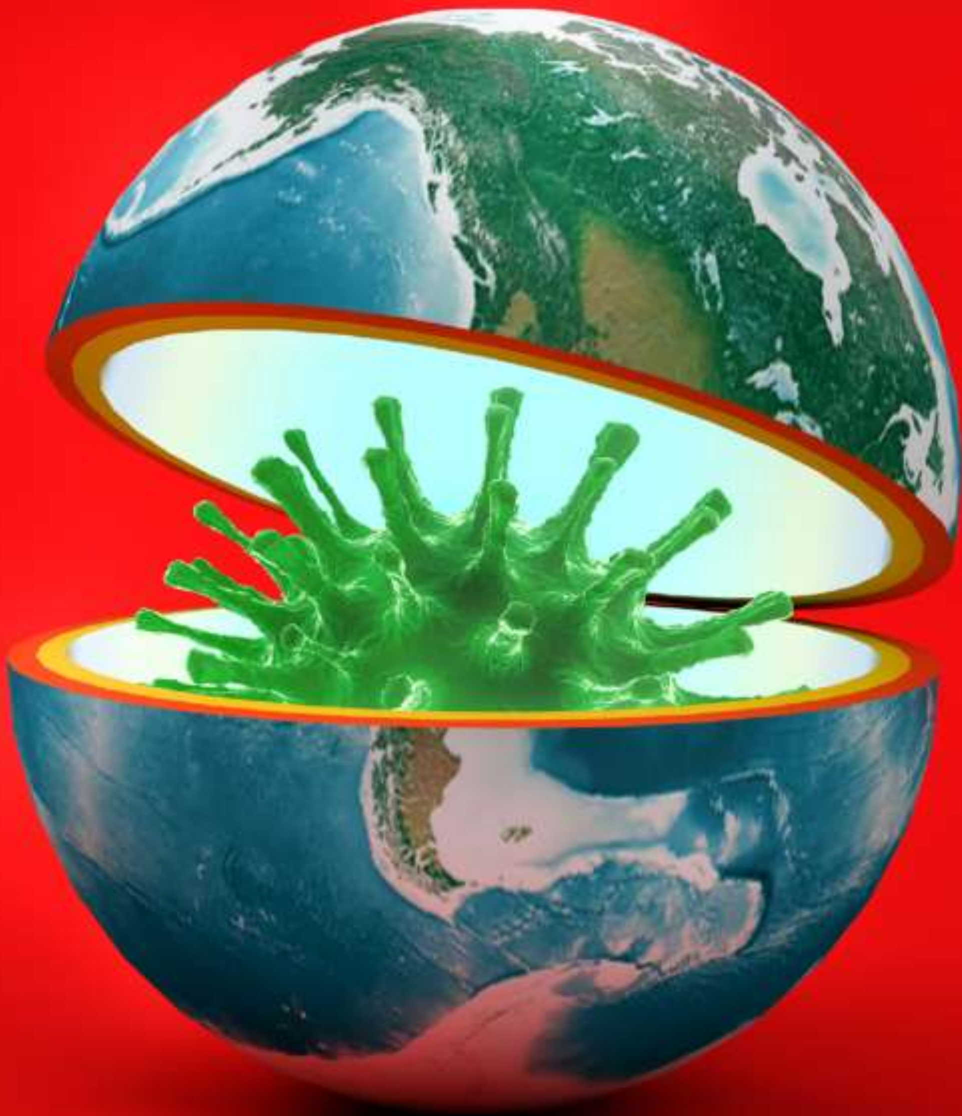


ECONOMIC MEASURES FOR COVID-19

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

STAY HOME
SAVE SOUTH AFRICA

Introduction

COVID-19 pandemic is a health and economic crisis

The COVID-19 pandemic is simultaneously a health crisis and a global economic crisis. Led by the President, government has acted decisively to prioritise the health and lives of all South Africans. Yet the economy, which was already weak before the emergence of the pandemic, has been hit by interlocking shocks to supply and demand.

Immediate priority is supporting livelihoods but fiscal sustainability required for long-term prosperity

The immediate priority is to use the joint levers of fiscal and monetary policy to support economic activity and alleviate hardship. Government has adopted a risk-adjusted approach to reopening the economy, with the initial easing of lockdown measures on 1 May. This document sets out a 3-phase approach to government's economic interventions over the next 18 months – a period during which the most severe effects of the public health crisis are expected to be resolved. This must, however, not compromise fiscal sustainability, which will ensure South Africa's long-term prosperity.

As the President noted in his 21 April address, over the longer term, the South African economy cannot merely return to where it was before the pandemic. Forging a new economy in a new global reality will require a social compact between business, labour, communities and government. It will require far-reaching structural reforms enabling millions of South Africans to participate in building a more productive and prosperous society. It will require steps to reimagine government's industrial strategy and overhaul state-owned enterprises.

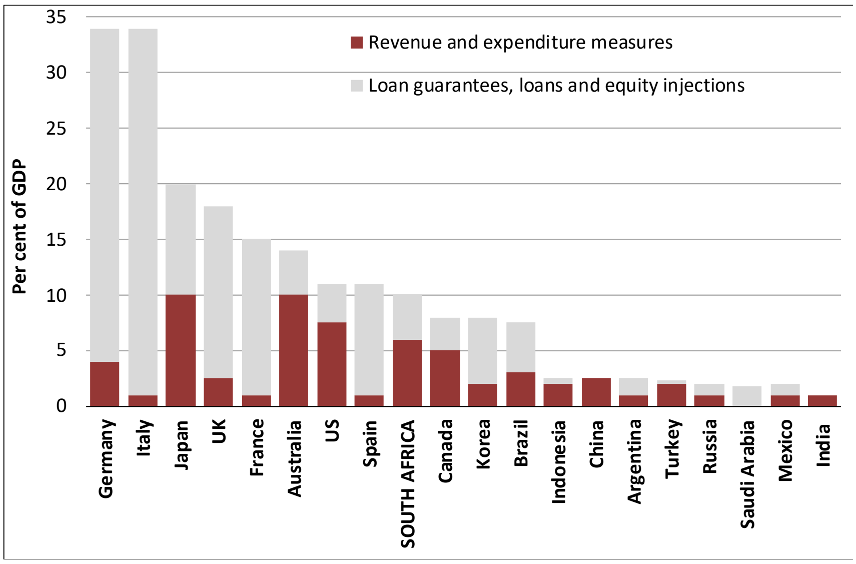
In the coming months, a special adjustment budget will set out a range of economic reform proposals and measures to stabilise the public finances.

Figure 1: Summary of short-term economic support measures

Support healthcare	• Increase in healthcare spending, including support for increase in mass-testing and tracing • Help with streamlining and centralising procurement
Relieve hunger and distress	• Expansion of grants, particularly those that target the vulnerable • Social relief of distress targets those without access to UIF benefits or social grants
Support companies and workers	• Temporary employment relief scheme • Tax deferral and postponement of new taxes • Loan guarantees for firms with turnover below R300 million
Reopen the economy in phases	• Appropriate steps to take into account both the health and economic considerations • Support the easing of structural constraints
Intervene in monetary and financial markets	• Repo rate reduction • Bank regulatory measures • Financial sector support (e.g. interest and premium holidays)

The R500 billion fiscal support package combines revenue and spending measures, as well as loan guarantees, totalling about 10 per cent of GDP. This is larger than equivalent support measures announced by other emerging markets in the Group of 20. This amount is the result of a careful balancing act of fiscal sustainability and the need to ensure that productive economic capacity is not lost.

Figure 2: Economic support measures announced by G20 governments



Source: IMF analysis

A coordinated, phased response

Public and private sector response has been rapid and coordinated

Government, the South African Reserve Bank and the private sector have acted rapidly to minimise the economic impact of COVID-19. This has been achieved by imposing a lockdown combined with cash-flow support for households and businesses. Government's response, in the context of limited budgetary resources, aims to protect vulnerable groups in particular, and to mitigate the economic effects of the shock. As the economy is reopened in phases, government will continue to provide targeted temporary support to households and firms.

The National Treasury is working closely with provinces and local government to coordinate spending across all spheres of government, including through weekly online meetings with Finance MECs, provincial treasuries and metropolitan municipalities.

In the months ahead, government's response will shift towards helping support employment and investment, and to position the economy for structurally higher growth. This will happen in three phases:

- Phase 1 is to **preserve** the economy through a set of immediate, targeted and temporary responses.
- Phase 2 is a plan to **recover** from the immediate effects of the crisis by supporting investment and employment.
- Phase 3 is a **pivot** to position the economy for the faster growth needed to restore the country's long-term prosperity.

These phases are summarised in Figure 3.

Figure 3: Summary of the three-phase economic response

PHASE	Timeline	Priorities
Phase I: Preserve	• Immediate to next 6 months	• Health spending increases to contain the pandemic • Support vulnerable households and firms to get through the crisis • Provide fiscal support • Begin phased conclusion of lockdown • Accompanying monetary policy and financial regulatory measures
Phase II: Recover	• 6 – 12 months	• Continue with health response • Economic focus shifts towards spurring activity to bolster the recovery, as restrictions on domestic economic activity ease, global growth returns • Implement significant fiscal reprioritisation
Phase III: Pivot	• 12 – 18 months +	• Return the public finances to a path of fiscal sustainability • Position the economy for structurally higher growth

Phase 1: Preserve

The focus of this phase is on immediate interventions to ensure health preparedness, as outlined by health authorities. Restrictions on economic activity will be gradually phased out to support businesses and workers. This is complemented with support to vulnerable households and firms to survive the impact of restrictions on economic activity. The proposed measures to support basic incomes and cash flow are temporary and easy to implement, leveraging existing mechanisms and requiring no complicated legislative changes.

Phase 2: Recover

As the restrictions on economic activity ease, the focus will shift toward supporting households and businesses to resume economic activity. This will require emphasis on measures to support employment and investment. The special adjustments budget will provide more details on these steps, and the withdrawal of temporary support measures. Far-reaching structural reforms will also be necessary, focused on measures that help to lower the cost of doing business and living.

Phase 3: Pivot

This phase aims to ensure that South Africa's post-pandemic economy can rebuild and thrive. This requires rapid and sustained economic growth–both to reverse the steep decline associated with the coronavirus pandemic, and to break from a decade of weak growth. Long-term average economic growth expectations fell from nearly 4 per cent in 2008 to between just 1 and 1.5 per cent in 2019. South Africa's structural problems are well understood and are identified in the National Development Plan. These include high levels of inequality, spatial disparities, the uneven quality of public services and inadequate state capacity. Although a wide range of policies aim to address these problems, progress has been limited.

Economic outlook

Forecasts are uncertain and subject to change

The COVID-19 pandemic has led to a severe global economic crisis. The extent and duration of this downturn is uncertain: economic models are not well-suited to assess a global pandemic, and conditions are changing rapidly. As a result, all forecasts are highly uncertain and subject to change. Table 1 summarises the forecast from the International Monetary Fund (IMF) as published on 6 April and compares it to the Reserve Bank forecast published on 14 April.

Table 1: Economic growth in selected countries

	Actual	Forecast		
Region/country Percentage	**2010-2018**	**2019**	**2020[1]**	**2021[1]**
World	**3.8**	**2.9**	**-3.0**	**5.8**
Advanced Economies	**2.0**	**1.7**	**-6.1**	**4.5**
United States	2.3	2.3	5.9	4.7
Euro area	1.4	1.2	7.5	4.7
United Kingdom	1.9	1.4	6.5	4.0
Japan	1.4	0.7	5.2	3.0
Developing Countries	**5.2**	**3.7**	**-1.0**	**6.6**
Brazil	1.4	1.1	5.3	2.9
Russia	1.4	1.3	5.5	3.5
India	1.4	4.2	1.9	7.4
China	7.8	6.1	1.2	9.2
Sub-Saharan Africa	**4.2**	**3.1**	**-1.6**	**4.1**
South Africa (SARB)	1.8	0.2	-6.1	2.2
South Africa (IMF)	1.8	0.2	-5.8	4.0
Nigeria	3.9	2.2	-3.4	2.4
Kenya	5.9	5.6	1.0	6.1

1. Forecast

Source: IMF World Economic Outlook, April 2020,South African Reserve Bank

The shape of the global economic recovery will depend on both progress in ending the pandemic, and the pace and magnitude of fiscal and monetary policy measures. The IMF and other forecasters expect a growth recovery to begin in 2021.

South Africa faces a confluence of economic difficulties that compound the impact of the public health emergency. Economic growth slowed dramatically in 2019 to just 0.2 per cent. At the end of March South Africa's sovereign credit rating was downgraded, raising the cost of government borrowing. South Africa's external adjustment has consequently been larger than many other emerging markets. Compared to peers, spreads have risen higher and the exchange rate has depreciated more (see box).

The economy currently faces overlapping aggregate demand and supply shocks, which are occurring sequentially. These domestic shocks will be the most significant drag on growth.

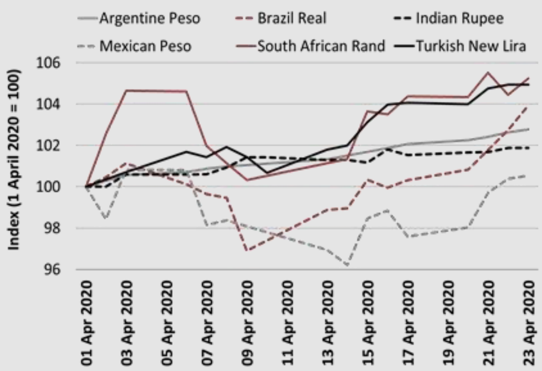
Analysis of the impacts of COVID-19 on the South African economy shows that approximately 33 per cent of the labour resources that were productive prior to the pandemic are idled as a result of the lockdown and its impacts. The labour force will work 25 to 40 per cent fewer hours, depending on education category, and capital utilisation also declines.

South Africa's level of nominal GDP is likely to be significantly lower than previously anticipated, with consequent knock-on effects on revenue. Terms of trade effects may to some extent counteract this – there has been a significant increase in the rand price of gold and a decline in the oil price.

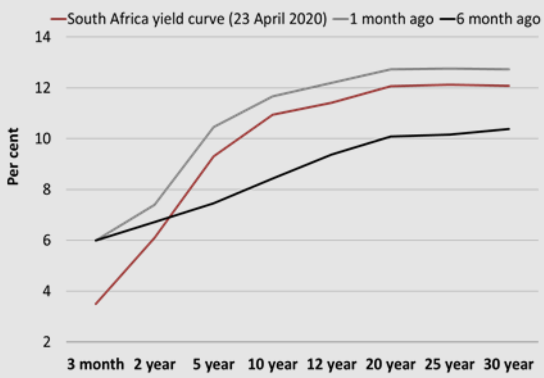
Returning to a path of fiscal sustainability

South Africa's weak fiscal position and low trend growth have made responding to this crisis with fiscal spending much more difficult. Worries about rising government deficits have seen bond yields rise faster than other emerging market economies. This mirrors the experience during the 'taper tantrum' of mid-2013. Then, five countries with weak macroeconomic fundaments (Brazil, India, Indonesia, Turkey and South Africa) experienced, on average, bond yields rising by 2.5 percentage points, equity markets falling by nearly 14 percent and exchange rates depreciating by 13.5 percent between the end of May and the end of August 2013.

The South African rand has depreciated more sharply than many other currencies…



… and long-term yields have risen significantly



Even without additional spending measures, falling revenues will prompt a widening deficit that compounds the increasing debt trajectory presented at Budget 2020. The widening deficit will further raise the cost of servicing debt as a share of revenue. It is projected to exceed the peace and security budget in 2021/22. Although rising yields feed gradually into the cost of servicing debt, an increased reliance on shorter-term borrowing (and larger amount of total debt outstanding) have increased the debt portfolio's sensitivity to interest rate and foreign currency movements. As the total debt burden mounts over time, debt-service costs will crowd-out expenditure on social transfers, infrastructure, and goods and services – reducing government's ability to respond to the needs of the people.

This highlights the urgency of returning to a path of fiscal consolidation and substantially raising economic growth, as outlined in Budget 2020. The measures outlined in this document are designed to be targeted and temporary.

Health and economic responses follow international best practice

South Africa's phased approach to resuming normal economic activity is informed by international best practice. The country has high levels of poverty and co-morbidity, and living conditions make social and physical distancing highly challenging. The longer that economic growth remains weak, however, the greater the risk that there will be a permanent reduction of supply-side capacity with profoundly negative implications for household incomes and welfare.

Going into this crisis, South Africa's fiscal position was weak, as outlined in the *2020 Budget Review*. Gross government debt has continued to rise as a result of weak economic growth, high levels of expenditure and repeated funding support to state-owned companies. Rating downgrades and currency weakness since the crisis began have further increased the cost of government borrowing.

Government will return to the fiscal consolidation path outlined in the 2020 Budget as soon as possible. Lower projected inflation will allow for reductions in the nominal expenditure ceiling. Further efficiency gains will have to be realised. Moreover, Government is committed to implementing structural reforms to move South Africa onto a higher growth path. The specific measures to do so, and details on the fiscal position, will be set out in the forthcoming adjustments budget.

Revenue forecasts

At this early stage of the fiscal year, estimating the impact of the pandemic on fiscal revenue for 2020/21 is challenging. Tax revenue is dependent on economic activity, and the highly uncertain economic outlook flows through to revenue forecasts. The usual relationships between economic variables and revenue changes can also break down during times of crisis. What is certain is that there will be a substantial shortfall compared to the revenue forecasts at the time of the 2020 Budget, both due to reduced revenue from economic weakness and from the estimated R26 billion in additional tax relief measures. This additional shortfall is not included in the calculation of the R500 billion financing package.

To better inform economic and revenue estimates National Treasury is closely monitoring real-time economic indicators. These indicate a sharp reduction in economic activity in the first three weeks of April. Average daily transactions through the national payments system have more than halved. Demand for electricity is down on average by 5,994 MW compared to pre-pandemic forecast. A recent survey from Statistics South Africa* found that just under one in three businesses is likely to close after a month with no business activity.

Monthly employees tax returns, value-added tax returns and customs information will provide timely insights. Tax revenue is traditionally low in April and May. A large share of corporate payments is due in June and this should offer an initial perspective of the impact on the business sector.

* Business impact survey of the COVID-19 pandemic in South Africa, April 2020

The overall COVID-19 fiscal response

The announced phase-out of the lockdown will support a resumption of economic activity. In parallel, the focus is on immediate interventions to ensure health preparedness, as outlined by health authorities. Government has also strengthened the economic safety net to ensure that the lockdown does not result in a permanent reduction of industrial and commercial capacity, and to enable households to cope with the restrictions that have been imposed.

The proposed measures to support basic incomes and cash flow are temporary and easy to implement, leveraging existing mechanisms and requiring no complicated legislative changes.

Table 2: COVID-19 fiscal response package

	R million
Credit Guarantee Scheme	200 000
Job creation and support for SME and informal business	100 000
Measures for income support (Further tax deferrals, SDL holiday and ETI extension)	70 000
Support to vulnerable households for 6 months	50 000
Wage protection (UIF)	40 000
Health and other frontline services	20 000
Support to municipalities	20 000
Total	**500 000**

Source: National Treasury

Healthcare spending

Spending on healthcare and other frontline services will be immediately increased by R20 billion. This will be used to support the treatment of those affected by the diseases, as well as efforts to manage its spread through the population, including mass testing and contact tracing, and the procurement of personal protective equipment.

Support for low-income households

Government is acting swiftly to ensure that low-income households can meet their basic needs by expanding financial support through existing transfer programmes. Government will make available R50 billion to top-up social grants and provide social relief of distress for a maximum of 6 months.

Fiscal impact

Government's R500 billion support package will provide substantial support to the economy but will increase the budget deficit and contingent liabilities.

These measures are temporary and are targeted to provide support where it is most needed. The loan guarantee scheme does not have immediate fiscal implications (see the technical annexure). Additional funding will be secured by shifting resources from non-priority programmes and drawing down surplus funds in institutions such as the Unemployment Insurance Fund. The National Treasury has also approached international financial institutions for loans at preferential lending rates.

Government is committed to returning the public finances to a sustainable position and stabilising debt as a percentage of GDP. This will require economic reforms and fiscal measures supported by a broad social compact forged by business, government, labour and communities.

Table 3: Funding sources for the COVID-19 fiscal response package

	R million
Credit Guarantee Scheme	200 000
Baseline reprioritisation	130 000
Borrowings from multilateral finance institutions and development banks[1] for business support, job creation and protection	95 000
Additional transfers and subsidies from the social security funds	60 000
Available funds in the Department of Social Development 2020/21 appropriation	15 000
Total	**500 000**

1. International Monetary Fund, World Bank and the New Development Bank
Source: National Treasury

Tax policy measures

Since the announcement of an initial set of tax measures in March, economic conditions have deteriorated. The National Treasury and the South African Revenue Service (SARS) have received a large number of requests for assistance, including from large businesses. Government's economic response package proposes additional tax measures. These measures will complement other government initiatives to respond to the pandemic. This includes the COVID-19 Temporary Employer/ Employee Relief Scheme, the Tourism Relief Fund and other support to small businesses and employees.

In line with the President's 21 April address, the following measures are expected to provide support of about R70 billion for businesses to continue operating, and to pay employees and suppliers:

- Skills development levy holiday: From 1 May 2020, there will be a four-month holiday for skills development levy contributions.
- Fast-tracking of value-added tax (VAT) refunds: Smaller VAT vendors that are in a net refund position will be temporarily permitted to elect to file monthly instead of once every two months.
- Payment deferral for excise taxes on alcoholic beverages and tobacco products: Due to the restrictions on the sale of alcoholic beverages and tobacco products, excise tax payments due in May 2020 and June 2020 will be deferred by 90 days.
- Three-month deferral for filing and first payment of carbon tax liabilities: The filing requirement and the first carbon tax payment will be delayed from 31 July to 31 October 2020.
- Postponing the implementation of some 2020 *Budget Review* measures: The 2020 Budget announced measures to broaden the corporate income tax base by restricting net interest expense deductions to 30 per cent of earnings, and limiting the use of assessed losses carried forward to 80 per cent of taxable income. Both measures were to be effective for years of assessment commencing on or after 1 January 2021. They will be postponed to at least 1 January 2022.
- Increase in the expanded employment tax incentive amount: The wage subsidy of up to R500 per month for each employee who earns less than R6 500 per month, announced in the first set of tax measures, will be increased to R750 per month.
- Increase in the proportion of tax to be deferred and in the gross income threshold for automatic tax deferrals: Tax-compliant businesses will be allowed to defer 35 per cent of their employees' tax liabilities over the next four months (ending 31 July 2020) and a portion of their provisional corporate income tax payments (without penalties or interest) over the next six months (ending 30 September 2020). The gross income threshold for both deferrals will be increased from R50 million to R100 million.

- Case-by-case application to SARS for waiving of penalties: Larger businesses (with a gross income of more than R100 million) that can show they are incapable of making payment due to COVID-19 may apply directly to SARS to defer tax payments without incurring penalties. Businesses with gross income of less than R100 million can apply for an additional deferral of payments without incurring penalties.

The following tax measures aim to assist individual taxpayers and to incentivise donations to the Solidarity Fund:

- Increasing the deduction available: The tax-deductible limit for donations will be increased from 10 to 20 per cent of taxable income for donations to the Solidarity Fund during the 2020/21 tax year.
- Adjusting pay-as-you-earn for donations made through the employer: Employers can factor in donations of up to 5 per cent of the employee's monthly salary, which would qualify for a deduction when calculating the monthly employees' tax to be withheld. The maximum donation percentage that can be factored in will be increased to a maximum of 33.3 per cent, provided the donation is made to the Solidarity Fund.
- Expanding access to living annuity funds: Individuals who receive funds from a living annuity will temporarily be allowed to immediately either increase (up to a maximum of 20 per cent from 17.5 per cent) or decrease (down to a minimum of 0.5 per cent from 2.5 per cent) the proportion they receive as annuity income, instead of waiting up to one year until their next contract "anniversary date".

The above measures will be included in the Draft Disaster Management Tax Relief Bill and the Draft Disaster Management Tax Relief Administration Bill. The National Treasury and SARS will also monitor the need for further relief.

Table 4 provides a breakdown of the level of support provided by the tax measures and is split by measures that provide additional liquidity (in effect, interest-free loans) that are ultimately paid back to government and measures that provide additional subsidies and result in lower tax revenue.

Table 4: COVID-19 tax measures

R billion	Liquidity / support (delayed revenue)	Revenue foregone
Expansion of employment tax incentive	-	15
Deferral of 35 per cent of PAYE liability	19	2
Deferral of 35 per cent of provisional tax payments	12	3
Skills development levy holiday for four months	-	6
A 90-day deferral for alcohol and tobacco excise duty due to be paid in May and June	6	-
Two-month deferral for filing and payment date of carbon tax	2	-
Case-by-case application for deferral	5	-
Total	**44**	**26**
Grand total		**70**

Source:National Treasury

The draft bills, alongside their draft explanatory memoranda, will be published for public comment on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites by 30 April 2020.

Monetary policy and financial regulatory measures

The South African Reserve Bank has unveiled a monetary and financial regulatory policy package, which will complement the fiscal stimulus. The measures are in line with measures taken in other countries.

The monetary policy and financial regulatory measures, introduced by the Reserve Bank, financial sector regulators and private-sector banks include:

- Reducing interest rates
- Relaxing regulatory requirements to support the flow of credit to households and businesses
- Introducing temporary payment holidays and other measures to support debtors.

Monetary policy is helping to support the cost of borrowing by providing liquidity in the bond market, helping to reduce bond yields. Reduced capital requirements will support additional lending, while the repo rate reduction will provide relief for borrowers. The South African Reserve Bank estimates that the monetary and financial sector policy elements of the package of measures will inject more than R300 billion into the economy. This takes the total combined fiscal and monetary policy measures to over R800 billion.

Table 5: Complementary monetary and financial regulatory measures

Measure	Details	Impact
Repo rate reduction	Repo rate reduced by 200 basis points	Reduced short-term borrowing costs
Intervention to support bond market liquidity	Bonds purchased in secondary market	Bond markets functioning liquidity risk premium reduced
Capital requirements	The Pillar 2A capital requirement (amounting to 1 per cent) and allow banks to draw down against the capital conservation buffer after consultation with the PA	Will support lending
Dividends	The Pillar 2A capital requirement (amounting to 1 per cent) and allow banks to draw down against the capital conservation buffer after consultation with the PA	Will ensure banks appropriately use capital
Liquidity coverage ratio	The PA lowered LCR requirement from 100per cent to 80per cent	Will support additional lending

Source: National Treasury, South African Reserve Bank, JP Morgan

Conclusion

It is critical that South Africa's responses to the COVID-19 pandemic deliver effective healthcare, alleviate hardship and preserve the ability of the economy to recover. Government has announced short-term economic support totalling R500 billion, with an equivalent amount of monetary support and regulatory measures provided by the Reserve Bank, regulators and private banks. In due course, government will announce longer-term measures to support households and firms, while protecting fiscal sustainability and growing the economy.

To build a stronger economy in the post-COVID-19 world, extensive structural reforms are required alongside an enduring social compact. Government intends to harness the spirit of change demonstrated by South African society during this pandemic in order to concertedly implement structural reform. An implementation plan will be set out in the special adjustments budget and the 2020 *Medium Term Budget Policy Statement*.

Technical annexure

This annexure provides additional details on:

- Division of revenue considerations
- The loan guarantee programme

Division of revenue considerations

Provincial treasuries, working with the National Treasury, are already identifying savings that can be used to fund the COVID-19 response.

Provincial health departments are responding directly to the virus, conducting testing, overseeing quarantine facilities and providing care and treatment for those who need to be hospitalised. The division of funding from the overall package will be announced in the adjustments budget. In this context, health departments will receive additional funding as part of the R500 billion support package, on top of the additional R466 million from disaster grants that was transferred to provinces in March 2020 to fund the purchase of personal protective equipment. Provinces are also adjusting their business plans for existing health conditional grants to prioritise facilities and equipment needed to respond to the pandemic.

Municipalities are providing additional services to communities during the lockdown, but local government revenue collection has been negatively affected by the sharp economic downturn. As announced by the President, additional funding of R20 billion will be made available to municipalities to provide emergency water supply, to sanitise public transport facilities and to support vulnerable communities. The National Treasury is working with the Department of Cooperative Governance and other stakeholders to determine how to allocate and transfer these funds so that they reach the intended beneficiaries, while ensuring necessary oversight.

Loan guarantees

The National Treasury and the Reserve Bank have been working with commercial banks to provide government-guaranteed loans to small and medium-sized businesses that may not be able to meet their financial obligations during the lockdown and when the economy reopens.

The loan guarantee arrangement will make R200 billion in new loans available to existing customers, of which R100 billion will be available in the first phase. The key features are as follows:

1. Businesses with annual turnover of less than R300 million, which are in good standing with their commercial banks, will be eligible for bank loans.
2. Funds borrowed can be used for operational expenses including salaries, rent and lease agreements, and supplier contracts. Loans will cover up to three months of operational costs and will be drawn down monthly.
3. Banks are not obliged to extend COVID-19 loans, and those that do will use their normal risk-evaluation and credit-application processes. Business owners may be required to sign surety for the loan.

4. Each business may accept only one COVID-19 loan.
5. Loans will be offered at a single agreed lending rate, which tracks the repo rate, by all participating banks.
6. A six-month repayment holiday will commence from the first drawdown, although interest will accumulate from the date on which the first drawdown occurs.
7. Interest and capital repayments will start after six months, and businesses have a maximum of 60 months to repay the loans.

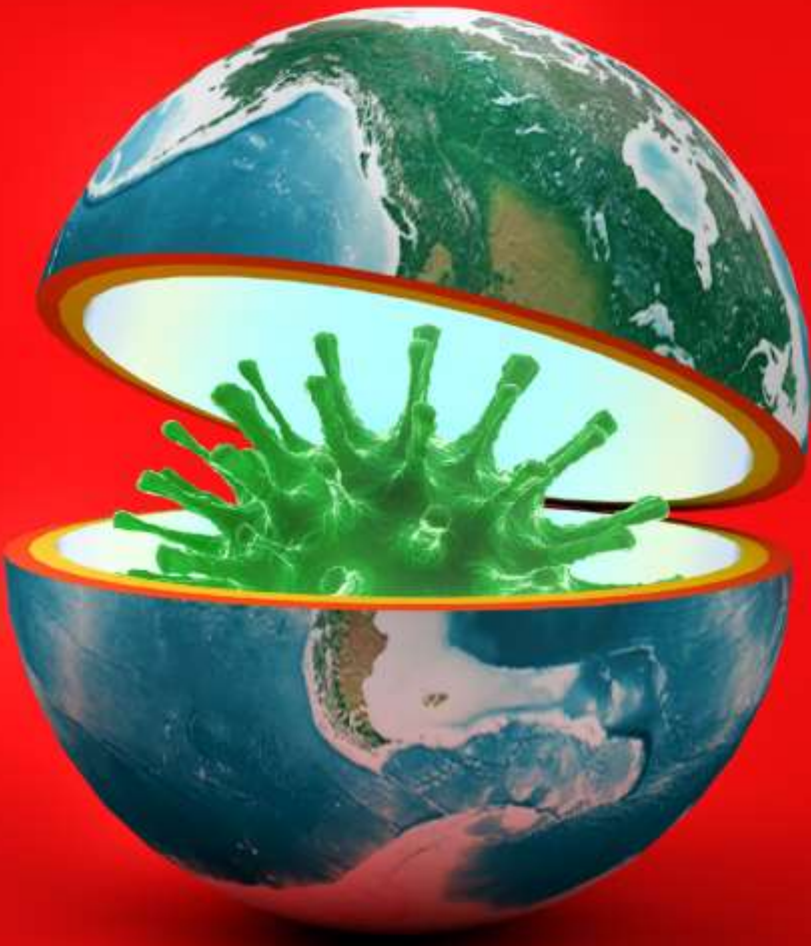
Potential loss to the fiscus

The scheme works on the principle that profits and losses are ultimately shared between government and the banks. The scheme will receive all 'profits' on the loans, i.e. the difference at which banks lend the money and their funding costs, plus a guarantee fee. These profits will be used to offset any losses that the scheme makes. If the scheme suffers further losses, these will be absorbed by the banks themselves, capped at 6 per cent of the size of the loan. Any further losses will ultimately be covered by the fiscus. Under baseline assumptions, the margin and fee will be sufficient to cover losses. Only under extreme scenarios do costs to the fiscus and banks arise. Under a highly stressed scenario the loss to the fiscus is also approximately 6 per cent of the size of the guarantee.

Contact Us

National Treasury welcomes comments and questions on government's short-term economic response to COVID-19. Please contact us at:

- Email: COVID-19@treasury.gov.za
- Post: Private Bag X115, Pretoria, 0001
- www.treasury.gov.za



ECONOMIC MEASURES FOR COVID-19

Private Bag X115, Pretoria, 0001 | 40 Church Square, Pretoria, 0002
Tel: +27 12 315 5757 | **Fax:** +27 12 315 5126
Web: www.treasury.gov.za

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA