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HOUSEHOLD AND CONSUMER WEEKLY

South African household sector cannot blame global events for its own inadequacies

30 August 2013

A. *Focal Point - The SA consumer can't prevent global economic shocks from happening, but how they affect us is to a large degree our own doing.*

The week past has been an eventful one for the consumer, although in some cases the potential impact has yet to feed through.

4 relevant data releases appeared during the course of the week, namely GDP (gross domestic product) and wage bill data, insolvencies, producer price inflation, and household sector credit data.

But arguably the key event of the week for the consumer, in the form of a threatened US-led invasion of Syria has possibly overshadowed those. What is the relevance of this to the consumer? Firstly, higher oil prices do have a dampening impact on a fuel-guzzling global economy, and weaker global economic growth, should it materialize, normally implies weaker South African economic growth which is bound to have an impact on employment and house disposable income.

In addition, higher oil prices mean higher petrol prices locally too. This in turn heightens the risks of still-higher consumer price inflation, and given SA's official inflation target, this in turn heightens the risk of interest rates rising. The matter is further exacerbated by this threat to global economic growth exerting further pressure on the Rand, and a weakened rand can raise imported price inflation on a wide variety of products.

These are all risks, but the potential impact depends on the duration and magnitude of heightened oil prices and rand depreciation.

Last week I focused on the already-heightened upside risk to interest rates, given that July CPI inflation had breached the upper inflation target limit to rise to 6.3% year-on-year. This week, the Syrian news merely further heightens those risks.

Despite all of this, our FNB forecast is not for interest rates to rise just yet. In fact, we still forecast a lengthy period of unchanged interest rates until 2015. And it still remains quite plausible that the SARB, which has long since stopped panicking about periodic short term volatility, will continue to keep rates on hold. The SARB doesn't panic because the reality is that as fast as such potential conflict situations arise, so they can subside. Oil prices have been driven up based on speculation regarding a possible conflict situation leading to disruption of oil supplies. Will such disruptions materialize? This is very difficult to predict.

In addition, it is important to get some perspective on the latest "surge" in oil prices and rand weakening. In Rand terms, should the rand hypothetically average R10.50/dollar, and Brent Crude say $115/barrel, the average rand-denominated Brent Crude oil price would be up 28.6% year-on-year, which is higher than August's estimated 16.7% year-on-year rise, and would thus probably lead to further petrol price inflation. But this is still relatively mild compared to November 2011's peak growth rate of 51.8% year-on-year, and even the aftermath of that surge only took CPI inflation marginally above the 6% target limit in the few months thereafter.

So at near $115/barrel, I wouldn't call it an oil price "shock" for the consumer yet. Nevertheless, even more so than a week ago, it is important to warn that consumers should be mindful of the heightened risks posed by the latest global events, as it need not end here.

The South African household sector cannot always blame global events for its own inadequacies. We proved about a decade ago that if our own "fundamentals" are in place, we can sail through these periodic shocks relatively unscathed, but if they aren't we will pay the price.

The 2001-2002 period is perhaps a good example of a period when these fundamentals were far more healthy, leaving the consumer to sail through a partly rand-induced inflation shock, and the resultant interest rate hiking.

From December 1998 to May 2001, oil prices (Brent) rose by around 185.6%. Not surprisingly, the US (the world's largest economy) economic growth rate had slowed from 4.8% and 4.1% real economic growth in 1999 and 2000 respectively, to 1.1% in 2001, including contractions in 2 of the 2001 quarters. This affected us all.

2001 was a troubled global political period too, and who will forget the infamous 2001 World Trade Centre destruction now referred to as 9/11. That opened up all sorts of conflict possibilities as President Bush's "War on Terrorism" started.

The post-9/11 months brought about a "flight to safety" by many global investors, and this saw a huge currency depreciation for South Africa, with the trade-weighted rand losing a massive -24% of its value in the final quarter of that year. If that Rand depreciation wasn't enough to drive inflation significantly higher, a global food price inflation surge appeared in 2002, implying further upward pressure on SA's inflation. And so it happened that core consumer price inflation (excluding certain volatile food components as well as interest rates on mortgage bonds) in South Africa rose from 5.8% at the end of 2001 to 9.9% by the end of 2002. The SARB, unsurprisingly (given its inflation target mandate), hiked interest rates by 4 percentage points over a 9 month period in 2002, with prime rate peaking at 17% in September of that year.

Now all of the fluctuations around that time, the rand slump, CPI surge, and magnitude of interest rate hikes, could be seen by today's standards as severe. But the impact on the consumer was not severe at all by today's standards, and the house price boom hardly took any notice at all. In 2002, real household consumption expenditure growth slowed moderately from 3.8% in 2001 to 3.2% in 2002, and bottomed at a still-acceptable 2.8% for 2003, a year in which interest rates remained high until the 2nd half.

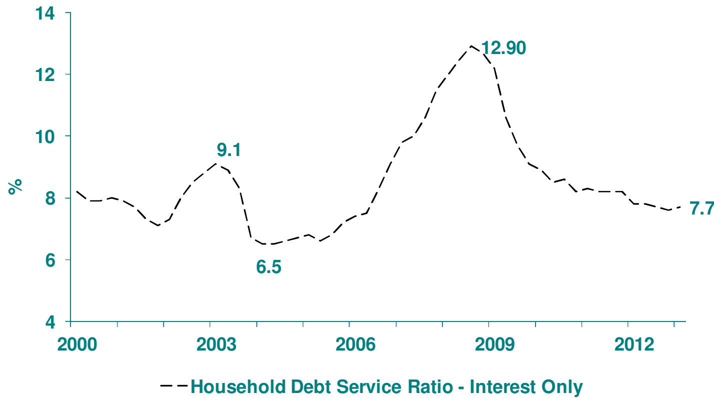
As for residential property prices, their growth accelerated from 14.3% average in 2001 to 15.3% and 21.2% in 2002 and 2003 respectively. Yes there was little that could stop the residential property party.

In fact I seem to remember 2002 and 2003 as years in which I had significantly under-forecasted the strength of household and consumer demand for those years, having believed that higher interest rates should have a more significant impact.

But I was off the mark, not because the consumer was necessarily crazy, but because the consumer was financially healthy…..at least by today's standards. And the biggest difference between then and now was the level of indebtedness. In the final quarter of 2001, the household debt-to-disposable income ratio stood at 55.3%. By mid-2006, just before the next period of rising inflation and interest rates, it was a far higher 71.8%, while the most recent level as at the 1st quarter of 2013 was 75.4%.

And so, whereas prime rate in 2002/3 peaked at a very high 17%, the debt-service ratio (the cost of interest on the total household sector debt burden expressed as a percentage of disposable income) peaked at a lowly 9.1%, while in 2008, prime rate peaked at a lower 15.5%, and the debt service ratio peaked at an extreme 12.9%, driven up by a far higher level of household indebtedness that time around.

The long term rise in household indebtedness has little to do with global economic events, but much to do with how sensitive we are to such shocks. So we remain highly sensitive to external shocks to a large extent through our own doing. We can't blame the world for everything.



The secret to weathering storms caused by external economic shocks is a low level of indebtedness to keep the debt-service ratio low even when interest rate rise.

At present, South Africa doesn't have that luxury, and so relies heavily on interest rates to stay low.

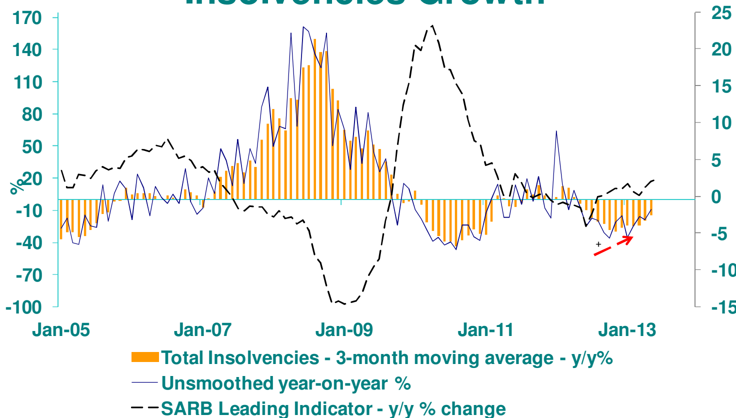
Data source: SARB

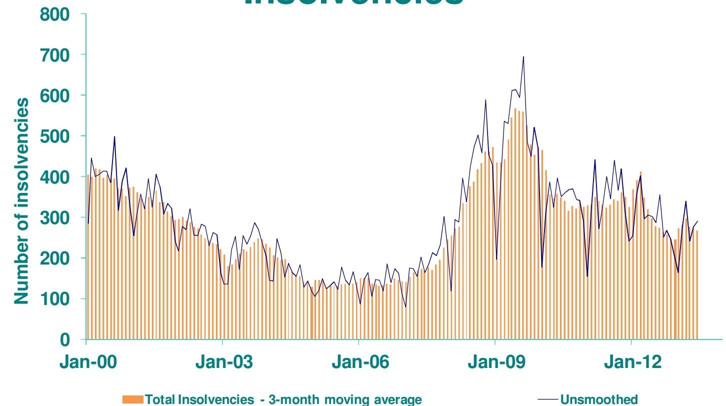
B. The week's household and consumer-related data releases

Insolvencies

The first important consumer-related data release was June insolvencies data. Insolvencies lag actual trends in consumer health slightly, but serve as a good "confirming indicator" of trends in consumer credit health. While the June data still showed a year-on-year decline of -9.48%, the trend is one of steadily slowing rate of year-on-year decline. With the SARB having reported a slight increase in the household debt-service ratio back in the 1st quarter of 2013, insolvencies growth is expected to turn mildly positive before 2013 is over.

To get a perspective of how we've performed in the current low phase of the interest rate cycle, it is perhaps better to look at the absolute level of insolvencies, and the monthly average insolvency level for the 2nd quarter of 2013 of 270 per month is slightly more than double the 3-month average of 132 for the 3 months to June 2005. Significantly, this is despite lower interest rates currently than those levels in 2005.





GDP and Household Sector Credit

Next came Gross Domestic Product (GDP) data, which should be read in conjunction with household sector credit growth. A manufacturing-led mild improvement in year-on-year GDP growth, from the 1st quarter's 1.9% to 2% in the 2nd quarter, helped the country's nominal wage bill growth to grow slightly faster, rising from 7.4% in the previous quarter to 8.6%.

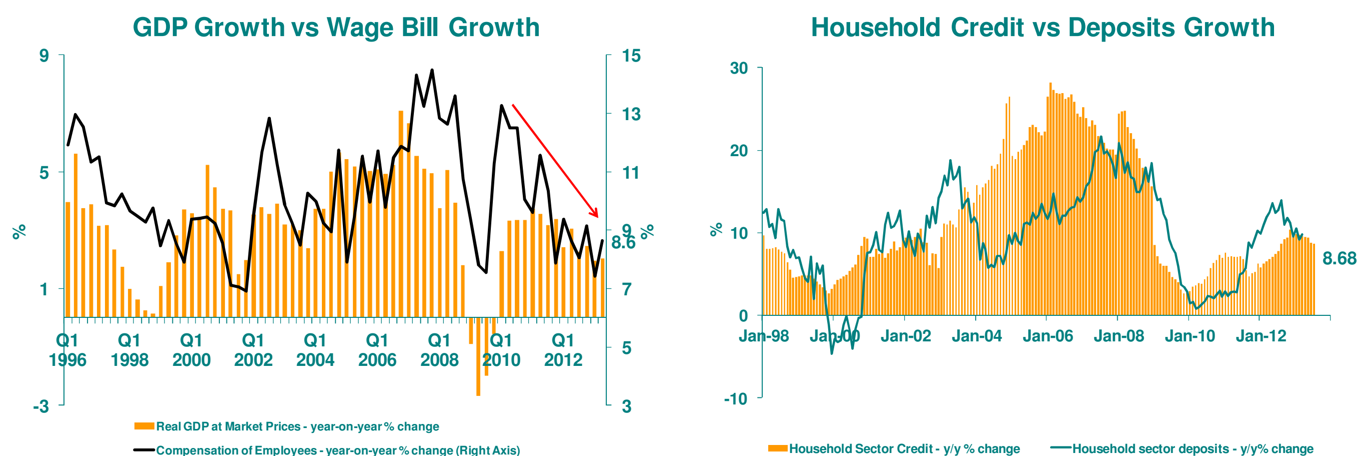
While any improvement is welcome, it definitely does not signal the start of an accelerating trend, and nominal wage bill growth still remains planted at low levels that are in line with those through the broadly stagnating growth period through 2012 to date. This stagnant phase has followed the strong "relief recovery" back in 2010/11.

Back in 2010, as rapidly declining interest rates and a recovering world economy had a positive effect on employment and wages, wage bill growth peaked at a lofty 13.3% in the 1st quarter of that year, and has since been broadly slowing

At the most recent rate of 8.6%, I suspect that we did not make any significant progress in lowering the household debt-to-disposable income ratio from its 1st quarter 75.4% level, because as at the end of the 2nd quarter, the SARB reports a very similar pace of household sector credit growth to that of wage bill growth, i.e. 8.8% year-on-year, and wage bill growth is the major part of household disposable income.

Encouraging news, though, is that the SARB reports a further mild slowing in household sector credit growth to 8.7% in July. The slowing can be attributed to slowing in the more consumer-related non-mortgage components. It may be that National Treasury's 2012 "verbal intervention", in the form of expressing concern to lenders regarding the then rapid growth in unsecured lending, may be starting to bear fruit.

However, at recent rates of wage bill growth, if we are to meaningfully lower the household debt-to-disposable income ratio, household sector credit growth will probably be required to slow significantly further.



Producer price inflation

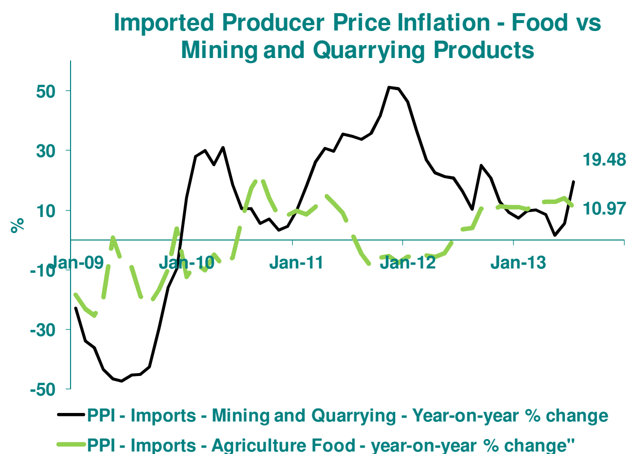
Finally, a comment of July Producer Price Inflation (PPI), which rose from 5.9% in June to 6.6% in July, with imported inflationary pressures starting to make themselves felt as a result largely of a weaker rand. It is old news that the PPI can be an important indicator of future direction of CPI inflation much of the time.

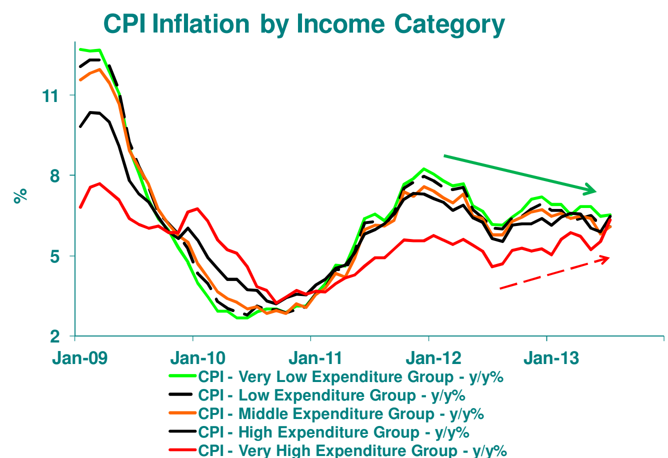
But to be watched more closely, perhaps, is to see just what impact the weaker rand has on imported food price inflation and therefore on overall food price inflation. Why the emphasis? Because food price inflation has a far larger impact on the poor than do many other components of consumer price inflation, and in these times of heightened social instability this is therefore a key risk on its own, over and above the usual risks to interest rates.

Fortunately, global dollar-denominated food prices have largely "played ball", not showing an major inflation, and the PPI for imported goods "Agriculture Food" component showed year-on-year inflation of 10.97%, slightly lower than the 14% of the previous month and not too problematic at this stage. The problem area has been more in imported "Mining and Quarrying" products, where oil prices play a key role, and this component of the PPI for imports rose by a more significant 19.5% in July.

It is crucial that the imported food price inflation impact remains limited. In recent times, lower income groups have seen their inflation situation broadly improving a little, and future food price movements will be key to the containment of their inflation rate in future.

At present, inflation rates between income groups show very little difference. Whereas the "Very High Expenditure Group" (Quintile 5) has seen its CPI inflation rate rise from 5.3% at the end of 2012 to 6.3% by July 2013, the "Very Low Expenditure Group" (Quintile 1), has actually seen its inflation rate decline from 7.2% to 6.5%.





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