Macro matters impacting SA's farmers

By Johan van den Berg

25 Oct 2018

Multiple macroeconomic factors are currently converging amidst a persistently weak economy to make times tough for everybody, including our farmers. In the second quarter of 2018, SA's GDP fell by 0.7% and the agriculture sector was named one of the largest negative contributors to growth, primarily due to a drop in field crop and horticultural product production.

© Wawrzyniec Korona – 123RF.com

From the strengthening dollar and relentless petrol price increases to the rapid changes instigated by Industry 4.0, here are some of the major macro-economic issues affecting agriculture and the role of insurance in bolstering resilience:

Macroeconomic factor 1: The drought

Good news: The Western Cape looks set to have record yields for its winter wheat crop. Additionally, the commodity price of wheat has increased due to drought conditions in Europe and Australia. So record yields in some areas plus a favourable commodity price all spell good news for farmers.

However, if next season isn't another wet one, we could be back to drought conditions. Even now, some areas across SA are still struggling. While we may experience better summer rainfall cycles for the next three to five years, we need to realise South Africa is a water scarce country and plan ahead by making provision for the long-term. In the medium-term, we need to consider how we can address the insufficient storage capacity of our reservoirs so we can store more water for the 'bad years.'

A big concern is farmers' access to quality water sources. If contaminated water leaves traces of negative elements in citrus fruit, for example, this fruit won't pass export standards. Something else to note is that more rain also brought more hail damage – seen through an increase in Santam's hail claims pay-outs this year. With wet cycles predicted to continue, farmers need to protect their crops with adequate cover.

Macroeconomic factor 2: The strong dollar and weak rand

The escalating price of the dollar has negative effects on costs like fuel and fertiliser, driving up the input costs farmers pay to produce. The lower value rand also means the commodity price is going up – for example, the price of maize has gone up by 15-20% in just the last month. The combined effect of the input and commodity cost ratio being against farmers could have more devastating effects than the drought for the sustainability of farm production.

Macroeconomic factor 3: The petrol price

If diesel and petrol prices keep rising, they could have a negative effect for the next year or two. Grain SA released figures showing farmers have three main input costs: fertiliser, fuel and seed. Fuel is the second highest contributor.

Macroeconomic factor 4: Global competition

If you look at crop production, about 10-20 years ago, we had 4 million hectares of maize; we are currently down to below 2.5 million hectares. One of the reasons is that we can’t compete with our international competitors, who have more favourable climate conditions and are closer to markets.

Conditions are especially challenging for small-scale farmers who have to contend with a variable climate, the difficulty of recovering from the drought and an ongoing lack of finance, which has a major role in crop production. For example, in the Free State, some farmers probably won’t get finance to plant crops next season – the value of the farms has dropped so low that they have insufficient security to offer financiers.

Unlike other countries, South Africa offers no subsidies through structured financial assistance. For international competitors, subsidies bolster resilience against factors like the global fuel price hike.

Macroeconomic factor 5: Tech and Industry 4.0

Farmers can’t afford high-level tech if they don’t have sufficient resources. This makes cutting-edge tech more commonly available to macro-scale farmers. This widens the gap between macro and small-scale farmers in South Africa and between South African farmers and their international competitors, whose subsidies make it easier for them to afford new innovations.

How insurance can bolster resilience against macroeconomic factors

The fact that small-scale farmers, in particular, are struggling to afford crop failure insurance is alarming. In the last few years, more and more hectares have been coming out of insurance systems.

Amidst tough times, insurance plays a pivotal role in stabilising income when any kind of damage occurs, because the price and yield (insured value) is predetermined when writing the policy for a specific area or number of trees. This means farmers can withstand losses brought about by variable climate conditions. The role of short-term insurance is to restore the insured to the same position they were in prior to the incident happened.

When there is no damage or uninsured damage occurs, then the price plays a very important role to determine the sustainability of a farmer, because when there's no insurance pay-out, the farmer has to make use of other hedging tools. Above average yields with low prices are sometimes a bigger risk than low yields with high commodity prices. So insurance plays a role to ensure that the climate, and, to a lesser extent, other factors like damage that may occur during transit of produce, fire and SASRIA (South African Special Risks Insurance Association) cover is covered.

For example, the direct cost of the production of maize is about R8,000 per hectare in the western production areas and up to R12,000 per hectare or more in the eastern production areas.

With a maize price of about R2,000/tonne, the direct production cost is about 4 tonne/ha in the western areas and about 6 tonne/ha in the eastern production areas. This is also about the long-term average yield of the area, so in about half of the years, farmers will not be able to recover the direct production cost. Then add to this the additional cost of living. Inevitably, the economy of scale plays a role as small- and macro-scale farmers require about the same amount to cover living costs, but the potential to recover the cost of living is reduced with the smaller income of the smaller farmer.

The worry is that with so many macroeconomic factors effecting input and commodity costs, insurance will be cut. But in reality, it's one of the best and most reliable defences farmers have against multiple factors they simply can't control.

ABOUT THE AUTHOR

Johan van den Berg, manager: specialised crop insurance and resident climatologist at Santam.