The SA economy: Now to sort out the supply side

Spending grew significantly faster than output in the third quarter. The growth in spending by households picked up only marginally, to a 3.7% annual rate in the quarter (from 3.3% in the second quarter) with household spending on durable goods (cars and appliances) growing at a highly robust 17.9% annual rate, while spending on non-durables (food) hardly advanced at all and spending on services supplied to households grew at a pedestrian pace of 2.5%. Clearly the prices of foods and services were rising rapidly and those of durables and semi-durables and services, including electricity, were rising at a much slower pace, if at all, and this made the difference to the composition of household spending.

Particularly encouraging in the third quarter was the further pick up in spending on new plant and equipment – the source of future growth in output. Gross fixed capital formation by all sectors, private government and public corporations continues to recover from the recession of 2009.

Spending on durable consumer goods, which may better be regarded as investment spending by households (if the new equipment is leased by firms to households it would be defined as investment spending), and capital formation are import intensive. In the third quarter, while the balance of trade remained in surplus at an R18bn annual rate (down by R2bn on the second quarter), ie the value of exports exceeded the value of imports, the volume of imports grew much faster (up by over 17% than the volume of exports. This deterioration in the real trade balance accounted for the difference between the growth in real Gross Domestic Expenditure (GDE), up by a respectable 4.2% pa, and real gross Domestic Product(GDP), up by a tardy 1.4% p.a. in the quarter. The growth in GDE was also assisted by a recovery in inventory levels that had declined sharply in the two previous quarters. Stocking up also has a large import component.

The weakness in GDP is mainly to be attributed to a dramatic fall in mining output (down by over 17% at an annual rate in the third quarter) and minimal growth in manufacturing output. Both sectors were seriously affected by work stoppages. The global mining boom, at least in volume terms, has passed SA by. We can but hope for continued encouragement from the prices of minerals and metals to allow SA a second chance to get right its policies for the mining sector (mining royalties rights and carbon taxes included) as well as its industrial relations. On should add that the only two formal sectors of the economy to have added (marginally) to their employment numbers since 2010 are mining and finance and financial services. Output growth without employment growth (at least formal employment growth) remains the order of the day for the SA private sector.

The debt service and especially the dividend service account of the balance of payments turned a trade surplus (despite a mostly strong rand in the third quarter) into a current account deficit.

Interestingly, the Reserve Bank calculates that the bulk of dividends remitted abroad this past quarter were by unlisted foreign owned companies rather than listed companies. No doubt faster GDP growth would encourage these foreign companies to reinvest their cash flows in SA, so adding impetus to growth and improvement to the balance of payments.

Households continued to reduce their debt relative to their disposable incomes. And debt service payments as a percentage of disposable income s are at close to record highs. They have declined from over 12% at the height of the consumer boom in 2007 to less than 7% today. The other side of the coin is that those households dependent on interest income are having a much worse time of it with lower interest rates.

The improved state of household and especially business balance sheets and their ability to pay interest has encouraged significantly more bank lending and borrowing from banks in most categories other than on mortgages. Total loans and advances by the banks were up by R44.2bn with loans to the corporate sector up by R36bn.

The weakness of house prices and so demand for mortgage loans has meant still modest increases in the size of the bank’s balance sheets. M3 includes notes and coins that are growing especially rapidly (at an annual rate of 30% in the third quarter) which accounts for the faster growth in M3 compared to bank lending. The increased demand for notes and coins is a sign of strong spending intentions as we have pointed out before.

The willingness of SA households and firms to spend more in the third quarter of 2011 should be regarded as encouraging for the longer term growth outlook. The case for encouraging further growth in spending by households and firms remains as strong as ever, even stronger given the likely weakness in global demand. Restraining the growth in government consumption spending – as planned by the Medium term Budget framework – would be helpful

too. The economy is not growing fast enough to exercise its potential or to help the government reduce its deficits. Foreign capital remains freely available to fund this growth. There is every reason to believe that faster growth would encourage capital inflows and cash retention. The supply side weaknesses of the economy, especially in policies for mining and employment, remain to be addressed. The National Development Plan is full of helpful intentions to this effect and it must be hoped that willingness to spend more will be matched by the willingness of the economy to produce more, as it should. ***Brian Kantor***