

### THREE SCENARIOS FOR COVID'S IMPACT ON SOUTH AFRICA

As we expected, the governor of the South African Reserve Bank (SARB), Lesetja Kganyago, announced that the SARB would reduce interest rates by 1%. This is to support indebted consumers and companies during these difficult times. We do not, however, have the scope to support the financial system with further liquidity by providing additional measures such as quantitative easing. It also wouldn't help recession-struck consumers, and the bond market, which has been struggling with liquidity in the recent sell-off. However, it might become a necessity if our worst-case scenario plays out.

#### **Worst-case scenario**

In the worst-case scenario 60%-70% of South Africans are affected, of which 20% are severely impacted, by the coronavirus, as predicted by the Health Minister Dr. Zweli Mkhize. Here, most operations in South Africa (SA) are brought to a complete standstill. In this instance only medical institutions and food retailers remain open and even service-related industries experience growth difficulties. The lockdown continuous for 4-6 months whilst the virus spreads and peaks in SA and Europe alike, only starting to slow down in the 3rd quarter. In this instance businesses and consumers will need all the help they can get. It will most likely have to be a give-and-take between government, labour and the private sector. Government will have to support both consumers and employers (from a monetary, fiscal, and legislative viewpoint) and employers will have to support employees (by not initiating mass lay-offs). Employees, in turn, would have to forego increases or take pay-cuts. Although the economy can contract as much as 5% in this instance, local equity markets should finally stabilize and surge in the 4th quarter. The mass sell-off we've seen lately is just silly business, as soon as large institutional investors get a hold on their emotions, we should see a recovery - this holds true for all our cases.

It's important to note that a reduction in economic activity is driven by both local and international factors. SA is unfortunately now feeling the pain of a double recession, one caused by internal mismanagement and the other by COVID-19 fears. In our worst-case scenario other countries, especially those in Europe, experience a similar degree of slowdown and global trade is eventually brought to a standstill. By the end of the year the rand remains weak around R17.50 levels and markets remain in negative territory albeit only barely. I'd say the likeliness of this happening is about 30%.

#### **Base-case only**

In our base-case only about 40%-50% of South Africans are affected. Economic activity lingers on, albeit under lockdown and severe constraints, for more or less three months. Europe and America see something similar but can avoid a cascade. In this instance, the economy only contracts by 1.8% and a similar neighbourly agreement between government, labour and the private sector is put in place. We expect markets to recover, starting in the 3rd quarter and ending flat. The rand might even appreciate back to R15.50 levels. The likeliness of this case occurring is probably 60%.

#### **Best-case scenario**

In a best-case scenario only 30%-40% of South Africans are affected, but the cost is severe constraints on economic activity and inflated government debt levels. In this instance the economy contracts by at least 1.8% but has more momentum in the 4th quarter to springboard us into 2021. A similar sensation is seen in markets that recover but are limited from entering positive territory by fears of global demand that linger. In this upbeat scenario the rand can strengthen back to R14.00 levels. This case only has a 10% probability of occurring.

No one knows exactly how any of this will play out, but it will most likely be a combination of all three cases. We've merely created these cases, so they can be updated as time progresses. One thing is clear, in all these cases we expect to see a considerable recovery in equity markets, as soon as hysteria and fear subsides, and reason returns.

