

Nedbank

Economic commentary

29 March 2010

WEEKLY MONITOR

Review of 22 to 26 March and preview of 29 March to 1 April 2010

DOMESTIC

The **rand** weakened last week, pressured by a combination of lower risk appetite, a firmer dollar, the Monetary Policy Committee's (MPC) surprise decision to cut interest rates as well as comments by the South African Reserve Bank's Governor, Gill Marcus, that a very strong rand is a cause of concern from the perspective of overall macroeconomic balance because it may affect the recovery of export- and import-competing sectors of the local economy. The unit ended the week at R7,43, R9,96 and R11,06 against the US dollar, the euro and the British pound respectively, down from R7,33, R9,90 and R11,00 at the previous week's close.

Bonds rallied later in the week, benefiting from the MPC's interest rate decision. The yields on the **R157 2015** and on the **3-, 6-, 9- and 12-year BESA actuaries** closed at 7,95%, 7,65%, 8,00% and 8,58% respectively on Friday, falling from 8,15%, 7,89%, 8,21% and 8,79% at the end of the previous week.

Money market rates declined, with the **3-, 6-, 9- and 12-month JIBAR** ending the week at 6,57%, 6,83%, 7,06% and 7,41% respectively from 7,07%, 7,46%, 7,63% from 7,64%.

Local equities moved higher in line with firmer global markets, particularly later in the week following news that debt-stricken Greece could receive a rescue package. The MPC's interest rate decision also boosted certain local stocks. The **FTSE/JSE all share index** closed the week at 28 583,5, up by a marginal 0,1% from the previous week's close. While **basic materials** gained 1,4% to end the week at 28 324,4, **industrials** and **financials** lost 1,2% and 0,4% respectively, to close at 27 284,3 and 21 021,8.

The **MPC** reduced the repo rate by 50 basis points to 6,5% on Thursday, stating that although there are signs that the economy has emerged from the recession, the pace of recovery is expected to remain slow, and that the inflation environment has improved. The MPC expects CPI inflation to average 5,3%, 5,4% and 4,9% in 2010, 2011 and 2012 respectively, citing that there is now greater certainty with respect to electricity tariff increases following National Energy Regulator of South Africa's (Nersa) decision to grant Eskom a 25% per annum increase in electricity tariffs in the next three years. The Reserve Bank also indicated that favourable food price developments as well as lower-than-expected inflation outcomes have also contributed to the improved inflation outlook. It also highlighted that there is no risk of demand inflation, with the main threat to the inflation outlook posed by high increases in administered prices. The committee also indicated that wage settlements remain concerning, with nominal unit labour costs rising significantly in the fourth quarter, and that although the appreciation of the rand is positive for containing inflation, it poses a risk to the recovery of export- and import-substituting sectors.

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The **Bureau for Economic Research (BER) Inflation Expectations Survey** showed that inflation expectations have improved significantly in the first quarter of 2010 compared with the last quarter of 2009. CPI inflation is expected to average 6,5% in 2010, down from 7,7% expected in the final quarter of 2009 and to average 6,7% in 2011, down from 7,7%. For 2012, inflation is expected to average 6,8%. The improved outlook was mainly due to the favourable changes in the expectations from the business sector and labour unions, while the expectations of analysts remained almost unchanged.

Consumer inflation came back within the target range in February, easing to 5,7% y-o-y from 6,2% y-o-y in January. The main driver of inflation remains the services sector. Insurance costs rose by 6,3% m-o-m and 11,5% y-o-y. Medical services also rose sharply by 8,1% m-o-m, although its overall weight in the basket is very small. Higher petrol prices also contributed towards the monthly increase in inflation, rising 2,4%. Food prices fell by 0,6% m-o-m and rose by a modest 1% y-o-y. All categories declined over the month, except sugars and sweets which remained unchanged. The largest monthly declines were recorded in the fruit and vegetable categories. Weak household demand, combined with the strength of the rand, continued to put downward pressure on prices of durable and semi-durable goods.

Producer inflation picked up further in February, rising to 3,5% y-o-y from 2,7% y-o-y in January, off the exceptionally low base established last year. Over the month, producer prices rose by 0,4%. Lower agricultural prices exerted downward pressure on producer inflation, falling by 1,9% m-o-m, mainly due to a 4,2% decline in food prices. On an annual basis, food prices at the agricultural level dropped by 13,5%. At the manufacturing level, food prices rose by a modest 0,1% m-o-m, but continued to decline on an annual basis. More modest increases in commodity prices over the past few months, combined with the strength of the rand, helped to contain increases in the mining and quarrying category.

The **South African Reserve Bank's Quarterly Bulletin** indicated that, after contracting for five consecutive quarters, **household consumption expenditure** turned the corner in the final quarter of 2009, rising by a seasonally adjusted 1,4% with the recovery attributed to an improvement in consumer confidence, lower interest rates, inflation, better economic prospects as well as an increase in disposable income. Over the quarter, strong growth in consumer spending was due to durable goods, which increased by a seasonally adjusted 15,2%, its strongest growth rate since the first quarter of 2006. For the year as a whole, final consumption expenditure declined for the first time since 1992, falling by 3,1% following 2,4% growth in 2008, dragged down mainly by weak spending on durable goods as the effects of the financial crisis hurt employment and consumer confidence over the year. Despite lower interest rates, households continued to struggle to service their debt. **Household debt to disposable income** increased to 79,8% in the fourth quarter from 78,4% in the third quarter. However, real household income rose by 2,7% over the quarter, following five quarters of declines, which helped the interest service to disposable income ratio to ease to 8,2% from 8,4%. Growth in **government spending** moderated to 2,3% in the final quarter of 2009 from 8,1% in the third quarter, with spending mainly channelled to labour-intensive employment programmes. **Fixed capital formation** remained weak, declining by 0,9% over the quarter but the rate of decline moderated from 6,5% in the third quarter. Fixed capital formation by **public corporations** remained firm, growing by 8,7%, while investment by the **private sector** contracted for the fourth consecutive quarter (down by 2,3% q-o-q), but the rate of decline moderated compared with the 14,5% drop in the third quarter. The 10% q-o-q drop in **government fixed investment spending** in the fourth quarter of 2009 was attributed to lower-than-budgeted spending on projects at provincial level. Overall growth in fixed capital formation moderated to 2,3% in 2009 from 11,7% in the previous year.

The **current account deficit** narrowed further to 2,8% of gdp in the fourth quarter of 2009, its lowest level since the second quarter of 2005 from a revised 3,1% (previously 3,2%) in the third quarter. An increase in the trade surplus and lower net service, income and transfer payments were behind the improvement. The deficit was 4,0% of gdp for 2009 as a whole, significantly down from 7,1% in 2008. The **financial account** remained in surplus, with further inflows (including unrecorded transactions) of R21,3 billion during the fourth quarter. For 2009 as a whole, the surplus amounted to R113,4 billion, equivalent to 4,7% of gdp, from R187,5 billion in 2008 (8,2% of gdp). **Net portfolio inflows** remained positive as South Africa continued to benefit from international investors' search for higher yields. Net inflows of R31,5 billion were recorded during the fourth quarter, with net portfolio inflows totalling R92,6 billion in 2009, partially reversing net outflows of R134,9 billion recorded during 2008. **Net direct investment flows** amounted to an outflow of R5,6 billion as inward investments of R4,0 billion were more than offset by residents' foreign investment totalling R9,6 billion during the quarter. **Net other investment outflows** amounted to R5,1 billion in the fourth quarter, as domestic banks repaid R1,3 billion of their foreign loans while foreign deposits with non-resident banks increased by R1,8 billion.

The **Quarterly Employment Survey (QES)** for the four quarter of 2009 indicated that the employment in the formal non-agricultural sector increased by 0,2% compared with the previous quarter, with the number of people employed increasing to 8,161 million from 8,143 million. On an annual basis, the number of people employed fell by 4,1%. Gross earnings increased by 12,0% to R294 509 million over the quarter from R263 024 million in the third quarter, and rose by 7,5% or R20 552 million over the year.

Preview of the week: 29 March to 2 April 2010

Country	Release	Period	Consensus forecasts	Nedbank forecast	Previous
South Africa					
Monday	-	-	-	-	-
Tuesday	Money supply	Feb-10	0,50% y-o-y	1,40% y-o-y	0,57% y-o-y
	PSCE	Feb-10	-1,04% y-o-y	-1,04% y-o-y	-1,12% y-o-y
Wednesday	Trade	Feb-10	-R2,5 billion	-R1,5 billion	-R3,3 billion
Thursday	Kagiso PMI	Mar-10	-	-	60,4
Friday	Public holiday	-	-	-	-

Key economic releases scheduled for this week include **credit** and **trade** data for February. We expect demand for credit to have improved slightly by 0,5% over the month following no growth in January, which will help the annual rate of decline demand for credit to moderate to 1,04% from 1,12% in January. We forecast the faster pace of recovery in exports, relative to imports over the month to have helped the trade deficit to narrow to R1,5 billion in February from R3,3 billion in January.

INTERNATIONAL

Equity markets rose last week as investor sentiment was boosted by indications that US interest rates will be kept low to revive the economy, while the Eurozone announced a standby facility to bail out Greece should the need arise.

The US's **Dow Jones**, **NASDAQ** and **S&P500** gained 1,0%, 0,9% and 0,6% to 10 850,63, 2395,13 and 1166,59, respectively. The **UK's FTSE 100** rose by 0,9% to 5 703,02, , the **German DAX** gained 2,3% to 6 120,05, while the **French CAC** closed 1,6% stronger at 3 988,93. In Japan, the **Nikkei 225** closed 1,6% higher at 10 996,37.

The **US dollar** gained against all the major currencies last week, supported by data indicating that the recovery in the world's largest economy has gained momentum while the other key industrialised nations continue to falter. The currency ended the week at \$1,3409 and \$1,4900 from \$1,3529 and \$1,5020 against the Euro and the British pound, respectively. The Japanese yen was slightly weaker, ending at ¥92,50 against the dollar from ¥90,53.

Commodity prices were largely steady. The **Brent crude oil price** closed at \$78,34 per barrel from \$78,63 and after touching \$80 early in the week. Precious metals were slightly weaker, with the **gold** price closing at \$1106,60 per ounce from \$1107,00, while **platinum** ended at \$1596,50 per ounce from \$1607.

In his testimony to the House Financial Services Committee, **Federal Reserve Chairman Ben Bernanke** reiterated that the Fed intended to keep interest rates at low levels for an extended period, asserting that the US economy still needs the support of accommodative monetary policies. However, he stated that the central bank will be ready to reverse the current high degree of monetary accommodation "at the appropriate time". The Fed will end its purchases of mortgage-backed securities this week as it unwinds its accommodative instruments. The chairman remained concerned about the high unemployment rate and the still very weak housing market, while he asserted that inflation will be "subdued for some time". Bernanke's testimony coincided with data indicating that the US housing remains weak. **Existing home sales** fell for the third consecutive month in February, decreasing by 0,6% m-o-m to a 5,02 million unit annual rate after falling by 7,2% m-o-m in January. **New home sales** fell for the fourth consecutive month in February, dropping by 2,2% m-o-m to a record low annual rate of 308 000 units from 315 000 units in January. The stock of new homes stood at 236 000, about 9,2 months of stock.

The second estimate of the **US fourth quarter gdp** was revised downwards to an annualised 5,6% q-o-q from the initial estimate of 5,9% q-o-q, with a significant downgrading of growth in business investment behind the revision. Market consensus was for an unchanged 5,9%. The US economy contracted by 2,4% in 2009.

Growth in **consumer spending** was revised to 1,6% q-o-q (previously 1,7%) after the 2,8% expansion in the previous quarter, with household expenditure, the largest component of US demand, contracting by 0,6% in 2009. **Business investment** was revised to 5,3% q-o-q (previously 6,5%), confirming that business spending rose during the fourth quarter after a few quarters of significant contraction. **Government expenditure** fell by 1,2% q-o-q (previously -1,3%), while the **gdp deflator**, an indicator of economy-wide inflation, rose by 0,5% q-o-q (previously 0,4%) and by 1,2% for 2009 as a whole, suggesting that demand inflation was subdued. US consumer sentiment remains bleak, with the **University of Michigan's Consumer Sentiment Index** remaining unchanged at 73,6 in March after falling from 74,4 in January. The current conditions index, however, increased to 82,4 from 81,8, the highest reading since March 2008. **Initial jobless claims** fell to a six-week low of 442 000 for the week ending 20 March from 456 000 in the previous week, with the four-week average down to 453 750 from 464 750, the lowest level since 13 September 2008. **Durable goods orders** increased by 0,5% m-o-m after rising by 3,9% in January and against market expectations of a 0,7% increase. Excluding transportation goods, orders gained 0,9% m-o-m after contracting by 0,6% in January.

The **Eurozone** has announced a rescue facility, which would be utilised only as a last resort measure, to bail out Greece. Two thirds of the funds will be contributed by Eurozone members, proportionately according to their shareholding the European Central Bank, with the other third contributed by the International Monetary Fund. No details about the size of the rescue package were released, but it is estimated to be around €20 billion. In the same week, Portugal's credit rating was downgraded by one notch to AA- with a "negative" outlook by Fitch ratings.

The **Ifo business climate index**, an indicator of business confidence in Germany, rose to its highest level since June 2008, suggesting that business conditions in the Eurozone's economy are improving at a more solid pace. The index increased to 98,1 in March from 95,2 in February. Eurozone **money supply** fell by 0,4% y-o-y in February after expanding by 0,1% y-o-y in January. Growth in total credit extended eased to 1,5% y-o-y from 1,6% y-o-y, with credit to the private sector remaining flat during the month. Loans to households were up by 1,8% y-o-y in February, driven mainly by a 2,1% y-o-y rise in mortgage finance. Loans to the non-financial corporate sector fell by 2,5% y-o-y.

In the **UK**, **retail sales** rose by a seasonally adjusted 2,1% m-o-m and by 3,5% y-o-y in February after contracting by 3,0% m-o-m in the previous month. On a three-month moving average sales contracted by 1,4% after declining by 0,8% in February, indicating that consumer demand still remains depressed. **Business investment** fell by 4,3% q-o-q in the fourth quarter, taking the decline for the whole of 2009 to 23,5%, the steepest fall since 1967.

In **Japan**, core consumer prices fell by 1,2% y-o-y in February, marking the 12th successive month of price deflation. The core-core CPI, which excludes food and energy prices, fell by 1,1% y-o-y. These data prompted **Japanese Prime Minister Yukio Hatoyama** to call for 'an all-out effort to end deflation' by stimulating domestic demand, this ahead of an upper house election expected in July. According to the Bank of Japan deflation will persist until early 2012, but price declines will ease as the economy recovers and this will not influence the public's long-term price expectations. The **trade surplus** rose to ¥650,98 million in February, with exports up by 45,3% y-o-y, while imports increased by 29,5% y-o-y.

Preview: 29 March to 1 April 2010

Country	Release	Month	Forecast	Previous
United States				
Monday				
Tuesday	Conference Board's Consumer Confidence Index	March	50,0	46,0
Wednesday				
Thursday	ISM Manufacturing Index	March	57,0	56,5
Friday				
Eurozone				
Monday	Consumer Confidence Index	March	-17	-17
Tuesday				
Wednesday	CPI	March	1,1% y-o-y	0,9% y-o-y
	Unemployment rate	February	10,0%	9,9%
Thursday	PMI - manufacturing	March	56,3	56,3
Friday				
United Kingdom				
Monday	M4 money supply	February	-	3,6% y-o-y
Tuesday	Gdp growth	4th quarter	0,3% q-o-q	0,3% q-o-q
Wednesday				
Thursday	PMI - manufacturing	March	56,8	56,6
Friday				
Japan				
Monday				
Tuesday	Household spending	February	1,5% y-o-y	1,7% y-o-y
	Unemployment rate	February	4,9%	4,9%
	Industrial production	February	31,8% y-o-y	18,5% y-o-y
Wednesday				
Thursday	Tankan Large Manufacturers Survey	1st quarter	-14	-24
Friday				

Overview: 22 to 26 March 2010

Figure 1: JSE All-share index

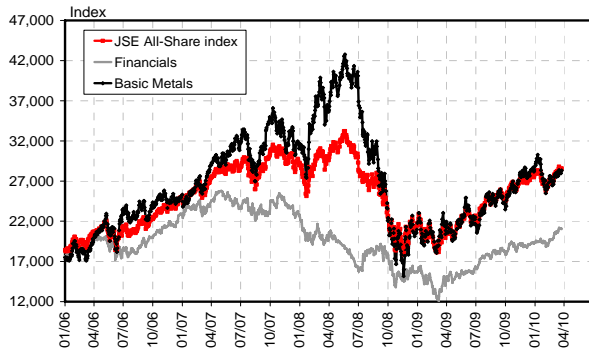


Figure 2: International equity markets

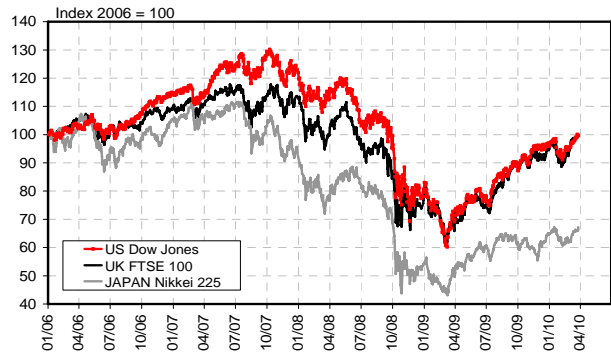


Figure 3: Currency markets

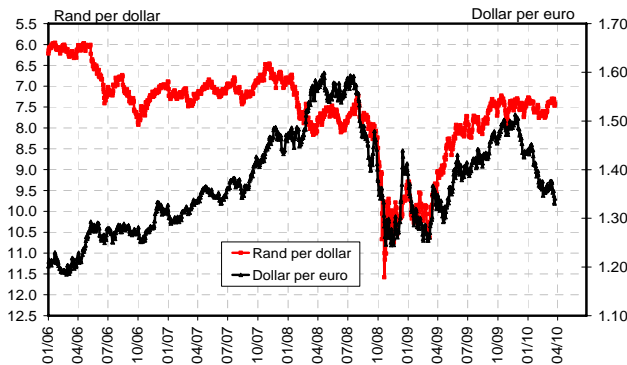


Figure 4: Commodity prices

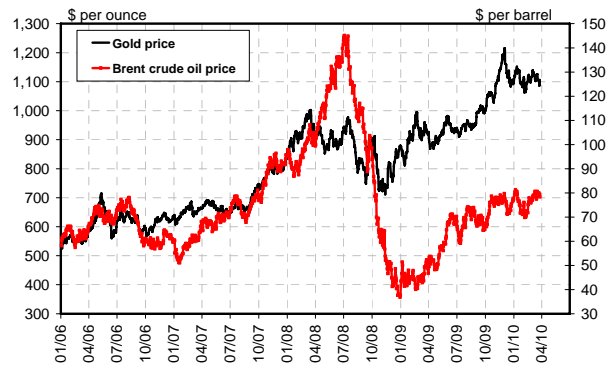
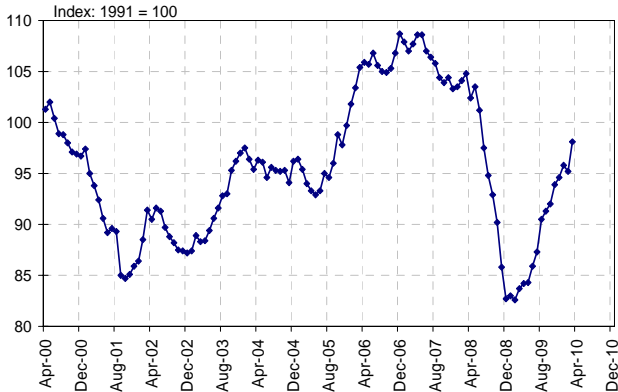


Figure 5: Ifo Business Climate Index



(Source: Datastream, I-NET)

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