Industry Insights | 30 August 2024

GDP Expectations

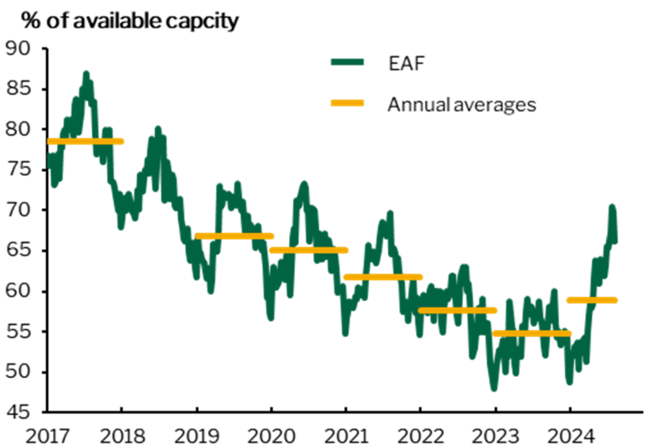
ECONOMICS | INDUSTRIES

NEDBANK

The economy likely turned the corner in Q2.

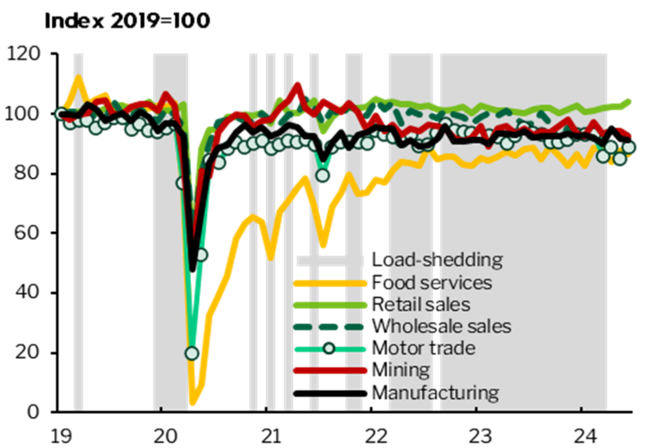
- High-frequency statistics reflect a feeble uptick in economic activity over Q2. The improvement reflects base effects, better operating conditions, and a weak but positive response in demand to falling inflation. Altogether, real GDP is forecast to grow by 0.4% qoq.
- The absence of load-shedding created a more favourable environment for producers. Enhanced efficiencies at power stations due to the return of three units at Kusile power station and increased planned maintenance led to an average energy availability factor (EAF) of 61%. Even though energy demand rose by 2% qoq over the winter, unplanned outages fell by 11% qoq and the use of Open Cycle Gas Turbine (OCGT) by 50.7% qoq. These improvements failed to compensate for continued inefficiencies in logistics networks, generally subdued global and domestic demand and lower commodity prices. Consequently, mining production contracted further while manufacturing output increased modestly off a low base.
- Lower inflation, especially on essentials such as food and fuel, supported consumers' purchasing power and real incomes, offsetting the ongoing squeeze from high interest rates. As a result, domestic trade increased over the quarter. Retail sales rose by 1.5%, and wholesale sales edged up by 0.9%. In contrast, vehicle sales, accommodation income, and food services declined further, contracting by 1.5%, 12.6%, and 0.2%, respectively. Passenger transport grew, while freight transport disappointed.
- We view the risks to our Q2 GDP forecast as relatively balanced. Upside risks to domestic trade, transport, communications, and government services will likely counter the downsides to agriculture and finance. Agriculture remains the wildcard. Lower summer crops will be a drag, but these could still be offset by higher value added from horticulture and animal farming.
- Despite mixed performances in Q2, we believe the worst of the downturn is probably behind us. We expect the economy to fare better in the second half of the year. The main boost will come from domestic demand, supported by firmer consumer confidence, a recovery in real household incomes driven by lower inflation, and lower debt services costs as interest rates ease. Despite the progress made on the structural front, operating conditions remain challenging and production costs high. These factors will continue to weigh on producers and exporters. While global demand will likely improve moderately as inflation and monetary policy ease, subdued demand from China will restrict the upside. Even if international demand does take off, SA's elevated cost structures, underlying inefficiencies and significant infrastructure constraints severely limit our producers' ability to exploit a global upturn fully. All told, we still expect growth of 0.9% in 2024, up slightly from 0.7% in 2023.
- Resolving the country's energy and logistical constraints remains the key to unlocking faster growth over the medium to longer term. While the Government of National Unity (GNU) has ushered in renewed optimism, this needs to translate into accelerated structural reforms to enhance the international competitiveness of industry, thereby enabling the economy to grow faster and create more jobs without hitting supply bottlenecks, driving up costs and stoking inflation.

Chart 1: Energy availability factor averaged to 61% over Q2 from 52.5 in Q1.



Source: EskomSePush & Nedbank calculations

Chart 2: High frequency statistics reflect a slight uptick in economic activity.



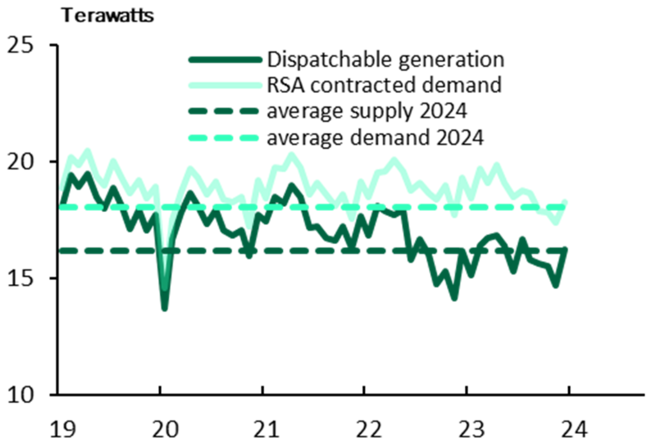
Source: Stats SA & Nedbank calculations

Energy supply improved significantly in Q2.

Meaningful progress has been made to improve electricity supply over Q2 2024. While some areas of the country battled intermittent load-reduction by municipalities, Eskom suspended nationwide load-shedding on 26 March 2024. Weaker demand set against increased supply made the difference. On the supply front, the return of three units at the Kusile power station and the ramping up of planned maintenance increased dispatchable generation by 8.8% qoq and 4.7% yoy. At the same time, subdued economic activity and the shift by households and consumers to renewable energy reduced the pressure on the grid. Total electricity demand declined by 5% yoy, even though Eskom's contracted demand rose by 2% qoq because of the colder weather and reduced sunlight hours. Nonetheless, the solar shift has been significant enough to enable an elevated level of planned maintenance, reflected in a 14% yoy increase in Eskom's Planned Capability Loss Factor (PCLF). Altogether, the EAF climbed to an average of 61% in Q2, up from 54.7% in Q2 2023. Eskom achieved this milestone without resorting to open cycle gas turbines (OCGT), whose use declined by a dramatic 50.7% qoq and 58.8% yoy.

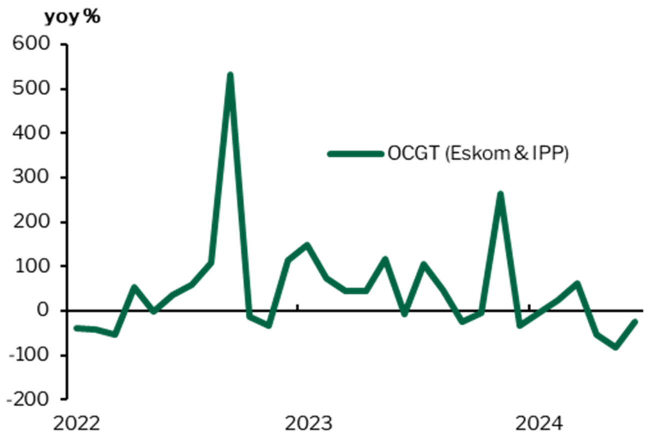
The sustainability of recent gains remains uncertain. So far this year, average electricity demand is still 11.6% higher than supply, as reflected in an unplanned capability loss factor of 28.9%. Although planned maintenance has increased, it may still not be enough to compensate for the years of neglect and the advanced age of most coal-fired power stations. Furthermore, grid capacity remains limited. An additional 2 200 MWh of renewable energy was added to the grid between 2020 and 2022, with no progress after that. On the plus side, the challenges are known, and there are plans to address them. However, success depends on the timeous and efficient implementation thereof. The actual test of the progress made so far will come once economic activity picks up pace.

Chart 3: Demand remains 11.6% above supply on average.



Source: Eskom

Chart 4: OCGT usage down 58.8% yoy in Q2.



Source: Eskom

Expected GDP outcomes in Q2 2024

The improvement in electricity production over the quarter supported GDP from the supply side. However, the extent of the boost was diluted by a still challenging logistical environment and subdued demand conditions. These circumstances continued to hurt mining production, which declined over the quarter, but manufacturing, electricity, and construction improved. Services activity also picked up modestly. However, stretched household finances and high interest rates still weighed on motor trade, accommodation, food services, freight transport, and real estate activity. Altogether, the economy likely grew by a humble 0.4% in Q2 after shrinking by 0.1% in Q1.

Agricultural output will be the swing factor in the Q2 GDP numbers. We expect value added by agriculture to increase by 1.2% qoq, a significant slowdown from the 13.5% jump recorded in Q1, inflated by the low base established late last year, higher horticultural output, and a recovery in the livestock and poultry industry. For horticulture, conditions soured somewhat in Q2. Severe frost damaged crops in some areas of Limpopo, while extreme wind and flooding hit parts of the Eastern and Western Cape.

These hits, combined with the effects of the El-Niño drought on the summer and winter crops, will likely subdue output in Q2. According to the 7th production estimate of the National Crop Estimates Committee (CEC), total grain and oil seed production declined by 22% from last season. Output of maize, soybeans, sunflower seeds, and ground nuts fell by 21%, 36%, 10% and 1%, respectively. In contrast, the sorghum and dry beans harvests are estimated to be higher than in the previous season. The CEC's 1st estimate of total winter cereal production reflects a 1.8% drop from last season due to a projected 7.2% decline in wheat output. Meanwhile, the barley, canola, oats, and sweet lupines harvests are estimated to be higher than in the previous season.

If horticulture and livestock farming hold up better than our assumptions, agriculture could surprise on the upside. However, the spread of foot-and-mouth disease outside the Eastern Cape and bird flu in some parts of the country pose downside risks.

Table 1: Latest economic indicators.

	mom %			yoy %			Q2 2024		2023
	Apr-24	May-24	Jun-24	Apr-24	May-24	Jun-24	qoq %	yoy %	yoy %
Mining	0.8	0.1	-1.6	1.4	1.3	-3.5	-0.9	-0.4	-0.2
Manufacturing	5.5	-3.6	-0.5	5.0	-1.2	-5.2	0.9	-0.6	0.6
Electricity	1.2	-0.5	2.3	5.7	5.5	5.4	2.1	5.5	-4.4
Buildings completed	25.9	-9.8	-15.9	-5.1	-28.0	-24.5	7.3	-19.6	-18.2
Wholesale sales	5.5	-3.6	0.6	0.7	-6.5	-9.0	0.9	-5.2	-3.1
Retail sales	0.5	-0.2	1.6	0.7	1.1	4.1	1.5	2.0	-1.0
Vehicle sales (Stats SA)	6.3	-6.0	4.9	3.4	-8.5	-9.9	-1.5	-5.3	-1.8
Acommodation income	-12.7	-4.9	1.9	-3.4	-0.4	-3.4	-12.6	-1.2	3.7
Food services income	-4.7	4.7	-1.6	-3.8	2.1	-1.8	-0.2	-2.5	23.5
Freight transport	-3.8	-3.4	4.8	-6.1	-8.6	-3.7	-5.0	-6.2	1.4
Passenger transport	5.4	-3.9	-2.9	29.1	6.7	3.0	1.1	11.9	15.8
Real credit extended	-1.0	0.0	1.1	-1.3	-1.2	-0.8	0.1	-1.1	0.0

Source: Stats SA

Mining production contracted in Q2 while manufacturing output recovered off a low base. The rate of decline in mining production moderated to 0.9% from 1.3% in Q1. The drag came from iron ore (-12.1%) and coal (-2.6%), which overshadowed a 3.6% increase in platinum group metals (PGMs) output. Nominal mineral sales rose by 4% qoq after weakening by 8.6% in the previous quarter. Manufacturing production grew by 0.9% qoq after shrinking by 1.2% in Q1. Six of the ten manufacturing divisions reported strong output, with the strongest recoveries recorded by motor vehicles, parts and accessories, and other transport equipment, as well as basic iron and steel, non-ferrous metal products, metal products, and machinery. Over the quarter, nominal manufacturing sales increased by 1.9% after contracting by 0.3% in Q1.

Electricity production improved by 2.1% qoq in Q2, following a decline of 0.7% in Q1. Value added by construction is forecast to grow by around 0.5% qoq, improving off Q1's low base, when output shrunk by 3.1%. We expect a lift from infrastructure investment ahead of the elections and increased building activity. The value of buildings completed rose 7.3% in Q2 after plunging by 29.9% qoq in Q1. The FNB/BER building confidence index increased to 35 in Q2 from 27 in Q1. The improvement in confidence stems from increased sales by hardware retailers and building materials producers, but around 65% of building firms were still dissatisfied with prevailing business conditions,

Performances within domestic trade varied in Q2, but overall value added is forecast to grow by a faster 0.7% qoq in Q2, up from a meagre 0.1% in Q1. Wholesale and retail trade recovered, supported by firmer consumer demand as inflation moderated, offering some counterweight to the consistent pressure emanating from high interest rates. Wholesale sales accelerated from 0.1% qoq in Q1 to 0.9% in Q2. Retail sales grew by 1.5% qoq in Q2, driven by retailers of textiles, clothing, footwear, and leather goods (3.2% qoq) and general dealers (up 1.1%). Motor trade income was hurt by a 1.5% drop in new vehicle sales, with the decline felt across the subsectors except for used vehicles. Since consumer finances remained stretched, food services and accommodation income declined by 0.2% qoq and 12.6%, respectively.

Meanwhile, freight transport was down by 5%, reflecting the slide in mining production. However, passenger transport grew by 1.1%. We expect value added by finance, real estate, and business services to have grown by a meagre 0.2% in Q1. However, banking conditions deteriorated, with real credit extension growing by a negligible 0.1% qoq. Relative to the same quarter a year earlier, real credit extension dropped 1.1% in Q2 from -1.9% the previous quarter.

Table 2: Quarterly forecasts.

Industries	Actual			Forecast				Forecast risks
	2023		2024	2024				
	Share (% of GDP)	Full year	Q1	Q2	Q3	Q4	Full year	
Agriculture	2.6	-4.8	13.5	1.2	4.2	5.6	4.0	Downside
Mining	7.3	-0.5	-2.3	-0.9	0.1	0.5	-1.1	Balanced
Manufacturing	12.0	0.3	-1.4	0.9	0.4	0.4	-0.4	Balanced
Electricity, gas & water	2.9	-4.0	-0.4	1.8	0.5	0.3	3.0	Balanced
Construction	2.2	-0.1	-3.1	0.5	0.4	0.3	-5.2	Downside
Domestic trade	12.1	-1.8	0.1	0.7	0.3	0.5	-1.5	Downside
Transport & communications	6.8	4.1	-0.5	0.2	0.3	1.6	2.5	Upside
Finance, real estate & business services	21.2	1.6	0.1	0.2	0.5	0.4	1.8	Downside
General government	8.0	0.5	-0.1	0.6	0.2	0.4	0.5	Upside
Personal services	14.6	1.8	0.1	0.3	0.5	0.7	2.2	Downside
Gross value added	89.6	0.7	0.0	0.4	0.5	0.7	0.9	Downside
GDP	100.0	0.7	-0.1	0.4	0.5	0.7	0.9	Balanced

Source: Stats SA & Nedbank forecasts

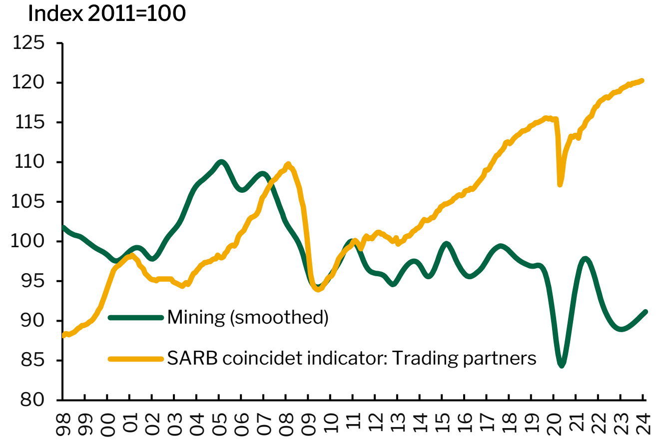
The outlook for the remainder of 2024

We expect the recovery to gain moderate momentum in the second half of the year. More reliable electricity supply and smoother logistics networks will enable slightly faster growth during the remainder of the year, providing much-needed relief to producers. The Government of National Unity (GNU) has lifted consumer and business confidence, which should trickle down to economic activity. Global demand should also improve as disinflation continues, monetary policy easing gains momentum, and China's measures to stimulate its economy bear some fruit. However, given SA's high-cost structures and generally unfavourable supply conditions, local producers' ability to exploit any upturn in the world economy is limited. On the domestic front, inflation has surprised on the downside in recent months, facilitating a slow recovery in real incomes. High borrowing costs will still contain the upside in Q3 before gradually easing as interest rates decline. We forecast two 25-bps rate cuts, one in September and another in November. Lower interest rates will boost consumer and business confidence but will take time to lift demand significantly, usually between 18-24 months. Nonetheless, the envisioned improvements on the structural and cyclical fronts should facilitate a turnaround in economic activity toward the end of the year and into next year. We expect growth of 0.9% in 2024.

Agriculture is forecast to expand by 4.8% in 2024, partly reflecting the strong rebound in Q1 and last year's low base. We also expect the higher rainfall associated with the La Niña pattern to support production over the upcoming summer planting season. However, agriculture faces considerable downside risks, including the threat posed by persistent animal diseases and extreme weather events aggravated by climate change.

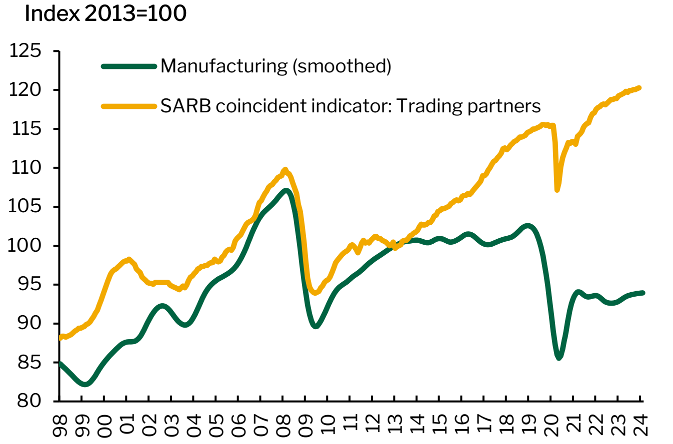
Despite recent improvements in SA's electricity and transport woes, the revamp of both networks will require extensive work. Until then, it will remain a binding constraint to mining and manufacturing production, capping the upside from cyclical upswings in domestic and global demand. The progressive decline in electricity production, which started around 2011, systematically eroded SA producers' international competitiveness, severely limiting these sectors' ability to exploit the global business cycle. Charts 5 and 6 show a structural break between SA's mining and manufacturing production and the business cycle in our main trading partners. Mining output started its sideways drift from 2011 onwards, while manufacturing followed in 2013. SA's fading competitiveness reflects the country's electricity woes, a rail network of which 42% is out of commission, ports ranked amongst the worst in the world, and high labour costs relative to productivity. On top of this, years of underinvestment. Even with expedited structural reforms, it will take time to reverse these pressures. We estimate declines of around 1.1% for mining and about 0.4% for manufacturing for the year. Over the next three years, we see only slow and modest improvements in mining and manufacturing.

Chart 5: Mining diverged from the global cycle around 2011.



Source: Stats SA & SARB

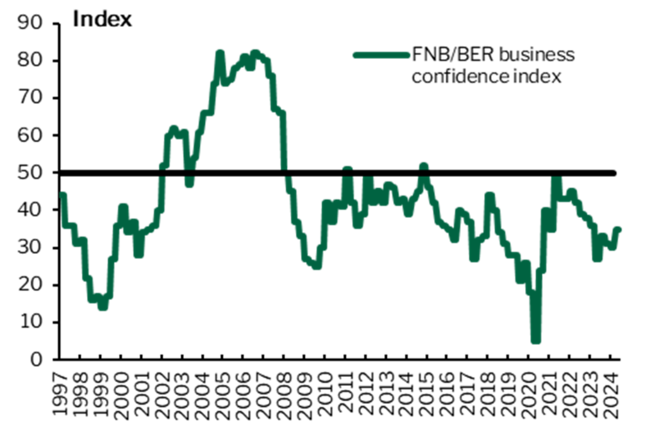
Chart 6: Manufacturing decoupled around 2013.



Source: Stats SA & SARB

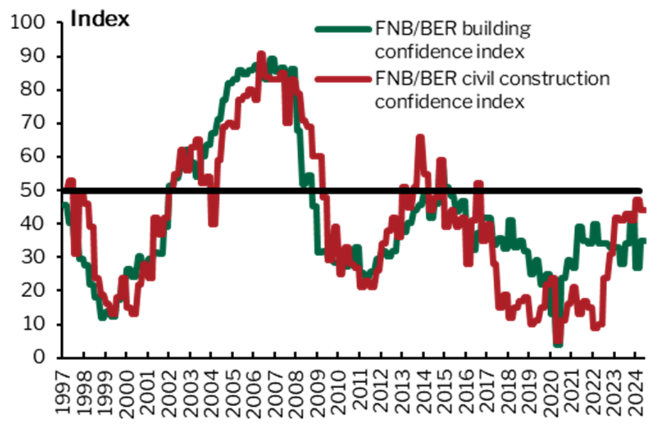
The slump in construction will likely continue during the remainder of the year. We forecast a contraction in value added of around 5.2% for the year, reflecting our expectation of continued weakness in fixed investment activity. Private firms will likely contain capital expenditure to cut costs and restore profits badly eroded by last year's severe energy and logistics disruptions. At the same time, most industries also sit with ample spare capacity. As a result, there is little need to expand operations until demand picks up significantly. Encouragingly, the Nedbank Capital Expenditure Project Listing reflects a significant increase in the value of new projects announced in the first half of this year. Although this bodes well for 2025, it is unlikely to lift fixed investment in 2024, given the long lag between when projects are announced and ultimately implemented. While we expect fixed investment in renewable energy projects to remain robust in the years ahead, these projects tend to be low on construction content (bricks and mortar) and high on machinery and equipment. If the government follows through on its plans to invest R393 billion in bulk infrastructure, particularly transport, water, and sanitation, it will support the construction sector over the next three years. However, the government has a poor track record in delivering on infrastructure.

Chart 7: Weak business confidence is weighing down the outlook for construction.



Source: FNB/BER

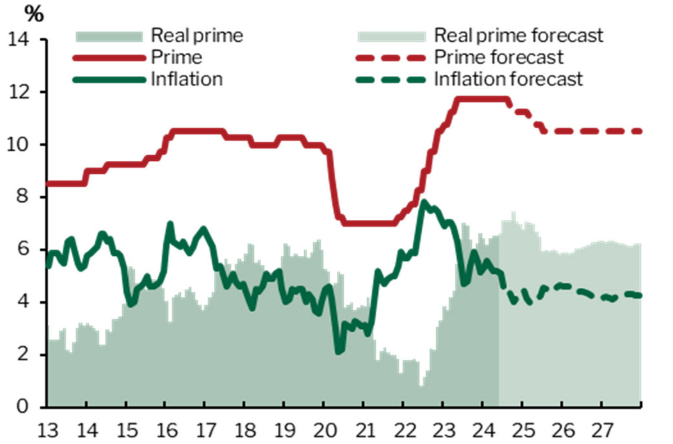
Chart 8: Building and civil construction confidence is not much better.



Source:

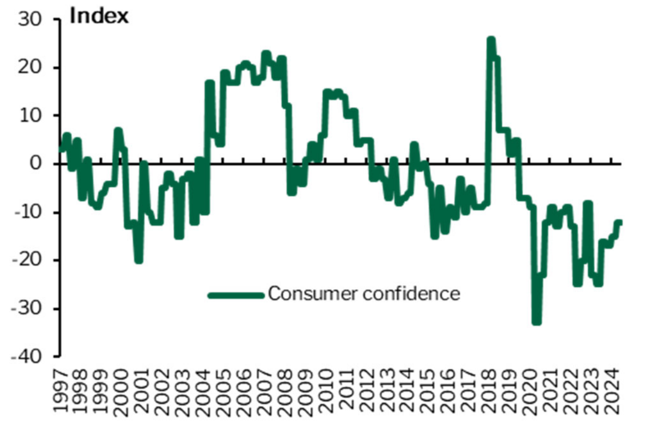
Pressures on domestic demand are slowly receding as inflation is cooling faster than expected, boosting purchasing power and real incomes. Even so, consumer confidence remains fragile, given high interest rates and rising unemployment. We expect confidence to lift significantly once interest rates come down, gradually reducing borrowing costs and freeing up funds for discretionary spending. Although encouraging, the cyclical upturn will come too late to alter the outcome of domestic trade in 2024. Value added by domestic trade, accommodation, and catering is still forecast to contract by 1.5% this year. The recovery in wholesale and retail trade will likely broaden and strengthen in the final quarters of the year. The motor trade industry will probably turn the corner later this year, but sales are only expected to gain meaningful momentum next year as interest rates decline more aggressively. Tourism and accommodation will likely remain robust, supported by increased international travel and tourism as global inflation and interest rates ease. Our forecast faces upside risks. The boost from lower inflation, interest rate cuts and the access to funds through the two-pot retirement system could be greater than we currently anticipate.

Chart 9: The decline in inflation and the forecasted interest rates…



Source: Stats SA

Chart 10: …should provide a lift to fragile consumer confidence.



Source: FNB/BER

Like tourism and hospitality, leisure and business travel are still normalising from the blow of strict lockdowns. Consequently, passenger transport should remain relatively robust. Freight transport will likely recover as economic activity picks up. This, combined with continued strong demand for communications, should support growth in value added by transport and communications of around 2.5% in 2024.

Banking will remain relatively subdued in the second half of the year. While real incomes will recover as inflation recedes, the pressure from high interest rates will persist for longer. Household credit growth normally still moderates as interest rates start to come down. However, the household loans appear to be around its trough in this cycle and should start to recover towards year end. Corporate credit demand will likely improve due to last year's lower base and increased activity in the renewable energy sector. Bank credit growth is forecast to end the year around 4% before accelerating to 6% in 2025 as interest rates fall further, structural reforms gain some traction, and economic activity picks up.

In conclusion, we still see a modest cyclical recovery in the second half of 2024, with growth averaging around 1.3% over the next three years. Domestically and globally, falling inflation and lower interest rates will likely boost demand later in the year. However, much still depends on the need for deep-seated reform in the energy and logistics space.

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