

Nedbank

Guide to the Economy

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The electricity crisis has raised doubts over the economy's ability to grow at potential over the medium term. This article examines the potential damage caused by the lack of sufficient electricity supply and the chances of reducing any such effects.

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Facts and forecasts

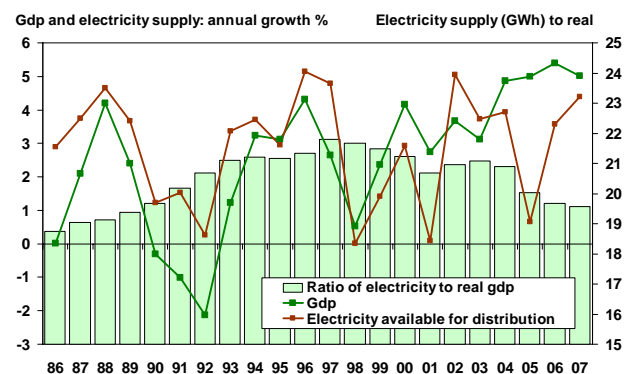
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THE ENERGY CONSTRAINT

The possibility of an energy constraint on economic growth emerging has been well documented for at least a decade, when a government White Paper famously noted that supply problems would emerge in 2007 unless new capacity was brought on stream. A policy hiatus has left capacity at much the same levels as it was in the late 1990s so there should therefore be little surprise that shortages have surfaced. However, the extent and timing of the problem that unfolded in January was unexpected. This article examines whether the constraint on available electricity supply will reduce South Africa's medium-term economic growth potential materially.

Graph 1: Gdp growth and electricity supply



The sudden collapse of electricity provision in the first few weeks of 2008 has cramped both the immediate economic growth outlook as well as the country's medium-term growth potential. From 10 January phased blackouts ('load shedding') initially inconvenienced consumers and small businesses, before escalating to enforced temporary shutdowns in key mining operations. The immediate cause of the crisis was a poorly maintained power-generating infrastructure working at close to full capacity, with uncharacteristically wet weather as well as coal supply and quality difficulties bringing problems to a head and culminating in massive breakdowns ('unscheduled maintenance'). By 25 January these had resulted in over 5 000 MW or around 13% of the total theoretical capacity



of 39 000 MW being lost. However, with planned maintenance this figure increased to around 8 700 MW or 22% of capacity. Against estimated demand of around 32 300 MW, this meant a shortfall of 2 000 MW or more and that something drastic had to be done.

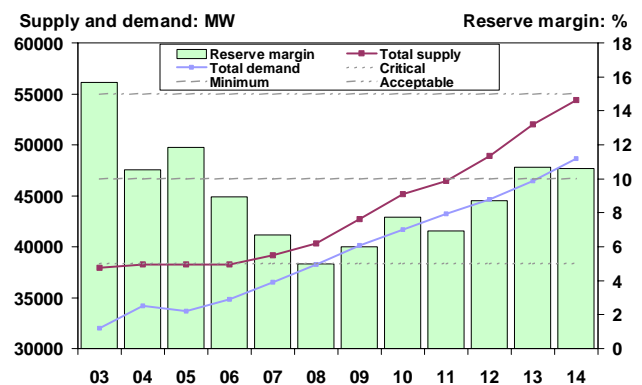
The energy-intensive components of the mining sector were initially informed that electricity could not be guaranteed – for around a month – while electricity capacity was being restored to more normal levels. For safety reasons, this implied a complete shutdown of this important industry. Had this situation persisted, it would have proved extremely expensive for the sector as well as the economy. Mining accounts for around 7% of gdp directly and gold and platinum mining for about 50% of mining. Adding other energy-intensive mining operations pushes the proportion to at least 60%. This meant that in one month more than 0,4% of gdp and R13 billion worth of export revenue would have been lost directly. Of course, the indirect effects would have been significant, but harder to quantify. Many companies exist as suppliers to the mining industry and would have had to cut back or adapt. Wages and jobs would also have been under threat and negative sentiment would have led to further cutbacks in consumer spending.

Mines were then told that they could resume operations at 90% of their previous electricity usage. Government also announced rationing for other users, with cutbacks ranging from 5%, for agriculture, to 20% (for hotels, resorts, retail and conference centres). Industry and residences are to reduce usage by 10% and commercial, large offices, government and municipalities by 15%. These short-term emergency rationing measures at the time of writing are scheduled to last for two months while unscheduled and scheduled maintenance is completed ahead of the peak winter season. Peak demand during this period will rise by over 18% of current levels, implying that the reserve margin (the difference between the supply and demand at peak demand periods) will fall to below 5%, leaving no room for any error or maintenance at all. This margin compares with internationally accepted norms of around 15% and a more acceptable 20% for South Africa, given the age of the equipment and its state of repair. This implies that, unless full capacity is restored by winter, the country will suffer significant problems.

Beyond these very short-term emergency measures, government's main focus has been on demand-side management (DSM) or energy saving. These include some interesting measures such as the planned subsidisation of one million solar-powered geysers over three years, the replacement of incandescent light bulbs with compact fluorescent ones, smart metering and remote control of electricity usage at peak periods, increased usage of liquid petroleum gas for cooking and other uses and changing building regulations to ensure energy-saving technologies are used in new buildings.

The gaping hole in the plans so far is the lack of urgency or creativity on the supply side of the equation. Eskom has warned that its first new base load capacity will be ready only in 2012. Before that, some demothballing of old power stations, some expansion of gas turbine generation and limited planned co-generation will add modest amounts of capacity. This leaves the economy very vulnerable to the success of the demand management programme. Simply put, electricity consumption has to be restricted over at least the next three to five years. Unless energy can be rationed in a way that does not cramp growth or additional electricity can be sourced, economic growth will be constrained.

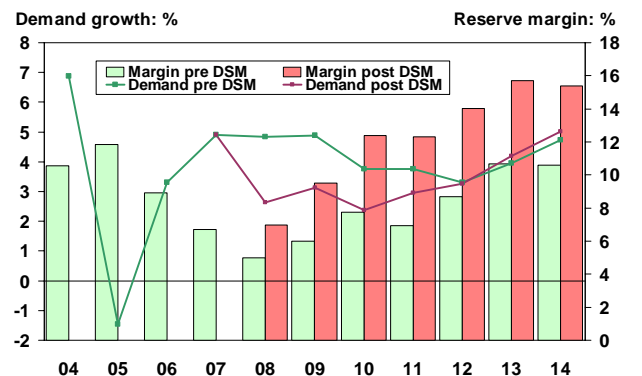
Graph 2: Projected electricity supply and demand



Graph 2 illustrates the effect of the supply crunch. Optimistically, supply will grow at around 5% per annum over the next three years (in the absence of any additional interventions) and growth in demand of just under 4,5% in response to economic growth of over 5% was anticipated. On the face of it, this appears manageable, but it implies that the reserve margin would have to stay at dangerously low levels of well below 10% over not only the short term, but even to 2012. This would probably result in continued unscheduled interruptions with damaging economic consequences and is therefore not a feasible option.

Government's plan focuses on reduced consumption

Graph 3: Effect of demand side management on the margin



The current plan is therefore to restrict demand so that the reserve margin can be restored to more acceptable levels. Graph 3 shows projected usage and the consequent margin before and after demand side management proposals are implemented. In the short term, growth in electricity consumption is restricted to around 2,7% compared with Eskom's pre-crisis demand estimates of closer to 5%. Over the three-year period consumption is held around 3%, again well below the 4% or so that might have occurred in an unrestricted environment. Even so, a reserve margin of over 10% is only restored in 2010.

The damage to the economy is potentially large

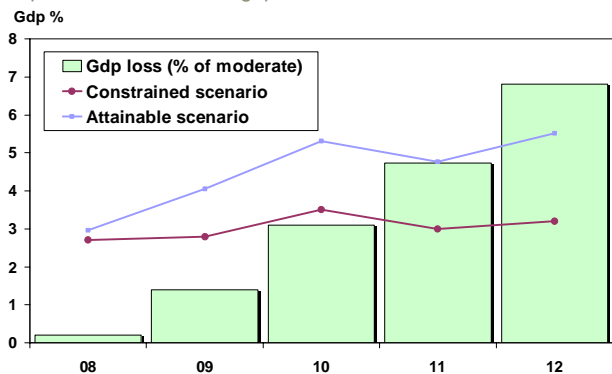
How damaging will this be for the economy? Simplistically, if economic growth of 5% leads to energy demand rising by 4%, it may imply that restricting electricity supply to 2,7% would constrain economic growth to under 3,5%. However, the relationship is more complicated, with the effects potentially being a lot more devastating or, alternatively, significantly less so. The damage caused in the short term by rationing is a relatively straightforward calculation of lost production and sales over the period. However, the longer-term effects depend crucially on confidence and, related to this, how the government manages the demand side management programme and the provision of new power generation. If confidence is restored quickly – not by rhetoric, but by concrete action – the damage to much-needed capital formation will be limited, essential foreign capital inflows will resume and negative indirect effects on the rand and interest rates will be contained.

Graph 4 illustrates the *potential* longer-term impact of an inadequate response. The first scenario (the attainable scenario) gives our current estimates of gdp growth over the next five years, taking into account the electricity constraint, but also the less favourable global environment over the next two years and the anticipated slowdown in consumer spending due to the current high interest rate environment in the short term. In the second – the constrained scenario – these factors are also taken into account, but the electricity constraint is magnified by an inadequate or inappropriate response, reducing capital formation to just above replacement rates rather than allowing for additional capacity to be installed.

The initial losses in both scenarios are similar as they both assume some short-term damage resulting from rationing. However, the gap then begins to open on rising efficiency losses emanating from a misallocation of resources and insufficient capacity in key sectors. By 2012 the gap between potential gdp and the constrained outcome is a huge 6,8% or R166 billion in today's rands. The cumulative loss in gdp over the period is R377 billion, more than Eskom's expansion programme. On current elasticities, the government would lose around R100 billion in taxation revenue in the five-year period

alone. All these losses would be compounded beyond this period because of the permanently lower base.

Graph 4: Potential loss of gdp due to the crisis



Properly targeted demand management crucial

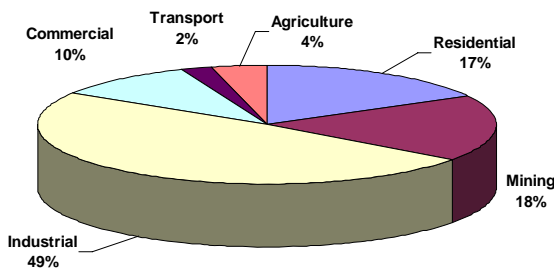
Clearly such losses are unacceptable. What separates the two scenarios? In the first, cutbacks on the demand side have to be targeted at areas where there has been unnecessary waste (possibly due to careless consumption resulting from the low electricity price) and therefore where interventions will not reduce the economy's productive capacity. As much of mining and industry have already been on energy efficiency programmes over the past few years, it is probable that forced reductions from current levels in these areas will have direct, negative and possibly non-linear effects. As recently seen, a reduction of 30% electricity provided to mining forced a total shutdown of production. The current 10% reduction will probably reduce output by considerably more than 10% as some 50% to 70% of energy consumed in deep mining is just for cooling and pumping. The remaining 50% is used for extraction, implying that a 10% overall cut in electricity is effectively a 20% cut on the production side.

In contrast, it is probable that households could make significant savings through relatively small behavioural adjustments rather than through any draconian measures. For example, according to Eskom, some 30% to 50% of a typical household's electricity usage is on hot water geysers and, of this, savings of up to 50% can be made by improving insulation and adjusting the thermostat. Widespread use of gas and solar heating could take this proportion up significantly (to over 70%). With other, more modest savings on household appliance use the overall savings from this category of user could climb to 30%. As households make up over 17% of electricity consumption, it is quite possible that 5% – or half – of needed savings could come from this source. However, this is unlikely to happen just through appeals. A system of incentives and penalties (for peak-hour usage) needs to be set up quickly and implemented.

In summary, proper cost benefit analysis needs to be carried out to assess the impact of various demand side

measures on the economy. It is quite possible that, done intelligently, the demand reductions could result in limited damage to growth and have the added advantage of increasing awareness of the environmental damage of wasteful consumption in the longer term. For a country that is 12th on the UN's top-30 list of carbon dioxide emitters – coming ahead of much larger economies such as France, Brazil and Spain – this would be a welcome development.

Graph 5: Share of electricity consumption



Supply side needs urgent private sector participation

The second distinguishing area between the two scenarios is on the supply side. This will be more important than the demand side in the medium term. Here the underlying problem has for a long time been a regulatory and legislative one. In the attainable scenario, the private sector is incentivised and encouraged to become a major part of the supply solution. At present the single-purchaser model is hampering this, where Eskom, the state monopoly and controller of the transmission grid, has to agree to price and long-term purchasing agreements with competitors. Eskom has been reluctant to sign deals that may raise its average long-term cost of energy even though the opportunity cost to the economy of not doing so is enormous and permanent as illustrated in graph 4. As a result co-generation deals and alternative base load supplies that could have averted the current difficulties have been delayed.

In the medium to longer term the government needs to re-examine the structure of the energy sector to encourage more efficient providers to enter the market. Massive cost overruns and delays in the state sector need to be examined critically and a new, predictable and fair regulatory regime has to be instated to avoid the mistakes of the past. In the short term the state has to move swiftly to ensure that Eskom's management is incentivised to ensure energy security, rather than incentivised to make financial targets. This may also entail temporarily using more diesel-powered gas turbines to alleviate short-term peak pressures despite their expense at a company level (around 33 times more than coal-generated power).

It is also likely that significant savings could be made through better maintenance of the transmission and distribution networks. Deterioration in this infrastructure could again be related to mixed goals and improper incentivisation of management.

The good news is that, if the government makes the necessary changes to allow the private sector to compete fairly in the provision of electricity, quicker and more creative solutions are likely to be found and the constraint on medium-term growth will be lifted.

Conclusion

The electricity crisis comes at an awkward time for an economy already burdened by higher interest rates and a slowing international economy. The potential impact extends well beyond the effect of a simple constraint on a vital input. It could damage consumer, business and foreign investor confidence, with deeper implications for potential gdp growth, the rand and interest rates. Fortunately, relatively small, but quick, interventions to influence the behaviour of all affected parties can make a massive difference to pushing the economy back onto a more favourable growth path.

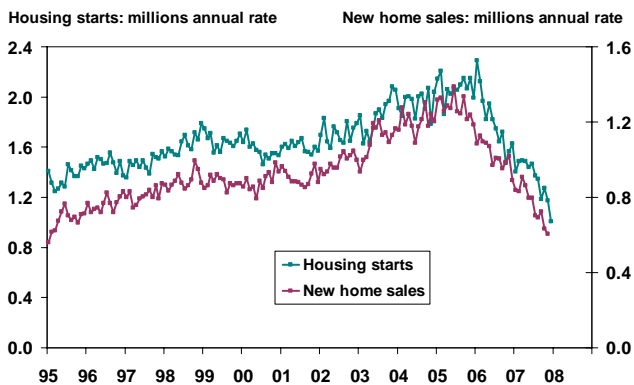
Dennis Dykes

Economic Review and Forecast

International background

Global growth is likely to moderate further during 2008. The risks that the slowdown could be worse than initially expected have increased, with recent data releases suggesting a further deterioration in major countries. Among the risks are concerns that the repercussions of August's financial turmoil will take longer to dissipate than expected. Risk premiums remain high and the slightest bad news has sent stock markets tumbling. Concerns that inflation will stay high have not yet abated and central banks may therefore be forced to keep rates on hold at a time when global growth is fragile. A further concern is significantly weaker consumer spending in the US, Europe and Japan, as consumers face rising prices, falling asset prices and tougher borrowing conditions. Although the consensus is that global growth will not slow too significantly, the extent of the slowdown will depend on how the global economy responds to malfunctioning financial markets and the possibility of a recession in the US.

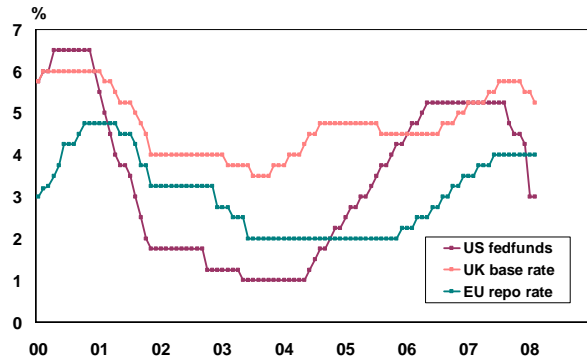
Graph 6: US housing in crisis



The outlook for the **US** economy has deteriorated, with some now fearing a recession. The stalwart consumer, who helped sustain the US economic expansion, is looking vulnerable. Energy and borrowing costs have risen sharply, eroding disposable income. Conditions in the labour market have softened noticeably, with employment edging higher. As a result, consumer confidence has weakened. Conditions in the rest of the economy have also worsened. Reduced capital spending and limited demand for new houses continue to hamper the construction and manufacturing sectors. Good news is yet to emerge from the housing market, with housing starts suggesting that the nadir of the current downswing is not yet in sight. In a bid to limit the repercussions of the credit crunch the Federal Reserve has cut rates by 175 basis points since August, while President Bush has announced a \$150 billion fiscal stimulus package. The fear of falling into a recession is currently overriding concerns of rising inflation. The risks to growth are on the

downside, with a further slowdown in consumer spending, continued financial market turmoil or a precipitous fall in house prices causing the economy to weaken further.

Graph 7: Interest rates on the way down



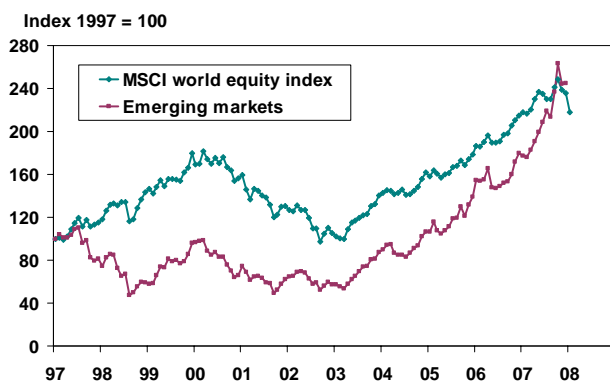
Growth in the **Eurozone** has proved to be more resilient than expected. Germany's robust investment spending and healthy manufacturing sector have been instrumental in helping the Eurozone weather the turbulence. However, leading indicators suggest a slightly gloomier outlook. The manufacturing sector has held up well. However, business sentiment is being eroded by a much stronger euro and slackening demand from the US and the UK. Although problems in the banking sector and sluggish consumer demand are starting to take their toll on the service sector, the European Central Bank (ECB) is maintaining its hawkish tone in the face of high inflation, which at 3% is a full percentage point higher than its target.

UK economic growth has remained remarkably buoyant in the face of higher interest rates, a stronger pound and last year's credit crunch, but the cracks have begun to show and recent data suggests that growth has probably peaked for now. Growth in the service sector – the largest sector – has begun to slip, while growth in industrial production has stalled. Consumers have been dipping into savings and taking on additional credit to fund consumption, which has driven domestic demand in the past. A marked turn for the worse in the housing market and tighter credit conditions will make a continuation of this trend unlikely, putting a further damper on growth. The government's weak fiscal position will make fiscal stimulus difficult to justify, should growth falter by more than expected. Inflation remains a concern. Above-inflation pay increases and rising energy costs continue to exert upward pressure on inflation. Despite this, the Bank of England cut rates in December, clearly fearing that the aftermath of the financial turmoil presents more of a danger to the economy in the short term.

Japan's modest but long economic recovery seems to have stalled. The slowdown has been precipitated by weak consumer spending as well as a sharp decline in housing construction, after the government introduced

new construction regulations. The sharp drop in the stock market, as well as the faltering housing market, will continue to weigh on consumer sentiment, making it less likely that domestic demand will pick up. Recent data suggests that capital spending has also begun to wane. Higher borrowing costs, owing to last year's financial turmoil, and new financial regulations are among the reasons for this trend. The lacklustre performance of the domestic sector makes the economy vulnerable to a recession in the US, its major trading partner. The strength of the yen will compound the problem. Deflation remains a concern, making it unlikely that the Bank of Japan will raise rates in the early part of this year, despite a desire to normalise rates.

Graph 8: Equity prices



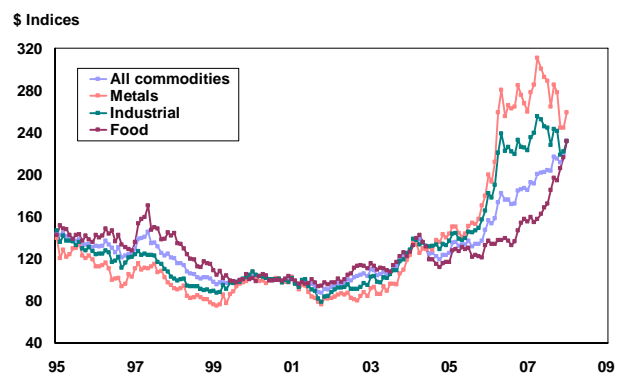
Source: Morgan Stanley

Emerging markets have experienced two years of remarkably strong growth. Growth should ease this year, albeit not as much as in developed countries, as the effect of slower US growth filter through. The **Chinese economy** will continue to expand at a robust pace, helped by low interest rates and an undervalued exchange rate. Inflation has risen sharply in China, fuelled by rising food prices, which has sparked popular dissent. Concerns about a possible stock market bubble, pollution and the upcoming Olympic games remain some of the most pressing issues. The prospects for **Asian** economic growth have deteriorated slightly, but growth should still remain robust, as the majority of these nations provide inputs into China's production process and will therefore benefit from the still strong growth in China. Rising inflation will be the most pressing domestic policy challenge. However, central bankers will be more averse to hiking rates with the outlook for growth looking more uncertain. **Sub-Saharan Africa's growth** is expected to accelerate further this year, driven by strong commodity prices, improved economic policies and foreign direct investment. Both higher growth and capital inflows will go disproportionately to resource-rich countries. **Latin America** may not escape last year's turmoil unaffected, given its close trade and financial linkages with the US. High commodity prices, which have allowed for more lax fiscal policy, have exacerbated inflation in the region. The

continued implementation of leftist policies by Venezuela, Ecuador and Bolivia has created additional uncertainty.

Commodity prices have broken new ground in recent weeks. The price of Brent crude oil reached a record \$100 per barrel, albeit briefly, on 2 January 2008. The oil price was driven by renewed unrest in Nigeria's oil-producing Niger Delta, ongoing tensions in the Middle East, tight world supply, robust demand from China and India, continued dollar weakness and some element of speculation. More recently fears that the US may be heading for a recession has caused the price of oil to pull back slightly. Gold and platinum prices continued their record breaking streak, reaching new peaks of \$929 and \$1 813 per ounce. Precious metal prices have been boosted by dollar weakness, rising inflation expectation, safe-haven buying and disruptions at some South Africa mines, owing to electricity shortages. Many base metal prices have continued to decline off a high base since the middle of last year on slightly weaker demand. Prices of agricultural goods, particularly wheat, have risen sharply and remain at elevated levels. More frequent adverse weather conditions, rising demand from the biofuels industry, strong demand from emerging markets as well as limited excess supply – inventories are at multidecade lows – have contributed towards rising agricultural prices. Commodity prices are expected to ease in the second half of the year as demand eases on slower global growth.

Graph 9: Commodity prices



Source: Economist

Global equity markets have been rocked by bouts of extreme turbulence since October, and have fallen steadily since late December. Equities have been unable to shrug off the shroud of August's credit crisis, with news of investment banks' losses, liquidity problems and expectations that corporate profits will be squeezed in 2008 weighing stocks down. Markets will remain jittery as new economic data provides further evidence of how economic growth might have been affected by the credit crunch.

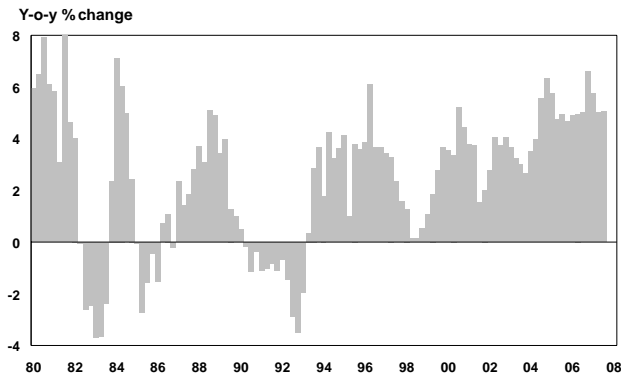
On **exchange rate markets** the dollar has had mixed fortunes. The US currency recovered slightly in mid-

December on speculation that the threat of rising inflation from record high oil prices could convince the US Federal Reserve to hold off cutting rates further. By the end of December the rally had run out of steam, as a series of data releases pointed to continued weakness in the US housing sector and consumer-related industries. After falling sharply for much of last year, the dollar is likely to stabilise, notwithstanding episodes of weakness, as trade conditions improve and growth in the UK, EU and Japan also slows.

International money markets have slowly begun to normalise after concerted action by the major central banks to add much-needed liquidity into the banking system. Short-term money market rates peaked in early December, as persistent problems in credit markets and year-end liquidity needs caused short-term funds to dry up. However, the interbank market remains nervous.

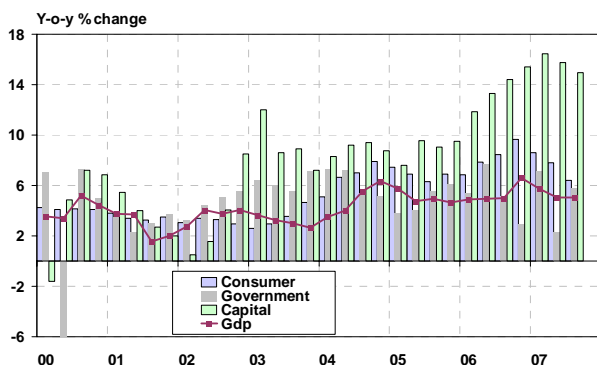
Domestic prospects

Graph 10: Gdp growth



Economic activity remained remarkably resilient in the third quarter of last year, with real gdp growth edging up to a seasonally adjusted annualised 4,7% from 4,4% in the second quarter. Robust performance in the 'finance, real estate and business services industry was the main contributing factor to the strong expansion, but firm activity levels in the construction, trade, transport and communication sectors also played a part.

Graph 11: Growth in components of gdp

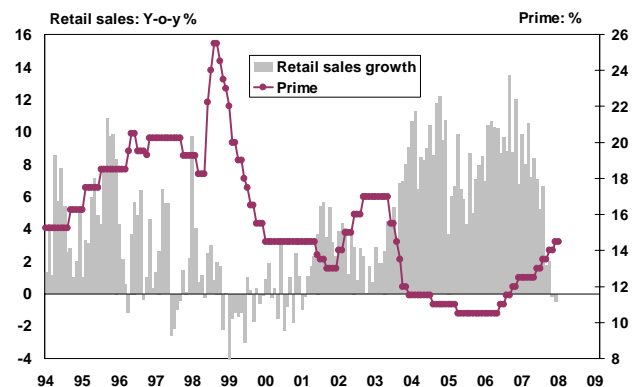


Domestic demand rebounded after recording poor growth in the second quarter. The recovery was largely due to a further acceleration in **fixed capital formation**, with strong growth in investment activity by the government and public corporations being attributed to the continued drive to alleviate capacity constraints and develop infrastructure ahead of the 2010 FIFA Soccer World Cup. In contrast, several discouraging financial factors led to a further moderation in **consumer spending** growth. These factors included much lower growth in real personal disposable income, still higher inflation and higher interest rates. Consumers cut back on purchases of semi durable goods (mainly clothing and footwear) and services, but increased their spending on durable and non-durable goods. Despite the tighter monetary conditions and the stricter lending criteria enforced by the National Credit Act (NCA), households took on yet more debt, pushing the household debt to disposable income ratio to a new record

of 77,4% in the third quarter of 2007 from 72,8% at the end of 2006. The ratio of interest service costs to disposable income rose above 10% from 9% at the end of 2006.

Both the trade and services deficits increased in the third quarter of last year. The trade deficit rose on the back of higher imports and lacklustre exports, while the services deficit (net payments for services and income to non-residents) was pushed up by higher interest and dividend payments to foreign owners of South African shares and bonds. As a result, the **current account deficit** widened to a record level of 8,1% of gdp from 6,5% in the second quarter. The outflow on the current account was again more than offset by **capital inflows**, which predominantly resulted from strong net portfolio inflows as foreigners increased their holdings of local equities and bonds. Reserves therefore increased further, with the international liquidity position improving by just more than US\$8 billion during 2007 to US\$31,3 billion.

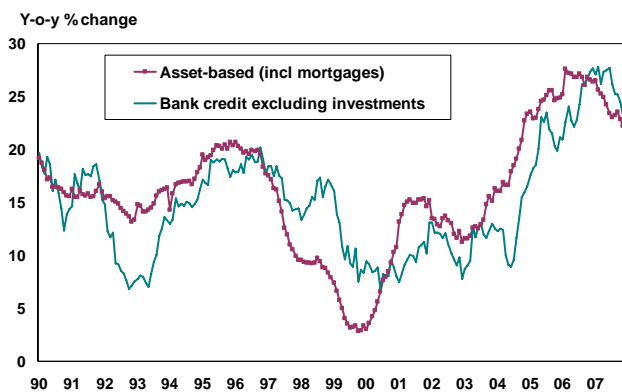
Graph 12: Retail sales under pressure



Unfortunately, the **outlook** for the economy has deteriorated. Recent events, both locally and globally, have forced a downward adjustment of domestic growth forecasts. Locally, the electricity crisis has made it evident that investment in power capacity started far too late, which has had and will have damaging consequences for economic activity, while the impact of higher interest rates on consumer spending is also expected to be more prominent than initially thought, largely due to a further deterioration in the financial environment. Globally, concern about international growth prospects became more pronounced as the possibility of a US recession increased. Domestic growth prospects for the next two years are therefore more subdued, with recent indicators already suggesting more subdued economic growth. New vehicle sales dropped further in the final quarter of 2007 and in early 2008, while the broader retail sales figure pointed to slower growth in consumer spending on the back of higher interest rates, rising prices and more restricted access to credit. Restrained growth in manufacturing output suggested that businesses were also affected by the change in economic circumstances.

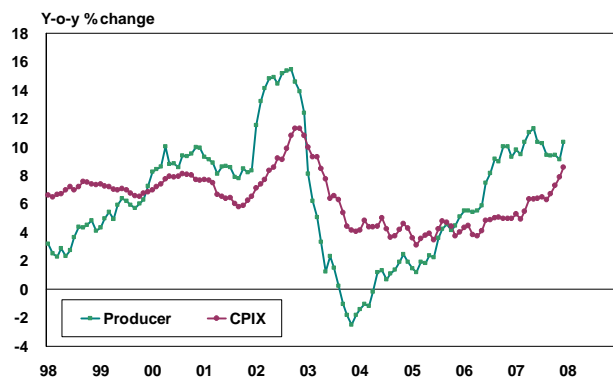
Fixed capital formation and government consumption expenditure should remain relatively firm, but this is unlikely to offset the anticipated slowdown in household spending. The need for capital inputs into fixed investment projects will further keep imports at an elevated level, while exports have been hampered by capacity constraints and predictions of a softer global economy. The trade and current account deficits are therefore expected to remain large. Growth in real gdp is forecast to moderate to 5% in 2007 as a whole from a robust 5,4% in 2006. This year economic growth is expected to lose significant momentum, before recovering somewhat during 2009, with predicted growth rates of 3% and 4% for 2008 and 2009 respectively.

Graph 13: Credit growth starting to ease



Demand for **credit** eased further, with annual growth in private sector credit extension, excluding the volatile investments and bills-discounted categories, falling to 22,2% in December 2007 from 25,2% and 27,7% at the end of the third and second quarters respectively. However, the instalment sales and mortgages categories still recorded surprisingly high growth rates due to strong corporate demand for credit, while extension to individuals slowed dramatically due to higher interest rates and more stringent lending criteria.

Graph 14: Inflation remains high



Inflation continued to soar further above the upper 6% limit of the inflation target range. CPIX inflation – headline

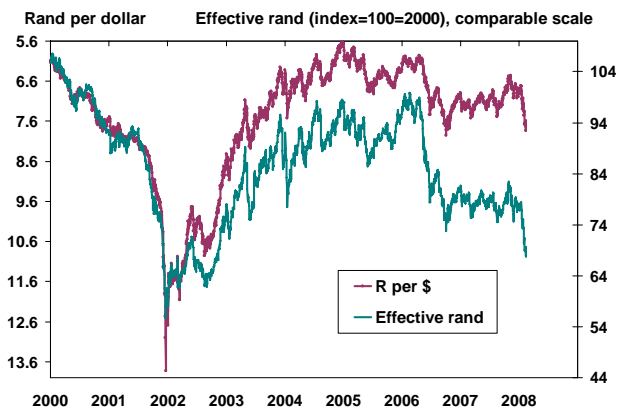
consumer inflation excluding interest costs on mortgage bonds – jumped to 8,6% in December last year from 6,7% in September, driven mainly by elevated food and transport costs. Food inflation is now up to almost 14%, following the upward trend of international food prices on high demand for human consumption, livestock feed and biofuel manufacturing. CPIX inflation averaged 6,5% in 2007, substantially higher than the 2006 average of 4,6%. Fortunately, above-average rainfall in certain areas of the country should help to contain local food prices later in the year. However, the approved large hike in electricity tariffs will offset the improvement in food inflation to some extent. CPIX inflation is expected to increase to about 9% in February and March, before easing towards 6% by the end of the year. Uncertainties in the inflation outlook include supply constraints, rising wages, the weaker rand and the high international oil price. As expected, the Reserve Bank's Monetary Policy Committee (MPC) hiked interest rates by a further 50 basis points at the December meeting, but kept rates unchanged at the January meeting. Although the risks remain firmly on the upside, more definite evidence of waning consumer demand in response to the cumulative 400 basis point increase in interest rates since June 2006 should emerge by the time of the next MPC meeting in April. The MPC is therefore expected to maintain a neutral policy stance in April, while possible rate cuts is forecast for the second half of the year.

Financial markets remained extremely volatile in the final quarter of 2007 and were even more so at the start of 2008 as nervousness about a possible recession in the US resurfaced and intensified, with more overseas companies being impacted by the US subprime mortgage crisis. The bond market generally weakened further due to higher domestic interest rates. The yields on the R153 2010 and the longer-dated R157 2015 increased to 9,33% and 8,73% respectively on 31 January 2008 from 8,95% and 8,26% at the end of September 2007. In line with international equity markets, the local equity market has lost significant ground since reaching record values in mid-October last year. Although the FTSE/JSE all-share index was still up by 16% in 2007, part of this added value was wiped out during January as risk aversion mounted on the back of concerns about global growth. The all-share index dropped to just more than 25 000 points on 23 January 2008 from a record high of 31 531,1 points on 11 October 2007, but recovered somewhat to end the first month of 2008 at 27 317,1 points. Both industrials and financials fell by almost 13% during January, while basic materials gained 2,5% as the gold and platinum indices soared.

The **rand** was also subject to extreme volatility and weakness. For 2007 as a whole the local unit fell by 3,5% against the trade-weighted basket of currencies owing to an 8% depreciation against the euro and a 3,3% depreciation against the Japanese yen. However, the unit gained 2,8% and 1% against the US dollar and the British

pound respectively. During January this year the rand lost a further 8,7% on a trade-weighted basis amid growing risk aversion against emerging market currencies. The local unit closed at R7,49 against the US unit on 31 January from R6,81 at the end of December and R6,87 at the end of the third quarter of 2007. Although the rand is still supported by the country's relatively sound fundamentals, strong precious metal prices and high interest rate differentials, it remains vulnerable due to the large current account deficit, the energy crisis, the looming slowdown in economic activity, bouts of risk aversion towards emerging markets as well as growing uncertainty about the political changes and the potential implications for economic policy in the future.

Graph 15: The rand has weakened against major currencies



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FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

13 February 2008

	2003	2004	2005	2006	2007	2008	2009
Growth (real, % change)							
Gdp	3.1	4.9	5.0	5.4	5.0	3.0	4.0
Gde	5.2	7.9	5.7	9.2	6.8	4.1	6.1
Pce	3.5	6.7	6.9	8.2	7.0	2.9	3.8
Gdfi	9.1	8.9	8.9	13.8	15.4	9.0	14.2
Exports	0.1	2.9	8.0	5.6	7.2	4.5	8.6
Imports	8.1	14.5	10.3	18.8	12.6	7.5	13.4
Balance of payments (Rbn)							
Exports	291.4	310.5	352.2	434.5	563.2	714.1	882.7
Imports	264.8	311.8	358.5	476.5	610.0	750.3	937.8
Trade balance	26.7	-1.2	-6.4	-42.0	-46.8	-36.2	-55.1
Net services	-40.3	-43.4	-55.8	-70.3	-94.0	-87.0	-90.4
Current account	-13.7	-44.6	-62.2	-112.3	-140.8	-123.1	-145.5
Capital account	8.8	82.2	96.4	142.1	142.0	120.4	148.6
Change net reserves	-4.9	37.5	34.3	29.8	1.2	-2.7	3.1
Gross reserves (eop)	52.9	82.8	130.5	178.3	174.6	202.7	215.1
Current account as a % of gdp	-1.1	-3.2	-4.0	-6.5	-7.1	-5.7	-6.2
Gold price (average per ounce)							
\$	363.5	410.4	445.7	605.1	699.0	859.3	844.7
Rand	2757	2652	2844	4103	4937	6768	6946
Exchange rates (average)							
\$/Rand	7.58	6.46	6.38	6.78	7.06	7.88	8.22
Euro-\$	1.13	1.24	1.24	1.26	1.38	1.46	1.46
\$/YEN	116.0	108.2	110.2	116.3	117.7	107.8	106.2
GPB-\$	1.63	1.83	1.82	1.84	2.00	1.96	1.95
Euro-Rand	8.56	8.03	7.93	8.51	9.71	11.51	12.00
Rand-YEN	15.3	16.7	17.3	17.2	16.7	13.7	12.9
GBP-Rand	12.39	11.83	11.60	12.48	14.13	15.43	16.00
Interest rates (end of period)							
Three-month JIBAR	7.73	7.47	7.05	9.18	11.25	9.54	8.64
Prime	11.50	11.00	10.50	12.50	14.50	13.00	12.00
Long bond	9.21	8.15	7.43	7.76	8.35	8.96	9.38
Inflation (average)							
Headline CPI	5.9	1.4	3.4	4.6	7.1	7.8	4.5
CPIX (metro and other urban)	6.8	4.3	3.9	4.6	6.5	7.6	5.9

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FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

13 February 2008

	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gdp (q-o-q annual %)	5.0	4.4	4.7	3.8	1.1	3.0	3.2	3.5	3.8	4.6	4.8	5.2
Interest rates												
Three-month JIBAR	9.18	9.78	10.21	11.25	11.19	11.04	10.44	9.54	9.11	8.60	8.62	8.64
Prime	12.50	13.00	13.50	14.50	14.50	14.50	14.00	13.00	12.50	12.00	12.00	12.00
Long bond (10 yr)	7.77	8.40	8.16	8.35	8.73	8.88	8.84	8.96	8.96	9.14	9.26	9.38
Inflation												
CPI	6.1	7.0	7.2	9.0	9.8	8.2	7.5	4.6	4.2	4.3	4.4	5.3
CPIX	5.5	6.4	6.7	8.6	9.0	7.7	7.4	5.6	5.6	6.0	5.8	6.0
Exchange rates												
\$-Rand	7.29	7.1	6.88	6.81	7.90	7.74	7.85	8.01	8.13	8.25	8.34	8.38
Euro-\$	1.33	1.34	1.42	1.47	1.48	1.47	1.45	1.43	1.45	1.46	1.47	1.49
\$-Yen	117.9	123.4	115.3	112.0	106.4	106.9	106.9	106.7	106.5	106.5	106.0	105.4
GBP-\$	1.96	2	2.02	2.00	1.96	1.94	1.95	1.95	1.93	1.93	1.95	1.97
Euro-Rand	9.73	9.55	9.75	10.04	11.70	11.36	11.38	11.49	11.78	12.02	12.26	12.45
Rand-Yen	16.17	17.4	16.75	16.45	13.47	13.82	13.61	13.32	13.09	12.90	12.71	12.58
GBP-Rand	14.30	14.2	13.92	13.60	15.47	15.01	15.31	15.62	15.69	15.93	16.25	16.50
Gold price per ounce												
\$												
Rand	663	648	737	834	892	874	857	840	844	844	844	852
	4834	4602	5074	5676	7045	6766	6730	6727	6862	6965	7035	7141

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