ECONOMICS UPDATE

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FIRST QUARTER 2017 STATSSA: POSITIVE SEASONAL CONTRIBUTION OF MINING TO THE ECONOMY MASKS ‘VERY CONCERNING’ UNDERLYING TRENDS

Johannesburg, 7 June 2017: “The positive seasonal contribution of mining to the economy masks the current precarious position of the South African mining sector,” says Chamber of Mines Chief Economist, Henk Langenhoven.

“The sector’s performance during the first quarter of 2017 was slightly better than the first quarter of 2016, hence the seasonality of the data pointing to an annualised 12.8% improvement. Digging deeper into these numbers reveals very concerning trends, however.”

On the face of it, positive international macro-economic trends over the last few months (or even the last year) should have had a positive outcome for the mining sector. The global economy seems to be on the mend, albeit slowly. Commodity prices seemed to have bottomed out and some have started to improve. The rand commodity price index improved by over 20% during the first quarter of 2017.

Based on these drivers:

- Sales (exports) of South African commodities *should have* continued to rise, even if only in ‘landed’ rand terms (when the interplay with the exchange rate is taken into account).
- Profits *should have* started to improve from the very low base (2015 returned losses of nearly R40 billion for the sector). And, based on Stats SA’s fourth quarter financial surveys, they did.
- Increased production should have followed, given better prices, even if only on the back of the low value of the rand. Mining production improved by nearly 6% during the first quarter of 2017, and was fairly widespread across the different minerals.

But, employment numbers are not improving, and we know that virtually no new investment is taking place. In fact, 2016 gross and net fixed investment showed strong declines. So the potential positive impact of mining improvements on the economy have not materialised.

"Digging deeper into the numbers reveals a desperate situation: The annualised 12.8% growth figure published derives from a quarter 1 2017 improvement of 3% on quarter 4, 2016 - which is a 4.5% improvement on the first quarter 2016. (The 3% quarter on quarter improvement would yield 12% growth over 12 months.) Looking at the actual (nominal) numbers, a completely different picture emerges. Quarter-on-quarter value-add by mining declined by 16% or R13.5 billion. Again, these numbers are easily explained."

The contribution of a sector to the economy (in effect, the value-add) is made up of:

- compensation to employees (salaries and wages),
- profits (net operating surplus); and
- allowances for depreciation (consumption of capital).

"Owing to the massive numbers of jobs lost between 2012 and 2016 – around 70,000 - the cost of employment is declining; during the first quarter 2017 it decreased by 13% or R5,124 billion on the last quarter of 2016. This explains 38% of the value-add shrinkage. Gross operating surplus (which includes depreciation) declined over the same period by 18% or R8,456 billion. The latter explains the 62% fall in value-add.

"Furthermore, we can assume that there was virtually no net investment in the first quarter of 2017, so the 18% decline actually represents an 18% drop in profits. When this number is superimposed on the historically reported profits in the quarterly financial surveys, the long-term trend of profitability falls back to the average of the last 10 years, indicating that mining is simply not recovering.

"These numbers beg an explanation. To recap: global economic growth has started to improve, as have commodity prices. Better prices should prompt more commodity exports from SA, but Stats SA reports that commodity exports actually declined during the first quarter of 2017. Estimates are that this drop was nearly 8% on the previous quarter. The net effect of lower volumes despite higher prices explains some of the profit pull back. The further reason for the latter must be cost increases. The intermediary input cost index (excluding labour costs) for mining has been running at 13% per annum over the last 10 years, and although the rate of increase has declined slightly, input costs are continuously eroding viability. At current prices, more than 60% of our platinum sector is loss-making. "The data released by Statistics South Africa on the value added by the mining sector to the SA economy mainly reflects the seasonally better performance in the first quarter of 2017. The actual (nominal) numbers tell a different story of a sector shedding many jobs (albeit at a lower rate than at the beginning of 2015), gross operating surpluses dropping even faster and no fixed investment, on the back of lower export earnings from commodity sales and increased costs threatening survival of the sector. If Eskom is granted a near 20% tariff increase as per its recent application, it will push input costs up by as much as 4 percentage points for some mines. This could prove to be the proverbial 'straw that breaks the camel's back'.

"These dynamics show the uncertainties faced by South Africa's mining industry. It is particularly telling that the improved performances of both agriculture (better rains) and mining (better commodity prices) were driven by exogenous factors over which neither domestic economic policies nor any endogenous (internal) demand factors had any influence.

"Sadly, all indications are that this recession is of South Africa's own making. Even the correlation between South Africa's downgrades and the government's debt-to-GDP ratios testify to the broader truth of this statement. Continued mining policy uncertainty and allegations of regulatory malfeasances within the minerals regulatory authority will continue to undermine recovery."

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