South Africa's response to the war in the Middle East must include targeted support and accelerated restructuring for energy security

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There is uncertainty as to how long the Middle East war will continue. If the recently announced time-limited ceasefire holds, then the war's direct impact on South Africa and the global economy may be limited to a few months. However, if the ceasefire does not hold and the war is protracted, or if there are to be ongoing clashes and standoffs this will reinforce the region as a geopolitical chokepoint. Such an outcome would have a structural impact on global trade and energy markets, and if sufficiently disruptive may yet trigger global recessionary or stagflationary conditions, with negative implications for the South African economy.

The South African government's response to the crisis so far, announced on 1 April, was designed to shield households and firms from significant price increases by reducing the general fuel levy on petrol and diesel by R3 per litre for a month. It is concerning that no support was given to reduce the price of paraffin which is used mostly by the poorest households. The estimated cost of the fuel levy intervention will be a tax loss of R6-billion per month. It will be difficult for the fiscus to sustain this support in the medium to long-run, especially in recessionary conditions.

Moving forward, the Ministerial Task set up in response to the crisis should:

- track daily developments in oil and gas prices, exchange rates, shipping flows, insurance costs, fertilizer supply and domestic fuel stocks;
- monitor the impact of the conflict on the cost of living and assess the likelihood of fuel and other shortages due to supply chain disruptions;
- develop appropriate response packages to short-term, medium-term and severe-shock scenarios for the South African economy;
- coordinate operational responses across departments and state entities; and
- trigger pre-agreed interventions when thresholds are breached, and
- provide the basis for ongoing, fact-based government communications during the crisis.

As part of its overall strategic response, government should avoid broad, open-ended subsidies. It should instead combine targeted support, disciplined macroeconomic management, stronger public communication and faster reform in energy and logistics. In essence, a two-track approach should be adopted:

- First, provide targeted relief to shield vulnerable households, commuters, and critical sectors from acute fuel, food, and logistics shocks.
- Second, accelerate resilience measures to reduce South Africa's structural exposure to imported fuel, imported fertilizer, freight disruptions and external capital market volatility.

On the first track, in addition to the temporary cut in the fuel levy that has already been announced, government should consider additional time-bound interventions, such as:

- targeted support for public transport commuters;
- targeted measures to cushion the impact on the most vulnerable households for whom higher food and fuel costs feed directly into food insecurity; and
- developing an appropriate response to unilateral surcharges that have begun to be levied by certain fuel suppliers, in a manner that the government response does not unintentionally trigger fuel supply shortages and is also effective at ruling out price gouging conduct by suppliers.

On the second track, government should emphasize improved energy security as a centre piece of its response to the crisis and should lead movement on unresolved energy policy questions:

- finalize and operationalize an integrated energy plan, including reduced reliance on imported fuel;
- devise and accelerate an electric vehicle strategy, including necessary infrastructure and incentives, in order to reduce oil dependency for the transport sector, targeted both at public transport (buses and taxis) as well as privately-owned vehicles;
- accelerate investment in renewable energy projects, batteries and peaking capacity, as gas and diesel electricity peaking plants rely on imported fuel, consider repurposing coal plants to provide supplementary peaking support to the electricity system as the contribution from renewable energy sources rises;
- reduce dependence on imported fossil fuels over time, and current events may alter the economics of alternative fuel sources such as green hydrogen and green ammonia, for the production of which South Africa enjoys competitive advantages, and
- create conditions for effective exploration for domestic sources of gas and oil, as well as critical minerals.

Government should treat this shock not only as a crisis to manage, but as a signal to reshape future investment choices. The crisis should trigger an acceleration of government's structural reform agenda as coordinated by Operation Vulindlela. Reforms and interventions designed to stimulate growth and

local investment should accelerate. As such, interventions to increase investment in rail, ports and electricity infrastructure should not be delayed by the crisis in any way. For example, the restructuring of Eskom and the establishment of an asset-backed Transmission System Operator should be implemented timeously in order to serve as the publicly owned backbone of a competitive electricity market, designed to achieve competitive electricity prices and increased investment.

Energy planning should be designed to achieve three strategic objectives, namely: a lower energy price path, increased energy security and decarbonization of the overall energy system.

South Africa's fiscal and monetary authorities should respond to the current crisis with discipline and credibility in order to contribute to the maintenance of macroeconomic stability.

Fiscal policy should be calibrated to provide targeted, temporary support in response to elevated fuel and other prices, while taking offsetting actions to avoid rising national debt. If debt service costs can be contained, together with improved spending controls and greater tax compliance, this will increase the scope for the prioritisation of infrastructure spending with the related benefits for employment and service delivery.

Monetary policy should respond appropriately in line with the SARB's mandate to maintain price stability in the interest of balanced and sustainable growth. It is still early days in the crisis and the situation is very fluid, but unlike at the start of the Russia-Ukraine war in 2022 inflation is currently lower and more stable, and this, together with the possibility that a number of other central banks around the world may initially take some time before raising interest rates, may allow for more flexibility in the response to inflation. At the same time, policymakers cannot ignore exchange-rate pressure, as further Rand weakness would feed directly into imported fuel prices and imported inflation, which in turn would put upward pressure on interest rates.

Government should also monitor the African capital markets dimension more closely. The shock could alter investor risk appetite across emerging and frontier markets, affect capital flows, and widen financing spreads even where domestic fundamentals remain broadly stable.

The central policy test is not whether South Africa can prevent the war's external shock, which it cannot, but whether the country can respond in such a manner that the shock does not trigger a domestic crisis or derail ongoing reforms aimed at accelerating growth, investment and job creation.

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