Only time will tell how these domestic challenges and external shocks will shape South Africa's economic reality

By Mosi Methula 01/02/25

The eurozone has been grappling with slow growth and political instability in several of its major economies. One prominent example is the aftermath of the snap French election in 2024, initiated by President Emmanuel Macron, which resulted in a hung parliament, meaning no party with a majority vote. This led to fragmentation in the French parliament, particularly over the nation's 2025 budget, which has faced significant delays. A vote of no confidence will take place on 5 February, determining the fate of Prime Minister François Bayrou and his government. Germany faced its second consecutive year of economic contraction, with a 0.2% GDP decrease in 2024. Later this month, the country will head to the polls, after its three-party coalition government disbanded in November 2024. On Thursday, January 30, European Central Bank (ECB) President Christine Lagarde announced an interest rate cut of 25 basis points to 2.75% in an attempt to boost growth within the eurozone economy, which stagnated in Q4.

The inflation rate continued to fluctuate above 2% throughout 2024, which is the ECB's expected medium-term target; additionally, the eurozone also benefited from a strong job market, with a low unemployment rate of 6.3% in December. However, their outlook remains cautious. Macro headwinds, such as threatened US tariffs, potential slow-to-recover consumption and investment levels, as well as disrupted energy supplies through geopolitical tensions, could hamper global trade and slow EU growth.

In contrast, the US economy has had a more resilient trajectory with a Q4 2024 GDP growth of 2.3%. Equity markets saw slight movement after the US Fed's much-anticipated halt to rate cuts, maintaining the federal funds rate at 4.25%-4.50%. This marked their first pause since September 2024. The Federal Open Market Committee (FOMC) statement highlighted a strong economy, low unemployment, and easing yet stubborn inflation above their 2% target. Fed chair Jerome Powell awaits further inflation figures, consumer behaviour data and the effects of Trump's policies, stating at the Fed's recent policy meeting, "The committee is very much in the mode of waiting to see what will happen".

On 4 February, China faces a newly imposed 10% additional tariff in response to Trump's accusation that China illicitly exported fentanyl to Mexico and Canada, which then found its way into the US, contributing to overdose deaths. This move, based on such a serious accusation, is diplomatically damaging and could escalate the ongoing back-and-forth trade controls between the two economic giants, further hurting bilateral trade. The Chinese Foreign Ministry spokesperson, Mao Ning echoed the same sentiment, that there are no winners in trade or tariff wars. In addition, the US White House on Tuesday will go forward with 25% additional tariffs on Canada, with its crude oil subject to a lower 10% tariff. Canada has threatened retaliation—25% tariffs against $155 billion worth of US goods. Following a conversation between Trump and Mexican President Claudia Sheinbaum, it was announced that US tariffs have been delayed by one month after a deal was reached between the two administrations.

The tense trade relations between the US and China brought more light to the $1 trillion US tech selloff on January 27. This coincided with a surprising development in China's

AI space, as DeepSeek, an AI lab based in Hangzhou, released its open source, free-to-use R1 large language model (LLM), which was trained using US-censored Nvidia chips. The model offers reasoning capabilities on par with leading US AI models, but at a fraction of the cost. LLMs are trained on vast datasets to respond to user prompts, such as answering questions like a human would, and despite using older Nvidia chips, the R1 model demonstrated that superior AI performance can be achieved with less powerful computing resources. This challenges the common idea that ultra-expensive AI infrastructure is essential to compete with Big Tech in AI. Secondly, the model is open source, unlike, for instance, ChatGPT's underlying models, further contributing to the democratization of AI technology.

The developer of the R1 model, DeepSeek, reportedly bypassed US export controls to obtain some of its hardware, raising concerns that protectionism hampers innovation in the AI space. The US posed national security concerns as the rationale for imposing these controls, but it may suggest something more startling: other countries can replicate similar advancements. Innovation, after all, is not a one-way street; it thrives on continuous global collaboration and competition. Full exposure to AI developments from diverse regions, including East Asia, would accelerate progress and ultimately benefit the whole industry.

As Trump cites trade deficits as the need for tariffs, stagflation—characterised by high inflation and stagnating growth, could unexpectedly persist in his economy, given that goods from China, Canada and Mexico account for over a third of all US imports. These policies may create recessionary pressures for both Canada and Mexico, with modest growth figures.

Turning to South Africa, our reserve bank recently held a meeting on 31 January, in which it announced its third consecutive 25 basis point cut, putting the current repo rate at 7.50%. Governor, Lesetja Kganyago reiterated in the newly issued Statement of the Monetary Policy Committee that they still hold an "uncertain global outlook." This comes as external factors are more imminent including possible global tariffs, fewer rate cut expectations and core inflation still above central bank targets. The committee's trade war scenario highlighted a universal 10% increase in US tariffs and retaliatory responses by other economies, giving way for higher global inflation and interest rates. This could tank the rand to R21 to the dollar and see an uptick in domestic inflation to 5%, with the repo rate 0.50% higher. This is an unlikely situation, but it illustrates the Monetary Policy Committee's (MPC) commitment to careful policy decision making.

The SA economy experienced average headline inflation of 4.4% in 2024, attributed to a 15-year low food inflation and lower fuel prices. Following a GDP contraction of 0.3% in Q3 2024, the MPC expects a rebound in growth for Q4 2024 due to stable agricultural production and higher consumer spending, driven by lower price increases and Two-Pot pension withdrawals, topping R43 billion. These tailwinds have made the MPC forecast a higher growth trajectory possibly reaching 2% by 2027.

The country was shocked when the term 'loadshedding' reappeared in our conversations after 310 days of uninterrupted power supply. This followed Eskom Group Chief Executive Dan Marokane's Friday announcement of planned Stage 3 loadshedding between January 31 and February 2, due to a 3600 MW loss in coal capacity, which resulted in depleted diesel and pumped-storage reserves. The situation worsened when, just a day before the announcement, Eskom was granted approval by the National Energy Regulator of South Africa (Nersa) to raise electricity tariffs by 12.7%, aiming to better meet its growing financial obligations. The public did not react lightly to this news, with Electricity Minister Kgosientsho Ramokgopa warning that it could undermine economic growth and increase poverty as a result.

South Africa continues to grapple with structural challenges, including high crime rates, corruption, weakened state institutions, rising national debt, staggering unemployment, expanding social welfare costs and a strained tax base. As a result, the risk premium for the country remains elevated, and the country's economic outlook continues to hang in the balance. The growing political nuances in the country add uncertainty to its economic trajectory. That said, only time will tell how these domestic challenges and external shocks will shape South Africa's economic reality.