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South African Economic Overview

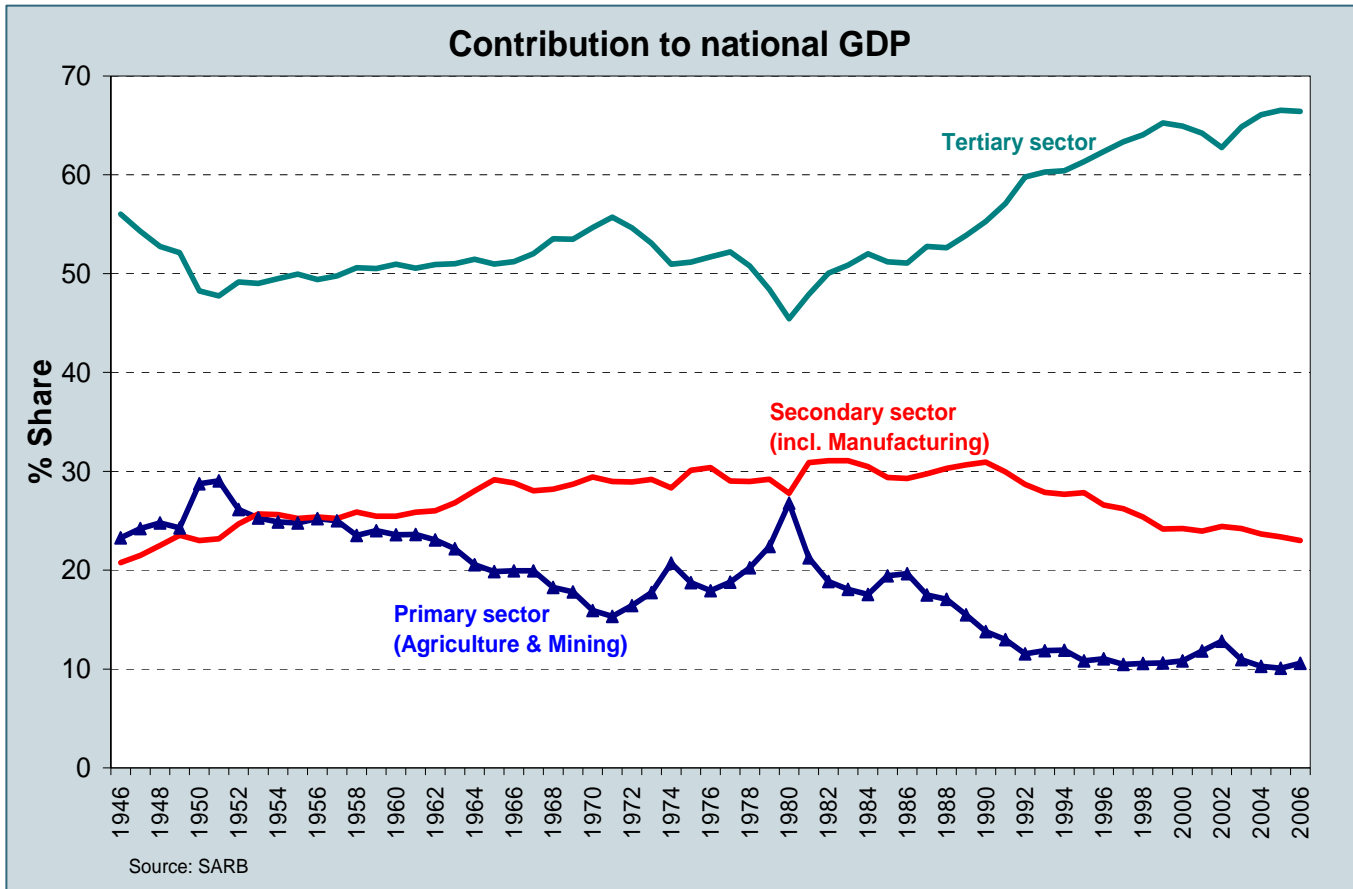
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Korea – Africa Forum

Johannesburg, 15 November 2007

South African economy: Changing composition

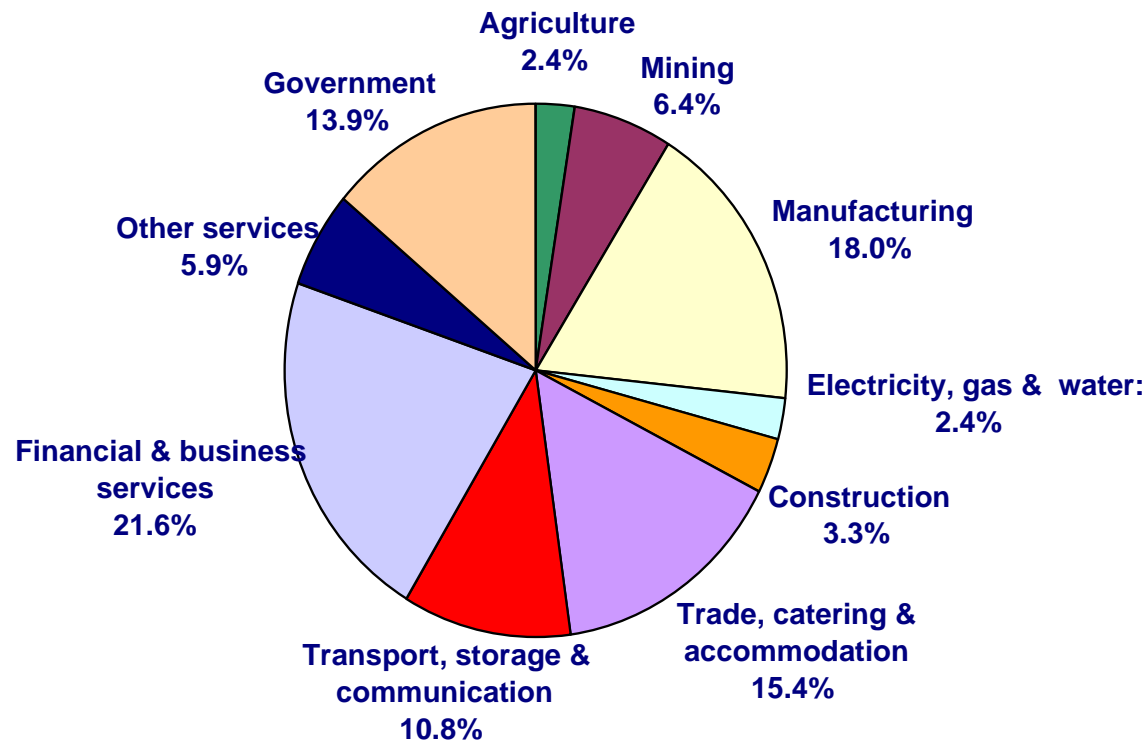


- The South African economy is increasingly dominated by services-related sectors - in line with international trends.
- The primary sectors - agriculture and mining - have seen their share substantially reduced over the past 5 decades.
- Share of the manufacturing sector - the 2nd largest sector of the economy - decreased sharply since the early 1990s in light of globalisation, trade liberalisation and an increasingly challenging global trading environment.

South African economy: Sectoral composition

Structure of the SA economy in 2006

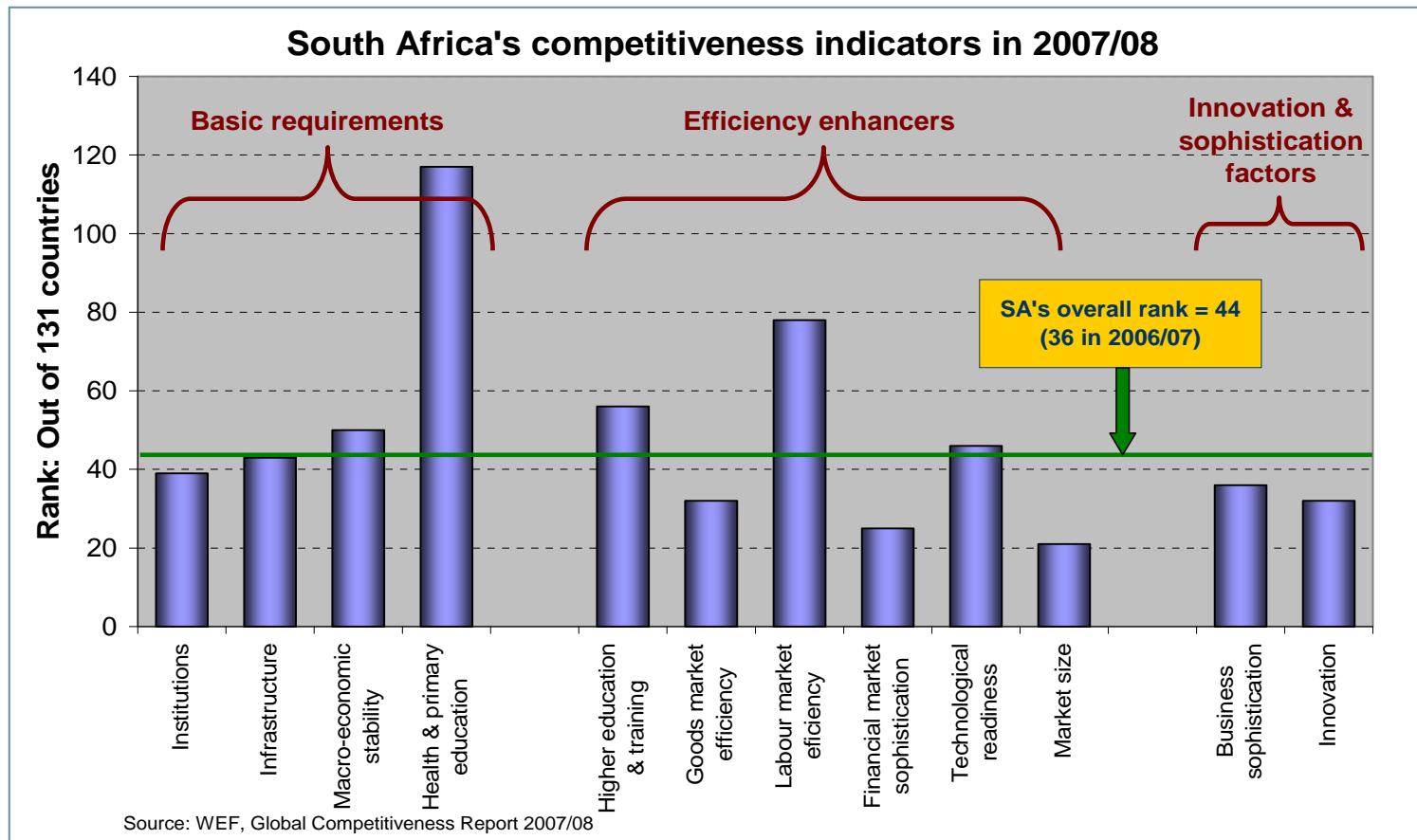
(% share at current prices)



Source: Stats SA

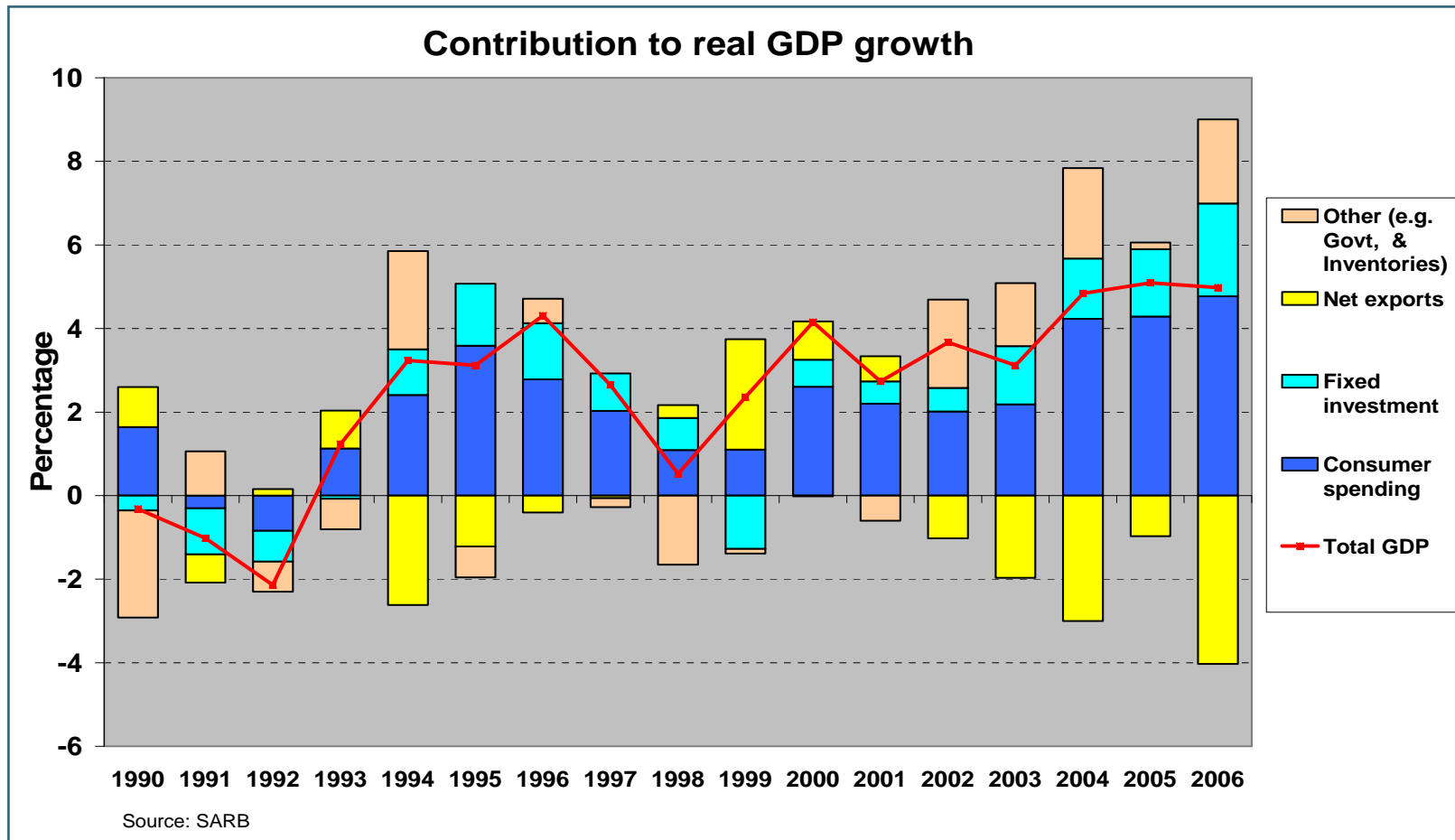
South African economy: Relative competitiveness

Although SA scores extremely well in certain indicators of global competitiveness, those pertaining to education and training are quite problematic.



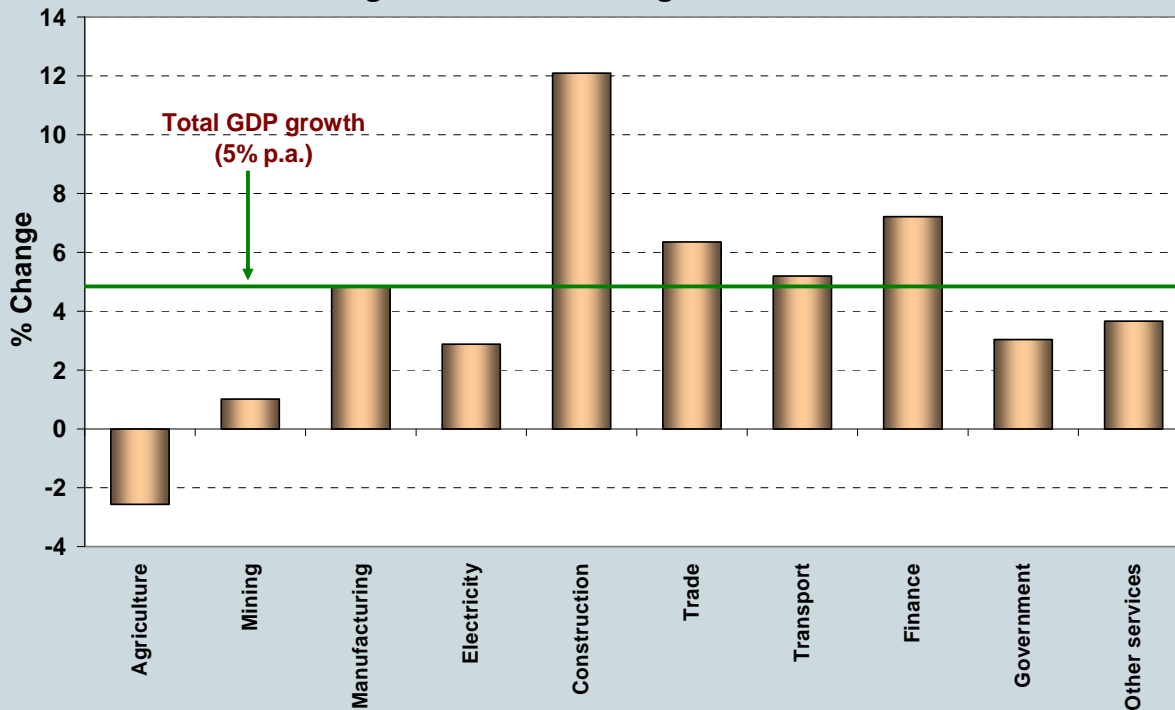
South African economy: Economic growth

A **solid growth performance** in recent years, mainly due to **strong domestic demand** (exports and imports remained a drag on what could have been an even better growth performance).



South Africa's economic performance: Sectoral growth

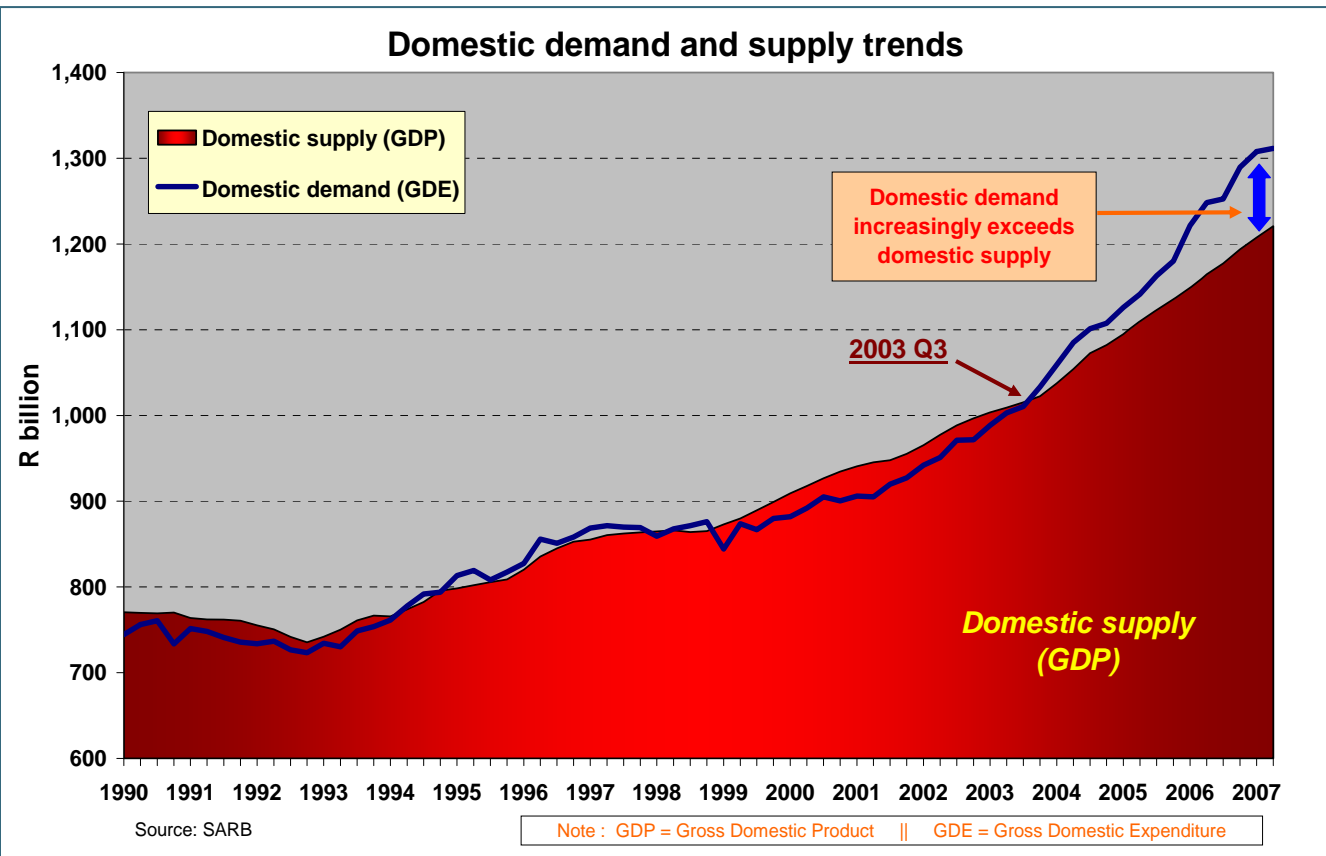
Average annual real GDP growth : 2004 - 2006



Source: Stats SA

- **Solid growth performance** of the SA economy continued throughout 2006, with some moderation in the first half of 2007.
- **Construction sector reported the strongest growth**, underpinned by increased building construction activity and high levels of fixed investment across most economic sectors.
- The strong consumer boom was reflected in high growth rates in the **trade and financial service sectors**.
- The brisk growth in the **manufacturing sector** was mainly due to **strong domestic demand** as exporters faced a challenging global trading environment.
- **Mining** activity has been adversely affected by a **continued decline in gold production**, although partially offset by the excellent performance of the platinum sub-sector.

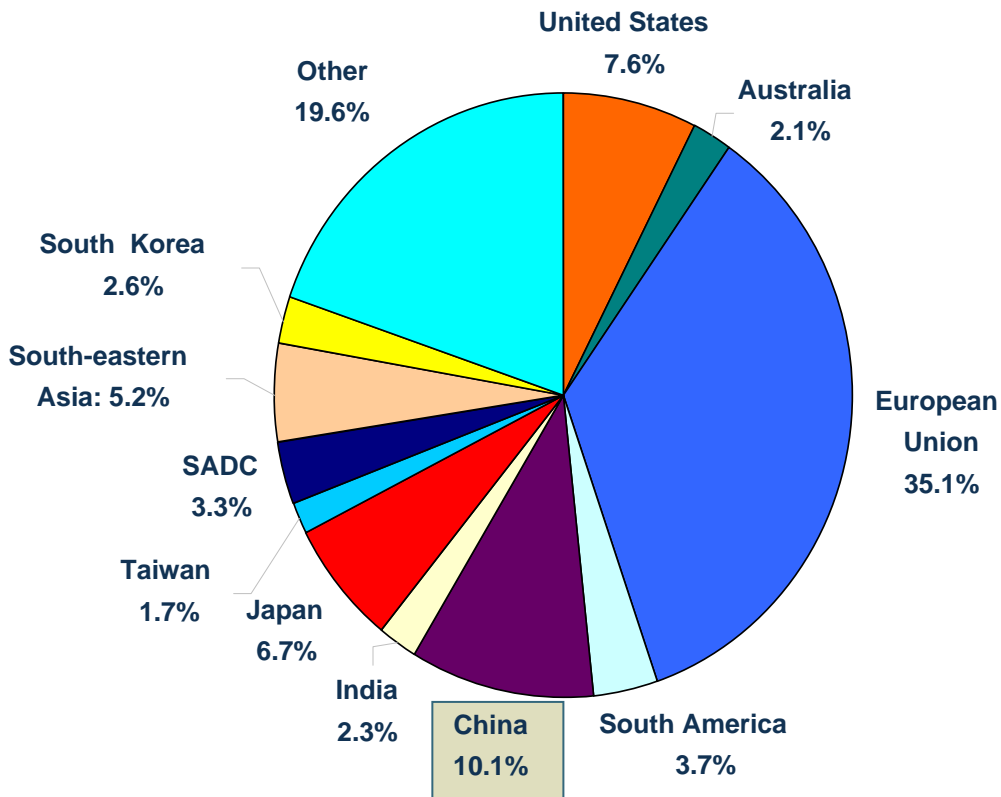
South Africa's economic performance: Domestic demand vs supply trends



- The sharp increase in domestic demand, including consumer spending and fixed investment, resulted in a widening output gap.
- Situation has also been aggravated by production capacity constraints experienced in various sectors of our economy.
- This is illustrating that SA is consuming more than it is able to produce
- Hence, a rapid rise in import demand for both consumer and capital goods has emerged.

South Africa's economic performance: Imports

SA imports by country of origin in 2006

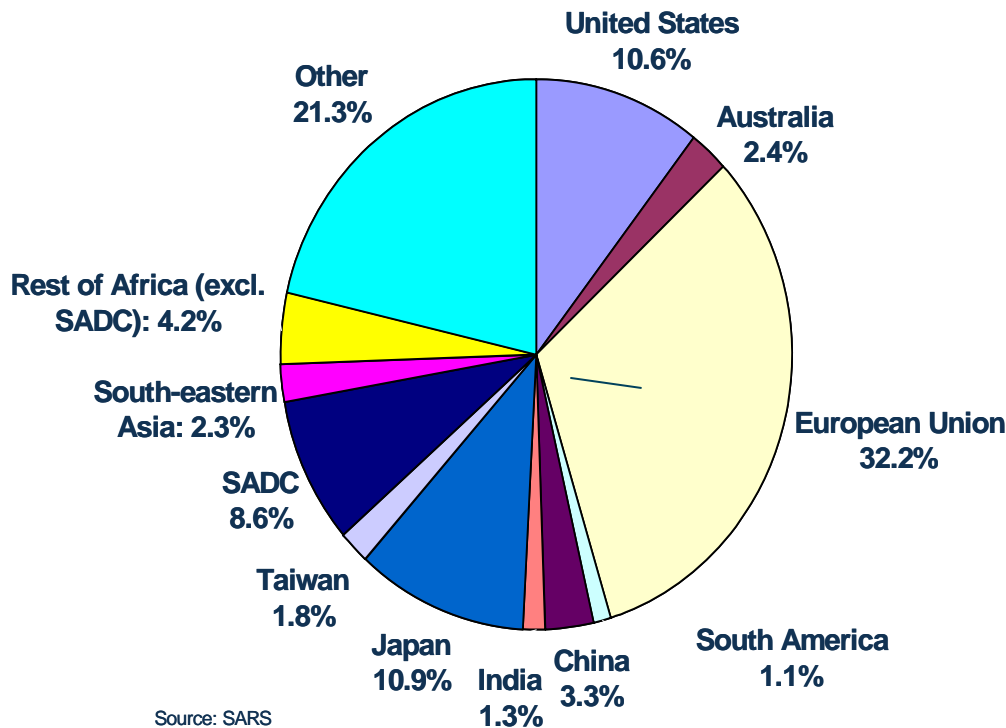


Source: SARS

- **Strong rise in import levels** associated with fixed investment activity and domestic consumption.
- Trade deficit measured R55.1 billion in the first 9 months of 2007, compared to a deficit of R42.5 billion over the same period in 2006.
- **Strong import demand over the Jan. to Sept. 2007:**
 - Imports of **base metals and metal products** increased by 49%
 - **Transport equipment** imports (incl. **vehicles**) increased by 34%
 - Imports of mineral products (**oil and fuel**) up by 40%
 - **Machinery and equipment** imports up 24%
 - Prepared **food products, beverages** and tobacco imports up by 41%
- **China** is becoming a **progressively larger source of imports**, with its share in the import basket rising from 1.7% in 1994 to just over 10% last year.

South Africa's economic performance: Exports

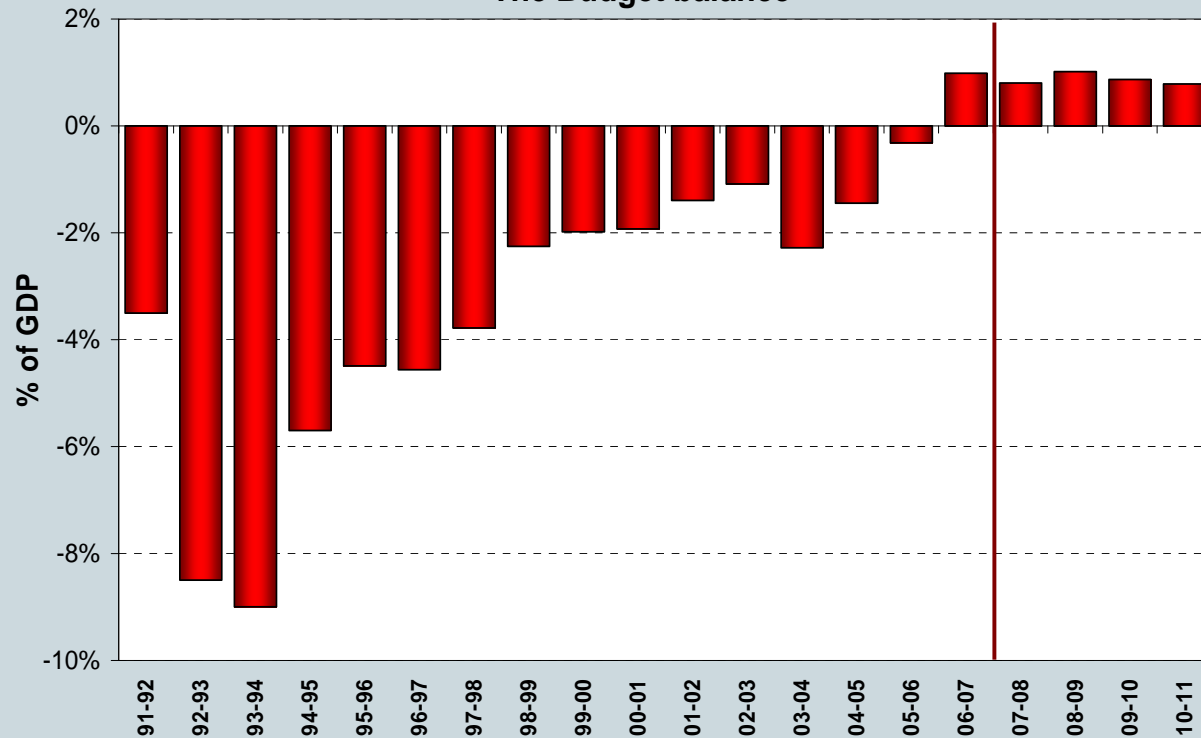
SA exports by country of destination in 2006



- SA's exports are destined mainly to the **EU**, followed by **Japan and the US** (combined **54%** share of exports in 2006).
- The **SADC region** also accounts for a significant share of SA's exports.
- Considerable headway has been made in the **diversification of the export basket** over the past decade.
- **SA's export propensity** (i.e. exports-to-GDP ratio) **increased sharply** from 22% in 1994 to 33% by 2002, but declined thereafter as a strengthening rand took its toll on the price competitiveness of export-oriented business enterprises.
- The **exports-to-GDP** ratio stood at **32.6%** in Q2 2007.

South African economy: Public finance

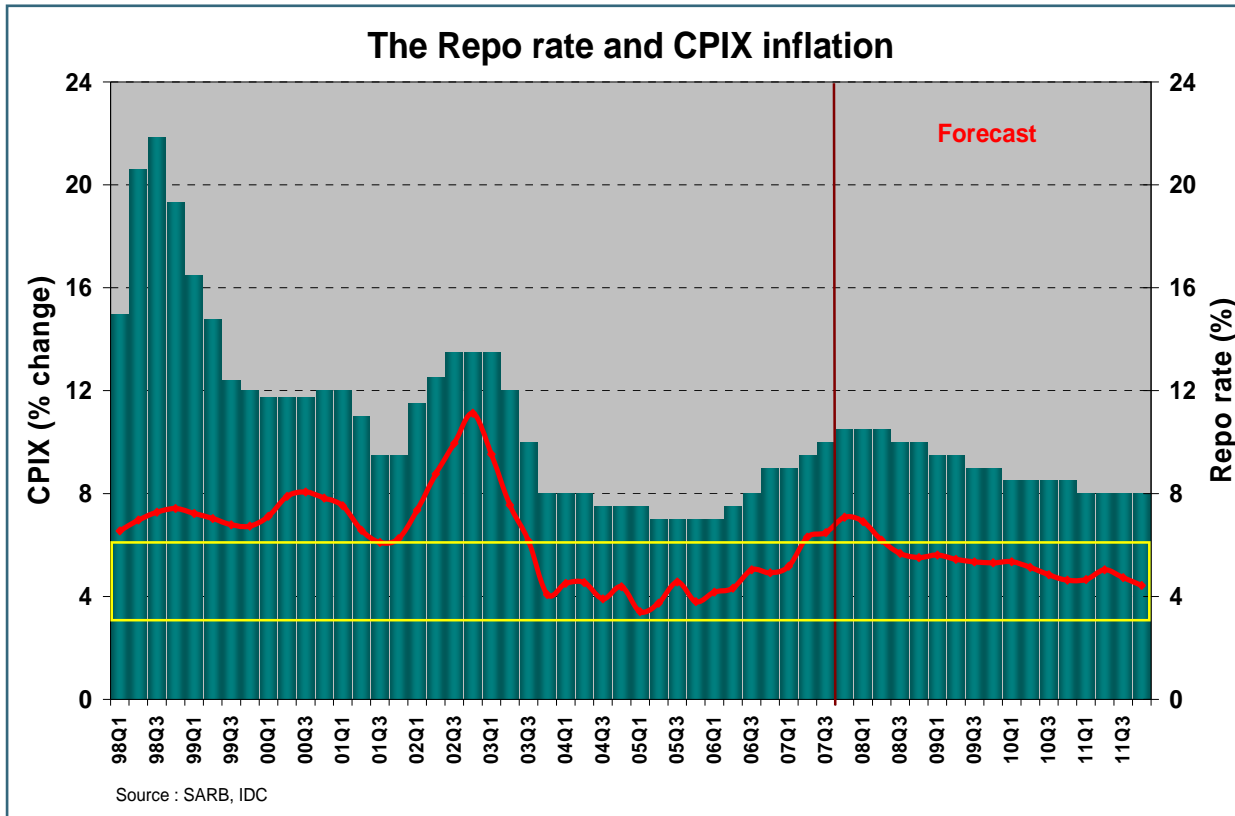
The Budget balance



Source: MTBPS, 30 Oct '07

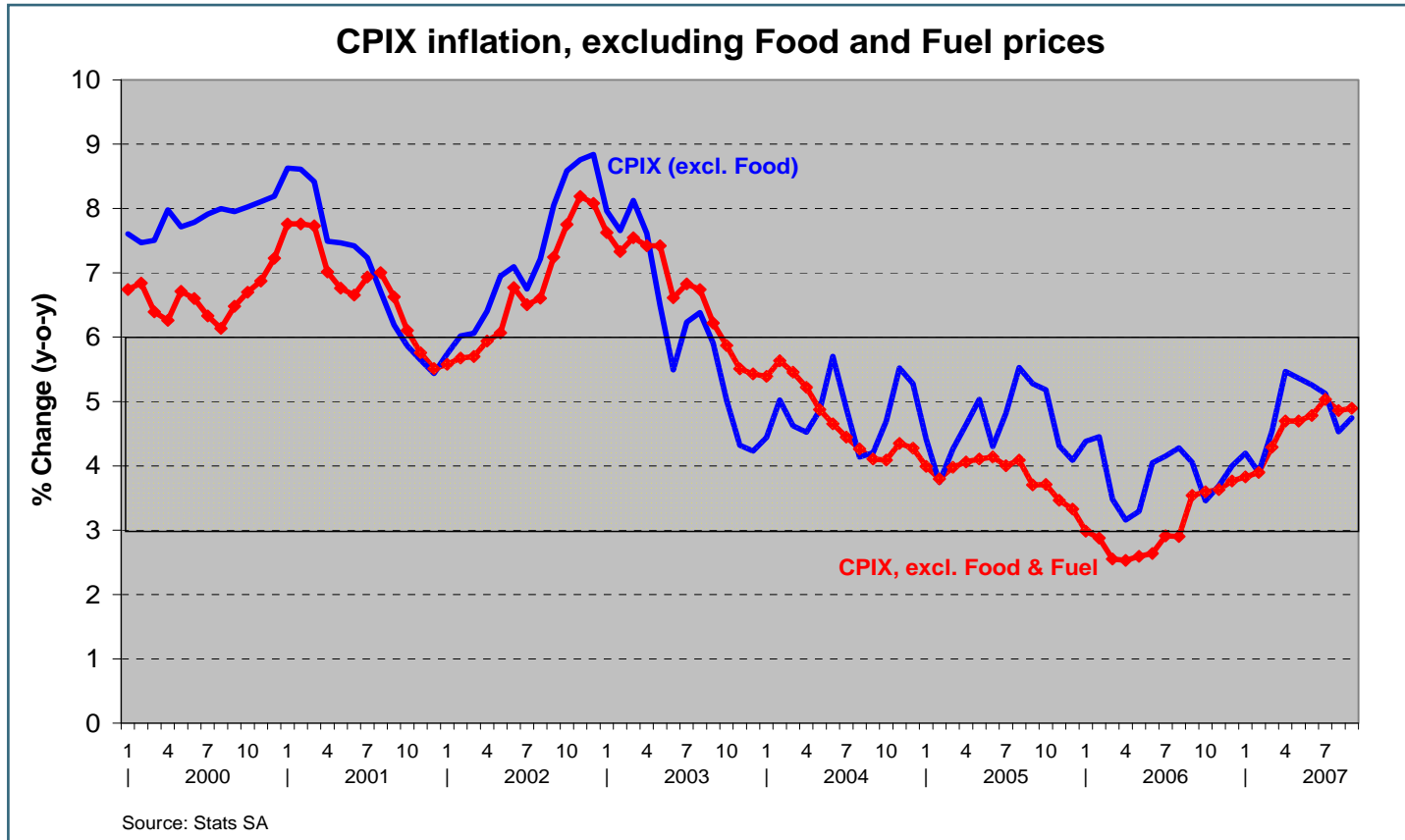
- Public finances have benefited substantially from the higher economic growth in recent years.
- Government is now budgeting for a surplus of roughly 1% of GDP over the period 2008/09 to 2010/11.
- The counter-cyclical justification put forward by Treasury for holding a budget surplus going forward is seen as holding only from an aggregate demand perspective, but possibly counter-productive from a supply perspective.

South African economy: Inflation and Interest rates



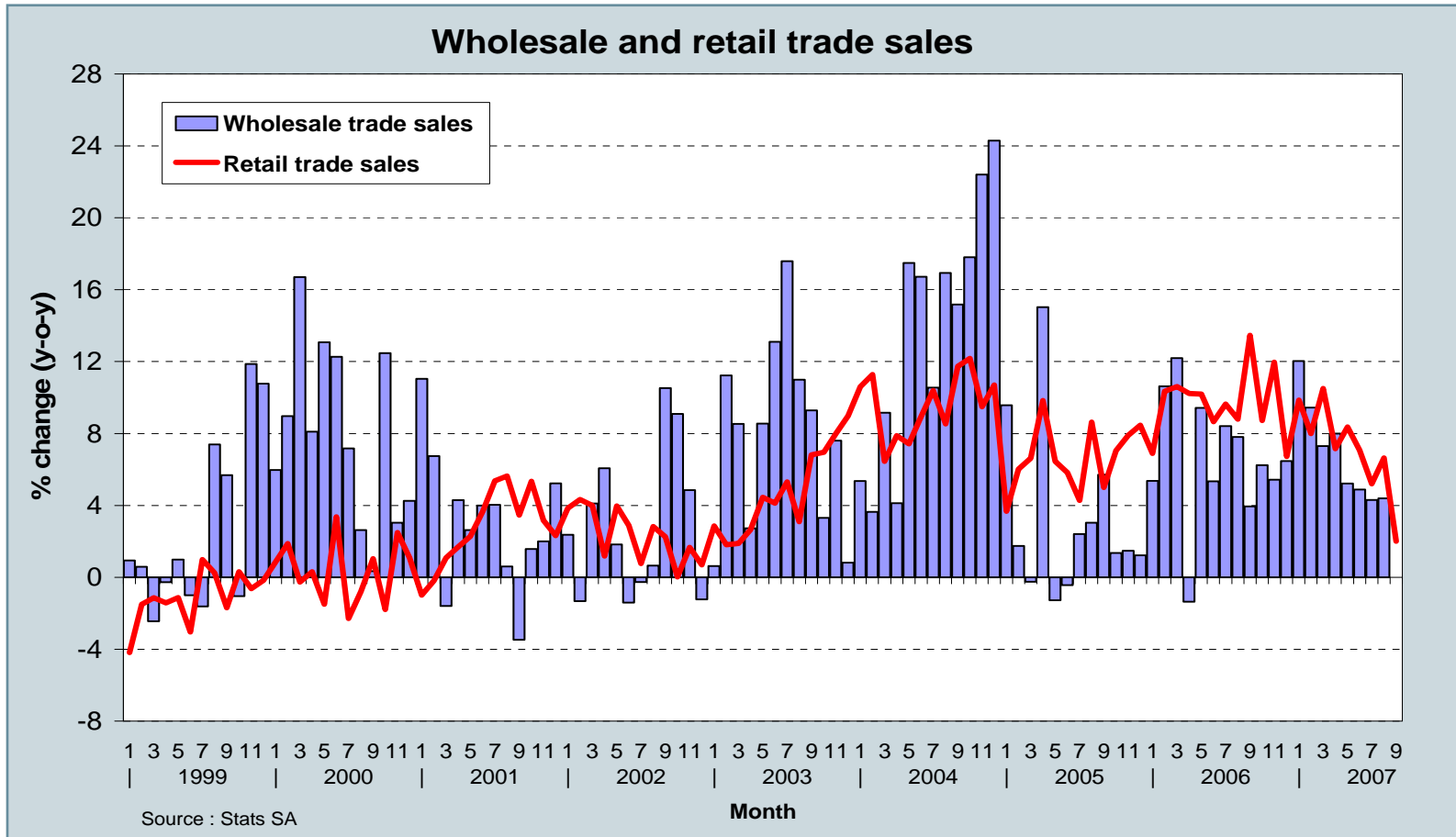
- The two main drivers (food and fuel) behind rising inflation in recent months are largely external factors, which are not likely to be affected by higher interest rates.
- Nonetheless, it is the SA Reserve Bank's objective to maintain price stability and bring inflation back into the target range.
- Stubbornly high producer prices also do not bode well for the inflation outlook.
- Should the inflation outlook deteriorate further than what is currently being expected, more rate hikes are possible.

South African economy: Inflation



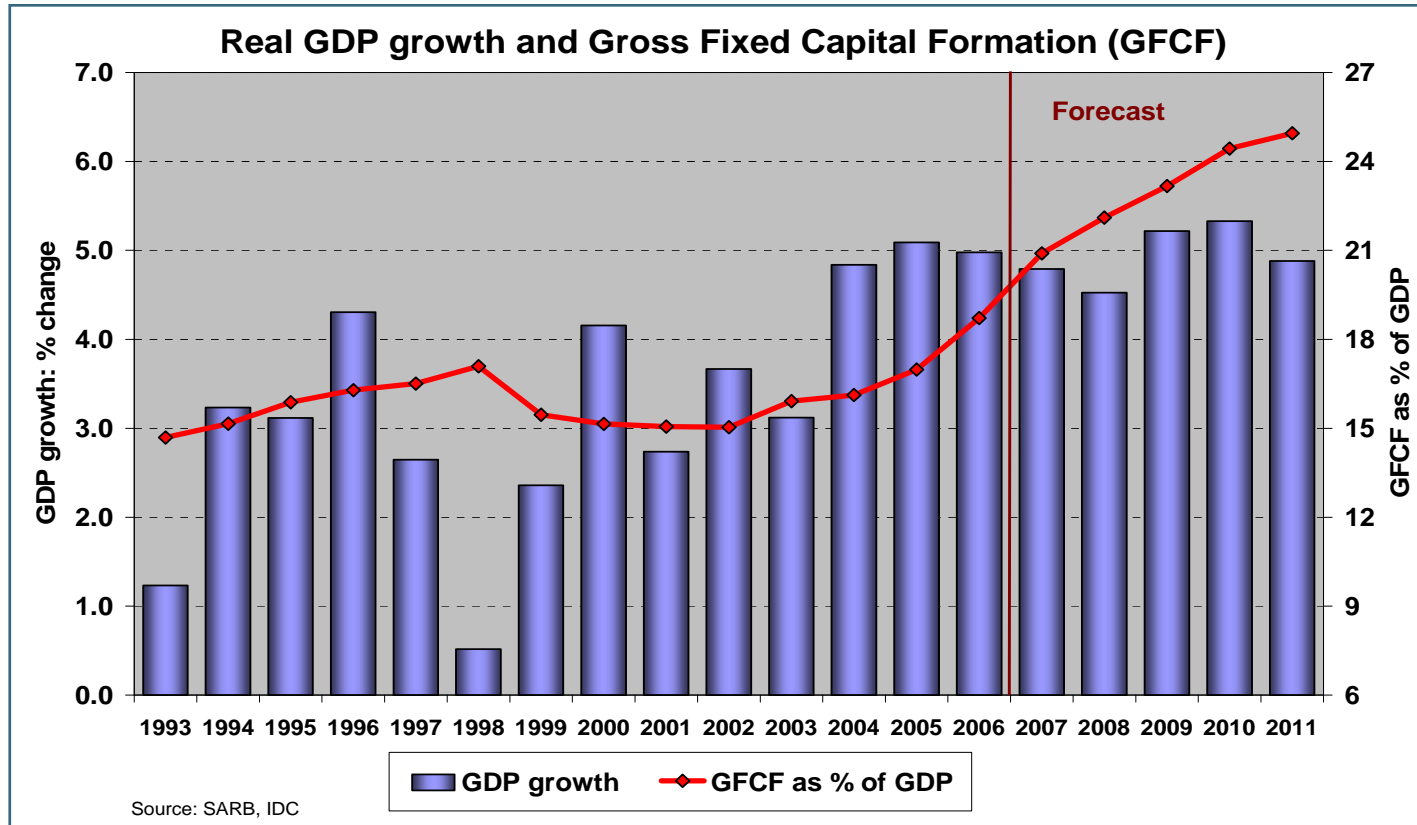
- **Excluding** the key inflation drivers, **food and fuel** (with a combined contribution of roughly 30% to overall CPIX), **inflation stood at 4.9%** in September 2007.
- The **sharp rise** in international oil prices in recent months has to some degree been **countered by** a stronger Rand-US dollar exchange rate.

South African economy: Retail & wholesale trade



- **Retail (and wholesale) sales growth has decelerated progressively and substantially since interest hikes set in from June 2006 onwards.**

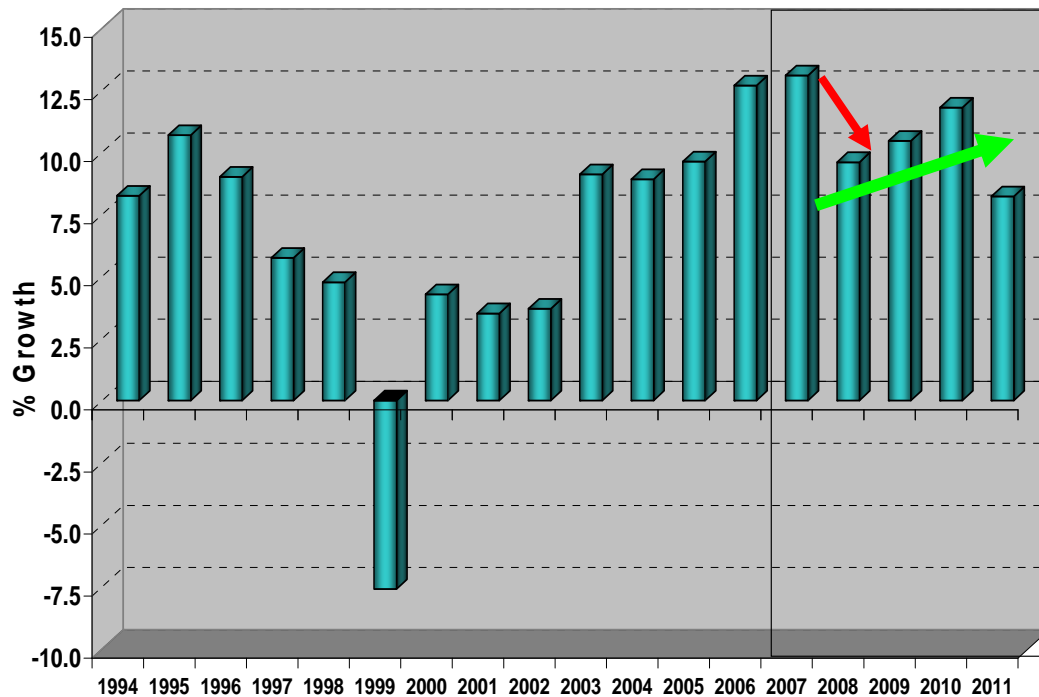
South African economy: Economic growth outlook



- Although GDP growth is likely to moderate to 4.5% next year, the economic outlook remains positive, with growth expected to average 5% p.a. over the next five years.
- Fixed investment is forecast to expand rapidly by 10% p.a., with the investment-to-GDP ratio expected to measure 25% by 2011.

South African economy: Fixed investment outlook

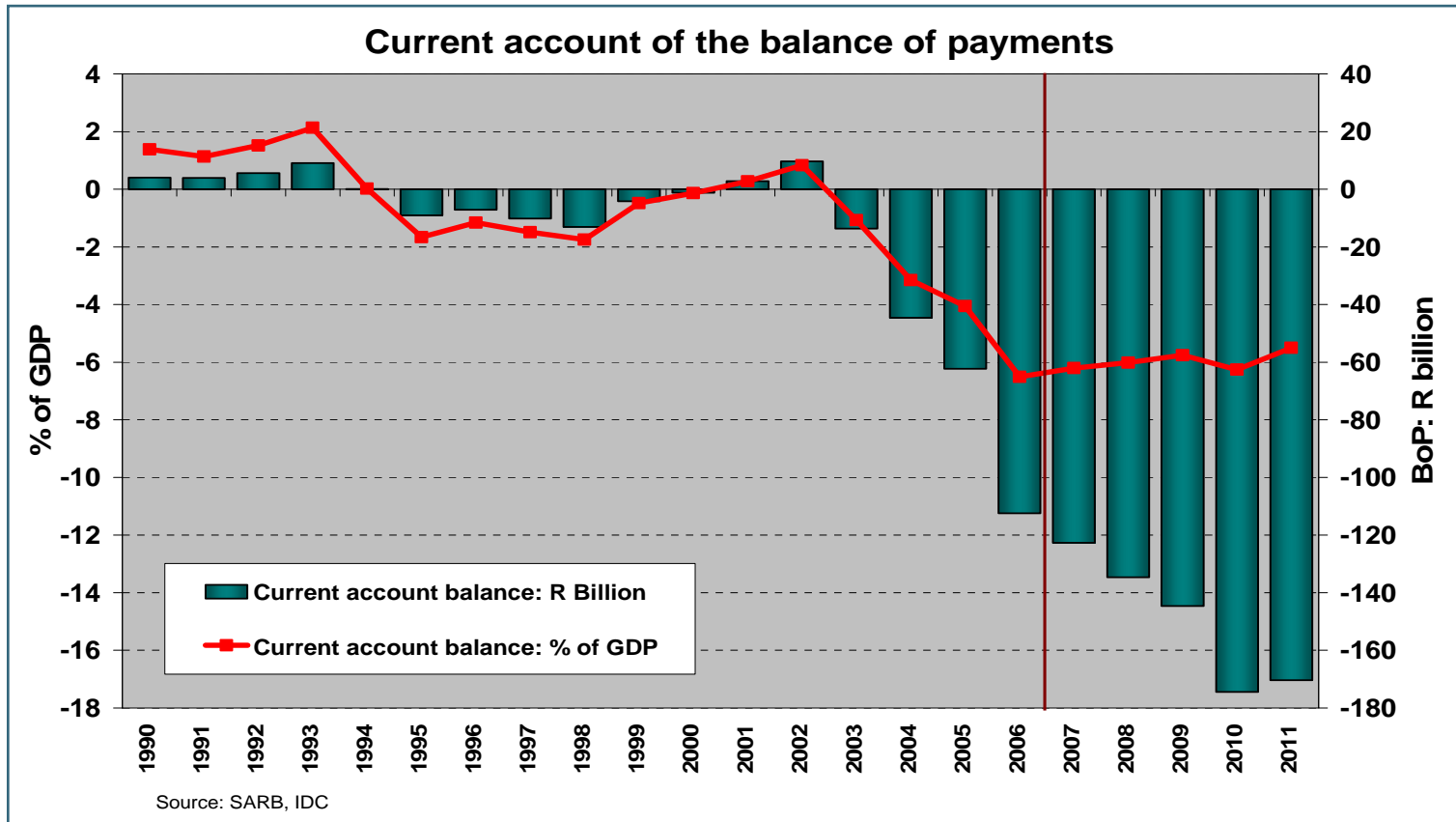
Real growth in fixed investment



Source: SARB, IDC

- Rapid increase in fixed investment over the past couple of years, particularly in residential property since 2003 and, more recently, substantial investment in non-residential buildings and plant and equipment.
- Fixed investment activity increased rapidly across most sectors of the economy.
- Large portion of investment in manufacturing was of a replacement nature, but manufacturers recently reported higher investment activity aimed at expanding production capacity.
- New investment activity is mainly driven by the lucrative domestic market.
- Investment outlook remains very promising with government planning to invest more than R420 billion in economic and socio-economic infrastructure over the medium term.
- Despite a slight deceleration in investment growth in 2008, private sector investment is expected to rise substantially over the next 5 years as business enterprises raise production capacity to meet strong and rising domestic demand.

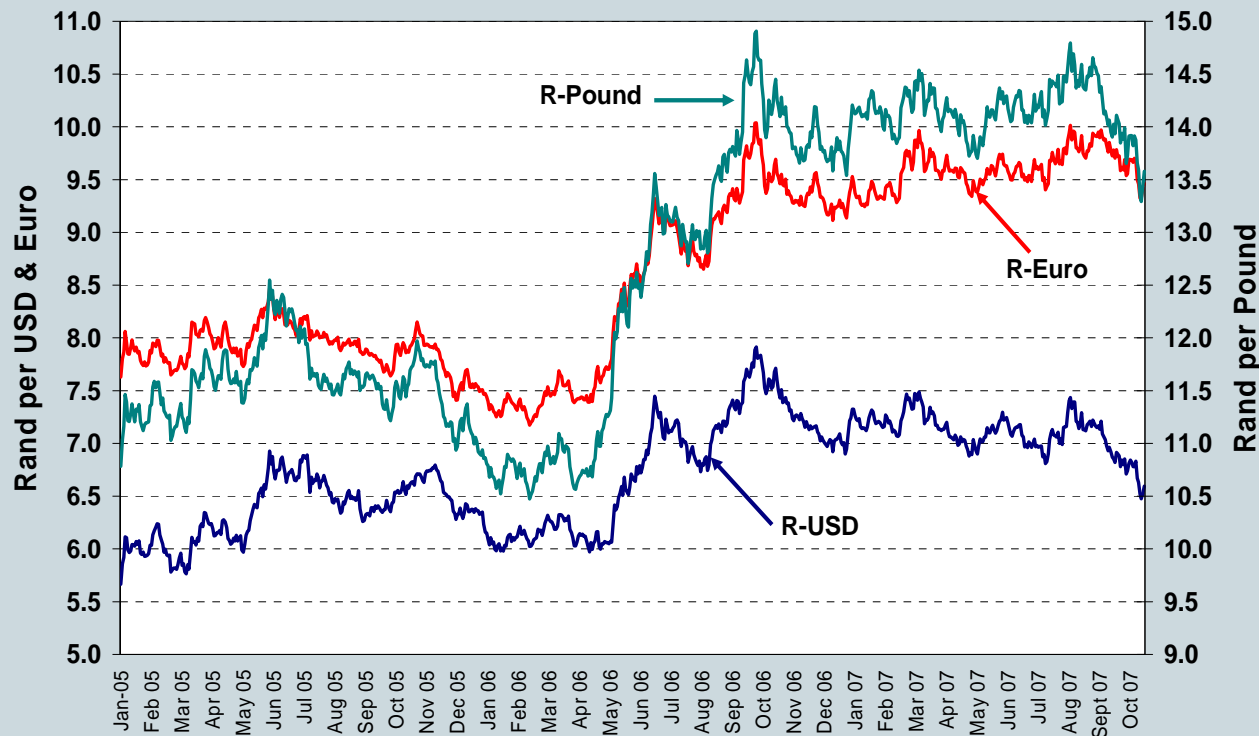
South African economy: Balance of payments outlook



- The **balance of payments** is expected to remain under pressure, with a **substantial widening** in the trade deficit, due largely to continued **strong demand** for imported **capital goods** (machinery and equipment, etc.) linked to both the public and private sector's **fixed investment activity**.

South African economy: Exchange rates

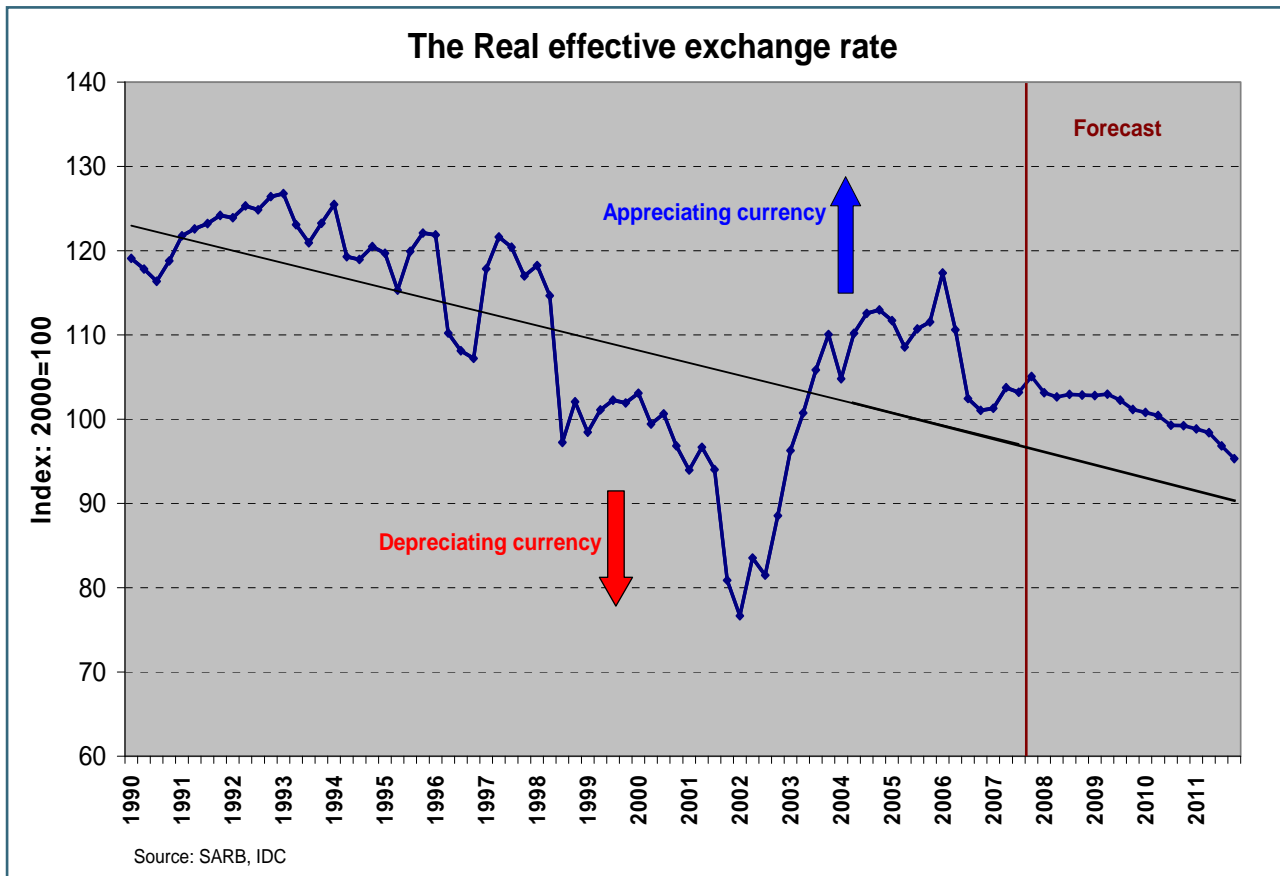
Daily movements in the exchange rate of the Rand



Source: Bloomberg

- Following a 10% depreciation against the US dollar in 2006, the Rand traded at fairly stable levels (R7.0 to 7.50 / USD) over the first nine months of 2007.
- The substantial strengthening of the Rand towards the end of October 2007 was largely due to the announcement that China's biggest bank the Industrial and Commercial Bank of China (ICBC) will buy 20% of Standard Bank, for an amount of R36.7 bn.
- The ICBC-Standard Bank announcement and continued strong capital inflows into the country along with the MPC's decision to raise interest rates all contributed to a strong currency scenario.
- The nominal effective exchange rate depreciated by 4% since the beginning of 2007, whilst in real terms the exchange rate managed a 1.6% appreciation (10.7% depreciation in 2006).

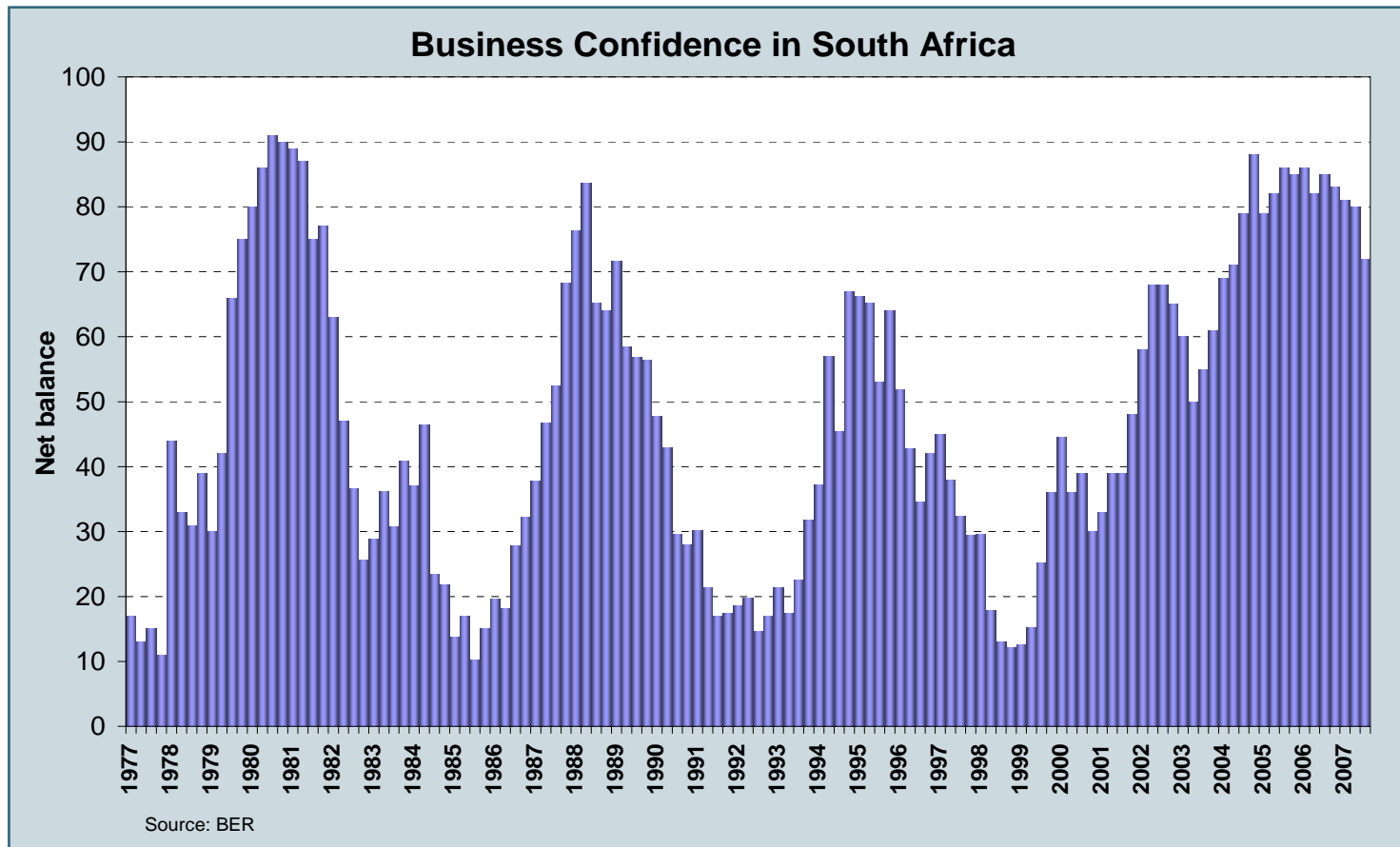
South African economy: Exchange rate outlook



- The Rand is expected to come under pressure over the forecast period, with a **moderate depreciation** in the **real trade weighted exchange rate** being forecast for the period 2008 to 2011.
- The **sizeable current account deficit** as a result of strong import demand for capital goods is expected to **exert** some **pressure on the exchange rate**.
- Although **exports** are forecast to **perform fairly good** over the next five years (especially against the assumption of a weakening currency and continued strong commodity demand), the **gap between imports and exports** is likely to remain sizeable.

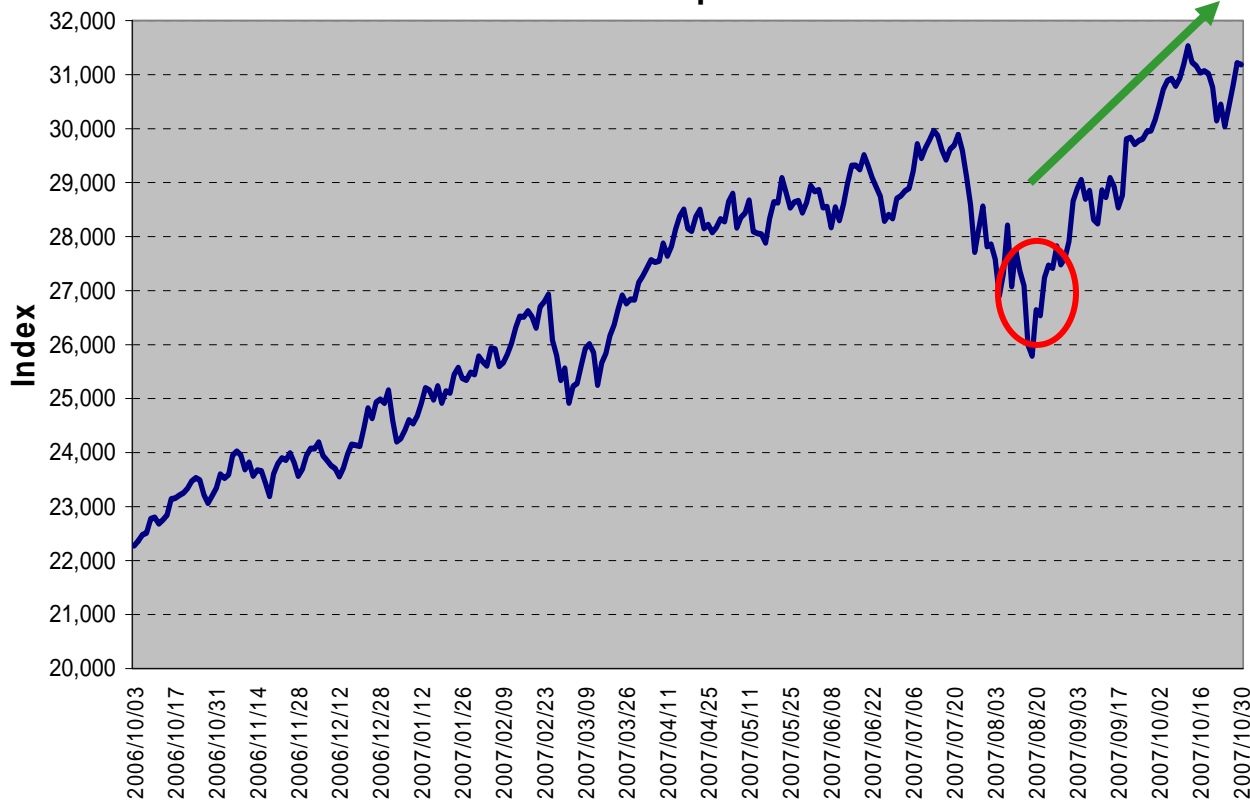
South African economy: Business confidence

- The **business confidence** index **dipped in Q3 of 2007**, but is still at a relatively high level from an historical perspective. **Higher interest rates** are impacting on business conditions.



South African economy: Equities market

JSE All-share index performance



Source: Bloomberg

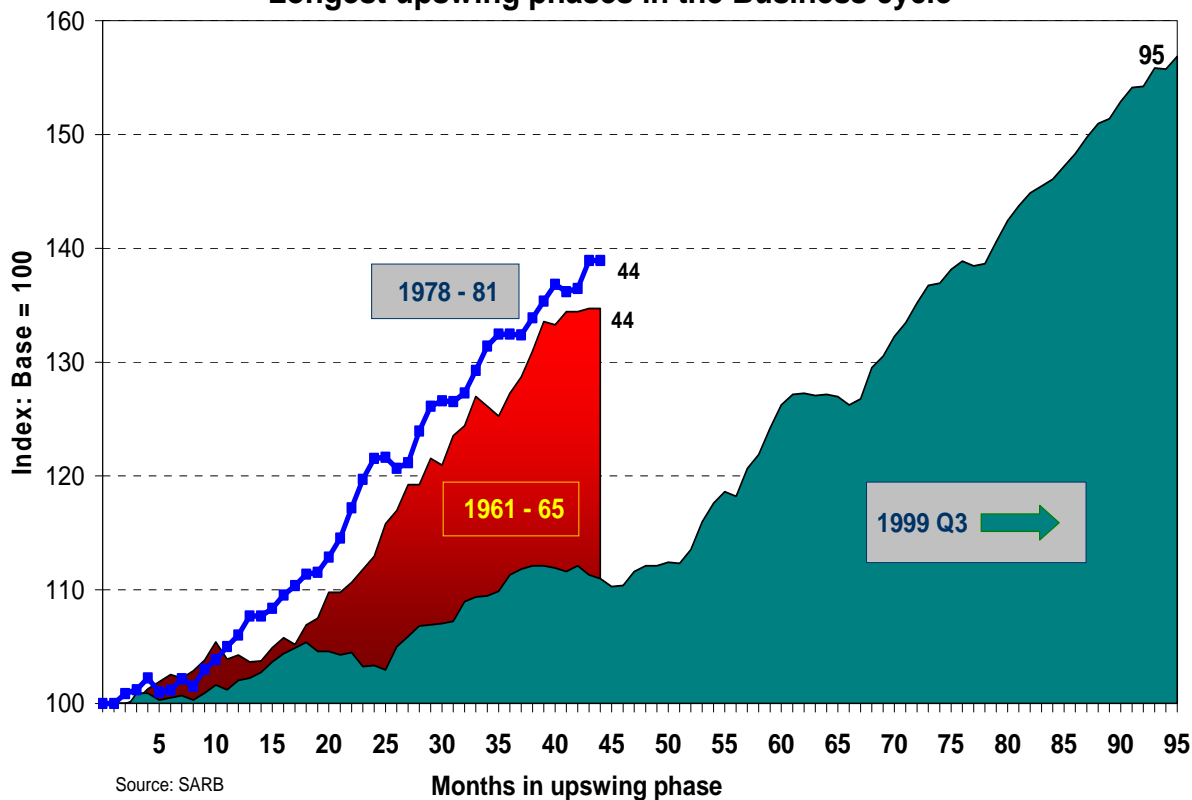
- Global equity markets staged a welcomed recovery following the sharp fall on the back of the sub-prime crisis in the US.
- The Johannesburg Securities Exchange staged a remarkable performance, with the All-share index rising to new record highs, following the sharp downturn in August.
- IMF cautioned in WEO (Oct '07) that: *"there remains the distinct possibility that recent turbulent conditions could continue for some time and generate a deeper credit crunch (globally) than envisaged"*.

SA stock market performance

- 2005 - increase of 43%
- 2006 - increase of 37.5%
- 2007 (Jan – Oct) - increase of just over 25%

Concluding remarks

Longest upswing phases in the Business cycle



- South Africa is currently enjoying the longest sustained period of economic growth on record (95 consecutive months).
- SA is partaking in many of the challenges of the globalisation process, facing an increasingly competitive environment that calls for:
 - productivity growth
 - lower production costs
 - technological innovation
 - capital deepening and job losses in many instances
 - as well as the identification of increasingly difficult to find niches in the marketplace .
- Competitive forces pose opportunities for technological upgrading, innovation, expansion (economies of scale), global joint ventures or partnerships, and identification of niche markets and sectors.

Concluding remarks

- SA's general economic stability and **sound macro-economic management and fundamentals** are widely acknowledged.
- **Inflationary pressures** more recently on the back of a sharp **rise in food and fuel prices**, thereby resulting in rising interest rates.
- A **developmental approach to fiscal expenditure** going forward.
- The **rand** is likely to come under pressure.
- The **efficiency and affordability** of physical support **infrastructure** are critical to economic efficiencies – hence the magnitude of the public sector investment programme currently being rolled out.
- **Skills shortages** are developing in a variety of sectors.
- The **resolution of the unemployment crisis** is key to alleviating South Africa's socio-economic challenges.
- **South Africa** has a substantial range of **comparative advantages** and **numerous investment opportunities** that, once exploited, will lead to a much higher growth trajectory.



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Thank you

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