EFFICIENT GROUP

ECONOMIC COMMENTARY

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Newsletter

11 December 2019

BIG, BAD AND A GLIMMER OF HOPE

Last week, Eskom once again failed to keep their coal (that they use to generate electricity) dry. One failure lead to another and Eskom was forced to reinstitute load shedding. Although this is something that doesn't even shock South Africans anymore, the intensity of this round of load shedding seemed to suggest that Eskom was under severe strain. We quickly went from stage 2, to stage 4, and even reached a new high: stage 6! Each stage reflects an additional 1000 MW of electricity which Eskom removes from the grid. Both consumers and producers feel the pain of getting stuck in traffic, being unable to connect to cell phone networks and bumping into things in a dark room. However, we updated our model that attempts to measure the GDP impact of load shedding.

Our cost of load shedding model considers GDP from the supply side and uses assumptions about the ability of an industry to mitigate the cost of downtime. Certain industries, and the businesses within it, can relocate during times of load shedding to continue business as usual, others can use generators more cost-efficienty, and still others can shift production and even consumption patterns to a later stage. But it's also true that industries, especially those where large corporates are present, find it more difficult to mitigate the cost of load shedding. We further assume an average downtime of 7 hours a day; which is equivalent to something between stage 3 and 4 on a consistent basis. Using these assumptions, we find that the cost of load shedding has reduced our GDP growth by roughly 0.30% in 2019. This translates to R8.5 bn of real, inflation-adjusted rands. This value is much less than some estimates going around, but these estimates usually do not adjust for the ability of consumers and producers to change their trade-habits and therefore, often overstate the impact of load shedding. What our simple model is unable to do, is capture the emotional cost caused by the added irritation (friction) of not being able to freely trade.

Understanding the cost of load shedding helps to explain why South Africa's economy contracted by -0.6% during the third quarter of 2019. Although this is not the only reason, it helps to explain why our economy is unable to lift itself out of a low growth environment. It's difficult to grow if there's no power and even more so if producers perceive that there will be a lack of power. Businesses do well in an environment of consistency and are often reluctant to invest long-term capital in an unsure environment. Among those economies who have been struggling most in 2019 the "agricultural" sector once again went into recession, so too did the "construction" and "transport, storage and communication" sectors. Luckily the trade (2.6%), finance (1.6%) and government (2.4%) sectors showed some growth. Considering the dismal performance of the third quarter's GDP and the ongoing load shedding we've adjusted our 2019 GDP forecast down from 0.5% to 0.3%.

Luckily though, we had some good news too, a silver lining that once again points towards a shift in momentum, from the trough of economic growth we're currently in towards long-term sustainability. In a somewhat surprise ruling, the South African Airways (SAA) was placed under business rescue. Although this doesn't sound like a big deal, the implications of this action mean a lot South Africa's future. By placing a state-owned enterprise that was previously considered "untouchable", or to quote Tito Mboweni's terms "a golden calf", under business rescue means that others will most likely follow. Also, being under business rescue means that a lot of the strategic authority is stripped from government and placed in the hands of a court-appointed business rescue team of experts, which gives us a lot of hope in terms of the restructuring of ailing SOEs. In doing so, another layer of protection against government inefficiency has been created.

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