SA ECONOMIC OVERVIEW & OUTLOOK

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Group Economic Research

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Outline

- Introduction
- SA trade highlights & balance of payments
- Rand, inflation and interest rates
- Economic growth
- Risks, challenges and forecast highlights

Introduction

Republic of South Africa

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Selected demographic and other indicators for South African provinces

	Population (million)	Population growth (% pa)	Urbanised (%)	Annual household income ($)	GGP ($ bn)	GGP (% of total)	GGP per capita ($)
Province							
KwaZulu-Natal	9.6	1.4	46.1	11 812	25.3	13.0	2 634
Gauteng	8.7	1.7	95.8	20 613	71.4	36.8	8 197
Eastern Cape	6.9	1.1	36.5	8 473	13.2	6.8	1 919
Limpopo	5.5	1.4	13.1	7 965	8.7	4.5	1 562
Western Cape	4.5	1,4	89.0	18 563	33.7	17.4	7 543
North West	3.8	1.3	38.2	8 885	12.9	6.7	3 418
Mpumalanga	3.3	1.7	41.7	10 002	15.6	8.1	4 811
Free State	2.9	1.0	71.7	8 404	9.5	4.9	3 242
Northern Cape	0.9	1.0	71.8	12 228	3.6	1.8	3 889
South Africa	46.1	1.4	55.4	13 011	194.0	100.0	4 207

Notes

Source: Stats SA; Global Insight

All figures are 2002 estimates

US$ amounts were calculated by applying the PPP rate to the rand amounts

GGP = gross geographic product

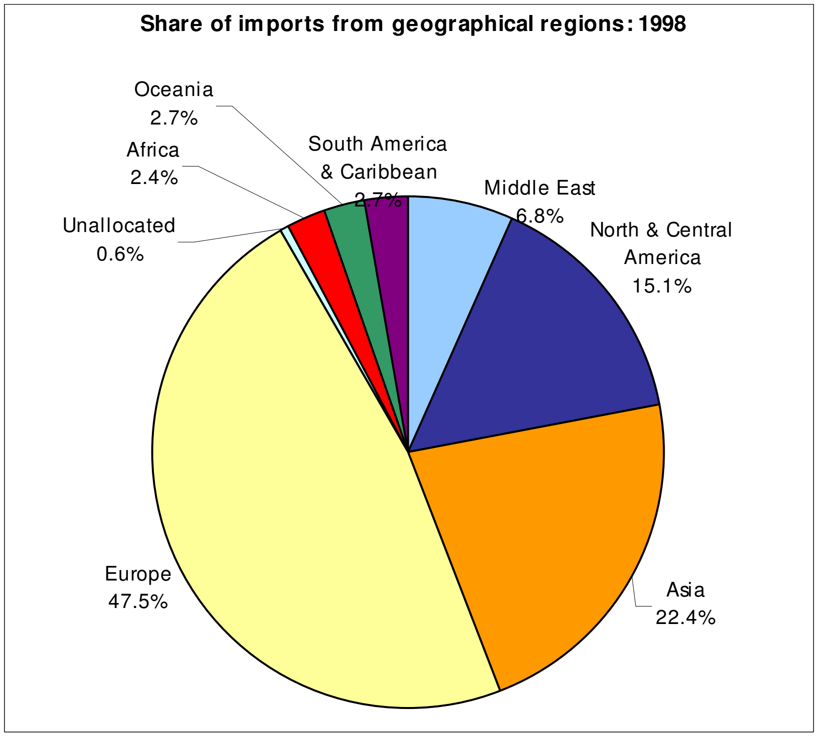
International comparisons

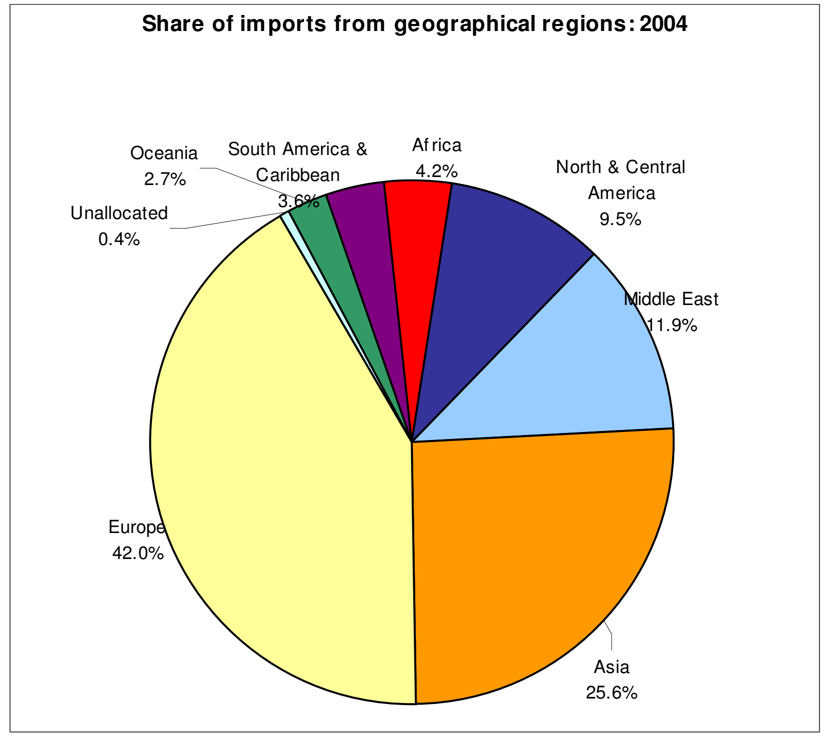
[rankings in brackets]

	GDP ($ bn)	GDP (PPP $ bn)	GNI per capita
USA	11 668 [1]	11 628 [1]	41 400 [5]
China	1 649 [7]	7 123 [2]	5 530 [116]
Australia	632 [13]	606 [16]	26 900 [24]
Turkey	302 [20]	553 [17]	7 680 [89]
South Africa	213 [27]	510 [20]	10 960 [74]
Belgium	350 [18]	323 [27]	31 030 [17]
Nigeria	72 [50]	156 [50]	930 [193]

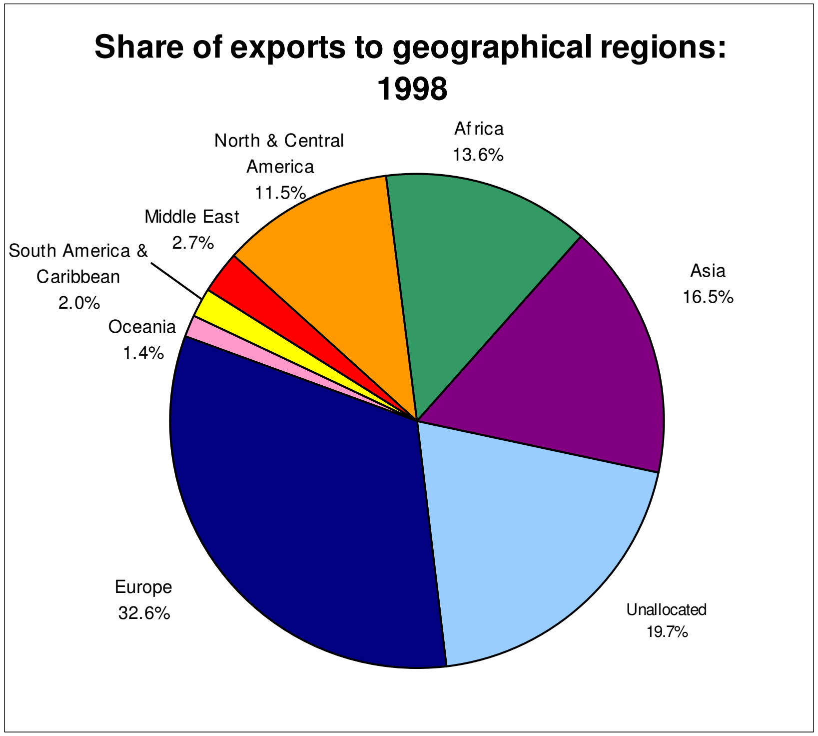
SA trade highlights and balance of payments

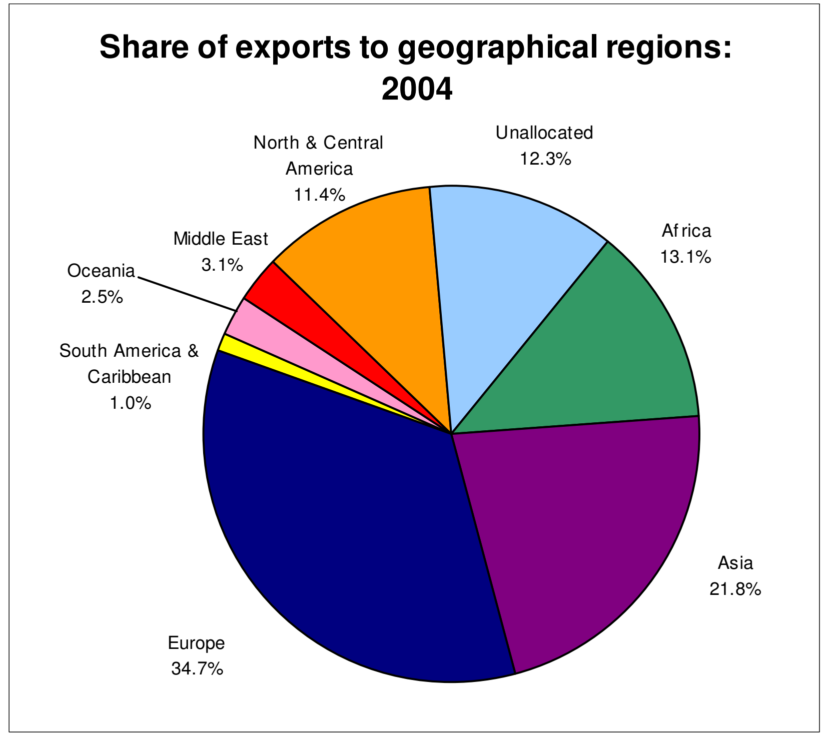
SA import origins – 1998 & 2004



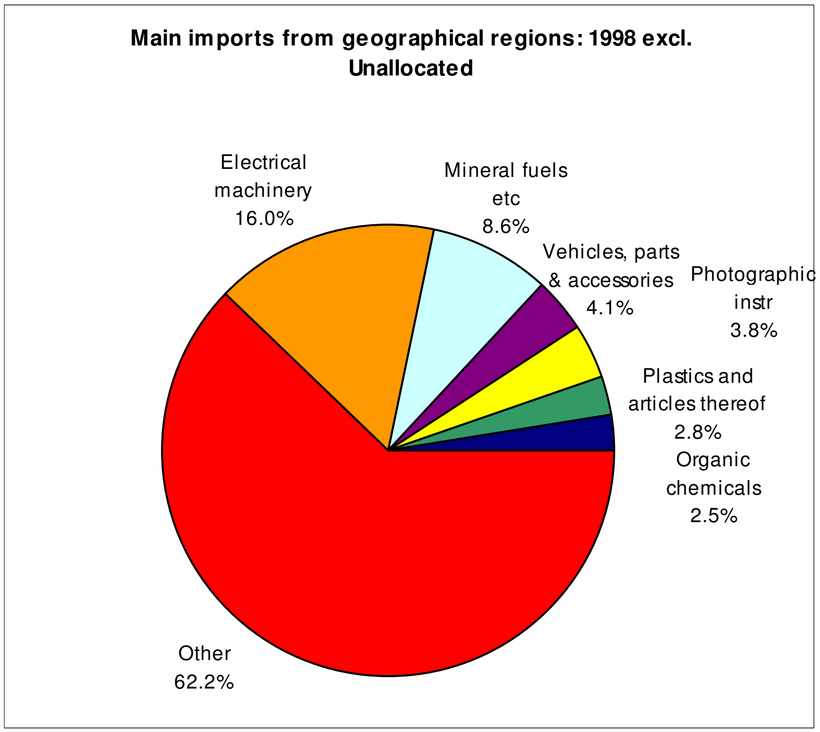


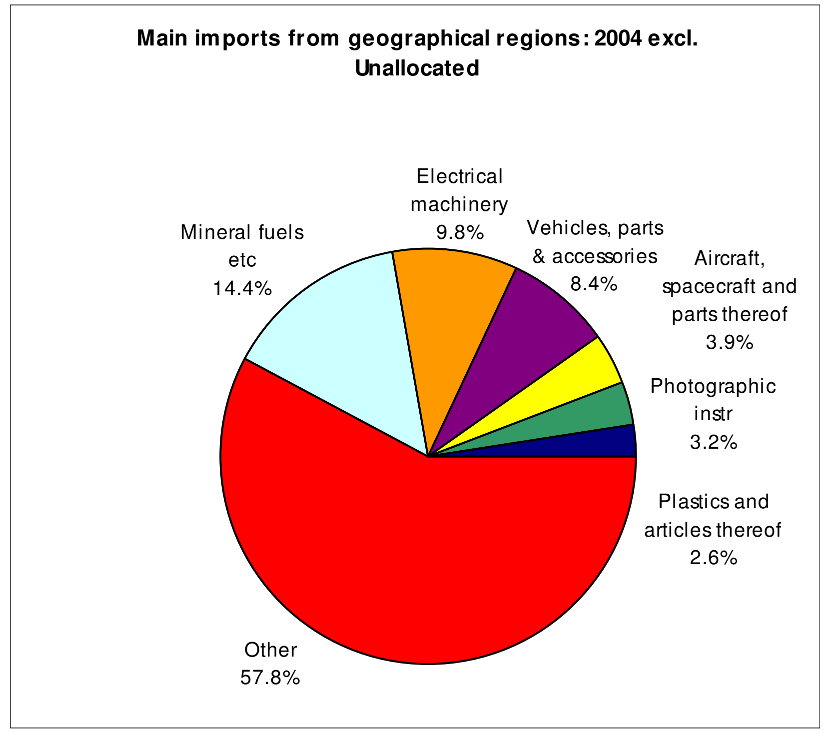
SA export destinations – 1998 & 2004



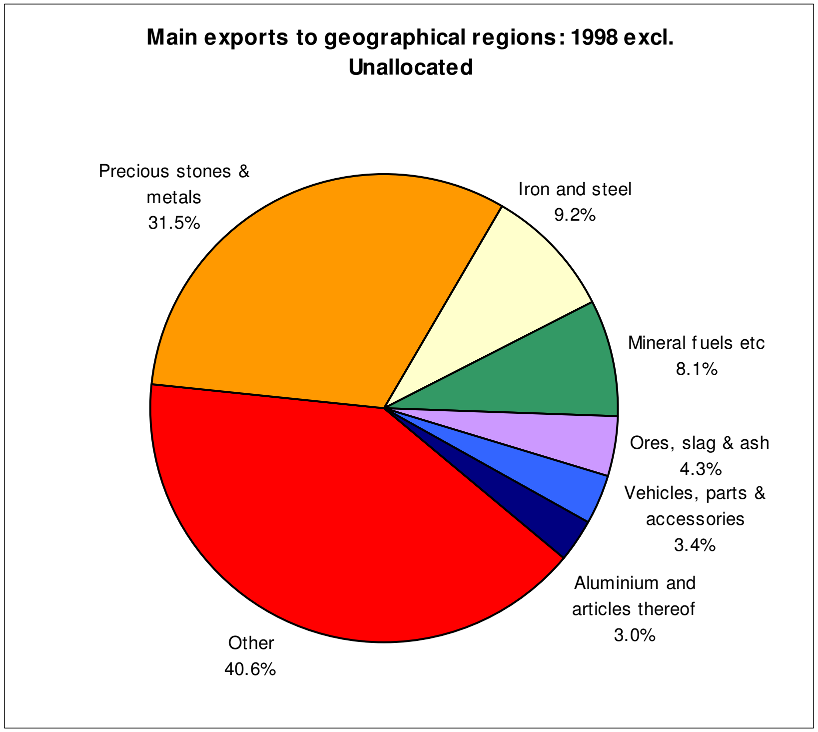


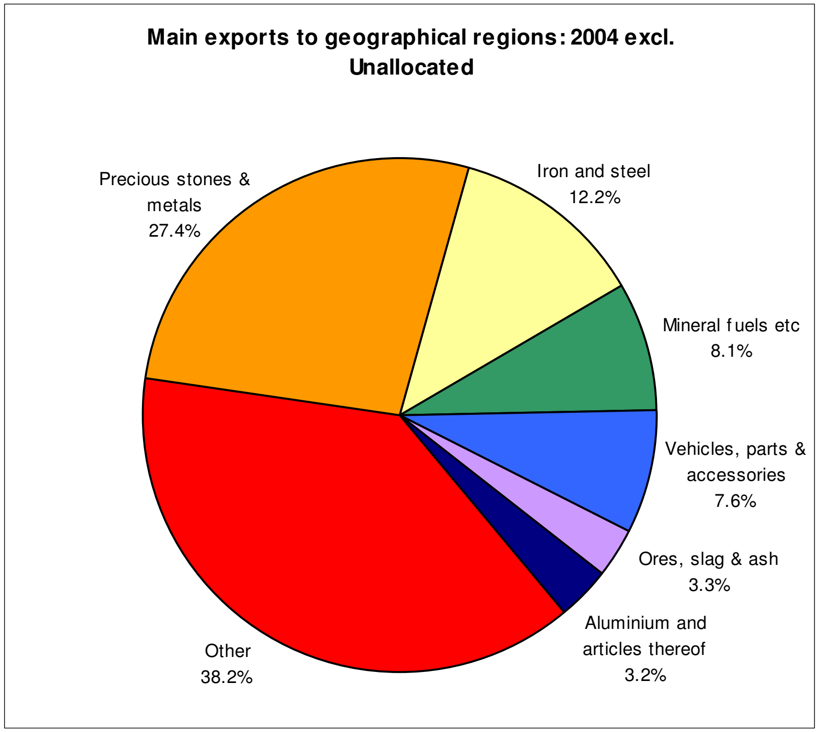
SA import categories – 1998 & 2004



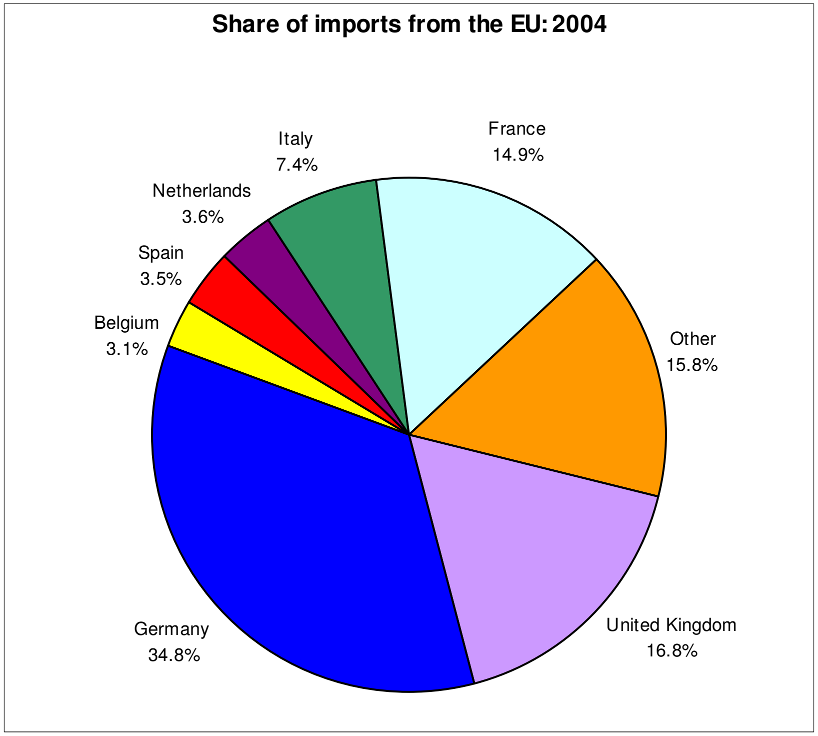


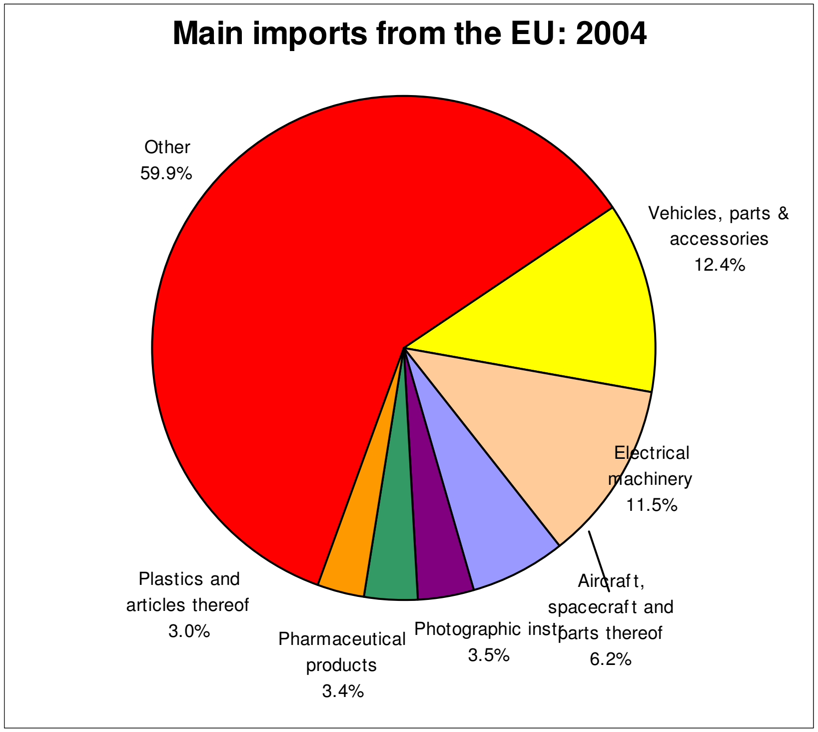
SA export categories – 1998 & 2004





SA imports to the EU - 2004





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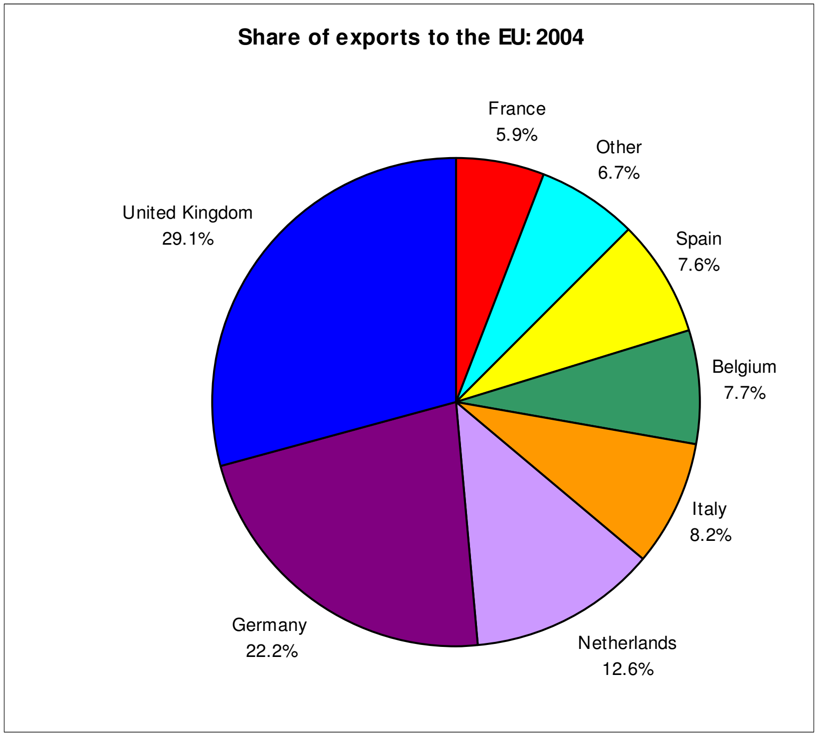
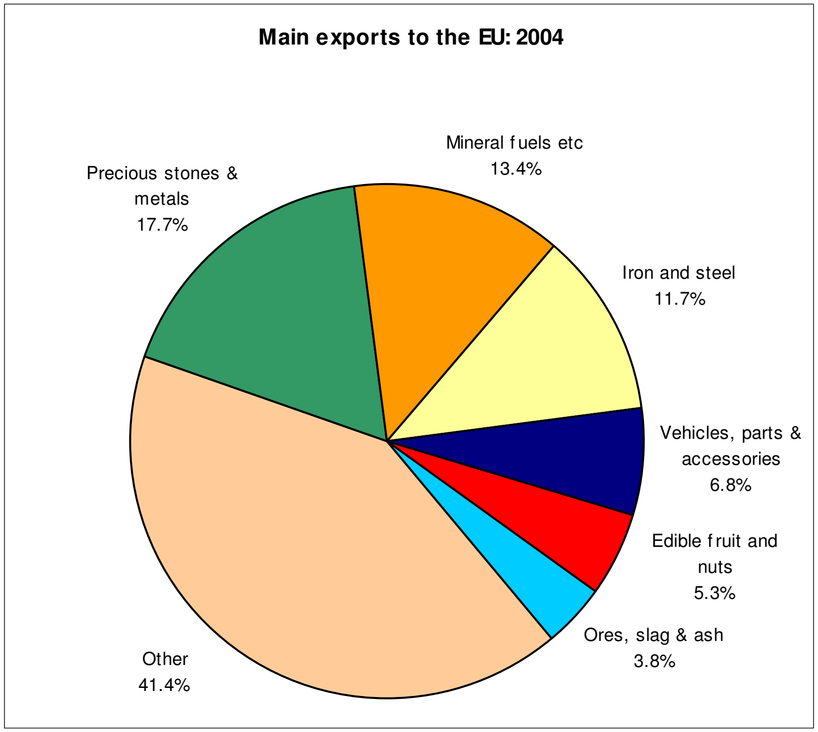
SA exports to the EU - 2004

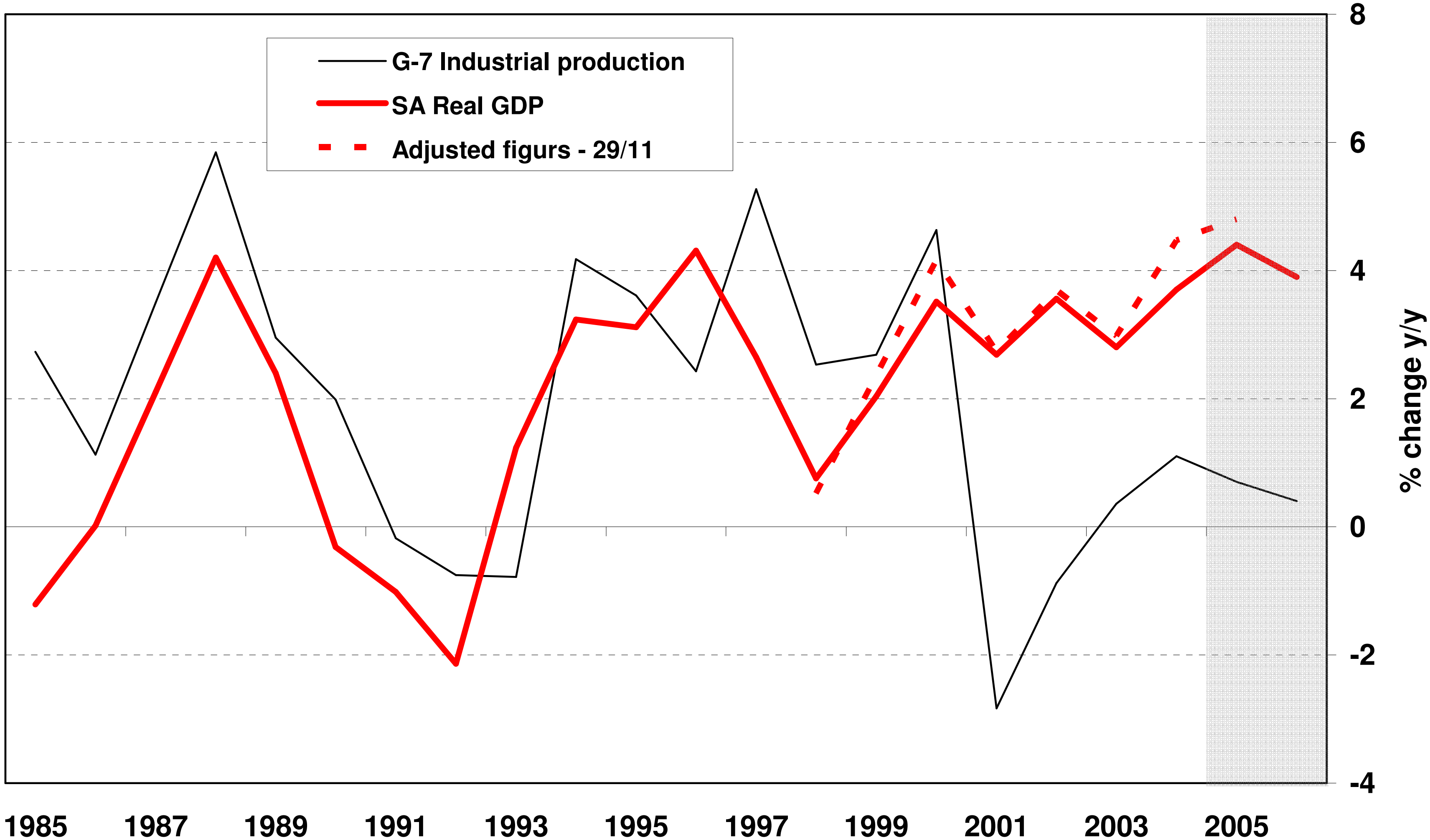




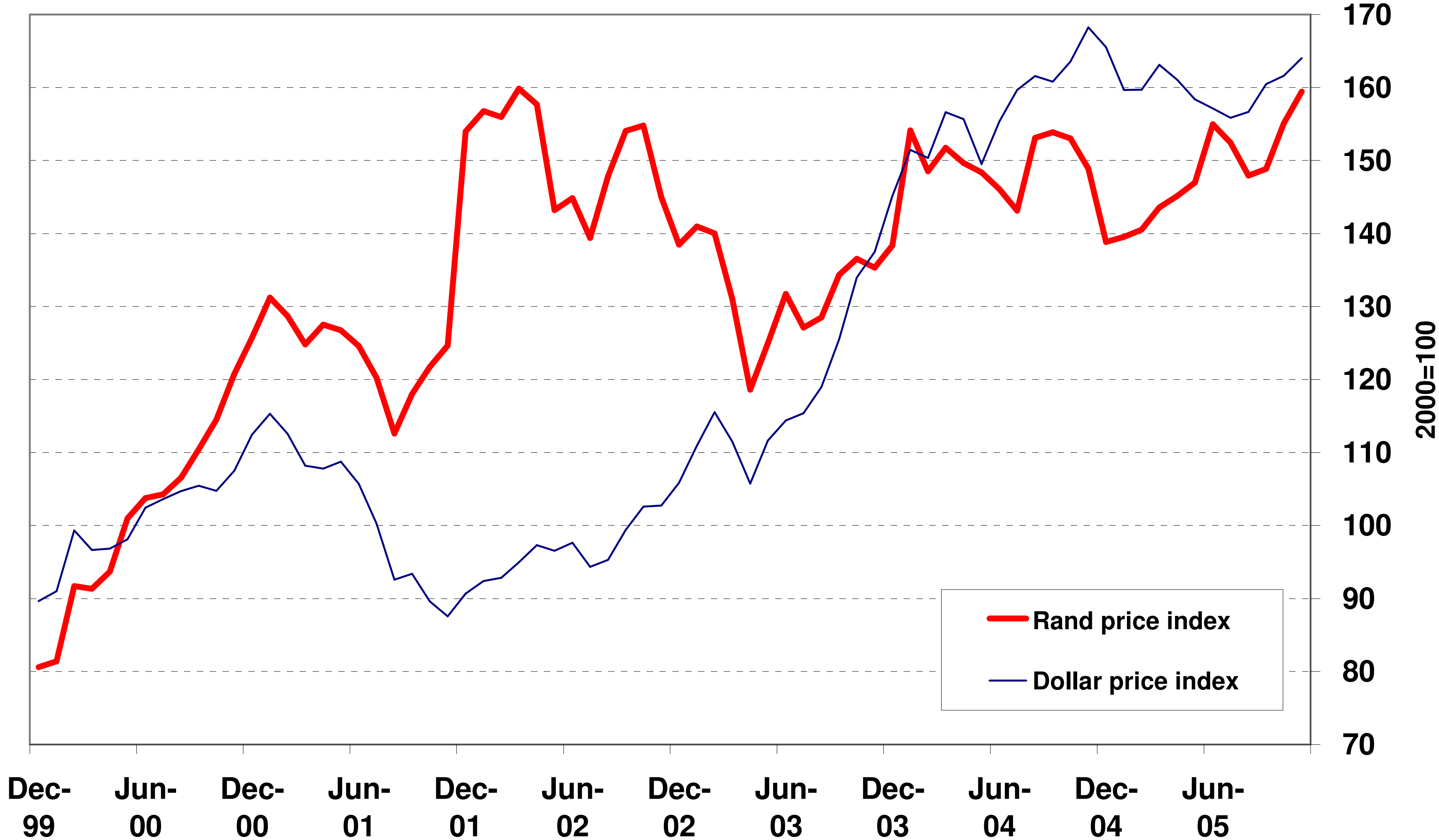
South Africa's trade with Belgium

Exports	R'000		Imports	R'000	
Precious stones, etc	2 607 037	36.1%	Machinery and mechanical appliances	654 555	17.1%
Iron and steel	983 372	13.6%	Plastics	456 661	11.9%
Edible fruit and nuts	615 931	8.5%	Organic chemicals	410 247	10.7%
Mineral fuels, oils and products	524 766	7.3%	Precious stones, etc	233 120	6.1%
Machinery and mechanical appliances	413 767	5.7%	Pharmaceutical products	203 965	5.3%
Vehicles	266 309	3.7%	Miscellaneous chemical products	179 332	4.7%
Organic chemicals	242 148	3.4%	Electrical machinery	135 876	3.5%
Ores, slag and ash	234 137	3.2%	Mineral fuels, oils and products	109 316	2.8%
Paper	136 381	1.9%	Inorganic chemicals	97 159	2.5%
Inorganic chemicals	113 994	1.6%	Iron and steel	93 242	2.4%
Beverages, spirits	105 286	1.5%	Vehicles	89 484	2.3%
Aluminium	102 785	1.4%	Articles of iron or steel	81 771	2.1%
Railway or tramway locomotives	99 936	1.4%	Fertilizers	79 824	2.1%
Other	780 811	10.8%	Other	1 014 464	26.4%
	7 226 660	100.0%		3 839 016	100.0%

G7 industrial production vs SA GDP



Absa SA mining commodities index



Absa SA mining commodities index

The Absa Mining Commodities Price Indec (MCPI) is a composite index of South Africa's most important mining export commodities. It consists of 12 mining export commodities that are weighted on export values. The weights are automatically adjusted each month and reflect the average values of the most recently available 12 month period. Gold, Platinum and Coal make up more than 85% of the index.

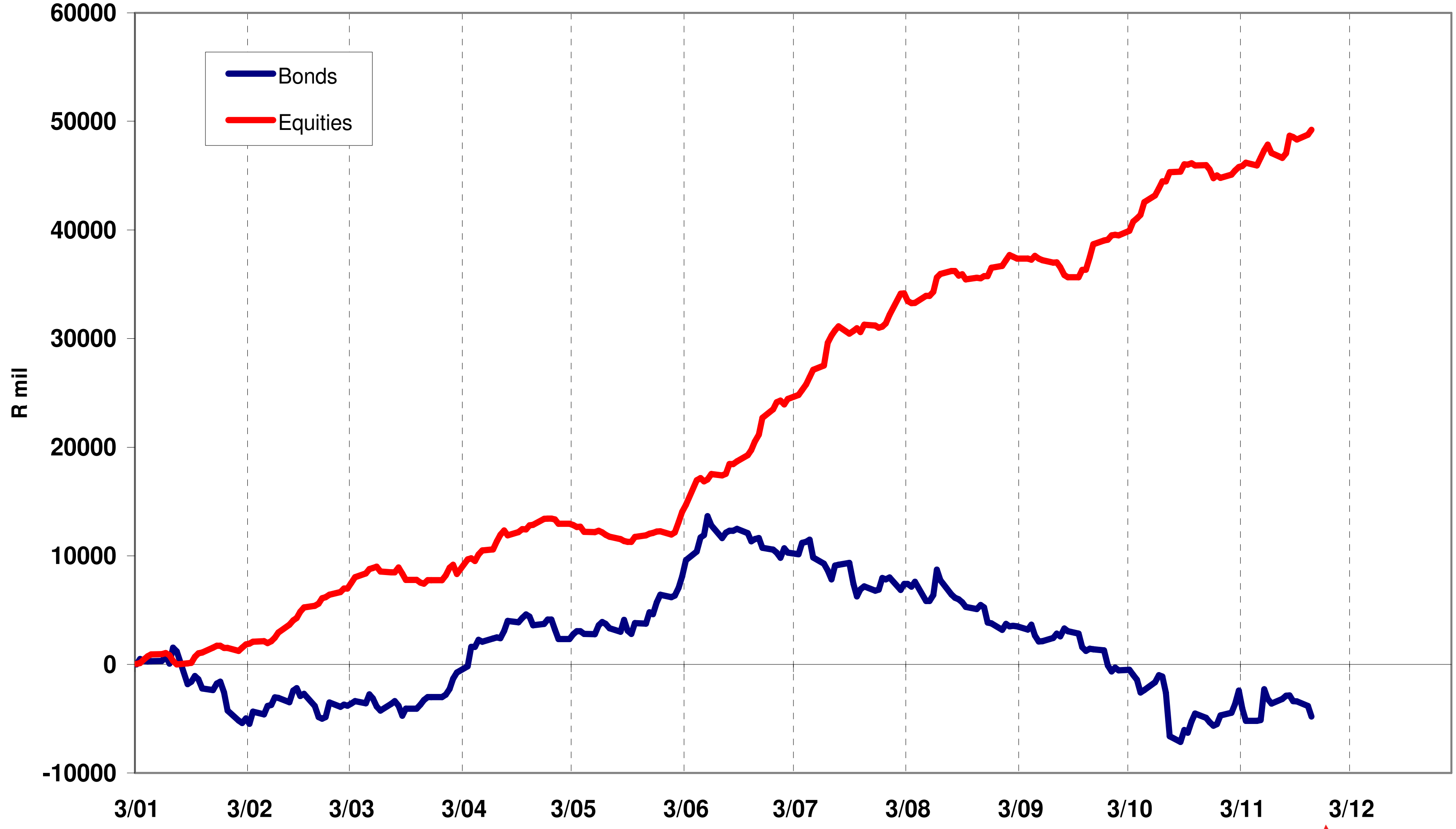
For October 2005, the weights were as follow:

Chromite	0.4%	Lead	0.4%	Silver	0.1%
Cobalt	0.1%	Manganese	1.8%	Platinum	34.7%
Copper	0.7%	Nickel	2.1%	Gold	31.1%
Irone ore	5.2%	Coal	20.0%	Palladium	3.3%

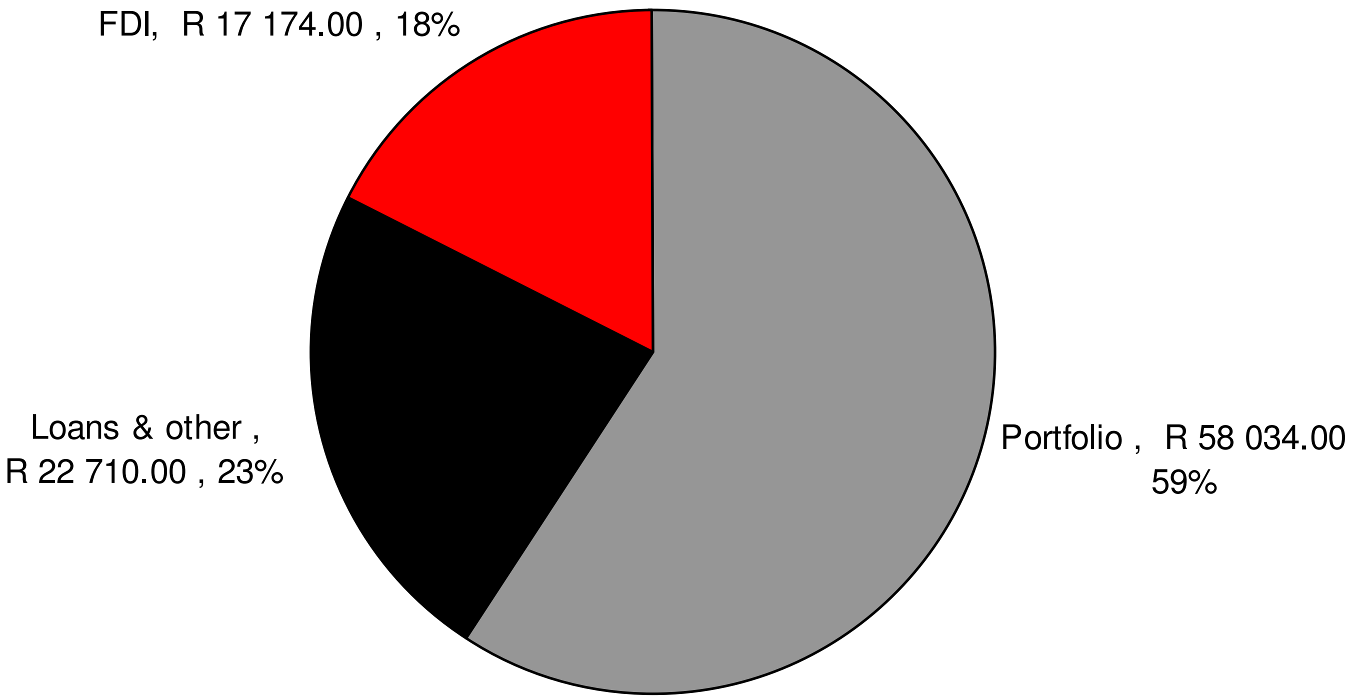
During November 2005, many of SA's export commodity prices were at multi-year highs, eg:
(average, in USD)

	Price	Highest in	y/y% change ($)	y/y% change (R)
Gold	$473.82/oz	18 yrs	8.0%	19.0%
Platinum	$958.46/oz	ever	12.4%	23.8%
Copper	$4250.6/tonne	ever	36.1%	50.0%
Palladium	$242.53/oz	1,5 yrs	13.5%	25.0%
Zinc	$1598.30/tonne	8 yrs	45.8%	60.6%
Iron ore	$385/tonne	-	-35.1%	-28.5%

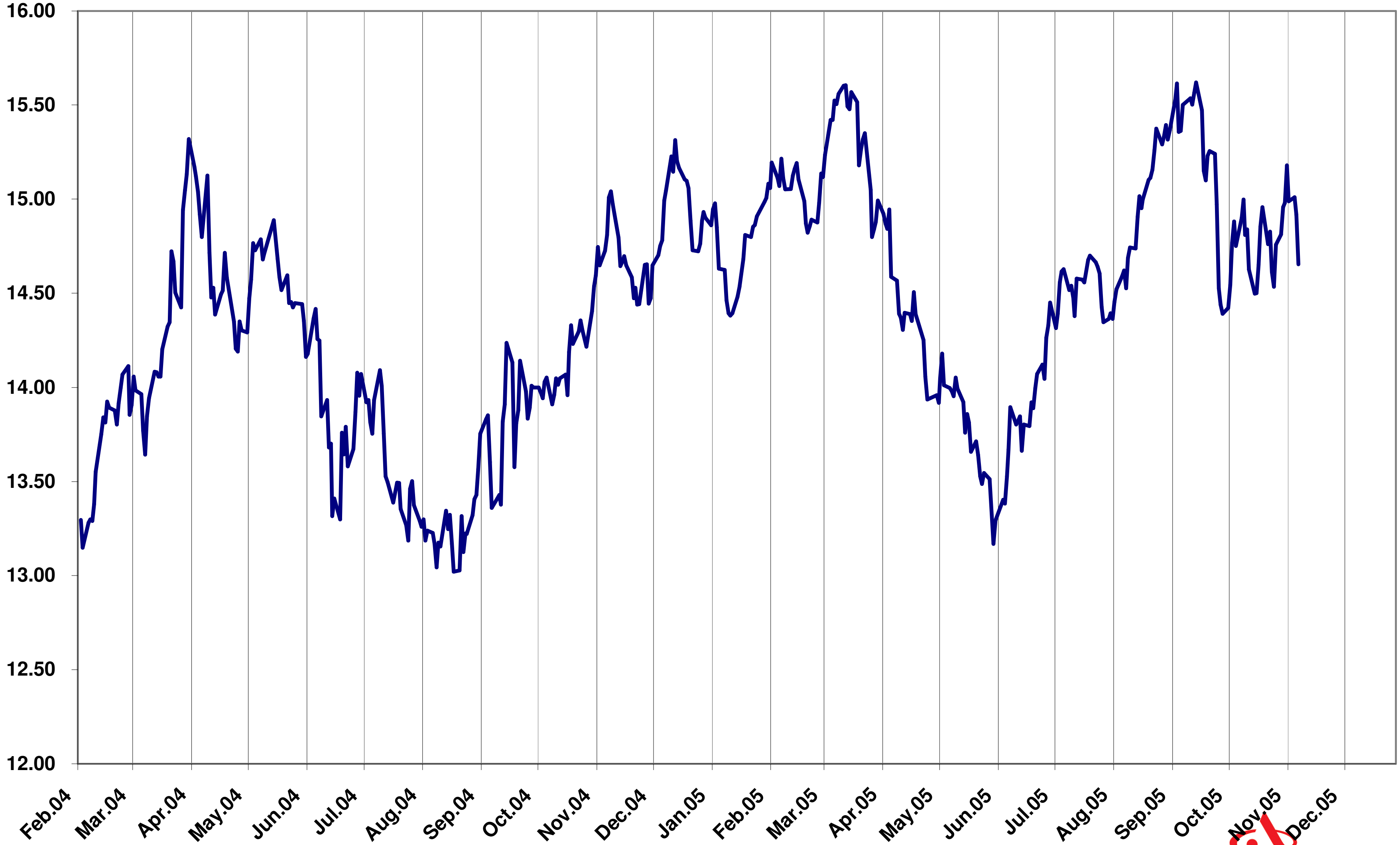
Net foreign purchases



Composition of capital inflows: 2002-2004



Alsi PE ratio



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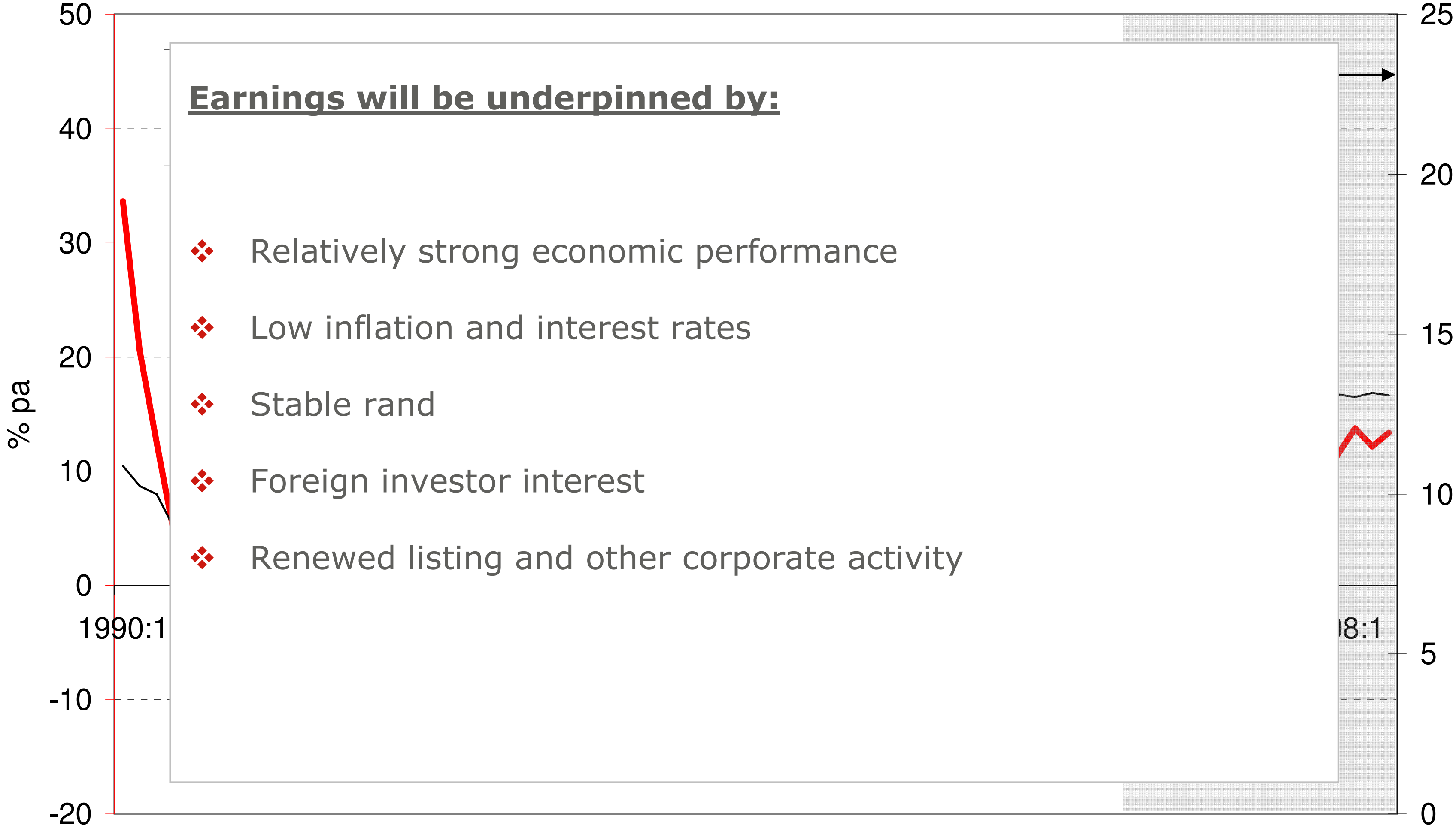
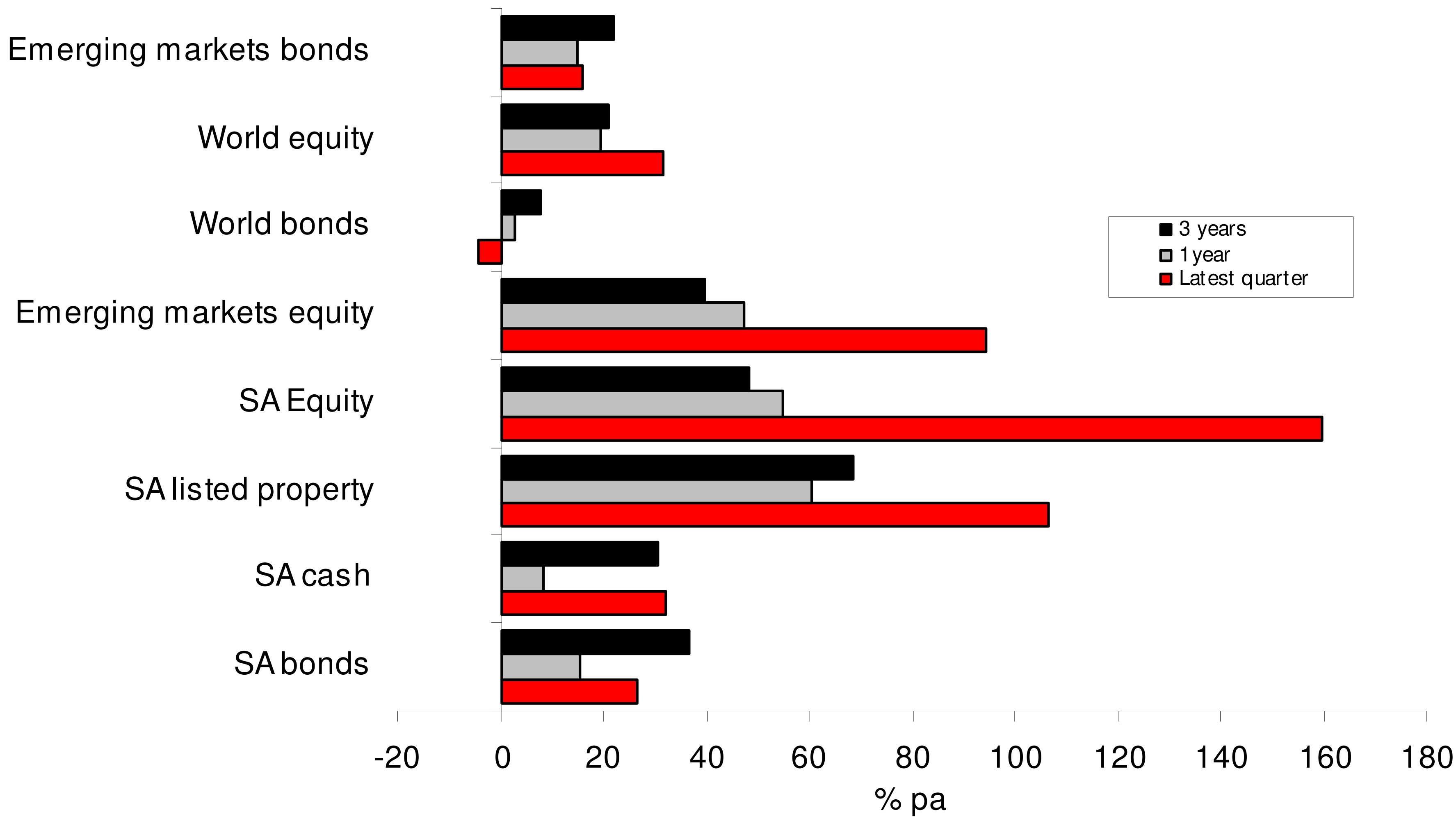
JSE All-share: PE and earnings growth forecasts



Earnings will be underpinned by:

- Relatively strong economic performance
- Low inflation and interest rates
- Stable rand
- Foreign investor interest
- Renewed listing and other corporate activity

Average returns up to end 09/2005



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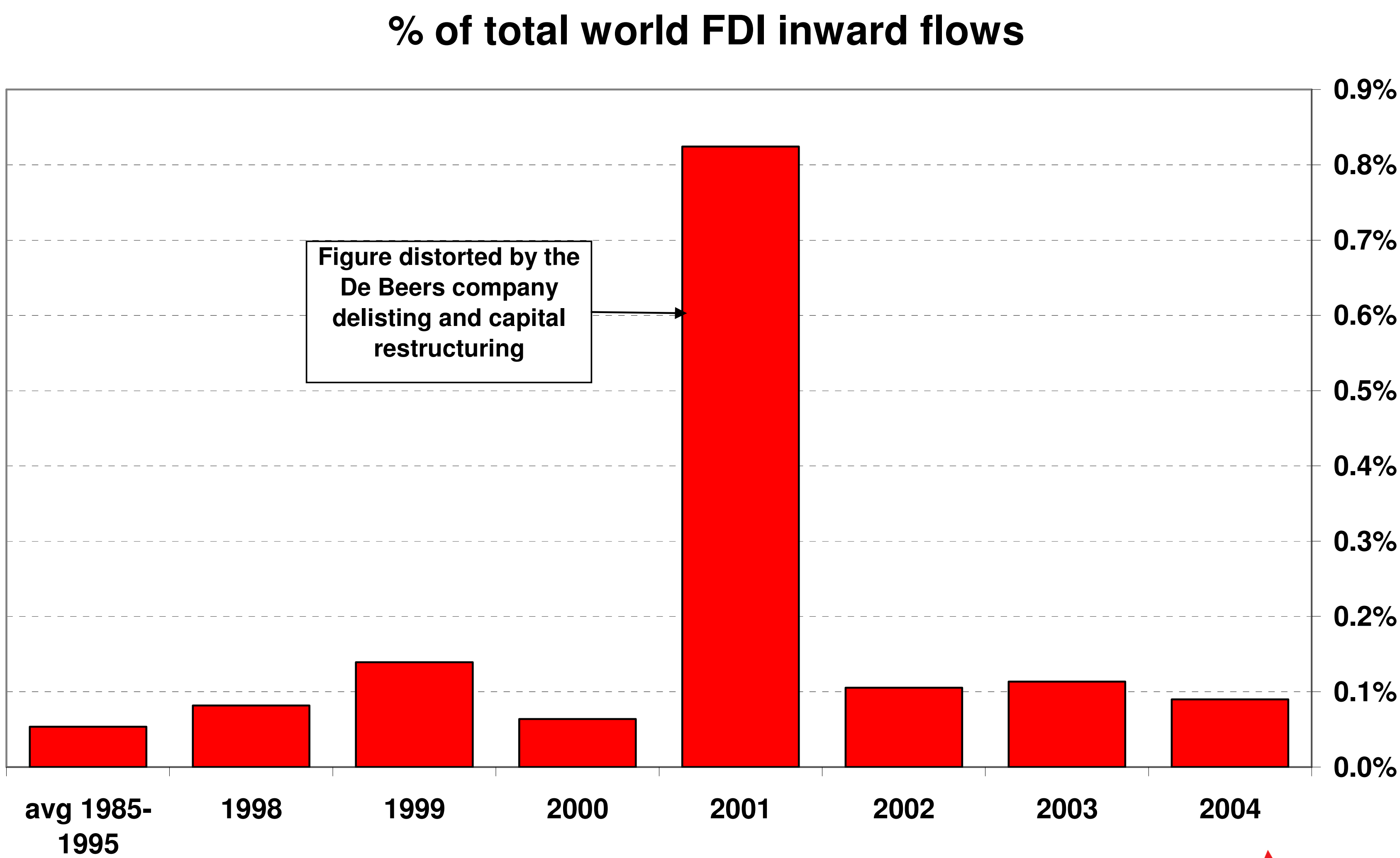
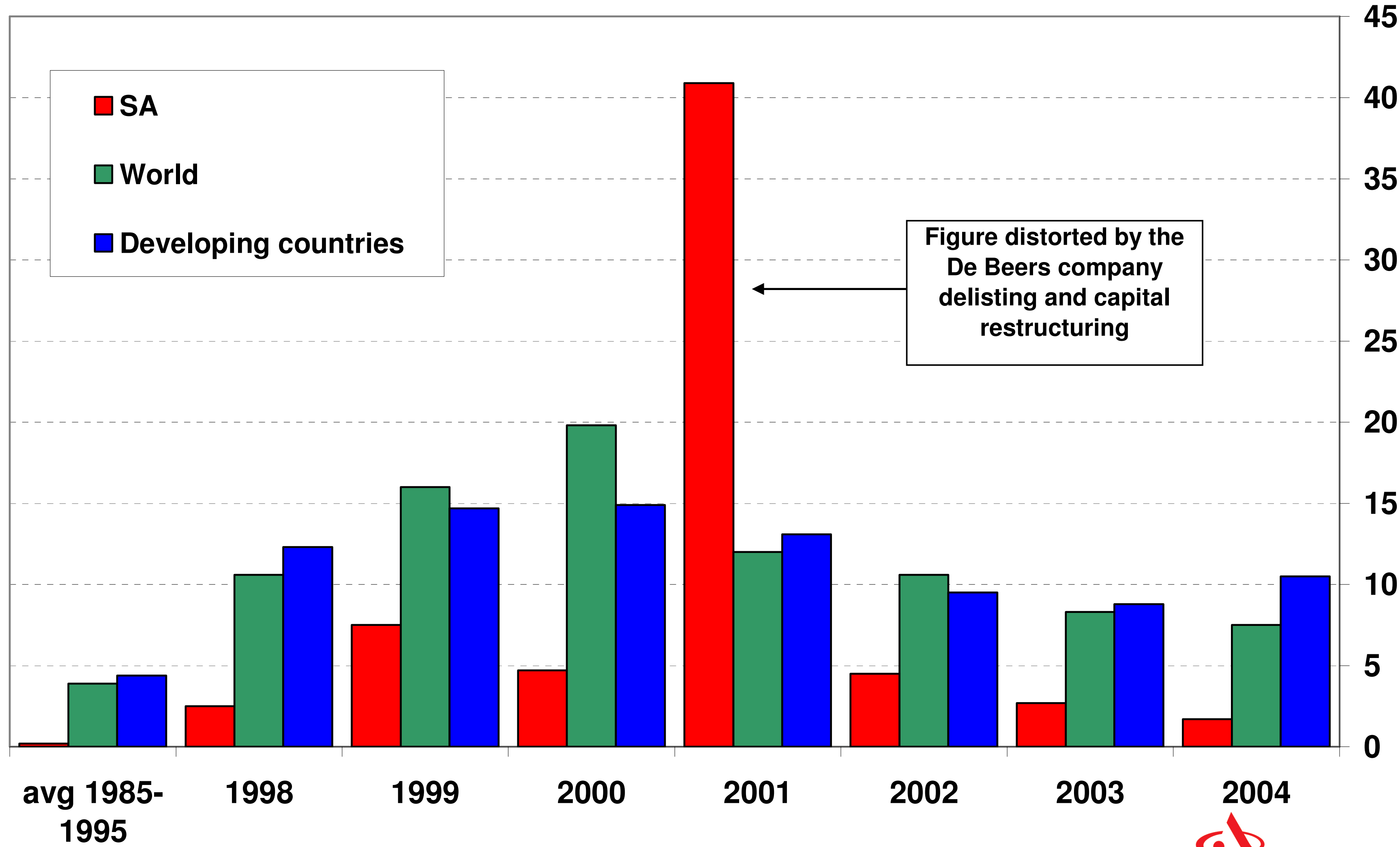
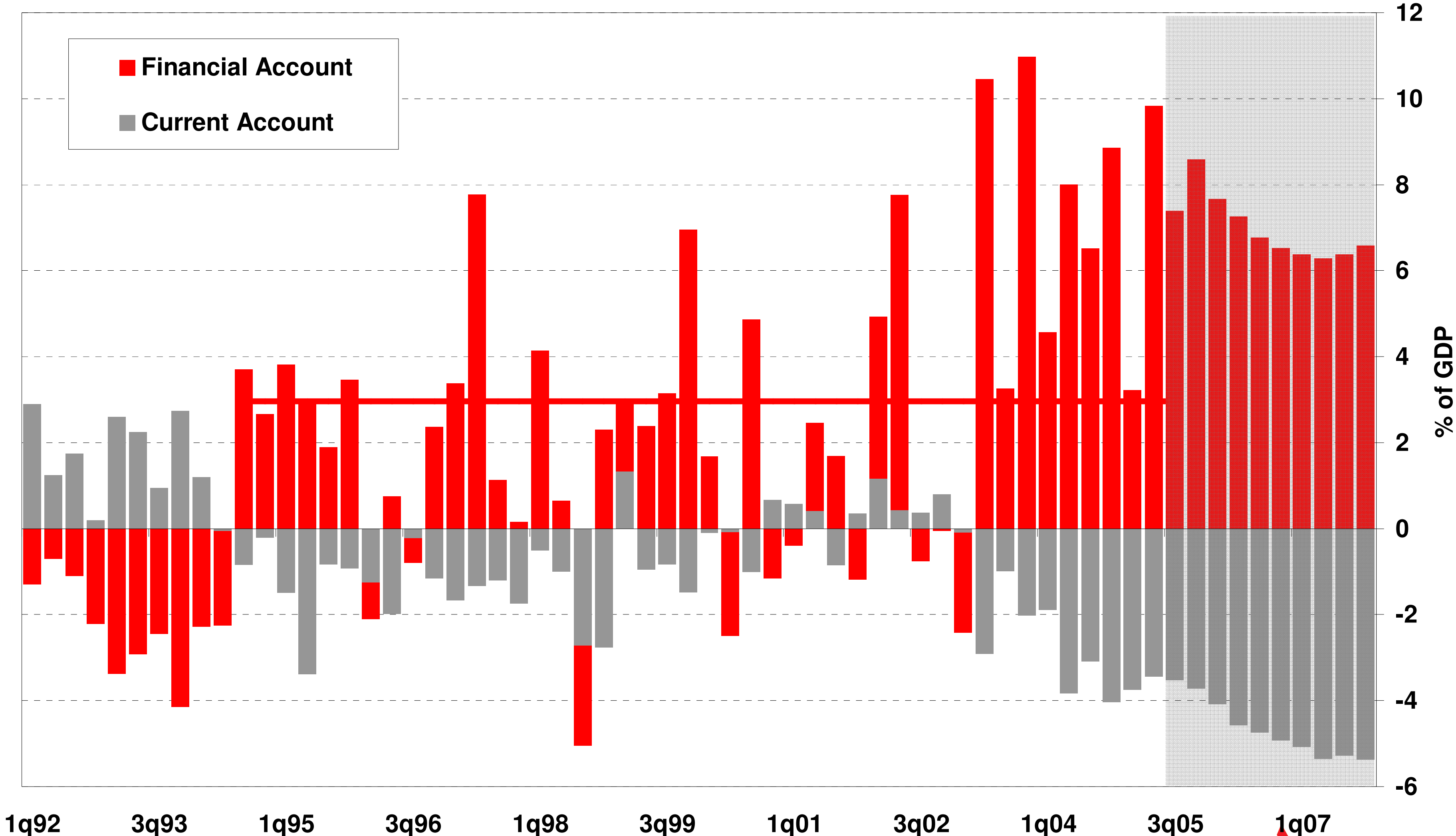
FDI inflows to SA



Inward FDI as a % of gross fixed capital formation



Balance of payments



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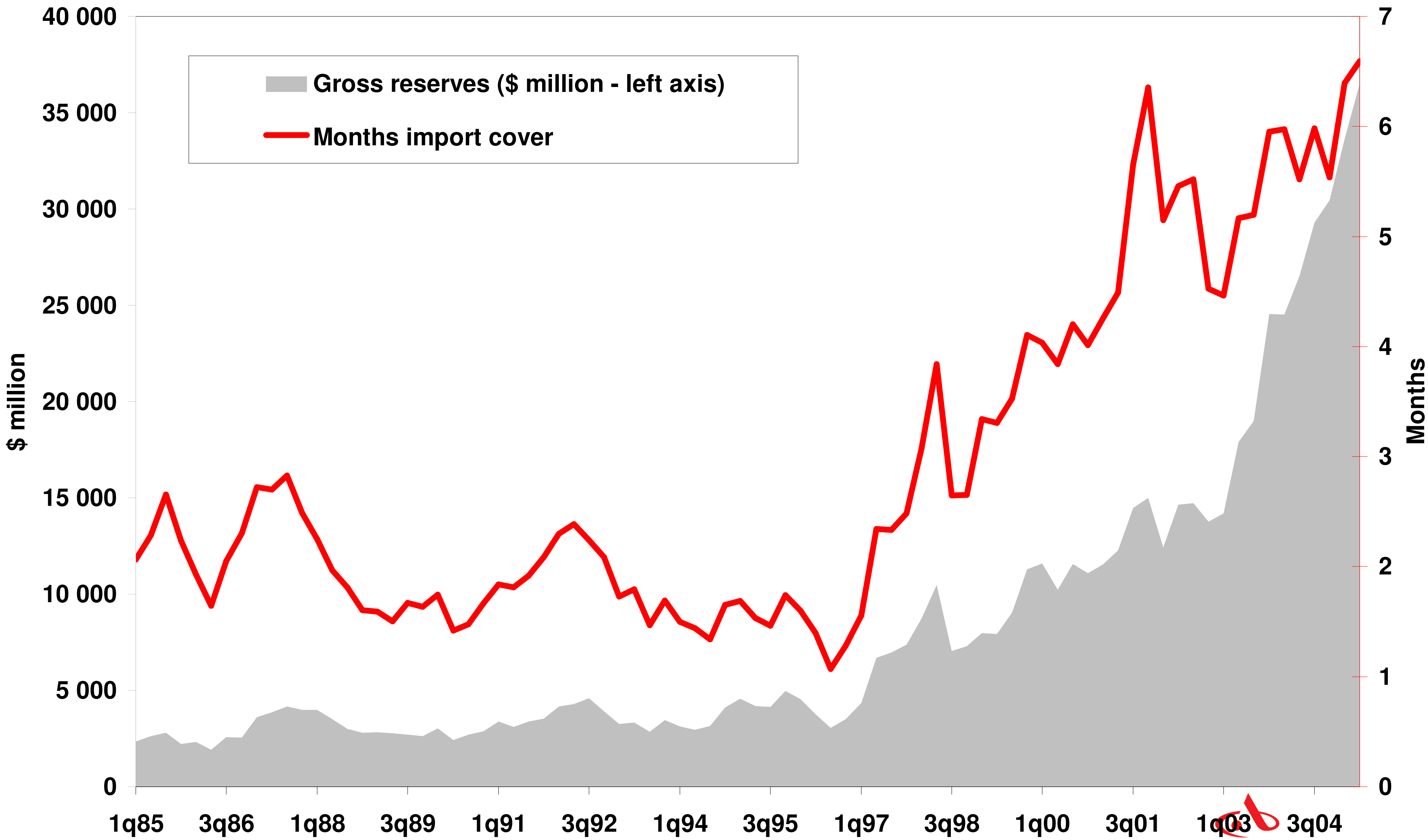
SA gross reserves



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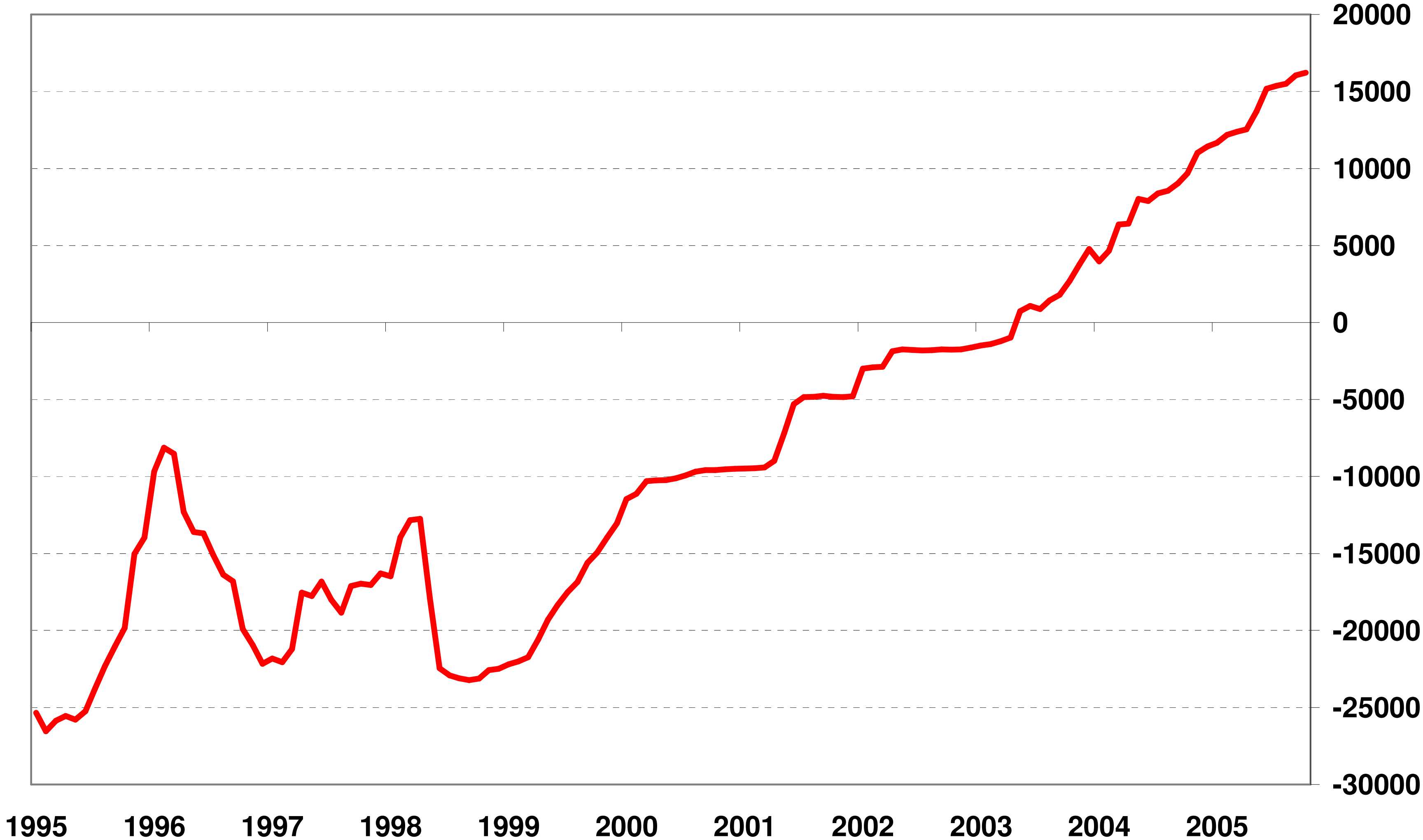
SARB's international liquidity position



Foreign debt ratios

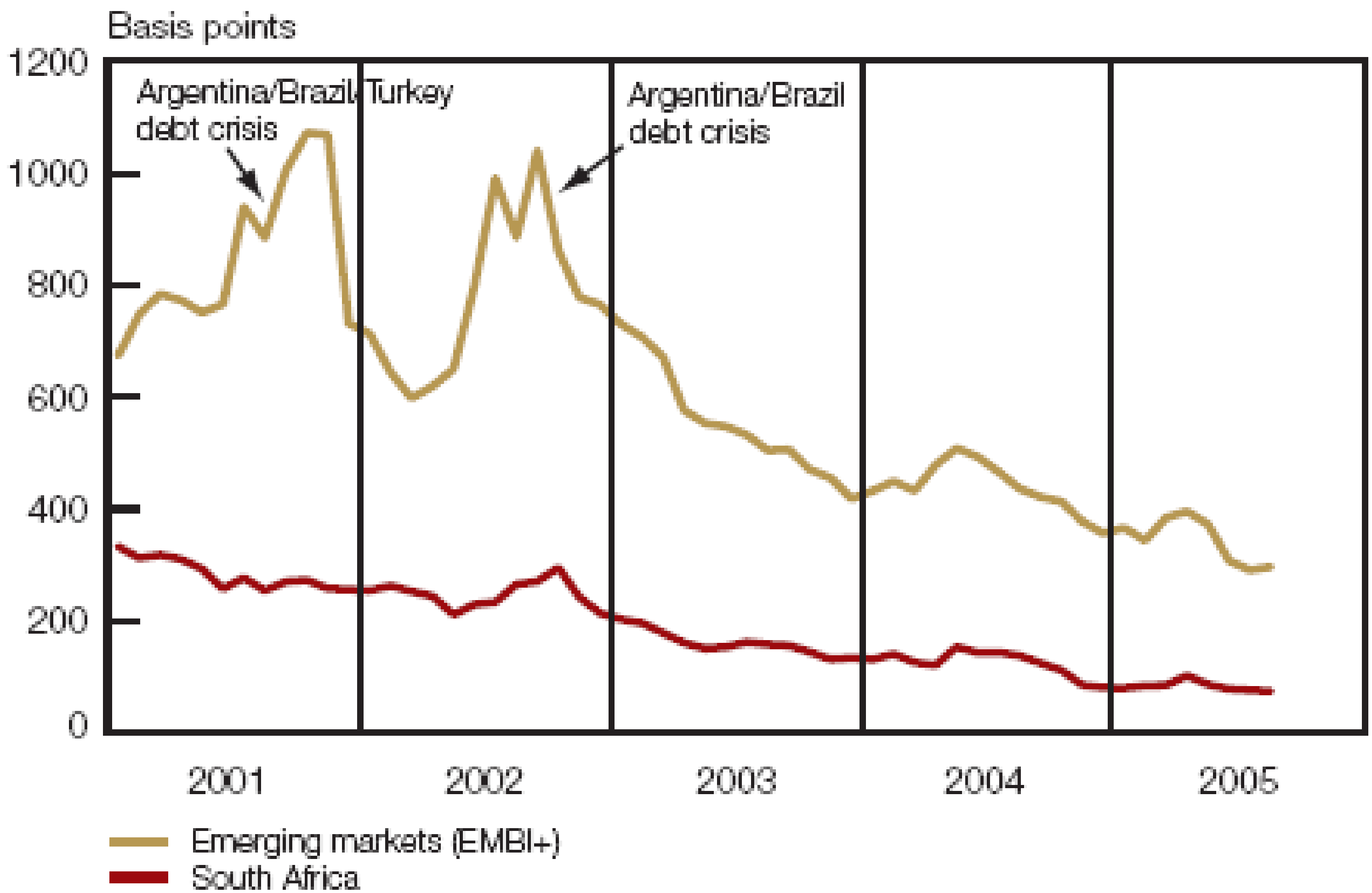
Sovereign risk ratings

Fitch sovereign long-term risk rating for SA		
	Foreign currency rating	**Outlook**
25 Aug 2005	BBB+	stable
21 Oct 2004	BBB	positive
2 May 2003	BBB	stable
11 Mar 2003	BBB-	Rating Watch positive
20 Aug 2002	BBB-	positive
21 Sep 2000	BBB-	stable
27 Jun 2000	BBB-	-
19 May 2000	BB+	-
28 May 1998	BB	-
17 Feb 1998	BB	Rating Watch positive
5 Jun 1996	BB	-
26 Oct 1995	BB	-
22 Sep 1994	BB	-

Moody's sovereign long-term risk rating for SA		
Jan 2005	Baa1	

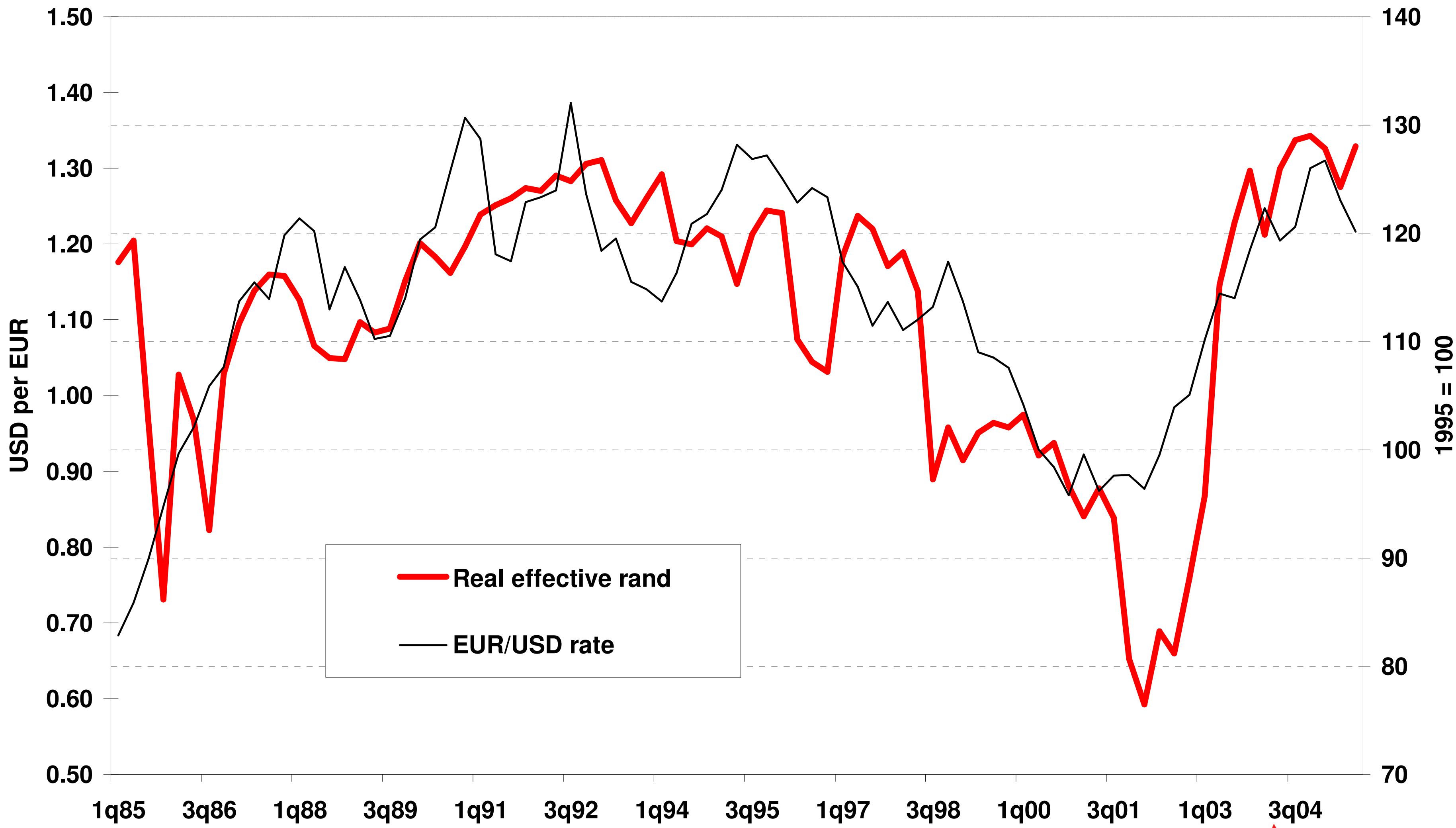
S&P sovereign long-term risk rating for SA		
Aug 2005	BBB+	

Yield spreads over US federal government bonds of emerging-market foreign-currency denominated debt



Rand, inflation, interest rates

USD vs real effective rand



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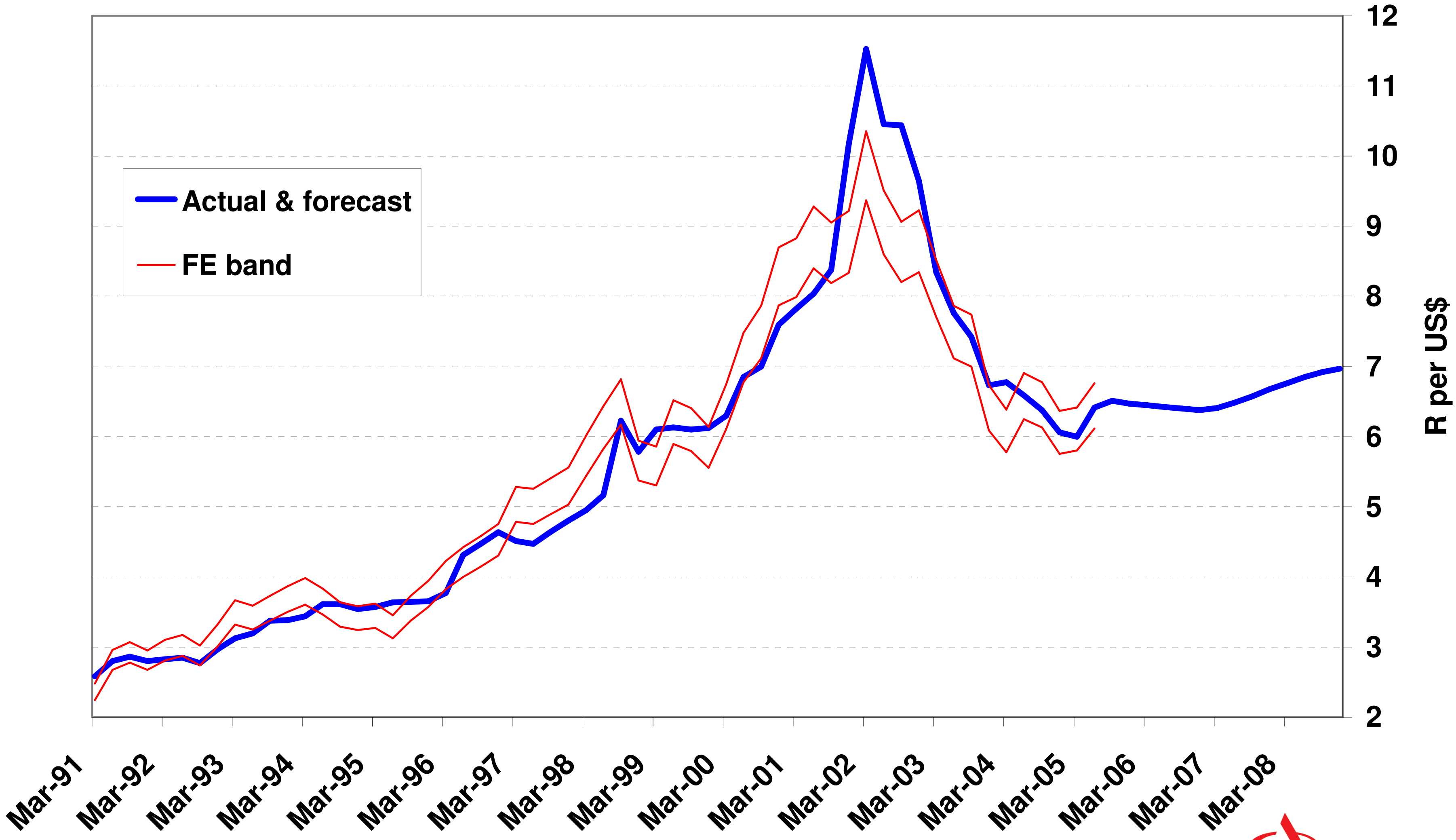
USD/ZAR exchange rate determinants

- Inflation rate differential
- USD value
- Balance of payments
- Interest rate differential

USD/ZAR fundamental equilibrium value

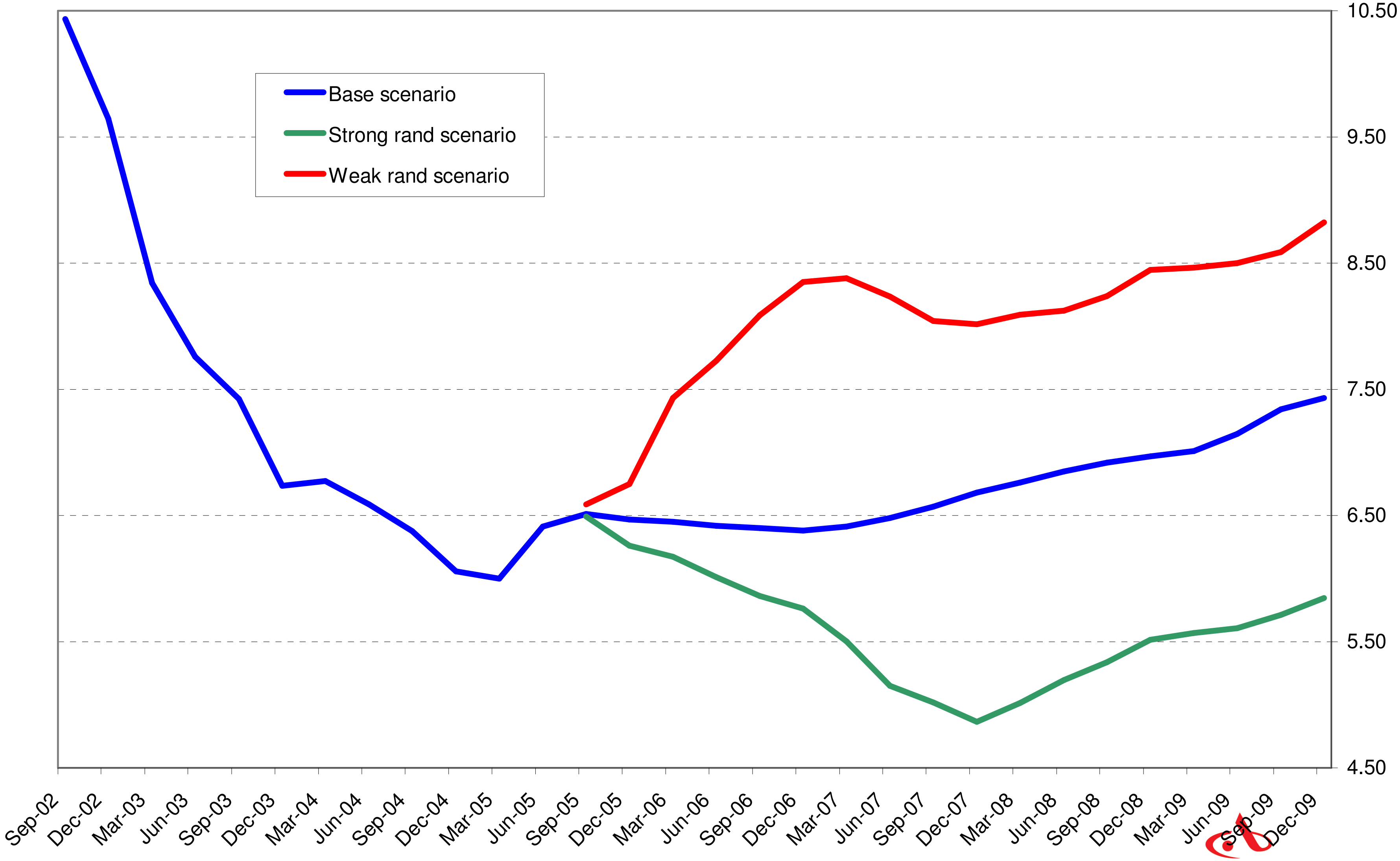


The SA currency

… unlikely to experience a weakening similar to 2001/02:

- "One-way bet" situation resolved
- Dollar weakness (?)
- Exchange control liberalisation
- NOFP / Reserves
- Sovereign risk upgrades
- Commodity cycle
- Relatively large interest rate differential
- Narrowing inflation differential
- Potential for portfolio flows

USD/ZAR scenarios



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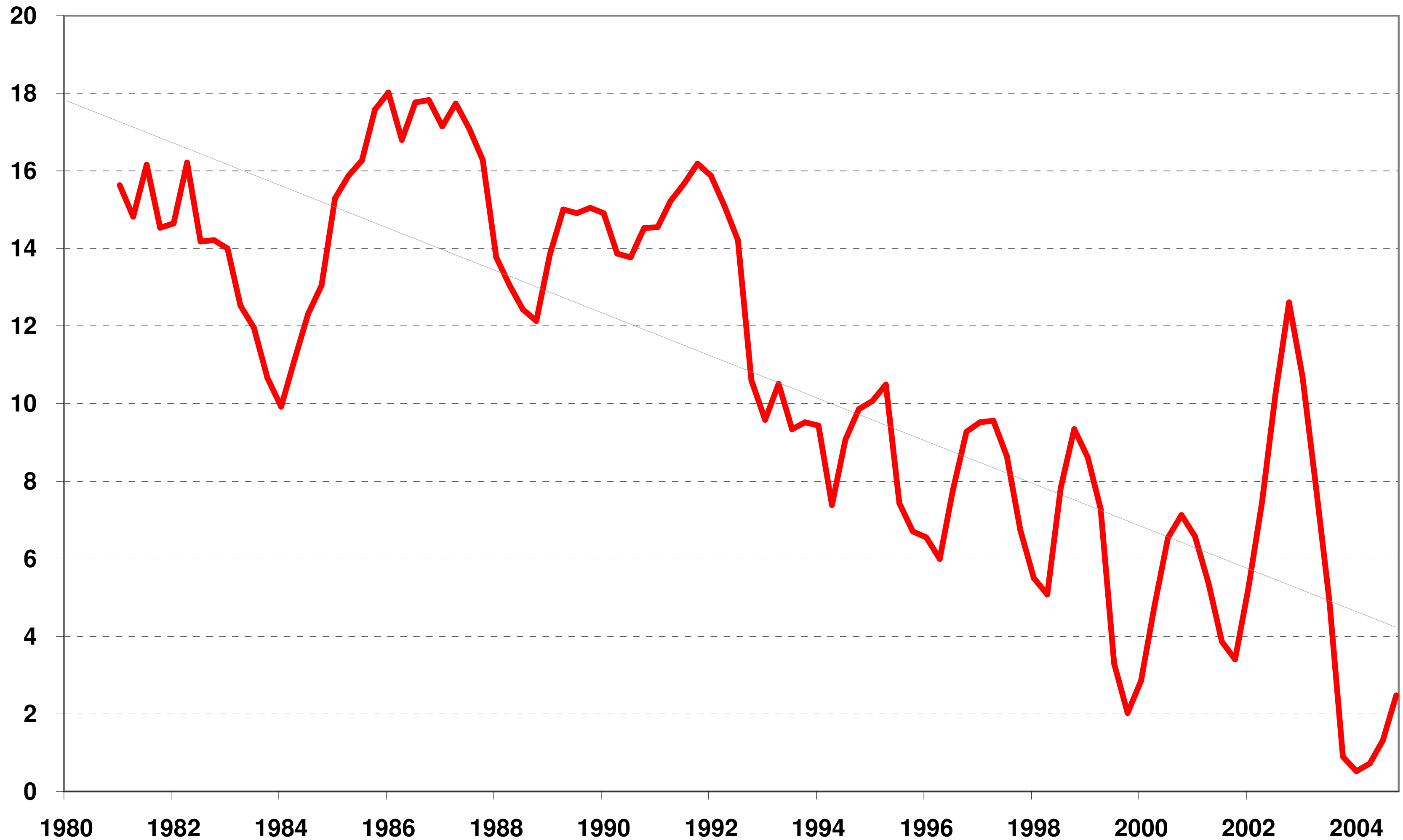
Long-term inflation



Long-term inflation – how much lower?

- Inflation **peaked** in the mid- to late 80s and has since been on a declining trend
- Stricter **monetary policy** and, since mid-90s a more **disciplined fiscal** policy, were the main factors that drove inflation lower
- Trade tariff reform, international developments, privatisation, and less price regulation (e.g. agriculture) have also helped
- **Slow growth** during much of late 80s and the 90s have meant that capacity constraints hardly ever became a problem, despite very low rates of fixed capital formation
- Over the past decade, "spikes" in inflation have mostly been caused by bouts of **rand weakness**
- Other factors which have caused some **inflation inertia** included often rapid increases in administered prices, sticky wages, and food price changes owing to adverse weather conditions

Factors supporting low (or even lower) inflation

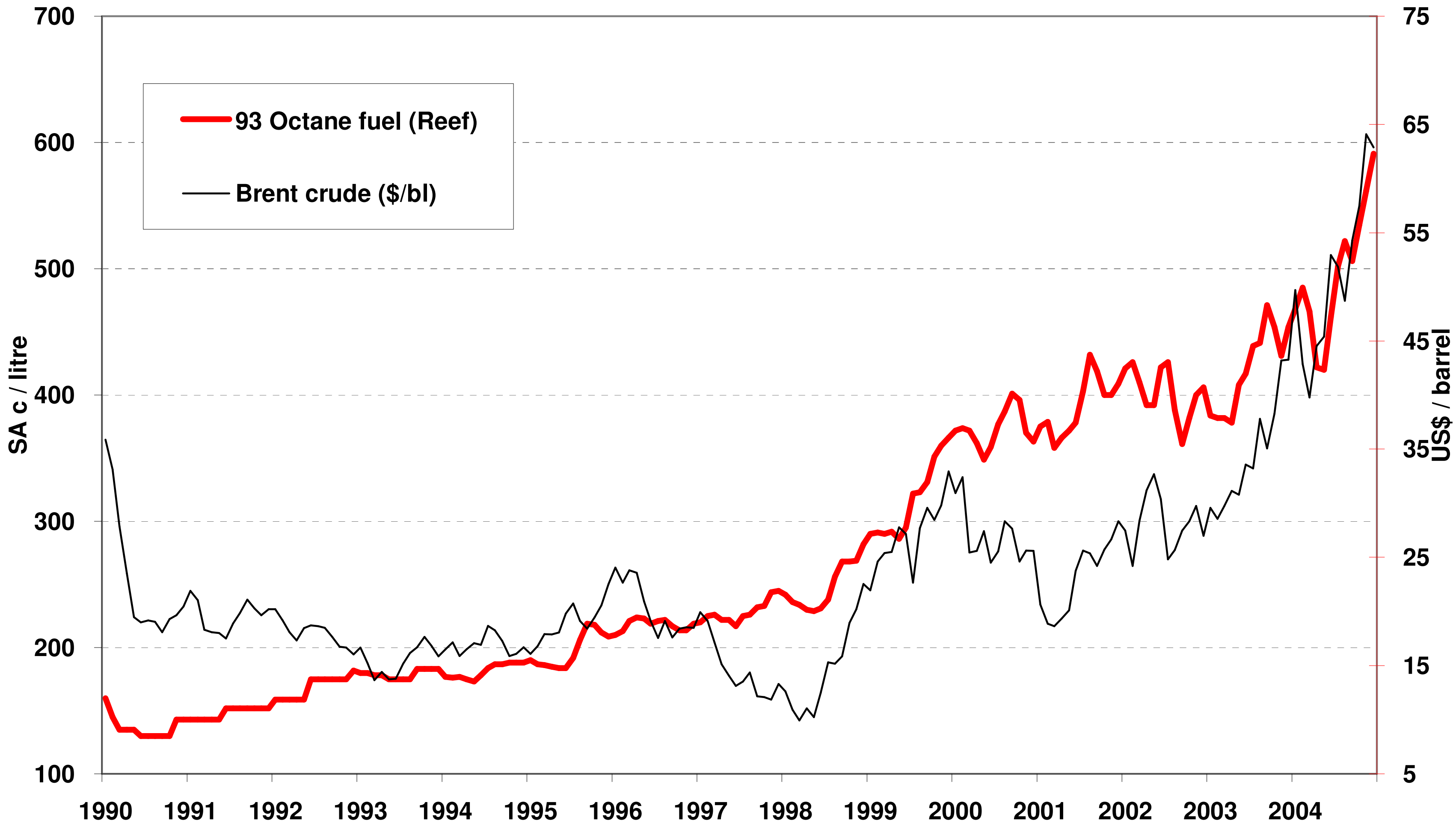
- **Internationally**, inflation remains benign, despite much higher commodity prices (China factor). Some countries, such as Japan, has been battling with **deflation** for many years
- **Monetary policy** remains well-balanced – high real interest rates still prevail
- **Rand** behaviour will be a major determinant. Strong rand has severely diminished the **pricing power** of local producers
- Inflation targeting policy is gaining support, while inflation **expectations** have been managed lower
- Increased levels of **competition** in certain sectors (e.g. telecommunications, banking)
- International **food** commodity prices are experiencing **deflation**, even in dollar terms

So, can we declare inflation as being defeated?

Factors militating against further disinflation

- Structurally, **fiscal policy** is becoming a concern once again, while the **rand** may experience some mild downward pressure in 2006
- Low levels of fixed capital formation to GDP are improving very slowly, while higher growth has caused high levels of **capacity utilisation**
- **Regulatory compliance cost** for business is high and rising; some government departments' believe in "**control**" rather than free markets, is a concern
- Relatively **high tax** rates are influencing SA companies' competitiveness
- State is slowly increasing its share in the economy, while **privatisation** is not a policy initiative any longer
- Infrastructural overhaul and expansion will imply higher **user charges**
- Increasing reliance on **private** education and health care, while personal tax burden is unlikely to be reduced significantly
- Rising unit **labour costs**, and high levels of **money supply/credit** growth remain concerns

Oil & domestic fuel prices



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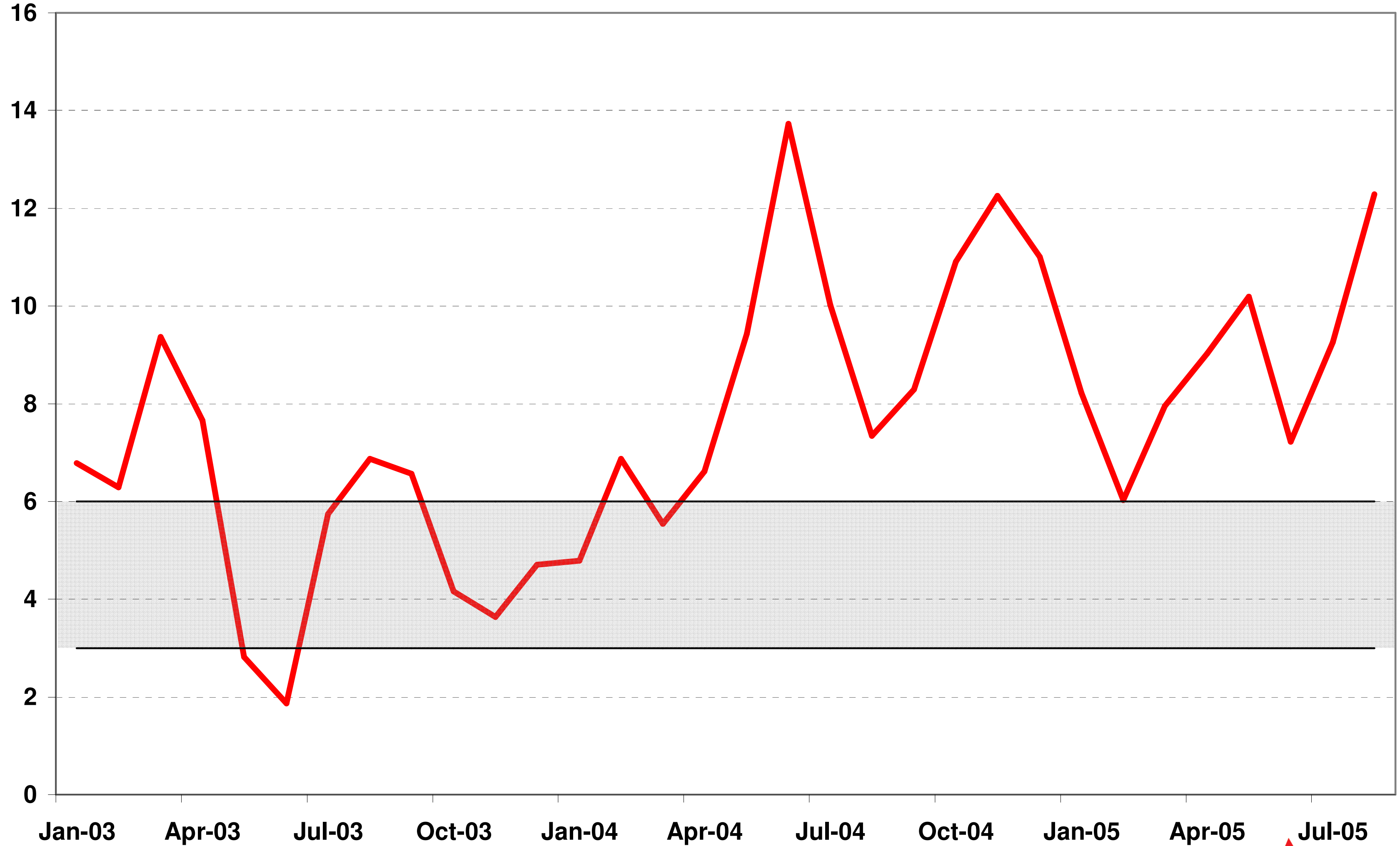
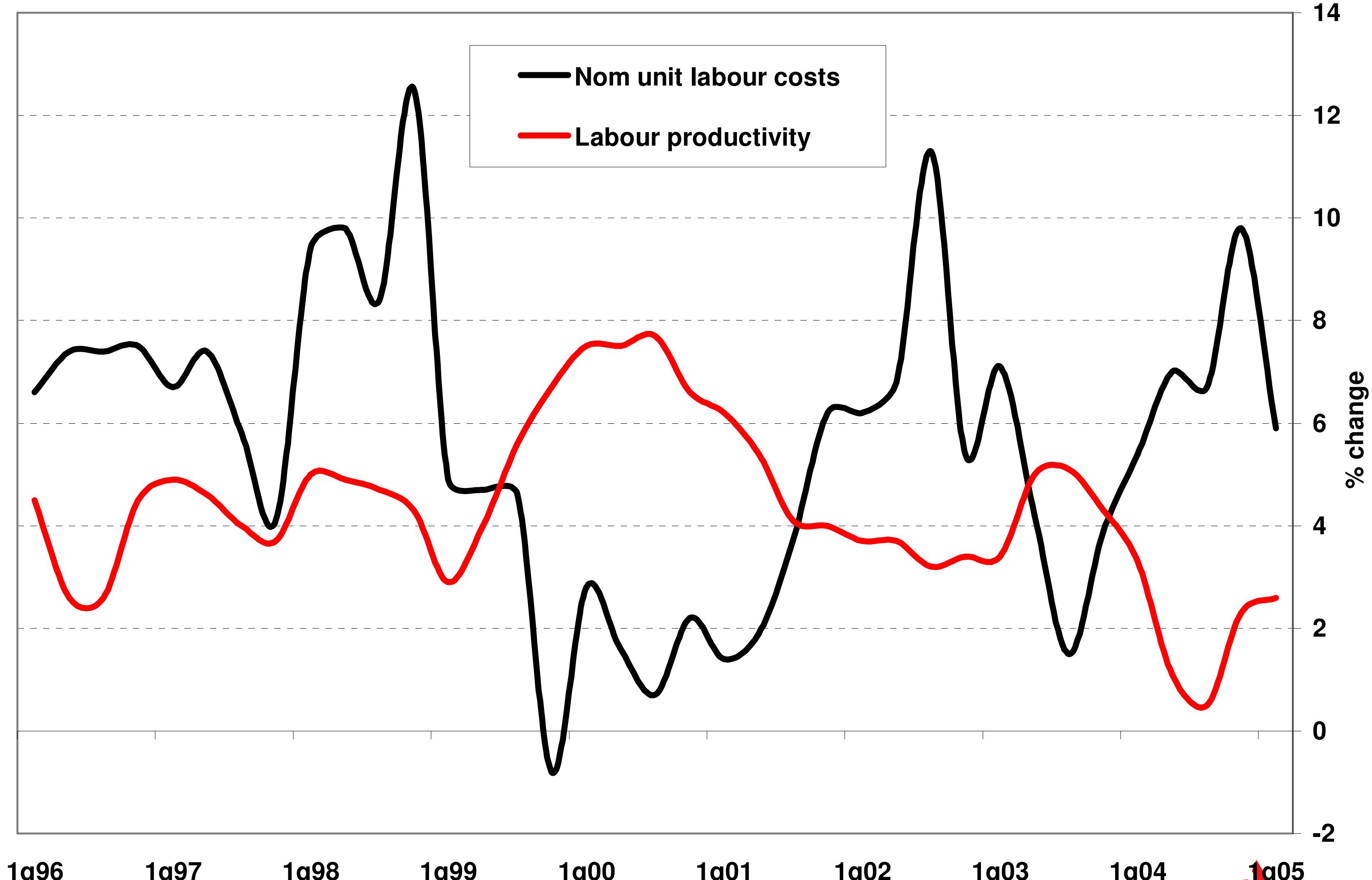
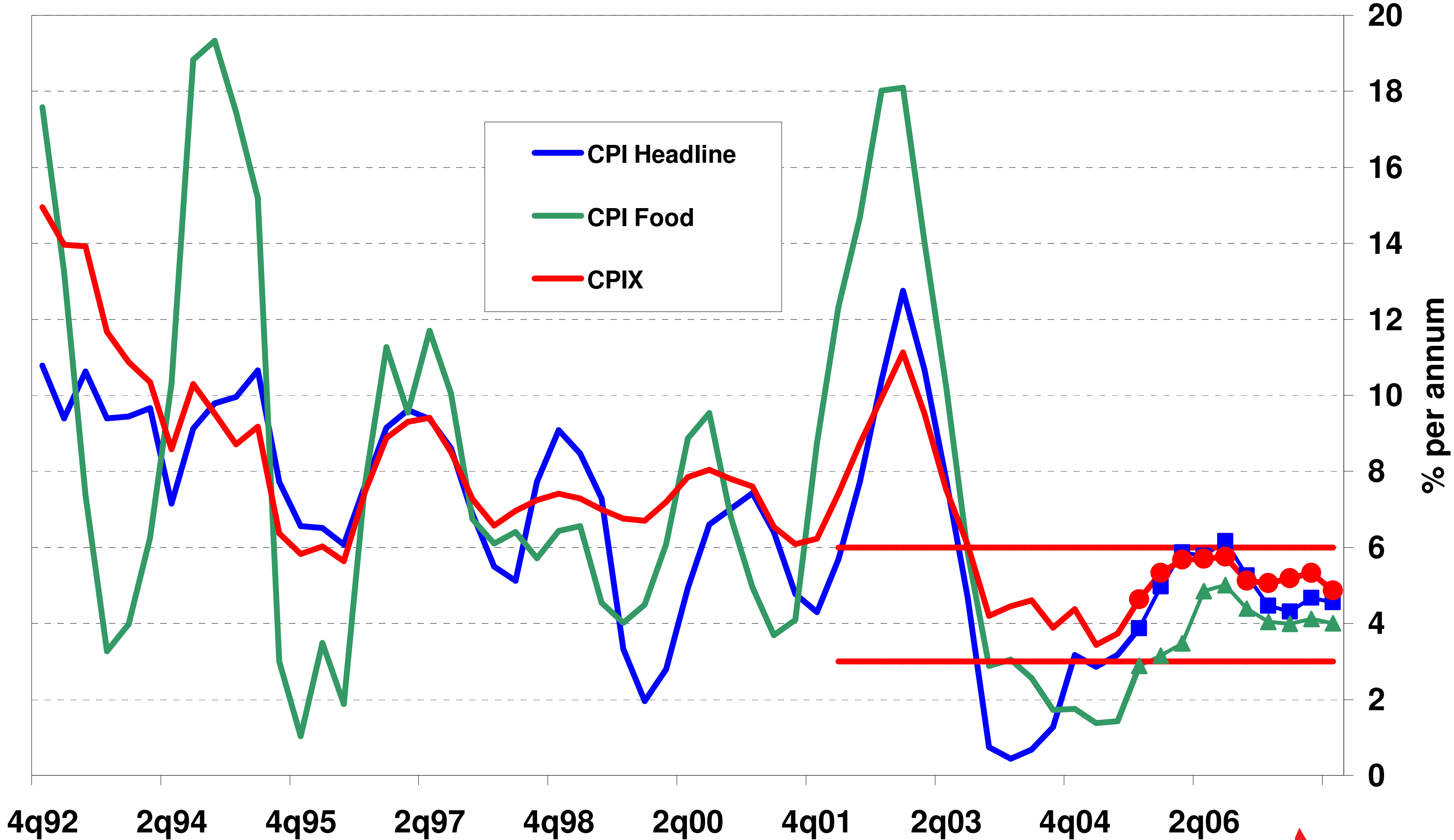
Administrative price increases



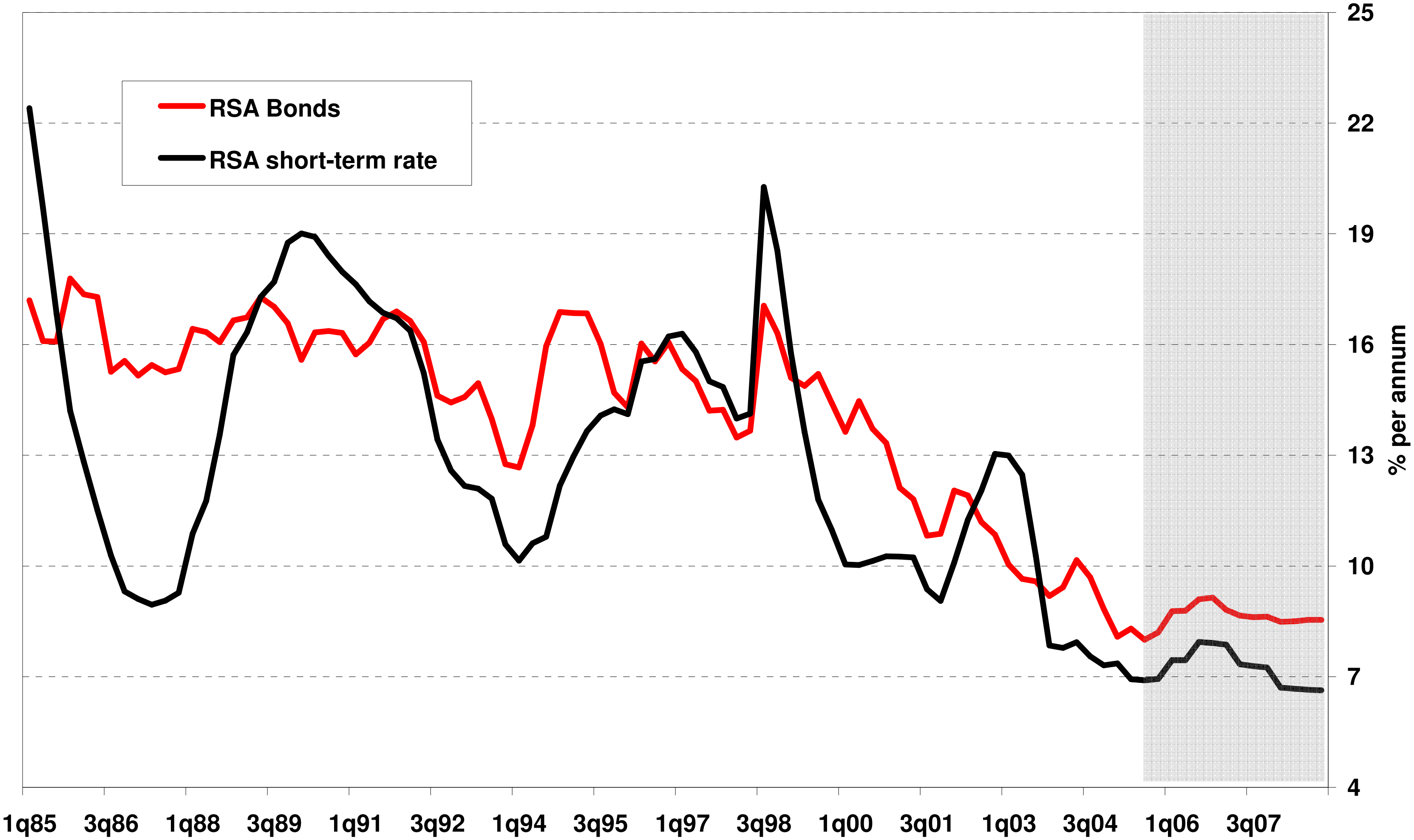
Labour costs vs productivity



Consumer price inflation



Yield curve expected to remain positive



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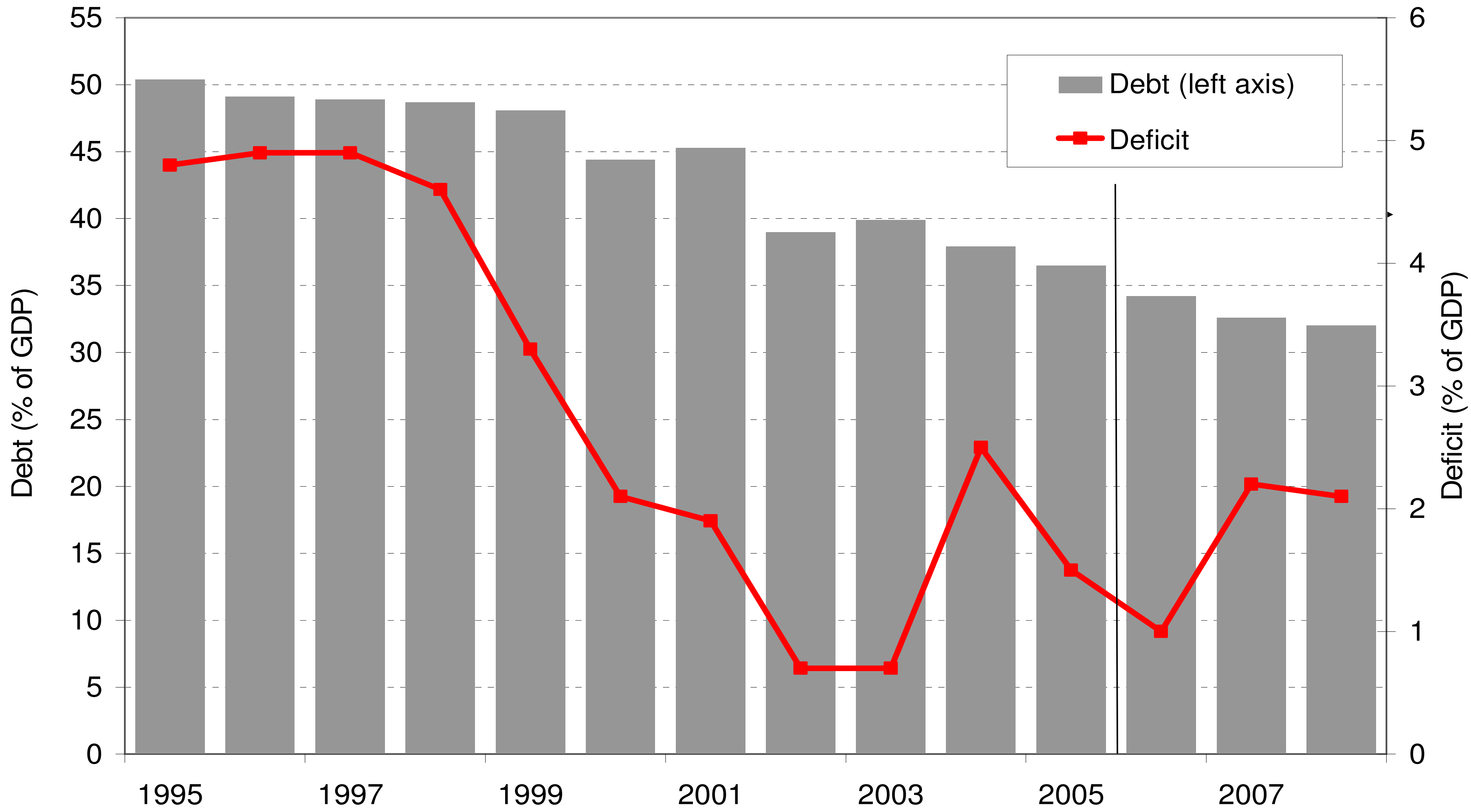
Government Debt and Deficit to GDP



•Based on National Treasury's MTBPS (Nov 2005)

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Economic growth and sectoral outlook

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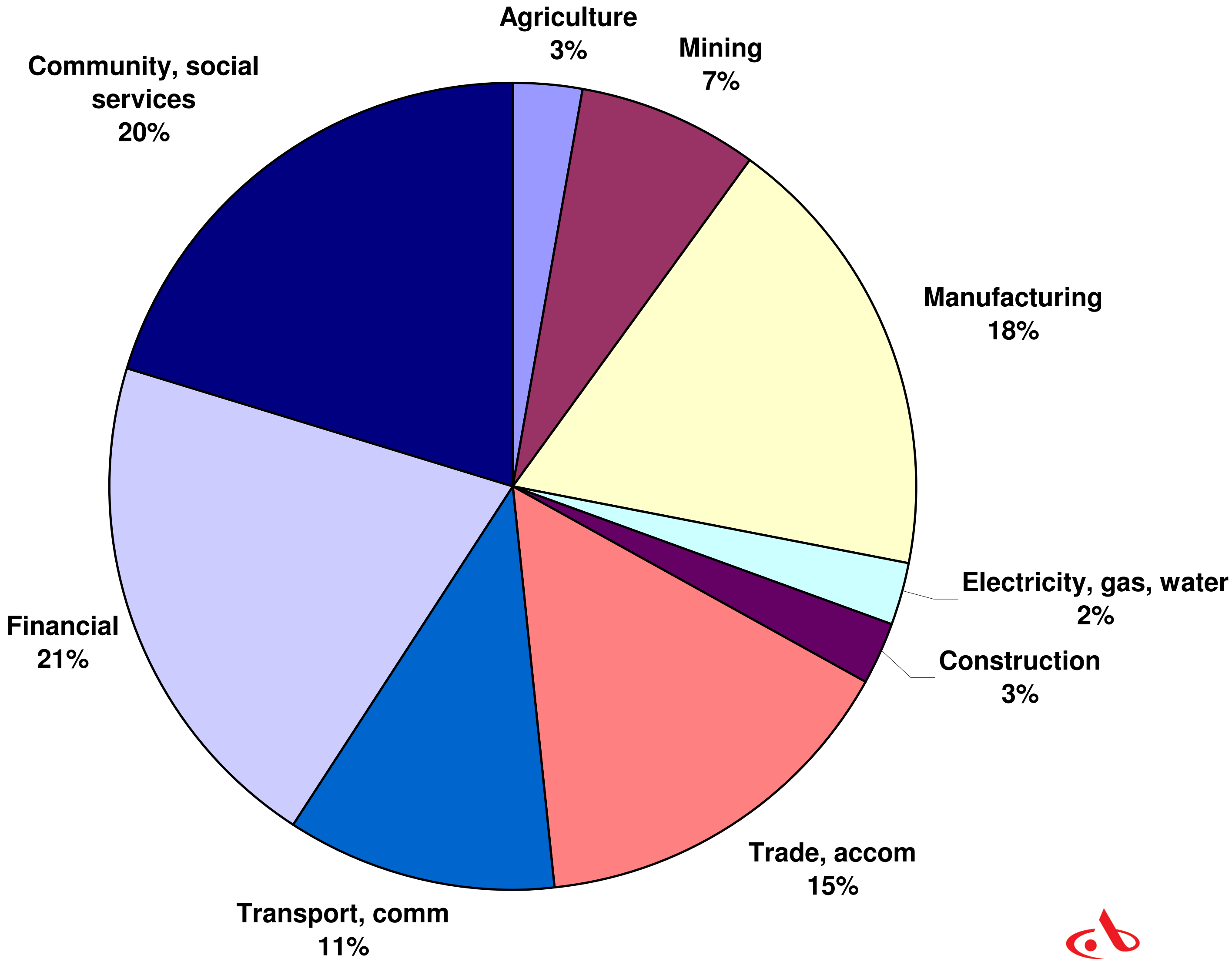
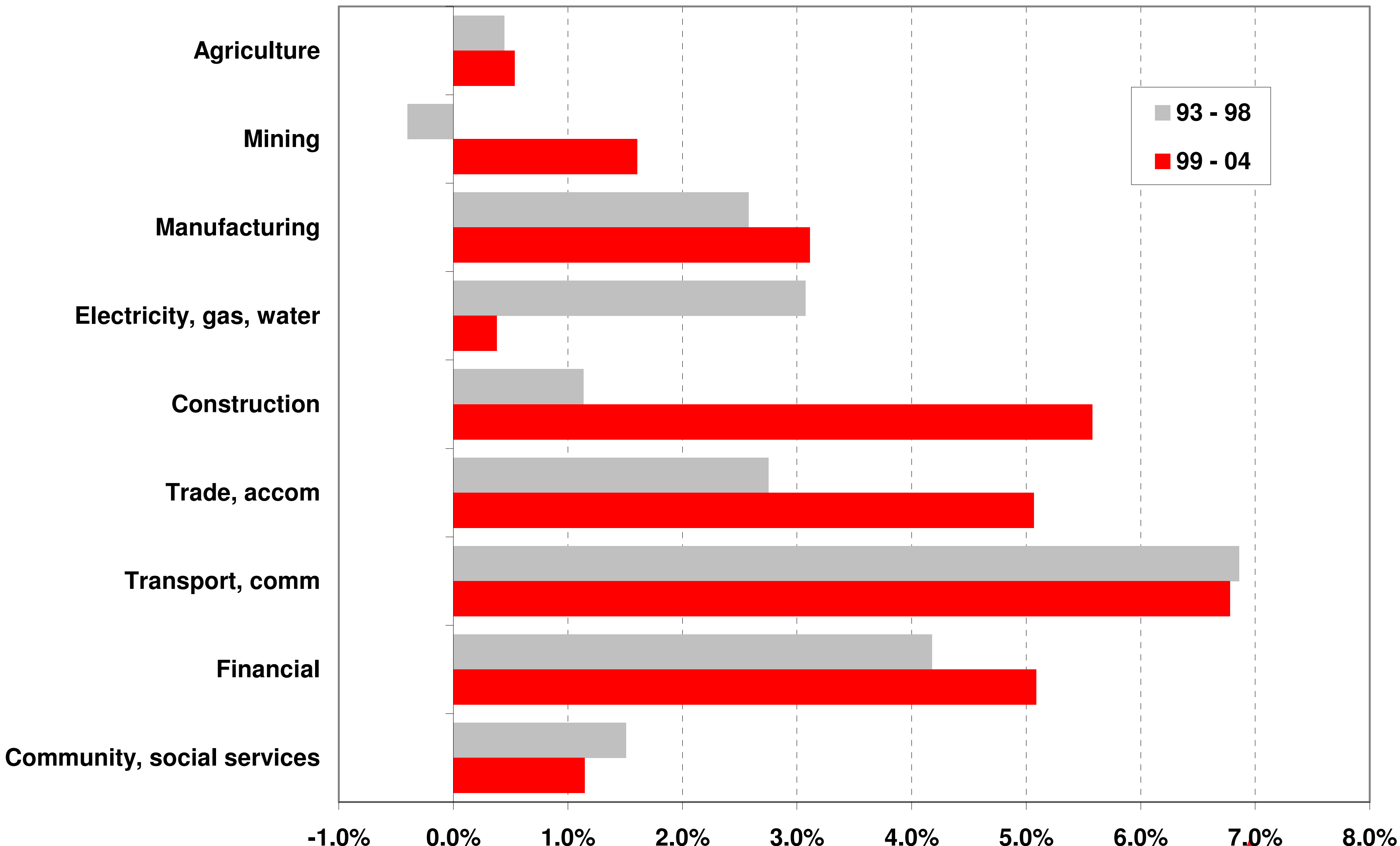
Main sector contributions to GDP



Average annual real growth rates (supply side)



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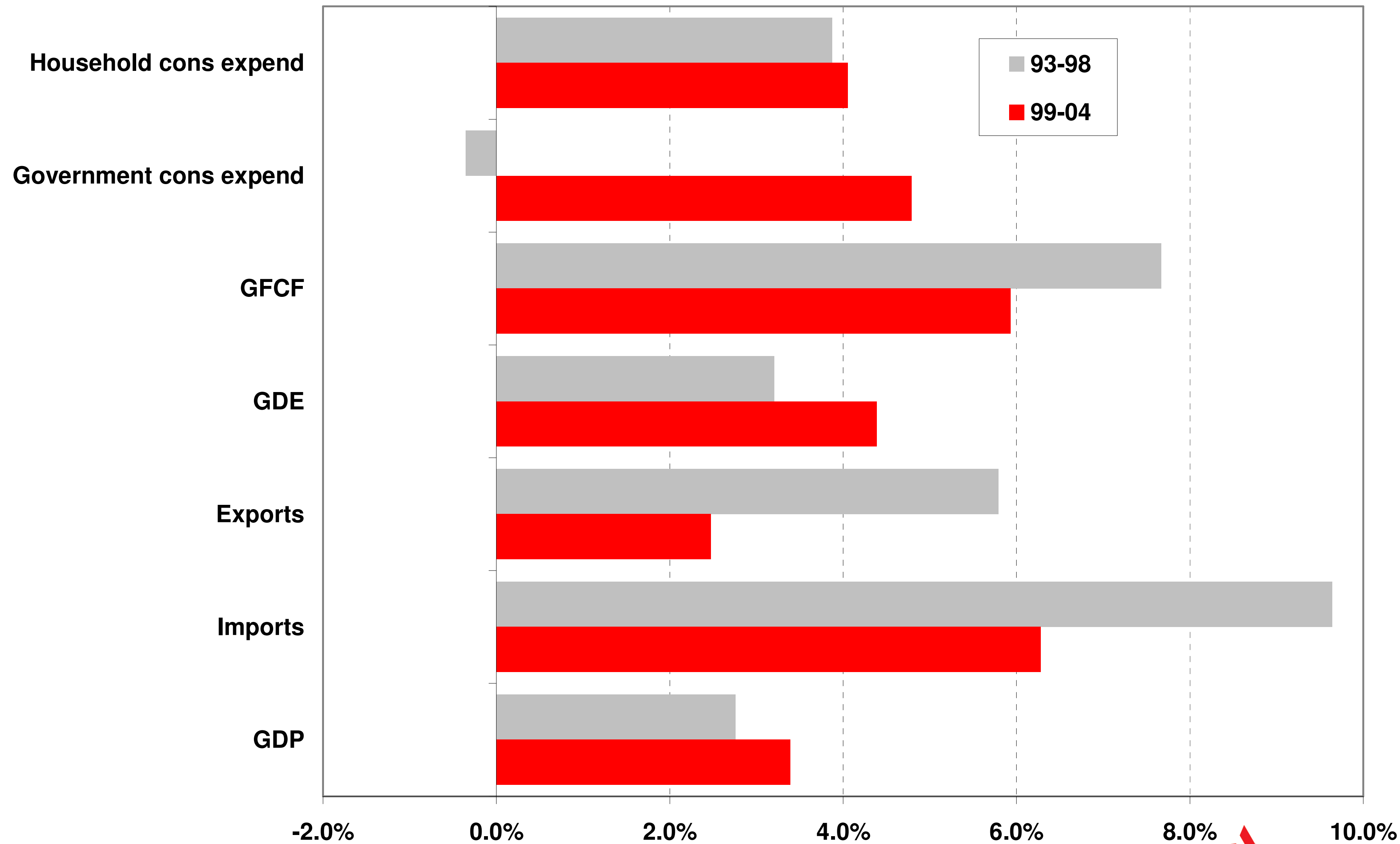
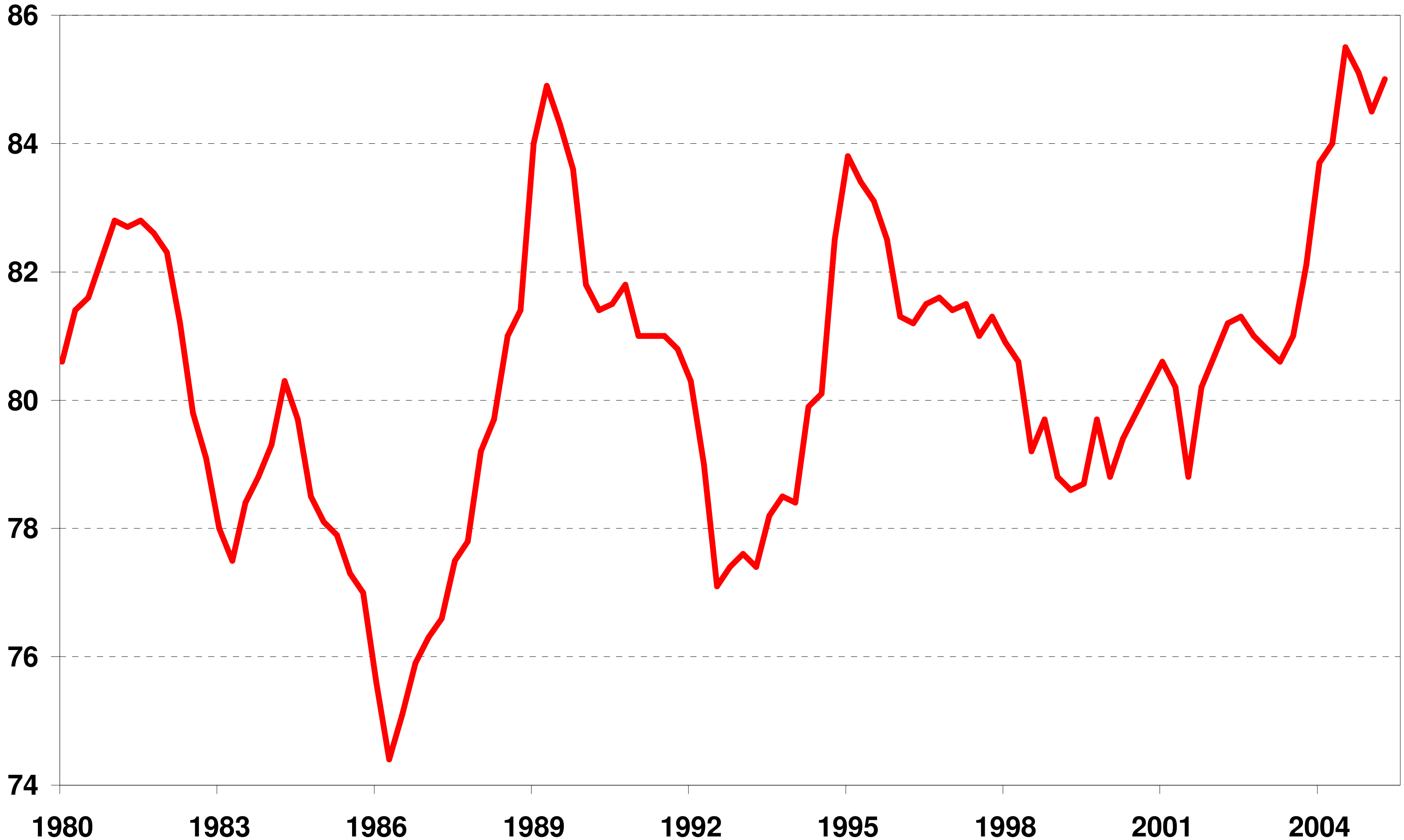
Average annual real growth rates (demand)

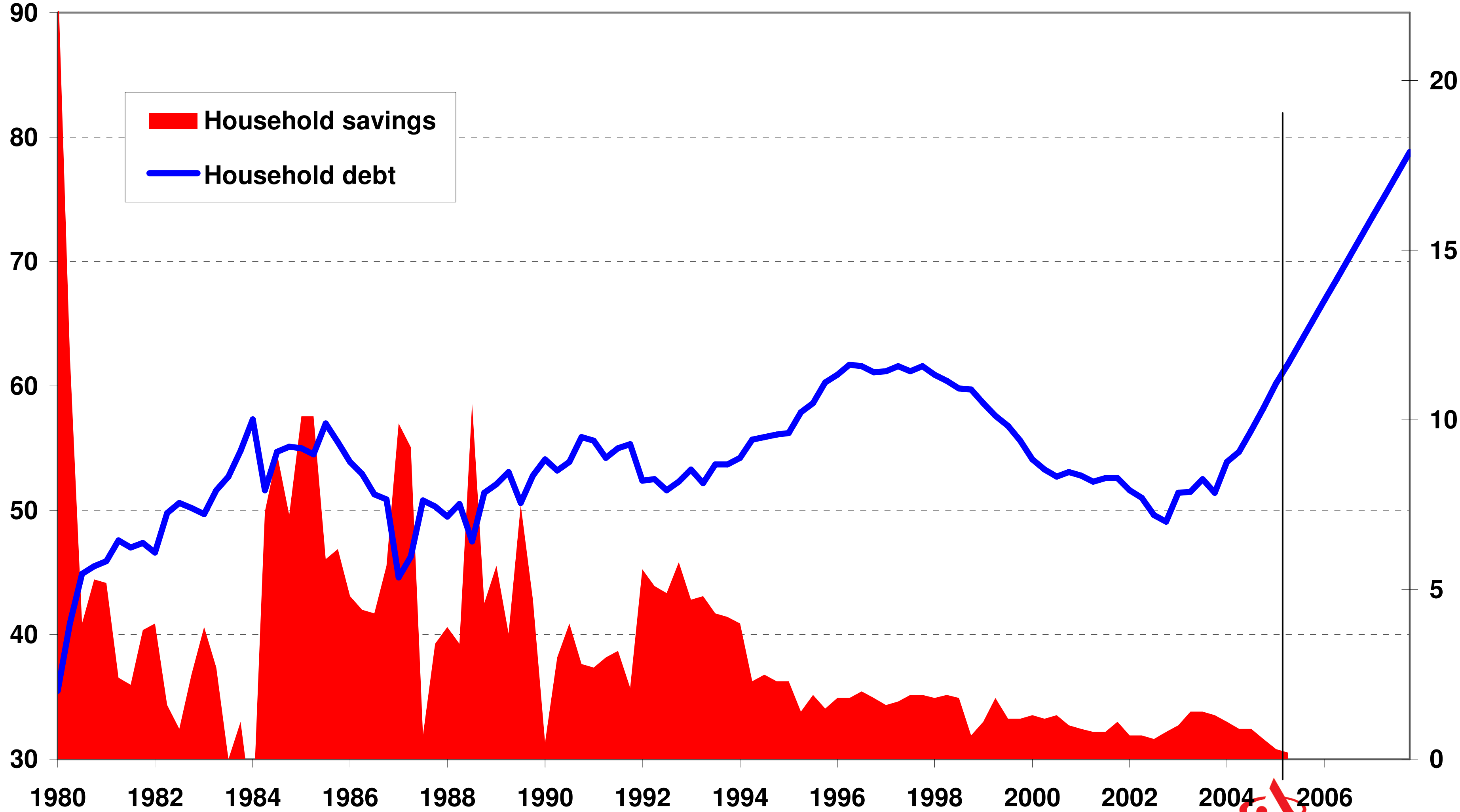


Capacity utilisation



Household debt & savings

(% of disposable income)



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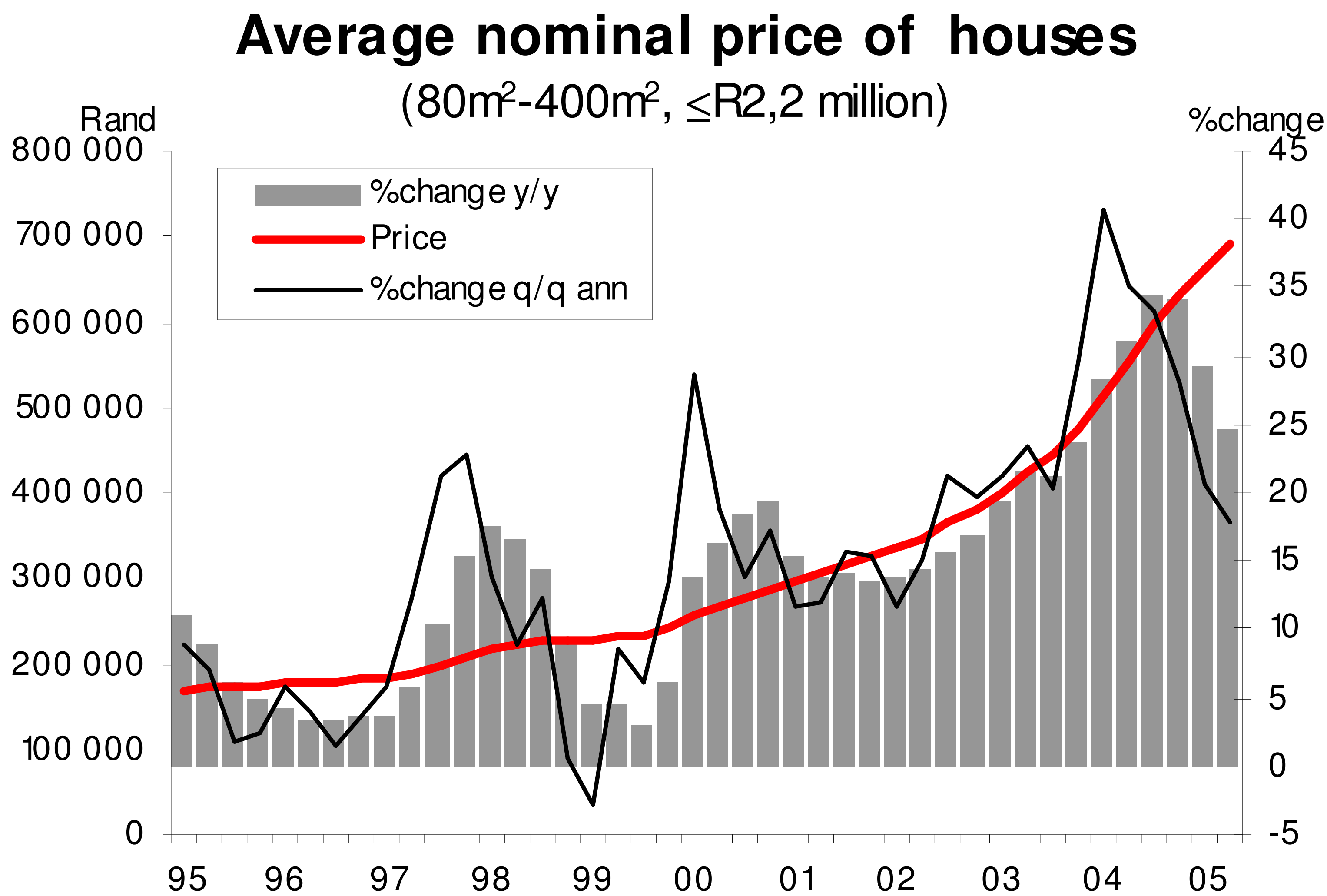
House price growth is slowing



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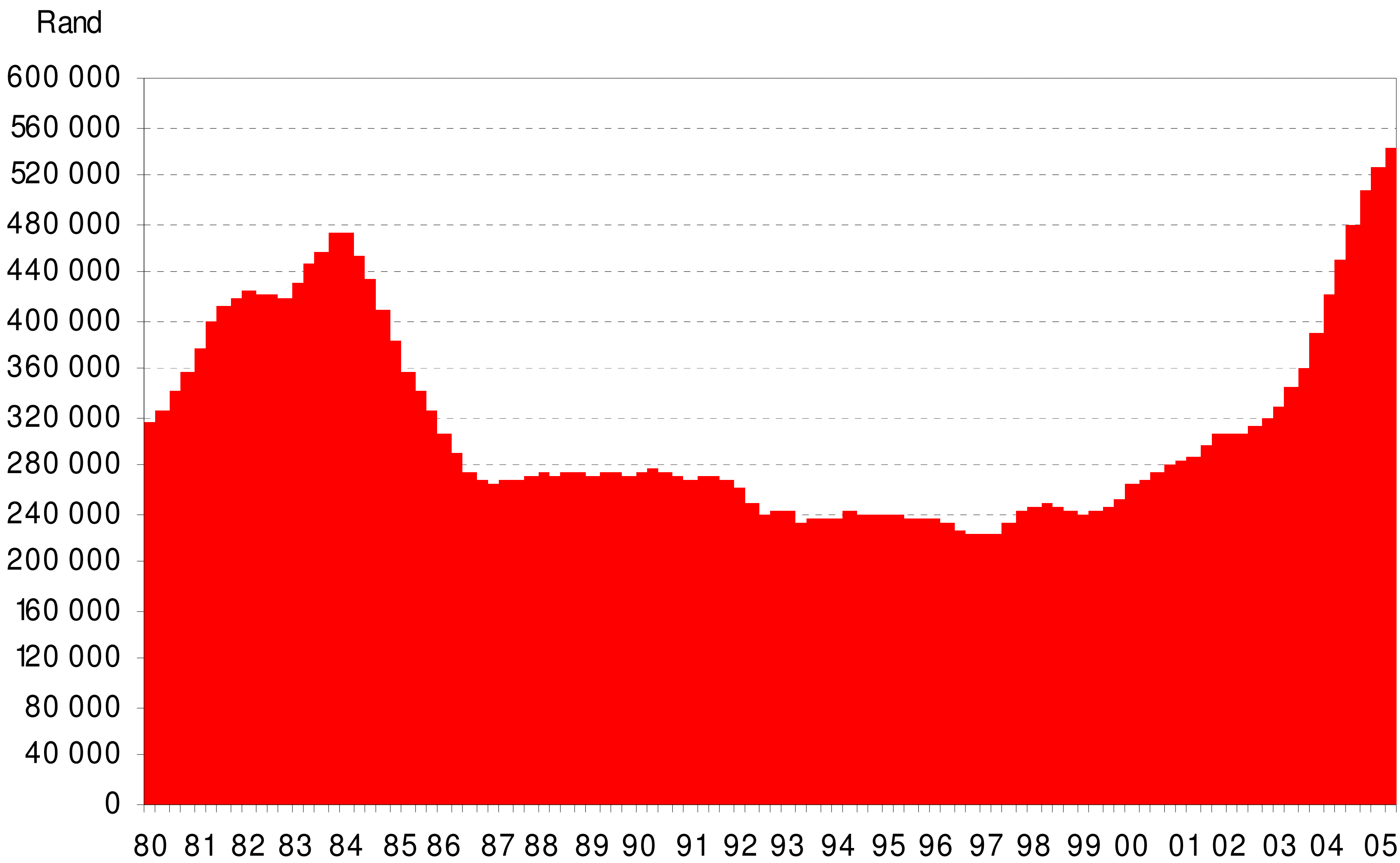
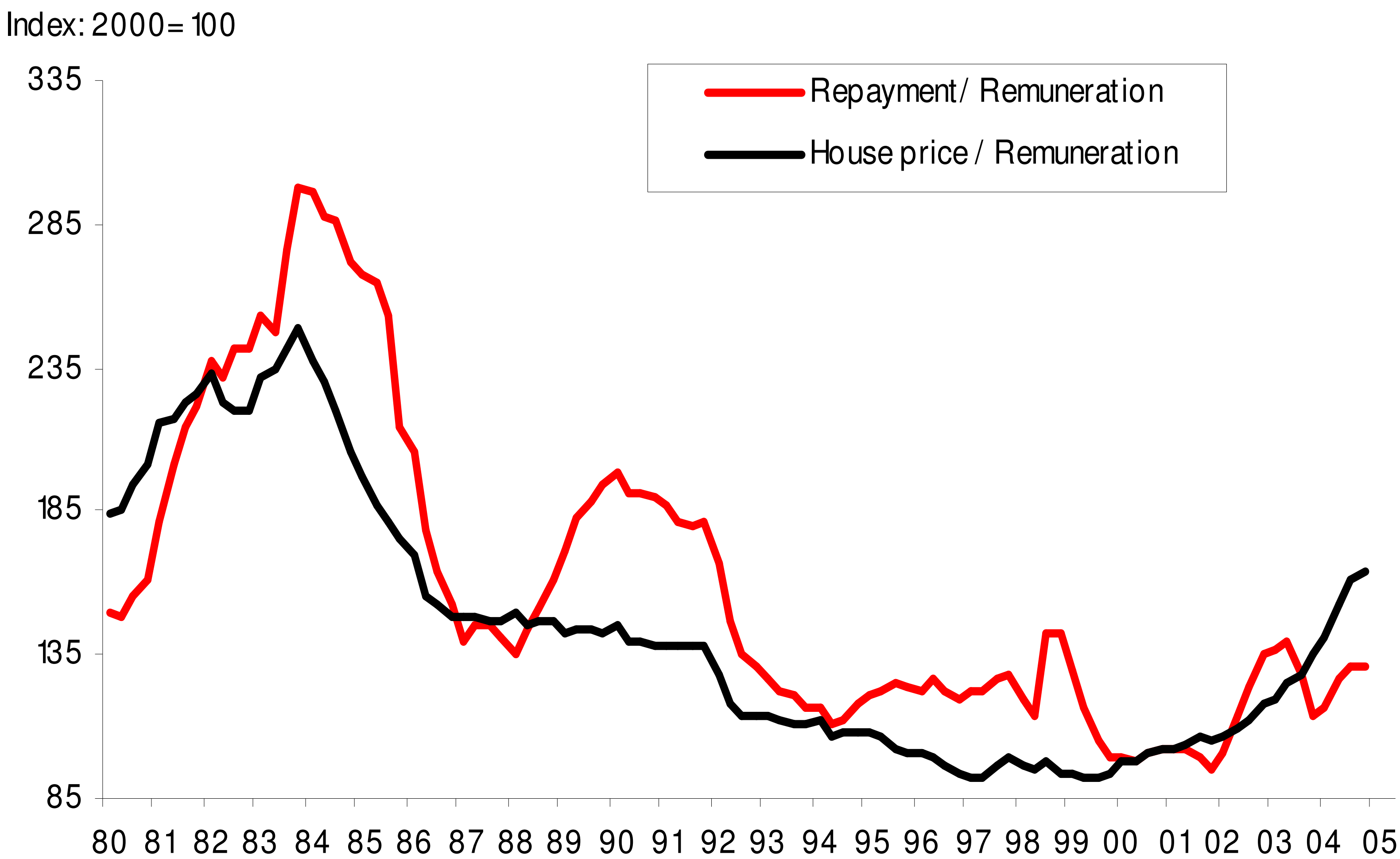
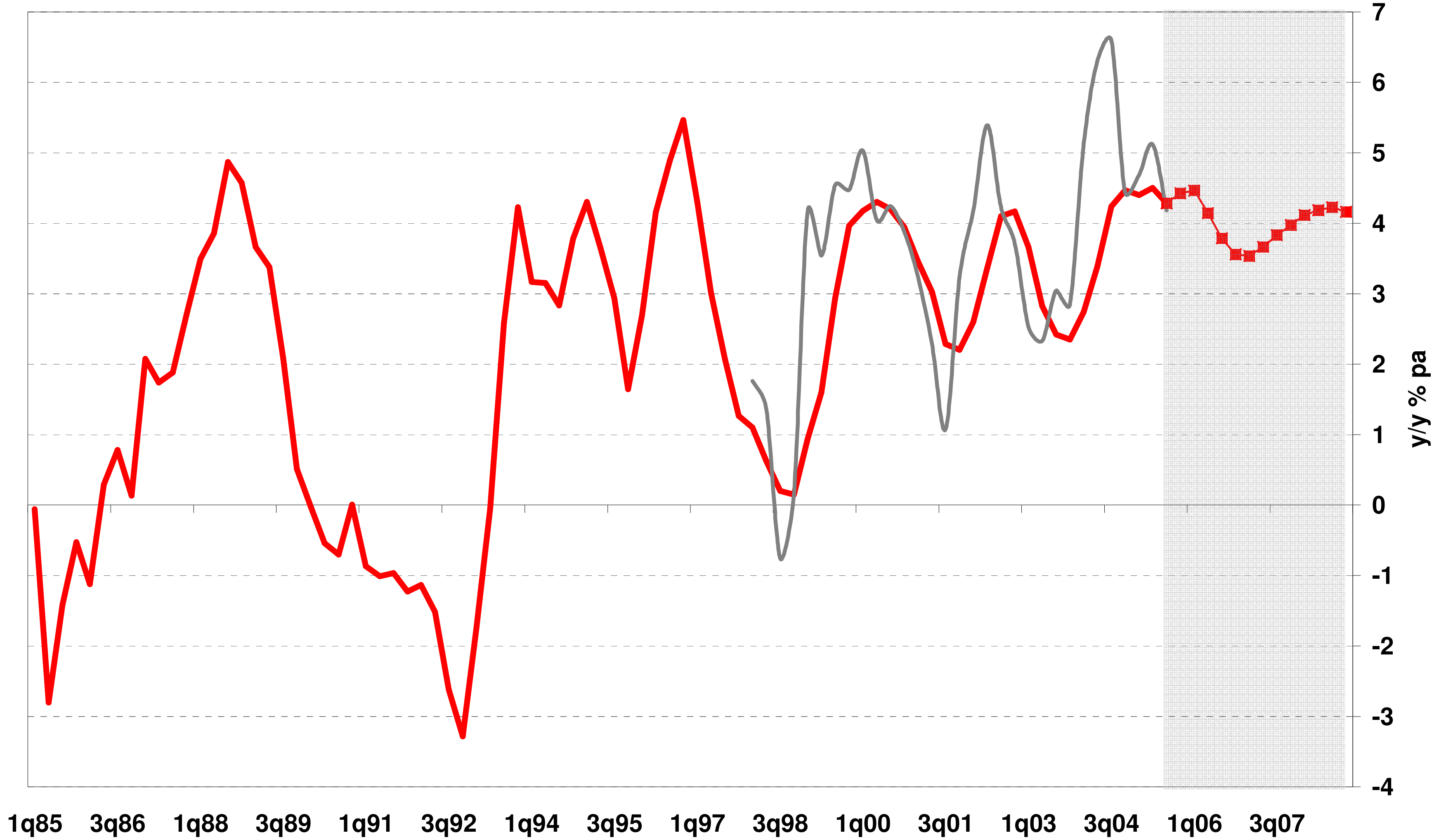
Real house prices – highest on record



Affordability of housing – under pressure



Real GDP growth



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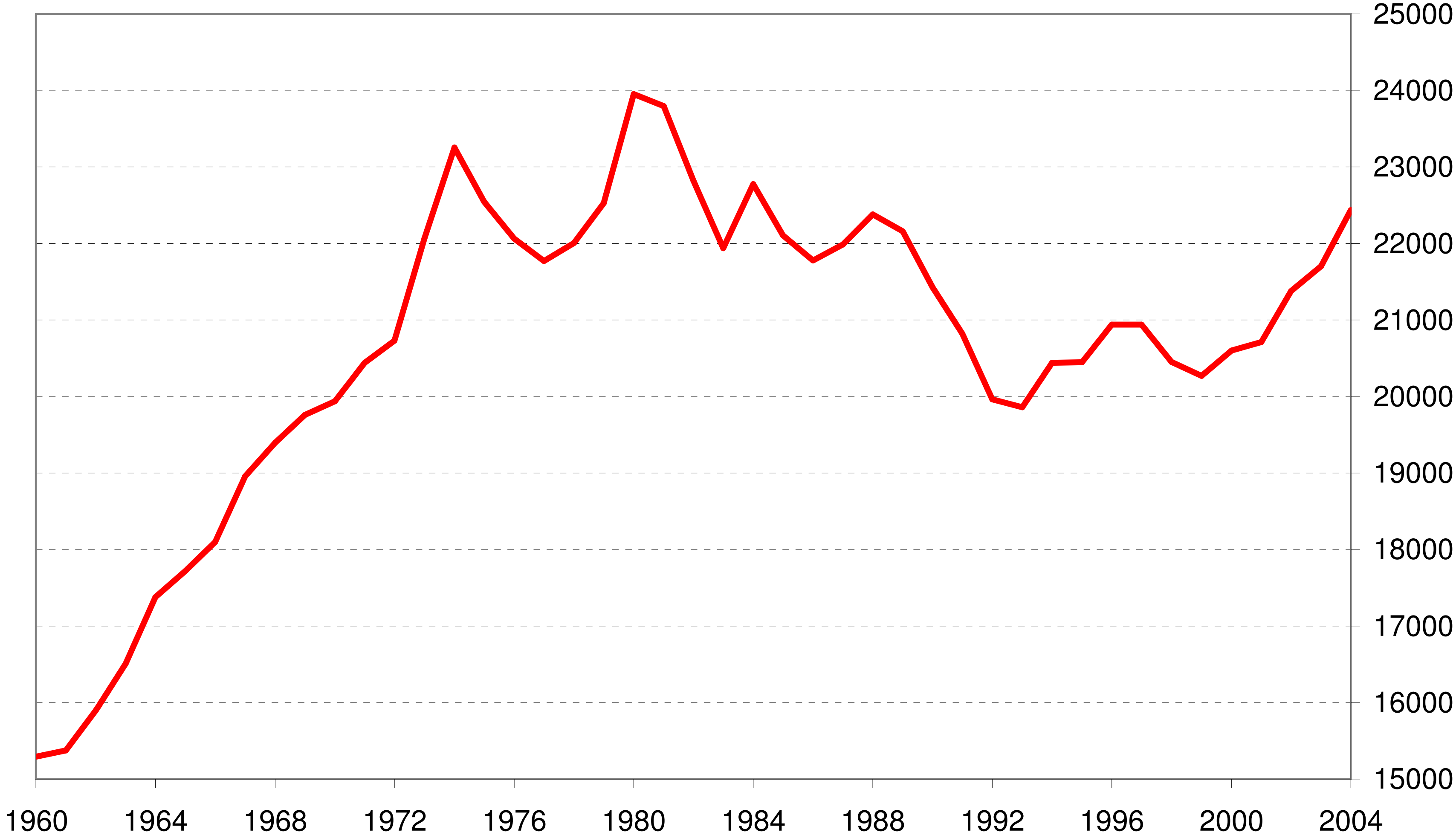
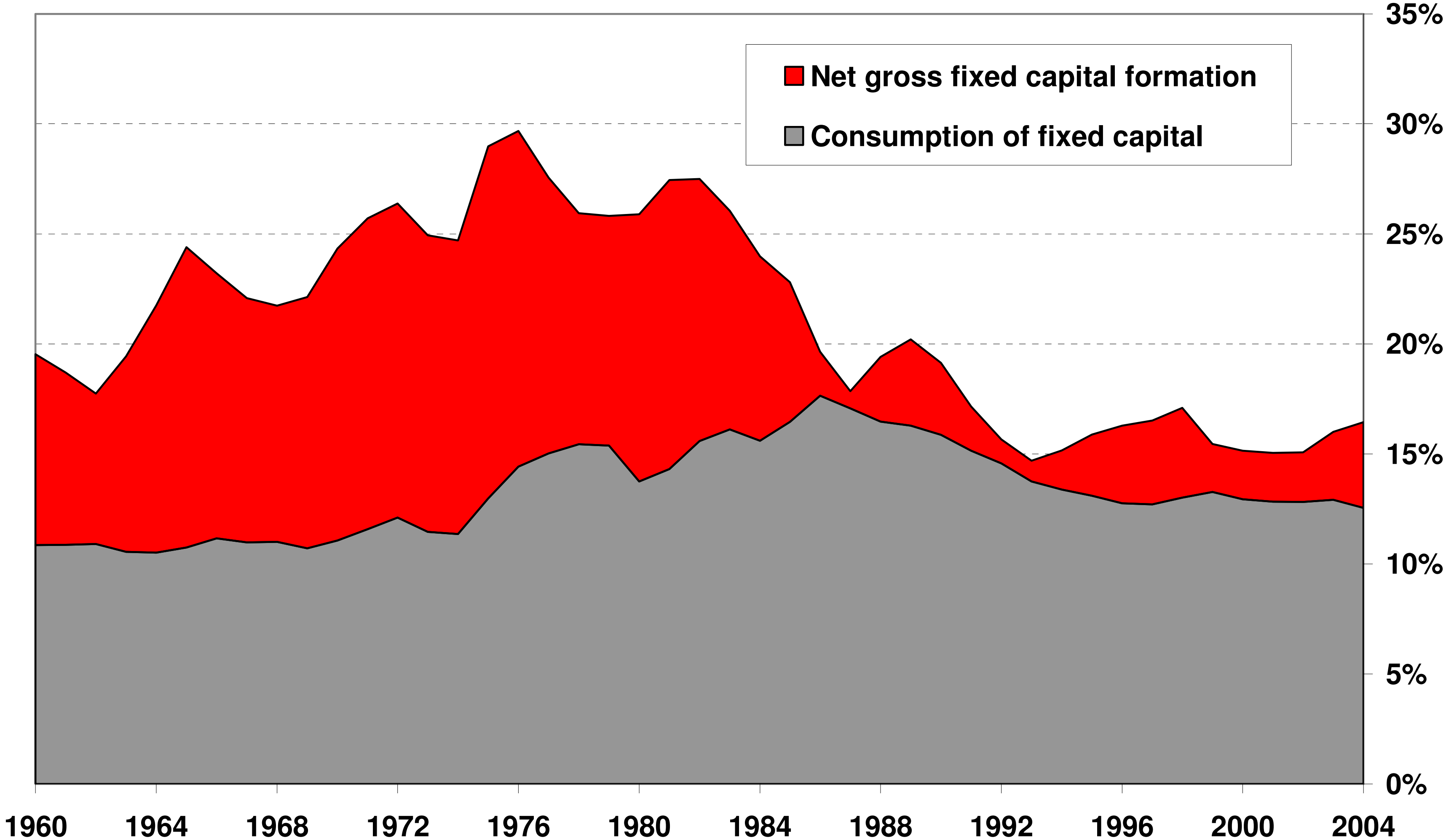
Real GNI per capita (2000 rand)



Fixed capital formation / GDP



6% economic growth – achievable?

- **Growth:**
  - **More application of resources (labour / capital)**
  - **Productivity**
- **Potential growth = TFP + 0.6*Labour% + 0.4*Capital%**

  = 1.5% + 0.4*2% + 0.6*2%

  = 3.5%
- **Required: 2% + 0.6*4% + 0.4*4%**

  = 6%

Prerequisites for growth

- The state's priority: maintenance of law and order, protection of private property rights, and elimination of corruption.
- Maintaining a stable macro-economic climate – especially low inflation – by sticking to sound fiscal and monetary policies.
- Motivated and skilled people, which depends foremost on a first-rate educational system.
- State and business must embrace new technologies.
- A fair, efficient and non-penalising tax system.
- Authorities ensuring sufficient competition in all sectors of the economy.
- Sufficient levels of saving and fixed capital formation are required.
- International creditworthiness needs to be maintained.
- Infrastructural expansion and maintenance must be priorities.
- Businesses must be allowed to operate profitably and with the lowest possible regulatory burden

Sectoral growth rates

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2004					2005	
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	5	7	9½	½	3½	7½	5½
Agriculture.................	8½	17½	11½	4	1	4	10
Mining	3½	3	9	-1	4	9	3½
Secondary sector	5	6	6½	3	3	-1	6½
Manufacturing	5	6	6½	2½	2½	-2	7½
Tertiary sector	3½	4	5	5	4	4½	4½
Non-agricultural sector ..	*4*	*4*	*5½*	*4*	*4*	*3½*	*4½*
Total	4	4½	5½	4	3½	3½	5

Sectors ranked according to expected growth

	Annual % change			
	1990-1994	1995-1999	2000-2004	2005-2009
Motor vehicles, parts & accessories	-5.6	4.6	6.0	13.3
Communication	1.5	15.5	10.8	8.9
Furniture	3.6	6.9	11.3	8.8
Leather & leather products	1.9	1.9	13.6	6.1
Plastic products	5.4	3.4	7.3	6.0
Finance & insurance	-2.4	7.2	7.4	5.9
Textiles	-4.3	-1.7	2.2	5.9
Civil engineering & other construction	-4.1	3.3	5.3	5.8
Rubber products	-1.8	1.5	1.7	5.7
Other chemicals & man-made fibers	0.5	8.1	5.0	5.5
Basic non-ferrous metals	5.3	11.2	0.5	5.4
Electrical machinery	-0.7	4.9	0.6	5.2
Wood & wood products	3.2	1.4	3.8	5.0
Wholesale & retail trade	-0.2	4.0	5.2	4.7
Coke & refined petroleum products	0.1	8.9	1.9	4.5
Glass & glass products	5.4	-1.5	7.3	4.5
Business services	4.3	2.7	3.2	4.4
Other community, social & personal services	4.2	5.2	4.7	4.3
Medical, dental & other health & veterinary services	3.2	5.9	4.0	4.2
Transport & storage	1.7	3.4	4.1	3.6
Building construction	-3.6	-1.6	5.8	3.6
Agriculture, forestry & fishing	0.4	0.1	0.5	3.5
Other mining	5.2	1.0	5.6	3.3

Risks, challenges and forecast highlights

SA Domestic

- Consumer boom continues unabated, driven by low inflation and interest rates, rising disposable income, slightly higher employment, tax relief, cheap imports
- Cooling down in consumption and credit growth rates are expected
- Household sector finances still appear relatively healthy, but saving is non-existent
- Corporate sector’s performance dragged down by manufacturing, with mining recovering somewhat
- Inflation remains low, but pressure may be expected from a number of sources
- Interest rate view remains uncertain, but no changes are expected in 2005
- Rand should remain strong in 2005. Balance of payments could exert downward pressure in 2006

Demand-side growth (average y/y % change)

		2003	2004	2005	2006	2007	2008
Real household consumption	%Δ	3.4	6.1	6.0	4.7	4.6	4.8
Real fixed capital formation	%Δ	9.0	9.4	8.3	6.5	5.5	6.2
Government consumption expenditure	%Δ	6.4	7.2	5.1	5.0	5.0	5.5
Gross domestic expenditure	%Δ	5.3	6.3	4.2	5.2	5.1	5.5
Exports	%Δ	-0.9	2.9	6.4	2.2	2.6	2.7
Imports	%Δ	8.5	12.9	5.4	7.0	6.7	6.7
GDP growth	%Δ	2.8	3.7	4.4	3.9	4.0	4.4

Monetary & other indicators (averages)

		2003	2004	2005	2006	2007	2008
USD/ZAR exchange rate	R per$	7.56	6.45	6.35	6.41	6.54	6.88
EUR/ZAR exchange rate	R per€	8.53	8.01	7.92	8.32	8.61	8.78
Current account balance	% GDP	-1.5	-3.2	-3.6	-4.6	-5.3	-5.7
CPIX inflation	%Δ	6.8	4.3	4.3	5.6	5.1	4.8
Bank credit extension	%Δ	16.3	19.2	23.7	16.6	13.5	13.8
Prime rate (year-end)	% pa	11.50	11.00	10.50	11.50	9.50	9.50

Risks to outlook

- Bursting of housing market bubble internationally
- Collapse of consumer confidence and spending boom in US
- Dollar crash
- Hard landing in China
- Oil price shock, taking the crude price to more than $80/bl:
  - Lower real disposable income growth because of higher inflation
  - Interest rate hikes
  - Higher current account deficit / weaker rand
  - Weaker global growth
- Rand crash

Economic /political challenges

- Low savings / fixed investment ratio
- Trade liberalisation / globalisation
- Service delivery / privatisation
- Exchange rate volatility / exchange control
- Labour market rigidity
- Skills / education / training
- Crime / corruption
- Over-regulation
- Aids
- Land redistribution
- Black aspirations / expectations
- Nepad / Zimbabwe
- After Thabo Mbeki ….

Overriding positive factors ...

- Fiscal discipline
- Monetary policy discipline
- Low levels of foreign debt
- Low political risk
- Freedom of speech / press
- Confidence in judicial system
- Functioning institutions
- World class companies

Thank you

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