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Guide to the Economy

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The world economy expanded further in early 2023, buoyed by China's reopening and unexpected resilience in the US and several other advanced and developing economies. However, the outlook remains clouded, weighed down by sticky inflation, high and rising interest rates and heightened concerns that the recent turmoil among US and Swiss banks could reduce the flow of credit to the world economy, amplifying the economic downturn. Although global inflation eased as oil prices receded, price pressures remained generally elevated. As a result, the US and other major central banks tightened monetary policy further. Inflation is forecast to decline more meaningfully during the remainder of this year, suggesting that the end of the global tightening cycle is near.

2 | Domestic review and prospects

Domestic economic conditions deteriorated, with activity repeatedly disrupted by severe power outages. The outlook for 2023 remains gloomy. The electricity shortage will hurt production and sales in all industries. GDP growth is forecast to fade to only 0.2%, down from 2% in 2021. Inflation remained high and sticky in the first quarter. In response, the Reserve Bank raised interest rates by another 75 basis points. Although inflationary pressures are forecast to subside gradually, the risk of a further tightening in monetary policy remains high, particularly in the first half of the year.

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INTERNATIONAL BACKGROUND AND OUTLOOK

Following a gloomy start to 2023, the global economy ended the first quarter on a less precarious but still fragile footing. Financial market turmoil ensued in March after the collapse of Silicon Valley Bank in the US and Credit Suisse in Switzerland. Authorities in both countries acted swiftly, preventing a broader economic meltdown. Economic activity recovered in advanced economies, but the rebound was not broad-based and was driven mainly by the services sector. Although the manufacturing sector improved in some instances, it largely remained at contractionary levels, stunted by the ongoing deterioration in global demand conditions. Consumers have proven quite resilient, but still-elevated inflation and rising interest rates will continue to erode disposable income and reduce purchasing power. Growth in emerging market economies (EMEs) has been fairly mixed, with some countries recording a modest recovery while others lag behind. Furthermore, the uneven recovery in private sector activity seen in advanced economies (AEs) was also observed in EMEs), with the exception of India. Global inflation has continued to trend downwards at a slow pace. The key central banks remain committed to bringing inflation back to target and most are expected to continue hiking, albeit at a less aggressive pace.

Worries about the global economy intensified in the first quarter after the failure of a few mid-sized US banks and a major Swiss bank raised fears of a repeat of the 2008 Global Financial Crisis (GFC). The root cause of the swift collapse of the two US banks Silicon Valley Bank (SVB) and Signature Bank was poor risk management in an environment of rising interest rates. Smaller banks have been losing deposits to larger banks and money market funds that can offer clients much more attractive interest rates. As deposits trickled out, these smaller banks were forced to sell some of their assets to shore up capital and liquidity. However, their assets consisted of mainly security portfolios dominated by long-term US treasuries, whose prices decline when interest rates rise. Consequently, they were forced to sell at a loss, alerting investors and depositors to their financial vulnerability and ultimately triggering a classic run on banks. SVB lost a quarter of its total deposits, amounting to $42 billion, in a single day. US regulators stepped in, placing the lenders in 'receivership' under the Federal Deposit Insurance Corporation (FDIC), which liquidated its assets to repay depositors and creditors. UK authorities quickly sold SVB's operations

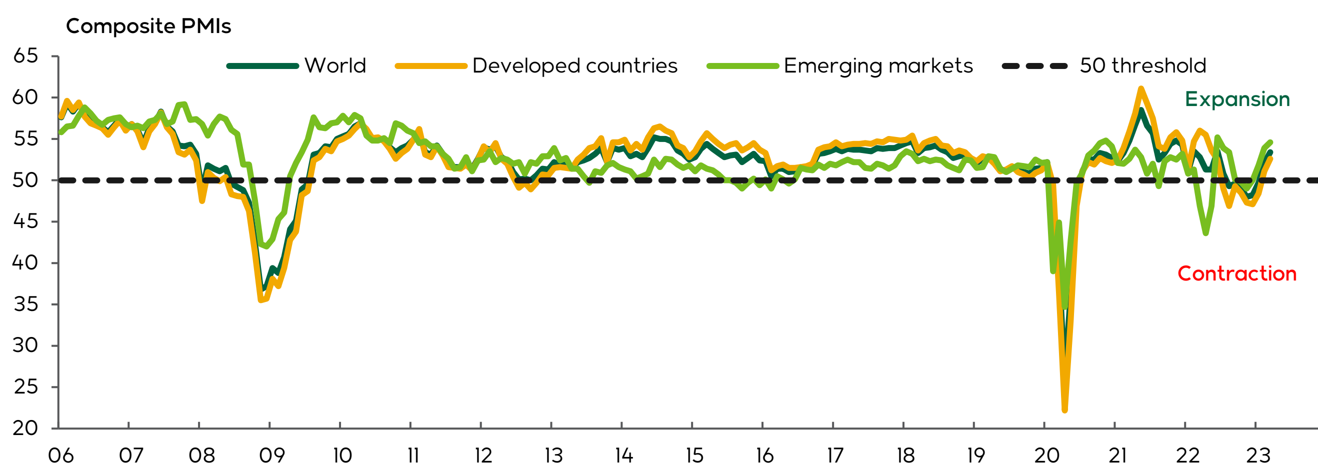
to HSBC. Another US bank, First Republic, was saved by capital injections from several large US banks. Credit Suisse experienced significant financial distress after it had been compelled to sell $2.25 billion of its shares to cover losses on its bond portfolio. One of its significant shareholders refused to recapitalise the bank due to major lapses in the lender's internal financial controls, pushing the Swiss bank to its eventual demise.

The turmoil in the banking sector fuelled risk aversion, resulting in sharp drops in share prices across the globe, with those of banks taking the heaviest beating. US and Swiss regulators managed to prevent a broader banking crisis, but the ructions bruised confidence, and fears remain that US banks could tighten credit standards dramatically, reducing the flow of credit to households and companies even further, thereby amplifying the downturn and potentially tilting the US economy into recession. This, in turn, would hurt a global economy already grappling with the lingering effects of the Covid-19 pandemic, the Russia–Ukraine war, elevated inflation, and historically higher interest rates in the US and other low-risk countries.

The International Monetary Fund (IMF) largely echoed these concerns in its latest edition of the World Economic Outlook, revising its global growth forecast for 2023 down slightly to 2.8% from 2.9% previously, citing elevated inflation, sharply higher interest rates, and the recent financial turmoil. The IMF stressed that the risks to the outlook remained heavily skewed to the downside. The critical downside risk is sticky and entrenched underlying inflationary pressures continue to erode household incomes and demand. Several forces pose upside risks to the inflation outlook. These include the threat posed by the ongoing war between Russia and Ukraine, the recent decision by the Organization of the Petroleum Exporting Countries (OPEC) and other large oil producers to tighten supply and its implications for energy prices, and stubbornly high food inflation in several countries. Further downside for the world economy stems from the slump in China's property market and the implications for its banking sectors. The IMF concluded that the likelihood of a hard landing had increased sharply.

Despite the gloomy mood, global economic activity proved relatively resilient in the first quarter, recovering from the troughs of late 2022. The Standard & Poor's (S&P) global composite purchasing managers' index (PMI), a measure of private sector activity, rose in the first three months of the year, climbing above the critical 50 threshold that divides contraction from expansion. The recovery, however, has not been broad-based and was driven mainly by a strong comeback in the services sector. The manufacturing sector remained weak, reflecting the slowdown in demand for goods, hurt by high inflation and interest rates. While the upturn in global economic activity has helped allay fears of a recession, there are concerns over its sustainability amid expectations of even tighter monetary policy.

Chart 1: The continued recovery in services lifted global economic activity in early 2023



Sources: S&P Global

The **US** economy remained relatively robust in the first quarter after having slowed in the last quarter of 2022. Private sector activity, as measured by S&P Global's US composite PMI, returned to growth in February, driven by a strong rebound in services. Manufacturing activity remained generally weak, but trading conditions improved somewhat over the quarter. Domestic demand also held up relatively well. However, recent high-frequency statistics suggest that demand conditions softened as the quarter progressed. Real retail sales and food services declined over February and March after a strong rebound in January. While job creation remained robust and the unemployment rate stood at a low rate of 3.5% in March, sticky inflation and sharply higher interest rates are starting to subdue household incomes and consumer spending. Interest rates will continue to weigh on households and companies. The financial strain on small to mid-sized US banks could further tighten credit conditions. The slowdown in the rest of the world economy will also exert downward pressure. The IMF expects US economic growth to ease to 1.6% in 2023 from 2.1% in 2022. The latest forecast is slightly better than the 1.4% predicted in January.

Eurozone economic activity has improved since January following the weakness in the final quarter of 2022. The S&P Global Eurozone composite PMI rose to 53.7 in March, expanding for a third straight month at the strongest pace since May 2022. Yet again, services drove the recovery as manufacturing fell deeper into contraction. Other data showed that household spending faltered, with retail sales contracting for a fifth consecutive month in February (-3% yoy), the deepest decline in almost two years. Consumer sentiment faded in March following five months of improvement. A similar trend was observed with businesses. While Europe managed to avoid an energy crisis this past winter, the IMF warns that a possible escalation in

the Russia–Ukraine war could spike prices, raising concerns of potential disruptions during the upcoming winter. The IMF expects the Eurozone's economy to grow by a moderate 0.8% in 2023 before recovering to 1.4% in 2024.

Economic activity also held up better than expected in the **UK.** Factory activity weakened in line with the trends in its peer economies. The S&P Global/CIPS Manufacturing PMI declined to 47.9 as fading demand prompted firms to reduce inventory holdings. Retail sales contracted by 3.5% yoy in February after having shrunk by 5.2% in January, highlighting the strain on consumer incomes. Unfortunately, the pressure from elevated prices intensified in March, with inflation unexpectedly climbing to 10.4% due to a jump in food prices. The economy is still expected to enter a recession in 2023, although the IMF revised its real GDP change forecast to -0.3% from the -0.6% projected in January.

Japan has been supported by a strong recovery in services as the dissipating impact of the pandemic and government support measures bolstered tourism activity. In March, the au Jibun Bank services PMI increased to 55, the highest level since October 2013. However, the export-dependent manufacturing sector remained in contraction for the fifth consecutive month. Retail sales rose to 6.6% yoy in February as domestic consumption recovered from the pandemic-induced slump. The country's ultra-loose monetary policy and relatively contained inflation have helped to bolster spending. While consumer confidence improved, business confidence deteriorated amid growing concerns over the global economic outlook. The IMF expects Japan's economy to expand by a slightly softer 1.3% in 2023, compared with the 1.8% growth predicted in January.

Table 1: Global growth revised slightly lower, but prospects look brighter for some economies

IMF Forecasts: Real GDP growth (%)	Estimate	Apr-23 forecasts		Jan-23 forecasts		Oct-22 forecasts	
	2022	2023	2024	2023	2024	2022	2023
World	**3.4**	**2.8**	**3.0**	**2.9**	**3.1**	**3.2**	**2.7**
Advanced economies	**2.7**	**1.3**	**1.4**	**1.2**	**1.4**	**2.4**	**1.1**
US	2.1	1.6	1.1	1.4	1.0	1.6	1.0
Eurozone	3.5	0.8	1.4	0.7	1.6	3.1	0.5
Germany	1.8	-0.1	1.1	0.1	1.4	1.5	-0.3
France	2.6	0.7	1.3	0.7	1.6	2.5	0.7
Italy	3.7	0.7	0.8	0.6	0.9	3.2	-0.2
UK	4.0	-0.3	1.0	-0.6	0.9	3.6	0.3
Japan	1.1	1.3	1.0	1.8	0.9	1.7	1.6
Developing economies	**4.0**	**3.9**	**4.2**	**4.0**	**4.2**	**3.7**	**3.7**
China	3.0	5.2	4.5	5.2	4.5	3.2	4.4
India	6.8	5.9	6.3	6.1	6.8	6.8	6.1
Russia	-2.1	0.7	1.3	0.3	2.1	-3.4	-2.3
Brazil	2.9	0.9	1.5	1.2	1.5	2.8	1.0
Mexico	3.1	1.8	1.6	1.7	1.6	2.1	1.2
Nigeria	3.3	3.2	3.0	3.2	2.9	3.2	3.0
South Africa	2.0	0.1	1.8	1.2	1.3	2.1	1.1

Source: IMF WEO April 2023

Emerging-market economies (EMEs) performances have been mixed. **Chinese** economic activity picked up after the government had removed its strict 'zero-Covid' measures. However, the recovery has been uneven, with a strong rebound in services activity masking a softer upturn in manufacturing. Trading conditions deteriorated unexpectedly in March, with the Caixin Manufacturing PMI falling from an eight-year peak in February. The slowdown reflected mainly ongoing weakness in external demand, and it will likely continue as consumers worldwide face tighter financial conditions. However, pent-up domestic demand will continue to support services. China's economy is expected to expand, off a low base, by 5.2% in 2023.

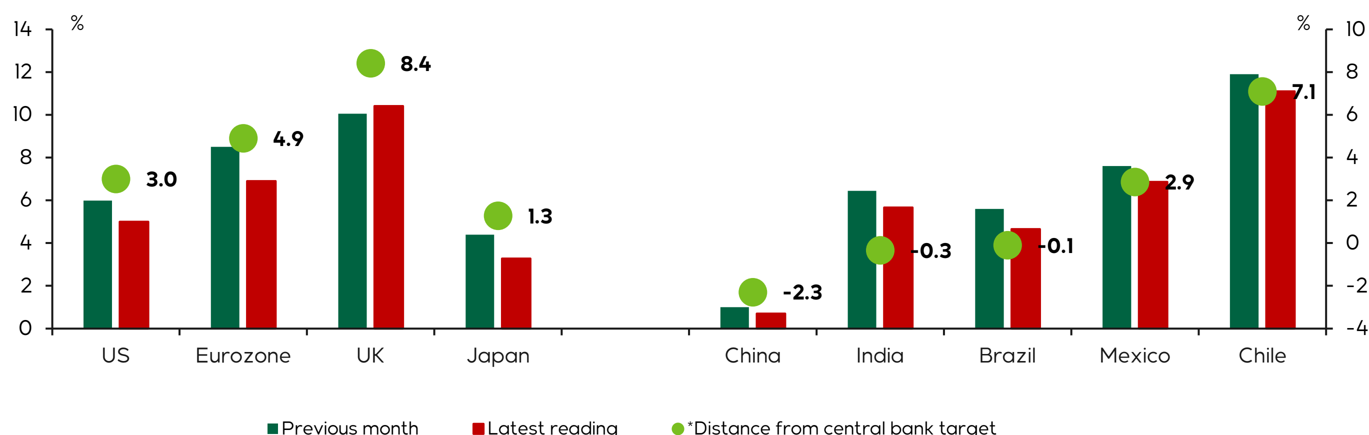
China's rebound will support other EMEs, partially offsetting the impact of the downturn in the rest of the world. In **Brazil**, the recovery lost momentum in the last quarter of 2022, with GDP contracting for the first time since the second quarter of 2021. Higher borrowing costs weighed on consumers, but services still fared better than manufacturing, hurt by weak export demand and falling commodity prices. The **Indian** economy started 2023 on a relatively firm footing. Activity remained robust, with the S&P Global's composite PMI moderating to 58.4 in March, still convincingly in expansion territory. India is among the few EMEs where private sector activity expanded throughout 2022 and the first quarter of 2023. The acceleration in manufacturing and services was underpinned by robust output and rising new orders. The IMF expects India's economy to grow by a robust 5.9% in 2023, marginally down from the 6.1% projected in January.

Inflation has eased on the back of moderating energy and food prices but remains above central bank targets in most economies. Inflation is expected to decline significantly in the second half of the year as food and energy prices fall off the high bases established last year. Upside risks to the outlook remain significant. Tightening supply in energy markets could again drive prices higher, potentially adding renewed upward pressure on inflation. Food inflation also remains sticky in most economies as the past surge in prices of grains and oils and fats continues to feed through to consumer prices.

US inflation continued its downward trend. Headline inflation declined to 5% yoy in March, its lowest level since May 2021, down from 6% in February. Easing energy costs were the main contributor, followed by falling used car and truck prices. Food inflation also moderated. In contrast, services inflation intensified, reflecting higher shelter costs. Demand for services has been robust, exerting upward pressure on prices, probably reflecting the continued normalisation in activity following the severe disruptions caused by the pandemic and lockdown measures. Core prices, excluding food and energy, remained sticky, increasing to 5.6% in March from 5.5% in February. The Core Personal Consumption Expenditure (PCE) Price Index, the Fed's preferred measure of inflation, also suggests underlying price pressures have been slow to dissipate. It eased only marginally to 4.6% in February from 4.7% in January. The main risk to the US inflation outlook emanates from the tight labour market, which could drive wages higher.

Price pressures in the Eurozone also subsided, albeit only slowly. Preliminary estimates showed that inflation fell to 6.9% yoy in March, its lowest rate since February 2022. The moderation was driven mainly by lower energy prices, which declined for the first time in over two years. A moderate decline in the prices of non-energy industrial goods also contributed. In contrast, inflation of food, alcohol and tobacco continued to accelerate, climbing to 15.4% from 15% in February. Furthermore, services inflation edged higher, rising to 5% from 4.8%. Core inflation reached a record high of 5.7% in March. The European Central Bank (ECB) stressed that underlying pressures remain strong, and it expects core inflation to trend above the 2% target until around 2025. UK inflation remained exceptionally high, moderating to only 10.4% in February after having peaked at 11.1% in October last year. Food and non-alcoholic beverage prices accelerated at the fastest rate since August 1977. Vegetable prices surged following a shortage driven by bad weather in Europe and North Africa. Additional upward pressure came from restaurants and hotels, clothing and footwear, and health care. Core inflation was 6.2% in February, hovering close to the record high of 6.5% in October 2022. The UK has the highest inflation-to-central-bank-target gap (8.4%) among the AEs. However, price pressures should ease in the months ahead. Energy costs will likely remain stable following the government's decision to extend the Energy Price Guarantee (EPG) programme until June 2023 (initially March 2023). In Japan, inflation fell to 3.3% in February, down from a 41-year high of 4.3% in January. The drop was due mainly to lower fuel, electricity, and water charges. At the same time, food inflation continued to reflect yen weakness and the extended pass-through of high raw material costs, rising for an 18th straight month. Core inflation fell to 3.1% in February, decelerating from a 41-year high of 4.2%.

Chart 2: Inflation trending close to or within target in some economies



Where the inflation target is a range, the upper bound is considered. *Difference between latest inflation reading and central bank target.

Sources: Refinitiv and Nedbank calculations

EME inflation eased on the back of lower global crude oil prices. In Brazil, inflation fell to 4.65% in March, the lowest since January 2021, dipping within the target range of 1.75% to 4.75%. In China, price pressures moderated further, with inflation receding to 0.7% in March, its lowest level since September 2021. Chinese inflation is expected to rebound later in the year as labour market conditions tighten. However, it will likely still fall short of the central bank's 3% target. In India, inflation dropped to 5.66%, also falling within the target range of 2% to 6%. Price pressures have also moderated in most other EMEs. However, food prices continue to exert significant pressure, trending at double-digit levels in some economies (mainly in Africa), reflecting the impact of high fertiliser costs and considerable currency weakness.

Most central banks tightened **monetary policy** further, although at a softer pace. Although the turmoil in the US banking sectors has raised market expectations of an imminent pivot in US monetary policy, the US Federal Reserve (Fed) stuck to its hawkish message. In his testimony to Congress, Fed Chair Jerome Powell stressed that the recent bank failures do not threaten the rest of the banking system or the broader economy, affirming that the Fed will remain vigilant in its quest for lower inflation. In March, the Fed hiked the federal funds rate (FFR) by 25 basis points (bps) to 4.75% to 5%. The central bank also hinted that 'some additional policy firming' would be required to return inflation to target, which suggests that the rate

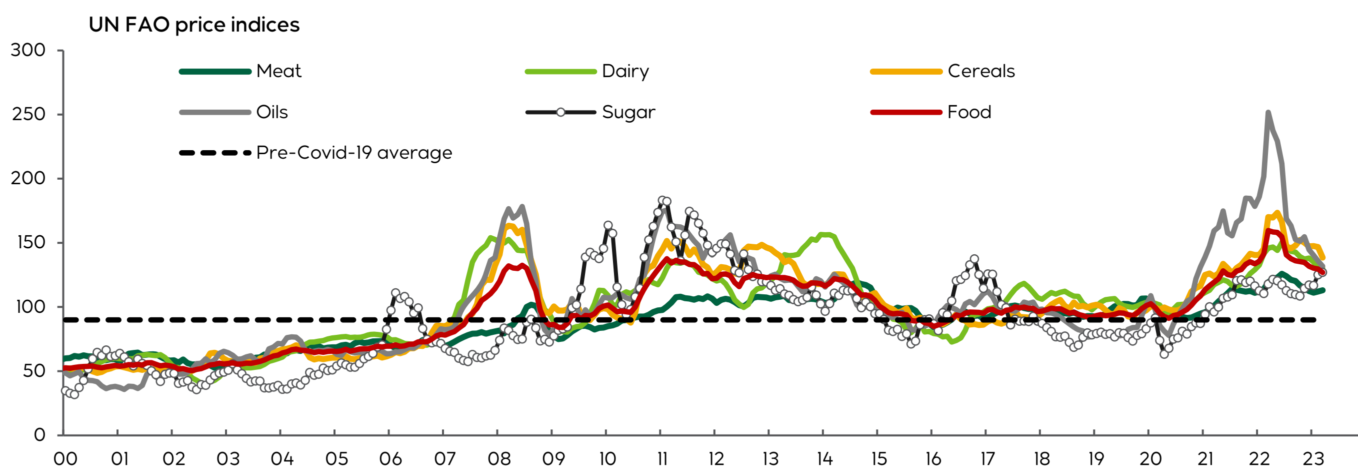
cycle has not yet peaked. The Fed forecasts the FFR at 5.1% in the final quarter of 2023 before falling to 4.3% in 2024. The central bank tweaked its inflation forecast up slightly. Core PCE inflation is forecast to average 3.6% in 2023 (previously 3.5%) and 2.6% in 2024 (previously 2.5%).

The European Central Bank (ECB) remained aggressive, hiking its main refinancing rate by 50 bps to 3.5%. The ECB stressed that underlying price pressures would likely remain elevated for longer, while the strong labour market and accompanying wage growth also add upside risks to the inflation outlook. The ECB forecasts inflation to average 5.3% in 2023, 2.9% in 2024 and 2.1% in 2025. The Bank of England (BoE) raised its policy rate by 25 bps to 4.25%. The BoE expects inflation to fall sharply from the second quarter onwards, due partly to the extension of the Energy Price Guarantee (EPG) and the freezing of the fuel duty. The Bank of Japan (BoJ) has maintained its ultra-loose monetary policy, with its key short-term interest rate at -0.1% and the yield on the 10-year bond yield at 0%.

Policy decisions were mixed in EMEs in the first quarter. The Central Bank of Brazil, which is among the few EMEs with inflation trending within target, has left its Selic rate unchanged at 13.75% since August. Mexico and Colombia increased their interest rates to 11.25% and 13%, respectively, as inflation exceeded their 3% targets. The Central Bank of India left interest rates unchanged at 6.5% in April against market expectations for a 25 bps hike, suggesting that the decision was due to the recent turbulence in global financial markets. The People's Bank of China (PBoC) cut its reserve ratio by 25 bps to support the economy. The PBoC, however, maintained the one- and five-year lending rates at 3.65% and 4.3%, respectively. Given the significant easing in Chinese inflation and the subdued economic rebound, markets have warned that there is more room for monetary policy easing.

Commodity prices continued to weaken, weighed down by softer global demand. The S&P Goldman Sachs Commodity Spot Price Index contracted for a second straight month in March, down by 10% yoy. The downturn in energy markets was exacerbated by lower consumption and higher storage levels in Europe following a better-than-expected winter, global growth concerns, and the banking sector troubles. On the upside, stronger demand from reopening the Chinese economy offered some support but not enough to prevent the downturn. Brent crude oil prices fell 23.7%, while natural gas and coal prices slumped by 60.7% and 34%, respectively. In recent weeks, OPEC+'s decision to reduce output by an additional 1.16 million barrels per day from May until the end of the year has lifted oil prices. Precious metals were up by 1.1% yoy in March, supported by the price of gold, which edged higher on fears of a global banking crisis. In contrast, non-precious metals contracted by a steep 21.6%. Agricultural prices eased further on the back of ample production and supply. The Food and Agricultural Organization (FAO) Price Index declined for a 12th consecutive month in March, down by 20.5% yoy in nominal terms, the most since August 2015. Vegetable oils fell by a steep 47.7% as lower soy, and rapeseed and sunflower oil prices offset higher palm oil prices. Cereal prices were down by 18.6% yoy, following the extension of the Black Sea Grain Initiative, higher production estimates in Australia and Brazil, improved crop conditions in Europe and ample supply in Russia, India, Vietnam, and Thailand. Meat prices were down by 5.3% yoy. Sugar prices were up by 7.7% yoy on worries about lower production in India, Thailand, and China. However, these concerns have been partially offset by the positive outlook for sugarcane crops in Brazil. While global food prices have trended downwards for the past year, they remained above the pre-pandemic level. Furthermore, the pass-through to some economies has been delayed, reflecting country-specific issues and higher electricity and input costs.

Chart 3: Food prices have trended downwards for the past 12 months, but they remain above the historical average



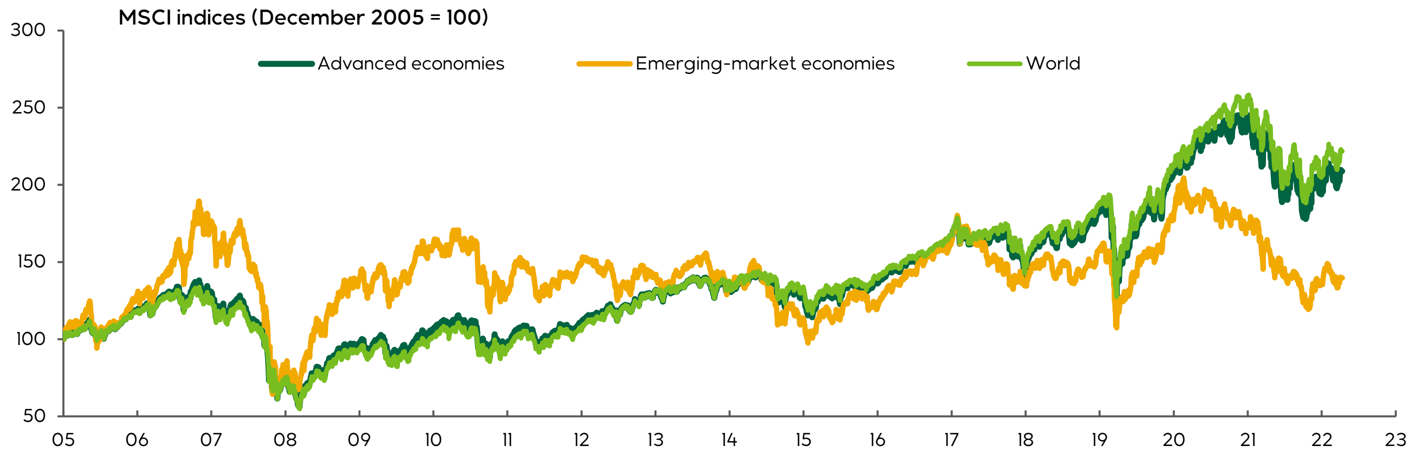
Pre-Covid-19 average = average between 2000 and 2019.

Sources: Refinitiv and Nedbank calculations

The **US dollar** weakened against most AE and some EME currencies in the first quarter. The depreciation in the greenback was driven mainly by easing global recession concerns and expectations of an early end to the rise in US interest rates. The bank collapses in March fuelled bets that the Fed would pause interest rates to support the financial system, adding to the downside pressure. The US dollar depreciated by 1.3% and 1.9% against the euro and pound in the first quarter. EMEs also benefited from the retreat in the greenback, with the dollar depreciating by 2.6%, 2% and 1.4% against the Brazilian real, Chilean peso and Mexican peso, respectively.

Global equity markets were buoyed by easing global recession worries and optimism regarding the reopening of the Chinese economy. While turmoil in the banking sector exerted significant downward pressure in mid-March, the impact was short-lived. As measured by the Morgan Stanley Capital Index (MSCI) for the World, AE equity prices were up by 5.3% in the first quarter, better than the 1.5% gain recorded in the last quarter of 2022. US equities were bolstered by easing US inflation and speculation that the Fed would soon end its hiking cycle. The NASDAQ and S&P 500 gained 7.1% and 3.1% over the quarter, while the Dow Jones Industrial Average was down 0.5%. In Europe, stocks were supported by gains in information technology, consumer discretionary, and communication services, while real estate and energy lagged. The Eurozone's financial sector gained over the quarter, with the troubles at Credit Suisse viewed as confined. The German DAX, French CAC, and FTSE 100 were up by 10.9%, 11.3% and 5.2%, respectively. Japan's Nikkei recovered relative to the last quarter but was up by only a modest 1.4%. EMEs recovered quite strongly over the past quarter, even outperforming AEs. The MSCI EM gained 7.5%.

Chart 4: Global equity markets remained resilient despite the turmoil in the global banking sector



Sources: Refinitiv

Liandra da Silva

DOMESTIC BACKGROUND AND OUTLOOK

Economic conditions deteriorated further during the first quarter, due to continued and severe power outages. The chances of slipping into a technical recession are high. Our base view is that the economy probably recorded no growth in the first quarter and that the economy will remain weak during the remainder of the year. Consumers are expected to be more cautious as elevated inflation and higher interest rates weigh on incomes, and concerns over job security erode confidence. Fixed investment is forecast to increase, albeit at a slower pace, buoyed by renewable-energy projects and spending on public infrastructure. Net exports will remain a drag as exports contract faster than imports. We forecast real GDP growth of 0.2% in 2023, revised down from the 0.7% projected in January. The forecast faces some downside risks, given the worsening electricity crisis and significant global headwinds. Inflation surprised slightly to the upside in February, but it will continue drifting lower, dragged down by lower global oil and food prices, softer domestic demand, and base effects. However, with inflation still above the 3% to 6% target range, the Monetary Policy Committee (MPC) is likely to hike interest rates by another 25 bps in May. Thereafter, we expect interest rates to remain unchanged before falling by a cumulative 100 bps in 2024.

Real GDP relapsed in the final quarter of 2022, contracting by a sharper-than-expected 1.3% qoq, after having bounced back by 1.8% qoq in the third quarter. Relentless load-shedding was mainly to blame, disrupting activity in all industries. Seven of the 10 major sectors contracted over the quarter, with the main drag stemming from lower value added by finance, followed by trade, catering, and accommodation. Value added by electricity and water also contracted for the third consecutive quarter due to constant breakdowns at Eskom's power stations. In addition to power shortages, export-oriented industries were hurt by slower demand in major economies and lower global commodity prices. As a result, the manufacturing and mining industries contracted. Personal services surprised to the upside despite tight household finances, with value added rebounding following a decline in the third quarter. Construction, transport and communications also expanded, albeit at slower rates.

Table 2: GDP breakdown by sector and expenditure category

Industries	Size	Annual growth rates				Quarterly growth rates			
	% of GDP	yoy % change				qoq % change (not annualised)			
	2021	2019	2020	2021	2022	Q1'22	Q2'22	Q3'22	Q4'22
Agriculture	2.4	-6.4	14.9	8.8	0.3	-1.8	-12.8	30.5	-3.3
Mining	7.8	-0.6	-11.8	12.0	-7.0	-2.4	-3.0	1.6	-3.2
Manufacturing	11.8	-1.0	-12.5	6.5	-0.1	4.6	-5.5	1.6	-0.9
Power and water	2.8	-3.3	-5.9	2.2	-2.6	2.3	-1.3	-2.7	-1.9
Construction	2.2	-3.4	-18.5	-2.2	-3.5	-0.5	-2.9	3.9	0.5
Domestic trade	12.3	-0.7	-12.4	6.4	3.5	3.0	-1.0	1.0	-2.1
Transport and communications	6.3	-0.7	-15.4	4.7	8.6	1.6	2.5	3.6	0.7
Finance	21.4	2.5	0.7	3.3	3.9	1.9	2.4	1.6	-2.3
General government	7.8	1.4	0.7	0.1	-0.3	1.1	-1.6	0.3	-0.7
Personal services	15.2	1.4	-2.0	5.5	2.7	0.5	0.1	-1.3	0.2
Value added	89.6	0.2	-5.9	4.7	2.1	1.7	-0.8	1.8	-1.3
GDP	100.0	0.3	-6.3	4.9	2.0	1.6	-0.8	1.8	-1.3
Household consumption expenditure	60.6	1.2	-5.9	5.6	2.6	1.0	0.4	-0.3	0.9
Government consumption expenditure	19.3	2.1	0.8	0.6	0.9	1.1	-1.0	0.6	-0.7
Fixed capital formation	13.0	-2.1	-14.6	0.2	4.7	3.5	0.3	0.3	1.3
∆ in inventories (Rbn)	-0.1	26.7	-59.3	-20.6	36.0	9.0	35.9	69.5	29.4
Gross domestic expenditure	92.8	1.1	-7.8	4.7	3.8	2.1	0.7	0.7	-0.2
Exports	31.1	-3.4	-11.9	10.0	7.5	3.7	-0.1	3.8	-4.8
Imports	25.0	0.4	-17.4	9.5	14.2	5.2	5.4	0.1	-0.8
Expenditure on GDP	100.0	0.0	-6.2	4.9	2.1	1.7	-0.8	1.7	-1.3

Source: Statistics SA

On the **expenditure side**, the fourth-quarter contraction resulted mainly from a significant deterioration in the net export position, subtracting 1.1 percentage points from GDP. During the quarter, exports fell sharply by 4.8% qoq, reflecting the impact of slower global demand, lower commodity prices and acute load-shedding. Meanwhile, imports contracted by a modest 0.8% over the same period, dragged down by slower consumer spending and subdued fixed investment. The boost from inventory accumulation also faded while government spending contracted. Encouragingly, growth in fixed investment accelerated by 1.3% qoq, after two consecutive quarters of slowdown. Household consumption expenditure (HCE) recovered, growing by 0.9% qoq in the final quarter, after having shrunk by 0.3% in the third quarter.

The latest statistics are mixed but suggest that the economy encountered further setbacks in early 2023. Persistent load-shedding remained a major issue, disrupting operations in most industries and adding to operational costs as companies resorted to other power sources, such as diesel generators. The frustrations caused by power shortages continued to weigh on confidence. The RMB/BER Business Confidence Index fell to a two-year low of 36 in the first quarter. Manufacturing production contracted for the fourth consecutive month in February. The Absa PMI suggests that manufacturing conditions will remain weak in the coming months, with the seasonally adjusted index stuck below the neutral 50-threshold for the second month in March. Mining production contracted for the 13th straight month by 4.5% yoy in February after having shrunk by 3.3% in January. New vehicle sales remained positive in the first quarter, but sales growth slowed significantly to 2.1% yoy from more than 15% in the fourth quarter of last year. Passenger vehicle sales fell by 1% yoy in the first quarter, while retail sales declined for the second consecutive month by 0.8% yoy in January, suggesting household incomes are taking strain under the combined weight of elevated inflation, sharply higher interest rates and a challenging job market. The stress on household finances and the unprecedented power cuts also hit consumer confidence, with the FNB/BER index plunging to -23 in the first quarter from -8 in the final quarter of last year. At this stage, the economy likely recorded no growth in the first quarter, and the risk of contraction is high. The country would have entered a technical recession if real GDP shrunk in the first quarter.

Gowth prospects for the remainder of the year have been downgraded significantly. The South African Reserve Bank (SARB) revised its real GDP growth forecasts for 2023 to 0.2% in March from 0.3% in January and 1.1% in November last year. National Treasury reduced its forecast to a subdued 0.9% in February from 1.4% at the time of the Medium Term Budget Policy Statement (MTBPS) in October last year.

Electricity shortages will remain the main drag on the economy. Load-shedding will likely worsen in the second and third quarters as demand for heating increases over the winter while the electricity supply remains severely constrained. It is becoming clear that the electricity crisis will not be resolved quickly. Although there are now three ministers in some way responsible for energy security, Eskom's operations have not improved. This is despite enormous fiscal support over the past decade amid persistent allegations of deep-seated corruption at the power utility. The new Electricity Minister, Kgosientsho Ramokgopa, recently indicated that Eskom could add 2 000 MW to the grid by the end of the year if plant maintenance is improved. The minister stressed that stabilising the grid would require the cooperation of Eskom suppliers and even more financial support from the government. This latest call for funds comes after National Treasury had allocated an additional R254.4 billion in debt relief to be disbursed over three years in February's National Budget. This debt relief package, in turn, followed several years of substantial public bailouts and repeated above-inflation hikes in electricity tariffs. Given the lack of progress at Eskom, load-shedding will probably persist for the next three to five years. Some relief will come as the independent power producers licensed under bid windows 4 and 5 start renewable-power output. The attractive tax incentives for corporates and households announced in the 2023 Budget Statement could also stimulate private sector investment in alternative power, helping to reduce the pressure on the national grid.

In addition to the severe power shortages, the crumbling rail network and the inefficient operations at the ports will continue to undermine mining and manufacturing production and, therefore, exports. Apart from these domestic constraints, exporters will also feel the pinch from slower global demand and falling commodity prices. Therefore, export volumes will likely decline in 2023. Import volumes will also decline, albeit at a softer pace, hurt by weak consumer spending and subdued fixed investment. Consequently, we anticipate that **net exports** will remain a drag on GDP in 2023.

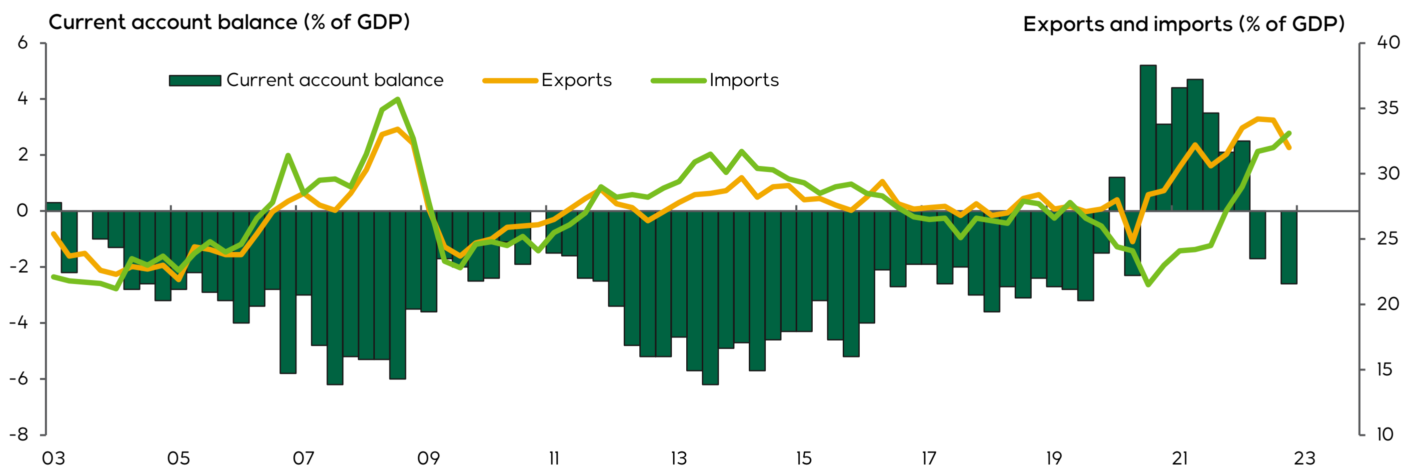
Gross fixed capital formation (GFCF) is forecast to remain positive, but the rate of increase will likely slow significantly. The extremely adverse domestic operating environment, dominated by the rolling blackouts and its impact of domestic demand, will continue to dampen business confidence, convincing more companies to postpone or scrap new capital expenditure projects. While the downside will be contained by increased investment in renewable-energy generation and some infrastructure spending by the government, growth in GFCF is forecast to slow to 2.3% in 2023 from 4.7% in 2022. A stronger and more sustained recovery in fixed investment will occur only when the energy crisis has been resolved and the structural reforms are accelerated.

Government consumption expenditure (GCE) will likely remain constrained despite the higher wage settlement. The focus will remain on containing consumption expenditure to reduce the budget deficit and slow the rate of debt accumulation. We forecast modest growth of 0.8% in GCE for 2023, down slightly from 0.9% in 2022.

Growth in **consumer spending** is also expected to slow. Household incomes are already under considerable pressure. Although real personal disposable income grew by 0.8% qoq in the final quarter of last year, the boost came from a strong rebound in other income sources, such as profits, rents, interest, and dividends. Real or inflation-adjusted compensation of employees, which accounts for 70% of personal disposable income, declined for the third consecutive quarter, shrinking by a further 1.6% qoq. Given that employment increased over the quarter, the decline in employee compensation suggests that nominal wage increases still fell short of inflation towards the end of last year. High and sticky inflation likely further damaged incomes in the first quarter. We expect price pressures to recede more meaningfully from the second quarter onwards. While this,

combined with higher wage increases, will help relieve some of the strain on household incomes, confidence will remain fragile as consumers will likely expect relentless load-shedding to undermine economic activity and threaten job security. At the same time, higher interest rates have already pushed debt service costs up significantly, consuming 8.1% of disposable income at the end of 2022 from only 7% at the end of 2021. With interest rates still climbing, up a cumulative 425 bps from their trough in 2020 and 2021, debt service costs are forecast to increase to over 9% of disposable income by the end of the year. These levels are historically associated with more significant financial stress. It is expected to reduce the funds available for discretionary spending and dampen demand for credit during the remainder of this year and into the early part of next year. As a result, consumer spending is forecast to slow to only 1% in 2023, down from a robust 2.6% in 2022 and 5.6% in 2021. Given continued upside risks to inflation and interest rate prospects and the threat of renewed job losses, the uncertainty in our forecast for consumer spending means it is still skewed to the downside. Altogether, **real GDP** is forecast to slow to a dismal 0.2% in 2023, compared with 2% in 2022 and 4.9% in 2021.

Chart 5: The deficit in the current account widened in the fourth quarter.



Source: SARB

On the balance of payments, the **current account** recorded a deficit of R174 billion or 2.6% of GDP in the fourth quarter of last year, the biggest shortfall since the third quarter of 2019. Merchandise exports contracted by 8.9% qoq, while imports rose by 3.6%. In calendar 2022, the current account registered a deficit of R31.8 billion or 0.5% of GDP after two years of surpluses. During the entire year, exports grew at a slower rate than imports, resulting in a narrower trade surplus. Softer global demand conditions, lower prices of key commodity exports, and domestic operational challenges contained export growth. In addition to extensive load-shedding, the Transnet strike disrupted operations at the country's ports for three weeks. Imports were raised by purchases of machinery and equipment for the energy sector as well as higher refined fuel imports amid limited domestic oil refining capacity. Even so, the upside to imports was capped by subdued consumer spending and high prices. The non-trade deficit widened during the year due to higher services and income payments. The trade balance will likely deteriorate further in 2023 as exports decline due to power outages, continued inefficiencies in rail and port operations, weaker global demand, and lower commodity prices. Imports are also expected to contract, albeit by less than exports, as by fading consumer demand contains the impact of higher capital equipment imports driven by increased renewable-energy projects. The non-trade deficit will widen slightly on lower income and services receipts as the global slowdown subdues tourist activity. As a result, we project the current account deficit to widen to 1.5% of GDP in 2023.

The inflows in the **financial account** held up well in the fourth quarter despite the turbulent global environment. Total inflows increased to R23.5 billion or 1.4% of GDP from R14.6 billion in the third quarter, lifting the inflows for the whole of 2022 to R67.9 billion and 1% of GDP after two years of outflows. Over the year, the boost came from 'other' investments, which jumped by R124.5 billion after the National Treasury and local entities raised foreign currency loans. Net inflows of direct investment also contributed, even though these declined significantly from the levels experienced in 2021. In contrast, the net outflows of portfolio investments continued to swell in the final quarter, bringing the cumulative outflows for the year to R64.8 billion. Although sizeable, it was still lower than the portfolio outflows of R80.4 billion recorded in 2021. Capital flows to South Africa will probably remain choppy in 2023. Global risk sentiment will likely remain volatile given weaker global growth prospects and heightened geopolitical tensions. The upside for South Africa will also be capped by the electricity crisis and its dire consequences for domestic growth.

Credit growth remained strong in early 2023. Growth in bank loans and advances accelerated to 9.9% in February after having slowed to 9.2% in December from a peak of 10.5% in September. The rise was led by an acceleration in corporate loans, which jumped to 12.2% yoy in February, amplified by last year's low base. The momentum was broad-based, but the strongest growth was recorded in overdrafts (up by 22.5% yoy) and general loans (up by 13.2%), with the latter probably reflecting increased funding for renewable-energy projects. Encouragingly, corporate demand for vehicle finance also remained robust, expanding by 11.1% in February. Even commercial mortgages, hard hit by lockdown and still subdued by work-from-home practices, recovered some lost ground, growing by 7% in February, up from 5.7% at the end of last year and only 2.1% at the end of 2021. Household credit also remained relatively firm but appears to be drifting sideways, reflecting the growing strain on household finances. Growth in home loans and vehicle finance moderated, hurt by rising interest rates. However,

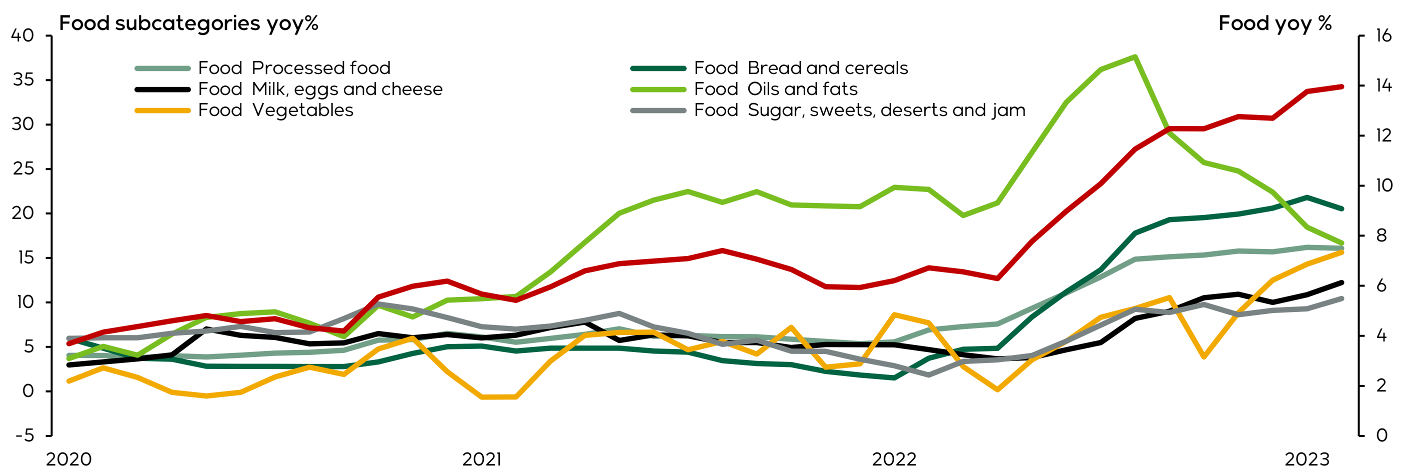
unsecured credit to households continued to gain momentum, possibly reflecting a degree of distress borrowing. Personal loans rose by 10% yoy in February, while credit card usage grew by 8.9%.

Bank credit growth is likely hovering around peak levels and is expected to moderate gradually during the remainder of 2023. Household demand will be contained by the lagged effect of higher interest rates, while the poor economic conditions and worries about job security will hurt consumer confidence, contain spending, and limit the appetite for new credit. At the same time, lenders could tighten credit standards given the unfavourable economic conditions, higher borrowing rates, and the potential risk of defaults. Corporate loan growth will also slow down as the low base effect created by the 2020 lockdowns dissipates. Furthermore, heightened uncertainty about the country's growth prospects, combined with rising production costs, policy uncertainty, and ample spare capacity in many industries will probably discourage new capital projects and subdue demand for general loans. However, renewable-energy projects should provide some foundation for corporate loans. We forecast bank credit growth to slow to 5.4% by the end of 2023, down from 9.2% at the end of last year.

Inflation surprised on the upside in early 2023. Headline inflation edged up 7% in February after having eased to 6.9% in January from the peak of 7.8% in July last year. Much of the drag came from fuel prices, which benefited from lower global oil prices. Petrol price inflation has moderated each month since reaching a peak of 56.2% yoy in July 2022, dropping to 10.9% in February. However, the upward pressure came mainly from sticky food prices. Although global food prices have declined significantly, a weaker rand and the additional expense incurred to run alternative electricity sources have driven local production costs sharply higher, with the cost passed through the supply chain to the retail level. As a result, food inflation jumped to 14% yoy in February, the highest rate since March 2009. Most of the upward force came from bread and cereals prices, which accelerated by more the 20% yoy. Prices of vegetables accelerated to 15.7% in February from a low of only 0.2% in April 2022. Prices of sugar, sweets, deserts and jam also rose at a double-digit pace in February, possibly reflecting the impact of lower supply following the financial scandal at Tongaat Hulett, one of the country's largest sugar refiners. Encouragingly, prices of oils and fats eased to 16.7% in February from a peak of 37.6% in August 2022. The slowdown in this category reflects improvements in global supply after Ukraine had resumed exports and other large producers such as the United States and Brazil ramped up their output. Most of the downward momentum in inflation came from fuel prices, which benefited from lower global oil prices. Petrol price inflation has moderated each month since the peak of 56.2% reached in July 2022, dropping to 10.9% yoy in February. More alarmingly, core inflation rose to a seven-year high of 5.2%, suggesting broader price pressures, with retailers starting to pass cost increases onto consumers more aggressively.

Headline inflation is forecast to trend lower off a higher base throughout the year, falling to 4.9% in December and averaging 5.9% for 2023 (revised up from 5.5% previously). Most of the downward pressure will stem from fuel prices, which will benefit from lower Brent crude prices. However, oil prices could increase again after OPEC+ had decided to cut production by an additional 1.16 million barrels per day from May. Food inflation has been sticky, but it is probably near its peak and should also begin easing on weaker domestic demand, lower global food prices, and ample domestic food production. However, the risks to the inflation outlook remain on the upside due to rising input costs, driven by the additional cost of generating electricity from diesel amid load-shedding, unpredictable weather patterns, and a vulnerable rand. In the 2023 Budget Statement, the National Treasury extended the diesel levy exemption to food manufacturers, which will help to contain the costs from higher use of diesel generators. Bureau for Economic Research (BER) inflation expectations survey showed a 0.2 percentage point increase in inflation expectations in the first quarter of this year. This, coupled with high food prices and electricity tariffs, could lead to another round of above-inflation wage increases, outpacing productivity and adding to inflationary pressures. Despite the sudden rise in February, core inflation will likely moderate during the year as the higher cost of living and weak confidence subdue consumer spending, limiting producers' ability to pass price increases on to consumers without hurting turnover.

Chart 6: Food inflation remains elevated

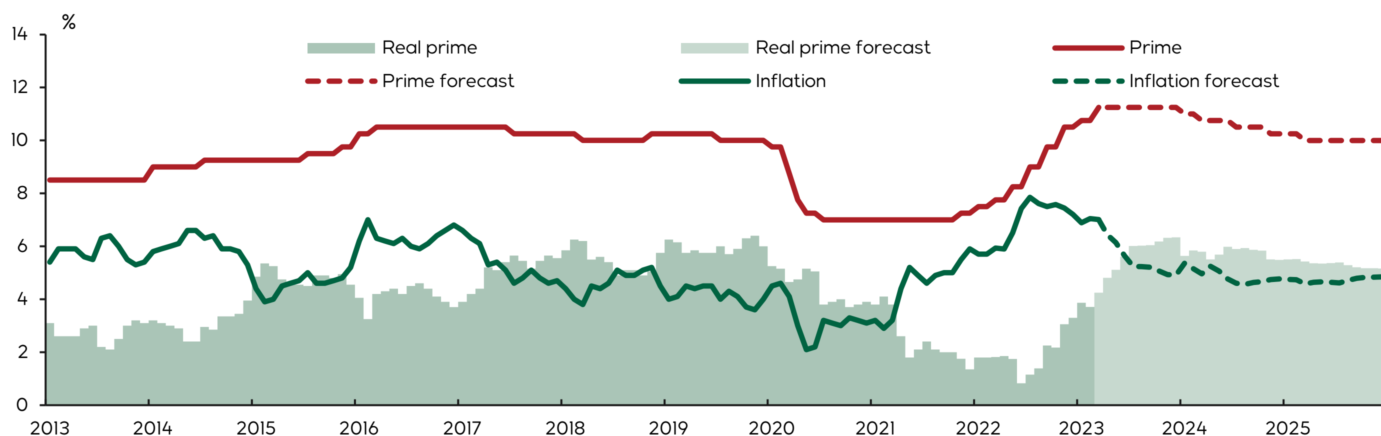


Sources: Statistics SA

The SARB's **MPC** tightened monetary policy further in March, surprising markets by hiking the repo rate by 50 bps versus the consensus forecast of 25 bps. The repo and prime rates rose to 7.75% and 11.25%, respectively. The MPC has increased interest rates by a cumulative 425 bps since the start of the hiking cycle in November 2021, lifting the policy rate to its highest level in almost 13 years. The hawkish outcome was driven by February's disappointing inflation numbers, rising inflation expectations, and continued upside risks to the outlook. The MPC fears that conditions in the global oil market could tighten again, given the ongoing Russia–Ukraine war and a rebound in Chinese demand. Other upside risks include higher domestic electricity and other administered prices, as well as elevated food price inflation and the broader price effects of load-shedding. Furthermore, high food inflation and sticky petrol prices could increase wages. The SARB expected inflation to average a higher 6% in 2023 and 4.9% in 2024, up from its January forecast of 5.4% and 4.8%, respectively. The forecast for 2025 was unchanged at 4.5%. The SARB expected the economy to expand by a slightly weaker 0.2% in 2023 (from 0.3% previously), before recovering at a marginally firmer pace than anticipated in January of 1% and 1.1% in 2024 and 2025, respectively.

With inflation likely to recede only slowly, the MPC is expected to remain hawkish. On top of sticky food prices, uncertainties surrounding the price implications of load-shedding, and the sharp rise in electricity tariffs, the rand will likely remain vulnerable to further hikes in US interest rates. While the outlook is exceptionally murky, we forecast one more rate hike of 25 bps in May, taking the repo rate and prime lending rate to peaks of 8% and 11.50%, respectively. The easing cycle is expected to begin in early 2024.

Chart 7: The SARB raised interest rates to an over 13-year high in March.

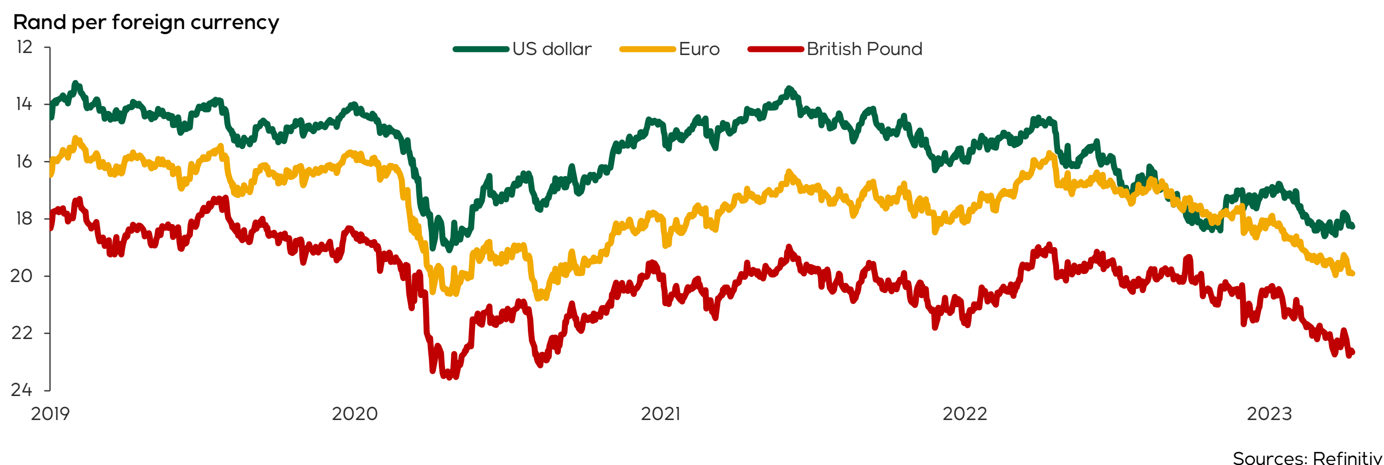


Sources: Statistics SA and SARB

Local financial markets have been extremely volatile since the beginning of the year. The negative forces included the choppy global risk sentiment caused by heightened uncertainty over the outlook for US interest rates, the recent turmoil in the US and Swiss banking sectors, and fears of a deeper-than-expected global economic downturn. Adverse domestic factors ranged from the impact of the ongoing electricity crisis and rising interest rates on corporate earnings to South Africa's greylisting by the Financial Action Task Force. Despite these shocks and wild swings in share prices, the **JSE All-share Index** was still up a reasonable 8% since the start of the year. The boost came from a 16.3% jump in the industrial index as China's reopening lifted heavyweight Nasper's share price to higher levels. Basic materials have risen by a modest 0.2% since the start of the year, hurt by the rolling blackouts, the global economic slowdown, and falling commodity prices. Financials increased by only 1.2% over the same period, struggling to recover from the hit caused by the country's greylisting and troubles in the global banking sector. Equity prices are likely to come under renewed pressure. Company earnings will be hurt by slower domestic growth and rolling blackouts, while global risk appetite will be undermined by slower world growth as tighter financial conditions take effect.

Bond yields eased during the first quarter on reduced fiscal risks and expectations of lower domestic inflation and interest rates over the next 12 months. The yield on the benchmark five-year government bond declined to 8.44% at the end of March from 8.77% in December, while the yields on the 10-year benchmark eased to 9.83% from 10.19% over the same period. Bond yields should decline further as inflation recedes and interest rates peak. However, the general outlook for the capital market is highly uncertain, given sovereign risk considerations on the back of the high public debt stock, unfavourable domestic growth prospects, and the threat of renewed social tensions in the build-up to the 2024 general elections. The risk premium will therefore remain high.

Chart 8: The rand depreciated sharply in the first quarter



Sources: Refinitiv

The **rand** was under pressure throughout the first quarter and early second quarter. South Africa's greylisting on 24 February hit the rand hard. Weak and volatile global risk appetites also contributed to the slide, particularly in early March, when the troubles with the US and Swiss banks surfaced. However, the rand still fared worse against a weaker US dollar than most other EME currencies. Although the rand briefly rebounded towards the end of March after the SARB had raised its policy rate by more than expected, the local unit failed to hold on to these gains in April. The rand's persistent underperformance reflects South Africa's poor growth prospects relative to its peer emerging markets, the narrower nominal and real differential between South Africa and US policy rates, and a widening current account deficit. So far this year, the rand has depreciated by 6%, 8.5%, and 8.6% against the US dollar, the euro, and the British pound, respectively. The outlook remains murky. Global risk sentiment will remain patchy as investors await the peak in US interest rates and the world economy slows. At the same time, domestic growth prospects are unlikely to improve, while the current account will likely widen. Therefore, the rand will likely remain under pressure for much of the year. Some recovery is likely towards the end of the year as global risk sentiment improves on expectations of lower US interest rates and firmer global growth.

Johannes Khosa

FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

Updated 17 April 2023

	2019	2020	2021	2022	2023	2024	2025
Growth (real, % change)							
GDP	0.3	-6,.3	4.9	2.0	0.2	1.3	1.6
GDE	1.1	-7.8	4.7	3.8	0.6	1.2	1.8
HCE	1.2	-5.9	5.6	2.6	1.0	1.4	1.9
GDFI	-2.1	-14.6	0.2	4.7	2.3	1.5	1.9
Exports	-3.4	-11.9	10.0	7.5	-2.7	4.7	4.2
Imports	0.4	-17.4	9.5	14.2	-0.9	4.0	4.5
Balance of payments (Rbn)							
Exports	1302.7	1394.0	1796.8	2013.5	1898.2	1959.3	2010.7
Imports	1263.7	1104.6	1348.7	1791.9	1731.4	1876.9	2011.0
Trade balance	39.0	289.3	448.1	221.6	166.8	82.4	-0.3
Net services	-183.1	-179.8	-220.4	-253.4	-268.7	-254.5	-210.3
Current account	-144.2	109.6	227.7	-31.8	-101.9	-172.2	-210.6
Financial account [1]	104.7	-129.0	-244.5	38.3	88.9	103.7	100.0
Change net reserves	-25.4	54.1	-67.3	-45.0	-40.0	-30.0	-38.0
Current account as a % of GDP	-2.6	2.0	3.7	-0.5	-1.5	-2.3	-2.7
Gold price (average per ounce)							
Dollar	1404.4	1783.4	1795.6	1817.1	1857.0	1968.1	1969.0
Rand	20330.2	29345.1	26809.9	29821.2	33192.3	34196.2	33246.4
Exchange rates							
Dollar–rand	14.48	16.45	14.93	16.41	17.87	17.38	16.88
Euro–dollar	1.120	1.148	1.182	1.052	1.094	1.123	1.155
Dollar–yen	109.0	106.2	110.3	131.8	132.0	130.2	127.9
British-pound-dollar	1.278	1.288	1.376	1.226	1.246	1.264	1.272
Euro–rand	16.20	18.86	17.63	17.23	19.56	19.52	19.50
Rand–yen	7.54	6.49	7.40	8.03	7.39	7.49	7.58
GBP–rand	18.49	21.15	20.54	20.06	22.28	21.96	21.48
Interest rates (end of period)							
Three-month JIBAR	6.80	3.63	3.87	7.21	8.18	7.16	7.15
Prime	10.00	7.00	7.25	10.50	11.50	10.50	10.50
Long bond	8.96	8.93	9.65	10.84	10.87	10.01	9.97
Inflation (average)							
CPI	4.1	3.3	4.6	6.9	5.9	4.7	4.7

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FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

Updated 17 April 2023

	2022				2023			
	Q1'22	Q2'22	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23	Q4'23
GDP (qoq %)	1.6	-0.8	1.8	-1.3	0.0	0.1	0.6	0.3
Interest rates								
Three-month JIBAR	4.35	4.99	6.47	7.21	7.91	8.20	8.20	8.18
Prime	7.75	8.25	9.75	10.50	11.25	11.50	11.50	11.50
Long bond (10-yr)	9.86	10.91	11.28	10.84	10.63	10.87	10.86	10.87
Inflation (end of period)								
CPI	5.9	7.4	7.5	7.2	6.9	5.7	5.3	4.9
Exchange rates								
Dollar-rand	14.49	16.20	17.90	16.97	17.82	18.16	17.78	17.57
Euro-dollar	1.117	1.044	0.983	1.065	1.088	1.093	1.109	1.104
Dollar-yen	121.6	136.4	144.4	132.5	133.3	131.8	130.9	131.3
British pound-dollar	1.314	1.215	1.118	1.205	1.237	1.253	1.259	1.253
Euro-rand	16.19	16.92	17.59	18.07	19.39	19.85	19.73	19.39
Rand-yen	8.39	8.42	8.07	7.81	7.48	7.26	7.36	7.47
British pound-rand	19.03	19.69	20.00	20.45	22.03	22.76	22.39	22.01
Gold price per ounce								
Dollar	1937.2	1806.9	1659.7	1824.4	1977.6	1944.0	1903.1	1946.9
Rand	28061.0	29278.4	29701.6	30965.5	35222.0	35308.1	33840.7	34203.6

Note 1: Financial account excludes reserves and includes unrecorded transactions.

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