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“The only real solution for South Africa’s complex problems is job-creating economic growth. Growth will only be higher if market friendly reforms happen and that it is accepted that enterprise profits and returns drive fixed investment and jobs.”

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THE ECONOMIC PAIN OF THE RIOTS AND FURTHER IMPACTS

By Mike Schüssler, Brenthurst Wealth Consulting Economist

There is no doubt that the horrific destruction of property and looting witnessed primarily in KZN and Gauteng mid-July, will have a detrimental impact on the economies of those provinces, but also directly on the country’s fragile recovery. South Africa has just tentatively started to recover following the worst recession in 100 years, and the impact of the riots will act as a further hurdle to the economy. Not only the direct impact of the destruction, but also the indirect impact will hover with us for some years to come.

DIRECT ECONOMIC EFFECT

Trying to estimate the exact cost to the economy of what has played out is near impossible, as companies are still in the process of calculating losses and different institutions report different accounts of the events. KZN’s contribution to the country’s GDP is 16%, compared to Gauteng’s contribution of 34%. While info is gradually coming to the fore, we have based a rough estimate of the direct impact of the devastation on the economy on Business Leadership South Africa’s indication that 200 shopping malls had been looted. Using the proportion of shopping centres in the country that were affected as between 8% and 9% we have concluded that the cost of rebuild is in the order of R14 billion.

Add to that the cost of about 40 trucks (and contents) that have been burnt on the N2 and N3 Highways which is estimated to be worth R500 million. Coal exports stopped for just over a week, which would add a further billion to the cost. Other exports also stopped when the harbours were closed.

However, apart from shopping malls, there were also numerous other shops, distribution centres and factories that were damaged in addition to the N3 route being closed for nearly a week. Inventories of final goods in the private non-financial sector were estimated at R634 billion at the end of the first quarter by StatsSA. Assessing destruction to be 8% to 9% as in the case of shopping malls this would mean a destruction of around R56bn of final inventory.

Some manufacturing plants also closed, and some inventory had to be discarded. South Africa had R148bn of intermediate and R227bn of raw materials in stock at the end of Q1 2021.

We estimate that the overall damage will be around R60 billion to R80 billion when the flames settle.

The economic growth impact is not only to be felt in 2021, but likely to filter into 2022 as well. Early indications suggest that the real GDP growth rate for 2021 could be 0.5 – 1.0 percentage points lower than earlier estimates, suggesting that the time needed to get back to pre-Covid production levels have indeed been moved out by some more quarters.

INDIRECT EFFECTS

An aspect that is also difficult to quantify, but very real in terms of risk to the economy, is the indirect impact of the rioting and destruction. Almost all these impacts are for the next few years as the results are not just immediate, but likely to take years to be fully realised. We highlight some thoughts on these.

1. FISCAL IMPACT

While the better-than-expected performance of the economy so far in 2021 created a windfall in tax receipts for the state (mainly driven by the mining sector), the damages caused by the riots will lead to lower taxes being collected given that many companies will make losses, while employees could lose jobs and thus PAYE taxes could surprise to the downside.

Furthermore, there is talk of a potential support package, while the idea of a basic income grant seems to be back on the table. Irrespective what gets the green light, this additional expenditure was not budgeted for and will add pressure on the fiscal scenario, just when we started to see some improvement.

2. UNEMPLOYMENT

Hundreds of businesses are affected and will result in thousands of employees being left without income/jobs, with the added risk that many affected businesses might not open again at all. This will fuel one of the very reasons mentioned as source of the unrest, unacceptable high unemployment levels. Government itself estimates that 150 000 jobs are at risk in KZN alone.

3. CONFIDENCE LEVELS

Following a prolonged period of mediocre economic growth (2009 – 2019), exacerbated by the impact of the Covid-19 induced recession in 2020, confidence levels among both corporate SA and households were already fragile and just started to recover. The sheer extent of the destruction, its economic and social consequences, and the inability of the South African security forces to handle the crisis effectively are likely to push confidence levels lower again, with the resultant negative impact on spending and investment levels.

4. FOREIGN PERCEPTION AND DIRECT INVESTMENT

The chaos got global media coverage and has definitely damaged South Africa's image as an attractive investment destination. In a scenario where South Africa already struggles to attract foreign direct investment, negative perceptions on security of investments will be an unhelpful additional negative factor.

Case in point: On 19 July, Toyota SA Motors noted that the eThekweni Municipality has been unable to provide reassurances about restoring stability in the wake of violent riots, putting the carmaker's investment plans at risk and indicating some production could be lost to other countries.

5. ECONOMIC GROWTH

All of the above will impact economic growth over the longer term.

6. COVID-19 VACCINATION DRIVE

Just as SA's vaccination drive starts to gain momentum, the riots and looting resulted in vaccination sites in all affected areas being closed, delaying the full reopening of the economy.

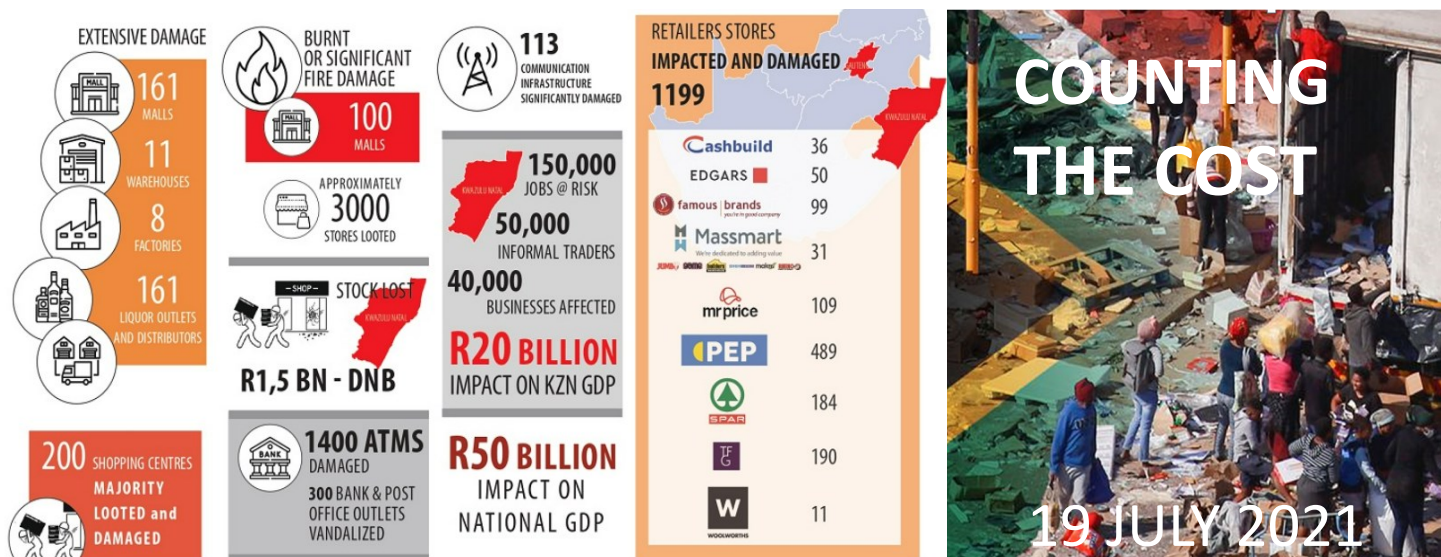
7. POLITICAL CRISIS MANAGEMENT

Just as we applauded some structural reforms that were recently announced (the steps to deregulate electricity generation, partial privatisation of SAA, etc.) the riots firmly pushed the government into crisis management and redirecting the focus from much-needed structural reform to the immediate crisis. With the stat (especially the security cluster) largely unable to deal with the situation effectively, the perception of "an incapable state" has come strongly to the fore once again.

8. CREDIT RATING AGENCIES' VIEWS

The budget deficit will now be larger and economic recovery longer. Government Debt to GDP will increase and South African in general will once again be poorer. Moody's has just downgraded five Metro's further. The riots could have the same impact on the government fiscus. Government faces larger deficits and higher Debt to GDP levels. Further downgrades can be expected and that should impact bond yields and the rand.

Government borrowing will become more costly as bond rates will increase to reflect the increased risk.



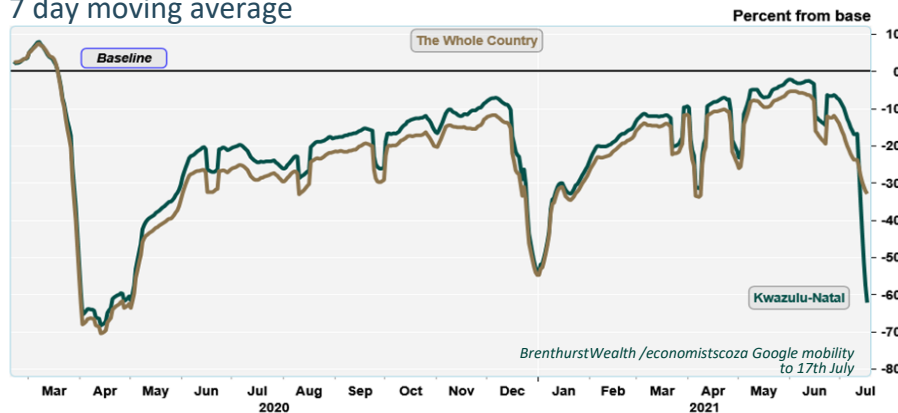
TO CONCLUDE

The only real solution for South Africa's complex problems is job-creating economic growth. Growth will only be higher if market friendly reforms happen and that it is accepted that enterprise profits and returns drive fixed investment and jobs.

We can only hope that the shocking events of the past few weeks, will result in some realisation by government that the status quo can not be maintained. Unfortunately, a deeply divided ruling ANC party will make it difficult to expect a clean slate and a strong new vision any time soon.

SOUTH AFRICA, PEOPLE AT WORKPLACES COMPARED TO BASELINE

7 day moving average



The graph which shows that KZN employees were generally more at work during most lockdowns.

During the looting in the province this declined back to level of the Easter Weekend during last year level 5 lockdown. This is an indication of the problems faced in the Economy of KZN.

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