Dairy market trends

May 2020

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Executive summary

The Covid-19 pandemic will deliver a devastating blow to the South African economy due to many years of mismanagement and poor economic policy choices. The Sub-Sahara Africa economy is projected to contract with 2% in 2020 (Source IMF). The SA economy is projected to contract with 10% in nominal terms in 2020 (6% real terms) (Source IMF). The size of SA economy in 2019 was R5.1 trillion (source Stats SA). A 10% contraction in nominal terms equals R500 billion less money in the economy. The effect of the South African government relief and stimulus programs which seem to be based on racial lines is difficult to model due to past delivery problems and endemic corruption. The macro picture suggests that total demand for many products will decrease.

During the first 70 days of the restrictive period demand for dairy products maintained a good position in the consumer basket. The inherent nutritional value of dairy played an important role in this achievement. Some import replacement withy locally produced dairy goods is taking place which is improving demand. It is important to note that dairy demand between processors could differ depending on the product mix output of the processor. The demand elasticity present in most dairy products also supported consumer preference/demand. If necessary, it is precisely this characteristic that retailers can use to stimulate demand.

In March 2020, the retail sales quantities of three dairy products were from 2.0 to 6.4 percent lower while the retail sales quantities of six dairy products were from 0.2 to 23.0 percent higher than in March 2019. The highest increases of 22.0 and 23.0 percent were respectively recorded for UHT milk and pre-packaged cheese. The noteworthy higher retail sales quantities of UHT milk and pre-packaged cheese in March 2020 are a result of the level of stockpiling by consumers in response to Covid19 and the related “lockdown” measures of the Government. Early indications seem to indicate a change in consumer behaviour giving rise to a new dairy product mix. Home cooking is driving this change and only time will tell whether it is permanent or temporary.

Unprocessed milk production for April 2020 is estimated at 241 million litres, 2.83% less than in April 2019. Milk production in April 2020 is indicative of the negative farm economics that have been plaguing the primary sector. Dairy farm economics were negative since early 2018 until February 2020 creating an extreme cost price squeeze, shaving off most reserves on dairy farms and leaving a wounded resilience on dairy farms. Market signals from the MPO throughout this period was that the cost price squeeze is severe in farm economics due to too low producer prices and high cost increases. Furthermore, some important milk production areas are still relatively dry with low dam levels. The current improved producer prices (increases in March and April 2020), will assist dairy farmers to claw back some production capacity lost during 2018/19 and enable the repayment of debt accumulated during this period. However, this would only be possible if the upward trend in producer prices prevail.

The upward trend in feed cost started in January 2018 and continued into the first four months of 2020. In May 2020, feed prices dropped mainly due to export parity reducing on the back of a stronger Rand/weaker United States Dollar (USD) – April R18.57 and May R18.11 to the USD. The milk:feed price ratio has improved in March, April and May 2020. However, it is still at a level not adequate to create sufficient returns for the primary industry.

In USD terms all dairy product prices in May 2020 compared to May 2019 declined, butter -31%, skimmed milk powder (SMP) -1%, cheddar -23% and whole milk powder (WMP) -17%. During the same time, the Rand took a beating devaluating against the USD with 26%. The result was that both SMP and WMP prices in Rand terms increased respectively with 24% and

5% due to the still relative high USD price levels for both powders while butter and cheddar prices in sync with dollar prices decreased: butter -13% and cheddar -3%.

The decline in dairy product prices in USD terms is confirmed by three sets of data from the FAO, GDT and United States Department of Agriculture (USDA).

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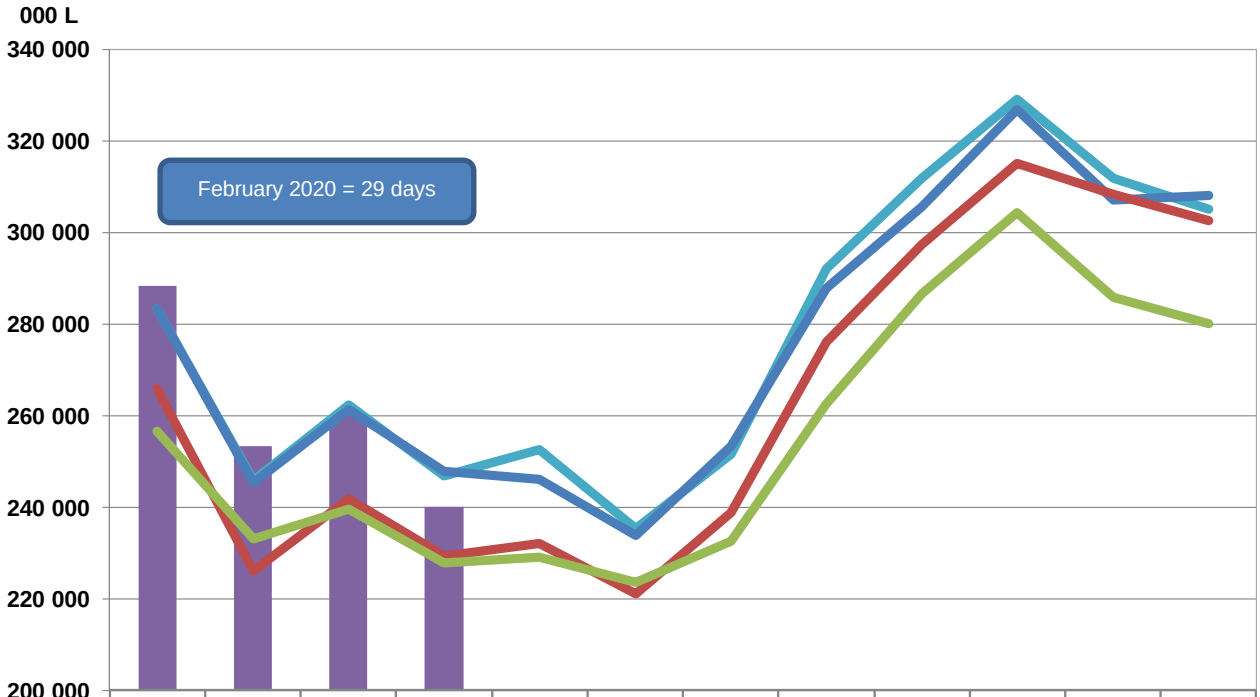
1. Milk supply, demand and prices

1.1 Milk production

Unprocessed milk production for April 2020 is estimated at 241 million litres, 2.83% less than in April 2019. Milk production in April 2020 is indicative of the negative farm economics that have been plaguing the primary sector. Dairy farm economics were negative since early 2018 until February 2020 creating an extreme cost price squeeze, shaving off most reserves on dairy farms and leaving a wounded resilience on dairy farms. Market signals from the MPO throughout this period was that the cost price squeeze is severe in farm economics due to too low producer prices and high cost increases. Furthermore, some important milk production areas are still relatively dry with low dam levels. The current improved producer price (increases in March and April 2020), will assist dairy farmers to claw back some production capacity lost during 2018/19 and enable the repayment of debt accumulated during this period. However, this would only be possible if the upward trend in producer prices prevail.

Cumulative unprocessed milk production for the first four months of 2020 (inclusive of April and including February only as a 28 day month) was 1 065 million litres indicating a decline of 0,45% in comparison to the same period in 2019.

Monthly milk production is reflected in Figure 1 below.

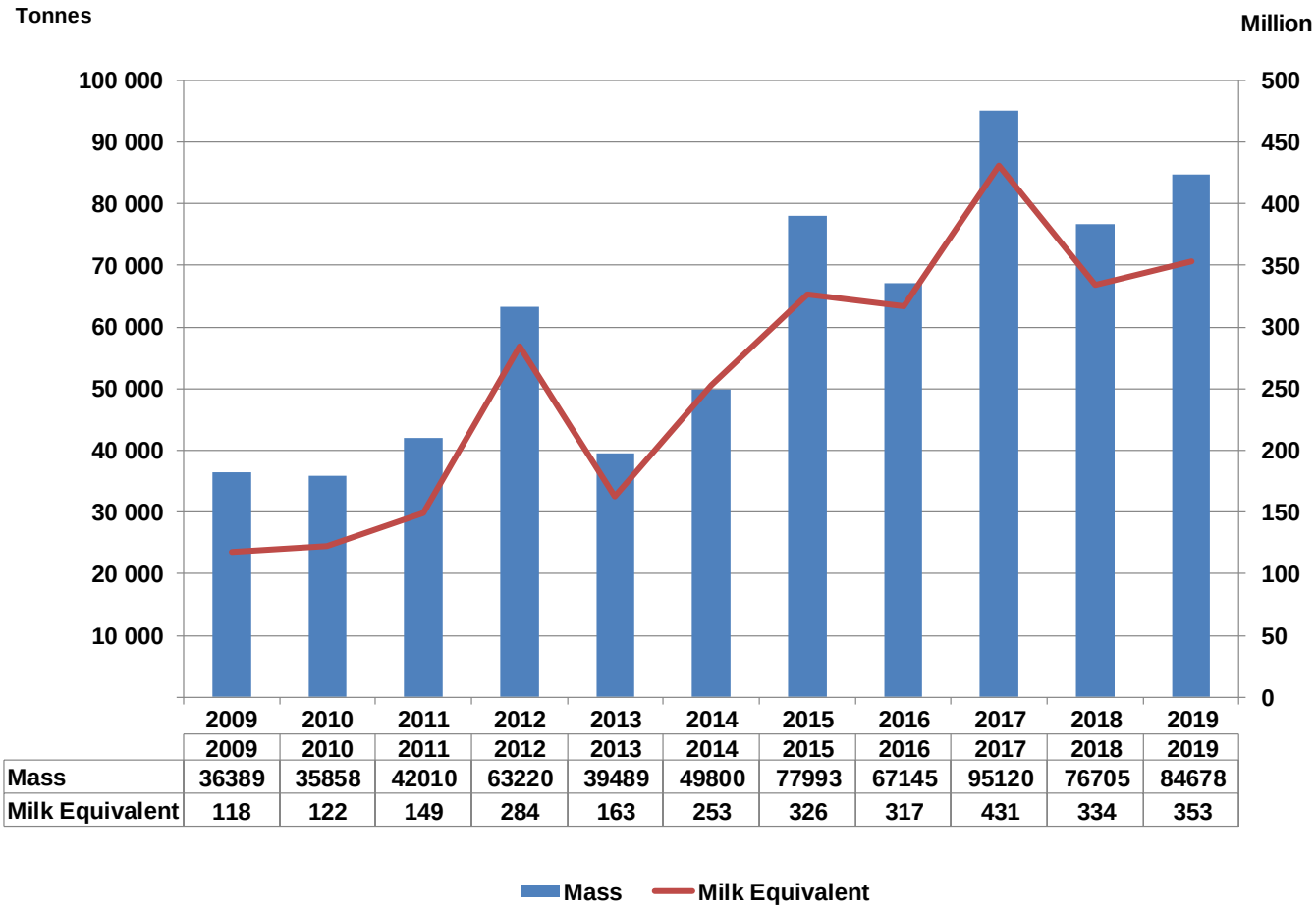


	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	288 265	253 383	260 068	239 937								
2019	283 271	245 696	262 240	246 916	252 456	235 318	251 630	291 985	311 935	329 081	311 949	305 174
2018	283 221	245 228	261 423	247 708	245 962	233 780	253 262	287 816	305 684	326 816	307 035	308 130
2017	265 808	225 966	241 736	229 246	232 006	221 080	238 704	276 158	297 339	315 032	308 405	302 532
2016	256 582	233 053	239 493	227 836	229 021	223 451	232 556	262 467	286 603	304 285	285 936	280 178

Figure 1 Monthly milk production ('000 L.).

Source: Milk SA, March and April are preliminary

1.2 Dairy imports



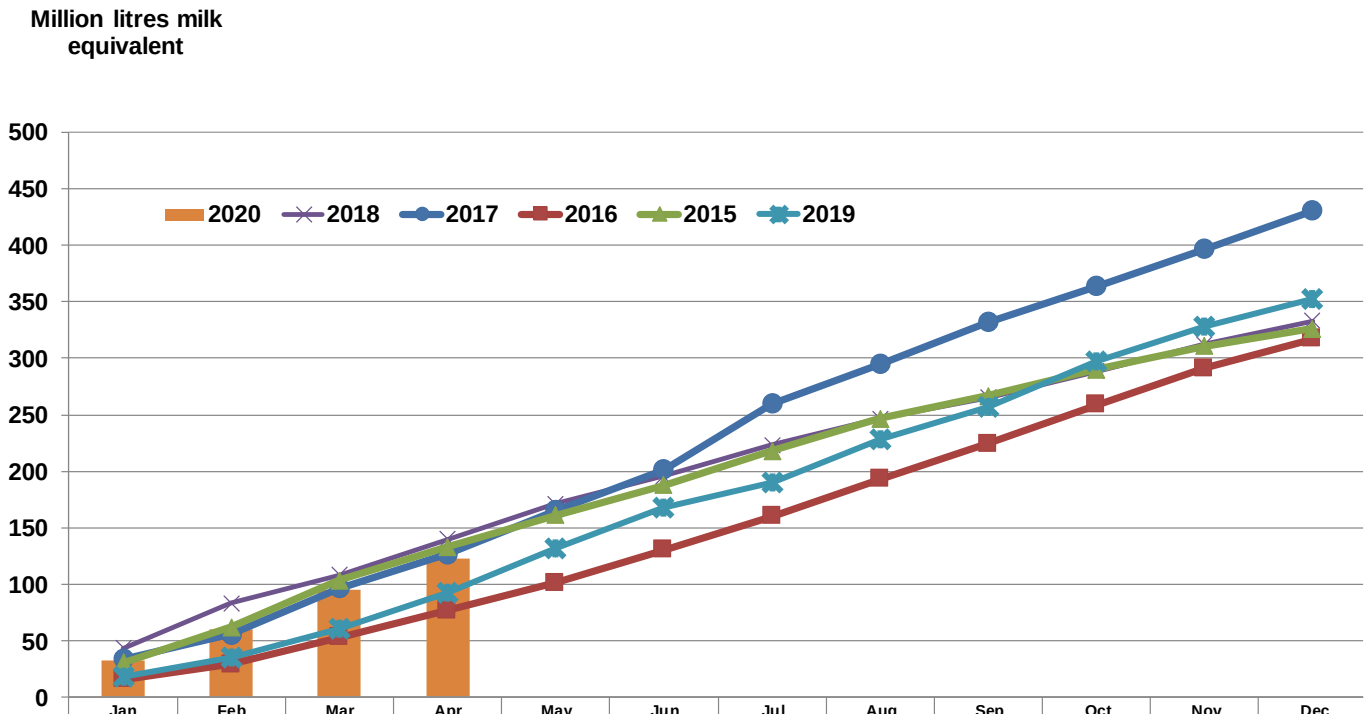
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Mass	36389	35858	42010	63220	39489	49800	77993	67145	95120	76705	84678
Milk Equivalent	118	122	149	284	163	253	326	317	431	334	353

Figure 2 Annual imports, mass and milk equivalent basis, 2009-2019

Source: AgriInspec

Figure 2 illustrates the fluctuation in dairy imports on a mass and milk equivalent basis over the past 10 years. Imports for 2018 are at the same level as in 2015, registering a 19% drop in imports when compared to 2017. This is mainly due to reduced imports of UHT milk as a result of high levels of milk production in SA and the accelerated depreciation in the value of the rand in the second and third quarter of 2018. Imports in 2019 in terms of milk equivalent is 5,7% higher than in 2018 and in mass terms 10,4% more than in 2018. The increase in imports reflects the market interpretation of a slowdown in production during 2019 in the primary sector.

Figure 3 illustrates cumulative dairy imports. Imports for the first four months of 2020 is at the same level as in 2017. The weak Rand did not reduce imports as significantly as was expected. One needs to point out that import level at the beginning of 2019 was extremely low.



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	32	59	95	122								
2018	43	83	108	140	171	195	223	246	265	288	312	333
2017	33	56	96	127	165	202	260	295	332	364	397	431
2016	15	29	53	76	101	130	160	193	224	259	291	317
2015	30	62	103	133	161	188	218	246	267	290	311	326
2019	18	35	60	92	132	168	190	228	257	297	328	352

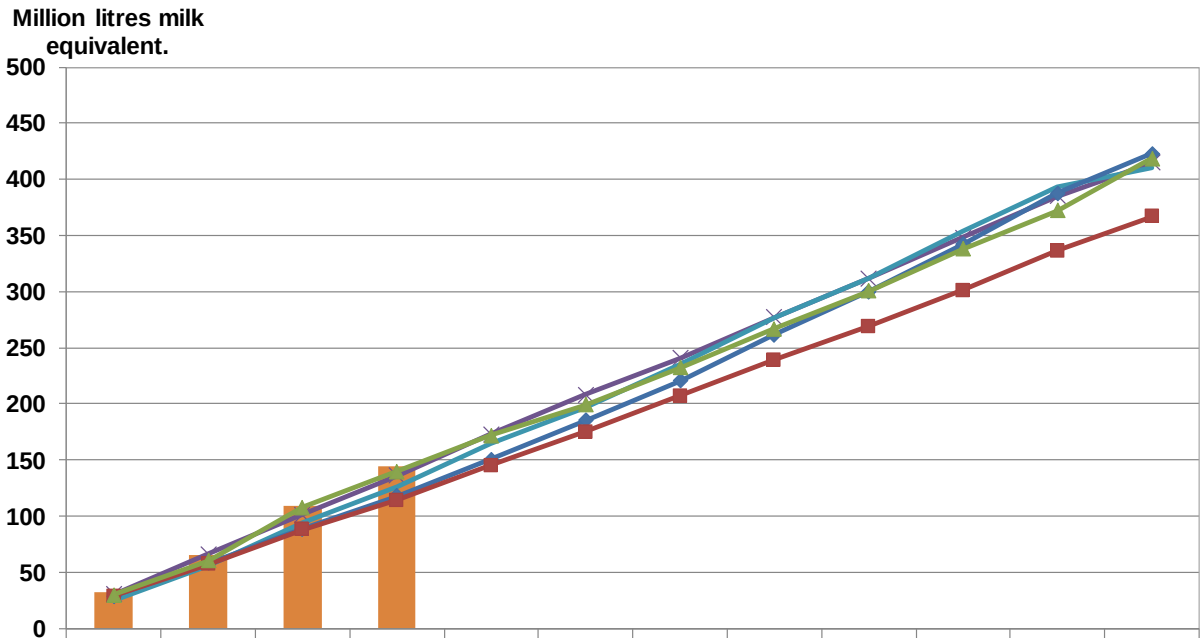
Figure 3 Monthly cumulative imports, (Mil. L.) milk equivalent basis

Source: AgriInspec

1.3 Dairy exports and sales to BLNS countries

Monthly cumulative exports on a milk equivalent basis are reflected in Figure 4 below. Exports for the first four months of 2020 is higher than any of the previous 5 years. This is a feather in the cap of the dairy value chain and effected government departments – the route to market was maintained despite the “lockdown” in South Africa and in our trading partners.

Further, it is an indication that export markets are well looked after by the SA exporters and that the markets are satisfied with the product range and quality.



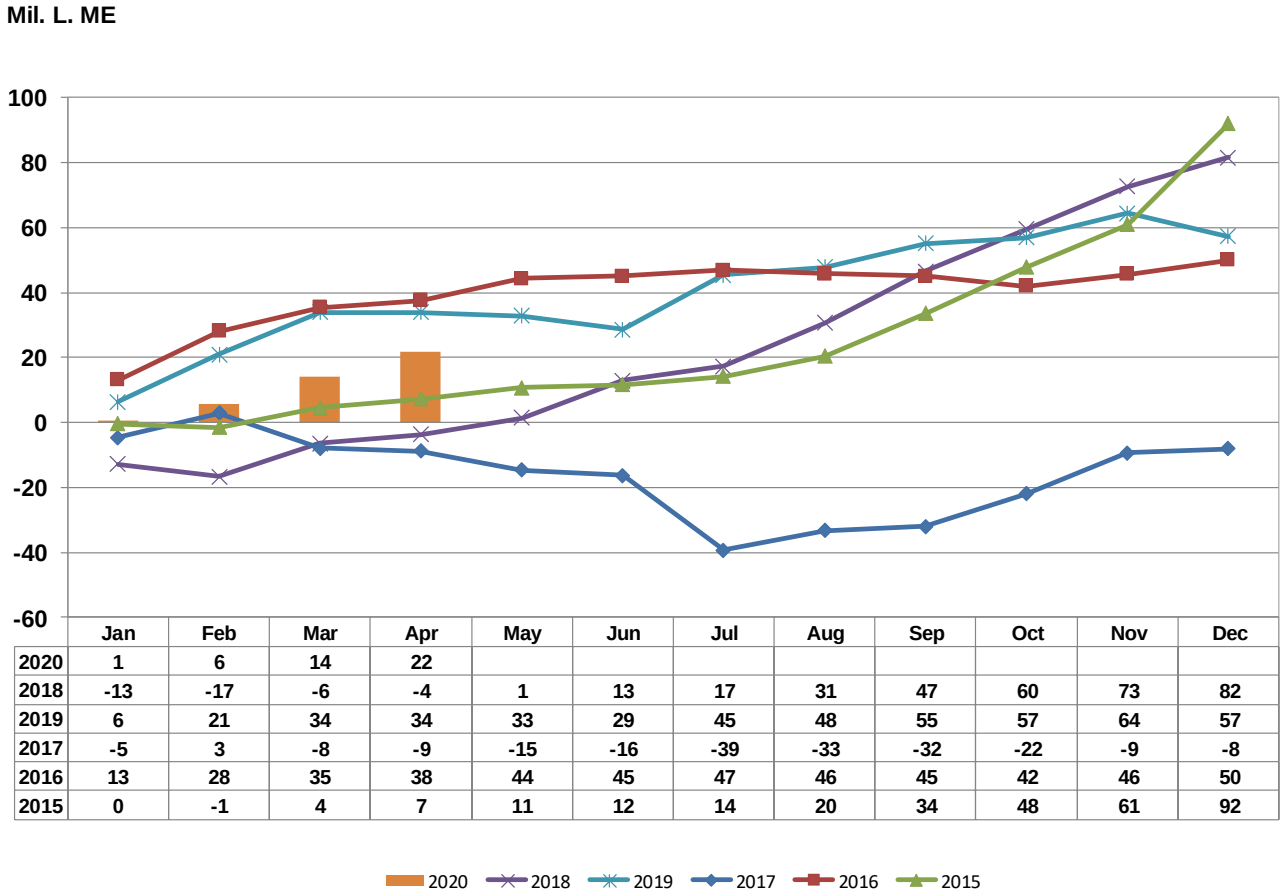
	1	2	3	4	5	6	7	8	9	10	11	12
2020	33	65	109	144								
2018	30	66	102	136	173	208	241	277	312	348	385	415
2019	24	56	94	126	165	196	235	276	312	354	393	410
2017	29	58	88	118	151	185	221	262	300	342	388	423
2016	29	57	88	114	145	175	207	239	269	301	337	367
2015	30	60	108	140	172	199	232	267	300	338	372	418

Figure 4 **Monthly cumulative dairy exports (Mil. L.), milk equivalent basis**

Source: AgriInspec

1.4 Net exports (Inclusive of sales to BLNS countries)

The SA dairy industry regained its status as a net exporter of dairy products in 2018, maintained that status in 2019 and for the first four months of 2020. Exports in 2018 exceeded imports with 82 million litres and with 57 million litres in 2019. Net exports in 2018 were higher than in 2017 and 2016 and only slightly below the level of 2015. Cumulative net exports (total exports plus sales to BLNS countries less total imports) on a milk equivalent basis are shown in Figure 5 below.



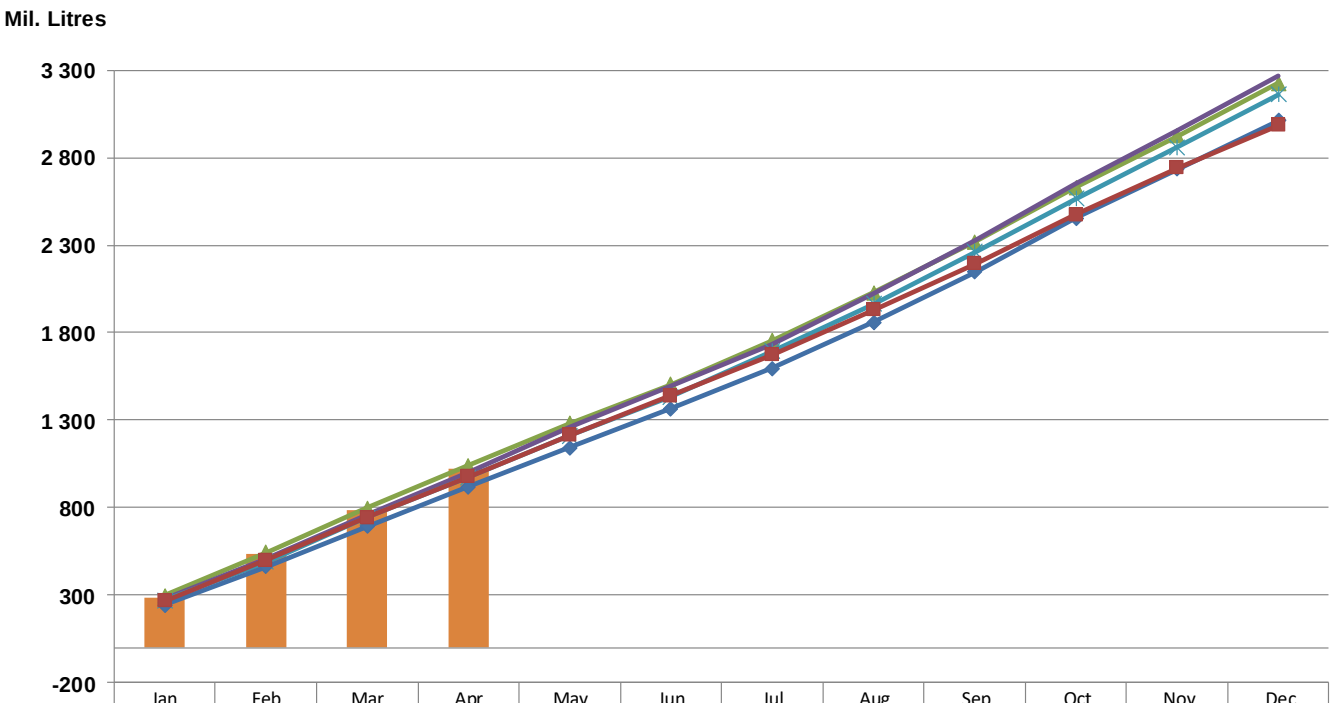
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	1	6	14	22								
2018	-13	-17	-6	-4	1	13	17	31	47	60	73	82
2019	6	21	34	34	33	29	45	48	55	57	64	57
2017	-5	3	-8	-9	-15	-16	-39	-33	-32	-22	-9	-8
2016	13	28	35	38	44	45	47	46	45	42	46	50
2015	0	-1	4	7	11	12	14	20	34	48	61	92

Figure 5 Cumulative net exports, milk equivalent basis (Mil. L.)

Source: AgriInspec

1.5 Total milk supply

The total cumulative monthly supply of milk, consisting of locally produced milk less net exports (total exports inclusive of sales to BLNS countries less total imports) is reflected in Figure 6. The total cumulative supply of milk for the first four months of 2020 is at the same level as in 2018 and 2019.



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	288	536	788	1020								
2018	296	545	796	1041	1282	1504	1753	2028	2317	2631	2925	3224
2019	277	508	757	1004	1258	1497	1732	2022	2326	2654	2958	3270
2017	270	489	741	972	1209	1432	1694	1964	2260	2565	2861	3162
2016	243	462	694	919	1142	1364	1595	1859	2146	2453	2736	3011
2015	267	499	743	975	1212	1440	1674	1930	2194	2476	2741	2983

Figure 6 Total Cumulative monthly milk supply

Source: MPO calculation

1.6 Milk demand

Table 1 contains information with regard to the change in retail demand for different dairy products for the 12-month period from April 2018 to March 2019 compared to the 12-month period from April 2019 to March 2020.

In March 2020, the retail sales quantities of three of the nine dairy products were from 2.0 to 6.4 percent lower while the retail sales quantities of six of the dairy products were from 0.2 to 23.0 percent higher than in March 2019. The highest increases of 22.0 and 23.0 percent were respectively recorded for UHT milk and pre-packaged cheese.

The noteworthy higher retail sales quantities of UHT milk and pre-packaged cheese in March 2020 are a result of the level of stockpiling by consumers in response to Covid19 and the related “lockdown” measures of the Government.

Early indications seem to indicate a change in consumer behaviour giving rise to a new dairy product mix. Home cooking is driving this change and only time will tell whether it is permanent or temporary.

TABLE 1: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR MAJOR DAIRY PRODUCTS FOR THE 12 MONTH PERIOD FROM April 2018 TO March 2019 COMPARED TO THE 12 MONTH PERIOD FROM April 2019 TO March 2020

PRODUCT	Sales in the month of March 2020 versus the sales in the month of March 2019	Sales in the 3 months from January 2020 to March 2020 versus the sales in the 3 months from January 2019 to March 2019	Sales in the 6 months from October 2019 to March 2020 versus the sales in the 6 months from October 2018 to March 2019	Sales in the 9 months from July 2019 to March 2020 versus the sales in the 9 months from July 2018 to March 2019	Sales in the 12 months from April 2019 to March 2020 versus the sales in the 12 months from April 2018 to March 2019
	percent	percent	percent	percent	percent
Fresh Milk	-4.2	-5.5	-3.5	-2.2	-2.5
UHT milk	22.0	3.9	-1.1	-4.1	-3.1
Flavoured milk	-6.4	-9.3	-6.9	-4.9	-3.3
Yoghurt	9.5	5.6	6.7	7.5	7.5
Maas	9.0	10.3	10.8	13.2	15.8
Pre-packaged cheese	23.0	11.3	8.3	7.0	6.9
Cream cheese	2.5	-1.4	-1.8	-1.5	-1.2
Butter	0.2	0.1	-0.6	-0.6	1.0
Cream	-2.0	-4.9	-5.4	-5.6	-5.0

Source: Nielsen supplied by Sampro

Table 2 contains information with regard to the change in retail demand for different dairy products for the 12-month period from April 2018 to March 2019 compared to the 12-month period from April 2019 to March 2020 and the change in retail prices from March 2019 to March 2020. In the year that ended in March 2020, the retail sales quantities of five of the nine dairy products were from 1.2 to 5.0 percent lower, while the retail sales quantities of four dairy products were from 1.0 to 15.8 percent higher than in the year that ended in March 2019. Retail prices for all the products increased with only two products increasing with less than inflation.

TABLE 2: PERCENTAGE CHANGE IN RETAIL SALES QUANTITIES FOR MAJOR DAIRY PRODUCTS FOR THE 12 MONTH PERIOD FROM April 2018 TO March 2019 COMPARED TO THE 12 MONTH PERIOD FROM April 2019 TO March 2020 AND THE CHANGE IN RETAIL PRICES FROM March 2019 TO March 2020

Product	Change in quantity sold %	Change in retail prices %
Fresh milk	-2.5	5.3
Long-life milk (UHT)	-3.1	6.7
Flavoured milk	-3.3	5.2
Yoghurt	7.5	2.1
Maas	15.8	4.6
Pre-packaged cheese	6.9	2.2
Cream cheese	-1.2	5.0
Butter	1.0	10.0
Cream	-5.0	10.3

Source: Nielsen figures supplied by SAMPRO

During the first 70 days of the restrictive period demand for dairy products maintained a good position in the consumer basket. The inherent nutritional value of dairy played an important role in this achievement. Some import replacement is taking place, improving demand. It is important to note that dairy demand between processors could differ depending on the product mix output.

The demand elasticity present in most dairy products also supported consumer preference/demand. If necessary, it is precisely this characteristic that retailers can use to stimulate demand.

In normal circumstances, the industry will have a reasonable idea of future demand (2 – 2.5% growth per year). The current circumstances being a function of the SA economy contracting with 6% in real terms in 2020 introduces too many unknowns. Stimulus and relief packages from the government and the cost of credit at a 50 year low introduce even more uncertainty with specific reference to consumer disposable income. The level of demand is uncertain due to drastic changes in economic activity and the consequential influence on consumer disposable income. At a macro level, total demand for dairy products should be less with some products being effected more than others are and retail pricing could utilise demand elasticity to reduce the magnitude in demand shift. To avoid major swings in the dairy value chain, the flow of information from the retailer via the processor to the dairy farmer should be a focus point.

1.7 Producer prices

Producer prices are indicated in Figure 7. The graph is calculated by the MPO based on information supplied by members and other role players, and is a national average. Increased producer prices from most processors were announced on a wide front, some effective from 1 March 2020 and others from beginning April. The price of milk solids also increased in both months together with an overall improvement of milk solids.

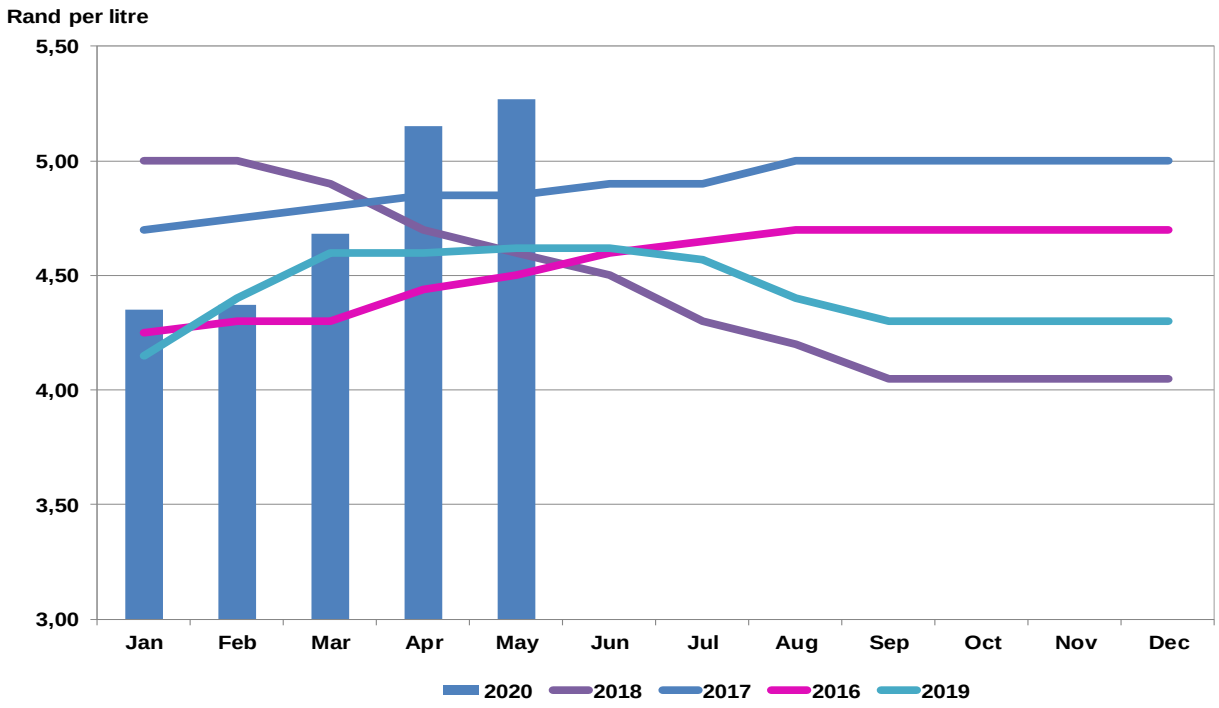


Figure 7 Monthly milk producer prices, 2016-2020

Source: MPO calculations

1.8 Retail prices

Retail prices of fresh milk in different packaging are supplied by the South African National Consumer Union (SANCU). The retail prices of fresh milk per litre for milk packaged in 2-litre plastic containers are compared to producer prices in Figure 8. The spread should improve in April 2020. However the increasing gap (two trend lines in figure 8) between the retail price and producer price is not sustainable and indicating a market distortion that the MPO is investigating.

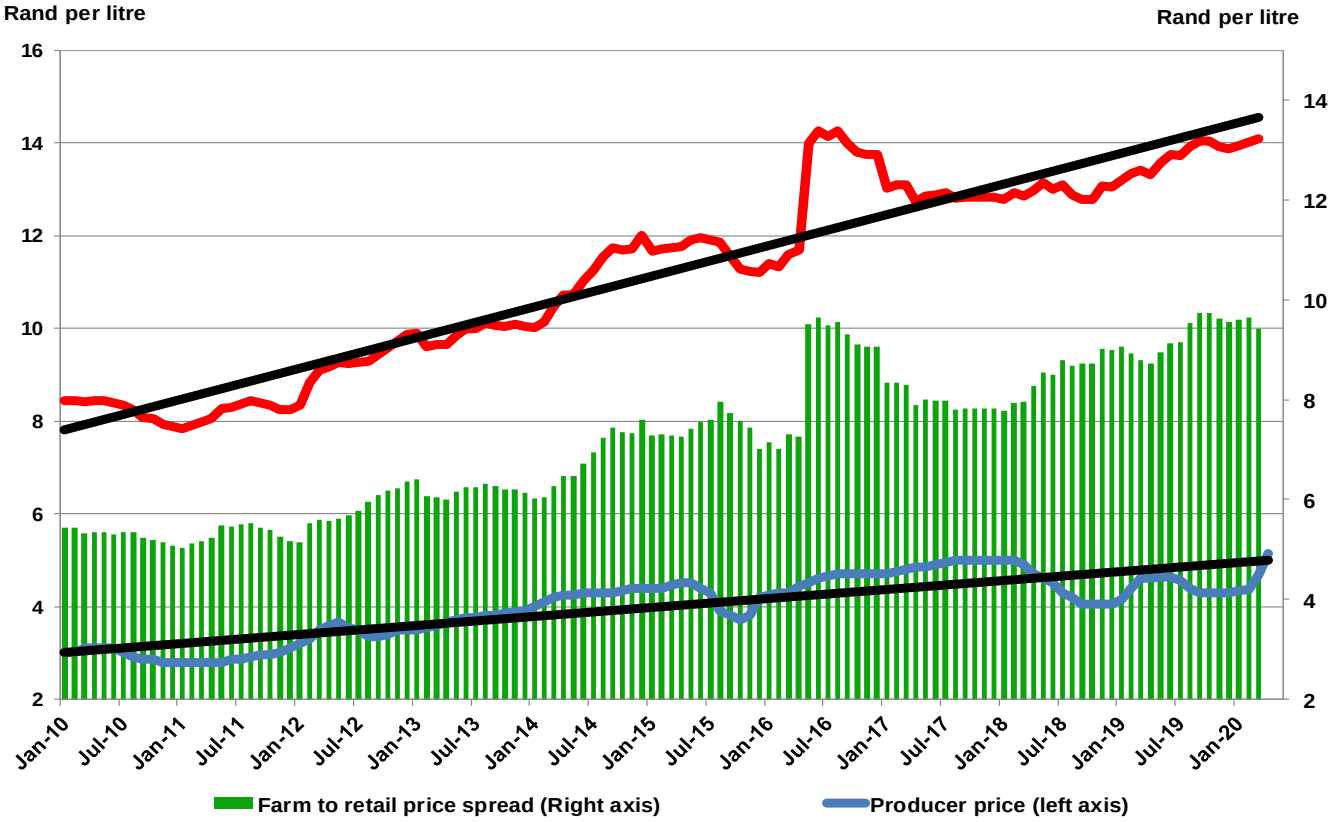


Figure 8 Monthly producer and retail prices, 2010- 2020

Source: MPO, SANCU

1.9 Feed prices

Feed cost is the most important cost item for milk producers. Internationally the price of maize and soybeans are used as a proxy for feed prices. A derived feed price is thus defined as the weighted price per kilogram of maize and soybeans (70% maize, 30% soybeans). Feed prices, based on Safex nearest month prices, are reflected in Figure 9. Farmers' production decisions are not based on absolute prices, but on relative prices. If producer milk prices decrease in relation to feed prices, farmers will tend to produce less, and if prices increase relative to feed prices, production will increase. Unfavourable milk: feed price ratios will result in slower production growth or lower production over time.

The upward trend in feed cost is clearly visible since January 2018 and continued into the first four months of 2020. In May 2020, feed prices dropped mainly due to export parity reducing on the back of a stronger Rand/weaker USD – April R18.57 and May R18.11 to the USD.

The milk: feed price ratio is illustrated in figure 10. The ratio has improved in March, April and May 2020. However, it is still at a level not adequate to create sufficient returns for the primary industry.

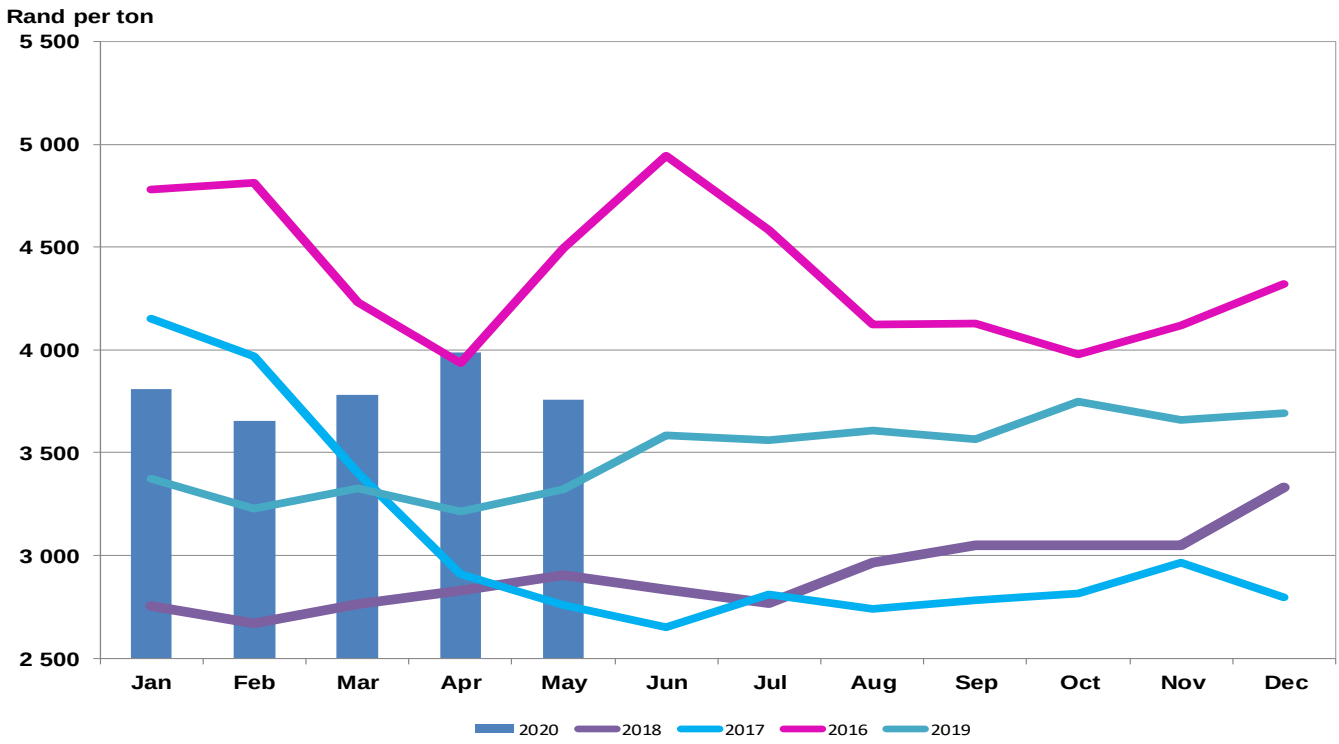
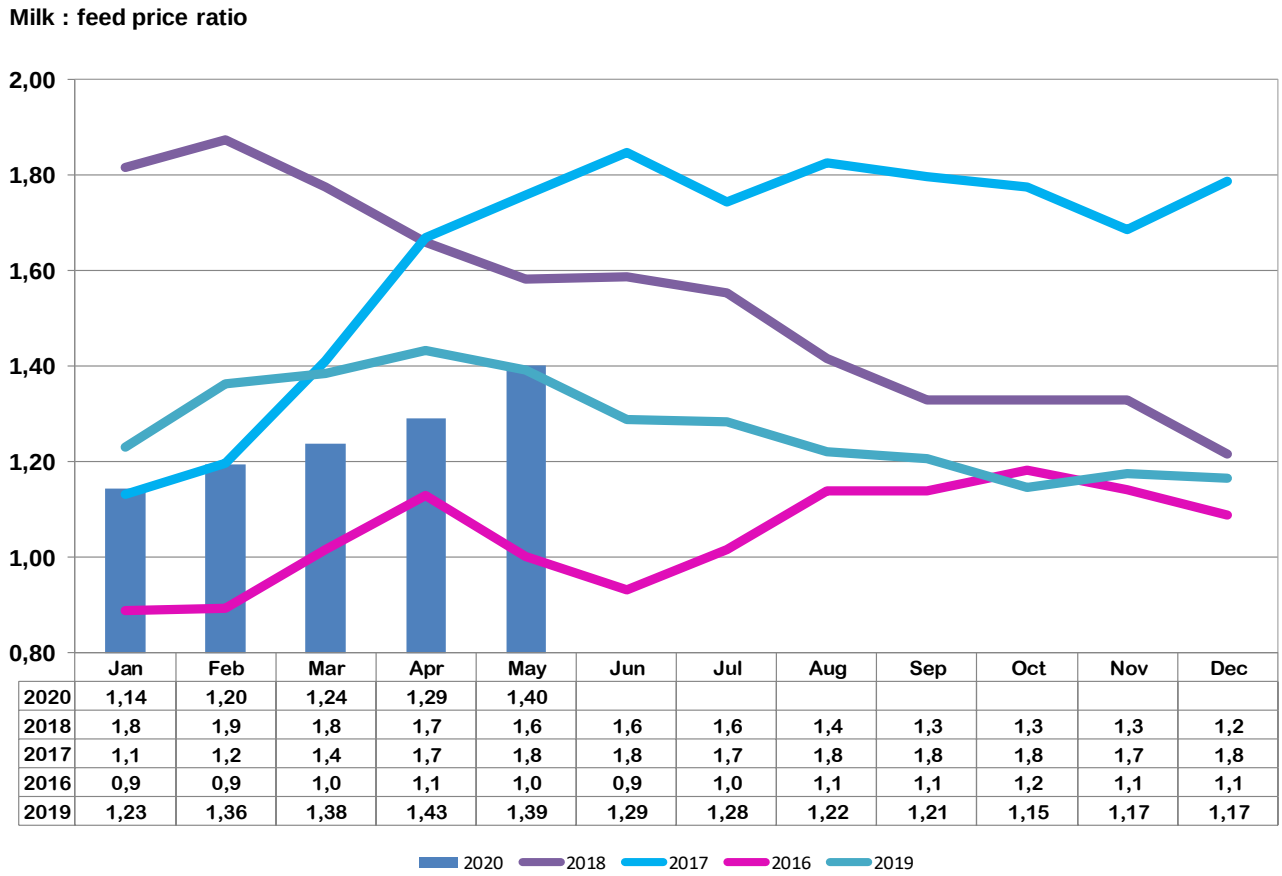


Figure 9 **Calculated dairy feed prices, 2016-2020** *Source: Safex nearest month data*



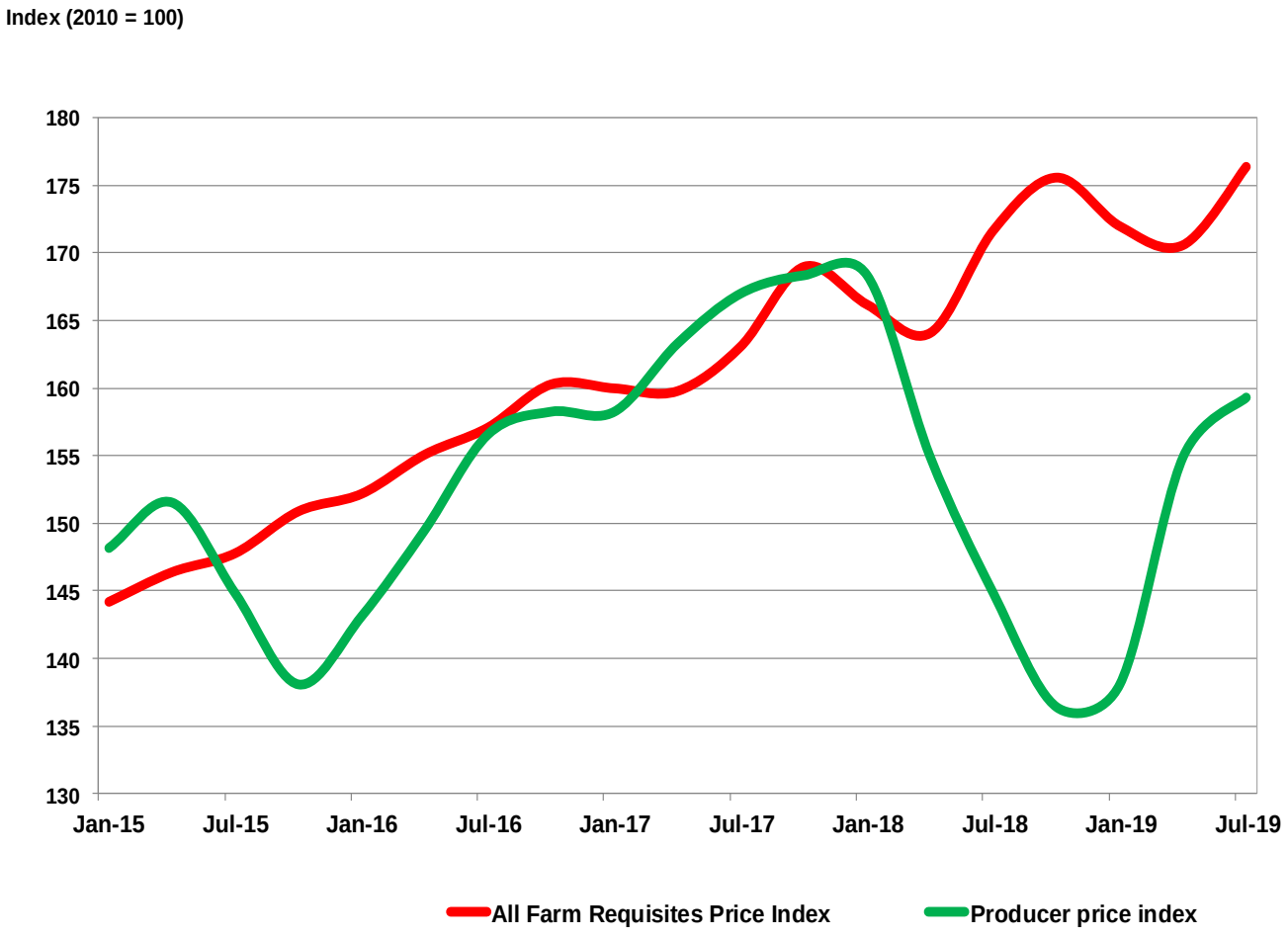
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020	1,14	1,20	1,24	1,29	1,40							
2018	1,8	1,9	1,8	1,7	1,6	1,6	1,6	1,4	1,3	1,3	1,3	1,2
2017	1,1	1,2	1,4	1,7	1,8	1,8	1,7	1,8	1,8	1,8	1,7	1,8
2016	0,9	0,9	1,0	1,1	1,0	0,9	1,0	1,1	1,1	1,2	1,1	1,1
2019	1,23	1,36	1,38	1,43	1,39	1,29	1,28	1,22	1,21	1,15	1,17	1,17

Figure 10 **Milk: feed price ratio, 2016-2020** *Source: MPO calculations*

1.10 Input prices

The Department of Agriculture, Forestry and Fisheries publishes price indexes for farm requisites on a quarterly basis. As with all indexes, this index simplifies a very complex data-set to a level that does not correspond to individual farm data-sets. However, the trend in this index gives an indication of the direction of input price changes. The farm requisite index and producer price index are shown in Figure 11. The developments early in 2019 indicate that the cost price squeeze has reduced slightly, however still at a severe level. Cost management will be crucial over the coming months and optimising energy utilisation will play a big role in containing costs.

The slope of the downward trend in producer prices during 2018 is more severe than the slope of the trend that occurred in July 2015 which resulted in financial difficulty for many farmers. The downward trend depicted in the All Farm Requisite Price Index from the beginning of 2018 was reversed in the second quarter of 2018 on the back of the continued weak rand resulting in, amongst other, higher fuel and fertiliser prices. In the first quarter of 2019, the trend changed and continued down in the second quarter.



Source: DAFF, MPO calculation

Figure 11 Quarterly Farm Requisites Price Index and Producer Price Index

1.11 International prices

The Food and Agricultural Organisation (FAO) Food Price Index* (FFPI) averaged 162.5 points in May 2020, down 3.1 points (1.9 percent) from April and reaching the lowest monthly average since December 2018. With the continued negative economic effects of COVID-19, the FFPI has been on a downward trend for four consecutive months. The latest drop in May reflects falling values of all the sub-indices with the exception of sugar, which rose for the first time in three months.

The FAO Dairy Price Index averaged 181.8 points in May, down 14.4 points (7.3 percent) from April, registering the third consecutive month of decline and setting the index value 44.3 points (19.6 percent) below its level one year ago. Quotations for all dairy products represented in the index fell in May, with the steepest drops registered for butter and cheese. Quotations for butter fell due to large seasonal supplies, especially in Europe, while those of cheese dropped, pressured by lower import demand amid high late season export supplies from Oceania. Despite continued high export availabilities and inventories, quotations for whole milk powder (WMP) and skim milk powder (SMP) declined only moderately, as low prices and renewed economic activities in China fuelled strong buying interests.

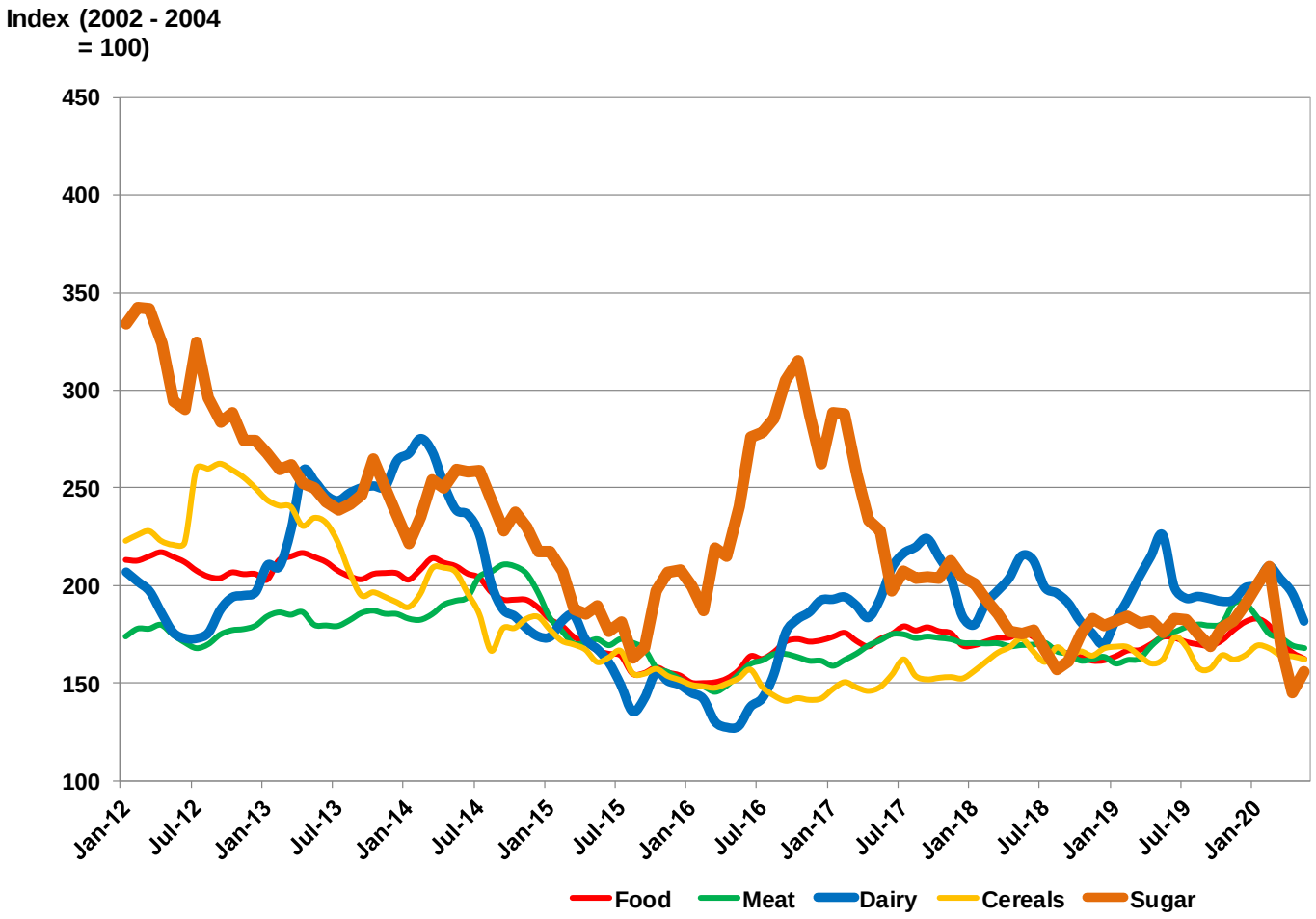


Figure 12 Monthly FAO food price indexes

Source: FAO food price index

The Global Dairy Trade platform is an online auction through which large volumes of dairy products can be sold or bought. There are two trading events per month where people across the globe can enter bids or offers.

Figure 13 shows the movement of the Global Dairy Trade (GDT) price index inclusive of May 2020. There is a clear price support level at 900 index points and a price resistance level at 1100 index points. For the first time in 14 months, the 900 price support level was breached in May, signalling significant decline in dairy prices. The downward trend did build momentum from the start of 2020 when the Covid-19 pandemic registered.

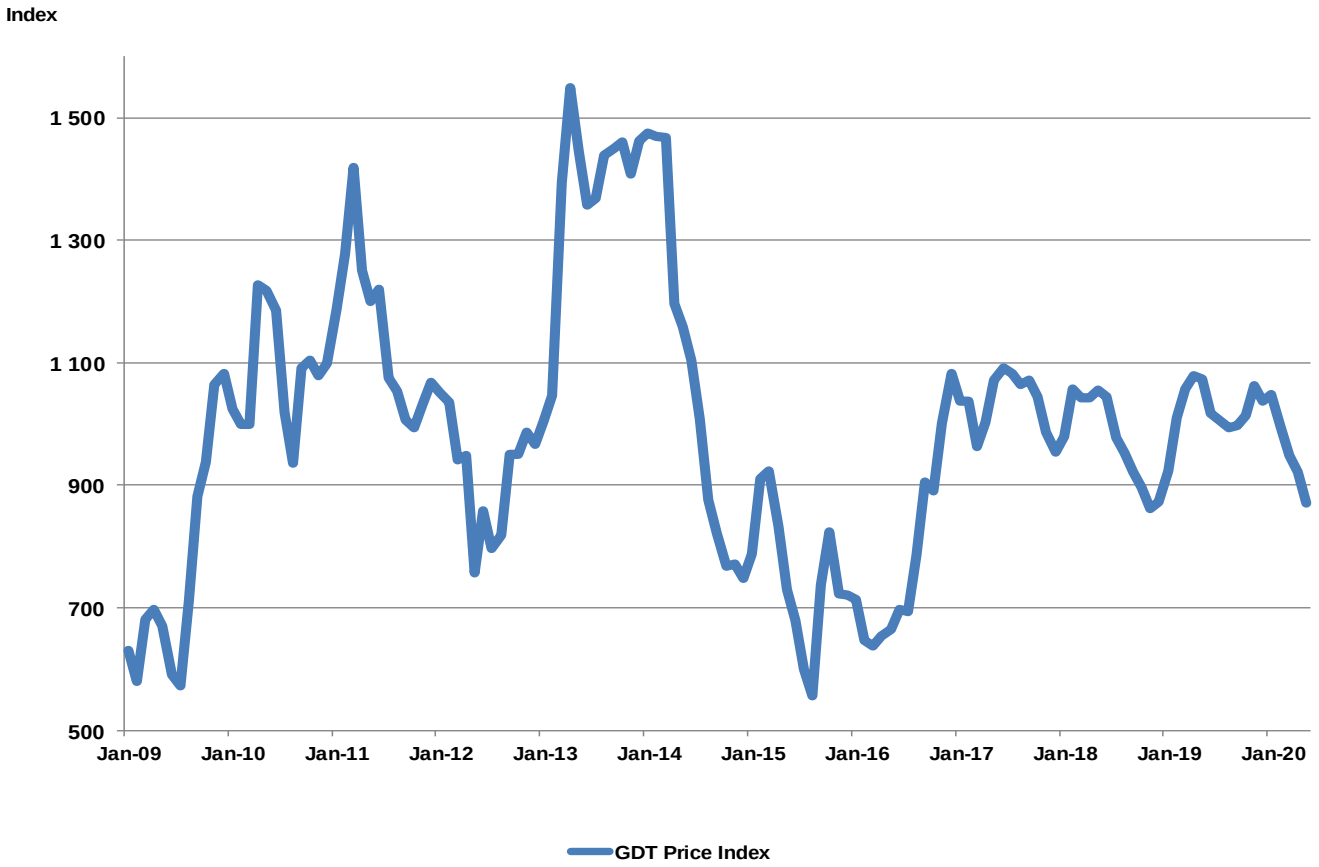


Figure 13 Global dairy trade-weighted price index

Source: Global dairy trade

Figure 14 shows international prices for milk powders, butter and cheddar cheese as reported by USDA in Rand/ton inclusive of May 2020. In USD terms all dairy product prices in May 2020 compared to May 2019 dropped, butter -31%, skimmed milk powder (SMP) -1%, cheddar -23% and whole milk powder (WMP) -17%. During the same time, the Rand took a beating devaluating against the USD with 26%. The result was that both SMP and WMP prices in Rand terms increased respectively with 24% and 5% due to the still relative high USD price levels for both powders while butter and cheddar prices in sync with dollar prices decreased: butter -13% and cheddar -3%.

The decline in dairy product prices in USD terms is confirmed by three sets of data from the FAO, GDT and United States Department of Agriculture (USDA).

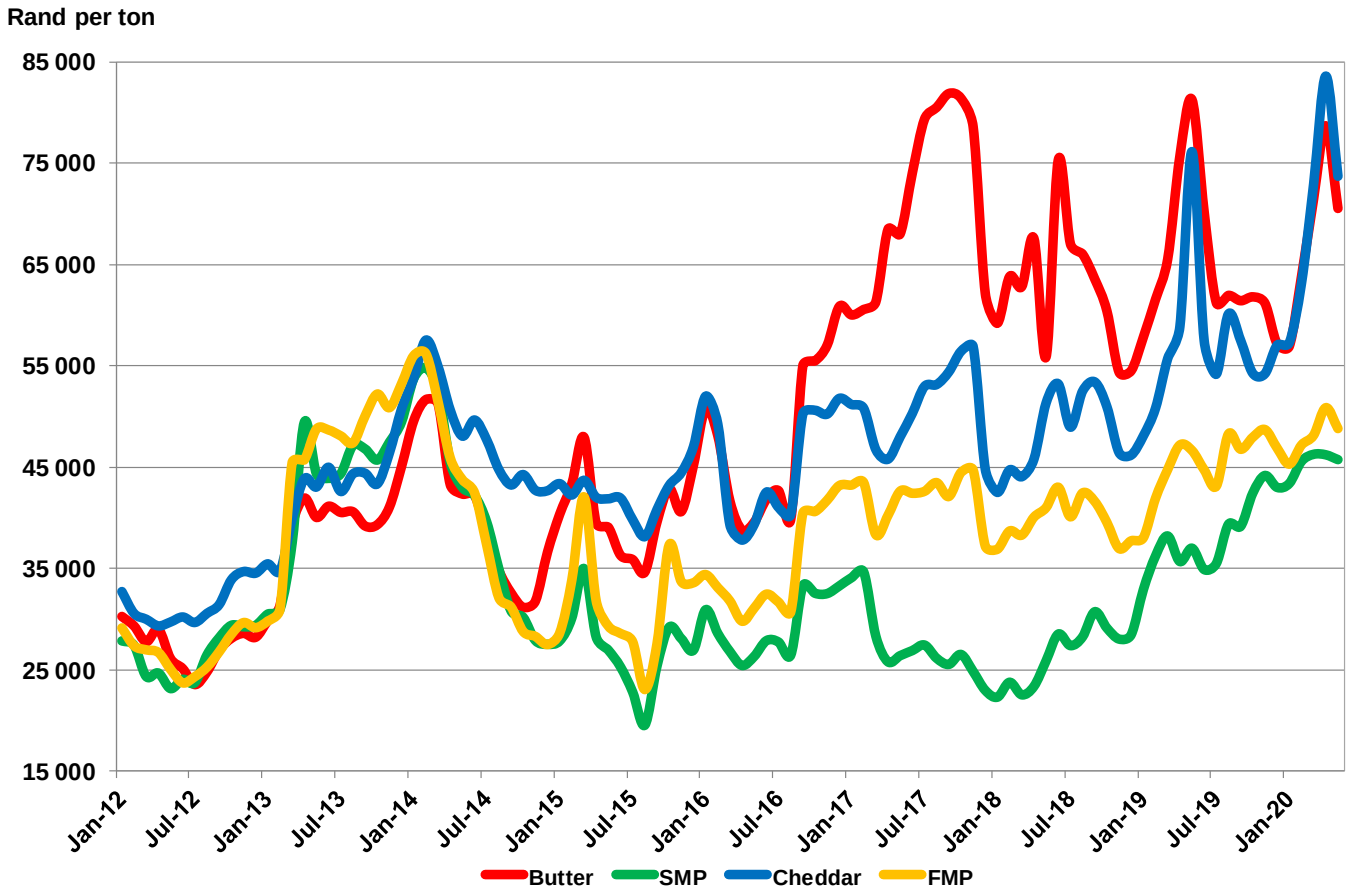


Figure 14 International dairy product prices (Rand/ton)

Source: USDA, SA Reserve Bank

1.12 Import parity and producer prices

The MPO's benchmark import parity is based on the published USDA prices, SA Rand/$ exchange rates, standard import tariffs and import and production cost as supplied by industry sources. The calculation methodology is standardised and while import parity may differ for a specific importer, based on a specific import mix and individual cost structure, the trend indicated by the import parity index is applicable to all importers

Import parity and producer prices are reflected in Figure 15.

The current difference in import parity and SA producer price is nearly touching the same extreme levels that were experienced in January 2014. The main drivers is the weak Rand and the still relative high international product prices.

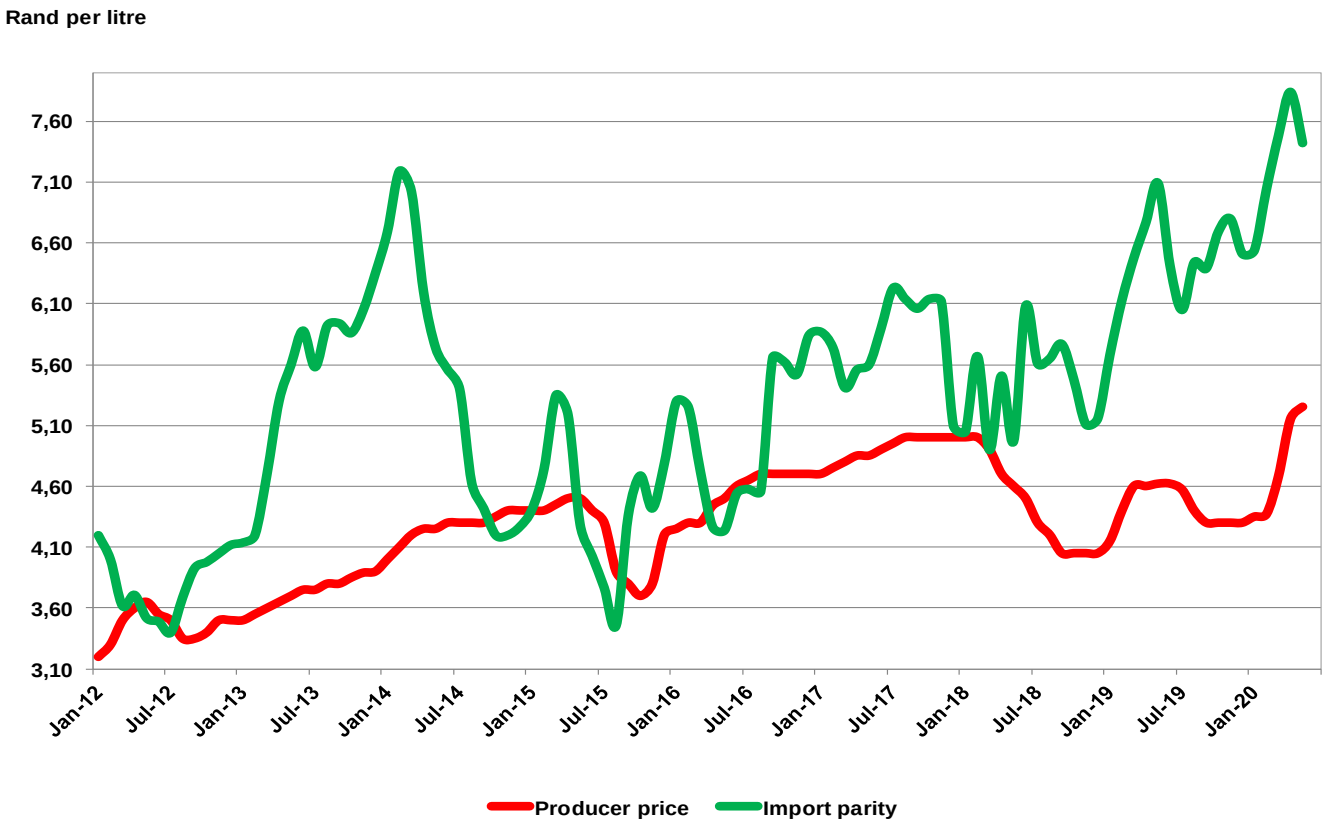


Figure 15 Monthly producer and import parity prices

Source: MPO calculations

Import parity and producer prices
Import parity at or below average producer prices implies that processors can import dairy products at current international prices at a lower price per litre than they have to pay local producers. An importing processor will still have to service the fixed cost on infrastructure and an importing retailer has to pay for packaging and manage returns.

2. Changes in cumulative unprocessed milk production in the major dairy exporting countries

Changes (%) in cumulative unprocessed milk production in the major dairy exporting countries and South Africa 2016 – 2020 (2020 only first three months). SA first four months, last two month preliminary.

	2016	2017	2018	2019	2020
USA	1.6	1.7	1.1	0.3	3.1
EU	0.2	2.1	1.4	0.4	2.9
AUS	-6.9	0	0.9	-7.3	4.9
NZ	-2.0	1.7	1.3	-0.8	-0.8
URU	-10.4	7.6	5.7	-4.0	2.7
ARG	-14.4	-1.6	6.4	-2.3	8.8
ZA	-0.5	3.0	5.0	0.7	0.34

(Source: CLAL and Milk SA)

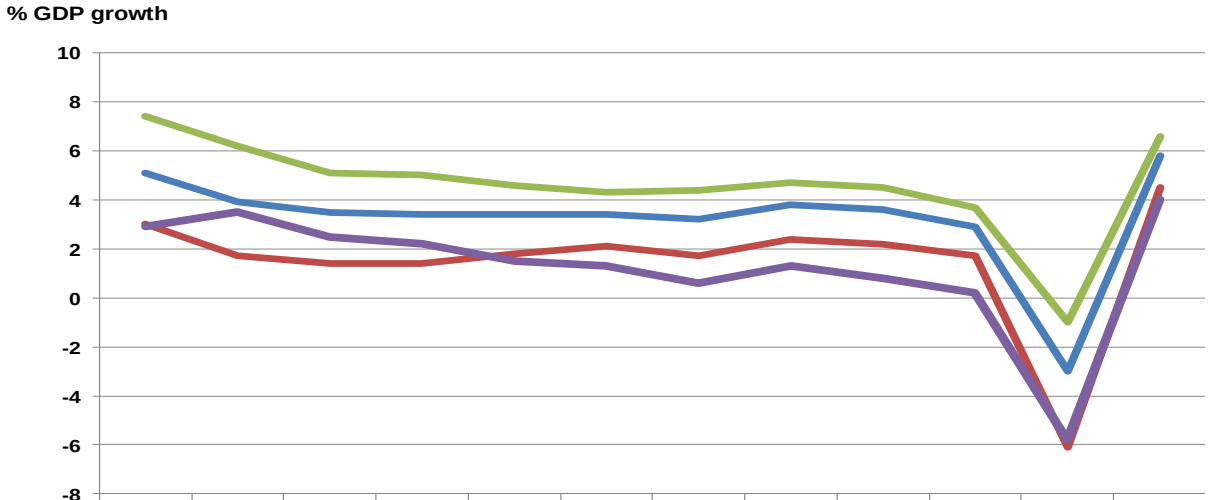
Milk production at farm level has improved in the first three months of 2020 compared to the same period in 2019 for all the major exporting countries except for New Zealand, which is moving sideways. This is due to better climatic conditions and improved producer price levels.

3. Economic overview

3.1 International economic outlook

The COVID-19 pandemic is inflicting high and rising human costs worldwide. Protecting lives and allowing health care systems to cope have required isolation, lockdowns, and widespread closures to slow the spread of the virus. The health crisis is therefore having a severe impact on economic activity. Because of the pandemic, the global economy is projected to contract sharply by –3 percent in 2020, much worse than during the 2008–09 financial crisis. In a baseline scenario, which assumes that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound, the global economy is projected to grow by 5.8 percent in 2021 as economic activity normalizes, helped by policy support.

Because the economic fallout reflects particularly acute shocks in specific sectors, policymakers will need to implement substantial targeted fiscal, monetary, and financial market measures to support affected households and businesses. Such actions will help maintain economic relationships throughout the shutdown and are essential to enable activity to gradually normalize once the pandemic abates and containment measures are lifted. The fiscal response in affected countries has been swift and sizable in many advanced economies (such as Australia, France, Germany, Italy, Japan, Spain, the United Kingdom, and the United States). Many emerging market and developing economies (such as China, Indonesia, and South Africa) have also begun providing or announcing significant fiscal support to heavily impacted sectors and workers. Fiscal measures will need to be scaled up if the stoppages to economic activity are persistent, or the pickup in activity as restrictions are lifted is too weak. Economies facing financing constraints to combat the pandemic and its effects may require external support. Broad-based fiscal stimulus can pre-empt a steeper decline in confidence, lift aggregate demand, and avert an even deeper downturn. However, it would most likely be more effective once the outbreak fades and people are able to move about freely.



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019*	2020**	2021**
World	5,1	3,9	3,5	3,4	3,4	3,4	3,2	3,8	3,6	2,9	-3	5,8
Advanced economies	3	1,7	1,4	1,4	1,8	2,1	1,7	2,4	2,2	1,7	-6,1	4,5
Developing economies	7,4	6,2	5,1	5	4,6	4,3	4,4	4,7	4,5	3,7	-1	6,6
South Africa	2,9	3,5	2,5	2,2	1,5	1,3	0,6	1,3	0,8	0,2	-5,8	4

Figure 16 International economic growth and estimated growth

* Estimate
** Projection

Source: IMF WEO Jan 2020

3.2 South African economy

3.2.1 Economic activity and growth

Indicators of economic activity are provided by the SA Reserve Bank in the form of a co-incident, leading and lagging indicator. The monthly movement of the leading and co-incident indicator of economic activity is reflected in Figure 17. The leading indicator signals future economic activity while the co-incident indicator reflects what is happening now in the economy. The co-incidence indicator clearly showing the slump in the economy since the third quarter of 2019 when the recession started and going through into 2020 while the leading indicator is tentative to indicate direction – dipping up and down

Figure 18 shows the quarterly growth rate of the SA gross domestic product. The SA economy contracted with 3.2% in the first quarter of 2019, in the second quarter a growth rate of 3.1% was achieved, in the third quarter it contracted again with 0.8% and in the last quarter of 2019 the economy contracted with 1,4%. The consecutive quarterly contractions placed SA in a technical recession. The SA economy registered a marginal growth rate of 0,2% for the full year 2019, which is the lowest over the past 10 years. The magnitude of the decay in government departments and parastatals has been under estimated and will take longer to fix. In the fourth quarter of 2019 agriculture contracted by 7.6%, manufacturing 1.8%, construction 5.9%, electricity 4.0%, trade 3.8%, the government 0.4% and transport 7.2%. Mining and

financial services grew respectively with 1.8% and 2.7%. The growth rate of the SA economy has been around 1% since 2015 and that is the elephant in the room. The main focus of the Minister of Finance in the 2020 budget speech on reducing government expenditure provides insight in the understanding of poor status of the SA economy. However, one needs to point out that although it is a step in the right direction the only way to stop the unsustainable growth in government debt as a percentage Gross Domestic Product (GDP) is through high levels of economic growth.

In a free market, economy where supply and demand reflects the scarcity of the different production factors the entrepreneur is the link in optimising these factors and creating competition. As soon as government's share of the economy starts to get to big, the role of the entrepreneur is suppressed with less optimisation and competition.

If economic growth is realised as the sweet spot to produce a thriving country the role of government in the economy should reduce while looking after infrastructure, the rule of law, education system, trade agreements, public health system and functioning government departments at all levels of government. Furthermore, growth policies or programmes should guard against all sorts of prefixes and warped economic concepts. "Inclusive economic growth" should be "economic growth" There is wide appreciation of the need to alleviate poverty and to expand wealth but first get the formula for economic growth in the SA context right. In the process, the income tax base will increase leading to increased income for the government. Once high growth levels are achieved, other leavers can be employed to enhance inclusivity. Beware of being prescriptive to the entrepreneur on how to do business, with whom business can be conducted, who must be employed and the fatal encroachment of private rights. The track record of the ANC government regarding economic policy is poor begging for rethinking the current approach. Unfortunately, the new leadership inherited a ship full of breaches and holes and to top it a Covid-19 pandemic.

In March 2020, Moody has joined the two other major credit rating agencies and downgraded South Africa's sovereign credit rating to a sub-investment grade (junk status). The outlook for the SA economy is alarmingly negative with economist and international financial institutions predicting a contraction of between 5% and 10% in 2020. In 2009 the SA gross domestic product contracted with 1,5% resulting in an estimated 800 000 job losses. Although difficult to predict SA will be looking at more job losses in 2020 due the current approach being followed by the government. Some of the regulations governing economic activity is illogical and creating the chimera of a hidden agenda.

The Covid-19 pandemic will deliver a devastating blow to the South African economy due to many years of mismanagement and poor policy choices. The Sub-Sahara Africa economy is projected to contract with 2% in 2020 (Source IMF). The SA economy is projected to contract with 10% in nominal terms in 2020 (6% real terms) (Source IMF). The size of SA economy in 2019 was R5.1 trillion (source Stats SA). A 10% contraction in nominal terms equals R500 billion less money in the economy. The effect of the South African government relief and stimulus programs is based on racial lines and is difficult to model due to past delivery problems and endemic corruption. The macro picture suggests that total demand will decrease for many products.

Indicators of economic activity

The coincident indicator of economic activity show whether the economy is in an upwards or downwards phase of the business cycle. The current slow downwards trend indicates a slowdown in economic activity. The leading indicator shows possible changes in economic activity in future. The decreasing trend points towards still lower economic growth in future.

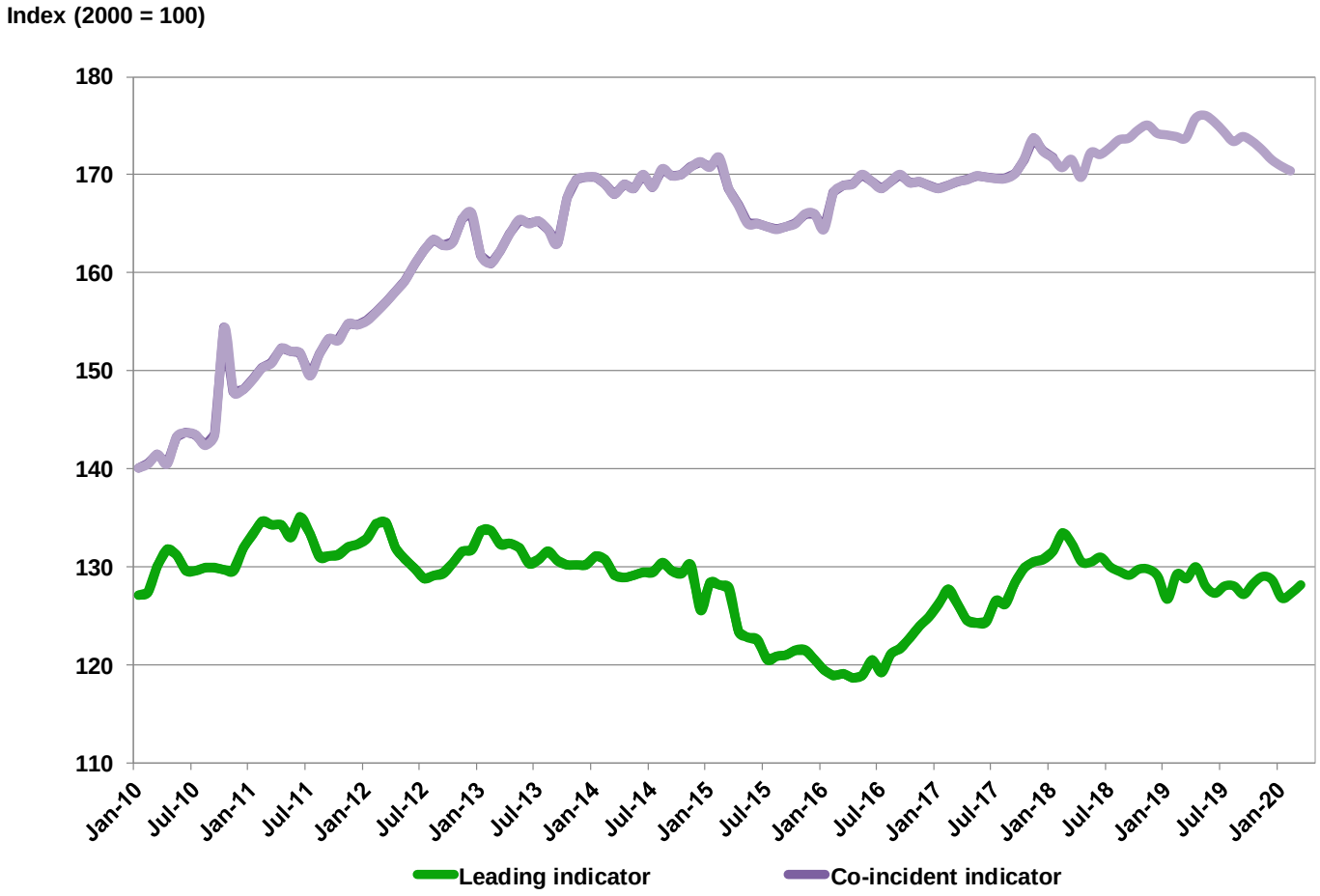


Figure 17 **Leading and co-incident indicator of economic activity** (*Source: SARB)*

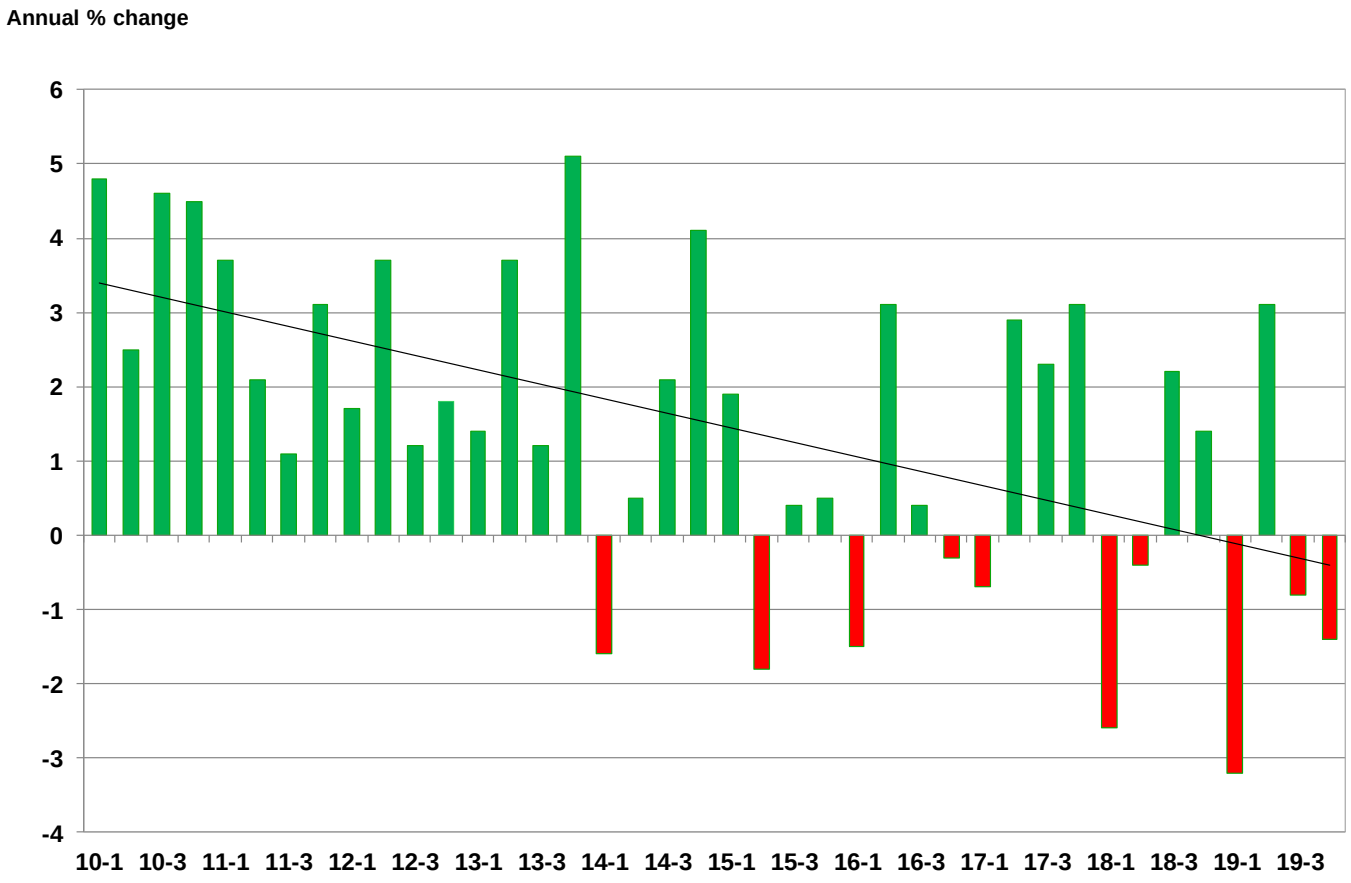


Figure 18 Quarterly change in real gross domestic product

Source: Stats SA

3.2.2 Household debt and income

Household debt at current prices as a percentage of household income has been on a steady decline since the first quarter of 2008. Household debt decreased from 87.8 to 71.3 in the third quarter of 2019.

3.2.3 Inflation

The consumer price index and monthly inflation rate are reflected in Figure 19.

Annual consumer price inflation was 4,1% in March 2020, down from 4,6% in February 2020.

Consumer price index (CPI) and inflation
The CPI is the value of a basket of goods and services on retail price level. The change in the value of this basket compared to the same period a year ago is called the rate of inflation. The Reserve Bank tries to keep the rate of inflation between 3% and 6%.

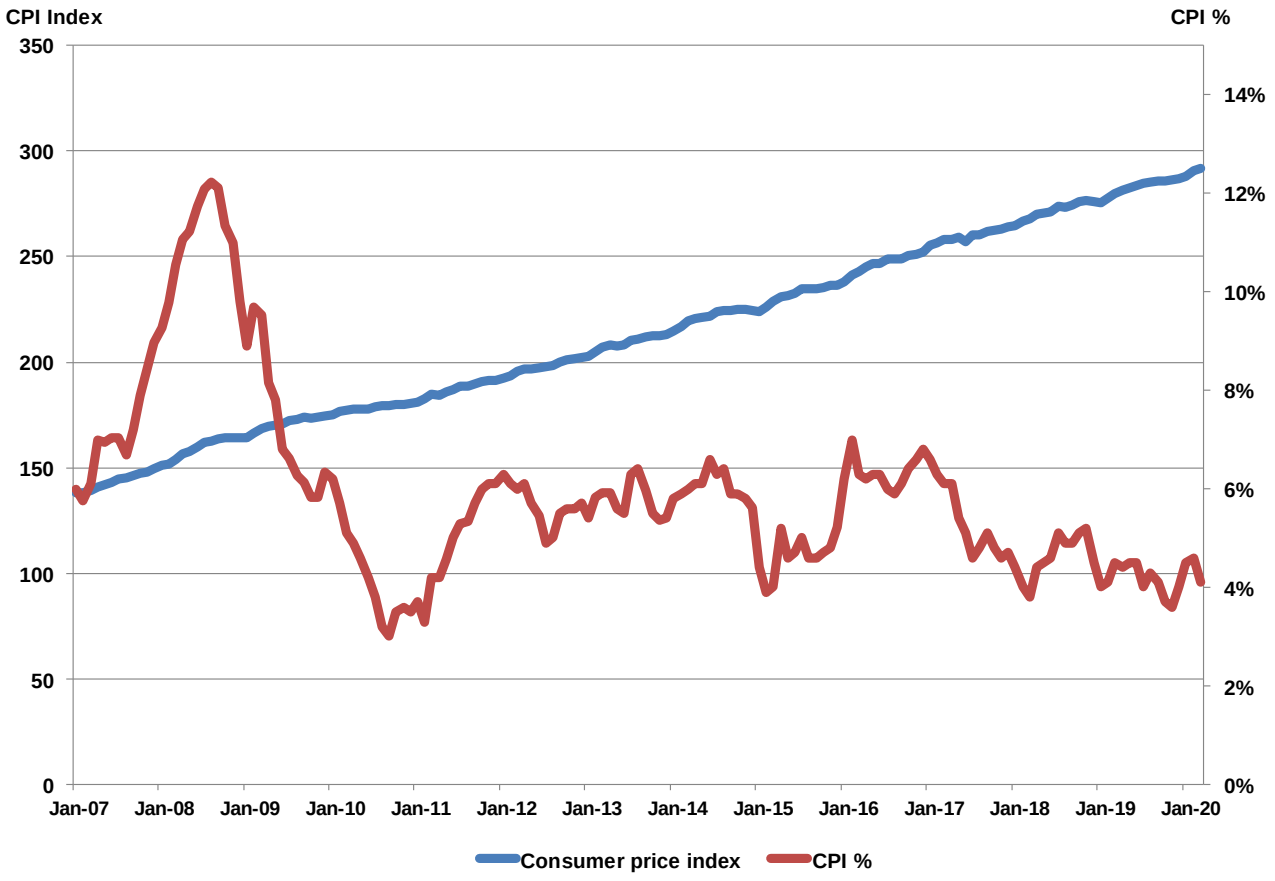


Figure 19 Consumer price index and consumer price inflation, 2007-2019

Source: Stats SA