Industrial Development Corporation

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Economic overview:

Recent developments in the global and South African economies

November 2020

Department of Research and Information

Contents

Highlights

- Growth in the world's largest economies in the third quarter of 2020 was generally stronger than anticipated. This was partly due to the support provided by the USD11.7 trillion in fiscal stimuli rolled out across the world and historically low interest rates, but also because of the rapid easing of restrictions during the northern hemisphere's summer season.
- Nevertheless, of the larger economies only China managed to attain a quarterly level of GDP above that recorded in the final quarter of 2019 (i.e. pre-lockdown). Both the United States and the Eurozone have yet to recover the lost ground.
- A strong resurgence in Covid-19 infections in several European countries and the United States in recent weeks is, however, threatening the recovery momentum. Lockdown measures have again been implemented in Germany France, Spain, Italy and the United Kingdom, although not as stringent as those introduced in April 2020.
- The announcements by pharmaceutical companies Pfizer and Moderna of vaccines against Covid-19, reportedly with efficacy rates of 90% to 95%, have been welcomed with considerable excitement, as reflected by sharp increases in global stock markets. Their roll out could apparently begin on a large-scale as from the first quarter of 2021, initially targeting the most vulnerable. This would certainly be excellent news for the world at large and the future performance of the global economy.
- Fiscal stimulus will, however, continue being required to support the economic recovery. The swift escalation of government debt levels in recent times is, however, reducing the appetite for further fiscal measures. In the United States, support for a second stimulus package may only come forth after President-elect Biden has taken office on January 20th, 2021. Central banks, in turn, are likely to maintain highly accommodative monetary policy stances for quite some time.
- Industrial commodity prices have maintained their recovery momentum, supported by tightening market balances due to restrained growth in refined metal supply globally, as well as the normalisation of economic activity in China.
- While the resurgence of Covid-19 infections may weigh on commodity prices in the near-term, particularly for those commodities with structural surpluses, recovering industrial activity in China and elsewhere in the world should curtail the risk of a steep decline in prices as was the case in the first quarter of 2020.
- A muted economic rebound is anticipated for sub-Saharan Africa in 2021, following a contraction of the region's GDP in 2020. Covid-19 and the resultant economic crisis have significantly increased the risk of external debt distress for several African countries, in certain cases pushing them close to sovereign defaults. The uncertain external environment, heavy public debt burdens and the limited fiscal space faced by many of the region's economies could compromise growth prospects.
- In South Africa, after the 16.4% decline (quarter-on-quarter, non-annualised) in real GDP in the second quarter of 2020, the economy is showing signs of recovery. Activity levels in the mining and manufacturing sectors rebounded strongly in the third quarter as lockdown restrictions were considerably eased. Retail trade sales also increased, vehicle sales improved and more electricity was generated. Although both business and consumer sentiment edged higher, they remain at low levels.
- Improving economic conditions globally and rising demand for commodities in China contributed to the strong rebound in South Africa's merchandise exports in the third quarter of 2020 (+42% in nominal value terms, quarter-on-quarter). Exports of manufactured goods rose by R62.8 billion (+49.3%) compared to the previous

World economic growth:

-4.4% in 2020
+5.2% in 2021

(IMF forecasts)

Global fiscal stimulus provided:

USD11.7 trillion
12% of global GDP

(IMF Fiscal Monitor)

Sub-Saharan Africa's economic growth:

-3.0% in 2020
+3.1% in 2021

(IMF forecasts)

South Africa's trade surplus:

R109.8 bn in Q3 2020

R172.9 bn over January-September 2020

(SARS)

quarter, while mining and mineral exports were 37.5% or R43.7 billion higher. As weak economic conditions domestically limited import demand, South Africa recorded a trade surplus of R109.8 billion over the three months to September – the highest quarterly surplus on record.

- Since South Africa's tourism and hospitality sector is highly reliant on international tourist arrivals and spending, travel restrictions and recessionary conditions in key source markets, among other factors, have had an extremely adverse impact on its performance. South Africa will, however, be lifting restrictions on all international travel, a move which will assist the sector's recovery.
- The Monetary Policy Committee is expected to continue supporting the economy's recovery by maintaining the repo rate at low levels, for consumer price inflation is projected to remain comfortably within the target band throughout the outlook period. Interest rates are expected to start rising very gradually as from 2022.
- The Covid-19 pandemic and resultant economic crisis have inflicted further damage onto South Africa's already precarious fiscal position. A R313 billion shortfall in revenue collections relative to February 2020 projections is estimated for the current fiscal year. The budget deficit is now projected by National Treasury to widen to 15.7% of GDP in 2020/21, and the ratio of gross government debt to GDP is expected to increase sharply to 81.8%.
- The South African economy is forecast to record an 8.5% decline in real GDP in 2020, with a 3.3% rebound potentially ensuing in 2021. Although the pace of expansion is projected to remain modest in subsequent years, the timeous and effective implementation of the Economic Reconstruction and Recovery Plan could propel the economy's growth momentum substantially higher.

South Africa's budget deficit in fiscal year 2020/21:

15.7% of GDP

(National Treasury estimate)

South Africa's economic growth:

2020 = -8.5%
2021 = +3.3%

(IDC forecasts)

Implications for business

Potential implications of global economic developments

- As the world economy gradually recovers, trading conditions in global markets are likely to improve for manufactured goods, agricultural products as well as commodities. However, competition from foreign producers may be fierce in specific markets and product categories.
- South African exporters must closely follow developments associated with the strong resurgence of Covid-19 infections and accompanying restrictions in key northern hemisphere markets, for these may result in reduced demand for their products once again.
- The rebound in China's economic growth, supported by a strong investment and infrastructure development drive, should bode well for commodity exporters. However, concerns over rising infection rates elsewhere in the world and the potential implications on economic activity may result in heightened commodity price volatility in the shorter-term.
- Volatility in equity and currency markets is likely to persist for some time as uncertainty prevails regarding the global economy's recovery trajectory and potential disruptions to trade, production and investment activity. However, positive developments with respect to the efficacy of a specific Covid-19 vaccine and its reportedly imminent roll-out would be a potential game-changer.
- The Rand has appreciated significantly in recent times and such a trend may continue for a while, with potentially challenging implications for exporters as well as import-competing businesses.

Potential implications of regional economic developments

- The anticipated recovery in several key African markets from 2021 onwards, complemented by the beneficial ramifications of the African Continental Free Trade Area's implementation, could provide significant trade and investment opportunities for South African businesses.
- Fiscal vulnerabilities and foreign exchange liquidity constraints have escalated in various African countries. Some are already facing heightened risk of sovereign debt distress and/or default, while others are likely to emerge from the ongoing crisis more indebted and fiscally strained. Such developments could negatively impact on the ability of certain regional clients to honour their debt repayment obligations to South African suppliers of goods and services.

Potential implications of domestic economic developments

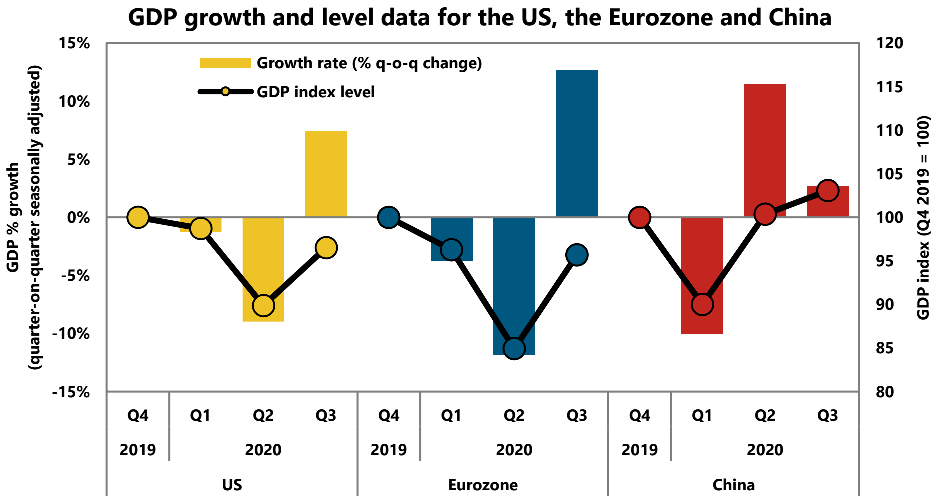
- The rebound in economic activity in South Africa in recent months reflects a welcomed but also gradual normalisation of trading and operating conditions for numerous business enterprises.
- The tourism sector will, however, remain under substantial pressure well into 2021, as domestic tourism will not be sufficient to counter the adverse impacts of limited international tourist arrivals. Consequently, enterprises operating in the sector, or indirectly involved as suppliers of goods or services, are likely to continue experiencing considerable hardship for an extended period.
- The Economic Reconstruction and Recovery Plan (ERRP) incorporates a massive infrastructure build programme which will rely on the crowding-in of private sector capital and operational participation via public-private partnerships (PPPs). Approximately R1 trillion in new infrastructure investment is expected to be leveraged by the R100 billion in blended finance that the Infrastructure Fund will make available during the next 10 years. If it is effectively implemented and the associated localisation efforts prove successful, such a programme will benefit numerous supplier industries and create investment opportunities for private sector players.
- A multitude of business opportunities may also emerge in several other focus areas of the ERRP, including the energy sector, agriculture and agro-processing, the green economy, telecommunications, the mining sector, as well as manufacturing due to the plan's strong emphasis on localisation, industrialisation and export promotion.
- Importantly, the effective implementation of the structural reforms deemed imperative in the ERRP would build a strong base for significantly higher rates of economic and investment growth over the medium- to longer term.

Global economic rebound being undermined by rising infections

Major global economies reported stronger than anticipated growth in Q3 2020

Amidst a renewed surge in Covid-19 infections in the United States (US) and several European countries, recent data releases have been reporting rebounding economic activity in major economies. The sharp rise in new cases and the concomitant re-imposition of lockdown measures in Germany, France, Spain, Italy and the United Kingdom (UK), among others, combined with the voluntary restriction of movement in other countries indicate that the final quarter of 2020 could report weak to negative growth figures.

Figure 1: Economic activity in the US and Eurozone in Q3 2020 was still below Q4 2019 levels

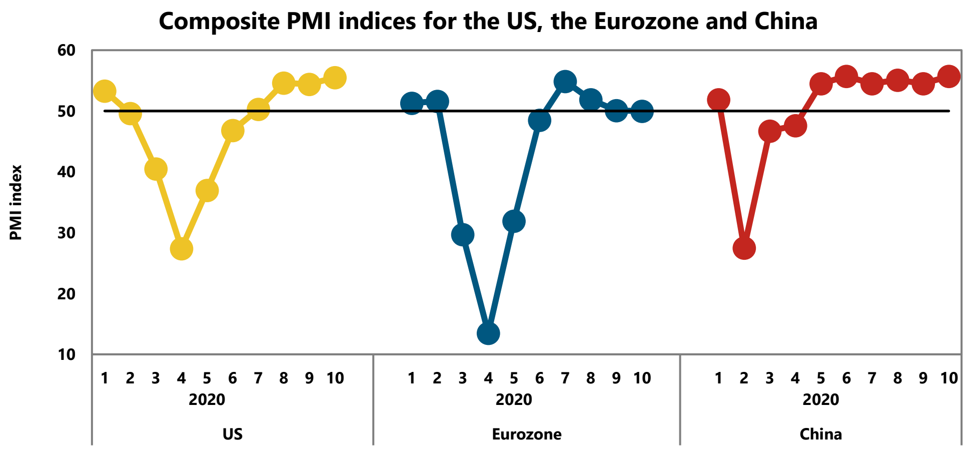


Source: IDC, compiled using OECD and National Bureau of Statistics of China data

Overall economic activity in the US and Eurozone remain below Q4 2019 levels, while China's has recovered fully

Economic growth in the US and Eurozone in the third quarter of 2020 was better than anticipated, highlighting the ability of these economies to recover from the enormous setbacks endured in the preceding quarter. Economic activity in China, which experienced the height of the pandemic and lockdown restrictions in the first quarter of the year, has managed to fully recover from the corresponding downturn. In the third quarter of 2020, its GDP exceeded the level recorded in the final quarter of 2019, whereas those of the US and Eurozone economies were still 3.5% and 3.3% lower, respectively.

Figure 2: Rising Covid-19 infections and lockdowns are threatening growth prospects



Source: IDC, compiled from IHS Markti tdata

Despite the better than expected third quarter growth data, the risk of renewed downward pressure in the fourth quarter of 2020 is increasing significantly as record high Covid-19 cases are being reported in various European countries and the US. The negative impact is starting to become visible in the most recent Composite Purchasing Manager's Index (PMI) for the Eurozone, as it posted a neutral reading of 50 in October. The PMI surveys the expectations of companies relative to the previous month, with readings above 50 indicating expectations of an expansion, and below 50 an expectation of contraction.

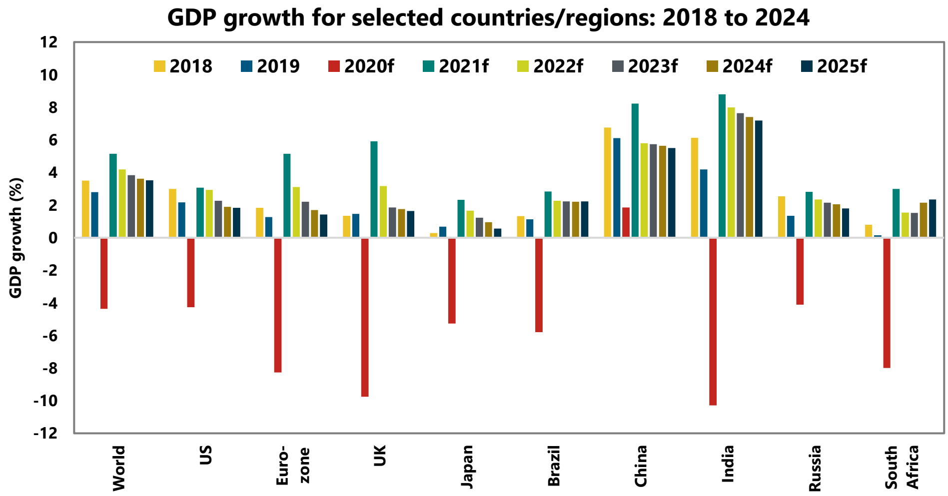
Rapidly rising Covid-19 infections are placing a damper on growth prospects for the US and the Eurozone

The Composite PMI for the US remained well above the 50-point mark in October, indicating continued optimism regarding future prospects, but such an outcome is likely to have been influenced by expectations of a second stimulus package being agreed upon by law-makers before the presidential election. Such expectations proved to be wrong, as the deadlock continued into the election. With a change in administration, as former Vice-President Biden defeated President Trump in the election, bipartisan support for a fiscal support package may not be forthcoming until the President-elect takes office in mid-January 2021.

The ability of the Chinese authorities to contain the spread of Covid-19 infections despite the lifting of restrictions quite a while back is supporting the sustained recovery of the world's second largest economy. The International Monetary Fund (IMF) projects that China will be the only major economy that will post positive economic growth, at 1.9%, in 2020. This is an improvement on the projections the IMF made in June 2020 (i.e. 1% growth).

China's ability to control Covid-19 outbreaks has supported its economy's positive growth in 2020

Figure 3: GDP growth in advanced economies projected to slow after a 2021 rebound



Source: IDC, compiled using IMF WEO (October) data

The IMF now expects the global economy to contract by 4.4% in 2020 (an improvement from the decline of 5.2% it had forecast in June), with significant upward revisions across most advanced economies. However, such projections may turn out to be optimistic considering the underlying assumption of no further lockdowns being imposed, even in countries that have recently been experiencing a resurgence of Covid-19 cases.

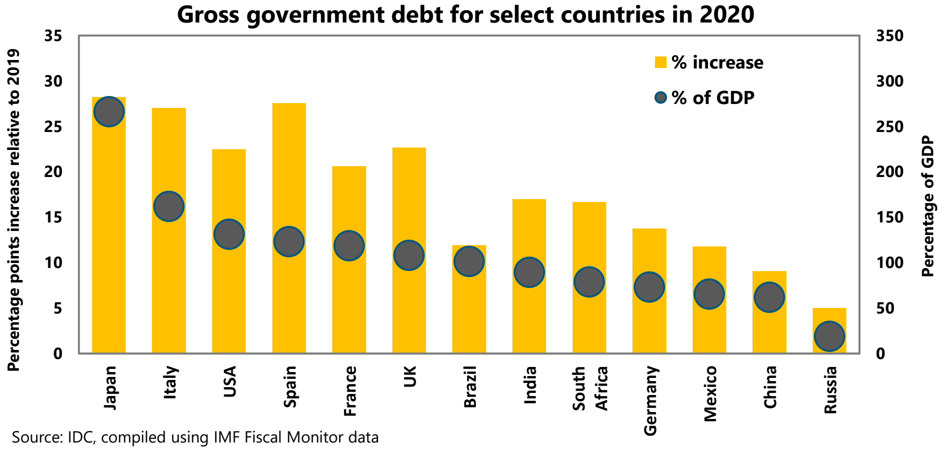
World GDP currently expected to decline by 4.4% in 2020, but such a projection could prove optimistic

The harsh reality though is that restrictions are being re-imposed in several sizeable European economies, although these are generally less stringent than the measures implemented in the second quarter of the year. IMF research has shown that even if lockdowns are not imposed in countries experiencing significant increases in the rate of infections, voluntary mobility restrictions are impacting negatively on economic activity. Hence, growth expectations in the US could also prove to be optimistic.

Various central banks across the world have highlighted the importance of fiscal stimulus for sustainable economic recoveries, as monetary policy has generally reached its limit in terms of the support it can provide. Furthermore, in light of the increasing risks in the global financial system, central banks will have to concentrate on securing its stability. However, the ability of governments to provide further stimulus, particularly in economies that are suffering renewed setbacks due to second-waves of Covid-19 infections, could be constrained by significantly higher debt levels associated with the USD11.7 trillion stimulus provided during the first three quarters of 2020.

High debt levels may limit further fiscal support

Figure 4: Fiscal support measures have significantly raised debt levels



Source: IDC, compiled using IMF Fiscal Monitor data

The announcements by pharmaceutical companies Pfizer and Moderna of vaccines against Covid-19, reportedly with efficacy rates of 90% to 95%, have been welcomed with considerable excitement, as reflected by sharp increases in global stock markets. Their roll out could apparently begin on a large-scale as from the first quarter of 2021, initially targeting the most vulnerable. This would certainly be excellent news for the world at large and the future performance of the global economy.

Industrial commodities: Prices supported by tighter market balances

Industrial commodity prices have continued their recovery from the lows recorded earlier in the year, fundamentally driven by tightening market balances. The key factors driving the market rebalancing have included restrained growth in refined metal supply globally, as well as the rapid normalisation of economic activity in China, fueled by infrastructure-intensive stimulus.

Tightening market balances behind the recovery in industrial commodity prices

China's debt-driven support for infrastructure development as part of its economic recovery programme has hastened large-scale strategic stockpiling of various commodities, resulting in a significant uplift in seaborne import volumes across the bulk and industrial commodities complex.

The easing of Covid-19 related lockdowns elsewhere in the world (ex-China) also contributed to the recovery in global demand for industrial commodities. More recently, however, the resurgence of infections and resultant imposition of new lockdown measures in a growing list of European countries (and the possibility of similar measures being imposed in the US) has placed renewed downside risks on the demand trajectory for commodities. Price volatility may thus increase going into 2021.

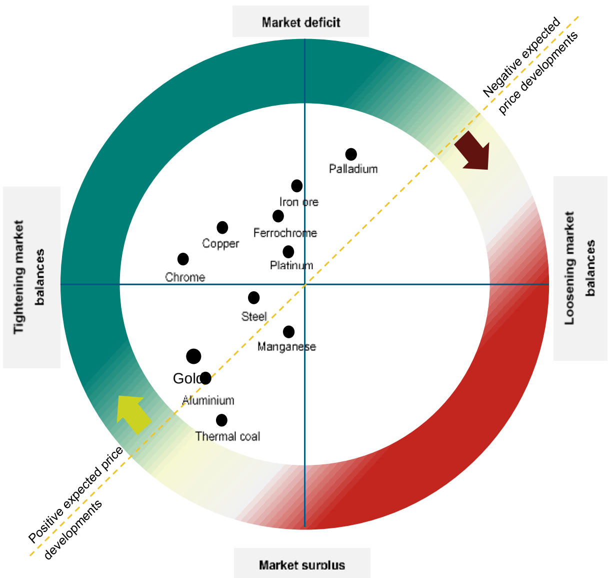
Resurgence of Covid-19 infections raising prospects of increased volatility in commodity prices in the months ahead

Renewed uncertainty relating to near-term global economic prospects has lifted investor risk aversion in global financial markets. This development is likely to deter capital investment into new capacity development in the commodities complex in the shorter-term, bearing in mind the potential of renewed shutdowns affecting mining and/or metal refining operations in affected economies.

The significant risks induced by a second wave of Covid-19 infections on the fragile global economic recovery ex-China, which is still heavily reliant on a combination of fiscal and monetary stimuli, implies that commodity supply may remain constrained in the near-term.

Nevertheless, the peaking precious metals price cycle despite unprecedented levels of monetary policy stimulus in major economies, with gold prices losing momentum, provides a signal of imminent portfolio rebalancing by global investors away from safe-haven assets into riskier options. The strategic rebalancing of long-term investment portfolios could precipitate capital inflows into the industrial and base metals complex in the months ahead, potentially unlocking previously mothballed mining and refined metals projects.

Figure 5: Developments in commodity market dynamics



Source: IDC analysis, adapted from HSBC Global Research

Structural underpin for commodity demand is expected to prevent a steep decline in prices amid 2nd wave Covid-19 risks

The risk of new capacity development over the short- to medium-term, amid higher market prices, could constrain further price increases for industrial commodities going into 2021. This is especially the case for commodities that have remained in a structural global market surplus, such as aluminium. Furthermore, the recent decline in crude oil prices below key threshold levels may, if sustained, weigh on input costs across commodity supply chains and raise the prospects for supply-side expansions, with adverse implications for prices.

Nevertheless, the rebound in global manufacturing activity alongside infrastructure-intensive fiscal stimulus strategies are anticipated to underpin demand for industrial commodities going forward and curtail the risk of a steep decline in prices amid a second-wave of Covid-19 infections.

Recent developments in and outlook for sub-Saharan Africa

Economic growth performance

Relatively muted economic rebound in the SSA region in 2021

A comparatively modest economic expansion for sub-Saharan Africa (SSA) is forecast for 2021, with regional growth expected to recover to 3.1% from a contraction of 3% in 2020. Persistent global uncertainty on the progression of the Covid-19 pandemic and, to some extent, the limited space faced by several countries in the region to maintain expansionary fiscal stances, are likely to limit the economic rebound.

A gradual improvement in external demand and commodity prices, in line with the anticipated recovery in the global economy, alongside a steady recovery in domestic consumption and investment activity should underpin the anticipated economic rebound in 2021. The pace of recovery and prospects for subsequent growth will differ substantially across countries, with some of the larger economies (such as Nigeria, South Africa and Angola), as well as those that are highly dependent on tourism activity, likely to take longer in returning to pre-Covid-19 GDP levels.

Growth prospects for the region still subject to significant uncertainties

However, the outlook for the regional economy remains subject to significant uncertainties and risks. A protracted global economic recovery and persistent macroeconomic vulnerabilities in the SSA region, including the erosion of fiscal and external balances against the backdrop of rising debt servicing costs, could limit the room for fiscal support in various African economies.

Increasing external debt vulnerabilities

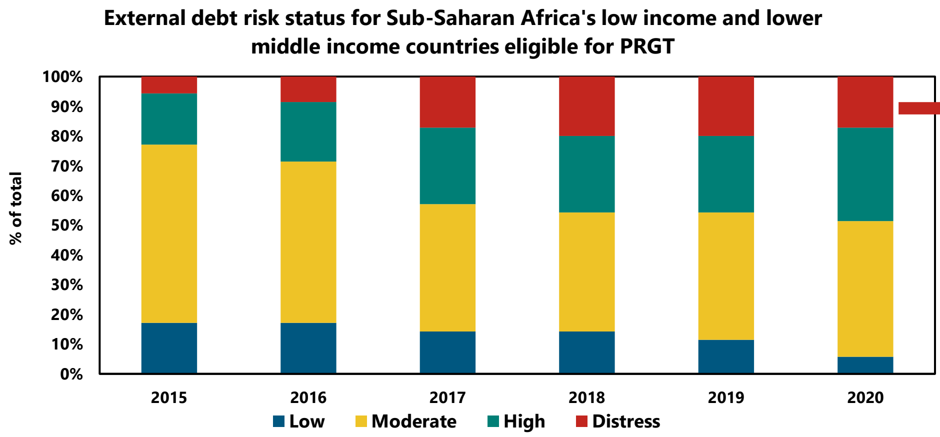
Heightened risks of external debt distress in several SSA economies

Rising fiscal vulnerabilities in the region over the past decade have been providing reason for concern. Fiscal positions had already taken a heavy toll in the aftermath of the 2008/09 global financial crisis and the commodity price shock of 2014 to 2016. The Covid-19 pandemic has exacerbated the situation.

Hard hit by sharply reduced inflows of external capital, relatively subdued commodity prices and rising costs of international capital in a highly uncertain global environment, debt-servicing burdens have risen in several SSA countries. Some are already facing a heightened risk of sovereign debt distress and/or default, while others are likely to emerge from this crisis more indebted and fiscally strained than previously.

Sharply reduced fiscal and external buffers have lessened the capacity of certain SSA countries to fully service their external debt obligations. A joint IMF-World Bank analysis of the debt sustainability of low income countries has indicated that 17 SSA economies face a high risk of external debt distress or already are in debt distress. Zambia, for instance, is expected to default on interest payments that are due on its USD3 billion Eurobond debt and has requested a six-month debt repayment moratorium as it battles liquidity constraints. Furthermore, vulnerabilities have increased even for countries with access to capital markets, such as Ghana and Kenya.

Figure 6: Increasing debt vulnerabilities across Sub-Saharan Africa



In debt distress as of 30 September 2020:

1. Republic of Congo
2. Mozambique
3. São Tomé Príncipe
4. Somalia
5. South Sudan & Sudan
6. Zimbabwe

Source: IDC, compiled using *IMF SSA Regional Economic Outlook data*, October 2020

Various initiatives have been put in place by the international community to provide some financial assistance to vulnerable countries in the region as well as to address their liquidity requirements. Nonetheless, these have remained limited in scope and may prove insufficient, according to the IMF. This institution is therefore calling for "bolder actions" to bridge the mounting fiscal pressures and financing needs of the region.

The Debt Service Suspension Initiative adopted by the Group of Twenty (G20) is providing a moratorium on bilateral debt servicing. However, the amounts eligible for such deferments are considered small and thus inadequate to ward off a looming repayment crisis. This is more so considering that Chinese state-connected and commercial creditors are not part of this initiative. In addition, debt-servicing requirements are expected to remain heavy over the next few years as several Eurobond repayments become due, with potential pressure on several sovereign credit profiles in the SSA region.

South Africa's economy showing signs of recovery

Signs of economic recovery are emerging, but the environment remains very challenging

After a dramatic collapse of economic activity in the second quarter of 2020, with real GDP falling by 16.4% on a quarter-on-quarter, non-annualised basis due mostly to harsh lockdown measures, the South African economy has been showing signs of recovery.

Output levels in the mining and manufacturing sectors have rebounded strongly from very low bases, retail trade sales have been recovering, new vehicle sales are picking up, more electricity is being generated, and both business and consumer confidence are edging higher (albeit still at low levels). However, in most instances the output levels reported in the third quarter of the year were still lower than those recorded in the final quarter of 2019.

Structural reforms, policy coordination and coherence are critical to raise the growth momentum

This demonstrates the challenges still being faced by the domestic economy despite the lifting of most restrictions on economic activity. It also points to the imperative of restoring consumer and business sentiment, which is highly dependent on the strengthening of trust among stakeholders, reduced uncertainty through the effective implementation of structural reforms and coherent policies, as well as avoiding a premature withdrawal of support measures.

Economic recovery may face numerous challenges

Strong rebound in economic activity after a dramatic collapse

As anticipated, economic activity rebounded strongly in the third quarter of 2020 as lockdown measures were considerably eased. Nevertheless, the severe damage caused by the Covid-19 pandemic and the measures taken to contain it will be felt for quite some time. Many companies are struggling to recover and liquidations are still widespread, resulting in continued job losses and declining household incomes.

Consumer environment: Households are facing numerous challenges that are constraining their ability and willingness to spend. In real terms, disposable income dropped by almost 15% in the second quarter of 2020 (year-on-year) due to the loss of 2.2 million jobs and reduced salary payments as lockdown measures took a toll on enterprise activity.

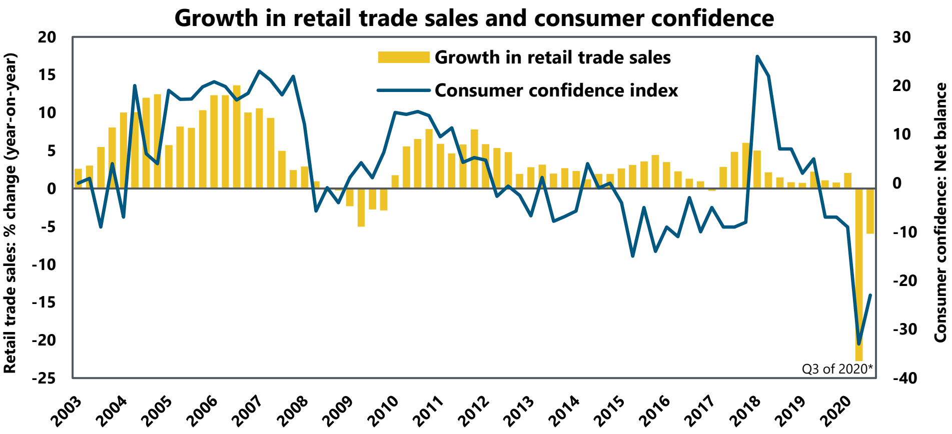
Households remain very concerned with their own financial situation and the weak growth prospects for the economy at large. Despite a slight improvement in the third quarter of the year, consumer confidence thus remains low, as illustrated in Figure 7.

Retail sector showing signs of recovery, but challenges remain

Although retail trade sales recovered in July and August, in real terms they remain below the levels recorded during the equivalent period last year. In the three months to September 2020, the number of new passenger vehicles sold more than doubled (60 832 cars were sold), compared to the previous quarter. However, the quantum of new passenger car sales for the period January to September was 34.4% lower compared to the same period in 2019.

Notwithstanding a much lower interest rate environment (the Monetary Policy Committee has slashed interest rates by a cumulative 300 basis points thus far in 2020), household demand for credit remains muted due to expectations of continued economic weakness.

Figure 7: Challenging consumer environment affecting household spending



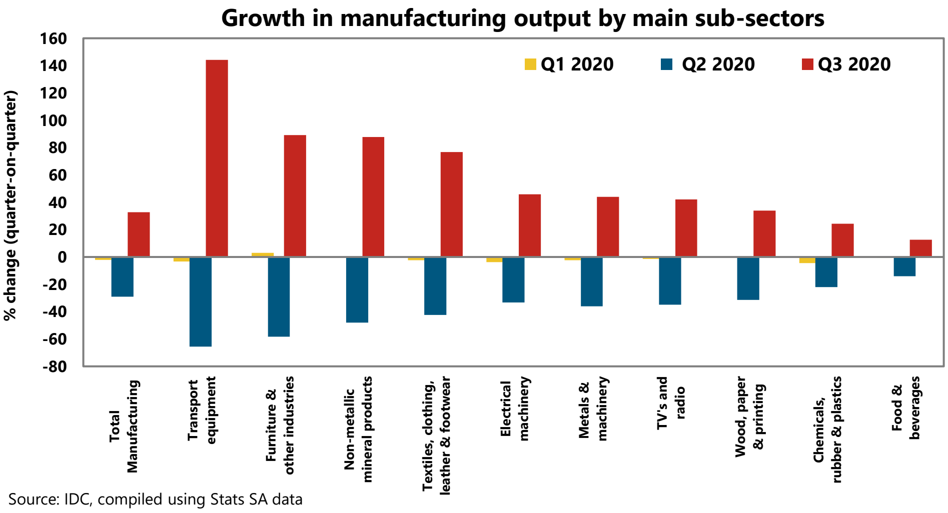
Source: IDC, compiled from Stats SA, BER data

Note: * estimate for retail sales based on July & August

Manufacturing: Production activity in the manufacturing sector rebounded in recent months, with output levels having risen sharply almost across all broad sectors, albeit off very low bases. Overall manufacturing output expanded by 32.9% (q-o-q) in the third quarter of 2020, following the 29.4% contraction recorded in the preceding quarter. For the period January to September 2020, the sector's output was still 14.4% lower compared to the corresponding period last year.

Manufacturing output has rebounded, but the momentum may not be sustained

Figure 8: Manufacturing recovery may not be sustained



Source: IDC, compiled using Stats SA data

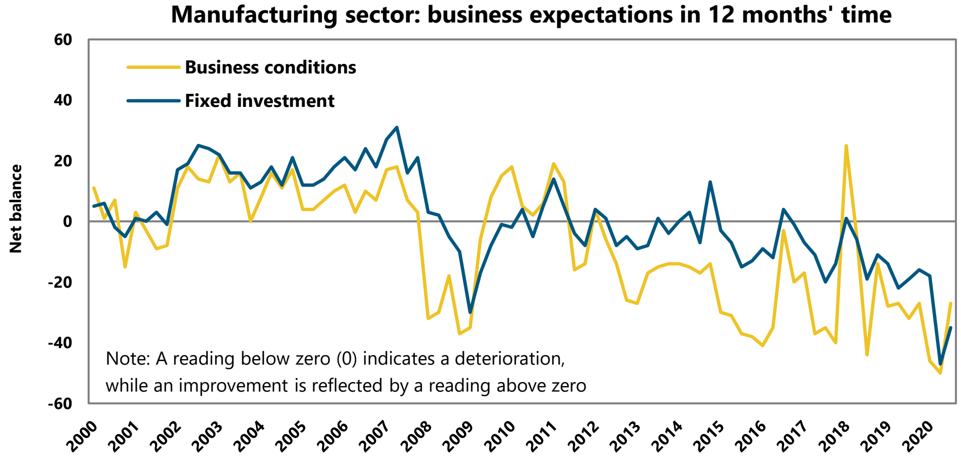
The surge in the manufacturing purchasing managers' index (PMI) to an all-time high of 60.2 points in October 2020, does provide some comfort that activity levels may rise further over the next couple of months. However, the drop in the 'expected business conditions' sub-index, which provides insight into the business environment in about six months' time, bears testimony to the challenges facing the sector.

Business confidence in the sector increased to a reading of 22 in the third quarter of 2020, from an all-time low of only 6 points in the preceding quarter. However, sentiment remains very low, with most manufacturers expecting business conditions to remain largely unsatisfactory over the next 12 months.

Confidence levels among manufacturers remain very low, affecting investment activity

Facing weak demand domestically and challenging conditions in key export markets, manufacturers in general are unlikely to increase their investment activity significantly in the year ahead.

Figure 9: Outlook for the manufacturing sector remains unsatisfactory

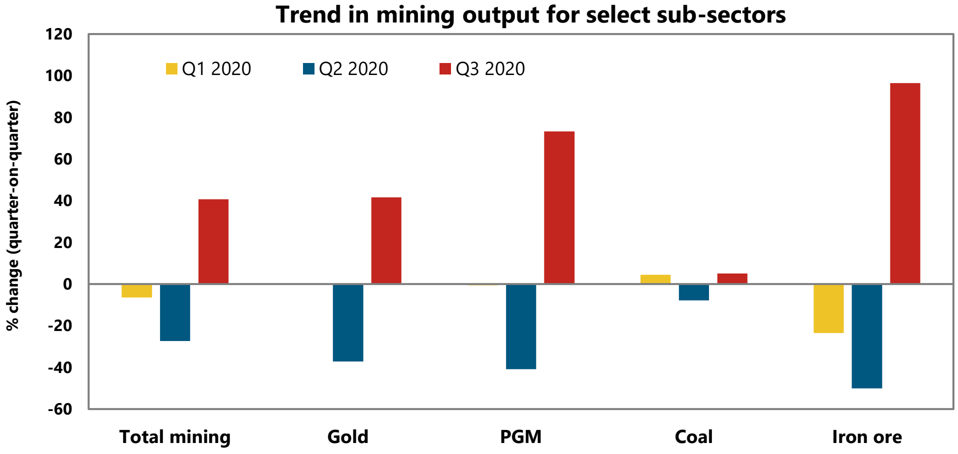


Source: IDC, compiled using BER, Stats SA data Latest data: Q3 of 2020

Recovery in global demand supporting higher mining output

Mining: The recent improvement in mining production has been supported by an up-tick in global demand, especially from China as a key export destination for South Africa's mining and mineral products, as well as higher industrial commodity prices.

Figure 10: Mining output has recovered considerably



Source: IDC, compiled using Stats SA data

After a strong 20.4% recovery in July 2020 (month-on-month), mining sector output lost momentum, decelerating to 6.8% in August and declining by 0.3% in September. Although gold output rose strongly by 13.5% in September (m-o-m), output levels declined in PGMs (-5.0%), iron ore (-2.2%) and in coal mining (-1.8%), among others.

Preliminary data for the third quarter indicates that overall mining output rose by 40.6% on a quarterly basis. Even though output levels recovered in recent months, lockdown measures globally and locally impacted adversely on activity levels. During the period January to September 2020, total mining output was 13.5% lower than in the corresponding period last year.

The relatively modest improvement in coal production in the third quarter of 2020, as shown in Figure 10, was mainly due to coal mining activity having continued normally throughout the lockdown period for electricity generation purposes, whereas other segments.

Higher commodity prices and recovering global demand should, if sustained, lead to an improvement in the mining sector's performance going forward and provide some relief to marginal mining operations that have been under pressure for some time.

Exports recovering, but challenges remain

Lockdown measures inflicted severe damage on world trade

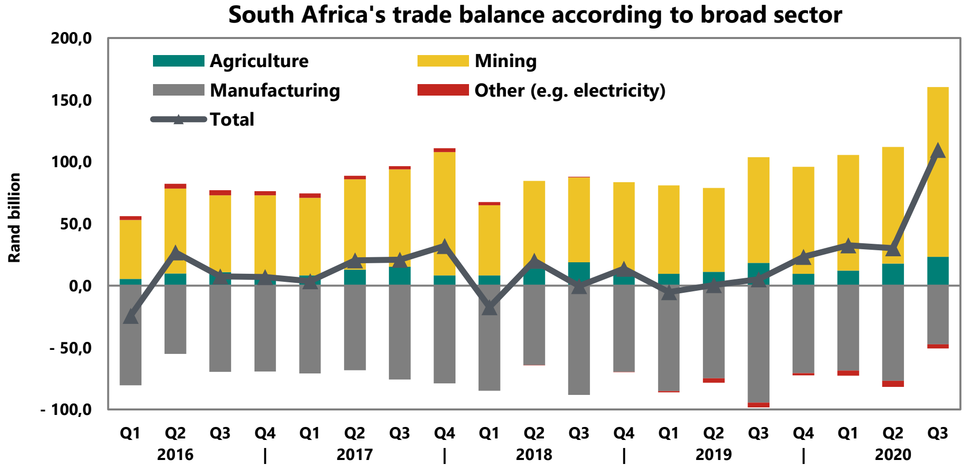
As the world's trading environment deteriorated amid lockdown restrictions around the globe, tensions between the US and China continued to provide a further layer of risk to trade flows. South Africa's exports of goods and services dropped by 27.4% in real terms in the second quarter of 2020 (quarter-on-quarter), as restrictions on production activity, supply chain disruptions and recessionary conditions globally affected demand. A major contributor to the steep decline was the fall in services receipts, such as earnings derived from travel services and international tourist inflows as travel receipts tumbled to R9.9 billion (nominal value) in the second quarter, compared to R121.2 billion in the final quarter of 2019. Gold exports also fell sharply, down by 31.6% in real terms, over the same reference period.

Rebound in South African exports as global trading conditions improved

However, as the global economy started recovering and commodity demand from China picked up, this had positive spin-offs for South Africa's exports. Merchandise exports increased strongly by 41.8% in the third quarter of 2020, compared to the preceding quarter (when a 16% drop was recorded), with exports totalling R388.5 billion.

Manufactured exports increased by R62.8 billion in nominal terms (+49.3%), underpinned largely by the R19.9 billion rise in the value of motor vehicle exports, followed by parts and accessories for motor vehicles (+R7.4 billion), other chemical products (+R3.7 billion), jewellery (+R3.4 billion), as well as basic non-ferrous metal products (e.g. aluminium) with an increase of R2.2 billion, among others.

Figure 11: Trade surplus substantially higher



Source: IDC, compiled using SARS data

Commodity exports also increased significantly, with platinum group metals, gold and non-ferrous metal ores (e.g. manganese, chrome, copper) having recorded substantially higher exports (q-o-q) in the third quarter of 2020. In total, mining exports measured R160.1 billion, an increase of R43.7 billion on a quarterly basis.

In light of the weakness in the domestic economy, demand for imports increased at a much slower pace of 14.4% (q-o-q) in the third quarter, amounting to R278.7 billion.

A trade surplus of R109.8 billion was consequently recorded in Q3 2020 – the largest on record. On a cumulative basis, South Africa recorded a trade surplus of R172.9 billion over the first nine months of 2020, compared to a very small surplus of just R435 million over the corresponding period in 2019. Although merchandise exports increased by only 3.6% (year-on-year) in nominal value terms over this period, imports fell by 14.5% as weak domestic demand reduced the need for imported goods, whether raw materials, intermediate products, capital equipment or consumer-related items.

South Africa's trade surplus for the first 9 months of 2020 totalled R172.9 billion, due to higher exports and considerably lower imports

As the world economy gradually resumes a higher growth trajectory and market conditions continue normalising, South Africa's export performance is likely to improve. Furthermore, the implementation of the African Continental Free Trade Agreement should also provide increased export market development opportunities for South African companies over the medium- to long-term.

Public finances have deteriorated significantly

South Africa's public finances worsened rapidly over the past decade, with the domestic economic recession as from the second half of 2019 having inflicted considerable damage. In 2019/20, the budget deficit widened to 6.4% of GDP, from 4% in the previous year. The fiscal performance worsened significantly thus far in the 2020/21 fiscal year as the economy is experiencing its worst recession on record. National Treasury expects real GDP to contract by 7.8% in calendar year 2020, in the process adversely affecting revenue collections.

Substantial deterioration in public finances as the Covid-19 crisis inflicted further damage

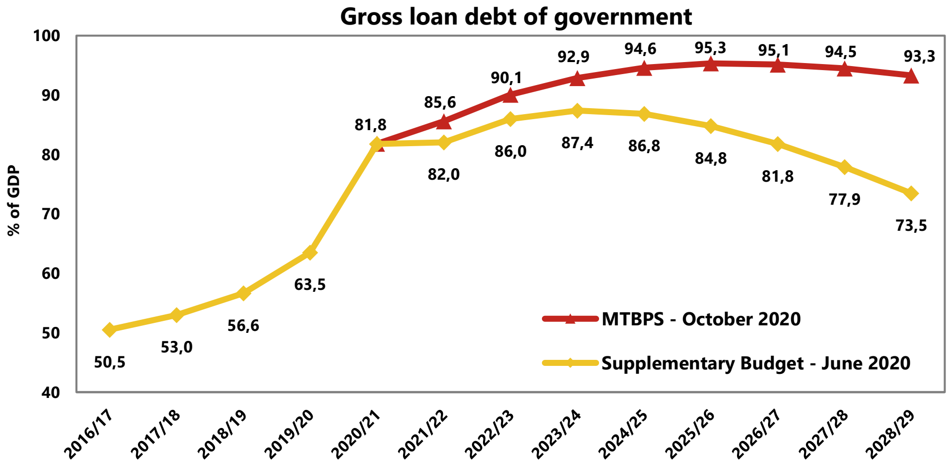
According to the October 2020 Medium Term Budget Policy Statement (MTBPS), a revenue shortfall of R312.8 billion is expected in 2020/21, compared to what had been estimated in the February 2020 Budget. In order to arrest the spread of Covid-19 and soften the impact of the required lockdown measures, government announced a massive R500 billion support package (equivalent to 9.6% of GDP). This contributed to a substantial widening of the budget deficit, now estimated at 15.7% of GDP for the current fiscal year, with a gradual improvement expected in subsequent years towards a ratio of 7.3% by 2023/24.

Budget deficit set to increase significantly

The borrowing requirements have risen sharply, with an expected increase of R358.9 billion to R774.7 billion in the 2020/21 fiscal year, compared to total borrowings of R237 billion in 2017/18. The debt servicing costs are estimated to measure R233 billion in the current fiscal year, absorbing approximately 21% of total revenue. Consequently, the gross loan debt of government is projected to total a staggering R3 974.1 billion (81.8% of GDP), representing an increase of around 60% since 2017/18.

Government debt rising unabatedly and close to reaching unsustainable levels

Figure 12: Public debt worsening significantly



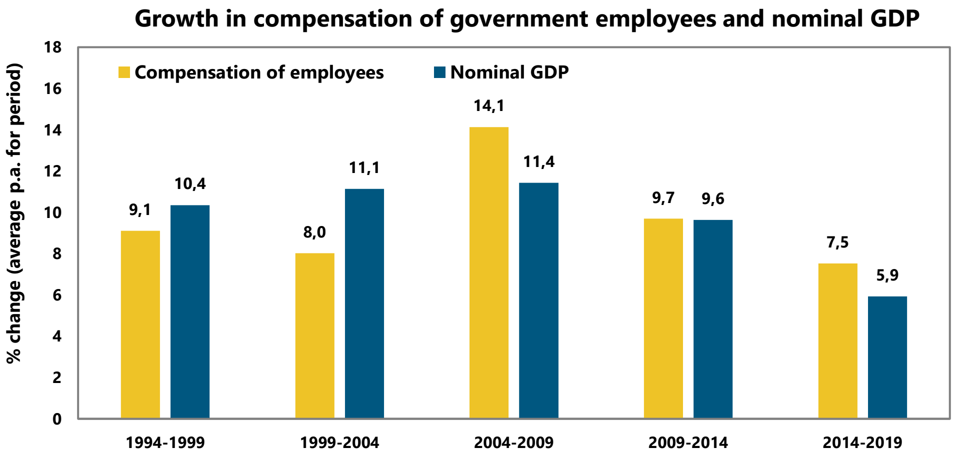
Source: IDC, compiled using National Treasury data

South Africa's public finances are set to worsen dramatically over the next couple of years, with the gross loan debt of government projected to rise towards a peak of 95.3% of GDP by 2025/26. Accordingly, government has announced cost-containment measures to steer away from the fiscal cliff, emphasizing the imperative of fiscal consolidation and debt stabilisation. Much will depend on its ability to rein-in expenditure in a meaningful manner.

Commitment to fiscal consolidation provides some comfort, but successful implementation is crucial

Much of the fiscal consolidation efforts are premised on a substantial reduction in the public sector wage bill. The wage bill has been increasing at a fast and unsustainable rate over the past couple of years, in excess of nominal GDP growth as shown in Figure 13. In 2019/20, overall compensation of employees stood at R626 billion, equivalent to 46.2% of all tax revenue. Considering the expected sharp drop in revenue in the current financial year, employee remuneration will rise steeply to an estimated 57.5% of tax revenue, potentially tapering off in subsequent years to 43.6% by 2023/24.

Figure 13: Compensation of public employees increasing at an unsustainable rate



Source: IDC, compiled using National Treasury data

A R310.6 billion reduction in public sector employee compensation is envisaged over the period 2020/21 to 2023/24. This includes a proposed wage freeze over the next three years as government strives towards improving the fiscal situation and avoiding the possibility of a debt trap. However, the proposed reduction in compensation is not being favourably received by government employees and their union representatives. Should government not succeed in reducing the wage bill as planned, debt levels and servicing costs will rise unabatedly, in the process crowding out spending on other critical goods and services.

Cost-cutting through a massive reduction in the public sector wage bill

The fiscal consolidation path also hinges on improved revenue collections, a difficult task in the economic environment that is likely to characterise the next couple of years. Should revenue collections disappoint, this would also compromise fiscal stabilisation efforts.

In order to assist in much needed job creation and/or sustain employment levels as set out in the Presidential Employment Stimulus, R12.6 billion has been allocated to various initiatives over the period October 2020 to March 2021. Although this will provide welcomed but largely temporary relief on the employment front, government must focus on ensuring an enabling environment for the private sector to recover and thrive, increase production activity and raise fixed investment spending, in the process creating sustainable employment opportunities.

A key component of the Economic Reconstruction and Recovery Plan (ERRP) is a massive infrastructure build programme, with R100 billion having been earmarked over the next 10 years for the Infrastructure Fund. This has the potential to kick-start economic activity and crowd-in substantial private sector investment and participation through PPPs. According

Renewed focus on investment could bolster economic growth to the MTBPS, spending priorities have been directed more towards investment than consumption expenditure. If implemented timeously and effectively, the focused investment drive can indeed contribute meaningfully to the rebuilding of the domestic economy.

The credit rating agencies remain concerned about the precarious state of South Africa's public finances and are of the view that government is too optimistic on the assumptions underpinning its path towards fiscal consolidation. Hence, the possibility of further downgrades of the sovereign ratings deeper into sub-investment territory looms large.

The credit rating agencies are keeping a hawk's eye on public finances

Employment losses recovered to some extent

Approximately 543 000 jobs were created in the third quarter of 2020 (quarter-on-quarter) as lockdown restrictions were gradually eased and economic activity rebounded. This recovery follows a massive loss of 2.2 million employment opportunities in the previous quarter amid restricted economic activity domestically and abroad. Although gradually higher economic growth is expected over the next few years, it will take some time to recover the employment lost earlier this year.

Some of the job losses have been recovered, but challenges remain

Overall employment in the manufacturing sector remained almost unchanged in the third quarter. At 1.46 million it was 31% lower, or 652 000 fewer jobs, than in the first quarter of 2008. Considering that manufacturers expect operating conditions to remain challenging over the next 12 months, this does not bode well for increased job creation in this crucial sector of the economy.

Table 1: Labour market indicators for the quarter to September 2020

Labour market indicators	Number ('000)	Change in '000s (q-o-q)
Population (15 to 64 years)	**39 167**	**146**
Labour force	**21 224**	**2 781**
Unemployed	**6 533**	**2 238**
Unemployment rate (%): change in %-points	**30.8%**	**7.5%**
Employed:	**14 691**	**543**
Agriculture	808	8.8
Mining	419	45.6
Manufacturing	1 460	3.8
Utilities	90	-22.5
Construction	1 080	13.8
Trade, catering & accommodation	3 008	61.9
Transport	878	-6.8
Finance & business services	2 434	200.1
Community services (incl. government)	3 381	137.3
Private households	1 121	115.5
Other	12	-14.9

Source: IDC, compiled using Stats SA data

The unemployment rate stood at 30.8% (or 6.53 million people unemployed) in the third quarter of 2020 - an all-time high. Roughly 60% of all the unemployed were younger than 35 years. Furthermore, close to 70% of the unemployed had been without a job for more than 12 months.

Unemployment rate at record highs

Growth outlook for the South African economy

A contraction of 8.5% in real GDP is expected in 2020, with a 3.3% rebound projected for 2021

South Africa's real GDP is forecast to contract by 8.5% in 2020 – the worst decline on record. Although a rebound of 3.3% is anticipated in 2021, operating and trading conditions are likely to remain very difficult for some time, resulting in only a very gradual recovery in economic activity in subsequent years. Structural challenges, especially energy supply, are expected to continue constraining the economy's expansion potential in the short- to medium-term, albeit to a decreasing extent as the interventions outlined in the ERRP are progressively implemented.

Table 2: Projections for key performance indicators for the South African economy

Variable (% change or % of GDP)	2016	2017	2018	2019	2020f	2021f	2022f	2023f	2024f	2025f
Growth in real GDP and its components:										
Household consumption expenditure	0.6	2.1	1.8	1.0	-8.1	3.9	1.6	2.2	2.1	2.5
Government consumption expenditure	2.2	0.2	1.9	1.5	0.3	-0.3	0.5	0.8	1.2	1.6
Gross fixed capital formation (GFCF)	-3.5	1.0	-1.4	-0.9	-16.5	2.0	6.3	3.6	4.3	4.2
Exports	0.4	-0.7	2.6	-2.5	-14.5	3.9	1.6	2.3	2.6	2.5
Imports	-3.9	1.0	3.3	-0.5	-13.1	3.5	3.2	2.5	3.0	2.9
GDP	**0.4**	**1.4**	**0.8**	**0.2**	**-8.5**	**3.3**	**1.9**	**2.2**	**2.1**	**2.4**
Consumer price inflation	6.3	5.3	4.6	4.1	3.4	4.7	4.9	5.1	4.8	4.7
Current account balance (% of GDP)	-2.9	-2.5	-3.5	-3.0	-1.2	-1.8	-3.0	-3.2	-3.8	-4.3
GFCF as % of GDP	19.4	18.8	18.2	17.9	15.5	14.6	15.0	15.0	15.1	15.3

Source: IDC, compiled using SARB data, IDC forecasts

Household consumption spending will be adversely affected by job losses, lower disposable incomes and uncertainty, while fixed investment activity is only likely to start recovering meaningfully once there are clearer signs of sustained normalisation of consumption and production domestically, as well as globally.

South Africa's export performance is expected to remain under pressure in the short-term due to a generally challenging global trading environment, particularly weak demand. The implementation of the African Continental Free Trade Area agreement should provide opportunities for local companies to expand their global reach, albeit over the medium to longer term.

Cognisant of a very weak domestic economy and in the absence of meaningful inflationary pressures, the Monetary Policy Committee is expected to maintain a growth-supportive monetary policy stance throughout the entire forecast period.

Department of Research and Information

16 November 2020