

An abstract graphic in the center of the page features 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 thin green and orange lines.

## ***Economic report:***

***Analysis of the potential impact of the United Kingdom's exit  
from the European Union on the South African economy***

28 June 2016

Department of Research and Information

## THE UK HAS DECIDED TO LEAVE THE EU ... NOW WHAT ?

The 23<sup>rd</sup> of June referendum on the future of the United Kingdom's membership of the European Union (the so-called Brexit vote) was always expected to be a neck-and-neck contest between the "remain" and "leave" camps. The results of various polls kept on swaying either way as time went by, but, as the voting date approached, expectations in global financial markets were mainly positioned towards the UK opting to remain in the EU. The contrary outcome therefore triggered a pronounced negative reaction across world markets.

Uncertainty levels intensified in a yet fragile global economy. Risk aversion shot up around the globe, with capital shunning equity markets, exposed emerging market currencies and industrial commodities, instead seeking refuge in perceived safe-haven assets such as advanced economies' government bonds and precious metals.

The impact of Brexit is transmitted through various channels, including investment and trade flows, with perceptions and future expectations playing a crucial role in determining the severity of the negative repercussions. The financial markets took the immediate brunt of the exit outcome and are expected to remain volatile for quite some time. The adverse effects on the real economy will soon also start being felt. Much will depend on how the various economic agents, from businesses and investors to households, react to the uncertainty accompanying the withdrawal process. Of particular importance in this regard is the time period involved in negotiations between the UK and the remaining 27 member states, and the actual deal that will be struck. The process may turn out to be protracted, with the accompanying uncertainty being clearly negative for growth.

In essence, the starting point will be the formal notification by the UK government to the authorities in Brussels of the decision to withdraw the country's membership from the EU. This in itself may take some time, firstly because the referendum result is not binding as such, but rather "advisory". Secondly, the British government, which would have to provide the required notification in terms of Article 50 of the EU treaty of Lisbon, has already provided an indication that it is not in a hurry to do so, despite mounting pressure from Brussels to speed up the process. This is being further complicated by the resignation of Prime Minister David Cameron, who led the "remain" campaign, and the forthcoming leadership contests within the ruling Conservative Party and the opposition Labour Party.

Once the relevant piece of EU legislation (Article 50) has been triggered, "*The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after notification*". Any extension to this two-year period would have to be unanimously agreed upon by the European Council, but this is likely to be resisted by the regional bloc as it would want to conclude the process as soon as possible.

Initial indications are that the "divorce" will not be amicable, for the EU would wish to provide a strong signal to other member states with similar exit intentions that the final outcome will be unfavourable, so as to prevent a contagion effect. The future of the regional bloc is at stake here. The silver lining may be the trigger set by Brexit for a set of actions within the EU in order to preserve and strengthen the European project, in line with its original integration goals.

## IMPACT ON THE SOUTH AFRICAN ECONOMY

The impacts of Brexit on the South African economy will be of a direct as well as indirect nature. The direct effects relate primarily to the impact on the UK as a key trading and investment partner, and as a source of leisure and business travellers to South Africa. The indirect effects, in turn, pertain largely to the impact on global financial and currency markets, and, importantly, on the growth performance in other parts of the globe.

### Indirect impacts

#### *Global economy's performance*

The exit of the UK from the EU is expected to have significant ramifications for the world economy. Increased levels of uncertainty and transmission risks will aggravate the economic environment globally, which is still fragile and quite subdued. Economic activity across a wide range of advanced economies could be hampered as companies delay investment decisions. Household savings, in turn, are expected to increase, impacting negatively on economic growth. Global trade could slow in the short- to medium-term as trading relationships are altered and supply chains have to be redesigned.

Increased uncertainty regarding the future performance of a large number of economies as well as higher risk aversion globally are likely to result in loose monetary policies over a longer period of time. The negative consequences of highly accommodative monetary policies over a protracted period have been highlighted by the Bank for International Settlements, for growth fuelled by debt is a major concern and such policies also lead to an inefficient allocation of capital.

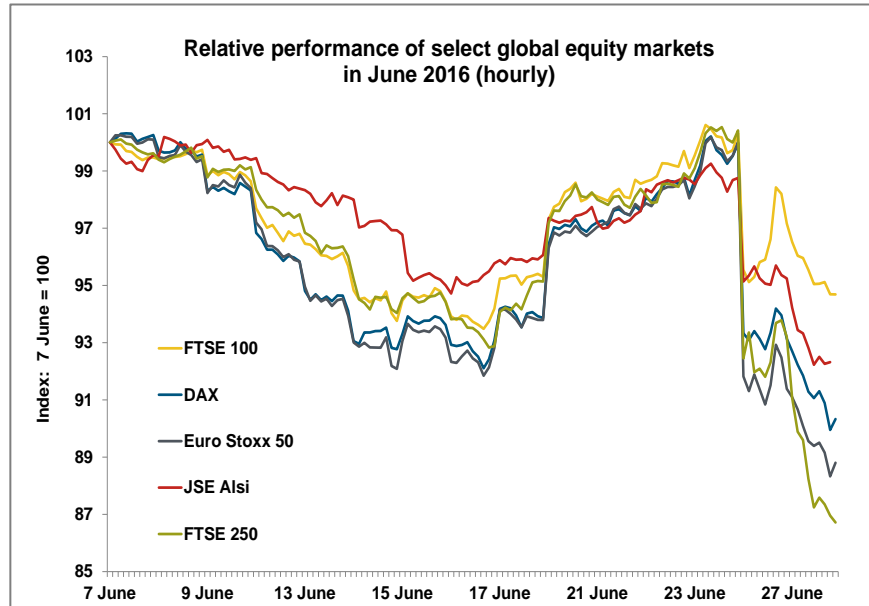
An OECD study conducted in April 2016 estimated that, by 2018, the European economy could be just over 1% smaller under a Brexit scenario as compared to the status quo. This impact becomes less pronounced in other major regional groupings or countries, with the size of the BRICS economies, for instance, being around 0.6% lower over the same period. The USA and Japan, in turn, would be less impacted according to the OECD analysis, with around 0.25% and 0.5% of economic value added being shaved off by 2018, respectively.

Due to its very open economy, South Africa's own growth performance would be affected by unfavourable developments globally as a result of Brexit.

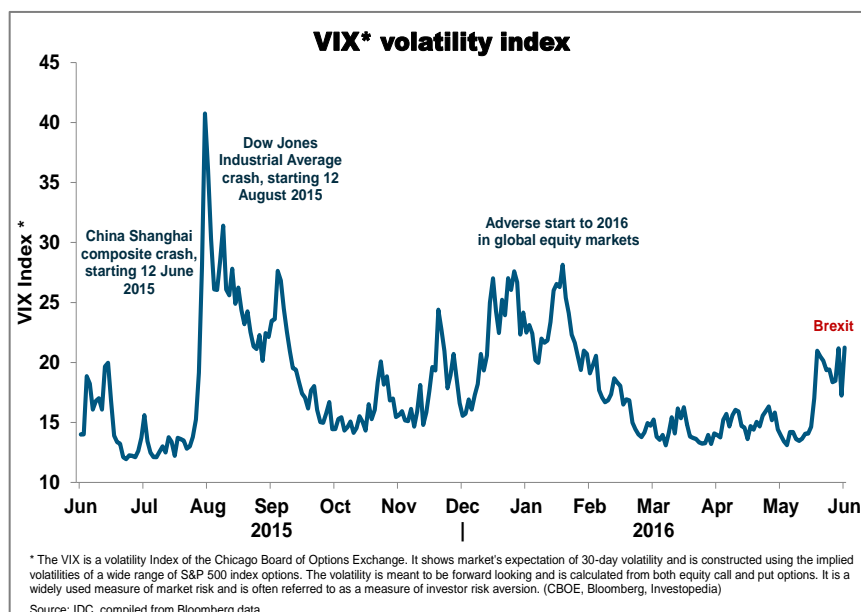
#### *Financial markets*

Downside risks to world growth have most likely risen due to the uncertainty associated with Brexit. The increased risk aversion globally is being reflected by higher capital market volatility and wider sovereign credit default spreads.

Equity markets reacted very negatively to the referendum results. The shockwaves reverberated around the globe, with most indices falling by at least 4% on the day of the announcement. The UK's FTSE 100 index, which captures numerous global companies, has since fallen by 5.6% (from 23 June close to 27 June close). The negative reaction was more pronounced in the FTSE 250 index, which covers the 250 most highly capitalised UK-based listed companies outside of the FTSE 100, for it fell 13.6%. Germany's DAX, France's CAC 40 and the Euro Stoxx 50 all endured declines of between 6% and 10%. Japan's Nikkei index dropped some 8%, signalling investors' concerns over a renewed economic recession in Japan. These were partly triggered by the sharp appreciation of the yen in the Brexit's aftermath, which is expected to affect Japan's exports. The JSE's All-Share index, which has a strong correlation with the FTSE and is dominated by large global players, tumbled by 6.5%.



The VIX volatility index, which is seen as a broad measure of the level of risk aversion by global investors, jumped by approximately 42% (an extreme move), from 17.3 to 24.5 on June 24<sup>th</sup>, indicating a sudden generalised loss of investor risk appetite. Despite this extreme move, VIX volatility levels were still well below those recorded in the wake of China's yuan devaluation in 2015.



Although Brexit has not culminated into a systemic risk event thus far, the strong economic linkages between the UK and EU economies do raise this potential if a possible fall-out is not contained. The UK's exit vote has raised credibility and future sustainability risks for the EU as a regional bloc, with adverse implications for global trade flows and overall economic growth

(the EU accounts for approximately 17% of world GDP).

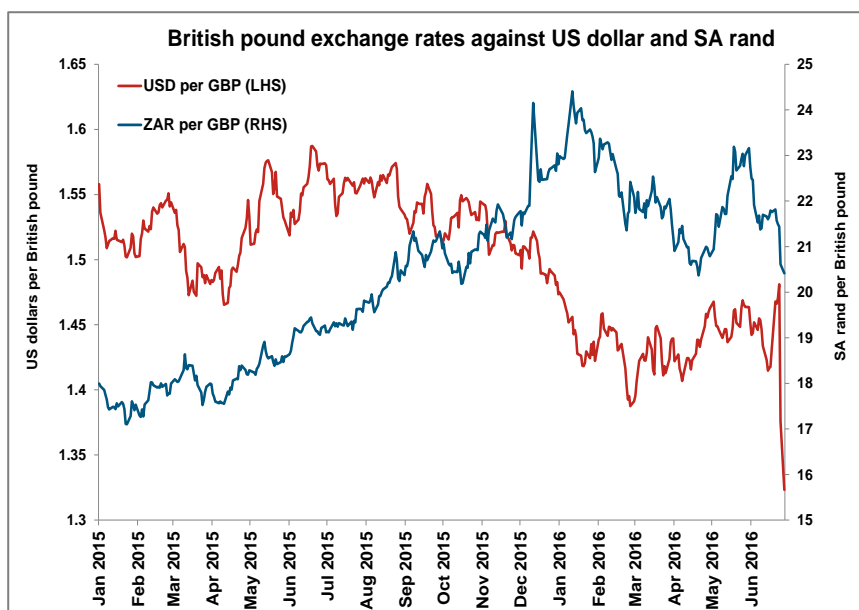
UK government bond yields, both short- and longer-dated, declined sharply in response to Brexit. While this was most likely an outcome of portfolio shifts from equities into advanced economies' bond markets due to the general uptick in risk aversion, the reduction in longer-dated UK government bond yields provided an indication of investors' confidence in the economy's ability to weather the negative impact of its withdrawal from the single market. This contrasted sharply with peripheral EU economies, which experienced sharp increases in both short- and longer-dated sovereign bond yields, thus pointing toward a general capital flight and lack of investor confidence.

The potentially high risk events that could play out as a result of the UK's referendum results have supported the case for sustained monetary policy accommodation, as far as possible, to contain systemic risks. Accordingly, the European Central Bank and the Bank of England indicated that they would take the necessary action, including injecting further liquidity into the financial system.

Across the Atlantic, the US Fed Funds rate futures indicated, following Brexit, that expectations for the next policy rate hike had been pushed further out from September to December 2016, if not next year. Given that further delays to the normalisation of US monetary policy would support investor risk appetite (under normal market conditions), a progressive equity market recovery could ensue in the months ahead. The yield on South Africa's 10-year government bond increased significantly after the referendum results were announced, but has since recovered.

## Currency markets

The British pound had already encountered incremental selling pressure since the passing of the UK Referendum Act in mid-2015, which set the legislative process for the Brexit vote. Over the ensuing period until February 2016, the pound depreciated by 12.5% against the US dollar, as rising global investor risk aversion and the prospect of a Brexit weighed on the British currency. It subsequently recovered 6.7% of its value up to the eve of the referendum. On the day the results were announced, capital flight to safe-haven assets triggered a record sell-off of sterling, taking its



depreciation for the day to 10.6%. Panic selling continued in the subsequent trading day (27 June), with the pound losing a further 3.6% of its value against the greenback to reach its weakest level since 1985.

The US dollar, in turn, has appreciated by 2.6% on a trade-weighted basis since the referendum results were announced. Increased global risk aversion triggered a reversal in the South African rand's earlier gains, with the local currency having lost almost 6% of its value against the dollar since the referendum. Diminished investor appetite for risk has repositioned the rand back onto a weaker bias as global markets continue to adjust to the Brexit news. Renewed potential for another episode of sustained rand weakness on a trade-weighted basis could raise inflation expectations, in turn increasing the risk of additional monetary policy tightening by the South African Reserve Bank, weighing down further on the growth prospects for the economy.

Although currency and financial markets are likely to have overreacted in the initial period following the Brexit vote, this major event represents a significant transition in the global financial market and economic architecture, with lasting repercussions. With expectations for the next US policy rate move having been pushed further out to December 2016, if not in 2017, this should contain downward pressure on emerging market currencies, including the rand, as well as on commodity prices, for some time, by potentially limiting the dollar's appreciation.

### **Commodity markets**

The sharp increase in global risk aversion has significantly benefitted the precious metals complex, with gold rising by as much as USD109/oz, or 8.6%, in the aftermath of the Brexit referendum decision. Despite potential downside growth risks to the UK as a result of Brexit, the platinum price also increased by 2%. Platinum benefitted from its association with gold as a safe haven and inflation hedge investment asset. However, a potential slowdown of the UK and EU economies has negative implications for platinum demand, with adverse ramifications for South Africa's PGM mining sector.

Industrial commodities have endured a negative impact due to decreased investor risk appetite. Importantly, crude oil prices fell by as much as 6%, with Brent crude oil currently below the key USD50/bbl psychological level.

Sustained lower oil prices are likely to have a deflationary impact on cost curves across the industrial commodities complex, which could encourage the sustenance of higher cost production and limit much needed production rationalisation to rebalance markets.

Further declines in global oil prices could therefore culminate in a renewed impetus for lower industrial commodity prices, given that most of these markets continue to suffer from large surpluses.



## Direct impacts

### *The UK's economic performance as a key partner*

As stated at the outset, the UK has historically been a key trading and investment partner for South Africa. It has also been a major source of leisure and business travellers. Accordingly, prospects for the UK economy are particularly important, especially as they impact on import demand for South African products (whether consumer goods, intermediate products or raw materials); on outward British investment, particularly but not exclusively in greenfield and brownfield investments; and on travel plans by UK businesses and households.

The adverse impact of Brexit on the UK economy is expected to be substantial and front-loaded, but it may extend well into 2020, detracting from GDP growth quite significantly. Some projections point to a possible contraction in GDP later in 2016 as well as in 2017. Concerned with the abrupt adjustment to the UK's economic prospects and the risk of other adverse developments arising as a result of the exit vote, Moody's revised its outlook for the UK from "stable" to "negative" under an AA1 rating on the day of the referendum results. On 27 June, Standard and Poor's as well as Fitch downgraded the country's sovereign rating by two notches and one notch, respectively, to AA with a "negative" outlook.

Most if not all sectors will be affected in one form or another and to varying degrees. The financial services sector is expected to be one of the most adversely affected sectors, if not the most, as EU-oriented financial sector players or business units shift towards Europe. In this regard, lenders will require separate registrations for their UK and EU operations so as to access the single market, as opposed to the previous system which permitted financial services operators legally established in one EU member state to establish and provide their services in other member states without additional authorisation requirements. London may gradually lose its dominant position as the major European financial centre. Paris and Frankfurt, among other European cities such as Dublin and Amsterdam, will seek to benefit from the financial sector migration in the years ahead.

Non-European companies seeking to access the EU's single market will now seek alternative entry points, detracting from fixed investment activity in the UK. The construction and related sectors will feel the impact of reduced activity as foreign investment in real estate dwindles. The retail sector, in turn, will be affected by reduced consumer discretionary income, while the hospitality industry is likely to experience reduced inward business and leisure travel.

The negotiation of new trading arrangements will be a lengthy and overwhelming process, particularly in light of the sheer number of trade deals that will have to be negotiated with numerous countries and regional blocs across the world. This will affect the performance of UK businesses as exporters, and as importers of inputs for their production and sales activities, in turn affecting their investment decisions. Imports will be dearer due to the weaker pound, affecting firms that rely on imported inputs (raw materials, intermediate products) and services.

On the positive side, many British companies (including SMEs) focused on the domestic (UK) market could, however, benefit from reduced competition from European producers (not only

due to the altered trade relationships but also as a result of the pound depreciation), and from a less burdensome regulatory environment. Many British exporters will benefit from the substantially weaker sterling. Furthermore, there may be a temporary increase in the demand for consulting services (regulatory, legal and other services) as firms seek to comprehend and adjust to the changing operating environment.

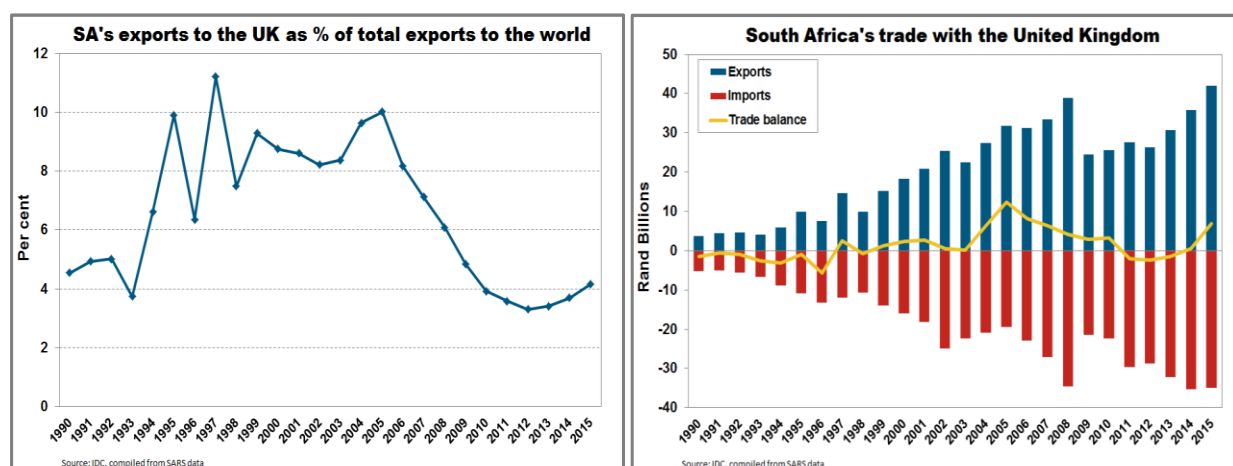
The negative effects of Brexit on the UK economy are likely to dissipate over the longer term, possibly between five and ten years' time, but growth would be off a lower base. The potential benefits of enhanced trade and investment relations with Asia, Africa and South America may in due course offset some of the adverse effects of the reduced trade with the EU.

## South Africa's trade performance

The implications of Brexit for South Africa's trade with the UK are not certain, but there will surely be adjustments. After its formal withdrawal from the EU, the UK will no longer be a party to any of the trade agreements between the EU and any other country or regional bloc (e.g. SACU, SADC). South African exporters have had preferential access to UK markets under two consecutive agreements entered into with the EU as a regional bloc - namely the Trade and Development Co-operation Agreement (TDCA) since 2000, which was more recently superseded by the SADC-EU Economic Partnership Agreement (EPA).

The trade adjustment process post-Brexit referendum will not be immediate and will take time to unfold. The UK will have to establish an entirely new trade and tariff regime and enter into a negotiation of trade deals with many countries, including South Africa as a member of SACU. However, in the initial phase it may be reasonable to expect the enactment of enabling legislation that will provide for a temporary autonomous and transitional tariff regime that could mirror the EPA, at least until permanent arrangements have been negotiated.

The UK is the seventh largest external market, at the individual country level, for South Africa's exports. However, the UK's relative importance as a trading partner has declined over time (refer to the chart on the left-hand-side), for it accounted for 4.2% of all of South Africa's overall merchandise exports in 2015, down from a 10% share in 2005.





Nevertheless, the UK remains a very important export destination for specific South African products, as highlighted later in this section. As illustrated in the previous chart (right-hand-side), South Africa has recorded a marginal trade surplus with the UK for most of the past 20 years.

Exports to the UK totalled almost R42 billion in 2015, compared to R166.8 billion exported to the other 27 members of the EU. Approximately 39% of South Africa's export basket to the UK in 2015 consisted of manufactured goods, with mining and mineral exports accounting for almost 47% and agricultural products claiming a 14.5% share.

On the import front, approximately R35 billion or 3.2% of South Africa's import basket was sourced from the UK in 2015. Imports from the UK are dominated by motor vehicles, parts and accessories; non-electrical machinery; chemical products (e.g. pharmaceuticals); refined petroleum products; as well as beverages.

As indicated in the following table, the top-10 South African export products (4-digit SIC) sold in the UK market in 2015 represented 85% of total merchandise exports to that country. The top ranked export product was platinum group metals (PGMs), with a total export value of R18.5 billion and claiming a 44% share of South Africa's export basket to the UK in 2015. More importantly, such PGM exports represented almost 21% of the domestic platinum mining industry's overall exports to the world at large, reflecting the crucial role of the UK as a trading partner. Similarly, the UK has been a very important export destination for South African primary agricultural products; motor vehicles, parts and accessories; wines; pulp, paper and paper products; and, among others, processed and preserved fruits and vegetables.

| SA's key export products to the United Kingdom in 2015 |   |                 |  |   |
|--|---|-----------------|--|---|
| Rank   | Product<br>(4-digit Standardised Industrial Classification) | R million       | % share in<br>SA export<br>basket to<br>the UK | SA exports to<br>the UK as % of<br>SA exports to<br>the world |
| 1  | Platinum group metals                                       | 18 525.1        | 44.1%  | 20.5%   |
| 2  | Agricultural products (mainly fresh fruits)                 | 6 089.4         | 14.5%  | 13.0%   |
| 3  | Motor vehicles  | 4 640.5         | 11.1%  | 4.4%  |
| 4  | Motor vehicle parts and accessories                         | 2 097.3         | 5.0%   | 6.7%  |
| 5  | Distilling industries (mainly wine)                         | 1 584.0         | 3.8%   | 11.7%   |
| 6  | Pulp, paper and paperboard                                  | 666.0           | 1.6%   | 4.3%  |
| 7  | Basic iron and steel  | 634.5           | 1.5%   | 0.9%  |
| 8  | Basic precious and non-ferrous metals                       | 443.3           | 1.1%   | 1.4%  |
| 9  | Soap, detergents, cleaning and polishing, perfumes          | 441.4           | 1.1%   | 4.1%  |
| 10   | Processed and preserved fruits and vegetables               | 432.8           | 1.0%   | 5.3%  |
| <b>Top-10 export total</b>                             |   | <b>35 554.3</b> | <b>84.7%</b>                                   |   |
| <b>Total exports</b>                                   |   | <b>41 980.8</b> |  | <b>4.2%</b>   |

Source: IDC, compiled from SARS data

The impact of Brexit on South Africa's trade with the UK will, in the short- to medium-term, be highly dependent on the latter's economic performance and import demand. However, future alterations in the trade arrangements between the two countries will affect South Africa's export sector in the longer run.

According to the EU's Article 50, the relevant treaties shall cease to apply to the UK from the date of entry into force of the withdrawal agreement, or failing that, two years after the member state's notification to the European Council, unless an extension is unanimously agreed upon by the other 27 member states of the EU.

The implications for South Africa from the perspective of trading arrangements include:

- The UK will no longer be part of the free trade agreements (FTAs) negotiated by the EU with many countries, including the SADC-EU Economic Partnership Agreement (SADC-EU EPA), which was signed on 10 June 2016. Trade commitments concluded by the EU for all its member states fall within the EU's ambit of responsibility, meaning that the commercial aspects of such agreements will no longer be legally binding for the UK and non-EU signatories, including South Africa.
- The UK could opt to negotiate with the EU and the rest of the world, where it would try to obtain the best possible free trade deal with the EU outside the internal market and also with third countries. It will have to re-negotiate from scratch a new FTA with SACU member states, including South Africa. In this regard, according to the 2002 SACU Agreement, all future preferential trade deals involving SACU members have to be negotiated with the bloc collectively. The risk here is that the UK might not secure as favourable a trade deal with SACU as it had under the auspices of the EU. Currently, trade between the UK and South Africa indicates a fairly equitable trading relationship between the two countries.
- The UK could enact a short-term interim regime by maintaining the existing market access provided to exports from South Africa to the UK. However, the UK would no longer be automatically eligible for preferential treatment in SACU and SADC. Its exports to these two regional markets would thus face Most Favoured Nation (MFN) tariffs, as provided for under World Trade Organisation (WTO) rules, until re-negotiations take place with the regional blocs.

The IDC's Research and Information department has analysed the South African export products that may be more at risk of facing higher tariffs in the UK market in the absence of an alternative arrangement. The basis for the analysis included the following parameters:

- The annual value of exports of the product to the UK was at least R50 million, on average, from 2013 to 2015.
- The UK is a significant market (more than 25% share) for the specific product in the broader EU market;
- The product currently faces either a low or zero tariff in the UK market under the TDCA preferential trade agreement;

- The current MFN rates will be significantly high (at least 5 percentage points higher) in the absence of a new preferential agreement between SACU and the UK post-Brexit.

The ten export product categories most at risk according to the above methodology are listed in the following table. Collectively, they represented R7.2 billion worth of exports, on average, over the period 2013 to 2015, or 29.6% of South Africa's total exports to the UK.

## South African export products most at risk of losing market share in the UK post-Brexit

| Product category   | Average annual SA exports to the UK: 2013-15 (R million) | UK's share of SA exports to EU (%) | TDCA tariff into the UK (%) | MFN tariff into UK (%) | Tariff differential (%) |
|--|--|------------------------------------|-----------------------------|------------------------|-------------------------|
| Motor vehicles for the transportation of goods                   | 3 019.3  | 25.1%                              | 0.0%                        | 13.5%                  | 13.5%                   |
| Wines  | 1 521.3  | 30.1%                              | 3.4%                        | 10.2%                  | 6.8%                    |
| Grapes   | 1 282.8  | 29.9%                              | 0.0%                        | 6.7%                   | 6.7%                    |
| Apricots, cherries, peaches, plums and sloes (fresh)             | 421.9  | 47.2%                              | 0.0%                        | 13.9%                  | 13.9%                   |
| Other fruit (fresh)  | 293.4  | 48.8%                              | 0.0%                        | 7.0%                   | 7.0%                    |
| Prepared fruits, nuts and other edible parts of plants           | 267.9  | 38.4%                              | 2.1%                        | 18.2%                  | 16.1%                   |
| Cut flowers and flower buds                                      | 107.5  | 47.3%                              | 2.7%                        | 8.7%                   | 6.0%                    |
| Fruit (dried)  | 95.2   | 62.8%                              | 0.0%                        | 6.6%                   | 6.6%                    |
| Fresh and chilled vegetables                                     | 69.0   | 52.6%                              | 0.7%                        | 11.8%                  | 11.1%                   |
| Men's or boys' suits, ensembles, jackets, blazers, trousers etc. | 51.2   | 93.1%                              | 0.0%                        | 12.0%                  | 12.0%                   |

Source: SARS with IDC calculations

Looking ahead, it is not a foregone conclusion that South African exports will necessarily be adversely affected, from a market access perspective, by the UK's decision to leave the EU. However, export trade is likely to be impacted negatively in the short- to medium-term (over the next two to three years) by a weaker growth performance of the UK economy, with the probability of a recession being very high.

Once the UK is no longer part of the EU, South Africa as part of SACU does not have to offer it preferential access to its market and will have to re-negotiate a new trade deal. The likely scenario is that the UK will kick-start trade negotiations with key trading partners during the two-year period before eventual exit. Since South Africa must negotiate trade deals with other countries as part of SACU, such negotiations would have to begin at SACU level to ensure that the region faces the UK as a united body. Simultaneously, the UK would have to negotiate new trade deals with its former partners in the EU and many other countries or regional blocs the world over. This will surely be an extremely time-consuming exercise.

In the longer-term, it is possible that SACU could strike a trade deal with the UK whose benefits may equal or even surpass those of existing agreements with the EU. Strong historical relations between the SACU member states and the fact that the trade negotiations will be conducted with one country, may favour the regional grouping. Having affected its relations with the EU 27 in light of its withdrawal from the union, the UK is expected to be in bridge-building or conciliatory mode in its trade negotiations with many countries or regional blocs around the globe. The low trade surplus should also count in South Africa's (or SACU's) favour, unlike a situation where trade is heavily skewed.

However, disruptions to supply chains across Europe and the UK could have significant impacts on South African exporters and importers, possibly requiring larger stock holdings and/or resulting in changes in transit times.

## *Automotive industry*

The UK is a key external market for South African produced motor vehicles, parts and accessories. Exports of such items were valued at R6.7 billion in 2015, with South Africa recording a deficit of R345 million with the UK in its automotive trade.

The UK is by far the largest export destination, at the individual country level, for South African made motor vehicles, accounting for 30.6% (or 101 704 units) of the total number of vehicle exports in 2015. The two major automotive industry products exported from South Africa to the UK are motor vehicles and catalytic converters. The latter has been affected adversely by the phasing down of incentives by the dti and has lost ground relative to other components in the export basket. Any imposition of new tariffs could have a further detrimental effect on the catalytic converter industry's overall export performance. The balance of automotive industry exports to the UK comprises a wide variety of components and accessories, including stitched leather seat covers, automotive glass and engine parts, which account for a smaller share of the total value.

Light commercial vehicles remain the dominant motor vehicle exports, totalling R2.9 billion in 2015. Passenger vehicle exports were valued at R1.7 billion. The major South African-based exporters of light commercial vehicles to the UK are Toyota and Ford, specifically their Toyota Hilux and Ford Ranger vehicles, respectively. Mercedes Benz and VW are the principal exporters of passenger vehicles to the UK market.

The uncertainty and adverse developments generated by Brexit are widely expected to weaken the UK's growth performance at least over the medium-term, impacting negatively on its demand for motor vehicles, parts and accessories, including those sourced from South Africa. Furthermore, the ripple effects on the EU 27 could further affect the export performance of South Africa's automotive industry.

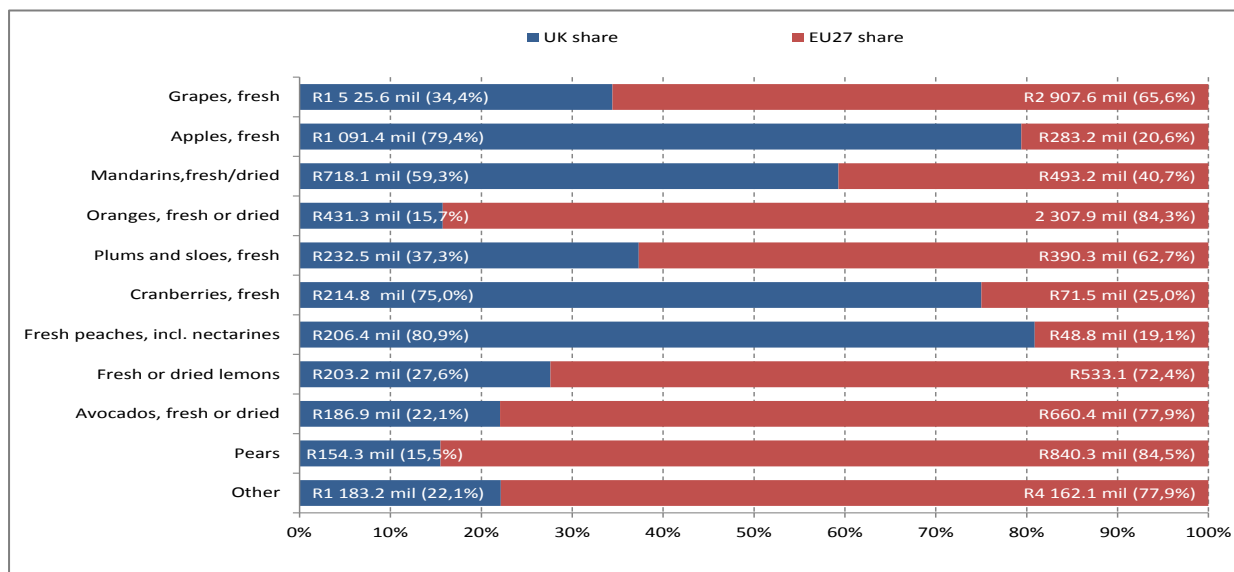
The UK itself is an exporter of passenger vehicles, mainly to the rest of the EU. In the absence of a negotiated trade arrangement with the EU, it could face a 10% tariff (MFN tariff level) on such items entering the European single market. This would undoubtedly affect UK exports negatively, and consequently its production activity, in turn affecting input requirements from foreign suppliers of parts and accessories, such as South Africa. The UK could consider adopting a somewhat protectionist stance, but, considering the fact that its own car industry is heavily export-oriented (exports represent about 75% of production), it could face the threat of retaliation by trade partners.

## *Agriculture, food and beverages*

South Africa's primary agricultural exports to the UK amounted to R6.2 billion in 2015. This is equivalent to almost one-third of the total of R18.9 billion for the EU as a whole.

The UK is currently the major market within the EU for South African fresh fruit exports. This is largely due to the seasonal differences between the two regions. To illustrate, the UK's imports of fresh peaches (including nectarines) from South Africa were valued at R206.4 million in 2015, or more than four times the equivalent entering the markets of the other 27 EU member states (refer to the chart below). As shown, the largest primary agriculture exports to the UK consist of grapes, apples, mandarins and oranges.

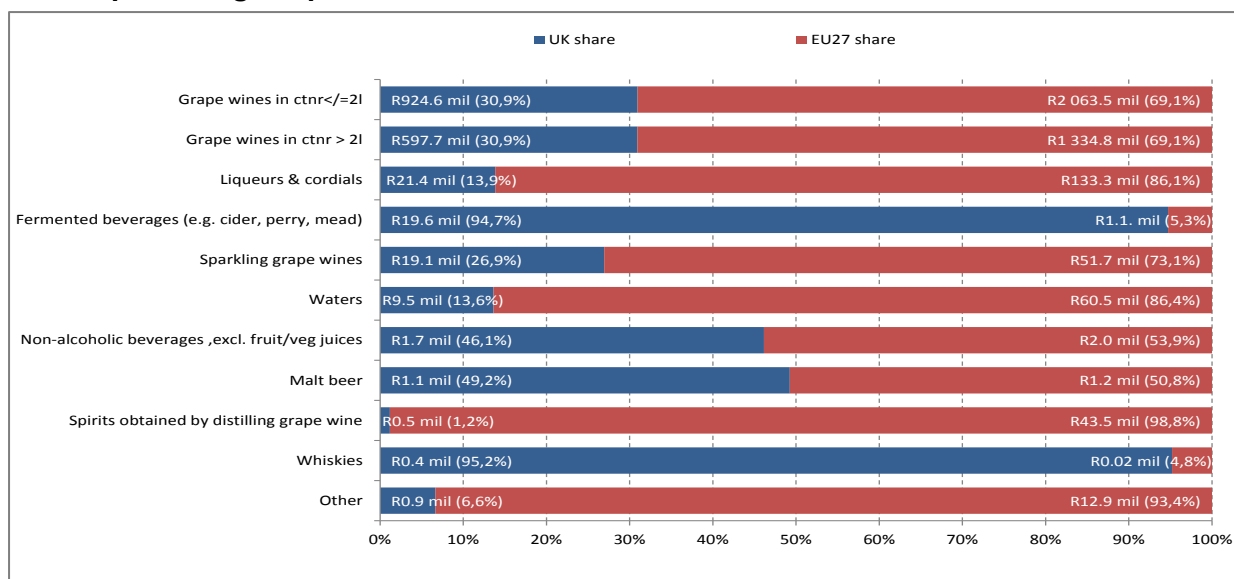
## SA's top agricultural exports to the UK and the other 27 members of the EU in 2015



Source: SARS

The UK consumed an average of R1.5 billion worth of South African grape wine in containers in 2015. As illustrated below, other significant beverage exports to the UK included liqueurs, ciders and sparkling grape wines, although the respective export values were much lower.

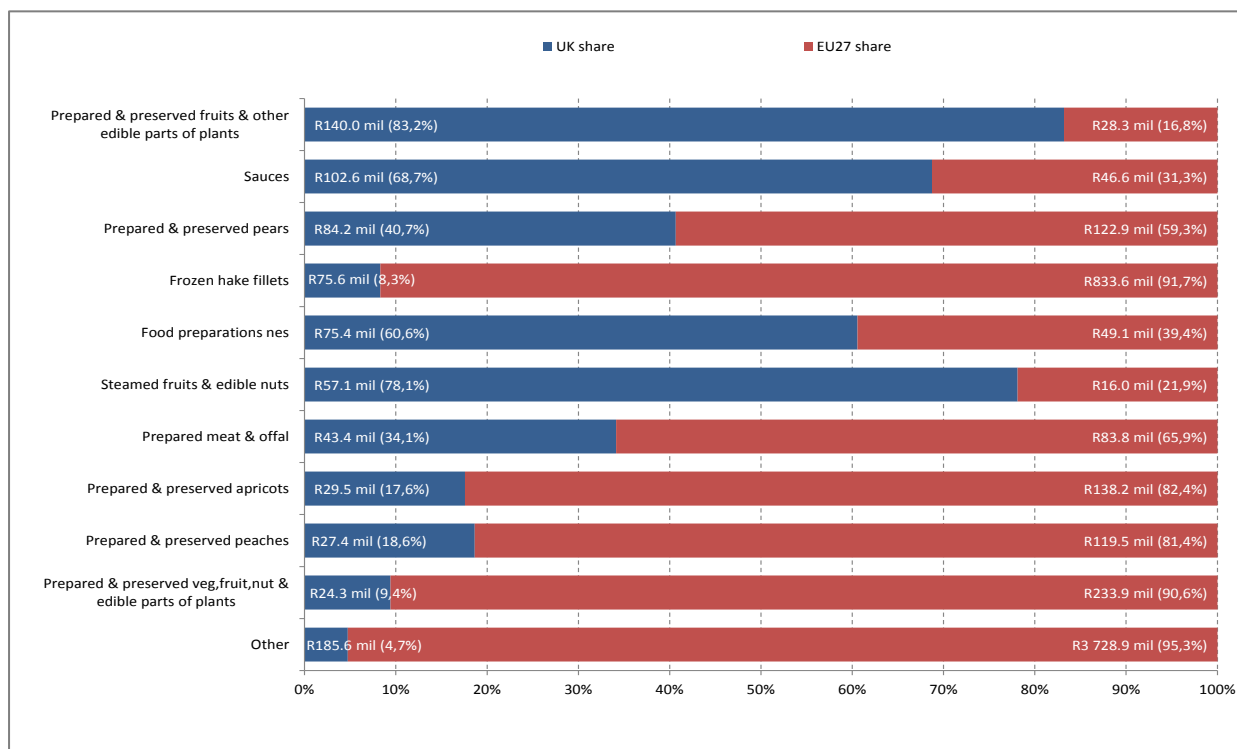
## SA's top beverage exports to the UK and the other 27 members of the EU in 2015



Source: SARS

The UK market also absorbs a considerable quantum of South African processed food exports such as prepared and preserved fruits, steamed fruits and sauces, as illustrated below.

## SA's top processed food exports to the UK and the other 27 members of the EU in 2015



Source: SARS

The above charts indicate that the UK remains one of the major external markets for South Africa's agricultural and food exports, with the relationship currently governed by the EU-SADC Economic Partnership Agreement. Brexit could thus affect their future performance, especially fruit and wine exports, as it alters the existing trading arrangements. Fruits such as grapes, apples, mandarins and oranges are among the agricultural products most at risk from different trade arrangements post-Brexit, by virtue of their large export exposures to the UK.

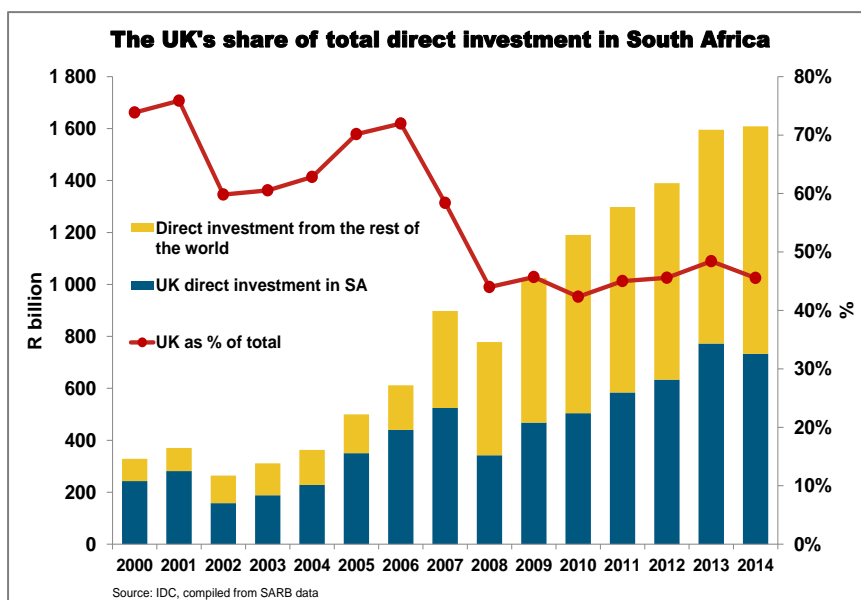
Similarly, the local wine industry will be particularly affected by any changes in the trading regime. The UK's exit from the EU will have a significant impact on the landmark wine export agreement between SADC and the EU, which allows South Africa to export 110 million litres of wine to Europe, up from the current annual duty-free quota of 48-million litres. The departure of the UK from the EU means that the quota under the agreement with the latter will no longer include the UK market, thus providing an opportunity for the domestic industry to export more if favourable trade arrangements are entered into.

The UK's agriculture, food and beverage exports to South Africa, which totalled around R4.4 billion in 2015, could be affected by a future trade agreement with SACU. This includes whiskies (R2.6 billion), poultry meat (frozen cuts and offal) (R247 million), cheese (R69 million), and milk powder (R48 million). This will potentially be used by British whisky and poultry exporters to push negotiators for securing favourable market access in the SACU region.



## UK direct investment in South Africa

The historical relationship between the two countries has contributed to the UK being the largest single country of origin for foreign direct investment (FDI) in South Africa. The UK accounted for almost 75% (R242.9 billion) of all FDI stock in the country in 2000.

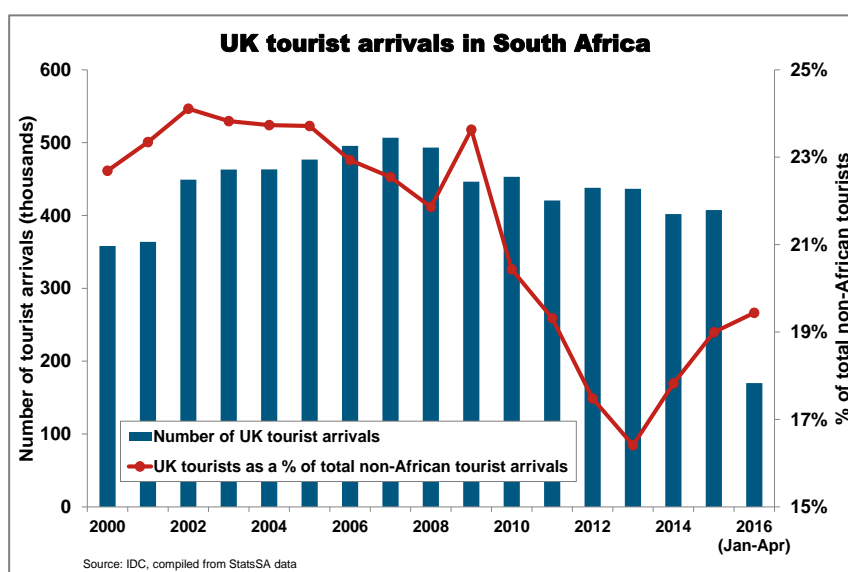


Subsequently, the direct investment momentum by UK residents fell short of the trends recorded by other key sources of FDI, thus taking the UK's share of total FDI stock in South Africa to around 46% (R732.8 billion out of R1.6 trillion) as at 31 December 2014. The UK is also the largest destination for local investors. South Africa's FDI stock in the UK stood at R185.1 billion in 2014, or almost 11% of

the country's total outward FDI stock. A weaker UK economy post-Brexit could result in lower levels of fixed investment in South Africa, especially if UK companies opt for establishing operations in the EU 27 in order to secure market access. In turn, South African companies that invested in the UK as an entry point into the EU single market may be impacted by Brexit, depending on future negotiations, by the weaker performance of the UK economy and by the gradual erosion of London's status as Europe's dominant financial centre.

## UK tourist flows to South Africa

The UK remains a very important source of tourists visiting South Africa. UK tourists currently represent approximately 20% of total non-African tourist arrivals in the country, down from over 24% in the early 2000s. As illustrated, the impact of the subdued economic environment after the global financial crisis and Great Recession of 2009 on UK visitor numbers is quite evident.



In light of the weaker prospects for the UK economy in the short- to medium-term, the ability of British tourists to visit South Africa, or their propensity to spend once in the country, may be constrained by concerns over their future earnings potential and savings requirements. The weaker exchange rate of the British pound vis-à-vis the rand will also be a key consideration.

## GENERAL IMPLICATIONS FOR SUB-SAHARAN AFRICAN ECONOMIES

Heightened uncertainty and risks in the global economy associated with the Brexit phenomenon are expected to have an adverse impact on Sub-Saharan African (SSA) countries through various channels, including trade, investment flows as well as development aid.

The following table indicates the Sub-Saharan African countries that are most exposed to the UK as an export market.

| Sub-Saharan Africa's most exposed exporters to the UK<br>(averages for the period 2013-2014) |  |  |                                 |
|--|--|--|---------------------------------|
| Rank   | Economy/country                                  | % share of UK exports to total exports | USD million (average 2013-2014) |
| 1  | Botswana   | 25.8                                   | 1 999.5                         |
| 2  | Seychelles                                       | 21.8                                   | 121.5                           |
| 3  | Equatorial Guinea                                | 13.8                                   | 1 888.5                         |
| 4  | Mauritius  | 12.6                                   | 375.3                           |
| 5  | Kenya  | 6.3                                    | 357.6                           |
| 6  | Nigeria  | 4.5                                    | 4 550.9                         |
| 7  | Malawi   | 4.5                                    | 57.7                            |
| 8  | Gambia   | 4.0                                    | 4.2                             |
| 9  | Ghana  | 3.9                                    | 481.0                           |
| 10   | South Africa                                     | 3.6                                    | 3 377.3                         |
|  | <b>Sub-Saharan Africa's exports to the UK</b>    | <b>3.7</b>                             | <b>15 447.5</b>                 |
|  | <b>(excluding South Africa)</b>                  | <b>3.8</b>                             | <b>12 070.2</b>                 |
|  | <b>Sub-Saharan Africa's exports to the World</b> |  | <b>412 367.9</b>                |
|  | <b>(excluding South Africa)</b>                  |  | <b>319 506.1</b>                |

Source: IDC calculations utilising UNCTAD data

As highlighted in previous sections, trade agreements entered into with various countries and regions under the auspices of the EU will have to be negotiated afresh and, depending on the duration of the negotiation processes, this has the potential to disrupt trade flows with various African countries.

In the interim period, any decline in import demand both in the UK and the EU has the potential to affect negatively the export performance of the African economies most exposed to these markets. Sub-Saharan African economies (excluding South Africa) exported USD9.5 billion worth of goods to the UK in 2014, down from USD14.7 billion in 2013, with agricultural commodities accounting for nearly 14% of total exports, while petroleum and petroleum products (including gas) accounted for over 70% of total exports.

The critical role played by the UK against the trade distortions (mainly subsidies) associated with the EU's Common Agricultural Policy will be significantly diminished, posing a serious challenge to African farmers.

The potential for further declines in commodity prices as a result of heightened uncertainty and further downside risks to global demand due to Brexit should not be underestimated. Lower traded volumes under more unfavourable terms of trade would put additional pressure on some resource-dependent SSA economies, while the likelihood of reduced external financing will impact negatively on the continent's frontier markets and economies.

A prolonged slump in the UK could result in a decline in FDI flows to the region. In 2014, the UK was the top investor economy in Africa, with inward FDI stock of USD66 billion. It was followed by the United States and France at USD64 billion and USD52 billion, respectively. Remittances from the UK and the EU, as well as development aid, could also be affected if weak economic conditions persist over a prolonged period of time.

**Department of Research and Information**

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