Economics | South Africa

10 December 2010

Economic Commentary

SARB Quarterly Bulletin (Q3 2010)

Domestic expenditure rose strongly, while the current account deficit widened by less than expected

- Gross domestic expenditure rose by 5,8% in the third quarter after rising by 2,3% in the second quarter, boosted by strong household demand and slower inventory depletion.
- The household debt to income ratio increased to 78,5% from 78,2%.
- Government spending contacted over the quarter.
- Gross fixed capital formation rose by a modest 0,9% over the quarter to levels still well below those prevailing a year ago.
- The current account deficit widened to 3,0% of gdp from 2,5% as the larger trade surplus was more than offset by a wider income and services deficit.
- For the year as a whole we now expect gdp to grow by 2,7% (previously 2,8%).
- The current account deficit is forecast to be 3,4% of gdp in 2010 and 3,8% in 2011.
- We expect the Reserve Bank's Monetary Policy Committee (MPC) to keep interest rates steady throughout next year before starting to hike towards the middle of 2012

Expenditure

Table 1 : Expenditure breakdown of gdp

Spending category	Q-o-q seasonally adjusted annualised growth rates (%)									
	2007	**2008**	**Q1'09**	**Q2'09**	**Q3'09**	**Q4'09**	**2009**	**Q1'10**	**Q2'10**	**Q3'10**
Household consumption expenditure	5.5	2.2	-5.5	-4.9	2.6	6.5	-2.0	5.8	4.9	5.9
Government consumption expenditure	4.1	4.7	7.0	1.0	8.4	1.3	4.8	6.9	7.0	-0.6
Fixed capital formation	14.0	14.1	-10.5	-10.4	-13.4	-5.1	-2.2	-2.4	1.3	0.9
Change in inventories (R'bn)	19.8	-12.4	-4.2	-40.0	-51.3	-42.5	-34.5	-7.9	-7.7	-0.9
Gross domestic expenditure (gde)	**6.3**	**3.4**	**5.1**	**-10.9**	**-1.6**	**5.0**	**-1.7**	**12.0**	**1.6**	**5.8**
Exports	6.6	1.8	-56.9	-12.6	11.0	20.3	-19.5	-15.2	17.8	13.8
Imports	9.0	1.5	-28.4	-36.4	-1.0	27.0	-17.4	14.1	10.1	24.9
Net exports (R'bn)	-55.2	-69.1	-103.7	-62.9	-51.5	-60.3	-21.1	-93.4	-88.7	-103.9
Gross domestic product (gdp)	**5.6**	**3.6**	**-5.9**	**-2.8**	**0.9**	**3.1**	**-1.7**	**4.6**	**2.8**	**2.6**

Source: SARB December Quarterly Bulletin

Comment:

Growth in gross domestic expenditure accelerated during the third quarter, mainly supported by household demand and slower inventory depletion. Government spending contracted, dragged down mainly by more moderate spending on government employee's salaries due to strike action and no arms procurement during the quarter. Growth in fixed capital formation remained weak due to the fragile economic recovery and following the completion of World Cup projects. Growth in private sector and public corporation spending eased, while investment by government declined.

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Growth in **household consumption expenditure** gained momentum during the second quarter, helped by income growth, a positive wealth effect as well as further monetary policy easing, while the World Cup also contributed. All the other major categories of consumer spending, except semi-durable goods, recorded growth during the period. The strongest contribution, however, came from spending on non-durable goods, which rose by a seasonally adjusted and annualised 2% over the quarter, recovering from a 2,1% contraction in the previous quarter. Spending on durable goods rose by 13,7%, although the growth rate moderated from 50,8% in the second quarter. The Reserve Bank attributed this slowdown mainly to a slower increase in spending on furniture and household appliances as well as a contraction in spending on recreational products and computer and related products. In contrast, spending on semi-durable goods contacted off the second quarter's higher base. Over the third quarter, spending on semi-durable goods dropped by 5,9% following two successive quarters of strong growth, dragged down mainly by a drop in spending on clothing and footwear and miscellaneous goods.

Spending on services accelerated by 10,7% over the quarter, its strongest growth rate since the fourth quarter of last year from a modest 0,7% in the second quarter and a sharp drop in the first quarter. Strong increases in spending were recorded in transport and communications services, which benefited from the World Cup.

Table 2 : Consumer spending trends, Q-o-q SAAR (%)

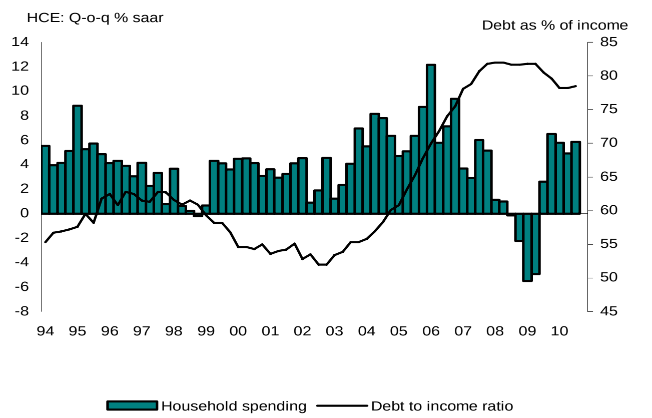
Spending category	2007	Q4'08	2008	Q1'09	Q2'09	Q3'09	Q4'09	2009	Q1'10	Q2'10	Q3'10
Durable goods	1.9	-23.5	-9.4	-5.1	-11.7	12.6	20.9	-9.6	37.9	50.8	13.7
Semi-durable goods	11.3	-1.7	4.2	0.0	-4.1	-8.6	-1.9	-1.8	31.8	10.1	-5.9
Non-durable goods	5.0	-3.4	0.8	-4.6	-6.7	1.7	-2.5	-2.7	13.1	-2.1	2.0
Services	5.5	3.8	5.9	-7.6	-2.2	4.5	13.8	0.2	-10.4	0.7	10.7
Total	5.5	-2.2	2.4	-5.5	-4.9	2.6	6.5	-3.1	5.8	4.9	5.9

Source: SARB

For the first time since the second quarter of 2008, expenditure by **general government** contracted, falling by seasonally adjusted and annualised 0,6% q-o-q in the third quarter. Government spending was dragged down by moderate spending on salaries for government employees due to strike action during the period. Non-wage spending also moderated during the period.

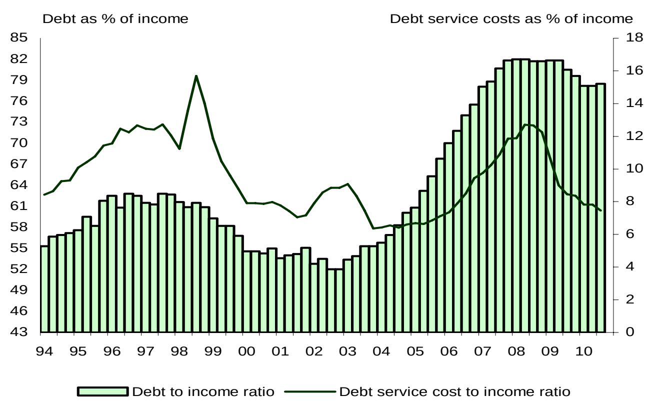
Lower interest rates and attractive retail prices prompted consumers to apply for additional credit during the third quarter. Despite the 5,6% increase in real disposable income during the third quarter, the **household debt to disposable income ratio** rose to 78,5% from 78,2% in the second quarter, the first increase following about four quarters of declines. However, lower interest rates helped to reduce the **debt service cost to disposable income ratio**, which eased further to 7,8% from 8% in the second quarter.

Chart 1 : Growth in household income versus household debt levels



Source: SARB

Chart 2 : Household debt and debt service cost to personal income



Source: SARB

Fixed capital formation increased only marginally in the third quarter, growing by 0,9% following a 1,3% expansion in the second quarter. The Reserve Bank attributed the slowdown in investment activity by the ***private sector*** to the fragile global recovery and a stronger rand - which reduced the competitiveness of exports. Investment by ***public corporations*** was driven by the projects in the communication sector, while weak capital formation by ***general government*** was attributed to slowdown in investment activity after the completion of World Cup related projects.

Table 3 : Trends in capital formation by sector: Q-o-q SAAR (%)

Sector/Institution	2007	Q4'08	2008	Q1'09	Q2'09	Q3'09	Q4'09	2009	Q1'10	Q2'10	Q3'10
Mining & quarrying	31.3	30.7	27.5	1.0	-8.5	-26.8	-14.5	7.2	2.4	8.5	5.1
Manufacturing	5.8	-3.0	12.9	-49.0	-17.3	-35.6	-19.1	-22.6	-1.4	4.3	-0.9
Power & water	34.2	41.4	44.3	107.8	19.5	5.1	1.5	43.2	-0.2	0.2	-4.5
Transport & communication	15.2	15.2	30.3	-19.8	-12.2	-10.7	21.6	-0.6	-1.1	0.0	11.8
Finance & real estate	5.7	-6.8	-6.1	-2.9	-15.2	3.4	-6.5	-5.2	6.4	1.6	0.1
Community services	22.1	2.1	11.2	-7.5	-13.9	-11.0	-8.2	-3.2	-25.0	-4.3	-3.0
Total	14.0	8.9	14.1	-10.5	-10.4	-13.4	-5.1	-2.2	-2.4	1.3	0.9
General Government	22.2	5.5	16.1	-5.4	-13.9	-16.0	-19.5	-4.0	-9.9	-5.0	-3.3
Public corporations	34.8	6.7	36.2	59.6	10.0	5.4	3.8	26.1	3.1	2.5	0.9
Private Sector	8.9	10.4	9.2	-25.4	-15.5	-18.5	-4.3	-8.9	-2.5	2.4	1.9

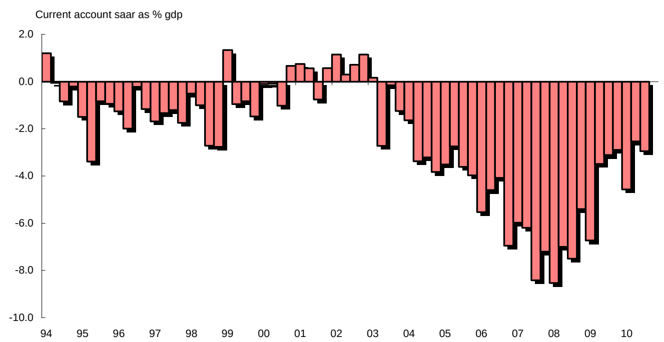
Source: SARB

Real inventory investment eased further during the third quarter, falling by R9 million from a decline of R7,7 billion in the second quarter, with inventory levels contracting in the trade sector. However, the inventories in mining sector rose in line with the rebound in mining production. The slower rate of inventory depletion was responsible for over half the growth in gdp in the third quarter.

The ***net export position*** deteriorated due to slow growth in exports and a strong rise in imports over the quarter.

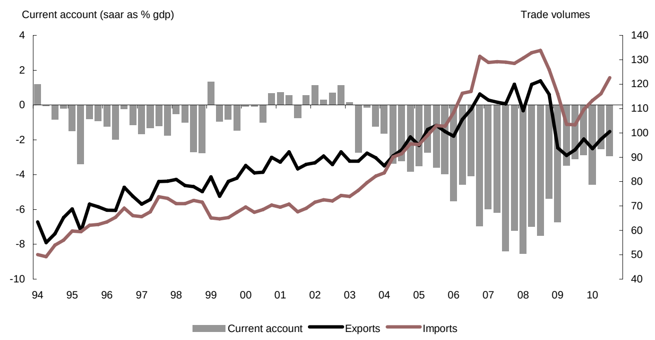
Balance of payments – current account

Chart 3 : Balance on the current account



Source: SARB

Chart 4 : Current account and change in trade volumes



Source: SARB

Comment

The **current account deficit** widened slightly as the rise in the trade surplus was more than offset by the wider income and services deficit. The current account deficit rose to a seasonally adjusted and annualised R79,2 billion in the third quarter from R66,9 billion in the second quarter, increasing to 3,0% of gdp from 2,5% and against a market consensus of 3,2%.

The **trade account** recorded a higher surplus of R32,4 billion on a seasonally adjusted and annualised basis from R13,2 billion, equivalent to 1,2% of gdp from 0,5% in the previous quarter. Export volumes rose during the quarter, boosted by firmer demand in South Africa's key markets, particularly in Asia. Recovering domestic demand and the firmer rand supported the rise in imports, although exports increased at a faster pace, with the resultant increase in the trade surplus.

Merchandise exports increased by 6,3% to seasonally adjusted and annualised R586,5 billion from R552,0 billion. Export volumes rose by 6,4% during the quarter, with volumes of manufactured exports up by 3,4%. Export volumes improved from a low base in the first half of 2010, with the increase more than offsetting the negative impact of lower commodity prices and the rand's strength during the quarter. Net gold exports increased by 6,8% q-o-q as the 7% rise in gold volumes exceeded the 0,2% decline in the rand price of gold during the quarter.

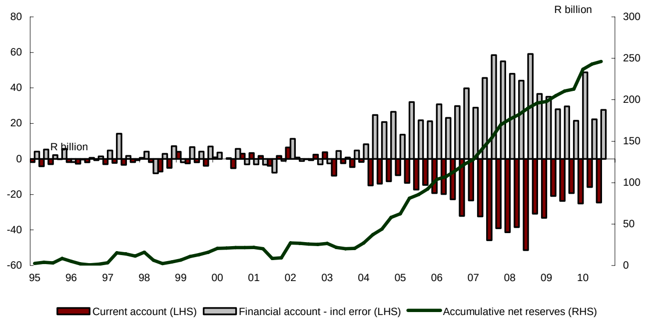
Merchandise imports increased by 3,2% to R617,2 billion from R597,8 billion. The value of merchandise imports was up by 3,2% q-o-q as volumes rose by 5,4% q-o-q, while with the rand price of imports fell by 2% q-o-q on the back of subdued global inflation and the firmer rand.

The **terms of trade** (the ratio of export to import prices) improved further in the third quarter, rising by 2,4%.

The deficit on the **net service, income and current transfer account** widened to R111,6 billion following the sharp drop to R79,8 billion in the second quarter. A significant drop in travel receipts following sharp World Cup related increases in the second quarter, and a marginal increase in foreign travel by South African residents widened the deficit.

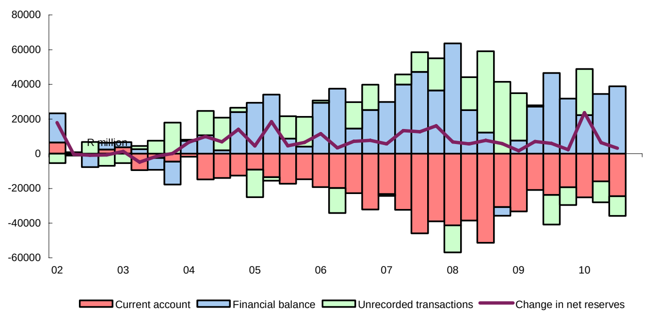
Balance of payments – financial account

Chart 5 : Balance of payments and net reserves



Source: SARB

Chart 6 : Breakdown of financial account



Source: SARB

The **financial account** remained in surplus as strong portfolio inflows continued, while other investment flows remained steady, offsetting direct investment outflows during the quarter. Inflows (including unrecorded transactions) increased to R27,6 billion from R21,8 billion in the previous quarter, equivalent to 4,1% of gdp from 3,4%.

Net portfolio inflows remained strong at R36,1 billion from R25,5 billion in the previous quarter. Portfolio inflows rose sharply to R45,8 billion during the quarter from R28,4 billion in the previous quarter as foreign investors took advantage of South Africa's attractive yields, with bond purchases of R41,2 billion, while outflows increased to R9,7 billion from R2,2 billion.

Net direct investment outflows rose to R5,9 billion in the third quarter from R2,5 billion in the previous quarter as inward investment by foreigners dropped to R1,1 billion from R2,9 billion while outward flows by South Africans increased to R7,0 billion from R3,3 billion.

Net other investment inflows remained unchanged at R8,6 billion in the third quarter. Inflows from foreign investors, mainly in the form of deposits and foreign loans, amounted to R15,1 billion after outflows of R1,5 billion in the second quarter, while domestic investors sent R6,5 billion to foreign countries after repatriating R10,2 billion in the second quarter.

Outlook

Consumer confidence will continue to be supported by low interest rates and income growth. This combined with attractive retail prices should help household spending during the last quarter of the year and in 2011. However, part of this will be offset by high debt and lingering employment concerns. We expect consumer spending to average 4,5% this year as a whole and to moderate to 3,9% in 2011.

Government consumption expenditure is likely to grow more modestly as the government attempts to reign in the budget deficit to more modest levels over the next three years. Government spending on key basic social services set out in the budget should continue.

Fixed capital formation is likely to recover at a very slow pace, as some organisations are still reluctant to resume capital spending, while others are sitting on ample spare capacity. We forecast overall gross fixed capital formation to decline by 3,7% this year before picking up slowly in 2011.

We now expect gdp to grow by 2,7% (previously 2,8%) in 2010.

The current account deficit is forecast to widen to 3,4% of gdp in 2010 and 3,8% in 2011 from 2,9% in 2009. Imports are expected to increase at a faster pace than exports on improving domestic demand, buoyed by low interest rates and improving incomes, while export growth will be subdued by a fragile global economy. The current account deficit will remain well financed strong portfolio inflows are likely to continue, with investors favouring emerging markets over stagnant industrial countries.

Implications

Domestic demand gained some momentum during the third quarter. However, other recent economic releases suggest that the overall economic recovery remains fragile, with production still taking strain. This, against the backdrop of a strong rand and subdued inflation should prompt the Reserve Bank's Monetary Policy Committee (MPC) to keep interest rates steady throughout next year before starting to hike towards the middle of 2012.

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