THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

FIRST QUARTER 2019

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

The GDP declined in the first quarter of 2019, while the economy lost jobs. The downturn continues the trend of volatile growth rates that began five years ago. Previous quarterly downturns in this period, however, were driven by agriculture; in contrast, the past quarter saw a broad-based decline. The briefing note on the economic slowdown explores factors behind these trends.

South Africa's GDP fell by 0.8% in seasonally adjusted terms from the last quarter of 2018 to the first quarter of 2019 (Graph 1). This follows two quarters of marginally positive growth in the third and fourth quarters of 2018, which were preceded by a technical recession of two quarters at the beginning of 2018. These figures highlight continued volatility in economic conditions as well as the slowing tendency.

On the expenditure side, household consumption turned negative in the first quarter of 2019 after years of driving growth (Graph 2). Income inequalities mean that the richest 10% of households account for over half of all spending. The downturn apparently reflects a combination of job losses and uncertainty about the overall economic climate. As discussed in more detail in other sections of the bulletin, investment continued the decline that started in 2015. Exports dropped almost 2%, reflecting the turbulence in international trade.

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

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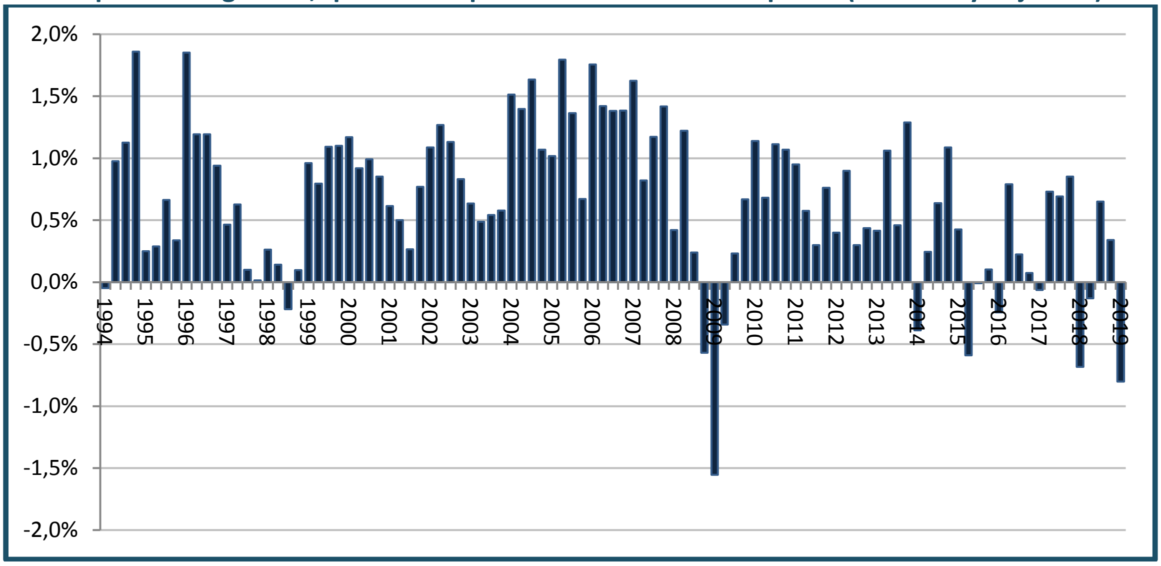
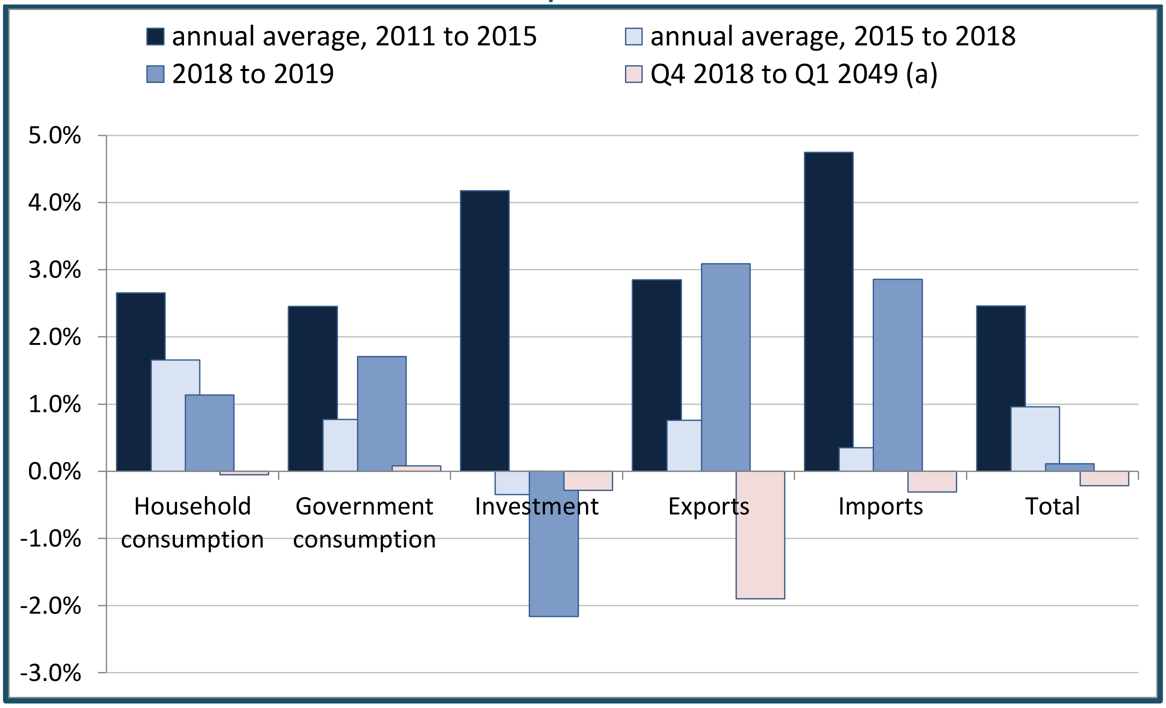
Graph 1: GDP growth, quarter on quarter in constant 2010 prices (seasonally adjusted)



Note: Seasonally adjusted change from fourth quarter 2018 to first quarter of 2019. Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019.

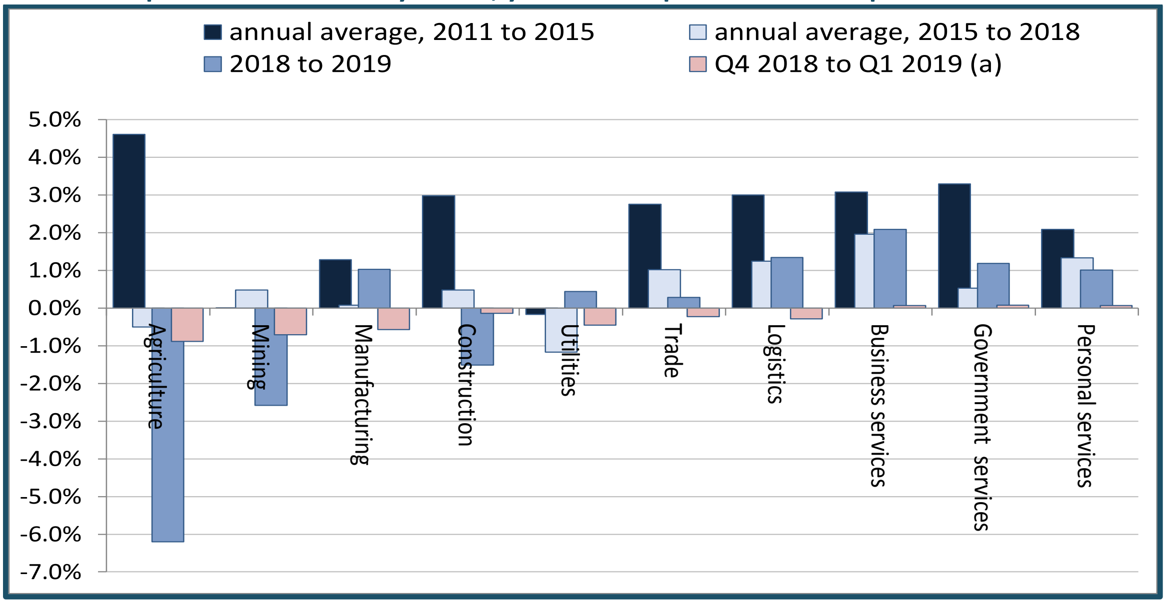
Graph 2: Change in expenditure on the GDP, year to first quarter and first quarter of 2019



Note: (a) Seasonally adjusted change from fourth quarter 2018 to first quarter of 2019. Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019

In terms of production, the fall in the first quarter of 2019 was broad-based, affecting every sector outside of the services – and they grew a mere 0.1%. Agriculture registered the sharpest contraction at -0.9%. The manufacturing and mining sectors fell by -0.6 and -0.7% respectively, while construction shrank by 0.1%.

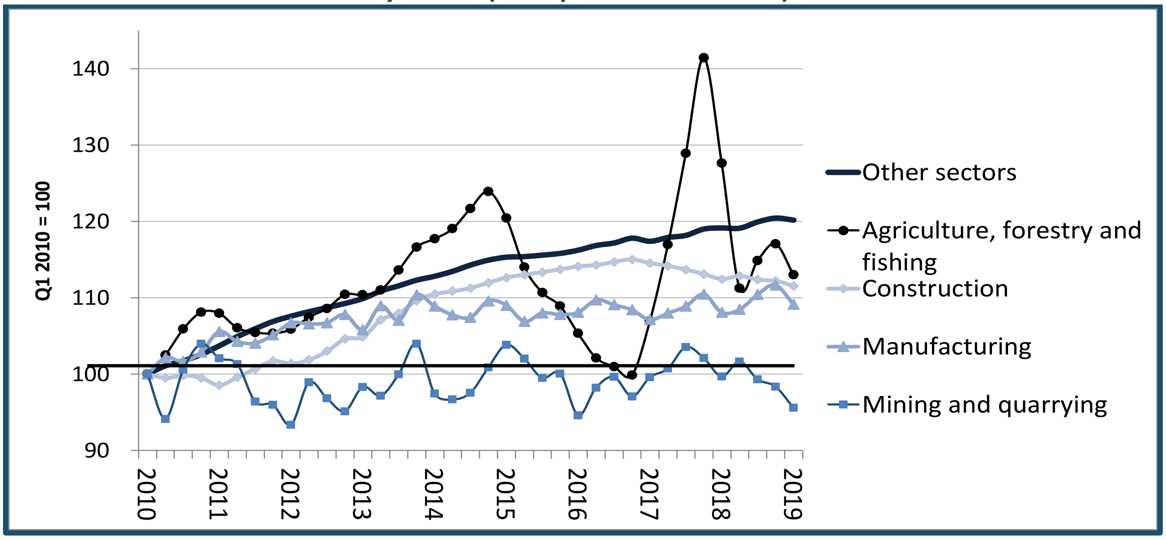
Graph 3. Growth rates by sector, year to first quarter and first quarter of 2019



Note: (a) Seasonally adjusted change from fourth quarter 2018 to first quarter of 2019. Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019.

The contraction in the first quarter of 2019 was the third consecutive quarterly decline for mining and construction. Manufacturing production has remained almost unchanged over the past five years.

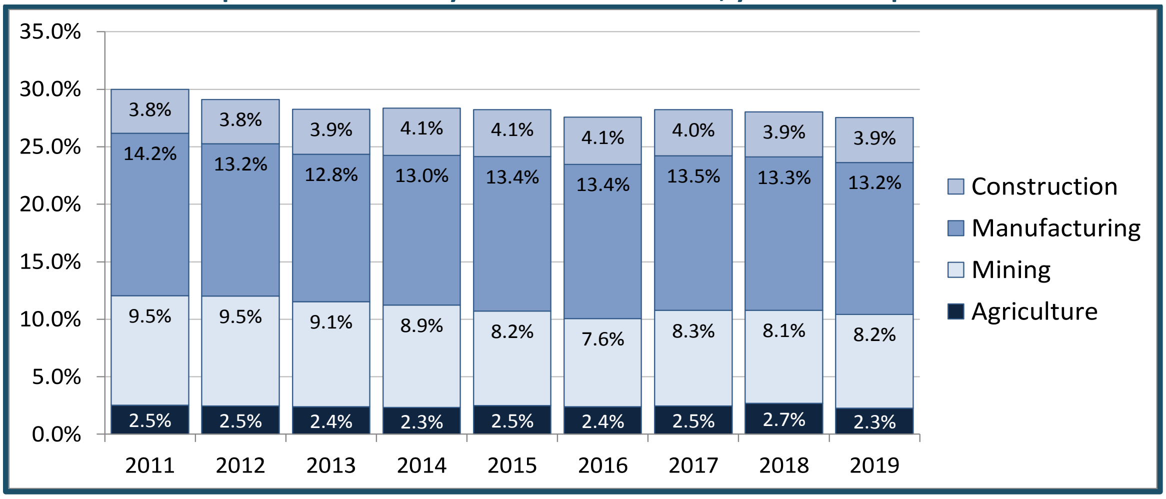
Graph 4. Indices of quarterly contribution to the GDP in constant terms by sector (first quarter 2010 = 100)



Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in June 2019.

The share of the real economy decreased for the second year in a row, from 28.0% in 2018 to 27.5% in 2019, down from a peak of 30% in 2011. Agriculture accounted for most of the decline in the past year, as its share dropped from 2.7% of the GDP in 2018 to 2.3% in 2019. The share of manufacturing has stabilised at just over 13% since 2013, after falling from 14% in 2011 when the end of the global commodity boom brought a downturn to the metals industry.

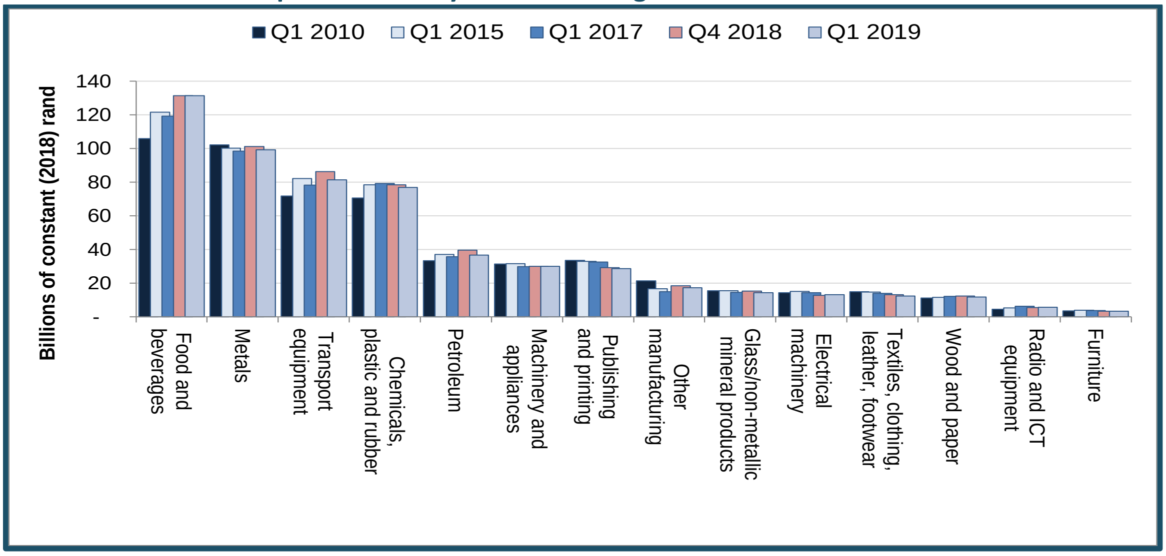
Graph 5: Real economy sector shares of GDP, year to first quarter



Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019.

In constant rand, manufacturing sales in the first quarter of 2019 were down 3% from the last quarter of 2018, falling from R638 billion to R563 billion. However, that was still 2% above the figure for the first quarter of 2018.

Graph 6: Quarterly manufacturing sales in constant rand



StatsSA. Manufacturing volume and sales from 1998. Excel spreadsheet. Downloaded in May 2019.

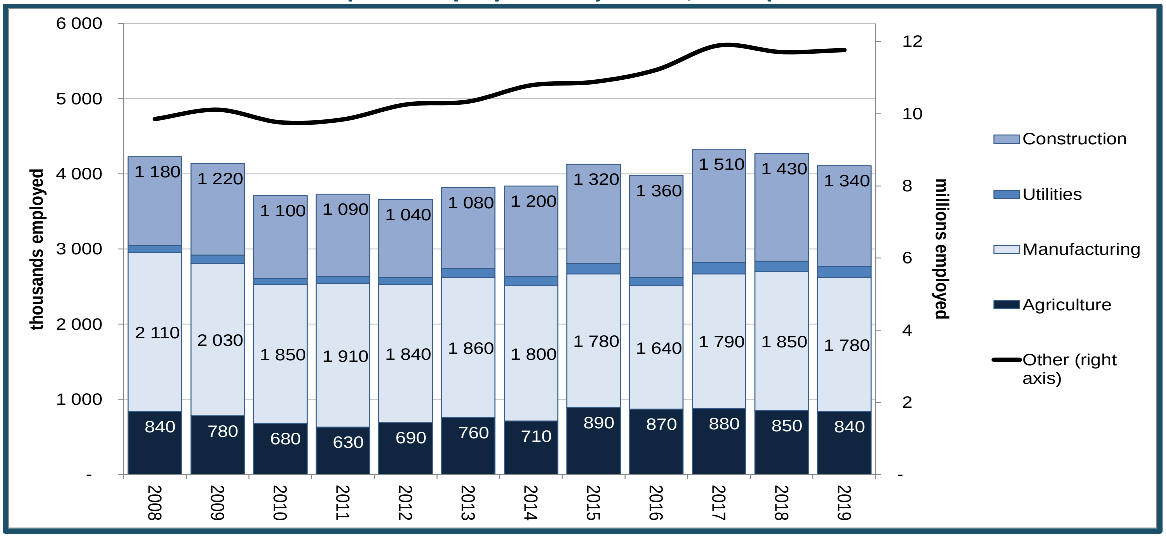
A decline in sales was recorded across the board. The food and beverages, furniture, machinery and appliances sectors maintained sales level with the previous quarter. The only sectors that registered positive growth in sales between the last quarter of 2018 and the first quarter of 2019 were the electrical machinery and the radio and ICT sectors (growing at 2% and 3% respectively). Major quarterly decreases in sales (ranging between 5% and 7%) were noted in clothing and footwear, petroleum products, glass and non-metallic mineral products and transport equipment.

Employment

Employment in the real economy fell by 160 000 jobs in the year to the first quarter of 2019. It is now at the same level it was in 2015. Manufacturing and construction accounted for the bulk of the net loss in jobs. In the rest of the economy, community and social services lost more than 200 000 jobs while other sectors gained employment. Overall, employment as a whole lost jobs for only the second time since 2010.

Employment data are not seasonally adjusted, and the first quarter generally sees net job losses. For this reason, only annual figures, comparing the same quarter of each year, are meaningful. As **Graph *7*** shows, employment in the real economy in the first quarter, excluding mining, has fallen for the past two years. Virtually all of the job losses came from construction, followed by agriculture. In the rest of the economy, employment flattened out over the past two years. Taken together, these developments meant that the economy as a whole lost jobs in the year to the first quarter of 2019 for only the second time since 2010 (the first time was in the year to June 2016).

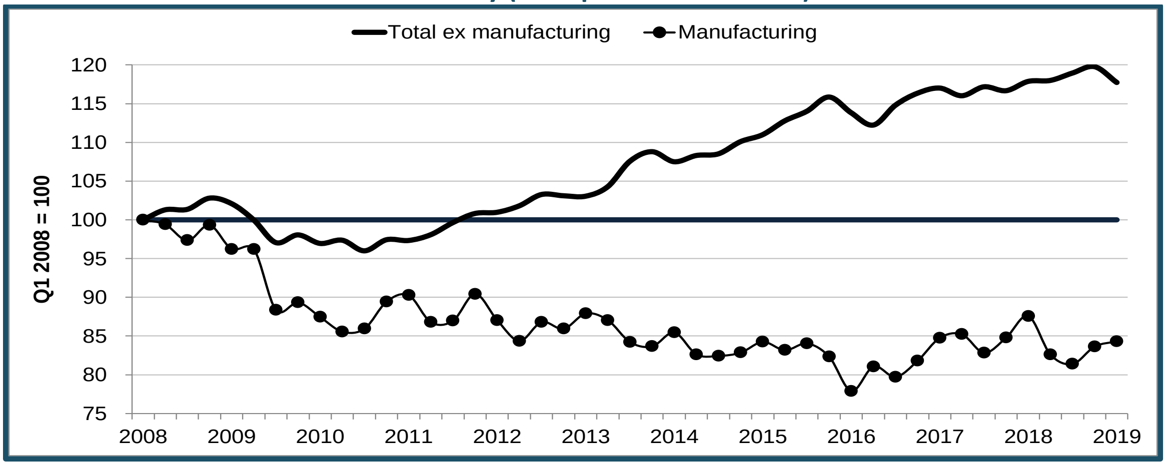
Graph 7. Employment by sector, first quarter



Source: StatsSA. QLFS –2008-2019 Q1. Electronic database. Downloaded from www.statssa.gov.za.

As Graph 8 shows, manufacturing employment remains below its levels in 2008, on the eve of the global financial crisis. It is now at the same levels seen in 2014, despite some fluctuations. In contrast, employment in the rest of the economy is over 15% higher than it was in 2008, although job losses in the first quarter of 2019 far outstripped the customary seasonal decline for the period.

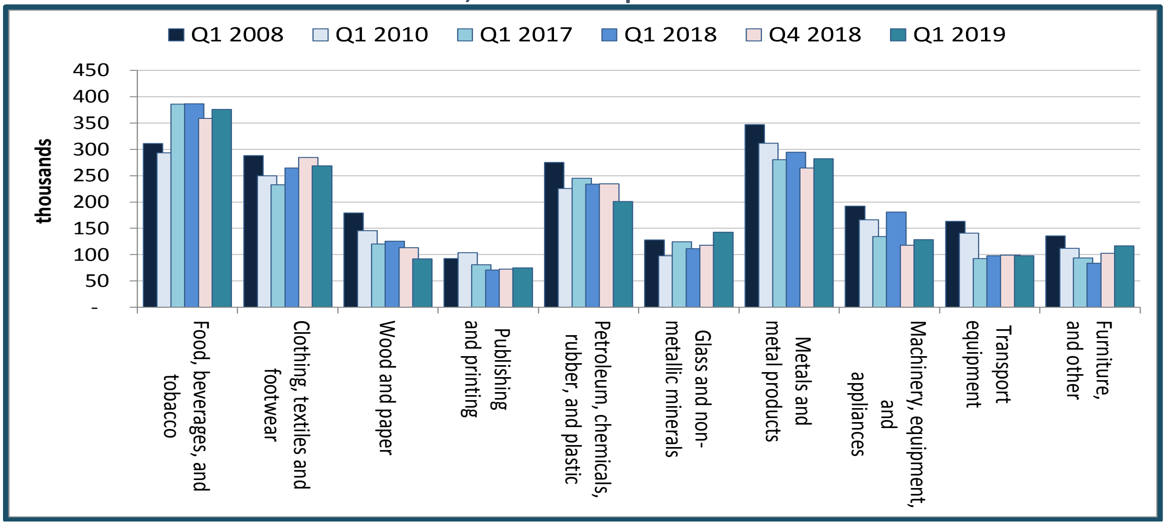
Graph 8. Indices of employment in manufacturing and the rest of the economy (first quarter 2008 = 100)



Source: StatsSA. QLFS –2008-2019 Q1. Electronic database. Downloaded from www.statssa.gov.za.

In the year to the first quarter of 2019, the largest job losses were in machinery and equipment, down 53 000, or 29%; wood and paper, down 33 000 or 26%; and chemicals and plastics, also down 33 000 or 14%. All three industries are significant exporters, suggesting the impact of the slowdown in major trading partners (see *Briefing Note: The economic slowdown*). In contrast, employment in clothing was stable, while metals and food saw comparatively small net job losses.

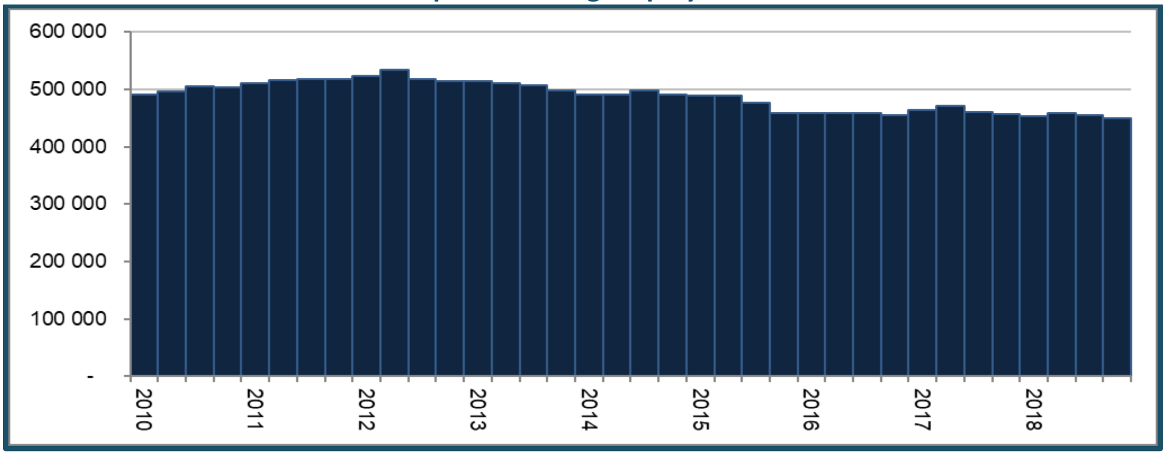
Graph 9. Employment by manufacturing industry, first quarter of 2008, 2010, 2017, 2018 and 2019, and fourth quarter of 2018



Source: StatsSA. QLFS –2008-2019 Q1. Electronic database. Downloaded from www.statssa.gov.za.

For technical reasons, figures on mining employment from the employer survey, the Quarterly Employment Statistics, are considered more reliable then the household based Quarterly Labour Force Survey. They are, however, only available through the fourth quarter of 2018. In 2018, mining lost 8 000 jobs, or 2% of the total. Since the fourth quarter of 2011, when the commodity boom ended, some 70 000 miners – around one in seven – have lost their jobs.

Graph 10: Mining employment



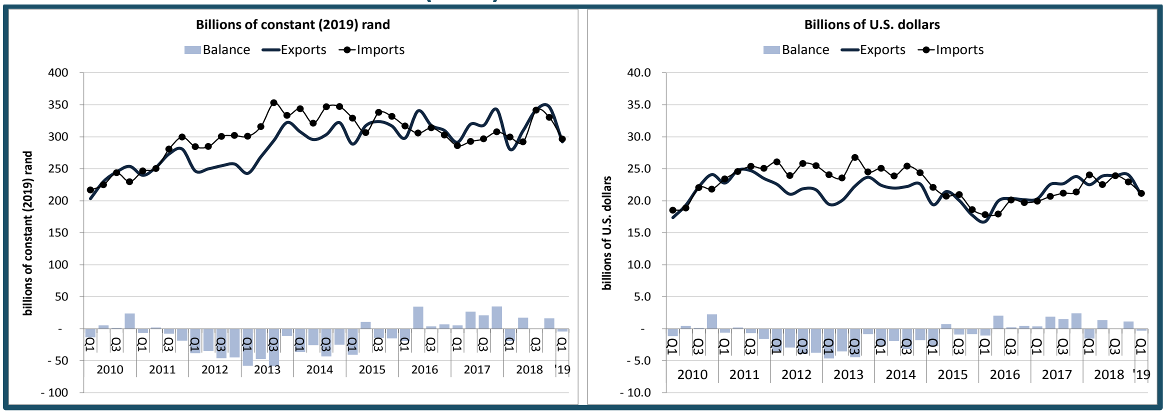
Source: StatsSA. Quarterly Employment Statistics. December 2018.

International trade

In constant rand terms, South African exports have barely grown since 2013. In US dollars, they climbed from 2016 to mid-2018, but fell more than 10% in the six months to March 2019. Nonetheless, an even faster decline in imports – due in part to slow growth and in part to fairly low petroleum prices – meant that the balance of payments remained positive for the year, although a deficit emerged in the first quarter of 2019.

Total international trade contracted sharply in the past quarter, although the figures are not seasonally adjusted. Exports dropped 16% in constant rand, while imports fell 10%. A trade deficit of R4 billion was reported in the first quarter of 2019, equal to US$300 million. In the year to the first quarter 2019, however, exports climbed 4% in rand terms while imports dropped 1%. Exports were up 4% at R292 billion from the last quarter of 2018. For the year to the first quarter, South Africa recorded a modest surplus of R30 billion.

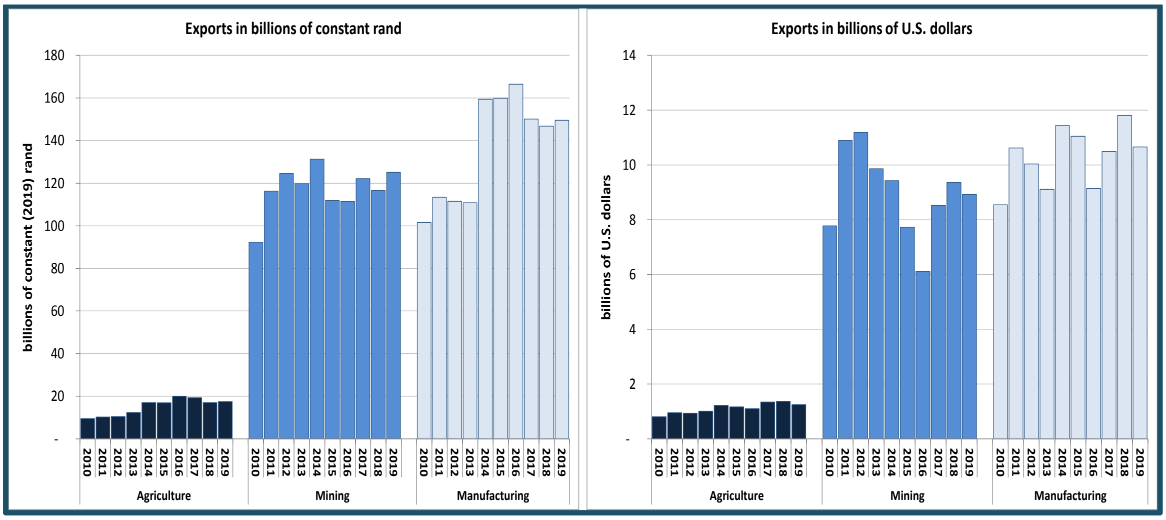
Graph 11: Quarterly exports, imports and balance of trade in billions of constant (2019) rand and current US dollars



Source: South African Reserve Bank (SARS) monthly data

In constant rand, compared to the first quarter of 2018 mining and manufacturing exports improved. The increase was, however, entirely due to depreciation, since both sectors saw a decline in dollar values.

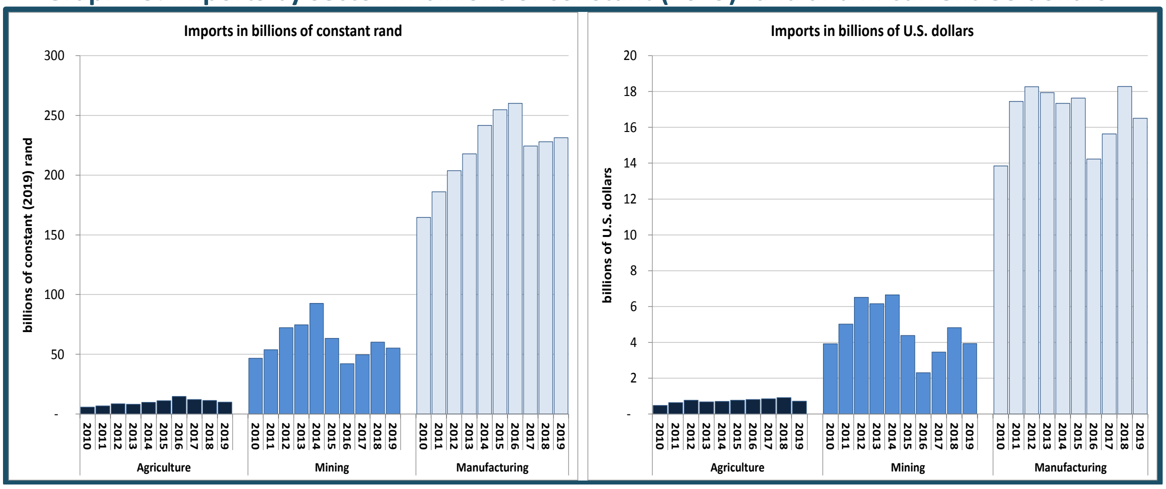
Graph 12: First quarter exports by sector in billions of constant (2019) rand and in current US dollars



Source: SARS monthly data

Mining imports, mostly petroleum, have tended to creep up from 2016 as prices have risen, but they moderated in the year to first quarter 2019 in both dollar and rand terms. Manufactured imports rose slightly in rand, but fell sharply in US dollars

Graph 13: Imports by sector in billions of constant (2019) rand and in current US dollars



Source: SARS monthly data

Transport equipment, metals, machinery and chemicals account for over 80% of manufactured exports. From the first quarter of 2018 to the first quarter of 2019, exports of transport equipment jumped 6% in US dollars and 20% in rand terms. In contrast, metals, machinery and chemicals all fell by between 6% and 15% in dollar terms, although the depreciation of the rand meant that they did not fare as poorly in rand.

Imports are more diverse, with around a third comprising a wide variety of machinery and equipment; almost a quarter transport equipment; and around a fifth various forms of chemicals and plastics. In dollars, imports of transport equipment climbed 3% from the first quarter of 2018 to the first quarter of 2019, but all other manufactured imports fell. The 13% decline in machinery and equipment was relatively sharp, reflecting the slowdown in investment.

In recent years, South Africa has seen an unexplained increase in imports and exports of paper money, under the heading of publishing. A decline in this activity explains the very sharp fall in trade in this industry in the year to March 2019.

Table 1: Trade by manufacturing subsectors

	Value (billions)		% change from Q1 2018		Change in billions	
Industry	**USD**	**Rand**	**USD**	**Rand**	**USD**	**Rand**
EXPORTS						
Food and beverages	0.9	12.5	-11%	1%	-0.11	0.07
Clothing and footwear	0.4	5.3	-20%	-9%	-0.09	-0.54
Wood products	0.1	1.9	-6%	6%	-0.01	0.10
Paper and publishing	0.2	2.9	-49%	-43%	-0.20	-2.20
Chemicals, rubber, plastic	1.9	25.9	-6%	6%	-0.11	1.55
Glass and non-metallic mineral products	0.1	1.5	-10%	1%	-0.01	0.02
Metals and metal products	2.5	34.9	-15%	-5%	-0.45	-1.74
Machinery and appliances	1.8	24.6	-11%	0%	-0.23	0.00
Transport equipment	2.6	37.0	6%	20%	0.16	6.26
IMPORTS						
Food and beverages	0.8	11.0	-11%	0%	-0.10	0.01
Clothing and footwear	1.2	17.0	-5%	6%	-0.07	0.98
Wood products	0.1	1.5	-4%	7.6%	0.00	0.11
Paper and publishing	0.5	6.7	-29%	-20%	-0.20	-1.70
Chemicals, rubber, plastic	3.1	43.7	-16%	-6%	-0.61	-2.82
Glass and non-metallic mineral products	0.3	3.6	-10%	1%	-0.03	0.04
Metals and metal products	1.1	15.8	-8%	3%	-0.10	0.41
Machinery and appliances	5.2	72.3	-13%	-2%	-0.74	-1.30
Transport equipment	3.9	54.7	3%	16%	0.11	7.51

Source: SARS monthly data

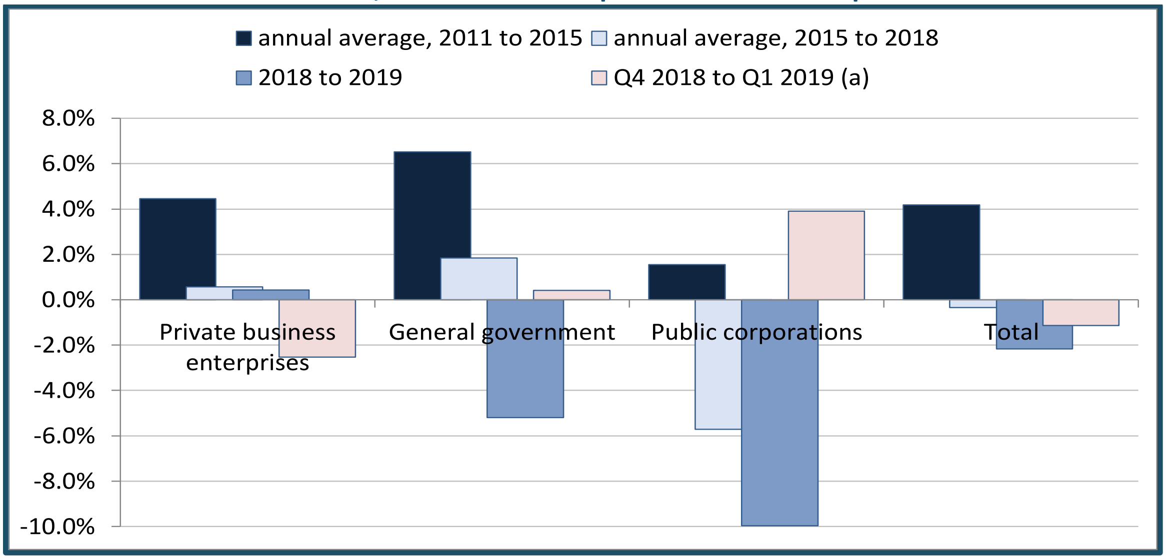
Investment and profitability

The 2% fall in investment from the year to the first quarter 2018 to the year to the first quarter 2019 was a central factor behind the economic downturn. The sharpest decline emerged for public investment, although both state-owned enterprises and government departments reported a recovery in the first quarter of 2019 alone. Private investment, in contrast, grew slightly year on year, but contracted sharply from the fourth quarter of 2018 to the first quarter of 2019.

Year-on-year, using the year to the first quarter, total investment dropped by 2.2% from 2018 to 2019. From the fourth quarter of 2018 to the first quarter of 2019 alone, it fell by 1.1%. For the past four quarters, investment has hovered at just 18% of the GDP, which is generally considered too low to sustain rapid growth. In constant rand, public investment has declined since 2016.

Private investment, which is far larger, was flat for most of the past three years but dipped over 2% in the last quarter.

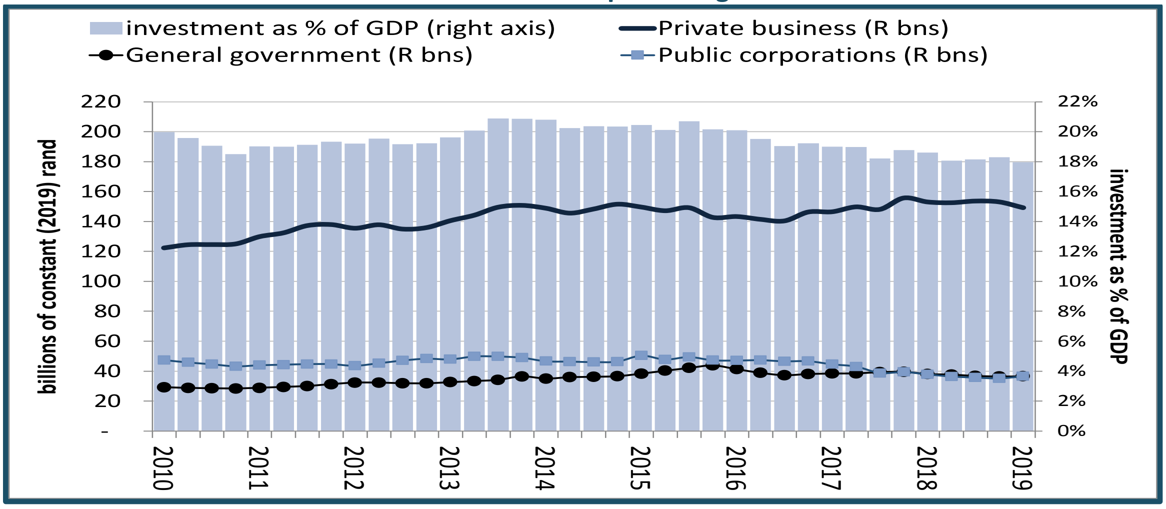
Graph 14: Change in investment by type of organisation, year on year for year to first quarter from 2011 to 2019, and from fourth quarter 2018 to first quarter 2019



Note: (a) Seasonally adjusted change from fourth quarter 2018 to first quarter of 2019. Source: StatsSA GDP data. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019.

As a share of GDP, total investment hovered around 18% for the year to the first quarter of 2019. It had dropped from just over 20% in the two years to 2016.

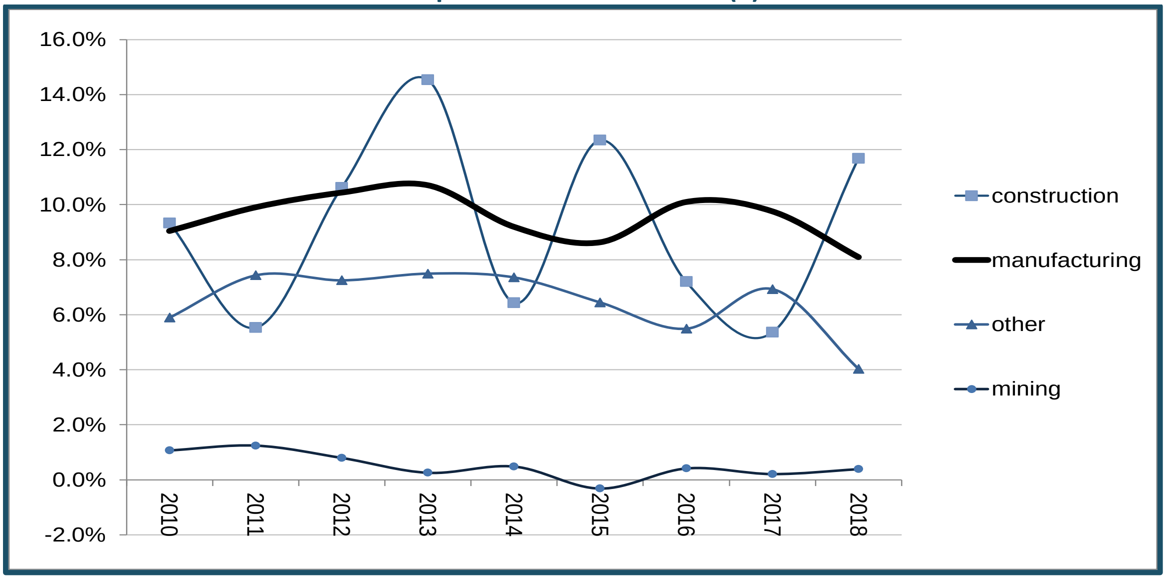
Graph 15. Quarterly seasonally adjusted investment by type of organisation in constant rand and as percentage of GDP



Note: (a) Seasonally adjusted change from fourth quarter 2018 to first quarter of 2019. Source: StatsSA GDP data. Excel spreadsheet downloaded from www.statssa.gov.za in June 2019.

Returns on assets for the manufacturing sector dropped from 9.8% in 2017 to 8.1% in 2018, highlighting continuing strain on the sector. Returns in mining remained low in 2018 despite a slight improvement, increasing from 0.2% in 2017 to 0.4% in 2018. The construction sector remained highly volatile. Its rate of return more than doubled from 5.4% in 2017 to 11.7% in 2018.

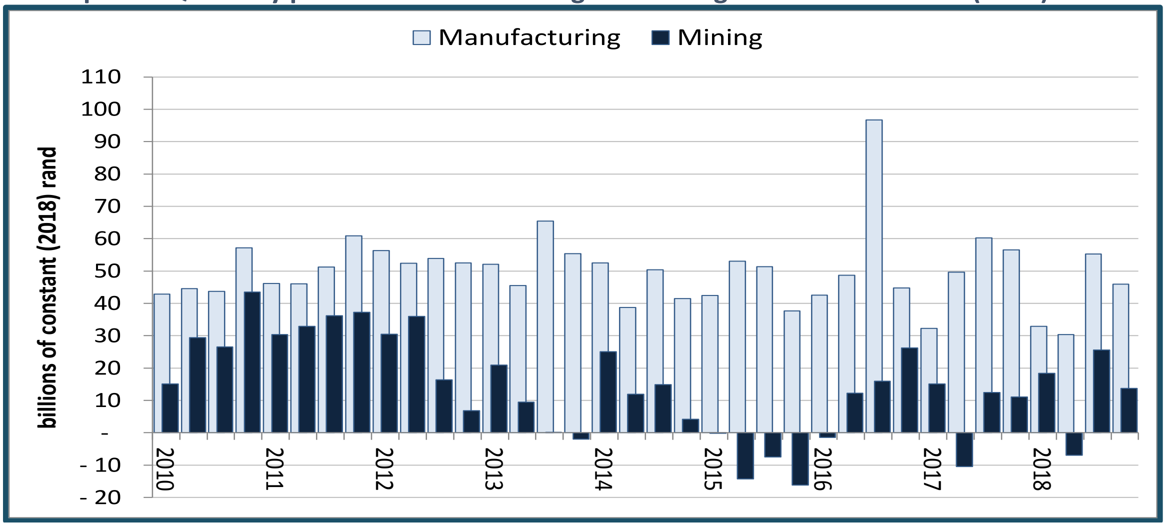
Graph 16: Return on assets (a)



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

Graph 17 shows quarterly manufacturing and mining profits in constant rand from 2010. It indicates the increased volatility of manufacturing returns in the past two years, as well as the challenges facing mining since the global commodity boom ended eight years ago. Mining profits dropped from R26 billion in the third quarter to R14 billion in the fourth quarter of 2018, while manufacturing profits fell from R55 billion to R46 billion.

Graph 17: Quarterly profits in manufacturing and mining in billions constant (2018) rand



Source: StatsSA, Quarterly Financial Statistics

Foreign direct investment projects

The TIPS FDI Tracker tracks foreign direct investment projects, analysing new and updated projects quarterly. Based on media monitoring, it added 14 new projects in the past quarter. Ten of these were in manufacturing, and five were greenfield projects. Six projects previously captured in the Tracker have been updated, with two reaching completion.

Table 2: New FDI projects captured in Quarter 1, 2019

	Announced	Construction	Exploration	Complete
Number of projects	7	2	1	5
Value(R bns)	R 139.7 Billion	R3.1 Billion	R2.3 Billion	R1.7 Billion
Industries	2 Services 4 Manufacturing 1 Mining	2 Services	Manufacturing	5 Manufacturing 1 Mining
Type	2 Brownfield 1 Upgrade 3 Expansion 1 Greenfield	2 Greenfield	1 Brownfield	3 Greenfield 1 Expansion 2 Upgrade
Companies	Royal Dutch Shell Weir Minerals Africa Helios Towers Handa Mining Komatsu Africa (2 Projects) Saudi Aramco	Jaguar SA/Grid Cars Nxuba Wind Farm	Total South Africa	Cummins Komatsu Africa Hisense Afarak Group Christian Hansen Weir Minerals Africa

New projects

The largest project announced this quarter is by Saudi Aramco. The oil company, which is owned by the Saudi Kingdom, pledged US$10 billion (R138 billion) for a new crude oil refinery and petrochemical plant. Saudi Aramco and the Central Energy Fund will jointly conduct studies to inform the next steps. The location of the project was not reported.

The second largest project was Helios Towers, a UK-based network infrastructure group that announced plans to build about 500 cellphone towers across South Africa for a pledged value of US$100 million (R1.4 billion). The company entered the South African market through a joint venture with local telecommunications firm, Vulatel, creating Helios Towers South Africa. It also acquired a controlling stake in SA Towers, a South African network infrastructure company. The project will be rolled out over a period of three years.

Following the launch of the Komatsu Industrial Campus in Germiston last year in November, the Japanese company Komatsu announced further investment in two projects for a total of R320 million. Its plans include a component remanufacturing centre that will cost an estimated R280 million. It will be based in Germiston with construction expected to be complete in 2020. The facility will be the final phase of the Komatsu Campus.

In addition, Komatsu has submitted plans to its board for an under-carriage repair and rebuild centre for an estimated R40 million. If approved, it will start construction in 2021.

Engineering solutions provider Weir Minerals Africa received capital expenditure approval of R30 million to upgrade its foundry in Port Elizabeth. The foundry supplies castings globally to Weir Minerals operations and direct customers. The investment will allow the firm to open its fourth moulding bay and enable the foundry to reach 100% capacity from the current level of between 60% and 70% in manufacturing metal castings. The moulding bay will be able to produce four castings of 18 tons a month. The company plans to commission the moulding bay at the end of June this year. The announcement of this project follows a R10 million investment completed last year in which Weir installed a Giesserei Umwelt Technik secondary sand reclamation plant, discussed below.

Shell South Africa and Canadian Handa Mining also announced new projects, but did not report on the anticipated value. Shell South Africa plans to launch electric vehicle charging stations in its retail network this year as part of its roadmap to 2025. Charging stations will be installed incrementally depending on demand. This investment follows an announcement last year by Shell of plans to invest about R1 billion in filling stations at 22 new locations as well as refurbishing existing stations and upgrading convenience stores across South Africa.

The final major project announced is a copper processing plant planned by Handa Mining. The company has signed a joint venture with O'okiep Copper and SHIP Copper, under which it will construct and fund the facility. The proposed plant will be in the Northern Cape. It will recover copper from broken rock on the surface of properties owned by O'okiep and SHIP. Handa will determine whether to go ahead with the project in the coming 60 days.

Jaguar and Enel Green Power South Africa account for the two projects under construction added to the Tracker. Jaguar is partnering with GridCars, a South African electric vehicle charging service equipment provider, on a R30 million infrastructure project. It plans to roll out around 82 public electric vehicle charging stations across the country. Stations will be located at every Jaguar Land Rover retailer and 30 designated key points including shopping centres in Johannesburg, Pretoria, Durban, Cape Town, Port Elizabeth, East London and Bloemfontein. South Africa's cities will also be connected through the Jaguar Powerway, a network of 22 charging station along major highways. The project was initiated in September 2018 and is scheduled for completion in November 2019.

Enel Green Power has started constructing the Nxuba wind farm in the Eastern Cape, investing over €200 million (R3.1 billion) in the project. The 140 MW wind farm is expected to generate over 460 GWh annually, preventing the emission of 500 000 tonnes of carbon dioxide per year. The project falls under Round 4 of the Renewable Energy Independent Power Producer Programme awarded in 2015. It has a 20-year power purchasing agreement with Eskom. It should be completed by September 2020.

French oil and gas company Total South Africa announced a major gas discovery about 275 kilometres south of Mossel Bay. The Brulpadda well spans about 19 000 square kilometres with water depths between 200 to 1800 metres. It is said to have a potential one billion barrels of gas condensate, which can be used as petrol. The gas condensate is a “wet” gas that contains small amounts of oil. Total owns 45% of the Brulpadda licensing rights in partnership with Qatar Petroleum (25%), Canadian Natural Resources (20%), and South African company Main Street (10%). Total and partners invested US$160 million (R2.3 billion) on the exploration. Total first attempted to drill in 2014 and abandoned that effort due to mechanical failures caused by the rough environment. The company intends to resume drilling in December 2019.

Existing projects

Of the complete projects added to the Tracker, the Komatsu Industrial Campus is the largest, worth R985 million. It will serve as the central hub for Komatsu’s operation across South Africa and the region. It comprises head offices, a technical training centre, an equipment workshop and a parts distribution centre.

Cummins, a US power company, has also consolidated its operations in South Africa in a central hub. It launched its new R350 million premises at the Midrand Waterfall Logistics Precinct. The investment consolidates the company’s expertise around mining, power systems, automotive and technical training. It will house the Cummins Southern Africa Regional Headquarters, the Master Rebuild Centre, Africa Learning Centre and Gauteng Operations.

Hisense has also expanded its Atlantis plant this quarter for an investment value of R72 million, creating around 150 job opportunities.

As indicated, Weir Minerals Africa completed the installation of a R10 million Giesserei Umwelt Technik secondary sand reclamation plant. The plant is a pneumatic conveyor system that operates at 14 tonnes per hour. It consists of three 70-tonne silos that store the facing sand, reclaimed sand and new sand, cooler-classifiers, rotary scrubber and magnetic separator. The investment aims to improve the reclamation and reusability of the sand used in the moulding process. As a result, it reduces the impact on the environment while improving the quality of the product at reduced production costs.

The Tracker added an investment by alloys producer Afarak, which is owned by a Finnish company. It has upgraded the Mogale Alloys processing plant in Krugersdorp by installing a system to convert industrial residual and flare gases into electricity, reducing energy costs and improving the plant’s environmental footprint. This is the first such system introduced in South Africa. There was no investment value reported for the investment.

Finally, the Lake Foods dairy application centre in Cape Town is a partnership between Christian Hansen and Lake Foods. Christian Hansen is a bioscience company headquartered in Denmark that supplies inputs to Lake Foods, which is the food and beverage division of chemical group AECI. Lake Foods manufactures and supplies specialty ingredients for bakery, dairy, nutrition and meat processing, among others. The value of the project, which will be financed by Christian Hansen in its first African project, was not reported.

Updated projects

Ford SA officially started building the Raptor in Silverton this quarter, in the official culmination of its R3 billion investment programme to expand the Silverton facility's capacity to build the Ford Ranger and Raptor.

Microsoft officially launched two Azure cloud data centres in Cape Town and Johannesburg to power cloud, artificial intelligence and edge computing innovations across Africa.

Tyme Bank, a digital bank that is a partnership between Australia's Commonwealth Bank and African Rainbow Capital (ARC), is now operational. It received its banking licence in 2017, the first issued by the Reserve Bank since 1999.

In mining there are updates for two projects.

Vedanta Zinc International officially opened the US$400 million (R5.5billion) first phase of its Northern Cape Gamsberg mine. With a 13-year expected life, this phase will produce four million tonnes of ore annually from the open pit and 250 000 tonnes a year of concentrate. Investigations into two further phases are underway that could lead to additional investment of at least US$350 million.

MC Mining has revealed a plan to develop the Makhado hard coking and thermal coal project. The project was initiated in 2012 but progress was delayed by lack of access to the key properties required to complete geotechnical drilling and confirm the positioning of the processing plant infrastructure. Title to the properties was transferred to an MC subsidiary in January 2019.

Briefing Note: The economic slowdown

The first quarter of 2019 saw a convergence of poor economic data. The GDP fell by 0.8%; investment, by 1.1%; and exports by 2%. Employment dropped by 1.4%, or 240 000 jobs. Seasonal job losses are not uncommon in the first quarter, but from 2010 to 2018 they averaged just 0.1%, so 2019 saw a significantly larger fall. Meanwhile, the fourth quarter of 2018 – the latest available data – saw net outflows of portfolio capital for only the second time since the global financial crisis in 2008, with almost R35 billion leaving the country.

The specific factors behind the slowdown are complex and contested, but understanding their dynamics are critical for developing appropriate responses. Inevitably, an analytical challenge arises around how much weight to give to international and domestic factors, and to policy missteps as opposed to economic trends.

The following figure indicates key issues in each of these areas.

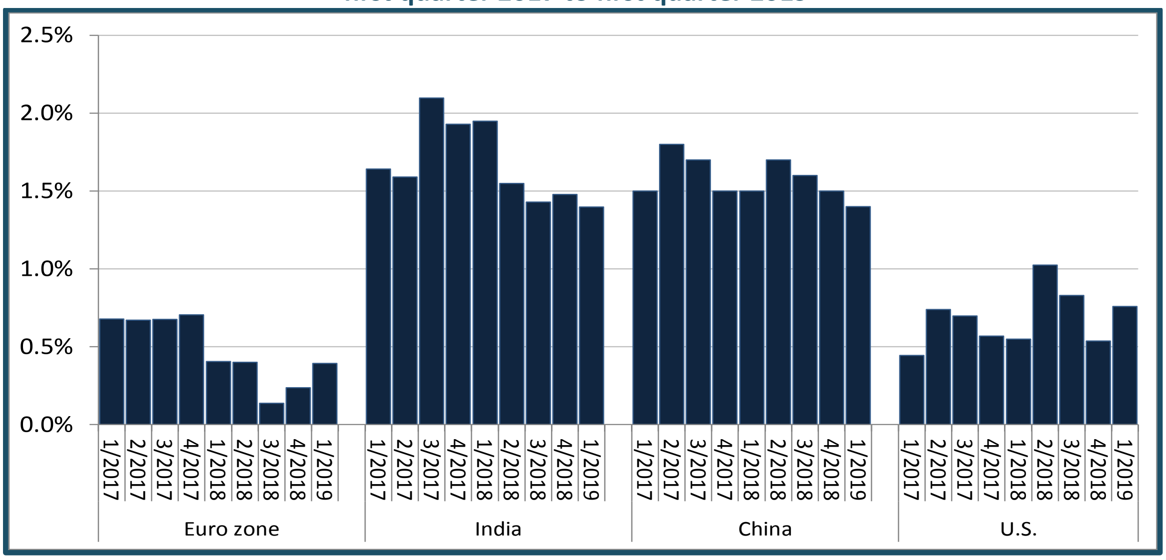
Figure 1. Sources of the downturn in the first quarter of 2019

International economic trends: • Slowdown in all of South Africa's major trading partners except the US. • Slowdown in the region with the end of commodity boom, deepening from 2015.	**International policy:** • Unpredictability of the Trump Administration affecting international investment climate and consumers, especially but not only through trade wars. • Uncertainty about US and EU interest rates leading to unpredictable financial flows. • Brexit affecting EU and UK, both major trading partners for South Africa.
Domestic policy: • Uncertainty due to elections and divided ruling party affecting high-end consumer confidence. • Uncertainty in aftermath of revelations about state capture.	**Domestic economic trends:** • Downward glide path from end of commodity boom (stagnation in heavy industry and mining). • Repeated droughts (linked to climate change). • Slowdown in government spending and SOC investment. • Failure to address on-going blockages to growth, especially electricity and logistics prices, permits of all kinds, workplace inequality and the associated conflict, and limits on skilled in-migration.

Over the past year, all of the dimensions in Figure 1 grew more hostile to growth. The current downturn has become a perfect storm, with domestic and international policy uncertainty aggravating the lingering impacts of the commodity price crash in 2011 and, more fundamentally, the 2008/9 global financial crisis.

China, Europe and India all saw slower growth in the past year; of the major economies, only the US expanded faster in 2018 than in 2017.

Graph 18. Quarterly growth in major economies (not annualised), first quarter 2017 to first quarter 2019



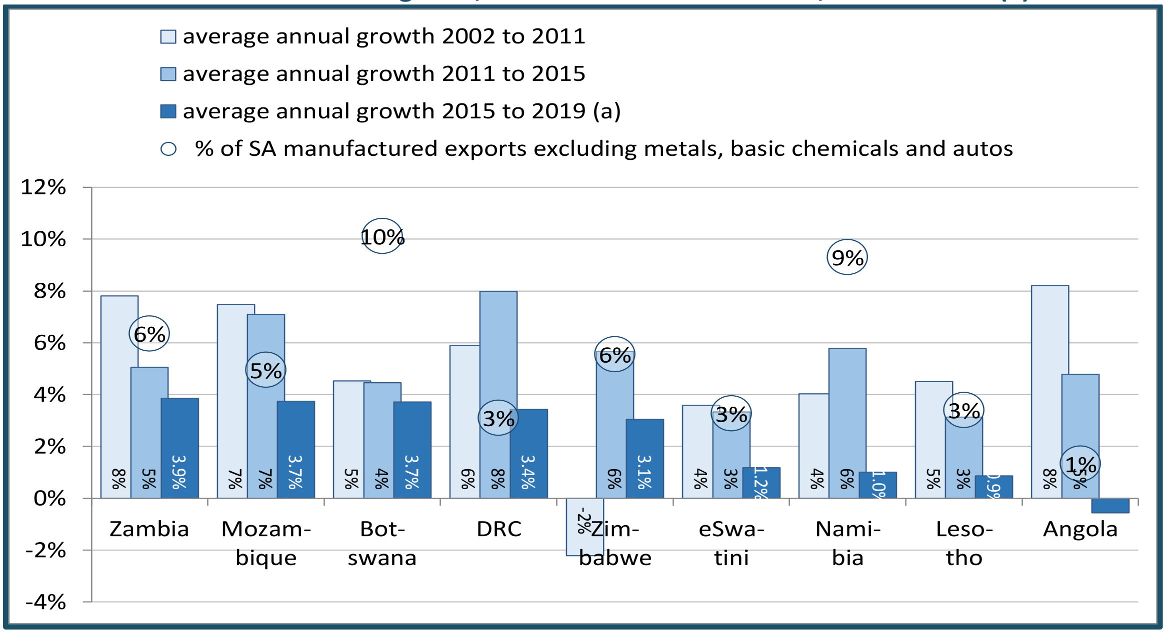
Source: OECD

International trade experienced a sharp contraction in the first quarter of 2019. In part that resulted from the underlying slowdown in major economies, especially China. It also followed from the deepening rivalry and the resulting trade war between the US and China, two of South Africa's three largest trading partners (the third is Germany). US imports fell 9% in the first quarter of 2019 and Chinese imports dropped 11%, while EU imports were essentially flat.

South Africa's exports to the US, the EU, Japan and Korea all dropped by over 10%, although its exports to China fell only 3%.

The Southern African region purchases half of South African manufactured exports outside of auto, basic chemicals and metals. It has experienced significantly slower growth since the end of the commodity boom in 2011, with a further slowdown in the past year.

Graph 19. Growth in southern African countries and share in South African exports of manufactures excluding auto, metals and basic chemicals, 2008 to 2019 (a)



Notes: (a) Projected by the IMF from 2018 for all countries, and from earlier years for some. Source: IMF. World Economic Outlook. February 2019.

In terms of international policy factors, the unpredictability of US trade policy aggravated the slowdown in global trade. The trade war between the US and China has contributed to slower growth in both economies, while US threats to impose tariffs on at least some commodities from virtually every major economy adds to uncertainty, deterring investment and undermining sales.

The uncertainty has also made it harder to predict US central bank policies, which largely shape capital flows into emerging markets like South Africa. Interest rates hikes in the US last year encouraged investors to leave South Africa. The risk of a slowdown means the US may end up cutting rates in the coming months, however, which could help reverse the short-term outflows.

Domestic policy factors behind the slowdown are harder to quantify. The past six months were marked by political uncertainty, linked in part to the run-up to the elections, and a drumbeat of reports on the state-capture project. That certainly contributed to delays in investment and consumer purchases, particularly by the higher income group – the top 10% of households – that accounts for over half of household consumption. It likely also accelerated the capital outflow at the end of 2018. The dire state of Eskom, which has a towering debt burden, has also affected both consumer and business decisions.

Domestic economic trends have been unfavourable for the past three years. In this period, public investment and government spending both saw slower growth; Eskom resorted repeatedly to loadshedding; and a series of severe droughts rocked agriculture and tourism, underscoring the failure to develop strategies to minimise the effects of climate change.

In sum, the loss of jobs and decline in GDP in early 2019 reflected a range of domestic and foreign factors in both the policy and economic arenas. The election outcomes should help address policy uncertainty, but only if there is more discipline in discussions, at least within the state and the ANC.

That won't fix the international slowdown, however, which has been aggravated by the repeated mini-crises provoked by unpredictable US dictates. In response, South Africa will have to explore pro-active approaches to sustain growth. Innovative measures are needed given the limited space for a conventional fiscal and monetary stimulus, although pro-cyclical measures should obviously be avoided. In addition to the existing investment drive, they could include for instance more developmental investments of the huge surpluses in the social security funds, especially to expand industrial finance, and more effective measures to promote local procurement. In addition, with global trade under threat, South Africa needs to play a more strategic and consistent role in supporting economic growth in the region, and look to the emerging opportunities from the African Continental Free Trade Agreement.

Briefing Note: African Continental Free Trade Area (AfCFTA) – Supporting inclusive growth and transformation*

The African Continental Free Trade Area (AfCFTA) requires 22 countries to ratify its adoption and submit proof/deposit the instruments of ratification with the African Union (AU) for it to come into effect. On 29 April that happened, and on 30 May 2019 the free trade agreement came into effect.

Work, however, still needs to be done on the operationalisation of the agreement, and the supporting instruments need to be finalised. These instruments will involve complex negotiations as they cover: "Rules of origin; schedules of tariff concessions on trade in goods; online non-tariff barriers monitoring and elimination mechanism; digital payments and settlement platform; and African Trade Observatory Portal."[1]

Several studies undertaken by economic researchers predict that the AfCFTA has the potential to increase growth, raise welfare and stimulate industrial development on the continent. The size of the market is staggering. The Brookings Institute argues that "if successfully implemented, the agreement will create a single African market of over a billion consumers with a total GDP of over US$3 trillion. This will make Africa the largest free trade area in the world."[2]

The major beneficiaries of the AfCFTA will be those economies in Africa that have the capacity to expand their exports of goods and services into the rest of the continent. These are mainly South Africa, Nigeria, Kenya and Egypt. However, there are concerns that some countries, particularly the smaller and more vulnerable economies, may experience the negative impacts of premature liberalisation and fiscal revenue losses.

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[1] AU. (2019) AfCFTA Agreement secures minimum threshold of 22 ratification as Sierra Leone and the Saharawi Republic deposit instruments. Press Release. African Union.

[2] Songwe, V. (2019). Intra-African trade: A path to economic diversification and inclusion. Foresight Africa 2019 Series. Brookings Institute.

Several authorities, including the UN Commission on Trade and Development (UNCTAD) and the Economic Commission for Africa, have also argued that the "sequential" or simple "free trade" European approach to regional integration is not appropriate for developing countries, especially in the African context. These researchers argue that African countries should adopt an approach to regional integration referred to as "developmental regionalism". This approach includes four elements: fair trade; structural transformation; cross-border investment in infrastructure; and democratic governance.

First, Africa's member states have a wide variety of categories of countries that may require special attention and specific treatment. The 55 African member states are made up of 34 least developed countries (LDCs), 16 landlocked developed countries (LLDCs) and six small island developing states (SIDS). Building trade agreements in favour of small and less developed economies will assist in contributing to fairer outcomes of the AfCFTA and a more balanced and mutually beneficial regional integration process.

The private sector, civil society and academics/intellectuals must play a robust and active role in driving the process in parallel, and in partnership with national governments.

Second, co-operation between Africa's emerging entrepreneurs and industries towards building regional value chains to compete more effectively in global markets will advance transformative industrialisation, obtain a fairer share of the value obtained from our commodities and our labour, and improve the lives of the people on our continent.

There are numerous industrial sectors in Africa that are ripe for the development of regional value chains: agro-processing, pharmaceuticals, iron and steel and capital goods, clothing and textiles, leather and footwear and the automotive sector.

The AfCFTA must allow for adequate policy space for African states to build the necessary trade and industrial policies, laws, regulations and institutions to build their infant industries.

Third, African countries will need to strengthen their co-operation in building their hard infrastructure (including, ports, road and rail) and soft infrastructure (including customs co-operation at borders, port efficiency and reducing roadblocks along major transport routes).

The AfCFTA has annexes on “customs cooperation”, “trade facilitation”, and on “transit”. All three of these issues are also covered in the World Trade Organization Agreement on Trade Facilitation and must be implemented with adequate attention to the capacity constraints of the poorest countries.

Fourth, co-operation between African governments on institutionalising and consolidating democratic governance will provide the stability required to stimulate economic growth and development.

The NEPAD Declaration on Democracy, Political, Economic and Corporate Governance adopted at the AU Summit held in Durban, South Africa, in 2002 committed African countries to work together in pursuit of the objectives of democracy, good governance, and the creation of an African Peer Review Mechanism (APRM).

Currently, the APRM has 37 members with Namibia and The Gambia being the most recent members to accede. At least 20 African countries have already undertaken a first country review. The APRM is a truly indigenous and locally owned initiative designed by Africans, for Africans.

This approach to regional integration in Africa has great potential to catalyse and accelerate a virtuous circle of regional trade integration, transformative industrialisation, cross-border infrastructure, democracy, inclusivity and good governance across the continent.

The coming into effect of the AfCFTA on 30 May 2019 will become a landmark, and the transition to a new phase in the historic journey of Africa to realise the dreams of the Pan-African leaders for a peaceful, prosperous and integrated Africa.

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