The potential cost of looting

The mayhem of week 29 in the calendar will leave us with images in our minds of outright lawlessness as "looting" became the most popular word on social media platforms. The full monetary impact of the riots will take some time to calculate. We tried to put some numbers to it and realized that it will have an immediate effect on this year's GDP forecasts. In addition, we draw some conclusions from an IMF research paper addressing the impact of social unrest on the longer-term economic growth path. Unless policy change becomes more urgent, the long-term rate of growth in SA might have been dealt a bad blow.

Willie Pelser

The mayhem of week 29 in the calendar will leave us with images in our minds of outright lawlessness as "looting" became the popular word on social media platforms. Political commentary ranged from: this was planned and orchestrated; this was a Free Zuma campaign that went horribly wrong; there were some well know individuals behind a coordinated attempt to dethrone the current President. As you are aware, we don't express explicit political views. Nonetheless, we share the press's sentiment that it took some serious planning around specific targets that then spiralled out of control as those suffering from hunger, unemployment and the ongoing impact of Covid vented their frustrations.

The full impact of events will take some time to calculate. Last week's Sunday press made mention of some 120 incidents of public violence, arson, looting and other unrest-related instances. Extensive damage has been caused to more than 160 malls and shopping centres, 11 warehouses, 8 factories and 161 liquor outlets and distributors. This does not include damage caused to roads and other infrastructure. The destruction (first quantifiable impact) and multiplier effect (second-round impact - for example the shortages of foodstuffs) in months to come will cost businesses, consumers and the country billions of rand.

How bad are the economic impact and potential cost?
Major retailers such as Makro, Game, Pick n Pay, Spar, Pep Stores, and Shoprite - the list goes on - have suffered the most damage. However, we can not lose sight that businesses in all spheres of the economy have been affected. For example, the loss of trade due to the complete lockdown of the N3 is an example as goods could not reach their intended destination for a week in other parts of South Africa. Landlocked countries like Zimbabwe and Zambia, who heavily rely on the SA for imports as well as the Durban port/N3/N1 corridor to transport goods, will also feel the impact in months to come.

SPEED READ

- **Cost estimates around the impact of the looting and lawlessness on property, inventory, road freight and other logistics will run into billions of rands.**
- **The direct impact on South African economic growth for 2021, taking into account some of the secondary effects which include a loss in confidence and slower expansion, could be as high as 0.5%.**
- **The IMF published a Working Paper on the impact of social unrest on various economies, ranging from developed countries to emerging markets. SA is included in the research. The impact of recent events will likely be felt for the next few years, based on the conclusions drawn from that study.**

We break our analysis into the following main headings to try and put a number to the impact.

Household consumption and industrial production

KwaZulu-Natal, which bore the brunt of the unrest, is a systematically important province accounting for 16% of GDP, while Gauteng contributes a further 35% of GDP. The most immediate and direct impact on GDP will be the loss of household consumption and industrial production in KZN and, to a lesser extent, Gauteng over the past week. Many businesses across different sectors (retail, manufacturing and even mining in parts of KZN) in both the formal and informal parts of the economy were forced to close to ensure the safety of their employees and customers. Some retail chains also temporarily closed their facilities outside the directly affected areas as a precaution. While mobility data shows a slowdown in foot traffic to food and pharmacy stores across all provinces since the start of level 4, KZN saw a dramatic drop last week.

While unaffected businesses should be able to reopen relatively quickly once the dust has settled, the shock of the past week may weigh on consumer and business confidence for some time, potentially negatively impacting consumer and business spending behaviour.

Infrastructure – Major impact on Malls/Distribution Centres.

South Africa has around 2,300 shopping malls with an estimated replacement value of approximately R180 billion. Various reports indicate that around 200 malls have been damaged – to varying degrees. I came across a simple calculation by economist Mike Schussler which estimated that the replacement value of the damaged and structurally affected building could amount to R15 billion (200/2300 x R180 billion). These are just estimates because you can argue that distribution centres are not malls and a few distribution centres have been cleaned out. Nonetheless, the 200 malls damaged relative to the total stock of 2,300 gives us an 8.7% number to work with.

> "A few back-of-the-match-box calculations show that between R2 billion and R5 billion of goods are transported along the N3 daily. "

Retail trade

How much in monetary terms could potentially have been looted? At the end of the first quarter of 2021 final goods in inventory (in the non-financial private sector of the economy) amounted to around R600 billion. Based on the 8.7% number above, the potential "value of the loot" could be as high as R52 billion.

Logistics/Transport

I have already mentioned that the N3 (including the railway line and pipeline) is an important corridor. Sanral statistics show that about 6,000 trucks pass through the Tugela toll plaza daily when conditions are "normal". The numbers here quickly add up: a fuel tanker with a capacity of 50,000 litres transports R800 000 of fuel per trip; a container filled with flat-panel TVs could be worth R2 million (especially when stacked neatly rather than squashed into the back of a Toyota Corolla). A few back-of-the-match-box calculations show that between R2 billion and R5 billion of goods are transported along the N3 daily. Given that the N3 was closed for a week, that implies that at least R14 billion worth of goods has not arrived at their intended destination. Fortunately, the highway is operational again, and some of this backlog will be recouped. But there are consequences. For example, some of the goods transported have expiry dates, and news reports were full of clips showing farmers pouring milk and other fresh produce down the drain. The point is that the mayhem and disorder came with additional costs.

From the little bit of arithmetic we did here, one can draw two conclusions. Firstly there will be an immediate impact on our rate of GDP growth for 2021, which we believe could be as high as 0.5%. Subtracting this from the current forecast for 2021, the SA economy might struggle to exceed the 4% growth rate that many economists were anticipating. The second conclusion revolves around the longer-term growth trajectory - whether reforms are now going to be fast-tracked. If so, the longer-term impact could be greatly reduced, or even mitigated entirely. We think that the crux of the matter for the longer-term prosperity of SA lies in this one key decision: implementation of pro-growth, pro-employment policies cannot be talked about at Summits anymore. We now need the Nike advertisement to run through our heads continuously… Just Do It!

How long will it take to recover?

Horrifying figures are coming from different business councils. At least 70% of small businesses which are affected by the violence are black-owned. The biggest concern is that these businesses are not insured and have effectively lost everything. A large number of these smaller businesses can also be classified as "informal" and survive on a "hand to mouth" basis. For example, they trade in anything that sells daily, use some of the proceeds to buy tomorrow's stock and repeat the cycle. Lots of these might get back on their feet as they don't necessarily employ people. They have to survive. However, the complexity for them now is that the source of their stock has also been affected. They can't afford to travel far to buy stock from a new source.

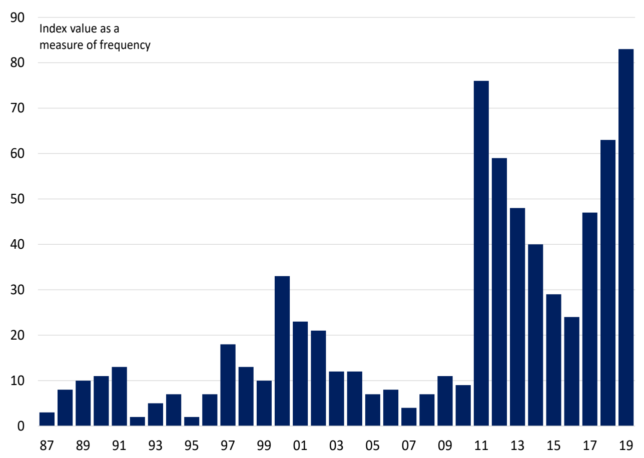
Bigger businesses are more fortunate. Firstly, insurance cover will limit the financial loss, and secondly, their national reach can ensure that they draw stock from unaffected areas. For them, the recovery will be quicker, and we are already seeing evidence of this from large listed companies who are "getting back to normal."

Coincidentally, two weeks ago the International Monetary Fund (IMF) released a Working Paper (WP/21/135) with the following heading, "The Macroeconomic Impact of Social Unrest." How appropriate to be able to draw some insight from this paper in answering the question about how long recovery may take.

The report has an econometric bias as it developed various statistical series to forecast and backtest the equations. In the section on "Data and Methodology", they used a social unrest index (RSUI, a monthly news-based index starting in January 1985 that quantifies the extent of social unrest for a large set of countries). Unsurprisingly, South Africa does feature as one of the constituents of the index. The opening paragraph of the introduction (and the chart that follows) was a sobering read:

> *"The frequency of social unrest has increased recently, with important social-political, and economic ramifications across the globe. Only in 2019, social unrest events have affected a diverse set of countries, ranging from advanced economies (France and the People's Republic of China, including Hong Kong Special Administrative Region) to emerging market economies (Chile and Lebanon). The latest Global Peace Index (2020) suggests that the number of riots, general strikes and anti-government demonstrations around the world increased by 244% over the last decade (2011 to 2019). Importantly, these unrest events have affected the lives and livelihoods of millions of persons around the world."*

GLOBAL INCIDENTS OF UNREST



Worryingly, unrest has been rising steadily across the world over the past decade. It seems that Humans are by nature a restless species.

Without boring the reader with all the jargon, formulas and assumptions, the research also focused on the differences in the levels of confidence in various countries before and after unrest, differences between developed and emerging economies, factors such as the level of rule of law, levels of poverty etc, and even the distinguished between different types of civil unrest. The key conclusion is that there is valuable insight to be gained from this study.

The conclusion of the study is quoted below.

> *"Abstract: This paper explores the macroeconomic impact of social unrest, using a novel index based on news reports. The findings are threefold. First, unrest has an adverse effect on economic activity, with GDP remaining on average 0.2 percentage points below the pre-shock baseline six quarters after a one-standard deviation increase in the unrest index. This is driven by sharp contractions in manufacturing and services (sectoral dimension), and consumption (demand dimension). Second, unrest lowers confidence and raises uncertainty; however, its adverse effect on GDP can be mitigated by strong institutions and by a country's policy space. Third, an unrest "event", which is captured by a large change in the unrest index, is associated with a 1 percentage point reduction in GDP six quarters after the event. Impacts differ by type of event: episodes motivated by socio-economic reasons result in sharper GDP contractions compared to those associated with politics/elections, and events triggered by a combination of both factors lead to sharpest contractions. Results are not driven by countries with adverse growth trajectories prior to unrest events or by fiscal consolidations, and are robust to instrumenting via regional unrest."*

In conclusion, the events of last week are most unfortunate, and they will impact negatively on both near term and longer-term growth through weaker sentiment, spending and investment. As is so often the case in SA, these events will prevent us from reaching our potential – we could have grown at 5% this year. Now that is unlikely. The country has bounced back quickly, and we will move forward – albeit at a slower pace than before. But policy reform is more urgent than ever – not only to regain the lost momentum but also to mitigate the risk of it happening again.

Please note, due to the concerns over the 3rd wave of Covid, Harvard House has decided to cancel our Insight presentations until further notice.

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Topic: n/a

Natal Midlands

Date:	TBC
Venue:	Fernhill Hotel Midmar / Tweedie Road Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	TBC
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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