A focus on the consumer

Local economic update: October 2010

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The South African economy increased further during the second quarter of 2010 albeit at a slower pace than in Q1. The focus this month is on the state of the consumer as described in the SA Reserve Bank's latest *Quarterly Bulletin*.

Employment positive for household income

There are signs that the employment situation is improving with a stabilisation in job shedding. Stats SA indicated that 41 000 new jobs were created in the formal sector of the economy during Q2 of this year, a reversal of the 61 000 which were lost in Q1.

This is welcome news for consumer disposable income. In addition to the tentative employment recovery, the rate of wage settlements over the same period has again been well over the upper band of the inflation target. A wage settlement is the final salary increase agreement reached between labour unions and the employers during a strike. For instance the wage settlement in the public sector strike was 7.5%. The inflation target is between 3 and 6 per cent, so the upper band is 6%. As a result, household disposable income increased further in Q2, supporting growth in expenditure.

Interest rates ease debt pain

Interest rates have dropped 600 basis points (i.e, 6%) from December 2008, following a further 50 basis points (0.5%) cut in the prime interest rate in September 2010. The prime overdraft rate, which was 15.5% in 2008, has now declined to a historic low of 9.5%. This means a saving of about R4300 a month on a R1 million bond!

Normally, this extra income would be spent on consumer goods and services, supporting economic recovery. However, South African consumers were, and still are, highly indebted.[1] So any extra income that consumers receive should be used to pay off debt before robust spending and sustainable growth can again become a reality. This situation will probably continue until next year when consumers feel they are able to

[1] Household debt as percentage of GDP is still quite high at 78.2% in the second quarter of this year; this has barely moved from the revised 78.7% recorded during Q1. Moreover, this is expected to remain at over 70% for the remainder of the year.

service their debts comfortably and banks relax their lending criteria, making it easier for people to get loans.

Households still not saving

Although the national saving ratio improved from 16 % in Q1 2010 to 16.9% in Q2, it was only because the rate of dissaving by the government moderated in Q2, not because of improved savings. Dissaving is when the ratio of saving is negative - when a sector actually withdraws from saving and borrows more than they save.

According to the Reserve Bank, rising tax revenues and lower levels of government spending had a positive effect on the level of saving. The level of household saving was unchanged between Q1 and Q2; clearly the household sector remains under considerable pressure despite the relief they have received on their incomes from the low interest, low inflation environment.

Slowdown in spending

Household consumption expenditure slowed down in the second quarter of the year compared to the first quarter. This was somewhat surprising and disappointing because the expectation was that the influx of tourists for the FIFA World Cup™ would boost retail sales, which would show up in the household expenditure growth rate.

However, the Reserve Bank estimates that the travel receipts portion of the balance of payments received a significant boost from the soccer tourists, helping to moderate the deficit in the current account balance. Expenditure on durable goods like cars was surprisingly buoyant and confirms the reported increase in car sales during the second quarter.

It's expected that growth in spending will weaken in the second half of the year as growth in this sector already took part during the first half of the year. Disposable income will still increase mainly because of relatively large wage settlements in several prominent sectors of the economy during August and September.

Although the current low inflation expectations give some room to the SA Reserve Bank for a further rate cut, it is unlikely that this will happen.

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