Economic Commentary: Issue No. 22

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Purpose of the Economic commentary

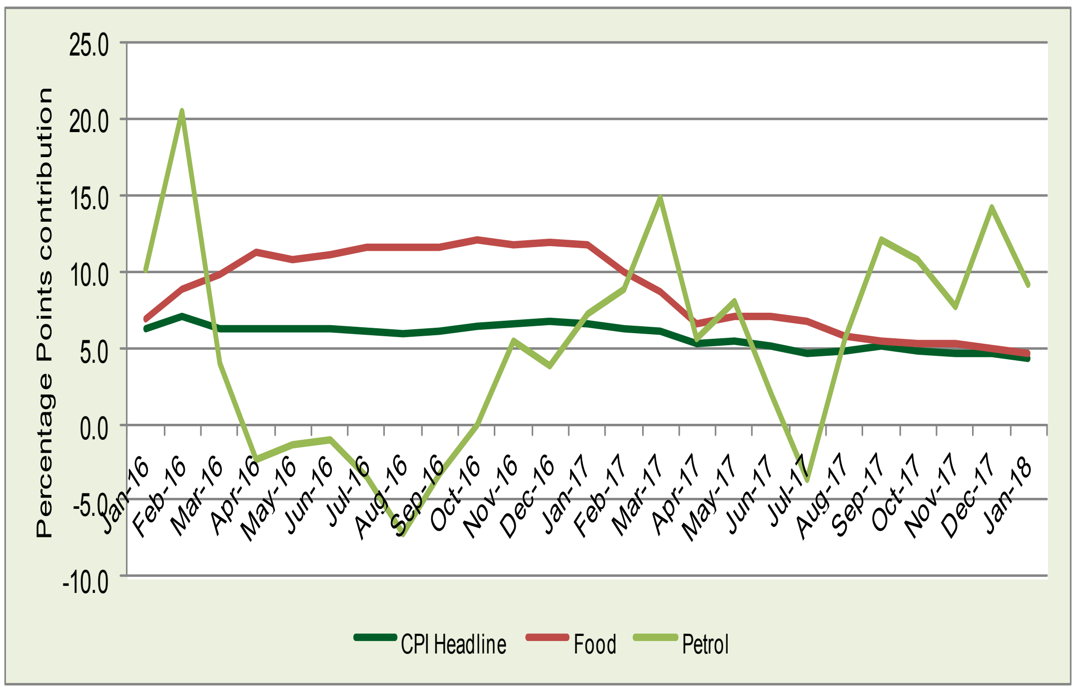
This publication is meant to inform internal stakeholders of the department about the impact of the macro economic indicators and related issues on the overall performance of the Agriculture, Forestry and Fisheries (AFF) sector. National announcements are frequently pronounced on macro economic issues; therefore the intension of the economic commentary is to digest the implication of the indicators and recommend actions that could be taken into account to cushion the performance and image of the AFF sector.

1. Budget Speech

Finance Minister Malusi Gigaba presented his budget in Parliament in February, just five days after the newly elected president Cyril Ramaposa delivered his first State of the Nation Address. Amongst the highlights in the budget speech was the rate hike which will change the VAT rate from 14% to 15% and is expected to bring in R22.9bn in additional revenue for the fiscus. The minister also announced that the allocation for the phase-in period of fee-free higher education would amount to R57bn over the next three years, of which R12.4bn will go towards needy first-year students in 2018/19.The consolidated budget deficit is projected to narrow from 4.3% of GDP in 2017/18 to 3.5% in 2020/21. Decreasing the budget deficit was flagged by ratings agencies as vital if SA wants to stave off another round of sovereign debt downgrades. The economy is expected to grow by 1% in 2017, up from 0.7% projected in October 2017. The economic growth of 1.5% is expected for 2018 and it will reach 2.1% by 2020. Relative higher growth will boost tax revenues and bring comfort to ratings agencies. The economy has benefited from strong growth in agriculture, higher commodity prices and, in recent months, an upturn in investor sentiment.

The Minister also announced that the General Fuel Levy will increase by 22 cents from R3.15 to R3.37 (7% increase), and the RAF Levy will increase by 30 cents from R1.63 to R1.93 (18% increase). Coupled with the increase in VAT, the increase to the fuel levies means poor South Africans and farmers will be faced with substantial hikes in their day-to-day living operational expenses. Farmers will pay more on their agricultural inputs such as fertilizer prices and agricultural machinery. The ultimate result is that it will raise the price of agricultural products. Consumers and poor communities that rely heavily on agriculture will be mostly affected since established farmers will shift the cost to consumers in the form of high prices for agricultural products. The increase in fuel levies will also have a negative impact on farmers' cash flow. However, the option of the diesel rebate should help farmers to mitigate the impact on their business. The Budget allocation for agriculture for this current year compared to the previous year increased from 26.5 billion 2017/18 to 30.2 billion in 2018/19, which represent a 14% increase. These are good news for the agricultural sector, as investment into the sector is expected to increase resulting in an increase in contribution of the sector to the country`s GDP.

2. CONSUMER PRICE INDEX, FOOD AND PETROL INFLATION



Source: Stats SA

Figure 1 indicates that CPI inflation came in at 4,4% (y/y) in January 2018, down from 4,7% (y/y) in December 2017, largely due to a decline in fuel prices and moderation in food inflation in January 2018. Food price inflation moderated to 4,6% (y/y) in January 2018, down from 4,9% (y/y) in December 2017. Within the food basket, meat price inflation moderated to 13,4% (y/y) in January 2018, down from 14,0% (y/y) in December 2017 while milk, eggs and cheese price inflation moderated to 4,2% (y/y) in January, down from 4,8% (y/y) in December 2017. According to Standard Bank, food inflation is expected to moderate in 2018 despite the worst drought in the Western Cape, which is expected to have a bigger negative impact on SA's economic growth and trade balance. Even though analysts expect the Reserve Bank to cut interest rates this year, the 14% to 15% VAT increase is expected to have a modest adverse impact on inflation though the impact is expected to be transitory. Petrol price inflation moderated to 9,1% (y/y) in January 2018, down from 14,2 % (y/y) in December. Petrol prices are expected to drop in February 2018 due to the rand strength against the US dollar, giving motorists further relief following a 30 cents drop per litre for both grades of petrol in January.

3. SA's TRADE BALANCE

Following a trade surplus of R 15,3 billion in December 2017, South Africa recorded a trade deficit of R 27,7 billion in January 2018, the highest trade deficit on record, as exports between December 2017 and January 2018 decreased by R23,5 billion. The magnitude of the deficit was substantially larger than the deficit of R 11,3 billion in January 2017; R18,2 billion in January 2016 and a deficit of R23,5 billion in January 2015, when economic activity restricted growth in imports of consumption and capital goods. Meanwhile between December 2017 and January 2018, exports contracted by 22.6% to R80,5 billion while imports increased by 21,9% to R 108,2 billion. Exports of vehicles and transport equipment plummeted by 47 %, exports of precious metals dropped by 34 % while mineral sales plummeted by 21 % month-on-month. During the same period, key imports in January 2018 were base metals and mineral products which increased by 56% and 21% respectively month-on-month. With the domestic economy expected to recover at a modest rate this year, export growth is expected to recover in the months ahead, broadly in line with foreign demand in the midst of an increasingly broad-based and synchronised lift in global economic growth while imports of consumption and capital goods should remain relatively constrained in 2018.

4. SA's AGRICULTURAL TRADE BALANCE

Agriculture contributed a positive net trade balance of R 1.3 billion in January 2018 compared to the overall trade deficit of R26,7 billion for January 2018. According to Agbiz, head of Trade and Investment Intelligence, agricultural exports amounted to R10,28 billion in January 2018, about 7.3% higher than in December 2017. Fruits, vegetables and beverages accounted for more than half of the agricultural exports with 44% of total agricultural exports destined to African markets while 34% of the agricultural exports were destined to the European markets. Agricultural imports on the other hand decreased by 3.6% in January 2018 due to import substitutions for grains and processed food as well the strengthening exchange rate. During the same period, agricultural imports that registered the biggest growth were animal products which grew by 15,4% in January 2018. According to Agbiz, the strengthening exchange rate is expected to reduce import costs which will benefit the supply side of the agricultural sector. However, the exchange rate and the lower harvest as a result of the drought could weaken export margins.

4. PRODUCER PRICE INDEX (PPI)

The annual percentage change in the PPI for final manufactured goods slowed to 5,1% in January 2018 compared with 5,2% in December 2017. The relief in the price pressure may be emanating from the pass-through effects of a stronger rand exchange rate. On a month-on-month basis, from December 2017 to January 2018, the PPI for final manufactured goods increased by 0,3%. The main contributor to the annual rate of 5.1% were coke, petroleum, chemical, rubber and plastic products contributing 2,2 percentage points. Meanwhile, the main contributor to the monthly increase of 0,3% was transport equipment contributing 0,4 of a percentage point. The annual percentage change in the PPI for intermediate manufactured goods slowed to 1.5% in January 2018 compared with 3.2% in December 2017. Meanwhile, from December 2017 to January 2018, the PPI for intermediate manufactured goods decreased by 0.3%. The wider positive spread between final and intermediate PPI indicates that manufacturers are facing less margin pressure. The annual percentage change in the PPI for electricity and water was 3,0% in January 2018 compared with 3,3% in December 2017 while on a month-on-month basis, the PPI for electricity and water increased by 1.3%. The Department of Energy estimates a further petrol price cut of 36c/litre for March while in the months ahead, the rand will play a key role in stemming cost pressures from global commodity prices. The annual percentage change in the PPI for mining was -0.1% in January 2018 compared with 6.1% in December 2017 while from December 2017 to January 2018, the PPI for mining decreased by 1.6%. Mining remains a key component of South Africa's economy despite declining output and productivity. The annual percentage change in the PPI for agriculture, forestry and fishing was 8,7% in January 2018 compared to 6,4% in December 2017. From December 2017 to January 2018, the PPI for agriculture, forestry and fishing decreased by 1,0%. The main contributor to the annual rate of 8,7% was agriculture (7,5 percentage points). The main contributor to the monthly decrease of 1,0% was agriculture decreased by (1,0 percentage point). PPI inflation is likely to come out at 3.8% year-on-year in 2018 as food price inflation remains suppressed, the rand strength feeds through and base effects from 2017's drought continue to unwind.

5. SA's ECONOMIC OUTLOOK

The economic outlook has improved. The newly appointed South African President has moved fast to address the country's most pressing by tackling corruption, promising to restore good governance and fiscal discipline throughout the public sector. The National Budget highlighted most of the President's promises which is expected to set the country on a faster yet tougher path towards fiscal consolidation. Up until this point, rating agencies have be optimistic about SA's credit rating and most forecast reflect a positive turn in domestic conditions. A stronger rand is expected while inflation expectations have supported have supported the exchange rate appreciation with expectation of an interest rate cut in the coming months. Consequently, analysts expect faster growth in consumer spending and a definite recovery in fix investment. Furthermore, GDP growth has been forecast up to 1.5% in 2018 (previously 1.1%) while prospects look good for an improvement in growth forecasts.

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FREQUENCY

The publication will be released on the 1st and the 15th of every month covering events taking place on the period concerned. The dissemination will take place through emails to all SMS and professionals in the Department including provinces.

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