THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

THIRD 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

For the second time this year, the GDP contracted in the third quarter of 2019. In the past two years, the economy has reportedly shrunk in four quarters, underscoring the effects of the slowdown. Reported GDP growth has also become unusually erratic, with the economy growing reasonably strongly when it was not actually shrinking.

After rebounding by 0.8% between the first and the second quarter, GDP contracted by 0.1% in the third quarter of 2019, which is an annual rate of 0.6%. The economy has contracted for two quarters this year, although the rate of the decline was smaller compared to the first quarter of 2019, when GDP contract by 0.8%.

Graph 1 reflects the growing volatility in GDP data since 2014. Since then, the reported GDP has contracted in eight quarters; in the previous two decades, it declined only during global downturns. The standard deviation for growth from 2015 was 2.5 times the average; from 2010 to 2015, it was smaller than the average. Some of the reported volatility apparently reflects problems with the seasonal adjustment of quarterly GDP figures, as discussed in the last issue of the REB, but the data also reflect both slower and more erratic economic growth.

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

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Passing of Ben Turok

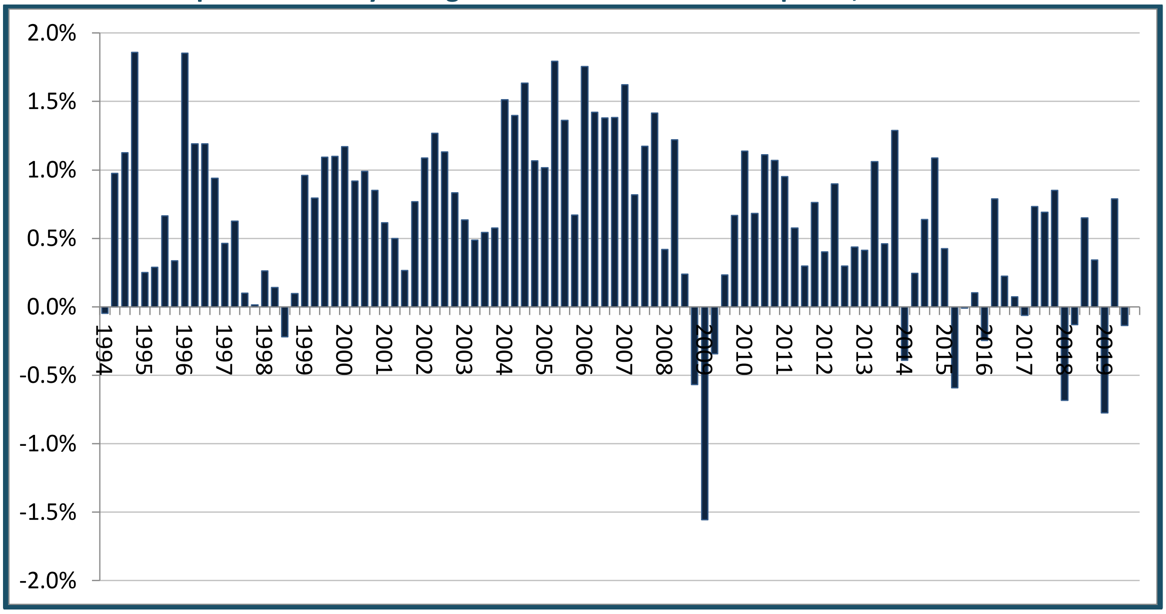
TIPS is deeply saddened by the passing of Professor Ben Turok. TIPS worked closely with Ben over the past few years as he used his leadership role in the Institute for African Alternatives and the New Agenda journal to open space for engagement on heterodox responses to the socio-economic challenges facing South Africa.

Ben was an inspiring orator and a prolific writer who played an important role in economic thinking and policy advocacy. From his contributions to the Freedom Charter seventy years ago to his recent work on structural inequality and economic dependency in modern South Africa and the continent as a whole, he promoted a vision of a more inclusive and equitable society.

Ben was passionate about our country and our continent. He was deeply concerned about the persistence of profound inequalities in wealth, incomes and power in South Africa, as well as the slow pace of structural transformation in African economies.

He will be missed.

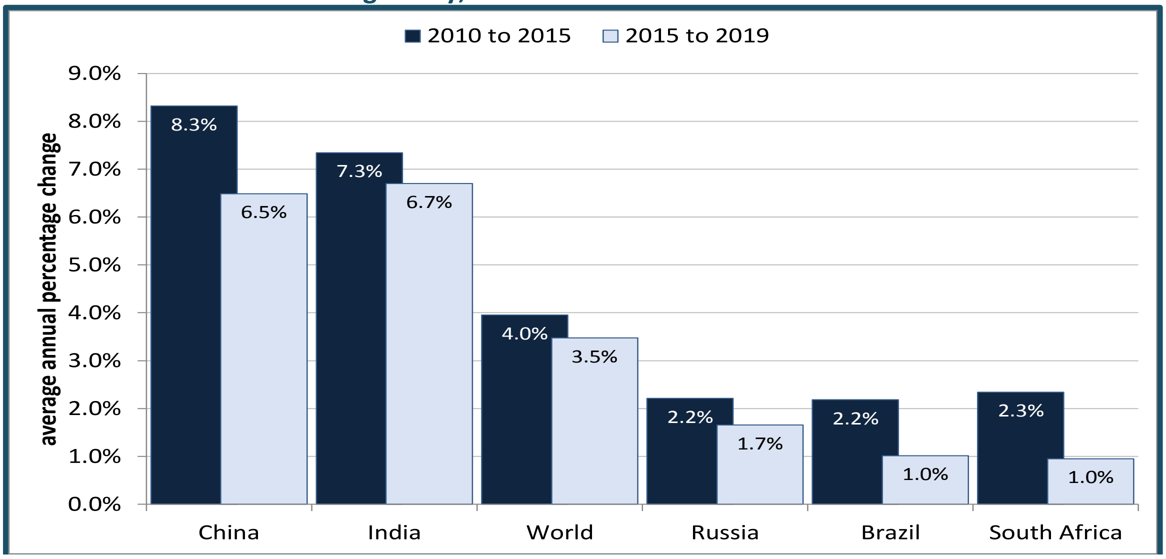
Graph 1. Quarterly change in GDP at constant 2010 prices, annualised



Source: Statistics South Africa (StatsSA) GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za December 2019.

South Africa has company in the slowdown since 2015, as the experience of the BRICS shows. Still, South Africa has seen more depressed growth (see Graph 2).

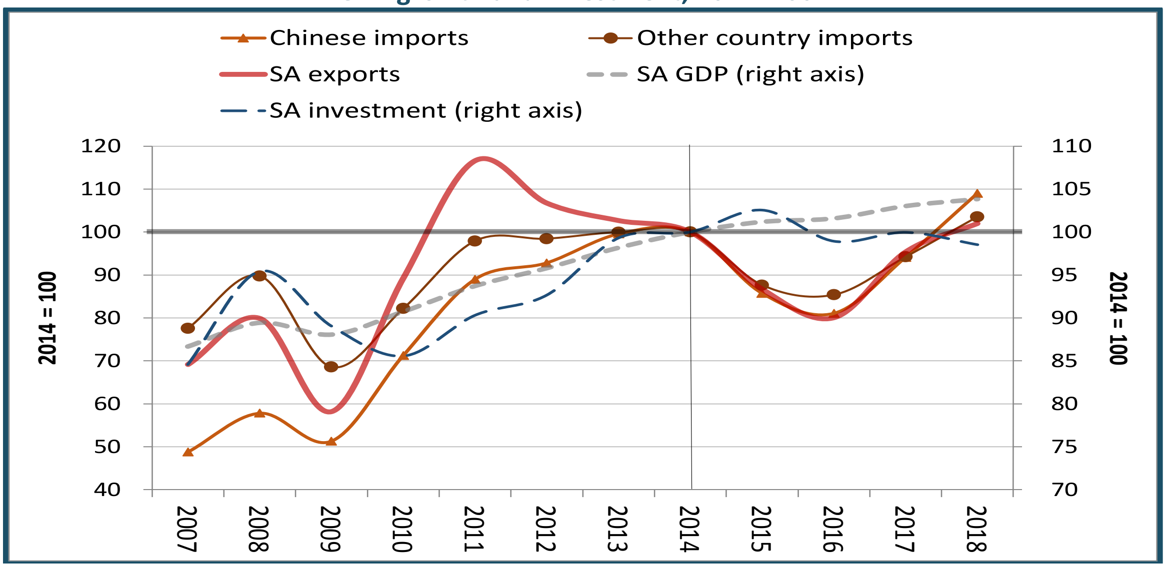
Graph 2. Annual percentage growth in GDP in BRICS countries (a) and globally, 2010 to 2015 and 2015 to 2019



Note: (a) The magnitude of the growth rates for both China and India have been queried, but the trends are likely accurate. Source: IMF, World Economic Outlook, October 2019. IMF estimates for 2019.

The slowdown across most developing economies points to the importance of global headwinds, not just domestic policy. In particular, from 2015, all of South Africa's main trading partners saw a fall in their total imports. In the same period, not surprisingly, South Africa's exports in dollars also fell, at a similar rate to the fall in its partners' imports. The decline in South Africa's foreign sales was associated with slower GDP growth and, with a delay, a drop in investment.

Graph 3. Indices of global import trends compared to South African exports, GDP growth and investment, 2014=100

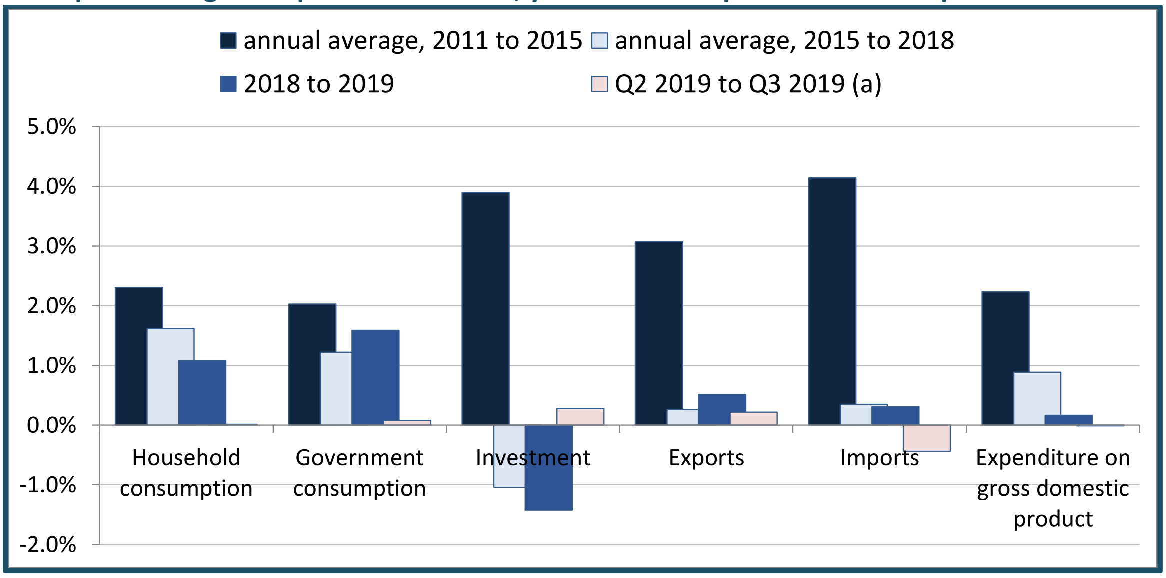


Source: For trade data, Trade Map; for GDP and investment, Statistics South Africa.

From the expenditure perspective, the contraction in the third quarter of 2019 was due entirely to a decline in inventories, as consumption, investment and the balance of trade grew at least somewhat. Inventories are far more volatile than other elements of demand, and their swings are often hard to explain. From 2018 to 2019, using the year to the third quarter, inventories fell from R8 billion to negative R10 billion. From the second quarter of 2019 to the third quarter, they dropped from R27 billion to negative 10 billion.

Still, the sharp fall in inventories only caused an overall contraction in the GDP last quarter because growth in government and household consumption slowed to far below the average for the year. In contrast, investment ticked up. As discussed in the section on investment, growth was entirely due to improved private investment.

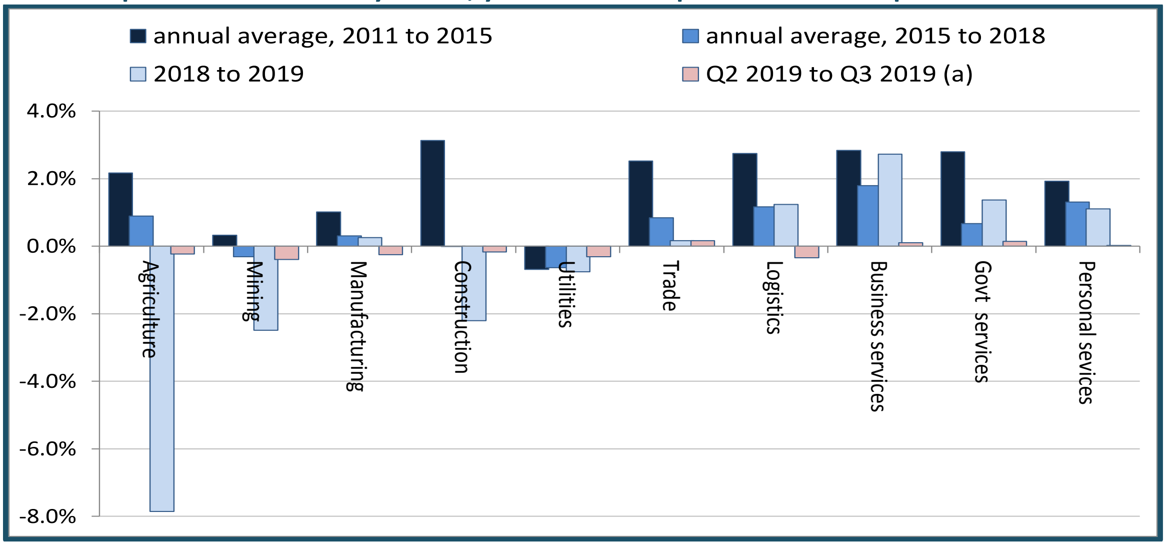
Graph 4. Change in expenditure on GDP, year to second quarter and third quarter of 2019



Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in December 2019. Note: (a) Seasonally adjusted.

By industry, all the sectors of the real economy saw a contraction between the second and third quarters of 2019. Only manufacturing recorded growth for the year to September. Agriculture again saw a sharp decline, reflecting severe localised droughts. Construction also continued to shrink, which – as noted below – was associated with significant job shedding. The services and retail grew, but only very slowly.

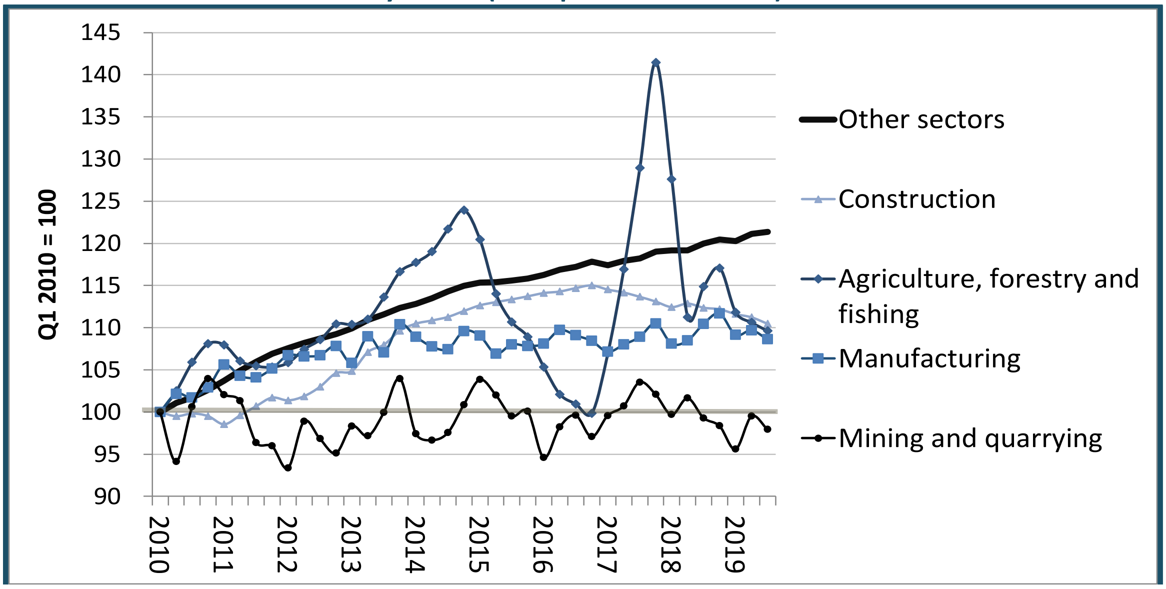
Graph 5. Growth rates by sector, year to second quarter and third quarter of 2019



Source: StatsSA GDP quarterly figures. Excel spreadsheet downloaded www.statssa.gov.za in December 2019. Note: (a) seasonally adjusted, annualised.

Graph 6 shows the extraordinary volatility of agriculture in recent years, reflecting the increased severity of droughts as the climate crisis deepens. Construction has shrunk in every quarter save one since the end of 2016, contracting a total of 4%, after it had grown equally steadily from 2010 to 2016. Manufacturing and mining have fluctuated but have remained essentially unchanged since 2014. The rest of the economy, dominated by public and private services and by trade, has shown comparatively consistent growth over the past decade.

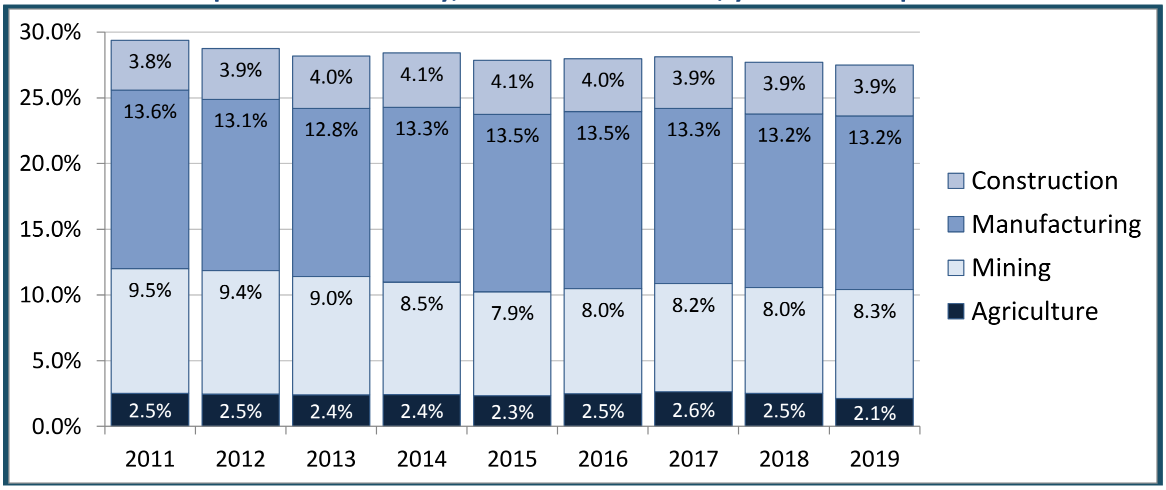
Graph 6. Indices of quarterly contribution to GDP in constant terms, by sector (first quarter 2010 =100)



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

As a result of these trends, the share of the real economy in the GDP fell from 29% in 2011 to 27% in 2019. From 2018 to 2019, using the year to third quarter, its share fell from 27.7% to 27.5%, mostly because of the decline in agriculture.

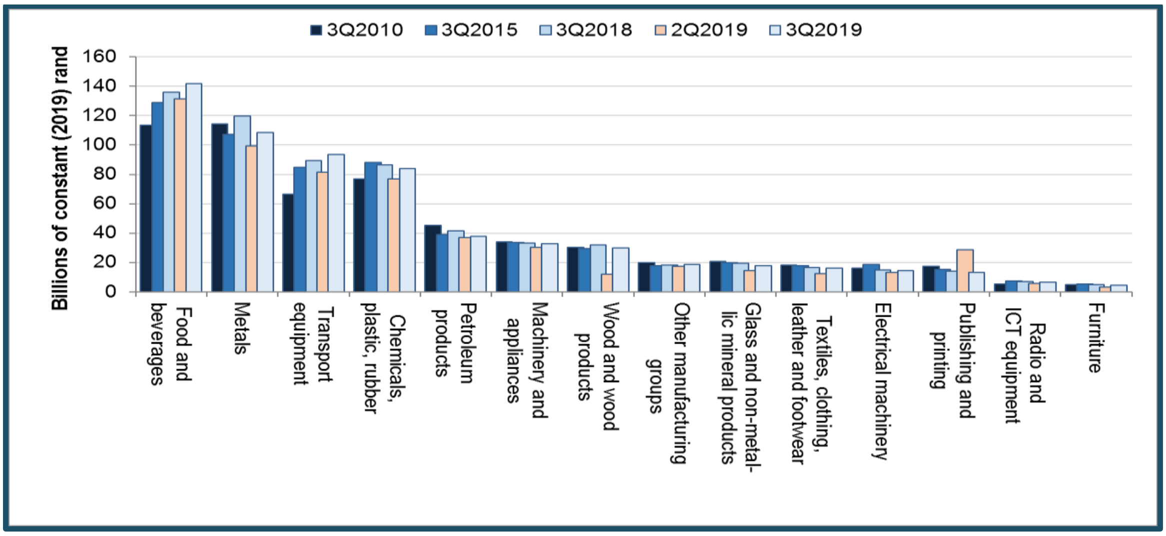
Graph 7. Real economy, sector shares of GDP, year to third quarter



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

In the third quarter of 2019, there was an uptick in total manufacturing sales compared to the second quarter of 2019. The quarterly figures are volatile, however, and manufacturing sales have shown no significant growth since 2015. Only publishing and printing showed a fall in sales between the second and third quarter of 2019. The largest gains were recorded for wood and wood products, transport equipment, metals, and food and beverages.

Graph 8. Manufacturing sales, constant rand, 2010 – 2019



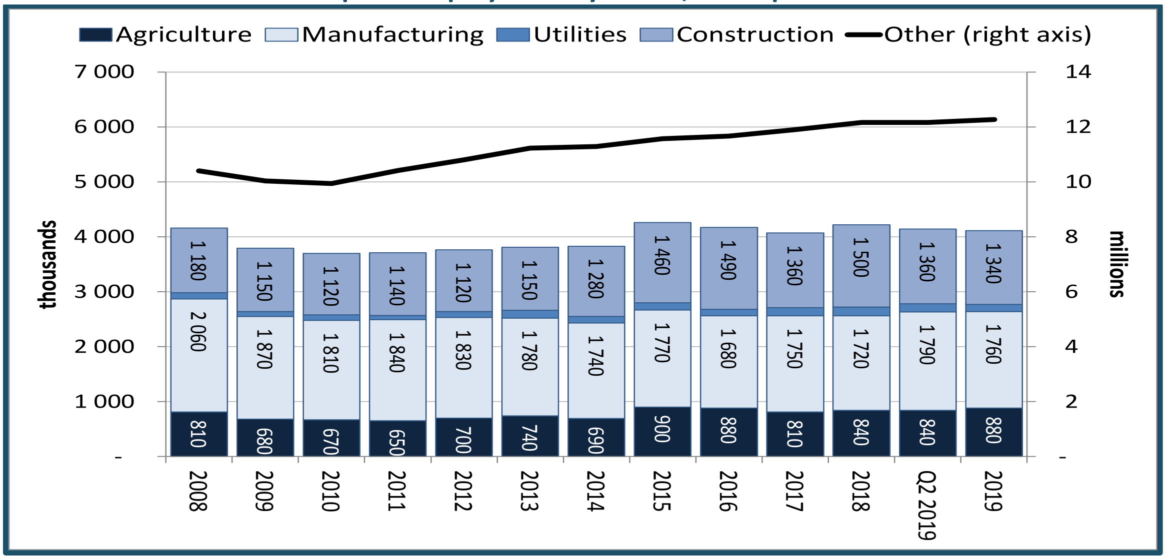
Statistics South Africa (StatsSA). Manufacturing volume and sales from 1998. Excel spreadsheet. Downloaded in November 2019.

Employment

Total employment remained virtually unchanged over the past year. Construction lost 160 000 jobs, however, which was offset by growth in other industries. Quarterly figures are hard to interpret because they are not seasonally adjusted.

From the third quarter of 2018 to the third quarter of 2019, total employment did not change significantly. Construction, however, shed 160 000 jobs, or over 10% of the total. The contraction in construction was offset mostly by a gain of 100 000 jobs in retail, as well as 40 000 each in agriculture and manufacturing. Employment in agriculture and manufacturing has remained almost unchanged since 2015.

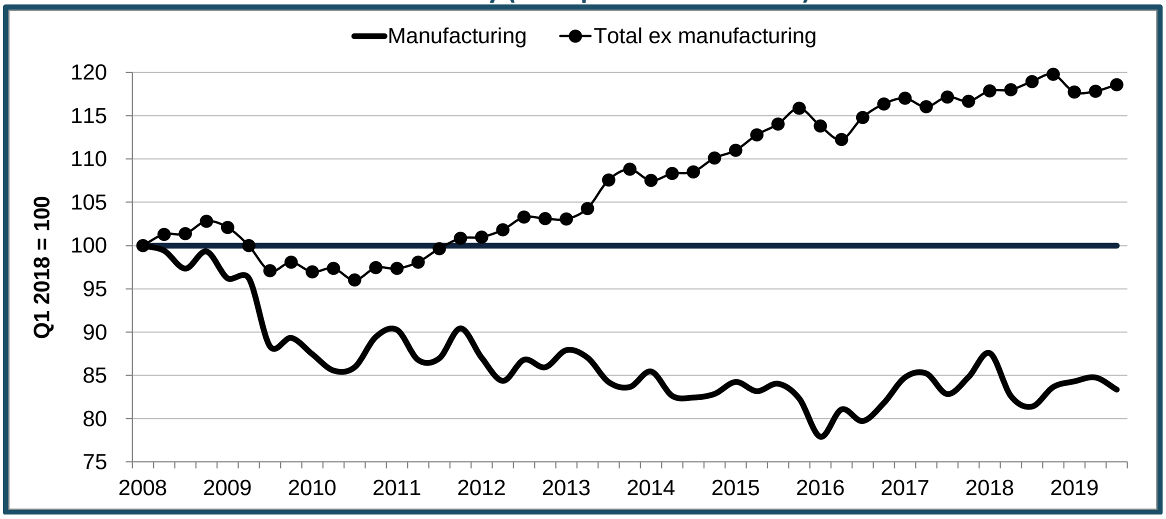
Graph 9. Employment by sector, third quarter



Source: Calculated from StatsSA. QLFS –2008-2019 Q3. Electronic database. Downloaded from www.statssa.gov.za.

As Graph 9 shows, for the past five years manufacturing employment has fluctuated in a narrow band around 1.75 million. In the third quarter of 2019, it reported employment at just 22 000 above the third quarter of 2015, which is a statistically insignificant change. In contrast, employment in the rest of the economy climbed by 335 000 in this period, or 2.3%. For comparison, the working age population increased by 2.5 million, or over 6%.

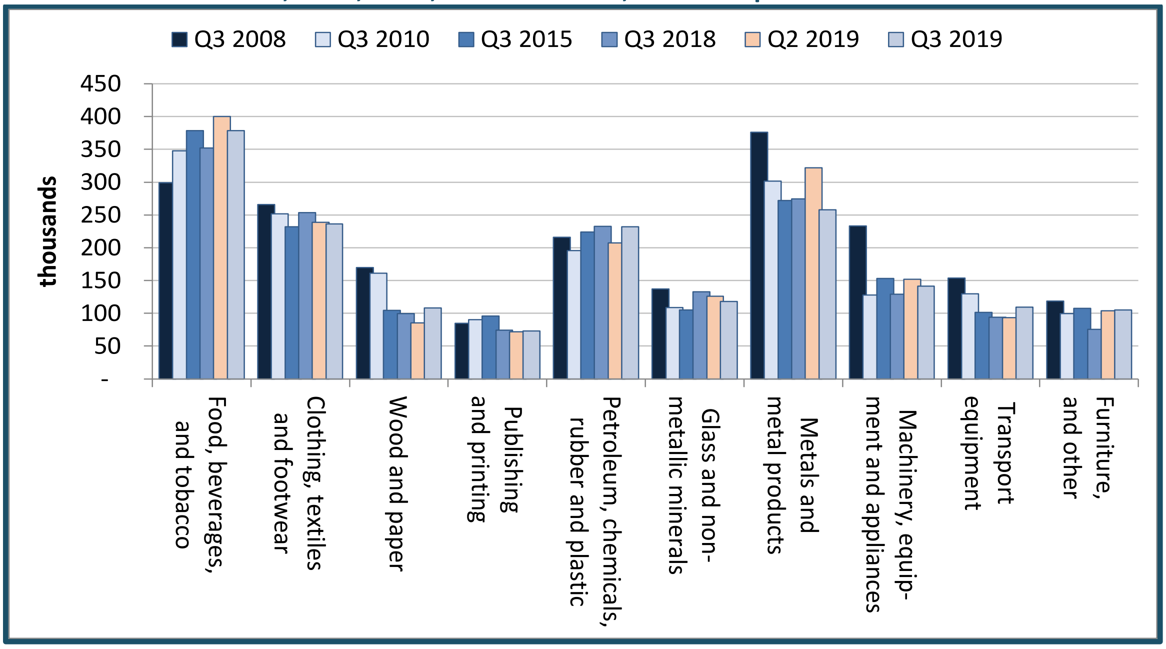
Graph 10. Indices of employment in manufacturing and the rest of the economy (first quarter 2008 = 100)



Source: Calculated from StatsSA. QLFS –2008-2019 Q3. Electronic database. Downloaded from www.statssa.gov.za.

Within manufacturing, metals, clothing and non-metallic minerals saw net job losses. Overall, heavy industry has not recovered from the severe job shedding it experienced in the 2008/9 global financial crisis. Employment in food processing, which saw rapid gains through 2015, has stagnated since then.

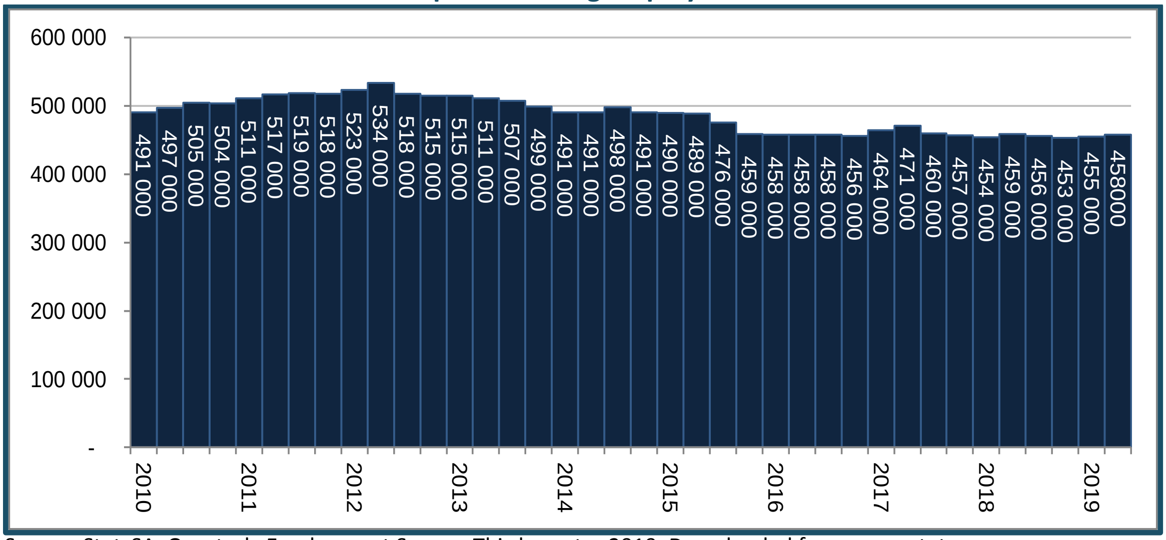
Graph 11. Employment by manufacturing industry, second quarter of 2008, 2010, 2017, 2018 and 2019, and first quarter of 2019



Source: Calculated from Statistics South Africa. Quarterly Labour Force Survey. Electronic database. Relevant quarters. Downloaded from Nesstar facility at www.statssa.gov.za.

For mining, Statistics South Africa recommends use of its employer survey, the Quarterly Employment Statistics, which lags a quarter behind the household-based Quarterly Labour Force Survey. The mines shed around 75 000 jobs from 2012 to mid-2017, but since then mining employment has flattened out.

Graph 12. Mining employment



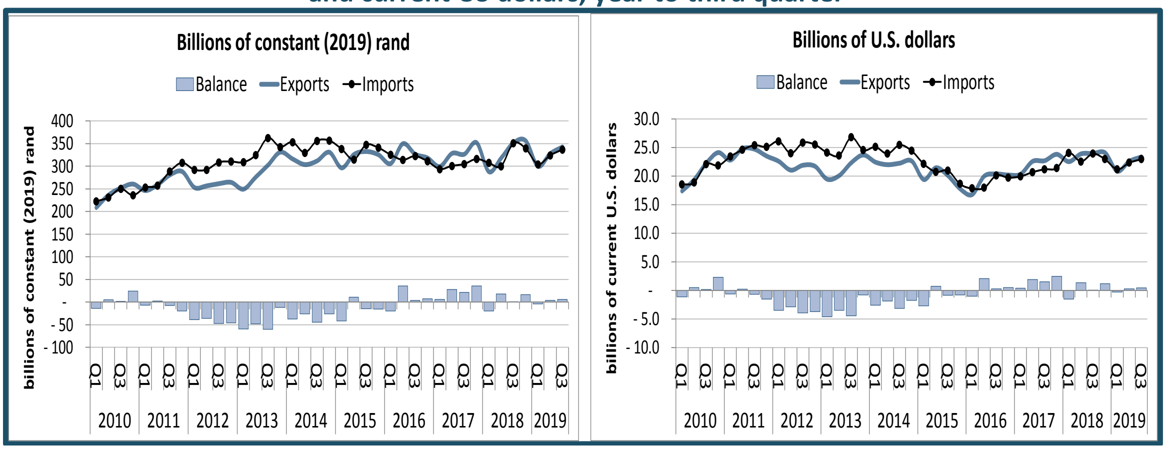
Source: StatsSA. Quarterly Employment Survey. Third quarter 2019. Downloaded from www.statssa.gov.za.

International trade

In constant rand, South African exports have increased slightly since 2014, while imports are lower than they were five years ago despite some increases in the past two years.

Over the last quarter, exports and imports both increased by 4%. The trade surplus stood at R6 billion. Since 2015, slower growth has been associated with an improved balance of trade in most years. In dollar terms, trade has been more volatile, with a sharp fall in imports and exports from 2014 to 2015 followed by a near-recovery.

Graph 13. Exports, imports and balance of trade in constant rand and current US dollars, year to third quarter

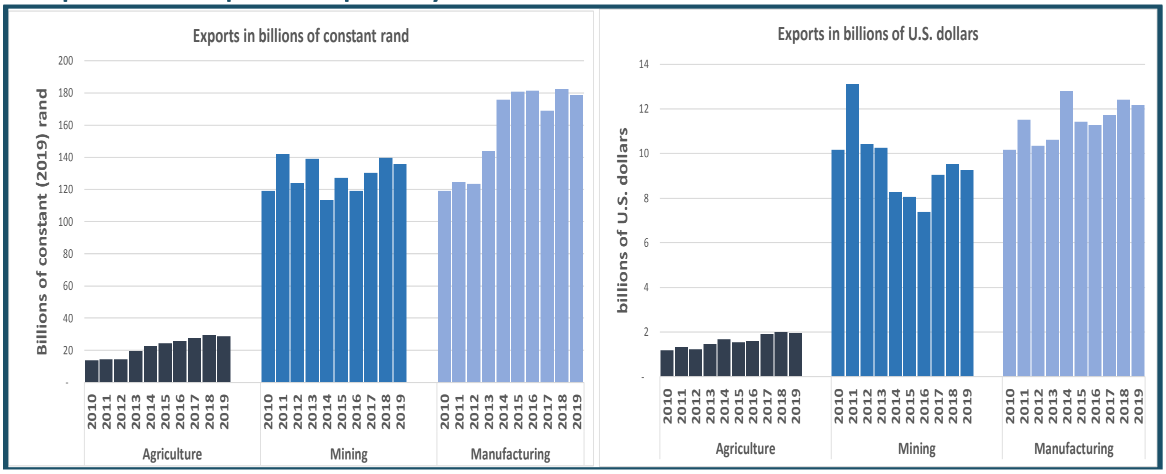


Source: South African Revenue Service (SARS) monthly data.

Exports declined slightly from the third quarter of 2018 to the third quarter of 2019 in both constant rand and dollars for agriculture, mining and manufacturing.

Mining exports recovered sharply in 2016 as metals and coal prices internationally moved up, although not to the heights of 2011, but have since levelled out. Manufacturing exports have essentially stagnated since 2016.

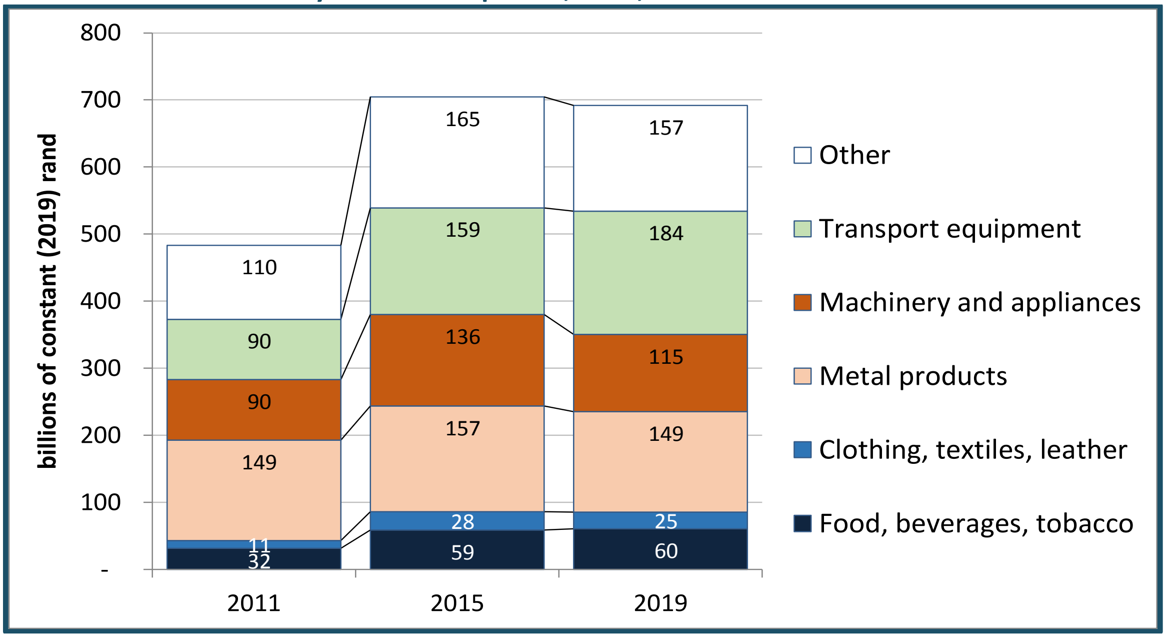
Graph 14. Third-quarter exports by sector in billions of constant rand and current US dollars



Source: South African Revenue Service (SARS) monthly data.

The relatively slow growth in manufacture exports has been accompanied by a substantial shift in their composition, with a decline in machinery and metals since 2016 offset by growth in auto.

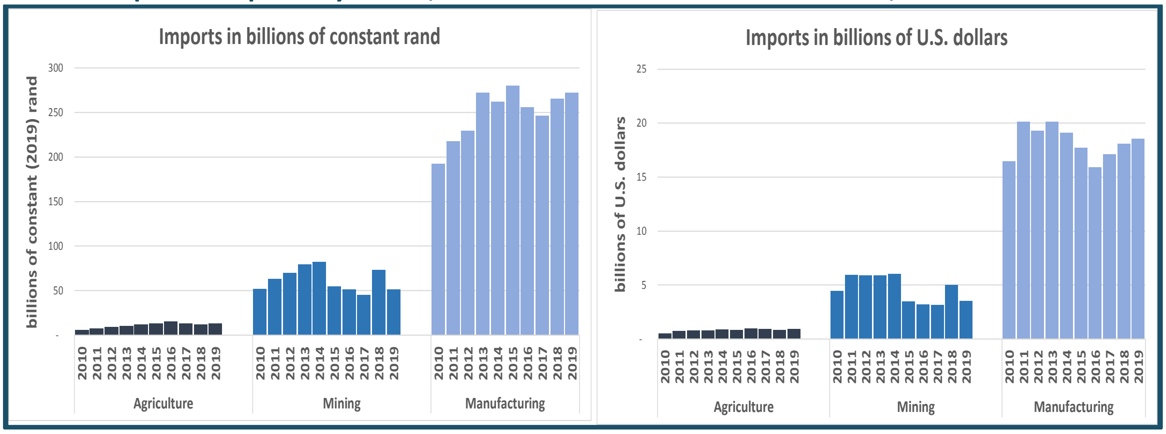
Graph 15. Manufactured exports by industry, in constant 2019 rand, year to third quarter, 2011, 2015 and 2019.



Source: South African Revenue Service (SARS) monthly data.

On the import side, manufactures continued to rebound after falling sharply from 2015 to 2016. The (much smaller) imports of agricultural and mining products remained largely unchanged from 2017 to 2019.

Graph 16. Imports by sector, constant rand and current US dollars, 2010 to 2019



Source: South African Revenue Services (SARS) monthly data.

Exports contracted across all subsectors of manufacturing, excluding metals and machinery, between the third quarter of 2018 and the third quarter of 2019. The contraction in exports was largely driven by transport equipment, glass and non-metallic mineral products, and clothing and footwear. Machinery and metals, in contrast, saw some recovery from their five-year decline. Both industries recorded positive changes in exports over the last year. Machinery and appliances improved by 13% in both constant rand and dollar terms, between 2018 and 2019. Metals and metal products improved by just below 2% which is an increase of just over half a billion, in constant rand.

Table 1. Trade by manufacturing industry

	Value (billions)		% change from Q3 2018		Change in billions	
Industry	**USD**	**Rand**	**USD**	**Rand**	**USD**	**Rand**
EXPORTS						
Food and beverages	0.42	6.1	-4.1%	-4.1%	-0.02	-0.26
Clothing and footwear	0.13	1.9	-14.0%	-14.1%	-0.02	-0.31
Wood products	0.40	5.9	-12.4%	-12.8%	-0.06	-0.87
Paper and publishing	1.86	27.2	-1.8%	-1.9%	-0.03	-0.53
Chemicals, rubber, plastic	0.11	1.6	-9.3%	-9.3%	-0.01	-0.17
Glass and non-metallic mineral products	2.29	33.6	-19.2%	-19.1%	-0.54	-7.93
Metals and metal products	2.10	30.8	1.7%	1.9%	0.04	0.59
Machinery and appliances	3.57	52.4	13.4%	13.1%	0.42	6.06
Transport equipment	0.21	3.1	-21.7%	-22.0%	-0.06	-0.87
IMPORTS						
Food and beverages	1.21	17.8	-2.0%	-2.0%	0.0	-0.36
Clothing and footwear	0.09	1.3	-2.4%	-2.4%	0.0	-0.03
Wood products	0.68	9.9	6.9%	6.9%	0.0	0.64
Paper and publishing	3.46	50.7	-3.7%	-3.6%	-0.1	-1.87
Chemicals, rubber, plastic	0.28	4.1	-0.5%	-0.3%	0.0	-0.01
Glass and non-metallic mineral products	1.13	16.5	-3.7%	-3.7%	0.0	-0.64
Metals and metal products	6.01	88.2	7.8%	7.7%	0.4	6.27
Machinery and appliances	4.39	64.2	5.3%	5.2%	0.2	3.20
Transport equipment	0.44	6.4	-7.0%	-7.0%	0.0	-0.48

Source: South African Revenue Services (SARS) monthly data.

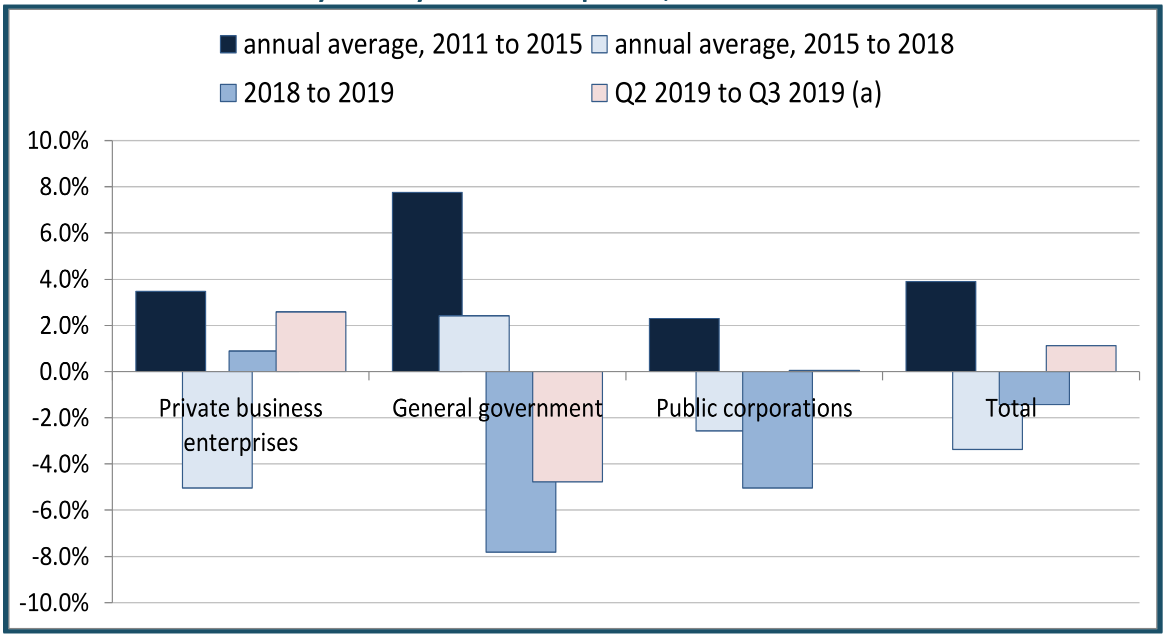
Turning to imports, six of the nine manufacturing subsectors recorded a decline in imports between 2018 and 2019. In rand terms, the largest contractions in imports were observed for transport equipment, glass and non-metallic mineral products and paper and publishing. Metals, machinery and wood products experienced the largest increases in imports.

Investment and profitability

Private investment recovered over the year to September 2019, with a particularly sharp increase in the second to third quarter 2019. This growth reversed a decline over the previous three years. In contrast, both the government and state-owned corporations (SOCs) saw a fall in investment.

Private investment climbed by almost 1% in the year to September 2019, and at an annualised rate of 2.6% in the third quarter alone. While modest for the whole year, the growth reversed the fall in the previous three years. This suggested that the government's efforts to promote private investment had enjoyed at least some initial success. In contrast, public investment, which accounts for around 30% of total investment, fell by 6.5% in the year to September 2019. Government investment alone dropped at annual rate of almost 5% in the third quarter.

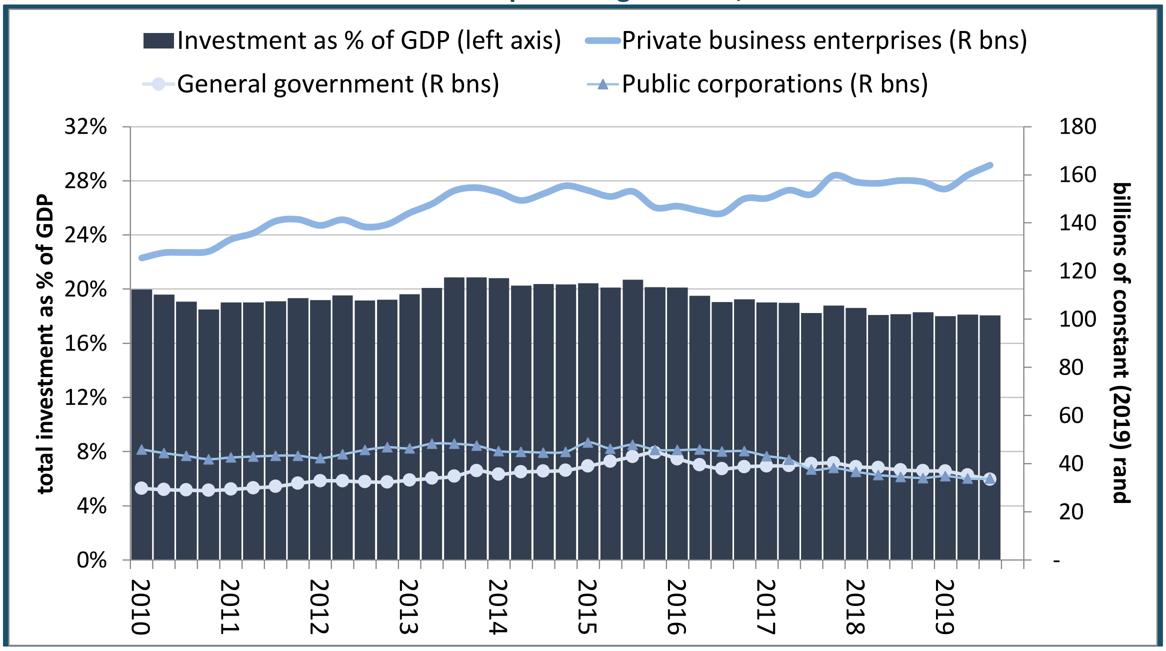
Graph 17. Change in investment by type of organisation, year on year to third quarter, 2011 to 2019



Source: Statistics South Africa (StatsSA) GDP quarterly figures. Excel spreadsheet downloaded from www.statssa.gov.za in December 2019. Note: (a) Seasonally adjusted.

As a percentage of GDP, investment has remained relatively unchanged at 18% since mid-2017, after falling from over 20% in 2015. The stabilisation in the investment rate reflects slow growth in overall investment, mostly due to the decline in capital formation by government and state-owned agencies.

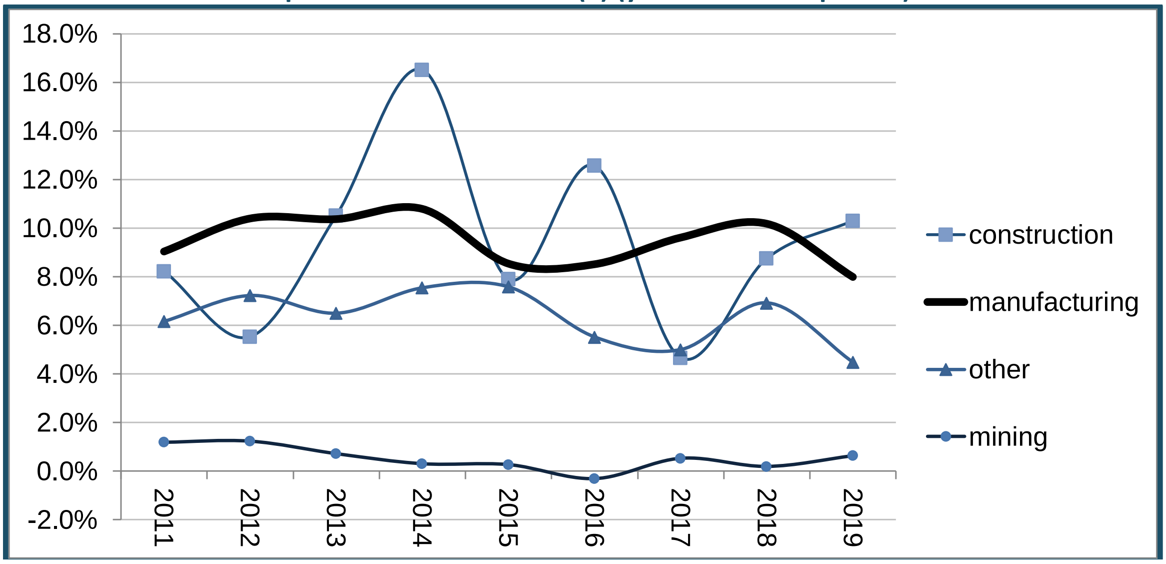
Graph 18. Quarterly seasonally adjusted investment by type of organisation in constant rand as a percentage of GDP, 2010 to 2019



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

The return on investment in manufacturing declined from 10% to 8% in the year to the second quarter 2019 (the latest available data). In contrast, mining and construction both saw a modest improvement in profitability, although construction remained highly volatile. Profitability in the rest of the economy, excluding agriculture, fell from over 6% to 4%.

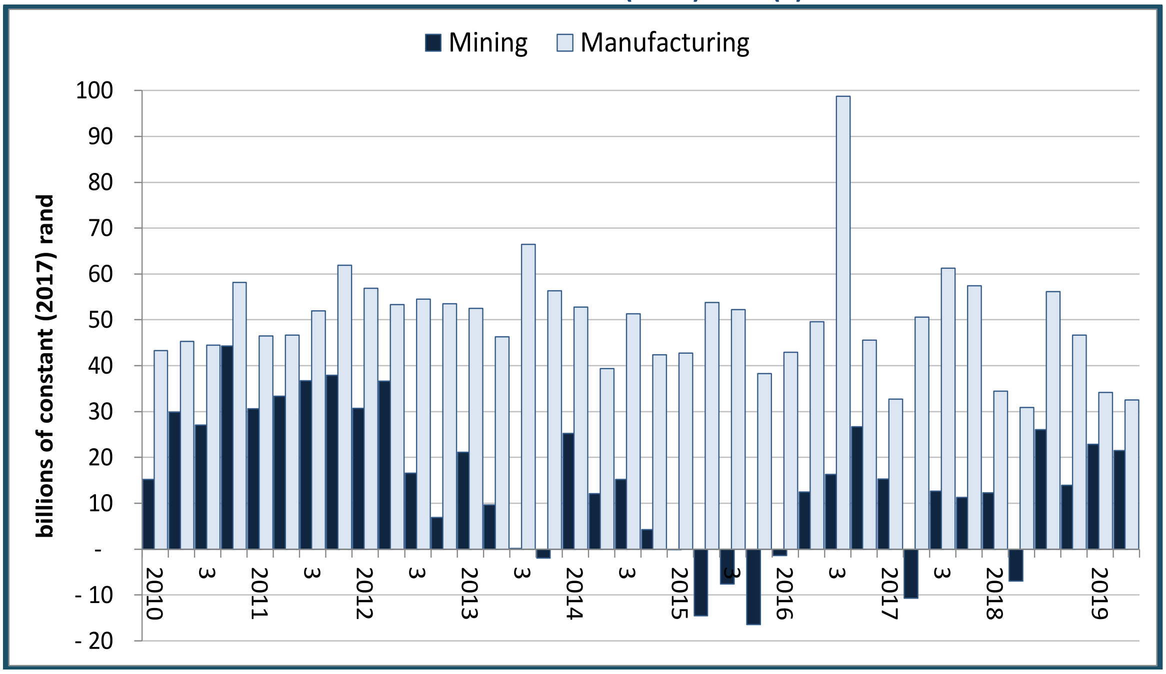
Graph 19. Return on assets (a) (year to second quarter)



Note: (a) Net profit or loss before tax as percentage of total assets. Source: StatsSA, Quarterly Financial Statistics.

In constant rand, manufacturing profits fell sharply in the first half of 2019, while mining profits stabilised.

Graph 20. Quarterly profits in manufacturing and mining in billions of constant (2019) rand (a)



Note: (a) Deflated with CPI rebased to June 2019. Source: StatsSA, Quarterly Financial Statistics.

Foreign direct investment projects

The TIPS Foreign Direct Investment Tracker monitors FDI projects, on a quarterly basis, using published information. In the third quarter of 2019, 16 projects were added to the FDI Tracker. Investment values were available for 11 of these projects, and the pledged value came to R13 billion.

Most of the investment projects were in the manufacturing sector, contributing R4.5 billion to the total investment value. The biggest contributors in terms of value, however, were from utilities projects, which comprised R6.7 billion of the total value of investment.

In terms of projects by type, greenfield projects dominate in the number of projects and the pledged investment value, with eight projects worth R7.3 billion. By phase, five projects under construction accounted for R8.5 billion.

Table 2. FDI Projects Captured in Quarter 3, 2019

	Announced	**Feasibility**	**Pre-project preparation**	**Construction**	**Complete**
Number of projects	3	1	1	5	6
Value (R billions)	3.3 billion	R529 billion	R606 billion	R8.5 Billion	R265 Million
Industries	1 Services 2 Manufacturing	1 Mining	1 Utilities	2 Utilities 1 Manufacturing	1 Manufacturing 1 Mining

				1 Wholesale and retail trade 1 Construction	1 Services 1 Agriculture 1 Construction
Type	1 Expansion 1 Upgrade 1 Brownfield	1 Brownfield	1 Greenfield	3 Greenfield 2 Expansion	4 Greenfield 2 Upgrade
Company	Amazon Web Services (Amazon) Diageo Mureza	Theta Gold Mine	Renergen	Enel Green Power (RSA) Heineken South Africa Leroy Merlin Radisson Hotel Group; Intaprop & RDC Properties	BFG Africa BlueRock Diamonds Aberdare Cables Tigers Ltd South African Breweries (SAB) Clarian

New projects

Amazon announced plans to expand its geographical presence with the launch of a special Africa Region in the first half of 2020, in Cape Town. The Amazon Web Services (AWS) Africa Region project will provide computing services for companies operating in Southern Africa, and in the rest of Africa.

One of the world's largest producers of beers and spirits, Diageo, has made a commitment to invest in 11 of the company's breweries in Africa, including South Africa. The firm plans to invest in renewable energy and water recycling systems to reduce its carbon footprint. The investment value and timeframes for the roll-out of the project have not been announced.

A new automotive company, Mureza, announced plans to assemble vehicles in Rosslyn, Pretoria. The project is a joint venture driven by a group of African investors from various countries. The first collection of vehicles will be produced through a joint venture with the SAIPA Group, an automotive company based in Iran. The vehicles will be assembled in Zimbabwe, Botswana and South Africa in semi-knocked down form. The value of the investment was not reported.

Existing projects

The mining company Theta Gold Mines (previously Stonewall), reported plans to invest US$35 million (R529 million) over a five-year period. Within this period, the project is expected to produce more than 5 700kgs of gold. Production is expected to begin at the end of 2020.

The US$40 million (R606 million) gas project by Renergen entails the exploration and production of a 187 000-hectare gas field. The company plans to construct a commercial liquid helium plant in the Free State. The project is funded through the United States Government Overseas Private Investment Corporation (OPIC). It will be rolled out in two phases. Phase one is expected to be complete by 2021 with capacity to produce an estimated 350kg of helium per day. Phase two is expected to come online between 2022 and 2033.

Italian multinational energy company Enel, through its renewable subsidiary Enel Green Power RSA (EGP RSA), has begun construction on two projects, also adding to utilities this quarter. In the Northern Cape, the €200 million (R3.2 billion) Garob will be a 140 MW wind farm expected to produce 573 GWh annually, once fully operational. In addition, Enel is constructing the £180 million (R2.9 billion) Oyster Bay wind farm in the Eastern Cape. The 140MW wind farm will have 41 turbines and is expected to generate around 568GWh per year. It is due for completion in the second quarter of 2021. Both wind farms will be supported by a 20-year power supply agreement with Eskom, as part of government's Renewable Energy Independent Power Producer Procurement Programme (REIPPP) fourth bid window, awarded in April 2015.

Beverage producer Heineken is in the process of improving its brewery in Sedibeng to expand capacity by 25%. The company plans to make a R60 million investment. Production is expected to grow from producing 5.3 million hectolitres to 7.5 million hectolitres a year by 2020. Construction is expected to be completed in the first half of 2020.

Retailer Leroy Merlin is expanding its operations with a R1 billion investment in Gauteng. It also plans to expand operations to the rest of South Africa.

The Radisson Hotel Group is opening the first Radisson Red hotel in Gauteng, the second in South Africa. The hotel will be developed in partnership with Intaprop and future owners of the hotel, Botswana-based company RDC Properties.

BFG Africa is a subsidiary of BFG International, a diversified composites manufacturer. The subsidiary is a partnership between South African black-owned financial services group Mergence, with a 51% share in the company. BFG Africa completed a R50 million facility that will manufacture and supply components made from composites including fiberglass.

In services, the China-based logistics and transportation company, Tigers South Africa, opened an e-commerce centre at its warehouse in Gauteng. The company specialises in providing supply chain solutions that are enabled by advanced technology. The value of the investment was not reported.

The Swiss chemicals company Clariant AG has officially launched a new centre of excellence. Clariant has four focus areas: care chemicals, catalysis, natural resources, and plastics and coatings. The infrastructure includes laboratories that will facilitate metallurgical test work, chemical filtration and separation solutions for mining companies. The value of the investment was not reported.

In manufacturing, Aberdare Cables completed construction of a R135 million factory to manufacture high-voltage power cables. The new product will offer up to 132kV from the current level of 33kV. Aberdare Cables will be the second company in South Africa to manufacture high-voltage cables locally. It is a subsidiary of the Hengtong Group, which plans to make additional investments in South Africa.

The upgrade of Blue Rock Diamond's Kareevlei diamond mine has been concluded. Upgrades included improvements to the crushing circuit and the installation of a larger cone crusher. It is expected that the upgraded crushing circuit should be able to handle the anticipated increase in material flows. The value of the investment was not reported.

South African Breweries (SAB) launched a R80 million agricultural research and development centre. The facility is expected to support creation of a knowledge base for emerging and commercial farmers. The facility is part of a R610 million agriculture investment planned over five years, part of SAB's commitment to R1 billion in public interest investment as part of its merger with AB Inbev in 2016.

Updates

Ford Motor Company Southern Africa (FMCSA) will be adding a third shift to its manufacturing plant in Pretoria. This has resulted in the company adding 1 200 new employees from August 2019. The third shift will allow FMCSA to ramp up production from 506 to 720 vehicle units assembled a day. The R3-billion investment was announced in 2017 and completed with the start of the production of the Raptor in early 2019.

MSC Cruises South Africa, a subsidiary of Switzerland based Mediterranean Shipping Company (MSC) Group, will begin the construction of the Durban Cruise Terminal at the Durban Port in November this year. Transnet National Ports Authority granted KwaZulu Cruise Terminal Consortium (KCT) a 25-year concession to finance construct, operate, and maintain a new terminal facility. The terminal will be a multi-user facility with MSC as the primary user. It will also house the MSC Shosholoza Ocean Academy. KCT was announced as the preferred bidder in 2017, and the project is due for completion in 2021. The investment is expected to amount to US$2.8 million (R200 million).

Briefing Note: Responding to the economic slowdown

The GDP has for the second time this year slipped into negative territory. As Graph 1 on page 2 shows, since 2015 the economy has struggled to break free from sluggish performance. An appropriate policy response, however, requires an accurate diagnostic. In particular, we need to understand why growth has slowed steadily since before 2011, not only in South Africa but globally.

Commentators often suggest that the period of rapid growth before 2011 resulted from better governance. But it was actually driven by the high international price for metals, which in turn resulted mainly from booming Chinese demand as well as a degree of speculation. Metals prices reached a 30-year peak in 2011, then crashed by over 50%. In dollar terms, global trade nonetheless expanded for a few more years. But it contracted by 15% in dollar terms from 2014 to 2016. It only surpassed its 2014 level in nominal dollars three years later, as Graph 3. shows.

In effect, high metal prices through 2011 masked the underlying structural weaknesses of the economy. When world markets slowed, however, those weaknesses – above all, unusually deep inequalities combined with heavy reliance on exports of coal, ores and metals – came into focus.

Under the previous administration, it was easy to blame the slowdown exclusively on state capture and policy mistakes. While those issues certainly aggravated the problem, they were not the sole cause. Now that we have an administration that is committed to clean government and consistent economic policy, we need to develop more effective strategies to address the underlying economic systems that reproduce slow and exclusive growth.

President Cyril Ramaphosa has made bold moves to attract investment, develop social compacts with private sector and labour, as well as working to fix core institutions that are critical to our democracy and to economic development. The increase in private investment in the past quarter suggests that these efforts are bearing some fruit.

Still, we need to scale up our responses to the slowdown. The large-scale commitments at the Job Summit provide an important basis, but more needs to be done. Two strategic directions are imperative: diversifying and strengthening our industrial base, including value-adding services and advanced agriculture; and promoting township and rural development and employment on a large scale.

Current work on master plans for our major industries are an important step in achieving the first strategy. The master plans entail high-level engagement between stakeholders to identify areas for technological upgrading and often reduce monopoly pricing for major inputs, as well as expanded industrial finance. In this context, the commitment by the financial sector to provide R100 billion in industrial finance over the next five years is particularly welcome. In addition, investment in infrastructure gaps would boost core industries such as the steel, plastics and chemicals sector. These measures would also contribute to job creation and should result in improved access to the economy.

The second leg relates to support for ground-up economic development, empowering individuals and communities through the transformation of township economies, rural development, and growth in community employment programmes. Because of the way apartheid eliminated small African-owned businesses, however, success in these areas often requires new systems to support small businesses. Because most small producers were shut out of the formal economy before 1994, however, the institutions and infrastructure they need to survive – access to serviced sites, customers, finance and training in particular – never developed. Despite the various support efforts since 1994, small businesses still lack a supportive ecosystem. Programmes to promote inclusive growth have to develop effective systems to change that.

The end of the metals boom and slow growth also constrain government resources. We need innovative approaches to mobilise finance for economic and social development. For example, the UIF surplus is now over R150 billion and the Government Employees Pension Fund holds R1.8 trillion rand in investments. Members of both of these funds would benefit more from faster, more inclusive growth than from the sluggish status quo. In addition, a genuine effort by both the public and private sector to strengthen local procurement and supply chain development would increase the impact on growth of every rand they spend.

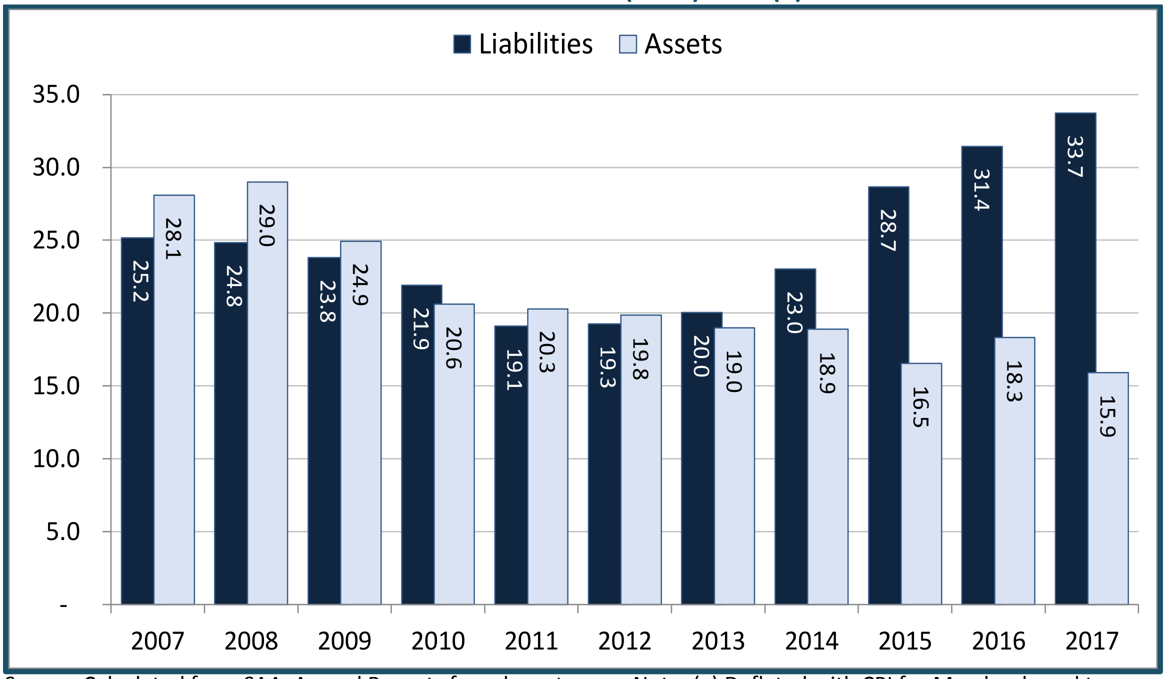
There remains a large measure of goodwill in South Africa – something many of our comparator countries and global trading partners do not have. All of the stakeholders recognise the need for a more equitable, inclusive, diversified economy. Going forward, we need to translate their commitment into large-scale, practical, sustainable programmes to address the structural weaknesses in our economy.

Briefing Note: SAA by the numbers

In the first week of December 2019, South African Airways (SAA) was put into business rescue. This briefing note provides an overview of its financial position, which left government with no other realistic option.

As the following graph shows, as of 2017 SAA's liabilities far exceeded its assets. (It has not published a financial statement since then.) That is, it was no longer a going concern in the normal sense of the term.

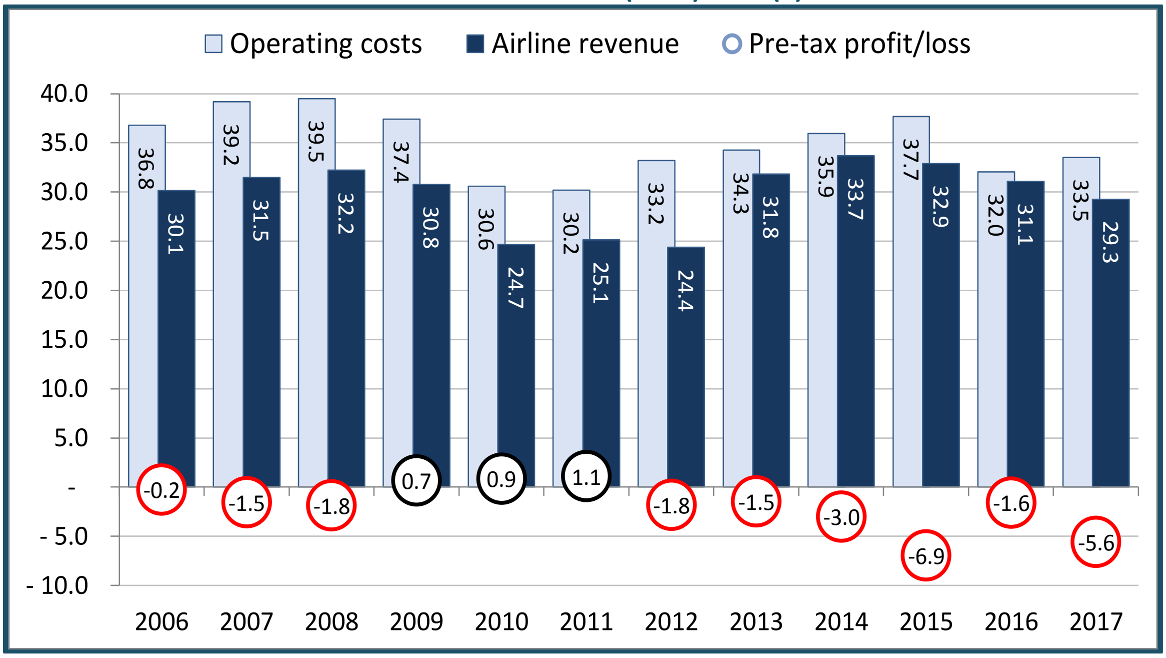
Graph 21. SAA's assets and liabilities, year to March, 2007 to 2017, in billions of constant (2017) rand (a)



Source: Calculated from SAA, Annual Reports for relevant years. Note: (a) Deflated with CPI for March rebased to 2019.

The immediate reason for SAA's declining assets and rising liabilities was its failure to make a profit since 2011. In 2017, its losses approached R6 billion. Since 2006, its operating costs have exceeded its airline revenue in every year.

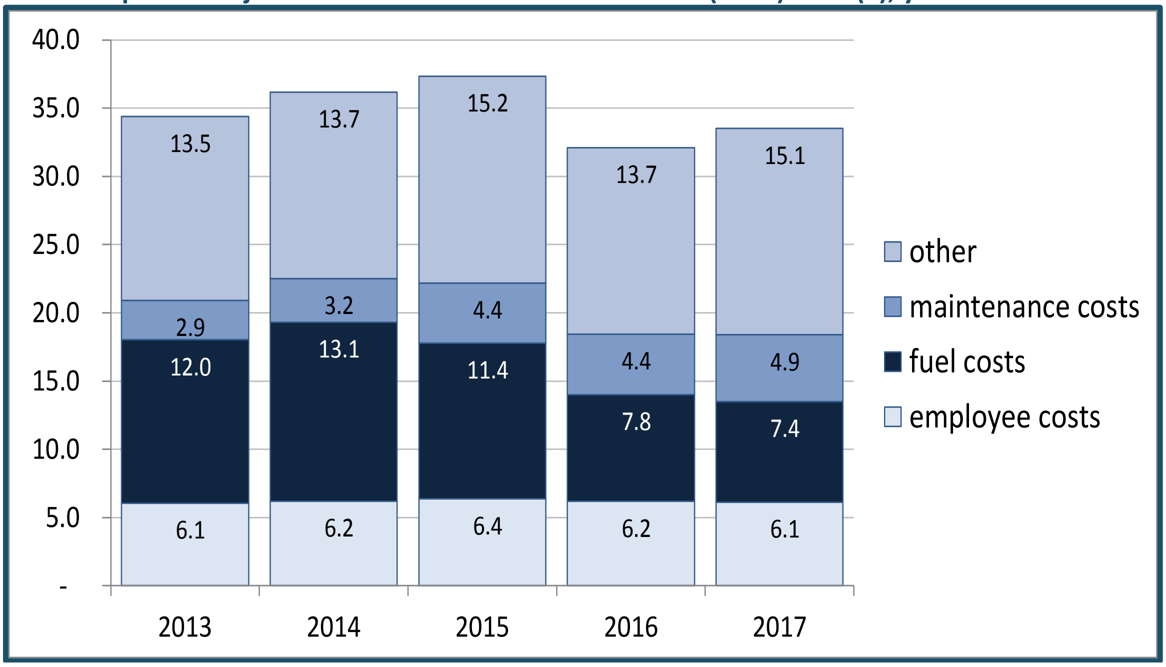
Graph 22. SAA's operating costs, airline revenue and pre-tax profits, year to March, in billions of constant (2017) rand (a)



Source: Calculated from SAA, Annual Reports for relevant years. Note: (a) Deflated with CPI for March rebased to 2019.

SAA does not provide much detail on its costs. Still, the information it provides shows that the main cost drivers were neither fuel nor labour, at least through 2017. Fuel costs fell sharply in 2016 (although they have since partly recovered). Labour costs have been completely flat in real terms, although SAA cut its labour force from 11 500 in 2013 to 9 750 in 2019. Maintenance costs climbed steeply, but SAA's annual reports do not explain why.

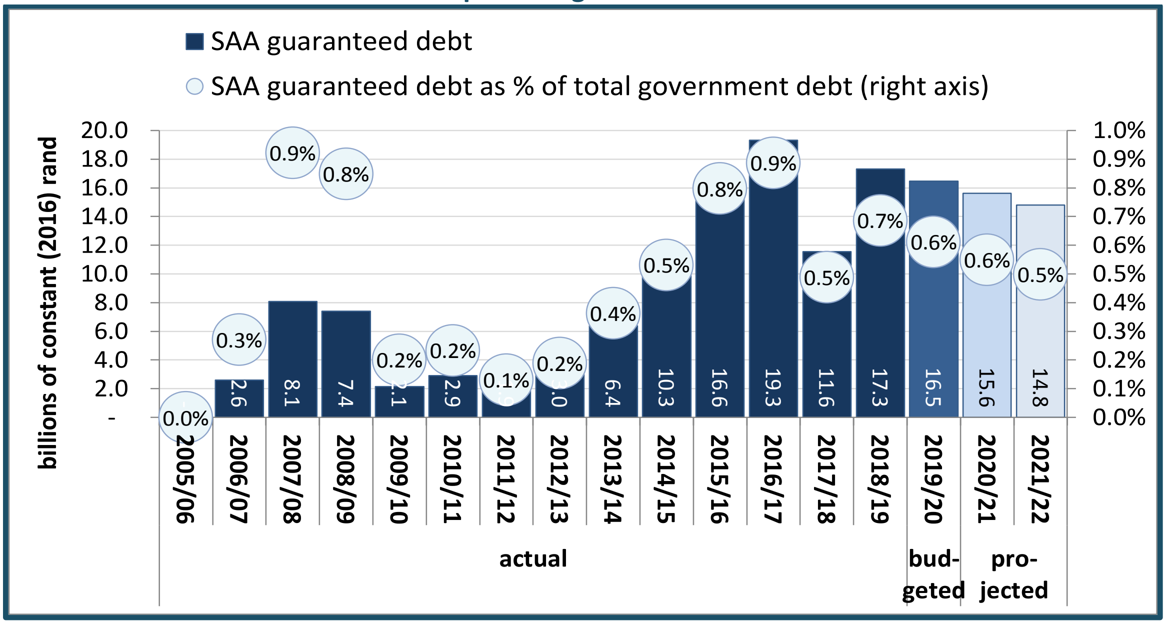
Graph 23. Major costs at SAA in billions of constant (2017) rand (a), year to March



Source: Calculated from SAA, Annual Reports for relevant years. Note: (a) Deflated with CPI for March rebased to 2019.

SAA's financing costs ballooned from 2012, rising from R200 million in constant 2017 rand to R1.6 billion five years later. As the following graph shows, in constant terms SAA's government-guaranteed debt soared from R2 billion in 2012 to R19 billion in 2016, then declined to R17 billion in 2018. Treasury, somewhat wistfully, projected a significant fall in its debt thereafter.

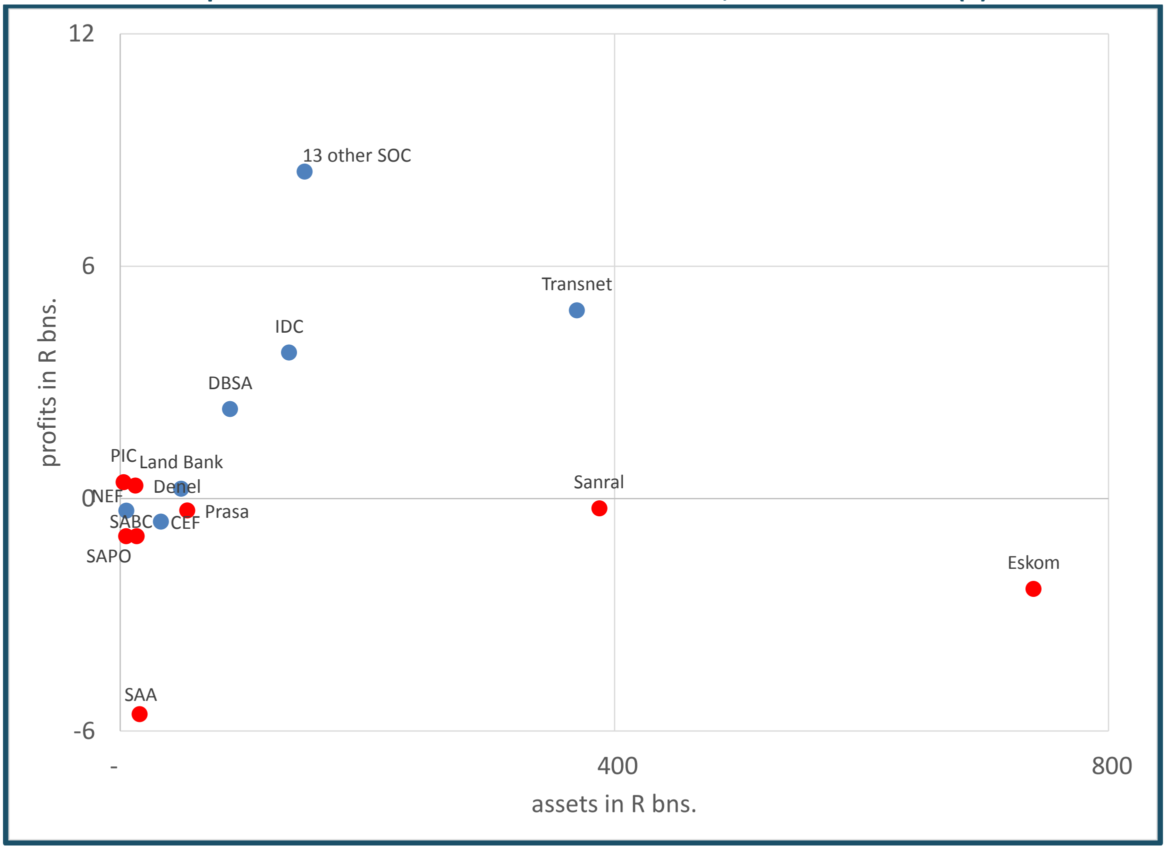
Graph 24. SAA government guaranteed debt in billions of constant (2019) rand and as a percentage of national debt



Source: Calculated from National Treasury. Table 11 – Net loan debt, provisions and contingent liabilities. Excel spreadsheet. Downloaded from national budget page at www.treasury.gov.za.

SAA was substantially more profligate with public resources than other SOCs. As the following graph shows, its losses were far larger compared to its size than any other SOC.

Graph 25. Profits and assets for SOCs and DFIs, in billions of rand (a)

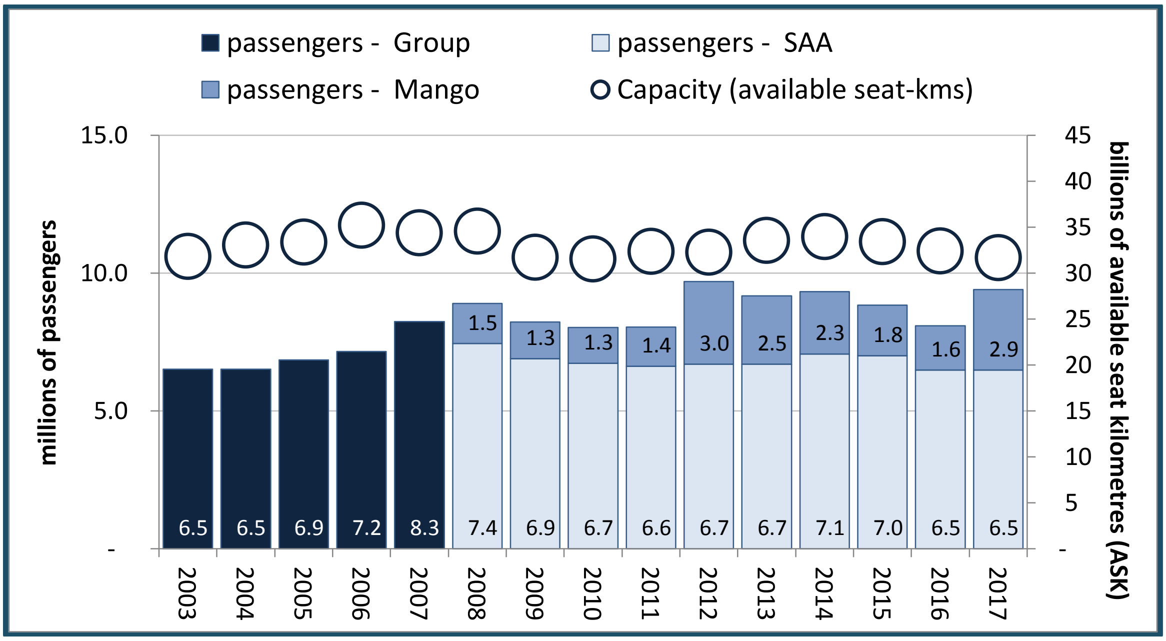


Note: (a) 2016/7 reports for Broadband Infraco, SAPO, SAA, SABC, CEF, Denel, Alexkor, NECSA, NEF, Safcol and State Diamond Trader; 2017/8 for all others. Source: Latest published Annual Report for each enterprise.

While its costs were rising steadily, SAA's ability to attract passengers proved limited. The number of travellers using SAA fluctuated at just under seven million from 2008 to 2015, fell to 6.5 million for the next two years, and reportedly dropped 30% in 2018/19. In 2019, SAA carried 13% of travellers in and out of South Africa.

Low loads meant that it made losses on most overseas routes; profited from flights from Johannesburg to most, but not all, South African metros; and generally made money on flights within Africa. As the following graph shows, its own low-cost carrier, Mango, generally enjoyed faster growth than SAA in numbers carried.

Graph 26. Passengers carried on SAA and Mango and SAA's available seat kilometres



Source: Calculated from SAA, Annual Reports for relevant years.

SAA itself argued that it could not compete with low-cost carriers while remaining a full-service airline. That argument was validated by its inability to grow its passenger base. At the same time, its costs also seemed out of control. That makes sense since, at least until this year, it could always fall back on the fiscus. Even now, as part of the business rescue process, the budget will provide another R4 billion to SAA this year.

Ultimately, SAA exemplified a central problem with many of South Africa's SOCs. On the one hand, it had no obvious social mandate that would justify receiving government support. True, in theory a national airline could earn its subsidies by providing more affordable transport for tourists and citizens, and by serving smaller towns. However, SAA never claimed to meet these or any other socio-economic objectives. At the same time, it apparently felt little pressure to develop a more sustainable financial model because for most of the past decade it could count on bailouts. Ultimately, SAA ended in business rescue because it could neither define a socio-economic objective that would justify continued subsidies nor a business model that made economic sense.