GAUTENG PROVINCE
ECONOMIC DEVELOPMENT
REPUBLIC OF SOUTH AFRICA

GGT2030
GROWING GAUTENG TOGETHER

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1. INTRODUCTION

The COVID-19 pandemic and its associated socioeconomic aftermath has been at the centre of global economic news as economies battled the containment of the spread of the virus whilst trying to maintain some reasonable level of socioeconomic stability and protection. Economic output and growth in most advanced and emerging market economies registered a significant recovery during the third quarter of 2020 (Q3:2020) as output and demand edged higher following the easing of lockdown restrictions and the broad-based resumption of economic and trade activity.

This report highlights the key economic trends and developments during the third quarter of 2020. The key global economic developments during the quarter included a moderation in COVID-19 related uncertainty as economies resumed operations and as measures that have stifled economic activity during most of the previous quarter were lifted. Domestically, the data highlighted continued strain in the economy albeit supported by stronger business and consumer sentiment and improved manufacturing output. In addition, joblessness at both the national and provincial level were weaker as the economy registered a strong recovery during the quarter. Stronger domestic demand and an increase in food and beverages and fuel prices led to higher producer and consumer prices, whilst the trade (wholesale and retail) sectors recorded slightly higher output growth.

In line with the global trend towards more accommodative monetary policy, the South African Reserve Bank’s Monetary Policy Committee (MPC) cut interest rates twice (April and May) since March 2020 however, the Bank kept rates unchanged during its September 2020 meeting. The decision to keep rates unchanged was underpinned by the stable inflation outlook on the back of weaker demand side pressures, despite the risks of stagnant economic recovery. As such, in 2020, headline inflation was forecasted to stabilise at an average rate of 3.3% whilst core inflation averaged 3.4%. As a result, no further cuts in the repo rate are expected in the near term, with two cuts foreseen sometime in 2021. In addition, several business and household support measures aided in supporting a struggling economy during the quarter, even as government struggled to reign in the fiscus in the wake of growing calls to increase spending and contain debt.

The rest of the report is set out as follows: Section 2 provides an overview of key Global Economic Developments. This is followed by a closer look at the Domestic Economic developments in Section 3. Lastly, Section 4 provides a brief conclusion.

2. GLOBAL ECONOMIC DEVELOPMENTS

2.1. GLOBAL ECONOMIC CONDITIONS SHOW SIGNS OF IMPROVEMENT IN Q3:2020

The COVID-19 pandemic continued to take centre-stage across global economies in Q3:2020. Although the rate of spread of the virus seemed to slow somewhat during the quarter, major economies across Europe, Asia and North America continued to battle with the after effects of earlier economic lockdown measures. Global manufacturing and merchandise trade activity saw some improvement in the quarter, all of which pointed towards stronger growth.

Manufacturing activity, in several leading global economies continued to show signs of a much-needed recovery in September 2020. This comes after several COVID-19 induced disruptions to manufacturing activity during much of the second quarter of 2020.

Table 1: Global Purchasing Manager's Indices (PMIs)

GLOBAL PURCHASING MANGER'S INDICES			
Manufacturing activity	**July 2020**	**August 2020**	**September 2020**
Caixin China PMI	52.8	53.1	53.0
IHS Markit US PMI	50.9	53.1	53.5
IHS Markit/CIPS UK PMI	53.3	55.2	54.1
IHS Markit Euorzone PMI	51.8	51.7	53.7
Japan Jibun Bank PMI	45.2	47.2	47.7

Data source: Trading Economics

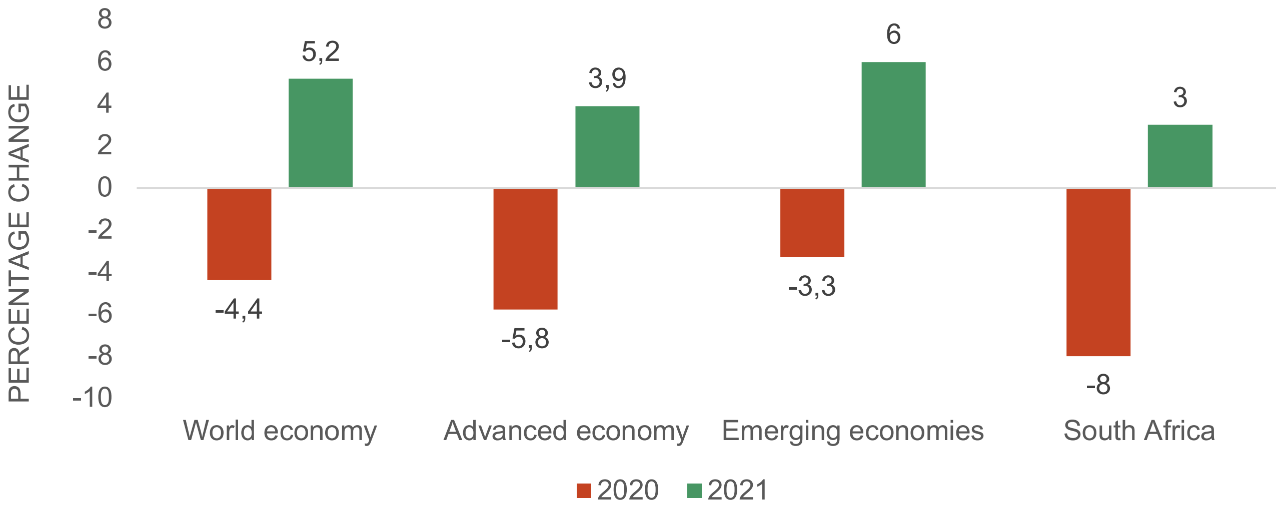
In September, manufacturing activity remained in expansionary territory (above 50 index points) in China, the US, UK and Euro Area economies. Specifically, the Caixin China General Manufacturing PMI was flat at 53.0 index points in September, slipping slightly from the 53.1 reading in August. The IHS Markit US Manufacturing PMI increased to 53.5 in September, marking the strongest expansion in sector activity since January 2019. Although manufacturing activity in the UK remained in expansionary terrain, it dipped lower to 54.1 from 55.2 a month earlier highlighting the impact of rising job losses and growing inflationary pressure for manufacturers. Meanwhile, the IHS Markit Eurozone PMI edged higher to register at 53.7 (the highest growth in output in over two years), improving from 51.8 and 51.7 readings recorded in July and August respectively. The broad-based recovery momentum in manufacturing output outlined above can be attributed to improvements in new orders, higher export orders as well as rising purchasing activity in these economies.

The only major economy continuing to feel the COVID-19 punch to manufacturing activity is Japan, with activity being in contraction for the past 7 months, even though it is improving. The Jibun Bank Manufacturing PMI improved to 47.7 points from 47.2 in August. New orders and export orders remain under pressure, although at a slowing pace, on the back of increasing demand from China. The latest global PMI readings all seem to be confirming a v-shaped recovery in global manufacturing activity. Manufacturers are generally more positive about the outlook of demand for the rest of the year. Disruptions to activity and global value chains are being rectified which, is a positive sign for the sector.

2.2. INTERNATIONAL MONETARY FUND UPWARDLY REVISES GLOBAL GROWTH PROSPECTS AS COVID-19 RAVAGES GROWTH

In mid-October 2020, the International Monetary Fund (IMF) shed a slightly more optimistic view of the global economy for the remainder of 2020, marginally revising its global growth forecast upwards. The IMF indicated that it projected the global economy to contract by 4.4% in 2020, an upward revision of 0.8 percentage points from an estimate of -5.2% made earlier in the year (June 2020). The revision was mainly driven by better-than-expected growth in advanced economies (specifically China) during the second quarter of the year, coupled with signs of stronger economic recovery in the third quarter after most countries lifted strict lockdown restrictions. Meanwhile, global growth was projected at 5.2% for 2021. Advanced economies were expected to contract by -5.8% in 2020, with growth expected to increase to 3.9% in 2021. Furthermore, emerging economies were expected to register a decline in economic activity of 3.3% in 2020, with growth increasing to 6% in 2020. The funding body further projected that sub-Saharan Africa would contract by 3% in 2020 before rebounding by 3.1% in 2021.

Figure 1: IMF Growth Forecasts (2020 – 2021)



Data source: International Monetary Fund

On the other hand, the IMF decided to keep its economic forecast for South Africa unchanged at -8% for 2020. However, it warned that South Africa's unemployment rate could see a further spike, which is concerning given the nation's dire employment situation and the consequent socioeconomic impact of rising joblessness. At the time, the South African economy was forecast to rebound by 3% in 2021 (0.5% lower than the June estimate), while employment could reach 36.5%. Additionally, South Africa's negative forecast was among the largest estimated for emerging market economies. Nevertheless, the strict lockdown that begun at the end of March 2020 caused the biggest ever quarterly contraction and cost the country more than two-million jobs. As such, SA's economic recovery plan should be correctly targeted and efficiently implemented so that the country can get back on a path towards a stable and equitable recovery.

Similarly, the Organisation Organisation for Economic Co-operation and Development (OECD) released an Interim Economic Assessment report titled "Coronavirus: Living with uncertainty", which outlined the key global economic developments since the outbreak of the virus as well as revisions to its growth forecasts in the wake of these developments.

According to the OECD, the global economic outlook remained highly uncertain as the effects of the pandemic continued to exert a toll on economies. Although signs of a slow recovery had began to show in the data, global output in the second quarter of 2020 was over 10% lower than at the end of 2019 with global trade declining by over 15% in the first half of the year – which highlighted the severity of the global shock. The gradual increase in demand, particularly in China, aided the strengthening of commodity prices and improved overall risk appetite in financial markets. However, low levels of confidence and high uncertainty about job security and overall economic conditions kept precautionary savings elevated.

Growth will remain subdued amid high uncertainty – a gradual global recovery was projected through the fourth quarter of 2020 and into late 2021, with the OECD projecting that the global economy could decline by 4.5% in 2020 and 5% in 2021. The South African Economy is projected to slip further compared to previous forecasts, contracting by 11.5% in 2020 and growing by 1.4% in 2021. The key reason for the revision is the prolonged spread of the virus coupled with high levels of poverty, informality and stricter COVID-19 regulatory restrictions for extended periods. In addition, SA's high public debt and contingent liabilities (low tax base), will constrain the further use of fiscal policy to support growth and incomes of vulnerable groups. This will shift the burden of economic stabilisation to monetary policy in turn, raising inflationary pressures and fiscal stability risks.

Going forward, the OECD has emphasised the continued need for policy support to be maintained to boost confidence and reduce uncertainty. Specifically, comprehensive public health interventions will remain necessary in containing and monitoring the spread of the virus and prevent new outbreaks.

In addition, macroeconomic policy support needs to be maintained through supportive monetary and targeted fiscal policy measures. Monetary policies need to create an attractive interest rate environment to attract investors and should be kept low for as long as possible to sustain confidence. Meanwhile, the possible extension of fiscal policy support into 2020 should be key a consideration for many governments but should consider the country specific budgetary constraints and challenges. Central to this fiscal support will be the evaluation and adjustment of key emergency programmes to limit long-lasting effects of the crisis.

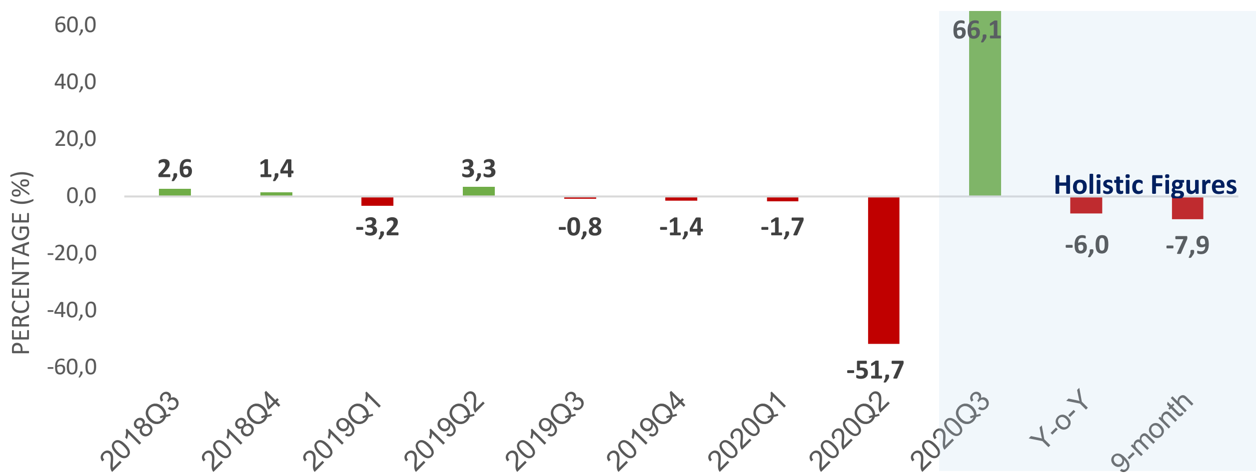
Support schemes for workers and companies need to be refocused and accompanied by structural reforms. The OECD highlights that the support measures implemented during the height of the pandemic may have run their course (especially as economies begin to reopen) as such, policy makers need to consider ways to continue support but in ways specifically tailored to address the emerging post-crisis needs and challenges.

3. DOMESTIC ECONOMIC DEVELOPMENTS

3.1. EASING OF LOCKDOWN REGULATIONS LEADS TO PSEUDO ECONOMIC GROWTH SPURT IN THIRD QUARTER

After registering four consecutive contractions, the South African economy registered a 66.1% quarter-on-quarter (q/q) annualised increase in economic activity for the third quarter of 2020. Meanwhile, activity contracted by -6% (year-on-year, unadjusted) and -7.9% between the first three quarters of 2020 and the first three quarters of 2019. The growth spurt was largely credited to eased lockdown regulations during the quarter, which aided a significant rebound in manufacturing and mining production activity.

Figure 2: South Africa economic growth (Q3:2018 – Q3:2020)



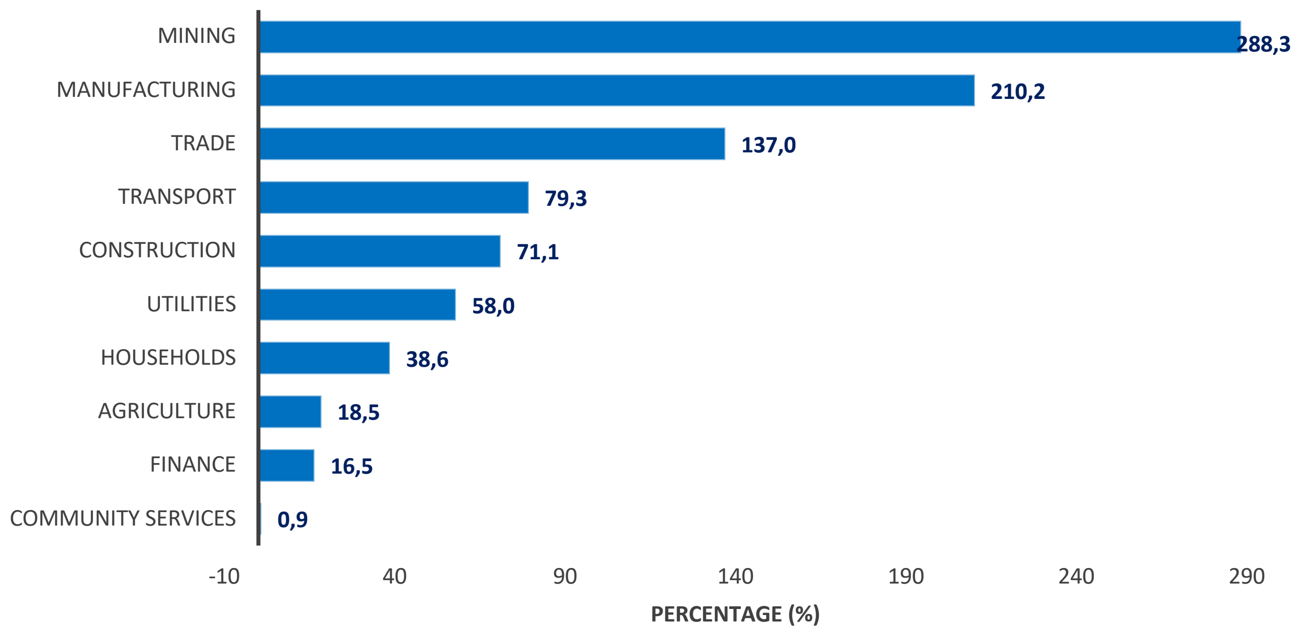
Data source: Statistics South Africa

The domestic economy recorded a broad-based improvement with the largest growth recorded in the primary industries (172.9%), followed by secondary (155.6%) and tertiary (37.6%) industries. The high spread between tertiary industries and other industries was expected because much of the industry's core activities where still unrestricted during the hard lockdown, supported by employees working remotely. As such, the easing of lockdown regulations allowed for a moderated spike in activity, most likely from businesses that had halted production during the hard lockdown.

Mining and manufacturing activity drive growth in Q3:2020

In line with expectations, manufacturing and mining activity stole the show, increasing by 210.2% and 288.3% respectively during the quarter. The uptick in mining and manufacturing activity was chiefly spurred by the rally in base and industrial metals caused by an upturn in global manufacturing activity and the rise in the demand for gold as a second wave of the virus loomed. In addition, the fulfilment of delayed orders and pent-up demand by manufacturers also contributed to the surge. Despite the upturn in manufacturing activity and sentiment, the outlook for the sector remains precarious. The ABSA Purchasing Managers Index (PMI) reading during the quarter signalled that the sector's upsurge is likely to wind down in the last quarter of 2020 - once manufacturing backlogs are cleared. The PMI decelerated from 60.9 to 52.6 index-points between October and November 2020, owing chiefly to a decline in the new sales order sub-index to below the 50-midpoint at 49 index-points.

Figure 3: Economic growth by sector (Q3:2020, Quarter-on-quarter)



Data source: Statistics South Africa

Correspondingly, increases in mining and manufacturing production was likely fundamental to the 58% expansion in utilities. During the hard lockdown utilities were mainly consumed at the household level, whilst commercial demand was muted due to limited or no economic activity in the production of non-essential goods and services. As a result, the easing of lockdown regulations induced an uptick in activity as the number of employees allowed back at work increased from 33% to 66% between Alert levels 4 and 3.

Construction activity increases for the first time in eight quarters

Construction activity increased by 71.1% in the third quarter of 2020, following eight (2 years' worth) uninterrupted quarterly contractions. The sudden surge was credited to increased residential building activity, non-residential buildings and construction works, all of which contributed to the 5 index-point escalation in the FNB/BER Building Confidence to 29 index-points for the fourth quarter of 2020. Owing to the much weaker performance of the sector prior to the third quarter of 2020, estimations predict that the surge is unlikely to be sustained. The latest reading is likely more of a pseudo increase incited by statistical bias. Going forward, activity is expected to somewhat recalibrate however, to levels below pre-COVID times. This is due to several factors including, the large exodus of firms during the hard lockdown, depressed domestic demand and changes in workplace dynamics driven by COVID-related uncertainties. Notwithstanding, the anticipated downturn could be cushioned by the public infrastructure projects that have been tabled over the medium-term.

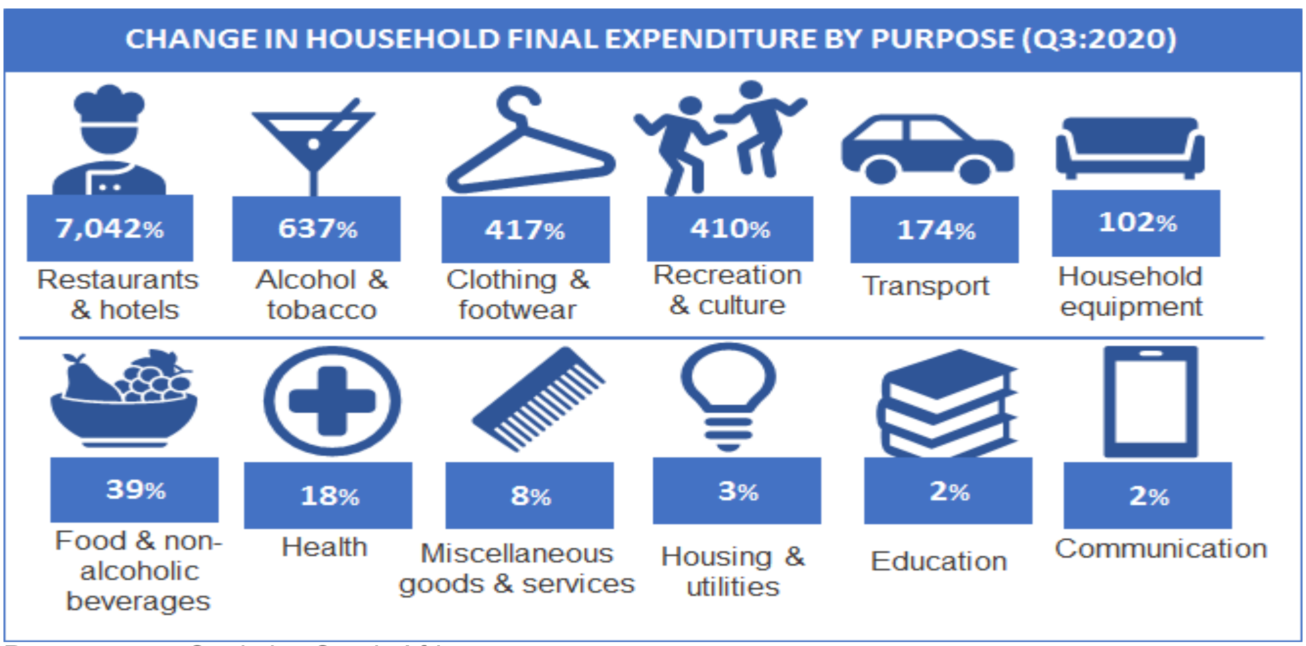
Working from home negatively affects growth in tertiary industries

Despite the 137% increase in trade activity, sectors in tertiary industries recorded relatively lower growth than primary and secondary industries activity, particularly community services which expanded by only 0.9%. The subdued growth in community services was attributed to slower activity in the sector following the rapid COVID relief-related interventions initiated earlier in the year such as increased employment in provincial governments and tertiary institutions. Likewise, the consequences of the lockdown were also felt in other sectors. For instance, growth in the finance sector was primarily attributed to COVID-related ramifications such as an increase in retrenchments (which may require pension pay-outs) and increased residential real estate activity as working remotely became the norm.

__Eating out dominates food spend during Alerts Levels 3 and 4__

Akin to the uptick in economic production, Gross Domestic Expenditure (GDE) expanded by 67.6% in the third quarter of 2020. Delving further, GDE decreased by -6.4% (y/y) and -8.5% for the year to date. Expenditure growth for the period was ascribed to widespread increases; specifically, the unprecedented 201.4% increase in exports which overwhelmingly dwarfed the -1.6% decline in imports that led to protracted trade surpluses since the lockdown began.

In the same tune, household expenditure was up 69.5%, underpinned by astonishing increases in restaurants and hotel figures (7 042.5%) and alcohol beverages, tobacco and narcotics (673.4%) which were 178,7 and 17 times higher than the growth in food and non-alcohol beverage spend. Furthermore, expenditure on recreation and cultural activities grew by 410.3% during the quarter likely due to the allowance of intra-provincial travel during the Heritage Day long weekend which also marked the end of Alert Level 3. Looking ahead, expenditure on travel and leisure activities is envisioned to continue to increase into the fourth quarter.



Data source: Statistics South Africa

Notwithstanding the extraordinary growth recorded for the quarter, the economic outlook for the country remained grim. Analyst indicated that year-to-date and year-on-year figures were not a true reflection of the state of the real economy and that the Q3:2020 tally was merely a confidence rather than an economic recovery as lockdown regulation eased. A closer look reveals sentiments continued to be reserved with FNB/BER Business Confidence Index having increased gradually since the hard lockdown but, remained below the 50-midpoint mark. In addition, although Consumer Confidence recuperated to -23 index-points, it remained in the red for the third quarter of 2020. Given these observations, it is estimated that the growth seen in Q3 would likely not continue in the near term but could follow a J-shaped confidence-based recovery and then a U-shaped economic-based repossession in the medium term.

Yet another credit ratings downgrade dampens SA's growth trajectory

In an unexpected move, both Moody's and Fitch announced on in late November that they had further downgraded South Africa's credit ratings deeper into below-investment (or junk) status. Citing concerns about SA's rising debt and growing risks of a further weakening in its fiscal position (somewhat exacerbated by the COVID-19 pandemic's effect on tax revenue collection), the two ratings agencies believed the risks sufficed to warrant further downgrades. Meanwhile, Standard and Poor (S&P) was the only leading ratings agency to maintain its rating, with a stable outlook. Moody's forecasts SA's government debt to GDP to increase to 110% by the end of the 2024 fiscal year.

Table 2: Credit ratings

Agency	Previous rating	Date	Current Rating	Date	Outlook
Moody's	Ba1	27 March 2020	Ba2	20 November 2020	**Negative**
Fitch	BB	3 April 2020	BB-	20 November 2020	**Negative**
S&P	BB-	30 April 2020	BB-	20 November 2020	**Stable**

Data source: Moody's, Fitch and S&P

The cut by Moody's took SA two (2) notches below investment grade status (which follows a ratings downgrade in March 2020), while Fitch's cut brought it three (3) levels below investment grade. In addition, both agencies maintained negative outlooks. These developments will ultimately increase the country's borrowing costs and further limit its already constrained fiscal space which will further limit the Treasury's ability to fund unexpected funding requirements during these difficult economic times. Finance Minister, Tito Mboweni, highlighted in a statement issued by the National Treasury that in the wake of higher borrowing costs, government will have to either reduce its social spending or increase taxes – both of which are unfavourable options given SA's current challenges. In addition, the statement emphasised that such downgrades have dire consequences for the value of a wide range of assets including, savings; retirement funds as well as property - all of which play a critical role in supporting economic growth.

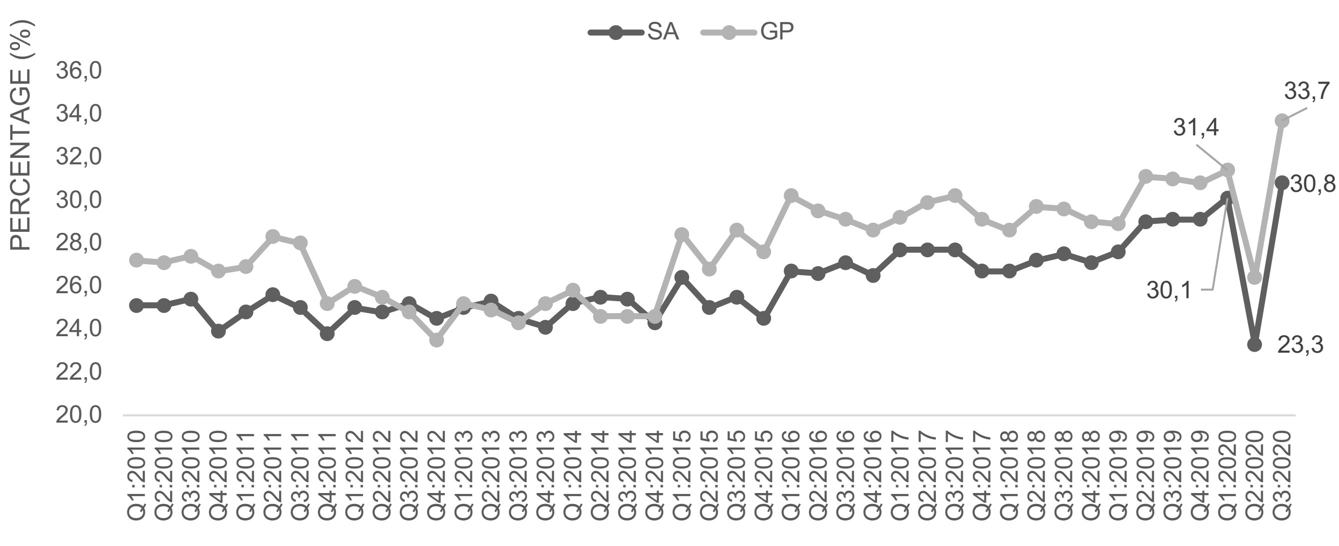
What does this mean for Gauteng?

Overall, the national growth figures signalled lower growth for the province during the third quarter of 2020. This is due to the province's significant tertiary base and dwindling manufacturing sector. Growth is expected to be underpinned by strong trade figures with subdued increases in mining and manufacturing activity which were the largest contributors to 66.1% annualised increase recorded at national level.

3.2. SA EMPLOYMENT NUMBERS RECOVER IN LINE WITH GRADUAL RESUMPTION OF ECONOMIC ACTIVITY DURING THIRD QUARTER

As the economy gradually opened in Q3:2020, the labour market correspondingly attracted increased participation - subsequently, pushing the unemployment rate to levels expected under such economic conditions. Following the massive decline in jobs (5 million) in the second quarter of 2020, the national labour force rose sharply by 2.78 million to 21.22 million reducing the number individuals classified as not economically active. However, due to the strained economic conditions, employment recovered much slower and only increased by 543 000 to 14.69 million – a level last witnessed during the third quarter of 2013.

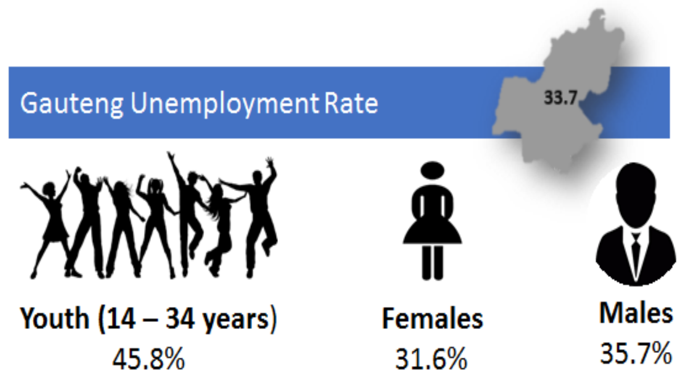
Figure 4: National & Gauteng official unemployment rate (Q1:2010 – Q3:2020)



Data source: Statistics South Africa

The slow recovery in employment suggested that only about a quarter (1 in 4) of the jobs lost in the previous quarter were recovered, providing what was possibly the first indication that some of the job losses may have been protracted and even permanent. Correspondingly, the number of unemployed people increased by 2.2 million to 6.53 million. As such, the official unemployment rate measured at 30.8%, increasing by 7.5 percentage points from a low 23.3% in the second quarter of 2020. On the other hand, the expanded unemployment rate increased marginally by 1.1 percentage point to 43.1%.

Gauteng labour market mimics national trends but, employment increased marginally relative to other provinces

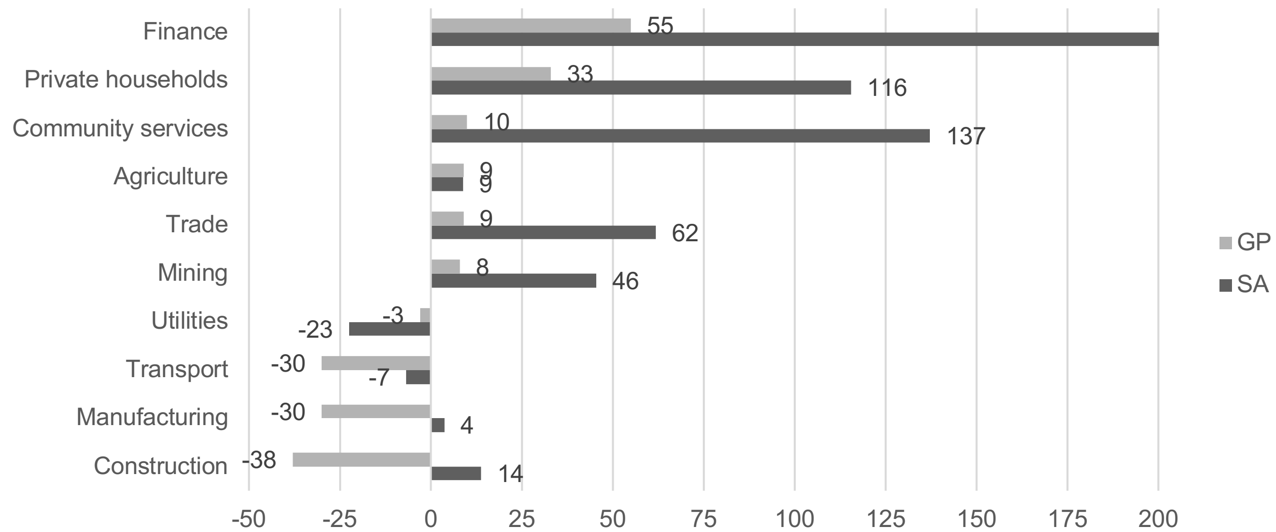


In line with the national level, half of the individuals who had exited the labour force in the previous quarter in Gauteng returned to the labour market, pushing up the labour force by 715 000 to 6.8 million. However, employment only increased by 33 000 to 4.5 million. With the prevailing economic conditions, it is unlikely that the increase in employment emanates from new jobs but could rather be attributed to more individuals returning to their jobs after being furloughed during the height of the lockdown. Specifically, employment slipped notably in the first quarter (-661 000) and the changes in the provincial third quarter employment suggested that only 5% of the 661 000 individuals were able to return to work whilst 95% remained unemployed. As such, the number of unemployed individuals increased by 683 000 to 2.3 million. Subsequently, the unemployment rate in Gauteng increased by 7 percentage points to register at 33.7%in Q3:2020.

Nationally, a quarterly rebound in jobs was recorded across most sectors. Specifically, eight (8) of the ten (10) sectors recorded job gains, led by Finance (200 000), Community services (137 000) and Private household (116 000). Meanwhile, employment in the Manufacturing sector only increased by 46 000, possibly weighed down by the auto motive sector, which was one of the hardest hit sectors during the lockdown. On the other hand, Utilities and Transport sectors shed 23 000 and 7 000 jobs respectively during the quarter.

At the provincial level, employment rose in six (6) of the ten (10) sectors, again job gains were led by the Finance (55 000), Community services (53 000) and Private household (10 000) sectors. Meanwhile, provincial job losses were recorded in the Construction (-38 000) as well as the Manufacturing and Transport sectors, which both shed 30 000 jobs.

Figure 5: Quarterly employment changes in SA and Gauteng (Q2:2020 – Q3:2020)



Data source: Statistics South Africa

The lockdown had a varying effect on employment across sectors, with some being more affected than others. Specifically, tourism, retail, transport and automotive sectors saw significant cuts in activity and job numbers as a result of COVID-19 induced restrictions to trade during the second and much of the third quarter.

Labour market hard-hit by lockdown measures

Whilst the labour market recorded some improvement on a quarterly basis, in order to ascertain the real impact of the lockdown on the labour market, a comparison is made between Q3:2020 and Q1:2020 - prior to the implementation of lockdown restrictions. Over this period, employment declined by 1.69 million and 628 000 at the National and provincial (Gauteng) level, respectively. Due to the mammoth exodus of individuals from the labour market, the unemployment rate which only increased by 0.7 percentage points in SA and by 2 percentage points in GP, did not fully mirror the impact on unemployment.

Table 3: Lockdown driven employment changes, Q3:2020 vs Q1:2020

Industry	South Africa	Gauteng
	Thousands ('000)	
Agriculture	-57	10
Mining	-17	-22
Manufacturing	-246	-112
Utilities	-25	-3
Construction	-264	-77
Trade	-311	-105
Transport	-117	-40
Finance	-83	-77
Community services	-378	-137
Private households	-195	-69
Total	**-1.7**	**-0.69**

Data Source: Statistics South Africa

Transport sector bloodbath: **441 000 jobs shed** in GP and **108 000 jobs shed** in SA

Tourism sector shed **16 700 jobs** in GP and **63 800 jobs** in SA

All sectors felt the sting of the lockdown such that, nationally, employment declined across all sectors whilst in Gauteng, employment only picked up in Agriculture. Furthermore, a larger portion of jobs had been lost in sectors known to employ a larger portion of the vulnerable groups, like the youth, women and the Black population.

Going forward, the employment stimulus highlighted by the President is expected to boost employment. However, the data suggests that Gauteng might need to push harder in implementing the employment stimulus to see the much-needed impact.

3.3. DOMESTIC INVESTMENT STRONGER IN Q3:2020 FOLLOWING DRASTIC DECLINES IN PRECEDING QUARTER

South Africa's Real Gross Fixed Capital Formation (GFCF), or net investments, has historically been characterised by extreme volatility. During the third quarter of 2020 (Q3:2020), Real Gross Fixed Capital Formation increased by much less than the contraction recorded in the second quarter of the year, rising by 26.5% compared with the 59.8% seasonally adjusted annualised decline recorded in the preceding quarter. Capital investment by both private and public sector corporations recovered somewhat, mainly supported by the easing of COVID-19 lockdown restrictions. GFCF by government, which was somewhat less affected by the restrictions under the national lockdown, advanced at a slightly slower pace in the third quarter as capital investment in emergency infrastructure slowed compared to the previous quarter. The level of real capital outlays by public corporations was 27.4% lower over this period – the lowest amongst the three sectors.

Table 4: Quarterly percentage change in Real Gross Fixed Capital Formation (seasonally adjusted annualized rate))

Sector	2019			2020		
	Q3	Q4	Year*	Q1	Q2	Q3
Private business enterprises	9.5	-10.3	1.1	-22.7	-63.3	33.2
Public corporations	0.7	-0.3	-1.6	-13.1	-82.9	16.8
General Government	-15.6	-17.6	-8.9	-2.2	15.2	9.8
Total	4.1	-10.0	-0.9	-18.6	-59.8	26.5

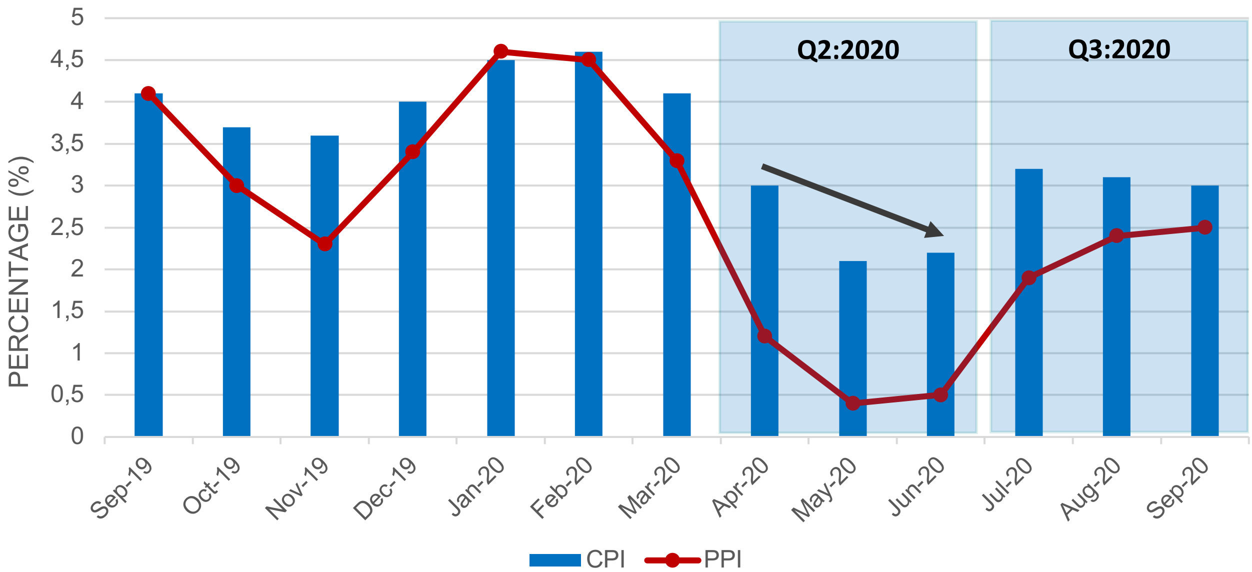
Data source: Statistics South Africa. * Percentage change over one year

Gross fixed capital outlays by private business enterprises expanded by 33.2% in Q3:2020, following a notable decline of 63.3% in the previous quarter. The broad-based rebound in private enterprise outlays was supported by advancements in construction as well as non-residential buildings. Meanwhile, GFCF by the public sector was driven by increased capital outlays by both public corporations and general government, expanding by 16.8% in Q3:2020. Public corporations invested primarily in transport and electricity generation, particularly in construction works, transport equipment as well as machinery and equipment. Slower growth in capital expenditure on COVID-19 related medical supplies and temporary public health operations led to general government capital expenditure moderating to 9.8% in Q3:2020 following an increase of 15.2% in the preceding quarter.

3.4. CONSUMER AND PRODUCER PRICE INFLATION ACCELERATE SOMEWHAT IN Q3:2020

Headline producer and consumer price inflation both accelerated somewhat from historical lows recorded in the second quarter of 2020. This came after a marked decrease in fuel prices in the wake of the COVID-19 pandemic. Headline producer price inflation accelerated from a 10-year low of 0.4% in May 2020 to a six-month high of 2.5% in September, driven by an acceleration in the pace of increase in the prices of food and tobacco products, rubber and plastic products, as well as motor vehicles, while coal and petroleum prices declined at a slower pace. Headline consumer price inflation accelerated from a 16-year low of 2.1% in May 2020 to 3.0% in September as the year-on-year pace of decline in fuel prices moderated notably. Overall, inflation remained notably below pre-COVID levels, affirming the constrained economic environment grappling with the effects of the pandemic and subsequent lockdown measures on aggregate demand and overall price conditions.

Figure 6: Consumer and Producer Price Inflation (Year-on-year % change)



Data source: Statistics South Africa

The quickening in consumer price inflation in Q3:2020 resulted from an acceleration in food and non-alcoholic beverage price inflation and, to a lesser extent, also in housing and utilities and miscellaneous goods and services inflation. Producer price inflation for intermediate manufactured goods accelerated gradually to 3.0% in September 2020 however, the acceleration was not broad-based, with many intermediate manufacturing categories remaining in deflation.

After reaching a four-month low in June 2020, producer price inflation for agricultural, forestry and fishery products quickened to 10.8% in October, led by higher agricultural product prices. Producer price inflation for mining products remained elevated through most of 2020 (including during the third quarter) and accelerated anew from 26.0% in June 2020 to 36.4% in September.

Producer price inflation of electricity and water decelerated for four consecutive months to 4.3% in September 2020. Although water price inflation remained unchanged at 7.4% for a fourth successive month, electricity price inflation slowed to a multi-year low of 3.9% in September 2020 and should see a slight acceleration the fourth quarter as annual price increases are implemented after being delayed in response to COVID-19.

Changes in administered prices moved from an annual increase of 9.2% in January 2020 to a decrease of 3.1% in May, in line with the marked deceleration in fuel price inflation from 13.7% to -25.9% over the same period. Following this, administered price inflation accelerated slightly to 0.9% in October as the decline in fuel prices slowed. However, when excluding electricity prices, administered price inflation moderated from 5.3% in January 2020 to 4.6% in September.

Overall, the inflation outlook remained mostly subdued with inflation expected to remain mostly flat (or moderate slightly) into 2021. On average, inflation will likely remain at levels significantly below those observed before the pandemic as both producers and consumers continue to grapple with the volatile supply and demand environment and producers have shrinking room to increase or pass on price pressures to an already constrained pool of consumers.

Given the much weaker inflation environment and contrary to expectations of yet another cut supported by the severely depressed second quarter GDP reading as well as the dovish stance of the Fed, the South African Reserve Bank (SARB) kept the repo rate unchanged at its monetary policy meeting in September 2020. The repo rate remained unchanged at 3.5% whilst the prime rate remained at 7.0%.

The decision to keep rates unchanged was underpinned by the stable inflation outlook on the back of no demand side pressures, despite the risks of stagnant economic recovery. As such, in 2020, headline inflation is forecasted stabilise at an average rate of 3.3% whilst core inflation averages 3.4%. Furthermore, over the medium-term, headline inflation is expected to be contained around the mid-point at 4.0% and 4.4% in 2021 and 2022 respectively. As a result, no further cuts in the repo rate are expected in the near term, with two cuts foreseen for later in 2021.

QUARTERLY PROJECTION MODEL FORECASTS – SEPTEMBER 2020			
INDICATOR	**2020**	**2021**	**2022**
Headline CPI	**3.3%** [3.4%]	**4.0%** [4.3%]	**3.4%** [4.3%]
Core CPI	**3.4%** [3.3%]	**3.7%** [4.4%]	**4.0%** [4.4%]
GDP growth	**-8.2%** [-7.3%]	**3.9%** [3.7%]	**2.6%** [2.8%]

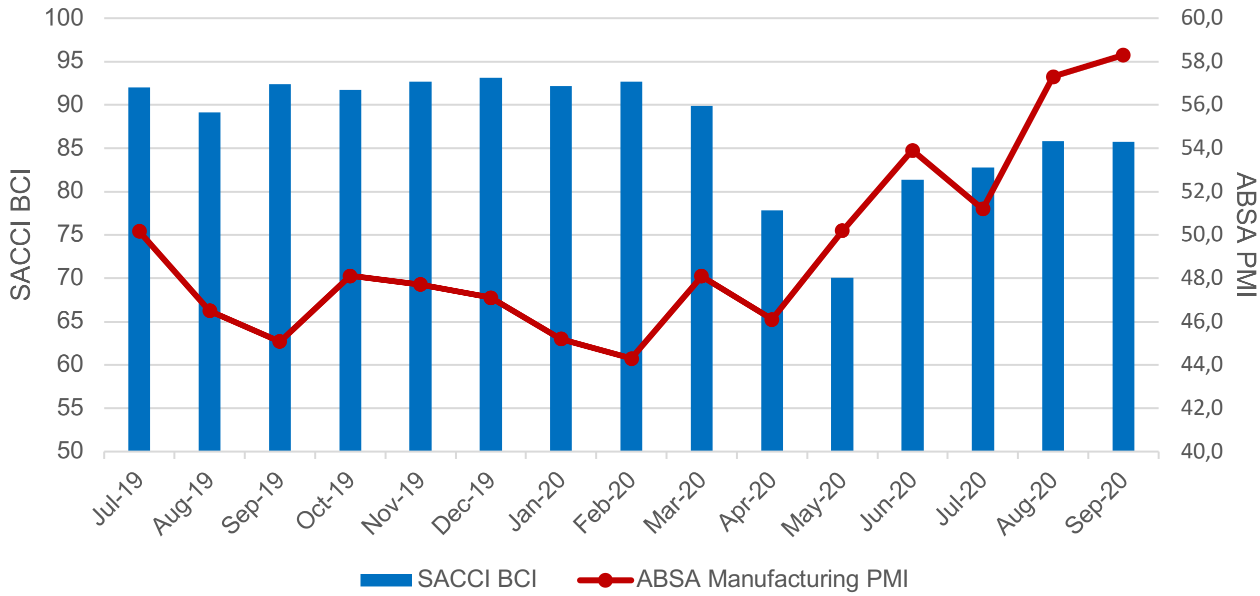
Data Source: South African Reserve Bank, values in [ ] indicate July forecasts.

On the economic front, the global economy was forecast to contract by 4.9%, a slight improvement from previous forecasts. For South Africa, as the economy continued to see the worst outcomes from the lockdown, and the SARB indicated that it expected GDP to slip further into a contraction, to register at -8.2% in 2020 this is worse compared to its previous forecast of -7.3% and -7.0% economic contraction announced in July and May respectively. Despite these revisions, SA's output gap (which shows the difference between SA's actual and potential output) is expected to improve to -6.5% in 2020 from a previous forecast of -7%, an indication of faltering investment and demand and consequently lower potential growth estimates.

3.5. BUSINESS CONFIDENCE AND MANUFACTURING ACTIVITY RECOVERS FROM COVID-19 INDUCED WEAKNESS

The Absa Purchasing Manager's Index (PMI) recovered further from the record-low weakness recorded in the first quarter of 2020. After improving in the second quarter of the year, manufacturing activity improved further in the third quarter edging further past the 50-midpoint that separates contraction from expansion. In the third quarter of 2020, the Absa PMI averaged 55.6 index points, recovering from the 50.1 average reading recorded in the second quarter of the year. The improvement was supported by strong improvements in manufacturing activity in both August and September 2020.

Figure 7: SACCI Business Confidence Index and ABSA Purchasing Manager's Index



Data source: BER and SACCI

The subsequent improvement in the PMI in August and September came after an improvement in business activity and optimism following the further easing of lockdown restrictions. Looking ahead, a further recovery in activity is expected. Even more encouraging is that the uptick in activity is supported both domestic and export demand – signalling an improvement in global sentiment as well.

Similarly, as shown in the figure above, overall business confidence, as measured by the South African Chamber of Commerce and Industry (SACCI) Business Confidence Index (BCI) showed stable improvement from the weaker readings recorded in April and May 2020. Specifically, the BCI improved from a low of just 70.1 in May 2020 to 85.7 in September.

Although the third quarter readings were an improvement from the previous quarter, they were still notably lower than those recorded in 2019, with the BCI continuing to reflect a business climate that is plagued by weak economic performance, recessionary pressures, high unemployment and growing fiscal unsustainability. In September 2020 the BCI nevertheless progressed by 15.6 index points above the trough of 70.1 of May 2020 – highlighting the impact of the severity of the lockdown process on the business climate earlier in the year. However, the

BCI was still 6.7 index points below the September 2019 level, averaging at 84.8 over the third quarter of 2020 compared to 91.2 in the same quarter a year earlier.

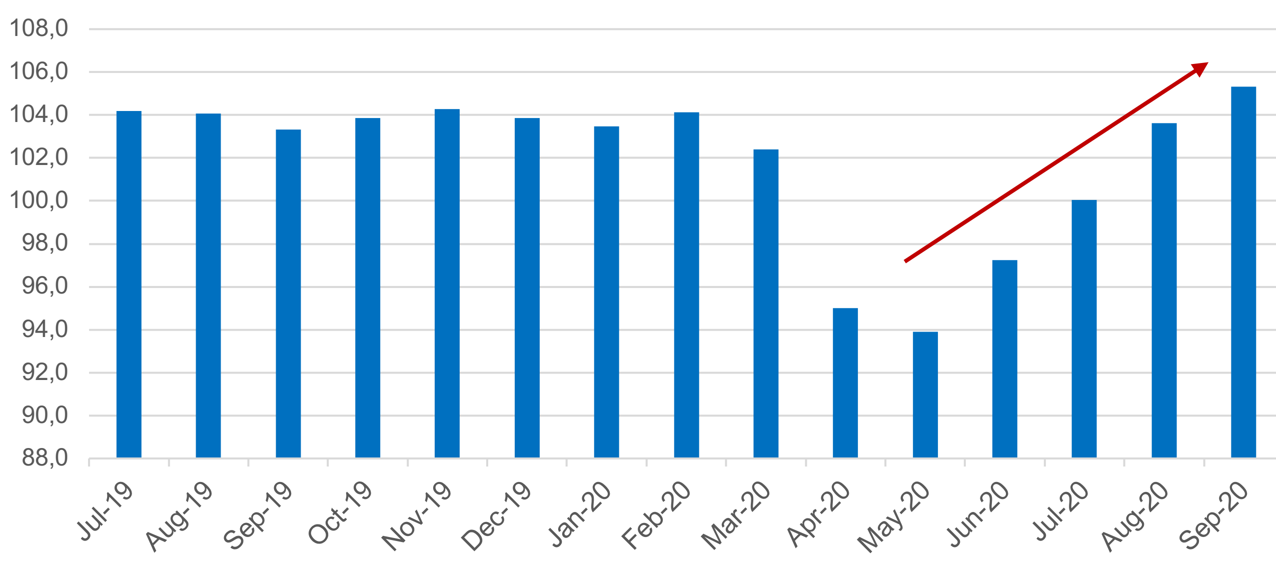
Confidence levels have generally been dampened by depressed retail sales volumes, lower share prices and declining real credit extension to the private sector, all of which have been burdened by COVID-19 uncertainty. On the upside, improved merchandise trade volumes and manufacturing production supported some business climate positivity.

Despite the third quarter recovery in confidence, the initial decline at the onset of the pandemic shows the sensitivity of the domestic economy and business environment to exogenous variables. The continued fragility of the domestic economy is expected into 2021 driven by changes in the global economic climate as well as uncertainty about government's ability to effectively and efficiently implement enabling policies that will support and encourage the private sector to fast track the full resumption of economic activity.

3.6. COMPOSITE LEADING BUSINESS CYCLE INDICATOR SIGNALS IMPROVED BUSINESS CLIMATE AHEAD

The composite business cycle indicators all registered improved month-on-month (m/m) readings in Q3:2020, following some improvement in several components of the indices. Specifically, the leading indicator improved from 97.2 in June to 105.3 index points in September, its highest reading in five months.

Figure 8: Leading Business Cycle Indicator



Data source: South African Reserve Bank

Improvements in the leading indicator came after seven of the nine available component series saw much stronger readings. The largest contributions to the higher reading were an uptick in the US dollar-denominated SA export commodity price index as well as an increase in the annual change in job advertisement space – which signaled a much-needed rise in demand for labour following the massive jobs bloodbath observed earlier in the year.

Meanwhile, the composite coincident business cycle indicator increased by 0.7% m/m in August on the back of improved production capacity utilisation in the manufacturing sector and general expectations of a meaningful recovery in economic activity in the third quarter of 2020. Overall, the improvement in both the coincident and leading business cycle indicators confirmed an ongoing improvement in economic activity and point towards a gradual upturn in the business cycle following the COVID-induced weakness recorded between April and June 2020. Significant pressure remained and as the economy entered the final quarter of the year, any exogenous and/or endogenous shocks to the economic climate were likely to translate in further weakening in business and economic conditions.

4. CONCLUSION

Following a quarter characterised by rising pressure and uncertainty stemming from the COVID-19 outbreak, the third quarter saw some much-needed reprieve from the economic turmoil experienced earlier in the year. The severity of the economic, social, and health impact of the pandemic was hard felt in the second quarter, which was followed by a slow, yet steady, recovery in key economic measures during the third quarter.

Domestically, the data released during the quarter highlighted a struggling and constrained economy which remains under tremendous pressure despite improvements in business and consumer confidence - as businesses continue to grapple with the aftermath of the pandemic-induced disruptions and shocks to operations. SA's labour market saw some recovery in job losses registered in the previous quarter as the domestic economy registered much stronger economic output in Q3:2020. Producer and consumer prices edged slightly higher during Q3:2020, following much slower decline in fuel prices and higher food and beverages prices.

As COVID-19 panic settled, and contrary to global monetary and fiscal policy authorities, the South African Reserve Bank's Monetary Policy Committee kept interest rates unchanged following its September meeting, citing a stable inflation outlook as the key reason. In addition, the national lockdown aimed at curbing the spread of the virus moved through various levels from the hard lockdown level 5 to level 2, all of which saw economic activity move from a complete shutdown to the broad-based reopening of industries.

As such, the last quarter of 2020 was undoubtedly expected to be a revealing one, as a government kept a close eye on new COVID-19 cases as the country entered the holiday season. Going forward, coordinated efforts by government, business, global lenders such as the IMF and World Bank and citizens remain key to ensuring that the negative consequences are minimised, and that aid is provided where and when needed.