



Growth unexpectedly contracts by 0.1% in Q1 2024

Highlights

- South Africa's (SA) economy unexpectedly contracted in the first quarter of 2024. According to Statistics SA (Stats SA), real gross domestic product (GDP) decreased by 0.1% quarter-on-quarter (q/q) according to the production method. Analysts surveyed by Reuters projected a slight increase of 0.1% q/q and the SA Reserve Bank (SARB) projected 0.2% q/q. When calculated using the expenditure method, the contraction in real GDP was more at 0.2% q/q.
- On the production side, six of the 10 industries contracted in the first quarter and thus contributed negatively to growth. Manufacturing, mining, and construction were the worst performing industries in the first quarter and this offset significantly positive growth in the agriculture industry.
- On the expenditure side, the biggest detractor from economic growth was a decrease in exports. However, imports decreased by more than exports and the net impact was positive on growth. This was, however, overshadowed by a contraction in the other four components of expenditure.
- We maintain our view that household consumption expenditure will be a bigger driver of economic growth in 2024 (1.2%) relative to 2023 (0.7%). The consumption boost from the two-pot retirement system (effective 1 September 2024) is estimated to be bigger in the first few months after implementation and decrease thereafter.
- In our view, economic activity remained weak in the first quarter of 2024 despite reduced loadshedding because energy availability is not a big driver of economic activity in industries which invested in sufficient back-up power during 2023. Another reason could be that loadshedding was still elevated compared to the period between 2020 and 2022 and thus continued to disrupt economic activity where dependence on Eskom had not decreased.
- The improved energy outlook in 2024 may be witnessed more through better company profit margins on the back of using diesel-powered back-up energy supply less than when loadshedding is more intense. Higher profit margins could potentially spillover to increased fixed investment.
- Economic growth is expected to tick up in the second quarter underpinned by no power disruptions in April and May (benefiting sectors that are still dependent on Eskom) and easing logistics constraints.
- The ongoing discussions about the future structure of government following the African National Congress (ANC) losing majority support in the 2024 election for the first time since the party came into power in 1994 has increased political uncertainty. The options under consideration include a coalition government, a Government of National Unity, a minority government or a working agreement with the opposition party.
- The outcome of these discussions could impact the economic growth trajectory. According to *Bloomberg Economics*, a coalition government which involves the Democratic Alliance (DA) will likely yield better economic growth compared to one which includes the Economic Freedom Fighters (EFF).

- Our estimates for economic growth remain unchanged at 1% in 2024, edging higher to 1.7% in 2025 and reaching 1.8% in 2026. We may revisit these projections if there is any major shift in the pace and/or direction of policy and structural reform.

Positive growth in agriculture offset by poor performance in mining, manufacturing, and construction

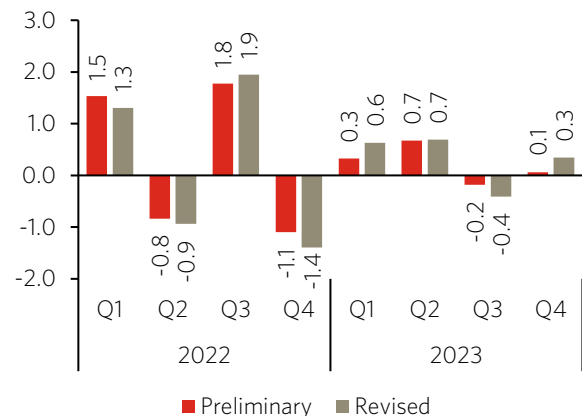
According to the production method, real economic growth for the first quarter of 2023 was negative 0.1% q/q, worse than the Reuters median consensus of 0.1% q/q and the SARB's estimate of 0.2% q/q. The decrease in economic activity in the first quarter follows an upwardly revised economic growth rate of 0.3% q/q in the fourth quarter of 2023 (previously 0.1% q/q).

On the production side, six of the 10 industries contracted in the first quarter of 2024. The worst performing industries were manufacturing (negative 1.4% q/q, detracting 0.2 percentage point from overall economic growth), mining (negative 2.3% q/q, detracting 0.1 percentage point) and construction (negative 3.1% q/q, detracting 0.1 percentage point). The slump in activity in these three industries has offset the positive contribution from the agriculture industry (13.5%q/q, contributing 0.3 percentage point). The surge in agriculture follows two consecutive quarters of contraction.

The first quarter GDP report published by Stats SA features revisions from the first quarter of 2012 until the fourth quarter of 2023. Following the revision exercise, Stats SA notes that average growth over this period is up to 0.3% from 0.2%. The largest upward revision was

in the fourth quarter of 2020 (2.8% q/q from 1.5% q/q), a quarter largely affected by the pandemic. The largest downward revision was in the second quarter of 2016 (0.1% q/q from 0.8% q/q). The reasons for these revisions include additional information from data sources, independent annuals from detailed data sources and benchmarking and rebasing. The preliminary and revised growth rates for the past two years are illustrated in chart 1.

Chart 1: Preliminary and revised real GDP growth rates based on the production method, % q/q



Source: Stats SA, Momentum Investments

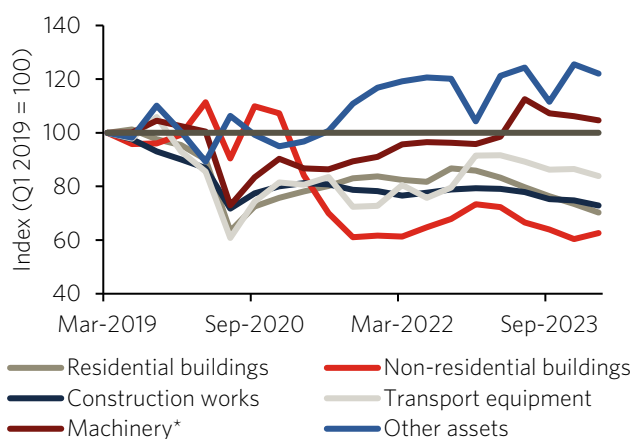
Broad-based decrease in the expenditure approach

On the expenditure side, five of the six expenditure components detracted from growth in the first quarter of 2024. The largest negative contribution stemmed from exports (negative 2.3% q/q, detracting 0.7 percentage point). However, imports decreased by more than exports (negative 5.1% q/q, contributing 1.5 percentage points) which means the net impact on growth was positive (i.e. net exports contributed 0.9 percentage point to economic growth).

Gross fixed capital formation (GFCF) decreased for the third consecutive quarter (1.8% q/q, detracting 0.3 percentage point) in the first quarter of 2024. The decrease was broad-based with five of the seven assets recording negative growth. Fixed investment in machinery and equipment (the largest component which accounts for around 40% of GFCF) decreased by 1.4% q/q. Machinery and equipment was the biggest driver of growth in fixed investment in 2023 on the back of private sector investments in energy related projects.

Growth in machinery and equipment is gradually decreasing in line with the decrease in energy-related imports (e.g. solar panels). However, machinery and other equipment remain above pre-pandemic levels (see chart 2).

Chart 2: GFCF in machinery and equipment steadily tapering off



Source: Global Insights, Stats SA, Momentum Investments

* Machinery and other equipment

Data until first quarter of 2024

GFCF in non-residential buildings (smallest component of GFCF accounting for around 5%) is still significantly

below pre-pandemic levels but picked up slightly in the first quarter of 2024 (see chart 2).

Household consumption expenditure decreased by 0.3% q/q in the first quarter (detracting 0.2 percentage point). Within household consumption, expenditure on durable goods, semi-durable goods and services decreased in the first quarter. The only increase in consumption expenditure was recorded for non-durable goods which points to the fact that consumers are prioritising necessities given still elevated inflation and interest rates.

Our forecast for household consumption growth is 1.2% this year, up from 0.7% in 2023. Interest rate cuts are delayed but will help alleviate financial strain on consumers once the interest rate cutting cycle starts in the second half of this year. The two-pot system (effective 1 September) will likely provide an immediate boost to household consumption in the few months after implementation and the impact will likely wane off. Even though some consumers may withdraw from their pension to settle debt, this could be positive for consumers' future spending ability. The gradual moderation in inflation has, so far, been positive for consumers' disposable income.

Reduced loadshedding could benefit the economy through profit margins and fixed investment

Evidence from 2023 suggests that the economy became increasingly resilient to power outages. This was partly due to energy-intensive industries being subject to load curtailment which allowed them to plan operations better. Furthermore, the ramp-up in self-generation improved energy reliability and allowed businesses to continue operating despite power interruptions from Eskom.

In the first three months of 2024, loadshedding was significantly lower than in 2023 (see chart 3). Despite the improvement from the high levels reached in 2023, economic activity in the first quarter of 2024 contracted. This could be because (1) energy availability is not a big driver of economic activity in industries which invested in sufficient back-up power during 2023 and (2) loadshedding was still elevated compared to 2020, 2021 and 2022 and thus continued to disrupt

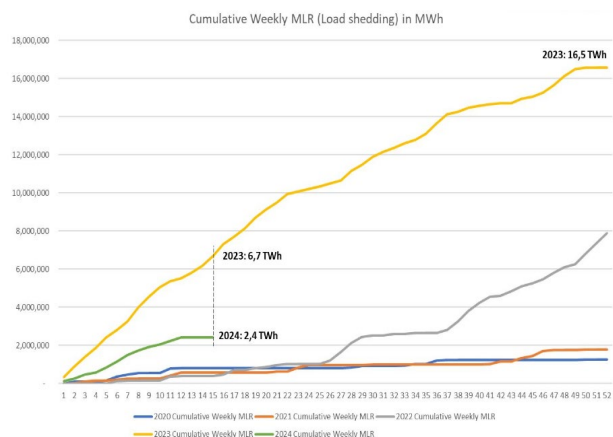
economic activity where dependence on Eskom had not decreased. The second quarter is likely to be different in that a more reliable energy supply could be supportive of economic growth. This is because the country went through the first two months of the second quarter with no electricity interruptions so all sectors of the economy could operate without disruption.

Overall, loadshedding is expected to be lower in 2024 compared to last year. In the May MPC, the SARB revised its estimate for energy shed in 2024 down from a level that was already significantly lower than total energy shed in 2023 (see chart 4).

The SARB also revised its estimate of the load-shedding impact on economic growth to negative 0.5 percentage point in 2024 from the previous estimate of negative 0.6 percentage point. Again, the 2024 estimate is lower

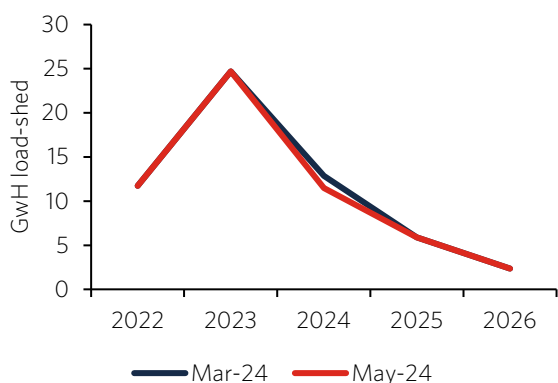
than the 2023 estimate of negative 1.5 percentage points (see chart 5).

Chart 3: Loadshedding lower in 2024 but remains elevated



Source: Energy Council of SA, Momentum Investments

Chart 4: Estimated total energy shed revised lower for 2024

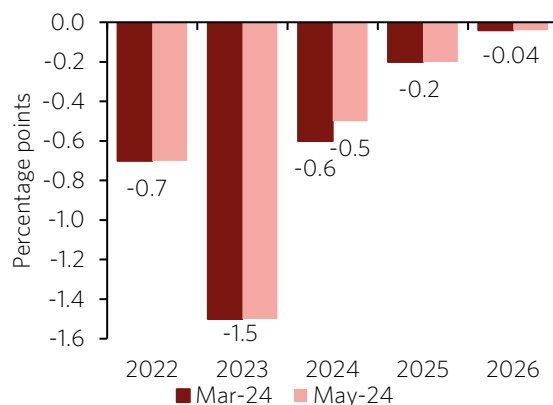


Source: SARB, Momentum Investments

Better economic growth expected in Q2 2024 but political unease poses challenges

Economic growth started the year on a low base, contracting by 0.1% q/q according to the production method in the first quarter of 2024. The second quarter is expected to register slightly stronger economic growth. The SARB's estimate for economic growth in the second quarter sits at 0.7% q/q (May estimate) and the Reuters median consensus is also better than the first quarter at 0.4% q/q (May survey) but below the SARB's projection. The expected improvement is underpinned by easing structural constraints (loadshedding and logistics).

Chart 5: Loadshedding impact on economic growth estimated to be negative 0.5 percentage point in 2024



Source: SARB, Momentum Investments

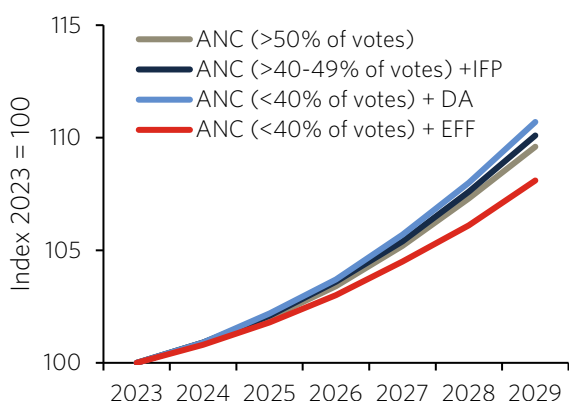
The improved energy outlook will be supportive of economic activity but the extent of the positive benefit is dulled by the built-up resilience in the short-term. Where the benefit could be more visible is in company profit margins from using diesel-powered back-up energy supply less than when loadshedding is more intense. Higher profit margins in conjunction with an improvement in business sentiment could boost private sector fixed investment. We anticipate that better electricity reliability will have a more meaningful impact on economic growth in the medium- to long-term when energy reforms from the first phase of Operation Vulindlela are implemented.

Over the long term, the economic growth trajectory will be influenced by how the political landscape unfolds. In our view, we can expect a gradual improvement in growth over the medium term but the degree of the improvement may be affected by the political makeup.

The election results announced on 2 June 2024 showed a big decrease in ANC support nationally from 57.5% in 2019 to 40.18% in 2024. This marks the first time that the ANC has lost majority support since the party came into power in 1994 and has introduced coalitions into the national government sphere. There are ongoing

discussions about the structure of government going forward. Prior to the elections, *Bloomberg Economics* published scenarios mapping out likely growth projections under various coalition agreements (see chart 6).

Chart 6: SA's economic growth under different coalition scenarios



Source: Bloomberg Economics, Momentum Investments

Focusing on the last two scenarios modelling growth projections in the case of ANC support dropping to below 40%, *Bloomberg Economics* indicates that the growth trajectory would be better under an ANC-DA

coalition compared to an ANC-EFF coalition. The projection of higher growth under an ANC-DA coalition is premised on investment improvement which would also support job creation. In addition, the exchange rate is expected to respond positively which would aid in maintaining price stability and protect consumers' disposable income. On the other hand, slower growth under an ANC-EFF administration is linked to investor sentiment and the exchange rate being negatively affected. In our view, the momentum on the structural reform agenda will also play a big role in the economic trajectory.

The ongoing discussions are broader than just one party as these scenarios suggest. Other options include a Government of National Unity, a minority government or working agreements. More clarity about the government structure will likely emerge by the 20th of June 2024.

Our estimates for economic growth remain unchanged at 1% in 2024, edging higher to 1.7% in 2025 and reaching 1.8% in 2026. We may revisit these projections if there is any major shift in the pace and/or direction of policy and structural reform.

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