momentum
investments

Herman
van Papendorp
Head of Investment
Research & Asset Allocation

Sanisha
Packirisamy
Economist

in the
moment

2021 Economic outlook: Anticipated vaccine rollout lights up an uneven post-pandemic path

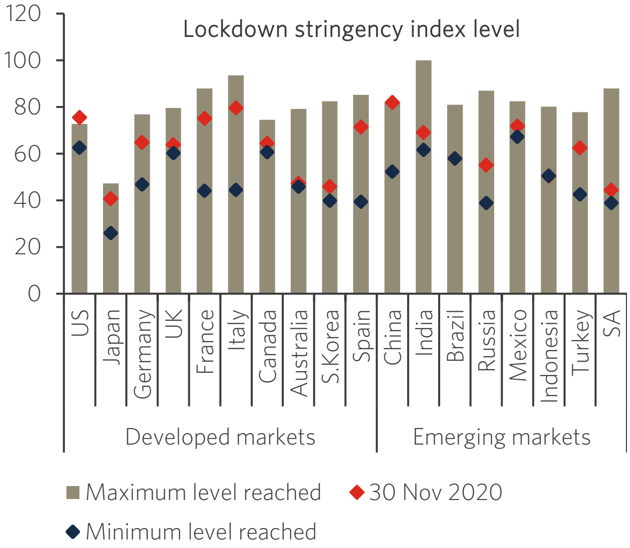
Highlights

- Stricter lockdown rules are likely to trigger a growth slump in the final quarter of 2020 and the first quarter of 2021 in the European and North American economies. Nevertheless, these regions are likely to emerge stronger as high expected vaccination coverage will allow for greater mobility and higher levels of economic activity.
- Pharmaceutical breakthroughs have fed optimism for a faster global snapback, though we still view the road to recovery as uneven and uncertain. The strength of the upturn will be reliant on the success of vaccination campaigns and greater global co-operation to guarantee an efficient distribution of vaccines worldwide.
- Continued fiscal support and an ultra-accommodative monetary policy stance are crucial in keeping the economy afloat and will lessen lasting economic damage from the crisis. A premature withdrawal of stimulus could pull the rug out from under the nascent recovery if the private sector cannot pick up the economic growth baton.
- Instead of invoking an acceleration in the prices of goods and services, central bank policy decisions have instead driven up asset price inflation, which has worsened trends in inequality. With less equitable growth outcomes emerging in the post-pandemic era, global policy uncertainty will likely remain elevated.
- After contracting at an anticipated 8.1% in 2020, growth in South Africa (SA) is expected to increase to a below-consensus 2% in 2021 before slowing to 1.6% in 2022. In our view, a likely rise in bankruptcies, electricity supply constraints, a poor jobs outlook, and material fiscal constraints lower the ceiling on SA's expected recovery.
- The major rating agencies have flagged that fiscal consolidation and the Economic Reconstruction and Recovery Plan face high implementation risk. Further negative rating action can be expected later in 2021 if government fails to arrest the increase in its debt burden through extensive wage bill cuts and capping additional financial support to poorly performing state-owned enterprises (SoEs).
- A more favourable terms-of-trade and positive momentum behind global vaccine hopes should support the rand in the interim. Nevertheless, we continue to see a depreciating bias in the local currency in the medium term given SA's deteriorating macro-fundamentals on a relative emerging market (EM) comparison.
- While near term inflation pressures are likely tilted to the downside, we see inflation rising in the medium term from an expected 3.2% in 2020 to 3.9% in 2021 and 4.7% in 2022.
- Additional monetary policy easing is less likely from here, unless SA suffers another growth setback induced by a renewed country-wide tightening in lockdown restrictions or if there is another sharp dip in inflation. We project a shift higher in interest rates in the second half of 2021 given the SA Reserve Bank's (Sarb) warning against the dangers of running negative real interest rates for a protracted period.

Promising vaccines unlock hope for an economic recovery

Just as life was seemingly returning towards normal, a second wave of COVID-19 infections washed over Europe in the fourth quarter of 2020. Governments have been hesitant to reintroduce the same level of stringency of lockdown measures used in April 2020 during the first wave of the pandemic. However, restrictions have lifted from their minimum levels reached since the start of the great lockdown to fight a resurgence in COVID-19 cases (see chart 1).

Chart 1: Renewed tightening in lockdown measures

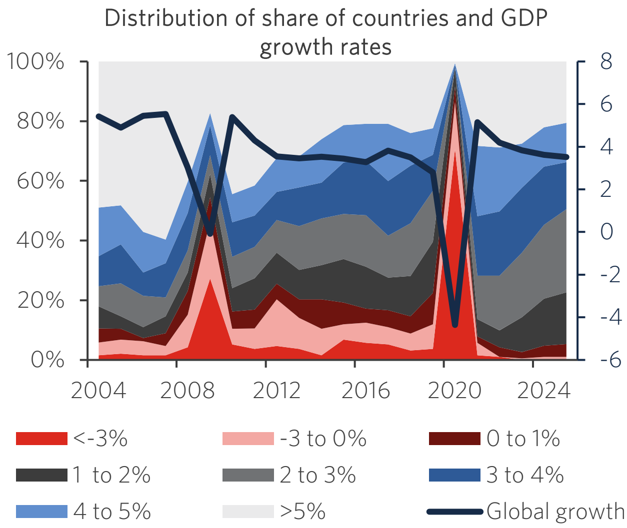


Source: University of Oxford, Momentum Investments

Pharmaceutical breakthroughs have fed optimism for a faster global economic recovery, though we still view the road to recovery as uneven and uncertain. In our view, countries that are larger, more flexible, exposed to less contact-intensive activity and that have a more diversified underlying contribution to economic activity will likely fare better in the coming quarters. Meanwhile, smaller, more concentrated economies that are reliant on services, such as hospitality and tourism, oil or a more entrenched small business culture are likely to require further support and will take longer to recover (see chart 2).

After a sharp contraction in growth in 2020, the global economy is nonetheless likely to gain momentum overall in 2021 as medical advances lead to a gradual relaxation in restrictions on mobility, allowing for a significant bounce in activity in many economies.

Chart 2: A more widely distributed expectation of global growth than what followed the 2008 crisis



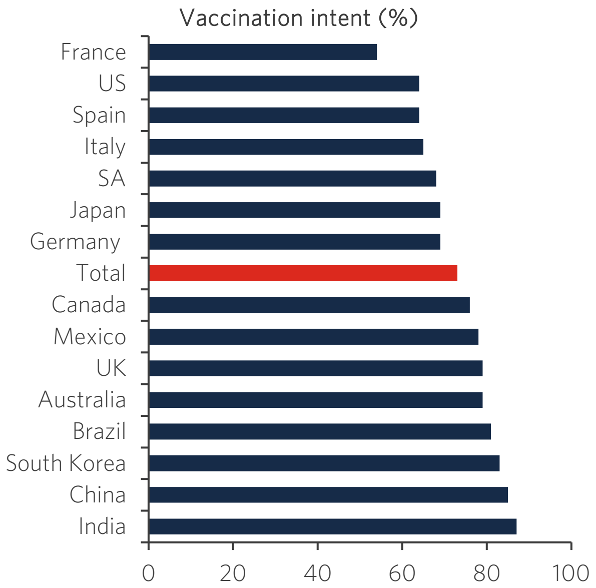
Source: International Monetary Fund (IMF) Financial Stability Report, Momentum Investments
Global growth read of the right-hand axis

The strength of the economic upturn will, however, be reliant on the success of vaccination campaigns (see chart 3) and greater global co-operation to guarantee an efficient distribution of vaccines worldwide.

After an expected growth slump in the final quarter of 2020 and the first quarter of 2021, the European and North American economies are likely to emerge strong from the colder weather as warmer weather sets in and lockdown measures ease as large shares of the population are vaccinated, which will allow for greater mobility and higher levels of economic activity. Several Asian economies, including China which entered the pandemic first, have benefited from advanced tracing and tracking systems and have been more successful in curbing the increase in infection rates. China is the only major economy worldwide that is expected to grow in 2020 and stage a more impressive recovery in 2021. According to the Organisation for Economic Co-operation and Development (OECD), the recovery in

China is expected to account for one third of world economic growth in 2021.

Chart 3: Speedy clinical trials raise concerns over vaccine side effects



Source: Ipsos, Momentum Investments
Surveyed in October 2020

Unprecedented fiscal (12% of global gross domestic product (GDP)) and monetary policy stimulus helped to avoid a more catastrophic growth outcome resulting from stringent lockdown measures. However, the crisis has had a disproportionate effect on society, with small businesses and informal sectors bearing the brunt of the economic pain. While those covered by social safety nets were largely protected from more adverse economic consequences of the pandemic, a slower improvement in low-skilled employment will drive an asymmetric disruption in this area of the labour market. The cumulative loss in world output relative to the pre-pandemic projected path is projected by the IMF to grow to US$28 trillion between 2020 and 2025. This means the path to improvement in average living standards across the globe has been severely impaired, and progress in eradicating global poverty will likely stall.

In our view, with global interest rates at all-time lows, continued fiscal support and an ultra-accommodative monetary policy stance are crucial in keeping the economy afloat and will lessen lasting economic damage from the crisis. A premature withdrawal of stimulus could pull the rug out from under the nascent recovery if the private sector cannot pick up the economic growth baton. This remains the key downside risk to a more robust economic outcome in 2021, in our view.

Even though world debt levels are on track to surpass World War 2 levels, fiscal instruments with a high effect on economic activity can lead to stronger, self-sustaining growth in the private sector. The IMF warns that aside from jeopardising economic gains made so far, exercising austerity too soon could trigger adverse changes to financial conditions and could lead to stickier levels of unemployment, which would raise inequality and spur political unrest. Similarly, any disappointment on the distribution or efficacy of vaccines could wound confidence, and further waves of infections could prompt tighter containment measures, once again stifling the budding economic recovery.

Table 1: Low inflation is a more likely outcome in the medium term than significant reflation

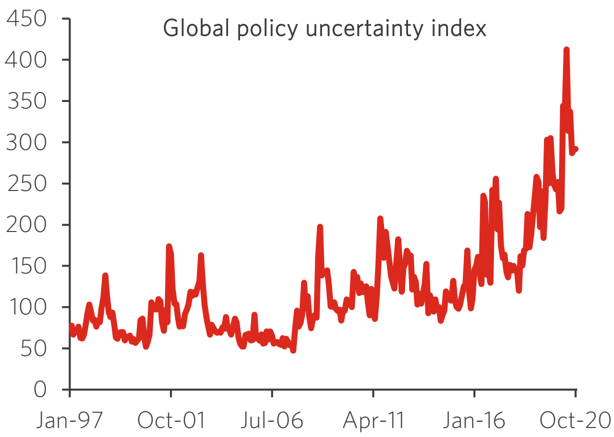
	Driver	ST	MT	LT
Cyclical	Output gap	↓	↓	↑
	Virus measures	↑	→	→
	Inflation expectations	↓	↑	↑
Policy	Fiscal policy	↑	↑	→
	Monetary policy	↑	↑	→
	New tools	↑	↑	→
Structural	Technology	↓	↓	↓
	Income inequality	↑	↑	↑
	Labour bargaining power	↓	↓	↓
	Demographics	↓	↓	↓
	Deglobalisation	↑	↓	↓

Source: BNP Paribas, Momentum Investments
ST=short term, MT=medium term, LT=long term

Although one would expect higher levels of fiscal spending, swollen central bank balance sheets and a shift to average inflation targeting in the United States (US) to result in much higher rates of inflation, supply-side disruptions have been countered by a collapse in demand. Impaired balance sheets, job losses and wage cuts are likely to repress demand in the near term, while technological advances, ageing populations and reduced labour bargaining power are likely to keep a lid on inflation in the medium term (see table 1).

Output gaps (the difference between actual and potential growth) are likely to remain negative for some time, which will limit upward pressure on inflation. This should allow developed markets to keep interest rates accommodative for the foreseeable future. With interest rates at rock bottom in advanced economies, central banks are expected to further expand balance sheets in 2021 to continue supporting the economy.

Chart 4: Elevated global economic policy uncertainty



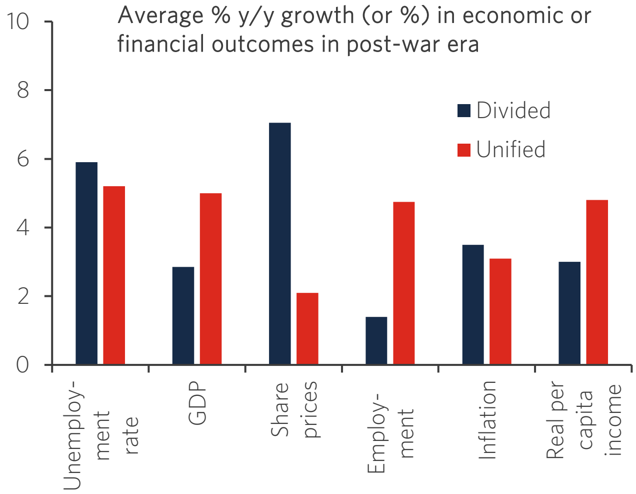
Source: Economic Policy Uncertainty, Momentum Investments

Instead of invoking a significant acceleration in the prices of goods and services, central bank policy decisions have driven up asset price inflation, which has worsened trends in inequality. The University of Cambridge has shown that net worth has increased for older generations but has declined for younger age cohorts since the global financial crisis. Subsequently, young people today are less satisfied with the performance of democracy than older generations and this poses a threat to the established global capital order. With less equitable growth outcomes emerging in the post-pandemic era, global policy uncertainty will likely remain elevated (see chart 4).

Although policy uncertainty indices for the globe and the US refuse to settle below pre-pandemic levels, the recent outcome of the November 2020 US presidential election promises better relations between the US and the rest of the world. Hopes for more predictable multilateral and diplomatic dividends have emerged given the incoming administration's increased appetite for international co-operation.

Even though Republicans lost the presidential battle, they are poised to retain control of the Senate. President-elect Joe Biden has an ambitious agenda, but a split Congress is likely to present an obstacle to bold changes in legislation and a larger fiscal stimulus package. BBVA Research shows that a divided government has not had enough space, historically, to make significant changes to policy, whereas a unified government has had a mandate to implement far-reaching legislative actions which can result in significantly more favourable economic outcomes (see chart 5).

Chart 5: Unified branches of government are better for the economy



Source: BBVA Research, Momentum Investments

A fraught fiscus and solemn sentiment lower the ceiling on SA's recovery

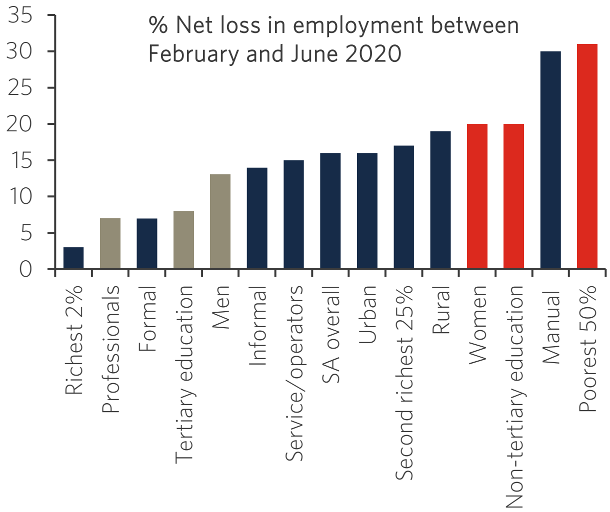
The IMF has shown that countries which tightened lockdowns when the number of COVID-19 cases was low managed to delay the rapid spread of infections early on in the crisis, while those that adopted more stringent lockdowns once cases had already surged struggled with worse epidemiological outcomes. In SA's case, government's swift lockdown awarded the country with time to optimise the healthcare system's preparedness to cope with the outbreak. However, the protracted nature of SA's hard lockdown measures were criticised as being economically unfeasible, given the unintended health and economic consequences of these interventions, including the following:

- **Growth:** According to the Sarb, the SA economy is anticipated to experience the third sharpest growth contraction from a range of EMs despite deploying the sixth largest fiscal stimulus and the second steepest interest rate cuts.
- **Poverty:** The rate of adult hunger spiked to 22% in May/June 2020, with 47% reporting no money available to buy food. These levels nevertheless dropped to 16% and 37%, respectively in July/August 2020, with the COVID-19 Social Relief of Distress Grant successfully supporting poorer households.
- **Health:** The Department of Health noted a 57% decline for HIV testing at public health facilities during the first month of lockdown, while the Western Cape Health Department noted a 47% decline in tuberculosis testing in June 2020. Momentum and Discovery medical aid schemes further observed a 30% to 50% drop in routine cancer screening during this period.
- **Employment:** The National Income Dynamics Study – Coronavirus Rapid Mobile Survey (NIDS-CRAM) threw a spotlight on the polarised nature of SA's labour market (see chart 6). The net job losses between February and June 2020 for the poorest 50% of SA's labour force amounted to 31%, 20% for those without tertiary education and 20% for women. Meanwhile, job losses were capped for professionals (7%), those with tertiary education (8%) and men (13%).

Data from credit-reporting agency TransUnion shows that job losses continued well into the third quarter of 2020, raising concerns over a potential spike in non-performing loans. Moreover, employment intentions as surveyed by the Bureau of Economic Research (BER) remain close to all-time lows, suggesting lingering negative effects on prospects for job creation.

The global financial crisis primarily took its toll on jobs in SA with a delay in 2009 and 2010. It took nearly five years for jobs to recover back to levels seen at the end of 2008. In the COVID-19 pandemic, instead of slashing jobs, some firms opted to cut pay or reduce working hours. More than a quarter of respondents surveyed by Statistics SA in May 2020 reported a decrease in their income. In businesses where these cuts were applied more permanently, it may take time for incomes to get back to pre-pandemic levels.

Chart 6: COVID-19 exacerbated the polarisation in SA's labour market

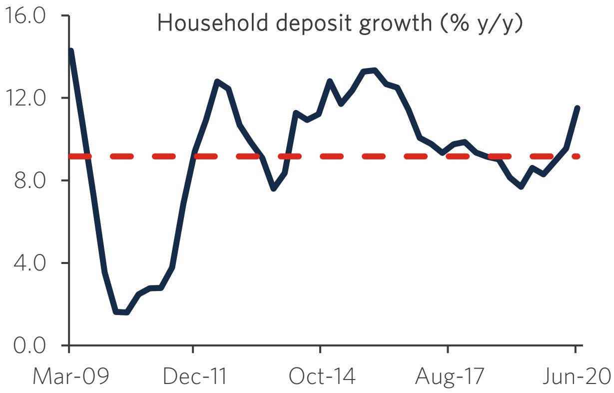


Source: NIDS-CRAM, Momentum Investments

By the end of October 2020, Government's Temporary Employee/Employer Relief Scheme had paid out R51 billion (11.5 million payments), but for those still out of work, an anticipated lethargic recovery in employment augurs a slow recovery in consumer spending. Households are further displaying an element of caution with a renewed uptick in growth in household deposits (see chart 7).

According to the Sarb, this may reflect households' expectations that unemployment benefits and cash flow relief from debt repayment holidays are only a transitory income windfall. With lower-skilled informal jobs likely to take even longer to recover, there will be pressure on government to continue supporting these households beyond the extended date of the COVID-19 relief funds. This will be challenging to achieve under already-strained fiscal conditions.

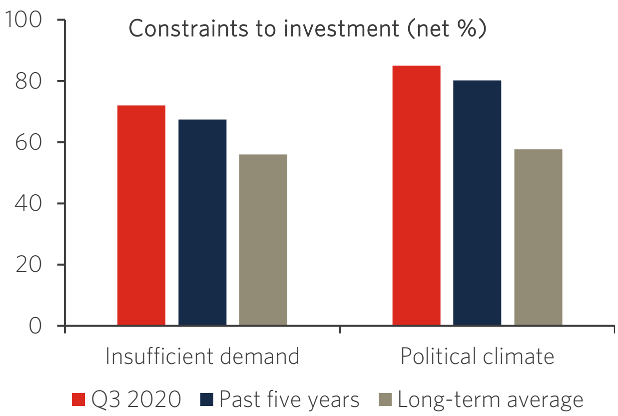
Chart 7: SA households adopting a cautious outlook



Source: Sarb, Momentum Investments

Although formal business liquidations have been slow to rise, data captured in the World Bank's Doing Business project points to a two-year delay in the time taken to resolve insolvency in SA, compared to one year in the US. Moreover, according to the Centre for Development and Enterprise, the negative effects of the lockdown have been more severe for SA's informal sector, which hires an estimated five million workers (University of Witwatersrand).

Chart 8: Businesses face constraints to investment

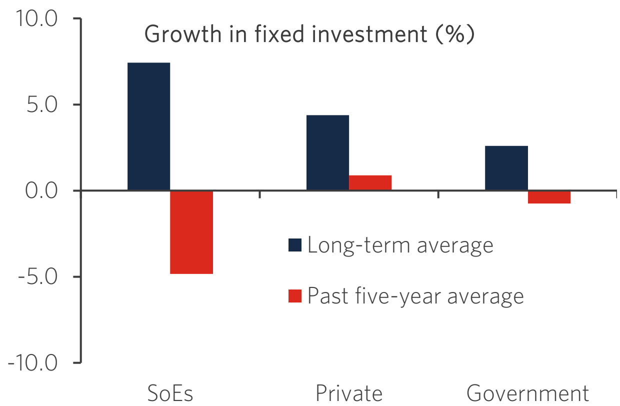


Source: BER, Momentum Investments

The BER's Business Confidence Index, which measures to what degree formal businesses are satisfied with prevailing conditions, bounced off a low of five index points in the second quarter of 2020 to 40 index points in the fourth quarter as lockdown restrictions continued to ease, but the sustainability of this bounce remains highly uncertain. The results of the BER Manufacturing Survey for the third quarter of 2020 indicated that a near-record 85% of survey respondents viewed the general political climate as a key constraint to investing. Insufficient levels of demand to substantiate investment spending was cited by 72% of respondents in the same survey (see chart 8).

With the private sector accounting for more than 70% of total gross fixed capital formation, reigniting confidence remains critical in generating faster growth in investment. Sluggish progress in implementing reforms and uncertainty in key areas of economic and regulatory policy have scuppered growth in private sector fixed investment in the past five years (see chart 9).

Chart 9: Disappointing growth in SA fixed investment



Source: Iress, Momentum Investments

SA may well have to contend with policy uncertainty for a while longer given a busy political calendar ahead. The by-elections held on 11 November 2020 served as a barometer of change in the political mood in SA following the after-effects of the pandemic. Although voter turnout remained low, the by-elections still serve as a preview of the municipal elections, which are expected to be held in the third quarter of 2021. Despite public criticism hurled at the African National Congress (ANC) government for its handling of the COVID-19 crisis, the ANC stood out as the most stable political party emerging from the by-elections. It maintained 64 seats, lost three seats and gained five seats. High-profile resignations in the official opposition party hurt by-election outcomes for the Democratic Alliance

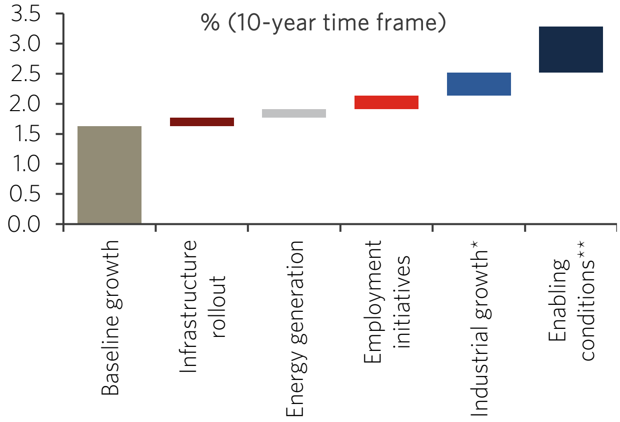
(DA). The DA maintained 14 seats, gained two and lost nine, of which four of the latter were lost to small parties, potentially signalling a loss in the DA's appeal as a party for minorities.

A number of postponed conferences will also take place in 2021, including the ANC Women's League Conference, the ANC Youth League Conference and the ANC National General Council, in which there will be further signs of President Cyril Ramaphosa's ability to consolidate his political authority in the 2022 ANC Elective Conference ahead of the 2024 National and Provincial elections.

One of the ways in which government aims to re-energise growth in SA is through bolstering its infrastructure efforts. Nonetheless, the Head of the Office of Investment and Infrastructure in the Presidency has admitted that the national investment target of R238 billion per year is unaffordable for the fiscus alone and this level of spend is reliant on private sector participation. To quell the debate around prescribed assets, the ANC subcommittee on economic transformation has proposed encouraging private pension funds to fund profitable infrastructure projects through a more collaborative approach rather than being forced to invest in specific SoEs, where government maladministration and deficient operational capacity remain concerning. Higher local investment will help to enhance economic activity. But in our opinion, providing a stable regulatory environment and building confidence in a higher expected growth trajectory will also help to attract foreign direct investment.

Government's Economic Reconstruction and Recovery Plan is a display of social compacting efforts and is centred on infrastructure and employment programmes to kickstart SA's stuttering economic engine and ultimately increase the country's relative attractiveness for inward investment. Treasury proposes that SA can achieve growth above 3% in the next decade and can create up to a million jobs through accelerating the implementation of much-needed reforms to create enabling conditions for businesses to operate (see chart 10).

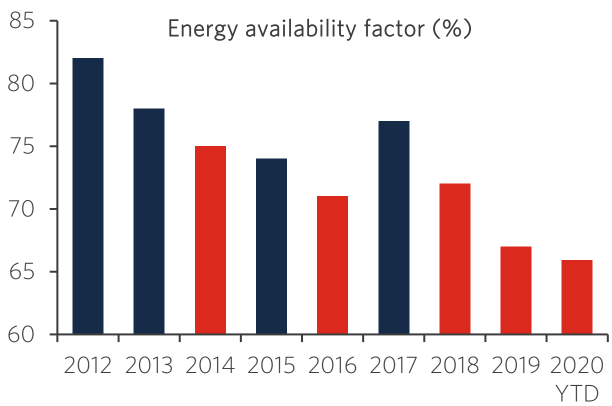
Chart 10: How to achieve a 3% growth rate in SA



Source: National Treasury, Momentum Investments
**Industrial growth = agriculture and manufacturing, **Reducing barriers to entry, easing the skills constraint and implementing tourism initiatives*

Nevertheless, Treasury itself has failed to predicate its longer-term growth assumptions on this number in the October 2020 medium-term budget. It has used a 2% forecast for medium-term growth instead. In our opinion, trend growth for the next five years has likely fallen to 1.7%. After contracting at an expected 8.1% in 2020, growth in the SA economy is likely to increase to a below-consensus 2% in 2021, before slowing to 1.6% in 2022. In our view, muted confidence and ongoing electricity supply constraints (see chart 11) will contain the anticipated recovery in growth in 2021.

Chart 11: Low energy availability factor



Source: BNP Paribas, Momentum Investments
Red bars = load shedding years

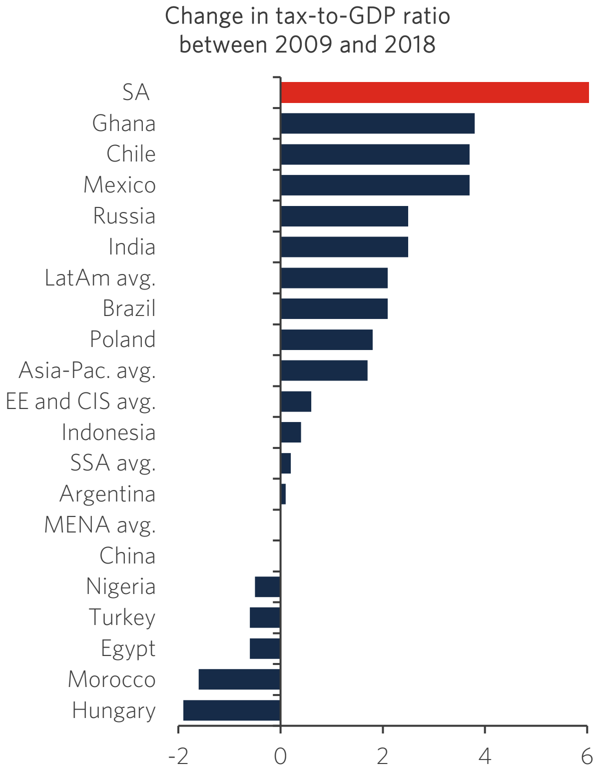
Estimates by the Council for Scientific and Industrial Research (CSIR) suggest that SA's energy availability factor will remain below 65% until 2030, which is below the 75.5% projection in the 2019 Integrated Resource Plan. A likely rise in bankruptcies (given the delay in liquidation proceedings in SA), lingering levels of elevated unemployment and significant fiscal constraints further dampen recovery prospects, in our opinion.

Even though low-hanging fruit such as the auctioning of broadband spectrum, negotiating supplementary power purchase agreements with existing renewable energy independent power producers, implementing gazetted infrastructure projects and reforming visa regulations should provide some growth underpin for the economy, harder-hitting reforms, such as overhauling operational and financial inefficiencies at SA's major parastatals, strengthening state capacity, improving educational outcomes or addressing rigidities in the labour market are unlikely to unfold in the near term. As such, the ceiling remains low on SA's expected growth recovery in the medium term.

The SA government responded to the pandemic with the largest relief effort in the country's history, even though EMs in general have had to tackle this crisis with fewer fiscal resources and higher borrowing costs. Once the risk of sliding back into recession dissipates, numerous EMs are likely to change tactic to achieve a faster and more sustainable pace of fiscal consolidation by broadening their respective tax bases. In SA's case, however, there is limited room to implement tax-raising measures to narrow a burgeoning budget deficit. SA's tax burden (tax-to-GDP ratio) is among the highest in an EM context. Onerous tax measures applied in the past decade have left SA ranking as the country experiencing the largest change in its tax burden between 2009 and 2018 (see chart 12).

While Moody's anticipates the weighted global average fiscal deficit ratio to recover from 11% in 2020 (after expanding from 3% in 2019) to about 5.5% in 2022, SA's fiscal deficit is likely to be around 9% of GDP. This means that SA will experience the biggest jump in its debt ratio relative to its EM counterparts in the next three years.

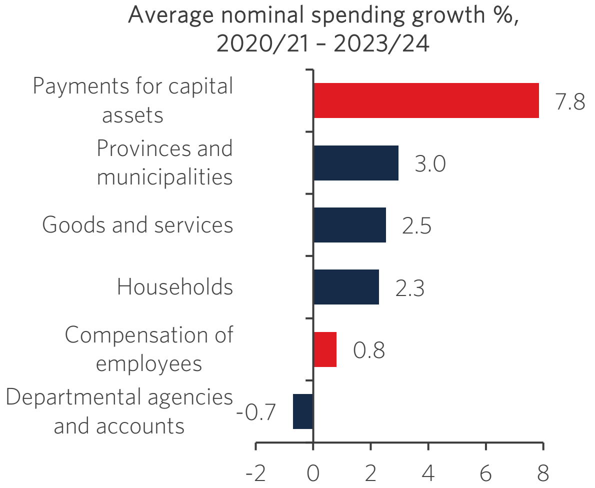
Chart 12: Onerous tax increases in SA



Source: Moody's, Momentum Investments
LatAm = Latin America, Asia-Pac = Asia-Pacific, EE = Eastern Europe, CIS = Commonwealth of Independent States, SSA = Sub-Saharan Africa, MENA = Middle East and North Africa

SA's diminishing fiscal multiplier is testament to the country reaching its fiscal limitations. In 2010, SA managed to attain R1.60 in economic growth for every rand spent via the fiscus. In 2019, this figure dropped into negative territory. Treasury attributes this to increased borrowing to cover the interest bill and investing in low consumption multipliers. The latter was likely driven by excess government wage payments in place of spending on growth-enhancing infrastructure. Government addressed this problem in the October medium-term budget by outlining its intentions to shift spending away from the civil servant wage bill and allocate more resources to capital assets (see chart 13).

Chart 13: Intention to reallocate spending efforts

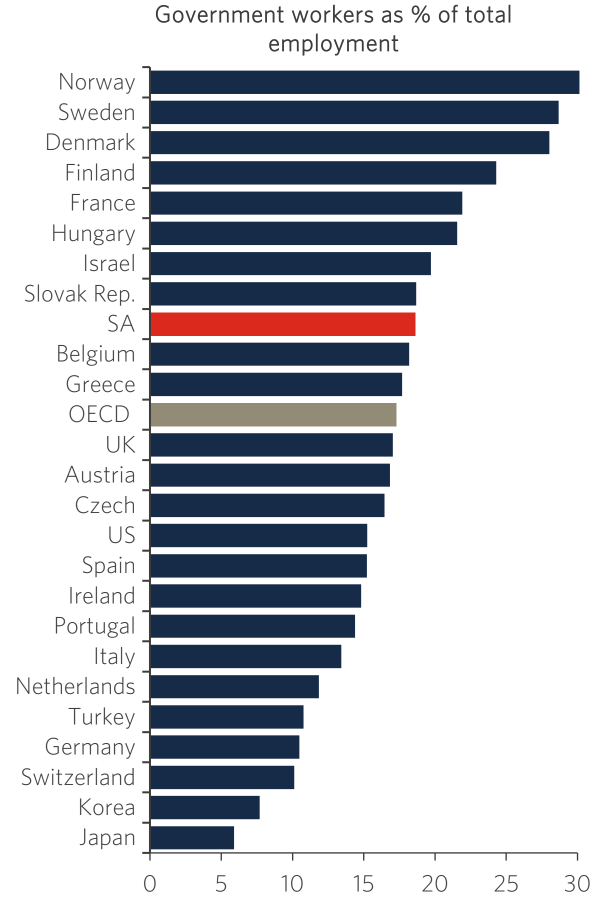


Source: National Treasury, Momentum Investments

In real terms this would imply an overall decrease in the government wage bill. Protecting incomes for lower paid workers (according to Treasury, 35% of government workers earned an average salary of R233 000 in fiscal year (FY) 2019/20) and being more frugal at the high end may be more palatable for the labour unions. Nevertheless, drawn out negotiations on civil servant wages for the next three years remain a risk and government could miss the 31 March 2021 deadline for agreement on the wage deal. Although the appetite for strike activity may have lessened in a scarce jobs environment, public sector labour market disruptions cannot be ruled out completely.

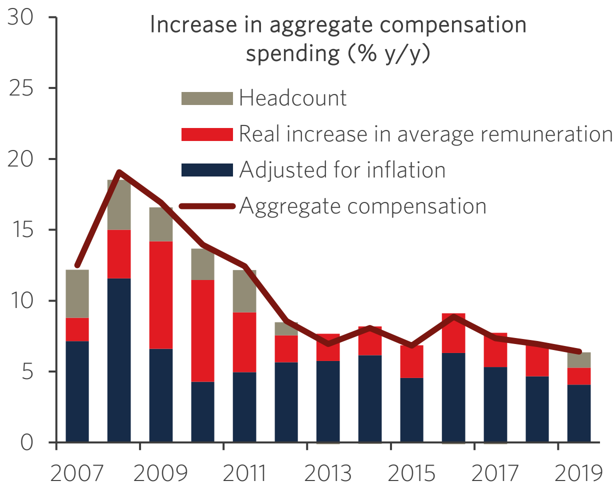
The OECD has shown that the share of public sector workers in SA is not unusually high relative to the OECD average (see chart 14). This leaves the level of compensation (65% of government workers earned an average salary of R435 000 a year or higher in FY2020/21) and the rate of real wage increases, in particular, as the main culprits behind the burgeoning government wage bill (see chart 15).

Chart 14: Intention to reallocate spending efforts



Source: OECD, Momentum Investments

Chart 15: An increase in headcount is not to blame for the outsized government wage bill



Source: National Treasury, Momentum Investments

The major rating agencies have flagged that fiscal consolidation and the Economic Reconstruction and Recovery Plan face high implementation risk. In response to intensified economic challenges and social obstacles to economic reforms in a post-pandemic setting, Moody's and Fitch downgraded SA's sovereign rating on 20 November 2020 and kept the rating outlook on negative (see table 2). The rating agencies further mentioned a deterioration in SA's debt affordability, the poor financial performance of SoEs and persistent challenges in the business environment posed by labour market rigidities and unreliable power supply as the primary reasons behind their rating decisions.

Table 2: Sovereign rating matrix

Long-term rating	S&P	Fitch	Moody's
Investment grade	A-	A-	A3
	BBB+	BBB+	Baa1
	BBB	BBB	Baa2
	BBB-	BBB-	Baa3
Sub-investment grade	BB+	BB+	Ba1
	BB	BB	Ba2
	BB-	BB-	Ba3
Outlook	Stable	Negative	Negative

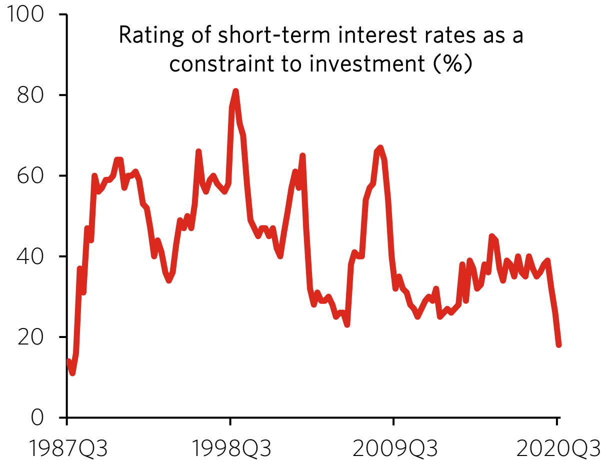
Local currency rating
Foreign currency rating
Both ratings

Source: S&P, Moody's, Fitch, RMBMS, Momentum Investments
Rating decisions as at 20 November 2020

In our view, the conciliatory and consensus-building approach taken by the president to implement structural reforms suggests a more incremental pace of progress on achieving the country's reform targets. These efforts will contribute to a higher growth trajectory over time rather than reflect immediately in the form of significantly higher near-term growth rates. Consequently, efforts to arrest the increase in government's debt burden will likely be constrained and could lead to further negative rating actions later in 2021, in our view.

Growing fiscal deficits and rising public debt place constraints on further easing of monetary policy. In a November 2020 speech, the Sarb explored two avenues in which fiscal policy affects monetary policy. In the first instance, an unfavourable fiscal position creates uncertainty for investors, which has the potential to increase volatility in the exchange rate. Secondly, a deterioration in fiscal metrics raises sustainability concerns and lifts the premium investors require on SA bonds.

Chart 16: Interest rates are not a major constraint to fixed investment



Source: BER, Momentum Investments

The Sarb has been clear that monetary policy faces limitations in trying to boost potential growth. Instead, interest rates cuts aim to help consumers and firms with debt, to better manage their cash flows. In our view, the level of interest rates is not a major constraint to growth. Average lending rates to households (8.4% as of August 2020) and corporates (7.3%) are low relative to history. Moreover, fewer than 20% of local manufacturers have cited short-term interest rates as a constraint to investment, which is the lowest rating since 1988 (see chart 16).

As such, we are of the view that additional easing is less likely from here, unless SA suffers another growth setback induced by a renewed country-wide tightening in lockdown restrictions or if there is another sharp dip in inflation. While near term inflation pressures are likely tilted to the downside (see table 3), we see inflation rising in the medium term from an expected average 3.2% in 2020 to 3.9% in 2021 and 4.7% in 2022.

Table 3: SA inflation pressures

Inflation component	Short term	Medium term
Food	↑	→
Energy	↑	↑
Wage growth	↓	↑
Rental prices	↓	↑
Imported prices	↓	↑
Administered prices	↑	↑
Output gap	↓	↓
Credit growth	→	→
Inflation expectations	↓	→

Source: Momentum Investments

Real interest rates based on one-year ahead inflation expectations are negative. Although running negative real interest rates could put pressure on the local currency to depreciate, the level of pass-through has remained muted in an environment where retailers are trying to protect growth in sales volumes. Furthermore, the currency strengthened late in 2020 on vaccine optimism and a general alleviation in volatility in financial markets. A more favourable terms-of-trade and positive momentum on global vaccine hopes should support the rand in the interim. Nevertheless, we continue to see a depreciating bias in the local currency in the medium term given SA's deteriorating macro-fundamentals on a relative EM comparison.

We are projecting a shift higher in interest rates in the second half of 2021 given the Sarb's warning against the dangers of running negative real interest rates for a protracted period.