The economic impact of Covid-19

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Saica hosted a webinar on 6 April 2020 where chief economist for Investec Bank Limited South Africa, Annabel Bishop, spoke about the effects of sub-investment grade status and the coronavirus on our country's already struggling economy.

The South African Institute of Chartered Accountants (Saica) is offering a *Leadership in a time of crisis webinar* series as part of the institute's response to Covid-19. One of the sessions was presented by Annabel Bishop, chief economist for Investec Bank Limited South Africa, who gave her perspective on how the virus will impact the country's economy.

Chief economist for Investec Bank Limited South Africa, Annabel Bishop

South Africa is moving deeper into a recession

Bishop does not mince her words when she says that the slowdown we are going to see in the global and the domestic economy will be more substantial than that of the Great Recession. "This year, the GDP is expected to contract by -2.7% (now -4.8%) in South Africa," she says. "However, on a peak to trough basis, this figure is closer to -4% (now -11.2%), which is a greater contraction than we saw in 2008 and 2009."

These numbers give some sense to why the markets are reacting the way they are. South Africa's recent credit rating downgrade to sub-investment grade status, the depreciation of the Rand against the dollar and the fact that the global economy is expected to go into a substantial recession, have created a perfect storm for the markets.

The global economy

The global economy is expected to fall into recession this year, says Bishop. "However, we are looking at a U-shaped recovery, rather than the typical V-shaped recovery, where the economy suffers a sharp but brief period of economic decline, followed by a strong recovery," she adds.

The key concern globally is the uncertainty around when the pandemic will peak and start to subside, and when we will return to business as normal. "If you look at the cities that are currently worst hit, such as London and New York, they are key financial centres," says Bishop. "The concern is that as we creep into the second half of the year, we may not be back to business, and the global recession could therefore be even worse than is currently anticipated," she adds.

The effect on South Africa

Of course, anything seen as negative by the financial markets tends to lead to a negative market reaction, and this extreme uncertainty is elevating risk-off. "From a financial market perspective, players tend to sell off what are perceived as risky assets, whether these are equities or, indeed, emerging market assets, and globally there has been a huge sell off of emerging market assets," says Bishop, adding that in South Africa, bonds in particular are being sold off because of our credit rating downgrades.

"In South Africa, the 21-day lockdown, which has seen a sharp shutdown of manufacturing, (non-food) retail and a number of other sectors, is expected to see our country contract in the second quarter by about 15%," says Bishop. "You would expect that in the second quarter we will see a rebound, and we do currently have that as 10%, but if the lockdown extends, we will fall into a down case scenario."

According to Bishop, in 2021, we can expect a rebound of GDP growth of about 0.8%, moving to about 2-3% thereafter.

Government response

Bishop explains that the government in South Africa is looking at additional expenditure measures to provide support during the Covid-19 crisis, but cautions that this of course risks elevating the debt metrics.

"I must stress that breaking the spread of Covid-19 is paramount, and that the cost to South Africa would be even greater if we did not flatten the curve," she says.

Bishop goes on to explain that locally, a number of structural problems, such as electricity production issues, persist and that these limit the potential economic growth of the country. However, she is hopeful that there will be extensive service and maintenance on Eskom power stations during the lockdown, where possible.

The finance minister has specified that South Africa may approach the IMF for Covid-19 health relief. "South Africa's credit ratings face further downgrades and it is imperative that government spending be contained to prevent further slippage down the rating ladder, and so eventual application to the International Monetary Fund to come under its adjustment programme in order to access funding," says Bishop.

Bishop goes on to explain that many governments have put drastic measures in place internally to promote expenditure. "South Africa is not yet looking to put out an emergency budget, but rather at reprioritisation, that is, switching expenditure from one area to another.

Many countries have identified large stimulus packages, but the issue for South Africa, Bishop explains, is that there is very little opportunity for additional spend in the budget, and even less so with the recent downgrade, and the subsequent weakening of our domestic currency. To put it mildly, the South African government is stuck between a rock and a hard place.

Oil prices and commodities

The prospect of a global recession and weak demand levels, coupled with the price war between Russia and Saudi Arabia, have led to a substantial weakness in oil prices. This has seen fuel cuts locally, with over R1 per litre cuts in April, and possibly up to R3 per litre in May.

"Reduced fuel prices will provide some relief to consumers, but higher prices in the shops for some imported goods such as wheat and rice are likely on the currency depreciation," says Bishop, adding, that household and corporate balance sheet will benefit little from the fuel cuts for stay at home consumers and corporations, which are still locked down.

That said, given that we are a food-producing nation, most of the goods we produce in South Africa will be less impacted by the exchange rate. "As a consequence, we will be quite well provided for, and there are no substantial food shortages expected locally, which is important in terms of this crisis," she assures.

Liquidity measures

"The South African Reserve Bank (SARB) has instituted significant liquidity measures in South Africa, and the spread between South Africa's repo (bank) rate and its three-month money market rate (the Jibar or Johannesburg Interbank

Average Rate) has normalised, after some dislocation," explains Bishop.

The Moody's downgrade placed some upwards pressure on South Africa's borrowing rates in the long-end, but before the latest Moody's downgrade, the SARB had already instituted substantial liquidity measures, by purchasing longer-term government bonds and extracting liquidity in the short end of the market to neutralise the impact.

"While the SARB may choose to lower rates again to provide debt relief, there are significant mechanisms incoming and, recently, in existence already, looking to assist households and corporates with debt holidays for those that qualify and numerous other measures," says Bishop.

Conclusion

While this all sounds rather negative, Bishop is hopeful for the future, for several reasons. "Our government is acutely aware of what needs to be done," she says, explaining that the president himself has said we need to enact the economic growth plan from the National Treasury, which in essence aims to make South Africa a more market-orientated, focused economy, that supports faster economic growth.

What's more, Bishop explains that there is a very strong realisation by the government that it needs to provide substantial support for households and corporates in the face of Covid-19, while at the same time closely controlling government expenditure to avoid wastage, inefficiencies and corruption. Otherwise that will find us in a situation where we don't provide the necessary support to lives and livelihoods to get us through the crisis, and are still likely to face further credit rating downgrades.

"Finally, there is a huge number of very intelligent people working on vaccines to try and contain this virus as quickly as possible," says Bishop. "Globally, we have the best medical minds working on it and I am hopeful we are not going to see this virus persist and continue to be as destructive as it currently is."

For more information and possible scenarios, download Bishop's report here.

Kindly note that the content contained in this article is from a webinar that took place on 6 April, and reflects the situation as it was then. Bishop reiterated that her presentation could not take into account all the changes expected in this volatile environment.

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