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Contents

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Covid-19 lockdowns: Impact more severe than previously thought

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Abstract

This note improves on earlier work assessing the economic impact the Covid-19 pandemic by incorporating fiscal and monetary policy stimulus. We find that lockdown measures will lead to a GDP contraction of 28% (saar) in Q2 relative to Q1; with annual GDP contracting by between 16% and 8.6% depending on the speed with which the economy normalises. The fiscal and monetary policy package is expected to reduce the contraction in annual GDP by around 2.4% under modest assumptions. The scenarios suggest a revenue shortfall of between R259 billion and R544 billion, with the intermediate value of R354 billion, higher than the current National Treasury estimate of R304 billion. Two policy implications are immediate. First, policy efforts should be directed towards reducing risk aversion, increasing confidence and improving the pass-through of the current measures to aggregate demand. Second, government needs to take bold action to stabilise the debt trajectory to avoid an economic implosion.

1. Introduction

This note expands on an earlier note estimating the impact of the Covid-19 lockdown on the South African economy.[1] These estimates are different to the official forecast as they include the indirect impacts through sector linkages but exclude some important relationships such as the Phillips curve. The current estimates complement the forecast by illustrating the role that sector linkages play in amplifying the negative effects of the lockdown levels and the positive effects associated with the policy relief package.

The nationwide lockdown, which began in March 2020, was implemented to slow down the spread of Covid-19 and help buy time for the healthcare system to address capacity challenges. There are five lockdown levels, each with different rules and regulations governing the degree of movement and economic activity. Level 5 has the most stringent restrictions, with firms required to halt operations, except for those providing essential goods and services, while under level 1 majority of the sectors of the economy are allowed to operate, with some restrictions on travel and tourism. South Africa is currently under lockdown level 3, where some sectors of the economy such as, agriculture, mining and manufacturing are allowed to operate at full capacity while others (e.g. construction, tourism, and retail) are still subject to restrictions.

Similar to the previous note, we use the multiplier approach based on Arndt et al. (2020) to estimate the impact of these lockdown measures. The multiplier model is developed from a 2015 Social Accounting Matrix for South Africa and captures both direct and indirect impacts.[2] We distinguish four channels through which the lockdown is expected to impact economic activity, namely (i) the forced reduction in production as a result of a national lockdown and other restrictions on non-essential business operations, (ii) the impact of the lockdown on household demand for goods and services (e.g., tourism as a result of travel and movement restrictions), (iii) the

[1] See EN13

[2] A SAM is a matrix showing the flows of goods and services around the economy over a given period.

effect of disrupted global production and supply chains on South African exports, and (iv) the effect of uncertainty on business investment.

In the earlier note, assumptions were based solely on the announced regulations, as there was no hard data on actual activity at that point. Here, we improve on the previous work in at least two dimensions. First, we take advantage of the data that has come out since the lockdown began, allowing for refinement of the assumptions underpinning the analysis. Second, we evaluate the extent to which the government fiscal (and monetary) policy stimulus announced in April 2020 will cushion the impact of the Covid-19 pandemic on the South African economy. Third, we assess the likely impact on tax revenue and the fiscal deficit.

2. Results

In this section, we estimate the impact of different lockdown levels on output in Q2 and provide annual estimates based on assumptions regarding the likely lockdown levels in the third and fourth quarter. The results are informed by government regulations on which sectors are allowed to operate under different levels as well as assumptions regarding the recovery in exports and investment. These assumptions are summarised in Table 1 and Table 2, below.

Table 1: Assumptions on sector activity under the lockdown levels 3, 2 and 1[3]

	Level 3	Level 2	Level 1
Agriculture	Agriculture at 100% employment.	Agriculture at 100% employment.	Agriculture at 100% employment.
	Production across all subsectors operates at 100% capacity. The easing of restrictions globally boost export demand.	Production across all subsectors operates at 100% capacity.	Production across all sub-sectors operates at 100% capacity.
Mining	All mining at 100% employment.	All mining at 100% employment.	All mining at 100% employment.
	Production capacity is expected to improve to 70%, as restrictions are eased. Increased demand from trading partners will provide some support to demand.	Production capacity is expected to improve to 80%, as restrictions are eased.	Production capacity is expected to improve to 85-90%, as restrictions are eased. Worker infections constrain full scale operations.
Manufacturing	All level 4 manufacturing allowed but now scaling up to 100% employment. All other manufacturing is permitted to scale up to 50% employment.	All manufacturing is scaling up to 100% full capacity.	All manufacturing at 100% employment capacity.
	Production capacity is expected to improve to 80%, as restrictions are eased. The resumption of other sectors in the economy will likely increase activity in the sector.	Production capacity is expected to improve to 90%, as restrictions are eased.	Production capacity is expected to improve to 100%, as restrictions are eased.
Electricity	All electricity, gas and water at 100% capacity.	All electricity, gas and water at 100% capacity.	All electricity, gas and water at 100% capacity.
	Production capacity 80% employment as most of the activity in the economy begins to normalise.	Production capacity 90% employment as most of the activity in the economy begins to normalise.	Production capacity will be at full employment as most of the activity in the economy normalises.
Construction	All level 4 sub-sectors are allowed to continue to operate. Additionally, all other public works civil engineering is allowed as well as commercial building projects.	Expands to permit private residential building projects.	100% capacity. All construction projects are permitted.

[3] Assumptions for lockdown levels 4 and 5 are presented in the appendix. We do not make adjustments for the recent relaxation of the level 3 regulations which allow a number of businesses to reopen (e.g. personal care services, cinemas and theatres and sit-down meals at restaurants).

	70% capacity as private sector is slowly permitted to return to normal activity.	80% capacity as more of private sector is allowed to resume activity.	Sector doesn’t quite recover to full capacity as many projects would likely have been abandoned. Operates at around 85% capacity.
Trade, catering and accommodation	Retail trade of goods have been expanded to include all clothing, home textiles and footwear and alcohol (under certain restrictions). Vehicle sales are also permitted.	All retail trade is permitted. Alcohol sales are allowed, albeit with restrictions. Both takeaways and deliveries services at restaurants.	All retail trade is permitted. Alcohol sales are allowed, albeit with restrictions. All restaurants services are also permitted.
	Operations increase to 62% of full capacity, as restrictions in the sector are eased. However, activity constrained by the uncertain economic environment and increased financial strain (households and firms).	Sector operating at 70% of full capacity. The sector will likely be constrained by the low business and consumer confidence and overall slow economic recovery.	Operations at 80% of full capacity. Low business and consumer confidence remain a constraint.
Transport	Limited domestic travel. Ocean travel allowed for limited cargo. Public transport will resume at levels subject to further directions.	Limited domestic travel as well as ocean transport. Public transport will resume at levels subject to further directions.	The following is permitted: air, ocean travel and transport. Essential imported goods will continue be prioritised through ports. Export to neighbouring countries will be expanded. Public transport will resume at levels subject to further directions.
	The sector operates at 65% of full capacity, as restrictions are eased to allow transportation of more goods. Air travel largely restricted.	Sector operates at 75% of full capacity. Freight and shipping activity will likely improve as other sectors increase production.	Sector operates at 85% of full capacity.
Telecommunications	All telecommunication services and infrastructure is allowed.	All telecommunication services and infrastructure is allowed.	All telecommunication services and infrastructure is allowed.
	Operates at full capacity, unchanged from level 4.	Operates at 100% of full capacity, as economic conditions improve.	Operates at 100% of full capacity, as economic conditions improve.
Finance	Employees are encouraged to work from home. Where this is not possible and the service provided is essential in supporting other services permitted under level 3, activity will be permitted.	Employees are encouraged to work from home. Where this is not possible and the service provided is essential in supporting other services permitted under level 2, activity will be permitted.	All financial business and activity is permitted. However, employees are still encouraged to work from home.
	The sector operates at 90% of full capacity. Majority of transactions carried online.	The sector operates at 100% of full capacity. Branches begin to open and economic conditions improve.	Finance operates at 100% of full capacity.
Real estate	Commercial real estate activity is permitted.	All real estate activity is permitted.	All real estate activity is permitted.
	Activity operates at 45% of full capacity, as the sector operates partially. Agents mostly work from home and offer virtual viewings to prospective buyers. The deeds office opens, allowing for transactions to take place. However, a potential downside risk is buyers choosing to delay their purchasing due to financial strain and economic uncertainty.	Operations at 55% of full capacity, despite all activity being permitted. The sluggish activity will likely be due to the slow recovery of the sector, and buyers choosing to delay their purchases due to financial strain and economic uncertainty.	Operations at 70% of full capacity, despite all activity being permitted. The sluggish activity will likely be due to the slow economic recovery, buyer financial strain and uncertainty. However, on the upside, lower interest rates may attract new home buyers.

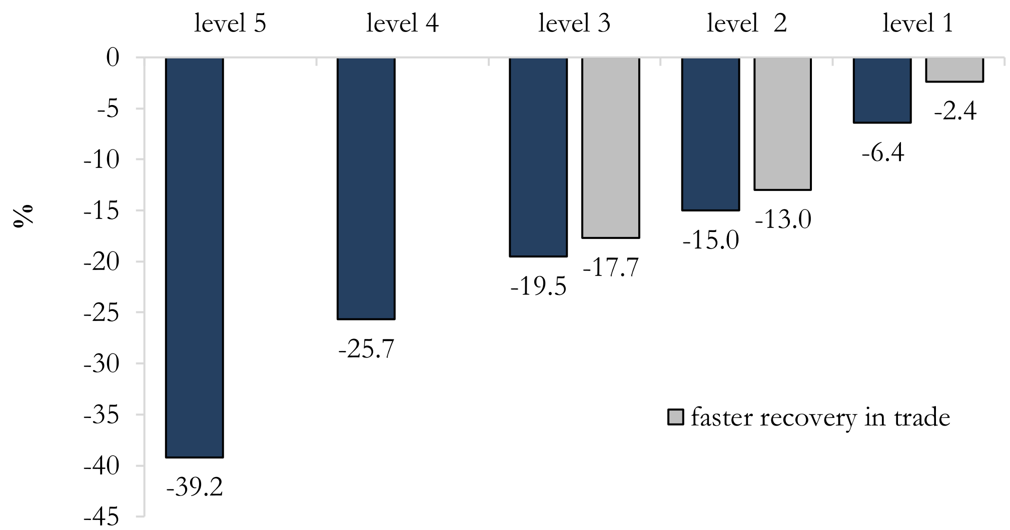
Table 2: Assumptions on exports and investment[4]

Level 3	Level 2	Level 1
Investment demand is 30 to 35% lower than in Q1 Exports are lower by 20 to 37% than in Q1	Investment demand is 19 to 22% lower than in Q1 Exports are lower by 8 to 15% than in Q1	Investment demand is 13 to 15% lower than in Q1 Exports are lower by 4 to 7.5% than in Q1

Impacts excluding fiscal Covid-19 package

Figure 1 presents estimates of the impact of different lockdown levels. The level 5 lockdown leads to a 40% decline in GDP.[5] In our previous analysis, we argued that the impact would be just below 35%. New information, however, suggests that this impact is likely to be larger. For example, at the time of the initial estimates we assumed that the health sector would expand during lockdown level 5. However, indications are that demand for health services fell by roughly 50% during level 5 lockdown.

Figure 1: Impacts on GDP under different lockdown levels (deviation from baseline)



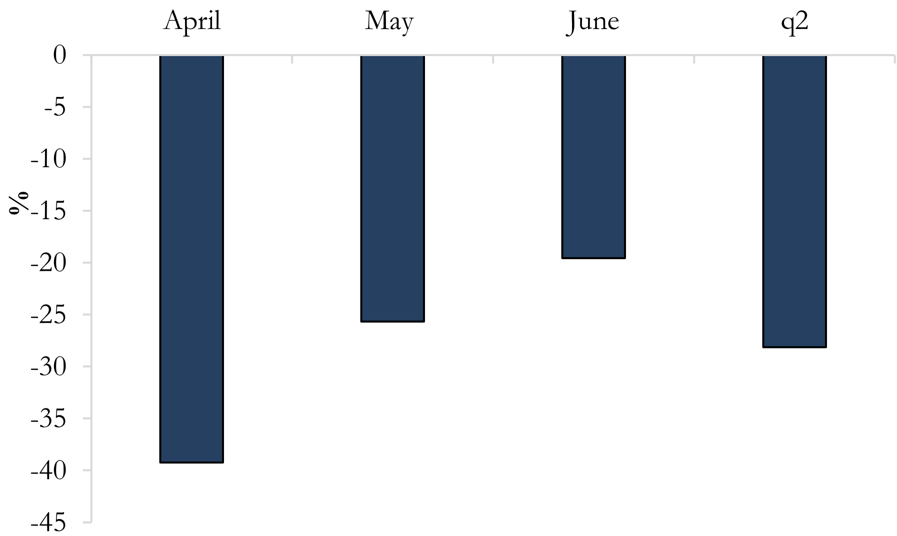
Source: Authors' own calculations.

Our estimates suggest a sizable impact on the economy even under lockdown level 1. While most restrictions are removed under this level, we still expect an impact through investment expenditure and global demand for South African exports. We assume that investment expenditure remains below 10 to 15% below Q1 levels as confidence remains low and real long-run borrowing costs remain elevated. Export receipts are 4 to 7% below Q1 levels owing to weak global recovery. Assuming that exports recover completely (faster recovery in global growth and trade), lockdown level 1 leads to a smaller reduction in GDP (from 6.4% to 2.4%). The sizable effect is also driven by indirect effects. Our methodology takes into account both the direct and indirect effects.

[4] The estimates for trade are based on a global economy contraction of 5% in 2020, which is in line with current estimates from the IMF and World Bank, and decreased trade intensity of global growth.

[5] The results are interpreted as the contraction per unit time, which can be a month or a quarter. For example if level 5 was for just one month, then the contraction in the month would be 40%, if level 5 was applicable for the entire quarter then the contraction would also be 40%.

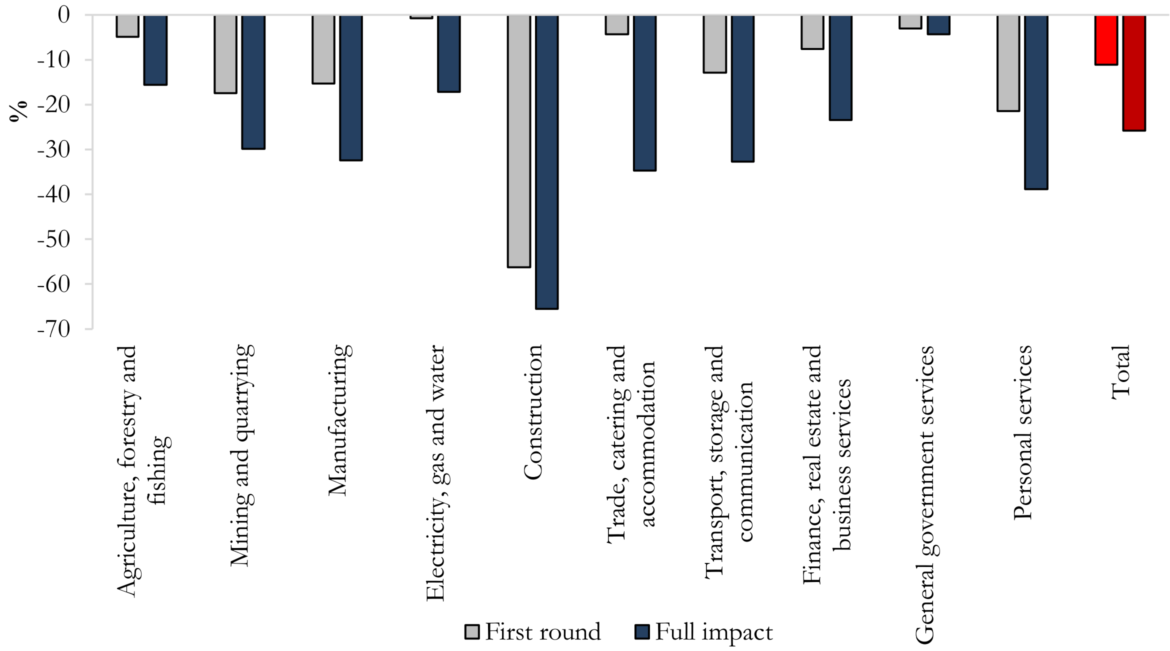
Figure 2: Estimate for Q2 (deviation from baseline)



Source: Authors' own calculations.

Using the output estimates for the different lockdown levels, we provide a revised Q2 estimate. We now expect that output will contract by 28% (saar) in Q2 relative to Q1 (see Figure 2). Sectors, which are not subject to restrictions contract as well due to indirect effects from other sectors. For example, even though the electricity, gas and water sector is not subject to restrictions, the sector contracts as the demand for electricity from restricted sectors such as mining and manufacturing declines. In Figure 3, we show the direct and indirect effects for the main sectors of the economy. The indirect effects dominate the direct impacts.

Figure 3: Q2 direct and indirect impact on specific sectors (deviation from baseline)

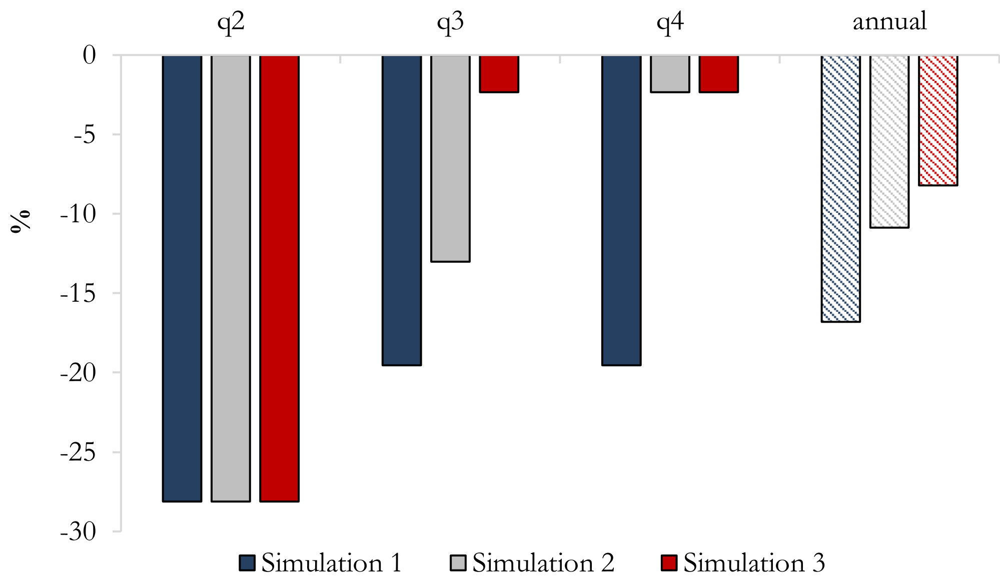


Source: Authors' own calculations.

In Figures 4 and 5 we present the outcomes for annual GDP and employment under three simulations. In simulation 1, we assume that the lockdown level 3 remains for Q3 and Q4. In simulation 2 we assume that in Q3 we move to level 2 and in Q4 we move to level 1, while in simulation 3, the economy moves to level 1 in Q3 and remains at that level in Q4.[6,7]

Under the first simulation, the annual deviation from the baseline is 16%, while simulation 2 yields a decline of just over 10%. This is in line with our estimates presented in our previous note.[8] If the economy returns to level 4 or 5 for three months before the end of the year, the decline will be over 18% relative to the baseline. The most optimistic scenario still generates a sizable contraction of 8.2% and this is if exports recover strongly in Q3 and Q4. Our preferred scenario is simulation 2. Comparing it with other forecasts, we find that the estimated decline of 10% is far larger than that of the QPM (6.95%) and Reuters poll (6.5%). Our estimate is larger as we take into account the indirect effects. The impact of the Covid-19 relief measure on economic activity can reduce the contraction and we illustrate this in the next section.

Figure 4 : Annual GDP impacts

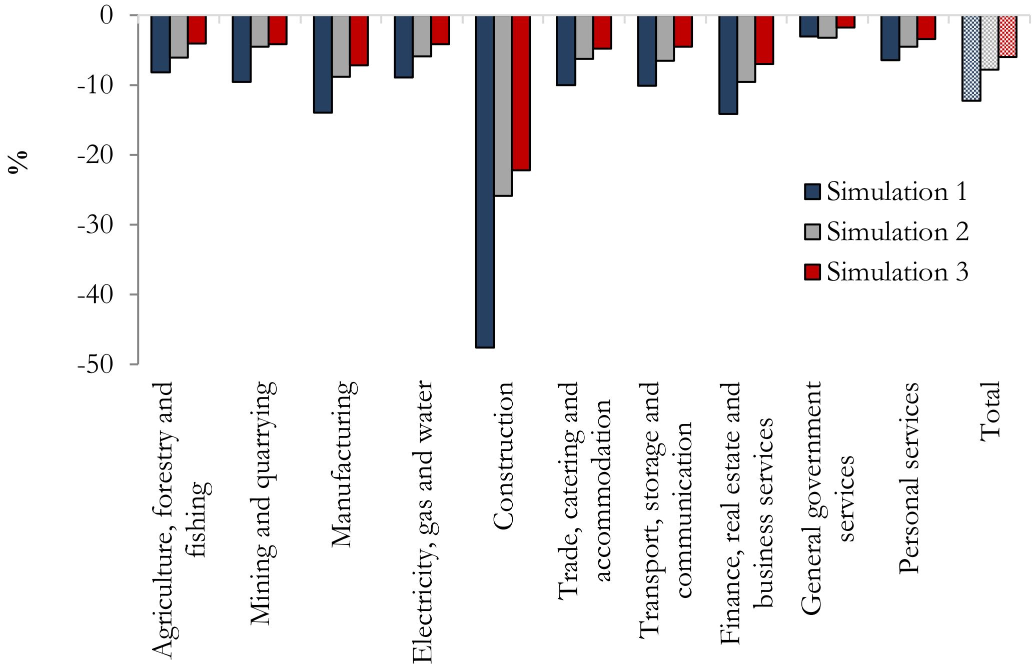


Source: Authors' own calculations.

Total employment is expected to contract by 12% in simulation 1, 7.8% in simulation 2 and 6% in simulation 3. The construction sector is expected to record the largest declines. Under simulation 1 close to 50% of those employed in the sector are projected to lose their jobs. Although not presented in the figure, we also consider employments impacts by income decile. The bottom deciles of the income distribution record smaller declines in their income as government grants are their major income source rather than income from employment. Transfers from government are sheltered from the downturn and these transfers comprise almost 70% of total income for households in the lowest income decile. This share falls roughly linearly to 28% for households in decile 5 and then quickly becomes a minor share of income for households in the upper half of the income distribution. Most affected are deciles 5 to 8.

[6] We don't show Q1 in Figure 4 as there is no deviation. The output level is Q1 is the baseline level. The annual deviation is a function of the weighted average of the quarterly deviations.
[7] It is possible that we could move back to level 5 but we see this as a low probability event. It is also possible that we could move between levels more frequently.
[8] See EN13

Figure 5: Annual employment impacts



Source: Authors' own calculations.

Results including the support package

Table 3 below summarises the Covid-19 support package. We assume that the government budget support of R130bn does not increase overall aggregate demand as the funds are prioritised from other programmes. The net new support is equivalent to R800bn.[9] The impact of this support package on aggregate demand depends on the take up of various programmes, the marginal propensity to save (which is likely to be very high for high-income households given constrained spending opportunities), and the financial sector decisions regarding lending or buying other financial assets as well as the timing. For example, the capital regulatory relief measures may not translate into higher lending if banks are highly risk averse or the demand for lending takes time to recover. The impact of the credit guarantee scheme and the regulatory relief measures is most uncertain. Extension of loans through the credit guarantee scheme is well below what was expected. We assume that only R240bn of the R800bn translates into higher aggregate demand in the current calendar year, and this is made up of around R60bn in repo rate relief, R40bn from the capital regulatory relief measures, with the rest coming from the fiscal side, including the credit guarantee scheme.[10]

[9] The changes in the composition of government expenditure can generate large indirect effects. For example, investment expenditure by government can have a larger impact on the domestic economy than consumption expenditure, which may be more import intensive. Government has not finalized what programmes will see budget cuts. We have assumed that the reprioritization of expenditure does not change the indirect effects.

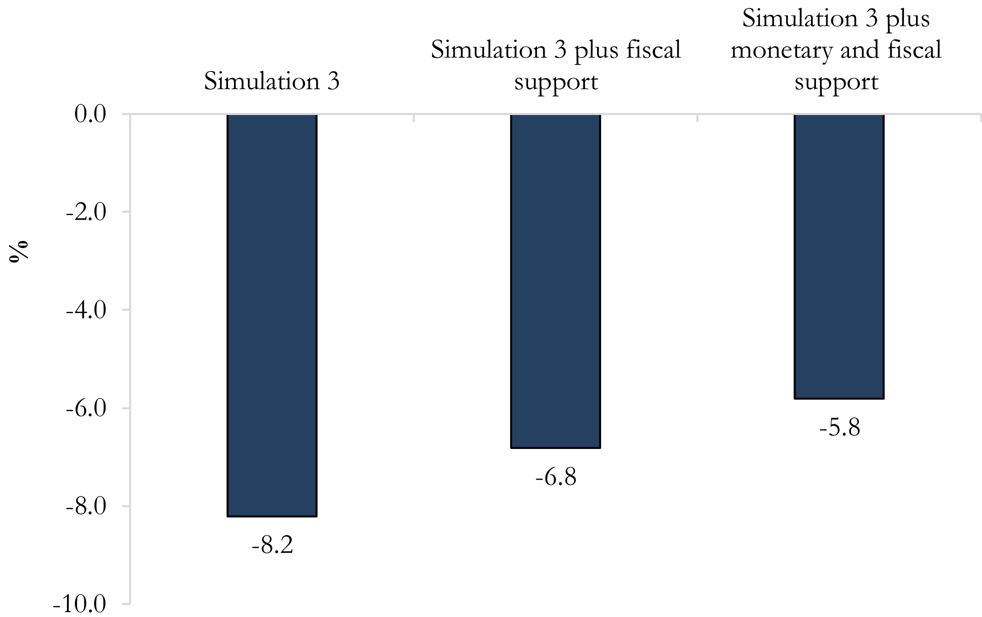
[10] We assume that out of the R170bn of government support additional to budget reprioritization, R100bn translates into an increase in aggregate demand. This reflects difficulties with disbursement and higher propensity to save. We also assume that the credit guarantee scheme translates into additional R40bn. Because the model is linear, a pass-through of R120bn would generate half the current impact. In other words, the weaker the pass-through the smaller the impact. For the same reason (linearity), the impact of fiscal and monetary stimulus is independent of the simulation considered (i.e., impact of same pass-through is the same across different simulations).

Table 3: Total Covid-19 Package

R million	2020/21
Budgetary support (spending)	130,000
Credit guarantee scheme	200,000
Measures for income support (including further tax deferrals, SDL holiday and ETI extension)	70,000
Drawdown on government balance sheet for wage protection (e.g. UIF, Compensation Fund)	40,000
Contingent amount for additional employment and wage support	60,000
Repo rate reduction estimate	80,750
Regulatory relief measures	250,000
Total Covid-19 package	830,750
% of GDP	16.78%

Note: The Pillar 2A relief amounts to a further R31. 2 billion and if we assume that the average minimum capital adequacy ratio of all banks amounts to 12.48% and the average risk weighting of exposures to bank clients are 100%, an additional amount of R250 billion could be supplied to the South African economy. Source: National Treasury and SARB.

Figure 6: Policy impacts[11]



Source: Author's own calculations.

The results, presented in figure 6, indicate that the fiscal and monetary package have reduced the contraction by around 2.4%. This reduction, however, is dependent on the pass-through of policy measures to aggregate demand and supply. Higher pass-through can reduce the contraction further. Our result suggests that the current challenge for policymakers is not the size of the package but the transmission of support measures to economic growth.

Dealing with risk aversion by firms and consumers can increase this pass-through. Addressing the deteriorating fiscal situation can reduce risk perceptions and improve confidence. Our results, however, indicate further deterioration in the fiscal framework. Table 4 below presents the revenue shortfall for the current fiscal year based on a combination of tax buoyancies and nominal GDP growth estimates. Using our estimate for annual GDP contraction of around 10% and assuming GDP inflation of 4% (nominal GDP contraction of 6%) and a buoyancy of 3.5 generates a revenue shortfall of R354bn. This implies a fiscal deficit of 17.5% for the current fiscal year. Government needs to take bold action to stabilise the debt trajectory.[12]

[11] The credit guarantee scheme is assumed to be part of fiscal support.
[12] Larger buoyancy reflects close to 50% reduction in CIT and sin taxes.

Table 4: Tax revenue shortfall

	Buoyancy		
Nominal GDP growth (%)	1.5	2.5	3.5
-10	272.9	408.5	544.1
-6	191.6	272.9	354.3
-4	150.9	205.1	259.4
-2	110.2	137.3	164.5

Source: Author's own calculations.

3. Conclusion

Refining the assumptions owing to recent data releases allows us to better estimate the impacts of Covid-19 on the economy. Results suggest that GDP will contract by 28% in 2020Q2 relative to 2020Q1 on a seasonally adjusted annualised basis. On an annual basis, GDP is expected to contract by 16% under simulation 1, and by 10% and 8.6% in simulations 2 and 3, respectively. The covid-19 fiscal and monetary stimulus packages can reduce the contraction in annual GDP by around 2.4%, depending on the pass-through of policy measures to aggregate demand. Policy efforts should be directed towards reducing risk increasing confidence and improving the pass-through of the current measures to aggregate demand and supply. Revenue shortfall is projected at R354bn in the intermediate scenario, implying a fiscal deficit of 17.5% for the current fiscal year. Government needs to take bold action to stabilise the debt trajectory to avoid an implosion.

Appendix

Table 5: Assumptions on sector activity under the lockdown levels 5 and 4

	Level 5	Level 4
Agriculture	Food-related agriculture, livestock, transport of live animals and auctions (subject to health directions) and related agricultural services. All fishing and related activities that are essential to prevent the wastage of primary agricultural goods.	All agriculture, hunting, forestry, fishing and related services, including the export of agricultural products permitted.
	Production across all subsectors operates at 90 % capacity. The impact of the lockdown is likely to be mildly negative, as the sector is deemed as essential.	The eased restrictions under level 4 will provide some relief to the sector which saw a large proportion of business activity temporarily shut down in level 5, even though the lockdown regulations called for the sector to largely remain operational.
Mining	Coal production for Eskom scaling up to full employment; and all other mining starting in batches scaling up towards 50% employment. All other mining starting in batches scaling up towards 50% employment.	Production is permitted to gradually be scaled-up over the lockdown period subject to the sector's ability to put the necessary safety measures in place. Open-cast mines will gradually be increased to a baseline of 50% of capacity and thereafter increase to full capacity.
	Production capacity is around 40% to 50%. Production capacity was likely very constrained. Particularly in the PGMs sub-sector (a major player in the industry) that is comprised mostly of deep-level mines.	60.7% of mining should be operational. The sector had warned that it wouldn't be easy to ramp up production given the difficulties around the complex logistics and processes of returning thousands of miners to work after a long stoppage. Even though coal, for instance, is permitted to operate at full capacity, it is unlikely to have been operating at that level given the amount of electricity Eskom has been producing.
Manufacturing	Manufacture of all retail products permitted to be sold under Level 5, and all input products, permitted scaling up to full employment, except where otherwise indicated. Manufacture of paper, packaging, petroleum smelters etc. allowed to scale up to full employment.	Further loosening of regulations. Essential segments of the textiles sub-sector are allowed to initially operate at 25% and thereafter increase production to 50%. The automotive, steel and other metals subsectors, as well as rail and ships building will be scaled up in phases to 50% of full capacity over the level 4 lockdown period. All other manufacturing are permitted to scale up to 30% employment.
	Production capacity is at around 45%. Food and beverages as well as the petroleum and chemicals make up almost half of manufacturing's gross value added, representing a large share of manufacturing. However, these sub-sectors would not have been operating at full capacity during the lockdown.	Around 68-73% of manufacturing should be operational. However, if we consider that alcoholic beverages sub-sector, for example, is not permitted to operate during this time, operation in the food may be lower. Additionally, other manufacturing sub-sectors in the value-chain tied to tobacco or alcohol industries are also impacted.
Electricity	All electricity, gas and water at 100% capacity.	All electricity, gas and water at 100% capacity.
	Around 75% of the normal capacity is utilised considering the sharp fall in net energy sent out in comparison to the corresponding period in 2019 due to the reduced demand from heavy industry.	Capacity would be at around 80% as some sectors are permitted to gradually scale up production.
Construction	Civil engineering for public works projects (including water, energy, sanitation) is permitted. Only critical public works construction; and maintenance and repairs is allowed.	Regulations are loosened to include critical maintenance and repairs as well as road and road and bridge projects (including local road repairs).

	Utilisation levels are at around 30 %. A small amount of construction activity is expected. The only activity allowed under the level 5 lockdown is necessary infrastructure, road works and maintenance. However, this will unlikely offer significant offset to a reduction in building and construction activity.	40-60% utilization levels, however, this is likely to be lower given that private civil engineering and building are still not permitted to operate.
Trade, catering and accommodation	Only trade that relates to essential goods and services is permitted.	Restrictions have been eased to include sales of winter clothing, footwear, bedding and heaters, children's clothing and fabrics, hardware supplies, and personal information and communication technology (ICT) equipment under level 4. Restaurants are also permitted to operate, but only for food delivery services subject to a curfew.
	Production capacity is at around 40%. Only a few sub-sectors are allowed to operate during the level 5 lockdown (i.e. food and pharmaceuticals). This will have a significant bearing on activity in the sector.	Operations in the sector to be around 45% of full capacity. The boost is expected to come from restaurants and sales from online shopping. A downside risk to this trajectory is lower than expected demand due to households' experiencing increased financial strain.
Transport	Rail, ocean and air transport permitted only for the shipment of cargo. Public transport is restricted on capacity and times.	Passenger transport is permitted to provide services to the boarder public, however, certain restrictions apply. All transportation may not carry more than 50% of its permissible passenger carrying capacity, except for minibus taxis. Freight transport, warehousing and logistic services is now limited to the transportation of essential medical, hygiene and food items, mining outputs (e.g. coal) as well as manufactured goods permitted under level 4 lockdown regulations.
	Approximately 40% of operations in the sector is able to continue.	Operations in the sector will operate at 59% of full capacity.
Telecommunications	All telecommunication services and infrastructure is permitted while postal services and courier services related to transport of medical products are allowed. ICT services support essential services only.	All telecommunication services and infrastructure is permitted while postal services and courier services related to transport of medical products are allowed. ICT is expanded to support all private and business customers.
	All telecommunications and infrastructure is allowed to operate. Activity in the sector will likely be positive as adaptation to the lockdown prompts employees to work remotely, increasing demand in telecommunication and internet products.	All telecommunications and infrastructure is allowed to operate.
Finance	Employees are encouraged to work from home. Where this is not possible and the service provided is essential in supporting other services permitted.	Financial services continue to operate during level 4, albeit partially, with employees encouraged to work remotely. For banks, activity in physical branches will be limited.
	Approximately 80% of operations in the sector is able to continue. Financial services will be least impacted by the lockdown, as the sector is deemed essential. While activity in branches is expected to be limited, the increase in online transactions will provide some offsetting effects.	The finance sector operates at 90% of full capacity.
Real estate	Not permitted to operate.	Real estate services are not listed as essential under level 4, unchanged from level 5. Commercial and residential real estate activity will only be allowed at level 3 and level 2. This means that agents, property managers, property practitioners or

		landlords are not permitted to travel to, do or conduct any activity in the ordinary course of business.
	Approximately 20% of the sector is able to operate. Real estate activity is not listed as essential under level 5. Moreover, the increased economic uncertainty will likely see house prices come under significant pressure and buyers delay their purchasing decisions.	The sector operates at 30% of full capacity. Real estate activity remains relatively muted under level 4, with restrictions unchanged from level 5. This will have a considerable bearing on the sector's performance.