

SOUTH AFRICA

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THE SOUTH AFRICAN ECONOMY 2008/09

Significant political changes occurred in 2008 with the State President stepping down prior to the end of his term of office and a General Election coming up in April 2009.

GDP growth slowed and for the first time in over a decade there was contraction of 1,8% in the last quarter of 2008. Major fuel price increases impacted heavily on inflation in 2008 which reached over 13% in November but was back down to 8,1% y/y in January 2009. PPI for January 2009 was 9,2% up y/y. Lending rates have decreased by half a percent to 14% p.a. and the exchange rate (Rand to US\$) has fluctuated dramatically. It is currently (March 2009) at R10,53 to US\$1.00. In spite of the weaker Rand the export sector has not benefitted much, because of the slump in global demand.

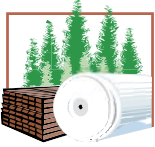
Notwithstanding Government's expanded public works programme focussing on infrastructure development, the Accelerated and Shared Growth Initiative of SA (ASGISA) as well as capital expenditure programmes associated with the 2010 Soccer World Cup which is to be held in South Africa, official GDP growth estimates have been revised downwards from 6% to 1,2%. Following the contraction seen in the last quarter however, even this may be optimistic. Exports plunged more than 25% in January, widening the country's trade deficit to a record R17,4bn. Several of SA's main trade partners Britain, Europe, the US and Japan are in recession, and this has eroded demand for SA exports. This presents a bleak outlook for the rest of 2009 for manufacturing production, which dived a record 22% in the last quarter of 2008.

On a positive note most of the inflation experienced in South Africa was imported inflation driven by the spike last year in the oil price. Similarly the widening current account deficit and fluctuating currency have more to do with the global market crisis than South Africa's economic fundamentals. On this issue it should also be noted that none of South Africa's financial institutions have required State funding interventions.

THE FORESTRY AND FOREST PRODUCTS SECTOR IN RELATION TO THE ECONOMY

A year ago domestic and international demand for SA forest products was outstripping supply by about 15%.

Given the current global financial turmoil, short-term demand has fallen off dramatically. Last year roundwood sales recorded by FSA amounted to 16.9 million tons whereas forecasts for this year are below 15 million tons. Having said this, the medium and longer-term forecasts still suggest that to meet demand over the next 25 to 30 years we should be increasing our planted area by a minimum of 25,000 hectares p.a. Unfortunately there are limited areas available for new afforestation and the restrictive regulatory burdens imposed on applications to plant timber, are further hampering the issuing of licences where areas are available to plant.



2008 was a record year for pulp and paper with paper production up by 27% on 2007 and paper imports down by 6% (this also being affected by a weaker domestic currency). This increased reliance on local products is good for the industry. With the current downturn however, the only grades of paper still showing robust demand are newsprint and tissue paper.

Pulp production for February 2009 is 30% down year on year which reflects the decreased global demand.

South Africa is probably one of very few countries in the world currently experiencing recovered fibre shortages, despite an increasing recovery rate of 54.5%. The weaker domestic currency further aggravates the supply problem as importing recovered fibre is not an attractive option.

EMERGING ISSUES FACING THE INDUSTRY

Emerging issues of importance facing the industry are timber supplies, support to new entrants into forestry, fires, pest and diseases, competitiveness and climate change.

TIMBER SUPPLIES

As discussed above, the medium to longer-term shortages of roundwood supplies into all market segments are of major concern. Increased imports, improved yields, better utilisation of logs, lower plantation losses, will all be necessary, but the critical ingredient regardless, has to be an increase in the rate of new afforestation. Although the target should be 25,000 hectares p.a., in reality given water, environmental, climatic and agricultural constraints, a target of 10,000 hectares p.a. is more realistic. The chances of achieving this are however not that good as South Africa's water stress situation makes it extremely difficult to obtain authority to plant trees through the acquisition of mandatory afforestation water use licences. Forestry is the only dry-land cropping activity subject to such licensing requirements and the Industry is making huge efforts to change Governments perspectives on this. Broad misconceptions on Forestry's water use exist, despite scientific evidence and global experience dictating otherwise.

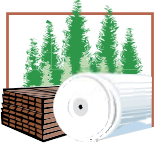
SUPPORT TO NEW ENTRANTS

Through statutory black economic empowerment initiatives and a strong land reform and redistribution programme, close to 60% of the current forestry estate is likely to be transferred to new ownership over the next 10 years. Industry and Government are working closely to ensure that new entrants into the sector are empowered to manage their newly acquired forestry assets, derive meaningful benefit from participation and ownership and that the sustainability of the sector is ensured. To this end the Minister of Land Affairs endorsed post-settlement support models to deal with land claims involving forestry land.

The support received by FSA from the FAO for the development of small grower toolkits was immensely valuable. The toolkits have been produced in all the relevant official languages and have assisted FSA greatly in leveraging major funding from the Forest Industries Education and Training Authority for the training of new entrants into forestry in the application of the toolkits. This training has been initiated and will continue throughout 2009.

FOREST FIRES

Following the disastrous fire season in 2007 where close to 64,000 hectares of plantation was destroyed, in 2008 about 25 000ha were lost to fire again causing great financial loss and placing additional strain on the short, medium and long term supply situation.



PESTS AND DISEASES

Amongst Pine plantations serious problems continue to exist due to infestations by the Sirex Woodwasp. The incidence of new infestations has however decreased significantly due in large part to the excellent biological control strategies being implemented throughout the country. *Fusarium* or Pitch Canker is again becoming a big problem, with mortality arising therefrom for the first time being seen in older age class compartments of Pine.

Serious problems are also being encountered in stands of Eucalyptus throughout the country as a result of infestation by *Thaumastocoris peregrinus*. Cold tolerant *Eucalyptus nitens* is also being attacked by the Cossid Moth. During 2007 a new pest by the name of *Leptocybe invasa* arrived in S.A. which is considered a major threat to plantations of Eucalyptus. In all, 15 – 20% of the entire Forestry state is being impacted upon by various pests and diseases resulting in unaffordable timber losses. The Government has provided funding for the combating of Sirex and has commissioned the development of an integrated protection strategy to deal with pests, diseases and fire to help counteract these problems.

COMPETITIVENESS

With profit margins being under such pressure for the first time in several years, there will undoubtedly be a move towards increased mechanisation and investment in newer and more efficient production, processing and manufacturing capabilities. This may result in a decreased dependence on human capital which may also be affected by the soon to be released increased minimum wages for forestry workers and the continuing impact of HIV/Aids in South Africa.

Reduced global demand has left South Africa with its liberal trade regulations vulnerable to dumping which needs to be vigilantly monitored.

OTHER EMERGING ISSUES

(i) HIV/AIDS

The HIV/Aids prevalence rate amongst the population ranges between 11% and 20% depending on age category, with infections having increased by almost 50% since the year 2000. It was reported that 362,000 people were expected to die from HIV/Aids related illnesses during 2007, which amounts to almost 1,000 people per day. The epidemic is already having a catastrophic effect on the population.

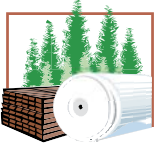
In the Forestry Industry the effect is particularly severe, given the rural nature of the business, with up to 40% of its labour force in certain areas being infected. The cost in lives, in human misery, in productivity and on competitiveness are huge. Major efforts by the Government and business are being made to combat the scourge although it is going to take super-human efforts by all to be successful.

The cost to business of managing this situation are becoming massive and the sector is gradually being recognised by government as a social partner in combating this disease and other health challenges particularly in rural areas.

(ii) Climate Change

While the world a year ago was almost singularly focussed on global warming, the global financial crisis has eclipsed almost every other key issue.

This does not however diminish the threats posed by climate change which cannot quickly nor easily be stopped or reversed. Some of the impacts of climate variability are being felt



already by the Forestry Industry with plantation yields dropping in specific areas and mortality as a result of fires and pests and diseases increasing. Extensive research on its impacts was done in 2006 and continues to be done by both Industry and Government, with attention being focussed on greater site-species matching and variation in genus and species being planted, amongst others.

Opportunities for tree planting activities under the C.D.M. are also being investigated although it still does not yet recognise plantations as a legitimate mitigation strategy. This is in spite of the fact that forests as a land use are unparalleled in their ability to sequester carbon.

(iii) Sustainable Forest Management-Forest Certification

Even through 85% of South African Timber plantations are already certified under the FSC, much attention is now being put on making certification much more accessible to small plantation owners. Currently 20,000 plus small black emerging growers are being assisted in this regard through the development of a small grower FSC certification programme commonly referred to as the SLIMF programme (Small and Low Intensity Managed Forests). As part of this Government and Industry in South Africa are currently developing a National Certification Standard which should be in place during 2009 and which will form the basis for certification by all certification bodies.

(iv) Profile of Plantation Forestry

South Africa is no exception when it comes to the profile of plantations and a lot needs to be done to improve this. Misunderstanding and misrepresentation of the facts about tree plantations is more often the norm than the exception. The industry is working hard to remedy this, and the Code for Planted Forests developed by the FAO in this regard is being of great assistance.

The FAO also funded, through its NFP facility, the production of a sector promotion and awareness raising strategy which has been immensely useful. The document accurately reflects all the key messages of global and local importance in forestry in South Africa and describes the key target audiences, media and role players which should be involved in addressing and delivering the messages.

BUSINESS DEVELOPMENTS DURING THE PREVIOUS YEAR

FOREST SECTOR TRANSFORMATION CHARTER

A significant development during the last year has been the finalisation and Gazetting of the Broad Based Black Economic Empowerment Transformation Charter for the Forest Sector. This Charter, required in terms of the Broad Based Black Economic Empowerment Act, seeks to bring about socio-economic transformation in the forestry sector which will facilitate greater participation of previously disadvantaged people in South Africa and growth in the forestry sector. The objectives of this Charter are to:

- promote meaningful participation of black people in the entire forestry value chain;
- achieve sustainable change in the racial and gender composition of ownership, management and control structures and in the skilled positions of existing and new forest enterprises;
- increase the extent to which black men and women, workers and cooperatives own and manage existing and new forest enterprises; and
- use the forest industry as a catalyst for empowering rural and local black communities to access economic activities, land and infrastructure.



To achieve these objectives Industry participants will have to comply with a transformation scorecard which comprises 7 elements. Briefly these are:

(i) Ownership

25 +1% of Industry to be owned by black people within a period of 10 years.

(ii) Management Control

50% of management (Board level, Executive and Senior) to be in control of black people within 10 years;

(iii) Employment Equity

75% to 80% of all employees, by grading, to be black people within 10 years;

(iv) Skills Development

4% of total annual payroll to be spent on skills development for black people within 10 years.

(v) Preferential Procurement

70% of total procurement spend to be spent on black owned or black empowered business within 10 years.

(vi) Enterprise Development

3% of entities net profit after tax to be spent on enterprise development for black people and communities within 10 years;

(vii) Socio-Economic Development

1% of entities net profit after tax to be spent on socio-economic development activities for black people and communities within 10 years;

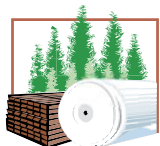
Whilst the abovementioned will place enormous responsibility on the Industry to achieve, and will come at a high cost, all Industry participants have accepted the challenge and have committed themselves to its implementation. Of major concern, as already mentioned, is how to ensure that ownership transfer will not result in existing timber plantations being converted to other land uses. Even a small change could have significant implications for the future sustainability of the Industry, given the current and future timber supply situation.

PRIVATISATION OF STATE FORESTS

The privatisation or restructuring of state forests has been ongoing for almost 9 years, and in the process has created considerable investment uncertainty. During 2006 the last, but biggest portion of State Forests was successfully bid for, but then stopped by the Competition Authorities. Resulting from this the Government then announced that it would retain ownership and control. A revised strategy was touted for the privatisation of this asset but again more recently the Government has indicated that the asset will not be privatised for the foreseeable future.

GROWTH AND DEVELOPMENT STRATEGY FOR THE FOREST SECTOR

Flowing from a report prepared by the consulting firm Genesis Analytics in 2005, entitled “The Contribution, Cost and Development Opportunities of the Forestry, Timber and Pulp and Paper Industries in South Africa”, the South African Department of Trade and Industry in collaboration with the Sector itself has recently completed a sector growth and development strategy which has been approved by the Cabinet. Resulting from this the Forest Sector has been classified as a major



sector earmarked for growth through the country's recently released National Industrial Policy Action Plan. This has also been embedded in the Broad Based Black Economic Empowerment Charter in an attempt to ensure that government and industry work together on ensuring growth in the sector, but to date the efforts of government on facilitating the expansion of forestry and the ensuring the availability and affordability of enabling infrastructure (road and rail in particular) have not been successful.

It is hoped that the major constraints and challenges being felt by the sector will serve as a catalyst for increased government focus on these and other binding constraints to forestry in South Africa.

SYNOPSIS OF INDUSTRY PROFILE – 2000 vs 2008 FORESTRY SECTOR

CRITERIA	Unit	2000	2008	Change
Planted area	Ha	1,330,944	1,266,194	(4.9%)
Roundwood Production	m ³ /p.a.	16.7 million	20.3 million	21.6%
Value of Roundwood Sales	Rand	2.6 billion	5.2 billion	100%
Percentage by value of Agricultural output (crops)	%	8.7%	21%	137%
Plantation losses (fires, pests & diseases)	ha	23,000	25,000	9%

FOREST PRODUCTS SECTORS (all sectors excluding Paper)

CRITERIA	Unit	2000	2008	Change
No. of Plants		167	178	6.5%
Roundwood Intake	m ³	17.1 million	19.8 million	15.8%
Value of Sales	Rand	12.9 billion	18.5 billion	43.4%
Contribution to Mnfg. G.D.P.	%	3.6%	4.3%	19.4%
Foreign trade balance	Rand	4.6 billion	2.4 billion	(47.8%)

PULP, PAPER AND BOARD SECTOR

CRITERIA	Unit	2000	2008	Change
No. of Plants		23	33	(43%)
Pulp Capacity	tons	2.6 million	29 million	11.5%
Paper and Board Capacity	tons	2.6 million	3.0 million	15.3%
Per Capita Consumption	kg	42.0	55.7	32.6%
Production				
- Pulp	tons	2.2 million	2.4 million	14.3%
- Paper and Board	tons	2.1 million	2.6 million	23.8%
Value of Exports	Rand	5.0 billion	9.3 billion	86.0%