

PREFACE

The core business of this directorate is to do analysis on national level in order to produce agricultural economic information and advice for sound decision-making on the South African (SA) agricultural sector. To support this important task the division (Economic Research) concentrates on economic analysis of performance of and external impact on the agricultural sector and its industries.

This publication developed from a need within the Department of Agriculture (DoA) to be yearly informed on South African and world economic trends in the agricultural sector. The Annual Economic Review has now been established as a yearly feature in the Directorate's work plan. Since the beginning of 2006 the report is also published for outside consumption to add value to a number of existing regular economic publications on the agricultural sector. It is our vision to maintain it as indispensable reading for every serious student of the SA agricultural sector.

Any comments on the content of this annual review series are most welcome.

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1. INTRODUCTION

This document takes a review of the South African macro economy in 2006 (in perspective of the outside world) with a special section on the agricultural sector. To get a holistic picture of the economic condition in 2006, a broad range of indicators are graphed and discussed, in order to identify trends, abnormalities and structural breaks. However, such a wide range of indicators are in existence, which makes it impossible to discuss them all. The main and popular indicators are presented mostly in real 2006 value. External impacts such as commodity prices and the exchange rate are discussed with its impact on agriculture. **The wages** and number of jobs in the economy are used as indicator for the health of the economy. Total unemployment and economic growth are discussed with speculations on what can be expected in future. The general stand of the South African economy is evaluated by looking at income per capita, developedness, employment and comparing economic growth with that of other countries. The stand of Government is evaluated by taking a look at Government's role in the economy, its debts and deficits and overall finance. Agriculture as sector is analysed in terms of its sub sectors, its return to capital, trade, and most importantly: its ability to provide enough food for the population of South Africa. From all these analysis it was **concluded** that Government's finances are healthy, the economy is growing satisfactorily with unemployment decreasing for the first time in years. In general South Africa entered a healthy and good economic state with expectations that are positive. The agricultural sector

itself is a little unsure as a result of climatic volatility and a lack of political support, yet production is currently just sufficient to supply in the basic and luxury demand.

2. INTERNATIONAL

2.1 News Events

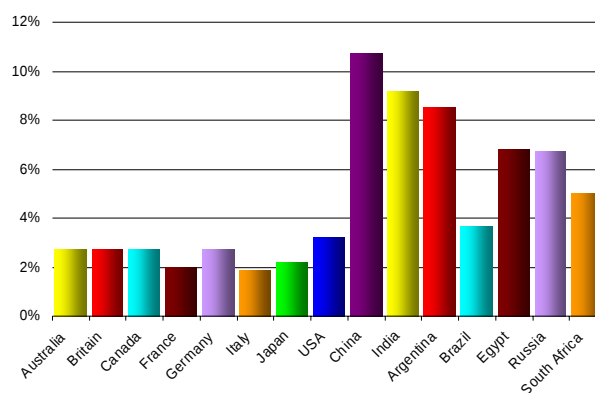
Before the stand of the world economy can be analysed, world events of importance in 2006 should be reviewed in short. World **cereal stocks** declined sharply in 2006, due to a slight decrease in global cereal output and significant growth in utilisation, according to estimates by the United Nations Food and Agriculture Organisation. During the third quarter of 2006 **oil prices** surged to record highs above \$78 as global geopolitical storm clouds gathered, though it recovered to \$60 by the end of September. **Israel and Lebanon** moved closer to all-out war as missiles rained down on both sides of the countries' shared border and the United Nations scrambled to stem the escalating chaos in the region. **Airlines** cancelled hundreds of flights into and out of London after a foiled bomb threat sparked a security alert. The Sudanese government rejected a plan to send thousands of UN peacekeepers to try to halt three years of killings in **Darfur**. The Iraqi authorities have begun taking control of their armed forces from the US-led coalition. The North Atlantic Treaty Organisation (NATO) expanded its military operations into eastern Afghanistan. **Cuba's** Communist Party emphasised that it would stay in control no matter what happened to its leader, Fidel Castro. **Thailand's** new military leaders moved to tighten their grip on power, restricting political activities and taking

over legislative power. The world **rice** price, said to have increased by 48% in 2006, is expected to rise considerably due to high demand and very tight world stocks. Rice inventories worldwide are already near a 26-year low and anticipated to drop further as fertiliser and irrigation costs are rising with energy prices, forcing many farmers to turn to cheaper-to-grow grains, fruits and vegetables. **Iran** had test-fired dozens of missiles, including the long-range Shahab-3, during the first hours of new military manoeuvres. The Democrats won a crucial senate seat in Virginia which clinched majorities in both houses of the **US** congress for the first time since 1994. A seven-member international consortium has agreed to build a multi-billion-dollar experimental nuclear fission reactor in southern France designed to emulate the power of the sun. The International Monetary Fund has warned that **China's** emergence as an alternative lender is creating a new wave of hidden debt in Africa. South Korea's Ban Ki-moon has been sworn in as the new UN secretary general at a ceremony in New York.

2.2 Economic Output

World economic growth increased from 4,9% in 2005 to 5,4% in 2006 (*IMF, 2007*). China and India, in particular, are helping to lift the global economy as their economies continue to expand rapidly. Growth has also been very resilient in the least developed countries (LDCs), improving their prospects for fulfilling the Millennium Development Goals (MDGs). The housing market in the USA has turned downward and by the end of 2006 nearly 7% of Americans had larger mortgages than their houses were worth.

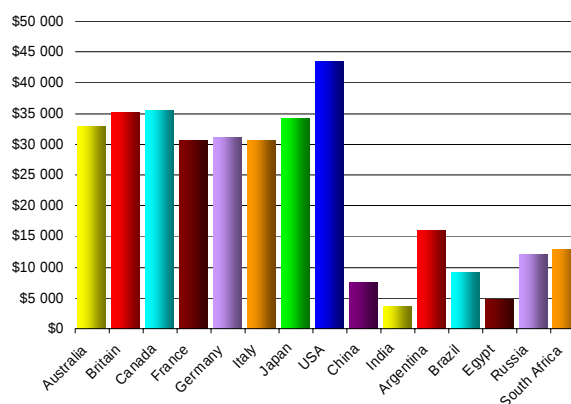
Figure 2.1: GDP Growth, 2006



Source: IMF, 2007

Most countries experienced higher growth rates in 2006, except for South Africa. Of the bigger economies China experienced the highest economic growth rate (10,7%) compared to Italy recording only 1,9% and Japan 2,2%. Of the advanced countries the USA recorded the highest growth rate of 3,3% in 2006, slightly higher than the 3,2% in 2005 (though its population is also growing relatively fast). South Africa recorded a growth rate of 5% in 2006 (virtually the same as the 5,1% in 2005), which is very good in its own historical perspective, but lower than many other emerging economies.

Figure 2.2: GDP per Capita (PPP), 2006



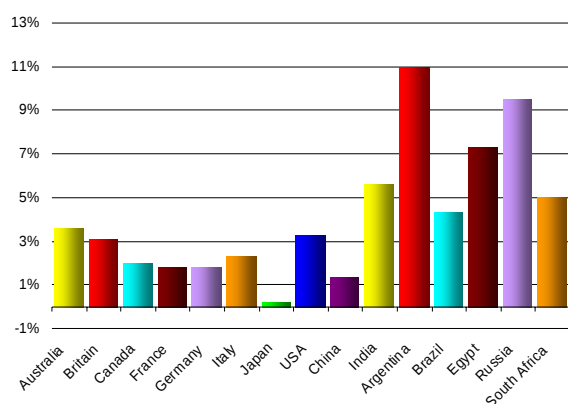
Source: IMF, 2007

Most advanced countries tend to have an economic output per person that is higher than \$30 000 per annum. For the USA it was more than \$43 000 in 2006. The USA is in a league of its own, outperforming other advanced economies by 35%. South Africa is classified as a low-middle income country and falls in the same class as Russia, Brazil and Argentina, with a GDP per Capita of more than \$10 000 (in terms of Purchasing Power Parity). This is a good indication for South Africa, however the very skew income distribution should be taken into account.

2.3 Outlook Indicators

Inflation and interest rates are good indicators of the financial stability of a country and are used by investors to determine what return they can realize on their investments. Countries with a high real interest rate provides a good investment opportunity, on condition that inflation is not too high (indicating high risk).

Figure 2.3: Inflation, 2006

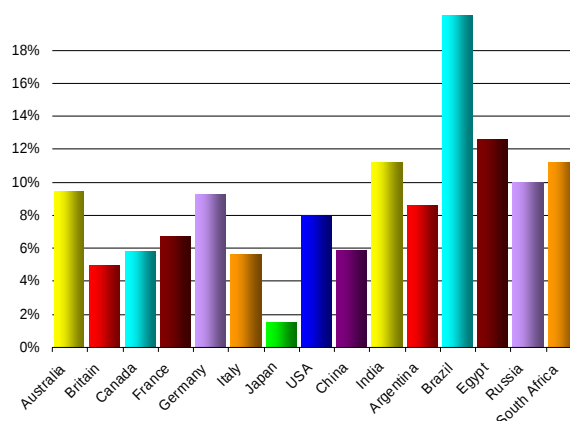


Source: UN, 2007

Though world economic growth rates have increased in 2006, inflation in many countries has also increased. World inflation rates tend to be

under control in the latest decade. Low inflation rates are a common characteristic of the advanced economies, reflecting on their low risk. Japan experienced inflation for a change during 2006, compared to deflation in 2005. South Africa had an inflation rate of 4,7% in 2006 (3,4% in 2005), Russia had 9,5% (11,8% in 2005). and Argentina had 11% (9,6% in 2005). China had a very low inflation rate for a country growing so fast, indicating that it is not at risk of overheating currently.

Figure 2.4: Lending Interest Rates, 2006

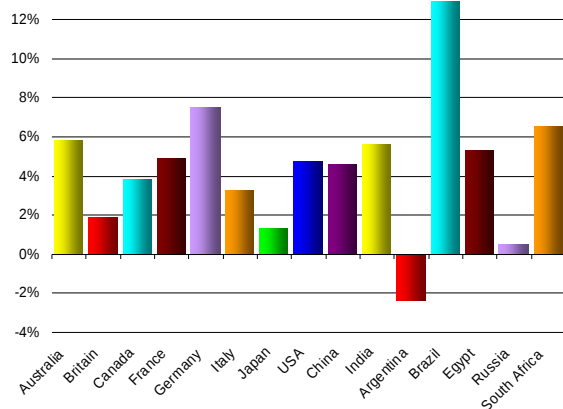


Source: The EIU, 2007

As a result of the higher inflation levels in 2006, interest rate levels have also increased. Nominal interest rates keep a balance between the cost of money and inflation. Countries with very high nominal interest rates are experiencing inflation problems also. Brazil has an exceptional high interest rate, though it did bring its inflation under control. Interest rates tend to be lower in advanced economies compared to emerging countries. In Japan lending interest rates were 1,5% per annum in 2006 (1,4% in 2005) compared with 50,8% in Brazil (55,4% in 2005). South Africa had a rate around 11,2% in 2006, slightly higher than the 10,6% in 2005. In

the US lending interest rates increased from 6,2% in 2005 to 8% in 2006.

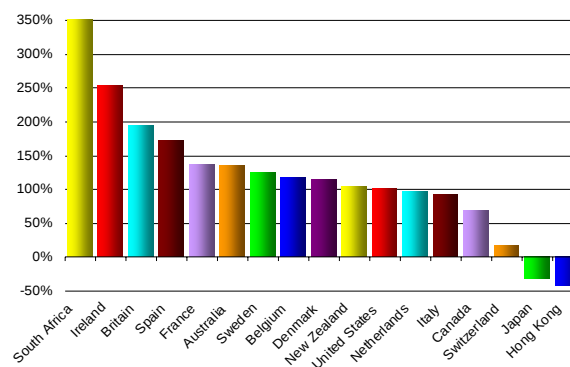
Figure 2.5: Real Interest Rates, 2005



Source: Derived from The EIU, 2007

The cost of borrowing (related to the cost of capital) is a good indication of the demand for capital in a specific country. Real interest rates (after the impact of inflation) will be low if the demand for capital is low. Brazil had an abnormal high real interest rate of 46,5% in 2006, indicating that the country is capital hungry. Argentina had a negative real interest rate, which is just as unhealthy – indicating that capital may leave. South Africa's real interest rate is in the same vicinity as that of Australia, Germany and India. Japan had a low interest rate, one of the reasons why the Japanese tend to invest their money abroad.

Figure 2.6: House Price Growth, 1997-2006



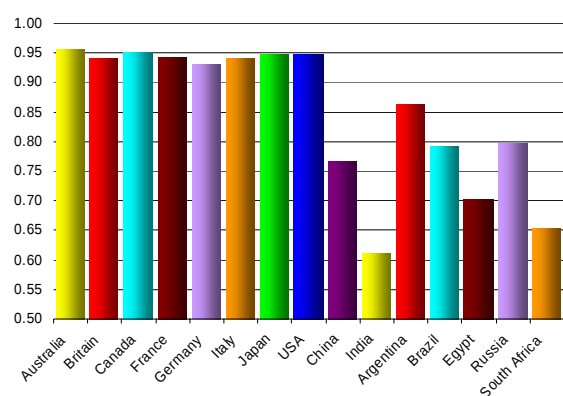
Source: The Economist, 2007

Property prices in most parts of the world have increased substantially in the last decade, mostly as result of low interest rates, growing populations and higher levels of income. The average house price in South Africa has increased by 350% in the last decade, more than any other listed country in the world. Higher prices are also an indication of a higher income of the general population. In Japan and Hong Kong prices have declined as their populations did not grow anymore and economic growth was sluggish. High property value allows households to borrow against their houses, which is a risk when trends start to turn around, such as in the US in 2006. This may result in bad debt, which is negative for the banking sector.

2.4 Development Indicators

The condition of a country's population can be described by development indicators of which the Human Development Indicator of the UN is the most valuable. It captures the standard of living in a country such as life expectancy, literacy and income. Other important indicators are the unemployment rate and prisoner population which reflects on crime levels and legal efficiency.

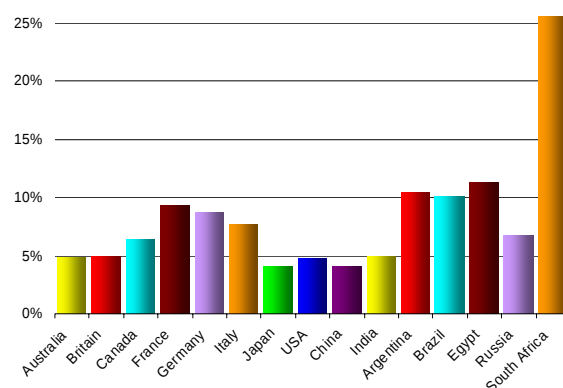
Figure 2.7: Human Dev. Index, 2004



Source: United Nations, 2006

The advanced economies all have very high levels of human development, related to a high life expectancy, near full literacy rate, good secondary and tertiary education and high income levels. South Africa is not scoring well in this regard, with values declining from 0,74 in 1995 to 0,66 in 2003 and 0,65 in 2004. The most important reason for the sharp decline is the impact of HIV on life expectancy (48 by 2003 and 47 by 2004). China is scoring relatively high, even with the low income levels it has, since life expectancy in China is 72 and literacy is high.

Figure 2.8: Unemployment Rates, 2006

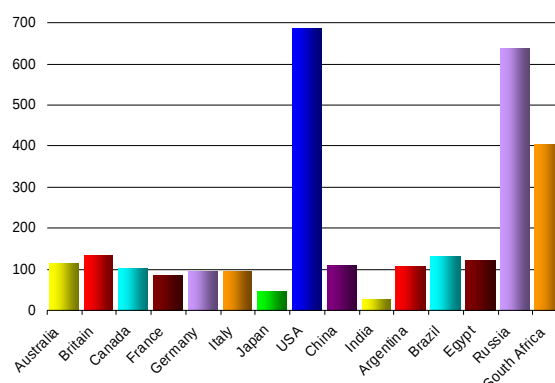


Source: UN, 2007

The Far Eastern countries, Japan and China,

both had the lowest unemployment rates of 4,1% in 2006. In the EU, countries such as France had unemployment of 9,3% in 2006, nearly twice as much as the UK with only 5%. Unemployment in South Africa decreased from 26,6% in 2005 to 25,5% in 2006 (according to the narrow definition). Compared to other countries this is still extremely high and perhaps South Africa's most urgent economic problem. This is impacting negatively on the income distribution of the population.

Figure 2.9: Prisoners per 100 000 people



Source: Home Office, United Kingdom, 2004

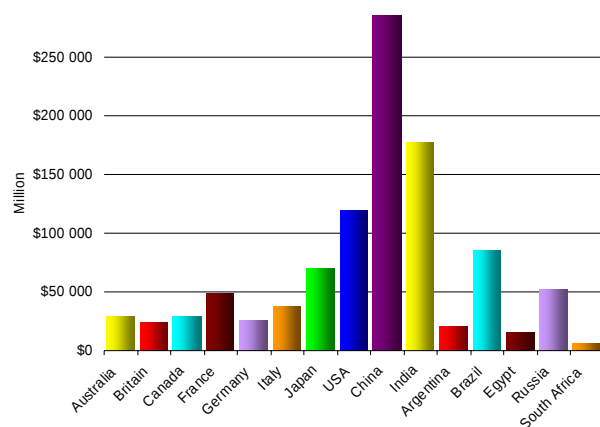
A country's prison population is not a clear indicator of economic wellbeing, however, it does say something holistic about living conditions. More than 8,75 million people are held in penal institutions throughout the world. The United States has the highest prison population rate in the world, some 686 per 100 000 of the national population. Prison population rates vary considerably between different regions of the world, and between different parts of the same continent. More than three-fifths of countries (62,5%) have rates below 150 per 100 000. South Africa has a relatively high prison population, a symptom of the high crime rate. The high prison rate of the US can probably be attributed to an

extreme effective police and prosecution system with a no tolerance policy.

2.5 World Agriculture

In the past decade and a half, agricultural net production increased annually by 2,2%. This growth has been mainly in the developing world which increased output by almost 3,4% per year, while the developed countries increased by just over 0,2% per year (FAO, 2007). World grain output decreased in 2006 by 2% from 2015 million ton to 1975 million ton –against a growing world population. This indicates that the planet's population is in a worse position to feed itself than a year before. Agriculture tends to be a smaller part of advanced economies compared to emerging economies.

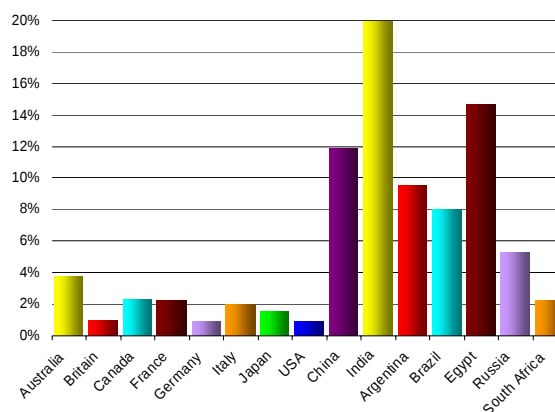
Figure 2.10: Agricultural Output, 2006



Source: Derived from IMF, CIA World Fact Book, 2007

China has the world's largest agricultural output (\$313 billion in 2006), followed by India. Both of these countries have very large populations to feed. South Africa had an agricultural output of \$5,6 billion in 2006, a decrease from 2005. Of the EU countries France is the leader in agricultural production. Russia increased its agri-output from \$37 billion in 2005 to \$52 billion in 2006.

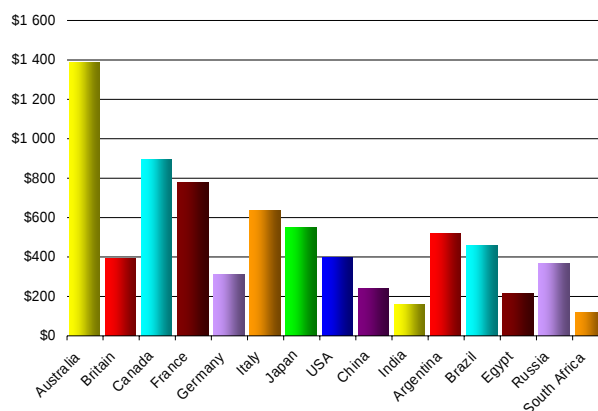
Figure 2.11: Agriculture as % of GDP, 2006



Source: CIA World Fact Book, 2007

In most countries the contribution of agriculture to the total economy declined, especially in the fast growing countries such as China and India. South Africa's agricultural contribution of only 2,2% in 2006 places it in the same class as advanced countries. In some countries such as Russia, Japan and Australia the agricultural contribution increased from 2005 to 2006. In the emerging countries the contribution decreased, such as India which still has a very large agricultural sector – indicating that India has plenty of room for development. The same accounts for China and Egypt.

Figure 2.12: Agric Output per Capita, 2006



Source: Derived from IMF, CIA World Fact Book, 2007

During 2006 South Africa had an exceptionally low agri-output per capita of only \$118, compared to India which had \$159, Egypt \$219 and Australia which had \$1 389. This places South Africa in a very bad situation concerning food security –it should raise concern and the South African government should reconsider its agricultural strategy. Though the advanced countries tend to have small agricultural sectors they still tend to produce slightly more agricultural output per capita than emerging countries.

3. RSA ECONOMIC OUTPUT

3.1 News Events

Before the stand of the South African economy can be analysed, domestic events of importance in 2006 should be reviewed in short. Chief **executives** of South African companies are paid 35 to 53 times more than average workers, according to a report released by trade union Solidarity. President **Vladimir Putin** visited South Africa, seeking to widen his sphere of political influence on the continent beyond Moscow's traditional Cold War allies. South Africa said that it would delay imposing planned quotas on Chinese clothing and **textile** imports from September to January 2007. The increases in residential real estate prices continued to slow during the course of 2006. The FNB-BER Consumer Confidence Index decreased slightly in the last quarter as inflation and interest rates increased. The South African construction boom stretched **cement** producers to capacity as they struggle to expand production to meet the demand. Interest rates have increased and inflation was creeping upwards. Cabinet had approved the long-awaited codes of good

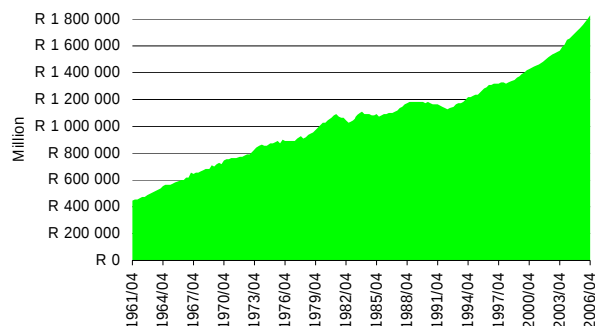
practice on broad-based black economic empowerment (**BEE**), in December. The DTI accused steel giant Mittal Steel SA of abusing its market dominance after the company increased steel prices for the third time in three months. **PetroSA** is said to become a key player in the proposed construction of a new synthetic-fuel refinery to be completed by 2014 as part of government's strategy to ensure fuel supply security. Cabinet had given its approval to the proposal to create six regional electricity distributors (REDs) which will be established as public entities under the auspices of the **Electricity** Distribution Industry (EDI). Gold theft from South African gold mines was estimated at R2bn annually, the Chamber of Mines announced in November. Since 1980 more than 10,3 million foreigners who entered South Africa legally, never declared their departure, an employment report released in November showed. Tourists to South Africa were breaking all records in 2006, making the **tourism** industry an important leg of the ASGISA initiative to reach 6% economic growth. SA Tourism announced an increase of 11,3% in tourist arrivals with annual arrivals exceeding 2005's record-breaking 7,3 million. By the end of 2006 new and used **car prices** have declined by an average of 3,3% in the previous three years.

3.2 Gross Domestic Product

The Gross Domestic Product refers to the actual size of a country's economy. Over time the GDP is expressed in real value in order to make provision for inflation. Only relative to the population size can the GDP be an indicator of the level of wealth of a country. The annual growth of GDP is an indication of the economic progress that a

country is making and it is regularly influenced by world growth.

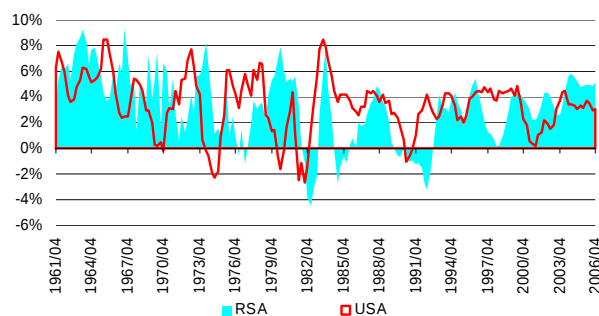
Figure 3.1: Gross Domestic Product, 2006R



Source: SARB, 2007

By 2006 the GDP of South Africa was just over R1 830 billion, twice the size it was 1978. South Africa's economy shows some impacts from its political history. The upward trend was disturbed during the oil crises of the 1970's and escalated in the 1980's partly as economic sanctions against South Africa were intensified by the international community, and also as a result of worldwide economic volatility. Since 1994 the economy recovered to its original trend and in 2004 it assumed a new stronger trend.

Figure 3.2: Economic Growth

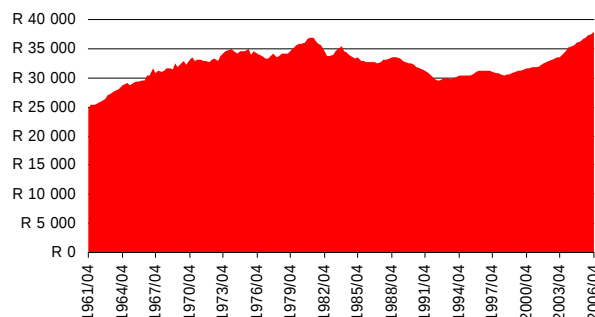


Source: SARB, 2007

During 2006 the economy grew by 5%, virtually

the same as the 5,1% in 2005. South Africa has experienced no recession since 1993, which has put the country on a strong new growth path. The impact of the U.S. economy can be seen in figure 3.2, also showing the volatility that started in the 1970's.

Figure 3.3: GDP per Capita, 2006R

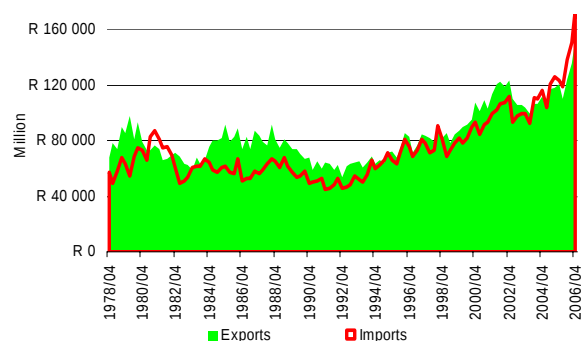


Source: SARB, 2007

By the end of 2006 the GDP per capita reached a historical maximum of R38 000. The economic volatility of the 1980's had a negative impact on GDP per capita, which decreased at that time. Since 1997 the GDP per capita started to rise again as a result of both higher economic growth and lower population growth.

3.3 Exports and Imports

In 2006 tourism has overtaken gold as the largest earner of foreign currency for the country. Historically gold and mining commodities constituted a large quantity of South Africa's exports. With time the balance shifted to the export of manufactured products, while the share of agriculture also increased. Most of South Africa's imports are in the form of manufactured products, while agricultural imports have decreased sharply as a share of the total.

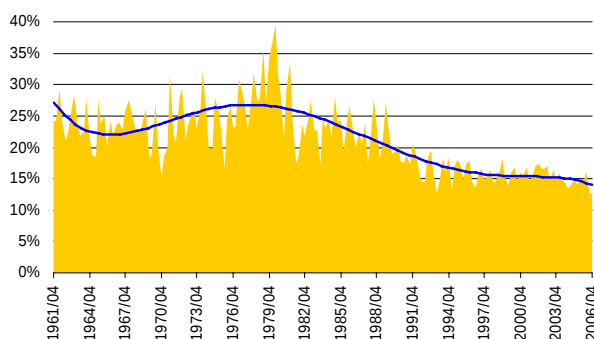
Figure 3.4: Quarterly Exports and Imports, 2006R

Source: SARB, 2007

The level of exports is strongly influenced by the exchange rate. When the rand was weak in 2002 exports increased but when the rand appreciated exports fell again. In 2005 exports recovered mostly to the levels of 2002 and imports reached record highs of R120 billion per quarter. By the last quarter of 2006 imports shot up to R173 billion compared to exports of R152 billion.

3.4 Savings and Investment

Savings is used to finance investment, otherwise funds should be found from foreign sources. South Africa has a very low savings rate and therefore is dependant on foreign investment for the economy to grow.

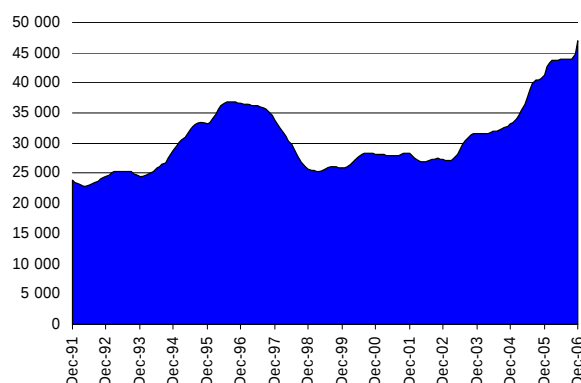
Figure 3.5: Gross Savings as % of GDP

Source: SARB, 2007

By the end of 2006 savings have declined to 12,7% of GDP from 14,9% a year earlier. Savings reached a peak of 34% of GDP when the gold price was over \$800 in 1980. Since 1992 saving decreased to lower levels, going even lower after 2003. To counter depreciation and finance new investment, a savings rate of 25% is ideal. Luckily South Africa attracts enough foreign money to finance this 12% gap.

3.5 Motor Sales

As a result of the sustained upswing of the South African economy since 1998, income levels of many households have increased up to a level where many can now afford automobiles. Car sales also serves as an indication of the industrial output of a country since it consumes much raw material such as metals and chemicals as well as skilled labour.

Figure 3.6: Monthly car sales

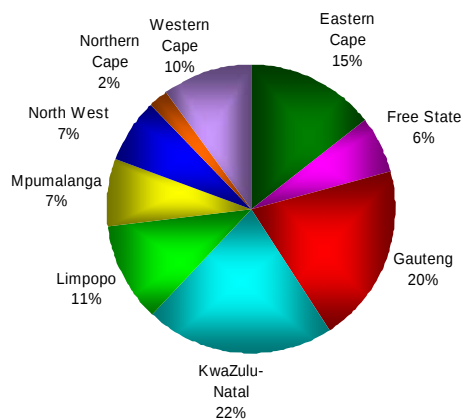
Source: Department of Transport, 2007

The sale of motor cars have surged since 2004 and reached record levels of 47 000 units sold per month by the end of 2006, compared to 41 300 by the end of 2005. In 1999 car sales were around 25 000 units per month, indicating that cars sale have nearly doubled in 7 years.

4. PROVINCES

Though South Africa seems to be functioning well in economic terms, the nine provinces of the country tend to differ substantially in terms of their own level of development. Provinces such as Gauteng and the Western Cape could be classified as first world whereas provinces such as the Eastern Cape and Limpopo could be classified as third world provinces.

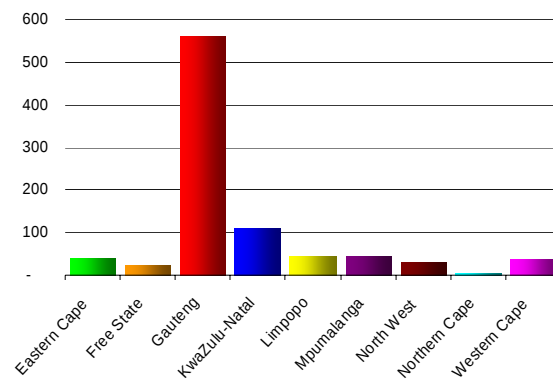
Figure 4.1: Population share of Provinces: 2006



Source: StatsSA, 2006

The South African population increased from 46,9 million in 2005 to 47,4 million in 2006. Of all the 9 provinces Kwazulu-Natal has the highest population, reaching 9,92 million in 2006 (22% of the total). Gauteng, the smallest province has the second most people (9,53 million). Only 2% of South Africa's population resides in the Northern Cape, which is the largest of all the provinces. Current migration patterns would result in a larger population for Gauteng in the near future. As South Africa emerges into an advanced economy, communities migrate from rural areas to urban ones. Kwazulu-Natal is currently very rural as opposed to urban Gauteng.

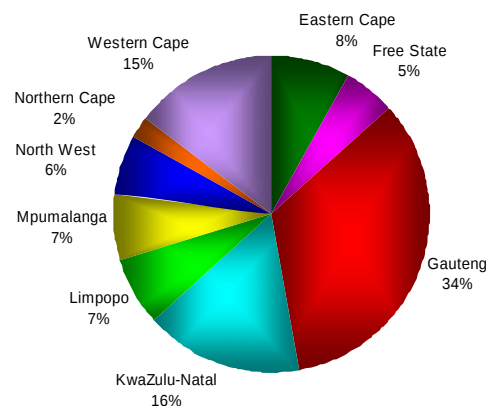
Figure 4.2: Persons per km², 2006



Source: StatsSA, 2006

Population density in Gauteng increased from 530 per square km (2005) to 560 persons per square km (2006). Gauteng is the province with by far the highest population density (even more than the Netherlands, and more than twice as dense as Germany or Britain). Population density in the Eastern Cape, North West and Limpopo has decreased as result of internal migration as people leave the poorer rural provinces to seek a better life in wealthier cities.

Figure 4.3: Economic share of Provinces, 2005

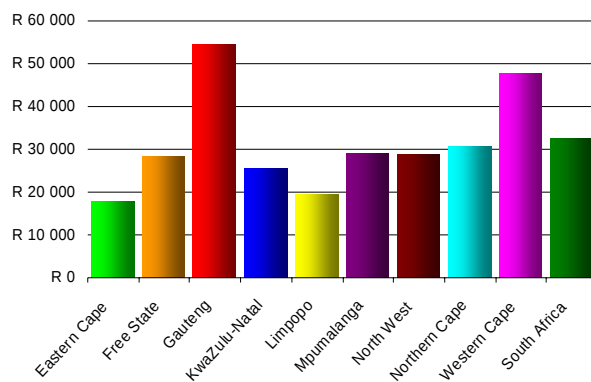


Source: StatsSA, 2007

Gauteng has the largest economy in South Africa. More than one third of South Africa's economic output is generated on 1,4% of its surface

area. The second largest economy after Gauteng's is Kwazulu-Natal which constituted 16% of the economy in 2005, down from 17% in 2004. In the third place is the Western Cape which increased its share from 14% in 2004 to 15% in 2005. The province with the smallest economy is the Northern Cape. To bring the population and economic size of each province into perspective, the output per capita is as follows:

Figure 4.4: GDP per capita: 2005



Source: Derived from StatsSA, 2007

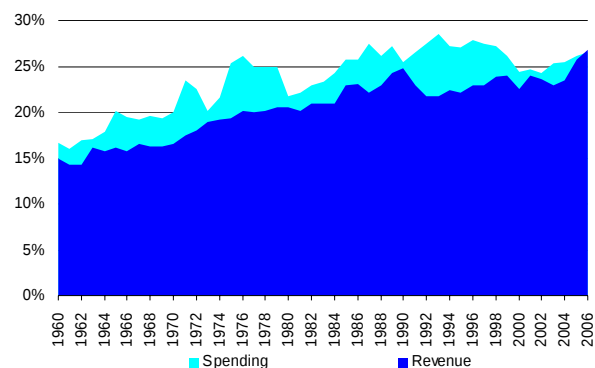
The economic output per person differs dramatically from province to province. The output per person in Gauteng increased from R56 864 in 2004 to R58 788 in 2005, remaining the highest in South Africa (R32 828 in 2005), with the Western Cape in second place and the Eastern Cape (R16 730 in 2004 and R17 283 in 2005) in last place. The output per person in Gauteng is 3,4 times as high as that of the Eastern Cape and 1,8 times the South African average. This puts Gauteng on the level of a developed country.

5. GOVERNMENT

5.1 Income, Expenditure and Deficit

The participation of government in the economy differs from country to country, with a theoretical ideal of 20%. Governments tend to be less efficient and competitive than private firms, which implies that participation should be kept under control

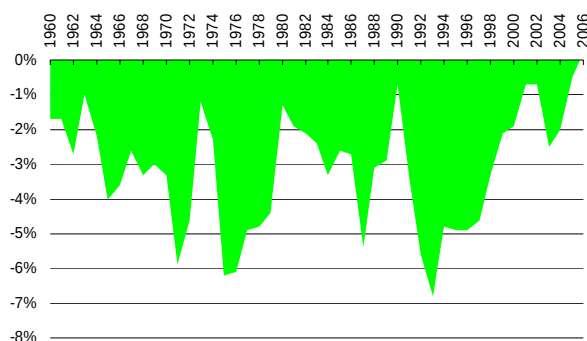
Figure 5.1: Government Income & Expenditure as % of GDP



Source: SARB, 2007

For the first time in 50 years did Government revenue exceeded expenditure, leaving a surplus on the national budget in 2006. In the long run the South African government has systematically involved itself in the economy at a higher rate. By 1993 Government expenditure reached a maximum of 28,5% and levelled off to 26,6% to GDP in 2006, compared to only 16,7% in 1960.

Figure 5.2: Deficit as % of GDP



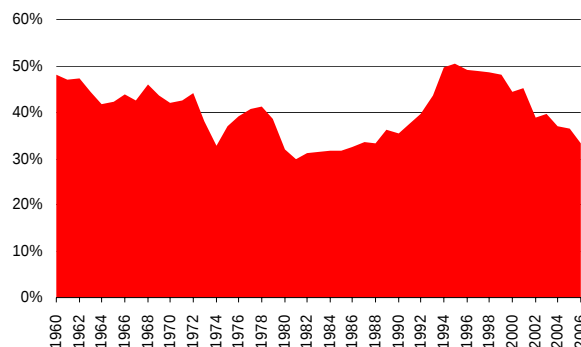
Source: SARB, 2007

Low interest rates and good financial discipline resulted in a surplus on the budget in 2006 of 0,2% to GDP (compared to a deficit of 0,5% in 2005). As a result Government did not need to borrow much and future interest payments can be low. More debt can be repaid than initially expected, allowing more room for surplus funds. South Africa had its highest deficit (6,8% to GDP) in 1993.

5.2 Debt and Interest

As a result of deficit spending, Government needs to borrow money in different forms. These debts accumulate and are eventually expressed as a % to GDP. In many years the interest on debt had been one of government's greatest single expense, though low interest rates and debt repayment in recent years have changed this situation in South Africa.

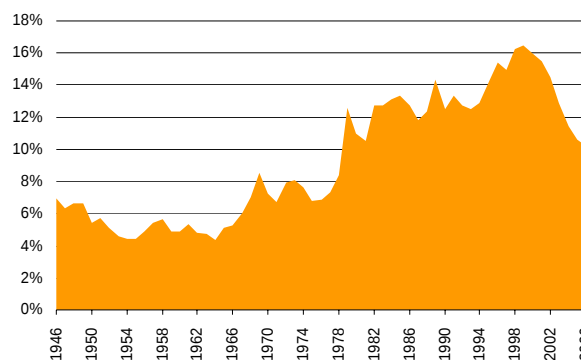
Figure 5.3: Government debt as % of GDP



Source: SARB, 2007

South Africa's state debt decreased from 37% to GDP in 2005 to 33% in 2006. This is at a moderate level when compared to other industrialised countries. When interest rates were low Government could afford to have high debts, but with high interest rates during the 1980's Government were forced to keep its debt low (30% to GDP). Debt reached a maximum of 50% to GDP in 1995. Since then Government succeeded to bring this burden down as a result of very good fiscal discipline.

Figure 5.4: Interest as % of Public spending



Source: SARB, 2007

In 2006 interest payment of Government decreased to 10,2% of expenditure, from 10,6% in 2005. The interest bill of Government depends on the level of debt as well as interest rates. In-

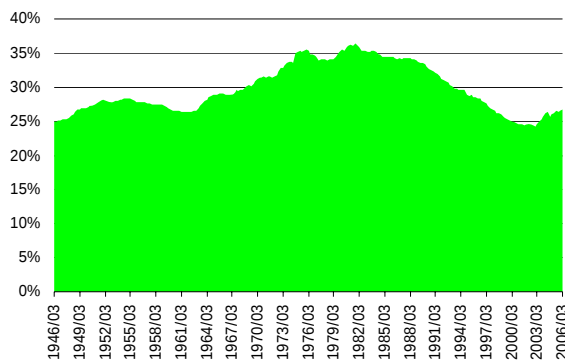
terest payment reached a maximum of 16,5% to expenditure in 1999. Since then debt as well as interest rates decreased allowing interest payment to fall.

6. LABOUR

6.1 Employment

Employment is perhaps the most important factor concerning economics. It allows for a more fair distribution of income and it increases economic output. An indication of the level of employment in a country is the % of the population that works. Another indication is the % of potential workers that don't work, called the unemployment rate.

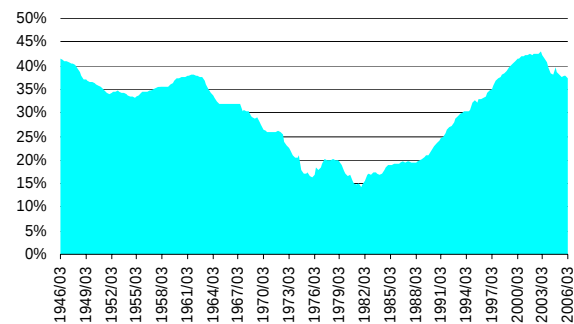
Figure 6.1: % of SA population employed



Source: Derived from SARB & StatsSA, 2007

The % of the population that works in South Africa is low compared to countries such as the USA (which has 45%). Employment increased by 340 000 from 12,44 million persons in 2005 to 12,78 million in 2006. This constituted 26,6% of the population by the end of 2006 (26,3% in 2005). Employment reached a maximum of 36,5% in 1982 and a minimum of 24,2% in 2003.

Figure 6.2: Unemployment Rate



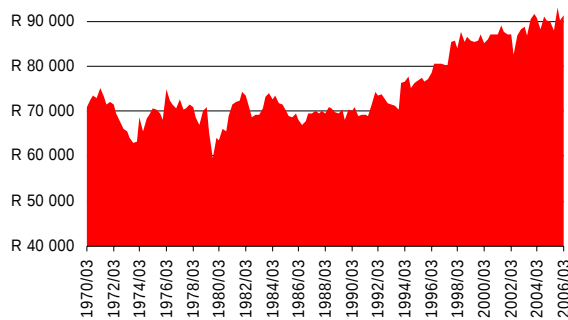
Source: Derived from SARB & StatsSA, 2007

South Africa differentiates between the official unemployment rate and the extended rate where people give up on looking for a job. The official unemployment rate decreased from 26,7% in 2005 to 25,5% in 2006. The extended unemployment rate decreased from 38,2% in 2005 to 37,3% in 2006. Unemployment reached a minimum of 14% in 1982 and a maximum of 43% in 2003. The trend turned around and lower unemployment figures can be expected in future.

6.2 Employee Remuneration

Of the nearly 12,8 million people employed in South Africa, only 8,4 million work for a salary in the formal sector of the economy in 2006, compared to 8 million in 2005. The balance is working in the Agricultural-, informal- and domestic service sector (4,4 million).

Figure 6.3: Average Formal Salary, 2006R



Source: Derived from SARB & StatsSA, 2007

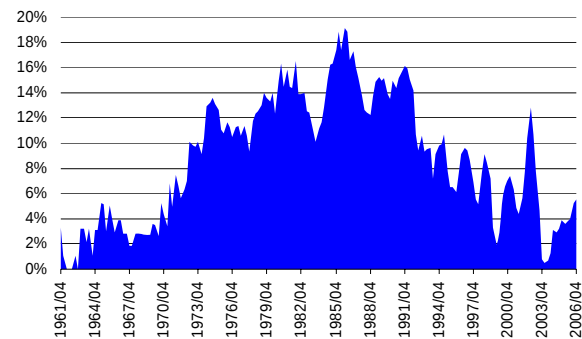
During 2006 the average salary reached an all time high of R91 500 per annum (R7 625 per month), slightly higher than the R89 800 of 2005. In the long run higher salaries are associated with higher labour productivity. The average salaries of employees in the formal sector have increased substantially since 1994. Fewer labourers were thus needed and it partly resulted in the high current unemployment rate.

7. OUTLOOK INDICATORS

7.1 Inflation and Interest Rates

Inflation and interest rates move hand in hand. South Africa, along with world trends, has managed to bring inflation down and along with it interest rates. Both in low terms are beneficial to economic growth.

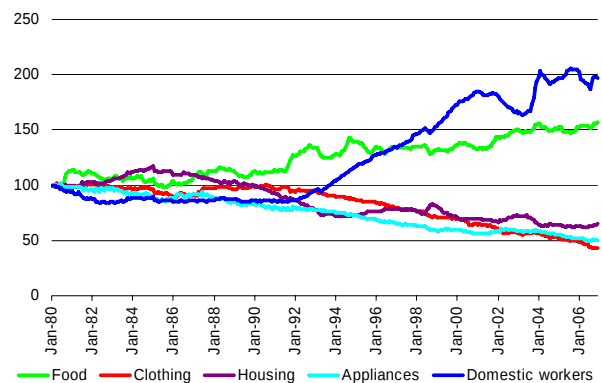
Figure 7.1: Consumer Inflation



Source: SARB, 2007

Consumer inflation increased to 5,51% by the end of 2006, from 3,64% by the end of 2005. However, the long run trend is currently very low, back to the levels before 1970. High inflation was present in many countries (advanced and emerging) during the 3 decades from 1970 – 2000. Currently the lower level of inflation allows for a lower level of interest rates. In the past decade low interest rate levels world wide has been responsible for the property boom.

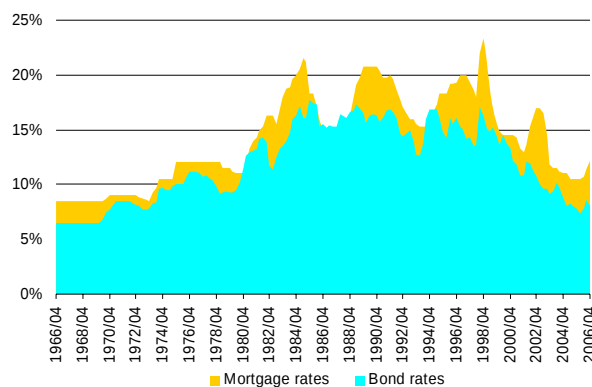
Figure 7.2: Relative Real Prices



Source: StatsSA, 2007

The CPI indicates an average basket of prices, but the price ratios of different products change over time. By the end of 2006 food prices were 57% more expensive in real terms compared to 1980. On the other hand, the real cost of housing was 35% cheaper in the same period. Education was 350% more expensive in real terms, by the end of 2006. The higher level of food price indicates that demand for food grew faster than the supply. This is a result of very high population growth between 1980 and 2000.

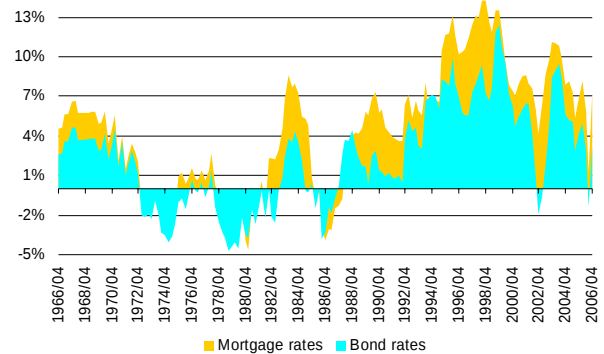
Figure 7.3: Mortgage and Bond rates



Source: SARB, 2007

During 2006 the prime interest rate was increased 4 times from 10,5% to 12,5%. The rates on government bonds also increased slightly from 7,85% in 2005 to 8,02% in 2006. Before 1970 mortgage and bond interest rates had been low and stable for long periods at a time. Since then volatile and high inflation was experienced but the trend has turned downwards after 1999.

Figure 7.4: Real Mortgage and Bond Rates



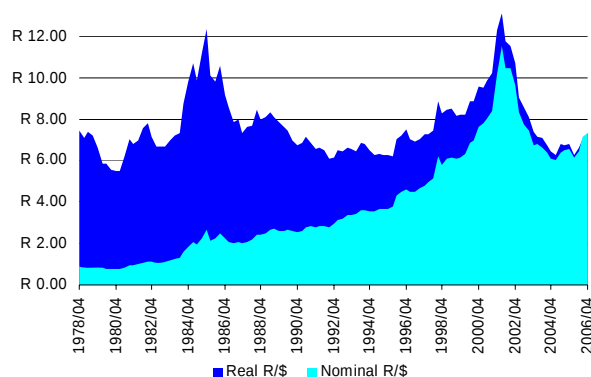
Source: Derived from SARB, 2007

The real mortgage rate increased from 6,8% by the end of 2005 to around 7,3% by the end of 2006. The real bond rate decreased from 4,2% by the end of 2005 to 3,1% in 2006. This is a low rate compared to the last few years which may cause a lower attraction of foreign capital. Interest rates should normally be higher than the inflation rate in order to have a positive real interest rate. During the 1970s and 1980s there were long periods with a negative real interest rate.

7.2 Exchange Rate and Gold

Related to interest rates and inflation is the exchange rate. High real interest rates result in an appreciating currency while a high inflation rate results in a depreciating currency. Gold also plays an important role in the exchange rate of South Africa since gold itself is a virtual world currency. A high gold price would therefore result in an appreciating Rand.

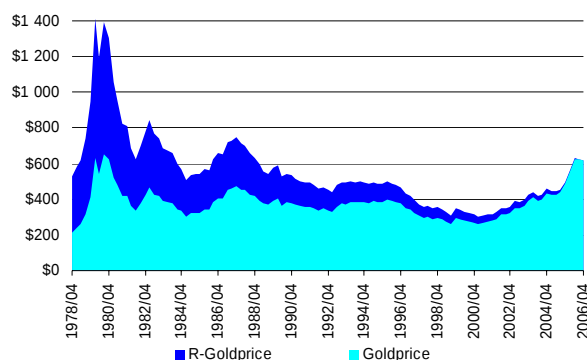
Figure 7.5: Exchange Rate, 2006R



Source: Derived from SARB, 2007

During 2006 the Rand weakened substantially (13%), from R6,53/\$ by the end of 2005 to R7,32/\$ at the end of 2006. A better indication of the strength of the Rand is taking into consideration the impact of inflation in South Africa in relation to inflation in the USA. The real exchange rate of the Rand reached a historical low point at R12,70/\$ in 2002 and a high point at R5,30/\$ in 1980. The real Rand closed the year 2006 at R7,32/\$, which is still average compared to its long run history.

Figure 7.6: Real & Nominal Gold Price, 2006\$



Source: Derived from SARB, 2007

In the late seventies and early eighties the gold price was very volatile and has since stabilised relatively. Since 2003 the gold price have

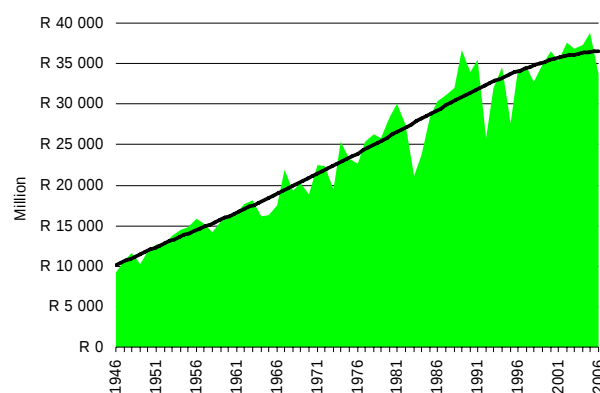
started to increase again substantially and by the end of 2006 the gold price was around \$616/ounce, 27% higher than a year before. This is very positive for the South African economy which is strongly commodity based, as more foreign currency would be earned to pay for imports. It should support the Rand in the process and thus keep inflation and interest rates stable.

8. AGRICULTURE

8.1 Size of Agriculture

The size of the Agricultural sector can be measured in nominal terms and also as % of the total economy. In the case of advanced economies agriculture constitutes a very small portion of the gross economy. In the case of emerging economies the opposite is true.

Figure 8.1: Agri Output, 2006R

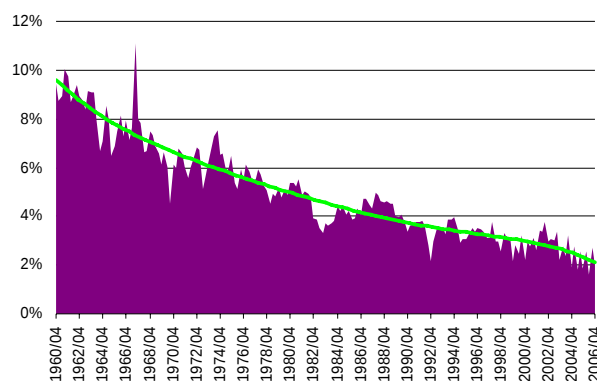


Source: Derived from SARB, 2007

The year 2006 has been very bad for agriculture. The sector's economic output decreased by 13% to R33,7 billion in 2006, from R38,8 billion in 2005. In the long run the South African agricultural sector has shown a steady growth in terms of real production. By 2006 the agricul-

tural output was 264% more than in 1946. Years that show a sudden and sharp decrease in output is usually as a result of dry spells, as was the case in 2006. This may cause food prices to increase in the following season. In monetary terms agri-production are lower today compared to 4 decades ago –all as result of much lower prices for agri-products.

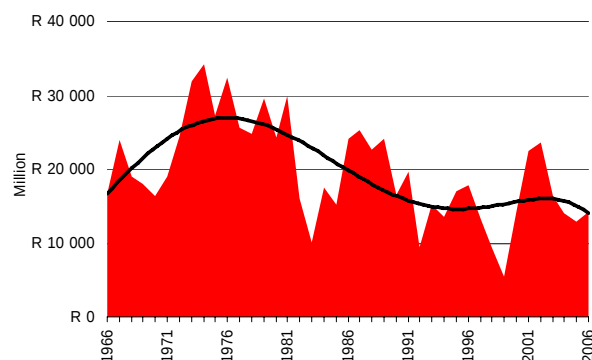
Figure 8.2: Agriculture as % of GDP



Source: Derived from SARB, 2007

Agriculture as % of GDP (the total economy) has decreased in the long run. This implies that South Africa's economy has slowly become more advanced. In 1960 agriculture constituted 9,1% of the total economy and this decreased to only 2,2% in 2006. Though this decrease seems to be a negative trend from a farmer's perspective, it signals that the South African economy is reaching maturity as the secondary and tertiary sectors become more important.

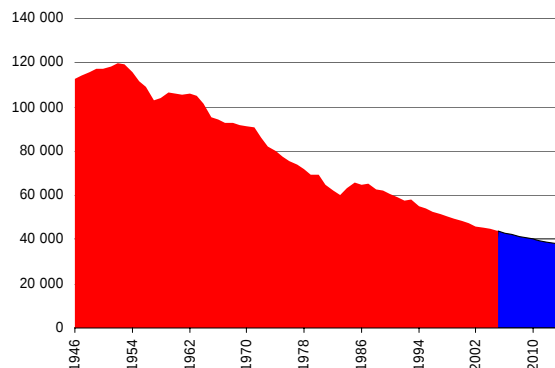
Figure 8.3: Net Farm Income, 2006R



Source: Department of Agriculture, 2007

Another important factor concerning the size of the agricultural sector is the combined net income of all farmers. This net income did not increase along with the size of the sector, as it is supposed to be in a normal situation. Real prices of agri-products are much lower now compared to 30 years ago, which inflates previous production (in monetary terms) artificially. Net farmer income increased from R12,8 billion in 2005 to R14,3 billion in 2006 (with a net sector value added of R33,8 billion). Since the profit of farmers have decreased steadily in the long run, the number of farmers have decreased substantially too.

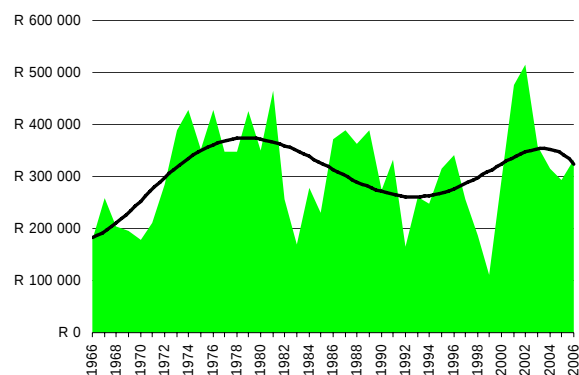
Figure 8.4: Number of Farmers



Source: Department of Agriculture, 2007

As a result of globalisation and improving agricultural technology, the number of farmers in South Africa is on a decreasing trend. This is not unique to South Africa and happened world wide since the dawn of the industrial revolution. However, since the middle 1980's the trend in South Africa have slowed down somewhat. This fall is in accordance with the decrease in net farm income. According to econometric estimates the number of farmers have decreased from 43 800 in 2005 to 43 000 in 2006.

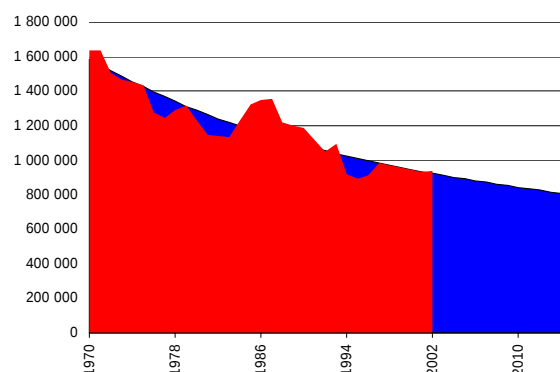
Figure 8.5: Annual Profit per Farmer, 2006R



Source: Department of Agriculture, 2007

During 2006 the drought resulted in higher prices for agri-commodities. Combined with high grain prices worldwide, the profit per farmer increased from R293 000 in 2005 to R332 000 in 2006, despite the decrease in agri-output. The annual profit per farmer is very volatile from year to year, but is still on an acceptable long run level. The middle 1970s was the most profitable period. In 2001 and 2002 farmers had high returns as a result of a weak exchange rate. Since the Rand regained its value profitability have normalised downwards again.

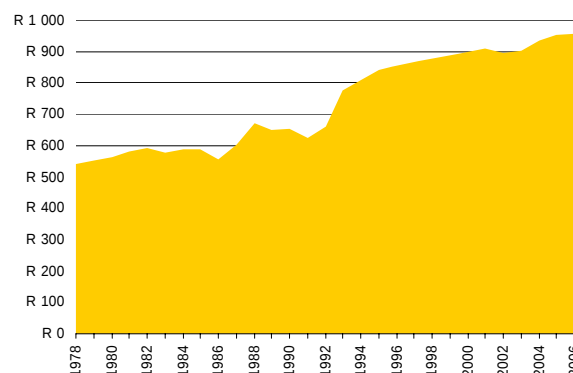
Figure 8.6: Number of Farm Workers



Source: Department of Agriculture, 2007

Along with the number of farmers, the number of farm workers has also decreased. According to econometric estimates farm workers have decreased from 891 000 in 2005 to 881 000 in 2006. The decrease in farm workers is slower than that of farmers. From 1970 to 2006 farmers have decreased by 54% compared to the 46% for farm workers.

Figure 8.7: Farm Worker Monthly Salary, 2006R



Source: Department of Agriculture, 2007

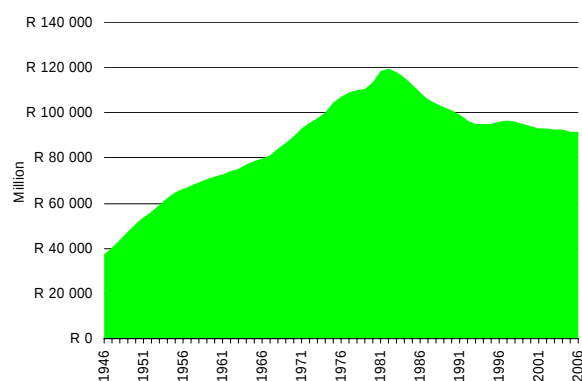
The monthly salary of farm workers is much more stable than the annual profit of farmers. Salaries increased slightly from R953 per month in 2005 to R957 per month in 2006. In 1978 the average farm worker salary was only around R543 per month – a 76% increase in 28 years. This is much higher than the 28% salary increase in

the general economy over the same time span. In 1993 farm salaries had its largest annual increase so far.

8.2 Agricultural Capital and Debt

Even though farming output improved in the long run, the number of farmers have decreased. What did farming capital do, considering a rising farm production level? Interestingly enough farming capital has also decreased sharply since 1982.

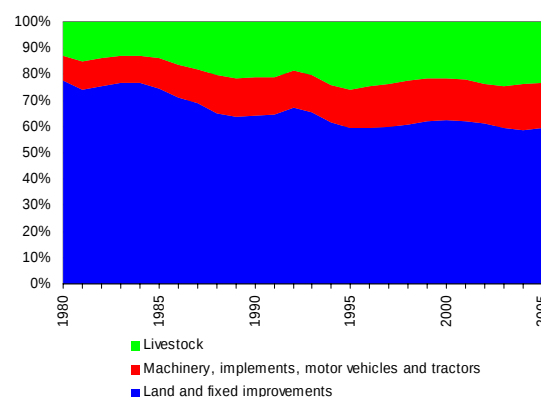
Figure 8.8: Farm Capital, 2006R



Source: Derived from SARB, 2007

For many years the total value of capital in the agri-sector increased. In 1982 the trend turned around abruptly, decreasing by 20% from 1982 to 1994, from where the value of capital has decreased by only 3% in total until 2006. From 2005 to 2006 the value has increased from R91,8 billion to R91,9 billion. However, agricultural output increased against a fall in capital, implying that capital productivity increased tremendously, along with labour productivity.

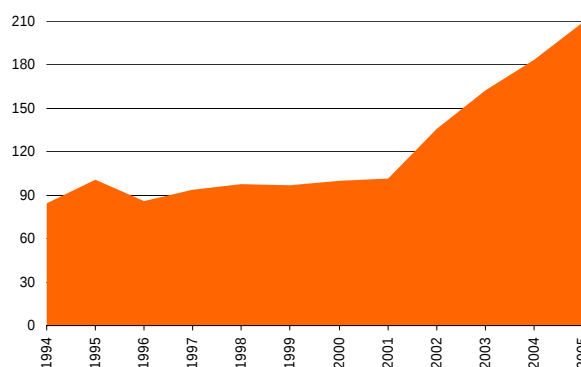
Figure 8.9: Composition of Agric Capital



Source: Department of Agriculture, 2007

The composition of capital has changed over time. The proportion of land and fixed improvements has decreased in favour of livestock and machines. This decrease can mostly be ascribed to the steady fall in the market price of land up to 2001. In 2004 this trend reached a bottom and may be reversing now as land and fixed improvements constituted 59,4% in 2005 compared to 58,4% in 2004.

Figure 8.10: Nominal Farm Price Index

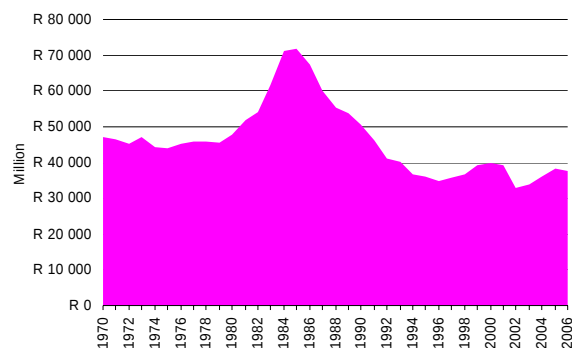


Source: Department of Agriculture, 2007

The price of property increased tremendously around the world during the last 5 years, South Africa was no exception. Though, this was merely a correction of the decrease in the real price of farmland which accumulated over

many years. From 2000 to 2005 the average price of farmland increased by 109%.

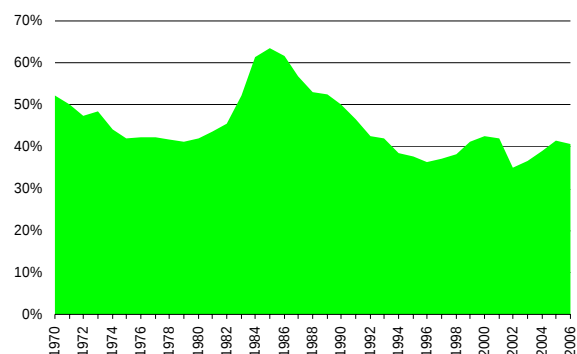
Figure 8.11: Farming Debt, 2006R



Source: Department of Agriculture, 2007

As farm capital decreased since 1982, farm debt had to follow since capital serves as collateral for debt. Farming debt reached a peak in 1985 from where it decreased to a more stable level below R40 billion since 1994. These low levels are very beneficial to the farming sector, keeping interest payments low and as result the price of food produced. Farm debt decreased slightly from R38,2 billion in 2005 to R37,5 billion in 2006.

Figure 8.12: Farm Debt-to-Capital Ratio



Source: Derived from SARB, 2007

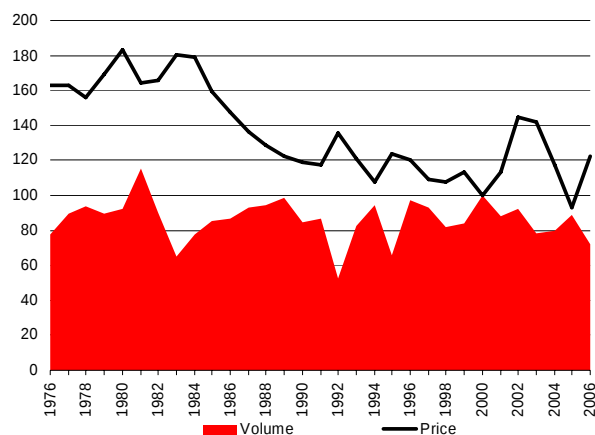
The debt covered by capital as collateral reached its most risky level in the mid 1980's when capital started to depreciate and debt

levels only followed 3 years later. At that time more than 60% of farm capital was at risk of loans. Since the 1990s this level came down to a more normal level below 45%. The debt-to-capital ratio decreased from 41,6% in 2005 to 40,8% in 2006.

8.3 Production

The production of agricultural commodities is very volatile from year to year since external factors such as climatic conditions have in important influence. In the long run production have steadily increased as South Africa's population have grown and the demand for food along with it. Due to improved technology the farming sector was able to increase output by utilising fewer natural resources. For the 3 main categories of production, Horticulture and Animal Production have shown an increase in 2006, but Field Crop Production has shown a decrease.

Figure 8.13: Field Crop Indexes

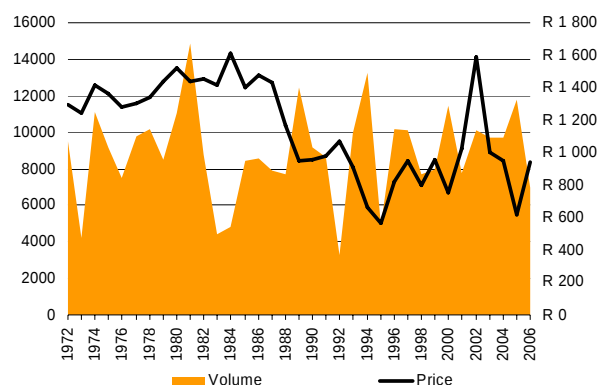


Source: Department of Agriculture, 2007

In three decades the volume of field crop production decreased slightly. This varies from year to year as rainfall and climate has a big influence. The real price that farmers receive for

field crops has steadily decreased until 2000 from where it started to move side ways.

Figure 8.14: Maize Production



Source: Department of Agriculture, 2007

Production of the most important field crop, maize, has decreased sharply from 11,7 million ton in 2005 to 6,9 million ton in 2006. This is mostly as a result of low maize prices in 2005 that resulted from surplus production. The decrease in maize production resulted in much higher prices in 2006, however, as a result of the drought of 2006 the maize harvest for 2007 will remain small. The average price of 2006 was 53% higher compared to 2005.

Table 8.1: Production forecast for this season

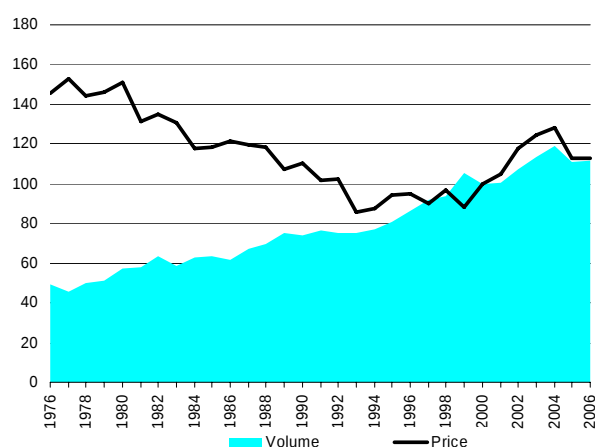
Crop	2 nd Forecast	2007 vs. 2006
	Tons	%
Total maize	6 907 450	4,37
White maize	4 063 400	-2,96
Yellow maize	2 844 050	17,01
Sunflower seed	276 780	-46,77
Soybeans	238 650	-43,71
Groundnuts	49 400	-33,24
Sorghum	141 325	47,21
Dry beans	46 970	-30,16

Source: Department of Agriculture, 2007

The effect of the higher maize price encouraged farmers to plant 60% more hectares,

though as a result of the drought the total maize harvest is expected to be only 4,4% higher in 2007 compared to 2006. Only the sorghum harvest is expected to increase substantially. All other grain harvests will decrease by huge amounts as a result of farmers who substituted back to maize and also the drought. Now the second year with such a low level of maize production, it contains some risk to Southern Africa's food security as many countries depend on maize imports from South Africa, and current surplus stocks are depleting fast. If the next production season is as dry as the current one, the whole region would be in need of international food assistance, while South Africa will be able to afford food imports.

Figure 8.15: Horticultural Indexes

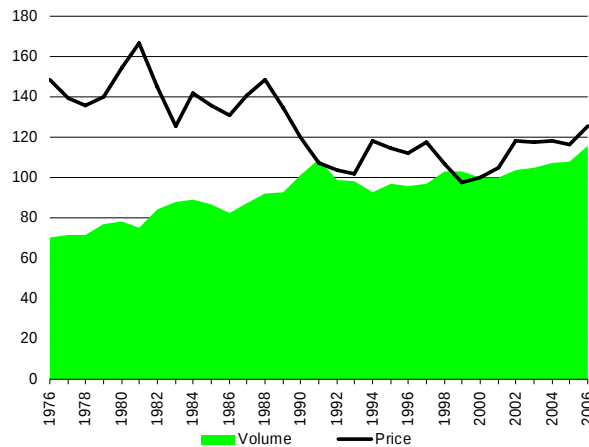


Source: Department of Agriculture, 2007

Of the Horticultural sub sector, deciduous fruit is the most commonly produced. In the long run real farm gate prices of horticultural products have decreased until 2000, as production increased. This implies that demand did not improve along with production. However, from 2000 prices rose along production, indicating an increase in demand as income levels in

South Africa improved. In 2006 production rose by 0,5% compared to 2005. During the same period the real price of horticultural products remained constant.

Figure 8.16: **Animal Product Indexes**



Source: Department of Agriculture, 2007

Chicken is South Africa's most widely consumed meat. The production of animal products is steadily improving and it is not very volatile. The real farm gate price of animal products decreased in the long run as production improved (until 1999), indicating that the growth in demand was not that strong. From 2000 real farm gate prices started to increase. Animal production increased by 7,5% in 2006, compared to 2005. During the same period the real price increased by 8%.

9. CONCLUSION

Government finance is in a very good condition as there was a surplus on the budget, debt and interest payments were at very low levels in 2006, saving government some money. The gold price maintained high levels throughout 2006. However, the tourism industry bypassed

gold as the largest earner of foreign currency for South Africa, indicating a benefit to the Rand and assisting in keeping inflation and interest rates under control. Imports have risen sharply (much more than exports) which have an exchange rate risk to it. Another risk is the very low savings rate which is still decreasing in the long run, making South Africa dependant on foreign investment. The nature of South Africa's dual economy is clear when internationally compared. South Africa is growing fast along with most emerging economies, though its agricultural sector constitutes a very small portion of economic activity as is the case in advanced countries. Currently South Africa's largest problem would be the high unemployment rate. This is slowly changing, though at the current growth rate of 5% it will take another generation or two to be solved. Since population growth is at historical lows, the GDP per capita has started to make significant gains. Regarding the agricultural sector, output has decreased during 2006, mostly as a result of adverse climatic conditions and low prices in 2005 which discouraged farmers to plant. As a result of a deficit production of maize the price increased substantially, causing farmers to increase their plantings of maize during 2006. However, as a result of the severe drought that started in 2006 the crop harvests for 2007 is not expected to be very high. Overall the South African economy (with the exception of the agricultural sector) is in a good condition that can be maintained if the international environment remains stable and peaceful.

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