



**Western Cape  
Government**

Economic Development  
and Tourism

**BETTER TOGETHER.**



**Quarterly Economic Bulletin**  
Quarter 2 2016

# Quarterly Economic Bulletin

Quarter 2, 2016



# MINISTER'S FOREWORD

It gives me great pleasure to present the Western Cape's latest Quarterly Economic Bulletin, which offers an analysis of the trends in this province's economy.

This Quarterly Economic Bulletin provides a considered update on our economy during the second quarter of this year. During the period under review, new figures, which confirmed that the Western Cape has continued to outperform the national economy, were released.



Recent employment data tabled by Statistics South Africa showed that the Western Cape was the country's fastest job-creating region. This data showed that there were 210 000 jobs created overall in 2015, with 62 000 jobs created in the last quarter. Jobs growth was at 9.7%, compared to a national figure of 4.6%, while Gauteng, which is South Africa's largest economic centre, grew at only 4.3%. In addition, the very latest Quarterly Labour Force Survey (Q12016), showed that 92 000 jobs were created year-on-year in the province.

Our number one objective in the province is the creation of opportunities for jobs and growth. These latest trends show that through our policy choices, we are moving our economy in the right direction. This bulletin further sheds light on some of the factors influencing these gains, and features a broad range of topics. Some of the topics discussed are the global economic outlook, energising the Western Cape, electric cars and gap-housing. Our analysts highlight potential opportunities in the economy and we hear from investors about doing business in the province.

I trust you will find the content engaging, and we encourage your feedback.

A handwritten signature in black ink, appearing to be 'AW', written in a cursive style.

**Alan Winde**

*Minister of Economic Opportunities*

# HEAD OF DEPARTMENT'S FOREWORD

Despite the predictions of a rather dismal economic growth trajectory for the country, it is still the intention of the Economic Cluster in the Western Cape to ensure an enabling environment for businesses to grow and to expand.

I believe that government's role is to ensure that business has access to a stable investor climate, competitive skills set, catalytic and growth-stimulating infrastructure, and an economic environment in which constraining red tape is reduced in an environment that makes it easier to do business.



The Department of Economic Development and Tourism continues to commit to ensuring that the criteria for investment, as stated above, is constantly addressed in a dedicated and innovative manner.

The production of the Quarterly Economic Bulletin is one of the methods we use to ensure that the engagement with businesses is in a relevant and informative way.

We hope that you will find this bulletin a useful and interactive tool in creating an economic environment conducive to growth and prosperity for all our citizens.

A handwritten signature in black ink, appearing to read 'Solly Fourie'. The signature is fluid and cursive, with a large initial 'S' and a trailing flourish.

**Solly Fourie**

*Head of Department*

*Department of Economic Development and Tourism*

# EDITOR'S NOTES

This has been another frantic quarter. Brexit has come and the UK has gone, and while any hint of global negativity normally sends the Rand spiralling downwards, surprisingly it has not been the case this time. The Rand strengthened some 20% against the British Pound, from R23 to below R19 per sterling, some 10% against the US Dollar, and the All Share Index (ALSI) recovered just about all its losses in response to Brexit. The rapid appreciation of the Rand does not bode well for South African exporters (particularly Western Cape agri-exporters), but it does bode well for motorists and inflation.



South African employment growth turned negative in the first quarter, recording a decline of 15 000 formal non-agricultural jobs, and employee gross earnings declined by 4% (or R22 billion). Quarter-on-quarter Trade showed the largest decline in jobs (-36 000) and Community Services the largest expansion (44 000). Business Services was the only sector in which gross earnings grew (R3.7 billion), with Trade and Manufacturing declining most (-R7 billion and -R6.3 billion, respectively).

Job losses are particularly concerning, because even though Standard & Poor's kept South Africa's credit rating one notch above sub-investment (junk) grade, the rating agency warned that if growth does not improve, the country could still lose its investment grade status. Given the Reserve Bank's expectation of no growth over the next twelve months, it does not bode well for South African debt costs if S&P does downgrade our debt. It must be said that National Treasury is implementing a very austere fiscal stance that may sway the S&P in our favour. It is also likely that much of our debt is priced at sub-investment grade already and the impact of a downgrade may not be as severe as we expect.

As noteworthy as these events are, they pale in comparison to the threat presented to jobs by what is now known as the fourth wave of industrialisation. Jobless growth is not only a South African phenomenon; more countries are reporting similar trends. The BBC reported that Foxconn, the world's largest electronics manufacturer, reduced the number of employees in one factory from 110 000 to 50 000 with the introduction of robots.

Creative destruction, as the Austrian economist Joseph Schumpeter coined it, is simple and easy to understand, but its impact can be devastating. When the automobile replaced the horse as the primary mode of transport, jobs related to stabling, horse rearing activities, blacksmiths, the horse feeding industry, and saddle and cart activities, were all rendered pretty much worthless. Schumpeter argued that it was innovation, through competition, in the capitalist system that was the real force for growth and the associated sustained long-term economic growth and the real force behind sustained increases in wellbeing, and up to now he appears to have been right.

In the past, whenever jobs and industries were creatively destroyed, it was accompanied by new jobs that could not be handled by machines. Labour productivity increased significantly, as did incomes. Nowadays robots and sophisticated software are replacing jobs faster than the disruptions create new jobs. One of the single largest occupations in the US is truck driving, with a total of 3.5 million drivers. Last year a number of truck manufacturers, including Volvo, completed a week-long test of autonomous driving across Europe. This one innovation alone will render 3.5 million jobs in the US redundant.

More sophisticated service jobs are also currently being automated. Radiographic software has proven to be more accurate at analysing X-rays than humans. Johnson & Johnson has been selling an FDA approved anaesthesiologist robot, and these days' orthopaedic surgeons are already using automated machines to assist with surgery.

In response to the wave of sophisticated machine automation, Switzerland held a referendum on unconditional basic income. Whilst the Swiss rejected an unconditional basic income of \$2 500 per month, Utrecht in the Netherlands plans to test an unconditional basic income of about \$10 000 per year.

Work does not only provide an income, but contributes to meaning in our lives. If robotic automation does indeed threaten jobs to the extent to which analysts insist it would, we would need to reconsider the notion of economic well-being, how it is measured, and how economic growth fits into all of this. Even if the disruption creates new jobs at a similar rate to which it makes jobs redundant, is our education system geared to equip us with the required skills fast enough to take up these opportunities? What is clear is that the future of employment involves more technology and more innovation, and if we intend to be an employed part of it, we need to start planning not only for employment in manufacturing, but in the innovation economy.



**Nezaam Joseph**

*Director and Editor*

*Department of Economic Development & Tourism*

Thank you for all your constructive feedback on previous editions. Please feel free to comment on content or any other matters that will improve future editions.

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KHULISA NEWSLETTER

PORTFOLIO INSIGHTS

SPOT THE OPPORTUNITY

INVESTOR NARRATIVE

GAP HOUSING

GLOBAL OUTLOOK

NATIONAL OUTLOOK

PROVINCIAL OUTLOOK



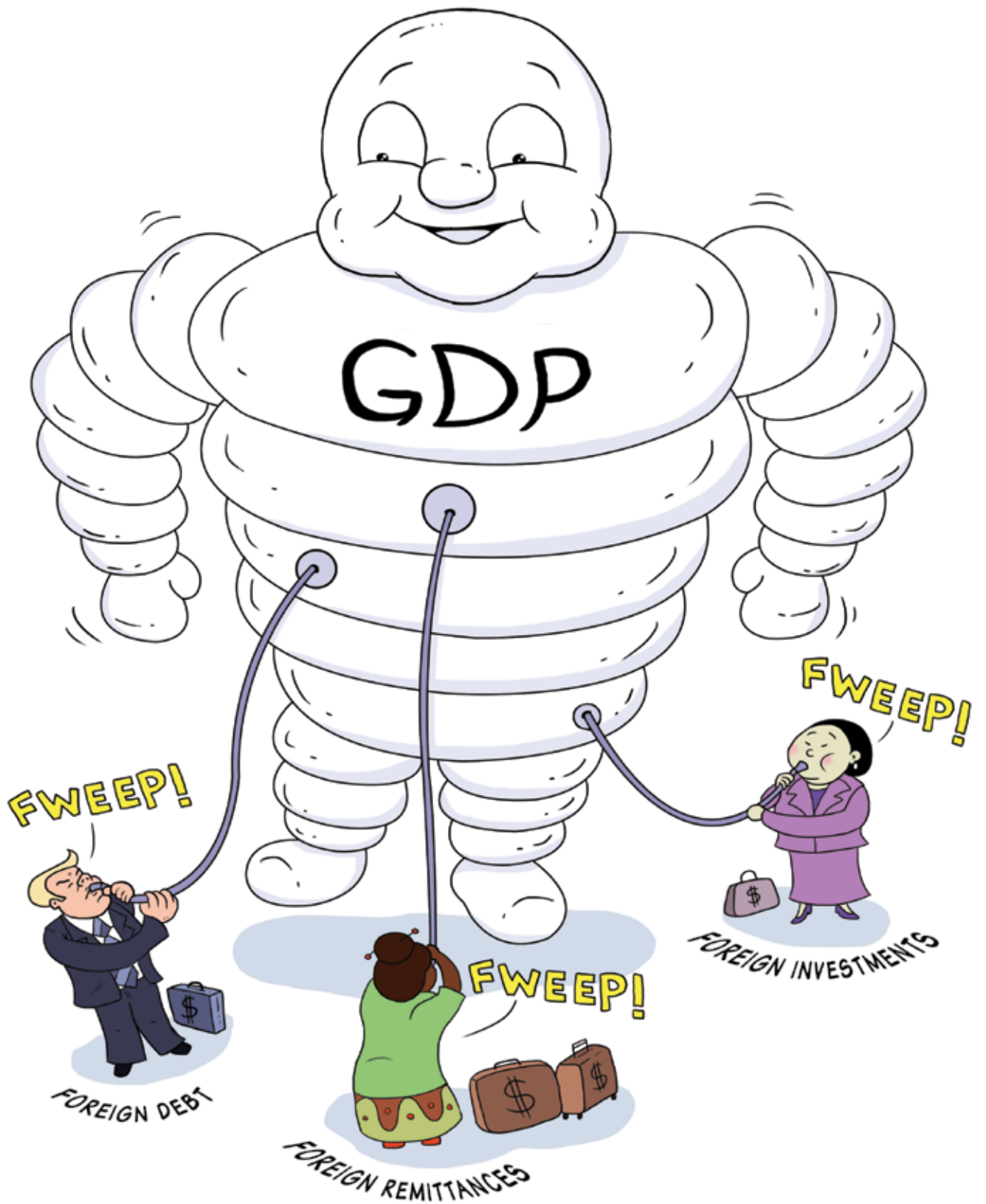
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# OPINION: WHY GDP TELLS US VERY LITTLE ABOUT THE ECONOMY

NEZAAM JOSEPH

There are very few numbers that can instil excitement and depression quite like Gross Domestic Product (GDP). Government policies are shaped, budgets are set, debt ceilings are determined and, at office watering holes, this mystical number is analysed by economists and laymen alike. Our very sense of wellbeing is directly influenced by the publication of the number. While most of us understand GDP as a measure of economic health, not many of us who use GDP have an appreciation of what the measure actually counts and what it omits in reflecting overall economic health.

So, here is a piece of GDP trivia that I'm sure might have escaped you. In 2008, Bermuda eclipsed Luxembourg to record the second highest GDP per capita (\$93 000). It was only the small, oil-rich state of Qatar that recoded a higher GDP per head. Today, Bermuda's GDP per capita is 70% more than that of the United States. I don't know about you, but all that comes to my mind when I think of Bermuda are bronze bodies meandering across the even bronzier beaches – certainly not the global model of industrialisation and productive economic growth.

This begs, what I think, a set of rather important questions about GDP, such as: what does it measure, how is it measured, what can it be used for, and what does it say about our economic well-being?

## Origins of GDP

The concept of GDP was first developed by William Petty to defend landlords against unfair and unsustainable taxation during the Dutch-English wars of the mid-1600s. His calculation entailed a very crude method to determine the total production of goods and services.

It was not until 1933 that Kuznets, at the request of the US congress, produce a method sufficiently sophisticated to calculate GDP in an industrial economy. The concept of GDP was further promoted by John Maynard Keynes, who is generally regarded as the father of macroeconomics.

I am always taken aback by the fact that while concepts of trade, clear distinctions between labour and capital classes, factors of production and money are all hundreds if not thousands of years old, but the study of macroeconomics as we know it today is barely 70 years old. Perhaps it was because central to the study of macroeconomics is macro-indicators such as employment levels, inflation and, of course, GDP, none of which were available to the economist before the 20th century.

Accurately measuring macro-indicators such as GDP, employment and inflation as frequently as four times a year, is a mammoth task. The accuracy of the estimation is correlated to both cost and time. To improve the cost-benefit ratio of collecting and presenting macroeconomic statistics timeously, a very small part of the economy is surveyed and modelled. With any survey data, in inferring the characteristics of the population from a survey, we accept a combination of sampling, measurement, coverage and response errors.

To increase confidence in GDP, we do measure GDP in three different ways, by:

- a) aggregating all spend in the economy (*expenditure approach*),
- b) adding all earnings in the economy (*income approach*), or
- c) adding all value added (*production approach*), that is the price of outputs less the price of intermediate inputs.

In South Africa, GDP is calculated using the production method by Statistics SA (StatsSA) and using the expenditure method by the Reserve Bank (SARB). Theoretically, all three methods ought to be equal, but in reality, growth estimates between the SARB and StatsSA can vary by more than 25%. Residual differences between the two methods in 2015 was as much as R24.4 billion or 0.6% of GDP in current prices.

## Give Me a Number, Any Number Will Do



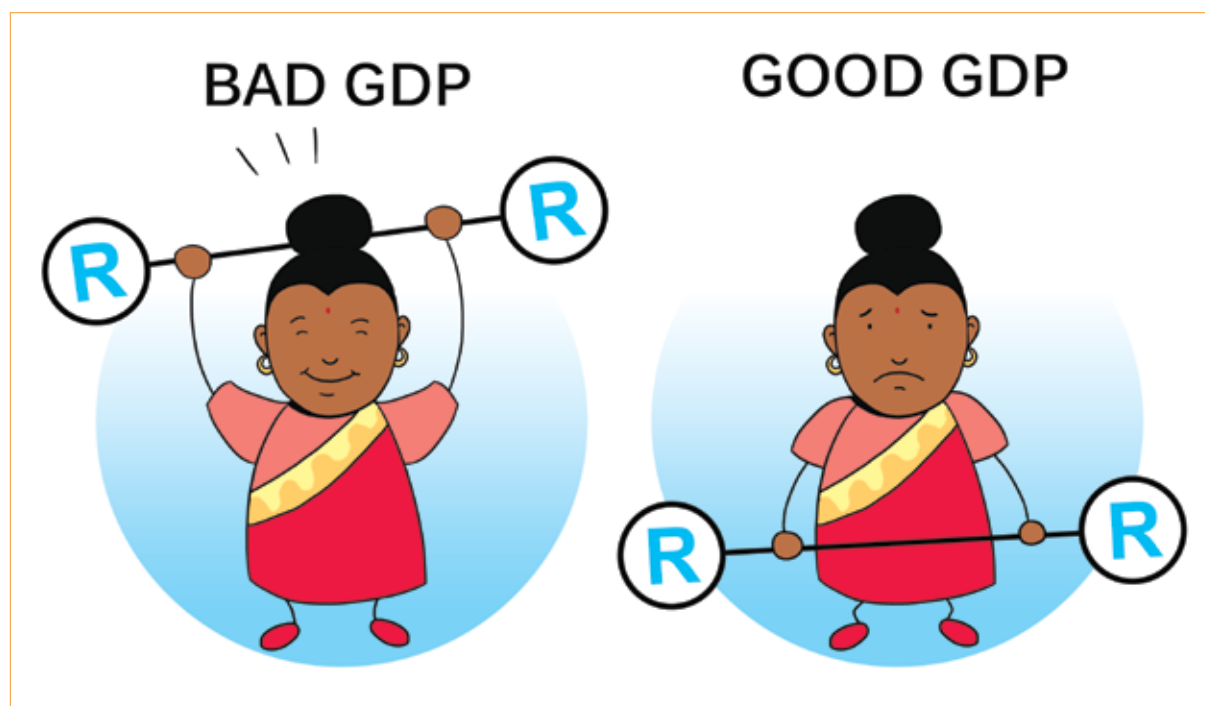
How GDP influences decision-making in markets is rather peculiar. One would assume that if decisions were made on grossly incorrect GDP data, it would lead to less optimal outcomes than if those decisions had been made with more accurate GDP data. One would also expect the market to react, should the number be significantly revised. Only, in the case of Nigeria prior to 2014, the GDP number was off by a magnitude of 89%. Economic outcomes do not appear to have differed much between decisions made prior to 2014 and those made subsequent to the Nigerian GDP revision. Furthermore, market reactions were all but absent in response to an 89% GDP revision. All rather peculiar, because government debt-risk levels, the price of debt and the government budgets and expenditure, are all dependent on levels of GDP.

If you think the primary reasons of these massive revisions is because Nigeria is a developing economy with less sophisticated and reliable reporting capacity and methodologies – not so. These wild GDP swings prevail in OECD countries too. The Irish Central Statistical Office (CSO) released the official Irish GDP statistics in July. The CSO announced that the Irish GDP grew by a staggering 26.3% and industry, including Construction, advanced by a colossal 87.3%. The annual growth is even more staggering when considering that GDP declined by more than 2% over the first quarter under the year of review.

Market valuations are nearly always amplified by reports on the health of the real economy, however over the last twelve months, the Irish Stock Exchange (ISE) declined by more than 10%. Even before the Brexit announcement, ISE performance was negative over the last twelve months. Critical indicators such as debt-to-GDP ratios fell significantly, improving credit worthiness and likely the price of future government debt. But markets did not move much in response to the reported Irish economic expansion. Perhaps markets placed more emphasis on indicators (other than GDP), such as employment, wages and consumer spend, which all show significantly more modest growth rates.

Revising GDP measurement methods or estimates is standard practice across all economies. Here again, the contrast in market reactions between initial GDP estimates and revisions are most peculiar. The initial official US annual 2015Q1 growth rate was 0.1%, which was revised 1% downwards one month later, and a final downward revision to -2.9%. That is a revision downwards of about half a trillion US\$. It was not so much the dramatic revision of the number that got my attention, but the contrast in market reaction between the two numbers. Market and public reaction would be significantly more dramatic had the initial estimate reflected a 2.9% economic contraction. The revision was barely noticed and hardly moved any market dials.

## No Aiming Required, Just Shoot



Developing economic policy that is dominated by GDP goals can lead to unintended and suboptimal economic and social outcomes. There are a number of very specific examples of how GDP misguides policy decision on matters such as economic activity, value and well-being.

A case in point: IHS estimates the cost to produce a 16 GB iPhone 6s Plus is \$236. Because the device is exported to the US for the manufactured price of \$236 and sold in the US for \$749, value added in the US or contribution to US GDP equals \$513 ( $\$749 - \$236$ ). That is, the value added by U.S. advertising and the 19 year-old sales consultant is \$513 to GDP for every iPhone sold. This is without any production carried out in the US.



The shortcoming in value addition does not end there. The entire \$513 is counted towards GDP in the US, but 40% of US corporate bonds and 15% of US equities are foreign owned. The returns of these assets are in the hands of non-US domiciled persons and one would expect that these returns are expatriated. So even though the expatriated profits would contribute to the wellbeing of another country, it is still counted towards GDP in the US, by the value-addition approach. In the case of the South African equity market, foreign ownership of the JSE stands at around 40%, much higher than that of the US. Corporate profits earned by firms on the JSE all count towards local GDP, even though 40% of JSE returns contribute to the well-being of citizens in other countries.

GDP diverges from reality even more when the \$236 iPhone is exported to tax free countries such as Bermuda, or to a low tax country, such as Ireland at the cost of production, then marked up to \$700 before it is exported to a third country where it is sold for \$749. Gross Value Added or Gross Domestic Product in the transit country would have increased by \$474 without any addition to value other than an accounting mark-up. This approach to GDP makes sense only to economists but very little sense to the Bermudan who expects her well-being to have increased because GDP reflected growth.

Gross National Product (GNP) or Gross National Income (GNI) does indeed discount GDP for profits earned by foreigners that are not locally resident. GNP is not typically as widely published nor as widely used in the determination of the health of the economy as GDP. Ireland does calculate GNP, which is about 20% lower than GDP. Counting GNP makes more sense for a country such as South Africa, that is so heavily dependent on portfolio flows into equity and bond markets. GDP and GNP do not always move in the same direction. Quarter 1, 2015 saw US GDP decline by 0.2% but GNP increased by 1.9%. That is GNP increased by more than \$300 billion at the same time of a declining GDP.

## Not All That Can Be Counted Is Important



Then there is the issue of things that GDP does not count. The Internet, to me, is the most important innovation of my time. It has toppled governments, accelerated research and development, reduced the cost of education and increased educational effectiveness. Were it not for the Internet, we would still be trying to decode the genome. In the world of Internet, Google and similar search engines, are the single most important service. Strange then that the universal measurement of living standards, GDP, ignores the value of Google in its measurement of living standards.

In fact, at times, GDP moves in the opposite direction than that of living standards. A case in point: If googling the Internet involved some type of subscription cost, it would contribute positively to the GDP, but because the service is free, it does not. But if the price of Google increases, *ceteris paribus*, living standards would decline because the size of the basket of goods and services that can be afforded is reduced. Odd then that to increase GDP, we would need to decrease wellbeing.

This is true for the sharing economy in general, the true sharing economy that is, not the one that masquerades as sharing such as Uber or AirBnB. These type of firms do not share any more than my local video store shares rental movies with me, or any more than the Protea hotel chain shares rooms with their patrons. Just because many small providers make their wares available online at a cost, does not (in any way) make it a sharing economy. But I digress, back to GDP and its peculiarity. If my neighbour and I live in our own respective paid up homes, there is no contribution to GDP, but if we live in each other's homes for R10 000 per month respectively, GDP increases by R20 000 per month. At the risk of belabouring the point, from a living standards or wellbeing perspective, GDP has some glaring oddities.

A statistic that has become rather topical of late is that of economic wellbeing of US households. Notwithstanding wealth creation of biblical proportions, middle income households are no better off than their parents were in the 1960s. Using GDP as an indicator for wellbeing, that may be true, but if incomes today are identical to that of the 1960s, surely by virtue of the fact that we live longer, that we developed cures to many of the diseases that would cause suffering, that we have so much more choice, that we have the Internet, and that communication with loved ones at the other end of world is all virtually free, this would imply an increase in living standards. To drive this point more aggressively, even though Augustus Caesar was worth more than \$4.6 trillion – considerably more than my net wealth – I get to experience more of the world, in greater comfort and have access to more than a 100 channels on DSTV. Oh and I am immune to Polio and Chicken Pox, he was not!

## Alternatives

GDP's popularity as a measure to understand the health of the macro-economy is found in its simplicity – a true rarity in economics – but paradoxically, it must not be used as the central indicator in the development of economic policy and strategies aimed at improving economic health and living standards. For that, it is just too simple a measure to capture the complexities of macro-economic health. Neither can the measure, on its own, be used to infer wellbeing of the citizens. It was never its intended use. Kuznets famously pronounced that the welfare of a nation can scarcely be inferred by a measure of national income.



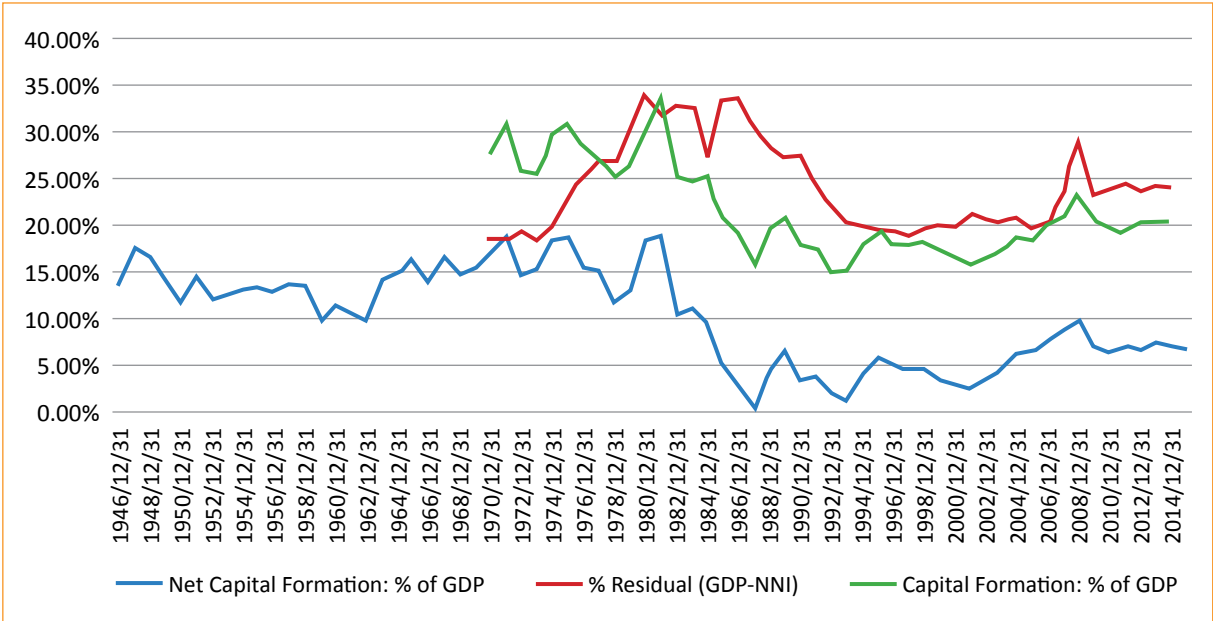
No doubt GDP is a useful number; using it for policy or insights for which it was not intended, however, could lead to poor policy decisions. One argument put forward in support of GDP is that as long as GDP's methodology is held constant, it provides sufficient insights into economic movements. The thing is, GDP might grow, but the sphere of growth might not be the spheres of intended growth. Furthermore, not all growth contributes to economic health or citizen wellbeing.

The creation of a tax haven might see GDP and GDP per capita soar, but might not contribute in any way to the wellbeing of the citizen. Cheap imports that are significantly marked up and immediately exported may present high levels of corporate profits, but add very little to economic health. While these profits contribute to GDP, they do not contribute much to the sustainable wellbeing of the citizen.

GNP gets us closer to the actual health of the economy by adding wages and income from abroad and subtracting income earned by foreign capital and non-residents within our borders. Net National Income (NNI) goes a step further by subtracting capital depreciation and depletion of natural resources from GNP. NNI's approach recognises natural resources as an asset that is used up and discounts its usage accordingly.

The red line in Figure 18 below illustrates the extent to which GDP is over stated after compensating for earnings in South Africa by foreign capital, depreciation and depletion of natural resources.

**FIGURE 1** South Africa: Economic Performance



Source: World Bank, Statistics SA & Own Calculations

## Sustainable Development



The Western Cape Government has long recognised that growth at all costs is unsustainable and that externalities must be internalised. It recognises that dirty coal energy is only more cost effective in the short-term and that eventually the cost of dirty air will have to be paid through higher healthcare costs, poor tourism growth, negatively impacting future levels of competitiveness and other payment mechanisms.

The province's strategy to develop the province as the region with the lowest carbon footprint is underpinned by internalising externalities. It makes a moral argument against borrowing from future generations by promoting and developing strategies and policies for sustainable growth.

Other countries and cities are also developing a dual approach to development and growth. The Nobel laureate and previous chief economist of the World Bank, Joseph Stiglitz, at the request of then French president, Nicolas Sarkozy, chaired the commission to address the shortcomings of GDP and to propose a different approach to measure economic health of an economy. The proposal puts forward many issues currently being explored by the OECD, which aims to include activities that contribute to the overall well-being and discount economic activities that take away from overall wellbeing in a national dashboard.

Others are promoting the Genuine Progress Indicator that compensates for pollution, externalities social ills such as, alcohol abuse and social costs. The current method of calculating economic prosperity is ever so slightly odd in that both pollution generating activities and their respective clean-up activities both contribute positively to GDP, resulting in double counting. Surely, an activity that erodes wellbeing such as pollution, must be reflected as such, vis-à-vis, the indicator must capture the costs and benefits and not only benefits of economic activity.

In conclusion, GDP is being asked to do much more than it was designed for. It was developed for a world that no longer exists. Increasing production and productive capacity was the economic goal in the midst of the Great Depression. The growth of the autobot driven services economy, transfer pricing, record levels of inequality and the dawn of the fourth wave of industrialisation, which is set to vaporise millions of jobs by the introduction of self-driving cars to robots manufacturing goods instead of people, requires a new approach to measuring economic health.

GDP (Consumption + Investment + Government + Exports – Imports) have served us well for over seventy years. To take us into the twenty-first century, what is now required is GDP+ or GDP 2.0.



# ENERGISING THE WESTERN CAPE

DR HILDEGARDE FAST

PROVINCIAL OUTLOOK

NATIONAL OUTLOOK

GLOBAL OUTLOOK

GAP HOUSING

INVESTOR NARRATIVE

SPOT THE OPPORTUNITY

PORTFOLIO INSIGHTS

KHULISA NEWSLETTER

ELECTRIC VEHICLES

ENERGY SECURITY

LOOKING AT GDP

South Africa has had its fair share of energy challenges in recent years. Even though there are signs that the energy situation is improving, our long-term energy problems will not be solved unless we use the lessons learnt in the past to implement improvements for our future.

The lessons learnt are:

- South Africa does not have enough energy to support a 4–5% growth rate, even if plant maintenance improves further and new generation comes on line.
- South Africans are still wasting a lot of electricity – and as individuals and businesses, we have the capacity to contribute to our own energy solutions.

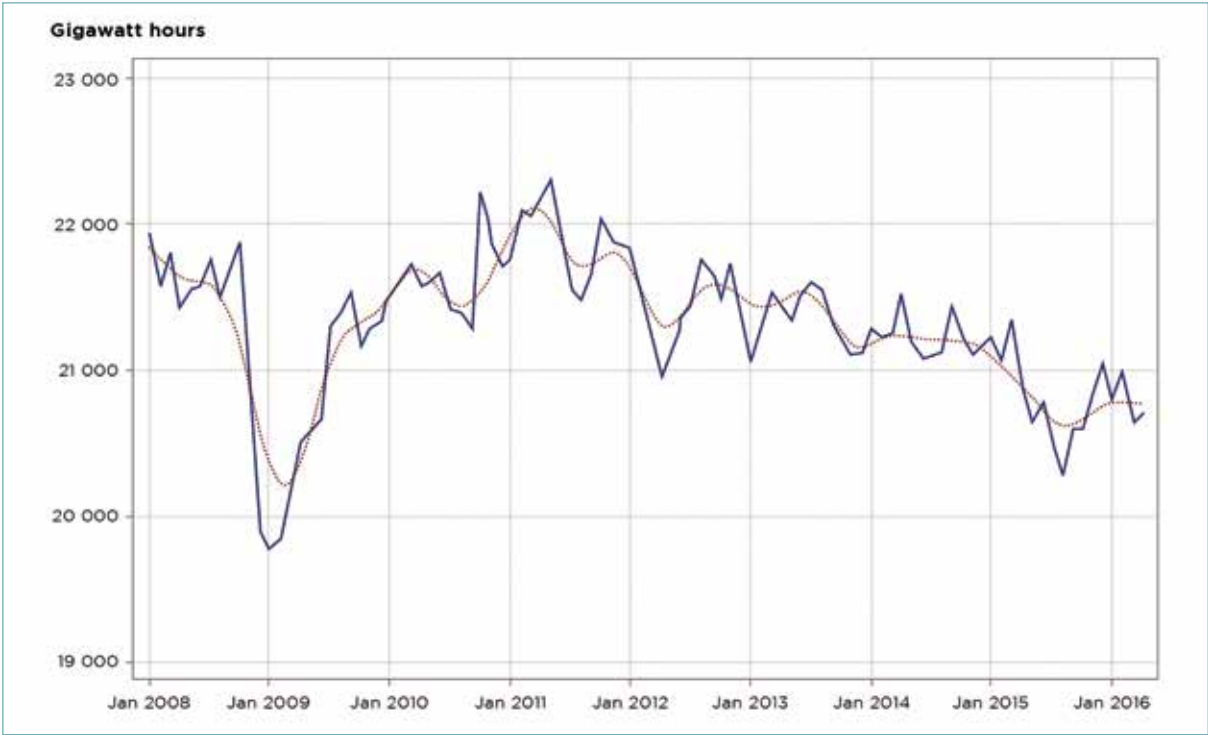
In this article, we outline the current energy challenges faced by all South Africans. We then take a closer look at how the Western Cape Government (WCG) is tackling these challenges. We go on to explain how the path to an energy-secure future depends on improved energy efficiency, more installations of rooftop solar power and solar geysers, and new solar, wind, and natural gas capacity on a utility scale that municipalities can access.

In short, we are issuing a call to action to every resident and business in the Western Cape to contribute to the energy security of the Province.

### The South African Energy Landscape

Security of energy supply is fundamental to every modern economy. As witnessed during the recurring national power outages in 2015, the disruption of electricity supply not only has an adverse impact on the personal lives of consumers, but also impacts negatively on economic growth and the credibility of South Africa as an investment destination.

**FIGURE 2** Electricity Generated in South Africa



Source: StatsSA

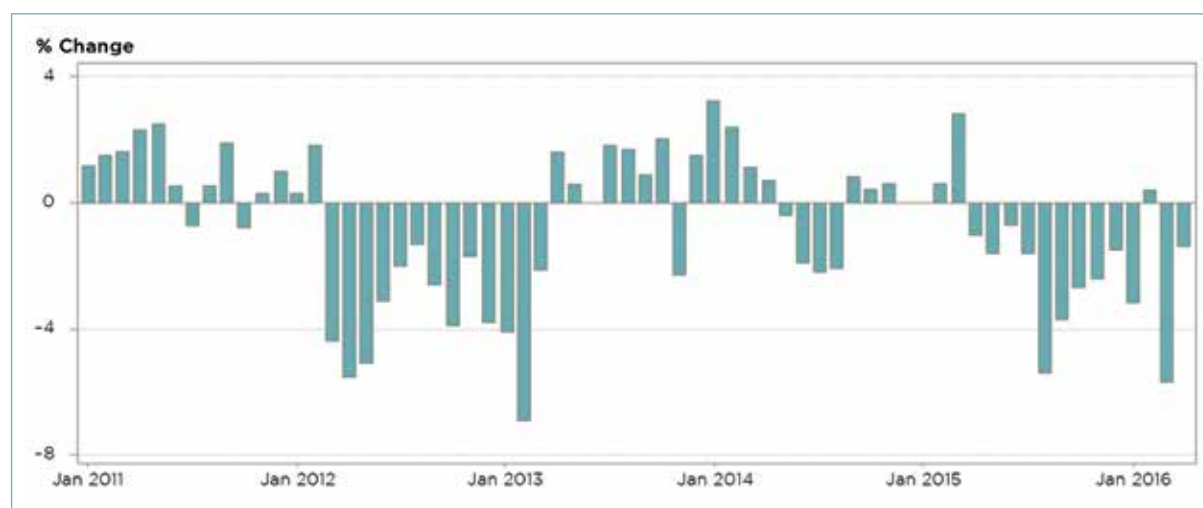


There have, however, been notable improvements in the general performance of the Eskom generation fleet in the recent past. The average Energy Availability Factor (EAF) has increased from 70% to 81% (June 2016), and the implementation of planned maintenance interventions required to ensure the continuous reliability of installed infrastructure has been consistently improving. Figure 2 above shows this improvement, which has resulted in a 0.8% year-on-year increase in electricity generation as at April 2016.

Although there is no apparent threat of imminent power outages, the short-term outlook for security of supply remains uncertain; and at periods of peak demand, the recorded reserve margins are still significantly below the desired international standard of 15% of total demand.

Figure 3 below shows that there has been a decrease in total energy consumption in recent months. According to StatsSA, electricity distribution decreased 1.4% year-on-year in April 2016; and compared with the previous three months, seasonally adjusted electricity distribution decreased by 0.9% in the three months ending April 2016.

**FIGURE 3** Energy Distributed/Consumed in South Africa



Source: StatsSA

While this step change could partially be attributed to the success of energy efficiency campaigns, increased prices and the subdued South African economy can also be directly linked to the decrease in electricity demand.

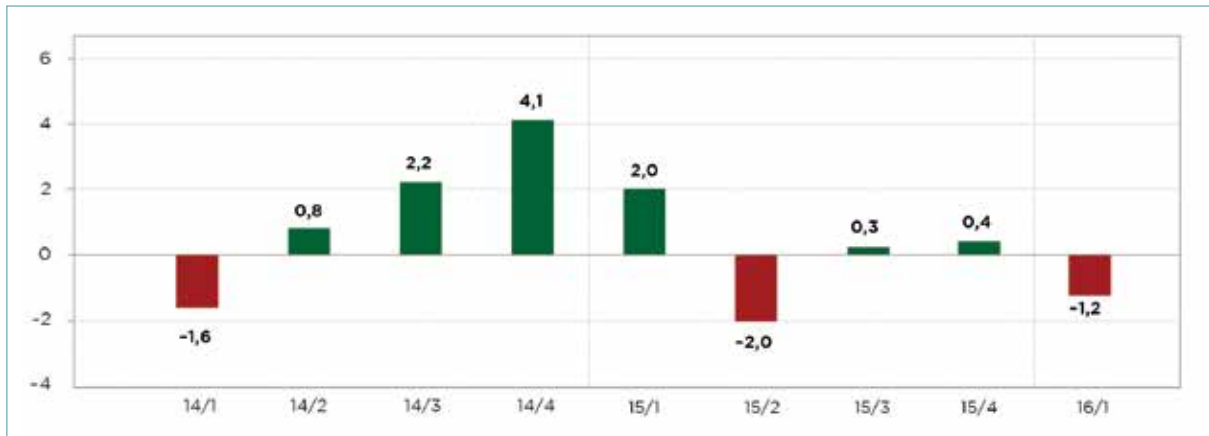
## Diversifying our Electricity System

Energy security not only relies on the reliability of installed generation, transmission and distribution infrastructure, but increasingly also on the diversity of the energy mix of the region. Currently South Africa relies heavily on coal as a primary source of energy, with over 90% of the Eskom generation coming from coal-fired power plants.

Different studies have shown diversity of fuels and technologies to be fundamental to a properly functioning and cost-effective electricity system, as it assists in balancing the benefits, risks and costs associated with producing electricity. In South Africa, there remains an urgent need to diversify energy sources, thereby incorporating cheaper, sustainable and cleaner alternative technologies.

Figure 4 below shows undesirable levels of growth for the South African economy in the past year. The adequacy of the current energy supply capacity relies on a dormant economic growth outlook, and would be incapable of supporting the type of rapid economic growth that the WCG endeavours to stimulate.

**FIGURE 4** GDP growth



Source: StatsSA

The WCG and the City of Cape Town (CCT) have identified the availability of quality, reliable and clean energy as a key strategic imperative. To this end, the Energy Security Game Changer – which is a joint effort by the WCG, the CCT and the five largest local municipalities (Stellenbosch, George, Drakenstein, Saldanha Bay and Mossel Bay) – was established. This effort seeks to ensure long-term energy security through the availability of reliable, diverse and low carbon energy to support economic and social growth in the Western Cape. Already half of the Western Cape grid is supplied through nuclear generation.

Successful implementation depends critically on the continuous engagement and co-operation of multiple stakeholders within both government and the private sector.

“If we want to continue on the upward trajectory of economic growth and job creation in Cape Town, we need to act now to make our city and province energy secure... We cannot leave the future of energy security in the hands of Eskom. We no longer want to merely be distributors of electricity but want to become energy creators as well.”

*Patricia de Lille, Cape Town Mayor*

*The message therefore is that there is insufficient power to support the economic growth rates that the Western Cape is aspiring to, and even a slight uptick in the economy could result in power outages. So we are not out of the woods, and a special effort is needed to change the energy landscape of the Western Cape to support growth.*

# Vision and Strategy for Change in the Western Cape

## OUR GOAL

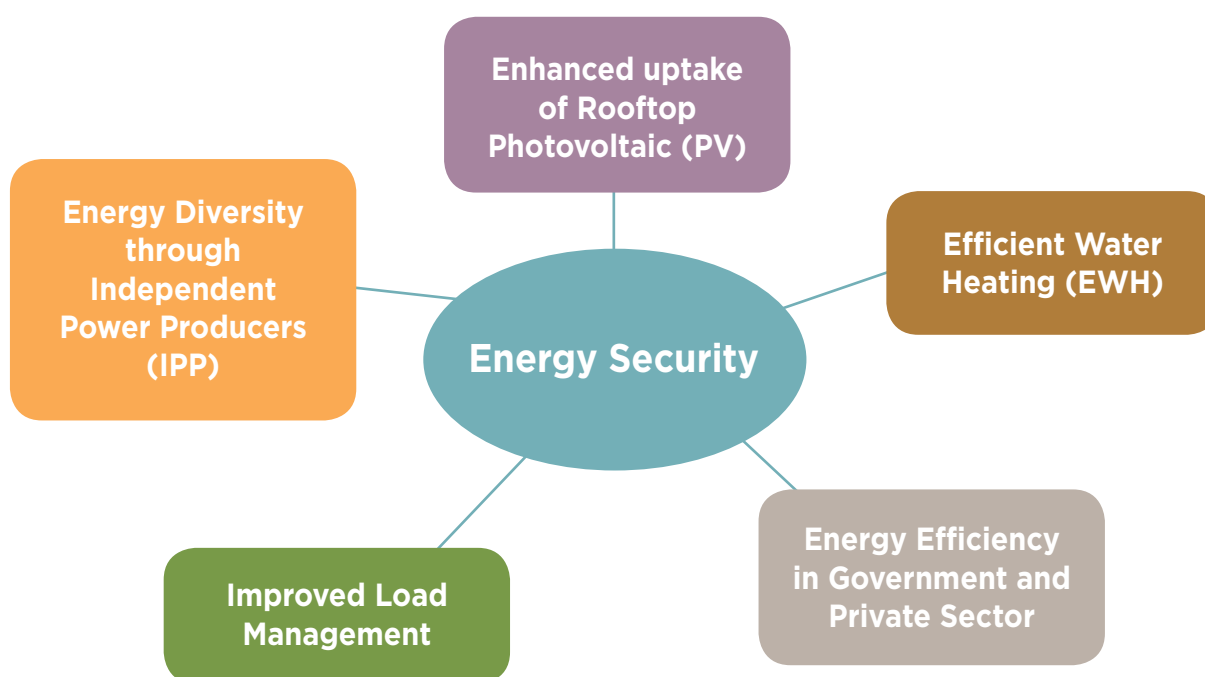
To ensure energy security that supports economic growth in the Western Cape, incorporating diverse and low carbon sources of energy by 2020.

### Levers of Change and Related Key Performance Indicators

Our Key Performance Indicator for the accomplishment of our goal is a 10% reduction in demand from Eskom. This can be achieved through five levers to change the energy demand patterns in the Western Cape. The end result will be more alternative energy, for example, Rooftop Solar Photovoltaic (PV) and Liquefied Natural Gas (LNG); and more efficient management of energy usage by government, businesses and households.

The five levers are shown in Figure 5 below:

FIGURE 5 Energy Security Game Changer Levers



Each lever has specific outcomes and targets leading up to 2020, all developed through a rigorous stakeholder engagement process.

These are outlined below:

- **Enhanced uptake of Rooftop PV:** increase the installed capacity of rooftop PV to Western Cape electricity supply to 135 MW (equivalent to the capacity of four wind farms based in the Western Cape) by 2020.
- **Enhanced uptake of Efficient Water Heating (EWH),** including Solar Water Heaters (SWH): increase the installed SWH and heat pump units to 155 000 by 2020.
- **Reduced energy consumption in both public and private buildings:** 30% reduction in energy consumption in provincial government buildings by 2020.
- **Enhanced load management:** optimally manage the electricity grid in order to reduce peak demand and minimise the likelihood and impact of load shedding.
- **More electricity generated through wind, solar and natural gas:** increased diversity of electricity supply through Independent Power Producers (IPPs) by 2020.



## Rolling out Change: Starting at the Governmental Level

### ENERGY EFFICIENCY

*Energy efficiency* has to be the first intervention by businesses and households. As a demonstration of leadership and commitment, the WCG has set an ambitious target of electricity saving for its facilities. In addition, it is testing Rooftop Solar PV and new delivery and financing mechanisms to support and speed up the necessary investment in energy-efficient technology.

Efficient water heating is a critical component of energy efficiency. Households can save on average 50% on their water heating bill if they install a solar geyser or heat pump, and the payback period can be as short as three years. The WCG is launching an extensive awareness campaign to make residents aware of the benefits of making a switch.

### ALTERNATIVE ENERGY

*Alternative energy* is another focus of the Game Changer. It is important for the Western Cape to transition to clean energy sources such as wind and solar.

It is the intention of Western Cape municipalities to buy electricity directly from solar and wind farms (also known as Independent Power Producers), because this power is cheaper and cleaner and diversifies their energy mix. The WCG and the CCT are engaging with national government to enable this process.

Another alternative to coal-fired power is natural gas. The Province is very keen on introducing natural gas – also called Liquefied Natural Gas (LNG) in its liquid form – to be landed in the Western Cape. Some benefits of using natural gas are listed below:

- It produces only 50% of the carbon emissions of coal, and its importation will therefore contribute to our climate change targets.
- It can be used in a variety of industrial processes. It burns more cleanly than its alternatives (such as coal and heavy fuel oils) and can be cheaper. If we wish to promote industrialisation in the Western Cape, while at the same time avoiding increased emissions, then natural gas is the better choice.

### ROOFTOP SOLAR PV

Our strategy for rooftop solar PV is to promote significant take-up – first by businesses and then by households. While there are a number of systems being installed, it is crucial to our strategy to ensure that households and businesses stay on the grid and feed the excess solar energy back into the grid. Feeding in benefits South Africa as a whole, because the consumer continues to support grid maintenance and investment and supplies additional electricity into the grid. Additional to this is the benefit of feed-in compensation from the municipality for the consumer, which in turn contributes to their investment in PV, thus making it more cost effective.

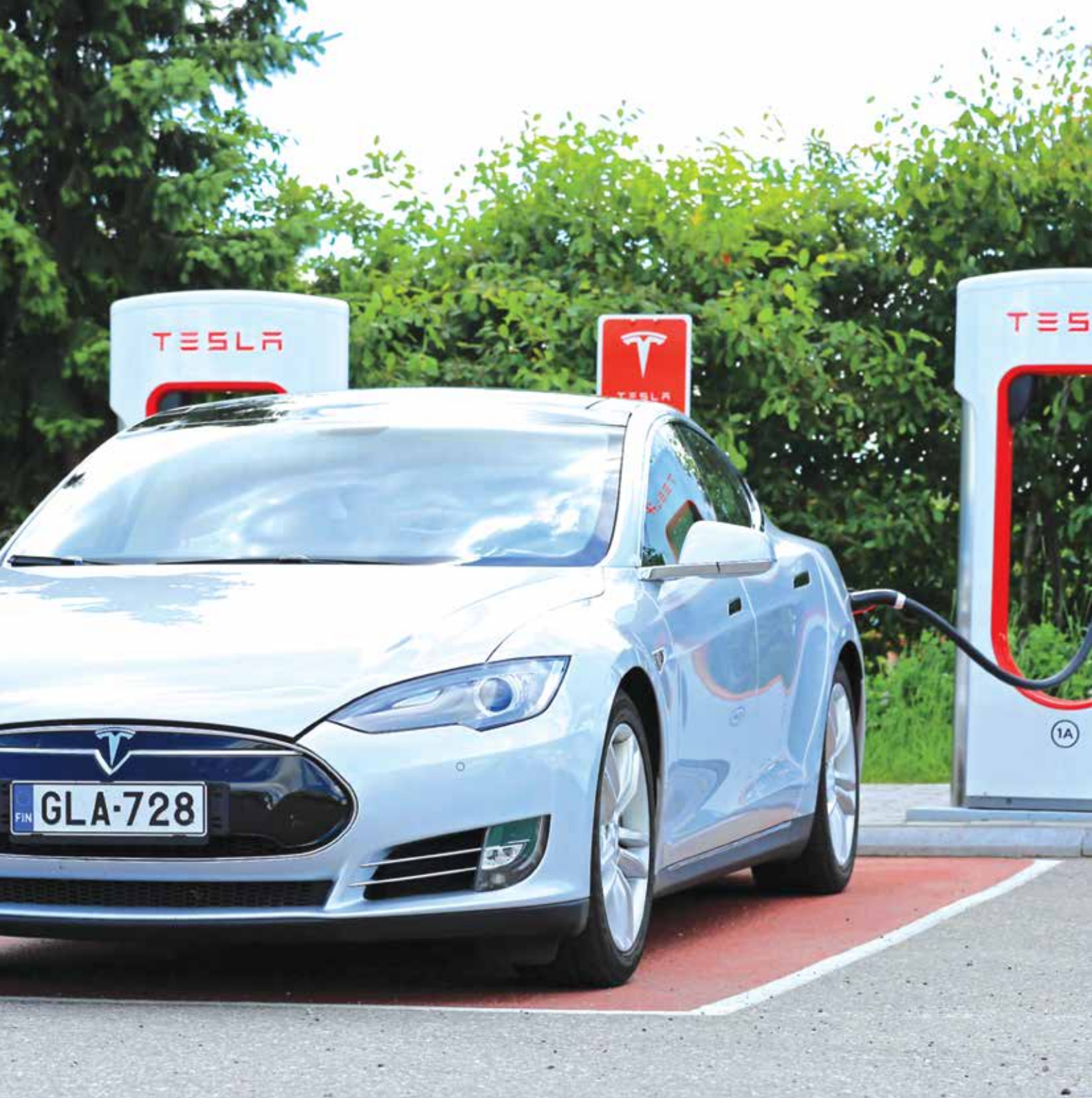
Cape Town was the first municipality in South Africa to receive approval from the energy regulator (Nersa) for a feed-in tariff for rooftop PV, and through this Game Changer, the WCG and its partner, GreenCape. Through a sector development agency that supports businesses operating within the green economy in the Province – have worked with other municipalities to put the legal frameworks and tariffs in place. The next effort will be in assisting municipalities to establish the necessary application and approval systems for rooftop PV.

## Conclusion

There are other exciting alternatives being considered. As the article on electric vehicles in this issue illustrates, 22% of all carbon emissions are produced by transport. A switch to electric vehicles can change our energy landscape, if it is accompanied by an increase in renewable electricity generation and the installation of smart grid technology throughout South Africa.

If households and businesses invest in green technologies such as solar water heaters and solar PV panels and reduce their electricity use, then together we can achieve the goal of reducing our demand for electricity by 10% and create the space for our economy to grow.

Energy security is in everyone's hands, and the Province is challenging every person in the Western Cape to find ways to contribute to an energy-secure, greener future.



# ELECTRIC VEHICLES

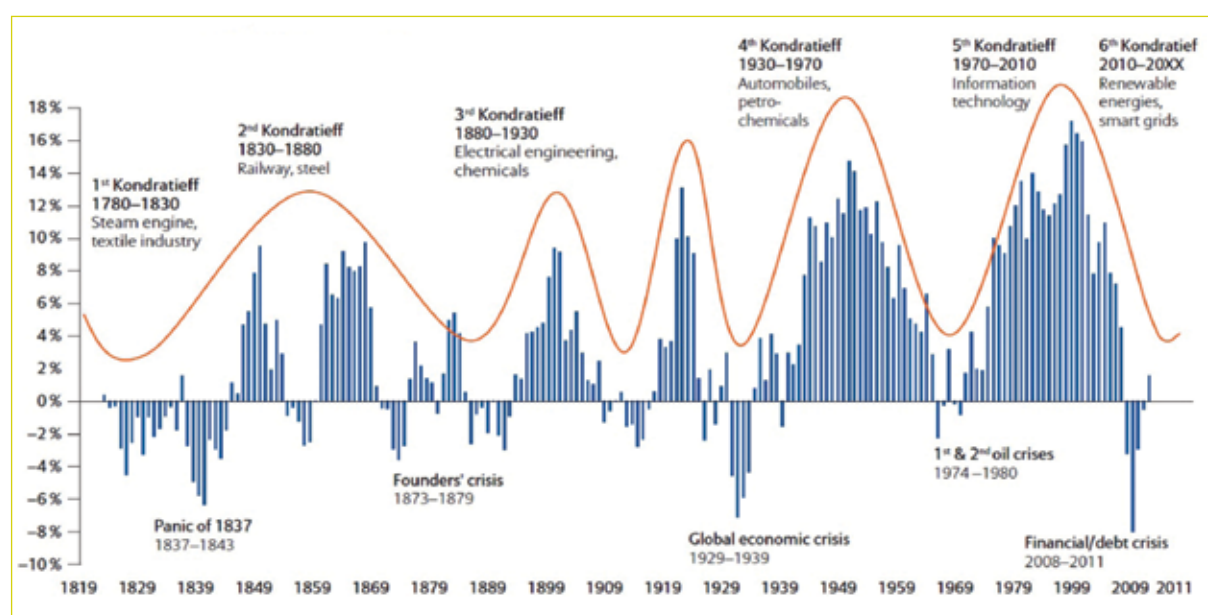
VICTORIA DELBRIDGE

“The best way to predict the future is to create it.”

Abraham Lincoln

Since the industrial revolution of the nineteenth century, there have been a string of disruptive technologies that have altered the path of economic development globally. This continual innovation was coined ‘creative destruction’ by Joseph Schumpeter in the 1900s, and describes cycles of development from the steam engine to automobiles to information technologies and finally to the current age of renewable energy and smart grids. These cycles do not happen by chance; they are a product of large private and public investment, government policies and, of course, entrepreneurial and innovative expertise. Countries and entrepreneurs take huge risks to create new technologies and see them through to mainstream production and a new era of development.

**FIGURE 6** Creative Destruction, Rolling 10-year returns on the S&P<sup>1</sup> 500 since 1814



Source: Datastream; Illustration: Allianz Global Investors Capital Market Analysis

These disruptive technologies quickly filter through to the rest of the world as they become commercially viable. Some countries seizing the opportunity to become a part of the value chain, while others who do not are forced to import the innovations in order to keep up. Those who seize the opportunities often see vast development benefits – South Korea and Japan automobile markets are not, as cases in point. However, this often requires significant risk and coordinated government policy and support.

The clues to tomorrow's revolution are often found at the fringe of society where entrepreneurs are seeing ‘crazy’ ideas turn into reality and hit mainstream markets. These entrepreneurs are the kind of people who envision fundamental equilibrium changes and address the critical challenges in which traditional markets fail. One such entrepreneur is South African born Elon Musk, who has managed to make wide-scale Electric Vehicle (EV) use commercially viable in less than six years since starting

1 The S&P 500 is an American stock market index based on the market capitalisation of 500 large companies. It is considered one of the best representations of US economic activity.

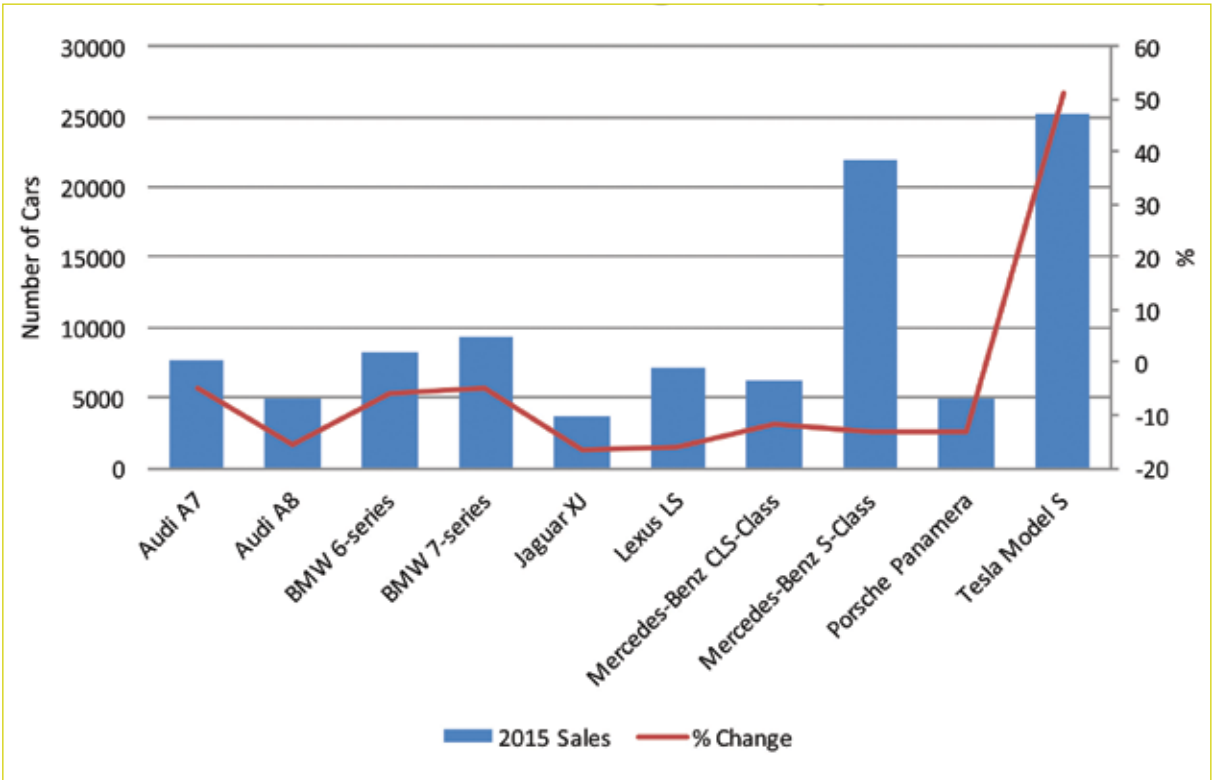


his company, Tesla. These EVs were envisioned to have the potential to entrench the viability of renewable and distributed energy generation as the future of sustainable energy. Elon Musk is a definitive example that the best way to predict the future is to create it.

### Case Study: Tesla

Tesla was founded 13 years ago to fulfil Musk’s mission of furthering the transition to sustainable energy, with cars being the first step. Tesla has shown that electric cars can be superior to petrol-powered cars in efficiency, performance and appearance. Holding true to this, Tesla became the number one best-selling large luxury vehicle in the US in 2015, with over 26 000 units sold, outperforming both classic favourites Mercedes Benz and BMW. It was also the only vehicle to have a positive change in sales in this class between 2014 and 2015, with an increase of over 50%.

**FIGURE 7** US Sales of large luxury vehicles 2015



Source: Tesla Fourth Quarter & Full Year 2015 Update (Feb, 2016)

Not only are Tesla’s sales skyrocketing, but their share of market capital is rising disproportionately. Tesla’s productive capacity is less than 0.5% of General Motors (GM), and yet Tesla’s market capital, \$33 billion, is more than 50% of GM’s \$58 billion. The extraordinarily high market cap per vehicle produced shows the confidence that investors have in Musk’s vision as well as the future of EVs. Clearly this technology is disrupting the entire automobile market.

The first idea that pops to mind when thinking of an electrically powered car is that of a glorified golf cart wandering the city streets. And yet, the Tesla Model S has Ferrari-like acceleration to 100 km/h in around three seconds and has a range of 426 km on a single charge. It also makes no sound and emits zero emissions as it moves, with many clients reporting that the experience of driving a Tesla EV is in fact better than most conventional automobiles. Tesla has succeeded in making EVs stylish instead of just being the 'green' alternative.

The infographic below shows the extent of awards the Tesla model S won between 2012 and 2014, amongst which it was honoured as the 2013 car of the year by the highly esteemed Motor Trend magazine.

**FIGURE 8** Tesla Model S Awards 2012 - 2014



DeMorro, C for Clean Technica. "How Many Awards has Tesla won". Feb, 2015. Copywrite: Evannex.

Whilst this may explain some of the leap in Tesla's sales, the fact that Tesla has outperformed traditional automobile suppliers is still surprising. Not just because it is an electric vehicle, but also because it does not have the extensive dealer network that Mercedes, BMW and Audi have, or the decades of brand building and advertising, or even the production capacity. Sales have also increased in the face of declining world oil prices, which lowers the relative cost of petrol-powered vehicles. This shows that the EV market is robust, because the choice to purchase a Tesla is currently more about taste than being a substitute for petrol-powered cars. As the price of EVs drop, however, we may see them becoming direct competition for conventional cars, further increasing their demand. This will become evident with the release of the more affordable Tesla model 3 and Chevrolet Bolt in 2017.

Whilst it may be dubbed the 'first-mover' in fully electric car production, Tesla is not the only company in the EV market. Furthermore, it is actually not even the most popular. The Tesla model S ranked third after the Renault Zoe and the Nissan Leaf, with the Volkswagen e-Golf in fourth place. However, Tesla does own around 25% of the market and is fast gaining a competitive advantage over the other manufacturers. There are a number of reasons for this competitive edge:

1. Large investment into its own battery supply chain, making its batteries a good tier cheaper than the other EV manufacturers. These batteries also have uses outside of powering EVs and thus it expands the scope of profitability of the company and opportunities for economies of scale. This underpins Tesla's position as a sustainable energy company rather than just a car manufacturer.
2. Investment in a super-charging infrastructure network, making charging EVs faster and easier around the US – combatting one of the main limitations to owning an EV.
3. The software is also far superior to the competition with over the air updates (like we get on our smartphones) and state of the art autopilot features.
4. Tesla has developed a reputation of superb customer service with integrity and morality, which has created many brand loyalists.
5. Smart business model – Tesla has captured a niche market by selling low volumes of the high value roadster. They then used the income from that to expand down to slightly lower value and higher volume cars. The plan is to continue in this fashion until they are able to manufacture a cheaper car to reach the masses.

Musk believes that the company could have a market cap equal to that of Apple's in 10 years' time, even though it currently stands at less than 4% of Apple's \$700 billion. This would seem absurd if one considers Tesla an ordinary car company, but it is much more tenable when one considers that cars are just part of the much larger technology company that Tesla encapsulates. Tesla's capacity is far more about the batteries that go into the cars than the actual cars themselves. Many top executives of automobile manufacturers are conceding that the majority of their competition is likely to come from tech companies in the future as EV, batteries and autonomous cars become commonplace. Rumour has it that Apple is in fact in the process of manufacturing the first 'iCar' to rival Tesla.

## Electric Vehicles and the Future of Energy

Last year renewable energy soared to new heights as global investments in renewables finally exceeded those into fossil fuels, reaching almost \$286 billion, and up by 5% from the previous year.<sup>2</sup> Whilst this bodes well for the elimination of greenhouse gases (GHGs) and the stabilisation of climate change, it has a number of shortcomings with regard to the consistency of supply. New battery technology has the power to help stabilise the demand and supply of renewable electricity by providing smoothing for the sometimes intermittent renewable generation, and storing it to create firm blocks of power during peak periods. In this way the EV batteries have even more important benefits than just that of fuelling EVs – they have the potential to form the basis of a reliable, integrated and sustainable power grid.

The viability of this sustainable energy system relies on the development of a national 'smart grid', which is an electricity supply network that enables a two-way communication between the utility and the household. This means that households can act as both producers and consumers of electricity and that the tariffs can be adjusted according to the relative demand and supply at the time. For example, a household may choose to charge their electric vehicle during off-peak hours and pay a lower premium, and then decide to supply some of this stored electricity to the grid during peak hours when the rates received are high. This system creates a win-win situation in which utilities can spread the load over a greater time period and households can reduce their expenditure by using electricity at different times. The model is based on 'distributed' or 'embedded' electricity generation, which highlights the movement away from a heavy dependence on centralised, base-load generating grids.

## The Global Market for Electric Vehicles

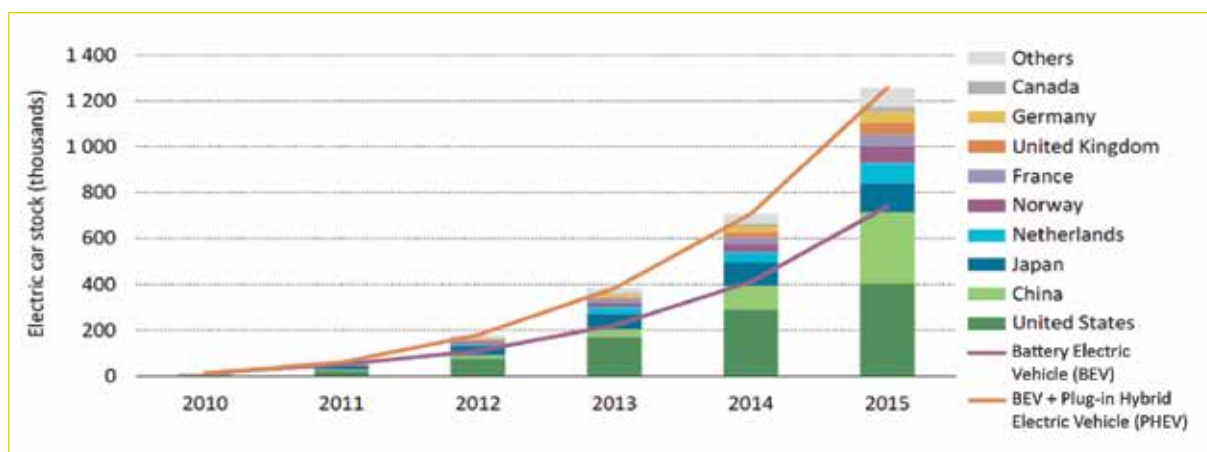
Figure 9 below shows the evolution of the global electric car stock and its exponential growth in the last five years. In 2015, the global threshold of 1 million electric cars on the road was exceeded, closing at 1.26 million. Whilst it is still a relatively small market, it is growing fast; and as supporting incentives, infrastructure and awareness are expanded in other countries, this demand is set to keep increasing.

The majority of the growth has come from the US, which has strong incentives for EV use. Depending on the state, one could be saving as much as \$10 000 on each vehicle bought. In 2015, China also entered the EV market with great force, ranking in as the fastest growing EV market in the world. The government is encouraging green cars with subsidies of up to \$8 475 per vehicle, and requires foreign automakers to develop those cars with Chinese joint-venture partners. Their growth is possibly also aided by their proximity to Asian battery manufacturers such as Samsung, LG and Panasonic. Battery manufacturing is possibly the single most important aspect of the EV, and is the key to its competitive success in the future. China is also home to the greatest deployment of e-scooters and electric buses.

2 McCrone, A., et al., Global Trends in Renewable Energy Investment 2016, Renewable Energy Investments: Major Milestones Reached, New World Record Set, Frankfurt School-UNEP, in collaboration with the Centre for Climate & Sustainable Energy Finance and Bloomberg New Energy Finance, 2016



**FIGURE 9** Evolution of the Global Electric Car Stock, 2010 - 2015



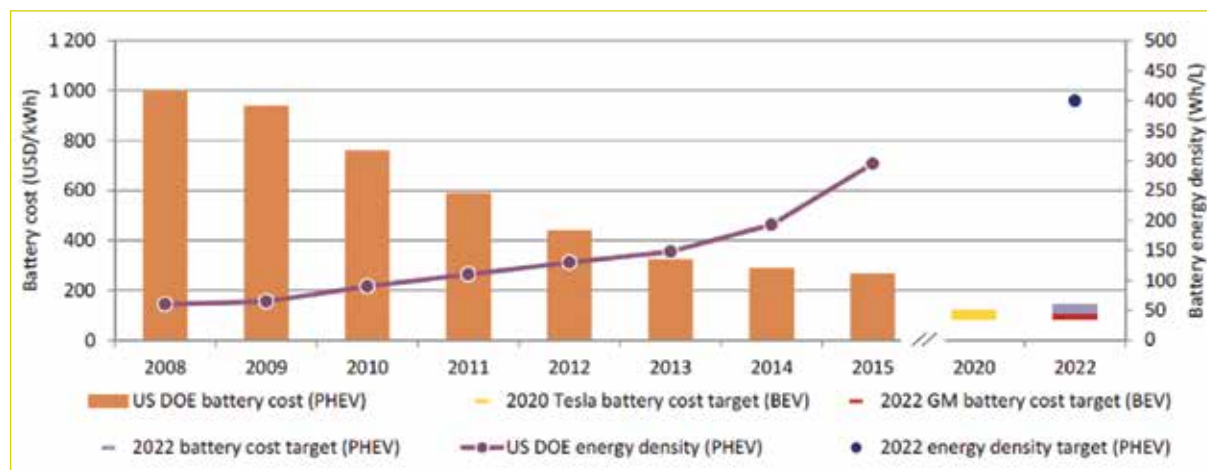
Source: Global EV Outlook 2016

Germany's small share shown in Figure 9 above does not bode well for their status as the automobile hub of the world. Although the German government was hesitant at first, the enormous response to Tesla's pre-order campaign for the Model 3 melted any remaining doubts about the urgent need for action. The Germans have thus developed an EV incentive scheme that gives a rebate of EUR4 000 for a battery-electric car and EUR3 000 for a plug-in hybrid. In exchange, car makers agreed to pay half the costs of the subsidies and step up investment in research and development of batteries and other technology. This will only apply to cars costing less than EUR60 000 so as to ensure it is not a subsidy for the rich. The support for EVs is similar to the policy stance Germany took in the 1960s when they protected Airbus, the large jetliner manufacturing company, to protect aviation jobs and prevent the US building a monopoly in the industry.

Whilst not yet on the charts for having a large stock of EVs, developing economies like India and Brazil are also paying significant attention to expanding the demand for and local production of EVs. Brazil has implemented tax cuts for locally produced EVs, and slashed import duties on their required parts. Furthermore, they have significantly reduced import duties on importing whole EVs in order to stimulate demand for these vehicles and subsequently attract investment for local production. India has plans to operate off of 100% electric transport by 2030. Incentives have been set out under the government's Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles (FAME) programme launched in April 2015. Incentives of up to \$457 will be on offer for new electric scooters and motorcycles, and subsidies of up to \$2 177 will be available for new electric cars. This could see the cost of EVs dropping by as much as 15%.

The competition to the US is welcomed because more competitors will further drive down the cost of EVs, making it a sustainable and viable technology that is accessible to a much wider range of people than it currently is. This is not far from being a reality, as the cost of the batteries (the most expensive component) drop and their energy density improves. It is projected that EVs should reach purchasing price parity with petrol-powered vehicles by 2022. With lower operational costs and declining initial investments, prices are set to favour electric vehicles in the future and further increase the demand for these vehicles.

**FIGURE 10** Evolution of Battery Energy Density and Cost



Source: Global EV Outlook 2016

The impact potential of EV adoption in Africa as a whole is also interesting in terms of energy security. Vast tracts of the continent lack formal electricity infrastructure and national electricity grids. Leapfrogging straight into decentralised generation could save significant development costs, in the same way that many African countries skipped investment into telephone lines and straight into mobile phone networks. This, if properly regulated and implemented, could result in cheaper and cleaner electricity generation for EV use as well as battery storage for general energy use – fast-tracking sustainable energy development in these countries. EVs also require lower maintenance, which makes them more feasible in countries without the facilities for constant servicing and reliability checks.

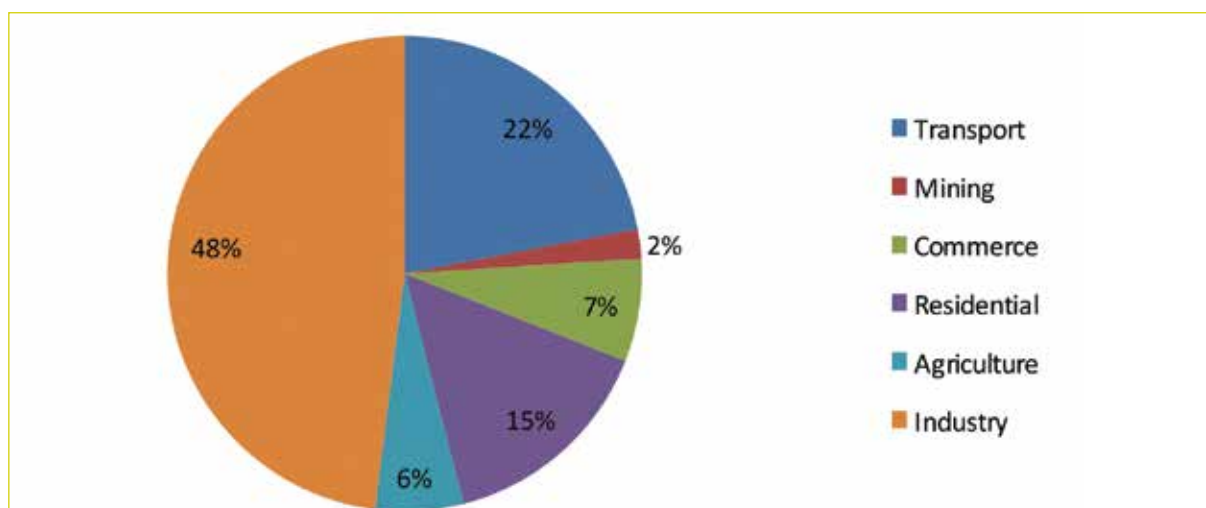
### The Market for Electric Vehicles in South Africa

South Africa is the thirteenth highest emitter of greenhouse gases in the world, with 22% of these emissions being contributed by the transport sector. Furthermore, transport consumes around 30% of final energy in South Africa, and this is expected to double by 2050.<sup>3</sup>

Demand for transport is increasing as urban populations and incomes rise, and thus the sector needs to become far more efficient if it is to cater for the improved mobility of an increasing number of people in the future, whilst also not increasing the total country emissions. This is especially important in light of the recent international climate negotiations and imminent carbon tax implementation.

3 Dane, A., The potential of electric vehicles to contribute to South Africa's greenhouse gas emissions targets and other developmental objectives: How appropriate is the investment in electric vehicles as a NAMA?. Energy Research Centre, University of Cape Town, 2013

**FIGURE 11** Source of Carbon Emissions in South Africa



Source: Department of Environmental Affairs and Development Planning. 2007. Sustainable Energy Strategy for the Western Cape.

Electric motorisation is one of many transport options that the country has been exploring in the transition to more sustainable solutions. EVs have been available for sale in South Africa since 2013, with a total of roughly 350 sold to date. The models available are the BMW i3 and the Nissan LEAF, which are imported from Germany and Japan respectively. Tesla cars are also set to start rolling in from late in 2017.

**TABLE 1** Electric Cars Available in South Africa

Car	Range	Estimated Cost
Nissan Leaf	195 km	R450 600
BMW i3	129–161 km	R595 000
Tesla Model 3	346 km	R520 000

The present low volume of sales speaks to a number of reservations surrounding the use of EVs in South Africa. These include the unstable electricity supply from Eskom, and the relatively high percentage (around 90%) of coal-based electricity feeding the national grid. There are also concerns surrounding the limited range of electric vehicles as a safety hazard in South Africa, and the relatively high purchase price of EVs as detailed in Table 1 above.

### CHARGING INFRASTRUCTURE AND VEHICLE RANGE

The lack of public charging stations and associated limited range of the current vehicles available is one of the largest reasons that people are hesitant to drive EVs in South Africa, where urban distances are relatively large. It is not enough just to charge at home, we need the security of fast charging stations at workplaces and commonly used public spaces such as malls. Although investing in a national charging infrastructure seems like an intimidating task, investment in furthering EVs and public transport systems actually reduces investment needs when compared with current development trends in cities.

In line with these needs, BMW South Africa and Nissan South Africa have already formed a partnership to expand EV charging infrastructure, and in September 2015 BMW installed its first public charging station in Melrose Arch, Johannesburg. The aim is to create a national charging network, which can be used by all brands of EVs in South Africa. In Cape Town there are plans for installing public charging stations at the V&A Waterfront and Constantia Village Mall. The charging times vary from under 30 minutes for the DC chargers, and up to three hours for the AC chargers. It is estimated that at current electricity prices, this will cost around R30 per charge.

South Africa has been home to some forward thinking innovations for EV charging systems. BMW SA, in partnership with a local renewable energy company Sunworx, has designed a new solar carport charger. The aim of the carport is to produce a zero-carbon footprint when driving an EV in the interim while the national grid is still carbon intensive. Grid Cars, a South African company based in Pretoria, has also been innovating local solutions for charging stations. They have been creating charge point operating systems, as well as designing and building the actual charging points for BMW. Having an established local company already working on this lowers the cost of implementing the technology, and is beneficial in that it is being designed for South African electricity loads and constraints instead of trying to adapt international designs.

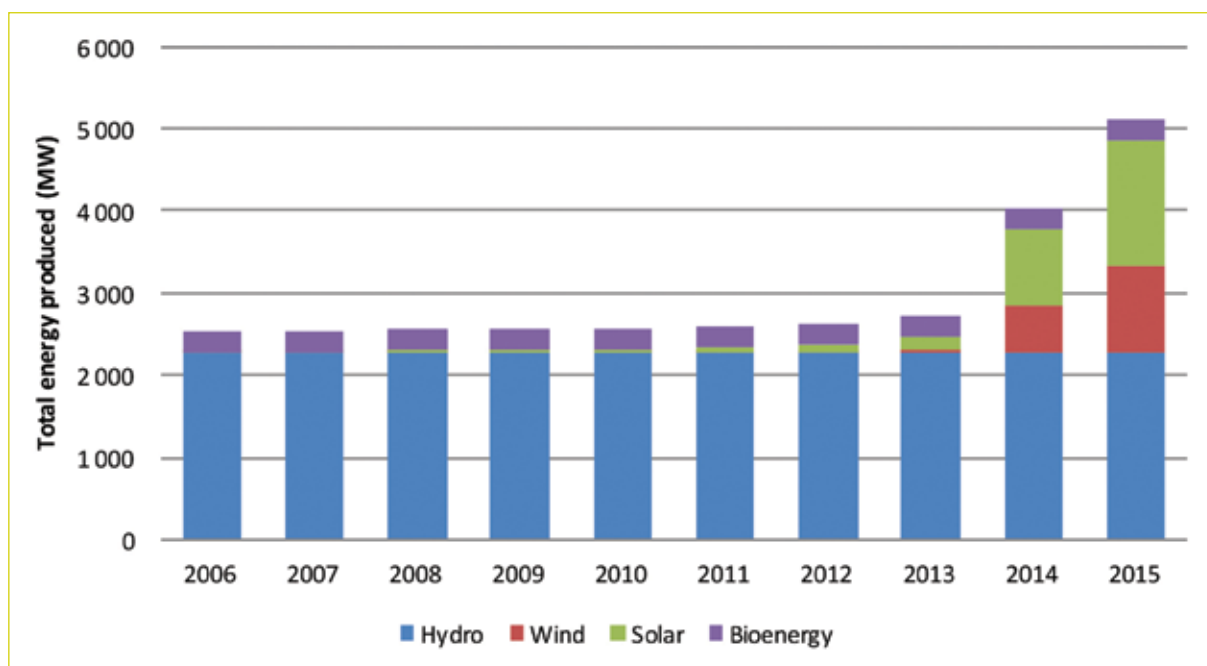
The range of the vehicles describes the distance they can travel on one charge. This will improve as EVs receive further attention and investment and the battery technology improves. The Tesla Model 3 already has almost double the range of the other vehicles. This should alleviate some of the concerns consumers have around the convenience and reliability of EVs. It is also important to note that the infrastructure required for refuelling EVs is not as extensive as the current petrol station networks. Ideally most people will be able to recharge at home and at work, using supercharging stations only on long car trips. This calls for a focus on installing charging stations along major national highways as a priority to make electric vehicles viable as both a city and long distance vehicle.

## THE NATIONAL ELECTRICITY GRID

There are concerns surrounding the source of our electricity being coal intensive and using more electricity to power vehicles as not being sustainable or environmentally friendly. This is a valid concern because coal-powered electricity has the ability to vastly increase the emission intensity linked to powering vehicles electrically. However, detailed studies show that even with our dirty energy supply, EV use is still cleaner than an internal combustion car. Furthermore, South Africa has been named one of the fastest growing renewable energy destinations over the last few years, largely due to targeted government interventions (the REIPPPP<sup>4</sup>). Figure 12 below shows the rapid increase in solar and wind power in 2014 and 2015. It is also likely that investment in EV infrastructure will actually improve both the quantity and cleanliness of the electricity supply as the battery systems improve the reliability of renewable energy sources.

4 Renewable Energy Independent Power Producer Procurement Programme

**FIGURE 12** Renewable Energy Capacity in South Africa



Source: IRENA 2016

Apart from the carbon intensity of our current national electricity grid, there are also concerns around the reliability of the electricity supply. In response to this Eskom has invested in a number of BMW i3s in an attempt to better understand the impact of EVs on the national grid. The cars are being driven by a task team with mobile charging stations as they try to map out how they will need to support the growing EV market. This support will be in the form of setting specialised EV tariffs and extending electricity supply to charging stations. Perhaps it will also speed up the implementation of a smart-grid in South Africa.

Investment in smart metres is already underway in a number of municipalities in the Western Cape. Whilst these will not update on real time, they will have different tariffs specified at different times of the day, allowing consumers and Eskom to better manage the demand for electricity and the prices paid. It will also allow households to become producers of their own electricity, fostering decentralised electricity supply. This consumption smoothing effect combined with the rapidly increasing investment in utility scale renewable energy stands the country in good stead to be able to support a growing number of EV users.

### PERCEIVED PERFORMANCE

The average citizen knows very little about electric vehicles, or if they do, many still picture the failed attempts in the twentieth century. The perception is that EVs are slower than, and not as powerful as, their petrol counterpart. As we have seen in the Tesla case study, this is simply not the case. It is therefore important that there are public awareness campaigns to improve perceptions around the performance concerns of those who prefer conventional vehicles.

Uber is currently running a promotion called *UberGreen* in the city of Cape Town, in which users may ride in a BMW i3 for the same price as the UberX. This may contribute positively to people's awareness of EVs, whilst also serving as a valuable source of data on the ease of use, range and reliability of the vehicles.

## PRICE

The current price of electric vehicles is such that only a small minority of middle and upper class citizens can afford them. This situation is worsened by the fact that the vehicles are imported and carry a 25% import duty on top of the weak exchange rate. There is also a perception that these vehicles are more expensive to run on the back of increasing electricity prices in South Africa, however officials from the National Association of Automobile Manufacturers in South Africa (NAAMSA), have found that the current running cost of petrol versus electric is 5 : 1 in favour of electric.

## LOCAL PRODUCTION

Local production has the potential to reduce the costs of electric vehicles and increase domestic demand. It also allows us to grab a slice of the global market whilst the industry is still in its infancy. Participating in the global value chain in EV production would have enormous development benefits for the country in terms of job creation and increasing the trade balance. Investing in an industry that promotes sustainable energy use is also wise in the face of eminent global carbon taxes and as finite resources become scarcer.

This opportunity was noticed by the Cape Town-based company, *Optimal Energy*, which developed its own electric vehicle – the Joule – in 2008. The car was successfully launched in Paris and attracted the interest of over 130 distributors worldwide. It was marketed as an ‘electric vehicle for the masses’ retailing at a relatively affordable R250 000. However, the company was closed in June 2012 before the car went into mass production because of its inability to secure sufficient funding. This is likely as a result of the company launching prematurely, as the risk and uncertainty surrounding EVs was much higher then than it is today.

For local EV production to attract sufficient initial investment, it is necessary that there is a healthy domestic demand for EVs. This will be aided by the infrastructure investments currently underway and the increased incidence of imported EVs. It will also be essential for government policy and incentives to support the industry in making EVs more affordable and attractive, as was done in the US as well as the other major international players mentioned earlier. Whilst it may seem to be counter-intuitive, encouraging international manufacturers to set up in South Africa can have many spill-over effects to supporting the local industry in the long run.

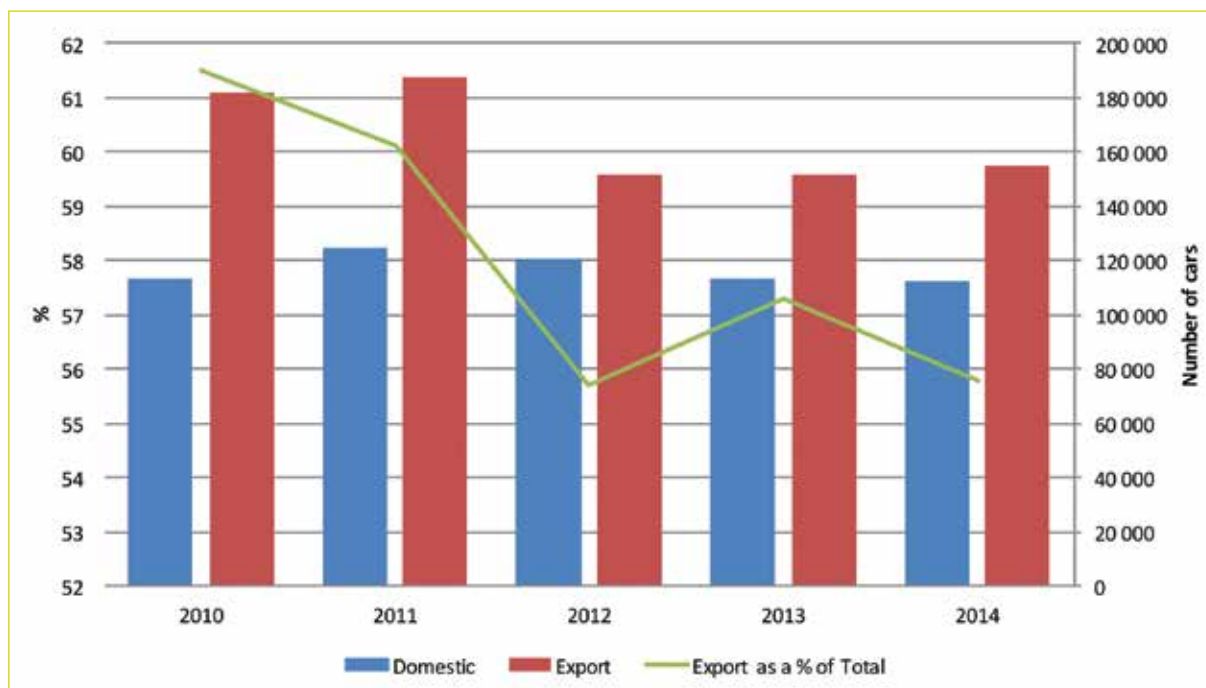
## POLICY

Government support and incentives play a large role in increasing the viability of driving as well as producing EVs in a country. In the majority of infant industries, government assistance is needed to solve coordination failures and support R&D in areas that are not already commercially viable.

Luckily, encouraging investment in automobile manufacturing is something that the South African government does best. 65% of all incentives between 2010 and 2011 went to vehicles, parts and accessories. The continued support through the Motor Industry Development Programme (MIDP) from 1995 and the Automotive Production and Development Programme (APDP) from 2013 has resulted in the automotive industry becoming the largest manufacturing sector in the country. It contributes a non-negligible 6% to national GDP and 12% of South African manufacturing exports, and accounts for around 300 000 jobs – before multipliers are even taken into account. As can be seen in Figure 13 below, the majority of locally produced vehicles are exported.



**FIGURE 13** Local Production of Passenger Vehicles



Source: South Africa Automotive Export Manual 2015

Whilst this bodes well for conventional vehicles, the support for alternative and more sustainable technologies has been less successful. Currently, South Africa is investing in the exploration of too many technologies instead of focusing on becoming competitive in one. This is inefficient as many resources are spent on R&D in various fields, leaving few funds available for supporting a particular technology into production – the Joule as a case in point.

In 2013, the Department of Trade and Industry released the *Electric Vehicle Industry Roadmap* which outlines the proposed role of government in facilitating a greater local demand and production of EVs. The policy document included demand stimulation, public education, investment support and an accommodative regulatory framework. Government committed to the purchase of 3 000–5 000 electric vehicles per year from 2015. Companies who produce more than 5 000 EVs annually will be reimbursed 35% of production costs over three years. However, this is only 5% more than a normal vehicle and stakeholders say the number of vehicles to be produced needs to be lowered in the early stages in order for it to be effective. This incentive is not only available to local companies but multinational firms manufacturing in South Africa as well.

Whilst this is a step in the right direction, they have failed to integrate the EV industry roadmap properly with the ADPD and other policy surrounding automobile manufacturing. This will limit it from becoming part of the core automotive approach. The current approach rather seems to be to stay aware of developments, but not to jump in to heavy investments while there is still significant market risk and uncertainty. However, this risk is fast disappearing as more countries begin to develop their own local EV production policies, and demand continues to increase. Once the market has expanded and there is global consensus surrounding the opportunities EVs bring, the market will be over-crowded and it will be too late. The small window of opportunity for South Africa to enter the market will therefore not be around forever.

One of the other major concerns is around the very high 25% import tax on EVs. This needs to be revised at least as the industry starts out. Making EVs (even imported EVs) cheaper means that there will be greater demand for them. This will incentivise more infrastructure investment, making local production less risky. Import duties can always be implemented later, or only on certain EV classes so that we are able to create a niche market in South Africa. India, for example, has set extremely high import duties of 60% on all low cost EVs, because this is the section of the market they wish to become competitive in.

## Opportunities in the Western Cape

The Western Cape government has its sights set on becoming the lowest carbon province in the country, and the leading green manufacturing hub of the African continent. The provincial government has recognised the Green Economy as a strategic priority, which identifies and supports sustainable opportunities within the province along with a special purpose vehicle, GreenCape, to support and grow industry within this space. 110% Green is a Premier-led networking and awareness platform acting to mobilise the whole of society around the green economy. Whilst greening the province is a difficult mandate, international climate change agreements and new global carbon tax policies are fast making green technologies and investments the more attractive option.

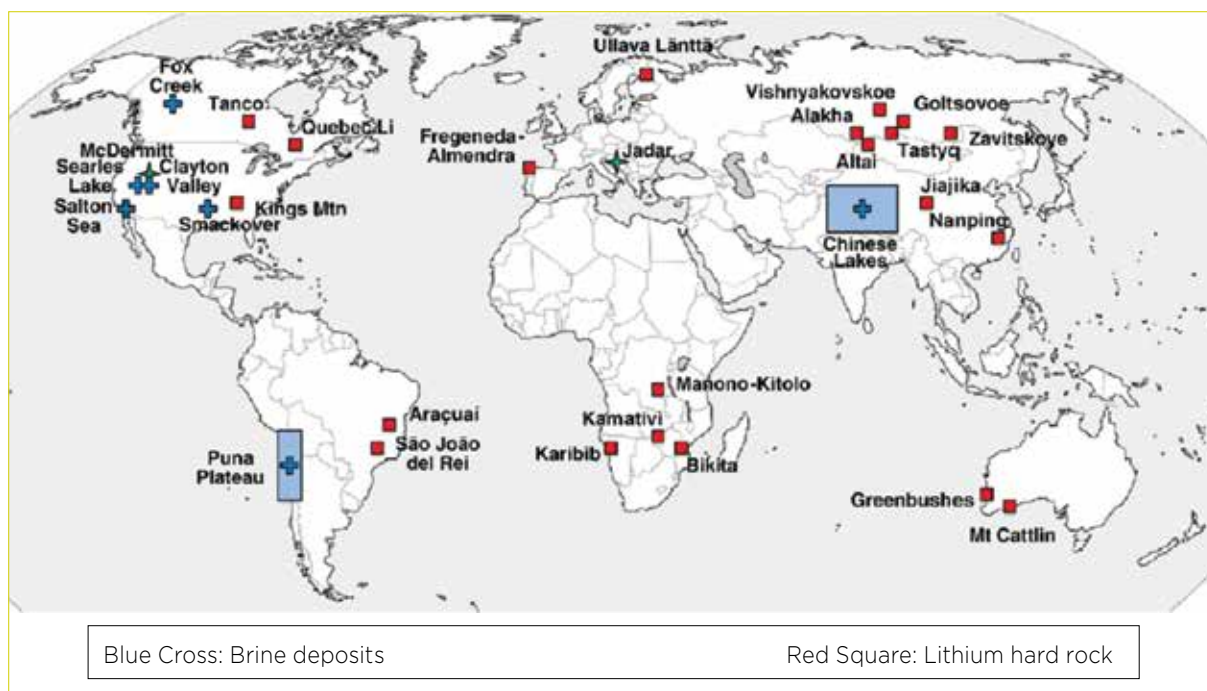
Renewable energy investment nationally has more than trebled over the last year due to the targeted support for Independent Power Producers (IPPs). The majority of renewable energy project developers placed their headquarters in the Western Cape, bringing the associated investment and expertise. In addition to this, all tiers of government in the Western Cape have worked to build the Atlantis Special Economic Zone that focuses on industrial development and employment creation in the Green Economy. This adds a new dimension to our already highly competitive manufacturing and tech industries evidenced by examples such as Hisense and The Silicon Cape Initiative, which attracts and brings together local and foreign investors, technical talent and entrepreneurs to foster the creation and growth of world-class IP start-up companies. This competitiveness is further enhanced by the depreciated Rand.

Within this context, perhaps joining the global value chain of electric vehicle manufacturing, is a budding opportunity for development in the Western Cape. We certainly have the potential from a human capital point of view, being home to the three leading universities in the country. There are also leftover skills from the Joule, which was engineered and constructed in the Western Cape. Furthermore, the government has already taken the first strides in demand-stimulation by purchasing a number of Electric Buses for the MyCiti expansions from a company in China.

The Western Cape, although not the main area of focus when it comes to OEM (Original Equipment Manufacturer) companies, is home to a number of localised automotive component suppliers. The Western Cape manufacturing contribution ranges from engine blocks to interior trims – and everything in between. These established linkages to the major car producers and the skills learnt could be capitalised on in the transition to EV production.



**FIGURE 14** Global Lithium Deposits



Source: *Global lithium resources: Relative importance of pegmatite, brine and other deposits*, Stephen E. Kesler A, Paul W. Gruber, Pablo A. Medina, Gregory A. Keoleian, Mark P. Everson, Timothy J. Wallington

Of particular interest is perhaps to take part in the supply of the lithium ion battery technologies required for the electric vehicles, as this is by far the most important component. Tesla has set up an office in Cape Town focusing on the sale of their Powerwall battery pack for domestic consumption. A company called *Batco* is manufacturing similar batteries in Atlantis. Whilst this battery is for household use, the skills learnt in battery construction may be the beginning of an industry capable of greater things. The Western Cape may have a competitive advantage in battery manufacturing due to our proximal location to Zimbabwe and Namibia, two of the only countries in the world to be rich in lithium – the foundation of the battery technology. This would be facilitated by the free-trade agreement between us and the two countries.

Despite this, there is an important limitation to the Western Cape becoming competitive in this arena – and that is achieving the scale of production required to make it cost effective. It would take years to compete with Tesla's gigafactory, which intends to more than double the world's production of lithium ion batteries. Focussing on other elements of the ecosystem such as charging infrastructure, smart metres and other components may be more prudent in the short term. Then if demand reaches sufficient scale, full local assembly would become more viable and there would be greater investment opportunity and a larger market available to tackle the battery supply chains.

The global value chains of petrol-powered cars and electric vehicles, respectively, are relatively similar apart from the lithium-ion battery used to power EVs. This means that our current advantages in component supply could stand us in good stead to expand into construction of locally produced EVs. Realistically it is going to be a long time before we can fully manufacture EVs here, and so developing the EV component supply chain in the meantime will position us well for full manufacture in the future.

For us to enter into the EV market whilst the window for market share is still open, we would need to identify a niche section of the industry in which to compete. It is likely that we would be competing with other developing countries to produce a lower cost EV that could be afforded by lower-middle income families. *GridCars* had the vision of developing a 2-seater publicly shared commuter vehicle. Capturing the African market and building vehicles to suit the specific needs of African countries could be a powerful and unique position to hold.

The opportunities for local development are also not limited to local production. Incentivising international companies to set up shop in the Western Cape brings with it head offices, consultancy jobs and skills. These all contribute to fostering the industry's success in the country as well as job creation and revenue generation. It is from these sorts of partnerships that the conventional automobile market has been so successful in South Africa.

The world as we know it is in a fundamental period of transition. In the face of climate change and rapid resource depletion, many industries have been forced to rethink their approach to be sustainable in the future. Transport is one of the most vital sectors for change because of its vast contributions to GHG emissions and its vital economic development benefits. Elon Musk of Tesla Motors identified the Electric Vehicle technology to be the most promising as a solution for sustainable transport and with an enabling policy environment, was able to create a large market for EVs when others thought it was not viable. It seems that these opportunities are within reach in the Western Cape, and perhaps greater policy attention needs to be paid to create an enabling environment for South African investors before the window of opportunity closes.





# KHULISA NEWSLETTER



Next month marks the first anniversary since Project Khulisa was approved by the Western Cape Government.

The two departments spearheading the special projects to grow agri-processing – the Department of Agriculture (DoA) and the Department of Economic Development and Tourism (DEDAT) – kicked off with their implementation plans at the start of the new financial year, after a series of consultations with our industry partners. Despite budgetary constraints, through clearly defined programmes of action and the endeavours of a solid team under the keen leadership of Dr Dirk Troskie (DoA) and Mr Goodwell Dingaon (DEDAT), we are sticking to our plans. This newsletter serves as a brief report back to our stakeholders on our progress toward creating growth and jobs in this important and vibrant sector of our economy – a more detailed report is also available.

– Khulisa team

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GROWING THE WESTERN CAPE HALAL INDUSTRY

We are working with the business community to develop our Halal industry. This is new territory for us. We are confident this sub-sector has huge potential to create jobs in our economy, and we have received positive feedback on our proposed plans. These include:

- Setting up governance structures in the Halal industry
• Optimising Halal certification systems
• Developing a Halal data and measurement system
• Exploring the creation of a Halal processing hub
• Promoting SA Halal products in key markets
• Providing SMME and PDI access to the halal value chain
• Ensuring skills supply meets demand.

Key achievements to date include the commissioning of a feasibility study into a Halal hub to determine its financial viability, and how many jobs could be created if it is built. This study is due to be completed by the end of this financial year. After this, we will consult with industry on the results, to determine whether there is appetite to proceed.

We have also commissioned a deep dive study into the full Halal value chain to determine additional areas of opportunity, particularly for SMMEs.

We are working closely with the Western Cape Government Skills Game Changer team to devise a systematic approach to determining the skills needed by industry to enable growth. We are also working with skills providers to ensure we can meet this gap.

In the next two months we will kick off our first formal Halal industry engagements. The body that has been devised will guide us as we move forward with our Halal agri-processing initiatives, ensuring that we maximise on the opportunities we are driving.

KHULISA AGRI-PROCESSING IS MADE UP OF THREE STRATEGIC INTENTS

- 1 Growing the Western Cape Halal Industry
2 Growing wine and brandy exports to China and Angola
3 Growing local capacity to produce agri-processed goods

CONTACT US

We are eager to receive your feedback and questions.

Please contact the team on:

HelenH@elsenburg.com



## GROWING WINE AND BRANDY EXPORTS TO CHINA AND ANGOLA

In collaboration with Wesgro – our trade and investment agency – and WOSA – our wine industry promotion body – we have devised a strategic plan for the year ahead to significantly ramp up exports of wine to China and Angola.

Our plans to grow wine exports to Angola are challenged by the slowdown in that economy due to the slump in the oil price. This forced us to re-evaluate our strategy in respect of this market.

Key interventions which are being jointly implemented this year, amongst others, include:

For Angola:

- Wine Seminar in Cape Town for Luandan buyers
- In-store consumer promotion and tastings in Luanda, inclusive of BEE produce
- Hosting of strategic buyer to SA Winelands
- South African wine exhibition.

For China:

- Development of e-guide on doing business in China
- Inward buying mission to SA winelands for key buyers
- Hosting of food and wine pairing networking events in China
- Participation in PRoWine China for BEE producers.

We are on track to deliver the above programmes.

Working strongly with industry, we are moving on our turnaround strategy for South African Brandy on two key levels: **Premiumisation** of the brand by means of disruption modelling, and Geographic Indicator naming through a crowd-sourcing initiative and through global benchmarking workshops. Working with the team at BrandySA, we expect to have the GI name and brand category processes completed before the end of 2016.

We are also working on a bigger project to create jobs in this space. Through the raising of the canal walls which transfer water into the **Brandvlei Dam**, we can increase water capacity in the dam by 33 million cubic metres. This would enable another 4 000 hectares to come under irrigation in the region, creating around 7 000 jobs. A strong collaboration effort is underway between all spheres of government, with a special role for the Department of Water Affairs, to execute this project. Progress is being made due to the firm commitment of all stakeholders, and we are already in the process of seeking the required funding approvals.

At the same time, we are also facilitating the development of a full strategy to promote growth in the Greater Brandvlei Area, and we are devising a system to ensure that the process of new water licence distribution promotes land reform in this region. These processes are underway.

## GROWING LOCAL CAPACITY TO PRODUCE AGRI-PROCESSED PRODUCTS

Our goal is to double the size of the **agri-processing sector**. To do this, we will need to ramp up our reputation as a producer of quality products, and to open new markets for export through the reduction of trade and non-trade barriers.

In an exciting step, we have received approval to develop a world-class **residue and quality testing facility** and have already ordered the equipment for the lab, and it is due to arrive by the end of September. The facility will be housed at the Veterinary Lab in Stellenbosch, where a series of accreditation tests will need to be performed before the facility opens its doors to industry. International accreditation is a complex process that will take approximately 24 months. Once completed, the facility will break down barriers to export, such as in the European cheese market, for which we already have a duty free quota, but currently we cannot meet their testing demands.

We have also made significant progress in driving the formation of **an inland port terminal facility** for which both a cold sterilisation and irradiation facility are envisaged. This facility is set to ease the path of key Western Cape products to external markets by ensuring that the phytosanitary protocols of importing countries can be met, and that the logistics related to passing through the port are quickened. We are facilitating the development of a private sector consortium and the response from the fruit industry has been hugely positive – the facilitation workshop is scheduled for July 2016. The IDC supports the project.

Several smaller projects are paving the way for entrants into the agri-processing environment, such as a booklet on how to start a food company, which is about to go to print. The Khulisa team is also driving general skills development in this sector. In this year, we have facilitated the training of **blockmen and artisans** to broaden the skills base in the industry. This skills training is underway.







# PORTFOLIO INSIGHTS AT THE END OF THE UNIVERSE

RUSSELL BOEZAK

LOOKING AT GDP

ENERGY SECURITY

ELECTRIC VEHICLES

KHULISA NEWSLETTER

PORTFOLIO INSIGHTS

SPOT THE OPPORTUNITY

INVESTOR NARRATIVE

GAP HOUSING

GLOBAL OUTLOOK

NATIONAL OUTLOOK

PROVINCIAL OUTLOOK

## A War of Nerves<sup>5</sup>

The last few months, gentle reader, have seen some seismic macroeconomic activities, which had – and continues to have – a direct impact on South Africa's equities.

In reverse-chronological order, the trio of ratings agencies' decision to maintain our rating one notch above sub-investment grade (Standard & Poor's BBB– Negative, Moody's Baa2 Negative and Fitch BBB– Stable) means that:

- we narrowly dodged a bullet;
- our country's creditworthiness is judged to still be sound; and
- we are still viewed as having the ability to repay our loans (both principal and interest portions).

Overseas money such as pension funds, wealth funds and sovereign (or state-owned) investors looking for a home will watch these ratings with anticipation, and use it as the sole benchmark when determining South Africa's suitability for investment. They may have no choice if their funds have a mandate that dictates that the credit rating be adhered to for investment purposes.

If we had been downgraded to sub-investment grade – or 'junk' – it would simply mean that the funding required to plug the shortfall between government's income (through taxes) and planned expenditure would have to be obtained at far more punitive interest rates.

For you and I, this would mean a possible rate hike by our central bank – the South African Reserve Bank – which would mean an increase in the cost of living because every loan we have – be it our car loan, home loan, unsecured loan, etc. – would cost a great deal more, and this – coupled with forecasted low economic growth – would mean less and less discretionary money left at the end of the month for you and I to save and invest.

Unit trusts and Exchange Traded Funds (ETF) debit orders would be suspended – if not altogether cancelled. Dips into the stock market would become less and less frequent as we try and protect our ability to meet our month-to-month obligations; and, in the long run, may dissuade us from climbing in at a time when the share price of strong, dependable, listed companies could prove quite attractive.

## The French Drop

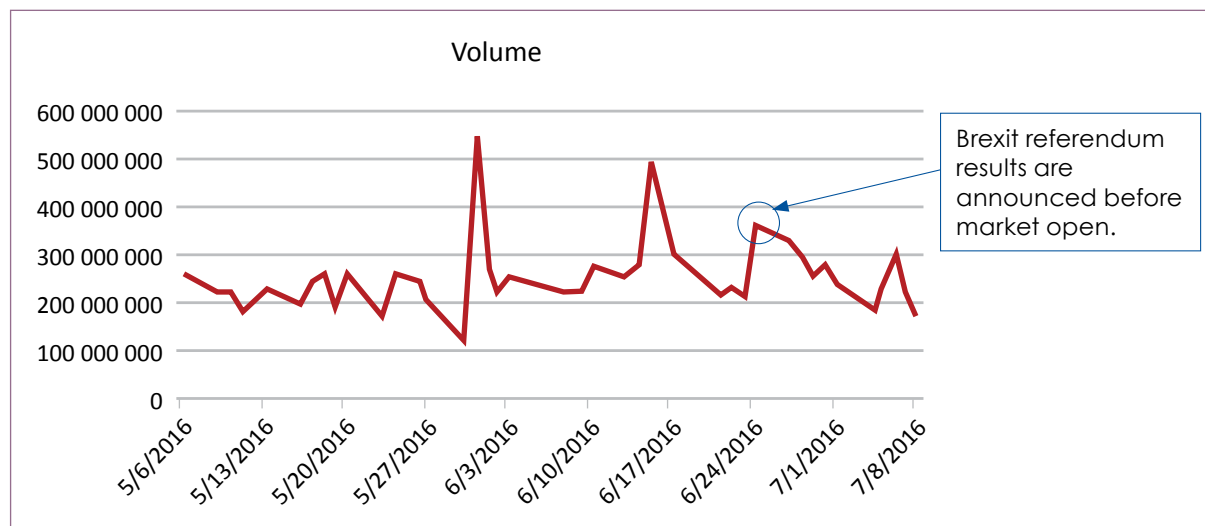
This brings us to Brexit. It showed the strength of democracy at its strongest, with the people deciding the country's future, and its appointed leaders having their mandate determined by the will of the people.

Figure 15 shows the drop in value of the JSE's All-Share Index for a full week after the result of the referendum was released.

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5 Headings refer to relevant movie titles.

**FIGURE 15** ALSI results one week after Brexit announcement



The uncertainty surrounding the referendum result was not just due to the UK leaving a 27-nation trading bloc, or that during this period, the UK parliament had only an acting Prime Minister and almost no opposition given the 172-to-40 vote of no-confidence in its leader. The problem was that because both the UK and the EU are so tightly trade-coupled to the rest of the world, it spooked the market and – as is almost always the case – led to a flight to gold, which has seen a remarkable rally in both the commodity as well as listed gold equities.

The real story, however, is not evident in the figure, and therefore could be left untold, had it not been for eagle-eyed investors watching the first hour of the first trading session on the JSE on Monday, 27 June 2016. The data above is based on end-of-day closing prices for the ALSI. Tick data (the change in the price of a share from trade to trade) of that first hour showed a drop in price of many stocks by as much as 9% – purely as an emotional response to the result. By midmorning it had recovered to previous trading day levels, before closing down again at the end of the day. This pattern was repeated (to some extent) every trading day for the next week giving cash-rich investors a great opportunity to increase their holdings, whilst simultaneously lowering their average cost price.

So that's the buying opportunity, dear reader – and I hope you had the cash and the courage to get in as much as you could.

But what is the lesson for the retail investor? The lesson could be – always support your companies. You live here, so do they. You have a far better chance of predicting the future if you are using the goods and services of our listed companies on a near-daily basis. Brexit or no Brexit – do you still buy airtime? Do you still buy toothpaste? Do you still purchase groceries, then put petrol in your car on the way home from work? Do you still pay school fees, your rent, your bond? Do you still treat yourself?

Life finds a way to move on, doesn't it and eventually, not only is equilibrium restored, but so too the upward trend of value.



## Bleak Midwinter

Despite the waffling, let us look at how our stocks have fared and update our numbers.

TABLE 2 Stock Trading

Investment	Price at 29-2-2016	Price at 11-7-2016	Change
AdvTech	1357c	1441c	+6.2%
Calgro M3	1820c	20000c	+9.9%
Jasco	77c	95c	+23.4%
Schroder REIT	2201c	2310c	+4.7%
Woolworths	8079c	8200c	+1.5%

Source: Sharenet

Despite the gloomy macroeconomic outlook, all stocks are up. This may mean that our companies are far more trade resilient even in difficult operating conditions, and – more importantly – are perceived as such by their investors.

Perhaps it could also mean that despite our weakening currency, low growth rate and even difficult foreign operating environments for our more geographically-diversified Top40 stocks, the JSE is still viewed as a viable investment vehicle by companies listed there – and investors with their money placed there – not only for return on capital, but also for return of capital.

## The Russian House

When your portfolio is being bashed about by conflicting opinions; which portfolio management behaviours could you hold on to, in order to try and make sense of where your portfolio is heading?

1. **Beat the market on the day.** Very myopic perhaps, but sometimes you cannot ingest all the news across all your channels and still make sense out of it – much less execute a trade. This is especially true if your portfolio incurs losses over a few days. If you lost less than the ALSI on the day, your portfolio is more resilient to bad news than the index.
2. **Watch the exchanges ahead of your time zone.** Sometimes the Hang Seng and the Nikkei will give you a good preview as to how your market will open. Depending on how deeply diversified you are – and your foreign to domestic equity ratio – it could tell you whether your portfolio reaction to market-open is *normal* or *abnormal*.
3. **Buy when your trading signal is Buy.** You decided on an approach in calmer waters. When stormy seas are raging all around, you must test your approach, and with every wave you ride out, you become more aware of the ebb and flow of investor behaviour. Remember, trade-time and research-time seldom coincide, and this is how it should be.

## Among the Few

In the previous edition I promised you an Excel trick or two.

Earlier I spoke about beating the market on the day. To track this in Excel, there is a feature (not well-known) to assist you. Assume that you have the following table that represents your daily return percentage for the previous day's return, and the same for the index:

	A	B	C
1	Daily Derby		
2	Us	ALSI	Δ
3	0.3%	0.0%	0.30%
4	0.6%	(-0.3%)	0.57%
5	0.1%	1.0%	(-0.85%)
6	0.1%	0.3%	(-0.21%)
7	1.0%	1.1%	(-0.05%)

To count the number of days you won, use the following formula: `=SUM(IF(A3:A7>B3:B7,1,0))`

After typing the formula, use the keypad and enter Ctrl-Shift-Enter. Your result should look like this:

Fund vs. Index Daily Derby	
Total trading days	5
Fund EOD <sup>6</sup> higher	2
ALSI EOD higher	3

With that dear reader, fill next time.

6 End of day





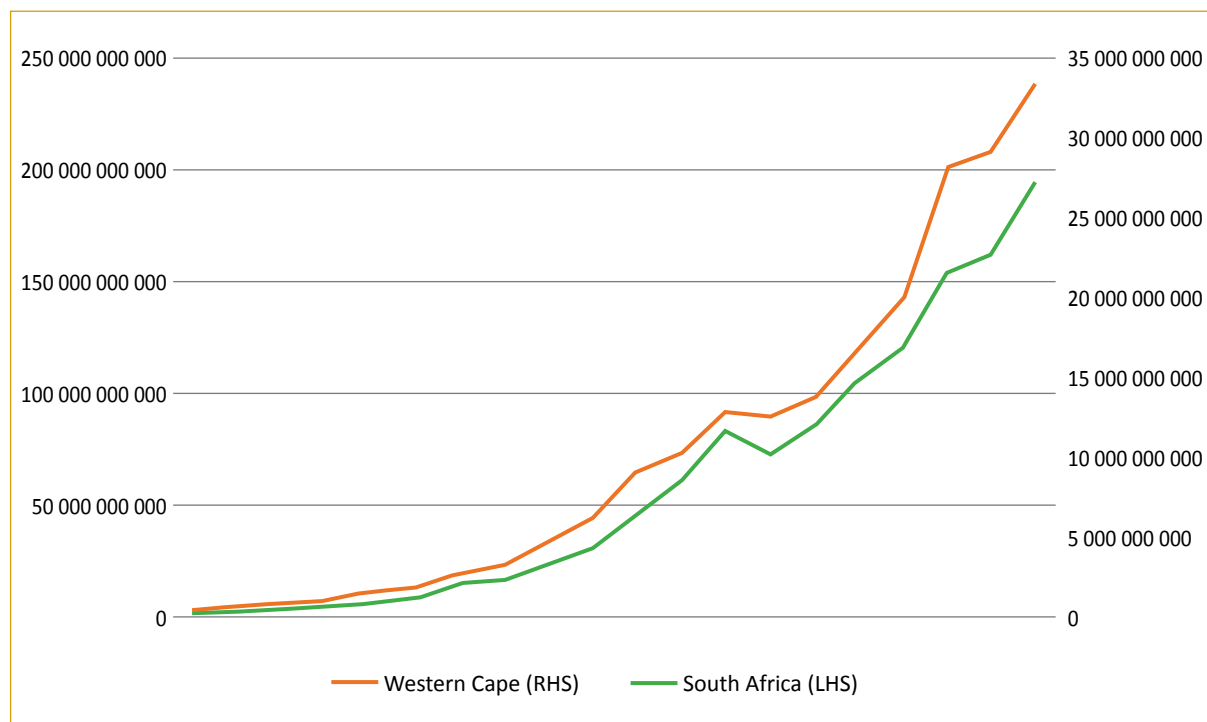
# 'SPOT THE OPPORTUNITY'

A case to bring back clothing  
and textile manufacturing

NEZAAM JOSEPH

Over the past 15 years, the local manufacturing sector has faced some of the toughest headwinds. Since 2005, imports from China to South Africa have grown by more than 500%, while at the same time imports from China into the Western Cape have grown more than 440%. Chinese imports have been driven primarily by price differentials, mainly through labour-price arbitrage. Local manufacturing industries, such as clothing and textiles, were severely affected by this. While demand for clothing and textiles grew markedly, thousands of jobs were lost, particularly in the provincial clothing and textile industry as dozens of popular firms either had to close doors or shifted from manufacturing products locally to importing clothing-related goods from China.

**FIGURE 16** Chinese Imports to South Africa and the Western Cape

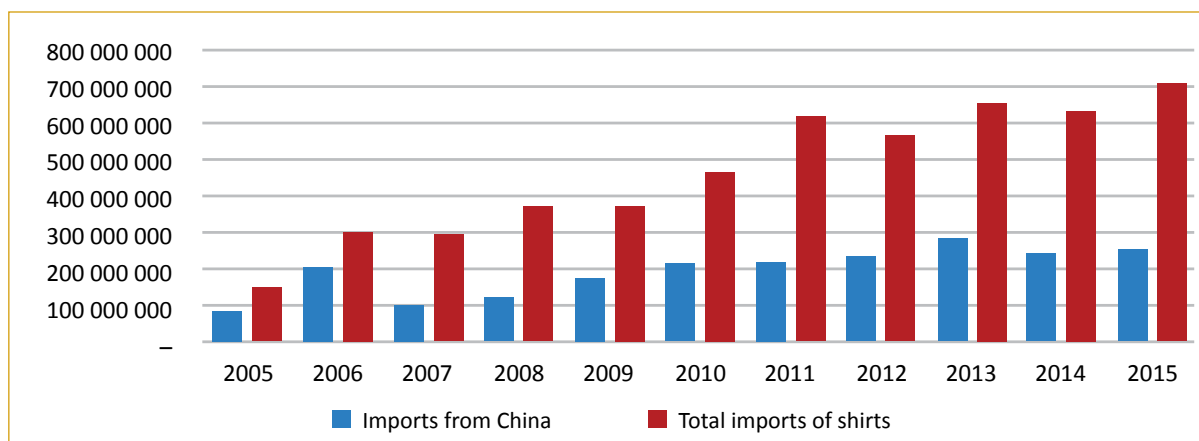


Source: IHS

Since 2005, the local clothing and textile sector grew by more than 27% nationally and 21% provincially (the markup between import and sales prices contribute to sector growth). During the same period, the sector realised a 16% contraction of jobs nationally and 18% provincially. The primary reason for job losses has been the increase in imports, predominantly from Asian countries.

The figure below illustrates the growth in imports of men's shirts from China and the rest of the world over the last 10 years. This serves as a proxy for the growth in clothing and textile imports from China. Since 2005, imports of men's shirts grew from just over R151 million to R709 million. Chinese imports of men's shirts contributes more than 30% of all said imports.

**FIGURE 17** Imports of Men's Shirts from China and the Rest of the World



Source: Quantec

Local industry cites the two primary factors driving imports to be electricity supply challenges and labour costs:

- Electricity shortages, which started in 2008, negatively impacted the competitiveness of manufacturing through sharp increases in the price of electricity and issues regarding the reliability of supply. The unpredictability and unreliability of power supply caused significant economic wastages as hordes of employees sat idly and the disruption of electric-powered public transport severely affected production efficiencies as employees arrived late for work.
- Wages increased faster than inflation, and more alarmingly, wage increases outstripped productivity increases. Higher wage increases resulted not only in higher inflation but also negatively affected the competitiveness of key productive sectors across the economy.

Imports from low cost destinations such as China flooded our markets with products manufactured with factors of production that were significantly cheaper than that of local factors. In real terms, the manufacturing sector in the province contributed less to GDP in 2015 than in it did in 2012. Industry consensus is that costs in China continue to be much more competitive than in South Africa. However, the reality is that key economic developments in China, South Africa and the Western Cape have drastically eroded Chinese production cost advantages.

## Power On

From an electricity supply perspective, Eskom has realised major improvements, and they are now easily meeting electricity peak demands without the implementation of load shedding. While electricity consumption has decreased by about 2% year-on-year to date, peak demand over the past twelve months was 34 899MW, which is 418MW higher than peak demand last year. It is not average monthly or yearly consumption that triggers blackouts, but whether peak demand exceeds peak supply. Thus, Eskom's ability to keep the lights on during periods of peak demand signals significant improvements in the national utility's ability to support households and industry.

Furthermore, during 2015, the Western Cape and City of Cape Town managed to support the grid more effectively than any other province. This was achieved through the effective management of public power usage and resulted in reduced power disruption in the province. The combination of improved supply from Eskom and the

City's management of the power grid ensures that the likelihood of future power disruptions remain very low.

When comparing South African and Chinese residential electricity pricing as a proxy for commercial electricity prices, we found that South African residential electricity prices (at just over R1.50 per kWh) are about 20% higher than Chinese residential prices. However, given the low weighting of electricity costs in total manufacturing costs, and the import tariffs applicable to Chinese imports, the case for on-shoring should remain strong. In addition, as China cleans up air pollution, energy price differentials ought to narrow.

## Exchange Rates

**FIGURE 18** RMB/ZAR Exchange Rates



Source: INet

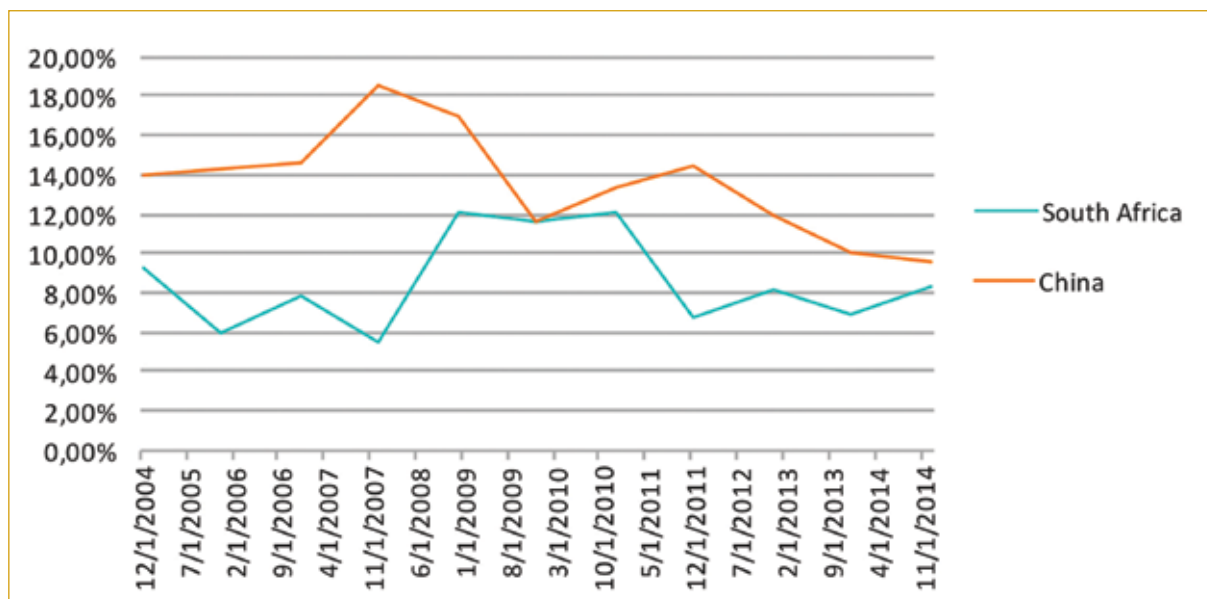
Long-term movements in the Rand have also positively contributed to local competitiveness. Because the JSE has a significant component of commodity-based firms, and because foreign equity and bond ownership is high (around 40% of bonds and JSE equity are foreign owned), foreign portfolio flows are large and volatile and have a significant impact on the Rand. The Rand is thus regarded as one of the most volatile currencies in the world. Despite this Rand volatility (Figure 18) the long-term trend of the rand has been downwards, which increases the price of imports.

## Labour Costs

Figure 19 below shows the percentage growth in wages in South Africa and China. Non-compound per annum growth has been significantly higher in China than in South Africa. The average annual growth rate in South Africa and China from 2004 to 2014 was 8.54% and 13.55% respectively. Chinese wages have grown nearly 37% faster per annum than that of South African wages.



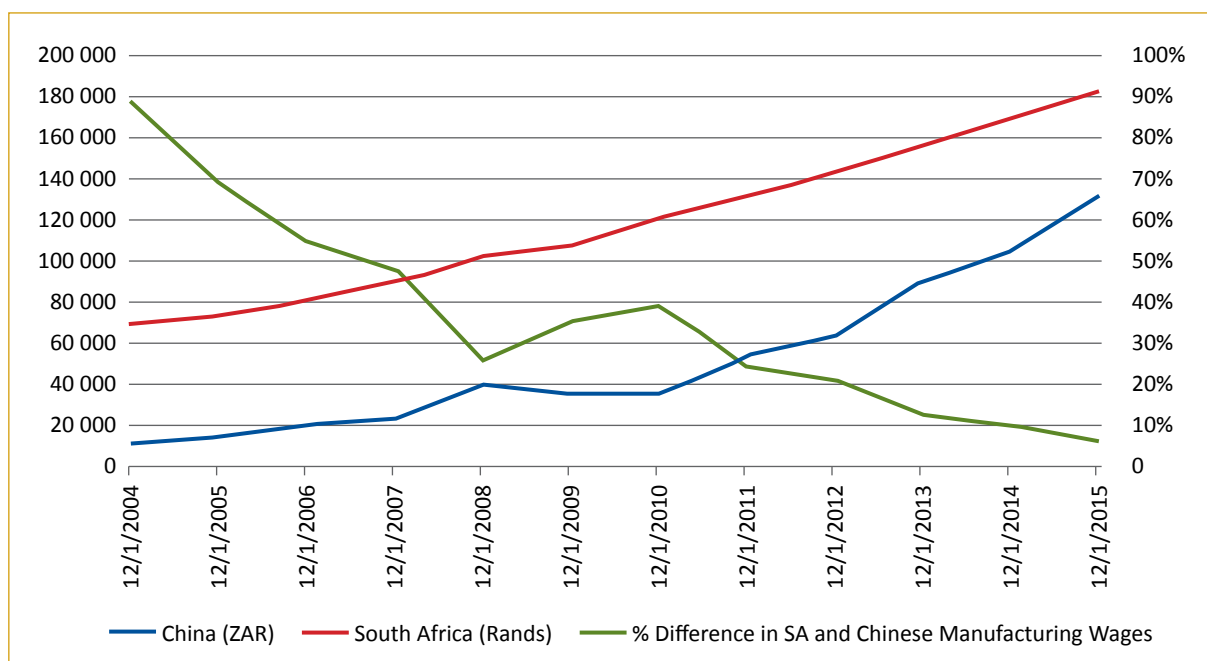
**FIGURE 19** % wage Growth in South Africa and China, 2004 - 2014



Source: Quantec, National Bureau of Statistics China, Own Calculations

Lower wage rate growth coupled with the fact that the rand depreciated by more than 67% against the Chinese Yuan between 2004 and 2016 (from RMB 1.45 to the rand to RMB 0.46 to the Rand, means that the average Chinese worker, in rand terms no longer offers significant cost advantage over the South African worker. As illustrated by the figure below, the average South African manufacturing worker earned more than five times of South African manufacturing worker in 2004. By end 2015, the premium paid for a South African manufacturing worker, in Rand terms, was only 37%. Over the last three years alone, Chinese manufacturing wages increased by 29.

**FIGURE 20** Average Yearly Manufacturing Wages for South Africa and China (Rand)



Source: Quantec, National Bureau of Statistics China, Own Calculations & IHSs



After compensating for logistics and other import tariff costs, the South African clothing and textiles industry would be as competitive as Chinese imports. This is a trend we seeing across many manufacturing industries. HiSense, which manufactures fridges and other white goods, is exploring the possibility of exporting white goods from their factories in Atlantis, Cape Town to South America. The average clothing and textile wage is 15% lower in the Western Cape than in the rest of the country, which strengthens the case for relocating clothing and textile manufacturing in the Western Cape even further.

The case forreshoring manufacturing from China is not only a South African phenomenon. A recent survey conducted in the US by the Boston Consulting Group said that 24% of firms are actively shifting production from China back to the US. If US firms are reshoring, the case for South African reshoring must be even stronger.

## Industry Support

In addition to cost drivers, the Department of Trade and Industry (DTI) offers significant assistance to clothing and textile firms. The DTI's *Clothing and Textiles Competitiveness Programme* (CTCP) aims to stabilise employment and improve overall competitiveness in the clothing, textile, footwear, leather, and leather goods manufacturing industries. Through the *Competitiveness Improvement Programme* (CIP), the CTCP promotes cluster formation through cost-sharing grants. In addition, The *Manufacturing Competitiveness Enhancement Programme* aims to provide further support to manufacturing firms. In the next edition of the QEB we will discuss these programmes in more detail.

In conclusion, it is our view that within the context of recent labour market and currency trends, reshoring clothing and textile manufacturing offers an opportunity to local manufacturers. Cost factors that drove notable increases in imports from low cost destinations such as China have dissipated. The Western Cape still has considerable labour capacity, know-how and management skills in the clothing and textile industry. These could be productively utilised and effectively outcompete Chinese clothing and textile imports.

Retailers are demanding considerably shorter production times and quicker time-to-market timeframes. Logistics from China could add more than a month to the time it takes goods to make it to retailers' shelves. With the assistance of the DTI's Clothing and Textile industry support initiatives, more agile production approaches could be employed by smaller scale local manufacturers, which would shorten time-to-market even further.

Given the growth in consumption of clothing and textiles (not only in South Africa but also in the SADC region), changes in comparative cost structures, national support to the industry, and shifts in retailers' requirements, investors will do well to consider the value proposition presented by the clothing and textiles manufacturing sector.



# WESTERN CAPE: FOREIGN DIRECT INVESTMENT (FDI) 2015

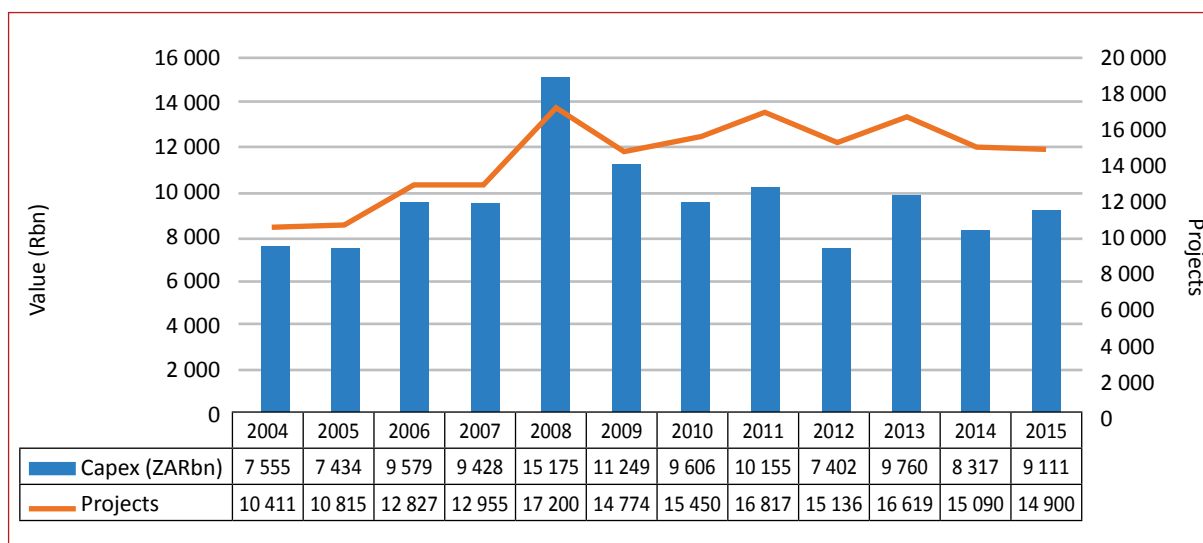
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## Global FDI trends

Global foreign direct investment (FDI) inflows increased from R8.3 trillion in 2014 to R9.1 trillion in 2015. This 9.5% increase, was mainly due to the average capex per project increasing to levels last seen in 2011, as well as a larger number of companies investing than in previous years.

Global FDI growth prospects could potentially be limited due to economic policy changes in the United Kingdom, one of the largest source and destination markets for FDI globally, owing to the United Kingdom's forthcoming exit from the EU.

**FIGURE 21** Global FDI Performance, 2002-2014



Source: FDI Intelligence, 2016

FDI flows to the Asia-Pacific region has dominated over the past few years with capex values nearly treble that received by Western Europe. Over 25 000 companies have invested into this region over the past 11 years.

FDI projects into Africa have been on the rise but have experienced a slump since 2014. The corresponding decline in capex values for the continent indicates that the projects of a high capital nature are not flowing to the continent at the same rate as before.

Western Europe remains the primary source region globally for FDI projects and capex. Nearly 30 000 companies from Western Europe have been investing globally over the past 11 years. Considering the large multinationals present in those markets it is unsurprising that the region would be the highest contributor to FDI flows globally.

North America, particularly the United States, is the second largest source region for FDI globally with a higher average capex value and job creation value than Western Europe, even though Asia-Pacific has the projects with the highest average jobs per project than any other global region.

## GLOBAL FDI MARKETS & SECTORS

### SOURCE MARKETS

The United States was the largest source of FDI, from 2003 to 2015, in terms of the number of projects invested (40 599 projects) and capital invested (R22 trillion).

This was followed by Germany investing in 16 882 projects and the United Kingdom investing in 16 245 projects.

The top five largest FDI source markets by projects, were also the largest source markets by capex.

Other large source markets for FDI in terms of the number of projects and capital value of investment across the world were China, South Korea and the UAE.

FDI flows are mainly emanating from cities such as London, Tokyo, Paris, New York and Seoul.

**TABLE 3** Top 10 Global Source Markets for FDI, 2003 - 2015

Rank	Source Country	Projects	Capex (R billion)
1	United States	40 599	22 377
2	Germany	16 882	9 087
3	United Kingdom	16 245	8 565
4	Japan	12 626	9 406
5	France	10 938	6 907
6	Spain	6 288	3 998
7	Switzerland	5 692	2 809
8	Italy	5 237	3 088
9	Netherlands	4 921	3 586
10	Canada	4 657	4 228
<b>TOTAL</b>		<b>182 509</b>	<b>123 227</b>



Source: FDI Intelligence, 2016

### DESTINATION MARKETS

China was the top destination market for FDI, from 2003 to 2015, in terms of the number of projects and capex, with investments in 17 054 projects and capital invested worth R15 trillion.

The United States is the second largest destination market for FDI projects and capex, with investments in 16 247 projects worth R8.4 trillion.

Of the top 20 markets, Vietnam and Brazil had the highest capex per project and Vietnam also had the highest number of jobs created per project.

**TABLE 4** Top 10 Recipient Countries for FDI, 2003 – 2015

Rank	Recipient Country	Projects	Capex (R billion)
1	China	17 054	15 104
2	United States	16 247	8 460
3	UK	11 691	5 519
4	India	9 807	5 987
5	Germany	8 409	2 274
6	France	5 964	1 801
7	Russia	5 071	3 830
8	Spain	4 879	2 133
9	UAE	4 139	1 668
10	Brazil	4 060	4 154
<b>TOTAL</b>		<b>182 509</b>	<b>51 111</b>



Source: FDI Intelligence, 2016

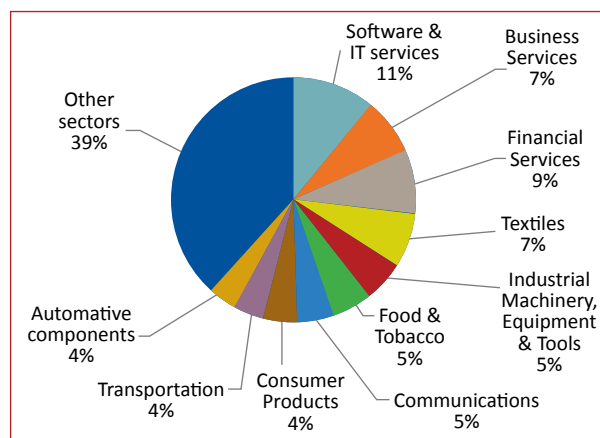
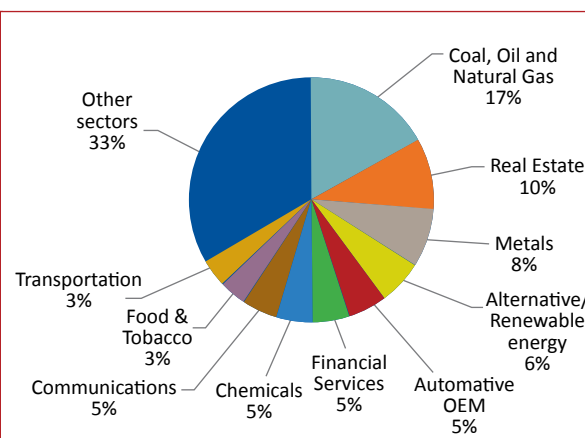
The top global destination cities for FDI were London, Singapore, Shanghai, Dubai, Hong Kong and Beijing.

The share of global FDI by sectors is shown in the figures below. In terms of FDI projects, most projects were in the following sectors:

- Software and IT services accounting for 11% of projects
- Business services accounting for 7% of projects
- Financial services accounting for 9% of projects
- Textiles accounting for 7% of projects

In terms of FDI by capex, most FDI went to the following sectors:

- Coal, oil and natural gas accounting for 17% of capex
- Real estate accounting for 10% of capex
- Metals accounting for 8% of capex
- Alternative and renewable energy accounting for 6% of capex

**FIGURE 22** Top 10 Global Sectors for FDI by Projects, 2003 – 2015**FIGURE 23** Top 10 Global Sectors for Capex, 2003 – 2015

Source: FDI Intelligence, 2016



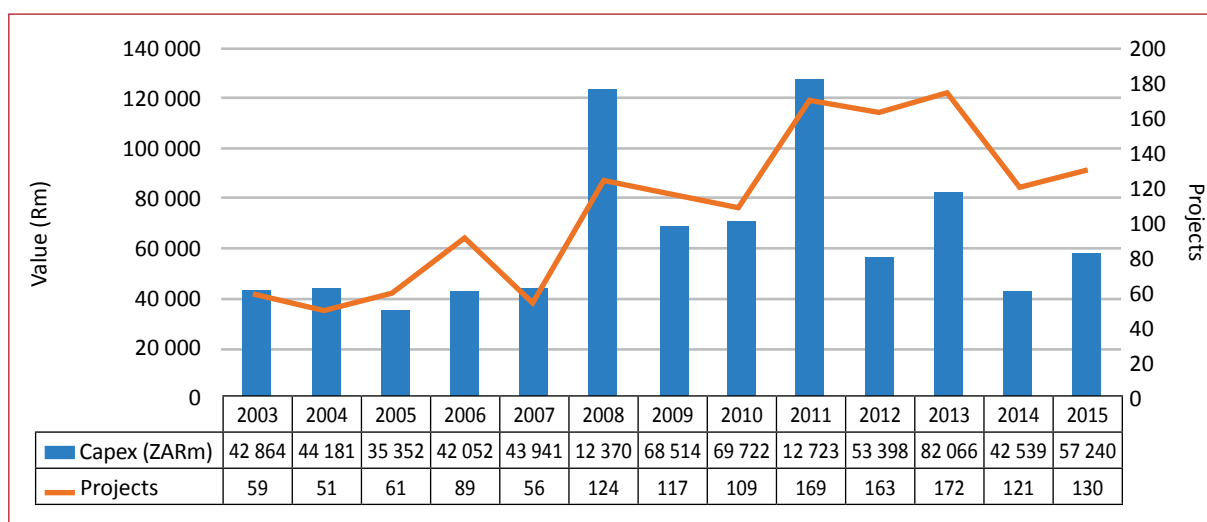
## South Africa FDI trends

### INWARD FDI

In the period between 2003 and 2015, a total of 1 421 FDI projects were recorded into South Africa. These projects represent a total capital investment of R835 billion and an average investment of R588 million per project.

South Africa continues to attract investment due to its sophisticated infrastructure and growing middle class. South Africa is also seen as a business hub for companies wanting to launch into African markets and obtain access to free trade agreements, enabling market access.

**FIGURE 24** Inward FDI into South Africa, 2003 - 2015



Source: FDI Intelligence, 2016

From 2003 to 2015, the top source markets for FDI into South Africa, in terms of number of projects were the United States (300 projects), the United Kingdom (272 projects), Germany (110 projects), India (81 projects) and China (57 projects).

These markets were also the top source markets by FDI by capital value, with the exception of Australia.

**TABLE 5** Top 10 Source Markets for FDI into South Africa, 2003 - 2015

Rank	Country	Projects	Capex (Rm)	Companies
1	United States	300	121 236	244
2	UK	272	152 715	199
3	Germany	110	70 828	79
4	India	81	61 710	59
5	China	57	24 878	46
6	France	57	29 641	47
7	Australia	51	65 023	36
8	Japan	50	27 622	39

Rank	Country	Projects	Capex (Rm)	Companies
9	Switzerland	45	27 464	32
10	Netherlands	42	15 975	38
Other Countries		356	238 731	291
<b>TOTAL</b>		<b>1 421</b>	<b>835 823</b>	<b>1 110</b>

Source: FDI Intelligence, 2015

The best performing sectors in attracting FDI from abroad to South Africa, from 2003 to 2015, by number of projects and capex are shown below.

In terms of FDI projects, most projects were in the following sectors:

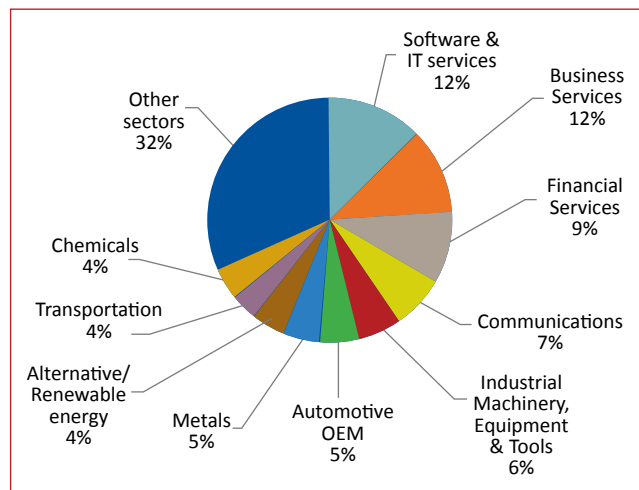
- Software and IT services accounting for 12% of projects
- Business services accounting for 12% of projects
- Financial services accounting for 9% of projects
- Communications accounting for 7% of projects

In terms of FDI by capex, most FDI went to the following sectors:

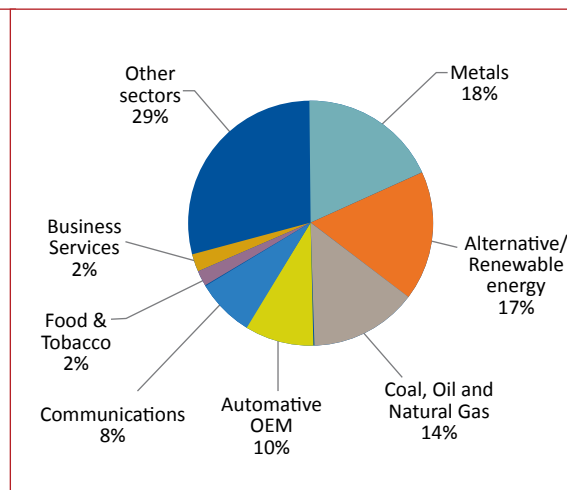
- Metals accounting for 18% of capex
- Alternative and renewable energy accounting for 17% of capex
- Coal, oil and natural gas accounting for 14% of capex
- Automotive OEM accounting for 9% share of capex

These sectors were among the top five global sectors attracting FDI, meaning that South Africa's sectors for FDI were in line with global sectors.

**FIGURE 25** Inward FDI to South African Sectors by Projects, 2003 - 2015



**FIGURE 26** Inward FDI to South African Sectors by Capex, 2003 - 2015



Source: FDI Intelligence, 2016

The FDI performance on a provincial level to a certain extent mirrors the different provinces' contribution to national GDP.

Despite being the third-ranked province in terms of contribution to national GDP, the Western Cape continued to outperform KwaZulu-Natal in terms of the number of FDI projects as well as FDI capital value. The Western Cape was also ranked as the second most favoured provincial destination, from 2003 to 2015.

The differing economic compositions of the provinces also provide an indication of the best performing sectors in attracting FDI into each respective province.

In terms of FDI attracted and contribution to national GDP, Gauteng remains the top ranked province, because of its reliance on primary industries such as mining of metals, as well as tertiary and secondary industries (to a greater degree than other provinces).

The Western Cape GDP composition is skewed towards the tertiary sector. This becomes evident in the sectors attracting FDI into the province. These sectors are the software and IT services, financial services sector, and the business services sector.

On a city-level, the top South African cities attracting FDI from 2003 to 2015, were Johannesburg (456 projects), Cape Town (239 projects), Durban (65 projects) and Pretoria (40 projects). Another city in the Western Cape that attracted FDI was Stellenbosch.

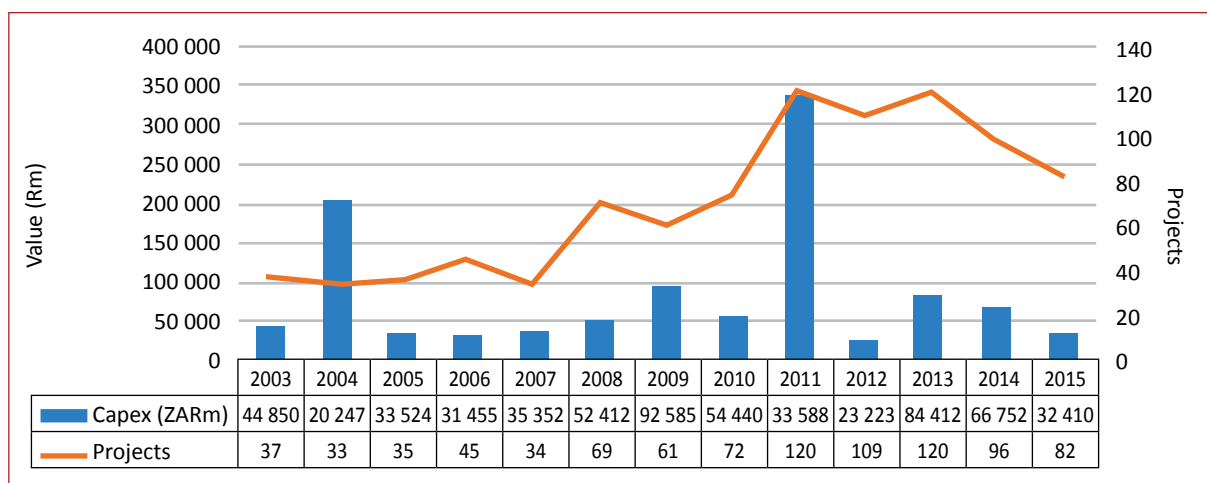
### OUTWARD FDI FROM SOUTH AFRICA

To determine the extent to which domestic companies are participating in the global arena, it is important to consider South Africa's outward investment.

Between 2003 and 2015, a total of 915 outward FDI projects were recorded. These projects represent a total capital investment of R1 089 billion, which is an average investment of R1 190 million per project.

It is significant to see that outward FDI from South Africa has grown substantially in the past five years (particularly in terms of the number of projects). This shows that South African businesses have an appetite for foreign investment and are actively seeking foreign opportunities.

**FIGURE 27** Outward FDI from South Africa, 2003 - 2015



Source: FDI Intelligence, 2015

Between 2003 and 2014, Africa was the largest global region for South Africa's FDI both in terms of projects and capex, accounting for 50% projects and 38% capex. Among the top 20 global destination markets for South Africa's FDI in terms of projects, an estimated 60% goes to Africa. This further demonstrates the importance of Africa as a destination for South African businesses.

In terms of investment projects, the United Kingdom (with 69 investment projects) was the largest recipient of FDI from South Africa. This was followed by Nigeria and Ghana, with 55 projects and 47 projects respectively. The top 10 destination markets for outward FDI lists seven African countries, showing the prominence of African markets for South Africa.

**TABLE 6** Top 10 Destinations for Outward FDI from South Africa, 2003 - 2015

Rank	Country	Projects	Capex (Rm)	Companies
1	UK	69	19 007	52
2	Nigeria	55	52 261	40
3	Ghana	47	103 106	33
4	Zambia	45	20 297	30
5	United States	43	246 263	30
6	Namibia	39	11 415	32
7	Kenya	36	6 008	34
8	UAE	35	8 953	29
9	Mozambique	33	112 358	28
10	Angola	28	8 315	16
Other Countries		485	501 799	75
<b>TOTAL</b>		<b>915</b>	<b>1 089 782</b>	<b>399</b>

Source: FDI Intelligence, 2016

The best performing sectors in attracting FDI from South Africa, from 2003 to 2015, by number of projects and capex are shown below.

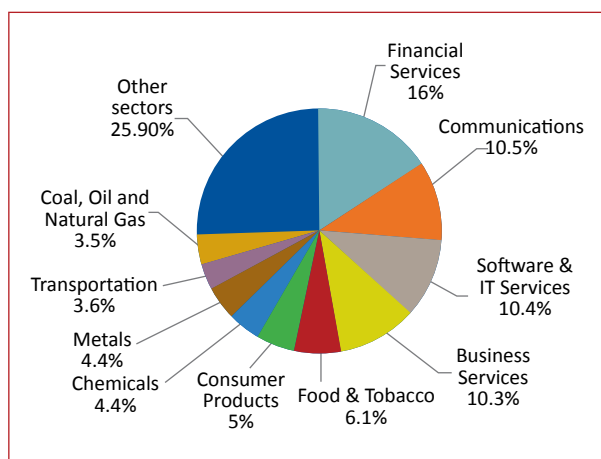
In terms of FDI projects, most projects were in the following sectors:

- Financial services accounting for 16% of projects
- Communications accounting for 11% of projects
- Business Services accounting for 10% of projects
- Software and IT services accounting for 10% of projects

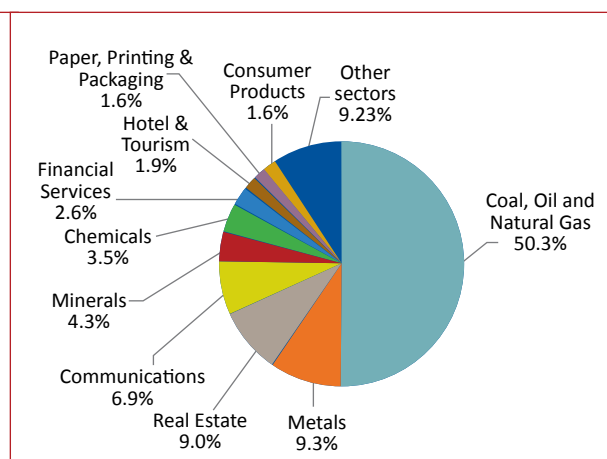
In terms of FDI by capex, most FDI from South Africa went to the following sectors:

- Coal, oil and natural gas accounting for 50% of capex
- Metals accounting for 9% of capex
- Real estate accounting for 9% of capex
- Communications accounting for 7% of capex

**FIGURE 28** Outward FDI from South African Sectors by Projects, 2003 – 2015



**FIGURE 29** Global FDI from South African Sectors by Capex, 2003 – 2015



Source: FDI Intelligence, 2016

## Western Cape FDI trends

### INWARD FDI

Between 2003 and 2015, a total of 265 FDI projects were recorded into the Western Cape with a capex value of R106 billion, which is an average investment of R401 million per project.

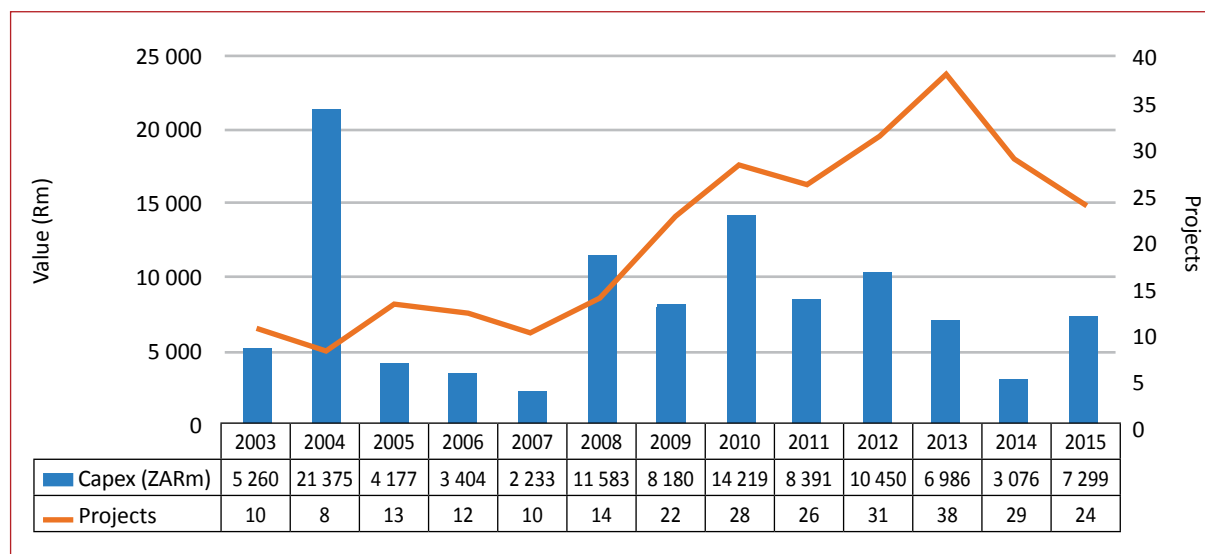
In 2015, the Western Cape attracted 24 projects, with a total capex value of R7 billion.

The Western Cape is regarded as an attractive investment destination due to the following reasons:

- Strategic position as a springboard into Africa
- Highly sophisticated infrastructure
- 2nd busiest airport (Cape Town International airport) in South Africa and 3rd busiest in Africa
- Three advanced ports catering for different sectors
- Newly designated Industrial Development Zones (soon to be introduced as Special Economic Zones)
- Availability of skilled workforce
- A growing ICT and manufacturing hub



**FIGURE 30** Inward FDI into Western Cape, 2003 – 2015



Source: FDI Intelligence, 2016

Between 2003 and 2015, the Western European region represented the largest global source of FDI for the Western Cape – both in terms of projects and capex, accounting for 56% projects and 65% capex.

In terms of number of projects during this period, the top source markets for FDI into the Western Cape were the United Kingdom, the United States, Germany and the Netherlands. Interestingly, these top FDI source markets are also top export markets for the Western Cape.

Between 2003 and 2014, the largest FDI capital value into the Western Cape were from the United States, Norway (although from one project), the United Kingdom, France and Germany.

**TABLE 7** Top 10 Source Markets for FDI into the Western Cape, 2003 – 2015

Rank	Country	Projects	Capex (Rm)	Companies
1	UK	64	15 509	60
2	United States	62	19 553	58
3	Germany	19	6 466	18
4	Netherlands	16	5 092	16
5	France	14	8 384	12
6	China	12	1 634	11
7	Switzerland	8	997	7
8	India	6	1 686	6
9	Italy	6	5 100	6
10	Canada	5	1 008	5
Other Countries		53	41 214	53
<b>TOTAL</b>		<b>265</b>	<b>106 643</b>	<b>252</b>

Source: FDI Intelligence, 2016

From 2003 to 2015, the best performing sectors in attracting FDI from abroad to the Western Cape by number of projects, were software and IT services and business services (with 48 and 47 projects respectively).

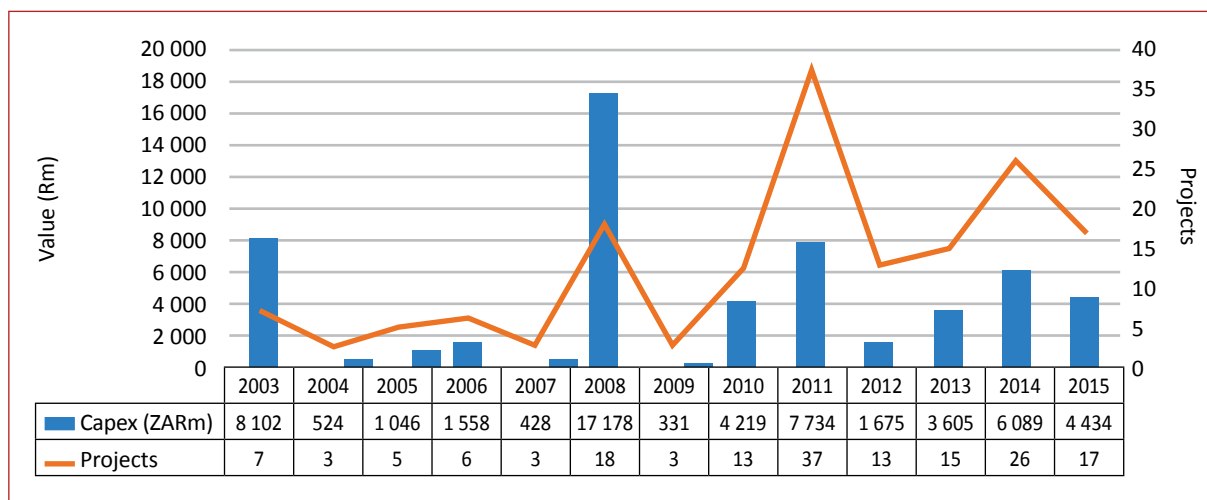
In terms of capex, the sectors that performed the best over the 11 year period were coal, oil and natural gas (R21 billion) and alternative/renewable energy (R20 billion).

The sector that accounted for the highest number of job creation through FDI activity was textiles, with an average of 284 jobs per project. This was followed by consumer goods at 281 jobs per project.

## OUTWARD FDI

Between 2003 and 2015 a total of 166 outward FDI projects were recorded from Western Cape companies investing globally. These projects represent a total capital investment of R56 billion, which is an average investment of R343 million per project.

**FIGURE 31** Outward FDI from the Western Cape, 2003 – 2015



Source: FDI Intelligence, 2016

Between 2003 and 2015, Africa was the largest global region for the Western Cape's outward FDI – both in terms of projects (86 projects) and capex (R21 billion).

The top 20 global destination markets for the province in terms of projects comprised of twelve African markets, demonstrating the importance of Africa as a destination for Western Cape businesses.

Nigeria was the largest recipient of FDI from the Western Cape in terms of FDI projects, followed by the UAE and Angola.

The largest destination markets by capital investment value were the United Kingdom, Venezuela, Qatar, Nigeria, Namibia and Angola.

**TABLE 8** Destination Markets for Outward FDI from the Western Cape, 2003-2015

Rank	Country	Projects	Capex (Rm)	Companies
1	Nigeria	17	4 951	10
2	UAE	12	3 899	7
3	Angola	11	2 851	7
4	UK	11	9 782	10
5	Kenya	10	1 459	10
6	Zambia	9	1 974	6
7	Ghana	6	1 541	5
8	Namibia	6	3 122	6
9	United States	6	636	6
10	Germany	5	91	5
Other Countries		73	26 622	4
<b>TOTAL</b>		<b>166</b>	<b>56 928</b>	<b>76</b>

Source: FDI Intelligence, 2016

The best performing sectors attracting FDI from the Western Cape were food and tobacco with 34 projects and R8 billion in capex, followed by software and IT services at 29 projects and R3 billion in capex. The sector creating the highest jobs per project was real estate at 752 jobs, followed by healthcare at 406 jobs.



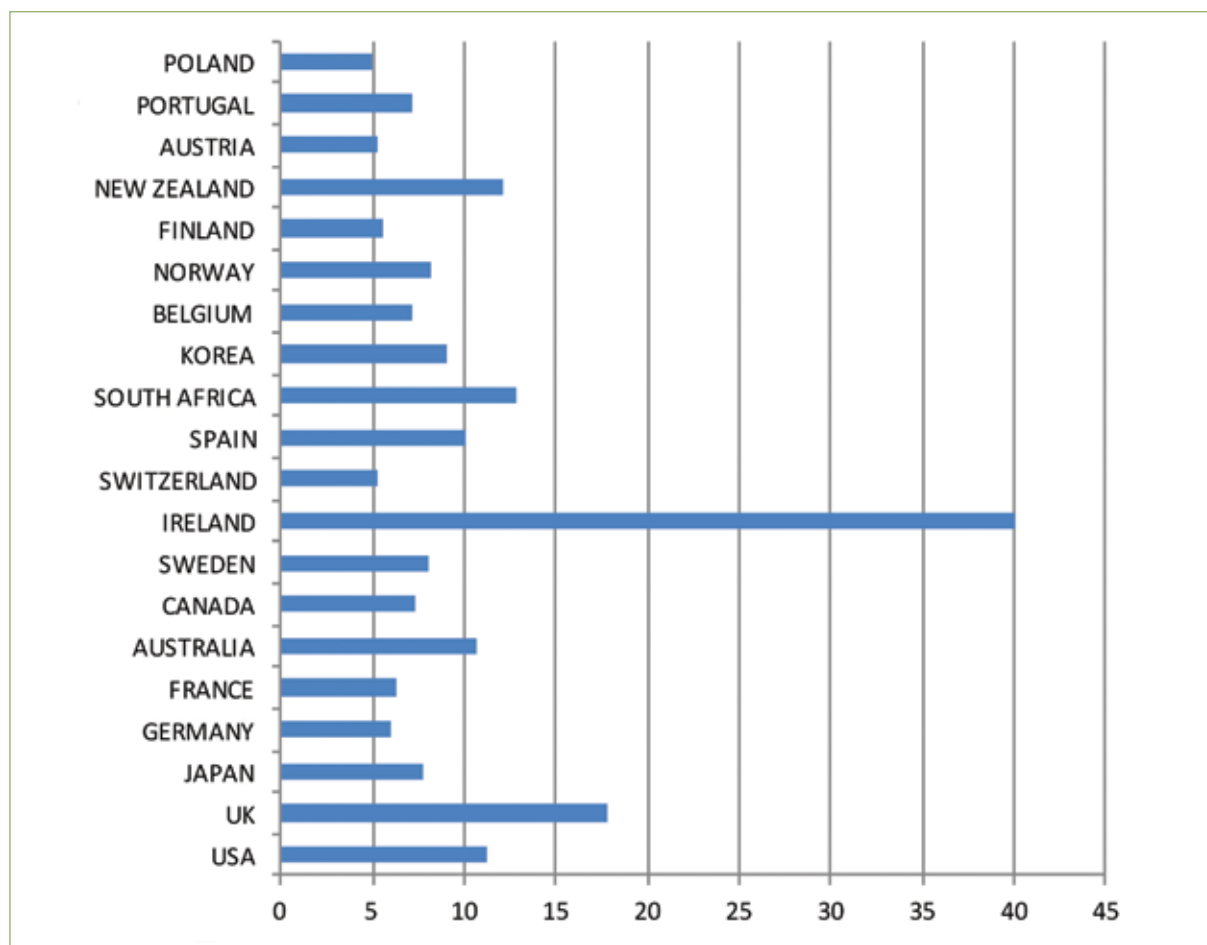
# WESTERN CAPE GAP- HOUSING – Affordable housing market opportunities

LEONARD MAMOGOBO

Purchasing property is often one of the key investment areas for large financial institutions. Thus, understanding the property market context is without a doubt very important for both business and investors. With a common understanding, business and investors can conceive opportunities, imagine solutions, and build a better, more intentional future, while broadening the housing opportunities available to even our lowest income residents.

In 2014, the Investment Property Databank (IPD), a global annual property index by Morgan Stanley Capital International (MSCI), ranked South Africa as the third best performing property market in the world, just after Ireland and the UK (Figure 32). This is underpinned by the demand for housing in the major metro areas, partly due to the continued rapid urbanisation of the South African population.

**FIGURE 32** Global Property performance (2014 Total return)



Source: IPD Global annual property index (2015)

## Case for Affordable Housing

The Western Cape accounts for approximately 40% of all South African residential building plans passed and completed. Notwithstanding the high level of real estate activity, the province has emerged as the top performing property market in the country, recording on average 8.0% capital growth – well above the national average of 5.8% in 2016Q1. This essentially means that the province has the most expensive homes.



Most economists define a market as a place where the forces of demand and supply interact. There are a number of dynamics at play on the demand- and supply-side of the housing market in South Africa, particularly in the Western Cape.

High real estate price inflation has inevitably contributed to the deterioration in the supply of affordable housing in the province, which has significantly impacted on households in the so called 'gap-housing market'. Perhaps the biggest irony is that while the Western Cape has experienced relatively good economic growth (which has driven the relative strength in its residential property market), the high real estate pricing has impacted negatively on its housing market. In the long run – should the lack of new stock and affordability challenges be left unaddressed – it can become a growth constraining factor. Put simply, what we often fail to acknowledge is that even though high property values are often glorified as a virtue, it will eventually prohibit the attraction of skills due to in-affordability, and can ultimately become a constraining factor for economic growth.

The provision of fully subsidised housing remains the standard form of housing assistance in the Western Cape for lower-income households earning less than R3 500 per month. Still, the Western Cape government faces enormous housing challenges in providing affordable houses for households earning between R3 500 and R15 000 per month.

The reality of limited budgets and increasing building costs (amongst other constraints) makes it difficult for the province to maintain the required pace of housing provision. Delivering housing opportunities at scale is often technically, socially and financially demanding. This challenge becomes even more complicated by increasing population rates, net in-migration, and the reduction in functional households. The result is smaller household units across all populations and limits in construction industry capacity. The Western Cape is not delivering at the rate and scale needed for housing supply to meet demand, nor, given the differing levels of affordability and access to credit, is it serving the diversity of the market – not in the gap market, nor in the subsidy-eligible market. A strategy to address the shortages in the supply of gap-housing is to encourage the private-sector to spot the excess demand and respond by stretching down lower in the housing market.

## What is Gap-housing?

Gap-housing is used to describe the shortfall in the market between residential units that are supplied by the state and houses delivered by the private sector. The gap-housing market accommodates people who typically earn between R3 500 and R15 000 per month – which is deemed too much to qualify for state assistance, yet too little to enable them to take part in the private property market.

The Western Cape government estimated that in 2014, about 36% of households in the Western Cape were in the gap-housing market, with no access to mortgage credit. This is projected to increase to 41% by 2040.

The 2011 State of Cities Report (SoCR) noted that progress in delivering housing to the gap-housing market segment has been limited and very few households have successfully accessed private mortgage funding to acquire housing in this market. With this in mind, it is clear that there are gaps in the housing ladder between the subsidised houses that someone earning less than R3 500 might have access to, and the affordable house that someone earning more than R15 000 might have access to.

The SoCR states that there is a very high demand in the gap-housing market segment, but supply of housing is not matched to the affordability of the market because there is a shortage of affordable housing – those areas or properties with values under R500 000 – which are often perceived as weak, stagnant and risky.

However, a very different reality appears when key market indicators of affordable housing markets are isolated and compared to overall markets. The results from SoCR present an investment opportunity for the private sector.

When affordable property markets in the Western Cape are compared to overall markets, the SoCR concludes that:

- Affordable markets are growing faster than markets overall.
- Many markets considered affordable by average values are not affordable when local incomes are used to measure housing affordability.
- Equity can be used to close the housing gap and boost the purchasing power of homeowners in affordable markets.

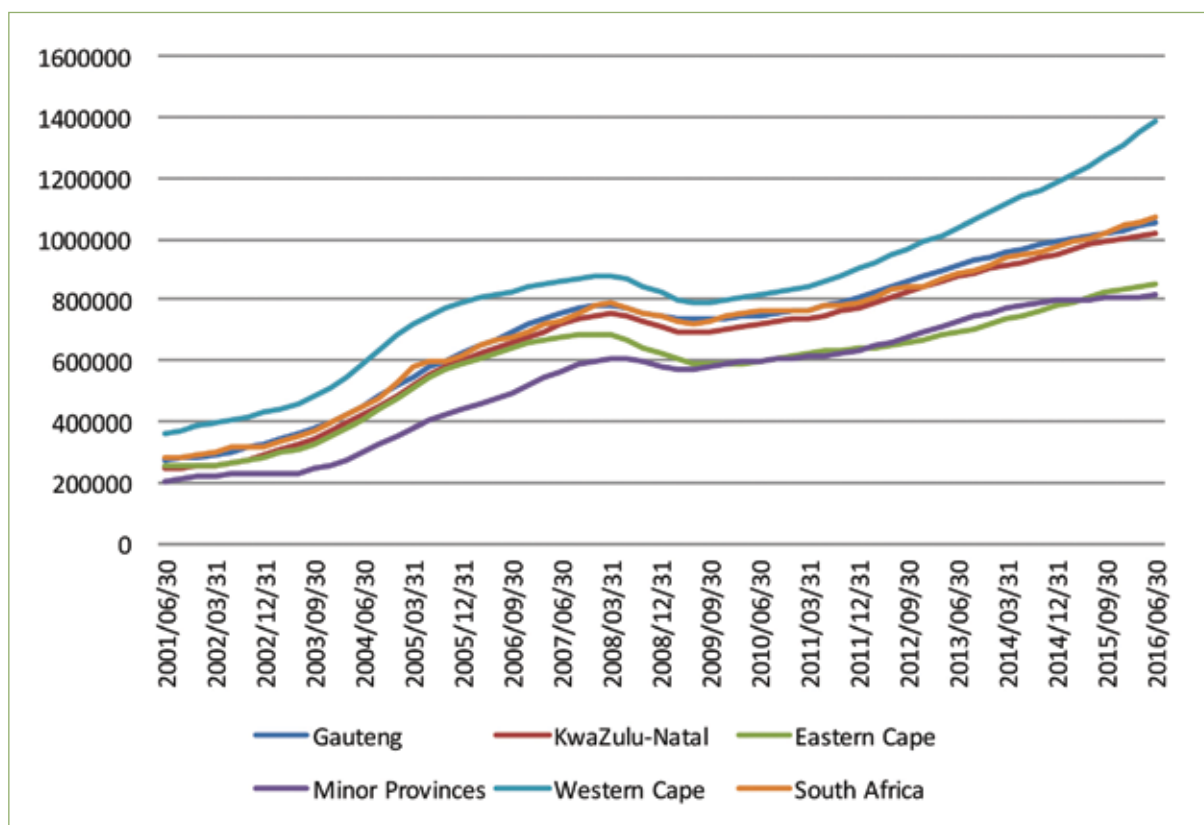
Households in the Western Cape faced increased financial strain during 2015 and there is evidence that affordability stress is rising in the province. The South African Reserve Bank (SARB) data released for 2016Q1 show household debt-to-income ratio at almost 80%. This is very high, and will increase if fuel and electricity prices increase.

## House Prices in the Western Cape

The FNB Western Cape House Price Index shown in Figure 33 below confirms that the Western Cape economy continued to outperform the national economy in 2016Q2. The Western Cape recorded the fastest average house price growth between 2013Q2 and 2016Q2, shown by the broadening of the housing price gap between the Western Cape and other provinces.

During the same period, the property outlook for the Western Cape shows that a house price was on average R1.353 million – making it, on average, the province with the most expensive homes. The FNB Western Cape House Price Index suggests that this house price inflation has inevitably contributed to the deterioration in affordability of housing in the province.

**FIGURE 33** Average House Price by Province (Rand)



Source: Quantec and FNB House prices

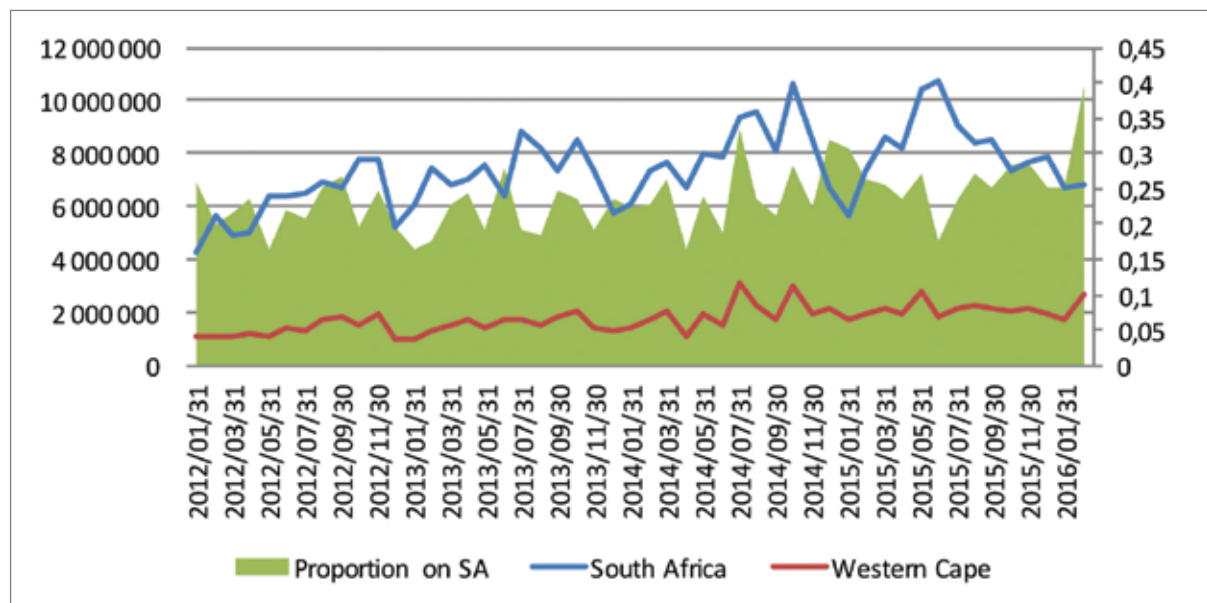
Property developers in the Western Cape have reported that in the current market, entry-level housing cannot be built for less than R400 000. The primary reason for this has to do with red tape – delays in the achievement of regulatory and administrative steps in the housing delivery process – and the impact this has on the cost and availability of funding to support the delivery.

To some degree, red tape has an impact on the rate of delivery. It simply takes longer for housing to be delivered, and as a result, the province's annual delivery figures are much lower than demand would suggest is commercially possible. In simple economic terms, this also places upward pressure on housing prices as fewer houses are available for purchase amongst the available buyers. Possibly more significant, is the impact on the cost and scale of delivery. The analysis suggests that in a development of 2 259 units, a 24-month delay increased development costs by 175%, which translated into an increase of 124% on the originally budgeted selling price of the development. The increased costs contributed towards an increase in the selling price of the unit (and thereby declining affordability). This reduced the capacity of the funds available to deliver more units, undermining the scale of delivery, and putting additional upward pressure on prices.

In short, the affordability of property in the Western Cape is declining and the inflation of house prices in the province means good returns on properties in the province. Despite the number of state-provided housing supply options to meet the demand of households that are unable to access the bonded market, the shortage of housing stock in the gap market perpetuates a cycle of rising prices and supply shortage.

## Supply Side Issues (Building Activities)

**FIGURE 34** Total Building Plans Passed in South Africa and the Western Cape

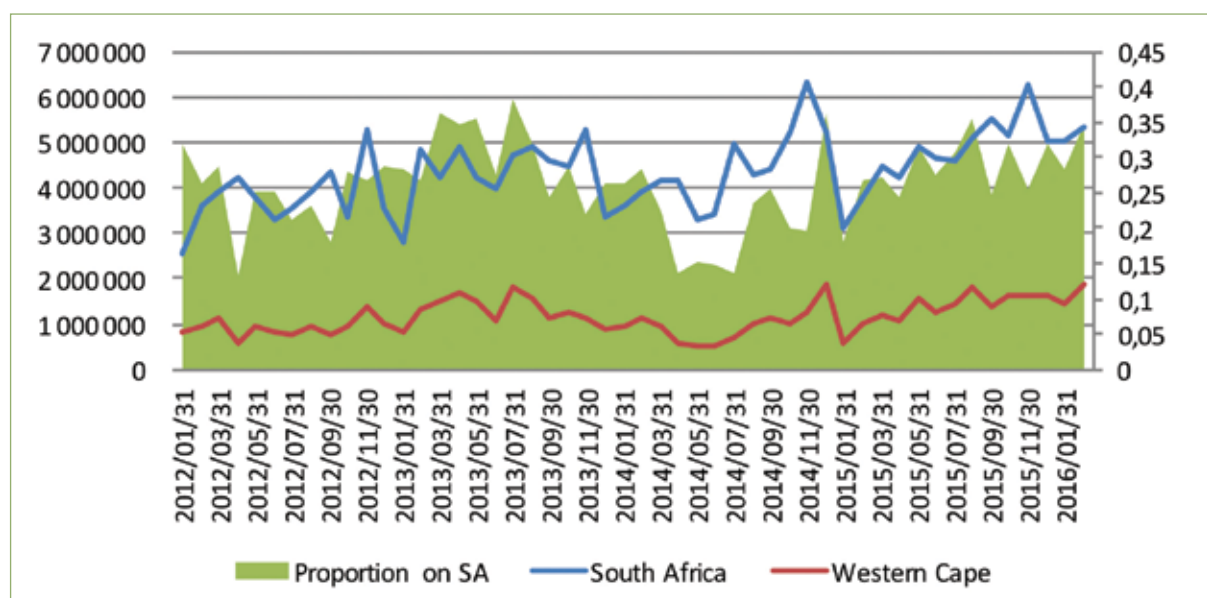


Source: Quantec

According to StatsSA (reported by FNB), housing delivery has not recovered since the decline after 2015Q1. Figure 34 above shows that in 2016Q1, Western Cape's share as a percentage of total building plans passed increased to approximately 40%. The number of residential unit plans passed in 2016Q1 grew by 3.1% year-on-year.

Such a small growth in building plans passed suggests a lack of growth in building activity and completions in the near term, a possible mild decline, and even a shortage of houses supplied.

**FIGURE 35** Total Building Plans Completed in South Africa and the Western Cape



Source: Quantec

Figure 35 above shows the Western Cape's share of all residential buildings plans completed in 2016Q1. About 35% of all residential building plans completed were from the Western Cape for this period. It also shows slight growth (year-on-year) in the level of residential buildings completed for the province, after the previous quarter's decline. This is as a result of the increase in the market share of flats and townhouses from 11.33% of total building completions in February 2015 to 23.82% in early 2016.

Flats and townhouses look set to outgrow free standing homes during 2016. Dwelling Houses Smaller than 80 square metres and Dwelling Houses Greater than 80 square metres both saw their share in overall building plans completed decline in 2016Q1.

Affordable houses in the Western Cape are thus extremely limited and evidence of this can be found in the fact that the number of residential buildings smaller than 80 square metres completed in the Western Cape in 2016Q1 declined by 23%. Notwithstanding the rise in residential unit plans passed and the increase in the market share of flats and townhouses, the market is under-delivering new real estate stock.

Building plans completed data for 2016Q1 suggests that we may well see positive growth in the number of homes completed, with the average size of homes declining. This is also shown by the positive growth in building plans passed, which is normally a leading indicator of square metres of completions to come. Construction activities (housing supply) in the province have to increase to accommodate the increasing demand and capital growth due to a growing number of buyers moving up into the higher-value markets.

Another factor that has affected the housing industry in the province is the slow growth in the economy. This slow growth has constrained job creation and negatively impacted on household income, making it even more difficult for households to afford houses. Its impact on the Western Cape construction and development sector has been two-fold. Firstly, building costs have risen significantly, and secondly, affordability levels have declined. Both make delivery more complicated.

## Opportunities for the Private Sector

Considering all the facts discussed in this report, businesses, investors and property developers should consider finding new ways to support the growth of affordable housing in the Western Cape. This could be done by exploring and reconsidering areas for new investment, expanding existing investment, or confirming the success or strategic revision of ongoing activities.

Some opportunities are listed below:

- The Province's residential property market is ripe for large-scale investment in the affordable housing sector. With the proportion of households in the gap-housing market in the province expected to grow from 36% in 2014 to 41% by 2040, the possible areas for investment are in dwelling-houses less than 80 square metres, and in flats and townhouses. There is also huge demand for rental housing situated centrally, close to amenities and work, at an affordable rate for lower income groups. Thus, enhancing the supply of new rental housing opportunities and encouraging improved property management of rental stock should be encouraged.



- Investment in the Province's largest townships such as Mitchell's Plain, which has an approximate population of one million. This, and similar areas, are where demand far exceeds supply. A partnership between potential investors and property developers can help to catalyse affordable and social housing developments at key development nodes in the province. Investment opportunities in underserved areas are widely available.
- Building of private-public partnership (PPP). From modelling demand for residential property, it is clear that the state cannot continue to be the chief provider of low-income gap-housing. Generally, building these partnerships will require a clear communication of the roles of stakeholders in meeting the objectives of integrated, sustainable human settlements.
- Investing in new models around affordability to capture the low income market and ways to mitigate the risk of default on financing for the gap-housing market, given households' high levels of indebtedness.
- Exploring an Investor Partnership Fund to assist housing developers with equity-type loans, which enhances the bankability of projects to enable senior lenders to access finance on favourable terms.
- By improving the levels of employment in these income groups will in turn impact the level of need, type of housing and government support required.

A frustration often voiced is that affordable markets are difficult to understand. We believe that more investment would be made available if there were a clearer sense of where opportunity might exist, not only for developers, builders and brokers, but also for city planners, housing advocates and residents. Understanding affordable housing markets more fully can expand housing opportunities, especially for the province's lower income residents.

Year-on-year residential activity levels have declined recently, as one would expect in this credit-dependent residential market when interest rates are rising. However, the availability of gap-housing depends on factors affecting accessibility, supply and affordability.

Managing the gap market is without a doubt an imperative, because it not only affects the current generation, but also future ones. The affordable housing market should be an area that the state and investors should look to grow, because numerous opportunities await those willing to commit to it.



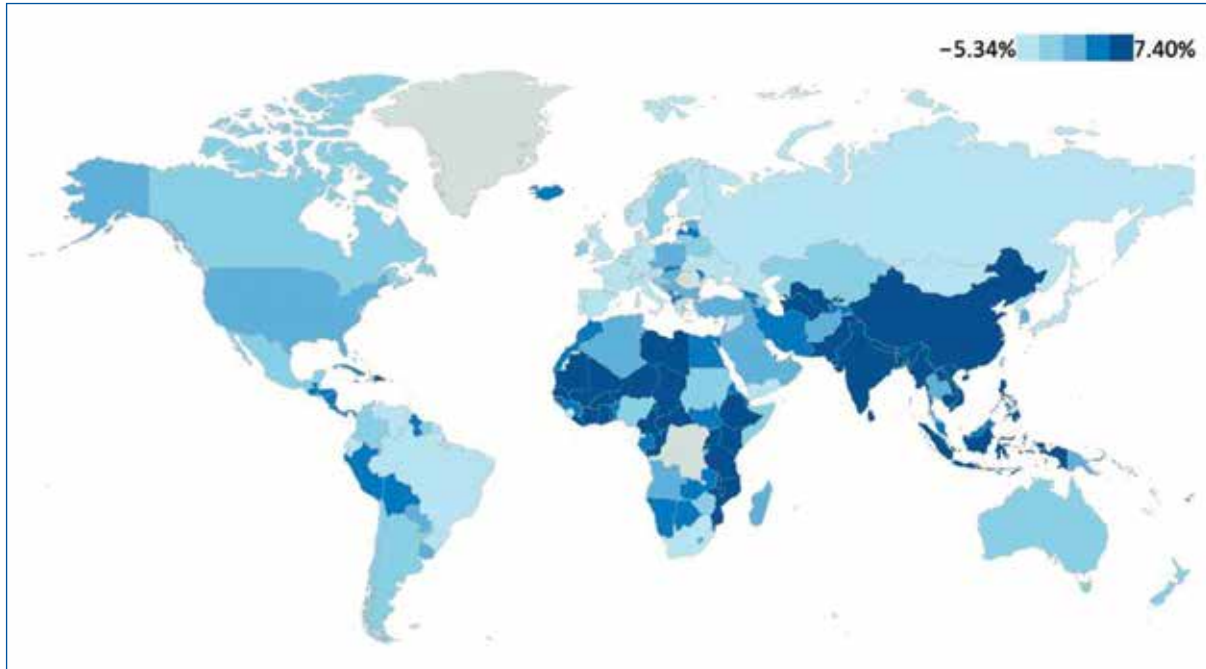
# WORLD ECONOMIC OUTLOOK AND PERFORMANCE

MIRACLE MANGENA

# GROWTH OUTLOOK

World economic growth outlook patterns show high growth in Africa, China and India. Figure 36 below shows projected growth across countries.

**FIGURE 36** GDP, Real Year-on-year Change 2016 - 2017



Source: IHS

The global growth outlook continues to be influenced by three key transitions. These include:

- the slowing down and rebalancing of the Chinese economy (although it continues to outperform many other developing countries);
- lower prices for commodities; and
- a gradual tightening of monetary policy in the United States as several other advanced economy central banks continue to ease monetary policy.<sup>7</sup>

Another critical transition whose effects are yet to manifest themselves, is the decision by Britain to exit the European Union (EU).

Table 9 presents growth projections and the outlook for selected advanced, emerging and developing economies.

<sup>7</sup> International Monetary Fund, *Subdued Demand, Diminished Prospects*, World Economic Outlook Update January 2016



**TABLE 9** World Economic Outlook and Growth Projections

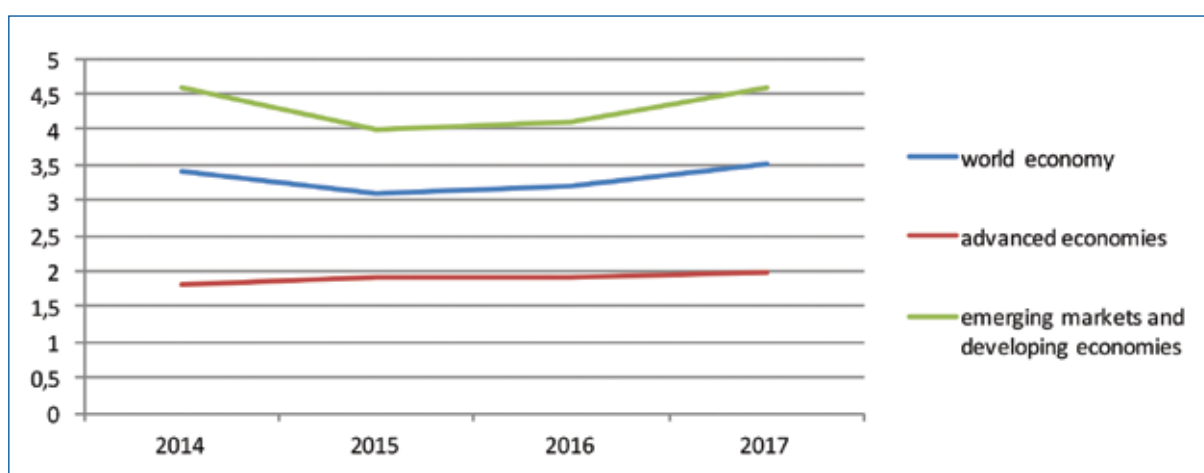
		2014	2015*	2016*	2017*
<b>World</b>		<b>3.4</b>	<b>3.1</b>	<b>3.2</b>	<b>3.5</b>
	<b>Advanced Economies</b>	<b>1.8</b>	<b>1.9</b>	<b>1.9</b>	<b>2.0</b>
	United States	2.4	2.4	2.4	2.5
	Germany	1.6	1.5	1.5	1.6
	Euro Area	0.9	1.6	1.5	1.6
	<b>Emerging Economies and Developing Economies</b>	<b>4.6</b>	<b>4.0</b>	<b>4.1</b>	<b>4.6</b>
	Russia	0.7	-3.7	-1.1	1.3
	China	7.3	6.9	6.5	6.2
	India	7.2	7.3	7.5	7.5
	Brazil	0.1	-3.8	-3.8	0
	South Africa	<b>1.5</b>	<b>1.3</b>	<b>0.0</b>	<b>1.0</b>
Nigeria	6.3	2.7	2.3	3.5	

Source: IMF, SARB

\* Forecasts

Global growth, which was estimated at 3.1% in 2015, is projected to increase by 0.1 percentage points to 3.2% in 2016. The main source of growth is from emerging markets and developing economies, which are projected to grow by 4.1% in 2016 – a slight increase from the estimated 4.0% growth in 2015.

The trend graph below shows projected economic growth rates in advanced emerging and developing economies:

**FIGURE 37** World Economic Outlook

Source: IMF, World Economic Outlook update, January 2016

## Advanced Economies

Growth in advanced economies is projected to remain modest at just below 2% between 2014 and 2017. The EU is expected to show some growth while the UK's economy will likely contract after its decision to leave the EU.

Overall, economic activity remains resilient in the United States (supported by financial conditions and strengthening housing and labour markets); but with Dollar strength weighing on manufacturing activity, and lower oil and other commodity prices curtailing investment in mining and energy sectors. The US economy has grown by over 2.4% in 2015, and is projected to continue at rates above 2% in 2016 and 2017.

## Euro and United Kingdom

In the Euro region, stronger private consumption supported by lower oil prices and easy financial conditions, are outweighing a weakening in net exports. The Euro area has managed to overcome two recessions in quick succession, and has now recorded a growth rate of 1.6% in 2015 and is projected to grow by 1.5% in 2016. France, Portugal and Spain have also shown encouraging economic growth recoveries.

Unemployment in the Euro area remains over 10%, with the exception of Germany, which recorded a 4.3% unemployment rate. Countries with the highest unemployment rates are Greece (24.6%) and Spain (20.3%). The inflation rate has also remained well below the European Central Bank's target of 'below but close to 2%', which allows for lower interest rates for longer.

Although the United Kingdom economy has been driving growth in the advanced economies, there are concerns about its departure from the European Union (EU), which has led to an initial loss of confidence and capital outflows. The GBP has weakened more than 13% against the USD, which may support UK exports in the short term but not sufficiently to maintain overall UK growth.

As the UK prepares to exit the EU it may not participate in a single market, vis-à-vis free trade with the UK's largest trading partners. Any future investments in the UK will be in jeopardy. Even if the UK does manage to agree on reasonably good trade terms (and that is a big if), uncertainty of business will see a significant curtailing of investment until such time as industry has a better understanding of trade conditions.

The sector most likely to be impacted is financial services. The expectations of job losses vary widely. Companies, which include JP Morgan, Citi, BoA, Goldman Sachs, Morgan Stanley and Deutsche, have indicated that more than 10 000 jobs will be relocated from the current EU financial capital to either Dublin or continental Europe. Fortune expects a short term reduction of 40 000 jobs and PWC's longer term expectation (2020) is as high as 100 000 jobs. It is the longer term impact of these job losses that the UK must be concerned about. If it indeed loses 100 000 jobs in financial services, the wider impact on the UK economy and London, specifically, will be immense. When these high paying jobs do relocate to other EU countries, it will have a multiplier effect on the UK economy.

While Moody's calculated that Brexit wiped \$2 trillion off global markets, the FTSE held up reasonably well. The FTSE 250 declined by 12% immediately after the Brexit result, but recovered much of its losses to end up 5.8% lower. Markets generally gyrate violently to uncertainty and from a macroeconomic perspective, we should not read too much into the market movements now. However, for an overall view, the JSE was down 3.9%, but gold shares were up 11% as the gold spot increased by 18%.



The IMF expects the UK economy to shrink by between 1.4%–4.3%. The upper limit appears to be very pessimistic though. In response to economic decline and liquidity risk, the BoE has made 250 billion GBP available. It is likely that the Conservative's goal to reduce government debt will be delayed to limit the effect of Brexit.

### Emerging Market and Developing Economies

Growth in developing economies continue to outpace that of developed economies. It is projected to increase from 4% in 2015 to 4.6% in 2017. Growth in emerging Europe is projected to continue at a steady pace in 2016, with Russia remaining in recession.

In Latin America and the Caribbean, a number of economies are projected to contract in 2016, with Brazil remaining in recession and confidence taking a heavy knock given the corruption developments (Petrobras Saga) and impeachment of the president by parliament.

Whilst higher growth is projected for the Middle East, there are concerns about lower oil prices and in some cases geopolitical tensions, which have the capacity to weigh negatively on the outlook.

### BRICS

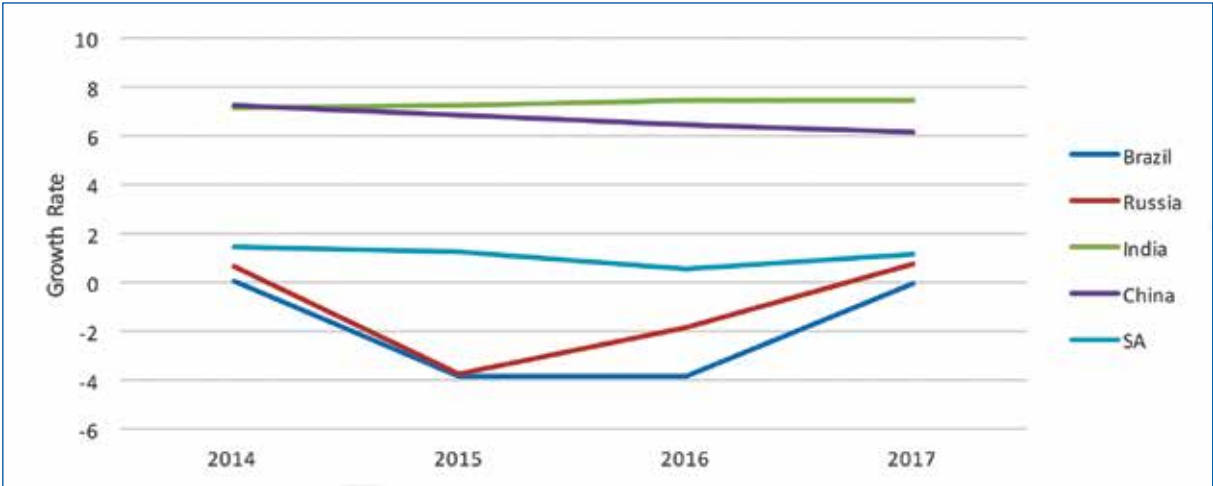
China and India are both projected to continue having robust growth rates of above 5%. The slowing down and rebalancing of the Chinese economy (from investment and manufacturing to consumption and services) had spillover effects on a number of emerging markets trading with China.

Economic data released for the first quarter of 2016 by the Chinese National Bureau of Statistics show:

- evidence of stabilisation with a growth rate of 6.7%;
- a rise in fixed-asset investment of 10.7%; and
- an expansion of industrial output by 5.8%.

India's robust growth continues to surprise. While many economists are questioning India's actual growth, the global BPO and ICT Services hub's growth rate is expected to be around 7%, supported by domestic growth.

**FIGURE 38** Growth Rate Projections in the BRICS, 2014 - 2017



Source: IMF, SARB

Apart from the slowing down and rebalancing of the Chinese economy, and a steady growth in the Indian economy, Russia and Brazil are projected to remain in recession in 2016. These countries have seen their debt levels rising sharply and subsequently their sovereign credit ratings have been downgraded. Standard & Poor's (S&P) and Moody's placed Russia below investment grade in 2015. Brazil was placed in sub-investment grade by S&P in September 2015, followed by Fitch in December and finally Moody's in early 2016.

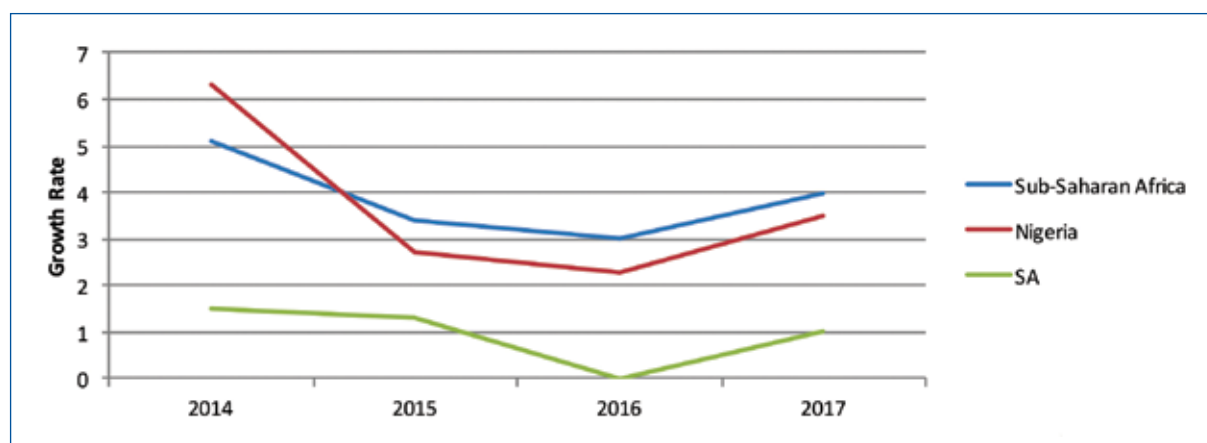
## Africa

In sub-Saharan Africa, lower commodity prices and higher borrowing costs will weigh heavily on the region's largest economies such as Nigeria, South Africa and Angola. The outlook for sub-Saharan Africa is based on:

- a fall in commodity demand and prices;
- slowing down in China, one of the region's biggest export markets;
- drought in a number of economies, especially in Southern Africa; and
- large fiscal and current account deficits exacerbated by depreciating currencies.

Figure 39 below shows the outlook in sub-Saharan Africa.

**FIGURE 39** Sub-Saharan Africa Outlook, 2014 - 2017



Source: IMF, SARB

A number of Southern African countries face severe drought conditions, which do not only impact on growth and exports, but also cause domestic food prices to increase. The inflationary pressure coupled with weakening exchange rates weighed heavily on growth.

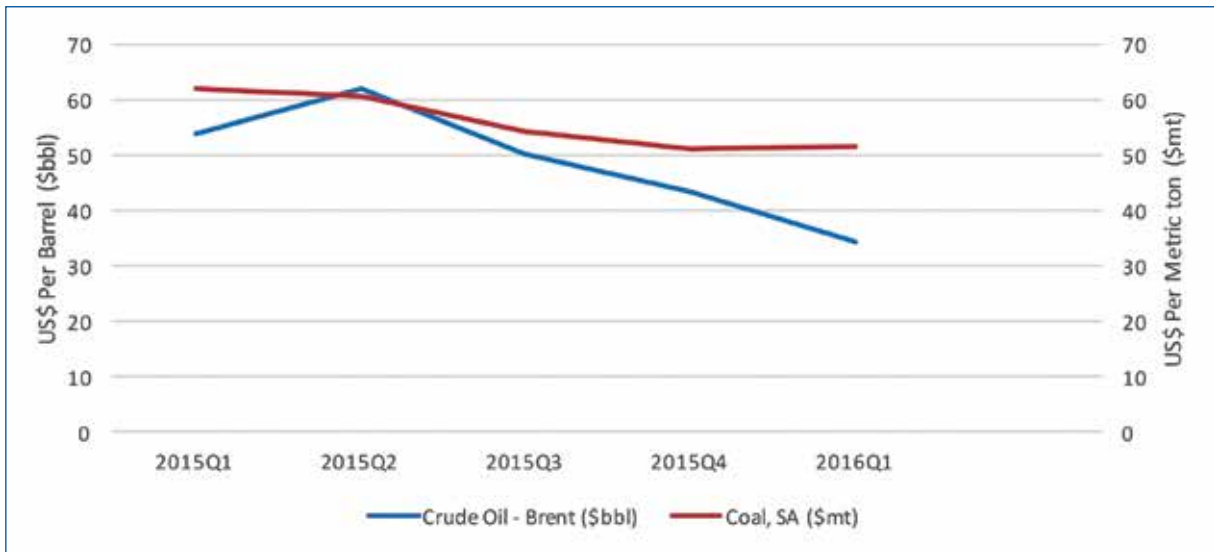
## Commodity Prices and Outlook

Oil prices declined significantly in 2015 and are projected to record modest increases in 2016 and 2017. The decline in oil prices is projected to impact negatively on fuel exporters (and fuel export dependent economies) and investment in oil and gas extraction. Crude oil prices fell from \$53.9 per barrel in 2015Q1 to \$34.4 per barrel in 2016Q1.

A similar price trend – although more gradual – is also observed for coal, which fell from \$62.1 to \$51.5 per metric ton during the same period.

Figure 40 below shows commodity trends for oil and coal over the last five quarters, 2015Q1 – 2016Q1.

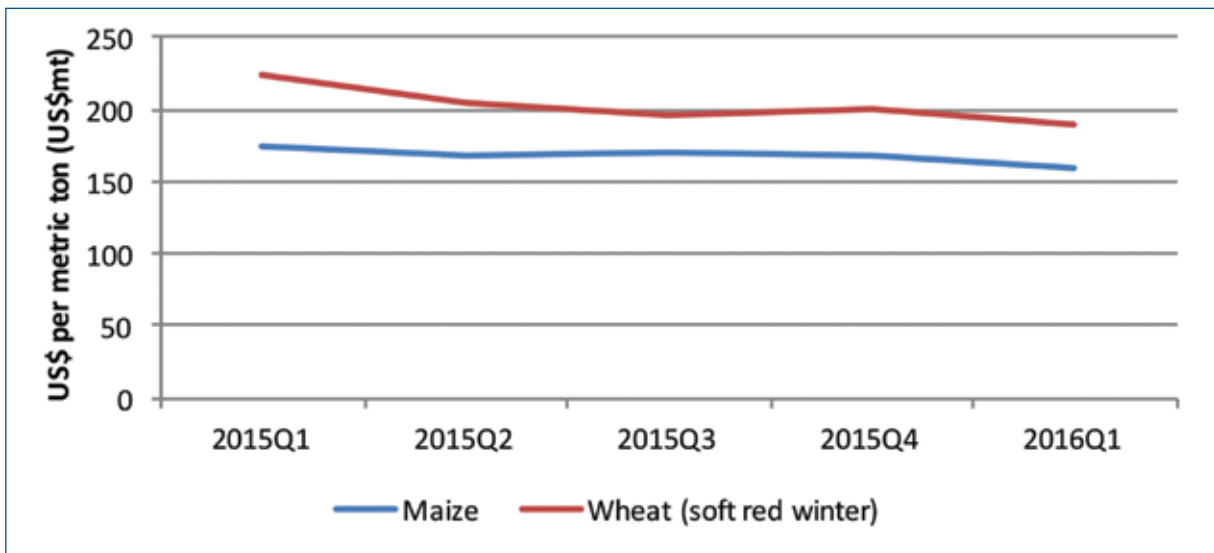
**FIGURE 40** Commodity Prices, Energy, 2015Q1 – 2016Q1



Source: World Bank

Figure 41 below traces the trend of maize and wheat between 2015Q1 and 2016Q1.

**FIGURE 41** Commodity Prices, Grains, 2015Q1 – 2016Q1



Source: World Bank

The decline in global wheat and maize prices in the first quarter of 2016 coupled with the strengthening Rand should, if sustained, reduce pressure on food inflation. Global and South African maize prices have moved in opposite directions mainly because of the South African drought. Lower global prices may assist in tempering national food inflation.

## Risks to Global Outlook

The major risks to the global economy outlook are:

**Geopolitical tensions** – An escalation of ongoing geopolitical tensions in a number of regions affecting confidence and disrupting global trade, financial and tourism flows.

**Slowdown in emerging market economies** – The slowdown in China poses more international spillovers through trade, commodity prices and demand, and confidence.

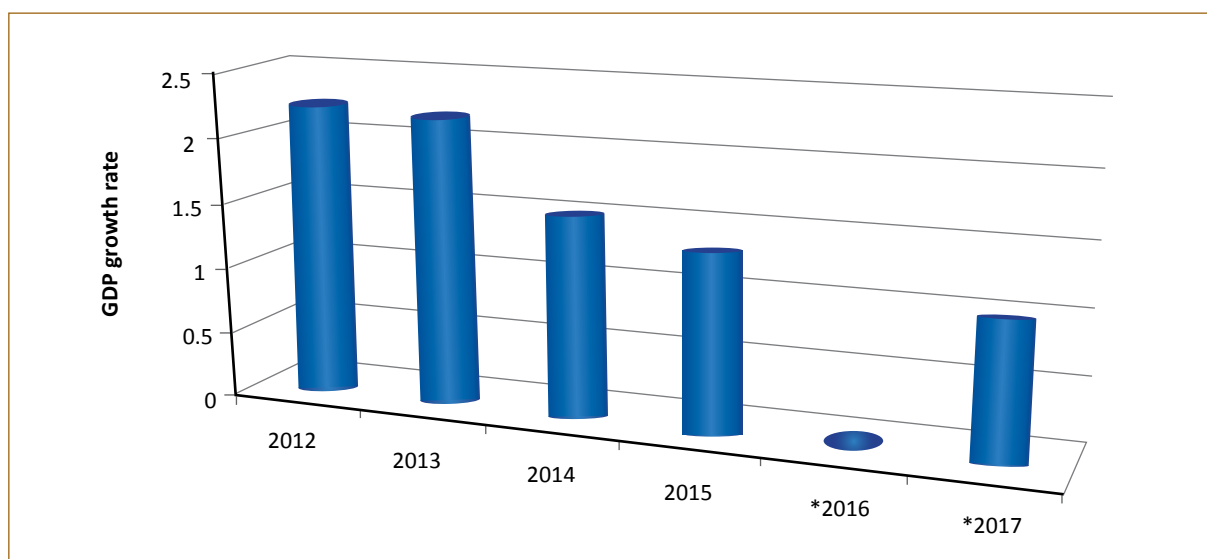
**Lower commodity prices** – Commodity prices pose dual risk. Continued drop in commodity prices may worsen the outlook for commodity producers and the decline in oil prices may provide a stronger boost in demand in oil importing countries.

# SOUTH AFRICA PERFORMANCE AND OUTLOOK

## Growth

GDP growth has significantly declined since 2012 and is projected to deteriorate further in 2016. Figure 42 below shows changes on the GDP growth rate and projections.

**FIGURE 42** GDP Growth and Forecast for SA



Source: SARB

\*2016 and 2017 are estimates

There has been a steady decline in output between 2012 and 2015 in South Africa, and a further decline is projected for 2016.

The South African Reserve Bank attributed the decline in growth to:

- household debt (pre-crisis debt burdens reduce scope for credit fueled expansion);
- electricity shortages (hampered production and disincentivised investment);
- severe drought conditions;
- rising interest rates emanating from the steep depreciation of the Rand; and
- the world economic environment (rebalancing of the Chinese economy, quantitative easing in US, and a fall in commodity demand and prices).

The South African Reserve Bank also noted that whilst household consumption has contributed significantly to growth post the financial crisis of 2008/9, the consumer has become increasingly constrained due to rising inflation and reduced net savings as a result of high debt levels.

Growth is projected to remain pedestrian in 2017, with a rate of 1%. This is on the backdrop of recovering commodity prices and a return to normality in agriculture after the devastating drought.



In Africa, South Africa is ranked as the third largest economy in terms of GDP (dollar value of its GDP) after Nigeria and Egypt. Attempts to unpack this development have led to a number of possible reasons, stretching from administrative to real performance.

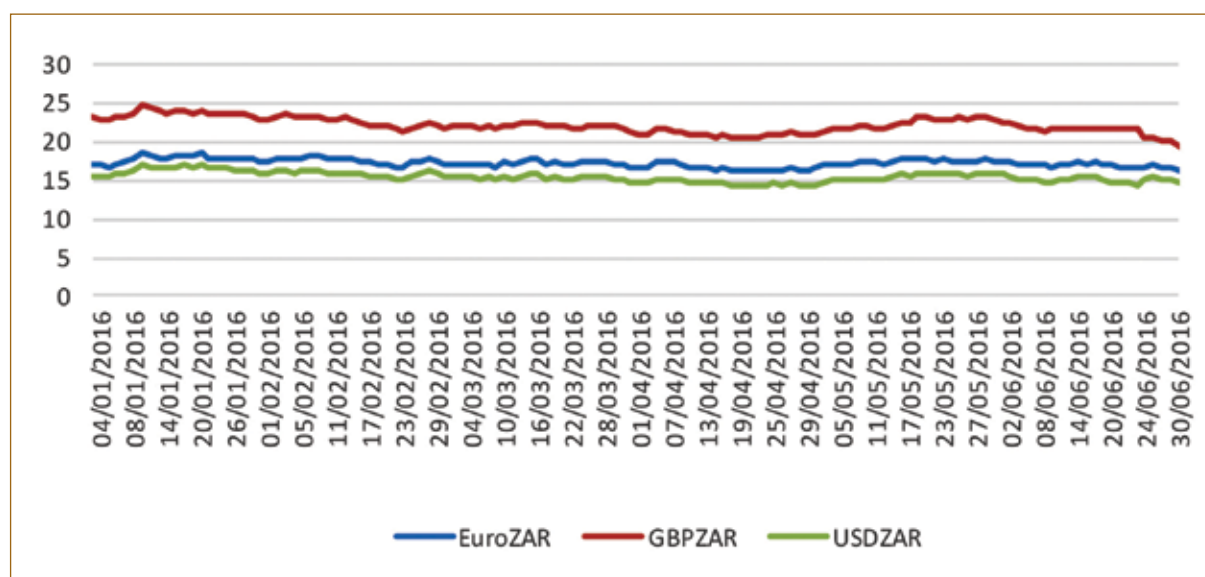
The reasons include the re-basing of Nigeria's GDP; the depreciation of the Rand against the Dollar (especially in managed exchange rate regimes); and falling growth on a sustained basis – impacting on the relative size of the GDP.

## Exchange Rate

The Rand exchange rate to major trading currencies strengthened slightly in February and March 2016 mainly due to:

- SARB's commitment to maintain price stability
- National Treasury's austere fiscal stance
- Positive improvement in commodity prices, especially gold and platinum.

**FIGURE 43** Exchange Rates



Source: INET

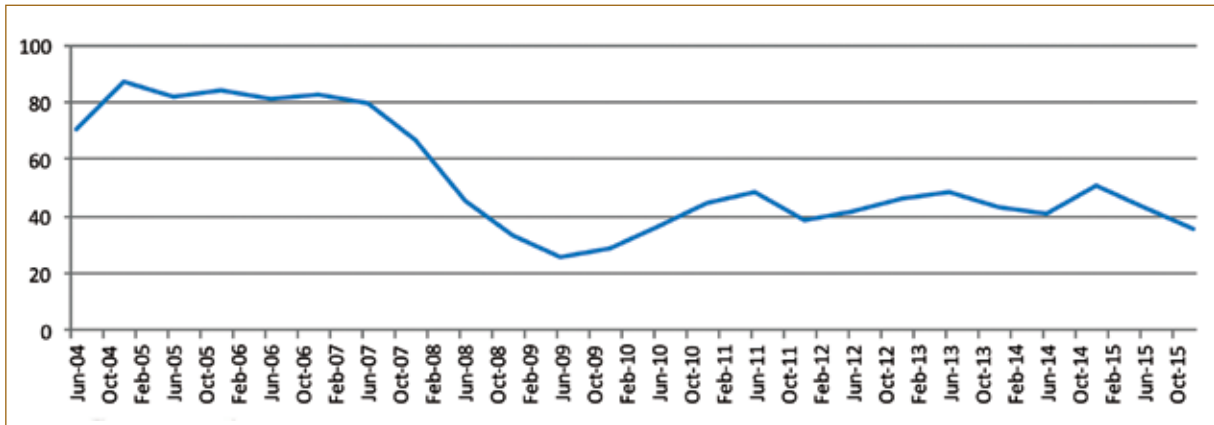
The moderate recovery witnessed in June is mainly attributed to the decision by all rating agencies to reconfirm their investment grade ratings (S&P and Fitch) and investment grade plus one notch (Moody's). A stable exchange rate is necessary for domestic price stability.

## Business Confidence

The Business Confidence Index shows a sharp decline, which negatively affects economic growth.

Figure 44 below summarises the fall in business confidence.

**FIGURE 44** BER Business Confidence Index for SA

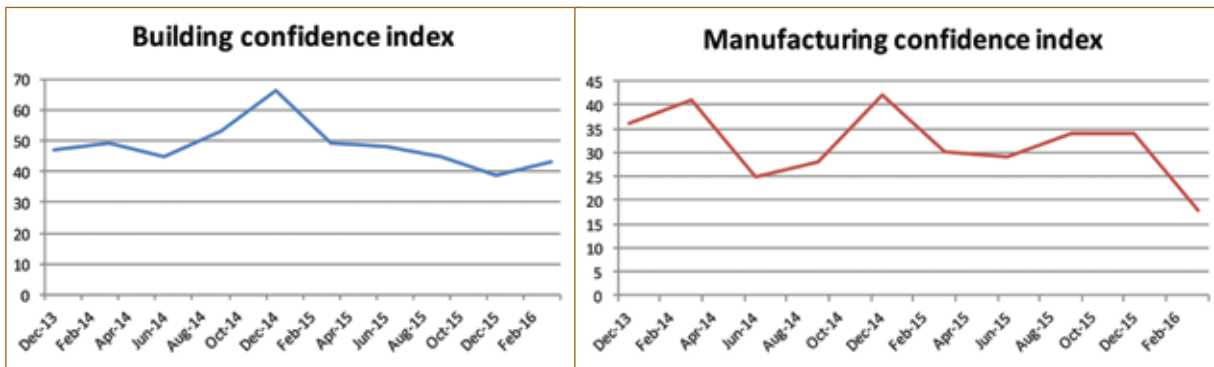


Source: BER

The Business Confidence Index fell from 48.8 index points in March 2015 to 35.8 index points in March 2016. This fall was mainly due to declines in the manufacturing and building business confidence indices.

Figure 10 below summarise the trends in these sectors between December 2013 and March 2016.

**FIGURE 45** SA Building and Manufacturing BCI, Dec 2013 - Mar 2016

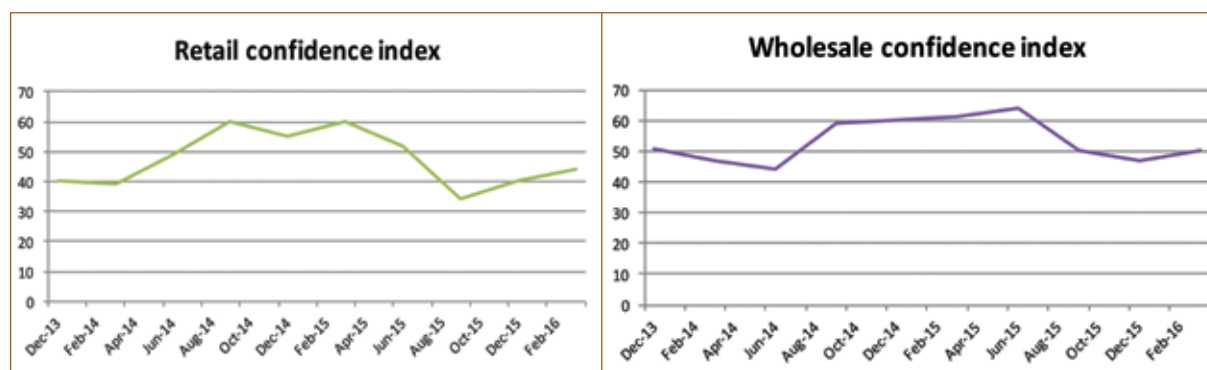


Source: BER

The Wholesale and Retail sectors performed marginally better, with the former recording 50 index points in the month of March 2016.

Figure 46 below traces business confidence in these two trade sectors.

**FIGURE 46** Wholesale and Retail BCI, Dec 2013 – Mar 2016



Source: BER

## Labour Market

The Quarterly Labour Force Survey reflected a decline in employment and associated rise in the unemployment rate.

Table 10 below summarises the changes in employment.

**TABLE 10** Changes in Employment, SA

	2015		2016	Qtr-to-Qtr change	Yr-on-Yr change	Qtr-to-Qtr change	Yr-on-Yr change
	Q1	Q4	Q1				
	Thousand				Per Cent		
SA	15 459	16 018	15 663	-355	204	-2.2	1.3

Source: StatsSA

During the first quarter of 2016, employment decreased by 2.2%, which translated to 355 000 persons losing employment. The main sectors that lost jobs were trade (119 000), manufacturing (100 000) and construction (77 000). The decline in employment, especially in manufacturing and construction during the first quarter of 2016, coincides with the decline in business confidence indices in these sectors.

During the first quarter of 2016, the rate of unemployment increased by 2.2 percentage points from 24.5% to 26.7%. The highest rate of unemployment was in the Free State (33.9%), whilst the province with the lowest rate was Limpopo (18.2%).

The expanded rate of unemployment indicates that more than a third (36.3%) of the labour force in the first quarter of 2016 was unemployed.

# WESTERN CAPE PERFORMANCE AND OUTLOOK

## The Brexit Impact

The outlook for the province is informed by global, national and regional developments.

At a global level, recent developments in the UK are of significant interest given the economic relationship between South Africa (as well as the province) and the UK, demonstrated through trade, tourism, investment and the financial markets. The UK is amongst the top export destinations, especially for the province's food and beverages exports. It is also one of the leading source markets for the tourism sector, and it significantly contributes to Foreign Direct Investments in the province.

The initial reaction to Britain's decision to exit the EU brought with it uncertainty and shocks, punctuated with the depreciation of the Pound, which declined by around 8% against the US Dollar. There was a 3% fall in equity prices, and a fall of between 4% and 6% in almost all commodities prices – with the exception of gold which firmed by around 3%. This uncertainty was also felt in South Africa, where the Rand depreciated initially by 7% to the Dollar before slightly gaining, though remaining 4% weaker than its initial rate before the outcome of the referendum.

Current trade agreements are primarily with the EU, and therefore EU market access is not threatened. Of note is the Economic Partnership Agreement (EPA), a trade agreement between the European Union and six countries of the Southern African Development Community (SADC). The EPA promotes the Tariff Rate Quota (TRQ) of South African wine to be imported duty-free into the EU for a specified quota, which is set to more than double in the first year of implementation for bulk and bottled wine.

The UK will have to renegotiate with each trading partner. This could be a lengthy process, but should not take as long as the fifteen years taken for the EPA. Complexities are less, given that this process will be between two economies as opposed to two blocs of economies (SADC vs EU).

What is evident is that there is uncertainty concerning the impact of Brexit on the Western Cape economy due to a number of factors which include internal political discord in the UK concerning the exit decision, and the rules which will govern trade with the UK. The financial markets maintained a level of volatility post Brexit, signalling that this uncertainty is still prevalent. Currently, trade figures show that:

1. Of the R30 billion WC exports to the EU, 55% are food and agri-product related. It is hard to imagine a sharp decline in these products due to the nature of demand thereof.
2. R8.7 billion or 28% (2014) of the WC's R30 billion exports are exported to the UK. If the UK is a logistical transit to the EU, some of the R8.7 billion is at risk. A very small percentage of that is likely transit products destined for the EU. Given that SA's current trade agreements are primarily with the EU, our EU market access is not threatened. New agreements will have to be developed with the UK.

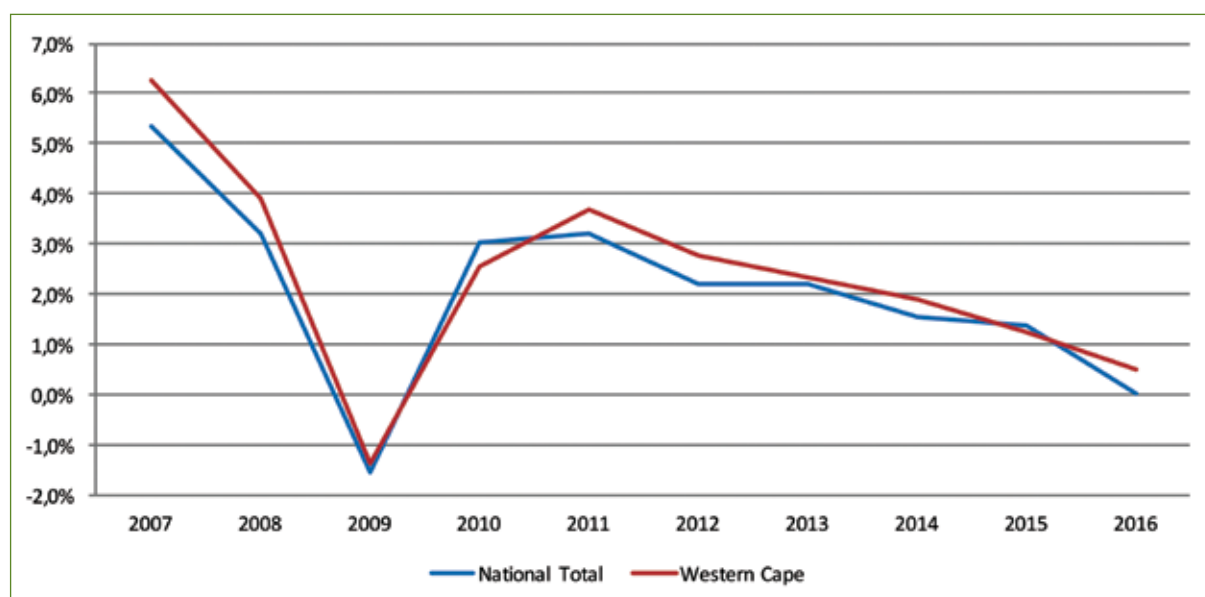
- About 20% of the WC's exports to the UK are inputs into industry. Locally manufactured exports used in the UK for the purpose of either maintenance or as inputs into the production process, in short to medium term will not likely be affected. Inputs for the purpose of new investments are likely to be impacted, and even then, the impact will only relate to UK produced goods that are likely to be exported from the UK to the EU. Much of the locally produced goods in the UK are locally consumed and not exported to the EU.

## Growth

The growth rate in the Western Cape Province follows the national average trend.

Figure 47 below traces growth rates from 2007 to 2014, and provides projections for 2015 to 2016:

**FIGURE 47** WC and National Total (SA) Growth Rates, 2007 - 2016



Sources: IMF, StatsSA, SARB and IHS

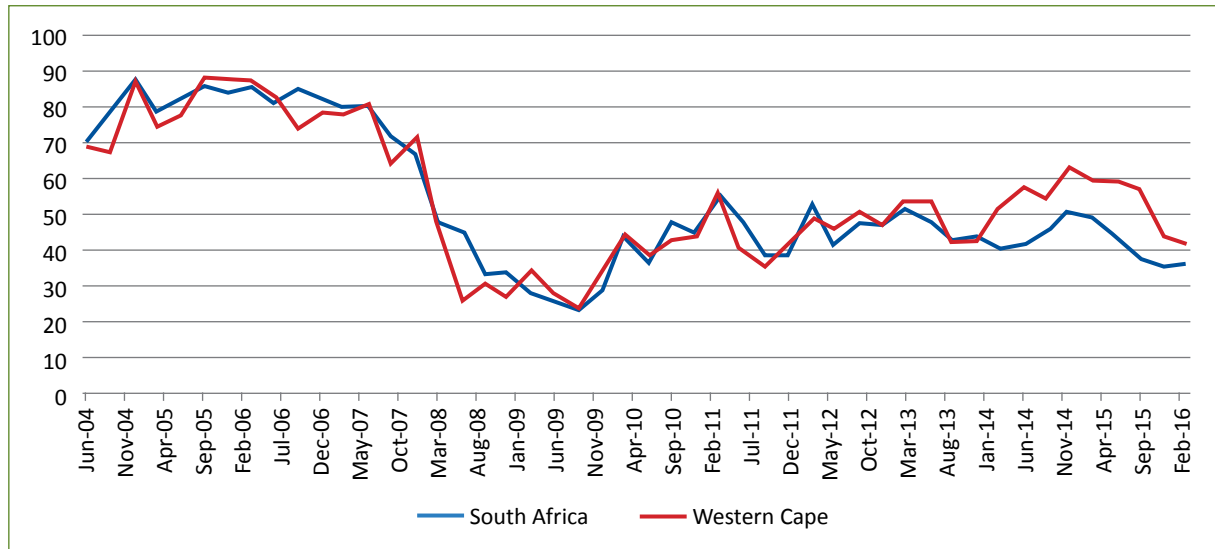
The growth trend in the province reflects the developments in the global economy. In the last five years, growth peaked in 2011 at 3.7%, thereafter it has been increasingly constrained.

## Business Confidence

The Western Cape Province's business confidence remains higher than the rest of the country. The poor economic performance in emerging economies, coupled with domestic economic challenges, has seen business confidence declining across all provinces in the country in the first quarter of 2016.



**FIGURE 48** RMB/BER Business Confidence Index, Jun 2004 - Mar 2016



Source: BER

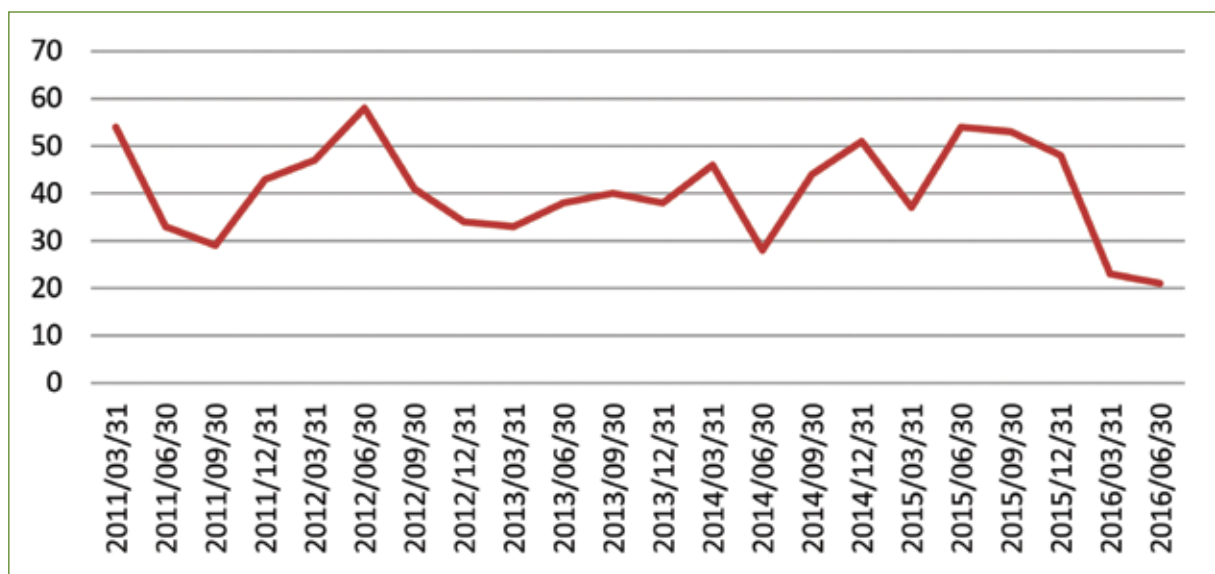
The business confidence index G150 remains well above the national average (which remained stagnant at 36 index points).

The main sector driving business confidence in the Western Cape was the wholesale sector, whose confidence increased from 55 to 66 index points during the first quarter of 2016.

## Manufacturing Sector Business Confidence

The manufacturing sector's business confidence index declined in the first quarter of 2016. Figure 49 below shows changes in this sector:

**FIGURE 49** Manufacturing Business Confidence Index - Western Cape, Mar 2011 - Jun 2016



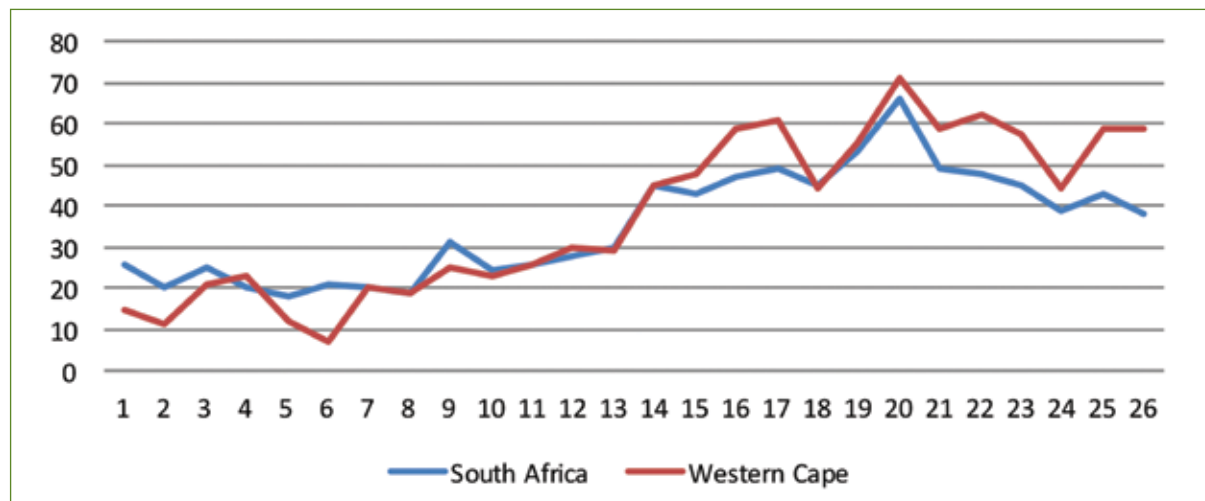
Source: BER

## Building Contractors: Business Confidence

The building business confidence remained high in the province, rising significantly in the first half of the year from 44 index points on the 31st of December 2015 to 59 index points in June 2016, signifying an expected increase in building activity. More significant is the fact that the confidence is above 50 index points, which suggests that sentiments are positive for the sector.

Figure 50 below traces the changes in this sector:

**FIGURE 50** Building Contractors - Business Confidence, Mar 2011 - Jun 2016



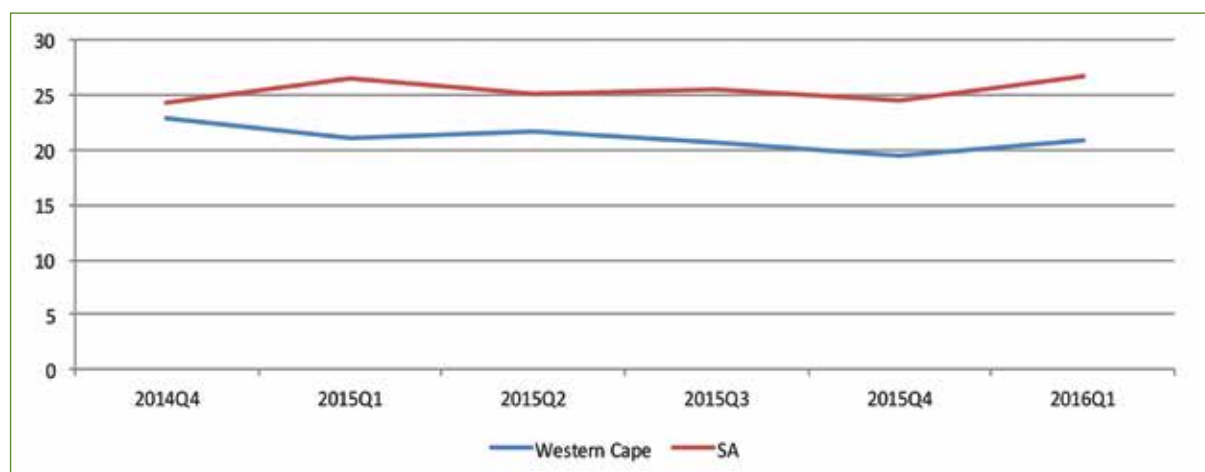
Source: BER

## Labour Market

The rate of unemployment in South Africa increased to a record high level post the 2008/09 financial crisis period, settling at 26.7% in 2016Q1.

The province, whilst consistently lower than national, has not been spared from this trend. Figure 51 below shows the trend of unemployment rates since 2014Q4:

**FIGURE 51** Unemployment Trends 2014Q4 - 2016Q1



Source: Statistics SA QLFS

The trend shows that the unemployment rate in the Western Cape increased by 1.5 percentage points from 19.4% to 20.9% between 2015Q4 and 2016Q1.

The Western Cape swapped positions with Limpopo to become the second lowest province in terms of the unemployment rate. Limpopo recorded an unemployment rate of 18.2% during 2016Q1.

Table 11 below shows how the province fared when compared to other provinces.

**TABLE 11** Unemployment by Province

Official unemployment rate					
	2015Q1	2015Q4	2016Q1	Qtr-to-Qtr Change	Yr-on-Yr Change
	Per Cent			Percentage Points	
South Africa	<b>26.4</b>	<b>24.5</b>	<b>26.7</b>	<b>2.2</b>	<b>0.3</b>
Western Cape	21.0	19.4	20.9	1.5	-0.1
Eastern Cape	29.6	27.4	28.6	1.2	-1.0
Northern Cape	34.1	25.8	27.8	2.0	-6.3
Free State	30.4	29.8	33.9	4.1	3.5
KwaZulu-Natal	23.6	20.5	23.2	2.7	-0.4
North West	28.4	23.9	28.1	4.2	-0.3
Gauteng	28.4	27.6	30.1	2.5	1.7
Mpumalanga	28.4	25.7	29.8	4.1	1.4
Limpopo	20.1	19.8	18.2	-1.6	-1.9

Source: StatsSA

Although the number of employed people in the province decreased by 1.1% on a quarter-on-quarter basis, from 2 380 000 in 2015Q4 to 2 353 000 in 2016Q1 (which translates into a 26 000 job decrease), the overall number of employed people increased on a year-on-year basis by 4.1%, which is the second highest in the country.

Table 12 below shows employment by province.

**TABLE 12** Employment by Province

Employment							
	2015Q1	2015Q4	2016Q1	Qtr-to-Qtr Change	Yr-on-Yr Change	Qtr-to-Qtr Change	Yr-on-Yr Change
	Thousands				Per cent		
South Africa	<b>15 459</b>	<b>16 018</b>	<b>15 663</b>	<b>-355</b>	<b>204</b>	<b>-2.2</b>	<b>1.3</b>
Western Cape	2 261	2 380	2 353	-26	92	-1.1	4.1
Eastern Cape	1 358	1 411	1 367	-44	9	-3.2	0.7
Northern Cape	307	312	313	1	5	0.4	1.7

Employment							
	2015Q1	2015Q4	2016Q1	Qtr-to-Qtr Change	Yr-on-Yr Change	Qtr-to-Qtr Change	Yr-on-Yr Change
	Thousands					Per cent	
Free State	802	825	790	-35	-12	-4.2	-1.5
KwaZulu-Natal	2 546	2 529	2 488	-41	-57	-1.6	-2.2
North West	912	969	924	-46	12	-4.7	1.3
Gauteng	4 911	5 090	4 895	-195	-16	-3.8	-0.3
Mpumalanga	1 154	1 191	1 161	-30	7	-2.6	0.6
Limpopo	1 208	1 311	1 372	62	164	4.7	13.6

Source: StatsSA

The decrease in the level of employment in the Western Cape Province is the lowest when compared to Gauteng (with a decline of 3.6%) and KZN (with a decline of 1.6%).

Table 13 below shows changes in employment in the Western Cape across sectors.

**TABLE 13** Western Cape Employment by Sector, 2015Q4 - 2016Q1

	Qtr-to-Qtr change 2015Q4-2016Q1	Yr-on-Yr 2015Q1-2016Q1
Agriculture	14 000	-25 000
Mining	0	-1 000
Manufacturing	-38 000	-21 000
Utilities	-5 000	-5 000
Construction	-12 000	23 000
Trade	-3 000	47 000
Transport	-4 000	5 000
Finance & Other Business Services	11 000	65 000
Community & Social Services	9 000	-3 000
Private Households	0	6 000

Source: StatsSA

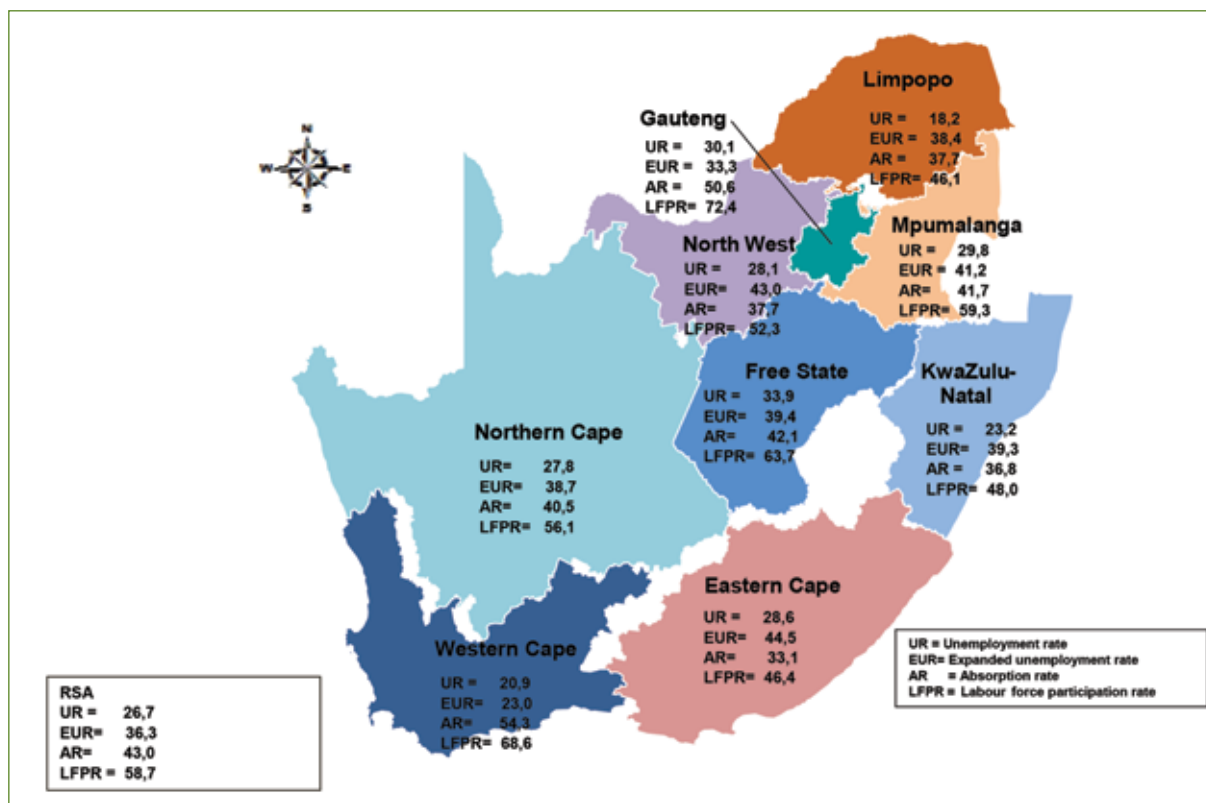
The performance of the agricultural sectors in the province (in terms of employment) remained positive despite the impact of the drought. The sector created net employment of 14 000 jobs during the first quarter of 2016. Another sector that created significant employment was finance, which created net employment of 11 000 jobs during the first quarter of 2016.

The sectors which lost employment during the first quarter of 2016 in the Western Cape were: Manufacturing (38 000), Construction (12 000), Transport (4 000) and Trade (3 000).

However, on a year-on-year comparison, for the labour market performance of 2015Q1 and 2016Q1, the Western Cape Province created 92 000 jobs.

Figure 52 below highlights some interesting labour market trends.

**FIGURE 52** Interesting Labour Market Trends, 2016Q1



Source: StatsSA

## Labour Absorption Rate

The labour absorption rate measures the proportion of the employed working aged population. The Western Cape has the highest absorption rate in the country. It stands at 54,3%, with Gauteng at 50,6% and Free State at 42,1%.

This reveals that while the Western Cape is able to absorb a little more than half of its working aged population into employment, KwaZulu-Natal can only provide job opportunities for 36,8% of its working aged population. Eastern Cape performs the poorest with only 33,1% of their working aged population being able to secure job opportunities.

Furthermore, even though Limpopo has a lower unemployment rate (18,2%), it is only able to absorb 37,7% of its working aged population into employment.



## Labour Force Participation Rate

If we compare the labour force participation rates, it is clear that the Western Cape performs well. The labour force participation rate of the Western Cape (68,6%) is 4,9% higher than the labour force participation rate of the Free State (63,7%), and 22,2% higher than the Eastern Cape (46,4%). Limpopo has both the lowest unemployment rate and the lowest labour force participation rate.

There could be a number of factors driving this, but the change in expanded unemployment rates suggests that the Western Cape has a much more actively searching labour force.

## Official Unemployment Rate versus Expanded Unemployment Rate

When comparing the official unemployment rate (meeting the criteria of actively searching) and the expanded unemployment rate (including discouraged workers who want work but have not actively searched for employment) the results are very interesting. The Western Cape has the lowest expanded unemployment rate (23,0%).

It is 10.3% lower than Gauteng. In stark comparison, there is a 16.4% difference between the Western Cape and Free State and 21.5% difference between the Western and Eastern Cape (which is the highest at 44.5%).

## Summary Labour Market Analysis

Extending the analysis beyond looking only at the official unemployment rates reveals that the Western Cape is performing well in terms of being able to provide job opportunities for its working aged population.

A comparison of official and expanded unemployment rates further suggests that the ability of the Western Province to provide job opportunities may be linked to job search behaviour and plays a role in the province having fewer discouraged workers.

## Current Employment Initiatives

The Province's plans to create employment are clearly articulated through Project Khulisa. It also plans to create an enabling environment for businesses to grow and absorb more labour through skills development and improving the ease of doing business.

Looking beyond employment and unemployment rates alone, it is clear that the labour market of the Western Cape has been performing better than many other Provinces.

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