SUPPORTING ECONOMIC TRANSFORMATION

# Economic impacts of and policy responses to the coronavirus pandemic: early evidence from South Africa

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## Key messages

- As of 16 April, South Africa has reported over 2,500 confirmed cases of COVID-19 and 34 deaths. Infections are confirmed in most urban areas and large townships, where water is scarce and self-quarantine measures are difficult to adopt. Since 26 March, the country has been in lockdown and the sale of alcohol is prohibited. All non-essential businesses are closed until at least the end of April.
- South Africa's economy was already in recession before the outbreak. The lockdown, the rand's depreciation and the sovereign rating downgrades will put additional pressure on an already fragile domestic economy. The IMF expects the economy to contract by 5.8% in 2020 and unemployment to increase to 35.3% (from 28.7% in 2019).
- So far, the central bank has announced various strong measures. The fiscal response has been relatively limited, potentially because of the country's limited fiscal policy space.

## Introduction

South Africa confirmed its first COVID-19 case on 5 March; 10 days later President Ramaphosa declared a 'national state of disaster'. A number of restrictions on movement were introduced. At this stage, cases were generally in suburban areas among those who had recently travelled abroad. However, the outbreak rapidly worsened, with the virus spreading to all nine provinces and infections confirmed in the vast townships of Alexandria (Gauteng) and Khayelitsha (Western Cape).

A three-week national lockdown has been in place since 26 March: citizens can go out only for food and medicine or to collect a public grant. All industries but those deemed essential to maintain the supply of food, medicine and certain key services are closed. Public gatherings, outdoor exercise and the sale of cigarettes and alcohol have been banned. This lockdown, sometimes violently enforced, was extended on 9 April for a further two weeks. Despite the economic hardship caused, President Ramaphosa has assured citizens that early indicators suggests the measures are worthwhile: the daily growth rate of new cases has slowed from 42% to 4%. As of 16 April, South Africa has just over 2,500 confirmed cases and 34 deaths (having conducted some 100,000 tests). Although case numbers are low compared with Europe and the US, the spread of the disease to more crowded urban areas (where running water is scarce and self-isolation is near-impossible) does not augur well.

South Africa's lockdown is particularly strict, and its already-anaemic economy can ill-afford a lengthy shutdown in production. In the week following the start of the lockdown, Moody's downgraded South Africa's sovereign credit to sub-investment grade (junk status), a step that all other credit rating agencies had already taken. The National Treasury responded to the downgrades by reiterating its commitment to structural reforms, including of ailing state-owned enterprises, and to prioritising measures to contain the spread of COVID-19.

The Treasury acknowledged that Moody's downgrade 'could not have come at a worse time', as financial markets were already under coronavirus-related pressure and facing significant equity sell-offs. As a result of the downgrade, government securities were excluded from the FTSE World Government Bond Index, which will likely continue to contribute to capital outflows and reduce foreign investors' appetite to hold the securities. Between January 2020 and mid-April, the rand lost more than a third of its value against the US dollar, making it the worst-performing emerging market currency in 2020 thus far. Over the same period, non-resident investors sold around R100 billion ($5.4 billion) of domestic assets.

## Economic and social impacts

Before the outbreak, South Africa was already in the midst of a recession. According to the South African Reserve Bank (SARB), 'the 2010s were the worst decade for South African growth on record'. Output expanded by only 0.2% over 2019, with drought stifling agricultural output and electricity shortages limiting the mining and manufacturing sectors.

The SARB has reduced its GDP growth projections for 2020, from +1.2% in mid-January to -6.1% in mid-April. Similarly, the IMF has revised its growth projections downwards by 6.6% and expects GDP to contract by 5.8% in 2020. Both the IMF and the SARB expect the economy to partly recover in 2021, with growth rate estimates between 2.2% and 4.0% for 2021. Exports are expected to fall 9.6% in 2020.

Prior to the outbreak, South Africa had notoriously high unemployment (28.7% in 2019) and job growth had largely stalled. The lockdown will likely result in additional job losses. The IMF expects unemployment to increase to 35.3% in 2020. In a country with high inequality, these losses are likely to disproportionately affect poorer citizens, many of whom cannot work from home and ordinarily live hand to mouth.

## Monetary and financial policy

On both 19 March and 14 April, the SARB reduced its repurchase rate by 100bp, resulting in a rate of 4.25%. These drastic monetary policy measures aim to ease financing conditions and increase household and firm resilience. It also introduced liquidity-enhancing measures for the banking sector, including the easing of capital requirements and a reduction of the minimum liquidity coverage ratio, and started a government bond-buying programme to inject additional liquidity into the economy, without committing to a specific amount or maturity of bond purchases.

The SARB has room to cut the repo rate further and can be generous through the bond-buying programme. However, the risk of further currency depreciation and capital outflows limits its policy space. Local investors, however, are unable to shift the entirety of their investments out of the South African market owing to a regulatory limit on holdings in foreign markets of 25%. The SARB has underlined that monetary policy 'cannot on its own improve the potential growth rate of the economy or reduce fiscal risks'.

## Fiscal policy

With scarce fiscal space, the government's fiscal stimulus options are limited. Debt sustainability was already a source of concern before the outbreak. Public debt was expected to increase to 61.6% of GDP by the end of this fiscal year and to grow further to 71.6% in 2022/23. In the past five budget framework papers, the debt trajectory has been continuously revised upward, reflecting the government's fiscal indiscipline and inability to control expenditures. Tax revenues have routinely fallen short of targets, not least because of poor economic growth. The extra health expenditures in the COVID-19 pandemic will weigh further on South Africa's fiscal outlook.

The Treasury has implemented a fiscal package with three main tax measures. First, private sector employers can obtain a tax subsidy of R500 ($27) per month, for four months, for each employee earning under R6,500 ($349) per month. The second measure increases the frequency of employment tax incentive reimbursements, from biannually to monthly. Finally, SMEs with gross revenue less than R50 million ($2.7 million) are allowed to defer 20% of their employees' tax (PAYE) liability for four months. They can also defer some of their provisional corporate tax payments without incurring penalties or interest. R500 million ($26.9 million) has been freed up for SME debt relief.

While these measures are aimed at wage protection and avoiding potential job losses, they exclude South Africa's informal labour force, which recent national labour force surveys indicate could account for as much as 20% of total employment.

In addition to tax measures, South Africa's Unemployment Insurance Fund has put aside R40 billion ($2.1 billion) to assist employees who cannot work. The government have also established a Solidarity Response Fund to prevent the spread of the disease and support those whose lives have been disrupted. The fund mobilises resources from companies, organisations and individuals. This has so far raised R2.2 billion ($118 million) and senior politicians have pledged to take a one-third salary cut for the next three months, to be donated to the fund.

## Donor support

While the finance minister has reportedly considered asking the IMF or World Bank for health-related financing, he has not yet done so. The New Development Bank (established by the BRICS countries in 2014) announced its willingness to lend South Africa an immediate $1 billion for health support and a further $1 billion to support the economy. The finance minister replied that there might be interest in accepting the support in the future. However, he 'generally doesn't like loans', and several politicians have raised objections to IMF and World Bank support, citing fears of loss of sovereignty and the need to carry out (necessary but unpopular) structural reforms.

Despite the unwillingness to accept external support, South Africa does not appear to have sufficient policy room or financial resources to address the pandemic on its own. Economic recession, increased borrowing costs owing to an increased sovereign risk profile and a growing need for expanded public health spending all make further rises in government debt inevitable. An IMF programme would alleviate some of this pressure and help support investor confidence.

Information in this note is correct as of 16 April 2020.

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