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Economic outlook

In brief

- Since the 2022 *Budget Review*, global and domestic risks to the economic outlook have materialised, including slower global growth, higher levels of inflation, accelerating interest rate increases and intensified power supply interruptions.
- Real GDP is projected to grow by 1.9 per cent in 2022, compared with 2.1 per cent estimated in the 2022 Budget, and average 1.6 per cent from 2023 to 2025.
- Investment and employment levels remain lower than before the COVID-19 pandemic and lag behind the recovery in real GDP. Households are under increasing pressure from higher inflation and interest rates.
- A sustained improvement in growth and employment outcomes requires rapid and decisive implementation of economic reforms, supported by South Africa's clear and stable macroeconomic framework – and improved state capacity.

Introduction

South Africa's economic growth is expected to slow to 1.9 per cent in 2022, after reaching 4.9 per cent in 2021. The supportive external environment and commodity price levels that contributed to a faster-than-expected recovery from COVID-19 lows are dissipating.

Simultaneously, after a strong start to 2022, the impact of historic flooding focused in KwaZulu-Natal, the domestic electricity crisis and persistent constraints in network industries such as transport have severely affected economic activity, while high inflation and unemployment have weighed on private consumption. In addition, some of the risks outlined in the 2022 Budget have materialised, including slower global growth from supply chain disruptions and stringent lockdown restrictions in China, surging inflation and tighter monetary policy stances.

South Africa's structural economic constraints – including unreliable electricity supply, high levels of market concentration, inefficiencies in network industries and a high cost of doing business – limit the rate at which the economy can grow and create jobs. These longstanding impediments to growth have been aggravated by recent shocks, threatening to move the economy further away from the goals of the

National Development Plan. Recent events underline the importance of rapidly implementing the economic recovery plan, including through Operation Vulindlela, to narrow the gap between South Africa's poor economic outcomes and its aspirations.

The National Treasury has been conducting a review of macroeconomic policy since the 2008 global financial crisis. The draft review underscores the importance of a clear and stable macroeconomic framework – including a flexible exchange rate, low and stable inflation, and sustainable fiscal policy – as a foundation for a growing economy.

Building on this foundation, rapid implementation of economic reforms is required to boost economic growth. Since the 2022 *Budget Review*, progress has been made on important reforms that are expected to support investment and job creation:

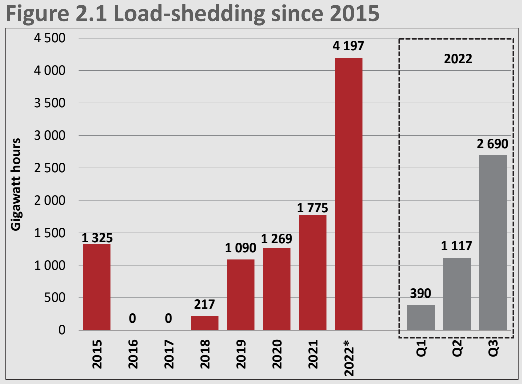
- In **transport**, the Transnet National Ports Authority has been corporatised, an important first step in raising the competitiveness of South Africa's ports. Third-party access to the freight rail network is being pursued. Private-sector partnerships are being developed for the Durban Pier 2 and Ngqura container terminals. The White Paper on the National Rail Policy was gazetted in May 2022, with a focus on measures to raise competitiveness, lower logistics costs and encourage investment.
- In **telecommunications**, the auction of broadband high-value spectrum has been completed. Draft by-laws for the deployment of electronic communications and facilities at municipal level have been published for public comment – a key step towards facilitating the provision of electronic communications infrastructure at the local level.
- Several **visa reforms** have been completed. These include reviewing the policy framework and processes for work visas. The eVisa system has been implemented in 14 countries, including key trading partners China, India, Kenya and Nigeria. A revised **critical skills list** has been published to help address the country's skills deficit.

Government plays an important role in ensuring that the regulatory environment and the provision of critical public goods and services support inclusive and sustainable growth. To do this, the state requires capacity to prioritise, sequence and coordinate interventions through adaptable policymaking and institutions that are accountable and capable. This includes the ability to make choices where trade-offs arise.

Emergency measures under way to address costs of electricity crisis

Unplanned power cuts have increased consistently since 2017. Eskom estimates that the electricity supply shortfall has risen to between 4 000 and 6 000 megawatts (MW), limiting its ability to adequately service electricity demand and undertake required maintenance. Load-shedding imposes an immense economic cost. Policy and legislative delays in the procurement of new electricity generating capacity under the Risk Mitigation Independent Power Producer Procurement Programme and Bid Window 5 of the Renewable Energy Independent Power Producer Procurement Programme have contributed to the power shortage.

Figure 2.1 Load-shedding since 2015



**2022 includes data for the first three quarters of the year*
Source: Eskom and CSIR

Emergency measures announced by the President in July 2022 prioritise improving the performance of existing power stations and adding new generation capacity to the grid as quickly as possible. Successfully enacted, efforts spearheaded by the National Energy Crisis Committee could add about 14 gigawatts of electricity capacity over the next two years. They include:

- Boosting Eskom's performance by addressing sabotage, theft and fraud; improving the quality and security of coal; procuring new power from existing independent power producers; and increasing imports from the Southern African Power Pool.
- Removing the embedded generation licensing threshold and developing special legislation to ease regulatory hurdles for all energy projects to boost private-sector investment in new generation capacity.
- Expanding and accelerating the procurement of new generation capacity from renewables, gas and battery storage.
- Facilitating investments in rooftop solar by developing a feed-in tariff for small-scale embedded generation projects, and investigating the expansion of tax incentives for commercial installations.

More recently, the amendment to Schedule 2 of the Electricity Regulation Act (2006), removing the licensing threshold for embedded generation projects, has been published for public comment. Key recommendations from an independent review diagnosing problems at power stations have been provided to Eskom. Work is ongoing to increase the capacity related to Bid Window 6, while finalising the procurement of battery storage. Talks are being held to facilitate cross-border power purchases.

Broader reforms under way include transforming the electricity market by restructuring Eskom, establishing an independent transmission company and finalising the Electricity Regulation Amendment Bill.

The Cities Support Programme, which is championing improved service provision in the eight large metropolitan municipalities, supports the effort to build state capacity. A key focus of the programme is boosting cities' resilience in adapting to climate change, an important consideration given the proliferation of extreme weather events such as the recent KwaZulu-Natal floods. Metropolitan municipalities have received support to integrate climate information into city planning systems and processes. All eight metros are being supported to develop reform action plans to improve service delivery outcomes through the subnational ease-of-doing-business project that draws from global best practice, with a number of pilots under way.

Government is formalising its response to the findings of the State Capture Commission. This is a key step in the fight against corruption and graft, including through state procurement, and ensuring the maximum return to citizens from scarce state resources. Over the medium term, government will continue to increase capacity in law enforcement and investigative agencies, including through a combination of reallocations and baseline increases. Additional resources for the National Prosecuting Authority, the Special Investigating Unit and the Financial Intelligence Centre will be outlined in the 2023 Budget.

Global outlook

Between January and October 2022, the International Monetary Fund (IMF) lowered its expectation for global growth in 2022 from 4.4 per cent to 3.2 per cent, and from 3.8 per cent to 2.7 per cent in 2023. This revision is mainly the result of rising inflation, tightening financial conditions, the Russia-Ukraine war and lingering COVID-19 effects. There are significant risks to the global outlook, which are tilted largely to the downside.

Although the worst of the COVID-19 pandemic shock was concentrated in 2020, global supply-demand imbalances persist and have resulted in continued inflationary pressures. The Russia-Ukraine war and its consequences escalated geopolitical uncertainty, contributing to a sharp increase in food and fuel prices. The IMF projects that global consumer price inflation will reach 8.8 per cent in 2022, before easing to 6.5 per cent in 2023. Inflationary pressures are more pronounced among emerging markets and developing economies, where consumer baskets are heavily weighted towards essential goods including food and transport.

Table 2.1 Economic growth in selected countries

Region/country	2020	2021	2022	2023	2024
Percentage	Actual		Forecast		
World	**-3.0**	**6.0**	**3.2**	**2.7**	**3.2**
Advanced economies	**-4.4**	**5.2**	**2.4**	**1.1**	**1.6**
United States	-3.4	5.7	1.6	1.0	1.2
Euro area	-6.1	5.2	3.1	0.5	1.8
United Kingdom	-9.3	7.4	3.6	0.3	0.6
Japan	-4.6	1.7	1.7	1.6	1.3
Emerging and developing countries	**-1.9**	**6.6**	**3.7**	**3.7**	**4.3**
China	2.2	8.1	3.2	4.4	4.5
India	-6.6	8.7	6.8	6.1	6.8
Brazil	-3.9	4.6	2.8	1.0	1.9
Russia	-2.7	4.7	-3.4	-2.3	1.5
Sub-Saharan Africa	**-1.6**	**4.7**	**3.6**	**3.7**	**4.1**
Nigeria	-1.8	3.6	3.2	3.0	2.9
South Africa[1]	-6.3	4.9	1.9	1.4	1.7
World trade volumes	**-7.8**	**10.1**	**4.3**	**2.5**	**3.7**

1. National Treasury forecasts
Source: IMF World Economic Outlook, October 2022

In response to higher global inflation, central banks initiated a broad tightening of monetary policy, with interest rates rising across major economies and many developing countries. Monetary policy tightening has prompted capital outflows from emerging markets to "safe-haven" assets, leading to a broad strengthening of the US dollar against a wide range of currencies. Between January and September 2022, the rand depreciated by 11.9 per cent against the US dollar.

Global bond yields have trended higher since February and reflect tightening financial conditions. This risk aversion will negatively affect countries that are heavily indebted and reliant on foreign savings, as already seen in emerging market bond yield movements.

Figure 2.2 Selected real monetary policy rates*

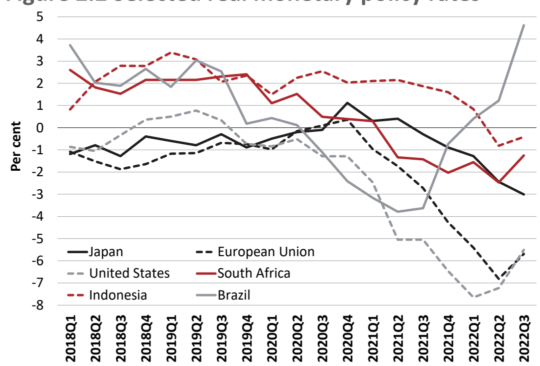


Figure 2.3 Selected currencies against the US dollar

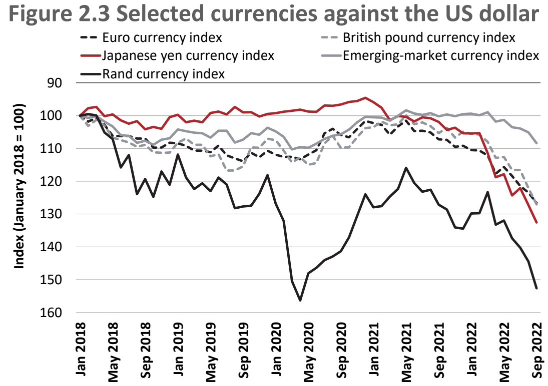


Figure 2.4 Commodity prices

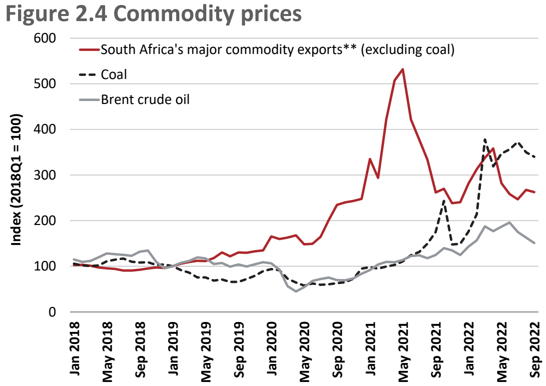
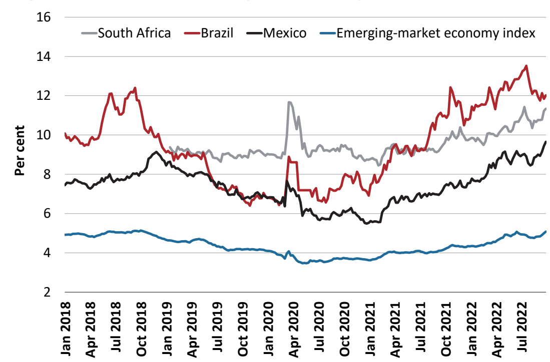


Figure 2.5 Selected 10-year bond yields



**The rate that banks charge one another to borrow funds*

***Trade-weighted index includes gold, iron ore, platinum, palladium and rhodium*

Source: Bloomberg

Global equity markets have broadly declined in response to global risks and rising interest rates. Commodity prices initially rallied at the onset of the Russia-Ukraine war, which extended price support to commodity exporters. Since March, energy commodity prices have risen due to persistent supply constraints in major exporting countries and trade disruptions associated with the war in Ukraine. Non-energy commodity prices are expected to continue easing in line with slowing global demand and reduced supply constraints.

Domestic outlook

The National Treasury forecasts real economic growth of 1.9 per cent in 2022, compared with 2.1 per cent projected in the 2022 *Budget Review*, in response to global and domestic shocks. Growth is projected to average 1.6 per cent from 2023 to 2025. Implementing structural reforms, especially in the energy sector, remains crucial to improve the economy's productive capacity and competitiveness.

The recovery in economic activity that began in 2021 was driven by a strong rebound in global economic activity, high commodity prices and easing COVID-19 restrictions. The scarring impact of the pandemic on employment and investment decisions will likely weigh on the recovery over the medium term. Investment remains well below pre-pandemic levels.

The economy grew by 1.4 per cent in the first half of 2022 compared with the first half of 2021. Real GDP grew more than expected in the first quarter of 2022, with output returning to pre-pandemic levels. However, a deteriorating global environment, flooding in KwaZulu-Natal and the Eastern Cape, industrial action in the electricity and mining sectors, and protracted and intense power cuts resulted in a broad-based contraction across most sectors during the second quarter. The third quarter was marked by frequent and prolonged power cuts, which significantly disrupted economic activity.

Table 2.2 Macroeconomic performance and projections

Calendar year	2019	2020	2021	2022	2023	2024	2025
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	1.2	-5.9	5.6	2.9	1.6	1.7	1.8
Final government consumption	2.1	0.8	0.6	0.8	-1.8	-1.0	0.2
Gross fixed-capital formation	-2.1	-14.6	0.2	4.0	1.9	3.6	3.8
Gross domestic expenditure	1.4	-8.0	4.8	3.6	1.2	1.6	1.8
Exports	-3.4	-11.9	10.0	7.4	1.9	2.8	2.9
Imports	0.4	-17.4	9.5	13.8	1.0	2.3	2.9
Real GDP growth	**0.3**	**-6.3**	**4.9**	**1.9**	**1.4**	**1.7**	**1.8**
GDP inflation	4.6	5.7	6.2	4.1	4.3	4.7	4.6
GDP at current prices (R billion)	**5 614**	**5 557**	**6 192**	**6 572**	**6 956**	**7 406**	**7 884**
CPI inflation	4.1	3.3	4.5	6.7	5.1	4.6	4.6
Current account balance (% of GDP)	-2.6	2.0	3.7	0.2	-0.9	-1.1	-1.2

Source: National Treasury, Reserve Bank and Statistics South Africa

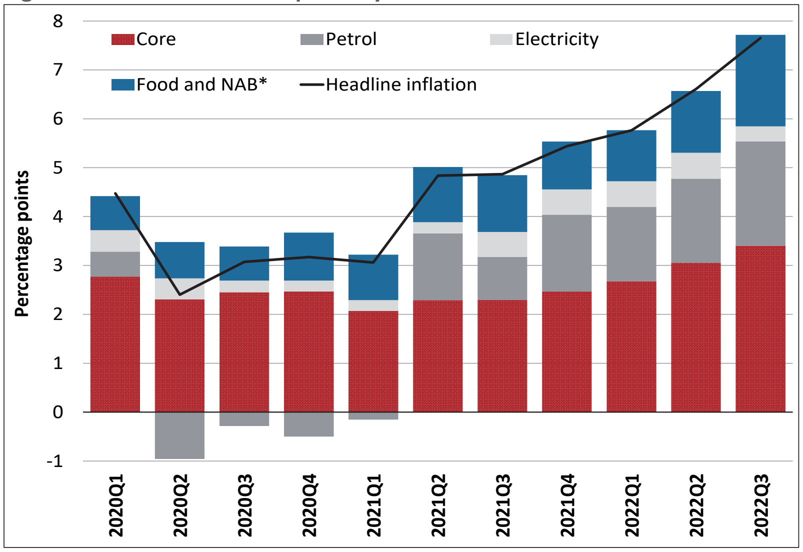
Employment

In the wake of the COVID-19 pandemic, the recovery in economic growth has outpaced the recovery in employment. A similar relationship was identified during the global financial crisis, although job losses are now more pronounced. At the height of the pandemic, 2.3 million people lost their jobs, and the initial employment recovery was mostly erased in July 2021 by the outbreak of public violence in Gauteng and KwaZulu-Natal and the fourth wave of COVID-19. Halfway through 2022, employment was about 858 000 people below pre-pandemic levels, with the recovery for low- and semi-skilled workers lagging behind high-skilled workers. Pandemic-related job losses are broad-based across sectors and constrain the pace of recovery in demand over the medium term.

Inflation

Headline inflation of 6.7 per cent is projected for 2022, declining to 5.1 per cent in 2023. High domestic food inflation and elevated fuel prices are key sources of inflationary pressure. Households face broad increases in the cost of living, with headline consumer inflation peaking in July 2022 at 7.8 per cent – the highest in 13 years – before easing in September 2022 to 7.5 per cent. Food inflation has averaged 8.5 per cent in the year to date, driven by rising bread, cereals and meat prices. The Russia-Ukraine war triggered a significant rise in global crude oil prices – well above the levels anticipated in February. Fuel prices have increased by 37.5 per cent in the year to date and are expected to remain well above the 2021 average.

Figure 2.6 Contributions to quarterly headline inflation



**NAB is non-alcoholic beverages*
Source: Statistics South Africa

Global supply-demand imbalances have triggered an acceleration in the price of raw materials and intermediate inputs, with producer price inflation sharply elevated at 16.6 per cent in August 2022 and averaging 13.9 per cent in the year to date. Higher input costs and reduced profit margins create risks of more persistent increases in consumer prices. In addition, core inflation is expected to contribute to elevated consumer prices in 2023 as increased input costs pass through to prices broadly, even as food and energy inflation pressures ease. Since the 2021 *Medium Term Budget Policy Statement*, the Reserve Bank has increased the repurchase rate by 275 basis points to 6.25 per cent in response to inflationary pressures.

Household consumption

A broad-based recovery in household consumption saw growth of 2.4 per cent in the first half of the year compared with the same period in 2021. Household consumption now exceeds pre-pandemic levels and is expected to grow by 2.9 per cent in 2022. The recovery in employment, although subdued, has supported household income, boosted by the extension of the *COVID-19 social relief of distress grant* in 2022/23. This support will now extend to the end of 2023/24. A strong rebound in disposable income was supported by improved real private-sector wages and labour productivity.

Households face an increased cost of living from elevated consumer inflation. With interest rates rising to rein in inflation, household spending is likely to moderate in 2022 and over the medium term. Modest real private-sector wage growth is expected as inflationary pressures ease. Credit extended to households has recovered, but rising borrowing costs will temper credit growth. Persistently high unemployment and weak economic growth will continue to weigh on the household spending recovery.

Investment

Gross fixed-capital formation grew by 3.7 per cent in the first half of 2022 compared with the same period last year. Investment remains about R62 billion below pre-pandemic levels, with private investment, the largest component of gross fixed-capital formation, accounting for 87.4 per cent of the shortfall. In 2021, private investment amounted to 9.9 per cent of GDP, and public-sector investment amounted to 4.1 per cent of GDP, well below the National Development Plan targets of 20 per cent and 10 per cent of GDP, respectively, by 2030.

Gross fixed-capital formation is projected to increase by 1.9 per cent in 2023 due to slowing global growth, rising borrowing costs, weaker equity markets and heightened risk aversion. In the near term, business conditions will remain challenging given the slow pace of economic reforms and inadequate electricity supply. Over the medium term, the rollout of energy infrastructure through the independent power producer initiatives and embedded generation projects will support investment.

Balance of payments

The trade surplus has continued to weaken as the value of merchandise imports outpaces that of exports. The robust net trade gains that benefited the current account in 2021 are expected to dissipate in 2022. In 2023, weaker external demand, easing of South Africa's export commodity prices, and electricity and logistical constraints will limit export volume growth, while a slowdown in domestic activity will constrain import volume growth. Over the medium term, a recovery in global demand and a gradual easing of domestic constraints will boost export volumes, with modest improvements in domestic demand supporting higher import volumes.

The current account surplus averaged 0.6 per cent of GDP in the first half of the year, narrowing from 3.7 per cent in 2021 as a result of higher-than-anticipated dividend payments made by firms in the second quarter of 2022. The current account is expected to moderate to a narrow deficit of 0.9 per cent of GDP in 2023 and 1.2 per cent of GDP in 2025. The financial account will be vulnerable to capital outflows from global monetary policy tightening and market volatility.

Macroeconomic assumptions

The forecast incorporates assumptions outlined in Table 2.3. Compared with the 2022 Budget forecast, the major changes are a higher export commodity price index for 2022, significantly higher crude oil prices in 2022 and higher food prices in the near term. An increased sovereign risk premium in 2022 and 2023 reflects both global and domestic factors, including rising US interest rates and frequent power cuts.

Table 2.3 Assumptions informing the macroeconomic forecast

	2020	2021	2022	2023	2024	2025
Percentage change	**Actual**		**Estimate**	**Forecast**		
Global demand[1]	**-3.4**	**6.0**	**3.2**	**2.9**	**3.6**	**3.5**
International commodity prices[2]						
Brent crude oil (US$ per barrel)	41.8	70.7	101.6	87.3	80.8	76.2
Gold (US$ per ounce)	1 769.5	1 799.8	1 802.6	1 774.2	1 835.0	1 880.7
Platinum (US$ per ounce)	883.2	1 090.8	937.8	889.9	914.0	939.6
Coal (US$ per ton)	65.2	125.2	304.1	290.8	270.4	259.2
Iron ore (US$ per ton)	108.1	158.2	122.4	101.9	95.3	89.2
Palladium (US$ per ounce)	2 192.7	2 398.2	2 138.3	2 076.3	2 080.9	2 084.8
Food inflation	**4.5**	**6.1**	**8.5**	**5.4**	**4.4**	**4.5**
Sovereign risk premium (percentage point)	**4.9**	**3.5**	**4.1**	**3.9**	**3.5**	**3.4**
Public corporation investment	**-22.7**	**10.7**	**9.3**	**7.3**	**6.6**	**6.9**

1. Combined growth index of South Africa's top 15 trading partners (IMF World Economic Outlook, October 2022)
2. Source: Bloomberg futures prices as at 16 September 2022
Source: National Treasury

Risks to the domestic growth outlook

Risks to the global and domestic outlook remain elevated. Unresolved structural constraints and scarring from COVID-19 leave the economy vulnerable to new shocks:

- Global growth could slow further if the Russia-Ukraine war escalates, with associated effects on global supply chains and inflationary consequences for food and energy prices. More severe disruptions of gas supplies from Russia to Europe could trigger energy rationing, with implications for global energy prices and energy-intensive industries.
- The pace and scale of monetary policy tightening could negatively affect economic output, while a further decline in Chinese economic growth could slow global demand and add pressure to global supply chains.
- Increased power cuts will compromise an already fragile and recovering economy. Conversely, accelerating the implementation of energy reforms could mitigate the adverse effects of load-shedding and support higher business confidence and investment. Industrial action in the ports and rail sector could constrain economic activity and reduce South Africa's competitiveness.
- A deterioration of the fiscal outlook due to unfunded spending pressures or the materialisation of contingent liabilities could increase borrowing costs, and crowd out both private and public investment.

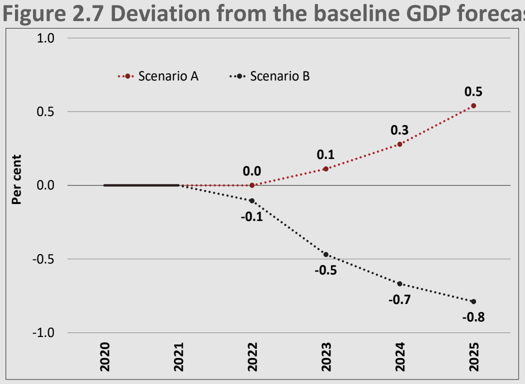
Alternative scenarios

The National Treasury has modelled two scenarios to the baseline economic forecast.

The upside **Scenario A** assumes that major public entities successfully scale up capital expenditure over the medium to long term, boosting overall fixed investment in the economy. The additional capital spending, as a result of efficiency improvements, allows these entities to rehabilitate eroded infrastructure, thereby improving their ability to provide core services (and goods) in line with their mandates. This supports a conducive business climate, enhancing private-sector participation and boosting the productive capacity of the economy. Business confidence levels improve, growth constraints are eased and economic activity is stimulated. Improved spending by public entities supports the economy mainly through improved spending on gross fixed-capital formation. Real GDP growth is estimated to be 0.5 percentage points higher, and investment is estimated to be 5.4 percentage points higher, than the baseline forecast for 2025. Furthermore, improvement in the operations and balance sheets of these entities should support their longer-term profitability and sustainability.

In the downside **Scenario B**, an appreciable slowdown in global growth is accompanied by persistently high inflation, particularly in 2023. Energy-related commodity prices trend higher owing to energy rationing in Europe and the switching from gas to oil for power generation. Higher global inflation triggers aggressive monetary policy tightening, leading to an even sharper slowdown in global growth, particularly in China, Europe, the United Kingdom and the United States. Due to growing risk aversion, South Africa's risk premium and borrowing costs rise. Private investment declines and consumer purchasing power is eroded. Sluggish global growth lowers the demand for both exports and non-energy related commodities, putting downward pressure on export commodities. Growth slows, measuring 0.8 percentage points below the baseline forecast in 2025.

Figure 2.7 Deviation from the baseline GDP forecast



Source: National Treasury

Sector performance and outlook

Agriculture

The agriculture sector contracted by 13.3 per cent in the first half of 2022 compared with the first half of 2021. While a contraction is expected for 2022 overall, this represents a return to more normal output following two years of standout growth, rather than a poor performance. Agriculture exports grew despite logistics constraints and disease-related trade bans. Risks to the sector are decidedly to the downside, and include uncertainty surrounding the Russia-Ukraine war, which has inflated input costs, especially for fertiliser and animal feeds, and the effects of the strike at Transnet, particularly on perishable exports.

Mining

Despite elevated commodity prices, the mining sector contracted by 7.3 per cent in the six months to June 2022 compared with the same period in 2021. Operational constraints weighed on the sector, including safety stoppages and logistics disruptions, while electricity supply disruptions, persistent rail constraints and labour action further dampened production.

The Transnet strike could weigh on the mining sector in the fourth quarter, with major mineral export harbours having operated at significantly lower capacity.

Manufacturing

Gross value added in the manufacturing sector was 1.3 per cent lower in the six months to June 2022 compared with the same period in 2021, reflecting intense electricity outages and input cost pressures, as well as the impact of the April 2022 floods. Production is yet to return to pre-pandemic levels, with the anticipated slowdown in global demand reinforcing the weak outlook for manufacturing exports.

Construction

The construction sector contracted 6.1 per cent in the first half of 2022 compared with the first half of 2021, mainly due to declining residential and non-residential buildings works, while a number of projects were halted or cancelled in the wake of the April floods. Sector activity may improve in the short term as these projects resume and damaged infrastructure is repaired. Conversely, building material shortages, delays in tender processes in the public sector, and the increased prevalence of illegal disruptions and damages to construction sites will depress growth going forward.

Utilities

Gross value added in the electricity, gas and water sector was 1 per cent lower in the first half of 2022 compared to the same period in 2021. Structural impediments, including high tariffs, illegal connections and ageing infrastructure, will continue to constrain the sector in the near term, with Eskom's power plants continuing to perform poorly and unreliably. According to Eskom, load-shedding is forecast to persist over the next 18 months. Any challenges preventing independent power producer projects from closing will imply more delays in procuring new capacity and stunt the sector's prospects going forward.

Transport and communications

The transport, storage and communication sector grew by 7.6 per cent in the first six months of 2022 compared with the same period in 2021. Along with the Transnet strike, infrastructure deterioration and vandalism, criminal activity and the shortage of locomotives and spare parts are expected to weigh on the transport sector going forward. In addition, delays in digital migration are offsetting the forward momentum of the auction of broadband spectrum that should create significant positive gains for the communications sector.

Finance and business services

The finance, real estate and business services sector grew by 3.2 per cent in the first six months of 2022 compared to the same period in 2021. While the sector has remained fairly resilient, the materialisation of the aforementioned risks, including slower global growth and tighter global monetary policy, could test the resilience of South Africa's well-regulated financial sector.

Conclusion

The supportive global conditions that spurred the economic recovery in 2021 are dissipating, and domestic shocks – particularly power cuts – have lowered economic growth and confidence. A broad slowdown in global growth and high inflation are forecast. Rapid and decisive implementation of structural reforms, especially in the energy sector, supported by a clear and stable macroeconomic framework and improved state capability, remain crucial to improve the economy's productive capacity and international competitiveness.