South Africa

Consumer at an inflection point

Peter Worthington
+27 21 927 6525
peter.worthington@absacapital.com

Miyelani Maluleke
+27 11 895 5655
miyelani.maluleke@absacapital.com

www.absa.co.za

- A variety of headwinds have been gathering against the South African consumer for the last year. The Q2 18 national accounts data, which show total household consumption expenditure contracting 1.3% q/q saar, may be a sign that these headwinds have finally forced the consumer to an inflection point.
- Curiously, the national accounts data show a strong deceleration of household spending on goods (particularly durables and semi-durables) but continued expansion of consumption of services. This odd pattern might reflect some issues with the deflators. If retailers are offering households lots of goods via special sales and promotional offers that are not captured in StatsSA's survey of shelf prices, or consumers are switching to cheaper goods, then the deflators for certain goods might overstate the true growth in per unit prices, and exacerbate the apparent 'real' contraction.
- One of the biggest ongoing headwinds to household consumption has been the weak jobs market. The Q2 18 Quarterly Employment Statistics (QES) released last week reinforce the picture of a weak jobs market; although overall private sector employment was steady compared with the previous quarter, there was further deceleration of wage growth. The national accounts data on employee compensation, which factor in employment outside the scope of the QES survey, also show deceleration.
- Two other big headwinds this year are the large consumer-related tax increases worth 0.7% of GDP in the 2018 Budget, including a 1 percentage point VAT increase, and the huge rise in the petrol price from the low in March. Although overall CPI inflation is expected to be lower this year than last, the price inelasticity of petrol, which accounts for 4.6% of household spending, is likely to drain a lot of spending power away from consumption of more optional goods and services. Middle income households' spending is likely to be particularly hard hit by the hike in petrol prices.
- Although we think banks are willing to lend, consumers have been slow to borrow, even though they appear exceptionally optimistic, according to the Bureau for Economic Research's Q2 18 survey. There is some early evidence that arrears may be starting to accumulate, but the National Credit Regulator's age analysis of the consumer debtors' book, due out this week, will be key. The National Minimum Wage could have a positive impact on household consumption. Even under fairly conservative assumptions, it could lift household income by 0.3% of GDP.

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Consumer may be reaching an adverse inflection point

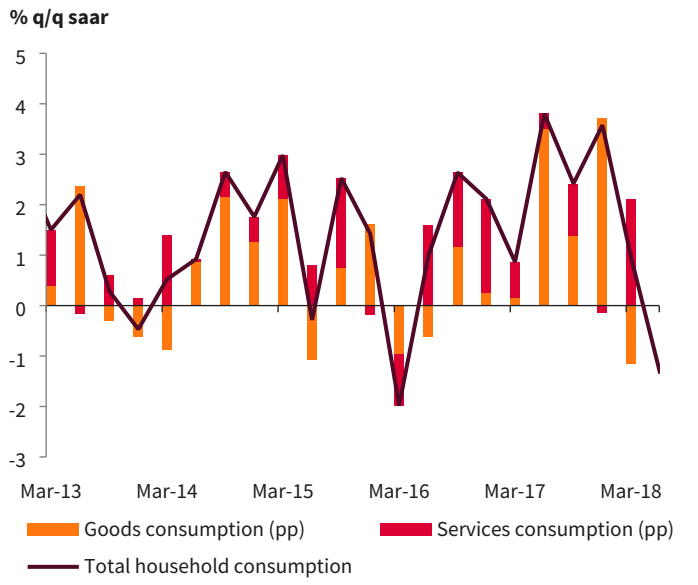
For some time now, we have argued that the South African consumer has been looking constrained, but not in outright crisis. However, a set of concomitant developments since the beginning of the year appears to have brought the consumer to an inflection point, as revealed by the exceptionally weak Q2 household consumption expenditure data. This analysis examines the current state of household spending and its rather dim prospects in the context of the various headwinds facing the consumer today.

The current state of household consumption expenditure

Real household consumption contracted sharply in Q2, with especially big drops in spending on durables and non-durables

The Q2 18 national accounts data, which tipped the South African economy into a technical recession, were a particularly grim read with regard to household consumption expenditure. Statistics South Africa (StatsSA) reported that the main demand-side driver of the economic slowdown was the collapse of real (i.e. inflation adjusted) household consumption by 1.3% q/q saar. This quarterly decline, the first since Q1 16, is equivalent to a drag of 0.8pp on the quarterly GDP growth rate, thus delivering South Africa into recession with a 0.7% q/q saar GDP contraction. Notably, the consumption contraction manifested most strongly in the more optional parts of households' spending, especially in durables and semi-durables, which contracted 11.2% q/q saar and 5.2% q/q saar, respectively. Curiously, spending on non-durables (more than half of which is foodstuffs and non-alcoholic beverages or NAB) also contracted by 2.4% q/q saar, but in contrast, household spending on services (43.4% of total household spending in 2017) actually rose 2.8% q/q saar in Q2 18 (Figure 1). This apparent divergence between households' consumption of goods versus services was also strongly present in the Q1 18 data where a 5.0% q/q saar growth rate in real spending on services was more than sufficient to offset a contraction in spending on goods (mostly semi-durables) to generate an apparent real growth rate for overall household consumption of 1.0% q/q saar. In contrast, in the previous three quarters (Q2-Q4 17), spending growth in services appeared muted, but household consumption of goods expanded strongly.

Figure 1: Real spending on goods contracted in Q2 but spending on services rose



Source: StatsSA, Absa Research

Figure 2: COICOP breakdown shows a big apparent decline in spending on foodstuffs

	Share of total	Growth rate, %q/q saar			
	2017	Q317	Q417	Q118	Q218
Food & NAB	21.4	-1.5	3.4	-2.0	-2.8
Clothing & footwear	5.2	2.3	20.7	-15.6	-6.8
Alcohol & tobacco	4.9	-1.5	-4.4	-1.6	-5.5
Furnishings & equipment	6.7	5.9	10.8	5.4	-3.4
Housing & utilities	14.7	-0.5	0.7	2.8	0.5
Communication	2.6	3.9	-0.6	9.0	6.5
Recreation & culture	4.5	9.7	7.8	-0.8	-7.6
Health	7.2	3.6	7.6	3.9	5.2
Education	3.7	1.2	0.6	2.4	2.4
Catering & hotels	2.6	9.3	-0.2	4.4	3.2
Transport	15.2	5.7	4.1	1.0	-6.1
Miscellaneous	11.3	2.2	-3.5	5.9	5.0
Total consumption	**100.0**	**2.4**	**3.6**	**1.0**	**-1.3**

Source: StatsSA, Absa Research

COICOP breakdown shows quarterly volatility in spending growth, but some of this makes sense in light of households' straightened circumstances

StatsSA also breaks down consumer spending data according to the United Nations standard, the Classification of Individual Consumption by Purpose (COICOP). This provides a more detailed breakdown of spending into broad categories such as food, housing, communication, health and transport (Figure 2). Interestingly, the pattern of apparent changes in real household expenditure by individual COICOP categories also proves somewhat volatile from one quarter to another, but some of this pattern can be rationalised if one thinks about where households would be likely to cut spending when their budgets are under pressure. For example, StatsSA shows real seasonally adjusted spending on alcohol and tobacco declining for the last four quarters straight, with a big

accelerated contraction in Q2 18, after higher VAT and sin taxes kicked in. While seasonally adjusted clothing expenditure shot up in Q4 17, followed by a sharp contraction in Q1 and Q2 of 2018, this seemingly unusual pattern in the consumption data, which is ostensibly seasonally adjusted, can be explained not just by lower consumption overall but also by the fact that Q4 Black Friday sales are a fairly new phenomenon in South Africa and thus cannot yet be smoothed out by statistical approaches to seasonally adjusting the quarterly spending data. The Q2 18 declines in household consumption expenditure in the COICOP categories of 'furnishings and household equipment' and 'recreation and culture' are not really a surprise since many purchases in these categories would appear to be discretionary, rather than essential, for most households most of the time.

Other features of the pattern of changed household consumption expenditure are harder to understand

However, the ongoing exceptionally strong growth rate in household spending on communication is a bit difficult to fathom, as is the Q2 18 rise in spending on catering and hotels. And in the other direction, the outright contraction in household spending on food and NAB (the single largest COICOP category of spending accounting for nearly 22% of total household spending in 2017) in three of the last four quarters also seems a bit perplexing, since no matter how great the budgetary pressures, people still need to eat, and food price inflation has halved over this period (from 6.9% y/y in Q2 17 to 3.6% y/y in Q2 18).

Challenges in deflating nominal expenditure data into constant price series might explain some of the strange patterns in household spending

However, we suspect that at least some of the volatility in StatsSA's real household consumption expenditure data could be related to the ever-present challenges of deflating nominal data into so-called real or constant price data. StatsSA's monthly Consumer Price Inflation (CPI) survey provides price series according to COICOP that are used to deflate households' expenditure at the three-digit COICOP level. An example of a product group at the three-digit COICOP level would be 'meat' or 'motor cars'. Thus, StatsSA's deflators skim over the reality that within the three-digit COICOP product categories consumers can switch to buying cheaper products, such as chicken instead of beef. Furthermore, the CPI is a Laspeyres index, with fixed past weights. Thus the consumption expenditure deflators do not allow for the possibility that consumers might also substitute away from relatively more expensive products not just within but also between the three-digit COICOP product categories. The most recent reweighting exercise by StatsSA took place for the 2016 CPI and there were some material reweightings from the 2014/15 Living Conditions Survey (Figure 3). Probably, since then, the share of expenditure devoted to food may have fallen (given the disinflation in food prices over the last year after the 2016 drought) while the share of household budgets going to petroleum fuels would likely have risen.

Figure 3: Expenditure shares for different product groups vary greatly by household income

	Expenditure decile										
	Lowest	2	3	4	5	6	7	8	9	Highest	All SA
Food & NAB	48.1	47.0	38.7	31.7	29.6	25.6	23.9	21.6	16.9	10.7	17.2
Clothing & footwear	8.8	8.8	7.7	5.7	6.3	5.2	5.0	4.8	4.0	2.7	3.8
Alcohol & tobacco	3.9	3.0	4.2	5.8	5.1	5.9	6.1	6.3	6.9	5.6	5.8
Furnishings & equip.	2.6	3.0	2.8	2.5	2.6	2.4	2.4	2.9	3.8	5.7	4.4
Housing & utilities	17.3	15.3	25.3	35.2	36.4	39.2	37.6	32.8	27.7	16.4	24.6
Communication	7.0	5.7	4.7	3.4	3.1	2.7	2.5	2.6	2.7	2.4	2.6
Recreation & culture	1.9	2.3	2.6	3.1	3.1	3.5	3.5	4.3	4.5	6.3	5.2
Health	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.7	0.8	1.8	1.4
Education	0.3	0.4	0.6	0.6	0.8	0.9	1.3	1.9	2.9	3.4	2.5
Catering & hotels	3.8	5.1	4.0	3.3	3.1	2.7	2.6	2.7	2.3	3.5	3.1
Transport	1.2	2.0	2.5	3.4	3.6	5.8	7.4	8.9	11.7	21.1	14.3
Miscellaneous	4.5	6.7	6.5	4.9	5.9	5.7	7.2	10.5	16.0	20.3	15.1

Source: StatsSA, Absa Research

StatsSA's price series are largely based on shelf prices and do not take account special offers, promotional discounts and coupon shopping, which means the deflators might be slightly overstated for some goods categories

A related issue is that StatsSA's price surveys generally do not factor in goods on sale and special promotions (e.g., buy two, get one free schemes), which in aggregate allow consumers to get more consumer goods at a cheaper actual per unit price than StatsSA is able to record. Such sale efforts

by purveyors of goods and services against a backdrop of weak household demand obviously manifests in retailer margins and earnings reports. We would argue that firms' discounting and other promotional activities pick up during times when they have to go the extra length to attract budget-constrained customers. Such sales and other promotions are also, we think, more likely to feature in goods markets, especially for durables and semi-durables, where the timing of the purchase – even the necessity of the purchase altogether – is somewhat at the discretion of the consumer. Consequently, despite a low apparent deflator as measured (in most cases) by StatsSA's CPI survey, the actual true deflator for certain goods might be even lower still. Since such promotional efforts are almost certainly more prevalent in goods markets than services markets (for example, the high share of the consumption basket accounted for by medical aid, education, housing rentals and owners' equivalent rent, which do not benefit from sale promotions). We suspect that these considerations might help explain some of the apparent pattern in real household consumption expenditure. We note, for example, that in nominal terms household spending on food and NAB only declined in Q2 18 but not at all in the previous three quarters.

Retail sales in July came in stronger than expected, and passenger car sales also appear to have risen in July and August, compared to Q2

Another partial explanation for some of the steep fall in Q2 18 household consumption compared to Q1 18 could be consumers' response to the announcement of the VAT increase. Many consumers probably responded to the Budget announcement by rushing their planned purchases of big ticket items. For example, StatsSA's data show a 20% m/m sa increase in new motor vehicle sales in March, followed by a 33% m/m sa decrease in April. This preemptive buying behaviour would thus have pulled spending forward into Q1 18, thereby depressing Q2 18 consumption data. Thus, there are some signs that Q3 18 could look a little better than Q2 18. In particular, StatsSA reported real retail sales in July that were 1.0% higher than the monthly average for Q2 18 after seasonal adjustment, equivalent to a 1.3% y/y gain. And NAAMSA's data on car sales show that the number of passenger car sales per month in July-August averaged 3% higher than in Q2. Still, despite these mildly encouraging early data for Q3 18, the various headwinds blowing against the consumer are strong, and are likely to prove persistent. The consumer is likely to remain constrained, but perhaps the Q2 18 national accounts data should be interpreted with some caution.

Weak labour markets constrain overall household consumption

Weak GDP growth is intrinsically linked to weak employment growth, which limits household disposable income

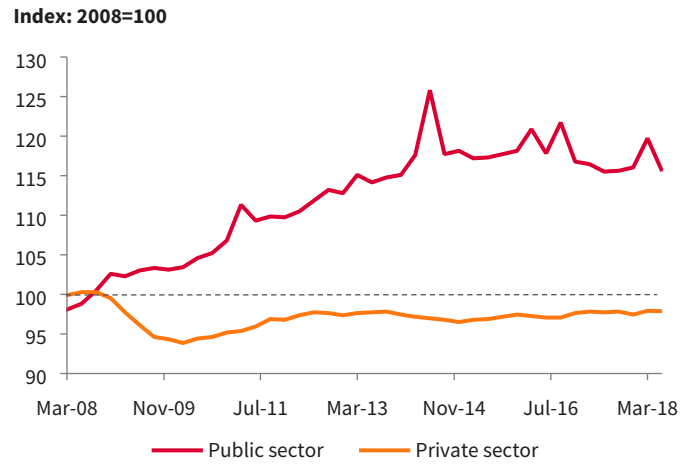
Without a doubt, the biggest problem for the consumer – and hence for household spending – is the fact that GDP growth has been weak for several years, with South Africa now in its first technical recession since the global financial crisis. Weak GDP growth has a causal negative sequence of effects running to firms' profitability, confidence levels, investment spending and thus finally to employment levels, which are ultimately the main driver of household spending power, via income paid to consumers in exchange for their labour services. Unfortunately, labour market data in South Africa have several shortcomings. In particular, they are volatile, often with more noise than signal, and are released only quarterly, with a material lag. Nonetheless, the broad picture that emerges from South Africa's available labour market statistics is one of scant net job creation, and therefore little growth in overall household disposable income.

Both sets of official labour market data – the QES and the QLFS – suggest that employment levels have been broadly flat

There are two sets of official data on employment levels: the Quarterly Employment Statistics (QES), a firm-based survey of payrolls, and the Quarterly Labour Force Survey (QLFS), which surveys households about their work. Unlike the QES, the QLFS also covers the agricultural sector, domestic work and informal employment. The QES shows that formal sector non-agricultural employment remains smaller than its level prior to the global financial crisis, while the state has massively expanded its payrolls (Figure 4), such that as of Q2 18, the government accounted for nearly one in every five formal non-agricultural jobs. With regard to the most recent trends, the latest QES survey showed that total formal sector employment shrank by 69k in Q2 18 compared to Q1 (a loss of 0.7% q/q), but notably, most of the job losses in Q2 (compared to Q1) were a reversal of a Q1 spike in government employment at the Independent Electoral Commission as a result of a big voter registration drive. In fact, private sector employment actually rose by about 2,400 jobs in Q2 compared to Q1, but this mildly encouraging figure does not negate the long-run trend of relative stagnation in private sector employment levels. Notably, the household-based QLFS also supports the view of broadly flat formal sector employment. The QLFS for Q2 18 found that total employment (including agriculture, domestic work and informal employment) fell by 90k q/q to 16.3mn workers, with a broadly flat trend over the past couple of years (Figure 5). The picture of a

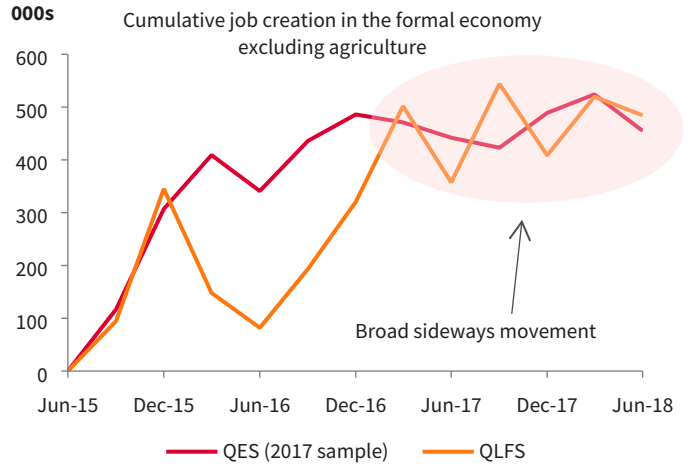
weak jobs market is further supported by survey data for Q3 18 from the Bureau for Economic Research, which found that firms in a variety of sectors across the South African economy – building, manufacturing, retailing, wholesaling, civil construction – are all reporting lower payroll headcount compared to a year ago (Figure 6).

Figure 4: Private sector employment has stagnated since the global financial crisis



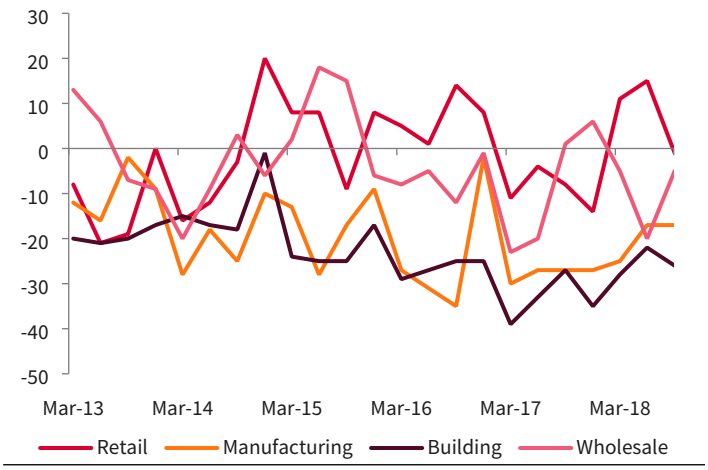
Source: SARB, StatsSA, Absa Research

Figure 5: Both QLFS and QES show sideways movement in employment recently



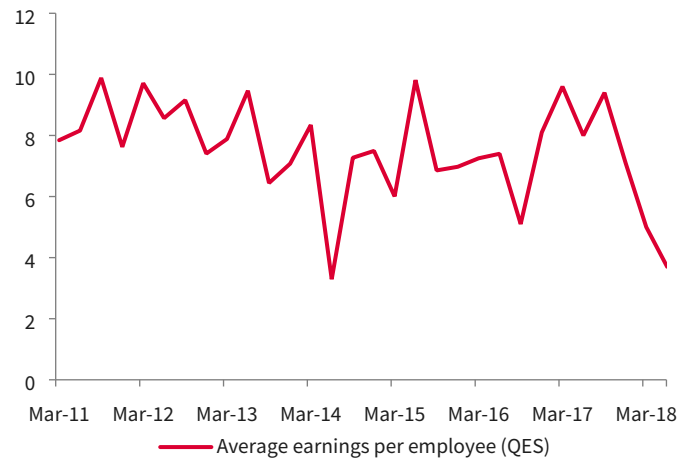
Source: StatsSA, Absa Research

Figure 6: Surveys of firms reveal ongoing declines in staff headcount



Source: BER, Absa Research

Figure 7: Employee wage growth seems to be decelerating



Source: StatsSA, Absa Research

StatsSA's survey of firms in the formal sector suggests that not only have employment levels been stagnant, but wage gains also have been slowly decelerating

The QES survey measures earnings as well as employment levels. Notably, the earnings data also support the picture of a soft jobs market, with a marked deceleration in average monthly earnings. For formal employment as a whole (both private and public sector), the growth in average monthly earnings (including overtime and bonuses) slowed to 3.7% y/y in Q2 from 5.0% y/y in Q1 and an average of 8.5% in 2017 and 6.7% in 2016. The current gold mining wage negotiations will provide another interesting window on this phenomenon. The talks have not yet concluded for the entire industry, but last week AngloGold settled a three-year wage deal at an average annual wage increase of 5.5% for miners, artisans and officials, though the lump sum uplifts for Category 4-8 workers probably works out to a higher percentage increase for lower paid workers.

National accounts data also suggest that employee compensation growth is slowing, with aggregate employee compensation growing just 6.6% y/y in Q2 18

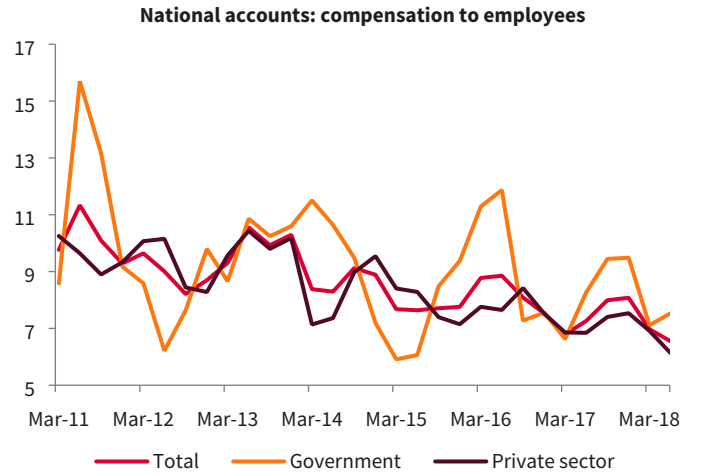
This picture of slowing compensation, derived from surveys of firms' payrolls, is also supported by South Africa's national accounts data, which usefully break down gross value added per production sector (e.g., agriculture, mining, manufacturing, trade and transport) into the share attributable to capital versus the share attributable to labour, or in other words, the share that goes to employee compensation. Thus, national accounts data – to the extent that they are accurate – can provide insight to employee compensation trends over the whole economy, not just the formal

non-agricultural economy covered by the QES. Unfortunately, the QLFS data, which theoretically could be used to calculate labour's share of GDP per employed person for each production sector are simply too volatile to generate a meaningful series in this regard. Nonetheless, what matters from the perspective of household consumption expenditure and its contribution to GDP growth is aggregate household income. South Africa's national accounts data show that the growth in total aggregate employee compensation slowed to just 6.6% y/y (in nominal terms) in Q2 18, the slowest pace since the global financial crisis, presumably as a consequence of both low employment creation and a slow deceleration in wage growth. The national accounts data also seem to confirm the general picture of public sector workers continuing to do better in aggregate than private sector workers; in Q2 18, the growth rate for employee compensation for government workers was 7.5% y/y and for private sector workers was 6.1% y/y as of Q2 18 (Figure 8 below).

Real household disposable income contracted q/q in Q2 18; this series is closely linked to household consumption expenditure patterns

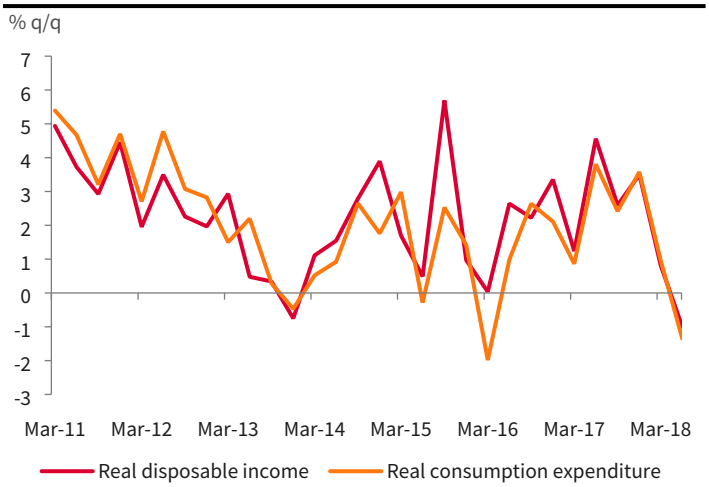
The SARB's economics department conducts various interesting transformations of StatsSA's raw national accounts data. In particular, they take StatsSA's data on the share of GDP attributable to labour and (via the production, distribution and accumulation account identities) add in property income and social benefits, and deduct direct taxes, interest payments, and mandatory contributions and the like to generate a series on disposable income, which they then seasonally adjust. We converted this series into real terms using the household consumption deflator. This transformation presents an interesting picture. It shows that in Q2 18, real household disposable income growth slowed to a mere 1.5% y/y. On a quarter-on-quarter seasonally adjusted and annualised basis, real disposable household income actually contracted for the first time since late-2013. There is a close correlation between real household disposable income and household consumption expenditure (Figure 9).

Figure 8: The growth of aggregate employee compensation fell to 6.6% y/y in Q2 18



Source: StatsSA, Absa Research

Figure 9: Household disposable income and consumption are closely correlated



Source: SARB, StatsSA, Absa Research

The near-term prospects for household disposable income are not very promising, given the bleak outlook for job creation

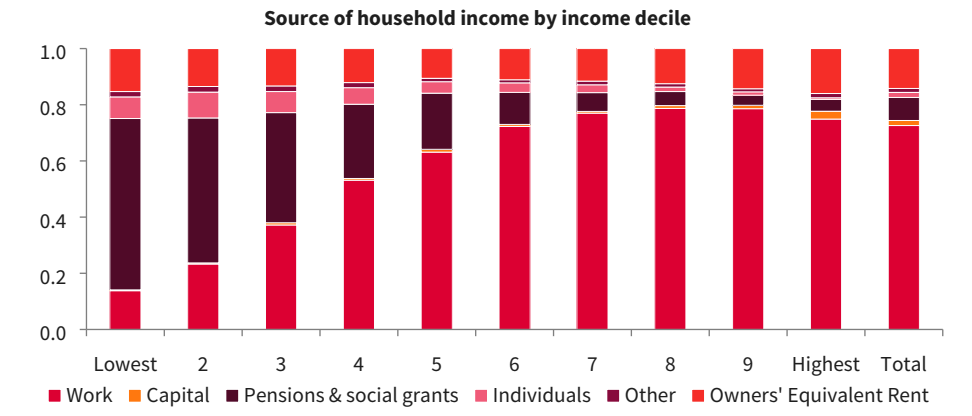
The prospects for household disposable income do not appear to be especially promising in the near term, principally because employment growth is likely to remain limited without stronger GDP growth, and stronger GDP growth is difficult to achieve without a robust consumer. Resolving this chicken and egg situation will be a slow process of structural reform to boost business confidence and productivity. But currently, as noted above, private sector firms covered by the Bureau for Economic Research's quarterly business confidence survey all report downward pressure on headcount. And the state, which has served as the employer of the last resort since the global financial crisis, will inevitably have to shrink headcount to some degree by some mechanism in order to achieve fiscal consolidation, although it continues to promise no mass layoffs. (The latest QES survey shows the three tiers of the government – national, provincial and local – plus extra-budgetary institutions like the IEC and StatsSA employing over 1.9mn people as of Q2 18, with provincial administrations accounting for 54% of this). With regard to employment creation, the mines will be worth watching. Despite massive downsizing in recent years, the mines remain a big direct employer as of Q2 18, accounting for 452k formal sector jobs directly. The recent

depreciation of the exchange rate, combined with the government's adoption of a much more industry-friendly Mining Charter, and its decision to withdraw the inimical pending Mineral and Petroleum Resources Development Act amendment legislation, could ease some of the immediate pressure for labour shedding in the sector, if mining houses respond by upping their investment plans, as promised. But, in general, the overall outlook for employment creation is dim, and although, in general, there is a socio-political dispensation to deliver annual real wage increases in South Africa, the weak economy will exert a grinding downward pressure on nominal wage settlements over time.

Social grants, which accounted for a material share of household income at the lower end of the income distribution, will only be lifted in line with CPI inflation at best due to fiscal constraints

Of course, there are sources of household income other than wages. The 2014/15 Living Conditions Survey found that households on average receive only 72.6% of their total income from work, but of course, the country-wide average marks considerable variation across the spectrum of income and expenditure distributions. Essentially, the percentage of household income derived from 'work' increases with income wealth such that households in the top decile (as regards to income per capita) receive nearly three quarters (74.9%) of their income from work but only 4.2% of their income from pensions and social grants, while for the bottom decile, households earn three-fifths (61%) of their income from pensions, social insurance and family allowances, but only 13.8% from work. Any move to boost social grants would, rather obviously, have a much larger impact on household spending power at the lower end of the income distribution. But despite the social or potential economic desirability of increasing social grants, fiscal constraints suggest that, for now, it is impossible to envisage real increases in budgetary spending on social grants.

Figure 10: Social grants account for a big share of income at lower income levels, but work income matters overall



Source: StatsSA, Absa Research

We think the National Minimum Wage, when it is ultimately implemented, will have a positive effect on consumption, in part because we think it is unlikely to lead to widespread job shedding

There is hardly any topic that is likely to provoke more dissent among economists than the idea of a minimum wage. Some economists argue on the basis of classical supply and demand theory– i.e. that against the backdrop of a big supply of unskilled labour – an increase in price of labour (i.e. the imposition of the National Minimum Wage or NMW) will lead to a big drop in demand (i.e. job shedding by businesses). We are a little more agnostic. International experience, for example in Brazil, has shown that the imposition of the NMW does not necessarily lead to widespread job shedding. Much depends on the level at which the NMW is set and the prevailing macroeconomic backdrop. With the NMW agreed in parliament and an enabling legislation currently sitting in parliament, the issue bears close watching no doubt. There would seem to be a real risk that socio-political pressures could see the NMW being ratcheted up annually from the current determination of ZAR20 per hour, regardless of the strength of the economy. Nonetheless, as a starting point, ZAR20 per hour (ZAR3800 month) does not seem too onerous for most firms' bottom lines. We think formal sector employers will largely comply with NMW because for most of them it will not seriously affect their bottom lines. For the exceptions (especially small businesses) we think compliance will be low, as government will have little ability to enforce NMW across all the employers in the economy. Very conservative assumptions as inputs to a back-of-the-envelope calculation suggest that NMW could ultimately provide a material boost to household incomes, and hence consumption, at the lower end of the income distribution. For example, a couple of years ago, the

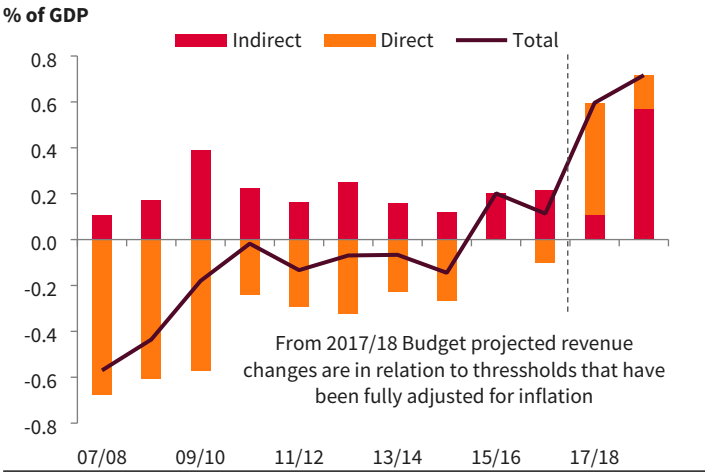
panel established to look at the question of the NMW determined that there were 6.6mn workers in South Africa earning less than ZAR20 an hour. Assuming that through wage inflation this number has now fallen by a third to 4.4mn, and that on average they currently earn ZAR17/hour, and that such workers work for 30 hours per week, and that compliance with the newly mandated hourly wage rate of ZAR20 will be 66%. The product of these reasonably conservative assumptions suggest that NMW could be a boost to household income of around ZAR14bn, or 0.3% of GDP. However, as an offset to this calculation, it is worth remembering that some of the lowest paid workers currently are likely to be in domestic service and agriculture, and the NMW legislation provides for a special dispensation minimum wage in the farming/forestry sector that is 90% of the general NMW, and for domestic workers one which is set at 75% of the general NMW.

2018 Budget tax hikes and petrol price increases have been big headwinds

Another key headwind has been the tax hikes of the Budget, including especially the 1 percentage point increase in VAT to 15%

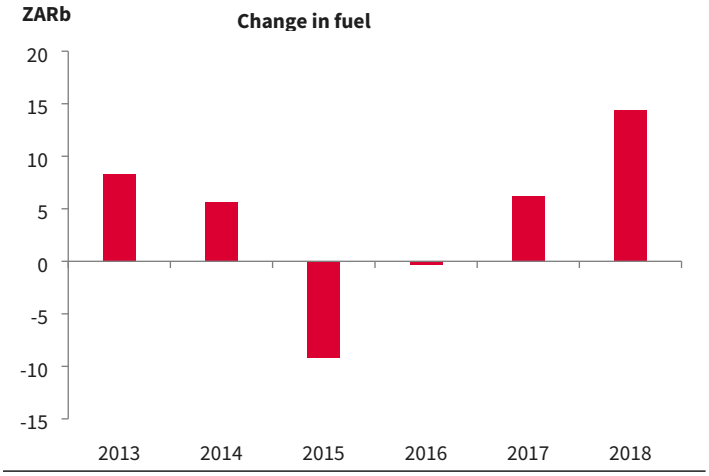
The big tax hikes of the 2018 Budget, including the 1 percentage point increase in VAT to 15%, fell predominantly on consumers. The tax hikes aim to raise some ZAR36bn additional tax revenues above baseline which equates to a drain of about 0.7% of GDP on consumers' wallets (Figure 11). The Q2 national accounts data were the first prints post the Budget tax hikes, and some of the contraction in household spending is likely due to the VAT hikes, especially if consumers pre-emptively bought durable and semi-durable goods in March, after the VAT hike was announced but before it took effect. Some very limited relief may be forthcoming. On 10 August, Finance Minister Nene released the recommendations of the panel he appointed to look into the question of expanding the zero-rated list of goods for VAT purposes. The panel suggested an addition handful of goods (including white bread, flour, nappies, ladies' sanitary productions and school uniforms) to be included at a total cost of ZAR4bn. However, the matter is still being considered and any changes would only be implemented for the Budget in February 2019.

Figure 11: The tax take from the consumer has increased sharply



Source: National Treasury, Absa Research

Figure 12: Consumer spending on petrol will likely increase by 0.3% of GDP this year



Source: SARB, Absa Research

Adverse movements in crude oil prices and the exchange rate delivered a big under-recovery of costs in September, seemingly auguring a further big price increase in October. However, government delayed its usual Friday announcement in this regard.

Another key headwind for the consumer has been the huge fuel price increases, up 17% from their March low (as of the 1 Sept price increase), due to a combination of a weaker rand, higher crude prices and increased fuel taxes. At the beginning of September, the government took the unprecedented step of not fully adjusting fuel prices in line with the automatic monthly cost recovery formula. The government promised that this partial subsidization of the fuel price was a 'one off', no doubt hoping that in October crude oil prices and the exchange rate would move in its favour, thereby allowing it to replenish the resulting ZAR500mn drawdown on the surplus balance in the Central Energy Fund's slate levy account. However, markets have gone in the other direction, such that the average under-recovery in September stood at about 100c/l for petrol and 125c/l for diesel. This would seem to auger big further fuel price increases for October, but notably the government has delayed its announcement, which normally comes out on the last Friday before month end. We do not think that the government has the fiscal resources to subsidize the fuel price

further, but the delay in the announcement could signal that perhaps some further intervention is in the offing.

Assuming the government does not intervene materially in the fuel price, households could be paying an additional ZAR14bn, or 0.3% of GDP, for fuel in 2018.

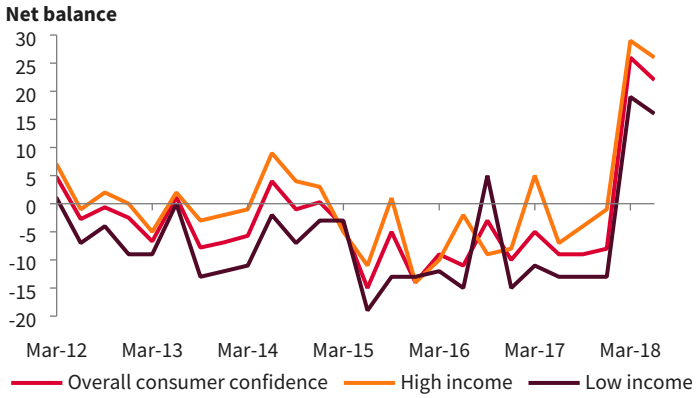
Assuming that fuel prices prices rise another 100c/l in the beginning of October and then more or less flatline for the remainder of the year, the fuel price would average roughly 15% higher this year than in 2017. Of all the goods and services that household consumers buy, petrol is likely to be only the most 'price inelastic' – meaning that the amount demanded by consumers will change very little regardless of its price because it has no substitute and most vehicle journeys are essential. This means households will buy petrol regardless of the price, thus draining spending power that might have been applied to other goods and services. Consumers are usually only able to adjust volumes of petrol consumed very marginally (by means of carpooling or biking or walking instead of driving for small journeys). Thus, although we expect the overall level of CPI to average lower this year than it did last year (forecasting 4.6% average in 2018 versus 5.3% in 2017), the fact that the inflation is manifesting heavily in petrol is of particular adverse relevance to household disposable income. The SARB's calculations on StatsSA's data show that South Africans spent ZAR97.4bn on petroleum products in 2017, which was about 3.5% of total household consumption expenditure, and roughly 7.3bn litres of fuel. Assuming a 1% drop in consumption volumes, consumers will still have to cough up an additional ZAR14bn this year for petroleum products relative to last year, a negative hit to spending power worth 0.3% of GDP or about 0.5% of household disposable income (Figure 12). But of course, the H1 18 story is now "booked" in this regard. How much worse, for household consumption spending, will H2 be compared to H1? Even assuming a 2% volume drop between H1 and H2, consumers would still be paying an additional ZAR5bn – about 0.2% of GDP – for fuel in H2 compared to H1. By way of comparison, at current household debt levels, a 25bp move in the repo rate is worth about ZAR4bn over the course of a year, assuming it is fully passed on to debtors.

Elevated confidence levels in Q2 18 unlikely to be sustained

Against all the headwinds, the apparent elevated consumer confidence as measured by the BER survey for Q2 18 is surprising, but we think it is unlikely to be sustained

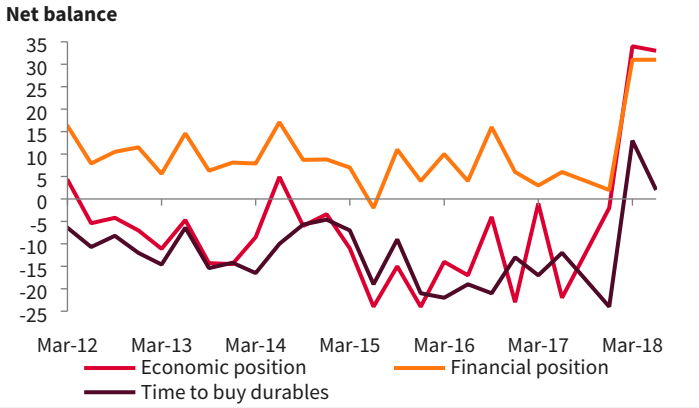
Against all these headwinds, we thus find ourselves encouraged, but also rather perplexed by the Bureau for Economic Research's Q2 consumer confidence survey, the fieldwork for which was conducted on 20 April and 7 June 2018. This survey shows consumer confidence levels remaining exceptionally elevated, close to their Q1 Ramaphoria peaks (Figure 13). Households' assessment of whether it was the right time to buy durables did ease somewhat in Q2, but households' confidence in the economy in general and in their own financial position remained close to record levels (Figure 14). Yet, such elevated consumer confidence is at odds with the recent narrative of anecdotal evidence and we would strongly expect the consumer confidence print for Q3 18, due out sometime in mid-November, to come down sharply.

Figure 13: Consumer confidence remained surprisingly high in Q2 18…



Source: Bureau for Economic Research, Absa Research

Figure 14: …although sentiment about buying durables eased



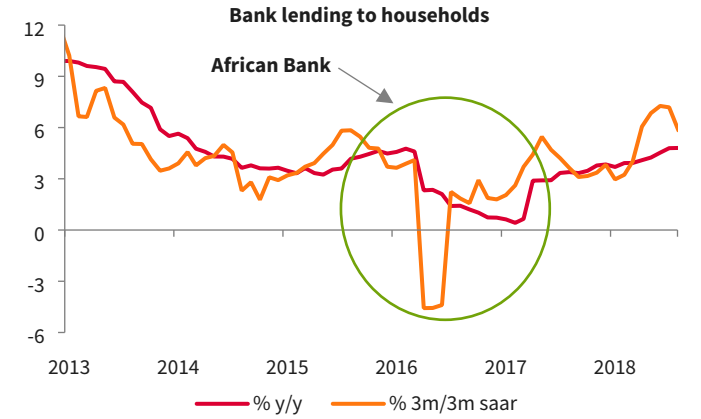
Source: Bureau for Economic Research, Absa Research

Household borrowing is picking up, but only very slowly, despite banks' willingness to lend.

As regards to the prospects for household spending, if consumer confidence was really as high as the BER survey suggests, one might expect a much stronger pace of borrowing, especially since the repo rate has been cut by 50bp in the current cycle. And yet, while household borrowing from banks has been creeping up, it remains fairly muted at 4.8% y/y, and some recent signs of momentum in household borrowing (calculated by 3-month on 3-month seasonally adjusted and annualised

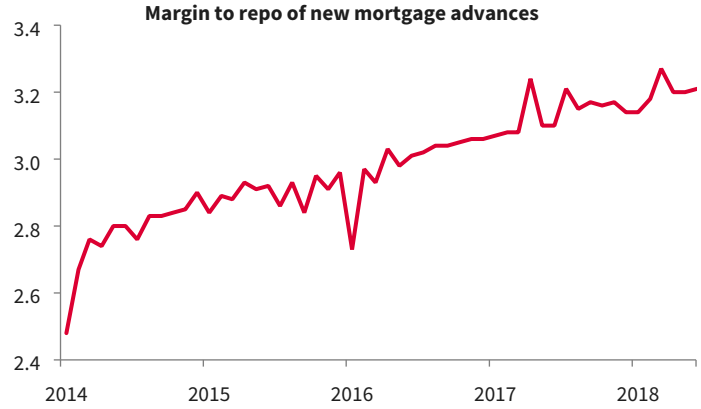
percentage change) appear to have ebbed in the August print (Figure 15). National Credit Regulator data show rejection rates on credit applications continuing to ease, with the total rejection rates on credit applications coming in at 48.5% in Q1 18, the lowest since 2011, suggesting that it is not really a lack of credit availability that has been keeping credit growth subdued. Interestingly, however, even though credit may be available generally, at least to the more creditworthy borrowers, it may be coming in at a relatively higher price, SARB data show that since the end of the global financial crisis, the spread of new mortgage lending rates above the repo rate has increased by over 100bp between the end of 2009 and mid-2018 to about 3.2 pp. To take a more recent focus, although the SARB cut the repo rate twice for a total of 50bp easing between June 2017 and mid-2018, the SARB's data show the average lending rate on new mortgage advances actually increasing by 8 basis points over this period. And proposed amendments to the National Credit Act, which are currently being considered by parliament, and which would require lenders to write off debt and expunge the records of defaults for certain types of defaulting low income borrowers could instead serve to restrict the supply of credit to such borrowers.

Figure 15: Bank lending to households is slowly picking up



Source: SARB, Absa Research

Figure 16: Banks have been increasing their lending margins over repo



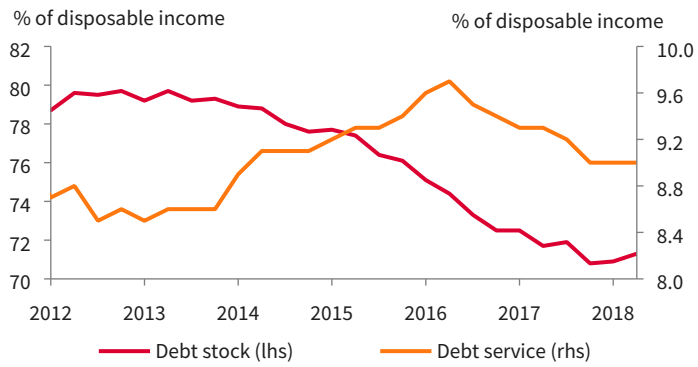
Source: SARB, Absa Research

Consumers seem reluctant to borrow for optional purchases

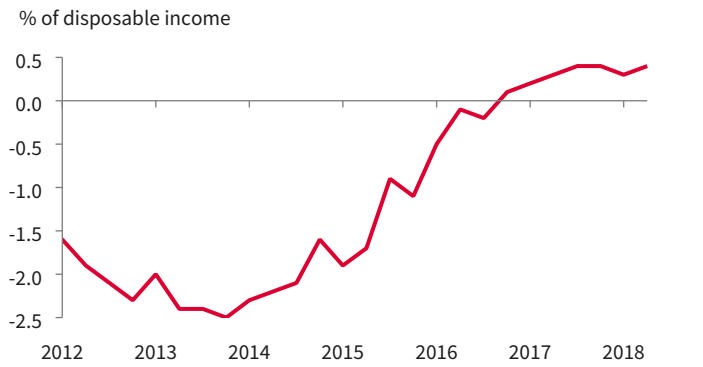
However, we doubt that it is just a higher price for credit that is deterring borrowers. We note that SARB QB data show that household deleveraging accelerated post 2016, even though the cost of servicing the debt as a ratio of disposable income started to fall at this point (Figure 17). Consumers have been incredibly defensive over the last few years, sharply increasing their net savings behavior (Figure 18). Overall, we think consumers – despite the apparent surge in Ramaphoria-induced confidence in Q1 and Q2 – are simply less willing to borrow to fund optional expenditure, having been traumatised by the debt burdens of the global financial crisis and the splurge of seemingly cheap but actually unaffordable credit in the subsequent unsecured lending boom domestically. Thus, we suspect that the zeitgeist has changed, and not just in South Africa, but globally as well; consumers simply do not want to contract debt for optional spending. But they may, during a difficult downturn, such as the current one, be willing to borrow to fund essential spending.

Figure 17: Households have delivered substantially in recent years…

Figure 18: …and have started positive saving



Source: SARB, Absa Research

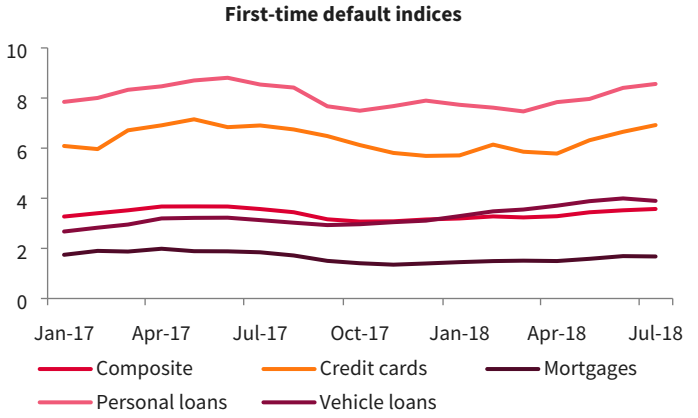


Source: SARB, Absa Research

Some very tentative signs that household balance sheets may be coming under strain

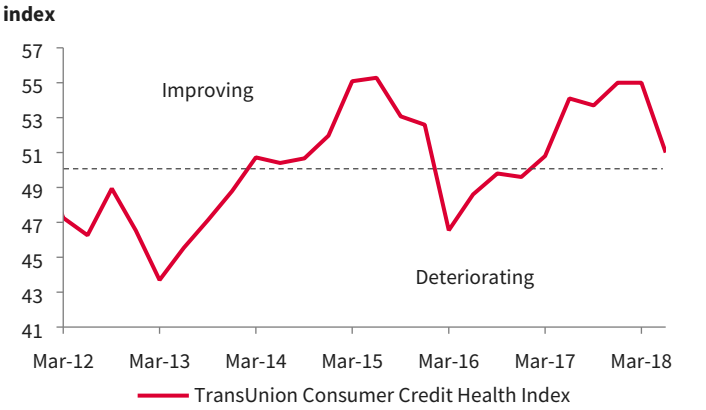
Additionally, there are now some signs that household balance sheets may be coming under some increased strain. For example, Experian, a local credit bureau, produces various indices of first-time consumer credit defaults, and these have all recently ticked up slightly (Figure 19). For example, the composite index rose from 3.52 in June to 3.57 in July, up from a recent low of 3.07 in October 2017. These are not big surges, but they do suggest that the tide may have started to turn. Moreover, TransUnion, another credit bureau, produces a quarterly index of consumer credit health based on payment behaviour and income flows, and it showed a sharp Q2 fall in credit health (albeit to still within improving territory from 55 to 51 (Figure 20). Meanwhile, the market is keenly awaiting a data update from the National Credit Regulator, which provides the most comprehensive age analysis of the consumer debt book. The Q2 18 data are due out imminently. The Q1 18 data do not show any big increase in actual arrears (defined as loan payments overdue more than three months) but they do show a bit of an increase in payments that are 1 to 3 months overdue (Figure 21). And these might conceivably have lengthened into actual arrears more than three months' overdue in the second quarter. Anecdotal reports suggest the situation could be worsening in the third quarter, although it will take a while before the hard data become available.

Figure 19: First time default behaviour rising slightly in 2017



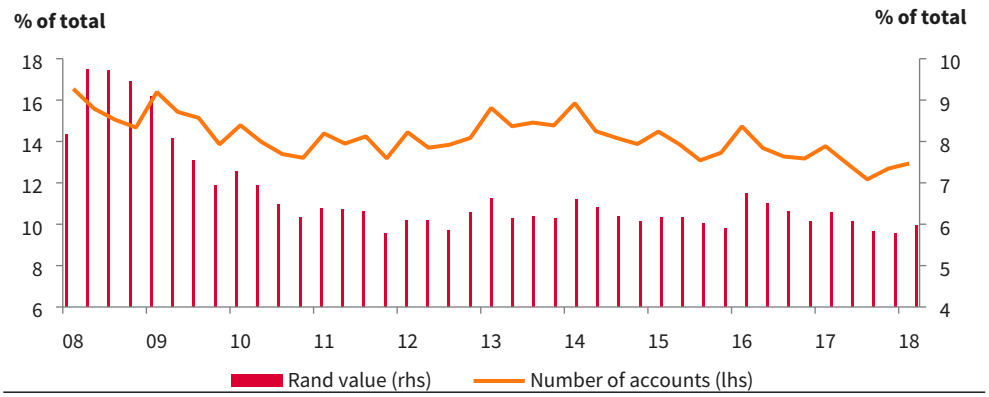
Source: Experian, Absa Research

Figure 20: Deterioration in consumer credit health in Q2 18



Source: TransUnion, Absa Research

Figure 21: …but fresh overdues of 1-3 months age picked up slightly in the first quarter



Source: National Credit Regulator, Absa Research

Despite the best efforts of economists and other seers to forecast the future, it remains, to a very significant degree, uncertain and unpredictable. Nonetheless, the prospects for household consumption do not appear terribly promising. Unless President Ramaphosa's stimulus package quickly kick-starts the economy onto a substantially higher growth path, with a much stronger pace of job creation, household incomes will remain under pressure. Hopefully, petrol prices may ease if shale gas production comes on stream quickly in volume, and crude prices and/or USDZAR falls, but this is a hope, rather than a probability. And of course, South Africa's ongoing fiscal challenges suggest that the tax burden on consumers will remain pressing for some time. One might only expect the tax burden to begin to ease materially if stronger growth comes to the rescue of the fiscus. We expect some pick-up in household recourse to credit-financed consumption spending, but it will be marginal rather than a chunky support. Our macroeconomic econometric forecast based on Q1 data put household consumption spending growing less than 2% per annum in 2018 and 2019, and rising slightly above thereafter. There is little reason, since the last Quarterly perspectives was published on 6 July, to believe that the imminent forecast update will change this picture materially.

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