

An abstract graphic featuring a green globe with a white swoosh, surrounded by grey and green leaves, and a grey circular arrow. The background has faint concentric circles and a large green circle. The title "Economic Overview" is written in a bold, blue, sans-serif font.

Economic Overview

*Recent developments in
the global and South African economies*

February 2016
Department of Research and Information

HIGHLIGHTS

Global growth is moderating further, towards the lowest level in the post-crisis period.

The expansion momentum is decelerating in most emerging markets, with some experiencing protracted recessions. China's slowdown has been largely in line with expectations, while India's economy continues to expand at a rapid pace. Growth remains sturdy in the USA and the economic recovery is proceeding steadily in the Eurozone.

The world's principal stock-markets experienced the worst start to a year on record.

Corrections were widely anticipated, as valuations were generally out of line with the underlying economic fundamentals, but the reversal in investor sentiment was abrupt and severe. China's Shanghai Composite Index and Brazil's Bovespa are in bear territory and several other stock-markets, including the JSE, have experienced substantial corrections. Markets now appear to be more sensitive to developments in the real economy.

Policy moves by the world's major central banks, although divergent, reflect concerns over economic prospects.

Having initiated the policy rate normalisation cycle last December, the US Federal Reserve now appears to be holding on. Monetary policy is still expansionary in Eurozone and, since policy rates were recently taken to negative levels, is increasingly so in Japan. The People's Bank of China continues to provide monetary stimuli to sustain economic activity.

Facing instability in financial and currency markets, monetary authorities in several emerging economies have been forced to hike interest rates.

Large outflows of investment capital and increased trade imbalances have resulted in sharp currency depreciations and rising inflationary pressures. Despite weak growth and in certain instances recessionary conditions, monetary policy has to be tightened to ensure price stability and protect external accounts.

A general slowdown in global industrial production continues to weigh on demand for commodities.

Despite the supply-side rationalisation currently under way in most industrial commodity markets, most are still grappling with significant surpluses. Consequently, prices are anticipated to remain relatively subdued over the short- to medium-term. China, which accounts for half of the world's consumption of industrial commodities, remains a primary downside risk factor.

The near-term growth outlook for Sub-Saharan Africa is less optimistic, with most commodity exporters likely to remain under pressure for some time.

Growth projections for the region have been moderated by the IMF to 4.0% and 4.7% for 2016 and 2017, respectively. Challenging conditions in world markets have been affecting investment activity, especially resource-seeking FDI, but ongoing infrastructure developments, positive consumption trends in certain economies, and anticipated improvements in global trading conditions underpin the favourable growth outlook over the medium term.

Economic conditions in South Africa worsened substantially during the past year.

Real GDP growth is estimated to have decelerated to 1.3% in 2015, with the slowdown having been generalised across all broad sectors of the economy. Agricultural output is sharply lower due to severe and protracted drought conditions. Rural populations have been harshly impacted.

The manufacturing sector is taking severe strain in a very difficult economic environment.

Continuing to experience subdued demand conditions in local and global markets, as well as rising operating costs and infrastructure-related production constraints, manufacturing output growth stalled in 2015. Several sub-sectors are already in recession and recent trends in the manufacturing PMI point to a very difficult year ahead, with potential cut-backs in fixed investment spending.

The rand has depreciated sharply due to substantial outflows of investment capital, large trade imbalances and a strong US dollar, compromising price stability.

Despite the weak economic environment, the Monetary Policy Committee has raised interest rates by 75 basis points over the past 3 months to contain inflationary pressures. Further hikes may follow, as consumer inflation is expected to average 6.4% and 6.9% in 2016 and 2017, respectively. With risk aversion towards emerging market assets clearly manifest, net capital outflows may persist for some time. Key markets for South Africa's commodity and manufactured exports are experiencing visibly slower growth, while import costs are rising on the back of a weaker currency.

The outlook for the South African economy is clearly unfavourable in the short-term.

A very difficult consumer environment, ongoing fiscal challenges, possible contractions in fixed investment spending by the public and private sectors, as well as a subdued export performance and a higher import bill underpin expectations of 0.4% growth in GDP in 2016. Rating agencies have expressed concerns over the government's ability to arrest the rising trend in debt levels in a weak economic environment, and have emphasized the imperative of addressing structural impediments to growth.

IMPLICATIONS FOR SOUTH AFRICAN BUSINESSES

Considering the current economic environment, **risks or adverse developments** may include:

- Globally, subdued rates of expansion in general, as well as relatively modest growth rates in key markets such as China and the rest of Africa are likely to weigh on South Africa's export performance for both commodities and manufactured goods, respectively:
 - The significant deceleration of China's growth momentum, as well as the changing drivers of such growth have not only resulted in reduced consumption of industrial commodities, but are structurally altering the composition of China's import basket.
 - The adverse impacts on businesses that have traditionally relied on the world's 2nd largest economy as an export market will be long-lasting, pointing to persistently challenging conditions for the mining sector locally and in the rest of Africa.
 - Resource-exporting economies the world over, many of which are significant markets for South African exports of goods and services, have seen their growth performances and outlook compromised by adverse developments in commodity markets. This includes many African countries, thus curtailing their ability and propensity to import items such as construction materials, machinery and equipment, motor vehicles and consumer products from South Africa, at least in the short- to medium-term.
 - The currencies of certain African countries (i.e Zambia, Angola and Mozambique) have weakened to a greater extent than the South African rand, thus affecting their import propensity and potentially their demand for South African manufactured exports, among others.

- Domestically, the economic environment has weakened substantially and the outlook is largely unsatisfactory, especially over the short-term. Businesses are being affected by weaker trading conditions in local markets, especially:
 - Very low or stagnant growth in household spending, particularly in the durable (e.g. motor vehicles, furniture, etc.) and semi-durable goods (e.g. clothing, household textiles, etc.) categories.
 - Continued efforts of business enterprises to reduce operating costs, which is impacting on their spending on goods and services and their respective suppliers across the economy;
 - Declining levels of fixed investment activity within the private sector, which is impacting on future procurement plans.
 - Extremely challenging conditions in the agricultural sector are not only impacting on farming operations per se, but are also affecting players along specific value chains (e.g. food processors) and many of their suppliers of goods (e.g. fertilisers, agricultural equipment) and services (e.g. transportation, warehousing).
 - Protracted difficult conditions in the mining sector are not only impacting on operations within this sector, but are also affecting many suppliers of goods (e.g. machinery and equipment, chemicals, wood and wood products, fabricated metals, food products) and services (transportation, logistics, catering services).
 - Facing reduced tax revenue, rising debt levels and interest costs, as well as the need to maintain SA's sovereign credit rating at investment grade levels, the South African government is being forced to contain both operational and capital expenditure. By implication, the business sector may see a significant source of growth in demand for its goods and services gradually curtailed.
 - State-owned companies are generally containing expenditure on consumables due to strained budgets and more difficult and dearer access to credit, while most of the spending on very large capital projects (especially Eskom's Medupi and Kusile) is already behind them.
- Risk aversion has intensified since the start of 2016, with stock-markets around the globe having experienced substantial corrections, including the JSE. Portfolio investors now appear to be more sensitive to the underlying economic fundamentals and developments. The attractiveness of emerging market assets has been further compromised by the sharp depreciation of their currencies. The rand is a particular case in point as the second most-affected emerging market currency, after the Brazilian real, since the start of 2015. Consequently, high volatility and continued downward revaluations of asset prices may be the order of the day for quite some time.
- While credit rating agencies would like to see improved fiscal stability and debt stabilisation in South Africa, they have emphasised that policy moves should not compromise economic growth. Should one or more of the rating agencies downgrade the country's sovereign rating to sub-investment territory (also known as "junk status"), this would most likely unleash a chain of negative developments, including large capital outflows, higher borrowing costs and lower confidence levels, that would affect the business environment to a considerable extent.

On the positive side, the following global and domestic factors or developments could be beneficial for local business enterprises:

- Trading conditions have improved in key export markets, particularly the United States and the United Kingdom. Conditions are also improving gradually in Eurozone markets. These are important destinations for manufactured exports, among others.
- The South African public sector is intensifying its procurement efforts from domestic producers through product designations and by means of localisation initiatives. Such actions should translate into market opportunities for domestic enterprises over the short- to medium-term.
- The rand's sharp depreciation, in excess of most peer emerging market currencies, has improved the relative price competitiveness of South African products and services (including tourism) in foreign markets. This may provide opportunities for export market development.
- A sharply weaker rand also provides increased protection against import competition for items already being locally produced, while paving the way for increased import replacement. However, companies should not only rely on a weaker exchange rate for improved competitiveness, but must also focus on increased productivity, the strategic positioning of their business, as well as more aggressive marketing of their products.
- Over the longer term, there will be substantial opportunities for the diversification of South Africa's export basket to China as its massive consumption base expands and is altered over time.

GLOBAL ECONOMIC CONDITIONS

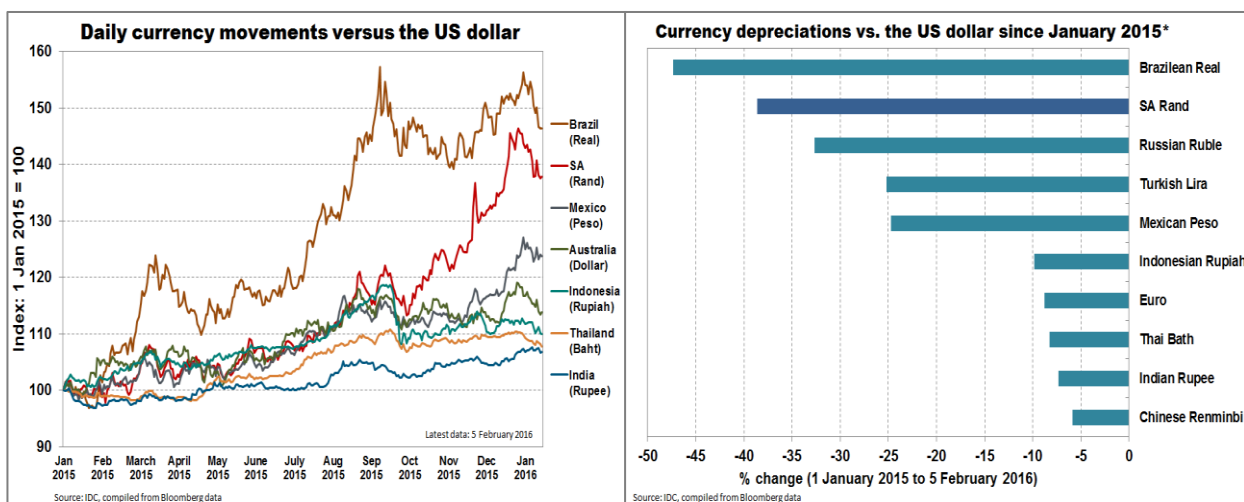
Perceptions of the outlook for the world economy are increasingly apprehensive. Falling equity markets and high volatility since the start of 2016, the absence of any sign of a turnaround in depressed commodity markets, the continuous exit of investment capital from emerging markets and a renewed sense of concern amongst the world's central banks all attest to this sentiment.

Fuelled by massive liquidity injections and easy access to credit associated with quantitative easing programmes and record low interest rates, stock-market performances around the globe had long been completely out of line with the economic fundamentals. Emerging market assets were expected to take the brunt of portfolio adjustments as the US Federal Reserve eventually unwound its quantitative easing and started the policy rate tightening cycle. As investor sentiment turned against assets perceived to be riskier, sharp stock-market corrections were widely anticipated to materialise, and emerging market currencies were expected to come under increasing pressure.

Net capital outflows from emerging markets amounted to USD735 billion in 2015 according to Institute of International Finance estimates, compared to outflows of USD111 billion in 2014. Total flows out of China were estimated at USD676 billion, underscored by concerns over a weakening currency and a slowing economy.

The corrective momentum became particularly manifest in China's equity markets during the second semester of 2015, but intensified at the start of the current year with spill-over effects onto other world markets. China's Shanghai Composite Index and Brazil's Bovespa are clearly in bear market territory, and South Africa's JSE All Share index has undergone a correction. Bearish investor sentiment has not only been directed at emerging markets, or equities for that matter. The JP Morgan Emerging Markets Bond Index fell 4% in the three months to January 2016, whereas US and German 10-year bond yields moved strongly lower in the opening month of the year.



The negative sentiment is being driven by a continuous trimming of global growth projections, with fears of economic recession resurfacing in some circles; by concerns over excessive USD strength; falling commodity prices; emerging market instability, including sharply weaker currencies and poor asset performance; as well as geopolitical risks, among other factors. The global investor community now appears to be more sensitive to developments in the real economy.





The International Monetary Fund (IMF) has lowered its growth projections for both advanced and developing economies in 2016 and 2017. World output is now forecast to expand by 3.4% and 3.6% over these two years, respectively, or 0.2 of a percentage point lower in both cases. Slowing demand from emerging markets, not only China but many troubled commodity exporting economies, and yet subdued consumption in several advanced economies are limiting international trade flows, affecting fixed investment activity and employment creation.


The ability of monetary and fiscal authorities around the globe to again play a counter-cyclical role in re-stimulating their economies is significantly more limited. Interest rates remain very low in most advanced economies, whereas several emerging markets are being forced to tighten monetary policy to contain inflationary pressures and stabilise capital flows and domestic currencies. The fiscal space has also become quite constrained for most governments due to modest tax collections and sovereign debt levels have escalated.




Developments in select advanced economies

<p>Eurozone</p> 	<ul style="list-style-type: none"> • The European Central Bank is expected to keep monetary policy highly accommodative in light of deflationary risks. Aggravated by the collapse in oil prices, such risks continue threatening the Eurozone's recovery. • The manufacturing purchasing managers index (PMI) has remained steady at just above the 52 level, indicating a sustained moderate expansion. The composite PMI, reflecting a broader measure of business conditions, is at a slightly higher level of around 54. • The slowdown in emerging markets has led the European Commission to lower its Eurozone growth forecast for 2016 from 1.8% to 1.7%. A slightly stronger growth rate of 1.9% is projected for 2017. • In contrast, IMF projections for Eurozone growth have been revised marginally upward to 1.7% in 2016, with the forecast for 2017 unchanged at 1.7%. • The large influx of refugees could destabilise certain economies, especially in periphery countries, indications are that it is lifting consumption spending and supporting growth.
<p>United States</p> 	<ul style="list-style-type: none"> • US growth slowed to 0.7% in the fourth quarter of 2015, from 2.0% in the previous quarter. GDP expanded by 2.4% for the year as a whole. • The manufacturing and composite PMIs declined substantially from the levels recorded in the opening months of 2015, but remain above the 50 level. The rate of expansion could therefore slow in coming quarters. • The IMF projects 2.6% growth for the US economy in 2016 as well as next year. This is unquestionably a solid pace of expansion for the world's largest economy. • However, there are clear downside risks to growth, as reflected by the US Federal Reserve's decision to keep its policy tightening bias on hold. The pace of interest rate normalisation is now expected to be slower than initially anticipated, with current futures contracts only expecting the next rate hike in the second half of 2016.

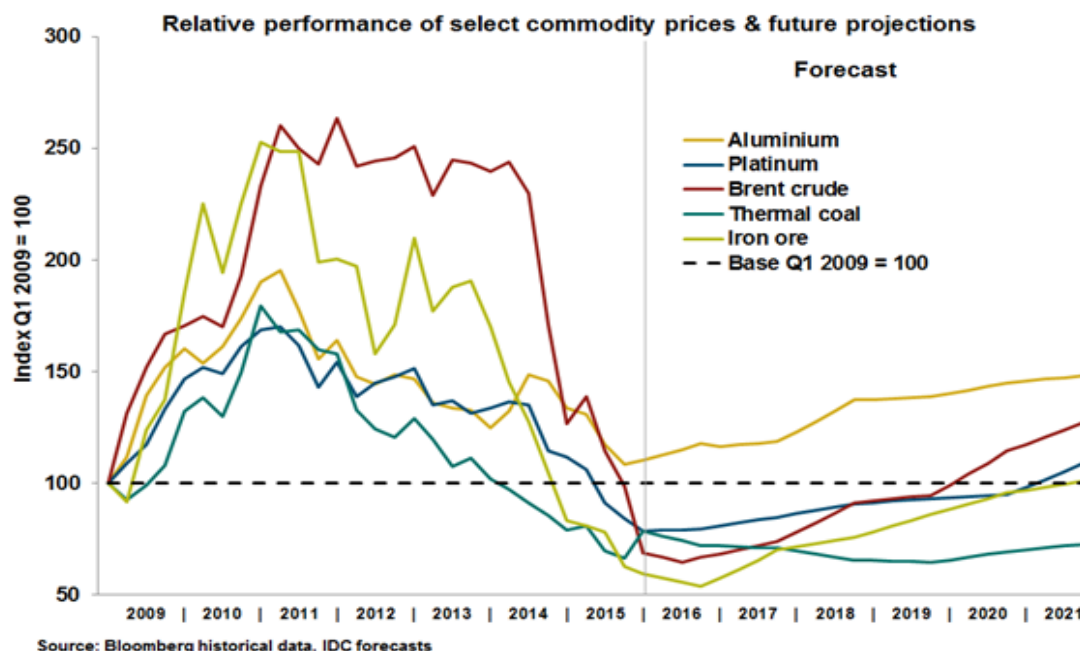
<p>Japan</p> 	<ul style="list-style-type: none"> • The Japanese economy entered a technical recession (i.e. two consecutive quarters of negative economic growth) in 2015, with expectations that real GDP contracted further in the fourth quarter. • Inflation is expected to remain muted in Japan. The Bank of Japan recently took policy rates into negative territory and is ready to increase stimulus measures to achieve its 2% inflation target. • Economic growth is expected to remain low, with the IMF projecting 1% for 2016 and slowing to 0.3% in 2017. • The weak economic outlook will raise pressures for further fiscal stimulus, although the impact of current measures have underwhelmed. Structural reforms - the “third arrow” in Prime Minister Abe’s economic policy - are not being implemented at the required pace.
<p>United Kingdom</p> 	<ul style="list-style-type: none"> • The UK economy has continued to expand at a steady pace, achieving 2.2% growth in 2015. The performance of the services and agriculture sectors supported growth in the fourth quarter, but the manufacturing and construction sectors recorded contractions. • Although the composite PMI has declined to 55 it still points to a sustained growth momentum in the economy. • The forthcoming referendum on whether to remain in the European Union or exit, also known as “Brexit” and which is expected to be held towards mid-year, is already having destabilising effects (e.g. currency markets) and could have a significant bearing on the economy’s performance in future years. • With inflation remaining marginally above 0% and little prospects of inflationary pressures building up, expectations are that the Bank of England will not increase interest rates in 2016. IMF forecasts indicate a stable GDP growth rate of 2.2% per annum over the next two years.

Developments in the BRIC economies

<p>Brazil</p> 	<ul style="list-style-type: none"> • Sharply lower commodity prices, especially iron ore and oil, macroeconomic instability and political uncertainty have taken a toll on business confidence in Brazil and have put the economy, which is already in a recession, under increasing pressure. The manufacturing and composite PMIs have remained below the 50 mark since early in 2015, driven by low demand from China and financial volatility. • Approximately 1.5 million jobs were lost in 2015 and a further 1 million may be shed this year, dragging consumer confidence and household spending propensity even lower. • The economy is estimated by the IMF to have contracted by 3.8% in 2015 and a further 3.5% decline is forecast for 2016. Double-digit inflation, a credit rating in “junk status” and persistently weak commodity prices provide little room for economic stimulus through fiscal or monetary policy.
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<p>Russia</p> 	<ul style="list-style-type: none"> • With oil prices at multi-year lows, the negative impact of western sanctions increasingly manifest and persistent instability in financial and currency markets, the recession-stricken Russian economy is estimated to have contracted by 3.7% in 2015. • Nearly half of government's revenue is dependent on the oil sector and the oil price is currently significantly below the levels required to balance public finances. • The IMF expects the Russian economy to remain in recession in 2016, with real GDP declining by a further 1%, but a return to positive growth (1%) is projected for 2017. • The economy's prospects are highly dependent on whether EU sanctions remain in place or are lifted, partly or fully, in the shorter term. The EU itself is under pressure to review its stance, for European companies are also being negatively affected by the sanctions.
<p>India</p> 	<ul style="list-style-type: none"> • The Indian economy remains one of the very few bright lights amidst an underperforming and currently challenged global economy. • India's import basket is benefitting from commodity prices at extremely low levels, particularly oil prices, as these are lowering input costs. Assisted by the protection provided by a relatively closed economy and by growth-conducive policy measures, such developments have enabled the economy to sustain growth rates of 7.3% over the past couple of years. • Sharply lower oil prices have not only helped to reduce input costs for Indian producers and raised the spending power of consumers, but also freed up government funds (by reducing fuel subsidies paid) for use in infrastructure projects. • India's growth momentum, which is expected by the IMF to accelerate to 7.5% both in 2016 and 2017, is highly dependent on the central government's ability to roll-out infrastructure programmes, many of which also require support from the individual states.
<p>China</p> 	<ul style="list-style-type: none"> • China's economy continues slowing, from 7.4% in 2014 to 6.9% in 2015. Various industries (e.g. steel) are under pressure due to excessive supply in the face of persistently weak demand conditions. This has led to the closure of some of the higher cost operations, with large job losses. • Increasing unemployment in certain areas of China is impacting on the willingness of (already savings-prone) consumers to spend, thus affecting investment activity and further weakening economic fundamentals. • The increased efforts to reign-in corruption are expected to slow infrastructure spending, while an increasingly limited fiscal space will result in greater selectivity regarding future investment plans. • Economic growth is forecast by the IMF at 6.3% and 6.0% over the next two years. This is undoubtedly a robust growth rate for the world's second largest economy, but there are growing concerns over the ability of the Chinese authorities to sustain the expansion momentum at an appropriate pace while its growth model is being intentionally altered.

Developments in select commodity markets



Oil

Supply-side factors continue to dominate price developments in the global crude oil market, with the surplus of 1.6 million barrels per day (mb/d) having contributed to the 43% drop in oil prices since the beginning of 2015. Non-OPEC supply growth has slowed dramatically in response, while OPEC supply increases continued unabated. This cartel once again resisted curbing supply growth at its most recent meeting. Crude oil supplies are expected to be boosted further by the lifting of economic sanctions against Iran, which is capable of raising oil output by as much as 1mb/d in the months ahead (barring infrastructure constraints). Oil demand growth, in turn, is expected to slow from 1.8mb/d in 2015 to 1.2 mb/d in 2016, thus weighing on prices. Brent crude is expected to average USD30 per barrel in 2016 and the lower energy intensity of economic growth points to oil prices not rising above the level of USD50 per barrel over the period to 2020.

Iron ore

Continued increases of low-cost iron ore entering the market prompted a 39% decline in the iron ore price, and a 127 million tonnes per annum (Mtpa) cutback in higher-cost lower-grade capacity since the start of 2015. The slowdown in productivity and capacity reductions in China's steel industry have weighed on global demand, with expected annual growth in demand for the period 2016 to 2018 reduced from 3.8% to 2.4%. Despite a further 55 Mtpa expected from low-cost mines, overall supply-side rationalisation is expected in the global iron ore industry. However, this is unlikely to be to the extent necessary to move the market into deficit. Despite the positive impact of cutbacks in supply, the overhang is expected to limit the extent of recovery in prices over the medium term.

Platinum

The recovery in South Africa's platinum production in 2015, subsequent to the strike during the first 5 months of 2014, occurred within an environment characterised by more subdued growth in global demand, thus weighing on platinum prices. This has been aggravated by investment fund outflows, which have been observed since the fourth quarter of 2015. Although the curtailment of further investment outflows has resulted in some price stabilisation thus far in 2016, substantial above-ground stockpiles, estimated at 2.5 million ounces (oz), combined with a market surplus of 216 000 oz going into 2017, is unsupportive of a sustained price recovery.

Coal

Sustained coal price weakness has led to global capacity reductions, estimated at 40 Mtpa by the end of December 2015. Although further supply-side rationalisation over the course of the year could limit further price declines, tepid global demand growth as a result of weaker industrial production in China and in other emerging economies should prevent price increases over the short- to medium-term. Thermal coal prices at Richards Bay are expected to continue to be negatively impacted by the Chinese government's restrictions on imports of coal with high sulphur and ash content.

Aluminium

Robust low-cost capacity expansions, especially from China, amidst weak global demand have weighed on market prices. Global aluminium capacity is expected to expand by a further 5% in 2016, which should result into a cumulative market surplus of 4.1 Mt over the period to 2018. This prognosis has led to a 60% decline in physical market premia, which is negative for market prices going forward. Although aluminium is expected to benefit from rising consumption intensity in the global automotive sector over the medium-term, a weak price recovery is projected.

FOREIGN DIRECT INVESTMENT IN AFRICA AND GROWTH OUTLOOK

A particularly challenging global economic environment, dominated by falling commodity prices and lower volume demand, especially from China, coupled with increased instability in financial and currency markets, weighed down on the growth performance of Sub-Saharan Africa (SSA) in 2015, which slowed to 3.5%, from an annual average of 5.6% over the period 2000 to 2014.

The tepid global environment has also had a negative impact on foreign investor activity on the continent, with foreign direct investment (FDI) flows into Africa declining by 31% to an estimated USD38 billion in 2015, from USD55 billion a year earlier.

The United Nations Conference on Trade and Development (UNCTAD) attributes this to a significant decline in 'resource-seeking FDI' flows into various countries of the SSA region specifically, since flows into North Africa rebounded from previous years. More concerning was the sharp drop of nearly 20% in the value of announced greenfield projects to USD71.1 billion.

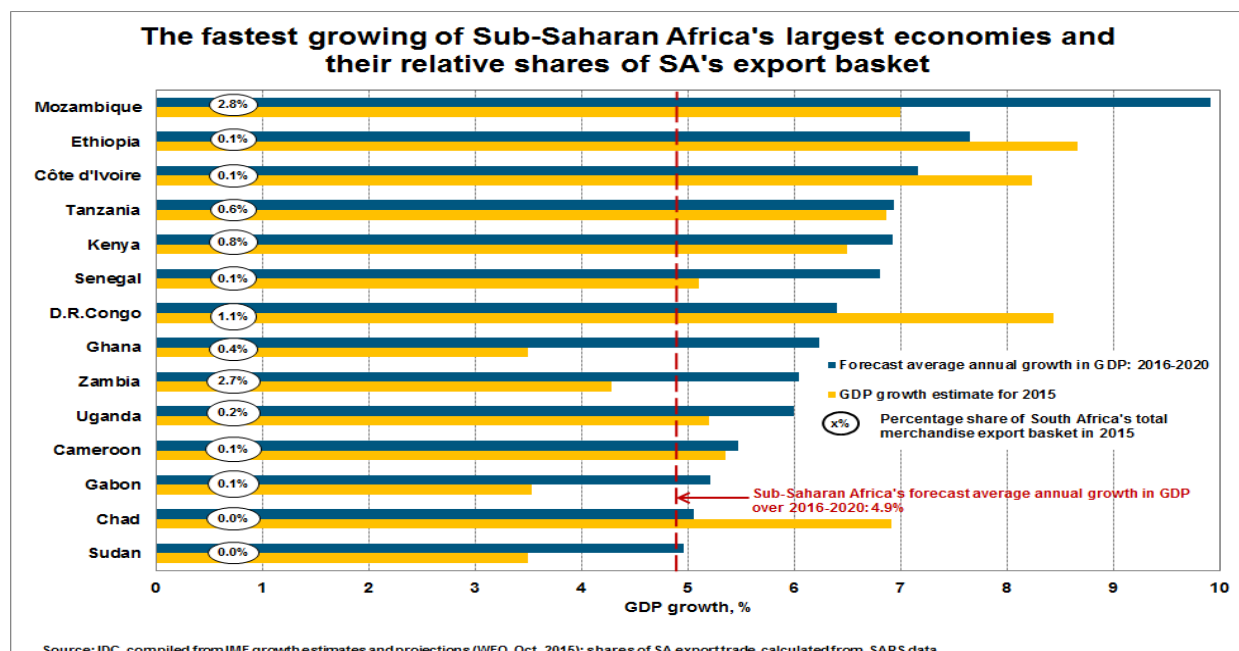
According to the latest UNCTAD report, South Africa, Nigeria and Mozambique were among the countries in SSA that registered the largest declines in FDI, at 74%, 27% and 21% respectively.

The near-term outlook for FDI is not promising, with many significant investments, particularly in the oil and minerals sectors, either on hold or likely to be delayed pending some improvement in economic conditions globally.

A number of countries in the continent continue to face various domestic macroeconomic weaknesses, including elevated fiscal and current account deficits, as well as rising debt levels in certain instances. This is rendering them highly susceptible to shocks, with their vulnerability reflected in currency weakness. The currencies of Zambia, Angola, Mozambique, South Africa, Tanzania, Ghana, Uganda and Botswana, in this order, have depreciated substantially against the US dollar since January 2015.

Nonetheless, medium term growth prospects for Sub-Saharan Africa remain relatively positive. Ongoing infrastructure development, particularly in the energy and transport sectors, strong consumer spending (especially among oil importers), a buoyant services sector in a number of economies and continued investment in resources sectors as commodity markets eventually stabilise are likely to underpin this favourable outlook.

The following chart illustrates the IMF growth projections for the fastest growing of Africa's largest economies over the next five years, specifically those expected to record growth rates above the 4.9% average for SSA. As indicated, with the exception of Mozambique, Zambia and to a lesser extent the Democratic Republic of Congo, these economies currently account for negligible shares of South Africa's merchandise export basket, pointing toward export development potential.



There are of course some caveats, including the possibility of further deterioration in global economic conditions, including developments in financial and commodity markets, as well as security concerns in some countries. Such downside risks would affect the region's performance through trade, investment and financial flows, among others.

ECONOMIC DEVELOPMENTS IN SOUTH AFRICA

Recent economic performance and developments

The South African economy slowed further in 2015. Worsening conditions domestically, weak demand in key export markets and persistently adverse developments in commodity markets took a toll on the economy's performance, with real GDP estimated to have risen by only 1.3%. The slowdown is generalised across all broad sectors of the economy.

Severe and protracted drought conditions (2015 witnessed the lowest average rainfall on record) resulted in sharply lower agricultural output. Rural populations have been severely affected and the spill-over effects are also being felt by many supplying industries to the agricultural sector.

Manufacturing activity remains constrained by weak demand conditions, domestically and globally, as well as by rising operational costs and infrastructure-related challenges, particularly electricity supply, transport and logistics. Growth in manufacturing output virtually ground to a halt in 2014 and 2015. In real terms, production levels are still well below those recorded some 7 years ago, prior to the 2008/09 recession. Several sub-sectors are in recession – such as base metals and fabricated metal products, non-metallic mineral products, chemicals, furniture, footwear, textiles and clothing, general purpose machinery, etc. - and subdued growth has been reported by many others. Fixed investment has been declining, the sector continues to shed jobs and, through its linkages with many suppliers of goods and services, the adverse effects are being felt in many supply chains.

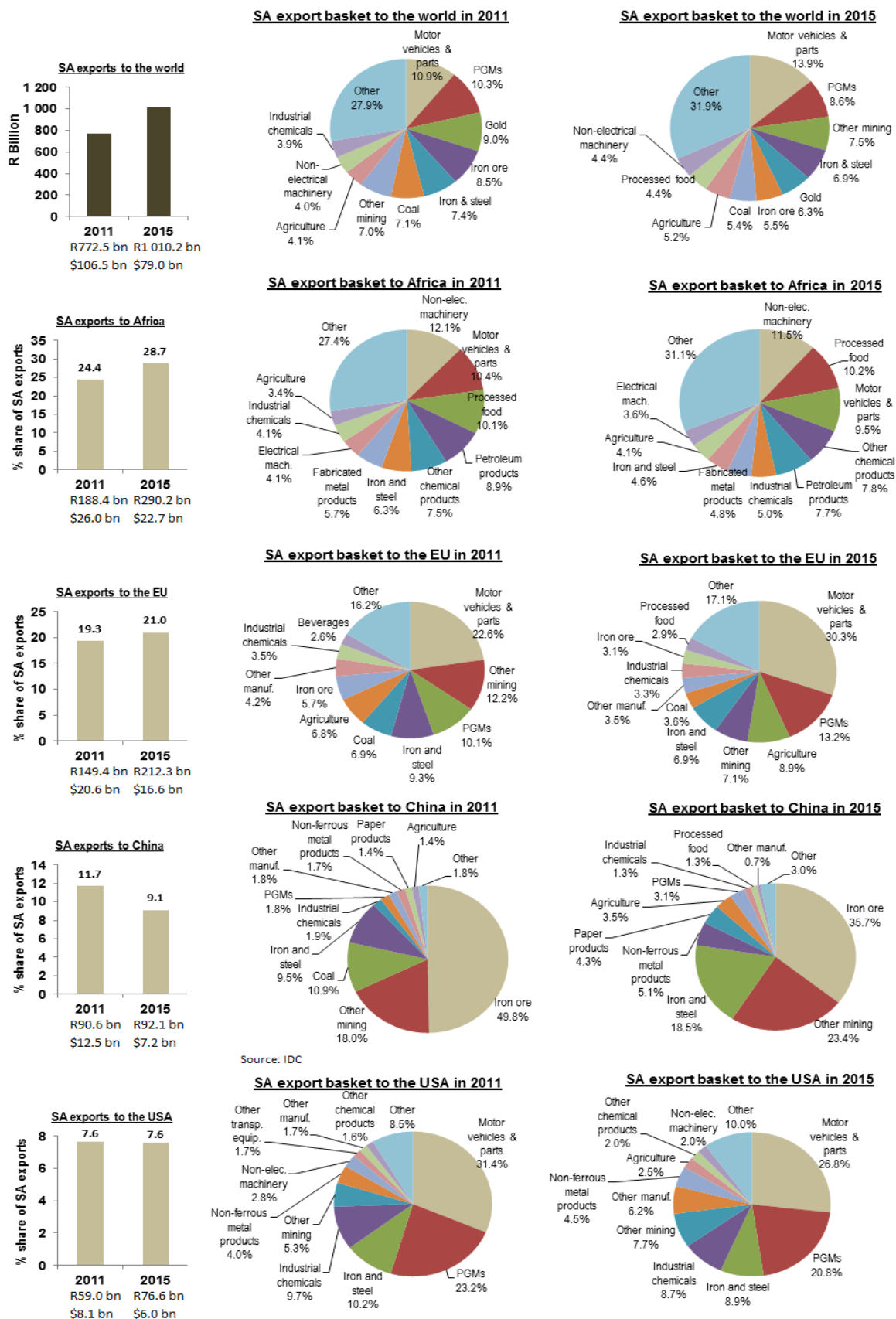
Within the mining sector, the rebound in output, which was mainly due to a strong recovery in the platinum group metals segment, is likely to be short-lived. The short- to medium term outlook for the sector remains very bleak, considering the depressed conditions in industrial commodity markets.

On the spending side, household consumption decelerated throughout the year. Contributing factors included moderate growth in disposable incomes, high household debt levels and tighter lending practices by the banking sector, rising living costs, higher interest rates and taxation. Consequently, consumer confidence fell steeply to a 14-year low.

The fiscal space has become increasingly constrained as poor economic growth affects tax revenues, resulting in large budget deficits and rising indebtedness. Government has thus been forced to contain both operational and capital expenditure, whilst having to put measures in place to ensure fiscal consolidation.

South Africa recorded a trade deficit of R78.7 billion in 2015. Merchandise exports increased at a rather modest rate of 5% in nominal rand terms. This was despite a much weaker exchange rate, which should have assisted, under normal circumstances, in improving the price competitiveness of export products in global markets. Valued at approximately R1.01 trillion in 2015, total merchandise exports were 31% higher than in 2011 (the peak of the commodity super-cycle) and the composition of the export basket changed substantially over this period, as illustrated on the next page. In US dollar terms, however, exports declined by almost 26% since 2011. The African continent claimed the largest share of South Africa's exports in 2015. The EU was the second largest export destination (21% of exports in 2015, up from 19.3% in 2011) at the regional level. China and the USA were the leading export destinations at the individual country level.

South Africa's merchandise export basket to select regions and countries: 2011 and 2015



In 2011, at the height of the commodities super-cycle, the contribution made by mining and mineral exports to South Africa's overall merchandise export basket stood at 42%. With the ensuing sharp drop in commodity prices and weaker demand, the relative share of mining exports fell to just over 33% by 2015.

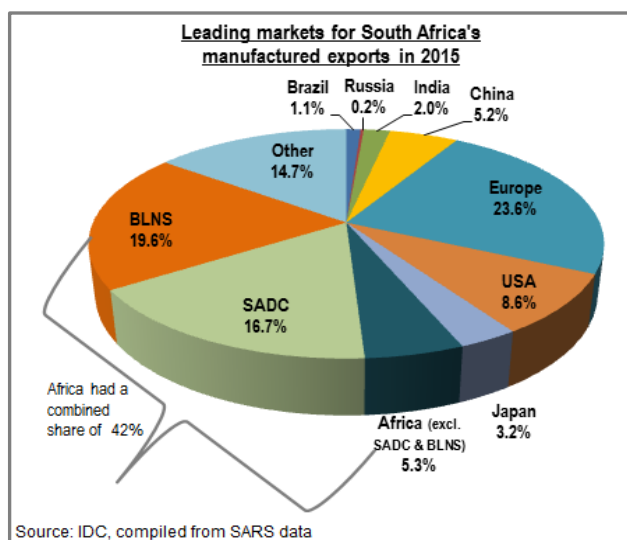
Manufactured exports, in turn, claimed a higher share of the export basket, rising from 54% in 2011 to 61% last year. Propelled by the Motor Industry Development Programme and its successor the Automotive Production Development Programme, South Africa's automotive industry has grown to dominate the export basket. Motor vehicles, parts and accessories were the leading export category in 2015, accounting for around 14% of overall exports to the world, compared to approximately 11% five years ago.

The share of agricultural products has remained fairly stable at an average of 4.7% per year. These are dominated by cereals and other crops; vegetables and horticultural produce; as well as fruits and citrus, especially oranges, grapes, apples, pears and grapefruit. These products had a combined contribution of 89% to overall agricultural exports in 2015. Animal products followed with a 9% share, while forestry and fisheries claimed a small 1.3% share of agricultural exports.

Exports to the African continent

Other African markets have become increasingly important for South Africa's export sector. Collectively they claimed a 28.7% share of South Africa's overall merchandise export basket in 2015, up from 24.4% in 2011 but slightly lower than the 30% share recorded in 2014.

Importantly, 42% (or R254 billion) of South Africa's total manufactured exports were sold in other African markets in 2015 (refer to adjacent chart). Non-electrical machinery was the leading export category, claiming 11.5% of the total. This pertained to exports of mining and agricultural machinery valued at R8.2 billion and R2.8 billion, respectively, with the rest of the SADC region as the principal market. Processed food comprised 10.2% of exports to other African countries and motor vehicles and parts recorded a 9.5% share. Other sizeable exports included petroleum products, industrial chemicals, fabricated metal products, as well as iron and steel.



Mining activity and investment spend in many of Africa's commodity-producing countries are likely to be negatively affected by adverse developments in commodity markets, affecting import demand for mining machinery and equipment going forward. Other local businesses focusing on African markets may also be affected by the somewhat slower growth momentum in the short-term.

Moreover, drought conditions are also being experienced in a number of countries in the southern African region, which could negatively impact on demand for agricultural machinery and equipment produced in South Africa.

Exports to the European Union

Although the European Union (EU) remains a key export market for South Africa, particularly for manufactured goods, its relative share has declined over time to 21% by 2015, after having peaked at just over 35% in 1995. Nevertheless, it is still a crucial external destination for products such as motor vehicles, parts and accessories, which have dominated the export basket to the EU for many years (30.3% share in 2015). The EU accounted for 22.2% of South Africa's overall manufactured exports to the world last year, up from 21% in 2011.

Other export products include platinum group metals with a 13.2% share, agricultural products (8.9%), "other" mining (7.1%), iron and steel (6.9%), as well as processed food products (2.9%). The top-10 export products to the EU accounted for 83% of South Africa's entire merchandise exports to this region in 2015, a modest decline from the 84% share claimed in 2011.

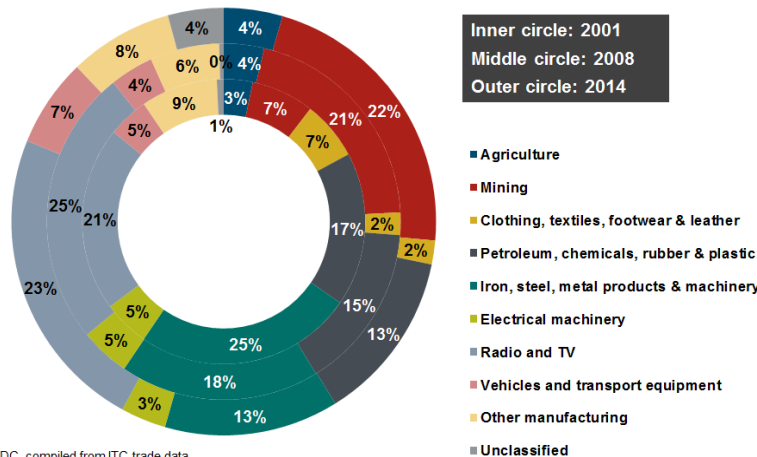
Exports to China

At the individual country level, China is still the leading export destination, accounting for R92.1 billion of South Africa's exports in 2015 or 9.1% of the total. However, the export basket to the world's second largest economy is overweight in commodities and base metals (R57.3 billion and R27.7 billion, respectively), with a combined contribution of almost 86% in 2015. Whereas 21% of South Africa's total non-gold mining exports were destined for China last year, this country claimed a mere 5.2% share of our manufactured exports.

The effect of tumbling commodity prices and weaker Chinese import demand has been particularly detrimental for the mining sector. The relative share of iron ore, South Africa's top export product to China, dropped from almost 50% in 2011 to 36% by 2015, as export values fell from R45 billion to R33 billion over this period. The average annual iron ore price fell by 67%, from USD168 per tonne in 2011 to USD55 per ton last year. Chrome and manganese dominated the "other mining" export category, which accounted for 23.4% of exports to China in 2015. Where manufactured exports were concerned, basic iron and steel retained a large 18.5% share despite the market glut.

Despite the rising share of mining commodities within China's import basket from the world at large since the turn of the millennium (refer to the adjacent chart), a number of export categories recorded gradual gains. These include radio, TV and communications equipment; vehicles and transport equipment; and agricultural products. However, agricultural products and processed food represented very small shares of South Africa's export basket to China in 2015, at 3.5% and 1.3% respectively.

**Composition of China's imports from the world:
2001, 2008, 2014**



Source: IDC, compiled from ITC trade data

Looking ahead, China's changing growth model, which will increasingly rely on domestic consumption and services sector activities, will provide new and/or alternative export opportunities for consumer-related items, including food and beverage products and a wide range of other manufactured items. The quantum and composition of demand for industrial commodities will change visibly. The implications for South African mining operations are already quite evident. South Africa's business sector needs to anticipate the evolution of China's import requirements going forward and position itself to gain from such developments.

Exports to the United States

South Africa's exports to the USA totalled R76.6 billion (7.6% of overall exports) in 2015, making it a key external market. The USA accounted for 8.6% of South Africa's manufactured exports in 2015, or R52.3 billion out of a total of R611 billion. Motor vehicles, parts and accessories dominated the export basket to the USA with a 26.8% share, followed by platinum group metal (20.8%), iron and steel (8.9%), and industrial chemicals (8.7%). Primary agricultural products claimed 2.5% (or R1.9 billion) of the overall export basket.

Last year, approximately 98% of South Africa's exports to the USA in value terms entered this market duty-free. Out of these, 59% faced a Most Favoured Nation¹ (MFN) tariff rate of 0%, a further 23.2% qualified for AGOA benefits, while an additional 15.3% were exported under the Generalised System of Preferences² (GSP).

The African Growth and Opportunity Act (AGOA) of the United States is a non-reciprocal unilateral trade preference system that offers African countries meeting certain criteria duty-free access for over 1 800 products into the American market. The recent stand-off between the USA and South Africa over poultry exports exposed uncertainties inherent in trade preferences of this nature because benefits can be withdrawn at any time, unlike in a free trade agreement.

Top ten US imports from South Africa in 2015 under AGOA, and respective MFN tariff benefits

HS Code	Description	Tariff benefit	Imports (USD '000)	Share of total
87032300	Motor vehicles for transport of persons	2.5%	1 343 624	77.8%
72021150	Ferromanganese containing by weight more than 4% of carbon	1.5%	88 902	5.1%
08026200	Macadamia nuts, shelled	5c/kg	50 377	2.9%
08051000	Oranges, fresh or dried	1.9c/kg	46 370	2.7%
38237060	Industrial fatty alcohols	2.4%	41 824	2.4%
22042150	Wine other than Tokay (not carbonated),	6.3c/litre	34 481	2.0%
81110047	Unwrought manganese flake	14.0%	18 629	1.1%
22071060	Undenatured ethyl alcohol of 80% vol. alcohol	2.5%	15 751	0.9%
08052000	Mandarins (including tangerines and satsumas);	1.9c/kg	12 127	0.7%
08062010	Raisins, made from dried seedless grapes	1.8c/kg	10 002	0.6%
Sub-Total			1 662 086	96.2%
Grand total			1 727 143	100.0%

Source: IDC, compiled using USITC data

¹ The MFN principle under the WTO agreements states that countries cannot normally discriminate between their trading partners. If a country grants another a special favour, such as a lower customs duty rate for one of their products, then it has to do the same for all other WTO members.

² The GSP provides duty-free entry into the USA market to 131 countries and territories (including South Africa) on over 3 400 products from designated beneficiary developing countries, and about 1 500 additional exports from least-developed beneficiary countries.

The above table indicates that South African exports under AGOA are dominated by motor cars, which accounted for 77.8% of the total last year. Yet, outside of AGOA motor cars face a tariff of 2.5%, hardly a barrier into any market.

A 2014 in-depth review of AGOA by the United States International Trade Commission (USITC) found that the uncertainty associated with the unilateral nature of the programme contributed to its failure to encourage investment in and grow imports from beneficiary countries. In the aftermath of collapsed free trade negotiations between SACU and the US in the mid-2000s, negotiations aimed at finding ways to expand the range of products that the US could import from South Africa have been under way. Should the agricultural products thereby considered be eventually covered by AGOA, with the sanitary and phyto-sanitary measures duly addressed, exports from South Africa and indeed the rest of Africa are likely to grow strongly in the medium- to long-term.

Economic outlook

Growth prospects for the South African economy have worsened substantially.

The recent drought is not only impacting on agricultural output, food security and prices at the present time, but the adverse effects will be felt long after climatic conditions have normalised, since farmers have scaled down planting in the face of uncertain weather conditions while their financial sustainability has often been harshly compromised. Grain crops, livestock farming and segments of the horticultural sector have all been detrimentally affected. To illustrate, first estimates for the 2016 maize production season stand at a crop of approximately 7.4 million tons. Although this is better than earlier estimates of just over 4 million tons, the overall maize crop estimated for 2016 represents a 25% drop from the 2015 maize harvest of 9.94 million tons. South Africa typically exports around 2.2 million tons of yellow maize annually. However, it is set to import around 3 million tons of maize this year.

The mining sector is anticipated to continue facing serious challenges in light of persistently negative developments in global commodity markets. Demand conditions remain largely unsatisfactory across most industrial commodities, while supply cut-backs have generally been insufficient to stabilise downward trending prices.

Manufacturing activity is likely to remain constrained by relatively weak demand and operational challenges for quite some time. A much weaker rand should be supportive of increased price competitiveness, enabling some local producers to compete against imports in the local market and to exploit trading opportunities in global markets. However, it also raises the costs of imported intermediate input materials and capital equipment, while demand conditions are generally far from buoyant.

Consumers are expected to curb their propensity to spend in light of stretched household budgets, higher interest rates, rising inflation and, among other factors, worsening employment prospects. Spare production capacity in many industries, higher borrowing costs, policy uncertainty in key sectors and low business confidence underscore expectations of restrained fixed investment spending by the private sector in the year ahead. The financial standing of the public sector, in turn, has generally weakened. Gross fixed capital formation is thus anticipated to drop in real terms in 2016.

Despite the rand depreciation, export growth is projected to be lower than in 2015 due largely to slower growth in the rest of Africa and in China, two key markets for South Africa's manufactured goods and commodities, respectively. Moreover, a poor export performance by the local steel sector is anticipated, whilst much lower exports of primary and processed food products are projected due to the impact of the drought.

Marginal GDP growth is projected for 2016, possibly around 0.4%. Difficult decisions will have to be taken to restore macroeconomic stability and address structural impediments to growth. Although these may affect the economy's performance in the short- to medium-term, they will lay the foundation for a stronger and more sustainable growth momentum in future years. Moreover, as and when the global economy returns to a higher growth trajectory, this will be beneficial for the domestic economy.

Key performance indicators for the South African economy								
Variable (% change or % of GDP)	2013	2014	2015e	2016f	2017f	2018f	2019f	2020f
Real GDP growth and its components:								
Household consumption expenditure	2.9	1.4	1.5	0.3	1.2	2.1	2.3	2.6
Government consumption expenditure	3.3	1.9	0.4	1.2	1.3	1.7	2.0	2.4
Gross fixed capital formation (GFCF)	7.6	-0.4	1.2	-0.7	1.0	3.6	6.0	5.8
Exports	4.6	2.6	9.8	3.6	4.1	4.7	5.1	4.6
Imports	1.8	-0.5	5.3	3.9	4.8	5.0	5.4	6.3
GDP	2.2	1.5	1.3	0.4	1.2	2.6	3.0	2.8
Consumer price inflation	5.8	6.1	4.6	6.4	6.9	5.7	5.4	5.2
Current account balance (% of GDP)	-5.8	-5.4	-3.7	-4.8	-5.2	-5.6	-5.8	-6.2
GFCF as % of GDP	20.0	20.3	20.3	20.1	20.2	20.5	21.2	21.8

Source: IDC, compiled from SARB data, IDC forecasts

Department of Research and Information

11 February 2016