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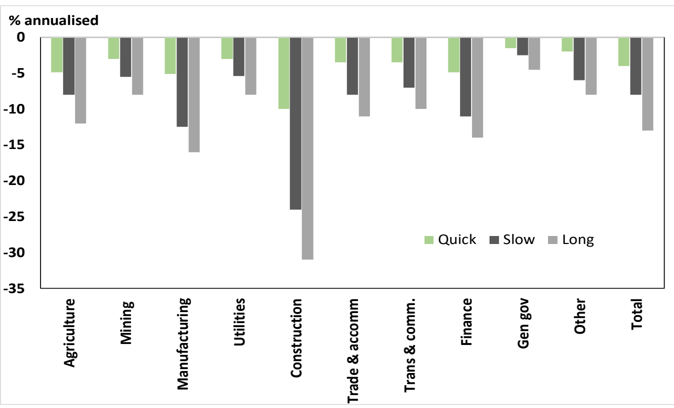
COVID-19: Budget and Economic Impact

Economics | South Africa

The South African economy is expected to experience worst economic performance in history

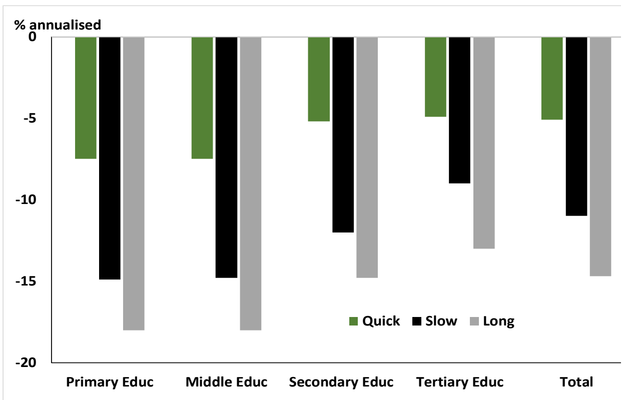
- National Treasury released a document in which they assessed the likely impact of COVID-19 on the economy and the national budget.
- The analysis was conducted using an input-output multiplier model, which captures the direct and indirect impact of shocks to the domestic economy. The outcome around the assumptions are summarised in three scenarios: ‘quick’, ‘slow’ and ‘long’.
- The **‘quick’** scenario appears to correspond to the assumptions also referred as the base scenario. These include: a slowdown in the rate of new infections by the end of the second quarter, the total lockdown is limited to 21 days, after which less strict measures are adopted but social distancing continues. Tourism performs below 50% pre-crisis levels, global demand is supported by stimulatory measures and domestic spending and investment start to pick up in the third quarter, benefiting from low interest rates and government stimulation. The economy starts to operate at 70% pre-crisis levels by the end of the second quarter and by 90% by the end of the third quarter. This scenario assumes that the pandemic is contained quickly and the economy bounces back convincingly. Under this scenario real GDP is forecast to contract by around 5.4% in 2020.
- Under the **‘slow’** scenario National Treasury assumes that pandemic takes longer to contain, causes greater underlying damage in terms of production capacity and employment and therefore the economy is much slower to recover. Under this scenario real GDP is forecast to shrink by 12.1% in 2020, with fixed investment collapsing by 26.6% and consumer spending plunging by 11.4%. Under these circumstances, there are significant company failures and large job losses.
- Under the **‘long’** scenario the pandemic takes even longer to contain, resulting in a slow progression through the various levels of lockdown. However, National Treasury still assumes that the worst is over by end-2020. This results in a very slow economy recovery, with a big hit to both domestic investment and demand. Under this scenario real GDP contracts by 16.1%, with fixed investment and consumer spending falling by 33.8% and 16.8% respectively.
- **All sectors will be affected negatively in all scenarios**, but the hardest hit will be construction, manufacturing and finance, while ‘trade, catering and accommodation’, mining as well as ‘transport, storage and communication’ will suffer large contractions.
- The direct impact on households will be reduced income, which cannot be avoided in all three scenarios as further job losses are expected. In all scenarios, the most affected sector is construction (which will lose over 30% of jobs on an annualised basis in the ‘long’ recovery scenario), followed by manufacturing and finances, while job losses in government will be kept at relatively modest levels. The largest number of jobs will be lost in the category of people with primary to middle levels of education.

Chart 1: Impact on employment



Source: National Treasury

Chart 2: Impact on wages and salaries by various levels of education



Source: National Treasury

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- Reduced economic activity due to the lockdown will have a significant impact on government revenue. Under the 'lockdown' or 'quick' scenario total tax revenue is estimated to be around 27% lower than pre-crisis levels, while this figure increases to 28% under 'lockdown plus' or the 'slow' scenario and up to 33% lower in 'full' impact or 'long' scenarios. The biggest losses will be on import taxes (55,6% in full lockdown), but this category accounts for only 4% of tax revenue. The biggest category - households and enterprises – which accounts for 55% of the tax revenue, will suffers up to a 25% reduction in the worst-case scenario.

Table 1: The impact on revenue on different scenarios

	% of total tax revenue	Lockdown (Quick)	Lockdown plus (Slow)	Full (Long)
Production tax	6.5	-27.9	-29.9	-33.8
Import tax	4.0	-44.5	-45.8	-55.6
Domestic sales tax	34.5	-34.1	-34.8	-41.8
Direct tax on households and enterprises	55.0	-21.1	-21.8	-24.8
Total Tax	**100.0**	**-27.0**	**-27.8**	**-32.5**

Source: National Treasury

- National Treasury stressed that these scenarios are for illustration purposes to show the broad economic impact of the pandemic. Normal planning processes, which will include macro-economic forecasts, revenue projections and the policy framework will still be conducted.

Table 2: The impact on growth in different scenarios

	Quick	Slow	Long
Household Consumption	-5.1	-11.4	-16.8
Fixed Investment	-11.4	-26.6	-33.8
Government Consumption	0	0	0
Exports	-8.1	-17.6	-20.8
Imports	-7.7	-17.3	-22.7
GDP	**-5.4**	**-12.1**	**-16.1**

Source: National Treasury

- Our assessment is that the economy will contract by 7% this year in our base scenario. This is not completely out of line with National Treasury projection of -5,4% under the 'quick' recovery scenario. In our view the R500 billion fiscal support package will, at best, provide support and is unlikely to provide any significant stimulus to the economy. We expect the recovery in employment to be slow, taking more than three years to neutralise the impact of the COVID-19 crisis (see our report: COVID-19: Labour implications) due to the severity of the negative consequences of the lockdown.

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