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in the moment

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Consumer pulse: Consumers more despondent

Highlights

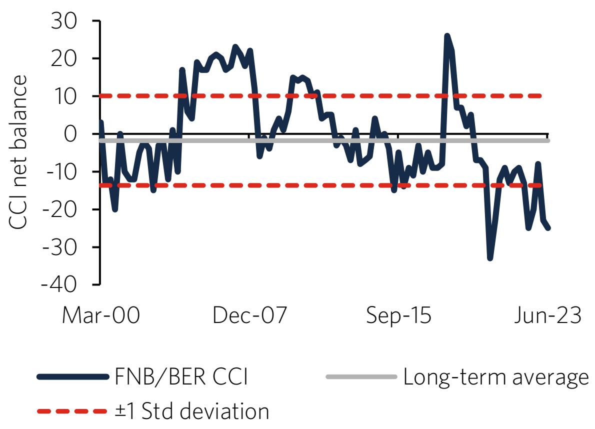
- The First National Bank (FNB)/Bureau for Economic Research (BER) Consumer Confidence Index (CCI) deteriorated by two points to negative 25 in the second quarter of 2023 and all three sub-indices of the CCI recorded a decline.
- The biggest driver of weaker sentiment stemmed from high-income earners whose confidence level fell to a record low of negative 40. This group is increasingly concerned about economic conditions over the next 12 months and they are becoming more reserved about buying durable goods currently.
- The bulk of South Africa's (SA) economic growth (GDP), much like the United States (US) is due to consumer spending. The long-term average ratio of domestic household consumption expenditure to GDP is just below 60%. In SA's case, a higher ratio of fixed investment-to-GDP would be more beneficial to increase the productive capacity of SA and foster higher levels of trend growth.
- The composition of household consumption expenditure has increasingly become skewed toward services. Spending remains unbalanced in the economy with most of the expenditure coming from the upper middle- to high-income earners. These two groups combined accounted for roughly 60% of current consumption expenditure by households in 2022 using estimates from Eighty20.
- According to Statistics SA's (Stats SA) Quarterly Labour Force Survey (QLFS), the unemployment rate ticked up slightly to 32.9% in the first quarter of 2023 and the Quarterly Employment Statistics (QES) showed an improvement in annual nominal gross earnings in the first quarter. However, real growth in gross earnings was negative, implying a loss of purchasing power for consumers.
- Credit statistics from the National Credit Regulator (NCR) show that consumers' appetite for credit was higher in the first quarter to address living costs but lending institutions are still broadly applying tight lending practices.
- The value of the total gross debtor's book increased in the first quarter as more people took on debt. While the value of the debtor's book largely comprises mortgages, most of the credit holders have a credit facility because it is relatively easy to obtain store cards and credit cards.
- The consequence of rising debt levels is that the repayments gradually reduce disposable income, which in turn makes it difficult to save. This results in a widening gap between household debt- and savings-to-disposable income ratios.
- Apart from a heavier reliance on credit to supplement income, consumers are also cutting back on or downgrading discretionary spending (e.g. gym and DStv subscriptions). While a survey done by InfoQuest shows that only a few people are cancelling essential items (e.g. insurance), deteriorating economic conditions may lead to more cancellations of essential items.

- Retailers have expressed downbeat confidence, particularly non-durable goods retailers.
- The move toward less dependence on Eskom will likely shift the composition of consumption expenditure in the near term, suppress demand and increase consumer debt levels.
- The depressed confidence levels together with elevated inflation, higher interest rates and weak employment prospects are not encouraging for household consumption expenditure. We expect growth in consumer spending to soften to 1% this year before climbing to 1.3% next year.
- The nature of economic growth being driven by consumption expenditure is unfavourable for long-term growth. In our view, SA's long-term growth remains capped at 1.75%.

High-income earners drive down the CCI

According to the FNB/BER CCI, sentiment deteriorated to negative 25 points in the second quarter of 2023 from negative 23 points in the first quarter. At this reading, CCI is two standard deviations below the mean which illustrates that the average consumer's confidence level is significantly weak. The last time confidence levels were this low was the second quarter of 2022 and negative 25 is historically the second-lowest reading after the record low of 33 points recorded in the second quarter of 2020.

Chart 1: CCI drops further into negative territory

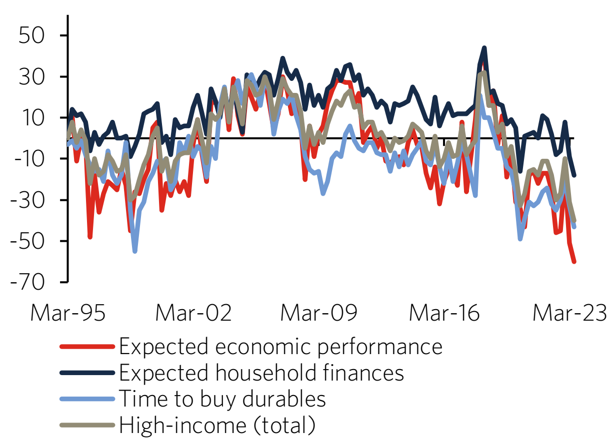


Source: BER, Momentum Investments

A drop in sentiment was recorded across all three sub-indices of the CCI. Expected economic performance dropped by three points to negative 37 after plummeting by 15 points in the previous quarter. This is the lowest reading among the three sub-indices which means consumers are becoming more worried about the country's economic prospects over the next 12 months. Inflation is showing signs of easing which will likely continue; however, prices of goods and services remain elevated. Furthermore, the SA Reserve Bank (SARB) estimates economic growth of 0.3% in 2023 and loadshedding will likely persist over the next year and dampen economic growth, all explaining the dampened sentiment levels. The other two sub-indices (expected household finances and gauging whether this is a suitable time to buy durable goods) slipped back slightly by one point each to negative two and negative 35, respectively.

High-income earners portrayed intensified pessimism in the second quarter, with confidence dropping by nine points to negative 40. This is a historical low for this income group (see chart 2) and the weaker sentiment was broad-based with expected economic performance dropping by nine points to negative 60, expected household finances down nine points to negative 18 and time to buy durable goods down 10 points to negative 43 points.

Chart 2: High-income earners' confidence at historical low



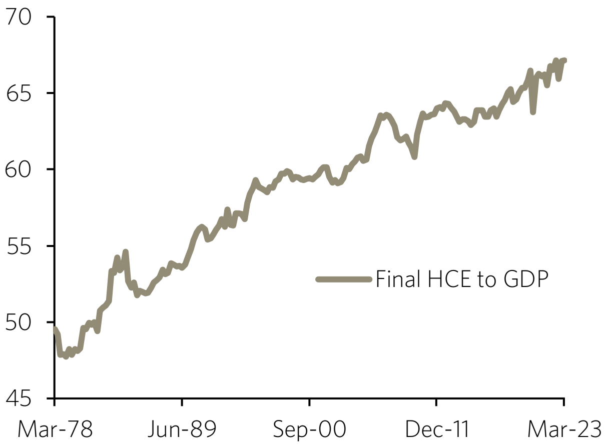
Source: BER, Momentum Investments
Data until the second quarter of 2023

The confidence level of low-income earners also dropped slightly from negative 21 points to negative 22 points but there was a one-point improvement among middle-income earners (negative 16 from negative 17).

SA is a consumer-driven economy

The ratio of household consumption expenditure to GDP in SA was hovering around 50% since 1978 to 1981. Since then, the ratio has consistently been above 50% of GDP for the past four decades and has been increasing over time as depicted in chart 3. In the first quarter of 1978, household expenditure accounted for 49.5% of total GDP and the ratio was higher at 67.3% in the first quarter of 2023. This illustrates the growing significance of consumers to domestic economic growth.

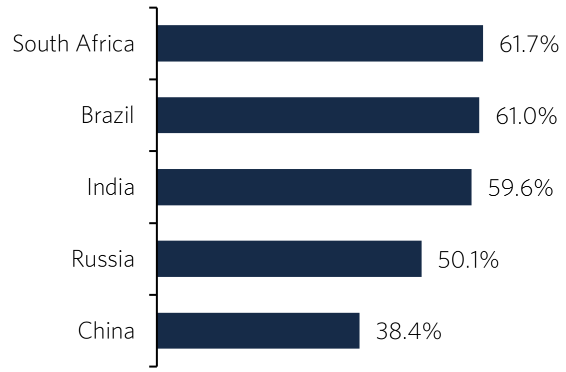
Chart 3: SA household consumption expenditure as a % of GDP has gradually increased



Source: Iress, Stats SA, Momentum Investments
HCE = Household consumption expenditure

According to *Global Economy*, global household expenditure is about 60% of world GDP. However, the range is wide among the different countries from as low as 21.9% in Qatar to as high as 140% in Somalia during 2021[1]. In the list of 153 countries reported by *Global Economy*, SA ranked 74th with a ratio of 61.7 in 2021 (higher than the world average). Moreover, SA ranked highest among the BRICS economies as seen in chart 4. China's ratio is lower because growth has predominantly been investment- and export-led. However, Chinese authorities are focusing on more inward-looking policies and transitioning the country to a more consumer- and services-led growth model.

Chart 4: SA had the highest ratio of household consumption to GDP in 2021 among BRICS



Source: Global Economy, Momentum Investments

The US ranked 53rd of the 153 countries with a ratio of 68.2. The reliance on consumer spending for economic growth in the US is partly the reason for elevated inflation over the past months because consumers have been resilient following the pandemic. This is owing to the tight labour market and excess savings. However, in SA, consumers are financially strained hence the lower demand and weaker household consumption expenditure. Treasury forecasts a slowdown in household consumption growth to 1% in 2023 from 2.5% in 2022.

Spending patterns of SA consumers have shifted over time. As seen in chart 5, households used to spend more on non-durable goods (e.g. food, beverages and fuel) relative to the other categories. Since the early 1990s, services (e.g. rent and restaurants) became the largest household expenditure item and currently accounts for more than half of household expenditure.

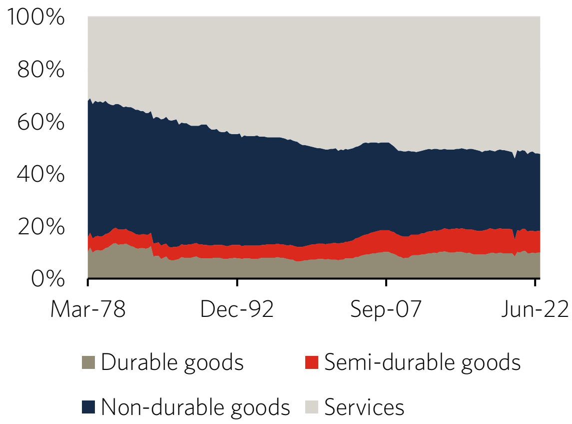
[1] The comparison is done using 2021 because that is the latest year where all the listed countries had available data.

The shift toward services is possibly influenced by higher levels of urbanisation and increased standard of living, albeit uneven. The second biggest component of household expenditure is non-durable goods followed by durable goods (e.g. furniture). Semi-durable goods (e.g. clothing) have consistently been the smallest spending category by share (tracking below 10% of the total) but there has been an increase over the years from 5.1% in the first quarter of 1978 to above 8% in the first quarter of 2023.

The growing share of services as a percentage of household expenditure has been driven by miscellaneous services (mostly insurance), rent, as well as transport and communication services. The largest expenditure category under non-durable goods is food, beverages and tobacco. Consumers spend more on personal transport equipment within durable goods and clothing and footwear is the largest semi-durable expenditure item.

Expenditure is not even among the different income groups. According to Eighty20, individuals with an average income of R15 000 per month (upper-middle income) have an annual expenditure of c. R720 billion and those earning an average income of R42 000 per month (high-income) make up c. R1.5 trillion of expenditure per year. The cumulative expenditure of these two segments is roughly R2.2 trillion and equates to 52.7% of current consumption expenditure by households in 2022. This is reflective of the extreme inequality in the country.

Chart 5: Services now account for the bulk of household consumption expenditure



Source: Iress, Stats SA, Momentum Investments
Data until the first quarter of 2023

Real gross earnings recover but remain negative

According to Stats SA's QLFS, the unemployment rate in the first quarter of 2023 was 32.9%, up slightly from 32.7% in the fourth quarter of 2022. However, the number of people employed increased by almost 258 000 meaning that the higher rate of unemployment was due to the rate of people entering the labour market outpacing jobs created. Jobs were created in both the formal (c. 209 000) and informal (107 000) sectors. Conversely, the QES shows a decrease of 21 000 formal sector jobs on a quarter-on-quarter (q/q) basis in the first quarter. Stats SA notes that differences between the two surveys are due to "coverage and conceptual issues" as summarised in table 1.

Table 1: Differences between QLFS and QES

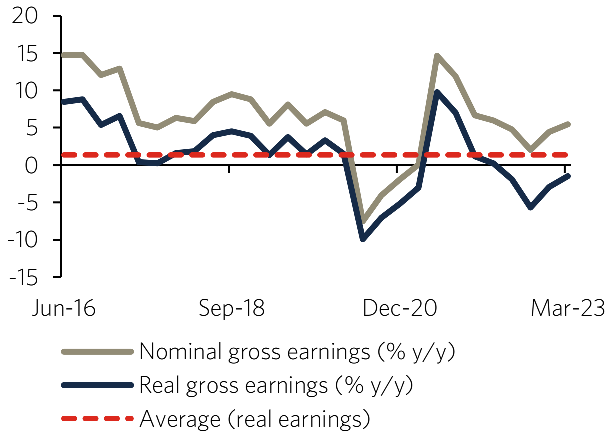
	QLFS	QES
Coverage	Private households and workers' hostels	Payroll of VAT registered businesses
	Non-institutional population (15 years and older)	Employees only (no age limit)
	Employment (including the informal sector; private households; agriculture and small businesses)	Formal sector (excluding agriculture)
Sample size	30 000 dwelling units in which households reside	+-20 000 VAT registered businesses
Reference period	One week prior to the interview	Payroll at the end of the reference quarter
Formal sector definition	Employers and own-account workers registered for VAT or income tax	Excludes agriculture and private households
	Employees paying income tax and those not paying tax but working for firms with five or more workers	Employees on the payroll of VAT registered businesses.

Source: Stats SA

The QES reported an increase in total nominal gross earnings of 5.5% year-on-year (y/y) in the first quarter of 2023 (see chart 6). The sectors that recorded the highest increases were mining (11.3% y/y), electricity (9.6% y/y), finance and manufacturing (8.2% y/y each) and transport (7% y/y). The lowest increases were wholesale (1% y/y) and community services (4.2% y/y). On the other hand, nominal gross earnings in the construction sector contracted by 2.7% y/y which corresponds to weak activity in the sector. The challenging operating environment in the construction sector is reflected in the 2000 jobs lost in the first quarter (QES) and the 8.6% q/q drop in the Afrimat Construction Index (a composite index which gauges the level of activity in the building and construction sector). Furthermore, the BER building contractors survey indicated that participants' sentiment deteriorated to 28 points in the second quarter of 2023 and the biggest sentiment drop was expressed by sub-contractors (from 57 to 40).

In real terms, year-on-year total gross earnings continued to fall which means that employees are generally in a worse off position than a year ago, with the Momentum-Unisa Consumer Financial Vulnerability Index (CFVI) reflecting this as well. In the first quarter, the CFVI improved slightly to 49.1 but was lower than 53.4 recorded a year ago. The sectors which recorded positive real growth earnings were mining, manufacturing, electricity and finance.

Chart 6: Further decline in purchasing power



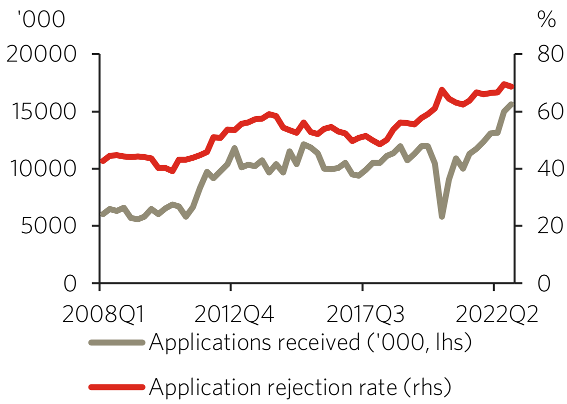
Source: Stats SA, Momentum Investments

The first quarter's real wage developments allude to constrained disposable income levels which may lead to an uptick in credit applications. This is exacerbated by elevated inflation which averaged 7% in the first quarter. However, softening inflation rates in the first two months of the second quarter may provide some relief.

Consumers accumulate more credit to weather the storm

During the fourth quarter of 2022, consumers' appetite for credit, measured by the number of credit applications received, continued an upward trend as seen in chart 7. Data from the NCR revealed that there were 15.6 million applications in the last quarter of 2022, up from 14.98 million in the previous quarter. This represents a 4.2% q/q increase and an increase of 26% y/y. However, lending standards remain tight. In the fourth quarter, 68.7% of applications received were rejected. Although this was slightly lower than 69.5% in the previous quarter, the rejection rate is higher than a year ago (66%).

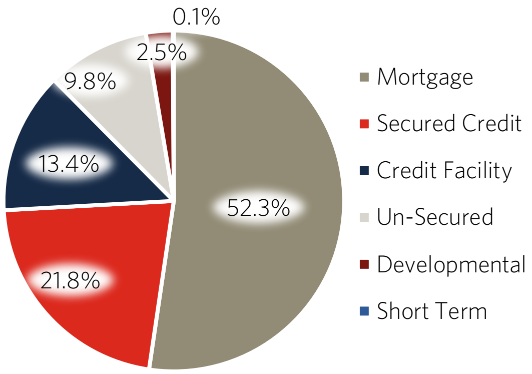
Chart 7: Lending conditions remain tight



Source: NCR, Momentum Investments
Data until the fourth quarter of 2022

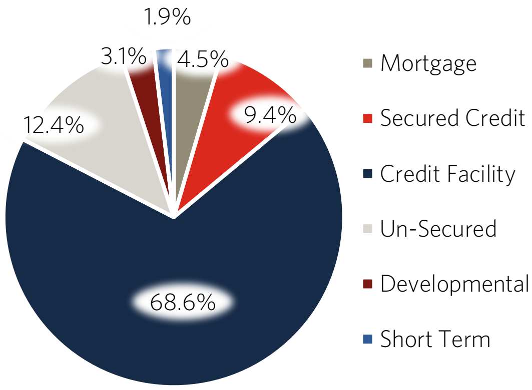
Despite a slightly lower rejection rate in the fourth quarter, the total value of credit granted was 2.7% q/q lower in the fourth quarter compared to the third quarter which means, on balance, more people were granted lower value loans during that period. This was particularly the case in credit facilities and unsecured credit granted. Nevertheless, the value of total outstanding debt increased by 1.9% q/q and the number of outstanding accounts increased by 2.2% q/q. The biggest growth in the value of outstanding debt was registered in short term credit (13.6% q/q). However, this credit type accounted for only 0.1% of the value of total outstanding debt in the fourth quarter as seen in chart 8.

Chart 8: Mortgages account for the largest share of the gross debtors book (by value)



Source: NCR, Momentum Investments

Chart 9: Defaults more common in credit facilities



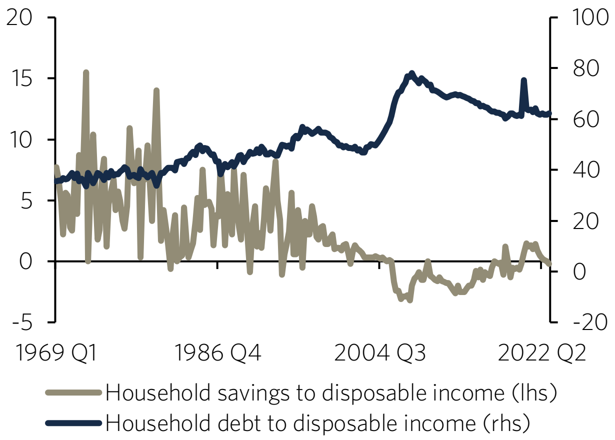
Source: NCR, Momentum Investments

Mortgages make up the bulk of the total value of outstanding debt. This has been the case historically because mortgages are typically of higher value than the other credit types. On the other hand, most of the outstanding accounts in the fourth quarter (reflecting historic trends) were credit facilities (mainly credit cards, store cards and bank overdrafts), while mortgages accounted for only 4.5% as illustrated in chart 9.

Over time, consumer debt levels have increased and the rate of increase in household debt has been greater than the rate of increase in nominal disposable income. This has resulted in a higher percentage of household debt to nominal disposable income over time (see chart 10). According to the SARB, growth in the value of nominal household debt outpaced disposable income in the first quarter of 2023 which lead to a higher ratio of 62.1% from 61.6% in the fourth quarter of 2023.

As household debt levels increase, debt repayment obligations also increase and crowd out savings. This is evident in the deteriorating ratio of household savings to disposable income over time. In the first quarter of 2023, this ratio deteriorated to negative 0.2% from 0% in the fourth quarter of 2022. The net effect has been a wider gap between the two ratios over time.

Chart 10: Household debt- and savings-to-disposable income inversely related, %

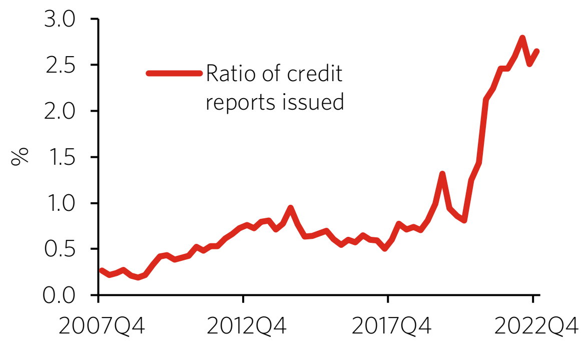


Source: SARB, Momentum Investments
Data until first quarter of 2023

According to the NCR's Credit Bureau Monitor (CBM), there was an increase of 6.54% q/q in the number of people who requested their credit report in the fourth quarter of 2022 and over 95% of these reports were issued for free. The demand for credit reports surged from the second quarter of 2020 as illustrated in chart 11 which signals that more people are becoming interested in knowing their credit profile health. This information is requested for a range of reasons and some consumers use it as a tool to improve their credit record to increase the likelihood of accessing credit. Despite higher demand, consumers requesting their credit record is still extremely low relative to credit active consumers, at only 2.6% in the fourth quarter of 2022.

A substantial improvement in this ratio has the potential of reducing application rejection rates without materially interfering with the general improvement in impaired records. In the fourth quarter, impaired records continued to trend lower as the number of customers with impaired records decreased slightly by 0.51%. Moreover, the ratio of defaults to the total number of credit active consumers was 36.1%, marginally lower than 36.6% in the third quarter.

Chart 11: More consumers requesting their credit records



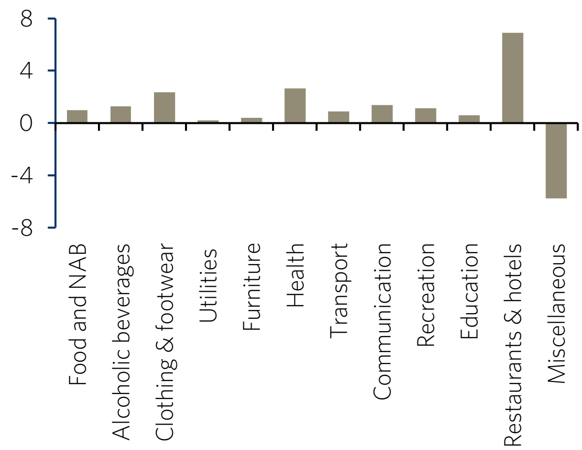
Source: NCR, Momentum Investments

High costs and weak demand dampen retailer sentiment

The domestic trade sector recorded positive gains at the start of the second quarter of 2023. According to Stats SA, real seasonally adjusted retail trade sales in April were 0.4% higher than in May, following two consecutive decreases in the previous months. Real wholesale trade sales and motor trade sales were also up by 3.3% m/m and 0.7% m/m, respectively in April. On a quarter-on-quarter basis, retail and wholesale trade sales were higher in the first quarter and motor trade sales were lower.

Real seasonally adjusted household expenditure grew slightly by 0.4% q/q in the first quarter, likely supported by the increase in employed persons reported in the QLFS. The higher household expenditure was broad-based across 11 of the 12 expenditure items as illustrated in chart 12 and the biggest increase was in restaurants and hotels. As mentioned in the 2023 first quarter Consumer pulse report, higher restaurant and hotel spend is driven by convenience, reliance on takeaways during loadshedding and higher hotel rates.

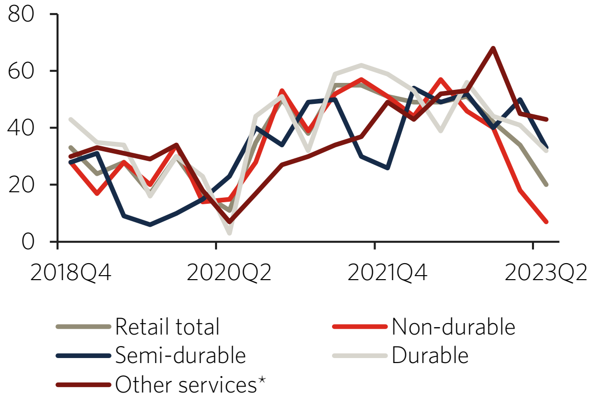
Chart 12: Broad-based first quarter growth in household expenditure, (% q/q)



Source: Global Insight, Stats SA, Momentum Investments
Descriptions have been shortened against the Stats SA publication

Overall, the gain was largely from semi-durable goods (2.4% q/q). Despite the increase in hotel and restaurant expenditure, services fell by 0.2% q/q which means the drag from miscellaneous services outweighed gains in the other services components. Given the significant share of services to household consumption expenditure, the contraction in services weighed down household expenditure as reflected in the lower growth rate of 0.4% q/q in the first quarter compared to 0.7% in the fourth quarter of 2022. Growth in semi-durable goods corresponds with improvement in the confidence levels of semi-durable goods retailers from 40 in the fourth quarter of 2022 to 50 in the first quarter 2023. The pessimism expressed by retailers of non-durable goods from 40 to 18 drove the deterioration in total retail confidence from 42 to 34 in the first quarter. This sub-index slumped further to 7 in the second quarter (see chart 13) likely due to sticky food inflation impacting volumes. Confidence levels of businesses in the other services sectors (hotels, restaurants, transport, real estate and business services) dropped from 45 in the first quarter of 2023 to 43 in the second quarter. Participants in the other services sectors cite insufficient demand as the biggest constraint to activity. This signals lower retail trade sales and activity in the services segment of the economy in the second quarter of 2023.

Chart 13: Depressed sentiment across retailers of goods and services



Source: BER, Momentum Investments

** Other services is a separate BER survey*

In the coming months, consumer expenditure may potentially experience downward pressure as consumers pursue reducing dependence on Eskom. These developments will be influenced by the middle and upper-income segment of the population who can afford solar PV (photovoltaics), batteries and inverters. Purchasing an inverter is one of the more affordable options of mitigating loadshedding followed by installing a generator but this option has diesel running costs. The most expensive options would be installing a hybrid system or going off-grid. According to Capitec, going off-grid can cost as much as R350 000. The purchase of these big-ticket items will reduce consumers' available funds that could've been spent on other expenditure items.

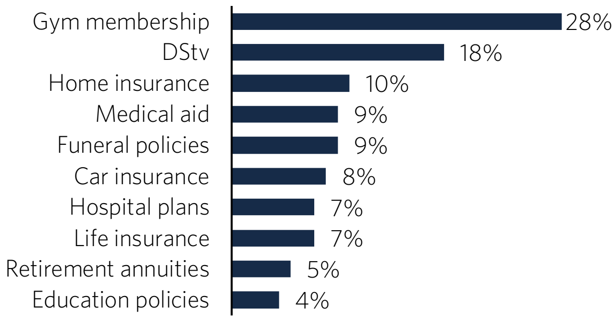
Moreover, the trend of investing in back-up power and going off the grid will also likely increase household debt levels. A consumer may opt to fund this investment using the traditional avenues of credit (personal loan, credit card). However, the top four banks have developed tailor-made renewable energy financing solutions. For instance, FNB offers their customers the option of applying for solar through a new or existing home loan.

Consumers cut back on discretionary expenditure as a coping mechanism

The high rejection rate on credit applications, falling disposable income and low levels of savings require consumers to make hard but necessary decisions to afford necessities.

Apart from increasing debt obligations and at times postponing debt repayments, consumers are also cutting out other expenditure items in their budgets.

Chart 14: Share of consumers cutting discretionary spend



Source: MyBroadBand, Momentum Investments

MyBroadband reports on survey results from InfoQuest which reveals that the top two cancelled subscriptions among 300 respondents over the past six months were gym memberships and DStv subscriptions as seen in chart 14.

Insights from Eighty20 correspond with InfoQuest's survey. Over and above the general trend of contract cancellations and downgrading product options, Eighty20 indicates that this behaviour is mostly exhibited by upper-middle class consumers (average salary of R15 000 per month) who are bearing the biggest brunt of the higher cost of living. Higher income earners (R42 000 per month) are coping with the higher cost of living by delaying vehicle purchases, postponing holidays and drawing on equity investments.

Multichoice's annual results released in March 2023 indicate that the biggest loss in SA subscribers who were active three months prior to the reporting date was among their premium packages, followed by their mid-market packages. On the other hand, lower packages saw an annual increase of 10%. This speaks to downtrading and cancellations. According to Multichoice, loadshedding also played a significant role in subscription activity because primetime viewing is disrupted when there is no electricity and loadshedding causes installation delays.

From the InfoQuest survey, it is evident that more consumers are cutting back on discretionary spend items and only a few are cancelling essential products. However, if consumers exhaust their discretionary spending options, essential products may be at risk given elevated inflation, high interest rates and subdued economic growth prospects which will perpetuate relatively low disposable incomes and high unemployment rates.

Weak consumer spending negatively affects economic growth prospects

The fact that SA is a consumption-driven economy is unfavourable for the country's long-term trend growth as it does not add to the productive capacity of the economy. In our view, SA's long-term growth remains capped at 1.75%. Faster progress to fix deficiencies in SA's network industries and to address crime and corruption is needed, in our opinion, to see a higher level of potential growth in the economy. Achieving a higher and sustainable economic growth rate will require more deliberate efforts to boost investment and improve the country's competitiveness.

The prevailing subdued confidence levels together with elevated inflation, higher interest rates and weak employment prospects are not encouraging for household consumption expenditure. We expect growth in consumer spending to soften to 1% this year before climbing to 1.3% next year as real wage growth improves on the back of falling inflation.

Typically, in an environment of weak wage growth, consumers prioritise spending over savings as they try to make ends meet. This is exacerbated by downbeat economic prospects, as is the case in SA (0.3% in 2023: according to the SARB), because consumers do not have sufficient savings to fall back on. The country's saving rate is low and the savings buffer accumulated during the pandemic has largely unwound.

Consequently, consumers are begrudgingly taking up credit to fund their cost-of-living expenses. This essentially means consumers are using future income to fund present expenditure because credit needs to be repaid with interest. In the 2022 fourth quarter Consumer pulse report, we flagged the concern of higher exposure of unsecured credit which attracts a higher interest rate. Lower income earners in SA are the ones who are typically exposed to unsecured credit. These consumers also have weaker levels of job security and face higher and more volatile inflation, suggesting increased stress at the lower end of the income-earning spectrum.