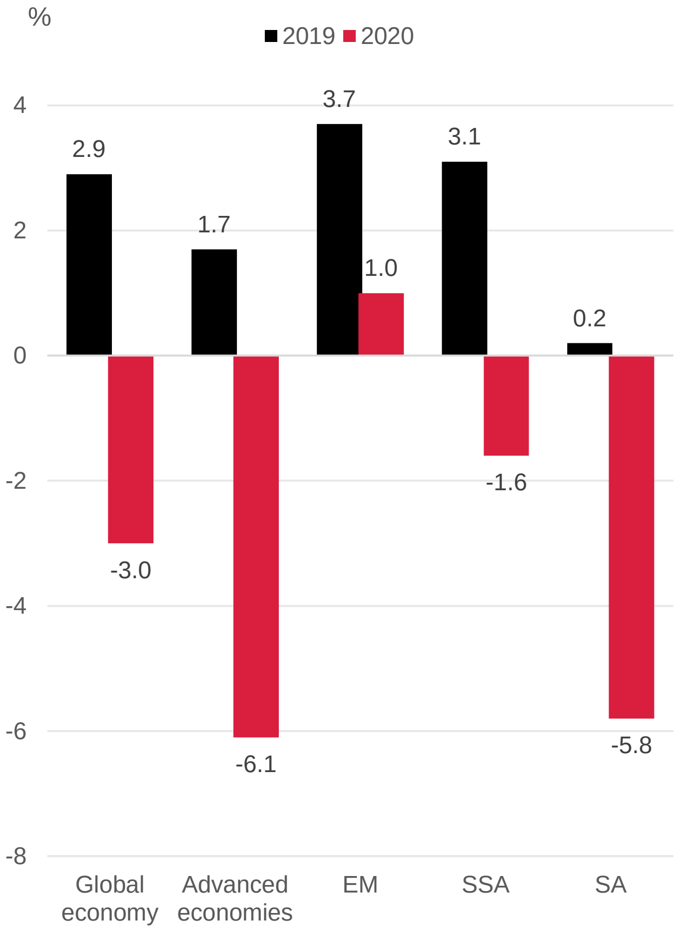
Life in the time of COVID19

Global GDP: The optimistic scenario

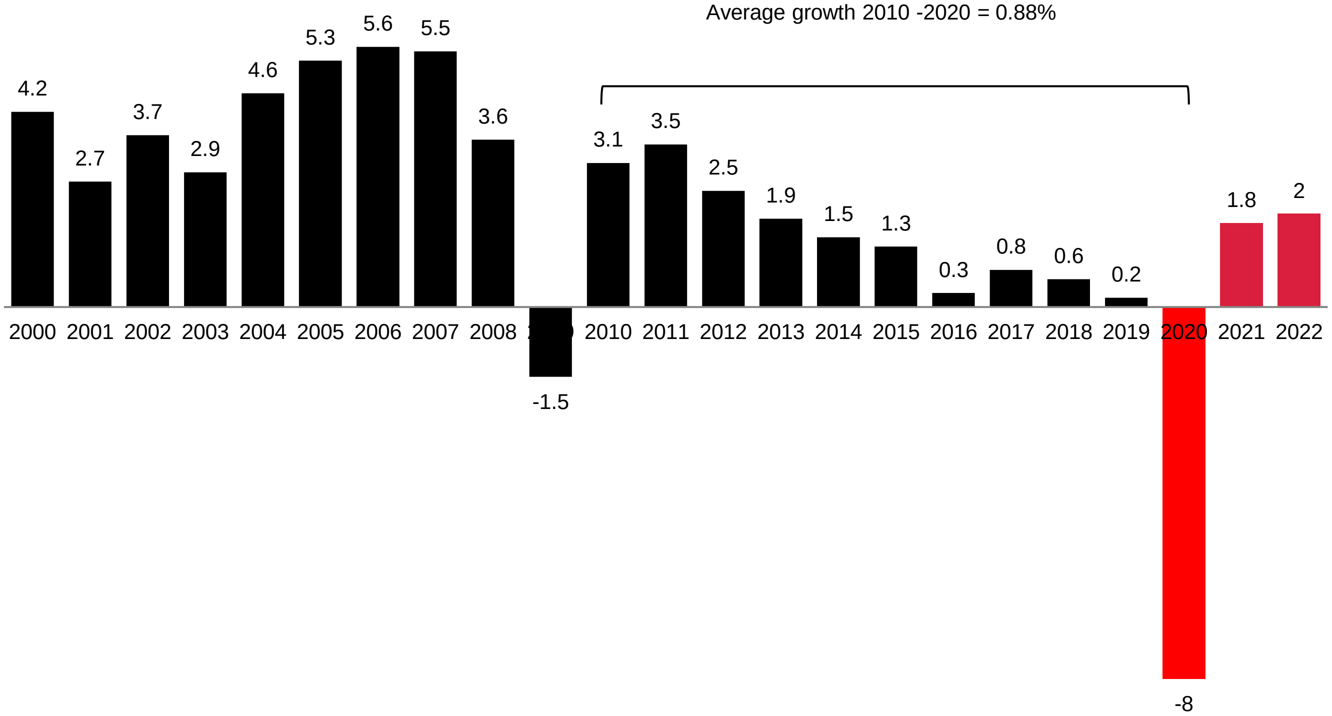


- The IMF expects a contraction in global GDP of -3.0%
- This is an optimistic view as output has yet to recover

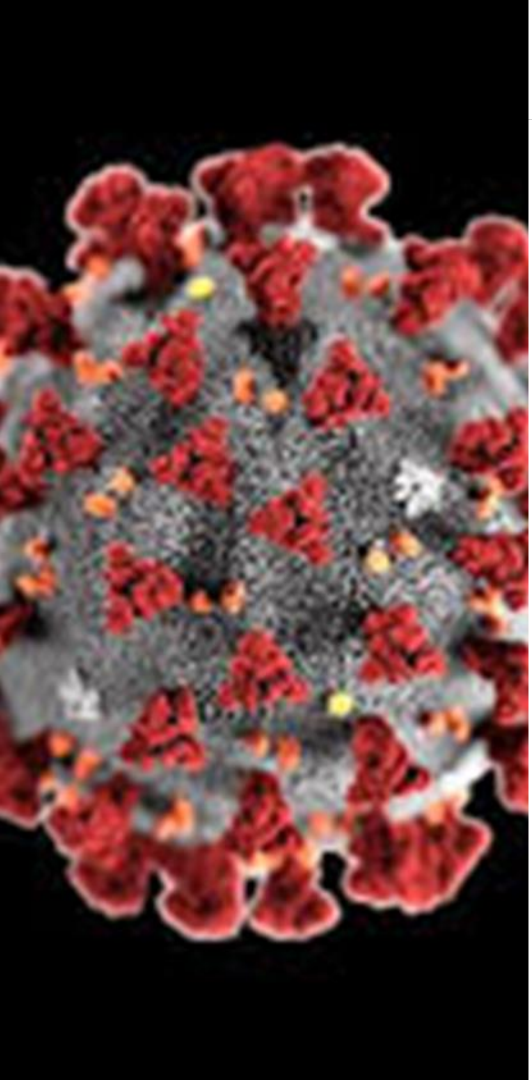
1. The shock is large. Output loss is much more severe than during the GFC
2. There is continued severe uncertainty about the duration and intensity of the shock.
3. In order to tackle the health crisis, policymakers have to do the opposite of stimulating aggregate demand.

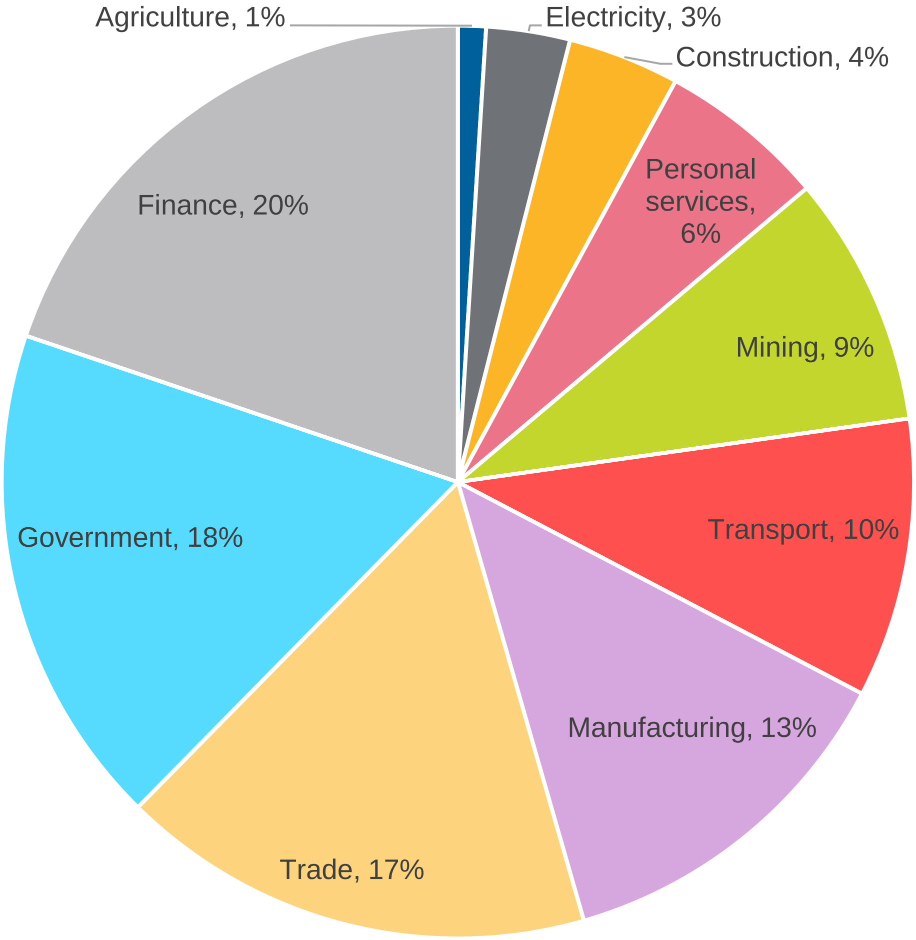
- Long-term consequences of COVID-19
- Increased tension between China and US
- Decoupling of relationship

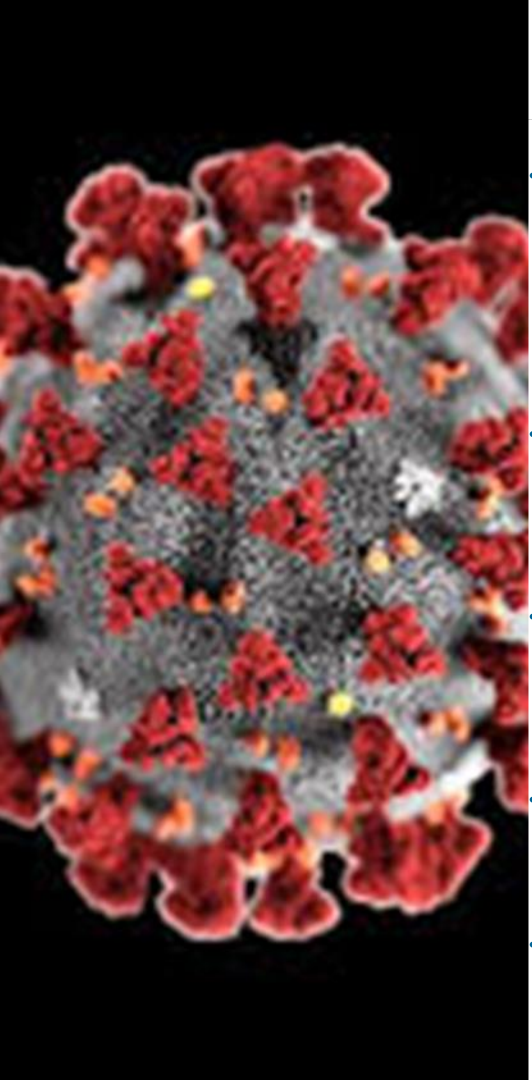
GDP


Average growth 2010 -2020 = 0.88%
4.2
2.7
3.7
2.9
4.6
5.3
5.6
5.5
3.6
-1.5
3.1
3.5
2.5
1.9
1.5
1.3
0.3
0.8
0.6
0.2
-8
1.8
2
2000 2001 2002 2003 2004 2005 2006 2007 2008 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022

GDP: Production







COVID 19 Impact on the sector & food security status in SA

- The South African agricultural sector was already constrained prior to the outbreak of COVID 19 due to a series of droughts, biosecurity issues, rising input costs induced by the weakening domestic currency, amongst other aspects. But there is a foreseen recovery period expected in 2020, as weather conditions have generally been favourable and there is an expectation of a bumper grain and fruit harvest. Agbiz estimates a 10% y/y recovery in SA agricultural GDP for 2020.

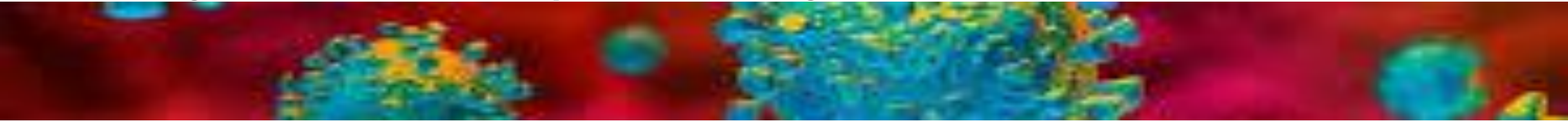
- As a result the South African agricultural and food will not be as hard hit by the COVID-19 shutdown due to a sufficient food stock supply & the exemption provided. Essentially, the domestic food supply is secure, at least, for the next 12 months.

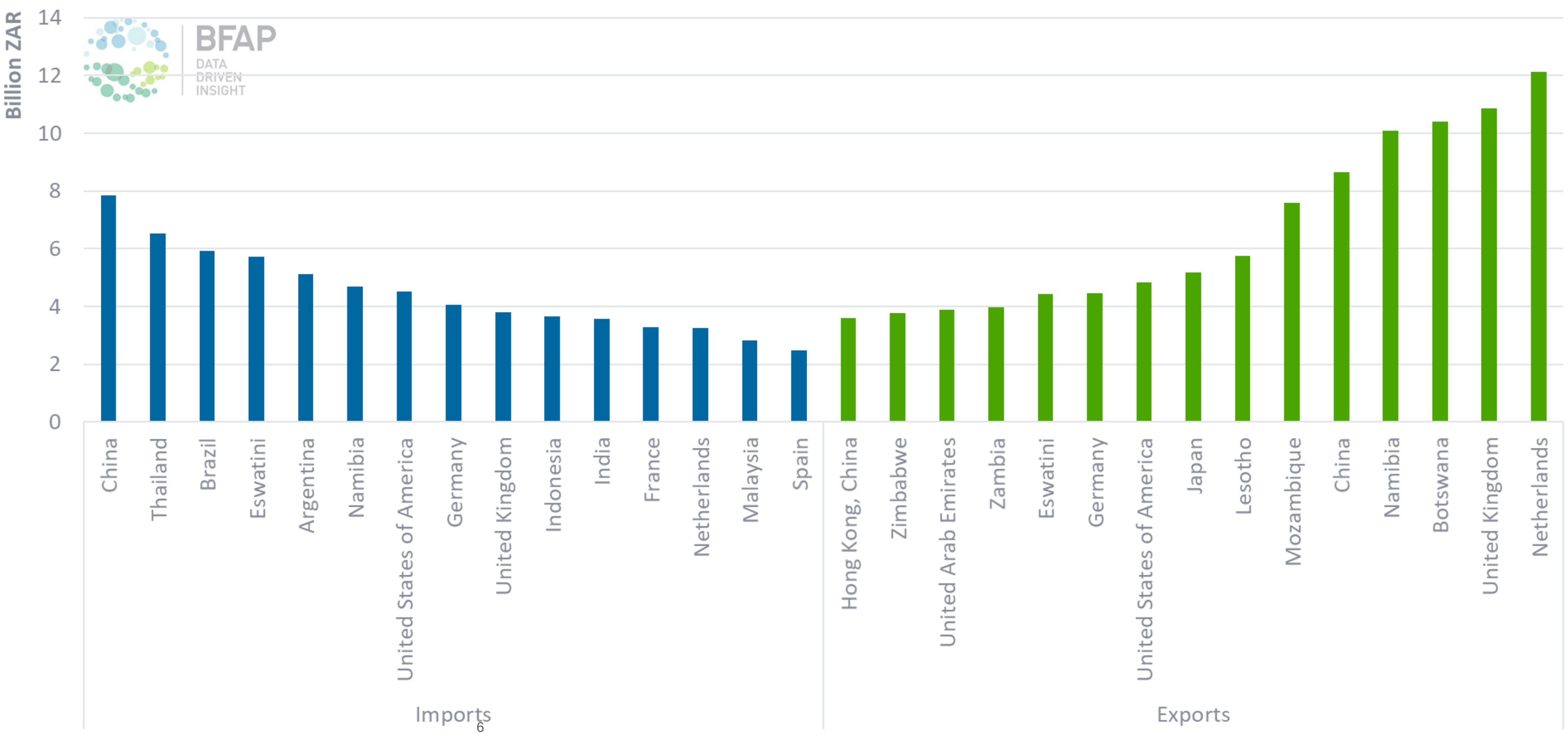
- Even imported food products such as rice (100% dependent on imports), wheat (50% dependent on imports), and palm oil (100% dependent on imports) have relatively good global stock levels – provided global logistics are not affected and our trading partners don’t institute any export bans on these essential products.

- However, there are four agricultural products were not classified as essential services during the lockdown & they are impacted. These include wool, cotton, mohair & wine and the state needs to re-open their operations.

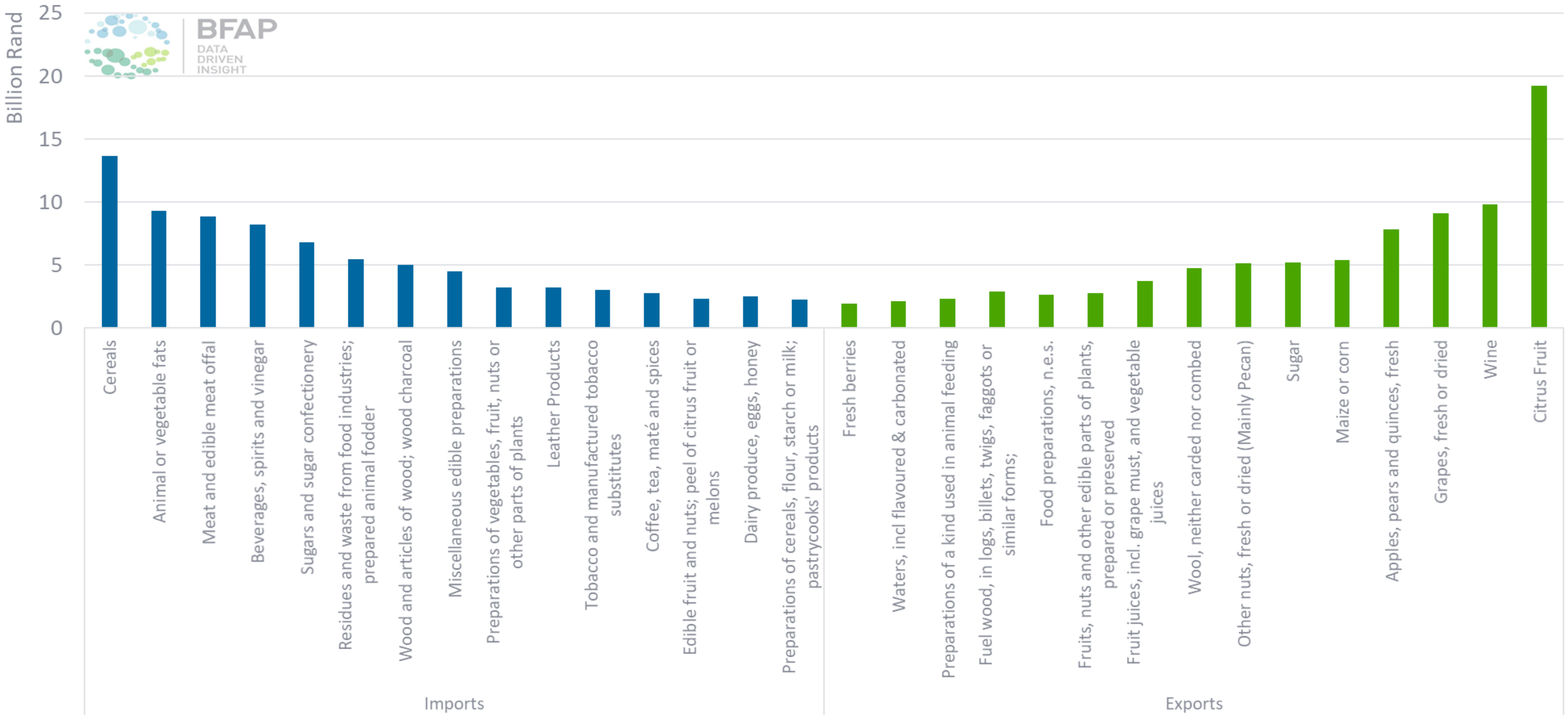
- Affordability of food in South Africa could become a problem as workers from other sectors not classified as essential start losing income as well as lower income households.

Trade in agriculture and food products : Avg 2017-2019





Trade in agriculture and food products : Avg 2017-2019



Agro-Food chain generally operational, although not at optimal levels

Inputs → **Producers** → **Handling** → **Processing** → **Int. Trade** → **Retail**

Inputs
- Fertilizer
- Chemicals
- Machinery
- Fuel
- Packaging
- Electricity
- Logistics

Producers
- Producer Organizations
- Logistics

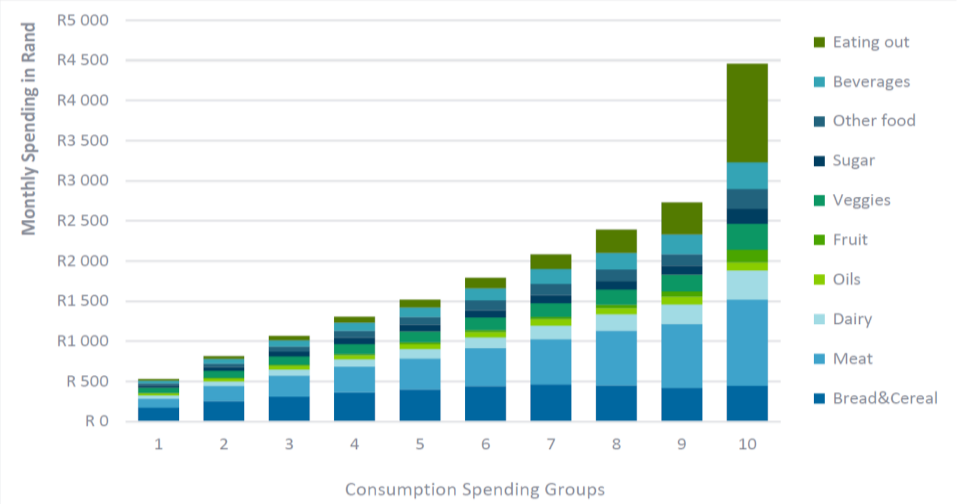
Handling
- Traders
- Storage
- Fresh Produce Markets
- Logistics

Processing
- Processors
- Warehousing
- Distribution
- Logistics

Int. Trade
- Imports
- Exports
- Sea Ports
- Dry Ports
- Logistics

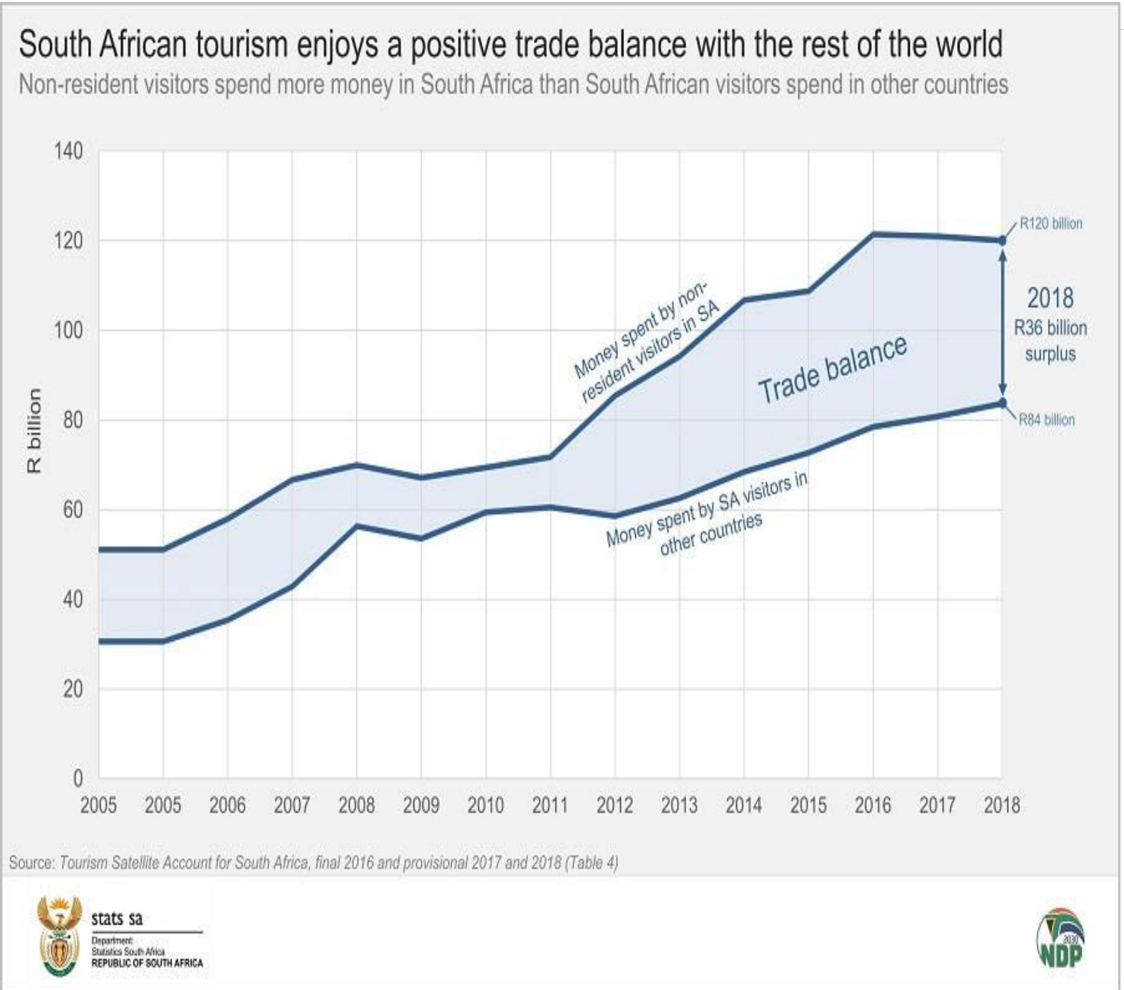
Retail
- Consumer Goods council
- Large retail chains
- Logistics

South Africa's Food Consumption per household income group in 2020

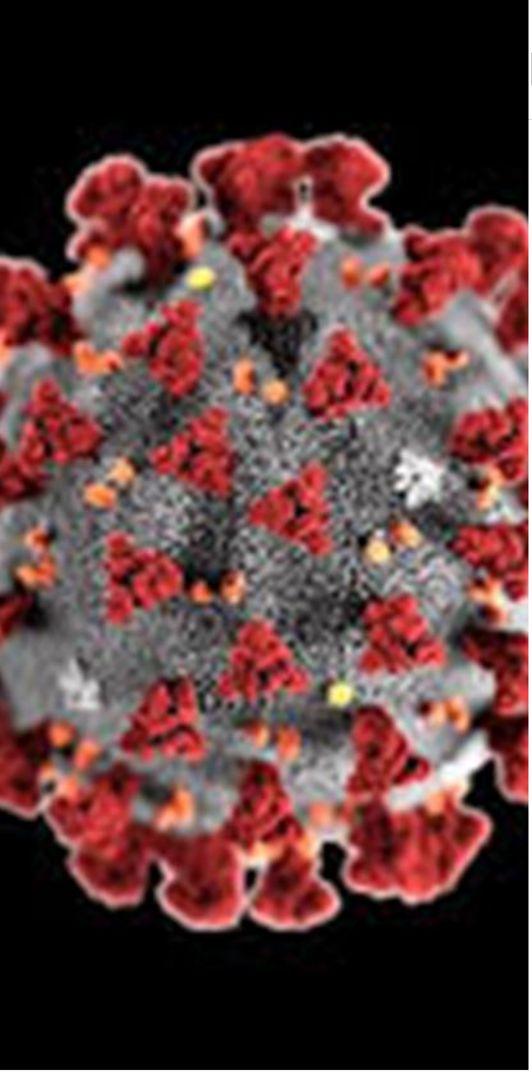


The Figure shows typical food consumption per household income level. Most lower income households spend up to 40% of their income on food.

Tourism:2.9%

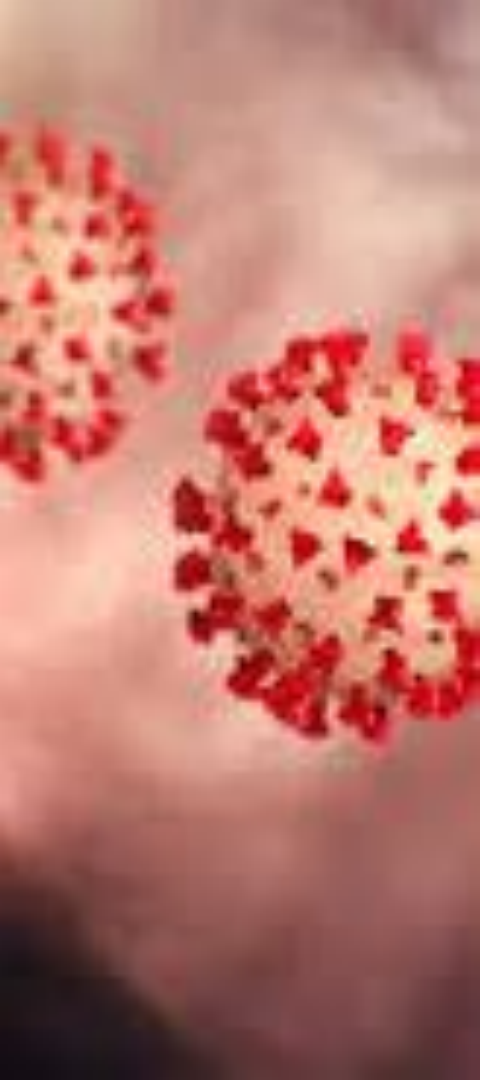


- The sector accounts for 10% of global GDP
- By far the most affected sector globally
- 50 million jobs could be lost worldwide, representing a reduction in jobs of 12-14%
- About 700 000 people are employed in the tourism sector
- It could take about 10 months for the sector to recover
- 2019, 30 680 548 foreign travelers were recorded
- The entire sector is affected
- All hotels are closed
- Flights are grounded and many including SAA and SAX will not recover
- The sector will have to reinvent itself

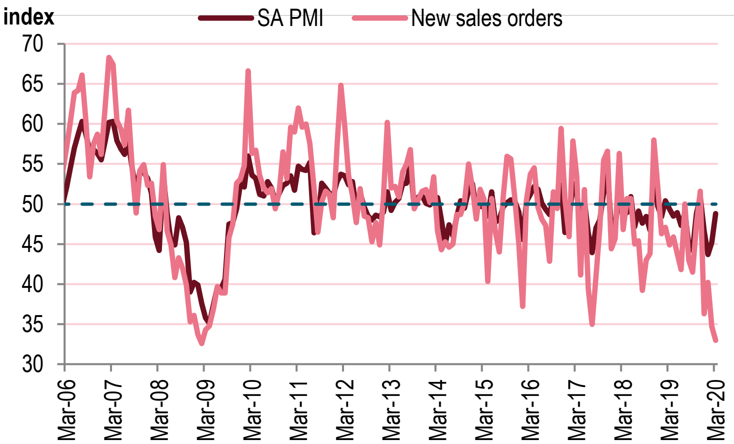


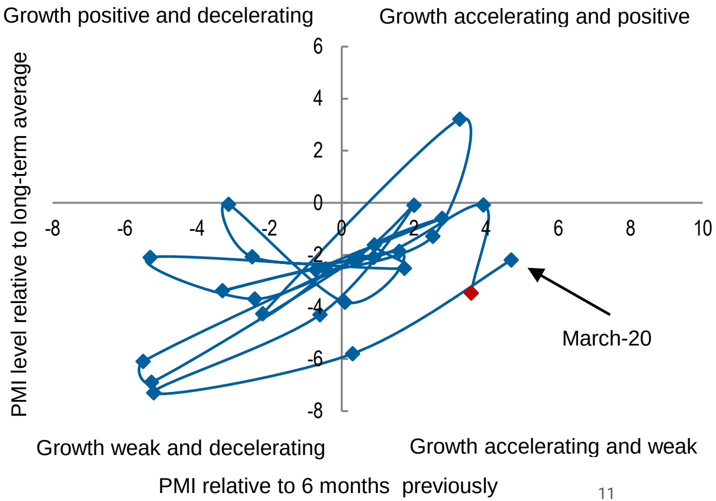
Mining production: 7%

- Limited mining production during Phase 1 of the lockdown
- Deep underground gold and platinum group metal (PGM) mines in particular were completely shut.
- Between 26 March and 16 April 2020 most mines were under care and maintenance while others were granted exemptions to work on a full-scale capacity or partial scale capacity.
- In Phase 2, the government amended the Disaster Management Act regulations to allow mining companies to ramp up operations to half of their capacities.
- Ramping up will take some time
- Global demand for minerals has slowed significantly
- Commodity prices have fallen
- Employs 5% of SA’s workforce
- The sector creates about 1.4m indirect jobs



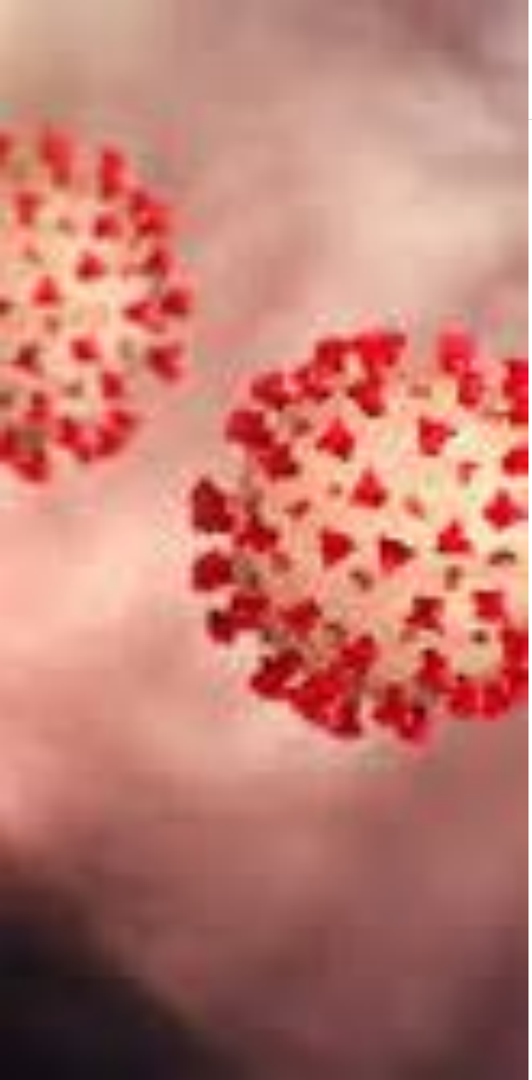
Manufacturing sector: 13%





- One of the worst hit sectors
- PMI 48
- PMI showed that business conditions in six months' time is expected to deteriorated further
- Manufacturing sector has been in declined. From 25% of GDP in the '80s to 13% currently.
- Deindustrialisation
- Most companies were closed during Lockdown Level 5 except some furnaces.
- Lockdown – Level 4
  - Some companies with start operating
  - Ramping up may take some time
  - Opening up may not immediately stimulate economic growth
  - GVC
- Weak ZAR should be a welcomed shock absorber.
- It should also result in cheaper exports
- Deindustrialisation has led to an increase in imports of raw materials at higher prices, thus increasing the cost of local products and diminishing returns.
- Small firms will not make it.
- Opportunities: new sectors will emerge

Global Value Chain

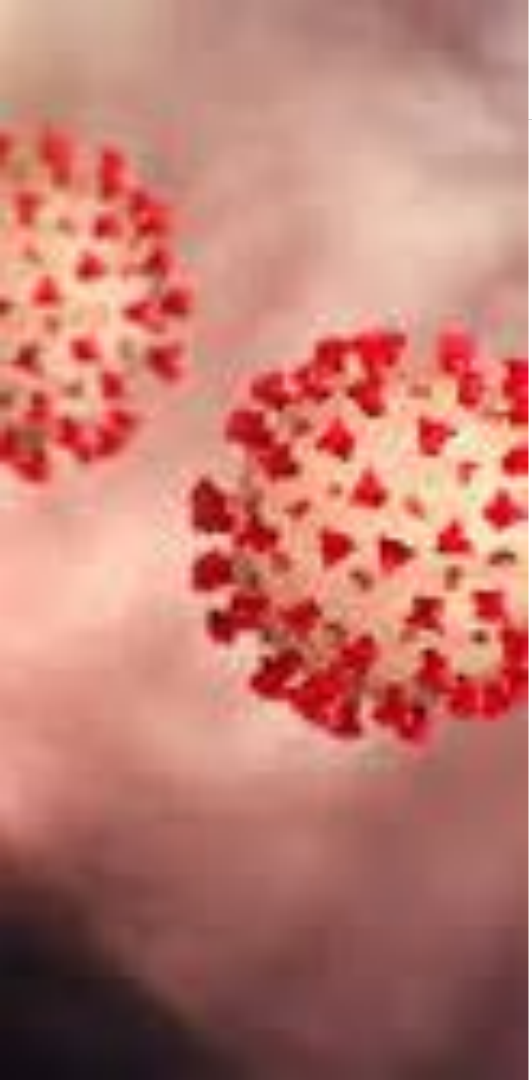


Global value chains – International production sharing

- Countries used to make products primarily in one country. That has changed.
- Today a single finished product often results from manufacturing and assembly in multiple countries
- Global value chain – is set of activities a firm undertakes to produce a product or a service and get it to the customer, and when this activities are spread across firms that are located in different countries, we call this value chain a global value chain
- GVCs are a powerful driver of productivity growth, job creation and increased living standards
- Countries often import products to exports products -chrome ore in SA and China e.g.

Relational trade – trade economists

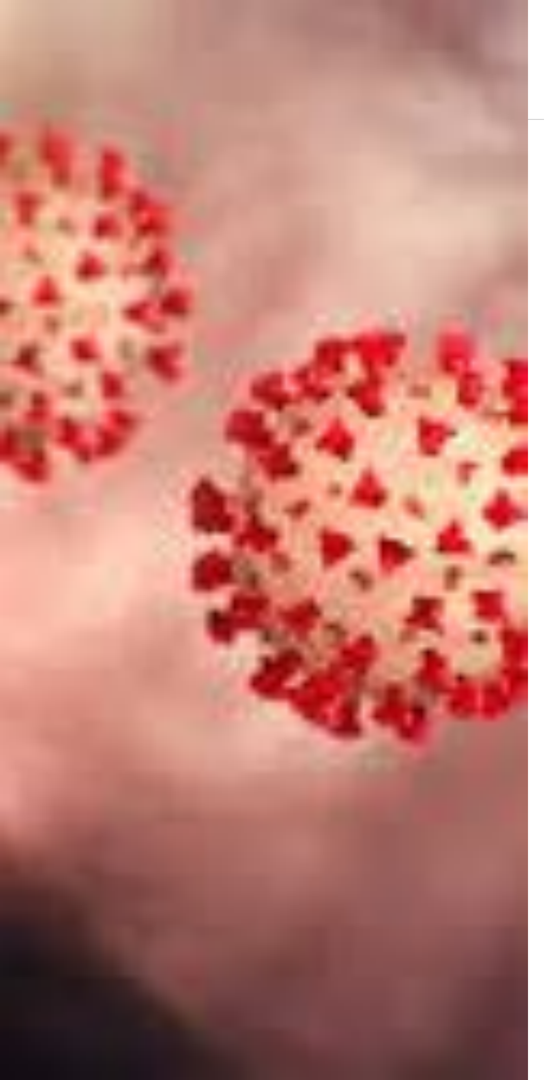
- COVID19 hit the largest economies almost simultaneously
- Most affected countries account for about 70% of the global trade
- ➢ China: Wuhan is a major industrial center, especially for automotive, electronics and pharmaceutical sector
- ➢ Korea: Gumi industrial complex near the city of Daegu: 85% of the country’s cases come from that region
- ➢ Germany; first case was in a small town near Munich, Bavaria. The first cases in Jan and early Feb originated from the headquarters of a car parts manufacturer there.
- ➢ Italy: Milan is a major industrial hub
- ➢ USA: Detroit automotive region
- Global industrial hubs are affected

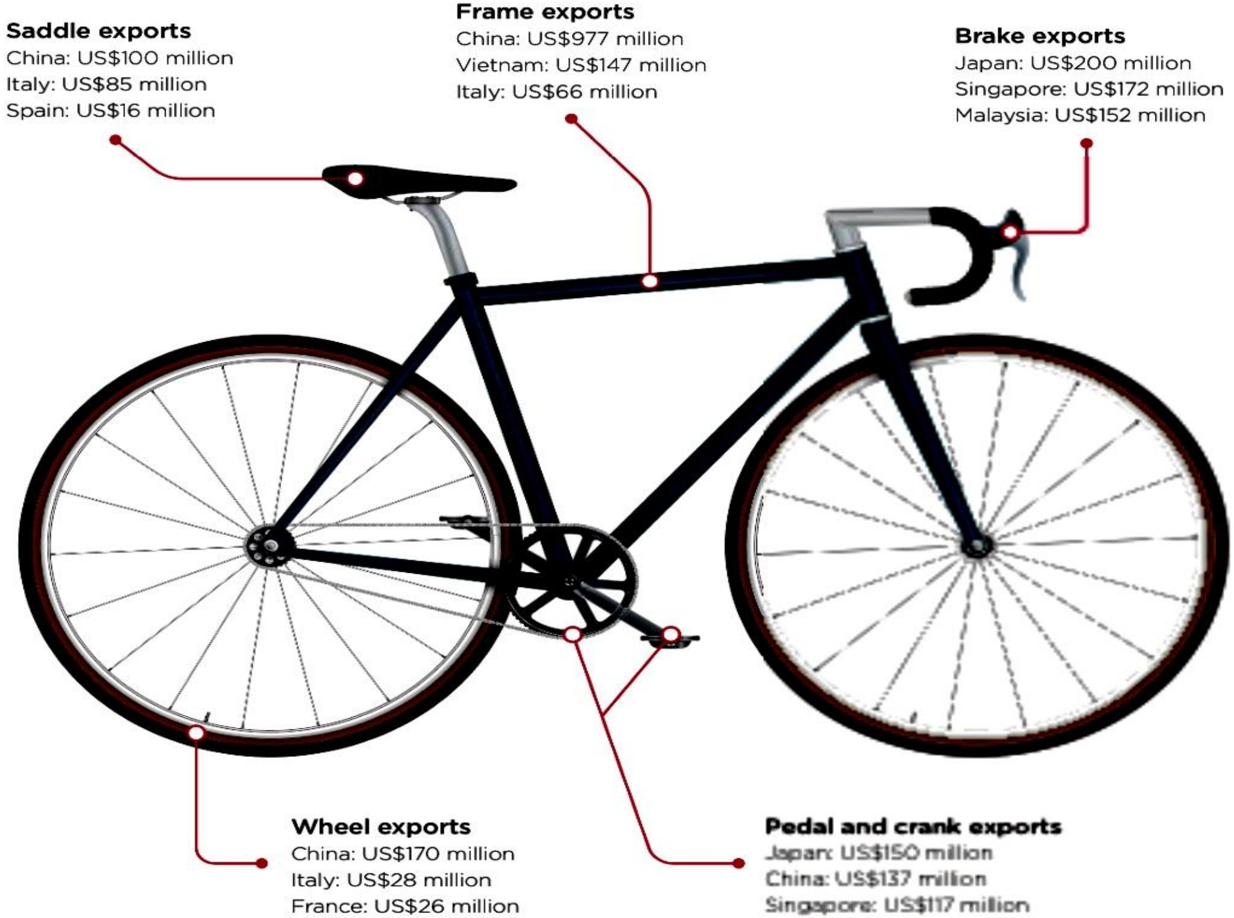


Global value chains – responsible for critical PPE

- N95 masks and Ventilators
- Because of off-shoring, no domestic capacity to meet increased demand – this is both DMs and EMs
- Export restrictions by other countries has restricted global supply – where there was exports, raised prices
- Sourcing of parts from multiple countries (GVCs) makes quick ramping up of production difficult, if not impossible
- Just in time production
- Global sabotage: China blaming Switzerland for delaying of ventilator parts.
- During a crisis, countries or even states ie US, prioritise their people first – ventilators, food supply etc

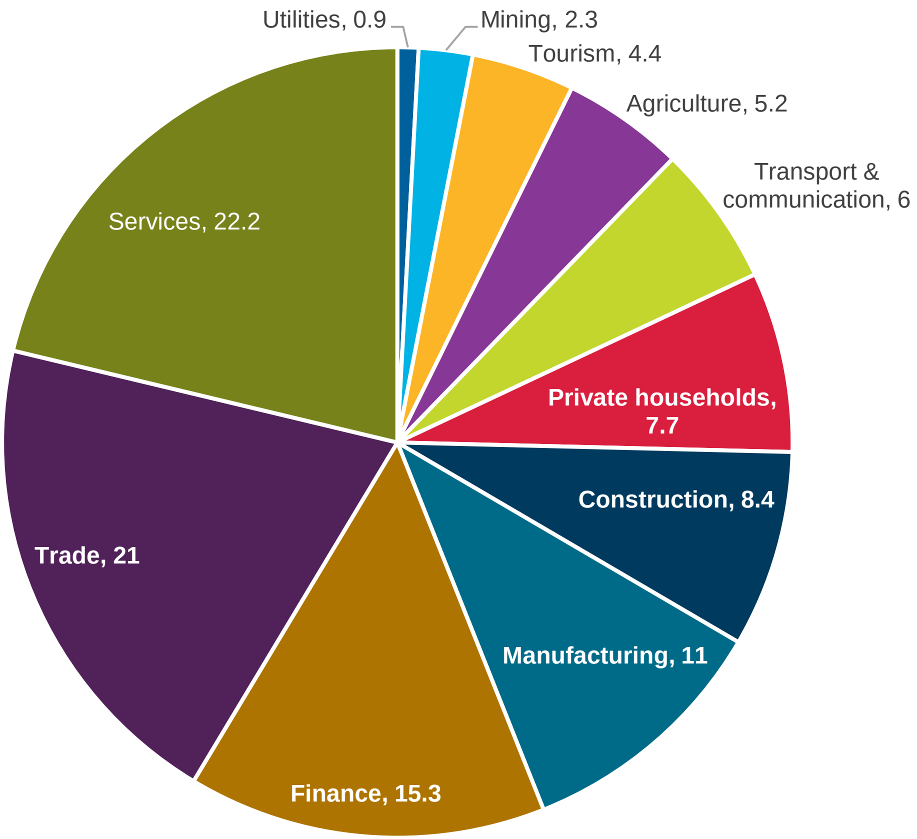
Where do bicycles come from?



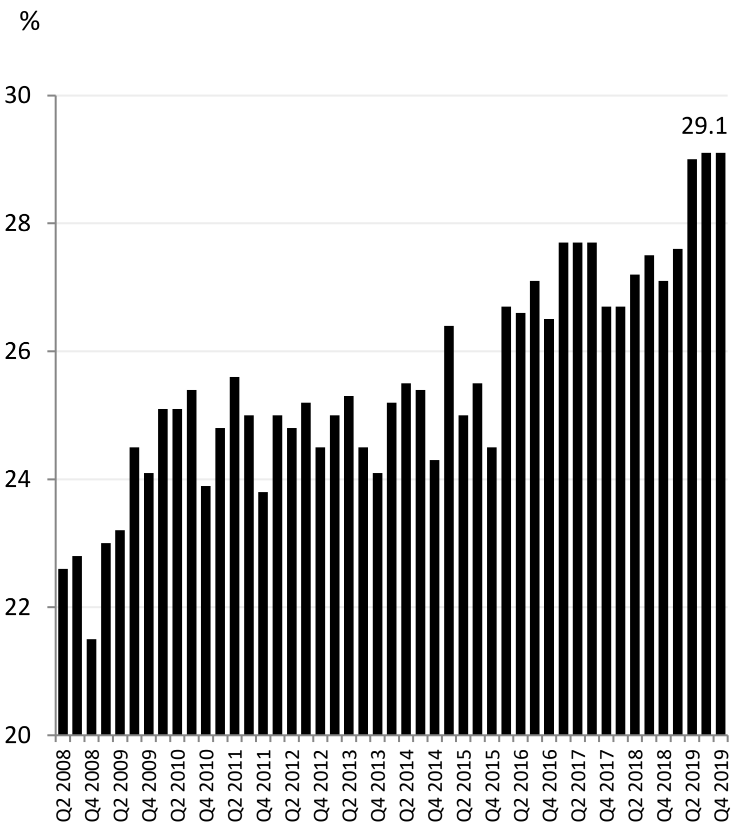


The unemployment rate

Employment by sector



Unemployment rate



- Data challenges globally
- There are scary trends in the US. 26.5m jobs lost – weekly jobless claims
- UIF and SARS should be able to give us info
- GFC over 1m jobs lost
- It will take a few months before we understand the number job losses as companies may only shed jobs later.
- Workplace closures disrupt supply chains and lower productivity.

Workers are highly valuable economic assets

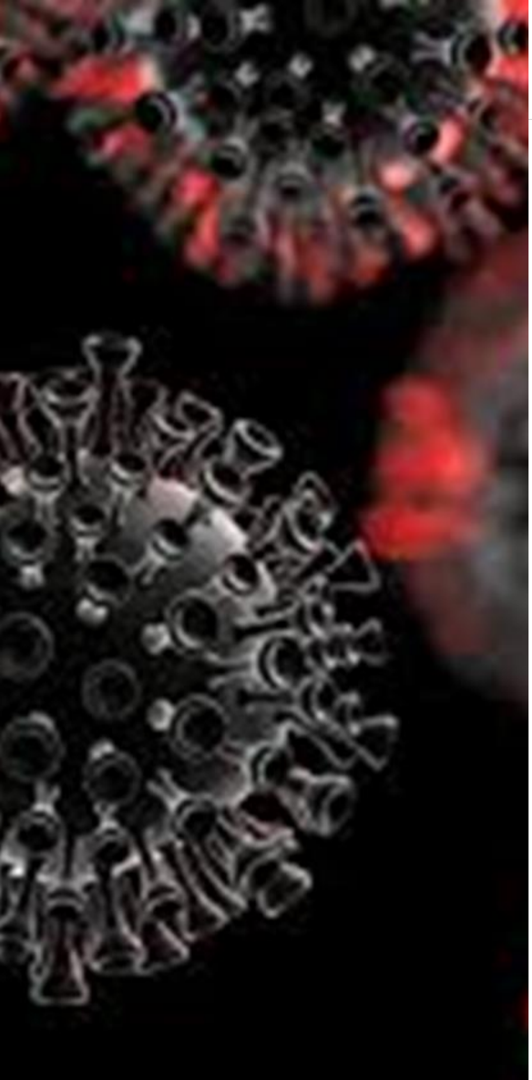
Fired employer

- Has to look for a new job
- This may take time and delays employer from being productive
- Uncertainty created by job search will make that person less likely to spend money
- Lack spending will crimp demand, causing businesses to avoid hiring, which means higher unemployment, more difficult job searches for everyone, more uncertainty and even less consumer spending
- US during the GFC
- **RECESSION OR EVEN A DEPRESSION**

- **Employer who keeps their job during shutdown**
- Company pays employee to work from home for a few months
- When lockdown ends, back to work on Day 1 with required knowledge
- Salary will allow for spending and therefore other workers will also be able to get jobs or keep their jobs
- Germany and Scandinavian countries during GFC
- **Economy bounces back quickly**

Covid19 and the fiscus


STEADY...
...AND JUGGLE!
REHEARSAL IN PROGRESS
BAILOUTS
UNION DEMANDS
'NO BAILOUTS!'
BUSINESS DEMANDS
INFLATION
EDUCATION
N.H.I.
DECAYING HOSPITALS
SLOW GROWTH
JOB LOSSES
S.O.E.s
SABC
S.A.A
ESKOM
TAX SHORTFALL
CLIMATE
I.P.P.s
ONE-OFF TAX?
SOCIAL GRANTS
GOVT. DEBT
CORRUPTION INQUIRIES
RATINGS DOWNGRADES
WAGE BILL
V.A.T.
ANC FACTIONS
TITO'S BUDGET
© ZAPIRO DAILY MAVERICK 25-2-20



Fiscal policy should have three goals

- **Fight the virus**

➢ Spending as much as needed to both deal with the infection now and to give incentives to firms to produce tests, medicine, and vaccines so that the pandemic can be both brought and kept under control

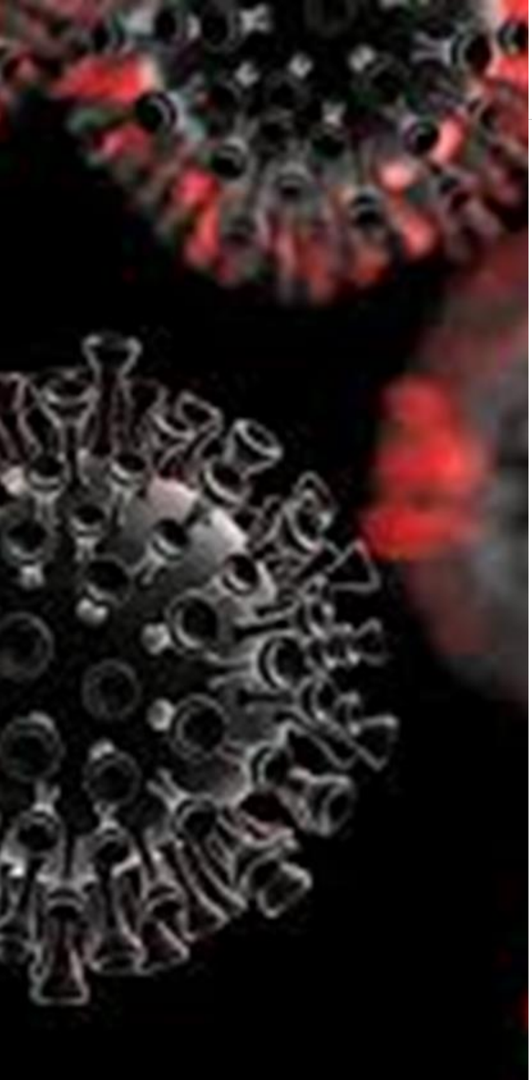
- **Provide disaster relief** – to ensure that people do not suffer from hunger and firms do nt go bankrupt

➢ Providing funds to liquidity-constrained households and firms. Many households do not have the cash to survive the next few months without financial help. Many firms do not have the cash to avoid banckruptcy without some help. Proving financial relief is essential to avoid extreme suffering and permanent damang to the economy.

- **Adjust aggregate demand** to stay close to potential output as possible

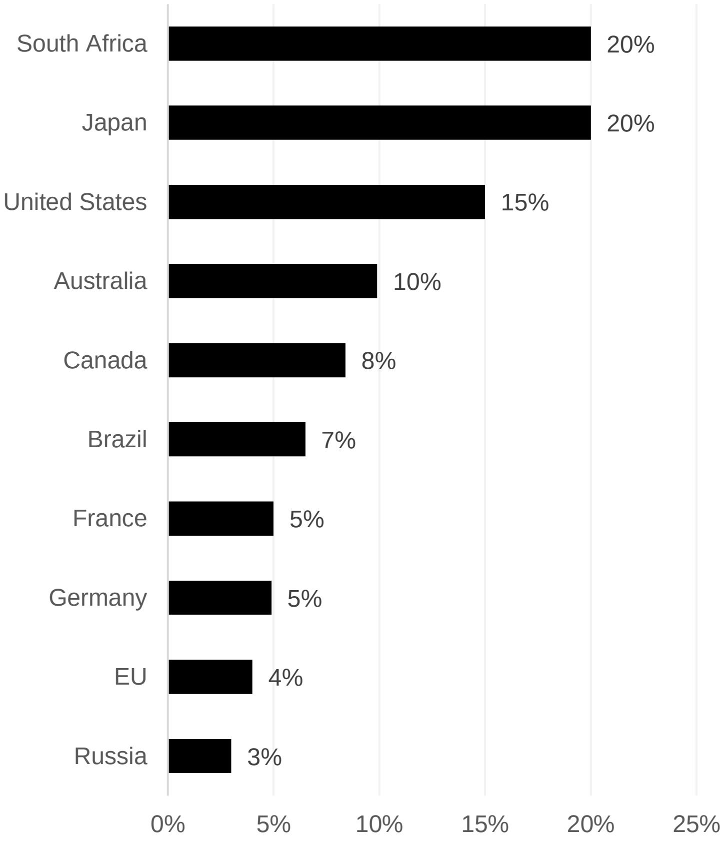
➢ Support aggregate demand to make sure that the economy operates as close to potential as it can, recognising that potential is, for the moment, profoundly impaired by health measures needed to decrease the infection rate

- Debt should remain sustainable



Fiscal support or austerity measures?

COVID-19 fiscal stimulus packages in G20 countries as of April 2020, % GDP



Relief fund is over 10% of GDP

Both fiscal support and austerity measures

R800 bn but could be increased to R1trn

However, unlike the other G20 countries, SA did not inject new money, but reprioritise spending from the Budget and the remainder will be sourced from multilaterals

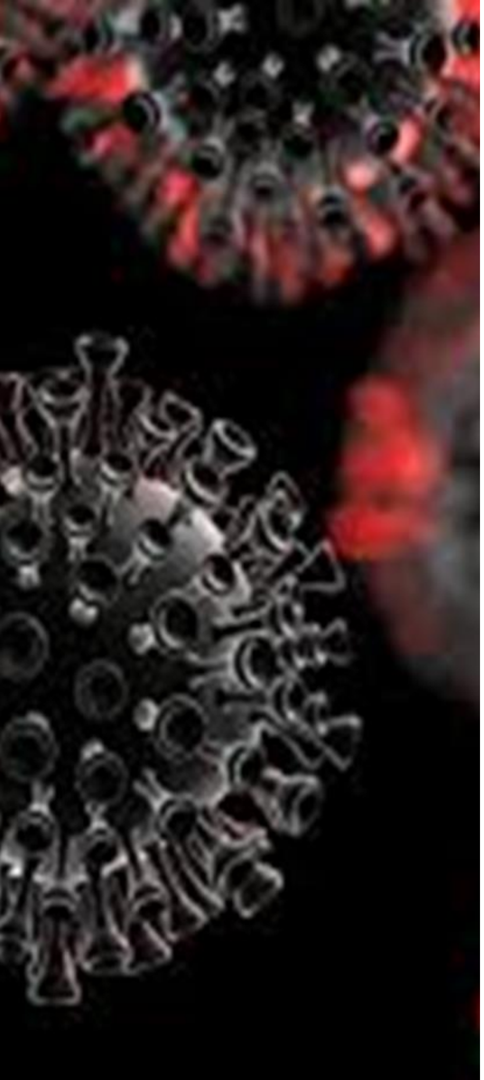
None of the external funding has been signed off, however, SA in in talks with the IMF, WB and NDB

All institutions off between zero and just above 1% interest rate with no conditionalities.

Austerity – which after privatisation, is an unpopular word in SA, but reprioritisations means having off funds from other government departments

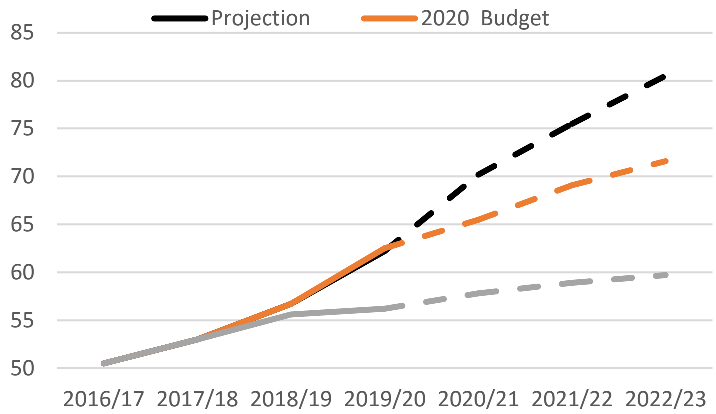
The National Treasury has cut about 20% from National and Provincial government.

Local government will receive R2bn

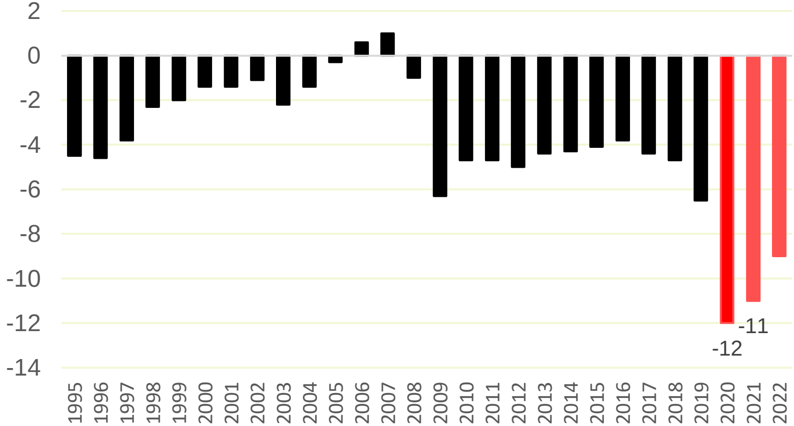


What does fiscal support mean for the deficit?

Gross debt-to-GDP



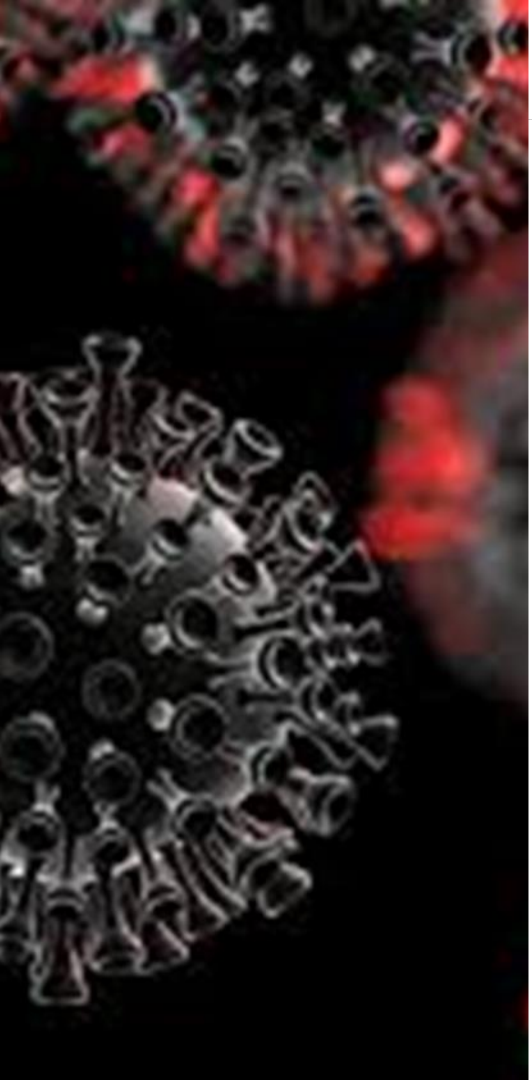
Budget deficit



- Since fiscal support is mainly the reprioritisation of the Budget, the widening of the deficit will be limited.
- However, should we add to the fiscal support, the deficit will widen to around 15% of GDP.
- Based on the R500bn fiscal support, the deficit is expected to widen to about -12% of GDP from -6.8% in FY20/21.
- Economic contraction, higher borrowing costs and higher social spending will add to fiscal deficits going forward.

This will make it more difficult to keep government debt from rising further.

IMF funding could bring much needed funding and help shore up investor confidence.



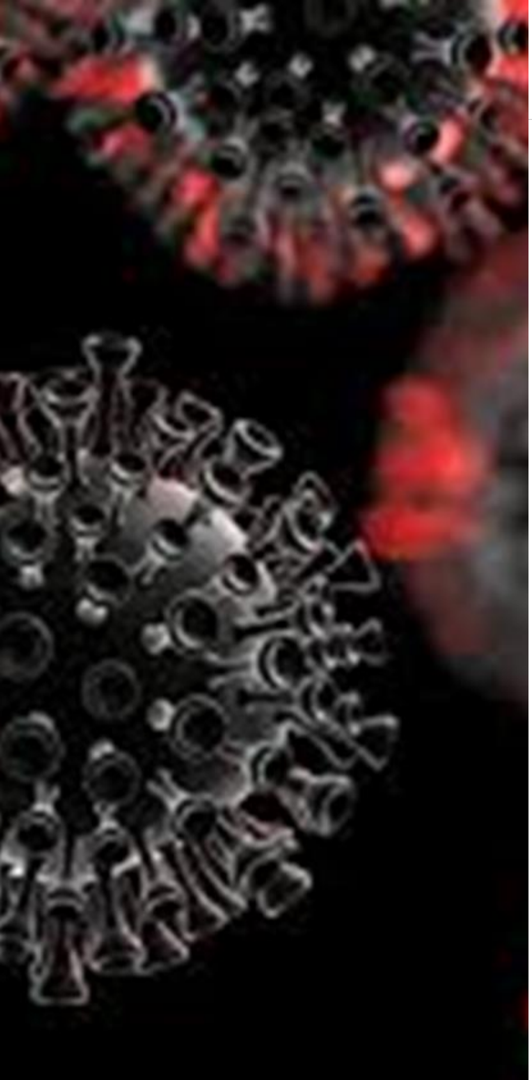
Where will funding come from?

Likely outcome

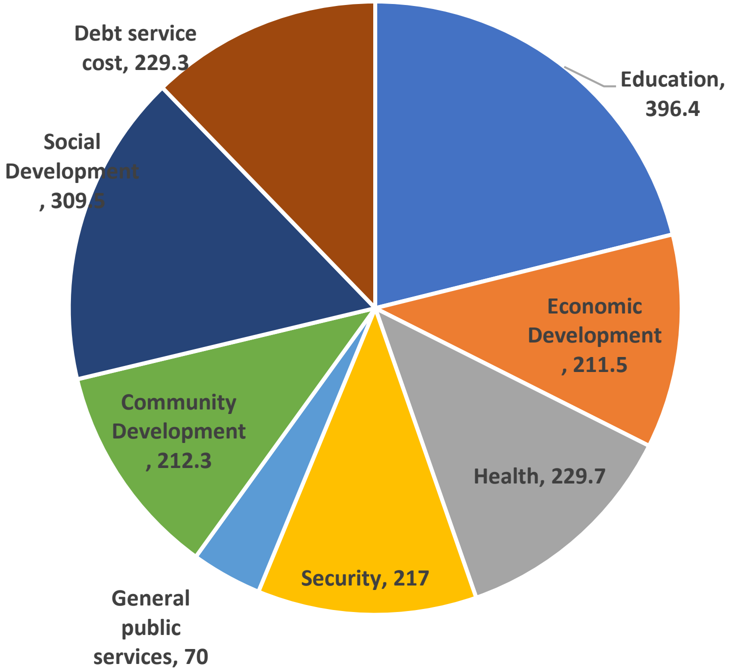
- R130bn Budget reprioritisation
- R40bn from the UIF – in their 2018/19 Financial Report, it is indicated that R19.5bn has been collected and there is R42bn in technical reserves
- Tax breaks, deferrals and other relief will amount to about R70bn
- R200bn will come from the loan guarantee scheme
- Multilateral organisations

Government document

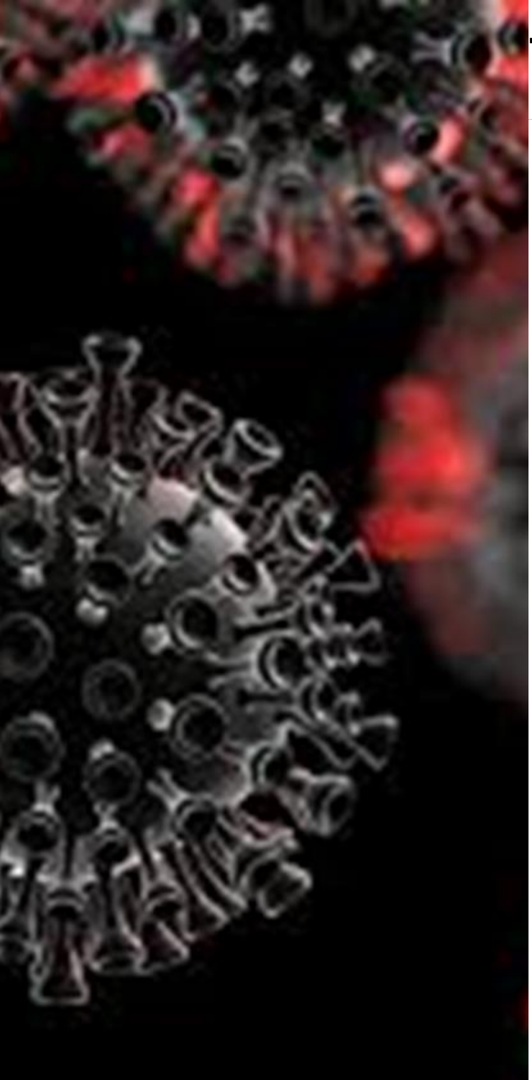
- Budget reprioritisation is R130bn
- The UIF will contribute abut R108bn. The UIF has a big surplus, which government plans to free up for increases in social grants, food parcels, increased unemployment benefits and wage guarantees.
- Tax breaks, deferrals and other relief will amount to R70bn
- R200bn will come from the loan guarantee scheme. These funds will come from the banking systems and the SARB, guaranteed by the government.
- Short-term borrowing from the private sector and the SARB can raise enough money to cover households and business tax and payment deferrals
- The balance will be sourced from multilateral organisations



Budget expenditure: Finding R1trn

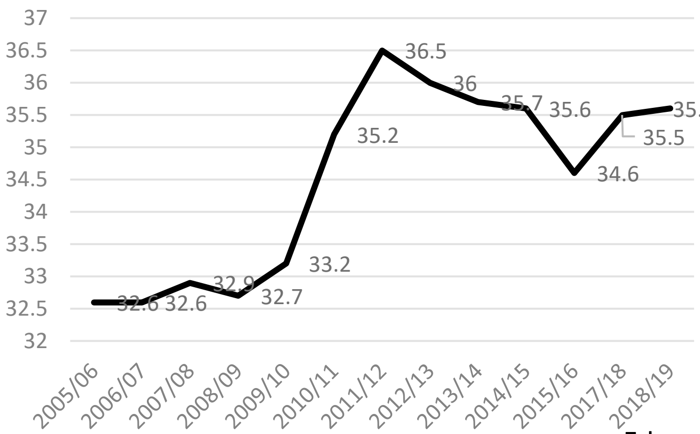


1. I believe we should borrow R500bn from the IMF/WB/NDB
2. ***Why would I approach these organisations?*** Favourable interest rates of just above 1% and no conditionalities is cheaper than issuing a bond.
3. I would reallocate the current health budget of R229.7bn
4. I would use the R500bn for health and health-related funding needs
5. **R229.7bn**
6. Compensation of employees for FY20/21 is R578.81bn, which is approximately 30.7% of total expenditure. I would cut 15% from total compensation.
7. **R192bn**
8. Cut unnecessary govt projects
9. **<u>Over R500bn raised from the current Budget</u>**

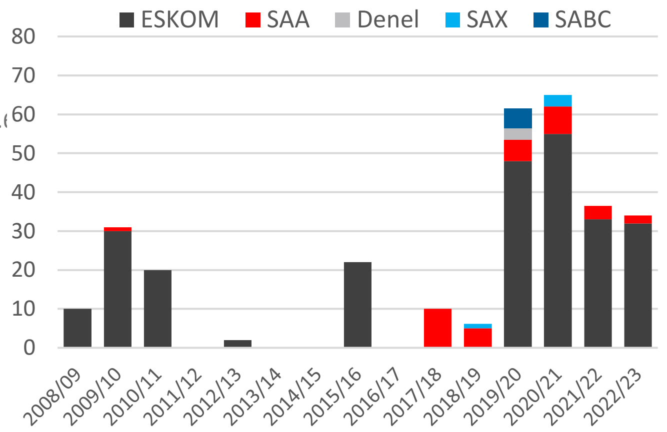


Two lingering unsolved financial costs

PUBLIC SECTOR WAGES % OF CONSOLIDATED EXPENDITURE

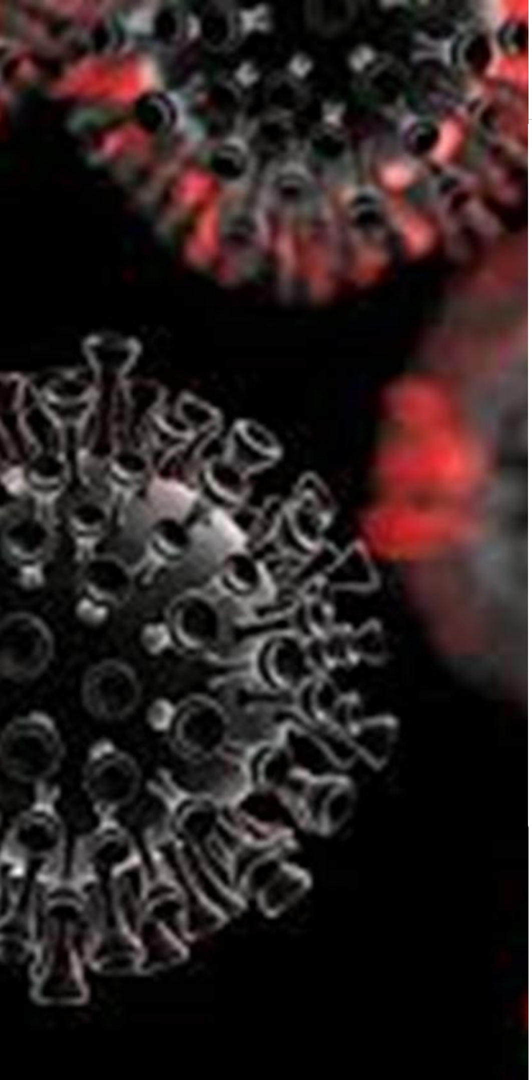


SOEs



- Between 2008/09 and 2019/20, major SOCs received R162bn in financial support
  - Eskom accounts for 82 per cent of fiscal support to state-owned companies over past 12 years.
- Over the next three years, projected support amounts to a further R129 billion, mostly for Eskom.

- **Eskom** – given equity injection of R49bn in 2020, R56bn in 2021 and R33bn in 2022
- **Transnet** – net profit to R6bn in FY18/19, however, ratings agencies downgraded Transnet citing increased liquidity risk as a result of loan covenants triggered by an audit qualification
- **SAA –** in Business Rescue since Dec 2019 because it was unable to meet its financial obligations. Since 2008, SAA has incurred net losses of over R32bn. Govt has set aside R16.4bn to settle guaranteed debt.
- **SAX** – illiquid and insolvent and unable to settle short or long-term debt. Incurred losses of about R1.2bn over 10 years. Under involuntary Business Rescue
- **Denel** – faces serious illiquidity problems. Govt provided R1.8bn in FY18/19. Govt guarantee amount to R6.9bn. Additional funding of R576m allocated for FY20/21
- **SABC** – Govt allocated R3.2 in FY19/20. R2.1bn transferred and remainder R1.1bn to be transferred in March 2020



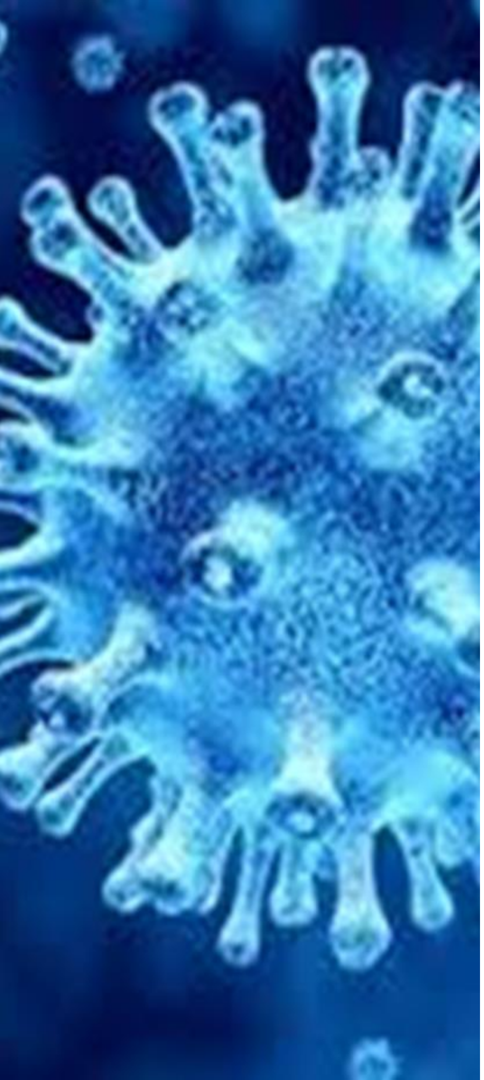
Transparency is vital

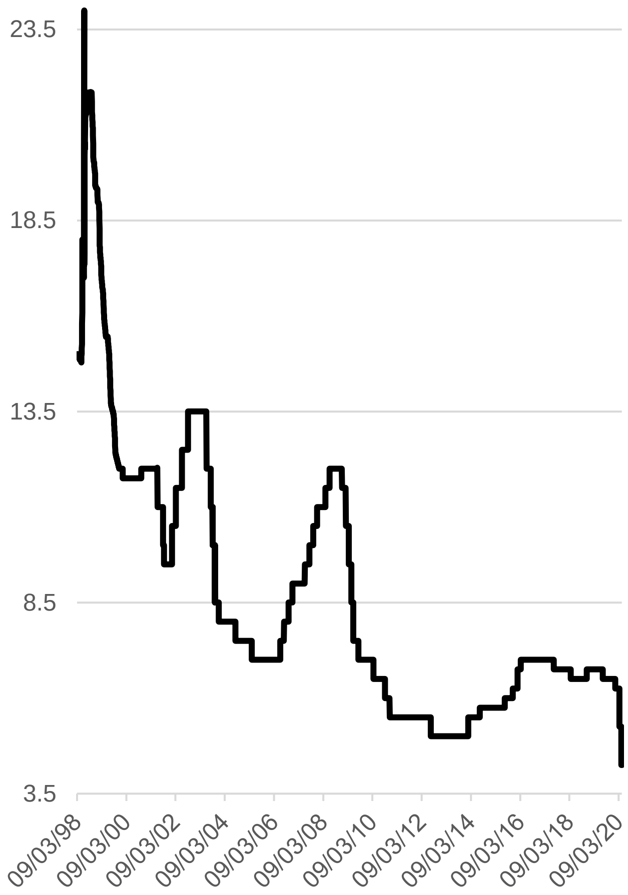
- Concerns about corruption are valid
- Centralisation of funds - Too many institutions involved in financing – IDC, Dept of Small Businesses, Solidarity Fund, COVID-19 grant etc
- Restrictive requirements for the informal sector to obtain funding – tax compliance
- Many foreign-owned shops or spaza shops hire locals. Lack of funding will affected local employees.

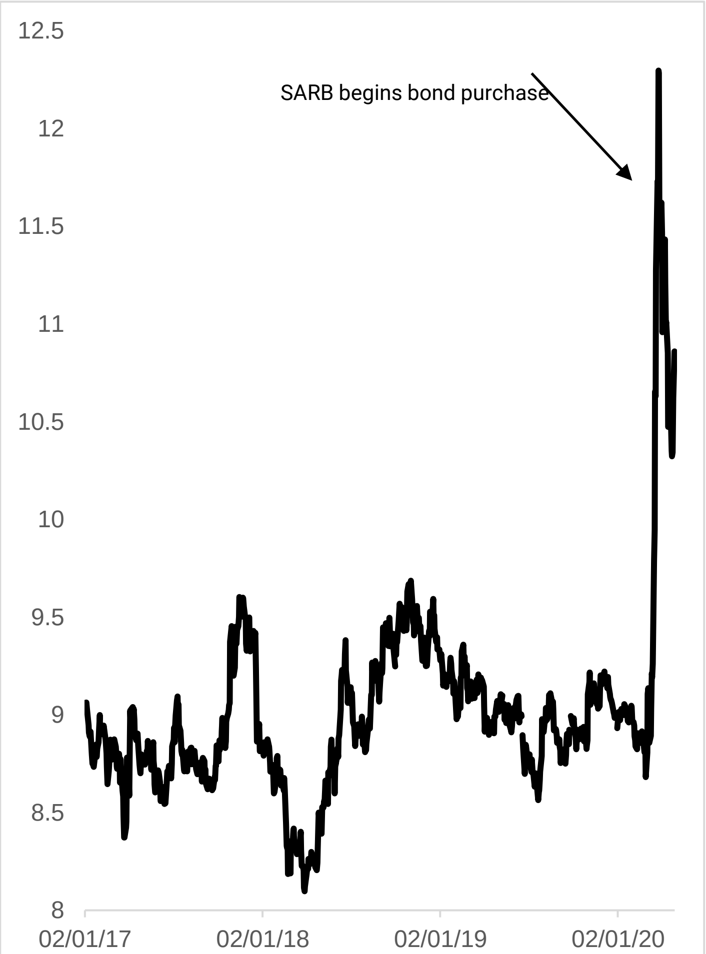
Covid19 and Monetary policy response

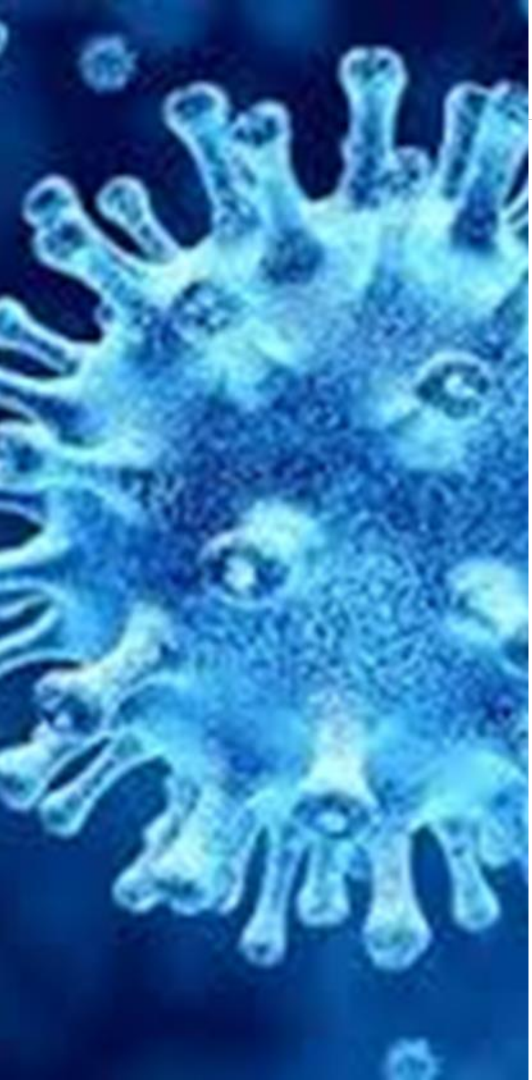
Living in unchartered territory

- In February and March, investors sold off more than $80bn in stocks and bonds from Ems
- The largest sell-off on record and three times that of the GFC
- Challenge for EMs is lack of fiscal space
- On MP – CB cut rates and emergency rate cuts to help add liquidity
- SARB 100bps – largest since 2019 to quell the markets and inject liquidity
- Market rates increased instead
- Measures to announce liquidity
- SARB bond buying



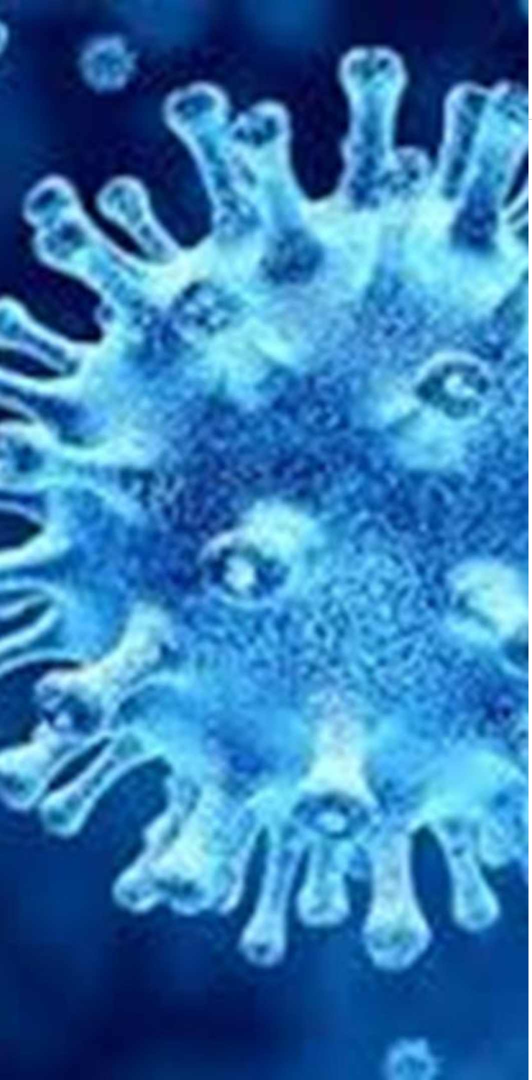

23.5
18.5
13.5
8.5
3.5
09/03/98
09/03/00
09/03/02
09/03/04
09/03/06
09/03/08
09/03/10
09/03/12
09/03/14
09/03/16
09/03/18
09/03/20


SARB begins bond purchase
12.5
12
11.5
11
10.5
10
9.5
9
8.5
8
02/01/17
02/01/18
02/01/19
02/01/20

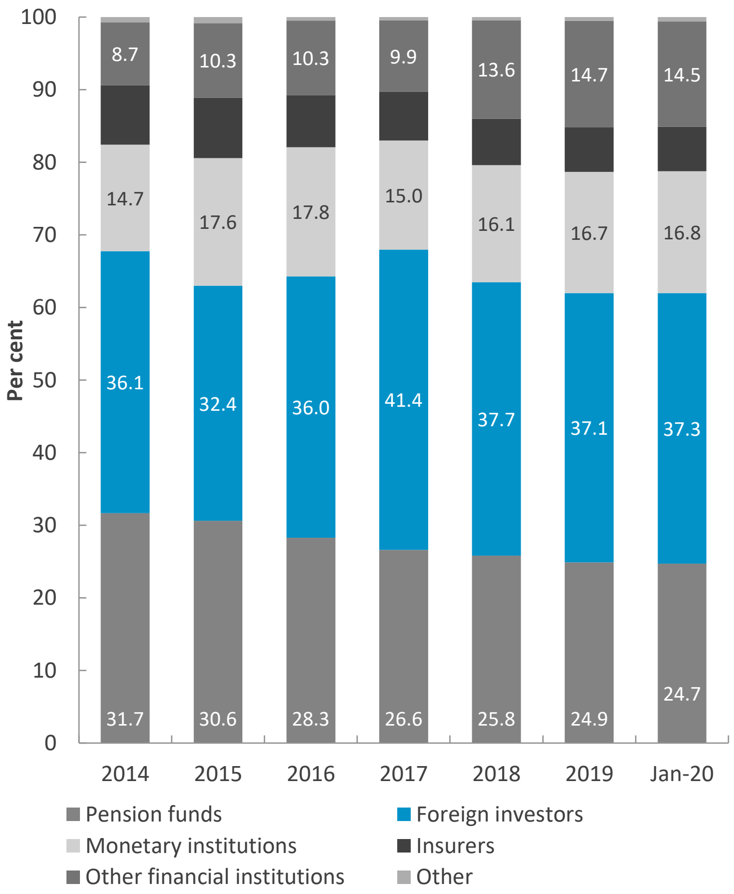


Why buying into the long end of the curve won’t work

- The market determine moves in the long end of the curve.
- Monetary policy does not influence the long end of the curve.
- If the transmission mechanism from a rate cut doesn’t impact on the long end of the curve, it implies that the market has very little confidence in the solvency of the country.
- It also means that investors would rather go elsewhere to buy bonds than SA. Local investors are selling the long end for the short end, currently.
- So, intervening in the bond curve may not work.
- Yield curve management also implies that the SARB would have to buy massively across the yield curve.
- When the Fed did Operation Twist during the GFC, they sold bonds in the short end and buying long end bonds. Of all their QE, Operation Twist was the only unsuccessful one.

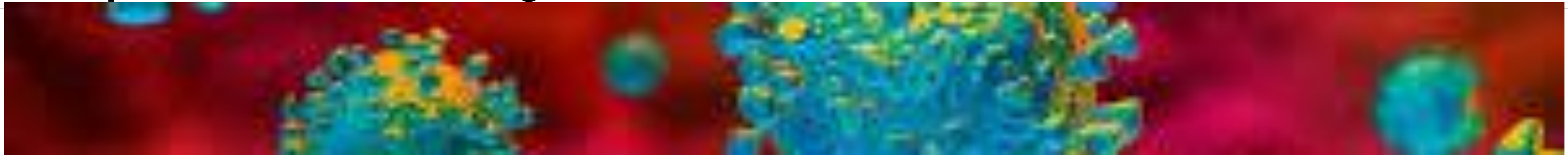


Ownership of domestic government bonds

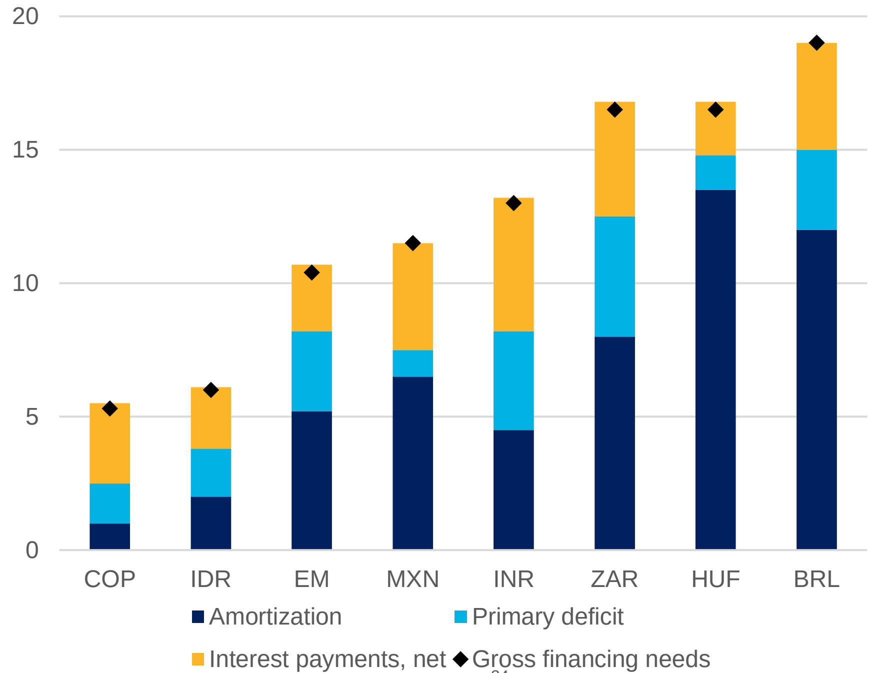


- Foreign bond holdings will decline as SA falls out of the world bond index end-April
- SA's weighting in the WGBI was 0.44%
- About $5.5bn worth of passive outflows is expected from both the WGBI and JPM GBI at the end of April.
- Local investor base in SA is deep, including institutional asset managers, but vulnerability is high on many fronts.
- Weak SOEs add to public financing needs
- Increases risk of wider deficits

Multiple shocks are hitting EMs

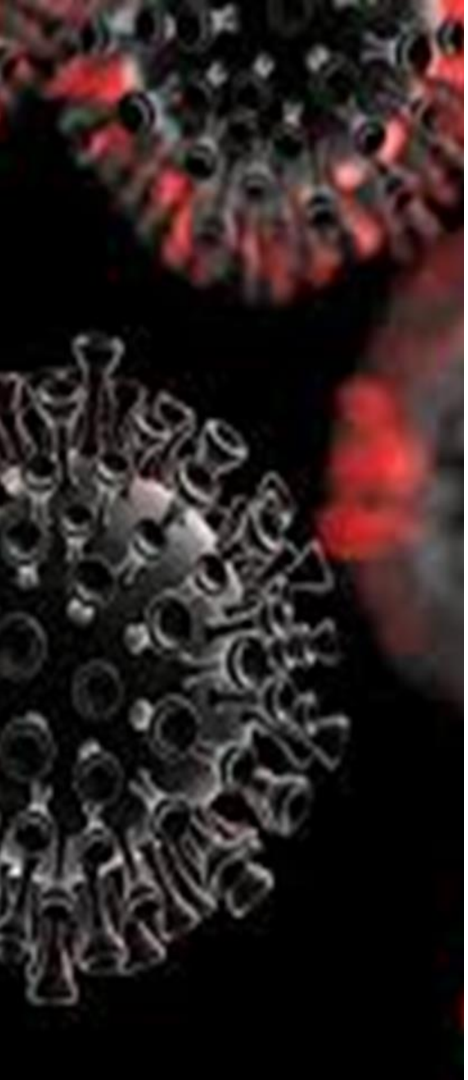


Public financing needs, 2020, % GDP



- Limited fiscal space
- Public financing needs are large in most of countries, especially Brazil, Hungary and South Africa.
- The nature of bond holders also matters for rollover risk.
- Brazil and India have the most stable investor bases. The are high debt countries running large deficits, but their sticky local investor base may facilitate more borrowing in the near term, even if it adds to medium-term sustainability concerns.
- Mexico and SA are in the opposite end of the spectrum. Financing needs are fairly large and bond sales to foreigners are a critical part of their strategy. SA and Mexico have particular high risk in this regard.
- External demand is falling as advanced markets go into recession.
- Fiscal positions will be under severe pressure, esp in countries where social and healthcare spending is underdeveloped.

Phase three: What does post-COVID-19 SA look like?



Post COVID-19

- Service delivery has improved
- Reforms –transform the economy

We need to cut the budget allocations of government departments which are not core in this period of economic recovery. These departments include:

Sports, Arts and Culture
Human Settlements – no houses should be rolled out.
International Relations and Cooperation – we have one of the highest number of embassies in the world
Public Service Administration
Communications
Tourism

The other departments such as Transport, Health, Education, mining have a multiplier effect which will help with economic growth.

- In 2 years' time some government departments will disappear and others should be government Agency's
- Sell-off SOEs
- Opportunities for new industries

- Fund managers will be severely impacted by the pandemic
- Infrastructure funds will very important
- Regulation 28 doesn't encourage investment in infrastructure
- Stable type of investment
- FSCA needs training for infrastructure investments
- More collaboration between funds. World Bank – when pension funds work together, there are benefits
- Banks are currently flushed with money and not willing to extend to the buy-side
- In the US, the Fed doesn't only repo with Banks but with the buy-side as well.
- AUM in the buy-side is about R10trn
- We are forcing R10trn to be intermediated through banks which account for about R5Trn

Total number of social grants by type