2

Economic policy and outlook

Growth is expected to rebound in the medium term, benefiting from broad recovery in the international economy, strong investment growth and rising disposable income.

Employment creation was a central theme of the Growth and Development Summit, focusing on short-term measures to alleviate the poverty impact of unemployment and build sustainable long-term employment opportunities.

Redistribution of economic opportunity remains a central platform of government policy, which has been given further impetus by the release of the financial sector charter in 2003, ensuring broad-based access to financial services.

Overview

2,1 per cent GDP growth in first half of 2003

The South African economy continues to expand, though the weakness in the international economy moderated the pace of growth over 2003. After expanding by 3 per cent[1] in 2002, economic growth slowed to 2,1 per cent in the first half of 2003. Weak international demand has impacted particularly on export-oriented manufacturing sub-sectors.

Global recovery gathering momentum

The long-anticipated recovery in global economic activity is beginning to gather momentum, particularly in the United States and East Asia. In the US, consumer and business confidence is firming, boding well for further growth and employment over the medium term. Sustained growth in international markets will support the South African economy, though the weakness in Europe remains cause for concern.

Investment expenditure remains firm

Amidst the global slowdown, South African firms have continued to expand productive capacity, with investment expenditure growing at around 8 per cent in the first half of the

[1] All growth figures are expressed as year-on-year changes, unless otherwise stated in the text.

year. This growth has been complemented by the significant expansion of public investment in economic infrastructure.

Gross domestic expenditure grew steadily over the first half of the year, driven by household consumption spending and firm investment growth. The current account of the balance of payments recorded a modest deficit in the first half of the year following a mild surplus in 2002.

Growth forecast at 2,2 per cent in 2003

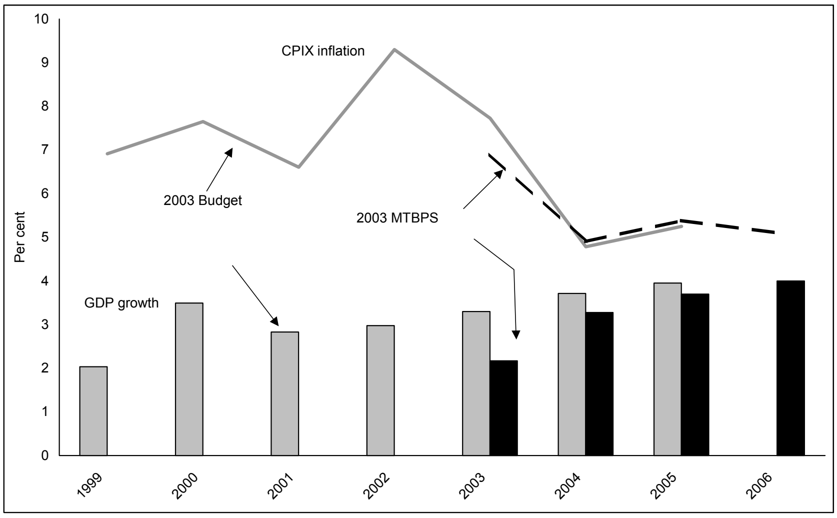
Since the 2003 Budget, the economic growth forecasts have been scaled back from 3,3 per cent to 2,2 per cent for 2003, rising to 4,0 per cent for 2006. Despite the downward revision, growth will be supported by recovering international demand, supportive fiscal policy, falling interest rates and rising incomes. Inflation fell within the target range of 3 - 6 per cent in September and will remain within the target over the MTBPS period.

GDS focuses on sustainable long-term growth

The Growth and Development Summit (GDS) in June focused on policy initiatives to underpin long-term sustainable growth and development in South Africa. Building on stable macroeconomic and fiscal policy, various government interventions are envisaged to support stakeholder efforts to create jobs, alleviate poverty and foster economic growth. These include:

- Improving the regulatory environment to support business development and boost market efficiency
- Enhancing public infrastructure capacity to meet both growth and social development objectives
- Expanding education and training programmes to underpin long-term job creation
- Deepening social security programmes to provide income support to the most vulnerable
- Supporting black economic empowerment initiatives to broaden access to economic activity and opportunity across the economy
- Strengthening partnerships at the sectoral level to encourage growth and job creation.

Figure 2.1: Growth in real GDP and CPIX inflation 1999-2006



Global developments

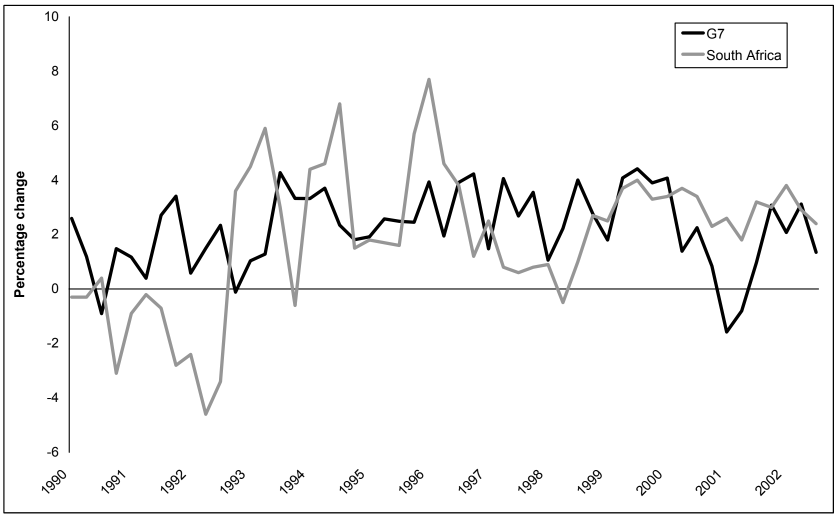
Close correlation with world growth

Figure 2.2 illustrates the correlation between growth in South Africa and growth in the G7 group of industrialised countries. While South Africa remains significantly affected by world growth, over the last three years South Africa's GDP performance has been less volatile and quite resilient relative to that of the G7 group of countries.

World GDP growth of around 3 per cent in 2004

After a protracted downturn in the world economy, the global recovery is beginning to gather momentum, particularly in the United States, Japan and emerging Asia. World GDP growth is forecast to hold above 2 per cent in 2003 and to accelerate to around 3 per cent in 2004.

Figure 2.2: South African and G7 economic growth, 1990-2003



US growth of 7,2 per cent s.a.a.r in the third quarter

Fiscal stimulus, an accommodative monetary policy stance and the depreciation of the US dollar all underpin the recovery in the US economy in 2003. Growth in the second quarter was revised upward to 3,3 per cent on a seasonally adjusted and annualised basis. Preliminary estimates are for growth of seasonally adjusted and annualised 7,2 per cent, seasonally adjusted and annualised, in the third quarter. Rising producer and consumer confidence suggest that this momentum will be maintained into the second half of 2003 and 2004.

Table 2.1 Annual percentage change in GDP, selected countries

	2001	2002	2003[1]	2004[1]
US	0,3	2,4	2,7	4,0
Japan	-0,1	0,2	2,4	1,3
Euro region	1,5	0,8	0,5	1,7
UK	1,9	1,7	2,0	2,6
North America	0,4	2,5	2,6	3,9
Western Europe	1,5	1,1	0,8	2,0
Asia Pacific	1,6	2,3	3,3	3,0
Eastern Europe	1,7	4,6	4,8	4,5
Middle East & Africa	1,7	1,7	2,6	2,7
Latin America	0,1	-1,2	1,2	3,6

Sources: Consensus Economics, October 2003.

1. Forecasts.

Despite imbalances, US remains the main driver of world growth

Despite weakness in the labour market, which has lagged the recovery in the economy, consumption expenditure has been the primary driver of the recovery in the US, supported by fiscal spending, particularly on defence-related activities. While imbalances remain, especially in respect of household debt levels, as well as the sustainability of the current and fiscal deficits, the US will remain the primary driver of world growth over the medium term, supporting recovery in Europe and elsewhere.

Europe recovers slowly

The European economy continues to be adversely affected by the global slowdown, the effects of which have been exacerbated by the strengthening of the Euro by 11,3 per cent this year to June. The Euro area is expected to return growth of less than 1 per cent this year, though rising business confidence, and more stimulatory fiscal policy should contribute to a mild recovery in 2004.

Structural reform in Europe underpins longer-term growth

Growth in Europe remains hampered by both long-term structural constraints and short-term restrictions on monetary and fiscal policy. Despite this, in support of domestic growth, many European economies have breached the fiscal limits set by the Growth and Stability Pact. In addition, countries such as Germany are developing reform measures to improve the efficiency of their economies, particularly in respect of regulation and their labour markets.

China continues to grow strongly, supported by growing domestic markets and the extremely competitive real level of the yuan. Sustained growth in China has supported commodity prices, despite faltering G7 performance. Expectations are that recovery in the G7 will further contribute to strengthening commodity prices.

Balance of payments

Current account

Mild current account deficit

After recording a surplus in 2002, South Africa's current account of the balance of payments is expected to record a deficit about 1 per cent of GDP this year. This reflects a weakening of the trade surplus, as well as a continued deficit on the income and service account.

Weaker world demand inhibits export growth

After depreciating sharply in the second half of 2001, the rand appreciated in 2002 and the first half of 2003, reaching a real effective exchange rate in July 2003 that was 11 per cent above its January 2001 level. Both the weakness of the international economy and the relative strength of the rand have contributed to lower nominal export earnings in 2003, by comparison with 2002.

Import expenditure up 2 per cent

At the same time, the relatively firm currency and the anticipation of a pick-up in international demand supported growth in gross domestic expenditure, including strong growth in investment. This contributed to an increase in import expenditure over the first half of 2003 of 2 per cent. Weaker exports and steady import growth combined to lower the surplus on the trade account to 2,4 per cent of GDP from 4,2 per cent in 2002.

Growth differentials driving rand in the short-term

The currency has shaken off the dampening effect of recent interest rate cuts. This suggests that the currency market is less affected by interest rate differentials than by growth prospects, which have responded positively to interest rate cuts, and higher global commodity prices.

Imports reflect increasing domestic capacity

Manufactured goods constitute over three-quarters of total imports, with machinery, electrical equipment, vehicles and transport equipment comprising the largest component. Growth in capital good imports reflects rising business confidence and provides a basis to meet increasing global demand in the coming years. The deficit in manufactured goods trade has risen from R26,5 billion in 1995 to R50,1 billion in 2002.

Figure 2.3: Year-on-year growth in exports and imports, 1980-2002

Europe accounts for 35,3 per cent of exports

Under the range of bilateral and multilateral trade agreements that have been signed, South Africa diversified its trade, both geographically and by product. According to 2002 trade data, South African exports (excluding platinum) to Europe accounted for 35,3 per cent of total exports. This compares with 9,1 per cent for the US. However, a significant proportion of platinum is exported to the US. Exports to East Asia account for 12,5 per cent and are growing due to increasing Chinese demand for commodities.

Currency depreciation and trade account performance

Given the recent volatility of the currency, the National Treasury commissioned a study to review the impact of the currency on the trade balance. Overall, the study suggests that a depreciation of the currency improves the trade balance, though rising domestic prices and wages erode the benefits over time.

A depreciation of the currency improves the trade balance by improving the profitability of export supply and raising the cost of imports relative to domestically-produced products. However, this competitive advantage is not sustained if domestic prices and wage costs rise and offset the relative price shifts that the depreciation of the currency caused. The South African evidence suggests that currency depreciation tends to be followed by fairly rapid increases in domestic prices, which neutralise the positive effect on the trade balance. Also, the evidence suggests that South African firms do not take advantage of the depreciation to cut prices and gain foreign market share.

Available evidence also suggests that the effect of currency depreciation is asymmetric. Currency appreciation is influenced by institutional structures that cause rigidities in the adjustment of wages and other domestic prices. For example, if wages and other domestic prices rise quickly in response to a depreciation, the gains to the trade balance will be short lived. In contrast, if they are rigid downwards, an appreciation of the currency may lead to a sustained negative impact on the trade balance. Current trends in domestic inflation suggest that prices have adjusted slower to the appreciation of the currency than they did in response to the depreciation in 2001. South African exporters have thus far faced falling export prices (in rand terms), while domestic prices have still risen, albeit at a slower rate.

Exchange rate volatility is an unavoidable feature of the present international environment, and affects all countries to varying degrees. Smaller businesses are often adversely affected, particularly if they are unable to diversify their sales internationally or otherwise hedge their foreign exchange risks.

South Africa continues to diversify trade

Reflecting the benefits of the Africa Growth and Opportunity Act (AGOA), 18,6 per cent of South Africa's exports into the US enter without duty. These comprise a diverse range of products, with manufactured exports accounting for over 50 per cent of total exports to the US.

AGOA benefits encourage exports, but efficiency improvement necessary

As AGOA expires in 2008, over the coming years policy will focus on improving the competitiveness of domestic production and ensuring that the investment attracted to South Africa to take advantage of the AGOA benefits is sustainable.

Europe remains SA's major trading partner

Despite the success in expanding the US market for South African exports, Europe remains South Africa's major trading partner. Continued expansion into this market is envisaged as the SA-EU Agreement on Trade, Development and Co-operation begins to bear fruit.

Despite weaker service receipts, South Africa remains well-placed for growth

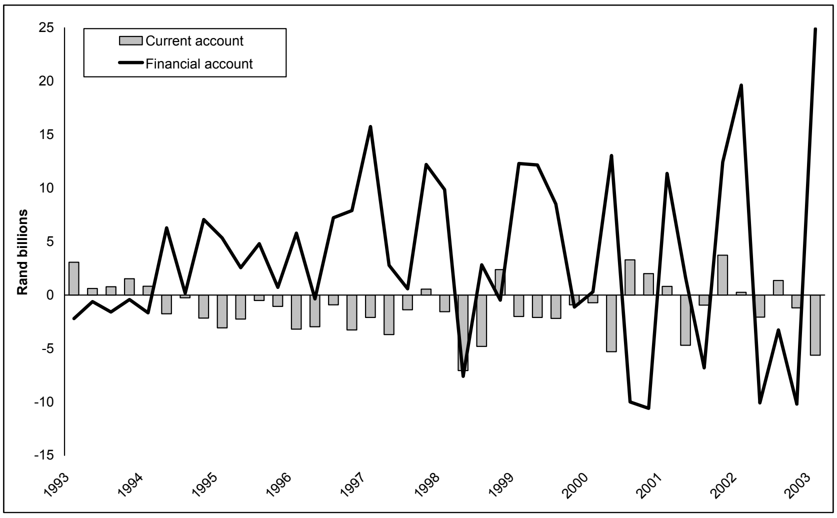
Weaker dividend inflows in the first half of 2003 and a dip in the second quarter passenger receipts contributed to further weakness in the service and income account, raising the overall deficit on the current account to 1 per cent of GDP. However South Africa is well placed to consolidate its position as a tourist and conference destination of choice in international markets, supported by expansion of capacity with the completion of several international convention centres.

WTO Ministerial Conference in Cancun

Expectations were high that the World Trade Organisation (WTO) Ministerial conference in Cancun would culminate in the removal of major trade barriers by 2005, particularly ensuring improved trade access for developing countries into protected agricultural markets. The meeting was concluded without agreement for a variety of reasons, including the so-called Singapore issues related to investment, competition policy, transparency in government procurement and trade facilitation, as well as reluctance on the part of developed countries to engage meaningfully on reducing subsidies for agricultural production.

The Ministerial statement, while noting the setback, asked the General Council to work urgently towards resolving outstanding issues. The Chairman was asked to convene a General Council meeting of Senior Officials by no later than 15 December 2003. South Africa remains committed to advancing the trade agenda, opening up new markets for South African producers, as well as other emerging markets. It is particularly important that the process proceed constructively and that developed country governments take seriously their commitments to dismantling barriers to emerging market products, especially if poverty in developing countries is to be addressed in a sustainable manner.

Figure 2.4: Balance on current and financial account, 1994-2003



Financial account

R22,6 billion portfolio inflows in second quarter

The deficit on the current account was financed primarily through increased net portfolio inflows from abroad, which reached R22,6 billion in the second quarter of 2003, driven mainly by the relatively attractive returns on domestic assets. Foreigners were net buyers of both domestic equities and bonds in the quarter.

Industrial expansion to support FDI

While in the second quarter net direct investment amounted to R1,3 billion, attracting higher levels of foreign direct investment remains a challenge. In the years ahead, direct investment will be supported by the envisaged expansion of the Coega industrial zone, as well as anticipated investment into the local motor industry.

Foreign reserves up to US$20,2 billion

Over the year, South Africa's foreign exchange reserve position continued to strengthen. By the end of September 2003, gross gold and other foreign reserves had risen to US$20,2 billion, up from US$14,9 billion at the end of March 2003.

NOFP now a positive $1,8 billion

In January 2003, the net open forward position of the SA Reserve Bank was US$1,5 billion. This oversold open position was completely eliminated in May 2003. Since then, the continued reduction in forward foreign exchange contracts has contributed to a strengthening of the NOFP to a positive US$1,8 billion at the end of September 2003.

Real output trends

Growth in domestic production slows in the first half of 2003

Short-term trends in output performance are strongly influenced by local and foreign demand conditions. Responding to slower growth in international demand and lower export profitability from the stronger currency, domestic production slowed in the first half of 2003. Output growth in the first half of the year moderated to 2 per cent, following annual growth of 3 per cent in the second half of 2002. However, the anticipated turnaround in international demand will contribute to stronger output growth over the medium term.

Agriculture

Agricultural production down 3,5 per cent in first half of year

Agricultural production contracted by 3,5 per cent in the first half of 2003, mainly due to a 7 per cent fall in field crop production over the previous season. The maize crop, in particular, was negatively affected by adverse weather conditions and will decline further in response to weakness in prices. However, as reflected in table 2.2, production of sorghum, groundnuts, soya-beans and dry beans is expected to rise this season.

Table 2.2 Crop estimates

Crop	Season area planted ('000 ha) 2002/03[1]	2003/04[2]	Percentage change
Maize			
White	2 083	1 826	-12,3%
Yellow	1 017	977	-3,9%
Sorghum	85	108	27,1%
Groundnuts	50	90	80,0%
Sunflower	628	590	-6,1%
Soya beans	108	116	7,4%
Dry beans	51	58	13,7%

Source: Crop Estimates Committee.
1. 2002/03 season shows actual area planted.
2. 2003/04 season indicates intentions to plant.

Land reform and agricultural support

While agricultural production remains susceptible to volatility in output prices and weather conditions, building capacity in agriculture remains a central theme of government policy. The advancement of the land reform programme, coupled with intensified agricultural support programmes, will broaden access to farming among previously disadvantaged communities.

Support for commercial agriculture

Government continues to improve and support rural security measures to provide stability to the farming sector and a platform for further growth and development. Government also continues to engage in trade talks to deepen market access for South African agricultural products abroad.

Mining

Modest growth in mining production

The modest recovery in annual growth in mining production continued in the first half of 2003, despite a contraction in the first quarter on a seasonally adjusted and annualised basis. The growth in the mining sector continues to be underpinned by solid performance in the platinum group metals sector, supported by growth in diamond mining in the second quarter. This more than compensated for the decline in gold and coal mining.

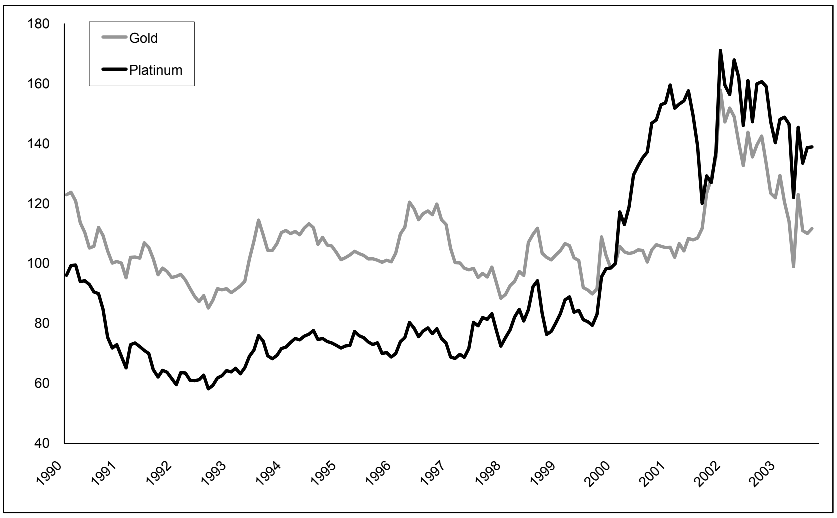
Healthy prices benefit mining sector

The mining sector, and gold and platinum in particular, have benefited from healthy international prices for their products, partly driven by prospects of an international recovery in the manufacturing sector and partly driven by weakness in the US dollar.

Rand gold price steady in real terms

While the strength of the South African rand has lowered revenue in rand terms and apparently contributed to a rescheduling of investment activity, figure 2.5 indicates that the real rand price of gold is in line with its long-term trend, while the real price of platinum comfortably exceeds its long-term average. With the anticipated global turnaround and continued growth in China's economy, it is expected that the commodity rally will continue over the medium term.

Figure 2.5: Real gold and platinum prices, (2000=100)



PGM projecting sustained growth in output

Prospects for the mining industry continue to be dominated by the performance of the platinum group metals. Output is projected to expand by up to 100 per cent over the next five years to meet global demand, which will involve investment in excess of R25 billion.

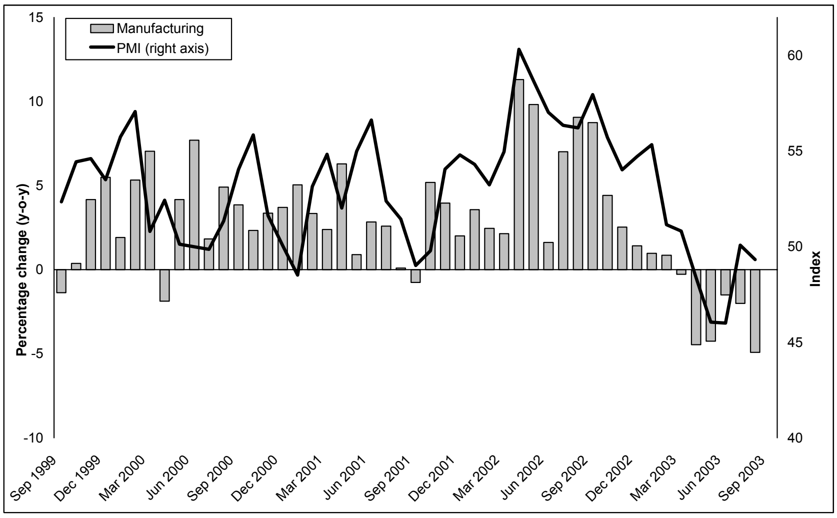
Further capital investment is envisaged in the coal sector in the light of Eskom's decision to recommission five coal-fired power stations by 2009. Further, investment in the Richard's Bay Coal Terminal will raise its coal handling capacity to 82 million tonnes of coal from the current 72 million tonnes, facilitating expansion into export markets, particularly in China.

Secondary Sector

Manufacturing growth momentum slows

Against the backdrop of weak international demand, the growth momentum in the manufacturing sector has slowed, with the index of manufacturing production contracting over the past six months compared to the previous year, as illustrated in figure 2.6.

Figure 2.6: Year-on-Year growth in manufacturing production and confidence index



Despite contraction, investment remains strong

Much of the slowdown in the sector was in the export-subsectors and those subject to significant import competition, including clothing and textiles, and electrical machinery and equipment. Despite this slowdown, the manufacturing sector has continued to invest in capacity to meet anticipated demand in the years ahead.

Investment growth in the sector averaged 5,6 per cent in the first two quarters, which has been supported by fiscal measures such as the strategic investment incentive programme, accelerated depreciation allowances and the protection afforded by the Motor Industry Development Programme to the automotive sector.

Construction expands 3 per cent

The construction sector expanded by 3 per cent in the first half of 2003, though the momentum of growth slowed in the second quarter. The prospects for the sector over the medium term are underpinned by anticipated growth in broad government infrastructure expenditure, especially in upgrading ports and harbours and the road and rail networks. A lower interest rate environment will provide further impetus.

Financial Sector Charter

Following the successful Nedlac Summit in August 2002, the financial sector committed itself to developing a Charter to address historical imbalances in the sector, particularly with reference to human resource development and access to financial services. Commencing in 2002, key stakeholders in the industry came together to develop the Charter, which was launched by the industry and the Minister of Finance on 17 October 2003. The Charter is built around the following central vision:

"…promoting a transformed, vibrant and globally competitive sector that reflects the demographics of SA, and contributes to the establishment of an equitable society by effectively providing accessible financial services to black people and by directing investment into targeted areas in the economy"

The Charter is premised on the following core areas:

- Human resources development
- Access to financial services
- Empowerment financing
- Procurement and enterprise development
- Broadening ownership and control
- Encouraging shareholder activism
- Corporate social investment.

The agreement has set targets for transformation in the sector, emphasising the targets for human resource development, procurement and access to financial services, as well as setting targets for ownership transfers. For instance, the Charter commits the financial services sector to ensuring that 80 per cent of the population in lower income groups has access to financial services by 2008.

The sector, Government and development finance institutions continue to work together to develop sustainable financing solutions to facilitate black economic empowerment programmes in this sector, as well as funding the commitments reached in other sector charters, such as the mining charter. Over the next few months, discussions will take place to ensure appropriate solutions are adopted, based on sound risk-sharing principles. In the 2003 Budget, government allocated R10 billion to facilitate BEE transactions over the next 5 years.

The Charter is an inclusive, voluntary and self-driven document that binds all in the industry, with very few exceptions, to a code that has their full support. It is a clear example of how the private sector has embraced and taken responsibility for government-led social change in the economy. The sector has acknowledged that government cannot alone be solely held responsible for this necessary change. It has to be a joint effort with all economic players, that builds an enduring partnership.

More importantly, the Charter takes a long-term view of the challenge and sets benchmarks against which progress can be monitored.

The agreements on the Charter are underpinned by the fact that there are no penalties driving the targets. Rather the signatories to the Charter have pledged an underlying commitment. The Charter sets a precedent and will serve as a benchmark for challenging other sectors.

The targets set in the Charter represent meaningful and achievable objectives for transformation.

This Charter, in many respects, embraces the principles agreed both at the Financial Sector Summit and the Growth and Development Summit:

- Elevating social dialogue to address the range of challenges facing South Africa and laying a solid foundation for the consolidation of our democracy;
- Strengthening partnerships between government, organised labour, organised business and the community constituency;
- Identifying a clear vision for growth and development;
- Promoting and mobilising investment;
- Contributing to economic empowerment for all, especially for black people, workers, people with disabilities, women and youth; and
- Contributing to poverty reduction and addressing the legacy of under-development.

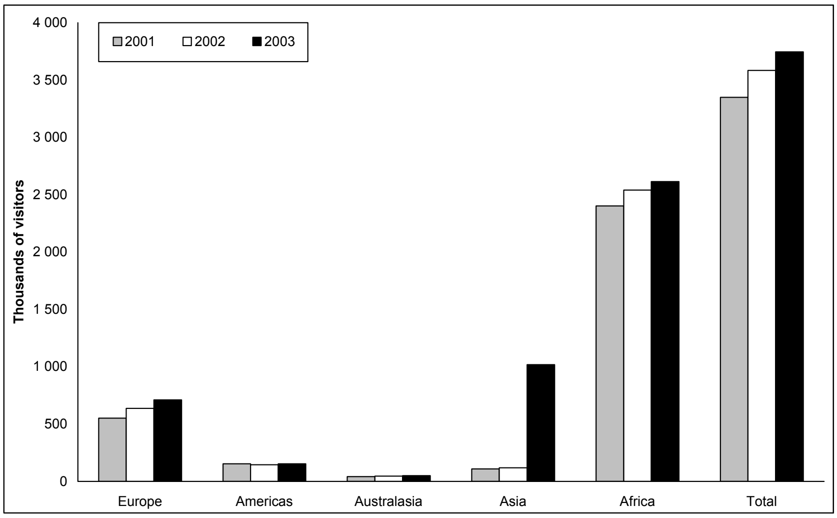
Tertiary sector

4,8 per cent increase in tourists

Rising tourist numbers continue to underpin growth in the tertiary sector, though the strength of the rand has moderated revenue growth in rand terms. In the first half of 2003, the number of tourists to South Africa increased by 4,8 per cent from all regions, despite a decline in worldwide tourism in the wake of the war in Iraq, the outbreak of Severe Acute Respiratory Syndrome in East Asia and the softer global economic conditions. South Africa continues to build further capacity to meet rising tourism numbers.

The telecommunications sector also continues to expand, capacity building critical network infrastructure for the development of a modern economy. Expansion is driven in particular by growth in the cellular telephone sector.

Figure 2.7: Tourist arrivals for January-July, 2001-2003



Quality assurance to maintain world-class standards

The increase in facilities available is supported by efforts of the Southern African Tourism Services Association to maintain high standards in the industry and provide appropriate grading and quality assurance services.

Domestic expenditure

Gross domestic expenditure up 4,8 per cent

In the first half of 2003, gross domestic expenditure strengthened further; rising 4,8 per cent year-on-year as interest rates declined and a stronger rand increased purchases of imported goods. The relative strength of expenditure growth over the past year is mirrored by the widening current account deficit.

Household consumption expenditure

Household consumption expenditure remains firm

Household consumption expenditure has slowed from the peak growth rates of 3,8 per cent realised during mid 2002 to 2,7 per cent in the second quarter of 2003. The most recent retail sales figures indicate that consumption spending has remained healthy, as sales grew 2,7 per cent in June and accelerated to 5,8 per cent in July.

Growth in expenditure on durable and semi-durable goods underpinned this expansion. For durables, a strong exchange rate benefited sales of a range of imported goods, but electronics benefited the most, with sales of televisions and audio systems rising by more than 10 per cent. Increased consumption of semi-durables were concentrated in clothing, with footwear recording growth of 26,6 per cent. Non-durables recorded lower growth rates, and beverages fell 6,9 per cent.

Household debt levels remain sustainable

Although household debt as a percentage of disposable income increased marginally from 53 per cent in March to 53,3 per cent in June, the consumption spending trend remains sustainable, particularly as interest rates have fallen and households have benefited from rising disposable income. This has also been reflected in an upward trend in private sector credit extension. In contrast, savings remain low and households saved approximately 0,5 per cent of their disposable income, unchanged from the trend over the past three years.

Gross fixed capital formation

Robust investment growth underpins growth

South African firms continue to invest in the productive capacity of the economy, building a sound platform for sustainable growth in the years ahead. Despite adverse economic conditions and relatively high real interest rates, investment expenditure expanded by over 8 per cent in the first half of the year. While investment spending has slowed from the rapid growth of 9,6 per cent in the final quarter of 2002, the prospects for further growth in the years ahead are sound, as interest rates begin to fall and the profit outlook improves.

Key steps to higher investment

Building productive capacity remains a fundamental driver of long-term sustainable growth, providing a foundation for job creation and welfare improvement. In partnership with the private sector, key elements of Government's strategy for encouraging investment include:

- Stable macroeconomic and fiscal policy, including inflation targeting to anchor long-term financial expectations
- Maintaining a competitive tax environment for both domestic and foreign investment
- Enhanced crime prevention strategies to mitigate uncertainty

- An industrial strategy based on enhanced microeconomic efficiency and improved regulation, and improving the business climate for small, medium and micro enterprises
- Facilitating international market expansion through trade negotiations
- Land reform and sustained public infrastructure expansion to support economic activity
- Further enhancement of the provision of key economic services, particularly telecommunications and transport services.

Sector summits to support growth and development

Complementary to these efforts, stakeholders agreed at the GDS to engage in sector summits to deepen agreement on strategies for sectoral development.

Enhancing the efficiency of administered pricing

The setting of administered prices is important for a number of reasons. First, efficient setting of these prices is critical to the overall competitiveness of South African industry. Second, to an extent that they form part of the CPIX basket they contribute to overall inflation trends in the economy.

As part of its ongoing commitment to the GDS, Government has commissioned a series of investigations to look at the production efficiency of key utilities and the efficiency of regulatory structures to ensure that the pricing of critical services approximates to a competitive outcome. Amongst the considered policy responses are improved competition through increased entry of new suppliers and improved regulation.

In respect of the inflationary impact of administered prices, these services account for no more than ¼ of the overall CPIX basket, but clearly contribute to overall inflation. It is therefore critical that administered prices are set appropriately, to minimise their inflationary impact.

Cabinet will soon be presented with an analysis of pricing and regulation in the key utility sectors, against which it will make a decision on how Government will promote further efficiency in this part of the economy.

Labour market developments

Unemployment remains core challenge

Employment creation remains a critical policy challenge. Unemployment, as measured by the labour force survey, has increased from less than 20 per cent in 1996 to about 30 per cent today, and the burden of unemployment is particularly severe amongst young people, women and rural communities. The evidence suggests that job creation has broadly kept pace with economic growth, with employment rising by an average of 3,2 per cent a year between 1996 and 2002. However, the labour force has grown more rapidly, averaging 5,6 per cent a year over this period. Rapid growth in the size of the population cohort leaving school and entering the labour market, increased economic participation of women and migration from rural to urban areas are amongst the features of the present demographic transition that underlie this expansion of the economically active population.

GDS focuses on comprehensive strategy for job creation

Job creation was at the centre of the deliberations at the GDS. The Summit Agreement reflects the commitment of all social partners to introduce short-term measures to alleviate the poverty impact of unemployment, while building an environment for employment creation and productivity improvement. These include:

- Intensification of the Expanded Public Works Programme to create short-term job opportunities and income support, to create 750 000 work opportunities over the next 5 years.
- Broadening the Public Investment Initiative to develop, revitalise and maintain public infrastructure, and accelerate investment expenditure growth.
- Expanding access to learnership opportunities to more than 80 000 by March 2005, up from just over 26 000 currently, with specific focus on unemployed learners in particular attention to enhancing the effectiveness of the SETAs.

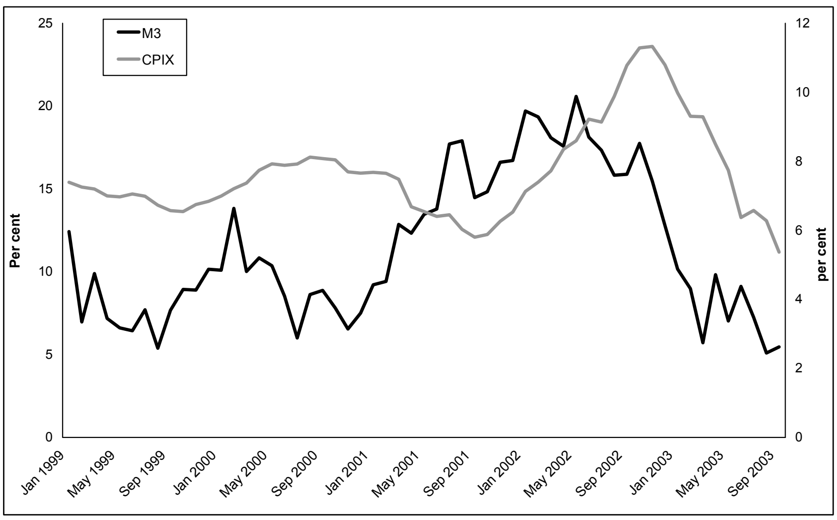
Over the medium term, the recovery in domestic production activity on the back of rising global growth will complement the GDS initiatives to encourage job creation.

Money supply and interest rates

Modest money supply growth

Money supply growth has slowed significantly over the past 18 months. Annual broad money supply growth peaked at 20,6 per cent in May 2002, before falling to 5,5 per cent in September 2003. Figure 2.8 illustrates the growth in M3 money supply and changes in CPIX inflation from 1999.

Figure 2.8: Annual growth in M3 and CPIX inflation



SARB lowers foreign currency swap activity

In line with the unwinding of the NOFP and management of exposure to currency risk in monetary policy operations, the SARB has been reducing the use of foreign currency swaps to manage money market liquidity, relying more on SARB debentures and reverse repurchase agreements in government bonds that the SARB holds. The proportion of foreign currency swaps in SARB monetary policy operations declined to 19 per cent in October 2003 from a peak of 83 per cent in January 2002.

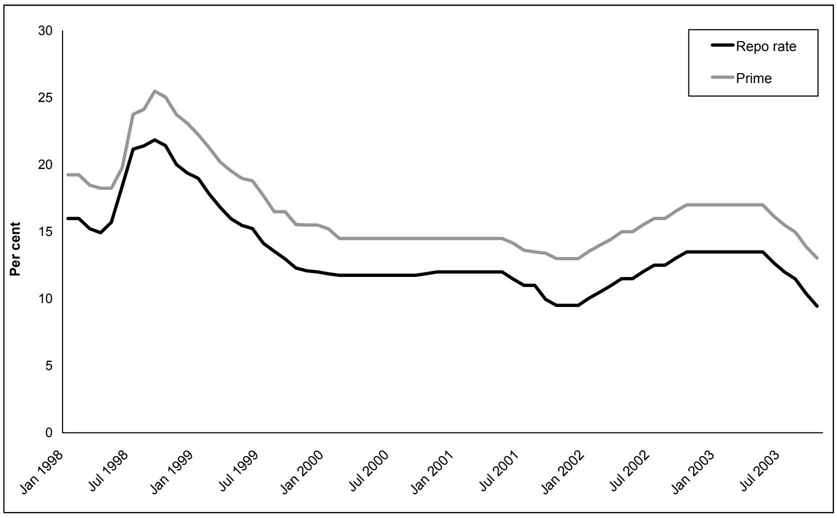
11,6 per cent increase in private sector credit in September

Private sector credit extension continues to expand, which is reflected in both the strength of gross domestic expenditure and in the property market. On the back of declining interest rates, loans and advances to the private sector expanded by 11,6 per cent in the year to September, up from 9 per cent in November 2002. The bulk of this credit (60 per cent) was in mortgage advances and instalment sale agreements.

Repo rate falls 500 basis points since June 2003

The SARB raised the repo rate by 4 percentage points in 2002 to curb second-round inflationary pressures after the depreciation of the currency in 2001. As the inflation pressures subsided and the outlook for inflation improved, aided in large part by the correction of the currency over the past 18 months, the SARB has lowered the repo rate by 5 percentage points since June 2003. This relaxation of monetary policy will support domestic economic activity in anticipation of the turnaround in the global economy in the years ahead.

Figure 2.9: Repo rate and prime rate, 1998-2003



Inflation

Inflation moderates significantly

As forecast at the time of the Budget, inflation has moderated considerably over the course of 2003 and is now within the target range of 3 – 6 per cent. The producer price index (PPI), which usually leads changes in consumer prices, fell by 1 per cent in September.

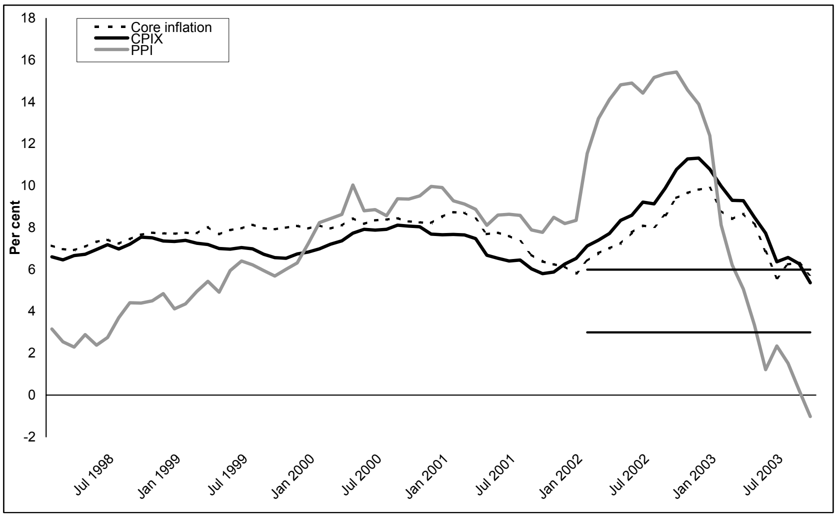
Strong rand contributes to lower inflation

The rapid strengthening of the currency – the currency has appreciated by 70 per cent against the US dollar since the end of 2001 and by 27 per cent since January 2003 – has contributed significantly toward lowering both producer and consumer prices, particularly for imported and tradable commodities.

CPIX below 6 per cent

After peaking at 11,3 per cent in October 2002, CPIX inflation has fallen to 5,4 per cent in September this year, the first time since October 2001 that it fell below the 6 per cent level.

Figure 2.10: Year-on-year inflation, 1998-2003



Pricing power mitigates price decreases

Improved conditions in agricultural markets contributed to moderation of food inflation, which fell to 4,2 per cent in September this year. As illustrated in figure 2.10, the decline in producer price inflation has been even steeper, falling below zero in recent months.

Industry concentration leads to pricing power

Part of this gap between consumer and producer price trends can be attributed to pricing power at the secondary and tertiary levels of the economy. In a study undertaken for the National Treasury, it was established that mark-ups in South African industry are twice those found in the US, which is in part a function of high concentration ratios.

Inflation to remain within target through 2006

While risks remain, particularly in respect of food price inflation, oil prices and the exchange rate, CPIX inflation is expected to remain within the target over the medium term, averaging 4,9 per cent, 5,4 per cent and 5,1 per cent in 2004, 2005 and 2006, respectively.

Inflation targeting framework

After considering recent experience with inflation-targeting in South Africa and reviewing international best practice, the Minister of Finance and the Governor of the South African Reserve Bank have agreed to a number of technical amendments to the inflation-targeting framework that will take immediate effect. These include specifying the target as a continuous target, rather than an annual average, and reformulating the escape clause.

The inflation target is currently set as an annual average target range. In other words, CPIX inflation must average between 3 and 6 per cent over a calendar year. The current specification complicates implementation of the framework and could lead to inconsistencies in monetary policy, which may include:

- A variable time horizon for monetary policy, which could lead to excessive interest rate volatility or inconsistent monetary policy.
- Ineffective management of inflation expectations.

The Minister and the Governor have agreed on the following amendments and clarifications:

1. That the inflation target be specified as a continuous target of 3 – 6 per cent and that this range will remain the target, until for the period beyond 2006.
2. In the past, the inflation-targeting framework included a formal ‘escape clause’. Against the backdrop of reformulating the target as a continuous target, the escape clause is reformulated as an ‘explanation clause’. When the economy is buffeted by a supply side shock similar to those envisaged by the original escape clause that will take CPIX inflation outside the target range (e.g. an oil price shock, a drought, a natural disaster, or financial contagion affecting the currency), at the subsequent meeting of the Monetary Policy Committee, the SARB will fully inform the public of the nature of the ‘shock’, the anticipated impact on CPIX inflation and the monetary policy response to ensure that inflation returns to the target and the time frame over which this will occur.
3. The target basket – CPIX – will remain. This is appropriate to ensure that achievement of the target will be consistent with the broadest consumer basket.
4. Finally, the success of the inflation-targeting framework depends on appropriate, accurate and timely information flows from policymakers to the public. The SARB has fundamentally transformed the way in which it interacts with the public in respect of monetary policy through the monetary policy forums, the Monetary Policy Reviews, the statements of the Monetary Policy Committee and other measures. The SARB will continue to identify mechanisms for improving these information flows in the interests of successful implementation of the framework.

Domestic and global outlook

Growth forecast at 2,2 per cent in 2003

GDP growth is expected to be lower than forecast at the time of the Budget, mainly as a result of the weaker international environment. Overall growth for 2003 is now forecast to be 2,2 per cent, down from 3,3 per cent expected at the time of the Budget. Growth is expected to rebound in the outer years, as the international environment improves. This is indicated in table 2.3.

Domestic expenditure expands 4,7 per cent

Gross domestic expenditure is expected to remain firm in 2003, with growth forecast to be 4,7 per cent, up from the 3,8 per cent projected at the time of the Budget. GDE will be driven by steady growth in consumption expenditure (up 2,8 per cent), continued exceptional growth in investment spending (up 7,7 per cent); and an expansionary fiscal stance (government consumption expenditure up 3,6 per cent).

Weak trade balance slows growth

The narrowing of the trade balance will continue to slow overall growth over the short term. Exports are expected to fall by

4,2 per cent, hampered by a weak global economy and a strong currency, while firm domestic consumption and investment growth will boost import demand, raising volumes by 5,8 per cent in 2003.

International economy rebounding

Over the medium term a revival of world growth prospects is foreseen. The United States appears set to lead industrial countries out of the recent slowdown. Encouraging signals from the Japanese economy suggest that the Far East could support world growth in the years ahead. These favourable external developments will contribute to further expansion of the domestic economy over the medium term.

CPIX inflation within target over the medium term

The forecast for CPIX inflation in 2003 has been revised from 7,7 per cent to 6,9 per cent. The lower forecast takes into account the data revision of the series in April and a stronger rand. It is expected that the inflation rate will fall to around 4,5 per cent by the end of 2003 and remain in the target band over the forecast period.

Table 2.3 Macroeconomic projections

	Actual			Estimate	Forecast		
Calendar year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Percentage change unless otherwise indicated							
Final household consumption	3,5	3,1	3,2	2,8	3,2	3,5	3,7
Final government consumption	3,1	3,3	3,7	3,6	3,3	3,1	3,4
Gross fixed capital formation	0,8	3,2	6,5	7,7	6,1	6,7	7,0
Gross domestic expenditure	3,0	2,3	4,2	4,7	3,7	3,8	3,9
Exports	8,4	2,5	-1,4	-4,2	4,6	6,3	6,9
Imports	7,1	0,3	3,1	5,8	6,6	6,7	6,4
GDP growth (real)	**3,5**	**2,8**	**3,0**	**2,2**	**3,3**	**3,7**	**4,0**
GDP deflator	7,2	7,6	8,5	5,8	4,6	5,9	5,0
GDP at current prices (R billion)	**888,1**	**982,9**	**1 098,7**	**1 187,5**	**1 283,5**	**1 409,0**	**1 539,4**
CPIX (Metropolitan & urban, average for year)	7,7	6,6	9,3	6,9	4,9	5,4	5,1
Current account balance (% of GDP)	-0,4	-0,3	0,3	-0,8	-1,4	-1,7	-2,0

Table 2.4 Macroeconomic projections, 2002/03 – 2006/07

	Actual	Estimate	Forecast		
Fiscal year	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**
GDP at current prices (R billion)	**1 124,0**	**1 207,3**	**1 313,3**	**1 440,9**	**1 573,5**
GDP growth (real)	2,9	2,2	3,5	3,8	4,0
GDP inflation	8,4	5,1	5,1	5,7	5,0
CPIX (metropolitan & urban, average for year)	9,8	5,6	5,3	5,4	5,1