How will growth play out in a #Covid-19 & load shedding world?

By Arthur Kamp

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The year has barely commenced and GDP growth forecasts are being revised lower. Why is growth weakening?

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Load shedding dims SA growth

Electricity load shedding, which hit SA GDP in the last quarter of 2019, triggering a recession, is usually one of the first culprits identified, although the modest gain in mining GDP in the quarter is an interesting development. Historically, this industry has been sensitive to electricity outages. But, seemingly, mines have adapted to cope better with relatively low intensity electricity load shedding.

In the end, though, the 1.4% fall in GDP in the last quarter of 2019 surprised already subdued consensus expectations, leading to downward revisions of growth forecasts for the year ahead.

But, whereas we have a reasonable handle on the impact of electricity outages on GDP growth, the same cannot be said for the spread of the coronavirus (Covid-19).

It's reasonable to expect panic to be followed by economic recovery

If the severe acute respiratory syndrome (SARS) outbreak of 2003 is a reliable a guide, the near-term hit to global growth should be followed by a V-shaped recovery. This would have a limited impact on global economic activity and the South African economy for the year overall.

The global manufacturing and service purchasing managers' data for February 2020 confirms a material slowdown in growth is unfolding. It is severe, led by exceptionally weak data in China. And, it could intensify.

Does available data suggest a V-shaped recovery is plausible? On the plus side the daily increase in reported Covid-19 infections in China has slowed to close to 0%, while the number of active cases in the country is around half the cumulative number of infections recorded. Further, anecdotal evidence and some (although by no means all) high frequency data releases suggest China's economy is slowly preparing to return to production.

However, as the virus has continued to spread globally over the past week it seems increasingly likely the impact on the world economy may be more prolonged and deeper than initially thought. Perhaps the recovery will be U-shaped, rather than V-shaped. But, either way in the base case scenario, the global economy is expected to recover in the second half of 2020.

Our flexible exchange rate may absorb some of the shock of a base case scenario

If so, the impact on South Africa is expected to be negative, but partially contained as we rely on the flexible rand exchange rate to act as a shock-absorber, supported by monetary policy easing as the collapse in oil prices should help contain inflation. The problem is South Africa's current potential growth rate is so low and its unemployment situation so dire, that even a small hit to economic activity is keenly felt. Also, likely further worsening of South Africa's already unsustainable fiscal position could constrain the extent to which the Reserve Bank responds.

The "what-if?" scenario

Economists are at a disadvantage, though, when analysing epidemiological events. There are many moving parts and a dearth of important information. What is the true transmission rate of the virus? Are the number of infections substantially under-reported? What is the true death rate? Is it significantly lower than currently reported, or not?

Estimates of the damage to the economy are open to adjustment as new information becomes available. To start, it is not known whether the number of infections will increase again in China once production commences.

Also, even though the reported incidence of Covid-19 infections outside China has been highly concentrated in three countries (Iran, South Korea and Italy), the prevalence of Covid-19 is increasing elsewhere. Indeed, the number of countries reporting infections have quadrupled since early February 2020 to more than one hundred. And, reported Covid-19 infections outside China have been increasing by an average of around 20% per day since late February 2020.

The risk of transmission through the world may be higher than we think and it is possible Covid-19 may spread through the northern hemisphere in the months ahead, before permeating to the southern hemisphere as we head towards the winter season here.

Irrespective of the development of the virus, SA growth will be constrained

Much now depends on behavioural patterns. Assuming individuals go about their daily work and home lives as per usual to pay the bills, then "normalisation" of economic activity and human interaction is likely in the months ahead, in which case the global economy still recovers in this year with relatively limited damage.

On the other hand, if, as is the case currently in Italy, the nascent clamp-down on transport, tourism, trade and events intensifies as the virus and associated news spread; and if more and more consumers in more and more countries seek to limit human contact and reduce discretionary consumer spending, the negative impact will probably be prolonged. If so chances are the impact of the virus on economic activity does not unfold in a neat, predictable fashion. One would expect further downward revisions to growth forecasts, a disinflationary impulse in the near term, interest rate cuts (the US Federal Reserve has already cut its target range by 50bps in response to the virus), use of central bank balance sheets and, probably, fiscal loosening.

In the absence of sufficient information the view is as clear as mud. The collapse in oil prices helps the terms of trade but, the bottom line is, either way, the outlook for the South African economy remains severely constrained as the outbreak arrives at a time when our economy is weak and vulnerable, against the backdrop of an unsustainable fiscal position. In the interim, there is an argument to be made that monetary policy easing abroad is creating room for South Africa. An interest rate cut looks likely next week. Our deteriorated fiscal position may give pause for thought, but possibly only temporarily. This consideration may merely limit the extent of the expected cut in the Reserve Bank's repo rate.

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