SOVEREIGN
AFRICA RATINGS

Year in Review:

Republic of South Africa 2022

January 2023

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The economy of South Africa in 2022 was impacted by rising input costs due to Russia's invasion of Ukraine, including higher fuel prices and a weaker rand-to-dollar exchange rate. Food prices increased dramatically, causing uncertainty about the future of the global economy. Economic activity gradually normalised as COVID-related restrictions were eased. Real GDP increased by 1.9% in Q1 2022, contracted by 0.7% in Q2 2022, and by end of Q3 picked up again by 1.6%. Unemployment decreased in Q3 2022 by 3.4% to 7.73 million, with the official unemployment rate decreasing to 32.9%. The South African government's gross loan debt increased in 2022 and the Medium-Term Budget Policy Statement (MTBPS) outlined a strategy to improve public finances and stabilise debt while supporting economic growth. Interest rates increased due to domestic inflationary pressures and the exchange rate of the rand saw significant fluctuations due to global risk aversion and domestic factors such as electricity loadshedding.

Geopolitical Factors

In 2022, Russia's invasion of Ukraine had a significant impact on South Africa's economy, as the international crude oil prices surged, and Brent crude oil escalated to US$130 per barrel in July 2022 (although this did drop to US$70 per barrel in early December 2022). As such, South African consumers bore the burden of high fuel prices, which were further exacerbated by the weaker rand-to-dollar exchange rate.

Domestic and global producer price inflation remained elevated throughout the first four months of 2022, as input costs such as fuel, coal, electricity, metals, fertilisers, and freight transportation rose sharply. The ongoing war between Russia and Ukraine further exacerbated global supply chain disruptions and caused shortages of critical commodities such as wheat and crude oil. Food prices also increased drastically, including basic food items like cooking oil. This led to higher input prices and uncertainty about the future trajectory of global economic activity. The difference between domestic consumer and producer price inflation also reached an all-time high of 7.2 percent in April 2022.

Lifting of National State of Disaster, 4 April 2022

The South African government adopted the Economic Reconstruction and Recovery Plan to combat the COVID-19 crisis in October 2020. The lifting of the national state of disaster in South Africa on April 4, 2022, marked a significant step towards the normalisation of economic activity in the country. This was made possible by the high vaccination rates and the easing of COVID-related restrictions.

In Q1 2022, the real GDP in South Africa increased by 1.9%, building on the 1.4% increase seen in Q4 2021. This growth was driven by a stronger expansion in the secondary and tertiary sectors, while the primary sector contracted. This growth brought the level of real GDP above the average level seen in 2019, before the onset of the pandemic.

However, in Q2 2022, economic activity in South Africa lessened by 0.7% following two consecutive quarters of expansion. The contraction was seen across primary, secondary, and tertiary sectors.

Despite this decrease, the level of real GDP remained 1.4% higher in Q1 2022 compared to the same period in the previous year, but 0.3% lower than the average level in 2019.

In Q3 2022, South Africa's economic activity saw an increase across primary, secondary, and tertiary sectors. The real GDP grew by 1.6%, driven by growth in the agricultural and finance, insurance, real estate, and business services sectors. Despite variations among sectors, the overall level of real GDP surpassed the level seen before the onset of the pandemic and was 2.3% higher in the first three quarters of 2022 compared to the same period in 2021.

South Africa's Economic Performance

South Africa's economy showed signs of recovery in the first three quarters of 2022, with real GDP growing by 2.3% year-on-year. While the tertiary sector saw a significant increase of 4.1% year-on-year, the secondary sector saw a decline of 0.9%, and the primary sector dipped by 6.1%. Despite this overall growth, unemployment remained at high levels, with the official rate standing at 32.9% in Q3 2022.

A positive aspect of the economy was the increase in real fixed investment, which grew by 4.4% year-on-year in the first nine months of 2022, a considerable improvement from the 0.2% growth seen in 2021 and 14.6% decline in 2020, which were caused by the State of Disaster and pandemic. However, it is important to note that more fixed investment is still needed to offset the decline of 2020 and to support long-term economic growth above 3% annually.

RSA GDP Growth 2020-2022 (3Q)

	GDP Growth					
SECTOR	2020	2021	1Q 2022	2Q 2022	3Q 2022	¾ 2022
	%Δ	%Δ	Y-o-Y %Δ	Y-o-Y %Δ	Y-o-Y %Δ	%Δ
Transport and Communication	-15.4%	4.7%	9.0%	6.2%	11.3%	8.9%
Wholesale and Retail Trade; Hotels and Restaurants	-12.4%	6.4%	6.0%	1.1%	7.5%	4.8%
Finance, Real Estate, and Business Services	0.7%	3.3%	1.6%	4.8%	5.5%	4.0%
Personal Services	-2.0%	5.5%	6.2%	3.7%	2.0%	3.9%
Manufacturing	-12.5%	6.5%	1.2%	-3.4%	2.7%	0.2%
General Government Services	0.7%	0.1%	0.9%	-0.7%	-0.6%	-0.2%
Electricity and Water	-5.9%	2.2%	-0.2%	-1.8%	-4.6%	-2.3%
Construction	-18.5%	-2.2%	-6.5%	-5.1%	-2.4%	-4.7%
Agriculture, Forestry, and Fishing	14.9%	8.8%	-1.7%	-23.8%	22.3%	-4.9%
Mining and Quarrying	-11.8%	12.0%	-4.6%	-9.6%	-6.2%	-6.9%

GDP Excluding General Government	-6.6%	5.2%	2.9%	0.3%	4.5%	2.5%
GDP Excluding Agriculture	-6.50%	4.60%	2.80%	1.40%	3.50%	2.60%
GDP at Market Prices	-6.30%	4.90%	2.70%	0.20%	4.10%	2.30%

Source: StatsSA

Electricity Loadshedding

Electricity loadshedding in South Africa has been a persistent problem in recent years, with the frequency of loadshedding increasing significantly. From the beginning of 2022 until the end of October, loadshedding was in effect 33.4% of the time, an average of 10.4 calendar days per month. This includes a severe period of power outages in the third quarter of 2022, when loadshedding reached an all-time high of 1 054 hours, or 47.7% of the time, an average of 14.8 calendar days per month, including 187 hours of stages 5 and 6 loadshedding.

The persistent power cuts have had a significant negative impact on the economy, particularly in the third quarter of 2022 when the real GDP growth was only 1.6%, 2.3 percentage points lower than it would have been without loadshedding. The power cuts have constrained GDP growth, and it is expected that the problem will continue for at least the next six months. This puts further pressure on the economy in the fourth quarter of 2022 and into 2023.

The power cuts have also had a negative impact on various sectors of the economy. Industries, commerce, agriculture, and households have been forced to go off-grid, further eroding the income base of Eskom, the state-owned electricity utility company. The power cuts have also adversely affected revenue collection by the South African Revenue Service (SARS), as more businesses, mining companies, and corporates that contribute a significant amount of revenue are negatively impacted.

It is important to note that the power cuts have caused significant economic damage to the country, and they will likely continue to affect revenue collection, investment, and economic activity in the coming months. This may include further pressure on the unemployment rate, lower productivity, and less economic growth.

Monetary Policy

South Africa's economy faced several challenges in 2022, including rising input costs due to Russia's invasion of Ukraine, which resulted in higher fuel prices, a weaker rand-to-dollar exchange rate, and a dramatic increase in food costs. The easing of COVID-related restrictions in South Africa led to a gradual normalisation of economic activity, and the country's real GDP increased by 1.9% in Q1 2022, contracted by 0.7% in Q2 2022, and grew by 1.6% in Q3 2022, with positive contributions from the agricultural and finance sectors. Despite this overall growth of 2.3% in the first three quarters of 2022, South Africa's economy still faced challenges such as unemployment, a declining secondary sector, and a dipping primary sector. The South African Reserve Bank (SARB) lowered its expectation of real GDP growth from 1.9% to 1.8% for 2022 and raised the repurchase (repo) rate by a further 75 basis points to 7.00% per annum in November 2022 due to inflationary pressures from the war in Ukraine and domestic factors such as electricity loadshedding. Additionally, loadshedding continues to constrain GDP growth and erode the income base of Eskom as well as negatively impact revenue collection by the South African Revenue Service.

Exchange Rates

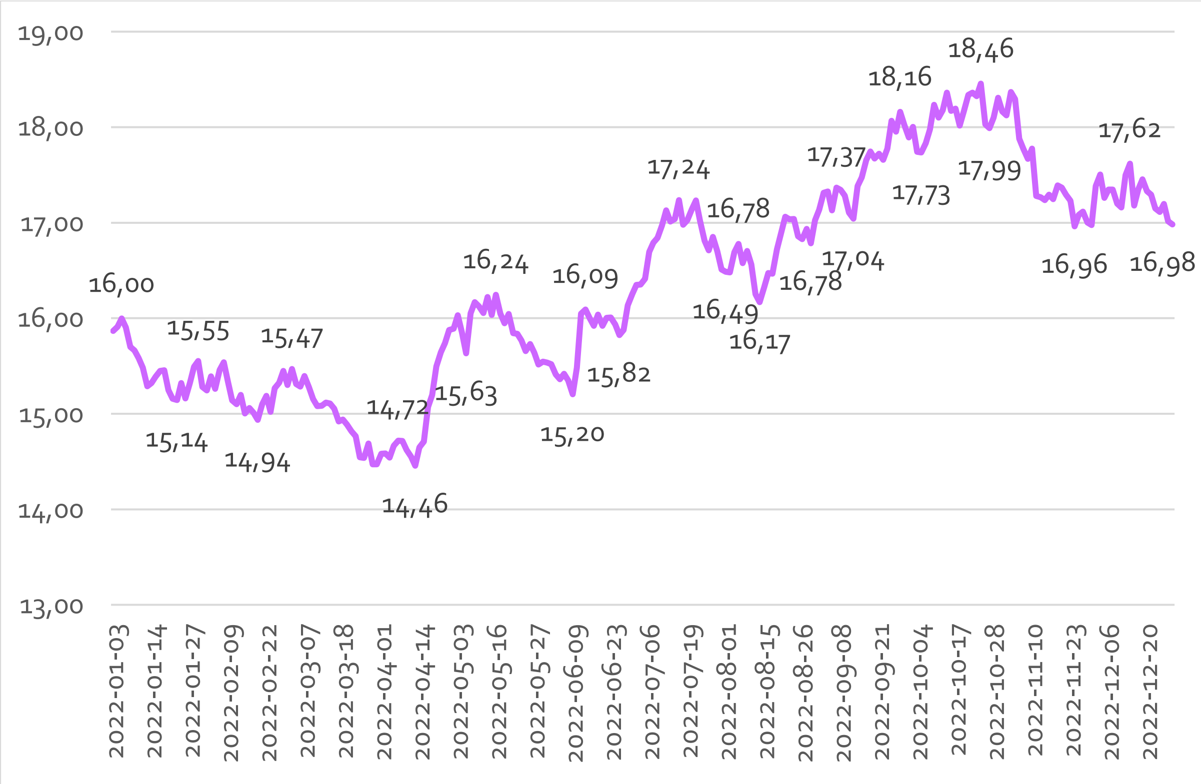
The exchange rate of the South African rand saw significant fluctuations in 2022, as the country faced a number of economic challenges including rising input costs due to Russia's invasion of Ukraine, the negative effects of electricity loadshedding, and global inflation concerns.

The nominal effective exchange rate (NEER) of the rand increased by 10.8% in the first quarter of 2022, but then decreased by 6.2% in the second quarter, and by a further 3.6% between June and September 2022. These fluctuations were due to a combination of global risk aversion, increased monetary policy tightening in response to inflation concerns, and negative impacts on investor sentiment and economic growth prospects from domestic factors such as electricity loadshedding.

The NEER of the rand decreased by 0.8% in July 2022 and further by 4.6% in the third quarter. The real effective exchange rate (REER) of the rand also increased by 6.8% between December 2021 and September 2022, negatively impacting the competitiveness of domestic producers in foreign markets.

In addition to these fluctuations, the rand also faced increased pressure from a stronger US dollar and recorded losses of as much as 15%. As a result of this, the dollar/rand exchange rate reached a high of 18.58 in October 2022. The South African government has implemented various plans and strategies to address these issues and to improve the overall economic performance of the country.

Rand Dollar Exchange Rate, 2022

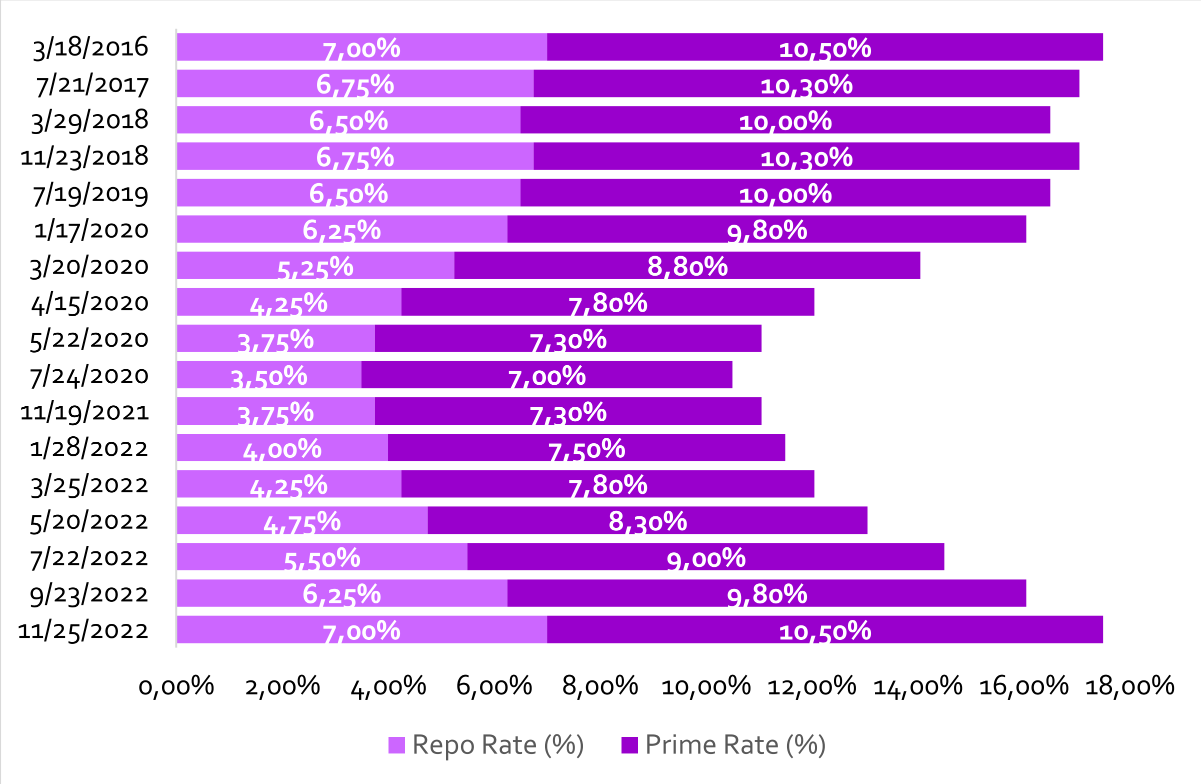


Source: South African Reserve Bank Bulletin, 2022

Interest Rates

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) responded to rising inflationary pressures by increasing interest rates in the domestic money market throughout 2022. The repo rate, a key benchmark interest rate, saw a significant increase, rising from 3.5% in November 2021 to 7.0% in November 2022. This surpasses the pre-pandemic repo rate of 6.25%. The increases in short-term interest rates were less pronounced than those in longer-term rates. Rates on forward rate agreements (FRAs) also trended higher, reflecting both higher-than-expected domestic inflation outcomes and fluctuations in the exchange value of the rand. The MPC's decision to raise the repo rate by 75 basis points in November 2022 was in response to rising inflationary pressures, including global factors such as the ongoing war in Ukraine, and domestic challenges such as electricity loadshedding and supply chain disruptions.

Money Market Interest Rates (%), 2016-2022



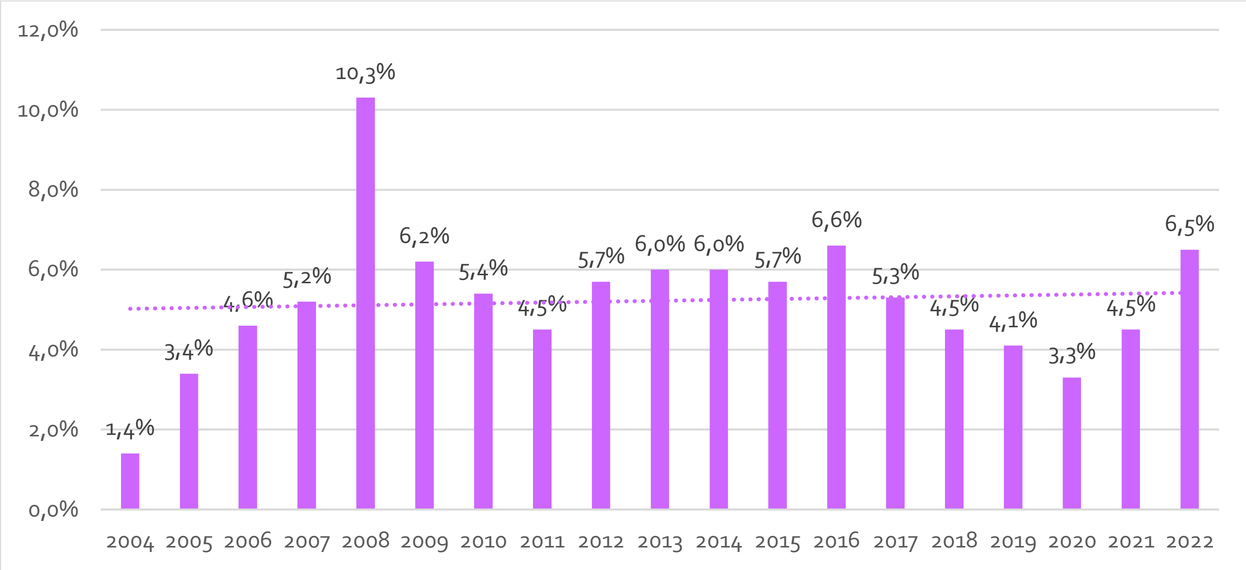
Source: South African Reserve Bank Bulletin, 2022

Inflation

Inflation in South Africa remained elevated throughout 2022, driven primarily by rising energy and food prices, as well as supply and demand imbalances caused by the ongoing war in Ukraine. The headline consumer price inflation rate reached a peak of 7.8% in July 2022, before slowing slightly to 7.5% in September and then accelerating to 7.6% in October.

Measures of underlying inflationary pressures also gradually rose throughout the year, surpassing the midpoint of the inflation target range set by the South African Reserve Bank. Despite efforts by the Reserve Bank's Monetary Policy Committee to curb inflation through interest rate increases, domestic inflation remained above the 6.0% upper limit of the target range. These figures have put a further burden on consumers, industry, and the overall economy, which increases uncertainty on the future trajectory of growth and development.

Inflation Levels (percentages), 2004-2022



Source: South African Reserve Bank Bulletin, 2022

Financial and Capital Markets

South Africa's financial and capital markets experienced fluctuating trends throughout 2022. Bond yields trended upwards in response to higher inflationary pressures, driven by global events such as Russia's invasion of Ukraine in February 2022. This increase in bond yields was reflected in the total nominal amount of outstanding rand-denominated debt securities issued in the domestic bond market, which increased by 10.1% YoY to R5.7 trillion by the end of October 2022. The net bond issuance by the general government accounted for 66.4% of the total net issuance in the domestic primary bond market.

The domestic primary corporate bond market saw net redemptions of R174 billion in 2020, followed by net issuance of R9.7 billion in 2021 and a marked increase of R145 billion in the first three quarters of 2022. The daily average value of turnover in the domestic secondary bond market was R144 billion in the first 11 months of 2022, a 1.3% increase from the previous year.

The JSE All-Share Index (AlSI) experienced a decline of 12.3% in Q2 2022, following increases in the previous two quarters. This decline was in line with trends on international bourses. The value of equity capital raised in domestic and international primary share markets for JSE-listed companies was 40% less than in the corresponding period of 2021. The largest amounts raised were R1.3 billion in September by an investment management company, and R1.5 billion in October by an integrated energy and chemical company. Despite this decline, the JSE All-Share outperformed its counterparts, with a gain of 18% since the start of Q4 2022, driven by mining, resource, and industrial stocks.

Fiscal Policy

Fiscal policy in South Africa in 2022 has been marked by fluctuations in government debt and revenue. According to the South African Reserve Bank, total gross loan debt increased from R4.39

trillion in May 2022 to R4.70 trillion in October 2022, with 88% of the debt being domestic and 12% being foreign. The national government's gross loan debt also increased by 11.9% year-on-year to R4.65 trillion as of September 2022. This was driven by a sharp increase in foreign debt of 32.1% year-on-year, contributing to the overall increase in gross loan debt. The debt-to-GDP ratio also increased to 71.4% as of September 2022, up from 68.1% the previous year.

The 2022 Medium-term Budget Policy Statement (MTBPS) outlined the government's strategy to improve public finances, stabilise debt and support economic growth through structural reforms. The main goals of the MTBPS are to achieve a primary budget surplus of 0.7% of GDP by 2023/24 and to stabilise gross loan debt at 71.4% of GDP in 2022/23. Additionally, the consolidated government budget deficit was revised to 4.9% of GDP for fiscal 2022/23, down from the original projection of 6.0% in the 2022 Budget Review, and is expected to decline further to an average of 3.7% over the medium term.

Revenue collection also showed positive signs, with consolidated government revenue being revised upward by 6.3% to R1.882 trillion for fiscal 2022/23, compared to the original estimate of R1.771 trillion in the 2022 Budget Review. Tax revenue also showed an increase, with gross tax revenue for fiscal 2022/23 estimated at R1.682 trillion, R83.5 billion more than originally projected. National government revenue also increased by 8.7% year-on-year to R784.6 billion in the first half of fiscal 2022/23. These increases in revenue will be used to reduce the gross borrowing requirement and bring the budget deficit down to 4.9% of GDP for 2022/23, further expected to decline to 3.7% in the medium term.

Unemployment

The data suggests that employment contracts of limited duration experienced the greatest increase, rising by 28.2% year-over-year. Contracts of permanent nature and those of unspecified duration saw more modest increases of 8.1% and 5.2%, respectively. In the third quarter of 2022, the number of unemployed South Africans decreased by 269 000 (3.4%) to reach 7.73 million, resulting in a decrease in the official unemployment rate to 32.9% from 33.9% in the second quarter. The seasonally adjusted unemployment rate also decreased further from 33.6% in the second quarter to 32.7% in the third quarter. In Q3 2022, the majority of unemployed individuals were new entrants to the labour market (45.7%), followed by job losers (26.4%), and those who had been employed five years ago represented 22.3% of the unemployed population.

The youth unemployment rate for those aged 15-24 actively searching for work remained above 60% for eight consecutive quarters before decreasing to 59.9% in Q3 2022. Additionally, of the 10.2 million young people in this age group, 34.5% or 3.5 million were not in employment, education programmes, or training during the third quarter. The unemployment rate for those aged 25-35 years decreased slightly from 41.2% in Q2 2022 to 40.5% in Q3 2022. Both the official and expanded unemployment rates have declined over the past year.

Unemployment	Quarter 1	Quarter 2	Quarter 3
Official Unemployment Rate	35%	34%	33%

Expanded Unemployment Rate	46%	44%	43%

Source: StatsSA

Households

Households in South Africa experienced a decrease in real final consumption expenditure in the third quarter of 2022, primarily due to lower spending on food and non-alcoholic beverages, as well as recreation and culture. However, spending on restaurants, transport, and housing increased during this period. Real spending on semi-durable goods and non-durable goods dropped, while spending on durable goods increased. Additionally, real spending by households on services decreased during the third quarter.

This decrease in household consumption expenditure was in line with the decrease in real disposable income of households in the third quarter of 2022. Despite rising interest rates, increased stock availability and improved business confidence among new vehicle dealers led to increased real spending on personal transport equipment.

Household debt as a percentage of nominal disposable income edged lower to 62.8% in the third quarter as the increase in nominal disposable income exceeded that of household debt. However, a combination of higher debt levels and interest rates led to an increase in the households' cost of servicing debt relative to disposable income to 7.5% in the third quarter. Furthermore, households' net wealth declined further in the third quarter of 2022, as the increase in liabilities outweighed the slight increase in total assets. As a result, the ratio of net wealth to nominal disposable income decreased further to 332% in the third quarter.

In South Africa, the cost-of-living crisis is driven by inflation, and there are many complex factors contributing to it, including the ongoing impact of disrupted global supply chains.

External Accounts

In the third quarter of 2022, the value of South Africa's exports and imports of goods both reached all-time highs. However, the trade surplus narrowed from R252 billion in the second quarter of 2022 to R233 billion in the third quarter, as the value of merchandise imports increased at a faster pace than that of net gold and merchandise exports. Additionally, an increase in the rand price of imports of goods and services, along with a decrease in the rand price of exports, resulted in a further deterioration in South Africa's terms of trade during the third quarter.

The value of merchandise exports increased by 2.5% in the third quarter of 2022, driven by a marginal increase in mining products. This was due to a decrease in platinum group metals (PGMs) being more than fully counteracted by an increase in mineral products such as coal, chromium ore and concentrates, as well as pearls and precious and semi-precious stones. Coal exports to Europe surged, mainly to replace similar imports from Russia.

The further increase in the value of merchandise imports in the third quarter of 2022 was dominated by the imports of refined petroleum products, due to reduced domestic oil refining capacity.

The deficit on the current account of the balance of payments as a percentage of GDP declined from 1.6% in the second quarter of 2022 to 0.3% in the third quarter, as the further narrowing of the trade surplus was more than offset by a marked decrease in the deficit on the services, income, and current transfer account.

The net flow of capital on South Africa's financial account of the balance of payments (excluding unrecorded transactions) reverted to an inflow of R14.6 billion in the third quarter of 2022, following an outflow of R1.4 billion in the second quarter.

South Africa's total external debt decreased from US$173.8 billion at the end of March 2022 to US$169.3 billion at the end of June 2022. However, in rand terms, the country's total external debt increased by almost 10% from the end of March 2022 to R2.752 trillion at the end of June 2022, following the depreciation of the exchange value of the rand against the US dollar over this period.

State-Owned Enterprises

Given their significant number in South Africa and their potential to promote development, the role of state-owned enterprises (SOEs) in South Africa's developmental state has received significant attention. However, many SOEs have become loss-making companies, due to factors such as corruption, unconventional business practices, and the struggle to balance broader public policy objectives with commercial viability. The underperformance of most of these SOEs has continued to place an enormous strain on the government budget in the form of government guarantees and bailouts, particularly with Eskom, which has been one of the main challenges for the country. The National Treasury will take on a third or two-thirds of the R401 billion of Eskom's debt. If government inaction and Eskom's inability to manage its coal fleet continue, tax revenues will continue to suffer in South Africa.

Furthermore, dilapidated rail and port infrastructure and inefficiencies, as well as mismanagement of Transnet, continue to affect South Africa's ability to optimally conduct trade (exports and imports) seamlessly. This has resulted in a significant loss of South Africa's competitiveness, loss of production and GDP as well as loss of potential tax revenue. Transnet needs to stabilise and improve the throughput of South Africa's rail and port systems. Transnet has been beset by challenges in the past two years, from civil unrest in 2021 to floods that damaged infrastructure as well as vandalism. This has led to mining companies losing billions of rand and has hit the South African government budget.

Economic sabotage in South Africa has continued, inclusive of cable theft, damage to rail infrastructure and rail networks, vandalising of oil pipelines, damage to water and road infrastructure, and lack of maintenance thereof, which continue to affect the private sector and public sector business entities as well as the welfare of households. These issues collectively are causing not just economic but also social damage to the country's overall welfare.

Political Leadership Battles and Successions

In December 2022, the 55th Conference of the African National Congress (ANC) was held, which caused concern among the investor community and financial markets about the implications of the leadership succession on future macro and fiscal policy, continuity in economic policy, continuity in the implementation of structural reforms, and the adoption of economic policy resolutions. The markets viewed the outcome of the conference as neutral, with no major shifts in economic policy expected as a result.

The Road Ahead

As South Africa looks toward the future, several key risk factors will need to be addressed to ensure a stable and prosperous economy.

- Debt: South Africa's public debt has been on an upward trend in recent years, reaching over 60% of GDP in 2021. High levels of debt can limit a government's ability to respond to economic shocks and may limit the scope for much-needed infrastructure investment and social spending.
- Climate Change: South Africa is one of the most vulnerable countries to the impacts of climate change, including droughts, floods, and extreme weather events. These impacts have the potential to harm economic growth and disrupt supply chains and may also exacerbate poverty and inequality.
- Digitisation: The digital economy is rapidly growing and is becoming an increasingly important driver of economic growth and job creation. However, many South African businesses and workers lack the skills and infrastructure needed to fully participate in the digital economy.
- Just Transition: South Africa will need to transition to a low-carbon economy to mitigate the impacts of climate change and meet its commitments under the Paris Agreement. This transition will have significant implications for workers and communities that have traditionally relied on fossil fuel-based industries.
- Dilapidated Infrastructure: Many of South Africa's economic and social infrastructure, including transportation, energy, and water systems, need repair and upgrading. Lack of maintenance, coupled with rising population pressures, can cause breakdowns and failures in key services, which will have a negative effect on the economy and society.
- Erosion of Social Cohesion: High unemployment, poverty, income inequality, and the cost-of-living crisis continue to be major challenges in South Africa. Addressing these issues will be key to achieving a stable and prosperous economy. Poor social cohesion can lead to increased crime and other social problems, which can act as a drag on economic growth and investment.
- Economic and Political Risks for South Africa in 2023: South Africa will be at risk of an inflation shockwave as a result of the global inflation that began in the United States in 2021 and spread worldwide in 2022. This economic phenomenon is expected to have a significant impact on the country, leading to a recession and increased financial stress. Additionally, it may also fuel social unrest and political instability. Another risk facing South Africa in 2023 is the potential for rising interest rates and a global recession. This could lead to a crisis in emerging markets, as seen in the past during the early 1980s, 1997, and 2008, when a sudden stop in capital flow occurred. This could be a nightmare scenario for South Africa and would have a severe impact on the country's economy.

Addressing these challenges will require a strategic and multi-faceted approach, including significant investments in infrastructure, education, and training investments, and smart and sustainable economic policies that promote growth and social inclusion.

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