2010: a subdued year

Local economic update: December 2010

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A look at how the South African economy fared over the last year

After the financial crisis of 2009 when economic growth plummeted into negative territory for the first time since 1992, 2010 has proven to be a somewhat better year although growth remains fragile. Consumer activity broadly mirrored that of the general economy with growth in consumer spending still on the low side.

Employment or rather unemployment

A total of 4.4 million people were unemployed by the end of the third quarter of 2010. Of concern is that of those, about 1.94 million were new entrants into the job market. A large number of matriculants and university graduates battle to be absorbed into the labour market which has now increased youth unemployment significantly. And this does not include the 1.3 million people who were retrenched up to the third quarter of 2010. There's some light at the end of the unemployment tunnel; the rate of job losses has been declining as the economy continued to grow, albeit at low rates. In their latest growth strategy announced a few weeks ago, government hopes that, in partnership with the private sector, 5 million jobs will be created in the next ten years.

Household debt still a concern

Before the introduction of the National Credit Act, low interest rates and easy credit extension conditions allowed households to purchase a lot of personal assets. The value of residential buildings increased from R1.02 trillion in 2005 to R1.59 trillion in 2009. At the same time, household debt as percentage of household disposable income increased from 64.3% in 2005 to 80.2% in 2009. So households have not been able to spend 'freed-up' disposable income when interest and inflation environment dropped: they have had to use this income to service high levels of debt.

Throughout 2010, debt levels have barely moved, declining to 78.2% during the second quarter of 2010, the latest available data. The reduction of debt to pre-crisis level is important for improving consumer confidence and spending patterns.

We are still not saving enough

As consumers are still focused on debt reduction, there is less discretionary income available for anything else, including saving.

The national saving rate as percentage of GDP was 16.9% in Q2 2010, well below the 20% to 25% needed to finance investment expenditure, boost growth and create jobs. The picture is even more dismal for the household sector where the ratio of saving to GDP amounted to just 1.6% in Q2. It's important for the country to save but even more so for the household sector; with tighter lending criteria you most certainly need a deposit for your next mortgage bond so saving is important for personal financial freedom. Different saving vehicles are appropriate for different needs. While it's important that you save for your financial needs, like housing, there's the much neglected area of putting money aside for life risks like the loss of breadwinner income via death or disability.

A recent ASISA[1] report indicates that South African earners are underinsured by up to R10 trillion. The burden eventually falls on the state if people are not insured against disability and have to depend on government grants or their dependants if they are left destitute. As a developing nation, we can ill afford an increase in the grant budget as that takes revenue away from other service delivery projects.

Disposable income expected to improve

Growth in household disposable income has fluctuated with changes in economic growth as well as employment trends. This is expected to improve next year as economic growth moves beyond the 3% expected for 2010 and moves towards our potential output of 4.5%. As economic growth gains traction, the rate of retrenchments will dwindle back to pre-crisis levels and company balance sheets will strengthen enough for them to increase the size of their labour force. The Andrew Levy Wage Settlement Survey projects that wage settlements will average between 7.5% and 8.5% in 2010; this has boosted disposable income for those consumers fortunate enough to still have jobs.

Interest rate cuts

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) held its last meeting this week. As widely expected they cut interest rates by 50 basis points. In total, the MPC has cut rates by a cumulative 650 basis points since December 2008. This brings the repo rate down to 5.5% and the prime overdraft rate to 9%. The bank's decision is good news for the economy and was made against a backdrop of fragile growth prospects and a weak inflation environment.

While the SARB's mandate remains that of inflation targeting, they are flexible in that they can look at other economic indicators like economic growth when making interest rate decisions. Lower interest rates will boost spending, which is essential for the economy to grow, and make the cost of servicing debt cheaper.

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[1] Association for Savings and Investment SA

Even at the current low rates there are still a substantial number of consumers out there who are struggling to meet their monthly debt obligations, so this is good news for them.

It has to be mentioned that people dependent on interest income as their only source of income like pensioners are always hard hit when interest rate come down and are kept low for long periods. The 'consolation' is that in South Africa, inflation is also quite low, unlike in some advanced economies where pensioners face low interest rates in an environment of rising inflation.