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Foreign Economic T rends and Their Implications for the United States

MAY 1989

SOUTH AFRICA

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KEY ECONOMIC INDICATORS
(In Billions of U.S. Dollars Unless Noted)
Projected
Domestic Economy 1989
Gross Domestic Product
(Current Prices) 8
Real GDP Growth Rate (Percent)
Population Est. (1) (millions) 3
Population Growth Rate (Percent)
GDP Per Capita
(Dollars) (Current Prices) (1)
Consumer Price Index Change
(Percent, Year End)
Gross Nationa? Product
(Current Prices)
Production and Emgloyyent
Labor Force (Millions) (1)
Unemployment (Including
homelands)(percent)(l)
Manufacturing Volume Index 98
Mining Volume Index 97
Government Deficit (Fiscal Year
ends March 31) (Percent of GDP) 4.6
Balance of Paygents and Foreign Investment
Exports (FOB) 21.0
Imports (FOB) 13.8
Current Account Balance 3.0
Gold and Foreign Exchange Reserves
Held by Reserve Bank (Year End) 3. N/A
U.S. Direct Investment 1. N/A
External Debt ’ 22. N/A
Ratio of Foreign Interest Payments
to Exports (Percent) N/A
Exchange Rate (dollars per rand) 0.38
U.S. Exports to South Africa N/A
U.S. Imports from South Africa N/A
U.S.4S.A. Trade Balance - . . N/A
(1) OffiCial statistics depending on population are unreliable. They often exclude the populations of the so called independent homelands. Most economists believe that black unemployment is in excess of 25 percent, compared to government estimates closer to 15 percent. Rates among other racial groups are lower.
Sources: From data available in April 1989 from South African Reserve Bank, Central Statistical Services and various private forecasts.

SUMMARY

1988 was the second straight year of improved economic growth in South Africa. After real growth of 2.1 percent in 1987, real GDP increased by about 3.2 percent last year. A stronger rand over most of 1987 and modest levels of monetary expansion over that year led to a decline in inflation in 1988, with the CPI increase falling to 12.5 percent by year end.

While the economy last year showed some positive trends, at least in comparison to the dismal economic performance over most of the 19805, there are signs that the economy began to run into a balance-of-payments constraint. Increased economic growth pulled in a record volume of imports, and the current account surplus fell from over 6 billion rand in 1987 to about 3 billion rand last year. Capital outflows, in part explained by debt repayment inside and outside the standstill net, far exceeded the surplus on the current account. With South Africa's access to international capital markets extremely limited, gold and foreign currency reserves fell by 1.5 billion rand, despite a 12 percent decline in the value of the rand over the year.

In an effort to stem the external hemorrhage, the government instituted an import surcharge of up to 60 percent in July 1988. The Reserve Bank also sharply increased interest rates over the year, with the prime bank lending rate going from 13 percent in January to 18 percent in November.

While the economy showed continued strength in the fourth quarter of 1988, most economists expect the economy to slow down in 1989. Predictions are for a 1-2 percent real GDP growth rate, which should allow a current account surplus in the range of 4 billion rand. A closer balance between South African interest rates and those of its foreign trading partners should reduce the size of capital outflows and allow a modest replenishment of foreign reserves. On the other hand, higher than targeted money supply growth and depreciation of the rand last year may boost inflation into the 15-17 percent range in 1989.

U.S. exporters participated in the South African import surge last year, with U.S. exports up by about one third. The principal categories of U.S. exports included computer equipment and aircraft and aircraft parts. The Comprehensive Anti-Apartheid Act of 1986 (CAAA) continues to inhibit South African exports to the United States, with levels considerably belowupre-1987 volumes. Americans are still prohibited from making new investments in South Africa, except for ventures with majority black ownership. The best prospects for investments in black enterprises are in franchises related to consumer services such as auto parts and servicing, printing shops, beauty products, dry cleaning and industrial catering and plant maintenance.

RECENT ECONOMIC GROWTH TRENDS

The economic upswing of the recent business cycle seems to have peaked, and the economy may be losing the momentum which began in the fourth quarter of 1987. Domestic spending, which was encouraged by government policies in 1986 and 1987, fueled the upswing in growth. The upswing, however, has caused inflationary pressures and increased spending on imports. Accordingly, the government introduced measures in the second half of 1988 designed to curb domestic spending in order to protect the balance of payments. Spending, however, has been slow to respond to the government's efforts Seasonally adjusted and annualized real GDP growth rates by quarter were:

lst Q. 1988	2nd 9. 1988	3rd 9. 1988	4th 9. 1988
3.8	2.2	3.5	2.9

There was a general improvement in the performance of the different sectors of the economy. The mining and agricultural sectors showed some improvement compared to 1987.

Gross domestic expenditure increased during 1987 by 18 percent in nominal terms and by 4 percent in real terms. The estimated further rise in 1988 was 22 percent in nominal terms and 7 percent in real terms. Consumer spending (much of which was based on credit) grew at an annualized average rate of between 5 and 6 percent during the third quarter in 1988 but fell to about a 4 percent rate in the fourth quarter. Durables such as car sales showed an improvement from 1987 levels. Real domestic fixed investment showed an improvement of 6.5 percent in 1988 after six years of decline, but it is expected to decline again in 1989.

EMPLOYMENT AND LABOR

Employment and Unemployment: Manufacturing jobs were up almost 1 percent in December 1988 from a year earlier. Jobs in construction were up 1.3 percent over the same period. However, in both sectors, there are now fewer jobs than at the start of the decade. In mining, average total employment dropped 3.2 percent from 1987 to 1988, reversing the upward employment trend of 1984-87. Overall, employment in the nonagricultural sectors of the economy grew by 1.2 percent in the first three quarters of 1988. Compared to estimated population growth of about 2.3 percent, the rate of job creation continues to be inadequate. '

Government surveys of the unemployment of "coloreds," Asians, and blacks, which should be treated skeptically, show the continuing employment effects of the economic recovery.

	Jan. 87	April 88	Nov. 88
Coloreds	10.7%	10.3%	8.6%
Asians	10.8%	10.5%	9.1%
Blacks	17.0%	14.7%	12.5%

Government surveys do not include the so-called independent homelands of Transkei, Ciskei, Bophuthatswana, and Venda, and, according to private economists, significantly underestimate black unemployment, which is estimated to be between 25 and 37 percent or between 3 and 4. 6 million people. Unemployment among whites is less than 2 percent.

Wages: The year-on- year increase in the average nominal wage per worker in the first three quarters of 1988 was 16. 3 percent. Settlements by private sector unions averaged 17. 9 percent and 20. 7 percent according to two private surveys. This compares to a 12. 5 percent rise in the consumer price index. In September, the State President announced a 15 percent increase for government workers which took effect January 1,1989.

Productivity: According to the South African Reserve Bank,1abor productivity (1. e., real gross domestic product per worker outside the agricultural sector) rose by 1. 9 percent in the first three quarters of 1988 vis- a-vis the first three quarters of 1987. Despite the advances in labor productivity, the accelerated rise in nominal wages caused the rate of increase in labor costs per unit to rise slightly.

Over the longer term, the increase in labor productivity was extremely modest--only 5.1 percent from 1980 to 1988, a figure which lags well behind those of the industrialized Western countries.

Industrial Relations: There was a sharp drop in industrial strike activity in 1988 compared to the peak year of 1987: only about 1 million workdays lost compared to 5.7 million workdays in 1987. It is unlikely that this is the start of a trend. In fact, workdays lost to political "stay aways" increased in 1988, and, as long as apartheid denies blacks a meaningful vote, politically motivated industrial action will recur. The passage of the Labor Relations Amendment Act of 1988, viewed by black trade unions as rolling back some labor reforms, introduces an unsettling factor into this year’s labor relations.

MONEY! PRICES AND GOVERNMENT FIibAIANCE

Money and Prices: South African policies have been officially restrictive, but, at the same time, defacto expansionary effects are allowed to prevail. For example, the broad money supply, M3, has grown at rates far over the Reserve Bank’s announced targets. Compared with the official target range of 12 to 16 percent, M3 was growing at a rate of 29.4 percent between the second and third quarters of 1988 and at a rate of 27 percent at the end of the year. Much of the growth is attributed to increases in credit extended by banks and building societies to the private sector. This increase was itself made possible by the Reserve Bank's extension of credit to the banks and building societies. The Bank acted in midyear to support the more restrictive official policy by increasing the bank rate to 14.5 percent and placing other limits on borrowing.

Inflation leveled off during the last six months of 1988 to an annual rate of 12.5 percent. This compares well to 19.6 percent in 1986 and 13.9 percent in 1987, but is still much higher than the inflation rates in the countries that are South Africa's major trading partners. Most economists predict inflation will reach 16 percent in 1989.

Government Finance: Government fiscal policy has also been an uneasy mixture of expansionary effects amid officially restrictive policies. The deficit before borrowing in the first several months of fiscal year 1988-89 was below the deficit in 1987-88. However, a 15 percent salary adjustment granted civil servants announced prior to the municipal elections in October increased the expected fiscal year deficit before borrowing to roughly 10 billion rand. Increased tax revenues from income tax bracket creep, import surcharges, and higher gasoline taxes may reduce the deficit, but it is still likely to be in the range of 4 to 5 percent of GDP. This expansionary result is contrary to the government's official policy of keeping the economy from growing too much in order to protect the balance of payments. In 1988, the government implemented import surcharges and tax increases to restrict the economy which had been fueled, in no small part, by the government's deficit spending.

BALANCE OF PAYMENTS

The balance-of-payments position of South Africa deteriorated in 1988. As a result of increased domestic spending, imports increased faster than exports. The current account, at a seasonally adjusted annual rate, showed a small deficit of 410 million rand in the first quarter and a surplus of only 960 million rand in the second quarter. The position improved substantially in the third quarter which showed a surplus of 4.5 billion rand at an annualized rate. For calendar year 1988, a current account surplus of roughly 3 billion rand was achieved. This is down considerably from the over 6 billion rand surplus in 1987. Predictions for 1989 are for a 4 billion rand current account surplus.

The current account surplus is vital to South Africa's debt repayment scheme under arrangements with foreign creditors made following a drop off in 1985 of new foreign capital going to South Africa. A payments crunch arose as foreign banks both stopped lending new money and called in old loans. The banks' actions prevented refinancing South Africa's debt and forced a rescheduling.

Maintaining a positive balance-of-payments position has been extremely difficult for South Africa because of serious weaknesses in its capital account. According to the Reserve Bank, there has been a large net capital outflow for several years. In 1985 9.2 billion rand, in 1986 6.1 billion rand, and in 1987 3.1 billion rand left the country. 1988 continued the trend. After only 0.7 billion rand left in the first quarter, the rate of outflow increased to 2.1 billion rand in the second quarter and 2.4 billion rand in the third quarter, but slowed to 1.2 billion rand in the fourth quarter. These rates of capital outflow greatly exceed the planned debt repayments. The current account's shaky start in 1988 led to foreign and gold reserves dropping in 1988 to 6.7 billion rand ($2.8 billion). This is a decline from a peak of 7.1 billion rand ($3.4 billion) in August 1987.

SANCTIONS AND DISINVESTMENT

A number of nations have imposed economic sanctions against South Africa in protest against apartheid. U.S. sanctions are embodied in the Comprehensive Anti-Apartheid Act of 1986 (CAAA). The CAAA bans the import into the United States of South African coal, iron and steel, agricultural and food products, military goods, uranium, textiles, gold coins, and the products of South African parastatals (in effect, covering gold bullion and aluminum ingots). U.S. exports to South Africa face fewer restrictions, but the major items which cannot be exported to South Africa include crude oil and petroleum products, items on the munitions list, and nuclear-related items. There are prohibitions on the sale of computers to the South African police, military and apartheid-enforcing entities. Americans are prohibited from making new investments in South Africa except in black-owned firms.

While the precise economic impact of American and European sanctions cannot be calculated, it is generally recognized that South Africa's exports, particularly in 1987, have been affected and that the absence of significant new capital inflows (partly due to sanctions) has put an effective ceiling on growth.

Disinvestment has reduced the U.S. corporate presence in South Africa by more than half; while the pace of firms leaving the country has slowed, the outflow continues.

MINING AND AGRICULTURE

Mining: South Africa’s mining and quarrying industry contributes 13 percent of GDP, accounts for about 15 percent of gross fixed domestic investment, and employs 748,000 workers. The industry is especially important to the South African economy as a source of foreign exchange, and 81 percent of total mineral sales by value are exported. South Africa is the world’s largest gold producer. Gold contributes 38 percent of total merchandise exports. In 1988, gold production increased by 2.6 percent to 618 tons, with exports valued at nearly 20 billion rand, up from 602 tons in 1987 with a value of 17 billion rand. However, the gradual aging of South Africa’s present gold mines has made the development of a new generation of mines crucial. Coal, platinum group metals, and other minerals account for an additional 14 percent of merchandise exports. In 1988, 82 percent of the $1.59 billion in U.S. imports from South Africa were minerals and metals (mainly platinum and ferroalloys).

The most significant developments in South Africa’s mining industry in 1988 were new mining taxation proposals, which could mean the establishment of numerous new mines, and a proposed minerals bill which could result in less government control over mining rights. Based on favorable prospects for the precious metals markets in the 19905 as well as more favorable tax treatment, analysts expect the South African mining industry to embark on new gold and platinum projects valued at 14 billion rand (in 1989 rand) over the next 5 years.

During 1988 there was an overall improvement in labor relations, with significantly less strike action at the country’s mines. Inflation continues to exert strong pressure on the companies to cut costs and was one of the major factors causing a 25,589 decline in employment in the industry -- mainly in the gold mines.

The South African Government is continuing with its privatization program. ISCOR, South Africa’s largest iron and steel producer, was selected as the first of the state enterprises to be sold.

Agriculture: Agriculture’s contribution to gross domestic product increased by 12 percent to 9.9 billion rand in 1988. The volume of agricultural production was 3 percent higher than in 1987. This was mainly due to a 7 percent increase in field crop production. Producer prices increased by about 10 percent in 1988, with livestock prices showing the highest increase followed by field crops and horticultural products. The combination of these two factors led to a 15 percent increase in the gross value of agricultural production. Gross income also increased by 12 percent. Expenditure on intermediate goods and services increased by 15 percent over the year, mainly due to a 12 percent price increase for farming requisites. The biggest increase was 24 percent for fertilizers. As a result, the net income of farmers increased by a total of 5.4 billion rand, a 19 percent increase over 1987.

Interest payments on farm debt now constitute the major farming expense totalling about 1.7 billion rand in 1988. On December 31, 1988, total farm debt amounted to about 14 billion rand. The farm debt/asset ratio increased from about 12.8 percent in 1979 to 27.1 percent in 1986, but it improved to 26.7 percent in 1987 and 25.7 percent in 1988.
Consumer spending on food increased by 24 percent in 1988 to 30.7 billion rand. Food prices increased by 16 percent.
An even better year is expected in 1989. Summer grain crops are doing exceptionally well. Corn, wheat, sugar, wool, and fruit exports appear very strong.
BLACK ECONOMIC SECTOR
Discriminatory legislation historically has severely circumscribed the range of economic opportunities open to South African blacks. Until the late 19705, blacks were legally prohibited from forming corporations, owning manufacturing plants, or entering most skilled professions. However, demographic pressures and the growing dependence of the South African economy on blacks as consumers and workers led to several notable changes in recent years, such as the lifting of restrictions on blacks' freedom of mobility, the legalization of the black trade union movement, and the granting of permanent land tenure in areas designated for occupation by blacks. In recent years the South African Government also recognized the growing importance of new businesses in job creation and income generation, and has moved to loosen the regulatory stranglehold on black business development. For example, since 1986 over 100 central business districts have been desegregated and now are open to business people of all races.
Growing demand for skilled black workers, the bargaining power of the black trade unions, and the successes -- albeit limited -- of black business have resulted in a slowly rising standard of living for emplOyed blacks. Blacks received an estimated 80 percent of the growth in personal disposable income from 1980-85. While it is important to note that this increase is derived from a very small base and is distributed over a large population, it is indicative of economic advances achieved through the opening of greater opportunities. The substantial progress achieved in deregulating black business and the public commitment by the South African Government to improved educational and economic opportunities for blacks are encouraging but not sufficient in the near term to overcome the historical disadvantages, educational deficiencies, and denial of opportunities which continue to hamstring black economic advancement. Moreover, millions of unemployed blacks have yet to benefit at all.

OUTLOOK
Economic analysts anticipate roughly 2 percent real economic growth in 1989, a current account balance of about 4 billion rand, and inflation rising to near 16 percent by year-end. The rand is expected to depreciate further in 1989 to around 38 U.S. cents. Many factors could alter this forecast, however, such as sharp changes in the world gold price, OECD growth rates, the political situation within South Africa, and world reaction to it.

Experience in the past few years has shown that South Africa has a difficult time achieving a growth rate of more than 2 to 3 percent without inflows of foreign capital, because of the overriding need to protect its balance-of-payments position and foreign reserves. The government has had to attempt to balance its management of the economy so as to sustain the maximum amount of growth short of causing demand for imports to rise too high. Domestic capital generation, the only alternative to foreign capital, has lagged as savings rates have remained very low and large amounts of capital have moved out of the country in search of higher real interest rates and investment security.

The burden of the situation facing the government has fallen on the domestic economy and especially on consumers. Encouraged by expansionary policies in 1986 and 1987, consumer spending drove the current upswing in the economy. Consumer borrowing made much of the spending possible. Now, increasing interest rates will fall heavily on consumers because in South Africa most consumer loans are at variable rates. Consumers, who now pay a general sales tax of 13 percent on almost every purchase, also face 16 percent inflation, import surcharges of up to 60 percent, a 10 cents per liter tax increase on gasoline, and bracket creep in income tax rates. In short, the average South African will likely experience a decline in living standards in 1989.

Low growth rates and declining living standards will also worsen the problem of rising black unemployment. The South African Reserve Bank estimates that 4 million black workers are now left outside of the formal economy in marginal jobs or unemployment. The Reserve Bank further estimates that even if the economy expands_at a rate of 3 percent per year, by the year 2000, 6 million black workers will be underemployed or unemployed. To accommodate the number of new workers, the economy would have to grow at a rate of 5 percent per year, which is closer to South Africa’s economic potential and its experience in the 19705, but this is not likely in the present circumstances.

IMPLICATIONS FOR THE UNITED STATES

Over 120 American firms are still operating in South Africa whose total investments exceed $1.5 billion in 1987 and represent about 33 percent of all U.S. fixed investment in Sub-Saharan Africa. U.S. exports to South Africa accounted for 40 percent of sales to the region in 1988.

American trade with South Africa in 1988 reversed the decline of the last few years. American exports to South Africa in 1988 increased by a third over 1987 to $1.7 billion. Key exports were electronic data processing and related equipment ($145 million); aircraft and aircraft parts ($98 million); and wheeled or tracked mining, construction, and agricultural machinery ($77 million). South African exports to the United States in 1988 were mostly platinum group metals, ferrochromium, ferromanganese, ferrosilicon manganese, chrome ore, and other minerals (over $740 million) and diamonds and other gemstones ($56 million). U.S. imports from South Africa rose 13 percent to $1.6 billion.

There are a number of factors which make South Africa an interesting short- and long-term market for American suppliers. It remains one of the 20 or so most highly industrialized market-economy countries in the world. It has a large and growing population, much of which is entering the market as consumers for the first time and which is creating a demand for new social and infrastructural services. The country has a well-developed economic infrastructure. Its commercial regulations, practices, and language are already familiar to Americans. Nevertheless, traders on both sides are clearly concerned about the possibility of supply disruptions for political reasons and are reluctant to spend time or money on market development. American sales can encounter resistance based on fear of disruptions.

Most promising are sectors in which American technology enjoys a clear advantage. Demand for computers, software and peripherals remains strong. Sales of public transportation equipment, especially aircraft and associated avionics, are consistently good. Substantial sales of large aircraft are anticipated during 1989. South Africa’s mining industry is among the world’s largest and most advanced. U.S. equipment, services, and technology have long held an important position in the mining sector. Modernizing and automating industry are creating a need for industrial controls and laborsaving machinery.

Consumer spending among blacks is growing faster than that of the white population. Black consumers have historically preferred American style and quality--especially in clothing, toiletries, and children's toys and accessories. Significant markets may be developed among black consumers by American companies. As black entrepreneurs continue to emerge, opportunities for franchising opportunities are rising. Promising opportunities are available in auto parts and services, printing, hairdressing and beauty treatment, employment and staff training, dry cleaning, industrial catering, and plant maintenance. Franchisors should expect to share in the capitalization of new ventures. Note: under the CAAA, new U.S. investment in South Africa is permitted only in black-owned businesses. The U.S.Export-Import Bank may extend cover to black-owned enterprises.

The U.S. Foreign Commercial Service maintains an office in Johannesburg and reference libraries in Johannesburg and Cape Town. Counseling and business introductions are available to Americans seeking opportunities in South Africa.