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Large downside surprise in fourth-quarter growth

Highlights

- **According to Statistics South Africa (Stats SA), seasonally adjusted (sa) real gross domestic product (GDP) contracted by 1.3% quarter-on-quarter (q/q) in the fourth quarter of 2022. This was a much worse outcome than the median Reuters consensus expectation of negative 0.4% q/q. Growth for last year averaged 2%.**
- **The finance sector as well as trade, catering and accommodation on the production side largely dampened growth in the fourth quarter. On the expenditure side, net exports detracted from growth and countered the increase in household consumption expenditure.**
- **The largest contributors to growth in 2022 were the services sector on the supply side and exports on the demand side. However, growth in 2022 slowed relative to 2021 partly due to strong base effects. Five out of 10 sectors on the production side recorded lower economic activity in 2022 compared to 2021 with large contractions in the mining, utilities and construction sectors.**
- **On the expenditure side, growth in household consumption was weaker in 2022 in relation to 2021. This corresponds with higher inflation and interest rates during 2022, which eroded household disposable incomes. On the other hand, growth in exports and imports were strong. However, export growth is expected to slow this year largely due to global factors (commodity prices and global economic growth).**
- **According to data from EskomSePush, national loadshedding hours in the fourth quarter escalated to 1 944 (an estimated 6 018 GWh). The high estimate of total energy shed in the quarter is the result of more hours of stage five and stage six loadshedding (collectively totalling 277 hours) during the quarter.**
- **Loadshedding negatively impacted economic growth in 2022. However, quantifying the exact impact has proven to be a challenge. The estimated impact of loadshedding on growth last year spans a wide range from 1.3% by ABSA to as much as 5% according to PwC.**
- **The energy crisis is expected to continue into the year and further dampen growth given that the Eskom debt relief programme is a long-term solution and the plan announced by the National Energy Crisis Committee (NECOM) of adding 8 822MW of new energy capacity this year is deemed optimistic.**
- **Economic growth is expected to be subdued in 2023. The SA Reserve Bank (SARB) projects the lowest growth of 0.3% y/y compared to other institutions due to increased loadshedding from 100 days to 250 days and logistic constraints. The International Monetary Fund (IMF) forecasts growth of 1.2% y/y, broadly in line with our estimate of around 1% for 2023.**
- **Apart from ongoing bouts of loadshedding, the subdued projections take into account the weak economic outlook, constrained consumers and disruptions to the logistics network.**

Economic growth in 2022 largely driven by the services sector and exports

GDP fell below pre-pandemic levels in the fourth quarter of 2022. The real growth contraction of 1.3% q/q, sa was more pronounced than the median Reuters consensus of negative 0.4% and it rounds off the year with an annual growth rate of 2%.

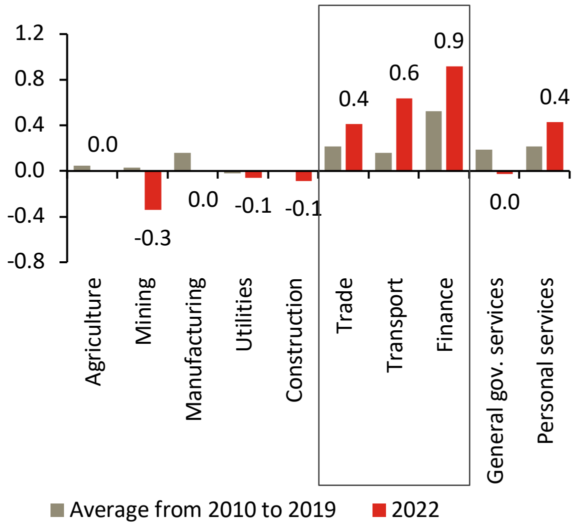
Last year growth fluctuated significantly on a q/q basis. The year commenced with relatively strong growth of 1.6% q/q, sa largely due to growth in the manufacturing sector from the production side and an expansion in household consumption on the expenditure side. However, the contraction in the agriculture, mining and manufacturing sectors in the second quarter weighed on growth and resulted in a rate of negative 0.8% q/q, sa (revised). This was followed by a rebound of 1.8% q/q, sa (revised) in the third quarter on the back of stronger growth in the agriculture sector as well as an increase in export revenue.

The contraction recorded in the last quarter of 2022 largely stemmed from negative growth in the finance sector (2.3% q/q) followed by trade, catering and accommodation (2.1% q/q) on the production side. The expenditure side was suppressed by exports which fell by 4.8% q/q contributing negative 1.4% and inventories which contributed negative 0.9%. These two components offset the strong growth in household consumption which added 0.6% to the quarterly growth rate.

The increase in household consumption was due to the category which incorporates the expenditure of residents who are abroad (0.5% contribution) and an increase in restaurants and hotels (0.2% contribution).

However, the expenditure in restaurants and hotels is still 6.5% below pre-pandemic levels.
While the 2022 real growth rate is slightly below market expectations and lower than the robust growth rate of 4.9% y/y in 2021, it is above the average growth of 1.7% achieved over the period between 2010 (post-global financial crisis (GFC)) and 2019 (pre-pandemic).

Chart 1: Annual contribution to real GDP (% y/y)



Source: Global Insight, Momentum Investments
Data labels reflect 2022 growth contributions

As illustrated in chart 1, the services sector (trade, catering and accommodation; transport, storage and communications; finance, real estate and business services) contributed the most to the overall growth rate of 2% in 2022. This is despite the negative contributions to fourth-quarter outcomes. On the demand side, the bulk of growth was due to exports which contributed 2% while imports detracted 3.7% from the annual growth rate.

Production side sectoral breakdown

Growth in economic activity in 2022 was lower than in 2021 in five of the 10 sectors as illustrated in chart 2. While this is partly due to base effects from strong growth in 2021, the sectors were also affected by the ongoing energy crisis and logistics constraints, among other factors.

The mining sector contracted the most (negative 7% y/y) in 2022 compared to 2021. Production in this sector was largely constrained by loadshedding and disruptions in the logistics network due to the strike at Transnet and two significant derailments in the third quarter. This sector is expected to remain constrained because mining production has been stagnant over the long-term and commodity prices have been coming down. However, the impact of loadshedding on this sector may be less in comparison to other sectors over the medium term provided that the average stage of loadshedding is below four. This is because mining companies are ahead of the curve in terms of acquiring alternative sources of energy, particularly for above-ground operations. The majority of the 9 000MW renewables projects that the private sector registered with the energy regulator are from mines.

Utilities, which capture electricity, gas and water, also contracted by 2.6% in 2022. This is no surprise given that loadshedding reached record-high levels during last year. The Pan SA Language Board declared loadshedding as the word of the year in 2022 which speaks of the impact of loadshedding on the country.

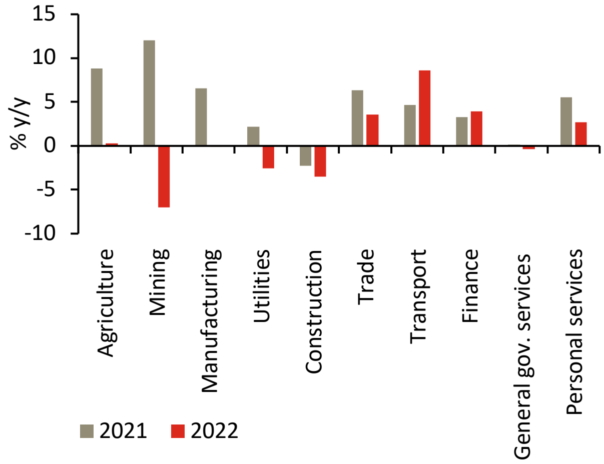
Another sector that contracted in 2022 compared to 2021 was the construction sector (negative 3.5% y/y). Treasury attributes poor performance in this sector to weak investment, lower confidence levels, undercutting on tender prices and crime.

The manufacturing sector also contracted slightly by 0.1% y/y. Growth in this sector is expected to remain under pressure as loadshedding persists. Moreover, the third quarter manufacturing survey published by the Bureau for Economic Research (BER) highlighted that manufacturers are concerned about the impact of the political climate on business conditions. While the extent of this risk has likely subsided slightly given that Cyril Ramaphosa was re-elected as president of the African National Congress (ANC) during the ANC's 55th National Elective Conference in December 2022, the percentage remains high.

A more frequent index that measures political uncertainty (North-West University's Policy Uncertainty Index) eased to 53.2 points in the fourth quarter from 59.9 points in the third quarter reflecting positivity from the results of the ANC conference. However, the university notes that the index is still in negative territory (above 50) and was weighed down by weak prospects for economic activity and the resignation of Eskom's chief executive officer (CEO) amid an energy crisis.

Furthermore, the percentage of respondents in the manufacturing survey who cited insufficient demand as a constraint on investment increased to 58% in the fourth quarter. This indicates that manufacturers anticipate that consumers are likely to be constrained for a while longer which will further dampen the sector's performance.

Chart 2: 2022 sectoral GDP performance (% y/y), production side



Source: Global Insight, Momentum Investments

The agriculture sector grew slightly by 0.3% y/y in 2022 compared to a year ago. Adverse weather conditions, high fertiliser costs, the foot-and-mouth disease outbreak, loadshedding and water supply constraints negatively affected this sector. However, production in the sector remains agile and is expected to support growth in 2023.

The transport and communications sector recorded strong growth of 8.6% in 2022 compared to 2021. This is off a low base due to the impact of the July 2021 riots. However, the constraints experienced by Transnet will likely restrict growth in 2023.

The finance, real estate and business sector also recorded relatively strong growth of 3.9% y/y in 2022 compared to 2021. This sector will likely remain supportive of growth this year. Greylisting was initially identified as a risk for the financial sector. However, the Treasury indicated that the number of actions required by the Financial Action Task Forced (FATF) have been reduced from 67 to only eight and the financial sector is not included in this list of actions.

Lastly, growth in trade, catering and accommodation was also relatively strong at 3.5% y/y in 2022 as the post-pandemic recovery in the services industry continues.

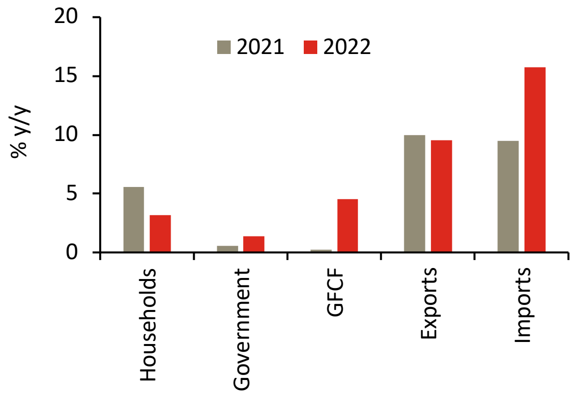
Expenditure side sectoral breakdown

On the expenditure side, household consumption expenditure grew by 2.6% y/y in 2022, lower than in 2021 as illustrated in chart 3. Household consumption was damped by the increasing cost-of-living during the year and bleak consumer confidence which reached a low of negative 25 points in June 2022. Treasury projects household consumption growth of 1% in 2023, 1.5% in 2024 and 1.8% in 2025, which reiterates that households are expected to face more strain over the medium term.

Growth in government expenditure was low at 0.9% y/y in 2022 relative to 2021. This component may continue growing at a low rate in 2023 as the government adheres to fiscal consolidation.

On the other hand, growth in gross fixed capital formation (GFCF) was stronger at 4.7% y/y in 2022. However, Treasury projects slower growth of 1.3% in 2023 and a pickup to 3.8% in 2024. This suggests that the pace of implementation for projects related to bringing new energy online is expected to gain momentum in 2024, which is later than we had initially anticipated.

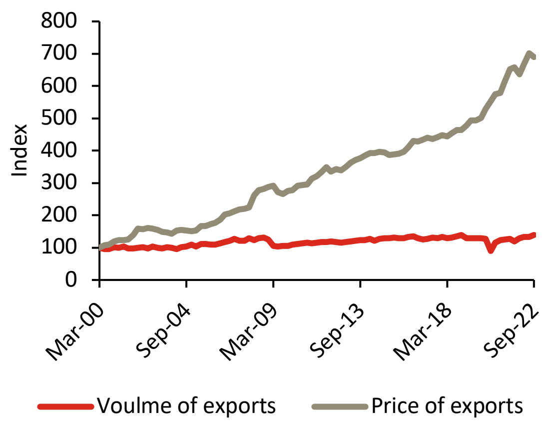
Chart 3: 2022 sectoral GDP performance (% y/y), expenditure side



Source: Global Insight, Momentum Investments

Export and import growth was strong at 7.5% y/y and 14.2% y/y, respectively. Higher growth in imports relative to exports is reflected in the lower trade surplus from R432 billion in 2021 to R193 billion in 2022. Growth in exports was to a large extent on the back of higher commodity prices as depicted in the widening gap between the indices of export prices and volumes in chart 4. However, the contribution from exports is expected to be lower in 2023 given that commodity prices have dropped and are expected to recede further. Moreover, the weaker global outlook will likely dampen export demand.

Chart 4: Post-pandemic commodity boom



Source: Global Insight, Momentum Investments

A further risk to the outlook for exports as flagged by *Engineering News* relates to potential revenue being lost due to the European Union's (EU) provisional[1] Carbon Border Adjustment Mechanism. This agreement will have an impact on SA because Germany (one of SA's largest trading partners) is part of the EU. The agreement aims to implement 'emissions tariffs on import goods with a high risk of carbon leakage from countries which are not members of the EU Emissions Trading System'.

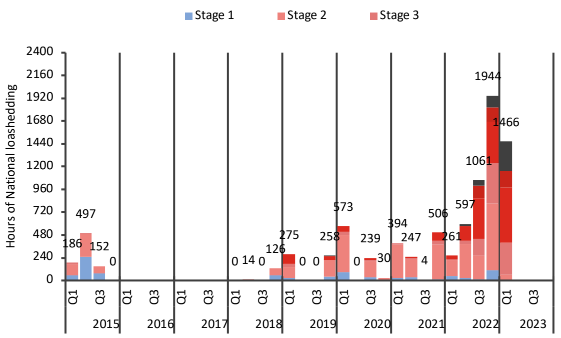
[1]The agreements have not yet been adopted by the European Council and European Parliament

Some reprieve from the detailed risks on exports may come through the form of higher commodity prices from the reopening of the Chinese economy. The extent of the increase in commodity prices will be dependent on demand and improvement in the country's property sector.

Loadshedding weighs on economic activity

SA's economic activity in 2022 has been resilient in the face of severe and persistent loadshedding - totalling an estimated 3 863 hours, according to EskomSePush data. In particular, economic growth of 1.8% q/q, sa in the third quarter was unexpectedly high given that the country was without electricity for around 1 061 hours (approximately 44 days) during the quarter as indicated in chart 5 below. The severity and duration intensified in the fourth quarter resulting in an estimated 1 944 hours of loadshedding (approximately 81 days, 6 018 GWh) and the impact of this is reflected in the real GDP contraction during the quarter under review. Intensified loadshedding during the fourth quarter was due to breakdowns in some of Eskom's generating plants (Kusile and Koeberg) and a shortage in diesel which reduced the energy availability factor (EAF).

Chart 5: Severity and duration of loadshedding intensified in the fourth quarter



Source: EskomSePush, Momentum Investments

While it is hard to quantify the impact of loadshedding on growth, PwC estimates that loadshedding shaved off as much as 5% of GDP in 2022. As such, GDP growth of 2% in 2022 could have been higher had it not been for loadshedding. The SARB has increased its estimate of the impact of loadshedding on economic growth in 2023 from 0.6% to 2% signalling that loadshedding is expected to persist throughout 2023. The number of hours of loadshedding in the first quarter of 2023 (data up until 7 March 2023) is at 1 466 hours which is already higher than the annual loadshedding hours in all the years since loadshedding started, with the exception of 2022.

The government has announced plans to address the energy crisis, such as Eskom's debt relief programme of R254 billion over the next three years. The intention is to relieve Eskom of its debt obligation (capital and interest) and provide them with room to focus on operational requirements such as maintenance, generation and transmission. However, the debt relief plan is a longer-term solution. On the other hand, NECOM has a target of adding 8 822MW of new capacity in 2023, but industry experts believe that this is unlikely to happen as a big part of the plan rests on making the failed units operational again which will take longer than one year. ABSA estimates that only half of NECOM's target can be achieved in 2023. Therefore, it is a plausible assumption to expect loadshedding to persist and dampen growth.

Quantifying the impact of loadshedding on growth is challenging because loadshedding impacts various sectors of the economy to varying degrees depending on the stages. Some of the consequences include less production and operational time across all the sectors, higher operational costs incurred by businesses to install backup energy which reduces margins, lower consumer confidence which filters through to lower demand and a decrease in investment given the uncertain operating environment. The 2023 Budget Review estimates that an additional R173 billion in investment over the medium term could be achieved if loadshedding is eliminated by the end of this year.

Growth projections subdued over the medium term as risks to the outlook persist

The outlook for SA's growth is bleak, particularly for this year. As detailed in table 1 below, various institutions project lower growth in 2023 compared to 2022 and a slight improvement in 2024 and 2025. The SARB is, however, more pessimistic with an expectation of below 1% for both 2023 and 2024.

Table 1: Real GDP (% y/y) projections

	2023	2024	2025
National Treasury	0.9	1.5	1.8
SARB	0.3	0.7	1.0
IMF	1.2	1.3	
Reuters	1.0	1.5	1.8

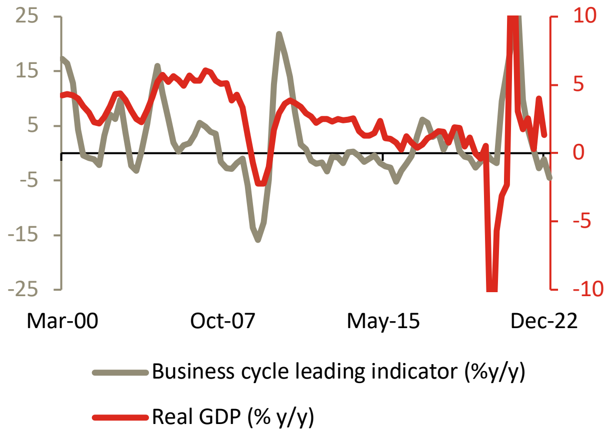
Source: National Treasury (2023 Budget Review), SARB (January 2023 MPC Statement), IMF (January 2022 IMF WEO), Reuters (February 2023 survey)

The reasons quoted by these institutions for the subdued growth estimates include the weak global economic outlook with a higher recession risk in Europe and the United States, continuous loadshedding, logistics constraints, the impact of monetary policy tightening, lower consumer and investment spending, as well as softer export expectations.

We believe further risks to the growth outlook will stem from high unemployment rates, high levels of corruption and the cost-of-living crisis. Furthermore, SA being placed on the grey list by the FATF may discourage investments and dampen economic growth. As such, we expect pedestrian growth of around 1% in 2023 and a slight improvement to around 1.5% in 2024.

The business cycle leading indicator illustrated in chart 6 signals a contraction in the upcoming quarter which reiterates that the economy is expected to remain under pressure in the near term.

Chart 6: Leading indicator points to a further contraction in growth



Source: Global Insight, Iress, Momentum Investments
Axes truncated for the pandemic-affected years

Effective implementation of the measures announced to alleviate loadshedding and reduce logistic constraints could boost economic growth over the medium term. Moreover, the re-opening of China could be supportive of higher commodity prices which could lead to slight upward revisions in growth projections. However, the increased severity of loadshedding indicates that the bias to near-term growth forecasts are firmly to the downside.