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1. BROAD TRENDS IN THE ECONOMY, 1999 - 2002

Encouraging Signs of Growth

Since 1994 South Africa has enjoyed only moderate economic growth and a mixed industrial performance. There is clear evidence of a growing ability to compete in demanding international markets, shown by our better export performance and underpinned by significant growth in productivity. However, output, investment and particularly employment growth have been far from satisfactory. Sectors that have low levels of export orientation have generally performed particularly poorly, as domestic demand has been constrained.

However, from late 1999 the situation began to improve. This improvement accelerated in 2001. The South African GDP grew at an annualized 2.5% in the last quarter of 2001. The manufacturing sector experienced particularly strong growth of 5.6%. Moreover, this may have accelerated further in the first quarter of 2002. Manufacturing business confidence rose in the first quarter of 2002 and is currently at its highest level for six years.

There are two reasons for this improvement: firstly, enhanced export growth following the decline in the value of the Rand, and the anticipated economic revival in the global economy that is expected to gather speed in the second half of 2002; secondly, the currency-induced shift away from (now more expensive) imports to local production. The decline in the value of the Rand is therefore expected to have a positive impact on the performance of the manufacturing industry.

The short-term outlook for the manufacturing sector is therefore distinctly favourable. The outlook for the retail and wholesale trades and building and construction sectors is similarly good. The projections for output, export, investment and employment growth for 2001, and projections for 2002 and 2003 for the manufacturing sector are summarized in Table 1.

2. OUR ECONOMIC PERFORMANCE 1999-2002

Strong Manufacturing Sector Growth

Starting in the third quarter of 1999, the manufacturing sector has grown steadily – averaging almost 4% year-on-year growth in production volumes. Despite the sharp weakening of the world economy since the middle of 2000, the manufacturing sector has shown no tendency to decline. Indeed manufacturing growth accelerated at the end of 2001 and has remained buoyant in the first quarter of 2002.

By the end of 2001, industrial production in South Africa was growing at over 5%. This compares favourably with most other middle income industrializing countries (see Appendix, Table A). However, this figure is probably somewhat inflated by people buying ahead (e.g. motor vehicles, imported goods) to avoid considerable price hikes caused by the fall of the Rand in the last few months of 2001. According to *The Economist*, year-on-year growth for industrial production for February 2002 continued at 5.5%[1].

Amongst the sectors that have tended to perform well in terms of gross output over the last few years are motor vehicles, parts and accessories, chemicals and television, radio and communications equipment. Increasing output in the motor vehicle sector has also provided a considerable spur to related industries – glass, rubber, leather and plastics.

Poor Performing Manufacturing Sectors – Some Conclusions

The poorly performing sectors include the wage goods (consumer) industries – particularly textiles, wearing apparel and footwear as well as food and beverages. Poor performance is mainly a result of slow growth in the domestic market. In turn, this is linked to high interest rates.

In terms of growth (gross value of production less intermediate inputs), an appropriate measure of an industry's performance, since 1994 plastics, basic non-ferrous metals, basic chemicals, other chemicals,

[1] The Economist, April 20-26, 2002

- Capital goods and equipment such as electrical machinery and transport equipment, excluding motor vehicles and parts. This is related to low levels of domestic investment.

The slow rate of growth of the wage goods sectors has been particularly significant. The share of manufacturing output accounted for collectively by the food, beverages, wearing apparel, textiles, footwear and furniture sectors declined precipitously from 29% in 1994 to only 24% in 2001.

Towards the end of 2001 there was a significant acceleration of consumer expenditure and of investment. The increase in consumer spending probably was in order to pre-empt price hikes caused by the depreciation of the Rand. As a result, the retail sector saw sales volumes rise by 4.6% year-on-year during the final quarter of 2001. This is unlikely to last. Nevertheless, retail business confidence is currently quite high and wholesale confidence rose in the first quarter of 2002.

Less spectacularly, but more sustained, there was also a rise in investment expenditure. Some of this was also pre-emptive currency-induced purchasing, but there are indications that a part of this expenditure reflects more optimistic projections of the future on the part of business. In addition, government expenditure – both consumption and fixed investment – has been accelerating.

Export Performance

The share of exports in manufacturing output has more than doubled in seven years. In 2001, 28% of manufactured output was exported as compared to 14% in 1994. This is consistent with world trends where exports of manufactures have been rising 3.5 times more rapidly than output[2]. Manufacturing's share of total exports has risen from 35% in 1994 to over 50% now[3]. The lessons for a manufacturing-centered industrial strategy are clear.

[2] World Bank (2002): p. 39

[3] TIPS South African Standardised Industry Base (see www.tips.org.za)

were responsible for more than 56% of manufactured net exports. The outstanding performer here is machinery and equipment (which includes catalytic converters)[4]. Machinery and equipment has become the largest net exporter, responsible for more than one-quarter of all South African manufactured exports. Other high technology sectors, more particularly motor vehicles and parts, also exhibit substantial growth in net exports. The high technology sectors share of net exports has consistently been rising more rapidly than the high technology sectors' share of value added. In 2001, by contrast with both the low and medium technology sectors, the high technology sector was responsible for a larger share of manufacturing net exports (56%) than manufacturing value added output (41.5%).

It should be noted, that a number of the consumer goods industries that have high labour intensities – notably food and food products, beverages, textiles, wearing apparel and footwear – all have a low export orientation. This has implications for employment (see below).

A number of factors account for the growing export orientation of our manufacturing sector. They include:

- A consistent industrial strategy that has placed considerable stress on exporting. Overall tariff liberalization and export-import arrangements, as for the auto industry, have been combined with supply support measures.
- Exchange rate depreciation has provided a direct stimulus to exports; but it has also provided considerable protection to domestic producers faced with declining tariffs.
- The rapid rate of growth in the world economy – at least until the end of 2000.
- The adoption of new technologies and the upgrading of existing systems has seen substantial rises in labour productivity. This has, in

[4] The high net exports for this category, in particular, need to be treated with some caution. Note that net exports (R10,386bn.) exceed the value added for this sector (R6,432bn.). Some exports, such as catalytic converters, will have a high net export value since they are high value exports which utilize largely high value local inputs and few imported intermediates. Similarly, because high value (local) inputs constitute a large share of gross output, the value added for these products is low.

Rising productivity underpins increases in employee pay – employee remuneration has been rising rapidly and increased by just over 3% in 2001. Rising labour productivity and labour productivity increasing at more rapid rates than employee remuneration are significant signs of the growing capacity of South African manufacturing firms to compete in global markets.

The implications for employment are not so encouraging. For a given level of output, the higher the labour productivity gains, the fewer employees per unit are needed (lower labour absorption). Rapid productivity increases in South African manufacturing have taken place in a context where output has been growing only slowly. As a consequence, manufacturing has consistently been shedding labour. Between 1997 and 2001, while manufacturing value added increased by 6% in total, employment decreased by 11%, indicating a structural shift towards lower labour intensity. There are only a few sectors that have, over the last five years, experienced any increase in their demand for labour – leather and leather products, plastic products, wood and related products, other chemicals and television, radio and communications equipment, printing publishing and recorded media and basic chemicals. However, there is some indication that the shedding of labour is now bottoming out (see below).

Many of the sectors that have seen rapid increases in output, such as television and communications equipment, motor vehicles, parts and accessories and basic and other chemicals, are also less labour intensive than is the manufacturing sector on the whole. The more labour intensive sectors are consumer goods industries that tend to be strongly dependent on the domestic market. With domestic demand limited by high interest rates, and not being strongly export-focused, these sectors have seen significant declines in output.

Furthermore, a number of these most labour intensive sectors – such as clothing, wood and wood products, footwear and furniture – have seen significant declines in employment intensity as measured by the employment/output ratio.

The Database

The BER sample for its survey in the first quarter of 2002 was 1151 executives. The response rate was 58%. The sectoral composition of the sample was as follows:

• Food	96	• Paper	56	• Basic metals	67
• Beverages	96	• Printing & publishing	56	• Metal products	67
• Textiles	96	• Leather products	56	• Machinery	67
• Clothing	96	• Rubber	56	• Electrical machinery	67
• Footwear	96	• Chemicals	56	• Transport	67
• Wood products	96	• Non-metal minerals	56	• Plastics	67
• Furniture	96				

Table A: South Africa – Comparative Industrial Performance 2001

	INDUSTRIAL PRODUCTION DEC 2000 – DEC 2001 YEAR ON YEAR CHANGE
ASIA	
China	+8.7
India	+1.6
Malaysia	-7.7
Philippines	-11.3
South Korea	+3.3
Taiwan	-6.1
Thailand	+1.3
LATIN AMERICA	
Argentina	-18.3
Brazil	-6.1
Chile	-1.9
Colombia	-1.4
Mexico	-3.6
EASTERN EUROPE	
Turkey	-9.4
Czech Republic	+7.0
Hungary	+1.6
Russia	+2.6
SOUTH AFRICA	**+5.4**

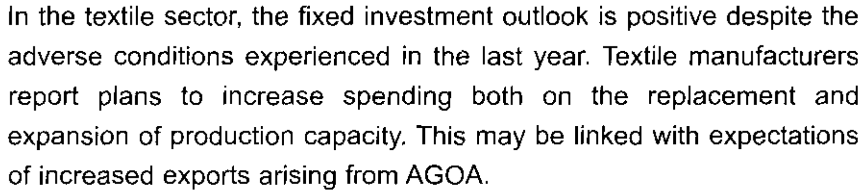
Source: The Economist February 9th, 23rd, March 2nd 2002

In terms of the BER's baseline forecast, no further dramatic rise in rates is anticipated.

While the private residential sector has experienced a sharp revival since 1999, confidence levels in the industry remain below their 1995 peak. Private residential investment is expected to continue its growth in the short term as the number of building plans passed for residential buildings is still growing. The budget allocation for public sector housing has been accelerated and is projected to grow in nominal terms above the 10% level over the next three years. Focus will now shift to the provision of medium density housing, expanding the rental stock and placing greater emphasis on the People's Housing Process, whereby households will be encouraged to supplement their housing subsidies by building or organizing the building of their housing themselves. This process will provide great opportunities for small businesses and employment to grow in the construction sector.

Investment in non-residential buildings, being a reflection of overall domestic economic activity, has exhibited a declining trend since 1995. An adequate stock of industrial and retail space exists at prevailing levels of growth and no meaningful recovery in this sector is expected before late 2003.

The combined outlook for the building industry remains modest, but in construction works the outlook is more positive. Investment in construction works declined throughout the nineties, principally because of government's policy to curtail expenditure. Government has recently stated its intention to step up its overall capital expenditure program. Aggregate capital expenditure is projected to increase in nominal terms by no less than 30.9% in the next fiscal year. Capital, as a percentage of total expenditure will rise from 6.6% in 2001/02 to 8.5% in 2004/05. This rise in capital expenditure should have a notable positive impact on the construction works sector over the next three years.

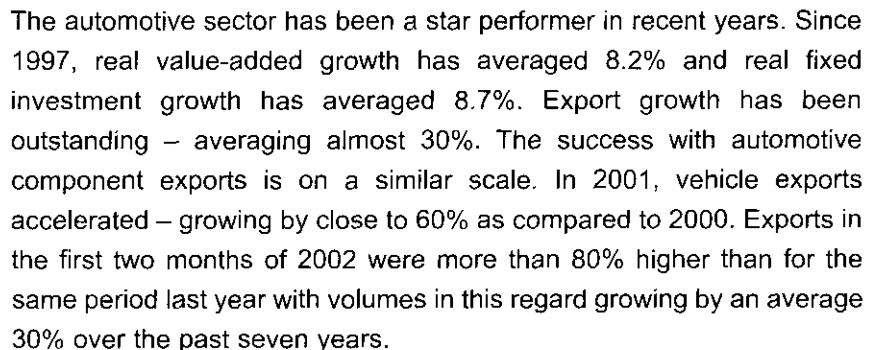


In the textile sector, the fixed investment outlook is positive despite the adverse conditions experienced in the last year. Textile manufacturers report plans to increase spending both on the replacement and expansion of production capacity. This may be linked with expectations of increased exports arising from AGOA.

The clothing sector's performance is dependent on consumer demand. Private consumption expenditure and its determinants (interest rates, and particularly, real after-tax personal income) are the important drivers of business conditions in this sector. Textiles have strong forward linkages with the clothing industry particularly. It is anticipated that real household expenditure will increase from the second half of 2002, substantially increasing prospects for this sector. In the textile sector, the fixed investment outlook is positive.

Automotive

Recent Success – Global Challenges



The automotive sector has been a star performer in recent years. Since 1997, real value-added growth has averaged 8.2% and real fixed investment growth has averaged 8.7%. Export growth has been outstanding – averaging almost 30%. The success with automotive component exports is on a similar scale. In 2001, vehicle exports accelerated – growing by close to 60% as compared to 2000. Exports in the first two months of 2002 were more than 80% higher than for the same period last year with volumes in this regard growing by an average 30% over the past seven years.

The sector's outstanding export performance and its increasing integration into the global vehicle manufacturing industry is a direct result of government's Motor Industry Development Programme (MIDP), introduced in 1995.

Domestic sales of new vehicles increased by 7.6% in 2001. While heavy commercial vehicle sales remained strong in the first quarter of 2002, there has been a decline in the sales of passenger cars and light

Other factors that underpin favourable investment intentions are a notable easing of the tax constraint following the fixed investment tax incentives announced in the budget in February 2001, a more expansionary budget and an increase in government investment and infrastructural spending, and manufacturers' improved rating of the general political climate.

Overall real manufacturing fixed investment is projected to increase by 7.2% in 2002 and accelerate to 10.2% during 2003.

Employment: Labour Intensive vs Capital Intensive Sectors

There are indications that the decline in manufacturing employment is bottoming out. In the first quarter of 2002, only a net 10% of manufacturing respondents are expected to retrench workers. This compares to 30% a year ago. There are also indications of declining rates of retrenchments from a number of other sectors – retail and wholesale trade, and building, construction and civil engineering

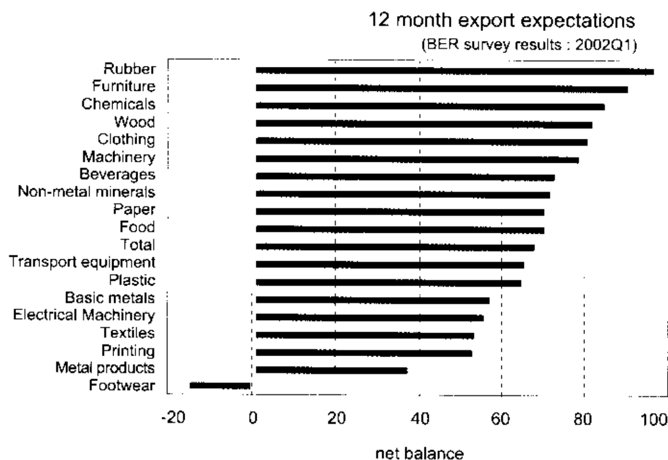
A number of manufacturing sectors reported strong year-on-year increases in factory employment during the first quarter of 2002. These include non-metallic minerals and a number of export sectors including rubber, chemicals and machinery. Sectors reporting more limited declines in employment include basic metals, transport equipment, paper, plastics, wood, metal products and electrical machinery.

Many of these sectors are capital intensive. It remains a concern that the labour intensive sectors that have seen significant employment declines, such as food, clothing, footwear and furniture, have reported deep cutbacks in employment. Printing and textiles have also seen significant employment reductions.

If there is to be any substantial employment creation in manufacturing, there will need to be improvement in employment in the labour intensive industries. These industries are very dependent upon the domestic market.

This very positive outlook is characteristic of all manufacturing sectors – with the sole exception of footwear. In most sectors, more than 50% of BER respondents expect to increase export volumes. Sectors with the most optimistic short-term expectations for exports include rubber, furniture, chemicals, wood products, clothing, machinery beverages, non-metallic minerals, paper and food. The fact that this includes some sectors that currently have a low export orientation is both encouraging and worthy of note from a policy perspective. The agro-processing industry appears to be benefiting substantially from the EU FTA. AGOA is likely to stimulate exports of clothing and textiles as well as from the automotive and component sectors. Exports on the part of the consumer good industries – furniture, clothing, food and beverages – are driven, to some extent, by adverse domestic market factors.

Graph 1: 12 Month Export Expectations



Source: BER Short term outlook for South African industry

Strong export growth combined with higher prices for imports following the decline in the value of the currency should further reduce the deficit on the manufacturing trade balance. This is expected to be R25 billion in 2002 and R20.5 billion in 2003.

Real manufactured exports (SIC chapter 3) are projected to grow by 6.6 % during 2002 and accelerate further to 10.5 % in 2003.

The physical volume of production is projected to grow by 4.4% during 2002, from 3.5% last year, and to accelerate to 5.5% in 2003.

Mixed Messages: Domestic Economic Prospects

There has been strong growth in domestic demand and a rising level of unfilled orders. This is not due to acceleration in consumer demand, but rather a result of increased local sourcing following the currency depreciation. The acceleration in demand has also resulted in insufficient finished goods inventories, which will further stimulate production.

However, the weaker currency will also impact negatively on the domestic market due to the impact that it will have on capital equipment and imported input prices and on the interest rate.

There has been a considerable improvement in the building and construction and civil engineering sectors, and more recently, in the private residential sector. This will benefit the non-metallic minerals sector. Increased mining investment and increased spending by government on infrastructure will also have a favourable impact on the downstream non-metallic minerals and glass sectors.

A number of other sectors reported strong domestic demand during the first quarter of 2002 – including rubber, beverages, chemicals, plastics, base metals, wood products, metal products and clothing and textiles.

There are a number of risk factors facing the domestic market in the short term:

- The impact of higher prices and higher interest rates and concomitant price and interest rate expectations.
- The end of pre-emptive buying. This is likely to impact on the durable goods sector.
- The likely decline in real wage income growth as inflation overtakes wage increases.
- Increases in the petrol price.