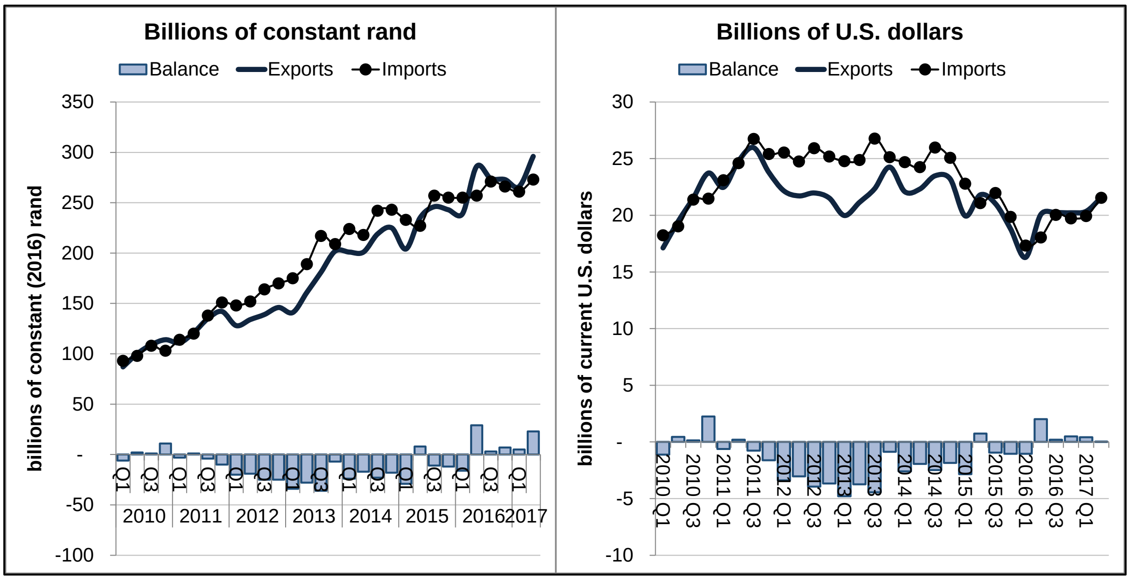
Trade

The second quarter of 2017 saw a strong uptick in exports combined with a moderate increase in imports. The resulting improvement in the balance of trade boosted GDP growth. In the year to the second quarter of 2017, both manufacturing and mining exports increased in dollar terms but manufacturing exports fell slightly in constant rand, mainly due to the 25% appreciation in the rand in real terms from the beginning of 2016. Year-on-year in constant rand, mining exports rose by 9% while manufacturing exports fell by 1%. Agricultural exports also performed well during the quarter, but that partly reflects seasonal factors.

As Graph 13 shows, in constant rand exports rose sharply in the last quarter, mostly due to higher mining prices and the recovery in agriculture, while imports increased more moderately. South Africa has seen a balance of trade surplus for the past five quarters.

The trends in trade since 2010 suggest that the economy has begun gradually to adjust to the new realities of lower metals prices. The strengthening in the rand, linked to higher metals and coal prices plus stronger portfolio inflows over the past year, means that exports have grown faster in dollar terms than in constant rand. (See Briefing Note on page 16, *The exchange rate and the real economy*)

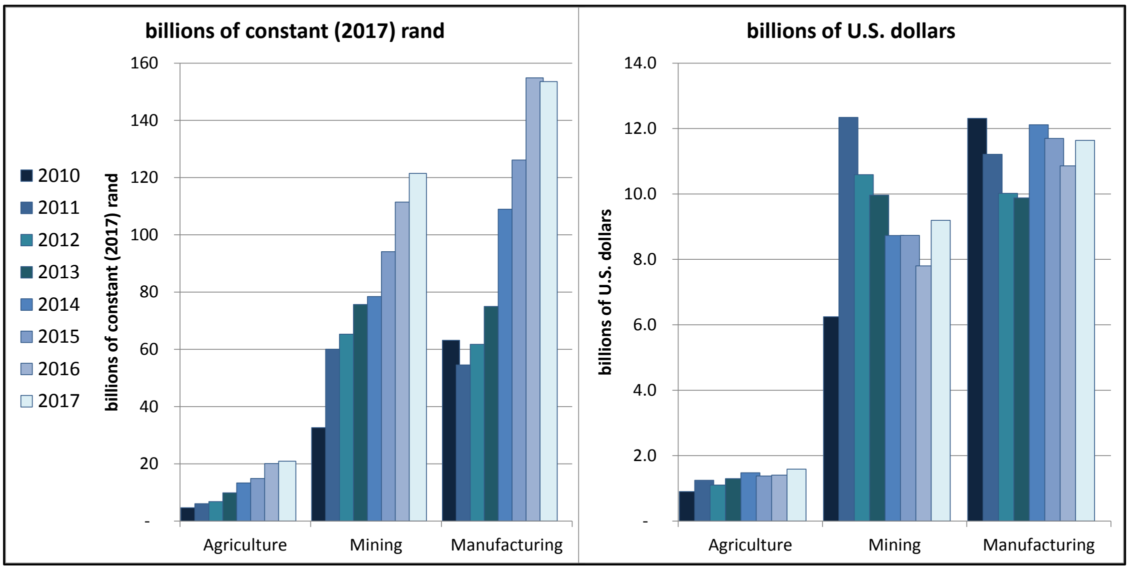
Graph 13: Exports, imports and the balance of trade in constant (2017) rand (a) and current US dollars



Source: Calculated from SARS. Trade Balance Graph for 2010-2017. Excel spreadsheet. Downloaded from www.sars.gov.za in September 2017.

In rand terms, both manufacturing and mining have seen some recovery in exports over the past three years to the second quarter, despite a slight decline in US dollar revenues for manufacturing (Graph 14). Over this quarter, exports gained in both constant rand and dollar terms. Manufacturing exports grew 8% over the last quarter. On a year-on-year basis, however, manufacturing exports declined in constant rand terms (-1%) although they increased in dollar terms (+7%). Agricultural exports in dollar terms progressed by 13% on a year-on-year basis, driven by the end of the drought and bullish food prices. Mining exports increased both compared to the quarter and in year-on-year terms. Mining exports increased by 18% in dollar terms (9% in rand terms) compared to the same period last year.

Graph 14: Exports in billions of constant rand and U.S. dollars, second quarter of each year



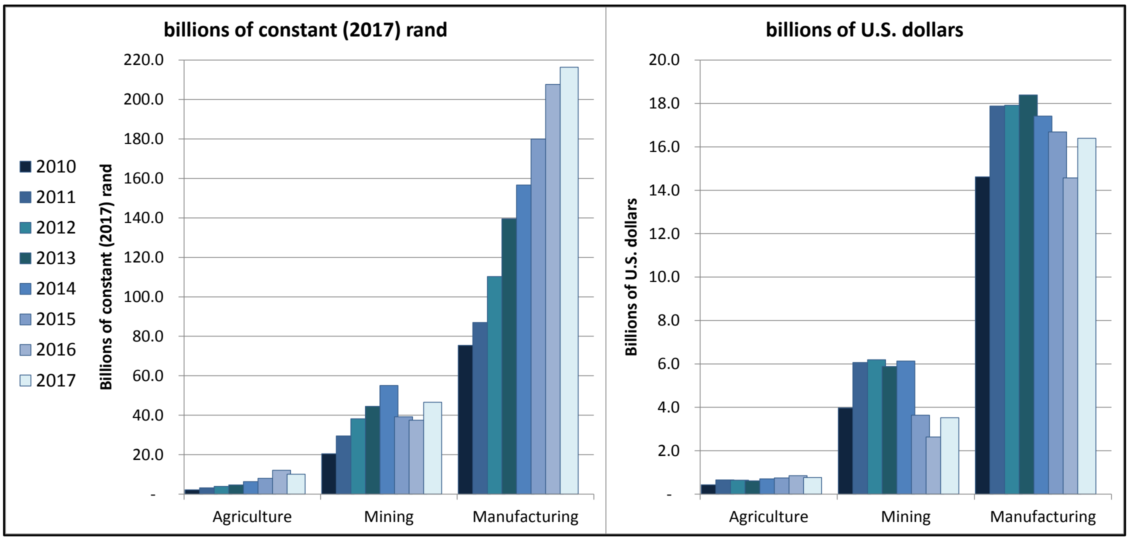
Note: Rand figures deflated with CPI. Source: Calculated form SARS data on monthly exports, downloaded in September 2017.

Manufacturing imports increased by 5% both in constant rand terms and in dollar terms on a quarter-to-quarter basis. Compared to the first quarter in 2016, manufacturing imports rose materially in dollar terms (+13%), while imports decreased in constant rand terms (4%) as shown in Graph 15.

Mining imports, which are mostly petroleum, increased only 2% over the quarter. However, on a year-on-year basis, this corresponds to a sharp increase of 34% in dollar terms and 24% in rand terms, reflecting the recovery in commodity prices over the year.

Agricultural imports decreased about 10% from the previous quarter. In constant rand terms, they fell by 17% compared to agricultural imports in the same quarter of 2016, which translates to a decrease of 10% in dollar terms. Again, this mainly reflects the reduction in maize imports as the drought has ended.

Graph 15: Imports in billions of U.S. dollars and constant rand, second quarter of each year



Note: Rand figures deflated with CPI. Source: Calculated form SARS data on monthly exports, downloaded in September 2017.

Within manufacturing, exports were driven by metals and chemical products, with healthy growth also in wood and wood products, pulp and paper and food and beverages (Table 2). In rand terms, exports of metal and metal products grew just under 10% in the second quarter, up from 5% in the previous quarter in constant rand terms.

The acceleration of exports was even sharper in dollar terms. Metal exports and chemical exports increased by 19%, respectively, from quarter one, clothing and textiles exports grew by 13% and wood and paper product exports grew by 10%. However, dollar imports increased in almost every manufacturing industry, except paper products and publishing, when compared to 2016. Table 2 provides more detail on exports and imports by manufacturing sub sectors.

Table 2. Trade in manufactures to second quarter 2017 in current US dollars and constant (2017) rand

	Value (billions)		% change from Q2 2016		Change in millions	
	USD	Rand	USD	Rand	USD	Rand
Exports						
Food and beverages	1.0	12.7	5.7%	-2.4%	52	-307
Clothing and footwear	0.5	6.0	12.8%	4.5%	52	259
Wood products	0.1	1.8	9.8%	1.5%	12	27
Paper and publishing	0.4	5.3	9.7%	1.5%	36	79
Chemicals, rubber, plastic	1.8	23.7	18.7%	9.7%	282	2 096
Glass and non-metallic mineral products	0.1	1.4	-14.8%	-21.0%	-18	-368
Metals and metal products	2.8	36.8	18.9%	10.0%	443	3 360
Machinery and appliances	1.9	25.4	-3.0%	-10.2%	-60	-2 893
Transport equipment	2.7	36.2	-1.0%	-8.5%	-28	-3 340
Imports						
Food and beverages	0.7	9.8	8.7%	0.9%	60	91
Clothing and footwear	1.0	13.7	9.4%	1.4%	90	184
Wood products	0.1	1.2	9.6%	1.5%	8	18
Paper and publishing	0.3	3.5	-5.4%	-12.5%	-15	-495
Chemicals, rubber, plastic	3.0	39.4	11.7%	3.4%	313	1 313
Glass and non-metallic mineral products	0.2	3.1	0.1%	-7.4%	0	-248
Metals and metal products	1.2	15.4	19.6%	10.8%	191	1 502
Machinery and appliances	5.3	70.2	5.2%	-2.5%	265	-1 768
Transport equipment	4.2	55.0	25.9%	16.4%	857	7 768

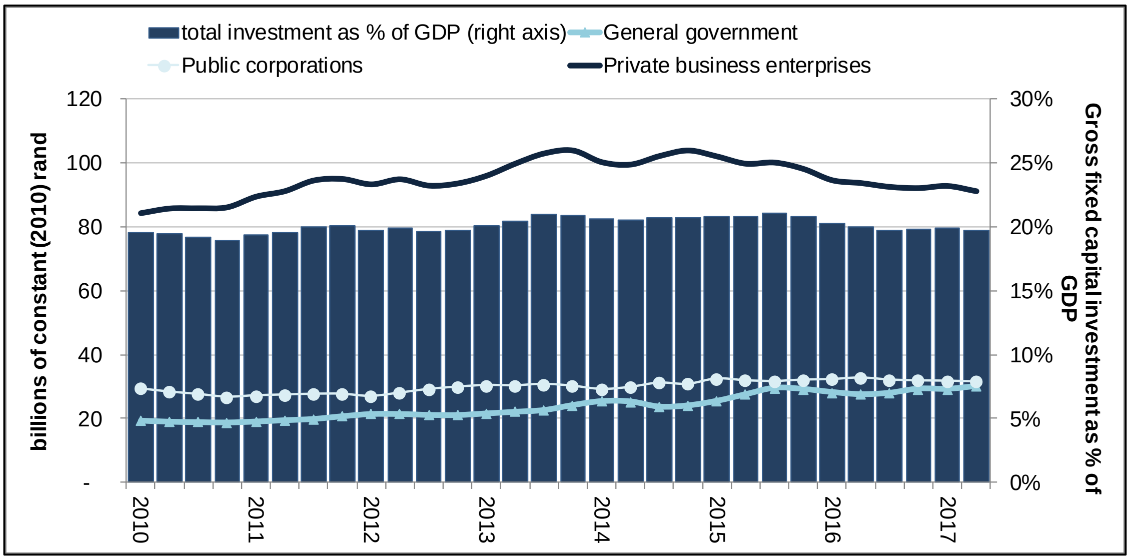
Notes: Deflated with CPI. Source: SARS data on trade.

Investment and profitability

Total investment fell slightly by 1% in the second quarter of 2017, with a fall in both the public and private sectors. The decline of state investment is mainly due to continuing fiscal consolidation. Consistent with investment, the past year saw lower profitability in the real economy, although data are only available through the first quarter of 2017. Construction saw profits fall by three quarters compared to the first quarter of 2016.

Total investment fell by 1% in the second quarter of 2017 (Graph 16). As a result, investment remained at around 20% of GDP in 2016, far from the 2008 peak of 23,5%.

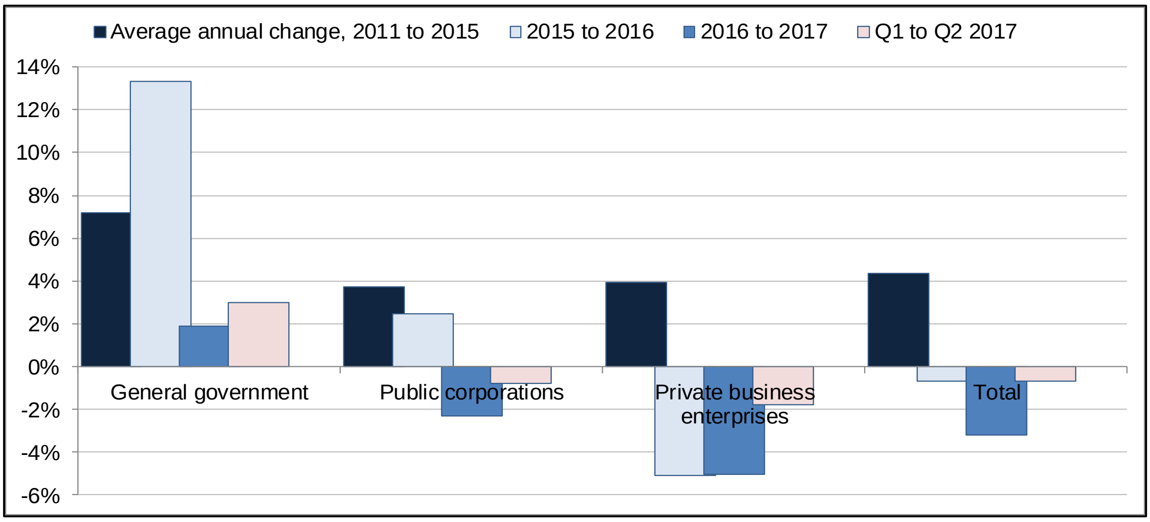
Graph 16. Yearly investment by type of organisation in constant 2010 rand, 2000 to 2017



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

Private sector investment fell 2% in the second quarter of 2017, continuing a downward trajectory from 2015. Government investment increased by 3% this quarter after levelling out in the previous quarter and through 2016, in line with the fiscal consolidation. Investment by state-owned enterprises declined about 1% in the second quarter (Graph 17).

Graph 17. Change in investment by type of investor, 2011 – 2017



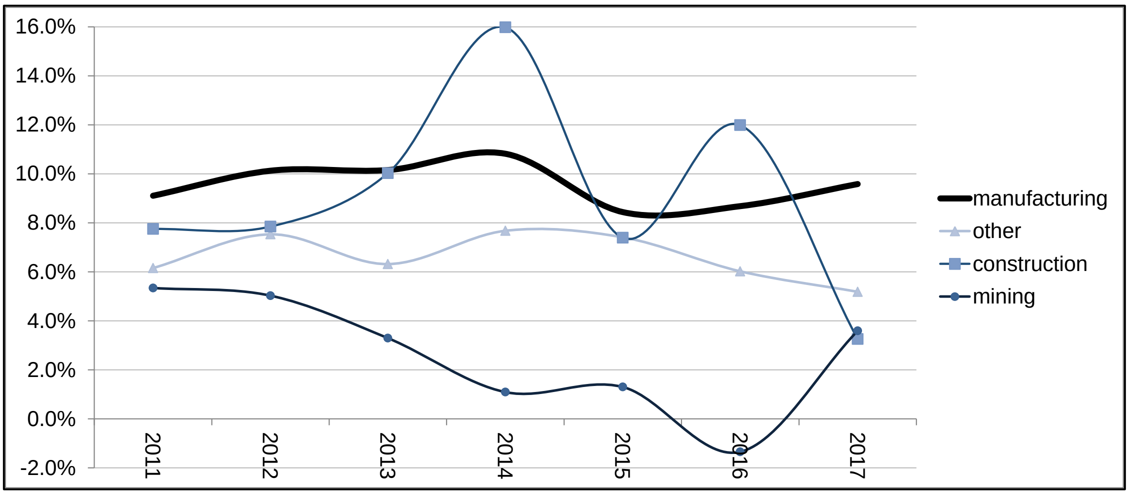
Source: StatsSA GDP quarterly figures. GDPp_Tables_2q_2017. Excel spreadsheet downloaded from www.statssa.gov.za in September 2017

Profitability in the first quarter of 2017[2], calculated as pre-tax profits relative to assets, declined significantly in the real economy (Graph 18). Profits in the manufacturing sector experienced a sharp decline of 26% compared to the previous quarter, dropping from

[2] Profitability is calculated from Statistics South Africa Quarterly Financial Statistics (QFS) which are only available through the first quarter of 2017.

R39 billion to R29 billion. Mining profits also fell. The construction sector saw the fastest decline in profitability, with its pre-tax profits dropping from R22 billion in the first quarter of 2016 to R5 billion in the first quarter of 2017. The rest of the economy saw a modest increase in profits, although remaining well below 2015 levels.

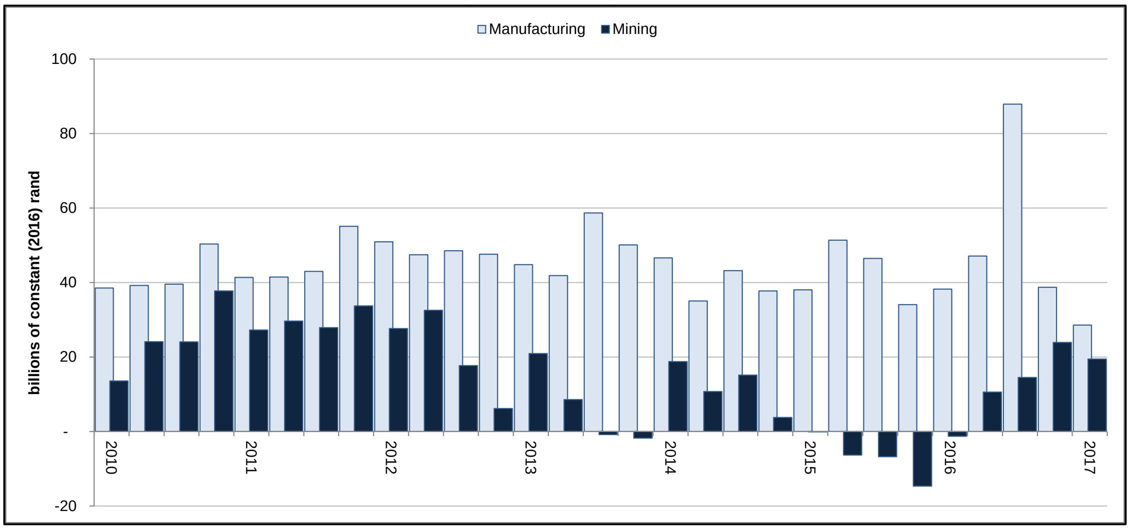
Graph 18. Return on assets (profit before tax as % of asset value) in the fourth quarter, 2011 to 2017, by sector



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

In constant rand, profits in the manufacturing sector fell to lowest levels since before 2010 (Graph 19). The spike in profits in the third quarter of 2016 was an anomaly due to a major merger in the beverages industry. Moderating profitability in the mining sector indicated the fragility of the recovery of the sector despite the previous three consecutive quarters of profitability improvements.

Graph 19. Profits in manufacturing and mining in constant (2016) rand, 2010 to 2017



Note: The unusual spike reported in 2016 quarter three resulted from a major merger in the beverages industry
Source: Statistics South Africa. Quarterly Financial Statistics, relevant years.

Foreign direct investment projects

This section summarises new and updated investment projects identified in the second quarter of 2017.

The TIPS-dti Foreign Direct Investment (FDI) Projects Database uses a media monitoring tool, known as Dexter, to track reporting of new investment projects. Identified projects are then analysed by a TIPS researcher, using both publicly available data and interviews with project representatives, with the resulting profile captured in the database.

Table 3. Summary of new projects from the TIPS-dti FDI Projects Database

	Announced	Construction	Complete
Number of projects	6 projects	1 project	3 projects
Value of projects	R2.169 billion	R0.35 billion	R3 billion
Sectors	Manufacturing: Automotive; Petroleum and Chemicals; Metal manufacturing; Construction and utilities Services: Tourism; Information and Communication Technology	Construction	Manufacturing: Transport Equipment; Utilities
Type of investment	4 Greenfield 2 Expansion	1 Greenfield	3 Greenfield
Companies making investments	KwaZulu Cruise Terminal (KCT) Beijing Automobile Works Co., Ltd. Petredec and Bidvest Tank Terminals Isithebe, KwaZulu-Natal Microsoft South Africa Osho Cement and Heidelberg Cement MM Engineering and Repkon	MM Engineering and Repkon	ABB Lucchini South Africa Enel Green Power RSA

Source: Foreign Direct Investment Projects Database, Report Prepared for the Department of Trade and Industry (the dti): Quarter 2, 2017. July 2017.

In the second quarter of 2017, the database identified 10 projects that were not previously captured by the database. This includes six new FDI projects, one project that began construction, and three projects that were completed.

The largest new investment for the quarter was the R650 million planned construction of a cement crusher at the Coega Special Economic Zone, undertaken by German firm Heidelberg Cement and Osho Ventures, a Dubai-headquartered firm with interests in the mineral resources and industrial sectors including, coal, construction and recycling. The facility will make subsidiary Osha Cement the seventh cement producer in the country when it comes online in 2018.

Coega will also host a gas cylinder production plant developed by South African engineering firm MM Engineering, in partnership with Turkish firm Repkon. The facility is the second investment linked to the Liquefied Petroleum Gas (LPG) industry this quarter, with the announcement of an effort by Bidvest Tank Terminals and Petredec to build an LPG import facility at Richards Bay. The two investments indicate positive sentiment in the potential of the LPG market in South Africa, seen as a viable low-cost heating alternative for consumers and industrial needs.

Two new expansion and upgrading plans indicate a continuation of a trend seen in previous quarters, in which established foreign investors have been deepening their investment. The first is the construction of a second furnace at the Isithebe Foundry. The new investment is by Finland's Metso, and will focus on the R54-million development of castings for heavy crusher wear parts. The improved facility will be able to manufacture wear parts for the Nordberg MP2500 cone crusher as well as for Metso and third-party primary gyratory wear parts using the latest manufacturing technologies. The second is the expansion and upgrading of BAW's taxi plant in Springs. It points to continued confidence from parent company BAIC Group, which made an R11 billion commitment in 2016 to develop a major new automotive plant in East London.

Outside of manufacturing, two other projects are notable. The first is the awarding of preferred bidder status to MSC and empowerment partner Africa Armada for the KwaZulu-Natal Cruise Terminal in Durban. The joint venture will construct the port on a build-operate-transfer basis, with the initial R215 million investment being paid off over a 20-year concession period. The project aims to begin construction in May 2018 and be completed by October 2019, at which point it will be able to host two 300-foot cruise vessels simultaneously.

The second is a commitment by Microsoft to develop data centres in Johannesburg and Cape Town, which will provide cloud computing services to the region. The facilities will serve existing cloud based services such as Microsoft Office 365, and will allow the introduction of the corporate-services platform Microsoft Cloud. Previously, companies in Africa had to rely on Microsoft's European data-centre hubs such as Ireland and the Netherlands. This investment will make Microsoft the first large ITC company to have data centres providing cloud services on the African continent.

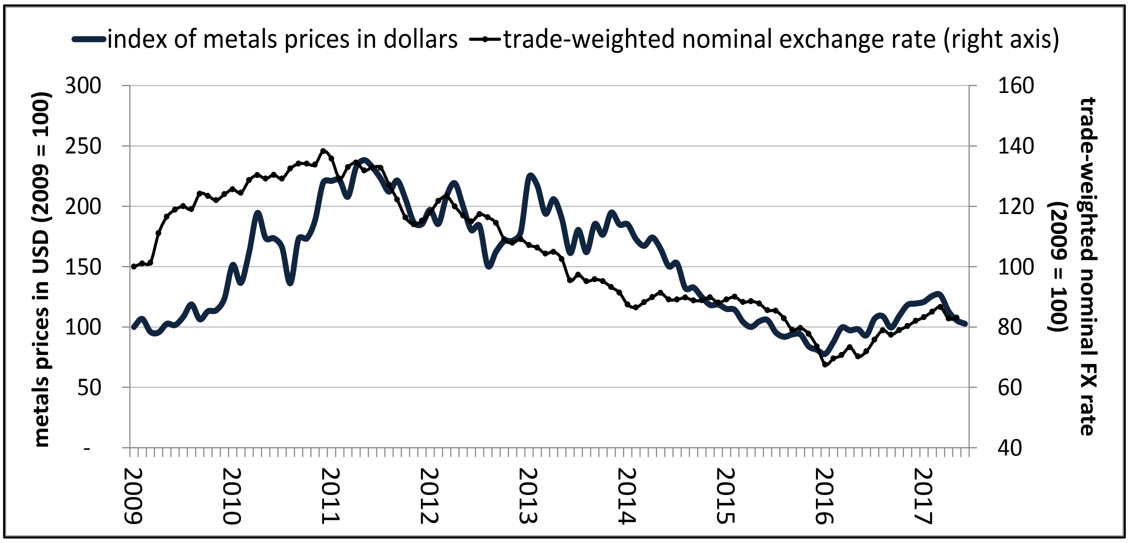
Briefing Note: The exchange rate and the real economy

The appreciation of the rand since early 2016 has mixed impacts on the real economy. On the one hand, it reduces the cost of inputs. On the other, it makes South African products less competitive.

The main factor behind the appreciation of the rand has been the increase in metals and coal prices. As Graph 20 shows, indices of dollar prices for South Africa's main mineral exports – iron ore, coal, platinum and gold – and the trade-weighted nominal exchange rate have been visibly aligned since the global financial crisis. This situation emerges because mining-based products account for over half of South Africa's exports.

The exchange rate is also affected by international capital flows, particularly portfolio inflows into the stock and bond market. The risk is that sustained high levels of short-term investment in South Africa reflect the broader asset bubble that is emerging in international exchanges generally.

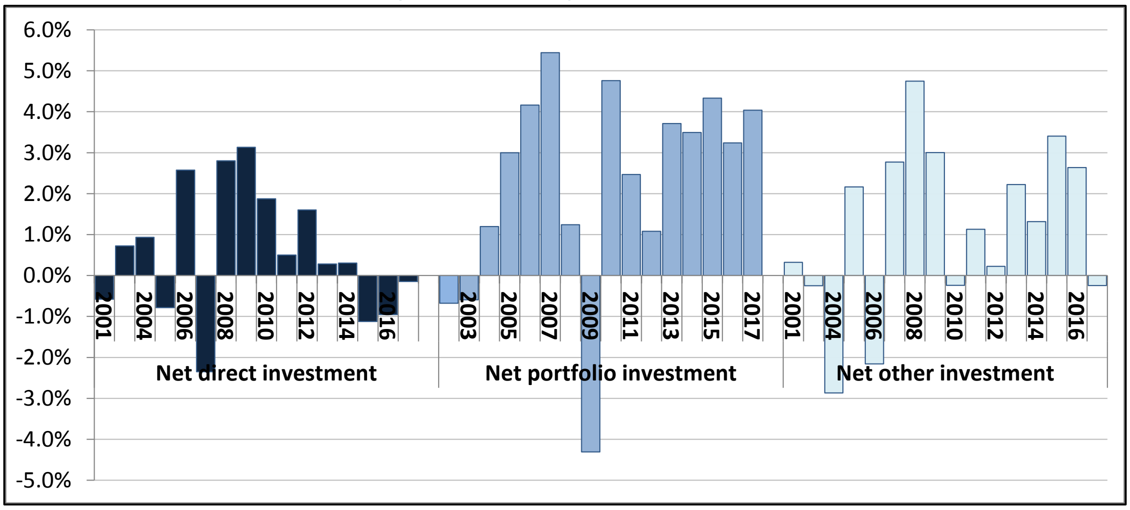
Graph 20. Exchange rates and index of metals prices (2009 = 100)



Source: Calculated from: exchange rate – Reserve Bank; prices of coal and iron ore – IMF; prices of gold and platinum – Kitco.

As Graph 21 shows, foreign direct investment has fallen sharply relative to the GDP, but both portfolio and other investment – mostly loans – have remained robust. Direct investment is generally considered more important for the real economy, since it comes with support for production and marketing. In contrast, portfolio investments typically relate to financial transactions and may aggravate asset bubbles, while higher dependence on foreign debt, included under other investment, entails higher repayments in the future. Moreover, increased institutional ownership of listed companies arguably pushes their management toward a shorter-term profit horizon as they try to sustain high share prices to satisfy financial investors.

Graph 21. Net foreign investment by functional classification as a percentage of GDP, year to first quarter, 2003 to 2017

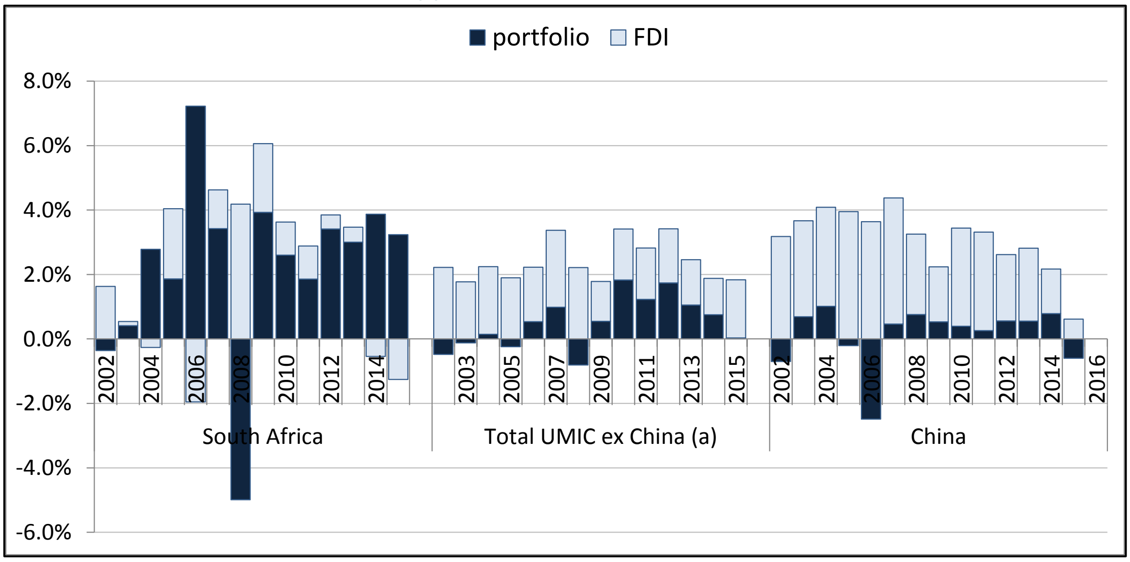


Source: Calculated from Reserve Bank, interactive dataset.

The decline in foreign direct investment reflects increasing investor uncertainty, which can lead investors to substitute short-term, liquid resources for fixed investment, as well as the shedding of assets by the mining companies since the end of the commodity boom in 2012. In the event, the returns on assets across the real economy (see Graph 18 on page 14) remain lower than the normal rates for South African financial holdings.

The recent trends return South Africa to its position as a (relatively minor) financial centre, with significant portfolio flows but only limited direct foreign investment. As Graph 22 shows, relative to GDP South Africa has long had higher short-term capital inflows than other upper-middle-income economies.

Graph 22. Net foreign portfolio and direct flows as percentage of GDP, South Africa and other upper-middle-income economies



Note: (a) Sample consists of 32 countries including South Africa and China. Source: Calculated from World Bank, World Development Indicators. Electronic database. Series on foreign direct investment, portfolio investment and GDP in current U.S. dollars. Downloaded from www.worldbank.org in September 2017.

Briefing note:
IDC results give hope – should it be better resourced?

Over the past quarter the Industrial Development Corporation (IDC) released its annual results for the 2016/7 financial year. It posted strong results, and its focus on finance for the industrial sector of the economy, black industrialists and job creation ensures that it plays an important and transformative role in the economy. The IDC, as the largest Development Finance Institution (DFI) in South Africa, is playing a counter-cyclical role during this period of slow growth in South Africa. Its lending has more than doubled in real terms over the past decade. Still, relative to the GDP it remains far smaller than its peers in similar economies, which points to the scope for growth.

Key results include:

- The IDC approved transactions of R15,3 billion.

- It dispersed R11 billion to businesses.
- It expected to create (or save) over 20 000 jobs as a result of this finance, based on previous tracking of the impact of its lending to particular sectors.
- Of the R15,3 billion approved, R7,7 billion was for manufacturing operations.
- Of the R15,3 billion approved, R4,7 was for black-owned manufacturing firms/black industrialists.
- The IDC generated a surplus of R2,2 billion, which will contribute to its sustainability and be used for financing in future years.
- Its assets grew by 7% over the year, to reach a total value of R129,8 billion.

These are good results that make a significant impact on the South African economy with the IDC approvals equal to 1% of South Africa's GDP. This contribution has grown steadily since the mid-2000s, growing from about 0,2% of GDP to 1% today. Given the current period of low growth, this level of this contribution can make the difference between recession and growth. It provides a stimulus in a key sector of the economy – manufacturing – and contributes to employment creation.

How does the IDC compare to DFIs of other countries? The ratio of lending by these institutions to GDP provides a better indicator as a comparator than a dollar (or converted rand) amount, as the economies have significantly different scales. For developed countries that have a history of strong DFIs such as Germany and Japan it is 14% and 3% respectively. For BNDES, the Brazilian DFI, it is 11%; the China Development Bank is 12%; and South Korea's Korean Development Bank (KDB) is 16%.

Compared to the lending of the South African banking sector, the IDC is also a small player. But while the IDC has increased its lending, there has recently been a slowdown in credit extension by the South African banks. Credit extension has declined from 8,37% growth in April 2017 to 7,81% in July 2017. In a recent article in Business Report, FirstRand Chief Executive Officer Johan Burger stated that "Credit extension is going to be low for the next two to three years, unless we see some real recovery in economic growth," and that all four of the major South African banks having slowed lending since 2015.[3]

In sum, the IDC is making a significant contribution to a countercyclical response to the downturn and to strengthening industrialisation. In this context, new options should be explored to significantly increase its resourcing.

[3]Renee Bonorchis. *South African bank lending seen flat lining as economy stutters*. Business Report. 7 September 2017. Renee Bonorchis. *South African banks are reining in loans*. Bloomberg. 7 September 2017.

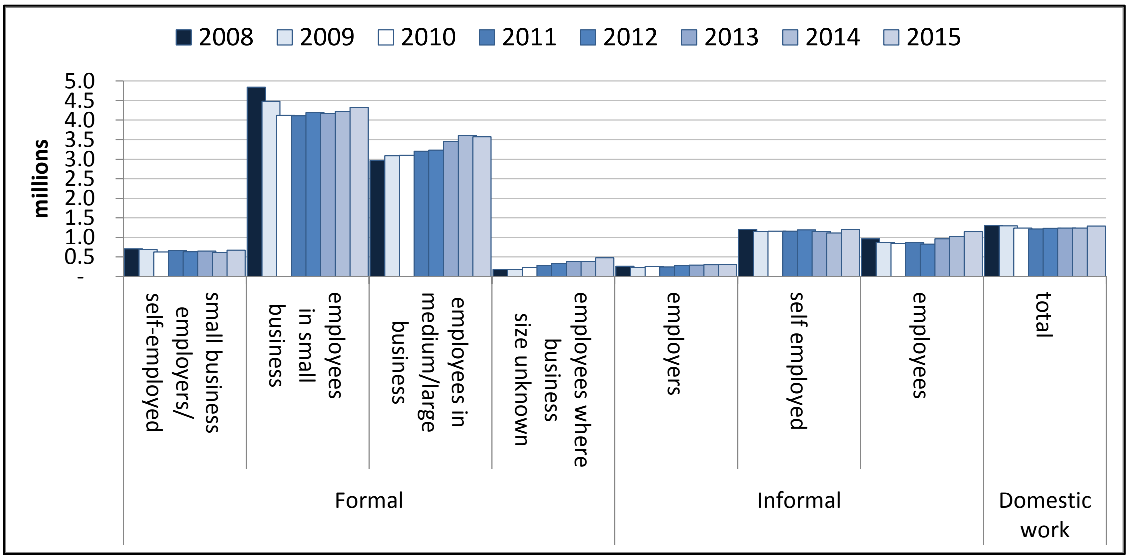
The Real Economy Bulletin Special Edition: The state of small business in South Africa 2017 – Executive summary

The state of small business in South Africa is a special edition of The Real Economy Bulletin. It reviews the state of small business in South Africa and its evolution over the past decade. It then summarises the findings from two TIPS studies into policy related to small business: proposals around how it should be defined in legislation, which in turn affects who benefits from state support; and a review of regulatory obstacles and burdens that arise from national legislation.

Small business is often seen as a key potential driver of job creation, equality and innovation in South Africa. In manufacturing, small business accounts for a fifth of employment, although only a tenth of revenues. Yet the number of small formal businesses declined from 2008 to 2015, and South Africa continues to have low levels of small business compared to other middle-income economies.

As Graph 23 shows, from 2008 to 2015 small business was the largest source of employment in South Africa. In 2015, there were 670 000 small formal business owners who employed a total of 4,3 million people. In contrast, large companies (with 50 or more employees each) employed 3,6 million people. In addition, a total of 1,5 million people worked in the informal sector, of whom 1,2 million were self-employed, 300 000 were employers, and 1,1 million were employees.

Graph 23. Private employment by sector and size of enterprise, 2008 to 2015

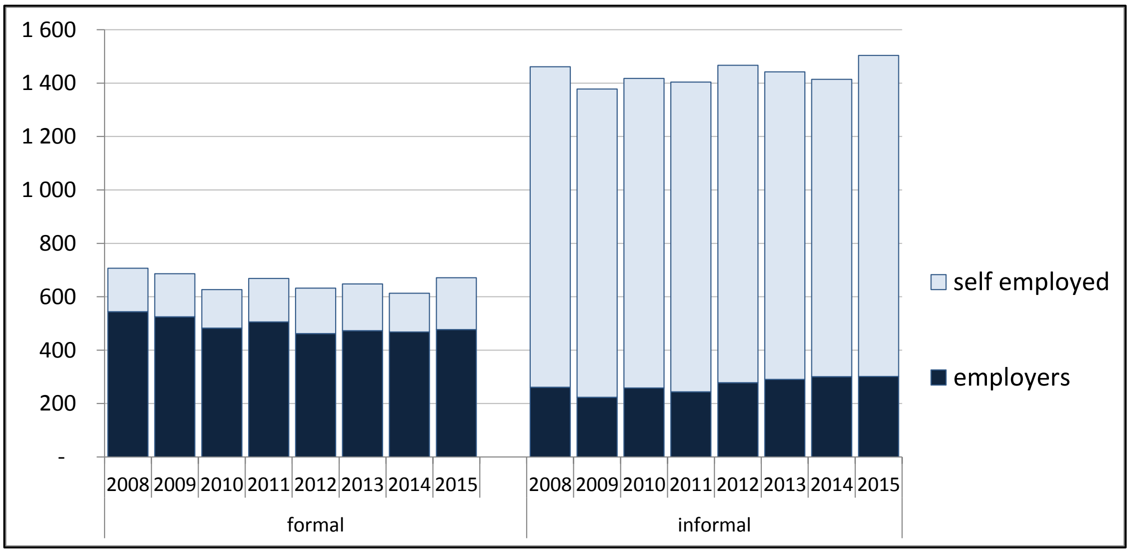


Source: Calculated from Statistics South Africa. Labour Market Dynamics electronic databases for relevant years. Series on main work, type of work, and number of employees. Downloaded from Nesstar facility at www.statssa.gov.za.

But the number of jobs in small formal business declined from 2008 to 2015. Small business accounted for virtually all the positions lost by the private formal sector in the global financial crisis, with its employment falling 14%. Then, from 2010 to 2015, employment by small formal businesses grew less rapidly than larger employers in every year except in 2015. The number of workers and employers who said they worked in small business increased by a total of 7% from 2010 to 2015, while those who said they worked in medium and large companies climbed by 15%. For comparison, the working-age population rose by 9% in this period.

The number of small formal businesses followed the employment trend, with a fall from 710 000 in 2008 to 630 000 in 2010, and then a slow recovery to reach 670 000 in 2015. The number of informal businesses has remained virtually unchanged over the period (Graph 24).

Graph 24. The number of formal and other small and micro businesses, 2008 to 2015 (a)



Note: (a) Self-employed here means small businesses with no waged employees. Source: Calculated from Statistics South Africa. Labour Market Dynamics databases for relevant years. Series on number of employees, main work and sector. Downloaded from Nesstar facility at www.statssa.gov.za in relevant years.

Download the full edition: The state of small business in South Africa. (Available online from 22 September 2017.)