DEPARTMENT: AGRICULTURE
REPUBLIC OF SOUTH AFRICA

Quarterly Agricultural Economic Review and Forecast October to December 2004

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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. To support this important task the division (Economic Research) concentrates on economic analysis of 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 developments and expected economic trends in the agricultural sector. The quarterly report has now been established as a regular feature in the Directorate's work plan. Since the beginning of 2004 the report is also published for outside consumption to add value to a number of existing regular economic publications on the agricultural sector. It is our vision to maintain it as indispensable reading for every serious student of the SA agricultural sector.

At this stage most of the content is based on sources outside the DoA. In time we hope to incorporate more departmental generated material. Any comments on the content of this quarterly report series are most welcome.

Mr B J van Wyk
Senior Manager: Economic Analysis
February 2005
Pretoria

1 WORLD ECONOMY

The world economy's prospects of going forward has undoubtedly been adversely affected by the sustained increase in the oil price earlier this year, but the indications are that global GDP growth is likely to continue on a sustained basis. According to the Economist Intelligence Unit (EIU), the world economy is expected to expand by nearly 5% in 2004 (real gross domestic product (GDP) measured at purchasing power parity exchange rates), the fastest rate of growth for 20 years. Although growth is expected to slow down over the next couple of years owing to policy-tightening in some of the major global economies, the rate of growth will remain strong over the next two years. In the case of the United States of America (US), the EIU forecast the growth rates at 4.2% in 2005 and 4.1% in 2006. Consumer spending in the US economy has been knocked in the second quarter by the adverse impact of the oil price. However, this has been short-lived as the third quarter saw reaccelerated consumer spending. The weaker dollar has stimulated exports and the International Monetary Fund (IMF) forecasted the real GDP growth to come in at 4.4% and 3.5% for 2004 and 2005 respectively. Table 1 below indicates the World economic outlook in real GDP growth.

2 SUB-SAHARAN ECONOMY

According to EIU, the real GDP growth in Sub-Saharan Africa is expected to pick up in 2004 to a robust 4.4% and remain at this level for the coming two years. The IMF is even more optimistic, forecasting real GDP growth for Sub-Saharan Africa to 4.6% and 5.8% during 2004 and 2005 respectively. Growth looks set to remain strongest in the **Franc zone**, although after the exceptionally strong growth forecast for 2004, at 6.5%, the real GDP growth rate will fall back to 5,4% in 2005 and 5.3% in 2004. The high growth in the region as a whole has been supported by high rates of growth in a number of countries that are experiencing sharp increases in oil production, notably Equatorial Guinea and Chad. However, despite being the best-performing subregion, growth in the Franc zone would be higher if there were to be an end to the political crisis in Côte d'Ivoire that would allow the country to set in place appropriate policies to drive an economic recovery in the sub-region's largest economy. One of

TABLE 1: The World Economic Outlook-Real GDP growth

Industrial countries	2003	2004	2005	Developing countries	2003	2004	2005
Major seven	2.1	3.5	2.8	Emerging Asia[2]	3.7	5.7	4.2
USA	3.0	4.4	3.5	China	9.3	8.8	7.9
Japan	2.5	4.2	2.2	India	8.2	6.0	6.5
Euroland[1]	0.5	1.9	2.2	Latin America	1.6	5.7	4.0
UK	2.2	3.1	2.4	Emerging Europe[3]	5.4	6.7	5.1
Germany	-0.1	1.4	2.1	Sub-Saharan Africa	3.7	4.6	5.8

[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, Fourth quarter 2004*

the factors that will contribute to the slow-down in growth in the Franc zone, which includes many countries in the Sahel region, in 2005 is a major locust invasion. After a relatively poor economic performance in the 2000 – 03 period, economic growth in **East Africa** is forecast by EIU to pick up substantially, with real GDP growth increasing from 4.7% in 2004, to 4,8% and 4,9% in 2005 and 2006 respectively. **Southern African Development Community** (SADC) growth is forecast to rise to 3.8% in 2004, to 4.3% and 4.4% in 2005 and 2006 respectively. Although **Central and West Africa** was the fastest growing sub-region in 2003, real GDP growth in the sub-region is forecast to fall from 4.6% in 2004 to 3.7% in 2005. However, with growth in the Nigerian and Ghanaian economies recovering marginally in 2006, the real GDP growth in the region should rebound to 3.9% in 2006 according to EIU.

3 SOUTH AFRICAN ECONOMY

In November 2004, Statistics South Africa (StatsSA) revised the GDP figures and a picture of an economy growing at a robust pace was painted. The economic growth in the last quarter surged, rising at an annualised rate of 5.6% (the fastest pace in more than eight years). The released figures for the past five years from StatsSA reflect a booming economy, and one that has been resilient in the face of a strong rand and difficult global conditions. The level of GDP for 2004 was revised upwards to R1.251 trillion from R1.209 trillion, which translated in an increased growth rate from 1.9% to 2.8%. Similar changes on the expenditure side as has been seen on the production side are expected according to sources at the South African Reserve Bank (SARB) (gross expenditure figures are compiled on quarterly basis by the Reserve Bank). The current macroeconomic environment of low interest rates, strong currency, negligible inflation pressure and above-inflation wage growth is expected to persist for the foreseeable future. It is therefore not unexpected that the South African economy received a vote of confidence when Moody's Investors Services made an announcement in October 2004 that South Africa's sovereign rating will be upgraded from Baa2 to Baa1.

4 MACROECONOMIC VARIABLES AND THEIR IMPACT ON AGRICULTURE

4.1 Inflation

Recent trends: The consumer price index excluding interest rates on mortgage bonds (CPIX) has remained within the inflation target range of 3 to 6 percent since September 2003. According to the latest data released by StatsSA, the CPIX as well as the producer price index (PPI) for all commodities for South African consumption continued to decline in rate. The CPIX rose 4.6% year on year in November and 4.3% year on year in December, whilst the (PPI) rose by 1.9% year on year in December from 2.5% year on year in November. The official average annual CPIX inflation rate for the year 2004 (i.e. year on year) is 4.3% while the average annual rate of increase in the PPI in 2004 is as low as 0.6%.

Forecast: By December, the targeted inflation rate, CPIX had been within SARB'S 3-6% target band for 16 consecutive months. Furthermore, the indications from Table 2, suggest that the market expectations are that the CPIX will on average remain within

TABLE 2: Annual CPIX inflation rates

	2003	2004	2005
BER	6.8	4.6	5.6
BMI	4.0	4.6	5.5
CONSENSUS	5.0	4.5	4.8

Bureau for Economic Research (BER); Business Monitor International (BMI); Consensus between ABN Amro, ABSA bank, Deutsche Bank, Goldman Sachs, IMF, ING, JP Morgan, Lehman Brothers, the SARB's target band during 2005 despite the persistent oil price threats. The continued strength of the rand helped cushion the effects of these international oil prices trends.

Impact on agriculture: The current macro-economic environment of low inflation is impacting positively on the sector by maintaining the current low and steady level of interest rates. These low levels enable the farmers to service their debts much easier.

4.2 Growth

Recent trends: The economy continued its relentless expansion in the third quarter of 2004, growing by a substantial 3.8% year on year in real terms, its fastest rate since the second quarter of 2002 according to (Business Monitor International) BMI. The current estimates of real GDP growth in 2004 are probably too modest. The economy is generally rising solidly being propelled by solid private consumption growth, which reached a whopping 6.2% year on year in the third quarter of 2004, as well as an expansionary fiscal discretion, with government spending that rose by over 6.5% in real terms for two consecutive quarters. The rand has stayed exceptionally strong, peaking around R5.75/US$ in late December, and has subdued import costs. Most industries are presently enjoying a buoyant period, a fact reflected in the fourth quarter RMB/BER business confidence index reaching a level not seen since 1980. Only the manufacturing sector is failing to record levels of confidence seen throughout the economy, mainly due to the fact that the sector is more exposed to exports than most other sectors. The problem, however, is that the economy is increasingly unbalanced, due to the strength of the rand. According to South African Revenue Services (SARS), South Africa's trade deficit increased dramatically in the third quarter of 2004. Cumulative trade figures for the first 10 months of the year give a startling picture of the debilitating effect the currency has had on the trade balance, with the surplus of R15.5billion recorded from January to October 2003 turning into a deficit of R13.6billion for the same period in 2004.

Forecast: The macroeconomic environment characterized by low inflation, negligible inflation and strong currency is once again leading most economists to the path of economic optimism. The BER has upgraded the forecast for real GDP growth in 2004 to 2.9% from 2.7% forecast previously, mainly due to stronger than expected growth in real domestic expenditure during the first half of the year as well as upbeat business survey results in respect of the third quarter (see Table 3). Not only has the outlook for inflation and interest rates become more favourable, but there are also signs of improved employment creation in the economy. According to BER, gross domestic expenditure (GDE) growth will come in at a healthy 5.3% in 2004 and will only decelerate to 4.5% growth in 2005. The BMI as well as Consensus (group of financial institutions) have underestimated the strength of domestic demand but they remain optimistic for prospects in 2005.

TABLE 3: Annual real GDP growth rates

	2003	2004	2005
BER	1.9	2.9	4.0
BMI	2.8	3.8	3.0
Consensus		2.9	3.2

Bureau for Economic Research (BER); Business Monitor International (BMI); 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

Impact on agriculture: The South African growth prospects as well as the fact that agricultural industry was mentioned as one of the main contributors to the increase in economic activity for the second and third quarters, has a positive impact on the sector. The GDP figures for the third quarter show spectacular growth in the sector, which grew at an annualised rate of 14.7% (on a seasonally adjusted and annualised basis), due to expectations of a bigger maize crop in 2005.

4.3 Exchange rates

Recent trends: The rand's general strength continues despite the temporary depreciation following the interest rate cut in the second quarter of 2004. The currency has actually gained more than 15% against the US dollar in 2004, making it the second-best performer against the US currency in the year. The local unit touched a new five-year high of R5.75 against the US dollar earlier in December prompting calls for the Reserve Bank to cut interest rates to weaken the currency. Several factors seem to be behind the sustained currency strength and among them are the following: a favourable emerging markets financing environment, defined by a weak dollar; strong commodity prices and low interest rates in the major industrialised countries as well as the favourable domestic conditions. The problem with the rand relates to its high volatility. Since 2002, the real effective exchange rate of the rand as well as the euro appreciated in real terms, but the appreciation of the rand exceeded that of the euro by a considerable margin. According to the SARB quarterly bulletin (December 2004), the real effective exchange rate of the rand has been substantially more volatile than that of the euro since the beginning of 2002, as evident in the coefficient of variation of 13.0 and 6.6 for the rand and euro respectively.

Forecast: South Africa's trade balance has deteriorated into an atypical deficit despite its increased terms of trade over the past two years. The strong capital inflows are currently financing a widening current account and the composition of the net flows reveals a lack of long-term oriented capital. This deficit without demonstrated ability to attract long-term capital could lead to selling pressure on the rand when interest rates abroad "normalise" and the commodity cycle tops out in 2005. This could render the rand exchange rate vulnerable to a capital flow reversal and/ or deterioration in terms of trade. As indicated in Table 4, the BER has reviewed its exchange rate forecast from R8.30/$ to R8.00/$ for 2005, BMI left it unchanged for 2005 whilst the Consensus review it from R7.60/$ to R7.30/$ for 2005. The imminent foreign direct investment injection (such as the Barclays-ABSA deal) could still maintain the rand's strength.

TABLE 4: Annual average R/$ exchange rates

	2003	2004	2005
BER	6.74	6.60	8.00
BMI	6.64	5.96	7.80
Consensus	7.20	6.80	7.30

Bureau for Economic Research (BER); Business Monitor International (BMI); 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

Impact on agriculture: Once again the impact of the strong rand has mixed fortunes for the agricultural sector. On the positive side, the environment of the strong rand and low interest rates has enabled the farmers to take the opportunity to replace ageing equipment. For example, figures released by the SA Agricultural Machinery Association (SAAMA) revealed that sales of combine harvesters rose by 48% in 2004 and baler sales by 67% compared with sales recorded in 2003. On the negative side, the strength of the rand is once again reducing the competitiveness of agricultural exports. For example, the strong rand drags down prices (maize) in Rands, which are based on international quotes that are in dollars.

4.4 Interest rates

Recent trends: The third quarter saw the SARB, in both October and December MPC (the Monetary Policy Committee) meetings, leaving the repurchase rate (repo) level unchanged having cut it six times since June 2003 to a 23-year low of 7.5%. The private sector banks have subsequently left their prime overdraft rate and predominant rate on mortgage loans unchanged at 11%. These rates are currently at their lowest in 24 years, following an overall reduction of 6% points from June 2003 to August 2004. These historical lower levels of the interest rate are contributing to the continued buoyancy in domestic consumer spending.

Forecast: Tightened and less accommodative monetary stances have been assumed by several countries. This monetary-policy tightening cycle has been led by Australia, US and the United Kingdom among others as inflationary concerns started to rise. In most of these countries, the concerns have been around the high oil prices as well as the increased demand. In South Africa, although the picture is that of benign inflation outlook, the worrying factors seem to evolve around high domestic demand as well as uncertainty around sustainability of the rand at its current exchange rate levels. The BER is expecting the interest (repo) rate to increase with prime heading for 12, 5% at the end of 2005. BMI's view is that the falling output gap means that the monetary policy will have to be tightened at some point to slow the strong domestic demand in order to stem inflation. They are expecting the repurchase rate to increase from the current 7.55 to 8.25% by the end of 2005.

Impact on agriculture: In October and December the MPC left interest rate level unchanged and at this level, agricultural sector will continue to benefit. Should the interest rate forecast be real, the sector will be negatively affected mainly in two ways: the higher level of interest rate would mean increased interest repayments and the sector may also have to face increased currency strength. This is a matter of concern against the present low price levels for certain agricultural commodities (grain – see paragraph 5.3).

5 OTHER FACTORS IMPACTING ON AND RELATED TO AGRICULTURE

5.1 Climatic conditions

The western half of the country received good rains in October whereas the eastern part received only sporadic falls. Rainfall shifted to the east in November while rainfall was confined to the central and southern parts during December 2004. The high evaporation rate due to high temperatures resulted in massive moisture depletion. Most of the rains received over the country until end of December were below the long-term mean and as such could not have a significant effect in breaking the prevailing drought conditions. **Levels of dams:** Generally the levels of dams are low in the country because of the below normal rainfall conditions. Good rains received in places did not make much difference. **Crop conditions:** In most farming regions, the crops under irrigation are in good conditions although water restrictions are a major constraint. A limited number of farmers under dry-land planted earlier in the planting season and most planted later in the season mainly due to climatic conditions that later improved. **Livestock conditions:** Up to the end of December the livestock was in fair to good conditions in most provinces. Due to the continuing drought, the Provincial Departments of Agriculture are supplying additional fodder to the livestock in critical conditions and this is done on subsidy basis. **Forecast of rainfall and temperature: <u>January to May 2005</u>**-The weak El Niño is expected to prevail until end of the current summer season. Higher probabilities for hot and dry conditions are expected over most of the country except the north-eastern interior as well as the eastern and southern coastal regions where near-normal rainfall conditions are likely, with these conditions improving further during early winter. Although a promising start to the winter rainfall season is likely, temperatures are expected to remain on the warm side in early winter over practically the whole country. The drought assistance might still be necessary in view of the onset of winter where the bulk of the country is expected to receive less rainfall. **SADC**: Food security in the region continues to deteriorate especially in those countries where food crop production was insufficient to meet domestic requirements. In more severe cases (as in some areas of Zimbabwe), staple cereals are increasingly unavailable countrywide, causing retail food prices to rise and exacerbating food access problems for the most vulnerable households. Following an erratic start to the 2004/05 rainy season, many areas received normal to above normal rains in December, which improved conditions for agriculture in many areas across the region. Agricultural activities are reported to be underway throughout the region, although there are reports of shortages of or lack of access to requisite farm inputs, constraining farmers' ability to plant sufficient crops to meet their requirements.

5.2 Crop production and estimates

Table 5 summarises the preliminary estimated plantings of the most important summer crops for the 2004/05 season. The estimated area that South African commercial maize producers have planted to maize during the current 2004/05 season is 2.895 million ha. The area estimate is 1.8% up from the 2.843 million ha planted to maize in the previous season. The ratio of white to yellow maize plantings is 63:37 as against the previous seasons' 65:35. The expected white maize plantings is 1.830 million ha, down 0.6% from the previous seasons' plantings of 1.842 million ha, while yellow maize plantings are 1 065 000 ha, up 6.4% from 1 001 300 ha. The majority of South Africa's maize is planted in the Free State, Mpumalanga and North West Provinces. Plantings of maize in

TABLE 5: Estimated plantings of summer crops for the 2004/05 season (Final recalculated crop estimates)

Crop	Estimated plantings for the 2004/05 season	Change from the 2003/04 season		Estimated production for the 2003/04 season
	Ha	Ha	%	Tons
Total maize	2 895 000	51 700	1,82	9 482 000
White maize	1 830 000	(12 000)	(0,65)	5 805 000
Yellow maize	1 065 000	63 700	6,36	3 677 000
Sorghum	122 200	(7 800)	(6,00)	373 000
Groundnuts	46 350	(25 150)	(35,17)	115 000
Sunflower seed	481 050	(48 950)	(9,24)	648 000
Soya-beans	134 350	(650)	(0,48)	220 000
Dry beans	52 150	(4 050)	(7,21)	80 000

Source: Directorate Agricultural Statistics

Mpumalanga is 585 000 ha - an increase of 5.0% in comparison with 557 000 ha in 2003/04. The expected plantings of maize in the Free State increased by 1.5%, from 1 010 000 ha to 1 025 000 ha, and in North West by 0.8%, from 952 000 ha to 960 000 ha, compared to the plantings in the previous season. The preliminary area estimate for sunflower seed is 481 050 ha, which is about 9.2% less than the 530 000 ha planted the previous season. The area estimate for sorghum is 122 200 ha or 6.0% less than the 130 000 ha of the previous season. For groundnuts the area estimate is 46 350 ha, which is 35.2% less than the 71 500 ha planted for the previous season. It is estimated that 134 350 ha have been planted to soya-beans, which represents a slight decrease of 0.5% compared to the 135 000 ha planted last season. In the case of dry beans the area estimate is 52 150 ha or 7.2% less than the 56 200 ha planted the previous season. The main reasons for the decline in the plantings of most summer crops are the large carry-over stocks from the 2004 crop, poor price expectations and rising domestic input costs. Using the previous seasons' yield of 3.33 ton/ha and an area of 2.895 million ha, a production total of 9.640 million tons of maize could be realised during the 2004/05 season. Table 6 summarises the estimated plantings and production of the most important winter crops for the 2004/05 season. According to the sixth production forecast, the expected commercial wheat crop is 1.731 million tons, which is 190 680 tons or 12.4% higher than the crop for the previous season (2003/04). The main producing areas are within the Free State, with a production of 562 500 tons (32.5%), followed by the Western Cape with 526 880 tons (30.4%). The expected yield for wheat is 2.03 t/ha as against the 2.06 t/ha the previous season. The expected yield for the Western Cape is 1.48 t/ha. The estimated yield for the previous season was 1.63 t/ha. The expected yield for the Free State is 1.50 t/ha, the same for the previous season. The production forecast for malting barley is 189 365 tons, representing a decrease of 21.1 % or 50 635 tons compared to the previous season. The main producing area is within the Western Cape with a production forecast of 122 120 tons (64.4%). The expected yield is 2.29 t/ha compared to the 2.85 of the 2003/04 production season. The production forecast for canola is 34 250 tons, a decrease of 16.0% or 6 520 tons compared to the 2003/04 season. The expected yield is 0.75 t/ha as compared to the 0.92 t/ha of the previous season. The production forecast for sweet lupines is 3 950 tons, a decrease of 2.2 % or 90 tons compared to the 2003/04 season. The expected yield of 0.56 t/ha, as against the 0,4 t/ha the previous season.

5.3 Maize price slump

The first weeks of January 2005 saw maize prices plunging below R600 per ton on SAFEX, which acts as a benchmark for pricing in the rest of the maize market. This fol-

TABLE 6: Estimated plantings and production of winter crops for the 2004/05 season

Crop	Estimated plantings for the 2004/05 season	Change from the 2003/04 season		Estimated production for the 2004/05 season	Change from the 2003/04 season	
	Ha	Ha	%	Tons	Tons	%
Wheat	851 200	103 200	13,80	1 730 680	190 680	12,38
Malting barley	82 650	(1 570)	(1,86)	189 365	(50 635)	(21,10)
Canola	45 500	1 300	2,94	34 250	(6 520)	(15,99)
Sweet lupines	7 100	(3 000)	(29,70)	3 950	(90)	(2,23)

Source: Directorate Agricultural Statistics lows the recent November quoting of white maize, the most traded variety, at R1024 per ton. This implies that the farmers who hedged by going short or selling a future at around R1000 per ton would currently benefit nearly R400 per ton but those who went long, or bought, face losses of the same amount. Most grain producers claim that they won't be able to break-even at these prices and also that they will be unable to pay their creditors. The Rand value of prices are also dragged down by the strong rand since they are based on international quotes that are in dollars. The good rains that have cleared the fears that maize production might be hit by drought as well as the three million ton surplus from last year's crop have contributed largely to this situation. According to the Department of Agriculture (see Table 5), this year's harvest is now expected to be about nine million tons of white and yellow maize while South Africa consumes about eight million tons, leaving four million tons surplus.

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