MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

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METALS AND ENGINEERING INDABA

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Introduction and comments on global economic conditions and uncertainty

Eight years since the global crisis hit, the South African economy, along with many other economies in the world continue to struggle for a sustained recovery. Although developing economies have fared better, short to medium term prospects remain uncertain. The IMF and World Bank have recently revised world GDP and trade downwards yet again, and these changes affect both the developed and developing world.

Experts fear that the gradual recovery that we had been experiencing in the last few years is now faltering. In the US, where growth had been recovering better than other developed economies, downside risks have emerged given tighter financial conditions while the EU has experienced growth of not much more than 1.5 per cent now for a number of years. In the UK the talks Brexit are dominating (UK exiting the Euro) with all the risks on growth and trade.

Rapidly changing fortunes of developing countries

The low commodity prices have had a negative impact on the terms of trade for many countries and especially commodity dependant economies such as ourselves – and how this will affect the basic building blocks of industrial or supply led growth.

In response to a weak global economic landscape many countries have had to look inward for economic reforms that would release growth potential and reduce dependence with the rest of the world. Deglobalisation is in focus. We should not find ourselves behind the curve. It is therefore important, as building blocks for self-sufficiency to maintain strong and prudential macro-fiscal policy, limit political or sovereign risk, and to always ensure credibility and investor and business friendly environment.

How all of this affects South Africa

Owing to our links with the rest of the world, global developments beyond our control can have significant impacts on our industries and our livelihoods. Each particular country or regional trend that unfolds brings its own set of impacts on us. One particular story that your industry is very familiar with – is that of China, now our largest trading partner. In the preceding 3 decades, China has orchestrated unprecedented growth, leveraged itself up from being a poor country to perhaps the single most important driver of growth and demand – and has simultaneously developed a vast appetite for commodities.

This has helped to drive the boom which has characterised the last 15 years or so, barring the financial crisis and recession of 2008/09. Through relentless investment and industrial growth, China has exerted an ever greater influence on many economies including our own and especially on commodity exporters and our sub-Saharan African neighbours in the North.

But now China is rebalancing growth, away from high savings and investment led, and towards consumption driven. It is trading its incessant building of infrastructure and cities (and some ghost cities), industrial facilities, factories and capacity and endless power plants, for shopping malls, consumer products and financial services – things which are more consistent with its rapidly growing middle income class.

This has significant ramifications on its demand for commodities like iron ore, coal, manganese, and chrome (the raw ingredients of most ferrous metal products, the backbone of industry – and which we just so happen to be most richly endowed in). And it is very difficult to forecast exactly what this means for the next couple of decades and for other commodity dependant developing countries. And while oil prices have fallen thanks to other large global trends (things like the rise of shale gas, geo-politics, and the role of OPEC, but also the declining energy intensity of demand coupled with growth in renewable energy etc.) the net effect of lower non-oil commodity prices and a weakening Rand offset many of these gains – domestically - while the negative impacts on oil exporters tax revenues and fiscal position in regional countries like Angola and Nigeria, have spilt over into the rest of the region.

What this means for manufacturing

One sector where these impacts are keenly felt is the manufacturing sector which remains the second largest contributor to growth, accounting for approximately 13% of GDP and employing 1.8 million people. Whilst real value added in manufacturing has increased by over 50 per cent between 1995 and 2014, more recently it has come under pressure from various global trends including those emanating from China. While this extraordinary economic revolution was occurring in China, they were expanding their capacity in various industrial sectors at unparalleled rates.

I have recently learnt that China accounted for virtually all of the growth in global steel output from 2000 through 2013, that Chinese steel climbed from 15% of the world total in 2000 to 50% by 2013, and that in 2015 it could produce and land a ton of steel in SA for $422, compared to the domestic cost price of $484.

Domestic manufacturers have also been hit by rising input costs, strikes (in both its sector and related sectors), on-going skills constraints, currency volatility, and various infrastructure related challenges – the most obvious of which is the electricity crisis – both security of supply and the rapidly rising increases in prices.

We think Manufacturing is important

We are not blind to these challenges, nor are we ignorant of the importance of the sector to the wellbeing of our economy. Manufacturing is far more important than its simple proportion of the economy might suggest. It is vital in that it forms the basis of a modern economy, raises productivity levels, and drives structural change (from traditional resource based extractive economies).

Manufacturing helps to introduce new products and technologies, drives technological progress and is, globally, the main driver of innovation. Research and Development is concentrated in the manufacturing sector, and has been shown to be integral for investment and long term sustainable growth.

Furthermore, the manufacturing sector is particularly important as a source of demand for the services sector as well as the rest of the economy through its strong backward and forward linkages, and is a critical earner of foreign revenue through exports. And as you know, we need these exports to balance our current account, reduce our foreign exposure, keep our terms of trade healthy and simply put - earn the forex required to repay our dollar denominated debt or import the capital equipment required to invest and grow.

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Manufactured exports have grown at an annual average rate of 11 per cent between 2005 and 2015, and have helped us in moving up the value chain and diversifying the products we produce and export towards those embodying greater levels of sophistication and value add.

We also recognise the importance of the metals products sub sector which now accounts for about 20 per cent of South Africa's manufacturing total production, and the strategic nature of the steel industry, not only because it represents about 1.5 per cent of the GDP and has indirect linkages to other sectors comprising a significant 15 per cent of GDP and employing 8 million people – but also because it is unique in sub-Saharan Africa, critical to industrialisation, and vital to the growth drivers outlined in the Industrial Policy Action Plan, National Development Plan, and the nine-point plan.

What is the Government doing about the steel crisis and industrialisation:

Government has recognised the importance of the steel crisis and what its implications are for industry and the economy more broadly – and is working on numerous measures to intervene. To this end, the Department of Trade and Industry (DTI) and Economic Development have met with steel producers, users and other stakeholders, and agreed on a package of support measures for the industry. So far the industry has received support in the form of tariff protection on certain steel products, at the maximum level allowed by the World Trade Organisation (WTO) in terms of its bound rates.

Our colleagues at the DTI have also done a significant amount of work to support the foundries, including the development of a new incentive to complement many other manufacturing focused incentives, such as the Manufacturing Competitiveness Enhancement Programme (MCEP) and 12i Tax Allowance.

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In total a significant amount of money is allocated each year to such incentives - aggregated medium-term funding of R16.2 billion for example is dedicated to various incentives, promotion of various industries, and assistance to small enterprises and cooperatives, whilst Government also forgoes revenue of about R24 billion each year to provide various business tax incentives. There are also the designated sectors where Government uses public procurement to create demand for local industries and steel is one such sector. A multi-departmental Steel Task Team has been set up to implement various measures and monitor the metals and industry related issues.

What the government is doing more broadly?

But Government also needs to do things at a much broader level, to shore up investor confidence, avoid ratings downgrades, implement various reforms and work closer with the private sector. In this we have really stepped up our efforts to collaborate with all the stakeholders, industry, labour and the civil society to restore confidence in the economy. Whilst there are significant external pressures – we need to be captains of our fate (to paraphrase a line out of the famous invictus poem) – and make sure we do all that we can domestically first – so that we are best placed to face whatever the world throws at us.

While there are many factors weighing down on the sovereign credit ratings, the very low GDP growth has been cited as main constraints, given its multiplier effects in the economy. The lower commodity prices, heightened financial market volatility, diminished consumer and business confidence, as well as the most severe drought in 20 years have reduced the performance of the economy.

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Constrained electricity supply also limits economic growth and deters fixed investment, given the delays in the commissioning of major power plants

To address the low growth risk Government is collaborating with the private sector, labour and the civil society to restore confidence in the economy and address the structural constraints to economic growth. The National Development Plan (NDP) remains the catalyst for growth and the 9 Point Plan will ensure that the following milestones are achieved:

- Maintaining public infrastructure investment. Over the medium-term, government and the State Owned Companies (SOCs) have committed R865.4 billion for investments in housing, roads, rail, public transport, water and electricity;
- Partnerships to expand co-investment in economic infrastructure, social facilities, innovation and skills development;
- Increasing electricity supply and improving reliability by mobilising private-sector co-investment in technologies that promise rapid results;
- Promoting a stable and cooperative labour relations environment;
- Encouraging development of energy-efficient, job-creating industries, such as tourism, agriculture and agro-processing, that can benefit from the weaker rand to boost exports;
- Stimulating economic activity. Public institutions with strong balance sheets, including development finance institutions and social security funds, will be encouraged to make greater use of their resources to back economic stimulus and job creation;
- Lowering the cost of doing business, removing regulatory constraints – such as easing onerous visa restrictions – and acting swiftly to remove policy uncertainty;

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- Encouraging the growth of small business. The Department of Small Business Development and the National Treasury are working with the private sector to explore establishing small business innovation fund; and
- Transforming the urban landscape.

In addition, there are existing strong platforms that support higher long-term growth. The country's strong institutional framework promotes accountability and transparency. The domestic financial sector is well regulated and capable of attracting global investment flows. The country's prudent fiscal monetary and fiscal policies help stabilise inflation and keep interest rates low, anchor investors' risk perceptions, ensure continued inflow of capital to finance the savings shortfall and reduce fluctuations in production and investments. And monetary policy remains committed to keeping inflation in check, both to support the competitiveness of South African businesses and to protect the individual purchasing power.

In conclusion

We are aware of the challenges facing the sector, and the economy more broadly, and are working towards addressing them. One of the things we view as key to this is greater participation from the private sector in policy formulation, and investment – and we are reaching out to you through a variety of initiatives. Please support us in our endeavours and help us move the country forward, together.

Thank you.

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