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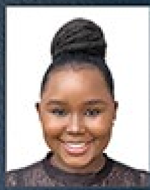
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SA dodges a technical recession in the fourth quarter of 2023

Highlights

- According to Statistics South Africa (Stats SA), SA's economic activity was weak in the fourth quarter of 2023. Real gross domestic product (GDP) increased by 0.1% quarter-on-quarter (q/q) in the fourth quarter following a contraction of 0.2% q/q in the third quarter.
- The transport, storage and communication industry (2.9% q/q) as well as mining and quarrying (2.4% q/q) recorded robust growth. The agriculture industry (negative 9.7% q/q) and trade (negative 2.9% q/q) were a drag on economic growth.
- In terms of the expenditure approach, economic growth was mainly lifted by a change in inventories (contributing one percentage point) while the biggest negative contribution came from imports (detracting 1.2 percentage points).
- On an annual basis, real GDP expanded by 0.6% year-on-year (y/y) in 2023 according to the production method. This was lower than growth in the previous year (1.9% in 2022) and the pre-pandemic average growth rate of 2.7%.
- The agriculture sector recorded the biggest decrease in 2023 (negative 12.2% y/y). On the expenditure side, household consumption increased slightly (0.7% y/y) in 2023 compared to 2.5% y/y in 2022 which is reflective of the higher cost-of-living in 2023 and weak consumer confidence.
- On a sectoral basis, the biggest contributor to SA's economic growth in 2023 was the tertiary sector growing by 1.3% y/y. The primary sector was mostly down throughout the year and contracted by 5% y/y.
- Economic activity in 2023 was constrained by a myriad of factors including power outages, inefficiencies in the logistics network, lower commodity prices, modest global growth and tight monetary policy. We expect slightly better economic growth in 2024 of 1%. Our forecast is in line with the International Monetary Fund's (IMF) projection but slightly lower than the Reuters median consensus (1.1%), the SA Reserve Bank's (SARB) projection of 1.2% and National Treasury's estimate of 1.3%.
- An improvement in economic activity this year is premised on a reduction in power cuts, some anecdotal evidence of easing constraints in the logistics network, easing inflation and a reduction in interest rates. However, the estimated GDP forecast remains subdued and growth is expected to remain weak over the medium term.
- Household consumption expenditure (accounting for around 60% of GDP) is expected to boost economic growth in 2024 due to a rise in real wages and lower interest rates partly alleviating consumers' financial burden. Growth in fixed investment could increase further in 2024 but will remain weak outside of renewable energy-related investment.

- **On the production side, the agriculture industry may pick up slightly in 2024 due to a reduction in loadshedding and contained animal diseases. However, factors that could negatively affect agriculture production are looming. The outlook for mining and manufacturing remains subdued amid lower global commodity prices and high input costs. There are signs of better activity in the construction industry, from a weak base, which could be supported by energy, logistics and water-related infrastructure projects.**

Trade and agriculture industries weigh down on economic growth

According to Stats SA, economic output in SA barely grew at 0.1% q/q in the fourth quarter of 2023, resulting in an annual economic growth outcome of 0.6% y/y in 2023 according to the production method and 0.7% y/y according to the expenditure method. The quarterly economic growth outcome was lower than the February 2024 Reuters median consensus of 0.3% q/q.

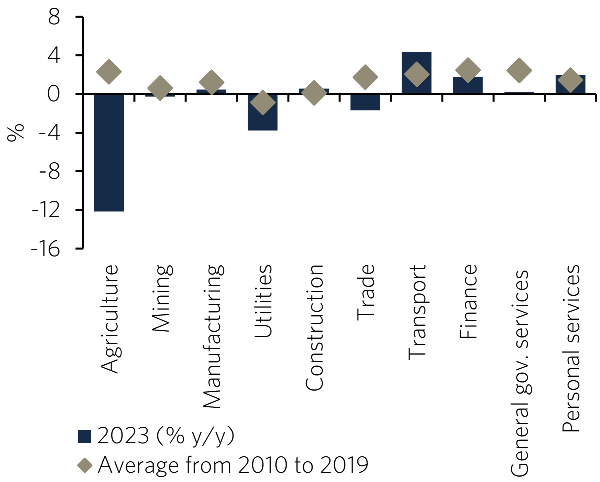
On the production side, the industries that contributed positively to economic growth in the last quarter of 2023 were transport (2.9% q/q, contributing 0.2 percentage points) as well as finance (0.6% q/q), personal services (0.9% q/q) and mining (2.4% q/q) each contributing 0.1 percentage point to growth. The biggest detraction from growth was recorded in the trade industry (negative 2.9% q/q, detracting 0.3 percentage points) and agriculture (negative 9.7% q/q, detracting 0.2 percentage points).

Unlike the volatility experienced in 2022, economic activity was relatively stable in 2023, albeit subdued. The year started with broad-based positive growth across eight of the 10 industries resulting in a 0.3% q/q growth rate (revised down from 0.4% q/q). The second quarter recorded an improvement to 0.7% q/q (revised up from 0.5% q/q). The second half of the year experienced weaker economic activity with a contraction of 0.2% q/q recorded in the third quarter, and 0.1% q/q in the fourth quarter primarily due to the agriculture industry.

Overall, the agriculture industry was the hardest hit in 2023, contracting by 12.2% y/y followed by utilities and then trade (see chart 1).

The agriculture industry was expected to contribute positively to growth in 2023 but shocks, including severe loadshedding and its impact on irrigation as well as the Avian flu outbreak, affected the industry's performance. The industry's growth rate remained below the average recorded between the global financial crisis (GFC) and COVID-19 pandemic (2010 to 2019). Nevertheless, agricultural experts maintain the view that the agriculture industry remains resilient. Agricultural exports are expected to grow with a boost from Saudi Arabia and China lifting import bans on SA's red meat. Furthermore, farmers intend to plant more summer field crops in 2024 (1.7% y/y more than in 2023). The risks associated with El Niño have decreased on the back of better-than-expected rain, but SBG Securities notes that February rainfalls were low which is a risk to agriculture production in 2024. Ongoing loadshedding, although less year-to-date, rising geopolitical tensions, the weak rand, subdued economic growth as well as logistics inefficiencies pose a risk to the performance of the agriculture industry.

Chart 1: Agriculture hit the hardest in 2023

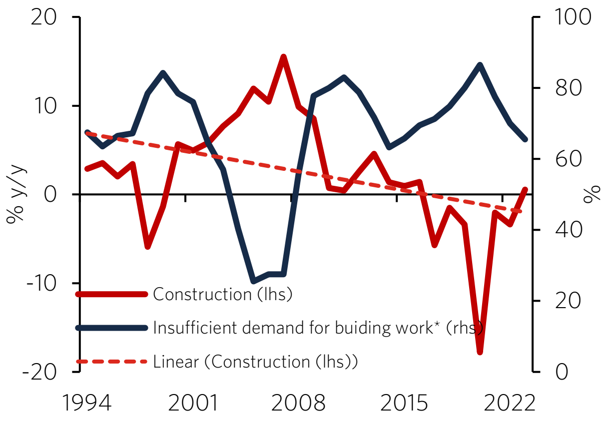


Source: Global Insight, Stats SA, Momentum Investments

The mining industry contracted marginally (0.3% y/y) in 2023 compared to a negative 7.1% y/y in 2022. Lower commodity prices, load curtailment as well as rail and port constraints weighed on the industry's performance. According to the Minerals Council of SA, the mining industry's contribution to GDP dropped from 7.3% in 2022 to 6.2% in 2023 and mineral exports decreased by more than 11%.

Manufacturing production disappointed in the fourth quarter of 2023, growing by 0.2% q/q, which explains the minor contribution to growth in the fourth quarter. On an annual basis, manufacturing activity was slightly higher (0.5% y/y) but remained below the average recorded between the GFC and the pandemic. Speedy implementation of reforms to address structural challenges in the network industries is crucial for an improvement in this industry's performance.

Chart 2: Structural decline in the construction industry



Source: Global Insight, Stats SA, Momentum Investments
Data until 2023
** Annual average*

The construction industry recorded positive annual growth (0.6% y/y) in 2023 for the first time following six consecutive years of negative growth since 2017 (see chart 2). Furthermore, growth in construction in 2023 was better than the 0.1% average growth rate recorded between 2010 and 2019. According to the fourth quarter construction survey published by the Bureau for Economic Research (BER), the biggest constraint on activity is insufficient demand for building work. However, this subindex has been improving (see chart 2) which indicates a possibility of better construction activity which could benefit economic growth. Energy, logistics and water-related infrastructure projects may provide a boost to the construction industry; however, we remain cautious as progress in this regard has been slow. A major project that is underway is the second phase of the Lesotho Highlands Water Project which is expected to be completed in 2028 (eight years behind schedule). In the energy domain, the construction of a mega hybrid power plant is expected to begin construction soon according to *News24*. Infrastructure projects often require a lot of capital. Consequently, the Development Bank of Southern Africa (DBSA) has introduced a new financing instrument (Project Vumela) which aims to leverage private-sector resources and expertise for projects related to water, roads and electricity.

As acknowledged by government, the construction sector is important for employment growth because it is labour intensive. Therefore, an improvement in the construction industry could assist in reducing SA's high unemployment levels. SA's unemployment rate rose to 32.1% in the fourth quarter of 2023 from 31.9% in the third quarter.

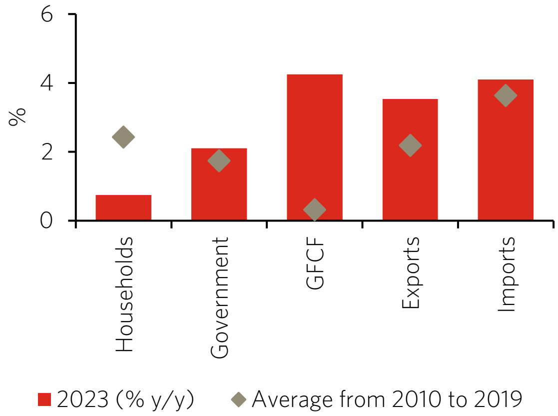
The finance industry continued to display resilience, growing at 0.6% q/q in the fourth quarter and showcasing an annual growth rate of 1.8% y/y in 2023. The transport industry recorded the highest annual growth rate (4.3% y/y) in 2023 surpassing the average of 2% recorded between the GFC and the pandemic.

Consumers bounced back from a technical recession and fixed investment rose

The biggest contributor to growth in the fourth quarter of 2023, according to the expenditure approach, was the change in inventories which added one percentage point to overall growth. The positive contribution from inventories was outweighed by imports detracting 1.2 percentage points from growth.

Household consumption expenditure grew by 0.2% q/q in the fourth quarter of 2023 following two consecutive quarters of contraction. Consumer expenditure in the quarter was likely supported by an increase in disposable income on the back of lower fuel prices, Black Friday specials and festive season spending. The weak annual growth of 0.7% y/y in 2023 (see chart 3) compared to 2.5% y/y in 2022 is reflective of the high cost-of-living environment, weak consumer confidence and lower real wages. In the 2024 Budget Review, National Treasury forecasts household consumption growth of 1.3% y/y in 2024 (down from 1.4% in the MTBPS but better than 2023) and a lift to 1.8% y/y in 2025. Higher consumer spending is anticipated based on a rise in real wages and lower interest rates which could partly alleviate consumers' financial burden.

Chart 3: Household expenditure was the only category tracking below the 2010 to 2019 average



Source: Global Insight, Stats SA, Momentum Investments

Government expenditure was 0.3% q/q lower in the fourth quarter relative to the third quarter but ended 2023 2.1% y/y higher than a year ago. Treasury projects government expenditure to contract in 2024 and 2025 by 0.7% and 0.2%, respectively. The projected contraction is supportive of government's fiscal consolidation plans but we view risks as tilted to be upside given the upcoming general elections, plans to implement the National Health Insurance (NHI), ailing state-owned entities which may require additional bailouts and the looming permanent extension of the Social Relief of Distress Grant (SRD). These factors could require an increase in government expenditure.

In the 2024 Budget Review, Treasury noted that the fiscal multiplier has decreased over time and is currently below one. This means higher government spending has not translated into higher economic growth as theory suggests. Treasury attributes this to rising government debt crowding out private investment and government spending being focused mostly on short-term consumption spending as opposed to growth-enhancing capital investment.

Following the contraction of 3.8% q/q in fixed investment in the third quarter, fixed investment contracted by 0.2% q/q in the fourth quarter and rounded up 2023 at 4.2% y/y. Energy-related capital expenditure (e.g. solar panels) supported fixed investment growth in 2023. However, investment in energy-related capital goods has come off from the peak reached in the second quarter of 2023 and will likely continue to ease given the end of the rooftop solar tax incentive for households that was implemented in the 2023 Budget Review. The solar tax incentive for businesses will run until 2025. Growth in fixed investment should lift in 2024, however, growth will remain narrowly based on energy-related infrastructure spending. Fixed investment could become a bigger drive of growth from 2025 onward on the back of continued renewable energy investment.

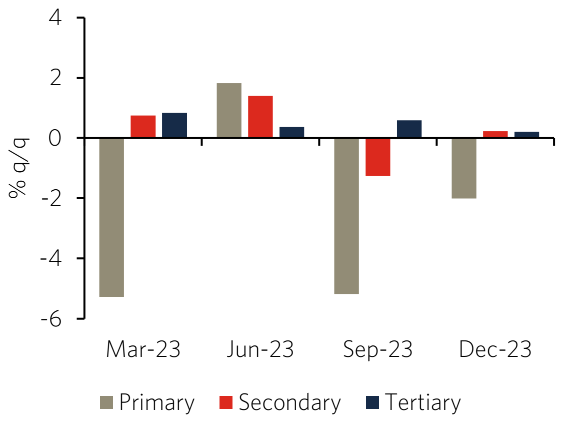
Primary sector was the worst performing sector in 2023

The tertiary sector, the biggest contributor to SA's GDP, expanded by 0.2% q/q in the fourth quarter of 2023. The tertiary sector (comprising of trade, catering and accommodation; transport, storage and communication; finance; general government services and personal services) is the only sector that did not experience a contraction during 2023 (see chart 4). The sector expanded by 1.3% y/y in 2023.

The primary sector (comprising of agriculture, forestry and fishing as well as mining and quarrying) was mostly down during 2023 with three quarters of contraction and only one quarter of expansion. The decline may be attributable to animal diseases, changes in weather patterns, logistics bottlenecks and changes in commodity prices. Overall, the primary sector was the worst performing sector (negative 5% y/y) and weighed down on growth in 2023. Commodity prices pose further downside risks for 2024. According to the

World Bank's commodity market outlook published in October 2023, the World Bank's commodity price index (including energy, agriculture, metals and minerals) is expected to fall by 4% in 2024 (see chart 5)

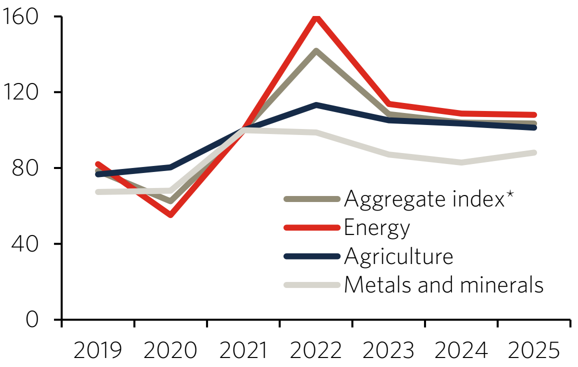
Chart 4: Tertiary sector experienced three quarters of contraction in 2023



Source: Global Insight, Stats SA, Momentum Investments

The secondary sector, comprising of manufacturing, utilities and construction grew by 0.2% q/q in the fourth quarter of 2023 following a contraction of 1.3% q/q in the third quarter. The secondary sector concluded 2023 marginally lower (0.1% y/y) relative to 2022.

Chart 5: Slight decline in commodity prices expected in 2024



Source: Stats SA, Momentum Investments
** Aggregate index excludes precious metals.*
Historical data from 2019 to 2022, 2023 to 2025 are forecasts (as of October 2023)

Slightly better economic growth expected in 2024 but it remains weak

Economic activity in 2023 was constrained by a myriad of factors including power outages, inefficiencies in the logistics network, lower commodity prices and weak global growth. Tight monetary policy throughout 2023, aimed at tackling inflation, also contributed to the slowdown in economic growth through dampening consumer spending and investment growth.

Looking forward, we expect slightly better economic growth in 2024 (1%). This is on the back of less severe loadshedding, expected monetary policy easing from the second quarter of 2024, at the earliest, higher real wage gains as inflation falls and nominal wages playing catch up to living costs. We note the risk of a later and shallower interest rate cutting cycle.

According to the SARB, the number of days of loadshedding are expected to be lower at 150 days in 2024 (287 in 2023). A further reduction to 100 days is expected in 2025. In the 2024 State of the Nation Address (SONA), the president proclaimed that "the worst is behind us and the end of loadshedding is finally within reach". While economic growth is expected to be marginally better than in 2023, it remains subdued.

In the January 2024 World Economic Outlook (WEO), the IMF lowered its 2024 growth projection for SA down from 1.8% to 1% (in line with our estimate). Reasons cited included the logistical constraints and ongoing loadshedding.

Table 1: Weak growth expected over the medium term (%)

Institution	2024	2025	2026
National Treasury	1.3	1.6	1.8
SARB	1.2	1.3	1.6
IMF	1	1.3	
Reuters	1.1	1.6	1.8
Momentum Investments	1	1.7	1.8

Source: National Treasury (2024 Budget Review), SARB (January 2024 MPC Statement), IMF (January 2024 IMF WEO), Reuters (February 2024 survey)

Expected weak economic growth over the medium-term (see table 1) sets SA back from achieving the goals set out in the National Development Plan (NDP) 2030.

The NDP 2030 goals largely hinge on the domestic economy growing at an average rate of 5%. National Treasury is projecting an average growth of 1.6% over the medium term, slightly higher than the SARB's forecast of 1.4%. Factors hampering economic activity include logistics and energy constraints; commodity prices stabilising at lower levels than in 2022; slower economic growth globally relative to trend growth, weak business and consumer confidence; high unemployment and corruption.

The IMF outlined that a boost in SA's economy could be derived from additional embedded energy generation capacity, more private sector renewable energy and a conducive environment to attract more private investment. In the 2024 SONA, the president noted that government is on track to resolve the energy and logistics constraints. Measures taken include:

- Implementation of the energy plan through the National Energy Crisis Committee (NECOM)
- Reforms to enable private sector involvement in the energy space.
- A conditional debt relief package for Eskom
- Revival of the renewable energy programme which has resulted in the connection of 2 500 MW of solar and wind power to the grid.
- Tax incentives and financial support to encourage rooftop solar installation. Installation of rooftop solar more than doubled in 2023.
- Finalisation of the Freight Logistics Roadmap
- Allowing for private rail operators.

The president further alluded to mitigating climate change as a focus area to achieve higher future growth.