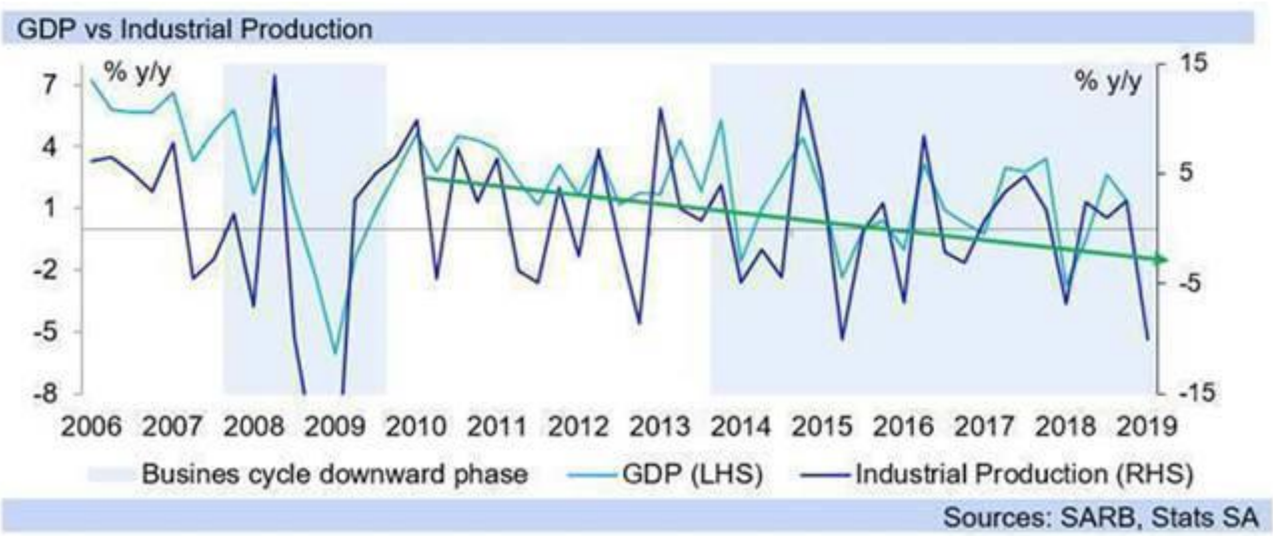
Investec

SA Economics

Industrial production note

28th May 2019

GDP is likely to contract in the first quarter of this year with industrial production already falling by -10% qqssa in Q1.19, while longer term, regulatory blockages can contribute to deindustrialisation in South Africa



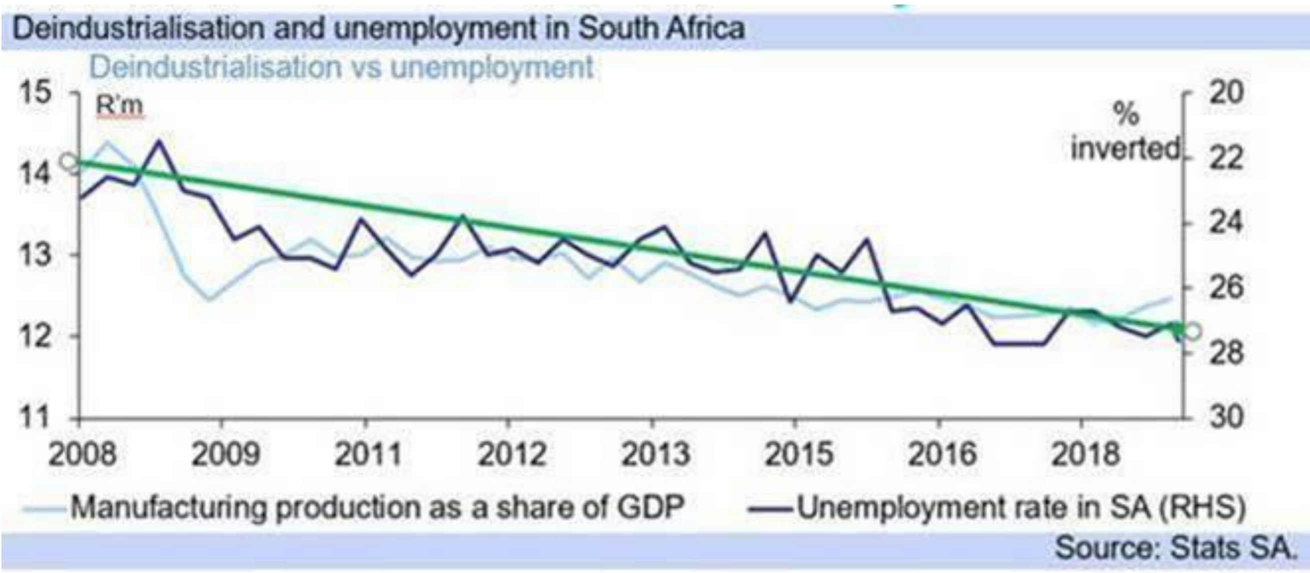
- Industrial production's components, comprising of manufacturing, mining and electricity production, fall into the primary or secondary sectors. As a consequence, they impact the tertiary sector, having a meaningful influence on GDP growth. Overall industrial production itself accounts for 22% of GDP in SA, and in Q1.19 fell by 10% qqsaa.

- With Q1.19 also seeing a drop in retail sales, of -2.9% qqsaa, GDP could contract at the start of this year (qqsaa), which is unhelpful for job creation in SA. The agricultural sector has a small weighting, and is expected to return a modest, positive outcome in Q1.19 on some good crop performance, but the construction sector has largely been in decline for two years.

- Manufacturing production fell by -9.1% qqsaa, mining production by -12.7% qqsaa and electricity production by -10.0% qqsaa in Q1.19, partly on the back of load shedding and seasonal effects. However, it would be a mistake to ascribe the deindustrialisation trend in SA over the past ten years merely to insufficient electricity supply. A number of other factors have been at play.

- Declining investor sentiment, depressed business confidence, and weak confidence in the manufacturing industry (a significant proportion of GDP) are all reflective of the moderation in SA's competitiveness, which has dropped substantially, to sixty seventh, from thirty ninth in 2007/08 (the World Economic Forum's Global Competitiveness Survey).

- South Africa has seen its unemployment rate rise in the past ten years, from below 22% (see graph directly below, inverted axis for unemployment), to closer to 28%, driven lower in part by the drop in manufacturing as a % of GDP (deindustrialisation), with the industry seen to be afflicted to some degree by some regulatory blockages.



- The deindustrialisation trend in SA has also added in part to the decreased opportunity for decent job creation in South Africa. Periodically reweighing the regulatory burden to ensure it is streamlined to promote economic growth while still fulfilling necessary functions, and boosting the ease of doing business in SA, particularly for the reindustrialisation of the country, is a necessity.

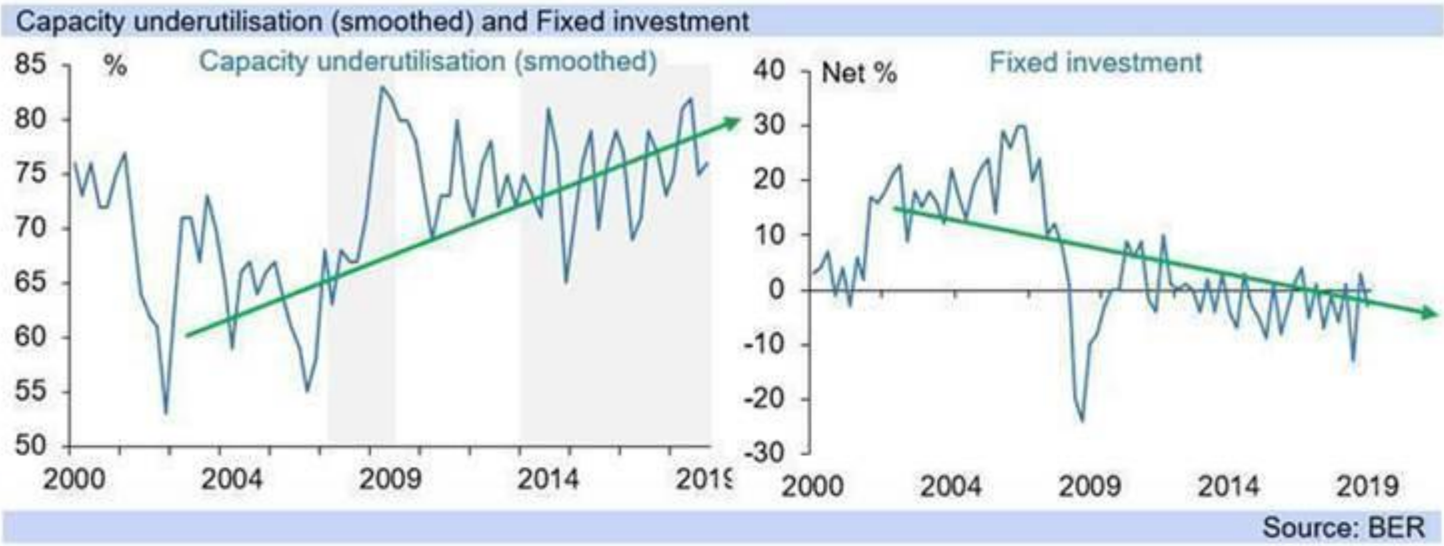
- SA needs to eradicate regulatory blockages to growth, industry and job creation (where/if they exist) and so reassess regulations in cost benefit analyses. The aim should not only be to reduce red tape, but also to drastically reduce the time it takes to get licenses, including EIA (environmental impact assessments), and increase the ease of being complaint (and so of doing business).

- SA needs to increase its ease of doing business, while the regulatory burden is seen to have increased (including the proliferation of regulations, specifically bureaucracy), with an increasing move to statism (increased government control of the economy, among other areas) in South Africa over most of the past decade.

- If regulations are arbitrarily, inconsistently or retrospectively applied (with sudden deemed non-compliance), and/or even applied differently by one government employee or department to another, companies can feel misled (which damages business confidence). This is especially the case if years of operation were previously sanctioned, but then are deemed non-compliant, and severe, to draconian, punishments imposed.

- If draconian punishments for non-compliance occur or are threatened, such as possibly imprisonment of company owners and/or directors, or even severe fines that could cripple or extinguish the company, such punishments would likely damage business confidence for future endeavours (and dramatically lowers ease of doing business).

- Should instances occur where non-compliances is deemed historic and a company only recently notified of the deemed historic non-compliance to regulation/s, with retroactive severe punishment, the future incentive for capital investment (fixed direct investment) could be damaged. While this is not expected to be the intention of the regulations/legislations, it would likely be valuable for care to be taken so that substantial disincentives, even indirect disincentives, to fixed direct investment do not occur if possible.



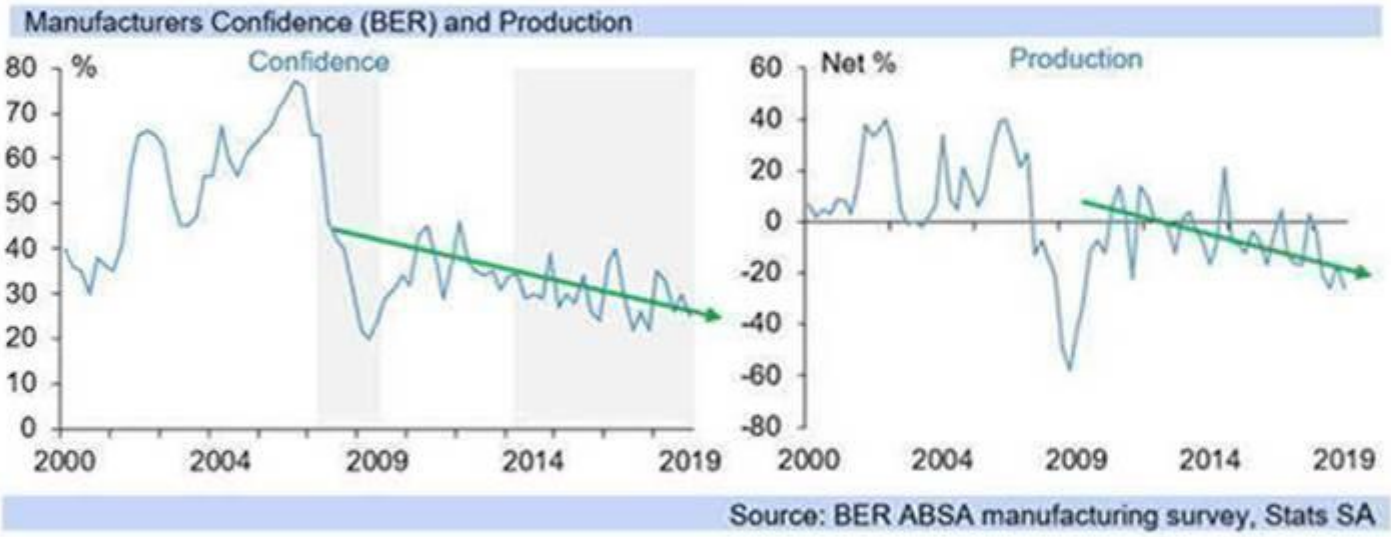
- Very severe fines, or worse punishment (see next bullet point), for non-compliance, if it occurs, could even see companies shut down lines of production, or the company become insolvent, resulting in higher unemployment and a drop in the contribution to GDP. Consistent, clear application of regulations that are not onerous, as well as consistency between regulators, is helpful.

- Additionally, severe fines and threats of, or actual, imprisonment of company owners and/or directors, if they occur, would likely disincentive industry players from operating in SA, especially if the legislation is not clearly understood and consistently applied. Inconsistently understood, and inconsistency applied, regulations between government departments would likely also be problematic.

- Companies attempting to rectify regulatory non-compliance are likely impeded if it is at great cost to the company, particularly if companies are prohibited from expanding or operating until the matter is resolved, the fines paid and authorisation and licenses are granted – and likely if authorization/s and licenses are not granted, or regranted.

- Furthermore, for companies that are small, and need to expand to the size of their competitors in order to be competitive (to survive), running into regulatory issues could mean the company may not be able to survive long enough for the matter to be finalised, particularly if lengthy, and this could possibly put the company, as well as the jobs of those it employs, at risk.

- While outlined potential regulatory issues may not be the experience of all, or even many (if they exist at all), if any do exist and are preventing any new industrial producers from opening, or existing ones from expanding or even operating in the current weak economic environment, they matter, and regulations need at least to be reassessed.



- An onerous regulatory burden (if it exists) is particularly problematic for small companies seeking a foothold to build operations, employment and economic growth. Small and micro companies typically hold the solution to reducing unemployment in the future, if they experience a sufficiently supportive (including sufficiently efficient regulatory) environment to help them grow.

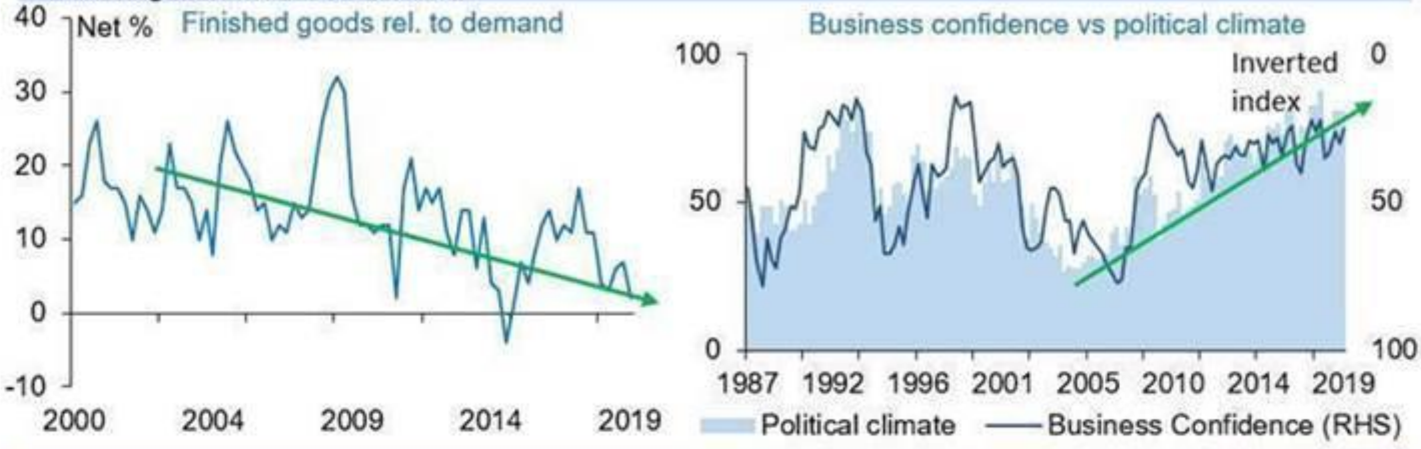
- Indeed, a sufficiently supportive environment for companies to grow and flourish (including employing more staff) typically means from a regulatory perspective, less rather than more (particularly complicated) regulations, efficient quick communication with regulators instead of any lengthy delayed processes, and consistently applied understanding of regulations by all regulators

- Another problem can be where regulations and legislations are 'cookie-cut' from advanced, or other, economies, and are not necessarily applicable to all countries and economies. Additionally, the opportunity for corruption (including bribes) may even possibly at times hide behind complicated and delayed regulatory processes, should such processes exist.

- While environmental issues can be extremely emotive, environmental legislation and regulations also need to undergo reassessment with cost benefit analyses fairly regulatory to ensure they are, on balance, beneficial, and do not unnecessarily impede economic growth, job creation and the ability of firms to flourish and grow into significant job creators. Widespread and inclusive industry opinion clearly is also crucial on this.

- The mining sector has seen a heralded improved charter last year, if one that is not yet seen as fully supportive of all the needs of the industry, it is generally seen as a good departure point to work from. In general, any regulations and legislations seen by private sector industry players to substantially impede their ability to do business, should fairly regularly undergo reassessment to increase the ease of doing business.

Finished goods relative to demand



Source: BER