

# Economics

## Swaziland: Annual economic outlook

### Weak fundamentals hinder recovery

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#### Projections for 2010:

- Real GDP growth of about 1% expected
- Annual inflation expected to average 5.5%
- Exchange rate expected to average SZL7.67/USD
- Trade balance to deteriorate as export earnings drop
- Large fiscal deficit of about 13% of GDP is expected in 2010/11

#### Recent trends

##### Production

Swaziland did not escape the global economic turmoil and recession caused by the sub-prime crisis in the US. The impact of the financial crisis was, however, delayed, as the transmission channel was not directly through the banking and financial sectors, but rather indirectly through the macroeconomic channel, negatively affecting, for example, real variables, such as global trade and commodity prices, amongst others.

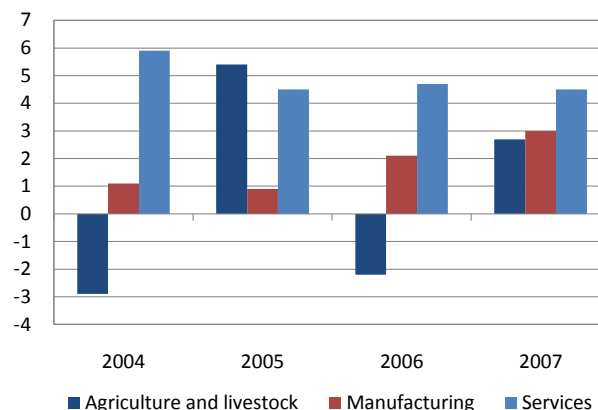
Swaziland's economic data is published after lengthy delays and the most recent (almost) complete set of economic data is available only for 2008. The Central Bank of Swaziland's (CBS) latest *Annual Report* (for April 2008 to March 2009), published in June 2009, covers mostly the 2008 period. Some preliminary information is available for 2009 and additional financial data is available for the first quarter of 2009. Financial data is typically more readily available. However, some real economic variables, such as sectoral growth rates, are available for up to 2007 only.

It is therefore not possible to assess the full impact of the global crisis on the Swazi economy as yet. However, as the financial and real sectors are interconnected, some of the financial data is indicative of the stress that the real economy is under.

The manufacturing sector, the largest contributor to output (31.7% of GDP in 2007), is dominated by production of goods produced mainly for export. With a population of 1.2 million, the country has no option but to produce for export markets, as the domestic market is tiny and hence domestic demand is low. Textiles and clothing production for export to the US is an important manufacturing sub-sector. The sector grew by 1.8% on average between 2003 and 2007. In 2007 it grew by 3%. This figure is expected to have dropped as apparel exports declined in 2008 and 2009 (see Figure 7 below).

Public administration (18.6% of GDP) reflects the relatively large number of civil servants and dominance of the government in the economy. The large wage bill and recent salary increases, despite a dramatic drop in government revenues, have come under scrutiny by the authorities and the donor organisations. For example, in the latest budget speech, the Minister of Finance stated that the large wage bill is unsustainable. The services sector, of which public administration is the largest sub-sector (at about 45% of the services sector), grew by 4.5% on average between 2003 and 2007. In 2007 it grew by 4.5%. In 2008 and 2009 the sector is expected to have increased as well.

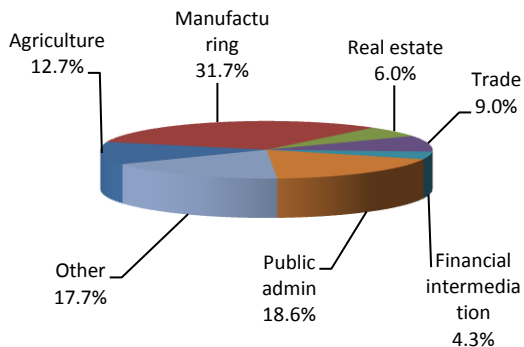
Figure 1: Real growth of the largest sectors (%)



Source: International Monetary Fund

Swaziland's economy is largely dependent on the agricultural sector, which contributes 12.7% to GDP. Agricultural land makes up 78% of the total land area, and 70% of the population depends on agriculture for its livelihood. Agriculture has strong linkages to the manufacturing sector, which processes agricultural products, linkages such as between sugarcane growing and sugar manufacturing for example. The sector's growth is volatile and it contracted in 2005 and 2006. The agriculture and livestock sector grew by 1.6% on average between 2003 and 2007 and by 2.7% in 2007. In 2008 and 2009 the agricultural sector is likely to have grown marginally.

**Figure 2: GDP by type of activity**



Source: Central Bank of Swaziland (CBS)

The dual land tenure system – Swazi Nation Land (SNL) and Individual Tenure Farms (ITFs) – affects the productivity of the agricultural sector. SNL is communal land, is not irrigated, is used mostly for subsistence farming and is characterised by low productivity levels. Adverse weather conditions affect the sector directly. Maize, cotton and tobacco are important SNL crops. ITF is private land, is largely irrigated, is mostly used for productive commercial farming and is less affected by droughts. Sugarcane, citrus, timber and pineapples are important ITF crops. In terms of value, ITFs accounted for about 75% and SNL for 18% of agricultural output in 2005.

Generally, sugarcane and maize are the two most important commercial agricultural crops. Sugarcane is largely grown on irrigated land and has been partially protected from the effects of regional droughts. Cotton is also grown as it is suitable for dry areas. The sector has been adversely affected by erratic rainfall patterns, low prices and currency volatility.

The economy is relatively well diversified within a sub-Saharan Africa (SSA) context, where the extractive industries typically dominate, but greater diversification of production and exports will reduce overall risk.

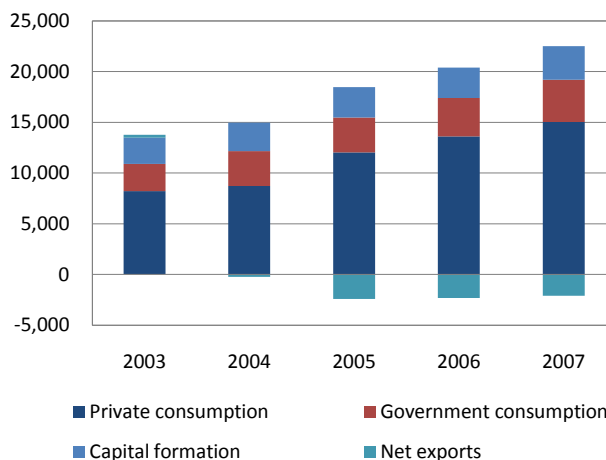
**Domestic expenditure**

Private consumption expenditure accounted for 73.8% of GDP in 2007, rising from 59.7% in 2003. Consumption expenditure, although a large share of GDP, is generally muted by the extremely high incidence of poverty (69% of the population lived below the national poverty line in 2001-2007) and low life expectancy (46 years at birth in 2008). The

HIV/Aids pandemic, with HIV prevalence of 26.1% of the population of ages 15-49, is one of the main causes of these dismal demographics. However, gross national income (GNI) per capita of US\$2 400 is significantly above the SSA average of US\$1 082, as well as the lower-middle-income average of US\$2 078. In 2008 and 2009, in particular, private consumption is expected to have been restrained by the global recession and slowdown in South Africa. Private employment in agriculture and manufacturing was relatively stable in 2008 and 2009 as economic growth was positive at 2.4% and 0.4% respectively. However, public employment in the civil service boosted consumption expenditure, as salary levels and the overall wage bill have increased over a number of years. Swaziland is classified as a lower-middle-income economy by the World Bank.

Government spending accounted for 20.3% of GDP in 2007, on par with 19.5% in 2003. Government spending has generally been constrained by the global economic slowdown in 2008 and 2009. However, Southern African Customs Union (SACU) revenue was based on projected values, whereas the actual customs pool receipts have been lower than projected. Over-payment of SACU receipts will need to be paid back to the revenue pool. Government spending was therefore higher than justified by actual SACU income.

**Figure 3: Domestic expenditure (E million)**



Source: IMF

Investment (fixed capital formation) accounted for 16.2% of GDP in 2007, down marginally from 18.8% in 2003. Foreign direct investment (FDI) amounted to only US\$37 million in 2007 and US\$10 million in 2008, according to the World Bank. The low levels of investment could be ascribed to the country's weak institutional environment and low absorptive capacity. More significantly, Swaziland also fails to protect investors; according to *Doing Business*, it is ranked at 180 out of 183 countries assessed. In terms of overall "ease of doing business", it is ranked at 115 out of 183.

Net exports have been negative since 2004 and have been a drag on economic growth (see Figure 3). Swaziland's sugar industry, as well as its clothing and textile industry, enjoys preferential trade status. As preferential trade agreements are often granted unilaterally, they are

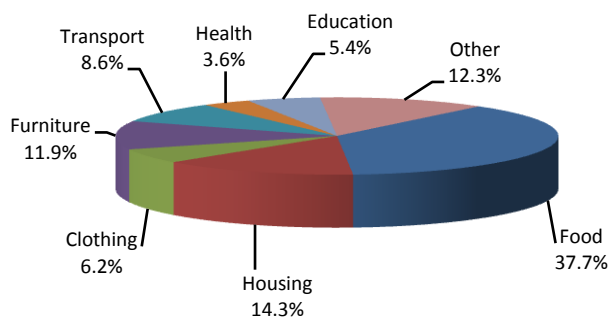
not sustainable in the long run, as the global trade regime is in constant flux. For example, the sugar industry is facing a 40% drop in sugar prices over time due to changes in the EU sugar regime.

Negative net exports are expected to have worsened in 2009 on the back of buoyant imports and stagnating exports. This drag on growth, as well as the slowdown in fixed investment and in private consumption expenditure are expected to have resulted in the sluggish growth of 0.4% in 2009.

### Monetary policy

Swaziland's average inflation rate dropped to 7.5% in 2009 from 12.6% in 2008. Lower food inflation was the major cause of the lower overall inflation, as the food group accounts for almost 38% in the consumer basket. Food inflation fell from 18.5% in 2008 to 10.2% in 2009.

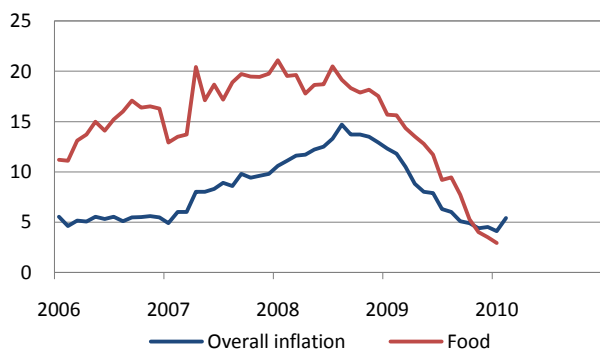
Figure 4: CPI weights



Source: CBS

Swaziland's inflation rate largely tracks South Africa's inflation rate as it imports about 90% of its goods and services from there. South Africa's inflation rate has dropped steeply, from 11.5% in 2008 to 7.1% in 2009. Swaziland's inflation rate is typically higher than South Africa's (by 0.8 percentage points over the past four years) as transport costs add to price pressures. Also, the weights in the consumer price index are different. In particular, the food group is significantly higher in Swaziland (37.73% weight) than in South Africa (15.68% weight).

Figure 5: Inflation (% y/y change)



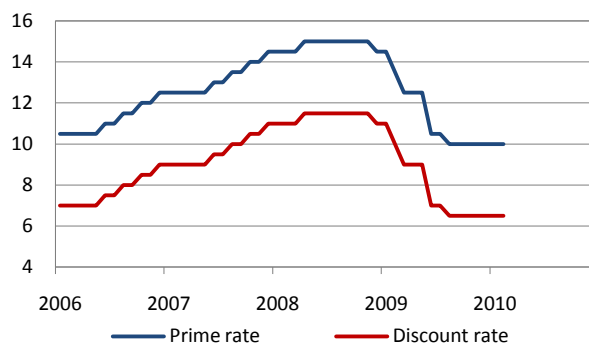
Source: CBS

In 2010 inflation remained low at 4.1% in January and 5.4% in February on the back of subdued food inflation, which fell to below 5% in November 2009. Food inflation is now below overall inflation, an unusual event.

Swaziland's interest rates have fallen in line with lower inflation and lower interest rates in South Africa. Swaziland's discount rate, the policy rate, fell in 2009 and averaged 7.9% in 2009 from 11.3% in 2008. The prime rate also fell in 2009 and averaged 11.4% in 2009 from 14.8% in 2008.

Interest rates have remained unchanged since August 2009. The discount rate, the policy rate, is 6.5% and the prime rate is 10%, as in South Africa. The Common Monetary Area (CMA) ensures that interest rates tend to converge over time. Swaziland's interest rates cannot diverge by a large margin from South Africa's rates, as the CMA permits the free transfer of funds for current and capital transactions between members.

Figure 6: Interest rates (%)



Source: CBS

The interest rate differential between the discount rate and the prime rate is typically 350 basis points in Swaziland and has been maintained for a number of years, as is the case in South Africa.

### International trade

Swaziland is a small open economy with a GDP of US\$2.6 billion in 2008 (World Bank) and merchandise trade accounting for 140.6% of GDP in 2008, as mentioned above. Swaziland's main trading partner is South Africa. Swaziland is landlocked and surrounded by South Africa and Mozambique. Swaziland imported 92.9% of its goods and services from South Africa and 45.2% of its exports were destined for South Africa over the 2005-2007 period (IMF). Europe received 14.4% of its exports and the US 3.2%. Trade with neighbouring Mozambique is small.

Swaziland's proximity to the relatively large South African market has been an advantage for exports, which are further strengthened by membership of the CMA and the SACU.

Exports amounted to 76.9% of GDP in 2007, marginally lower than 86.8% in 2003. Swaziland scores poorly in terms of *Doing Business's* the "trading across borders" category. It is ranked at 158 out of 183, a

poor ranking for an open economy highly dependent on exports for economic growth. The costs of exports and imports (i.e. per container costs measured in US dollars) are particularly high, and could be partly a function of the fact that Swaziland is a land-locked country with an inadequate transport infrastructure. These trade costs are also significantly higher than South Africa's. High transport costs are not a unique problem in Swaziland, and generally hinder trade in SSA.

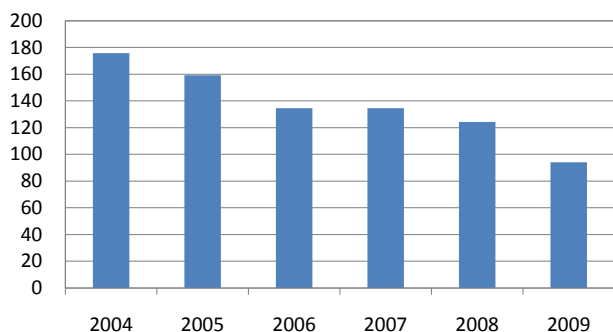
The main export commodities are sugar and sugar-based products, apparel, wood pulp, and soft drink concentrates/edible preparations (i.e. Coca Cola).

Swaziland's economy is largely dependent on the agricultural sector and sugar production is the backbone of the sector. According to the *Swaziland Sugar Association*, sugar production at the country's three sugar mills amounted to 626 984 tons in 2008/09 and an estimated 636 134 tons in 2009/10. The season runs from April to March the following year.

Swaziland exports sugar to four main markets: the Southern African Customs Union (SACU), the EU, the US and the world/regional market. The EU and SACU markets have received the bulk of sales in recent years. In 2009/10, of the total sales of 628 577 tons, 325 000 tons were destined for the SACU market, 276 317 tons for the EU market, 27 260 tons for the regional market and none for the US and world markets. Excess sugar is sold on the world and regional markets, where prices are generally low.

Sugar prices differ in the four export markets. The average EU domestic prices averaged 69.69 US\$/kg in 2008, dropping to 52.44 US\$/kg in 2009, reflecting the lower prices set by the EU sugar regime. Sugar exports to the EU enjoy preferential status under the ACP-EU Protocol on Sugar and the Complementary Quantity. The US domestic prices averaged 46.86 US\$/kg in 2008, rising to 54.88 US\$/kg in 2009. Sugar exports to the US have preferential status under the Tariff Rate Quota. The world sugar price averaged 28.21 US\$/kg in 2008, rising steeply to 40 US\$/kg in 2009. (World Bank commodity price data/*Pink Sheet*.)

**Figure 7: Apparel exports to the US under Agoa (US\$ million)**



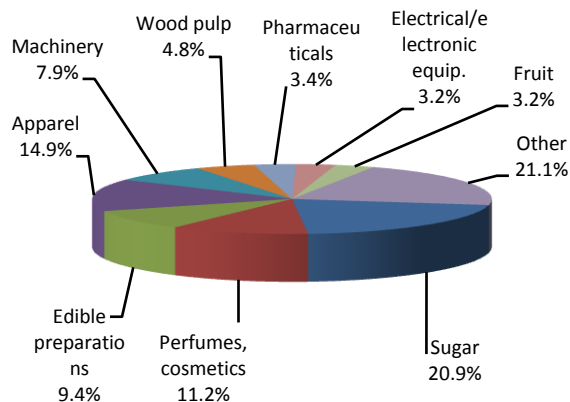
Source: US International Trade Commission

The manufacturing export sector benefited from the US African Growth and Opportunity Act (Agoa) as exports of textiles and apparel

increased up to 2004. Since then these exports have levelled off as a result of China's textile exports becoming accessible to world markets in 2005.

An unfavourable exchange rate also hampered the sector. Clothing exports to the US amounted to US\$124.2 million in 2008, but dropped to only US\$94.2 million in 2009 (Figure 7).

**Figure 8: Composition of exports (2008)**



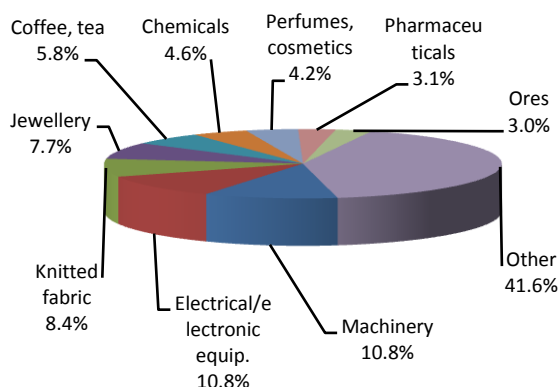
Source: ITC

Exports of agricultural products under Agoa have been volatile and amounted to US\$6.5 million in 2007, dropping to only US\$1.2 million in 2008, then rising to US\$6.8 million in 2009. Adverse weather conditions, such as droughts and floods, are often responsible for the output volatility.

Swaziland does not have a manufacturing base able to serve domestic needs. Consumer and capital goods are therefore imported, mainly from South Africa. Swaziland's main merchandise imports are machinery and transport equipment; various manufactured goods; food; and chemicals and chemical products.

Imports amounted to 87.2% of GDP in 2007, compared to 84.7% in 2003. Swaziland imports most of its consumer and capital goods from neighbouring South Africa, as mentioned. Machinery, transport equipment, manufactured goods, food and chemicals are the main imports.

**Figure 9: Composition of imports (2008)**



Source: ITC

Trade data is not available as yet for 2009. Between 2005 and 2008 the trade balance was mildly negative, with the trade deficit narrowing from E1 641.3 million (US\$259 million) in 2005 to E1 077.3 million (US\$131 million) in 2008. Total imports rose by 16.5%, whereas total exports rose by 24.5% over the same period. Imports of food and agricultural products rose to meet the shortfalls in domestic agricultural production experienced during drought periods. Rising crude oil prices and the weak exchange rate also pushed imports higher. However, export earnings, particularly of flavoured soft drink concentrate, were boosted by the weak exchange rate in 2008.

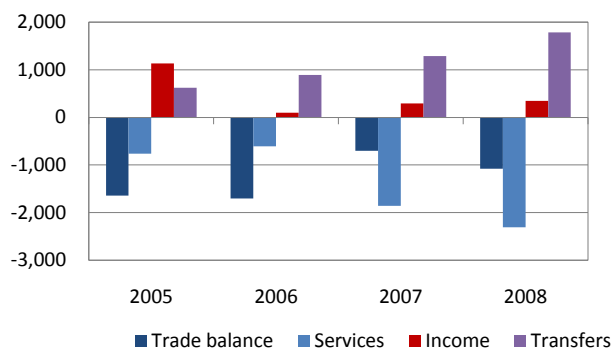
The trade deficit has been partially offset by SACU receipts (current transfers) and labour income from employee compensation (income). Transfers, mostly SACU receipts, have risen in the past few years. Between 2005 and 2008, receipts rose from E619.8 million (US\$97 million) in 2005 to E1 782.2 million (US\$216 million) in 2008.

Over the same period labour income earned by Swazi nationals working in South Africa's mining sector, albeit relatively low, was volatile. In general, monthly wages increased and the number of mineworkers employed was higher, resulting in income inflows rising marginally between 2006 and 2008.

Services outflows – a large component, see Figure 10 – rose dramatically over the period, from E765 million (US\$120.8 million) in 2005 to E2 311.5 million (US\$281 million) in 2008. These services outflows comprise payments for freight and transportation services, business and leisure travel-related expenditures, royalties and licence fees, and other business services, such as legal, managements and accounting services.

Small but rising current account deficits were recorded between 2005, with E652.7 million (US\$103 million, or a deficit of 4.1% of GDP), and 2008, with E1 261.5 million (US\$153.4 million, or an estimated deficit of 5.7% of GDP).

**Figure 10: Current account components (E million)**



Source: CBS

It is anticipated that Swaziland's trade deficit will have deteriorated in 2009 as the global recession and lower sugar prices took their toll on exports, while imports, particularly of consumer goods and services, remained high. SACU transfers are expected to come under pressure as intra-SACU trade dropped. The income component is expected to

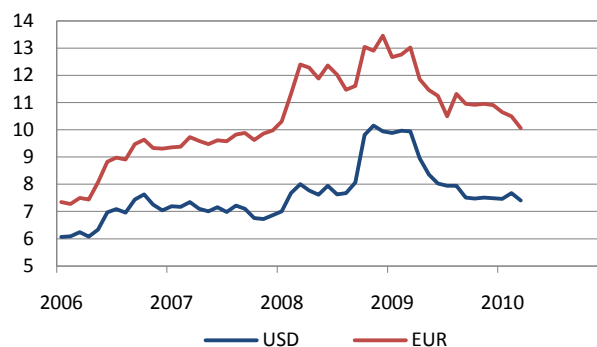
have come under pressure as South Africa's economy contracted by 1.8% in 2009, thus reducing employment in the mining sector. Weak economic growth in Swaziland in 2009 – estimated at 0.4% – is expected to have dampened the services deficit, as transport and travel costs, and business expense are expected to have stagnated.

The current account deficit is expected to have widened to about 6.9% of GDP in 2009 on the back of a wider trade deficit and lower SACU transfers.

**External sector**

Swaziland's currency, the lilangeni (plural emalangeni (E)), is pegged to the South African rand at par under the CMA agreement. The exchange rate strengthened during 2009, from a monthly average of SZL9.89/USD in January to SZL7.48/USD in January 2010. This is a consequence of global risk appetite for emerging market assets reviving during 2009 after suffering a severe curtailment during the global financial crisis in 2008. In terms of annual averages, the currency traded at SZL8.22/USD in 2008, weakening marginally to SZL8.42/USD in 2009.

**Figure 11: Exchange rate (SZL/USD and SZL/EUR)**

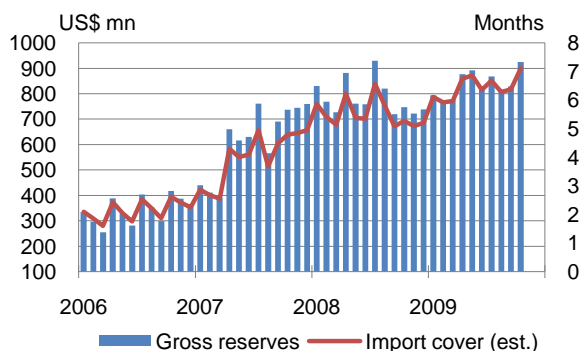


Source: Bloomberg

Buoyant SACU receipts and budget surpluses in some recent years have enabled the central bank to accumulate foreign exchange reserves. Swaziland's gross foreign exchange reserves rose during 2009, from US\$793.6 million in January to US\$925.2 million in October 2009. In October 2008, reserves amounted to US\$746.7 million. Import cover thus rose from an estimated 6.1 months of imports to 7.1 months of imports over the same period. In October 2008, import cover was 5.3 months.

Swaziland's international reserves were bolstered by the IMF's global liquidity injection of August and September 2009 to supplement members' foreign exchange reserves. The Special Drawing Rights (SDR) allocation amount is based on the relative size of the economy. Swaziland received a total of SDR41.9 million (about US\$61.6 million). This injection accounts for the rise in reserves in September and October.

**Figure 12: Gross foreign exchange reserves and import cover**



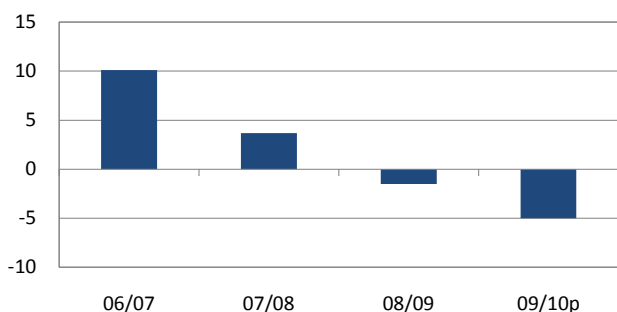
Sources: Bloomberg, IMF, Standard Bank est.

### Public and external solvency indicators

Minister of Finance Majozo Sithole delivered the 2010/2011 National Budget to parliament on 26 February 2010.

The minister said that a budget deficit of 1.5% of GDP was recorded in 2008/09. SACU receipts, which accounted for 64% of total revenue and grants (E9.4 billion or about US\$1.12 billion), increased by 22% to E6 billion (about US\$713 million) over the previous period. Domestic revenue from income, sales and property taxes also rose. Total expenditure of E9.78 billion (about US\$1.16 billion) was 37% higher than in the previous fiscal year, because recurrent expenditure rose steeply, on the back of the ballooning wage bill.

**Figure 13: Fiscal balance (% of GDP)**



Source: Ministry of Finance, budget speeches

The wage bill continues to rise at an alarming and unsustainable rate and is one of the highest in Africa. According to the *African Economic Outlook*, public servants' wages and salaries were equivalent to 13.3% of GDP in 2008 (in comparison, they were 9.8% in South Africa). Civil servants received a 10.5% wage hike in 2008/09, pushing the ratio higher and damaging fiscal sustainability in the long run.

Preliminary data indicated a deficit of about 5% of GDP was projected in 2009/10, which is lower than the 8% of GDP that was projected in the previous budget, even though SACU receipts were lower. The reason for the better outcome is the low implementation rate of 80% of capital programmes.

These budgets point to the main problems the fiscus is facing: the over-dependence on SACU receipts, the unsustainable wage bill (a problem recognised by the finance minister in the latest budget speech) and the lack of capacity to spend allocated funds.

Swaziland total external debt stock, including private sector debt, amounted to E3 995 million (US\$475 million) in March 2009, up from E2 581.9 million in March 2005 (US\$407 million), according to central bank figures. Of the total external debt, 57.7% (the five-year average) was owed to international organisations (mostly the African Development Bank), 27.5% to foreign governments (such as Denmark, Germany, Japan, Kuwait and South Africa) and 12.8% to private lenders (such as the Development Bank of Southern Africa).

Swaziland's domestic debt amounted to E387.7 million (US\$46 million) in March 2009, below the E507.3 million (US\$80 million) in March 2005. Local commercial banks typically hold the bulk of the outstanding domestic debt. Treasury bills of 91-day maturity make up the bulk (about 87%) of the domestic debt and two government bonds the rest.

Swaziland has not been given sovereign ratings by any of the large ratings agencies, such as Standard & Poor's, Moody's or Fitch.

### National policy assumptions and the international environment

Swaziland's *National Development Strategy* (NDS) was published in 1999 by the Ministry of Economic Planning and Development, covering the 25-year period from 1997 to 2022. The document states that: "The purpose of the NDS is to formulate a Vision and Mission Statement with appropriate strategies for socio-economic development for the next 25 years and provide a guide for the formulation of development plans and for the equitable allocation of resources. It is designed to strengthen the government's development planning and management capacities and anchor it firmly to a national consensus on the direction of future developments in the country."

The NDS is further given substance in *Vision 2022*, which articulates the following aims: "By the Year 2022, the Kingdom of Swaziland will be in the top 10% of the medium human development group of countries founded on sustainable economic development, social justice and political stability." The following issues are covered in the vision: macroeconomic strategies; sectoral strategies; public sector management; macroeconomic management; physical infrastructure; agriculture, land and rural development; economic services; education and training; population, health, and social welfare; gender; and disadvantaged groups. Key macroeconomic strategies cover areas such as economic management; economic empowerment; human resource development; agricultural development; industrialisation; research for development; and environmental management.

The Ministry of Economic Planning and Development also drafted the *Poverty Reduction Strategy and Action Plan* (PR SAP) in March 2005. PR SAP guides the planning and budgeting framework until 2015. It aims to reduce poverty by more than half by 2015 and ultimately

eradicate it by 2022. Volume 1 contains the strategy for poverty reduction and Volume 2 the action plan. The national policy priorities spelled out in the document relate to fiscal prudence, promotion of a more equitable pattern of growth, investment in people, ensuring food security, increasing agricultural production and productivity of SNL farmers, investment in rural infrastructure to increase rural productivity, reducing the poor people's vulnerability, decentralisation and strengthening governance institutions.

### Monetary policy

Swaziland's membership of regional organisations is important to understanding its economic dynamics. It is a member of the CMA with Lesotho, Namibia and South Africa. Consequently, Swaziland's monetary policy is largely determined by the South African Reserve Bank (SARB) and its interest rates tend to follow similar trends to South Africa's. Swaziland's CMA membership is based on its close trade and financial links with South Africa.

Because of CMA membership and the fact that more than nine-tenths of its imports are from South Africa, Swaziland's inflation rate largely imports inflation from its largest trading partner. Inflation in Swaziland has, however, been above South Africa's over the past decade, because of higher transport costs for imports and the larger weight of the food component in the consumer price index. Swaziland's consumer price index was rebased in August 2007 and new weights introduced.

The central bank's main monetary policy objective is to support the currency peg with the South African rand by maintaining adequate foreign exchange reserves. Interest rates cannot diverge by a large margin from South Africa's rates, as the CMA permits the free transfer of funds for current and capital transactions between its members. Funds could therefore flow to the country with higher interest rates if the differential becomes favourable. This does not imply that interest rates need to be identical.

Historically, the CBS has maintained marginally lower interest rates than the SARB to stimulate investment and lower the cost of borrowing and doing business. However, policy rates (the discount rate in Swaziland and the repo rate in South Africa) converged from September 2001, and prime rates from September 2003, until May 2008. From June 2008 interest rates were 50 basis points lower in Swaziland than in South Africa. However, in March 2010 South Africa lowered its repo rate to 6.5%, but the CBS left the discount rate unchanged.

Under the CMA agreement the lilangeni is pegged at par (1:1) to the rand. Developments in the exchange rate are therefore dependent on the underlying factors affecting the South African rand's performance against other currencies. The exchange rate is determined only by South Africa's economic dynamics, such as international trade, portfolio flows, commodity prices, particularly gold and platinum, interest rate differentials, and investors' risk aversion and sentiment towards emerging markets. Economic factors in Swaziland (or in any

CMA member outside South Africa) do not affect the value of the exchange rate. The rand is a liquid, market-determined and floating currency. The exchange rate is therefore determined by global market forces.

The rand is legal tender in Swaziland, but the lilangeni is not legal tender in South Africa.

### External sector

Swaziland is also a member of the Southern African Customs Union (SACU), a free trade area, whose other members are Botswana, Lesotho, Namibia and South Africa. The SACU, which is a century old this year, has promoted fiscal stability and prosperity for its members. Several modifications to the agreement have been implemented since inception and the most recent changes were introduced in 2002. Negotiations are ongoing to continue the modernisation process.

The steep rise in SACU receipts during the boom period up to 2007 is largely based on South Africa's high economic growth rate, as it accounts for about 60% of intra-SACU imports, according to the IMF.

The revenue-sharing formula, which determines the member country's revenue allocation, is based on three components: customs revenues, excise revenues and level of economic development. The change in the revenue-sharing formula also boosted the receipts of the smaller SACU members, such as Lesotho, Namibia and Swaziland.

SACU payments are based on projected variables and actual payments to members do not as yet reflect the sharp deceleration in trade in 2008.

### Fiscal policy

The *Medium Term Budget Policy Statements* (MTBPS), published by the Minister of Finance, guides the country's fiscal policy for the next two years. The most recent MTBPS, published in December 2009, for the period 2010/11 to 2012/13, provides the economic context within which the budget is prepared, as well as for the all-important economic forecasts, particularly the budget balances, for the period. The MTBPS 2009 argued that the global recession was one of the most difficult environments in which to plan and allocate resources efficiently.

The MTBPS also outlines the many and serious socio-economic challenges the country is facing. For example, in 2007 the number of people between the ages of 15 and 49 living with HIV and Aids was 26%, the world's highest. Life expectancy was 46 years. The Gini index (which measures the degree of income inequality) of 50.7 (in 2001) is relatively high, but below Botswana's (61) and South Africa's (57.8). According to the *African Economic Outlook* (AEO), 62.9% of the population lived below the international poverty line of \$1 per day in 2001.

### International environment

The IMF's economic growth revisions (published in April) projected that a global recovery is imminent. The global economy contracted by

0.6% in 2009, with most countries showing negative growth. Of the advanced economies, all the largest ones contracted. A number of emerging and developing countries, however, showed positive growth, as shown in Table 1. SSA grew by 2.1% in 2009, below 5.5% recorded in 2008.

The April growth revisions are generally more upbeat than the January projections. Global growth is expected to average 4.2% in 2010, with the advanced economies growing by 2.3%, and emerging and developing economies at a significantly faster pace of 6.3%. Developing Asian countries' growth outlook is particularly optimistic and signals a gradual shift of economic power and influence to Asia, mainly China. Asian exports to the industrialised countries are particularly important for sustained growth in that region. African countries' robust growth outlook is predicated on the region's natural resource abundance and the expectation that commodity prices will continue to recover. SSA is expected to grow by 4.7% in 2010.

Standard Bank forecasts that South Africa will grow by 2.9% this year, 3.7% in 2011 and 4.1% in 2012. In 2009 the South African economy contracted by 1.8%, after growing by 3.7% in 2008.

**Table 1: Global economic outlook**

	Real GDP growth (year-on-year)			
	2008	2009	2010p*	2011p*
World	3.0	-0.6	4.2	4.3
Advanced economies	0.5	-3.2	2.3	2.4
United States	0.4	-2.4	3.1	2.6
Euro-area	0.6	-4.1	1.0	1.5
United Kingdom	0.5	-4.9	1.3	2.5
Japan	-1.2	-5.2	1.9	2.0
Emerging and developing economies	6.1	2.4	6.3	6.5
China	9.6	8.7	10.0	9.9
India	7.3	5.7	8.8	8.4
Brazil	5.1	-0.2	5.5	4.1
Russia	5.6	-7.9	4.0	3.3
Sub-Saharan Africa	5.5	2.1	4.7	5.9
Developing Asia	7.9	6.6	8.7	8.7

\* p = projection

Source: IMF

Swaziland's economic growth is directly linked to South Africa's growth performance, as South Africa is Swaziland's main trading partner, as discussed above. Although South Africa contracted in 2009, Swaziland's output grew by a marginal 0.4%.

## Forecast summary

### National accounts

Swaziland's small open economy is at the mercy of global growth as well as international trade conditions, as it depends on exports for growth. A large part of its exports, however, are into preferential markets: sugar into the EU, and clothing and textiles into the US. Preferential trade agreements are often unilateral or bi-lateral trade arrangements, rather than multi-lateral agreements, such as under the

*World Trade Organisation* (WTO). The WTO, for example, facilitates fair trade disputes under its rules and protects smaller economies from trade marginalisation.

China and other low cost producers' access to the large US clothing market will continue to impact negatively on Swaziland's clothing exports, as domestic costs tend to be high, and despite its preferential access to that market under Agoa. The weak US consumer market and low consumer confidence will continue to impact negatively on clothing and textile sales.

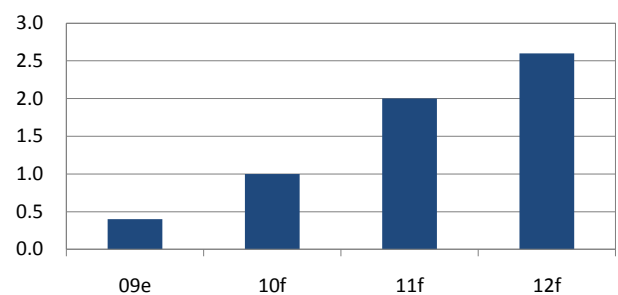
Sugar prices received under the EU sugar agreement are expected to continue to be cut. According to the central bank, EU sugar prices dropped by a cumulative 36% between 2006 and 2009. In addition, the relatively strong exchange rate, particularly against the euro (in which most sugar exports are priced – see Figure 11), will put pressure on domestic earnings. The industry has shifted production from raw sugar to high value sugar, such as refined sugar, to compensate for the price declines, which should boost earnings. Given falling prices, the industry is likely to respond by expanding production volumes. The completion of the Lower Usuthu Smallholder Irrigation Project (LUSIP) should add to sugar output.

The small tourism sector is unlikely to reap significant benefits from the Soccer World Cup to be played in South Africa in June and July this year, despite the expected opening in May of the new Sikhuphe International Airport. The airport is located about an hour's drive from the capital, Mbabane.

Relatively low inflation and interest rates will boost economic activity to some extent, but the strong exchange rate, particularly over the past year, remains a perennial problem for the exporter sector.

It is therefore expected that Swaziland's economy will only gradually recover and output will grow by about 1% in 2010. It is expected that thereafter growth will improve to 2% in 2011 and 2.6% in 2012. The growth rate is insufficient to raise the bulk of the population out of poverty in the short or medium term.

**Figure 14: Real GDP growth (% y/y)**



Sources: IMF, CBS, Standard Bank est.

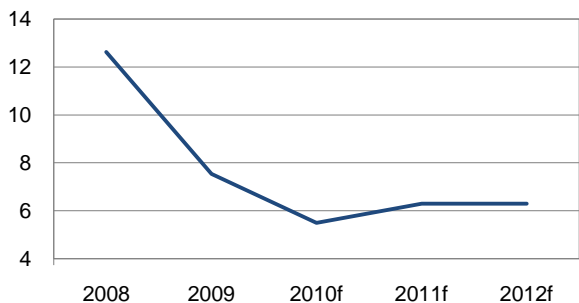
### Monetary sector

Lower inflation and falling interest rates are expected to continue over the next few years. South Africa's inflation dropped to within the central bank's target range of 3-6% in 2010 and the target-friendly trend is

expected to continue for the next three years. South Africa's inflation rate is expected to average 5.2% in 2010, 5.4% in 2011 and 5.5% in 2012, according to Standard Bank forecasts.

As inflation is largely imported from South Africa, we expect Swaziland's inflation to drop in line with South Africa's. Swaziland's inflation rate is expected to average 5.5% in 2010, and 6.3% in 2011 and 2012. Swaziland's inflation is typically higher than South Africa's on account of transport costs and different weights in the consumer price index, as discussed.

**Figure 15: Consumer inflation (annual average %)**

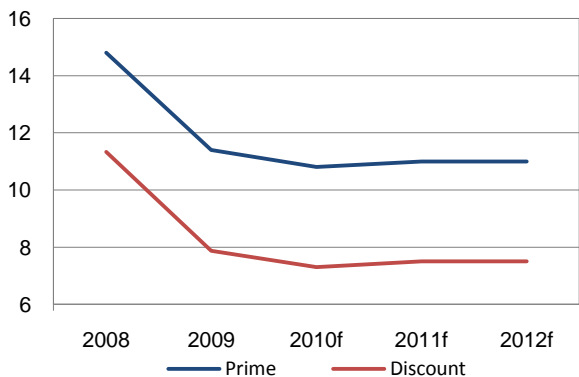


Sources: IMF, Standard Bank

The average interest rate is expected to decline in 2010 on the back of falling inflation. South Africa's policy rate, the repo rate, at 6.5% is the lowest for almost 30 years. South Africa's prime rate is 10%. It is unlikely that the repo rate will change in 2010. Interest rates are expected to remain low and to start to rise only in 2011 in South Africa.

Swaziland's discount and prime rates are expected to follow these trends broadly. Swaziland's prime rate is projected to average 10.5% in 2010, and 11% in 2011 and 2012. The two countries' policy rates – at 6.5% – are expected to remain at par going forward, as the CMA agreement promotes policy convergence.

**Figure 16: Interest rates (%)**



Sources: CBS, Standard Bank est.

### External sector

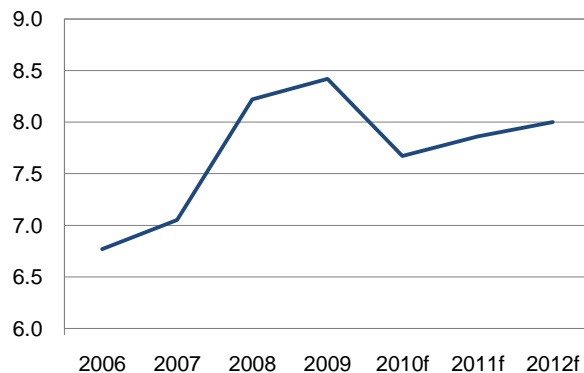
The exchange rate is expected to strengthen in 2010 to average SZL7.67/USD, compared to SZL8.42/USD in 2009, according to Standard Bank forecasts. In 2011 and 2012, a weaker trend is

expected. The currency is expected to trade at an average of SZL7.86/USD in 2011 and SZL8.00/USD in 2012.

Fluctuations in the international value of the lilangeni/rand are largely driven by capital flows and the changing risk appetite towards emerging markets. A weaker lilangeni/rand may result from greater risk aversion towards emerging markets. The positive inflation differential vis-à-vis the main trading partners also tends to weaken the exchange rate over time. However, high commodity prices may have supported positive sentiment towards the rand, which should help prevent a sharply weaker exchange rate.

The weaker expected exchange rates in 2011 and 2012 should help to boost export earnings and could support economic growth. Unlike some developing countries that manage their currencies at weak levels to promote exports, it is unlikely that the free-floating and market-determined rand will be managed lower by the South African authorities to support the export sector.

**Figure 17: Exchange rate, SZL/USD (annual average)**



Sources: Bloomberg, Standard Bank est.

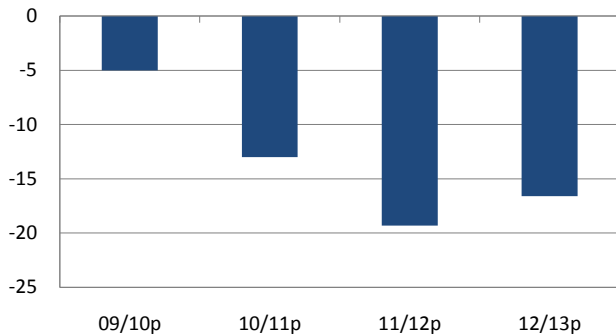
### Government sector

In his previous 2009/10 budget speech, the finance minister said the "honey moon of budget surpluses has ground to a painful halt". The budget deficit theme was continued in the 2010/11 budget speech.

The minister introduced several austerity measures in the latest budget. Firstly, the Revenue Authority will be launched in July 2010 to streamline tax collection. Secondly, a draft bill to introduce value added tax (VAT) is being finalised, to replace the less efficient Sales Tax currently in use. Thirdly, excise duties will be raised to harmonise them with the rest of the SACU region. Fourthly, the Central Transport Administration is to be improved consequent upon the recommendations of the 2007 forensic audit. Fifthly, a number of measures were taken to reduce the wage bill. Finally, the minister called on some ministries to reduce spending by 14%.

Although the minister did not raise income taxes, a new 3% minimum tax was introduced (so that lower-income tax payers are drawn into the tax net); a new Capital Gains Tax was introduced; and the Casino Levy and Lotteries and Gaming Taxes were raised from 4.5% to 15%.

**Figure 18: Budget balance**



*Sources: Ministry of Finance, Standard Bank est.*

Despite these measures, a larger-than-expected budget deficit of 13% of GDP was estimated in the current budget, which is significantly worse than the deficit of 8% of GDP projected in the previous budget. However, the budget 2010/11 figure is significantly lower than the 17% of GDP estimated in the latest MTBPS for 2010/11-2012/13. The main culprit for the expected drop in total revenue is SACU income, which will drop by 62%, causing overall revenue to fall by 28% in 2010/11.

With SACU revenue contributing a large share to state funds, it will be difficult but necessary to continue to try to find other sources of revenue to offset the fall in SACU collections.

The minister reported that Swaziland's debt burden was within the critical debt levels. The total debt stock amounted to 14.9% of GDP, significantly below the critical threshold of 60% of GDP. Debt service payments amounted to 4.8% of exports of goods and services, also significantly below the critical threshold of 15%.

There is thus room for increasing the country's domestic debt to help buffer the economic slowdown, if there is sufficient domestic capacity and appetite to absorb the additional debt.

## Outlook

Although the global economy is expected to recover in 2010, the direct impact on the Swazi economy is expected to be subdued, as the preferential trade dispensations largely dominate export performance. Domestic factors such as a high unemployment rate of 28.2% (2007 Labour Force Survey), a shrinking population (according to the population census as mentioned in the 2009/10 budget speech) and a high HIV and Aids prevalence rate (of over a quarter of the adult population, the highest in the world) are expected to be contributory factors to the low economic growth rate.

Inflation has fallen and the positive outlook will reduce pressure on interest rates, which are expected to moderate. Monetary policy will be accommodative to stimulate economic growth rather than combat inflation.

The rand, to which the lilangeni is pegged, is one of the most liquid and traded currencies in the world. The exchange rate should weaken marginally over the next three years, bringing some relief to the

important export sector. By itself, however, a weaker currency is not a substitute for improving the overall productivity and efficiency in the economy.

The drop in SACU receipts remains the determining factor for the ballooning budget deficit, which is beyond the control of the authorities. As with many developed and developing countries, fiscal sustainability is a major concern for the country. With a budget deficit on a par with Greece's, which is causing financial disruptions in the European Union and elsewhere, pressure will be on the government to rein in government spending. South Africa's growth recovery in 2010 to 2012 will boost SACU income, but may not be sufficient to ensure a large improvement in the budget deficits going forward.

The much-needed social spending on health, education and infrastructure could be the main casualty of fiscal tightening. The level of human capital development, an essential ingredient of economic growth and social development in the long run, will be further impaired under these trying circumstances.

## Swaziland

### Standard Bank forecasts of selected indicators

	2006	2007	2008	2009	2010f	2011f	2012f
<b>National accounts</b>							
Gross domestic product (E million)	11,905	12,320	12,640	12,691	12,817	13,073	13,416
% change	2.9	3.5	2.6	0.4	1.0	2.0	2.6
<b>Prices</b>							
Inflation (%) – annual average	5.3	8.2	12.6	7.5	5.5	6.3	6.3
<b>Monetary sector</b>							
Interest rate (%) – prime rate (average)	11.2	13.2	14.8	11.4	10.5	11.0	11.0
Exchange rate (LCU/USD)	6.76	7.05	8.22	8.42	7.67	7.86	8.00
<b>Public sector</b>							
Budget deficit (% of GDP)	-1.5	10.1	3.7	-1.5	-5.0	-13.0	-19.3

Sources: World Bank, IMF, CBS, Ministry of Finance, Standard Bank est.

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