Parliamentary Budget Office

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Quarterly Economic Brief

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Boxes

The Parliamentary Budget Office (PBO) was established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees.
The PBO provides quarterly analysis of economic developments for Members of Parliament following the release of quarterly economic data by Stats SA, the South African Reserve Bank and the National Treasury.

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Introduction

This Parliamentary Budget Office's (PBO) Quarterly Economic Bulletin (QEB) provides an update of the performance of the South African economy for the third quarter of 2020. The QEBs usually provide economic updates, particularly with regard to the macroeconomic performance, based on the most recent quarterly and monthly data releases from organisations such as Statistics South Africa (StatsSA) and the South African Reserve Bank (SARB). The Covid-19 pandemic has been such an important and hugely disruptive event in the global economy and on South African society. As a result, the economic situation changes quite rapidly from one quarter to the next, where this quarter's economic trends have been no different.

As we compile this QEB while in lock down, one thing we know is that no-one can reliably predict the severity of the pandemic and the human and socio-economic impact it will have in the long-term. The lockdown regulations continue tighten and loosen with the rate of infection in the country and because of this, the nature of the pandemic on economic activity, the organisation of work, and communities appears to not only be unsettling but persistent. COVID-19 has also presented itself as a health crisis, exacerbating a host of pre-existing inequalities and creating an economic crisis in South Africa. As a result of the level of inequality in South Africa, the public health and economic responses to the pandemic are likely to have differentiated outcomes for different groups in society, shaping the health and economic outcomes as a result of the pandemic.

What we do seem to know is that future outcomes will be shaped by individuals and their actions to lower the infection curve, the actions of individual governments and collective action in the international community. The greater the effort and resources we invest in mitigating the impact on South African society now, particularly helping the poorest communities, the higher the socio-economic returns for our society as a whole.

Global outlook and the impact of the Covid-19 pandemic

Signs of a recovery from the Covid-19 pandemic appeared in the global economy during the third quarter of 2020. The International Monetary Fund's October 2020 *World Economic Outlook* (WEO) predicted that the Gross Domestic Product (GDP) for the global economy for 2020 would shrink by 4.4 per cent – an improvement in the downturn from their previous predictions for 2020. The South African Reserve Bank's Monetary Policy Committee (MPC) in a press statement released on 19 November 2020, also highlighted recovery of global economic indicators after the disruption in global economic activities caused by the Covid-19 pandemic. However, the MPC warned that second waves of the pandemic worldwide and measures to address it, including re-imposed lockdowns in some places, will extend the time needed for economies to return to pre-pandemic activity levels.

There are uncertainties caused by new waves of the pandemic about the potential scale of infections and impact on society that makes economic forecasting difficult. Much has been learnt about the virus and how to treat it, but the rates of infections is expected to be higher during the new waves. Uncertainty has increased with the positive news of approval and rollout of vaccines in some countries. The vaccines raise hopes that the economic and social impacts of social distancing and other measures to avoid Covid-19 infections will begin to decrease across many countries by the middle of 2021. However, there is much uncertainty related to the rollout of vaccines, particularly in developing countries, and how quickly social distancing measures could be reduced. There also seems to be reluctance to be vaccinated by relatively large numbers of people in some countries.

Further uncertainty is caused by the state of economies and businesses with regard to how they address the new waves of the pandemic and the pace and depth of the recoveries. It is difficult to predict the medium and longer-term effects of the pandemic on societies and their economies.

The socioeconomic impact of the pandemic and the trauma caused, as well as the way in which governments have handled the pandemic is also yet to be fully felt around the world. The scale of the pandemic infections and the impact on society has been larger than expected. And it occurred in a global economy that was already suffering from the beginning of a downturn where inequality had increased and the fight against poverty and unemployment faced tremendous difficulties.

The social, political and economic consequences and trauma associated with the pandemic may last for more than one generation. On 11 December 2020, the World Health Organisation's dashboard reported that worldwide there were over 69 million confirmed cases of Covid-19 and more than 1.5 million deaths in 220 countries, areas or territories. The result has affected the struggles against poverty and unemployment and caused relatively large increases in inequality. Poorer countries have generally been more affected by the economic impacts of the pandemic. The International Labour Organisation's Global Wage Report 2020/21, released on 2 December 2020 finds that workers in less precarious employment have been better off in terms of wage reductions, which has had the effect of exacerbating inequality. In terms of gender, women were worse off than men plus there has been an increase in gender based violence. At the same time, the wealth of billionaires globally has generally increased relatively rapidly and stock market indices have risen to record highs in a number of countries while the poorest members of society have generally grown poorer.

There is much that has been learnt and that we continue to learn in terms of the impact and the governments responses to the pandemic. To some extent the pandemic has united the world and people within countries. But it seems to have more dramatically shown up and exacerbated the fault lines and weaknesses in our societies. Many governments have made huge efforts to reduce the impact of Covid-19 on their societies but many efforts have been seen as too little, too late and too often inefficiencies and corruption have featured. The IMF in their October 2020 WEO point out that governments had to increase their expenditure and increase debt, but that those governments that acted fast and made large efforts made noticeable inroads into addressing the impacts of the crisis. The IMF point out that governments will have to deal with the continued need for increased expenditure, a number of years of lower revenues, which should be relatively low because of the expected slow pace and timing of the predicted recoveries, and higher levels of debt.

The lessons from the global financial crisis of 2008, the slow and unimpressive recovery from this crisis across the globe and the current pandemic have upended long-held mainstream economics ideas. Countries and their policymakers can face the future by letting go of these outdated economic views and ensure through their planning and budgeting, and even with higher debt levels, that the state plays an active, developmental role in reducing poverty, reducing inequality and generally improving the quality of life in their societies.

Update on the domestic spread of Covid-19

South Africa moved to Alert Level 1 on 21 September 2020 as new COVID-19 infections continued to slow across the country and the National Department of

Health reported that the epidemiological curve had plateaued. At the time, the cumulative number of detected COVID-19 cases was 661 936 with only 725 new daily cases identified. Over two months later, on the 9th of December 2020, Health Minister Dr Zweli Mkhize announced that South Africa had, according to its statistical models, entered a second wave of COVID-19 infections. By the end of September, the 7-day moving average was approximately 1000 positive infections a day. By the end of the first week of December, the number of daily new cases had breached the 6000 mark. The majority of the new cases were from four provinces – the Western Cape (30 per cent), Eastern Cape (24 per cent), KwaZulu-Natal (23 per cent) and Gauteng (17 per cent). These provinces are the key drivers of this new wave.

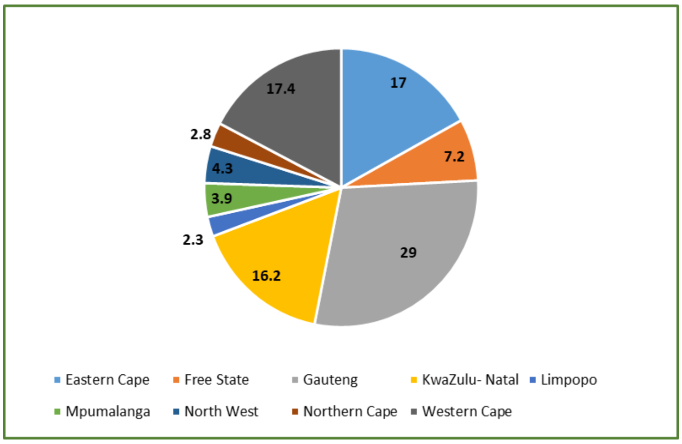
Table 1: South Africa's Covid-19 numbers at the end of the first week of December 2020

Province	Total Cases as at 9 December 2020	Total Deaths as at 9 December 2020
Eastern Cape	140647	5116
Free State	59501	2030
Gauteng	240261	5069
KwaZulu- Natal	134184	3413
Limpopo	18940	512
Mpumalanga	31906	617
North West	35223	566
Northern Cape	23517	333
Western Cape	144419	4918
Total	828598	22574

Source: Department of Health, South Africa

Some key concerns raised by Minister Mkhize included: 1) The positive rate of infections at 18 per cent, was significantly higher than the ideal of 10 per cent that the Ministerial Advisory Committee on COVID-19 recommends; 2) The exponential increase in the seven day moving average in provinces such as Kwa-Zulu Natal and Gauteng. This increase may foretell a faster rise in the number of infected people and a higher peak than the first wave; 3) Between 7 and 9 December 2020, the age distribution of new cases showed a different pattern from the norm: the peak age in this period is in the 15-19 age group. This change is believed to be due to large numbers of end of year parties involving young people, too much drinking of alcohol and little to no adherence to non-pharmaceutical precautions, i.e., wearing of masks, social distancing and hand and surface sanitizing.

Figure 1: Proportion (Per cent) of total cases of Covid-19, per province as at 9 December 2020



Source: Department of Health, South Africa

Members of Executive Councils (MECs) have been urged to prepare their respective provinces for a second wave. In particular, provinces should ensure that testing turnaround times are as quick as possible to facilitate faster patient flow. They should also assess bed capacity, including recalling field hospital beds, urgently attend to staffing and equipment needs, tighten up monitoring and evaluation, and reporting to the national health department.

Gross domestic product[1]

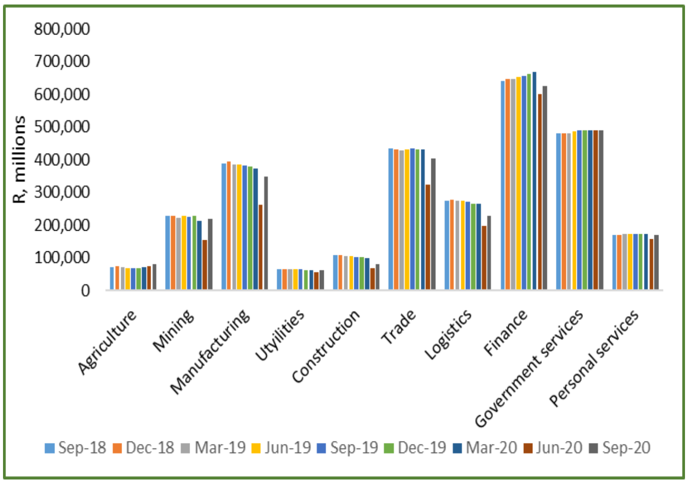
South Africa had been faced with consistently weak economic growth, rising unemployment and negative GDP per capita growth before the COVID-19 pandemic struck. Prior to the pandemic, real GDP growth forecasts for 2022 were near 1 per cent, due to persistent structural challenges and ongoing electricity supply issues. Indeed, South Africa ended 2019 in a technical recession, after two consecutive quarters of negative growth. The country's annual GDP growth rate by the end of 2019 was a meagre 0.2 per cent.

South Africa had one of the world's strictest lockdown restrictions in place since the end of March 2020, as the country prioritised saving lives in response to the health crisis. Economic activity came to a complete halt for a number of weeks in the second quarter across many sectors, which greatly affected economic data: Real GDP dropped by 51 per cent quarter-on-quarter (seasonally adjusted and annualised), in quarter two of 2020, after a 1.8 per cent contraction in the first quarter.

[1] All quarterly expenditure/growth data is seasonally adjusted and annualised unless otherwise stated

As a result of the easing of COVID-19 lockdown restrictions, real GDP (measured by production) increased at an annualised rate of 66.1 per cent in the third quarter of 2020, (without annualising however, the quarter-on-quarter seasonally adjusted growth rate was 13.5 per cent). It is important to note that this number is the result of a specific set of dynamics. The first is the fact that we are measuring growth for the quarter from a very, very low base because GDP more than halved in the second quarter (quarter-on-quarter, seasonally adjusted, annualised). Secondly, we are also measuring from lockdown restriction and comparing it to the economy opening up. As a result, we see a relatively strong rebound number for the third quarter of 2020.

Figure 2: Quarter-on-quarter changes in industry value added to GDP growth (in constant 2010 prices)



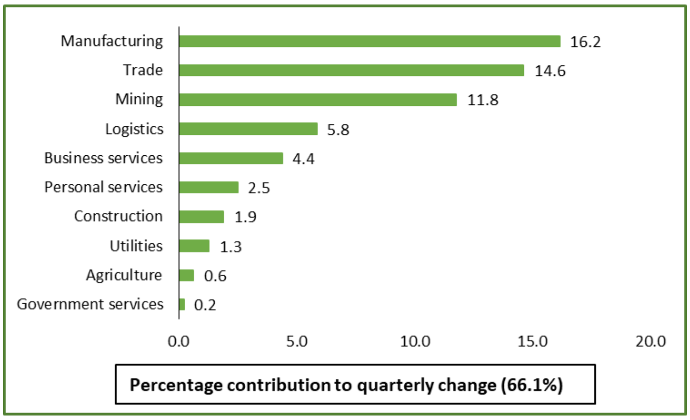
Source: StatsSA

All industries recorded positive growth between the second and third quarters of 2020. The largest positive contributors to growth in GDP in the third quarter were the manufacturing, mining and trade industries. The manufacturing industry increased at a rate of 210.2 per cent and contributed 16.2 per cent to GDP growth. All ten manufacturing divisions reported positive growth in the third quarter. The four divisions with the largest contributions to the increase were basic iron and steel, non-ferrous metal products, metal products and machinery; petroleum, chemical products, rubber and plastic products; transport equipment; and food and beverages The mining and quarrying industry increased at a rate of 288.3 per cent and contributed 11.8 per cent to the third quarter growth in GDP. In the third quarter the industry recovered largely on account of the easing of local and global lockdown restrictions. Higher production was mainly due to increased activities in the production of platinum group metals (PGMs), iron ore, gold, manganese ore and diamonds.

The trade, catering and accommodation industry increased at a rate of 137 per cent and contributed 14.6 per cent to growth in the quarter. Increased economic activities were reported for wholesale trade, retail trade, motor trade, catering and accommodation. However, so severe was the impact of COVID-19 in the second quarter that total value added for the industry in the third quarter remained below its level in the first quarter of 2020.

The recent opening up of the economy in the third quarter is likely to have stimulated a short term rebound in growth, but is unlikely to result in a medium- or long-term trend in positive economic growth.

Figure 3: Sector percentage contribution to the second quarter GDP decrease

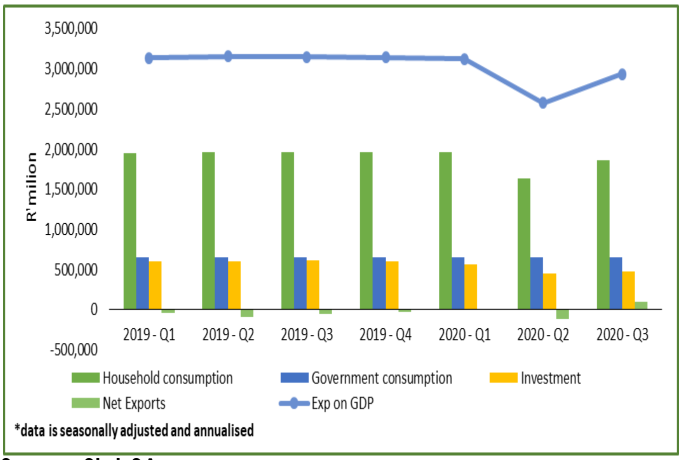


Source: StatsSA

Expenditure on GDP

Gross domestic expenditure is calculated by adding household consumption, government consumption, investment and net exports (exports minus imports).

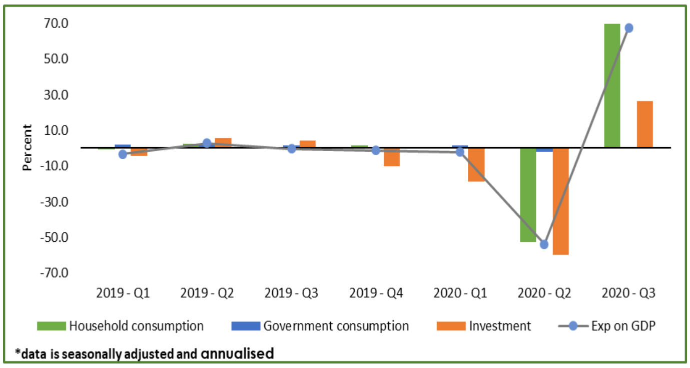
Figure 4: Quarterly change in sector value added to GDP growth (in constant 2010 prices)



Source: StatsSA

Figure 4 shows actual values of South Africa's real gross domestic expenditure (GDE). The real GDE increased to R2.9 trillion in the third quarter of 2020 after it dropped by R547.1 billion to R2.6 trillion in the second quarter of 2020.

Figure 5: Sector contribution to positive third quarter GDP growth



Source: StatsSA

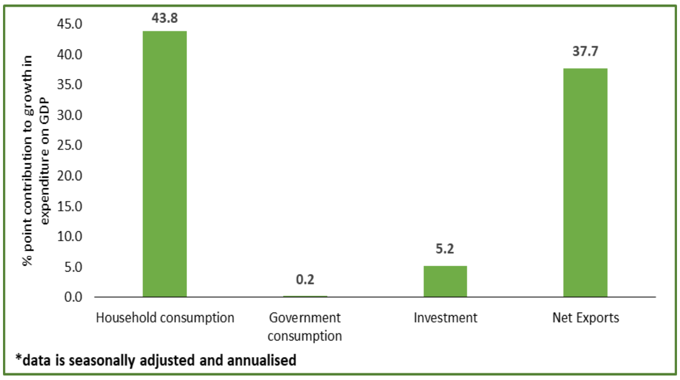
South Africa's real gross domestic expenditure (GDE) increased by 67.6 per cent from the second to third quarter of 2020 after it dropped by 53.7 per cent in the second quarter of 2020. Technically, this positive change in GDE represents a recovery from four consecutive quarters of recession since the third quarter of 2019. However, overall economic growth remains fairly muted and uncertainty remains about future GDE growth given the second wave of the pandemic.

Government's gradual relaxation of lockdown regulations have had a positive impact in boosting GDE in the third quarter. The positive percentage change from the second to third quarters of 2020 occurred after the large drop in the percentage change of GDE from the first to second quarter of 2020 when South Africa was still in level 5 of lockdown. The largest growth in the third quarter was in net exports, which grew by 203 per cent in the third quarter of 2020 after a 22 per cent decline in the second quarter.

Household consumption and investment expanded by 69.5 per cent and 26.5 per cent from the second to third quarters of 2020, respectively, after both had contracted by more than 50 per cent in the second quarter of 2020. The rebound in expenditure on investment from the second to third quarters of 2020 was less than half of its decline from the first to second half of 2020. The percentage change in expenditure on investment was negative in the final quarter of 2019 and first quarter of 2020, i.e., before the pandemic and lockdown. Expenditure on government consumption reflected government's commitment to fiscal consolidation, even though, aggregate demand in the economy has declined, the economy suffered from poor economic growth and recession and then had a massive knock from the pandemic and lockdown.

Figure 6 shows the percentage contribution of different expenditure categories to the 67,6 per cent growth expenditure on GDP in the third quarter of 2020. Real quarterly percentage growth in household consumption expenditure (43.8 per cent) and exports (38.3 per cent) was positive after negative contributions in the second quarter of 2020.

Figure 6: Sector contribution to positive third quarter GDP growth



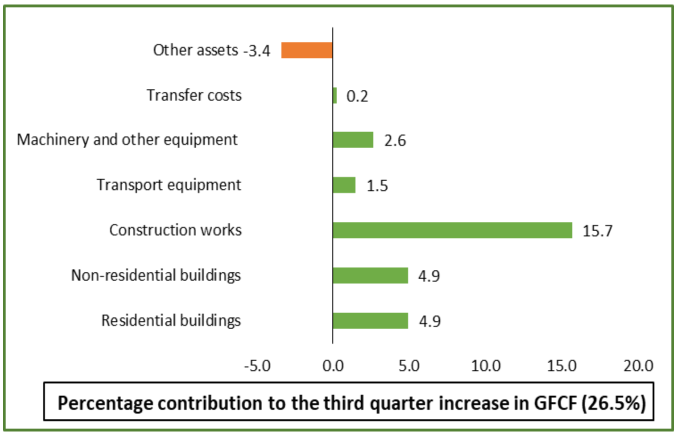
Source: StatsSA

The largest contributors to the 43.8 per cent expansion in third quarter household expenditure were transport services (17.2 per cent), alcoholic beverages (9.5 per cent), food and non-alcoholic beverages (9.1 per cent) and clothing footwear which all recorded more than 9 per cent contributions. The 37.7 per cent positive contribution made by net exports to GDP was largely due to an increase in exports of vehicles and other transport equipment, machinery and equipment, precious metals and stones; mineral products and base metals. The decline in imports was largely driven by decreases in textiles and textiles articles, chemical products and prepared foodstuffs, beverages and tobacco products

Investment

Gross fixed capital formation (GFCF) increased by 26.5 per cent in the third quarter of 2020. The main contributors to the increase were construction works, residential buildings, non-residential buildings and machinery and other equipment. There was a R156.2 billion (annualised) drawdown of inventories as well in the quarter. Large decreases in trade and mining contributed to the inventory drawdowns experienced in the third quarter of 2020.

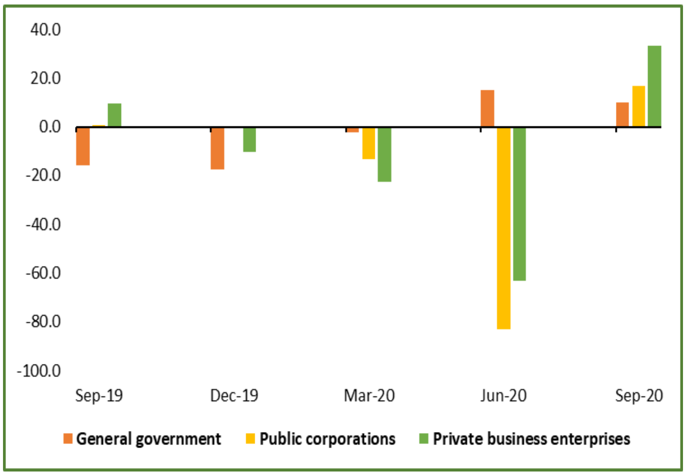
Figure 7: Real Gross fixed capital formation by type of asset



Source: StatsSA

GFCF by type of organisation indicated that while there were very large declines in investment in both public corporations (82.9 per cent) and private enterprises (63.3 per cent) in the second quarter, they registered positive increases in the third quarter of 2020 (16.8 per cent and 33.2 per cent, respectively). Nevertheless, the positive growth in private enterprises and public corporations registered in the third quarter of 2020 was still far below pre-pandemic levels. In the third quarter, private investment recovered only 7 per cent, meaning that it was 16 per cent lower than in the first quarter of 2020. Investment by public corporations increased by only 4 per cent in the third quarter, so it was still 33 per cent below pre-pandemic levels. Also, investment by government declined in the third quarter as compared to the second quarter of the current year, from 15.2 per cent to 9.8 per cent. These trends meant that investment in the third quarter of 2020 was R40 billion lower than a year earlier in constant rand terms.

Figure 8: Gross fixed capital formation by type of organisation



Source: StatsSA

Employment

According to the Quarterly Labour Force Survey, which measures formal and informal employment, the estimated official unemployment rate rose to 30.8 per cent (6.5 million people) in the third quarter of 2020. Quarter-on-quarter, the labour force grew by 15.1 per cent (2 780 686) in the third quarter of 2020 while the number of people employed also grew by 3.8 per cent (542 654). The result shows a 52.1 percent (2 238 032) increase in the number of unemployed people in the same period. Year-on-year, the labour force declined by 8.2 percent (1 884 963) and the number of people employed also declined by 10.3 percent (1 684 139). The year-on-year (i.e., third quarter 2019 to third quarter 2020) number of unemployed people decreased by 3 per cent (200 824).

The broad unemployment rate, which includes discouraged job-seekers, increased by 8.5 per cent (872 892) in the third quarter of 2020 compared to a year ago. It increased by 8.6 per cent to 43.1 per cent in the third quarter of 2020 compared to previous quarter.

The unemployment rate for both men and women increased in the third quarter of 2020 compared to previous quarter. The unemployment rate for males (29.6 percent) and females (32.3 per cent) both increased by 7.5 per cent in the third quarter of 2020. However, the overall female unemployment rate remains higher than that of males.

Table 2: Key labour statistics – Quarterly Labour Force Survey

	3Q 2019	2Q 2020	3Q 2020
Labour force ('000s)	**23 109**	**18 443**	**21 224**
Employed	**16 375**	**14 148**	**14 691**
Unemployed - official	**6 734**	**4 295**	**6 533**
Unemployed - broad*	**10 272**	**10 259**	**11 145**
Not economically active ('000s)	**15 474**	**20 578**	**17 944**
Discouraged job-seekers	2 793	2 471	2 696
Other (not economically active)	12 681	18 107	15 248
Unemployment rates			
Official unemployment rate (narrow)	29.10%	23.30%	30.80%
Broad unemployment rate*	38.50%	42,0%	43.10%
Unemployment Rates - Gender			
Male - official	27.70%	22.10%	29.60%
Female - official	30.90%	24.80%	32.30%
Unemployment Rates - Race			
Black African - official	32.80%	26.30%	34.60%
Coloured - official	23.50%	19.00%	23.50%
Indian/Asian - official	13.30%	14.40%	18.40%
White - official	7.40%	6.10%	8.60%
Youth**			
Unemployment rate - official	41.90%	34.10%	43.20%
Unemployment rate - broad*	52.50%	55.20%	56.30%

* The broad unemployment rate includes discouraged job seekers
** Youth is defined as age 15 - 34

Source: StatsSA

BOX: Labour Dynamics and the face of the unemployed

It is important to provide a nuanced, descriptive understanding of the characteristics that define the labour market and the face of mass unemployment in South Africa. That is to say, a look at the interactions with variables such as race, gender, and geography as it relates to the labour market trends in South Africa, provides a deeper, more detailed perspective of what the face of unemployment in the country looked like. Characterising the unemployed and prevailing labour market conditions will predominantly draw from StatsSA's 2019 Labour Market Dynamics Report, which highlighted important disaggregated data on labour market trends between 2014 and 2019, as provided for by QLFS panel data.

At the end of 2019, the official unemployment rate was 28.7 per cent, which was 3.6 per cent higher than the unemployment rate in 2014. Between 2014 and 2019, the working-age population as a percentage of the total population varied across population groups. The working-age population as a percentage of the total population increased among people classified as Black/African and Coloured (1.6 per cent and 0.8 per cent, respectively). However, the share of the working-age population in the total population for people classified White and Indian/Asian declined during the same period. The share of the working-age population that was employed decreased amongst the Coloured population group and increased amongst the White and Indian/Asian population groups, and remained unchanged among the Black/African population group.

The White population group recorded the highest proportion of the working-age population that was employed compared to other population groups. The share of the unemployed in the working-age population decreased among White and Coloured population groups, and increased among the Indian/Asian and Black/African population groups. Black/Africans recorded the largest increase (3.3 per cent) of the unemployed in the working-age population. Discouraged work-seekers increased in all population groups except among the Indian/Asian population group between 2014 and 2019. The proportion of those who were found to be "not economically active" decreased in the White, Indian/Asian and Black/African population groups, with the exception of the Coloured population group in 2019.There were more women aged 15–64 (working-age population) years than men in South Africa in 2019. There were 19.4 million women in 2019 compared to 19.1 million men in the working-age population.

Examination of the geographical spread of the working-age population showed that 68.0 per cent of the working-age population lived in urban areas, 28.3 per cent in traditional areas and only 3.7 per cent on farm areas. About nine out of ten people of working age in Gauteng and Western Cape reside in urban areas. Limpopo recorded the lowest percentage of the working-age population that lived in urban areas (22 per cent) in 2019.

Irrespective of population group, a gender gap persists in the labour market. Women recorded a higher unemployment rate, lower absorption rates and lower labour force participation rates compared to their male counterparts. Between 2014 and 2019, the unemployment rate was higher among the Black/African population group, irrespective of gender. Both white males and females recorded the lowest unemployment rates, the highest absorption rate and labour force participation rate relative to the other population groups. The labour force participation rate increased for all population groups, with the exception of White males, Coloured males and Coloured females. Although Black/African males and females recorded the lowest labour market rates, they recorded the highest increase in the labour force participation rate (up by 3 and 3.6 per cent, respectively) in 2019.

Young people remain vulnerable in the labour force. The age group 15–24 years is associated with a higher unemployment rate, lower absorption rate and lower labour force participation rate. Between 2014 and 2019, the unemployment rate increased across all age groups. Those aged 15–24 years recorded the largest increase in unemployment rate, followed by those aged 25–34 years (up by 5.7 and 5.3 per cent, respectively). The labour force participation rate increased across all age groups, and the largest increase was observed among those aged 45–54 years, followed by those aged 35–44 years (up by 4.6 and 2.2 per cent, respectively).

Labour market rates vary significantly depending on education level. Generally, the more educated a person is, the more likely they are to find employment. Between 2014 and 2019, the unemployment rate increased irrespective of the level of education, with the largest increase observed among those with below matric level of education (up by 4.2 per cent). The absorption rate decreased across all levels of education. Generally, the labour force participation rate decreased across all education levels, with the exception of below matric level of education (up by 2 per cent).

In both 2014 and 2019 the share of the White population group employed in skilled occupations increased from 61.1 per cent in 2014 to 62 per cent in 2019. Black/Africans reflected the lowest share of persons employed in skilled occupations compared to other population groups (17.3 per cent in 2014 and 16.8 per cent in 2019). The Coloured population employed in skilled occupations accounted for 22.4 per cent in 2014, but this declined to 20 per cent in 2019.

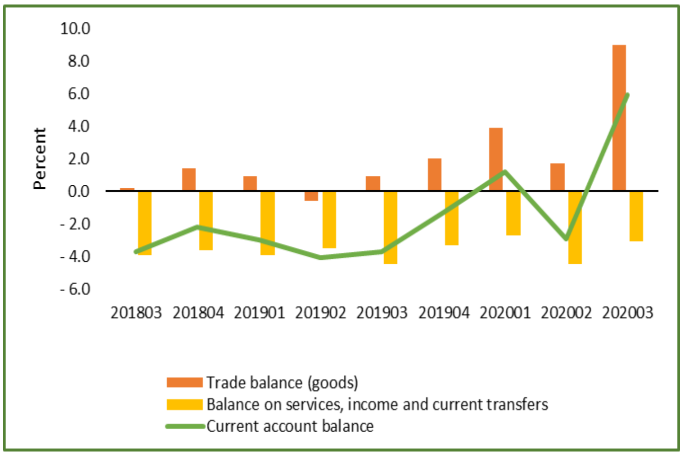
In 2014 and 2019, a higher percentage of women were employed in skilled and low-skilled occupations relative to men. In contrast, more than 50 per cent of employed men were working in semi-skilled occupations in both 2014 and 2019. Over the period 2014–2019, both proportions for men and women employed in skilled occupations declined by 1.6 per cent and 1.1 per cent, respectively.

Men accounted for larger shares of employment as Managers over the period 2014–2019, 69.6 per cent of men were employed in Managerial occupations compared to 30.4 per cent of women. The share of women employed in Managerial occupations decreased by 1 per cent from 31.4 per cent in 2014 to 30.4 per cent in 2019 over the period 2014–2019. Women employed in skilled occupations were more likely to work as Technicians from 2014 to 2019 compared to Managers and Professionals.

Current Account

The balance on the current account of the balance of payments shows a significantly large surplus of R297.5 billion in the third quarter of 2020 from a deficit of R123.7 billion in the second quarter. Consequently, the current account balance as a ratio of gross domestic product (GDP) was a surplus of 5.9 per cent in the third quarter of 2020 from a deficit of 2.9 per cent in the second quarter of the current year.

Figure 9: Change in the balance of the current account (as a percentage of GDP)



Source: SARB

Figure 10: Quarterly change in imports and exports (R, Millions)

Source: SARB

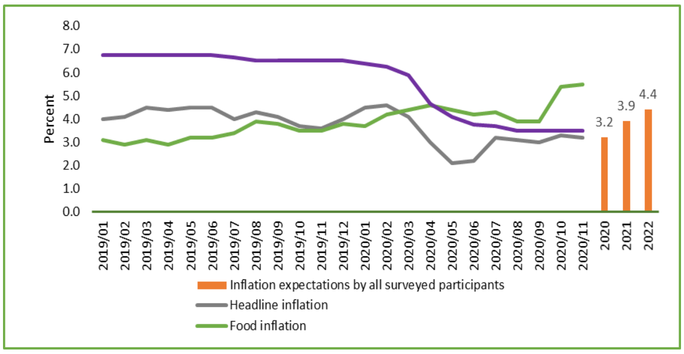
South Africa's export volumes increased in the third quarter of 2020 in line with global trade, following the easing of COVID-19 lockdown restrictions and the relative rebound in economic activity. As a result, South Africa's trade surplus was six times larger than what it had been in the second quarter- from R71.4 billion to R453.6 billion in the third quarter of 2020. The improvement in the trade balance can be linked to the substantial increase in the value of merchandise exports to imports. The higher value of merchandise exports is primarily due to higher volumes, while changes in merchandise import is the result of an increase in prices. The quarter-on-quarter increase in imports therefore, was only approximately 5.6 per cent compared to a 39.2 per cent increase in exports. The shortfall on the services, income and current transfer account, which continues to put negative pressure on the current account and balance of payments, narrowed to R156.1 billion in the third quarter of 2020 from R195.1 billion in the second quarter. The size of this deficit seems to be affected by volatile, speculative short-term cross border capital flows that have become more uncertain during the pandemic. The deficit on the services, income and current transfer account as a ratio of GDP decreased to 3.1 per cent in the third quarter of 2020, from 4.5 per cent in the second quarter.

Inflation and monetary policy

Headline consumer price inflation (CPI) for all urban areas was 3.2 per cent in November 2020, down from 3.3 per cent in October 2020. Inflation on food and non-alcoholic beverage prices increased by 0.7 per cent between October 2020 and November 2020 and 5.8 per cent year-on-year.

In its press statement released on 19 November 2020, the South African Reserve Bank's Monetary Policy Committee (MPC) highlighted recovery of global economic indicators after the disruption in global economic activities caused by the Covid-19 pandemic. According to the MPC the overall domestic risks to the inflation outlook appears to be to the downside in the near term and balanced over the medium term. This phenomenon is due to global producer price inflation and relatively low oil prices which mean that South Africa's terms of trade remain robust due to commodity export prices remaining high while oil prices remain low. The MPC also noted that while there are no demand side pressures evident that potential inflationary pressures from electricity and other administered prices remain a concern. In this context, the MPC decided to keep the repurchase rate unchanged at 3.5 per cent per annum.

Figure 11: Inflation remains relatively low

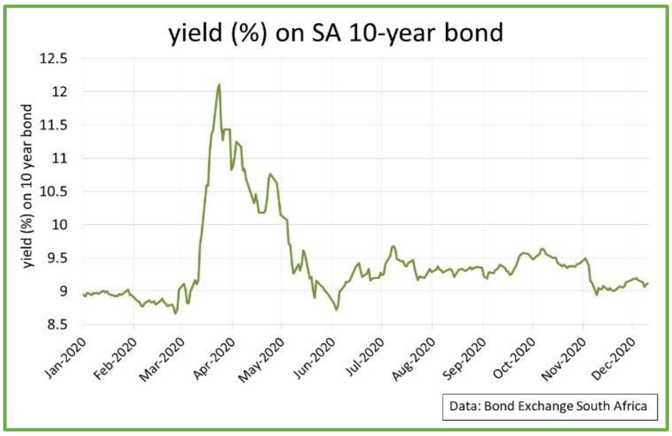


Source: SARB

Sovereign risk and debt outlook

The yield on South Africa's 10-year benchmark bond is an indicator of appetite for South African government bonds by different types of funds and other buyers in global and domestic financial markets. The yield on this bond dropped during March 2020, increased gradually over the second quarter of 2020 and settled at around 9.5 per cent during the third quarter of 2020. During November 2020 the yield on the SA 10-year bond dropped to around 9 per cent (the level in January 2020) and has been slightly above this level during December 2020.

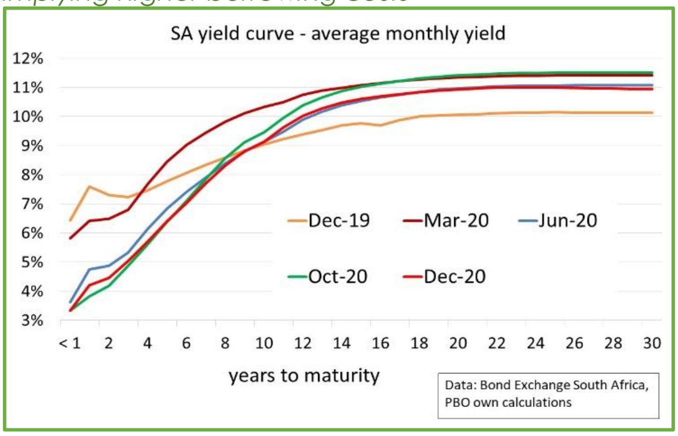
Figure 12: Yield on SA 10-year bond



Commentators say that the worsening yield of the SA 10-year bond at the end of the first quarter of 2020 was due to the downgrade by the ratings agency Moody's of South Africa's domestic currency debt to sub-investment grade. This downgrade would have triggered an automatic exclusion of South African government bonds from the FTSE World Government Bond Index (WGBI). Funds that track the WGBI would have sold South African government bonds and caused the yield to decrease. Another reason for the yield to decrease was a massive sell-off of emerging market assets in global financial markets at the onset of the Covid-19 pandemic. Many funds that had emerging market bonds in their portfolio of assets quickly sold higher yielding emerging market debt to buy developed country debt, which they perceived to be a safer asset during the initial uncertainty of the Covid-19 pandemic.

During the second half of 2020 these funds and other buyers once again bought emerging market bonds for their higher returns. However, uncertainty caused by the pandemic with regard to the global economic outlook has supported only a partial reversal of capital outflows from emerging market economies, despite the higher returns.

Figure 13: Steepening and elevated yield curve implying higher borrowing costs



The yield curve for South African government debt – presenting borrowing costs at different maturities – shows an increase in borrowing costs of more than one percentage point for medium to longer dated debt. Bond yields benefitted from the SARB's programme of secondary market bond purchases which sought to ensure liquidity in the domestic market. The partial improvement in bond yields across all horizons (see yield curve in Figure 12) has been due to South African private funds and other buyers purchasing domestic bonds, rather than a return in appetite from international buyers. Whilst bond yields recovered over the second half of the year, they are still at higher levels than a year ago.

Figure14: Increasing cost of issuing government debt

Corresponding to the increase in the yield curve, the results from government bond auctions show that the South African government's borrowing costs have increased since the beginning of the year while demand for South African government debt has generally been good.