

MEDIA RELEASE

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SA LIKELY TO ESCAPE RECESSION IN THIRD QUARTER 2009

Recent economic data are pointing to the likelihood that South Africa came out of recession during the third quarter of 2009, with third quarter GDP data likely to show economic growth of around 2.0% ((on a seasonally adjusted annualised (saar) basis)), according to Johann Els, senior economist at Old Mutual Investment Group SA.

Els says that following contractions of -6.4% q/q (saar) in the first quarter and -3.0% q/q (saar) in the second quarter of this year, the local economy is starting to show solid signs of recovery following the consolidation of economic growth in the rest of the world.

“Although consumer demand remains weak, the strong government demand, improved exports and the inventory cycle are all supportive of growth,” he notes. “Key indicators like manufacturing output and new orders are rising, while electricity production and cement sales are higher, as are commercial vehicle sales. Even corporate credit extension has seen some small growth after two quarters of decline.”

However, the South African consumer has yet to experience the recovery, as shown by the -7.0% y/y fall in retail sales in August, the -8.8% drop in car sales in September and the contraction of 0.9% in consumer credit over the third quarter of the year, he points out.

Other factors supporting the recovery include the improving current account, which has moved from a deficit of over 8.0% of GDP in 2008 to around 3.0% of GDP currently, and the stronger rand, which has helped keep inflation in check.

Looking beyond the third quarter, Els is forecasting a relatively slow recovery, with average GDP growth of about 2.5% y/y for 2010, accelerating to around 4.0% y/y in the following two years.

Els says that relative to other economies emerging from the recession, South Africa’s forecast 2.5% growth rate lags those of most of Southeast Asia (at between 4% and 6%), as well as China (9%) and India (6.5%). It is roughly in line with the likes of Argentina, Australia, New Zealand, the US and Turkey.

However, SA compares poorly in terms of its expected 2010 government budget deficit of around -6% of GDP, which is higher than most countries apart from Malaysia, the US, Spain and Iceland (the latter two at more than -10% of GDP).

South Africa's inflation rate is also seen to be stubbornly higher than most, with Els projecting average CPI at 5.5% y/y for 2010. Only Russia (10%), Pakistan (7%), Argentina (6.2%) and India (6%) are higher (in our sample).

With CPI likely to remain at the upper end of the SARB's 3%-6% y/y target range for the foreseeable future, he believes that the South African Reserve Bank (SARB) is unlikely to reduce interest rates any further, with the repo rate remaining at its current level of 7.0% for the next 18 months or so. "The SARB is likely to cut rates further only if inflation drivers (like food and oil prices) *improve* substantially and the real economy *does not improve* substantially," he explains. "Or they could be forced to reduce more, despite the poor inflation outlook, if the economy proves to be weaker than expected, in combination with a strong rand."

Apart from the risk of a too-strong rand, the other key downside risk going forward, Els cautions, is the failure of consumer demand to recover. "Sustained consumer weakness is key to a 'W-shaped' cycle. Watch out for indicators such as capital spending, employment, household incomes and spending, as well as the SARB's outlook assessments."

A much lower risk is the possibility of a stronger-than-expected demand recovery. "This would warrant sooner-than-expected interest rate hikes from the SARB, which would put a clamp on the emerging growth cycle," he concludes.

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