SOUTH AFRICA

AN ECONOMY PARALYSED BY LOAD SHEDDING

After years of underinvestment in its power grid, South Africa is experiencing daily load shedding, the intensity of which has only increased in recent months. Economic activity is severely impacted. The restoration of electricity production capacities will be slow, which will have a significant impact on growth and the trade balance in 2023. Supply-side constraints will keep inflation high, while the unemployment rate is a concern. Under these conditions, the ruling party, the ANC, will be pushed to revise its budgetary consolidation trajectory downwards. Furthermore, the partial transfer of the debt of electricity company Eskom to the government will contribute to a sharp increase in public debt.

Between 1991 and 2021, while South Africa's electricity needs increased, Eskom built only one power plant. Years of corruption and mismanagement have left the utility company with a considerable debt that has prevented it from investing heavily in building new infrastructure and maintaining the old ones. As a result, production is now insufficient to meet demand. In order to preserve the national electricity grid, Eskom has to resort to voluntary power outages, which have a significant impact on the country's economic growth, public finances and political stability.

SUDDEN SLOWDOWN IN GROWTH

Compared to the anaemic growth experienced by South Africa before the pandemic (1% on average over the 2015–2019 period), the 4.9% growth rebound in 2021 was a promising record. However, it turned out to be short-lived: caught up by long-known infrastructure constraints, growth suddenly slowed to 2% in 2022, bringing South Africa's GDP back to its pre-pandemic level by the end of the year.

Last year, economic activity experienced a sharply fluctuating development marked by an initial contraction in Q2 (-0.8% q/q) attributable to severe weather conditions affecting the KwaZulu-Natal region, as well as the first high-intensity cases of load shedding imposed by the public company for electricity Eskom. The country saw a record 207 days of load shedding in 2022 (compared to 75 in 2021), which increased both in frequency and intensity over the last quarter, which alone amassed 90 days of load shedding. As a result, economic activity in Q4 contracted again (-1.3% q/q), well beyond the forecasts of the South African authorities.

The primary and secondary sectors, which include energy-intensive industries, are threatened by the most intensive stages of load shedding. More specifically, the mining sector contracted by 7% in 2022, also held back by logistical constraints and the strike at the public carrier Transnet last October. The secondary sector contracted by 0.9%, weighed down by the decline in the construction sector since 2017. Thus, only the tertiary sector proved to be a vector for growth in 2022, supported by finance (+3.9%) and trade (+3.5%).

Over the whole calendar year, despite the adverse environment, investment growth accelerated to 4.7%. However, this is mainly a rebound effect after almost zero growth (+0.2%) in 2021, since gross fixed capital formation remained 10% below its 2019 level in 2022. Household consumption was robust (+2.6%), while it had already recorded a solid upturn of 5.6% in 2021. It thus exceeded its 2019 level by 2%. However, inflation remained at a high level. Since May 2022, it has been above the upper bound of the Central Bank's target (6%), propelled by the rise in commodity prices and the persistence of bottlenecks in the country. The Central Bank was therefore forced to raise its main policy rate by 350 basis points over the past twelve months bringing it to 7.75% at the end of March. Despite these interventions, the rise in prices continued to spread to all sectors of the economy: inflation accelerated slightly to 7% year-on-year in February, buoyed by food price inflation (+13.6%) and inflation in the transport sector (+9.9%). It is expected to decrease only very slowly in the coming months, forcing the Central Bank to keep its key rate around its current level until the end of the year.

The short- and medium-term growth outlook is heavily impacted by the electricity shortage. The South African Central Bank estimates that it would cost growth 2 points of GDP in 2023, for an expected 250 days of load shedding. Despite the declaration last February of a national

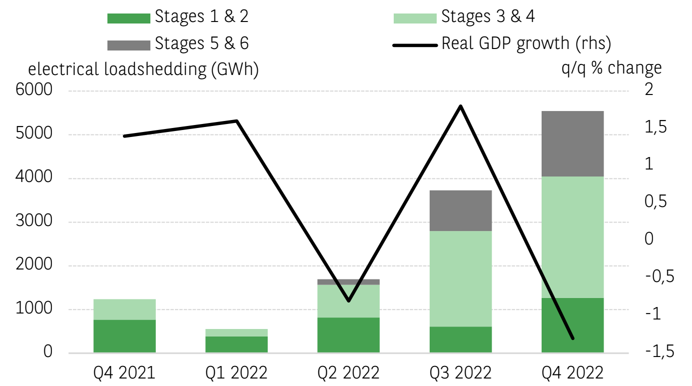
FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-6.3	4.9	2.0	0.2	1.0
Inflation, CPI, year average, %	3.3	4.6	6.9	6.1	5.4
Central Gov. balance / GDP, % (1)	-9.8	-5.1	-4.6	-4.5	-4.6
Central Gov. debt / GDP, % (1)	70.7	68.0	70.1	70.6	71.1
Current account balance / GDP, %	2.0	3.7	-0.5	-1.6	-1.8
External debt / GDP, %	47.3	39.4	40.6	41.2	41.3
Forex reserves, USD bn	54.2	55.5	59.0	60.2	61.4
Forex reserves, in months of imports	8.2	6.4	5.1	5.0	4.8

TABLE 1

(1) FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SOUTH AFRICA: LOAD SHEDDING INCREASED IN FREQUENCY AND INTENSITY



Note : to reach a higher stage of loadshedding means Eskom rations the country by a further 1000 MW of power

CHART 1

SOURCE: CSIR, STATS SA, BNP PARIBAS

state of disaster making it possible to accelerate the development of energy-generating projects and to open up the electricity distribution network to the private sector, the restoration of production capacities will be slow and uncertain.

A MISSED OPPORTUNITY FOR COMMODITY EXPORTS

After the sharp contraction of the economy in Q2 2020, exports were the driver of the post-Covid economic recovery. Driven by the surge in commodity prices, they reversed the trade balance trend, which was structurally in deficit, and generated historically high trade surpluses. However, since the start of the war in Ukraine, the 12-month rolling trade balance has gradually eroded, returning to its lowest level since September 2020 at the end of 2022.

The trend can be explained firstly by the sustained increase in import volumes, up 14.2% annually, combined with the deterioration in the terms of trade. In particular, the rise in global prices is weighing heavily on oil imports in value terms, which rose 79% year-on-year in December and accounted for 23% of total imports in Q4 2022. In addition, there is a risk that demand will increase in the coming months. Indeed, Eskom is limiting the intensity of load shedding at the most critical times by using electric generators running on diesel. At the same time, exports have recorded lower growth rates than imports since June 2021, weighed down in particular by the sharp contraction in the mining sector.

Thus, 2022 sounded the death knell for the current account surpluses that had been observed since the start of the pandemic. The current account deficit is expected to widen in 2023, as the increased constraints on the primary sector and its exports will not allow South Africa to fully benefit from the still-high prices of commodities and the reopening of China.

THE BURDEN ON PUBLIC FINANCES

The resolution of the energy crisis in South Africa will have a direct impact on the country's public debt trajectory. After years of poor management, Eskom has accumulated a debt equivalent to 6% of South African GDP, leaving it powerless. For Eskom to continue to operate, last February the government announced it would take on 60% of the stock of this debt. This debt relief will gradually extend over the next three years through zero-interest loans and a direct debt transfer that will take place during fiscal year 2025/26. As a result, public debt will increase significantly in the medium term, while it already reached 70% of GDP at the end of fiscal year 2022/23.

Furthermore, in this deteriorating economic environment, the government's persistent optimism about the trajectory of reducing budget deficits should be viewed with caution. The sudden stop to growth in 2023 will have a significant impact on government revenues, and will contribute to the deterioration of the budget deficit beyond the 3.9% envisaged by the government for the 2023/24 fiscal year.

In addition, there are numerous risks of fiscal slippage which are already materialising. Last February, when the government presented its budget for the coming fiscal year, it was counting on a 4.7% revaluation of public sector salaries. However, negotiations with trade unions have been turbulent. As they are about to be concluded, the government has finally proposed a 7.5% wage increase, which will put a heavy strain on the trajectory of the fiscal balance. In addition, trade unions want to sign an agreement for two years only, compared to a typical term of three, which would increase uncertainty in the medium term. It seems

SOUTH AFRICA: END OF THE EXPORT BOOM

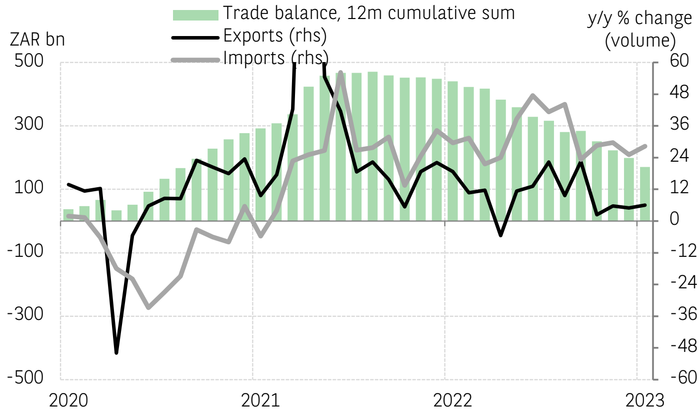


CHART 2

SOURCE: SARS, BNP PARIBAS

unlikely that the government will be able to limit its other expenditure items to compensate for this unforeseen event. The temporary social relief allowance introduced in 2020 in response to the pandemic shock was extended until March 2024. Its continuation is being increasingly envisaged given the stagnation of the labour market, burdened by a worrying unemployment rate (32.7% in Q4 2022). Coupled with high inflation, all of these factors are putting a heavy strain on the popularity of the ANC, which is going through a profound crisis.

A POLITICAL CRISIS

The electricity crisis turned into a major political crisis from the beginning. It has become a symbol of the government's difficulties in bringing about significant reforms, evidenced by the proliferation of Eskom's supervisory bodies, the creation of a new Ministry of Electricity, and the declaration of a severely criticised national state of disaster.

This paralysis is deeply eroding the population's support for the ANC, which had already reached its lowest historical level in the last local elections in 2021. According to the latest polls, voters are turning away from the ANC in droves due to the persistence of load shedding. The ruling party may not be able to form a majority in the upcoming 2024 general elections given its current popularity.

The re-election of President Cyril Ramaphosa as leader of the ANC last December ensures the continued fight against corruption in the short term. However, in the race for the presidency, there will be many challenges for the ANC. Its priority to limit the intensity of load shedding via massive oil imports, in order to preserve its electorate, constitutes an additional risk to the budget and the success of this approach will be decisive with regard to the alliances that the party will have to form to maintain power. A coalition with the political party Economic Freedom Fighters, desired by a more radical fringe of the ANC, could jeopardise the ambitions of reforms and the fight against corruption. It would also send a negative signal to international markets, while the FATF has just put South Africa on its grey list for its lack of transparency in the fight against money laundering and terrorist financing.

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