Dr David Masondo

Deputy Minister of Finance

Key Note Address

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Steel and Engineering Industries Federation of Southern Africa

80 Years OF SERVICE 1943 - 2023

Dr David Masondo: Deputy Minister of Finance

Very tough times ahead if we do not turn this ship around – and fast.

— *"Government has a crucial role to play in shaping the economic future of South Africa – however, it cannot do it alone, labour market stability is a key contributing factor."*

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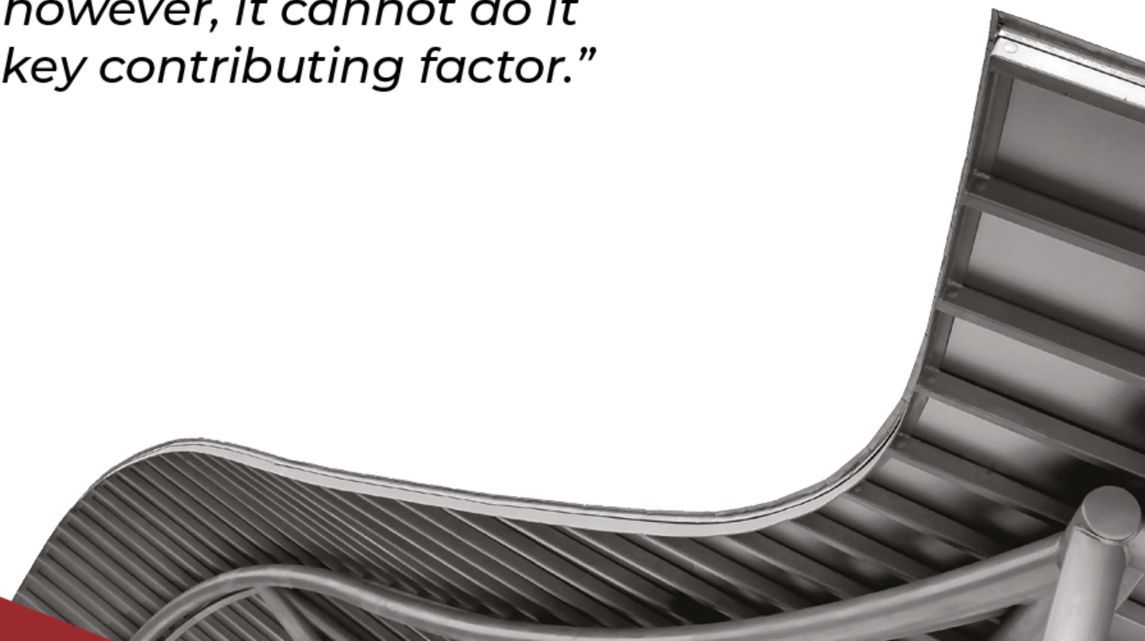
Steel and Engineering Industries
Federation of Southern Africa



Presentation Outline

- **Metals and Engineering Sector Overview**
  - Production
  - Investment
  - Labour/Employment
- **Economic Outlook**
  - International
  - Domestic
- **M&E Sector Load Shedding Impact Assessment**
  - Employment
  - Investment
  - Input Costs
- **M&E Sector Revised Outlook**

The Metals and Engineering Sector

- The sector constitutes 26.15% of the manufacturing sector based on output, representing the metal production, fabrication, the heavy engineering value chain and the plastics product sub-sector.
- The definition of the sector is as per the Metals and Engineering Industries Bargaining Council (MEIBC).
- The respective weights of the sub-sectors relative to total manufacturing and the rebalanced weights to indicate the sub-sectors weighting in the aggregated metals and engineering sector production index.
- The sector represents the real economy and the backbone of the industrial sector.

Sub-Sector	% of Manfacturing	M&E Weights (%)
Plastic products	2,29%	8,8%
Basic iron and steel products	2,82%	10,8%
Non-ferrous metal products	3,26%	12,5%
Structural metal products	1,98%	7,6%
Other fabricated metal products	3,35%	12,8%
General purpose machinery	3,46%	13,2%
Special purpose machinery	3,87%	14,8%
Household Appliances	0,73%	2,8%
Electrical machinery and apparatus	2,31%	8,8%
Bodies for motor vehicles, trailers and semi-trailers	0,71%	2,7%
Other transport equipment	1,37%	5,2%
Total M & E Sector	**26,15%**	**100,0%**

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The Metals and Engineering Sector

Economic Variable	2020	2021	2022
M&E Production (% growth/contraction)	-12,3%	27,2%	1,6%
M&E GDP (Rand biliion)	115,7	130,6	131,1
M&E GDP (% growth/contraction) (2015 Prices)	-23,9%	-0,8%	-6,5%
Manufacturing Sector Share of GDP (%)	15,0%	15,5%	14,8%
M&E Share of Manufacturing (%) – Value add	27,4%	27,2%	26,2%
M&E Share of GDP (%)	2,5%	2,6%	2,5%
M&E Capacity Utilisation (%)	66,6%	75,5%	75,8%
M&E Sector Input Cost Inflation (%)	12,4%	9,8%	13,1%
M&E Employment (number)	371 955	371 390	374 496
M&E Employment (% growth/contraction)	-5,1%	-0,2%	0,8%
Gross Earnings (Rand billion)	96,6	105,6	107,7
M&E Total Sales (Rand billion)	638,5	809,4	914,2
M&E Export Sales (Rand billion)	256,1	323,5	342,9
Export sales % of total sales	40,1%	40,0%	37,5%
M&E Imports (Rand billion)	347,4	416,6	471,1
M&E Trade Balance (Rand billion)	-91,3	-93,1	-128,2

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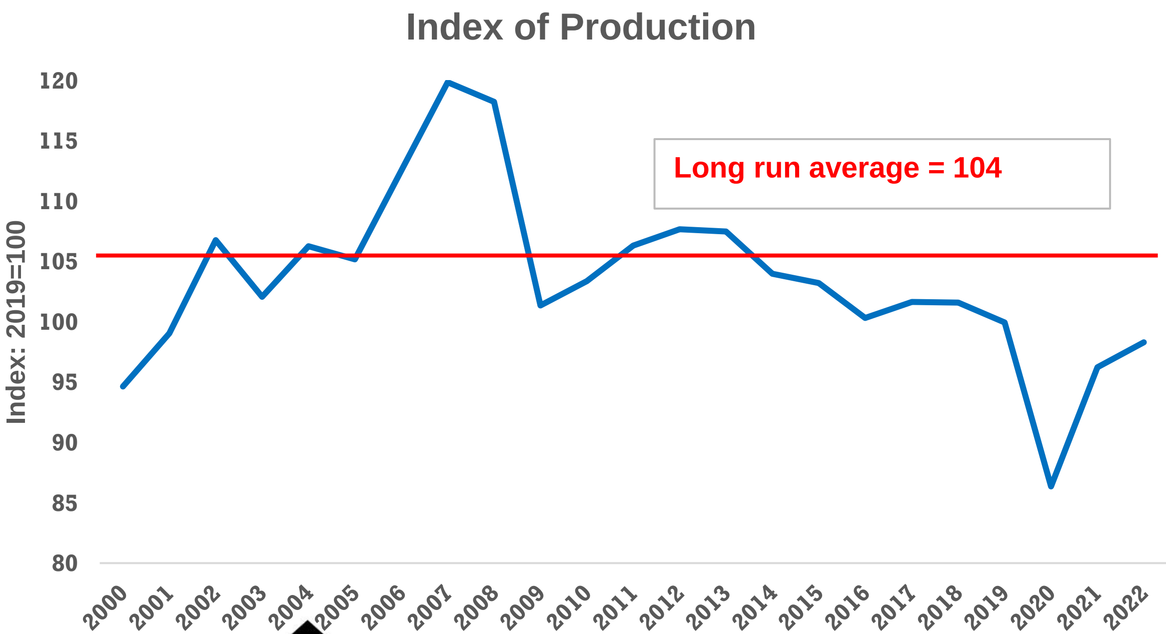
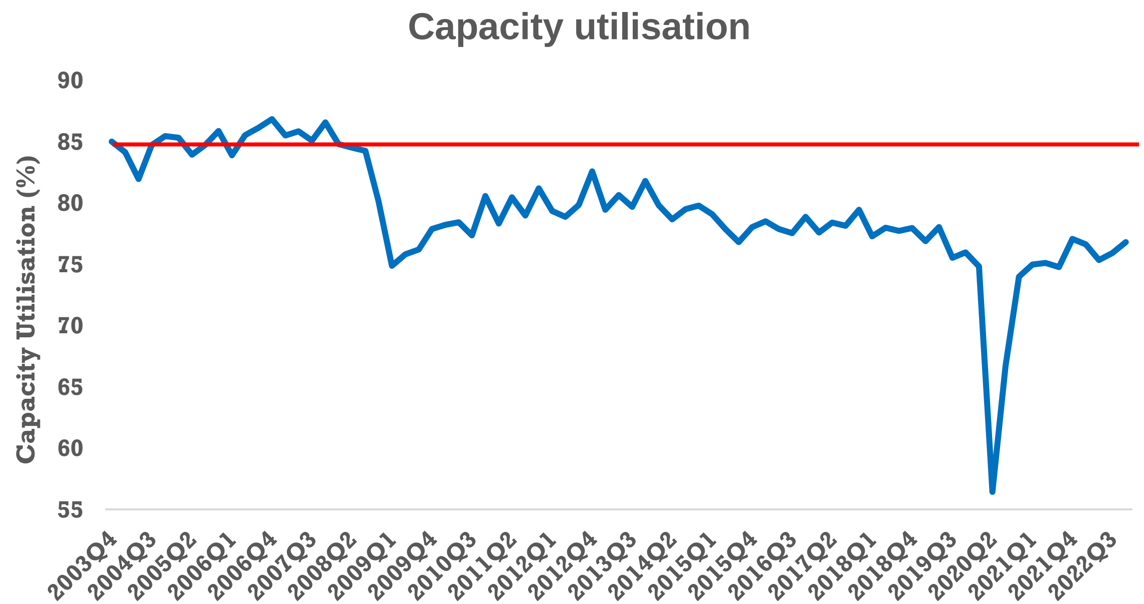
The Metals and Engineering Sector

- The sector has recorded a multi-year contraction in production since the 2008/9 financial crisis, recorded at a - 1,3% (CAGR)
- The bounce back from the Covid-19 pandemic was sharp, however, production is still 1,6% pre-covid levels and 5,2% below the adaptive moving average
- Output adjusted capacity utilisation was recorded at 76,2% (Q3 2023) and notably below the 85% optimal capacity level





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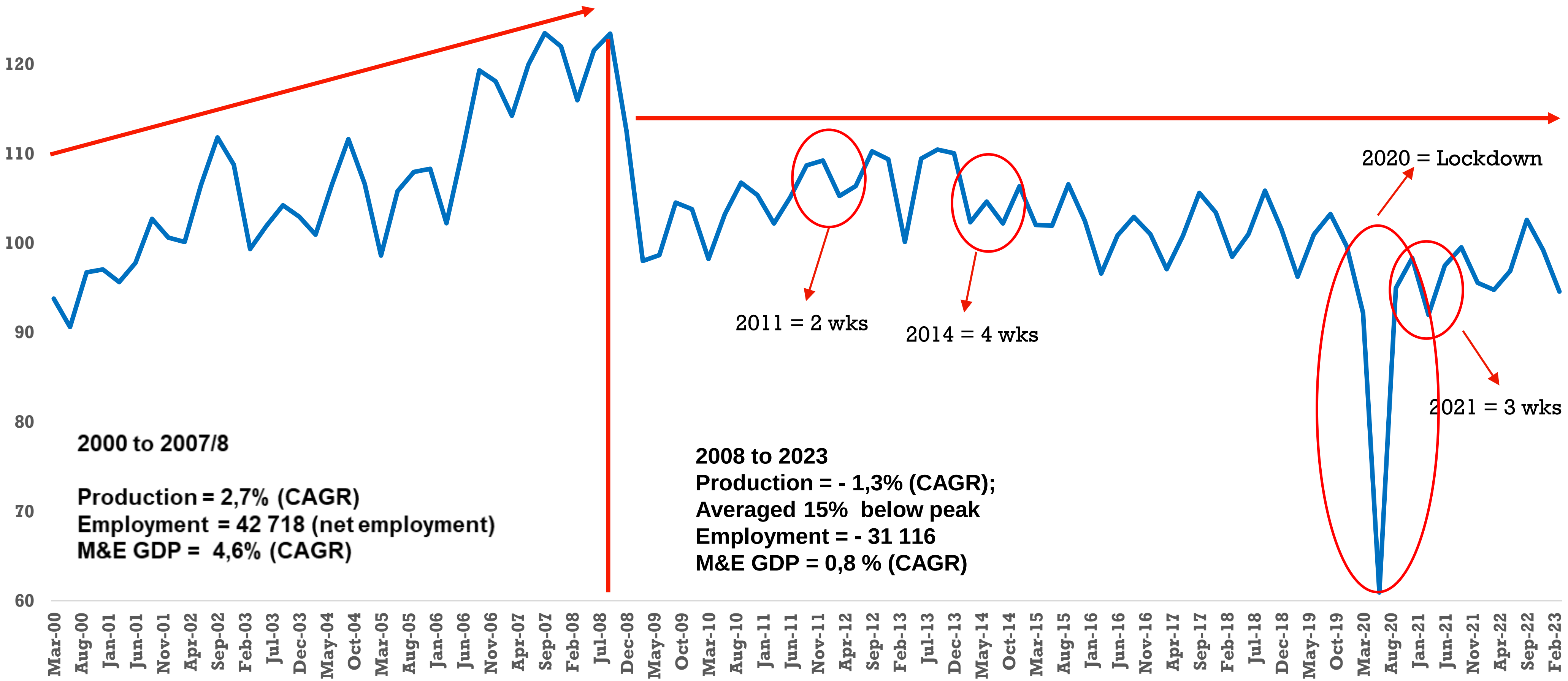
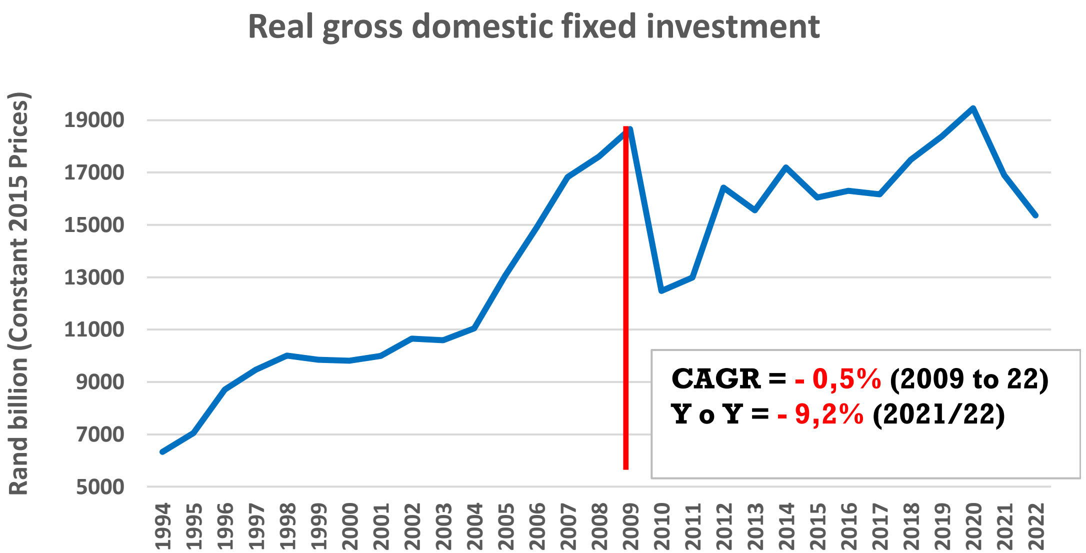
Index of Production M&E

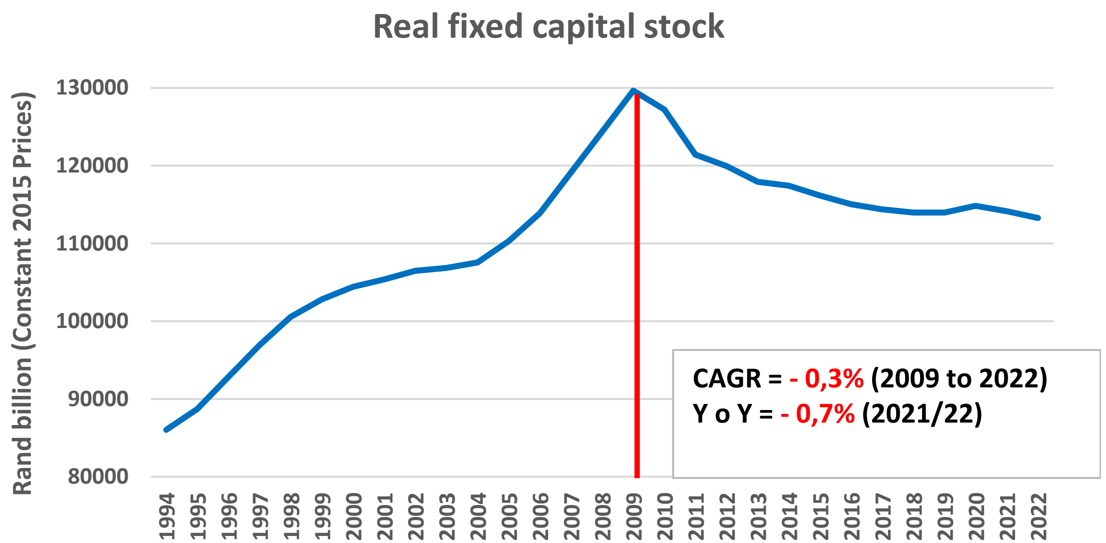


S E I F S A

Investment

- Real gross domestic fixed investment declined by 9,2% in 2022.
- Fixed capital stock has also continued to deteriorate, as net investment has not been sufficient
- This presents long term risks to competitiveness





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Labour Input cost and M&E GDP

- In 2022, the sector employed 374 496 employees, of which 217 618 are factory workers.
- This represented a 0,8% (1064 employees) increase on the prior year
- Compensation of employees amounted to R107,7 billion
- Labour costs make up 18% of total input cost but 79% of metals and engineering sector GDP (classic pareto distribution).

Cost Basket	Total Mining
Intermediate Cost Basket	
Mining & quarrying	30,84%
Wood & wood products	0,44%
Coke & refined petroleum	1,24%
Basic chemicals	0,06%
Other chemicals	0,23%
Rubber products	0,05%
Metal products excluding machinery	23,34%
Machinery & equipment	3,30%
Electrical machinery & apparatus	0,28%
Transport equipment	0,29%
Electricity, gas & water	2,04%
Wholesale & retail trade	7,55%
Transport & storage	3,30%
Finance, insurance, real estate & business services	4,86%
Government and Community	0,33%
Other Intermediate Inputs	0,07%
Imported Intermediate Inputs	21,78%
Total Intermediate Costs (Ex Labour)	**100%**
Intermediate Costs	82%
Compensation of Employees	18%
Total Input Costs	**100%**

GDP Component	%
Compensation of Employees	79,1%
Consumption of Fixed Capital	13,9%
Net Surplus	7,0%
Total GDP	100,0%

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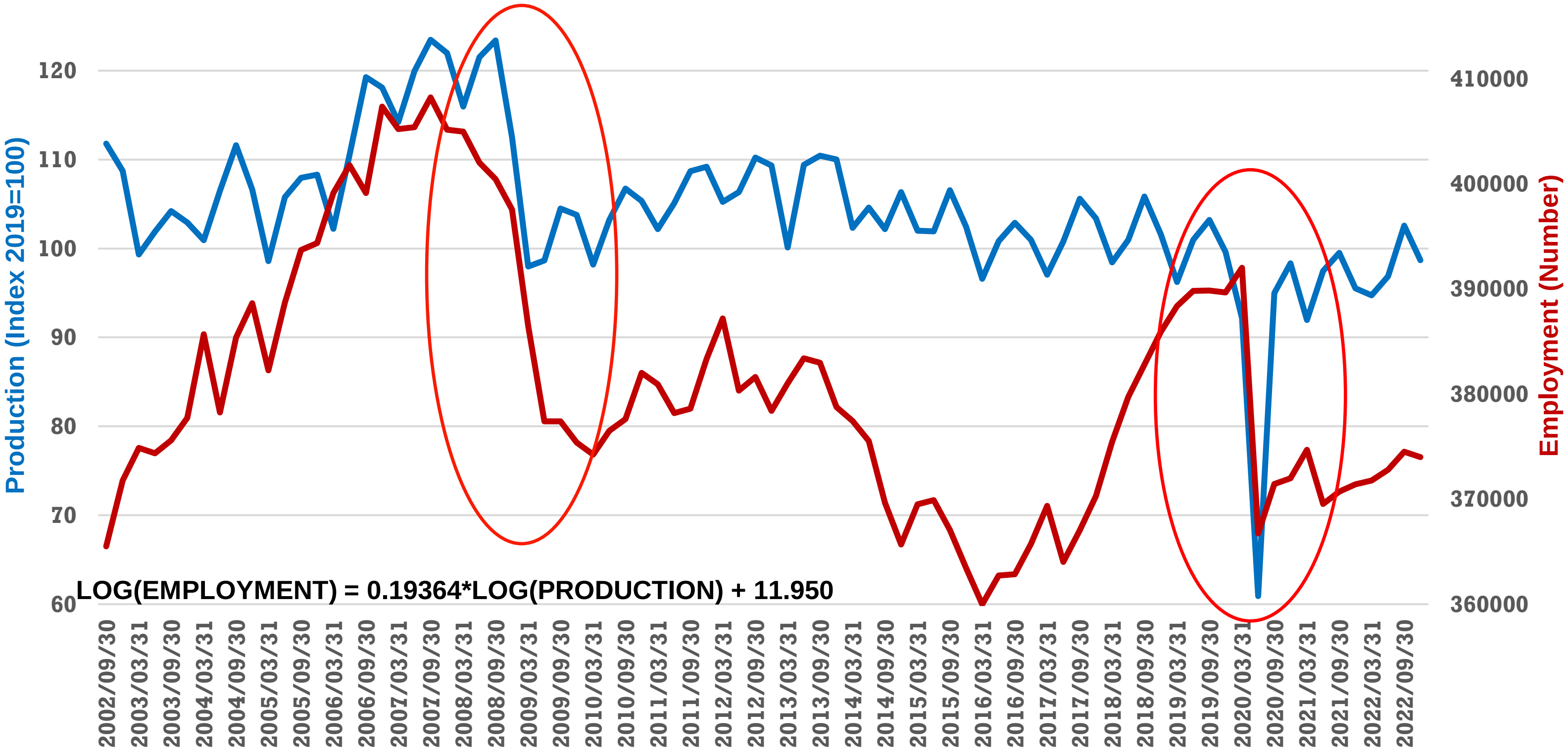
Production and Employment

- The link between production and employment has continued to weaken. Increases in production are no longer as a sufficient condition for increases in employment (5% increase in production for a 1% increase in employment)



Sub-Sector	(Year on Year %) 2022/2021
Plastic products	-0,6%
Basic iron and steel	-0,5%
Basic Non-ferrous metals	-3,4%
Casting of metals	3,6%
Structural metal products	-0,1%
Other fabricated metal products	-1,6%
General purpose machinery	1,8%
Special purpose machinery	2,2%
Household appliances	7,2%
Electrical machinery	0,4%
Parts and Accessories	4,4%
Transport equipment	-7,9%

Dates	Production	Employment	
Dec 2019 to June 2020	-38,87%	-5,89%	
June 2020 to June 2021	60,1%	0,8%	
Dec 2019 to Dec 2022	-0,9%	-4,0%	- 15667 jobs

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Outlook – Factors confronting the sector

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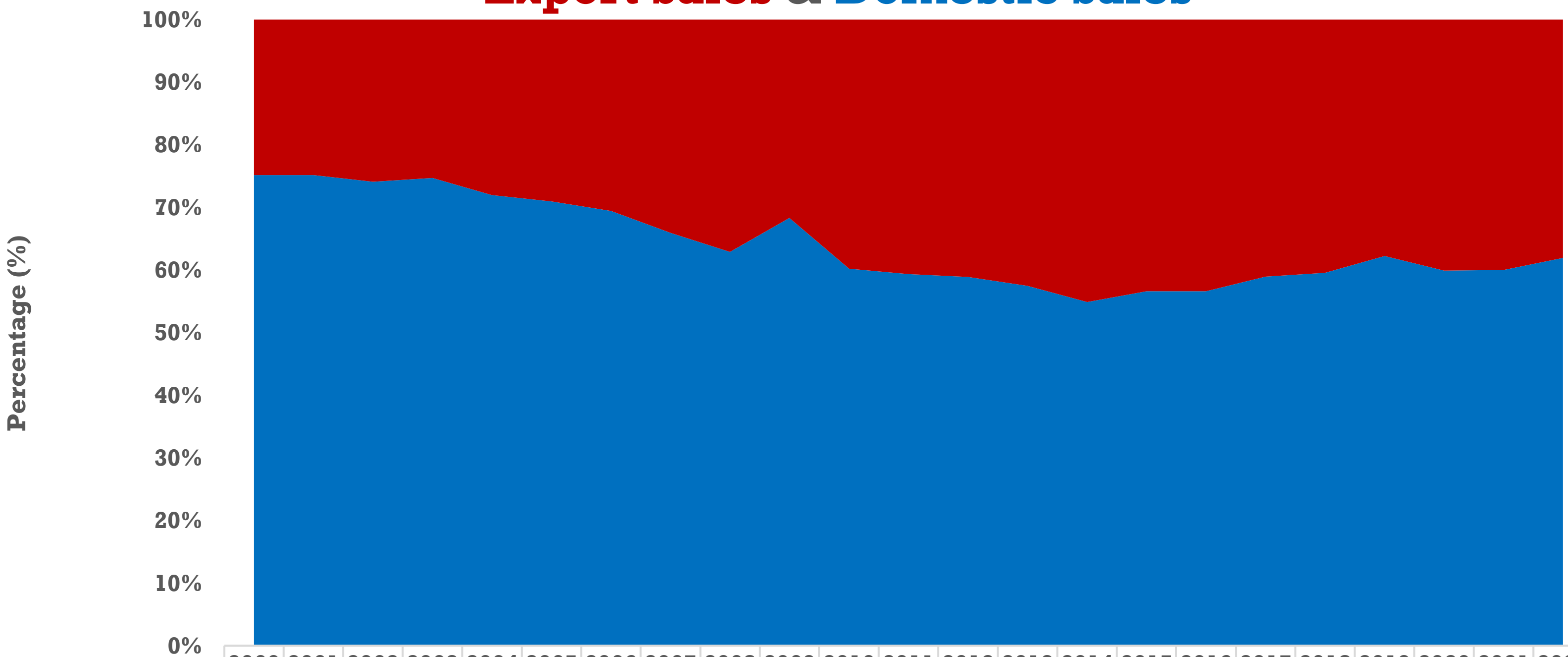
Outlook – Factors confronting the sector

- The structure of the export to domestic sales split has shifted considerably over the last two decades in favour of exports.
- Globalisation has been a dominant economic narrative over the period in question therefore this trend is in line with expectation

Export Sales & Domestic Sales



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Export Sales	25%	25%	26%	25%	28%	29%	31%	34%	37%	32%	40%	41%	41%	43%	45%	43%	43%	41%	40%	38%	40%	40%	38%
Domestic Sales	75%	75%	74%	75%	72%	71%	69%	66%	63%	68%	60%	59%	59%	57%	55%	57%	57%	59%	60%	62%	60%	60%	62%

Continent	M&E Sector Export
Africa	39,6%
Asia	24,7%
Europe	21,8%
Americas	12,2%
Oceania	1,3%
Antarctica	0,0%
Not Allocated	0,4%
Total	100%

Outlook – International

- The global economic environment remains constrained and less supportive for demand in the medium term
- Stubbornly high inflation and higher interest rates for longer are a constraint to economic activity and investment
- Economic activity in SSA has been revised downward as fiscally vulnerabilities, as a result of higher financing costs, manifest (Ghana, Zambia and latest Kenya)
- Chinese economic growth is expected to rebound, however, much of the trade with the country is in primary products
- Geo-political tensions continue to plague the EU
- The United States is also expected to show a slower economic growth reading in the medium term (and concerns of AGOA re. South Africa raise risks to the outlook)
- Domestically supply side challenges (mainly the electricity crisis) have resulted in SA growth being revised down considerably. The same for the M&E sector's outlook

		Projections	
	2022	2023	2024
World Output	**3.4**	**2.8**	**3.0**
Advanced Economies	**2.7**	**1.3**	**1.4**
United States	2.1	1.6	1.1
Euro Area	3.5	0.8	1.4
Germany	1.8	−0.1	1.1
France	2.6	0.7	1.3
Italy	3.7	0.7	0.8
Spain	5.5	1.5	2.0
Japan	1.1	1.3	1.0
United Kingdom	4.0	−0.3	1.0
Canada	3.4	1.5	1.5
Other Advanced Economies[2]	2.6	1.8	2.2
Emerging Market and Developing Economies	**4.0**	**3.9**	**4.2**
Emerging and Developing Asia	4.4	5.3	5.1
China	3.0	5.2	4.5
India[3]	6.8	5.9	6.3
Emerging and Developing Europe	0.8	1.2	2.5
Russia	−2.1	0.7	1.3
Latin America and the Caribbean	4.0	1.6	2.2
Brazil	2.9	0.9	1.5
Mexico	3.1	1.8	1.6
Middle East and Central Asia	5.3	2.9	3.5
Saudi Arabia	8.7	3.1	3.1
Sub-Saharan Africa	3.9	3.6	4.2
Nigeria	3.3	3.2	3.0
South Africa	2.0	0.1	1.8

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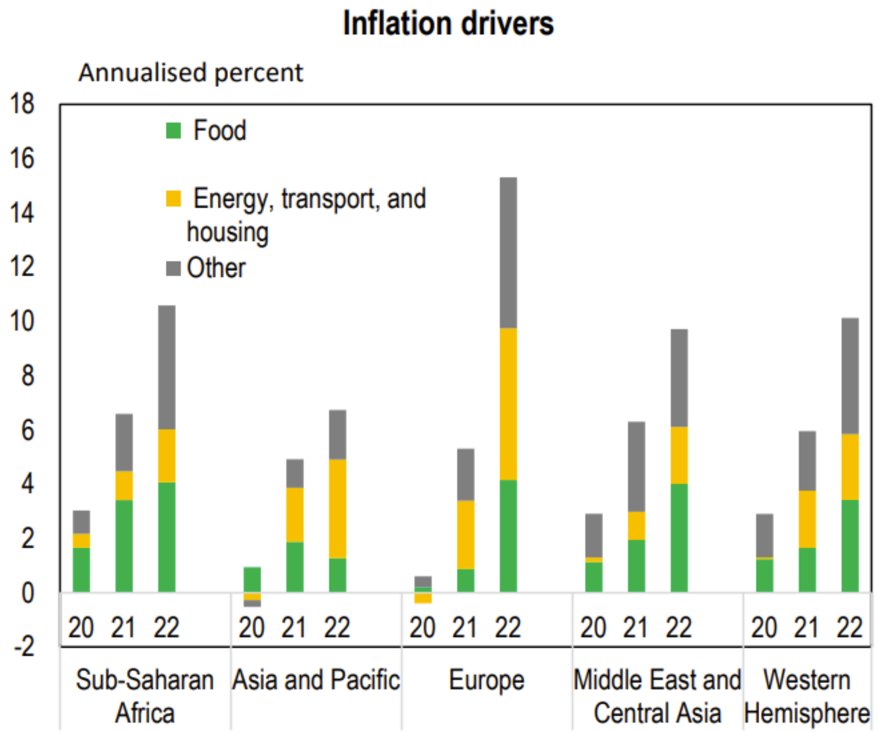
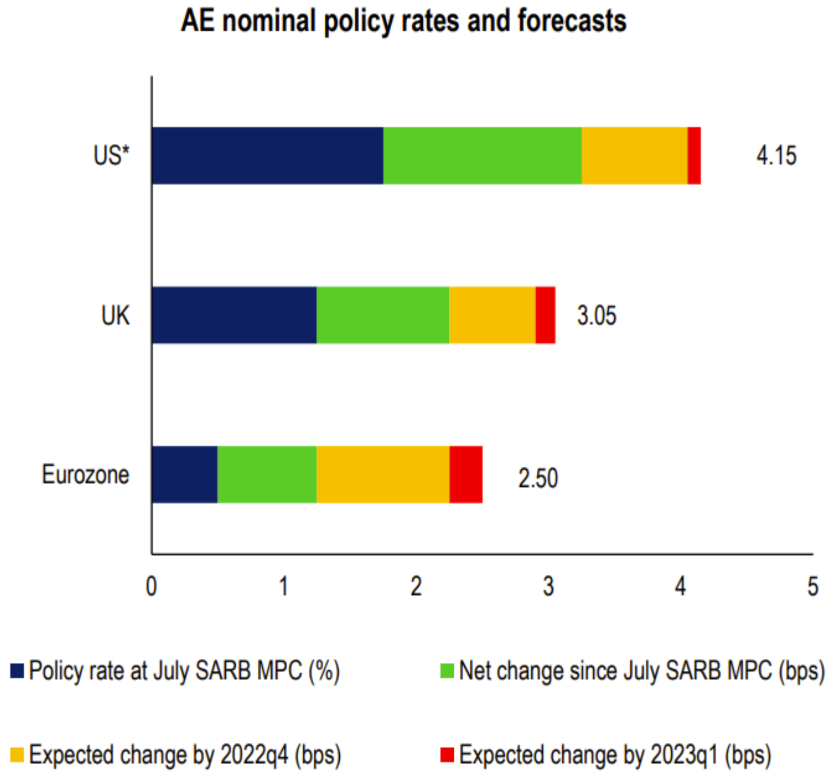
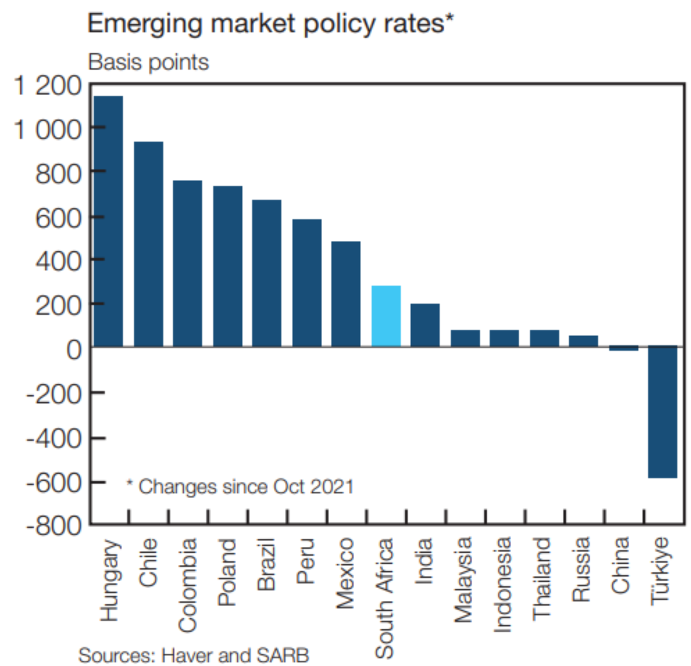
Outlook – International & Domestic

- Inflation remains stubbornly high as it has entrenched from headline inflation to core – higher rates for longer (this is a major global headwind)
- Domestic factors continue to push the exchange rate weaker (over and above interest rate differentials), therefore the SARB will need to continue its tightening path.







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Outlook – Domestic

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Industry INSIDER GOLD

SA's cement industry faces multiple threats

Government's 'massive infrastructure expenditure' plan coming to life would help, as would more strategic tariff protection.

By Roy Cokayne 12 Jan 2023 00:03

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Economy 3 INSIDER GOLD

Auto industry contribution to the economy threatened by power crisis

Component manufacturers hardest hit, with obvious impact on vehicle production and exports.

By Roy Cokayne 18 Jan 2023 00:02

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Loadshedding is hitting South Africa's agricultural sector and food inflation is 'sticky'

ECONOMY

Eskom crisis causes sharp fall in mining production

The price of electricity for the mining industry has increased eightfold since 2008 while consumer prices have doubled

BL PREMIUM

17 JANUARY 2023 - 13:02 *by* THULETHO ZWANE

UPDATED 17 JANUARY 2023 - 21:10

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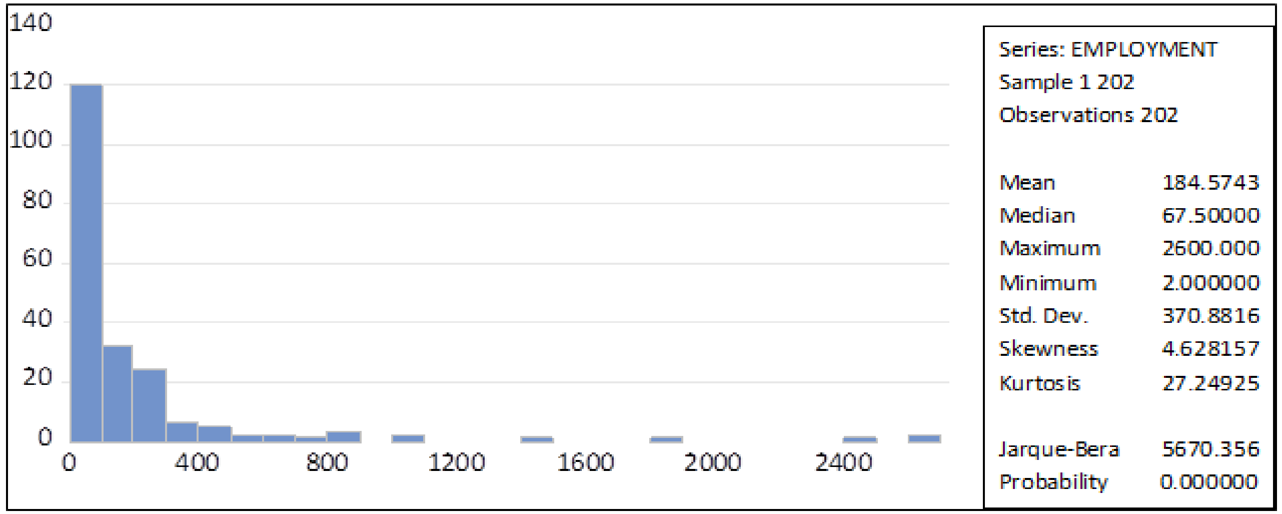
M&E Load Shedding Impact Assessment

- In January 2023, the SEIFSA office was tasked by its board to undertake this load shedding impact assessment with the view that the outcomes will assist the office in the advocacy work in the electricity supply industry.
- The reference period covered in the survey is February 2022 to February 2023
- The employee head count is the pivot variable on which the weighted statistics are consolidated
- Average company size of the companies that responded to the survey is 184, with a good mix between small, medium and large companies

Category	Sample
Number of respondents (companies)	206
Total Employee Count (from responding companies)	37 284
Average number of employees (proxy for company size)	184
% of sample to total SEIFSA member employee headcount	26.5%
% of sample to total M&E Sector employee headcount	9.9%



Load shedding Impact Asses – Employment

EMPLOYMENT	OUTCOME
Number of companies indicating that they have reduced head account as a result of the energy crisis	24,2%
Weighted average employment reduction	-25,32%
Employment reduction (number)	9432
Number of companies that have implemented short time	33,20%
Vulnarable (companies that have already reduced head count AND are working short time)	16,90%
Number of companies that have not reduced head count, but working short time (leading indicator for job losses)	17,30%

- The employment losses, mostly attributable to companies responding to the energy crisis over the reference period, indicate some very concerning trends.
- A quarter of companies indicated that they have had to reduce head count in response to the electricity crisis, by as much as a quarter of their employment, equating to 9 432 people.

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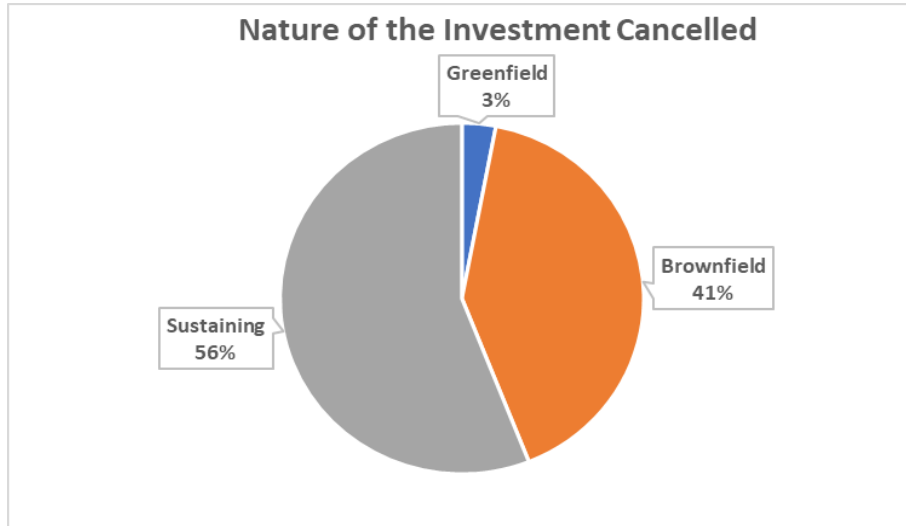
Load shedding Impact Asses – Investment

INVESTMENT	
Companies that have cancelled investment/expansion plans (motivated by the energy crisis)	42,70%
Value of Investment Cancelled	R2,64 billion
Potential jobs not created due to cancelled investments	1620

- It is therefore concerning that 42.6% of companies have indicated that they have cancelled investment and/or expansion plans owing to the uncertainty presented by the electricity crisis.
- The value of these investments amounts to R2.64 billion with the potential of creating 1 620 new jobs. The split of the nature of investment is included below.



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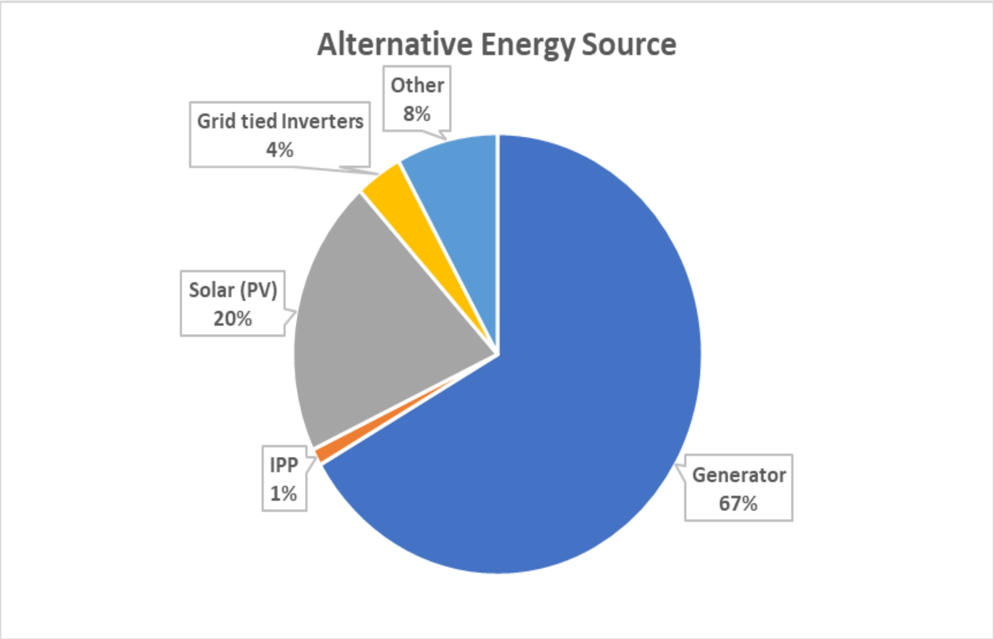
Load shedding Impact Asses – Alternative Energy

ALTERNATIVE ENERGY SOURCE INVESTMENT	
Companies that have invested in alternative energy solutions (in the last 12 months)	79,20%
Capital Cost of alternative energy	R 985,9 million
Extent to which alternative power source meeting consumption	53,60%
Installed capacity (Generator)	116,6 MW
Installed capacity (Solar)	36,2 MW

- The amount invested into alternative energy sources of R985 million is considerable when put into perspective that it accounts for 37% of the value of investments cancelled.
- This again highlights the point that companies are sacrificing scarce long-term capital to fulfil an immediate survival, presenting long-term adverse implications regarding the sustainability of the sector.



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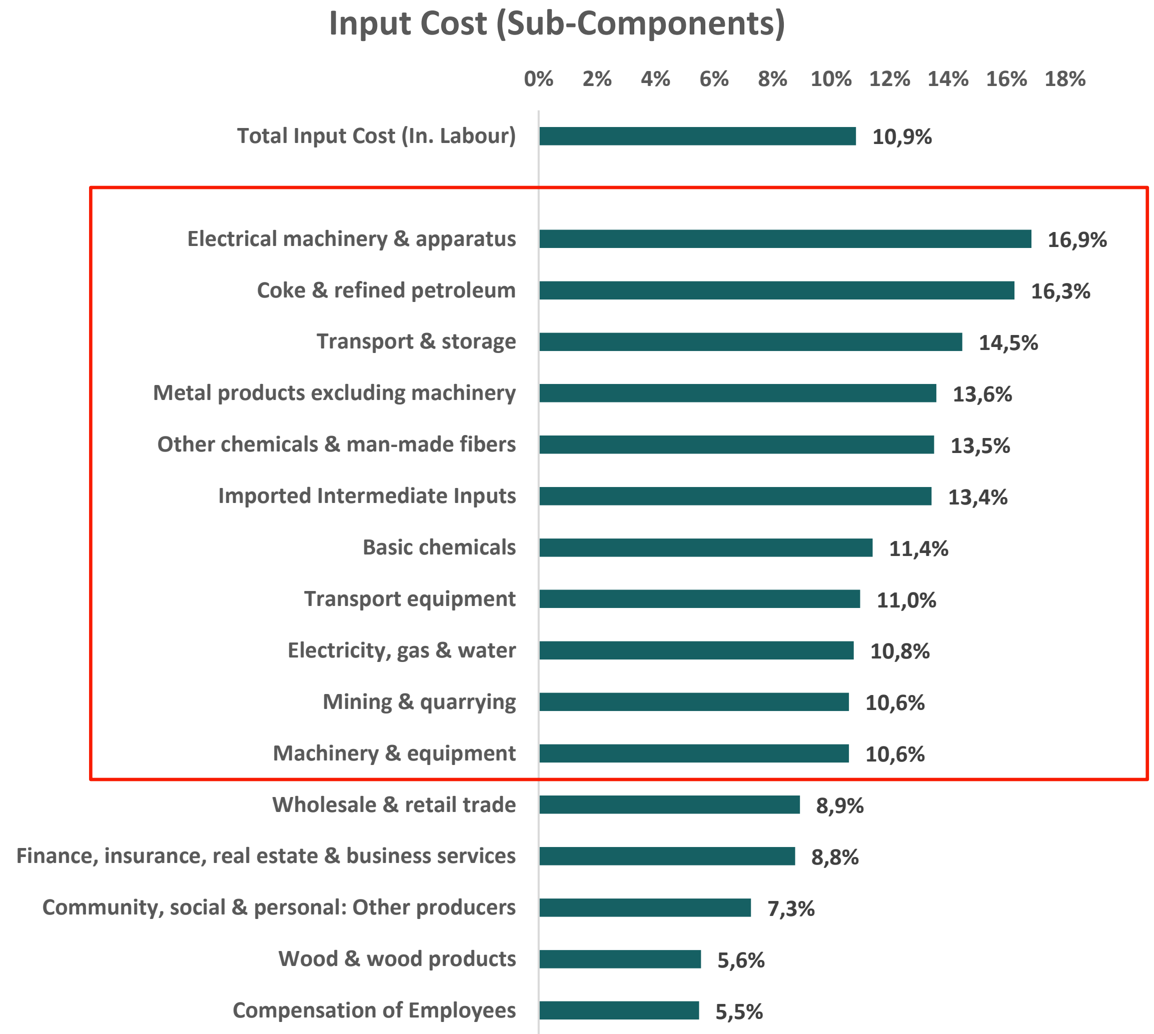
Load shedding Impact Asses – Input Costs

- In April 2023, input cost inflation for the sector was recorded at 10,9% (Y o Y%)
- 64 % of the input cost items increased at double digit rates

Cost Basket	2022	Total Mining
Intermediate Cost Basket		
Mining & quarrying	106 466	30,84%
Wood & wood products	1 527	0,44%
Coke & refined petroleum	4 290	1,24%
Basic chemicals	198	0,06%
Other chemicals	777	0,23%
Rubber products	187	0,05%
Metal products excluding machinery	80 566	23,34%
Machinery & equipment	11 397	3,30%
Electrical machinery & apparatus	962	0,28%
Transport equipment	1 012	0,29%
Electricity, gas & water	7 057	2,04%
Wholesale & retail trade	26 046	7,55%
Transport & storage	11 397	3,30%
Finance, insurance, real estate & business services	16 760	4,86%
Government and Community	1 122	0,33%
Other Intermediate Inputs	242	0,07%
Imported Intermediate Inputs	75 182	21,78%
Total Intermediate Costs (Ex Labour)	**345188**	**100%**
Intermediate Costs	345 188	82%
Compensation of Employees	77 991	18%
Total Input Costs	**423 179,0**	**100%**



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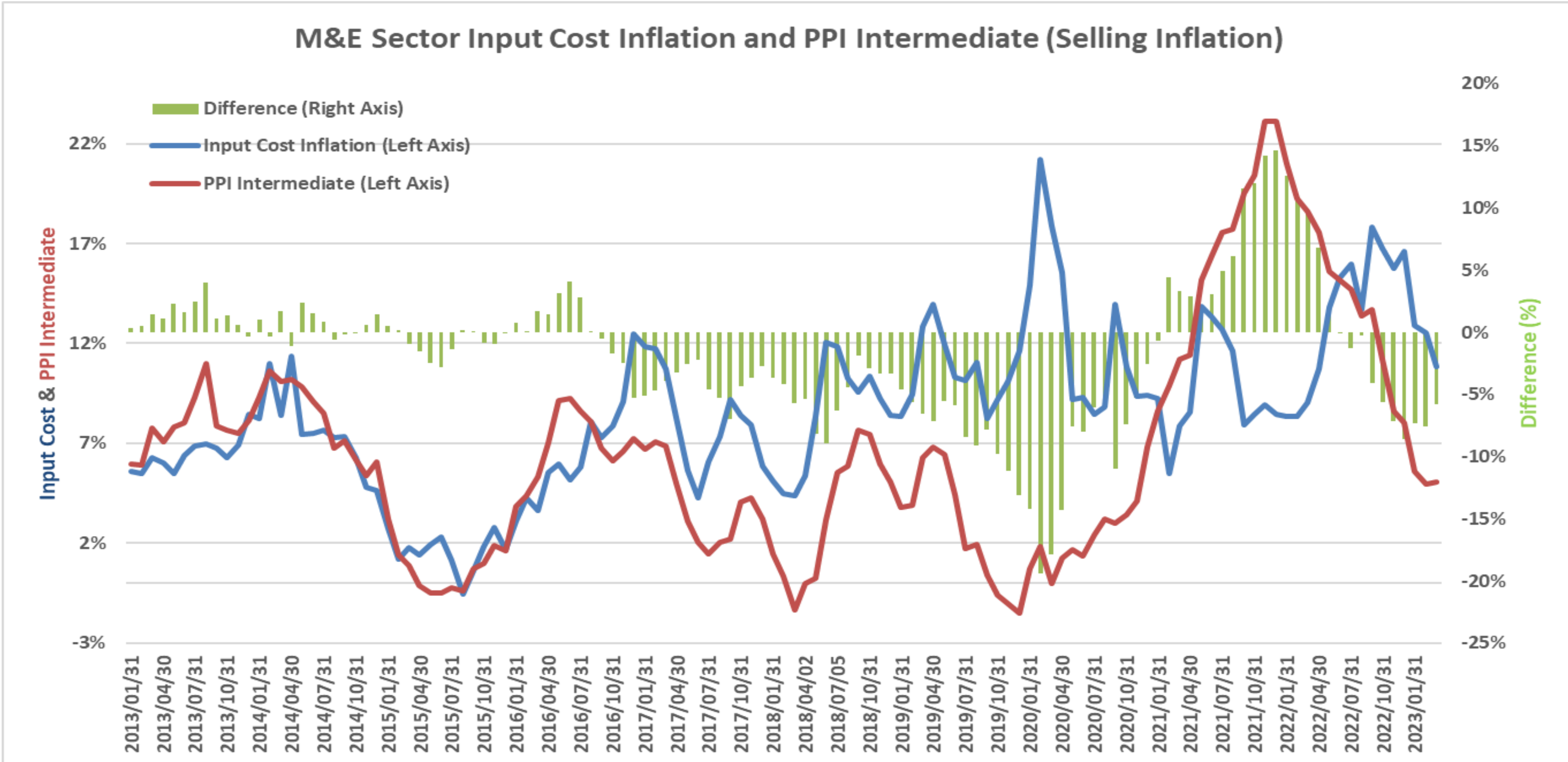
Load shedding Impact Asses – Input Cost and Selling Price Inflation

- Y o Y% Input cost inflation = 10,7%
- PPI Intermediate = 5,2%
- In 2023, input costs are running at 7 percentage points ahead of selling prices (average)
- 2,6 percentage points long run adaptive average



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Load shedding Impact Asses – Input Cost Inflation

- On a weighted average basis, companies have indicated increases to monthly operating costs to the extent of 24.9% from the extensive use of generators.
- This does not bode well for a sector whose input costs are running at 11% (y o y - April 2023).
- Factoring in the results of the survey to the input cost model results in input costs increasing by 1.7 percentage points to 12,7% for the sector.
- The less supportive demand environment means that these companies cannot easily pass on these costs, thereby resulting in considerable margin squeeze and ultimately long-term sustainability.

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Outlook - Production

M&E % = SA GDP + DOMESTIC ECONOMY + EXPORT

DOMESTIC ECONOMY		
61,8%		
Primary Sector	Agriculture	6,8%
	Mining	21,0%
Secondary	Basic Iron and Steel	23,3%
	Machinery and Equipment	19,8%
	Chemicals	4,2%
	Construction	16,7%
	Automotive	4,9%
Tertiary	Government (direct)	3,2%

EXPORT	
38,20%	
Africa	39,6%
Asia	24,7%
Europe	21,8%
Americas	12,2%
Oceania	1,3%
Antarctica	0,0%
Not Allocated	0,4%

M&E Sector (Forecast)	2023 (Initial)	2023 (Revised)
Plastics	4,0%	2,8%
Basic Iron and Steel	0,3%	-15,0%
Non Ferrous	-1,5%	-5,0%
Structural Metal	-4,0%	4,9%
Fabricated Metal	-3,0%	-7,3%
General Machanery	2,0%	-14,4%
Special Purpose Machiney	2,0%	-0,1%
Household appliances	-5,0%	-0,8%
Electrical Machinery	-10,0%	-11,4%
Parts and Accessories (MV)	-3,1%	2,9%
Transport Equipment	-8,3%	2,0%
Total	-2,3%	-5,3%

- The respondents to the survey indicated production declines as much as 34.2% (weighted) as a result of the impact of load shedding
- However, factoring in the results from this survey, the forecast for the 2023 year deteriorates to – 5.3% for the 2023 (a deterioration from the -2.2% originally calculated at the beginning of the year)

Conclusion

- Global economic growth has been downgraded considerably presenting a less supportive economic environment
- Inflation is expected to remain stubbornly high suggesting higher interest rates for longer
- The composition of the export basket, particularly its gearing to the Africa continent presents some opportunities (ACFTA), however, fiscal vulnerabilities are presenting strongly (especially on the back of higher finance costs) which will affect demand from this market
- Domestically, the energy crisis presents the most significant binding constraint for the metals and engineering sector, and also the industries to which it supplies. This is expected to remain the case in the medium term framework
- Companies are investing into alternative energy sources:
  - Trade off between sacrificing scare capital to meet an immediate survival need
  - Generators provide the most practical electricity alternative given the baseload demand, however, this is resulting in sharp increase in operating costs, which is particularly problematic in an environment of constrained economic activity.

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