

How should the localization strategy be drafted in SA's agriculture sector?

The South African government is currently drafting its localization strategy as part of various measures underpinning the Economic Reconstruction and Recovery Plan from the destruction caused by the pandemic. The agriculture, food and beverages sector accounted for an average 8% of South Africa's total imports over the past five years, an annual value of about US\$6.5 billion. This makes it a fairly notable sector to be explored in the process of promoting localization.

The top-ten products in the import list account for 46% of all agriculture, food and beverages imports. These are rice (7%), poultry meat (7%), wheat (6%), alcohol (vodka, whiskies, spirits, gin, rum, etc.) (5%), sugar cane (5%), palm oil (4%), beer from malt (4%), protein concentrates (3%), sunflower oil (3%), and unspecified animal foods (dog or cat food for retail) (2%). This top-ten import list might draw the attention of policymakers, or even persuade them to explore ways of reducing the imports in this category. But this is not where the attention should be. The focus should rather be on relatively small and niche value chains where South Africa might have capabilities of improving domestic production.

As an example, the top-ten imports list comprise of some products that South Africa does not have a conducive climate to increase its production. Such products are palm oil, wheat and rice, which account for 18% of overall agriculture, food and beverages import bill of US\$6.5 billion. With that said, there could be an improvement in the medium to long term in reducing the imports of poultry products, sunflower oil, sugar cane and animal foods through improvements in domestic production. In the case of poultry and sugar industries, the Master Plans and various trade instruments in place are some of the policy steps that seek to support domestic production and reduce import dependency.

Other imported products, which are not part of the top ten, yet notable include live cattle, fruit juices, bottled water, coffee, soybean oilcake, pork products, pasta, honey, beef and sources, amongst others. Closely studying this list and identifying products and value chains that South African business can expand operations on will be essential in the drafting of the localization strategy. Another important aspect will be an increased focus in value chains that are also labour intensive so that the localization strategy can also address the core challenge in South Africa, which is the growing unemployment.

Importantly, South Africa will need to foster the localization strategy while also being cognizant of the trading partners perception of this strategy. The country should minimize the use of trade instruments such as import tariffs, and rather focus more on providing incentives to develop the value chains that will be identified as key. We mention this because of South Africa's agriculture, food and beverages' dependence on export markets. The annual exports over the past five years averaged US\$9.6 billion. Therefore, any trade policy instrument that would signal increased protection for the local sector to South Africa's trading partners might not be a good signal. The localization strategy should rather be packaged and communicated as a way of boosting local production in employment-intensive subsectors that will help address the growing unemployment in the country.

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Wandile Sihlobo

Chief Economist
+27 12 807 6686
wandile@agbiz.co.za

www.agbiz.co.za

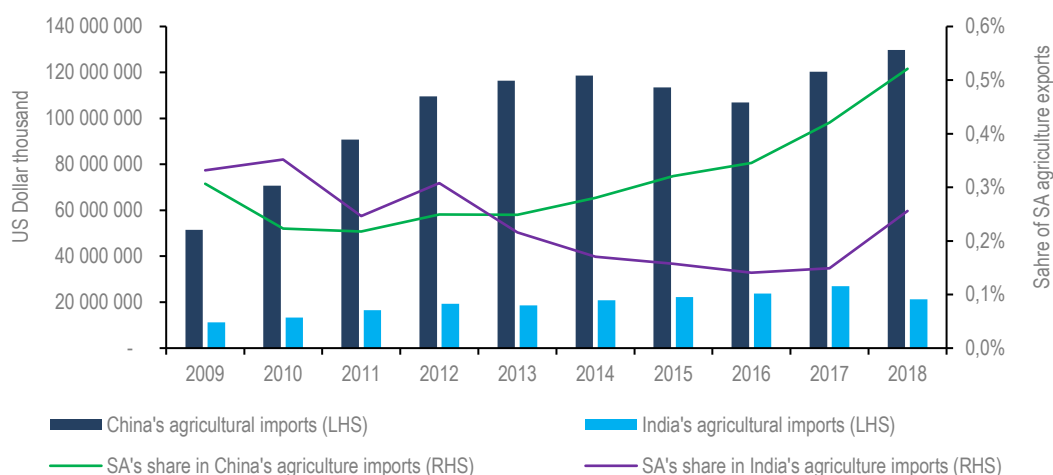
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Moreover, the same level of energy will be required for expanding the export markets for products that South Africa currently produces. In the case of agriculture, the horticulture sector is seeing growing volumes in fruits such as citrus and more volumes will be harvested in the coming years and there will need to be a market for these products. In addition to the typical EU markets that South Africa participates in, the needs to be increased attention in gaining market access for South Africa's agricultural products in markets such as India and China, who have a growing population and where South Africa's agriculture, food and beverages presence is still minimal. South Africa's share in India and China's agriculture, food and beverages imports is a mere 0.5% and 0.3%, respectively, as illustrated in Exhibit 1. Both these countries are part of the BRICS group, which provides a mutual political space for South Africa to promote the desire to increase market access for these products. Such ambition, however, will need to be aware of the reciprocities that these countries might need and how important such industries will be for the South African economy. Balancing these will be a task of the policymakers.

In sum, there is room for the localization strategy in South Africa's agriculture, food and beverages sector. Yet, the focus needs not to be primarily on the top-ten imported products, rather on niche and labour-intensive value chains that haven't been explored to full potential. Determining such value chains will require deep research which the Department of Trade, Industry and Competition should lead, along with private sector players. The use of trade policy instruments should be careful thought-out and not lead to a situation where trading partners will deem South Africa as being a protectionist country.

Exhibit 1: South Africa is still a small player within India and China agriculture markets



Source: Trade Map, Agbiz Research

Weekly highlights

The October uptick in South Africa's food price inflation may be a temporary blip

South Africa's food price inflation accelerated to 5.6% y/y in October 2020 from 4.2% in the previous month, and well above the average of 4.4% for the first nine months of the year. This was broad-based and reflective of the agriculture commodity price increases we have observed in the past few months. In this section we highlight a few products with higher weighting on the food price inflation basket, namely: (1) bread and cereals, (2) meat, (3) vegetables, (4) milk, eggs and cheese, and (5) oils and fats.

First, the increases in bread and cereals price inflation mirrors, although to a limited extent, the surge in grains prices that's been underway over the past couple of months. The South African grains prices were pushed higher mainly by the weaker domestic currency, stronger

demand in the Southern Africa region and also the Far East, as well as generally higher global grains prices, which are, in turn, supported by strong demand from China. This happened despite the country having received its second-largest maize harvest in history in 2019/20, about 15.4 million tonnes.

Second, the decline in slaughtering rate of red meat (aside from cattle), along with the recent increase in poultry import tariffs are amongst the factors that have provided an increase in meat price inflation. Moreover, there is also an element of base effects as meat price inflation was fairly subdued in 2019. Third, South Africa had a fairly good season in field crops and horticulture perspective, but that was only at the aggregate level. Some important vegetables which include potatoes saw prices rising in the past few weeks because of lower harvest in central and northern regions of South Africa. But this is all temporary. The outlook for the 2020/21 production season is positive, with prospects of La Niña rains.

Fourth, the increase in milk, eggs and cheese category of the food price inflation was a surprise as total raw milk purchases and supplies in the country have generally been higher than the previous five years, according to reports from the South African Milk Processors' Organisation. Perhaps, this somewhat reflects the global dynamics, where milk prices have generally been at higher levels compared to 2019, according to the FAO Dairy Price Index.

Lastly, the acceleration in oils and fats price inflation is partly influenced by the weaker domestic currency in the past few months. South Africa remains a net importer of vegetable oils and therefore exposed to exchange rate risks. Moreover, the global vegetable oil prices have generally been at higher levels in recent months, boosted, in part, by the growing demand from China. These dynamics influenced price levels that we observed in the South African market. Nevertheless, this is all history, and the interest is probably on the outlook view going into 2021. We are generally optimistic that South Africa's food price inflation might not exceed an average of 5% y/y in 2021. The expected La Niña rains could help boost the domestic harvest; and importantly, improve the harvest across Southern Africa. This could subsequently lessen pressure and demand for South African products. This, in turn, could lead to softer agricultural commodities prices and contain food price inflation at comfortable levels. In addition, the strengthening domestic currency also bodes well for products the country imports such as vegetable oils and fats.

Exhibit 2: South Africa's food price inflation



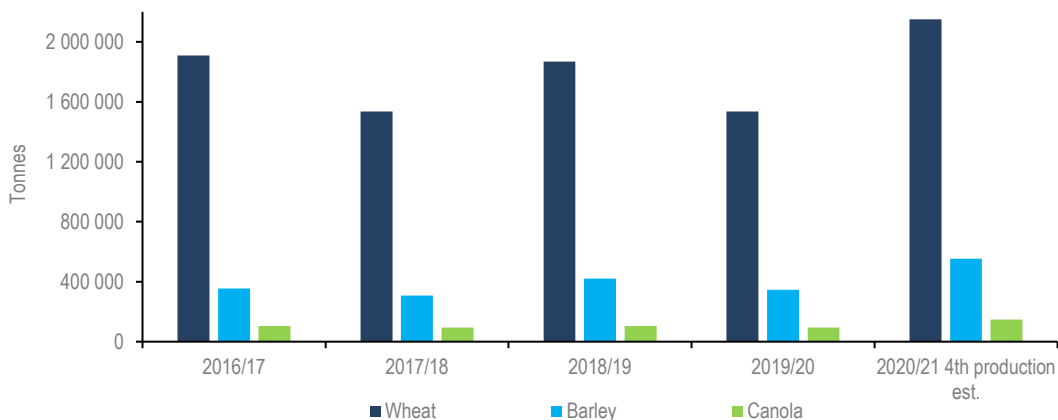
Source: Stats SA, Agbiz Research

South Africa's winter crop production forecasts revised up

The Crop Estimates Committee lifted its production estimates for wheat, barley and canola 1%, 5%, 8%, respectively from October 2020 to 2.15 million tonnes, 552 766 tonnes, and 148 456 tonnes. These will be the largest harvest on record for barley and canola, while for wheat it will be the largest harvest in 19 years.

Nevertheless, the increase in production will have minimal impact on prices, specifically wheat, of which South Africa is a net importer. And thus, wheat prices largely depend on developments in the global market, along with domestic currency movements. Having said that, while South Africa will remain a net importer, the volume will fall notably compared to the previous year. The most recent estimates from the South African Grain and Oilseeds Supply and Demand Estimates Committee suggest that wheat imports could fall by 18% y/y to 1.54 million tonnes, which bodes well for the agricultural trade balance. Meanwhile, the recovery in barley production will see South Africa being a net exporter. Canola and oats will mainly be for domestic consumption.

Exhibit 3: Winter crop production



Source: CEC, Agbiz Research

Data releases this week

This is a relatively quiet week on the agricultural calendar. On the global front, we start the week with the **US weekly crop progress report** which will be released later today by the United States Department of Agriculture (USDA). The report will mainly focus on winter wheat conditions, as the maize and soybean harvest process has been completed in the US.

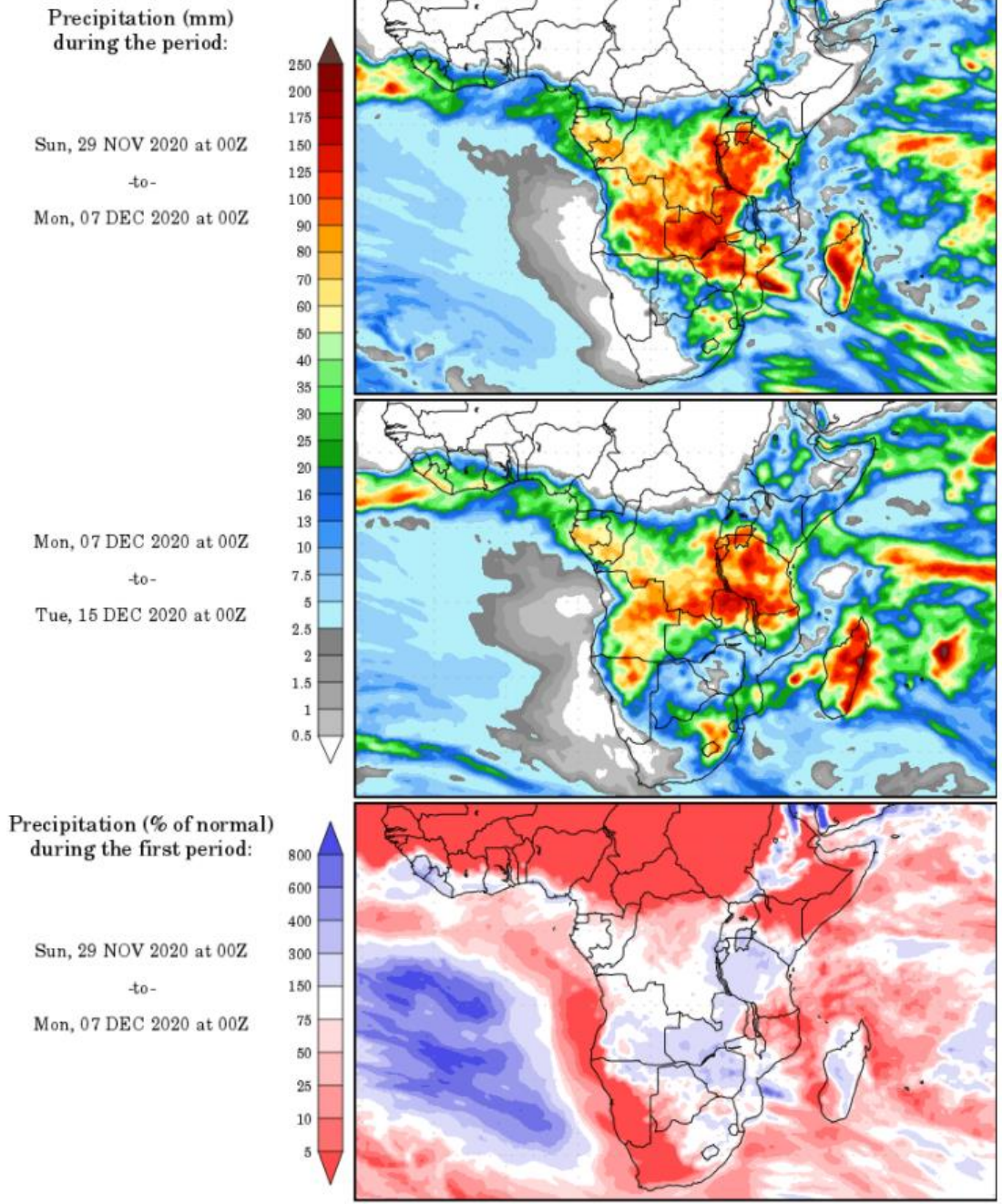
On Thursday, the USDA will release the **US weekly export sales data**, which also help in tracking the agricultural trade activity between the US and China. In recent weeks, China has been buying large volumes of both maize and soybeans, and the demand is expected to hold as the country rebuilds its pig herd which was devastated by African swine fever. In October 2020, the size of China's national pig herd is up by 27% y/y, according to China's Agriculture Ministry.

On the domestic front, on Wednesday, the South African Grain Information Service (SAGIS) will release the **weekly grain producer deliveries data** for the week of 27 November 2020. This data covers both summer and winter crops. But the focus has shifted towards winter crops whose harvest is underway. In the week of 20 November 2020, about 312 350 tonnes of winter wheat were delivered to commercial silos. This placed the 2020/21 wheat producer deliveries at 695 898 tonnes, which equates to 32% of the expected harvest of 2.15 million tonnes.

On Thursday, SAGIS will release the **weekly grain trade data** also for the week of 27 November 2020. In the previous week of 20 November 2020, South Africa's 2020/21 total maize exports were at 1.75 million tonnes, which equates to 70% of the seasonal export forecast (2.50 million tonnes). In terms of wheat, South Africa is a net importer, and in the week of 20 November 2020, the eight consignment for the 2020/21 marketing year had arrived, putting the total imports at 418 941 tonnes. This equates to 27% of the seasonal import forecast of 1.54 million tonnes.

Exhibit 4: South Africa's precipitation forecast

Precipitation Forecasts



The next two weeks could bring higher rainfall over the summer crop producing regions of South Africa.

Source: George Mason University (wxmaps)