



Media Release: South Africa's economic growth surprisingly strong – could top 3.5% in Q1 2010

20 April 2010 - The South African economy has come through the first quarter of 2010 with surprisingly strong momentum, with GDP growth likely to top the 3.5% q/q (seasonally adjusted annualised rate - saar) posted in the fourth quarter of 2009, according to Johann Els, senior economist at Old Mutual Investment Group (SA) (OMIGSA).

"The key economic indicators in the past months have mostly surprised to the upside, making the local recovery much stronger than previously expected," said Els. "We could see GDP growth for the first quarter of 2010 coming in as high as 4.0% q/q (saar). This has been propelled by company restocking after last year's sharp downturn in demand, as well as a long-awaited revival in consumer demand."

Els is particularly encouraged by the latest evidence from South African consumers, showing steadily rising consumer confidence and a slow recovery in net debt usage. However, he notes, this consumer recovery is likely to be slower than previous cycles because of the severity of the decline in real incomes – real disposable income growth has been negative since 2008 and remains so, with after-tax income growth still not keeping pace with inflation.

That being said, key indicators pointing to the surprisingly robust state of the economy include (all measured on a quarter-to-date basis relative to the fourth quarter of last year at an annualised pace): car and commercial vehicle sales with growth of 117% and 59.3%, respectively; retail sales growth of 15.5%; electricity production growth of 16.9%; mining production at 12.0%; and an increase in consumer credit extension of 3.7%.

"This puts us on track for annual average GDP growth of around 3.5% for the 2010 calendar year," added Els. "Our forecast is somewhat more optimistic than the current 3.1% median broker forecast, because we are placing more importance on the recovering inventory cycle's impact on the economy over the next few quarters. This has already been a positive influence on the Q4 2009 GDP data."

Also adding to the positive picture is the marked improvement in the country's current account deficit, which now sits at -2.8% of GDP compared to -8.5% of GDP as recently as Q1 2008. This has helped underpin the rand, the strength of which has been a notable feature in recent months.

"The rand has been remarkably strong thanks to our relatively high real interest rates versus many other countries, plus our healthy fundamentals like government debt," explained Els. "The only concern we have on this front is the negative impact on our exports, which could bring pressure on the current account again. We do expect the rand to weaken gradually in the second half of 2010, to around R8.00 per US dollar. For now, though, the rand is benefitting from South Africa's healthy relative fundamentals and this is helping keep inflation in check."

On the inflation front, Els says the strong rand and falling food inflation are helping to push the overall CPI lower, and he expects inflation to dip below 5.0% y/y in the short term before drifting gradually higher in the 5.0%-5.5% y/y range in the second half of the year. "Consumers should enjoy the lower prices while they can, because we expect pressure from many different administered sources to make themselves felt during the rest of the year, he cautions. "Apart from the well-published Eskom electricity tariff increases, we'll see hikes in municipal rates and taxes, water, education and medical costs, among others."

With CPI set to remain just below the upper limit of the South African Reserve Bank (SARB)'s 3%-6% target range, Els expects interest rates to stay put at their current level for the remainder of the year, as long as the rand remains relatively steady and no other unexpected threats emerge.

"Given that the SARB has lowered interest rates in the past when the rand was very strong, as is the case now, there is an outside chance of another 50 basis point interest rate cut at the next Monetary Policy Committee meeting, but this is not our base case scenario," he explains. "There is also the risk that a weaker rand and higher oil price could combine to raise the inflationary threat towards the end of the year, which could cause the SARB to hike rates, but this is also a low probability. We only expect interest rates to begin rising in the first quarter of 2011," Els concludes.

ENDS

For further information, please contact:

Lynn Bolin
OMIGSA head of media and communications
(083) 443-0105
lbolin@omigsa.com