Parliamentary Budget Office

PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

Quarterly Economic Brief

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Contents

Gross domestic product 1
Expenditure on GDP 1
Current account 2
Exchange rate...2
Sovereign risk 2
Inflation and monetary policy 3
Public finances 3
Outlook 3

The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees.
The PBO provides quarterly analysis of economic developments for Members of Parliament following the release of quarterly economic data by Stats SA, the South African Reserve Bank and the National Treasury.

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This report incorporates data available up to and including the 16 September 2020, and was released on 21 of September 2020. Employment data are not presented in this edition, due to Stats SA delaying the publication of the Quarterly Labour Force Survey.

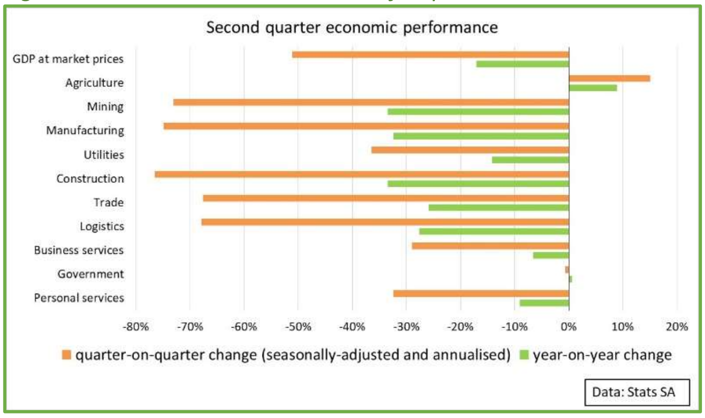
Gross domestic product

South Africa's GDP contracted by 17.1 per cent in the second quarter of 2020 compared with the second quarter of 2019. This contraction marks the country's largest ever quarterly contraction of GDP on record. The large contraction in GDP was mostly due to the nation-wide lock-down imposed from the last week of March to help contain the spread of Covid-19, as well as disruption to trade and investment arising from the Covid-19 pandemic and containment measures imposed by other countries.

Over the second quarter, all but one sector of the economy experienced large contractions. The single exception was the agriculture sector, which recorded growth of 9 per cent compared with the same quarter of 2019.

During the first half of the year, the economy contracted by 8.9 per cent compared with the first half of 2019.

Figure 1: An economic contraction of unprecedented scale



When compared with the first quarter of 2020, the economy recorded a contraction of 51 per cent on a seasonally adjusted and annualised basis (see Box 1).

Figure 2: Almost all sectors subtract from growth

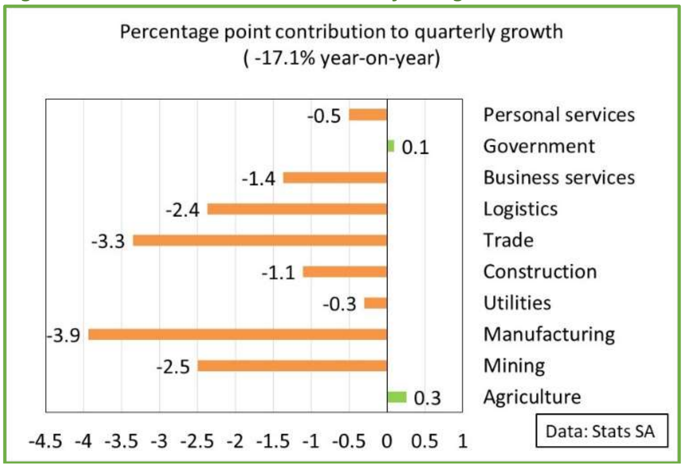


Table 1: Several sectors have experienced successive quarterly contraction

y/y growth	2Q2020	1Q2020	4Q2019	3Q2019	2Q2019
GDP	-17.1%	0.1%	-0.5%	0.1%	0.9%
Agriculture	8.9%	15.9%	2.1%	-7.4%	-6.3%
Mining	-33.4%	-4.5%	-1.0%	-0.7%	-1.4%
Manufacturing	-32.4%	-3.5%	-2.6%	-1.5%	0.5%
Utilities	-14.2%	-2.9%	-3.6%	-2.4%	-0.5%
Construction	-33.4%	-5.3%	-4.6%	-3.7%	-2.5%
Trade	-25.9%	0.6%	-0.3%	0.6%	0.4%
Logistics	-27.6%	-3.0%	-3.7%	-1.0%	2.5%
Business serv.	-6.6%	3.1%	1.4%	2.3%	3.1%
Government	0.6%	1.6%	2.0%	1.9%	1.8%
Personal serv.	-9.0%	0.9%	0.5%	1.3%	0.8%

Expenditure on GDP

Measured from the expenditure side, GDP contracted by 17.6 per cent over the second quarter of 2020 compared with the same quarter of 2019. Large contractions were recorded for investment (25.8%) and household consumption (15.7%), subtracting 9.6 and 9.5 percentage points from the quarter's GDP growth respectively. Over the first half of 2020 GDP contracted by 9.2 per cent.

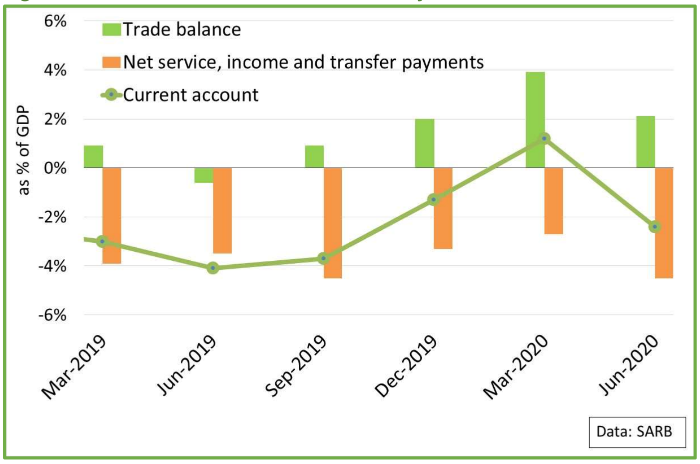
Table 2: Only government experienced growth

y/y growth	2Q2020	1Q2020	4Q2019	3Q2019	2Q2019
GDE	-17.2%	-2.1%	1.1%	0.4%	1.8%
Household cons.	-15.7%	0.9%	0.9%	1.3%	1.5%
Gov cons.	0.4%	1.4%	1.6%	1.7%	1.4%
Investment	-25.8%	-5.6%	-1.3%	0.9%	-0.5%
Exports	-26.8%	-0.1%	-6.1%	-4.3%	-0.5%
Imports	-25.1%	-5.0%	-2.0%	-2.7%	3.3%

Current account

South Africa's current account, which recorded its first surplus in 17 years in the first quarter, fell back into a deficit in the second quarter. The second quarter current account deficit was due to a large fall in income for trade in services (57%: R114 bn), and a smaller surplus on the trade account. The reduction in the trade account surplus occurred as exports recorded a larger contraction (22%), compared with imports (16%) over the quarter.

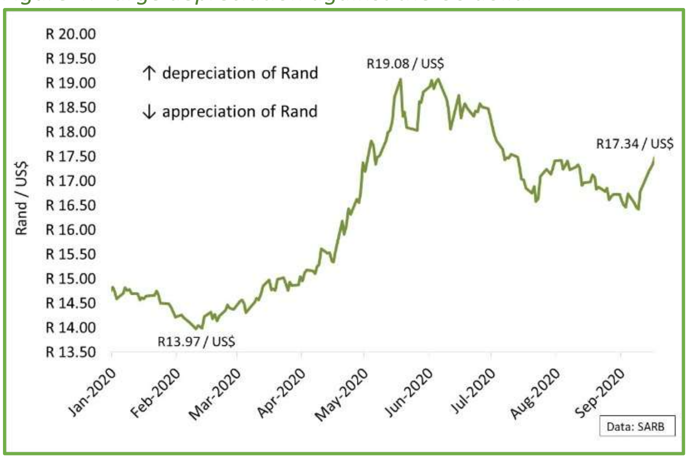
Figure 3: Current account returns to deficit



Exchange rate

The rand weakened consistently against the US dollar and other major currencies from the end of the first quarter of 2020 as the coronavirus spread over the world and the economic effects of hard lock-downs in almost all countries took effect.

Figure 4: Large depreciation against the US dollar

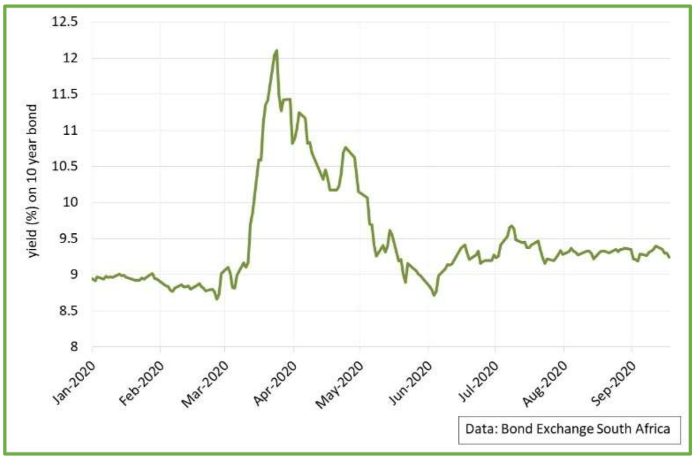


The rand weakened over 25 per cent against the US dollar between March 2020 and June 2020. In a rush to safety, foreign investors withdrew billions from developing countries' financial markets, including selling off a large quantum of domestic rand assets. Appetite for emerging market assets returned since the middle of the year after large accommodative monetary and fiscal support measures by many advanced economies. The rand regained some of its value against the US dollar.

Sovereign risk

The yield on South Africa's 10-year benchmark bond – an indicator of market sentiment about the riskiness of South African government bonds – worsened significantly at the end of March following the decision by ratings agency Moody's to downgrade the country's domestic currency debt to sub-investment grade. The downgrade by Moodys triggered an automatic exclusion of South African bonds from the FTSE World Government Bond Index (WGBI), resulting in forced selling by investors tracking the WGBI. Compounding the effect of South Africa's exclusion from the WGBI, was the aversion from global investors towards emerging market assets due to effects of the Covid-19 pandemic.

Figure 5: Yield on SA 10-year bond



The yield on the South Africa's benchmark bond improved over the second quarter following the announcement of supportive monetary and fiscal measures by most advanced economies. The recovery in the benchmark yield did not return all the way to its level at the beginning of the year.

The Supplementary Budget tabled in June 2020 showed a substantial increase (79%: R344.2 bn) in the borrowing requirement for the 2020/21 fiscal year compared with the estimate provided in the February 2020 Budget Review. The substantial increase in borrowing required, due to the large contraction expected in GDP and the concomitant revenue shortfall, has and will continue to affect public sector borrowing requirements and the yields on this debt place pressure on the SA debt.

The yield curve for South African government debt – presenting borrowing costs at different maturities – shows a marked increase in borrowing costs of around two percentage points for medium to longer dated debt.

Corresponding to the elevation in the yield curve, the results from government bond auctions show an increase in borrowing costs from February through to April. This increase probably reflects the combined effects of risk-aversion towards emerging market assets in the wake of the spread of Covid-19, as well as South Africa's bonds being excluded from the WGBI. Yields on South Africa's newly issued bonds again increased since June. The average bid-to-cover ratio – an indicator of market appetite for a country's bonds – has similarly fallen over the last four months indicating lower overall demand for South African bonds.

Figure 6: Steepening and elevated yield curve indicating perception of higher risk, implying higher borrowing costs

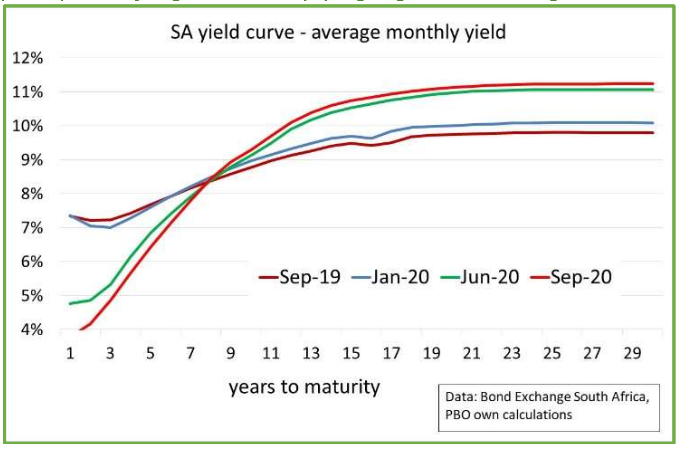


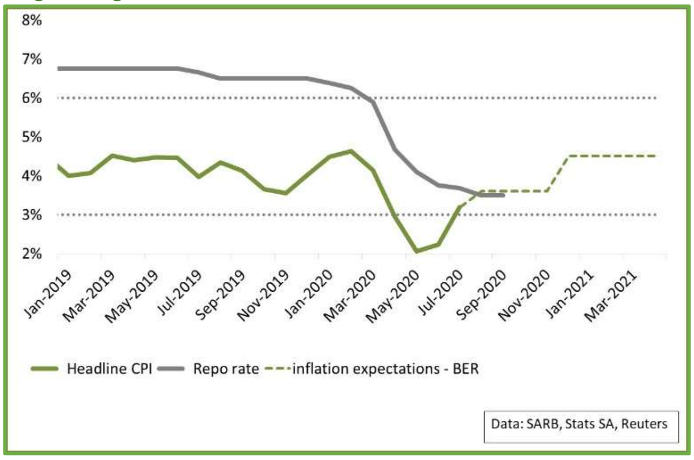
Figure 7: Increasing cost of and decreasing demand for government debt

Inflation and monetary policy

Headline inflation – as measured by the consumer price index (CPI) for all urban areas – has almost entirely remained below the mid-point of the South African Reserve Bank's (SARB) 3 to 6 per cent target range since the end of 2018. Despite the rand depreciating significantly since the beginning of the year, headline inflation fell below the lower bound of the target range. Low inflation primarily reflects the depressed state of the local and global economy due to the economic impact of the Covid-19 pandemic.

The Monetary Policy Committee of the South African Reserve Bank has engaged in unprecedented cuts to the repo rate in the wake of the economic effects of the Covid-19 pandemic. The Monetary Policy Committee cut the repo rate at its January (25 bps), March (100 bps), May (50 bps), and July (25 bps) meetings, but kept rates fixed at 3.5% at its September meeting.

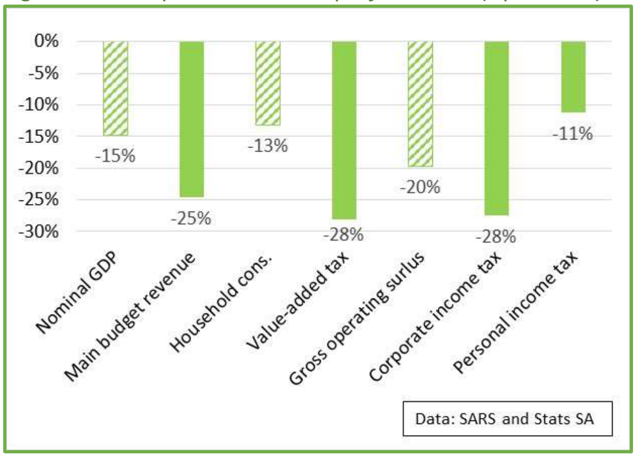
Figure 8: Headline inflation to remain around mid-point of the target range



Public finances

Over the first quarter of the fiscal year - corresponding to the second quarter of the calendar year – the economy experienced large and unprecedented declines in revenue growth across all major revenue instruments. These declines correspond to the large nominal contraction in the economy observed over the quarter. The large contraction in revenue and nominal GDP over the quarter contributed to a large main budget deficit as a share of GDP of 11.7 per cent for the quarter.

Figure 9: First quarter revenue performance (April-June)



Outlook

The Covid-19 global pandemic and the economic restrictions to contain its spread has drastically altered the growth outlook for economies around the globe.

There remain many uncertainties and risks that could negatively affect the economic outlook for the domestic and global economies. These uncertainties and risks include the risk of additional waves of the virus and its effects on economic activity, the lead-time for the successful development and roll-out of a vaccine, and the efficacy of relief measures announced by major economies.

Economic growth is expected to pick up over the third and fourth quarters and over the medium term as hard lock-downs are lifted, and economies start to reopen. However, South Africa's GDP is expected to contract by over 8 per cent this year, a larger contraction than assumed in the Supplementary Budget.