Industrial Development Corporation

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# Economic overview:

## Recent developments in the global and South African economies

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Department of Research and Information

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## Highlights

- **The world economy has been surprisingly resilient in the face of considerable adversity.** Growth has slowed substantially, but not to the extent anticipated by numerous analysts, at least for the time being. Recessionary conditions have been averted thus far in most of the world's economies, despite the strong headwinds.

- **Economic conditions are, however, likely to deteriorate going forward.** Inflation's income eroding effects, alongside the lagged impact of progressively higher interest rates since late in 2021, and the likelihood of further hikes in the months ahead, will intensify financial stresses and negatively affect household spending, business performances and investment activity. The pace of economic expansion globally is thus likely to decelerate further in the second semester of 2023 and will possibly be weaker than previously anticipated in 2024.

- **Continued tightening of monetary policy will place further strain on the global financial system.** The risk of financial stress among sovereigns, banks and/or non-financial entities will increase, with the possibility of contagion effects. Policymakers are thus facing a very challenging pathway in their quest to bring inflation under control while safeguarding macro-financial stability and avoiding tilting economies towards recession, with the associated socioeconomic consequences.

- **Further downward pressure on global FDI inflows is expected in 2023.** A high degree of uncertainty and risk aversion prevails among the investor community, as evidenced by very weak trends in FDI project activity in the first half of the year. FDI flows into Africa may thus be relatively subdued in the near term, although the momentum may increase in 2024 and beyond on the back of major projects recently announced, investment opportunities arising from the restructuring of global supply chains, and the finalisation of various AfCFTA protocols. The continent also has a greater role to play in the energy and greening transition.

- **Six of the top 15 greenfield investment megaprojects announced globally in 2022 are in Africa**. The total value of greenfield FDI projects announced on the continent increased almost fourfold, year-on-year, to USD195 billion in 2022. Greenfield projects in energy and gas supply dominate, rising to a record USD120 billion.

- **South Africa's economy is facing stagflation.** Output growth is weak or negative in key sectors, as challenging operating and trading conditions take a toll. Inflation remains high, resulting in progressively higher interest rates. Disposable incomes are being eroded, affecting the ability of households to spend. Government is struggling to provide counter-cyclical support due to fiscal constraints. Subdued fixed investment cannot support higher rates of economic growth and job creation on a sustained basis. Very marginal GDP growth is thus projected for 2023, potentially rising only slightly next year. The unemployment rate will thus remain very high for quite some time.

- **Reduced competitiveness and deindustrialisation have resulted in an increased reliance on imports over time.** The share claimed by imports in gross domestic expenditure rose to an all-time high of 26.4% at the start of 2023, reflecting the extent to which imports are meeting domestic demand.

- **Consumer price inflation surprised on the downside both in May and June but remains well above the 4.5% mid-point of the inflation target band.** Despite concerns over second-round effects and inflation expectations being substantially higher than the Reserve Bank's current projections, the Monetary Policy Committee decided to keep the repo rate unchanged at its meeting on 20 July 2023.

World economic growth:

**2022: 3.1% (e)**
**2023: 2.1% (f)**
**2024: 2.4% (f)**

(World Bank)

FDI flows into Africa in 2022:

**Total: USD44.9 bn**
**S. Africa: USD9.1 bn**

(UNCTAD)

Greenfield projects announced in Africa:

**2021: USD52.2 billion**
**2022: USD195 billion**

(UNCTAD)

South Africa GDP growth in Q1 2023:

**Agriculture: -12.3%**
**Mining: 0.9%**
**Manufacturing: 1.5%**

(Stats SA)

Consumer inflation and interest rates:

**CPI (June 2023) = 5.4%**
**Repo rate = 8.25%**

(Stats SA; SARB)

- **Exports play a crucial role in the South African economy.** Exports of goods and services increased by 7.4% in real terms in 2022, accounting for 33.5% of national GDP. Merchandise exports are estimated to have supported and/or created, both directly and indirectly, almost 2.35 million employment opportunities in the economy in 2022, representing 19.7% of all formal sector jobs. The main contributions to export-related employment in SA are estimated to have emanated from South African exports to the rest of the African continent, the EU, US, Japan, China, UK and India, in this sequence.

- **South Africa's merchandise exports were under pressure at the start of 2023.** Export growth slowed to only 4.5%, year-on-year, in nominal terms over the period January to May 2023. Lower commodity prices, weaker global demand and infrastructure-related challenges affected South Africa's export performance. Given the export sector's importance to the economy's expansion, as well as to the preservation of employment and the creation of additional jobs, it is paramount that fruitful politico-economic relations with key trading partners be safeguarded and enhanced.

Surpluses in SA's trade balance in Jan.-May 2023:

**Overall: R7.6 bn**
**Africa: R139.2 bn**
**Japan: R27.1 bn**
**UK: R24.9 bn**
**US: R0.9 bn**

(SARS)

## Implications for business enterprises

*Potential implications of global economic developments*

- **The expected slowing of global growth in the second half of 2023 will likely impact on South African exporters to differing degrees:**
  - Consumer spending and certain types of investment activity are anticipated to weaken in key markets such as the US, the Eurozone and the UK, potentially affecting export sales of passenger and/or commercial vehicles, catalytic converters, platinum, mineral ores and metal products, among others.
  - The strength of China's economic performance in the near- to short-term is yet uncertain. However, considering ongoing challenges, the recovery in its import demand may not be as sturdy as previously anticipated, with downward price pressures in several commodity markets reflecting such expectations. South African exporters of various mineral ores (e.g., iron, manganese, chrome and zinc ores), platinum and ferro-alloys should monitor developments closely.
  - Relatively strong growth in India (a key market for coal, chemical wood pulp and manganese ores) and in several Sub-Saharan African economies that have historically imported a diverse range of South African products, should provide a degree of support to the respective domestic exporters.

- **African entities should consider enhancing their financial sustainability strategies** in light of the risks emerging in national financial systems and among corporates as monetary policy is tightened further.

- **Rising capital costs and risk premia will impact on investment decisions.** International investors are becoming increasingly selective in their project selection, the required hurdle rates and the targeted locations for investments, as reflected by recent unfavourable trends in foreign direct investment (FDI) flows globally.

- **Relatively high levels of uncertainty will continue to underpin significant volatility in financial markets for some time, requiring the application of sound asset and liability management (ALM) practices.** Equity, bond and currency market performances in recent months bear testimony to this. The possibility of sharp movements in the near- to short-term should not be underestimated.

- **Rising tensions between global powers, along with nationalistic and friend-shoring strategies are affecting geographic production and the sourcing of minerals, intermediate and final products that are critical for the greening of economies, including the energy transition, as well as the digital economy.** This is impacting on investor decision-making, with rising concerns for those involved in new electric vehicles (NEVs) and renewable energy (RE) projects, among others, for their attractiveness and long-term sustainability may become increasingly dependent on a complex set of strategic priorities of the parties involved.

*Potential implications of regional economic developments*

- **Expectations of improved foreign investor activity in Africa in the short- to medium-term**. Several economies present major investment opportunities across various sectors, as evidenced by continued FDI inflows and increased project activity. These include countries such as Ethiopia, Senegal, Mozambique, Democratic Republic of Congo, Côte d'Ivoire, Uganda and Ghana, which have continued to attract relatively large FDI inflows. Some are also the locations for sizeable greenfield projects recently announced.

- **The greening of economies and digitalisation trends currently underway are raising demand for the associated minerals and metals.** Several African countries are already major producers of these minerals, with some dominating globally in terms of reserves. Attractive investment opportunities are thus proliferating not only in exploration and extractive mining activities, but also across the energy-green transition value chains.

- **Specific sectors and related value chains have been prioritised for development under the African Continental Free Trade Area's (AfCFTA) Private Sector Engagement Strategy.** The identified and prioritised sectors for development include agriculture and agro-processing, automotive, pharmaceuticals, as well as transportation and logistics. This should result in business opportunities for African enterprises and investors in general.

- **The Summit for a *New Global Financing Pact* held in Paris on 22-23 June fell short of expectations.** Hyped as intending to mobilise financial support to countries facing excessive debt, climate change impacts and poverty, especially developing and low-income economies, the summit's outcomes consisted mainly of progress reports on previous pledges, measures to be adopted, and a roadmap aimed at building key milestones for an 'international agenda'.

- **Business enterprises should remain mindful of the macroeconomic vulnerabilities facing specific African countries to which they are financially exposed,** as these may significantly aggravate their risk profiles, possibly resulting in liquidity constraints.

*Potential implications of domestic economic developments*

- **Subdued growth in the South African economy has far-reaching implications for business performances.** Weak investment activity is likely to affect those companies whose activities are closely dependant on the investment cycle, with many suppliers of construction materials to be adversely impacted. In addition, businesses that target the consumer market may continue facing challenges as households are talking strain from high inflation and rising interest rates.

- **Electricity supply and transport and logistics challenges, exacerbated by the recent attacks on trucks in major transportation routes in KwaZulu-Natal and Mpumalanga, remain serious constraints to business sustainability.** It is of paramount importance that public sector efforts to alleviate and ultimately resolve these obstacles be rolled out swiftly and effectively, for they are at the core of the economy's poor performance while denting business and investor confidence.

- **South Africa's increased reliance on imports emphasises the need to address several factors impacting domestic competitiveness.** These include structural impediments to growth; inadequate implementation of the industrial and trade policies/strategies that are deemed appropriate for competitiveness improvements, global market development and protection from unfair import penetration; insufficient skills in many sectors; and, among others, the inordinate impact of high and still rising administered prices on input costs. It is imperative that these challenges be addressed swiftly and effectively to prevent the further erosion of domestic production capacity.

- **Low sentiment levels among businesses and investors will likely make it particularly challenging to develop a sizeable industrial funding pipeline in the months ahead.** Many private sector players are refraining from committing capital to new investments in the current environment, with their focus being presently confined to maintenance and/or technological upgrading to withstand competition from foreign producers whether in local or export markets.

- **Inflation is expected to remain higher for longer and an additional interest hike may still be on the cards.** This will affect highly indebted business enterprises and investment spending in general, and is likely to delay the economy's recovery process.

- **Despite the substantially weaker outlook, investment opportunities remain in various niche areas,** particularly in energy, transport & logistics, and water infrastructure; segments of the agriculture sector and several agro-processing activities; critical minerals' exploration and mining; the digital economy; as well as in cross-border investments aligned with AfCFTA objectives. Furthermore, specific industrial segments also present opportunities for competitiveness-enhancing investments.

## Global economy: Resilience in the face of adversity

*The world's economy's expansion momentum has slowed considerably*

The world economy has been surprisingly resilient in the face of considerable adversity. Growth has slowed substantially but not to the extent anticipated by numerous analysts, at least for the time being. Recessionary conditions have been averted thus far in most of the world's economies, despite the strong headwinds.

These have included persistently high inflation and aggressive tightening of monetary policy to bring it under control; continued geopolitical crises, particularly the Russia-Ukraine war and its regional and broader impacts; increased tension in the global trading and investment arenas; jittery financial markets and intensifying macro-financial vulnerabilities, especially in certain developing economies; and highly volatile commodity markets, among other factors.

This resilience, which has led multilateral institutions such as the World Bank to upwardly revise its projections for global growth from 1.7% to 2.1% in 2023, has been particularly manifest in the world's largest economy, the United States (US), but also in China and, to a much lesser extent, the Eurozone.

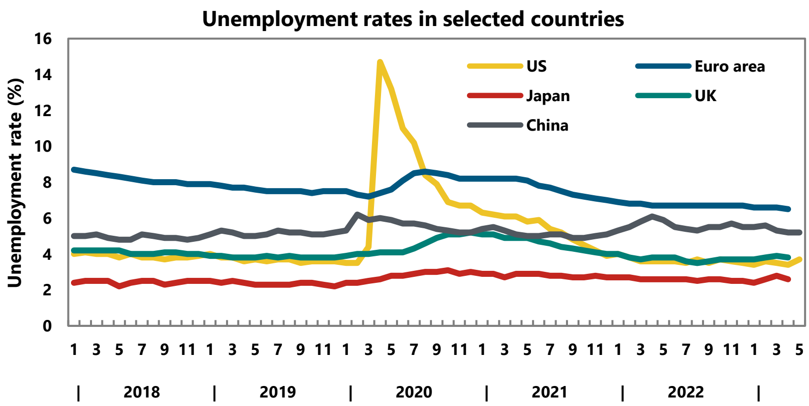
To date, the soft-landing narrative has won the day. The expansion momentum in the US has been supported by strong consumption spending as a tight labour market boosts wage growth. In China, the economic rebound after the lifting of Covid restrictions initially surprised on the upside but the momentum subsequently slowed. The Euro area, in turn, has been managing to post marginal growth on the back of fiscal support to households and businesses, a mild winter and lower energy prices, although the German economy entered a technical recession in the first quarter of 2023. The relative normalisation of several supply chains has also played a beneficial role in sustaining global production activity.

*Economic conditions expected to be adversely affected by further monetary policy tightening*

However, economic conditions going forward are unlikely to be as favourable. Jerome Powell, US Federal Reserve (Fed) Chair, stated in mid-June: "The labor market has remained extremely tight". He later indicated that "The labor market is really pulling the economy, … (and) although policy is restrictive, it may not be restrictive enough and it has not been restrictive for long enough" to have the desired inflation impact, particularly core inflation.

Christine Lagarde, President of the European Central Bank (ECB), made similar observations at a forum on central banking held towards the end of June in Sintra, Portugal: "… we must ensure that inflation expectations remain anchored as the wage catch-up process plays out, … that firms absorb rising labour costs in margins. If monetary policy is sufficiently restrictive, the economy can achieve disinflation overall while real wages recover some of their losses."

***Figure 1: Tight labour markets underpinning sturdy wage growth and consumption spending***



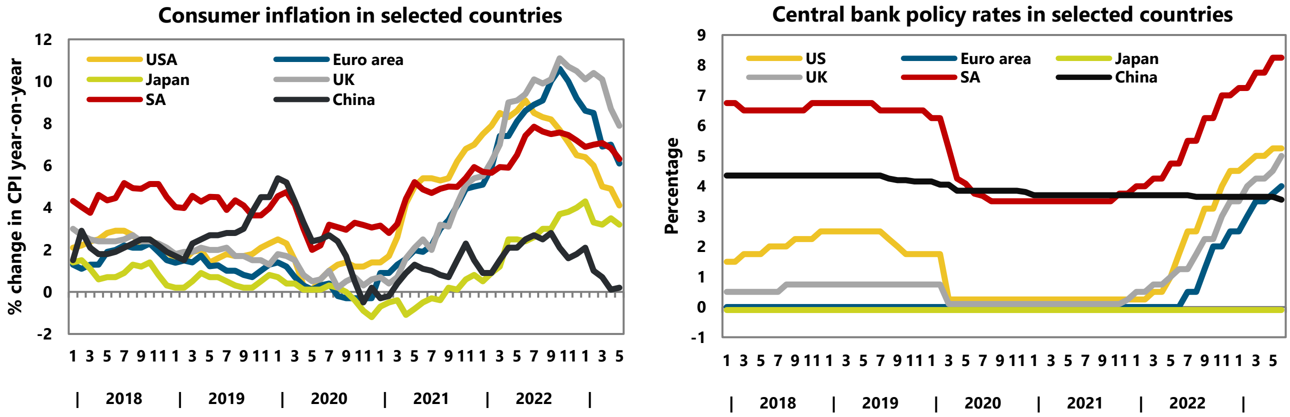

Source: IDC, compiled using OECD, NBS and EuroStat data

These statements from central bankers forewarn of more challenging economic conditions ahead. Notwithstanding the most aggressive and synchronised global monetary policy tightening cycle since the 1980s, inflation remains high, particularly core inflation, as shown in Figure 2. The longer excessive inflation persists, the higher the probability that it becomes entrenched, making it both more challenging and costly to tame. Cognisant of this, the monetary authorities in several economies are likely to maintain restrictive policy stances for as long as it is necessary.

Inflation's income eroding effects, alongside the lagged impact of progressively higher interest rates since late in 2021, and the likelihood of further hikes in the months ahead, will intensify financial stresses and affect confidence levels. This should be reflected in weaker household spending, business performances and investment activity.

A major exception has been China, where inflation is near zero. The People's Bank of China has thus opted for interest rate reductions and has announced other measures to support the economy, as the pace of its recovery is causing some concern. This is reflected in the manufacturing purchasing managers index (PMI), which at 49 points in June indicated a contraction in manufacturing activity for the third consecutive month. However, the scope for significant fiscal support has narrowed due to the very high debt levels of the Chinese government and non-financial sector entities, as shown in Figure 4.

***Figure 2: Inflation is moderating but interest rates are likely to be raised further to bring it closer to targeted levels***

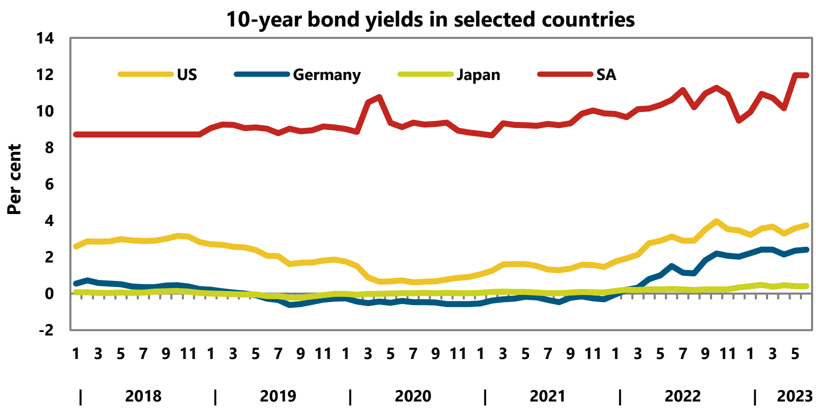



Source: IDC, compiled using US Fed, ECB, Bank of England, Bank of Japan and SARB data

*Global growth likely to slow further in the 2nd half of 2023 and may fall short of earlier projections in 2024*

The pace of economic expansion globally is thus likely to decelerate further in the second semester of 2023 and will possibly be weaker than previously anticipated in 2024. The World Bank has lowered its forecast for world GDP growth next year to 2.4%, or 0.3 of a percentage point weaker than its January projections. In the United States, the yield curve's inversion, which reflects higher short-term bond yields than longer-term borrowing costs, is the most pronounced in four decades. An inverted yield curve has historically been indicative, with a couple of exceptions, of forthcoming recessionary conditions.

***Figure 3: Bond yields have risen sharply***




Source: IDC, compiled using Bloomberg data

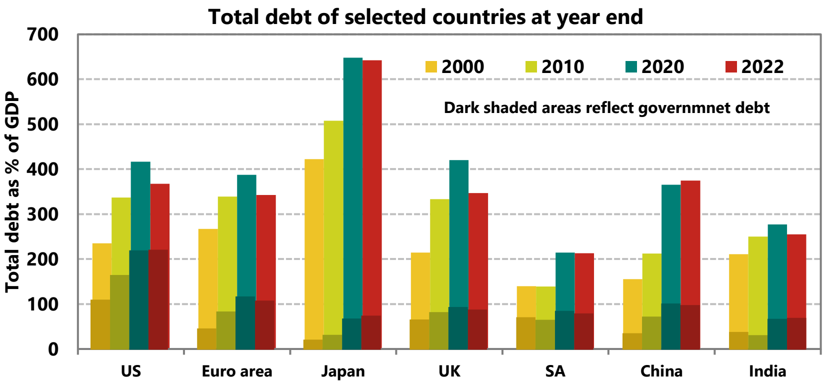
Record low interest rates and quantitative easing over several years made the cost of incurring and holding debt extraordinarily low, thus encouraging both public and private sector entities to borrow further. Debt ratios progressively rose to very high levels, as illustrated in Figure 4, with sovereign debt positions building up to unsustainable levels in certain economies, such as Zambia and Sri Lanka, especially if debt servicing conditions were to be altered.

*Sovereign debt positions built up to unsustainable positions in certain economies*

The normalisation of monetary policy was not only inevitable but also essential for macro-financial stability. The unprecedented quantum of liquidity doing the rounds in the world economy for many years was bound to have inflationary impacts. As it happened, the emerging inflationary pressures as economies recovered from the Covid pandemic were exacerbated by bottlenecks in global supply chains, and, since February 2022, by the impacts of the Russia-Ukraine war on energy, industrial and agricultural commodity prices.

Steep increases in interest rates by central banks in response to such developments have resulted in a sharp escalation of debt servicing costs for both governments and non-financial sector borrowers. Excessively high levels of indebtedness generally imply increased vulnerability during a monetary policy tightening cycle, especially an aggressive one.

***Figure 4: Overall debt remains at very high levels globally, underlying financial vulnerabilities***




Source: IDC, compiled using Bank for International Settlements (BIS) data

The global financial system is clearly under strain and the risks of financial stress among sovereigns, banks and/or non-financial entities are significant, with the possibility of contagion effects always present. Policymakers are thus facing a very challenging pathway in their quest to bring inflation under control while safeguarding macro-financial stability and avoiding tilting economies towards recession as well as the associated socio-economic consequences.

*Central bankers facing a difficult balancing act in their fight against inflation, to safeguard financial stability and avoid recessionary conditions*

## Foreign direct investment activity in Africa

Foreign direct investment (FDI) flows to the African continent declined by 43.5% year-on-year to USD44.9 billion in 2022, according to data recently released by the United Nations Conference on Trade and Development (UNCTAD). However, an extraordinary single large intra-firm financial transaction in South Africa, involving an exchange of shares between Naspers and Prosus, had inflated flows to Africa to a record high of USD79.6 billion in 2021, thus creating a very high base. In the absence of such a transaction, a moderate increase in FDI inflows would have been recorded in 2022. Nevertheless, Africa's share of global FDI inflows remained very low at 3.5%.

*Africa's share of global FDI inflows remained low, at 3.5%, in 2022*

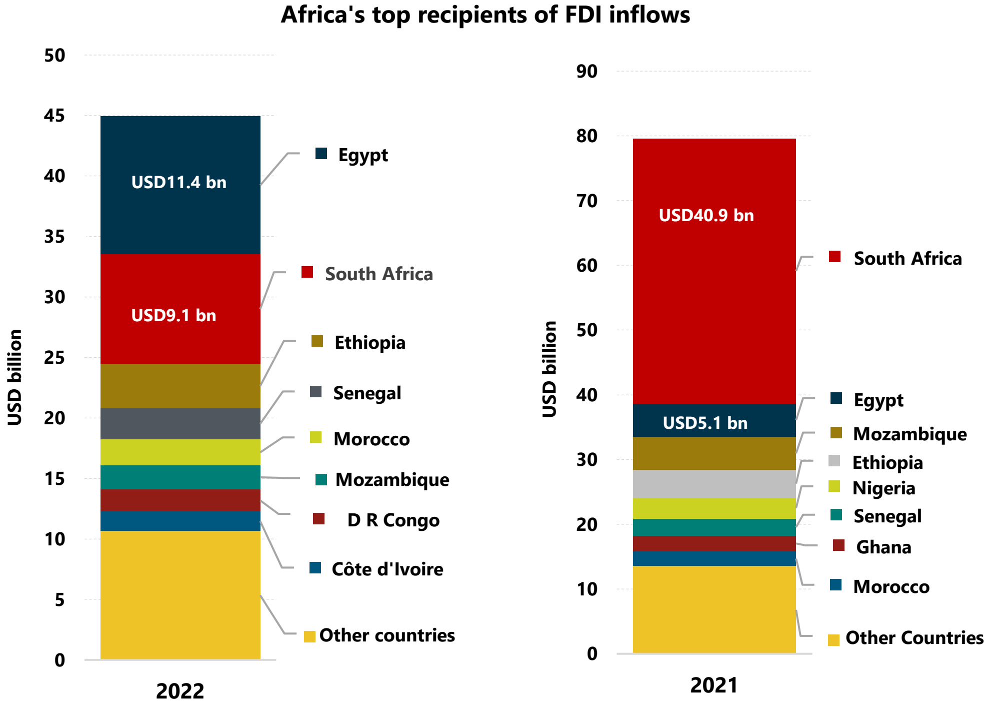
Announced greenfield FDI projects recorded a high of USD194.9 billion, up from USD52.2 billion in 2021. This suggests increased foreign investor interest in the region and positive prospects for investment in its future productive capacity. Energy and gas supply projects dominated, recording the largest increase in greenfield investment at nearly USD120 billion,

*USD195 billion worth of greenfield FDI projects announced in 2022* from USD24.4 billion in 2021, followed by those in the construction (USD24 billion) and extractive industries (USD21 billion).

At the individual country level, Egypt, South Africa, Ethiopia, Senegal and Morocco were the largest recipients of FDI in the continent in 2022, as shown in Figure 5.

*South Africa in 2nd position among the leading African recipients of FDI in 2022*

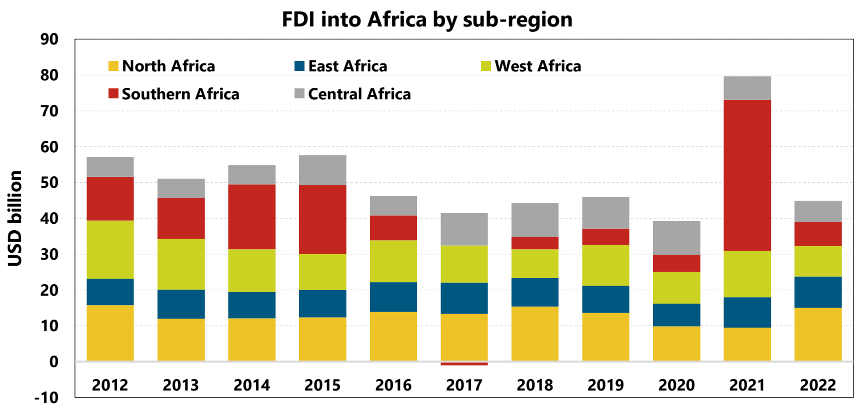
***Figure 5: Some of Africa's larger economies attracted higher FDI flows in 2022***




Source: IDC, compiled using data from UNCTAD's FDI databases, July 2023

In terms of sub-regions, FDI inflows rose in North and East Africa, while Central, West and Southern Africa recorded declines.

***Figure 6: FDI flows into Africa back to around the pre-pandemic levels in 2022***




Source: IDC, compiled using data from UNCTAD's World Investment Report of July 2023

**North Africa** attracted significantly higher FDI inflows than other sub-regions at USD15 billion, with Egypt leading the pack with inflows of USD11.4 billion as cross-border mergers and acquisitions (M&A) increased. The country's announced greenfield projects and international project finance deals also rose substantially to USD107.4 billion and USD23.7 billion, respectively, in 2022. Morocco was the second highest recipient of FDI inflows in the sub-region at USD2.1 billion, while plans to build a hydrogen and green

*A USD10 billion hydrogen and green ammonia production plant is being planned in Morocco* ammonia production plant estimated at more than USD10 billion pushed its announced greenfield investments to more than USD15 billion.

In **East Africa**, FDI inflows rose to USD8.7 billion, with Ethiopia alone attracting USD3.7 billion (2021: USD4.3 billion). Other major recipients were Uganda (USD1.5 billion) and Tanzania (USD1.1 billion). Large announced greenfield FDI projects in Uganda include the development of the Lake Albert oil field, and the construction of the 1 440-kilometre East African Crude Oil pipeline, in partnership with Tanzania.

*Large oil related projects announced in East Africa*

FDI inflows declined in **West Africa** to USD8.5 billion. Nigeria recorded negative FDI inflows in 2022 (-USD187 million) attributable to equity divestments. However, USD2 billion worth of greenfield projects were announced, representing a 24% increase year-on-year. The construction of a combined 936MW solar power plant and 443MW/hour battery storage facility estimated at USD1.8 billion is among the largest projects announced in Nigeria. Senegal managed to attract USD2.6 billion in FDI. A 300 000 $m^3$ per day reverse-osmosis plant is being developed, while USD1.1 billion has been committed by DP World for port construction in Senegal.

*Port construction projects in Senegal and renewable energy projects in Nigeria*

FDI flows into **Southern Africa** totalled USD6.7 billion in 2022. At USD9.1 billion (2021: USD40.9 billion, boosted by the extraordinary Naspers-Prosus transaction), inflows to South Africa still exceeded the annual average for the past decade. Cross-border M&A accounted for a large part (USD4.8 billion) of total inflows. UNCTAD reported several investments in battery storage projects in South Africa, with capacities of between 35MW and 300MW, as well as plans to build Africa's largest sustainable city (USD20 billion). Flows to Mozambique moderated to USD2 billion (2021: USD5.1 billion), attributed to negative company loans.

*Cross-border M&A accounted for a large portion of FDI inflows in South Africa*

FDI activity in **Central Africa** was largely dominated by mining and offshore oil projects, with the Democratic Republic of Congo (USD1.8 billion) leading in terms of inflows. Gabon followed at USD1.1 billion. There are plans to expand the Kamoa-Kakula copper mining complex in the DRC for an estimated amount of USD2.9 billion.

As indicated earlier, there was a significant jump in announced greenfield FDI projects in Africa in 2022, which bodes well for FDI activity in the short-term. The sectoral/industry distribution of these projects, which are dominated by service-oriented sectors, are shown in Table 1.

***Table 1: Services-oriented investments dominate greenfield projects***

**Sectoral distribution of announced FDI greenfield projects by value (USD million)**

| **Sector/industry** | **Value (USD million)** | |
|---|---|---|
| | **2022** | **2021** |
| **Total** | **194 903** | **52 220** |
| Primary | 21 403 | 3 822 |
| Manufacturing | 10 154 | 10 525 |
| Services | 163 347 | 37 873 |
| **Top 5 industries by value in 2022** | | |
| Energy and gas supply | 119 653 | 24 382 |
| Construction | 24 009 | 2 781 |
| Extractive industries | 21 372 | 3 606 |
| Transportation and storage | 7 452 | 2 676 |
| Information and communication | 6 674 | 4 336 |

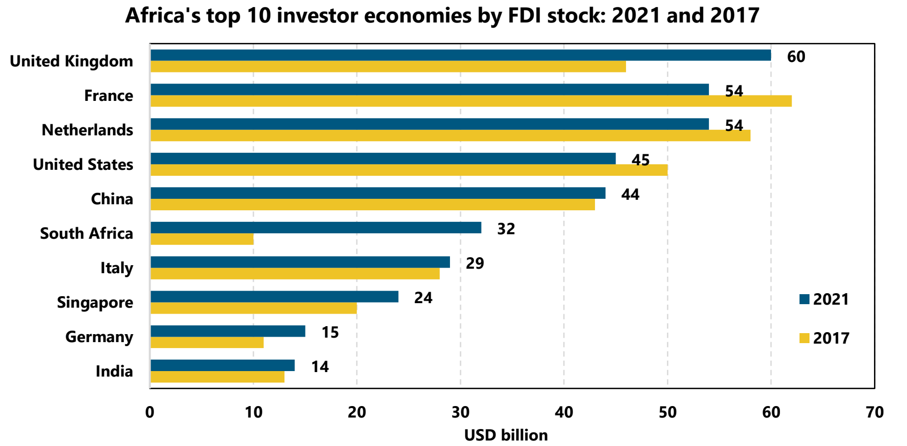
Source: UNCTAD World Investment Report 2023

Although the holders of FDI stock in Africa are becoming more diversified, European investors still dominate, with the United Kingdom (USD60 billion), France (USD54 billion) and the Netherlands (USD54 billion) leading the pack as indicated in Figure 7 below.

*European investors still dominate FDI stock holdings in Africa*

However, there have been divestments over the years as some investors from advanced economies have been selling their fossil fuel assets. South Africa remains a dominant player in intra-African FDI, featuring among the continent's top 10 inward investors.

***Figure 7: South Africa among the key direct investors in the rest of Africa***




Source: IDC compiled using data from the UNCTAD World Investment Report, 2023

*Global FDI activity under pressure in the face of high levels of uncertainty*

UNCTAD expects further downward pressure on global FDI inflows in 2023. A high degree of uncertainty and risk aversion prevails in the investor community, as evidenced by very weak trends in FDI project activity in the first half of 2023. Recent financial sector woes in some advanced economies have added to this uncertainty.

Foreign investment activity in Africa may remain relatively subdued in the near term, considering a more modest economic outlook amid persistent challenges facing the global environment. However, the momentum may increase in 2024 and beyond on the back of the approval and implementation of key announced projects, new investment opportunities arising from the restructuring of global value and supply chains, as well as the finalisation of various protocols under the African Continental Free Trade Area agreement. The continent has a greater role to play in the global energy and greening transition, which should augur well for increased investment activity going forward.

## South African economy facing stagflation

### Recent economic performance and outlook

*SA economy facing many challenges affecting its performance*

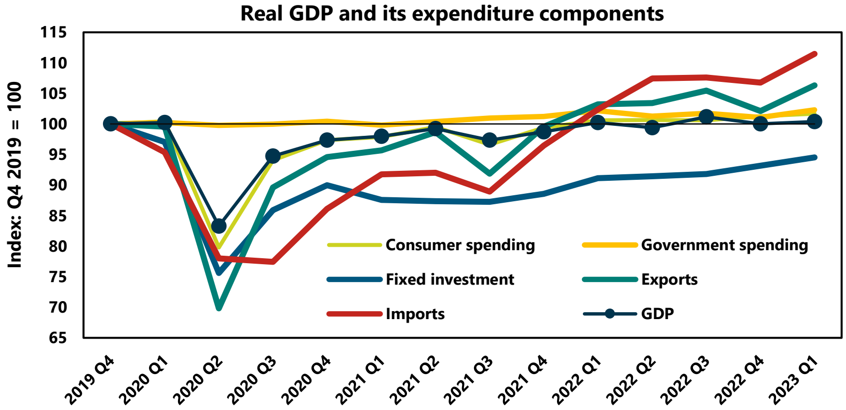
Faced with multiple challenges of a serious nature, the South African economy finds itself in a rather precarious state. Weak spending, production and fixed investment activity in an environment characterised by high inflation, sharply higher interest rates, extremely high unemployment and increased poverty, social unrest, and operational constraints on various critical fronts underlie the very low confidence levels and major uncertainty prevailing in the economy.

*Growth prospects have worsened, with real GDP projected to expand only marginally (+0.2%) in 2023*

Real gross domestic product expanded by only 0.4% quarter-on-quarter in the first quarter of 2023, after having contracted by 1.1% in the final quarter of 2022, thus reaching a level that was only marginally higher than pre-pandemic, as shown in Figure 8 below. GDP growth of a mere 0.2% is currently forecast by the IDC for 2023, which is tantamount to economic stagnation.

The International Monetary Fund projects economic growth in South Africa at a similar rate (+0.1%) for the current year. In its latest review of the economy, it emphasised the need for urgent reforms, particularly "improving the country's energy and logistical constraints, reducing barriers to private sector investment, addressing structural rigidities in the labour market, and tackling crime and corruption". Without such reforms the economy will not achieve much faster rates of growth on a sustained basis.

***Figure 8: Economic recovery constrained by several challenges***




Source: IDC, compiled using Stats SA data

**Household consumption** expenditure increased by only 0.4% q-o-q in Q1 2023. With household budgets being adversely impacted by inflation pressures, high levels of indebtedness and substantially higher interest rates, subdued growth in disposable incomes and high unemployment, consumer confidence fell to its second lowest reading on record in Q2 2023. This does not bode well for a meaningful up-tick in consumption expenditure over the short-term.

*Households facing difficult circumstances, affecting their ability and willingness to spend*

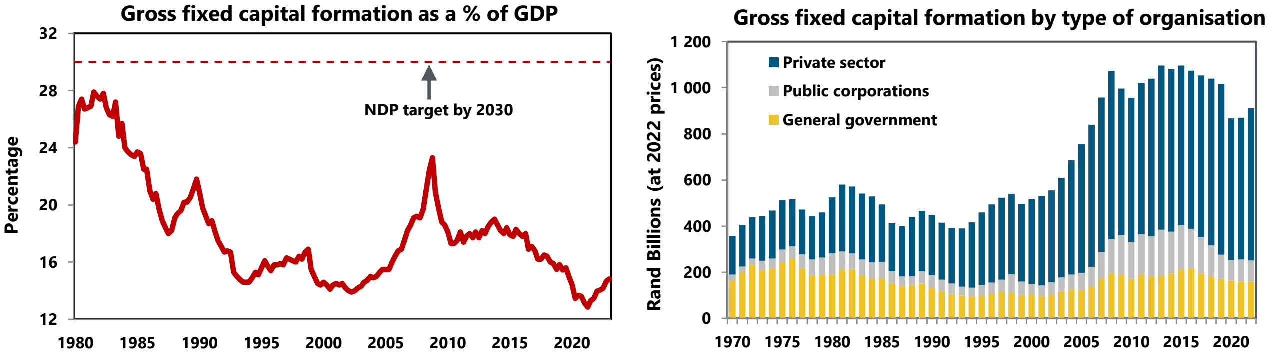
**Government consumption** spending played a very modest counter-cyclical role due to fiscal constraints, rising by 1.2% q-o-q in Q1 2023. Weak economic conditions are likely to affect revenue collections over the remainder of the year, but pressure on social expenditure may increase. The budget deficit is therefore expected to be substantially wider than projected in the Budget 2023, while government debt should be significantly higher. Deteriorating public finances could impact much needed infrastructure expenditure as the focus may lie on service delivery and social spending. Considering the large public debt and government's borrowing requirements, the cost of capital will compromise fiscal consolidation efforts and the attainment of debt sustainability targets.

*Substantial borrowing requirements and higher interest rates to impact fiscal consolidation efforts*

**Fixed investment** expanded by 1.4% q-o-q in the opening quarter of the year, but the quantum of capital spent remained well below pre-pandemic levels. The weakness in capital outlays is reflected by the sharp declining trend in the ratio of fixed investment to GDP over time, for it stood at only 14.8% in Q1 2023 compared to 21.6% in 2008, and well below the 30% envisioned in the National Development Plan.

*Fixed investment has been recovering gradually, but the trend may not be sustained due to ongoing challenges*

***Figure 9: Low levels of fixed investment unable to sustain faster rates of economic growth***




Source: IDC, compiled using SARB, Stats SA data

**Last data point: Q1 2023**

**Last dapa point: 2022**

**Exports** increased, in real terms, by 7.4% in 2022 and by 4.1% q-o-q in Q1 2023 despite a more challenging global trading environment. Domestic producers have had to rely increasingly on world markets to sustain and/or to raise production activity, as local demand has been generally weak in recent years. In nominal terms, the share of exports (goods and services) in national GDP rose to 33.5% in 2022, well above the peak of 29% recorded in 2014. This illustrates the importance of global demand as a driver of domestic economic growth and, therefore, the imperative of maintaining good relations with international trading partners.

*Resilient export performance, despite challenging global trading conditions*

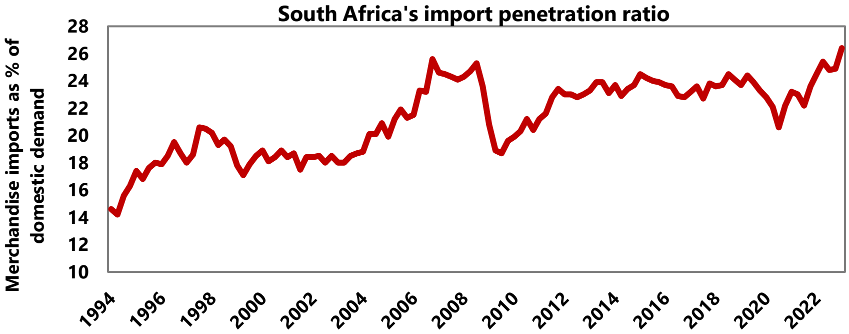
In the shorter-term, however, slowing economic growth and consequently weaker import demand may be expected in several of South Africa's key global markets, thus affecting the country's export performance over the next year or two.

**Imports** have been on a rising trend, which is partly a reflection of the progressive loss of competitiveness in various domestic industries, as well as local consumers opting for cheaper alternatives. By Q1 2023, imports of goods and services were 11.5% above pre-Covid levels in real terms. The economy's import penetration ratio (i.e., real imports of merchandise goods as a percentage of gross domestic expenditure) has risen steadily over time, reaching a record high of 26.4% in Q1 2023. Looking ahead, relatively weak fixed investment activity may affect demand for imported capital goods such as machinery and equipment, while subdued household spending could reduce demand for consumer items.

*Strong import demand despite the prevailing economic weakness*

*Import penetration ratio at a record high of 26.4%*

***Figure 10: South Africa increasingly dependent on imports to meet domestic demand***




Source: IDC, compiled using SARB data

**Last data point: Q1 2023**

**Sectoral performances** have differed but generally reflected ongoing weakness. Manufacturing production was 1.5% higher q-o-q in Q1 2023, but the sector continues to face major challenges, including insufficient and irregular electricity supply, transport and logistics challenges (recently exacerbated by criminal activity targeting truck transportation), rising input costs and other factors affecting domestic competitiveness, as well as insufficient demand. Manufacturing output fell by 1.3% in May and the PMI declined further in June to a reading of 47.6, the lowest in 23 months. However, the rebound in the 'expected business conditions' segment of the index, which refers to a period six months ahead, provides some optimism of higher output towards the latter part of the year.

*Manufacturing, mining and agriculture sectors facing considerable challenges, as reflected in declining output*

The modest 0.9% recovery in mining sector output in Q1 2023 was short-lived, as production fell sharply (-3.8% month-on-month) in May. Adverse factors impacting the sector include inadequate energy supply, transport and logistics bottlenecks, lack of investment, rising operating costs and policy uncertainty. Mining and mineral exports are facing serious difficulties with inland transportation to ports and lower prices, although a weaker currency may lift export earnings in Rand terms (albeit unfavourable for imported input costs).

Agriculture production has been under some pressure since the latter part of 2022, with sectoral GDP contracting by 2.4% q-o-q in Q4 2022 and by a further 12.3% q-o-q in Q1 2023, mainly due to lower field crops and animal production. Confidence in the agri-businesses sector has fallen sharply since its peak in Q2 2021, with sentiment levels in Q2 2023 being the lowest in three years.

## Business confidence

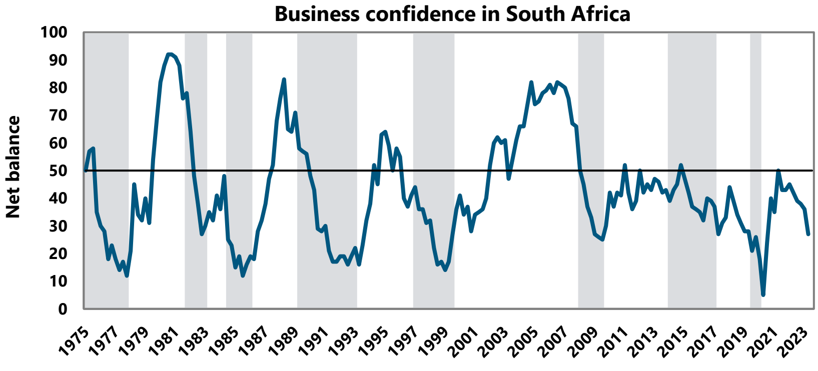
Business confidence has been at low levels for an extended period and declined by a further 9 points to a reading of only 27 points in Q2 2023, the lowest level in almost 3 years. Confidence amongst manufacturers remained at very low levels, with more than 80% of those surveyed being unhappy with operating conditions. Sentiment levels among retailers and new vehicle dealers also plunged in Q2 2023, indicative of a deteriorating consumer environment.

*Business confidence at the lowest level in 3 years*

Low business confidence along with a steep declining trend in the leading business cycle indicator forewarn of very weak growth in the months ahead. Economic sentiment and activity levels are expected to recover only once critical constraints to business operations, primarily in the electricity, transport and logistics, and water infrastructure spheres, start being addressed in a decisive and effective manner, while a greater degree of policy certainty becomes evident to assist the private sector in its business planning, including investment decisions.

*Low sentiment indicating subdued investment and production in the months ahead*

***Figure 11: Low business confidence indicative of difficult operating conditions***



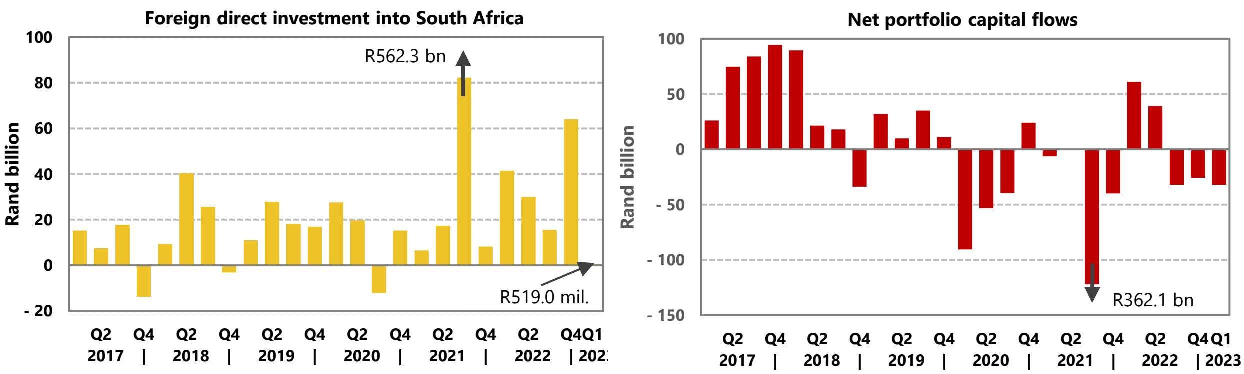

Source: IDC, compiled using BER data **Last data point: Q2 2023**

## Foreign direct investment and portfolio capital flows

The challenging investment climate in the country is influencing foreign capital flows. Foreign direct investment (FDI) inflows amounted to a mere R519 million in Q1 2023, compared to a R64 billion inflow in Q4 2022 and an annual inflow of R151 billion for the entire year. Low FDI inflows are of concern given the imperative of raising the level of fixed investment spending in South Africa to an enormous extent vis-à-vis the relatively low level of domestic savings.

*Sharply lower FDI inflows in Q1 2023 are indicative of investor concerns with the investment environment in SA*

***Figure 12: Sharp drop in FDI inflows at the start of 2023, while the net outflow of portfolio capital continues unabated***




Source: IDC, compiled using SARB data

Net outflows of portfolio capital amounted to R32 billion in Q1 2023. Being the third consecutive quarter to record net outflows, it provides a clear indication of the lack of non-resident appetite for acquiring and/or holding South African investment assets, specifically bonds and listed equities, given the significantly higher perceived risk premia.

*Substantial portfolio outflows are indicative of the increased risk associated with South African investment assets*

## Inflation and interest rates

Consumer price inflation came in at a lower than anticipated rate of 5.4% in June 2023, the lowest in the past 19 months. This compares with 6.9% in January and the recent peak of 7.8% in July 2022. Sharply lower petrol price inflation at -8.3% (July 2022: 56%) and a moderation in food price inflation to 11.1% (March 2023: 14.4%) contributed significantly to the welcomed inflation trend since the start of the year.

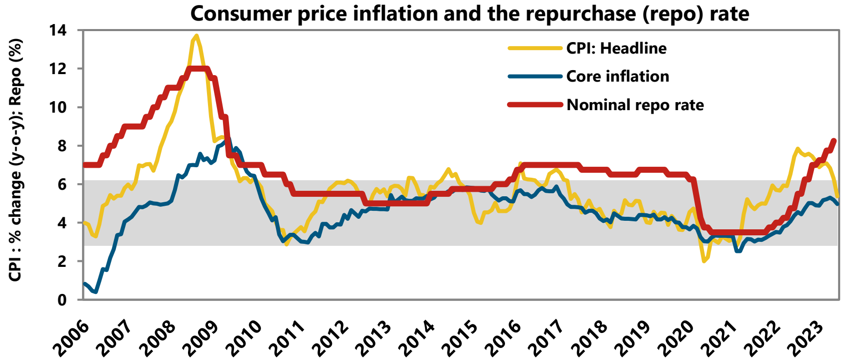
*Inflation surprised on the downside, but core inflation remains sticky*

However, core inflation (i.e., excluding volatile fuel and food prices) remains somewhat sticky, having measured 5.0% in June 2023. This is of concern from a monetary policy perspective as it indicates that second round inflationary pressures remain elevated. The Bank for International Settlements recently cautioned that restoring price stability and managing financial risks will remain key challenges for central banks going forward.

The South African Reserve Bank (SARB) has indicated that interest rates are likely to remain higher for longer than previously anticipated. With June's inflation outcome resulting in its re-entry into the SARB's target band, the MPC opted to leave the repurchase rate unchanged at 8.25% on 20 July. However, the central bank is still concerned with the upside risks to the inflation outlook and the need to anchor expectations. According to the Bureau for Economic Research's media release on 6 July, average inflation expectations of analysts, businesses and trade unions increased in Q2 2023 by 0.2 percentage points (ppts) to 6.5% for 2023 and by 0.1% ppt to 5.9% for 2024, which exceed the SARB's latest forecasts.

*The repo rate was left unchanged on 20 July but concerns remain over the upside risks to inflation*

***Figure 13: Headline inflation on a declining trend, but core inflation remains elevated***



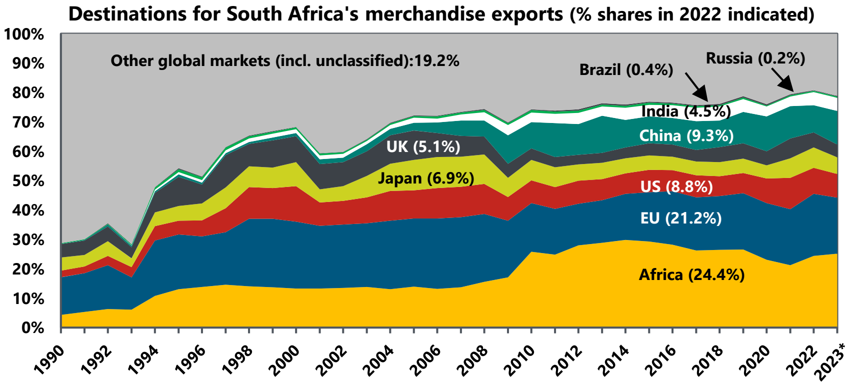

Source: IDC, compiled using Stats SA and SARB data

**Last data point: June 2023**

## External trade

The global destinations for South African exports have undergone substantial changes over time, as shown in Figure 14.

***Figure 14: Africa and China have become increasingly important markets for SA exports***




Source: IDC, compiled using SARS data

*** January to May 2023**

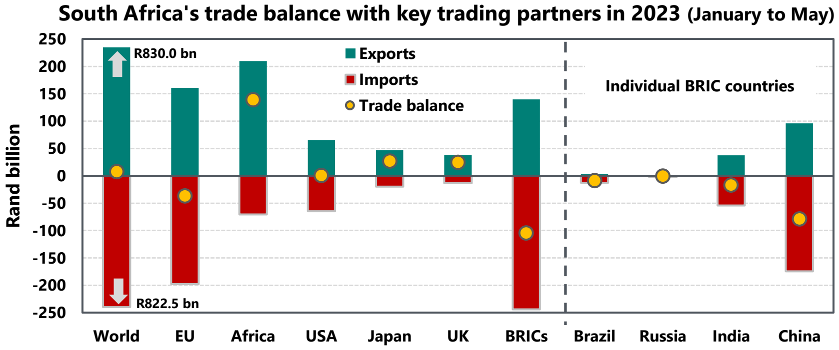
African economies have collectively claimed substantially larger shares (24.4% in 2022) of South Africa's merchandise exports over time, although the peak was recorded in 2014. China has also become an increasingly important market, claiming a 9.3% share of the export basket in 2022. The European Union (21.2%), the United States (8.8%), Japan (6.9%) and the United Kingdom (5.1%) collectively accounted for 42% of South Africa's exports in 2022, up from 30.9% in 2012. The BRIC economies as a group claimed a 14.4% share.

*The BRIC economies accounted for only 14.4% of SA exports to the world in 2022, the bulk of which was sold in China*

South Africa's merchandise exports were under pressure at the start of 2023, rising by only 4.5% y-o-y in nominal terms over the period January to May. Lower commodity prices, weaker global demand and infrastructure-related challenges affected South Africa's export performance. Import demand, in turn, increased at a very robust pace of 19.9% over this period, despite a subdued economic performance. Consequently, the balance of trade recorded a marginal surplus of R7.6 billion, while sizeable trade deficits were reported in South Africa's trade with China and the European Union (EU).

*SA exports under pressure in the first 5 months of 2023, but import demand was robust*

***Figure 15: Exports under pressure, while import demand recorded strong growth***




Source: IDC, compiled using SARS data

South Africa recorded a sizeable R139.2 billion surplus in its trade with markets across **Africa** over the period January to May 2023. Merchandise exports to the continent rose by R22.6 billion, year-on-year, with the main contributors to this increase being refined petroleum products (+R3.2 billion); motor vehicles (+R3.0 billion); agricultural products (+R2.1 billion); soap, detergents and other cleaning products (+R1.5 billion); as well as mining machinery and equipment (+R1.6 billion). It should be noted, however, that a considerable increase (+R4.7 billion, or +76.4% y-o-y in exports of mining of non-ferrous metal ores (e.g., chrome, manganese, copper) was also reported. However, these products are likely to have been shipped via the port of Maputo (Mozambique) to destinations elsewhere in the world (probably to China and/or India) due to transport and logistical challenges in South Africa.

*SA recorded a large R139.2 billion surplus in its trade with other African markets collectively over the period January to May 2023*

Exports to the **European Union** declined by 5.8% or R9.9 billion year-on-year over the review period, with lower exports mostly due to sharp declines in jewellery (-R6.0 billion); platinum group metals (-R4.2 billion); pharmaceutical products (-R3.4 billion); coal (-R2.8 billion); and iron ore mining (-R2.5 billion). Imports from the EU, in turn, increased very strongly (+27.4% or +R42.5 billion), largely due to higher imports of motor vehicles and parts; machinery and equipment; chemical products; basic iron and steel; and beverages. The trade deficit recorded with the EU amounted to R37 billion in the first 5 months of 2023.

*SA exports to the EU fell by 5.8% y-o-y over the first 5 months of 2023, while imports rose by 27.4%*

Exports to **China** increased by R26.1 billion or 37.3%, year-on-year, over the period under review. Key contributors to this increase included higher mining and mineral exports of non-ferrous metal ores such as chrome and manganese (+R8.8 billion); basic iron and steel (+R7.1 billion); iron ore (+R2.9 billion); basic non-ferrous metal products (+R2.2 billion); and paper and paper products (R1.9 billion). Imports from China rose considerably, specifically by 29.2% (+R39.5 billion) to a total of R174.7 billion, with the main contributors to the increase being electrical machinery and equipment (+R22.1 billion); television, radio and communication apparatus (+R7.0 billion); and motor vehicles and parts (+R4.5 billion). South Africa recorded a R78.6 billion deficit in its balance of trade with China over the period January to May 2023.

*SA recorded a sizeable R78.6 billion deficit in its trade with China from January to May 2023*

South Africa recorded sizeable surpluses in its balance of trade with the **United States** over the past 3 years. During the period January to May 2023, however, the surplus amounted to only R0.9 billion. Exports to the US over this period fell by R2.5 billion (or -3.7%) year-on-year, mainly due to a steep decline in platinum exports (-R10.9 billion) as well as basic iron and steel (-R0.7 billion). Nevertheless, several export categories recorded significant increases year-on-year, including non-ferrous metal products (+R3.1 billion) and motor vehicles (+R2.8 billion). South Africa's imports from the US, in turn, rose by 28.8%, an increase of R14.5 billion. Demand for aircraft and spacecraft, machinery and equipment, as well as motor vehicles and parts, dominated this increase in imports.

*SA has recorded surpluses in its balance of trade with the US in recent years*

Exports to **Japan** were largely affected by a sizeable R10.7 billion drop in platinum group metals exports during the period January to May 2023, with overall exports being 18%, or R10.3 billion, lower year-on-year. Imports from Japan fell only slightly (-0.6%) over the same period. South Africa recorded a surplus amounting to R27.1 billion in its trade with Japan.

*SA exports to Japan fell by 18% y-o-y in the first 5 months of 2023*

The 14.3% drop (or -R6.4 billion) in exports to the **United Kingdom** was mainly due to much lower platinum exports, which had fallen by R3.9 billion over the reference period, while lower exports of motor vehicles and that of non-ferrous metal products also contributed to this decline. Even though demand for imports increased by 19%, underpinned largely by higher imports of motor vehicles and parts, machinery and equipment, petroleum and petroleum products, as well as chemicals and chemical products, a R24.9 billion trade surplus was still recorded.

*Lower platinum exports underpinned much of the 14.3% decline in exports to the UK*

Merchandise exports to **India** were overwhelmingly dominated by coal, followed by other mining exports such as chrome and manganese. Imports comprised mostly of petroleum and related products, motor vehicles, chemicals and chemical products, as well as machinery and equipment. A trade deficit of R16.8 billion was recorded over the period January to May 2023.

*SA exports to India dominated by coal*

A mere 0.4% (R8.3 billion) of South Africa's total merchandise exports in 2022 was sold to **Brazil**. Imports, in turn, measured R26 billion. Mining and mineral products, motor vehicle components, and base metals dominated the export basket. Processed food (mainly poultry meat), motor vehicle components, machinery and equipment, and base metals were the main import categories. South Africa recorded a deficit of R8.8 billion in its trade with Brazil over the period January to May 2023.

*SA recorded a deficit of R8.8 bn in its trade with Brazil, a very minor market for its exports, from January to May 2023*

South Africa's merchandise exports to **Russia** represented a miniscule 0.2% of exports to the world at large in 2022. Valued at only R4.6 billion, these consisted largely of agricultural products such as citrus and deciduous fruits. Imports from Russia totalled R9.0 billion last year, with fertilisers accounting for 46% of the total, but fell sharply (-34.3% year-on-year) in the first five months of 2023, while South Africa's exports to Russia increased robustly (+52%). This resulted in a marginal trade deficit of R0.3 billion over the 5-month period.

*A miniscule 0.2% of SA's total exports were sold in the Russian market in 2022*

### *The importance of exports for employment in South Africa*

Totalling R2 013.8 billion in 2022 and accounting for 30.4% of national GDP, merchandise exports are extremely important for the South African economy. They play a critical role in sustaining economic activity, stimulating fixed investment and, importantly, in creating and/or supporting employment opportunities across various sectors.

*Exports play a crucial role in sustaining/raising production activity and employment in SA*

The IDC's Research and Information Department has estimated that merchandise exports in 2022 supported and/or created a total of 2 348 995 job opportunities in the formal sectors of the South African economy, as indicated in Table 2.

Of these, 882 384 employment opportunities could be linked directly to exports (initial impact), while an additional 777 636 jobs were supported and/or created at all supplying and supporting industries (first round impact) to the exporting sectors. The initial and first round impacts are the direct employment contributions that may be associated with exports, as indicated in Table 2. Considering that these supplier industries also require goods and services from various other sectors in the domestic economy, jobs are also supported and/or created elsewhere in these sectors (indirect impact). An additional 688 975 jobs are estimated to have been indirectly supported and/or created in the economy due to overall merchandise export activity in 2022.

These estimates demonstrate the importance of exports in creating/supporting employment opportunities in the economy, with export-related jobs (directly and indirectly) estimated to have accounted for a sizeable 19.7% share of all formal sector employment in 2022.

***Table 2: Exports make a considerable contribution to employment in South Africa***

**Estimates of the employment associated with SA merchandise exports to the world at large, the principal global markets, as well as to Russia and Brazil, in 2022**

| Export destination | Initial impact | First round | Direct impact | Indirect impact | Total impact |
|---|---|---|---|---|---|
| | a | b | c = a + b | d | e = c+ d |
| **World at large** | **882 384** | **777 636** | **1 660 020** | **688 975** | **2 348 995** |
| Africa | 242 524 | 179 993 | 422 517 | 170 047 | 592 565 |
| European Union | 168 629 | 147 888 | 316 517 | 143 069 | 459 585 |
| United States | 62 193 | 76 188 | 138 381 | 69 844 | 208 225 |
| Japan | 51 892 | 75 076 | 126 969 | 56 560 | 183 529 |
| **China** | 54 348 | 56 477 | 110 825 | 49 233 | 160 058 |
| United Kingdom | 44 656 | 48 123 | 92 779 | 40 032 | 132 811 |
| **India** | 41 332 | 30 854 | 72 186 | 23 294 | 95 480 |
| . | | | | | |
| . | | | | | |
| . | | | | | |
| **Russia** | 5 485 | 2 566 | 8 051 | 2 361 | 10 411 |
| **Brazil** | 3 076 | 2 452 | 5 529 | 2 789 | 8 317 |
| **BRICs** | **104 240** | **92 350** | **196 590** | **77 677** | **274 267** |

Note: Induced impacts (i.e. those impacts associated with higher labour remuneration and the subsequent increase in consumer spending) are not included in this analysis

Source: IDC estimates

**Africa** was the largest market for South Africa's merchandise exports in 2022, with a 24.4% share of the total. Consequently, an estimated 592 565 jobs were directly and indirectly associated with South Africa's exports to African markets collectively in 2022, representing 25.2% of all export-related jobs. The **European Union**, which is the second largest export market at the regional level, was estimated to have supported and/or created, both directly and indirectly, 459 585 jobs in the domestic economy in 2022, or 19.6% of the total.

An estimated 208 225 formal sector jobs may have been associated, directly and indirectly, with South Africa's merchandise exports to the **United States** in 2022. The world's largest economy was the market for 8.8% (R177.9 billion) of South Africa total merchandise exports last year. Its estimated employment impact represented 8.9% of the total. South Africa's exports to **Japan** in 2022, in turn, were accountable for an estimated 183 529 employment opportunities, or 7.8% of all the export-related jobs last year.

Although **China** is the largest market for South Africa's exports at the individual country level (9.3% share of the total in 2022), the associated employment impact, estimated at 6.8% of the total or 160 058 jobs, is less than that pertaining to export sales to the US and Japan. The underlying reason is that the export basket to China is dominated by mining and mineral products such as iron ore and non-ferrous metal ores (e.g., chrome, manganese), whose extraction/production has a lower employment intensity and a relatively smaller employment multiplier.

An estimated 132 811 employment opportunities in South Africa are estimated to have been linked with exports to the **United Kingdom** in 2022, while exports to **India** were estimated to have been responsible, directly and indirectly, for 95 480 job opportunities. Considering the very limited export trade with **Russia** and **Brazil**, the estimated employment impacts stood at only 10 411 (0.4% of the total) and 8 317 (0.35%) jobs, respectively, in 2022.

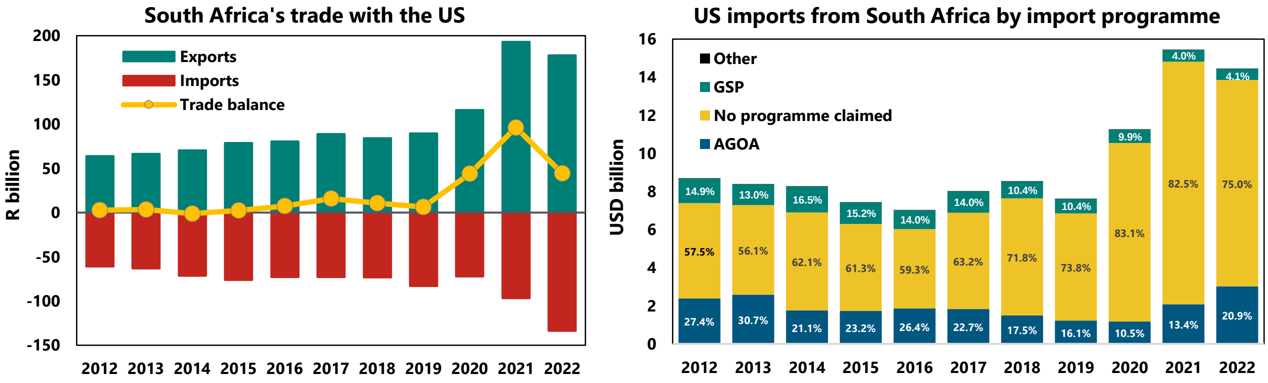
*South African exports to the United States under AGOA and other programmes*

The United States remains an indispensable trading partner for South Africa. Merchandise exports to this very large market increased noticeably over the last two years, reaching R177.9 billion (8.8% of the total) in 2022. As indicated in the previous section, some 208 225 formal sector jobs in South Africa may have been associated, directly and indirectly, with these exports in 2022, representing 8.9% of all the estimated export-related employment in the domestic economy.

Furthermore, except for 2014, South Africa recorded surpluses in its balance of trade with the US over the past decade, with the quantum having been significantly large in the past three years, as illustrated in Figure 16.

In 2022, 71.8% of US imports from South Africa entered that market duty-free because the Most Favoured Nation (MFN) tariff stood at zero, while a further 20.9% entered duty-free due to the Africa Growth and Opportunity Act (AGOA) and an additional 4.1% enjoyed duty-free entry under the Generalised System of Preferences (GSP). Only 3.2% of South African exports, therefore, paid import duties upon entry to the American market.

***Figure 16: South Africa's trade with the US over the past decade and benefits associated with US import programmes***

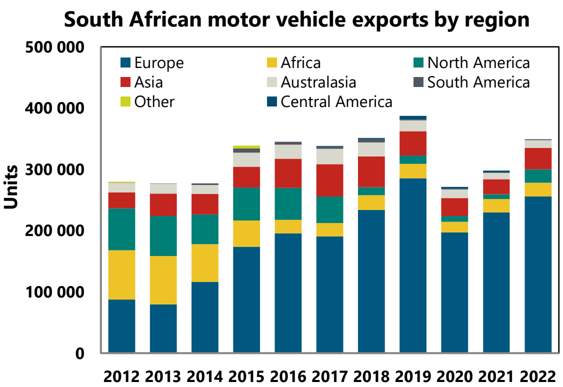



Source: IDC, compiled using SARS data

Source: IDC, compiled using USITC data

Passenger vehicles dominate US imports from South Africa under AGOA. These accounted for 49.2% of the total in value terms, with the balance being a diverse product range. According to Lightstone data on a unit basis, US vehicle imports from South Africa in 2022 were predominantly produced by BMW (54.5% of the total) and Mercedes-Benz (45.0%), as indicated in the table below. Although the alternative MFN import tariff is only 2.5%, the collective quantum that would have been potentially incurred by importers in the absence of AGOA benefits, at USD37.1 million in 2022, is significant when considered in total value terms.

***Figure 17: South Africa's vehicle exports by region, manufacturer and type of vehicle***




Source: IDC, compiled using AIEC data

**South African exports to North American markets by manufacturer and by type of vehicle, 2021-2022**

| Type | Market | 2021 | 2022 |
|---|---|---|---|
| **United States** | | | |
| **BMW X3** | Passenger | 867 | 11 211 |
| **Ford Ranger** | Light commercial vehicle | 110 | 105 |
| **Mercedes AMG C** | Passenger | 509 | 177 |
| **Mercedes C-Class** | Passenger | 5 335 | 9 073 |
| **TOTAL** | | **6 821** | **20 566** |
| **Mexico** | | | |
| **BMW X3** | Passenger | 1 699 | 778 |
| **Ford Ranger** | Light commercial vehicle | 210 | 359 |
| **Mercedes C-Class** | Passenger | 243 | 538 |
| **TOTAL** | | **2 152** | **1 675** |

Source: IDC calculations using Lightstone data

The US is the second largest destination for South African automotive component exports, which amounted to R8.8 billion in 2022. These were dominated catalytic converters (61.2% of the total), followed by engine parts (14.4%). The MFN tariff applicable to catalytic converters is zero in the US market and, therefore, these export products would be unaffected if South Africa was to be excluded from AGOA.

Other US imports from South Africa under AGOA include ferrochromium, ferrosilicon, gold necklaces, industrial fatty alcohols, and agricultural products such as citrus fruit and macadamia nuts.

South African exports to the US under the Generalised System of Preferences shrank markedly due to the imposition by the Trump administration of import tariffs amounting to 25% and 10% on steel and aluminium products, respectively. US imports of aluminium from South Africa were particularly hard hit, resulting in a decline from USD378.9 million in 2017, a year before the tariffs took effect, to USD206.3 million in 2022. Despite the higher import tariff, imports of steel products from South Africa were less affected, having fallen from USD976.4 million in 2017 to USD 909.7 million in 2022, possibly due to insufficient production capacity in the US to meet domestic demand.

**Department of Research and Information**

**20 July 2023**