ECONOMIC COMMENTARY

12 March 2020

NEDBANK

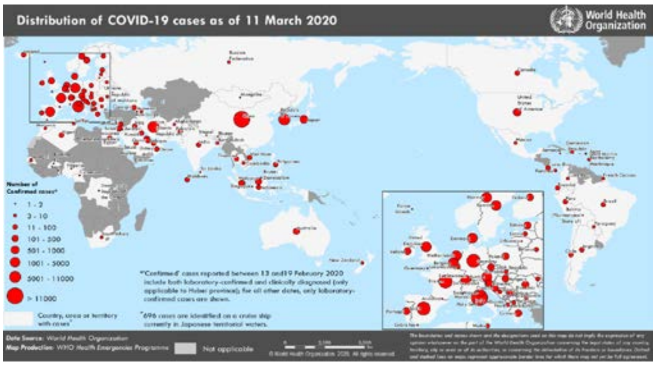
COVID-19: The Economic Consequences

Economics | South Africa

COVID-19 is the black swan of 2020

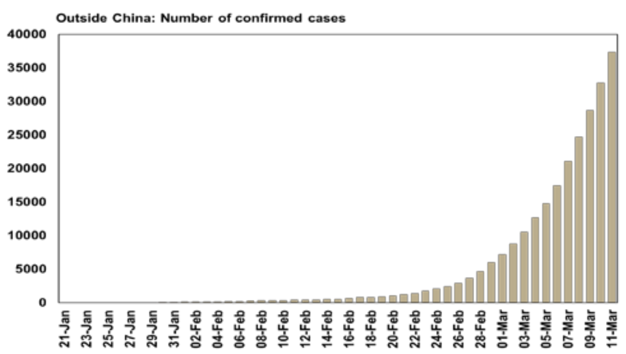
- **The scale of the problem:** The coronavirus (COVID-19) originated from the city of Wuhan in Hubei province of China as early as November 2019. The outbreak grabbed the world's attention as the virus gained critical mass and the Chinese authorities began to impose strict containment measures. The World Health Organisation (WHO) started to provide daily situation reports from 21 January. Since then the virus has spread rapidly within China and across the globe. **The number of confirmed cases globally rose from 282 on 21 January to 118 326 on 11 March.** China remains the epicentre of the outbreak, with 80 955 confirmed cases and 3 162 fatalities as of 11 March, accounting for 68.4% of all confirmed cases. In China, the rate of new infections has moderated considerably. It averaged 0.3% over the past two weeks. However, COVID-19 has spread at an increasing rate (which averaged around 22% over the past two weeks) outside China to 113 countries, with 37 371 confirmed cases to date.
- **Affected countries:** The most affected countries outside of China are South Korea (7 755 cases), Italy (10 149), Iran (8 042), Germany (1 296), France (1 774), Japan (568), Spain (1 639), Switzerland (491), the US (696) and the UK (373).
- **Global economic implications:** The outbreak is currently expected to hit China and Italy the hardest. While China's GDP growth forecast for 2020 has been reduced to between 4.5% and 5.5% (previously just above or below 6%), Italy is now expected to contract by between 0.5% and 1% (previously estimated to grow by around 1%). The US is still expected to grow but at a slightly slower pace. World growth estimates have also been reduced to between 1.9% and 2.6% from around 3% previously.
- **Global financial implications:** Risk-off sentiment is expected to dominate with much higher levels of underlying volatility. Global investors are likely to opt for safe-haven assets until the spread of the virus is halted and some of the extreme preventive measures are lifted. This has already inflicted considerable strain on emerging market equities, bonds and currencies. Global monetary policies will become even more accommodative. Gold prices will probably remain elevated, but other commodity prices, particularly that of crude oil, are likely to slide in line with weaker global demand.
- **Consequences for SA:** The economy is highly exposed to economic conditions in China and the world economy through trade, services and financial linkages. The economic threat posed to an already frail domestic economy is therefore significant. The outbreak is expected to hurt growth, hitting the export-orientated mining and manufacturing industries as well as the broader travel, tourism and hospitality industries the hardest. The risk of company closures and job losses are the highest in these sectors. The Reserve Bank's Monetary Policy Committee (MPC) is forecast to respond to the country's faltering economic prospects by cutting interest rates further, supported by a subdued inflation outlook which is reinforced by the implosion of global oil prices. The rand will probably remain weak and volatile, dominated by swings in global risk sentiment. We have revised our GDP forecasts downwards to 0.3% in 2020, 0.9% in 2021 and 1.1% in 2022. The risk of a recession is high.

Chart 1: Countries with confirmed cases



Source: WHO 8 March 2020

Chart 2: Confirmed cases outside China



Source: WHO 8 March 2020

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The impact on global economic activity

The virus has already caused immeasurable human tragedy, affecting the health of over 100 000 people worldwide, resulting in over 4 000 deaths. The economic and financial damage has also been significant. The **real economic impact** is most visible in highly affected countries.

China, the origin and epicentre of the outbreak, has been hardest hit. Activity in both manufacturing and services plunged in February. The Caixin China General Manufacturing PMI plummeted to a record low of 40.3, far below the 50 threshold that separates an expansionary environment from contractionary or recessionary conditions. Output, new orders and employment fell by the most since records began in 2004, hurt by factory shutdowns and extensions of the Lunar New Year to contain the spread of the virus. Export sales also shrunk at its fastest rate on record, dragged down by lower production, order cancellations and shipping restrictions. Within China, supply chains and logistics networks were disrupted, delaying deliveries of essential inputs and components, forcing many companies to rundown inventories, driving up production costs and eroding already slim profit margins as most companies resorted to heavy discounting to boost sales. The Official NBS Non-Manufacturing PMI also collapsed to a record low of only 29.6 in February from 54.1 in January, with these industries affected by quarantine measures and travel restrictions. New orders, employment, output charges and business confidence among non-manufacturing firms declined sharply. Services were not spared either. The Caixin China General Services PMI dropped to a record low of 26.5 in February from 51.8 in January, again caused mainly by company closures, the quarantine of highly infected cities and travel restrictions.

A similar tale, albeit somewhat less severe, unfolded in South Korea. The IHS Markit manufacturing PMI fell to a four-month low of 48.7 in February from 49.8 in January. Output and export sales shrank on the back of factory closures and sharply lower demand from China. South Korea also experienced severe disruptions to supply chains, which have hit automobile manufacturers the most.

Elsewhere, the corona-effect is not yet visible in the latest high-frequency statistics. This is not surprising as the rate of new infections only started to gather critical mass in other parts of the world in March. However, anecdotal reports and company newsfeeds suggest that the impact will be significant in the most affected countries and in specific industries. Manufacturing and services have been disrupted to varying degrees by containment measures in Italy, Germany, France, Spain and Japan. In Italy, the government recently announced the lockdown of the northern regions, home to 16 million people and the powerhouse of the country's economy, where most of the major vehicle, textile and clothing manufacturers are based.

Industries where the impact of the virus is being felt regardless of whether companies are based in countries with high, low or no infections include all cross-border transportation and logistics, tourism and related services as well as manufacturing with globally integrated supply chains. Companies with high overheads and generally tight cashflows are most vulnerable.

However, most countries will be impacted indirectly. The coronavirus will impact both global supply and demand.

Global supply-side shocks:

- In countries with high infection rates, increased sick leave and quarantine will reduce output and increase production costs by lowering productivity.
- Measures to contain the pandemic will have a much wider and larger impact on global activity. China's PMI figures provide the first glimpse of how strict containment measures including quarantine, social distancing, factory closures and lockdowns of the movement of people and goods to certain cities and regions have hurt production throughout China and the rest of the world. Export-orientated countries and industries will be hurt by lower exports due to the sharp fall in Chinese demand. China is also a key supplier of intermediate goods to the rest of the world. The lockdown in parts of China have already disrupted global supply chains, making it difficult for companies outside China to source key components to sustain production. The industries that are most vulnerable are electronics, automotive, machinery, equipment and other specialised manufacturing industries.

Global demand-side shocks:

- In countries with high infection rates, the loss of income caused by containment measures, the fear of contagion and mounting uncertainty will hurt consumer confidence and reduce spending, hitting demand for services and sales of retailers.
- Travel restrictions and contagion fears have already disrupted global travel, tourism and hospitality. The hit to global tourism and business travel will have far-reaching ripple effects on transport, hotels, casinos, other entertainment and small businesses, from small B&B operations to restaurants and retailers. If the impact is sustained it could result in retrenchments, cashflow woes and even business closures. The shipping and airline industries are particularly vulnerable to such a vicious cycle.
- The largest knock-on effect works through sentiment. Fading consumer and business confidence could lower company expectations of future demand, thereby reducing spending and investment. This could trigger a downward spiral, leading to business closures and further job losses, driving confidence and demand even lower, resulting in a further round of company closure, job losses and plunging confidence.

- Global investors have been spooked by the rapid spread of the virus, triggering a spike in risk aversion and a selloff in global equity markets, with investors taking flight to perceived safe-haven assets including gold and low-risk bonds, particularly US treasuries.
- The impact on the world economy is highly uncertain and almost impossible to quantify as the pandemic is still spreading. The worst of the contagion appears to be behind China as the rate of new infections has declined significantly over the past two weeks, but the same cannot be said for the rest of the world, where the rate of new infections have accelerated to over 20% over the same period. Affected countries have responded differently to the crisis. The impact on global growth depends on:
- How quickly can the spread of the virus be contained? The WHO indicated that the development of a vaccine is progressing well but would probably only be available for widespread distribution around 2021.
- How strict are containment measures? How long will these measures remain in place? Naturally, the damage would be greater if more countries adopted factory closures, quarantine, regional lockdowns and travel restrictions and kept these in place for an extended period.

Despite the many moving parts, some of the world's leading research institutions have produced estimates of the possible impact on global growth in 2020. Until very recently, the general assumption was that the virus will be contained to China. China's GDP was widely expected to contract sharply in the first quarter, before bouncing back strongly off a low base in the second quarter. As a result, world growth was expected to slow in the first quarter but to regain moderate momentum as China recovered.

As the virus has spread to over 100 countries in the space of three weeks, these assumptions have been significantly altered. The impact of COVID-19 is now expected to extend into the second quarter, shaving between 0.2 and 0.5 percentage points off global growth in 2020.

Table 1: Revised global growth forecasts

	China		US		World	
	Previous	Revised	Previous	Revised	Previous	Revised
OECD	5.7	4.9	2.0	1.9	2.9	2.4
EIU	5.4	4.5	-	-	2.3	1.9
World Bank	6.1	5.9	1.9	1.8	2.7	2.5
Moody's	5.2	4.8	1.7	1.5	2.4	2.1
Fitch Solutions	5.9	5.6	1.8	1.6	2.7	2.6
Citibank	5.8	5.3	2.0	2.0	2.7	2.5

Source: Various

The fallout on the global financial markets

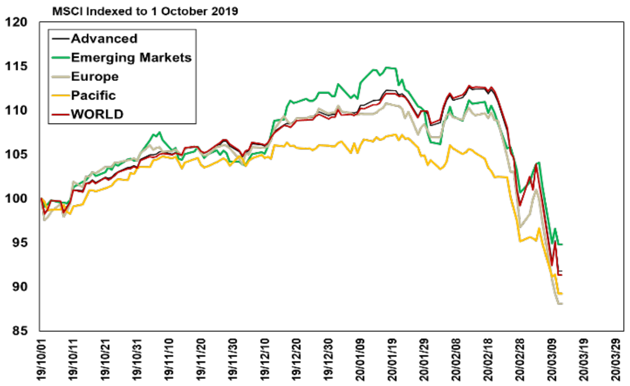
The fallout in global financial markets has been dramatic. Global investors woke up with a jolt to the risks posed by COVID-19 to the world economy over the week from 24 to 28 February. Ever since, global stock markets have been extremely volatile and weak as panic spread and skittish investors scrambled to quantify and isolate the possible effects of the virus on the world economy, specific countries, various asset classes, specific industries and companies.

Global equity markets so far

Global stock markets have been badly affected, recording losses equivalent to that of the 2007/08 global financial crisis as they plunged deep into correction territory. On 9 March, the main US stock market indices fell so rapidly from opening, with the Dow Jones Industrial Average falling by 8.4% and the S&P 500 plunging by more than 7%, triggering a 'circuit breaker', effectively closing the market to allow investors to calm down and reconsider their options. US markets wobbled again on 12 March, triggering another 15-minute suspension of trade. In Europe, where infection rates have climbed higher and containment measures have become stricter, the impact was even more severe. The UK FTSE100 nose-dived, ending the day 12.3% lower (its worst one-day fall since October 2008), the German DAX shed 7.6% and French CAC fell by 8.4%. On 9 March, the Italian MIB fell by 11.2%, its second-largest drop since the index began trading in 1998. This capitulation followed the announcement by the Italian government that several central and northern provinces will be placed under quarantine, including the financial capital of Milan. On 12 March, European bourses took another hammering as the US imposed sweeping travel restrictions and governments across the scrambled to contain the spread and economic damage of the pandemic.

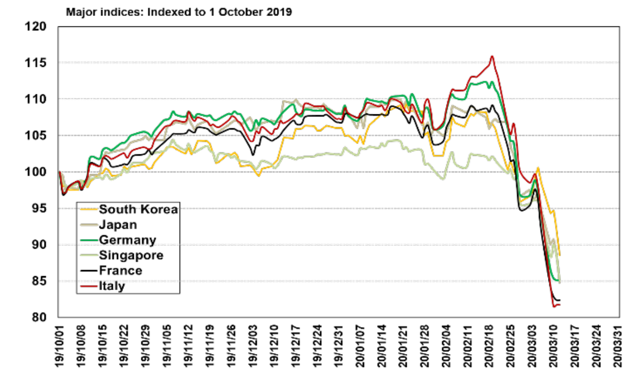
Most emerging market bourses followed the majors to lower ground. The Morgan Stanley Capital Index for Emerging Markets dropped by 6.3% on 9 March, bringing the slide for the year to date to 14.9%.

Chart 3: The global equity markets



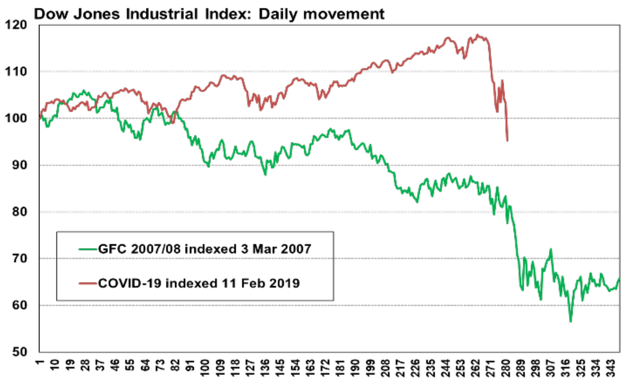
Source: MSCI sourced from Refinitiv

Chart 4: Equities of most affected countries



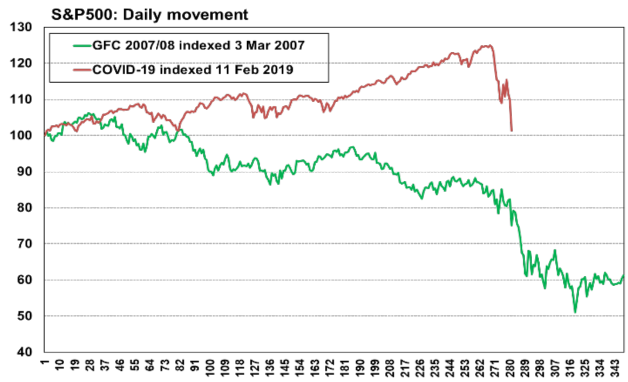
Source: Refinitiv

Chart 5: DJIA drop relative to GFC of 2007/08



Source: Refinitiv

Chart 6: S&P500 drop relative to GFC of 2007/08



Source: Refinitiv

Global bond markets

The virus-induced mayhem increased demand for perceived safe-haven assets, with low-risk sovereign debt a major beneficiary. Increased risk-aversion is only part of the tale. Global bond yields also moved lower in anticipation of renewed monetary policy stimulus by the US Federal Reserve and other major central banks to ease the strain on the global markets and world economy, hoping to prop up confidence and risk appetites by cutting interest rates and injecting liquidity. The yields on the 10-year government benchmark bonds of France, Germany and Japan slipped deeper into negative territory, while that of the UK fell to 0.26% from just over 0.60% in mid-February. US Treasuries were in high demand, with the yield on the 10-year benchmark dropping below 1% on 12 March from over 1.38% a week ago and 1.92% at the end of 2019.

Ironically, the Chinese bond markets also rallied following the recent cut in US interest rates and renewed fiscal and monetary stimulation by the Chinese authorities. The 10-year yield fell by 50 basis points since the end of last year to around 2.6%, its lowest level since 2002.

Most other emerging markets have been less fortunate. Bond yields rose sharply as risk-aversion spiked. While some calm returned recently, global investors are likely to be wary of emerging market sovereign debt, especially in countries with high debt burdens, structural imbalances and high export and other exposures to China.

Global commodity markets

Expectations of much weaker Chinese and global demand have triggered sharp falls in the prices of most commodities. The downturn in global oil prices have also fuelled tensions among major producers, Saudi Arabia and Russia, about how best to deal with the current depressed trading conditions. Saudi Arabia pushed for major supply cuts to force prices higher at the recent

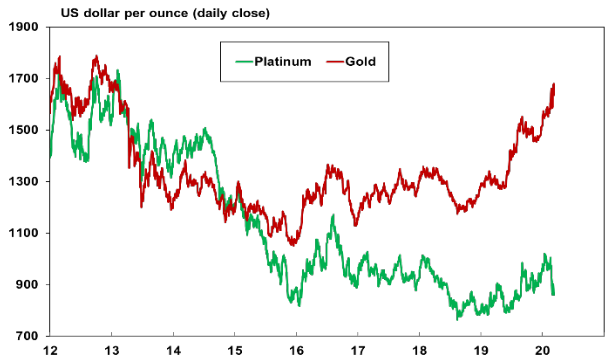
OPEC+ meeting, but Russia resisted. Saudi Arabia then surprised the markets by slashing its April official selling prices, signalling the start of a price war, which spooked all markets as oil prices collapsed. On 9 March Brent crude oil ended 23.5% lower at $34.75 per barrel from $45.42 on 6 March, which already compared dismally with a peak of over $70 in early January. Over the year to date the slide in oil prices total 47%. The International Energy Agency has also cut their forecast for global oil demand for 2020, with global crude consumption now expected to contract for the first time in over a decade.

Other commodity prices also came under some selling pressure, albeit at much more modest pace, falling at rates varying between 2% to 7%. Over the year to date, prices of copper, thermal coal, iron ore, steel and platinum have declined by 10.5%, 6.4%, 4.9% and 8.9%. In sharp contrast, the surge in global uncertainty have greatly enhanced the appeal of gold as a store of value and a hedge against financial uncertainty and volatility. Gold prices rose significantly throughout 2019 and have extended these gains even further in 2020. So far in 2020 gold prices are up another 9.4%.

Chart 7: Global oil price trends

Source: Refinitiv

Chart 8: Gold & platinum prices

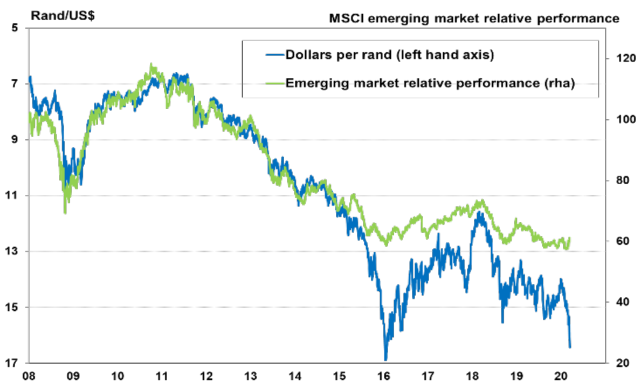


Source: Refinitiv

The currency markets

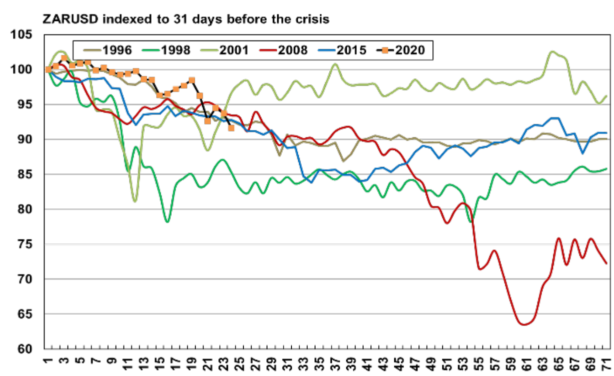
Foreign exchange markets have been extremely volatile, reflecting the sharp gyrations in global risk appetites, fears of a liquidity crunch as well as the dramatic change of course in global monetary policies and its implications for investment strategies and asset allocations. The dollar initially strengthened as investors fled to safety but lost traction following the cut in US interest rates, liquidity injections by the US Fed and the sharp drop in US treasury yields. Expectations of even further monetary easing and fiscal stimulus also weighed on the dollar in recent days. As a result, the Japanese yen, the Swiss franc and the euro regained some lost ground. Emerging market and commodity-based currencies were hammered, hurt by wild swings in risk appetites, fears about growth prospects and debt service abilities in countries with high sovereign or corporate debt burdens, heavy export exposure to either China or the global oil markets

Chart 9: Rand vs emerging market risk premiums



Source: Refinitiv

Chart 10: Rand trajectory over previous shocks



Source: Refinitiv

The global policy response

Most central banks have responded by easing monetary policy. The Peoples Bank of China (PBoC) have reduced interest rates, lowered their reserve requirement ratios and injected liquidity into financial markets. Some analysts believe that the PBoC may also relax current restrictions on the shadow banking system in order to facilitate greater access to credit for small- to medium-sized firms to ease the squeeze on cashflow many are experiencing. In early March, the US Fed announced a 50-basis-point emergency interest rate cut - the first emergency action and largest single cut since the global financial crisis (GFC) of 2008. The Bank of England also cut interest rates by 50 basis points and introduced liquidity support for small to medium business. Both the European Central Bank (ECB) and the Bank of Japan (BoJ) have limited scope to respond to the economic threat posed by the coronavirus as their base lending rates are already below zero. Both the ECB and BoJ have however, indicated they are ready to act, but the only realistic options are to inject further liquidity and offer targeted support to small and medium enterprises.

Given the constraints on monetary policy in many advanced countries, some governments have stepped in to provide additional support and stimulus (see summary in Table 2). High public debt burdens also restrict the ability of advanced countries to provide substantial fiscal stimulus. Italy faces the additional complication of a very fragile banking sector.

Table 2: Summary of policy responses by major advanced countries

	Fiscal policy measures	Monetary policy action	Summary
China	US$6.8bn package to deal with the effects of the epidemic	7-day Reverse Repo Rate (RRR) cut to 2.40% from 2.5%; 14-day RRR cut to 2.55% from 2.65%; Y150bn injected into reverse repo market; reserve requirement ratio reduced by 50bps 1-year rate on Medium-term lending Facility lowered to 3.15% from 3.25%	The measures are equivalent to about 2% of GDP, according to *Capital Economics*
United States	US$8.3bn emergency package approved by Congress. Trump has proposed a payroll tax cut totalling up to $700bn and paid leave for US infected workers	Fed target rate cut by 25bps to a range of 1.25%−1.50%	More cuts and liquidity injections likely, should the need arise. Next FOMC meeting on 17-18 March.
United Kingdom	A £30bn fiscal package with broad economic objectives	BoE cut its repo rate by 50 bps to 0.25% and maintained its holdings of gilts at £435bn and corporate bond holdings at £10bn. It is implementing a term funding facility for small and medium businesses, targeted at over £100bn, for 4-year loans at an interest rate close to the repo rate	More fiscal injections and interest rate cuts likely
Eurozone	Germany − temporary hiring measures, financial support for small business, government investment to be raised by €3.1bn a year, over the next 3 years Italy − a stimulus package totalling €7.5bn	Additional liquidity injections under the LTRO III and TLTRO III programmes, and additional €120bn in purchases of corporate bonds	Germany − measures are equivalent to about 0.1% of GDP Italy − the stimulus package equates to 2% of GDP
Australia	A AU$17.6bn package which includes income support for households as well as subsidies and tax write-offs for businesses	Reserve Bank of Australia reduced its policy rate to 0.5% from 0.75% and stands ready to cut further	The government package is worth about 1.2% of GDP

Source: Various

The possible impact on SA's economy

Estimating the impact on economic growth is challenging, partly because the virus is still spreading and the global fallout is still unfolding, but also because there are numerous other factors that influence underlying economic activity. History confirms that SA is vulnerable to changes in global conditions. SA has never escaped world recession or global financial market turmoil unscathed. This is because the economy is small and open, with low domestic savings, which means that the country is highly dependent on foreign capital inflows to sustain investment and therefore also vulnerable to abrupt changes in global investor sentiment and risk appetites.

Since the country's reintegration into the world economy in 1994, the economy has been subjected to three localised currency crises, the emerging market crisis of 1997/98, the bursting of the dot.com bubble of 2000/01 and the global financial crisis of 2007/08. Each of these shocks were different in cause and effect. Domestic political, fiscal and economic conditions also differed in the period preceding the crisis. In 2007 and 2008 the domestic economy was booming, driven by strong consumer spending and fixed investment, underpinned by robust global growth and rising commodity prices. Rapid growth in bank credit and rising asset prices clouded the risks of mounting household debt burdens and overvalued house prices. However, government's finances were healthy. Budget deficits were contained to well below 3% of GDP and gross government debt gradually fell to a low of 26% of GDP in 2009. All three major international rating agencies considered SA's sovereign debt investment grade. These attractive fiscal metrics also disguised the lack of timely investment in key economic infrastructure, notably electricity, which came to the fore in the 2008 electricity crisis.

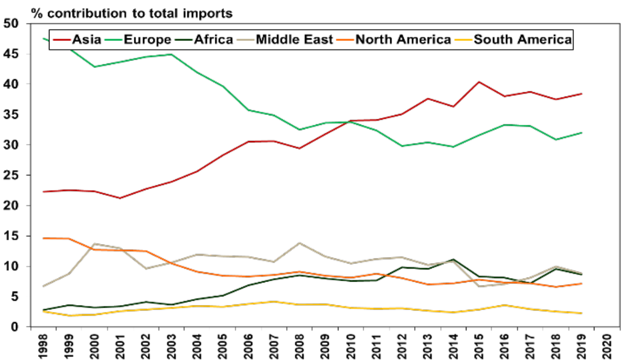
In sharp contrast to 2008, prior to the coronavirus outbreak the domestic economy not only remained stuck in the longest economic downswing since records began in 1945 but also entered its second technical recession in the space of two short years in the second half of 2019. Business confidence is largely absent, eroded by years of political turmoil, policy uncertainty, destructive legislation, electricity constraints, poor economic infrastructure, deeply entrenched public sector corruption and rising operating costs. Household confidence is also fragile given the rise in unemployment rates, growing job insecurity, persistent pressure on incomes, high taxes, depressed asset prices and the erosion of public services. Hopes of a meaningful recovery were dashed in early 2020 as Eskom continued load-shedding, which is now likely to persist for next 18 to 24 months. Government finances are weak, with budget deficits of over 6% of GDP and the gross debt burden already over 60% of GDP and projected to rise to well over 70% of GDP - excluding the bailout of Eskom and other struggling SOEs. SA is also on the brink of losing its last investment grade sovereign risk rating. Given these realities the outlook for 2020 was already bleak. GDP growth forecasts ranged from 0.5% to 0.9%. Our forecast was for growth of 0.7% prior to outbreak of the virus.

The question now is how much worse will things get? The outbreak will affect SA through trade and financial linkages. The exposure of the real economy is significant.

Global trade linkages:

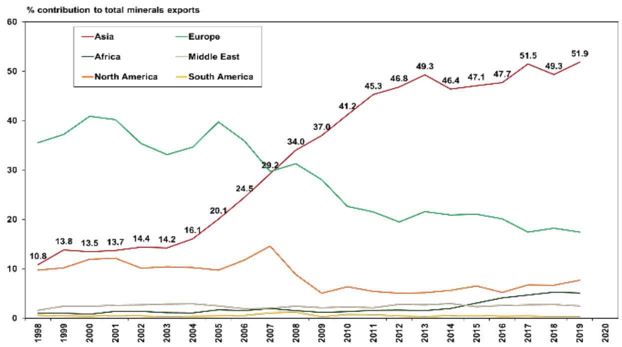
- Exports and imports combined accounted for 59.4% of GDP in 2019.
- Asia and Europe are SA's largest regional trading partners.
- Of total exports, 32% goes to Asia and 29% to Europe. Most international research and finance institutions, including the IMF, the World Bank and the OECD agree that the outbreak will hurt growth in every Asian economy in 2020. The worst affected will be China, with the highest number of confirmed cases and the strictest containment measures. China's GDP is widely forecast to shrink in the first quarter. Some factories opened for production in recent days, but output will probably only return to full capacity during the second quarter. Other Asian economies have also been hard hit by the drop in inter-regional trade, the disruptions to global supply chains and the slump in tourism. The economic repercussions have been most significant for South Korea, Hong Kong, Taiwan, South Korea, Japan, Singapore, Thailand, Malaysia and Sri Lanka. So far India has held up relatively well.
- Of the R372 billion exports (about 7.3% of GDP) destined for Asia, the bulk consist of raw commodities, followed by manufactured products. Asia consumes R238 billion or a massive 51.9% of SA's total commodity exports and R116 billion or 18.6% of total manufactured exports. Agricultural exports to Asia total about R19 billion or 29.8% of all agricultural exports. China is SA's largest export market, consuming 12% of total exports, which amounts to 2.7% of GDP. Of the R139.1 billion exports to China in 2019, R102.5 billion was raw commodities and R29.7 billion was manufactured goods.
- Weak growth is expected in Europe given the sharp and persistent rise in confirmed cases in the region's largest economies such as Italy, France, Germany and Spain. The containment measures adopted in these countries will also undermine sentiment and reduce demand. The travel and tourism industries are already feeling the effects of these measures and the sharp drop in tourist numbers. In the UK the number of confirmed cases has increased but not nearly at the same pace as those on the continent. Added to this, the containment measures have so far been less severe. SA exports about R334 billion worth of goods to Europe (about 6.6% of GDP). Europe is an important market for local manufacturers, consuming about 37% of total manufactured exports. Europe is also a major market for local agricultural produce and raw minerals, accounting for close to 40% of total agricultural exports and around 18% of total mineral exports. Germany is SA's largest trading partner in the region, accounting for 9.4% of total exports.

Chart 11: Breakdown of SA exports by region



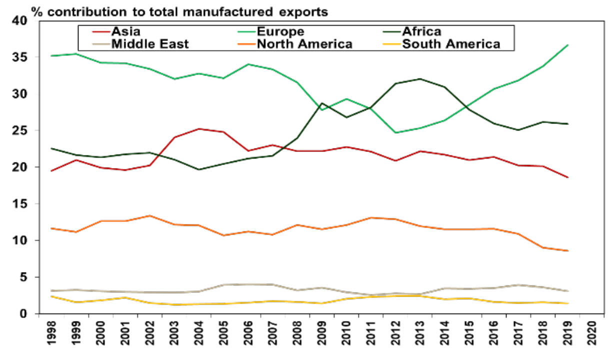
Source: MSCI sourced from Refinitiv

Chart 12: Mining exports by region



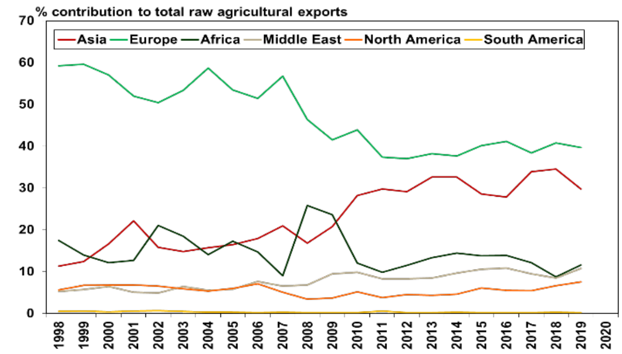
Source: Refinitiv

Chart 13: Manufactured exports by region



Source: MSCI sourced from Refinitiv

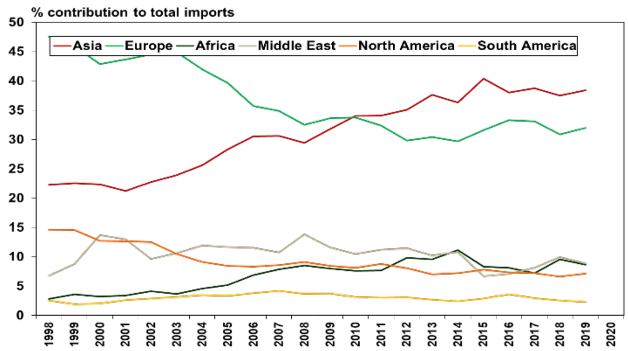
Chart 14: Agricultural exports by region



Source: Refinitiv

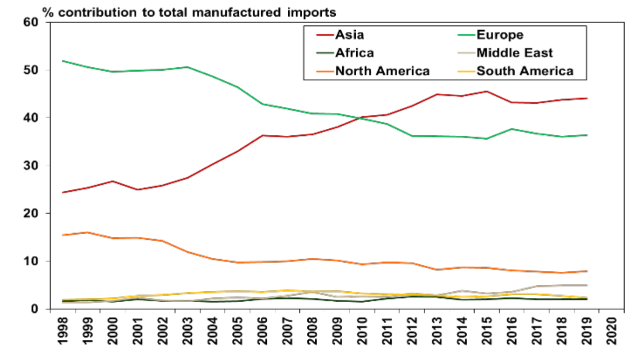
- Of total imports, 38% comes from Asia and 32% from Europe. Imports from Asia and Europe totalled R472 billion (9.3% of GDP) and R392 billion (7.7% of GDP) respectively in 2019. SA is highly integrated in Asian and European supply chains, with 44% and 36% of total imports of manufactured goods emanating from these two regions. The bulk of manufactured imports come from China and Germany. Asia and Europe are also the dominant sources of SA's agricultural imports, accounting for 22.3% and 19.4% of total imports of raw agricultural materials. This suggest that local manufacturers, wholesalers and retailers are probably already encountering difficulties sourcing products and components.

Chart 15: Breakdown of imports by region



Source: MSCI sourced from Refinitive

Chart 16: Manufactured imports by region



Source: Refinitive

In brief, a total of 61% of SA's exports is destined for the most affected regions, Asia and Europe, while a total of 70% of the country's imports is sourced from these same regions.

On the export side, the economic drag from the virus could potentially disrupt activity totalling R707 billion or about 14% of GDP. The most vulnerable sectors are mining, manufacturing and agriculture.

On the import side, activity around R864 billion or about 17% of GDP could be affected. The most vulnerable sectors are manufacturers reliant on component imports and wholesalers and retailers reliant on both imports of finished manufactured goods as well as raw and processed agricultural products.

Consequently, through trade linkages about 30.9% of GDP is vulnerable to potentially sharp declines in export sales as well as possible severe disruptions to the supply of components and finished goods.

Another heavily exposed sector is travel, tourism and hospitality. While domestic air travel capacity has already been reduced due to restructuring at SAA after it was placed in business rescue, the dramatic drop in global business and foreign travellers will nonetheless hurt domestic carriers. Airline and cruise-line operators are particularly vulnerable due to high overheads and tight profit margins. The sharp drop in global oil prices may, however, offer some relief to those airlines and cruise operators that manage to survive the current implosion in global and domestic air and sea travel. The implosion in inbound tourism will also hurt hotels, restaurants, other accommodation, wholesalers and retailers. It will probably have a disproportionate effect on the regional economies of the Western Cape, Kwazulu-Natal and Mpumalanga.

The local travel and tourism industries are most reliant on European visitors. Visitors from the most affected countries in Europe constitute about 40% of all overseas visitors to SA. It is difficult to quantify the exact impact as the spending of foreign tourism not only affects incomes by airlines, cruise operators, hotels and other accommodation, it also impacts on entertainment, retail sales, catering and banking services.

The above global trade and services linkages only capture SA's direct expose. It therefore provides only a rough indication of SA's vulnerability. It does not, however, reflect the potential damage that could be inflicted by the spread of the virus within South Africa or by second-round effects such as the loss of production capacity caused by company failures, increased job losses, a prolonged downturn in global commodity prices and the threat of the world economy slipping into recession. Once these secondary effects start to emerge, the economic damage will be far more substantial, undermining fixed investment and consumer spending. The scale of the threat depends on how successful containment measures are and how effective the current cocktail of monetary and fiscal stimulus is in bolstering global confidence.

We constructed three scenarios around different assumptions of Chinese and global growth.

- **A best-case outcome:** Assuming China returns to work in the second quarter and bounces back strongly in the second half of 2020, the rest of the world manages to contain the spread of the virus during the course of the second quarter and activity rises off a low base in the second half of the year. In this scenario China manages growth of 5.5% and world growth registers at around 2.6% in 2020.
- **A mild-stress scenario:** Both the spread of the virus and the effects prove harder to manage than assumed above and some secondary adverse effects start to develop. The global policy response fails to bring about a strong recovery, while price wars and excess capacity contribute to mild deflationary conditions. China's GDP growth slows to 4.5% and the world economy muddles along at 2.3%.
- **A high-stress scenario:** The virus continues to spread. The more authorities' efforts fail, the more extreme containment measures are adopted in a sequential manner by different countries as the virus spreads. Second-round effects take hold, confidence fades and the world economy enters recession. China's GDP growth comes in at around 3.5% and world GDP growth drops to 1.9%.

If we feed these estimates of China's GDP and world GDP into our general equilibrium model, keeping all other inputs unchanged, it illustrates that under our high-stress scenario the trade effect alone could knock about 0.5 percentage points off export growth and about 0.2 percentage points off GDP growth in 2020. However, all other inputs will undoubtedly change. The slump in fixed investment will probably intensify and companies will probably accelerate restructuring efforts as profits vanish, forcing households to cut back on spending. This is therefore a highly conservative indication of the potential effect that just a knock to exports could have on GDP.

The worst-case scenario is one where the world economy enters a deep recession of similar intensity as the Great Recession of 2009. Under these circumstances SA's technical recession will probably deepen and extend throughout 2020.

Financial linkages

Local financial markets also capitulated. The FTSE/JSE all share index lost 23% of its value over the past two weeks. The heaviest losses were recorded in resources (down 35%), financials (down 18%) and industrials (down 15%). Nervous foreign investors sold R33.9 billion worth of local government bonds since 24 February, pushing the yield on the 10-year government benchmark up by 98 basis points to 9.795%. The rand also tumbled down the rabbit hole, sliding to R16.40 against the US dollar, a depreciation of 7% over the past two weeks.

Recent events have implications for inflation and interest rates. Until recently, inflation has been well contained around the 4.5% mid-point of the Reserve Bank's 3% - 6% target range, kept in check by the absence of any meaningful demand pressure on prices. The implosion in global oil prices and the virus-induced shock to a domestic economy already in technical recession are expected to outweigh the impact of the 8% slide in the rand on a trade-weighted basis since the start of this year. Inflation is therefore forecast to fall below 4% around the middle of the year, before edging higher off a low base towards the end of the year, averaging about 4% in 2020. Given the subdued inflation outlook, the threat posed to a faltering domestic economy and the renewed shift towards monetary stimulus by the US Fed and other major central banks, the South African Reserve Bank's Monetary Policy Committee is forecast to cut interest rates by at least another 25 basis points and possibly 50 basis points next week. If the corona-induced economic crisis persists into the second half of the year, more cuts are on the table. If not, the MPC is likely to keep interest rates on hold at lower levels.

Lower interest rates should provide some counter to the harsh economic realities most households are facing. It is, however, unlikely to bring about a meaningful recovery in domestic demand as the economy will continue to grapple with regular power outages, high public debt burdens, falling corporate profitability, strained household income, high unemployment and heightened job insecurity.

Conclusion

As a result of all these considerations, we have revised our GDP growth forecasts for the next three years to 0.3%, 0.9% and 1.1% for 2020, 2021 and 2022 respectively, down from 0.7%, 1.1% and 1.3% previously. The risk of recession has however increased substantially. The COVID-19 crisis is starting to look and feel a lot like 2008.

Table 3: Nedbank Economic Forecasts

	Annual growth rates (%)					
	Actual			Forecast		
	2017	**2018**	**2019**	**2020**	**2021**	**2022**
HCE	2.1	1.8	1.0	0.8	1.3	1.4
GCE	0.2	1.9	1.5	0.9	1.0	0.9
GFCF	1.0	-1.4	-0.9	-1.4	-0.3	1.2
EXPORTS	-0.7	2.6	-2.5	-2.1	3.1	3.6
IMPORTS	1.0	3.3	-0.5	-0.9	3.0	4.1
GDP	**1.4**	**0.8**	**0.2**	**0.3**	**0.9**	**1.1**

Source: Nedbank Group Economic Unit