

# Nedbank

## Guide to the Economy

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##### 1 | International background and outlook

Global growth has slowed in recent weeks while inflation has remained relatively high. High unemployment, weak credit markets, and massive public and private debt overhangs are hampering the recovery in much of the developed world, while high food and energy prices, credit bulges and limited infrastructure are raising fears of booms and busts in key developing countries. The outlook will depend on how well these competing forces can be managed by policymakers.

##### 6 | Domestic review and prospects

The domestic economy has slowed after a strong start to the year. Recent indicators suggest that growth has moderated significantly from the surprisingly strong 4,8% experienced in the first quarter, with a 3,8% expansion now forecast for the year as a whole. The economy has been supported by good global growth and low inflation and interest rates. However, the global environment is deteriorating, prices are rising and heavily-indebted consumers are reluctant to incur further debt so close to the start of an interest rate hiking cycle.

#### Facts and forecasts

##### 11 | Annual

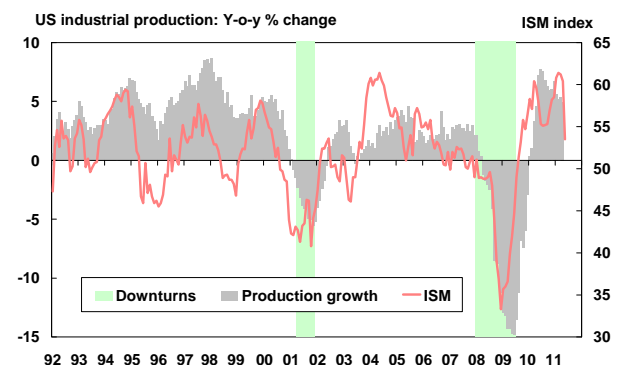
##### 12 | Quarterly

NEDBANK GROUP ECONOMIC UNIT  
Nedbank Headoffice  
135 Rivonia Road Sandown 2196  
PO Box 1144 Johannesburg 2000  
Tel +27 (0)11 295 6363  
Fax +27 (0)11 294 6363  
Email EstelleO@Nedbank.co.za

#### International background and outlook

*The global economic environment deteriorated in the second quarter, with growth slowing, inflation picking up and risks generally increasing. After an encouraging start to the year the stop-start nature of the upswing quickly reasserted itself, underlining the deep structural issues still hampering the international economy. In much of the developed world economies are constrained by high public and household debt levels. House prices and construction activity remain weak and employment gains have lagged the recovery. Fiscal policy has started to reflect the new reality, with consolidation rather than expansion likely over the medium term. Markets have been rattled by the resurfacing of the peripheral European sovereign crisis and budgetary uncertainty in the United States. The expansionary monetary policies that helped to divert disaster at the time of the crisis are now also creating problems in the form of higher inflation generally and excess credit creation in key developing countries.*

Graph 1: US manufacturing activity moderating



Source: Datastream

**US growth** softened in the first quarter as households remained cautious and government investment spending dropped. Exports to emerging markets as well as business investment in new software helped to support economic activity. Recent economic indicators suggest that second quarter growth is not likely to impress. Industrial production stalled in April as the earthquake in



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Japan disrupted supply chains. Durable-goods orders, an indicator of future manufacturing activity, also declined. Consumer confidence has also slipped on softer conditions in the labour market, while measures of business confidence also appear to have peaked.

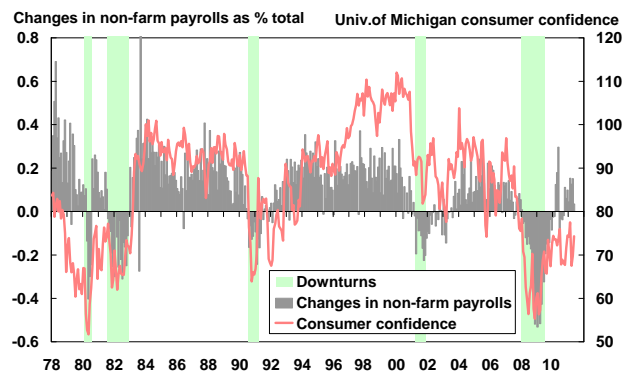
Table 1: IMF April 2011 forecasts

Countries and regions	Forecasts April 2011								
	2005	2006	2007	2008	2009	2010	2011	2012	2013
World	4.6	5.2	5.4	2.9	-0.5	5.0	4.4	4.5	4.5
Advanced economies	2.7	3.0	2.7	0.2	-3.4	3.0	2.4	2.6	2.5
US	3.1	2.7	1.9	0.0	-2.6	2.8	2.8	2.9	2.7
Japan	1.9	2.0	2.4	-1.2	-6.3	3.9	1.4	2.1	1.7
Euro area	1.7	3.1	2.9	0.4	-4.1	1.7	1.6	1.8	1.8
Germany	0.9	3.6	2.8	0.7	-4.7	3.5	2.5	2.1	1.9
UK	2.2	2.8	2.7	-0.1	-4.9	1.3	1.7	2.3	2.5
Emerging and developing	7.3	8.2	8.8	6.1	2.7	7.3	6.5	6.5	6.5
Developing Asia	9.5	10.4	11.4	7.7	7.2	9.5	8.4	8.4	8.5
China	11.3	12.7	14.2	9.6	9.2	10.3	9.6	9.5	9.5
India	9.2	9.7	9.9	6.2	6.8	10.4	8.2	7.8	8.2
Middle East and N Africa	5.4	5.8	6.2	5.1	1.8	3.8	4.1	4.2	4.3
Sub-Saharan Africa	6.2	6.4	7.2	5.6	2.8	5.0	5.5	5.9	5.7
South Africa	5.3	5.6	5.6	3.6	-1.7	2.8	3.5	3.8	4.2
Angola	20.6	19.5	23.9	13.8	2.4	1.6	7.8	10.5	6.5
Nigeria	5.4	6.2	7.0	6.0	7.0	8.4	6.9	6.6	6.3
Zimbabwe	-2.2	-3.5	-3.7	-17.7	6.0	9.0	7.3	5.7	5.2
Namibia	2.5	7.1	5.4	4.3	-0.8	4.4	4.8	4.5	4.4
Latin America	4.7	5.6	5.7	4.3	-1.7	6.1	4.7	4.2	3.9
Brazil	3.2	4.0	6.1	5.2	-0.6	7.5	4.5	4.1	4.1
Mexico	3.2	5.2	3.2	1.5	-6.1	5.5	4.6	4.0	3.4
Central & Eastern Europe	5.9	6.4	5.5	3.2	-3.6	4.2	3.7	4.0	3.9
Russia	6.4	8.2	8.5	5.2	-7.8	4.0	4.8	4.5	4.3

Source: International Monetary Fund

While headline growth figures have looked relatively respectable, key areas of the economy remain weak. Persistent problems in the labour market are a concern. The economy has added only 1.5 million jobs over the past year, bringing the unemployment rate down to around 9%. This situation is not expected to improve rapidly, with 150 000 new jobs needed every month to keep up with the growth in the working-age population. Discouraged workers will also begin to return to the labour force. The housing market also remains in the doldrums, with home sales and building activity only slightly off record lows and prices continuing to fall.

Graph 2: US labour market still unresponsive

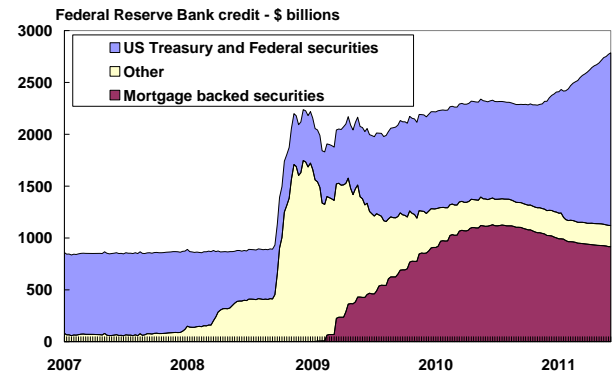


Source: US Federal Reserve

Federal Reserve Chairman Ben Bernanke has given little indication that monetary policy will be tightened soon, despite the fact that inflation will average above the Fed's de facto 2% target this year. The Chairman rather opted to focus on the 'transitory' nature of the current bout of

inflation, highlighting the impact of higher commodity prices. Government finances are expected to deteriorate this year, with the deficit rising to 10% of gdp. A credible fiscal consolidation programme still seems some way off, with politicians lacking the will to come to a bipartisan agreement.

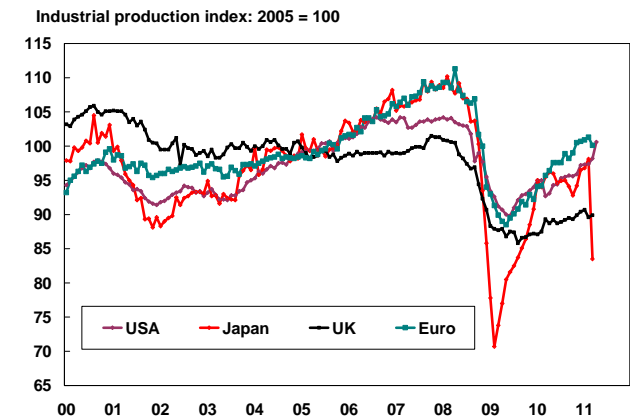
Graph 3: US quantitative easing about to end



Source: US Federal Reserve

Recent business surveys suggest that manufacturing-led recovery in **Europe** may be starting to lose some momentum. Although headline industrial production figures, notably in Germany, France and the Netherlands, remain robust, new orders – particularly export orders – have begun to decline. This may be an early indication that the strength of the euro has begun to bite. Economic activity is still sluggish in Spain and Italy, while the Portuguese economy contracted for a second consecutive quarter and Greece remains in the doldrums. The hawkish European Central Bank (ECB) finds itself in a difficult position. Inflation has been persistently above the ECB's 2% target for some time now. Normalising interest rates would do little damage in countries like Germany and France, but could complicate matters in peripheral countries, where growth is elusive and banks remain dependent on cheap ECB funding. The ECB's task might be further complicated if there are further signs that the economy is beginning to weaken.

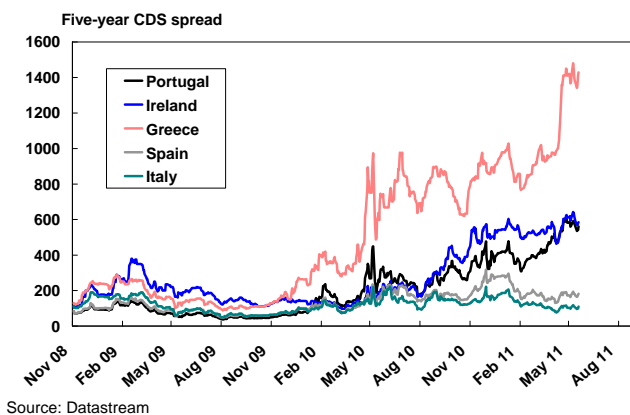
Graph 4: Industrial production: Japan under pressure



Source: I-Net

Despite a no-bailout clause being central to the Maastricht Treaty, European authorities seem adamant that Greece will neither default nor restructure its debt. The strategy – so far – has been to provide stop-gap financing under the assumption that it will give the government enough time to introduce structural reforms. This has proven woefully inadequate. The yields on ten-year government bonds has surged above 17% and the spread on five-year credit default swaps is well over 1 400 basis points, suggesting that most believe Greece will default at least partially. Attention will now focus on whether the IMF and the EU can reach an agreement on an additional bailout facility and whether Greece will meet the conditions imposed by the IMF. If not, a restructuring looks inevitable.

Graph 5: European risk premiums have risen further

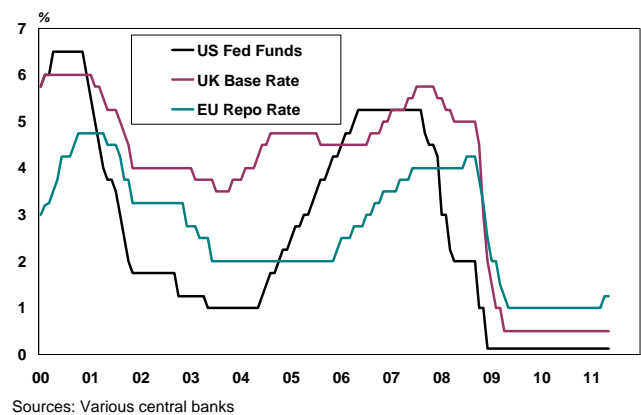


**UK growth** remained tepid in the first quarter, with trade largely responsible for the modest expansion helped by the weaker sterling. However, rising input costs are squeezing manufacturers' profit margins, putting pressure on them to raise prices, which will begin to erode competitiveness. The temporary boost provided by the royal wedding will lift consumer spending in the second quarter, but the improvement is likely to be temporary. Real wages are under pressure, as inflation exceeds earnings growth. VAT has increased along with income tax and contributions to national insurance. The construction sector, which came under pressure during the housing slump, will continue to struggle as the government cuts back on building contracts. Net government investment is expected to fall by 20% this year. Inflation reached a 30-month high in April, driven by rising commodity prices, higher VAT rates and a weak currency. Although interest rates are expected to rise, the recent minutes of the MPC meeting suggest that, due to the weakness in the economy, there is no hurry to tighten policy.

**Japan** slipped back into recession in the first quarter of 2011, following the earthquake and tsunami that struck the country's industrial north-eastern region. Industrial production fell by the most on record in the aftermath of the disaster – vehicle production plummeted by more than 45%. Exports dropped sharply in response, with the trade

balance tipping into deficit for the first time in two years. A further contraction is expected in the second quarter, as supply chain disruptions, power shortages and factory closures persist. In the latter half of the year reconstruction efforts and factories catching up on orders will boost growth. However, underlying fundamentals will remain weak, particularly for the consumer. Consumer confidence stands at near-record lows, dragged down by falling expectations about employment prospects. Much also depends on whether supply disruptions, particularly power shortages, can be resolved quickly. The Bank of Japan is expected to ease policy further this year to support the recovery, which will probably take the form of additional asset purchases from the market. Directly underwriting government bonds to fund the reconstruction effort has also been mooted as a possibility.

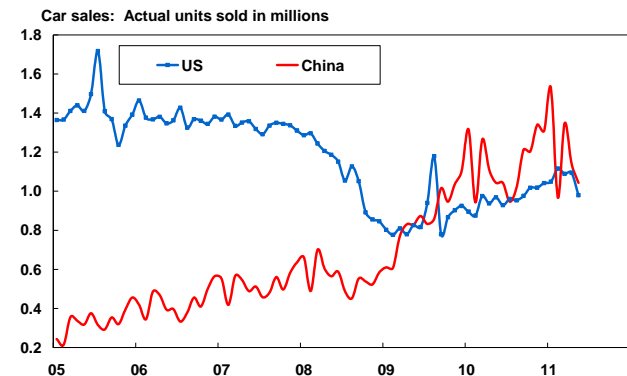
Graph 6: ECB has started to tighten, but gradually



**Chinese** authorities face a difficult balancing act. Inflation, which has been running well ahead of the government's desired 4% target, needs to be brought under control. At the same time growth, which was still a robust 9.7% in the first quarter, has to be kept above 8%. Recent indications suggest that the economy is slowing too quickly. The purchasing manager's index has come down steadily over the past few months, along with industrial production, while growth in retail sales is at its lowest level since 2004. Power outages, similar to those experienced in 2004, are expected to get worse and hurt industrial production. Poor profitability due to elevated coal prices, rather than a lack of generating capacity, is behind the outages. Policy measures to curb inflation could prove too effective at stemming growth. Authorities have increased bank reserve requirements eight times to 21% and hiked interest rates four times since October, with further increases expected. This, combined with a glut of new property on the market in some areas as well as measures to tighten banks' lending practices, could put a damper on the construction industry as well as on the growth in house prices. The 12<sup>th</sup> five-year plan, which outlines the direction the country will take, again focused on the need to rebalance the economy from an over reliance on exports and investment towards consumer spending. However, similar goals were set in the last five-

year plan, with few concrete steps taken to redress the imbalances.

Graph 7: Car sales easing



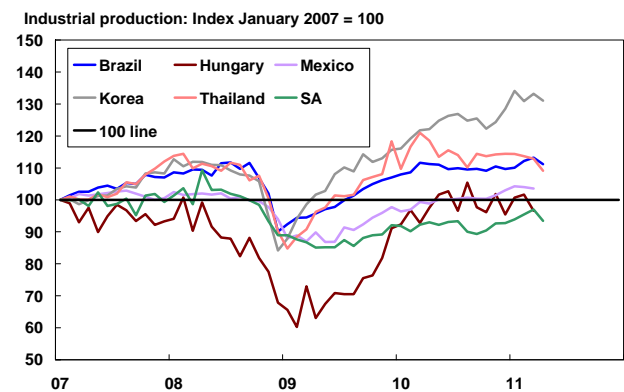
Source: Datastream

Asian growth is expected to slow to just below 7% this year, as the stimulus provided by the recovery in trade flows subsides and domestic demand responds to tightening economic policy. Asia will be highly dependent on developments in China, which is an important engine of regional economic growth. The major economies, including Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam, have been boosted by capital inflows, which have raised some concerns about overheating and have eroded exchange rate competitiveness. Domestic demand remains robust, supported by income growth and strong growth in domestic credit. Credit growth remains elevated in India and Indonesia, with real credit growth in excess of 10%, and money flowing into real estate and large infrastructure projects. Credit growth in Singapore and Malaysia has been more modest. However, asset prices have risen sharply on an inflow of foreign currency. There is a risk that boom-like conditions may intensify in these and other economies over the next year. As a result inflationary pressures could build up in response to rising capacity constraints, as well as higher food and fuel prices. This could put upward pressure on wages. 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.

Domestic demand continues to drive the economic recovery in many **Latin American** countries. Commodity-orientated countries, such as Peru, Chile and Brazil, have benefited from strengthening trade links with China and have grown faster than others in the region. Strong wage growth, an expanding labour force as well as improving access to credit will also help to support growth. In contrast, Central America and the Caribbean will grow more slowly, due to their close links with the United States. Employment prospects in the United States, the key driver of income for many households, remain poor, particularly due to weakness in the construction sector.

Loose economic policy will support growth in Argentina in 2011, but during the course of the year the government will need to start to reign in spending and hike interest rates, which should begin to weigh on growth in 2012. Policymakers across the region face a difficult challenge. Interest rates need to rise more aggressively in order to combat inflation and curtail the risk of overheating. However, higher interest rates would exacerbate already large capital inflows. For example, wide interest rate differentials combined with strong economic growth have made Brazil a particularly attractive investment destination. China has invested \$15 billion in Brazil over the past year alone.

Graph 8: Production momentum has slowed

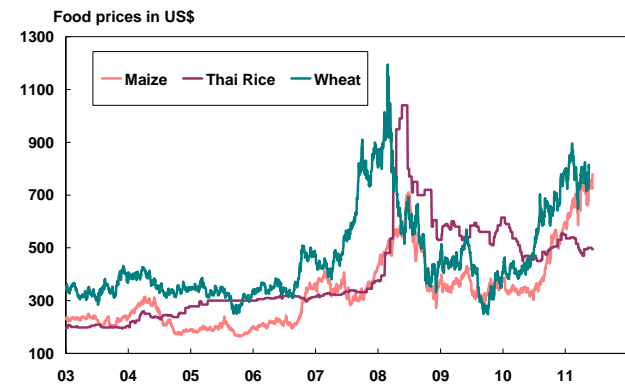


Source: Datastream

Growth is expected to average more than 5% in **sub-Saharan Africa** over the next two years, supported by infrastructure spending and high commodity prices. Wide regional differences remain. East Africa is forecast to be the best performing region, led by Kenya and Tanzania. Growth in Kenya will benefit from infrastructure spending and a recovery in the agricultural sector following last year's drought. Mining, construction and services will boost the Tanzanian economy. In contrast, growth in central and west Africa will slow modestly. Nigeria, the region's biggest economy, will continue to benefit from high oil prices. However, persistent problems in the oil-producing Niger Delta will make it difficult for the country to increase output and take full advantage of higher prices. Growth in southern Africa will be more modest in comparison, due to the large weight of the South African economy in the region. Angola will be one of the best performing countries, growing by more than 7% on the back of investment in the oil sector.

African countries remain very vulnerable to higher global food and fuel prices – food accounts for around 50% of many of these countries' consumer inflation baskets. Price shocks, along with stronger domestic demand, will see inflation rising higher. Robust demand should cause economic policy to be less accommodative. However, the authorities are reluctant to reign in spending and hike rates.

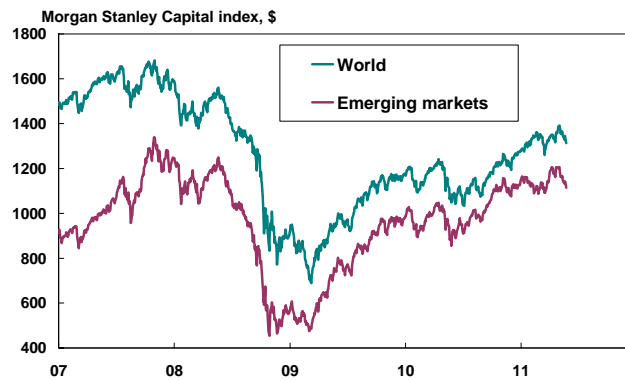
Graph 9: Global food prices slightly off, but still high



Source: Datastream

**Commodity prices**, including agricultural prices, have corrected slightly off earlier highs, with the unrelenting upward trend seemingly broken in recent weeks. This followed recent economic statistics from the United States and China that suggest some weakness is creeping in. Concerns centre on China's monetary tightening, the European sovereign debt crisis and the end of quantitative easing in the United States at the end of June, which could impact liquidity and reduce commodity prices. In addition, higher food prices will induce a supply response in time. Of course, climatic vagaries will continue to cause volatility, but some moderation in prices is still expected in the second half of the year.

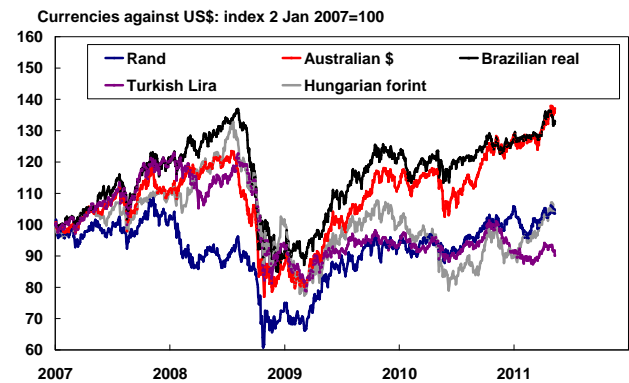
Graph 10: Equity markets have corrected



Source: MSCI Barra

**Global equity markets** continue to be supported by excess liquidity and generally favourable economic data. However, volatility has increased as risks have re-emerged. Concerns have centred around the possibility that Chinese efforts to cool the economy may prove too effective, as well as the risk of a Greek restructure and possible contagion to other peripheral Eurozone countries. Recent evidence that growth is beginning to slow in Europe and the United States is also weighing on markets.

Graph 11: Mixed performance in emerging market currencies



Source: Reuters

In **currency markets** the dollar touched a six week high against the euro in late May, as Greece's fiscal troubles entered the spotlight again, helping the dollar to retrace some of its earlier losses. In early June the dollar appeared to have lost favour again, following disappointing gdp statistics and evidence that consumer spending weakened, making an early interest rate hike less likely. Emerging market currencies have regained favour since late March. In the first three months of the year investors disinvested from emerging market equity funds on speculation that the dollar was likely to stabilise and probably strengthen on improved growth prospects. In April and early May the carry trade play returned in force, with investors favouring China, Thailand, Korea, Turkey and South Africa.

**Carmen Altenkirch**

## Domestic review and prospects

Economic growth accelerated in the early part of the year, helped by strong manufacturing performance. The favourable start makes growth of around 3,8% likely for the year as a whole, a significant improvement over the 2,7% experienced in 2010. However, conditions in the second quarter have not been as favourable and growth will probably be moderate for much of the remainder of the year. The global economy remains vital for manufacturing and mining in particular, while on the expenditure side of the economy consumer spending will be supported by continued low interest rates and firm wage growth, but hampered by high debt levels, rising living costs and concerns of approaching interest rate hikes. The recovery in fixed investment spending will be slow due to sufficient capacity in the private sector and delivery issues in the public sector.

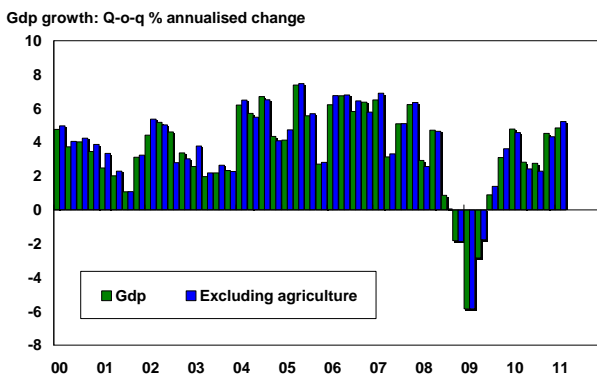
Table 2: Gdp sector breakdown

Industries	Growth										Size % total 2010
	2008	Q3'09	Q4'09	2009	Q1'10	Q2'10	Q3'10	Q4'10	2010	Q1'11	
Agriculture	16.1	-13.7	-11.0	-3.0	4.9	13.6	16.3	12.5	0.9	-2.6	2.5
Mining	-5.6	-3.7	7.7	-4.2	18.7	-24.5	33.7	17.1	5.8	1.8	9.6
Manufacturing	2.6	8.2	10.8	-10.4	8.3	5.7	-4.9	4.1	5.0	14.5	14.6
Power & Water	-3.1	3.6	2.7	-1.6	4.9	-1.7	-2.2	5.6	2.0	3.3	2.8
Construction	9.5	2.9	1.2	7.4	1.3	1.0	0.6	0.2	1.5	0.0	3.8
Trade	0.8	-0.3	-0.1	-2.5	3.1	6.0	3.3	3.5	2.2	4.4	13.9
Transport & comm	3.4	2.4	3.0	0.6	2.4	4.5	3.0	4.2	2.9	3.6	9.1
Finance	7.3	-0.6	1.8	0.9	3.2	4.0	1.4	1.7	1.9	4.8	21.2
General government	4.5	2.0	5.2	4.1	1.2	4.6	0.5	5.7	3.0	1.8	16.1
Personal services	3.9	-4.2	-4.4	-0.3	3.5	3.6	3.1	3.3	0.6	2.7	6.3
Value Added	3.7	1.0	3.2	-1.5	4.6	2.7	2.6	4.5	2.8	5.0	100.0
GDP	3.6	0.9	3.1	-1.7	4.9	2.8	2.7	4.5	2.8	4.8	

Source: Statistics South Africa

The economy fared well in early 2011. Real gdp growth accelerated in the first quarter, growing at an annual rate of 4,8% q-o-q, up from 4,5% in the final quarter of 2010. The stronger-than-expected performance was mainly due to a surge in manufacturing production as the big export-orientated industries stepped up production to take advantage of strong global demand and high commodity prices.

Graph 12: Strong start to the year

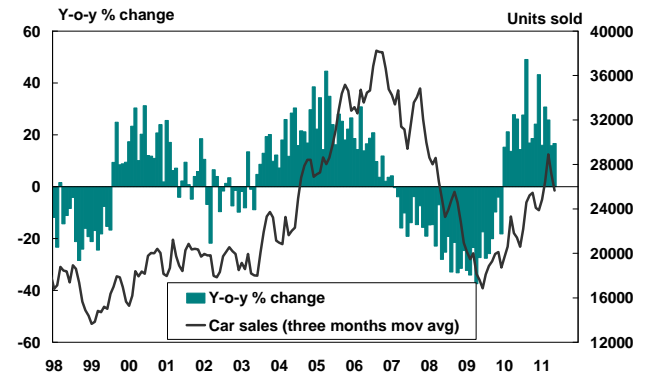


Source: Statistics South Africa

Apart from the jump in manufacturing, the services industries also performed well as consumer spending accelerated on higher household incomes and the lowest interest rates in over 35 years. Wholesalers and retailers

benefited the most from the consumer upswing, but credit demand also picked up moderately off a low base, resulting in a better-than-expected performance from the banking industry. In contrast, real estate activity remained subdued as reflected in faltering house prices and modest growth in mortgage advances. Expansion in most other major sectors slowed in the first quarter, but a disappointing field crops season dragged agricultural production down, and construction activity stalled on weak fixed investment activity and slow infrastructure spending.

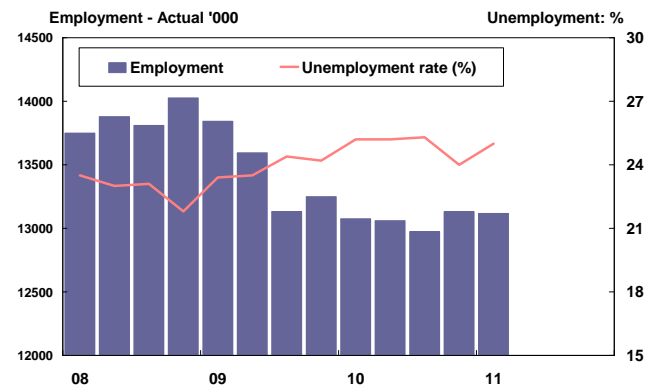
Graph 13: Vehicle sales have eased off recent highs



Source: National Association of Automobile Manufacturers of South Africa

Given the relatively strong start to this year, the economy is now expected to grow by around 3,8% in 2011 as a whole. The pace of growth is, however, expected to moderate off a higher base in the quarters ahead. Although consumers will continue to spend, underpinned by robust wage growth and cheap credit, the upside will be limited by rising cost pressures and fears of possible interest rate hikes later this year. Business should slowly regain confidence as the wider upswing develops, resulting in a greater willingness to undertake investment in new capacity. However, the pace of investment spending will be constrained by the stop-start nature of the recovery both locally and globally as well as structural constraints including insufficient power and transport infrastructure.

Graph 14: Labour market has stabilised

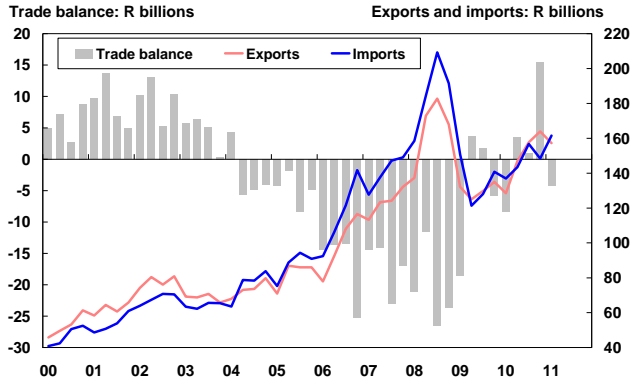


Source: Statistics South Africa

Government spending will be broadly supportive of growth, but some moderation will be required to reduce the budget deficit to more comfortable levels over the next three years. However, if the public sector achieves the roll-out of infrastructure projects, it would provide a significant boost to the economy, with R252,9 billion allocated to infrastructure in 2011/12 and a further R269,3 billion in 2012/13. Nevertheless, anecdotal reports suggest that the funds allocated for 2011/12 are unlikely to be spent in full, held up by a general lack of skills and capacity to deliver within the public sector and a complicated and cumbersome tender process.

The outlook for 2012 and 2013 is a little brighter with economic growth forecast to quicken to around 4%. Business investment should strengthen, helped by a more favourable global environment. As the cycle develops, there will also be a natural improvement in employment levels, supporting household income and spending. In contrast, government's contribution will fall as fiscal consolidation gains traction. On balance, we still expect that the current upswing will be less vigorous than the 2002 to 2007 experience due to persistent structural constraints in the local economy and below potential output in key trading partners, which are constrained by high private and public sector debt.

Graph 15: Trade account back in deficit

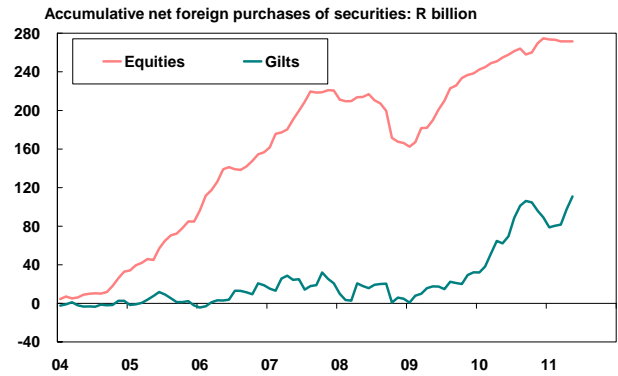


Source: South African Revenue Service

Underlying conditions on the **balance of payments** deteriorated slightly in the first quarter. The trade balance slipped back into deficit as import volumes outpaced those of exports, while surging global fuel prices hurt the terms of trade. At the same time improved corporate profitability and higher dividend payments probably led to a widening of the services deficit. Although capital inflows should still cover the shortfall on the current account, net portfolio inflows were disappointing as demanding valuations in emerging markets forced some consolidation in the first quarter. Net foreign sales of local bonds and equities amounted to R8,2 billion and R856 million respectively in the first three months of this year. Since then interest in emerging markets returned as concerns over sovereign default by Greece and other smaller European economies

resurfaced and intensified. In April and May foreigners returned to the local bond market, with net purchases totalling R31 billion, but foreigners remained cautious of equities, with net sales of around R64 million.

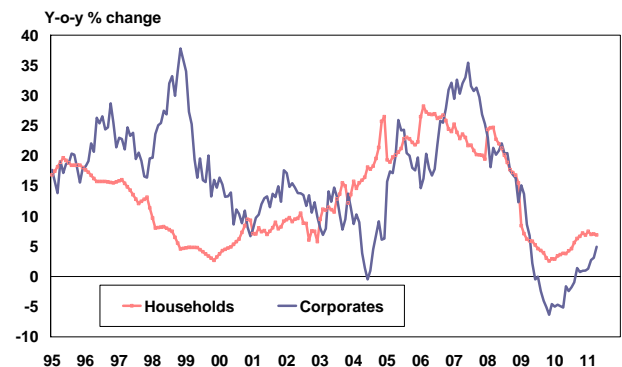
Graph 16: Foreign bond purchases remain strong



Source: I-Net

The trade balance is expected to deteriorate mildly in 2011 as a whole. Softer global demand later this year will contain growth in export volumes, while stronger consumer spending and some demand for capital goods will prop up import volumes. The country's terms of trade will also suffer from elevated oil prices, although export prices have also risen. Added to this, the services deficit will 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 around 3,9% of gdp in 2011 from 2,8% in 2010. Capital inflows should remain more than sufficient to offset the shortfall on the current account deficit, but net portfolio inflows will probably remain volatile given heightened uncertainty about global growth prospects and lingering concerns about valuations of emerging market assets.

Graph 17: Credit growth still modest



Source: South African Reserve Bank

**Credit demand** improved further, but remained generally subdued. Bank credit extension rose by 6,2% y-o-y in April, up from 5,1% in March and 5,5% at the end of last year. Barring mortgages, which remained lacklustre, most

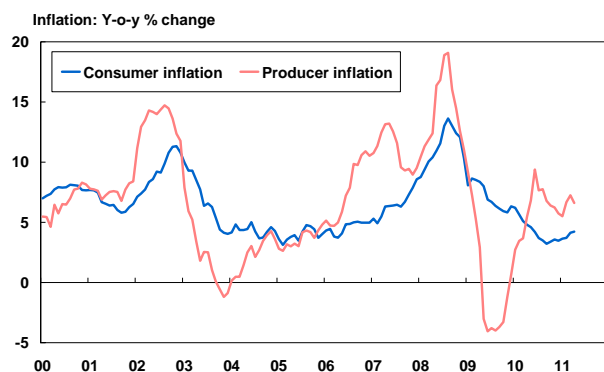
other categories of credit showed gains. Growth in total advances was mainly driven by stronger household demand for credit, especially for instalment sales and personal loans. Corporate demand for credit remained relatively weak and erratic in the first three months of this year, but picked up noticeably in April.

The recovery in credit demand will continue during the remainder of this year. 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 spare capacity, concerns over the strength of this upswing and infrastructure constraints will contain investment activity and limit the upside. The current credit cycle is likely to be modest given more conservative attitudes of borrowers and lenders, still relatively high household debt burdens and slow progress with job creation.

Inflation generally surprised on the upside in early 2011. Consumer inflation rose to 4,2% in April, only slightly up from 4,1% in March, but significantly higher than 3,5% at the end of last year. A lower base as well as rising food and fuel prices pushed inflation higher, but price-sensitive consumers and a strong rand contained prices of durable and semi-durable goods and generally helped to keep the inflation rise in check.

Inflation is forecast to move higher off a low base during the remainder of the year as the earlier surge in global food and fuel prices slowly filters through, retailers regain some pricing power and the rand depreciates moderately. Inflation is forecast to end 2011 around 5,7%, close to the upper 6% limit of the Reserve Bank's target band. The upside risks to the forecast will mainly come from above-inflation wage increases, a sharper-than-expected depreciation of the rand or renewed upward pressure on global food and oil prices.

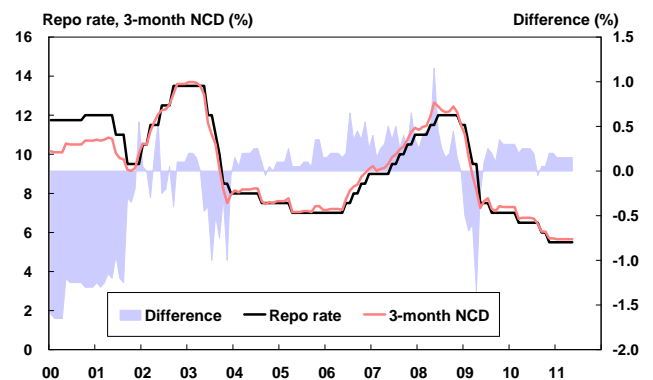
Graph 18: Consumer inflation still low but rising



The Reserve Bank's Monetary Policy Committee (MPC) has maintained its accommodative stance, leaving the repo rate unchanged at 5,5%, which kept the prime rate at

9%, its lowest level since May 1974. The MPC opted for a wait-and-see approach even as the economic recovery gained momentum and the upside risks to inflation increased. The Reserve Bank also revised its inflation forecast in May, expecting CPI temporarily to breach the upper 6% limit of the target range by the end of the year. Inflation is now forecast to average 5% in 2011 (previously 4,8%) and 6% in 2012 (previously 5,7%). As a result, the markets are expecting interest rates to increase by between 50 to 100 basis points later this year. However, growth prospects remain clouded by considerable downside risks, while the recent rise in inflation is largely due to higher global oil and food prices, with little to no evidence of any second-round effects or demand pressures on prices. The MPC will probably remain reluctant to tighten monetary policy too quickly or aggressively, as higher interest rates will do little to contain inflation, but will hurt the economy and job creation. Consequently, we expect the MPC to hold off on the first rate hike until early 2012.

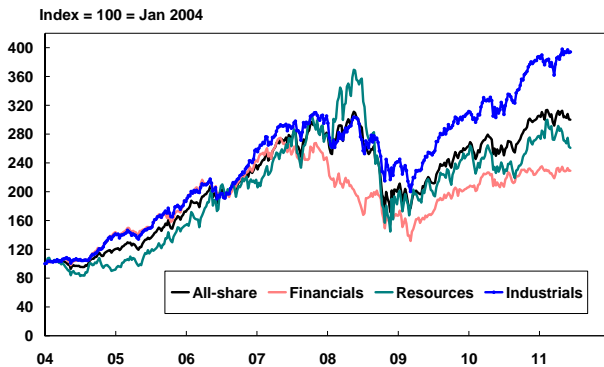
Graph 19: Interest rates set to rise



Financial markets were volatile and weak in early 2011. Weaker global markets contained local equity prices in the first quarter as investors grappled with the sharp rise in oil prices due to political upheaval in North Africa and the Middle East, the implications of natural disaster in Japan, Europe's continued sovereign debt worries, the implications of slower growth in China for commodity prices and the unexpected downgrade of the long-term outlook for US sovereign debt to negative. Consequently, the FTSE/JSE all-share index managed to gain only 0,3% in the first quarter, with financials and industrials falling by 0,2% and 2,2% respectively, while resources rose by 2,2% over the quarter. In April and May sentiment improved slightly and the all-share index gained a modest 1,1%, with financial and industrial stocks rebounding, but resources shedding 1,9% of its value on early signs of some moderation in Chinese demand, which, coupled with the approaching end of the US Federal Reserve's second round of quantitative easing (QE2), also took the edge off international commodity prices. Local equities are

expected to remain volatile throughout 2011, given high valuations and an unpredictable global environment.

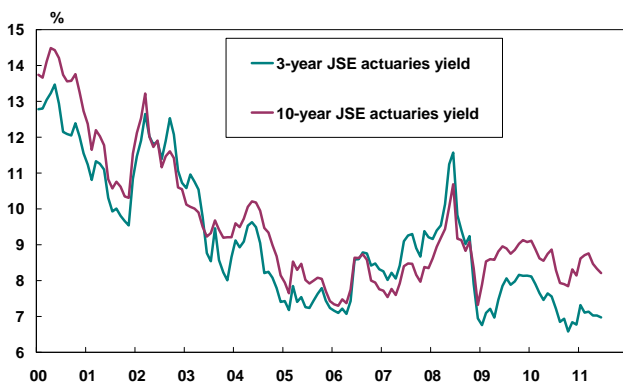
Graph 20: Equity prices still reflecting uncertainty



Source: I-Net

Bond yields moved higher in the first quarter as inflation edged up, speculation of possible interest rate hikes increased and as foreigners reduced their holdings of local bonds. The yields on the R157 2015 and the R186 2025 edged up to 7,82% and 8,97% respectively by the end of March from 7,33% and 8,31% at the end of 2010. However, the bond market strengthened in April and May as foreign buying returned, global oil and food prices corrected slightly from earlier highs and the Reserve Bank's MPC kept interest rates unchanged, indicating that the Bank was waiting for evidence of more generalised inflationary pressures before considering a tighter stance. Bond yields will probably drift higher in the months ahead as the risk to both inflation and interest rates resides on the upside, but much depends on foreign appetites.

Graph 21: Bond yields still favourable

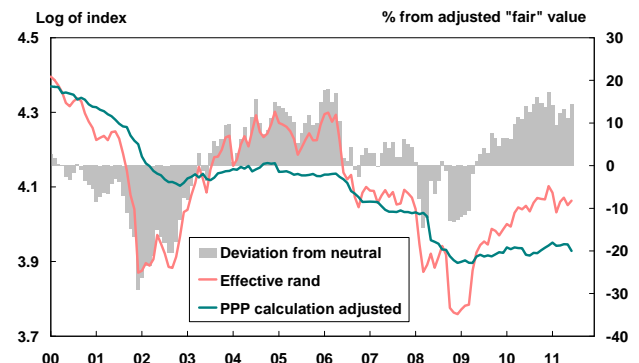


Source: I-Net

The rand steadied in April and May following weakness in the first quarter. It eased by 1,8% on a trade-weighted basis, after depreciating by 5,6% in the first quarter. In January and February the dollar strengthened as the United States economy surprised on the upside, while in March, April and May the rand lost ground against a stronger euro as the European Central Bank hiked interest

rates to contain inflationary pressures emanating from the rise in energy and food prices.

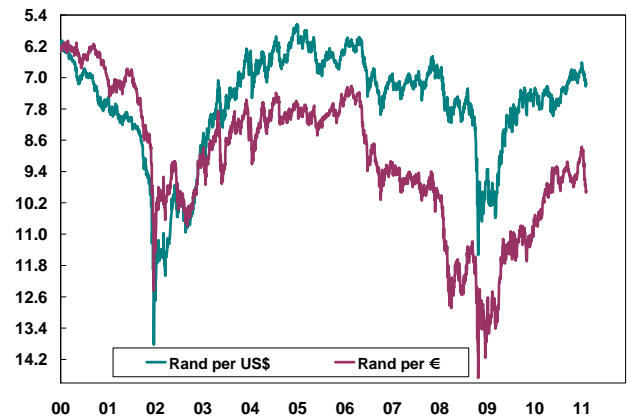
Graph 22: The rand remains strong



Sources: Reuters, Nedbank calculations

The rand is likely to remain volatile in the short term, supported by the carry trade, but made more vulnerable by tighter monetary policies and consequently softer commodity prices. On balance, the rand is forecast to ease on a trade-weighted basis as the second half progresses.

Graph 23: The rand firmer against the US dollar



Source: Reuters

**Nicky Weimar**



## FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

10 June 2011

	2007	2008	2009	2010	2011	2012	2013
<b>Growth (real, % change)</b>							
GDP	5,6	3,6	-1,7	2,8	3,8	3,9	4,1
GDE	6,3	3,4	-1,7	4,2	4,6	5,0	4,8
PCE	5,5	2,2	-2,0	4,4	4,6	4,5	4,6
GDFI	14,0	14,1	-2,2	-3,7	2,0	5,2	5,8
Exports	6,6	1,8	-19,5	4,7	8,0	6,2	8,0
Imports	9,0	1,5	-17,4	9,6	10,3	9,5	9,5
<b>Balance of payments (Rbn)</b>							
Exports	537,5	704,3	556,4	626,3	827,9	874,2	1 106,4
Imports	573,9	739,9	554,2	598,2	811,7	858,0	1 058,0
Trade balance	-36,3	-35,6	2,3	28,1	16,2	16,2	48,4
Net services	-104,2	-126,3	-99,3	-102,2	-146,2	-155,0	-189,0
Current account	-140,6	-161,9	-97,1	-74,1	-130,0	-138,8	-140,6
Capital account	188,4	187,9	114,1	105,4	120,0	165,0	190,0
Change net reserves	47,8	26,1	17,0	31,3	-10,0	26,2	49,4
Gross reserves (eop)	224,3	317,3	293,0	290,7	312,1	362,4	432,1
Current account as a % of GDP	-7,0	-7,1	-4,1	-2,8	-4,5	-4,3	-3,9
<b>Gold price (average per ounce)</b>							
Dollar	696,5	872,2	973,1	1 226,8	1 469,3	1 467,3	1 365,6
Rand	4919	7208	8217	8996	10271	10998	10877
<b>Exchange rates</b>							
Dollar-rand	7,06	8,26	8,44	7,33	6,99	7,50	7,97
Euro-dollar	1,37	1,46	1,39	1,33	1,41	1,37	1,31
Dollar-yen	117,7	103,4	93,5	87,8	81,7	84,7	85,0
British pound-dollar	2,00	1,83	1,56	1,54	1,62	1,60	1,61
Euro-rand	9,67	12,10	11,75	9,76	9,88	10,23	10,45
Rand-yen	16,7	12,5	11,1	12,0	11,7	11,3	10,7
GBP-rand	14,13	15,16	13,17	11,33	11,34	12,00	12,79
<b>Interest rates (end of period)</b>							
Three-month JIBAR	11,25	11,43	7,23	5,55	5,73	8,28	9,03
Prime	14,50	15,00	10,50	9,00	9,00	11,50	12,50
Long bond	8,35	7,33	9,08	8,15	8,74	9,02	8,88
<b>Inflation (average)</b>							
CPI new			7,1	4,3	4,7	5,9	6,0
CPIX (metro and other urban)	6,5	11,3					

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## FACTS AND FORECASTS OF KEY ECONOMIC VARIABLES

10 June 2011

	2010				2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>GDP (q-o-q annual %)</b>	4,8	2,8	0,0	0,0	0,0	3,0	3,3	3,4	4,0	4,4	4,3	4,0
<b>Interest rates</b>												
Three-month JIBAR	6,67	6,62	6,03	5,55	5,58	5,53	5,63	5,73	6,78	7,28	7,78	8,28
Prime	10,00	10,00	9,50	9,00	9,00	9,00	9,00	9,00	10,00	10,50	11,00	11,50
Long bond (10 yr)	8,62	8,86	7,90	8,15	8,76	8,37	8,57	8,74	8,73	8,85	8,99	9,02
<b>Inflation</b>												
CPI new	5,1	4,2	3,2	3,5	4,1	4,5	5,6	5,7	5,9	5,9	5,7	6,0
CPIX												
<b>Exchange rates</b>												
Dollar-rand	7,36	7,65	6,98	6,62	6,78	6,82	7,09	7,23	7,34	7,49	7,64	7,79
Euro-dollar	1,36	1,22	1,36	1,34	1,42	1,45	1,42	1,40	1,38	1,36	1,35	1,34
Dollar-yen	93,2	88,6	83,4	81,6	82,8	80,3	81,9	82,3	83,9	85,2	85,6	86,1
British pound-dollar	1,51	1,51	1,59	1,55	1,59	1,64	1,63	1,62	1,60	1,60	1,60	1,59
Euro-rand	9,99	9,36	9,48	8,84	9,62	9,86	10,05	10,15	10,10	10,20	10,31	10,41
Rand-yen	12,66	11,58	11,95	12,32	12,20	11,78	11,55	11,38	11,44	11,38	11,21	11,05
GBP-rand	11,09	11,52	11,06	10,29	10,77	11,21	11,55	11,72	11,78	11,95	12,19	12,37
<b>Gold price per ounce</b>												
\$	1109	1243	1310	1426	1432	1503	1473	1503	1518	1472	1443	1385
Rand	8161	9513	9136	9442	9713	10250	10446	10868	11142	11024	11019	10790

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