ECONOMICS

% Economics

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The year 2017 marked 10 years since the global financial crisis and the collapse of the commodity price cycle. Countries that responded with appropriate economic policies have recovered whereas others, like South Africa, failed to provide a policy environment conducive to growth.

As world economic growth has recovered with concomitant resumption of growth in international trade and higher demand (and prices) for commodities, the mining sector has responded positively.

International geopolitical tensions eased towards the end of 2017 with the US returning to a 'Monroe doctrine'-like self-imposed isolation and, although brash, it was not cause for instability.

Renewed world economic growth resulting in higher demand for commodities seems to indicate that the commodity cycle has reached the lower turning point of the cyclical trough and will slowly recover from here on.

South Africa's dismal economic growth performance was fuelled by a crescendo (towards the end of 2017) of contradictory and inappropriate economic policies stifling growth with almost complete focus on redistribution as opposed to growth. In many cases, there was brazen looting of assets from private and public coffers. The mining sector was at the face of this onslaught, and suffered greatly from uncertain policies towards it, causing costs to rise dramatically and loss of competitiveness. The sector grew unattractive to investors.

The mining sector's share of the South African economy is estimated to have been 6.8%, marginally down from the 7% of overall gross domestic product (GDP) recorded in 2016. This despite the fact that growth resumed from the dismal decline (-4.3%) in 2016 to an expansion of about 4.6% in 2017, contributing R312 billion to GDP.

Due to higher mining production, employment is estimated to have increased by 1.6% to 464,667 during 2017. This has finally arrested the rate of job losses which stood at 30,000 jobs between 2014 and 2017. Among the major commodities, estimates point to the gold sector having shed another 4,000 jobs between 2016 and 2017 while the PGMs, iron ore, diamonds, chrome and manganese sectors employed more people in 2017 than in 2016. Mining employment represents 6.1% of private non-agricultural employment and 4.8% of total non-agricultural employment.

The sector contributed R80.9 billion to fixed investment in 2017, which constituted 18.2% of private-sector fixed investment and 10.8% of the country's total fixed investment for the year. In the decade between 2007 and 2017, the mining industry's fixed investment has been on a downward trajectory. The recovery in fixed investment is a sign of better prospects for the sector, but it still hung in the balance at the end of 2017.

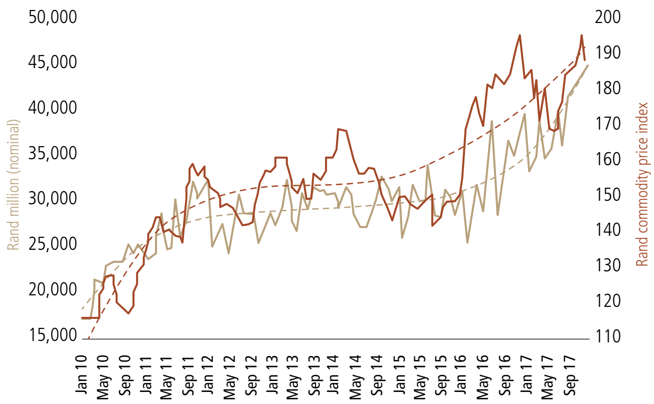
The industry exported R307 billion worth of produce, which is 27% of the country's R1.1 trillion export book. The 10% strengthening of the rand against the US dollar in 2017 adversely affected the rand receipts for exports. On a US dollar equivalent basis, exports increased by 16.1%, but only by 7% in Rand terms.

In the 2016/2017 fiscal year, the industry paid R5.8 billion in royalties, representing a 56% increase on the previous year. The industry paid R16 billion in taxes over the same period.

The state of mining in 2017 was again influenced by a complex set of dynamics. The sales performance of the sector is largely determined by the dollar commodity price trends translated into 'landed' rand prices.

CAPTION
Rand Refinery

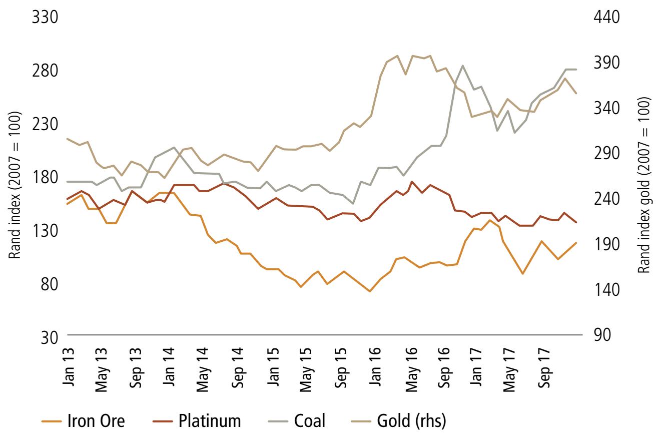
Rand commodity price index and nominal sales: 2010 – 2017



Source: *World Bank, South African Reserve Bank and Chamber of Mines*

The overall weighted ***dollar*** commodity price index (coal, iron ore, gold and platinum) for South Africa hardly moved between 2016 and 2017. In dollar terms, this was due to gold's lacklustre price trend (+0.8%) and the decline in the platinum price (-4%), negating increases in the price movements of coal (+28%) and iron ore (+22%). The equivalent rand commodity price index also hardly moved (given differential price movements and weights). Please see the graph on annualised production versus rand commodity price trends in this section for details; a rise during 2016 was negated by a decline during 2017, leaving the average prices virtually unchanged.

Rand commodity price indices: 2013 – 2017



Source: *World Bank, South African Reserve Bank and Chamber of Mines*

Each major commodity exhibited unique trends (in rand terms), which could, in general, be explained by the differential recovery in markets for South African commodities.

Each commodity had specific drivers. Please see pages 14 and 15.

Overall sales of commodities exported increased by nearly 7% (in real terms) in 2017 on 2016.

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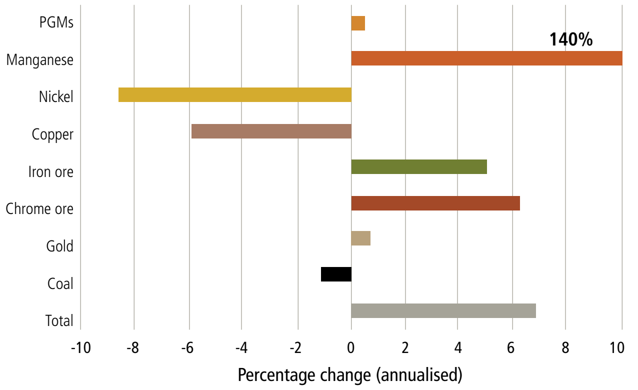
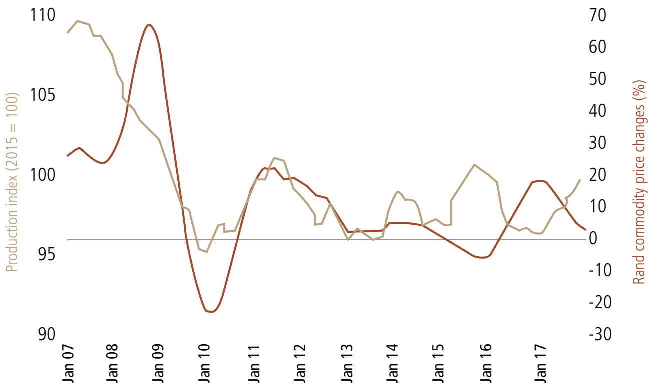
Sales performance of various commodities in 2017



Source: *Statistics South Africa and Chamber of Mines*

Total production of commodities increased by 3.5% between 2016 and 2017. On average the rand appreciated against the dollar by 10% over the same period. It is clear that production trends do not directly correlate with commodity price movements, as depicted in the graph below. A lag of one year to 18 months is evident between the two variables over recent years.

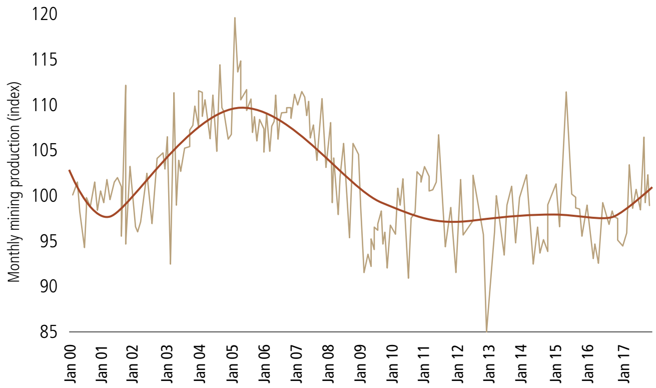
Annualised production versus rand commodity price: 2007 – 2017



Source: *World Bank, South African Reserve Bank, Statistics South Africa and Chamber of Mines*

Mining production rose to **R620 billion** in 2017

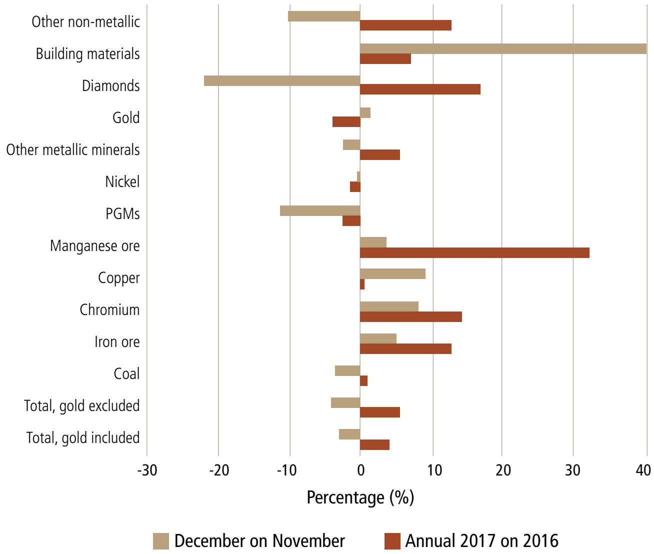
Index of monthly mining production: 2000 – 2017



Source: *Statistics South Africa*

The varied production performance by each commodity in the sector is shown in the following graph.

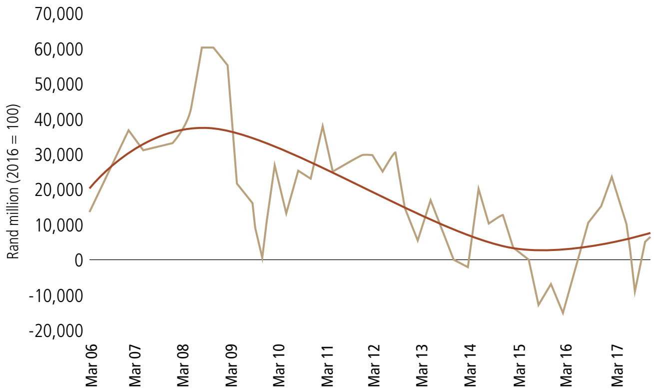
Production performance by commodity: 2017



Source: *Statistics South Africa and Quantec 2017*

The sector as a whole struggled to remain profitable. This was mainly due to commodity prices not improving strongly and domestic costs continuously rising. Mining input costs increased by nearly 6% over the same period.

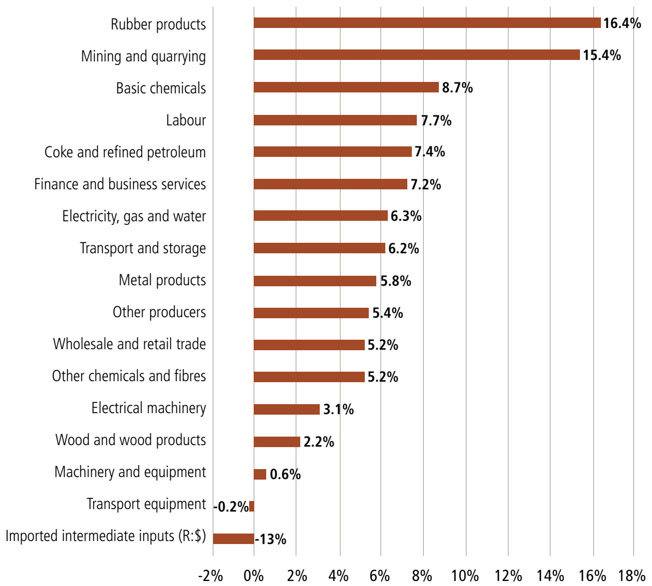
Quarterly net profit and losses before taxes: 2006 – 2017



Source: *Statistics South Africa: Quarterly Financial Surveys 2017*

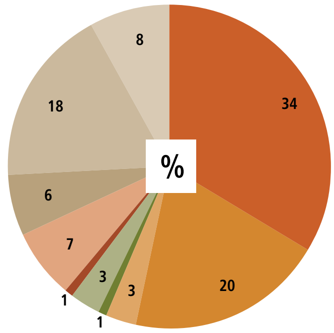
The Economics Department developed a mining input cost index. Based on this research, the contribution of intermediate inputs was 69.5% and labour 30.5% during 2017. The split of intermediary input cost is depicted by the graph below. The graph was developed from the estimated input-output tables for mining, augmented by company data as reported in their published reports. More than 50% of these costs (petroleum, electricity, transport and storage) are determined by administered prices.

Differencial increases in cost components: 2017



Source: *Chamber of Mines*

Mining industry expenditure 2017 (R million)



Purchases	223,611	Paid rental on plant and machinery	3,889
Salaries and wages (incl. severance)	135,283	Depreciation	46,987
Interest paid	17,615	Losses on assets	37,368
Royalties paid	5,651	Other expenditure	121,601
Paid rental on land and buildings	18,147	Capital expenditure	53,269

Source: *Statistics South Africa: Quarterly Financial Surveys 2017; Chamber of Mines*

Rapidly rising costs, a large proportion of which are completely out of mining companies' control, keep eroding profitability in the sector. Apart from costs eroding profitability, they also have a direct impact on employment. As an example, the potential job losses related to the attempted 20% electricity tariff increase by Eskom would have cost 48,000 mining job opportunities. NERSA only awarded a 5.2% tariff increase after serious opposition from the Chamber and other private sector organisations.

The uncertain, and sometimes openly hostile, domestic policy environment has had a direct and negative impact on the mining sector (see case study on page 28). The cabinet reshuffle, which included firing Finance Minister Pravin Gordhan in March and April 2017, and the subsequent downgrading of South Africa's sovereign credit rating, had a negative impact on the sector's cost of capital. Lingering uncertainty regarding the revised Mining Charter weighed heavily on investor confidence and mining share prices, which countered the optimism of commodity prices stabilising and, for some commodities, rising. These factors, if not rectified, will continue to have a negative impact on fixed investment in mining and may therefore result in the country's mining sector losing out on the next commodity price cycle upturn.

The mining sector continued to provide significant employment in South Africa. Total employment for 2017 was 464,667 people, which is slightly higher than it was in 2016.

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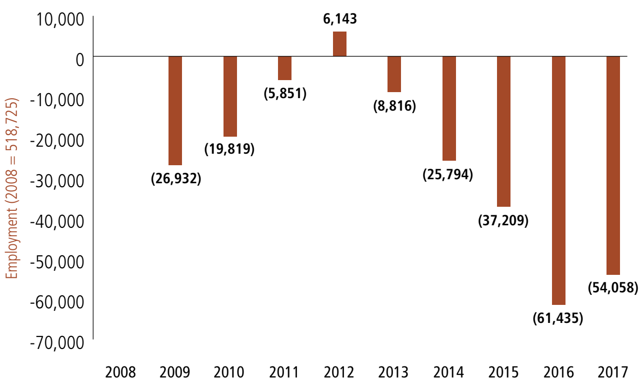
Number of employees and earnings: 2017

Commodity	Employment	Total earnings (R 000s)
Gold	112,200	29,027,067
PGMs	175,770	48,258,265
Iron ore	21,794	5,791,755
Chrome	17,535	4,775,778
Manganese	8,314	2,437,046
Diamonds	18,227	5,243,203
Coal	81,962	22,415,572
Aggregate and sand	7,390	1,244,248
Other mines and quarries	21,475	6,817,005
Total	**464,667**	**126,009,944**

Source: *Department of Mineral Resources*

Employment losses: 2008 – 2017



Source: *Statistics South Africa and Chamber of Mines*

The graph above shows the impact of all the factors discussed above on employment since 2008.

CAPTION
Kumba Iron Ore – Kolomela