THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

THIRD 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.*

CONTENTS

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GDP growth

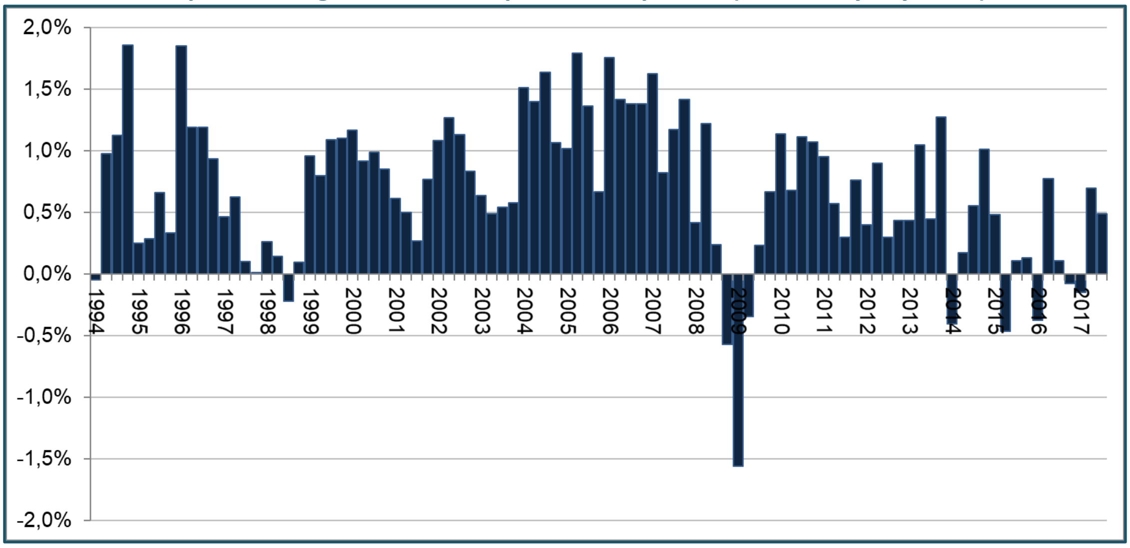
The past six months have seen the GDP recover from the contraction that marked the previous six months. Still, growth remains more variable, and generally slower, than it was before 2014. Increased variability in the GDP results in part from the end of the commodity boom and in part from fluctuations in agriculture as a result of the 2015 drought. While mining and manufacturing have seen fairly stable growth, construction slowed markedly in the year to September 2017. Private investment has continued to fall, and was a significant drag on GDP growth in this period.

South Africa's GDP grew by 0,5% in the third quarter of 2017, equal to around 2% in annualised terms. It continued the rebound from the contraction in the last quarter of 2016 and the first quarter of 2017. It is, however, too soon to say if this growth represents an end to the erratic growth pattern of the past two years (see Graph 1).

Quarterly GDP growth excluding agriculture was 0,26% (not annualised) compared to 0,49% with agriculture's contribution included. In effect, the drought aggravated the downturns in the past two years, while the recovery from it has boosted growth in the past six months (see Graph 2).

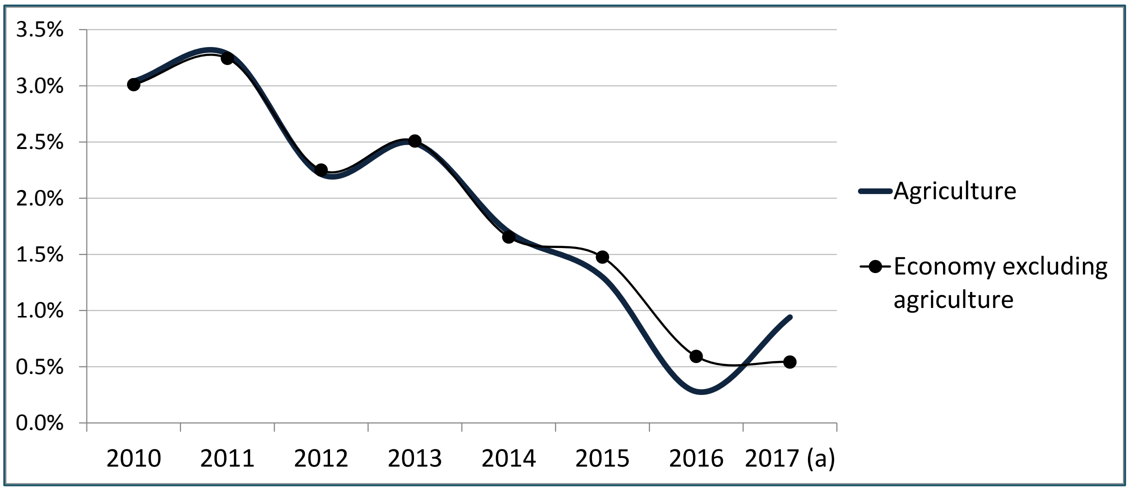
*Available at www.tips.org.za/the-real-economy-bulletin

Graph 1. Change in the GDP, quarter on quarter (seasonally adjusted)



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

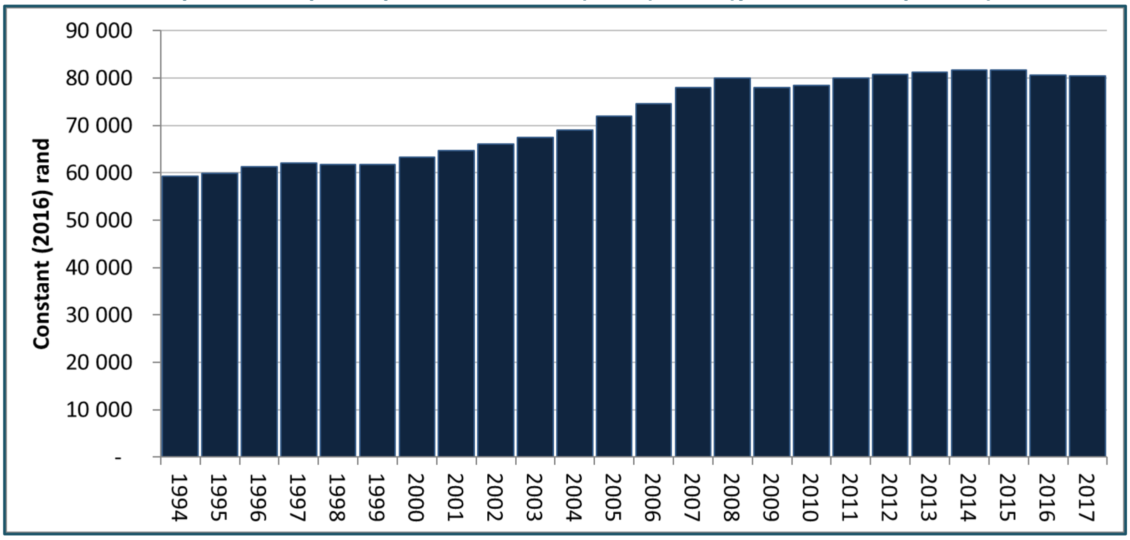
Graph 2. Growth in agriculture and in the rest of the GDP, year to third quarter



Note: (a) Year to third quarter (other years are calendar years). Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in December 2017.

GDP per capita continued to decrease in real terms, down 0,15% from 2016 to R80 420 per person (see Graph 3).

Graph 3. GDP per capita in constant (2017) rand (year to third quarter)

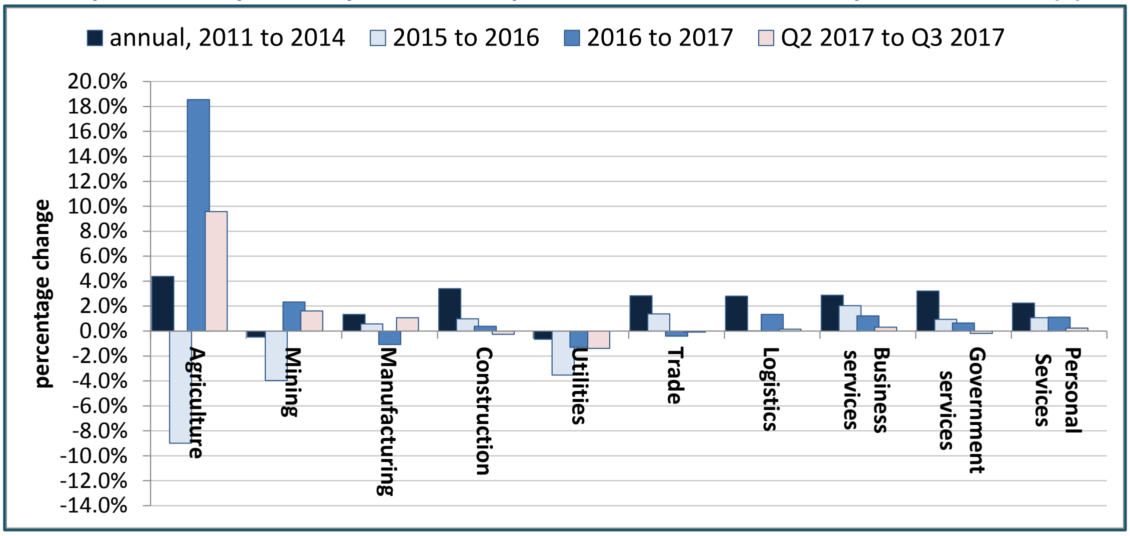


Source: For the GDP, StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in December 2017. For population, World Bank except for 2017, which uses StatsSA mid-year population estimates.

In terms of sectoral contributions to GDP growth, the rebound from the drought has spurred agricultural production. Growth was relatively slow in the mining and manufacturing sectors. Still, manufacturing has recovered in seasonally adjusted terms over the past two quarters, after declining for the three quarters before that (see Graph 4).

In contrast to the rest of the economy, construction saw a further decline in the third quarter of 2017. That marked the third quarter in a row that it has shrunk, in the first decline since the World Cup building programme ended in 2010. We analyse these trends in more detail in the *Briefing Note: Slowdown in the construction industry* (see page 15).

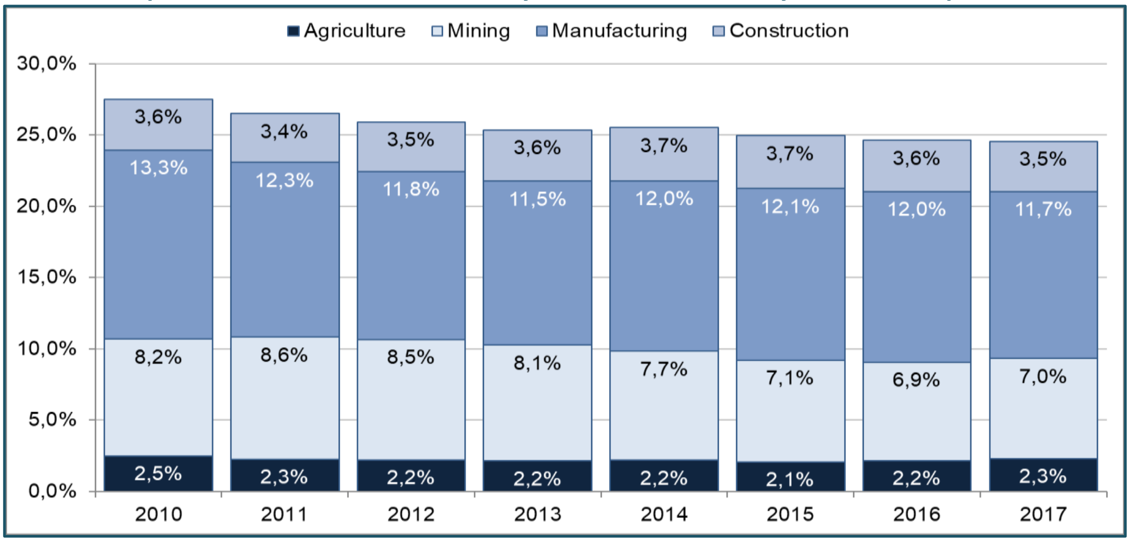
Graph 4. GDP by sector, year to third quarter and second to third quarter for 2017 (a)



Note: (a) Figures for second to third quarter 2017 are seasonally adjusted. Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in December 2017.

The share of the real economy in economic activity decreased again, with construction and manufacturing seeing their contributions to the GDP falling to near their lowest levels in five years. The manufacturing sector dropped from 13,3% of the GDP in 2010 to 11,7% in 2017 (see Graph 5).

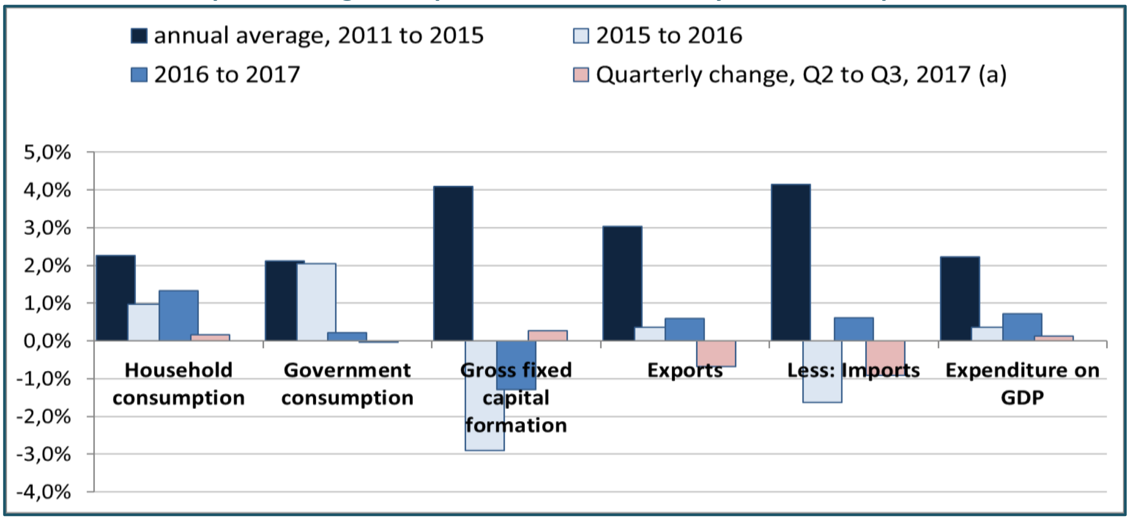
Graph 5. Share of the real economy sectors in the GDP, year to third quarter



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

On the expenditure side, in the year to the third quarter of 2017, the 1,3% decline in investment was the main drag on growth. Government spending grew at just 0,2%, in sharp contrast to earlier years. It accounted for just 6% of the growth in GDP, compared to over 20% in the previous five years. In these circumstances, household consumption, which climbed by 1,3% in the year to the third quarter of 2017, became the leading driver of growth. It was followed by trade (see Graph 6).

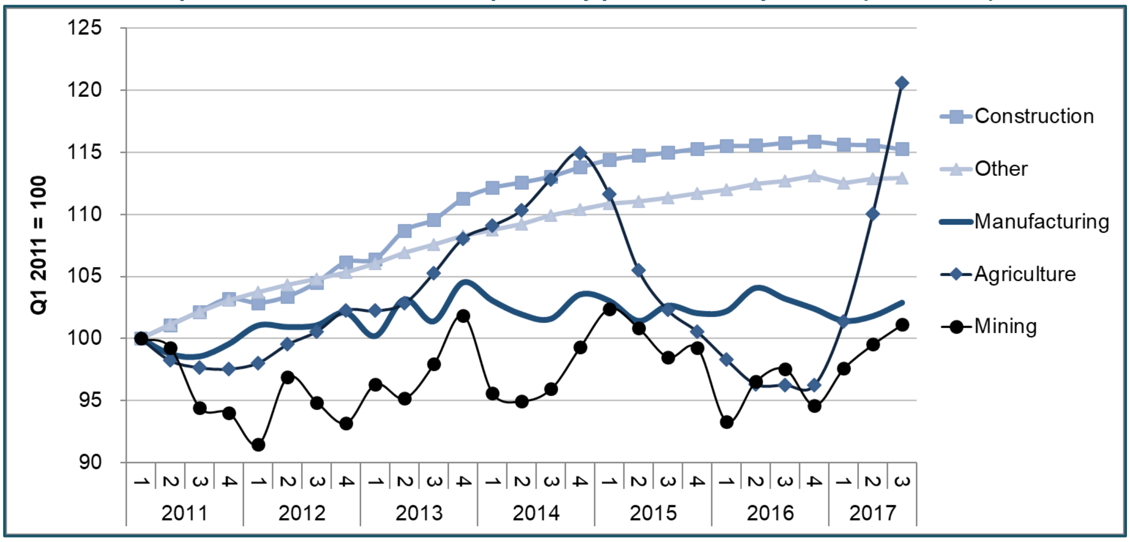
Graph 6. Change in expenditure on the GDP, year to third quarter



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

In sectoral terms, the drought and the recovery from it accounted for much of the change in GDP over the past few years. In the past nine months, production in agriculture climbed sharply, surpassing its peak in 2014 before the drought. In volume terms, mining production is slowly inching towards levels last experienced towards the end of 2014, although the value of production and exports remains far below their heights during the commodity price boom that ended in 2011/12. The recovery in manufacturing continued, but continues the essentially flat trend seen since 2013. Construction has now contracted for three quarters (see Graph 7).

Graph 7. Index of volume of quarterly production by sector (2011=100)

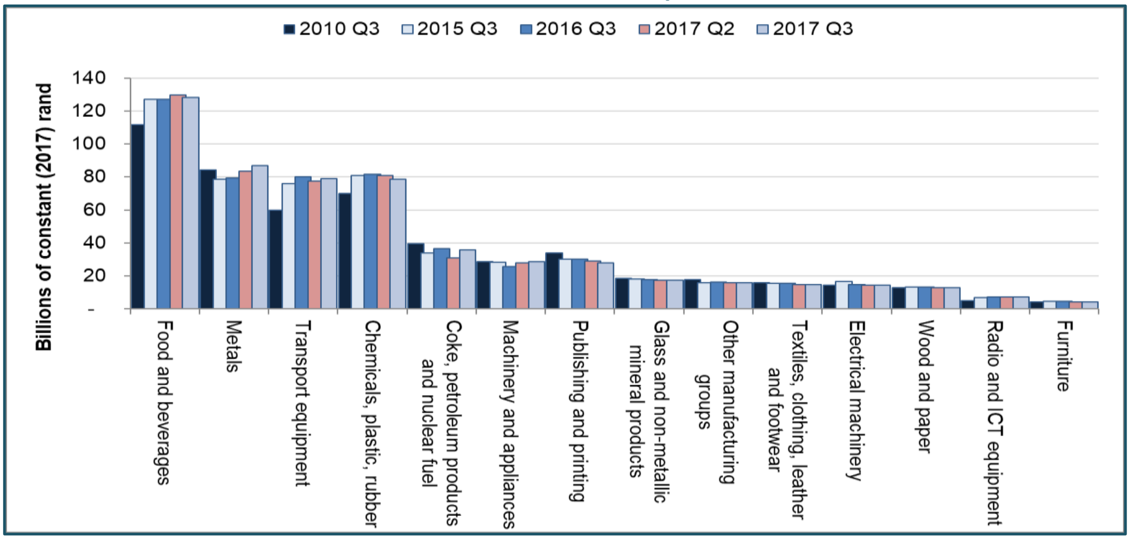


Source: StatsSA GDP quarterly figures. GDPp_Tables_2q_2017. Excel spreadsheet downloaded from www.statssa.gov.za in December 2017.

Manufacturing sales were up by a modest 1% to R552 billion from the second quarter of 2017. This is virtually no change from the same period in 2016. The metals and machinery industries are the only sectors with sales higher than at this point last year, with sales up 9% and 11% respectively. The food and beverages sector achieved marginal growth in sales of 1% from Q3 2016, but quarter-on-quarter agro-processing sales were down 1% to R128 billion from R130 billion.

In the main, heavy industries – metals, transport equipment, petroleum and basic chemicals, and machinery – saw the only significant growth in the past quarter. Their sales climbed by 4% in metals, 2% for transport equipment and for machinery, and 16% for petroleum and basic chemicals. Sales were lower in other chemicals and plastic products; wood and paper; ICT; and publishing. They were stagnant in the glass, textiles, electrical machinery and furniture industries (see Graph 8).

Graph 8. Manufacturing sales in constant (2017) rand, third quarter 2010, 2015, 2016 and 2017, and second quarter 2017



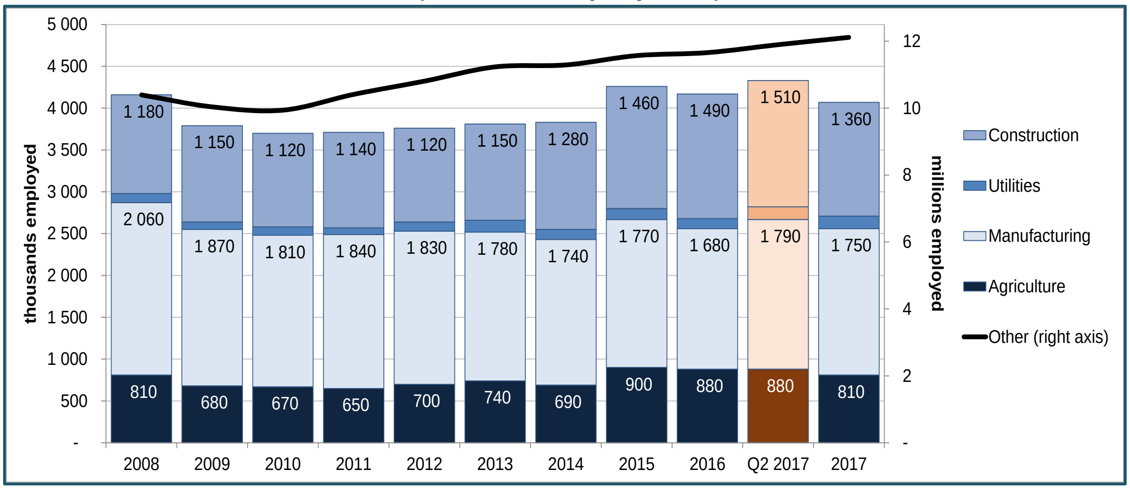
Source: StatsSA. Manufacturing volume and sales from 1998. Excel spreadsheet downloaded in November 2017.

Employment

While total employment climbed in the third quarter of 2017, in figures that are not seasonally adjusted, employment in the real economy fell. The main factor behind job losses in the real economy was a sharp fall in construction employment, followed by manufacturing. In contrast, mining employment appears to have stabilised after significant job losses from the end of the commodity boom in 2011/12.

From the second to the third quarter of 2017, employment in the real economy decreased by 2,4% (or 100 000 jobs), falling from 4,17 million to 4,07 million. Jobs in the real economy are now down from a 2015 peak of 4,25 million (see Graph 9).

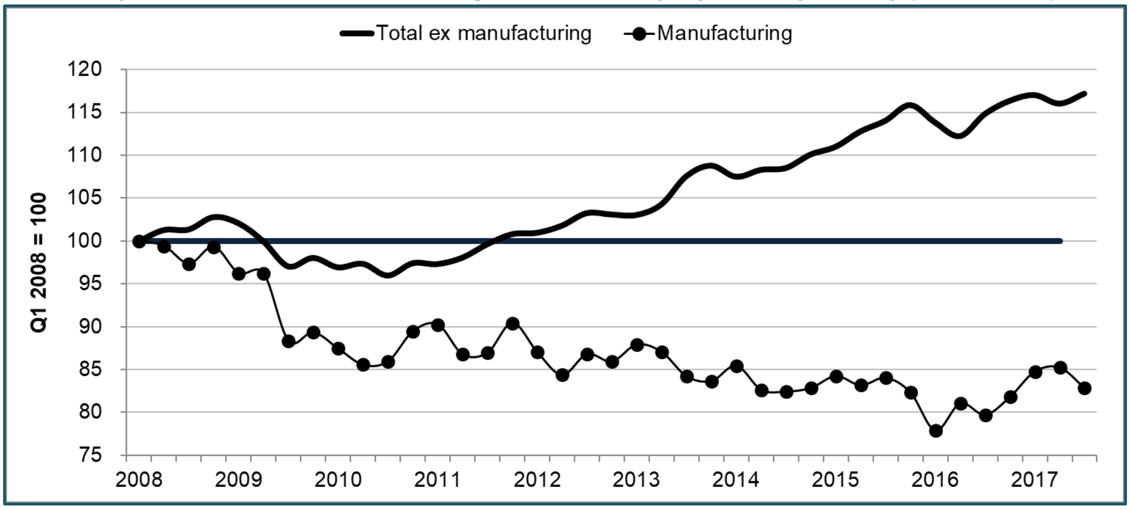
Graph 9. Employment by sector, third quarter, and in second quarter 2017 (not seasonally adjusted)



Source: StatsSA. QLFS trends 2008 - 2017 Q1. Downloaded from www.statssa.gov.za in November 2017.

Manufacturing employment has recovered from a low point in 2016. In the third quarter of 2017, there were 70 000 more manufacturing jobs than a year earlier (see Graph 10).

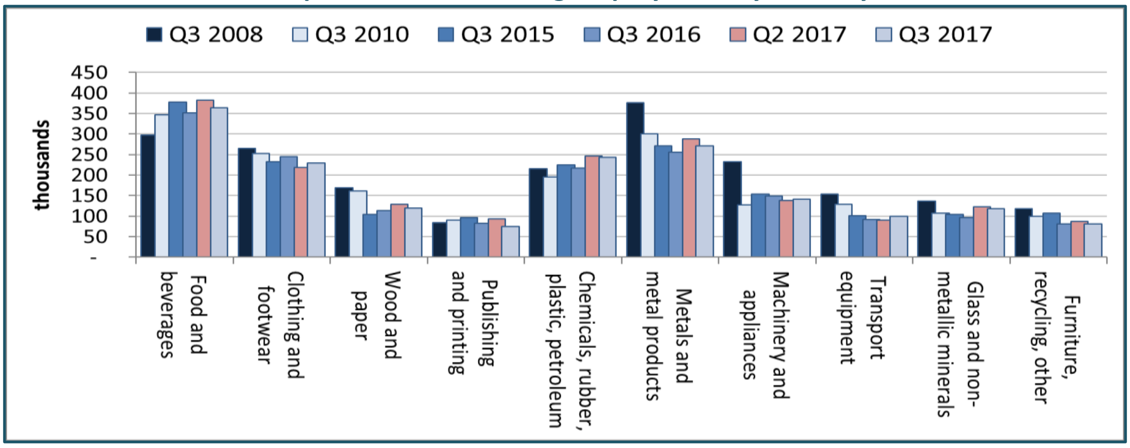
Graph 10. Index of manufacturing and other employment, quarterly (2008 = 100)



Source: StatsSA. QLFS trends 2008-2017 Q1. Excel spreadsheet downloaded from www.statssa.gov.za in November 2017.

Most of the jobs growth in the year to the third quarter 2017 came primarily from chemicals and non-metallic minerals, followed by metals and food and beverages. In contrast, clothing and textiles reported job losses, continuing the trend from 2008 (see Graph 11).

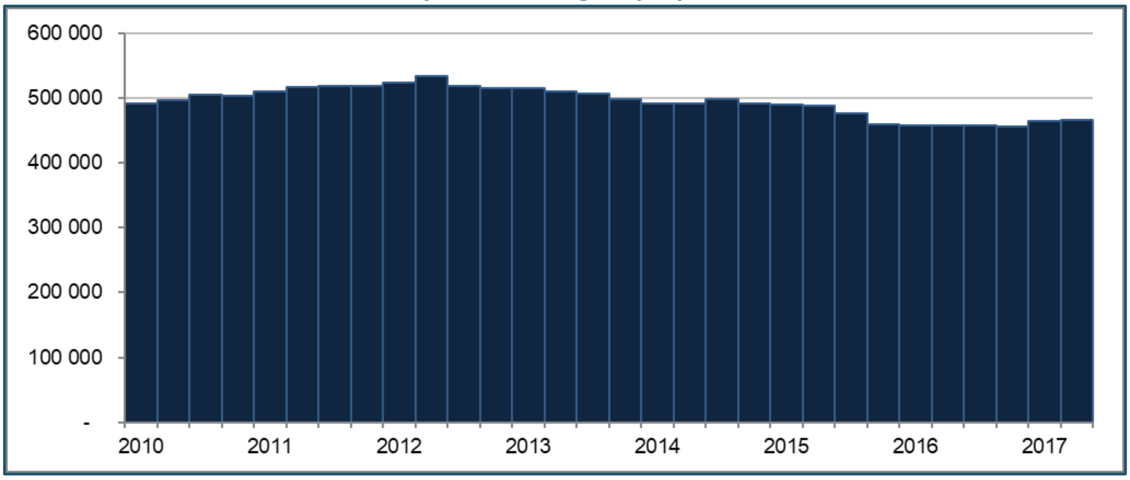
Graph 11. Manufacturing employment by industry



Source: StatsSA. QLFS July - Sep. Electronic database. Downloaded from www.statssa.gov.za in November 2017.

The mining sector improved employment creation following a modest rebound in key resource prices. After stagnant employment in 2016, the mining sector saw 11 000 net new jobs created in the first two quarters of 2017. While 8 000 jobs were created in the first quarter, the second quarter saw an increase of 3 000 new mining jobs, bringing mining employment up to 467 000 (see Graph 12).

Graph 12. Mining Employment



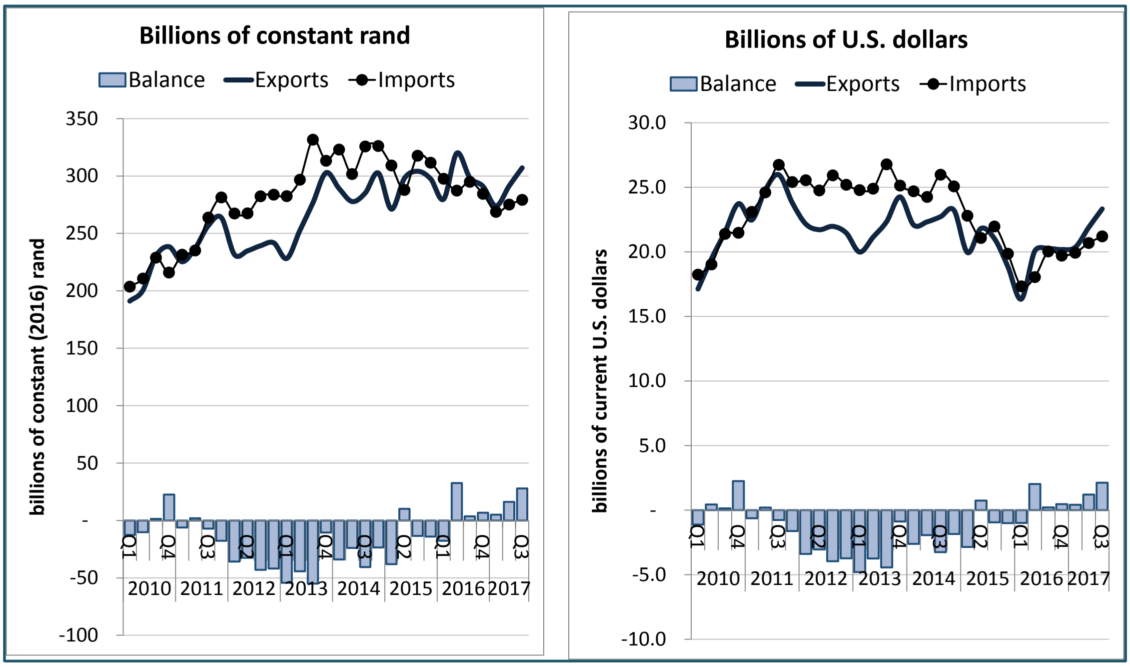
Source: StatsSA. Quarterly Employment Statistics. November 2017.

International Trade

In dollar terms, exports have recovered rapidly over the past two quarters, mostly due to a sharp uptick in mining exports. Imports also increased, but at a slower rate, over this period. Manufacturing exports, however, declined from the third quarter of 2016 to the third quarter of 2017.

Total international trade continued an upward trajectory in both dollar and rand terms, with a rising balance of trade surplus (see Graph 13).

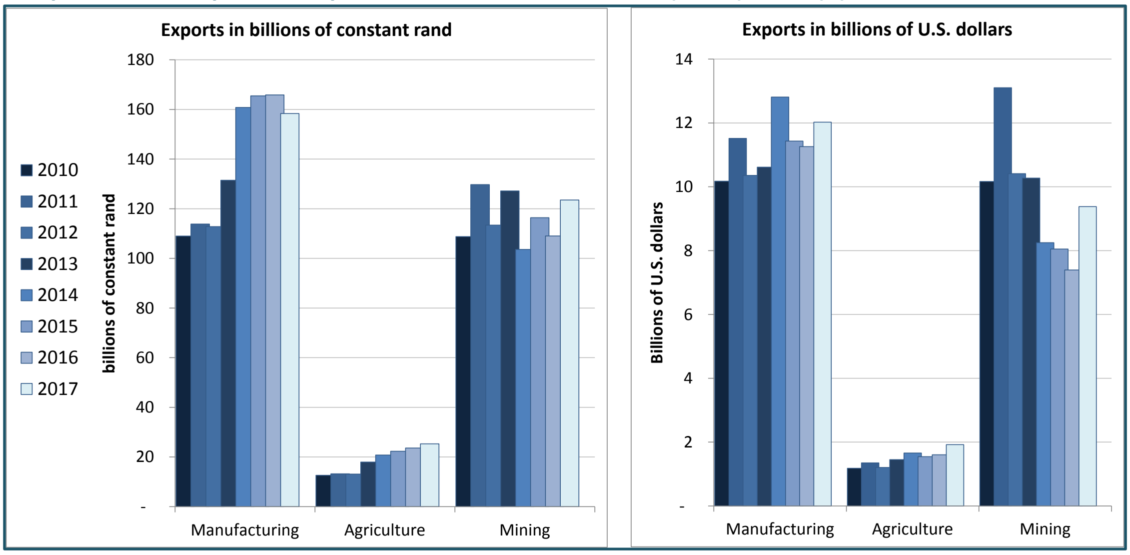
Graph 13. Exports, imports and balance of trade in constant (2017) rand (a) and current US dollars



Note: (a) Deflated with CPI rebased to third quarter 2017. Source: SARS monthly trade data.

Mining exports increased significantly from the third quarter of 2016, growing by 20% in rand terms, reflecting an increase in output – especially for precious metals – as well as a moderate improvement in prices. Manufactured exports declined in rand terms despite an uptick in dollars, reflecting the volatility of the currency. Still, they remain far stronger than five years ago, largely because competitiveness improved with the depreciation of the rand after the metals price boom ended in 2011/12.

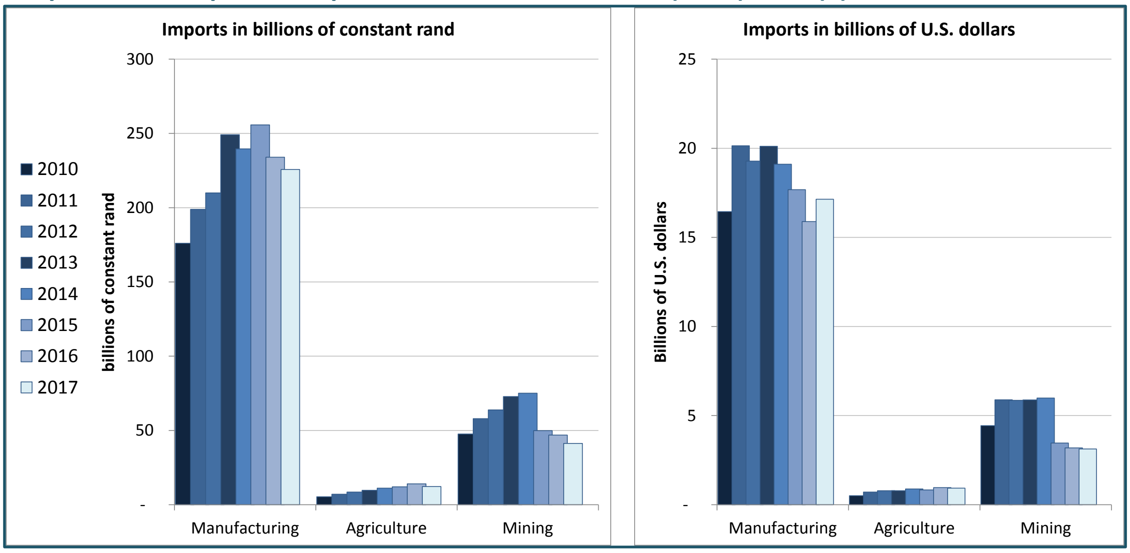
Graph 14. Third quarter exports in billions of constant (2017) rand (a) and current US dollars



Note: (a) Deflated with CPI rebased to third quarter 2017. Source: SARS monthly trade data.

Despite the increase in imports over the past three quarters, in mining and manufacturing they remain substantially lower than they were in 2015. The fall was sharper in US dollars due to depreciation since 2011/12 (see Graph 15).

Graph 15. Third quarter imports in billions of constant (2017) rand (a) and current US dollars



Note: (a) Deflated with CPI rebased to third quarter 2017. Source: SARS monthly trade data.

In manufacturing, the largest export industries are auto, metals, machinery and chemicals. In constant (2017) rand terms:

- Exports of cars dropped by R3,6 billion, or 8,5%, compared to the third quarter of 2016, while machinery dropped 10,4% or 3,1 billion.
- Exports of metal products climbed by R0,9 billion, or 2,7%, and chemicals rose R0,2 billion, or 0,8%.

Imports are dominated by machinery, transport equipment and chemicals. In the year from the third quarter of 2016, machinery imports fell 6,4%, or almost R5 billion in constant (2017) rand, reflecting the fall in investment. Transport equipment imports climbed R1,4 billion or 2,7%. Imports of chemical products dropped R0,7 billion or 1,6% in the same period.

Table 1. Trade by manufacturing subsectors

	Value (billions)		% change from Q3 2017		Change in billions	
	USD	Rand (a)	USD	Rand (a)	USD	Rand (a)
Exports						
Food, beverages, tobacco	1.1	14.3	9.2%	-2.4%	0.09	-0.35
Textiles, clothing, leather and footwear	0.5	6.1	16.9%	4.6%	0.07	0.27
Wood and wood products	0.2	2.1	31.3%	17.5%	0.04	0.31
Paper and publishing	0.4	5.5	-7.8%	-17.2%	-0.04	-1.14
Chemicals, rubber, plastic	1.9	24.5	12.8%	0.8%	0.21	0.20
Glass and non-metallic mineral products	0.1	1.6	4.9%	-6.2%	0.01	-0.10
Metal products	2.6	34.6	14.9%	2.7%	0.34	0.90
Machinery and appliances	2.0	26.9	0.2%	-10.4%	0.00	-3.13
Motor vehicles, parts and accessories and other transport equipment	3.0	38.8	2.5%	-8.5%	0.07	-3.60
Imports						
Food and beverages	0.9	12.4	12.9%	0.9%	0.11	0.12
Clothing and footwear	1.2	15.9	3.7%	-7.3%	0.04	-1.24
Wood products	0.1	1.3	3.0%	-7.8%	0.00	-0.11
Paper and publishing	0.3	4.0	-6.9%	-16.7%	-0.02	-0.81
Chemicals, rubber, plastic	3.3	43.7	10.0%	-1.6%	0.30	-0.70
Glass and non-metallic mineral products	0.3	3.4	2.7%	-8.2%	0.01	-0.30
Metals and metal products	1.1	14.6	5.1%	-6.1%	0.05	-0.96
Machinery and appliances	5.4	71.7	4.7%	-6.4%	0.24	-4.91
Transport equipment	4.0	53.2	14.9%	2.7%	0.52	1.39

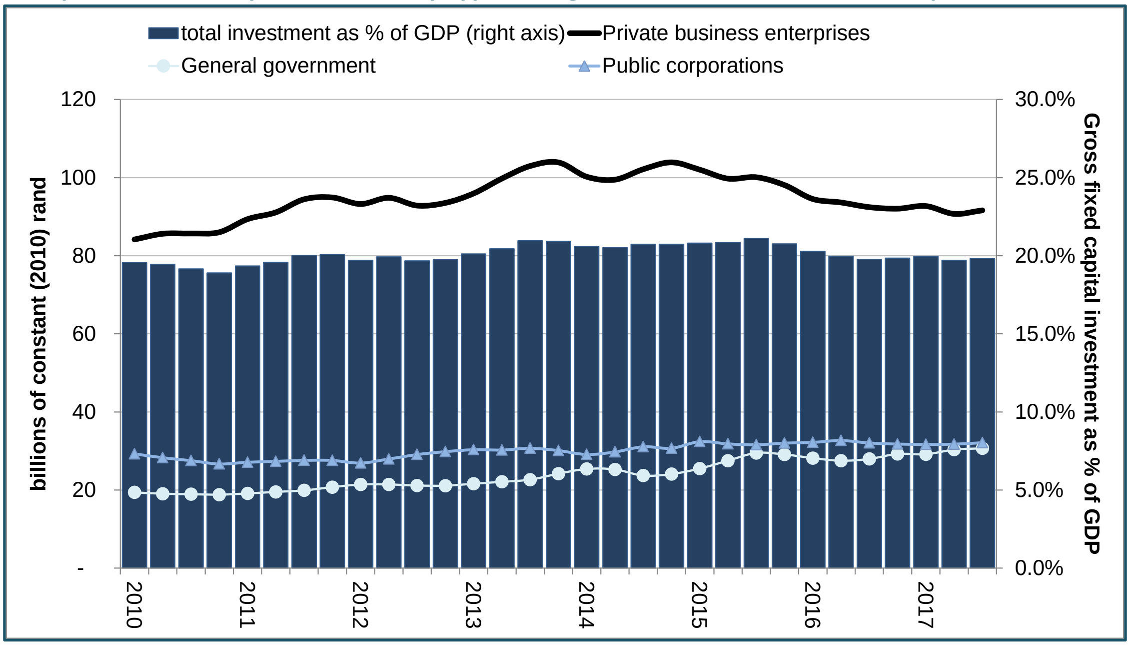
Note: (a) Deflated with CPI rebased to third quarter 2017. Source: SARS monthly trade data.

Investment and Profitability

Investment levelled out in constant terms from mid-2016, and remained under 20% of the GDP. Mining and construction profits dropped sharply in the second quarter of 2017, the latest available data, while the returns in manufacturing remained fairly stable.

The overall investment rate remained just under 20%, substantially lower than two years earlier, despite a modest recovery in the past quarter (see Graph 16). From 2015, private investment has fallen by 12%, SOE government investment has climbed some 27%, and SOC investment has been essentially flat.

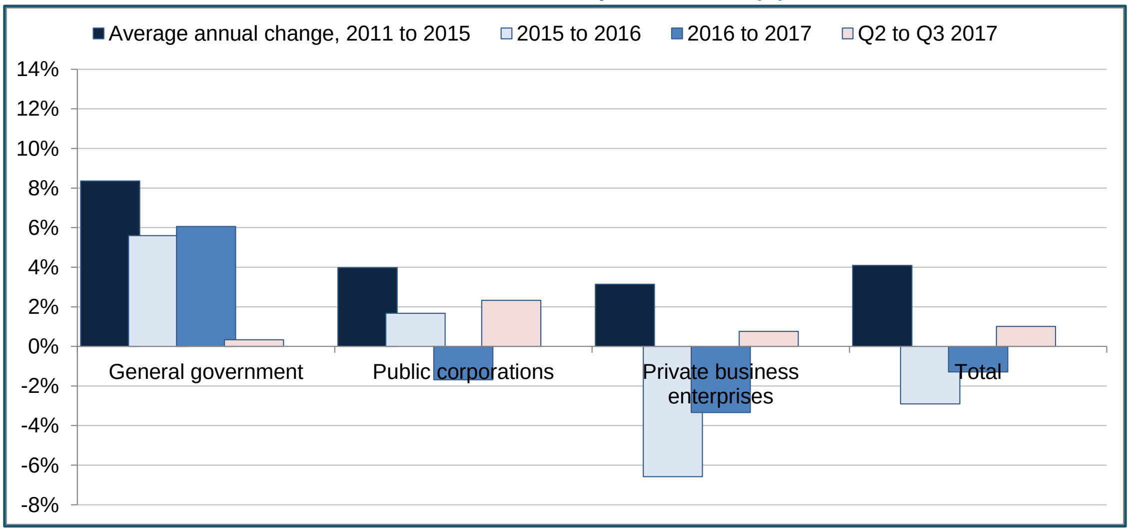
Graph 16. Quarterly investment by type of organisation and investment as percent of GDP



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

Graph 17 shows that, in the past quarter, investment recovered slightly in both public and private business, but not enough to offset the decline in the previous three quarters. In contrast, government investment grew significantly more slowly in the past quarter than in the previous year, but it did not decline.

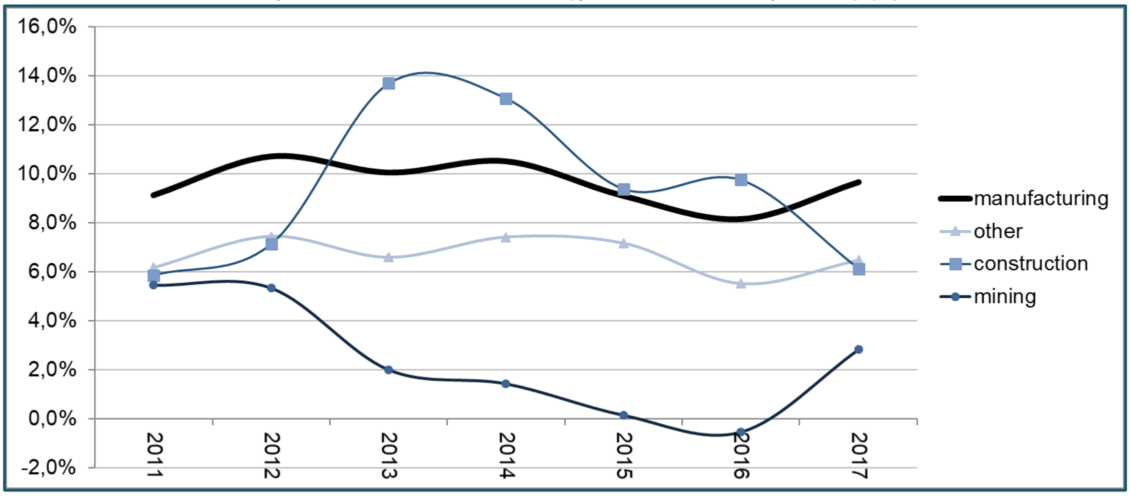
Graph 17. Change in investment by type of investor, year to third quarter and second to third quarter 2017 (a)



Note: (a) Second to third quarter 2017 figures are seasonally adjusted. Source: StatsSA GDP quarterly figures. GDPp_Tables_2q_2017. Excel spreadsheet downloaded from www.statssa.gov.za in December 2017.

Using the year to the second quarter, returns on assets for the manufacturing sector, climbed to 9,7% in 2017, compared to 8% in 2016. The mining sector returned to positive territory after losses in the year to the second quarter of 2016, reaching a modest 2,8%. In contrast, returns in construction have fallen from a peak of 14% in 2013 to only around 6% in the current year (see Graph 18).

Graph 18. Return on assets (year to second quarter) (a)

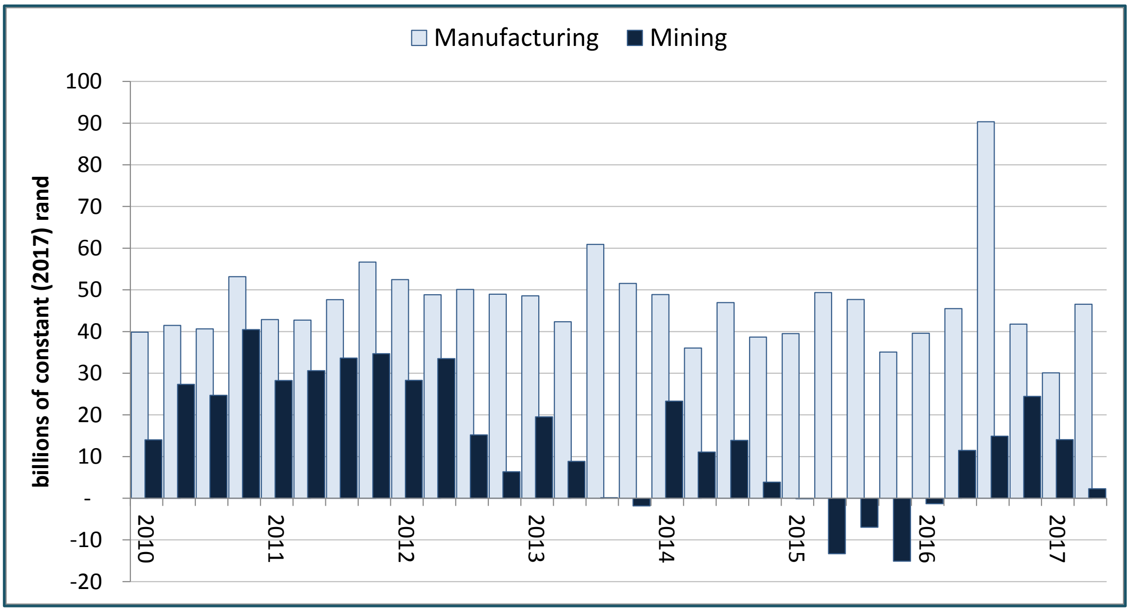


Note: Net profit before tax as % of carrying value of assets. Source: StatsSA, Quarterly Financial Statistics

Profits in manufacturing remained stable in constant rand (the spike in 2016 resulted from restructuring in the beverages industry). In contrast, over the past six months mining profits have fallen to near zero (see Graph 19).

Construction profits declined by around 50% in the year to the second quarter of 2017 compared to the year to second quarter 2016.

Graph 19: Manufacturing and mining profits (year to second quarter)



Source: StatsSA, Quarterly Financial Statistics, relevant quarters.

Foreign Direct Investment Projects

The TIPS Foreign Direct Investment Monitor tracks FDI projects, analysing new and updated projects on a quarterly basis. For the third quarter of 2017, the monitor tracked changes in 11 projects (see Table 2). Two projects were newly announced, another two were in feasibility stage, a further five were under construction, and one was recently completed, while the stage of one project is unspecified.

Table 2. FDI Projects as of third quarter 2017

	ANNOUNCED, FEASIBILITY AND UNSPECIFIED	CONSTRUCTION	COMPLETE
No of projects	5 Projects	5 Projects	1 project
Value of projects	R1,001 billion	R36,91 billion	R0,65 billion
Sectors	Services, Manufacturing and Mining	Mining and Manufacturing	Services
Type of investment	2 Greenfield 3 Expansion	3 Greenfield 2 Expansion	1 Greenfield
Companies investing	Commonwealth Bank of Australia and African Rainbow Capital Averda China's Jinhua Municipality Stonewall Mining Pan African Resources.	AB Inbev (SAB Miller) Gibela Rail Transport Consortium Wesizwe Platinum. Pan African Resources. Ivanhoe Mines	Burgan Cape Terminals

Investment projects in Quarter 3 were dominated by the mining sector. The dominance of mining represents both the end of the shakeout from the end of the commodity boom, with a modest recovery in prices, and changes in data collection methods for the database.

Mining accounted for half of all projects in the database, and 90% of the R38,6 billion in investment value monitored in the quarter. Most are already underway.

Two large platinum mine developments made up the bulk of the mining investments, with the Canadian-Japanese Platreef platinum mine advancing on its R20,7 billion project, and the Chinese co-owned Wesizwe continuing its R10,7 billion Bakubung Platinum mining project. The Platreef project is a tier one project, which aims to develop a mine with supporting infrastructure just outside Mokopane in Limpopo. Sinking of the first shaft has proceeded during the quarter, and is expected to reach the platinum deposit in 2018. The Bakubung project also entails construction of a new platinum mine, located north of Rustenburg. The project is approaching completion of its first phase, with the installation of two conveyances on the main shaft, which aims to be completed at the start of 2018.

Other mining projects included Australia's Stonewall Mining's development of Rietfontein and Beta, two gold projects valued at R900 million. Pan African Resources, a British-based firm, aims to invest R105 million in a new sub-vertical shaft at its Fairview mine at its Barberton site. The company is also developing the R1,7 billion Elikhulu tailings retreatment plant. The project straddles the line between manufacturing and mining, offering beneficiation of waste tailings at Pan African Resource's Evander gold mine, and will aim to re-treat a million tons of gold tailings per month. Construction is expected to be completed in the third quarter of 2018.

Three projects were identified in manufacturing, of which two were new investments for the quarter. AB Inbev's R2,8 billion expansion represents the largest manufacturing investment for the quarter. It centres on growing the packaging capacity of its Alrode and Rosslyn plants, while also adding a new brewhouse to its Rosslyn plant. The Chinese City of Jinhua and Buffalo City Metro have entered into an agreement through which four unnamed Chinese firms will invest in electronics manufacturing at the East London Industrial Development Zone (ELIDZ). Work continued on the Gibela Rail Transport Consortium's R1 billion Dunnottar train manufacturing complex, which will feed into Transnet's rolling stock procurement.

Rounding out major investment projects for the quarter are three new investments in logistics, recycling and banking. The Burgan Cape Terminal, Cape Town's first independent oil storage and distribution terminal, officially opened with an investment value of R650 million. Averda, a Lebanese waste management company, aims to upgrade the company's existing waste treatment facilities, invest in a new medical waste treatment plant and expand its investment in the Vlakfontein hazardous waste landfill site. Finally, Australia's Commonwealth Bank received a banking licence to operate under its TymeDigital brand, which aims to compete with banks such as Capitec. The banking licence is the first to be issued since 1999. The investment is in partnership with African Rainbow Capital (ARC).

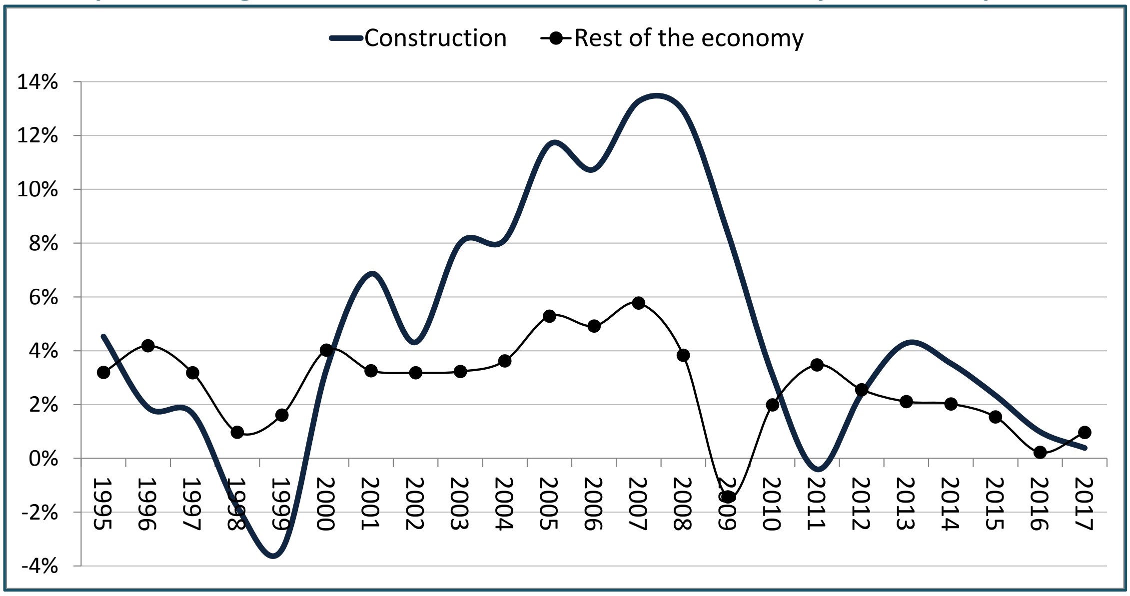
Data on permanent direct job creation from major investment projects was limited for the quarter, with only four projects providing estimates. By far the largest was the Bakubung platinum mine, which is expected to directly employ 3 135 people when fully operational. Aside from Bakubung, the Jinhua investment in ELIDZ is the largest job creator, offering 400 additional permanent jobs, while the development of a tailings plant at the Evander gold mine aims to create 250 jobs, and the SAB expansion a further 70. Other projects listed temporary job creation during the construction phase, with the Elikhulu tailings retreatment project creating 700 temporary jobs and the Port of Cape Town's fuel storage and distribution project creating 500 temporary jobs.

Briefing Note: Slowdown in the construction industry

The construction industry saw a sharp slowdown in the past year, after being a key driver of growth in the South African economy for most of the last 15 years. The main factor behind its slowing expansion appears to be the flattening out of investment in buildings and construction works as part of the overall downturn in investment over the past two years.

As Graph 20 shows, before the 2008/9 global financial crisis growth in construction outstripped the rest of the economy. It rose to 13% a year in the year to the third quarter of 2008. As a result, it climbed from 2,2% of the GDP in 2002 to 3,5% from 2009. Although its growth fell sharply after 2009, it recovered to 4% in the year to the third quarter of 2013. In the year to the third quarter of 2017, however, the industry's growth fell back to near zero, below the national growth for only the second time since 2000.

Graph 20. Change in value added in construction and the GDP, year to third quarter

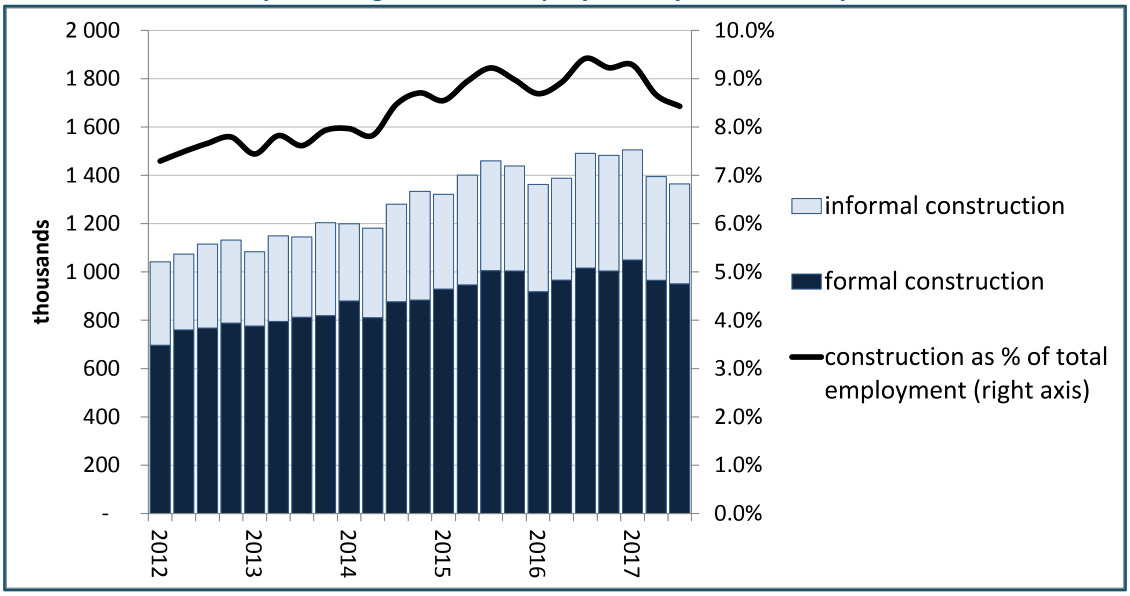


Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in December 2017.

Because construction is relatively labour intensive, the slowdown has significant implications for employment. Construction provided 1,6 million jobs, or 8,5% of total employment, in 2017. Slower growth has brought significant job losses.

Construction lost 118 000 jobs in the year to the third quarter of 2017, even as the rest of the economy added 218 000 positions. Formal construction lost 53 000 jobs, or 6%, while informal construction saw 65 000 jobs or 13% of the total disappear.

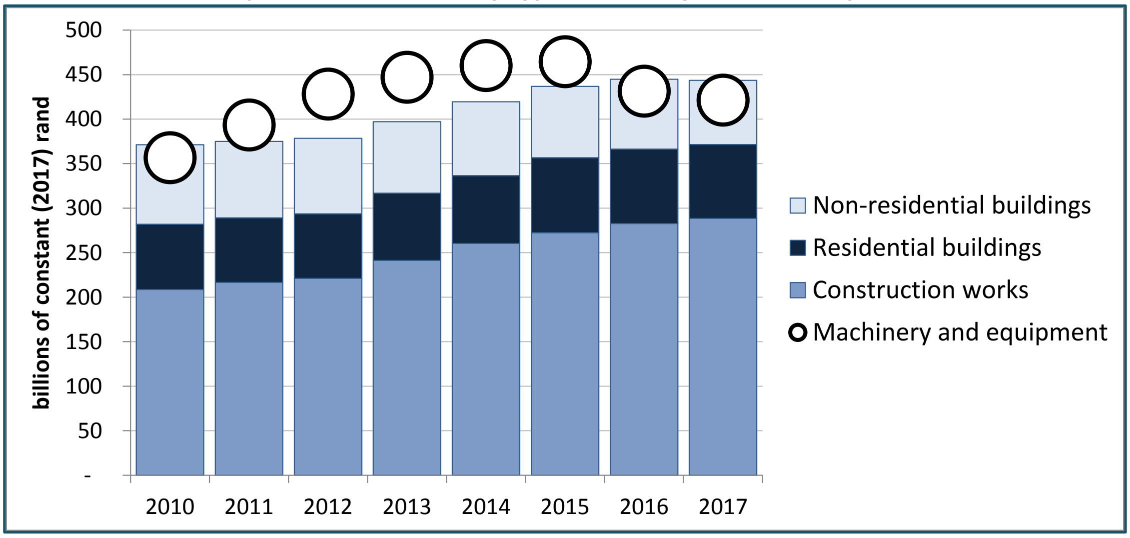
Graph 21. Jobs in formal and informal construction, in thousands of positions and as a percentage of total employment, year to third quarter



Source: StatsSA. QLFS trends 2008 - 2017 Q1. Downloaded from www.statssa.gov.za in November 2017.

The slowdown in construction appears to be related to the decline in investment. Around half of investment spend goes on residential and non-residential buildings plus construction works, which includes mining works as well as infrastructure. As the following graph shows, spending on these types of assets levelled out in the past two years after experiencing relatively rapid growth from 2010. Purchases of machinery and equipment, which constitute the rest of total investment, saw a substantially sharper fall, however (see Graph 22).

Graph 22. Investment by type of asset, year to third quarter



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

The decline in construction reflects both an initial response to the fall in investment, and a source of dislocation for tens of thousands of low-income households.

Briefing Note:
The unbalanced economy: a cause for concern

Since the first quarter of 2015, the South African economy has experienced its worst period of growth since the transition to democracy (aside from the global financial crisis in 2009). The economy has been dipping in and out of negative growth on a fairly consistent basis over the past three years.

Slow growth is a cause for concern by policymakers and impacts on the ability of the state to deliver basic services and support industrialisation. To shore up the economy, the national budget has increasingly been going into deficit with the commitment by the government that the deficit would be scaled back once the economy picked up. Using deficit finance to sustain economic growth during periods of downturn combined with strong public sector programmes is an important measure to keep the economy from heading into a downward spiral, keeping jobs intact and preventing the poor from going into desperate poverty.

South Africa’s international creditors and investors have started to push back on the budget deficit, and recent public announcements show the government is taking those views very seriously. The risk is that South Africa moves from much needed government "cost containment" measures into budget cuts and full austerity. The easiest place to start cutting is always on capital projects. That would impact on the construction sector, which has already seen three quarters of decline.

Most practical economists agree that austerity would be pro-cyclical and would reinforce the downward trajectory of the economy. Throwing more people into the ranks of the unemployed would likely result in social upheaval that the country cannot afford.

While the slow growth is a cause for concern for policymakers, it is less so for the financial sector. In the past quarter the JSE has reached its highest ever levels. It is a serious bull market and people are earning good returns.

The question is whether this is an asset bubble that will inevitably implode. Given low growth in the economy, the economic fundamentals are clearly not the underlying cause of the stock market appreciation. It appears that we are seeing a delinking of the financial sector from the real economy, due in large part to global financial flows managed by huge institutional investors. The growth on the JSE comes from a global upward trend in stock markets generally – South Africa is just following the international trend.

The answers to the contradiction between fiscal pressures, slow growth and high prices on the JSE are not immediately visible. Keynes would argue that we cannot split the financial sector from the rest of the economy, as firms borrow on the market and are present in the market through their balance sheet and investments. As we saw in the 2008 financial crises and resulting depression, a financial sector implosion has far-reaching implications for the rest of the economy. In South Africa we lost a million jobs and pushed many people below the poverty line.

A core challenge is that South Africa's stock market capitalisation to GDP is abnormally high at over 300% (the average is 61% for Upper Middle Income Countries, which are South Africa's global peers). There are clearly risks to the financial sector with the current capitalisation of the JSE and a downgrade may see offshore funds being withdrawn. In contrast, the rest of the financial sector has been prudently managed with good governance and normal rates of private credit extension relative to the size of the economy. Arguably, indeed, the economy would benefit from larger and more affordable credit flows to industry.

There is an urgent need for the government and private sector to respond to this unbalanced state. The two immediate priorities are:

- Rapidly addressing high unemployment. In the short run, given the scale of what is required this can only be achieved through public employment programmes. The Community Work Programme is one such initiative that has already reached hundreds of thousands of unemployed people in over 200 sites across the country.
- Supporting significant growth in the real economy, which would require well targeted and run government programmes undertaken in partnership with the private sector. Like other developing countries, South Africa needs to implement a significant Credit Guarantee scheme targeted at manufacturing firms. Such a scheme would crowd in private sector finance and stimulate investment; administration of the scheme by the Industrial Development Corporation (IDC) would give banks and industrial firms a

measure of confidence in the approach. Other areas include strengthening incentive support and partnering with structures such as the Manufacturing Circle to address unused capacity and unlock new investment.

Addressing both priorities would in turn restore confidence in the South African economy and policymakers. The options for financing such interventions include reprioritising existing budgets, using off-budget resources or borrowing more. Reprioritising budgets, ensuring state resources are used effectively and for their intended purpose is something that governments should always strive for and there are ongoing efforts on this. Off-budget resources could come through selling non-core state assets; drawing on the Unemployment Insurance Fund (UIF) surplus with agreement from social partners; or requesting the pension funds to do more to finance new productive and infrastructure projects. Regulation 28 allows pension funds to use up to 10% of funds for non-listed investments, and less than 5% has been used in this way. Pension funds have a vested interest in ensuring balance in the economy and protecting the trillions invested in the stock market.

Can South Africa borrow more? Developing countries are often advised to follow the orthodox Washington Consensus approach of roughly 3% of deficit financing and to keep government debt down. Currently, South Africa's deficit is at 5,3%. Borrowing more is a risk for developing countries as they may run into a foreign exchange crisis if they offshore deficit finance beyond a certain amount. This issue is less of a risk for South Africa given the capital account inflows directed to the stock market, but a sudden withdrawal of funds from the market in the event of a downgrade would have a significant impact on foreign exchange, among other consequences.

South Africa has an unusual level of financialisation for a developing country. The possibilities exist for both the public and private sector to use those resources to grow the real economy (and manufacturing in particular) and address high unemployment to bring balance back into the economy and mitigate the risk of unbridled asset price inflation.

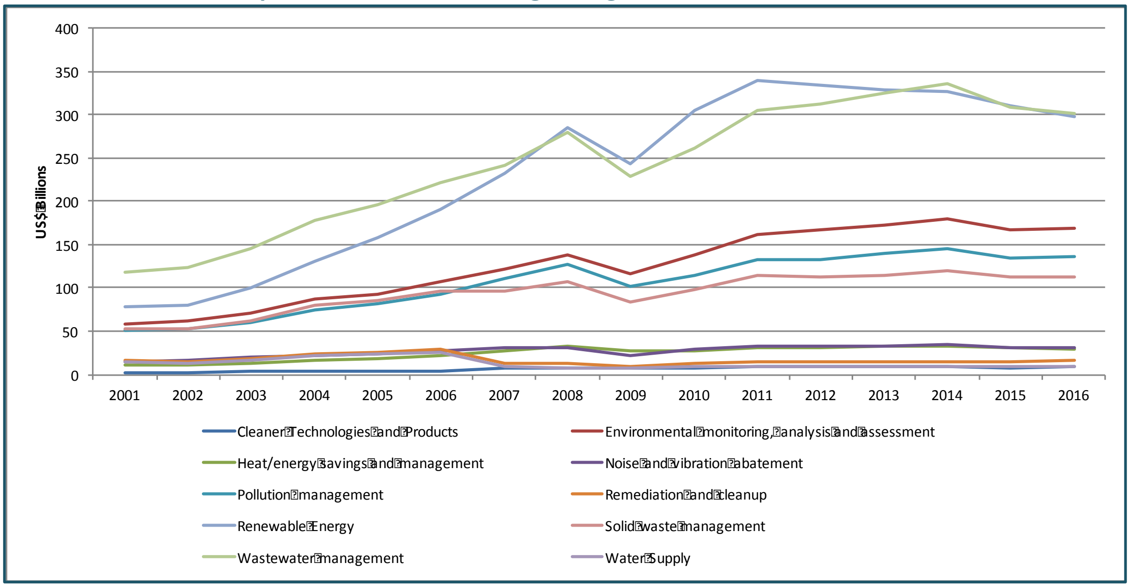
Briefing Note: The transition to a green economy – A manufacturing and trade opportunity for South Africa

South Africa's green economy strategy has traditionally rested on the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP), and has attempted to leverage off government procurement to promote the development of local manufacturing capacity for the likes of solar panels or wind towers. But with the programme in a state of paralysis, now is an opportune moment to reassess the opportunities available to South Africa, and expand the strategy to best position the country to take advantage of the industrial opportunities offered by the global transition to sustainable development.

A forthcoming TIPS study with the United Nations Partnership for Action on the Green Economy (PAGE) and the South African Government indicates that these opportunities are plentiful. The study assesses what manufacturing opportunities are available to South Africa in the world of green trade.

Global trade in green goods has expanded by 167% between 2001 and 2016, as a combination of rapidly advancing technology, government programmes, and global initiatives have driven the industry forward. South Africa has benefited from this growth, expanding exports in important strategic industries, such as catalytic converters and electro-technical components such as pumps and boilers. On balance, South Africa has, however, been a net importer of green goods, even as localisation efforts have simultaneously increased local production capacity. Deepening local manufacturing has the potential to displace imports and boost export capacity. Nevertheless, in an extremely competitive and complex global market defined by non-tariff barriers such as local procurement programmes, South Africa's green manufacturing and trade efforts need to be carefully targeted in areas in which the country has the highest potential.

Graph 23. Global trade in green goods, from 2001 to 2015



Source: TIPS, based on Trade Map data.

The study identified four high potential green manufacturing and trade opportunities for South Africa. The domestic production of **water technologies** in both the conservation and treatment space offers the potential to help address South Africa water security issues, while leveraging off local innovations, such as water filtration membranes.

The **biogas-to-transport** value chain offers a viable and environmentally-friendly alternative energy source for mass public transport, and can create new markets for agricultural and waste industries.

The rollout of **small-scale embedded generation** offers a viable way forward on South Africa's energy impasse, while providing the opportunity to expand existing manufacturing capacity in areas like smart meters.

The local development of **biocomposites**, plastic-like materials made from agricultural products and waste, offer a way to address structural imbalances in the local plastics industry, while reducing the packaging industry's reliance on petrochemicals.

Unlocking all these industrial development opportunities calls for a mix of government interventions. Local research and development requires additional support, with a focus on bringing viable technologies to market. All industries also require strategic incentives to stimulate investment in new technologies and bring them to commercial viability, with a basket of specific interventions needed for each product.

Green industries are frequently considered in isolation from the broader real economy. In reality, the transition to a green economy is a vital test case of the capacity of industrial policy to respond to rapidly changing technology and the emergence of new economic opportunities. Careful sectoral targeting and support can offer a way forward on sustainability, and impart important lessons on the future of South Africa's industrial policy.

Further information on the study can be found here.