The real impact of the unrest on SA's economy

By Carmen Nel

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As calm steadily returns after the recent social unrest, analysts are hard at work tallying the cost of the looting and disruption to economic activity. So far, the damage to 2021 growth is estimated at between 0.5 and 1.0 percentage points.

Carmen Nel, economist and macro strategist, Matrix Fund Managers

The market impact belies the severity of the unrest. Yes, the rand and bonds weakened, but in the bigger context, the declines were muted. This probably reflects two things: firstly, that global conditions tend to dominate, and secondly, that SA assets already embed a substantial risk premium. This does not mean that markets will be impervious to renewed local turmoil, but recent events have not been enough to offset the benefit of high commodity prices, the current account surplus, and the decline in weekly issuance.

Conceptual impact of the recent social unrest

- **Short-term impact**
  - **Growth: The impact will be unambiguously negative, as two of the largest – by activity and population – provinces were affected by the disruptions. Gauteng accounts for roughly 34% of national GDP, while KwaZulu-Natal contributes around 16%. The unrest affected the supply side of the economy, via store and road closures, damage to infrastructure, inventory losses, and uncertainty around job security. The disruptions to road and port logistics will have a negative, albeit temporary, impact on exports and imports, while the refinery closure will dent short-term petroleum supply, which will have a knock-on effect through the supply chain. Various commentators have suggested that supply chains in the affected areas could take up to three months to be fully restored.**
  - **Inflation: The supply-chain disruptions could lead to higher prices in the affected areas and sectors, but the unrest is unlikely to have a large, immediate impact**

    on consumer price inflation. The exchange rate, aggregate supply/demand balance, and inventory cycle usually influence price formation with a lag.

    - Fiscal position: The unrest will be negative for revenues via lower net tax receipts, particularly net VAT receipts, as well as lower corporate income tax. The shortfall may be more acute in the retail sector, given that the damages were most notable to malls and by extension retailers. This would be over and above the loss in excise revenue from the Level 4 alcohol sales ban. A measure of the revenue losses may be offset by revenue gains from the positive terms of trade boost.

      Sovereign credit ratings: We think the impact is neutral, for now, given that the unrest has petered out. The ratings agencies have flagged prolonged disruption as a negative factor, but the major agencies – Moody's, S&P, and Fitch – have conservative macro assumptions and already high debt levels built into their credit assessments. Granted, if there are further rounds of severe social unrest and attendant anarchy then the impact on the adverse rating dynamics will accelerate.
    - Monetary policy: The renewed uncertainty and downside risk to GDP growth should make the SA Reserve Bank (Sarb) somewhat more cautious on the timing and pace of normalisation. The Level 4 lockdown coupled with the protests will very likely dent consumer confidence amid already weak credit growth, the post-Covid jobs shortfall, and subdued income growth. Global considerations remain important, however, but even on this front, the immediate need to raise rates more aggressively has dissipated as the Fed has backtracked somewhat on its perceived hawkishness. Importantly, the rand has remained resilient, which also negates the need for tighter monetary policy in the very short term.

- Medium-term impact
    - Growth: An upside from the unrest is the anticipated repairs to infrastructure and rebuild in inventories, which should offset much of the immediate weakness. However, the net effect could still be negative given the hit to business and consumer confidence, as well as the potential for permanent job losses. Even so, supply-chain normalisation will boost local trade activity, as well as exports and imports.
    - Inflation: Assuming a relatively quick normalisation, the current disruptions are unlikely to have a major impact on inflation. Base effects remain in play, causing some volatility in cyclical inflation. Moreover, weaker confidence and lower income levels should result in lower demand growth than would have been the case, which should offset some of the frictional inflation associated with

temporary supply limitations.
    - **Fiscal position: Lower tax revenues associated with business closures will be met with pressure to support employers and households via the Unemployment Insurance Fund (UIF) Covid-19 Temporary Employer-Employee Relief Scheme (Ters) and renewal of the Covid-19 Social Relief of Distress (SRD) grant. Based on the uptake of the SRD grant over the past year, the cost to the fiscus is estimated at up to R2bn per month. This could be absorbed via the contingency reserve, as well as the likely additional revenue overrun associated with the positive terms of trade boost. Hence, there is some room in the fiscal position to absorb temporary measures without derailing the short-term debt stabilisation drive.**
    - **Sovereign credit ratings: The degree of support and hit to tax revenues could add to the already negative bias in the rating outlook. However, it will depend on the duration of support and whether there are mitigating factors via reform.**
    - **Monetary policy: The monetary policy outlook will depend on the pace of the rebuild, the evolution of inflation and inflation expectations, as well as global policy dynamics. A rapid rebuild and supply-chain normalisation should lead to a renewed focus on policy normalisation, which would be in keeping with expectations for the first hike by the end of the year.**

- **Long-term impact**
    - **Growth: The potential for a sustained negative impact on domestic business confidence, as well as on foreign investor sentiment towards SA will very likely lead to lower investment levels and, as a result, lower productivity and potential GDP growth. This will, in turn, limit the capacity of the economy to create jobs, resulting in a higher unemployment rate. Lower capex will also reduce the economy's competitiveness in export markets.**
    - **Inflation: Lower potential growth and capital formation would lead to a smaller output gap, which, according to the Sarb's framework, will contribute to higher inflation. Various analysts have already commented on a short-term stagflation environment – both here and abroad – but a sustained fixed investment retrenchment risks a more durable period of stagflation, akin to the late 1980s and 1990s.**
    - **Fiscal position: The combination of a smaller tax base due to lower productivity, business closures, and job losses, will be met with increasing pressure for welfare support. Given already curtailed fiscal space, the government's financial position will come under renewed pressure once the commodity price cycle has run its course.**
    - **Sovereign credit ratings: Renewed declines in per capita GDP growth and rapidly rising debt and debt servicing costs will most likely result in another round of credit rating downgrades on a two to three year horizon.**
    - **Monetary policy: While lower potential growth would usually result in a lower real neutral interest rate, the Sarb's current framework incorporates a risk premium that could more than counter the fall in growth. In addition, if the rand depreciates due to the deterioration in domestic fundamentals – lower credit ratings and eroded productivity differentials – then the FX-induced inflationary pressure would contribute to a higher policy rate. This assumes that the Sarb's independence remains intact over the longer term.**

ABOUT THE AUTHOR

Carmen Nel is an economist and macro strategist, Matrix Fund Managers.