ABSA

Economic Research

1 June 2018

The South African consumer

Constrained but not in crisis

- Household consumption surprised to the upside last year, expanding by 2.2% despite big increases in personal income tax and weak credit extension. Falling inflation, especially on price inelastic goods such as food and petrol, helped to lift consumers' real incomes. And as far as jobs are concerned, while the dominant narrative was of a stagnant labour market, formal employment actually expanded by 2.5%.
- There are various headwinds that could constrain consumption this year. The 2018 Budget implemented further consumer-related tax increases worth 0.7% of GDP, most notably a one percentage point hike in VAT, which will likely be harder for consumers to avoid than the personal income tax increases of the previous year. Petrol prices have also risen sharply and food price inflation will also pick up anew.
- Formal sector employment is likely to remain weak with projected growth of 0.3-0.4% per annum in 2018 and 2019, but nominal wage increases look likely to remain fairly elevated, so aggregate real income growth is likely to be stronger this year than last (given that CPI inflation should average lower in 2018 than in 2017).
- Relative to other factors, the 50bp of easing in the current cycle offers only marginal assistance to consumers, with each 25bp cut worth less than 0.1% of GDP over the course of a full calendar year.
- The sharp apparent increase in consumer confidence in Q1 18 to record highs should serve to boost credit extension to households. Absa forecasts sizeable growth in household borrowing of 6.3% this year, up from 3.8% last year, but so far there is no sign of a pickup. The monetary aggregates for end-April show bank credit to households rising by just 4.1%.
- Consumer creditworthiness looks to be in good shape. Net wealth improved over 2017, household savings moved back into positive territory, National Credit Regulator data show declining household debt arrears, and two credit bureaus' own indices of consumer credit health suggest that households are in reasonable shape.
- We will be watching the Q1 18 household consumption data closely when they are published with the full national accounts data on 5 June. We expect consumption to contract in Q1 but to recover thereafter. We forecast consumption growth of 1.8% this year and 2.4% in 2019. Interestingly, the SARB MPC said recently that it expected household consumption to be the main driver of growth going forward, expanding by less than 2% in 2018 and 2019 but rising to 2.5% in 2020.

Peter Worthington
+27 21 927 6525
peter.worthington@absacapital.com
Absa, South Africa

Miyelani Maluleke
+27 11 895 5655
miyelani.maluleke@absacapital.com
Absa, South Africa

www.absa.co.za

PLEASE SEE ANALYST CERTIFICATIONS AND IMPORTANT DISCLOSURES STARTING AFTER PAGE 7

The consumer is an important driver of overall economic performance in South Africa, accounting for three fifths of GDP

In 2017 household consumption spending accounted for about 61% of GDP in South Africa. Thus, "the consumer" is a key driver of growth and broader economic health. This report examines recent data on household spending and other consumer related metrics. We find that, while spending is likely to remain somewhat subdued in the face of modest credit growth, weak job creation and rather large tax and petrol price increases, there is scant evidence of any crisis. Of course, for a country like South Africa, with its exceptionally wide income disparities and cultural differences, any talk of "the consumer" can be somewhat misleading. Income and expenditure trends can vary widely from one individual to another. We forecast total household consumption growth of 1.8% this year and 2.4% in 2019.

Household spending was surprisingly robust last year

Real household consumption expenditure growth of 2.2% last year overshot most expectations, given a variety of headwinds

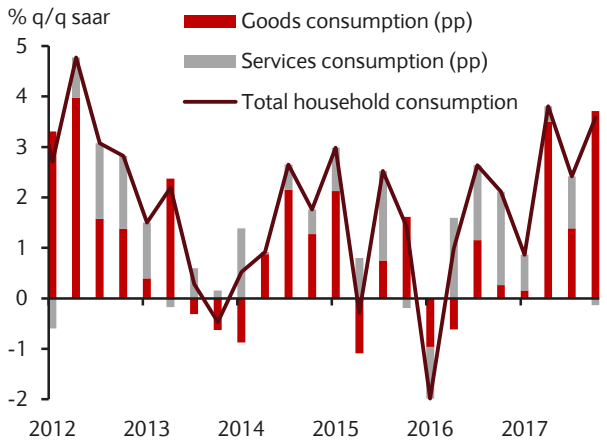
Last year, household consumption spending proved surprisingly robust, growing by 2.2% overall (Figure 1). This contrasts markedly with our forecast in the January 2017 Quarterly Perspectives that it would expand by just 0.9% and National Treasury's forecast (in the 2017 Budget) of 1.3%. We had thought that weak household confidence, subdued bank lending to households, a moribund job market, and hefty income and indirect tax increases in the 2017 Budget would have easily outweighed the benefits accruing to consumers' wallets from declining inflation (as nominal income growth remained elevated) and the 25bp rate cut by the SARB MPC in July. In the end, however, household spending surprised greatly to the upside, with especially strong spending on durables (Figure 2).

Consumer spending looks to have collapsed in the first quarter with retail sales and car sales both contracting compared to Q4 17

Of course, the past is not quite as interesting as the future, and the question is to what extent consumer spending will remain similarly robust in 2018 despite persistent headwinds this year. Certainly the early omens do not appear very positive. Retail spending, which accounted for 36.4% of total household consumption spending in 2017, fell dramatically in the first quarter, by 5.2% q/q saar (Figure 5). The last time real retail sales contracted so dramatically on a quarterly basis was in the depths of the global financial crisis, when total household consumption also contracted. Nor does the picture look much different if the statistically opaque miscellaneous category of "other" retail spending is stripped out (see box for further explanation). Excluding the "other" category, real seasonally adjusted retail sales still shrank by 3.6% q/q saar in Q1 18. Other metrics such as car sales, which accounted for 61.4% of durable spending and 4.6% of total household consumption in 2017, also suggest that personal consumption expenditure will probably have contracted in Q1 18. The National Association of Automobile Manufacturers of South Africa reported an 8.8% q/q saar drop in the number of passenger cars sold domestically in Q1 18, while Statistics South Africa's monthly data series on the value of new motor vehicle sales show a real 4.7% q/q saar contraction in Q1 18 (Figure 4).

FIGURE 1

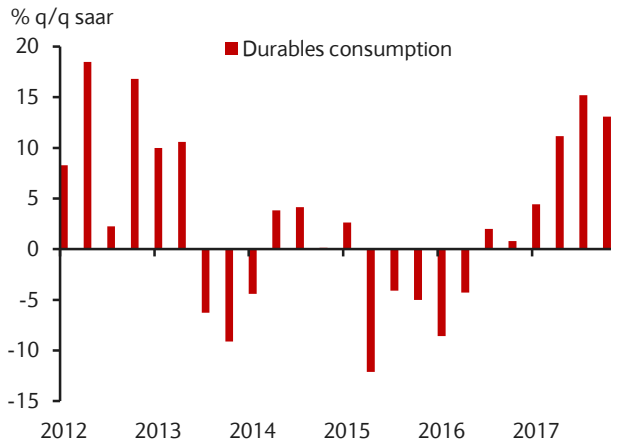
Strong household spending in 2017…



Source: Statistics South Africa, Absa Research

FIGURE 2

…especially on durable goods



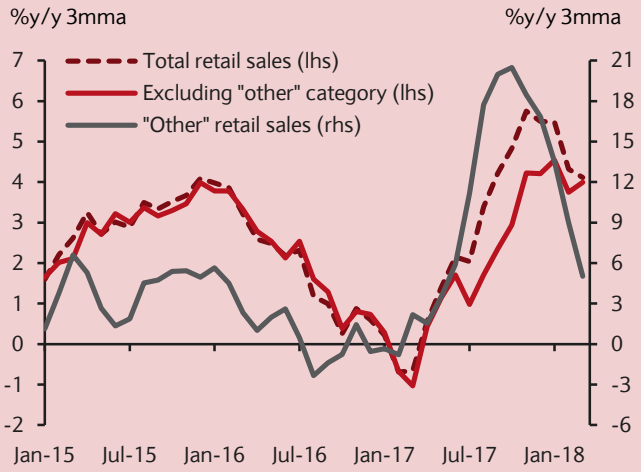
Source: Statistics South Africa, Absa Research

Quirks in the retail sales data in 2017 look to be abating

The data on total retail sales in 2017 were skewed somewhat by the "other" category of retail spending, which includes book and stationery stores, jewellery stores, sporting goods and entertainment equipment stores, personal and household goods, repair shops, other specialized stores, second-hand stores and online sales. This miscellaneous category of retail sales, which accounted for 11.2% of total retail sales in 2017, exhibited rather odd behaviour last year, with real growth rates peaking at 20.7% y/y in November 2017 before falling back to just 3.8%y/y in March 2018 (Figure 4). Statistics South Africa have hinted that this was due to strong sales of Krugerrands in the 50th anniversary year, but this explanation does not seem entirely satisfactory to us. Sales volumes would have had to nearly doubled in 2017 from the 1.1 mn ounces sold in 2016 to fully account for the 13.5% increase (worth ZAR13.4bn) in nominal sales in this category in 2017. But Rand Refinery data show sales volumes rising from 1.2mn oz in FY 2016/17 only to 1.6mn in FY 17/18.

FIGURE 3

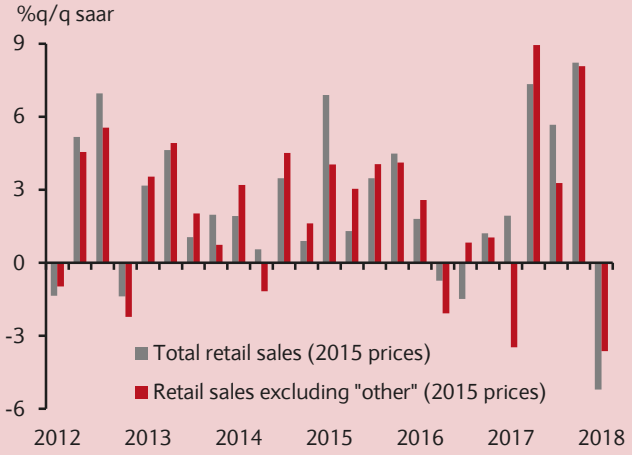
"Other" retail sales had an inexplicable surge in 2017…



Source: Statistics South Africa, Absa Research

FIGURE 4

…but even excluding them retail sales collapsed in Q1 18



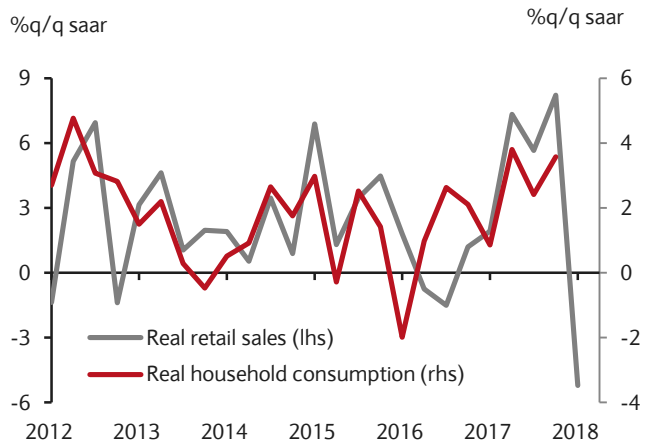
Source: Statistics South Africa, Absa Research

We think the first quarter contraction in household spending will likely prove temporary

Of course, some of this likely Q1 18 contraction in total household spending likely reflects the relatively new phenomenon of Black Friday sales promotions on the last Friday in November, which seem to have gathered a bolus of household spending, especially on durables and semi-durables, into the fourth quarters over the past couple of years, at the expense, it would seem, of household consumption in the first quarters. However, one should not overstate the impact of this phenomenon on total household consumption patterns. Durables and semi-durables together accounted for less than 16% of total consumption in 2017. Nonetheless, our latest demand-side macroeconomic model run suggested a 1.8% q/q saar contraction in household consumption spending in Q1 18. At any rate, investors will not have long to wait to see the Q1 18 demand-side GDP data: Statistics South Africa is due to publish them on 5 June.

FIGURE 5

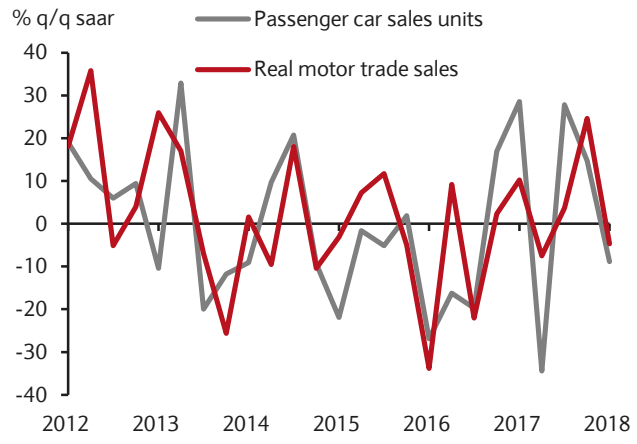
Big 5% annualized contraction in real retail sales in Q1 18…



Source: Statistics South Africa, Absa Research

FIGURE 6

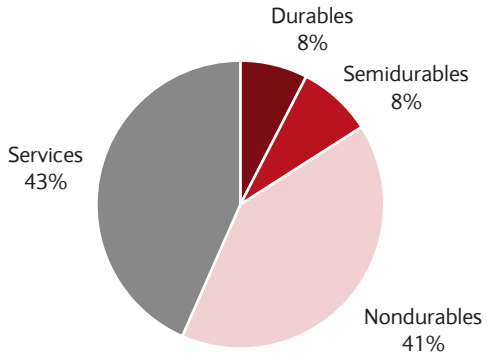
…and spending on new cars also fell compared with Q4 17



Source: Statistics South Africa, Absa Research

FIGURE 7

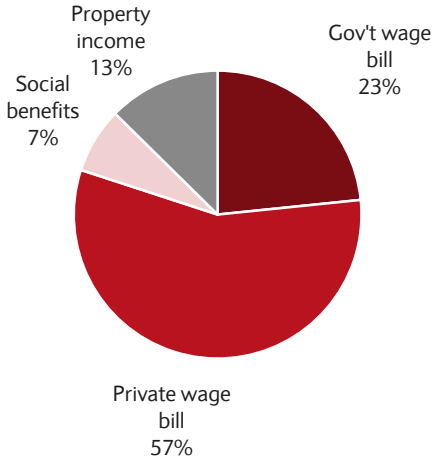
Durables were just 8% of household consumption in 2017



Source: Statistics South Africa, Absa Research

FIGURE 8

Private sector wages were 57% of household income in 2017



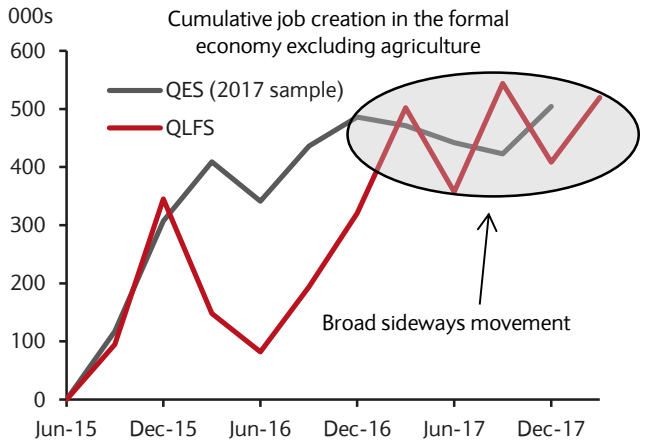
Source: SARB, Absa Research

Job creation is the most important driver of consumption trends in the long run, but the outlook is not particularly promising, given South Africa's low skills levels and the Fourth Industrial Revolution

Again, however, it is the future that is most of interest here. What happens after Q1 18, for the remainder of the current calendar year, and into 2019? Obviously, the most important driver of growth is household incomes, and underpinning incomes are jobs. Alas, the news on the jobs front is mixed. Data from the household-based Quarterly Labour Force Survey (QLFS) show formal sector employment in the formal non-agricultural economy increasing by 111k in Q1 18, while employment collectively in agriculture, domestic services and the informal sector increased by 95k. However, this is just one print and does not seem to reflect a trend; the quarter to quarter data on formal employment from the QLFS as well as from the Quarterly Employment Statistics (QES), a payrolls-based survey of VAT registered enterprises, are volatile but have trended broadly sideways since the end of 2016 (Figure 9). With a low elasticity with respect to growth, especially given South Africa's weak skills levels against the backdrop of the burgeoning Fourth Industrial Revolution, employment creation is likely to remain poor, in our view, unless growth accelerates sharply, absent a raft of policy interventions to boost labour absorption. Looking ahead, surveys of companies by the Bureau for Economic Research (BER) show that most employers have generally been keen to shrink their payrolls, although the survey of the retail sector in Q1 18 for the first time since 2016 suggested some greater willingness to hire (Figure 10). However, this is likely not

FIGURE 9

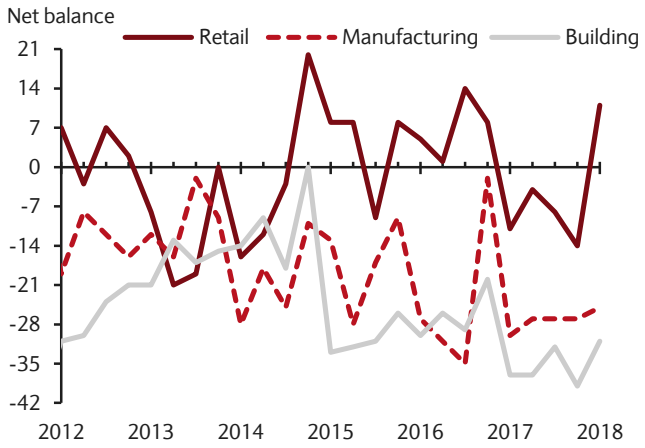
Formal sector job creation has flatlined since end-2016



Source: Statistics South Africa, Absa Research

FIGURE 10

Firms in the formal sector have wanted to shrink payrolls



Source: Bureau for Economic Research, Absa Research

enough to offset caution elsewhere in the economy, especially given that South Africa's mining industry continues to shrink employment, while the severe fiscal constraints mean the government can no longer increase its staffing as it has done aggressively since the global financial crises. We are willing to entertain the idea that the so-called "gig economy" may be providing more jobs and incomes than are captured in surveys by Statistics South Africa or the Bureau for Economic Research. For example, we doubt that employment created by Uber and Airbnb and similar internet-based matching services is being properly recorded, despite the fact that the QLFS, by design, is supposed to capture everyone in some form of paid employment or self-employment. Absa's demand-side macroeconomic model run after the release of the Q1 18 SARB Quarterly Bulletin (which had national accounts and balance of payments data to end-2017) forecast job creation of just 0.3% in 2018 and 0.4% in 2019 after surprisingly strong growth of formal sector employment of 2.5% in 2017. Given total gross earnings of ZAR2506bn in 2017 (according to the QES), an employment increase (assuming average wage) of 0.3% would be worth about ZAR7.5bn more consumption spending, if nominal wages remained unchanged. But of course, they never are (see below).

Wages account for four-fifths of household incomes, so small changes in the pace of wage growth can make a big difference to household incomes and spending

While jobs are the root driver of household consumption, they manifest through wages, which account for 80% of household incomes (Figure 8). And of course, nominal wages in South Africa inevitably increase from one year to another. The weighted average of both private and public sector wages is projected in our model to grow around 6% in 2018 and 2019 (average of increase both private and public sector wages), which combined with projected employment creation, generates projected household income growth of ZAR138bn this year and ZAR 143bn next year (Figure 11). Once other sources of income are factored in, such as social transfers and income from property, the projected increases in household disposable income amount to ZAR193bn this year, little improved from ZAR 191bn in 2017 and ZAR199bn in 2019. Given the magnitudes involved, it is not difficult to see how a small difference in the level of average wage settlements translates into fairly sizeable differences in household disposable income.

National Minimum Wage to be introduced at some point this year could also help to support household consumption

New labour market legislation may also help to support household consumption, to the extent that it does not spark widespread job losses. With some 6.6mn workers in South Africa currently working for less than the planned National Minimum Wage (NMW) of ZAR20 per hour, the NMW legislation, which is yet to be completely processed by parliament, could also support consumption, although the magnitude of the support will depend on the degree of employers' compliance with the new rules. Assuming, however, that the 6.6mn workers are currently working for an average of ZAR15 hour and they work

for 40 hours a week, for 48 weeks a year and employer compliance is 75% the additional uplift to household incomes would be about ZAR48bn, roughly 1% of GDP. This is a very rough calculation which assumes no offsetting job losses from the imposition of NMW, and ignoring the special dispensations for workers in domestic service and agriculture, and for employers, for example in the furniture manufacturing industry, who may apply for and receive an exemption on the grounds of affordability.

Nominal wage settlements are likely to remain elevated, despite the decline in inflation which should support real income growth

Overall, we think the near-term risks to our wage growth forecast for 2018 of 6% probably lie to the upside, with nominal wage adjustments not falling in line with lower inflation and declining inflation expectations (much to the chagrin of the SARB). The bus industry, which employs 17,000 drivers nationwide, is a case in point. After a drawn-out four-week strike, employers settled in mid-May at 9% in the first year and 8% in the second year plus some expensive benefit adjustments (such as standby pay for the relief drivers on long-distance journeys), compared with CPI inflation of 4.5% y/y at the latest measure. The public sector wage deal also looks set to somewhat outpace inflation, with even the government's latest offer (which some unions refuse to sign) seeming to offer wage and benefit adjustments somewhat in excess of the 7.3% total uplift pencilled into the 2018 Budget for employee compensation in FY 2018/19. Of course, one must recognize that private sector wage settlements include those for non-unionized workers, who may not fare as well as South Africa's bus drivers, for example, but even so we think average nominal wages will on balance remain sticky and not fall quickly. We will run our macroeconomic model again once the full Q1 18 macroeconomic data set is published with the next SARB Quarterly Bulletin on 21 June.

FIGURE 11

Absa macro model output on employment, wages and consumption

%y/y, except as noted	2016	2017	2018	2019
Total employment	0.3	2.5	0.3	0.4
Private sector	-0.1	3.3	0.5	0.6
Government	2.4	-3.0	-0.7	-0.8
Wage rates*	7.6	6.1	6.1	5.9
Private sector	8.5	4.3	6.0	5.6
Government	5.4	10.4	6.3	6.5
Wage bill	8.3	7.6	6.2	6.1
ΔZARbn	158	156	138	143
Household income	8.2	7.4	6.9	6.7
ΔZARbn	196	191	193	199
Real household income	1.9	2.7	1.6	2.3
Real household consumption	0.7	2.2	1.8	2.4
Durables	-4.9	6.0	3.0	2.7
Semidurables	2.9	3.1	3.9	2.7
Nondurables	0.9	1.1	1.7	1.8
Services	1.3	2.3	1.2	2.6

*Weighted 29% public sector, 71% private sector average nominal wage increase. Source: StatsSA, Absa Research

Budgeted tax increases are a big headwind to consumption spending

Obviously, consumers do not get to spend all their wages. Even before they can consider savings, the taxman and creditors take a chunk of their earnings. Sizeable consumer-related tax increases in the past two budgets have been, and will continue to be, a material headwind to household consumption growth. We were somewhat surprised that household consumption performed as well as it did in 2017, after tax policy changes in the 2017 Budget that aimed to raise the tax take (above baseline) in 2017/18 by ZAR28.0bn, worth

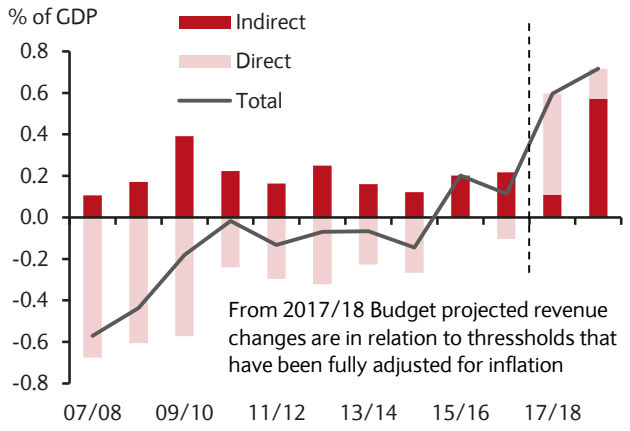
0.6% of GDP (Figure 12). Of this total increase, about three quarters fell on consumers, including a projected ZAR16.5bn increase in PIT receipts though incomplete adjustment for fiscal drag (ZAR 12.1bn) and a higher top marginal rate of income tax (ZAR 4.4bn). However, as Figure 14 shows, despite the planned increase in the total tax take, collections actually fell considerably short, by ZAR49.0bn, a little over 1% of GDP, with nearly three quarters of the shortfall coming in the consumer-related categories of PIT (ZAR21.1bn) and VAT (ZAR14.8bn) thereby leaving money in consumers' wallets relative to what the budget envisaged. Of course, the shortfall was probably due to some combination of unexpected patterns of economic activity (including mainly weaker than expected growth) and changed levels of compliance, and it is rather difficult to disentangle these two broad causative factors. For example, VAT receipts last year also came in substantially below expectations (down relative to budget targets by ZAR14.8bn), even though real household consumption spending held up relatively well, at least until Q1 18, although this would have been at least partly offset by lower than anticipated inflation. Interestingly, as regards tax compliance it is notable that tobacco excise duties came in at ZAR4.2bn (0.1% of GDP) below projections last year. Given that tobacco prices rose by 4.6% in FY 2017/18, and consumption volumes are unlikely to have declined much given how notoriously addictive nicotine is, the large 26.8% shortfall of receipts relative to budget targets likely reflects a degree of cigarette smuggling, ie, reduced tax compliance.

We think the resort to a VAT hike will make it harder for consumers to avoid a higher tax contribution, especially if SARS moves quickly under its new leadership to restore better tax compliance

For this year, caught between a rock and a hard place, National Treasury was forced to further tighten the tax squeeze on consumers in the 2018 Budget, with tax policy changes for FY 2018/19 aimed at collecting a further ZAR36bn (0.7% of GDP) above the baseline. Almost all of this falls on consumers. Notably, this year's tax hikes included a 1 percentage point hike in VAT, aimed at collecting ZAR22.9bn (Figures 12 and 13). Notwithstanding last year's surprising shortfall in VAT receipts relative to the budget target, we would argue that it would seem to be easier for consumers to avoid paying PIT than VAT, and thus at least in respect of consumer-related tax collections, performance to this year's budget targets should be higher. (However, we should note that Finance Minister Nene has appointed a high level panel to investigate whether or not to expand the list of zero-rated VAT items in order to better insulate the poor from the impact of the VAT hike, potentially with some negative impact for the fiscus, but presumably positive for lower income consumers' purchasing power.) Nonetheless, we think that political changes generally in South Africa, plus the efforts of the new leadership

FIGURE 12

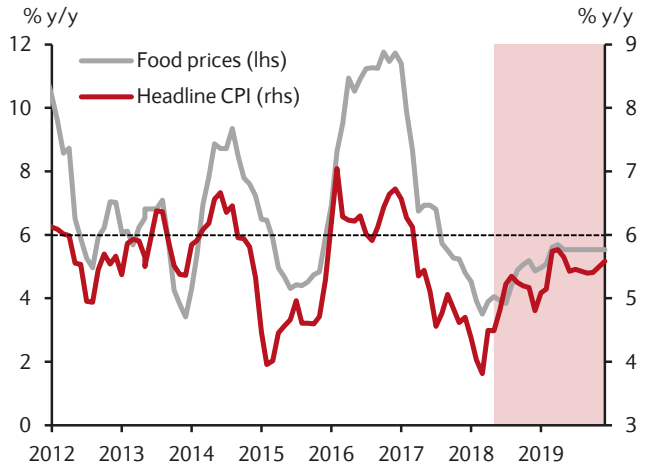
Tax increases over the last two years amount to 1.3% of GDP



Source: National Treasury, Absa Research

FIGURE 13

Inflation is likely to pick up, eroding real incomes more



Source: Statistics South Africa, Absa Research

FIGURE 14

Big tax shortfalls in 2016/17 and 2017/18 in the PIT and VAT categories

	2016/17						2017/18						2018/19		
	Before tax proposls	After tax proposals	Projected difference	Amount collected	Actual difference	Projected less actual	Before tax proposls	After tax proposals	Projected difference	Amount collected	Actual difference	Projected less actual	Before tax proposls	After tax proposals	Projected difference
PIT	446.7	441.0	-5.7	424.5	-22.1	-16.5	465.6	482.1	16.5	461.0	-4.6	-21.1	498.3	505.8	7.5
Taxes on companies	222.5	223.5	1.0	236.0	13.5	12.5	246.6	253.4	6.8	246.0	-0.6	-7.4	263.0	262.7	-0.4
CIT	197.3	198.3	1.0	204.4	7.1	6.1	218.7	218.7	0.0	217.4	-1.3	-1.3	231.6	231.2	-0.3
STC/DWT	25.2	25.2	0.0	31.6	6.3	6.3	27.9	34.7	6.8	28.6	0.7	-6.2	31.5	31.5	0.0
Taxes on payrolls	17.6	17.6	0.0	15.3	-2.3	-2.3	16.6	16.6	0.0	16.0	-0.6	-0.6	16.9	16.9	0.0
Taxes on property	15.4	15.5	0.1	15.7	0.3	0.2	17.0	16.5	-0.4	16.6	-0.4	0.1	17.2	17.3	0.1
Estate duties	2.0	2.0	0.0	1.6	-0.4	-0.4	2.1	2.1	0.0	2.3	0.2	0.2	2.6	2.7	0.2
Transfer duties	8.0	8.1	0.1	8.2	0.2	0.1	8.9	8.4	-0.4	7.7	-1.1	-0.7	8.3	8.3	0.0
VAT	301.3	301.3	-0.0	289.2	-12.1	-12.1	312.8	312.8	0.0	298.0	-14.8	-14.8	325.2	348.1	22.9
Domestic VAT	322.4	322.4	-0.0	321.5	-1.0	-1.0	344.8	344.8	0.0	336.3	-8.5	-8.5	363.0	378.6	15.6
Import VAT	164.0	164.0	-0.0	149.3	-14.7	-14.7	162.3	162.3	0.0	152.8	-9.5	-9.5	162.2	169.5	7.3
Refunds	-185.2	-185.2	0.0	-181.6	3.6	3.6	-194.4	-194.4	0.0	-191.1	3.3	3.3	-200.0	-200.0	0.0
General Fuel Levy	57.7	64.5	6.8	62.8	5.1	-1.7	67.7	70.9	3.2	70.9	3.2	0.0	76.3	77.5	1.2
Specific excise duties	39.0	41.3	2.3	39.2	0.2	-2.1	41.6	43.5	1.9	41.1	-0.4	-2.4	43.4	44.8	1.5
Alcohol excise duties	19.3	20.8	1.5	20.7	1.4	-0.1	20.4	21.7	1.3	23.4	3.0	1.7	24.8	25.7	0.9
Tobacco duties	14.1	14.8	0.8	12.6	-1.4	-2.2	15.0	15.7	0.7	11.5	-3.6	-4.2	12.0	12.4	0.4
Ad valorem taxes	3.3	3.3	0.0	3.4	0.1	0.1	3.6	3.6	0.0	3.8	0.1	0.1	4.1	4.2	0.1
Health promotion levy													0.0	1.9	1.9
Customs duties	54.5	54.5	0.0	46.1	-8.4	-8.4	53.6	53.6	0.0	49.9	-3.7	-3.7	52.9	54.1	1.1
Gross tax revenue	1 169.8	1 174.8	5.0	1 144.1	-25.7	-30.7	1 237.5	1 265.5	28.0	1 216.5	-21.0	-49.0	1 309.0	1 345.0	36.0

Source: National Treasury, Absa Research

at the South Africa Revenue Service (SARS) to reboot the institution after the state capture depredations of the previous leadership, should boost overall tax compliance, provided that the shortfalls do not reflect simply accumulated losses that companies are bringing forward to reduce tax liabilities or substantially weaker compensation trends in the highly paid financial service sector, which accounts for such a large chunk of total PIT receipts. Thus, barring a deep and persistent negative growth shock, it seems unlikely that the tax shortfalls of the last few years will repeat. And while this is good and desirable for the fiscus, this is likely to come at the expense of consumers' disposable incomes.

Higher petrol prices will likely drain about ZAR12bn from consumers' wallets this year

Taxes eat into consumers' disposable income available for consumption, but so do big price hikes in essential goods and services such as food, petrol and electricity, which are likely to be relatively price inelastic, because they are essential and have little substitutability to other products. Overall, consumer price inflation is likely to trend up this year, in contrast to 2017 when it fell sharply due to favourable base effects after a drought-related surge in food prices in 2016. Even so, after a series of recent downside surprises, we think CPI inflation will still average lower in 2018 at 4.8% than the 5.3% 2017 average, even as nominal wage increases are expected to remain unchanged at 6%. We think it is worth looking at petrol prices in particular, as a constraint on consumption in 2018, given their high share in the consumption basket (4.6% according to the latest Income and Expenditure survey, as reflected in current CPI weightings). Assuming a likely large petrol price increase in June (according to current under-recovery rates), petrol prices this year will have risen 15% above their March low, due to a higher USDZAR, higher crude oil prices and higher fuel taxes. We forecast that retail petrol prices will average nearly 12% higher this year than they did in 2017. Given consumption volumes in 2017, a price increase of this magnitude equates to an annual ZAR12bn drain on consumers' wallets, given that petrol has practically no substitutability to other goods and thus is probably one of the most price inelastic items in the consumption basket.

FIGURE 15

Some adverse influences on household consumption persisted into 2017, but the surge in confidence is material

	2016	2017	2018F	2019F
Personal income tax (PIT)	Net cuts of ZAR5.7bn for 16/17	Net hikes of ZAR16.5bn for 17/18	Net hikes of ZAR7.5bn for 18/19	No further PIT increases assumed
Value added tax (VAT) and indirect taxes	VAT unchanged with ZAR9.1 bn indirect tax hikes in 16/17	VAT unchanged with ZAR 5.1bn indirect tax hikes in 17/18	1 pp increase in VAT projected to raise ZAR22.9bn and ZAR5.8bn other indirect tax hikes in 18/19	No further VAT increase assumed
Interest rates	25bp hike to 7.0% in March 2016	25 bp cut in July 2017 worth ZAR 3.6bn pa, thus ZAR1.8bn for calendar 2017*	25 bp cut in March 2018 worth ZAR2.7bn in calendar 2018*	25bp forecast hike September 2019
Bank lending to HH	0.7% increase = ZAR 10.3bn	3.8% increase = ZAR57.0bn	Forecast 6.3% increase = ZAR97.6bn	Forecast 7.4% increase = ZAR121.6bn
Consumer confidence index (CCI), net balance	-15	-2	CCI soared to a record high of +26 in Q1 18. Some reversal seems likely	CCI will likely track SA's political and reform progress
Total CPI, % y/y	6.3	5.3	4.8	5.5
Food, % y/y (17.2% of CPI basket)	10.5	6.9	4.3	5.5
Electricity, % y/y (3.8% of CPI basket)	9.2	4.7	5.4	7.7
Petrol, % y/y (4.6% of CPI basket)	1.6	7.7	11.8	4.5

*Calculated on the basis of total consumer debt of 1675bn in mid-2017, assuming 85% is floating rate. Source: StatsSA, SARB, Bureau for Economic Research Absa Research

The 50bp of repo rate cuts so far this cycle are of marginal benefit to consumers

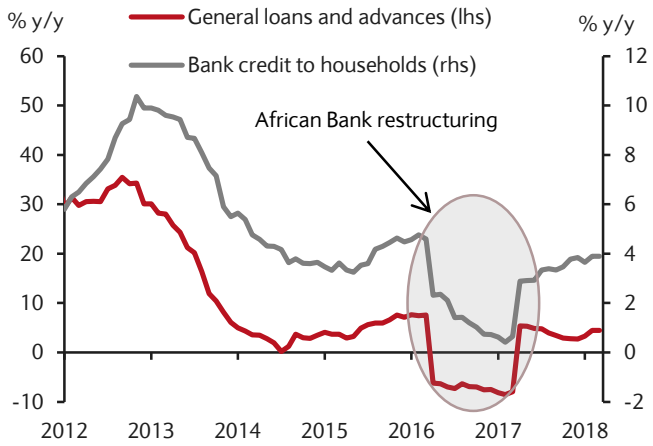
However, although it seems likely that petrol prices and taxes will prove a considerable drain on consumers' wallets this year, there are a variety of countervailing beneficial influences. One is the 50bps of cuts in the repo rate in the current cycle since mid-2017. However, it is easy to calculate that this monetary adjustment is only a small assist to consumers in the grand scheme of factors affecting household consumption, compared with other drivers such as credit growth or wage settlements. SARB data show total bank lending to consumers standing at about ZAR1512bn in mid-2017, but of course some consumers borrow from other lenders as well. National Credit Regulator data put total consumer debt at ZAR1675bn in mid-2017. Thus, a 25bp rate cut is worth about ZAR3.6bn to the consumer over the course of an entire year, assuming 85% of the consumer debt is floating rate. Of course, this is just the repo rate, and banks may have been tightening their effective lending rates even as the repo rate has fallen. The prime lending rate is 3.5 percentage points above the repo rate, ie, 10.0% currently. A few years ago it seemed many lenders were providing credit to many borrowers at the prime rate less a margin, but this appears less common nowadays.

A big boost to confidence from "Ramaphoria" should pave the way to a faster flow of credit to consumers

Far more important for household consumption trends than the cost of credit is the actual quantum of credit provided. While this is obviously sensitive to price (ie, the interest rate), it reflects a variety of other factors as well. For example, banks' credit standards affect the supply of credit. Unfortunately, the Bureau for Economic Research is no longer surveying the financial sector and its metric of whether banks are tightening or easing lending standards is thus discontinued. We think, however, that weak growth in consumer credit in recent years – currently tracking at 4.1% y/y, below the rate of inflation (Figure 16) – is as much about lack of consumer demand as banks' willingness (or unwillingness) to lend. In this regard, we note that National Credit Regulator data show rejection rates on credit applications declining to below 50% in Q4 17 from a peak of 59% in Q1 14 even as the number of credit applications has declined 1.5mn from its peak in Q2 15 to about 10.5mn in Q4 17, suggesting greater consumer prudence than bank lending caution (Figure 17). All in all, consumers have deleveraged substantially over the past several years in the soft sense (ie, relative to disposable income), and this has continued even as the total cost of their borrowing to disposable income has started to ease (Figure 18). Reduced borrowing is reflected in the sharply improved household savings rate, which moved into positive territory at the end of 2016 (Figure 19).

FIGURE 16

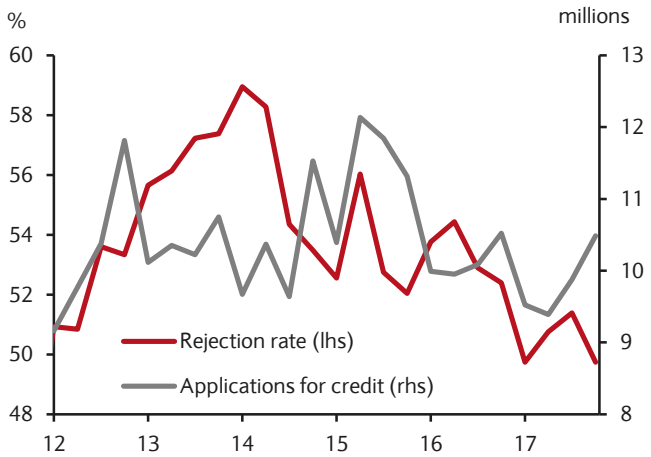
Bank lending to consumers is growing 4% y/y



Source: SARB, Absa Research

FIGURE 17

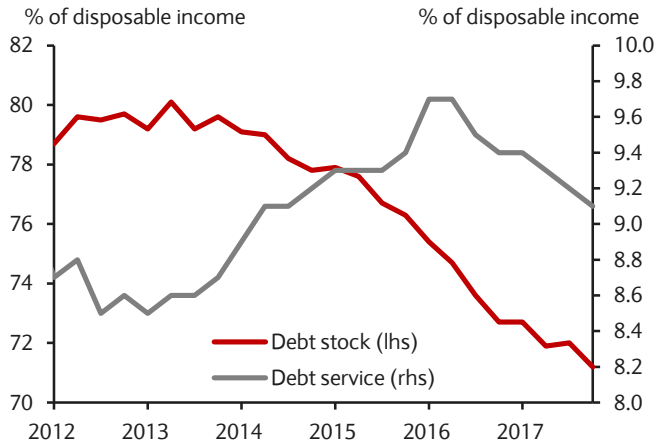
Declining rejection rate on consumer credit applications



Source: National Credit Regulator Data, Absa Research

FIGURE 18

Households have deleveraged over the past few years…



Source: SARB, Absa Research

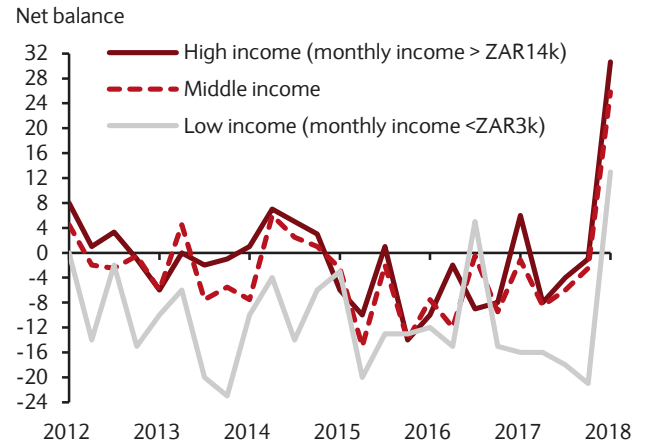
FIGURE 19

…and increased their savings rate

Source: SARB, Absa Research

FIGURE 20

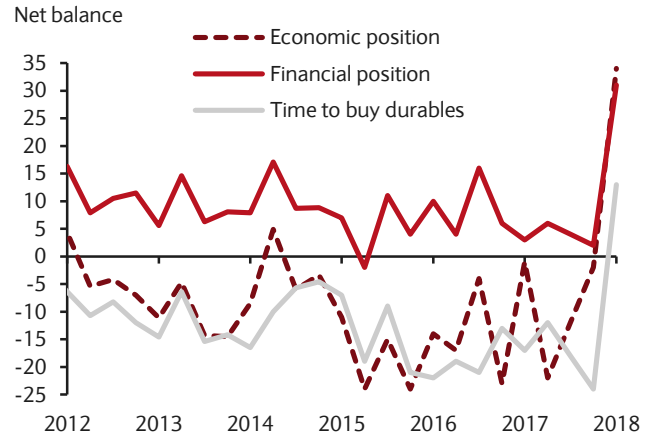
Confidence surged across all HH income groups…



Source: Bureau for Economic Research, Absa Research

FIGURE 21

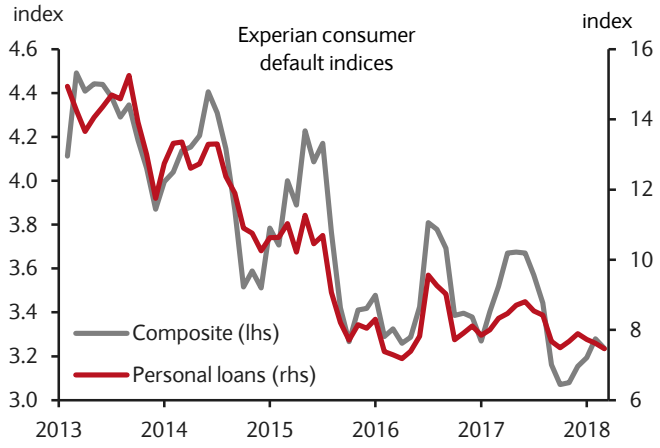
…and all three components may hit a record high in Q1 18



Source: Bureau for Economic Research, Absa Research

FIGURE 22

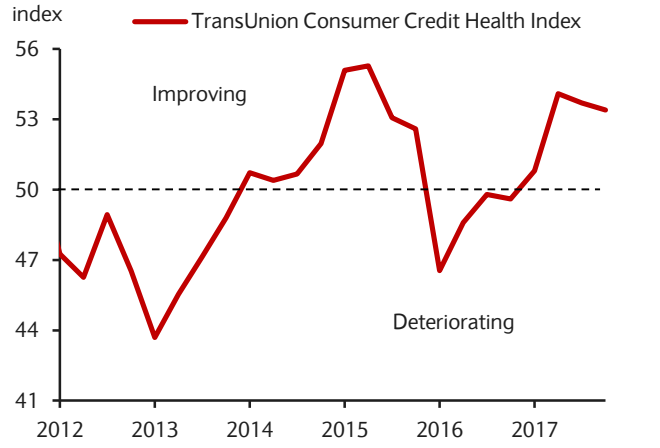
Little sign of increasing default behavior…



Source: Experian, Absa Research

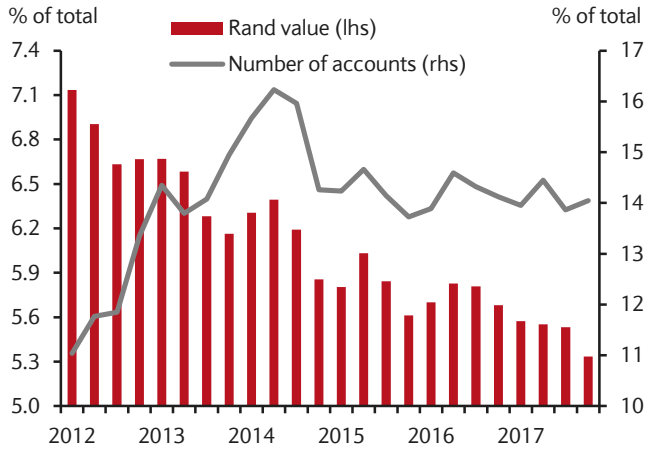
FIGURE 23

…with improving consumer credit health



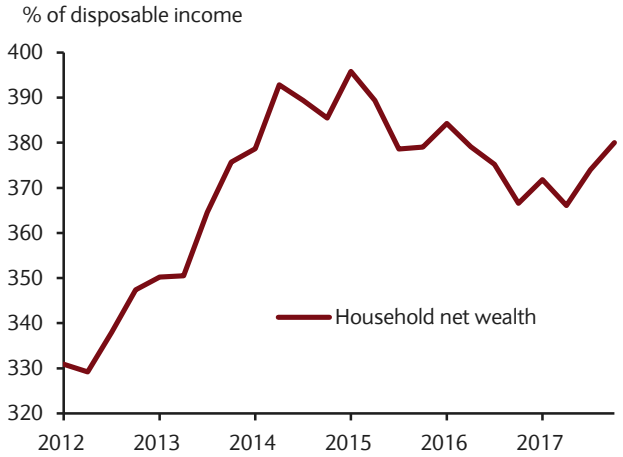
Source: TransUnion, Absa Research

FIGURE 24
NCR data point to declining arrears by value



Source: National Credit Regulator, Absa Research

FIGURE 25
Household net wealth picked up over the course of 2017



Source: SARB, Absa Research

Significantly stronger confidence should encourage consumers to borrow and spend more

A big question then is the degree to which any consumer reticence to borrow and/or bank reluctance to lend to households will remain in place. We would argue that the surge in business and consumer confidence since President Ramaphosa's victory at the ANC's electoral conference in December and subsequent replacement of Jacob Zuma as state president could unblock the credit taps. Notably, the Consumer Confidence Index (CCI) surged to a record high of 26 in Q1 18, with gains across all income groups. One might expect higher household confidence to manifest in a greater willingness on the part of households to borrow, especially since consumer creditworthiness, on average, appears to be on an improving trend according to some of South Africa's leading credit bureaus (Figures 22 and 23), with declining arrears according to NCR data (Figure 24), and household net wealth up over the course of 2017 (Figure 25). Moreover, while some reversal of Q1's exceptional surge in the CCI might be expected, as "Ramaphoria" fades to realism, a mobile poll released by IPSOS last weekend showed that 76% of respondents approved of President Ramaphosa's performance as head of state, while 79% thought he was doing a good job with the economy. This compares to approval ratings for former president Jacob Zuma of just 20% in Q4 17, and suggests that elevated consumer confidence could persist as long as President Ramaphosa continues to make progress in addressing South Africa's challenges.

Absa expects household credit extension to jump significantly in 2018, but no material acceleration in borrowing is observable so far in the data to April

Absa's latest macroeconomic model run projects expansion of bank lending to households of 6.3% over 2018, worth nearly ZAR98bn, roughly 2% of GDP, and up from 3.8% expansion in 2017. However, so far, there are no real signs of accelerated consumer credit expansion. In the SARB monetary data for April released earlier this week, bank lending to households accelerated only marginally, to 4.1% y/y, from 3.9% in March, and the seasonally adjusted 3m/3m annualized figure of 4.5% does not suggest any underlying upward momentum in the data.

In conclusion, household consumption expenditure in 2018 and 2018 will manifest at the intersection of a variety of different factors. Despite headwinds from weak job growth, big tax increases, and stronger efforts to enforce tax compliance, we see continued support from elevated nominal wage settlements combined with subdued inflation, and much stronger household confidence which should encourage households to borrow (and spend) more. In the 2018 Budget, National Treasury forecast household consumption growth of 1.7% this year and 1.9% for 2019. Interestingly, the SARB's last MPC statement argued that household consumption to be the main driver of growth going forward, with real expansion of "close to 2%" for 2018 and 2019, rising to 2.5% in 2020. We forecast 1.8% this year.

Thus we are all in the same ballpark for 2018. However, we are slightly more optimistic for 2019, with our forecast of 2.4% real household consumption growth – assuming, of course, that President Ramaphosa and his new executive leadership maintain the pace of reform and renewal that they have exhibited during his first 100 days in office. South Africa's economic challenges and constraints are significant, in areas as diverse as state-owned enterprises, labour markets and land reform, and thus our forecasts probably have more downside than upside risk. Over the long run, consumption growth could only expand sustainably faster, in our view, if South Africa implements a coherent set of policies to address its most pressing challenge: joblessness, unemployment and poverty.

Analyst Certification
We, Miyelani Maluleke and Peter Worthington, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Important Disclosures:
Absa Research is produced by Absa Bank Limited acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and also affiliated with the Investment Bank of Barclays Bank PLC and its affiliates (referred to as "Absa").

All authors contributing to this research report are Research Analysts unless otherwise indicated. The publication date at the top of the report reflects the local time where the report was produced and may differ from the release date provided in GMT.

Availability of Disclosures:
For current important disclosures regarding any issuers which are the subject of this research report please refer to https://publicresearch.barclays.com or alternatively send a written request to: Barclays Research Compliance, 745 Seventh Avenue, 13th Floor, New York, NY 10019 or call +1-212-526-1072.

Absa does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Absa may have a conflict of interest that could affect the objectivity of this report. Absa regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). Absa trading desks may have either a long and / or short position in such securities, other financial instruments and / or derivatives, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, Absa fixed income research analysts regularly interact with its trading desk personnel regarding current market conditions and prices. Absa fixed income research analysts receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the Corporate and Investment Banking division), the profitability and revenues of the Markets business and the potential interest of the firm's investing clients in research with respect to the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Absa trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. The Absa Research Department within Absa Bank Limited operates independently from the Barclays Research Department within the Investment Bank of Barclays Bank PLC and its affiliates (collectively "Barclays"). Eligible clients may receive research reports from both research departments, which may reach different conclusions and may contain different or conflicting ratings or research recommendations, whether as a result of differing time horizons, methodologies, or otherwise.
In order to access Barclays Statement regarding Research Dissemination Policies and Procedures, please refer to *https://publicresearch.barcap.com/static/S_ResearchDissemination.html*. In order to access Barclays Research Conflict Management Policy Statement, please refer to: *https://publicresearch.barcap.com/static/S_ConflictManagement.html*.

All pricing information is indicative only. Prices are sourced from Thomson Reuters as of the last available closing price at the time of production of the research report, unless another time and source is indicated.

Explanation of other types of investment recommendations produced by Absa FICC Research:
Trade ideas contained herein that have been produced by the Credit teams within Absa Research are valid at current market conditions and may not be otherwise relied upon.
Trade ideas contained herein that have been produced by other research teams within Absa FICC Research shall remain open until they are subsequently amended or closed in a future research report.

Disclosure of previous investment recommendations produced by Absa and Barclays FICC Research:
Absa FICC Research may have published other investment recommendations in respect of the same securities/instruments recommended in this research report during the preceding 12 months. To view previous investment recommendations published by Absa FICC Research and Barclays FICC Research in the preceding 12 months please refer to *https://live.barcap.com/go/research/ResearchInvestmentRecommendations*.

Legal entities involved in producing Absa Research:
Absa Bank Limited (Absa, South Africa)

Disclaimer:
This publication has been produced by Absa Bank Limited acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and affiliated with the Investment Bank of Barclays Bank PLC (referred to as "Absa"). It has been distributed by Absa or one or more Barclays affiliated legal entities listed below. It is provided to our clients for information purposes only, and Absa makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any data included in this publication. To the extent that this publication states on the front page that it is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors under U.S. FINRA Rule 2242, it is an "institutional debt research report" and distribution to retail investors is strictly prohibited. Absa also distributes such institutional debt research reports to various issuers, regulatory and academic organisations for informational purposes and not for the purpose of making investment decisions regarding any debt securities. Any such recipients that do not want to continue receiving Absa institutional debt research reports should contact debtresearch@barclays.com. Absa will not treat unauthorized recipients of this report as its clients and accepts no liability for use by them of the contents which may not be suitable for their personal use. Prices shown are indicative and Absa is not offering to buy or sell or soliciting offers to buy or sell any financial instrument.
Without limiting any of the foregoing and to the extent permitted by law, in no event shall Absa, nor any affiliate, nor any of their respective officers, directors, partners, or employees have any liability for (a) any special, punitive, indirect, or consequential damages; or (b) any lost profits, lost revenue, loss

of anticipated savings or loss of opportunity or other financial loss, even if notified of the possibility of such damages, arising from any use of this publication or its contents.

Other than disclosures relating to Absa, the information contained in this publication has been obtained from sources that Absa Research believes to be reliable, but Absa does not represent or warrant that it is accurate or complete. Absa is not responsible for, and makes no warranties whatsoever as to, the information or opinions contained in any written, electronic, audio or video presentations of third parties that are accessible via a direct hyperlink in this publication or via a hyperlink to a third-party web site ('Third-Party Content'). Any such Third-Party Content has not been adopted or endorsed by Absa, does not represent the views or opinions of Absa, and is not incorporated by reference into this publication. Third-Party Content is provided for information purposes only and Absa has not independently verified its accuracy or completeness.

The views in this publication are those of the author(s) and are subject to change, and Absa has no obligation to update its opinions or the information in this publication. If this publication contains recommendations, those recommendations reflect solely and exclusively those of the authoring analyst(s), and such opinions were prepared independently of any other interests, including those of Absa and/or its affiliates. This publication does not constitute personal investment advice or take into account the individual financial circumstances or objectives of the clients who receive it. The securities discussed herein may not be suitable for all investors. Absa recommends that investors independently evaluate each issuer, security or instrument discussed herein and consult any independent advisors they believe necessary. The value of and income from any investment may fluctuate from day to day as a result of changes in relevant economic markets (including changes in market liquidity). The information herein is not intended to predict actual results, which may differ substantially from those reflected. Past performance is not necessarily indicative of future results.

This document is being distributed (1) only by or with the approval of an authorised person (Barclays Bank PLC) or (2) to, and is directed at (a) persons in the United Kingdom having professional experience in matters relating to investments and who fall within the definition of "investment professionals" in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order"); or (b) high net worth companies, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2) of the Order; or (c) other persons to whom it may otherwise lawfully be communicated (all such persons being "Relevant Persons"). Any investment or investment activity to which this communication relates is only available to and will only be engaged in with Relevant Persons. Any other persons who receive this communication should not rely on or act upon it. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange.

The Investment Bank of Barclays Bank PLC undertakes U.S. securities business in the name of its wholly owned subsidiary Barclays Capital Inc., a FINRA and SIPC member. Barclays Capital Inc., a U.S. registered broker/dealer, is distributing this material in the United States and, in connection therewith accepts responsibility for its contents. Any U.S. person wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Barclays Capital Inc. in the U.S. at 745 Seventh Avenue, New York, New York 10019.

Non-U.S. persons that are clients of Barclays should contact and execute transactions through a Barclays Bank PLC branch or affiliate in their home jurisdiction unless local regulations permit otherwise.

Barclays Bank PLC, Paris Branch (registered in France under Paris RCS number 381 066 281) is regulated by the Autorité des marchés financiers and the Autorité de contrôle prudentiel. Registered office 34/36 Avenue de Friedland 75008 Paris.

This material is distributed in Canada by Barclays Capital Canada Inc., a registered investment dealer, a Dealer Member of IIROC (www.iiroc.ca), and a Member of the Canadian Investor Protection Fund (CIPF).

Subject to the conditions of this publication as set out above, Absa Bank Limited, acting through its Corporate and Investment Bank division, which is a part of Barclays Africa Group Limited and affiliated with the Investment Bank of Barclays Bank PLC, an authorised financial services provider (Registration No.: 1986/004794/06. Registered Credit Provider Reg No NCRCP7), is distributing this material in South Africa. Absa Bank Limited is regulated by the South African Reserve Bank. This publication is not, nor is it intended to be, advice as defined and/or contemplated in the (South African) Financial Advisory and Intermediary Services Act, 37 of 2002, or any other financial, investment, trading, tax, legal, accounting, retirement, actuarial or other professional advice or service whatsoever. Any South African person or entity wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Absa Bank Limited acting through its Corporate and Investment Bank division in South Africa, 7th Floor, Barclays Towers West, 15 Troye Street, Johannesburg, 2001. Absa Bank Limited is an affiliate of the Barclays group.

All Absa research reports are distributed to institutional investors in Japan by Barclays Securities Japan Limited. Barclays Securities Japan Limited is a joint-stock company incorporated in Japan with registered office of 6-10-1 Roppongi, Minato-ku, Tokyo 106-6131, Japan. It is a subsidiary of Barclays Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokucho (kinsho) No. 143.

Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

Absa equity research reports are distributed in India by Barclays Securities (India) Private Limited (BSIPL). BSIPL is a company incorporated under the Companies Act, 1956 having CIN U67120MH2006PTC161063. BSIPL is registered and regulated by the Securities and Exchange Board of India (SEBI) as a Research Analyst: INH000001519; Portfolio Manager INP000002585; Stock Broker/Trading and Clearing Member: National Stock Exchange of India Limited (NSE) Capital Market INB231292732, NSE Futures & Options INF231292732, NSE Currency derivatives INE231450334, Bombay Stock Exchange Limited (BSE) Capital Market INB011292738, BSE Futures & Options INF011292738; Depository Participant (DP) with the National Securities & Depositories Limited (NSDL): DP ID: IN-DP-NSDL-299-2008; Investment Adviser: INA000000391. The registered office of BSIPL is at 208, Ceejay House, Shivsagar Estate, Dr. A. Besant Road, Worli, Mumbai – 400 018, India. Telephone No: +91 2267196000. Fax number: +91 22 67196100. Any other reports produced by Absa are distributed in India by Barclays Bank PLC, India Branch, an associate of BSIPL in India that is registered with Reserve Bank of India (RBI) as a Banking Company under the provisions of The Banking Regulation Act, 1949 (Regn No BOM43) and registered with SEBI as Merchant Banker (Regn No INM000002129) and also as Banker to the Issue (Regn No INBI00000950). Barclays Investments and Loans (India) Limited, registered with RBI as Non Banking Financial Company (Regn No RBI CoR-07-00258), and Barclays Wealth Trustees (India) Private Limited, registered with Registrar of Companies (CIN U93000MH2008PTC188438), are associates of BSIPL in India that are not authorised to distribute any reports produced by Absa.

Barclays Bank PLC Frankfurt Branch distributes this material in Germany under the supervision of Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

This material is distributed in Mexico by Barclays Bank Mexico, S.A.

Nothing herein should be considered investment advice as defined in the Israeli Regulation of Investment Advisory, Investment Marketing and Portfolio Management Law, 1995 ("Advisory Law"). This document is being made to eligible clients (as defined under the Advisory Law) only. Barclays Israeli branch previously held an investment marketing license with the Israel Securities Authority but it cancelled such license on 30/11/2014 as it solely provides its services to eligible clients pursuant to available exemptions under the Advisory Law, therefore a license with the Israel Securities Authority is

not required. Accordingly, Barclays does not maintain an insurance coverage pursuant to the Advisory Law.

Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Principal place of business in the Dubai International Financial Centre: The Gate Village, Building 4, Level 4, PO Box 506504, Dubai, United Arab Emirates. Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority.

Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi).

Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. Related financial products or services are only available to Business Customers as defined by the Qatar Financial Centre Regulatory Authority.

This material is distributed in the UAE (including the Dubai International Financial Centre) and Qatar by Barclays Bank PLC.

This material is not intended for investors who are not Qualified Investors according to the laws of the Russian Federation as it might contain information about or description of the features of financial instruments not admitted for public offering and/or circulation in the Russian Federation and thus not eligible for non-Qualified Investors. If you are not a Qualified Investor according to the laws of the Russian Federation, please dispose of any copy of this material in your possession.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this report, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is 10 Marina Boulevard, #23-01 Marina Bay Financial Centre Tower 2, Singapore 018983.

This material is distributed to persons in Australia by either Barclays Bank PLC, Barclays Capital Inc., Barclays Capital Securities Limited or Barclays Capital Asia Limited. None of Barclays Bank PLC, nor any of the other referenced Barclays group entities, hold an Australian financial services licence and instead they each rely on an exemption from the requirement to hold such a licence. This material is intended to only be distributed to “wholesale clients” as defined by the Australian Corporations Act 2001.

IRS Circular 230 Prepared Materials Disclaimer: Absa does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.