Industrial Development Corporation
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Economic overview:

Recent developments in the global and South African economies

February 2017
Department of Research and Information

HIGHLIGHTS

- **Prospects for global growth are set to improve over the medium term, following a difficult 2016.** Faster rates of expansion in the world's most advanced economies and in some emerging markets, such as India, may lift global growth to 3.4% in 2017, from an estimated 3.1% in 2016.

- **The rebound in commodity prices through 2016 and early in 2017 has brought about some relief for resource-reliant economies, many of which in Sub-Saharan Africa.** Although the upward trend in commodity prices is expected to gain additional momentum, especially in the short-term, the underlying market fundamentals remain generally unsatisfactory. Moreover, higher interest rates in the US and further dollar strength would impact negatively on prices.

- **Recent developments in the United States pose substantial downside risks to world growth and may lead to an escalation in geo-political tensions.** The inwardly-orientated and protectionist strategies espoused by the Trump administration may result in fundamental changes to the world's politico-economic order, potentially impairing global trade and investment activity, slowing down the world's expansion momentum and further destabilising the world's fragile political environment.

- **The United Kingdom's withdrawal from the European Union brings forth additional uncertainty.** Its impact is and will continue being transmitted through various channels, including investment and trade flows. The effects on the real economy, not only in the UK but elsewhere in Europe, will start being felt in due course. The South African economy stands to be affected as well, particularly if economic conditions in the UK weaken significantly, for it is an important trading partner, the largest foreign investor in the country and a key source of tourists.

- **The past year was particularly challenging for the South African economy.** Lacklustre performances were recorded by most sectors, with sharply lower output levels reported by both agriculture and mining, and only marginally higher manufacturing production. Improved climatic conditions, particularly good rainfall in most of the maize producing areas, underpin expectations of significantly higher agricultural output in 2017, notwithstanding the threat posed by the Fall Armyworm outbreak in the northern part of the country. However, weak demand domestically and subdued economic conditions in key external markets should continue affecting the manufacturing and mining sectors' performances.

- **South Africa's trade balance improved substantially in 2016, supported by increased export revenues.** The deficit on the trade account dropped to R12.5 billion, from R82.7 billion in 2015. The recovery in commodity prices and a weaker currency contributed to the 8.1% rise in the mining sector's exports, while higher fruit exports backed the 16.2% increase in agricultural exports. Although manufactured exports were R41 billion higher, the sector still recorded a R300 billion deficit in 2016. The trade balance may yet again be under pressure during 2017.

- **The protectionist measures being advocated by the new political administration in the United States could have adverse implications for South Africa's economic performance.** Should countries such as China and Mexico, among others, face high barriers to entry in the US, they are likely to seek alternative world markets, including South Africa, intensifying competition in the global marketplace. Major South African export sectors have benefitted from preferential trade arrangements under AGOA, which provides duty-free access to the US market. Although not anticipated at this stage, major changes to AGOA could affect the performances of the sectors producing motor vehicles, beverages, clothing and footwear, among others.

- **South Africa's economic growth is expected to improve slightly in 2017, but will remain unsatisfactory.** Better demand conditions in key external markets and higher commodity prices may underpin a reasonable export performance, but it could be somewhat compromised by the rand's relative strength, if sustained. The improved outlook for inflation may justify the end of the interest rate hiking cycle, providing some comfort for households and businesses. Fixed investment is, nevertheless, likely to remain weak due to spare production capacity in most sectors of the economy. The threat of downgrades to the sovereign rating still looms large.

IMPLICATIONS FOR SOUTH AFRICAN BUSINESS IN SELECT SECTORS

Potential impact of domestic and global developments on South African businesses in select sectors over the medium-term

Sectors	Domestic economic environment	Potential impact of US policy developments	Potential impact of Brexit	Potential impact of commodity price movements
Basic metals and mining	Marginally negative	Marginally negative	Neutral / no impact	Marginally positive
Machinery and equipment	Marginally positive	Marginally positive	Neutral / no impact	Neutral / no impact
Automotive and transport equipment	Marginally negative	Marginally negative	Neutral / no impact	Neutral / no impact
Basic and speciality chemicals	Neutral / no impact	Marginally negative	Neutral / no impact	Negative
Chemical products and pharmaceuticals	Marginally positive	Marginally negative	Neutral / no impact	Marginally negative
Agro-processing and agriculture	Marginally positive	Positive	Positive	Marginally negative
Clothing and textiles	Marginally negative	Negative	Neutral / no impact	Neutral / no impact

Positive	Marginally positive	Neutral / no impact	Marginally negative	Negative

- Business confidence in the **base metals and fabricated metals** sectors is at very low levels at present, and business conditions are expected to remain largely unfavourable throughout 2017. Relatively weak investment activity, both in the residential and non-residential building segments, is affecting construction activity. Furthermore, marginal rates of growth in household expenditure are impacting on demand for consumer products, with implications for producers of cans and other packaging. Such developments will continue to weigh on the base metals sector, including structural and other fabricated metal products, at least in the short-term.

Furthermore, the base metals sector could be adversely affected by protectionist policies in the US, as these could prompt Chinese manufacturers of fabricated metal products to seek alternative markets. This could result in dumping practices, both in South Africa and elsewhere on the African continent.

The recent recovery in commodity prices will be supportive of the viability of mining operations, although the potential weakening of Chinese demand may erode some of these benefits. Domestic **mining** activity is expected to continue being affected by on-going operating challenges and policy uncertainty.

- The public sector's infrastructure investment programme should impact positively on the capital goods industry, particularly electrical **machinery and equipment** required by Eskom's build programme as well as IPPs, particularly with revived efforts by the State to increase localisation. The anticipated recovery in private sector fixed investment spending from 2018 onwards should also be supportive of the machinery and equipment sector.

  Potentially strained trade relations between the US and China, as well as with Mexico, could support domestic machinery and equipment production by filling the market void that could emerge. On the other hand, local producers could face significant competition in domestic and export markets due to Chinese and Mexican machinery and equipment manufacturers seeking alternative markets for their products.

- Considering the difficult consumer environment, spending on durable items such as **motor vehicles** is likely to remain under pressure over the short-term. Since domestic economic growth is forecast to remain quite modest, corporate demand for commercial vehicles is also likely to be subdued, especially in 2017. However, exports of passenger cars are projected to remain quite strong due to the integration of the local industry in global supply chains.

  Under AGOA, South African produced motor vehicles have duty-free access to the US market. This benefit is not expected to change any time soon, but exports could be affected by lower economic growth in the US if the adverse effects of protectionism highlighted in this report materialise. However, AGOA may be reviewed by the Trump administration to obtain greater reciprocity. As such, caution should be exercised if foreign OEMs potentially facing punitive tariffs in the US market attempt to use South Africa or other African countries as export bases from which to penetrate the American market, as this could jeopardise the AGOA arrangement.

  South Africa's motor vehicle exports to the UK may benefit from Brexit should vehicles produced in the EU face more difficult market entry. However, potentially lower economic growth in the UK and/or EU due to Brexit may counter such potential benefits to some extent. Furthermore, should the UK vehicle producing industry suffer setbacks, its demand for South African vehicle parts and components may decline.

- The industries manufacturing **chemical products** (e.g. pharmaceuticals, paints and varnishes, soaps and detergents, pesticides) are expected to benefit from domestic demand, whether from the household sector or through public sector procurement for, say, pharmaceutical products.

  However, the broader chemicals value chain is expected to face increased competition from Chinese competitors should their access to the US market be curtailed.

  Higher input costs due to rising commodity prices are expected to add further difficulties for the value chain, as the costs may not be easily passed on to intermediate- and/or end-users.

- A recovery in household consumption expenditure over the medium term should be growth-supportive for the **processed food and beverages** sectors, as well as for primary agriculture (e.g. fresh fruits, vegetables). The agricultural sector will also benefit from the normalisation of climatic conditions. The associated decline in primary agricultural prices should translate into lower input costs for the food processing sector, increasing its price competitiveness.

  Demand emanating from the US and/or China could increase in the event of punitive trade tariffs being applied to one another. Seasonal production factors will, of course, play a role.

  The UK's withdrawal from the EU may enable the Southern African Customs Union to negotiate improved access for agro-processing and agricultural products to the UK market as the restrictive conditions hitherto imposed by other EU countries will no longer have to be accommodated.

- Since the short-term outlook for household spending remains generally unsatisfactory, demand for **clothing and textiles** may weaken in 2017.

  Import competition would most likely intensify if Chinese and Mexican clothing manufacturers loose substantial market access in the US. This would counter on-going efforts to stabilise the domestic sector.

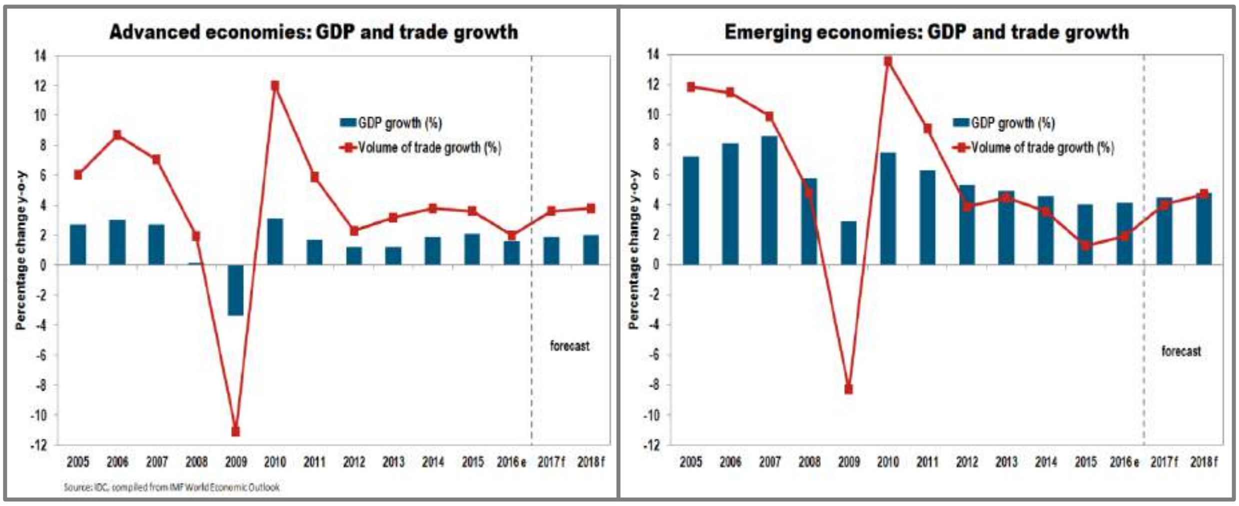
GLOBAL ECONOMIC CONDITIONS

An extraordinary degree of uncertainty and unease has characterised the world's politico-economic environment since the start of 2017. Powerful forces currently at play point toward potentially fundamental changes in the world order, both from an economic perspective as well as geopolitically.

In its January update and projections, the International Monetary Fund (IMF) expects the global economy to recover somewhat during 2017, with its output forecast to expand by 3.4%.

The advanced economies as a group are projected to grow by 1.9%, largely underpinned by marginal improvements in the growth outlook for Germany, Japan, the United Kingdom (UK) and the United States (US). Economic activity accelerated in the second half of 2016 in most of these countries and, in the case of the US, fiscal stimulus is anticipated going forward.

The growth outlook for emerging markets has been lowered slightly, particularly due to downward revisions for large economies such as India and Mexico, which offset the impact of marginally better prospects for the Chinese economy. The recent rise in commodity prices is supportive of commodity producers, but expectations are that some degree of consolidation might occur.



The IMF has emphasised, however, that the downside risks to its forecasts are elevated due to the level of uncertainty brought about by recent developments in the US and the UK and the impact which these could have on the global economy.

Potential impact of policy developments in the United States under the Trump administration

Since President Trump's inauguration there has been a flurry of executive orders and pronouncements aimed at progressively fulfilling or confirming promises made during his election campaign.

In the economic arena these range from pulling the US out of the Trans Pacific Partnership (TPP) trade agreement, confirming a forthcoming review of the North American Free Trade Agreement (NAFTA) and radical tax reforms, using moral suasion on select companies to retain the benefits associated with their activities in the American economy and, among others, speeding-up environmental reviews for infrastructure projects.

Under the slogans “Make America Great Again” and “America First”, the core of his administration’s economic policy is, simplistically, likely to be characterised by inward-oriented and import substitution strategies aimed at expanding domestic production and consumption of locally-produced items, increasing investment spending and employment levels, raising wage levels and accelerating economic growth.

Trade, industrial and fiscal policy instruments, as well as regulatory reforms will be used for this purpose, including import tariff and other trade barriers, industrial incentives, tax reforms, deregulation and, among others, massive spending on infrastructure development and upgrading. Tactical strategies will also be pursued to tilt the balance of benefits in existing trade agreements more in favour of the US, as well as in seeking to alter aspects of the global trading and investment regimes that are deemed to be “unfair”. Out of its principal trading partners, Mexico and China have been specifically targeted since the start of President Trump’s election campaign.

A goal of 4% growth in US GDP by 2020 has been communicated widely. However, this will be extremely difficult to achieve for an advanced economy, especially the world’s largest. Furthermore, the Trump administration will, along the way, face strong opposition, obstacles and, in many instances, convoluted bureaucratic processes, the extent of which have perhaps been underestimated or unanticipated.

Whether or not the Trump administration succeeds in implementing most of its policy proposals and strategies, the seeds of uncertainty will have been sowed in the process. This will clearly affect global markets, which are highly driven by perceptions, expectations and sentiment. In addition, the relatively unpredictable and at times inconsistent approaches displayed thus far, generally communicated through the unconventional and “instant” use of twitter messages, exacerbate the reaction.

The risks posed to the global economy are thus likely to remain high throughout the four-year term of this new, protectionist or mercantilist American administration. A bird’s-eye view of potential economic impacts associated with a changing US policy environment is provided in the table below. Such effects would be transmitted through various mechanisms, either directly and/or indirectly, potentially altering the world’s economic landscape to a substantial extent.

Possible impacts of shifting US trade and foreign policies on the global economy

International trade	• Protectionist measures adopted by the US would adversely affect the export performance of the targeted trading partners (most likely Mexico and China). These would surely lead to retaliatory measures and consequently affect the US's own export performance. • Moves by the US to redress what it deems to be unfair practices in world trade could ultimately alter, substantially and possibly somewhat irreversibly, the global trading regime. Such moves include labelling China a currency manipulator and instituting trade cases against Chinese subsidies both in the US and the World Trade Organization (WTO). Possible US withdrawal from the WTO if complaints against the US tariffs are lodged. • Relocation of US companies' global production to the US, discouraging them from investing in production facilities offshore, will affect global value chains and the associated trade. • Disruption of global supply chains as US companies' onshore production may impact on the global competitiveness of industries across various countries. • Increased protectionist tendencies worldwide, as countries aim to protect domestic industries, would lead to reduced global trade and possibly overall world demand. • Changes in the relations between the US and some of its principal trading partners may trigger a realignment of global trade relationships on much broader level, potentially creating opportunities for certain countries to benefit from the resulting gaps in the market.
International capital markets	• Relatively high volatility may be expected in global financial markets as the Trump administration rolls out some of its policies and strategies. This would be largely due to their impact on the status quo, the potential for policy conflict, inconsistency and/or incoherence, and/or their premature announcement. • In the short-term, ahead of a future lowering of tax rates and capex spending on infrastructure, there could be increased portfolio flows to US equity markets in anticipation of higher corporate profitability and/or earnings. However, reversals may ensue in the medium- to longer-term as protectionist measures and global retaliation take a toll on US business performance. • A substantial lowering of company tax rates in the US would prompt corporate relocations and possibly increased FDI flows to the US, diverting them away from other host countries. • Increased fiscal spending combined with lower tax revenue result in a significant rise in government debt levels, increasing the risk of US government debt securities; • Volatility in currency markets as trade and investment capital flows are altered significantly and the US dollar potentially faces increased competition as the currency of choice for global transactions. • The US Federal Reserve may be forced to raise interest rates at a faster pace and to a greater extent than currently anticipated in an effort to counter the build-up of inflationary pressures accompanying policy-led distortions in product markets. The realignment of financial flows around the globe may lead to significant volatility in exchange rates and asset prices. • In retaliation for trade-related actions taken by the US, China (world's largest creditor nation) may reduce its exposure to US debt, with serious implications for bond yields.

<table>
<tr><td>Global economy</td><td>

- Support to US GDP growth is expected to be short-lived with risks for slower growth over the medium-term, impacting on global economic prospects negatively:
  - In the short-term, reduced US imports of lower-priced foreign items is likely to lead to disruptions in production, raise inflationary pressures, hamper the competitiveness of US products in external markets due higher input costs, and, by implication, affect US growth;
  - Retaliatory measures would result in current US suppliers to global markets being negatively impacted, reducing the export potential for US producers in general;
  - Lower imports and sizeable infrastructure development programme would support manufacturing activity and overall growth in the US in the medium- to longer-term;
  - Immigration policies are likely to prove quite costly to the US economy due to: the cost of removing illegal immigrants and containing the entry of non-residents; upward pressure on wages; loses in private sector output; negative impacts on the US economy as price competitiveness and household discretionary spending are potentially curtailed;
  - US fiscal deficit could rise substantially during President Trump's term, taking the debt-to-GDP ratio to considerably higher levels.
- China's slowing economy would be affected negatively by an adversarial relationship with the US, which would seek to substantially curtail Chinese export penetration in US markets. Considering its current structural weaknesses, Europe is unlikely to play a countering role.
- A protectionist US stance towards trade and investment could prompt other countries to follow suit in an effort to protect their domestic economies and political interests. Initial reactions from global trading partners indicate that there could be significant push-back, with the likelihood of trade wars with at least China and Mexico.
- Rising protectionism would be visibly reflected in reduced world trade flows, impacting negatively on the export and economic performance of the world's open economies albeit to varying degrees. Over time, this would also lead to increased inefficiencies in global production, higher inflationary pressures and reduced technological advancement.
- Constrained trade flows and slower growth globally would impact negatively on emerging economies, such as South Africa and other African economies, particularly as exports of commodities and certain manufactured products are curtailed.

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<tr><td>Geo-political stability</td><td>

- The Trump administration may accelerate the transition to a multipolar world, thereby creating unpredictable stresses in the international system or world order, and lead to an escalation of geo-political tensions.
- A weakening of NATO's power and US relations with some of its key allies could tempt some regional actors to test the resolve of the US and other western powers on territorial sovereignty matters.
- Geo-political instability could result in disruptions to global trade and value chains (e.g. increased conflict in the South China Sea; shipping routes affected by regional conflicts; supply of crucial commodities interrupted, such as oil supplies from the Middle East).
- A relatively "temperamental" Trump administration, coupled with the potential for nuclear proliferation could have unpredictable consequences for world peace and security.

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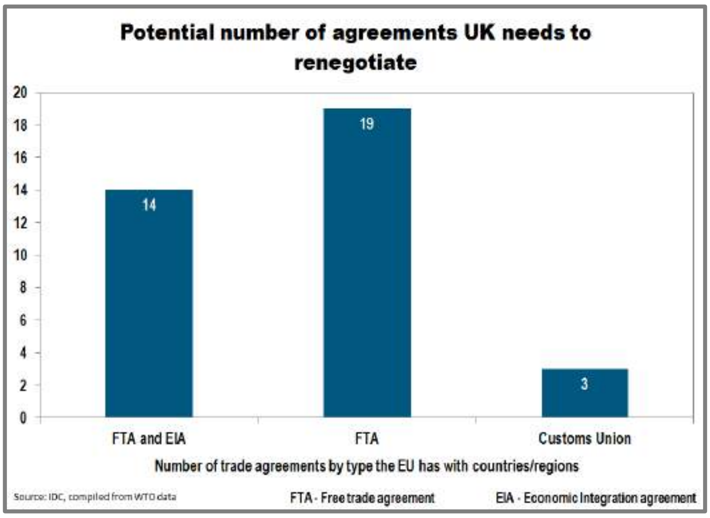
Brexit poses substantial risks[1]

In the United Kingdom, the House of Commons approved the European Union Bill, which authorises government to invoke Article 50 of the Treaty of Lisbon and thus start negotiating the terms of the country's withdrawal from the European Union (EU), commonly referred to as Brexit. The bill must still be approved by the House of Lords, but expectations are that Prime Minister Theresa May will formally trigger the start of the negotiation process as early as the first week of March. In general terms, the impact of Brexit is still expected to be negative, not only for the UK and the EU but also for the global economy.

The impact of Brexit is and will continue being transmitted through various channels, including investment and trade flows. Perceptions and expectations of future developments will play a crucial role in determining the severity of repercussions. The financial markets, particularly the stock-markets and currency markets, took the immediate brunt of the exit outcome. These are expected to remain volatile for quite some time. The effects on the real economy will soon also start being felt. Much will depend on how businesses, investors and households, react to the uncertainty accompanying the UK's withdrawal process from the EU.

Of particular importance will be the time period involved in negotiations between the UK and the remaining 27 member states, and of course the actual deal that will be struck. The process may turn out to be protracted, with the accompanying uncertainty being clearly negative for growth. The position which the EU will take in the negotiation process is difficult to predict at this stage. Although EU countries, especially Germany and France, initially communicated a fairly hard stance, the tone has softened to some extent more recently. However, some of the bloc's largest economies are facing crucial national elections in 2017 and the incumbent governments may thus be inclined to adopt tough stances to discourage voters from voting for an exit. The eventual positioning could well be different after the elections though, as the UK remains an important trading and economic partner.

The UK will have to negotiate trade agreements with many regional blocs and individual countries around the globe. These agreements could be substantially different from the prevailing ones under the umbrella of the EU, as the UK will aim to protect its own interest and will not be bound to the interests of some of its European partners.

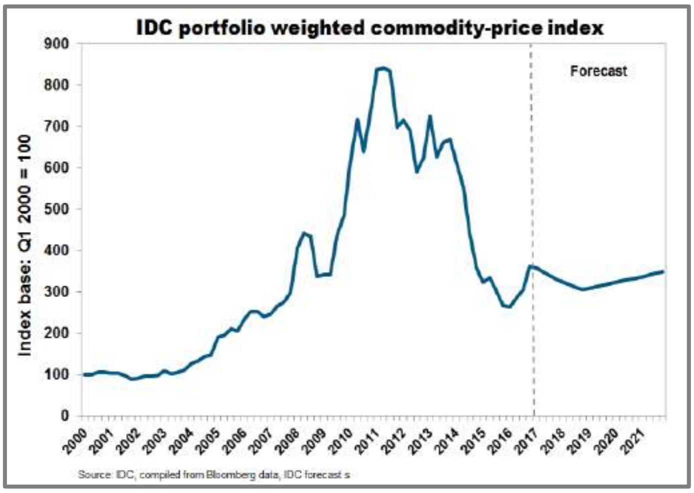


[1] For a more detailed analysis please refer to a report compiled by the IDC's Research and Information Department in June 2016, entitled: "Analysis of the potential impact of the United Kingdom's exit from the European Union on the South African economy".

Developments in commodity markets

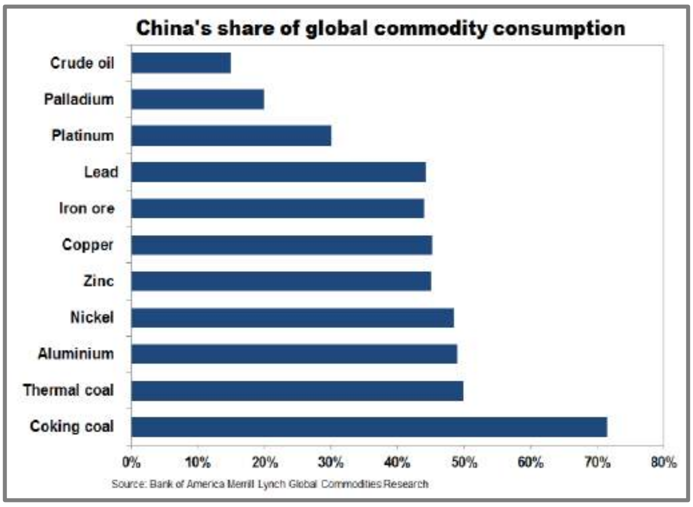
Industrial commodity prices have been on an upward trend since early 2016, largely due to producer discipline containing supply, and demand-side resilience as global manufacturing recovered. More recently, the rhetoric on the Trump administration's infrastructure development plans has fuelled investor appetite and renewed investment flows in commodity markets.

However, expectations of US inflation approaching the Federal Reserve's 2% target have raised prospects for further interest rate hikes and a stronger US dollar in 2017. This could impact negatively on demand for industrial commodities. Mining output growth, supported by recent price movements, should place additional downward pressure on commodity prices. Moreover, global uncertainty surrounding US economic policies in the years ahead and the roll-out of Brexit remain sources of potential weakness in commodity markets. Should the Trump administration follow through on promises to impose high tariffs on Chinese products, China's export performance and production activity would be highly affected. Coupled with the impact of a subsequent Chinese retaliation on growth in the US, aggregate demand for commodities would tend to fall, but the effects would differ across the commodities complex.



Source: IDC, compiled from Bloomberg data, IDC forecast s

China is the largest consumer in most commodity segments, accounting for around 50% of global demand for industrial commodities. Together with the US, it accounts for 37% of the world's crude oil demand. Hence, negative forces on both countries' future growth trajectories will inevitably raise oil price volatility, affecting prices across the commodities' spectrum via production costs. With the US and China being key drivers of global demand for jewellery and motor vehicles, the longer-term prognosis for precious metals is also weighed on by the potential for weaker economic growth in the US and China.



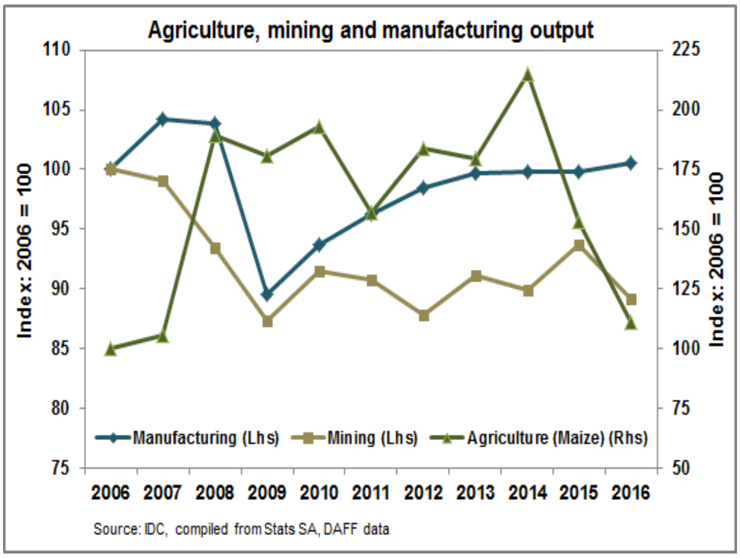
Source: Bank of America Merrill Lynch Global Commodities Research

While the shorter term impact on the price dynamics of steel related commodities due to increased US trade protectionism should be marginal, given that Chinese steel exports to the US have long been on a steep downward trend due to prevailing anti-dumping tariffs imposed by the US, the negative impact on China's manufacturing sector has adverse ramifications for the prices of steel and its related commodities over the medium to longer term.

ECONOMIC DEVELOPMENTS IN SOUTH AFRICA

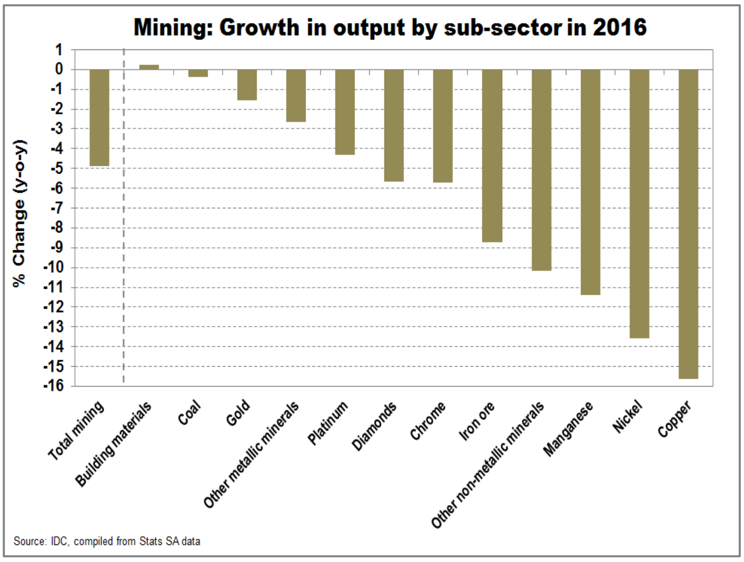
Performance of the goods-producing sectors

The economic environment remained very challenging throughout 2016, particularly for the goods-producing sectors of the South African economy. The mining sector continued to be negatively affected by weak demand, especially in China, with domestic operating challenges also at play. Softer demand locally and difficult economic conditions in key external markets took their toll on the manufacturing sector. The past five years have witnessed a lacklustre performance by the manufacturing sector, considering average output growth of only 0.9% per year. Agricultural output fell sharply in 2016 due to severe drought conditions, with the maize crop falling to the lowest level in nine years.



Mining sector

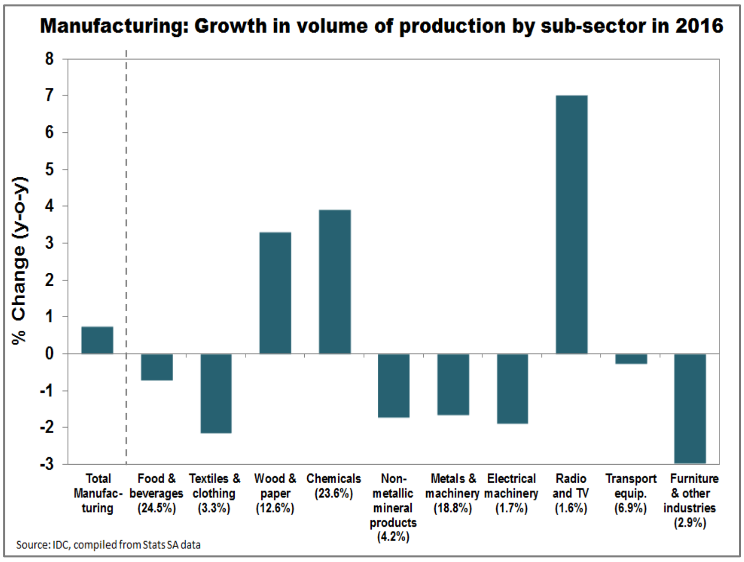
Output levels dropped in all but one of the mining sub-sectors in 2016. This was despite the rebound in commodity prices during the course of the year, which provided some relief in the form of higher revenues and improved profitability. The 4.9% decline in overall mining production was the worst performance since 2009. In the final quarter of 2016, total mining output fell by 2.7% on a quarter-on-quarter basis, with the iron ore and platinum group metals segments reporting sharply lower production. On a monthly basis, however, overall mining output edged slightly higher in December 2016.



The steep drop in iron ore output may be linked to lower demand from China, which accounted for 55% of South Africa's iron ore exports in 2016. Exports of copper and chrome also fell considerably in volume terms. The mining sector is likely to continue facing difficult operating conditions for some time, since the underlying market fundamentals remain largely unfavourable.

Manufacturing sector

The manufacturing sector managed to record positive growth in 2016, but only marginally so at 0.8%. The key contributors were the sub-sectors producing chemicals as well as wood and paper, which together account for 36.2% of overall manufacturing output. Of concern, however, was the 1.1% drop in manufacturing output in the final quarter of 2016, with 7 out of its 10 sub-sectors recording lower production compared to the previous quarter.



Domestic demand conditions remained largely unsatisfactory as both consumer spending and fixed investment activity came under renewed pressure. Business sentiment deteriorated due to insufficient demand and concerns over the political climate, including policy uncertainty. Although exports showed signs of improvement, this was largely underpinned by higher motor vehicle exports on the back of the local industry's integration into global supply chains. In general terms, however, the manufacturing sector's export performance remained subdued due to weak economic growth in key export markets.

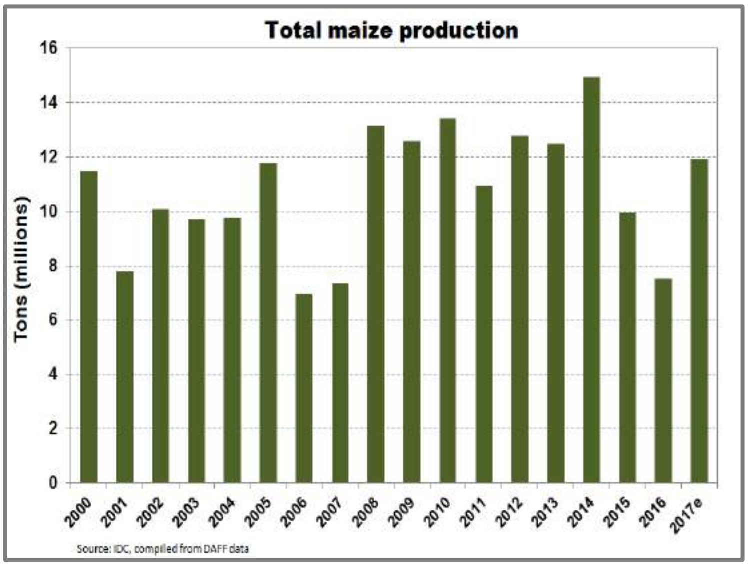
Manufacturers appear to have become slightly more pessimistic about business conditions in the South African economy in 12 months' time, according to the latest survey of the Bureau for Economic Research. New order volumes, both in domestic and external markets, are expected to remain under pressure, especially in the short-term. This does not bode well for production activity and employment in 2017.

Agriculture sector

After a very difficult two years, conditions in the agricultural sector are expected to improve in the 2016/17 season, on the back of improved rainfall in most of the maize producing areas in South Africa, although the potential spread of the fall army worm does pose a significant risk.

Having plummeted by almost 50% between 2013/14 and 2015/16 to just over 7.5 million tons, maize production is anticipated to show a marked recovery in the current year. Early projections are for the maize crop to rise to around 11.9 million tons, as illustrated in the following chart. The area planted under maize increased by almost 31% to 2 549 200 hectares in the 2016/17 planting season, while producers of groundnuts, soybeans and dry beans also reported increases in areas planted compared to the previous year.

The increased optimism is reflected in the recent up-trend in business confidence in the agri-business sector. Nevertheless, as would be expected after a severe drought and the resulting impact on farming income, the sub-index pertaining to net operating income dropped sharply in the final quarter of 2016. Furthermore, maize prices have fallen recently in anticipation of a better maize crop.



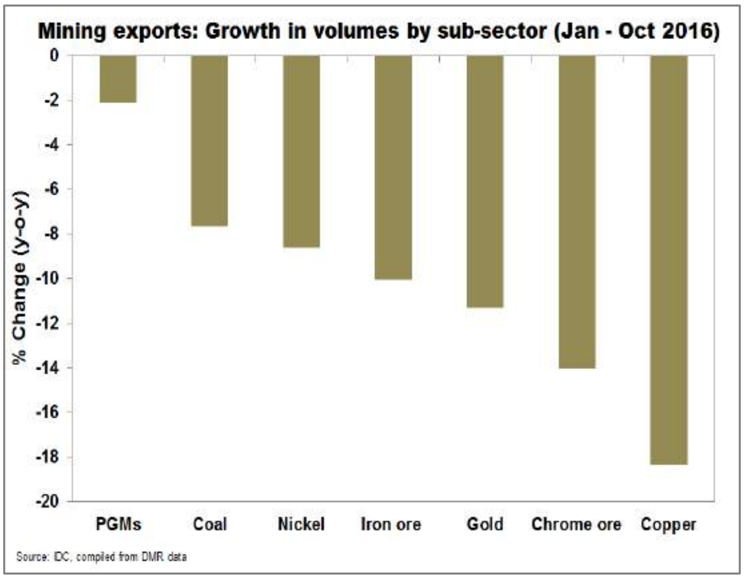
South Africa's table grape industry is also likely to record a better harvest in 2016/17, estimated to be at least 5% higher than in 2015/16. New market opportunities in China should boost its export performance.

Livestock farming, which makes the largest contribution to overall agricultural production in South Africa, was also harshly affected by the drought, with farmers having been forced to slaughter large numbers of cattle. Hence, despite an improved outlook for the agricultural sector at large, the recovery in livestock farming could take some time to normalise as farmers need to re-build their breeding herds.

External trade performance

South Africa's balance of trade improved markedly in 2016. The trade deficit narrowed sharply to R12.5 billion, from R82.7 billion in 2015.

Higher commodity prices and a weaker exchange rate resulted in an 8.1% increase in the mining sector's export earnings to R362 billion in 2016, with the sub-sectors mining gold, coal and diamonds having made the largest contributions. However, export volumes declined in all key mining sub-sectors compared to 2015, as illustrated in the chart. This reflects the difficult trading conditions in global markets, especially China. Crude oil imports fell by R3.5 billion due mainly to lower prices, on average, for the year as a whole.



Mainly due to higher fruit exports, total agricultural exports increased by R8.6 billion in nominal terms, or 16.2%, in 2016. Maize imports rose substantially as the drought took a toll on local production, contributing to the 38% increase in overall imports of agricultural products in 2016. The agricultural sector recorded a surplus of just over R31 billion.

SA's leading manufactured exports in 2016

Source: IDC, compiled from SARS data

Despite an increase of almost R41 billion in the value of manufactured exports in 2016, the sector recorded a trade deficit of around R300 billion. Motor vehicle exports, which increased by 16.2% or R16.8 billion, contributed the most to the improvement in manufactured exports. Other key contributions emanated from the sub-sectors exporting iron and steel (R9.5 billion); pulp, paper and paperboard (R2.6 billion); parts and accessories for motor vehicles (R2.1 billion); and pharmaceutical products (R1.1 billion). South Africa's manufactured export basket remains highly concentrated though. Motor vehicles top the list with an 18.7% share of total manufactured exports in 2016, followed by iron and steel (12.1%), refined petroleum and petroleum products (5.2%), as well as parts and accessories for motor vehicles (5.2%).

Imports of manufactured goods remained almost unchanged at around R950 billion in 2016. Lower crude oil prices, weak economic growth and lower fixed investment spending in real terms underscored the R17.9 billion drop in imports of petroleum and petroleum products and the R3.3 billion decrease in electrical machinery imports. Iron and steel imports fell by R2.3 billion due to weak domestic demand and public sector interventions to stabilise the domestic steel industry.

Without a meaningful recovery in global demand and limited price increases, South Africa's trade balance may yet again be under pressure during 2017. Increased competition in global markets and efforts by foreign producers to penetrate the domestic market, particularly if faced with adverse market-entry conditions in the US market, may aggravate the situation.

Developments in the United States and potential impacts on the South African economy

With the US and China being amongst South Africa's most important trading partners, adverse developments potentially triggered by protectionist policies of the Trump administration would impact on the domestic economy. The challenge could escalate if protectionist tendencies proliferate and, as a result, global trade and production activity are negatively affected. The transmission mechanisms would be both direct and indirect, impacting on South Africa's export performance, competition from foreign producers in the local market, foreign direct investment and overall fixed investment activity, portfolio capital flows, currency movements and monetary policy.

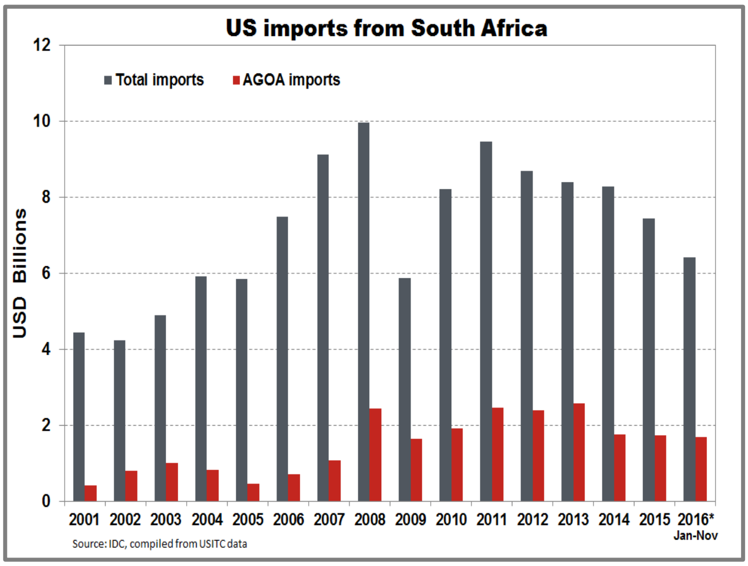
Sensitive export products

Considering the possibility of import demand in the US being detrimentally affected by increased protectionism under the Trump administration, whether indirectly via slower economic growth or directly if the US government seeks to alter the prevailing trade arrangements with South Africa, it is important to identify the export product categories most at risk of being negatively affected.

The US is South Africa's third largest export market at the individual country level, after China and Germany. South Africa's merchandise exports to the US totalled R79 billion in 2016, or 7.3% of overall merchandise exports, while imports from the US amounted to R73 billion, which was equivalent to 6.6% of South Africa's merchandise imports.

Manufactured goods accounted for 73% (R57 billion) of South Africa's exports to the US in 2016. Motor vehicles, parts and accessories dominated the list with a share of 28.3%, followed by iron and steel (10.9%), industrial chemicals (7%), non-ferrous metal products (5.8%) and chemical products (e.g. pharmaceuticals, paints, soaps) with a 2.4% share.

Since 2001, South Africa has had duty-free access to the US market, under the African Growth and Opportunity Act (AGOA), for a wide range of designated products. Over the period 2009 to 2016, US imports from South Africa under AGOA totalled close to USD24 billion (just over R216 billion), out of a total of USD115 billion (or R1 002 billion). This amounted to an average annual share of almost 21% claimed by AGOA of all the merchandise imports by the US from South Africa over the mentioned period. The share claimed under AGOA-related trade peaked at 30.7% in 2013 and stood at 26.7% over the period January to November 2016.



The sectors that have most benefitted from AGOA are motor vehicles, parts and accessories; beverages; agricultural products (mainly fruits and nuts); clothing and footwear. For all of the aforementioned sectors, imports by the US under AGOA accounted for more than 50% of all US imports from South Africa in 2016.

The motor vehicles, parts and accessories sector has benefitted most, as indicated by the fact that AGOA-qualifying items (mainly motor vehicles) represented 86.1% of all US imports of motor vehicles, parts and accessories from South Africa (refer to the table below).

US imports from South Africa under AGOA (January to November 2016)

Rank	Sector	Value in USD '000	AGOA* (%)
1	Motor vehicles, parts and accessories	1 365 607	86.1
2	Beverages	40 370	73.3
3	Agriculture	109 045	73.2
4	Clothing, excl. footwear	5 732	57.3
5	Footwear	383	55.6
6	Glass and glass products	560	46.1
7	Leather and leather products	4 109	42.6
8	Other chemical products	52 033	39.1
9	Processed food	18 310	23.3
10	Non-ferrous metal products	26 993	12.2
11	Basic iron and steel products	49 295	11.1
	Other products	10 349	-
	Total imports	**1 682 786**	

Source: IDC, compiled from USITC data
Note: * The share of AGOA imports in overall sector imports by the US

It is clear that any change to AGOA, in so far as it affects South Africa's duty-free exports to the US, would have a visible impact on a range of sectors/industries in the domestic economy. For instance, exports of motor vehicles to the United States accounted for 13.8% (or R16.8 billion), of South Africa's total motor vehicle exports to the world in 2016.

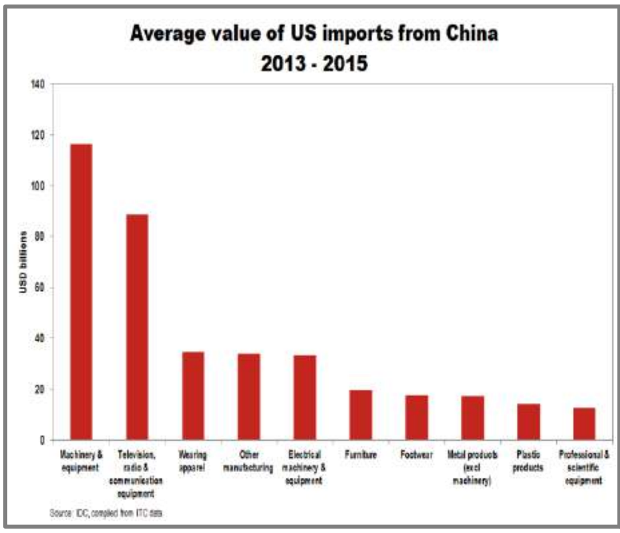
Although not explicitly mentioned by the Trump administration, AGOA could come under scrutiny in an increasingly protectionist US, for the trade benefits may be perceived to favour African countries. The Trump administration could indeed seek greater reciprocity in due course. A watered down version of AGOA or one with more reciprocal benefits could have significant consequences for South African exporters (and associated supplying industries) that have relied on the US market under this preferential trade arrangement. Furthermore, AGOA-related exports would probably not be the only ones under threat from protectionist measures in the US.

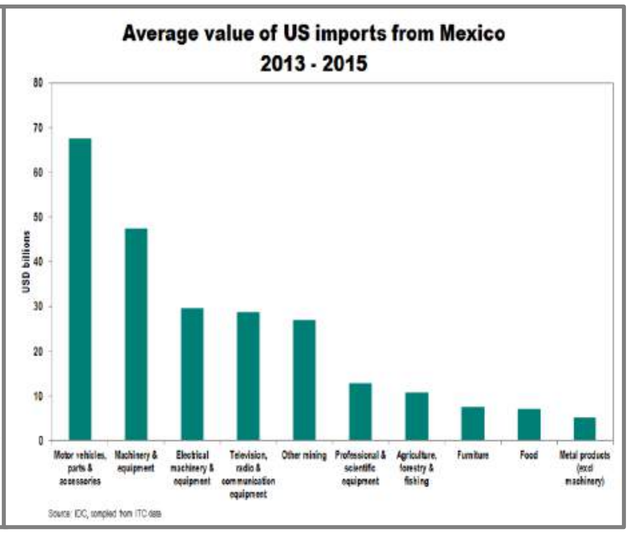
Strained trade relations between the US, China and Mexico: Threats and opportunities for South Africa

If imposed, punitive US tariffs on imports from China and Mexico (potentially 45% and 35%, respectively) will have implications for global trade flows. Should their level render specific products from these countries uncompetitive in the US market, their respective exporters in these countries will seek alternative markets, disrupting existing global production and trade patterns. On the other hand, it may open up opportunities for other global producers in the US market, although it should be borne in mind that the intention of US trade policy in this regard would remain import substitution.

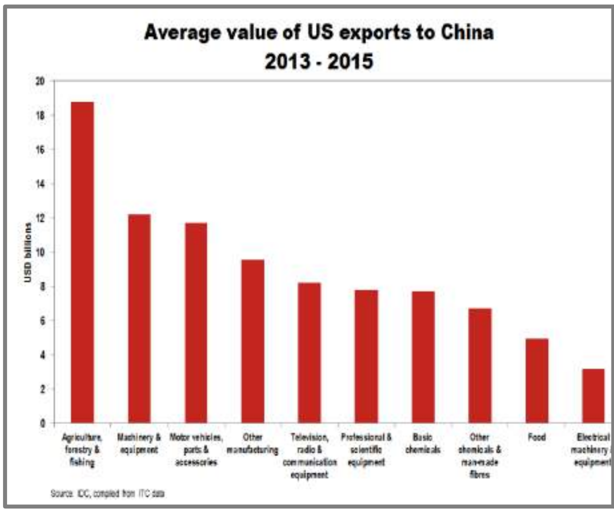
Machinery and equipment manufacturers in both China and Mexico, for example, have relied heavily on export sales to US, as illustrated in the following charts. The loss of such a market, even if partial, is likely to lead to concerted efforts to penetrate other international markets, including African economies, posing competitive threats to local manufacturers in the domestic markets.

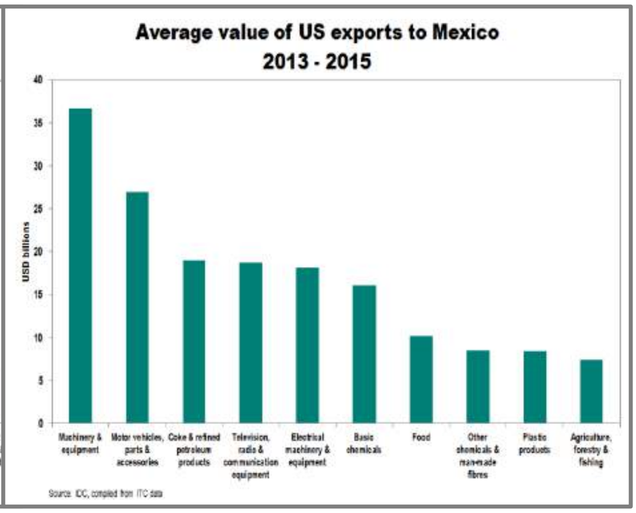
However, increased protection in the US from Chinese and Mexican imports could present export opportunities for African producers in the American market, especially South African exporters. This would be facilitated by AGOA, which was approved by the US Congress until 2025. Although AGOA has not yet been the subject of the trade policy discourse of the new US administration, it is subject to annual reviews and could thus be altered as it seeks higher reciprocity.





Export opportunities for South African producers could also emerge in the Chinese and Mexican markets, should these countries impose, in retaliation, punitive tariffs on US products. Agricultural and processed food products are cases in point, for these have been important US exports to both China and Mexico, as illustrated below. South African as well as other African producers may stand to benefit from the resulting gaps in these markets due to strained relations with the US.



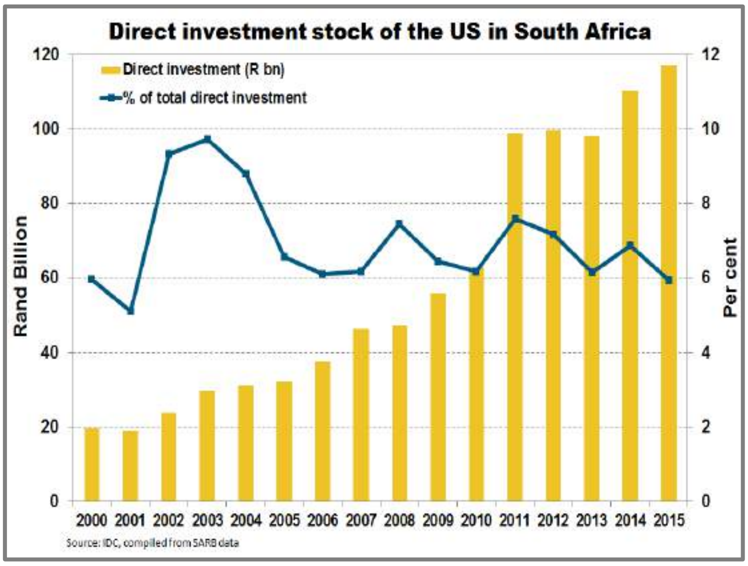


US direct investment in South Africa

The potential implications for the South African economy of an inward-focused US under the Trump administration extend beyond trade flows.

Constraints on the outward investment practices of US companies and attempts to reverse their external presence, although very difficult to implement/achieve in the world economy of today, would impact significantly on global foreign direct investment (FDI) flows, including merger and acquisition (M&A) activity. This would manifest itself not only in US companies revisiting their global production and trading practices and strategies, but also by affecting the investment and trading decisions of non-American companies worldwide with respect to accessing US markets.

The planned reduction in US company tax rates to levels comparable with those of countries offering highly attractive tax regimes could also attract significant FDI investment flows to the US.



US companies have, over the years, invested heavily in the domestic economy, with foreign direct investment (FDI) inflows continuously on the rise. By December 2015, the overall stock of US direct investment in South Africa stood at R117 billion, equivalent to 5.9% of the total FDI stock, which was valued at R1 970 billion.

However, the relative importance of the US as a direct investor in South Africa has declined since 2003, when it accounted for 9.7% of total direct investment in the country. The US has substantial investments in the local automotive industry, with companies such as General Motors and Ford as examples. More recently, Walmart acquired a significant presence in the local retail sector through Massmart.

Major shifts in US FDI would have implications for the South African economy. The adverse effects would be reflected in lower direct investment activity (mergers and acquisitions, greenfield and/or brownfield investments), employment creation, as well as balance of payments and currency implications. It could also affect South Africa's participation in global value chains supplying US markets.

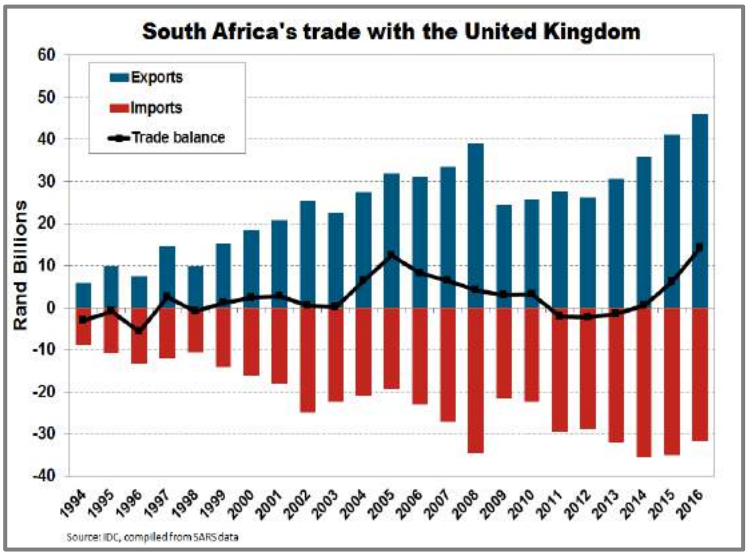
Potential impacts of Brexit on the South African economy

The United Kingdom's withdrawal from the European Union, commonly known as Brexit, is likely to have significant implications for the South African economy[2]. The impacts will be of a direct as well as indirect nature:

- The direct effects relate primarily to developments in the UK itself as a key trading and investment partner, as well as a source of leisure and business travellers to South Africa;
- The indirect effects, in turn, pertain largely to the impact on global financial, currency and commodity markets, and, very importantly, on the growth performance in other parts of the globe.

Sensitive export products

The UK remains one of South Africa's largest trading partners, ranking 8th in 2016. Merchandise exports to the UK amounted to R46 billion in 2016, whereas South Africa's imports from the UK came close to R32 billion. The relative importance of the UK as a trading partner has, however, declined over time, with its share of South Africa's overall export basket having fallen from 11.7% in 1997 to 4.2% by 2016.



The export basket to the UK is dominated by platinum group metals (PGMs), with a 43.6% share in 2016, or close to 23% of all of South Africa's PGM exports to the world at large.

The top ten South African export products to the UK in 2016 are indicated in the following table. Combined, these export products accounted for more than 87% of South Africa's exports to the UK, with the top three products claiming just over 73% of the total.

It is not yet clear exactly how the negotiations between the UK and the EU will unfold. It is highly unlikely, however, that the status quo in terms of market access will be maintained. Furthermore, new opportunities for South African trade with either the UK and/or the EU may emerge as time goes by. Local companies should thus monitor such developments closely in order to act timeously in renegotiating trade deals and/or in taking advantage of opportunities that may emerge in the process.

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[2] For a more detailed analysis in this regard, please refer to a report compiled by the IDC's Research and Information Department in June 2016, titled: "Analysis of the potential impact of the United Kingdom's exit from the European Union on the South African economy".

South Africa’s wine industry, for instance, could benefit from a changed trading regime. The UK’s exit from the EU will have a significant impact on the landmark wine export agreement between SADC and the EU, which allows South Africa to export 110 million litres of wine to Europe, up from the current annual duty-free quota of 48-million litres. Subsequent to Brexit, the quota under the agreement with the EU will no longer include the UK market, thus providing an opportunity for the domestic wine industry to export more if favourable trade arrangements are entered into.

South Africa's key export products to the United Kingdom in 2016

Rank	Product: 4-digit Standardised Industry Classification	Rand million	% share in SA export basket to the UK	SA exports to the UK as % of SA exports to the world
1	Platinum group metals	20 017	43.6%	22.6%
2	Motor vehicles	6 872	15.0%	5.7%
3	Agricultural products (mainly fresh fruits)	6 813	14.8%	12.5%
4	Parts and accessories for motor vehicles	1 757	3.8%	5.2%
5	Beverages (mainly wine)	1 644	3.6%	11.5%
6	Pulp, paper and paperboard	755	1.6%	4.2%
7	Basic iron and steel	670	1.5%	0.9%
8	Basic precious and non-ferrous metals	598	1.3%	1.9%
9	Processed and preserved fruits and vegetables	516	1.1%	6.0%
10	Soap, detergents, cleaning and polishing preparations, perfumes	443	1.0%	3.9%
	Top-10 exports	**40 084**	**87.2%**	
	Total exports	**45 957**		**4.2%**

Source: IDC, compiled from SARS data

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

- The annual value of exports of the product to the UK was at least R50 million, on average, from 2013 to 2016.
- The UK is a significant market (more than 25% share) for the specific product in the broader EU market;
- The product currently faces either a low or a zero tariff in the UK market under the TDCA preferential trade agreement;
- The current MFN rates will be significantly high (at least 5 percentage points higher) in the absence of a new preferential agreement between SACU and the UK post-Brexit.

The ten export product categories most at risk according to the above methodology are listed in the following table. Collectively, they represented R8.3 billion worth of exports, on average, over the period 2013 to 2016, or 21.5% of South Africa’s total exports to the UK.

The UK’s minister for trade and investment has been engaging trading partners such as South Africa to have initial discussions on future relationships. As previously stated, future agreements could be substantially different from the prevailing ones under the umbrella of the EU, as the UK will aim to protect its own interest and will not be bound to the interests of some of its European partners. For example, access to UK markets by certain fruit products could be easier as the interests of Spain will not have to be accommodated in new trade agreements.

Products from SA at risk of losing market share in the UK after the Brexit

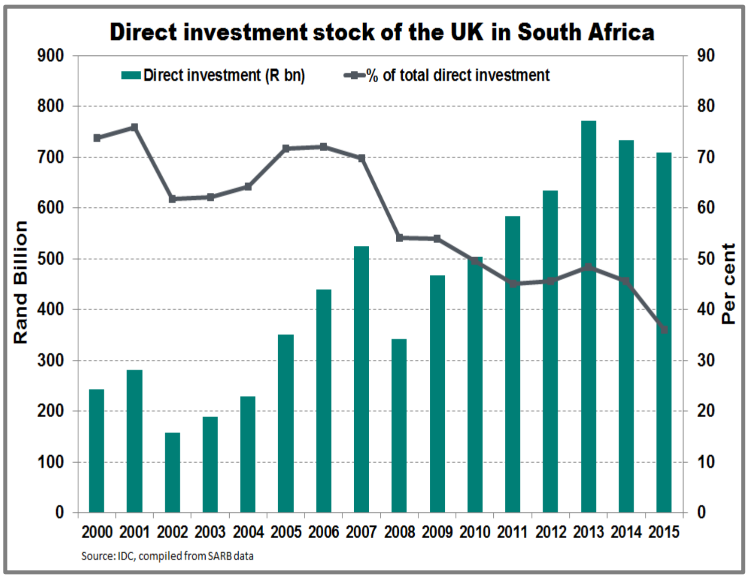
Product category	Average annual SA exports to the UK: 2013-16 Rm	UK's share of SA exports to the EU (%)	TDCA tariff into the UK (%)	MFN tariff into the UK (%)	Tariff differrential (%)
Motor vehicles for goods	3 886.6	25.6%	0.0%	12.1%	12.1%
Grapes	1 401.1	30.6%	0.0%	8.4%	8.4%
Citrus fruit	1 368.4	27.0%	0.0%	10.8%	10.8%
Apples, pears and quinces	1 115.7	46.5%	0.0%	7.2%	7.2%
Apricots, cherries, peaches, plums and sloes, fresh	443.1	46.2%	0.0%	12.0%	12.0%
Other fruit, fresh	360.8	48.9%	0.0%	8.0%	8.0%
Prepared fruits nuts and other edible parts of plants	306.2	41.3%	2.4%	17.9%	15.5%
Fruit, dried	120.2	66.9%	0.0%	5.7%	5.7%
Cut flowers and flower buds	115.6	47.0%	3.1%	8.7%	5.6%
Certain fresh and chilled vegetables	85.1	50.0%	0.0%	9.5%	9.5%
Men's or boys' suits, ensembles, jackets, blazers, trousers, etc.	51.4	93.6%	0.0%	12.0%	12.0%

Source: IDC calculations based on SARS and WTO data

African countries, especially Commonwealth member states such as South Africa and Kenya, could benefit from the UK's withdrawal from the EU, as it could free up an important market from certain restrictions currently imposed by other EU member states. The opportunities could be particularly significant where agricultural products, processed food and beverages are concerned, among others.

Bilateral investment

Looking beyond the potential trade implications, it should be noted that the UK is by far the single largest foreign investor in South Africa. The direct investments of UK companies in the domestic economy totalled almost R710 billion by the end of 2015. This is equivalent to 36% of all direct investments by foreigners in the country. However, the share of FDI stock claimed by the UK has declined over time, considering that it stood at 75% in 2000. In terms of South Africa's own outward investments, the UK tops the list, with direct investments having measured R235.2 billion in 2015, a



share of about 10% of the country's overall outward FDI stock.

Any adverse impact on the UK economy due to Brexit could potentially have negative implications for South Africa in the sense that British companies might opt to rather invest in the UK itself, or even elsewhere in the EU so as to maintain business and trade relations due the proximity of markets.

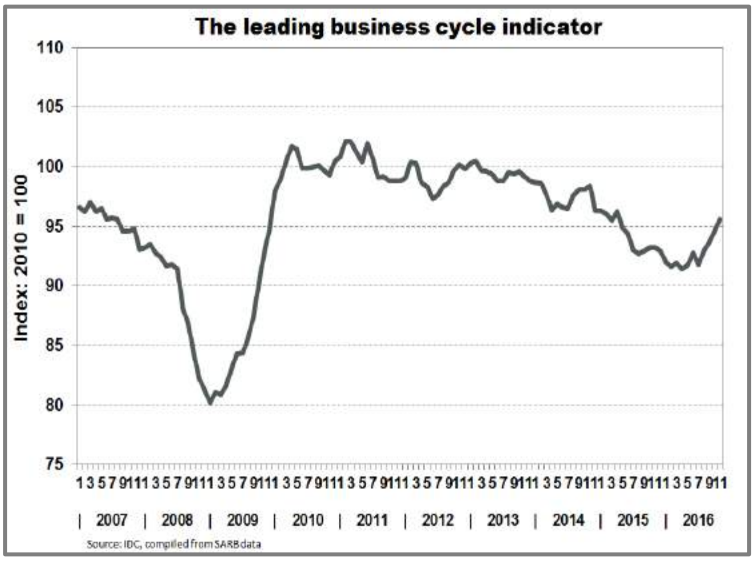
Tourist flows

A further potential impact of Brexit on the South African economy could materialise via tourist flows, both for business and leisure purposes. Over the 11 months to November 2016, about 395 000 British tourists visited South Africa, representing 17% of all non-African visitors.

Should the economic performance of the UK economy be adversely affected by Brexit, as is anticipated at least over the medium-term, the ability of British tourists to visit South Africa, or their propensity to spend once in the country, may be constrained by concerns over their future earnings potential and savings requirements. The weaker exchange rate of the British pound vis-à-vis the rand will also be a key factor.

Growth prospects for the South African economy

After a very difficult year in 2016, South Africa's growth momentum is expected to improve in 2017, although the projected rate of increase has been revised slightly downward compared to earlier forecasts. Nevertheless, factors such as low consumer and business confidence, relatively weak fixed investment spending on the back of subdued demand conditions, the possibility of a credit ratings downgrade and political uncertainty, point to yet another challenging year for the domestic economy. In addition, the likelihood of a hike in personal income taxes, specifically for high income earners, will impact on consumer spending.



However, the recent up-tick in the leading business cycle indicator provides some comfort that the trough in the current business cycle may have finally been reached. Slightly stronger growth is thus likely from the second half of 2017 onwards.

Higher commodity prices, albeit only modestly, should provide some relief to the mining industry at large, while gradually improving demand conditions globally should be beneficial for local exporters over the short- to medium-term. Economic developments in key external markets for locally manufactured products, such as the rest of the African continent, the Eurozone and the US are of particular importance in this regard.

South Africa's economic growth is expected to improve slightly in 2017 to 1.0%, but will remain unsatisfactory. This should be largely underpinned by a marginally higher rate of increase in household consumption expenditure and an improved export performance.

Capital outlays by public corporations are forecast to drop sharply in real terms in 2017 and 2018, while on-going fiscal challenges are likely to weigh on general governments' ability to raise infrastructure spending meaningfully. Private sector fixed investment, in turn, is projected to increase modestly in 2017, but is set to gain a stronger momentum over the remainder of the outlook period.

Key performance indicators for the South African economy

Variable (% change or % of GDP)	2013	2014	2015	2016e	2017f	2018f	2019f	2020f	2021f
Real GDP growth and its components:									
Household consumption expenditure	2.0	0.7	1.7	0.9	1.1	2.2	2.5	3.2	3.0
Government consumption expenditure	3.8	1.8	0.2	1.6	1.4	1.4	1.5	1.9	2.1
Gross fixed capital formation (GFCF)	7.0	1.5	2.5	-4.0	-1.5	1.9	4.3	5.2	5.5
Exports	3.6	3.3	4.1	-1.3	2.8	3.3	3.9	3.9	3.3
Imports	5.0	-0.5	5.3	-4.5	0.7	4.4	4.5	5.4	5.0
GDP	**2.3**	**1.6**	**1.3**	**0.4**	**1.0**	**1.9**	**2.7**	**3.0**	**2.9**
Consumer price inflation	5.8	6.1	4.6	6.3	5.9	5.5	5.4	5.2	4.9
Current account balance (% of GDP)	-5.9	-5.3	-4.3	-3.8	-4.0	-4.1	-4.4	-4.6	-4.9
GFCF as % of GDP	20.3	20.5	20.6	19.6	19.0	18.8	18.8	18.9	19.2

Source: IDC, historical data compiled from SARB data, IDC forecasts

Department of Research and Information

16 February 2017