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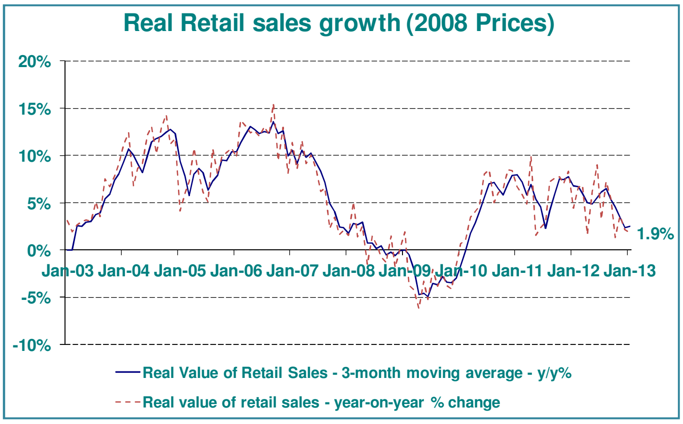
HOUSEHOLD SECTOR – JANUARY RETAIL SALES

After having slowed significantly through 2012, real retail sales growth is expected to settle between 2-3% in 2013

13 March 2013



Real Retail sales growth in January 2013 slowed to 1.9% year-on-year, from 2.2% in December 2012. This comes as little surprise, and is in line with a prior expectation of broad weakening in growth going into.

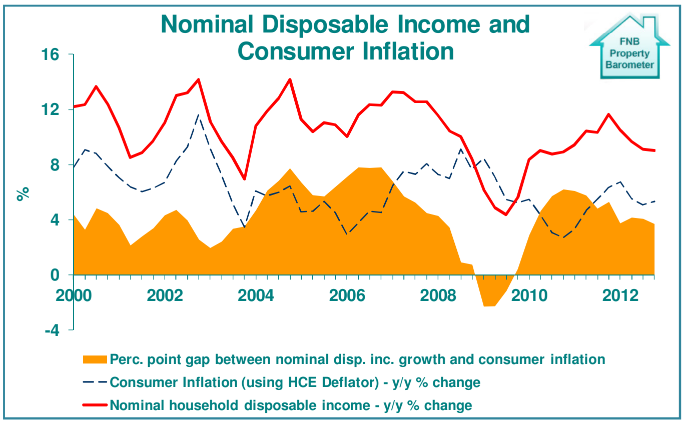
Monthly data can be volatile, and for this reason we prefer to focus on the 3-month moving average to analyse the short term trend. For the 3 months up to and including January, the real year-on-year growth rate in retail sales was 2.5%. This is slightly higher than the 2.4% for the 3 months up to December, due too a very poor October growth rate exiting from the 3-month total in January. However, we are not convinced that the slightly better 3-month growth figure in January means any looming upturn in growth, but rather a broad stabilization at best.

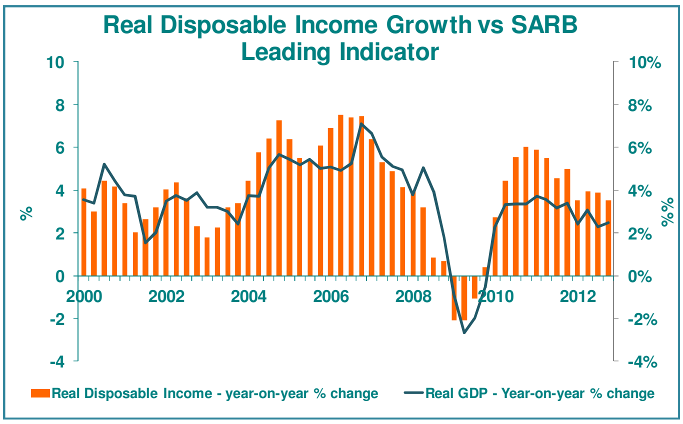
The late 2012 slowing in real retail growth was not only expected, but also arguably appropriate, given that real household disposable income growth has been broadly slowing on a year-on-year basis since a very high 6% peak reached in the final quarter of 2010.

After often exceeding even the healthy real household disposable income growth rate for much of the last 3 years, it has become time for this real retail sales growth to come down more into line with real disposable income growth.

In turn, real household disposable income growth, after exceeding economic growth by a considerable margin in recent years, appears to be coming back down to earth and into line with economic growth.

From late-2009, the post-recession "Relief Recovery" boosted real household disposable income growth to significantly higher levels than the rate of economic growth at the time. How was this "positive differential" achieved? On top of the economic growth recovery providing the "normal" boost to employment and income, 2010 saw strong double-digit growth in nominal average employee remuneration. This was probably the lagged response of wage growth to the huge 2008 cost of living spike. The "discretionary reward" component of remuneration also normalized (rose) sharply with a lag after the recession. On top of this, 2011 and 2012 saw 15.2% and 16.7% nominal growth in income on investments respectively, after 2 prior years of decline, while 2010 had seen positive consumer inflation developments, with consumer inflation receding to below 4% at a stage. And so, whereas real GDP growth reached a "Relief Recovery" peak of 3.7% year-on-year in the 1st quarter of 2011, real disposable income growth peaked at a far higher 6.04% in the final quarter of 2010.

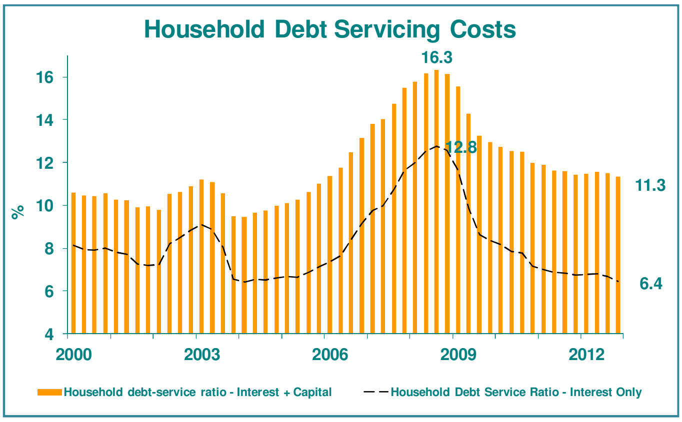




The, perhaps surprisingly, strong real retail sales growth over the past 2-3 years can thus be largely explained by a very strong real disposable income growth rate as certain "normalizations" took place after the big 2008/9 price and recession shock.

But these normalizations appear largely a thing of the past, and the differential between real disposable income growth and the country's anaemic economic growth rate has gradually become less significant, with real disposable income growing at 3.5% year-on-year, and real economic growth at around 2.5%.

Not all of the past few years' strong retail sales growth can be explained by strong income growth, however. Accelerating household sector credit growth, driven largely by consumption-related credit growth, must also have played a role.



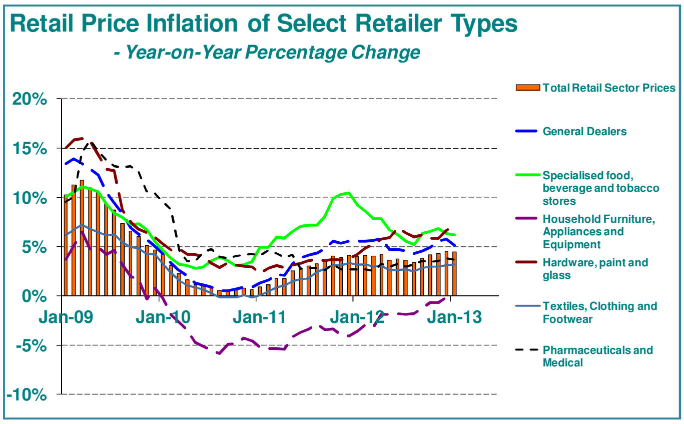
However, the SARB reported that the Household Sector Debt-to-Disposable Income Ratio more-or-less stabilized through 2012, showing no further decline on late-2011.

This, coupled very little downward movement in interest rates in 2011/12, implies very little further progress in reducing debt-servicing costs relative to disposable income, limiting growth in disposable income available for consumption. The Household Debt-Service Ratio (the cost of servicing the total debt burden expressed as a percentage of household sector disposable income), Interest+Capital version, ended 2012 on 11.3%, only slightly down on the 11.5% at the end of 2011. The Interest-only Debt-Service Ratio also declined only marginally through the year, helped by a lone interest rate cut in the 3rd quarter.

So whereas the rapid decline through 2009/10 in the 2 debt-service ratios was steadily freeing up more disposable income for consumption, the almost flat move in the ratios through 2012 has become "neutral-to-negative" for consumption expenditure growth.

Therefore, the slow January year-on-year retail sales growth rate was arguably to be expected, and recent trends in disposable income growth and household debt-servicing costs continue to influence my expectation of a mediocre real retail sales growth rate more-or-less in line with pedestrian real economic growth. Given our expectation that real economic growth will average 2.7% for 2013, the expectation is that the slowing growth trend in real retail sales may now be virtually at its end, and that real sales growth will hover around levels not far from those of recent months, and average 2-3% growth for the year 2013.

RETAIL PRICE INFLATION STILL WELL-BELOW OVERALL CONSUMER PRICE INFLATION, BUT SIGNIFICANTLY UP ON 2010/11 PERIOD

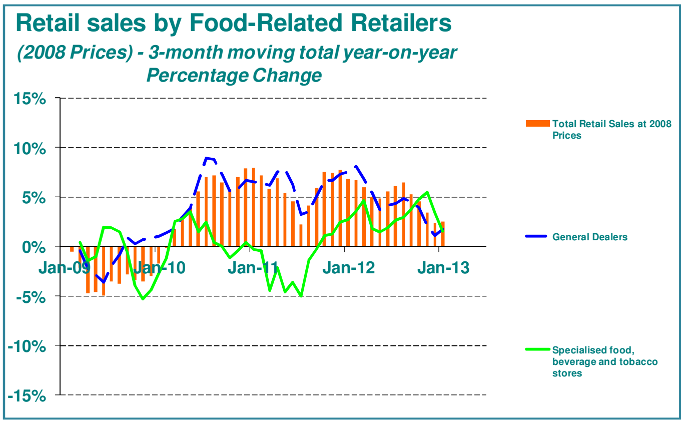


The Retail Sector's "price competitiveness" relative to other consumer areas has been a further contributing factor to strong retail sales growth in recent years. By this we refer to a lower retail price inflation rate compared to SA's overall consumer price inflation rate. Whereas the overall consumer price inflation rates was 5.4% year-on-year in January, with "non-retailer" prices such as electricity, municipal rates and water, and petrol exerting upward pressure, the total retail price inflation rate for January remained lower at 4.5%.

However, the 4.5% retail inflation is now significantly higher than 0.6% inflation lows reached around mid-2010. The relatively troublesome retail inflation categories are "Hardware, Paint and Glass" retail price inflation at 7.2% year-on-year, "Specialised Food and Tobacco Stores" at 6.2%, and General Dealers with 5.1% inflation. However, the gradual rise in retail price inflation has been broad-based, and while food has been a problem area for a few years, more recently even the "well-behaved" Household Furniture, Appliance and Equipment retail prices have moved from significant price deflation from 2010 to 2012, to slight price inflation by January. This suggests that inflationary pressures in recent times may have been more home grown, and not just the result of isolated events such as periodic global food price inflation surges.

Retail price inflation is far from problematic at 4.5%, but the fact that it is now significantly higher than in 2010, and much of 2011, does just apply the brakes on retail sales growth a little more these days.

FOOD RETAIL GROWTH REMAINS SLOW



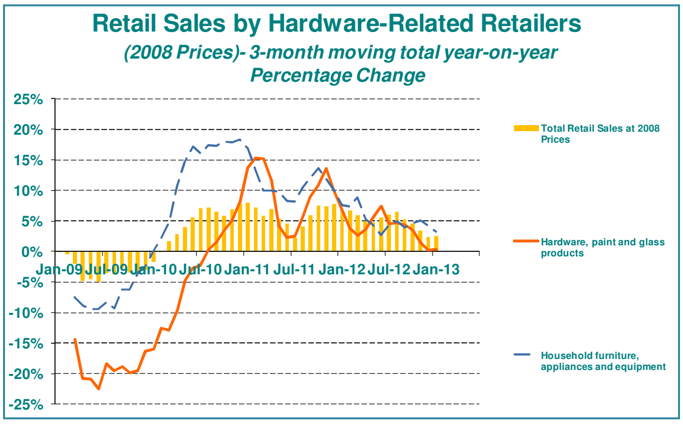
Food consumption is typically less cyclical than, say, durable and semi-durable consumer goods. The food price surge through 2010/11 did, however, lead to some cut-back in food spending and thus food-related retail, especially on the specialized food retail side, through 2010/early-2011. Then, late in 2011 this situation reversed itself with some positive growth in the specialised food retail area, and renewed acceleration in General Dealer real retail growth around the same time.

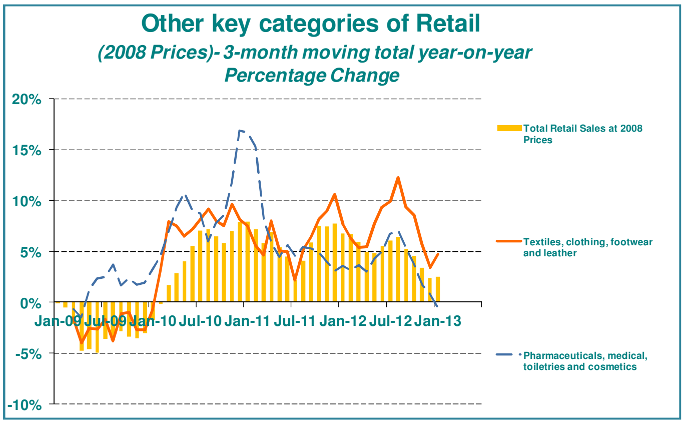
This "normalization" in food related retail levels appears to have run its course for the time being, however, with the 3 months to January showing 1.6% year-on-year growth for Specialised Food and Beverage retailers. General Dealer real retail sales growth for the 3 months to January was also sluggish, with an only marginally higher 1.7% year-on-year growth rate.

HARDWARE SALES GROWTH IS "MEDIOCRE", BUT CLOTHING AND FOOTWEAR REMAINS A KEY DRIVER OF RETAIL

In the semi-durable categories of retail, certain "replacement and maintenance" backlogs appear to have been reduced. By this I am referring specifically to the "Hardware, Paint and Glass" retailer category, whose growth for the 3 months to September was a "below-average" 0.3%, well down from double-digit peaks in 2011 as levels of home maintenance appeared to normalize following a previous slump. The other home-related retailer category of "Household Furniture, Appliances and Equipment" is a little above-average" at 3.3% year-on-year in real terms for the 3 months to January, but this is well-down from near 20% growth levels late in 2010.

So the relatively strong category remains Textiles, Clothing and Footwear Retail. Although this category is also coming down to earth, it would appear, its growth rate for the 3 months to January was a still-above average 4.7% year-on-year.





CONCLUSION – REAL RETAIL SALES GROWTH EXPECTED TO MODERATE FURTHER GOING INTO 2013

In short, therefore, there are a number of factors that are stacked against retail sales growth in the near term, and are expected to keep it at currently moderate levels. These include the expectation of a mediocre near term economic growth rate averaging 2.7% for 2013, slower real disposable income growth compared to recent years, and little further progress in lowering the household debt-service ratio due to stable interest rates and a debt-to-disposable income ratio. In addition, retail price inflation is significantly up from 2010/11 lows.

However, it is believed that the broad slowdown in real retail sales growth has all but ended, and that 2013 will see the rate averaging between 2-3% in 2013, more-or-less in line with expected real economic growth.

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