

WHEN WILL THE RECESSION END?

RMB Research, Economics Report by Ettiienne Le Roux, RMB Chief Economist, 14 September 2009. Based on trends in the Reserve Bank's leading economic indicator, South Africa should emerge from a year-long recession by the end of 3Q09. This is encouraging news.

However, while there are signs that the economy will soon return to positive growth, the strength of the prospective upswing remains uncertain.

NO PLAIN SAILING

After one of the most severe global (and domestic) recessions on record, the local economy returning to positive growth soon is encouraging. But recession drawing to a close is one thing — how strong the subsequent upswing will be is a different matter. On this score, we remain cautious mainly because prospects for household expenditure and business fixed investment are clouded.

THREE CONSUMER WORRIES

The headwinds facing households are strong.

Firstly, with asset values down sharply from their recent peaks and with debt levels having grown so much during the 2004 – 2007 boom years, households today are more geared than at any time in the past. We wonder therefore if consumers will be willing, or able, to increase their debt levels much further, especially when a strong near-term rally in house prices is most unlikely and a repeat of the most recent surge in equity prices looks improbable?

Secondly, even if consumers are willing or able to borrow more, it is questionable whether credit will be readily available. In addition to the impact of the National Credit Act, given the global financial crisis, banks the world over are now even stricter in pricing risk, and local banks are no exception. This could put an additional dampener on the supply of bank loans.

Thirdly, with credit hard to come by, it leaves income as the main source of spending. But non-wage income is falling, fewer hours are being worked in the private sector and unemployment is rising.

All this means overall employee compensation is under pressure, making it difficult for consumers to service existing debt, despite lower interest payments. From a sharp contraction this year, these headwinds point to only a moderate recovery in real household expenditure in 2010, most likely accompanied with a much needed increase in personal saving levels.

COMPANIES RELUCTANT TO COMMIT

Of the many determinants of investment spending — business confidence, tax rates, cost of capital etc. — the outlook for consumer expenditure is arguably the most important.

Consequently, with prospects not that encouraging, companies are unlikely to be in any rush to invest. This is especially so as businesses typically wait until demand for their products meets existing capacity before they commit to new capital spending. According to most recent BER business survey results, and supported by sharply lower manufacturing capacity utilisation rates, companies have significant slack, which needs to be taken up first.

This implies business fixed investment will be slow to recover, especially in areas which currently suffer from oversupply, such as shopping centres, car dealerships and town houses. With only a prospective moderate recovery for private expenditure (household spending and corporate fixed investment combined), any short-term boost to overall economic activity brought about by restocking is unlikely to last.

BOTTOM LINE

GDP contractions will soon be a thing of the past. Economic activity is beginning to stabilise and a return to sustained positive GDP growth in 4Q09 and beyond is very possible.

But, while the recovery is no longer in doubt, the strength of the recovery is. Looking through the near-term boost expected from strong restocking, underlying conditions remain weak, notably in the case of consumers. Simultaneously, business profits are under pressure, given weak demand and the now much stronger rand. Companies now struggling with excess capacity appear in no mood to commit to new investment any time soon. Government consumption (and fixed investment) expenditure are likely to remain firm, and export volumes should benefit from improving trading partner demand. Still, with the two main engines of growth — household consumption and private sector fixed investment — largely out of action, the upcoming recovery is expected to be modest.