South Africa's industrial performance and its challenges

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Local Innovation and Production Systems Seminar

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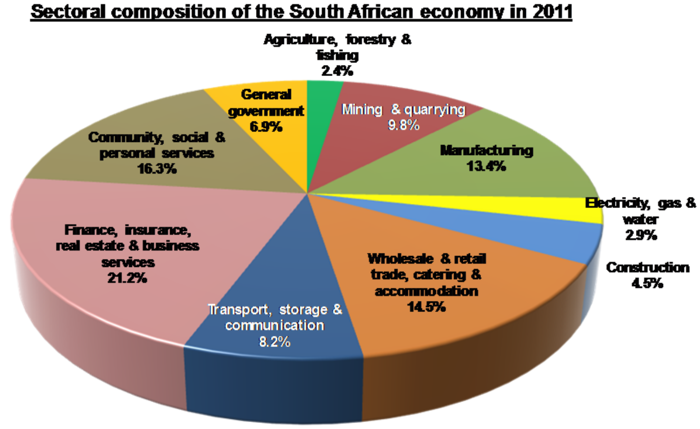
Sectoral composition of the SA economy

Goods-producing sectors (i.e. Agriculture, forestry & fishing, Mining, Manufacturing) accounted for 25.5% of overall economic activity (GDP) in 2011, compared to 32% in 2002.

Sectoral composition of the South African economy in 2011



Note: Sector share according to GDP at basic prices (current prices)

Source: IDC, compiled from Stats SA data

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SA economy increasingly dominated by tertiary sectors

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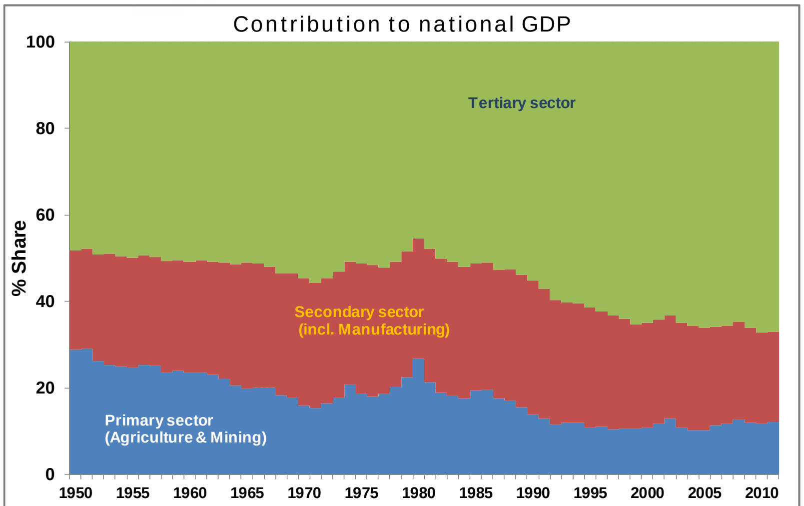
Since the early 1980s, the relative importance of the primary and secondary sectors has been declining.



Source: IDC, compiled from SARB data

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SA economy increasingly dominated by tertiary sectors

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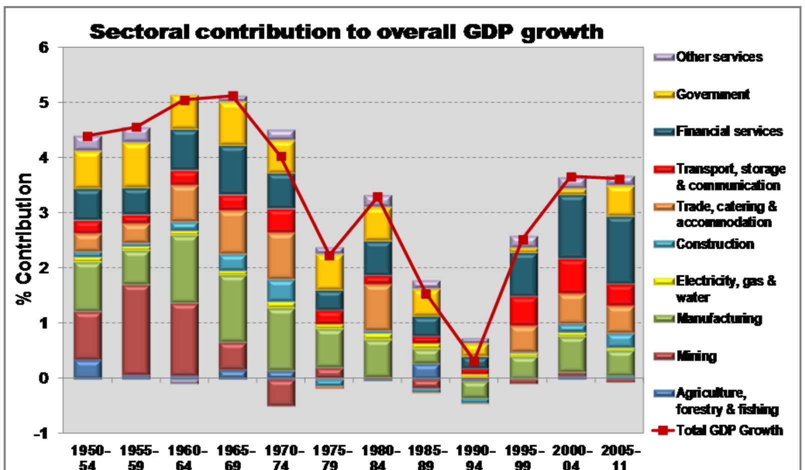
Positive contribution by manufacturing to GDP growth since 1994, but a fraction of those made by services sectors such as financial & business services, and substantially lower than in 1960s and 1970s.



Source: IDC, compiled from SARB data

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SA economy increasingly dominated by tertiary sectors

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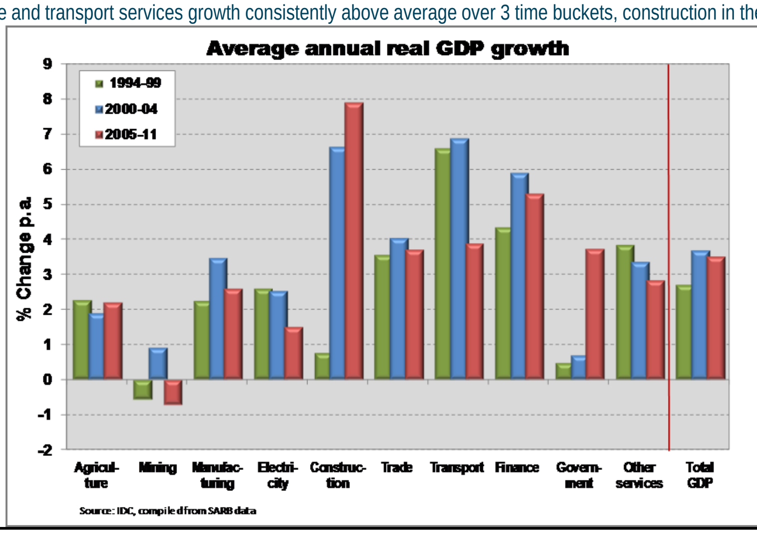
- Manufacturing and agriculture growth sub-average, while mining mostly contracted despite commodities boom.
- Finance and transport services growth consistently above average over 3 time buckets, construction in the 2000s.



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Economic recovery characterised by a mixed performance across sectors

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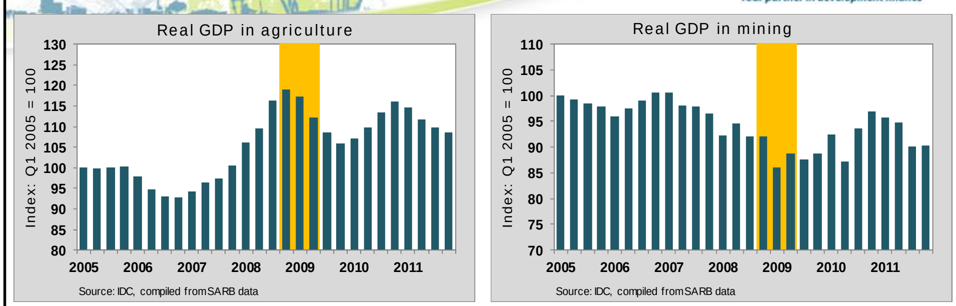
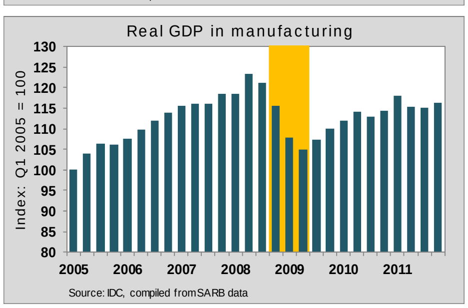




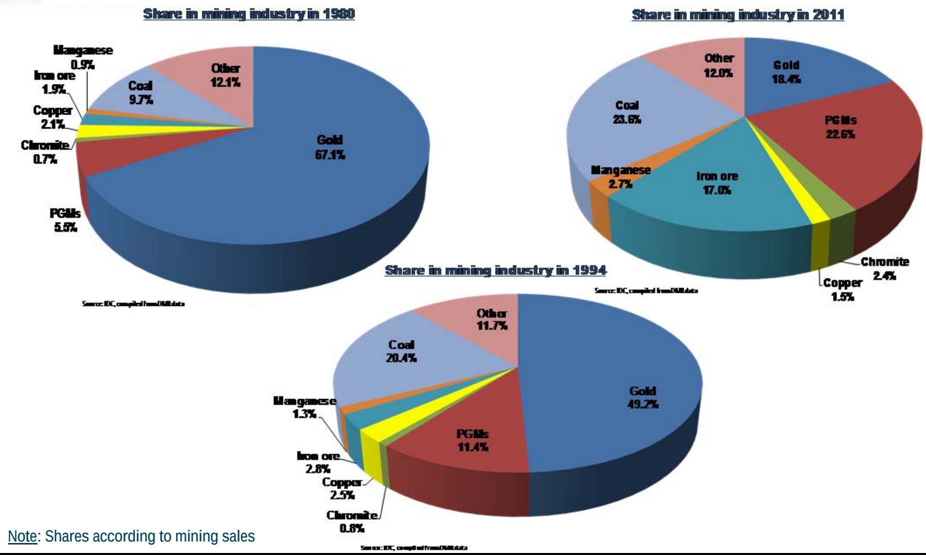
- The South African economy has now seen a return to positive growth for more than two years.
- For the economy at large, the level of output (real GDP) has exceeded the pre-crisis peak, whilst R86 billion in additional output has been added since Q3 of 2008.
- However, output of the agricultural, mining and manufacturing sectors is still well below those levels attained prior to the downturn.

Note: Shaded area indicates period of negative GDP growth (i.e. Q4 2008 to Q2 2009).

6

A radically different mining sector today, far more diversified

PGMs the dominant sub-sector, gold a mere shadow of its former glory, coal & iron ore increasingly important.



Note: Shares according to mining sales

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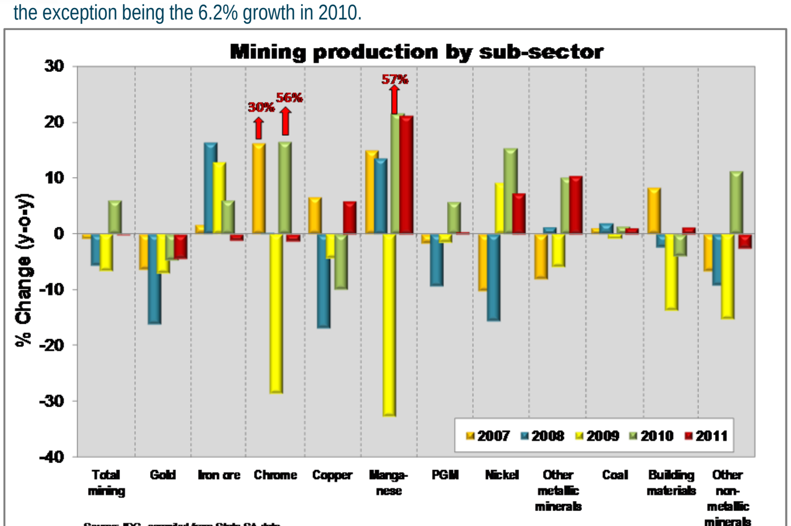
Growth performance of mining sub-sectors

Mining sector under pressure with output volumes having contracted for every year since 2006, the exception being the 6.2% growth in 2010.



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Export performance of mining sub-sectors

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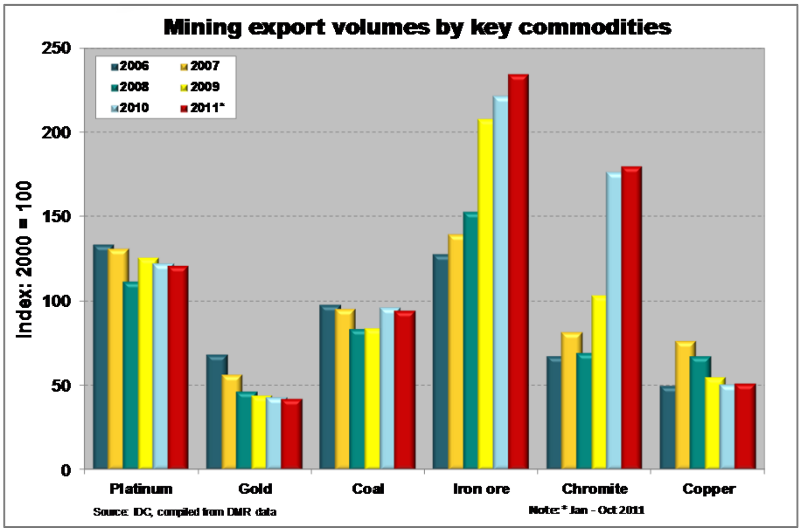
Commodity exports remained subdued despite relatively strong global demand. Gold is continuing on its long-term declining trend, whilst platinum exports still constrained by developments in the global automotive industry.



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Manufacturing dominated by a few sub-sectors …

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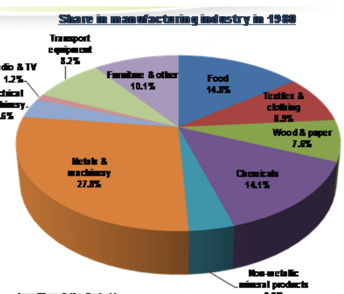
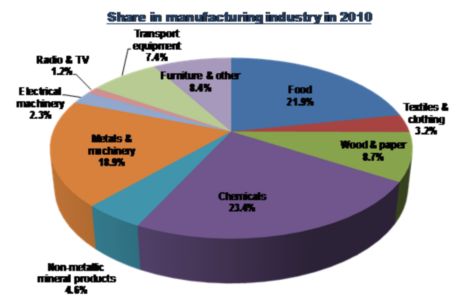
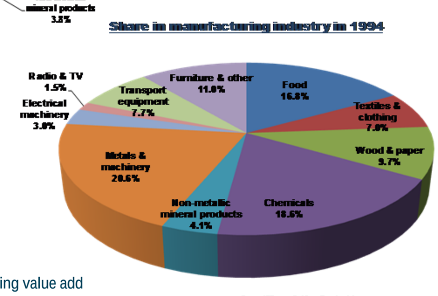
Chemicals claiming progressively larger shares, metals & machinery recovering, food on the rise







Note: Shares according to manufacturing value add

10

Substantial de-industrialisation, with the share of manufacturing sector sharply lower

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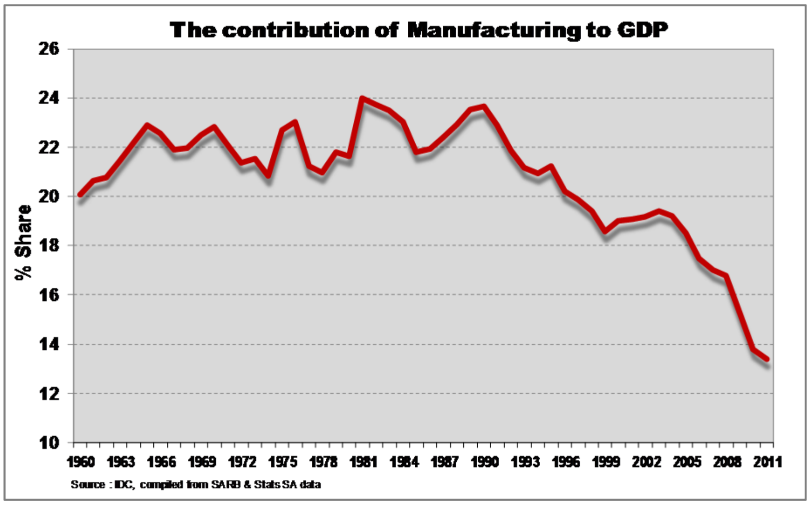
After many decades as the single largest sub-sector in the South African economy, manufacturing's share declined steadily since the early 1990s, with financial and business services haven overtaken it as the largest sub-sector in 2002.



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SA's manufacturing sector following a similar trend to that in other regions

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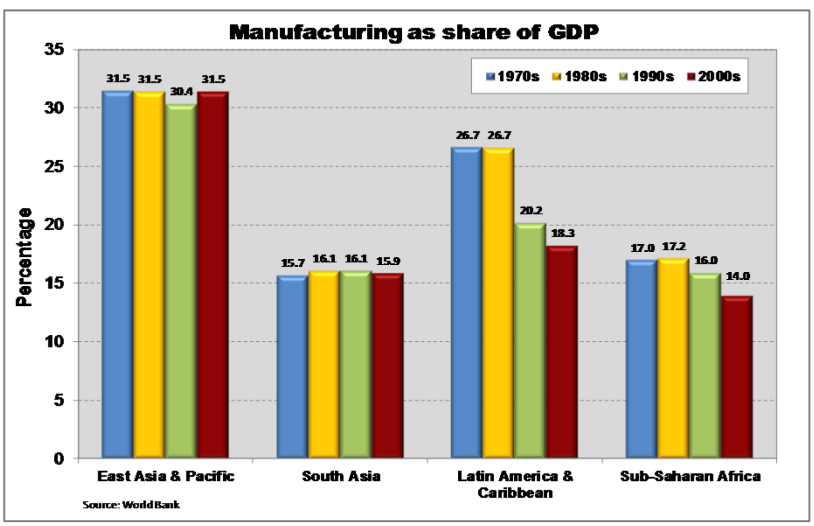
The declining share of manufacturing in the economy is also visible in other regions around the globe. However, in East Asia and the Pacific the share has remained fairly stable at a much higher level.



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Growth performance of manufacturing sub-sectors

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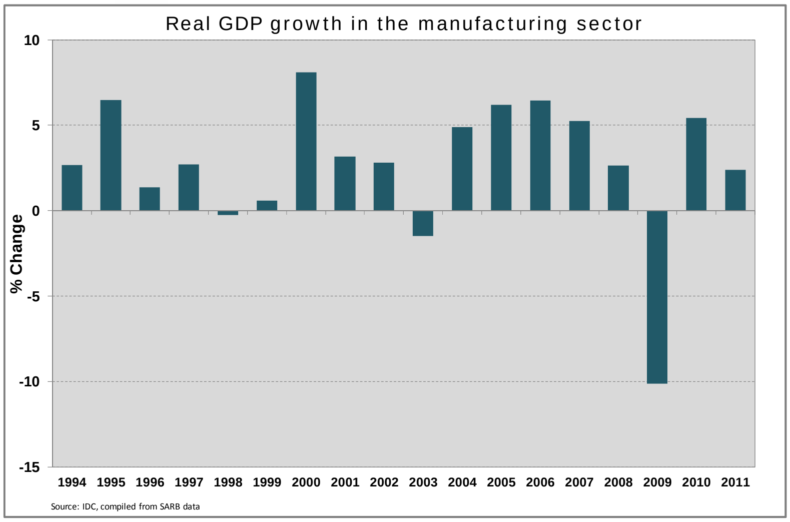
The global economic crisis saw the SA economy experiencing its first recession in 17 years, with manufacturing output falling sharply as external and internal demand was reduced.



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Growth performance of manufacturing sub-sectors

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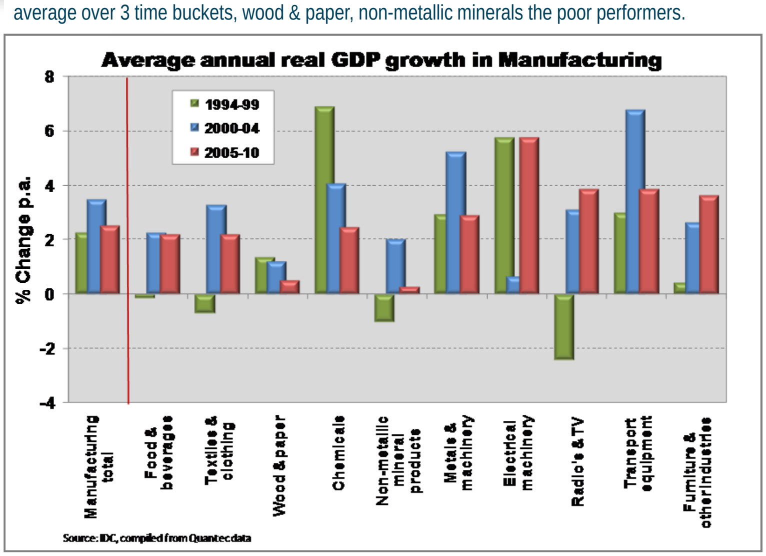
Chemicals, transport equipment, metals & machinery consistently above/on manufacturing average over 3 time buckets, wood & paper, non-metallic minerals the poor performers.



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Manufacturing output still well below pre-crisis levels

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Following a relatively solid recovery in 2010, the manufacturing sector came under renewed pressure in 2011 as the sector was faced by numerous challenges.

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Manufacturing sentiment rather disappointing for job creation, exports showing some improvement

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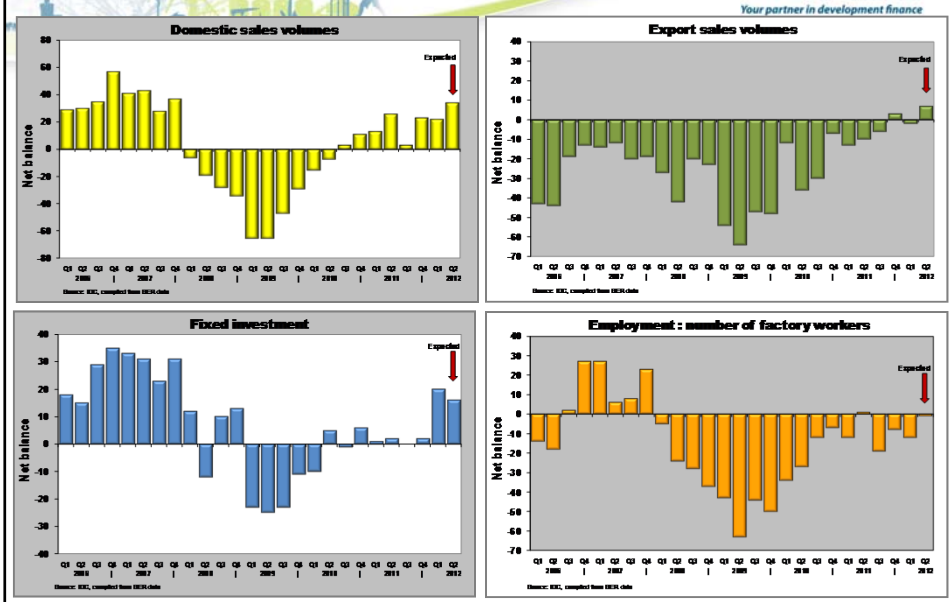

Note: BER manufacturing survey of Q1 2012

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Employment creation remains a key challenge despite the sustained economic recovery

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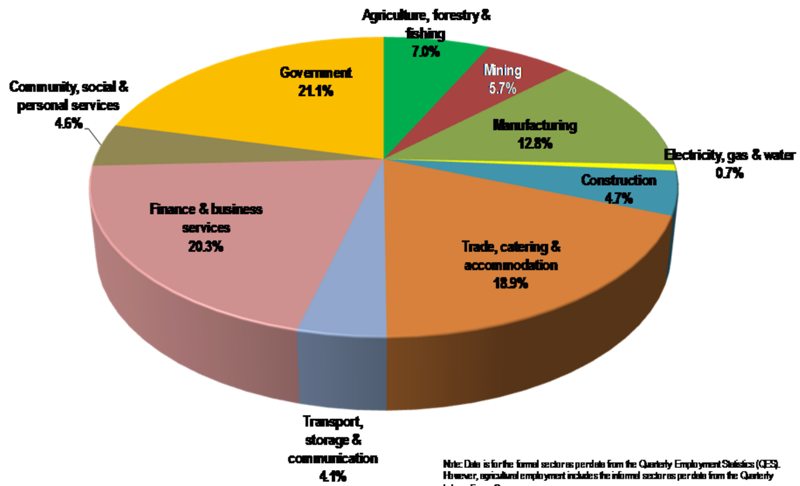
Sectoral composition of employment in South Africa in Q4 of 2011



Note: Data is for the formal sector as per data from the Quarterly Employment Statistics (QES). However, agricultural employment includes the informal sector as per data from the Quarterly Labour Force Survey.

Source: IDC, compiled from Stats SA data

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Goods-producing sectors saw substantial declines in employment numbers over the past two decades

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Insufficient economic growth over the past decade has resulted in a deterioration of the labour absorption capacity of the economy.

Employment by broad economic sector : Number ('000)

Year	Agricul-ture	Mining	Manufac-turing	Services	Govern-ment	Total
1970	1 867	659	1 074	3 397	648	**7 645**
1980	1 747	790	1 460	4 200	1 109	**9 306**
1990	1 621	775	1 581	4 804	1 490	**10 272**
2000	1 362	417	1 349	5 346	1 427	**9 901**
2011	630	518	1 157	4 804	1 898	**9 007**

Source: Quantec, Stats SA

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Economy finding it challenging to create new employment on a meaningful scale

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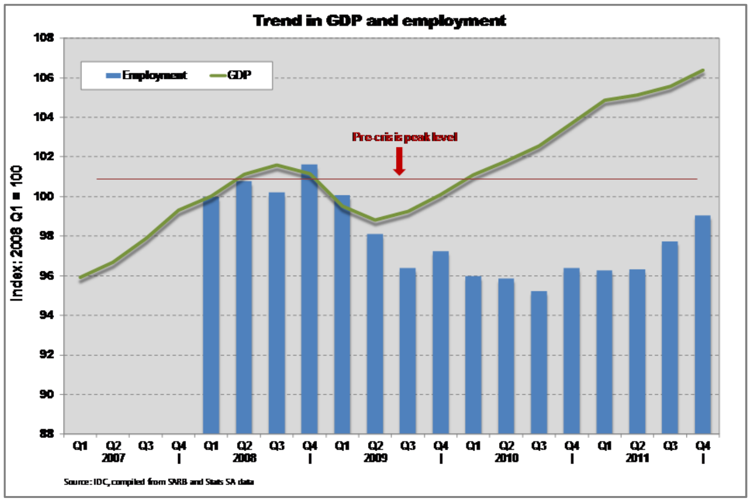
Despite employment gains since Q4 of 2010, there is still a shortfall of 350 000 jobs compared to the pre-crisis levels.



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An unfavourable trend in labour productivity has been observed more recently

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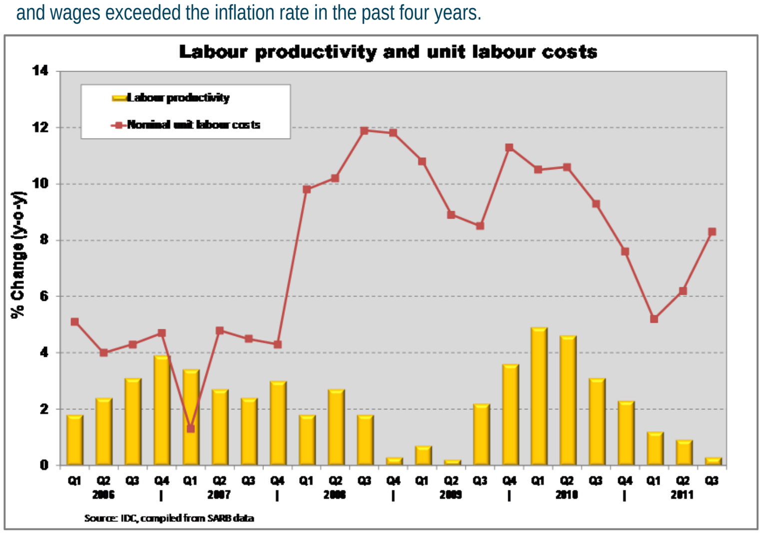
Notwithstanding the relatively poor labour productivity trend, the pace of increase in salaries and wages exceeded the inflation rate in the past four years.



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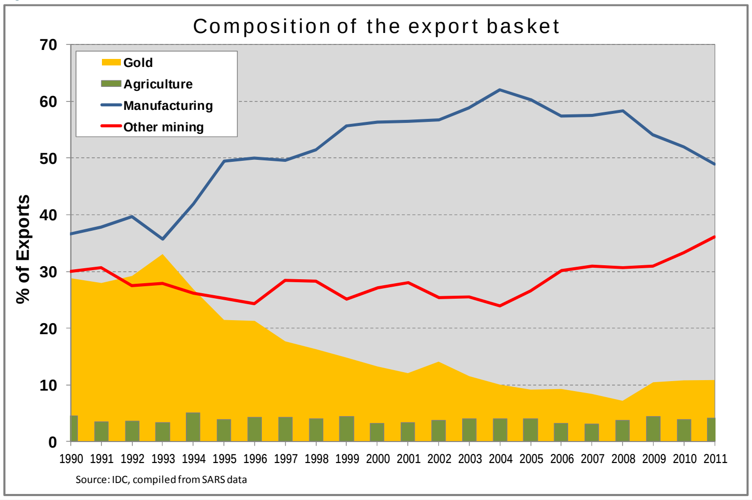
South Africa's trade challenge:
Manufacturing exports very hard hit, PGMs & iron ore exports benefitted from commodities' run

The global crisis had an adverse impact on SA' export performance, with manufactured goods particularly hard hit. As the global recovery remains fragile, demand for local manufactured goods could still be subdued for some time.



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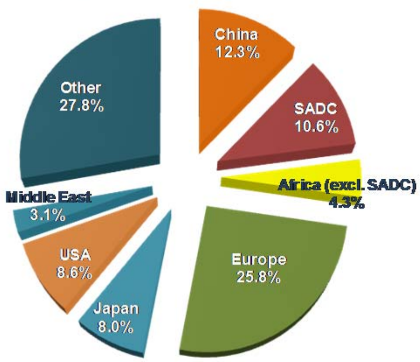
South Africa's trade challenge:
Need for geographical diversification of the export basket

Regional composition of South Africa's export basket in 2011



Source: IDC, compiled from SARS data

- South Africa is still heavily reliant on its traditional trading partners as export destinations.
- Furthermore, the growth prospects for these countries are rather subdued going forward. Thus, their demand for SA exports is likely to remain relatively depressed.
- China, in turn, is forecast to continue on a rapid growth path, albeit at a more moderate pace, providing alternative export opportunities.
- Moreover, China became South Africa's largest export market in 2009 as the global crisis saw exports to Europe, Japan and the USA falling sharply.
- In 1990, SA's exports to China totaled a mere R130 million (0.2% of total merchandise exports), but by 2000 exports amounted to R4.1 billion (1.9% share). This was followed by a rapid expansion over the past ten years to R85 billion in 2011 – i.e. a market share of 12.3%.
- The African continent also has ample opportunities for South African exports that should be exploited further.

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South Africa's trade challenge: Challenges in diversifying the product mix of SA's exports

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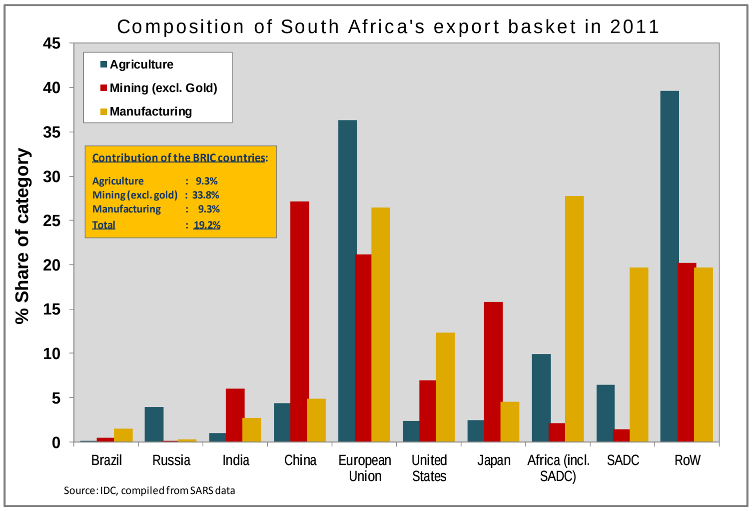
The product composition of South Africa's export basket varies among regions, with exports to China being predominantly commodity-based.



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South Africa's trade challenge: Product mix of SA's exports varies among regions

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Europe, the United States and Africa are important destinations for SA's manufactured exports, whilst commodity exports feature strongly in countries like China and Japan.

South Africa's exports to selected countries/regions in 2011

Broad sector	World (Total exports)	USA	Europe	Japan	China	Africa	Rest of World
Agriculture	2.3	0.7	4.4	0.5	1.4	2.4	1.9
Mining	49.2	29.4	42.8	71.8	79.4	5.5	61.5
Manufacturing	48.5	69.9	52.7	27.7	19.3	92.0	36.6
Total exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IDC, compiled from SARS data

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South Africa's trade challenge: A highly concentrated export basket

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Major exports to select regions/countries in 2011 (% share of exports)

	Europe		China		Africa	
	Sector	% share	Sector	% share	Sector	% share
1	Motor vehicles, parts and accessories	18.5	Iron ore	46.9	Non-electrical machinery (e.g. mining machinery)	14.5
2	Platinum	18.4	Non-ferrous metal ores (excl. Gold & PGMs)	19.0	Basic iron and steel products	10.2
3	Basic iron and steel products	8.8	Coal mining	11.1	Processed food	8.8
4	Non-ferrous metal ores (excl. Gold & PGMs)	7.2	Basic iron and steel products	9.9	Other chemical products	8.0
5	Coal mining	6.3	Industrial chemicals	2.0	Metal products, excl. machinery	6.7
6	Other mining	5.8	Platinum	1.9	Industrial chemicals	6.7
7	Other manufacturing	5.4	Non-ferrous metal products	1.9	Petroleum and petroleum products	5.8
8	Iron ore	5.1	Other manufacturing	1.9	Motor vehicles, parts and accessories	4.9
9	Agriculture, forestry & fishing	4.4	Paper and paper products	1.6	Electrical machinery	4.5
10	Industrial chemicals	3.3	Agriculture, forestry & fishing	1.4	Coal mining	4.1
11	Non-ferrous metal products	3.2	Processed food	0.4	Paper and paper products	2.9
12	Processed food	2.2	Other mining	0.4	Agriculture, forestry & fishing	2.4
	Cumulative % of above	88.7	Cumulative % of above	98.4	Cumulative % of above	79.4

Source: SARS, IDC calculations

Note: Items in red refer to mining

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Sharply higher import penetration in pre-crisis period

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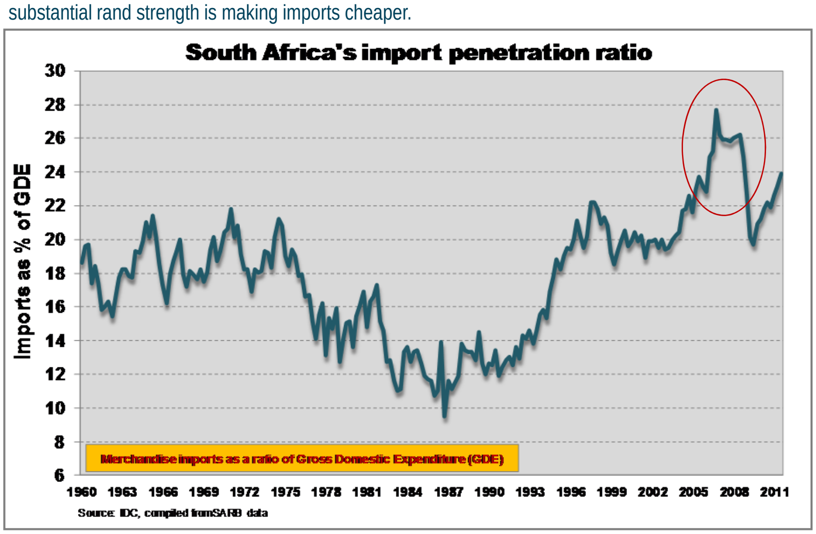
South African businesses are facing increasing global competition in the domestic market as substantial rand strength is making imports cheaper.



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Consumer goods imports made substantial inroads

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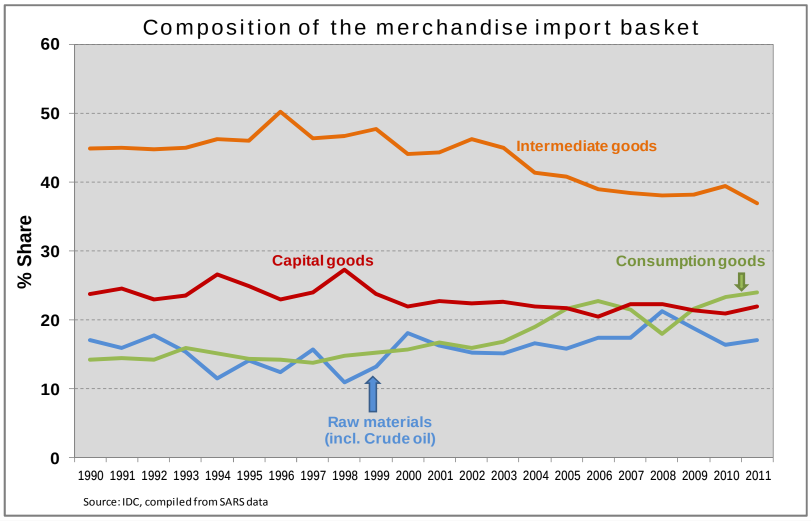
Despite the massive public sector infrastructure roll-out in recent years, the share of capital goods in the import basket declined. The increasing share of raw materials is associated with crude oil imports.



27

Business confidence rebounded after falling sharply in 2011, but confidence still at low levels

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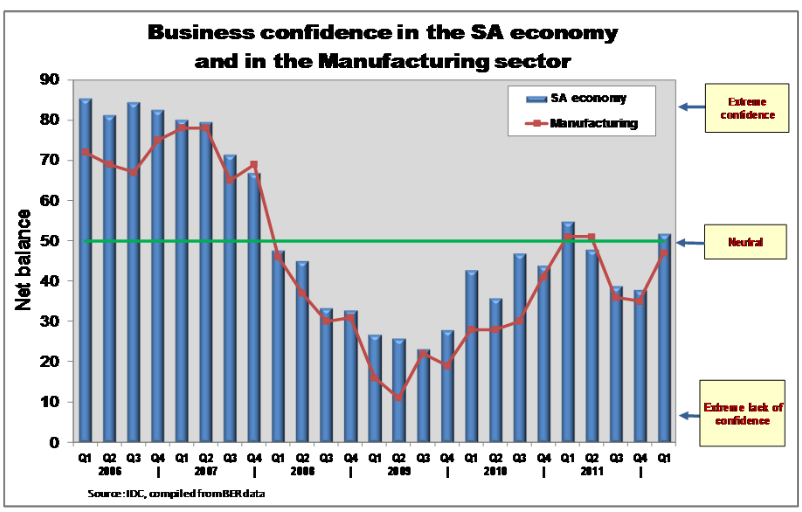
Despite the recent uptick, confidence among manufacturers is still indicative of difficult operating conditions, with the international trading environment, especially Europe, being of particular concern.



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Business conditions expected to remain relatively weak

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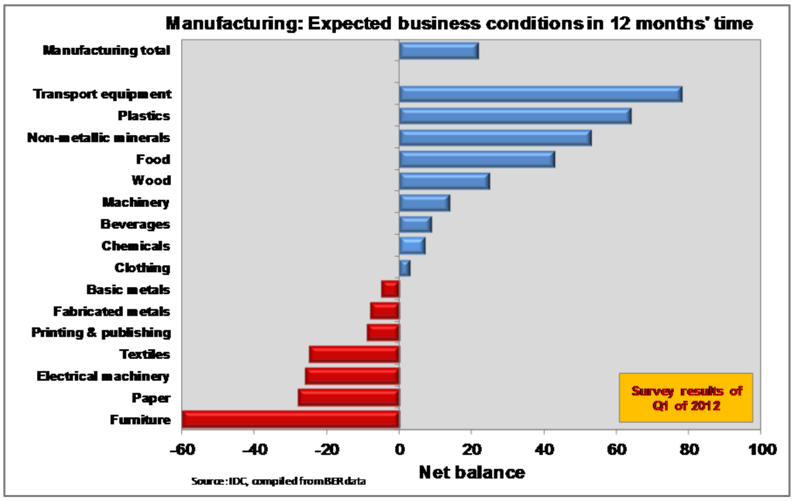
Manufacturers are expecting 2012 to be yet another challenging year, whilst the possibility of the Euro area experiencing a mild recession further aggravating the situation.



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Substantial spare capacity in various manufacturing sub-sectors

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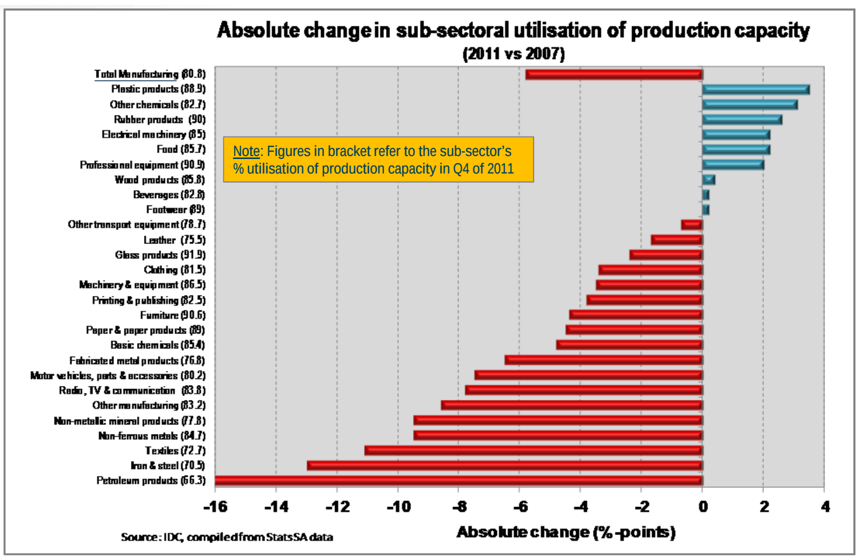
Surplus capacity reduces the need for immediate investment to meet higher demand as SA economy recovers.



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Loss of price competitiveness due to Rand appreciation weighs heavily on trade performance

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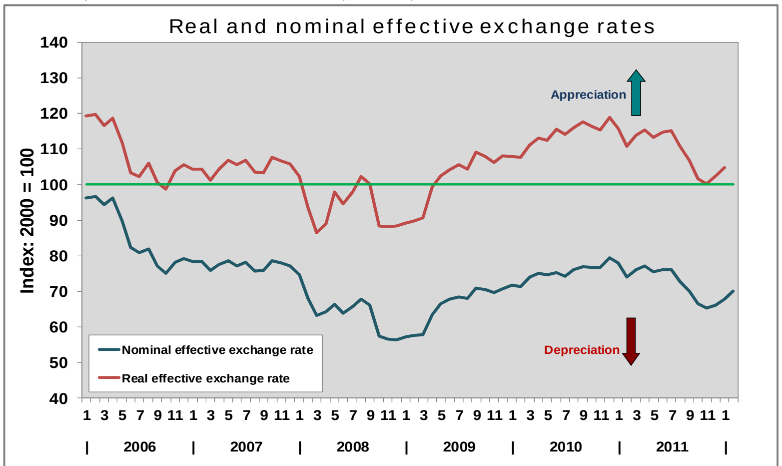
The predicament of an overvalued currency along with weak global demand not only results into loss of export markets, but also reduces import competitiveness.



Source: IDC, compiled from SARB data

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Substantial currency volatility is impacting on business decisions

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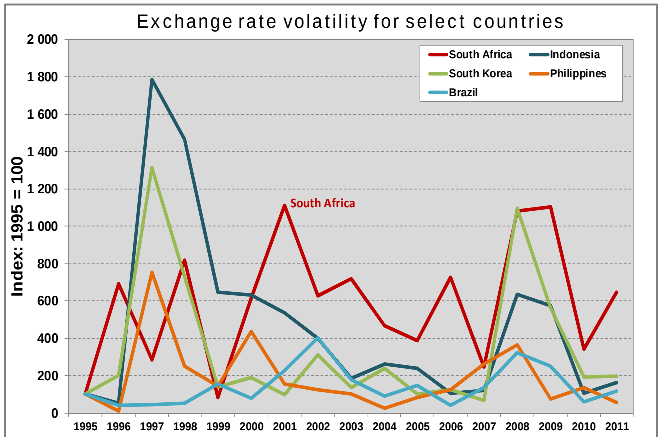
South Africa has one of the most traded currencies, with substantial volatility being experienced.



Source: IDC, compiled from IFS data

- However, excessive currency volatility is of even greater concern than the level of the currency at a given point in time.
- Currency volatility compromises business decisions and can lead to strategic indecisiveness (re. decisions on investment, exports, imports, etc.)
- Moreover, it can also impact on policy decisions and strategies, e.g. industrial development, trade promotion, capex, interest rates, reserve levels, exchange rate management, etc.

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Substantial rise in electricity prices impacting on costs to do business

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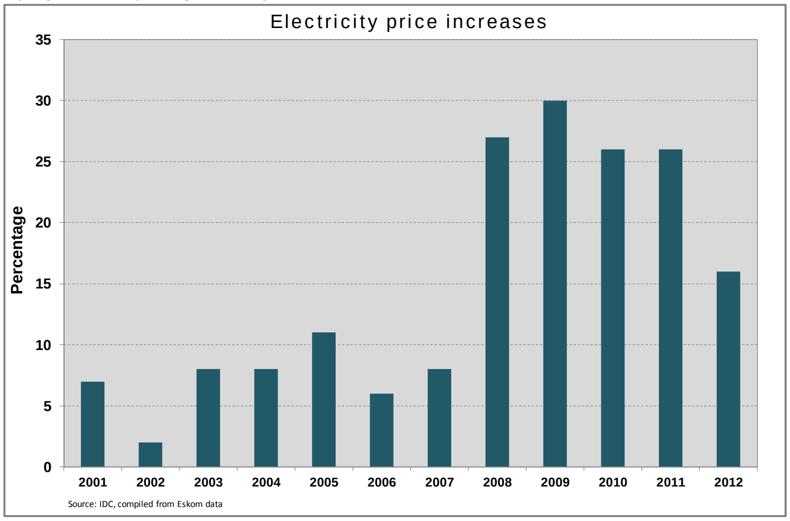
Electricity prices increased sharply in recent years to fund Eskom's capital expansion programme, impacting adversely on domestic inflation and costs to do business.



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Electricity prices increased rapidly over the past decade

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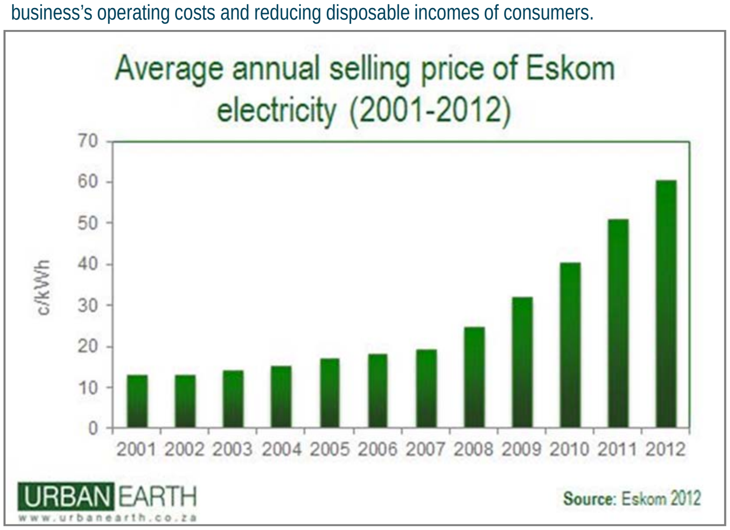
Electricity prices now more than 3-times higher than in 2007, negatively impacting on business's operating costs and reducing disposable incomes of consumers.



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Skilled labour availability the major constraint for manufacturers

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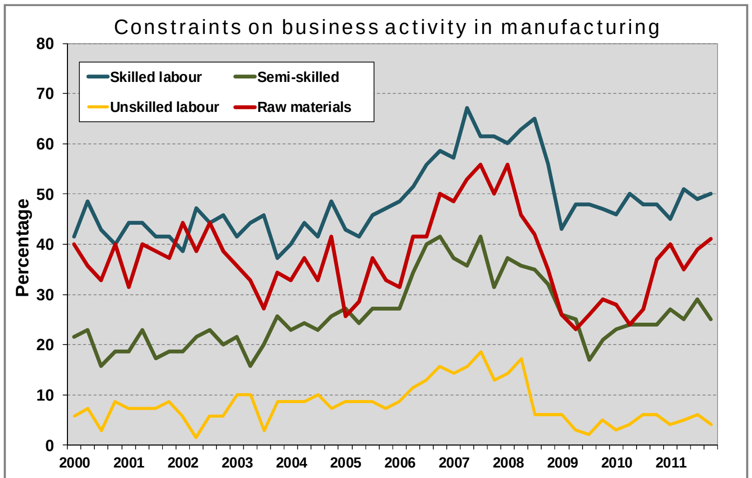
The shortage of skilled labour remains a key constraining factor, although not to the same degree as in the recent past.



Source: IDC, compiled from BER data

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Manufacturers particularly constrained by insufficient demand since crisis

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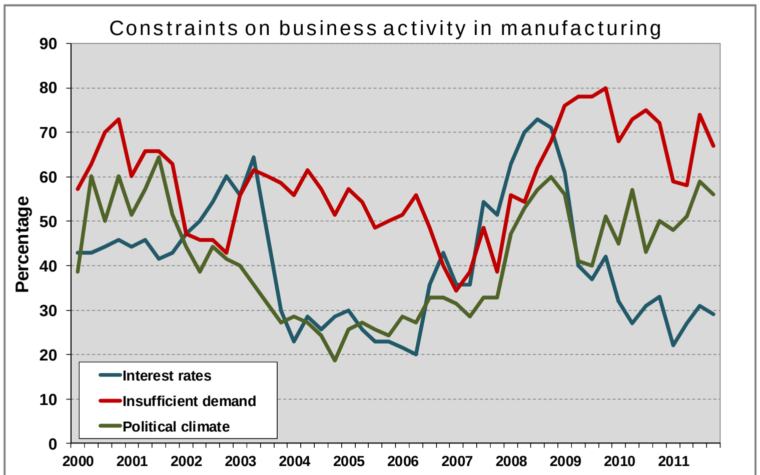
Insufficient demand continues to be the most important constraining factor on business activity.



Source: IDC, compiled from BER data

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Challenges faced by the manufacturing sector

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- The level and the excessive volatility of the Rand is impacting on business planning, export market development, the ability to maintain global market share, as well as by influencing export proceeds.
- Reduced global demand due to the recent global recession and a rather fragile recovery, particularly by the advanced economies (SAs largest trading partners for manufactured goods).
- The state of infrastructure in our economy – availability, effectiveness, cost, etc.
  - Electricity – both availability and the substantial rise in cost over recent years
  - Transport and logistics (rail, ports & harbours) – efficiency and costs
  - Telecommunication – SA has among the highest costs in a global context
  - Urban infrastructure not adequate to sustain and promote higher levels of economic development.
- High costs of doing business to be reduced by addressing bottlenecks in infrastructural services provision, improve service efficiency and through lowering the costs of economic infrastructure.
- The regulatory environment (e.g. registering a company, issuing of mining licences) as well as bureaucratic red-tape should be addressed so as to provide a more efficient public service.

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Challenges faced by the manufacturing sector (cont.)

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- Investor and business confidence is at low levels considering the rather uncertain outlook for the global economy as the recovery in advanced economies is still fragile.
- Labour costs relative to productivity levels are of concern as the steep rise in demand for salary and wages is not necessarily matched by a similar improvement in output per worker, resulting in rising and often uncompetitive unit-labour costs.
- Incentives provided by government perhaps not always well communicated or well received by private sector (lack of knowledge about their existence and/or access thereto).
- Incentives are biased towards the automotive industry, with the APDP taking the largest share of the DTI incentive allocation.
- SA's manufacturing sector is quite concentrated, with a few key industries dominating production, a situation that is even more prevalent on the export side. Such overconcentration makes the country extremely vulnerable to changes in economic conditions, both domestically and globally, that impact on either production or export performance of these key sectors.
- Barriers to entry and unfair practices (e.g. monopolistic behaviour) need to be lowered so as to provide a more enabling operating environment for business enterprises.

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Challenges faced by the manufacturing sector (cont.)

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- SA's exports still highly reliant on its traditional trading partners (advanced economies), especially in the case of manufactured goods. As economic prospects for the advanced economies remain unsatisfactory, demand for our manufactured goods could be limited.
- Although China is now our single largest export destination, the export basket is highly skewed towards commodities (mining and mineral products), which account for roughly 80% of exports to this Asian giant. Moreover, iron ore takes the majority share of SA's exports to China. Adding basic iron and steel and non-ferrous metals to these mineral exports, about 90% of all exports comprise mining and primary beneficiated products.
- Trade policy must be geared towards achieving a much more diversified export basket, both in terms of product mix and geography.

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Challenges faced by the manufacturing sector (cont.)

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- Public sector capex should be leveraged to support increased localisation spin-offs and thereby benefitting the establishment of new and/or expansion of existing business enterprises for the development of the SA economy through increased value addition, job creation, export orientation and/or import replacement.
- Government and state-owned enterprises must put actions in place to ensure that a substantially larger portion of the budgeted capex is indeed being spent. Public sector capex could go a long way in reviving much needed business and investor confidence in rather difficult times for the domestic economy.
- Timeous payment for services provided and/or products supplied to the state is critical to the cash flows and the survival of many firms, especially for SME's.
- From a fiscal perspective, government must ensure improved efficiency in the application of scarce funding source, by channelling such funds into creating a more enabling investor and business environment through providing quality and efficient infrastructure.
- Government must prevent of placing a too heavy burden on the economy by limiting/managing the increase in the public sector workforce to more affordable and sustainable levels.
- The tax burden is increasing continuously and thereby limits the private sector to expand its production capacity.

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Challenges faced by the manufacturing sector (cont.)

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- High energy prices are challenging the viability of many existing projects, whilst a continuation of this rising trend could jeopardise the creation of new investment projects and/or resulting in more existing projects becoming unviable in future.
- Rising energy prices could also have major implications for the country's industrial base and capacity to remain competitive in an ever increasing challenging global trading environment (both for exports and import competition).

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Recently announced actions to support industrial growth and development

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- In December 2011, the Trade and Industry, Finance, and Economic Development Department announced the *Designated Sectors for Local Procurement* programme, with the objective to support the purchasing of various goods, such as power pylons, rolling stock, buses, canned vegetables, clothing, textiles, footwear and leather goods, as well as Set Top Boxes, from local manufacturers.
- The *Manufacturing Competitiveness Enhancement Programme* (MCEP) has at its aim to provide production and distressed funding support so as to boost productivity, competitiveness, to raise the level of fixed investment, as well as to create much needed employment opportunities.
- A *Special Economic Zones* programme was also announced in the 2012 Budget, with its aim to provide infrastructure and incentives to develop clusters of firms, encouraging private investment and employment growth. Incentives will target improvements to business conditions and productivity through skills development, business incubation, reducing red tape, technology transfer and adaptation, and providing assistance with access to markets and logistics.

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Thank you

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