

Nedbank

Guide to the Economy

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The year has started with improved optimism following a difficult two years. Markets are reflecting the better sentiment and there is hope that a more normal pattern of growth will resume. However, the financial crisis of 2008 has left its scars in developed countries, with still high levels of personal indebtedness and a massive buildup of government debt. Monetary policies remain very loose and there is a real threat that inflation may return through rising commodity prices. Credit is still constrained as banks come to terms with tighter regulatory requirements. In the developing world conditions are positive, but economies risk overheating.

6 | Domestic review and prospects

Growth is set to rise above 3% in 2011, helped by low interest rates, easing debt levels, rising terms of trade and improved confidence. However, manufacturing and mining will still be hampered by continued rand strength, infrastructural constraints and mixed fortunes in key trading partners. Although some improvement in employment levels is likely, the labour market will remain relatively weak, reducing the chances of a more broad-based recovery in consumer spending.

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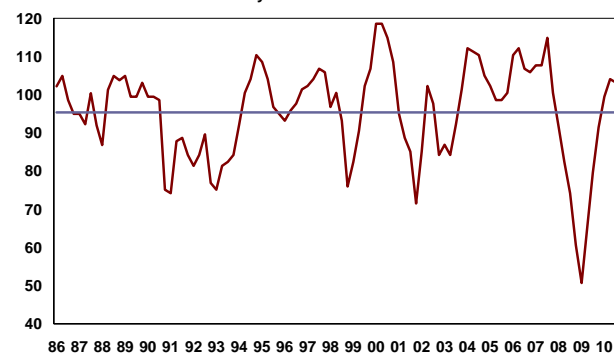
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International background and outlook

Some optimism has returned to global markets and forecasts. Last year ended on a strong note, with stock markets hitting new highs, commodity prices mostly on the way up and forecasts of a more solidly based recovery in developed economies. However, underlying structural problems remain in many of these economies and the policy cures administered to avert further crises themselves carry consequences and increase dangers of further dislocations. Fiscal overhangs have to be addressed, which will hurt the chances of robust recovery over the medium term. Even more ominously, the massive liquidity provision that has so far helped bolster asset prices and support the financial system is starting to push food and energy prices higher, further exacerbating inflationary pressures in developing countries. Strong liquidity has also meant that equity markets have run ahead of valuations, increasing the chances of corrections in the months ahead if a more fundamentally based upswing fails to emerge.

Graph 1: Global sentiment has improved

Ifo world economic climate survey 1995 = 100



Source: Wefo

After losing some momentum during the middle of 2010, the **US** recovery appears to have regained some traction, supported by investment spending and export growth. Manufacturing production is at its highest level since the



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start of the recovery, while leading indicators of manufacturing activity suggest that this trend is likely to continue well into 2011.

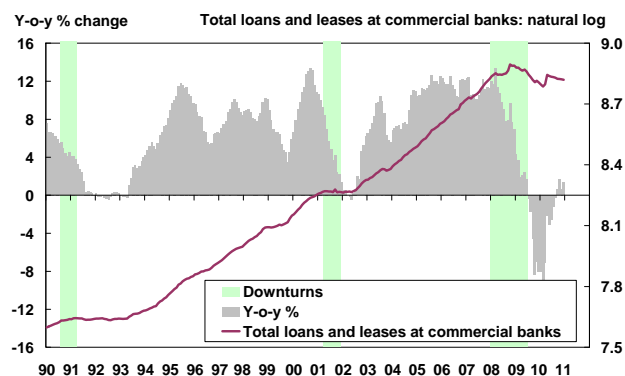
Table 1: IMF forecasts revised higher again

Countries and regions	2007		2008		2009		2010		Forecasts October 2010		Forecasts January 2011	
	2007	2008	2009	2010	2011	2012	2011	2012	2011	2012		
World	5,3	2,8	-0,6	5,0	4,2	4,5	4,4	4,5	4,4	4,5		
Advanced economies	2,7	0,2	-3,4	3,0	2,2	2,6	2,5	2,5	2,5	2,5		
US	1,9	0,0	-2,6	2,8	2,3	3,0	3,0	3,0	2,7	2,7		
Japan	2,4	-1,2	-6,3	4,3	1,5	2,0	1,6	1,6	1,8	1,8		
Euro area	2,9	0,5	-4,1	1,8	1,5	1,8	1,5	1,5	1,7	1,7		
Germany	2,7	1,0	-4,7	3,6	2,0	2,0	2,2	2,0	2,0	2,0		
UK	2,7	-0,1	-4,9	1,7	2,0	2,3	2,0	2,0	2,3	2,3		
Emerging and developing	8,7	6,0	2,6	7,1	6,4	6,5	6,5	6,5	6,5	6,5		
Developing Asia	11,4	7,7	7,0	9,3	8,4	8,4	8,4	8,4	8,4	8,4		
China	14,2	9,6	9,2	10,3	9,6	9,5	9,6	9,5	9,5	9,5		
India	9,9	6,4	5,7	9,7	8,4	8,0	8,4	8,0	8,4	8,0		
Middle East and N Africa	6,0	5,0	1,8	3,9	5,1	4,8	4,6	4,7	4,7	4,7		
Sub-Saharan Africa	7,0	5,5	2,8	5,0	5,5	5,7	5,5	5,8	5,8	5,8		
South Africa	5,5	3,7	-1,7	2,8	3,5	3,9	3,4	3,8	3,8	3,8		
Latin America	5,7	4,3	-1,8	5,9	4,0	4,2	4,3	4,1	4,1	4,1		
Brazil	6,1	5,1	-0,6	7,5	4,1	4,1	4,5	4,1	4,1	4,1		
Mexico	3,3	1,5	-6,1	5,2	3,9	5,0	4,2	4,8	4,8	4,8		
Central & Eastern Europe	9,5	3,0	-3,6	4,2	3,1	3,8	3,6	4,0	4,0	4,0		
Russia	8,5	5,2	-7,9	3,7	4,3	4,4	4,5	4,4	4,4	4,4		

Source: International Monetary Fund

Consumer confidence, after slipping in the third quarter, picked up towards the end of the year. However, consumer spending will remain constrained by three factors. Income growth has been contained by the lacklustre recovery in the labour market, with only 1,2 million jobs added in the private sector since the lows reached in December 2009. Secondly, the housing market has remained very depressed, with activity near record lows, and is unlikely to recover soon, with 14,5% of housing stock unoccupied, causing prices to fall further. Thirdly, the deleveraging process is also now well underway. Household credit as a percentage of income is down by 12 percentage points to 118% since the start of the recession – the largest fall in household indebtedness since the Great Depression.

Graph 2: US bank loans still weak

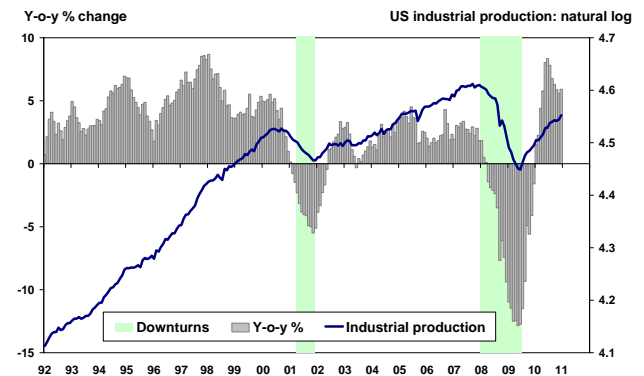


Source: US Federal Reserve

Both fiscal and monetary policy should continue to support the recovery this year. Against expectations a \$858 billion fiscal package was signed in December. This extends Bush-era tax rates, cuts the payroll tax and extends unemployment insurance. The Federal Reserve announced a second round of quantitative easing worth

\$600 billion in November, which the Fed estimates will help create three million jobs and add 1% to inflation by 2012.

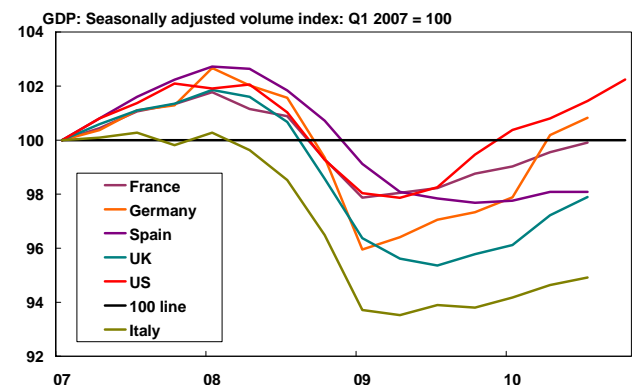
Graph 3: Industrial production on the mend



Source: US Federal Reserve

The **Eurozone's** stronger-than-expected recovery in 2010 was largely driven by a resurgent Germany, while peripheral countries, including Greece, Portugal and Ireland, lagged far behind. Cross-country differences are expected to widen further in 2011. Germany's business confidence index rose to a record high at the end of last year and early indications are that Germany and other core countries will continue to experience reasonable growth in 2011. Companies are likely to see a further boost from exports, supported by a weak euro in the coming months. Retailers will benefit from an improvement in consumption, supported by wage growth and falling unemployment. However, fiscal tightening in the region will begin to hit demand.

Graph 4: A weak economic recovery in industrialised countries

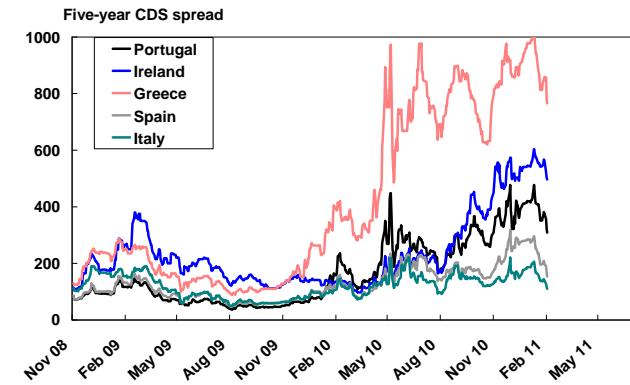


Source: Eurostat

The risks of further problems emerging in peripheral Eurozone countries this year are high. So far the EU and the IMF's attempts to restore the market's confidence in these debt-laden countries have provided investors with little more than temporary solace. These have included a €750 billion bailout fund as well as a Greek and Irish rescue. After a brief respite over December, bond yields and credit default swap spreads have spiked again on concerns that Portugal too might require a bailout

package. Over the coming months much will depend on underlying economic conditions and how the markets react. Investors will remain sceptical that these countries will be able to avoid restructuring their debt, if not this year, then most likely in 2012.

Graph 5: Risk premia have eased but are high



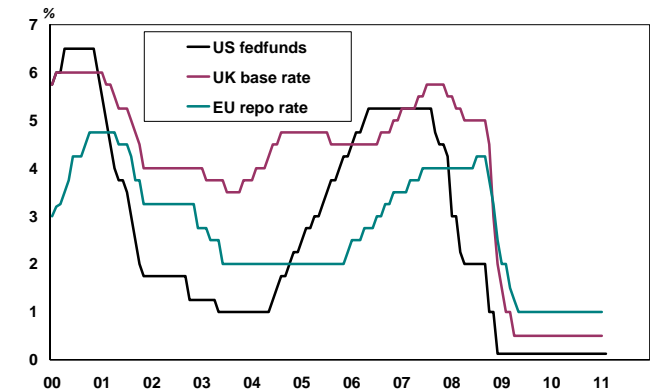
Source: Datastream

Growth in the **UK** picked up last year, supported by rising construction activity, solid manufacturing gains and government spending. However, divergent trends appear to have emerged. Manufacturing continued to perform well, boosted by a weak pound, with the purchasing managers' index (PMI) reaching a 16-year high. In contrast, the services sector, which is beginning to feel the pinch from the government's spending cuts, contracted in the final month of the year. The government's four-year £80,5 billion fiscal consolidation programme will begin in earnest in 2011, resulting in the largest real public expenditure cuts since the 1940s. Fiscal consolidation, which will include public sector job losses as well as spending cuts on social services and infrastructure, will make a dent in the headline growth figure, as the private sector is not in a position to compensate for falling government spending. Consumers will be hit by declining real wages and rising unemployment as well as poor credit availability. An increase in the value-added tax (VAT) to 20% at the beginning of this year will also weigh on spending. Inflation remains stubbornly above the Bank of England's (BoE) target of 2%. However, the BoE will tolerate higher inflation in the short term, arguing that headline inflation is being driven by higher sales tax, a weaker currency and rising commodity prices.

Fiscal spending, which provided a temporary lift to consumption, and a recovery in exports boosted **Japanese** growth in 2010. In 2011 domestic demand, particularly household consumption, is expected to be disappointing as the effects of both car and electronic incentive schemes come to an end and deflation persists until at least 2012. In contrast, exports will continue to perform relatively well, supported by strong growth in China and the US. However, the continued strength of the yen, which appreciated by more than 10% against the dollar last year, will weigh on competitiveness. Export

growth is yet to translate into a strong recovery in investment spending, with the latest Tankan Survey, a measure of business's expectations about future capital expenditure, slipping lower in December, indicating that businesses will remain wary to expand capacity in 2011.

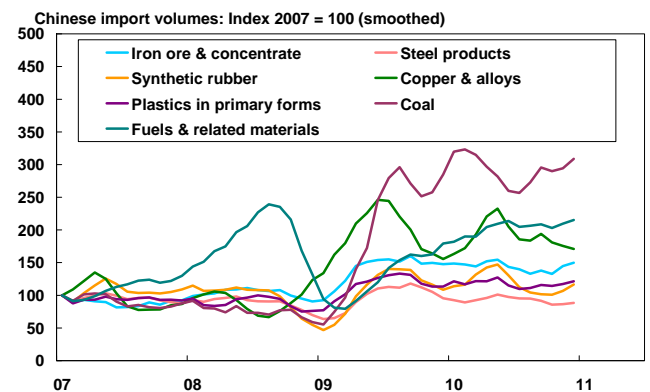
Graph 6: Monetary policy remains very stimulatory



Source: Various central banks

China is estimated to have grown by just over 10% in 2010, helped by loose credit conditions and an investment-heavy fiscal stimulus package. Concerns about excessive lending fueling a property bubble as well as inflation, which reached a 28-month high in November, prompted the People's Bank of China to tighten monetary policy. The Central Bank has increased banks' reserve ratio requirements six times last year and raised interest rates by 50 basis points during the fourth quarter. This is designed to curb rising inflationary pressures and bring growth closer to 8% in 2011. Direct control on credit through bank lending quotas have also been introduced to dampen housing demand, which has caused a further moderation in house price inflation to 7,7%. Fiscal policy will remain stimulative to offset tighter monetary policy. Efforts to improve the social welfare system in order to reduce household savings will require further fiscal expenditure, while various programmes to increase household consumption, such as subsidies on consumer durables, are likely to be extended.

Graph 7: Chinese raw material imports buoyant



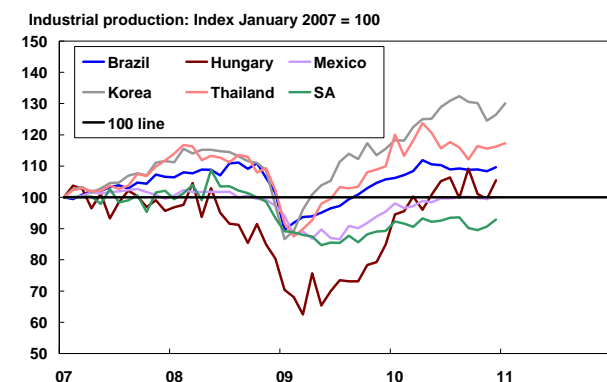
Source: Datastream

Exports are also expected to remain resilient. Recent figures show that exports rose by 35% over the year, supported by strong regional growth and rising demand from the US. However, strong export growth and a widening trade surplus will be something of a double-edged sword for Chinese authorities, as it will be met by increased pressure from abroad to allow the renminbi to appreciate more quickly.

India's economy grew by nearly 9% in the third quarter, putting upward pressure on prices and forcing the Central Bank to continue raising interest rates. Recent economic data, including industrial production, the PMI as well as car sales, point to robust growth in the fourth quarter. Despite tighter monetary policy, growth on the subcontinent is expected to pick up further this year, supported by high savings and investment rates, a fast-growing labour force as well as the expansion of the middle class.

Elsewhere in **Asia** the recovery has been supported by a quick rebound in consumer spending and booming exports. However, the region will face some challenges this year. The most important will be dealing with the inflow of foreign capital, which is causing local currencies to appreciate rapidly, as well as rising inflation. This leaves policymakers with a conundrum. Higher interest rates – to curb inflation – will attract further capital, making these economies yet more vulnerable to sudden changes in sentiment. Continued reserve accumulations as well as further capital controls are likely to be implemented during 2011. So far such measures have only met with limited success. In Indonesia and Malaysia growth will be driven by rising household spending, which is supported by accommodative monetary policy, rising wages, a strong currency and a growing middle class. Low interest rates in South Korea should encourage both consumer and investment spending. Over the next year the authorities will tighten economic policy, as they try to put a damper on asset price inflation, driven by excess liquidity, strong growth and an overvalued currency. Political uncertainty in Thailand in the runup to the next elections later this year may curb domestic spending.

Graph 8: Production generally improving in developing world

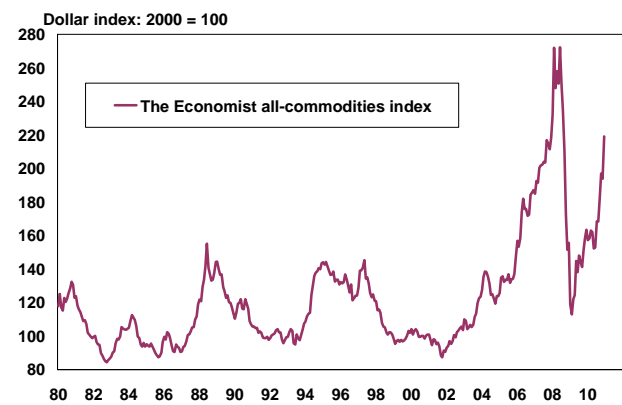


Source: Datastream

The recovery in **Latin America** continued strongly in 2010, supported by expansive fiscal and monetary policy, rising commodity prices as well as easily accessible credit. The region faces two main challenges during 2011, namely curbing inflation as well as falling competitiveness due to overvalued currencies. Brazil's recovery has been driven by a rebound in consumer spending, benefiting from strong disposable income and credit growth. This has put upward pressure on inflation, which has been aggravated by the government's expansionary fiscal policy. There are doubts that the new government has the political will to reign in the economy. Mexico, which was the laggard of the region in 2010, should recover more convincingly in 2011, gaining from its close trade and investment ties with the United States. Chile's growth will be supported by reconstruction efforts following last year's earthquake, as well as investment into the mining industry. Argentina, which is showing signs of overheating, is forecast to experience a volatile year, with the authorities likely to remain unwilling to cut back spending and hike interest rates before the elections.

Africa's growth this year is expected to rise above 5%, supported by high commodity prices, rising external inflows, as well as ongoing fiscal spending. Increasing interest in Africa as a trade and investment destination by China and other Asia countries will also help support growth. There are two key risks this year. Firstly, altogether 17 elections – the highest number in 20 years – are due to be held across the continent. This increases the risk of both political instability as well as fiscal imprudence. Secondly, aid and budget support could be jeopardised by fiscal cutbacks in advanced countries, which may result in some African countries facing significant funding gaps. Despite this, longer-term growth prospects remain positive, due to ongoing economic reforms, combined with capital inflows as well as high commodity prices.

Graph 9: Global commodity markets again booming



Source: I-Net

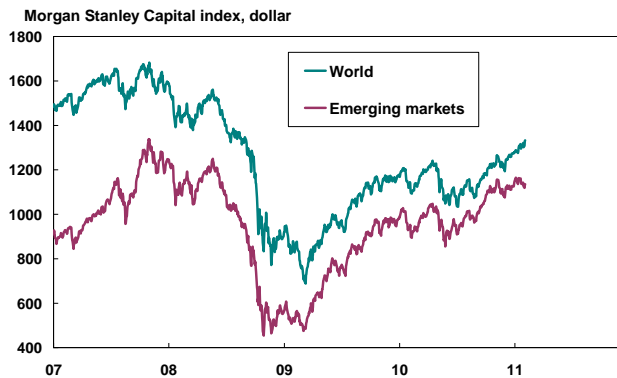
Commodity prices rose sharply between September and December 2010, with *The Economist* commodity price index rising by 18% over the period. Prices rose sharply

on the back of quantitative easing in the US, the announcement of the extension of Bush-era tax cuts as well as continued investor interest. Crude oil also rose strongly, reaching \$98 per barrel in mid-January, boosted by bad weather in Europe and the US, while gold reached a record high of \$1 423 per ounce in December 2010. Global agricultural prices have risen sharply, due to floods in Canada, fires in Russia as well as increased investor interest in soft commodities.

However, this trend has reversed slightly after concerns about southern Europe’s debt troubles re-emerged in recent weeks.

Carmen Altenkirch

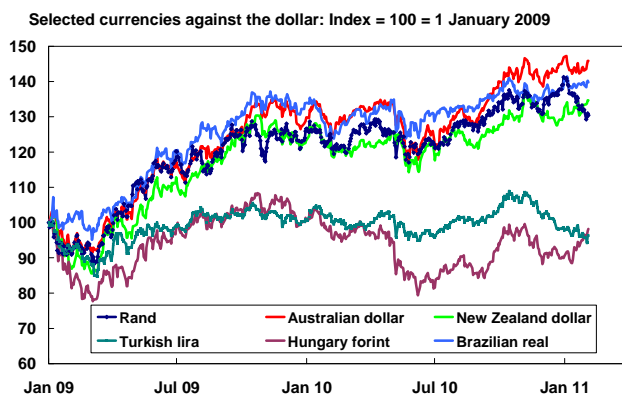
Graph 10: Equity markets have been strong



Source: MSCI Barra

Global equities rallied sharply over the past four months, with the MSCI World Index rising by 20%. The announcement of a €750 billion rescue package for troubled European countries assuaged concerns about an imminent default, while the Federal Reserve’s \$600 billion quantitative easing programme also helped to buoy the market.

Graph 11: Emerging market currencies are diverging



Source: Reuters

In **currency markets** the US dollar continued to strengthen against the euro and the British pound in the fourth quarter due to ongoing concerns about a possible Greek or Irish default. Weaker economic prospects in Europe relative to the US also supported the dollar. Emerging market currencies gained against the dollar following the announcement of a second round of quantitative easing in November, as cheap money continued to flood into high-yield emerging market assets.

Domestic review and prospects

Some improvement in growth is likely in 2011, but the economy is still facing some headwinds. After expanding by 2,7% in 2010 the economy will grow by around 3% in 2011, helped by low interest rates, rising terms of trade and improved confidence. However, growth in the production side of the economy will be hampered by rand strength, infrastructural constraints and mixed fortunes in key trading partners. Although some improvement in employment levels is likely, the labour market will remain weak, reducing the chances of a more broad-based recovery in consumer spending.

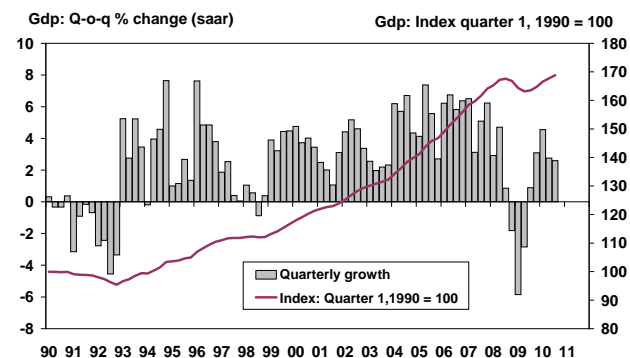
Table 2: Gdp sector breakdown

Industries	Growth (q-o-q % saar)										Size % total 2009
	2008	Q1'09	Q2'09	Q3'09	Q4'09	2009	Q1'10	Q2'10	Q3'10		
Agriculture	16,1	-8,1	-18,7	-13,7	-11,0	-3,0	4,9	13,6	16,3	2,9	
Mining	-5,6	-22,9	16,9	-3,7	7,7	-4,2	18,7	-22,2	28,1	9,1	
Manufacturing	2,6	-24,3	-10,7	8,2	10,8	-10,4	7,8	5,0	-5,0	15,2	
Power & water	-3,1	-4,5	1,7	3,6	2,7	-1,6	4,9	-1,7	-2,2	2,8	
Construction	9,5	15,6	5,5	2,9	1,2	7,4	1,3	1,0	0,8	4,0	
Trade	0,8	-1,6	-4,6	-0,3	-0,1	-2,5	3,1	6,0	3,3	13,5	
Transport & comms	3,4	-1,6	-0,4	2,4	3,0	0,6	2,4	4,5	3,0	9,1	
Finance	7,3	-0,1	-3,4	-0,6	1,8	0,9	2,6	3,8	1,5	21,5	
General government	4,5	3,5	4,1	2,0	5,2	4,1	1,2	4,6	0,4	15,7	
Personal services	3,9	-0,1	-1,5	-4,2	-4,4	-0,3	3,5	3,6	3,1	6,2	
Value Added	3,7	-5,9	-2,3	1,0	3,2	-1,5	4,3	2,7	2,3	100,0	
GDP	3,6	-5,9	-2,8	0,9	3,1	-1,7	4,6	2,8	2,6		

Source: Statistics South Africa

The local recovery lost momentum in the second half of last year. Real gdp grew at a slower pace in the third quarter, expanding at an annual rate of only 2,6%, down from a moderate 2,8% in the second quarter and a more impressive 4,6% in the first. A protracted strike in the broader automotive industry was mainly to blame for the disappointing growth performance, which undermined production in the manufacturing sector, where real value added dropped at an annual rate of 5% over the third quarter. Softer global demand and a strong rand also diluted economic growth by holding back export sales. Consequently, the country's net export position deteriorated significantly in the third quarter.

Graph 12: Recovery lost momentum in the third quarter of 2010

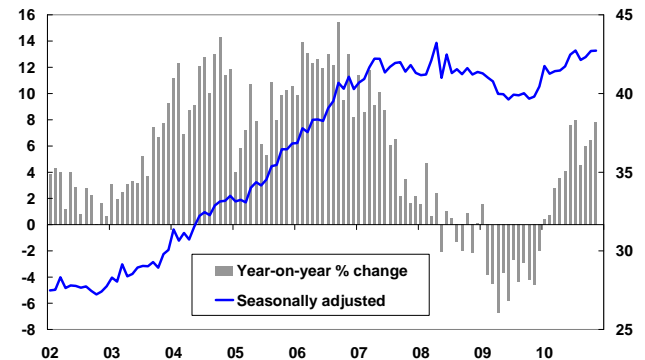


Source: Statistics South Africa

Although production stalled, spending accelerated. Stronger consumer spending and a slower pace of contraction in real inventory holdings were the main drivers of domestic expenditure in the third quarter.

Household spending accelerated as disposable income grew faster and net wealth levels rose, mainly on account of a surge in equity prices. Lower interest rates also supported household confidence and encouraged increased borrowing and stronger spending. Interest rates edged down another 50 basis points in the third quarter, taking the ratio of debt servicing costs to disposable income down to a manageable 7,8% from 8% at the end of the second quarter.

Graph 13: Consumer spending has been relatively robust



Source: Statistics South Africa

In contrast, government spending declined mainly due to the drawn-out public service strike, while growth in fixed capital formation eased as outlays by public corporations and private firms slowed and capital spending by government declined.

The economy is likely to have ended 2010 on a slightly stronger note. On the production side early indications are that mining production held up relatively well, while manufacturing output bounced back off the low base caused by industrial action in the third quarter. On the consumption side low interest rates and higher incomes appear to have boosted household confidence and reawakened credit demand. Retail sales remained surprisingly robust in October and anecdotal reports point to reasonably firm sales over the festive season. Overall, the economy probably expanded by over 3% in the final quarter of last year, taking the growth rate for the year as a whole to 2,7%.

Most analysts are quite upbeat about the growth prospects for 2011. Low interest rates, rising incomes and firmer asset prices are expected to encourage banks to extend more credit and consumers to troop back to the stores. As domestic spending improves and the global recovery continues, companies are expected slowly to grow in confidence, accelerating production to meet higher orders and rebuild stocks. Private firms are also expected to increase spending on future capacity moderately. The consensus is therefore that the economy will grow at a rate of somewhere between 3,4% and 3,8% in 2011. We are not quite as optimistic. Unfortunately, the production side of the economy may prove a bigger drag

on economic growth than most analysts anticipate. The global recovery remains fragile, moderate, uneven and fraught with downside risks. In 2011 growth in the major industrialised countries will probably still be contained by high unemployment and high debt burdens in both the private and public sectors. The ongoing sovereign debt saga in Europe could still unwind and end in dislocation, triggering financial market instability, placing renewed pressure on the global banking sector and undermining demand. Even if defaults are avoided and financial markets remain relatively steady, the tough fiscal austerity measures adopted by some European countries will dampen confidence and contain economic growth in the region.

Slow growth in Europe will hurt local producers, as Europe remains a key export market, with almost 28% of all local exports going to the region in the first 10 months of 2010. Local manufacturers are especially vulnerable to any setbacks in Europe, as the continent accounted for just over 30% of all manufactured exports in the first 10 months of 2010. Local mining companies are more insulated, as only 23% of all mining exports goes to Europe, while just over 40% goes to rapidly growing Asia, particularly China. While demand for commodities in most emerging markets is expected to remain relatively robust in 2011, China and some other developing countries also face the challenge of containing rising inflation without placing too much strain on economic growth and employment creation. On balance the world economy is forecast to grow at a slower, albeit still reasonable, pace in 2011 compared with 2010. The modest outlook for global growth and the ongoing loss of competitiveness due to a strong rand and rising local cost structures are likely to hurt local exporters.

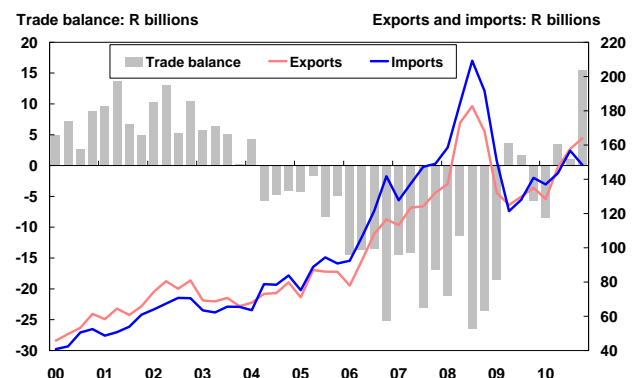
Business may face other headwinds in 2011. There are threats of possible disruptions to electricity supply as domestic demand continues to recover, a very wet summer impacts on coal quality and capacity remains constrained. The legislative environment is also likely to become more complex. Concerns over the threat of nationalisation and the implications of the new land reform policies have not yet been convincingly resolved. Government's 'New Growth Path' released late last year has a welcome focus on job creation, but brings new uncertainties and contains elements that may increase state interference in the private sector, and undermine profitability and competitiveness in the process. Given these uncertainties and still ample idle capacity, producers are unlikely to expand their workforce or accelerate capital spending to add new capacity aggressively. Consequently, fixed investment activity is forecast to increase by only 1% in 2011 after contracting by about 3,7% in 2010 and 2,2% in 2009.

The slow recovery in capital formation and moderate growth in exports are forecast to restrict gdp growth to

around 3% only in 2011, before the economy gains some traction in 2012 and 2013. Overall the current upswing will be more modest and medium-term prospects less rosy as the global economy grapples with sizeable structural issues, while the domestic economy remains constrained by high household debt levels, high unemployment, persistent skills shortages, insufficient and ageing infrastructure, capacity constraints within government and an increasingly burdensome and complex regulatory and legislative environment.

As far as the **balance of payments** is concerned, the current account deficit deteriorated to 3% of gdp in the third quarter after narrowing to 2,5% in the second quarter from 4,6% in the first. A larger deficit on the services account was mainly to blame, as travel receipts normalised after the completion of the FIFA World Cup. This offset the impact of a bigger trade surplus, which came about as both export volumes and prices outpaced those of imports in the third quarter. However, the wider current account deficit was once again financed by strong net capital inflows as quantitative easing in the US and exceptionally low interest rates in most major industrialised countries continued to support capital flows to emerging markets experiencing lower debt levels, stronger growth prospects and higher interest rates.

Graph 14: Trade back in surplus



Source: South African Revenue Services

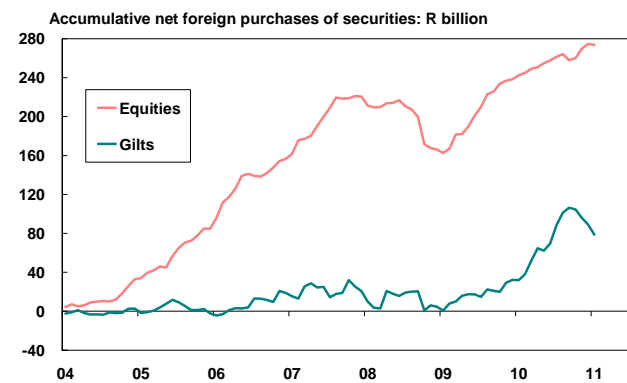
The underlying trade situation probably remained relatively unchanged in the final quarter of last year, with the current account deficit forecast to have narrowed to around 3,4% in 2010 as a whole compared with 4,1% in 2009. A large surplus is expected on the financial account, as capital inflows remained robust throughout the year.

The trade balance is expected to deteriorate mildly in 2011. Softer global demand will contain growth in export volumes, while stronger consumer spending and some demand for capital goods are likely to prop up import volumes. The country's terms of trade will probably also deteriorate slightly, as rising global food and oil prices are expected to partially contain the positive impact of relatively strong demand for commodities from emerging Asia on export prices. Added to this, the services deficit is

also expected to widen as dividend payments to foreigners continue to rise on improved corporate earnings. Overall the deficit on the current account of the balance of payments is forecast to widen to 4,2% of gdp in 2011.

Although capital inflows should comfortably offset the shortfall on the current account deficit in 2011, net portfolio inflows may become more volatile as the year progresses. After two years of redirecting funds towards emerging markets international investors are likely to become more discerning, especially as valuations appear more stretched.

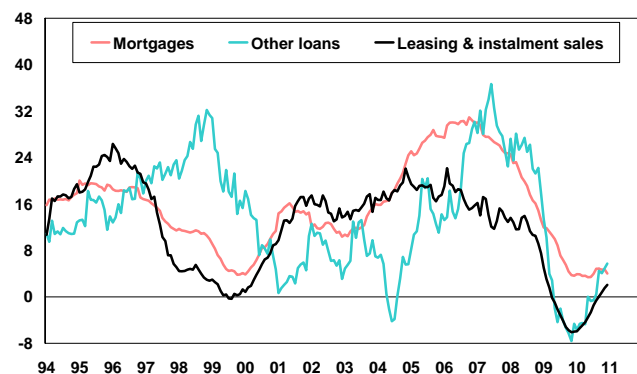
Graph 15: Foreign capital inflows have slowed



Source: I-Net

Credit demand picked up off a low base towards the end of last year. Private sector credit extension rose by a firmer, but still modest, 4,6% y-o-y in November, up slightly from 4,4% in September and a very weak 0,9% in March. Most categories of asset-based credit fared better towards the end of year, supported by stronger household demand as income rose and interest rates fell even further. Corporate demand for credit also improved, but remained very erratic, as companies remained conservative. Nonetheless, the 'other loans and advances' category, which is dominated by unsecured loans to the corporate sector, edged up to 4,9% y-o-y in November from 4,5% at the end of September.

Graph 16: Credit growth is picking up

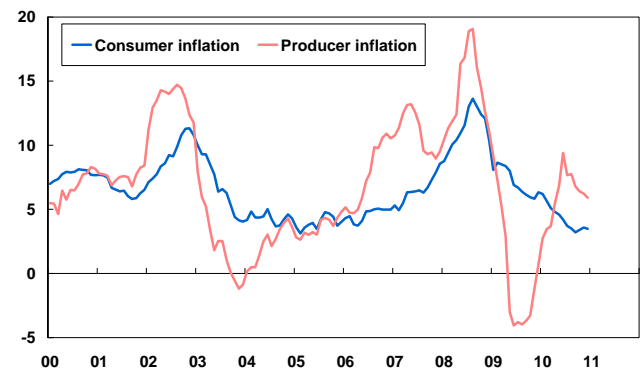


Source: South African Reserve Bank

Credit demand should improve in 2011. Household demand for credit will increase off a low base on stronger household balance sheets, better cashflows and low interest rates. Corporate demand for credit should also improve, but will probably remain relatively sluggish, as business lacks underlying confidence due to doubts about the strength of both the global and local recoveries. However, the current credit cycle is likely to be more contained, as households will be more cautious about borrowing in view of already high levels of indebtedness and sluggish employment growth.

Consumer inflation edged up in the final quarter of 2010 after surprising on the downside for most of the year. Consumer inflation rose to 3,5% in December after easing to only 3,2% in September, its lowest level since May 2006. A lower base in the second half of 2009 as well as rising food and fuel prices pushed inflation marginally higher towards the end of last year, but softer prices of durable and semi-durable goods due to subdued demand, low global inflation and a strong rand continued to keep inflation in check.

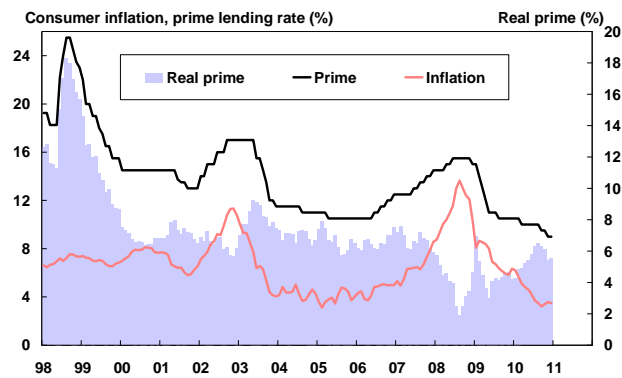
Graph 17: Consumer inflation remains moderate



Source: Statistics South Africa

The outlook for inflation remains relatively encouraging, although the upside risks are likely to increase. Inflation is forecast to move gradually higher over the next four months on rising global food and fuel prices, but a strong rand and price-sensitive domestic consumers will contain the increase to below 4% up to April. Thereafter inflation is forecast to rise at a faster pace as stronger domestic spending help producers and retailers to restore margins eroded by heavy discounting and rising labour costs. A softer rand and higher international food and other commodity prices are also expected to add to inflationary pressures in the second half of the year. Consequently inflation is forecast to end 2011 above 5%, still within the Reserve Bank's target band, but closer to the 6% upper limit. The upside risks to the forecast are above-inflation wage increases, a sharper-than-expected depreciation of the rand, persistently high global food prices and further oil price increases.

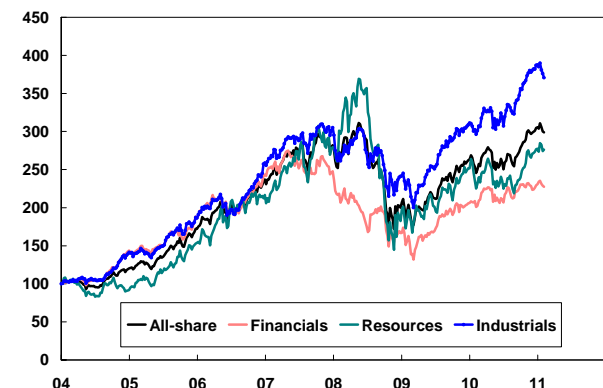
Graph 18: Interest rates eased further late last year



Source: Statistics South Africa, South African Reserve Bank

The Reserve Bank's Monetary Policy Committee (MPC) cut interest rates by 50 basis points in both September and November last year, taking the prime rate down to 9%, its lowest level since May 1974. At the time concerns over the impact of a weaker Europe and a strong rand on local exports and employment prospects tipped the scales in favour of monetary easing, especially as inflation outcomes consistently beat expectations and the inflation outlook appeared tame. Entering 2011 the upside risk to the inflation outlook has increased with the surge in global food and oil prices and the destruction of local crops by the recent floods. At the same time the local recovery remains uneven and fragile, with producers still exposed to a strong rand and a brittle global economy while households appear to be gaining confidence and increasing spending. On balance the scope for further rate cuts is limited, unless the recovery is truly derailed or the rand strengthens significantly. Interest rates are therefore forecast to remain on hold at these low levels throughout 2011 and into early 2012.

Graph 19: Equity prices have been strong



Source: I-Net

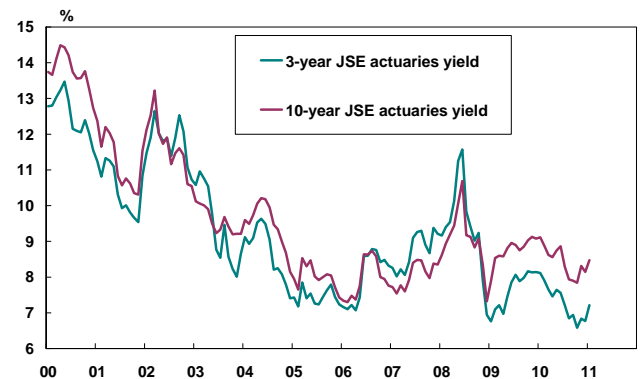
Financial markets strengthened in 2010, boosted by a stronger economy, subdued inflation, low interest rates and rising foreign purchases of emerging market assets. Equities were more volatile but still recorded significant gains, with the FTSE/JSE all-share index ending 2010

16% higher. Industrial counters were the top performers of 2010, with the overall index gaining almost 24% over the year. The other sectors also fared relatively well, with financials up 12% and resources up 9,8% over the year as a whole.

Equities remained firm in early 2011, propped up by strong demand for resources as the rand weakened and global commodity prices shot up in the first few weeks of this year. Local equities are expected to be volatile in 2011, as the bourse appears to be fully valued.

Local bond yields eased significantly in 2010. Strong foreign buying pushed yields down sharply, but expectations of mild economic growth and subdued inflation over the medium term also supported the market. The yields on the R157 2015 and R186 2025 eased from 8,4% and 9,0% respectively at the end of 2009 to 7,3% and 8,3% by the end of 2010. In early 2011 bond yields moved higher. The weaker trend is expected to continue in the months ahead as inflation edges up, the local rate cutting cycle comes to an end and foreign purchases of local bonds level off.

Graph 20: Interest rates signalling tighter policy ahead



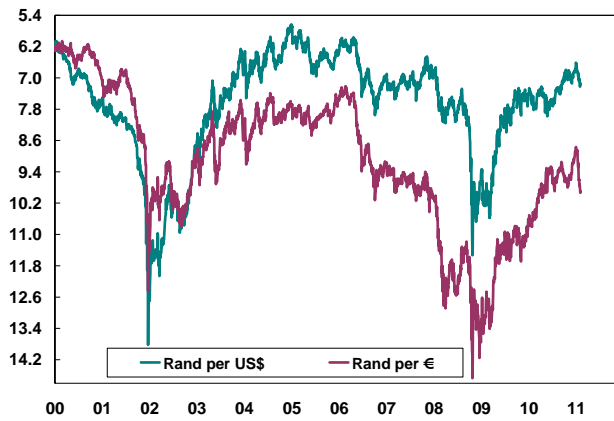
Source: I-Net

The **rand** ended 2010 stronger. The local unit gained a further 6,3% against the trade-weighted basket of currencies in the final quarter, taking the appreciation for the year as whole up to 12,7%. During the course of last year the rand mainly benefited from the wave of funds flowing towards emerging markets, seeking better growth prospects, higher yields and some insurance against the potential long-term inflationary consequences of easy money in some industrialised countries, notably the US. The rand gained over 11% against the US dollar, but strengthened most against an embattled euro, dragged down by sovereign debt concerns and the painful consequences of the fiscal austerity measures for economic growth in the region. In early 2011 the rand lost some ground, depreciating by 3,9% on a trade-weighted basis since the start of the year.

The outlook for the rest of the year will once again be dominated by global trends, but the local policy

environment is expected to be important as investors become more discriminating between emerging markets as assets become more expensive. Given the Reserve Bank's intentions to intervene more aggressively in the foreign exchange markets, uncertain local economic policies and the currency's current overvaluation, the rand is likely to be volatile and weaker.

Graph 21: The rand has eased



Source: Reuters

Nicky Weimar

FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

3 February 2011

	2007	2008	2009	2010	2011	2012	2013
Growth (real, % change)							
GDP	5,6	3,6	-1,7	2,7	3,2	3,9	4,2
GDE	6,3	3,4	-1,7	3,9	4,2	4,8	4,9
PCE	5,5	2,2	-2,0	4,5	4,0	4,5	4,6
GDFI	14,0	14,1	-2,2	-3,7	1,0	5,2	5,8
Exports	6,6	1,8	-19,5	5,4	5,0	6,3	8,0
Imports	9,0	1,5	-17,4	9,7	8,4	9,0	9,5
Balance of payments (Rbn)							
Exports	537,5	704,3	556,4	629,8	743,9	961,7	1 280,2
Imports	573,9	739,9	554,2	598,5	723,0	939,5	1 223,8
Trade balance	-36,3	-35,6	2,3	31,3	20,9	22,2	56,4
Net services	-104,2	-126,3	-99,3	-103,2	-129,7	-169,8	-218,3
Current account	-140,6	-161,9	-97,1	-71,9	-108,8	-147,6	-161,8
Capital account	188,4	187,9	114,1	104,9	120,0	165,0	190,0
Change net reserves	47,8	26,1	17,0	33,0	11,2	17,4	28,2
Gross reserves (eop)	224,3	317,3	293,0	290,7	337,4	400,8	445,0
Current account as a % of GDP	-7,0	-7,1	-4,1	-2,7	-3,8	-4,6	-4,9
Gold price (average per ounce)							
Dollar	696,5	872,2	973,1	1 226,8	1 366,9	1 373,8	1 278,5
Rand	4919	7208	8217	8996	9804	10823	10647
Exchange rates							
Dollar-Rand	7,06	8,26	8,44	7,33	7,17	7,88	8,33
Euro-Dollar	1,37	1,46	1,39	1,33	1,34	1,27	1,22
Dollar-Yen	117,7	103,4	93,5	87,8	81,4	82,9	83,0
British pound-dollar	2,00	1,83	1,56	1,54	1,63	1,61	1,60
Euro-rand	9,67	12,10	11,75	9,76	9,61	10,03	10,14
Rand-yen	16,7	12,5	11,1	12,0	11,3	10,5	10,0
GBP-rand	14,13	15,16	13,17	11,33	11,66	12,70	13,36
Interest rates (end of period)							
Three-month JIBAR	11,25	11,43	7,23	5,55	5,73	8,28	9,43
Prime	14,50	15,00	10,50	9,00	9,00	11,50	13,00
Long bond	8,35	7,33	9,08	8,15	8,96	9,24	9,04
Inflation (average)							
CPI new			7,1	4,3	4,2	5,9	6,0
CPIX (metro and other urban)	6,5	11,3					

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FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

3 February 2011

	2010				2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (q-o-q annual %)	4,6	2,8	2,6	4,3	2,6	3,2	3,3	3,6	4,0	4,4	4,3	4,0
Interest rates												
Three-month JIBAR	6,67	6,62	6,03	5,55	5,58	5,63	5,68	5,73	6,28	6,78	7,78	8,28
Prime	10,00	10,00	9,50	9,00	9,00	9,00	9,00	9,00	9,50	10,00	11,00	11,50
Long bond (10 yr)	8,62	8,86	7,90	8,15	8,72	8,64	8,84	8,96	8,95	9,07	9,21	9,24
Inflation												
CPI new	5,1	4,2	3,2	3,5	3,4	4,0	4,8	5,1	5,9	5,9	5,7	6,0
CPIX												
Exchange rates												
Dollar-Rand	7,36	7,65	6,98	6,62	7,22	7,07	7,22	7,43	7,65	7,88	8,12	8,28
Euro-Dollar	1,36	1,22	1,36	1,34	1,36	1,35	1,32	1,31	1,28	1,27	1,26	1,25
Dollar-Yen	93,2	88,6	83,4	81,6	81,6	80,8	81,2	81,6	83,2	82,8	83,2	83,2
British pound-dollar	1,51	1,51	1,59	1,55	1,62	1,63	1,64	1,66	1,64	1,59	1,59	1,58
Euro-rand	9,99	9,36	9,48	8,84	9,84	9,54	9,54	9,73	9,83	10,02	10,22	10,32
Rand-yen	12,66	11,58	11,95	12,32	11,30	11,42	11,25	10,98	10,87	10,50	10,25	10,04
GBP-rand	11,09	11,52	11,06	10,29	11,68	11,56	11,85	12,33	12,57	12,57	12,95	13,08
Gold price per ounce												
\$	1109	1243	1310	1426	1326	1366	1379	1407	1421	1378	1351	1297
Rand	8161	9513	9136	9442	9572	9662	9954	1045	1087	1086	1097	1074

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