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South Africa Economic Outlook

Forecast scenarios for key macro data in 2023

30 January 2023

About this document

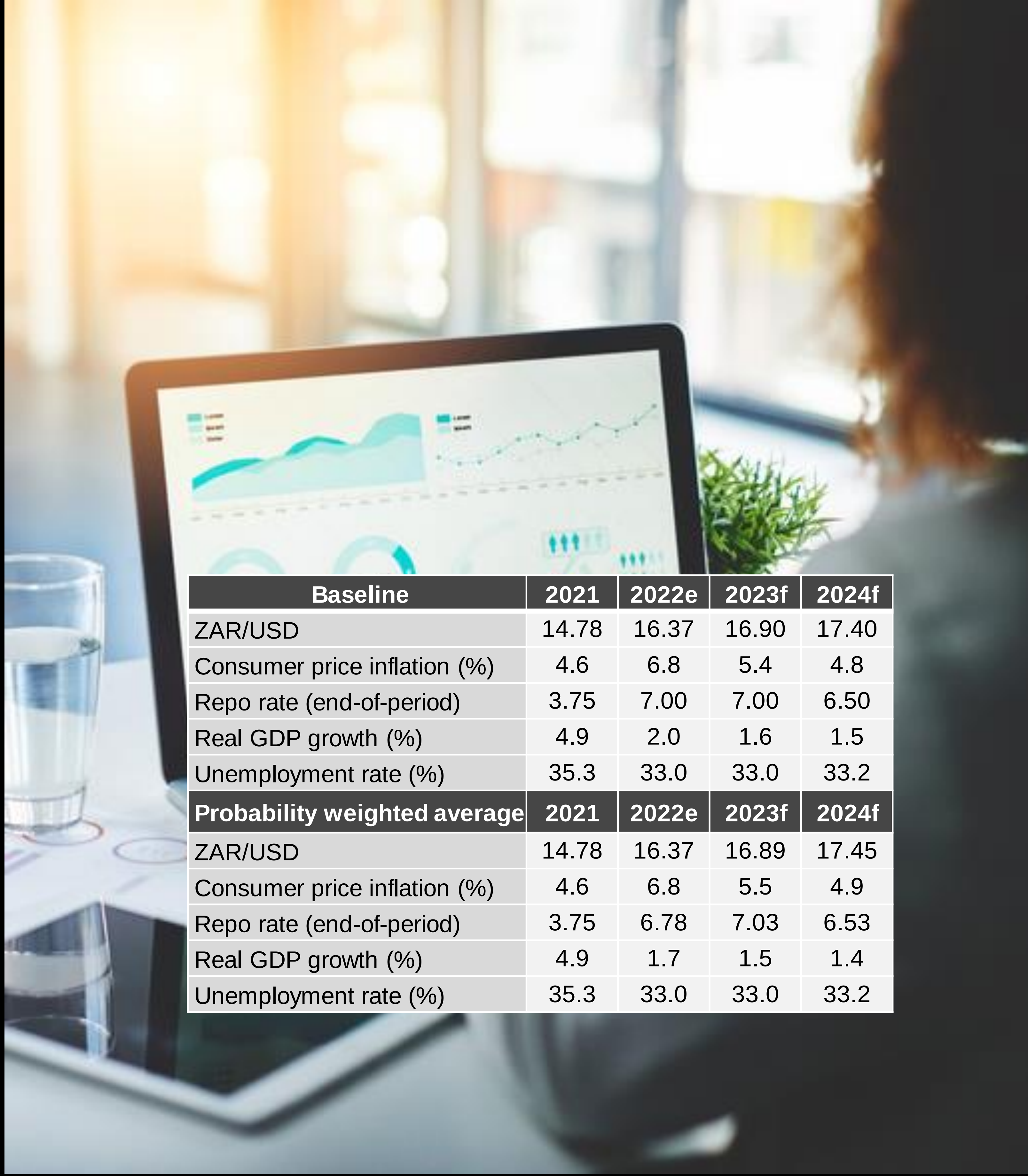
In the first edition of the South Africa Economic Outlook for 2023, we review PwC's current scenarios for five key macroeconomic variables: the exchange rate, consumer price inflation, interest rates, economic growth and the unemployment rate.

The year started with many uncertainties — some old, some new — which could result in different macroeconomic scenarios playing out during 2023. In this report, we look at some of the narratives surrounding different scenarios for the following variables:

- Exchange rate: Highly-traded rand's value will (as always) be determined by local and global factors (page 3).
- Consumer price inflation: Declining trend set to continue as production cost pressures decline (page 4).
- Interest rates: Monetary policy could start easing in the second half of the year (page 5).
- Economic growth: Load-shedding remains the biggest challenge to growing the economy (page 6).
- Unemployment rate: A turning point in 2023 followed by increased joblessness thereafter (page 7).

In our regular Environmental, Social and Governance (ESG) focus, we look at the actions that will be taken in 2023 towards implementing South Africa's Just Energy Transition Investment Plan (JET IP), and what the country's decarbonisation journey means for private companies (page 8).

Lastly, we reflect on how PwC can assist with economic scenario planning (page 9).



Baseline	2021	2022e	2023f	2024f
ZAR/USD	14.78	16.37	16.90	17.40
Consumer price inflation (%)	4.6	6.8	5.4	4.8
Repo rate (end-of-period)	3.75	7.00	7.00	6.50
Real GDP growth (%)	4.9	2.0	1.6	1.5
Unemployment rate (%)	35.3	33.0	33.0	33.2
Probability weighted average	**2021**	**2022e**	**2023f**	**2024f**
ZAR/USD	14.78	16.37	16.89	17.45
Consumer price inflation (%)	4.6	6.8	5.5	4.9
Repo rate (end-of-period)	3.75	6.78	7.03	6.53
Real GDP growth (%)	4.9	1.7	1.5	1.4
Unemployment rate (%)	35.3	33.0	33.0	33.2

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Exchange rate: Highly-traded rand's value will (as always) be determined by local and global factors.

South Africa Economic Outlook January 2023

South Africa's rand was the tenth-most volatile and 18th-most traded currency during 2022.

The South African rand is amongst the most traded currencies globally. It was the 18th-most traded currency in April 2022 (latest available comparative data from the Bank of International Settle-ments) out of 180 currencies globally. The frequency of rand-related transactions also results in a very volatile exchange rate: the rand/US dollar pairing was the tenth-most volatile exchange in 2022, according to the Bank of International Settlements (BIS).

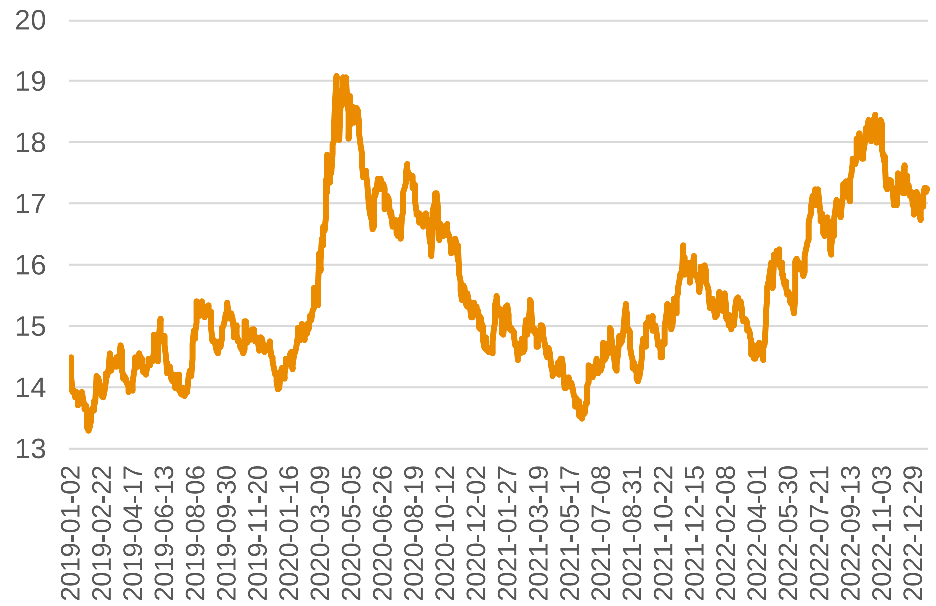
Table 1: Most traded currencies (April 2022)

Currency	Share of global currency transactions	Currency	Share of global currency transactions
US dollar	44.3%	Norwegian krone	0.9%
Euro	15.3%	New Zealand dollar	0.9%
Japanese yen	8.4%	Indian rupee	0.8%
British pound	6.5%	Mexican peso	0.8%
Chinese yuan	3.5%	Taiwan dollar	0.6%
Australian dollar	3.2%	**South African rand**	**0.5%**
Canadian dollar	3.1%	Brazilian real	0.5%
Swiss franc	2.6%	Danish krone	0.4%
Hong Kong dollar	1.3%	Polish zloty	0.4%
Singaporean dollar	1.2%	Thai baht	0.2%
Swedish krona	1.1%	Israeli shekel	0.2%
South Korean won	1.0%	Other	2.9%

Source: Bank of International Settlements (BIS)

This volatility was especially evident at the start of December when uncertainty over the political fate of President Cyril Ramaphosa caused a flurry of trades in South African assets. The rand weakened from below R17/$ on November 30 to nearly R18/$ on December 1, with the currency's one-week implied volatility at its highest in two years at the start of December.

Figure 1: ZAR/USD and volatility index



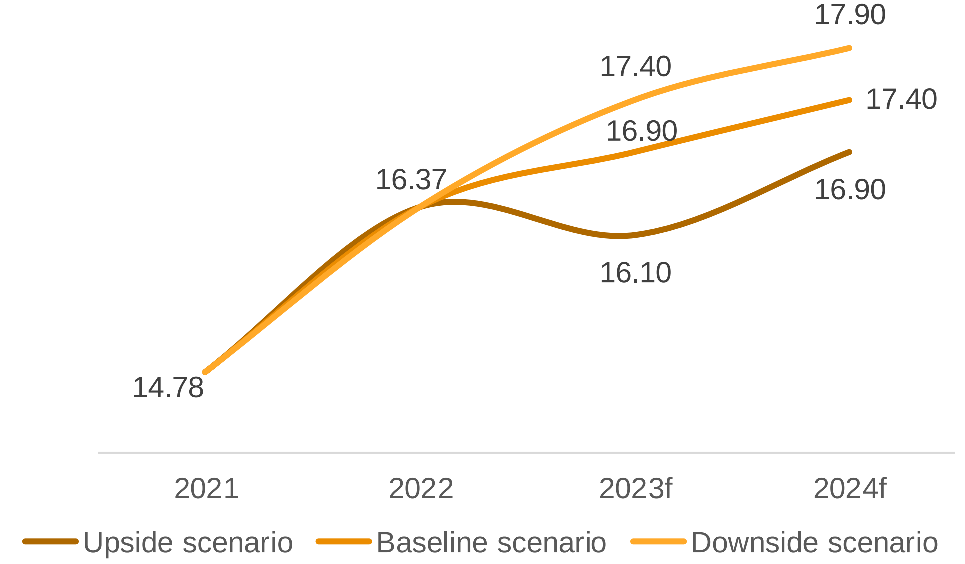
Source: SARB

The rand will again be hard to predict in 2023, with a long list of global and local risk factors.

The rand's volatility makes it hard to predict the value of the currency over the short term. At the start of 2022 we forecast the rand to average R15.28/$ during the year. The South African currency eventually averaged a weaker R16.37/$ during 2022. The biggest factor in the gap between our forecast and the eventual average was the global fallout from the Ukraine-Russia conflict which was unforeseen in January 2022. Military activity in Ukraine resulted in the disruption of many global supply chains, not least of which was the export of food supplies (like wheat and sunflower oil) that South Africa purchases from the country. The conflict also increased global energy prices and geopolitical tensions between the West and the East. These are all factors that have an adverse impact on the value of emerging market assets (like the rand) in global financial markets.

The key question for 2023 is: what are the major global risks that could roil financial markets once more and cause volatility in the rand? We can look at Eurasia Group's recently released list of top ten risks for 2023 to understand the diversity of factors that could impact the global environment. This includes, amongst many others, governance risks in the world's largest economies, including political divisions in Washington. Globally, the political and economic ripple effects of decades-high inflation will add to household financial stress and could stoke social discontent and instability. Other risk factors include technological advances in artificial intelligence (AI) that will erode social trust and disrupt businesses and markets. On the local front, local policy developments will again be a key driver of rand movements.

Figure 2: Rand/$ scenarios



Source: PwC

Consumer price inflation: Declining trend set to continue as production cost pressures decline.

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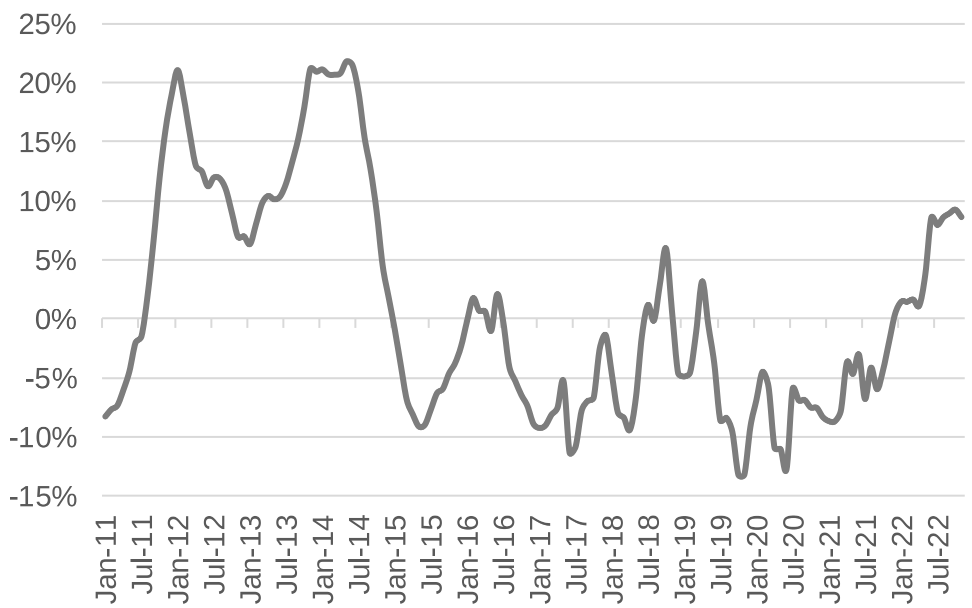
Supply chain cost pressures are moderating after producer price inflation peaked in July 2022

The value of the rand against other currencies has a direct impact on the cost of living due to South Africa's dependence on imports. For example, more than half of the clothing and textiles sold in the country are imported, with almost 60% of these imports coming from China. South Africa imported nearly R25bn worth of apparel, clothing and accessories during the first three quarters of 2022. According to Statistics South Africa (Stats SA), imported clothing and footwear cost 8.9% y-o-y more in November 2022, with footwear being 18.9% y-o-y more expensive to buy from abroad. This kind of supply chain pressure contributed to overall inflation on imported goods rising to 9.2% y-o-y in October (the highest in eight years) before moderating to 8.6% y-o-y in November.

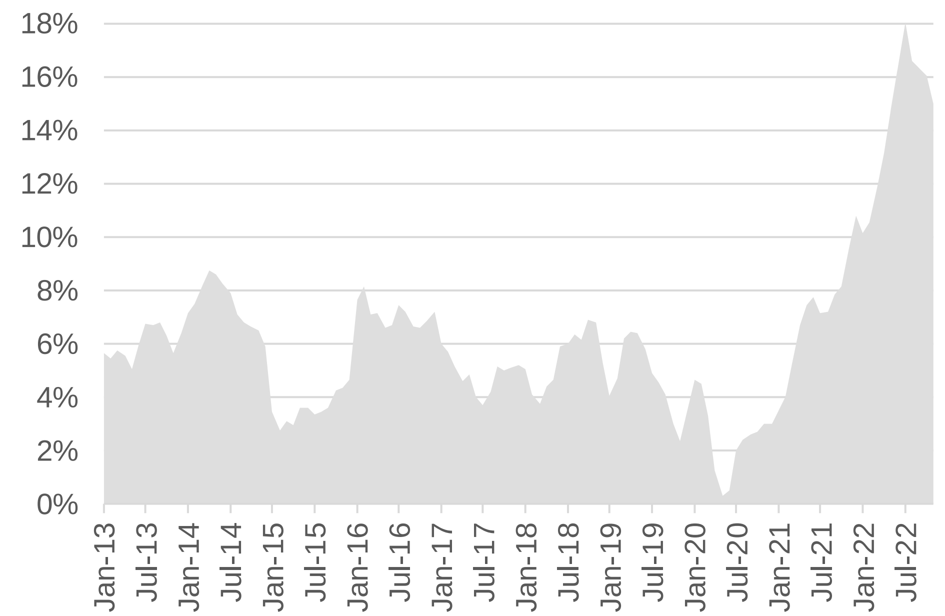
Figure 3: Imported inflation (% y-o-y)



Source: Stats SA

Aside from final goods imports, South Africa also purchases many production inputs from abroad. For example, imported grain mill products cost 29.0% y-o-y more in November last year, with global grain prices spiking in 2022 as exports from key supplier Ukraine dried up. With the elevated cost of these imported inputs, the local production cost of bakery products increased 11.9% y-o-y in November. Overall, the producer price index for final manufactured goods increased by 13.5% y-o-y in December. On a positive note, PPI inflation peaked in July (18% y-o-y) last year, and following declines in the subsequent five months, is now seen as being on a downward trend. PPI inflation is expected to average 6.0% in 2023. This is good news from a pricing perspective at the retail level: with less inflation pressure in the supply chain, shop prices will also soon see less upward pressure.

Figure 4: Producer price inflation (% y-o-y)

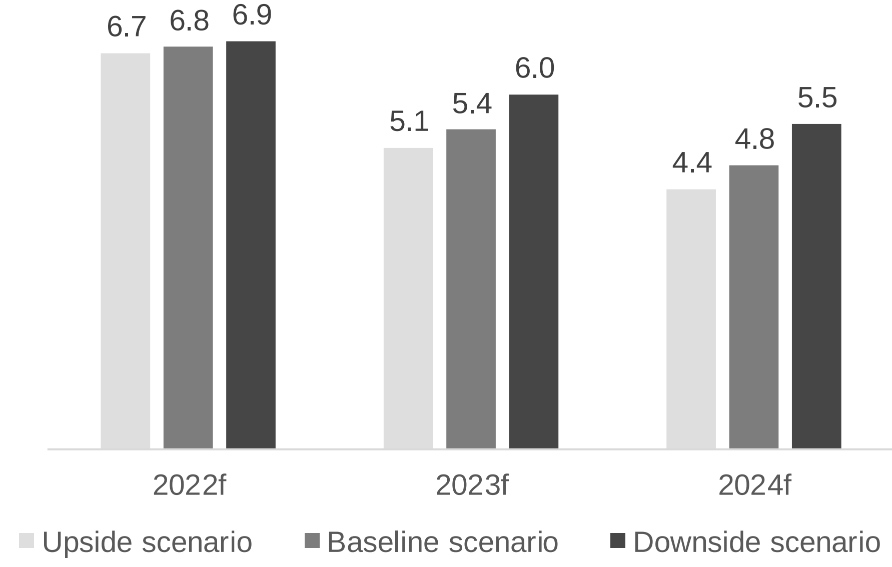


Source: Stats SA

Inflation is expected to average 5.4% this year, but with a downside scenario risk of up to 6.0%.

With easing supply chain cost pressures in mind, as well as the impact of tighter monetary policy (see page 5), we expect consumer price inflation to moderate from 7.4% y-o-y in 2022Q4 to around 4.8% y-o-y in 2023Q4. On a calendar year basis, our baseline scenario is for inflation to average 5.4% this year from a mean of 6.8% in 2021. The 5.4% reading is still elevated compared to the inflation target range (3%-6%) as well as the central bank's favour for inflation to be closer to the midpoint (4.5%) of the target. This mid-point is only likely to be a more familiar feature of inflation data during 2024. Our downside scenario projects average inflation of 6.0% in 2023, and includes additional pressures emanating from higher international fuel prices due to the enduring Ukraine-Russia conflict.

Figure 5: Consumer price inflation (% y-o-y) scenarios



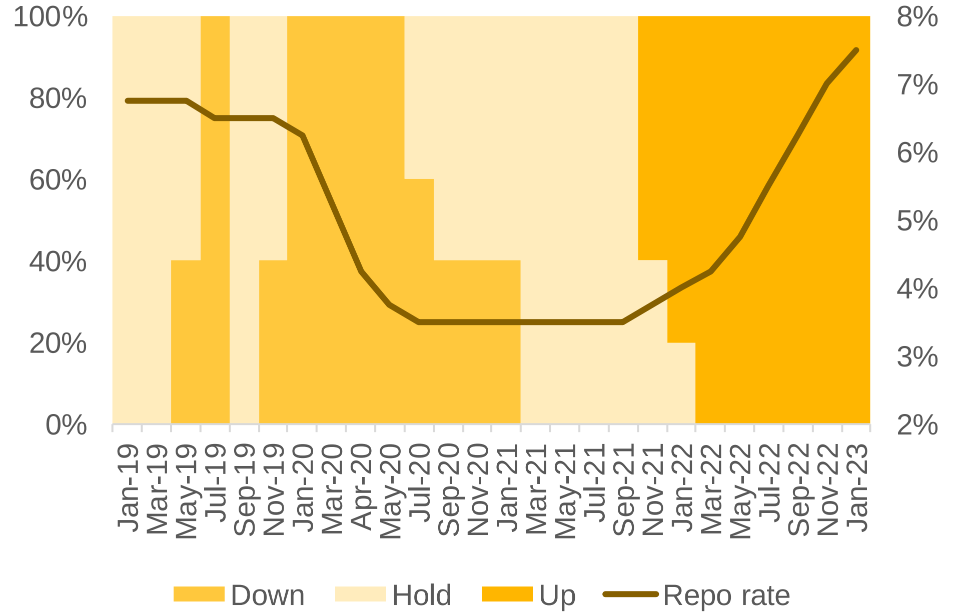
Source: PwC

Interest rates: Monetary policy could start easing in the second half of the year.

South African Reserve Bank (SARB) Monetary Policy Committee (MPC) lifts repo rate by another 25 bps in January.

The SARB MPC lifted interest rates by a further 25 basis points at its meeting in January. The central bank has lifted interest rates by a cumulative 375 basis points since November 2021 as it normalised monetary policy (following big rate cuts in 2020H1) and attempted to manage local inflation expectations as price pressures escalated in 2022. This month witnessed the sixth consecutive unanimous vote by the five MPC members to lift interest rates, with the repo rate now at the highest level since before the 2008-2009 global financial crisis. We do, however, want to highlight that recent monetary policy tightening has been less aggressive (based on the cumulative upward adjustment over a similar time period) compared to several instances in the recent past. This includes hiking cycles that started in 1994, 1998 and 2002.

Figure 6: SARB MPC votes

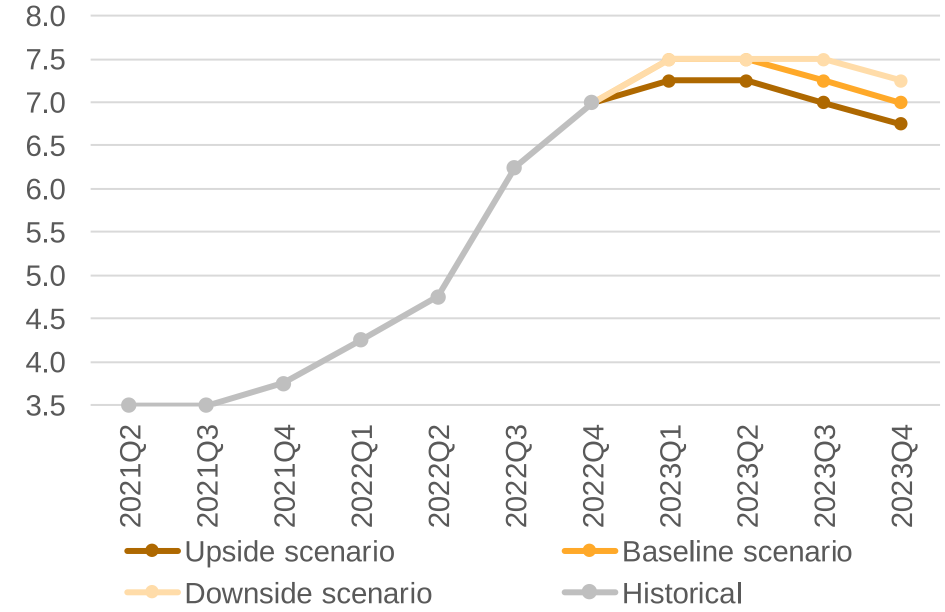


Source: PwC calculations based on SARB data

Interest rates are on the cusp of peaking and could start declining from the third quarter of the year.

The SARB bases its interest rate decisions on forward-looking considerations, specifically their inflation forecasts. The latest SARB projections indicate the central bank expects inflation to be around the midpoint (4.5%) of the target range from the third quarter of 2023. As such, we expect interest rates to start easing in the second half of this year, given that recent monetary policy tightening has taken the repo rate to above its pre-pandemic level. However, with continued upside risks to the inflation outlook, there will be limited scope for lowering interest rates this year and heading into 2024.

Figure 7: Repo rate (%) scenarios



Source: PwC

Non-performing loans (NPLs) increase to a 'modest level' of 4.7% of banks' gross loan books.

A key question is whether the monetary policy tightening seen since 2021Q4 has had a significantly adverse effect on the local economy, in particular the consumer. There is concern about debt dynamics given that non-performing loans (NPLs) as a percentage of gross loans and advances increased to 4.7% of total gross loans by October 2022, easing to 4.6% in the month thereafter. This is higher than an average of 4.0% seen over the past 15 years. However, the SARB noted in its latest Financial Stability Review (published in November 2022) that it viewed NPLs as being at only a "modest level". On a positive note, the latest FNB/BER Consumer Confidence Index (CCI) shows that the majority of South African households actually expect an improvement in their finances over the next 12 months, despite the recent increase in lending rates. This optimism is already evident in credit data: private sector credit extension (PSCE) increased by 9.74% y-o-y in September, which was the highest since 2015.

25bps

The SARB MPC lifted interest rates by a further 25 basis points at its meeting in January. The central bank has lifted interest rates by a cumulative 375 basis points since November 2021

Economic growth: Load-shedding remains the biggest challenge to growing the economy.

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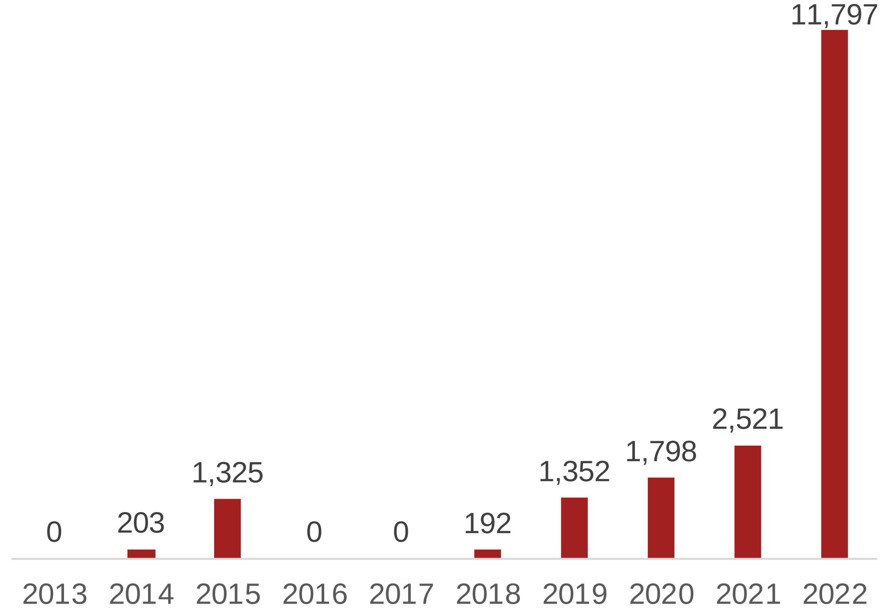
Load-shedding on 208 days reduced real GDP growth by up to five percentage points in 2022.

Statistics South Africa (Stats SA) reported early in December that the local economy expanded by 1.6% q-o-q in 2022Q3 at a seasonally adjusted and annualised rate. This positive number kept the country from falling into a technical recession after the economy shrank by 0.7% q-o-q in the preceding three-month period. With the positive growth seen in the third quarter, the South African economy was 4.1% y-o-y bigger in 2022Q3. However, as with many of the recent quarters, q-o-q and y-o-y economic growth was below potential due to electricity load-shedding. Rolling blackouts were implemented on 208 days during 2022 (or four days every week), totalling 11,797 Gigawatt hours (GWh) of lost power last year.

Figure 8: Electricity load-shedding (GWh)



Sources: Council for Scientific and Industrial Research (CSIR), EskomSePush

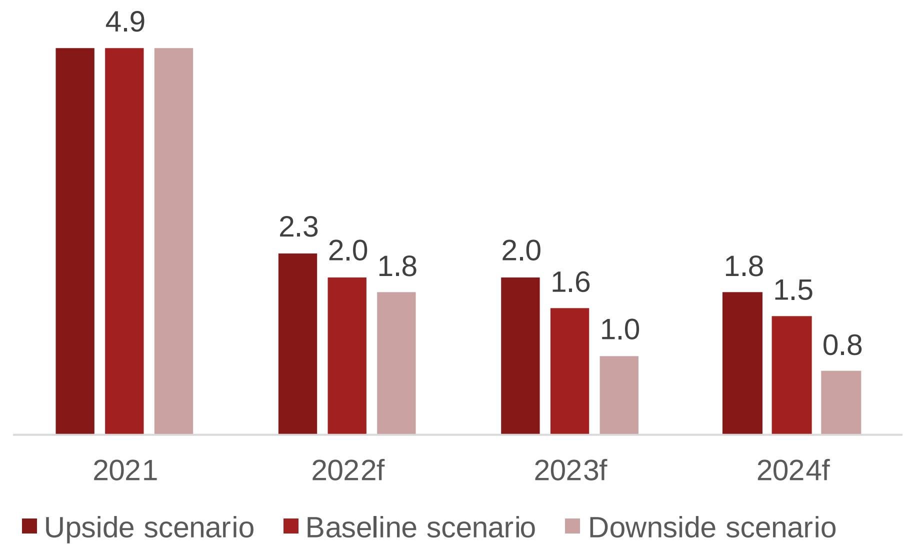
We previously estimated that South Africa lost 2.9 percentage points of real GDP growth in 2021 due to the adverse effect of load-shedding, based on an estimated 2,521 GWh of power outages. We estimated that the cost of load-shedding was R50/KWh — this is roughly half of the modelled total effect of the cost of unserved energy (CoUE). Given that the economy grew by 4.9% that year, our estimate suggests the country's potential economic growth was at least 7.0% in 2021. This includes the base effects from the deep 2020 recession where the economy contracted by 6.4%.

Since then, calculating the impact of load-shedding on GDP has become more challenging — though this is due to some positive factors. Behavioural change has seen the South African public adapt to and mitigate the impact of load-shedding. For example, in 2022, the country imported more than R5bn worth of solar panels, up from around R4bn in the preceding year. We estimate that these panels provide an additional 2,000 MW of generating capacity in 2023. Put differently, based on varying usage patterns, these off-grid solar panels could be saving the rest of the country from an additional stage of load-shedding at any given time. Furthermore, load-shedding has increasingly been implemented outside of normal business hours and on weekends, thereby reducing the impact of power cuts on the production side of the economy. As such, we are of the view that the R50/KWh estimate applied previously is probably too high in the current circumstances, given the changing behaviour towards adapting to load-shedding. For example, many of the country's largest companies have been able to acquire off-grid power solutions like solar power or diesel generators.

Admittedly, our calculations do not capture the economic pain experienced by, for example, small businesses, non-governmental organisations (NGOs), and the majority of households who cannot afford off-grid alternatives. The reduced impact of power cuts on GDP is being driven by the adaptability of large companies and wealthy households. That, however, tells only part of the story. The other part of the story includes millions of small businesses who have a small impact on GDP but a large impact on employment, food security and community stability. These small businesses are seeing production downtime, increased supply chain costs, reduced operating hours, and increased security risks due to the lights going out.

Again using our CoUE approach, we can now consider a more moderate estimate for the impact per KWh. Based on 11,797 GWh of load-shedding in 2022 and a reduced cost of R20/KWh, PwC estimates that power cuts reduced real GDP growth by five percentage points in 2022. (In other words, economic growth could again have been close to 7.0% last year were it not for load-shedding.) The channels of negative impact were diverse, including: weaker consumer confidence weighing on retail spending; lower business confidence impacting investment decisions; and tainted international perceptions limiting foreign investment. Looking beyond GDP, society also faced increased crime risk due to off-line security systems, longer journeys linked to delayed transport, and unreliable communication from slower mobile telecommunication services, amongst other issues.

Figure 9: Real GDP growth (%) scenarios



Source: PwC

Unemployment rate: A turning point in 2023 followed by increased joblessness thereafter.

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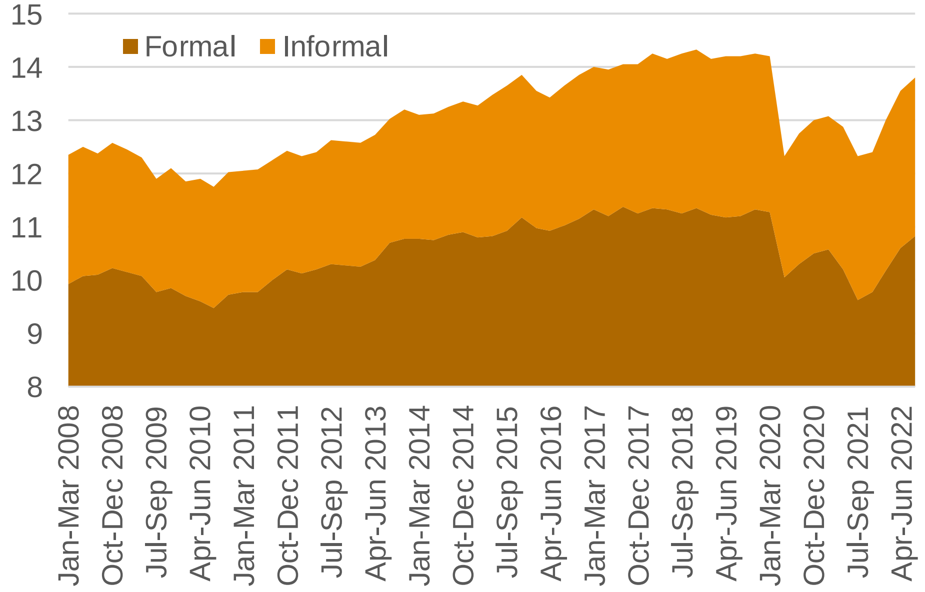
Total employment increased by 1.2 million in January-September 2022 on the back of stronger-than-expected GDP growth.

South Africa's official (narrowly defined) unemployment rate declined in 2022Q3 to 32.9% of the labour force. It was the third consecutive quarterly decline from a record high of 35.3% in the last quarter of 2021. During the first three quarters of last year, total (formal and informal) non-agricultural employment increased by a net 1.2 million (8.4%), reaching 15.8 million jobs in 2022Q3. This, in turn, was the country's highest non-farm employment number since the outbreak of COVID-19. Stronger-than-expected economic growth certainly contributed to this improved jobs market situation while other supporting factors included greater resilience towards the impact of electricity load-shedding at a business level. The CareerJunction Employment Insights Report November 2022 noted that recruitment activity (measured by online job postings) increased by 9.0% y-o-y in October last year.

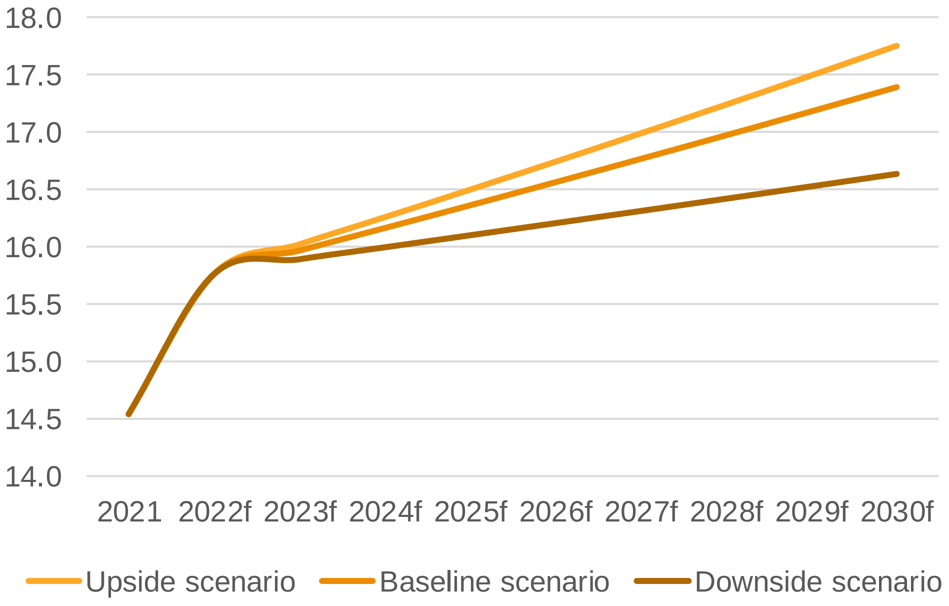
Figure 10: Non-agricultural employment (millions)



Source: Stats SA

However, elation about the increase in employment and decline in the unemployment rate will be short-lived. South Africa's official and youth unemployment rates are still the highest in the world, with associated social risks explored in our recently published report '<u>Rebuilding social cohesion is essential to South Africa's economic development</u>'. Based on our updated GDP forecasts, we expect around 200,000 jobs to be added to the economy in 2023. This will be significantly lower compared to last year due to several factors, including the end of the post-pandemic jobs bounce-back and slower overall economic growth. There is certainly upside potential to the jobs growth outlook for 2023. However, the country's labour market has not fundamentally changed compared to the pre-pandemic period in terms of the quality of skills and the nature of regulation. As such, upside potential is limited.

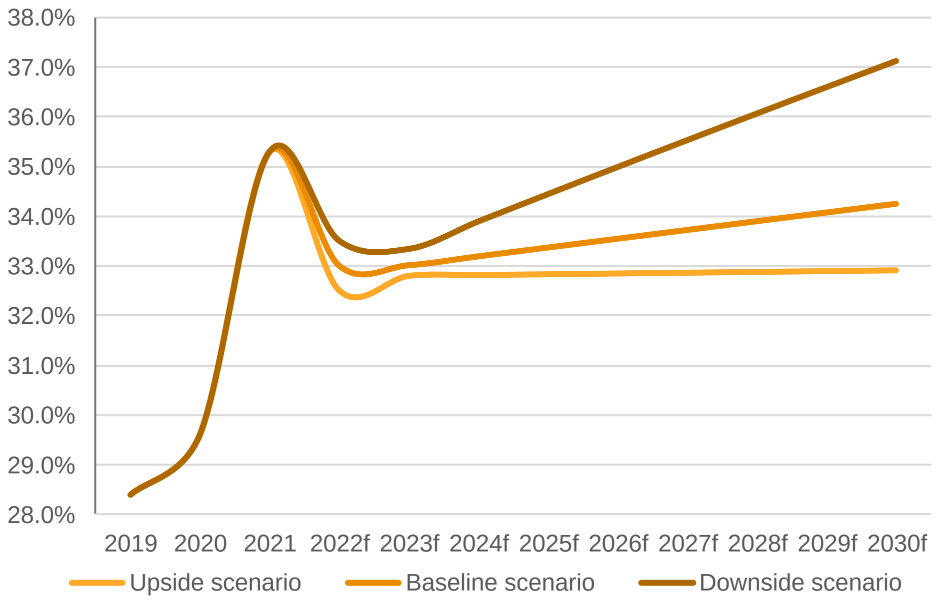
Figure 11: Employment (millions) scenarios



Source: PwC

The expected growth in employment over the next decade (at an average of 1.2% p.a.) will be slower than the anticipated labour force growth rate (1.5% p.a.). As a result, following last year's labour market recovery, the unemployment rate is estimated to have reached a turning point in 2022-2023, and will slowly rise in the years ahead under our baseline scenario. The September 2022 edition of this report ('<u>Building skills to increase employability and staff retention</u>') noted that in order to address the country's unemployment crisis, a social compact between government, labour, the private sector and other stakeholders would need to encompass a national skills vision which includes roles, responsibilities and expectations for every stakeholder. The compact was initially expected to be completed in the second quarter of 2022, as per a timeline set out in the State of the Nation Address (SONA) in February last year. However, the social compact was not concluded by the start of 2023, with stakeholders seemingly unable to find a consensus on many of the big ticket items. An update is expected in SONA 2023.

Figure 12: Unemployment rate (%) scenarios



Source: PwC

Environmental, Social and Governance (ESG) focus: From planning to action on SA's Just Energy Transition (JET).

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Arrangements for implementing the JET investment plan will start in February 2023.

Our recently published 'Net Zero Economy Index 2022: South African viewpoint' shows that the country reduced its carbon intensity by 4.6% in 2021. This was largely attributed to strong economic growth coupled with a 0.8% decline in coal usage. The reduced coal consumption was, however, not due to the country actively trying to use less of this resource, but rather largely as a result of increased electricity load-shedding during 2021, caused by significant breakdowns at coal-fired power stations. As a result of its relative inaction in decarbonisation, South Africa is still the most carbon-intensive economy within the Group of 20 (G20) countries due to its reliance on coal for electricity generation. The country's weak performance is largely attributed to poor comparative assessments for the share of non-fossil fuel sources for energy, CO2 emissions (metric tons) per capita, and the slow pace in taking action to reduce CO2 emissions.

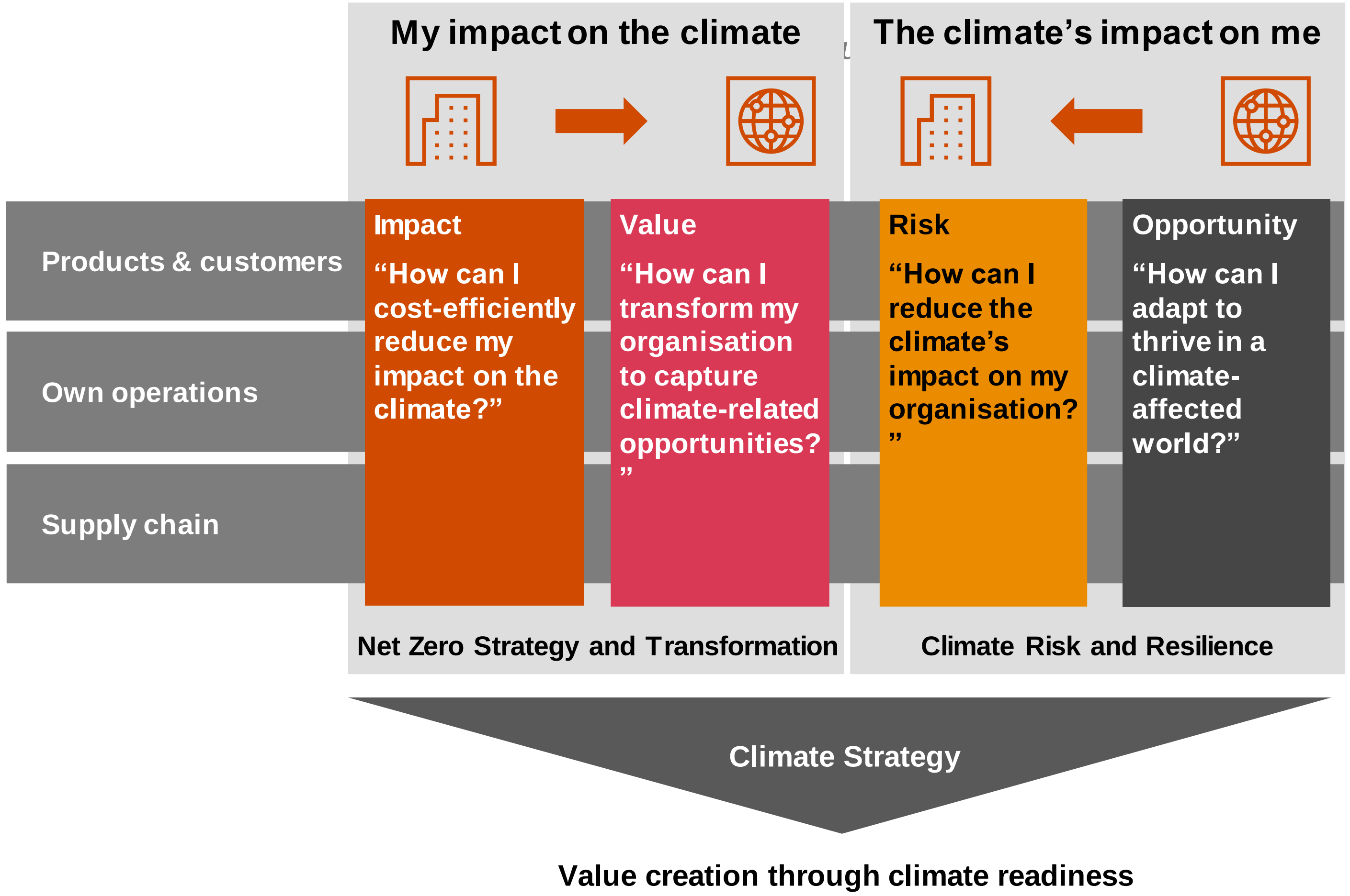
As noted in our recent report 'South Africa's just energy transition: moving from planning to action in 2023', this year is anticipated to be a period of much greater climate action in South Africa. The government recently launched its Just Energy Transition Investment Plan (JET IP) at COP27 for an initial period of five years (2023-2027). The country developed this investment plan to clarify its priority investment requirements in the electricity, New Energy Vehicles (NEVs), and green hydrogen sectors, to support goals of energy security, a just transition, and economic growth. In the immediate future, arrangements for JET IP implementation will start in February 2023. The implementation plan will be a product of efforts across government, civil society, trade unions and the private sector. The plan will include relevant timelines and will rely on existing South African institutions and systems — augmented by adopting both local and international best practice across various disciplines.

Climate resilience is a powerful source of protection for companies against disruption and value loss.

On a practical level, what does the national decarbonisation drive mean for private companies? From our interactions with government and business leaders at COP27, it is clear that evidence of decarbonisation is a powerful differentiator for businesses in an environment where having a CO2 emissions target is merely a licence to operate. Leading organisations are generating value by reimagining how their capabilities will be deployed in a post-carbon world and appealing to sustainability-aware consumers, investors, staff and other stakeholders via sustainable transformations. Climate resilience is a powerful source of protection against disruption and value loss.

Scope 1 emissions are direct greenhouse (GHG) emissions that occur from sources that are controlled or owned by an organisation - e.g. emissions associated with fuel combustion in vehicles, generators, etc. (For a sector-specific example, see our 'Education Newsletter November 2022' where we consider how carbon tax is becoming more relevant in the education sector.) Apart from focussing on Scope 1 emissions, companies also need to address the environmental footprint across their supply chains. Upstream and downstream emissions often dwarf the carbon impact of direct operations: for most companies, they make up 65%–95% of their carbon impact. Furthermore, as much as 80% of an organisation's supply chain emissions come from as few as one-fifth of its purchases. South African companies need to build climate resilience via a deep analysis of value chain exposure to physical and transitional risks. This will in all likelihood be mandated through sustainability reporting standards, although the speed of adoption in South Africa is still unclear.

Figure 13: Value creation through climate readiness



Source: PwC

PwC Economics services and contacts.

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How we can help.

Economic scenarios

South African businesses are looking at the rest of 2023 with many more uncertainties compared to the start of 2022. This report sets out our core macro forecasts for 2023, with the upside, baseline and downside scenarios providing a perspective on three alternative futures for the South African economy in 2023. However, in the coming months, these forecasts will be updated as assumptions change and new data is released. For example, Budget 2023 will be released next month, which will review fiscal assumptions for the year.

We are working with clients to understand the various potential scenarios for the rest of this year and beyond. Based on the information contained in this report, as well as other research and data, these discussions are helping our clients formulate business strategies for the next 12 months — a period where domestic and international disruption is guaranteed to remain a major factor.

Economic scenarios help companies identify potential risks, operational considerations, impacts and actions in many key areas, including:

– Crisis management and response
– Workforce
– Operations and supply chain
– Finance and liquidity
– Tax, trade and regulatory
– Strategy and brand

Our services

The PwC South Africa Strategy& Economics team is a specialised unit of economists who serve our clients in a variety of ways. Our services include:

Measure your impact on the economy and society

– Environmental, Social and Governance (ESG) and Just Transition
– Economic Impact Assessment (EIA)
– Socio-Economic Impact Assessment (SEIA)
– Regulatory Impact Analysis (RIA)
– Total tax contribution
– Localisation calculations

Make decisions about risk and investment

– Macroeconomic research
– Market entry analysis
– Country and industry risk assessments
– Commercial due diligence assistance

Plan for future economic scenarios

– ESG scenario planning
– Economic and political scenario planning
– Industry and macroeconomic modelling
– IFRS 9 audit assist

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