2

Macroeconomic policy and outlook

South Africa's healthy balance of payments, declining inflation and sound public finances provide a firm foundation for future growth and development. Although growth will be slower this year than anticipated in the February budget, economic performance is expected to improve steadily in the period ahead. Key features of the domestic outlook include:

- *A marked improvement in public and private sector investment spending*
- *Downward trends in interest rates and inflation*
- *Prospects for further improvements in trade performance, supported by productivity gains and the depreciation of the rand*
- *GDP growth expected to rise from 2,6 per cent in 2001 to average 3,3 per cent over the next three years.*

Overview

South Africa has largely avoided the dislocation experienced by many other developing economies from a continuous series of global financial and economic shocks in recent years.

Lower interest rates and inflation, growth in investment and improved productivity underpin strong macroeconomic foundations

Declining interest rates and inflation, significantly enhanced competitiveness, higher tax revenues at lower tax rates, lower household debt, and the strong possibility of a credit upgrade indicate vigorous and healthy macroeconomic conditions for South Africa.

In the past year, private and government investment grew robustly, with investment rising by 5,6 per cent in the first half of 2001. Earnings growth remains strong and productivity high, contributing to subdued domestic inflationary pressures and the downward trend in long-term interest rates.

Household spending continued to rise, but at a more moderate pace than last year. Total employment has remained stable.

Inflation is within the target range for next year and is expected to decline steadily in years ahead

CPIX inflation declined to within the target band of 3 to 6 per cent in August and September 2001, and is expected to average 5,5 per cent in 2002. New targets have been set for 2003 and 2004 to ensure a declining path for inflation and stability in households' real incomes in coming years.

Prime lending rates and government bond yields fell sharply in 2001. Monetary easing has resulted in real interest rates that compare well with those in other emerging market economies.

Steady reduction of the net open forward position (NOFP) underpinned the sharp decline in bond yields and interest rates. The NOFP is expected to reach zero by the end of 2002. The rand fell sharply against major currencies, while contributing to a substantial boost in competitiveness and a trade and current account surplus.

Fiscal policy adjustments will reinforce growth over the MTEF period

The budget deficit is expected to be 2,3 per cent for 2001/02, rising to 2,6 per cent in 2002/03, with real increases in non-interest spending averaging 3,7 per cent over the forthcoming MTEF period. Declining bond yields have lowered government borrowing costs to their lowest levels in four decades.

Fiscal adjustment and monetary easing in the face of a weaker global environment, and a more competitive cost structure of the South African economy, should accelerate economic activity and raise the cyclical and potential growth

Adjusting to slowing world growth

Although the US and world economies are expected to rebound in the second half of 2002, the effects of the deflation may hinder economic growth in many parts of the world for a longer period of time. Falling prices and household spending combined with declining investment and output send signals to policy makers that adjustments toward greater fiscal and monetary easing are advised. The poor global economic environment is expected to affect South Africa primarily through lower growth in exports and weaker confidence and consumption.

Some precautionary easing has occurred in South Africa's monetary stance this year, and the exchange rate has weakened. Government spending has strengthened and a steady recovery in public sector capital expenditure is underway. Fiscal and monetary policy adjustments are contributing to sustaining the momentum of economic growth, despite the unfavourable international environment.

The inflation target for 2003 will remain at 3 to 6 per cent for the target range of CPIX inflation [additional changes to the target are discussed in detail on pages 15-16]. With a declining trend in inflation, bond yields and interest rates will have room to continue falling to lower the cost of doing business.

Fiscal policy will be adjusted for the next fiscal year (2002/03) and through the MTEF period. The budget deficit for 2002/03, which was expected to be 2,3 per cent of GDP, is now expected to reach 2,6 per cent of GDP as spending on social services increases and tax reductions take effect. Deficits for the outer years are similarly adjusted by about 0,3 per cent of GDP. A declining trend in the deficit will, however, be maintained to ensure that borrowing costs continue to fall, thereby freeing up additional fiscal resources.

The adjustments proposed aim to ensure that South Africa is well-placed to take advantage of rising economic activity in the rest of the world in 2002.

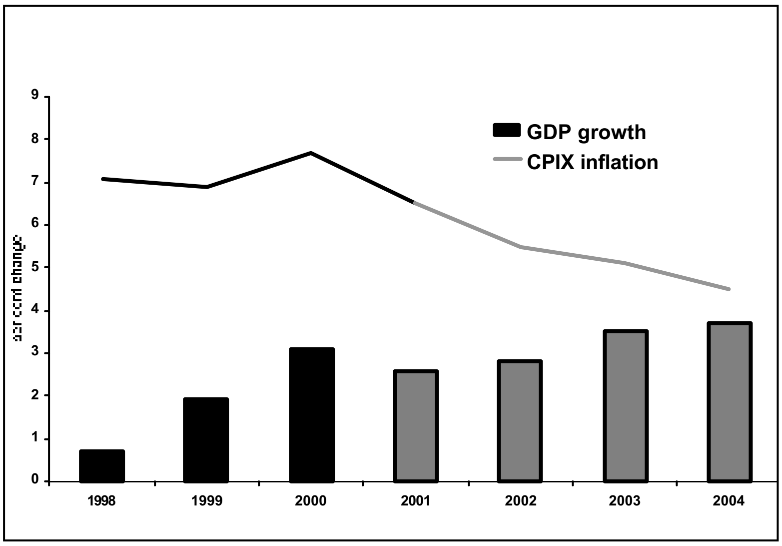
rates of the economy. Appropriate microeconomic and institutional reforms are required to complement macroeconomic adjustment in order to raise growth rates and sustain poverty reduction.

Growth forecast

GDP is expected to rise by 2,6 per cent in 2001, and the cyclical strengthening to continue in 2002 contributing to GDP growth of 2,8 per cent next year. Growth for 2003 and 2004 is projected to be 3,5 and 3,7 per cent, respectively.

Growth is expected to rise from 2,6 % to average 3,3 % over the next three years

Figure 2.1: Percentage growth in real GDP and CPIX, 1998-2004



Global developments and the balance of payments

Investment spending on information technology declined sharply in the United States this year, which then spilled over into other areas of the economy. The New York Stock Exchange has experienced sharp delinces in equities prices.

For small open economies worldwide, the investment collapse presently unwinding in the US and European economies has depressed growth and trade. Industrial production in South Korea, Malaysia, Taiwan and Singapore declined by about 10 percent in August from a year earlier.

Recent international events have depressed growth and trade in developing economies

Further turbulence in financial markets and capital flows was created by the attacks on the US, which prompted the Federal Reserve and the European Central Bank (ECB) to increase liquidity.

Monetary policy has eased, underpinning prospects for growth in 2002 and beyond

Alongside fiscal easing, coordinated monetary policies have provided a large stimulus to world markets, which is expected to strengthen economic growth in 2002.

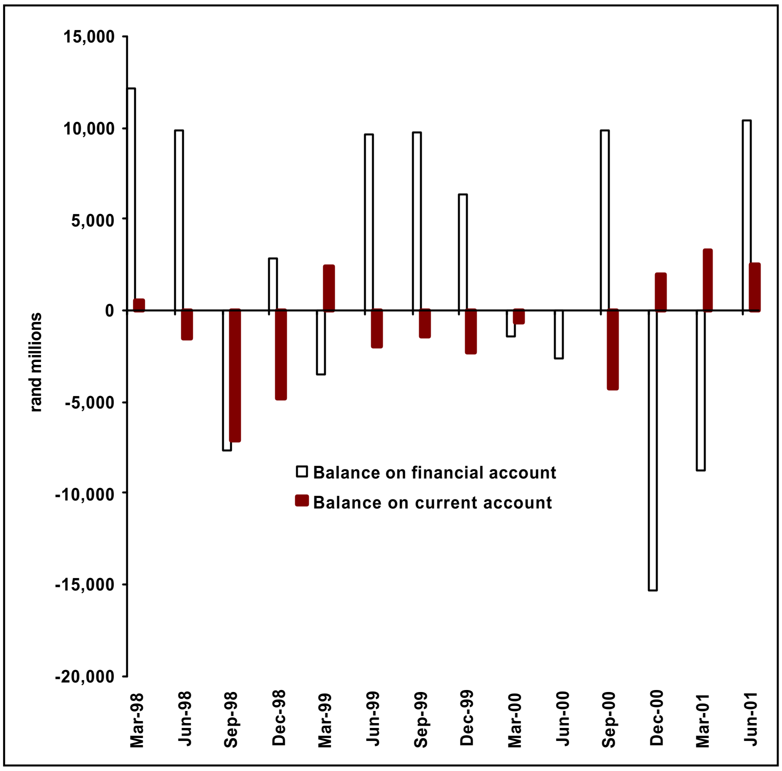
Table 2.1: Global monetary easing in 2001 (world interest rates)

Percentage	High	Current	Difference
US Fed Funds	6,5	2,5	-4,0
ECB Repo Rate	4,75	3,75	-1,0
RBA Cash Rate	6,25	4,5	-1,75
SARB Repo Rate	12,0	9,5	-2,5

Improved competitiveness has contributed to South Africa's healthy trade performance

The impact of global developments is reflected in the current and financial accounts of the balance of payments. South Africa has fared better than most other developing economies, primarily due to sound financial regulation and low external borrowing. A significant increase in South Africa's overall competitiveness lowered growth in imports and raised exports, contributing to a surplus on the current account in the first half of this year. This was mirrored by a small but positive net inflow of capital through the financial account.

Figure 2.2: Balance on the financial and current accounts



Financial Account

South Africa continues to attract foreign portfolio investment

Emerging market concerns and the possibility of recession in the US, Europe and Japan this year led to sharp reversals in capital flows and considerable currency volatility in many emerging markets. In South Africa, by contrast, non-residents continued to be substantial buyers of listed shares, although they were net sellers of bonds.

Capital flows were largely dominated by the restructuring of the shareholding in the De Beers mining company. Foreign direct investment into South Africa rose from a net outflow of R6,4 billion in the first quarter to a net inflow of R93,8 billion in the second quarter of 2001.

Capital flows in 2001 have been dominated by the restructuring of De Beers

The matching component of this transaction resulted in a large net portfolio investment outflow as shareholders received shares in a non-resident company (Anglo American Corporation) in return for the delisting of their De Beers shares. Net portfolio investment amounted to an outflow of R60,8 billion in the first half of 2001, compared with an outflow of R13,8 billion in 2000.

On a net basis, other investment flows declined in the first two quarters of 2001 by R5,7 and R19,3 billion as South African firms repaid cross-border loans and extended trade finance. On a net basis, South Africa's financial account experienced a small cumulative surplus of R1,6 billion in the first half of 2001.

External debt and foreign borrowing

Foreign debt amounts to 19,7 % of GDP

South Africa's foreign currency debt is about US$25 billion, 19,7 per cent of GDP and 64,1 per cent of exports. Interest payments remain low, falling from 8,6 per cent of total export earnings in 1999 to 6,2 per cent in 2000.

South African bonds remain well-priced on international markets, despite an increase in the average cost of issuing new debt in most emerging markets. South Africa's favourable status amongst emerging markets allow South Africa to borrow abroad as relatively low interest rates.

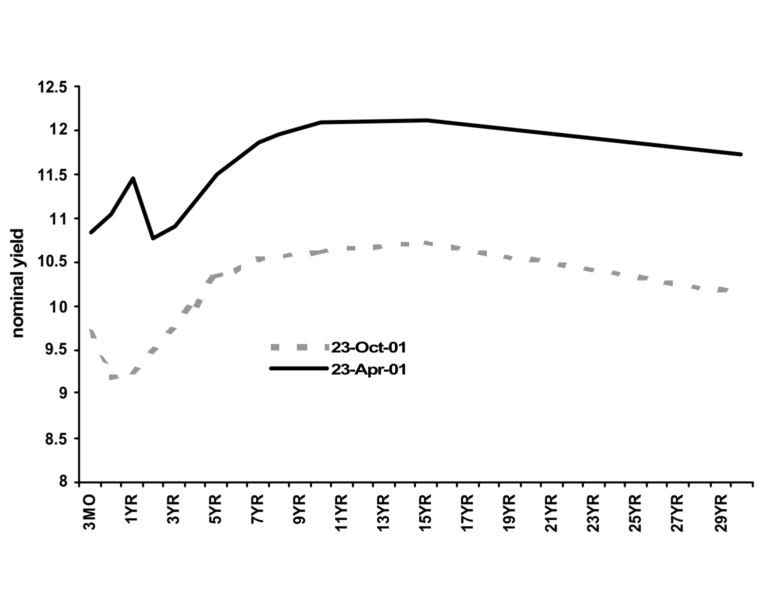
Bond and share market developments

Sales of government bonds by non-residents in 2001 did little to slow a rally in the bond market predicated on lower government borrowing and declining inflation. Figure 4 illustrates the decline in bond rates across the yield curve since April 2001, and figure 5 shows the trend in the R150 and R153 yields since 1995.

Declining interest rates have reduced government's borrowing costs

The public sector borrowing requirement (PSBR) fell from 4,8 per cent of GDP in 1997 to an expected 1,1 per cent of GDP in 2001, contributing to a sharp drop in long-term government bond yields. Domestic and foreign borrowing will remain moderate in the MTEF period.

Figure 2.3: Comparison of yield curves, April and October 2001



Current account

Strong growth in exports have contributed to a healthy current account of the balance of payments

The current account has been in surplus (0,7 per cent of GDP) over the course of 2001, primarily due to a much-improved competitive position of South Africa's exports. Despite weaker global demand conditions, South African manufacturing and services exports have responded well to the increased competitiveness of the rand.

Impact of depreciation on the economy

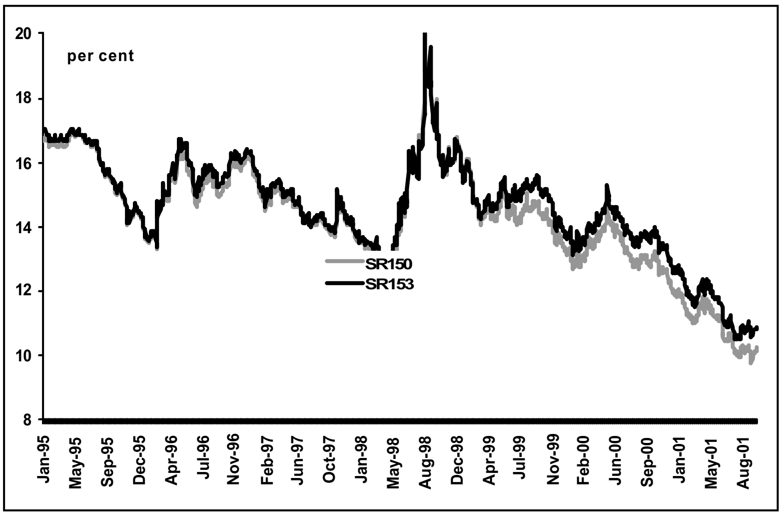
South Africa's long-term adjustment away from being a primary exporter of commodities and to a more diverse manufacturing and services base entails substantial changes in the value of the rand.

Exchange rate depreciation can affect the economy in various ways depending on the size of the depreciation and the price-setting response by firms, unions, importers and exporters. Depreciation of the rand has benefited the economy, mainly in encouraging higher exports and offsetting the negative impact on exports of declining commodity prices.

Depreciation further refocuses domestic consumption onto domestically-produced rather than imported goods. Alongside rising demand for South African exports, this raises effective demand and contributes to improved profitability and more rapid growth. Rising demand for South African products in foreign countries, furthermore, leads to increasing demand for rand and appreciates the exchange rate.

Most emerging market currencies have depreciated over the year against the US dollar.

Figure 2.4: Yield on government debt, 1995-2001



The market yield on government bonds has declined to historic lows

Merchandise export volumes expanded by 10,4 per cent in the first half of 2001 compared to the first half of 2000, while services exports grew by 15,2 per cent in the same period.

Platinum exports rose above those of gold in late 2000 and into 2001. The depreciation of the rand this year is expected to offset the impact on the mining sector of the recent fall in the US dollar price of platinum.

Higher prices for imported goods resulted in sluggish import demand in the first half of 2001, with import volumes growing by just 2,9 per cent, compared with the same period in 2000.

Large trade surplus in the first half of 2001

Strong exports and moderate imports resulted in a cumulative trade surplus of R25,1 billion for the first half of 2001. Imports are likely to grow with the expected

Regional developments

The New partnership for the development of Africa aims to free the continent from underdevelopment and integrate it firmly into the global economy via a three pronged development strategy in areas of political governance, priority sectors and resource mobilisation.

Targeted programmes are planned for infrastructure, information and communications technology, human development, agriculture as well as production and export diversification. Under the Economic Governance Initiative of the plan, countries commit to appropriate economic standards and appraisal mechanisms in areas of fiscal policy, public expenditure management, debt management, monetary policy, banking regulation and data dissemination.

Policy convergence in SADC

Finance Ministers from the Southern African Development Community (SADC) agreed to enhance regional economic cooperation and coordination this year. The Macroeconomic sub-committee of SADC set out a convergence programme to help achieve appropriate fiscal and monetary policies and greater stability, and a consultative oversight mechanism headed by Finance Ministers to monitor progress toward the targets. This macroeconomic convergence plan is expected to be ratified by the end of the year.

acceleration in economic activity and a more stable rand in the remainder of this year and next.

International trade agreements create opportunities for future export growth

South African exports are expected to benefit from the African Growth and Opportunity Act that came into effect this year. This is likely to be strengthened as the current gap between returns to exports priced in dollars and rand-denominated production costs is maintained.

This fundamental improvement in microeconomic competitiveness may accelerate the relocation of export industries to South Africa from developed economies.

Services and income account

Dividend outflows by foreign-listed companies with domestic operations were the key contributor to changes in the services and income account in 2001.

Both payments and receipts on the services and income account have increased sharply

Dividend outflows on foreign direct investments increased by a seasonally adjusted and annualised R22,8 billion, and on portfolio investments by R8,7 billion, from the first to the second quarter of 2001.

The change in inward non-direct investment dividends was also large, rising by a seasonally adjusted and annualised R12,5 billion from the first to the second quarter of 2001.

Pervasive uncertainty about global growth prospects have led to significant weakness in the value of most emerging market currencies, including the rand.

The rand has weakened along with other emerging market currencies

Although various factors have been identified as contributing to rand weakness, on a purchasing power parity basis, the rand is significantly undervalued – making investment in export-oriented industries significantly more attractive.

Figure 2.5: Rate of change in the value of total income receipts and payments, 1994-2001

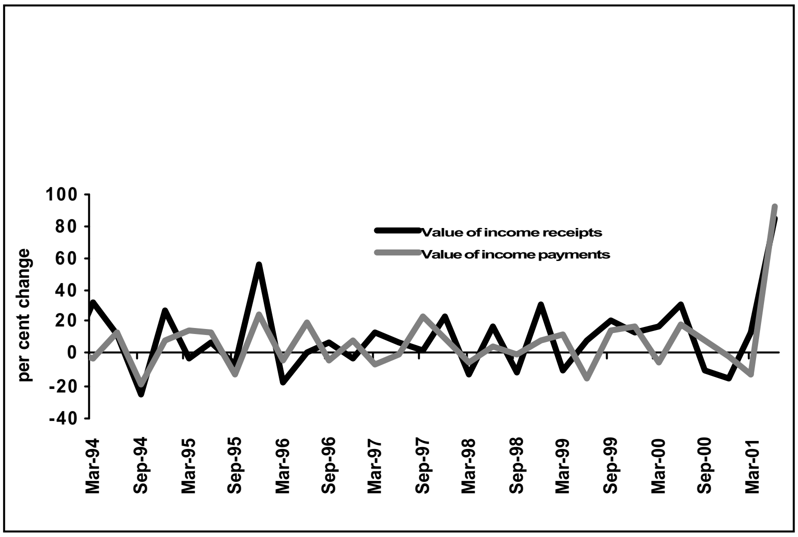


Figure 2.6: Exchange rate indices (index 1995 = 100)

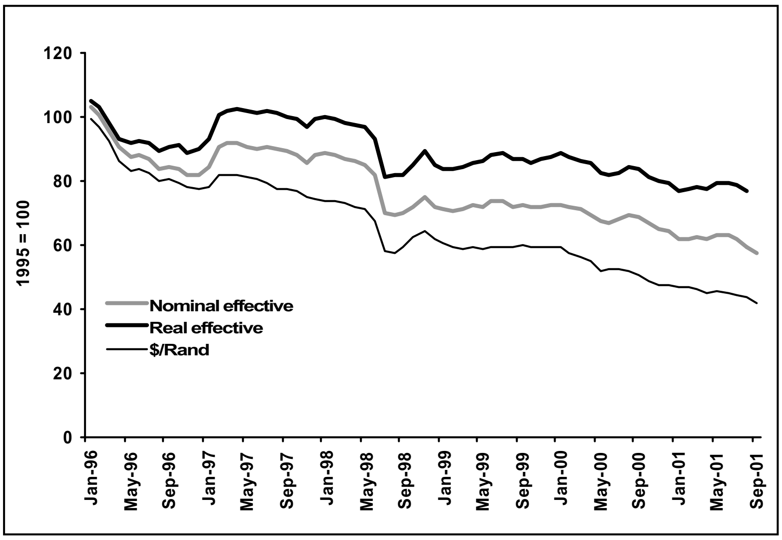
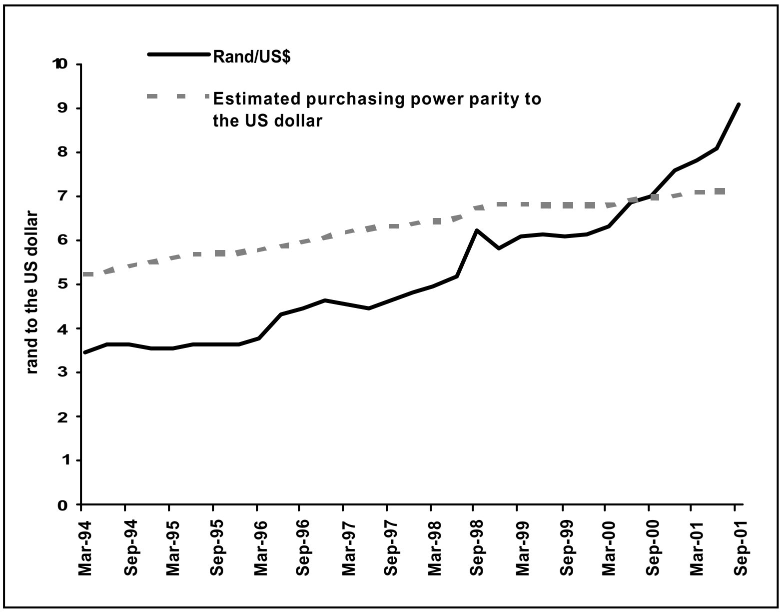


Figure 2.7: Nominal depreciation and purchasing power parity on a US dollar basis



Foreign reserves and the NOFP

Marginal improvement this year in gross reserves

Gross official reserves improved marginally in 2001, rising from US$7,51 billion in January to US$7,53 billion in September. Net reserves, however, declined from US$4,92 billion to US$3,54 billion, as dollar proceeds from a syndicated loan were used to reduce the forward book.

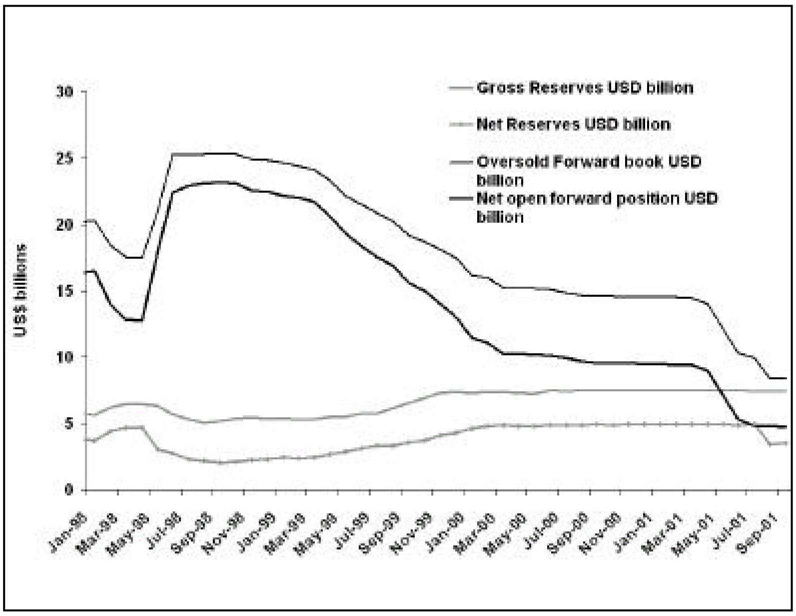
The net open forward position has been substantially reduced since 1998

The Reserve Bank is phasing down its provision of forward cover in the foreign exchange market. Progress in reducing the net open forward position was rapid in 1999 and slowed in 2000 due to smaller capital inflows. In 2001, the NOFP was reduced to US$ 4,8 billion.

NOFP expected to be eliminated next year

The NOFP is expected to reach zero some time in 2002, in response to the Reserve Bank's purchase of US dollars in the event of inflows related to state asset restructuring and Government's foreign borrowing.

Figure 2.8: The NOFP, Forward Book, Gross and Net reserves, 1998 to 2001, in billions of US dollars



Real output and expenditure trends

Output in manufacturing, construction and trade have grown this year…

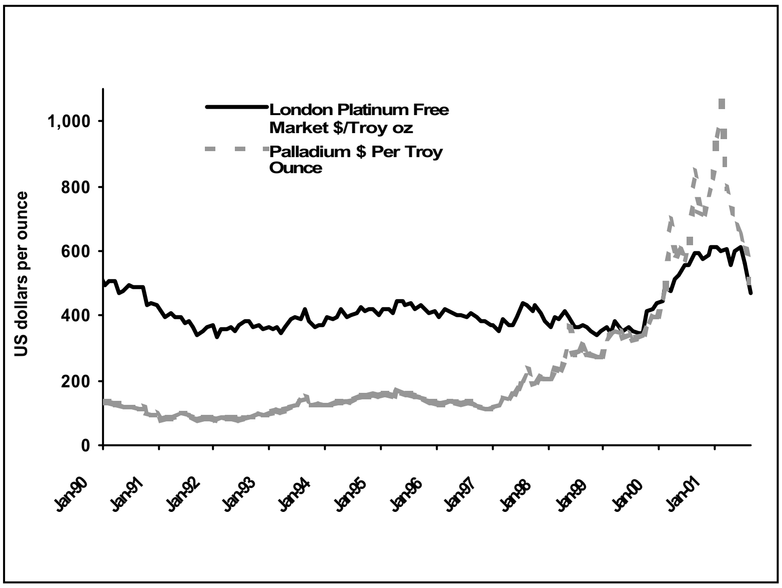
Investment and output in manufacturing, construction, trade, and services have contributed to good rates of growth this year, and are expected to strengthen in the next few years as lower production costs raise profitability in export-oriented sectors of the economy.

…while mining and agriculture have declined

Mining production fell by 1,9 per cent from June 2000 to June 2001, largely due to a sharp decline (-9,1 per cent) in gold production. Platinum production continued to rise in 2001, pushing the annual growth rate to 6,2 per cent. Platinum output is likely to continue to expand as investment unfolds

Output in the agricultural sector decreased in the first half of 2001 by a seasonally adjusted and annualised 3,1 per cent. Progress in agricultural and land reform will enhance income-generating opportunities for more of the rural population.

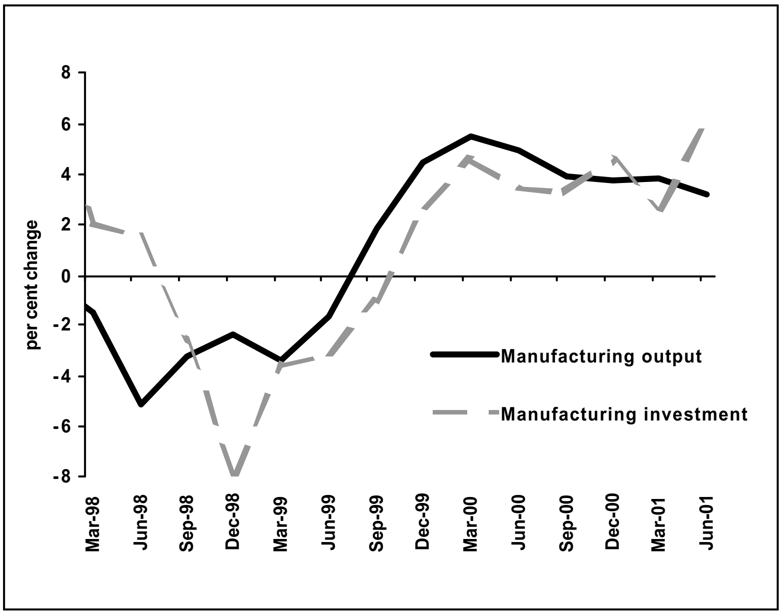
Figure 2.9: Platinum and palladium prices, 1990- 2001



Investment and output in manufacturing have recovered from a slump in 1998 and 1999

Manufacturing output increased by an average of 1,2 per cent on a seasonally adjusted and annualised basis in the first two quarters of 2001, while the electricity, gas and water sector grew by 1,5 per cent.

Figure 2.10: Investment and output in manufacturing, 1998-2001 (quarterly, year on year growth)



The services sector has become increasingly important for the general competitiveness of the broader economy and a large contributor to employment.

Wholesale and retail trade, and financial services grew by an average seasonally adjusted and annualised rate of 3,3 and

Trade, financial services, transport and communications are growing strongly

4,1 per cent in the first two quarters of 2001, respectively. The transport, storage and communications sector grew by an average of 4,5 per cent in the first two quarters of 2001.

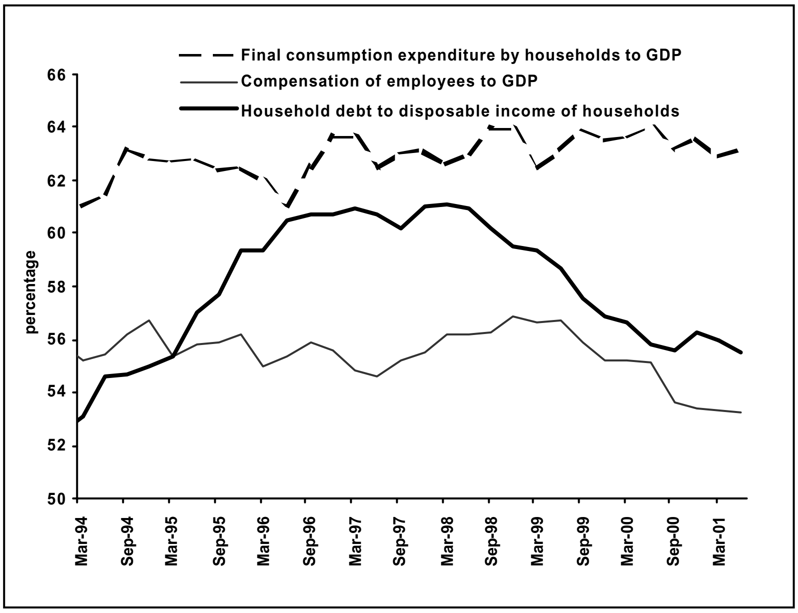
Domestic expenditure

Declining imports and inventories contributed to reduced gross domestic expenditure in the second quarter of this year

Gross domestic expenditure declined somewhat in the second quarter of 2001, due to a shift away from expenditure on imports and a decline in inventories, after having increased in the first quarter by 2,6 per cent on a seasonally adjusted and annualised basis from a year earlier. Firms continue to draw down inventories in order to meet unfilled orders. As the economic expansion continues, however, inventory rebuilding is expected to accelerate.

Real household consumption expenditure rose by about 2,3 per cent in the first two quarters of 2001. Real government consumption expenditure rose in the first half of 2001 and is expected to grow by an annual average of 2,5 per cent in the MTEF period.

Figure 2.11: Ratios of household consumption and its determinants, 1994-2001

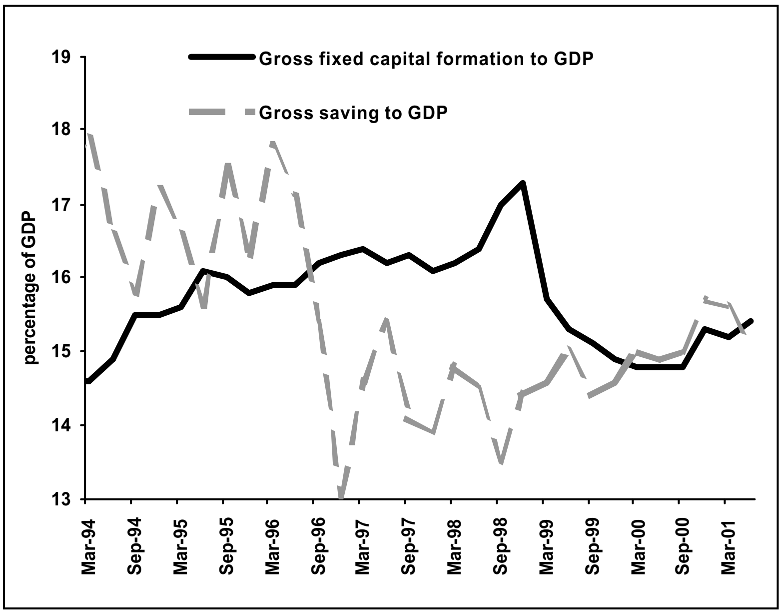


Investment and saving

Investment and output in manufacturing have recovered from a slump in 1998 and 1999

The broader shift in the economy toward greater export production is expected to feed through into non-tradable and import-competing sectors. Investment performance improved in almost all sectors in the first half of 2001.

Figure 2.12: Investment and saving, 1994-2001



Both investment and saving show signs of recovery

Investment increase of 5,6 % in first half of 2001

Gross domestic fixed investment as a percentage of GDP increased to 15,3 per cent in the first half of 2001. Private corporations and the public sectcor contributed positively to the 5,6 per cent average rise in investment in the first half of 2001. Government's real contribution to gross capital formation grew by 1,8 per cent in the same period

Broad-based improvement in investment

On a sectoral basis, the rise in investment growth rates since the first half of 2000 has been unusually widespread. Economy-wide and sector-specific factors – such as declining relative costs and platinum prices – have contributed to the improvement.

Investment in mining, manufacturing and financial services remained strong or accelerated somewhat in 2001. The long shakeout in the construction industry appears to have ended in 1999, with positive investment growth in 2000 and 2001

Government dissaving has declined steadily…

Gross domestic saving rose from 15,2 to 15,3 per cent of GDP from 2000 to the first half of 2001. Net dissaving by government has declined from 5,9 per cent of GDP in 1994 to 1,2 per cent of GDP in the first half of 2001.

Table 2.2: Real sectoral investment (quarterly changes, seasonally adjusted, annualised rates)

	Mining	Manufacturing	Construction works	Transport and communication	Financia services
Dec-00	10,6	4,0	6,8	16,3	9,9
Mar-01	10,0	1,7	11,9	3,0	9,9
Jun-01	8,1	16,3	16,8	-9,4	4,0

... and household debt are falling

Private firms increased dividend payments, thereby lowering their contribution to overall saving. Household debt continued to fall, to about 55,5 per cent of disposable income in the second quarter of 2001 – the lowest level of household debt since 1994.

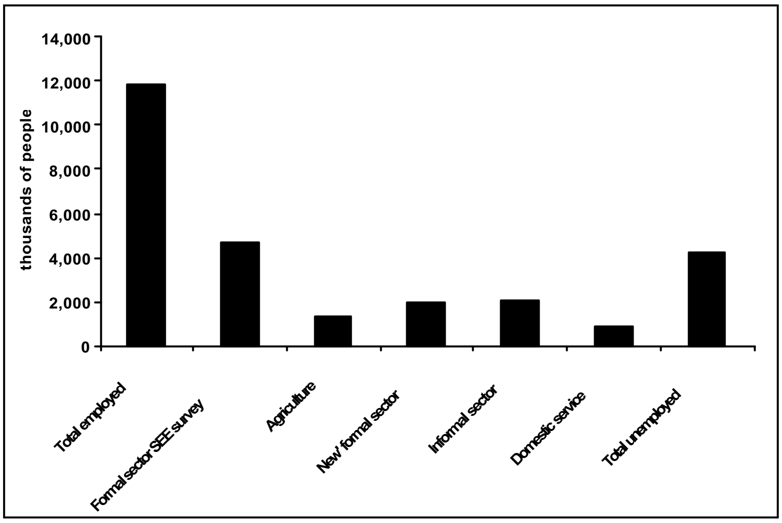
Employment and remuneration

Employment data indicate marked shifts in the structure of employment

Data from the new Labour Force Survey (LFS) suggest that employment losses in the older, formal sectors of the economy have been mitigated by employment gains in newer sectors of the economy, the informal sector, and extensive outsourcing.

These shifts reflect changes in the composition of demand for South African products with little net change in effective demand. Currency depreciation and heightened competitiveness have also played a role in the employment shifting process by increasing total demand and contributing to employment creation in exporting industries.

Figure 2.13: Components of employment in SA, 2001



Productivity and earnings

Strong productivity growth has contributed to rising earnings and real household disposable income growth

Productivity growth remained strong in 2000 and the first quarter of 2001, resulting in moderate increases in unit labour costs, lower domestic price inflation and healthy corporate earnings.

Over the past two years, productivity has risen faster than real wages, reducing labour market disequilibria and setting the stage for employment increases in the medium-term. The rate of increase in the real disposable income of households remained healthy in 2001, rising by about 2,5 per cent in the first half of the year, compared to the first half of 2000.

Money supply and inflation

Since 1994, growth in the money supply has fluctuated with a series of innovations and structural changes in the financial sector, contributing to a breakdown in the relationship between M3 and inflation.

Private sector credit growth reflects expansion in mortgages and installment sales

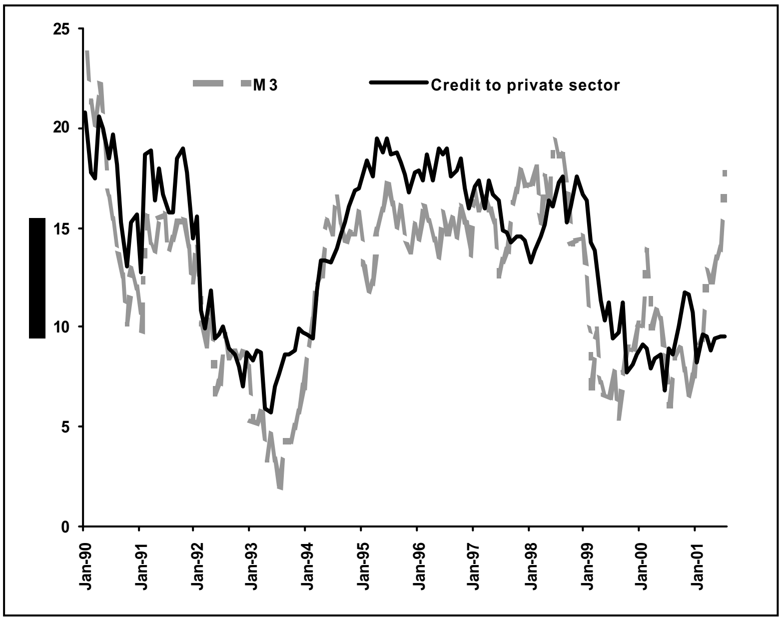
Growth in credit to the private sector accelerated more gradually in 2001, rising by 10,4 per cent in the year to August. Mortgage advances and installment sales credit provided the major part of the rise in overall credit.

Interest rates

The repo rate and prime lending rates have been reduced twice this year

The Reserve Bank cut the repurchase rate by 100 basis points from 12 to 11 per cent in June 2001, resulting in a decline in the prime rate from 14,5 to 13,5 per cent. A subsequent rate cut of 50 basis points in September, in addition to a technical change in how the repurchase market functions (100 basis points), resulted in a further decline in the repo rate to 9,5 per cent, of which only the 50 basis point decline was intended to have any impact on money market and prime lending rates. The prime rate fell to 13 per cent. Lower short-term interest rates were accompanied by a large decline in long-term interest rates.

Figure 2.14: M3 and credit to the private sector, 1990-2001 (monthly, percentage change over 12 months)



Yields on the R153 fell from 12,6 per cent in January 2001 to about 10,4 per cent in September.

In real terms (the nominal yield adjusted for inflation), interest rates have declined from an average of about 12 per cent from 1995 to 1998 to about 6 per cent in 2001. The level of South Africa's real interest rate compares well with other emerging markets.

Inflation

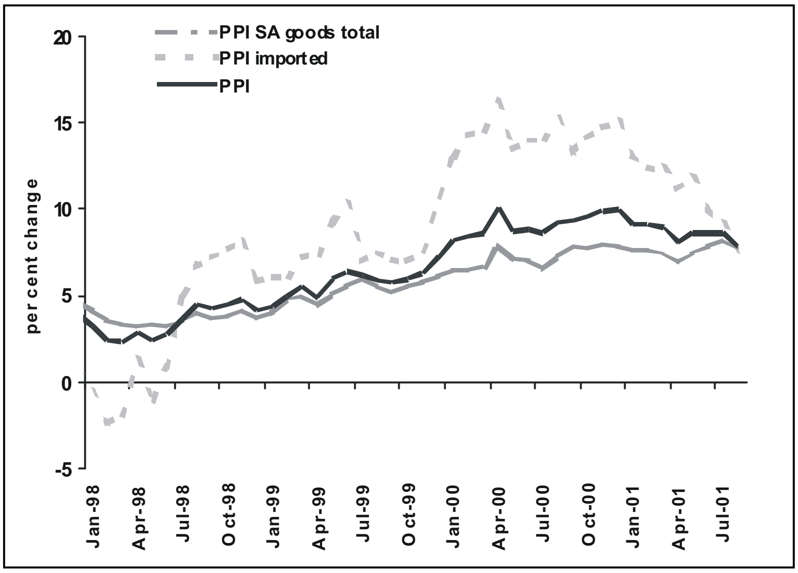
Real interest rates have declined markedly since 1998

Domestic producer price inflation rose at a rate of 7,8 per cent in the year to September and is expected to decline as the prices of imported goods stabilise in the year ahead.

Consumer price inflation has reached the 3-6 % target range

Consumer price inflation as measured by CPIX (the targeted measure) peaked in 2000, and has since continued to decline, reaching 6 per cent in August and 5,8 per cent in the year to September 2001. Slower growth in food and oil prices were the primary factors behind the easing in consumer price increases.

Figure 2.15: Imported and domestic producer prices, 1998-2001



More moderate increases in administered prices

Although administered prices continue to grow more rapidly than CPIX, the trend in the rate of growth is easing. Medical and transport costs, for instance, increased by 11,9 and –3,6 per cent in the year to August 2001, down from 16,1 and 10,1 per cent in March and January, respectively. Rates of increase in administered prices will moderate as these sectors adjust more fully to market conditions, changes in regulatory and industry structures and legislation.

The new inflation targets

Government announced an inflation targeting framework to guide monetary policy in the 2000 Budget, with an initial target band of 3 to 6 per cent to be reached as an annual average of consumer prices minus mortgage interest costs (CPIX) in the year 2002.

Sufficient lead-time for the monetary authorities to adjust policy to meet targets is required due to the time lag between a change in policy and its impact on CPIX. For that reason, Cabinet has decided that the target will remain at 3 to 6 per cent of the annual average of CPIX for the year 2003.

Critical to the achievement of lower inflation in the future is the impact of the framework on the expectations of future inflation held by the financial markets, producers and labour market agents. The Reserve Bank has made good progress in opening the monetary policy-making process to public scrutiny and explaining the benefits of lower inflation to the public.

Cabinet has opted to further enhance the transparency and credibility of the framework by also announcing the inflation target for 2004 and 2005 as recommended by a joint National Treasury and Reserve Bank Technical Committee. The CPIX target for 2004 and 2005 will be an average increase in CPIX of 3 to 5 per cent.

The following considerations, among others, influenced the joint report of the Inflation Targeting Technical Committee:

- That a path for achieving a lower rate of inflation reduces market speculation on the long-term inflation goals of Government and will help reduce expectations in the short-term.
- That an adjustment in the target band for 2004 and 2005 is appropriate for South Africa since it represents an intention by South Africa to achieve inflation rates similar to those of our major trading partners, and therefore maintains the competitiveness of the economy.

The framework has also been adjusted to make more concrete the characteristics of the ‘escape clause’ underpinning the flexibility of the framework in the event of exogenous and supply side shocks to the economy. The text of the escape clause is as follows:

It is recognised that there may be some economic supply shocks or extraordinary events impacting on CPIX inflation that are unforeseen and beyond the control or influence of monetary policy. Most of these factors reverse over time. It is not possible to specify in advance all the economic shocks that could affect CPIX inflation, but such factors include a sharp rise in international oil prices, drought, changes in indirect taxes, and international financial contagion which causes major changes in the exchange rate which are unrelated to domestic economic fundamentals and domestic monetary policy. Reacting to such events could result in costly losses in terms of output and jobs. In such circumstances where it is expected that the target for CPIX inflation will not be met, it will be indicated in a monetary policy statement and the Monetary Policy Committee will set out the path and time horizon over which the inflation rate will be brought back in line with the target.

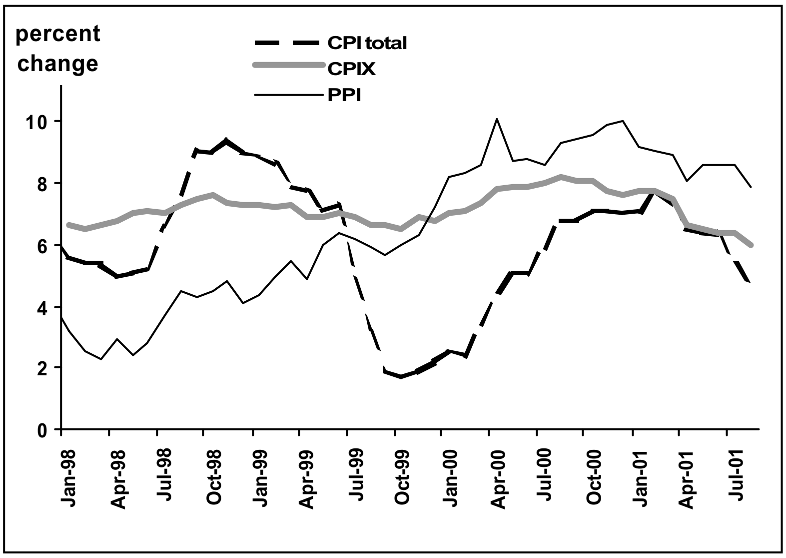
Global and domestic outlook

The global economy started to weaken around the middle of this year, and a rebound is expected next year as both monetary and fiscal policies have been significantly eased to stabilise major world economies.

Developments in the major industrial economies

Most economists expect United States growth to be negative in the third and fourth quarters of this calendar year as the IT sector, financial services, hotel and air transport sectors weaken further.

Figure 2.16: Consumer and producer prices Global and domestic outlook



A more sustained slowdown in household consumption could occur through weaker consumer sentiment, declining wealth, precautionary saving, and falling real disposable income.

Monetary policy easing in United States

However, the Federal Reserve has cut the Federal Funds rate nine times this year from 6,5 to 2,5 per cent, and with the cooperation of the European Central Bank (ECB) and the Bank of Japan (BOJ), has provided unprecedented monetary stimulus to the US and global economy. The US government has further provided a fiscal stimulus with a combination of tax cuts and increased spending of about US$150 billion, or 1,5 per cent of GDP.

Growth remains positive in Europe

Positive growth in Europe for 2001 (2,3 per cent) should limit the negative impact on the world economy of a recession in the US. Growth in 2002 is expected to be 2,2 per cent. The ECB eased monetary policy in August and September by cutting interest rates, and has implied further easing if inflation continues to fall. Increasing budget deficits in EU member states also indicate more growth-oriented fiscal positions.

The Japanese economy shrank by 0,8 percent in the second quarter of 2001, largely due to a weak export performance. Business confidence remains weak.

The Japanese government plans tighter fiscal policy for 2002, and significantly eased monetary policy this year. The deflationary trend, however, has not yet been reversed, and more aggressive monetary and structural measures may be necessary to reverse the deflation.

Prospects for commodity prices

Prices of commodities have been falling in real terms for some time, but are expected to recover over the medium term in line with the rebound in global economic activity.

Japan's economy continues to stagnate

Although oil prices have remained high for most of the year, they declined to about US$21/barrel in September as it became clear that the demand for oil would decline as world growth decelerates. Crude oil is expected to continue trading in a range of about US$22-28 in the next few years.

Oil prices have declined in recent months

Despite a recent pickup in the price of gold (about US$20/oz), no major increase in the gold price is expected over the medium term. Prices of platinum group metals are expected to remain relatively high and continue to underpin income from mineral exports.

Gold and platinum prices are expected to remain stable

Domestic economic outlook

Sound policies should ensure continued stable economic results for the South African economy, which is likely to experience better growth than most of the emerging world.

A surplus on the current account of the balance of payments this year, followed by moderate deficit over the MTEF period

Although GDP growth is expected to slow somewhat in the latter half of 2001, the economy is still expected to grow by about 2,6 per cent.

Growth is expected to accelerate over the next three years, primarily from rising household consumption as domestic confidence improves, real exchange rate competitiveness and an expected acceleration in gross fixed capital formation from lower interest rates, and increased government capital expenditure.

Growth has slowed in 2001, but is expected to strengthen over the next three years

Growth in real final consumption by government is expected to average 2,5 per cent in real terms over the forecast period as real increases in allocations have been budgeted and improvements in financial management are extended throughout the public sector.

Fiscal policy will contribute to sustaining expansionary momentum

Business confidence, and hence investment, will continue to benefit from structural improvements in South Africa since the mid-1990's, including a steep reduction in government dissaving, much lower inflation, accelerated pace in infrastructure and social delivery, lower interest rate costs; and improved external competitiveness.

South Africa is under review for a credit upgrade by Moody's this year as macroeconomic conditions continue to improve, which will contribute to significantly lower

Moody's credit upgrade under review

borrowing costs and an improvement in capital inflows. Foreign capital inflows have covered domestic saving shortfalls and foreign reserve levels have more than doubled over the past two years, with the net open forward position expected to be eliminated by the end of next year.

Table 2.3: Macroeconomic projections (calendar years): 1998 to 2004

Calendar year:	1998	1999	2000	2001	2002	2003	2004
		Outcome			Projected		
Real growth in demand:							
Final household consumption	1,3%	1,1%	3,2%	2,8%	2,9%	3,3%	3,4%
Final government consumption	-0,5%	-1,9%	-2,5%	1,6%	2,3%	2,6%	2,8%
Gross fixed capital formation	5,8%	-6,0%	1,3%	5,3%	6,1%	6,9%	7,2%
Gross domestic expenditure	0,4%	-0,2%	2,7%	1,5%	3,8%	3,1%	3,3%
Exports	2,2%	1,3%	8,2%	6,0%	2,2%	6,4%	6,5%
Imports	1,2%	-7,4%	7,4%	2,2%	6,5%	5,1%	5,2%
Real GDP growth	0,7%	1,9%	3,1%	2,6%	2,8%	3,5%	3,7%
GDP inflation	6,8%	6,2%	6,5%	6,7%	5,3%	5,0%	4,5%
Gross domestic product at current prices (R billion)	735,1	795,6	873,6	955,8	1 034,3	1 123,8	1 217,9
CPI inflation:							
Headline	6,9%	5,2%	5,3%	5,8%	4,5%	4,9%	4,5%
CPIX (Metropolitan and urban areas)	7,1%	6,9%	7,7%	6,5%	5,5%	5,1%	4,5%
Balance of payments:							
Current account balance (% of GDP)	-1,8%	-0,4%	-0,3%	0,2%	-0,5%	-0,6%	-0,8%

Table 2.4: Macroeconomic projections (fiscal years): 2001/02 to 2004/05

Fiscal year:	2000/01	2001/02		2002/03		2003/04		2004/05
	Outcome	2001 Budget	Revised	2001 Budget	Revised	2001 Budget	Revised	
Gross domestic product (R billion)	896.5	987.2	974.1	1 069,3	1 057,5	1 154,9	1 148,2	1 244,3
Real GDP growth	3.1%	3.7%	2.4%	3.5%	3.1%	3.3%	3.6%	3.7%
GDP inflation	7.1%	6.0%	6.0%	4.7%	5.3%	4.6%	4.8%	4.5%
CPI inflation:								
Headline	6.5%	5.6%	5.0%	4.8%	4.7%	4.5%	4.7%	4.5%
CPIX	7.8%	6.2%	6.0%	5.2%	5.5%	4.6%	4.9%	4.5%