



SA economy averts a technical recession in Q1 2023

Highlights

- According to Statistics South Africa (Stats SA), seasonally adjusted (sa) real gross domestic product (GDP) was 0.4% quarter-on-quarter (q/q) in the first quarter of 2023, in line with the Reuters median consensus.
- The marginal uptick in growth in the first quarter prevented a technical recession following a contraction of 1.1% q/q, sa in the fourth quarter of 2022 (revised up from negative 1.3% q/q, sa).
- The main contributors to growth on the production side were the manufacturing industry (1.5% q/q, sa, contributing 0.2%) and the finance industry (0.6% q/q, sa, contributing 0.2%). On the expenditure side, growth stemmed from exports (4.1% q/q, sa, with a contribution of 1.1%). However, this was cancelled out by a rise in imports which detracted 1.3% from growth.
- Growth was positive in eight out of the 10 industries on the production side, supported by low base effects from the previous quarter.
- The revised growth outcomes (dating back to March 2018) resulted in a shallower contraction in the fourth quarter of 2022. Moreover, the revision lifted the fourth quarter contraction in the finance industry from being a historical low (apart from the pandemic disruption) to the same level as the first quarter of 2019.
- The challenging operating environment, due to idiosyncratic factors such as the energy crisis, is stifling economic activity from meaningfully surpassing pre-pandemic levels.
- The heightened likelihood of stage 8 loadshedding during winter, as announced by Eskom, will further dampen growth prospects, particularly because the economic cost associated with higher stages of loadshedding is much higher than lower stages. The SA Reserve Bank (SARB) estimated that the nominal cost of stages 1 and 2 varies between R0 to R1.2 million and is exponentially higher from stages 3 to 6 (between R204 million to R899 million) when continued on a 24-hour basis on weekdays.
- Improvement in the intensity and severity of loadshedding is largely dependent on repairing the broken units at Kusile and Medupi and bringing the Koeberg unit online. The power generated by these units is equivalent to almost four stages of loadshedding.
- Further risks to the growth outlook in the medium term include global recession risks, the outcome of the 2024 national elections, increasing concerns about SA's foreign policy stance, softer commodity prices, depressed consumer and business sentiment and inefficiencies in SA's network industries.
- With a high severity and frequency of loadshedding largely unavoidable in the coming months due to large units of Eskom's generation capacity being offline, activity is likely to stall in the local economy this year. We expect growth to drift higher from 0% in 2023 to 1% in 2024 and 1.6% in 2025 as operational constraints such as

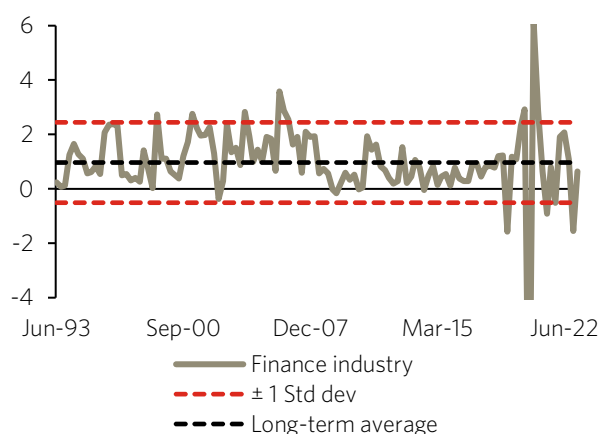
loadshedding and logistics are reduced in line with efforts from Operation Vulindlela in conjunction with private sector investment.

Low base effects cushion first quarter economic growth

Stats SA reported real GDP growth of 0.4% q/q, sa in the first quarter of 2023 as the market had expected, according to the Reuters median consensus. More notably, SA avoided a technical recession (two quarters of negative growth) despite the tougher operating environment. This points to some resilience in the economy considering the intensifying energy crisis. However, growth was also supported by the low outcomes in the fourth quarter of 2022 (base effects).

Today's GDP report indicates that Stats SA revised growth outcomes dating back to the first quarter of 2018. As a result, the growth performance of the fourth quarter of 2022 was revised higher from negative 1.3% q/q, sa to negative 1.1% q/q, sa. On the production side, the most notable upward revisions were in the agriculture sector (from negative 3.3% q/q, sa to negative 2.4% q/q, sa) and the finance sector (from negative 2.3% q/q, sa to negative 1.6% q/q, sa). The previous print of negative 2.3% q/q, sa in the finance sector was the biggest dip (apart from the pandemic disruption) historically. However, the revisions have improved this dip to be at the same level as the first quarter of 2019 as seen in chart 1.

Chart 1: Growth in financial services recovered in Q1 2023, %y/y



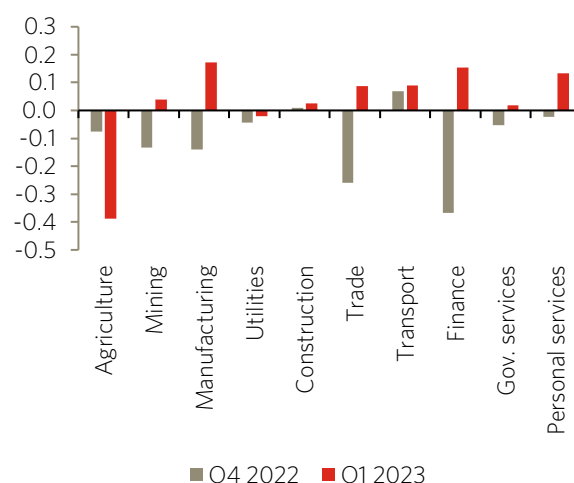
Source: Global Insight, Stats SA, Momentum Investments
Data until March 2023 (Q1 2023)
Y-axis truncated

On the other hand, manufacturing and personal services were revised lower from negative 0.9% q/q, sa to negative 1.2% q/q, sa and from 0.2% q/q, sa to negative 0.1% q/q, sa, respectively.

On the expenditure side, the most notable revision was an upward revision to exports (negative 3.2% q/q from negative 4.8% q/q, sa).

The quarter-on-quarter growth improvement in the first quarter was broad-based with eight out of 10 industries contributing positively to growth compared to just two industries in the fourth quarter of 2022 (see chart 2). The biggest positive contributors to growth on the production side were the manufacturing industry (1.5% q/q, sa and contributed 0.2%) and the finance industry (0.6% q/q, sa and contributed 0.2%).

Chart 2: Q1 2023 production side contribution to GDP (%) vs Q4 2022



Source: Global Insight, Stats SA, Momentum Investments

On the other hand, economic activity in the agriculture, industry contracted significantly by 12.3% q/q, sa. in the first quarter of 2023. This correlates with the deterioration in the Agricultural Business Chamber (Agbiz)/IDC Agribusiness Confidence Index from 49 to 44 in the first quarter of 2023. According to the report,

the pessimism in the sector is due to high input costs, continuous power outages, outbreak in animal diseases, an increase in trade protection and disruptions in the logistics network.

Exports contributed the most to first quarter growth

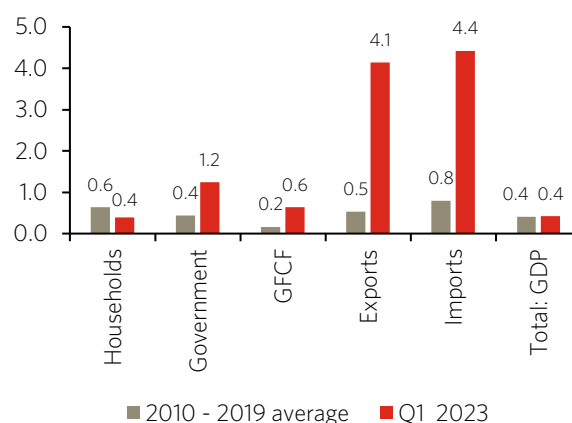
In the second quarter of 2020, growth contracted by a historical record of 17% q/q, sa (according to the expenditure approach) as the economy came under severe pressure from the pandemic. Since then, all the expenditure components have recovered quite reasonably (in level terms) apart from government expenditure, which has remained largely unchanged.

However, growth in the first quarter of 2023 was the same as the average growth during the period after the global financial crisis (GFC) and before the pandemic (2010 to 2019). As illustrated in chart 3, exports and imports were significantly higher than the pre-pandemic average. In the first quarter of 2023, the increase in exports (4.1% q/q, sa) was the biggest contributor to growth. However, given that imports outpaced exports at 4.4% q/q, sa, the net impact was negative. Over the near- to medium-term, export growth will be dented by softer commodity prices and the slower global growth.

Only household consumption expenditure recorded growth which is below the pre-pandemic average in the first quarter.

Another sector that contracted was the electricity, gas and water sector. More intense loadshedding is evidence of this.

Chart 3: Sectoral growth performance (expenditure side), %y/y



Source: Global Insight, Stats SA, Momentum Investments

First quarter household consumption expenditure was weighed down by a contraction in miscellaneous goods and services (negative 5.8% q/q, sa), the largest contraction historically. The components of goods and services do indicate lower demand in services in the first quarter. Higher demand was evidenced in semi-durable goods (2.4% q/q, sa) and non-durable goods (1% q/q, sa).

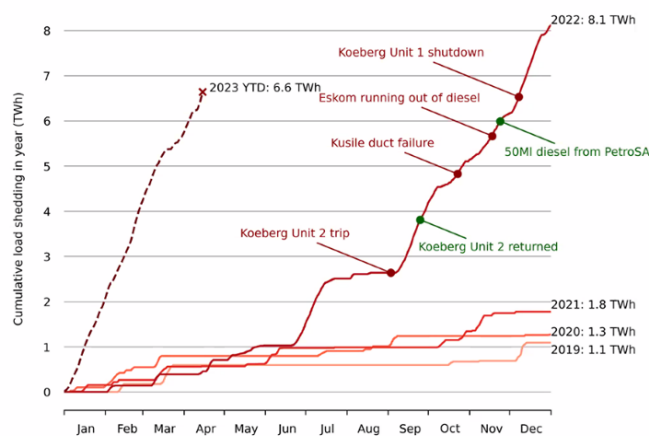
Possibility of stage 8 loadshedding may further undermine growth prospects

In a media briefing on 18 May 2023, Eskom's interim CEO warned that SA may experience stage 8 loadshedding during peak demand in winter 2023 but reiterated that a national grid collapse remains a low probability scenario.

The power utility indicated the likelihood of stage 8 against the backdrop of reduced generation capacity compared to last year due to the damage of Kusile Unit 1 to 3 (c. 2 100 MW), Medupi Unit 4 (c. 700 MW) and the shutdown of Koeberg Unit 1 (920 MW), cumulatively resulting in almost four stages of

loadshedding. As indicated in chart 4, the amount of energy shed during 2022 surged when these big units started failing and the trend has continued into 2023. According to communication from Eskom, the units at Kusile are estimated to come on by December 2023. Once the one unit at Koeberg has been restored, the other unit will also go offline which means Koeberg will operate will operate on one unit for a while.

Chart 4: 2023 loadshedding will surpass 2022 levels



Source: Meridian Economics

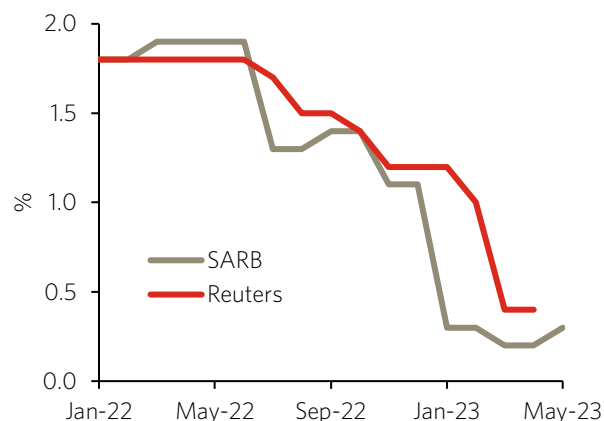
The head of the Project Management Office in the Office of the Presidency mentioned four possible measures that can be implemented to prevent loadshedding from exceeding stage 6 during winter. These measures involved reducing unplanned breakdowns to 15 000 MW, returning 10 units to service from various power stations, demand management, and or increasing the load factor of open cycle gas turbines (OCGTs) which will require additional diesel (negative fiscal implications).

The SARB estimated that the nominal cost of stages 1 and 2 varies between R0 to R1.2 million and is exponentially higher from stages 3 to 6 (between R204 million to R899 million) when continued on a 24-hour basis on weekdays. The overall impact on growth is estimated to be negative 2%. The eventuality of stage 8 loadshedding (or higher) will exacerbate the impact on the economy and may lead to further downward growth revisions driven by the deteriorating operating environment. Chart 5 illustrates the steep downward revisions in projected growth for 2023 since January 2022 to date) and the SARB has, so far, been ahead of the curve.

Downside risks to the growth outlook remain elevated

Further risks to the growth outlook in the medium term include global recession risks, the outcome of the 2024 national elections, increasing concerns about SA's foreign policy stance, softer commodity prices, depressed consumer and business sentiment and

Chart 5: 2023 GDP forecast changes



Source: SARB, Reuters, Momentum Investments

In the May 2023 Monetary Policy Committee (MPC), the SARB revised their GDP forecast back to 0.3% after downgrading it to 0.2% in March 2023.

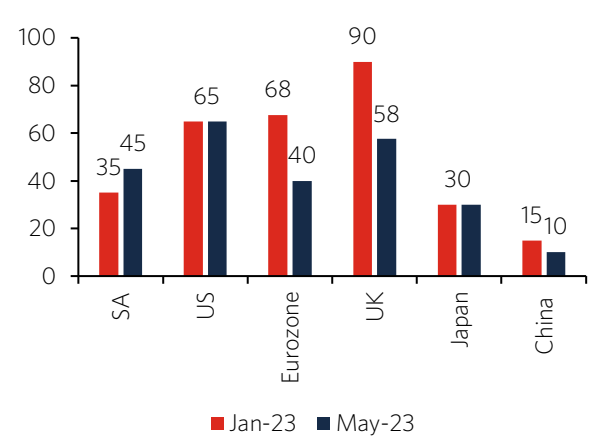
With increasing electricity outages since 2022, business have had to invest in alternative sources to reduce the impact of loadshedding. Trade and Industry Policy Strategies report that imports of solar panels reached a record high of US\$ 200 million in the first quarter of 2023. Furthermore, the value of inverters imported in 2022 were almost double of what was imported in 2021. Nevertheless, consensus is that the implemented solutions largely help business cope with stage 1 to 4 loadshedding. Anything higher is still costly hence the higher estimated cost for higher stages of loadshedding by the SARB. Moreover, depending on geographic location, solar PV can be less effective in colder weather if it is not paired with storage capacity. Lastly, an introduction of higher stages of loadshedding increases the risk of raising the load curtailment limit past the current 20% which will be negative for large industries and thus growth prospects.

inefficiencies in SA's network industries.

According to Bloomberg, the probability of a recession in SA over the next 12 months has increased from 35% in January to 45% in May, partly due to the intensifying

energy crisis (see chart 6). The probability in the United Kingdom (UK) and Eurozone has decreased substantially because Europe did not experience the anticipated severe energy crisis during winter. Nevertheless, the probability of a recession in the UK is still considered to be above 50% due to the cost-of-living crisis and political uncertainty. The probability of a recession in the United States (US) is also high because of the recent regional banking turmoil. In the event of a global recession, demand reduces which has a direct impact on SA exports.

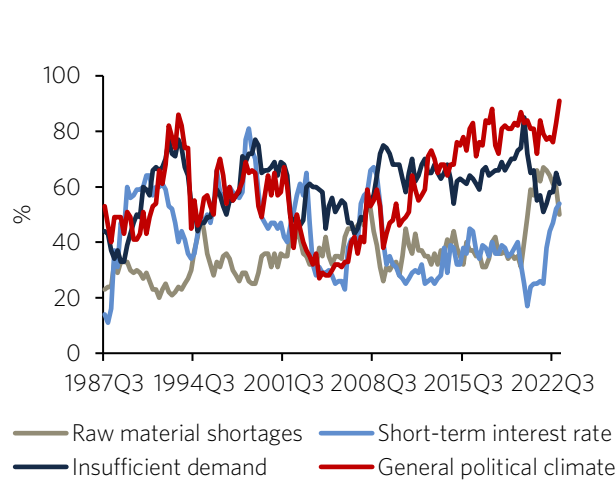
Chart 6: Median forecasted probability of recession higher in SA



Source: Bloomberg, Momentum Investments

With regards to politics, there are growing concerns about political stability with elections coming up next year. According to the first quarter manufacturing survey published by the Bureau for Economic Research (BER), manufacturers view the political climate as the top constraint on current activity (87%) as well as for investments over the next 12 months (91%). These are the highest percentages in the history of the surveyed responses.

Chart 7: Political climate concerns at historical high



Source: BER, Momentum Investments
Data until 2023 Q1

Another factor dampening sentiment is the escalation in concerns regarding SA’s actions not aligning with its neutrality stance regarding the Russia-Ukraine war. Over and above sentiment, political experts indicate that this poses a high risk for SA being excluded from the African Growth and Opportunity Act (AGOA) in 2025. According to Standard Bank, exports under AGOA amounted to c.R60 billion in 2022. Furthermore, in the May 2023 Financial Stability Review, the SARB flags the risk of secondary sanctions which may lead to an inability to make international payments thus hampering trade.

These risks add to risks flagged in the March GDP note, namely, softer exports due to lower commodity prices and logistics constraints.

With a high severity and frequency of loadshedding largely unavoidable in the coming months due to large units of Eskom’s generation capacity being offline, activity is likely to stall in the local economy this year. We expect growth to drift higher from 0% in 2023 to 1% in 2024 and 1.6% in 2025 as operational constraints such as loadshedding and logistics are reduced in line with efforts from Operation Vulindlela and in conjunction with private sector investment.

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