South African Reserve Bank

Introductory remarks by Dr Monde Mnyande, Chief Economist and Adviser to the Governor at the launch of the March 2012 *Quarterly Bulletin* of the South African Reserve Bank

19 March 2012, Conference Centre Auditorium

Welcome to the launch of this issue of the *Quarterly Bulletin*, in which the focus is on the economic developments in the fourth quarter of 2011. My introductory remarks highlight just a handful of aspects that are noteworthy, while a more comprehensive overview of economic developments as covered in the *Bulletin* will be presented by one of my colleagues.

The picture of the South African economy that emerges from the analysis in this issue of the *Quarterly Bulletin* is slightly more positive than the snapshot taken three months earlier. Following the disappointing growth outcomes in the middle quarters of 2011, the economy expanded at a significantly higher growth rate in the final quarter of the year. While part of this improvement reflects a recovery from activity levels which had been dampened by industrial action and other short-term forces, part of it also seems to indicate a more firmly grounded and sustainable performance.

An aspect that is of particular interest to the public, not least to central bankers, is the behaviour of the household balance sheet in general and household debt in particular. The outstanding amount of household debt rose further in the final quarter of 2011, as it has been doing throughout the post-crisis period. However, over the four years up to early 2008 it rose at an average rate of 21 per cent per annum, almost double the pace of increase in households' nominal disposable income. Over the past three years, by contrast, household debt has been growing at a rate of 5 per cent per annum, while income has been rising at rates of around 8½ per cent per annum. Accordingly, the ratio of household debt to annualised disposable income soared to a peak value of 82,7 per cent early in 2008, but subsequently receded to 74,6 per cent at the end of 2011.

What stimulated the household sector's appetite to borrow (and the lenders' willingness to lend) during the period up to 2008? The sharp increases in the value of the household sector's assets played an important role: For instance, with house prices increasing rapidly, many households found that they could incur further debt but still have higher net worth (household assets minus household debt) at the end of the period than at the beginning of the period. From a lender's perspective, this upward movement in net worth also improved confidence in prospective borrowers' ability to repay loans. Household net worth rose much more rapidly than household income in the four years to early 2008. But as the upward cycle reached maturity and with monetary policy being tightened from 2006, more expensive borrowing and slower increases in net worth started to restrain the appetite for borrowing, in turn acting as a constraint on further increases in asset prices.

From 2008 to the present day house prices have been subdued, which has been reflected in household borrowing in general and the demand for mortgage finance in particular. We have been fortunate in that, on one hand, the unsustainable surge in household debt has come to an end, but, on the other, household deleveraging did not take place in leaps and bounds accompanied by a collapse in consumption expenditure. A situation as we have seen over the past few years, with increases in household consumption expenditure tuned to growth in household income while deleveraging is gradually taking place, is quite appealing.

That said, South African households' debt-to-annual-income ratio at almost 75 per cent is still quite high compared with its average over the past two decades of approximately 64 per cent. One should also be mindful that the so-called unsecured lending to households is currently rising apace, and that installment sale credit has been increasing alongside brisk expenditure on durables, while growth in mortgage credit and housing activity has been very slow in the light of South Africa's housing needs. Over time, an element of rebalancing in these respective growth rates would probably be to the benefit of the economy. The recent increases in employment could bring the prospect of firmer increases in mortgage lending and housing activity closer, since "jobs" tend to come before "housing."

The second matter that I would like to refer to briefly is the increase in fixed capital formation in 2011, which is well covered in this *Bulletin*. The acceleration that was recorded towards the year-end is to be welcomed, not least on account of the emphasis which the President of the Republic of South Africa, in his *State of the Nation address*, placed on infrastructure projects as a key element of the country's drive to create jobs and grow the economy. Both the public and the private sector played a part in the recent acceleration in capital spending.

Finally, with inflation currently running above the inflation target range, a number of points should be underlined. Firstly, the Bank is mindful of the lags in monetary policy and so the emphasis should be on where inflation is projected to be 18 to 24 months into the future. Recent projections provided for a path with consumer price inflation remaining moderately above 6 per cent in 2012 but receding to below 6 per cent from early 2013. Secondly, underlying measures of inflation (interchangeably referred to as core inflation) deserve thorough scrutiny because they can give a sense of whether the more exogenous drivers of inflation have started to ignite second-round price effects. In this connection the consumer price index excluding volatile components such as food, petrol and electricity prices has recently exhibited rates of inflation that are higher, but still well within the target-range – in fact still marginally below the midpoint of the target range of 3 to 6 per cent. In addition, the above-the-target-range increases in labour costs and other administered prices such as rates and taxes, education and water, are expected to exert upward pressure on core inflation over the short- to medium term. However, the recent appreciation of the exchange rate of the rand, together with the weaker global growth, is likely to have a moderating impact on the core inflation trajectory in the medium term. Thirdly, Bank staff are currently working hard to update these projections, for instance, to incorporate scenarios with a higher oil price and a lower price of electricity[1] than previously. These will be interrogated extensively in the forthcoming Monetary Policy Committee meeting.

[1] The recent announcement by the National Energy Regulator of South Africa (NERSA) to cut the average increase in Eskom's electricity rates to 16 per cent for 2012/13, from the previously approved 25,9 per cent increase, will have a positive effect on headline inflation.