South Africa COVID-19 Level 4 economic impact analysis

Compiled by e-SEK (Date: 10 April 2020)

Introduction

Is the cure worse than the disease? This phrase has been used with some abandon in recent times, when some ponder if the economic damage wrought by the lockdown response against the COVID-19 pandemic is worse than the thousands of lives saved by the intervention.

Yet considering the fast pace of the Pandemic and the haphazard discovery of information to inform strategies against it, it's far too soon to declare any side right or wrong. But we should acknowledge and praise the South African State's quick and clear responses, under the leadership of President Cyril Ramaphosa.

That being said, we cannot ignore damage caused to the economy and the long-term effects thereof. Thus this analysis does not seek to judge different responses or weigh opinions offered around this subject. Instead, what we offer here attempts to be an objective analysis of events in the economy, their likely consequences, and what action could be considered at this stage.

The purpose of this analysis document is to explore the situation and its options, to encourage healthy debate and aid our leaders in making clear decisions. Considering the oblique

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and confusing nature of the pandemic, nobody will get everything right or even most things right. But as the maxim goes, a good plan now is better than a perfect plan later. In the spirit of this, e-SEK presents the below analysis of the South African economy's current and future states.

Level 4 impact analysis

In this follow-up to our initial document, e-SEK will reflect on previous predictions and how the situation has evolved since our previous report. To reiterate some of the remarks opening the previous report, the COVID-19 pandemic is without precedent.

There aren't obvious blueprints to follow, and radical action had to be taken to limit the loss of life. The Government and Presidency should be praised for keeping both death and infection rates below the thresholds seen in other countries. Though it is too soon to declare victory, South Africa has done a great job thus far to contain COVID-19, a fact reflected by praises from expert groups such as the World Health Organisation.

But one of the consequences is damage to economic systems. South Africa has just emerged from a decade of devastating blows to its economy, and it is necessary to soberly analyse that impact going forward. The clearest and shocking example of the devastation is evident in a potential 6.3% contraction of South Africa's GDP.

COVID's local impact

The general outcomes we predicted previously are still in play, such as rising unemployment and the closure of businesses. Yet while the previous report still speculated on those outcomes, the reality is now very evident.

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Tax revenues will be impacted, and the State's debt is rising to take up an overwhelming ratio to GDP.

Yet there is a big positive to take from this: it is clear that when things need to be done, Government can work. If it can follow through by increasing pressure on establishing the best governance structures and models, much of the momentum and gains can be solidified and useful after the pandemic subsides. We are seeing a more decisive state, something that the country has been asking for.

These elements are fundamentally necessary. South Africa is spending more than R500 billion to fight COVID and sustain the economy - money the State doesn't really have. This will be aggravated by the further eroding of the tax base as companies go under and people join the unemployed. To overcome finance hurdles, it will need to borrow from other institutions such as the World Bank and BRICS Bank, cut the deadwood among its enterprises, and deploy more rigorous financial management practices.

Though there is some political dissent about some of these points, the stark reality is that there are no alternatives. There is little fat left to cut, and when there is no fat, the body consumes the muscles. If the Government doesn't act realistically, it will end up significantly weakening the country's capacity and capabilities - possibly permanently.

COVID's global impact

To not repeat too many points from our previous report, we'll focus on what has transpired since at a global level. It's astounding that it took COVID-19 mere months to bring the global financial system to its knees. Airlines that were

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solvent are not crashing out of existence, as what happened to Virgin Airlines Australia.

The reduced demand from airlines and shipping has had a detrimental effect on oil. Coupled with a badly-timed trade dispute between Russia and OPEC, the oil price crashed to its lowest levels in modern memory. Currently, there are oil tankers wasting time at sea, filled with crude that can't find customers or, in some cases, even space to offload.

This should give us an indication of how badly supply chains are also being impacted. Concerns about the stability of supply chains - especially those tied to major trading partners such as China, India and the US - remain serious. We've not yet seen the real impact of the pandemic on major economies, other than now knowing China's growth has already contracted for the first time since the current State there was established nearly a century ago.

We are getting a much clearer picture of how different countries are managing the crisis. Countries such as Brazil and the US do not fill one with confidence, and prolonged lockdowns in India are cause for concern. But at least other nations, such as South Korea, have shown there is a way to get through COVID-19.

Sector-specific analysis

The following section explores the evolving fates of different sectors within South Africa.

Mining sector

As anticipated, demand for South African resources is down, as they have been across the globe due to the abrupt slowing and halting of major economies. These include SA's major trading partners China, India and the

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US. Prices for resources are down - this will affect local growth in the mining sector.

Even though some sectors are being restarted, this will not reverse the above trends. Coal production will return to 100% capacity, but the lower demand from coal customers such as Eskom will not match supply in the near future. This is already evident when Eskom declared force majeure on some of its coal contracts, and the coal industry will need to find alternative markets for its goods.

Platinum mines are also being heavily impacted. Gold will likely not have such a rough ride, due to historically high demand and stockpiling of the resource. But most core resources - coal, platinum, manganese, and chrome - will suffer from vastly lower prices.

The weak rand and under-capacity ports will also reduce returns from resource sales. Other mining activities will return to different levels: opencast mining will return to 50% capacity and other mines to a third of their full capacity. But the Minerals Council expects mining activity won't even reach 50% any time soon due to low demand and other factors.

While those phased introductions will help avoid over-supply, the under-utilisation of labour - coupled with much weaker earnings - will lead to forced retrenchments very soon. Mines are also bound to pursue automation more aggressively in order to ensure their survival. These are virtually guaranteed to cause collisions with unions and will heavily impact mining communities.

It must be noted that mining workforces are particularly vulnerable to COVID-19 infections, due to close working proximities and the prevalence of dis-

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eases such as HIV and TB. Even as the sector prepares to start working again, a second surge in infections could have dire consequences.

The next 3 to 6 months will be very hard for the mining sector. The Mineral Council of South Africa has responded with a 10-point action plan to deal with COVID-19, but there must be expanded engagement with the Government to agree on strategic interventions and stop the mining sector from collapsing.

Mining's woes will cause a ripple effect that is set to impact many other sectors in the South African economy. This is bound to become worse as redirected funds to save mining affect other industries.

Manufacturing sector

The manufacturing sector has both good and bad news for its future. Foremost, it is one of the worst-affected sectors, due to the collapse of exports and stunting of supply chains. Manufacturing, like mining, is also a very time-sensitive sector and any lockdown period will affect it badly. To compound matters, many manufacturers have mining companies as their customers or part of their supply chain.

On the other hand, manufacturing has a capacity to pivot into new roles, repurposing their lines for where demand is. Specifically, many manufacturers are producing safety equipment and sanitation products. Yet this is only sustainable in the short term, and there will need to be more repurposing to ensure they don't shut down. A considerable number of manufacturers will apply for business rescue in the next 3 to 6 months.

Construction sector

Construction is another sector that is affected by the mining slowdown ripple, especially as mines are deferring

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capital projects and redirecting those funds elsewhere. These will be heavy blows to a sector that was already contracting and engaged in consolidation.

Logistics sector

The pandemic and lockdown's impact on logistics remains heavy, though the easing of some movement of goods during phase 4 will alleviate some of those pains. The lower oil price also creates a small window of reprieve in terms of operating costs. But the main concern is the short-term reduced demand from consumers and a long-term slump in demand from export markets.

Again, the slowdown of mines, coupled with the lower demand for mineral resources, massively impact the fortunes of the logistics sector. Ongoing reluctance to open up e-commerce and other delivery-reliant businesses is also limiting the sector's potential recovery.

There are good signs at a micro-level, such as increased deliveries to end consumers. But the big picture is not as positive. A big issue is the limit of cross-provincial traffic, which does not align with the modular and distributed logistics networks that major shipping interests rely on.

Financial sector

It is a rare silver lining that South Africa's financial sector is proving to be as organised and resilient as it is often portrayed. At this stage, there is no indication of a major collapse in the sector, which is being buffered through bailout packages. Several banks have also taken the lead to help distribute the State's bailout funds for other sectors and individuals. Some credit should go to the rapid modernisation of the sector in recent years.

Interventions by the Treasury have

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helped shore up the sector, and many institutions are offering payment holidays. But it is also evident that many are struggling to pay their employees and suppliers, as reflected in several local institutions being downgraded to junk status. It remains an open question whether the current interventions - bailouts and payment holidays - are sustainable.

The financial sector can't be treated as a bulwark against the impact of the pandemic and lockdown. Right now, it's holding out, but that situation can - and likely will - change in the next 6 months. Financial companies that are not active at the moment or not finding ways to repurpose their business models are in particular danger.

Retail sector

The woes of the retail sector are now becoming crystal clear as companies such as Edcon throw in the towel. Low movement at malls are not only hurting retail, but also have a knock-on effect for property owners, discussed further down. Social distancing, which limits traffic in stores, will continue to have a long-term depressing effect on retail numbers.

Many retailers, particularly those based at malls, will apply for business rescue. Practically all of the sector will need to review their business models. Some retailers have been able to expand or pivot into new areas, though.

Property sector

The property sector is in serious trouble. At the moment landlords are taking the blows as many of their customers - particularly retailers - need rent holidays or reduced rents. This issue extends into the private property sector as well, both in terms of rent and limiting the ability to sell property. It's very likely property prices will drop in the residential market.

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But there is a bigger concern. Remote working has awakened companies to the effectiveness of this model. Along with a need to cut costs, many companies are likely to significantly reduce their office footprints in favour of arrangements such as hot-desking. This will have a profound impact on the property sector and might even equate the bursting of a property value bubble. Even though property prices aren't necessarily artificially inflated, the drop in demand might cause a collapse similar to as if it were inflated.

This will have a massive knock-on effect. Property is regarded as a prime investment vehicle and many major investors, such as pension funds and the PIC, rely on property-based returns. Considering some of these funds are being used to fight COVID-19's impact on health and the economy, such efforts might soon find their foundation eroding very quickly. Defaulting on property loans due to reduced rent will also have a big impact on the financial sector, which is already offering payment holidays. But the long-term sustainability of such tactics is not assured at all.

Automotive sector

The thin margin/high volume business models of the automotive sector are being crushed by the pandemic and lockdown, leading to much lower shipping or vehicles as well as very low demand from consumers. Though it is not obvious yet, this might be the most affected sector in this crisis, which is of big concern to South Africa and its vast automotive manufacturing sector.

To grasp how sensitive this sector is, just consider how the 2011 tsunami that hit northern Japa decimated Toyota's part supply lines - an event that took years to correct. That was one manufacturer and affected one of its prod-

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uct sectors. The COVID-19 pandemic is hitting every part of the automotive industry.

The slowdown of logistics and general people movement also means the lower wear on vehicles and thus delayed spending on maintenance and replacement. It's also very likely that general maintenance and replacement activities will reduce as funds grow less and owners are forced to sweat their vehicles for longer. The sector has already experienced major drop in first- and second-hand vehicles, unprecedented in living memory.

This sector will face serious medium- and long-term challenges. But it may not be first in line for bailouts, even though it represents a significant percentage of South Africa's workforce. The automotive sector will have to revisit its workforce and business models. It will also likely defer infrastructure investments, specifically the massive Rosslyn Hub Development launched in Tshwane.

Aviation sector

Aviation is well up the creek with no paddle in sight. This is clear from airlines that were sustainable businesses going into business rescue, such as Comair and Virgin Australia. The heavy reduction in airline traffic has already nailed the coffin of SAA and its auxiliaries, and efforts to revive these or replace them are both pyrrhic and underestimate the long-term damage to this sector. It is very likely that many more airline will fold and the sector will only recover after significant consolidation activities.

The closed borders and reduced people movement is devastating the aviation sector, as well as industries that rely on it, such as logistics and tourism. In fact, we could equate the ripple effect caused in this sector to that emanating from the mining sector. ${}^{2}/_{5}$s of airport traffic has been lost, impacting

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even airport revenues and the sales of airport retail sites.

South Africa should be very concerned about two major impacts stemming from this sector: the future viability and liquidity of ACSA, and difficulties implementing the crucial Africa Free Trade Agreement.

Tourism and entertainment sector

Another major loser in the lockdown will be the tourism sector. As it's a big part of South Africa's growth strategy, this is a significant concern. One in every twenty jobs in sub-Saharan Africa is in this sector.

The ongoing uncertainty and racialisation of bailouts for the sector will only cause more damage to a sector already very hurt by a decline in visitor numbers. Tourism will also be one of the last sectors to recover, as it is negatively impacted by a slowdown in economic activity and travel, a slowdown in disposable income due to looming global recession conditions, and ongoing social distancing.

Beyond this, work-from-home cultures and growing austerity measures among businesses will radically reduce physical conferences and business travel, both high important revenue streams to the entertainment sector. Entertainment production has already been impacted, leading to fewer local jobs and a growing reliance on international entertainment imports. Live engagements such as concerts and theatre productions have yet to find a new working model during the pandemic.

The most optimistic estimates are that tourism in some countries will take 10 months after the pandemic to recover. For developing economies such as South Africa, this may take well over a

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year or even longer.

Education sector

The education sector faces a very uncertain future. The most urgent priority is trying to salvage the current academic year. This may be less of an issue at tertiary levels, where many universities and colleges have invested in systems to enable remote learning. That being said, many of those investments were projected on campus activity, and the long-term ROIs of those projects are in doubt.

Campuses will have no choice but to change over the next 2 to 3 years to adjust to the new realities of the pandemic and post-pandemic world. Since some campuses are used by tens of thousands of students, this will be a significant challenge. Some universities are offering data bundles to staff and students. But given the high prices of mobile data, this is an expensive and likely short-term intervention. Unless South African internet access becomes significantly more affordable, education institutions will soon suffer more.

Campus students are very engaged through libraries, lecture facilities and sporting events. These types of congregations make them the most at-risk group outside of township residents. It's a factor that has to be considered very carefully and with urgency.

Basic and secondary education is in for a much tougher time. Very few schools outside of the 4th and 5th quintile groups have access or means to fund access to online education. Though there has been some reduction in data prices, as well as zero-rating of selective educational services by mobile networks, these moves are mostly symbolic and fall far short from meeting the needs of most South African students and teachers. Outside of affordable data, many schools don't

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have access to devices, and some don't even have access to electricity.

The Government has introduced a multi-model campus strategy, including online access. But as mentioned above, these won't fully mitigate the loss from on-campus infrastructure investments - not only technology services, but science programmes and laboratories.

More than ever, the call to align basic education with industry needs should be met. Efforts must be made to create closer cooperation between schools and industry, both to meet the skills gap and to help schools create sustainable learning environments. But at the very least, we can anticipate an increase in graduate unemployability, due to a drop in quality and contracting industries.

Telecommunications sector

Telecommunications remain the biggest winners in the COVID-19 pandemic. Remote-working and other digital activities leverage their infrastructure, and there has even been ample expansion of support for them through extra spectrum allocation. Recently the Telkom copper network was made more accessible to competitors, a move that some have called for since the early 2000s. Vodacom has also fast-tracked the release of its 5G network.

But despite these advantages, the price of mobile data and general connectivity remains very high and out of reach of most South Africans. The pandemic has made South Africa's digital divide even more obvious, and the largely-symbolic price cuts offered by networks come nowhere close to addressing this gap in our historical context, let alone the demands made by the current pandemic situation.

Telecommunications is arguably the

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most resilient economic pillar during and after the pandemic. If this sector could be convinced to become even more flexible and supportive, it could greatly alleviate several of the factors currently causing damage to South Africa's society and economy. At the moment, this is a very underutilised resource.

Insurance sector

COVID-19's impact on the insurance sector is still delayed, but likely to be devastating when it arrives. Foremost, many insurers are not prepared or funded for such a catastrophe - and some insurance products such as loss-of-income insurance already don't cover the pandemic. But even if they did, it's an open question whether sufficient funds are available to honour those payouts.

An influx of enquiries is also consuming the sector's resources, as is the ongoing task of determining the future risk of a very unclear situation. Insurance companies will need to review policies to see if all their sectors are covered in terms of the Government's risk-adjusted model. For example, how should insurers react if a company has an outbreak, but didn't implement all the protocols? Insurers will need to move faster to repackage their policies and adequately address the unfolding crisis.

Two other key factors will impact this sector. First, there is likely to be a dramatic rise in claims around unemployment, income loss, life and medical. Second, many insurance companies are invested in government bonds, which in turn are under severe pressure from the crisis. By most measures, the insurance sector is a ticking time bomb.

Treasury

The State Treasury has been very proactive in offering bailouts and other

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mitigating strategies. A support package of at least R500 billion has been created. But there are several key concerns that aren't entirely in the Treasury's control.

First, its strategy is a multi-pronged approach that needs the active involvement of multiple state departments and the municipalities. There is credible doubt that either group has the measures and controls in place to effectively and prudently manage the resources allocated by the Treasury. Given reports of selective food parcel management and graft, it's very likely similar underhanded activities will manifest in terms of distribution treasury resources.

Second, the bailout amount is astronomical - roughly 10% of GDP - and must be created by a state that has very little fat left to cut. A decade of bad management practices has left the State nearly bankrupt. Despite ideological and political protests against the move, the State will have to approach the BRICS Bank, IMF, World Bank and other lenders for support.

Other funds such as UIF, pension funds and the PIC are going to be drastically reduced by the joint impact of lower investment, property price collapses, reduced investment statuses, reduced contributions due to liquidations, and the fight to defeat COVID-19. Those resources cannot be relied on in the medium or long term.

It's important that all stakeholders respond to lending interventions with an open mind. It's an issue of perception that the institutions have their own agendas. But the institutions are there to support members - members have the right to borrow money from them.

Yet such debt also has dangers. The weak rand is pushing up debt payments, and bad debt management

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has consequences. For example, Zambia is currently losing control of key institutions to Chinese lenders. Yet a total opposition to lending will not help that, instead only serving to limit Treasury's negotiation scope. The two extremes to result from this are either a bankrupt and collapsed state or lending agreements that are even more draconian than what those currently opposed to the practice anticipate.

Third, the moves made to alleviate unemployment will create long-term headaches for the budget. For example, the increase of R350 to grant receivers is said to be temporary, but by all likelihood would have to become a permanent expenditure as poor South Africans will not let go of what meagre amounts they receive. It would be socially and politically untenable to reduce the grant after the proposed six month period.

The Government must create assurances that funds such as the grant, UIF and others will not be depleted. Yet expecting the State to be a guarantor without securing extra funding through lending is wishful thinking.

Municipalities

South Africa's municipalities are on a slippery slope. Existing problems of poor management, graft and underwhelming service delivery will be impacted as more of their residents become unemployed. And businesses liquidate. This will impact major income sources, such as property taxes and rates payments. It is very timely to ask if municipalities can continue to exist in their current form.

To avoid a humanitarian disaster, service delivery musn't collapse. The emergency provision of water is a key delivery issue. Poor communities don't even have regular access to drinking water, let alone washing hands. Providing food and shelter has been

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chaotic, needing more coordinated approaches. These services must be strengthened. Additionally, municipalities need to prepare to review and issue food permits, particularly to informal traders.

There is also a knock-on effect in funds reaching those who need it. Significant confusion continues around how to access disaster management funds, particularly for SMEs. Mixed and sometimes racialised messages from different government sources are compounding the problem. Clear communication protocols are needed at municipal levels to follow the State's strategies. SALGA needs to deliver clear messages from the top that municipalities can follow.

With the disbursements of funds, accountability is required. Municipalities can't violate the public finance management act. Governance needs to be strengthened and have extra capacity, for if there is lax accountability, there may end up with money being misused.

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