THE ECONOMIC POLICY ENVIRONMENT IN SOUTH AFRICA – CURRENT ISSUES

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Introduction

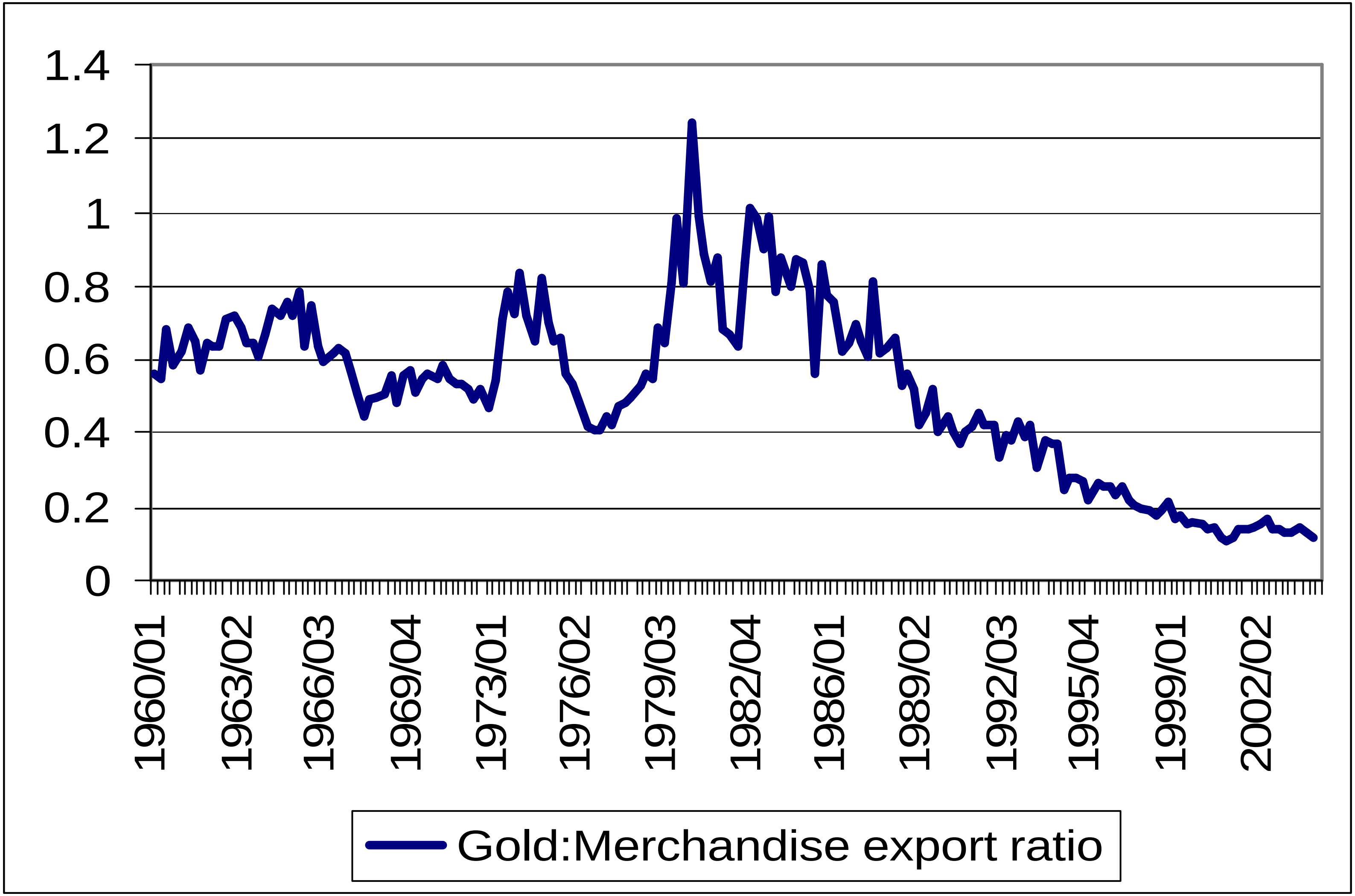
1. Brief political historic background
2. Sectoral structure (primary, secondary and tertiary)
3. Growth
4. Investor confidence and financial market activity
5. Financial health of the public sector
6. Financial health of the household sector
7. The BoP and the exchange rate
8. Inflation
9. Labour, wages and productivity
10. Investment and the cost of capital
11. Conclusion

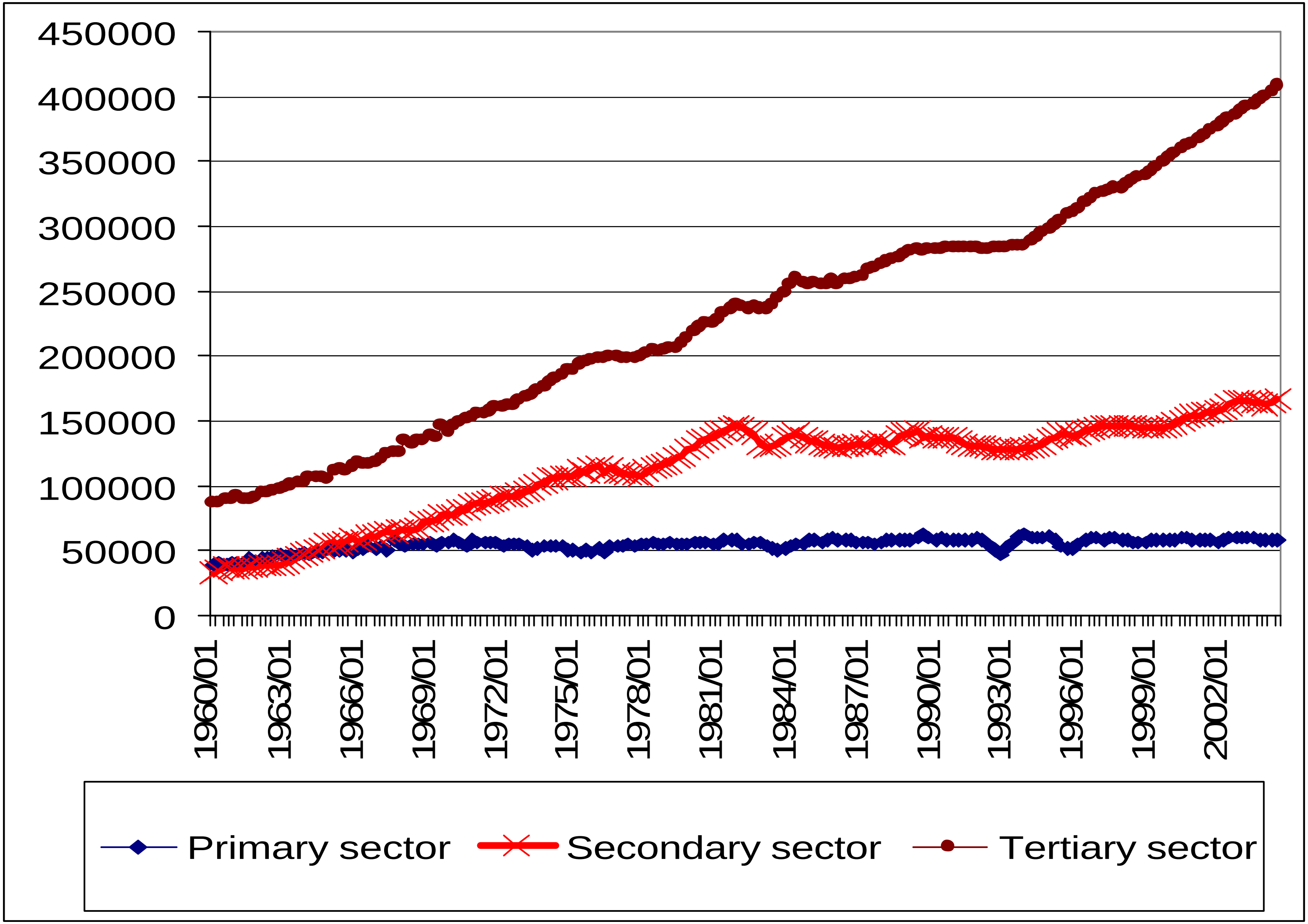
1. Brief political historical background

- South Africa as a country created in 1910
- Policy of Apartheid implemented from 1948
- First democratic election in 1994
- Had successful free and fair elections in 1994, 1999 and 2004

2. Sectoral structure (primary, secondary and tertiary)

- Gold discovery 1886: Johannesburg founded
- Became largest producer of gold to this day, though production currently much smaller
- Manufacturing and services (production and exports) much larger than gold production


1.4
1.2
1
0.8
0.6
0.4
0.2
0
1960/01
1963/02
1966/03
1969/04
1973/01
1976/02
1979/03
1982/04
1986/01
1989/02
1992/03
1995/04
1999/01
2002/02
Gold:Merchandise export ratio

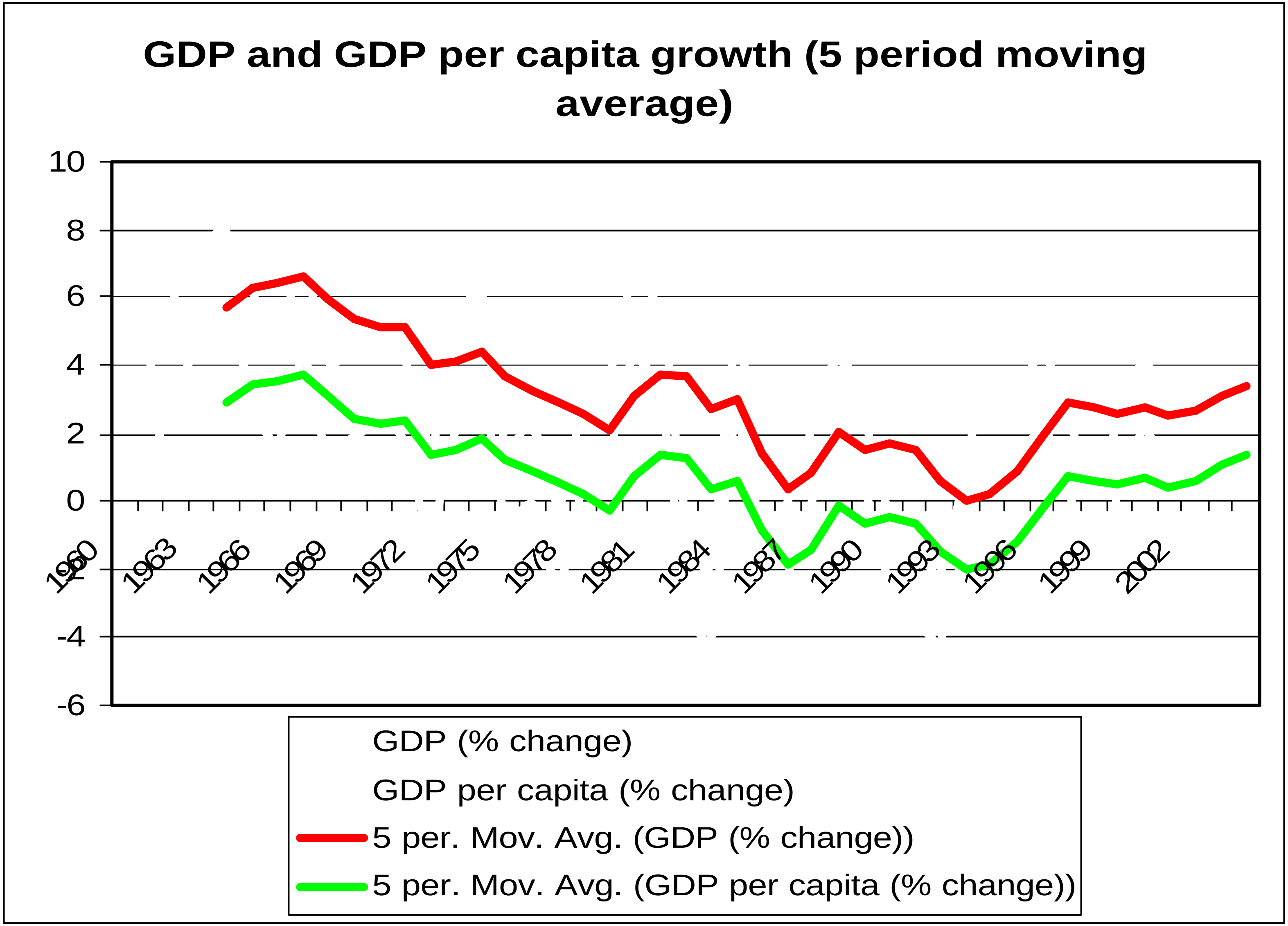


450000
400000
350000
300000
250000
200000
150000
100000
50000
0
1960/01
1963/01
1966/01
1969/01
1972/01
1975/01
1978/01
1981/01
1984/01
1987/01
1990/01
1993/01
1996/01
1999/01
2002/01
Primary sector
Secondary sector
Tertiary sector

3. Growth

- Given the composition of the economy, how successful was it in generating growth?
- World had a high growth phase in 1950s, 60s and early 70s
- Oil crises of 1973 and 1979 heralded the ‘Great Inflation’
- Economic growth internationally much lower since 1980s
- SA similar picture: 1950s, 60s and early 70s high growth
- Growth collapsed in 1980s

- Not just because world entered lower growth phase
- 1980s and early 90s characterised by political turmoil (state of emergency)
- Growth improved and stabilised at 2.6% in 1995-99
- Seems as if it now might turn up to ± 3.5% to 4%
- Objective 5% - 6%


GDP and GDP per capita growth (5 period moving average)
10
8
6
4
2
0
-2
-4
-6
1960
1963
1966
1969
1972
1975
1978
1981
1984
1987
1990
1993
1996
1999
2002
GDP (% change)
GDP per capita (% change)
5 per. Mov. Avg. (GDP (% change))
5 per. Mov. Avg. (GDP per capita (% change))

4. Investor confidence and financial market activity

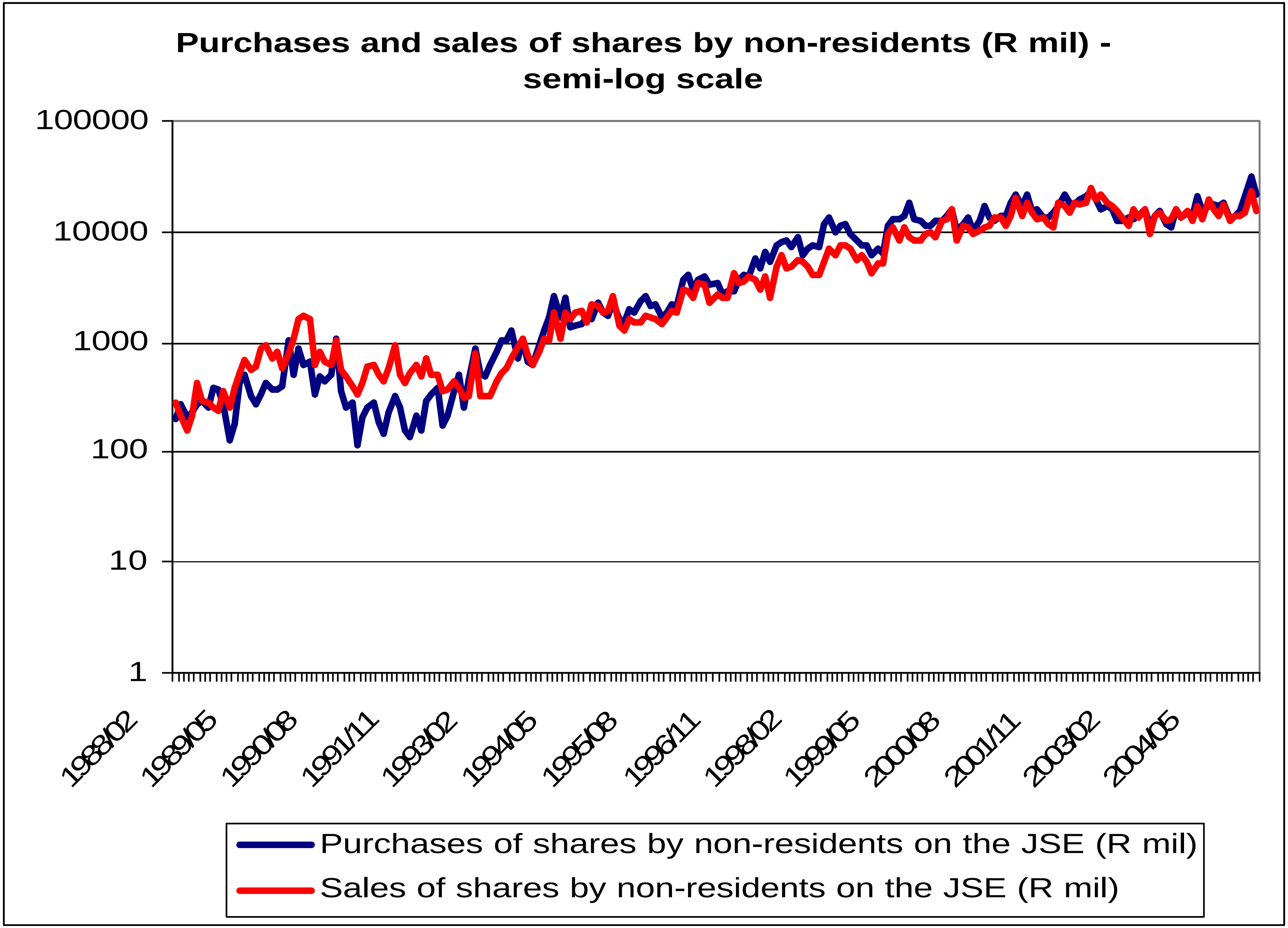
- Confidence continuously improving

- Moody's upgraded SAs sovereign credit rating again in January 2005
  - From Baa2 to Baa1
  - Baa3 and higher: Investment grade

A selection of sovereign bond yields on 28 February 200

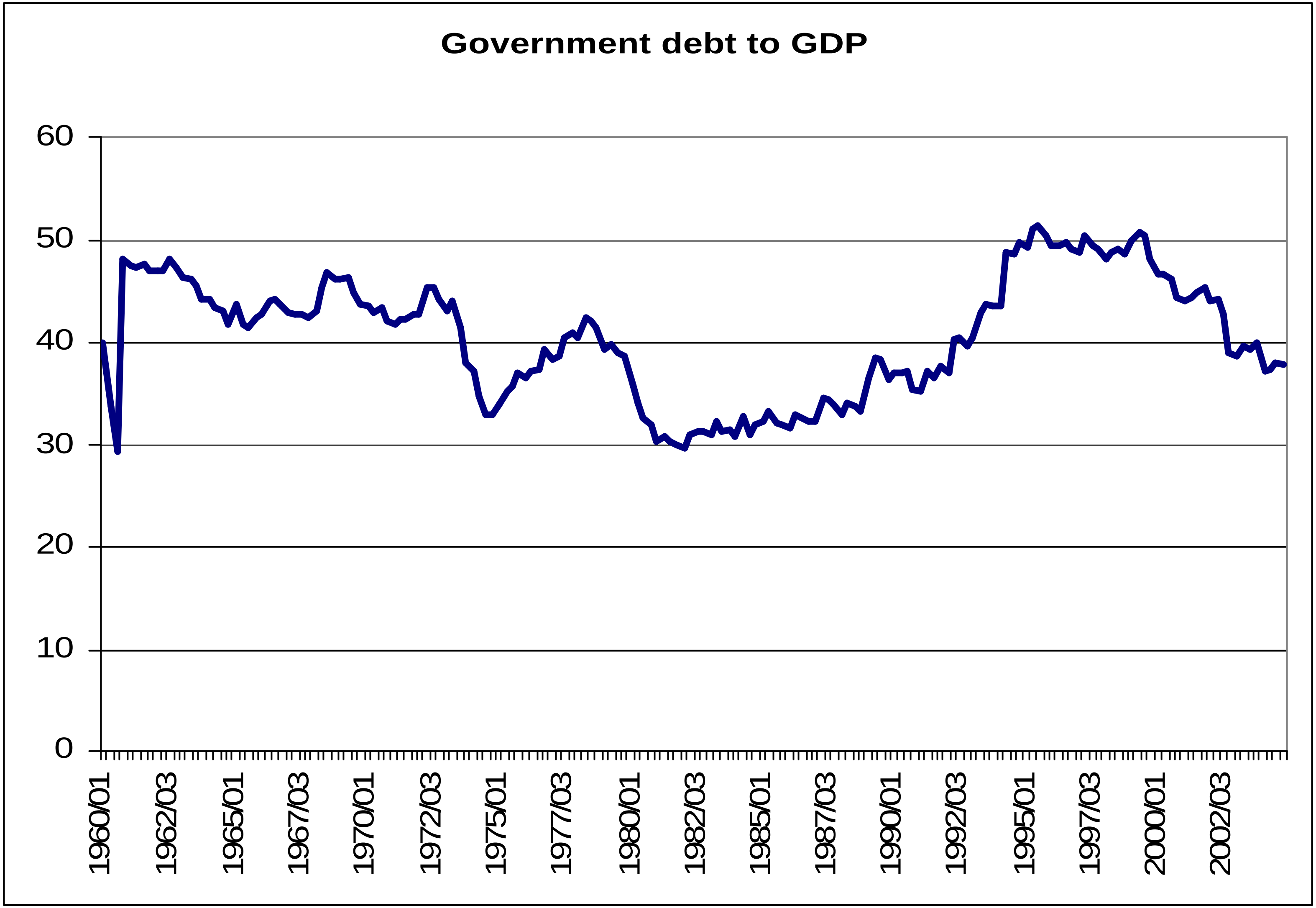
Country	Moody's rating	Per cent*	Maturity (year
Jnited States	Aaa	4,38	10
Sweden	Aaa	4,57	8
Belgium	Aa1	4,40	5
taly	Aa2	4,61	10
China	A2	4,76	8
Korea	A3	4,99	9
South Africa	Baa1	5,21	9
Mexico	Baa1	5,65	10
Barbados	Baa2	4,60	5
Russia	Baa3	6,11	13
Panama	Ba1	6,82	10
Colombia	Ba2	7,81	9
Peru	Ba3	6,83	10
Turkey	B1	6,61	10
Brazil	B1	7,84	9
Venezuela	B2	8,08	9
Argentina	Caa1	41,2	10

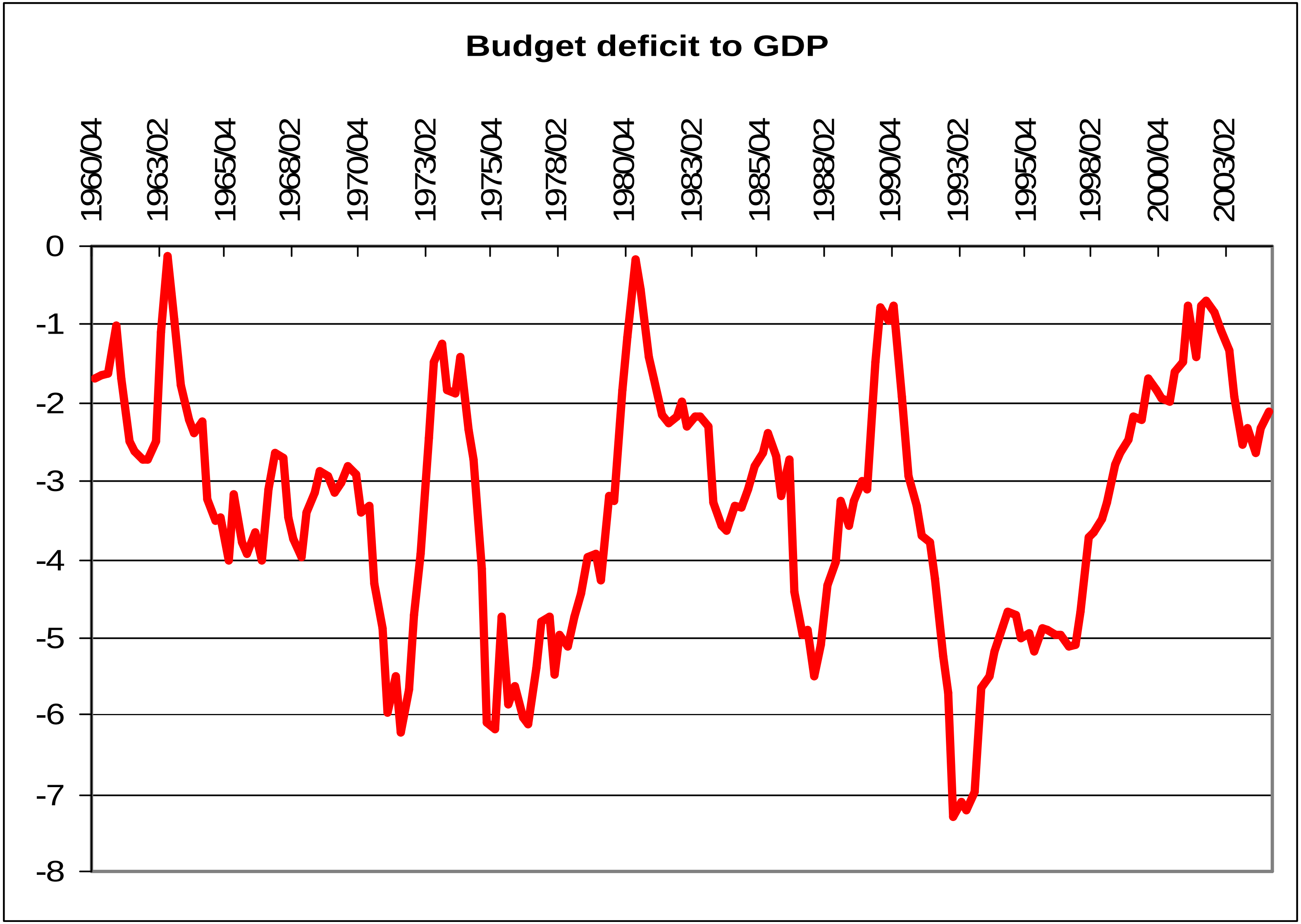
Rates on US dollar-denominated bonds in the 5 years and longer maturity rang


Purchases and sales of shares by non-residents (R mil) - semi-log scale
100000
10000
1000
100
10
1
1988/02
1989/05
1990/08
1991/11
1993/02
1994/05
1995/08
1996/11
1998/02
1999/05
2000/08
2001/11
2003/02
2004/05
Purchases of shares by non-residents on the JSE (R mil)
Sales of shares by non-residents on the JSE (R mil)

5. Financial health of the public sector

- Public debt and deficit increased significantly in the early 90s due to lower tax collection caused by collapsed economic growth
  - Public debt/GDP ratio reached 50% (Maastricht criteria: 60%)
  - Budget deficit reached an all-time high of 7.5% in 1992/3 (Maastricht criteria: 3%)
- Since 1994 the new democratic government stabilised the public debt/GDP ratio and even reduced it to below 40%
- Budget deficit since 1998 well below 3%


Government debt to GDP
60
50
40
30
20
10
0
1960/01
1962/03
1965/01
1967/03
1970/01
1972/03
1975/01
1977/03
1980/01
1982/03
1985/01
1987/03
1990/01
1992/03
1995/01
1997/03
2000/01
2002/03


Budget deficit to GDP
1960/04
1963/02
1965/04
1968/02
1970/04
1973/02
1975/04
1978/02
1980/04
1983/02
1985/04
1988/02
1990/04
1993/02
1995/04
1998/02
2000/04
2003/02
0
-1
-2
-3
-4
-5
-6
-7
-8

- In terms of size, public sector expenditure as percentage of GDP is ±27%

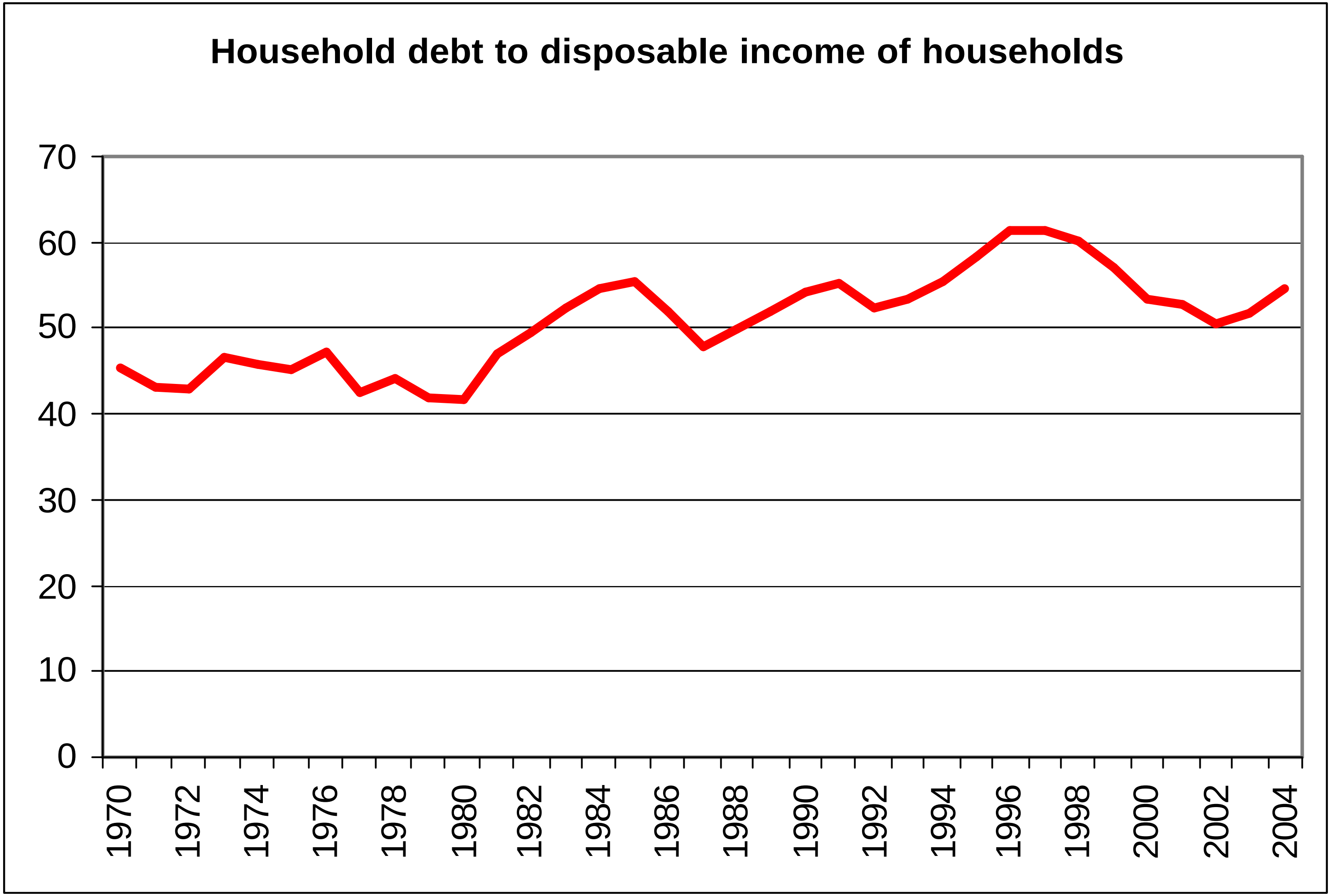
- This means SA government is much smaller than the average government in Europe or US where ratios can go up to 40%

- Trend is also *not* upward

6. Financial health of the household sector

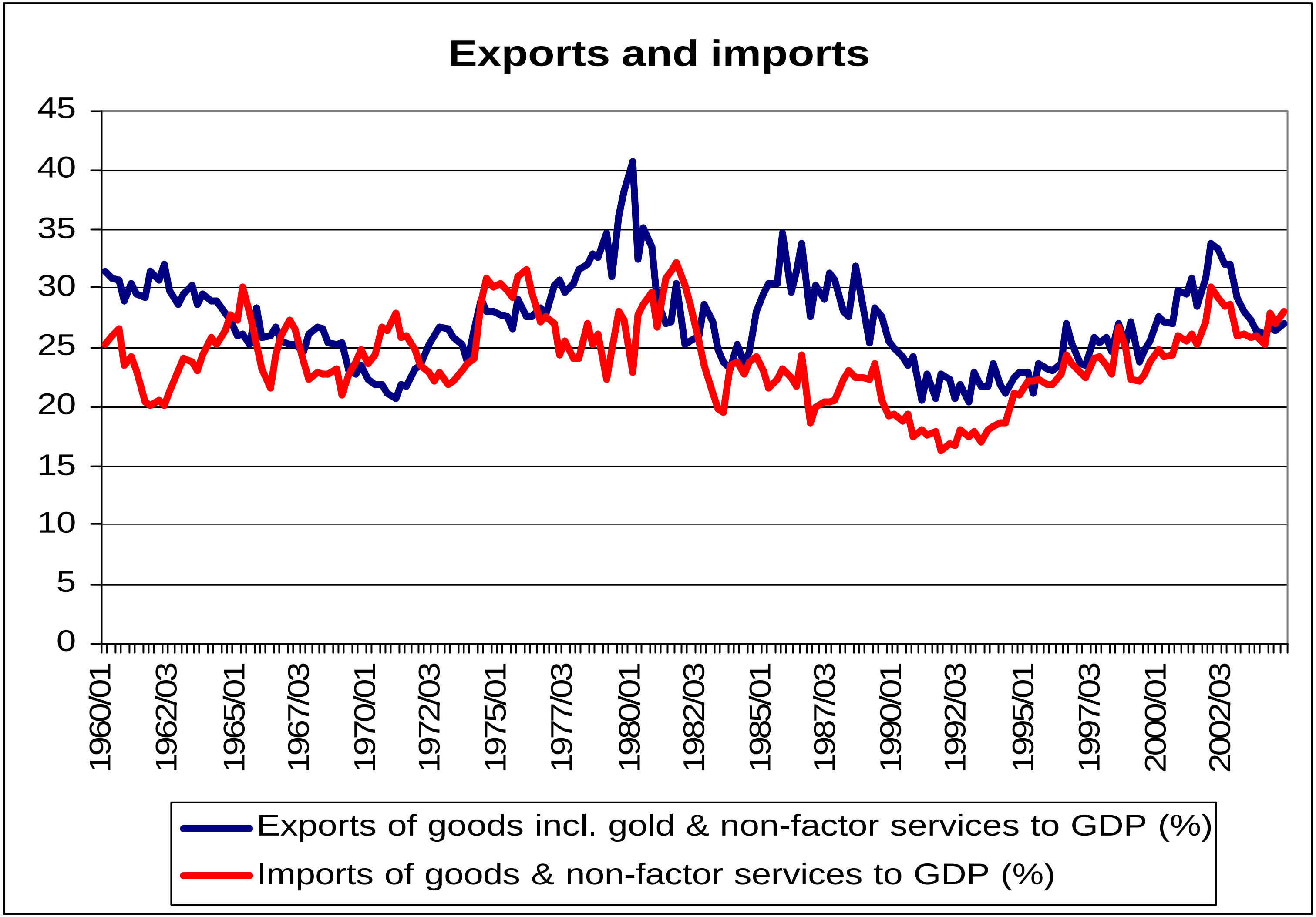
- Over the last two and a half decades household debt as percentage of Disposable Income fluctuated between 50% and 60%

- Much lower than in many developed countries where ratios double the size of the South African ratio is not uncommon

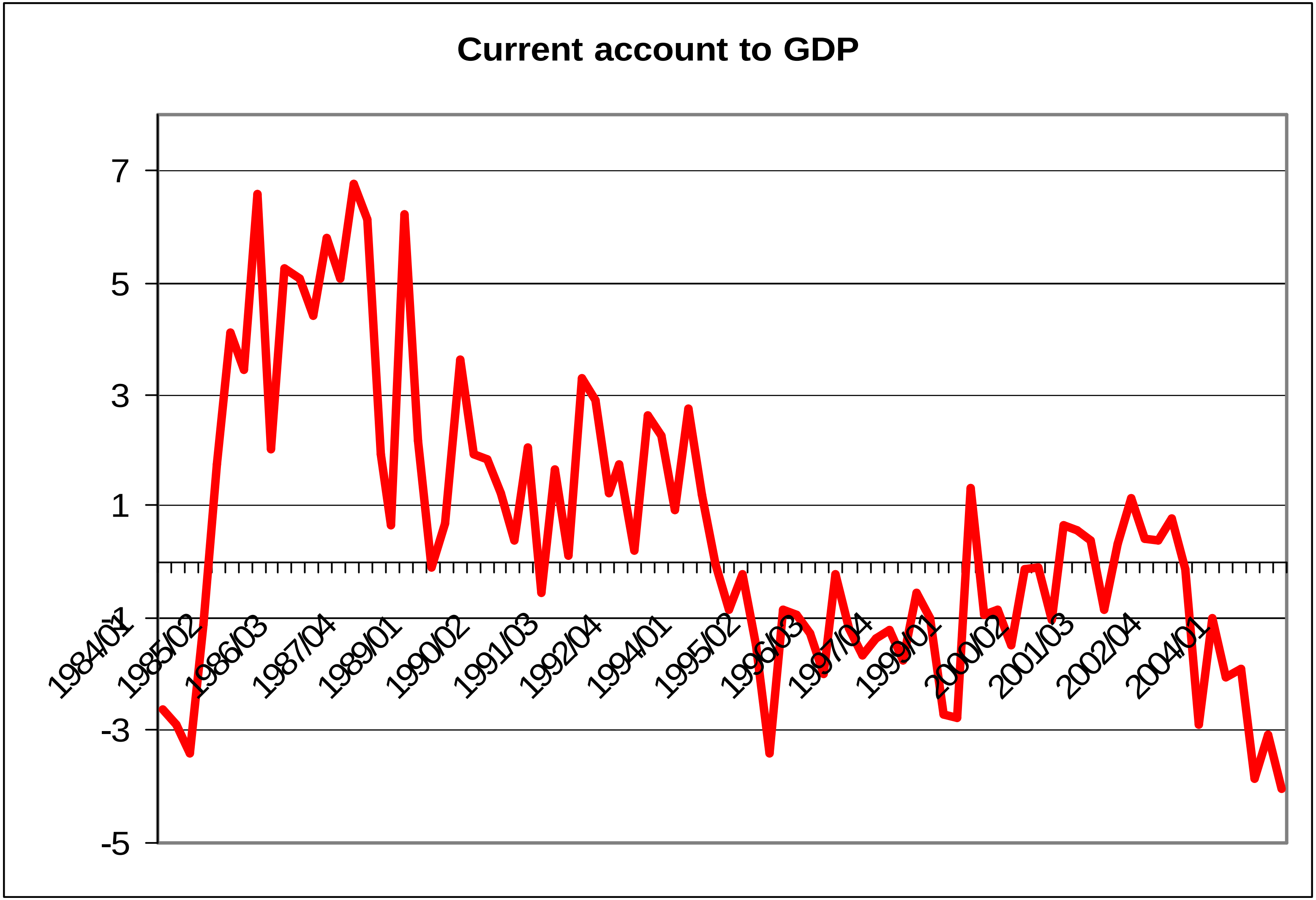

Household debt to disposable income of households
70
60
50
40
30
20
10
0
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004

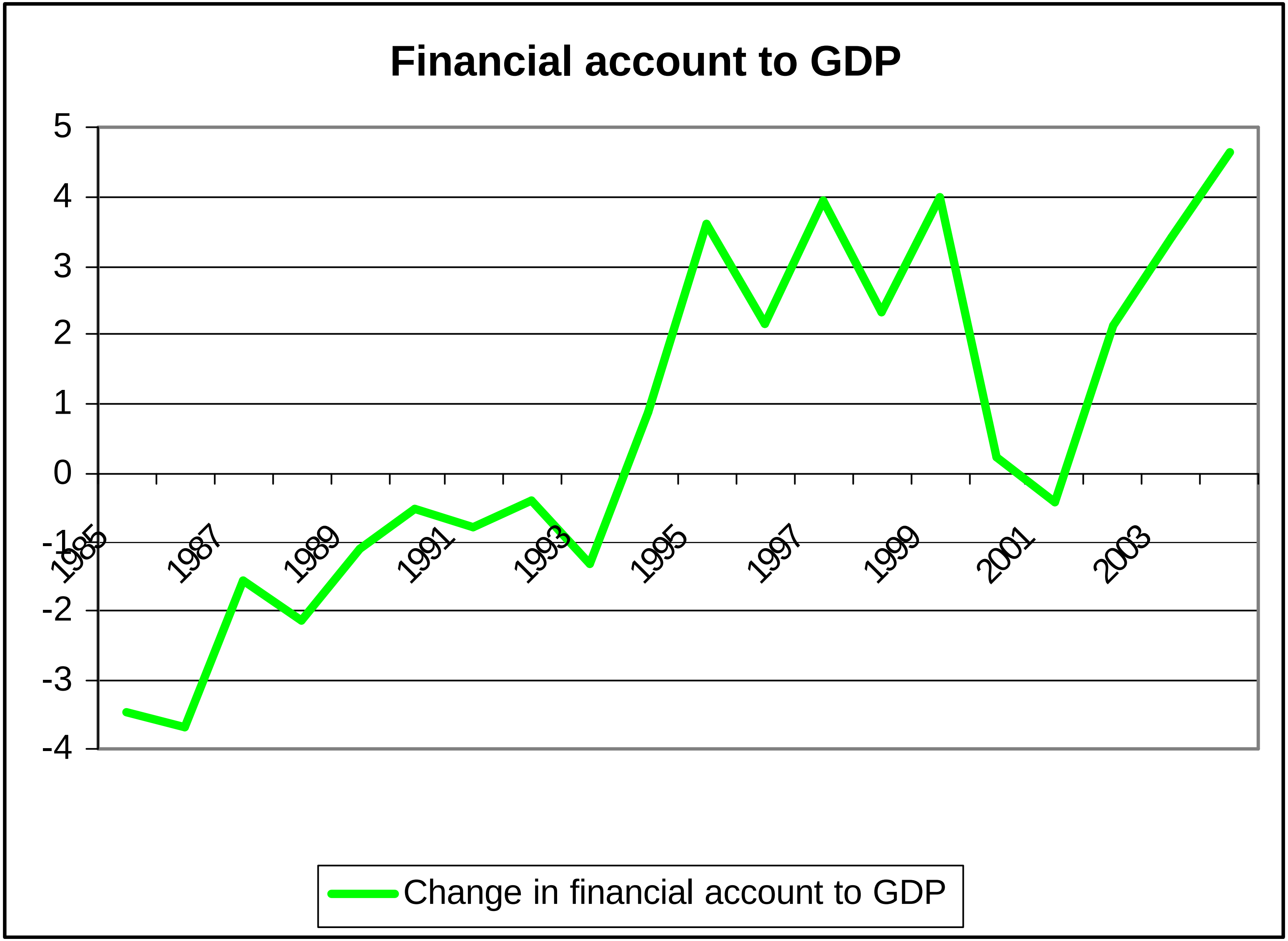
7. The BoP and the exchange rate

- Exports and imports: Each 25%-30% of GDP
- From 1985-94:
  - Capital account in deficit due to capital flight and debt standstill agreement
  - Current and trade accounts in surplus to offset deficit on capital account (done through high interest rates that suppressed imports)
- From 1994 the reverse is true:
  - Current account in deficit (currently ±4% of GDP)
  - Trade account mostly in surplus
  - Capital (now called financial) account in surplus (currently ±4.5% of GDP)
  - Financial flows portfolio, not FDI

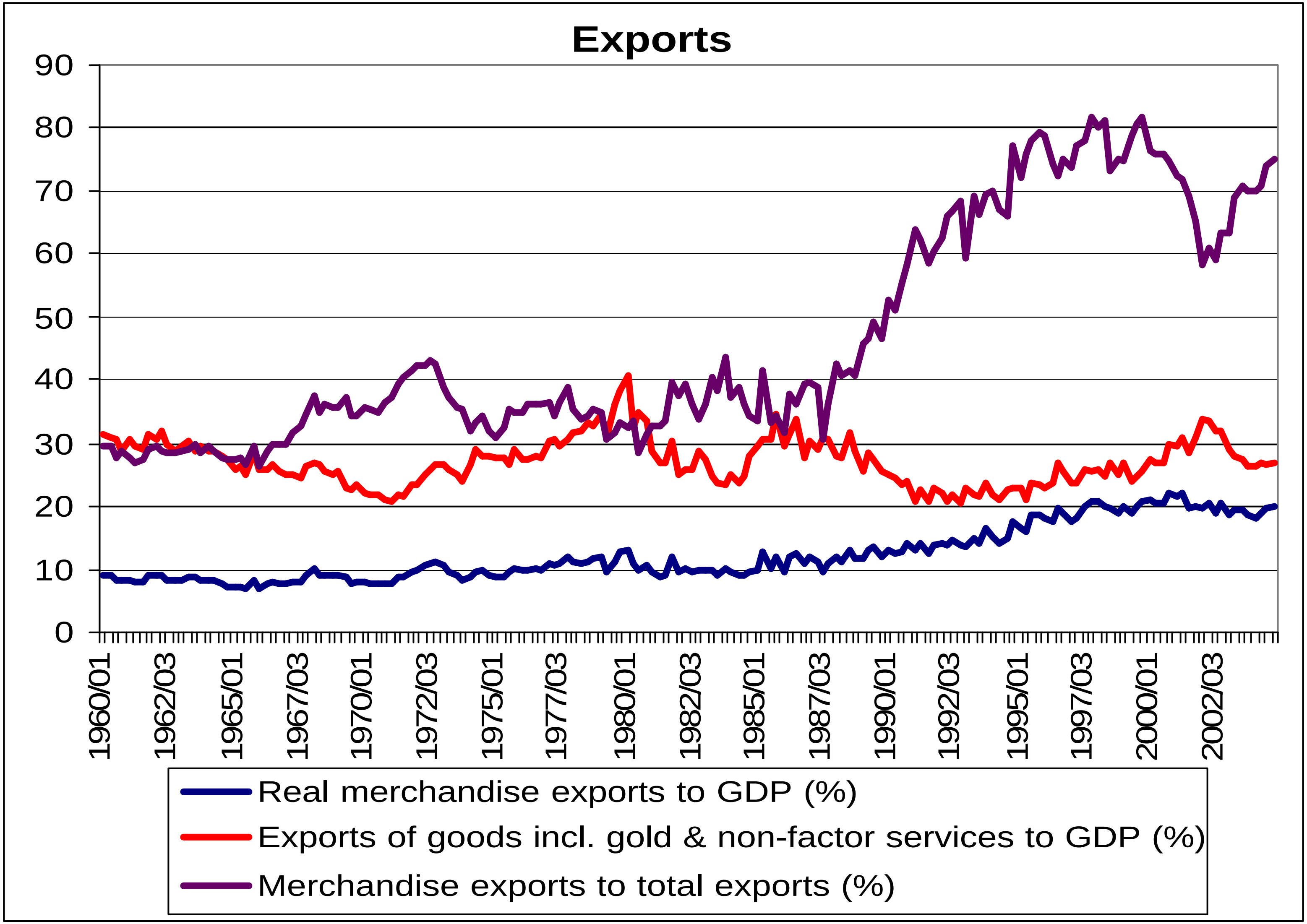


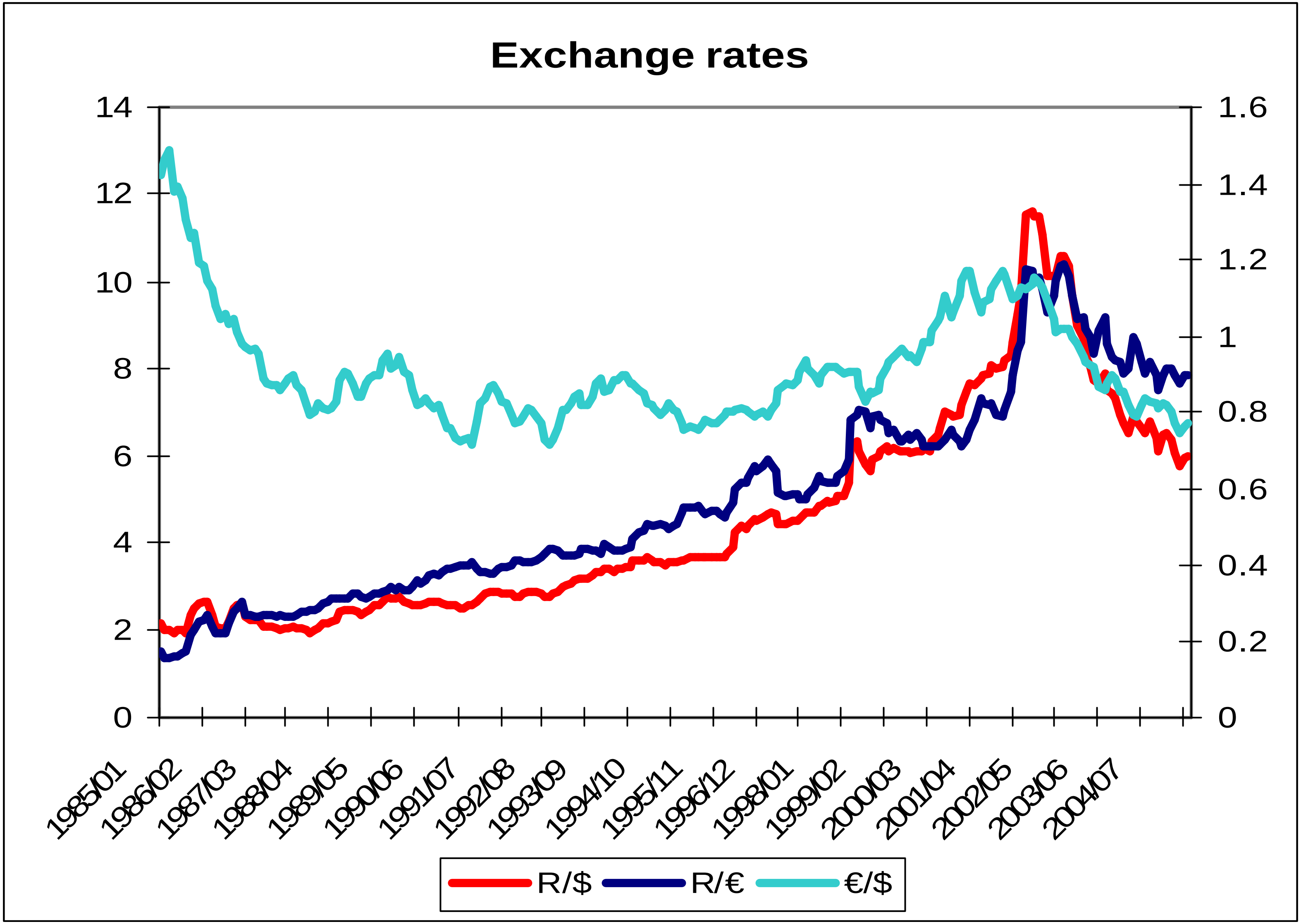
Exports and imports
45
40
35
30
25
20
15
10
5
0
1960/01
1962/03
1965/01
1967/03
1970/01
1972/03
1975/01
1977/03
1980/01
1982/03
1985/01
1987/03
1990/01
1992/03
1995/01
1997/03
2000/01
2002/03
Exports of goods incl. gold & non-factor services to GDP (%)
Imports of goods & non-factor services to GDP (%)


Current account to GDP
7
5
3
1
-1
-3
-5
1984/01
1985/02
1986/03
1987/04
1989/01
1990/02
1991/03
1992/04
1994/01
1995/02
1996/03
1997/04
1999/01
2000/02
2001/03
2002/04
2004/01

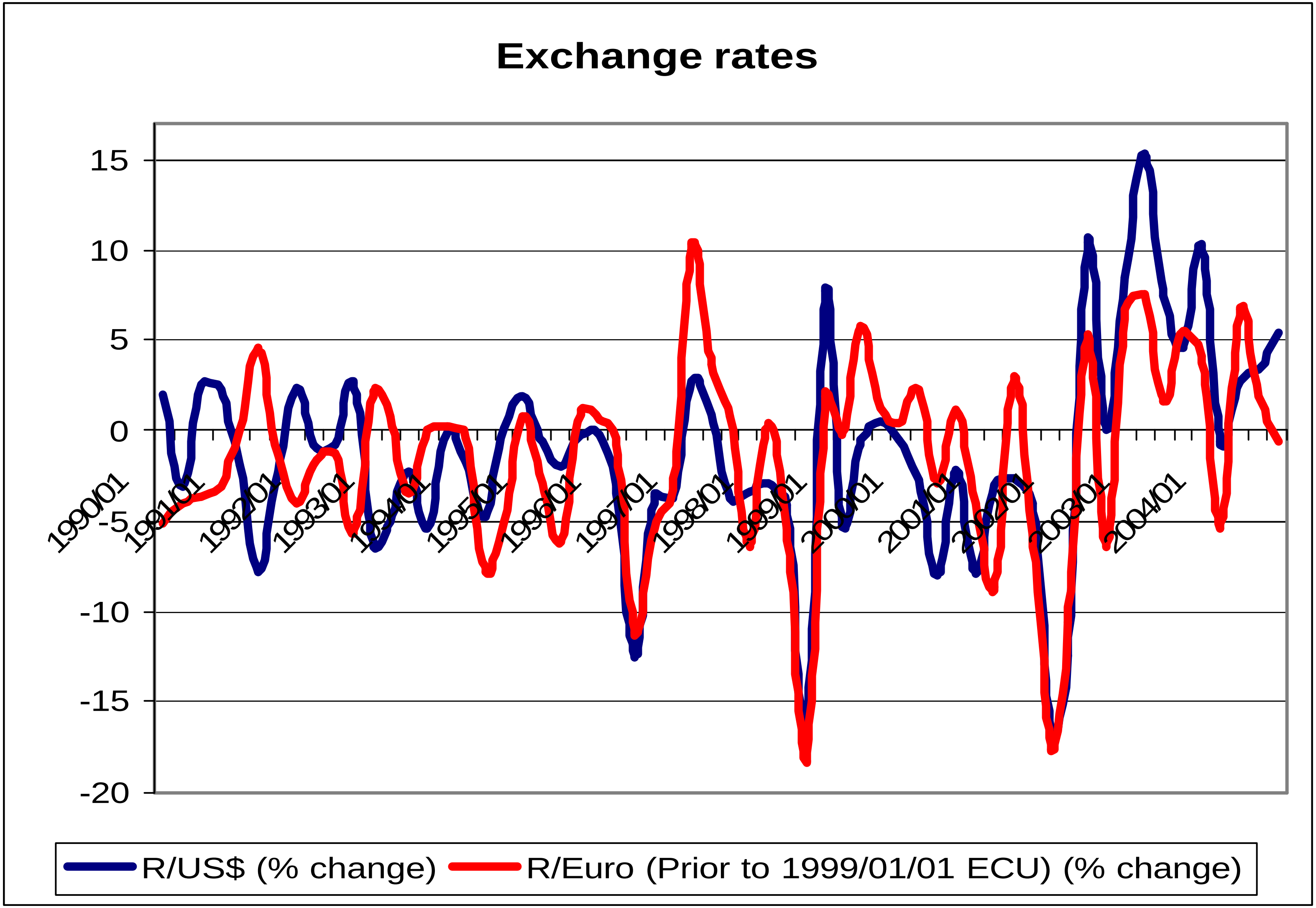

Financial account to GDP
5
4
3
2
1
0
-1
-2
-3
-4
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
Change in financial account to GDP

- Total exports to GDP stabilised at between 25% and 30%,
- Total merchandise exports as percentage of GDP increased from 10% of GDP in 1987 to 20% currently
- Ratio of merchandise exports to total exports almost 80%


Exports
90
80
70
60
50
40
30
20
10
0
1960/01
1962/03
1965/01
1967/03
1970/01
1972/03
1975/01
1977/03
1980/01
1982/03
1985/01
1987/03
1990/01
1992/03
1995/01
1997/03
2000/01
2002/03
Real merchandise exports to GDP (%)
Exports of goods incl. gold & non-factor services to GDP (%)
Merchandise exports to total exports (%)



Exchange rates
14
12
10
8
6
4
2
0
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
1985/01
1986/02
1987/03
1988/04
1989/05
1990/06
1991/07
1992/08
1993/09
1994/10
1995/11
1996/12
1998/01
1999/02
2000/03
2001/04
2002/05
2003/06
2004/07
R/$
R/€
€/$



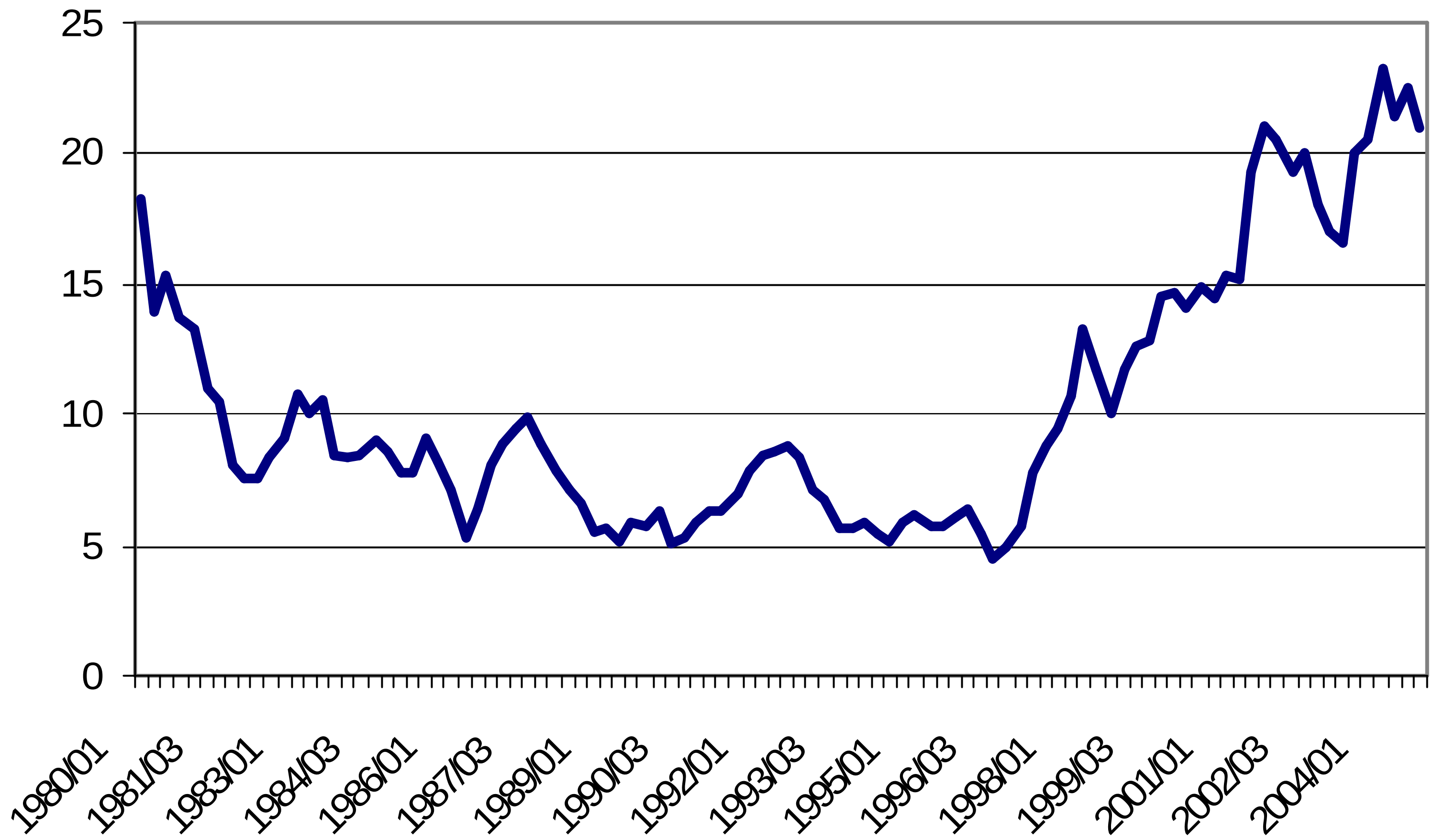
Exchange rates
15
10
5
0
-5
-10
-15
-20
1990/01
1991/01
1992/01
1993/01
1994/01
1995/01
1996/01
1997/01
1998/01
1999/01
2000/01
2001/01
2002/01
2003/01
2004/01
R/US$ (% change)
R/Euro (Prior to 1999/01/01 ECU) (% change)

- The South African Rand is an emerging market currency

- Rand volatility in the period May 1994 to February 2005 as measured by Standard deviation:
  - R/$ exchange rate: 18.3%
  - R/€ exchange rate: 16.3%

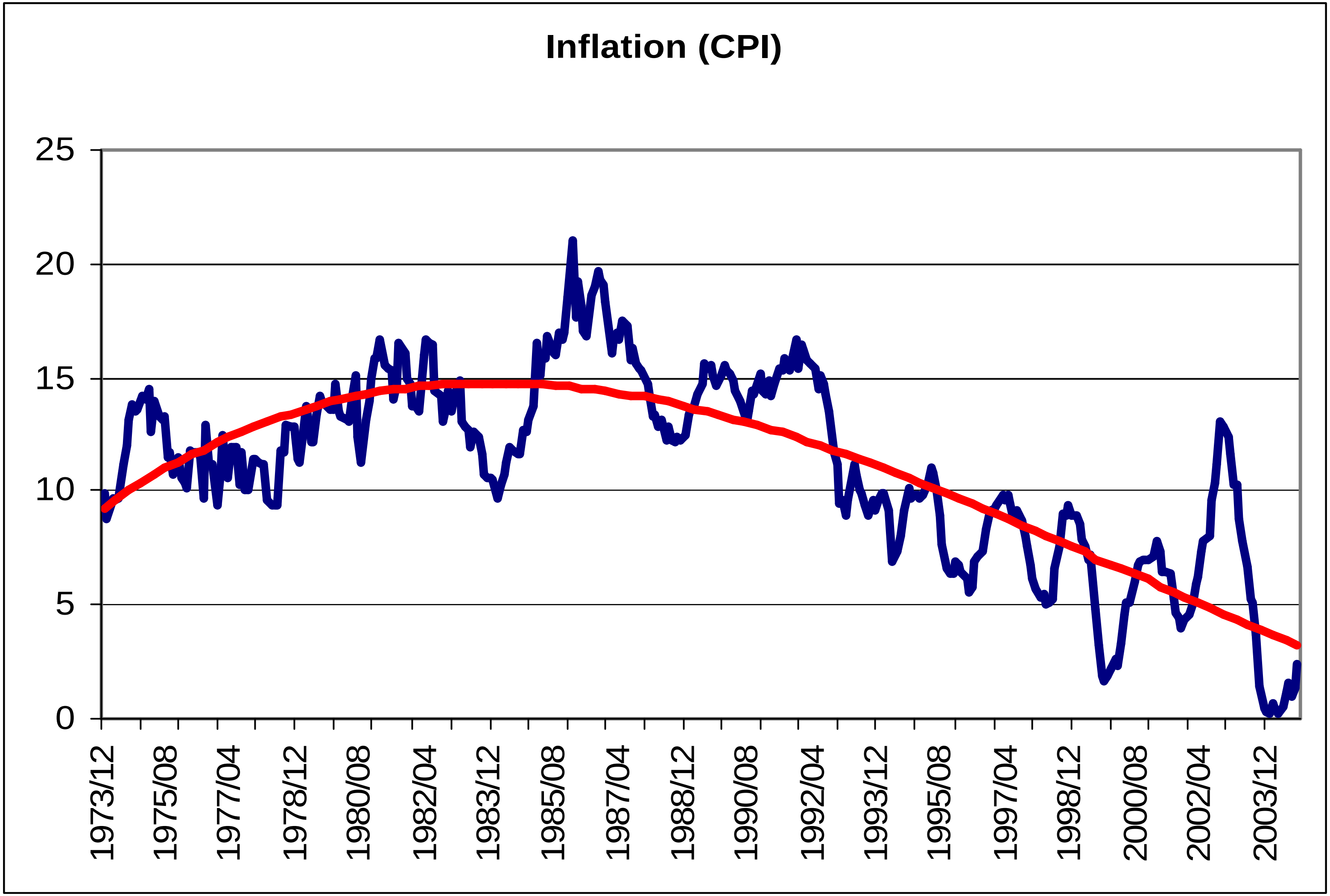
- Compare this to the volatility in the $/€ exchange rate over the same period: 10.4%

Ratio of imports covered by reserves (number of weeks)



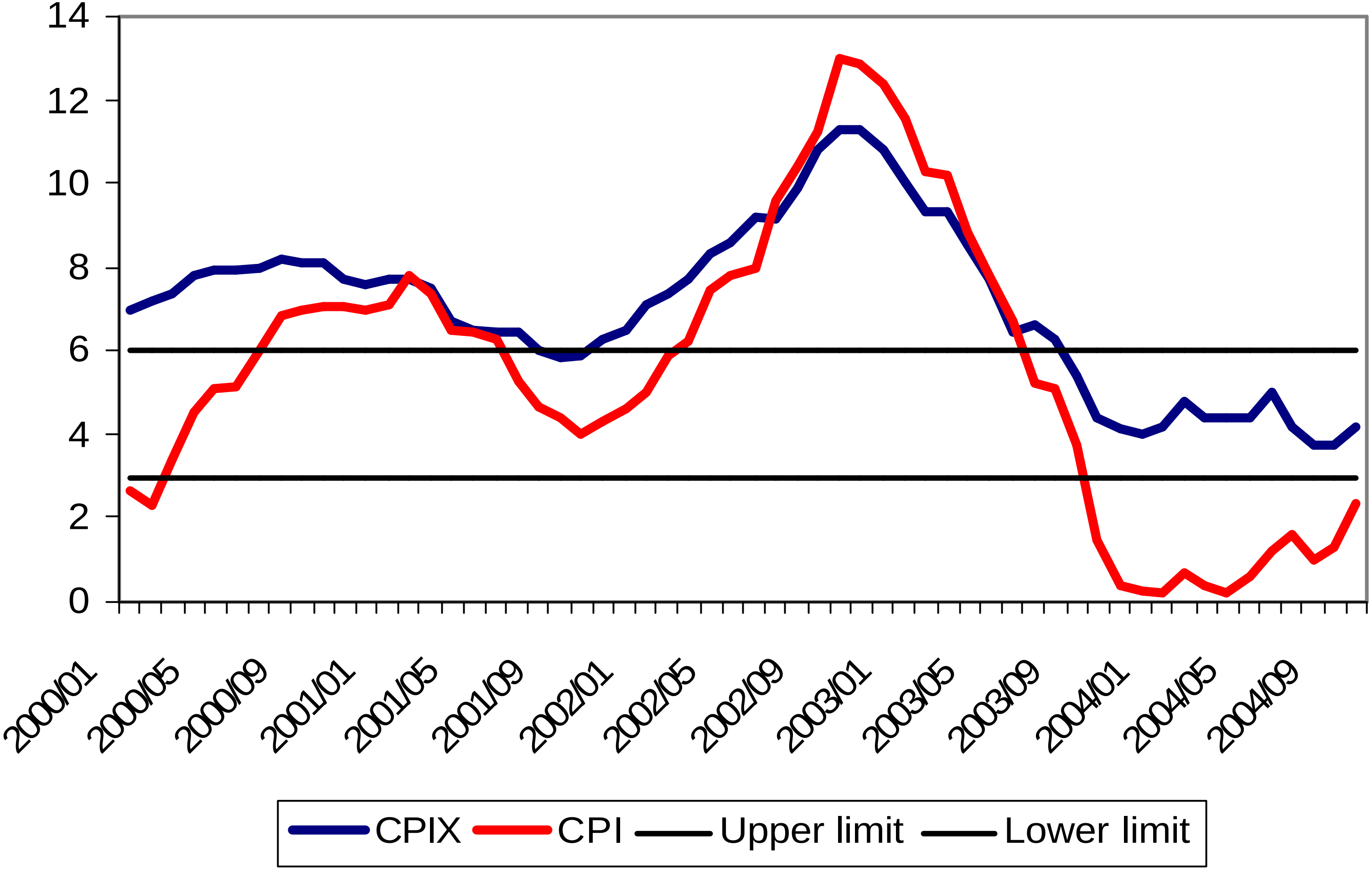
8. Inflation

- Decreased significantly in the 1990s
- Strong anti-inflationary policy
- Inflation targeting since 2000
- Inflation targets: 3% - 6%
- Stabilised inflation within target range



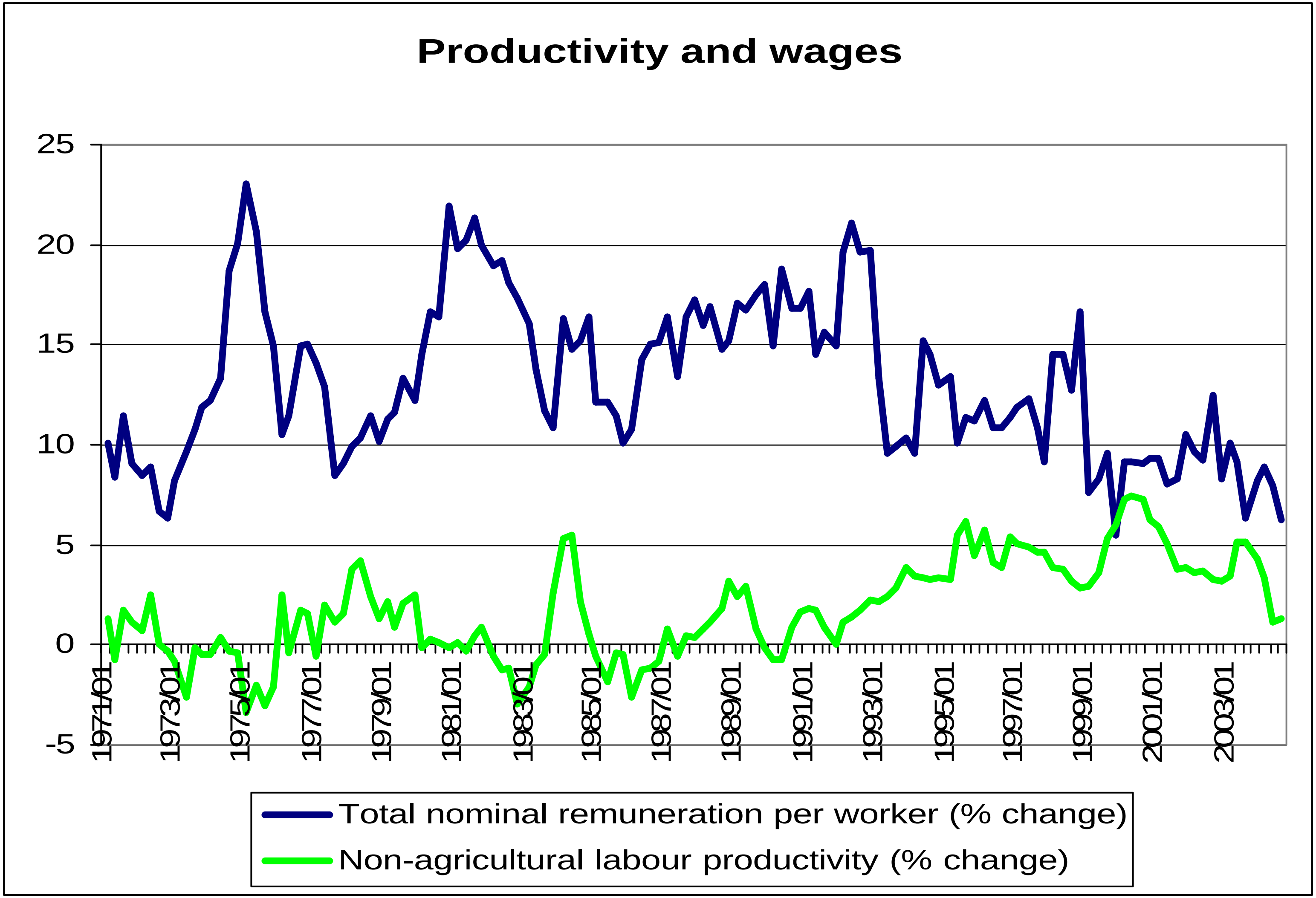
Inflation (CPI)
25
20
15
10
5
0
1973/12
1975/08
1977/04
1978/12
1980/08
1982/04
1983/12
1985/08
1987/04
1988/12
1990/08
1992/04
1993/12
1995/08
1997/04
1998/12
2000/08
2002/04
2003/12

CPI and CPIX inflation

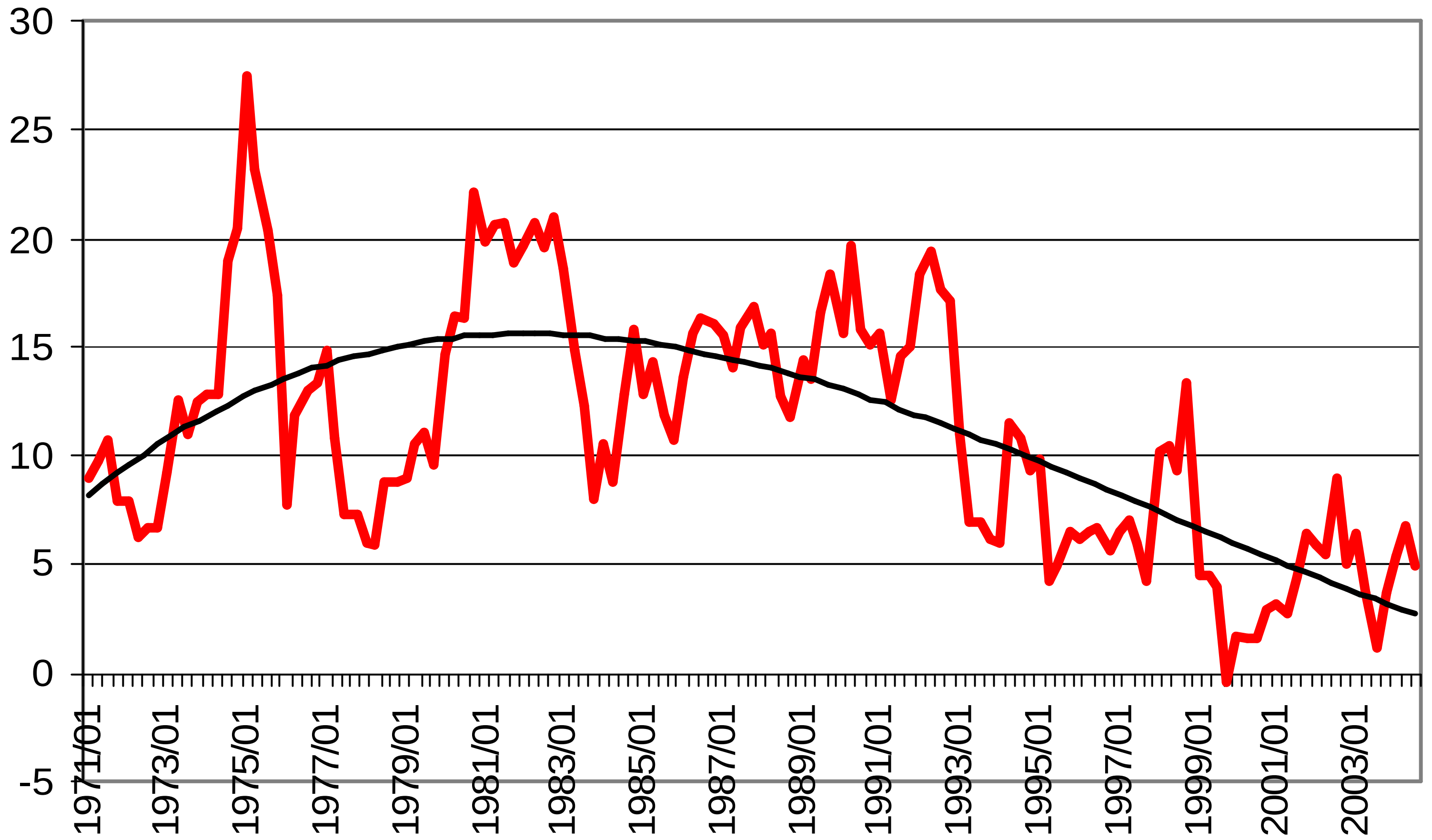


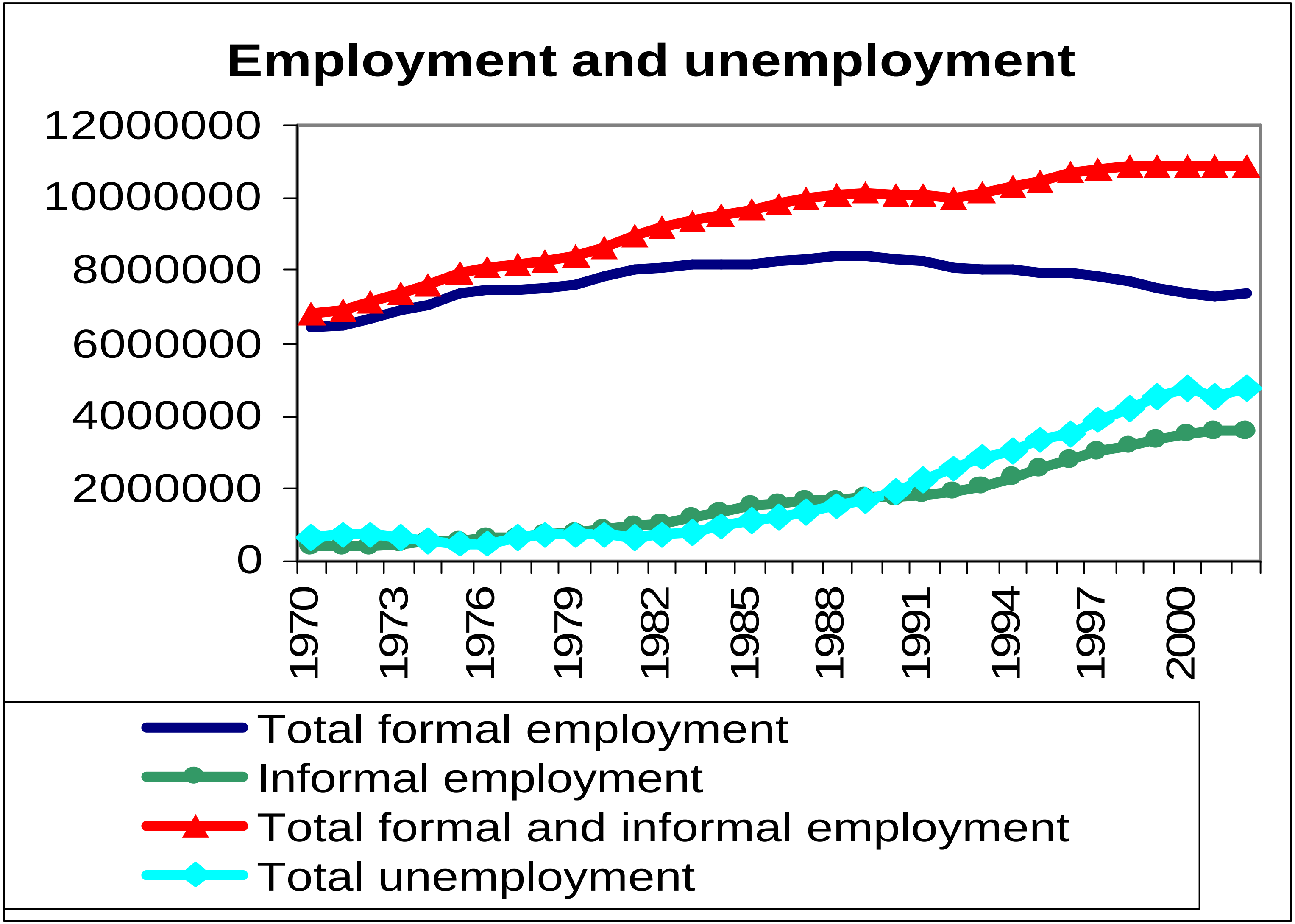
9. Labour, wages and productivity

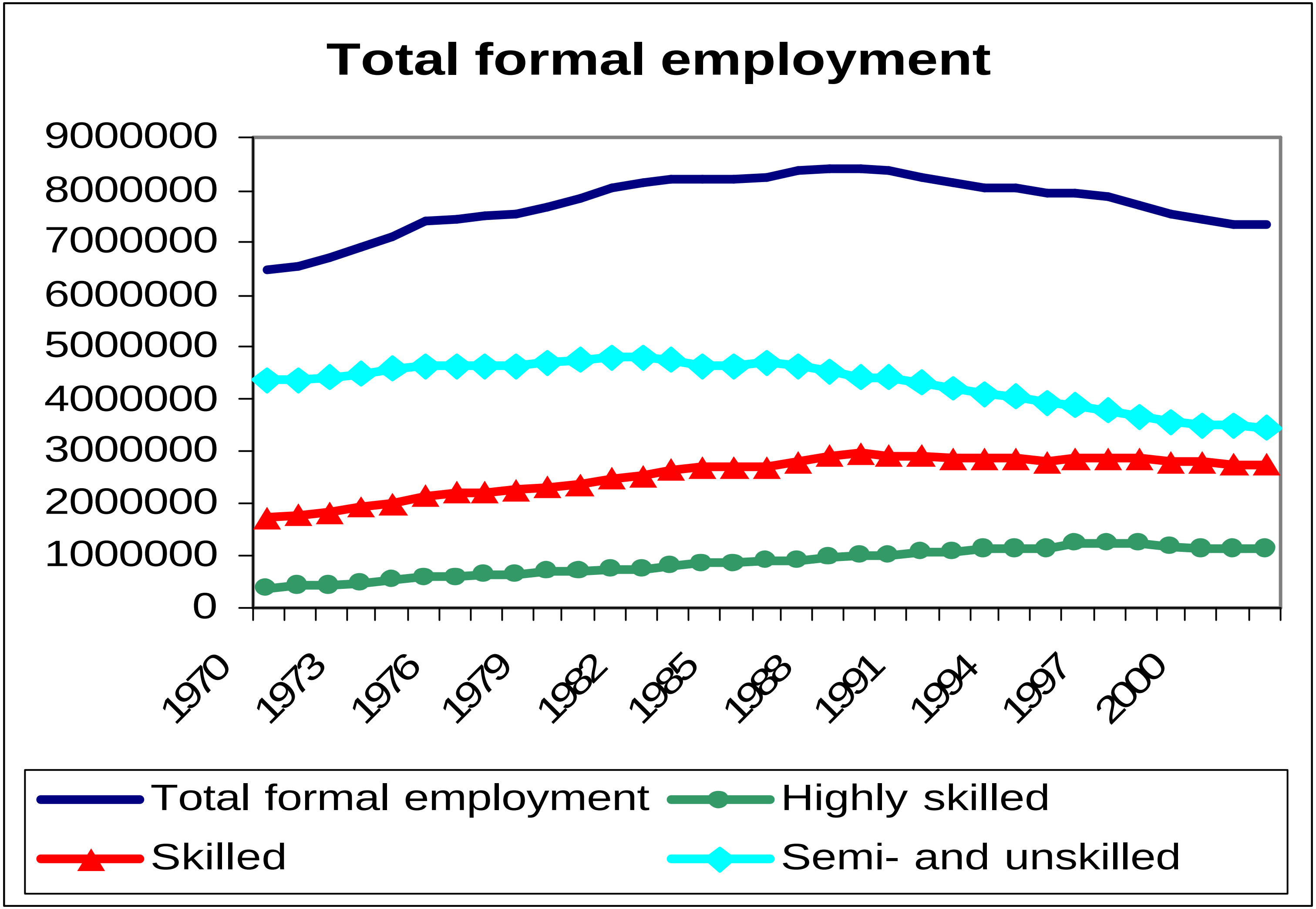
- Annual increase in nominal remuneration per worker contained at between 5% and 10%
- Rate at which labour productivity increases much higher from the early 1990s (between 2% and 8%)
- Average annual increase in unit labour cost displays decreasing trend; currently ± 5%

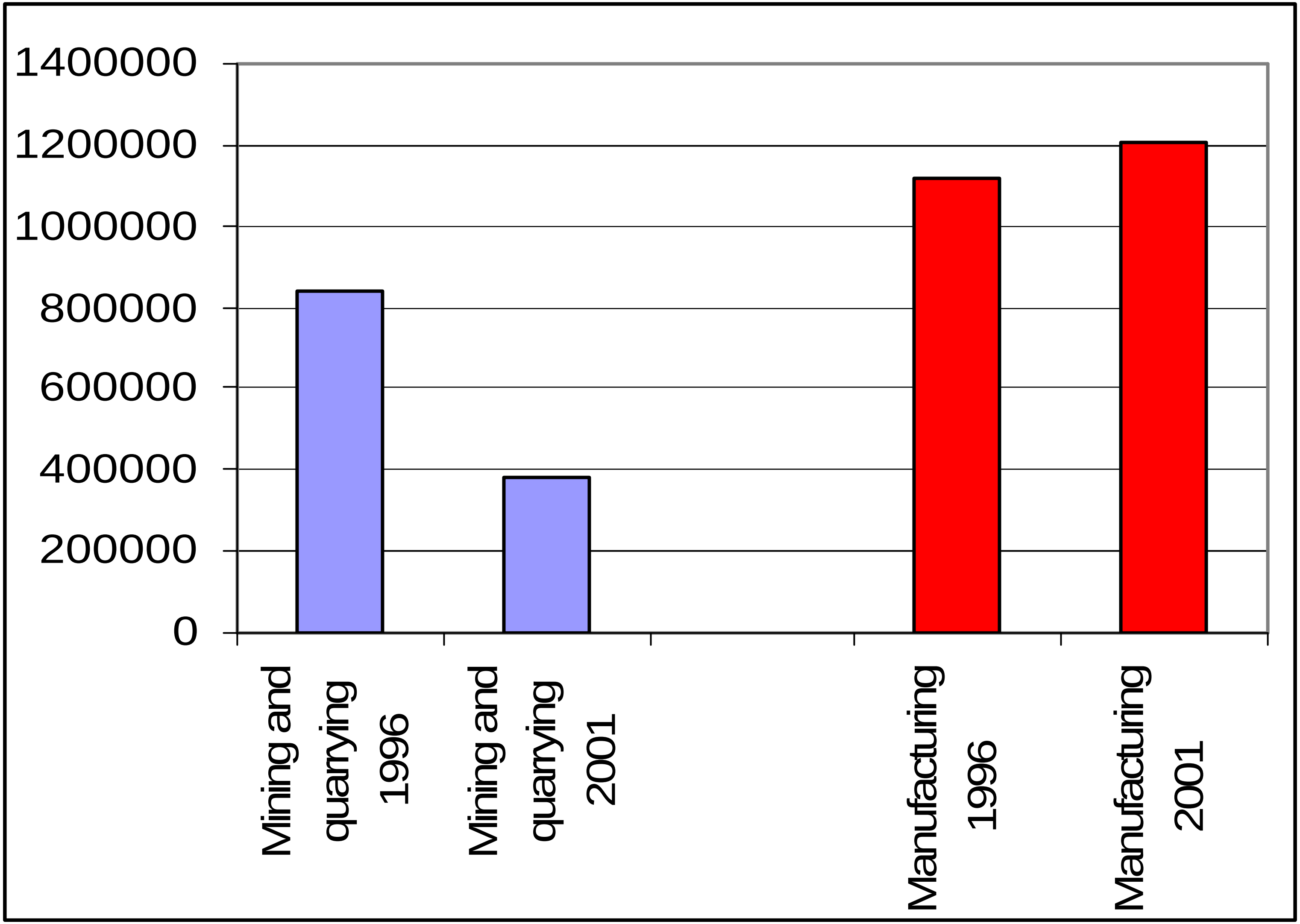

Productivity and wages
25
20
15
10
5
0
-5
1971/01
1973/01
1975/01
1977/01
1979/01
1981/01
1983/01
1985/01
1987/01
1989/01
1991/01
1993/01
1995/01
1997/01
1999/01
2001/01
2003/01
Total nominal remuneration per worker (% change)
Non-agricultural labour productivity (% change)

Unit labour cost in the non-agricultural sectors (% change)




Employment and unemployment
12000000
10000000
8000000
6000000
4000000
2000000
0
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
Total formal employment
Informal employment
Total formal and informal employment
Total unemployment

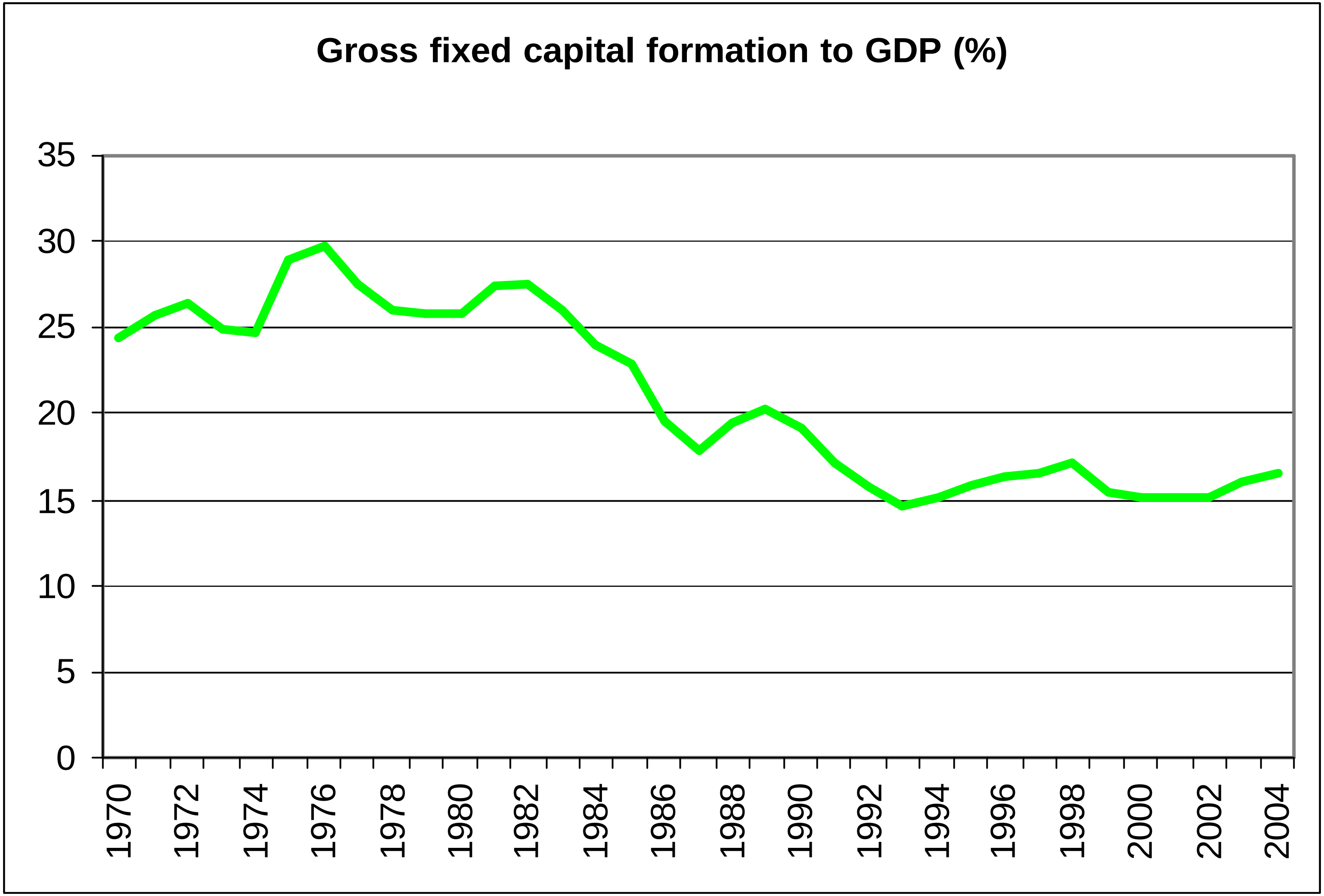

Total formal employment
9000000
8000000
7000000
6000000
5000000
4000000
3000000
2000000
1000000
0
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
Total formal employment
Highly skilled
Skilled
Semi- and unskilled



1400000
1200000
1000000
800000
600000
400000
200000
0
Mining and quarrying 1996
Mining and quarrying 2001
Manufacturing 1996
Manufacturing 2001

10. Investment and the cost of capital

- Gross Fixed capital formation: 17% of GDP
- Estimated that we might need ± 25% of GDP to generate growth of 6% to 7% of GDP
- Government stepping up efforts to increase public sector investment over next 5 years
- ESCOM: R95 billion (€11,9 billion)
  - Rehabilitating 3 power stations
- TRANSNET: R40.8 billion (€5.1 billion)
  - Expansion and overhaul of Durban and Cape Town harbours
  - Multi-purpose pipeline (Durban-Gauteng)


Gross fixed capital formation to GDP (%)
0
5
10
15
20
25
30
35
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004

- Cost of capital:
- Long term interest rates at ± 8%
- Real rates more sensitive to changes in inflation compared to nominal rates
- Real rates negatively correlated with inflation (limited Fisher-effect)

Conclusion

- Challenges:
  - Skills shortage driving unemployment
  - Currency is volatile (emerging market currency)
  - Need more FDI as well as domestic investment (from 17% up to 25%)
  - Need to improve productivity further (need transfer of technology by foreign investors)

- Optimism about the future based on:
  - Political system stable and democratic for over a decade
  - Do not tolerate corruption
  - Growth improving
  - Returns on investment in SA improves
  - Risk improving (cf. Sovereign credit ratings)
  - Thus, risk-return trade-off improves
  - Public and household finances in order
  - Inflation under control
  - Foreign investors do invest
  - Infrastructure investment by government stepped up
- Hence, I do believe that SA offers a good investment and business option for foreign investors and foreign import and export companies