Focus shifts to economic recovery

Dr Roelof Botha, Joint Managing Director, GOPA Group SA (Pty) Ltd *7 May 2020*

Now that a growing number of countries are starting to relax their lockdown regulations, including South Africa, it is necessary to shift the debate from quantifying the depth of the imminent recession to the drivers of recovery.

It is rather disingenuous to spend valuable time on attempting to determine the extent of economic contraction. By now, everyone realises that the world economy is heading for one of its worst recessions on record.

Due to the unprecedented nature of what can be termed a self-inflicted recession, it is impossible for any existing economic model to accurately predict the percentages by which economies will contract in 2020.

Models rely intimately on historical trends and data. This time around, they simply do not exist, as the modern history of the world has never witnessed the current universal disruption and abrupt cessation of most economic activity, albeit temporary.

An emphasis on the temporary nature of the pandemic is crucial in the quest to re-orientate the debate on the economic impact of the Covid-19 pandemic. In most countries, extreme lockdown regulations would have lasted for less than a quarter. In a couple of months from now, the worst effects of the pandemic will be over and businesses will be in the process of playing catch-up.

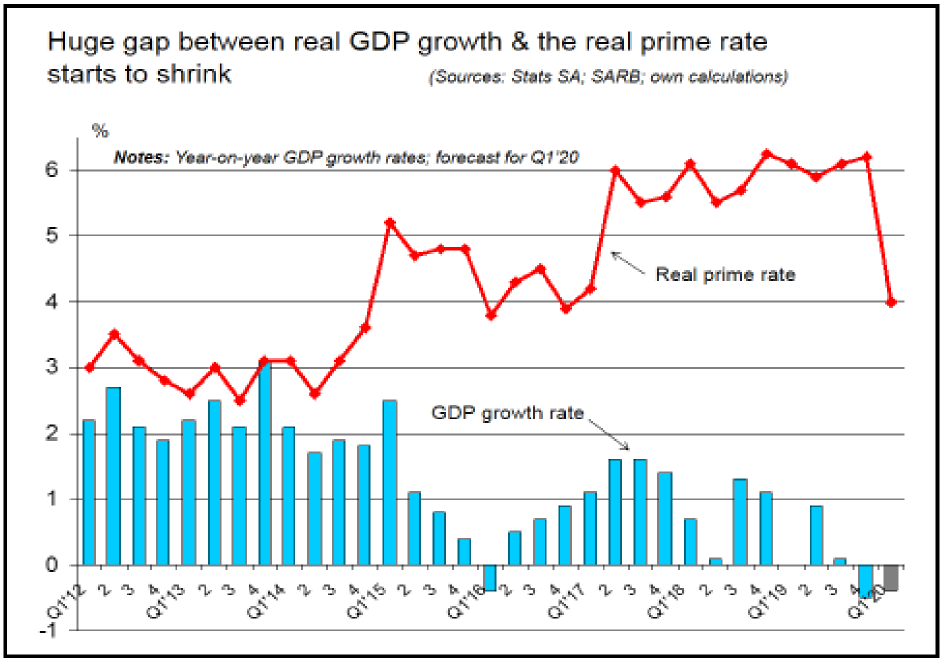
Drivers of recovery

The focus should be on the potential drivers of economic recovery. Several of them have already come to the fore, especially in the economic policy domain.

First and foremost in South Africa's case is the welcome change of heart at the Reserve Bank, which, for no apparent reason, had been following a restrictive monetary policy stance for the past five years.

Now that the Monetary Policy Committee (MPC) seems to have woken up to the realisation of the powerful impact that lending rates exert on demand, it is inevitable that household consumption expenditure will receive a boost in coming months.

Millions of indebted South Africans will benefit from the decision by the Reserve Bank to depart from its fixation on reducing inflation via high interest rates. Since the beginning of the year, the official bank rate (the so-called repo rate) has been lowered by 225 basis points, resulting in a current prime overdraft lending rate of 7.75%. This will lower the cost of working capital and of credit.



Total private sector credit in South Africa recently surpassed the level of R4-trillion, which means that the rate reductions thus far have the potential to stimulate demand over the next 12 months to the tune of more than R90-billion.

With the country's inflation rate at a 14-year low, substantial scope still exists for further interest rate reductions and another cut in the repo rate of at least 50 basis points may be in the offing.

Secondly, fiscal policy has assumed a distinct Keynesian look, which is exactly what the economy needs. National Treasury should be lauded for introducing a basic income grant as an interim measure for alleviating the plight of unemployed people. Recipients of the new temporary social grant extensions will spend the money forthright – mainly on food and other non-durables.

The economy has been suffering from a demand deficiency for several years and any measure aimed at enhancing household consumption expenditure and capital formation is most welcome.

National Treasury has also been quite innovative in the design of the funding required for the relief package announced in April. Importantly, an IMF facility at near-zero debt servicing costs is also being considered.

The saga surrounding the pandemic is now at a crucial juncture in South Africa, namely the first stage of relaxation of the lockdown regulations. Many businesses are up and running again and many people are back at their workplaces. The debate should now concentrate on the nature and speed of economic recovery.