2

Economic policy and outlook

The South African economy is expected to grow by about 5 per cent a year over the next three years. This positive outlook is supported by buoyant international economic conditions and the stable foundation laid during more than a decade of prudent macroeconomic management. Monetary and fiscal policies have helped to create an environment of low inflation, moderate interest rates and reduced costs of capital. Industrial restructuring and financial reforms have increased productivity, boosted real wages and improved competitiveness. Tangible gains have been registered as living standards improve, resulting in some measurable poverty reduction. Recent data revisions confirm that economic growth has been stronger than previously thought.

Realising the more rapid rate of economic growth that is within reach, however, requires stepping up the pace of reform and making further improvements to public policy. Economic policy will continue to emphasise the importance of industrial innovation and increasing exports to help drive greater investment and expand employment. Further adjustments to regulatory and tax design will help to lower the costs of doing business. Expenditure on infrastructure investment, service delivery, education and skills development aims to ensure that economic growth benefits all South Africans. The accelerated and shared growth initiative will introduce further reforms to relieve constraints to economic expansion and improve the competitiveness of certain sectors. Over the long term, sustaining macroeconomic stability remains a central priority, particularly given variations in the international business cycle and commodity prices, which are currently at high levels.

CPIX inflation should remain within the target range of 3 to 6 per cent over the MTEF period. Public and private sector investment will continue to grow vigorously. Household consumption, which has been a strong driver of GDP growth, is expected to moderate somewhat from the very high rate of growth experienced in 2005.

Overview of economic conditions and policy

Brisk economic expansion to continue over the medium term

South Africa's brisk economic expansion is expected to continue, with estimated growth rates of 4,9 per cent in 2006, 4,7 per cent in 2007 and 5,2 per cent in 2008. Further advances in economic growth are expected as policy reforms are realised over the medium term and participation in economic activity increases.

Improved policy coordination remains a central focus of government and the Reserve Bank. Principal economic challenges include promoting a more sustained expansion of key sectors of the economy and fostering greater industrial innovation. A more appropriate industrial, trade and competition policy stance is being developed to achieve these goals.

Infrastructure investment to broaden economic activity

Government spending on infrastructure will broaden economic activity while providing an expanded platform for industrial growth. Reducing constraints to employment creation in the labour market will directly boost household consumption and reduce poverty.

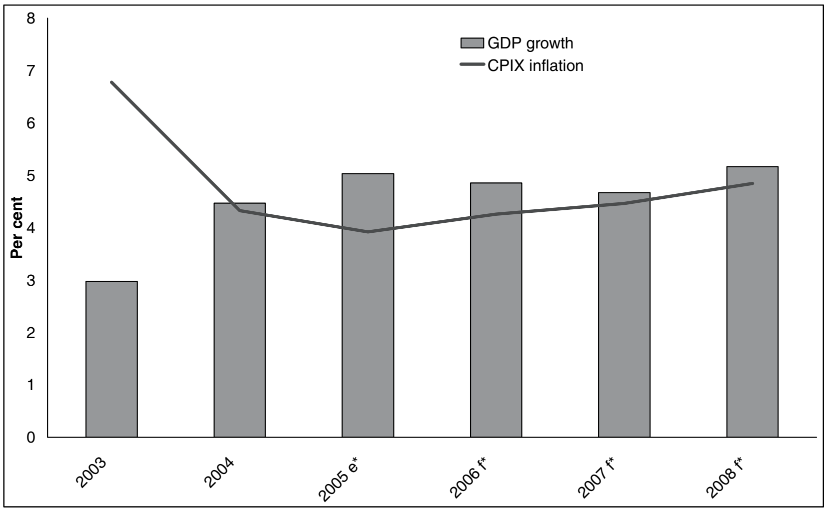
Policy adjustments will maximise structural factors that support more rapid economic expansion in the long term. These include the upgrading of productive capacity and the steady development of a better-skilled workforce. Public sector infrastructure projects will develop and refurbish major transportation links, create new sources of electricity, expand the road network and build new houses. Government's efforts to broaden and deepen the skills base will be strengthened by the extension of the learnership programme to boost youth employment.

Accelerated and sustained growth depends to a large extent on raising the pace of investment and appropriate economic policy reforms. The growth outlook is also sensitive to international developments. Global concerns include the persistent risk of renewed international financial contagion associated with financial imbalances in some major world economies, and the risk of unanticipated shifts in global commodity prices – including the price of oil.

Growth forecast to be adjusted as policy reforms take effect

The medium-term forecast expects economic growth to average about 5 per cent. As government's integrated policy reforms begin to take effect, the growth forecast will be revised accordingly.

Figure 2.1 Real growth and CPIX inflation, 2003 – 2008



** Where e = estimate and f = forecast*

Domestic outlook

As constraints to employment creation are reduced, rising income from employment and real wage gains will support robust household consumption spending, which is expected to average 4,7 per cent growth over the forecast period. While household debt levels have increased as a result of lower borrowing costs, they remain moderate by international standards.

Investment growth to reach nearly 10 per cent a year

Investment is expected to remain vigorous, rising to nearly 10 per cent annual growth by 2008. By the end of 2008, fixed investment is expected to rise to 19 per cent of GDP. Healthy levels of private investment, supported by appropriate market regulation, industrial policy and technological innovation, will be matched by consistently stronger investment by general government and state-owned enterprises. A range of large infrastructure projects will reach construction phase over the next three years, lending momentum to investment and growth. Infrastructure development at the community level will support the growth of small businesses, local trade and employment.

The South African economy has benefited from rising commodity prices. On 31 January 2006, the platinum price reached US$1 081/oz from a level of US$472/oz in January 2002, while the gold price reached US$572/oz.

Export growth continues to strengthen

Export growth is expected to strengthen from an annual average of 1,1 per cent between 2002 and 2004 to 6,7 per cent over the next three years, as both commodities and manufactured exports respond to rising global demand, and as competitiveness improves. Export levels will be boosted by adjustments to trade policy and sector-specific approaches to improve competitiveness. Sustained growth in both developed and developing markets will support South African exports in coming years.

Although overall import growth is expected to moderate as consumer demand softens, imports of capital goods will remain high as the public sector investment programme gathers pace. Consequently, the deficit on the current account of the balance of payments is expected to remain near present levels of 4,3 per cent in the period ahead.

Strong international demand for South African assets

A large surplus on the financial account in 2005 reflects South Africa's growing attractiveness to international investors for both long-term direct investment and shorter-term portfolio assets. The net inflow of foreign direct investment amounted to R35,7 billion during the first nine months of 2005.

The relative appeal of South African assets is expected to continue to attract savings from the rest of the world. Gross foreign exchange reserves have risen from US$7,6 billion in 2001 to US$22,2 billion at the end of January 2006, as the Reserve Bank bought foreign exchange to eliminate the net open foreign currency position and build reserves.

Moderate fiscal position improves currency outlook

Between 1995 and 2005, the value of the rand averaged R6,42 to the US dollar. In the second half of 2005, the rand strengthened by 5,6 per cent, partly in response to higher commodity prices. Over the medium term some improvement in the competitiveness of the currency is expected as world economic growth gathers pace and reserves continue to accumulate. The moderate fiscal position also supports the rand, placing less upward pressure on prices in the economy.

Low inflation will help sustain low interest rate environment

CPIX inflation, which averaged 3,9 per cent during 2005, is expected to remain well within the target range of 3 to 6 per cent over the medium term, averaging 4,5 per cent a year. This will help sustain the low interest rate environment that supports corporate investment and household consumption.

Mapping out growth

Government has adopted an accelerated and shared growth initiative to put the economy on a higher growth path. The Deputy President chairs the task team working on this initiative and has made documentation on the plans available. Government has also commissioned a panel of international experts to comment on constraints to more rapid growth and help to identify ways to boost long-term economic expansion.

The panel held an initial series of workshops in January 2006, addressing the following issues:

- The level and the stability of the exchange rate in an export-led growth strategy
- The role of public infrastructure in lowering the costs of participating in the economy
- The importance of appropriate, efficiently administered labour market institutions and empowerment policies to support employment growth, taking account of the legacy of apartheid in the labour market
- The role of modern industrial policy, appropriate competition and trade policies
- The need to increase innovation and investment in new technology in competitive markets
- The role of financial markets in supporting investment activity, and tools to enable firms to appropriately manage risk and to focus on their core activities.

The panel will address specific outputs in the period ahead and research papers will be made available.

Global developments

Steady global growth expected in 2006

Over the medium term, world economic growth is expected to remain fairly healthy. The global economy grew by an estimated 4,3 per cent in 2005, and global growth is expected to increase by about 4,4 per cent in 2007. As indicated in Table 2.1, growth in the developing world remains vigorous. Commodity prices reached their highest level in more than two decades in 2005, driven by increased demand and tight supply conditions. Oil and platinum led this trend.

US growth expected at 3,4 per cent in 2006

Growth in the United States economy in 2005 was accompanied by a slight increase in inflation and rising interest rates – although real interest rates remain low by historical standards. The trade deficit and current account balances deteriorated in 2005 and the US dollar weakened against the rand. Growth in the world's largest economy is expected to be 3,4 per cent in 2006.

Modest growth is expected in Europe over the medium term. Domestic demand in most major European economies remains sluggish and growth prospects are largely dependent on Europe's export performance. Expansion of the euro area to the east will help.

Upturn in Japan is significant for South African exports

From growth averaging below 1 per cent in 2001 and 2002, the Japanese economy is slowly improving, as financial and other constraints are reduced and consumer confidence is restored. The world's second-largest economy is projected to grow by more than 2 per cent in 2005 and 2006. This will favourably affect South African exports to Japan, which increased from 5 per cent of total exports in 2001 to more than 9 per cent in 2004.

Table 2.1 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2004 - 2006

Region / Country	2004	2005	2006	2004	2005	2006
Percentage	GDP projections			CPI projections[1]		
World[2]	**5,1**	**4,3**	**4,3**	**3,7**	**3,9**	**3,7**
USA[3]	4,2	3,6	3,4	2,7	3,4	2,8
Euro area[3]	1,8	1,4	1,9	2,1	2,2	2,0
UK[3]	3,2	1,7	2,1	1,3	2,1	2,0
Japan[3]	2,3	2,5	2,2	0,0	-0,2	0,2
Emerging markets and developing countries[2]	**7,3**	**6,4**	**6,1**	**5,8**	**5,9**	**5,7**
Developing Asia[2]	**8,2**	**7,8**	**7,2**	**4,2**	**4,2**	**4,7**
China[2]	9,5	9,0	8,2	3,9	3,0	3,8
India[2]	7,3	7,1	6,3	3,8	3,9	5,1
Africa[2]	**5,3**	**4,5**	**5,9**	**7,8**	**8,2**	**7,0**
South Africa[4]	4,5	5,0	4,9	4,3	3,9	4,3

1. The targeted rate of inflation, CPIX, used for South Africa.
2. IMF, World Economic Outlook, September 2005.
3. Consensus Forecast, January 2006.
4. National Treasury, January 2006.

Rising commodity prices

Commodity prices have rallied significantly since 2001, when perceptions of geopolitical risk fed through into the price of oil and other commodities. This trend has been sustained by global growth, increased speculative activity and rising demand for precious metals. Platinum and oil prices have doubled since 2000, while the gold price has risen by 60 per cent.

Indications are that crude oil prices will remain at levels in excess of US$50 per barrel over the medium term. During 2005/06, daily world demand for crude oil is expected to grow by 1,6 million barrels, while daily supply is only expected to rise by 1,3 million barrels. Spare crude oil production and refining capacity are at their lowest levels in three decades, reflecting years of under-investment. Political instability in key oil-producing regions contributes to the upward pressure on prices.

Since 1999 global demand for platinum has outstripped supply. The price of platinum rose from US$354/oz in January 1999 to more than US$1 000/oz in January 2006, reflecting increased use of catalytic converters in motor vehicle manufacturing. Catalytic converters absorb nearly half the platinum produced globally. Although the market for platinum jewellery has softened somewhat in response to rising prices, this remains the second-largest source of demand. South Africa is the world's largest platinum supplier, accounting for 78 per cent of all platinum production in 2005.

Supply and demand of platinum, 1996 - 2005

Thousand ounces (oz)	1996-2000	2001	2002	2003	2004	2005
Supply						
South Africa	3,694	4,100	4,450	4,630	4,970	5,120
Other	1,406	1,760	1,520	1,570	1,490	1,470
Total Supply	**5,100**	**5,860**	**5,970**	**6,200**	**6,460**	**6,590**
Demand						
Autocatalyst	1,399	1,990	2,025	2,625	2,855	3,060
Jewellery	2,458	2,590	2,820	2,510	2,160	2,020
Industrial applications	1,035	1,055	955	805	955	1,005
Other	454	595	670	590	620	625
Total Demand	**5,346**	**6,230**	**6,470**	**6,530**	**6,590**	**6,710**

Source: Platinum 2005 Interim Review, Johnson Matthey

Developing countries in Asia set a very high growth pace

Developing countries, particularly in Asia, are expected to post strong growth rates for 2005 and 2006. China's GDP grew by more than 9 per cent during 2005, bringing the world's most populous nation into the running for the world's fourth-largest economy. Although the rapid pace of expansion is expected to moderate in 2006, growth should remain robust. Growth in the Indian economy is expected to soften from an estimated 7,1 per cent in 2005 to 6,3 per cent in 2006.

Commodity exports to push African growth to 5,9 per cent in 2006

Economic growth in Africa continues to gather pace, rising from 4,5 per cent in 2005 to an expected 5,9 per cent in 2006. Rapid growth of commodity exports will drive this expansion – particularly as West African oil producers increase capacity. Africa provides a growing market for South African businesses seeking to expand beyond the Southern African Customs Union (SACU).

The value of direct investment by South African companies into the rest of the continent amounted to R23 billion at the end of 2004, an increase of 45 per cent from the previous year. South African exports to the rest of Africa increased by 20,3 per cent in 2005, while imports grew by 30,7 per cent. In rand terms, exports rose from R39,0 billion in 2004 to 46,8 billion in 2005. Over the same period, imports from the rest of Africa increased to R17,2 billion from 13,2 billion.

An overview of developments in the African continent

Africa is experiencing its best economic performance in nearly a decade, with GDP growth increasing from 2,2 per cent in 1990 to an estimated 4,5 per cent during 2005. This upward trend is supported by a strong expansion of primary exports (particularly oil), favourable weather conditions and robust domestic demand in many countries. Agricultural production has recovered following a drought that affected parts of eastern, central and southern Africa in 2003, and new oil fields have come on line in southern and central Africa.

Africa: Macroeconomic Indicators, 1990 – 2006

Percentage of GDP	1990	1996	2000	2001	2002	2003	2004	2005[1]	2006[2]
Real GDP growth rate	2,2	5,6	3,3	4,1	3,6	4,6	5,3	4,5	5,9
Inflation	15,1	28,0	13,1	12,2	9,6	10,4	7,8	8,2	7,0
Total debt service	6,5	6,3	6,3	6,3	4,9	4,7	4,3	4,0	3,1
Total external debt	59,9	67,5	60,8	58,5	56,4	50,0	42,8	36,0	29,5

Source: IMF World Economic Outlook, September 2005

1. Estimate.

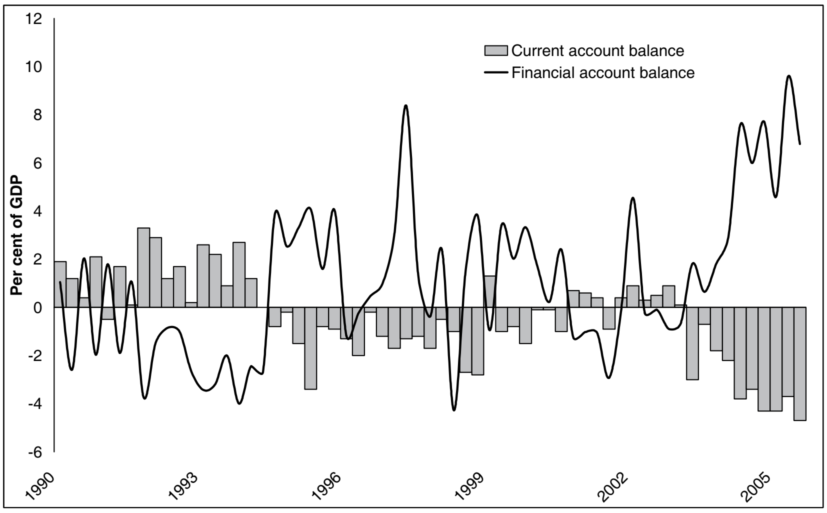
2. Forecast.

While much of Africa's improved performance is a result of increased oil exports and high commodity prices, there are signs that economic reforms are beginning to have a positive effect in a number of countries. These reforms include more focused macroeconomic policy, fiscal consolidation and structural improvements. These measures will place countries in a better position to export their products to major world markets if protectionist barriers to trade are reduced. The five fastest growing economies in 2005 were Angola, Chad, Republic of Congo, Sudan and Sierra Leone.

Inflation has continued to decline over the past decade, reaching an estimated 8,2 per cent in 2005. Lower inflation has boosted private sector confidence and investment. FDI flows also increased strongly, from US$3,9 billion in 1993 to an estimated US$19,5 billion during 2005. Higher prices and supply shortages have attracted international investment in new exploration and production facilities.

Strengthening of regional economic groupings has received renewed attention and the New Partnership for Africa's Development (NEPAD) has been at the core of regional development policy. NEPAD's African Peer Review Mechanism is expected to provide a candid assessment of the political and economic conditions in African countries and assist countries in improving policy reforms. Indications are that countries are increasingly designing policy to address deficiencies hindering the achievement of the United Nations Millennium Development Goals, with an increased focus on poverty reduction and infrastructure provision.

Figure 2.2 Current and financial account balances, 1990 – 2005



Balance of payments

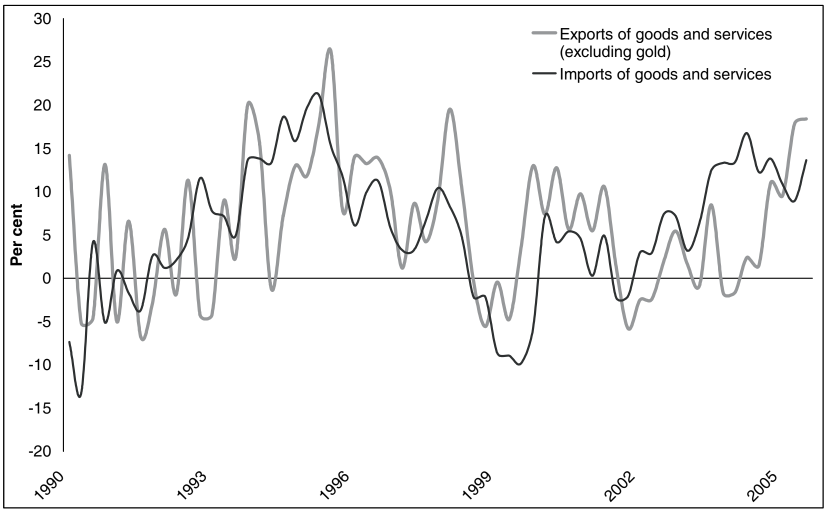
Current account

Current account deficit estimated at 4,2 per cent in the first 9 months of 2005

Rising imports have contributed to a trade deficit and increasing payments to the other members of SACU. Together, these two factors have pushed the current account deficit to an estimated 4,2 per cent of GDP in the first nine months of 2005. The deficit on the services and income account has remained between 2,6 and 3,6 per cent of GDP since 1994, as foreign-owned firms operating in South Africa maintain dividend payments to shareholders abroad.

The deterioration in the trade balance in 2005 came about despite a relatively strong export performance. Although export volumes grew faster than imports during 2005, higher oil prices and rising prices of other imported goods significantly raised the value of imports.

Figure 2.3 Growth in merchandise imports and exports, 1990 – 2005



After rising significantly in the early 1990s, the openness of the South African economy (as measured by export and imports as a percentage of GDP) has stabilised at approximately 54 per cent in 2003 and 2004.

Export performance

Between 1994 and 2004, the volume of exports rose on average by 4 per cent a year. This was driven by a programme of trade liberalisation and other export-supporting policies. Although export growth was broad-based, the base metals group benefited the most, accounting for 18 per cent of total export value, against 12,6 per cent in 2001. Transport equipment exports (including motor vehicles) grew rapidly, reaching 10 per cent of total export value in 2005.

Table 2.2 Composition of exports

Products	Value 2005 R million	Percentage change on 2004	Percentage share of total 2002	2005
Precious and semi-precious stones	82 408	2,8%	19,6%	25,0%
Base metals	59 133	3,2%	13,5%	17,9%
Mineral products	47 459	37,3%	13,9%	14,4%
Transport (including motor vehicles)	32 960	26,1%	8,3%	10,0%
Machinery	28 916	13,3%	8,6%	8,8%
Chemical products	21 909	23,2%	6,4%	6,6%
Food products	11 572	13,6%	3,9%	3,5%
Textiles	4 455	-9,2%	2,3%	1,4%
Other	41 164	8,8%	23,5%	12,5%
Total	**329 976**	**12,1%**	**100,0%**	**100,0%**

Source: South African Revenue Service, January 2006

Export growth in 2005 was the strongest since 1998, with export value increasing by over 12 per cent. Rising commodity prices raised the value of mineral product exports by 37,3 per cent. Manufacturing also performed well, with export volume up by about 8 per cent and export value increasing by 16 per cent. Motor vehicles and components and basic chemicals led the sector, with export values increasing by 26,1 per cent and 23,2 per cent, respectively.

Import performance

Imports up in 2005, reflecting demand for capital goods

The value of imports grew by 14,8 per cent during 2005. Imports of mechanical appliances and electrical goods were especially strong, reflecting buoyant demand for capital goods due to robust investment growth. The value of mineral products, including oil, grew by 13,6 per cent. Strong consumer demand increased the level of imported durables, particularly motor vehicles, which grew by 13,8 per cent in 2005.

Table 2.3 Composition of imports

Products	Value 2005 R million	Percentage change on 2004	Percentage share of total 2002	2005
Machinery	91 346	15,2%	27,8%	26,2%
Transport (including motor vehicles)	45 557	13,8%	9,3%	13,0%
Mineral products (incl. oil)	52 925	13,6%	13,2%	15,2%
Equipment	30 626	17,3%	9,0%	8,8%
Chemical products	31 503	13,8%	11,1%	9,0%
Base metals	14 654	13,9%	4,2%	4,2%
Textiles	11 213	11,3%	3,2%	3,2%
Other	71 387	16,1%	22,2%	20,4%
Total	**349 211**	**14,8%**	**100,0%**	**100,0%**

Source: South African Revenue Services, January 2006

South Africa's current account deficit

The deficit on the current account of the balance of payments widened to 4,2 per cent of GDP in the first nine months of 2005. The size of the deficit reflects more rapid economic growth and is more than offset by a strong financial account surplus.

Summary of current account, 1990 – 2005

Percentage of GDP	1990	2000	2003	2004	2005[1]
Exports (excl. gold)	15,4	21,1	20,6	20,3	21,1
Gold exports	5,8	3,0	2,6	2,1	1,7
Exports	21,2	24,1	23,2	22,4	22,8
Imports	15,4	20,5	21,1	22,5	23,6
Trade balance	**5,8**	**3,6**	**2,1**	**-0,1**	**-0,8**
Net service receipts	-0,3	-0,6	-0,2	-0,6	-0,8
Net income receipts	-3,8	-2,4	-2,8	-2,0	-1,9
Current account balance excl. SACU payments	**1,7**	**0,6**	**-0,9**	**-2,7**	**-3,5**
SACU payments and other current transfers	-0,3	-0,7	-0,5	-0,7	-0,7
Current account balance incl. SACU payments	**1,4**	**-0,1**	**-1,4**	**-3,4**	**-4,2**

1. *First nine months*

Current transfers consist almost entirely of SACU payments and are projected to reach 1 per cent of GDP in 2006. This reflects growth in customs and excise revenue and the revision of the SACU revenue-sharing formula. The payments are financed by customs and excise taxes and do not need to be matched by flows on the financial account. After adjusting for these payments, the current account deficit falls to 3,2 per cent of GDP over the medium term.

Supported by trade liberalisation, non-gold exports have risen substantially, from 14,5 per cent of GDP in 1994 to 21,1 per cent of GDP in the first nine months of 2005. Consequently, while gold exports have declined in importance, total exports have remained relatively stable as a proportion of GDP.

As indicated in the table, since 1990, the rise in imports as a proportion of GDP has led to an overall deterioration of the trade balance from 5,8 per cent to -0,8 per cent of GDP in the first nine months of 2005. The largest categories of imports are investment goods (primarily electrical machinery), transport equipment (including motor vehicles) and oil-related products. This reflects strong investment growth, increased demand for durable goods and a rise in the oil price.

The services and income account has remained consistently in deficit. In particular, there has been a rise in net dividend payments as a result of increased foreign direct investment. Receipts from transportation and travel now exceed R50 billion, underlining the increasing importance of tourism as a source of foreign exchange.

Flows on the financial account adequately cover the current account deficit and South Africa's external position remains stable. In the first three quarters of 2005, the cumulative net inflow of capital was R78,5 billion, compared with the current account deficit (excluding SACU payments) of R42,6 billion.

Financial account

Increasing net foreign direct investment inflows

The surplus on the financial account of the balance of payments (including unrecorded transactions) reached 5,3 per cent of GDP in the first nine months of 2005 compared to 4,2 per cent in the first nine months of 2004. Although portfolio inflows remained buoyant in 2005, the majority of inflows were foreign direct investment.

Net foreign direct investment inflows in the first nine months of 2005 reached R35,7 billion compared to net outflows of R3,6 billion for 2004 as a whole. This accounted for more than 45 per cent of inflows recorded in the financial account, mainly related to the acquisition of a controlling stake in ABSA Bank Ltd by the UK-based Barclays Plc.

Rally in gold and platinum prices stimulated demand for resource shares

Net portfolio capital inflows accounted for 48 per cent of the financial account. Portfolio inflows were dominated by net equity inflows, which reached R47,2 billion in 2005, and reflected the rally in gold and platinum prices that stimulated foreign demand for South African resource shares.

Exchange rate and international reserves

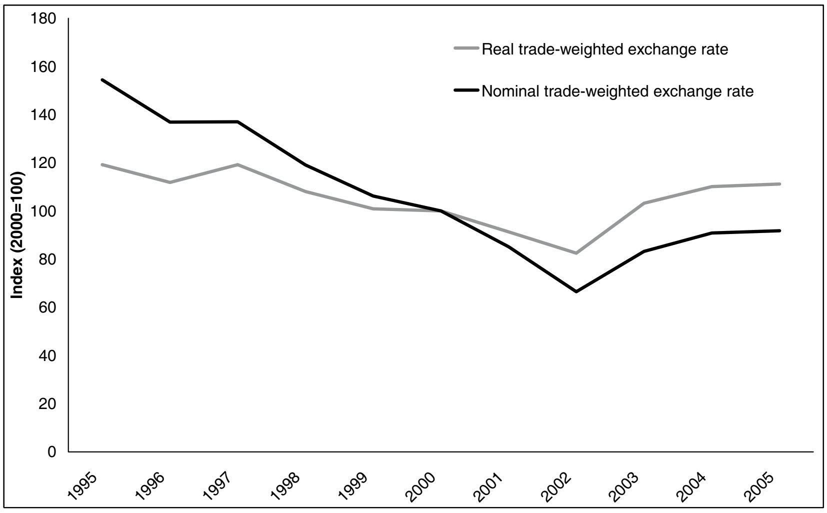
The trade-weighted value of the rand has stabilised since 2001

Following the sharp depreciation in the currency during 2001 and the subsequent correction, the annual trade-weighted value of the rand has stabilised (see Figure 2.4). This suggests a decline in the long-term volatility of the currency, assisted by a stable and consistent policy mix, and the prudent accumulation of foreign exchange reserves.

Reserve Bank continues to accumulate foreign exchange reserves

The accumulation of foreign exchange reserves by the Reserve Bank continued in 2005, with gross gold and other foreign exchange reserves reaching US$22,2 billion at the end of January 2006. At the same time, the net international liquidity position increased to US$18,7 billion from US$11,4 billion in December 2004.

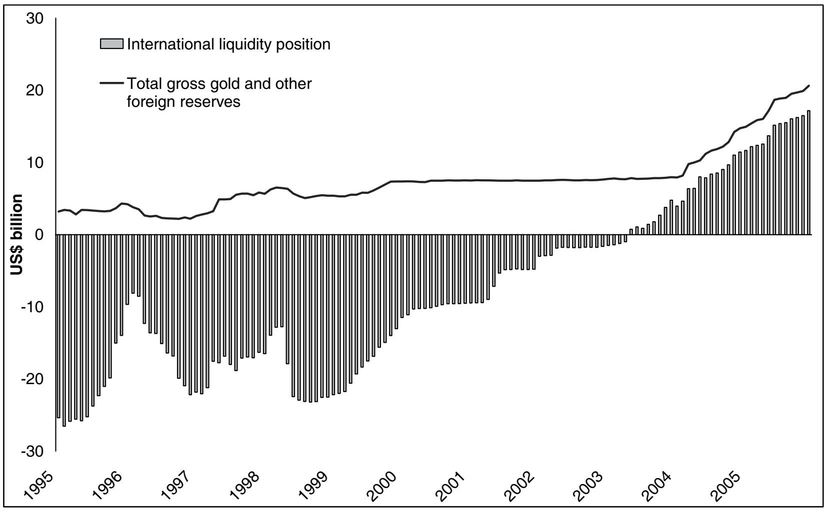
Figure 2.4 Average trade-weighted exchange rate, 1995 – 2005



Import cover has increased to 12,5 weeks

Import cover improved from seven weeks at the end of 2003 to 12,5 weeks at the end of September 2005. From the end of 2003 to the end of 2004, the ratio of gross reserves to short-term foreign currency denominated debt improved from 70 to 140,5 per cent.

Figure 2.5 Reserves and international liquidity position, 1995 – 2005



Further steps in the liberalisation of exchange controls

Since 1994 South Africa has gradually relaxed exchange controls on companies, financial institutions and individuals. These steps were taken in an environment of macroeconomic stability and enhanced financial regulation. The timing and pace of these reforms resulted in a significant relaxation of exchange controls without any shocks to the economy or to the financial system.

Offshore investment by individuals

At the time of the *2005 Medium Term Budget Policy Statement*, the Minister of Finance committed to further reforms of the exchange control limit on offshore investment by individuals upon the completion of the exchange control and tax amnesty process. As outlined in Chapter 4, the adjudication of all exchange control and tax amnesty applications is now complete. The amnesty process has enabled South Africans to regularise their offshore financial investments and laid the foundation for a more orderly process of portfolio diversification. It is now proposed that the offshore individual allowance be increased from R750 000 to R2 million per person.

Corporate and mandated parastatal investment in Africa

To promote the realisation of NEPAD development goals through more direct investments in Africa, the exchange control requirement that companies and mandated parastatals must obtain a majority (i.e. 50 per cent + 1) interest in all foreign direct investments is replaced with the lower requirement of a significant interest of at least 25 per cent. Further, the requirement that loans issued by development finance institutions to African companies or projects have a 50 per cent South African content falls away. These measures will also support the growth of South African businesses and the domestic economy.

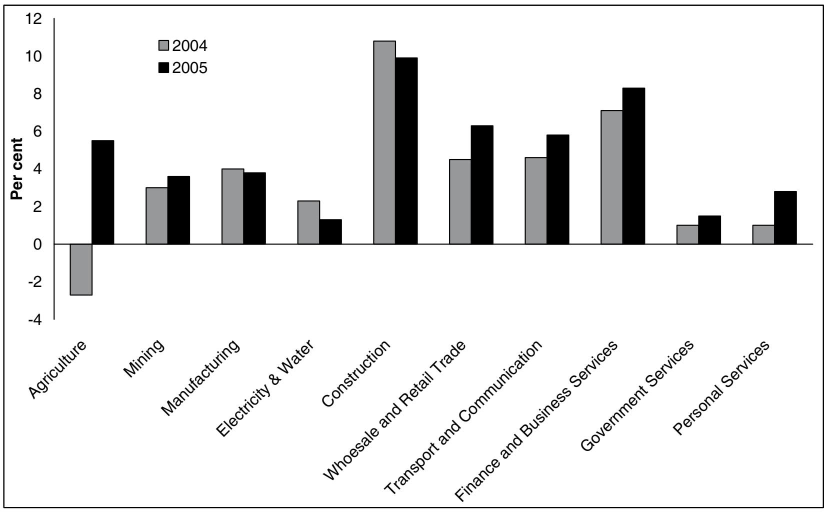
The Reserve Bank will provide further details of these exchange control reforms.

Real output trends

Broad-based growth across most sectors

The economy continues to exhibit vigorous and broad-based growth across most sectors. Real GDP growth is expected to average 5 per cent for 2005. Construction, retail trade, transport and communication and the financial sector grew strongly in the past year.

Figure 2.6 Sector growth, 2004 and 2005 (first nine months)



Agriculture

Field crop performance boosts agricultural output

Real output in the agriculture, forestry and fishing sector improved during 2005, from a 2,7 per cent decline in the first nine months of 2004 to a 5,5 per cent increase in the first nine months of 2005. This was largely due to an improvement in field crop output, which grew by 9,1 per cent compared to 2004. Horticulture production increased by a modest 0,5 per cent, while animal production expanded by 1 per cent. Table 2.4 indicates revised intentions to plant.

Table 2.4 Revised intentions to plant – summer crop

Hectares	Area planted 2004/05	Area planted as at 19 January 2006	Intentions to plant as at October 2005
White maize	2 024 960	954 150	744 360
Yellow maize	1 198 480	593 700	627 180
Sorghum	86 500	26 570	30 300
Groundnuts	40 000	44 200	65 000
Sunflower	460 000	491 510	592 100
Soybean	150 000	208 090	231 800
Dry beans	49 300	55 250	58 600

Source: Crop Estimates Committee (NDA), January 2006

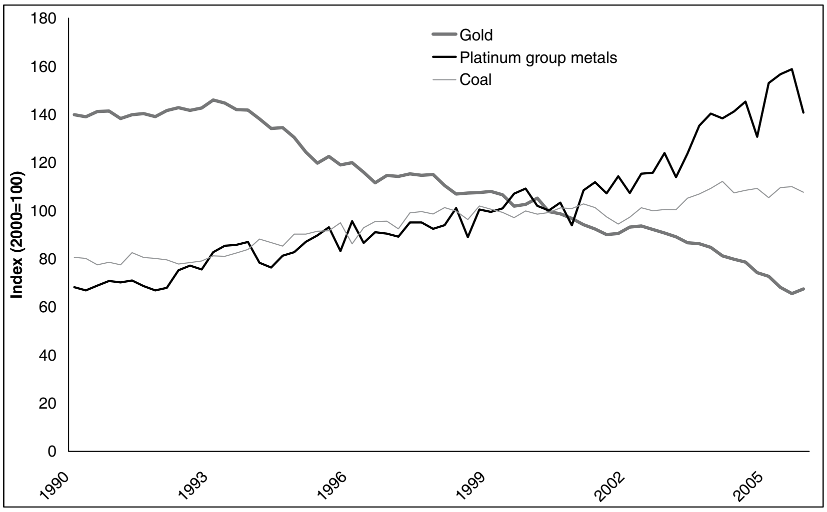
While food price inflation has remained low in recent years, the price of white maize on the South African Futures Exchange has increased from R561/ton in March 2005 to R1 056/ton for March 2006 delivery.

Mining

Strong commodity prices helped sustain growth in mining sector

The mining sector grew by 3,6 per cent in the first nine months of 2005. Growth slowed in the third quarter following wage strikes in August. Production of platinum group metals continued to grow strongly in 2005, as capacity increased and demand soared. Platinum breached US$1 000/oz in December 2005 and stayed above that level throughout January 2006. Coal production experienced steady growth. Gold production continued to decline despite prices increasing by nearly 10 per cent in 2005.

Figure 2.7 Mining production, 1990 – 2005[1]



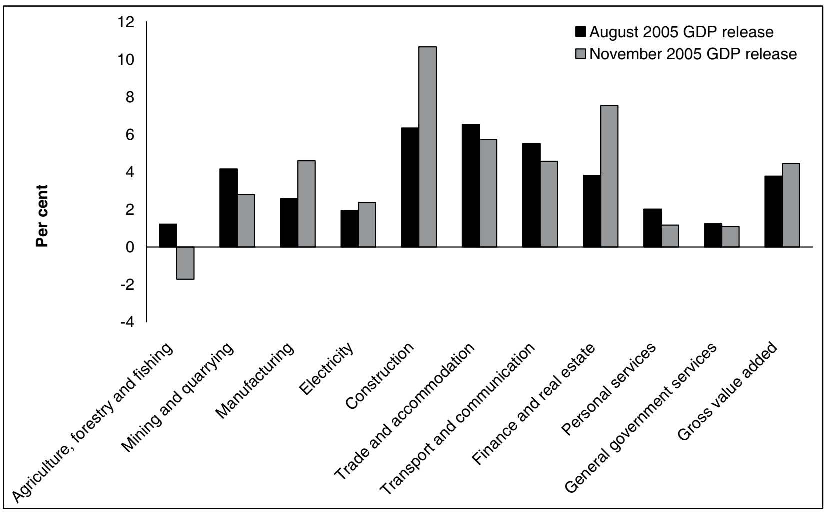
1. *Seasonally adjusted*

Revised estimates of GDP

The national accounts statistics are revised by Statistics South Africa (Stats SA) and the Reserve Bank each November to improve the accuracy of GDP estimates. The revisions take account of information (such as financial statements) released after Stats SA publishes the first preliminary GDP estimates in February.

In November 2005, the average real growth rate for 2004 was revised upwards from 3,7 to 4,5 per cent, largely due to higher growth reported in construction (growth revised upwards by 4,3 percentage points), finance and real estate (up 3,7 percentage points), manufacturing (up 2 percentage points) and electricity (up 0,4 percentage points). Growth was revised downwards in agriculture, mining, trade and accommodation, transport and communication, personal services and general government services. Gross domestic expenditure growth was revised upwards as revisions in household consumption and inventory growth offset a downward adjustment in investment growth. The figure shows how the revisions affect 2004 sectoral growth.

Revised average growth by sector, 2004



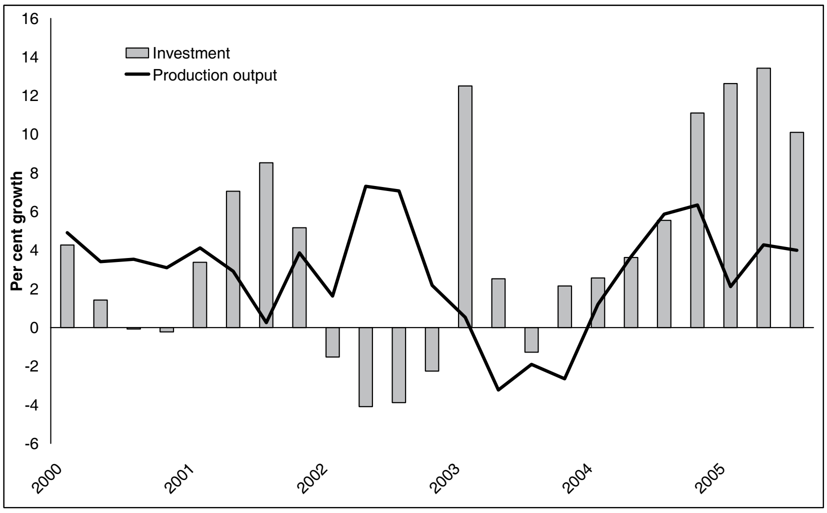
Manufacturing

Capacity utilisation reached above 85 per cent in September 2005

The manufacturing sector grew by 3,8 per cent in the first nine months of 2005, supported by growth in domestic consumption and exports. Growth took place across most subsectors. The strong growth in demand for manufactured goods resulted in capacity utilisation reaching 85,7 per cent in September 2005 from 83,1 per cent in 2003.

The transport (11,1 per cent), glass and non-metallic minerals (8,8 per cent), food and beverages (6,4 per cent), and furniture (7,0 per cent) subsectors reported above-average output growth during 2005. The level of fixed investment also grew strongly at a rate of 12,1 per cent. Production in the two largest subsectors – basic chemicals and iron and steel – grew by over 1 per cent during 2005.

Figure 2.8 Manufacturing performance indicators, 2000 – 2005



Domestic vehicle production has increased steadily, from 310 333 vehicles in 1998 reaching a peak of 523 873 vehicles. The increase was consistent across all categories of vehicles, with the largest growth being passenger vehicles. Production in passenger vehicles has almost doubled since 1998. New vehicle exports account for 26,7 per cent of total production and are expected to continue growing as new and existing export programmes gain momentum.

Increased competitiveness and better export opportunities are expected to support further growth over the period ahead.

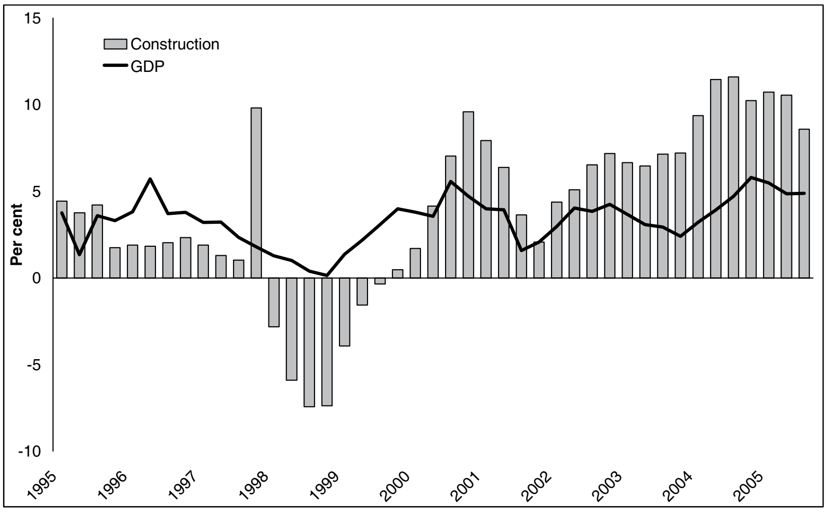
Construction

Infrastructure projects boost construction demand

The construction sector expanded by nearly 10 per cent in the first nine months of 2005 compared with the same period in 2004. A rise in the number of building contracts awarded, major infrastructure projects, and new residential and commercial projects, are expected to support a high rate of growth over the forecast period.

The spillover effects of the construction boom have been widespread, as reflected by reported employment gains and growth in input industries. Cement sales, for example, have increased substantially over the past four years, rising from 7,9 million tons in 2000 to 10,6 million tons at the end of 2004. By the end of the third quarter of 2005, cement sales had increased by a further 11,5 per cent compared to the same period in 2004.

Figure 2.9 Annual growth in construction, 1995 – 2005



Transport and communications

A decade of growth in response to demand for new products and gradual liberalisation

Robust growth in the transport and communications sector has been sustained for more than 10 years in response to fundamental changes taking place in these industries, demand for new and better products and services, and gradual liberalisation. The sector grew at 5,8 per cent in the first nine months of 2005, with annual growth averaging 6,5 per cent since 1997.

The telecommunications industry has experienced healthy growth, primarily due to the buoyant cellphone market. The three mobile operators service about 49 per cent of the population. The sector has also grown its market share in the rest of the African continent. Two South African cellphone providers have nearly 15,5 million subscribers outside South Africa.

The second network operator, licensed in December 2005, is expected to begin offering commercial services in the second half of 2006.

Financial sector and business services

Mortgage advances, low borrowing costs boost banking sector

The financial sector experienced 8,3 per cent growth in the first nine months of 2005. The buoyant growth rate can be attributed to healthy performance by banks and business services, partly as a result of strong growth of mortgage advances and the generally low cost of borrowing.

Growth in this sector is expected to remain robust as banks and other financial institutions broaden the reach of their services to provide affordable and appropriate products to the low-income sector in terms of their Financial Sector Charter commitments.

Developments in the retirement savings industry

Costs in the retirement funding and insurance sector came under scrutiny in the past two years. Rulings by the Pension Funds Adjudicator in 2005 were a further indication of growing discontent among contributors to retirement annuity funds. Many complaints arose as a result of inadequate disclosure to fund members.

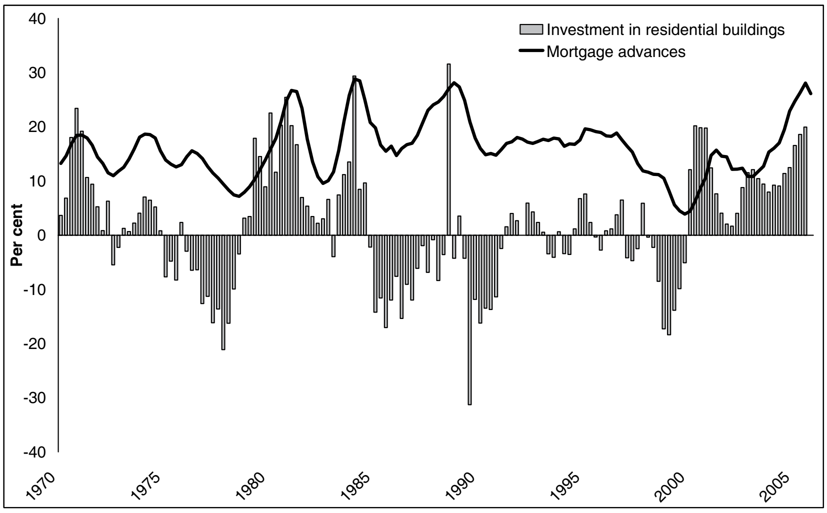
The need to offer consumers a better deal on early termination of their policies led to a statement of intent signed by the Minister of Finance and representatives of the long-term insurance industry in December 2005. The document contains proposals under which retirement annuitants and endowment policyholders who terminated or reduced contributions will be guaranteed certain minimum surrender values.

Various technical issues require further attention to ensure the realisation of all the provisions in the statement of intent. These include:

- A clarification of the jurisdiction of the long-term insurance ombudsman, Pension Funds Adjudicator and Financial Advisory and Intermediary Services Act ombudsman
- A review of commissions regulated under the Long-Term Insurance Act.

In broad terms, the minimum standards will apply to policies during which the premium cessation or reduction took place after 1 January 2001. The statement of intent also includes a commitment to examine other cost issues, including disclosure standards and consumer education. In any review of regulatory changes, broad-based consultation will take place, with the interests of consumers prioritised. This should help re-establish consumer confidence in the sector, and support the goal of South Africans making adequate provision for retirement.

Figure 2.10 Growth in mortgage advances and residential investment, 1970 – 2005



Real estate services continued to benefit from the thriving residential property market as the number of new housing developments multiplied and the secondary housing market expanded, supported by rising wealth effects.

Last year the competition authorities noted that fixed-percentage pricing and other fixed user charges are widespread in this sector.

Employment and remuneration

Growing alignment of employment and economic growth

There appears to be a growing alignment of employment and economic growth trends, with measured employment rising in recent years. Formal sector job creation appears to be concentrated in construction, transport, retail and wholesale trade, and business services.

The Labour Force Survey (LFS) for September 2005 indicates an increase in total employment from about 11,2 million jobs in September 2001 to 12,3 million jobs in September 2005. This represents a 2,5 per cent annual increase in employment since 2001 and an improved labour absorption rate in the economy. The pace of job creation is currently about 350 000 a year. As indicated in Table 2.5, the rate of unemployment declined from 29,4 per cent in September 2001 to 26,7 per cent in September 2005. The number of recipients of unemployment benefits has also declined in recent years, from about 577 000 in 2000 to about 440 000 in the beginning of 2005.

Table 2.5 Key labour market indicators, September 2001 to September 2005 (official definition of unemployment)

Labour market category R thousands	Sep 2001[1]	Sep 2005
Employed	11 181	12 301
Unemployed (official definition)	4 655	4 487
Total economically active (employed & unemployed)	**15 836**	**16 788**
Not economically active	12 281	12 909
Total aged 15 - 65 years	**28 117**	**29 697**
Unemployment rate	29,4%	26,7%
Labour force participation rate	56,3%	56,5%
Labour absorption rate	39,8%	41,4%

1. Revised on the basis of the new population estimates.
Source: Labour Force Survey, September 2001, September 2005

Nominal wage growth slows in 2005

The rate of increase in nominal wages in the formal non-agricultural sector slowed from an annual average of 9,1 per cent in 2004 to 7,9 per cent in the third quarter of 2005. The moderation of wage increases in 2005 will contribute to a low inflation environment over the medium term.

Domestic expenditure

Real gross domestic expenditure has been a major driver of economic growth since 2000. Household consumption expenditure contributed 2,6 percentage points to GDP growth between 2000 and 2004, and investment spending contributed one percentage point to growth over the same period.

Improving the quality of labour market statistics

In 2005, as part of its efforts to provide accurate information, Stats SA worked with the International Monetary Fund to review the quality of labour market data.

A task team reviewed the Labour Force Survey (LFS), concentrating on:

- The frequency of the survey and the relevance of the definitions used
- The sample design, use of weights and estimation processes
- The population coverage of the survey
- The contents and extensiveness of the questionnaire.

Suggestions for improving the quality of the LFS included:

- Simplifying tools used to collect labour market data
- Using more focused, quarterly surveys to better understand labour market dynamics

Detailed recommendations have been forwarded to Stats SA and the Minister of Finance for consideration. The review is set to continue. Stats SA will consult widely to ensure that all concerns regarding labour force data are taken into account.

Gross domestic expenditure projected to grow at 5,3 per cent over the MTEF

Gross domestic expenditure is projected to grow at a rate of 5,3 per cent over the MTEF period, with a marked shift from consumption spending to investment as government and the public sector launch substantial infrastructure programmes and private investment remains robust.

Gross fixed capital formation

New productive capacity added to economy

Gross fixed capital formation continues to rise steadily, adding new productive capacity to the economy to meet strong demand and enhance competitiveness. Investment is estimated to have expanded by 8 per cent in 2005. Private sector gross fixed capital formation, though still firm at an estimated 6,7 per cent for 2005, is off the high of 9,7 per cent realised in 2004.

Investment spending in the utilities sector grew by just over 30 per cent in 2005. Strong investment growth has also taken place in financial intermediation, insurance, real estate and business services. A range of large investments in mining and manufacturing are also expected, as indicated in Table 2.6.

Corporate savings are the largest source of investment finance

Corporate savings remain the largest source of investment finance, followed closely by foreign direct investment, which increased significantly as a source of funds in 2005. Domestic saving is expected to improve in response to rising real income.

Preparations for 2010 Soccer World Cup

As the preparations for the 2010 Soccer World Cup and public sector infrastructure programmes unfold, investment growth should accelerate to an average of 9,7 per cent per year over the medium term.

Table 2.6 Major private sector investments planned over the MTEF period

Sector and company	Project	Approximate value	Duration
Mining			
Steel (Highveld)	Technology upgrade	R 1,6 billion	Four years
Platinum (Impala)	Impala Shafts 16 and 20	R 6,6 billion	Five to eight years
Coal (Klipspruit)	New mine	R 1,2 billion	Start 2006
Iron ore (Sishen)	Expansion and upgrade	R 4 billion	Two to three years
Manufacturing			
Motor industry (across sector)	Investment programme	R 6,4 billion	In progress
Petrochemical (Sasol)	Synthetic and unleaded fuels	R 12 billion	To complete 2006
Cement manufacturers	Expansion projects	R 4,4 billion	In progress

Source: Engineering News; Nedbank Capex Survey 2005

Household consumption expenditure

Growth in household consumption remains strong, with growth for 2005 estimated at 6,7 per cent – the fastest rate of increase since 1981.

Consumption of durable goods records strong increase

Current consumption levels are driven by employment growth, rising real wages, smaller households, the increase in wealth due to buoyant asset prices and a favourable credit environment. The consumption of durable and semi-durable goods recorded increases above 17 per cent in the first nine months of 2005. Durable goods consumption has been underpinned by strong vehicle sales, which rose by 26 per cent during 2005, as consumers took advantage of a favourable credit environment.

Money supply and credit extension

Household debt trends upward as debt service costs decline

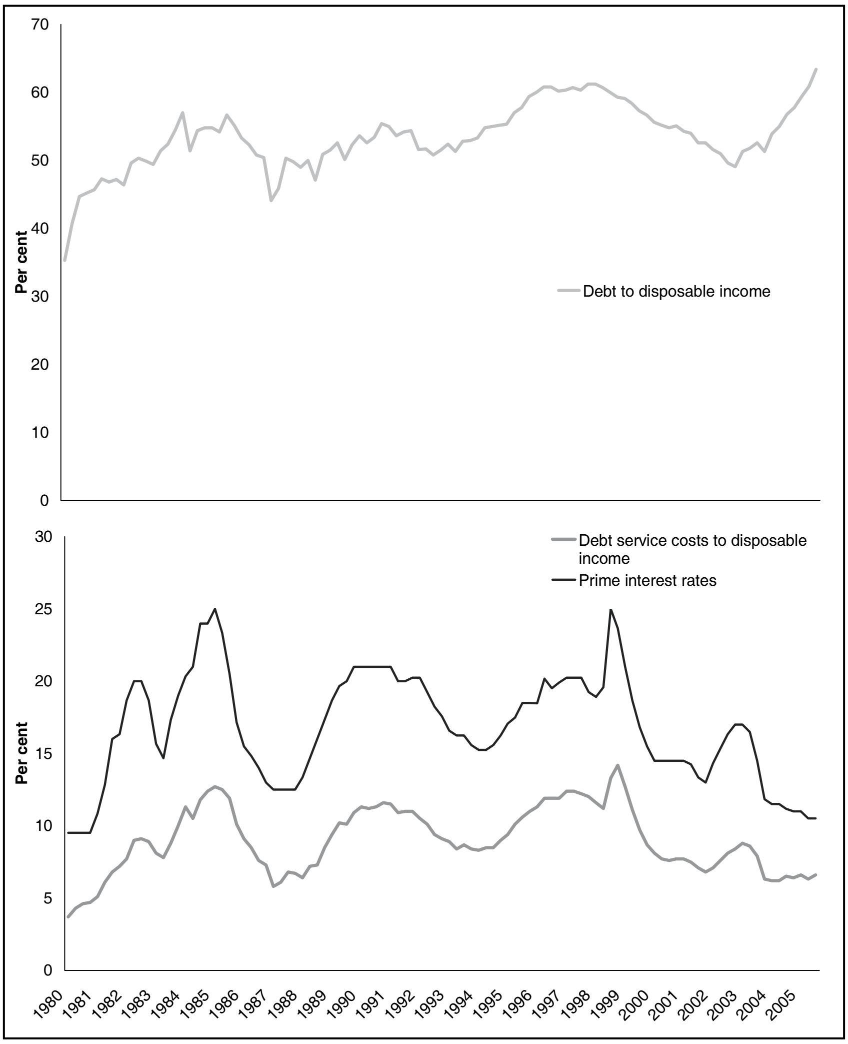
Household debt as a percentage of disposable income – mainly in the form of mortgage advances – has been trending upward since 2003. In the third quarter of 2005 this ratio reached an all-time high of 63,4 per cent. However, non-performing loans and provisions for bad debt in the banking sector remain at historic lows. This is due to declining debt service costs (financing cost to income), which have come down from a high of 14,8 per cent in 1998 to an average rate of 6,6 per cent in 2005.

Since 2003, mortgage advances have accounted for more than half of the growth in core private sector credit extension.

Growth in broad money supply increased to an average of 16 per cent

Growth in broad money supply (M3) increased from 13,2 per cent in 2004 to an average of 16 per cent in 2005. Growth in the money aggregates has remained strong in line with the increase in the transactional demand for money.

Figure 2.11 Household debt and debt service costs, 1980 – 2005



Inflation

CPIX inflation remains firmly within target band

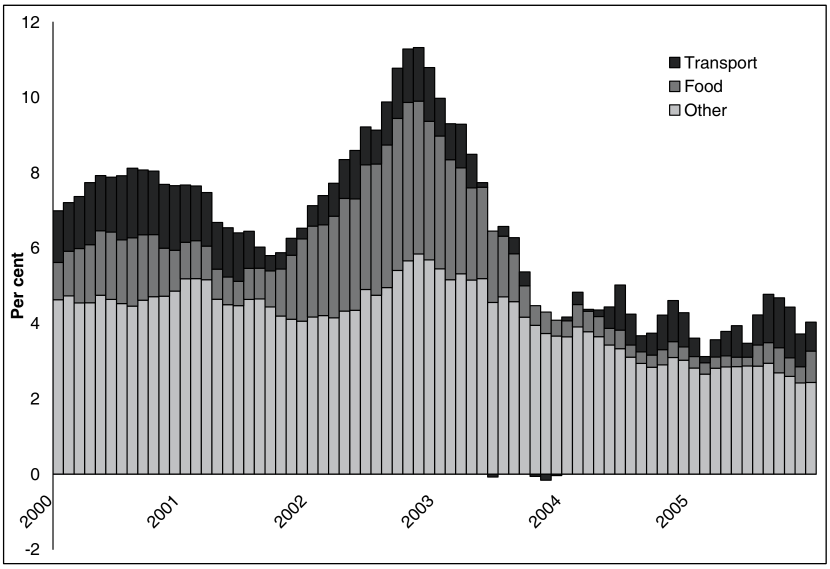
Consumer price inflation excluding mortgage costs (CPIX) has remained within the 3 to 6 per cent target range since September 2003. During 2005, after reaching a low of 3,1 per cent in February, CPIX inflation rose to 4,8 per cent in August before receding to 4 per cent in December. Lower inflation expectations and a slowdown in services inflation offset the upward pressure resulting from higher oil prices. Frequent oil price movements, however, did contribute to volatility in the transport component of the CPIX basket.

Excluding the transport component, CPIX inflation was stable for the year to December 2005 at about 2,8 per cent. Food inflation remained subdued, averaging 2 per cent during 2005, although food prices have begun to increase in recent months.

Imported components may push up producer price inflation

Producer price inflation remained low at an average level of 3,1 per cent in 2005 but has increased in recent months. This is mainly due to the increase in the imported component flowing from higher oil prices. In the period ahead, inflation pressures from South Africa’s trading partners may increase, which could result in an increase in producer price inflation.

Figure 2.12 Contribution of food and transport to CPIX inflation, 2000 – 2005



The inflation expectations of all surveyed groups, as measured by the Bureau for Economic Research Inflation Expectation Survey, moved in a narrow range during 2005. While showing a slight increase in the third quarter survey, inflation expectations should remain well within the inflation target band for 2006.

Domestic outlook

Strong output growth set to continue

The strong output growth recorded in 2005 should continue over the medium term, supported by robust growth in investment and consumption spending and a reasonably healthy external position. Recent data revisions indicate that economic growth is stronger than anticipated in the 2005 Budget or the *Medium Term Budget Policy Statement*.

Growth in household consumption spending should soften slightly from the levels realised in 2005, while remaining above 4 per cent over the medium term. Spending by households will be underpinned by significant employment growth, gains in real wages and a relatively stable currency. With inflation firmly contained within the target band, monetary policy should also remain broadly stable, supporting consumption going forward and providing households with the opportunity to reduce debt levels and increase savings.

Investment spending expected to grow strongly

Growth in investment spending is expected to increase as companies improve their capacity to meet buoyant domestic demand and seek new markets abroad. It is expected that investment will grow by 9,4 per cent in 2006, reaching 9,9 per cent in 2008. Residential investment is expected to moderate slightly as property price growth eases. Over the same period, government and the public corporations project large-scale public investment spending.

The 2005 export performance was stronger than anticipated, as businesses took full advantage of the upturn in world economic conditions and rising export prices. Continued strong export growth is foreseen over the medium term as the public and private sectors make concerted efforts to improve the logistics and transport services available to exporters. Export growth is expected to average about 6,7 per cent over the forecast period. Imports are projected to continue to record solid increases, growing by 9,4 per cent in 2006, then easing over the remainder of the forecast period.

The projected annual average for the current account deficit over the next three years is 4,3 per cent. The 2005 outcome of 3,9 per cent is lower than the projection made in the *Medium Term Budget Policy Statement.*

Table 2.7 Macroeconomic projections, 2002 – 2008

Calendar year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
		Actual		**Estimate**		**Forecast**	
Percentage change unless otherwise indicated							
Final household consumption	3,2	3,5	6,5	6,7	4,9	4,4	4,7
Final government consumption	4,6	6,5	6,9	4,9	4,8	4,7	4,8
Gross fixed capital formation	3,7	8,3	8,8	8,0	9,4	9,7	9,9
Gross domestic expenditure	4,9	5,2	7,5	4,8	5,6	5,0	5,4
Exports	0,5	0,3	2,5	12,6	7,1	6,2	6,7
Imports	5,1	8,8	14,1	10,9	9,4	7,2	7,2
Real GDP growth	**3,7**	**3,0**	**4,5**	**5,0**	**4,9**	**4,7**	**5,2**
GDP deflator	10,5	4,4	5,6	4,3	5,2	4,9	5,4
GDP at current prices (R billion)	**1 168,8**	**1 257,0**	**1 386,7**	**1 518,9**	**1 674,6**	**1 839,0**	**2 038,9**
CPIX (Metropolitan and urban, average for year)	9,3	6,8	4,3	3,9	4,3	4,5	4,8
Current account balance (percentage of GDP)	-0,6	-1,3	-3,4	-4,2	-4,4	-4,3	-4,2

Table 2.8 Macroeconomic projections, 2005/06 – 2008/09

Fiscal year	**2005/06**		**2006/07**		**2007/08**		**2008/09**
R billion	**2005 Budget**	**Revised**	**2005 Budget**	**Revised**	**2005 Budget**	**Revised**	
GDP at current prices	**1 528,6**	**1 559,6**	**1 674,0**	**1 714,5**	**1 847,3**	**1 884,9**	**2 095,9**
Real GDP growth	4,1	4,9	3,9	4,8	4,4	4,7	5,3
GDP inflation	4,6	4,7	5,4	4,9	5,7	5,0	5,6
CPIX (Metropolitan and urban)	4,2	4,2	5,3	4,2	5,3	4,5	5,0