Investec

Economic growth note: upside improves substantially as probability of a stronger outlook jumps

Friday 26 July 2024

Economic Scenarios:

		2023	2024	2025	2026	2027	2028	2029
Extreme	SA GDP y/y%	0.7	1.1	3.3	5.0	5.7	6.4	6.8
Up case	Gross Fixed Capital Formation y/y%	3.9	4.6	7.5	9.2	10.1	10.4	10.8

Extreme Up case **2%** (previously 1%)

SA economic growth rises to 3–5%, then 5-7%. Good governance, growth-creating reforms (structural constraints eradicated), strong property rights, no nationalisation or expropriation without compensation. High business confidence and fixed investment growth, substantial FDI, fiscal consolidation drives debt to low ratios of 2000s. Very subdued domestic inflation on extreme rand strength, very favourable weather conditions. Very short grey listing. Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings. Strong transition away from fossil fuel usage, a quick transition to renewable energy, very comprehensive measures to alleviate climate change impact on economy. The Russian/Ukraine war ends quickly.

		2023	2024	2025	2026	2027	2028	2029
Up case								
12%	SA GDP y/y%	0.7	1.0	2.4	3.1	3.8	4.4	4.8
	Gross Fixed Capital Formation y/y%	3.9	4.4	5.8	6.7	7.4	8.1	8.3

(previously 2%)

Economic growth lifts to around 4%, rising confidence and investment levels, structural constraints eroded, global growth strong, global financial markets risk-on. No nationalisation or expropriation without compensation. Low domestic inflation on favourable weather and global conditions, rand strength, lower state-controlled price inflation on increased private privatisation. Positive outlooks on credit ratings turn into upgrades on substantial fiscal consolidation, debt projections fall substantially. Grey listed for less than eighteen months. Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy. The Russian/Ukraine war ends.

		2023	2024	2025	2026	2027	2028	2029
Base	SA GDP y/y%	0.7	1.0	1.6	2.0	2.2	2.5	2.7
case	Gross Fixed Capital Formation y/y%	3.9	4.3	4.8	5.0	5.2	5.7	6.3

50% (previously 45%)

Economic growth modest but lifts towards 3.0% y/y over five years on sufficient domestic policy support measures (but still limited somewhat by load shedding, freight constraints), global financial market risk sentiment is neutral to positive. South Africa in the BB credit rating category bracket as fiscal consolidation (debt to GDP stabilisation) occurs leading to some positive outlooks. The rand stabilises and strengthens somewhat, inflation is impacted by the course of weather patterns via food price inflation. Little expropriation without compensation occurs and has no negative effect on economy, no nationalisation. A modest transition to renewable energy and slow move away from fossil fuel usage occurs and measures to alleviate the impact of climate change on the economy are modestly implemented. The Russian/Ukraine war persists and does not exacerbate, nor do middle East Tensions. The grey listing is temporary.

		2023	2024	2025	2026	2027	2028	2029
Lite	SA GDP y/y%	0.7	0.6	0.2	0.5	0.7	0.9	1.0
(domestic)	Gross Fixed Capital Formation y/y%	3.9	4.1	3.1	3	2.8	3.5	4.1

Down case **35%** (previously 43%)

The international environment (incl. risk sentiment) is that of the base case. South Africa fails to see government debt projections stabilise, falls into single B (local and foreign currency) credit ratings from all three agencies. Recession occurs. Business confidence depressed, substantial load shedding, marked freight constraints, weak investment growth, civil and political unrest. High inflation on unfavorable weather conditions, marked rand weakness. Little transition to renewable energy or measures to alleviate the impact of climate change. Very limited expropriation of private sector property without compensation, with a slight negative impact on the economy. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades. The greylisting is lengthy.

		2023	2024	2025	2026	2027	2028	2029
Severe	SA GDP y/y%	0.7	0.3	-2.0	-1.3	0.1	0.3	0.4
down	Gross Fixed Capital Formation y/y%	3.9	3.8	0.2	1.0	1.6	1.9	2.6

case **1%** (previously 9%)

Lengthy global recession, global financial crisis - insufficient monetary and other support domestically and internationally. Very high inflation on very adverse weather conditions, severe rand weakness. SA rated single B from all three key agencies, downgraded into CCC grade, increased risk of default. Government borrows from increasingly wider sources, sinks deeper into a debt trap, widespread, severe services load shedding, severe civil and political unrest. Failure to transition to renewable energy and measures to alleviate the impact of climate change on the economy. Limited expropriation of private property without compensation with a noticeable negative economic impact. SA is blacklisted. The Russian/Ukraine war widens into neighbouring (NATO) countries, Middle East tensions worsen.

Note: Event risk begins Q3 24. Source: Investec

Expected Case: Economic growth forecasts

Calendar year	2024	2025	2026	2027	2028	2029
GDP (Year on year growth, %)						
GDP Q3 2024	1.0	1.6	2.0	2.2	2.5	2.7
GDP Q2 2024	1.1	1.5	1.9	2.2	2.4	2.6
GDP Q1 2024	1.0	1.4	1.7	2.0	2.1	

Source: Investec Macro-Economic Outlook, 1st July, contact details below

Base Case: Q1 2024 vs Q3 2024 Economic growth forecasts						
Financial year	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
GDP (Year on year growth, %)						
GDP Q3 2024	0.8	1.3	1.6	2.2	2.2	2.6
GDP Q1 2024	**0.7**	**1.1**	**1.5**	**1.8**	**2.0**	**2.1**
						Source: Investec

- South Africa continues to work towards removing the impediments to a stronger economic growth environment, most tangibly so far is the halt in loadshedding, but key is that the change in government has lifted the potential for a stronger outlook.

- In addition, the downside risk has meaningfully reduced as fiscal consolidation is a fundamental tenet of the newly established Government of National Unity (GNU) in South Africa, with the risk of a shift to the left and fiscal deterioration avoided.

- Finance Minister Godongwana highlighted this month a very firm stance on fiscal restraint and consolidation. The bond market saw substantial gains (see Bond note, 25th July) on the political developments, along with lower SARB inflation projections.

- The MPC's recent lowering of its inflation forecast substantially towards our much lower view (see Interest Rate Outlook, 19th July) has come as the feared inflationary effects of a leftist government have been avoided by the formation of the GNU.

- The risk of an ANC/EFF coalition to govern the country worried markets ahead of the election, creating a marked political risk premium which was suppressing the rand, the bond markets and the JSE, with business confidence in depressed territory too.

- The likelihood has now fallen for the downside: of weakening economic activity, fiscal deterioration, rising bond yields and inflation, substantial rand weakness, weakening investment growth, persistent load shedding and other structural constraints.

- In the economic scenarios, the down case (lite and severe down cases combined) has reduced in probability to 36%, from 51% before the election, as South Africa has seen the likelihood of centrist economic policy outcomes substantially strengthened.

- That is, the ANC has joined with centrist political parties in the main in the GNU, and as such, in itself has seen the potential for centrist policy making and implementation increased, lifting the expected case probability to 50% from 45%.

- Consequently, the upside (which consists of the up and extreme up cases) now has the potential of a 14% outcome, up from a 3% likelihood, as the possibility of stronger economic growth outcomes has increased substantially.

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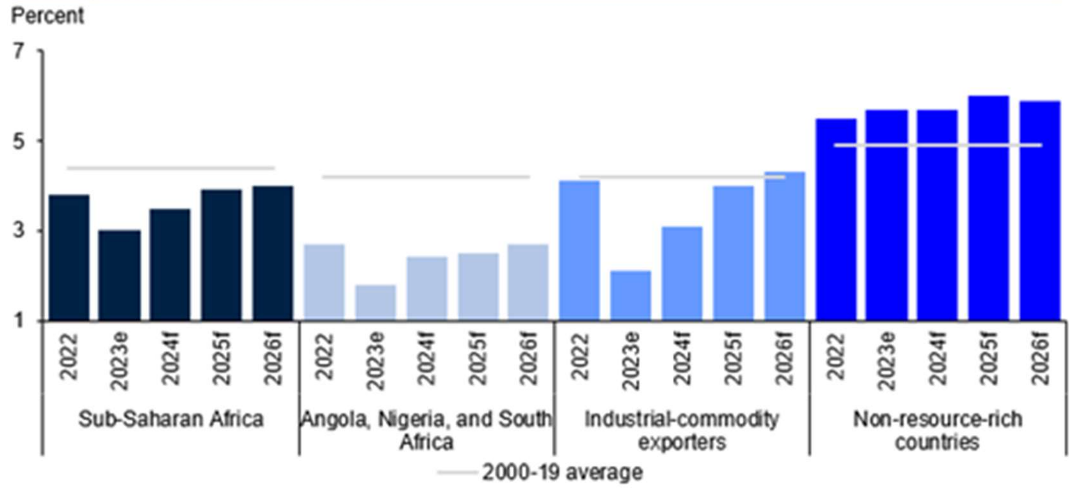
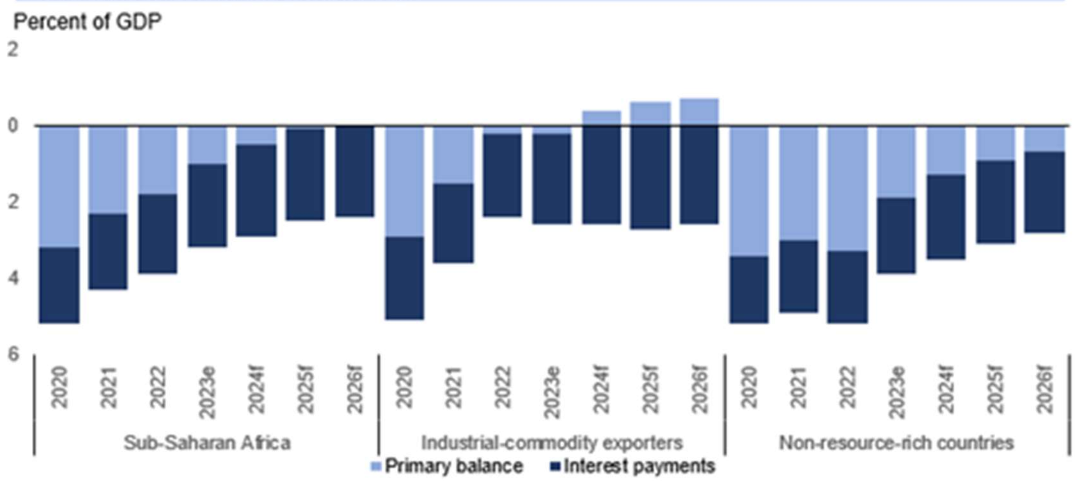
GDP growth in Sub-Saharan Africa



Source: World Bank, Global Economic Prospects June 2024

Note: e = estimates; f = forecasts. Industrial-commodity exporters excludes Angola, Nigeria, and South Africa. Non-resource-rich countries include agricultural-commodity-exporting and commodity-importing countries; excludes Chad and Sudan. Aggregate growth rates calculated using constant GDP weights at average 2010-19 prices and market exchange rates.

Fiscal balances in Sub Saharan Africa



Source: World Bank, Global Economic Prospects June 2024

Note: e = estimates; f = forecasts; SSA = Sub-Saharan Africa. Industrial-commodity exporters excludes Angola, Nigeria, and South Africa. Non-resource-rich countries include agricultural-commodity-exporting and commodity-importing countries; excludes

Detailed progress update

Activity status	No. of reforms	Reform
	2	• Address institutional inefficiencies in municipal electricity distribution • Review and adjust the fuel price formula
	7	• Develop a fit-for-purpose procurement regime for state-owned entities • Create an enabling legal and regulatory environment for hemp and cannabis • Expedite the issuance of title deeds for subsidised housing • Create a modern and efficient mining rights system • Procure new generation capacity in terms of IRP 2019 • Address institutional inefficiencies in municipal water distribution • • Develop a strategy for the devolution of passenger rail to local authorities
	6	• Improve Energy Availability Factor (EAF) to over 70% • Improve efficiency of ports • Implement third-party access to freight rail network • Complete restructuring of Eskom • •Strengthen regulation of price and service standards in the water sector • Implement the Energy Action Plan
	16	• Amend the Electricity Regulation Act to provide for a competitive electricity market • Publish revised Critical Skills List • Finalise the White Paper on National Rail Policy • Raise licensing threshold for embedded generation • Complete spectrum auction • Finalise Rapid Deployment Policy and Policy Direction • Implement e-Visa system • Enable municipalities to procure power from independent power producers • Streamline process for wayleave approvals • Review policy framework and processes for work visas • Clear backlog of water use, license applications • Expand visa waivers and explore visa recognition system • Finalise the revised raw water pricing strategy • Enhance the role of private sector participation in the water sector Reinstate the Blue Drop, Green Drop and No Drop water quality monitoring system • Streamline and improve water-use license application process
	4	• Establish a National Water Resource Infrastructure Agency • Corporatise the Transnet National Ports Authority (TNPA) • Complete migration from digital to analogue signal • Establish Transport Economic Regulator

Source: Operation Vulindlela Closeout Report, May 2024

- Strengthening infrastructure investment is an underpin to a marked improvement on the economic outlook (see Fixed Investment Outlook, 18th July) as electricity and logistic capacity rises so will business sentiment and economic growth.

- In the 2000s, which the up and extreme up cases are benchmarked against, good governance saw the highest consistent growth rate for South Africa in thirty five years and substantial fiscal consolidation yielded credit rating upgrades.

- The business confidence and the investor climate was boosted to the extent where the later years of the period of 2004 to 2008 saw an extreme up case (average growth 5.2% y/y). The ease of doing business in the country also improved.

- Minister Godongwana recently noted its key to "unencumber infrastructure financing from the traditional mechanisms used to fund the budget" with a process similar to the Independent Power Producers (IPP) Office's renewable energy procurement.

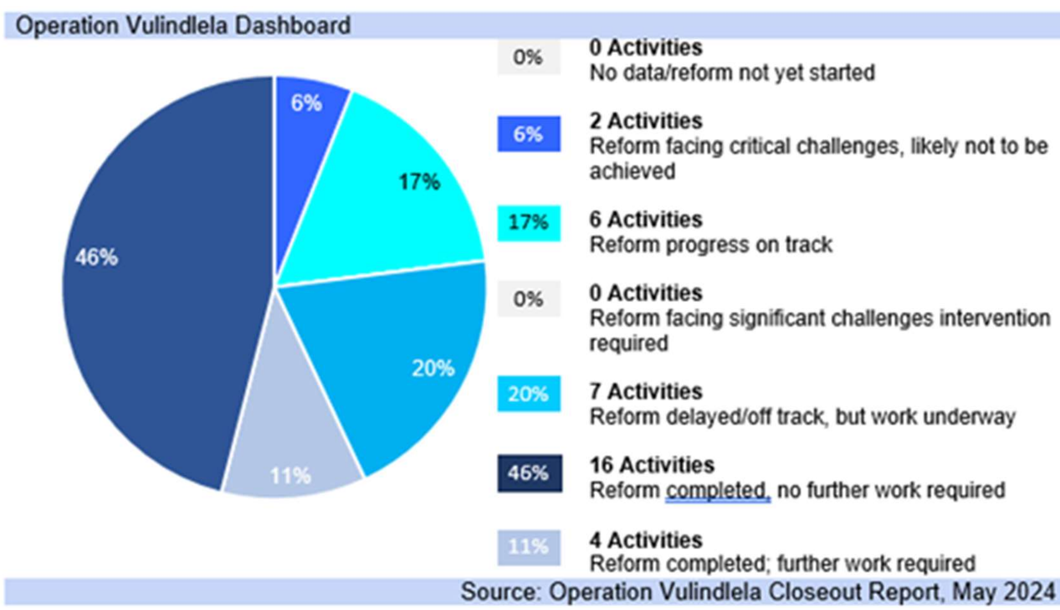
- And additionally, "(w)e want to have a similar structure for mega projects… In the case of the IPP Office, the Department of Energy cannot sit and adjudicate bids. It can only prescribe the criteria." This would make a marked improvement to economic growth.

- "(W)hat other reforms will be necessary? For instance, the ease of doing business is a critical issue. Just registering a company is a nightmare." Here reducing red tape and lowering the high compliance cost for small business.

- Both President Ramaphosa and Minister Godongwana are key proponents of Operation Vulindlela's (OV) which has seen substantial work on the energy sector so far as mentioned, with freight logistics and water infrastructure.

- Operation Vulindlela also focuses on planned reform for local government "ensuring that the institutional structure and funding model for local government is fit-for-purpose and that municipalities are financially and operationally sustainable".

- The free and fair elections, establishment of the GNU and it successful working partnership has allowed a stronger economic growth outlook, around 3.0% y/y by the end of the medium-term, and has improved investor sentiment substantially.



Roadmap

Source: Operation Vulindlela Closeout Report, May 2024

Overview of key economic statistics (as per Stats SA's monthly indicators published in June 2024							
	y/y % change			m/m % change			3-month
	Feb-24	Mar-24	Apr-24	Feb-24	Mar-24	Apr-24	Feb-Apr
Mining production	10.9	-4.8	0.7	5.2	-4.4	0.8	0.1
Manufacturing production	4.1	-6.5	5.3	-0.6	-2.5	5.2	-0.5
Electricity generation	4.2	0.0	5.7	1.6	-0.1	1.2	1.0
Buildings completed (value)	-14.7	-34.6	-6.3	-9.7	1.6	22.4	-18.4
Wholesale trade sales	-2.3	-12.7	1.2	2.3	-5.2	6.9	0.4
Retail trade sales	-0.7	2.3	0.6	0.9	1.3	0.5	0.1
Motor trade sales	1.3	-10.2	3.9	-0.6	-7.2	7.2	-2.2
Income from tourist accommodation	10.5	9.6	7.0	-0.3	-0.8	1.7	1.7
Restaurants, catering & fast-food income	5.2	3.3	-4.6	6.8	-2.0	-4.0	2.3
Rail transport: Freight payload	6.9	11.1	1.5	2.2	2.2	-3.7	1.0
Road transport: Freight payload	-1.5	-6.6	-8.0	-0.9	-1.1	-3.6	-3.2
Rail transport: Passenger journeys	73.0	42.9	96.1	5.5	-1.6	2.7	8.5
Road transport: Passenger journeys	8.8	-1.5	29.5	-3.0	-1.3	14.9	0.5
	Mar-24	Apr-24	May-24	Mar-24	Apr-24	May-24	
Consumer Price Index (CPI)	5.3	5.2	5.2	0.8	0.3	0.2	
Producer Price Index (PPI)	4.6	5.1	4.6	1.1	0.5	0.1	

Source: Stats SA