Industrial Development Corporation
Your partner in development finance

Economic overview:

Recent developments in the global and South African economies

Department of Research and Information

May 2022

Contents

Highlights

- Strong headwinds are hindering the world economy's expansion momentum. These include persistently high inflation; an anticipated aggressive tightening of monetary policy by major central banks; the adverse repercussions of the war in the Ukraine and the sanctions imposed on Russia; as well as the impact of China's Covid-related mobility restrictions on an already slowing Chinese economy and global supply chains.

- The International Monetary Fund (IMF) lowered its forecasts for global growth to 3.6% in 2022, from the 4.4% projected in January. Significant downward revisions were made to the growth projections for the economies of the Eurozone, the United Kingdom (UK) and Japan. The adjustment was relatively smaller for the United States (US) economy.

- Multi-decade high rates of inflation are prompting central banks to tighten monetary policy by ending asset purchases and raising policy rates. The US Federal Reserve and the Bank of England have already embarked on a relatively steep interest rate hiking trajectory, while the European Central Bank has signalled that it might start increasing rates in July 2022. Such developments have been raising concerns of recessionary conditions potentially emerging in certain economies.

- The Russia-Ukraine war is impacting on the prices of a range on commodities and, in certain cases, on their physical supply. This is exacerbating inflationary pressures globally. Sharp increases in fuel and food prices, and shortages in some instances, are affecting the world's poor the most and could ignite social unrest. Excessive volatility in global financial markets has been reflecting investor anxiety.

- The economic slowdown in China is being aggravated by the reimposition of mobility restrictions under a zero-Covid policy, and by continued governmental efforts to deleverage the country's property sector. Lockdown measures are affecting household and production activity. This is placing further strain on global supply chains and prices. The People's Bank of China is loosening monetary policy to support economic activity, while fiscal support for infrastructure development could be on the cards.

- Prices of industrial commodities rose to historical peaks in recent months. The impact has been particularly pronounced in energy markets given Russia's relative weight in the world supply of natural gas, crude oil and coal. Significant price volatility is likely to prevail across the commodities complex in the near- to short-term, while the prognosis is varied over the medium- to longer-term.

- Sub-Saharan Africa's economy is expected to expand by 3.8% in 2022 and by 4.0% next year. Many of the region's economies, particularly oil-importing countries, will be adversely affected by the high prices of oil and food products, putting further strain on external accounts and constraining their limited fiscal space. Some commodity producers, particularly oil exporters, may benefit from elevated prices, but the slowdown in China may affect their performance.

- South Africa's economic environment has worsened in the light of these developments in the world's economic and geopolitical landscapes. On the domestic front, several factors continue hampering the economy's growth performance, including frequent loadshedding, transport and logistics constraints, rising production costs and input shortages due to global supply chain challenges, among other factors. The devastating floods in KwaZulu-Natal left a trail of destruction to economic infrastructure and the livelihoods of thousands of households.

- Consumer inflation in South Africa has been trending upwardly for some time, reaching 5.9% in March 2022, the highest in 6 years. The deteriorating inflation outlook has

World economic growth:

+6.1% in 2021
+3.6% in 2022 (f)
+3.6% in 2023 (f)

(IMF)

Consumer price inflation in advanced economies:

+3.1% in 2021
+5.7% in 2022 (f)
+2.5% in 2023 (f)

(IMF)

Russia's share of global production:

Palladium: 44%
Natural gas: 17%
Fertilisers: 15%
Platinum: 14%
Crude oil: 12%

Sub-Saharan Africa's economic growth:

2021 = 4.5% (e)
2022 = 3.8% (f)
2023 = 4.0% (f)

(IMF)

prompted the Monetary Policy Committee to raise interest rates by a cumulative 125 basis points (bps) since November 2021, with the repo rate currently standing at 4.75%. The committee is expected to raise it by an additional 100 bps over the remainder of 2022, and by a further 25 bps in 2023.

- Manufacturing activity rebounded strongly in 2021, but output levels remained well below those recorded in 2019. Manufacturing production increased by a further 4.6% (q-o-q) in the first quarter of 2022, underpinned by robust growth in the sub-sectors producing transport equipment; chemicals, rubber and plastics; base metals and machinery; as well as food and beverages. The sector continues to face major challenges, but conditions should improve over the medium-term.
- After a solid performance in 2021, the mining sector's output fell by 1.5% (q-o-q) in the opening quarter of 2022. Steep declines were recorded in the mining of iron ore, PGMs and gold, but the output of the coal and manganese segments rose significantly on a quarterly basis. The sector has been particularly affected by loadshedding as well as by transport and logistics challenges. Regulatory processes also remain a hindrance to investment in exploration and the self-generation of electricity by mining companies.
- In the agriculture sector, 2022 is likely to mark a break from two years of solid growth, mainly due to an expected reduction in the summer crop harvest and high base effects. The heavy rains experienced at the start of the 2022 production season threatened certain crops, with various production areas experiencing visible damage. Although expected to be lower than in the 2020/21 production season, harvest sizes are still likely to exceed their long-term average.
- The South African economy remains on a challenging recovery path. It faces a modest growth outlook unless binding constraints are effectively addressed. Real GDP growth of 2.0% is projected for 2022 (previously 2.2%), potentially slowing to 1.8% in 2023.
- Factors such as rising inflation, higher interest rates and infrastructural constraints locally, alongside a weaker pace of expansion in the world economy and increased uncertainty will take a toll on domestic consumption spending, fixed investment activity and export performance. A gradual recovery of the economy's growth momentum is expected towards the latter part of the five-year outlook period.

South Africa's consumer price inflation:

2021 = 4.5%
2022 = 6.2% (f)
2023 = 5.4% (f)
(Stats SA, IDC forecasts

South Africa's unemployment rate:

Q4 2021 = 35.3%

(Stats SA)

South Africa's economic growth:

2021 = 4.9%
2022 = 2.0% (f)
2023 = 1.8% (f)

(Stats SA, IDC forecasts)

Implications for South African businesses

Potential implications of global economic developments

- Despite a slowing growth momentum in the shorter term, the world economy still presents significant opportunities for export market development by South African business enterprises. These include:
  - Opportunities associated with blocked or restricted entry for a number of Russian commodity exports (e.g. iron ore, platinum, thermal coal) and other products in specific markets due to the imposition of sanctions.
  - Shortages of specific products in global markets due to the ongoing military conflict between Russia and Ukraine may present export market development opportunities for domestic producers (e.g. maize, other food products).
  - A permanent change in the economic relationship between Europe and Russia is likely to translate into major structural changes in various European economies, especially in the composition of their energy sectors going forward and the external sources of required inputs. This could provide opportunities for the

participation of South African producers, both current and prospective, in such markets (e.g. thermal coal exporters in the short- to medium-term, suppliers within renewable energy industries such as those producing solar panels and cells, participants in the emerging hydrogen value chain).

- Opportunities associated with the diversification of sources of input supplies by companies around the globe to minimise the risk of supply chain disruptions.
- Ongoing tensions in the multilateral trading environment, particularly between the major economic powers, are opening up export market development opportunities for domestic business enterprises, as well as attracting foreign producers to South Africa in order to secure continued access to their affected markets.

- To ensure price competitiveness vis-à-vis foreign producers in a high inflation environment, a focus on cost containment and production efficiencies by South African business enterprises is imperative, whether these are export-oriented or competing against imports in the local market.
- Rising living costs in traditional export markets may impact negatively on the demand for consumer (and intermediate) products supplied by South African businesses.
- Domestic exporters servicing the Russian market (e.g. exporters of citrus fruit, apples and pears) may face increasingly challenging trading conditions.
- Slowing economic growth in China may have a negative impact on its overall import demand, whether for raw materials, intermediate products or consumer items, potentially affecting domestic business enterprises servicing these markets. However, efforts by the Chinese government to support economic growth, especially by means of infrastructure development, could provide a basis for sustained demand for commodities and products related to infrastructure investment.
- Uncertainty in the face of increased adversity in the global economic and geopolitical landscapes could impact negatively on investor decision-making in various areas of economic activity.
- However, fixed investment in infrastructure development and the green economy, including renewable energy generation and climate friendly industrial processes, is expected to accelerate globally throughout the outlook period. This should provide export opportunities for local and regional suppliers of associated input materials, intermediate and final products. Investment in renewables is likely to intensify significantly in Europe to address the risks currently faced in its energy sector.
- Monetary policy tightening by major central banks will likely result in substantial volatility in financial markets (equity, bond and currency markets) and risk repricing from time to time.

Potential implications of regional economic developments

- Demand for imported goods is expected to recover in several African countries as economic activity improves over the medium-term. This should bode well for export-oriented business partners, both existing and prospective.
- The normalisation of economic and investment activity in the region over the medium-term, alongside the roll-out of the African Continental Free Trade Area agreement should provide considerable trade and investment opportunities for South African companies. These may include increased exports of consumer items, capital

goods, as well as input materials linked to infrastructure development across the continent.

- Local companies may benefit from investment opportunities associated with cross-border supply/value chain development.
- Considering the region's remarkable potential for renewable energy and abundant mineral resource endowments that are key for the green transition (including copper, cobalt, platinum, nickel, alumina and rare-earth minerals), investment opportunities associated with the development of the global green economy are likely to arise for several African countries.

Potential implications of domestic economic developments

- A higher inflation and interest rate environment is likely to affect domestic consumption spending negatively. Companies that rely on the local consumer market may thus face relatively difficult trading conditions in the short-term. A gradual recovery is, however, expected over the medium-term.
- Facing significantly higher input costs in the months ahead, many business enterprises may struggle to pass the additional cost burden on to their own customers. This will likely result in a profit margin squeeze and, in several instances, financial difficulties.
- Additional interest rate hikes in 2022 and 2023 will raise the cost of borrowings for business enterprises, possibly impacting on the repayment ability of those that already are in a relatively stressed financial position, as well as on demand for debt funding for fixed investment purposes as companies reconsider the potential returns on, and the timing of their investment plans.
- Fixed investment activity may be somewhat limited in several segments of the domestic manufacturing sector in the near to short-term, considering the challenges they currently face. Nonetheless, a gradual improvement in manufacturing activity is expected over the next few years on the back of progressively improving demand both locally and regionally, potentially translating into capital spending of an expansionary nature.
- Investment activity is expected to increase in the exploration and extraction of mineral commodities facing positive prospects, including those associated with infrastructure development and the green economy, and, in certain instances, their beneficiation.
- Operating conditions in agricultural value chains are being adversely affected by the reduced availability and significantly higher prices of fertilisers in global markets due to the Russia-Ukraine conflict and export restrictions in China, as well as by rising costs of inputs such as fuel, wheat and edible oils, among others.
- Agricultural value chains will, however, continue to present a range of development and investment opportunities both in their primary production and processing segments. Similarly, investment opportunities are likely to be found in the supply of inputs to agricultural value chains, including fertilisers, pesticides, machinery and equipment, packaging materials, etc.
- Structural reforms and infrastructure development plans are opening up investment opportunities in the energy, transport and logistics, telecommunications and water infrastructure sectors. Progress is already being made on a number of fronts, such as the renewed roll-out of renewable energy infrastructure, embedded electricity generation (private sector), proceeding with the unbundling of Eskom, providing

opportunities for private sector participation in some of Transnet's operations, and the allocation of broadband spectrum.

- Fixed investment activity of an expansionary or greenfield nature should gain momentum over the medium-term as economic conditions generally improve, existing production capacity in South Africa's industrial sectors is increasingly utilised, and emerging business opportunities across a number of primary, secondary and tertiary sector activities attract investor interest.

Development / investment opportunities to be found in:

- Opportunities associated with the implementation of several masterplans
- Renewable energy generation and the localisation of related components' manufacturing
- Other energy sector opportunities (embedded generation, energy efficiency)
- Green economy opportunities (fuel cells, battery storage, green hydrogen, waste beneficiation, waste recycling, etc.)
- Localisation opportunities (dependent on public sector coordination)
- Increased integration of SA manufacturing in global supply chains (e.g. auto parts)
- Agriculture and agro-processing
- Commodities related to infrastructure developments and the green economy (e.g. copper, cobalt, platinum, nickel, aluminium)
- Water infrastructure
- Telecommunications sector
- Digital economy and other 4IR opportunities
- Advancing regional economic integration

Global economy slowing amid significant challenges

Global economy facing serious headwinds that are constraining its growth momentum

Strong headwinds are constraining the world economy's growth prospects. Key amongst these are excessively high and persistent inflationary pressures worldwide and the consequential shift from a planned gradual normalisation of monetary policy by major central banks towards more aggressive tightening; the far-reaching adverse implications of the military conflict between Russia and the Ukraine since February; as well as the impact of China's zero-Covid policy and associated restrictions on global supply chains and an already slowing Chinese economy.

The world economy's expansion momentum is thus slowing visibly.

Extraordinarily high inflationary pressures

Inflationary pressures have intensified significantly as supply-side constraints in the global economy coincided with strengthening demand as Covid-19 related restrictions eased and pent-up demand was supported by significant fiscal support, especially in advanced economies. The surge in demand placed further strain on stretched supply chains that had been disrupted by lockdown measures adopted since the start of the pandemic.

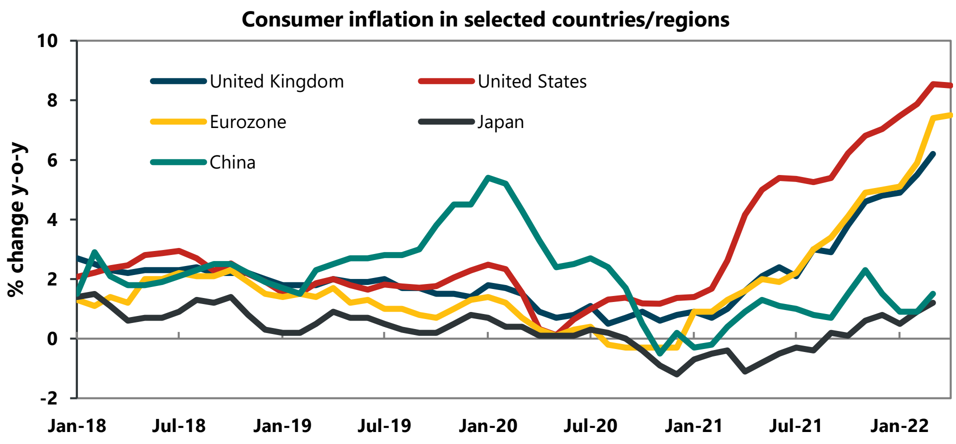
More recently, supply-chain disruptions were exacerbated by shortages of key commodities such as crude oil, wheat and fertilisers, among others, due to ongoing military conflict in the Ukraine and the sanctions imposed on Russia. The resultant demand-supply imbalances in global markets have been resulting in extraordinarily high rates of increase in the prices of a wide range of products and services.

Inflation outcomes at multi-decade highs in various countries/regions.

In the US, consumer inflation reached 8.5% in March 2022, the highest rate since January 1982, driven by significant increases in fuel, housing and food costs. However, it moderated slightly to 8.3% in April. In the Eurozone, the consumer price index (CPI) increased by 7.5% over the year to April, the highest level since the index was first published in 1996. In the UK, inflation measured 6.2% in March, the highest since 1992. Japan's inflation rate of 1.2% in March 2022 was comparatively low notwithstanding the significant price pressures being experienced around the globe. Nevertheless, it was at its highest level since October 2018. In China, consumer inflation has also remained relatively contained from a global perspective, measuring 2.1% in April. South Africa's CPI, in turn, increased by 5.9% over the year to March 2022, slightly below market expectations.

World inflation is thus expected to be significantly higher in 2022. At 7.4% according to the International Monetary Fund's latest projections, this would be highest level in 26 years.

Figure 1: Steep rising trend in consumer price inflation across the world



Source: IDC, compiled using OECD data

Significantly tighter monetary policy is on the cards

Major central banks tightening monetary policy to regain control over inflation

Multi-decade high rates of inflation in most advanced economies have prompted their central banks to withdraw the monetary stimulus provided in response to the Covid-19 pandemic (also known as quantitative easing), and to start raising policy rates.

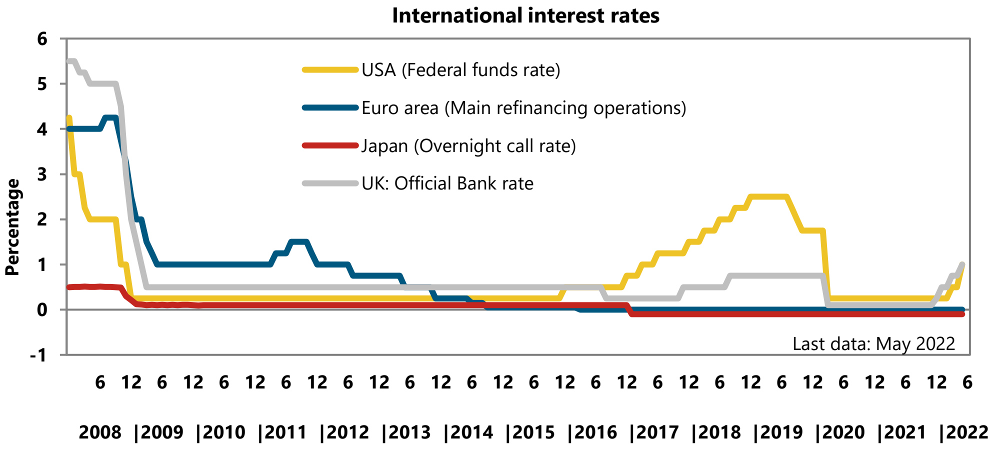
In the US, the Federal Reserve (Fed) ended its bond purchasing programme and has raised interest rates by 75 basis points (bps) thus far. Its chairperson, Jerome Powell, has indicated that US interest rates will continue rising, hinting at additional 50 bps hikes at each of the Fed's June and July meetings. Further increases have also been pencilled-in afterwards, with financial markets pricing in a Fed funds rate of close to 3% by the end of 2022, from 1% at present. The IDC expects policy rates in the US to be raised by an additional 150 bps over the remainder of 2022, reaching the 2.50% level.

The Bank of England (BoE) started raising interest rates earlier than the US Fed, with a cumulative increase of 100 bps to date. In contrast, the European Central Bank (ECB) is still busy tapering down its monetary policy support and is anticipated to implement its first interest rate increase in July 2022. The Bank of Japan, in turn, has indicated that it does not anticipate changes in its policy rate in light of a persistently low inflation environment in Japan. In stark contrast to the monetary policy action of central banks in advanced economies, the People's Bank of China (PBoC) has been providing support to the economy through a range of measures, most notably a reduction in the cash reserves requirements.

Efforts to contain inflation could result in recessionary conditions in certain economies

Strong growth and low unemployment rates in the US and UK provide scope for the respective central banks to tighten monetary policy significantly, although fears of ensuing recessionary conditions have been emerging. The ECB's efforts to control inflation in the Eurozone will be complicated by weakening economic conditions even in the absence of monetary policy tightening. This raises the risk of a serious economic contraction should the ECB raise interest rates significantly. The US Fed, ECB and BoE will have to walk a fine line between efforts to bring inflation under control by tightening monetary policy and pushing their respective economies into a recession.

Figure 2: The interest rate hiking process has begun in earnest



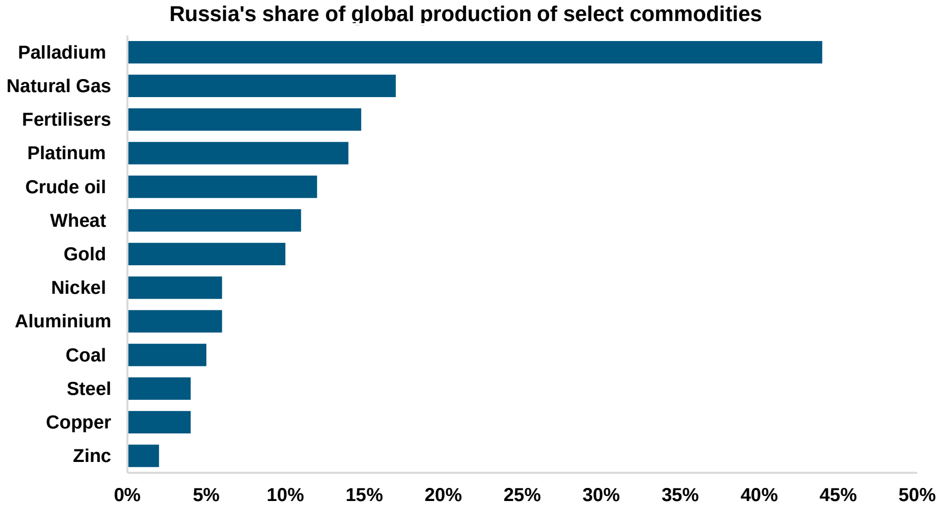
Source: IDC, compiled using, Federal Reserve, ECB, BOE and BOJ data

The Russia – Ukraine conflict is having serious economic repercussions

The ongoing military conflict between Russia and the Ukraine presents an important source of disruption, risk and uncertainty for the world economy in 2022 and beyond.

Russia and the Ukraine are very important suppliers of several commodities in global markets. Russia is a major exporter of crude oil, natural gas and coal among the energy commodities, as well as of palladium, high-grade nickel and iron ore within the industrial commodities grouping. It is also the world's leading exporter of nitrogen-based fertilisers and a major producer and exporter of wheat and maize. The Ukraine, in turn, is an important producer of wheat, maize, barley and seed (edible) oils on the agricultural front, and a significant producer of coal and iron ore.

Figure 3: Russia is a major player in global commodity markets



Sources: J P Morgan, Food and Agriculture Organization, International Fertilizer Association

The protracted nature of this war, the impact of the sanctions imposed on Russia and the severity of the damage being inflicted on production systems in the Ukraine are not only resulting in sharply lower levels of economic activity in both countries but are also affecting the global economy at large.

The transmission channels include disruptions in the supply of crucial products exported by Russia and the Ukraine and the concomitant impacts on supply chains, production activity, volumes traded and prices in global energy, industrial and agricultural commodity markets; the feed-through to producer and consumer inflation, in the process affecting spending by households and business enterprises; the adverse effects on sentiment levels and the performance of financial markets, including equity, bond and currency markets.

Economic slowdown in China, further disruptions to global supply chains

China's zero-covid policy is hampering economic activity

The Chinese government has set the growth target for the economy at 5.5% for 2022. However, renewed waves of Covid-19 infections and the consequent reimposition of mobility restrictions under a zero-Covid policy, alongside efforts to rein in the debt levels of China's property sector, are making it increasingly unlikely that this target can be met.

The central bank is thus expected to continue rolling out support measures, especially since inflation remains at low levels. Moreover, expectations are that further fiscal support will be unveiled, particularly targeting infrastructure investments in an effort to support the economy's performance. However, the positive impacts of such assistance may be eroded if the hard lockdowns affecting a significant number of large cities, most notably Shanghai, persist over a prolonged period and/or are extended to other cities.

Global supply chains facing renewed strain as production activity is constrained in China

The impact of lockdowns is being reflected in weaker consumption spending by households and in lower production activity, including goods destined for export markets. By implication, they are also exacerbating the challenges already faced in numerous supply chains, with further detrimental impacts on prices and global production.

Figure 4: A slowing Chinese economy poses major implications for world trade

Source: IDC compiled from IMF WEO, WTO and World Bank WITS data

Growth prospects for the world economy have been significantly curtailed

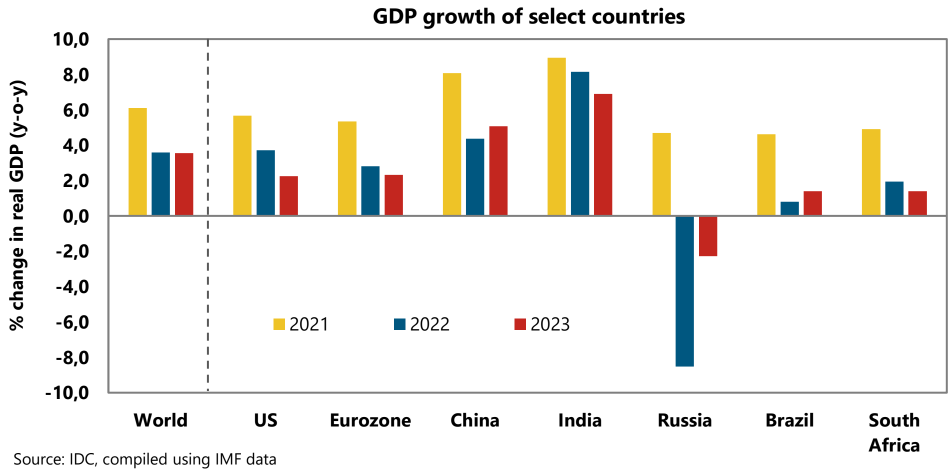
Projections for global economic growth lowered substantially

In light of recent developments, the IMF lowered its forecasts for global economic growth to 3.6% in 2022, from the 4.4% projected in January.

A substantial downward revision was made to the growth projections for the Eurozone, which is being significantly affected by the war in the Ukraine and the sanctions imposed on Russia. The bloc's economy is now expected to grow by 2.8% in 2022, compared to 3.9% previously. The UK's growth rate has been lowered by 1 percentage point to 3.7%, while that of Japan was reduced to 2.4%, a decline of 0.9 of a percentage point. The adjustment to the forecast US growth was relatively smaller at 0.3 percentage points, to 3.7%.

The IMF projects a 4.4% expansion in China in 2022, well below its government's target of 5.5%. The Russian economy is expected to contract by 8.5% as sanctions take a toll on its performance, while the Brazilian economy is anticipated to grow marginally (+0.8%).

Figure 5: Lower expansion momentum now expected for the world economy



Source: IDC, compiled using IMF data

Downside risks to global growth abound

Risks to the global economic outlook remain tilted to the downside. These include the possibility of a further escalation of geopolitical conflicts, the prevalence of very high rates of inflation over a protracted period, aggressive monetary policy in major economies resulting in recessionary conditions, debt sustainability risks, excessive financial market instability, and the possible emergence of new variants of Covid-19 with a degree of resistance to existing vaccines.

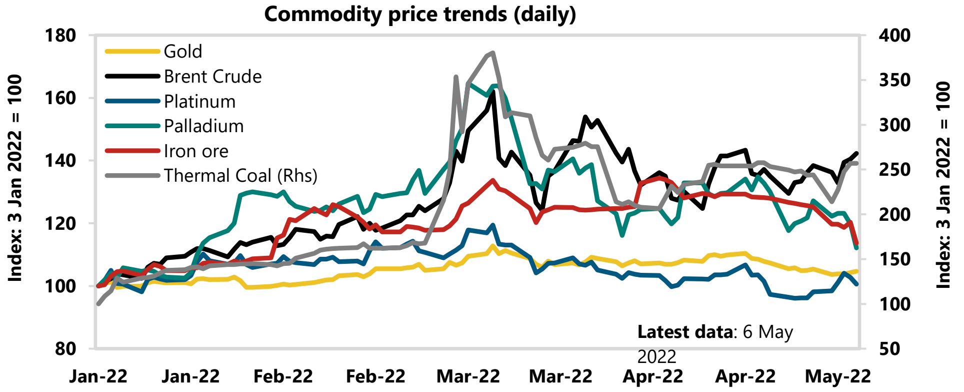
Industrial commodities: Supply disruption risks lift prices

The Russia-Ukraine conflict lifted commodity prices despite a weaker outlook for the world economy

Prices of industrial commodities ascended to historical peaks earlier in the year despite a confluence of downside risks on the demand side. While deteriorating prospects for global growth, partly due to constrained production activity in China, would have normally precipitated a steep correction in commodity prices, supply disruption risks at the onset of the Russia-Ukraine war and the subsequent imposition of sanctions against Russia fuelled prices across the commodities complex. The Bloomberg industrial commodities index has risen more than 20% since the start of the year.

The impact of potential supply disruptions on the commodities complex has been particularly pronounced in the energy markets, given Russia's relative weight in the supply of crude oil (around 11% of global supply), natural gas (45% of the EU's liquefied natural gas supply) and thermal coal. Market scarcity premia consequently propelled prices to historical highs in early March. Supply-demand balances in these energy markets had already been constrained by the dearth of capital investment prior to the Russia-Ukraine conflict, largely due to the decarbonisation mandates and ESG-led capital allocation strategies of financial institutions and investors.

Figure 6: Heightened instability across the commodities complex



Source: IDC, compiled using Bloomberg data

Elevated energy prices raising production costs across the industrial commodities complex

Higher energy costs are expected to filter through into increased production costs across industrial commodity value chains, placing upward pressure on prices. Furthermore, market price volatility is expected to persist in the months ahead in commodity segments where Russia yields a dominant or weighty supply position. Besides energy commodities, these include precious metals (platinum group metals and gold) as well as battery minerals, since Russia yields a dominant position in the supply of battery-grade nickel, a critical input for energy storage technologies.

On the other hand, the likelihood of relatively aggressive monetary policy tightening in most advanced economies, alongside slowing growth in China, represent material downside risks for industrial commodities, at least in the near- to short-term. However, some respite could emanate from the Chinese authorities' promises for the re-enactment of large-scale, commodity-intensive and growth supportive infrastructure investments.

Overall, the short-term outlook for industrial commodity markets remains uncertain, with the risks skewed to the upside over the medium-term. The outlook for brent crude oil, a leading indicator of future price developments in commodity markets, is highly dependent on the outcome of a potential EU embargo on Russian supply. Such an embargo would likely take the global crude oil market into structural deficit, fuelling prices above recent cyclical peaks.

Price dynamics in the PGMs market are likely to be influenced by Russian supply risks, the world economy's slowing expansion momentum and continuing supply chain disruptions in global automotive value chains. In the longer term, however, incremental increases in industrial demand for platinum, which is expected to benefit from the developing global hydrogen economy, augur well for future prices.

Base metals, including copper, aluminium and a suite of battery mineral commodities are expected to benefit from rising industrial consumption intensity globally. Price volatility is, however, expected in the copper market in the shorter term due to the on-streaming of new global refined metal capacity over the next two years.

Commodities associated with the steel value chain, including iron ore and manganese, will be impacted by deteriorating business conditions globally and continuing ESG-related constraints in steel production in China. The ramping up of Vale's production and seaborne export volumes will also pose downside risks for iron ore prices.

Recent developments in and outlook for sub-Saharan Africa

SSA's GDP growth for 2021 revised upwards to 4.5%

Regional economic growth expected to decelerate in 2022 but to remain relatively strong at a projected 3.8%

The economic recovery process in Sub-Saharan Africa (SSA) is facing headwinds of both an external and domestic nature, with GDP growth expected to ebb somewhat.

Following the upward revision of the region's economic growth outcome for 2021 to 4.5% (previously estimated by the IMF at 4.0%), the pace of expansion is expected to moderate to 3.8% in 2022. Various factors, including the anticipated slowdown in the world economy and consequently weaker external demand (especially from China, Europe and the US), the net impact of the Russia-Ukraine conflict, higher inflation and tighter monetary policy, continuing supply chain disruptions and persistent Covid-19 effects, underpin this growth projection.

The expected slowdown in economic activity in some of SSA's key trading partners (indicated in Figure 7 below) may result in reduced demand for the region's exports. The performance of commodity exporting economies will be particularly affected by the slowing expansion momentum in China.

Figure 7: Slower growth in key global markets is likely to affect the region's external trade

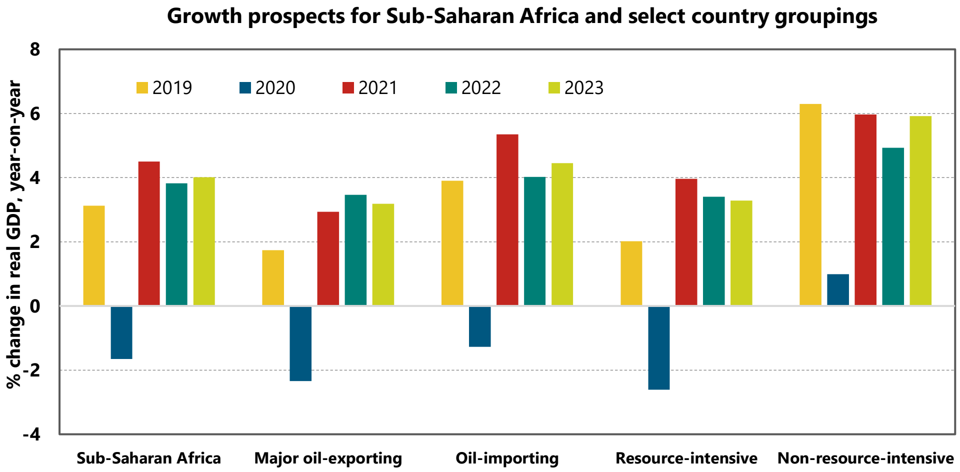
Source: IDC, compiled using UNCTAD data

Although the region's oil producers are likely to benefit from high crude prices and increased demand (for oil produced outside of Russia), both non-resource-intensive and resource-intensive economies in SSA will be adversely affected by elevated inflation. Higher energy and agricultural commodity prices have added to inflationary pressures and increased food security concerns across the region.

Several countries do not have the fiscal means to soften the adverse impact of the abovementioned developments on their economies, while tightening financial conditions in global markets will place further strain on already constrained public finances and potentially raise public debt levels. More than 50% of low-income countries in SSA are already in debt stress or facing higher risks of debt distress.

Sub-Saharan Africa's economy is forecast to post growth rates of around 4% over the medium term, but these will vary significantly across countries. The relatively higher growth projections from 2023 onwards will rely on improved global conditions as most current shocks subside, including the continued easing of Covid-19 related restrictions.

Figure 8: Economic growth momentum likely to weaken for most SSA countries in 2022



Source: IDC, compiled using International Monetary Fund data and forecasts

Ever-present risks to the region's macroeconomic outlook include fiscal constraints, elevated public debt levels, low Covid-19 vaccination rates, growing political and military tensions in parts of the region, climate-related shocks (which are becoming more frequent and severe) and shocks emanating from the global economy.

Given the region's persistent vulnerabilities to external shocks, an ambitious reform agenda is necessary to strengthen its resilience and raise its growth potential. In its latest regional outlook report, the IMF suggests a number of policy priorities in this regard, including the promotion of economic diversification, the development of new industrial capabilities and accelerated implementation of the African Continental Free Trade Area to enhance deeper regional integration and facilitate the development of regional supply chains.

The use of more innovative financing mechanisms to boost investment in the region and the channelling of capital spending towards climate change adaptation and mitigation projects are also deemed to be particularly important. Considering its remarkable potential for renewable energy generation and an enormous endowment of mineral resources that are key for the green transition, the region presents unparalleled investment opportunities.

South African economy under renewed pressure, gradual recovery anticipated

Economic environment worsened

Economic conditions have worsened, with several factors at play

Recent adverse developments in the world's economic and geopolitical landscapes have been affecting the domestic economic environment. The principal contributing factors include the impact of persistently high and still rising global inflation on domestic prices; the implications of monetary policy tightening for local interest rates; the repercussions of the Russia-Ukraine war and associated sanctions on the world economy's performance; a slowing Chinese economy and further supply-chain disruptions due to Covid-19 restrictions; and excessive volatility in financial markets.

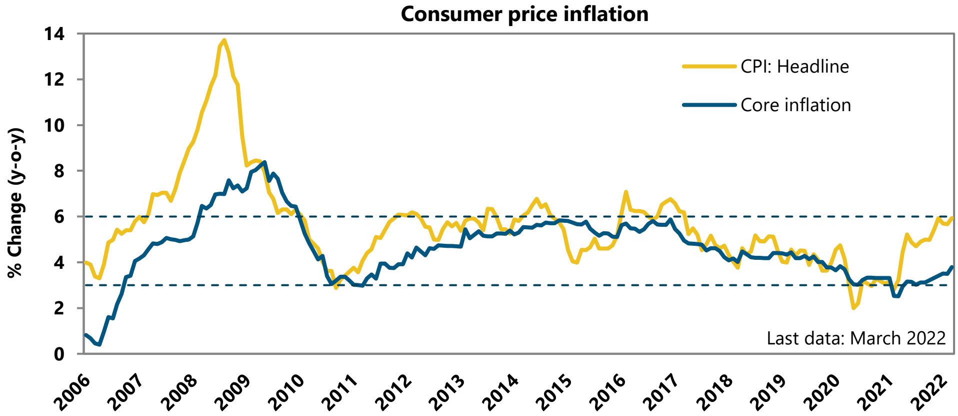
On the domestic front, several factors continue hampering the economy's growth performance, including frequent loadshedding; transport and logistics constraints; rising production costs, particularly freight, electricity and fuel costs, among others; increased competition from foreign producers both in local and external markets; delays in the roll-out of much-needed infrastructure projects; and shortages of input products due to global supply chain challenges. As a result, confidence levels remain low among households, business enterprises and investors, hindering economic activity.

Inflation and interest rates

Inflation on a rising trend and likely to result in more aggressive monetary policy action

Consumer price inflation in South Africa has been on a steep upward trend in recent months, measuring 5.9% (year-on-year) in March 2022, the highest in 6 years and just under the upper band of the SA Reserve Bank's target range. Inflationary pressures have, however, been largely of a cost-push nature. Sharply higher international crude oil prices, exacerbated by the military conflict between Russia and the Ukraine, have played a major role in this regard. Despite relatively favourable ZAR/USD exchange rate movements and a degree of support from the State (a R1.50 per litre reduction of the general fuel levy over the period 6 April 2022 to 31 May 2022), the domestic petrol price was sharply higher. Rising food prices and electricity tariffs contributed further to the worsening inflation trajectory.

Figure 9: Rising inflation leading to more aggressive hikes in interest rates



Source: IDC, compiled using Stats SA and SARB data

Producer price inflation (PPI) for final manufactured goods rose sharply to 11.9% in March 2022, the highest rate of increase in more than a decade, while the prices of intermediate manufactured goods were up by an extraordinary 19.3% and 18.6% (year-on-year) in February and March, respectively. Such developments at the producer level are likely to filter through to some extent to consumer prices. Considering recent developments with respect to several commodity prices, including crude oil, wheat and fertilisers, the outlook for domestic inflation has worsened considerably.

Against this background, the Monetary Policy Committee (MPC) is expected to tighten monetary policy more aggressively in the near- to short-term, as is the case elsewhere in the globe. The repurchase (repo) rate hiking cycle started in November 2021 with an increase of 25 basis points (bps), which was followed by two further hikes of 25 bps each in January and March 2022. The repo rate currently stands at 4.25% and the prime lending rate at 7.75%. The MPC is expected to raise the repo rate by an additional 100 bps over the remainder of 2022 (on top of the 50 bps hike announced on 19 May, which was in line with IDC forecasts) and by a further 25 bps in 2023, taking it to a level of 6.0% by year-end.

Sectoral performances

Economy's recent growth momentum unlikely to be sustained in the shorter term

Despite the significant recovery of the South African economy in 2021, with GDP rebounding by 4.9% from a 6.4% contraction in 2020, the growth momentum in unlikely to be sustained in light of the concerning developments in the global economy discussed earlier in this report as well as several home-grown challenges.

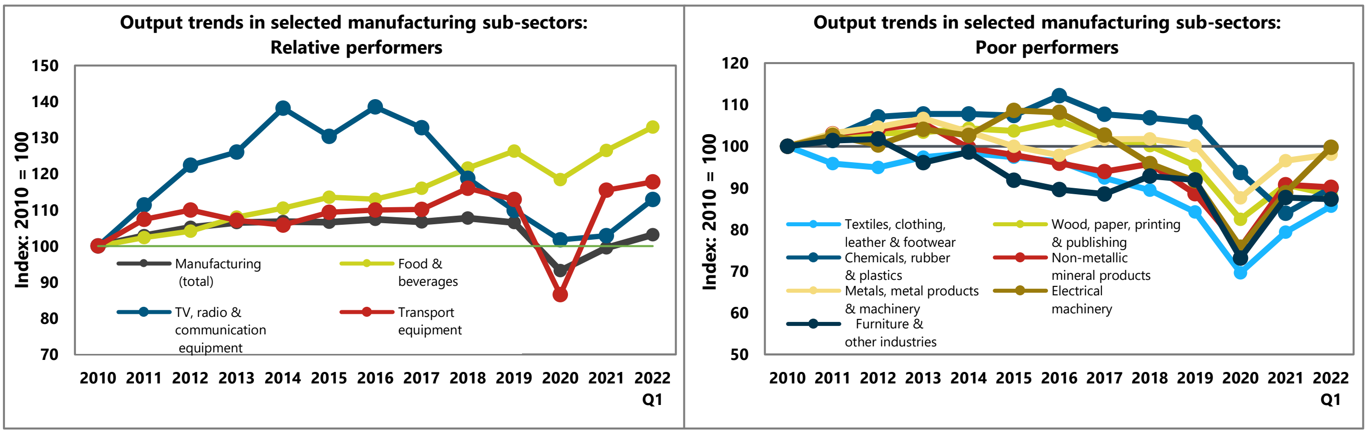
Recent trends in high frequency data for key economic indicators such as mining and manufacturing production, the manufacturing purchasing managers' index, retail and wholesale trade sales, electricity supply, as well as sentiment indices, attest to a challenging business and consumer environment. Furthermore, the downside risks are on the rise.

Manufacturing output has rebounded but remains below pre-pandemic levels

Manufacturing activity recorded a significant recovery in 2021. The sector's GDP increased by 6.6% in real terms (-12.3% in 2020) and rose further in the first quarter of 2022. Nevertheless, the level of output for the sector as a whole remained well below pre-pandemic levels, with numerous sub-sectors still struggling to record higher output on a sustained basis. The sector is facing numerous challenges which are affecting production and investment activity.

Manufacturing production recorded a relatively strong up-tick (+4.6%, quarter-on-quarter) in the first quarter of 2022. This was underpinned by robust growth in the sub-sectors producing transport equipment (+10.6%), chemicals, rubber and plastics (+7.6%), base metals and machinery (+5.7%), food and beverages (+5%), as well as electrical machinery (+3.6%), among others.

Figure 10: The relative performance of selected manufacturing sub-sectors



Source: IDC, compiled using Stats SA data

However, lower output was recorded in sub-sectors such as wood and paper (-4.1%), furniture (-0.5%) and "other manufacturing" (-2.1%). The upward trend in manufacturing output may, however, be short-lived, considering the challenging operating and trading environment at present.

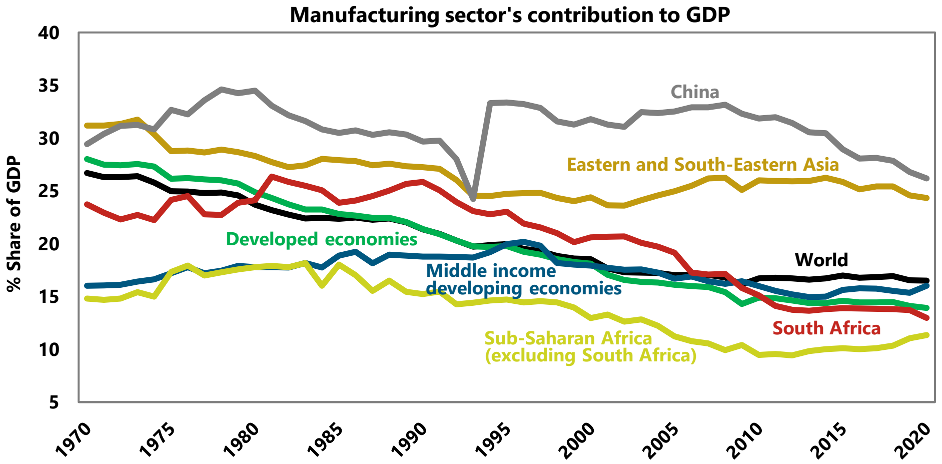
The ABSA purchasing manager's index (PMI) decreased sharply to 50.7 index points in April 2022, from 60.0 in March. This reflected the impact of the devastating floods in KwaZulu-Natal during April, the fallout from the Russia-Ukraine war and the weakening expansion momentum in China. Manufacturers also reported a sharp decline in export sales due to the temporary closure of the Durban harbour and the logistical challenges caused by the floods.

Furthermore, substantially higher prices for imported petroleum products, among others, since the start of the war in the Ukraine have been having adverse production cost implications for local manufacturers, who continue finding it difficult to pass the burden on to consumers in a subdued domestic environment. In addition, the significant downside risks posed by adverse geopolitical developments on the world economy's growth are of concern for export-oriented manufacturers.

Manufacturing's declining share of GDP

The share of manufacturing in world GDP has declined significantly over the decades. The downward trend has been particularly pronounced in South Africa, with the sector's share of national GDP falling from a peak of 26.4% to GDP in 1981 to 13.1% in 2021. This is well below the ratios recorded for China (26.2%), the Eastern and South-Eastern Asian region (24.3%) as well as the middle-income developing economies (16.0%).

Figure 11: Relative contributions to GDP of manufacturing sector for select regions



Source: IDC, compiled using UNCTAD data; SARB data for South Africa

Several challenges continue to affect the performance of South Africa's manufacturing sector in general, including:

- Relatively weak demand conditions, particularly in the domestic economy.
- Electricity supply challenges (availability, reliability).
- Transport and logistics constraints (rail transportation, ports).
- Rising production costs, including freight, electricity, fuel and other input costs.
- Strong competition from foreign producers both in local and external markets.
- Illegal imports affecting certain segments within manufacturing.
- Shortages of certain input products largely due to global supply chain challenges.

- Insufficient investment in new technologies to maintain and/or enhance competitiveness.
- Low business confidence in a challenging operating and trading environment.

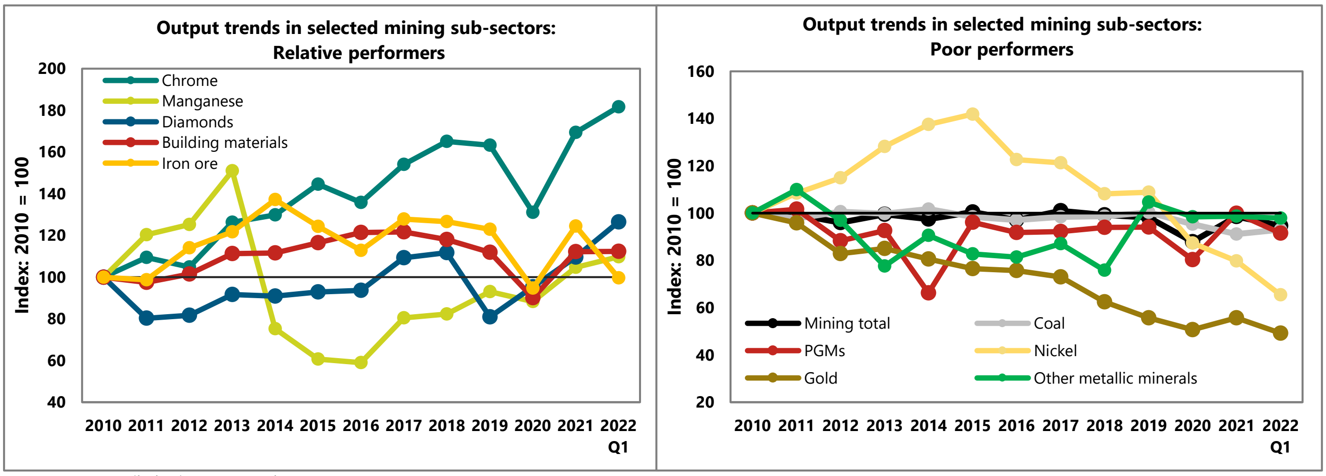
Mining activity constrained by loadshedding and transport and logistics challenges, among other factors

Mining output recovered by 12.1% in 2021, from the sharp 10.4% decline in 2020, with production volumes stabilising at pre-pandemic levels. However, the sector's performance did not mirror the steep rise in commodity prices. Furthermore, the strong recovery momentum could not be sustained at the start of 2022, for overall mining output dipped again in the first quarter.

The sector was particularly affected by loadshedding, transport and logistical challenges, as well as industrial action in some of its segments. Regulatory processes also remain a hindrance to much needed investment in exploration and self-generation of electricity by mining companies.

Overall mining output fell by 1.5%, quarter-on-quarter, in the first quarter of 2022. Steep declines were recorded in the mining of iron ore (-12.2%), PGMs (-11.8%) and gold (-7.1%). The output of the coal and manganese mining sub-sectors, on the other hand, increased by 6.5% and 12.7%, respectively, on a quarterly basis. Iron ore production was adversely affected by challenging operating conditions experienced by Kumba Iron Ore, including high rainfall and issues with the availability of equipment due to continued supply shortages of certain spare parts. In addition, export volumes were impacted by transport and logistical constraints.

Figure 12: The relative performance of selected mining sub-sectors



Source: IDC, compiled using Stats SA data

Despite lower mining production in the first quarter of the year, the nominal value of total mining sales rose by a further 6.5% (quarter-on-quarter), supported by higher market prices as the Russia-Ukraine conflict unfolded. This followed a 40% increase in 2021.

The war may have limited direct consequences on the volume of South Africa's minerals commodity trade due to the limited economic ties with Russia. Possible export gains may, however, arise in the coal, platinum and iron ore segments should South Africa replace some of Russia's supply share in specific global markets.

The indirect ramifications, however, provide cause for concern. Excessive volatility in commodity prices, while being tentatively beneficial for revenue generation by the mining sector, also bears longer term risks as steep increases in prices provide an incentive for previously mothballed production capacity elsewhere in the world to resume operations.

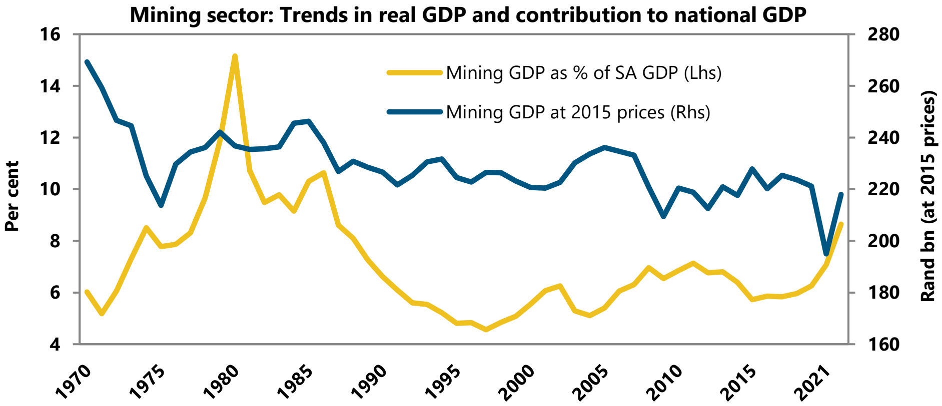
The risk that an influx of global mine supplies could precipitate sharp price corrections across the commodities complex in ensuing periods also complicates production planning in the mining industry, with potentially adverse implications for investor sentiment.

Mining sector recapturing some of its lost share of national GDP

South Africa's mining sector has faced significant challenges over the years, with lower output having been recorded on an annual basis in six out of the past ten years. Nonetheless, higher commodity prices supported overall mining and mineral sales, thus underpinning a rising relative contribution of the mining sector to national GDP over the past 25 years.

By 2021, the mining sector accounted for 8.6% of overall GDP (at current basic prices), compared to 5.1% in 2004 and 4.6% in 1997.

Figure 13: Mining sector's share of national GDP recovered in recent years



Source: IDC, compiled using SARB data

Agriculture production has been remarkably resilient since the onset of the Covid-19 pandemic. Agriculture was in fact the fastest growing sector (a 13.4% increase in its GDP) in the economy in 2020 and the second-fastest (+8.3%) in 2021.

Agriculture sector's performance in 2022 unlikely to match those of the past two years

2022 will, however, likely mark a break from two years of solid growth, mainly due to an expected reduction in the summer crop harvest and high base effects. The heavy rains experienced at the start of the 2022 production season threatened certain crops, with various production areas experiencing visible damage. Although expected to be lower than in the 2020/21 production season, harvest sizes are still likely to exceed their long-term average. The third production estimates of the Crop Estimates Committee (CEC) indicate that summer crop production could decline by 7.2% in 2022 to about 17.84 million tons, with the commercial maize crop projected to be 9.8% lower than in 2021.

The ongoing military conflict between Russia and the Ukraine presents an important source of risk and uncertainty for the agriculture sector in 2022 and beyond. Russia and Ukraine are very important suppliers of several commodities in global markets. Russia is the world's leading exporter of nitrogen-based fertilisers (14% of global exports), a major producer and exporter of wheat and maize, as well as a major exporter of petroleum products and gas.

Sharply higher fertiliser prices will affect agricultural production costs in South Africa to a major extent. Moreover, potential shortages of fertilisers and/or input materials in world markets may compromise their availability domestically and, by implication, affect output levels in a range of agricultural segments. Such developments will tend to aggravate inflationary pressures and impact significantly on the affordability of staple food products for the most vulnerable segments of the population.

Although Russia is the world's largest wheat exporter, it is the source of only 7.1% of South Africa total wheat imports, which emanate mainly from Australia (30.5%), Lithuania (23.3%) and Latvia (16.2%). Ukraine, in turn, is an important producer of wheat, maize, barley and seed (edible) oils to world markets. The ongoing conflict and the associated imposition of sanctions on Russia have been restricting the availability of these commodities in world markets and raising prices, including those of key inputs such as fertilisers and fuel. Challenges in the fertiliser market have been exacerbated by export restrictions in China, the world's second largest exporter of fertilisers (12% of global exports). Input costs in the domestic agriculture sector have consequently been increasing sharply.

The export performance of specific segments of the domestic agriculture sector will also be adversely affected by the ongoing Russia-Ukraine war. South Africa exports about 7.0% of its citrus production and 9.3% of its apples and pears (in value terms) to Russia, with this country in fact being the second-largest external market for locally produced apples and pears. Given the significance of the Russian market to South African fruit producers, the rerouting of volumes to other export markets and the domestic market could result in downward pressure on prices, affecting export earnings and farming incomes. This will likely have negative implications for the 2022/23 season and the general performance of the agriculture sector in 2023.

Employment creation lagging the economic recovery

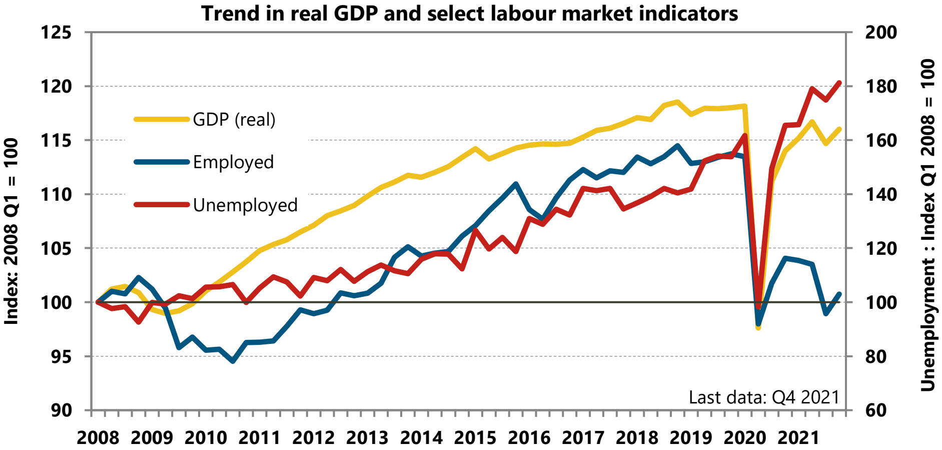
Employment creation lagging the economic recovery, with unemployment at record highs

Despite the economic recovery in 2021, the South African economy was unable to meaningfully reduce its extremely high unemployment levels, with many companies remaining in a difficult financial position and/or are hesitant to employ additional staff under current operating and trading conditions.

In the fourth quarter of 2021, substantial job losses (formal and informal sector combined) were reported in the following sectors of the economy on a year-on-year basis: community and social services (-286 500); manufacturing (-174 200); and retail and wholesale trade (-167 500).

By the end of 2021, the economy employed about 1.9 million fewer people compared to pre-pandemic levels. Approximately 7.9 million people did not have a job in the final quarter of the year and the unemployment rate increased to 35.3%. Amongst the youth (ages between 15 and 24 years) the unemployment rate stood at a staggering 66.5%.

Figure 14: Employment lagging the economic recovery



Source: IDC, compiled using Stats SA data

The unemployment rate is expected to remain at elevated levels for some time and may even rise further over the next couple of years before some moderation ensues. This poses major challenges for government as it strives to address the widespread poverty and inequality still prevailing in South Africa.

Growth outlook

The domestic economy remains on a challenging recovery path. It faces a modest growth outlook unless binding constraints to growth are effectively addressed.

Real GDP growth of 2.0% is projected for 2022 (previously 2.2%), potentially decelerating to 1.8% in 2023, as a weaker pace of economic expansion globally, rising inflation and higher interest rates domestically, as well as increased uncertainty due to adverse developments in the global arena take a toll on South Africa's export performance, domestic consumption spending and fixed investment activity.

Real GDP growth is projected to average 2.3% per year over the period 2022 to 2027, with a gradually faster growth momentum anticipated towards the latter part of the outlook horizon. This is premised on the assumption that the necessary structural reforms, as pledged in the Economic Reconstruction and Recovery Plan, are progressively implemented, for they are imperative to underpin investment activity. Without significantly faster rates of growth in capital spending, South Africa's growth potential will not be raised meaningfully.

Consumer spending is expected to remain under pressure, especially in 2022/23, due to a worsening inflation environment and higher interest rates, compared to previous forecasts. As investment activity gradually recovers and economic growth gains some momentum, additional jobs are likely to be created. This will result in increased incomes, which could underpin an up-tick in household spending, particularly towards the latter part of the outlook period.

Fixed investment is expected to increase at a somewhat subdued pace over the next few years, tempered by significant risks that are denting investor and business sentiment both domestically and globally. Key risk factors in the near- to short-term include continued loadshedding; transport and logistics challenges; geopolitical developments, supply chain disruptions and weaker economic growth globally, as well as developments regarding Covid-19.

Table 1: Projections for key performance indicators of the South African economy

Variable (% change or % of GDP)	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f	2026f	2027f
Real GDP growth and its components:												
Household consumption expenditure	0.7	1.7	2.4	1.1	-6.5	5.7	1.7	2.1	2.4	2.8	3.1	2.6
Government consumption expenditure	2.0	-0.3	1.0	2.7	1.3	0.0	0.1	0.3	1.2	1.0	0.9	0.8
Gross fixed capital formation	-1.9	-2.0	-1.8	-2.4	-14.9	2.0	2.7	3.3	3.4	4.7	5.1	4.2
Exports	0.4	-0.3	2.8	-3.4	-12.0	9.9	2.7	2.8	3.1	2.7	2.9	2.4
Imports	-4.1	1.5	3.2	0.5	-17.4	9.4	2.4	3.1	3.5	3.7	3.9	2.7
GDP	**0.7**	**1.2**	**1.5**	**0.1**	**-6.4**	**4.9**	**2.0**	**1.8**	**2.2**	**2.4**	**2.7**	**2.5**
Consumer price inflation	6.3	5.3	4.6	4.1	3.3	4.6	6.2	5.4	4.2	4.5	4.3	4.1
Current account balance (% of GDP)	-2.7	-2.4	-3.0	-2.6	2.0	3.7	0.7	0.6	0.1	-1.0	-2.2	-3.4
GFCF as % of GDP	17.4	16.4	15.9	15.3	13.8	13.0	13.0	13.2	13.6	14.0	14.5	14.8

Source: IDC, compiled using SARB data, IDC forecasts

Although public finances are expected to improve over the medium-term, the fiscal metrics remain of concern. The budget deficit is projected to widen to -5.9% of GDP in 2022 (-5.4%

in 2021), narrowing gradually in subsequent years. Although the credit rating agencies are not expected to downgrade the sovereign rating further, they continue to express concerns over the economy's weak growth prospects and the slow pace of structural reforms.

Conditions in external markets should still underpin a generally good export performance going forward. However, export growth is projected to be sharply lower in 2022 due to the high base effects set in 2021 and a slower pace of economic expansion globally. World trade will also be adversely affected in the short-term by the ongoing conflict in Ukraine and the sanctions imposed on Russia, as well as due to supply shortages and logistics constraints emanating from Covid-19 related lockdowns in China.

Several commodity markets should continue experiencing generally favourable conditions both in terms of volume demand and prices, while gradually recovering global and regional (Sub-Saharan Africa) demand over the outlook period should underpin improved demand for locally manufactured goods and agricultural products.

Considering the South African economy's strong reliance on imported capital goods such as machinery and equipment, consumer related goods (e.g. motor vehicles), intermediate goods (e.g. chemicals and chemical products), as well as energy (e.g. crude oil, refined petroleum), demand for imports should remain fairly strong over the forecast period. However, should some of the binding constraints be effectively addressed and progress made in raising the general competitiveness of local business enterprises, there should be ample opportunities for import replacement.

The rand is likely to remain under pressure in the short-term as USD strength persists or intensifies on the back of factors such as aggressive policy rate hikes by the US Federal Reserve and the relative preference for US dollar-based assets in an uncertain global environment. Favourable terms of trade and rising domestic interest rates should, however, counter to some degree the downward pressure on the rand in the short-term.

The inflation outlook has worsened significantly due to externally driven supply-side shocks. Domestic inflation is now expected to average 6.2% in 2022 (previously 4.7%). Assuming substantially reduced inflationary pressures globally and a concomitant deceleration of petrol and food prices increases domestically, consumer inflation is projected to moderate over the outlook period to around the mid-point of the inflation target band.

To curb rising inflationary pressures in the short-term, the Monetary Policy Committee is expected to raise the repo rate by an additional 100 bps over the remainder of 2022 (on top of the 50 bps hike announced on 19 May, which was in line with IDC forecasts) and by a further 25 bps in 2023. A gradual easing is projected from 2025 onwards, providing some relief to consumers and businesses.

Department of Research and Information

20 May 2022