Industrial Development Corporation
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South African economy:

An overview of key trends since 1994

December 2013

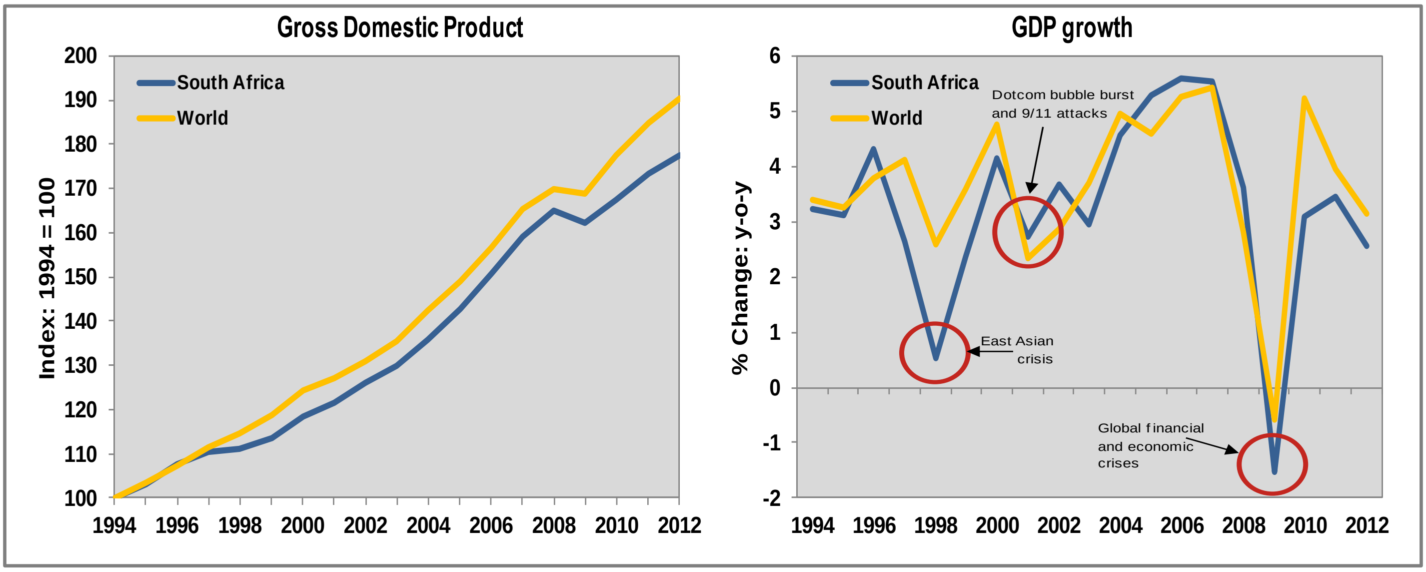
Department of Research and Information

Contents

1. ECONOMIC PERFORMANCE

The South African economy has undergone a substantial transformation since the advent of democracy. It recorded an average rate of economic growth of 3.3% per annum in real terms over the period 1994 to 2012, a remarkable improvement on the 1.4% average annual growth registered during the period 1980 to 1993. However, the pace of growth fell somewhat short of the 3.6% average recorded by the world economy. South Africa's gross domestic product (GDP) by 2012 was 77% larger in real terms relative to 1994, with the corresponding increase for the global economy having been 90%. On a per capita basis, the country's real GDP was 31% higher by the end of the period.

Growth has, nevertheless, been quite volatile and strongly correlated to the global economic performance. The period characterised by the East Asian crisis around 1998, however, reflected a more dramatic downturn for South Africa, as its economy was concurrently adjusting to its reintegration in the world economy, including substantial trade liberalisation and structural adjustments. This event initiated a differential between the long-term GDP performance trends of the domestic and global economies illustrated in the following graph (left-hand-side).



The period under review witnessed a number of external shocks as depicted in the above graph, with the most pronounced being: the aforementioned East Asian crisis; the period spanning the "dot.com crisis" (2000); the 9/11 events in the United States (2001) and the subsequent corporate scandals in 2002/03; and, more recently, the global financial crisis which started manifesting itself in late 2007, intensified in 2008 and resulted in the global recession of 2009.

The South African economy recorded its fastest growth rates since the 1960s over the period 2004 to 2007, with real GDP growth averaging 5.2% per annum. From a global perspective, this period was characterised by a strong bull-market and booming commodities markets.

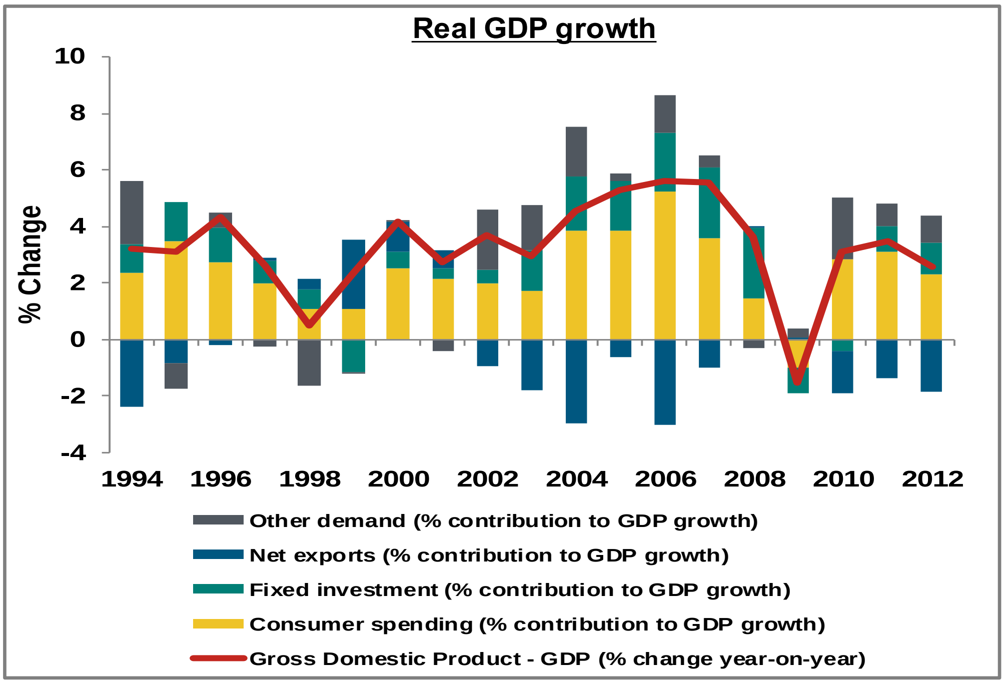
Domestically, household consumption expenditure and fixed investment activity elevated economic growth substantially, with the export sector also providing considerable impetus over the years 2005 to 2007.

For simplicity, the time buckets reflected in the following table have been selected to illustrate the different growth phases over the period being reviewed.

Total SA economy

Average annual growth rates (% growth p.a.)	1980 - 93	1994 - 2000	2001 - 07	2008 - 12
Gross Domestic Product (GDP)	1.4%	2.9%	4.3%	2.2%
Gross Fixed Capital Formation	-2.2%	4.4%	9.5%	3.4%
Capital Stock	1.9%	1.1%	2.1%	3.8%
Exports	2.2%	5.5%	4.1%	-1.4%
Imports	1.4%	6.6%	9.6%	1.9%
Employment	1.1%	0.5%	1.0%	-0.4%

On the expenditure side, the largest contributions to overall economic growth in South Africa over the period 1994 to 2012 emanated from household spending (with a 74.8% average annual contribution to overall economic growth), fixed investment (29.3%) and government expenditure (18.2%), with the latter included in "other demand" in the following graph. Net exports (i.e. exports minus imports), in turn, posed a drag on growth by pulling down the rate of economic expansion (i.e. an average contribution of -22.1% to the overall GDP growth rate of 3.3% over the review period).



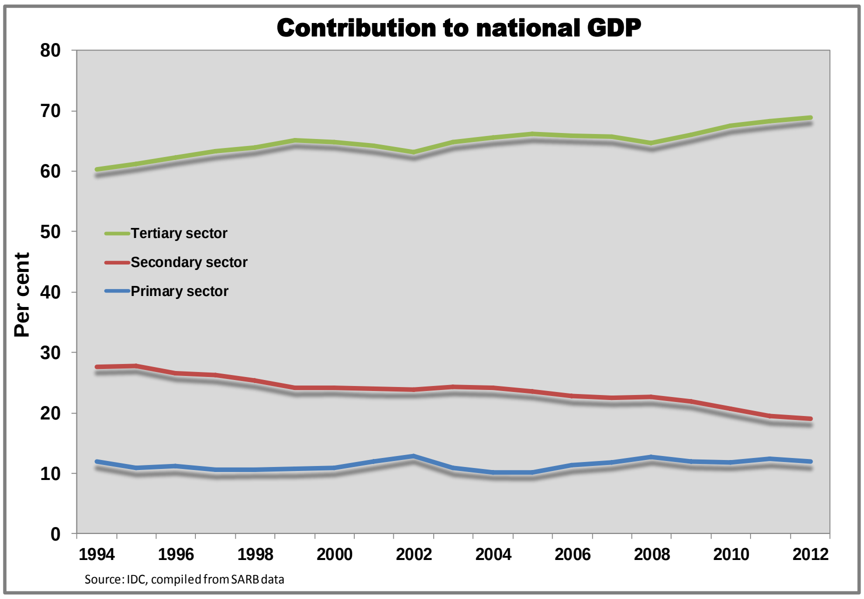
South Africa's key economic indicators: 1994 vs 2012		
Economic variable	**1994**	**2012**
Size of the economy (real GDP in R million at constant 2005 prices)	**1,100,300**	**1,954,303**
GDP per capita (current prices) in Rand	12,504	60,505
GDP per capita (constant 2005 prices) in Rand	28,536	37,476
Key economic ratios (% of GDP)		
GFCF (fixed investment)	15.2	19.2
Gross savings	16.8	13.2
Government debt (total net loan debt)	47.3	36.3
Budget balance	-4.8	-5.2
Current account balance	0.0	-6.3
Export (goods and services)	22.1	28.3
Imports (goods and services)	19.9	31.3
Household consumption expenditure	62.3	60.4
Government consumption expenditure	20.0	22.4
Other economic indicators		
Real merchandise imports as a % of gross domestic expenditure (GDE)	16.4	24.4
Import cover in weeks (imports covered by reserves)	4.0	19.4
Consumer price inflation (%)	8.8	5.6
Exchange rates (Rand per foreign currency unit)		
ZAR per US dollar	3.55	8.21
ZAR per EU euro	4.21	10.55
ZAR per British pound	5.44	13.01
South Africa's credit ratings		
Standard & Poors	BB	BBB
Fitch	BB	BBB+
Moody's (1995 & 2012)	Baa3	Baa1
Key labour and capital ratios in Rand (at constant 2005 prices)		
Average capital-output ratio	2.6	2.1
Average output-labour ratio	68,621	92,126
Average capital-labour ratio	176,100	195,501
Population and employment indicators		
Population (number '000)	40,157	51,069
Employment (number '000)	11,500	12,439
Unemployment rate (%)	22.9	25.1
Economic performance indicators (average annual real growth rates per annum)	**1980-93**	**1994-2012**
Gross domestic product (GDP)	1.4	3.3
GFCF (fixed investment)	-0.6	6.1
Consumer price inflation (average % per annum)	14.3	6.4
Unemployment rate (average % per annum)	15.8	23.9

***Note* : Data for 2012 as per March 2013 SARB bulletin, where applicable**

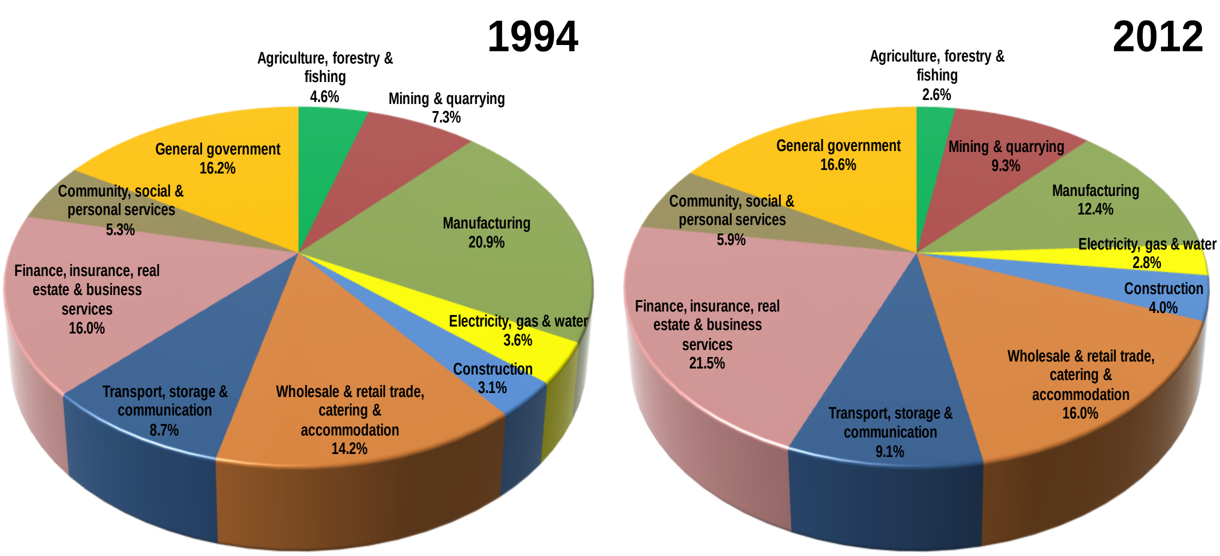
2. STRUCTURE OF THE ECONOMY AND SECTOR PERFORMANCE

The structure of the South African economy has changed considerably over time, as reflected by the broad sector contributions to GDP in the following charts. The domestic economy is characterised by a well-developed tertiary sector, which accounted for approximately 69% of the country's GDP in 2012, up from 60% in 1994.

The tertiary sector is dominated by the financial services sector (largely driven by a strong banking system), which accounted for close to 22% of overall GDP in 2012 (up from a 12% share in 1994). Trade (comprising retail, wholesale and motor trade, as well as catering and accommodation) and transport (consisting of transport, storage and communication) are further key services-related sectors.



The share of the secondary sector in GDP has eased continuously since 1994, from 27.7% to approximately 19% in 2012. Manufacturing dominates this category and is the fourth largest sector in the economy. The construction sector, although relatively small, played an important role in boosting economic activity as demand for residential buildings and non-residential construction escalated during the period 2003 to 2007.



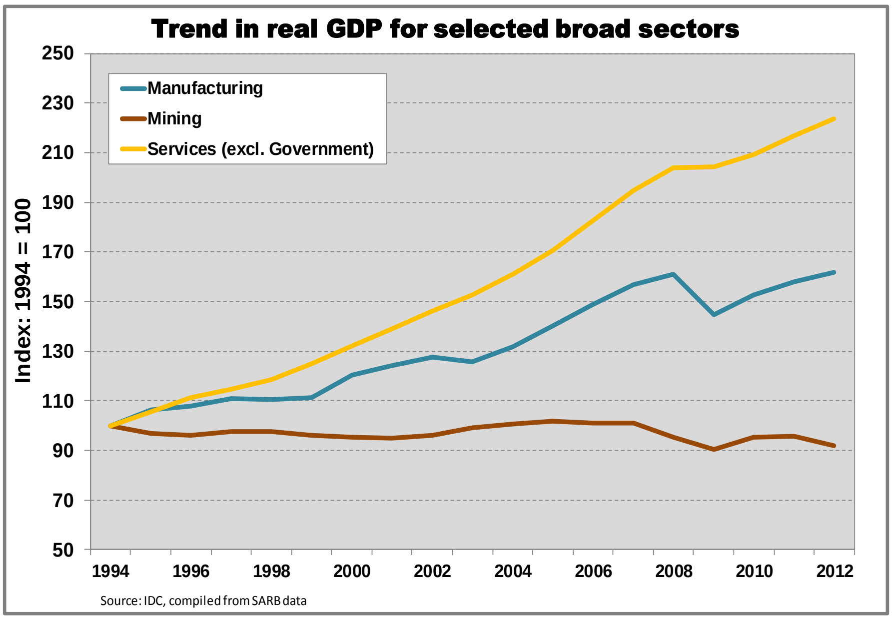
Source: IDC, compiled from SARB data

However, for a developing economy, the share of the secondary sectors, particularly manufacturing, is not only small but has been declining over the years. Such a trend reflects numerous challenges facing domestic manufacturing within a highly competitive global environment and underscores governmental efforts to re-industrialise the economy, particularly due to the labour intensity of this type of economic activity.

The three-year rolling Industrial Policy Action Plan (IPAP) sets out transversal and sector-specific programmes and action plans to retain, grow and diversify South Africa's industrial base. It aims to bring about structural change in the economy by focusing on value adding activity in the production sectors, particularly labour-intensive and export-oriented sectors, led by manufacturing. This government-led impetus is complemented by the medium term New Growth Path (NGP), which also emphasises the importance of a production-led growth trajectory.

In contrast, the primary sectors, which comprise the agriculture, forestry and fishing, as well as the mining sectors, have collectively maintained their relative share of GDP over time, amounting to 11.8% by 2012. However, their individual structure has changed significantly over time as elaborated upon later in this review. Moreover, the highly labour-intensive agricultural sector has lost 1.1 million jobs since 1994 for a variety of reasons, but particularly through mechanisation of farming activities.

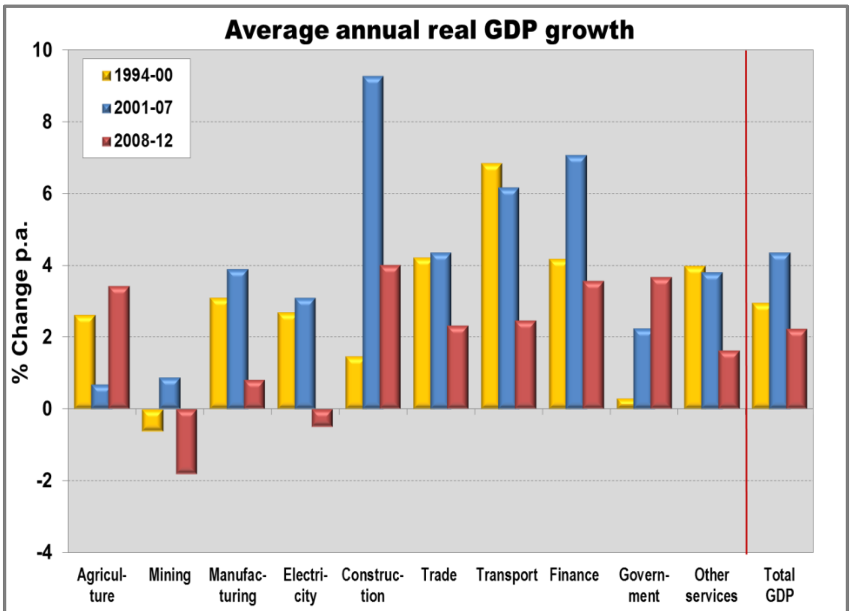
Real output of the mining sector has declined over the past 20 years, despite the enormous wealth and diversity of South Africa's rich mineral endowment. This sector did not fare as well as those of its peers during the commodities boom period (2003 to 2008) due to a multiplicity of factors, including: a changing minerals regulatory regime, insufficient supporting infrastructure for mining development, an eroding skills base. More recently, this sector has faced serious production disruptions and upward cost pressures due to technical and safety related matters, as well as intense industrial action.



In sharp contrast, the services sectors have been the pillar of overall economic growth, increasing their share steadily over the past two decades. The financialisation of the economy, the proliferation of business services and the strong expansion of the telecommunications sectors have underpinned the robust output performance of services-related sectors, whilst the retail- and wholesale trade sector further entrenched their strong status.

The manufacturing sector registered strong growth during the period 2004 to 2007, supported by robust export demand for some of its products and solid growth in domestic demand, although the performance of individual manufacturing sub-sectors varied widely. The manufacturing sector was adversely impacted upon by the global economic downturn, particularly due to weakened demand in traditional markets such as Europe, as well as difficult trading conditions domestically. The sector is facing fierce competition in both domestic and world markets, whilst having to deal with substantial cost pressures and other competitiveness challenges such as electricity supply, currency volatility, skills constraints, productivity levels etc.

The growth performance of the broad economic sectors over the past two decades shows a mixed outcome, with some benefitting significantly from a conducive environment, whilst others remained under pressure even during the upswing years. The construction sector outpaced all others during 2001-2007, complemented by outperformers such as the finance and transport sectors. The trade sector performed relatively in line with the economy's average, whilst the mining and agricultural sectors were underperformers during this period. Since the onset of the crisis, South Africa's aggregate GDP growth averaged 2.2% annually, with the construction, government, finance, agriculture and trade sectors outpacing this average rate of expansion. In turn, the mining and electricity sectors recorded contractions, on average, over the period 2008 to 2012.



Source: IDC, compiled from SARB data

The following chart illustrates the sectoral contributions to overall economic growth (i.e. on average 3.3% per annum) throughout the period 1994 to 2012. The largest contributions to growth over this period emanated from:

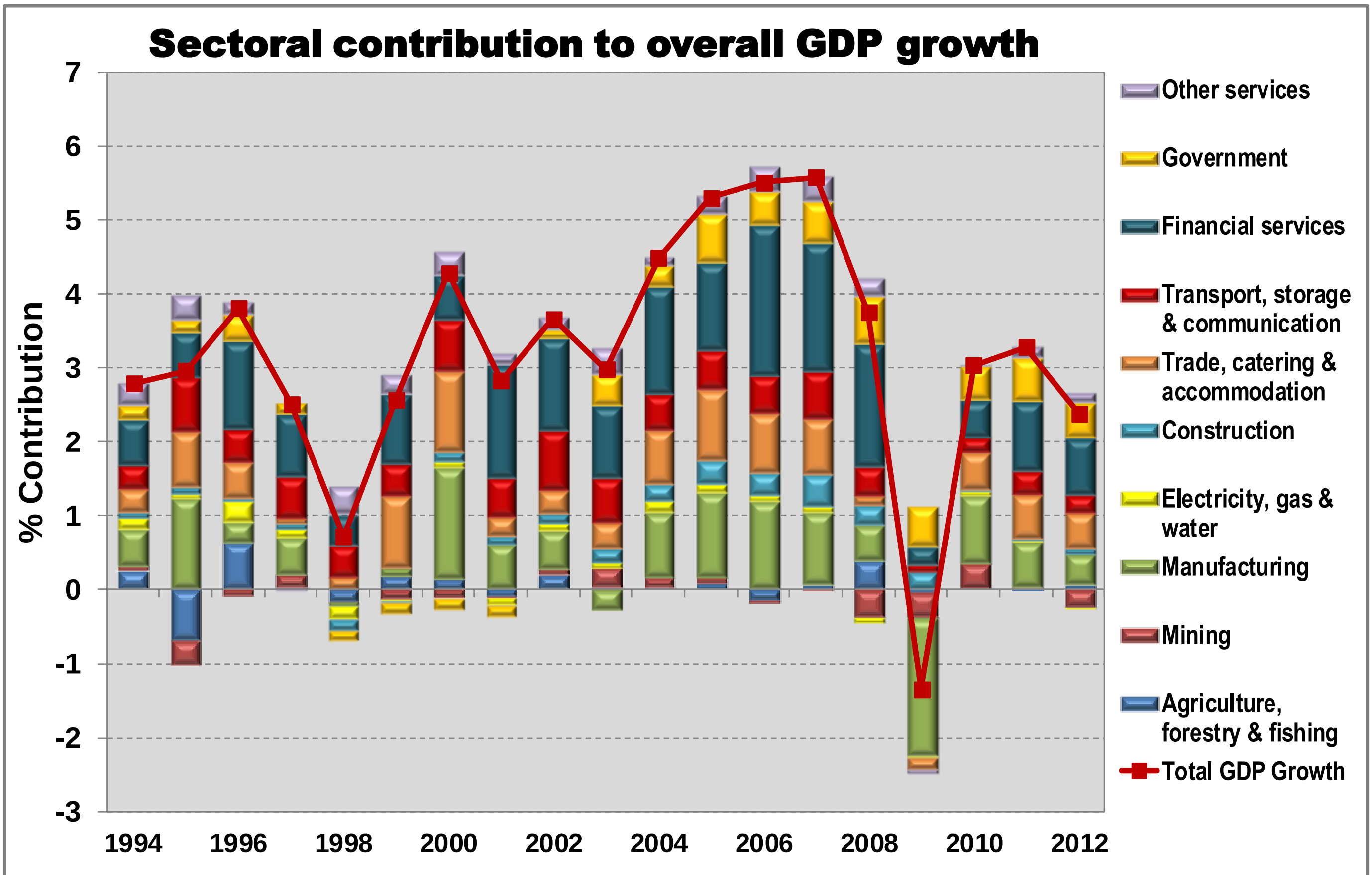
- The financial services sector, which contributed 1 percentage point to the 3.3% average annual growth in GDP. This sector made positive contributions throughout the period, with the exception of a very minor contribution in the recession year 2009.
- The manufacturing sector, which contributed 0.5 of a percentage point to overall growth. It made positive contributions throughout the period, with the exception of a large negative contribution in 2009, which dragged downward overall GDP growth in that year and, to a much lesser extent, in 2003.
- The trade sector (0.5 of a percentage point contribution) contributed positively throughout the period, with the exception of 2009, when it made a negative contribution.

- The transport sector (0.48 of a percentage point contribution) made positive contributions throughout the period, particularly in 1995, 2000 and 2002.

On a less positive note, the agricultural sector (0.05 of a percentage point contribution) exhibited very volatile contributions throughout the period, both positive and negative.

The electricity sector (0.05 of a percentage point contribution) made very minor contributions to overall growth largely due to its relatively small size and, in recent times, supply-side constrains coupled with demand-management practises.

The mining sector, in turn, made an average contribution of -0.03 of a percentage point to the 3.3 % average annual overall GDP growth over the period 1994 to 2012, exhibiting either very minor positive contributions or negative contributions throughout the period.

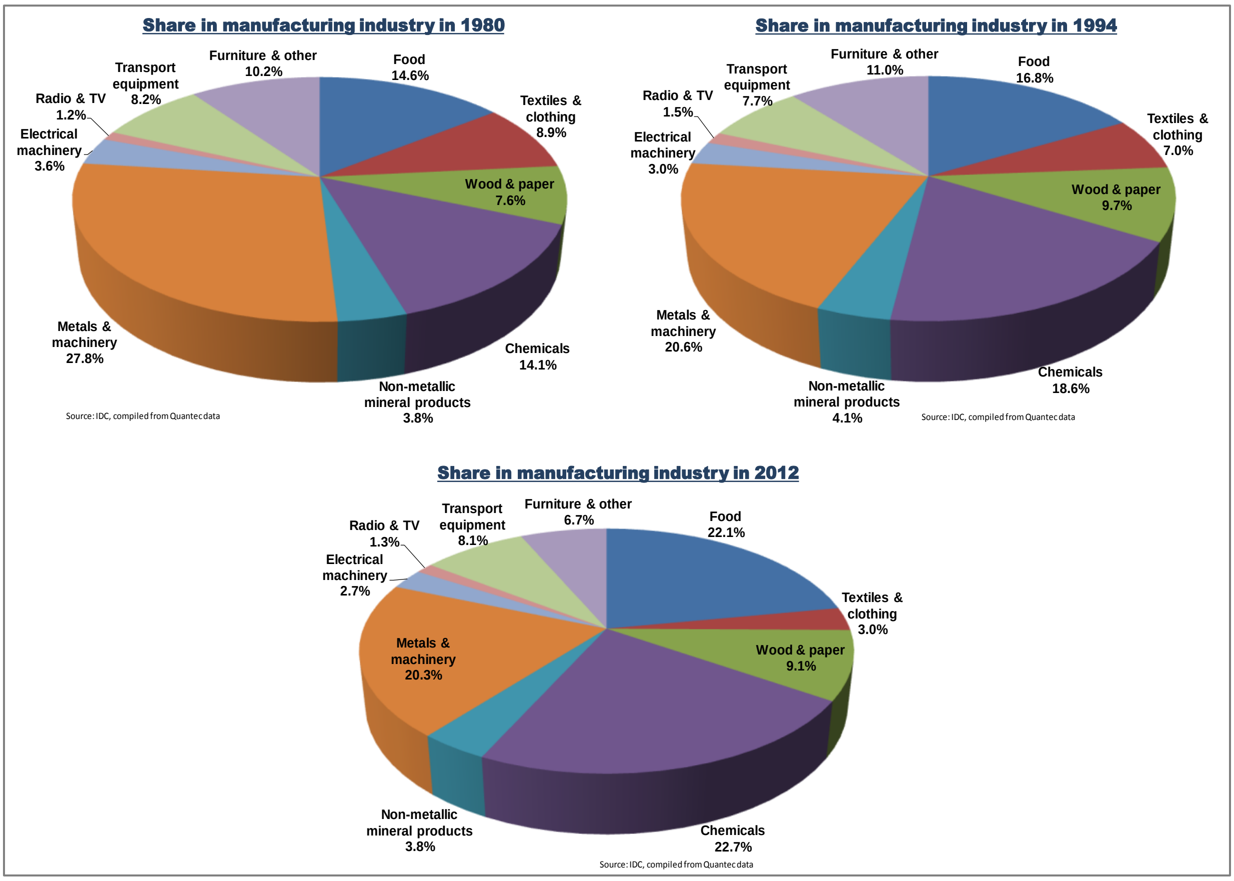


Source: IDC, compiled from SARB data

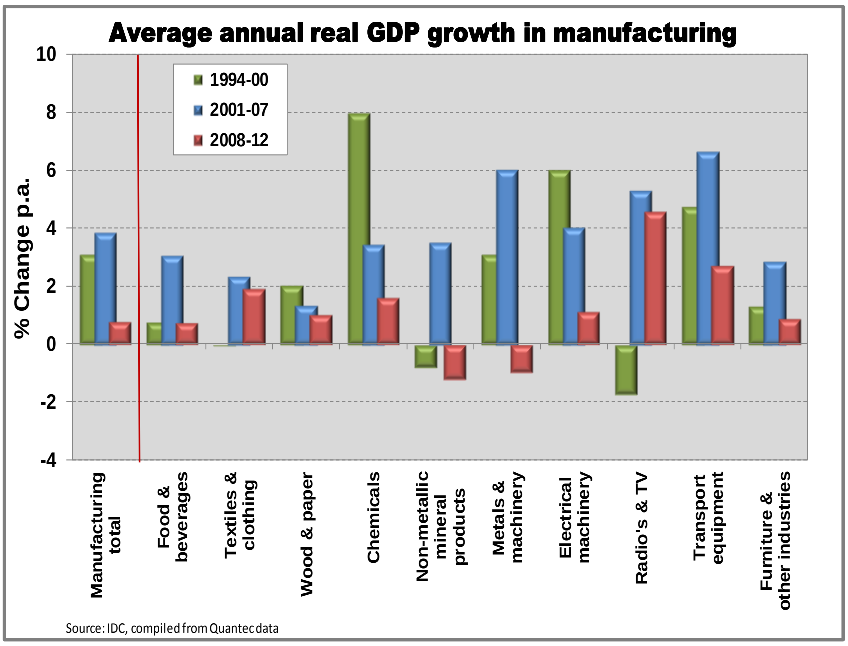
2.1. Manufacturing sector trends

The manufacturing sector's relative contribution to overall GDP and employment has declined over the two decades. Whereas it claimed the dominant position in the economy in 1994, when it represented close to 21% of GDP at current prices, the sector was only the 4th largest by 2012 (12.4% of GDP). However, a contracting share does not imply a decline in output, as in in real terms manufacturing GDP expanded by 61% from 1994 to 2012. Manufacturing's declining share of overall GDP thus reflects an inferior growth rate (i.e. averaging a mere 2.8% p.a. between 1994 and 2012) relative to those of other sectors of the economy. The sector also became increasingly export-oriented, with its share of total merchandise exports being substantially higher by 2012.

The manufacturing sector, although relatively diversified, is dominated by a few large sub-sectors, specifically chemicals, metals and machinery, as well as food processing. As illustrated, both the chemicals and food processing sectors expanded their respective shares of manufacturing value add since 1994, whilst that of metals and machinery remained basically unchanged. The textiles and clothing sector contracted substantially.

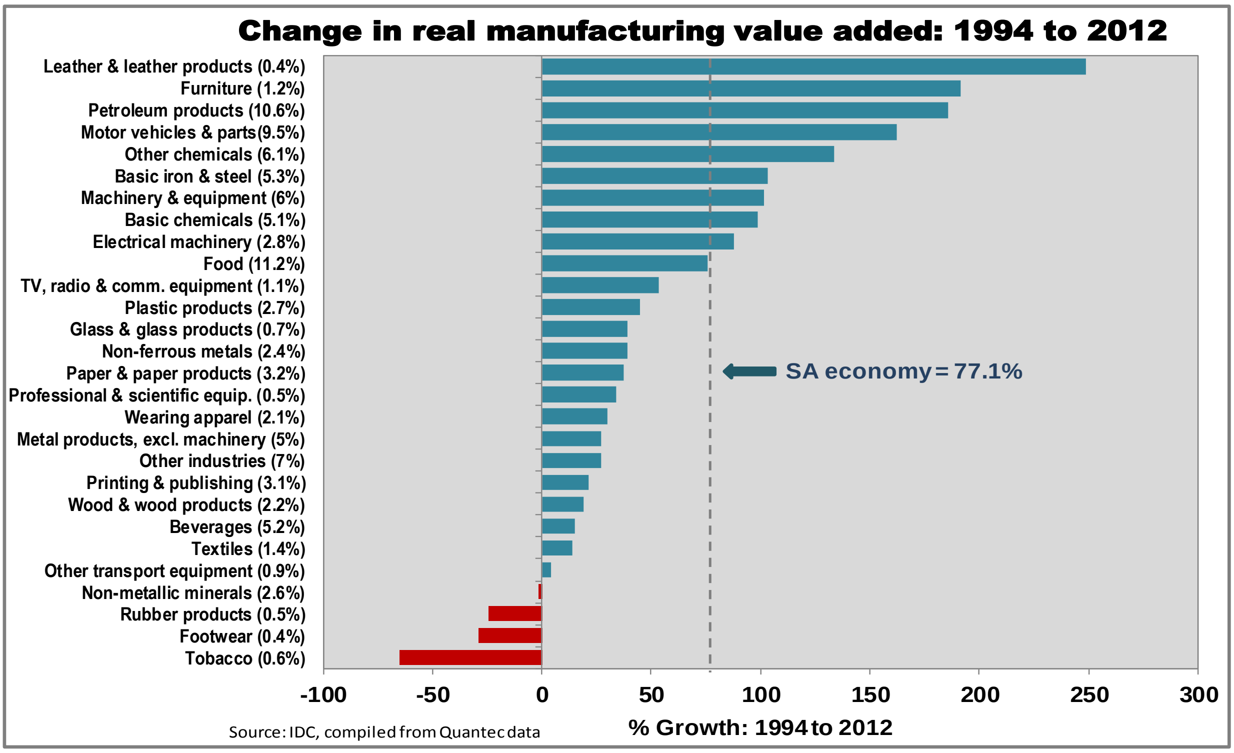


Whilst many manufacturing sub-sectors are domestic market oriented, others are highly reliant on export markets. Competitiveness is critical to their success as competition prevails across the board. Numerous factors affect their performance over time, including domestic and/or external demand conditions, currency movements, input costs and pricing practises (e.g. import parity pricing), technological upgrading, policy support, infrastructure and logistics, regulatory aspects and tariff protection, as well as competition/concentration issues, among others.



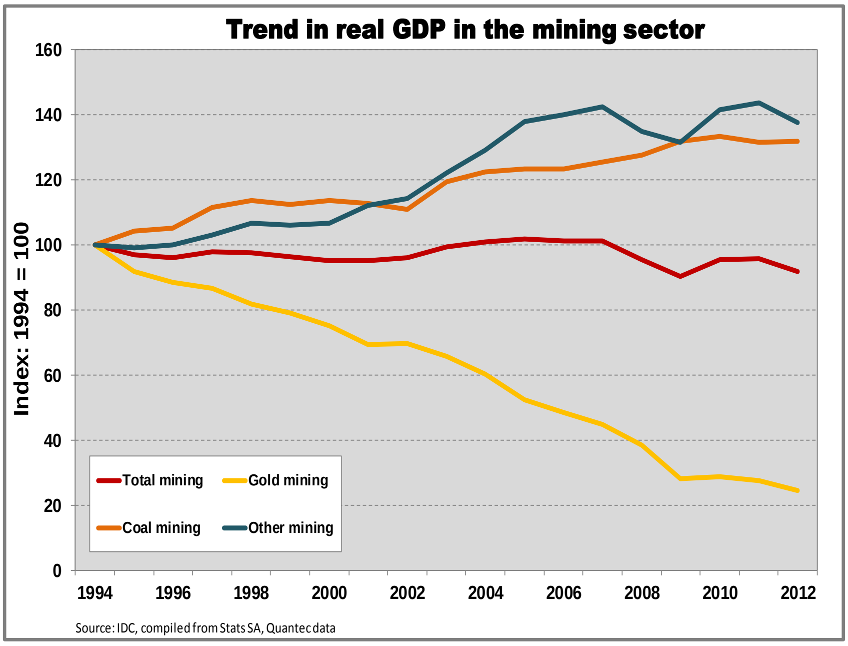
For instance, highly supported for many years by industrial policy initiatives, the transport equipment sector consistently outperformed the manufacturing sector average over the three time-buckets illustrated in the accompanying graph. The metals and machinery sector, in turn, posted a relatively strong performance over the period 2002 to 2008, strongly supported by construction and other forms of fixed investment activity, as well as by its export orientation. However, the sector's performance turned negative in 2009, when a 20% contraction was recorded. Since the onset of the crisis, the non-metallic mineral products sector also registered negative average growth, affected by weaker construction activity.

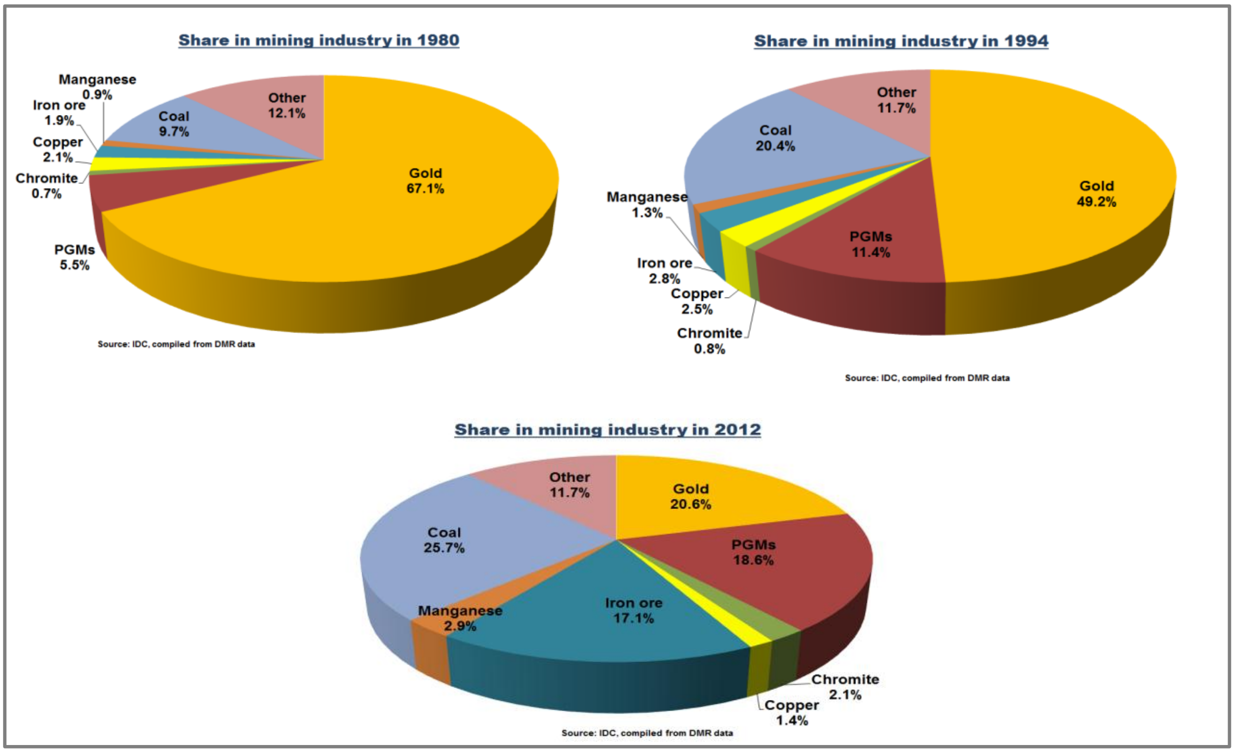
At sub-sectoral level, as illustrated in the following graph, the largest gains in real value add over the period 1994 to 2012 amongst the biggest manufacturing industries were recorded by the following: petroleum products; motor vehicles, parts and accessories; "other chemicals"; machinery and equipment; basic chemicals and electrical machinery. The food processing sector, which accounts for 11.2% of the manufacturing sector's GDP, posted a growth rate over this period, which was equivalent to the economy's 77.1% growth.



2.2. Mining sector trends

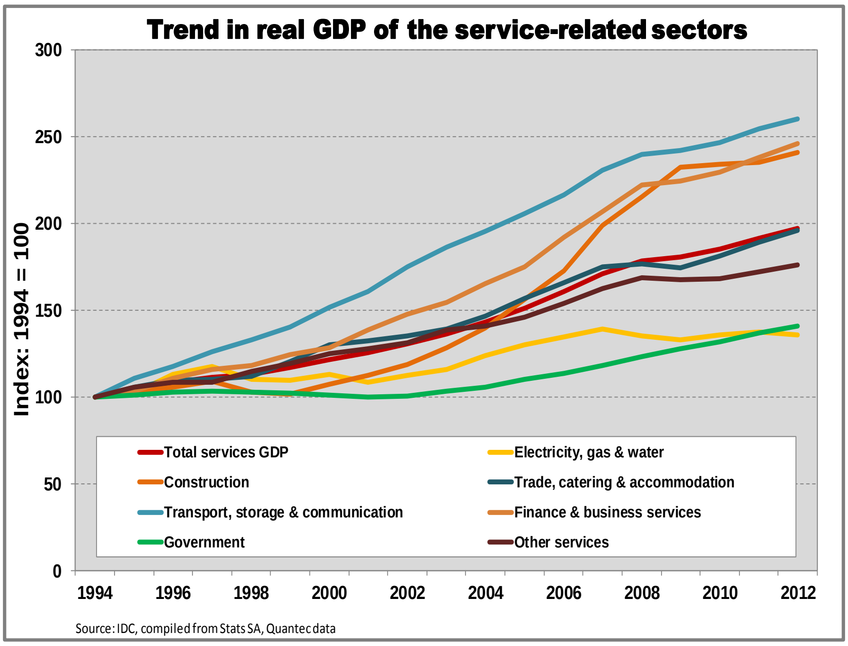
The output of South Africa's mining sector contracted over the past 20 years, largely due to steeply falling gold production as deposits became increasingly difficult to access. Nevertheless, the mining sector has become far more diversified over time, as illustrated in the pie charts below, with the platinum group metals (PGMs) sector growing in importance. The coal mining steady increase in output over most of the 20-year period has been related to domestic power generation requirements and export demand. The "other mining" sector represents the diversity of South Africa's rich mineral endowment, with PGMs making the largest contribution (45%) in terms of value add, followed by metal ores (36%) and other mining (copper, nickel and zinc) and quarrying (19%). This sector has been under pressure since the onset of the crisis, largely due to the impact of weaker demand for motor vehicles (and hence for catalytic converters) on the platinum industry. This has been compounded by production stoppages in 2012 related to safety and industrial relations issues. China's slowdown in recent times has also weakened demand for a variety of commodities and their respective prices, also impacting on the mining sector as a whole.



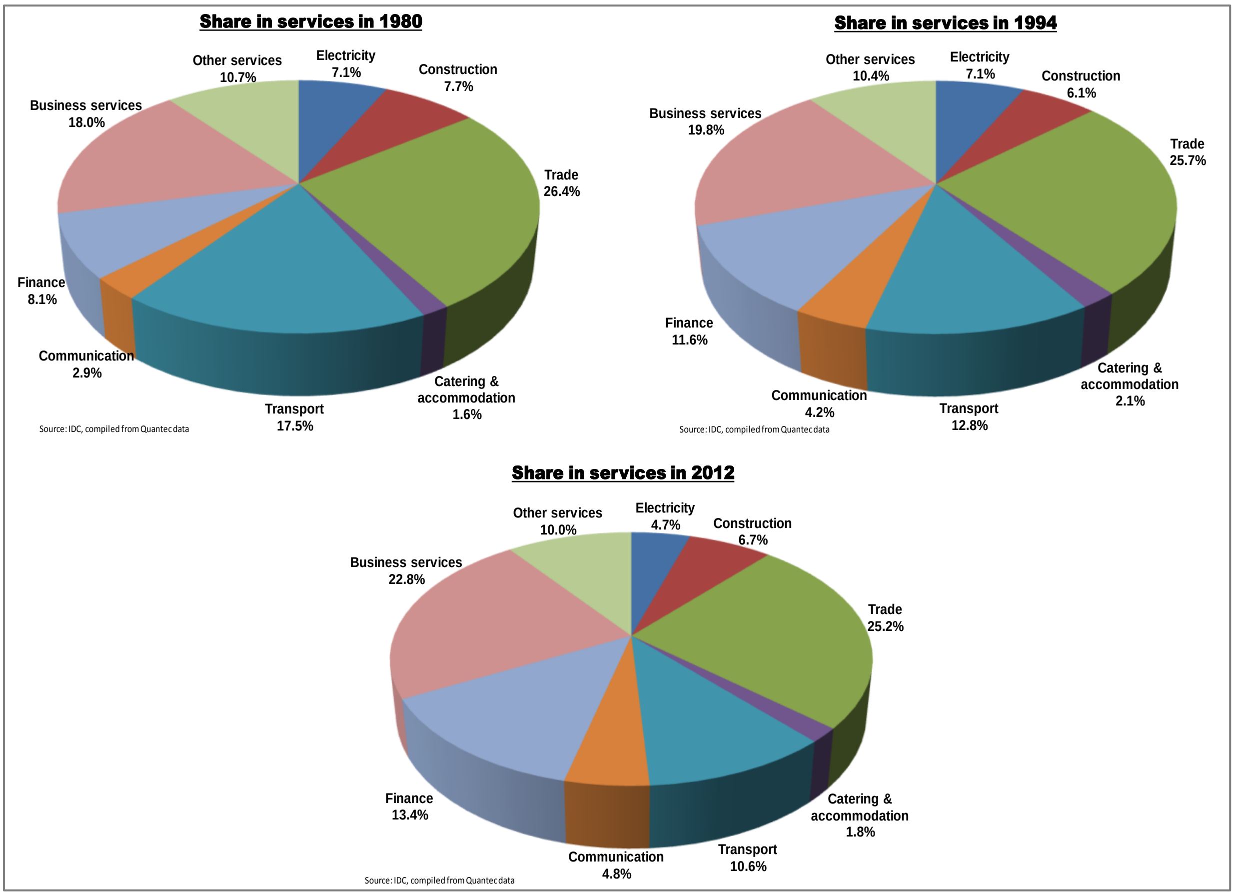


2.3. Services sector trends

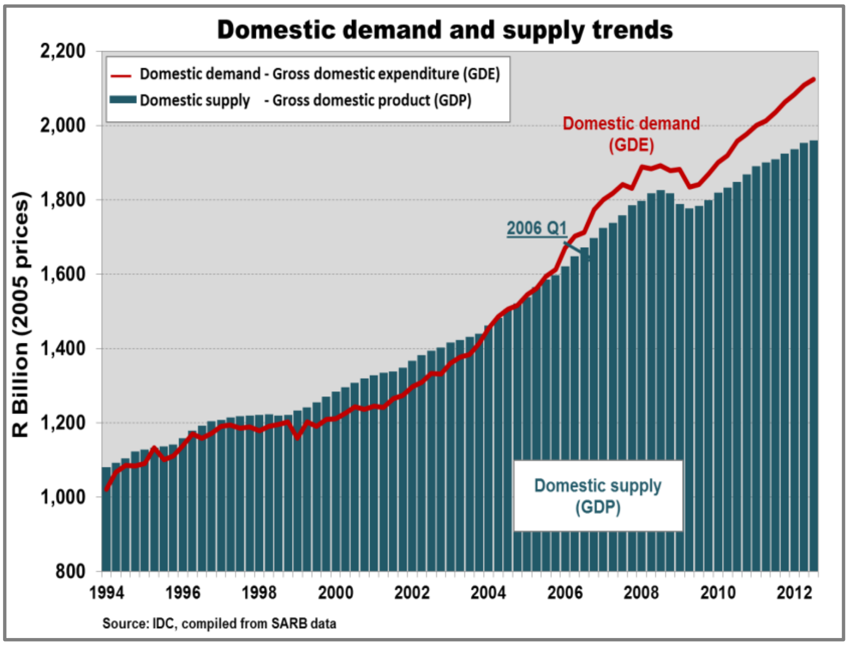
The output of the broad services sector increased at an average annual rate of 3.9% per annum over the period 1994 to 2012, although a substantially higher average annual growth rate of 5.3% was recorded over the upswing years 2003 to 2008. Key contributors to the relatively strong growth over this 6-year period were the transport, storage and communications sector, which expanded at an average rate of 5.4% per annum, finance and business services (7.1%) and the construction sector (10.5%).



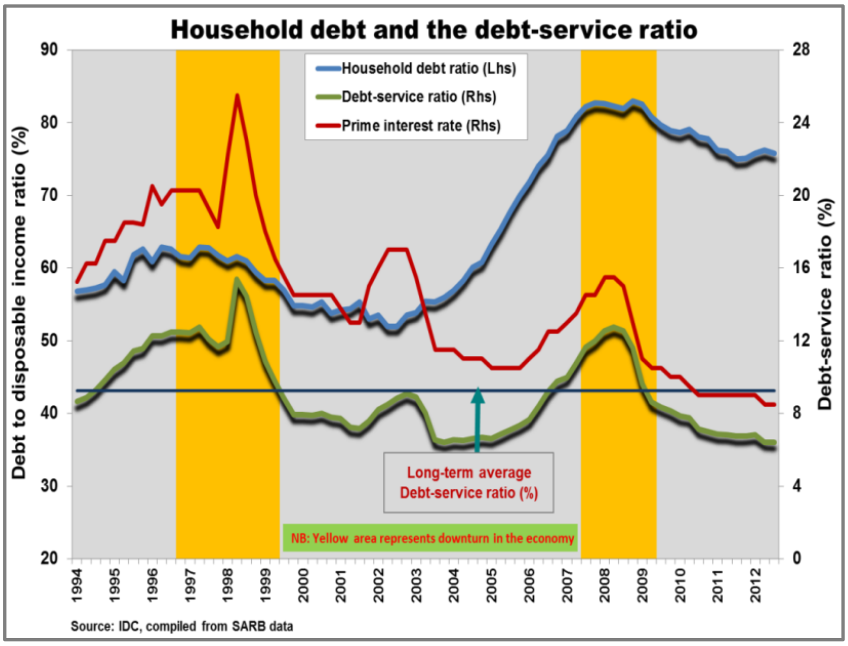
The business services sector saw its share of the services-related GDP increasing from 19.8% in 1994 to 22.8% by 2012, whilst the finance sector's share increased from 11.6% to 13.4% over the same period. In turn, the contribution of the electricity sector declined from 7.1% to 4.7%.



3. DOMESTIC DEMAND

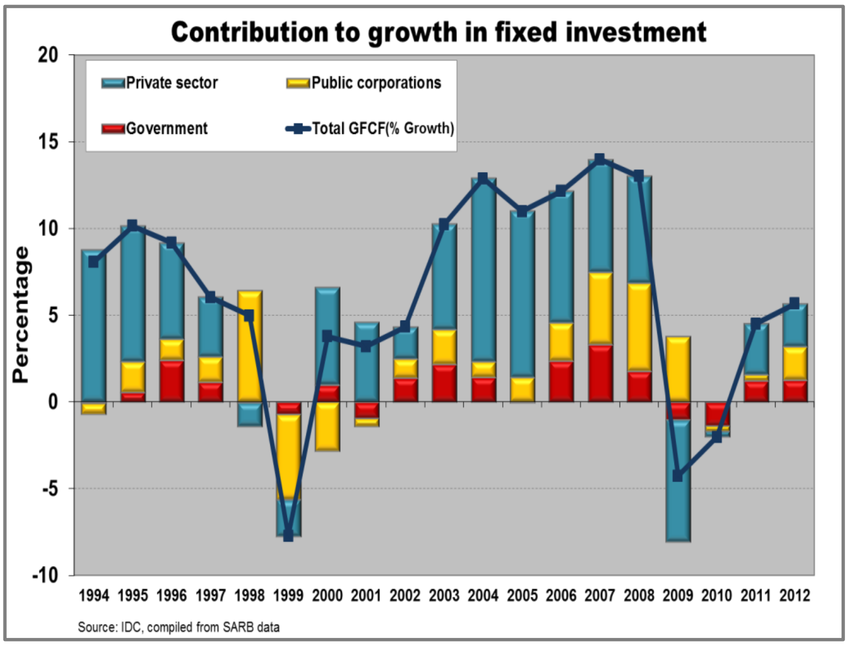


Gross domestic expenditure, or domestic demand, has been relatively strong over the past 10 years, underpinned by robust household consumption expenditure for most of the period and by rapid growth in fixed investment activity from 2003 to 2008. The supply-side of the economy, in turn, has faced serious challenges, including: rising wages; excessive escalations in electricity tariffs and other administered prices; productivity challenges; and logistics difficulties. Although surplus production capacity has been building up in several sectors of the economy, partly reflecting weak demand for their respective products, other sectors may lack the production capacity to accommodate specific and/or increasing demand requirements, either partly or fully. Such a mismatch has resulted in a widening demand-supply gap, as illustrated in the adjacent graph. Consequently, demand for imported goods, both consumer items (e.g. motor vehicles) and capital goods (e.g. specific machinery and equipment) experienced a steep rise, especially since 2006. This adverse development was then mirrored in a widening trade deficit.

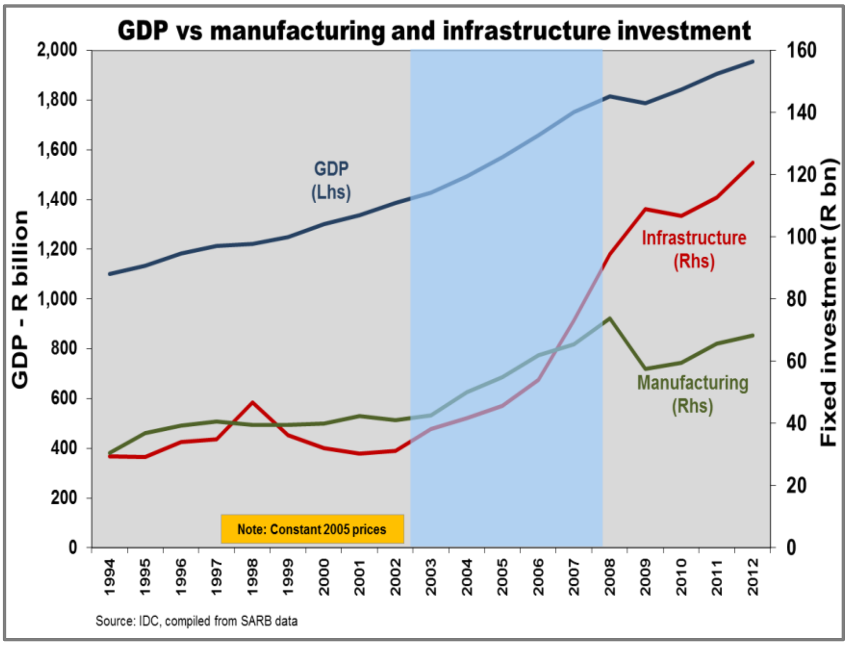


A low interest environment, rising real disposable incomes, increased job creation and ease of access to credit supported the strong growth in household consumption expenditure over the period 2004 to 2007. Spending on durable goods (incl. motor vehicles, furniture and other household equipment) expanded at a very rapid pace. This excessive consumption was partly driven by increased access to credit, resulting in a steep rise in household debt. The debt-to-disposable income ratio increased sharply from 52% in the final quarter of 2002 to an all-time high of 82.7% by the first quarter of 2008. Although debt levels have receded slightly (assisted by the introduction of the National Credit Act in 2008), households remain highly indebted as their debt represented 75.8% of their disposable income by the final quarter of 2012.

Increased consumption expenditure has also been reflected in a substantial deterioration in household savings over the years. The savings-to-disposable income ratio had stood at 2.7% in 1994, but a continued deterioration ensued in subsequent years, with this ratio falling to 0% by 2012. Over the period 2006 to 2011, households actually made a negative contribution to the national savings pool, as increased levels of dissavings were reported. Simultaneously, household indebtedness rose sharply from 64.3% of disposable income in 2005 to an all-time high of 82.4% by 2008, but subsequently declined to 75.6% by 2012.

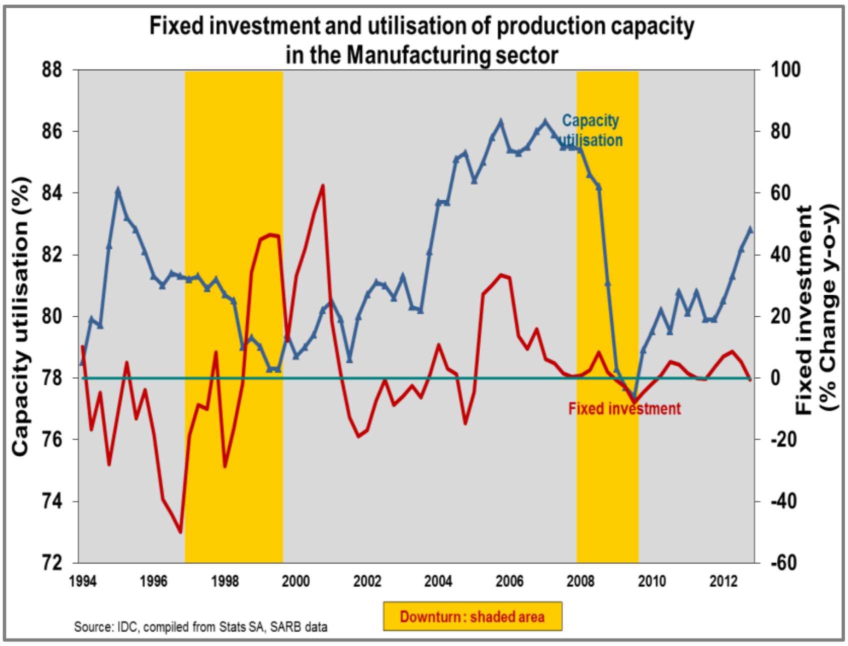


The expansion of a country's economic and socio-economic infrastructure is a prerequisite for sustainable economic growth and development, with government and public corporations being key players in this regard. On average, fixed investment activity has been fairly strong over the past 20 years, having recorded an average annual growth of 6.2% p.a.. The period 2003 to 2008 witnessed a substantial acceleration in fixed investment spending towards an average of 12.2% p.a.. Looking at the past decade, real capital outlays by the electricity sector topped the rankings, with an average annual growth of 20.7%, followed by the transport, storage and communication sector (10.9%).

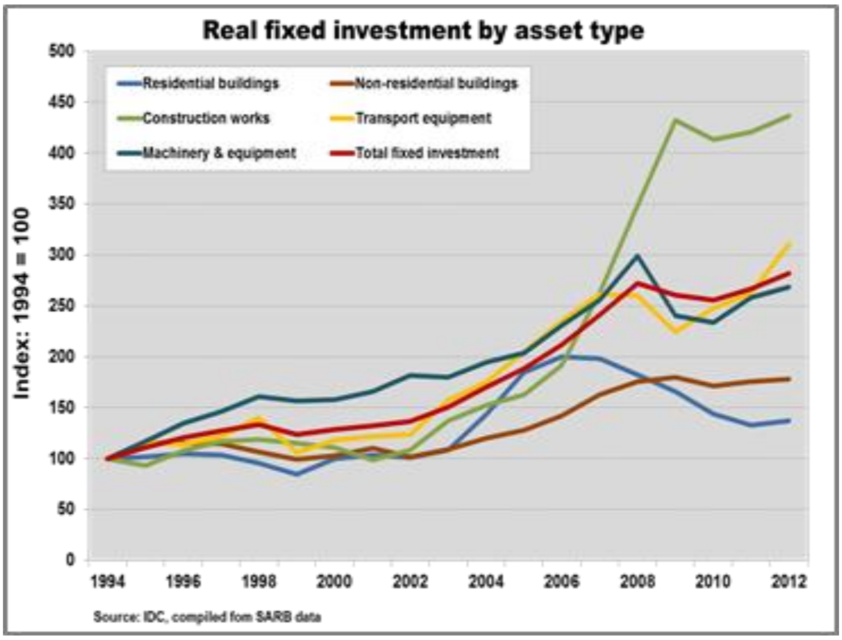


In both instances, the strong growth was significantly underpinned by the multi-billion rand public sector infrastructure roll-out. State-owned companies, particularly, Eskom and Transnet, have made a substantially higher contribution to overall fixed investment in the country, as reflected by the rising share of public corporations to overall fixed investment, from 10% in 2001 to almost 22% by 2012, in real terms. Public corporations recorded strong fixed investment growth of 16% p.a., on average, over the period 2003- 2012, as substantial infrastructure investments were made to expand the capacity and efficiencies of the energy and transport sectors. Furthermore, investment spending by general government on economic and social infrastructure also registered robust growth of 7.2%, p.a. over the same period.

This was significantly higher than the 3.2% average annual growth recorded between 1994 and 2002. The private sector has also experienced brisk growth in fixed investment activity, albeit at a more moderate pace than that of the public sector at large. However, it accounted for about 68% of overall real fixed investment over the past decade, although its share declined from an all-time high of 74.4% in 2005 to 63% by 2012. Despite on-going challenges, the mining sector still reported fairly strong growth in capital spending, having averaged 9.5% p.a. over the period 2003 to 2012, compared to growth of 8.1% per annum over the preceding 10-year period.



Manufacturing reported a slowdown in fixed investment spending over the past decade, which decelerated from an average of 5.8% p.a. over the period 1994-2002 to 4.6% p.a. from 2003 to 2012. The sector faced increasing competition from global players in export and local markets. Reduced demand domestically and abroad since the onset of the global crisis and the subsequently weak recovery have adversely impacted on the local manufacturing sector. Since manufacturing output growth has been subdued, investment in the sector in recent years is likely to have been more of a replacement and maintenance nature. However, a diverging trend has recently been evident between the level of fixed investment in manufacturing and the utilisation of production capacity, as shown in the accompanying graph.



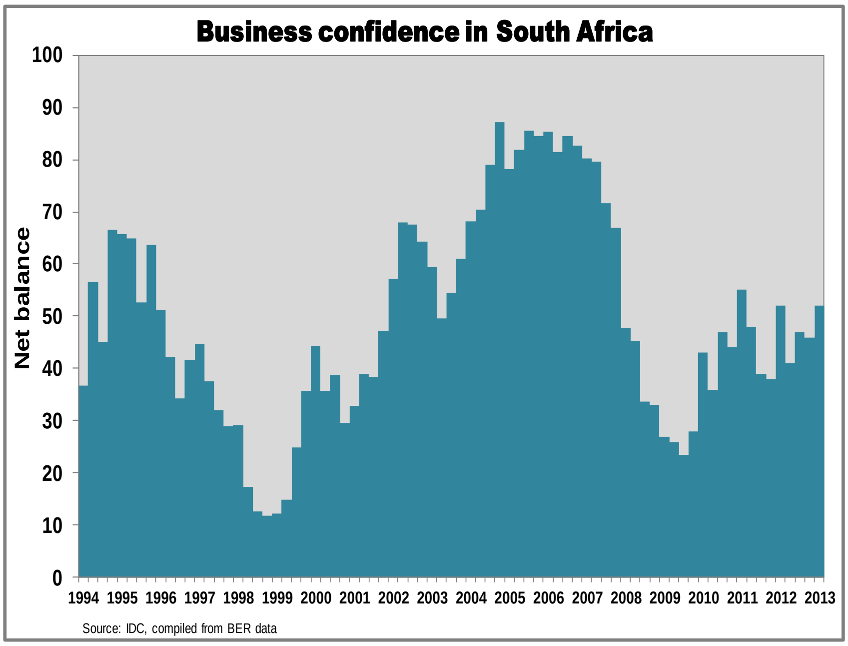
The steep rise in fixed investment in construction works since 2003 on the back of public and private sector infrastructure investment followed a period of under-spending and lack of infrastructure maintenance over the years 1994-2002. Large infrastructure investment programmes over the past decade have included the building/upgrading of new/existing stadia in preparation for the 2010 FIFA World Cup, the Gautrain rapid rail link, investments in energy infrastructure, transport and logistics networks and fuel pipelines. Higher spending in transport equipment is linked to Transnet's multi-year investment plan, whilst SAA's fleet expansion also made a significant contribution.

However, investment in machinery and equipment has been lagging, with a sharp drop in this category of investments during the recent recession. Although there have been signs of recovery over the past two years, real fixed investment levels in machinery and equipment remain below pre-crisis levels. The residential property market is still experiencing challenging times, with investments in 2012 being 31% lower than the R36 billion spent in 2006.

All in all, the ratio of gross fixed capital formation to GDP rose from 15.2% in 1994 to a peak of 23.1% in 2008, but subsequently declined to19.2% by 2012. The ratio thus continues to fall short of the desirable 25% level deemed necessary to make a meaningful dent on the unemployment and poverty challenges.

In contrast, gross savings in the South African economy as a ratio of national GDP remained fairly stable at an average of about 15.5% between 1994 and 2012. This ratio compares rather unfavourably with the average investment-to-GDP ratio of 17.3% over the same period. The widening savings-investment gap has been mirrored by a substantial shortfall in the current account of the balance of payments, with the country increasingly having to rely on foreign capital inflows to finance the shortfall on domestic savings.

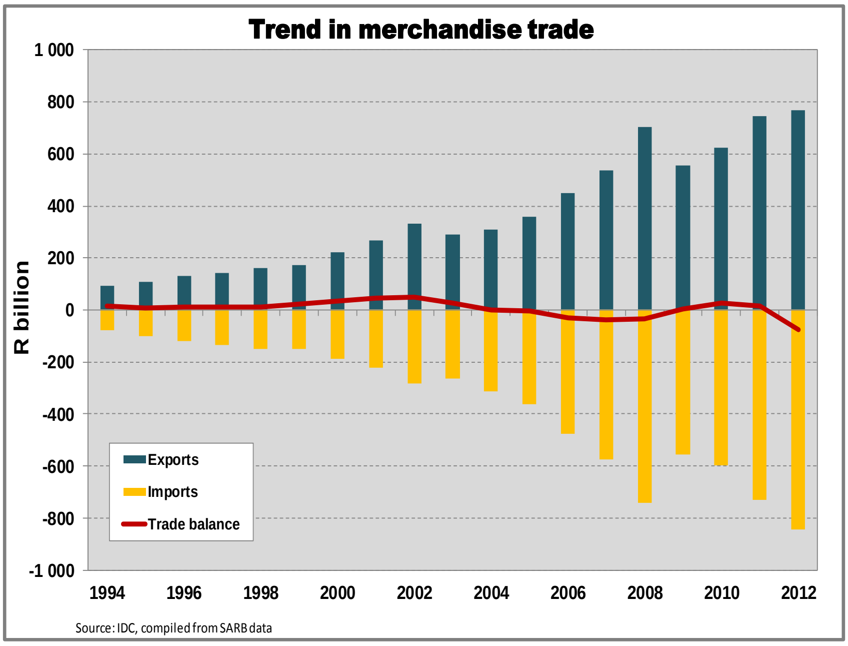
General government reported dissavings over the period 1994 to 2012, with the exception of the years between 2006 and 2008, when a positive savings contribution was made. Households have also seen their contribution deteriorating over time, with negative savings observed since 2006. The corporate sector, in turn, has continuously made a positive savings contribution, although the level of savings declined in 2012 following a steep rise in savings during the period 2009 to 2011.



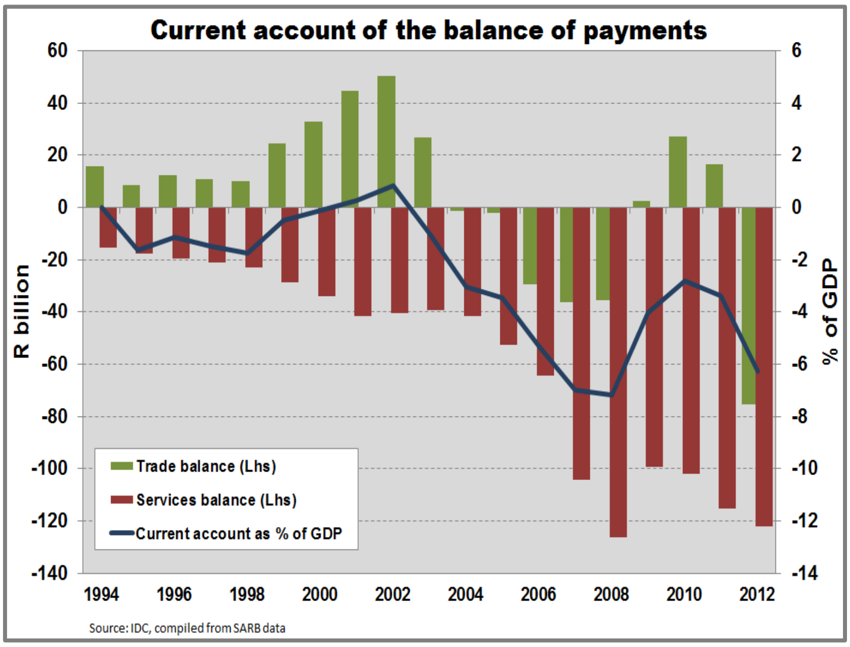
Overall business sentiment within the South African economy has tended to reflect cyclical conditions over the period under review. Hence, it fell sharply during the 1998 East Asian crisis, rebounding in a rather volatile manner up until the 2007/08 global financial and economic crises, having reached a 24-year high in 2004. Such an uptrend was temporarily interrupted by intermittent adverse developments such as the dot.com crisis and the 9/11 events in the United States. Business confidence fell dramatically as recessionary conditions became increasingly evident both globally and domestically from the latter part of 2008 to 2009. Although business confidence has improved somewhat in recent years, it still remains well below pre-crisis highs. Weak demand, underpinned by a yet sluggish global economic recovery and a more moderate pace of growth in domestic consumptions spending are at the core of the currently “neutral” levels of business confidence (i.e. neither pessimistic nor optimistic).

4. EXTERNAL TRADE AND THE BALANCE OF PAYMENTS

After having recorded a positive balance and expanding surplus over the first half of the period under review, South Africa's merchandise trade performance came under increased pressure from 2003 onward. Robust domestic demand, driven by a significant increase in household consumption expenditure saw the demand for imported consumer goods rise sharply over the period 2003 to 2007, as domestic production could not fully meet demand requirements. In addition, the public sector's massive infrastructure investment programme resulted in a steep rise in imported capital goods (machinery and equipment). A higher international crude oil price, in turn, resulted in the import bill for mineral products rising at a fast pace – to illustrate, the price of crude oil price, which averaged USD25 per barrel in 2002, rose steadily to an average of just over USD112 per barrel by 2012. Crude oil imports accounted for 15.8% of all merchandise imports in 2012, compared to 6.6% in 1994 and 10.5% in 2002.

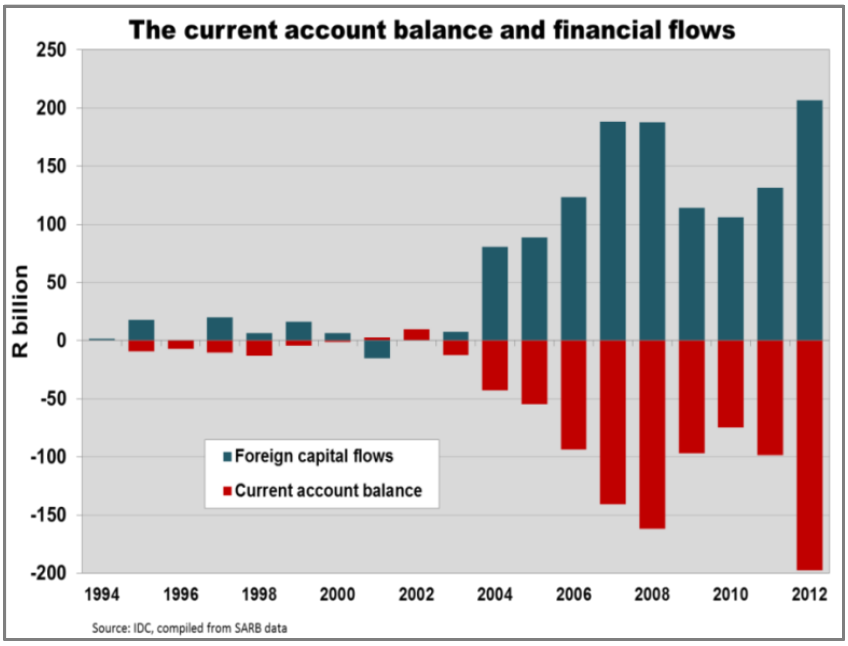


On the export front, local businesses faced an increasingly challenging operating environment over the past 10 years, including factors such as rising operating costs (incl. higher costs of electricity, fuel and harbour charges); infrastructure backlogs (e.g. electricity, rail transport, ports); safety and industrial action related production stoppages in the mining sector; a relatively strong currency over a large part of this period; and, over the years 2008-2012, the global economic recession and a subsequent fragile recovery, particularly in the advanced economies, which have been the principal markets for South Africa's manufactured exports. The trade balance thus deteriorated over the past decade. The deficit on the services balance, in turn, widened over the years. Increased foreign capital inflows in the form of either foreign direct investment (FDI) or portfolio investments resulted in a continuous and expanding quantum of interest and dividend payments to non-residents.



Consequently, the overall deficit on the current account of the balance of payments deteriorated to 7.2% of GDP by 2008. Following a relatively brief improvement in 2009 and 2010 due to a lower average rate of increase in imports relative to that of exports, such a deficit worsened to 6.3% of GDP in 2012 as import requirements expanded.

South Africa has benefitted from increasing global investor interest in emerging markets. Substantial capital inflows have been attracted by the high returns attainable in the domestic equity and bond markets, whilst the "carry-trade" has been lured by significant interest rate differentials. Net purchases of domestic shares by non-residents were particularly strong over the period 2004 to 2007, but fell sharply in 2008 as global risk aversion set in, particularly towards emerging market assets. Foreign interest in local shares, however, rebounded strongly to reach an all-time high of R75.4 billion in 2009 (in nominal values).



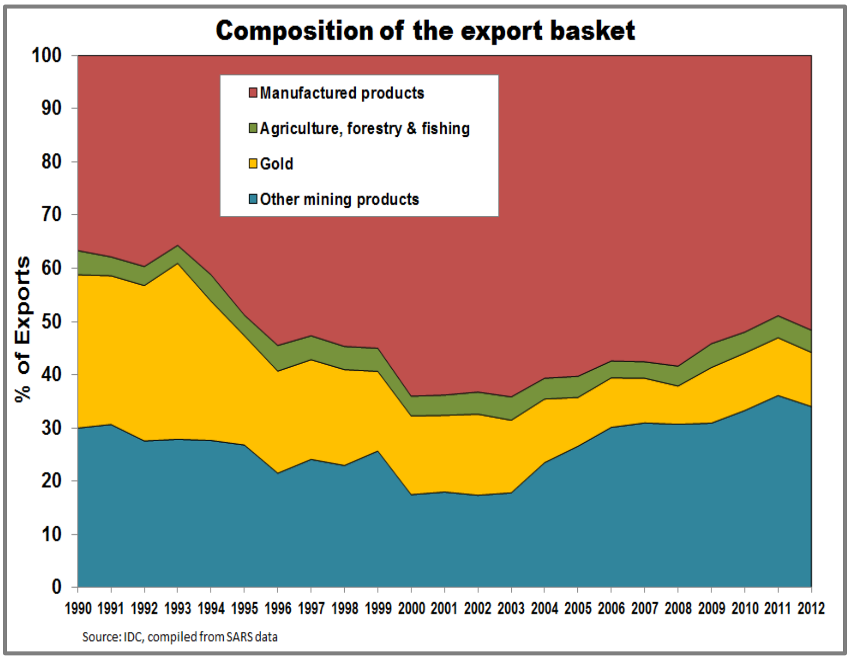
The local bond market only started to attract substantial foreign interest in more recent years, with considerable net inflows having been recorded since 2012 (a record net investment of R88.6 billion into the bond market was recorded in 2012). However, net purchases of local shares by non-residents moved into negative territory for most of 2011 and 2012. In most years over the period under review, the quantum of net capital inflows was more than sufficient to cover current account shortfalls.

4.1. The changing composition of the export basket and destination markets

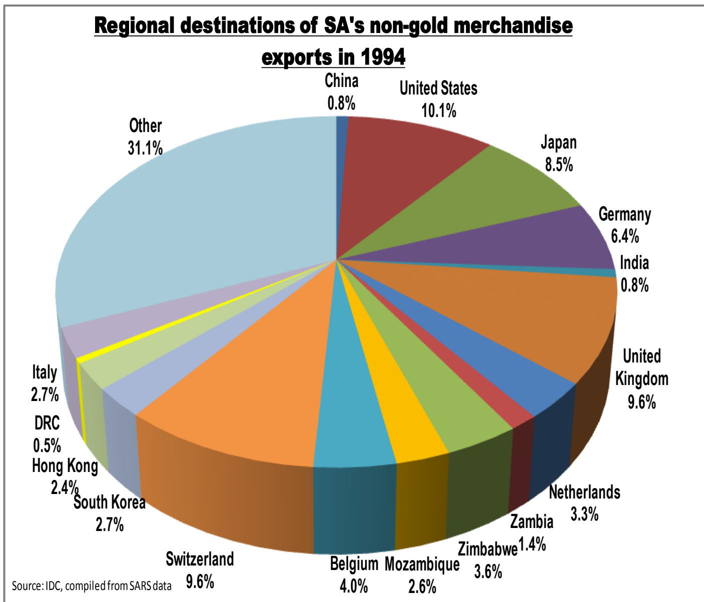
Manufactured goods claimed at larger share of the merchandise export basket at 51.6% of the total in 2012, compared to the ratio of 42% recorded in 1994. However, this falls short of the 62% peak attained in 2004. The following were the leading manufactured export categories in 2012: motor vehicles (7.6% of total merchandise exports); basic iron and steel (7.3%); parts and accessories for motor vehicles (3.7%); and basic chemicals (3%).

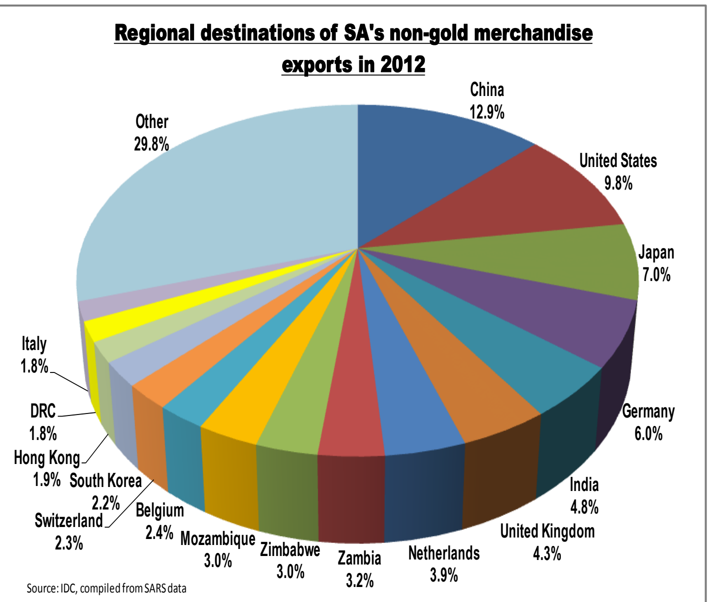
The share of the merchandise export basket claimed by mining sector exports fell from 53% in 1994 to a low of 34% in 2004, largely as a result of the successively smaller contribution made by gold mining exports.

The rise of exports of PGMs, iron ore, coal and other minerals, complemented by higher commodity prices, at least until the onset of the global economic crisis, elevated the share of mining exports in the overall basket to 46.8% by 2011. The ratio declined to 44% in 2012 largely due to the fall in the value of PGM exports as the local industry faced a difficult year. Gold exports claimed a 10.1% share of the overall merchandise export basket in 2012, followed by PGMs (9.3%), iron ore (8.8%) and coal exports (8.2%). The share of the export basket claimed by agriculture, forestry and fishing sector remained relatively stable throughout the period under review, amounting to 4.2% by 2012.



The geographical destination of South Africa's export basket changed considerably over the past 20 years, with new markets emerging and some of the traditional markets seeing their dominance reduced. This was particularly the case with respect to the UK, Japan and Switzerland, whilst the relative shares of the USA and Germany also shrunk, albeit to a lesser degree. China emerged as South Africa's most important export trading partner since 2009, with its share of non-gold merchandise exports at 12.9% in 2012, compared to a mere 0.8% in 1994.





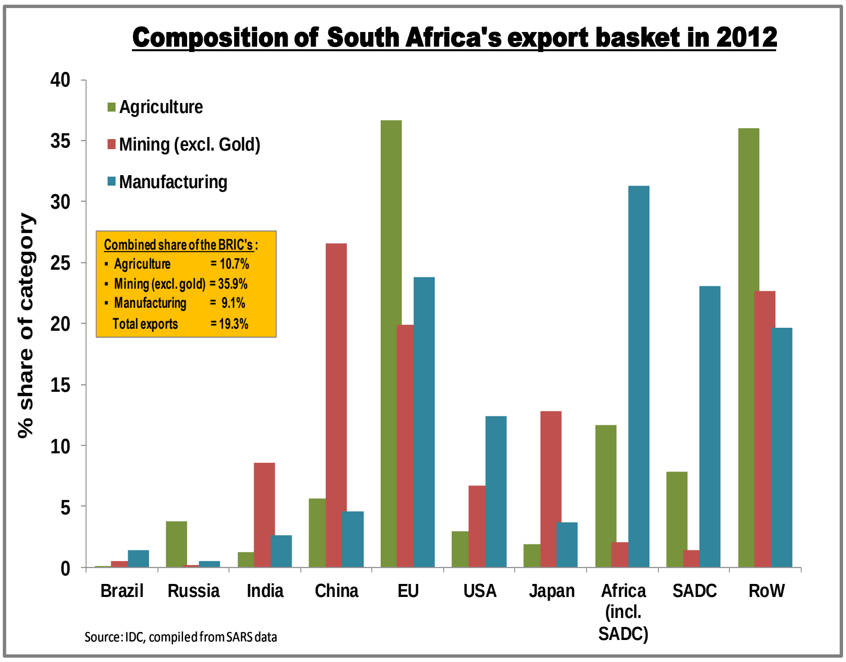
India now claims 5th position as an export destination, having overtaken the UK and Switzerland. A number of African countries, such as Zambia, Mozambique and the Democratic Republic of the Congo have also become increasingly important export markets, especially for South Africa's manufactured goods.

South Africa's exports to selected countries/regions in 2012							
Broad sector	World (Total exports)	USA	European Union	Japan	China	Africa	Rest of World
Agriculture	4.2	1.4	7.4	1.3	2.0	2.8	4.9
Mining	44.2	25.8	32.9	68.6	77.7	4.0	59.7
Manufacturing	51.6	72.8	59.7	30.1	20.2	93.2	35.4
Total exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Commodity exports dominated the export basket destined for China in 2012, as indicated in the following two tables, with iron ore topping the list at 47% of the total. Manufactured goods represented only 20% of this basket and consisted largely of basic iron and steel products, industrial chemicals, non-ferrous metal products, and motor vehicles, parts and accessories. The European Union (EU) claimed a 20.5% share in South Africa's overall merchandise exports in 2012. The basket destined for the EU was dominated by manufactured goods (almost 60% of the total), led by motor vehicles, parts and accessories, as well as basic iron and steel products. Mining exports to the EU represented approximately 33% of the basket, with platinum and coal exports taking top position. Agricultural exports to the EU represented a significant 7.4% share of the basket.

The rest of Africa and more specifically SADC have emerged as an increasingly important market for South Africa's exports. SADC's share of overall exports increased from 8.3% in 1994 to 12.9% by 2012, whilst for the entire African continent this share increased from 10% to 17.6% over the same period. The export basket destined for the rest of the African continent is substantially more diversified and overwhelmingly dominated by manufactured goods (93.2% of the total), led by non-electrical machinery, motor vehicles, parts and accessories, food products, and basic iron and steel products.

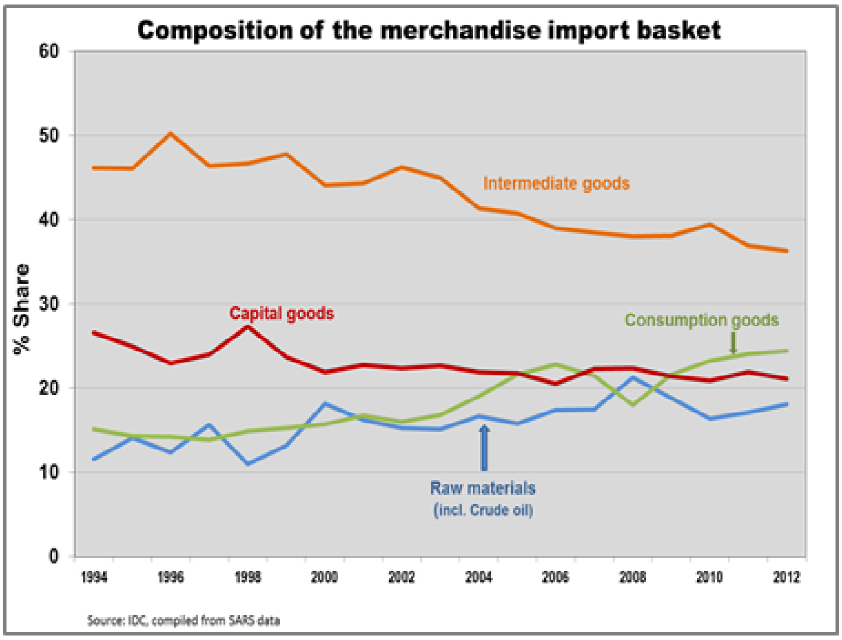
Major exports to select regions/countries in 2012 (% share of exports)						
	European Union		China		Africa	
	Sector	% share	Sector	% share	Sector	% share
1	Motor vehicles, parts and accessories	21.3	Iron ore	47.0	Non-electrical machinery	14.9
2	Platinum	10.1	Non-ferrous metal ores (excl. gold & PGMs)	17.2	Motor vehicles, parts and accessories	12.4
3	Basic iron and steel products	9.0	Coal mining	11.2	Processed food	8.8
4	Agriculture	7.4	Basic iron and steel products	7.5	Basic iron and steel products	7.7
5	Coal mining	6.4	Industrial chemicals	2.4	Other chemical products	7.1
6	Non-ferrous metal ores (excl. gold & PGMs)	6.2	Non-ferrous metal products	2.3	Industrial chemicals	6.9
7	Iron ore	5.4	Other manufacturing	2.1	Metal products, excl. machinery	6.6
8	Other manufacturing	5.0	Platinum	2.1	Petroleum and petroleum products	4.7
9	Other mining	4.7	Motor vehicles, parts and accessories	2.0	Electrical machinery	4.1
10	Industrial chemicals	4.0	Agriculture	2.0	Coal mining	2.8
11	Beverages	2.8	Paper and paper products	1.7	Agriculture	2.8
12	Processed food	2.6	Processed food	0.8	Paper and paper products	2.3
	Cumulative % of above	85.1	Cumulative % of above	98.3	Cumulative % of above	81.1



Approximately 31% of South Africa's manufactured exports were sold in African markets in 2012. The European Union claimed a much smaller share of the country's manufactured exports, at 23.8% in 2012. In terms of mining and mineral exports (excluding gold) to the world at large, China claimed 26.6% of the total, whilst the European Union took a 20% share. Almost 37% of South Africa's agricultural exports were sold in European Union markets in 2012, with the rest of the African continent (particularly the SADC region) being the second largest market.

4.2. The changing composition of the import basket

Although intermediate goods continue to dominate South Africa's import basket (albeit with a declining share), imported consumer goods have registered notable gains since 1994 and have overtaken capital goods as the second largest import category. This is in spite of the large capital equipment import requirements associated with the on-going public sector infrastructure investment programme. Over time, the penetration of foreign consumer products into the local market has been underpinned by a number of factors, including:

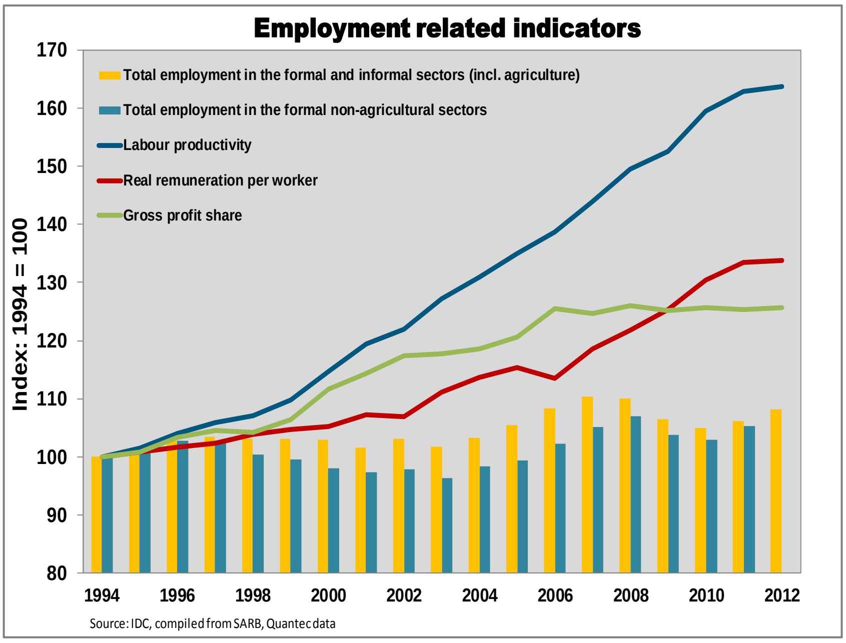


- A relatively stronger rand over large parts of the period under review;
- several other factors that have also undermined the price competitiveness of domestically-produced consumer goods;
- rising income levels and access to credit, which have boosted domestic consumption demand; and
- fierce competition by international producers and local importers, including through under-invoicing practices and illegal imports.

5. EMPLOYMENT

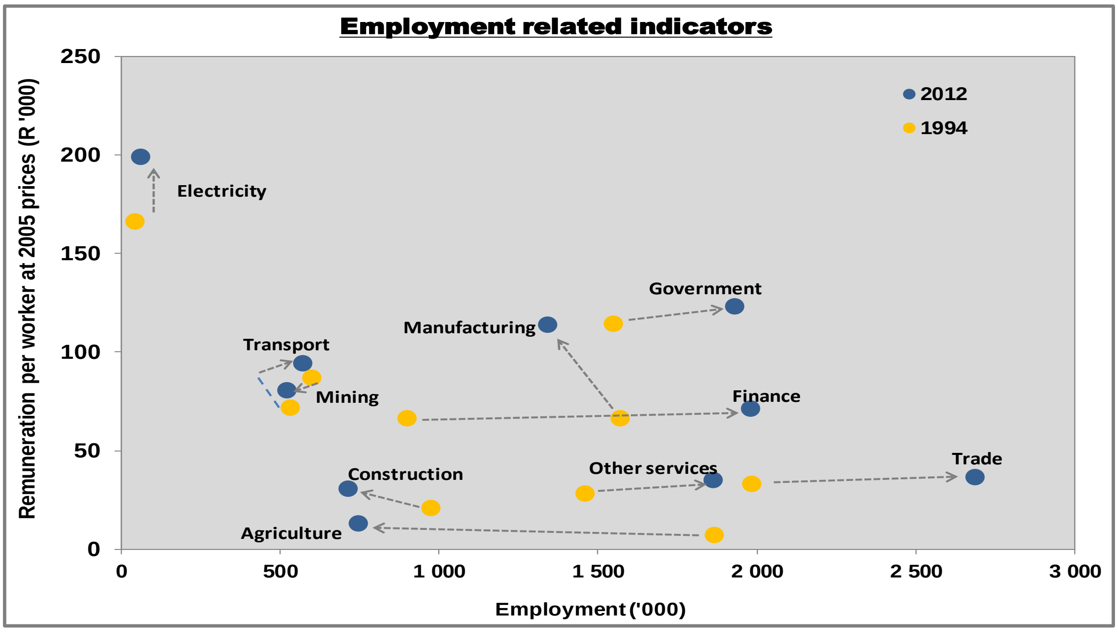
The South African economy has for many years not been able to generate sufficient employment opportunities to absorb a growing labour-force. Numerous factors have underpinned the extremely poor employment creation record, including: increased capital intensity in numerous sectors of economic activity, a mismatch of skills between what employers require and the available skills profiles; labour market rigidities and regulatory aspects; wage cost increases versus productivity growth etc. The impact of apartheid era education policies is clearly reflected in the diverse unemployment rates across the various race groups, with whites having an average unemployment rate of close to 5%, compared to the national average of around 25%, whilst that of blacks/Africans is approximately 30%.

Average annual employment growth increased from a rate of 0.5% over the period 1994 to 2000 to 1% during the years 2001 to 2007. The subsequent recession period resulted in substantial job losses. Although encouraging signs of renewed net job creation are being observed, by the end of 2012 there was still a significant shortfall in overall employment levels relative to those recorded prior to the 2008/09 economic downturn. Between 1994 and 2012 the domestic economy managed to create only 950 000 new jobs, implying an average increase in the order of just 50 000 additional jobs on an annual basis (as reflected by the yellow bars in the graph below). Data from the South African Reserve Bank, which only covers the formal non-agricultural sector of the economy (as illustrated by the blue bars in the graph), indicates a similar trend. Employment in the non-agricultural formal sector of the economy also recorded a rather dismal performance since 1994. By 2012, the employment level was only 6.5% higher than in 1994.



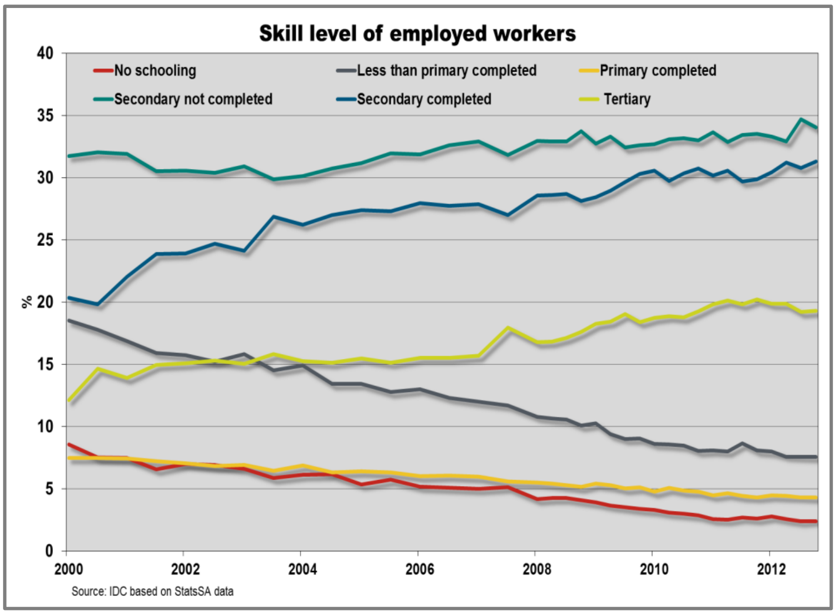
Plagued by structural unemployment for many years, job losses recorded in crisis periods are proving extremely difficult to recoup. Since 2000 the unemployment rate has been persistently above 21%, having peaked at 29.3% in March 2003. By the end of 2012, it stood at 24.9%, with 4.5 million people unable to find work. In the accompanying graph it is clear that substantial improvements in labour productivity have been progressively recorded over the review period, however, this has also partially been attributed to job shedding and/or rates of increase in employment that fall short of overall output growth. In turn, the generally upward sloping trend line reflecting real remuneration per worker may be misleading as it may conceal the changing skills composition of the workforce over time (e.g. in the recent recession, most job losses were in lower skill categories, resulting in a higher real remuneration for the remaining workers).

At the broad sector level, substantial job losses were reported over the period 1994 to 2012 in sectors such as agriculture, forestry and fishing (shown as "agriculture" in the accompanying graph), manufacturing and in the construction sector (including building construction and civil engineering). The mining sector has shed about 80 000 jobs since 1994. Combined, these sectors lost 1.69 million job opportunities over the period 1994 to 2012.



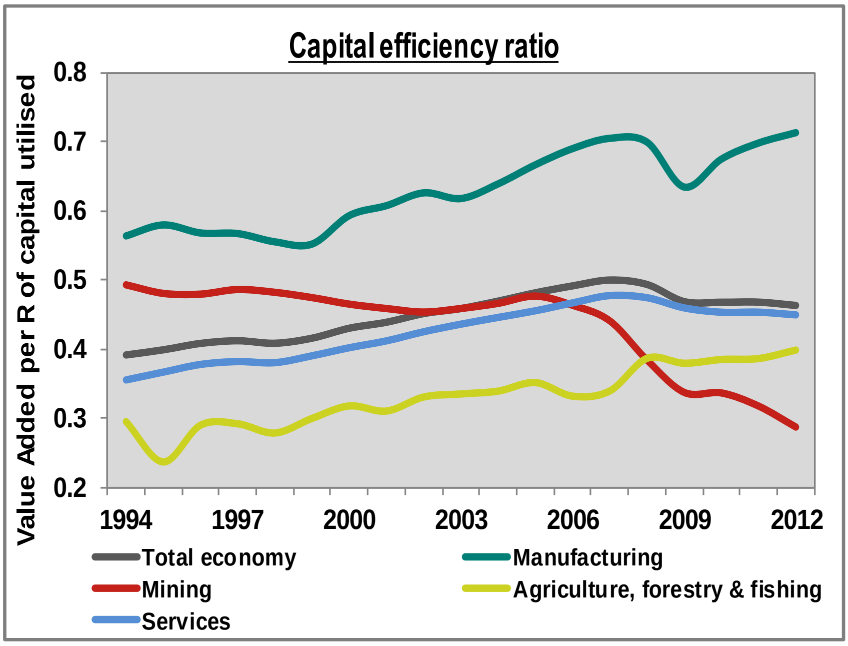
In turn, service-related sectors such as finance and business services (illustrated as "finance"), trade, catering and accommodation ("trade"), transport, storage and communication ("transport"), as well as the government sector managed to increase their workforce at varying magnitudes.

The skills level of the employed workforce has risen since 2000, as shown by a rising share of people employed with a tertiary education (from 12% in 2000 to just over 19% by 2012), as well as those who have completed their secondary education. In contrast, the ratios pertaining to those with primary education (whether completed or not) have been declining since the start of the millennium. Half of the employed labour force has at least completed secondary schooling, which is a significantly higher percentage compared to the total population with this level of education. These trends point to the skills requirements of the formal sectors of the economy, emphasising the imperative of education to ensure the employability of current and future generations.

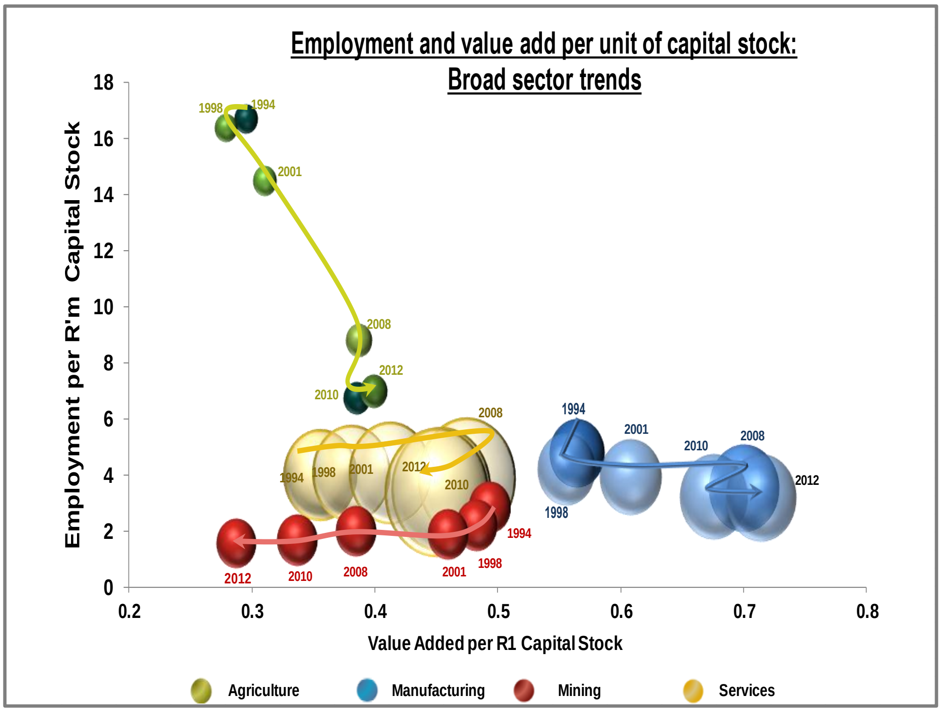


6. EFFICIENCY INDICATORS

The efficient use of resources is important for economic growth and development. It is therefore critical that capital stock invested in the economy creates sufficient value addition and also contributes to job creation. The accompanying graph shows the capital efficiency ratio, which measures the value-add generated for every R1.00 of capital stock. South Africa's capital efficiency increased from 0.39 in 1994 (implying that for every R1.00 of capital stock, 39 cents in value-addition was generated) to a peak of 0.50 in 2007, but moderated slightly to 0.46 by 2012, at constant 2005 prices.

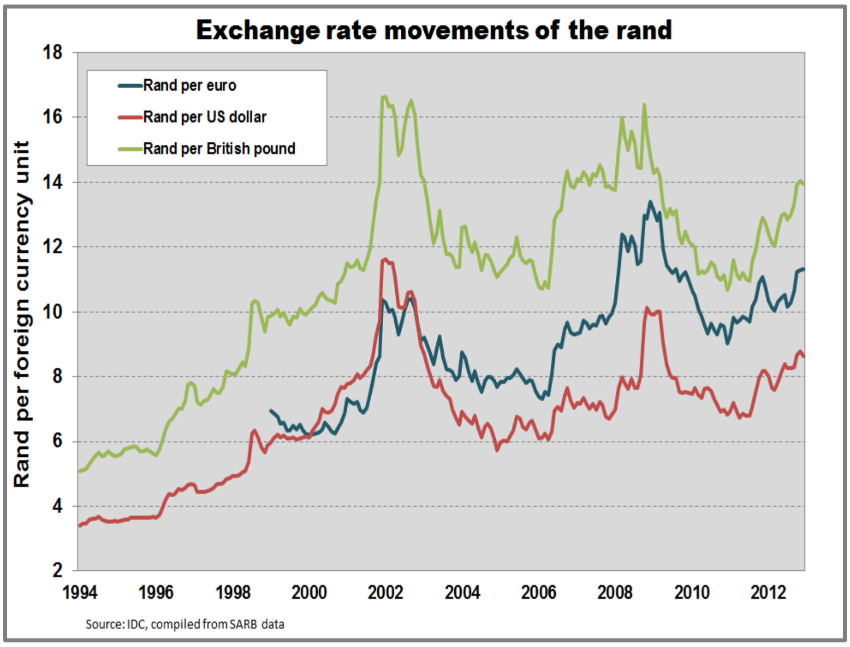


The capital efficiency ratio in the latter period was supported mainly by efficiency improvements in the broader manufacturing and agriculture sectors, whilst the mining sector experienced a deceleration in efficiency improvements from 0.49 in 1994 to 0.29 in 2012, on the back of lower ore yields and higher costs of mining operations. Not only did the mining sector experience lower capital efficiency, but its contribution to GDP also declined.

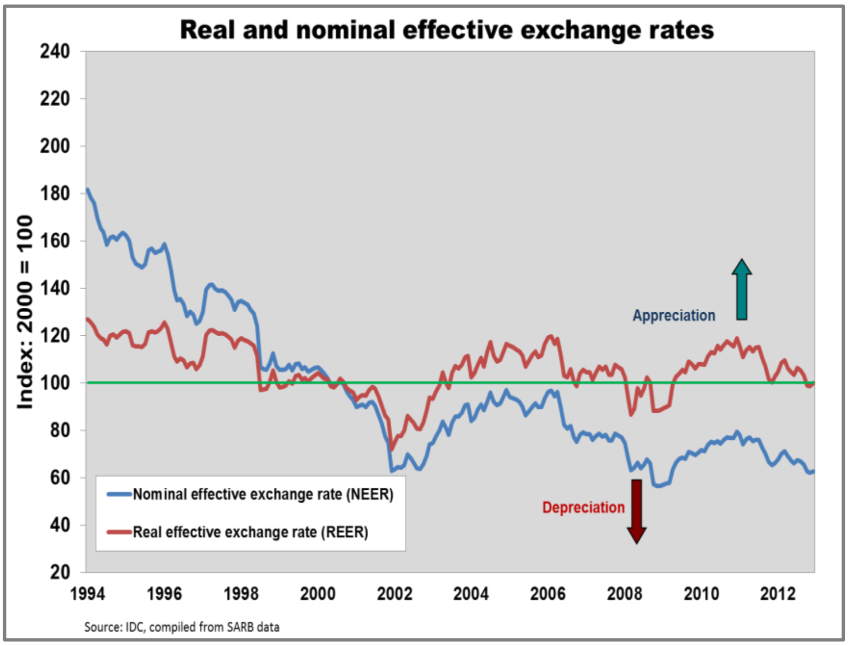


An analysis of employment efficiency reveals that, across most broad sectors of economic activity, with the exception of the services sectors, employment per unit of capital stock declined for most of the period post 1994. Regarding value addition, only the mining sector reported a declining trend in value added per unit of capital stock. The manufacturing sector, in turn, recorded a substantial increase in value addition per unit of capital stock, as this ratio increased from 0.56 in 1994 to 0.71 by 2012.

7. EXCHANGE RATES



The South African rand, as one of the most traded emerging market currencies, exhibited excessive volatility in a generally depreciating trend during the period under review. The pace of depreciation was particularly strong from 1996 to 2001, with the rand losing 15.8% of its value vis-à-vis the US dollar, in annual average terms. This rate of depreciation exceeded the average differential between the rates of consumer inflation in South Africa and the United States by almost 12 percentage points, on average per year, over this period. After free-falling in the aftermath of the 9-11 attacks in the United States, the rand not only recovered from this substantial depreciation in the final months of 2001, but remained extremely strong for the next couple of years. A weakening trend resumed early in 2008, with a sharp depreciation ensuing as the global financial and economic crises intensified.

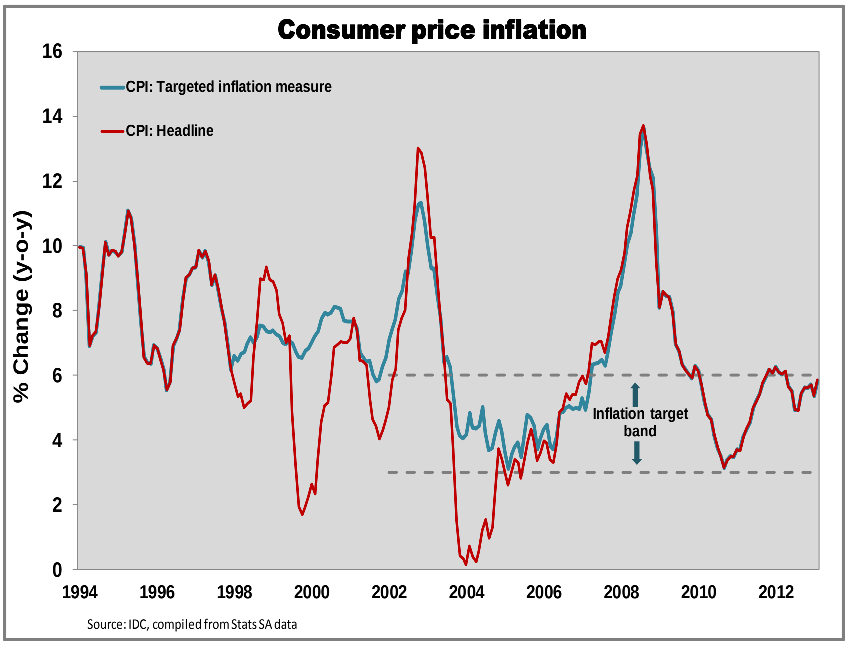


The nominal effective exchange rate (i.e. the rand against a basket of currencies of its major trading partners, on a trade weighted basis) exhibited a largely continuous downtrend during the period under review. The main exceptions were the periods 2003-2006 and 2009-2010, which were characterised by rand strength, with adverse implications for the price competitiveness of South African products in external and domestic markets, and therefore for the sustainability of many industrial enterprises. A substantial worsening of the deficit on the current account of the balance of payments from the start of 2011, among other factors, resulted in a sharp weakening of the external value of the rand in 2011 and 2012.

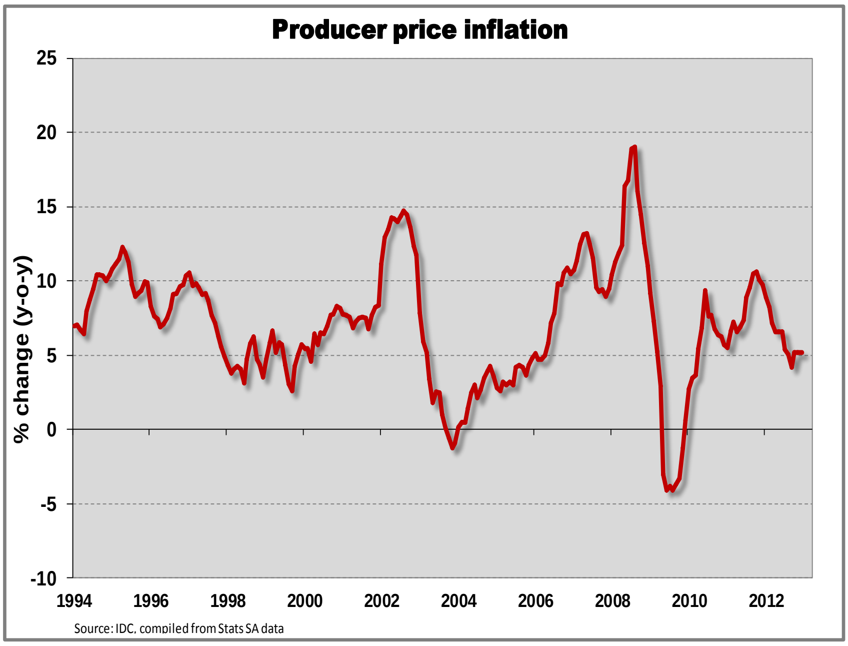
However, accounting for inflation differentials, the real effective exchange rate (REER) was fairly stable as illustrated above, moving generally sideways within a relatively narrow range, from 2003 to 2012.

8. INFLATION AND INTEREST RATES

Consumer price inflation embarked on a generally declining trend over the period 1994 to 2001. Consumer price inflation (headline inflation) averaged 9% in 1994, falling gradually to 5.7% by 2001. Since 2002, the South African Reserve Bank embarked on inflation targeting so as to ensure that the level of inflation remains between 3% and 6%. The rate of inflation initially exceeded the upper band of 6% as the rand weakened significantly in 2001 and 2002, in the aftermath of the 9/11 events in the United States. Headline consumer prices shot up sharply to an average rate of 9.2% in 2002. However, a substantial recovery in the rand exchange rate and continued currency strength over the period 2003 to 2006 resulted in overall consumer inflation moderating to an average of 2.5% per annum over this period.



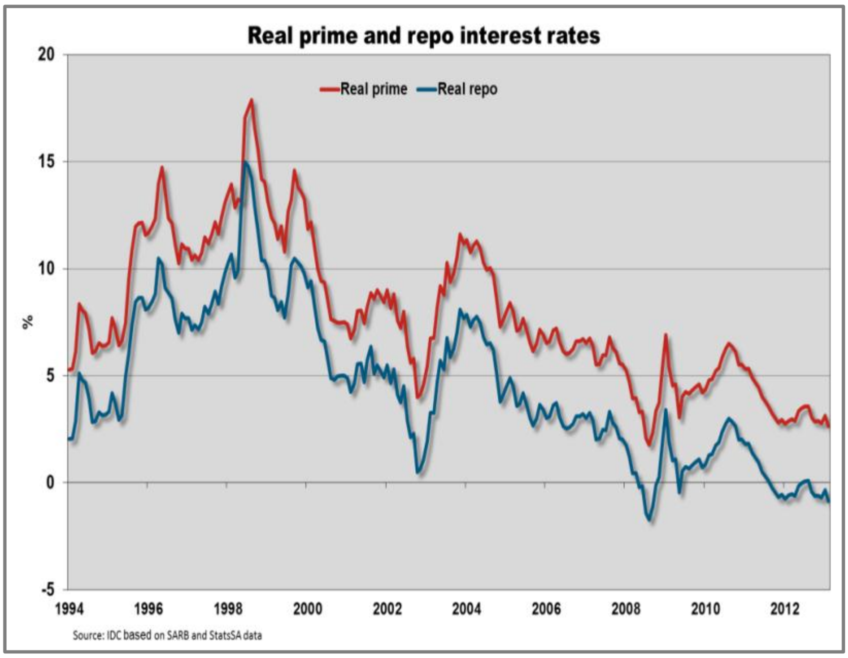
As the financial crisis set in during 2007/08 and resulted in a world-wide recession in 2009, commodity prices skyrocketed, with the oil price reaching a record high of almost USD150 per barrel by mid-2008. The higher oil price along with a substantial depreciation of the rand and higher food and administered prices put immense upward pressure on domestic inflation. Having reached a 20-year peak of 9.9% in 2008, consumer inflation declined in subsequent years, but still averaged around 5.5% per annum over the period 2009 to 2012.



Movements in the producer price (PPI) index have been significantly influenced by developments in the rand exchange rate given the strong linkages to imported components. Having reached a multi-year high in 2001, prices at the factory gate embarked on a steady declining trend, bottoming out in 2009 when a contraction in producer prices was recorded. This was mainly as a result of sharply lower commodity prices. Although producer prices moved higher during the crisis period, average producer price inflation measured 5.1% over the period 2009 to 2012.

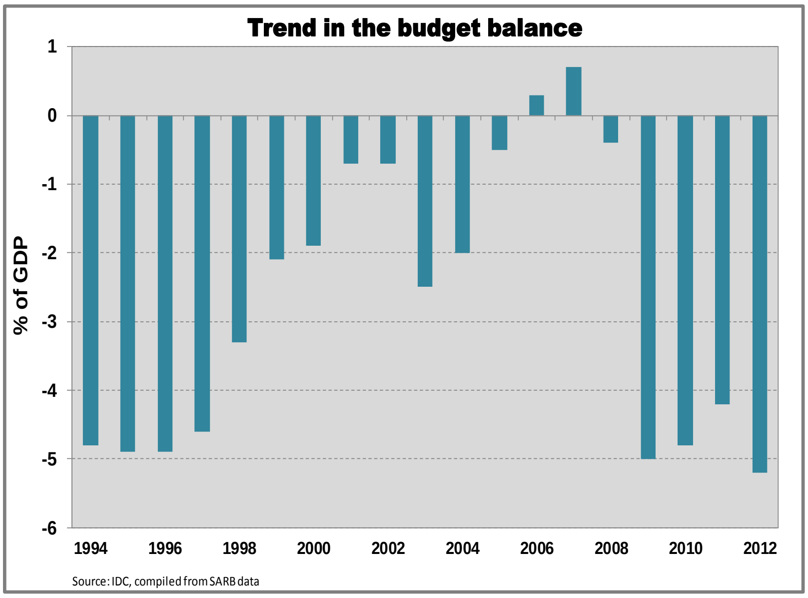
Interest rates remain a key tool of monetary authorities utilised to influence market behaviour in pursuit of price stability. As previously stated, the South African Reserve Bank introduced the policy of inflation targeting in 2002, aiming to anchor inflation expectations and actual outcomes within the 3% to 6% band.

In line with the long-term declining trend in consumer price inflation, the Monetary Policy Committee (MPC) has been prepared to progressively lower the repo rate, particularly from 1998 onward. The repo rate has been at its lowest level in almost 40 years since July 2012 (i.e. at a nominal level of 5%). In real terms, the repo rate has actually entered negative territory on a number of occasions over the past five years. Despite consumer price inflation having recently been extremely close to the upper band and being expected to temporarily exceed it in the near term, the MPC has kept rates stable in an attempt to support the economic recovery. Amongst other factors supporting such a stance, is the fact that demand-pull inflationary pressures do not appear to be present.



9. GOVERNMENT FINANCE

Prudent fiscal management in a democratic South Africa resulted in a complete turnaround in governmental balances from the precarious state of affairs inherited from the apartheid regime. The budget balance improved dramatically from a deficit of 4.8% of GDP to 0.5% by 2005, and turned into surplus territory over the subsequent two years. The impact of the economic downturn and subdued recovery, coupled with a counter-cyclical fiscal stance, has been reflected in a visible deterioration in public finances.

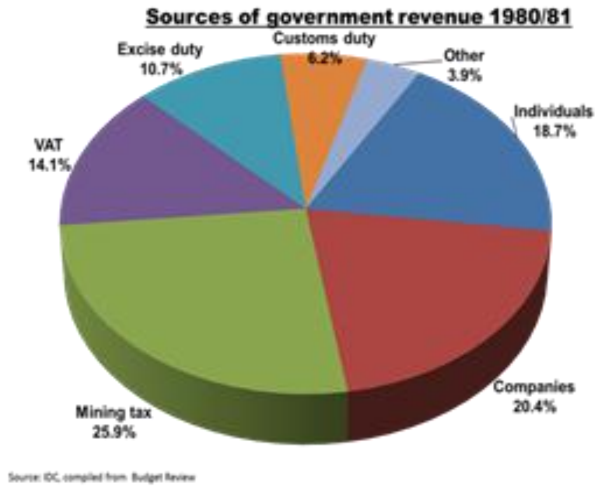


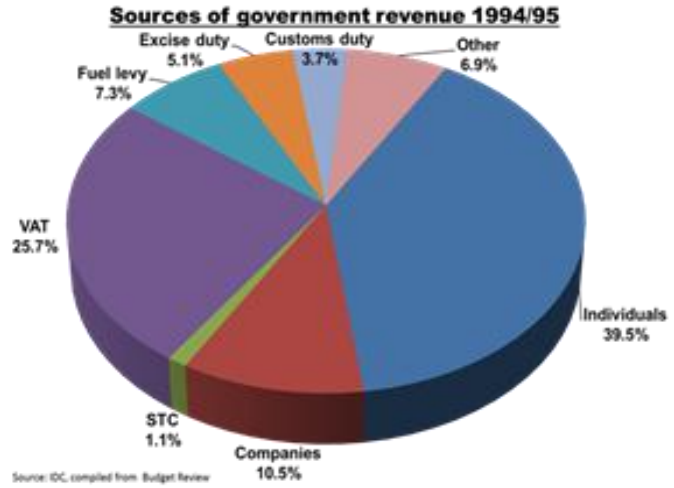
Revenue collection came under pressure as corporate profits dwindled, substantial job losses affected personal income tax payments and weaker household consumption expenditure adversely impacted on VAT receipts.

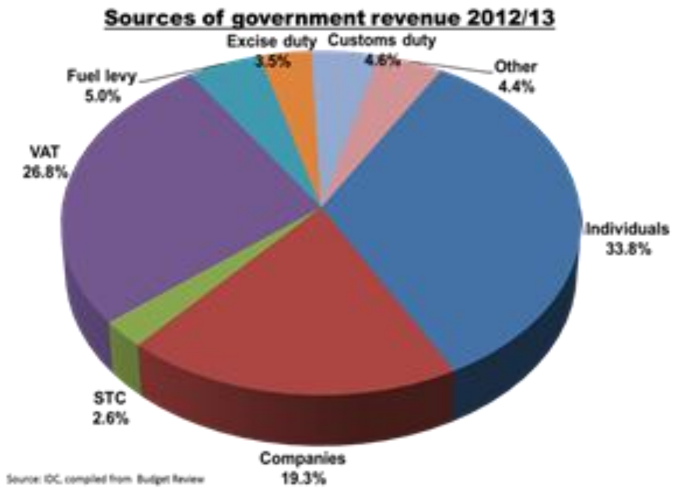
Considering that government utilised fiscal stimuli to soften the negative effects of the economic recession in the early stages of the recent downturn and to support a swift recovery in its aftermath, it is not surprising that the fiscal balance deteriorated substantially over the past four years. Despite the substantial widening of the budget deficit, South Africa's performance compares relatively well from a global perspective, although its fiscal space has become more limited.

Although individual tax payers continue to account for the largest share of tax receipts by government, the proportion has declined from almost 40% in 1994/95 to about 34% in 2012/13. In this regard, government introduced various tax reforms which have resulted in income tax relief, particularly for individuals within the lower income brackets.

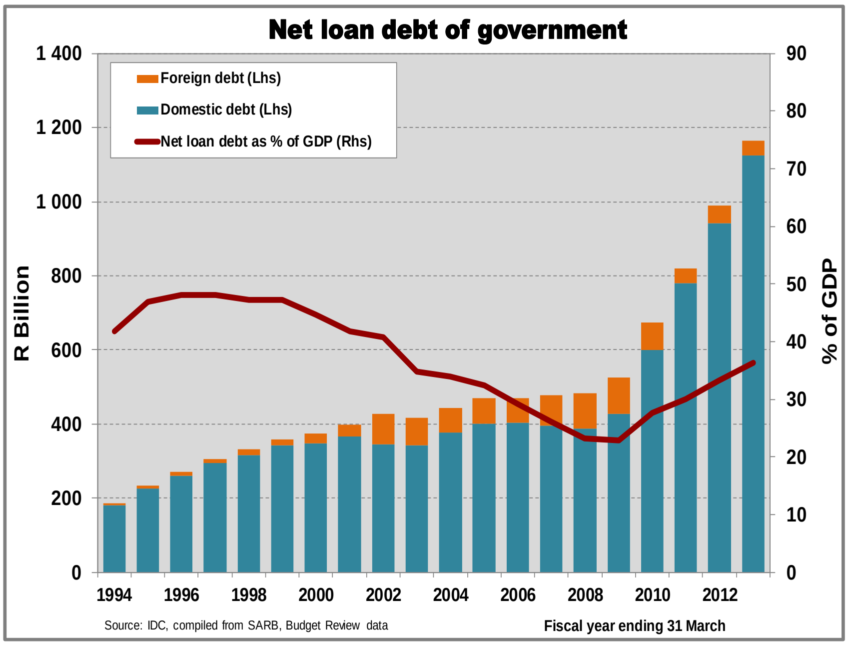
In contrast, the relative contribution made by corporate taxation to government revenue rose from approximately 11% in 1994/95 to 19% by 2012/13, whilst that of VAT expanded from 26% to 27% over the same period. The proportions claimed by direct versus indirect forms of taxation have remained largely unchanged.







In the early years of the new democracy there was limited exposure to foreign debt, largely due to limited access to international capital markets under the sanctions era. Nonetheless, this exposure rose over time, especially during the period 2002 to 2009, whilst the level of domestic debt increased at a much more moderate pace. As the economic crisis intensified in 2009, government's net loan debt increased substantially, from R525.6 billion in the 2008/09 financial year to R1 165.1 billion by 2012/13. Borrowing requirements also increased largely to accommodate a widening fiscal deficit as government revenue came under pressure whilst the need for stimulatory action to revive economic activity became essential.



Relative to the size of the economy, the net loan debt of government declined sharply from the peak of 48% of GDP reached in 1996/97 to 22.8% in 2008/09. Although the debt-to-GDP ratio subsequently rose to approximately 36.3% by fiscal 2012/13, it remains significantly below the 20-year high reached in 1996 and, in addition, it compares fairly favourably from a global perspective.

10. CONCLUDING REMARKS

The South African economy of today is radically different from the economy under siege prior to 1994. The average annual rate of economic growth since the advent of democracy has more than doubled when compared to the period spanning the years 1980 to 1993. Even higher rates of growth were being experienced prior to the global financial and economic crises, but the openness of South Africa's economy, now fully integrated within the world economy and capital markets, exposed its vulnerability to external developments.

In real terms, GDP per capita has risen by more than 30% since 1994 and the disposable income of South African households has increased by 93%. However, this obscures the prevailing levels of inequality, as reflected by a Gini coefficient at 0.69 in 2010 on an income basis. In addition, despite a rapidly growing black middle class and broad-based black economic empowerment efforts, the transformation of the economy has been extremely gradual.

Fixed investment has expanded by approximately 6% per annum at constant prices since 1994, compared to an average annual contraction of -0.6% in the preceding 14 years. The investment to GDP ratio rose from 15.2% in 1994 to 19.2% by 2012, but has yet to reach and be sustained at the desired 25% level.

Prudent fiscal management resulted in improved government balances towards a surplus position prior to the global economic crisis. However, this achievement was reversed during the economic downturn as revenue collections came under pressure and government pursued a countercyclical fiscal stance. The ratio of government debt to GDP declined sharply post 1994 and, although it has ticked upwards in recent years, it remains at manageable levels. In sharp contrast, a debt trap was looming during the last days of the apartheid economy.

Consumer price inflation, which was in double digits during the 1980s and early 1990s, was brought under control towards 5.6% by 2012, although international price trends, particularly an increasing penetration of Chinese products in global trade, also contributed to the deceleration. Consequently, the South African Reserve Bank has been able to maintain a highly accommodative monetary policy stance, as reflected by interest rates at the lowest level in almost 40 years.

Nevertheless, critical challenges prevail. The pace of economic expansion has not only fallen short of its potential but has been unable to make a significant dent on the unemployment plight, particularly amongst South Africa's youth, and to reduce substantially the incidence of poverty. Despite employment gains in the formal and informal sectors of the economy since 1994, the unemployment rate stood at 24.9% by the end of 2012, amongst the highest in the world.

A large and widening deficit on the current account of the balance of payments is also of concern, as the country remains particularly reliant on inflows of foreign capital to fund the substantial shortfall between investment and savings. The openness of the economy and the highly concentrated nature of the national export basket make it extremely vulnerable to global economic developments.

The country is also struggling to sustain its global competitiveness, particularly in manufacturing and mining activities, due to a variety of internal factors, aggravated by fierce competition from foreign players in external and internal markets. This has been reflected in their declining combined share of GDP, in contrast with a proliferating financial and business services sector, and frustrating national efforts to enhance labour absorption.

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Industrial Development Corporation

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