SOUTH AFRICA

A LONG, HARD ROAD

The South African economy narrowly avoided recession at the end of 2023. The poor quality of the country's infrastructure is significantly slowing down activity. In addition, the government lacks fiscal leeway and disinflation is slow and uneven, forcing the central bank to maintain its restrictive monetary policy. Faced with numerous macroeconomic challenges, the African National Congress (ANC) has initiated long-awaited reforms, but at a pace that is deemed insufficient. It is likely to pay the price at the general elections in May and lose its absolute majority in Parliament for the first time in its history. The choice of the party with which to form a coalition could disrupt the momentum of reforms and the trajectory of public debt.

FROM ENERGY CRISIS TO LOGISTICS CRISIS

In 2023, South Africa's economic growth slowed to 0.6%, held back by the accumulation of constraints due to the country's failing infrastructure. Firstly, the power cuts imposed by the state-owned company Eskom reached a peak with 335 days of load shedding, including 106 days at critical levels 5-6 (compared with 205 days, including 32 at levels 5-6 in 2022). According to the central bank (SARB), the electricity shortage subtracted 1.5 percentage points (pp) from GDP growth. In addition, logistics bottlenecks, which are penalising rail and sea transport, persisted in 2023 (chart 1). Last December, the state-owned company Transnet, which is in charge of this sector, had accumulated a backlog in the delivery of goods estimated at 0.7% of GDP. Against this backdrop, the economy narrowly avoided recession in Q4 2023: GDP rose marginally (+0.1% q/q) after contracting in Q3 (-0.2% q/q).

With economic growth expected to reach 1.1% in 2024, the outlook remains gloomy, although improving slightly. Load shedding will continue, but the worst of the energy crisis is over: the increase in private power generation facilities following the liberalisation of the sector in 2022 has gradually reduced demand for Eskom, while supply rebounded in Q4 2023 with the (temporary) resumption of activity at the Kusile power stations. Nevertheless, logistical difficulties will persist and prevent a more dynamic upturn in activity. On the demand side, investment and the rebound in consumption should support economic growth: after two quarters of contraction, household consumption picked up again in Q4 2023, and this momentum should continue as inflation gradually recedes. Since July 2023, growth in the consumer price index has remained below the SARB's upper target (6%), but in March 2024 it still stood at 5.3% y/y. The disinflation process will still be slow and uneven in the coming months: inflation is not expected to return to its preferential target (4.5%) until the end of the year. In addition, the Governor of the central bank recently announced that the preferential inflation target could be revised downwards by the end of 2024 in an attempt to make the economy more competitive. If such a measure is confirmed, the start of the SARB's monetary easing cycle, which is not currently expected before September 2024, could be delayed.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, %	4.7	1.9	0.6	1.1	1.7
Inflation, CPI, year average, %	4.6	6.9	5.9	4.8	4.5
Central Gov. balance / GDP, % (1)	-5.1	-4.7	-5.4	-4.8	-4.7
Central Gov. debt / GDP, % (1)	67.8	70.9	74.0	76.4	78.4
Current account balance / GDP, %	3.7	-0.5	-1.6	-2.8	-3.0
External debt / GDP, %	38.2	40.5	41.0	41.8	41.2
Forex reserves, USD bn	57.6	60.6	62.5	63.0	63.5
Forex reserves, in months of imports	5.4	4.8	5.3	5.0	5.2

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: ONGOING INFRASTRUCTURE CONSTRAINTS

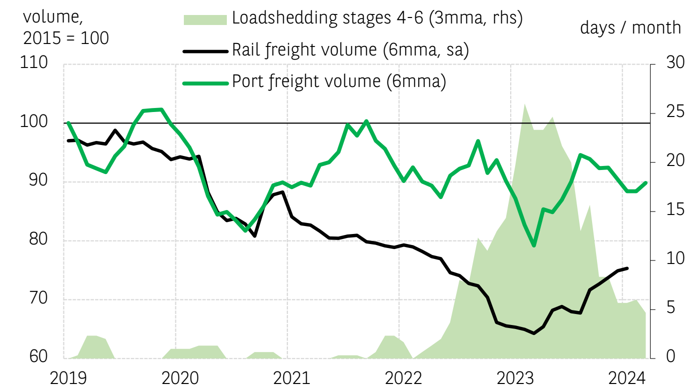

CHART 1

SOURCE: STATS SA, TRANSNET, ESKOMSEPUSH, BNP PARIBAS

A SHORTAGE OF PHYSICAL AND HUMAN CAPITAL

The infrastructure crisis is the result of chronic under-investment, but the severity of the failures of Eskom (electricity) and Transnet (logistics) over the past two years has finally made economic agents react. Thus, in 2023, investment continued the rebound that began in 2022, recording growth of 4.2%, driven by private sector investment (+4.9%, 72% of total gross fixed capital formation). However, at 15.2% of GDP, the investment rate has barely caught up with its 2019 level and remains below the 2011-2015 average (18%). It is also well below the average for upper-middle-income countries (34% of GDP), to which South Africa belongs.

Labour market trends are also worrying: at 32% at the end of 2023, the unemployment rate was still 3 pp above the levels seen in 2019. The extended unemployment rate, which takes into account discouraged jobseekers, was over 41%. Among young people (aged 15-24), unemployment was even more pronounced, exceeding 60% on average over 2023. In addition to the unfavourable economic climate, these figures also reflect a mismatch between the supply of skills and business demand. According to the OECD, in 2022 only 50% of 25-34 year-olds had a higher secondary education qualification, and only 1% of them had a master's degree (or equivalent). Yet public spending on education as a proportion of GDP is among the highest in the world (6.2% of GDP in 2022). Improving the quality of education in the long term will therefore require better management of spending.

It will take several years to make up the ground lost over the past decade in terms of physical and human capital, and thus sustainably restore the country's long-term growth potential. In the meantime, in an environment of weak economic growth, pressures on public finances will become increasingly acute.

PRAGMATISM IN PUBLIC FINANCES

The attempt at fiscal consolidation in 2023 has not borne fruit. Over the first eleven months of the fiscal year (April 2023 to February 2024), expenditure rose by a moderate 4.7% y/y, but revenue stagnated at +0.8%. The latter is being dragged down by the 11% contraction in corporate taxes, which had reached record levels in 2022 thanks to the strong performance of the mining sector, among others. For the 2023/24 fiscal year as a whole, the public deficit is expected to reach 5.4% of GDP, compared with 4.7% a year earlier.

Given the weakness of economic growth and the need to consolidate public finances, there is little room for manoeuvre in the budget. Thus, despite a difficult election campaign for the ANC, expansionary measures for 2024/25 were limited. The Social Relief of Distress (SRD) allowance has been extended until March 2025 but has still not been officially made permanent, and its increase for 2024/25 (+5.7%) is more or less indexed to inflation. Although the National Health Insurance Bill was passed by Parliament at the end of 2023, it did not receive any additional financial support in last February's budget. In addition, after much controversial debate, the Treasury has finally opted for cautious management of the profits made on its Gold and Foreign Exchange Contingency Reserve Account (GFECRA) held at the SARB: of the ZAR 507 bn in profits, ZAR 150 bn (2% of GDP) will be withdrawn over the next three years and will be used to reduce pre-existing financing requirements, not to finance new spending.

Despite these efforts, the Treasury's budget forecasts seem too optimistic to us. On the one hand, the economic growth rates forecast for the short and medium term seem too high. On the other hand, the primary budget surplus is likely to remain lower than forecast and public debt is unlikely to stabilise by 2026-27 (chart 2). The upward trend in debt interest costs (21.6% of government revenue in 2023/24) and weak GDP growth will automatically push up the debt-to-GDP ratio, beyond the Treasury's control. In addition, there are still major risks of fiscal slippage (materialisation of contingent liabilities owed to state-owned companies, perpetuation of the SRD, financing of health insurance). The announcement of the 2024/25 budget in February did not have the desired effect of reassuring investors: interest rates on Treasury bonds rose again (reaching 12.5% on the 11-year bond in mid-April, compared with 11.4% in mid-January), while the share of foreign investors in the domestic Treasury bond market fell to a record low of 24.6% in March. The uncertainty surrounding the May elections is also a major factor in investor concerns.

TOWARDS A COALITION GOVERNMENT

All eyes are now on the general elections of May 29th. Despite strong differences over the outcome of the vote, which calls for caution, all the polls so far point to one common result: the ANC is set to lose

SOUTH AFRICA: TRAJECTORY OF THE PUBLIC DEBT RATIO

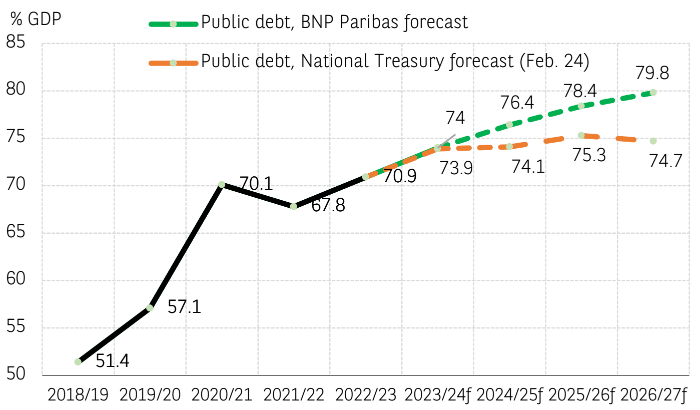

CHART 2 SOURCE: NATIONAL TREASURY, BNP PARIBAS

its absolute majority in Parliament. Since last December, the ruling party has fallen in the polls following the creation of the uMkhonto we Sizwe (MK) party, led by Jacob Zuma, the country's president from 2009 to 2018. Zuma, who is still very popular in the province of KwaZulu-Natal (2nd largest province in terms of the number of voters), could win between 7% and 13% of the vote, according to the most recent polls.

If the ANC manages to hold on to around 44-45% of the vote, it should be able to form a coalition government with a minority party. This would enable it to pursue its policy of structural reform over the next five years without too much trouble, thus guaranteeing relative economic and political continuity. On the other hand, if the ANC were to fall below the 44% mark, an alliance with one or more rival parties would be more delicate and would require compromises (transfer of a key ministerial portfolio). With a month to go before the elections, everything could change: the Constitutional Court still has to decide whether Jacob Zuma can stand in the elections. Its decision could reshuffle the deck.

PRESSURE ON EXTERNAL ACCOUNTS

In 2023, the current account deficit increased to 1.6% of GDP (compared with 0.5% in 2022). With the fall in the price of the raw materials the country exports (the price of coal, which accounts for more than a quarter of mining output, fell sharply in 2023), the trade surplus shrank from 2.9% to 0.9% of GDP. Net capital inflows held up well, amounting to 1.3% of GDP over the year as a whole, but slipped into negative territory in Q4 due to net portfolio investment outflows. The same dynamic is set to continue in H1 2024, putting downward pressure on the exchange rate. Since the beginning of the year, the South African rand (ZAR) has been trading above ZAR 18.5/USD. These pressures are likely to intensify in the coming weeks, ahead of the elections. In 2024, external accounts are also expected to suffer from the widening of the current account deficit, expected to reach 2.8% of GDP.

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