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# Budget
# Economic Outlook

## 2023

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# ENHANCING ECONOMIC GROWTH

The South African economy is facing weak fixed investment, high unemployment, and low growth. Low growth can be attributed to structural weaknesses in the economy, inefficiency in network industries (electricity, logistics, water, and telecommunications), inadequate competition, poor educational and skills mismatches. These problems require structural reforms, increased investment, and measures to improve the economy's resilience. The most pressing reforms are required in electricity and freight rail.

## Economic Recovery

Government has made some progress implementing its economic recovery plan in the last year. The National Energy Crisis Committee (NECOM) was established in response to the electricity crisis, power cuts, and to accelerate new energy generation. The work visa system is being updated and will include the introduction of a remote worker visa and a special dispensation for high-growth start-ups. Eight masterplans are being implemented to promote industrial growth. The presidential employment initiative has created over 1 million short-term jobs over the past two years. Critical infrastructure will be rolled out in water and sanitation, energy, and transport.

## Electricity

Eskom's lack of delivery in line with demand for electricity is demonstrated by the total hours of power cuts that increased from 1 165 in 2021 to 3 782 in 2022. NECOM aims to improve the availability of electricity and facilitate investment in generation capacity. If planned investments are implemented rapidly, 6 484 MW could be added to the grid over the next 24 months. Eskom's plant performance will be increased to ensure it procures power from existing independent power producers and import from neighbouring countries. Regulatory obstacles will be cleared through establishing a one-stop shop to bring electricity onto the grid more rapidly. The rollout of rooftop solar for households will be supported through a tax incentive to encourage electricity generation and expand the renewable energy tax incentive for business. A wheeling framework and grid capacity rules will be implemented to provide certainty to private producers investing in energy projects. Eskom is being unbundled into generation, transmission, and distribution entities. The 2023 Budget provides Eskom with debt relief of R254 billion over the next three years. This will relieve pressure on Eskom's balance sheet and allow it to undertake the required maintenance and investment.

## Transport and Logistics

Constraints in logistics negatively impacts economic growth and employment. More than a quarter of long-distance freight traffic has shifted to roads over the last five years due to deterioration in the freight rail network. The establishment of a transport regulator has been tabled in Parliament. Transnet is taking action to improve operations in key corridors. The operations and infrastructure management functions of Transnet Freight Rail will be separated by October 2023 to facilitate competition and improve pricing.

## State Capability

The 2023 Budget provides support to address the State Capture Commission recommendations and bolster anti-money-laundering and counter-terror-financing activities.

# GLOBAL OUTLOOK

Global growth will slow down to 2.9% in 2023. Some of the world's largest economies is set to slow down in 2023 and Europe and the United States have signs of weakening activity. Labour markets in advanced economies remain fairly resilient. Manufacturing purchasing managers' indices in major advanced economies and some emerging market economies contracted in the second half of 2022.

Geopolitical uncertainty from the war in Ukraine resulted in price increases. Headline inflation in both advanced and emerging market economies has probably peaked. The International Monetary Fund projects that global consumer price inflation will decrease from 8.8% in 2022 to 6.6% in 2023 before decreasing to 4.3% in 2024. Global inflation averaged 3.6% in the decade preceding the pandemic.

Global demand will slow down in 2023 linked with a broad-based easing of commodity prices. Shorter-term demand for coal and iron ore is expected to decrease, while easing supply constraints in the automotive industry will support medium-term demand for platinum group metals. The gold price reflects its "safe-haven" status in a period of global uncertainty.

The US dollar strengthened against major currencies for most of 2022. As the pace of monetary policy tightening in the United States moderates, this trend is expected to reverse, with a weaker dollar in 2023.

Higher interest rates and slowing global growth weighed on global equity markets and bond yields for most of 2022 before a late recovery in the fourth quarter, given signals of a slower pace of monetary policy tightening.

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### Domestic Outlook

The Budget forecasts real economic growth of 2.5% in 2022 compared to 1.9% projected in 2022. The growth in 2023 in real GDP will be constrained by weaker global support, load shedding, increased inflation, and higher borrowing costs. Growth in GDP is estimated to be 0.9% in 2023 and to average 1.4% in 2025.

### Employment

The South African economy lost 2.3 million jobs to the pandemic but regained 1.6 million jobs. The unemployment rate declined to 32.9% in the third quarter of 2022 (from 34.9% in the third quarter of 2021). South Africa had 7.7 million people unemployed in the third quarter of 2022, of which slightly less than half were new entrants into the labour force who could not find work. Nearly 60% of the 7.7 million were aged between 15 and 34. Employment recovery remains slow in the finance and business services, construction, transport and communications, and trade, catering, and accommodation sectors. Employment growth in the first three quarters of 2022 expanded by 4.6% compared to 2021.
The pace of job creation is expected to moderate in 2023,
before rising gradually over the medium term.

## Inflation

Inflation peaked in the third quarter and averaged 6.9% during 2022. Inflation is projected to reduce to 5.3% in 2023. Global crude oil and domestic food prices are sources of inflationary pressure. Electricity prices are estimated to increase by 4.6% over the medium term compared to the 2022 MTBPS and are projected to average 14% from 2023 to 2025, following the regulator's approval of an 18.7% tariff for Eskom in 2023/24. The broadening of price pressures in the economy is evident in core inflation, which is expected to average 5.2% in 2023 compared with 4.3% in 2022. Headline inflation is expected to ease to 4.9% in 2024 and 4.7% in 2025 as core inflation moderates over the medium term.

## Household consumption

Household consumption is estimated to have increased by 2.8% in 2022 (compared to 5.6% in 2021). Although credit extended to households supported some recovery in consumer spending, rising borrowing costs will most likely slow credit extension in the short term. Household consumption is expected to average 1.4% from 2023 to 2025. By the end of 2025, the purchasing power of households may improve due to lower inflation and increased employment.

## Investment

Gross fixed-capital formation grew in the third quarter of 2022, led by the public sector. Firms remain under strain given challenging domestic business conditions. Gross fixed-capital formation is estimated to have increased by 4.2% in 2022 (from 0.2% in 2021), mainly driven by private investment in machinery and equipment. Gross fixed-capital formation is estimated to reduce to 1.3% in 2023. The electricity crisis will weigh on investment decisions.

## Balance of payments

National Treasury expects the current account surplus of 3.7% of GDP in 2021 to reverse to a deficit of 0.4% of GDP in 2022, driven by slowing net trade gains. The trade surplus in the first three quarters of 2022 narrowed by more than 50% compared to 2021. In the shorter term, weaker external demand, the easing of export commodity prices, and electricity and logistical constraints will limit export volume growth. A slowdown in domestic activity will constrain import volume growth in 2023, while demand for imports will gradually improve over the medium term. The current account deficit is expected to average 2% of GDP from 2023 to 2025. In the shorter term, the financial account will be vulnerable to capital outflows from global monetary policy tightening and market volatility.

## Macroeconomic assumptions

Global demand is expected to increase by 3.2% in 2023. The export commodity price index is anticipated to decrease in 2023. The sovereign risk premium is expected to be 3.8% in 2023 and 3.6% in 2024 (averaging 4.1% in 2022). This decline reflects a slower-than-anticipated pace of tightening in global monetary policy, South Africa's fiscal consolidation, and progress in alleviating domestic structural constraints. Food prices are revised higher in the shorter term.

## Economic scenarios

National Treasury modelled three scenarios against the baseline economic forecast. Scenario A assumes full implementation of NECOM interventions to resolve the electricity crisis. In scenario A growth averages 1.8% from 2023 to 2025. In Scenario B, power cuts intensify in 2023 and 2024. Real GDP growth slows to 0.2% in 2023, recovering to 1.3% in 2025. Scenario C assumes the impact of a sharper global slowdown in 2023 and a more tepid recovery in 2024. GDP growth is estimated to slow to 0.6% in 2023 before reaching 1.7% by 2025. Growth is projected to average 1.1% from 2023 to 2025.

## Risks to domestic growth

Weaker-than-expected global growth, including the effects of monetary policy tightening in major economies. Further disruptions to global supply chains, inflationary pressures, and constrained food and energy supplies stemming from the war in Ukraine. A sustained period of lower growth and higher borrowing costs, which poses a threat to highly indebted countries. The domestic outlook faces a range of risks, led by load shedding and a deterioration in port and rail infrastructure. Slow implementation of structural reforms will deter new investment. Widespread criminal activity poses a threat to economic growth and national security.

## SECTOR PERFORMANCE AND OUTLOOK

Gross value in agriculture decreased by 4.9% over the first three quarters of 2022 compared to 2021. The sector faced higher input costs for fertiliser and fuel, market access constraints, and heavy rains during 2022. The electricity crisis poses a risk to growth in the livestock, grains, and horticulture subsectors. The sector is expected to have a strong performance in 2023.

Gross value added in mining decreased by 6.9% in the first three quarters of 2022 compared to 2021. Sales values benefited from favourable prices, but production volumes of gold, platinum group metals, and iron ore declined. Output was affected by safety stoppages, logistics, load shedding, freight rail constraints, and labour action. Growth will remain under pressure.

Gross value added in manufacturing was 0.2% higher in the nine months to September 2022 compared to 2021. Weak global demand and supply chain constraints remain a challenge. Logistics, high costs, and load-shedding, weighs heavily on the sector.

Gross value added in construction fell by 4.7% in the first three quarters of 2022 compared to 2021. The real value of the sector is still similar to that of 2007. Weak investment, low confidence, and an increase in organised crime contributed to the poor performance. The outlook for 2023 looks slightly more optimistic as public and private investment in capital infrastructure begins to materialise.

Gross value in utilities added was 2.3% lower in the first nine months of 2022 compared to 2021, resulting from deterioration in energy availability.

Transport and communications grew by 8.9% in the first nine months of 2022 compared to 2021. The growth was supported by increased freight transportation, higher passenger traffic and continued demand for digital services.

Finance, real estate, and business services grew by 4% in the first nine months of 2022 compared to 2021, driven by increased economic activity in financial intermediation, insurance, real estate, and business services. A grey listing of South Africa by the Financial Action Task Force will negatively impact growth in 2023.

## CONCLUSION

Economic growth will be slow in 2023. Higher and sustainable growth will depend on progress in implementing reforms and a capable state to provide public goods and services. The electricity shortage is one of the biggest contributors to the low economic growth.

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