

Lacklustre economic growth

Local economic update: September 2010

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The outlook for the South African economy remains subdued for 2010 compared to the boom years when the annual growth rate was around 5%.

Stats SA published its Q2 2010 gross domestic product (GDP) numbers which indicate a marked moderation in economic growth from the 4,6% rate achieved in Q1 to 3,2% in Q2 2010.

Economy slackening

Impressive growth rates were recorded in the agricultural sector as well as the trade and transport sectors. The agricultural sector benefited from a bumper maize crop harvested during Q2. Not surprisingly, the trade and transport sectors were positively impacted by the tourism associated with the Football World Cup. Also, for the period surrounding the World Cup, domestic consumers' spending increased with sports and appliance retailers in particular doing brisk trade. Mining production has been struggling for the better part of last year through to this year with quarterly growth decelerating to just under 21% for Q2. Mining sales have however benefited from higher commodity prices.

Manufacturing production for June was surprisingly strong, increasing higher than most analysts' expectations given the drop in the Kagiso purchasing managers index, a leading indicator of manufacturing activity. Its downward trend indicates that the recovery in manufacturing going forward might still be rocky. During Q2, growth slowed down to 6,9% compared with 8,4% in Q1. Growth in this sector has been, and will still be, hampered by subdued domestic demand and the uncertain global recovery which impacts our manufactured exports. In addition, the ongoing strength of the rand makes manufactured imports cheaper and harder to compete with, while at the same time making our exports less competitive.

Consumer spending still weak

The recovery in consumer spending will continue to be limited by constraints in discretionary income. Incomes are increasing in line with the higher wage settlements we've seen, but these increases only benefit people who have jobs - over 200 000 formal sector jobs were lost during the first half of this year.

In addition, consumer demand for credit is still very weak with overall demand for credit rising just under 1% in June. This is due to reduced appetite by highly indebted consumers still paying off those debts as well as

restrictive lending conditions by banks. At just over 78%, household debt to disposable income remains at record levels; consumers will not feel confident to borrow more if debt levels are not reduced to manageable levels. This means that demand for big-ticket items that are financed by credit will remain very modest. The exception has been car sales which continued to grow at a robust pace even after the World Cup.

Retail boosted by World Cup

Retail trade sales increased from 4.6% in May to 7.4% in June compared to the same period in 2009. This is the highest growth rate since June 2007. Overall demand for retail goods in June was boosted by World Cup related sales; modestly higher incomes and low interest and low inflation supported domestic demand.

According to Stats SA, substantial increases were recorded for retailers of household furniture, appliances and equipment, followed by retailers of textiles, clothing, footwear and leather goods, pharmaceutical and medical goods, cosmetics, and toiletries. This is consistent with World Cup related expenditure where locals who could not attend the games splurged on television sets and both tourists and locals spent on soccer shirts and other sports merchandise. However, as the World Cup effect wears off, growth in retail sales is expected to be lower in the second half of the year as consumers cut back on spending.

Inflation under control for now

CPI¹ inflation continued to drop, from 4.2% in June to a surprising 3.7% in July. Importantly for consumers, the decline in inflation can be attributed in part to a lower than expected increase in electricity prices and a continued fall in food prices. However, the ban of Russian exports of wheat as a result of the devastating fires in that country could put pressure on the global price of cereals and bread. Hopefully this will be mitigated by the substantial wheat stocks that remain from last year's good harvests. The lower than expected inflation rate means that targeted inflation is well around the midpoint of the inflation-targeting band of 3% to 6%, giving the SA Reserve Bank plenty of scope to cut interest rates further and provide the economy with a much needed stimulus without worrying about inflation moving out of the target any time soon. In any case, the Bank did leave some scope for a further interest cut as they said they will continue to monitor economic developments closely. And as mentioned above, the economic growth rate for Q2 was lower than market consensus.

The main points of concern remain the administered prices for utilities like water and electricity, which are increasing at rates way above the upper target band of 6%. These and the current wage settlements will put upward pressure on inflation through to 2011.

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¹Consumer Price Index: an index of the cost of goods and services to a typical consumer

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