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2023 MTBPS

ECONOMIC OUTLOOK

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CHAPTER 2

ECONOMIC OUTLOOK

In brief

- Economic growth is projected to moderate from 1.9 per cent in 2022 to 0.8 per cent in 2023. GDP growth is forecast to average 1.4 per cent over the period 2024–2026.
- The global outlook has weakened and risks remain elevated. The weaker outlook for China, lower commodity prices and the risk that US interest rates will remain higher for longer have made the global environment less supportive of South Africa's growth path.
- Government's macroeconomic framework supports the economy by mitigating fiscal risks, building buffers against economic shocks, stabilising debt and reducing the degree to which servicing debt crowds out development priorities.
- Medium-term reforms focus on strengthening the performance of electricity, rail transport and logistics, and improving the functioning of the state. Efforts by government and the private sector to rebuild electricity generation capacity are bearing fruit, and are expected to gain traction over the medium term.

INTRODUCTION

The medium-term economic growth outlook remains constrained by inadequate electricity supply and freight rail capacity and a weaker global outlook that is less supportive of South Africa's growth prospects.

Longstanding structural constraints continue to limit economic performance. In recent years, freight rail capacity and throughput have declined, constraining growth and exports, while large-scale and prolonged power cuts have plagued mines, factories, farms and households. Despite a recent improvement, private investment growth has declined over the past decade (Figure 2.1). GDP growth is expected to average only 1.4 per cent between 2024 and 2026.

South Africa's debt-to-GDP ratio continues to rise and the sovereign risk premium has increased during the course of 2023, reflecting concerns over materialising economic and fiscal risks (Figure 2.2). The resulting increase in government's borrowing costs has pushed up long-term lending rates in the economy. This in turn stifles demand and reduces economic growth. Elevated uncertainty and low levels of business confidence are likely to result in delays to investment and employment decisions. These conditions have led to a decline in international appetite for government bonds. The rand has also weakened sharply relative to other emerging market currencies (Figure 2.3), contributing to inflationary pressures that disproportionately affect poor households (Figure 2.4).

Government's clear and stable macroeconomic framework includes a prudent fiscal policy, an inflation-targeting framework and a flexible exchange rate. It is designed to support investment and employment while protecting the most vulnerable members of society. The fiscal policy stance set out in Chapter 3 will support medium-term economic growth by mitigating fiscal and economic risks, building buffers against economic shocks, stabilising debt and reducing the degree to which servicing debt crowds out expenditure on development priorities. This approach supports investor certainty. In contrast, in a low-growth environment, the failure to adopt a prudent fiscal stance would undermine confidence and growth, weakening the economy's ability to withstand external shocks.

As the National Treasury has highlighted for several years, lifting the economy's growth potential requires substantial structural reforms, as well as steps to reduce near-term risks and increase government efficiency.

In partnership with the private sector, government is tackling energy and logistics challenges. The Presidency and the National Treasury are coordinating government's wide-ranging economic reform programme through Operation Vulindlela. Reforms will be complemented by efforts to reconfigure the state.

Figure 2.1 Growth in investment

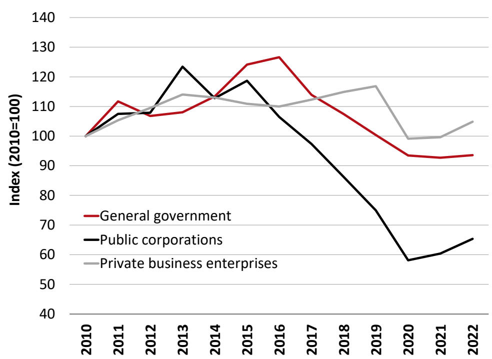


Figure 2.2 Debt forecasts for emerging markets vs change in CDS spreads*

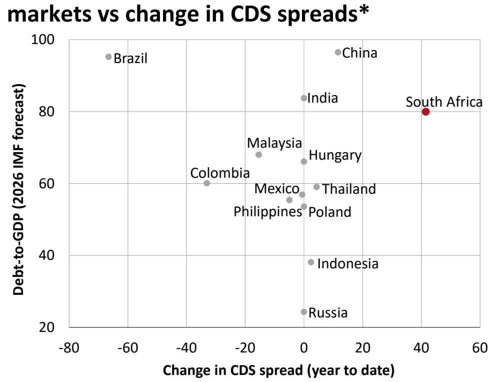


Figure 2.3 Year-to-date emerging market currency performance against the US dollar

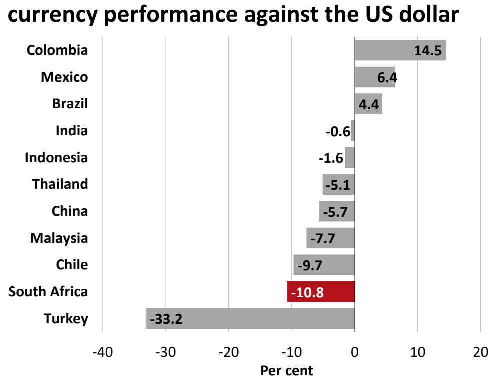
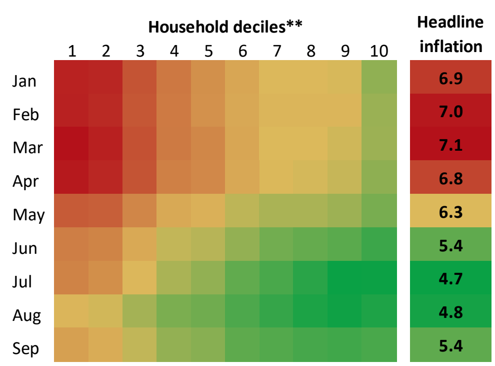


Figure 2.4 CPI by household decile in 2023



**IMF debt covers general government as defined in the national accounts: national, provincial and local government, as well as central agencies and social security funds. CDS spread is the credit default swap spread, which is a proxy for the sovereign credit risk premium*
***Green indicates lower rates of inflation and red indicates higher rates of inflation*
Source: National Treasury, Bloomberg, Statistics South Africa and IMF

REFORMS TO DELIVER GROWTH OVER THE MEDIUM TERM

Operation Vulindlela supports coordinating mechanisms such as the National Logistics Crisis Commitee to accelerate economic reforms by streamlining bureaucracy, reducing red tape and implementing policy changes to promote investment and growth. A comprehensive report will soon be published by Operation Vulindlela covering its work over the past three years.

This chapter focuses on reforms under way in electricity and rail. Chapter 1 sets out government's medium-term view on reconfiguring the state.

New electricity generation capacity and energy reforms

Although total Eskom power cuts to end-September 2023 already exceed the figure for all of 2022, load-shedding hours have declined quarter by quarter this year due to improved plant performance. Eskom recently returned two units to service at Kusile (1 600 MW) and is expected to return two more by the end of the year, adding another 1 600 MW of capacity to the grid. The energy availability factor has risen from an average of 53 per cent in the first quarter of 2023 to nearly 60 per cent at the beginning of the fourth quarter.

Additional capacity of over 11 000 MW from renewable sources is expected over the next three years (Figure 2.6), and this should sharply curtail power cuts. The pipeline of private energy investments, which is critical to progress, continues to grow. Over the past two years, private-sector energy investments capable of generating over 5 600 MW have been registered with the National Energy Regulator of South Africa (NERSA).

Figure 2.5 Load-shedding by stages*

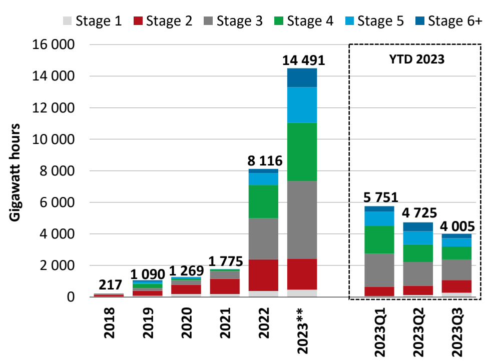
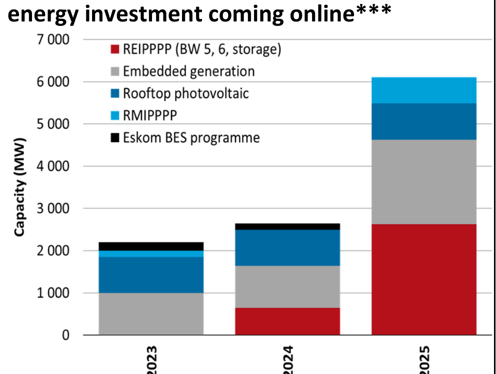


Figure 2.6 Capacity from expected renewable energy investment coming online***



**Stage 6+ includes incidences where manual load reduction exceeded 5 000 MW*
***Includes data until 30 September 2023*
****REIPPPP: Renewable Energy Independent Power Producer Procurement Programme, RMIPPPP: Risk Mitigation Independent Power Producer Procurement Programme, BES: battery energy storage*
Source: Eskom, National Energy Crisis Committee interventions and National Treasury calculations

Since the 2023 Budget, several other energy reforms have progressed:

- Three projects under the Risk Mitigation Independent Power Producer Procurement Programme, with capacity totalling 150 MW, will be ready for connection to the grid in November 2023.
- By 2025, nine projects with a total capacity of over 1 000 MW will be connected to the grid under the Renewable Energy Independent Power Producer Procurement Programme, with a further 1 000 MW expected in the next phase.
- In June, Eskom released interim rules to ensure fair and transparent allocation of limited grid capacity.

Deeper reforms to reshape the industry are under way to ensure the country's energy security. In August, Cabinet approved an amendment to the Electricity Regulation Act (2006) for public comment. The amendment aims to establish an independent transmission system operator and a competitive electricity market. NERSA has granted licences for transmission, trading and importing electricity to the National Transmission Company of South Africa. And the debt-relief arrangement announced in the 2023 Budget is expected to position Eskom for a financially sustainable future, while allowing Eskom to undertake critical plant maintenance.

Rail and ports reforms

Transnet's deteriorating rail performance threatens the economy, and the country's ports are inefficient and uncompetitive.

Since 2018, Transnet Freight Rail has consistently transported fewer volumes than targeted or contracted (Figure 2.7). This collapse stems from operational failures, increased theft and vandalism, reduced locomotive availability and the poor condition of infrastructure resulting from underinvestment. Coal and iron ore exports forfeited as a result of operational failures could have added 1.3 percentage points to the current account balance in 2022, resulting in a current account surplus. The cost of rail inefficiencies last year is estimated at R411 billion (Figure 2.8). This performance has also reduced tax revenue.

Figure 2.7 Transnet Freight Rail performance

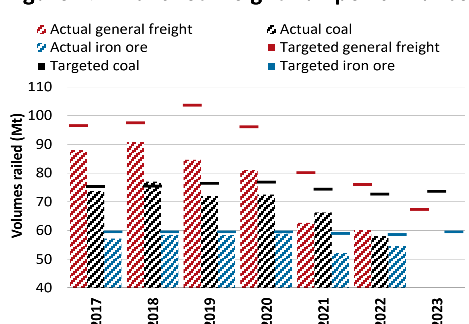
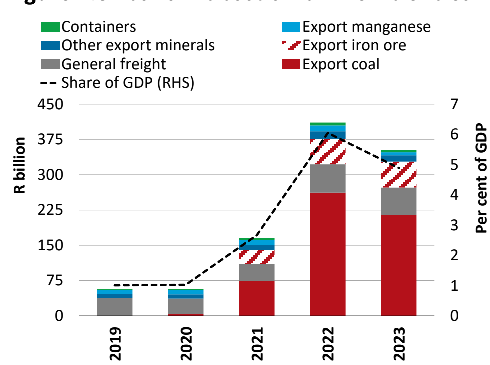


Figure 2.8 Economic cost of rail inefficiencies



Source: Transnet Freight Rail and Operation Vulindlela using GAIN Group data

Earlier this year, government established the National Logistics Crisis Committee. It aims to improve the operational performance of freight rail and ports, restructure Transnet to ensure it is financially sustainable and implement reforms to create an efficient, competitive and modern freight logistics system.

This work will be integrated with interventions under way within Transnet, including rehabilitating the rail network to improve service delivery, deploying digital solutions to improve efficiency and responsiveness, improving security and reviewing cost allocations to improve returns. Transnet Freight Rail has taken the first step in separating its operations and infrastructure management functions. When complete, separation is expected to facilitate competition. The Transport Economic Regulator will be established in early 2024, which will ensure fair access and transparent pricing on the rail network.

GLOBAL OUTLOOK

The International Monetary Fund (IMF) has lowered its global economic growth forecast for 2024 to 2.9 per cent, down from 3.1 per cent at the time of the 2023 Budget, with risks tilted to the downside. The expected slowdown is mainly due to lower manufacturing activity in major advanced economies. Near-term growth in emerging markets is expected to be more resilient owing to buoyant industrial activity in Brazil and India. The weaker outlook for Chinese growth has also weakened the outlook for mineral commodity prices.

Table 2.1 Economic growth in selected countries

Region/country	2021	2022	2023	2024	2025
Percentage	Actual		Forecast		
World	**6.3**	**3.5**	**3.0**	**2.9**	**3.2**
Advanced economies	**5.6**	**2.6**	**1.5**	**1.4**	**1.8**
United States	5.9	2.1	2.1	1.5	1.8
Euro area	5.6	3.3	0.7	1.2	1.8
United Kingdom	7.6	4.1	0.5	0.6	2.0
Japan	2.2	1.0	2.0	1.0	0.7
Emerging and developing countries	**6.9**	**4.1**	**4.0**	**4.0**	**4.1**
China	8.5	3.0	5.0	4.2	4.1
India	9.1	7.2	6.3	6.3	6.3
Brazil	5.0	2.9	3.1	1.5	1.9
Russia	5.6	-2.1	2.2	1.1	1.0
Sub-Saharan Africa	**4.7**	**4.0**	**3.3**	**4.0**	**4.1**
Nigeria	3.6	3.3	2.9	3.1	3.1
South Africa[1]	4.7	1.9	0.8	1.0	1.6
World trade volumes	**10.9**	**5.1**	**0.9**	**3.5**	**3.7**

1. National Treasury forecasts
Source: IMF World Economic Outlook, October 2023

Global monetary conditions are expected to loosen from 2024 as central banks in major advanced economies slowly reduce interest rates. Inflation in advanced economies is projected to ease from 7.3 per cent in 2022 to 3 per cent in 2024 due to lower energy and food prices. Higher-than-anticipated international oil prices and wage price increases pose upside risks to inflation. In this context, US dollar strength is expected to be sustained into 2024, with consequences for the rand, domestic inflation and fiscal risks.

The combination of weaker growth prospects for China – which is South Africa's largest trading partner – lower commodity export prices and the likely slow pace of US interest rate cuts makes the global economic environment less supportive to domestic growth over the medium term.

DOMESTIC OUTLOOK

The National Treasury forecasts real GDP growth of 0.8 per cent in 2023, compared with 0.9 per cent projected in the 2023 *Budget Review*. Growth is projected to average 1.4 per cent from 2024 to 2026. Relative to the 2023 Budget, the weaker projection for 2023 mainly reflects lower household consumption expenditure due to higher inflation and interest rates, and lower net exports. Power cuts are expected to continue for the remainder of this year and to gradually ease in 2024. Faster, determined implementation of energy and logistics reforms remains critical to boosting economic growth.

Table 2.2 Macroeconomic performance and projections

Calendar year	2020	2021	2022	2023	2024	2025	2026
Percentage change	Actual			Estimate	Forecast		
Final household consumption	-6.1	5.8	2.5	0.8	1.4	1.5	1.7
Final government consumption	0.9	0.5	1.0	0.6	-3.2	-0.5	0.2
Gross fixed-capital formation	-14.6	0.6	4.8	6.2	3.6	4.6	3.4
Gross domestic expenditure	-7.6	4.8	3.9	1.6	1.0	1.6	1.7
Exports	-12.0	9.1	7.4	4.2	2.1	2.6	3.1
Imports	-17.6	9.6	14.9	7.1	2.1	2.7	2.9
Real GDP growth	**-6.0**	**4.7**	**1.9**	**0.8**	**1.0**	**1.6**	**1.8**
GDP inflation	5.3	6.5	4.8	4.0	4.3	4.7	4.6
GDP at current prices (R billion)	**5 568.0**	**6 208.8**	**6 628.6**	**6 947.3**	**7 321.4**	**7 786.8**	**8 288.7**
CPI inflation	3.3	4.6	6.9	6.0	4.9	4.6	4.5
Current account balance (% of GDP)	1.9	3.7	-0.5	-2.4	-3.0	-3.0	-3.1

Source: National Treasury, Reserve Bank and Statistics South Africa

Employment

Although employment growth has moderately outpaced labour supply growth over the last two years, joblessness remains extremely high. The unemployment rate declined marginally from 32.9 per cent in the third quarter of 2022 to 32.6 per cent in the second quarter of 2023. Employment growth continues to lag South Africa's post-COVID-19 economic recovery, with 74 000 fewer people in employment in the second quarter of 2023 than in the fourth quarter of 2019. Improving employment growth sustainably over the long term requires faster GDP growth and improved education and skills development.

Inflation

Headline inflation is expected to decelerate as the energy and food price shocks associated with global supply chain disruptions and the war in Ukraine dissipate. Headline consumer prices are expected to fall from an expected 6 per cent in 2023 to 4.9 per cent in 2024. Fuel prices have fallen since June 2023, largely reflecting base effects. Food price inflation, which peaked at 14.4 per cent in March 2023, slowed to 8.2 per cent by August 2023. However, the pace of deceleration has been slow relative to global food prices. This can be attributed to a weaker rand exchange rate and elevated production costs. Core inflation has remained near 5 per cent for most of 2023 due mainly to higher insurance and vehicle price inflation.

Headline inflation is projected to return towards the mid-point of the 3–6 per cent target range in 2025. Upside risks to the medium-term outlook include rising oil prices, a weakening rand exchange rate, the avian influenza outbreak and elevated administered price inflation for services, including electricity and water.

Household consumption

Household consumption expenditure is expected to slow from 2.5 per cent in 2022 to 0.8 per cent in 2023 due to the cumulative effect of interest rate increases, elevated inflation and falling real disposable income, and generally weak consumer confidence. Growth in credit extended to households continues to decelerate for both secured and unsecured credit. National Credit Regulator data shows that in the first quarter of 2023, banks rejected 70 per cent of credit applications – the highest rate on record – reflecting concerns over households' ability to repay loans. Household consumption expenditure is expected to average 1.6 per cent from 2024 to 2026.

Investment

Gross fixed-capital formation is expected to reach 6.2 per cent in 2023, up from 4.8 per cent in 2022. Investment remains below pre-pandemic levels – particularly in the private sector – due to structural constraints, higher interest rates, global demand moderation and weak domestic demand. Although business confidence improved in the third quarter of 2023 for the first time since the first quarter of 2022, it remains low. Gross fixed-capital formation is expected to decline to 3.6 per cent in 2024 as a result of challenging domestic business conditions, sluggish global economic growth and elevated borrowing costs.

Strategic steps towards a clean energy transition

Government is committed to a just transition to cleaner energy, ensuring that workers and communities in affected industries are not left behind in the pursuit of climate goals.

South Africa's just transition initiatives will be supported by financing from international sources. Over the next five years, this funding will be used to improve electricity infrastructure, transition retiring coal plants, address regional energy transitions, promote new energy vehicles, support green hydrogen, develop skills and empower municipalities. These goals are supported by policies such as the Green Hydrogen Commercialisation Strategy, approved by Cabinet in October 2023.

In addition to decarbonising the electricity system, government will also propose measures to help the automotive industry transition to new energy vehicle production, with details to be announced in the 2024 Budget.

The private sector plays a major role in supporting South Africa's clean-energy transition. As reported earlier in this chapter, renewable energy investments are gathering pace. According to Eskom data published in July 2023, households and businesses have installed 4 412 MW of rooftop solar capacity – twice the capacity installed to date under the Renewable Energy Independent Power Producer Procurement Programme.

Balance of payments

The deficit on the current account is expected to widen from 0.5 per cent in 2022 to 2.4 per cent in 2023 and to 3 per cent in 2024 as imports grow faster than exports. This reflects increased import volumes for renewable energy investments as firms and households mitigate frequent power cuts, as well as higher oil prices. Relatively low export values reflect lower commodity export prices, while electricity and logistical constraints limit export volumes.

Risks to the domestic growth outlook

Risks to the domestic outlook remain elevated, despite progress in addressing constraints in electricity and rail. Other domestic risks include higher-than-anticipated inflation and high household indebtedness. Uncertainty in the global economy is high and the major risks to South Africa are illustrated in the scenarios.

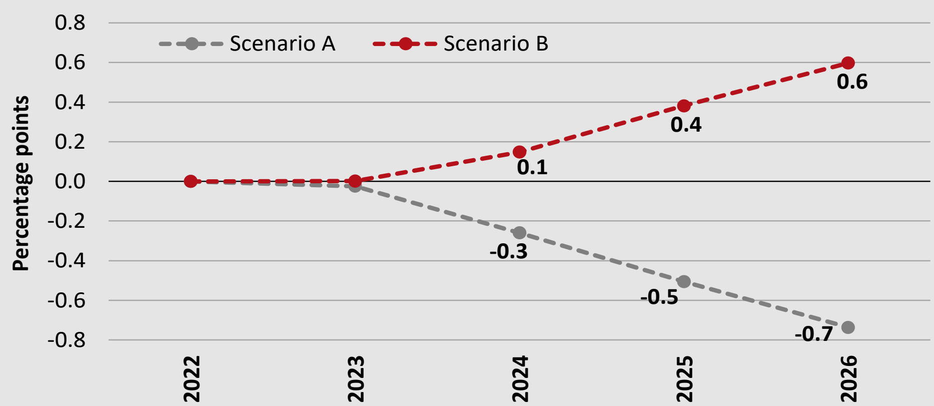
Alternative scenarios

The National Treasury has modelled two alternatives to the baseline forecast.

Scenario A assumes economic growth in China slows significantly, causing the terms of trade to deteriorate due to lower export commodity prices and elevated oil prices. Imported inflation pressure triggers further monetary policy tightening, which lowers consumer purchasing power and raises borrowing costs. The risk premium rises, further weakening the rand exchange rate. GDP growth stalls in 2024 before rising gradually thereafter. Meanwhile, inflation remains elevated in 2024 and 2025, converging to the baseline by the end of 2026.

Scenario B assumes a further easing of global supply chain disruptions, which reduces inflationary pressure and triggers a reduction in interest rates, lowering borrowing costs. Risk aversion declines, with a lower risk premium and stronger rand exchange rate. The purchasing power of consumers rises, while the cost of investment is reduced for firms. Consumer prices ease towards the mid-point of the inflation target range much quicker than the baseline, while growth exceeds the baseline over the next three years.

Figure 2.9 Deviation from baseline GDP forecast



Source: National Treasury

Table 2.3 Assumptions informing the macroeconomic forecast

	2020	2021	2022	2023	2024	2025	2026
Percentage change	Actual			Estimate	Forecast		
Global demand[1]	**-3.5**	**6.5**	**3.7**	**3.3**	**3.1**	**3.3**	**3.3**
International commodity prices[2]							
Brent crude oil (US$ per barrel)	41.8	70.7	100.7	84.2	84.8	79.3	75.7
Gold (US$ per ounce)	1 769.5	1 799.8	1 801.5	1 923.8	1 974.7	2 077.8	2 143.2
Platinum (US$ per ounce)	883.2	1 090.8	960.9	966.7	931.9	974.4	1 000.3
Coal (US$ per ton)	65.2	125.2	271.1	121.0	118.5	117.3	115.4
Iron ore (US$ per ton)	108.1	158.2	120.7	115.0	99.7	91.2	85.2
Palladium (US$ per ounce)	2 192.7	2 398.2	2 107.4	1 375.3	1 263.0	1 312.6	1 362.0
Food inflation	**4.5**	**6.1**	**9.2**	**10.4**	**4.5**	**4.6**	**4.4**
Electricity inflation	**8.9**	**10.1**	**11.1**	**11.7**	**13.9**	**12.7**	**10.5**
Sovereign risk premium	**4.9**	**3.5**	**4.1**	**3.9**	**4.1**	**4.0**	**3.9**

1. Combined growth index of South Africa's top 15 trading partners (IMF World Economic Outlook, October 2023)
2. Bloomberg futures prices as at 9 October 2023
Source: National Treasury

SECTOR PERFORMANCE

Agriculture

The agriculture sector grew by 7.8 per cent in the first half of 2023 compared with the first half of 2022. Despite strong field crop production, low growth is anticipated for the remainder of 2023 given declining commodity prices and market access concerns associated with the European Union's imposition of stricter phytosanitary regulations. The sector also faces downside risks due to continued power cuts, rail and port inefficiencies, higher fuel and input prices, recent flooding in the Western Cape and damage to the poultry industry following the outbreak of avian influenza.

Mining

Gross value added in the mining sector contracted by 1.1 per cent in the six months to June 2023 compared with the same period in 2022. Mining sales declined by 11.8 per cent over the same period, reflecting lower global demand and weaker export prices. Production continues to be suppressed by severe power outages and poor rail operations, which curtail export capacity. Community unrest, illegal mining and violent crime pose further risks. Weaker demand from China may dampen export prices.

Manufacturing

Gross value added in the manufacturing sector was 0.1 per cent lower in the six months to June 2023 compared with the same period in 2022. Manufacturing exports increased by 6.8 per cent over the same period, supported by food and beverages and vehicle exports. Production remains below pre-pandemic levels, owing to ongoing power cuts and rail constraints, as well as weak domestic demand. The outlook for the sector remains constrained by electricity outages.

Construction

The construction sector grew by 4.2 per cent in the first half of 2023 compared with the first half of 2022, due to expansion in residential and non-residential buildings and construction works. After contracting for six consecutive years, the sector is showing signs of recovery, yet activity remains well below pre-pandemic levels. A sustained improvement in construction activity will require private- and public-sector projects to move from the tender phase to adjudication and commencement.

Utilities

Gross value added in the electricity, gas and water sector contracted by 6.5 per cent in the first half of 2023 compared with the same period in 2022. Low generating capacity, high tariffs, illegal connections and ageing infrastructure – including at the distribution level – weighed on sectoral output. Unplanned outages remained elevated at about 30 per cent, signalling the poor performance of the coal generation fleet.

Transport and communications

Despite ongoing challenges with rail services, the transport, storage and communications sector grew by 5.6 per cent in the first six months of the year compared with the same period in 2022. Road freight remains critical for the economy: trucks carry the bulk of goods in South Africa. The communications sector should benefit in the medium term from the rollout of telecommunications infrastructure for newly licensed spectrum, which will facilitate wider and lower-cost coverage.

Finance and business services

The finance, real estate and business services sector grew by 1.5 per cent in the first six months of the year compared with the same period in 2022. Risks are building for consumers and large companies as economic growth remains subdued. Non-financial sector debt remains a key vulnerability that may be triggered by shocks to economic growth, spending or borrowing costs.

CONCLUSION

In the context of weaker global growth and risks to the domestic outlook, government is working to position the economy for sustained growth and resilience to shocks. A combination of a stable macroeconomic framework, the rapid implementation of economic and structural reforms, and improvements in state capability remains central to achieving higher growth, employment and competitiveness.