Parliamentary Budget Office

PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

# Quarterly Economic Brief

July 2020
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Authors: Rashaad Amra, Fatsani Banda, Dumisani Jantjies, Seeraj Mohamed, and Siphethelo Simelane
Editor: Fatsani Banda
Approved and edited by: Seeraj Mohamed
Enquiries: fbanda@parliament.gov.za
https://www.parliament.gov.za/parliamentary-budget-office

## Introduction

This Parliamentary Budget Office's (PBO) Quarterly Economic Bulletin (QEB) provides an update of the performance of the South African economy for the first quarter of 2020. The QEBs usually provide economic updates, particularly with regard to 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 a, disruptive event in the global economy and on South African society that the economic situation currently is totally different to what is was three months ago. As we compile this QEB, one thing is clear, that no-one knows how severe the human and socio-economic impact of the pandemic will be. The lockdown regulations in response to the COVID-19 health crisis have disrupted economic activity, the organisation of work, and communities. COVID-19 has 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 response 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.

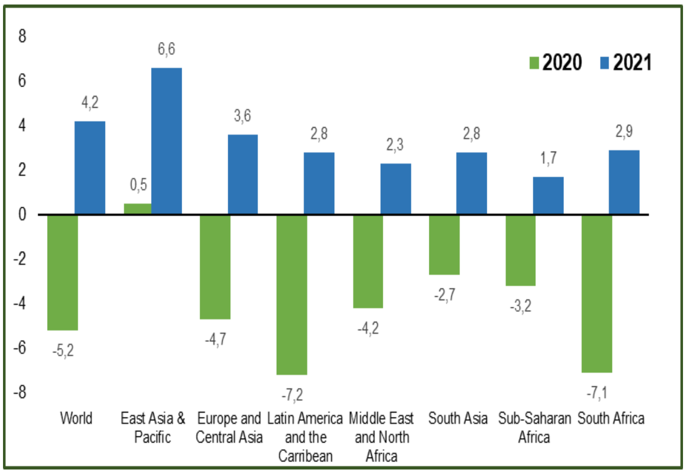
The country is faced with huge uncertainties where the outcomes will be shaped by individuals and their actions to lower the infection curve, the actions of individual governments and collective action in the international community. The greater the effort and resources we invest in mitigating the impact on the 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

The severity of the health and economic impacts of Covid-19 has required that earlier estimates of global economic growth had to be revised downward. For example, the International Monetary Fund's June 2020 World Economic Outlook Update revised their global economic growth estimate to -4.9 per cent for 2020. This estimate of global economic growth is 1.9 per cent less than the estimate in the IMF's April 2020 World Economic Outlook. According to the IMF, the revision was necessary due to the severity of the impact of Covid-19 in the first half of 2020. The impact was higher than expected and the economic recovery will be slower than they had previously forecast.

In light of the huge uncertainty with regard to the continued spread of Covid-19 and its impact on economic activity all current forecasts have a high degree of uncertainty. Figure 1 shows the World Bank's forecasts for GDP percentage growth rates for the world, regions and South Africa. The only region forecasted not to have a negative growth rate is the East Asia and Pacific Region. South Africa's forecasted decline is worse than most regions and on par with the large forecasted decline of the Latin American and Caribbean Region.

*Figure 1: Estimates of world, regional and South Africa's GDP growth rates for 2020 and 2021 (percentages)*




**Source: The World Bank's Global Economic Prospects, 30 June 2020**

The IMF noted in their June 2020 Global Financial Stability Report (GFSR) that the recent increase in market sentiment and the associated rise in share prices seems disconnected from underlying economic prospects. They warned that as a result of this disconnect global financial conditions may tighten. The 2020 World Economic and Social Prospects (WESP), a joint publication of several United Nations agencies, pointed out that the perturbing disconnect between financial markets and the real economic sector was caused by "overburdened monetary policies". Developed economies have attempted to stimulate their economies predominantly by the use of monetary policies, including bailouts involving buying 'toxic debt' of the private sector and quantitative easing. These developed economies have injected huge amounts of liquidity into their financial systems in order to stimulate their economies but the predominance of monetary policy has made these attempts much less effective than anticipated.

According to the UN's 2020 WESP, lower interest rates and more liquidity in developed economies did not increase productive investments because the main constraint on the private sector was uncertainty and poor economic expectations not financing costs. The 2020 WESP warns that "Overreliance on monetary policy is not just insufficient to revive growth; it also entails significant costs, including the exacerbation of financial stability risks (p.8)." High liquidity and low interest rates have caused risks to be underpriced and financial assets, such as equities, to be overpriced. Therefore, the overuse of monetary policy by developed economies is an important reason for the increase in worldwide private and public debt.

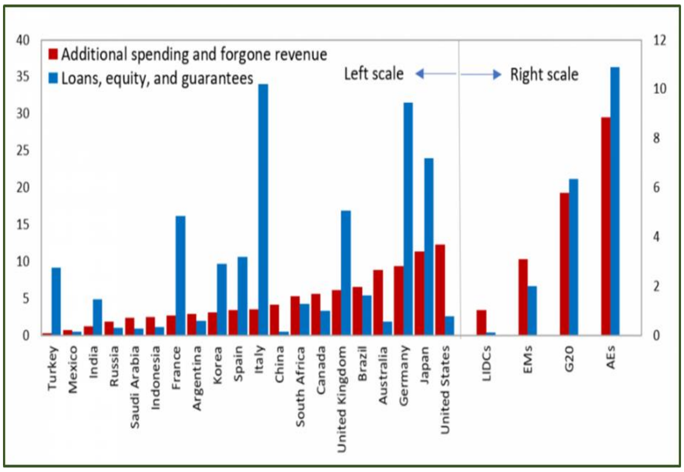
There is a widespread agreement that monetary policy have been overburdened and that the old view that fiscal policy is ineffective and should not be used is incorrect. The 2020 WESP called for a more balanced policy response to economic downturns that also includes fiscal policy aimed at stimulating economic growth that moves economies towards greater social inclusion, gender equality, and environmentally sustainable production and consumption. The responses by developed countries to the economic impact of Covid-19 have included much larger fiscal measures than before to boost healthcare responses, support nutrition and wellbeing of households and to save jobs and support businesses. However, these countries have also stepped up monetary measures even more than during the global financial crisis. The recent positive sentiment in financial markets despite the poor economic outlook mentioned by the IMF's June 2020 GFSR was due to this monetary policy boost, which may cause even further financial imbalances in the global economy and increase systemic financial risks. Covid-19 and financial imbalances will further weigh on global trade. As reported in previous QEBs, the confrontational approach to trade, particularly by the US, has led to poorer levels of global trade. The 2020 WESP says that trade tensions caused the growth in global trade to drop to only 0.3 per cent in 2019. This was the lowest global trade growth in a decade. The pandemic has already caused global growth in trade to turn negative.

Thus far the PBO has commented on changes in economic growth (GDP). However, economic growth (and even economic growth per capita) does not provide an adequate picture of an economic situation within a country or the world. According to the 2020 WESP, "GDP is the measure most widely used to assess economic prosperity and performance, it reveals nothing about how income is distributed within a country; the impact of economic activity on natural resources and the environment; or the quality of life enjoyed by the population in terms of education, health or personal safety." Recent additional work by the UN looking at the impact of Covid-19 on human development and the sustainable development goals (SDGs) helps to fill these gaps.

The United Nations Development Programme (UNDP) released a report, Covid-19 and Human

Development: Assessing the Crisis, Envisioning the Recovery in May 2020. The Human Development Index (HDI) is a composite index that takes into account standards of living, including income, education and health in a country. This recent UNDP report adjusts the calculations of the UNDP's HDI to take into account the impact of Covid-19 on the capabilities of people, which is an approach to policy that "… emphasizes the potential for people to be and do what they aspire in life as opposed to material resources or economic activity (p.3)". The adjustments to measuring HDI to take account of the capabilities impact of Covid-19 includes the widespread closures of schools and declines in national income. The UNDP characterises the impact of Covid-19 as a human development crisis.

*Figure 2: **LARGE FISCAL PACKAGES**- Advanced economies, and to a lesser extent emerging economies, have deployed a significant level of above- and below-the-line fiscal measures (July 2020)*




**Source: IMF**

A general finding of the UNDP report is that "… the decline in the index – reflecting a narrowing in capabilities – would be equivalent to erasing all the progress in human development of the past six years (ibid.)". They add that when schools reopen there could be a quick rebound in capabilities related to education but the economic impacts on human capabilities would follow the pace of economic recovery after the crisis.

The UN's *The Sustainable Development Goals Report 2020*, released on 7 July 2020, indicated that the impact of the Covid-19 pandemic would reverse the global multiyear decline in poverty that occurred before the pandemic and increase hunger and food insecurity. It estimated that 71 billion people could be forced into poverty during 2020. The report noted that even before the pandemic the world was not on track to meet the SDG goals set for 2030. This brief cannot report on all of the SDG so will highlight a few areas.

Poor global economic performance and increasing poverty meant that performance on important SDGs, such as food security and education, declined even before the pandemic and is now expected to get worse. They estimate that 90 per cent of all students were kept out of school but that remote learning is out of reach for more than 500 million students globally. In areas such as health, where there had been some progress, the pressures of dealing with the pandemic has caused reverses as well. For example, they report that 70 countries have had interruptions in children receiving immunisations and they expect the number of people dying from communicable diseases will spike. They also expect that deaths from malaria in sub-Saharan Africa will increase by 100 per cent.

They point out that the conditions of women globally were negatively affected by the increase in poverty before the pandemic and are now worsened by the pandemic. Women are underrepresented at all levels of government around the world but are at the frontline of the response to Covid-19. Seventy per cent of health and social workers around the world are women. Women took responsibility for 3 times as many hours of housework as men before the pandemic and this requirement has intensified since the onset of the pandemic. At the same time, the report notes that cases of domestic violence against women has increased by 30 per cent in some countries.

The Covid-19 pandemic affects all of society. However, the impact of the pandemic is harsher on the poorest and least represented members of society. The conditions that existed within society with respect to inequality and poverty in respect to access to basic services, decent employment and achieving one's capabilities affect how much more one will be affected by the health and socio-economic impacts of the pandemic. An important consideration for governments that now face higher expenditures and lower revenues because of Covid-19 is to consider the extent to which the poverty, inequality and poor quality and low levels of employment have added to their costs and affect the pace of recovery. The advice from all international economic institutions is for governments to rebuild in a more inclusive manner that takes into account welfare and the environment.

Governments around the world have also struggled with the question of whether they have made correct choices with regard to lockdowns and reopening of their economies. An article titled "Sweden has become the world's cautionary tale" in the New York

Times on 7 July 2020 indicates that "The elevated death toll resulting from Sweden's approach has been clear for many weeks. What is only now emerging is how Sweden, despite letting its economy run unimpeded, has still suffered business-destroying, prosperity-diminishing damage, and at nearly the same magnitude of its neighbours." According to the NY Times article the Swedish case shows that the mooted choice between lockdowns and saving lives versus the human costs associated with economic damage is a false choice. The article indicates that inadequate enforcement of social distancing measures leads to both losses of lives and economic damage that costs lives.

## Update on the domestic spread of Covid-19

The Coronavirus continues to spread quickly throughout South Africa. This QEB provides an overview of the domestic economy until the end of the first quarter of 2020. Table 1 provides a depiction of the spread of Covid-19 at the end of June 2020.

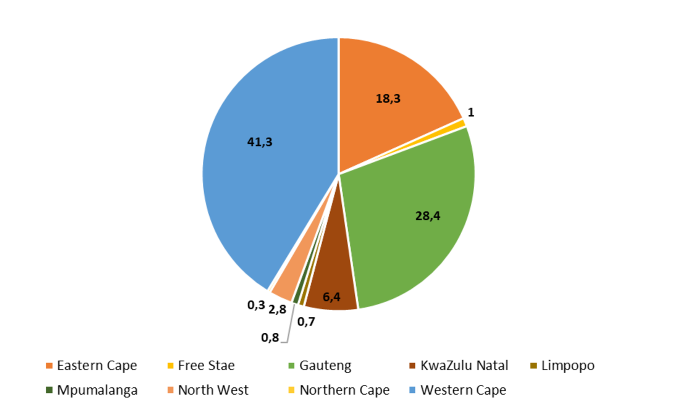
*Table 1: South Africa's Covid-19 numbers by the end of June 2020*

| Province | Total cases as at 30 June 2020 | Total Deaths as at 30 June 2020 |
|---|---|---|
| Eastern Cape | 27686 | 422 |
| Free State | 1514 | 9 |
| Gauteng | 42881 | 216 |
| KwaZulu Natal | 9674 | 126 |
| Limpopo | 1131 | 10 |
| Mpumalanga | 1190 | 7 |
| North West | 4187 | 7 |
| Northern Cape | 465 | 1 |
| Western Cape | 62481 | 1859 |
| Total | 151209 | 2657 |

**Source: Department of Health, South Africa**

By the end of June 2020, Covid-19 was spreading rapidly in Gauteng and the Eastern Cape. The daily growth rate of infections in Gauteng was approximately 8.5 per cent in the week ending 28 June, down from 10 per cent, the growth rate two weeks earlier. In the Eastern Cape, increase of infections continued to fluctuate around 7 per cent. In contrast, the KwaZulu-Natal daily growth rate of infections more than doubled during the two weeks to the end of June 2020, rising from 3 per cent to 8 per cent, while in the North West it grew by 11 per cent. New cases reported in the Western Cape declined, but there is the possibility that figures may have been affected by new testing protocols (TIPS, 2020).

*Figure 3: Proportion of total cases of Covid-19, per province as at 30 June 2020*




**Source: Department of Health, South Africa**

Although cases had already begun to escalate after the move to Level 3 at the beginning of June 2020, the government passed regulations that allowed casinos, conference centres and theatres to open as long as venues allowed a maximum of 50 customers at a time, and implemented other infection prevention measures. The regulations also permitted restaurants to serve customers on their premises from Monday, 29 June 2020. Restaurants would still be unable to serve alcohol, which meant that most bars would remain closed. This restriction presumably arose because international experience, from the United States to South Korea, shows that people seem to spread the infections more in bars. Infections in bars have been directly linked to the recent upsurge in cases in the US (TIPS, 2020).

The pandemic continues to show the fault lines of persistent inequality in South Africa. Those inequalities continue to emerge in the healthcare capacity of different provinces. Lack of capacity in the healthcare system is one major reason the Eastern Cape appears to be under pressure from the surge in positive Covid-19 cases under Level 3, even though the incidence per 100 000 is around a third of the number of cases in the Western Cape. Figures from Statistics South Africa's (StatsSA) Labour Market Dynamics Survey indicate the extent of the inequalities in healthcare. According to the survey, in 2018, there was one health worker, which in this estimate includes non-professional employees from both the public, and private healthcare sectors, for every 70 residents in the Western Cape and Gauteng. In the Eastern Cape and the North West, there were 110 residents per healthcare worker, that is, there were almost 60 per cent more people per healthcare employee. The main reason for this disparity was differences in the extent of private healthcare in different provinces, which is concentrated in the richest provinces of South Africa.

Over half of all healthcare employees in Gauteng and the Western Cape were in the private sector, whereas one-third of healthcare workers in the North-West and the Eastern Cape were in the private sector. Within healthcare in the public sector, there were 170 residents for each healthcare employee in the North West and the Eastern Cape, which compares favourably with Gauteng and the Western Cape at 160.

In the midst of all the challenges and inequalities in the South Africa's healthcare system, two announcements at the end of June 2020 shone a positive light on the healthcare system.

First, South Africa turned out to be a major global source of the steroid dexamethasone, which a new study showed may prevent a third of hospitalised deaths from COVID-19, if administered to severely ill patients (although it may be counterproductive for those with mild symptoms). Durban-based pharmaceutical company Aspen can provide 10 million tablets in a month, and could expand production even further if required. Second, the first South African vaccine trial run by Oxford University and the University of the Witwatersrand had begun in the final week of June. The test will involve over 50 000 people from the UK, the US, Brazil and South Africa. Trials of other vaccines are expected in South Africa in the future.

## Box 1: Government response to Covid-19 so far

| Expenditure | Amount (R' billion) | Effectiveness of intervention |
|---|---|---|
| **Health – Covid-19 intervention** | 20 | 1) Large backlogs of tests in laboratories;<br>2) The extent to which screening is being deployed is unclear;<br>3) Not enough being done to increase ICU bed capacity. |
| **Municipal allocation** | 20 | 1) Funds have been underspent and not been timeously utilised, highlighting under-servicing of rural, informal, and low-income areas;<br>2) There is little indication of the efficiency nor the amounts used thus far. |
| **Social and basic income grant** | 50 | 1) It took around 6 weeks before any grants were paid. As of 18 June 2020, only 1.2 million applicants, out of 6.2 million received, have been paid;<br>2) Increases to other grants have been implemented but limited increases leave many behind. For example, limiting the CSG increase to each caregiver, not each child, means almost one-third less support to the poorest people. |
| **Job creation and support for SMEs and Informal sector** | 100 | 1) There are no recent estimates of uptake. However, Stats SA reports in an April survey that only 4.25% of business-owning respondents had made use of the various tax deferral programmes.<br>2) The mechanisms to use these measures are vague, and smaller businesses, precisely those needing the help, lack dedicated tax and finance departments and are struggling to apply. |
| **Salary income support (UIF)** | 40 | 1) As of June 19 2020, 355 267 employers had been paid, with some being paid in more than one month. By contrast, the number of employers sitsat approximately 2.4 million. Only 8% of employers have been paid;<br>2) It does not guarantee workers receive support at least equal to the national minimum wage of R4 045;<br>3) The application and payment mechanism is cumbersome, bureaucratic and inefficient. Thousands of companies report failure to receive support. |
| **Tax relief** | 70 | 1) There are no recent estimates of uptake. However, Stats SA reports in an April survey that only 4.25% of business-owning respondents had made use of the various tax deferral programmes;<br>2) The mechanisms to use these measures are vague, and smaller businesses, precisely those needing the help, lack dedicated tax and finance departments and are struggling to apply. |
| **Business loan guarantee scheme** | 200 | 1) Extremely low uptake from businesses, with estimates of total loans of between R300 million and R6 billion extended.<br>2) Three-week delay between announcement and finalisation saw businesses reduce wages, retrench workers, and make other arrangements over the period. |
| **Total** | **500** | |

## Gross domestic product[1]

Gross Domestic Product (GDP) contracted by 2 per cent in the first quarter of 2020. Measurement of the contributions to GDP from the production side of the economy showed that five industries registered a decline in production during the first quarter of 2020: the mining, manufacturing, utilities, construction and trade sectors.

*Figure 4: Quarter-on-quarter percentage change in sectoral performance*

| % change q/q | Agriculture | Mining | Manufacturing | Utilities | Construction | Trade | Logistics* | Business services** | Government services | Personal services | GDP |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2019 - Q1 | -16,8 | -3 | -1,2 | 3,4 | -0,7 | -3,6 | 3,4 | 2,6 | -3,8 | -1,2 | -3,2 |
| 2019 - Q2 | -4,9 | 1,4 | -3,8 | 6,8 | 7,7 | -4,4 | -0,3 | -5,4 | -7,2 | 0,5 | 3,3 |
| 2019 - Q3 | -4,5 | 1 | 1,7 | 2,1 | 2,7 | 1,1 | 4,1 | 1,6 | 2,7 | 3,7 | -0,8 |
| 2019 - Q4 | -7,6 | 1,8 | -1,8 | -4 | -5,9 | -3,8 | -7,2 | 2,7 | -0,4 | 0,7 | -1,4 |
| 2020 - Q1 | 27,8 | -21,5 | -8,5 | -5,6 | -4,7 | -1,2 | 0,5 | 3,7 | 1 | 0,5 | -2 |

Data: StatsSA

*Logistics refers to Transport, storage and communication

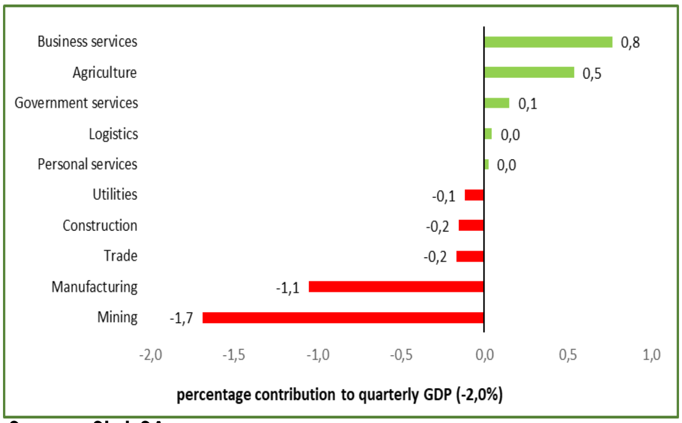
**Business services refers to Finance, real estate and business services

**Source: StatsSA**

The agriculture, forestry and fishing industry was the strongest performer across the quarter, registering a 27.8 per cent increase in value added after four consecutive quarters of contraction. The industry growth was mainly due to an increase in production of field crops, horticultural products and animal products. The mining and quarrying industry was the poorest performer registering a 21.5 per cent decline in value added due to decreased production in iron ore, manganese ore, and other metallic minerals and chromium.

The largest positive contribution to first quarter GDP in value added was finance, real estate and business services (0.8 per cent), followed by agriculture (0.5 per cent). Mining and quarrying (1.7 per cent) made the largest negative contribution to first quarter growth followed by manufacturing (1.1 per cent).

*Figure 5: Sector percentage contribution to the second quarter GDP decrease*

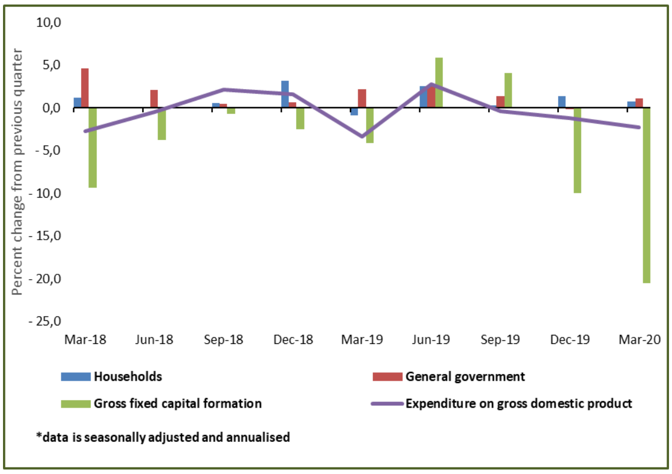



**Source: StatsSA**

## Expenditure on GDP

South Africa's real expenditure on GDP contracted by 2.3 per cent in the first quarter of 2020. This contraction was the third consecutive decline in quarterly GDP. Household consumption increased by 0.7 per cent from the previous quarter and contributed 0.4 per cent to total quarterly growth in the first quarter of 2020. The main positive contributors to the growth in household consumption were food and non- alcoholic beverages; furnishings, household equipment, maintenance; housing and utilities.

*Figure 6: Quarterly sector performance*



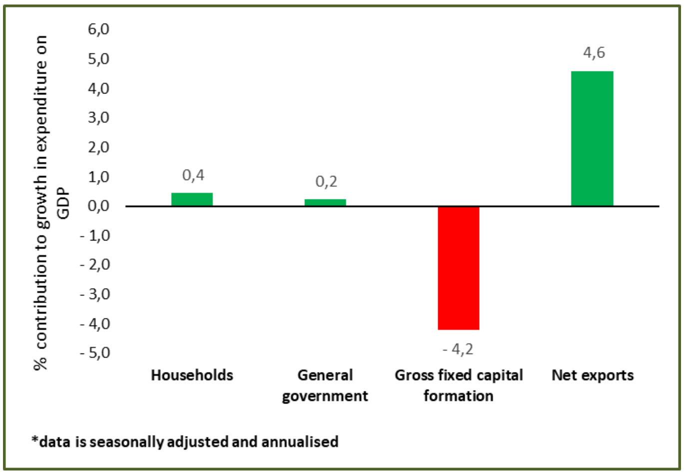

**Source: StatsSA**

Expenditure on transport and clothing and footwear decreased and contributed negatively to growth in household consumption. Expenditure by general government increased by 1.1 per cent, contributing 0.2 of a percentage point to the quarterly growth in expenditure. This increase in general government expenditure was due to increased expenditure on employment and goods and services recorded in the first quarter of 2020.

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

Gross fixed capital formation declined by a massive 20.5 per cent in the first quarter of 2020. Exports of goods and services were down 2.3 per cent by the end of the first quarter of 2020, largely influenced by decreased trade in precious metals, base metals and travel services while imports of goods and services decreased by 16.7 per cent in the first quarter of 2020, driven largely by lower imports of machinery and electrical equipment, mineral product services. As a result, net exports contributed 4.6 per cent to expenditure on GDP.

*Figure 7: Sector contribution to negative first quarter GDP growth*




**Source: StatsSA**

## Investment

By the end of the first quarter of 2020, gross fixed capital formation (GFCF) decreased by 20.5 per cent. The decline in GFCF was10 per cent in the fourth quarter of 2019. As seen in figure 7, there was a decline in investment for every type of assets. The main contributors to the decrease were machinery and other equipment, transport equipment and other assets.

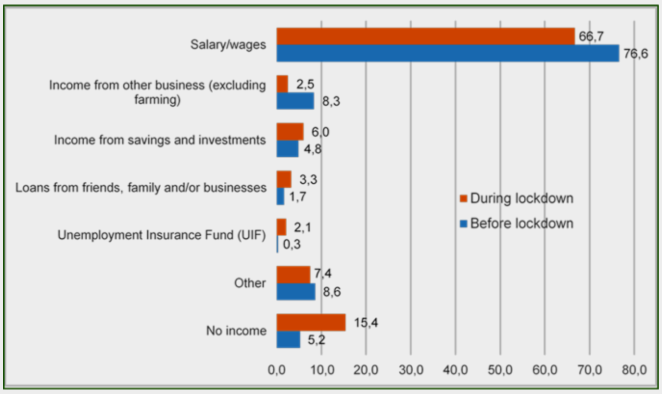
In figure 8, real gross fixed capital formation by private businesses declined for the second consecutive quarter. It declined by 25.3 per cent in the first quarter of 2020, after decreasing by 10.3 per cent in in the fourth quarter of 2019. This decline occurred after private businesses increased investment in the second and third quarters of 2019.

The positive contribution of public sector investment of 7.7 per cent during the first quarter of 2020, means that after three consecutive quarters of decline, real gross fixed capital expenditure by the public sector managed to contribute positively to real gross fixed capital formation. Gross fixed capital formation by public corporations contracted considerably by 20.9 per cent, after a contraction of 0.3 per cent in the fourth quarter of 2019.

## Box 2: Impact of Covid-19 on Household income and consumption

Statistics South Africa (Stats SA) embarked on a series of online surveys to measure the impact of the COVID-19 pandemic on individuals in the country. The second round of the survey (Wave 2) focused on employment, income and hunger-related issues. Any person aged 18 years and older and a South African resident during the national lockdown was able to voluntarily go online and complete the survey. Data collection for Wave 2 occurred during the sixth week of the national lockdown between 29 April and 6 May 2020. As respondents had already experienced more than a month in lockdown, most would have some indication of the impact the pandemic was having on their income and consumption patterns.

*Figure 1: Proportion of respondents by income source before and during lockdown*




In Figure 1, we see that the percentage of respondents who reported no income increased from 5.2 per cent before the lockdown to 15.4 per cent by the sixth week of the national lockdown. The majority of respondents reported salaries/wages as their primary source of income before and during the national lockdown, however, the percentage of respondents who received an income from salaries/wages decreased from 76.6 per cent before the national lockdown to 66.7 per cent by the sixth week of the national lockdown.

Figure 2 indicates the percentage distribution of respondents by the type of change in their weekly spending patterns during the national lockdown as compared to their usual weekly spending prior to the lockdown. Approximately 19.5 per cent of respondents said that their spending was about the same during these two periods. Close to forty percent of respondents (38.6 per cent) reported that they spent less per week during the lockdown compared to the period before the national lockdown, while over one-third (35.8 per cent) indicated that they were spending more per week.

*Figure 2: Percentage distribution of respondents by the type of change in their weekly spending behaviour during the national lockdown as compared to before the lockdown*

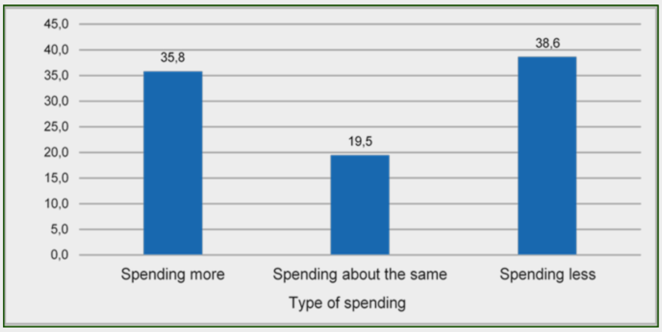
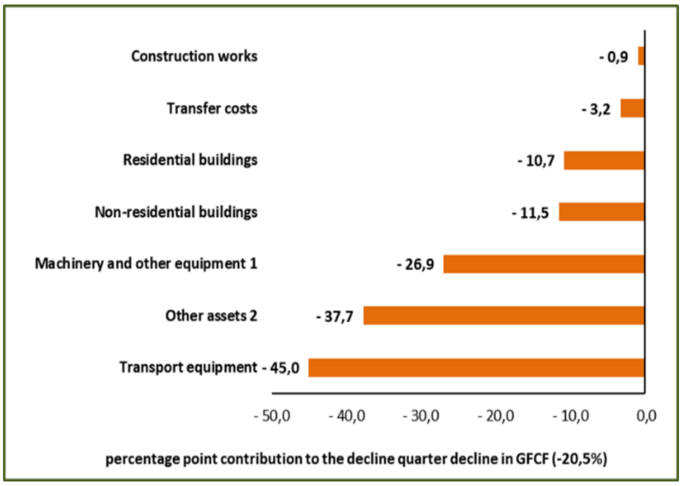
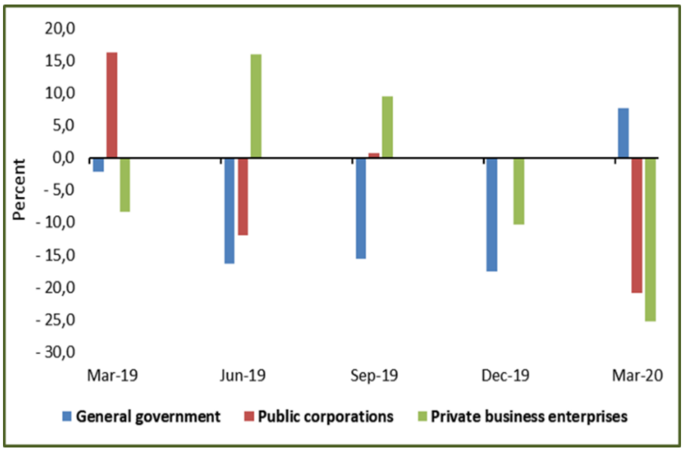


*Figure 8: Real Gross fixed capital formation by type of asset*




**Source: StatsSA**

*Figure 9: Gross fixed capital formation by type of organisation*




**Source: StatsSA**

## Employment

According to Statistics South Africa's Quarterly Labour Force Survey, which measures formal and informal employment, the official unemployment rate increased during the first quarter of 2020. The unemployment rate worsened by 1 per cent, from 29.1 per cent during the fourth quarter of 2019 to 30.1 per cent in the first quarter of 2020. The number of people who were unemployed (in terms of the narrow definition of unemployment increased by 343 866 during the first quarter. Therefore, the number of people classified as officially unemployed in South Africa increased to over 7 million. Compared to the situation a year ago, the number of unemployed people increased by 14 per cent (869 000), whilst the number of employed people increased by only 0.6 per cent (92 000).

The number of people considered not economically active decreased by 369 000. The official unemployment rate of people classified as youth also increased in the first quarter to 43.2 per cent, compared to 41.5 per cent in quarter four of 2019. The unemployment rate for females remained higher than that of males. The unemployment rates for people of both genders increased during the first quarter compared to the rate in the fourth quarter of 2019. The unemployment rate for females increased from 31.3 per cent to 32.4 per cent and the unemployment rate for males increased from 27.2 per cent in the fourth quarter of 2019 to 28.3 per cent in first quarter 2020.

*Table 3: Key labour statistics – Quarterly Labour Force Survey*

| | 1Q 2019 | 4Q 2019 | 1Q 2020 |
|---|---|---|---|
| **All absolute values are in thousands** | | | |
| **Labour force ('000s)** | **22 492** | **23 146** | **23 452** |
| **Employed** | **16 291** | **16 420** | **16 383** |
| **Unemployed - official** | **6 201** | **6 726** | **7 070** |
| **Unemployed - broad*** | **9 995** | **10 381** | **10 797** |
| **Not economically active ('000s)** | **15 791** | **15 581** | **15 422** |
| Discouraged job-seekers | 2 997 | 2 855 | 2 918 |
| Other (not economically active) | 12 793 | 12 726 | 12 504 |
| **Unemployment rates** | | | |
| Official unemployment rate (narrow) | 27,60% | 29,10% | 30,10% |
| Broad unemployment rate* | 38,00% | 38,70% | 39,70% |
| **Unemployment Rates - Gender** | | | |
| Male - official | 25,10% | 27,20% | 28,30% |
| Female - official | 29,30% | 31,30% | 32,40% |
| **Unemployment Rates - Race** | | | |
| Black African - official | 31,10% | 32,40% | 33,80% |
| Coloured - official | 22,20% | 24,90% | 24,00% |
| Indian/Asian - official | 11,40% | 13,90% | 13,00% |
| White - official | 6,60% | 7,60% | 8,10% |
| **Youth**** | | | |
| Unemployment rate - official | 39,60% | 41,50% | 43,20% |
| Unemployment rate - broad* | 51,50% | 52,40% | 53,80% |

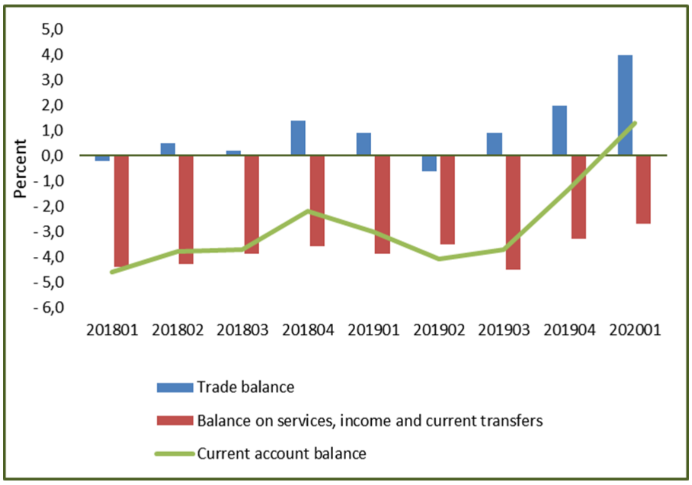
* The broad unemployment rate includes discouraged job seekers
** Youth is defined as age 15 - 34
Data: Quarterly Labour Force Survey, Stats SA

**Source: StatsSA**

## Current Account

The current account had a deficit in the fourth quarter of 2019 and a surplus in the first quarter of 2020. This surplus was the first surplus on the current account since the first quarter of 2003. The current account balance as a percentage of gross domestic product (GDP) increased from -1.3 per cent in the fourth quarter of 2019 to 1.3 per cent in the first quarter of 2020. The effects of the COVID-19 pandemic on South Africa's imports and exports were still limited by the end of the first quarter of 2020 as the domestic lockdown restrictions were implemented only from late March. The trade surplus occurred because the value of merchandise exports increased and imports declined. The higher value of merchandise exports reflected an increase in prices, while both lower volumes and prices contributed to the lower value of imported goods. The long-term, continued deficit in the services, income and current transfers on the current account continued into the first quarter of 2020. These financial outflows on the current account as a percentage of GDP declined from -3.3 per cent in the fourth quarter of 2019 to -2.7 per cent in the first quarter of 2020. The trade balance on goods as a percentage of GDP doubled since the fourth quarter of 2019 to the first quarter of 2020 – from 2 per cent to 4 per cent.

*Figure 10: Change in the balance of the current account (as a percentage of GDP)*




**Source: StatsSA, SARB**

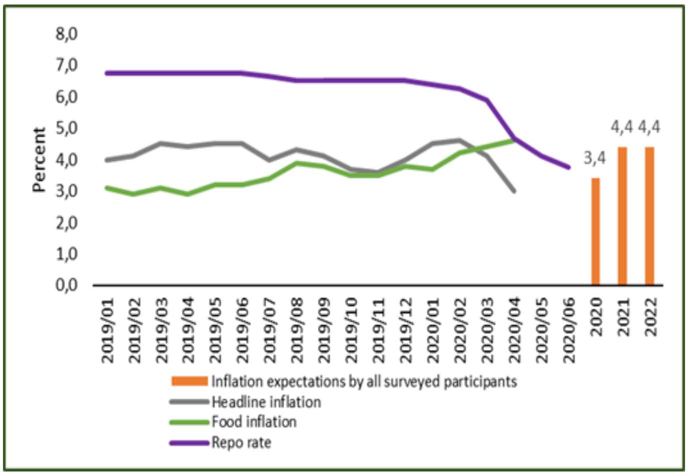
## Inflation and monetary policy

Statistics South Africa reported that the release of consumer price index (CPI) data have been delayed due to disruption caused by Covid-19. Headline consumer price inflation (CPI) for all urban areas was 4.1 per cent in March 2020, down from 4.6 per cent in February 2020 and 4.5 per cent in January 2020. Inflation on food and non-alcoholic beverage prices was 4.4 per cent in March 2020 up from 4.2 per cent in February 2020 and 3,7 per cent in January 2020.

The Monetary Policy Committee (MPC) of the South African Reserve Bank noted in its April and May 2020 statement that the global economic outlook has been revised downward and contractions are expected to deepen during the second quarter due to the outbreak and spread of Covid-19. According to the MPC, exports, imports and investment are expected to decline sharply for the whole year even as lockdown is relaxed in the coming months.

The crisis has caused extreme volatility in financial asset prices with sharp and deep market sell-offs. According to the SARB, the overall risks to the inflation outlook in May appears to be to the downside, but better than conditions in March and April. Local food price inflation is also expected to remain contained. The SARB's headline consumer price inflation forecast averages 3.4 per cent for 2020 and 4.4 per cent for 2021 and 2022. Against this backdrop, the MPC decided to cut the repo rate by 100 basis points in April 2020 and a further 50 basis points in May 2020. The repo rate was 3.75 per cent per annum, with effect from 22 May 2020. The reductions in the repo rate since January add up to 2.75 per cent (see figure 11).

*Figure 11: Inflation is currently at an all-time low*




**Source: SARB**

The global outlook for inflation is uncertain. The July 2020 *Monthly Briefing on the World Economic Situation and Prospects* of the United Nation's Department of Economic and Social Affairs points out that there are different upward and downward pressures on inflation within countries and the world. On the one hand, the increasing use of quantitative easing around the world to respond to the impact of the pandemic, including easing liquidity in financial markets and financing government deficits, leads to increasing the money supply and could drive up inflation. On the other hand, they point out that there is a majority view globally that there are serious, multi-year downward pressures on inflation that may more than offset the inflationary pressures from QE. They point to declining demand, "consumer confidence shattered by Covid-19" and increased uncertainty driving growing precautionary savings in households. They report that the household savings rate in the USA increased from 7.7 per cent in December 2019 to 23.2 per cent in May 2020. They say that the European Commission predicts that the savings rate in the Euro area will increase from 12.8 per cent in December 2019 to 19 per cent in 2020. There is a real fear that even if governments are rapidly increasing money supply that disinflation could cause massive economic damage and cause the recession to worsen and last longer.

Generally, mainstream economics commentators warn about the dangers of inflation but not deflation. One reason for this ongoing concern with inflation, even where the greater risk may be deflation, is because the focus of mainstream economists' proposals for macroeconomic policy has been to enforce the use of only monetary policy and to discourage fiscal policy. They warned that fiscal policy would be ineffective and make matters worse by causing increasing inflation. The global financial crisis has shown the weakness of mainstream macroeconomic thinking and shown that monetary policy by itself has large limitations. In fact, much of the monetary policy interventions in developed economies since the global financial crisis has been to boost inflation and shift monetary policy towards positive higher real interest rates.

Further, there is now broad agreement not only that that fiscal policy is not ineffective but also that it is required. And, that fiscal and monetary policy must be coordinated. The increasing financing of government deficits by central banks after the global financial crisis has increased even more now to help governments' budgets as they respond to Covid-19. An opinion piece by the Editorial Board of the *Financial Times* newspaper on 17 June 2020 titled "Emerging markets can use quantitative easing too" shows how far mainstream perspectives on central banks financing government debt has changed. It is widely agreed that fears of inflation growing were incorrect after the global financial crisis of 2008 and is not a major concern now either.

Governments and central banks, including in developing countries such as South Africa where inflation is generally higher than in developed countries, have to coordinate and respond to the possibility that some of the largest economies could have deflation and also that there could be aggregate disinflation globally. Deflation could worsen the current global recession substantially. John Maynard Keynes warning in 1923 that the impact of deflation could be much worse than inflation is still true today. His logic was that inflation may reduce the real returns to people with financial asset but deflation could cause declines in profits, incomes, jobs and investment that would increase the real burden of debt. Deflation causes prices to drop and households to postpone consumption because they expect lower prices to be in the future. In his book *Essays in Persuasion* (published in 1932), Keynes said "the fact of falling prices injures entrepreneurs; consequently, the fear of falling prices causes them to protect themselves by curtailing their operations." Those with debt will be harmed because deflation while increasing the real value of money because prices of goods and services decline means that the real cost of repaying debt increases. Therefore, it could cause hardship for businesses with debt and a collapse in demand for debt for real investment and household consumption. The actions of developed countries and the inadequacy of QE without stimulatory fiscal spending after the global financial crisis teaches us that expanded government consumption and investment will be required to mitigate the risks of deflation spreading.

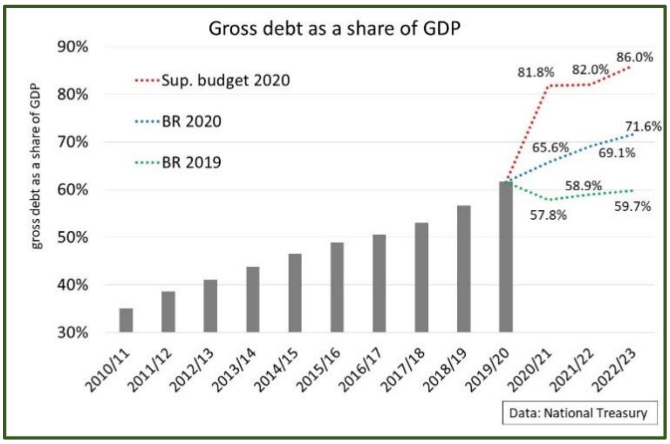
## Sovereign risk and debt outlook

Global levels of debt, including public debt, had increased much during the years before Covid-19 because of high levels of monetary stimulus and low interest rates. During 2019, poor global economic performance led to widespread credit ratings downgrades of public and private debt. The number of downgrades increased into the first quarter of 2020.

By March 2020, Covid-19 pandemic fear gripped financial markets and there was a large outflow of foreign capital from developing countries in 'flight to safety' to developed country financial markets. There was also increased numbers of credit ratings downgrades of private and public debt in both developed and developing countries. At the same time, the developed countries embarked on massive monetary easing that pushed equity prices higher at the same time that those economies were reporting large declines in economic activity and unemployment. During April and May 2020, there was some return of capital to developing countries that led to increases in equity and bond markets possibly as a result of the large monetary stimuli in developed countries. Uncertainty and speculation remain high in global financial markets. The outlook is one that indicates likelihood for increasing volatility that does not bode well for stability in financial markets of developing countries, including South Africa.

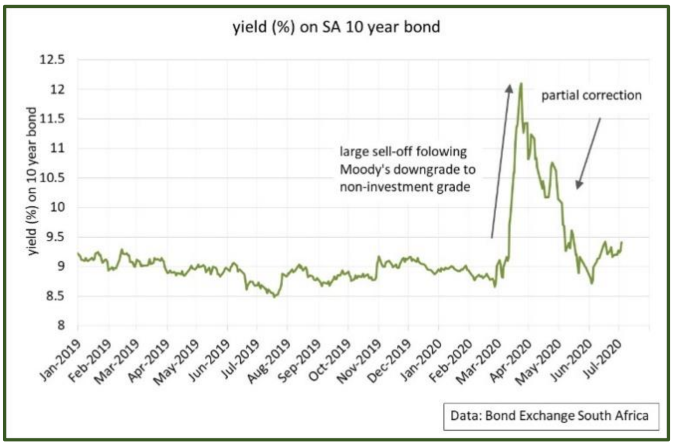
South Africa's debt outlook and sovereign risk have both worsened over the last twelve months due to weak economic growth and concern about public finances, which have been amplified by the Covid-19 crisis.

*Figure 12: Change in debt outlook*




The yield on South Africa's 10-year benchmark bond, which is considered a gauge of market sentiment with regard to South African government bonds, increased at the end of March. The increase followed Moody's downgrade of South Africa's long term foreign and local currency debt ratings to 'Ba1' from 'Baa3' respectively. Moody's maintains a negative outlook on South African bonds. As a result of the downgrade, South Africa was excluded from the FTSE World Government Bond Index (WGBI). South Africa's direct financing costs increased immediately as shown by the steep increase in the clearing yields in Figure 3. Bond yields improved in April and May 2020.

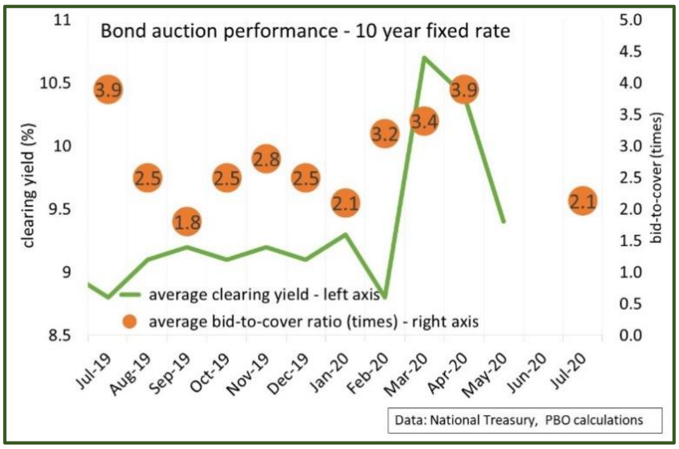
*Figure 13: Yield on SA 10-year bond*




The results from government bond auctions for the last 12 months, show continued elevated perception of risk. Following the decision by Moody's to downgrade South Africa's debt to sub-investment grade.

South Africa's yield curve for short, medium and long-term bonds, which can be interpreted to show– market risk perception of different government debt across different time horizons, changed at both the short- and long-end of the yield curve. Lower inflation, its moderate outlook, and lower interest rates contributed to yields over shorter horizons.

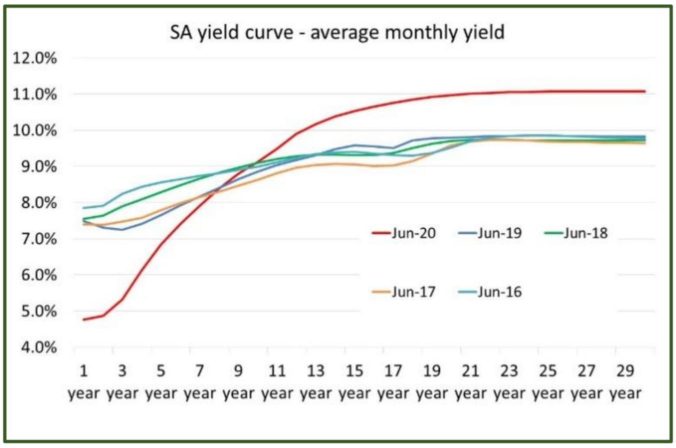
*Figure 14: Performance of government bond auctions*




However, the steep increase in the yield curve indicates market concerns around the sustainability of South Africa's debt, contributing to higher yields (government financing costs) over the medium and long term.

The outlook for South African equity and bond markets is particularly uncertain not only because of the pandemic and its potential length and intensity. The uncertain outlook for domestic financial markets is also caused by the unpredictable behaviour and responses within the financial markets of developed countries to the extraordinarily large monetary stimuli on the one hand and the economic devastation in their countries on the other hand. At the moment, the monetary stimulus is causing equity prices to remain high. However, monetary stimulus cannot prevent large declines in economic activity, productive investment, employment and profits nor can it stop bankruptcies.

*Figure 15: Increasing risks over the medium term*




The demand for developed country bonds with very low and negative interest rates increased even before the pandemic because institutional investors wanted to adjust their portfolios as concerns about high equity prices increased. This shift towards bonds may possibly portend good news for some developing countries' sovereign debt markets even at a time when these countries' government debt to GDP levels are rapidly rising to respond to the pandemic. Notwithstanding credit ratings downgrades, developing country government debt with positive interest rates could very well be the assets desired by institutional investors to improve their negative yielding portfolios.

## Box 3: Increased digitalization of business due to Covid-19 and some tax implications

The Covid-19 pandemic lockdown has caused a global economic decline. The decline in economic activities has led to a loss of much needed tax revenue for countries like South Africa where tax revenue accounts for more than 80% of government revenue. The lockdown and continued need for social distancing even as lockdowns are eased, continue to take a heavy toll around the world. Disruptions and business closure in many economic sectors have been accompanied by increased levels of digitalized economic activities, such as advertising, online shopping, online education, and many other activities. Even before the Covid-19 pandemic, the global economy experienced rapid growth in digitalization of economic activities. The decline in business activities has largely been due to the fact that many economic subsectors depend upon physical human interactions and movement. The continued national lockdown, despite slow easing, is therefore expected to lead to a further economic decline.

According to the United Nations Conference of Trade and Development (UNCTAD), the number of online shoppers has doubled globally since the 2008 Global Financial Crisis (GFC). Business-to-consumer (B2C) e-commerce transactions having increased from less than $1 trillion (R 18 trillion) to more than $3.8 trillion (R68.4 trillion) since 2008. The combined market value of digital multinational enterprises (MNEs), such as Amazon, Apple, Facebook, Google and Microsoft, rocketed from $500 billion (R9.2 trillion) in 2008 to more than $7.5 trillion (R 138 trillion) before the outbreak of Covid-19.

**Taxation challenge in digital economy**

The rapid digitalization of economic activities has deepened long standing weaknesses within the international tax system. The current international taxation system, although undergoing some reform since the 2008 global financial crisis, is still based on a principle that income or profits are taxed by a jurisdiction that can prove physical presence of a business or business activities. The assumption has been that value is created by the physical presence of businesses or business activities in a particular jurisdiction. Rapid digitalization of economic activities means that more economic sectors can now create value without physical presence in particular jurisdiction. As a consequence, the current international tax system fails to fairly allocate taxing rights (to multiple jurisdictions) in cross border digitalized economic activities, which leads to loss of much needed tax revenues in many jurisdictions. MNEs operating in South Africa within the digital economy are able to avoid paying their fair share of taxes on income generated in the Republic. This situation allows MNEs, such as Uber, Airbnb, Amazon etc., to earn incomes and profits in South Africa without paying their fair share of taxes on those incomes. Therefore, South African-based companies are at a large disadvantage to the digital MNES because the domestically based companies are required by law to pay their corporate income and other taxes locally. There is the possibility that digital MNEs could weaken and even bankrupt South African companies because of the gap in the domestic tax regime.

South Africa was one of the first countries to introduce VAT on consumption of digital economic activities in 2014. However, due to lack of international and domestic taxation rules for income generated from the digital economy, South Africa continues to lose much needed potential income tax.