South African Economic Overview

May 2023 I Economic

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RA Credit Rating Analytics

Q4 GDP Growth

Please click here for a video summary: https://youtu.be/yB_4Q0Q86oY or scan the following QR CODE:

South Africa's gross domestic product (GDP) measured by production & expenditure escaped a recession and expanded by a tenuous 0,4% in the first quarter of 2023 after a decrease of 1,1% in the fourth quarter of 2022. On an annualized basis, the economy performed poorly growing at just 0.2% year-on-year relative to 1.5% in the first quarter of 2022. On the production side, manufacturing (1,5%), transport storage & communications (1,1%), construction (1,1%), mining & quarrying (0,9%), personal services (0,8%), trade, catering and accommodation (0,7%), finance, real estate, and business services (0,6%) and general government services (0,2%) displayed positive growth. Electricity, gas, and water (-1%) and agriculture, forestry and fishery (-12,3%) performed negatively thereby creating a drag on the inflation numbers. On the expenditure side, Household final consumption (0,3%) and Government final consumption (0,2%) contributed positively with Gross fixed capital formation increasing by (1,4%) in the first quarter. Changes in inventories (-0,1%), and net exports (-0,2%) were the negative contributors to economic growth over the first quarter. The economy remained resilient on the backdrop of crippling blackouts (see the electricity section below); however, this was due to businesses putting in place additional measures to shield themselves from the impact of loadshedding and positive performance from non-electricity intensive sectors such as food and drinks manufacturing. These GDP figures should however be taken with caution as the economy faces major headwinds ahead, income growth of just 3,8% comes in much lower than inflation which will place a continued strain on South African consumers. Business sentiment still remains significantly in the red and the South African economy faces some trying times ahead resulting in our estimate of negative growth in both the second and third quarters of 2023.

Interest rates

The South African Reserve Bank (SARB) started its hiking cycle in November 2021, around 3 months before the US Federal Reserve began its interest-increasing cycle. The bank has thus far implemented 10 consecutive interest rate hikes (cumulatively 475 bps) which have led to the repo and prime rates now standing at 8.25% and 11.75% respectively.

The SARB's hiking stance has been primarily driven by disappointing inflation numbers, rising inflation expectations, and continued upside risks to the economic outlook. On the global front, the SARB fears that conditions in the global oil market could tighten again, given the ongoing Russia–Ukraine war and a rebound in Chinese demand (which has been subdued but could surprise to the upside). On the domestic front, a weaker exchange rate, load-shedding (the SARB recently said that load-shedding would raise inflation by around 1.1% in 2023), higher electricity and other administered prices, as well as elevated food price inflation pose a threat to the overall inflation outlook.

In its latest meeting[1], the SARB raised its inflation forecasts for the year to around 6.2% (up from 6%) which is above the bank's target band, and maintains that risks remain to the upside. With inflation currently at 6,8% y/y for April, the bank predicts that inflation will only return within the band later this year. Components within the inflation basket which have been flagged as risky include electricity and food prices. The SARB forecasts electricity to increase by 11.6% this year, 13.4% in 2024, and 10.9% in 2025. Food price inflation is now expected to be 10.8% in 2023 (up from 9.9%) and 5% in 2024 (up from 4.5%). Increasing prices of non-core[2] items could

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[1] May 2023

[2] These include food, electricity and petrol

increase wage inflation as this could see inflation expectations rise, thus deteriorating the overall inflation outlook, implying that the SARB would need to continue hiking interest rates. At the current assessment of risks, the SARB only sees inflation reverting to the mid-point of the target range by Q2:2025 (previously Q4:2024), with no more rate hikes forecast by the market over the medium term.

Currency weakness has also fed through to higher inflation. The weak Rand has been perpetuated by both domestic and global risks. The Rand has been trading at levels around R19.52/USD - R19.82/USD. From a domestic perspective, worsening electricity outages have dampened investor sentiment. Recently, the currency also slumped on the back of the news of South Africa potentially supplying arms to Russia. This led to fears that the US may sanction South Africa. On the global front, risk-off sentiment has been perpetuated due to fears of a US recession, the nearing of the US debt ceiling, and disappointment over the weakness of China's recovery. These conditions have worked against the Rand, which now trades at historic lows against the US dollar. Also contributing to the Rand's deterioration has been an unattractive carry trade for investors. While the SARBs hiking cycle has seen interest rates 475bps higher, US interest rates are 500bps higher. Meaning that the SARBs policy stance has not been enough to elevate real interest rates, exacerbating the Rand's weakness. The Rand weakness will add to higher inflation in South Africa, as the country imports most of its fuel, and key crops like maize and wheat, which are priced according to import parity (i.e., in dollar terms). Further, a weak Rand will limit the benefits of slowing global inflation to domestic inflation.

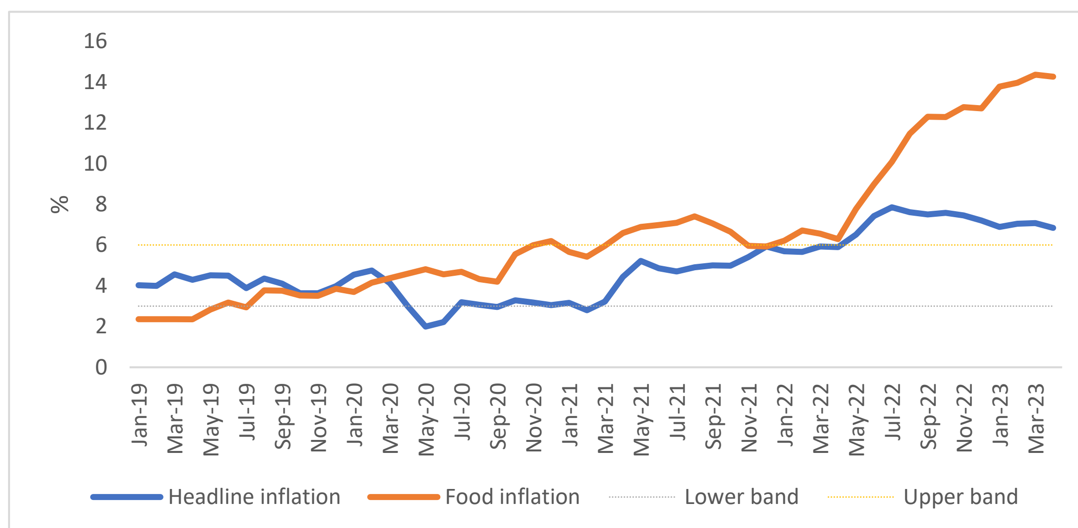
South Africa's growth outlook and deterioration of the overall economic outlook have also not sat well with investors. The Reserve Banks projection for economic growth this year is around 0,3% with load-shedding detracting from growth and ultimately adding around 1,1% to overall inflation. Investor sentiment towards domestic policy on this front has been negative. Another concern is that while the SARB is trying to dampen demand by hiking rates, the National Treasury (NT) is trying to boost the economy at the wrong time. This macroeconomic policy clash prevents the economy from growing and keeps inflation high. Some investors are skeptical that there is an incentive for politicians to keep inflation high, which ultimately erodes the real value of the government's debt.

Inflation

During the COVID-19 pandemic, there were loose monetary conditions globally, in a bid to boost spending and assist with subdued demand *(Figure 1).* However, towards the latter part of 2021, most central banks were seen hiking interest rates as loose monetary conditions saw inflation rise. While investors rewarded emerging markets with positive real rates, central banks who were not aggressive in their stance saw their currencies depreciate. During this period, there was an overall risk aversion in global markets, due primarily to the Russia-Ukraine war. The immediate impact of which were weaker exchange rates for emerging markets and soaring commodity prices. Notably, wheat and maize prices increased dramatically, causing concerns over food security as well as food inflation locally and globally. Further, oil prices had increased to the highest level since the global financial crisis *(*

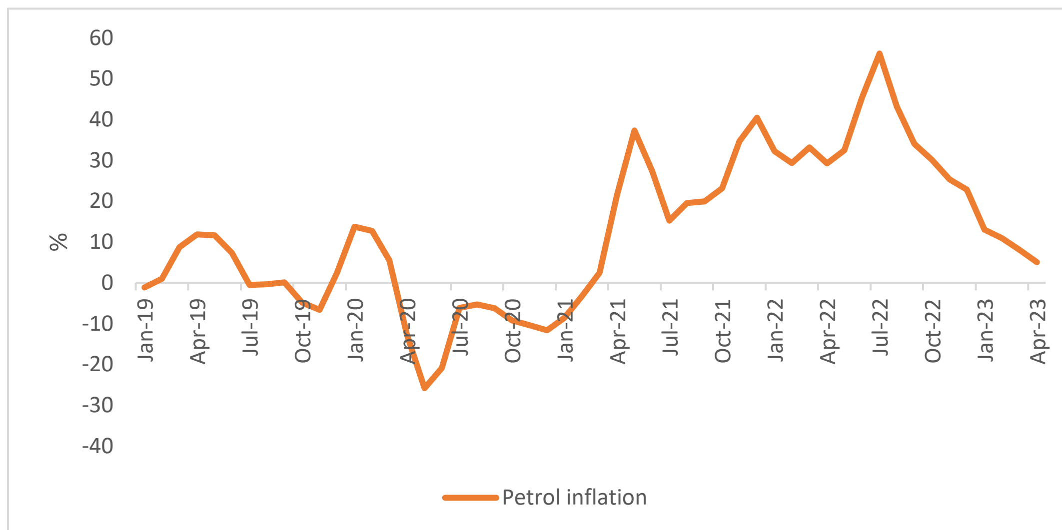
Figure 2*).*

Figure 1: Headline inflation vs food inflation



Source: Stats SA

Figure 2: Petrol inflation



Source: Stats SA

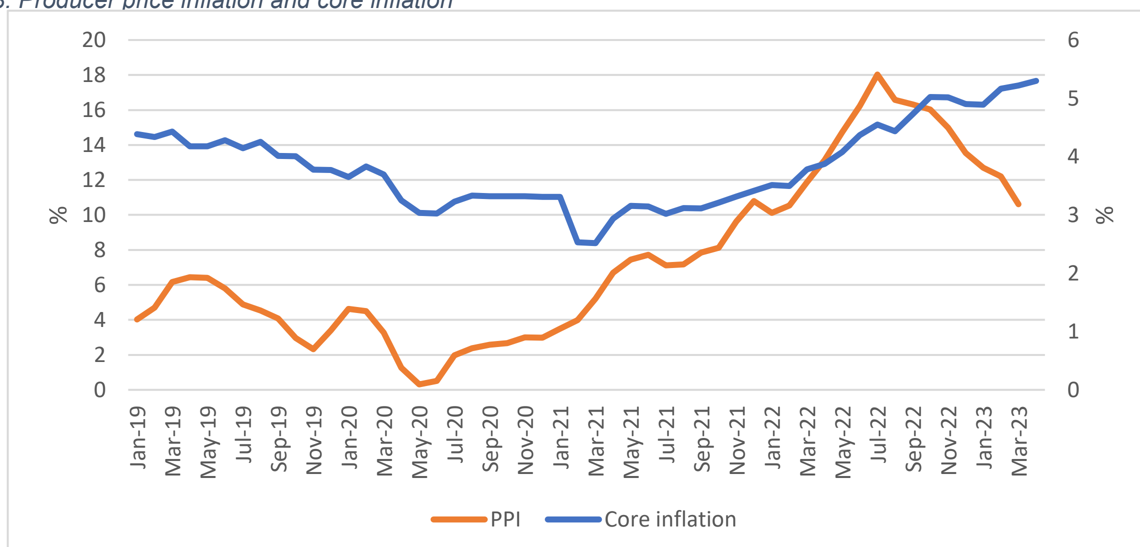
These combined phenomena (a weaker exchange rate, higher food and fuel inflation) have seen headline inflation increase in 2022. While food price concerns remain (Figure 1), oil prices began decreasing in the H2 2022, bringing some reprieve to headline inflation. Economists are optimistic that inflation will moderate in 2023. Headline inflation was down 6,8% y/y in April after having 7,1% y/y in March, the lowest reading since May 2022 (6,5% y/y). While petrol price inflation moderated by 5% y/y in April, after a peak of 56.2% y/y in July 2022 (

Figure 2). The upward pressure has come mainly from sticky food prices. Annual inflation for food and non-alcoholic beverages is around 13,9% y/y in April from 14,0% in March. Elevated food inflation continues to stem from essential items like bread and cereal prices. However, somewhat encouraging is that prices of oils and fats eased after Ukraine resumed exports.

Although global food prices have declined significantly, a weaker rand and the additional expenses incurred by producers who now must rely on alternative power sources for production have driven local production costs higher, with the cost passed being passed through to consumers.

According to Agbiz, while load-shedding continues to weigh heavily on optimal production, “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”. However, without access to these measures, farmers will continue to take the hit.

Figure 3: Producer price inflation and core inflation



Source: Stats SA

What is also of concern is that core inflation rose to a 7-year high of 5.3% y/y in April this year, meaning that there exist broader price pressures in the economy and that retailers are passing these costs on to consumers more aggressively. Further, this can also be seen from soaring producer price inflation, which peaked in July 2022 at 18% y/y (Figure 3).

While expectations are for headline inflation to fall within the SARBs target band by year-end, risks to the inflation outlook remain on the upside due to rising input costs, driven by the additional cost of generating electricity from diesel amid load-shedding, unpredictable weather patterns, and a vulnerable rand. Core inflation will likely also moderate during the year as the higher cost of living and weak confidence subdue consumer spending, limiting producers' ability to pass price increases on to consumers without hurting turnover.

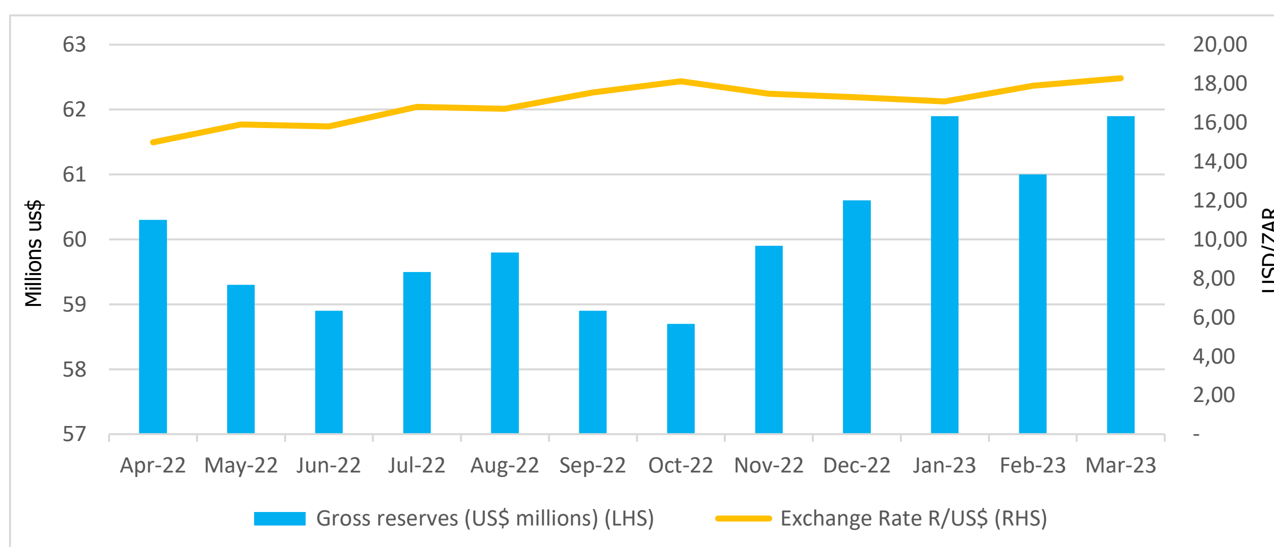
The Trade Balance Surplus Decreases

In March 2023, South Africa recorded a trade balance surplus of R6.9 billion. This was 35.6% lower than the R10.7 billion recorded in February 2023. The surplus was attributable to exports of R192.2 billion and imports of R185.3 billion. On a month-to-month basis, exports increased from R151.4 billion to R192.2 billion (26.9%) between February and March 2023 whilst imports also increased from R140.7 billion to R185.3 billion (31.7%) over the same period. Increases in export flows in March were driven by gold whilst increases in imports were on the back of higher importation of crude oil and petroleum oils. Year-to-date (01 January to 31 March 2023), South Africa's trade balance deficit deteriorated from an R61.9 billion trade balance surplus during the period January to March 2022 to a trade balance deficit of R6.2 billion for the comparable period of January to March 2023. Export flows during the same period increased by R21.3 billion (4.6%) from R482.0 billion when compared to (R460.7billion) over the same period of January to March 2022. On the other hand, import flows were 22.4% higher having increased from R398.8 billion during January to March 2022 to R488.2 billion during the same period in 2023.

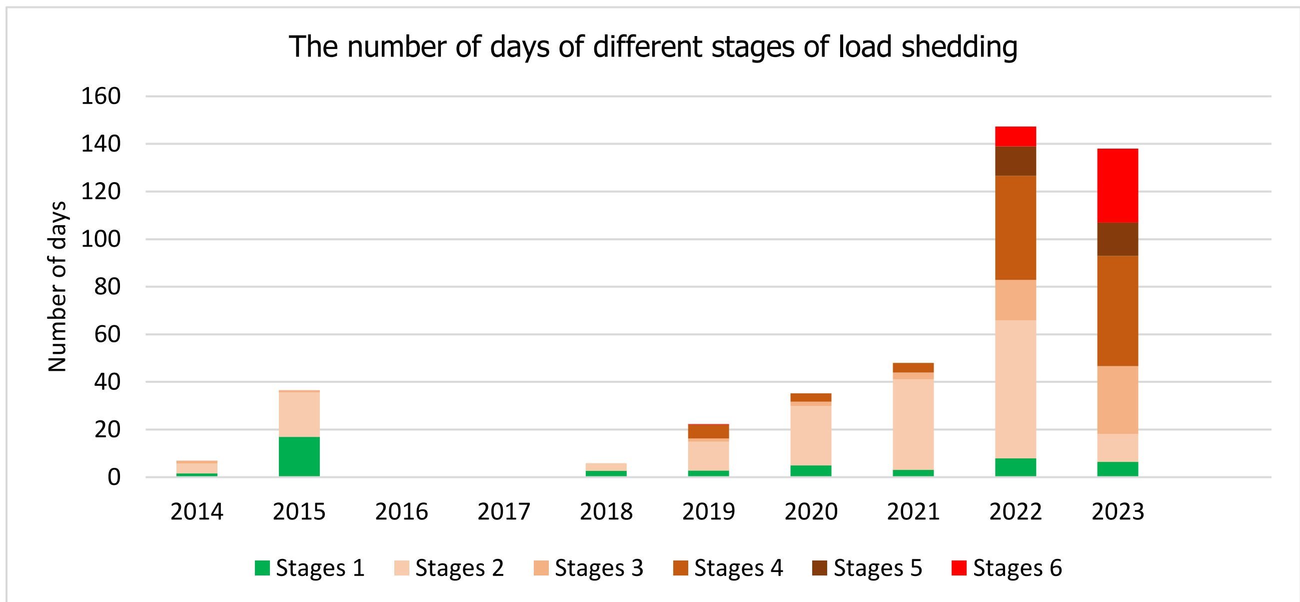
Reserves marginally increased on the back of a marginal decrease in import cover

In March 2023, South Africa's gross official international reserves marginally increased from $61 billion to $61.9 billion, which is about (1.4%) higher than the previous month. The increases in the gross reserves and international liquidity position were mainly due to the increase in the US dollar gold price, valuation adjustments due to the depreciation of the US dollar, and asset price movements. These factors were partially offset by the foreign exchange payments made on behalf of the government. This brought the import cover to 4.0 months which is lower than the 5 months recorded in February 2023.

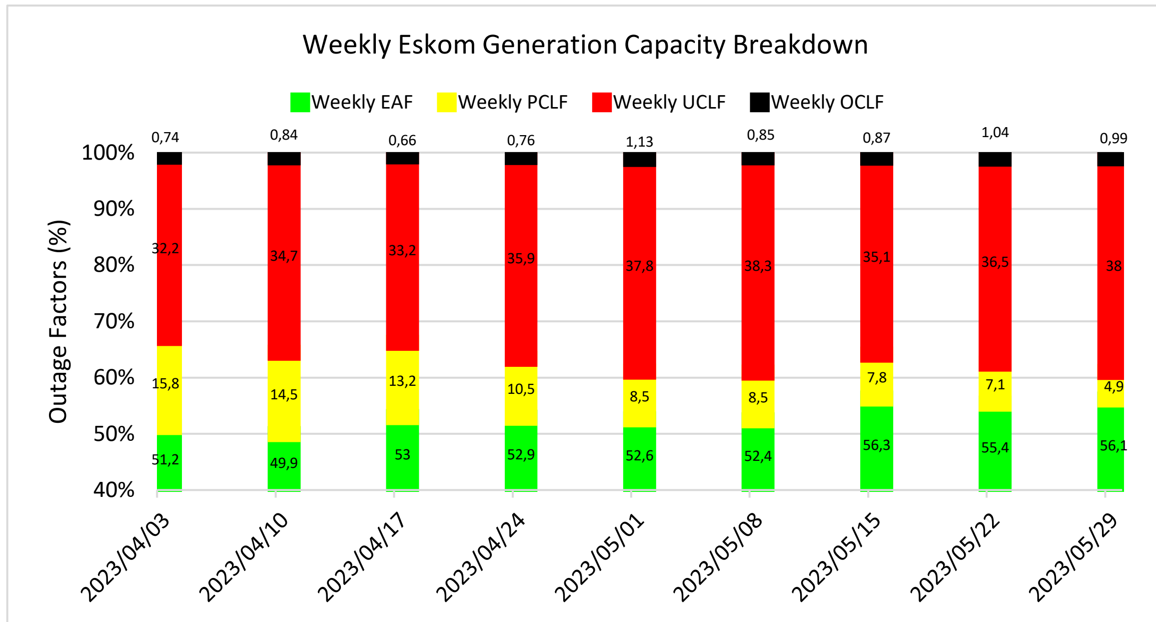
Trends in Reserves and Currency



The South African economy has been battered by a tenuous supply of electricity over the first five months of the year having already recorded a total of 142 days of load-shedding, relative to 206 days of load-shedding over the entire period in 2022. The intensity has also dramatically increased with a significant increase in the intensity of stage 6 load-shedding:



The graph above also highlights the fact that the country has already experienced more days of stage 4 and 6 load-shedding compared to the entire period in 2022. This has had a devastating effect on economic activity and will be reflected in the 2nd quarter GDP figures. The increased intensity will negatively impact some of the key socio-economic indicators such as employment of which it is estimated that 650 000 jobs were lost in the 2022 period due to the electricity crisis. Furthermore, if the load-shedding crisis extends beyond stage 6, there could be some additional repercussions for the economy. The platinum industry has for example indicated that it has been able to manage loadshedding up to stage 6 but additional stages could result in shaft closures and job losses. The same would be true for other key sectors of the economy such as manufacturing, agriculture, retail, property, forestry and fishery, which are typically most affected during power outages. It should be noted that Eskom does bring additional power on board during the winter period from planned maintenance projects that are typically scheduled to come online. However, given the current shortfall of 6000MW of generating capacity, and an energy availability factor of around 53%, the winter period will be extremely trying times for Eskom and the South African economy at large. With breakdowns or capacity unavailable due to unplanned maintenance at 15 000MW, load shedding might be predominantly implemented at Stage 5 over the winter months. Should these breakdowns reach 16 500MW, load shedding might then be implemented at Stage 6, and if unplanned outages average around 18 000MW, load shedding might be implemented up to Stage 8.



Source: Eskom

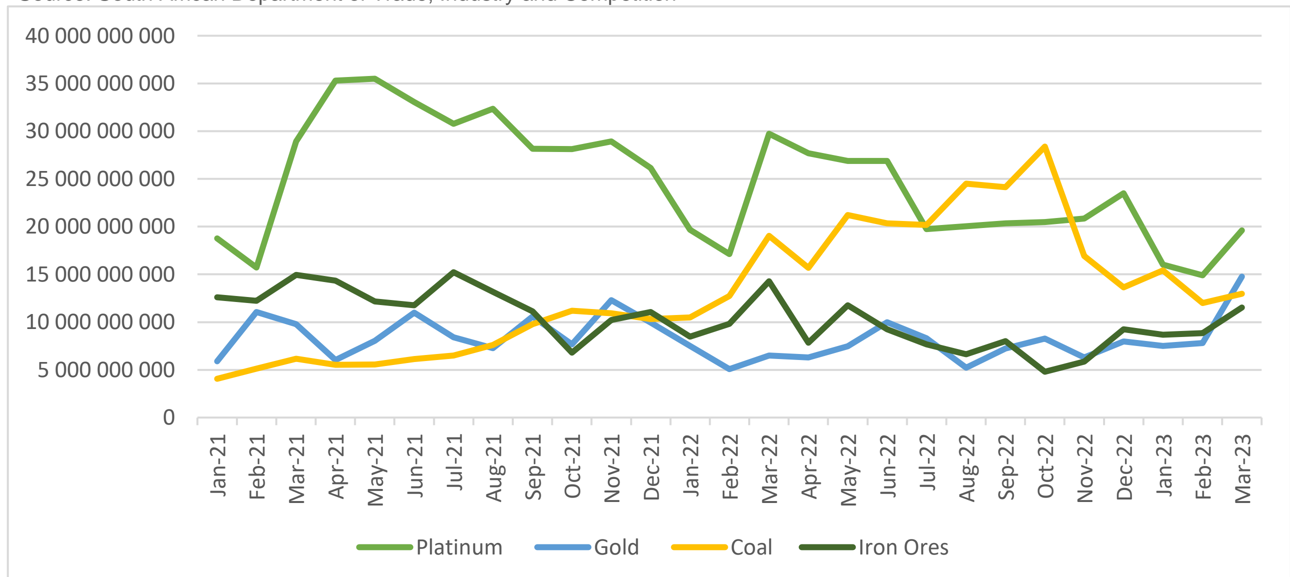
Eskom's energy availability factor (53.9%) has shown an increase from April but this is still down from May last year (60.3%) and has continued on a downward trend over the past 5-10 years. What is important to note is that Eskom's EAF for coal-powered stations is quite low remaining in the 40-45% region showcasing significant constraints. It is, however, worth noting that Eskom does see an increase in performance over the winter months with its coal fleet performing better in winter months relative to summer as well as with planned maintenance projects coming online to meet increased household demand. Some of this seems to have played out in early June which has seen a reduction in load shedding, some of the contributing factors other than those just mentioned are: 1. An increase in income generation from alternative sources such as wind which has performed well, 2. An increase in the use of open-cycle gas turbines, lower numbers of breakdowns, and a significant drop in planned maintenance over the period.

An overview of the commodity sector:

Platinum's export value in March 2023 has fallen by 34% on a month-on-month basis (a 32% reduction between 2021-2023). Gold and coal performed robustly with the export value of gold in March 2023 being 127% higher than in March 2022 (a 51% rally between 2021-2023). Coal had an overall growth of 111% from March 2021-March 2023, with a 32% reduction in March 2023 with respect to March 2022 – implying a significant rally (210%) between 2021-2022. Iron Ore has seen a 19% reduction in March 2023 compared to their levels in March 2022 (an overall reduction of 23% from 2021-2023). Although exports of coal in February and March this year have failed to reach the levels of the corresponding months in 2022, there was still a 47% rise in January 2023 from the January 2022 export value. The surge in coal exports has played a role in mitigating the potential effects of the declining platinum exports.

Trends in the Export Value (in ZAR) of Key South African Commodities

Source: South African Department of Trade, Industry and Competition



Monthly Data of Key Economic Indicators – 2022-23 (Alex to obtain the data)

Indicators	Unit	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23
CPI Inflation	y-o-y%	7.5	7.6	7.4	7.2	6.9	7	7.1	6.8	-
Core Inflation	y-o-y%	4.7	5	5	4.9	4.9	5.2	5.2	5.3	-
Key Repo Rate	%	5.5	6.25	6.25	7.0	7.0	7.25	7.25	7.75	8.25
Exports	ZAR Bn	186.3	166.1	172.1	162.7	138.4	151.4	192.2	163.8	-
Imports	ZAR Bn	166.2	164.9	164.7	157.8	162.2	140.7	185.3	160.3	-
Trade Balance	ZAR Bn	20.1	1.2	7.5	4.9	-23.8	10.7	6.9	6.3	-
Exchange Rate	USD/ZAR	17.5	18.1	17.5	17.3	17.1	17.9	18.3	18.2	19.7*
Gross Official International Reserves	USD ($) Bn	58.9	58.7	59.9	60.6	61.9	61.0	61.9	61.7	-
Import cover	No. of months	4.8	5.0	4.9	5.1	5	6	4.6	-	-
Energy Availability Factor	% (Yearly & Y-t-D)	55.7 (58)	56.5 (58)	54.7 (58)	50.7 (58)	51.2 (53)	52.8 (53)	55.1 (53)	51.6 (53%)	-

Source: Eskom, StatsSA. South African Revenue Service; Note: Core inflation denotes data for category Core 2; ZAR=South African Rand

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