

Growth returns to local economy

Local economic update: May 2010

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The economy is growing along with business and consumer confidence. The World Cup will benefit the economy but consumers are not quite ready to spend.

Higher growth expected

The economy officially exited the recession with a convincing growth rate of 3.2% in the fourth quarter last year. Growth for the first quarter of 2010, which will be announced in May, is expected to come in stronger as business and consumer confidence improves against a backdrop of low interest rates and lower inflation.

As the global recovery gathers momentum demand for our exports will increase despite the stronger rand, boosting manufacturing output. However, domestic economic performance remains far from optimal and will remain so until the fragile recovery in domestic demand strengthens. The economy will benefit from the activities associated with the Fifa World Cup™, particularly in the retail, transport and finance sectors.

Interest rates to support growth

The SA Reserve Bank has been asked by the Finance Minister to broaden its mandate from pure inflation targeting to include economic growth. Indeed, the decision by the MPC (Monetary Policy Committee) to cut interest rates by 50 basis points in March seemed to have been to boost weak consumer spending as all other indicators were pointing to a 'no change' stance in policy.

With retail sales coming in weaker than expected for February, many analysts were predicting a further cut in the upcoming MPC meeting but Governor Marcus appeared to pour cold water on this at a recent Bureau for Economic Research (BER) conference; "It does not follow that one bad retail sales number automatically leads to a need for further easing. The latest data were a confirmation of the fragile nature of consumption expenditure growth...however, the scope for further easing is limited, and the repurchase rate is likely to remain stable for some time."(Gill Marcus, 22/04/2010).

Steady inflation needed

Growth in CPI (consumer price index) inflation is back within target and is expected to remain so for the rest of the year. Average inflation for 2010 is expected to be 5.3%. Encouragingly, food prices are expected to also remain low throughout the year, boosting disposable income of particularly low-income consumers.

Of concern to the Reserve Bank is that inflation expectations of labour unions remain consistently above the upper band of the inflation target, which has an influence on wage settlements, which in turn have an impact on future inflation. It's important that inflation remains within the target band for a prolonged period. The improved outlook for inflation together with the strength of the rand enabled the Reserve Bank to cut rates in the last meeting. The chance of stable economic growth improves when inflation is low and not volatile, as businesses can make long-term plans for expansion in such an environment.

Consumers pay off debt

Despite the current low interest and low inflation environment, the recovery of consumption expenditure remains fragile. This is partly because of concerns about jobs and the still very high debt levels that consumers have to pay off; household debt as percentage of disposable income was 79.8% at the end of 2009 and is expected to average around 73% in 2010.

Encouragingly, consumers appear to be using extra income that is freed up by lower interest rates to pay off their debt, and the rate of taking up new debt, as measured by credit extension figures, remains at historically low levels. Household expenditure in South Africa is a function of overall household wealth, which includes conventional income, as well as of household assets like property and equities. Household wealth has been improving primarily as equity prices increased impressively for the first part of this year.

An improvement in employment will follow economic growth; retrenchments would have peaked in 2009.

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