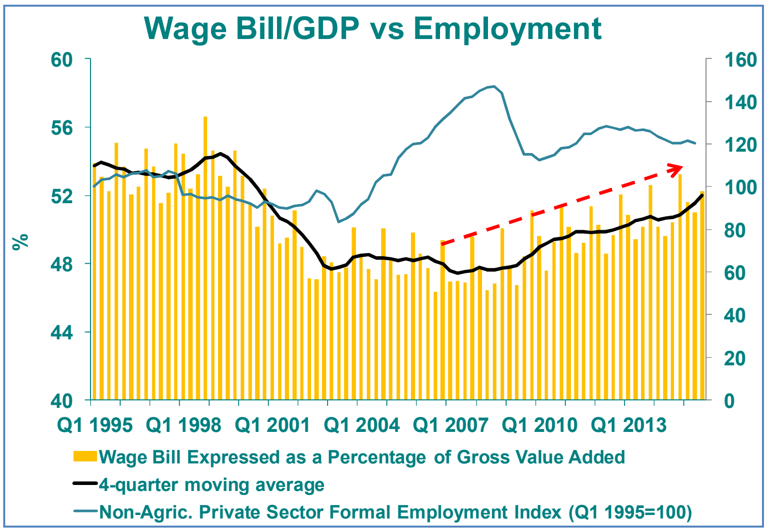
WEEKLY COMMENT - HOUSEHOLD SECTOR OUTLOOK

Amongst the Household Sector issues in 2016, loss of employment is expected to be the serious one, as we look set to move into a period where Real Household Disposable Income growth underperforms real economic growth?

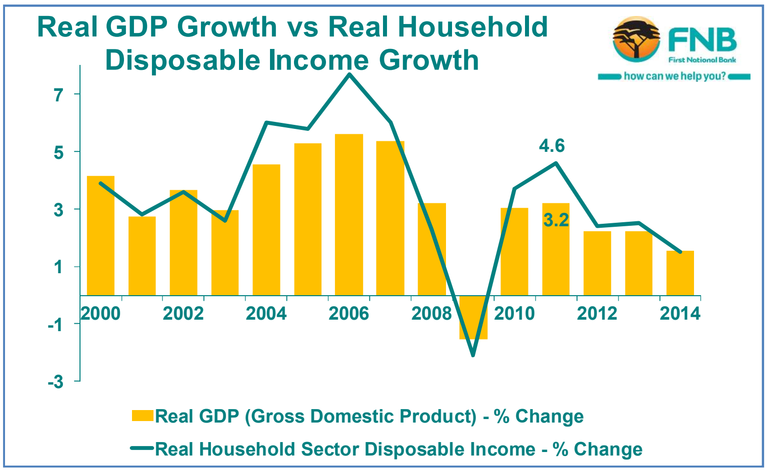
2 February 2016

Whereas the Corporate Sector has been experiencing mounting economic pressure for some time, it seems that the Household Sector has to date been "cushioned" to an extent, with average wages outpacing general inflation. However, this has meant a national wage bill increasing its share of total GDP (Gross Domestic Product), shrinking the Gross Operating Surplus of the economy for a number of years. Now, some years later, the lagged response to a looks set to be a more significant downsizing of the formal sector work force, the normal response to wage bill pressures in a stagnating economy.



Using a 4-quarter moving average, the average Wage Bill/GDP Ratio hit a low of 47.4% for the 4-quarters up to the 2nd quarter of 2007. That was the latter stage of South Africa's economic boom period, in which Real GDP growth exceeded 5% per annum for a few years. This growth had contributed to the Wage Bill/GDP ratio to decline all the way from above 54% in 1999, and with the economy-wide Gross Operating Surplus being boosted, implying economy-wide profitability being enhanced, those boom years were one of South Africa's few periods over the last few decades in which it could boast strong formal sector employment growth.

Since then, however, the end of the boom and subsequent 2008/9 recession is old news. Despite a massive interest rate and fiscal stimulus from late 2008 onward, SA's myriad of structural constraints, including a now highly-indebted Household Sector, have prevented economic growth from ever reaching those boom time glory days again.



However, while the economic growth didn't reach boom time growth rates again, Real Household Disposable Income growth arguably did for a while. Whereas Real GDP growth peaked at 3.5% in 2011 in the post-recession recovery, Real Household Disposable Income growth peaked at a significantly higher 4.6%.

In fact, over the years 2010 to 2013, Real Household Disposable Income growth outpaced Real GDP growth. One key contributing factor was interest rate cutting starting late-2008, which lowered the Net Interest Payments of the Household Sector, thereby boosting disposable income. A period of relatively low consumer price inflation, especially in 2010, also assisted. But perhaps most noticeable was average formal sector wage inflation outpacing consumer price inflation for much of the post-recession period. This took the total wage bill, expressed as a percentage of GDP, up to above 52% by 2015, from that near 47% in 2007.

When the wage bill's share of GDP rises, translating into a reduction in the Gross Operating Surplus as a percentage of GDP in a stagnating economic growth environment, the sad but likely outcome in the absence of salary reductions is job shedding.

And so, it seems realistic to expect that some of the pressure that South Africa's Commercial Sector has arguably been feeling for a while, especially in Manufacturing and Mining, will be increasingly felt by the Household Sector, as moves to curb the strong wage bill growth are stepped up.

Already, we have seen the SARB's Non-Agriculture Private Sector Formal Sector Employment Index decline by -5.9% from early-2013 to mid-2015, not good news at all, and further decline is expected, given our own FNB forecasts of Real GDP (Gross Domestic Product) growth slowing from around 1.5% in 2015 to 0.5% in 2016.

While there were some post-recession years of strong Government Sector employment growth, this has also tapered off, as Government runs into mounting fiscal constraints itself, with tax revenue growth coming under pressure.

The potential impact points for the Household Sector go further, however:

- Gradually rising interest rates increase net interest payments by households (interest on debt is more than interest received from deposits), taking a little more off disposable income.
- A drought driven acceleration in food prices, accompanied by higher imported inflation due to a sharply weaker Rand, lead to a forecast of significantly higher CPI inflation in 2016 compared to 2015. If Nominal Disposable Income growth is similar to 2015 rates, this should imply slower disposable income growth in real terms.
- The multi-year stagnation in economic performance to date can also be expected to exert some downward pressure on Household Income growth from investment income sources (dividends etc)
- And, finally, a further anticipated personal tax increase at 2016 Budget time.

It is thus expected that, whereas from 2010 to 2013 Real Household Disposable Income growth exceeded Real GDP growth, the next few years will likely be the opposite, with Real Disposable Income "under-performing" real economic growth.

By this, I am implying that the consumer may go from being one of the relative "strong points" in the economy in recent years to being one of the relative weak points in 2016.

Besides the expectation that this will translate into a slower year of retail and residential property demand growth, arguably the biggest concern must be around what rising pressure on employment and incomes can do to the already-high social tensions in South Africa, raising the risk of turbulence and instability.

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