



Consumer pulse: Consumers still expected to face more strain despite slight improvement in third quarter confidence

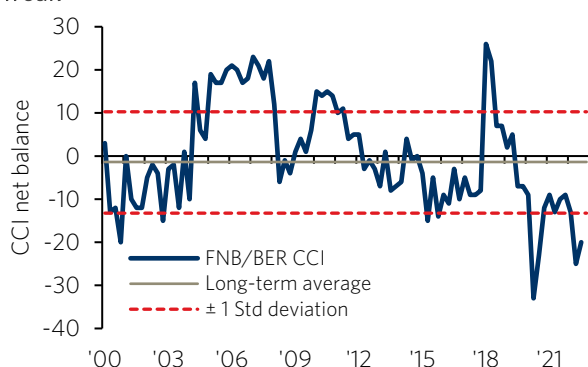
Highlights

- The FNB/BER Consumer Confidence Index (CCI) recovered slightly from negative 25 to negative 20 points in the third quarter of 2022. This was driven by an improvement in all three main sub-indices, with the reading for expected economic performance recording the largest improvement of eight index points.
- The high inflation and interest rate environment is eroding households' disposable income which requires consumers to spend a larger portion of their disposable income on non-durable goods (for example, food and fuel) as opposed to durable goods (for example, furniture and vehicles).
- Low-income households are showing signs of being more optimistic than medium- and high-income households. This is likely on the back of government support while higher mortgage rates are negatively affecting higher-income households.
- The number of jobs created for semi-skilled and non-skilled individuals during the last three quarters recorded an average growth of 1.9%. This has had a positive impact on household income and the magnitude of low-income households' confidence levels. However, in our view, structurally high unemployment will constrain confidence in the long run.
- The year-to-date retail trade sales indicate that consumers are in necessity mode and cutting back on discretionary spending despite possible higher incomes from positive jobs growth and higher wages.
- Household debt and debt service costs as a ratio of disposable income remained muted relative to post-global financial averages in the first quarter of the year. However, the anticipated interest rate hikes in September (75 basis points (bps) and November (50bps) are expected to push up the ratio of debt service costs to disposable income and dampen households expected financial position.
- The CCI outcome remains weak relative to history, suggesting a negative outlook for consumption expenditure in the coming quarters. We expect structurally high unemployment, higher inflation, a further increase in interest rates and lower asset price inflation to weigh negatively on consumer sentiment. Consequently, we expect growth in household consumption to slow from an expected 1.9% this year to 1.5% next year.

Consumer confidence recovers slightly in the third quarter

Consumer confidence improved slightly by five index points to negative 20 in the third quarter of 2022. The improvement precedes the record-low reading of negative 25 points in the second quarter of the year (not considering COVID-19). Notwithstanding this improvement, confidence levels remained weak in light of elevated inflation that breached the upper limit of the South African Reserve Bank's (SARB) target range of 3% to 6% and the subsequent cumulative increase in the repo rate of 200bps since the start of the hiking cycle in November 2021.

Chart 1: Consumer confidence ticks up, but remains weak



Source: Bureau for Economic Research (BER), Momentum Investments
Data until third quarter of 2022

The third quarter reading remained significantly below the long-term average of negative 1.4 index points and was 1.6 standard deviations below the mean. This reading points to the depressed state of consumers and the high uncertainty and volatility that households are grappling with.

The uptick in the CCI reading was due to the recovery in all three main sub-indices. The sub-index for expected economic performance recorded the largest recovery of eight index points from negative 39 to negative 31. The second largest recovery was recorded in the sub-index for suitability of the present time to buy durable goods from negative 32 to negative 28. However, households' confidence in their expected finances remains the highest with a single-digit reading of negative 2 in the third quarter of 2022.

The long-term trend of the three main sub-indices shows that consumers are generally more pessimistic about whether it is suitable at present to buy durable goods and about the country's expected economic performance than they are about their expected household finances. This is also reflected in the third quarter readings. Consequently, during periods of low consumer confidence, it is expected that households will trim down on their purchases of durable goods. This is exacerbated by the current environment of high inflation and interest rates, which necessitates households to spend a higher portion of their disposable income on non-durable goods. Additionally, we note that the growth rates of expenditure for the different spending categories are impacted by base effects as a result of the COVID-19 pandemic.

Table 1: Consumption trends are affected by high inflation and high interest rates

	4Q2021	1Q2022	2Q2022
Durable goods (%y/y)	0.54	-2.75	-
Semi-durable goods (%y/y)	2.37	1.88	-
Non-durable goods (%y/y)	2.22	4.04	-
Average inflation rate (%)	5.50	5.80	6.60
Cumulative rate hikes in the quarter	25bps	50bps	50bps

Source: Global Insight, Statistics South Africa (Stats SA), SARB, Momentum Investments

Table 1 shows that the year-on-year (y/y) growth in real final consumption expenditure by households on durable goods decreased from the fourth quarter of 2021 to the first quarter of 2022 as inflation and interest rates continued to increase while the growth of expenditure on non-durable goods almost doubled in the same period. Additionally, the growth in expenditure on semi-durable goods decreased, but to a lesser extent compared to that of non-durable goods. While we may see a slight improvement in real expenditure growth levels in the third quarter in line

with the slight bounce of the suitability of the present time to buy durable goods index, consumption expenditure will remain dampened in light of mounting consumer headwinds, including high inflation and rising interest rates.

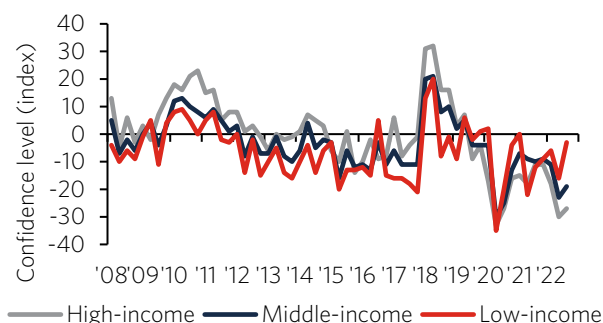
The stance of households being more pessimistic about the expected economic performance than they are about their expected household finances has created a widening gap between the two indices over time. The gap reached an all-time high of 34 points in the second quarter of 2022 before retreating to 29 points in the third quarter. Although the index for expected household finances recorded a negative reading in the third quarter of 2022, it has shifted closer to positive territory and the prevailing wide gap suggests that

households still expect to be relatively comfortable in their financial circumstances despite the economy performing poorly. This may be partly attributed to the higher wage settlements expected in 2022 in view of the higher cost of living. According to Andrew Levy Employment, wage settlements are expected to average 6.25% in 2022, up from 4.5% in 2021. Although growth in nominal wages is relatively high, growth in real wages is negative given higher rates of inflation. Therefore, we expect consumer sentiment and subsequently consumption expenditure to remain weak given that the average real wage rate increase is not expected to put consumers in a better position.

Government support buffers low-income households

Low-income households expressed the strongest improvement in confidence levels compared to middle-income and high-income households. The low-income confidence index increased by an impressive 13 points from the second quarter, rebounding to negative 3 in the third quarter – the strongest level since the first quarter of 2021. On the other hand, the middle-income and high-income confidence indices recorded marginal improvements from negative 23 to negative 19 and from negative 30 to negative 27, respectively.

Chart 2: CCI for low-income households improves at a higher rate



Source: BER, Momentum Investments

Data until third quarter of 2022

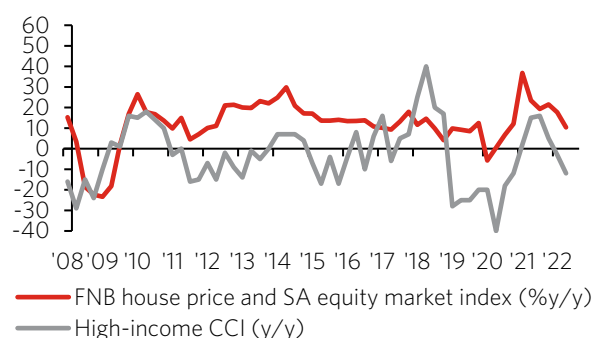
High -income = earning \geq R20 000 per month

Middle -income = earning between R2 500 and R19 999 per month

Low-income = earning \leq R2 500 per month

The different income groups experience different levels of confidence primarily because they get affected in varying degrees by factors such as inflation and the priorities and concerns that inform their respective sentiments are different. For instance, the sentiment of high-income households is informed by factors that impact their wealth, such as conditions in the equity market and housing market. Conversely, low-income households are more concerned about their income conditions.

Chart 3: Less favourable wealth effects



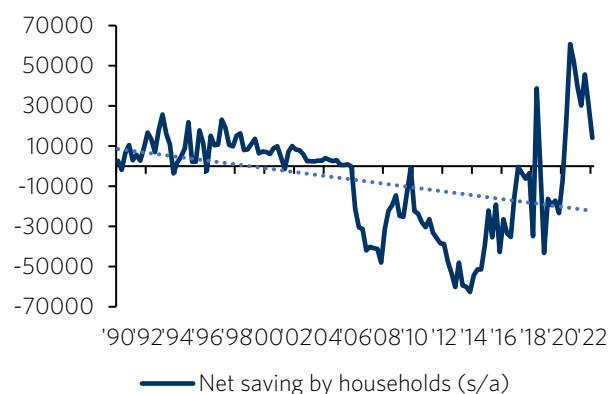
Source: BER, First National Bank (FNB), Momentum Investments

Data until second quarter of 2022

Chart 3 illustrates the positive relationship between the wealth conditions (proxied by the FNB house price index and the SA equity market) and the CCI for high-income households. From the chart, we see that the CCI

for high-income households increased sharply in line with the recovery of the equity market following the COVID-19 pandemic but has since been on a downward trend given the dip in equity markets.

Chart 4: High savings – a buffer for high-income earners in the current economic climate?



Source: SARB, Momentum Investments
Data until first quarter of 2022

Although high-income earners have a higher savings buffer which they built up during the COVID-19 pandemic, we expect the CCI for high-income earners to remain relatively subdued in the coming quarters given the current environment of high interest rates which negatively affect earnings, equity prices and consequently household wealth. Additionally, housing prices are negatively affected by the monetary tightening cycle since the resulting environment lowers the demand for owning property because owning becomes more expensive and renting becomes a more attractive alternative.

The optimism expressed by low-income households may be attributed to the extension of the special COVID-19 social relief distress (SRD) grant of R350 and the changes made to the qualifying criteria in August 2022.

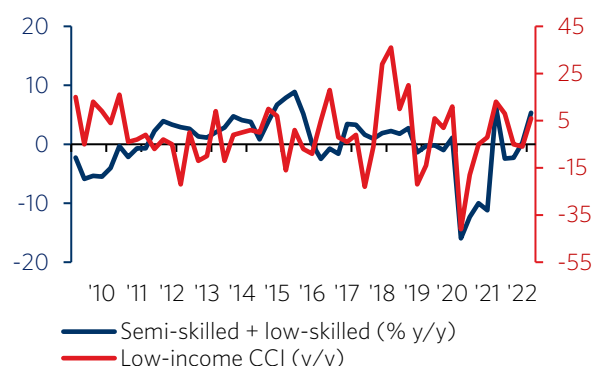
The SDR was introduced in May 2020 to assist qualifying persons to meet their individual and family needs during the pandemic. The SRD grant was initially introduced as a temporary measure for six months, but the President has extended it to March 2023 during his 2022 State of the Nation Address.

During the initial stages, there were almost 10 million applicants and monthly payments were made to just over six million recipients who met the qualifying conditions. In August 2022, the income threshold was raised to R624 (food poverty line) which meant that more people could apply. This led to an increased pool of just under 12 million applicants. However, the majority of applicants were rejected due to a host of reasons listed by the SA Social Security Agency (SASSA) and payments were made to around four million beneficiaries. The high levels of rejections and non-payments may have a negative impact on low-income households' confidence levels in the coming quarters.

Despite the decrease in the number of recipients, the grant has benefitted and provided relief to many vulnerable people. The report assessing inequality in Southern Africa published by the World Bank in 2018 found that the SA grant system has been effective in reducing poverty and inequality rates. Social grants were calculated to have reduced SA's inequality levels, measured by the Gini coefficient, by 6.4% in 2018. We believe this positive effect has translated to the relatively higher CCI reading for low-income households since the start of the SRD grant. In the absence of the grant, low-income households would likely be showing signs of more distressed sentiment.

Given the realised benefits, there is immense pressure from different groups lobbying for government to extend the SRD grant and turn it into a Basic Income Support. While this may be beneficial in preventing the index for low-income households from slipping back to more pessimistic levels, it will apply more pressure on an already constrained fiscus in SA. Without a consistent improvement in revenue collections, such as what was recorded in the first quarter of fiscal year 2022/23, it will be difficult to fund the grant on an ongoing basis and it may worsen the fiscal dynamics and further prevent the government from focusing on other priorities such as job creation.

Chart 5: Employment growth ticks up together with y/y low-income CCI



Source: BER, Stats SA
Data until second quarter of 2022

The rate of job creation for semi-skilled and low-skilled individuals in SA has been muted with an average growth rate of 0.2% from 2009. This coincides with the previously consistent pessimistic sentiment of low-income households witnessed in chart 2 which shows the low-income households' confidence levels below the other two categories for an extended period. However, the average rate of job growth for semi-skilled and low-skilled has averaged at 1.9% during the last three quarters, which has contributed positively to the optimism witnessed in low-income households.

Retail trade sales came in weaker than market expectations in June 2022

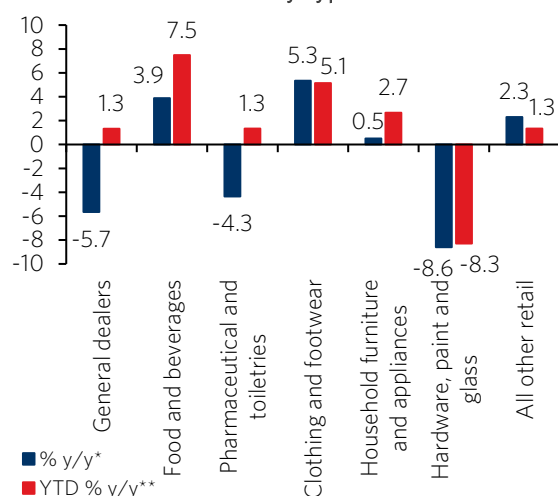
Retail trade sales in June 2022 were negatively affected by higher inflation rates, tighter monetary policy, continued loadshedding, the effects of the KwaZulu-Natal (KZN) floods and the resultant lower consumer confidence.

The seasonally-adjusted (s/a) retail sales volumes decreased by 0.4% month-on-month in June 2022 resulting in a y/y decline of 2.5%. This outcome surprised to the downside relative to the median Reuters market expectation of 0.4% y/y but this mirrors the weakness in economic growth seen in the second quarter of 2022.

The y/y decline in retail trade sales was a result of the negative growth rates recorded in hardware, paint, and glass (8.6%), general dealers (5.7%) and pharmaceutical and toiletries (4.3%) which outweighed positive growth recorded in clothing and footwear (5.3%), food and beverages (3.9%), other retailers (2.3%) and household, furniture and appliances (0.5%).

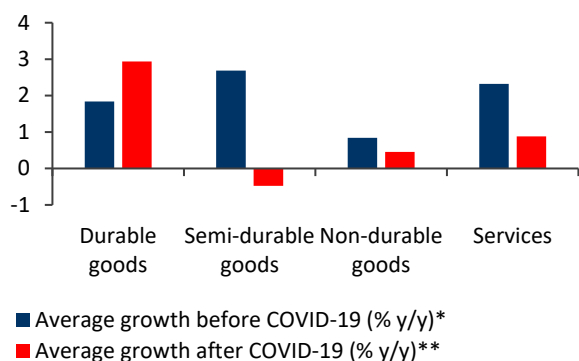
The year-to-date (YTD) data also indicates that the two largest contributors to retail sales are food and beverages (7.5%) and clothing and footwear (5.1%). The former may be due to a shift in consumers focussing on necessity goods given the pressure of high inflation and rising interest rates, as indicated in table 1, while the latter may partly be attributed to low base effects from the lockdown restrictions. On the other hand, hardware, paint and glass is the only retailer group recording negative YTD growth of 8.3%. This may partly be attributed to the high base effect because the industry experienced a surge during the COVID-19 pandemic when households embarked on home renovations to suit the working-from-home dynamics. However, we also believe the negative growth in hardware, paint and glass is reflective of consumers being in necessity mode and cutting back on discretionary spending given the prevailing economic conditions.

Chart 6: Retail trade sales by type of retailer



Source: Global Insight, Momentum Investments
Note: Some retailer names have been amended from the Stats SA publication
* June data
** YTD = January to June

Chart 7: COVID-19 affected spending habits



Source: BER, IRESS, Momentum Investments

*Before COVID-19 = first quarter of 2008 until the fourth quarter of 2019

**After COVID-19 = first quarter of 2020 until the third quarter of 2022

The trends witnessed in retail trade sales are a symptom of the effects of COVID-19. As depicted in

Household credit growth muted amidst the high interest rate environment

Household debt and debt service cost ratios (as a share of disposable income) were relatively unchanged from the fourth quarter of 2021 to the first quarter of 2022 at 52.5% from 52.6% and 7.3% from 7.2%, respectively.

Moreover, the real y/y growth in private sector credit extension to households recorded an average growth of negative 0.1% in the second quarter of 2022, suggesting that households are reluctant to ramp up debt in the current challenging economic environment of high interest rates.

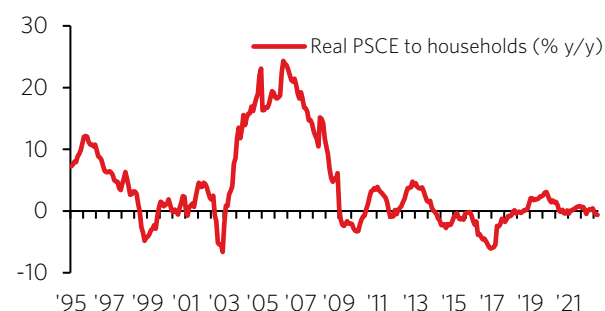
Therefore, we do not expect a major increase in the ratio of household debt ratio to disposable income in the second quarter of 2022 given reasonably weak household credit growth as depicted in chart 8, a reluctance to borrow and the expectation of a higher interest rate burden.

Hard times ahead for the SA consumer

Notwithstanding a marginal uptick in the consumer sentiment reading for the third quarter of the year,

chart 7 and alluded to previously, there was pent-up demand for durable goods (for example, desks and IT equipment) to make working from home more comfortable. As such, we may continue to see weaker growth for durable goods because of the high base effect. On the other hand, the services sector was the worst hit due to the lockdown restrictions which hampered face-to-face gatherings. We may see higher growth in this sector as households take on the opportunity to explore more and travel. Lastly, semi-durable and non-durable goods were also negatively affected, which signals higher future growth, on a relative basis, in these areas.

Chart 8: Household credit growth is mildly negative in real terms



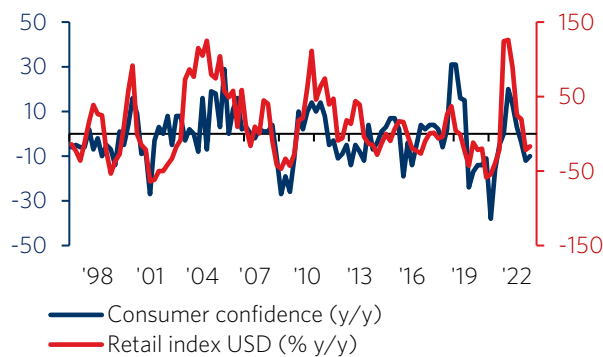
Source: Global Insight, Momentum Investments

Data until 31 July 2022

We expect further rate hikes by the Monetary Policy Committee (MPC) of 75bps in September 2022 and another 50bps in November 2022, and we expect these rate hikes to lead to an increase in the debt service cost ratio in the coming months. This will consequently dampen households' expected financial position and consumer sentiment in general.

consumer confidence remains depressed relative to the long-term average.

Chart 9: Consumer confidence drives the SA retailer index



Source: BER, Bank of America Merrill Lynch, IRESS, Momentum Investments
Data until third quarter of 2022

Chart 9 depicts the correlation between the consumer confidence and retailer indices which suggests that retail trade sales may rebound in the near term (third quarter of 2022) in line with the slight improvement in overall CCI and the sub-index relating to the suitability of the present time to buy durable goods. This signals a recovery in economic growth in the third quarter after the depressed growth in the second quarter which was driven down by extensive flooding in KZN and a higher incidence of electricity supply shortages.

Nevertheless, in the coming quarters we expect structurally high unemployment, higher inflation, a further increase in interest rates and lower asset price inflation to weigh negatively on consumer sentiment. Consequently, we expect growth in household consumption to slow from an expected 1.9% this year to 1.5% next year.

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