

Nedbank

Economic commentary

25 March 2009

SARB QUARTERLY BULLETIN

Consumer spending remained under pressure, while the current account deficit narrowed as imports contracted faster than exports

Expenditure breakdown of gdp (Q4 2008)

(Q-o-q seasonally adjusted annualised rates)

	2006	Q1'07	Q2'07	Q3'07	Q4'07	2007	Q1'08	Q2'08	Q3'08	Q4'08	2008
Household consumption expenditure	8.3	5.5	5.1	5.0	3.9	6.6	3.0	1.3	-0.9	-2.7	2.3
Government consumption expenditure	5.1	13.9	-3.9	8.5	1.0	4.8	12.3	-2.1	10.2	3.6	5.0
Fixed capital formation	13.2	20.4	15.0	14.5	15.6	16.3	10.4	5.2	7.3	3.0	10.2
Change in inventories (R'bn)	16.5	14.4	9.7	5.1	-12.5	4.2	11.1	-4.7	-11.2	-21.1	-6.5
Gross domestic expenditure (gde)	9.1	4.7	4.1	5.6	-1.6	6.0	12.5	-1.7	0.7	-3.9	3.1
Exports	6.0	-8.7	1.1	-3.8	30.9	7.5	-30.1	42.5	4.0	-16.4	1.7
Imports	18.9	-7.8	2.9	1.4	1.0	10.0	3.9	7.9	4.7	-19.0	2.2
Net exports (R'bn)	-51.6	-98.1	-100.3	-105.1	-83.2	-61.7	-117.6	-96.2	-97.9	-90.1	-80.8
Gross domestic product (gdp)	5.3	5.5	3.7	4.5	5.4	5.1	1.7	5.0	0.2	-1.8	3.1

Comment

Domestic spending remained under pressure in the last quarter of 2008 as consumer spending continued to decline, while government spending and fixed capital formation moderated further.

Household consumption expenditure recorded its second consecutive quarterly decline in the fourth quarter, pressured by a combination of the effect of previous interest rate hikes, tighter access to credit, high household debt levels as well as weak disposable income growth. This was exacerbated by the effect of the global financial crisis, which prompted some industries to reduce workers and working hours, exerting pressure on consumer income. Growth in household real income declined by 1,9% after falling by 0,8% in the third quarter, following the 3,1% and 1,6% increases in the first and second quarters, respectively. The ratio of household debt to disposable income increased to 76,4% from 75,6% in the third quarter but the level of household debt was still lower than the record high of 78,2% in the first quarter of 2008.

A significant decline in consumer spending on durable goods was recorded in the final quarter of the year despite the fact that the quarter is normally associated with high consumer spending during the festive season. This suggests that consumers exercised caution on purchases, particularly of big-ticket items, such as transport equipment. Demand for durable goods fell by a massive 20,1% following the 7,6% contraction in the third quarter. Demand for durable goods has been falling persistently since the fourth quarter of 2007.

Spending on non-durable goods also fell for the second successive quarter, down by 2,3% following a 3,2% decline in the third quarter. However, spending on semi-durable goods increased by 2,6% after growth moderated to 0,1% in the previous quarter. For the first time since the third quarter of 1993, spending on services declined in the fourth quarter of 2008, as tougher economic conditions prompted consumers to contain spending on travel and accommodation in particular. For 2008 as a whole, household spending grew by a moderate 2,3%, slowing from 6,6% in 2007.

Research

Group Economic Unit

Isaac Matshego
011 295 6451
IsaacMat@nedbank.co.za

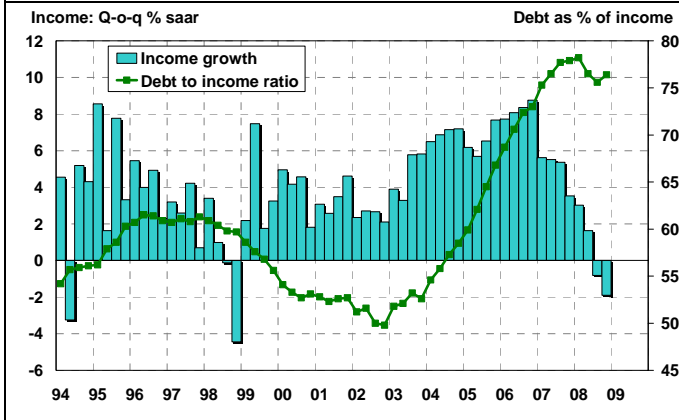
Johannes Khosa
011 294 1835
JohannesKh@nedbank.co.za

Dennis Dykes
011 295 6435
DennisD@nedbank.co.za

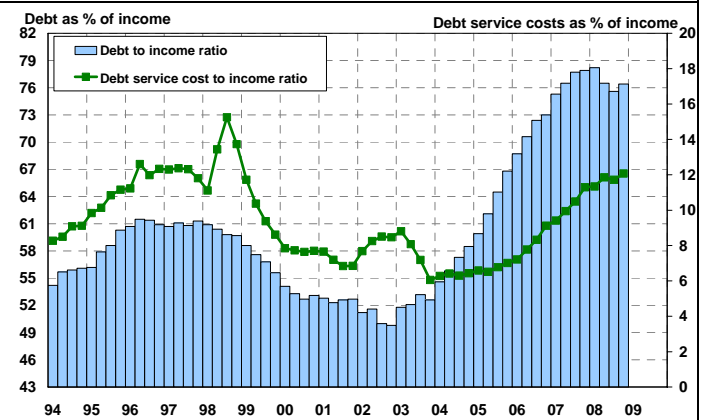
Consumer spending trends (Q-o-q seasonally adjusted annualised growth)

(Seasonally adjusted annualised growth rates)											
	2006	Q1'07	Q2'07	Q3'07	Q4'07	2007	Q1'08	Q2'08	Q3'08	Q4'08	2008
Durable goods	15.5	9.4	-12.6	7.6	-0.7	4.7	-5.2	-8.3	-7.6	-20.1	-5.2
Semi-durable goods	20.1	10.4	23.2	5.9	6.0	15.8	11.3	3.3	0.1	2.6	6.8
Non-Durable goods	5.5	4.5	5.1	6.1	2.5	5.5	0.8	0.6	-3.2	-2.3	1.3
Services	5.0	3.3	4.0	2.8	5.8	4.6	4.0	3.9	2.6	-0.1	3.7
Total	8.2	5.5	5.1	5.0	3.9	6.6	3.0	1.3	-0.9	-2.7	2.3

Growth in household income vs household debt levels



Household debt and debt service cost to personal income



Government spending grew by a more modest 3,6% in the fourth quarter, following a 10,2% expansion in the third quarter. This was mainly attributed to fewer defence procurement-spending requirements during the period. For 2008 as a whole, growth in government spending slowed to 9,7% compared with 19,4% in 2007.

Growth in real fixed capital formation continued to lose momentum, increasing by 3% in the fourth quarter, with the slowdown driven mainly by moderation in both government's and public corporations' spending. Spending on private capital formation, however, increased by 2,9% following 2,6% growth in the third quarter, helped by firmer capital formation in the mining sector, specifically in coal mining where production has been helped by higher demand for power generating coal.

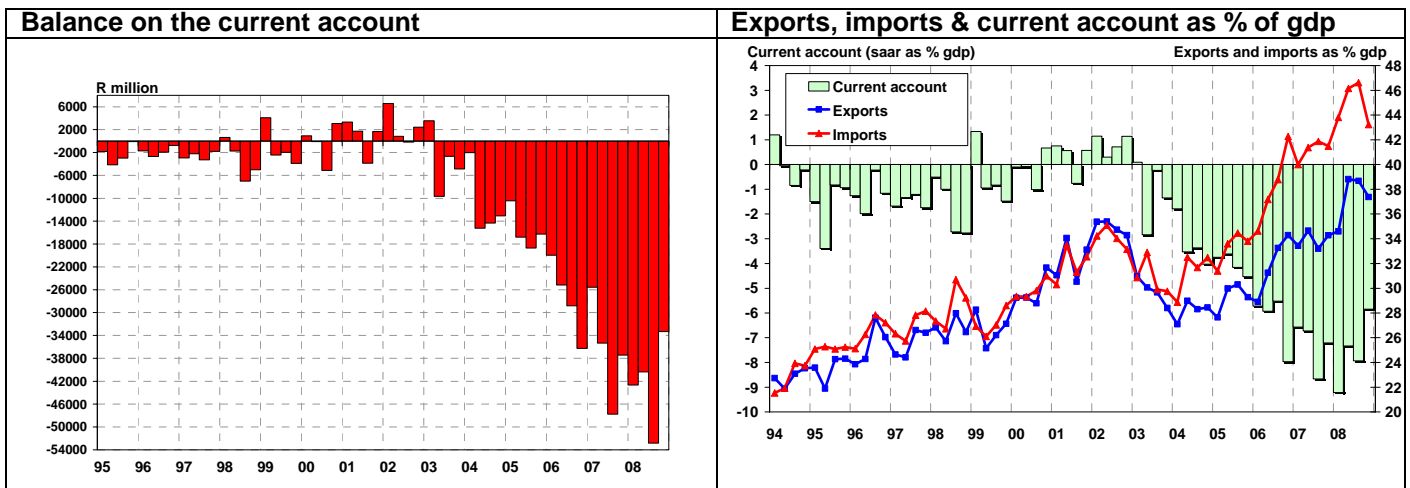
Fixed-investment trends (Q-o-q seasonally adjusted annualised growth)

TRENDS IN CAPITAL FORMATION BY SECTOR											
Q-o-q seasonally adjusted annualised rates											
	2006	Q1'07	Q2'07	Q3'07	Q4'07	2007	Q1'08	Q2'08	Q3'08	Q4'08	2008
Mining & quarrying	48.2	48.1	27.8	26.7	16.9	30.8	-21.9	1.3	1.1	42.6	3.8
Manufacturing	8.4	9.4	12.4	12.9	18.7	12.4	12.4	1.8	5.4	1.6	9.9
Power & water	13.1	163.3	5.7	-28.1	160.7	35.3	66.6	-1.9	84.4	22.3	42.6
Transport & communication	11.5	4.9	40.0	44.1	-5.0	22.1	42.7	9.3	4.6	-7.9	17.4
Finance & real estate	8.0	11.6	-0.3	9.5	4.2	6.6	-14.7	3.8	-11.9	-4.4	-3.2
Community services	17.6	18.1	19.8	9.9	13.2	18.7	9.4	-2.2	11.3	-1.7	7.9
Total	13.2	20.4	15.0	14.5	15.6	16.3	10.4	5.2	7.3	3.0	10.2
General Government	16.6	13.5	22.8	15.9	17.7	19.4	7.9	2.6	5.3	2.3	9.7
Public corporations	14.9	81.8	19.7	33.3	39.0	36.5	46.8	14.5	32.4	4.1	30.5
Private Sector	12.3	13.7	12.6	11.1	11.1	12.6	4.6	3.8	2.6	2.9	6.5

Inventory levels decreased further in the fourth quarter, mainly dragged down by a reduction in mining and manufacturing inventory accumulation. The decline in manufacturing inventories was attributed to lower import volumes. However, commercial inventories increased, and were helped mainly by agricultural stocks.

Balance of payments – current account (Q4 2008)

	2006	Q1'07	Q2'07	Q3'07	Q4'07	2007	Q1'08	Q2'08	Q3'08	Q4'08	2008
Trade account (Q-o-q saar%)											
Merchandise Exports	23,3	-0,2	4,9	-0,3	9,4	23,2	6,6	19,7	3,9	-5,4	32,8
Net Gold Exports	31,3	-5,6	-2,6	12,8	10,1	12,5	2,2	3,1	4,0	3,6	21,6
Merchandise Imports	33,1	-4,8	1,8	4,9	2,0	20,4	11,5	13,8	4,3	-6,7	28,8
Income account balance (R billion)											
Adjusted - seasonally adjusted annualised values	-76,0	-88,2	-98,8	-115,8	-131,5	-112,0	-136,2	-115,0	-123,8	-113,3	-122,1
Current account balance (R billion)											
Adjusted - seasonally adjusted annualised values	-110,2	126,1	130,4	175,1	152,6	-146,1	-192,4	-166,2	-180,6	-137,3	-169,2
Unadjusted	110,2	-25,5	-35,3	-47,8	-37,4	-146,1	-42,7	-40,4	-52,8	-33,3	-169,2
As a % of gdp											
	-6,3	-6,6	-6,7	-8,7	-7,2	-7,3	-8,8	-7,3	-7,8	-5,8	-7,4



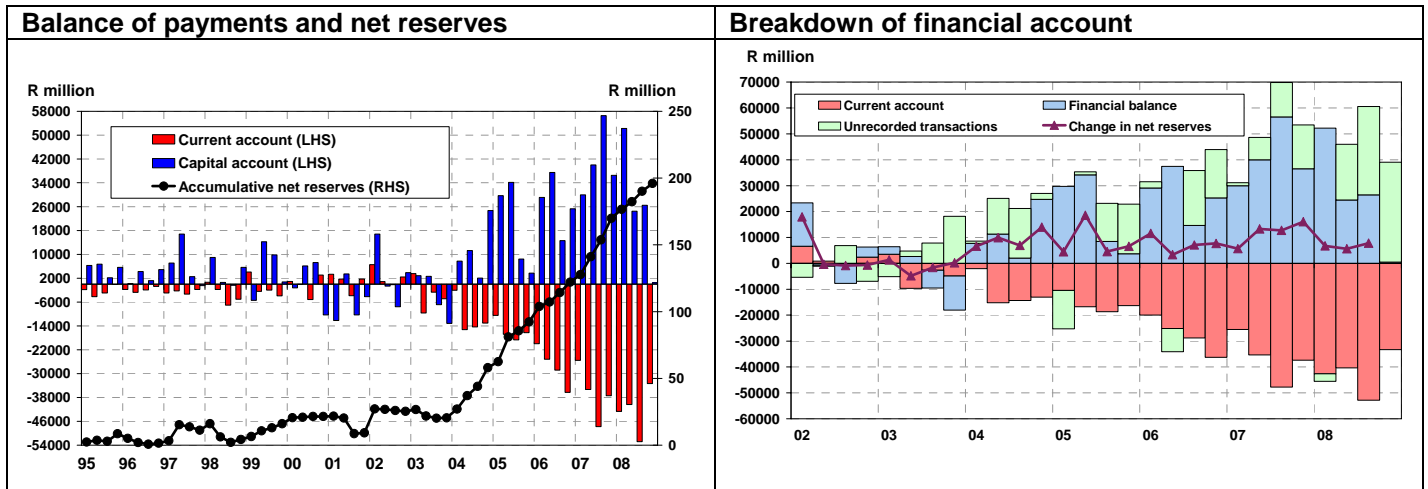
Comment:

The **current account deficit** narrowed to 5,8% of gdp in the fourth quarter from 7,8% in the third quarter as the trade deficit narrowed, while net payments for services and transfer payments declined. The first quarter deficit was revised to 8,8% from 9,2%, with the deficit for the year as a whole at 7,4% compared with 7,3% in 2007. In value terms, the deficit was R169,2 billion in 2008 from R146,1 billion in the previous year.

The narrower **trade deficit** during the quarter, which dropped to a seasonally adjusted and annualised R19,6 billion from R36,7 billion in the third quarter, reflected a sharper decline in imports compared with exports. Net exports benefited from the stronger rand price of gold, which increased by 19,4% q-o-q due to the weaker rand, more than offsetting the impact of the drop in the quantity of gold exported as well as the lower gold price. The gold price fell to \$796 per ounce from \$869 in the third quarter. Merchandise exports declined by 5,4% q-o-q to R668,2 billion, while net gold exports increased by 3,6% to R51,2 billion. Merchandise exports, which fell despite the significantly weaker rand, were dragged lower by declines in volumes and prices of key commodities such as like platinum, coal, copper and nickel. Merchandise imports on the other hand shank by 6,7% q-o-q to R739,0 billion, reflecting mainly weak domestic demand conditions and the lower international oil price. In volume terms imports were down 5,8% in the fourth quarter.

Lower dividend payments to non-resident investors were behind the decline in the deficit on the **net services, income and current transfer account**, which narrowed to R117,7 billion in the fourth quarter from R143,9 billion. For 2008 as a whole, the deficit was R133,6 billion from R105,6 billion in 2007, equivalent to 5,9% of gdp from 5,3%.

Balance of payments – financial (Q4 2008)



The country continued to attract foreign capital in the fourth quarter, mainly in the form of direct and other investments, while local investors repatriated some of their foreign holdings. The **financial account** recorded net inflows of R39,1 billion in the fourth quarter, with net inflows amounting to R195,1 billion in 2008, slightly more than the R193,8 billion recorded in 2007.

Net portfolio outflows accelerated to R57,3 billion in the fourth quarter from R7,6 billion in the previous quarter, with net outflows totalling R68,1 billion in 2008, partly offsetting the R97,4 billion inflows of 2007. Domestic investors transferred R51,1 billion during the quarter, bringing their total portfolio transfers for 2008 to R63,4 billion compared with R24,0 billion in the previous year.

Net direct investment inflows slowed to R3,3 billion in the fourth quarter from R22,4 billion in the third quarter, bringing net inflows for 2008 to R74,4 billion compared with R40,2 billion in 2007. South Africans on the other hand liquidated R50,7 billion of their holdings in foreign markets during the quarter and this more than offset net investments in the first three quarters of the year, bringing net disinvestments by locals to R29,2 billion in 2008 compared with net investments of R20,9 billion in 2007.

Net other investment flows plummeted to R2,0 billion from R22,2 billion in the third quarter, while domestic investors repatriated R52,9 billion during the fourth quarter. Local residents repatriated a total of R77,9 billion in 2008 compared with just R2,1 billion in 2007.

Outlook

The outlook for 2009 remains relatively bleak. Consumer spending may recover modestly over the next few months, as households benefit from some interest rate relief. However, this trend is unlikely to be sustained, particularly if unemployment begins to rise. In general, the economy will be tested by the global financial turmoil and a world recession. Production levels in the mining and manufacturing industries will remain under pressure as export sales decline in response to falling global demand and weak commodity prices. As a result of these factors, real gdp is expected to contract further in the first quarter of this year before consolidating at weaker levels in the second quarter. A mild recovery is expected to begin in the second half of the year, as infrastructure spending by public corporations and general government continues and perhaps even picks up ahead of the 2010 FIFA World Cup, while household demand is likely to gradually start improving on the back of lower interest service costs.

The current account is expected to narrow during 2009, but will still remain large at over 6% of gdp. Exports will remain under pressure as the global slowdown persists. The depth and duration of the global economic slowdown remain uncertain and this poses a downward risk to exports both in volume and value terms. Weak domestic demand and subdued international commodity prices should keep imports under pressure too. The drop in dividend payments, with some key South African corporates announcing no dividend payments, could lead to further declines on the income account deficit.

Implications

The latest Quarterly Bulletin confirms that the domestic slowdown gained momentum in the fourth quarter. Indications are that this trend continued in the first two months of this year and will remain in place at least until the second half of the year. Today's figures provide further justification for the Reserve Bank's decision to cut rates by a 100 basis points yesterday. With growth expected to remain flat or contract slightly this year, the Reserve Bank will probably continue to cut rates aggressively. However, today's poor inflation figures and the slight deterioration in the short-term inflation outlook may limit the Bank's ability to respond quite as aggressively as they might have liked.

We therefore still anticipate a further 100 basis point cut in April, followed by an additional 250 to 200 basis points by August this year. Thereafter, much will depend on whether the economic news remains dismal or if there are tentative signs of both the domestic and global economy having turned the corner.

Nedbank Head office
NEDBANK GROUP ECONOMIC UNIT
135 Rivonia Road Sandown 2196
PO Box 1144 Johannesburg 2000
Tel +27 (0)11 295 6363
Fax +27 (0)11 294 6363
Email EstelleO@nedbank.co.za

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