

Economics

South Africa: Macroeconomic perspectives

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Goolam Ballim
 Johan Botha
 Shireen Darmalingam
 Jeremy Stevens
 Danelee van Dyk

Forecasts

	2006 ^a	2007 ^a	2008 ^a	2009 ^a	2010 ^f	2011 ^f	2012 ^f	2013 ^f
Growth data								
GDP (% y/y)	5.6	5.5	3.7	-1.8	2.9	3.2	3.6	4.2
Final consumption expenditure by households – FCEH (% y/y)	8.3	5.5	2.4	-3.1	2.4	3.0	3.8	3.5
Gross fixed capital formation – GFCF (% y/y)	12.1	14.2	11.7	2.3	2.0	2.6	3.6	5.3
Current account balance (% of GDP)	-5.3	-7.2	-7.1	-4.0	-4.2	-4.5	-4.4	-4.7
Inflation data								
Headline CPI ¹ (% y/y) annual average	4.6	7.1	11.5	7.1	4.7	5.2	5.9	5.6
PPI (% y/y) annual average	7.6	10.9	14.2	0.2	6.0	6.5	7.2	7.0
Prime rates								
Prime (year-end)	12.50	14.50	15.00	10.50	10.00	11.50	11.50	12.50
Prime (average)	11.20	13.08	15.13	11.81	10.10	10.69	11.50	12.29
Exchange rates								
\$/R (average)	6.77	7.05	8.22	8.42	7.70	8.13	8.50	8.70
£/R (average)	12.51	14.09	15.06	13.10	11.58	12.55	14.02	14.20
R/¥ (average)	17.30	16.77	12.48	11.25	11.59	11.21	10.59	11.00
€/R (average)	8.52	9.71	12.01	11.67	9.71	9.73	11.90	12.35

a=actual

f=forecast

¹CPIX inflation until 2008, the CPI headline number from 2009 constitutes a reconfigured basket.

Exchange rate forecast

Quarterly averages	Q3 2010	Q4 2010	Q1 2011	Q2 2011	12-month trading range
EUR/USD	1.22	1.18	1.14	1.17	1.05 – 1.35
GBP/USD	1.50	1.47	1.51	1.48	1.30 – 1.65
USD/JPY	86.0	87.4	89.4	91.4	80.0 – 100.0
USD/ZAR	7.73	8.00	8.25	8.23	7.20 – 8.50
EUR/ZAR	9.43	9.44	9.41	9.63	9.00 – 10.50
GBP/ZAR	11.60	11.76	12.46	12.18	11.20 – 12.80
ZAR/JPY	11.13	10.93	10.84	11.11	10.80 – 12.50

Consumer inflation

Prime rate forecasts

Headline CPI – % y/y

Last prime rate change: 26 March 2010

	2010	2011	2012	2008	2009	2010	2011
January	6.2 ^a	4.7	5.8	14.50 ^a	15.00 ^a	10.50 ^a	10.00
February	5.7 ^a	4.7	6.0	14.50 ^a	14.00 ^a	10.50 ^a	10.00
March	5.1 ^a	4.7	6.1	14.50 ^a	13.00 ^a	10.00 ^a	10.00
April	4.8 ^a	4.8	5.9	15.00 ^a	12.00 ^a	10.00 ^a	10.00
May	4.6 ^a	4.8	5.9	15.00 ^a	11.00 ^a	10.00 ^a	10.50
June	4.4	5.0	5.8	15.50 ^a	11.00 ^a	10.00 ^a	10.50
July	4.2	5.3	5.9	15.50 ^a	11.00 ^a	10.00	11.00
August	4.3	5.5	5.8	15.50 ^a	10.50 ^a	10.00	11.00
September	4.2	5.6	5.8	15.50 ^a	10.50 ^a	10.00	11.50
October	4.4	5.6	5.8	15.50 ^a	10.50 ^a	10.00	11.50
November	4.5	5.6	5.9	15.50 ^a	10.50 ^a	10.00	11.50
December	4.4	5.7	5.8	15.00 ^a	10.50 ^a	10.00	11.50
Average	4.7	5.2	5.9				
Low	4.2	4.7	5.8				
High	6.2	5.7	6.1				

Introduction

The International Monetary Fund (IMF) forecasts that BRIC GDP will double from USD9 trillion (tr) to around USD18 tr over the next five years. The BRICs have captured the imagination, and rightly so. Meanwhile, an increasing arc of nations from Latin America, Asia and Africa is supporting the ongoing structural shift South and East. For instance, Africa's GDP is also likely to double from USD1.5 tr today to about USD3 tr in 2015. In contrast, the advanced economies are only expected to increase by a quarter. In this report, we explore the reason for and implications of macroeconomic sluggishness in the advanced nations.

International

Macroeconomic sluggishness in the advanced nations centres on the inability of governments to continue to place a floor under activity. Since mid-2008, the US Federal Reserve (Fed), the Bank of England (BOE) and the European Central Bank (ECB) have slashed interest rates to exceptionally low levels and undertaken a variety of conventional and unconventional programmes to support their economies. Similarly, led by the United States (US), Japan and China, massive fiscal stimulus support, amounting to 5% of global GDP, has been extended.

However, having undertaken significant programmes to create the conditions for economic stabilisation, governments are being challenged by financial markets to restore fiscal respectability to public sector balance sheets. Unfortunately, the simultaneous weakness and deleveraging in the private sector limit the prognosis for any robust recovery. Therefore, while the macroeconomic newsflow is generally improving, a number of challenges remain, which will retard the pace of the economic recovery on both sides of the Atlantic.

Emerging markets, led by the BRIC economies, are moving to the centre of global economic fluctuations. The gap in economic growth between emerging markets and rich countries has widened from virtually nil in 1991 to around five percentage points (ppts). The growth divergence will continue given the severity of the necessary austerity measures underway across the advanced world. As a result, the largest growth contribution will emanate from emerging markets.

Table 1: Contribution to global activity

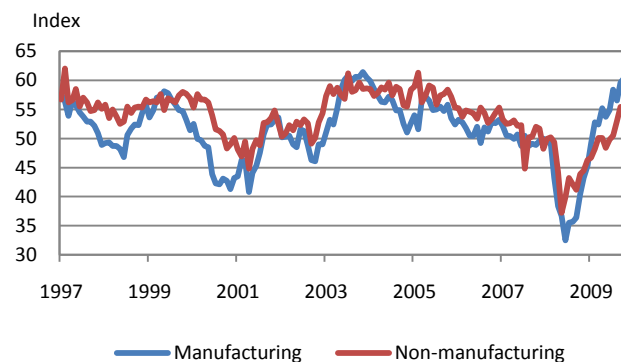
	Share of	2010	
	world GDP (2009, PPP) %	Growth %	Contribution ppt
World	100	4.0	4.0
US	20	3.0	0.6
European Union	21	1.1	0.2
Japan	6	1.9	0.1
China	13	10.0	1.3
India	5	8.8	0.4
Brazil	3	5.5	0.2
Russia	3	4.0	0.1
Sub-Saharan Africa	2	4.7	0.1

Sources: IMF, SBG

US economic growth in the first quarter is expected to have remained unchanged at 3% q/q from the previous estimate. But it is plausible that growth may be revised lower owing to negative repercussions of the European sovereign debt concerns on the US trajectory.

The first quarter saw the economic recovery broaden, transcending the confines of the manufacturing sector to include a wider arc. Since the later months of 2009, both the Institute of Supply Management (ISM) purchasing managers' indices for manufacturing and non-manufacturing have trended from lows and, since March, both have indicated expansion.

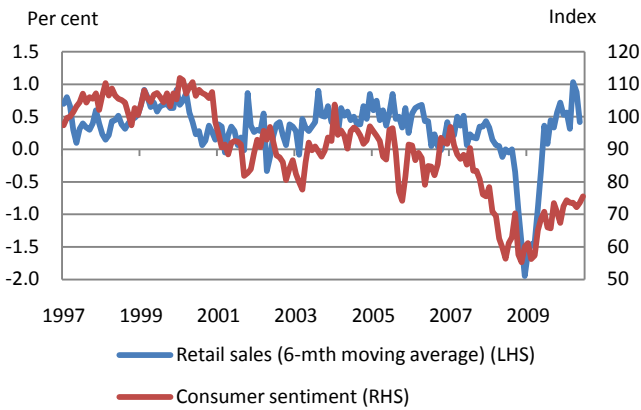
Figure 1: ISM manufacturing and non-manufacturing PMI



Sources: Bloomberg, SBG

In addition, there was increased private consumption growth in Q1. However, May saw the first contraction in retail sales since September, with sales falling from 0.6% m/m to -1.2% m/m. The momentum lost in retail sales diminishes the near-term outlook for consumption and GDP growth. Fortunately, the University of Michigan measure of consumer confidence increased from 73.6 in May to 75.5 in June, taking it to its highest level since the start of 2008, which superficially suggests that the fall in retail sales is temporary. Nevertheless, consumer sentiment remains relatively depressed taken from a historical perspective. Expect real consumption to fall from an annualised rate of 3.5% in Q1 2010 to 2% in Q2 2010.

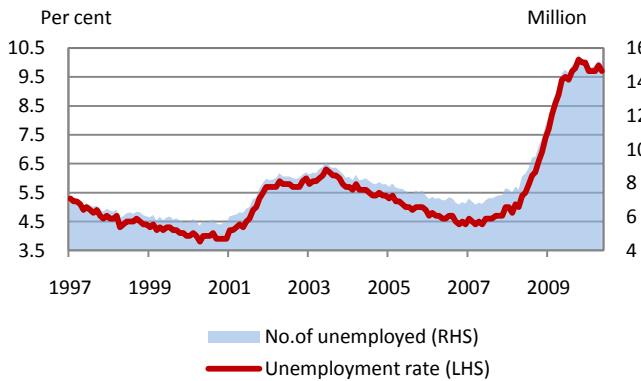
Figure 2: Retail sales and consumer sentiment



Sources: Bloomberg, SBG

Promisingly, the labour market is showing some signs of improvement, with the unemployment rate falling from 9.9% in May to 9.7% in June. Once again it is worth stressing that the most recent employment figure includes a substantial number of people involved in the census and excludes a large share of the labour force that has given up searching for employment. The artificial census-induced support dissipated from July while more workers will also rejoin the labour force over the next few months. Therefore, the unemployment rate could trend above 10% by year-end.

Figure 3: US unemployment



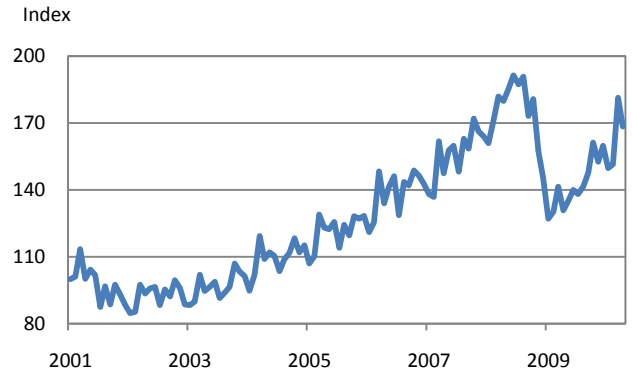
Sources: Bloomberg, SBG

The housing market remains a critical weak spot in the economy. The decline in the US NAHB housing index from 22 in May to 17 in June reverses the gains experienced in March and April. Evidently the expiry of the tax credit in April has hurt: current sales declined from an index level of 23 to 17, prospective buyers from 16 to 14, and the expected sales index from 27 to 23 (the lowest level since March 2009). The housing market remains unable to stand without the government's fist. Therefore, a double-dip in activity and prices is forming at present, which adds haze to the economic outlook.

While the internal dynamic showed early signs of sustainability, the weakness in Europe will stifle the improvements in global trade. Of course, brisk expansion in many large emerging markets has given support for US exports. However, it would be naïve to ignore the

harmful impact of a weak Europe, which typically consumes around a quarter of US exports. Therefore, while US exports are in the process of recovering, they remain below pre-crisis nominal levels.

Figure 4: US exports recovering but below pre-crisis levels

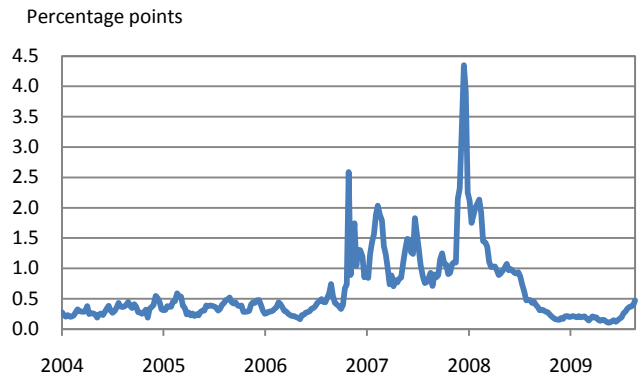


Sources: Bloomberg, SBG

The higher costs of imported oil pushed the current account deficit up from 2.8% of GDP in Q4 2009 to 3.0% of GDP in Q1 2010. However, the recent fall of oil prices to near USD70 per barrel of Brent crude means that the deficit should narrow somewhat in Q2 2010. However, considering that the US economy is leading the advanced economies out of the recession, the deficit will edge higher over the medium term.

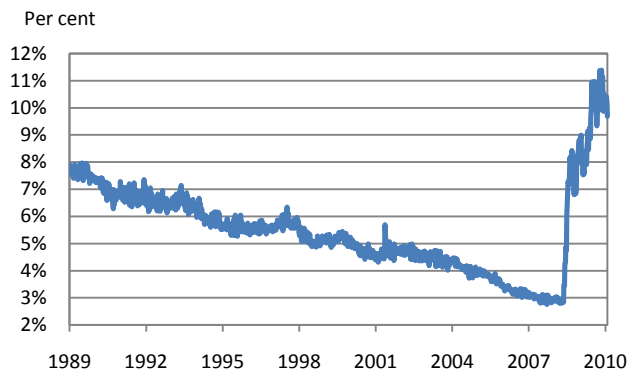
Most hoped for the US economy to expand by 3.3% in 2010, but this would require additional stimulus from the Fed, which, while not implausible, is unlikely. Given that the inventory restocking tailwind has run its course, and fiscal tightening will constrict activity, expect economic growth to come in at closer to 3% this year. Reinforcing the weaker outlook, financial conditions have recently taken a subtle turn for the worse. For instance, interbank funding is somewhat unsettled, stock prices are lower than last month and spreads have widened in money markets. Underlining uncertainty, the demand for cash persists.

Figure 5: TED-spread showing stress



Sources: Bloomberg, SBG

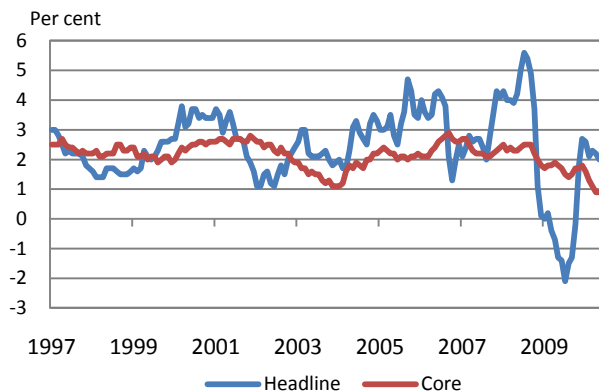
Figure 6: US commercial bank cash relative to total assets



Sources: Bloomberg, SBG

The US inflation rate continues to soften, with headline inflation falling from 2.2% in April to 2.0% in May. The fall was driven by a 5.2% m/m contraction in petrol prices, which are expected to fall by a further 8% m/m in June. Considering the base effects emanating from last year's surge in petrol prices in mid-2009, the headline inflation rate is expected to fall to 1.0% this month. Last month the annual rate of core inflation remained unchanged at 0.9% in May, but is expected to bottom at 0.5% over the next few months. Furthermore, according to Capital Economics, the contraction of broad money supply (M3) has accelerated, from 5% in April to 5.5% in May. Considering M3 expanded by an average of 8.1% between 2000 and 2009, the deflationary threat is pronounced.

Figure 7: US headline and core inflation



Sources: Bloomberg, SBG

The lower growth forecast for this year is likely to be conveyed by the Fed when it meets next week to decide on interest rates. Interest rates are expected to remain on hold until mid-2011 as price pressures remain elusive – especially with commodity prices expected to remain soft and elevated unemployment to prove stubborn.

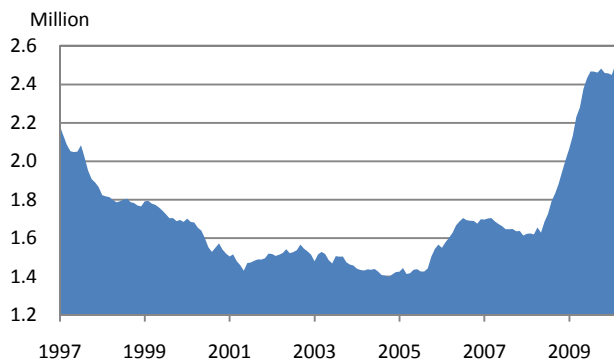
The substitution of the private sector by the public sector has manifest in an unprecedented escalation of government expenditure despite falling revenues. Public sector debt and budget deficits are a problem across virtually the entire developed world, but especially in Europe. Given that government fiscal revenue will be subdued this year, the

situation is worrisome. The most vulnerable have large public sector deficits and public sector debt levels relative to GDP.

Europe's economic recovery will lag the US. Economic growth will be led by the economies that are the most externalised and that have the least paralysing fiscal deficits and least vulnerable housing markets. As such, most anticipate Germany and France to be the bright spots. Conversely, Greece, Ireland and Spain are the very obvious weak spots.

The labour market is also weak. In the United Kingdom (UK) for example, according to the quarterly Workforce Jobs figures, UK employment declined by 119 000 in Q1 2010. Subsequently, the UK labour market is showing some signs of life. The unemployment rate declined from 8% in March to 7.8% in May and the number of people claiming jobless benefits fell more than expected in May to its lowest rate in more than a year. The claimant count unemployment fell by 30 900 in May in line with the declines experienced since April. However, after the unemployment count falling by 7 000 in Q1 2010, more aggressive public sector job cuts are nearby. Unemployment will consequently rise. Capital Economics forecasts that the number of unemployed individuals could reach three million by 2013.

Figure 8: Number of unemployed individuals in the UK



Sources: Bloomberg, SBG

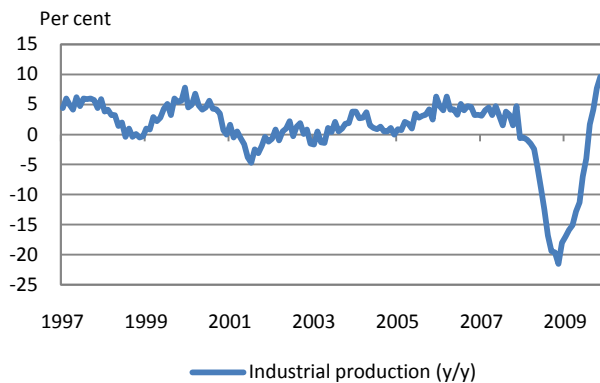
Confronted with high unemployment, falling wealth and limited access to credit, European households are under pressure. Nevertheless, as anticipated, decelerating income growth and greater economic uncertainty have resulted in household deleveraging. Hence, after virtually a decade of households reducing their share of savings-to-disposable income, 2008 saw a rapid acceleration of savings relative to income. Expect consumption to remain subdued in 2010.

Much like in the US, inflationary pressures are absent from the economic calculus, meaning that rates will remain supportive. While headline CPI did increase from 1.5% in April to 1.6% in May, the increase was due to elevated energy prices. In stark contrast, the core inflation was unchanged at 0.8%. Most anticipate both headline and core inflation to continue to trend lower.

Having contracted by an average of 14% y/y each month in 2009, industrial production across Europe has surged since the start of the year, increasing from 7.7% in March to 9% in April. However, spare

capacity is omnipresent: since 1997, capacity utilisation has averaged 83, meaning that, despite increasing from 72.3 in Q1 2010 to 75.5 in Q2 2010, there remains slack in Europe's economies.

Figure 9: European industrial production



Sources: Bloomberg, SBG

A central risk to the global economy centres on *the timing of the government's hand-over*. Removing policy support either prematurely or too aggressively could de-rail the recovery as fiscal stimulus transforms into fiscal drag. However, removing support too late could result in sovereign defaults. *Economic surprises on the downside*, relating to the real economy and financial markets, are more likely than positive surprises. This could result in panic. Just consider that stock markets around the globe are already at pre-Lehman levels, with a V-shaped recovery priced in. *One cannot exclude greater financial losses related to the real economy*, such as non-performing loans attached to credit cards and vehicles. Expect continued deleveraging in the advanced world's private sector.

South Africa

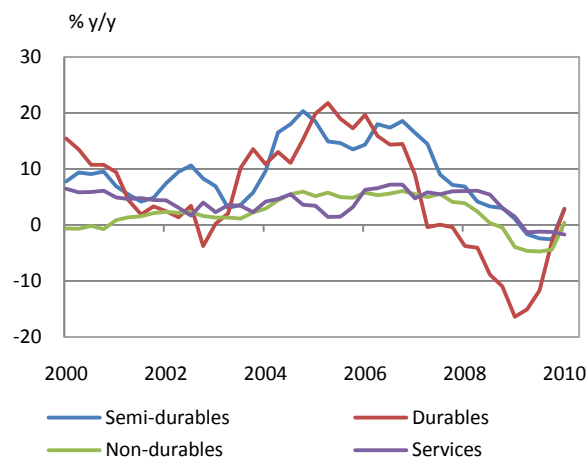
The second quarter of the year has seen a tentative momentum loss in consumer and business confidence, reflecting overarching concerns over the durability of the export-led recovery.

Household demand:

- The Reserve Bank *Quarterly Bulletin* reported a surprisingly strong increase in household spending of 5.7% q/q seasonally adjusted and annualised (s.a.a. – all rates quoted this way unless otherwise specified) in Q1 from 1.6% in Q4 last year. Demand for durables and semi-durable goods (motor vehicles, recreational and entertainment goods, furniture and household appliances, and clothing and footwear) increased by double-digit rates, of 16.8% and 28.4% respectively. In the case of the latter, this was the highest growth rate in 12 years, as pent-up demand during the recession gained traction, blowing out at the first sign of growth in nominal disposable income (15.1%). Non-durable sales (largely petroleum sales) also rose strongly, increasing by 9.5% in Q1 from -4.4% in Q4 last year. Services (largely resulting from falling transport services), however, declined by 4.6% from -0.6% in Q4.

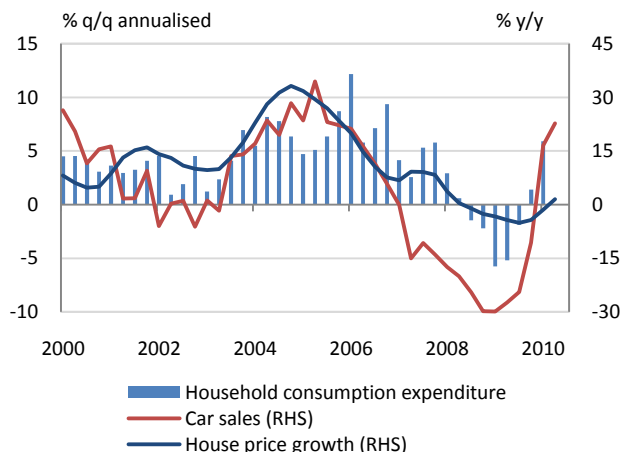
- Consumer confidence slipped in Q2 to 14 index points from 15 in Q1. While consumers were more optimistic about the condition of the economy in a year's time, this optimism was not reflected in their confidence regarding their own finances a year from now. The weakness was particularly strong amongst high- and low-income earners, whose assessment of financial conditions declined by five and seven index points respectively.
- This may be a result of a host of factors. High-income earners are more sensitive to the potential negative spillover effects from global fiscal austerity and the European debt crisis; the potential for higher interest rates a year from now; and prospects for low discretionary remuneration payments. Low-income earners' financial positions may not be as firm owing to no improvement, or even some deterioration, in employment conditions. Moreover, inflation is generally expected to head higher following the lower turning point in Q3 this year.

Figure 10: Household consumption expenditure on goods and services



Source: SARB

Figure 11: Household consumption expenditure, house price and vehicle sales' growth

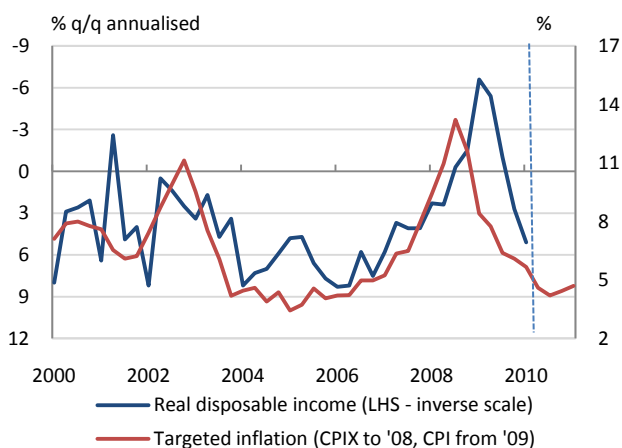


Sources: NAAMSA, SARB, SBG

Household earnings' potential:

- Real disposable income growth increased to 5.1% in Q1 from 2.3% in Q4, with higher employment levels at provincial government level and increased remuneration of public servants supporting this rise.
- A sustainable recovery in household demand is dependent on employment and income growth. At this juncture, the employment prognosis remains dismal. Admittedly the rate of decline in job losses slowed in Q4 to -1.2% from -8.2% in Q3 last year. Public sector job growth slowed to 0.7% in Q4 from 5.7% in Q3 – declines are probably on the cards in a few quarters' time as the government will have to manage its wage bill more effectively.
- The employment subcomponent in the purchasing managers' index (PMI) of Kagiso and the Bureau for Economic Research (BER) showed that manufacturers shed labour in May, the first decline following four months of gains.
- According to quarterly business confidence surveys by the BER for retailers and manufacturers, employment in these sectors is still in decline, but the rate of decline is expected to slow in Q3. Manufacturers are seemingly less optimistic in this regard than retailers. Similarly, building contractors have slashed employment more aggressively in Q2, and this is expected to continue in Q3, admittedly also at a slower pace. From the surveys conducted, employment prospects in the building construction sector are the least favourable.
- Negative employment repercussions may also arise from the hefty wage demands in recent wage bargaining. A potential of 250 000 jobs could be shed this year in the formal non-agricultural private sector, of which the manufacturing, construction and trade sectors comprise the largest shares. In all likelihood, if the public sector battles to contain its wage bill, job losses could increase by a further 150 000.

Figure 12: Household real income growth inversely related to inflation



- Inflation is expected to average 4.7% y/y in 2010 and 5.2% y/y in 2011. Given that wage demands are currently settling at between 7% and 11%, real wage gains will support household deleveraging and make for a modest recovery in spending of 2.4% this year and 3% in 2011.
- Given that the household debt-to-disposable income ratio declined to 78.4% in Q1 from 79.9% in Q4 last year, these advances were predominantly cash-financed. Accordingly, the rate of savings-to-disposable income growth declined to -0.2% in Q1 from 0% in Q4. The strong spending and income growth rates seen in Q1 are viewed as unsustainable and likely to adjust lower from Q2 onwards.

Gross fixed capital formation (GFCF):

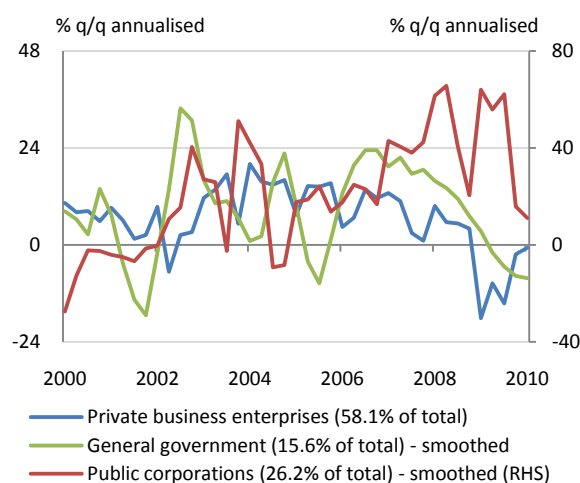
- Gross fixed capital formation (GFCF) rose by 0.2% in Q1 from -0.9% in Q4, supported by public corporations (7.4% in Q1). The slowdown in the rate of contraction in private sector capital formation to -0.7% in Q1 from -7% in 2009 was encouraging. The improvement was driven by a slower rate of decline in manufacturing GFCF and an increase reported by the broader financial and business services sector (see Table 2).

Table 2: GFCF by sector – % q/q s.a.a.

	% of total GFCF	'09 Q4 % q/q	'10 Q1 % q/q
Mining	9	-8	-10
Manufacturing	13	-19	-7
Utilities	15	2	5
Transport	19	21	9
Financial & business services	16	-9	5
Community and social	16	8	-13

Source: SARB

Figure 13: Fixed capital formation by type of organisation



Source: SARB

- According to the Q2 manufacturing survey by the BER, a modest balance of manufacturers (6% vs 4% in Q1) is expecting to

invest in machinery and equipment in 12 months' time.

- Manufacturers that have seen an improvement in investment intentions over the past few quarters are producers of wood, furniture, clothing, food, chemicals, basic metals and transport.
- The investment cycle is likely to turn relatively slowly, on the back of private sector deleveraging, relatively high levels of unutilised capacity, and global uncertainty. Admittedly, the recovery in the private sector will be partially countered by weakening public sector infrastructure development growth.

Net exports:

- The economy is slowly moving away from the sporadic small surpluses that have been recorded over the past year, to smaller deficits. On a non-seasonally adjusted basis, the trade deficit swelled to R2.9 billion (bn) in Q1, from R1.8bn in Q4 last year. If the R1.9bn deficit reported in April is sustained for the rest of the quarter, a trade deficit of R5.7bn will be reported.
- To be sure, the economy's growth engine is slowly turning towards household spending, while the infrastructure drive is unwinding. This has seen the share of consumer-related imports increase to 22% of total imports, up from the low of 18.1% in 2008 Q2, before the onset of the recession. In turn, the mature phase of infrastructure development has seen the share of capital and raw material imports ease to 46% in the first four months of the year, compared to 49% in 2009 Q2 (see Table 3).
- In turn, while exports have held up reasonably well during the economic recovery, exports have become more concentrated in commodities, with 63% of total exports in the first five months of the year comprising gold, platinum and precious stones and mineral products.

Table 3: Share of exports and imports according to category

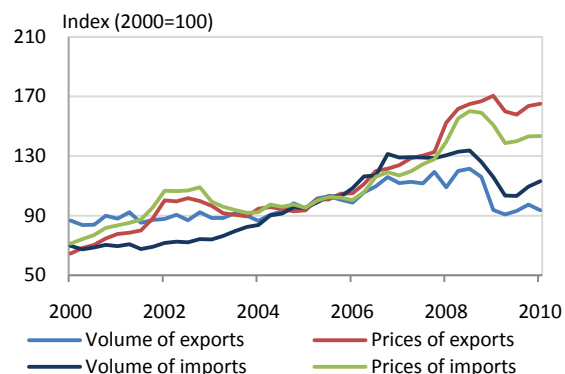
		Consumer	Commodities	Capital and raw materials
2003	Exports	26.9	51.4	21.7
	Imports	22.2	18.8	49.6
2008	Exports	19.4	58.9	21.2
	Imports	19.9	29.6	43.9
Jan-May '09	Exports	20.9	59.1	20.1
	Imports	22.1	27.6	50.4
Jan – May '10	Exports	18.5	62.7	18.8
	Imports	23.6	27.6	48.8

Source: SBG

- South Africa's imports are predominantly manufactured-based goods, while exports are largely commodities. A relatively strong currency could thus contribute to widening the current account deficit, especially if commodity prices falter in the event of intermittent weakness in Asian economies.

- While terms of trade are currently in favour of SA's trade dynamics (see Figure 14), the risks of such a reversal will see the current account deficit surge, while exposing the rand exchange rate.

Figure 14: Trade volumes and price indices



Source: SARB

- A further risk stems from the rand's strength against the euro, as the rand has appreciated by 10% since the start of the year. Around 36% of imports are from Europe (44% from Asia), of which nearly 90% comprise manufactured goods. This could very well contribute to manufacturers' woes in due course, as local production is substituted by imported goods. Indeed, if sustained, this risk could contribute to a widening of the trade balance.
- As it stands, export volumes declined by 3.3% in Q1 owing to weaker demand for SA manufactures (largely machinery and equipment, agricultural products and transport equipment) from the EU area and the US.
- The current account deficit widened to 4.6% of GDP in Q1 from 2.9% in Q4 last year. Even though the trade deficit widened to R12.9bn following a surplus of R24.9bn in Q4, it only comprised 0.5 ppts of the deficit-to-GDP ratio. Net income and services outflows are the largest contributors to the current account deficit, contributing 1.8 and 1.3 ppts, respectively, to the deficit. Given that these components are relatively rigid, accounting for around 3.7 ppts of the current account deficit over the past four years, a widening in the trade deficit is likely to keep the current account deficit at above 4% over the next several years.

Detailed breakdown of the production approach to GDP:

Mining and quarrying sector (4.6% of GDP; 6% of formal non-agricultural employment):

- *Current performance:* In April, mining output grew at the slower pace of 2.7% y/y from a lofty 11.5% y/y in March, with platinum group metals, gold and coal amongst the biggest decliners, falling by 8.2% y/y, 6.2% y/y and 2% y/y respectively.

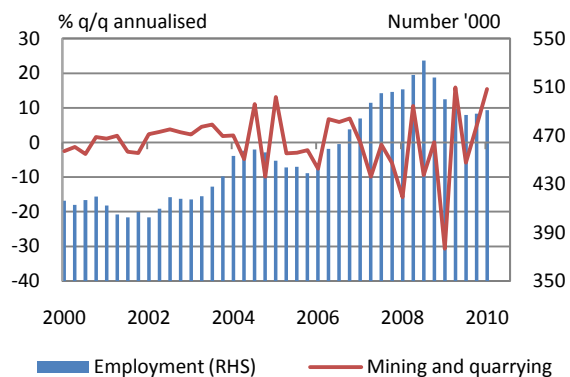
- *Top contributors to growth:* diamonds, manganese ore, iron ore, coal and platinum output. Gold, copper and building material mining output are draining growth.
- *Emerging trends:* Rising sovereign risk concerns have seen a moderation in the *base metal price complex*. A weaker second half of the year is envisaged this year, with prices of top commodities, i.e. platinum group metals, expected to consolidate.
- *Risks:* Policy normalisation in China and Europe – two key commodity consumers – could douse the demand for commodities. Deteriorating terms of trade conditions in China have contributed to a lower trade surplus over the past few months. This, together with focus on stimulating internal demand and limiting property market excesses, holds risk for continued commodity support.

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 15: Mining Gross Value Added (GVA) vs employment



Sources: SARB, Stats SA

- *Employment prognosis:* Jobs in the private non-agricultural formal sector were on the decline between 2008 Q3 and 2009 Q3, falling 8.5% peak-to-trough. Jobs, however, improved mildly in 2009 Q4 and 2010 Q1. According to the Manpower labour survey, the outlook for mining jobs has improved in the second quarter, both from a q/q and y/y perspective. Risks are, however, to the downside.

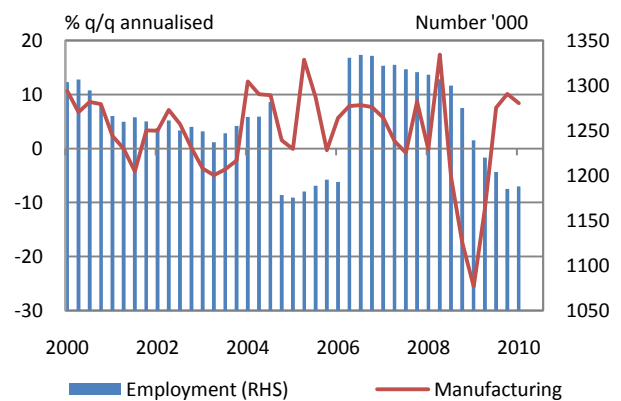
Manufacturing sector (14.4% of GDP; 14.8% of formal non-agricultural employment):

- *Current performance:* Manufacturing production growth slowed in May to 7.9% y/y from 8.7% y/y in April. On a quarterly basis growth in output increased to 1% s.a. from an increase of 0.8% s.a. in the quarter ending in April. The downside surprise in manufacturing production growth in May raises concerns that we

could see a contraction in the sector further down the line. At this stage, growth is buoyed by low base effects of last year with little other stimulus present to drive production growth once these effects have dissolved. Lacklustre internal demand combined with weak global economic developments will continue to remain prominent bugbears in the coming months.

- *Top contributors to growth:* Six of the ten manufacturing divisions supported output growth during this quarter. In particular, higher production volume in the wood and wood products, paper, publishing and printing division; food and beverages; electrical machinery; motor vehicles parts and accessories and other transport equipment divisions supported growth.
- *Emerging trends:* Despite the recent growth in production, manufacturers' confidence levels remain at historically low levels on concern over insufficient demand. Q2 saw a deterioration in export sales' volumes and orders; however, domestic sales' volumes are expected to improve in Q3.
- *Risks:* Manufacturers are also less optimistic over about business conditions in 12 months' time, this as insufficient domestic demand, maturing inventory cycles, and rising labour costs prove discouraging. Total cost per unit of output has risen in Q2, and is expected to remain high in Q3.

Figure 16: Manufacturing GVA vs employment



Sources: SARB, Stats SA

- *Employment prognosis:* Employment in the formal non-agricultural economy has declined by 11.2% since the peak in 2006 Q3. The risks for further weakness are to the downside, despite a modest increase of 3 000 in Q1. The net balance of manufacturers reporting a decline in average factory working hours has declined in Q2, but is seen reversing in Q3. This may slow the rate of job declines; however, the outlook for employment according to the Manpower survey remains net negative.

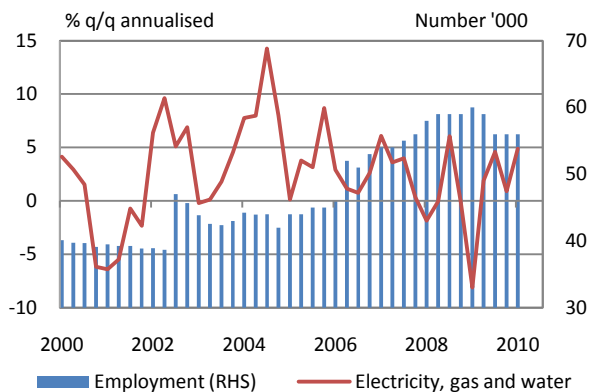
Electricity, gas and water (2% of GDP; 0.7% of formal non-agricultural employment):

- *Current performance:* Growth in electricity consumption eased moderately to 6.6% y/y in April from 8.0% y/y in March. In the

three months to April, growth in electricity consumption eased somewhat to 2.2% from 2.3% in Q1.

- **Emerging trends:** Modest progress was made recently when the independent power producer IPSA was given the green light to develop a small facility that provides electricity to Eskom until the end of June.
- **Risks:** Quality of coal remains a source of concern given the success of exports of high quality coal, leaving the local utility with inferior supply. The cost of this coal has also been too high given the local funding dilemma. This may contribute to long-term maintenance issues, raising risks of imminent supply shortages between 2011 and 2013. In the meantime, further demand-side management programmes to lower electricity consumption by 5 000 Megawatts are under investigation.

Figure 17: Utilities GVA vs employment



Sources: SARB, Stats SA

- **Employment prognosis:** The sector has seen limited job shedding compared to other sectors (4 000), representing a peak-to-trough decline of 6.7%. While the outlook for Q2 employment prospects improved, according to the Manpower survey, there may be weakness in Q3 post the World Cup.

Construction (4.1% of GDP; 5.5% of formal non-agricultural employment):

- **Current performance:** The rate of growth in real value of building plans passed of residential property improved to 5.7% y/y in April from -4.7% y/y in March (-36.9% y/y in 2009). For non-residential buildings, the rate of decline increased to -39.9% y/y in April from -12.1% y/y in March (-7% y/y in 2009). However, the data are notoriously volatile. In respect of residential buildings completed, the decline moderated in April to -20.7% y/y, following a 25% y/y contraction in 2009. Non-residential buildings completed are declining at a more rapid rate, having fallen by 26.5% y/y in April from -10.8% y/y in 2009.
- **Top performing industries:** civil engineering supported by government infrastructure.

- **Emerging trends:** Some normalisation is occurring in the number of plans passed and by square metreage in residential properties of above 80 squares per metre. This points to residential building activity in this sector improving a year from now. However, envisaged activity in the smaller categories and flats and townhouses remains bleak. In respect of building activity, the non-residential sector may only post a solid recovery two years hence.
- **Risks:** The overall sector remains burdened by insufficient demand. This could see squeezed margins for some time still. The construction sector may contract this year following several years of double-digit growth.
- Table 5 illustrates the detail of building plans passed when compared to the corresponding period the year before, and confirms that the lower turning point may have been reached for residential property. However, as expected, non-residential building plans continue to slide.

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

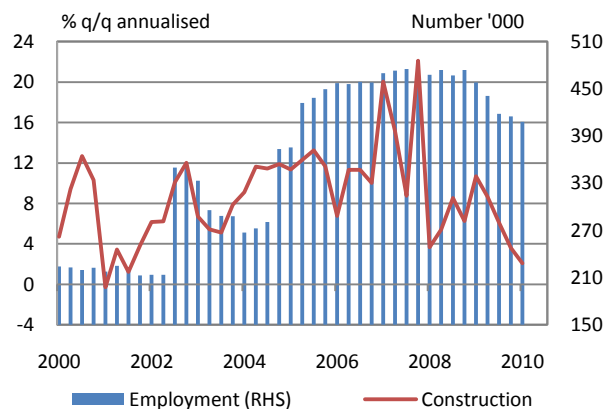
February 2010 – April 2010 vs February 2009 – April 2009 [#]	
Residential:	
< 80 square metres	-15.1% (-48.1%)
> 80 square metres	-1.8% (-4.5%)
Flats and townhouses	-44.3% (-48.2%)
Other*	-15.8% (-11.6%)
Non-residential:	
Office and banking space	-28.8% (-18.0%)
Shopping space	-25.3% (-31.3%)
Industrial and warehouse space	-35.9% (-44.9%)
Other**	4.1% (-21.5%)
Additions and alterations:	
Dwelling houses	5.8% (5.1%)
Other buildings	-57.9% (5.8%)

[#] Previous three months' data in brackets

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

** Includes schools, hospitals, and sports and recreation facilities
Source: Stats SA

Figure 18: Construction GVA vs employment



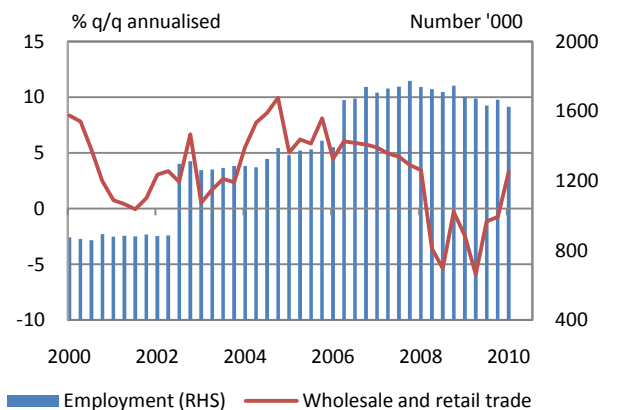
Sources: SARB, Stats SA

- *Employment prognosis:* The construction sector shed jobs for five consecutive quarters, with a peak-to-trough decline of 13.9%. Given the stress in the sector, we expect further job declines in the public infrastructure sector. The Manpower survey corroborates the view of a downward bias in hiring intentions over the following few quarters.

Wholesale and retail trade (13.8% of GDP; 20.1% of formal non-agricultural employment):

- *Current performance:* Retail sales in real terms gained traction in April, with growth increasing to 3.2% y/y from 2.7% y/y in March. This leaves the sector 1.8% up in the first four months of the year, relative to the same period last year. Even though rising from a low base last year, when the sector contracted by 3.6% y/y, the sector seems to struggle to sustain momentum. Indeed, retail sales rose by 1.8% in the quarter to April (compared with the previous quarter), which is a significant momentum loss following the 3.9% increase in Q1. In respect of wholesale trade, the sector is battling to gain substantial momentum, with sales having declined by 1% y/y in April following a slight advance of 0.6% y/y in March.
- *Top performing industries:* Interest rate-sensitive sectors, such as textiles and furniture and appliances industries, led the upturn at the start of the year, while price-sensitive sectors, such as general retailers and food and beverage retailers, only recently reported positive sales' growth.
- *Emerging trends:* Consumer confidence moderated in Q2, although remaining resilient, owing to reduced optimism in consumers' future financial conditions. Retailers of durable and semi-durable goods have signalled concern regarding the sustainability of sales' growth up to now.
- *Risks:* Risks of a post-World Cup hangover are tangible given anecdotal evidence of vast credit-based spend accompanying the event.

Figure 19: Trade GVA vs employment



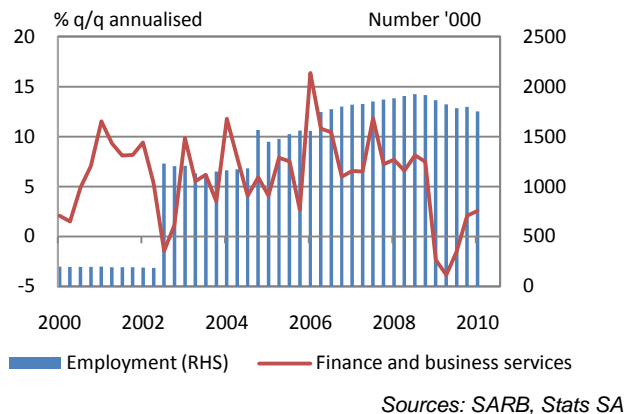
- *Employment prognosis:* Employment gains in the sector remain

largely seasonal; however, a decline of 7% has been noted since the peak was reached in 2008 Q4. Gains in employment are largely seen as tentative for now. The Manpower survey confirms a less optimistic hiring environment in Q2 relative to Q1.

Finance, real estate and business services (20.5% of GDP; 22.1% of formal non-agricultural employment):

- **Finance and insurance (45% of total sector):** Corporate degearing remains central to the relatively weak credit landscape. Weak business travel during the June/July period is likely to contribute to this trend.
- **Real estate (35% of total sector):** Growth in the housing market remains modest, according to Standard Bank's median house price. Despite improved affordability, concerns over employment prospects, purchasing power sapping utilities costs and high indebtedness suggest that the recovery will be uneven and lacklustre. Still, recent evidence is showing that stability is returning to the market.

Figure 20: Financial intermediation and business services GVA vs employment

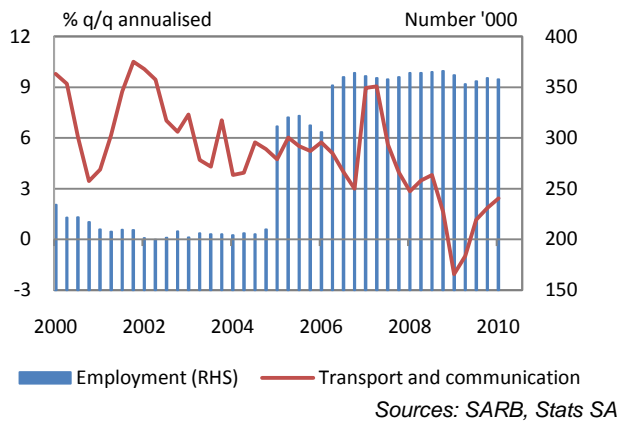


- *Employment prognosis:* The sector saw a modest gain in employment in Q4 after four consecutive quarterly declines, leaving employment 8.9% lower than at its peak in 2008 Q3. The Manpower survey expects further momentum loss in Q2, but, relative to a year ago, gains are envisaged.

Transport, storage and communication (10.3% of GDP; 4.3% of formal non-agricultural employment):

- *Emerging trends:* Recovery in retail and wholesale trade will see demand for road transport improve. Transnet is focusing on expanding private sector participation, with the chief aim to expand key commodity export corridors.
- *Risks:* Rising fuel prices and still-high logistic costs pose a risk to the sector's profitability.

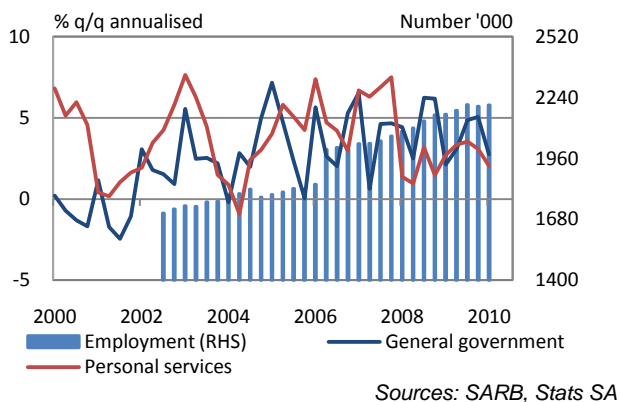
Figure 21: Transport and communication GVA vs employment



- *Employment prognosis:* The sector saw minimal job declines during the recession, with a peak-to-trough decline of 3.6%. Jobs have risen by 1.4% since reaching a low in 2009 Q2. The Manpower survey reports some moderation is expected in Q2. Levels are seen higher than a year ago.

General government and personal services (18.7% of GDP; 26.4% of formal non-agricultural employment):

Figure 22: General government and personal services GVA vs employment



- *Employment prognosis:* The sector saw its first decline in employment in three years in Q4 last year, but this was partly reversed in Q1. According to the Manpower survey, hiring intentions increased in Q1, but are expected to lose momentum in Q2, and to fall below last year's levels.

Conclusion

The global economy is on a two-track recovery profile, with emerging markets forging ahead while mature economies are still in the process of regaining lost ground as they head towards pre-crisis levels. At this juncture, the US leads the advanced world with a better internal dynamic and an improving external dynamic. However, growth will be softer than envisioned. Promisingly, inflation is still missing, meaning monetary policy will be supportive, somewhat offsetting tighter fiscus. For now, it seems unlikely that disturbances in Europe and uneven recoveries will debunk the shift in economic influences away from the advanced world towards the East (and increasingly the South). However, the global recovery profile includes a kaleidoscope of forces and it would be naïve to ignore the critical role of advanced economies in economic affairs.

Economic growth in the domestic economy is expected to ease to around 3.7% in Q2 as export activity loses traction. Advances in retail remain fragile, with consumers reflecting cautiousness about future financial conditions. Growth weakness in the second half of the year remains unavoidable, and employment and investment growth prospects are slim.

Group Economics

Goolam Ballim – Group Economist

+27-11-636-2910 goolam.ballim@standardbank.co.za

International

Jeremy Stevens

+27-11-631-7855

Jeremy.Stevens@standardbank.co.za

South Africa

Johan Botha

+27-11-636-2463

Johan.Botha@standardbank.co.za

Shireen Darmalingam

+27-11-636-2905

Shireen.Darmalingam@standardbank.co.za

Danelee van Dyk

+27-11-636-6242

Danelee.vanDyk@standardbank.co.za

Rest of Africa

Yvette Babb

+27-11-631-1279

Yvette.Babb@standardbank.co.za

Jan Duvenage

+27-11-636-4557

Jan.Duvenage@standardbank.co.za

Yvonne Mhango

+27-11-631-2190

Yvonne.Mhango@standardbank.co.za

Kenya

Malawi

Tanzania

Uganda

Zimbabwe

Botswana

Lesotho

Mauritius

Namibia

Swaziland

Angola

DRC

Ghana

Mozambique

Nigeria

Zambia

Simon Freemantle

+254 (20) 3269 027

Freemantles@stanbic.com

Kenya

Uganda

Tanzania

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