CONSUMER STATUS UPDATE: IT'S COMPLICATED

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What is the state of the local consumer? The answer matters not only because we are all consumers, but because consumption spending accounts for 60% of economic activity (when measured by expenditure). Therefore, in the absence of decent growth in household spending, the economy will be stuck in low gear. There are a number of factors to keep in mind, and we received new information on five of them last week, namely inflation; interest rates; income growth; sentiment and actual spending.

THERE IS GOOD NEWS AND BAD NEWS

The good news is that inflation remains surprisingly low. Even with the April VAT increase and series of steep fuel price hikes, the consumer price index was only 4.6% higher in June compared to a year ago. The consensus expectation among economists was for a 4.8% increase, meaning that it was yet another downside surprise. In fact, the cumulative downside surprise over the past year is 1.5%, pointing to a persistent overestimation of inflation. Core inflation, which excludes the impact of volatile food and fuel prices, was only 4.2%, down from 4.4% in May.

The biggest component of the core inflation basket is rent and owners' equivalent rent (the implied rent homeowners owe themselves). Actual rents rose only 4.2% from a year ago, while implied rents were only 3.7% higher, indicating the weak state of the residential property market outside the Western Cape. While rental inflation was 7.5% in the Western Cape, no other province had growth higher than 3.6%. In real terms, there has been no growth in the national house price average over the past decade and the absence of a proper property cycle is one of the reasons why economic growth has been so muted.

The bad news is that inflation is low because the economy is weak. Companies cannot afford to push up selling prices and have to absorb increases in input costs – such as fuel prices, electricity tariffs and imported goods prices. Landlords – both residential and commercial – can't afford to increase rent too much either.

OPTIMISTIC OUTLOOK EVAPORATED

The optimistic outlook prevalent at the start of the year, when the SA Reserve Bank (SARB) upgraded the growth outlook at successive Monetary Policy Committee (MPC) meetings, has all but evaporated. The SARB sharply lowered its growth forecast for this year from 1.7% to 1.2%. However, real growth is still expected to rise modestly to 1.9% next year and 2% in 2020.

At last week's meeting, the MPC's seven members unanimously voted to keep the repo rate unchanged at 6.5%. However, the tone of the post-meeting statement was 'hawkish', warning of several risks that could result in higher-than-expected inflation. These were the usual suspects: oil; the rand; US interest rates and Eskom tariff hikes. On the other hand, actual and forecast inflation is well within the SARB's 3% to 6% target rate. Moreover, each of these risk factors has at various points in the recent past moved in the wrong direction from an inflation-targeting point of view, without resulting in runaway inflation. Chart 1 shows the limited response of the consumer price index – i.e. the general price level – to the fairly dramatic rises in petrol and electricity prices, as well as the volatile exchange rate.

The sharp decline in the oil price in recent days and the rand steadying around R13.50 per dollar indicate that another big petrol price increase next month is unlikely.

The MPC still views its policy stance as "accommodative", which is unusual because real short- term interest rates are now around 2%, among the highest of any major economy. If rates were really accommodative, we'd see much faster credit growth. Yet household borrowing grew by only 4.2% in May, and corporate borrowing only 3%. The rate of borrowing is slowly creeping up for households, but it has declined rapidly for companies. Consumers have benefited somewhat from the 0.5% reduction in the repo rate over the past year, but further reductions are highly unlikely. Given the SARB's hawkish stance – aiming to keep inflation close to the mid-point of the target range rather than simply below 6% – modest increases in the coming year cannot be ruled out. If they materialise, these hikes will be driven by external factors – emerging market capital flows, US rates and dollar strength – rather than domestic developments.

WAGE GROWTH SLOWING

On the income side, we don't have any new official data. But we have news that Post Office unions settled for a 6.5% wage increase and Eskom workers seem to be settling on 7.5%. The MPC noted that it expects wage increases to average 7%, though this number will hide a wide discrepancy between industries and companies and between the private and public sectors. If the average wage increase is still above inflation, consumers will enjoy real income growth, supporting spending. But the trend is declining. The days of unions forcing double-digit wage increases appear to be over. At least the MPC will welcome this, as it sees inflation-plus wage increases (rather than productivity-linked raises) as a key source of inflation pressure in the economy.

SENTIMENT SURPRISINGLY HIGH

Consumer confidence is still surprisingly high according to the FNB/BER Consumer Confidence Index (CCI). It jumped to a record (and unrealistically) high level in the first quarter, following the political changes, but only fell back a few index points in the second quarter. The survey is based on answers to three questions. On the outlook for the economy, consumers are still very positive, and similarly for the outlook for household finances. On whether the present time is suitable to buy durable goods (such as cars and furniture), the respondents were neutral.

StatsSA also released numbers on the motor trade showing virtually no growth in the value of new and used vehicles sold over the year to May. While the CCI has a long and impressive track record, the reading of the past two quarters probably overstates the actual level of consumer sentiment. Nonetheless, it does make sense that confidence would be higher than a year or so ago.

SALES GROWTH SLIDE

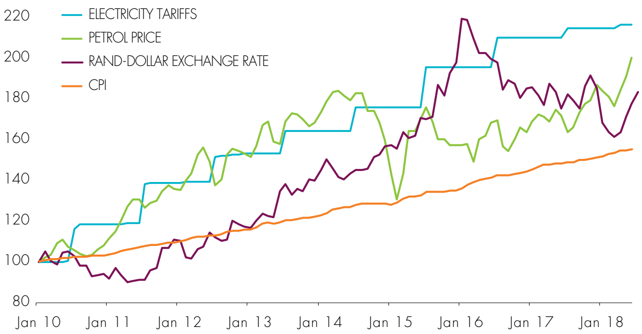
Real retail sales grew by 1.9% year-on-year in May, more than expected. This was better than April's 0.5% (probably impacted by the VAT hike), but still below the 4% to 5% growth rates recorded late last year and into the first months of 2018. Particularly noticeable is the slowdown in nominal growth, which declined from 7% at the start of the year to only 3.8%. This means that the inflation rate at retailers has declined to only 1.7%. This low inflation rate is consistent with what listed retailers have reported in recent weeks. While low inflation is good news for consumers, retailers need price increases to lift revenue growth. The JSE's General Retailers Index (which includes the large clothing chains) is down 14% year-to-date and the Food & Drug Retailers Index (including the large grocery and pharmacy chains) is down 5%.

IMPLICATIONS FOR INVESTORS

We all wear different hats. As citizens, taxpayers and consumers, there is some cause for concern, given the slow pace of growth. It helps that the global economy is still strong, despite the threats of trade disruptions. And while 'New Dawn' optimism might have faded, we must not forget where we were only a year ago.

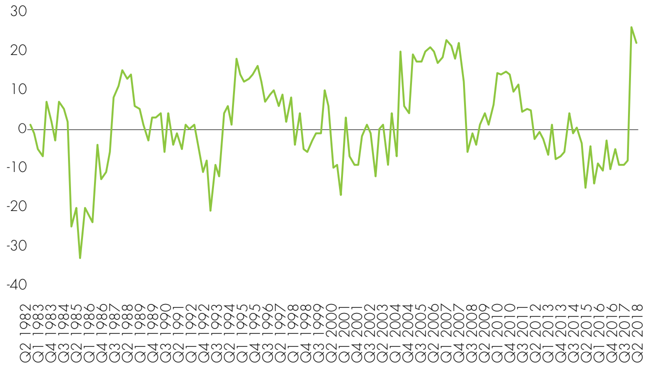
But if we put on our hat as investors, the above matters much less. Firstly, even in a standard balanced fund, the exposure to the local economy is less than commonly thought. Secondly, a lot of the negativity around the prospects of SA-focused companies has been priced in already. Thirdly, high real interest rates, while probably constraining economic growth, are to our advantage as investors. Finally, low inflation means it is easier to achieve real returns.

CHART 1: THE MUTED IMPACT OF PETROL, ELECTRICITY AND THE RAND ON INFLATION



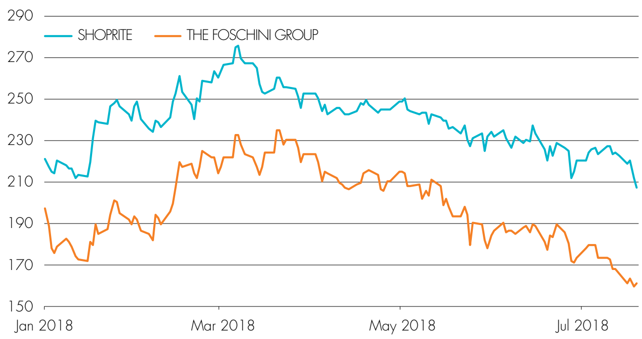
Sources: StatsSA, Thomson Reuters Datastream

CHART 2: FNB/BER CONSUMER CONFIDENCE INDEX



Source: Bureau for Economic Research

CHART 3: SHARE PRICE OF TWO SA CONSUMER-FOCUSED COMPANIES



Source: Thomson Reuters Datastream

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 135.0	0.00%	2.20%	1.52%	8.76%
United States	S&P 500	US$	2 802.0	0.04%	3.09%	4.79%	13.30%
Europe	MSCI Europe	US$	1 722.0	-0.17%	1.12%	-4.17%	0.29%
Britain	FTSE 100	US$	10 083.0	-0.56%	-0.04%	-3.06%	3.86%
Germany	DAX	US$	1 395.0	0.72%	2.72%	-1.29%	4.49%
Japan	Nikkei 225	US$	203.7	1.25%	1.06%	0.79%	13.59%
Emerging Markets	MSCI Emerging Markets	US$	1 061.0	-1.39%	-0.84%	-8.38%	0.19%
Brazil	MSCI Brazil	US$	1 742.0	0.87%	5.77%	-13.89%	-5.84%
China	MSCI China	US$	83.3	-2.21%	-3.36%	-5.85%	8.59%
India	MSCI India	US$	567.6	-1.47%	1.18%	-7.10%	1.18%
South Africa	MSCI South Africa	US$	505.0	-1.94%	0.00%	-16.53%	-2.51%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	56 990.0	1.11%	-1.08%	-4.23%	4.98%
All Share	All Share (Total Return)	Rand	8 219.0	1.12%	-1.05%	-2.73%	8.17%
TOP 40/Large Caps	Top 40	Rand	7 323.0	1.33%	-1.16%	-1.68%	9.38%
Mid Caps	Mid Cap	Rand	15 146.0	0.25%	-0.28%	-10.77%	-0.98%
Small Companies	Small Cap	Rand	19 733.0	-0.25%	-0.44%	-6.13%	-1.22%
Resources	Resource 20	Rand	2 555.7	-0.91%	-5.66%	11.79%	28.17%
Industrials	Industrial 25	Rand	14 481.0	2.12%	-0.30%	-4.20%	3.10%
Financials	Financial 15	Rand	9 154.0	1.77%	2.10%	-5.70%	12.97%
Listed Property	SA Listed Property	Rand	1 917.3	-0.99%	-1.02%	-22.19%	-14.18%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	938.2	-0.48%	-0.06%	-1.04%	0.80%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	618.1	0.32%	1.14%	5.18%	9.33%
Government Bonds	BESA GOVI	Rand	613.8	0.34%	1.19%	4.68%	8.81%
Corporate Bonds	SB JSE Credit Indices	Rand	114.7	0.23%	0.69%	-9.10%	-17.10%
Inflation Linked Bonds	BESA CILI	Rand	250.1	0.09%	-0.44%	-0.98%	1.94%
Cash	STEFI Composite	Rand	398.2	0.13%	0.40%	3.98%	7.33%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	73.1	-2.56%	-7.51%	9.06%	49.12%
Gold	Gold Spot	US$	1 232.0	-0.81%	-1.68%	-5.01%	-0.96%
Platinum	Platinum Spot	US$	827.0	0.12%	-2.71%	-11.08%	-10.88%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.40	-0.98%	2.47%	-7.62%	-2.85%
ZAR/Pound	ZAR/GBP	Rand	17.61	-0.17%	2.95%	-4.94%	-4.09%
ZAR/Euro	ZAR/EUR	Rand	15.71	-1.29%	2.09%	-5.42%	-3.58%
Dollar/Euro	USD/EUR	US$	1.17	0.00%	-0.17%	2.65%	-0.85%
Dollar/Pound	USD/GBP	US$	1.31	0.78%	0.53%	2.81%	-1.00%
Dollar/Yen	USD/JPY	US$	0.01	-0.79%	0.70%	-1.07%	-0.80%

Source: I-Net, figures as at 20 July 2018

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Producer inflation

US

- Second quarter GDP growth
- New and existing home sales
- House price index
- Markit Flash Purchasing Managers' Index
- Durable goods orders

EUROPE

- European Central Bank interest rate decision
- Eurozone Markit Flash Purchasing Managers' Index
- Eurozone loan growth

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