Little upward traction for South African growth

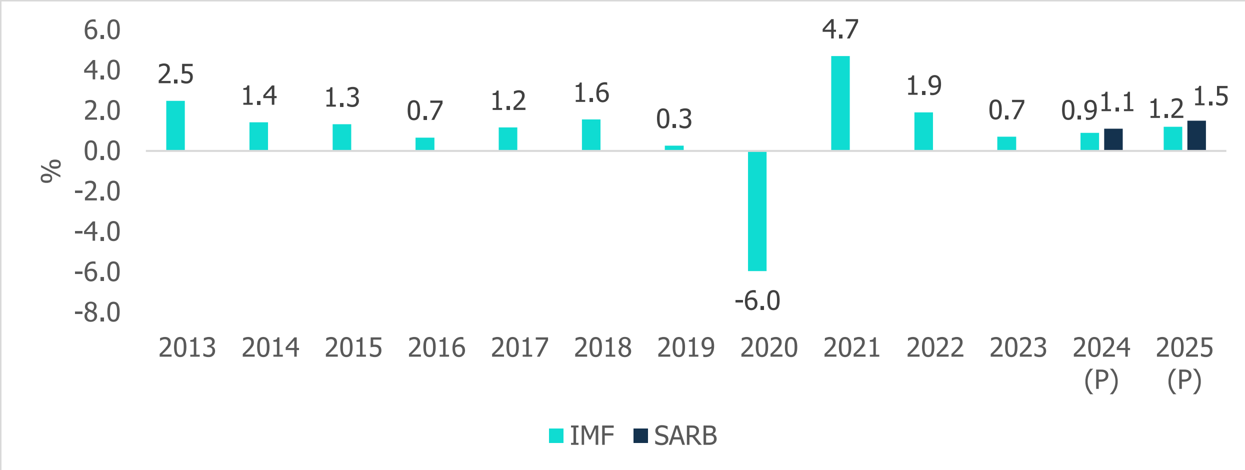
For South Africa, the IMF marginally revised its original projected GDP for 2024 from 1% to 0.9%. This was on the back of the economy contracting by 0.1% in Q1 2024. On the production side, low electricity production led to an uptick in load-shedding over Q1 negatively impacting the energy-intensive mining and manufacturing sectors. The downturn in these industries also weighed on freight transport, which dragged down the transport, storage, and communications industry. Further, constrained consumption amid high interest rates hurt services. On the expenditure side, the weakness was broad-based, with gross domestic expenditure and net exports falling. Household consumption expenditure, fixed investment, and government spending declined. There was also a significant inventory drawdown in Q1 following massive accumulation in Q4 2023 (also see South Africa Economy Update - June 2024).

For the remainder of 2024, South Africa faces another year of little to no upward traction in economic growth. This is due to tough operating conditions on the supply front (amidst underlying energy and logistics structural constraints), weak domestic demand, and a constrained global landscape. In H1 2024, high domestic interest rates will continue to strain household finances, weighing on consumer confidence and demand. On the global front, soft demand will continue undermining production across sectors. However, these pressures may start easing slightly in H2 as inflation continues its downward trend and the monetary policy easing cycle begins. **Altogether, while growth is expected at 0.9% in 2024, it remains slightly higher than 0.7% in 2023.**

Looking ahead, the IMF projects growth to improve to 1.2% (originally projected at 1.4%) for 2025. The improved growth outlook rests on less frequent load-shedding, with additional generating capacity coming online. Further, the IMF believes that there is room for interest rates to start declining as inflationary pressures recede, which may support consumption.

In its July Monetary Policy Committee (MPC) meeting the South African Reserve Bank (SARB) also lowered its growth projections for 2024 marginally from 1.2% to 1.1%. Nonetheless, further improvements in the country's power supply and logistics are expected to drive faster growth in the medium term. As such, the SARB projects growth in 2025 at 1.5% (from 1.4%). The SARB also noted that there is adequate scope for structural reforms to lift growth to higher ground over the medium term.

South African Real GDP growth



Source: SARB; IMF, World Economic Outlook

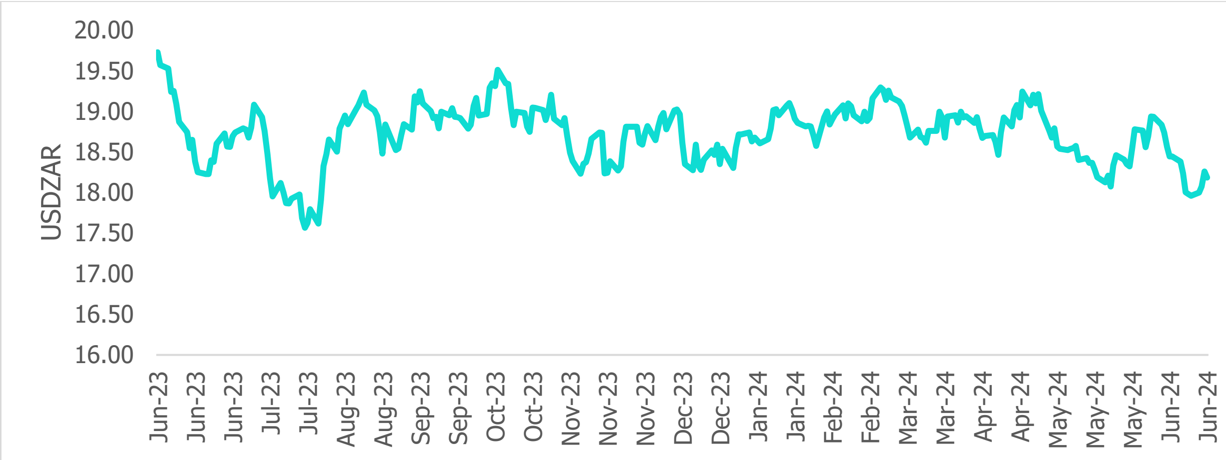
The Rand will take direction from sentiment around rate cuts

There are several factors which have supported the Rand over the past month. On the domestic front, the Rand gained on the back of reduced political uncertainty following the general elections on 29 May. So far, the market has reacted positively to the formation of a Government of National Unity (GNU) composed of the previous ruling party- the African National Congress (ANC), the Democratic Alliance (DA) and several other political parties. With the new government in place, the country remains on track towards achieving fiscal consolidation and growth reforms. However, the risk of political instability remains, as the alliance with the DA is still fragile.

Globally, market speculation for US interest rate cuts has lent some support to emerging market (EM) currencies such as the Rand. The market currently expects the US Fed to cut rates in September and December this year, which will limit the upside potential for the US dollar and provide Rand strength. However, Rand's strength may be limited by domestic rate cuts, which is now looking more likely, given the SARB's lower inflation forecast for the medium term (see below). The market is now factoring in almost an 80% chance of a 25bps interest rate cut at the SARB September MPC meeting, and just above a 40% chance of another 25bps rate cut at the November meeting. It is not certain these interest rate cuts will materialise because inflation data between now and then will have a marked influence on the interest rate decisions made by the SARB.

Lastly, the US elections and the consequent trade policies will have an impact on global growth and global risk appetite. EM currencies like the Rand will move based on sentiment around the election outcome.

USD/ZAR Movement



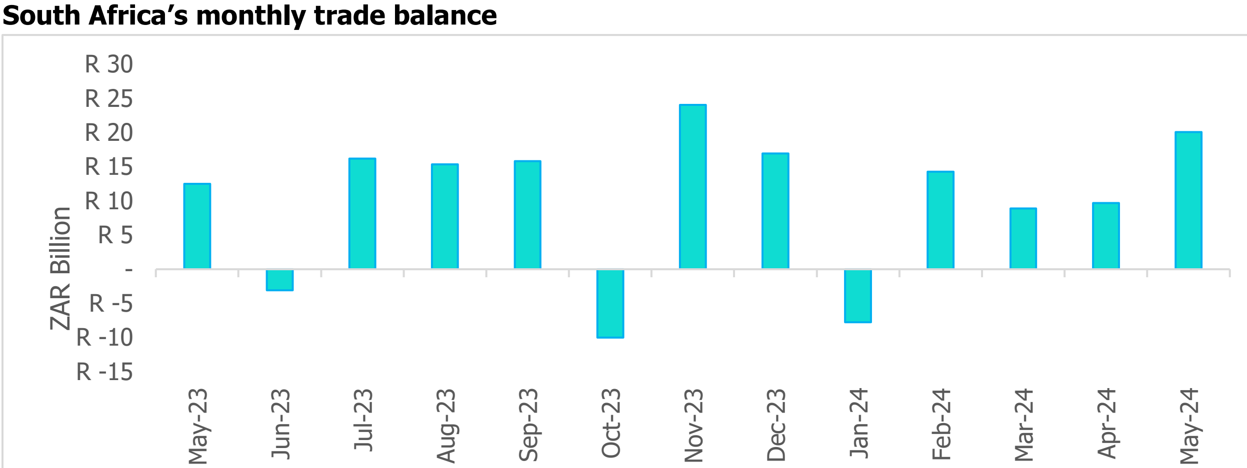
Source: BIS

Trade surplus continues in Q2

The trade surplus widened to ZAR20.1 billion in May from a revised ZAR9.7 billion in April. The growth in exports was led by vegetable products (25%) and prepared foodstuff (13%). While imports sustained a fall coming primarily from vegetable products (-15%) and textiles (-10%). The YoY figures for both exports and imports for May fell by 3% and 7% respectively.

Looking ahead, the surplus trend in the trade balance could be sustained through 2024. Exports will likely improve further on steadier electricity supply and improved logistics. In addition, the world economy is expected to fare better in H2 as easing monetary policy globally lifts demand in most advanced countries, and China's stimulus and interventions start to translate into firmer activity. Import volumes will likely remain subdued for longer based on subdued domestic demand, with a possible recovery toward year-end as domestic demand recovers, supported by lower inflation and easing interest rates.

South Africa's monthly trade balance



Source: South African Revenue Service

Headline inflation sticky, but food inflation continues on downward trend

Headline inflation eased to 5.1% YoY in June, down from 5.2% in May. Over the past 10 months, inflation has remained within the 5%-6% range. This is towards the SARB's upper target band for inflation of 6%. Almost all the major subcategories recorded lower annual price increases, including 'food', 'transport', 'housing and utilities' and 'miscellaneous goods and services'.

Inflation for food and non-alcoholic beverages (NAB) edged lower to 4.6% YoY in June from 4.7% in both May and April and from the peak of 14.0% in March 2023. June's reading is the lowest since September 2020- at the peak of the COVID-19 lockdowns. Several food and NAB categories registered lower annual rates in June, including sugar, sweets and desserts, vegetables, fruit, milk, eggs and cheese, and fish.

However, inflation increased for hot beverages; bread and cereals; oils and fats; cold beverages; and meat. Bread and cereals saw its first increase in 14 months, rising to 5.2% YoY in June from 3.9% in May. For some context, the producer price index (PPI) for final manufacturing, which measures prices at the factory gate, recorded a 4.6% YoY increase for maize products in May. Maize in the agriculture PPI increased by around 23.8% YoY in May. PPIs are often leading indicators of the CPI, as such, the data suggests that elevated inflation for maize-based products is widespread.

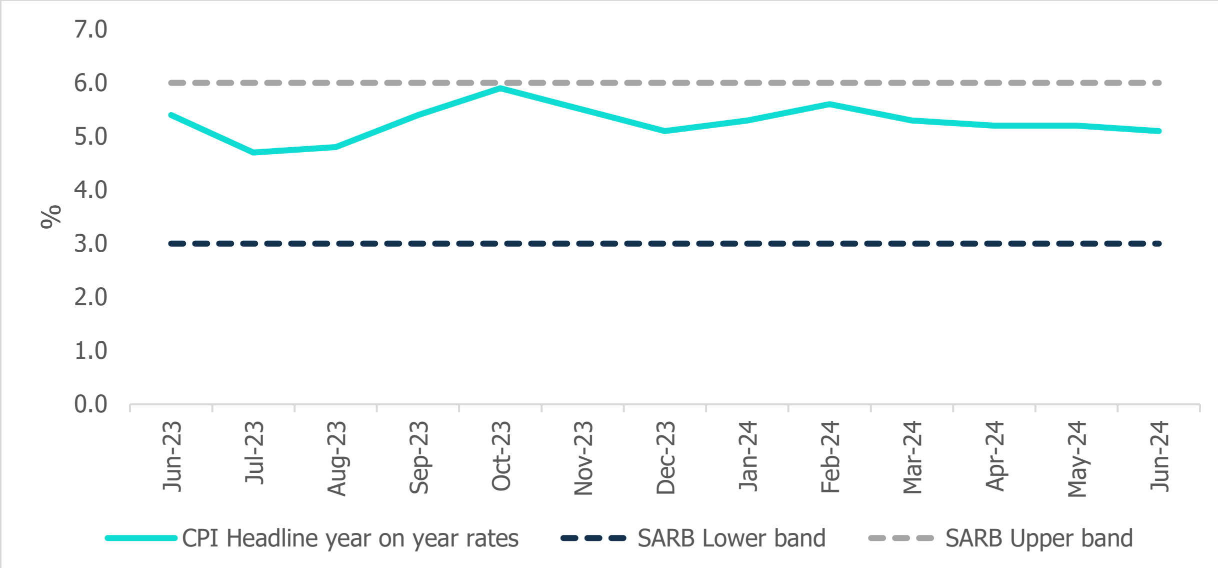
Transport inflation decelerated to 5.5% YoY in June from 6.3% in May due to a slower increase in fuel prices. In June, petrol prices declined by 4.5% as the rand appreciated against the US dollar, which outweighed the impact of the higher price of Brent crude oil for the month. Lastly, public transport costs and vehicle prices are also moderated.

Housing and utilities inflation fell to a 7-month low of 5.5% YoY in June from 5.8% in May, mainly dragged down by 'owners' equivalent rent', which eased to 2.8% from 3.3%. Actual rentals for housing also edged down slightly.

Prices of miscellaneous goods and services edged down to 7% YoY in June from 7.1% in May, dragged down by lower costs of personal care, while price increases for insurance increased slightly, and 'funeral and other services' were steady.

Lastly, core inflation also eased marginally to 4.5% in June to the midpoint of the SARB's inflation target band from 4.6% in May and April, as higher interest rates continued to subdue domestic demand.

South African monthly inflation



Source: Statistics South Africa

SARB MPC held interest rates steady in July meeting

The SARBs MPC left the repo rate unchanged at 8.25%. The decision was split, with two of the six members favouring a rate cut of 25bps.

The SARB sees the inflation outlook improving modestly. For 2024, headline inflation is expected to average 4.9%, lower than the 5.1% expected during the May meeting. Further, inflation is now seen reaching the midpoint of the target range in Q4 2024, vs Q2 2025. For 2025, inflation is forecast to average 4.4% from 4.5% previously, while the 2026 forecast is unchanged at 4.5%.

The core inflation forecast was also revised slightly lower to 4.6% (from 4.7%) for 2024 and 4.4% (from 4.5%) for 2025 but left unchanged at 4.5% in 2026.

The SARB remains concerned with the trajectory of inflation expectations, as the latest inflation expectations survey shows average expectations trending around 5% over the next 3 years, above both the SARB's 4.5% midpoint target and its forecasts. As such the MPC assesses the risks to the inflation outlook to the upside. The main risks to the outlook stem from higher global interest rates and the likely adverse implications for the Rand, elevated inflation expectations, and higher administered prices and services inflation.

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