

Economics

South Africa: Macroeconomic forecast



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Forecasts

	2004 ^a	2005 ^a	2006 ^a	2007 ^a	2008 ^a	2009 ^f	2010 ^f	2011 ^f
Growth data								
GDP (% y/y)	4.9	5.0	5.4	5.1	3.1	-1.5	3.0	3.2
Final consumption expenditure by households – FCEH (% y/y)	6.7	6.9	8.3	6.6	2.3	-3.1	1.3	2.5
Gross fixed capital formation – GFCF (% y/y)	8.9	10.2	13.2	16.3	10.2	4.4	3.3	5.8
Current account balance (% of GDP)	-3.2	-4.0	-6.3	-7.3	-7.4	-5.1	-5.6	-5.3
Inflation data								
Headline CPI ¹ (% y/y) annual average	1.4	3.4	4.6	7.1	11.5	7.3	6.1	5.4
PPI (% y/y) annual average	2.4	3.6	7.6	10.9	14.2	1.0	7.5	6.6
Prime rates								
Prime (year end)	11.00	10.50	12.50	14.50	15.00	10.50	12.50	12.50
Prime (average)	11.30	10.60	11.20	13.08	15.13	11.81	11.21	12.50
Exchange rates								
\$/R (average)	6.43	6.33	6.77	7.05	8.22	8.63	8.25	8.20
£/R (average)	11.74	11.50	12.51	14.09	15.06	13.48	14.42	15.42
R/¥ (average)	16.79	17.44	17.30	16.77	12.48	11.05	10.97	12.31
€/R (average)	7.97	7.83	8.52	9.71	12.01	11.92	12.23	12.46

a=actual

f=forecast

¹ The CPI headline number from 2009 constitutes a reconfigured basket.

Exchange rate forecast

Quarterly averages	Q3 2009	Q4 2009	Q1 2010	Q2 2010	12-month trading range
EUR/USD	1.43	1.46	1.53	1.50	1.30 – 1.60
GBP/USD	1.62	1.68	1.72	1.77	1.40 – 1.80
USD/JPY	94.40	91.50	89.06	88.90	80.0 – 100.0
USD/ZAR	8.05	8.23	8.17	8.32	7.80 – 9.00
EUR/ZAR	11.53	12.06	12.49	12.48	10.14 – 14.40
GBP/ZAR	13.06	13.79	14.04	14.68	10.92 – 16.20
ZAR/JPY	11.72	11.11	10.89	10.969	10.26 – 11.11

Consumer inflation

Prime rate forecasts

Headline CPI - % y/y

Last prime rate change: 13 August 2009

	2009	2010	2006	2007	2008	2009	2010
January	8.1 ^a	7.2	10.50 ^a	12.50 ^a	14.50 ^a	15.00 ^a	10.50
February	8.6 ^a	6.6	10.50 ^a	12.50 ^a	14.50 ^a	14.00 ^a	10.50
March	8.5 ^a	6.0	10.50 ^a	12.50 ^a	14.50 ^a	13.00 ^a	10.50
April	8.4 ^a	5.9	10.50 ^a	12.50 ^a	15.00 ^a	12.00 ^a	10.50
May	8.0 ^a	5.9	10.50 ^a	12.50 ^a	15.00 ^a	11.00 ^a	10.50
June	6.9 ^a	6.0	11.00 ^a	13.00 ^a	15.50 ^a	11.00 ^a	11.00
July	6.7 ^a	6.1	11.00 ^a	13.00 ^a	15.50 ^a	11.00 ^a	11.00
August	6.3	6.3	11.50 ^a	13.50 ^a	15.50 ^a	10.50 ^a	11.50
September	6.3	5.9	11.50 ^a	13.50 ^a	15.50 ^a	10.50	12.00
October	6.3	5.9	12.00 ^a	14.00 ^a	15.50 ^a	10.50	12.50
November	6.5	5.8	12.00 ^a	14.00 ^a	15.50 ^a	10.50	12.50
December	7.0	5.7	12.50 ^a	14.50 ^a	15.00 ^a	10.50	12.50
Average	7.3	6.1					
Low	6.3	5.7					
High	8.6	7.2					

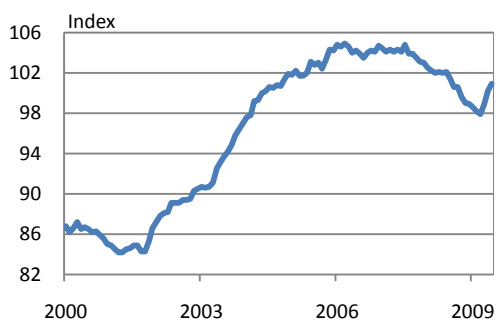
Introduction

Fresh progress in cyclical macroeconomic indicators has injected life into the global economic atmosphere, corroborating views that the harshest events of the contemporary meltdown have passed. Aggressive policy impulses have successfully incubated advanced economic activity from catastrophe. However, the convoluted affair of piecing together often self-contained strands of evidence indicates that, even though the trough has passed, the “recovery” period is likely to be lethargic, protracted and volatile because a concomitant signal from demand will prove elusive. Expect a prolonged time-frame of a multi-year downshift in growth.

International economy

In technical terms, the United States (US) recession probably ended in July. Overwhelming tides of forward-looking indicators are higher than their respective troughs – albeit still negative. Money supply, spurred by aggressive government support, which has diverted a systemic financial sector collapse and placed a floor under economic growth, reached its trough ten months ago. The Baltic Dry Index, ISM manufacturing index, months of existing home sales, nominal retail sales and the oil price each reached their respective troughs at least six months ago. More recently, other historically accurate leading indicators, such as equity markets, the University of Michigan consumer expectations, new home sales, building permits, the inventory to sales ratio, amongst a host of other variables, have improved in each of the past few months. In fact, only exports' volumes and industrial production, which typically trough in the month a recession ends, are yet to bottom. However, industrial production fell by a modest 0.4% m/m in June, which is the smallest monthly decline this year.

Figure 1: US leading economic index turned



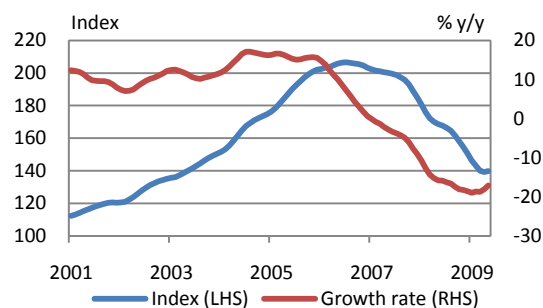
Source: Bloomberg

While it has indeed become far easier to find data points that reflect that the worst is over, we remain fastened to the view that sober analysis cautions that advanced economies are unlikely to experience a strong recovery. For one, the nerve-ending of the synchronised global downturn has been financial stress, unparalleled in scope since the Great Depression of the 1930s. Recessions triggered by financial sector distress are always the most severe and protracted. For instance, since 1960, there have been 28 such episodes, each lasting

around two-and-a-half years. Second, exacerbating the humdrum reality, the current recession has also been accompanied by the bursting of a house market bubble, which is especially damaging as households have become increasingly reliant on housing assets.¹ In the past 45 years, there have been 28 house busts, averaging four years, with house prices falling around 30% from peak to trough. Therefore, history reminds us that a collapse in asset prices and credit markets² tends to create a vicious cycle of reducing wealth of both firms and households, impairing their ability to borrow, spend and invest, which further erodes asset values.

Encouragingly, evidence suggests that conditions in the US housing market are starting to improve. Recall that the housing market has been at the core of the recession and is crucial for a durable recovery. In 2004 US house prices began to see a deceleration in growth. Then, in January 2007 house prices started to decline. Promisingly, since the start of 2009, house price declines have started to decelerate. Fastened to the description, having contracted by 18.1% y/y in April, house prices contracted by 17% y/y in May. In fact, the Case-Shiller house price index posted its first monthly gain since July 2006, increasing from 139.21 in April to 139.84 in May (see Figure 2). However, as was the case when prices started falling, stabilisation in home prices is likely to vary across regions.

Figure 2: House price declines have moderated



Source: Bloomberg

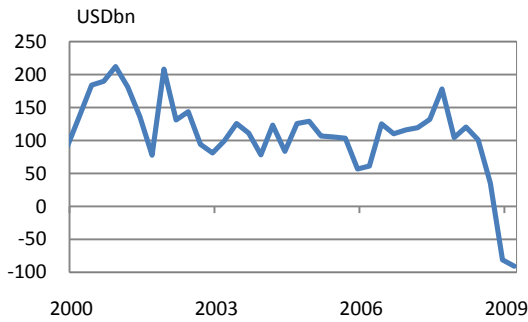
Moreover, although the financial sector has stabilised, it is still a long way from functioning in a normal fashion. Consider that credit write-downs on US originated assets alone are anticipated to total USD2.7 trillion (tr). Total write-downs, which include assets originated elsewhere, are expected to reach USD4 tr. As a result, overall credit to the private sector is expected to decline in 2009 and 2010 as financial institutions are forced to restrict lending amid a weaker economic environment and diminished capital bases. Already in the US, having averaged USD100 billion (bn) per quarter since 2000, private sector credit fell by USD81 bn and USD90 bn, respectively, in the first and second quarters of 2009 (the first quarterly contraction on record since

¹ For instance, total home equity, which peaked at around USD13 tr in 2006, has shrunk to USD8 tr (and is still falling) as house prices have fallen over 30% since peaking in 2006.

² Importantly, recessions connected to credit logjams or asset price implosions typically result in real GDP declines, of around 6%.

1952). So, not only are households trying to absorb severe asset price shocks, but are also either struggling or unwilling to take on credit.

Figure 3: Private sector credit extension

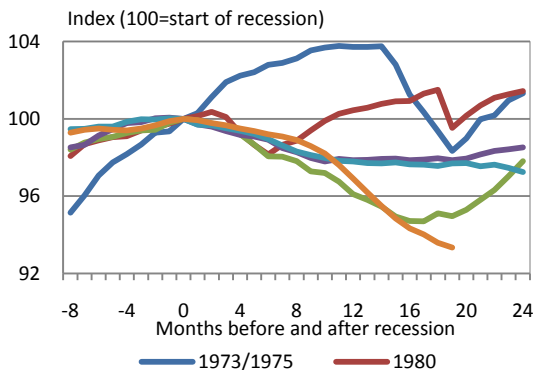


Source: Bloomberg

More worryingly, the most damaging imprint of the recession has been felt in employment. In August, markets gratefully received news that the US labour market experienced some improvement in July. Non-farm payrolls fell by a more modest 247 000 last month (the smallest decline since August 2008). However, the unemployment rate edged down from 9.5% in June to 9.4% in July as the labour force contracted by 422 000. Consider that any economic momentum will attract job seekers. Quite rightly, Federal Reserve (Fed) Chairman Ben Bernanke acknowledged that the unemployment rate will be well above its long-term sustainable rate in 2011.

Still, the extent of the labour shedding is difficult to square with notions of an imminent and genuine economic recovery. The US has shed 5.7 million (mn) workers over the past 12 months. In fact, since January 2008, the US has shed 80% of the 8.7 mn jobs created in the four years prior to the crisis, making the current recession the most aggressive in labour shedding terms since 1945 (see Figure 4). Tellingly, the US economy lost 265 000 jobs in the first month of the recovery in 2001, but the recovery was a jobless one. Now, as we enter the second half of 2009, the story is likely to be much the same.

Figure 4: Labour shedding persistent and severe



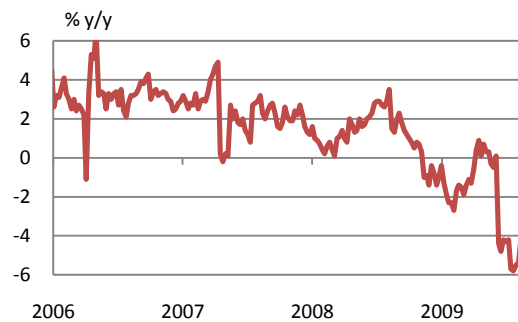
Sources: Bloomberg, Standard Bank Group

The prospect of a major fiscal tightening, designed to rein in the ballooning Federal budget deficit, is another reason for fearing that household consumption could remain lacklustre for several years. Considering that the fiscal budget deficit is around 12.8% of GDP and

that the government aims to bring this down to around 2% by 2012 (more likely 6%), a painful fiscal consolidation is necessary. Putting the budget back on a sustainable path will require tax increases as well as spending cuts.

To be sure, the immediate scaffolding underpinning the US consumer has improved somewhat: negative wealth effects have moderated, a partial recovery in world equity markets is underway and stabilisation of house price declines has commenced. However, consumer spending has yet to respond to inject verve into the economic atmosphere (see Figure 5). Until consumption picks up, any recovery will struggle to gather momentum. In reality, the US is in a transition phase, which will lead to less emphasis on household spending relative to exports.

Figure 5: Broad-based weakness in retail sales (four-week moving average)



Source: Bloomberg

On a positive note, productivity increased from 0.3% y/y in Q1 2009 to 6.4% y/y in Q2 2009. The reason was that the number of hours worked fell more sharply than output. The sharp increase in productivity coupled with an anaemic gain in compensation translated into a 5.8% drop in unit labour costs. The decline in unit labour costs implies the absence of inflationary pressures. For now, with the US Consumer Price Index (CPI) falling from -1.4% y/y in June to -2.1% y/y in July, the earliest the Fed will begin to drain liquidity and raise its policy interest rate is likely to be mid-2010.

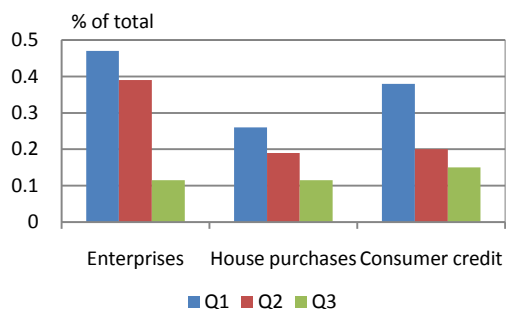
Despite structural headwinds to the US economy, it is clear that the broader economy has shifted from apocalyptic lows. Similarly, positive newsflow has recently emanated from Europe's largest economy, Germany, which experienced a gain in exports of 7% m/m in July. The news was seen as part of a broader global phenomena. That said, June's exports remained 23% y/y lower, reflecting just how far global demand has retreated. Given the weight of Germany, Euro-zone trade figures affirmed that the external sector is lacklustre. Euro-zone exports improved marginally from -24.1% y/y in April to -22.8% y/y in May. Evidently, weak global demand, coupled with the strength of the euro, is dragging down Euro-zone export growth. The picture is much the same for the United Kingdom (UK). For instance, UK export volumes are down by 16% a year ago, but also posted a monthly rise in June.

However, buoyed by Germany's activity, the Euro-zone, the world's second-largest contributor to global GDP, after recording an unprecedentedly weak GDP growth rate of -2.5% y/y in Q1 2009, contracted by 0.1% y/y in Q2 2009. Clearly the outlook has improved.

Again, much like the US, weak consumption casts an ominous shadow over the foreseeable horizon. Euro-zone retail sales fell – albeit less sharply – from -3.2% y/y in Q1 2009 to -2.4% in Q2 2009. Promisingly, in France, consumer spending increased from -1.2% y/y in May to 1.2% y/y in June. However, rising unemployment, which is expected to shift from a 10-year high of 9.5% in May to about 12% next year, will erode purchasing power. Testament to the anaemic demand, after a flat CPI rate in May, June's -0.1% y/y CPI figure confirmed that deflation has arrived.

Aware of the generalised fragility, banks are attempting to fuel a revival by relaxing lending standards (see Figure 6). However, even if banks are willing to lend, it is unclear that this will be matched by higher demand in the wider economy. Therefore, much like the US, the Euro-zone will only expand modestly in 2010.

Figure 6: Net percentage of Euro-zone banks expecting to tighten credit standards next quarter



Source: Capital Economics

South Africa

South Africa's recessionary cycle is approaching an advanced phase.

Detailed breakdown of the expenditure approach to GDP

Household demand:

- According to the consumer financial vulnerability index (Bureau for Market Research and FinMark Trust), South African consumers remain somewhat fragile, with a score of 5.17 in June, where 0 – 1.99 is financially very secure; 4 – 5.99 is somewhat financially vulnerable; and 8 – 10 is financially very vulnerable. This compares unfavourably with European countries, for instance, Sweden (0.4); Norway (0.9); Denmark (1.3) and Great Britain (3.1).
- Of this index, savings vulnerability, scoring 5.74, is the highest contributor, followed by income vulnerability (5.64), expenditure (5.54), and lastly debt servicing (4.37).

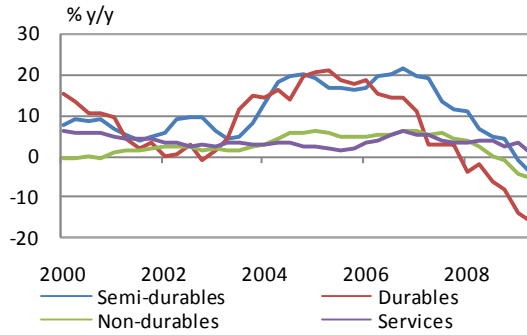
- These scores confirm that consumers have little or no savings buffer, while income vulnerability is heightened by the economic downturn and job cuts. Further, the relatively high expenditure vulnerability relates to stubbornly high levels of inflation, especially food inflation, which was between 12% and 16% at the time of the survey. Constructively, though, food inflation eased to 9.8% y/y in June, and is likely to ease the burden on consumers, especially low-income individuals.
- The survey noted that, of the more than 400 000 individuals that have lost their jobs since the start of the year, around 42.4% aren't able to keep up with account payments, even though they may have some income. Moreover, around 35% of respondents indicated that their ability to "get by" has deteriorated over the past year, and that they are therefore unable to save. Around 45% of the respondents' spending is restricted by what they can borrow.
- According to survey respondents (account managers and organisations, such as municipalities, clothing stores, and communications companies), the top ten reasons for the financial vulnerability of their clients are:

Too much debt	(63.8%)
Spending exceeds income	(60.3%)
Bad financial planning	(46.6%)
Low income	(43.1%)
Insufficient savings	(43.1%)
Carrying debts of partner/family/friends	(41.4%)
Adverse economic conditions	(41.4%)
Unforeseen necessary expenses	(39.7%)
Drop in income	(39.7%)
Job loss	(36.2%)

- Provinces with the highest vulnerability are the Eastern Cape, Northern Cape and Mpumalanga – these are also the poorest provinces with the highest unemployment rates of 27.9%, 26.5%, and 26.5% respectively.
- Although the more affluent provinces, such as Gauteng, are less vulnerable, they tend to be more constrained by high debt levels and service costs.
- The survey also revealed that financial vulnerability is the highest among the age group of 26 to 34 years, which is the credit-hungry cohort.
- These trends corroborate our view that the household debt-to-income figure may be slow to ease from its current level of 76.7%, but that it is likely to ease to 74% by year-end and to 71% by the end of 2010.
- From a household consumption expenditure perspective, demand deteriorated by -3.5% y/y in Q2 from -1.8% y/y in Q1. The decline was broad based, with sales of durables, non-durables and semi-durables contracting by -15.7% y/y, -5.4% y/y and -3.6% y/y in Q2

from -14% y/y, -4.3% y/y and -0.5% y/y in Q1, respectively (see Figure 7).

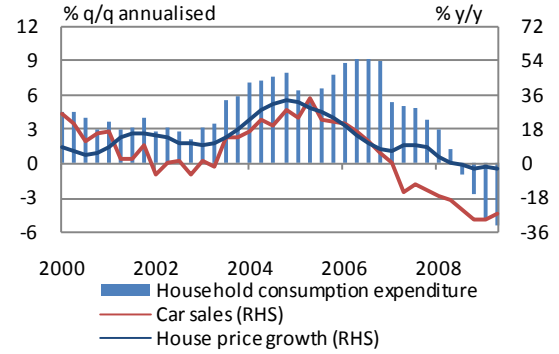
Figure 7: Household consumption expenditure on goods and services



Source: SARB

- The average 3.9% nominal decline in house prices in the first eight months of the year, alongside concerns over job security, could see households' precautionary savings increase, albeit slowly. Households dissaving improved from -R8.2 bn in 2007 Q1 (-0.7% of disposable income) to -R1.4 bn in Q2 this year (-0.1% of disposable income).
- In Q2, household credit decreased by R1.5 bn relative to Q1 (the first q/q decline since 2002 Q3), following a R11.6 bn increase between Q4 and Q1. The average quarterly increase in household credit since 2000 is R19.7 bn.
- Household debt as a ratio to income moderated marginally to 76.3% in Q2 from 76.8% in Q1. The higher pace of increase in nominal income growth of 2.3% q/q seasonally adjusted and annualised (s.a.a.) in Q2 helped to lower this ratio marginally to 76.3%. This is significant when viewed against the backdrop of job losses.
- Consolidation of debt should gain traction during the second half of the year, when the debt service cost-to-income ratio is expected to fall to around 8% from 9.5% in Q2, while lower inflation will further free up some cash.
- Passenger car sales remained little changed in August, falling by 0.2% m/m to -25.7% y/y from -27.6% y/y in July. The average rate of decline in passenger car sales improved to -27.4% y/y in Q2 from -29.9% y/y in Q1, confirming that the sales cycle bottomed in the first quarter. Car sales should end 2009 around 23% - 25% lower than in 2008. We expect a relatively sharp increase in sales by the second half of 2010 of 13.2% y/y, starting from a low base of around 2.2% y/y in the first half of 2010.
- Retail sales declined by 6.7% y/y in June, leaving total sales for the quarter 6% y/y down from the corresponding period last year.

Figure 8: Household consumption expenditure, house price and vehicle sales' growth

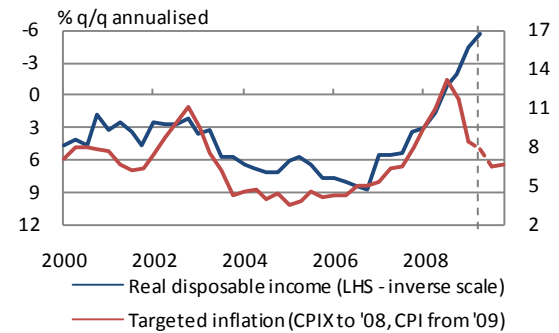


Sources: NAAMSA, SARB, Standard Bank Group

Household earnings' potential:

- Following a rapid decline of 4.5% q/q annualised in real personal disposable income growth in Q1, the second quarter posted a steeper 5.7% q/q s.a.a. decline. Despite this contraction households received some R13.6 bn in (annual) tax concessions owing to the adjustments of tax brackets in the National Budget.
- Moreover, the average level of wage settlements eased to 9.7% y/y in Q2 from 10.2% y/y in Q1 and 9.8% y/y in 2008.
- As inflation moderated from an average of 8.4% in Q1 to 7.8% in Q2, and 6.7% in August, along with additional interest rate reductions of two percentage points in Q2, and 50 basis points in August, households' real purchasing power would have improved in Q3. Aforementioned trends of generally weaker retail sales suggest that real income gains may have promoted more cautious spending, or savings.

Figure 9: Household real income growth inversely related to inflation and interest rates



Sources: SARB, Stats SA, Standard Bank Group

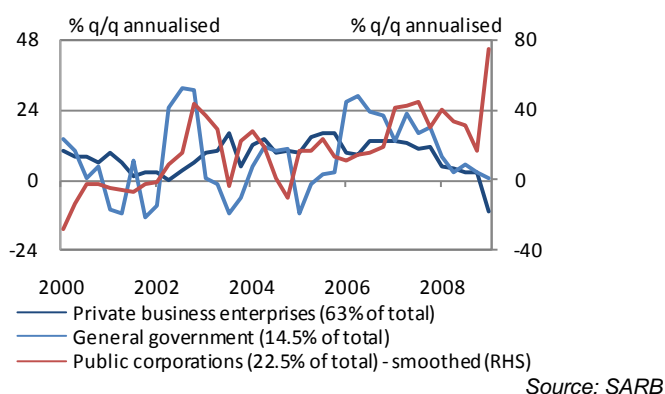
- The outlook for Q3 is promising owing to a further improvement in inflation to 6.4% y/y. Moreover, this season's relatively high wage increases could translate in higher real wages for the quarter. In addition, survey data from the Bureau of Economic Research (BER) revealed that the pace of retrenchments in the manufacturing, retail and construction sectors in Q3 may ease, suggesting a general improvement in overall income gains.

- These anecdotes tie in with our expectations for a mild improvement, or stabilisation, in GDP in Q3.

Gross fixed capital formation:

- Total capital formation fell from an upwardly revised 12.7% q/q s.a.a. in Q1 to only 0.1% q/q s.a.a. in Q2. Private capital formation declined given the generally poor business outlook (-11.6% q/q s.a.a. in Q2 from -10.6% q/q s.a.a. in Q1) while investment by public corporations fell from the massive increase (upwardly adjusted) of 187.5% q/q s.a.a. in Q1 to a more pedestrian 42.7% q/q s.a.a. The low level in investment by parastatals in Q1 probably reflected some funding issues. However, growth in infrastructure development by general government recovered marginally to 2.4% q/q s.a.a. in Q2 from 0.6% q/q s.a.a. in Q1.

Figure 10: Fixed capital formation by type of organisation



- The sectoral analysis below tends to confirm an increasing bias towards the postponement of capital projects, barring some mining projects, in both the private and public sectors. This highlights the downside risks in the near term, although the second half of 2010 is likely to see some rebound in capital formation.
- Fixed capital formation by the mining sector grew strongly, by 8.7% q/q annualised in Q1, from an already high base of 43% q/q in Q4. However, investment growth slowed 0.6% q/q s.a.a. in Q2. As such, this sector still maintained a larger share in total investment relative to 2008 Q2 (see Table 1). Investment grew by 3.8% in 2008.
- The electricity sector, which grew its investment by 211.5% q/q annualised in Q1 and a further 151.4% q/q annualised in Q2, also increased its share in the fixed investment pool relative to 7.3% in Q2 last year. We expect growth in capital formation to slow sharply over the medium-term horizon.
- Sectors reporting a marked contraction in capital formation in Q2 include the manufacturing sector (-30.3% q/q s.a.a. in Q2 from -38.7% q/q s.a.a. in Q1); transport and communications (-17.2% q/q s.a.a. in Q2 from 81.9% q/q s.a.a. in Q1); and the broader financial sector (including business services, insurance and real estate) (-6.7% q/q s.a.a. in Q2 from -8.3% q/q s.a.a.).

Table 1: Sectoral contributions to fixed investment 2009, Q2 ('08 Q2 in brackets)

Mining	9.4 (8.8)
Manufacturing	15.0 (19.3)
Electricity	14.2 (7.3)
Transport	16.5 (15.5)
Finance	19.0 (21.8)
Community services	14.4 (14.9)

Source: SARB

- Parastatals such as Eskom, Telkom and Transnet have recently revised their medium-term expenditure programmes, which lowers the overall government capital formation trajectory over the medium-to-long term.
- As can be seen from the comments on the construction sector below, tenders for civil projects are awarded less frequently, while a greater portion of projects are being postponed.
- An increased probability can be attached to the downward revision of government's R787 bn infrastructure programme; funding-related risks and lower revenue collections may lead to a prioritisation of projects, which could ultimately influence the medium-term project line-up.
- More recent upward pressure on the public sector wage bill will aggravate the government's budget deficit, which could rise to around 6.4% of GDP this year from an originally budgeted -3.9% ratio.

Table 2: Average annual public spending on infrastructure over 2009/10; 2010/11; and 2011/12

	General government	State-owned entities
Annual value	R130.2 bn	R132.3 bn
Share of total spend	49.60%	50.40%
Nominal growth	13%	17.80%

Source: SA National Treasury

- Overall capital formation growth will slow to below 2% in 2009 from 10.2% in 2008, and a long-term average of 5%. Risks to our forecasts for a rebound to 4.2% in 2010 are to the upside.

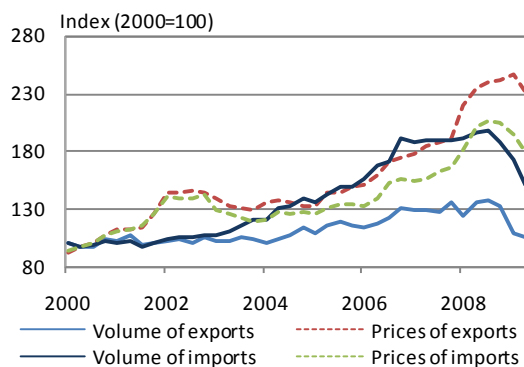
Net exports:

- Following the sharp cut in merchandise export volumes of 21% q/q s.a. in Q1 2009 compared to a decline of 6.3% q/q s.a. in Q4 2008, export volumes appeared to have stabilised at low levels, contracting by 2.8% q/q in Q2. While the value of export prices declined by 7.5% q/q s.a. in Q2 from 2.0% q/q s.a. in Q1, the value of merchandise exports declined at a slower pace of -10.1% q/q s.a. in Q2 from -19.4% q/q s.a. in Q1.
- Growth in merchandise export volumes averaged 8.3% y/y between 2005 and 2007, when global growth was at its peak.
- There are moderate upside risks to our still bearish exports' outlook, with recent evidence of a stronger performance in Asian

economies. Asia, largely driven by greater Chinese dominance, has overtaken Europe as South Africa's largest export destination. These exports are largely commodity based.

- The value of merchandise imports fell by 21.4% q/q annualised in Q2 2009 from -13.0% q/q in Q1 2009, owing to a 7% q/q decline in the prices of merchandise imports and a 15.5% contraction in import volumes.
- While it has been expected that capital projects would keep the import bill buoyed for a longer period (80% of total imports are production related), the risks are increasingly on the downside.
- Moreover, recent rand strength is likely to support import volumes, as the local re-stocking cycle is expected to kick in by the third quarter of this year. The trade balance stands the risk of deteriorating by the third quarter of the year.
- We expect a mild reprieve on the current account deficit in the second, and possibly third, quarter of the year, but for the deficit to move to above 6% of GDP by 2010. The Q2 current account deficit improved sharply to 3.2% of GDP in Q2 from 7.0% in Q1.

Figure 11: Trade volumes and price indices



Source: SARB

Table 3: SA imports, exports and trade balance (R bn)

	Share of total trade		Trade balance	
	Exports	Imports	2000	2008
Precious metals and stones	23.1%	1.3%	38.2	143.5
Base metals	17.3%	4.9%	23.8	78.7
Agricultural produce, food and beverages	7.2%	5.4%	7.7	8.4
Pulp and paper products	1.8%	1.5%	2.9	1.2
Transport and equipment	10.3%	9.7%	0.2	-2.6
Miscellaneous manufacturing	0.8%	1.4%	0.2	-4.8
Textiles, clothing, footwear and accessories	0.9%	3.1%	-3.6	-16.5
Chemical products, plastics and rubber	8.7%	12.2%	-12.3	-31.6

Mineral products	18.3%	23.7%	-0.5	-51.6
Other	2.0%	11.3%	2.2	-68.6
Machinery and appliances	9.8%	25.5%	-38.8	-120.7
Total	100%	100%	20	-64.5
Commodities	58.7%	29.9%	62.1	161.6
Consumer goods	19.2%	19.6%	4.5	-15.5
Capital & raw materials	22.3%	50.5%	-48.2	-219.7

Source: National Treasury

Detailed breakdown of the production approach to GDP

Mining and quarrying sector (5.1% of GDP; 6% of formal non-agricultural employment):

- According to the monthly production statistics by Statistics South Africa (Stats SA), mining production rebounded by 4.5% q/q seasonally adjusted (s.a.) in Q2 relative to a steep -12.8% q/q s.a. decline in Q1. The increase was driven by a 5.8% q/q s.a. rise in the production of non-gold minerals, particularly platinum group metals, which contributed four percentage points to the 4.5% q/q s.a. rise. Non-gold mineral production contracted by a steep 14.2% q/q s.a. in Q1, owing to the steep decline in demand for platinum as well as several mine closures. Gold production, however, declined by 4.2% q/q s.a. in Q2 following a mild gain of 0.2% q/q s.a. in Q1.
- Since the third quarter of last year, when the global recession markedly permeated the domestic cycle, mining production has declined by a cumulative 10.2% (up to the first quarter of the year). Gross value added in the sector rose by 5.5% q/q s.a. in Q2 from -32.8% q/q s.a. in Q1.
- According to reports, mining engineering companies are seeing encouraging signs of revival as several mining groups are seemingly dusting off projects, given the return of confidence regarding funding.
- Several firms in the platinum and gold sectors have raised capital via rights issues and bonds, respectively. The viability of several projects is being revisited in light of the current economic climate.
- Potential future demand and supply imbalances, owing to reduced capital spending, are underpinning upward revision of certain commodity price forecasts (such as platinum). Platinum prices are seen rising to around USD1 350/oz in 2010 from the current levels of around USD1 234/oz.
- South Africa accounts for some three-quarters of global platinum output. With margins having been squeezed, capital expenditure of around R55 bn over the next two to five years has been pushed to the sidelines.
- Similarly, net global gold sales are heading for low levels of around 140 tons this year (130 tons in 1994), according to precious metals consultancy GFMS. Sales in the first half of the year reached 39

tons, down 73% y/y from last year's levels.

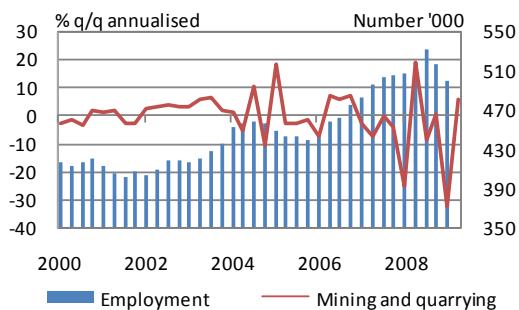
- Further confirming relatively optimistic investment prospects in the sector, Xstrata Coal recently confirmed R16 bn worth of development projects over the next five years, which could add some 20 million tons to the company's annual production.

Table 4: Share of top mining exports

	2004	2006	2008
Platinum group metals	26%	27%	27%
Gold and uranium ore	37%	28%	25%
Coal and lignite	17%	16%	15%

Source: Department of Trade and Industry

Figure 12: Mining Gross Value Added (GVA) vs employment



Sources: SARB, Stats SA

- Despite the general weakness in the mining sector, it still created 11 000 jobs in Q1 this year, although 1 000 jobs have been shed since Q1 2008.

Manufacturing sector (16.4% of GDP; 15% of formal non-agricultural employment):

- Manufacturing production fell by 17.1% y/y in June, little changed from the downwardly revised 17.2% y/y contraction in May. Clearly June's data reaffirm that industries are largely still running down their inventory stockpiles. The basic iron and steel (-24.3% y/y), automotive (-32.8% y/y), and petroleum and chemicals (-14.7% y/y) sectors remain the chief contributors to the slump in production relative to a year ago, contributing -5.4, -3.5 and -3.5 percentage points (pps), respectively.
- Production increased by a scant 0.1% m/m seasonally adjusted (s.a.), with growth reported in the petroleum and chemicals (2.8% m/m), glass and non-metallic mineral products (1.3% m/m), food and beverages (0.6% m/m) and basic iron and steel (0.2% m/m) sectors, which was partially offset by declines in output by the furniture and "other divisions" (-4.2% m/m), textiles (-2.9% m/m), wood and related products (-2% m/m) and automotive (-0.3% m/m) sectors.
- Moreover, the rate of contraction in production slowed significantly in the second quarter, improving to -3% q/q s.a. from -6.9% q/q s.a. in Q1. As such, the sector contracted by a smaller -10.2% q/q s.a. in Q2 after contracting by more than 22% q/q s.a. in Q1

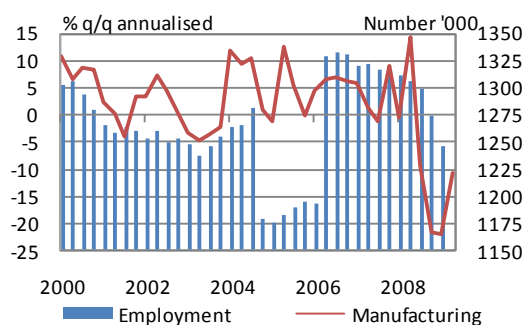
and Q4. The sector accounted for -1.6 pps of the -3% q/q s.a.a. decline in GDP in Q2.

- We maintain the view that the economy could see a mildly positive GDP growth number in Q3, as the pace of contraction and, more importantly, the rate of de-stocking draws to an end.
- We expect that a recovery in production will be closely tied to the re-stocking cycle, albeit from very low levels. Indeed, South Africa's manufacturing purchasing managers' index (PMI) seems to be lagging the PMIs of our major exporting partners (US, Germany, Japan and UK) by between two and six months.
- While these economies reached the troughs in their PMIs between November 2008 and February 2009, their PMIs have rebounded by nearly seven times more relative to South Africa's, since reaching their respective troughs. This suggests that by October the rate of decline in production growth will have slowed further, and that the domestic de-stocking cycle will have drawn to an end.
- To be sure, the de-stocking cycle that kicked in from October last year gathered traction in the first quarter of 2009, as the inventory component of the PMI fell from an average of 47.7 in Q4 last year to 31.1 in Q2 2009, pointing to an acceleration in the rate of stock depletion. Value-added losses during these two quarters were similar. By August, the rate of stock depletion declined at a slower pace, as this indicator rose to 37 index points.
- A turnaround in the inventory indicator will be pivotal to a recovery in production. And, the likelihood exists that the re-stocking cycle could start by the end of the third quarter, which could make for a firm rebound in manufacturing production, as a result of very low base levels.
- Recent reports reveal that major producers in the steel sector are seeing an end to the de-stocking cycle. This bodes well for the manufacturing sector, as the basic iron and steel sector accounts for 22.9% of production and 13% of major exports.
- Confirmation of the end of the de-stocking has been voiced by several industrial players, who are gearing themselves for an improved second half of the year. ArcelorMittal South Africa reported that demand for its products is expected to rise in Q3 this year, owing to several customers' de-stocking drawing to an end.
- Global steel production plunged by 21.3% y/y in the first half of 2009 compared to the same period a year before. China and Iran are the only two exceptions. However, it was noted that the pace of reduction in global steel output slowed to 16% y/y in June relative to the 21% y/y decline in May. China's steel production rose by 6% y/y in June to 49.4 million tons, accounting for the bulk of global output of 99.8 million tons.
- Despite still low levels of demand, ArcelorMittal announced a price increase for flat steel products of between 3% and 4% in August. This follows increases of between 4% and 6% in June, which were the first price increases since August 2008. Indeed, the firm cut

prices by over 60% between September 2008 and May this year, owing to the steep decline in international prices.

- High electricity tariff increases, rail and harbour charges are among the factors raising input costs, which are expected to weigh on earnings.
- That said, the firm is expected to increase its capacity utilisation levels to 75% in Q3 from an average of 60% in the first half of the year, up from a level of below 50% in the final quarter of last year.
- Total manufacturing capacity utilisation rose to 78% in Q2 from 77.1% in Q1, albeit down from the 84.4% level reached in Q2 last year. The sector's average capacity utilisation rate reached a level of 86.2% and 83.9% in 2007 and 2008, respectively.

Figure 13: Manufacturing GVA vs employment



Sources: SARB, Stats SA

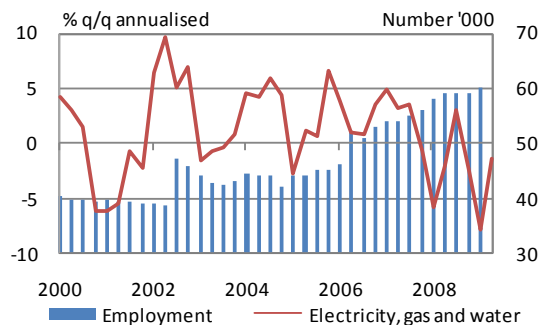
- The sector shed 49 000 jobs in Q1, leaving total employment 64 000 lower than the corresponding quarter of 2008.

Electricity, gas and water (2% of GDP; 1% of formal non-agricultural employment):

- Growth in electricity consumption, a gauge of the strength of economic activity, recovered in the second quarter to 2.9% q/q s.a. following a contraction of 3.6% q/q s.a. in Q1. However, consumption is still 5.8% lower than in the first half of last year; suffice to say that the rate of decline is seemingly reaching a bottom.
- The Department of Energy released its electricity regulations on planning for new generation capacity recently, which augurs well for reaching finality of the long-overdue power purchase agreement (PPA) between Eskom and TSX-listed CIC Energy, for its proposed USD3 bn (R24 bn) Mmamabula energy project in Botswana. This is still contingent on the conclusion of Eskom's funding model, which has been long delayed. However, this is one of the five projects which are currently on hold (see below).
- Moreover, the new regulations provide confirmation of government's commitment to deliver on its policy of purchasing energy from independent power producers (IPPs).
- The PPA is designed around a 30-year agreement which could see Eskom purchasing 75% of the plant's 1 200 megawatt (MW) capacity and Botswana Power Company buying the remaining 25%.

- Sub-par demand has seen the reserve margin (spare capacity) increasing from less than 5% last year to an average of 10% more recently compared to the desired level of 15% to 20%.
- However, sector challenges remain rife. Owing to cash constraints (Eskom is facing a funding shortfall of R161 bn), around R54 bn worth of capital expenditure, the total of which is around R340 bn, has been placed on hold. Three projects, Medupi, Kusile, and Ingula, which cost around R235 bn, will continue. However, the commissioning of the first unit of Eskom's Ingula pumped-storage scheme has been delayed by three to four months from its original date. The Medupi project, the first coal power station to be built in more than 20 years, is between four and six months behind schedule. As such, the country still runs the risk of running into electricity shortages in the future, which doesn't bode well for industrial projects and luring of foreign investment.
- In addition to the CIC Energy Mmamabula power project, other projects currently on hold are: Tubetse pumped storage project in Mpumalanga (R19 bn); Uppington solar power 100 MW plant at cost of between R2 bn and R6 bn; the R3 bn 100 MW wind farm in the Northern Cape; and the R1.8 bn Majuba rail venture.
- Should these projects be cancelled, lower electricity tariff increases are probable.

Figure 14: Utilities GVA vs employment



Sources: SARB, Stats SA

- Utilities created 18 000 jobs in Q1 this year, while the total workforce increased by 8 000 relative to Q1 2008.

Construction (3.6% of GDP; 6% of formal non-agricultural employment):

- There has been a significant upward revision to construction growth in Q1, according to the Q2 GDP figures. Gross value added in the construction sector rose by a revised 14.7% q/q s.a. in Q1 from a previous 9.4% q/q s.a. These revisions largely emanated from revised public sector spending. Growth slowed down to 12.2% q/q s.a. in Q2. Needless to say, the revision did not affect Q1 GDP growth.
- Construction projects are increasingly being scaled down as the private sector remains under strain. The Reserve Bank's Q2 GDP demand side figures reflect the underlying strains in this sector, as private sector capital formation was downwardly revised to a growth rate of -10.6% q/q s.a. in Q1, from an initial reading of

2.2% q/q s.a.a. The contraction continued well into the second quarter, posting a decline in growth to -11.6% q/q s.a.a. These declines were broad based, and in part reflected the more conservative lending practices of banks. We expect the contraction to continue in Q3, although at a lower rate.

- The number of square metres of new building plans approved for residential property (dwelling houses > 80 square metres) declined by 38.7% y/y in the first five months of the year. Similarly, for flats and townhouses, the decline has come to 64% y/y so far this year.
- However, according to industry experts, the lull in building activity may subside by the second half of 2010. According to the Aggregates and Sand Producers Association of South Africa (ASPASA) and the Southern African Readymix Association (SARMA), civil engineering turnover is expected to rise by a slow 5.7% in 2009 compared to the 25.1% and 38% growth in 2008 and 2007 respectively.
- Furthermore, ASPASA and SARMA predict that conditions in the construction industry will only improve late in 2010 and in 2011, underpinned by an improvement in the outstanding levels of household debt. However, total aggregate industry sales are expected to contract by 7.7% in 2009, 4.5% in 2010, and 1.2% in 2011. Sales are seen to expand by 2% in 2012.
- Given that the current slowdown in building activity is spilling over into the civil industry, with projects from Eskom, ACSA and Transnet having been revised, 2010 infrastructure spend may slow more considerably.
- Indeed, with house price deflation (-4.6% y/y in Q2) far below the average building cost inflation of around 4.2% y/y in Q2 (according to Stats SA's building and construction price inflation), new residential activity will be retarded well into 2010, when house price deflation is expected to bottom out.
- With the average replacement cost of new housing remaining higher than acquiring an existing home, supply of new residential buildings will be slow.
- Commercial building activity tends to lag developments in the residential building market. While commercial vacancy rates are still relatively low, rising corporate liquidations are expected to exert pressure on commercial building activity.
- Order books of major construction companies remain focused on public sector infrastructure and the social housing market.
- According to ASPASA and SARMA, the turnover in the civil engineering sector will grow by 5.7% this year.

Table 5: Growth in building plans passed (in square metres)

	2009 Q1 q/q%#
Residential:	
< 80 square metres	-2% (-44%)
> 80 square metres	-17% (-23%)
Flats and townhouses	-39% (-37%)
Other*	-52% (62%)
Non-residential:	
Office and banking space	-21% (10%)
Shopping space	-9% (4%)
Industrial and warehouse space	-12% (-33%)
Other**	54% (7%)
Additions and alterations:	
Dwelling houses	-23% (-5%)
Other buildings	-40% (-16%)

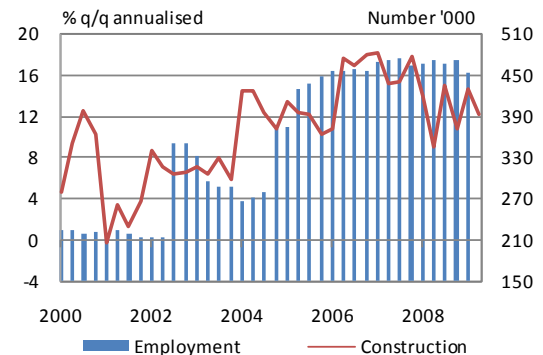
Q4 data in brackets

* Includes hotels, motels, guest houses, entertainment centres, B&Bs

** Includes schools, hospitals, sports and recreation

Source: Stats SA

Figure 15: Construction GVA vs employment



Sources: SARB, Stats SA

- Reflecting slowing building activity, the sector shed a total of 38 000 jobs in Q1. However, the sector has grown its workforce by 52 000 over the past year.

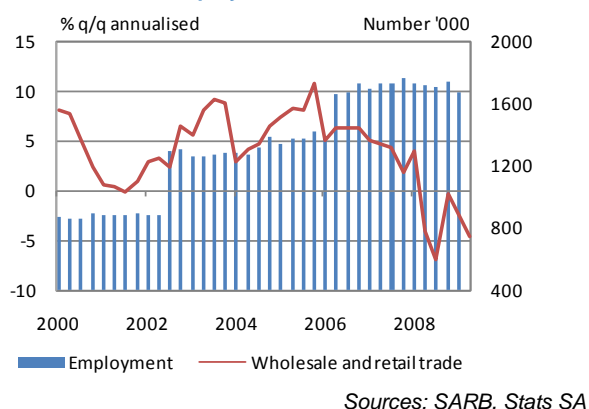
Wholesale and retail trade (13.8% of GDP; 20% of formal non-agricultural employment):

- According to Stats SA, real retail sales decreased in June by 6.7% y/y (-4.4% y/y (revised) in May). For the three months to June, real sales contracted by 6% relative to the corresponding period a year ago when growth was 0% y/y.
- In nominal terms, growth in retail sales increased by 3.6% y/y in June from 6.6% y/y in May. In the three months to June, nominal sales were 4.8% higher compared to the same period a year ago.
- The major contributors to the 4.8% increase in nominal retail sales for the quarter to June compared to the same period a year ago were general dealers (3.2 percentage points) and retail trade in specialised food, beverages and tobacco stores (1.2 percentage points). Retailers in hardware, paint and glass and retailers in household furniture, appliances and equipment subtracted 0.9 percentage points and 0.3 percentage points,

respectively, from the overall growth in retail sales over this period.

- Wholesale trade shrank by 9.9% in real terms in June from -10% y/y in May, which serves to corroborate that the second quarter may see a smaller overall contraction in GDP. Sales in the three months to June contracted by a lesser 3.4% s.a. when compared to the previous three months. In Q1, wholesale trade declined by 5.3% q/q s.a. Sales of gaseous liquids and metal ores are among the biggest laggards, while the food and beverages sector remains the key source of strength in the sector.
- Q2 GDP figures reveal a further decline in the value add of the broader trade industry, which contracted by 4.5% q/q s.a. from -2.5% q/q s.a. in Q1. A slowdown in the rate of contraction is envisaged for Q3.

Figure 16: Trade GVA vs employment



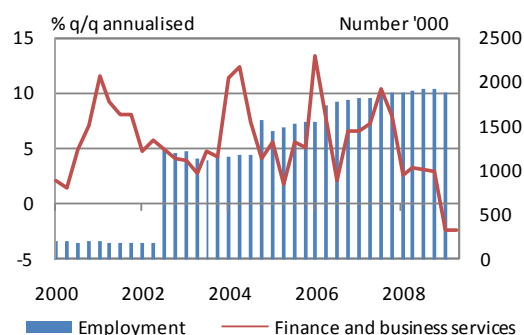
- Some 93 000 job losses were recorded in the broader trade sector in Q1, reflecting the significant decline in domestic demand. Total employment has fallen by 77 000 jobs since 2008 Q1.

Finance, real estate and business services (19.9% of GDP; 23% of formal non-agricultural employment):

- **Finance and insurance (42% of total sector):** Profit in the first half of the year and earnings of SA's four major banks confirmed the deepening trough of the local economic cycle, with a cautious outlook maintained for the rest of the year.
- While there is a general reluctance to buy on credit, several major banks are planning to relax their stringent lending behaviour on mortgages and vehicle loans in the second half of the year. This generally comes on the back of a sharp reduction in lending, while credit impairments rose fervently this year. That said, confirmation of slowing bad debts bodes well for a moderate improvement in credit demand by year-end.
- The insurance sector remains under strain, with policy lapse rates rising significantly, while more policy holders are either cancelling policies or buying down. Premium income has also been eroded by new regulations, which led to a drop in new business. However, risks should start moderating with evidence of the property and motor market reaching the lower turning point of the cycle.

- **Real estate (35% of total sector):** House prices remain in sharp deflationary territory, but preliminary evidence is pointing to a slowing in the rate of contraction.
- Data from the Deeds Office point to some bottoming in the decline of prices of repeat home sales, specifically of sectional title homes, which serves to corroborate that individuals have been buying down in search of value-for-money accommodation. The affordable market and middle-value segments are showing a stabilisation in the rate of decline, with positive month-on-month momentum having been reported over the past few months.
- **Business services (25% of total sector):** It is generally anticipated that corporates will embark on a strict rationalisation of IT infrastructure spend. Services sectors, for instance in education and training, tend to be negatively affected by extensive cost restructuring.
- The broader finance and business services sector thus posted a decline of 2.4% q/q s.a. in Q2 from -2.3% q/q s.a. in Q1. The sector expanded by 5% y/y in 2008. Further declines are expected, albeit at a slower pace in Q3.

Figure 17: Financial intermediation and business services GVA vs employment



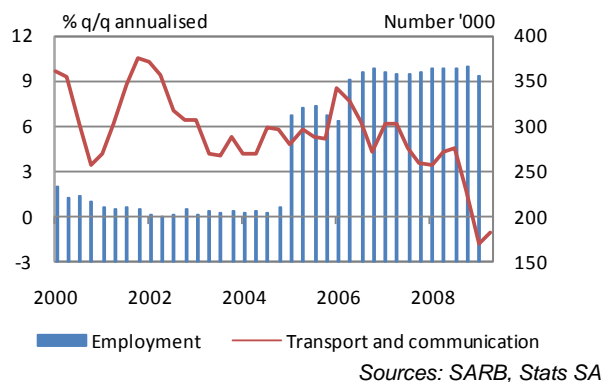
Transport, storage and communication (10% of GDP; 4% of formal non-agricultural employment):

- Q2 GDP data revealed a slight improvement in value add to -1.1% q/q s.a. from -1.8% q/q s.a. in Q1. The sector posted a 4% growth rate in 2008.
- In 2008, Transnet Freight Rail expected volumes of its general freight business to rise to 85 million tons during 2008/09 from 83 million in 2007/08. However, volumes fell to 77 million tons in the year to March 2009. Transnet along with major road hauliers expect no recovery in volumes over the next 18 months. Volumes are expected to fall to 92.5% of the 2007/08 year in the current financial year, before recovering to 98.3% in 2010/11.
- However, road hauliers of the Road Freight Association (RFA) reported a 45% decline in freight in the first half of the year relative to the second half of 2008. The decline in volumes started in July last year, suggesting that by year-end low base levels from last

year, and the first half of 2009, could make for a mild improvement in growth.

- However, in light of overcapacity and severe discounting by road freight operators, investment in new vehicles is likely to be substantially constrained. The RFA reported that truck prices have increased by 15% in the year so far.
- These trends, alongside Transnet's expected rail recapitalisation programme of 100 diesel locomotives, could make for a shake-up in the industry in the second half of 2010. However, rail turnaround times will have to improve in order to persuade freight operators to switch from road to rail. Indeed, increased usage of rail will be imperative if logistics costs of nearly 16% of GDP in 2007 are to fall within international standards (US logistics costs account for 10% of its GDP).
- Fixed-line telecommunications operator Telkom is expected to cut back its five-year infrastructure programme by 40%, to R34.1 bn, owing to a reprioritisation of projects with a higher return on investment, such as data centres as opposed to fixed-line assets. Voice, data, and broadband initiatives will receive the bulk of the capex (R29.6 bn), while some R1.1 bn will be spent on submarine cables. The company is expected to focus on fixed-mobile converged products since it disposed of its share in mobile phone operator Vodacom in May.
- Three to four new undersea cables are expected to be developed over the next 12 to 24 months. However, the economic impact could take years to come to fruition owing to the general tardiness of local business to fully exploit the benefits of such technology.

Figure 18: Transport and communication GVA vs employment



- The transport and communications sector shed a total of 14 000 jobs in Q1 this year, leaving the sector's workforce lower by 2 000 relative to Q1 2008.

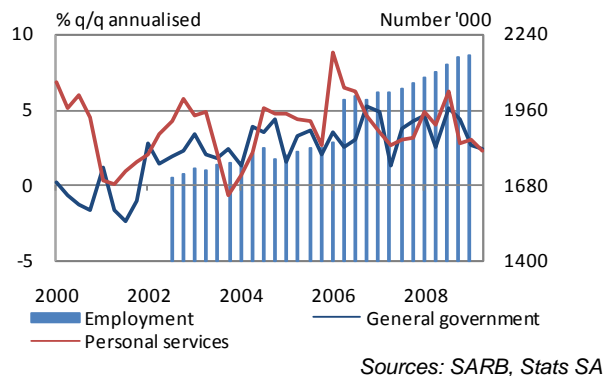
General government and personal services (17.7% of GDP; 25% of formal non-agricultural employment):

- General government services expanded by a slower rate of 2.4% q/q s.a.a in Q2 from 2.7% q/q s.a.a. in Q1, while personal services also posted slower growth of 2.3% q/q s.a.a. in Q2 from 3.1% q/q s.a.a. While these moderations may be indicative of the

current slowdown in revenue collections, we expect growth to return to marginally higher levels as the government's financial year gets underway.

- A clear bias towards social upliftment as part of government's counter-cyclical fiscal stance is likely to underpin growth in these sectors.

Figure 19: General government and personal services GVA vs employment



- While 8 000 jobs were shed in the first quarter of the year, total employment has increased by 102 000 since the start of 2008.

Conclusion

Many are starting to contemplate what the recovery will look like. Given the confluence of the aforementioned forces, expectations of a V-shaped recovery are clearly out of kilter with the multi-pronged extent of the trauma inflicted on the global economy and its capitalist philosophical underpinnings. And, most importantly, the consumer is still under serious pressure. However, promising improvements are manifesting, and not only in the US but around the world.

In SA, the contraction in economic activity has reached an advanced phase and the third quarter should mark the onset of economic stabilisation and then tepid recovery.

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