# ECONOMIC IMPACT OF THE RECENT UNREST

## SELECT COMMITTEE ON FINANCE

AUGUST 2021

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# THE UNREST THAT OCCURRED IN BOTH GP AND KZN IS EXPECTED TO WEIGH ON GDP GROWTH



- **KZN and Gauteng collectively account for ~50 per cent of national GDP.**
  - KZN has borne the brunt of the unrest and they alone account for 16 per cent of national GDP.
- South African Property Owners Association (SAPOA) reported that **the cost of unrest exceeds R20 billion in KZN** alone with the impact on **national GDP** estimated to be **R50 billion**.
- **Over 200 shopping malls were targete**d, majority of them having been looted and damaged.
  - 1,787 retailers' stores were impacted and damaged.
  - SAPOA has suggested that the rebuilding of malls may take up to two years depending on the extent of damage and the size of the shopping centre.
- The damage to the retail industry is anticipated to **exacerbate unemployment**, particularly in 3Q2021.
  - The Gauteng provincial government estimates that 14,500 jobs have been affected by the unrest in the province
  - Intellidex estimates that 150,000 jobs are at risk in KZN with 40,000 businesses having been affected.
- Rebuilding is likely to contribute positively to GDP, but the **induced uncertainty is anticipated to remain in the near-term** from the recent unrest.
  - Evident in the rising sovereign risk premium and the weakening of the Rand.
  - These factors potentially pose downside risks to future investment prospects.
- **Reports of unrest in other provinces** (Mpumulanga, Northern Cape, and Eastern Cape) were also received, although the damage appears to be limited.

# A SUMMARY OF HOW SOME OF THE SECTORS WERE AFFECTED BY THE RECENT UNREST

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- **Transport sector** was impacted by various supply chain interruptions,
  - …including movement of trucks, fuel shortages, rail line disruptions, staff availability, and shutdown of roads leading into and out of the ports.
  - Specifically disruptions to Durban and Richards Bay port operations, rail link between Durban and Gauteng and general truck transport along the N3 corridor.

- **Agriculture sector** was directly impacted in KZN through limited market access and transport disruptions
  - Transport trucks unable to reach diary farms, unable to send livestock to abattoirs, mills unable to process burned sugar cane and citrus exports were suspended.
  - Impacted on input costs, food supplies and expectations around food inflation.

- **Mining sector** continues to benefit from favourable pricing environment, higher demand, and economic recovery, but the unrest may still impact the sector
  - … some mines reported operation closures as a preventative measure to protect staff, and transportation blockages will affect mining exports.

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- **Manufacturing output** was impacted through damage to manufacturing plants and lingering logistical issues constraining the sector and negatively impact on the cost of production
  - SAPREF, which is responsible for 35% of the country's fuel supply, temporarily shutdown its crude oil refinery due to the unrest.
  - LG electronics TV manufacturing plant in Durban was burned down and its warehouse looted (opened in January 2020 and created 100 jobs).
  - In Isithebe Industrial Park, a new clothing factory (Kingspark Manufacturers) set up in September 2020 has been destroyed as machinery and raw materials have been looted resulting in 600 jobs being lost.
  - Food manufacturer Tiger Brands estimates the costs of the loss of stock to be in excess of R150 million.
  - South African Breweries (SAB) has suffered losses close to R80 million due to the ongoing riots, with its depots in Pietermaritzburg and Newcastle being heavily affected.
  - Toyota South Africa Motors suspended production at its Prospecton plant in Durban and exports from the plant have also been halted.

- **Surveys by the BeyondCovid research initiative indicate that SMMEs account for 89% of the businesses impacted** by the unrest:
  - Only 6% of impacted businesses are open as usual, while 51% of impacted business in the two riot-affected provinces have closed, of which 7% have closed permanently and 44% have closed temporarily.

# SOUTH AFRICA RISK PREMIUM INCREASES MORE THAN PEERS RECENTLY

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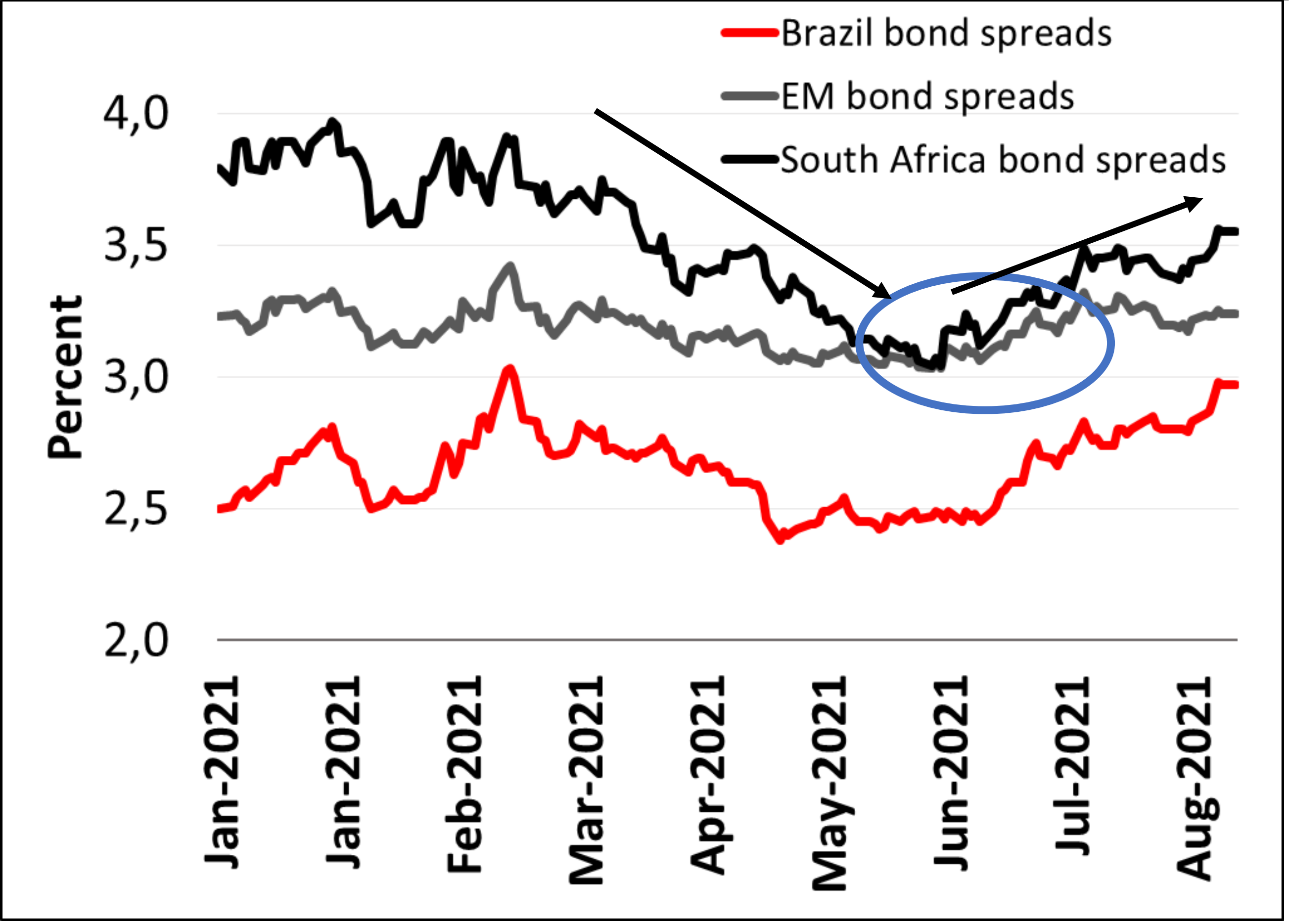
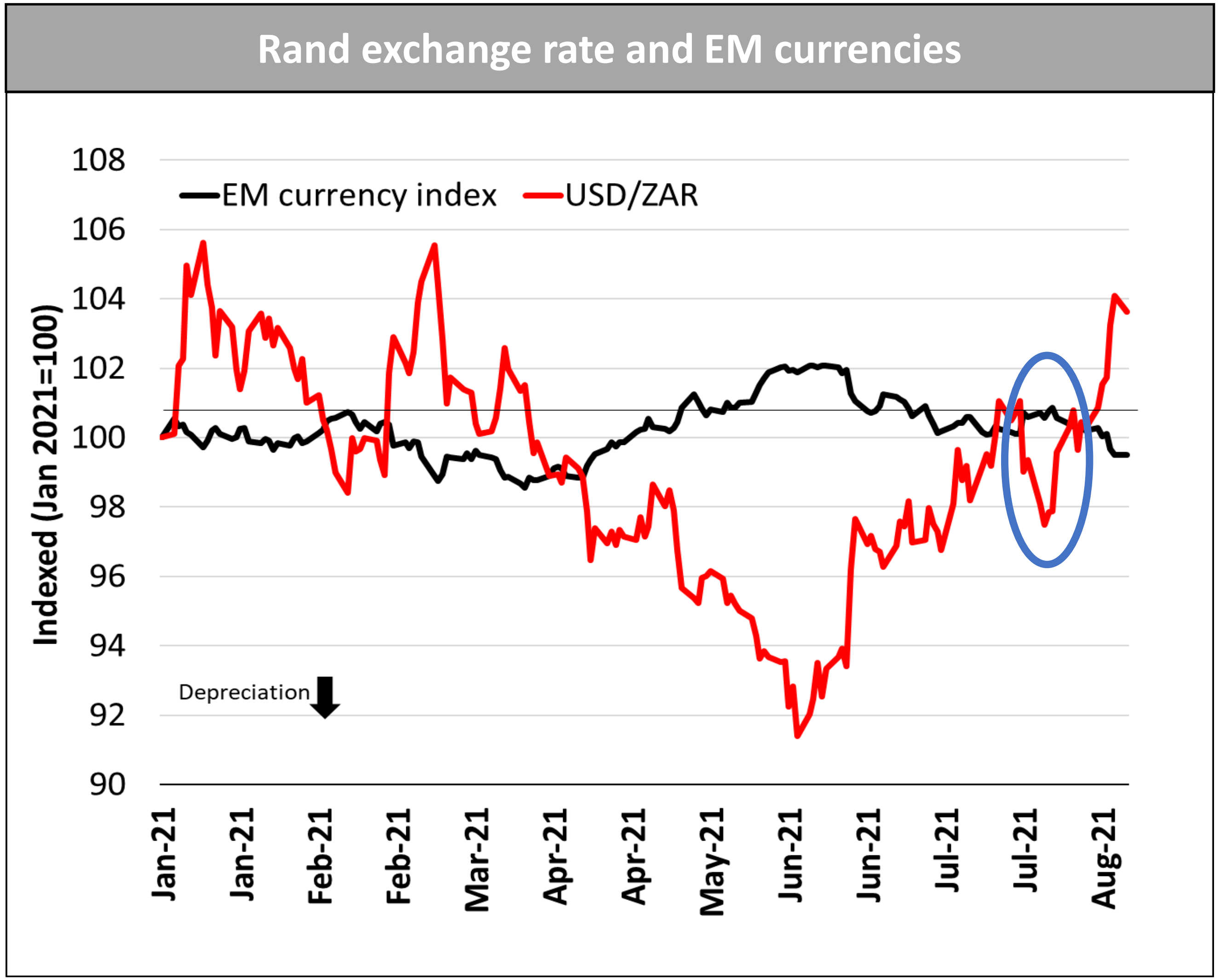
**Risk premium****




***Risk premium is measured as the difference (spread) between the yield of a 10-year bond of country A and the yield of the US 10-year bond. Spreads narrowing = risk premium decreasing, spreads widening = risk premium increasing*

- SA risk premium decreased consistently from March to June 2021, in contrast to our peers.
- Emerging market (EM) and SA risk premiums have increased since then
  - largely due to a drop in US bond yields as the US Fed kept its policy rate outlook unchanged in July as well as
  - the Delta-variant of Covid-19 dented sentiment posing downside risks to global growth.
- SA's risk premium however widened faster compared to EM peers as a result of social unrests in July 2021.
- Between 9-19 July, SA's risk premium was **up 0.21 percentage points** (pps) compared to 0.12 pp and 0.13 pp for EMs and Brazil.

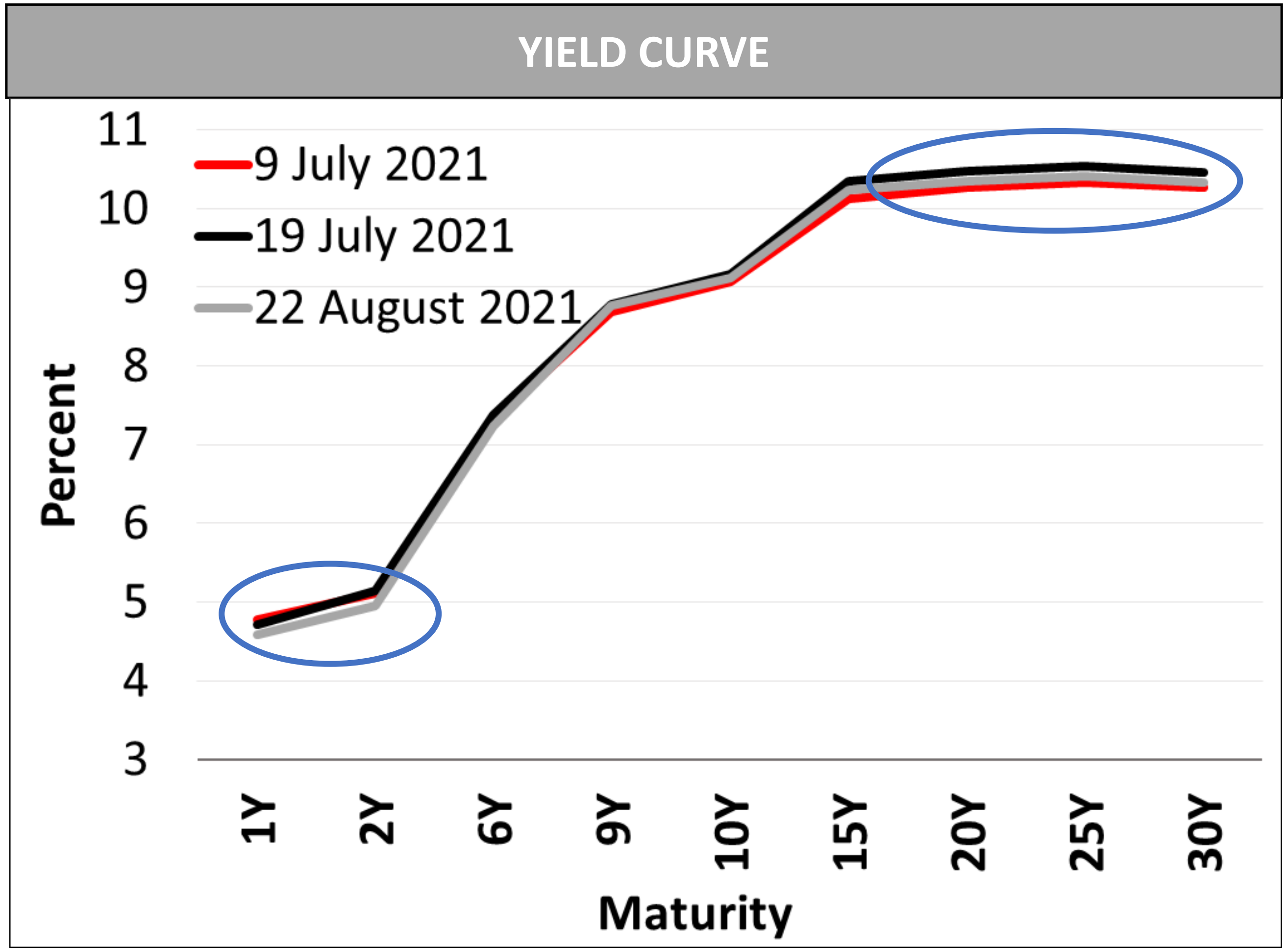
# THE RAND DEPRECIATED DUE TO INCREASED UNCERTAINTY EXACERBATED BY THE UNRESTS




- The rand has been appreciating since June 2021 largely due to rising commodity prices.
- Between 9 and 19 July 2021, the rand **depreciated by 2.4%** from R14.22 to **R14.57** to the US dollar
- Over the same period, the EM currency index was unchanged at 0.0%, suggesting rand declines which were unusually large and driven by idiosyncratic risks related to the unrest.
- The rand however had recovered since then bolstered by the US Fed indicating they are keeping their interest rate stable even as US inflation is increasing.

# LONG TERM BORROWING COSTS REMAIN ELEVATED AFTER THE UNRESTS






- Longer term borrowing costs increased in July due to the social unrests but have recovered somewhat.
- The local 10yr bond yield was trading at 9.06% on 9 July compared to **9.16%** and 9.12% on 19 July and 22 August respectively
- The local 30yr bond yield was trading at 10.26% on 9 July compared to **10.46%** and 10.33% on 19 July and 22 August respectively
- The increase in longer term rates reflected investors uncertainty about local political risks following recent riots and its implications for the country's economic growth and fiscal position.

# WHY IS THE YIELD CURVE AN IMPORTANT MACROECONOMIC INDICATOR?

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- South Africa's yield curve shows the interest rate payable on government debt issuances at different maturities
  - The longer the maturity the higher the interest rate payable to reward investors for the risk. For example, we pay a 10.5 percent interest rate on our debt that is issued for 20 years.
  - Therefore, for every R100 bn that government borrows, it would cost an additional R11 bn and add to the stock of debt.
- It is not possible to issue all our debt in the short-term because it will increase refinancing risk – the risk that we won't be able to pay the debt when due or at very high interest rates.
- Our yield curve determines the cost of borrowing: over time, the higher cost of borrowing translates to higher debt servicing costs which for 2020/21 was estimated at R233 bn (compared R247 bn allocated for Health and R219 bn for Peace and Security)
- To lower our debt-service costs (and create more room for other spending) we have to lower the interest rates we pay on our debt, which can be achieved by:
  - A lower budget deficit which improves the sovereign risk premium and help bring down the cost of borrowing,
  - Higher economic growth, and
  - Lower inflation (which improves the real return of our debt and its relative attractiveness)

# UNREST WILL LIKELY HAVE NEGATIVE IMPACTS ON GROWTH BEYOND 2021

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- The economic damage from the unrest could shave between 0.7 and 0.9 of a percentage point from GDP growth in 2021.
- The shock does not account for the potential value chain disruptions and the resultant potential second-round price/output effects.
- Literature estimates that GDP still remains below some pre-shock level after 6 quarters.
- We are concerned about the **potential scarring effect on employment and sentiment** that may outlive the shock and impact potential growth.

- The third wave of the pandemic and recent unrest will likely impede the innate momentum in the overall economic recovery.
  - **Damage to commercial property** and looting of stores related to unrest will directly impact economic activity, exacerbate unemployment, affect household income, and further constrain business confidence.
  - PMI and car sales data for July show **early signs of some economic impacts**.
  - **Unrest does not bode well for business confidence** and spending on fixed investment.