

Thinking creatively about a strategy for the Karoo sheep industry

On invitation from our members - Cape Wools, BKB, and OVK - we attended the Karoo Winter Wool Festival over the weekend. The festival was hosted in Middelburg, the Karoo region of the Eastern Cape. It was an excellent event, showcasing not only the value chain activities of the South African sheep industry but also the rich Karoo heritage.

We got an opportunity to share views in the speaking sessions. We used the occasion to reflect on the growth prospects of South Africa's agriculture with a focus on the activities of the Karoo region. The outlook for South Africa's agriculture is positive in the near term, and we forecast a 3% growth in the sector's gross value added this year (from 0,9% in 2022). This is all because of favourable rains during the summer season that supported crop production and grazing veld.

However, the medium-term outlook is uncertain. We have an El Niño on the horizon, which we believe may not be as devastating as the 2015/16 episode. But more issues are conspiring against the sector. These include persistent episodes of load-shedding, higher input costs, rising protection in some export markets, animal disease outbreaks, rising interest rates, intensified geopolitical tensions, ongoing weaknesses in municipal service delivery and freight, rail and port networks, and the deterioration of rural roads. These issues have kept the sentiment in the sector downbeat for some time. For example, the Agbiz/IDC Agribusiness Confidence Index was unchanged at 44 points in the second quarter of this year. This marked the third consecutive quarter below the neutral 50-point level, implying that agribusinesses remain downbeat about business conditions. Therefore, we need to address these issues to ensure the sector continues to prosper in the medium to long term.

Karoo specific issues

Regarding the Karoo specifically, our message focused on how South Africa can promote agricultural growth in this sparse and very remote region by unlocking its natural assets and the heritage of the Karoo. There are various opportunities to pursue, including the region's food heritage, high-end fashion and agritourism. Exploring and expanding these opportunities would ensure that the farmers in the Karoo can diversify and improve their revenue streams by not solely depending on export markets of wool. High dependence on wool exports can come with challenges, such as when China temporarily banned the exports of South African wool, leading to a 22% y/y decline in South Africa's wool export earnings (see Exhibit 1).

So what to do? At the very basic level, we need to eat to live, and food carries the smells and tastes of places, families and histories. It matters to people what, when and how they eat, and sometimes where their food comes from. Thus, food heritage is linked to ecology, sustainability, health and origin. Exploring food in the context of heritage can raise interesting questions about identity, people's relationship to the land, the availability and quality of local produce, poverty and health. This would not be the first time such is done. Various countries in Europe continue to benefit from their food heritage. For example, in 2010, Spain, Greece, Italy, Morocco, France, and Mexico successfully nominated the

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

www.agbiz.co.za

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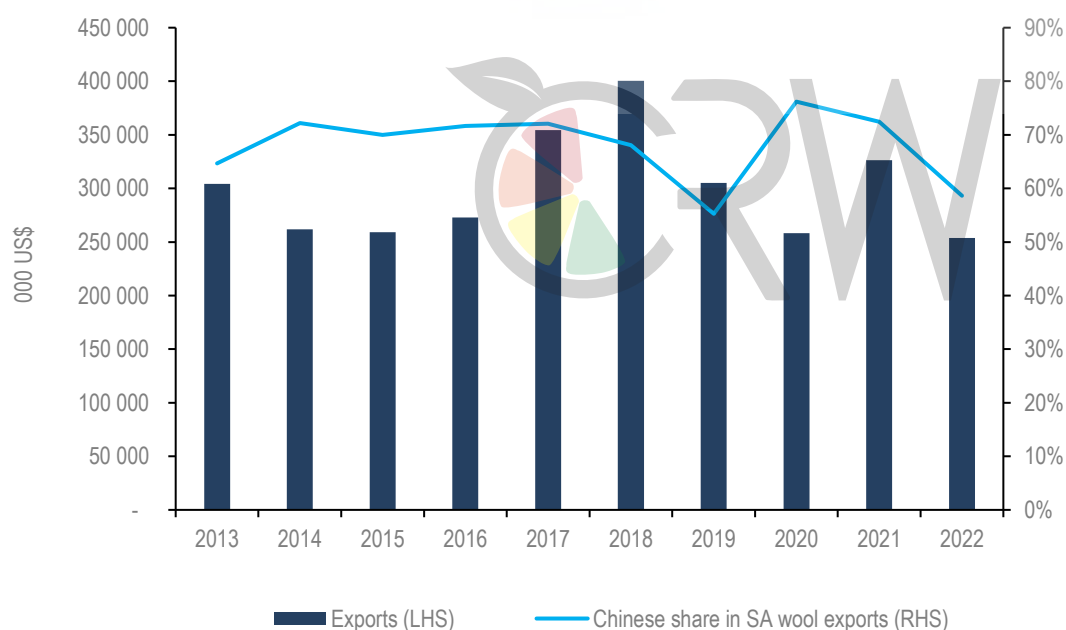
Mediterranean Diet, Mexican Cuisine and the Gastronomical Meal of the French as part of the Intangible Cultural Heritage of Humanity under the UNESCO Convention.

Therefore, food heritage offers obvious spin-offs in product development, economic value and tourism. We see elements of these foreign food heritage products on the shelves of our leading supermarkets, but somehow these same retailers do not showcase enough of our own heritage. The Karoo is South Africa's hinterland and one of the natural assets of the Northern, Eastern and Western Cape because of its pristine natural beauty, clean air, peace and quiet. It, therefore, has a strong commercial and marketing value which farmers can utilize. Still, the name "Karoo" has been widely misappropriated by various individuals and businesses, misrepresenting products such as "Karoo Lamb". Some retailers may be sourcing large volumes of lamb from the Karoo without acknowledging the origin and heritage of the product.

So, the Karoo region farmers should (1) reclaim the Karoo name by protecting the name and identity through the registration of a Geographical Indication (GI), (2) Lift Karoo Lamb out of the meat commodity mark and create its own pricing and distribution structure, (3) Create a different 'price point' for Karoo Lamb, (4) Enforce quality and food safety standards, (5) Ensure producer control of supply chain and form strategic partnerships with abattoirs, packers and wholesalers, (6) Prevent overdominance by major retail chains, (7) Educate consumers about quality and value of Karoo Lamb.

South African consumers are already buying European GI products in our supermarkets – many cheeses and hams carry the famous EU GI logo, and the retailers sell these famous names protected by EU legislation. South Africa also introduced similar regulations in 2019 and enabled Rooibos and now very soon Karoo Lamb as South Africa's first GI products. The ongoing efforts to promote Karoo Lamb as a GI have also brought about interesting spin-offs in relation to the fashion industry, which can add tremendous value to the Karoo. The global fashion industry, especially the luxury goods and clothing industry, is now demanding wool, mohair and leather from the Karoo because of the Karoo quality, reputation and heritage.

Exhibit 1: South Africa's overall wool exports



Source: Trade Map and Agbiz Research

Weekly highlights

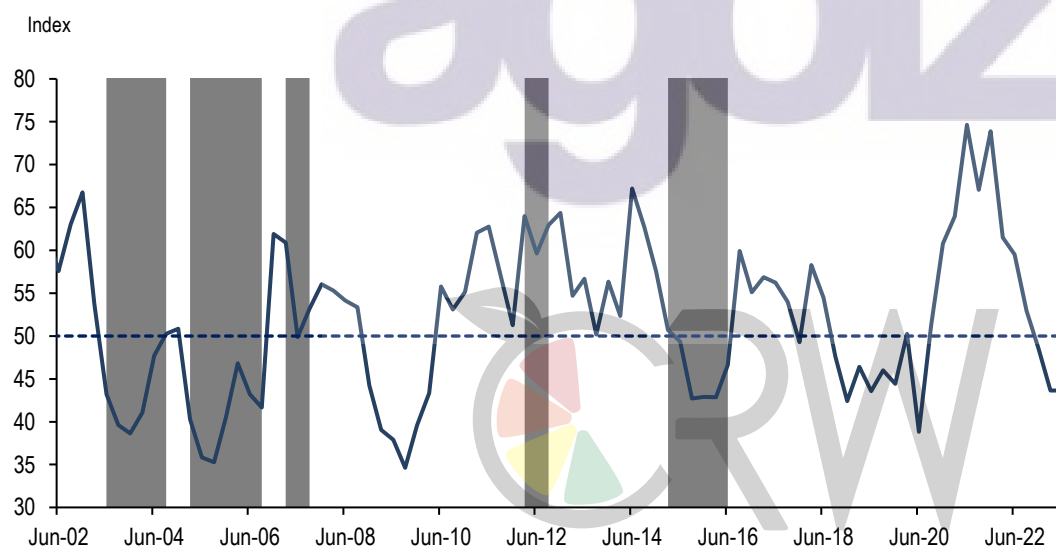
Agbiz/IDC Agribusiness Confidence Index remains subdued in Q2,2023

After a 5-point decline to 44 in Q1 2023, the Agbiz/IDC Agribusiness Confidence Index (ACI) was unchanged in Q2. The ACI level in the first two quarters of this year is the lowest since Q2 2020 when Covid-19 lockdown restrictions were first implemented. Notably, the second quarter reading marks the third consecutive quarter below the neutral 50-point level, implying that agribusinesses remain downbeat about business conditions.

Intensified geopolitical tensions, unfavourable draft water regulations, persistent episodes of load-shedding, rising interest rates, poor road conditions and ongoing weaknesses in municipal service delivery were the key factors survey respondents cited as their prime concerns. This survey was conducted in the first two weeks of June, covering businesses operating in all agricultural subsectors across South Africa.

Essentially, the Agbiz/IDC ACI's Q2 results show persistent concerns amongst the agriculture and agribusiness role-players about the economic conditions of this sector. Still, there remains great potential for growth in the sector, but that can only materialize if there is a favourable policy environment and supporting infrastructure. The recent draft water regulations are an example of policy missteps that South Africa would do well to avoid. Importantly, addressing the biosecurity issues, improving roads, and opening more export markets are key to improving sentiment and the sector's fortunes.

Exhibit 2: Agbiz/IDC Agribusiness Confidence Index¹



Source: Agbiz Research, South African Weather Service

(Shaded areas indicate periods when rainfall across South Africa was below the average level of 500 millimetres)

¹ The Agbiz/IDC Agribusiness Confidence Index reflects the perceptions of at least 25 agribusiness decision-makers on the 10 most important aspects influencing a business in the agricultural sector (i.e. *turnover, net operating income, market share, employment, capital investment, export volumes, economic growth, general agricultural conditions, debtor provision for bad debt and financing cost*). It is used by agribusiness executives, policymakers and economists to understand the perceptions of the agribusiness sector, and also serves as a leading indicator of the value of the agricultural output while providing a basis for agribusinesses to support their business decisions.

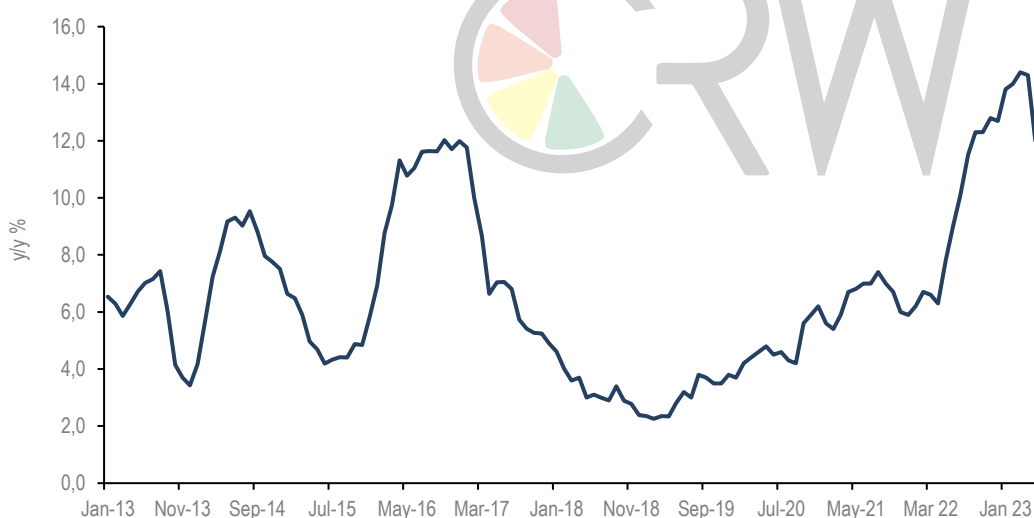
SA consumer food inflation decelerates

South Africa's consumer food inflation decelerated to 12,0% in May 2023 from 14,3% in the previous month. The food product prices primarily underpinning this moderation are bread and cereals; meat; fish; oils and fats; and fruit.

We expect consumer food inflation to continue decelerating in the second part of the year. As we stated in our previous notes, the red meat prices, which have softened at the farm level, should continue on this trend at the retail level in the coming months. Fruit prices will likely remain on a similar declining trend as the harvest across South Africa continues, and domestic supplies have improved. The decline in "oils and fats" products is in line with what we are seeing in the global environment, as South Africa still imports its palm oil usage. For example, in May 2023, the FAO's vegetable oil price index was at 119 points, down 48% y/y. Still, the relatively weaker rand exchange remains an upside risk to prices of imported products that could somewhat reduce the gains for local consumers. This mainly applies to rice and wheat, as South Africa is a net importer of these products. Moreover, the relatively lower farm-level maize prices will filter into the retail products mainly in the year's second half. There is a lag between three and five months between farm and retail prices of some products. The base effects will also help soften consumer food inflation in the year's second half.

The impact of load-shedding may continue to influence prices for the next few months. Still, the various interventions to ease the load-shedding burden on farmers, such as load curtailment, expansion of the diesel rebate to the food value chain, and, most recently, the launch of the Agro-Energy Fund, all support the production conditions. Hence, the 2022/23 maize harvest is estimated at 16,1 million, 5% higher than the 2021/22 season's harvest and the third-largest harvest on record. Soybeans harvest could reach a record 2,8 million tonnes. Other field crops and fruits also show prospects for decent harvest this season. With that said, the effectiveness of these energy support measures differs across farming enterprises and food companies, and the costs to food producers, mainly those not fully benefiting from the above efforts, remain high because of all the necessary mitigation measures.

Exhibit 3: South Africa's consumer inflation food price



Source: Statistics South Africa and Agbiz Research

Data releases this week

This week's agricultural data calendar is quite busy, with several domestic releases. But if we start with the global view, today, the USDA will release its weekly update of the **US Crop Progress Report**. The US farmers have completed summer crop planting, thanks to drier weather conditions in the past few weeks. The focus is now shifting to crop conditions. For example, on 18 June, about 96% of the US maize planted had emerged compared with 93% in the corresponding period a year ago. Of this maize crop, about 55% was rated good/excellent, which is down significantly from the 70% rating in the same week in 2022. This poorer crop rating is mainly due to dryness in some regions of the US. In addition, about 92% of the planted soybean crop had already emerged, compared with 81% on 18 June 2022. Of this crop, 54% was rated good/excellent, also down significantly from the 68% rating in the same week in June 2022. Similarly to maize, the drier weather conditions have thus far negatively affected the US soybean crop growing conditions. The USDA will release its weekly **US Grains and Oilseeds Exports** data on Thursday.

On the domestic front, the Crop Estimates Committee will release South Africa's **fifth production forecast for summer field crops for 2023** on Tuesday. We don't foresee major changes in the current estimates. If anything, there could be upward adjustments in crop forecasts. The feedback we continue to receive in areas that have harvested is broadly positive.

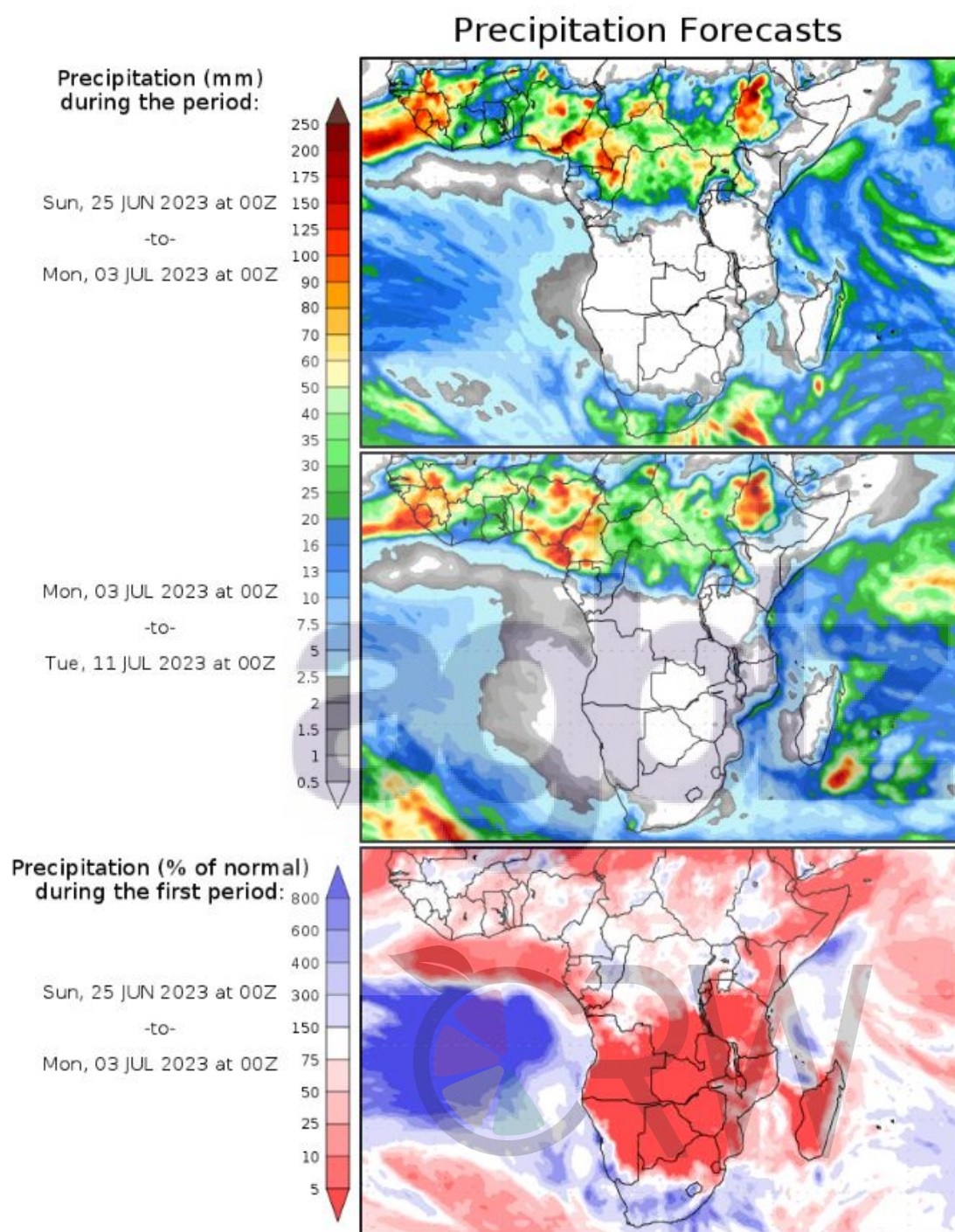
On Wednesday, SAGIS will release its weekly **South Africa Grain Producer Deliveries** data for 23 June 2023. In the previous release on 16 June, South Africa's 2023/24 maize producer deliveries were about 1,4 million tonnes. This placed the 2023/24 deliveries at 4,8 million tonnes out of the expected harvest of 16,1 million. The soybean harvest activity has progressed more than maize because it was planted earlier in the season. The harvest is now close to completion, and on 16 June, about 2,6 million tonnes of soybeans had already been delivered to commercial silos out of the expected crop of 2,8 million tonnes. On the same day, sunflower seed producer deliveries amounted to 568 787 tonnes out of the expected harvest of 797 610 tonnes.

On Thursday, SAGIS will publish its weekly **South Africa's Grain Trade** data for 23 June. In the previous release on 16 June, the seventh week of the 2023/24 marketing year, South Africa exported 90 359 tonnes of maize. Of this volume, about 33% was exported to South Korea, 31% to Taiwan, 25% to Japan, and the balance to the neighbouring countries. This placed South Africa's 2023/24 maize exports at 520 810 tonnes out of the seasonal export forecast of 3,0 million tonnes (down from 3,64 million tonnes of exports in the 2022/23 season).

South Africa is a net wheat importer, and 16 June was the 37th week of the 2022/23 marketing year, with a weekly import volume of 8 989 from Lithuania. This placed South Africa's 2022/23 wheat imports at 985 553 tonnes. The seasonal import forecast is 1,6 million tonnes, roughly unchanged from the previous season.

South Africa's major wheat suppliers in the 2021/22 season were Argentina, Lithuania, Brazil, Australia, Poland, Latvia and the US. If one looks into South Africa's wheat import data for the past five years, Russia was one of the significant wheat suppliers, accounting for an average share of 26% yearly. Argentina and Brazil replaced this in the 2021/22 season. However, Russia is back on the suppliers' list in the 2022/23 season and is again one of the significant wheat suppliers to South Africa thus far.

Exhibit 4: South Africa's precipitation forecast



Source: George Mason University (wxmaps)

As with the previous week, the weather forecast for the next two weeks show clear skies over most regions of South Africa.

This will help support the summer crop harvest process that is currently underway across the country.

However, the Western Cape, Eastern Cape, KwaZulu-Natal and southern regions of the Free State may receive light showers this week.

While this is conducive for winter crops in certain provinces, the Western Cape has received heavy downpours already and currently in need for a few days of warmer conditions.