DEPARTMENT: AGRICULTURE
REPUBLIC OF SOUTH AFRICA

Quarterly Agricultural Economic Review and Forecast April to June 2004

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CONTENTS

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PREFACE

The core business of this directorate is to do analysis on national level in order to produce agricultural economic information and advice for sound decision-making on the South African (SA) agricultural sector. In an effort to support this important task a new division (Economic Research) has been established in the directorate to concentrate on economic analysis relating to the performance of and external impact on the agricultural sector and its industries.

This publication developed from a need within the Department of Agriculture (DoA) to be regularly informed on recent developments and expected economic trends relating to the agricultural sector. To provide in the last mentioned need a quarterly report has been compiled for internal consumption over the last two years. Since the beginning of 2004 the report is also published for outside consumption as it can add value to a number of existing regular economic publications on the agricultural sector. The launch of this new series is therefore a historical landmark in the short history of the new Economic Research Division. It is our vision to establish it as indispensable reading for every serious student of the SA agricultural sector.

The format and content is still in the experimental phase. At this stage most of the content is based on sources outside the DoA. In time we hope to incorporate more departmental generated material. We would, therefore, appreciate comments on the content of this quarterly report series.

Mr B J van Wyk
Senior Manager: Economic Analysis
July 2004
Pretoria

1. WORLD ECONOMY

The world economy is set to register a strong economic growth rate this year, possibly exceeding that of 2000 at the peak of the previous global cycle. Growth is led by the USA and Asia (including China and Japan). The Japanese economy appears to be recovering from its decade long slumber. Growth also continues to power along in China, boosting industrial commodity demand and prices. All the Latin American economies are also sharing in the global economic recovery. While this is also true for the Euro area, economic growth forecasts for the region have recently been scaled down due to weak growth in household expenditure, in turn, a result of higher unemployment levels in the wake of the strengthening euro. The strong acceleration in global economic growth is contrary to the expectations of a constrained recovery. However, concerns regarding key macro-economic imbalances in the USA remain and we would caution against possible setbacks. Current areas of concern are sustainability of strong growth in the USA and China, surprise spikes in the interest rates and/ or sharper declines in the value of the US dollar. Real Gross Domestic Product (GDP) growth for a few important industrial and developing countries are summarized in Table 1.

2. SUB-SAHARAN ECONOMY

After a marked slowdown in 2003, Sub-Saharan Africa's economic growth is expected to rebound strongly. This will be driven by a pick-up in the South African and Kenyan economies and strong growth of over 5 % in other economies, including those of Botswana, Ghana, Mauritius, Tanzania and Senegal. The oil-exporting states, namely Angola and Nigeria, are in a strong position to benefit from both high global oil prices and inflows of foreign direct investment. Clearly, there are risks to such upbeat projections. These include intractable problems of diseases and poor infrastructure, a "generally poor business environment", and political instability in Zimbabwe, Côte d'Ivoire, and the Democratic Republic of Congo.

3. SOUTH AFRICAN ECONOMY

Domestic real economic growth decelerated to 1.9 % last year from 3.6 % during 2002, mainly as a result of the negative impact of the strengthening rand exchange rate on the goods producing sectors of the economy. Real domestic expenditure, i.e. the sum total of household and government consumption expenditure, business and government fixed and inventory investment, grew at a rate of 4.2 % during 2003, benefiting from lower interest rates and inflation and the strong rand, personal tax

TABLE 1: Real GDP growth

Industrial countries	2003	2004	2005	Developing countries	2003	2004	2005
Major seven	2.2	3.7	3.1	Emerging Asia[2]	3.7	5.8	4.5
USA	3.1	4.9	3.8	China	9.1	9.0	7.5
Japan	2.7	3.8	2.6	India	8.5	6.5	6.5
Euroland[1]	0.4	1.5	1.9	Latin America	1.5	4.7	3.4
UK	2.2	3.6	3.0	Emerging Europe[3]	5.3	5.6	4.7

[1] The 11 Euro countries

[2] Taiwan, Hong Kong SAR, Singapore, South Korea, Malaysia, Indonesia, Thailand and Philippines

[3] Bulgaria, Czech Republic, Hungary, Poland, Slovak Republic, Russia, Turkey

Source: *Economic prospects, Second quarter 2004* relief and high real wage growth. A substantial part of the keen domestic demand was met by imports, whilst exports declined due to the strength of the rand and weak global growth, with some sectors experiencing recessionary conditions, e.g. manufacturing. Statistics South Africa (SSA) has indicted that it will finalise its GDP benchmarking exercise in November, and expects it to show that the size of the economy is larger than had been estimated in the past. This follows new sample surveys that show that the manufacturing, retail and wholesale sectors are larger than previously thought. For example, manufacturing sector in 2003 was underestimated by 17 %, the reason being that the business register previously used did not take sufficient account of small business and the services sector, but was biased towards larger businesses and the commodities sector. According to SSA, real GDP could well be about 5 % greater than current estimates.

4. MACRO ECONOMIC VARIABLES AND THEIR IMPACT ON AGRICULTURE

4.1 Inflation

Recent trends: The CPIX (consumer inflation less mortgages) grew at 4.4% year-on-year in the earlier part of this quarter, unchanged from 4.4% posted in March and firmly within the target range set by the South African Reserve Bank (SARB) for the eighth consecutive month. The main pressure on inflation is from the rising costs of transport associated with high world oil prices. Furthermore, producer price fell at a faster rate than in February, -1.2 % year-on-year, in comparison with -1.0 % year-on-year. Although both data releases were taken as vindication of SARB's decision to keep interest rates on hold at its April meeting, the believe is that optimism should be tempered. Hopes of an oil price lull in the second quarter seem to have been over blown and higher global crude prices may add to imported cost-push inflation over forthcoming months. Producer Price Index (PPI), which tends to lead the CPIX by a few months, appears to be hitting the bottom of its current trend. The PPI's fall, which, while still negative, may be indicative of higher inflation to come.

TABLE 2: Annual CPIX inflation rates

	2003	2004	2005
BER	6.8	5.7	5.6
EIU	5.9	5.1	4.8
SARB		5.8	5.6

Bureau for Economic Research (BER); Economic Intelligence Unit (EIU); South African Reserve Bank (SARB)

Forecast: The South African Reserve Bank remains cautious and stated that it will only respond to second-round inflationary effects. As indicated in Table 2, CPIX inflation could possibly breach the upper band of the 3-6 % inflation target during the second half of 2004, whilst decelerating again in 2005, averaging 5.6 %. Overall, with domestic demand growing modestly, the likelihood of inflation remaining within SARB's target band will largely depend on the rand.

Impact on agriculture: The higher inflationary pressure expected for the third and fourth quarter of this year may still be realized due to imported cost-push inflation. These inflationary pressures affect the sectors' global competitiveness.

4.2 Growth

Recent trends: Having started in September 1999, we are about to enter the 20^{th} consecutive quarter of economic expansion. SSA recently indicated that real growth in supply-GDP accelerated from 1.3 % in the fourth quarter of 2003 to 3.1% in the first quarter of 2004. In the latest SARB's quarterly bulletin, this number was broken down from the expenditure side. The data paint a strong demand picture that may require a slightly tighter monetary policy stance. The growth in real domestic final demand (all current and capital expenditure, but excluding spending on inventories) accelerated to 7.5 % in the first quarter. But because companies ran down inventories, gross domestic expenditure growth moderated to 4.3 % from 7.2 % in the fourth quarter of 2003. Also weighing on economic activity was net foreign trade, with a further contraction in real exports a concern.

Even with global growth booming, export volumes shrank 14.2 % in the first quarter. Indicating a loss in competitiveness.

Forecast: The third and fourth quarters will see acceleration in real economic growth mainly due to continued strength in domestic expenditure. Real final household consumption expenditure is forecast to grow by 3.2 % in real terms during both 2004 and 2005. This is due to new tax-relief measures, structurally lower levels of inflation, a steady rise in employment opportunities as well as a more benign interest rate environment. Government consumption expenditure is projected at even sharper growth rates, i.e. 3.9 % and 3.6 % respectively, in line with the 2004-budget announcements. The budgetary announcements include increased spending on law and order, the HIV/AIDS programme and other social services. Whilst we continue to expect some slowdown in real fixed investment this year from 2003's heady 8.4 % pace, growth is projected at 6.4 % and 7.1 % during 2004 and 2005 respectively. Inventory investment is also expected to be strong in this climate of keen domestic demand conditions. Overall real domestic expenditure is therefore projected to grow by close to 4 % this year and slowing only marginally to 3.7 % next year. The negative impact of the strong rand on the bottom line, i.e. overall GDP growth, could still be substantial during 2004, but should fade next year as the export revival comes on stream and the rand depreciates. Real GDP growth is forecast at 2.7 % for 2004 (including relatively sharp quarter-on quarter acceleration over the course of the year). The acceleration in growth is expected to top out next year, with real GDP growth projected to average 3.3 %, see Table 3. In case of no surprises (unforeseen shocks), the current economic expansion has all the potential to last well beyond the current forecast period.

Impact on agriculture: The expected world's and South Africa's growth prospects will have positive spin-offs for the agricultural sector, with only some concern with the loss of competitiveness.

TABLE 3: Annual real GDP growth rates

	2003	2004	2005
BER	1.9	2.7	3.3
EIU	1.9	2.6	3.3
Consensus		2.9	3.1

Bureau for Economic Research (BER); Economic Intelligence Unit (EIU); Consensus between ABN Amro, ABSA bank, Deutsche Bank, Goldman Sachs, IMF, ING, JP Morgan, Lehman Brothers, Merrill Lynch, Nedcor Bank, Standard Bank, West LB Asset Management

TABLE 4: Annual average R/$ exchange rates

	2003	2004	2005
BER	6.74	7.10	8.50
EIU	7.56	7.19	7.60
Consensus	7.20	7.2	7.9

Bureau for Economic Research (BER); Economic Intelligence Unit (EIU); Consensus between ABN Amro, ABSA bank, Deutsche Bank, Goldman Sachs, IMF, ING, JP Morgan, Lehman Brothers, Merrill Lynch, Nedcor Bank, Standard Bank, West LB Asset Management

4.3 Exchange rates

Recent trends: The rand continued with its volatility but has strengthened steadily in the past eighteen months, but it weakened, to briefly touch R7 to US dollar, in late April as metal prices fell because of concern that slowing economic growth in China would dampen demand for commodities. However the rand recovered in May, to around R6,50 to US dollar level. This recovery was mainly attributed to profit-taking in the early part of 2004 and investor caution in the face of US interest rate hikes. The remarkable strength of the rand was seen in the last month of the quarter, when the currency was about R6,20 to the US dollar.

Forecast: At present, it is difficult to say when the rand will fall, but most South African economists expect a moderate depreciation in the final months of 2004. The current rand strength is to a large extent the flipside of dollar weakness and favourable capital inflows due to historically low interest rates abroad as well as the commodity boom that has benefited the rand. As indicated in Table 4, the Bureau for Economic Research (BER) forecast a relatively strong level for the rand exchange at the end of 2004, around R7,10 to a US dollar, as the euro is assumed to appreciate against the US dollar, rand depreciation against the euro could be sharper. Next year, when the interest rate levels in the major industrial countries normalise, the commodity cycle reaches a peak and the US dollar is expected to stage a comeback (from mid-2005), the pressure on the rand could become more intense.

Impact on agriculture: Until now, the Rand's impact on the net trade volumes has had limited contagion effects on the rest of the economy. There is about 6 to 9 month lag between the Rand's moves and adjustments in trade volumes. Put differently, the effect of the Rand's recent further appreciation should begin to impact trade volumes late this year and in 2005.

4.4 Interest rates

Recent trends: Monetary policy will remain focused on containing the level of inflation within the official target range of 3 % to 6 % per year set by the South African Reserve Bank over the forecast period. Although the inflation figures for the first five months of this year have been encouraging, leading indicators suggest that high fuel prices are likely to increase inflationary pressure in the latter part of the year. As expected, the South African Reserve Bank again left its key repo rate unchanged at 8 % (prime – 11.5 %), at its recent June 9th to 10th meeting. This has raised the debate about whether South Africa is now at the bottom of its current interest-rate cycle.

Forecast: In general, the consensus view is that interest rates will remain constant for some time, but will move up towards the end of 2004 or in early 2005. The expected increase in US interest rates by mid- to late 2004, coupled with stronger domestic demand, will mean that the repo rate cannot fall too far and will probably begin to edge up in the first quarter of 2005, to 8.5 %, with the prime lending rate rising to 12 %.

Impact on agriculture: The environment of low interest rates will continue to benefit agriculture as the interest payments are one of the biggest cost-items in the sector. The expectations of an increase in interest rates may have a negative impact in the sense that the currency will then appreciate further bringing gloom to the agricultural export sector.

5. OTHER FACTORS IMPACTING ON AND RELATED TO AGRICULTURE

5.1 Climatic conditions

Most of the farmers who planted their crops mid December to January had good yields as opposed to those who planted their crops during the beginning of 2003/04 summer-rainfall season. This is due to the rains that were received during the second half of the 2003/04 summer-rainfall season. Frost and snow has occurred in some of the areas and this will lead to the veld drying up quickly that will be exposed to fires. Most western parts of the country received good rains from June until early July 2004 and this will relieve both crop and livestock farmers in the province. The eastern half of the country also received patches of above normal rainfall and this will have a positive impact on the winter crops. A 45 % probability of below normal rainfall conditions is expected over the southwestern part of the country with 40 % probability of near normal rainfall conditions over the rest of the country is expected in September, October and November 2004. A 45 % probability of below normal mean temperatures is expected for the entire forecast region in July, August and September 2004, whereas 45 % probability of near normal temperature is expected over the entire region. Pockets of drought stricken areas have been reported in recent months in the winter rainfall regions as well as continuing longer-term drought conditions in some livestock and game farming areas.

5.2 Crop production and estimates

Table 5 summarises the estimated plantings and production of the most important summer crops for the 2003/04 season. The expected commercial maize crop is 8,056 million tons – 4,909 million tons white maize and 3,147 million tons yellow maize. The area planted to commercial maize is 2,646 million ha, of which 1,728 million ha (65 %) is for white maize and 0,918 million ha (35 %) is for yellow maize. The majority of South Africa's maize is produced in the Free State,

TABLE 5: Estimated plantings and production of summer crops for the 2003/04 season

Crop	Estimated plantings for the 2003/04 season	Change from the 2002/03 season		Estimated production for the 2003/04 season	Change from the 2002/03 season	
	Ha	Ha	%	Tons	Tons	%
Total maize	2 645 600	(539 350)	(16,93)	8 055 850	(1 335 600)	(14,22)
White maize	1 727 600	(504 850)	(22,61)	4 908 650	(1 456 900)	(22,89)
Yellow maize	918 000	(34 500)	(3,62)	3 147 200	121 300	4,01
Sorghum	118 750	23 253	24,35	302 870	83 356	37,97
Groundnuts	62 300	12 500	25,10	88 415	28 410	47,35
Sunflower seed	526 125	(80 325)	(13,25)	598 400	(44 210)	(6,88)
Soya-beans	122 260	22 130	22,10	207 585	71 065	52,05
Dry beans	56 200	5 190	10,17	76 710	16 415	27,22

Source: Directorate Agricultural Statistics

TABLE 6: Estimated plantings and production of winter crops for the 2003/04 season

Crop	Estimated plantings for the 2003/04 season	Change from the 2002/03 season		Estimated production for the 2003/04 season
	Ha	Ha	%	Tons
Wheat	846 200	98 200	13,13	1 540 000
Barley	81 175	(3 045)	(3,62)	240 000
Canola	46 000	1 800	4,07	40 770
Sweet lupines	8 000	(2 100)	(20,79)	4 040

Source: Directorate Agricultural Statistics

Mpumalanga and the North West provinces and represents respectively 31,4 %, 24,1 % and 27,3 % of production. Table 6 summarises the estimated plantings of the most important winter crops for the 2004/05 season. The preliminary area estimate for wheat is 846 000 ha, which is 13,1 % higher than the 748 000 ha planted for the previous season. An estimated 375 000 ha or 44 % are in Free State, 349 000 ha or 41 % in Western Cape and 52 000 ha or 6 % in the Northern Cape.

5.3 HIV/AIDS and food security

The HIV/AIDS pandemic is the second biggest threat to food security in Africa after poverty. According to the United Nation's Food and Agriculture Organisation (FAO), Aids is reported to have killed more than 7 million agricultural workers since 1985 in the 25 hardest hit countries in Africa and it is said to have the capability to kill a further 16 million before 2020. South Africa, Namibia, Botswana, Zimbabwe and

Mozambique are among the countries that are expected to suffer large losses in their agricultural sector by 2020. The United Nations and other governmental and international organisations predict that Aids-related deaths will peak in the next 10 to 15 years based on the past and current infection rates in the region. However, according to Standard Bank economist Henry Flint, research on the long-term effects of Aids has always appeared to project worst-case scenarios.

5.4 World Trade

Trade experts raised alarm over South Africa's mooted free-trade pact with China, warning that it could have dire consequences for the country if not negotiated with extreme caution. The free trade deal has been on the table for some time, but official negotiations have not started. There has been some concerns raised by local companies about the potential effect of a free-trade deal with China given China's rapidly growing penetration of the domestic market. In the wider context, the warnings have been elevated, particularly as South Africa's trade deficit, according to trade and industry statistics, has jumped 88 % from 2001 to about R10 billion, and seems set to continue. According to trade consultancy, Emerging Market Focus, South Africa's trade deficit with the booming Chinese market would rise to R12 billion next year. Some economic commentators visualize Hong Kong as a gateway for South Africa into China. Government and business should also have a clear understanding of the threats and opportunities that a free-trade deal with that country would present. The threat in the deal emanates from sheer volumes China produces at very low input costs. China has the potential to decimate quite important industries in South Africa, such as the textile and clothing industry. The fact that South Africa exported unbeneficiated minerals, such as iron-ore and gold, to China, while Chinese imports comprised high-valueadded products, such as appliances, caused concern over that country's penetration to South African market. It is consoling to hear from South Africa's chief trade negotiator, Xavier Carim, that government realised the vastness and complexities of the Chinese market and that it would study that market carefully before entering into a free-trade deal with China. Recently the South African and Chinese governments signed a Citrus Protocol that will pave way for South Africa to export its citrus produce directly to the Chinese market and adding to the current two-way trade revenue totalling R23 billion.

5.5 Empowerment sale

Commercial farmers and agribusiness are acutely aware of the pressures from the government and some community organisations for the transformation of the sector through black economic empowerment (BEE) deals. In a landmark sale, one of the big three South African sugar companies has disposed one of its mill and sugarcane farms to a black empowerment group for R335 million (US$46.8m). The purchaser, in turn, will in time sell a large portion of the estates to small- and medium-scale black growers. This deal provides the first time black participation in sugar milling. The sugar industry has committed itself to meeting the government's target of transferring 30 of farmland to blacks by 2014.

5.6 Cotton-growing project

South Africa produces only 38.2% of its annual cotton requirements of 329,000 bales, relying on imports for the balance. Cheap imports as a result of the strong rand have affected local production, but one of the country's largest textile manufacturers has launched a cotton-growing project in the Eastern Cape, which will produce 35,000 bales per year. The R150 million project involves the establishment of new areas of production, loans to farmers, and the erection of a cotton gin. An irritated area of 2,000 ha will be planted soon, and the gin will be completed before the first harvest, in April 2005. The land is owned by black subsistence farmers, and more is to be acquired by purchase from white commercial farmers. The cotton will be handpicked, and the project at full production will create between 5,000 and 6,000 jobs, the social significance of which will be high amongst impoverished rural communities.

5.7 The Proposed Electricity Pricing Policy and its implication to the agricultural sector

The Electricity Pricing policy envisaged by the electricity industry (The white Paper on energy, 1998) will increase cost for the agricultural sector in the short run and that stands also in direct contrast with the Agricultural Strategic Plan (2001), which identified global competitiveness as a core strategy and the lowering of overall production cost as a priority programme. However, in the long run it will encourage efficiency consumption of electricity and significantly increase renewable energy's share of the electricity market in the sector and that will generate environmental benefits to society. The Department of Agriculture will actively engage with other stakeholders in finding an effective strategy that will guarantee a global competitive agricultural sector adhering to WTO rules and providing "a safety net" for vulnerable groups such as emerging farmers. The inherent uncertainty of the transition to the new pricing and the recognition of important environmental and energy diversification benefits from renewable energy suggest that the national policy towards renewable electricity should be addressed in the context of the proposed pricing policy. An alternative to a top-up subsidy is a provision for more investment towards renewable energy and electricity infrastructure in the agricultural sector through the Comprehensive Agricultural Support Programme (CASP).

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