

**THE GLOBAL ECONOMIC SLOWDOWN: HOW
HAS THE AGRICULTURAL SECTOR GROWTH
BEEN AFFECTED?**

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EXECUTIVE SUMMARY

The global economy is now beginning to show some signs of recovery, with countries starting to experience moderate but positive growth in some of their sectors and price pressures are beginning to subside. However, the impact that this downturn has done in the world economy cannot be stressed enough. The South African economy also could not escape the downturn, as evidenced by many sectors entering into recession due to pressures from deteriorating demand. The vehicle sector, for instance, lost huge profits during 2008 and early 2009 as a result of declining sales which saw it scaling down its operations and laying off workers.

In the light of such background, the main objective of this report is to investigate the effects of the economic downturn on the agricultural sector growth by looking at various trends in the sector. Despite the observed sluggish performance in other sectors of the economy, the paper observes that the agricultural sector was not severely hit by the downturn, as evidenced by a positive trade surplus of over R5,9 billion recorded by the sector during 2008 after experiencing a trade deficit in the previous year. The quantity of exports also rallied, showing an increase of over 911 000 tonnes.

The report also looks at the consumption pattern of selected agricultural products, particularly meat and grains, which shows that consumer preference shifted from beef and mutton to poultry and other low cost meat products. Production of beef has also suffered showing a decline of 3,8% in 2008, while the production of other meat increased during the same period. Meanwhile, consumption of grains increased considerably, except for wheat which declined significantly by 12,7%.

The overall economic growth was resilient throughout 2007 and 2008, showing positive growth. However during the first and second quarters of 2009, the annual growth rate began to decline, showing signs of lagged effects of recession.

1. Introduction

The global economic slowdown is now beginning to show signs of reversal, with countries starting to experience moderate but positive growth in some of their sectors and price pressures are beginning to subside. However, the downturn across the globe has negatively affected growth in all sectors, which saw many countries going into recession. World gross domestic product (GDP) has been forecast to drop by 1,2% in 2009, compared to about 2,5% growth in 2008.

A decline in world GDP resulted in many countries, especially developing countries, cutting spending on food and industrial demand for agricultural products substantially. Imports have also declined significantly in importing countries. This was evident in countries like China, Taiwan, Mexico, Egypt and Russia (United States Department of Agriculture, 2009b).

After dramatic increases in the prices of most commodities in the last three years, commodity prices fell in the second half of 2008. International food, and fuel prices declined sharply by 33% and 70%, respectively, in December 2008 as compared with June 2008. However, prices of food and fuel still remain higher than they were for much of this decade (United States Department of Agriculture, 2009a). Despite a decline in food prices in late

2008, consumer's purchasing power and food security are expected to deteriorate in 2009 because of the growing financial deficits and higher inflation in recent years.

A decline in world growth has also contributed to the reduction in demand and prices for energy. The oil price plunged to its lowest level of \$35 a barrel in January 2009, after reaching a peak of \$147 a barrel in July 2008 (Economist Intelligence Unit, 2009).

The global economic downturn also resulted in the slowdown in the South African (SA) economy. The SA manufacturing and retail sectors were the hardest hit by the downturn, pushing these sectors into recession. Consumer spending has slowed considerably as a result of high interest rates and persistent rise in local prices.

Imports of agricultural products were adversely affected in 2008, restrained not only by reduced incomes and demand but also by increased exchange rate volatility, which raises transaction costs. As a result, many researchers perceived a stalemate in the progress towards further market liberalisation in the ongoing Doha Round of world trade talks as the use of protectionist measures regained some ground in response to market volatility. In other coun-

tries such as Greece, protests by farmers in response to declining commodity prices in early 2009 has led to the government putting together a €500 as a relief package (Institute for European Environmental Policy, 2009).

Agriculture imports by SA from Africa contracted by approximately 10,5% in the third quarter of 2008. This can be attributed to export bans imposed by various countries such as Tanzania, Malawi and Zambia which raised transaction costs as a way of protectionism.

2. GDP Trends

There is no doubt that the South African economy has taken a lot of strain over the last three quarters. The decline in growth moderated from -6.4% quarter on quarter seasonally adjusted and annualised (s.a.a.) in the 1st quarter of 2009 to -3% quarter on quarter seasonally adjusted and annualised in the 2nd quarter of 2009.

The data confirm that the slowdown in the economy has been spearheaded by a broad and substantial decline in the major components of domestic demand in household consumption expenditure (-5.8% from -4.8% in the first quarter), government consumption expenditure (0.2% from 5.8% in the first quarter) and gross fixed capital formation (0.1% from 12.7% in the first quarter).

Household debt-to-disposable income remained largely unchanged at 76.3% in the 2nd quarter of 2009 from 76.8% in the 1st quarter of 2009 (Standard Bank, 2009). However, the current account deficit narrowed substantially in the 2nd quarter of 2009 to -3.2% of GDP from -7% in the 1st quarter of 2009, supported by a striking turnaround in the trade account registering a surplus for the first time since the second quarter of 2005.

Despite the significant impact of the global economic downturn on all sectors of the economy, the South African agricultural sector remained relatively resilient during 2008 mainly due to the fact that agriculture is a basic necessity and a demand for staple food is relatively income-inelastic. However, during the 2nd quarter of 2009, the agricultural sector's annual growth rate declined by 17,1%. This can likely be attributed to the lagged effects of the economic downturn.

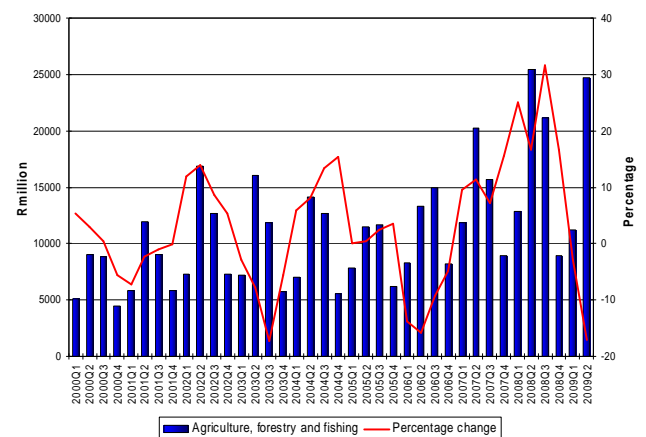


Fig. 1: Agriculture output and the growth rate

Source: Statistics South Africa (Stats SA)

3. Recent food price trends

Yearly average inflation was about 11,5% in 2008. In the 2nd quarter of 2008, inflation was a bit sticky, falling less than expected to 8%, from 8,4% in April, mainly due to increases in the prices of food, cars and household goods. Food prices have been persistently rising since 1990 to date.

The price index of machinery trucks and implements increased by 32,9% for the year ended March 2009 compared to 15% the previous year; with prices of fertilizers showing the biggest increase of 103,6 %. Farmers' terms of trade for the year ended March 2009 have declined by 18,4%, as inputs prices continue their upward trajectory (Department of Agriculture, Forestry and Fisheries (DAFF), 2009).

The cost of production inputs, which have been rapidly rising since late 2006, increased by between 20% and 30% since 2006. Fertiliser prices rose to historical highs of 70,6% in 2008/09, driven by increased demand for fertilisers by China, India and Brazil. Costs of seeds increased by 21,6%, while that of feeds increased by 20,1% during 2008/2009. However, prices of major grains remained persistently low in September 2009 as compared to last year.

4. Consumption Patterns

Consumer purchasing behaviour in animal products and other grains have been largely affected during 2008. The demand for higher cost livestock products such as beef and mutton were seriously affected as demand for livestock and dairy products is more reactive to income changes than demand for cereals.

The consumption of beef and mutton declined by 4,9% and 1%, respectively, in 2008, while the consumption of pork and poultry increased marginally by 0,3%, and 1,3%, respectively. Also, the production of beef declined by 3,8%, while the production of other animal products increased during the same period. The decline in consumption of beef and mutton can be mainly attributed to the changing health habits or increased preference for lower cost livestock products due to lower incomes.

On the other hand, consumption of grains increased significantly during the same period except for wheat which declined significantly by 12,7%. Maize and dry beans consumption increased substantially by 16,2% and 34,6%, respectively.

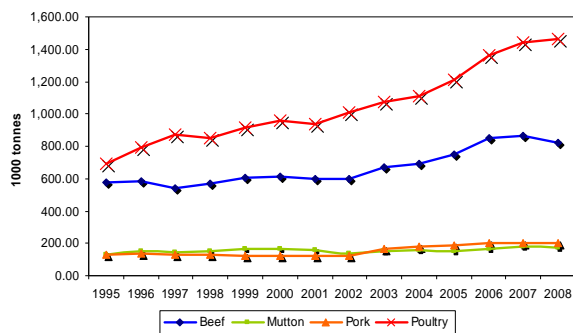


Fig. 2: Consumption of selected agricultural products

Source: Department of Agriculture, Forestry and Fisheries (DAFF)

5. Agriculture Trade Balance

The agriculture trade account registered a surplus of over R5,9 billion in 2008 after recording a decrease of over R62 million in 2007. On the other hand, quantity exported rebounded significantly in 2008, increasing by over 911 000 tonnes after declining sharply by 2,3 million tonnes in 2007. However, an analysis of the agricultural trade balance reveals that unprocessed agricultural exports are mostly responsible for a positive trade balance, while processed agricultural trade has fast lost its strong positive trade balance due to the strong growth in processed imports due to consumption patterns.

6. Import trends

As demand retreated amid weakened foreign economies and currencies, imports became more expensive. This is reflected in local decline in imports of grains, meat and animal fats and oils in 2008. Imports of meat, grains, vegetables and nuts, as

well as dairy and eggs had grown by between 20% and 45% annually between 2005 and 2007, but fell by between 8% and 24% in 2008. The value of some luxury imports such as wine has also declined slightly.

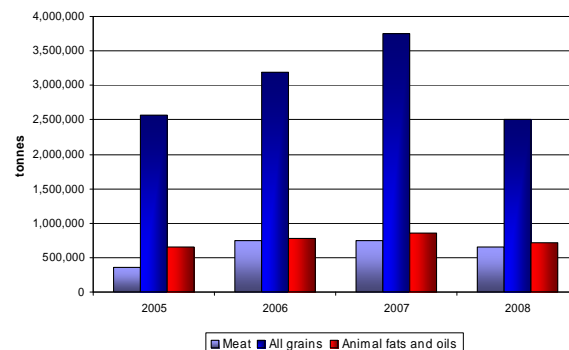


Fig. 3: Imports of selected Agricultural products

Source: Department of Agriculture, Forestry and Fisheries (DAFF)

7. Exports Trends

Over the last decade to 2006 agricultural exports increased from R12 billion in 1996 to R27 billion in 2006. Export volumes increased from 6 billion tons in 1998 to 8 billion tons in 2006. However, after 2002, the Rand strongly appreciated against the dollar, resulting in declined exports. Although an initial decline in exports occurred in 2003 and 2004, which was also overlapping with drought years, exports continued on a positive growth path in value terms until 2006. Processed exports were the largest contributor to overall agricultural exports. The composition of agricultural exports now comprises 62% processed and 38% primary exports (2007) in

value terms. After a sharp decline between 2006 and 2007, quantity of grains exported showed a record increase of more than 1,4 million tonnes in 2008. A sharp decline in quantity of grain exports is attributed to a sharp decline in grain production, particularly maize during the same period. Maize production declined sharply by over 40% between 2006 and 2007 before accelerating sharply by more than 70% in 2008. Vegetables and nuts increased by 95 000 tonnes in quantity exported in 2008. This can be attributed to the agricultural sector finding new markets or deepening regional integration, as well as the depreciation of the Rand in most part of 2008. Meat exports were flat between 2006 and 2008.

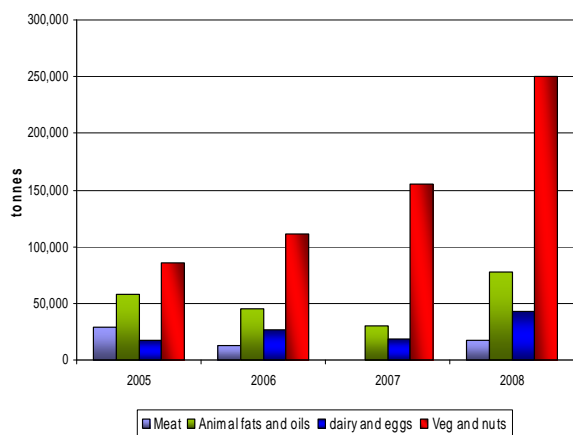


Fig. 4: Exports of selected agricultural products

Source: Department of Agriculture, Forestry and Fisheries (DAFF)

8. Consumer Spending

In the first half of 2009, overall private consumption slowed down from the same

period last year. Private consumption in the first quarter of 2009 contracted as consumers became more cautious in their spending coupled with growing concerns over economic slowdown and lower discretionary income resulting from imposition of working hour reduction and staff layoffs.

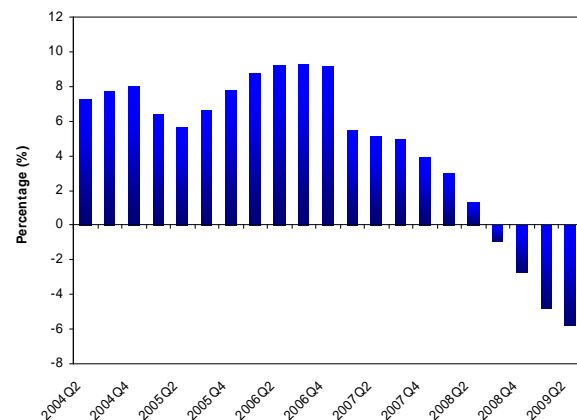


Fig. 5: Household expenditure

Source: South African Reserve Bank (SARB)

9. Summary and conclusions

The effects of the global downturn have been minimal on the agricultural sector as compared to other sectors of the economy. However, it is evident that the economic downturn has had an effect on consumption patterns of agricultural products as well as on the demand for imported agricultural products as demand retreated. However, the report further shows that agricultural trade is still increasing in significance as a component of SA’s agricultural economy and is essential to SA’s growth and prosperity despite the difficult eco-

conomic circumstances – recording a positive trade balance in 2008, after a trade balance deficit experienced in 2007. Exchange rate movements were a major factor underlying previous swings in South African exports. However, of particular concern to South Africa and other developing countries have been policy responses taken by developed and other African countries to counteract the effects of global agricultural markets volatility with implications for long term decline in trade competitiveness and growth. This is an indication that a long term hope to open markets – and thus contribute to efforts to encourage trade and promote poverty alleviation – may continue to be deterred by the use of short term protectionist measures.

South African agriculture output has become more resilient in the face of the economic crisis – showing positive quarterly growth rates (percentage change) between 2007 and 2008.

The episodes of extreme price volatility cannot be ruled out in coming years, particularly as commodity prices have become increasingly linked to oil and energy costs. Although agricultural production, consumption, and trade are expected to increase, access to food rather than food availability remains a big challenge, with poverty reduction and economic growth a

big part of the solution. Domestic agricultural development can best be supported through targeted policies such as infrastructure investment, establishing effective research and development systems and providing incentives for sustainable use of soil and water. There is also a need for greater opening of agricultural markets and broadening economic development beyond farming in poor rural regions.

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