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Investment Managers' Conference

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The Economic Conundrum

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Conundrum

Oxford dictionary:

- a confusing and difficult problem or question
- a question asked for amusement, typically one with a pun in its answer; a riddle

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~~Themes~~ Conundrums to be discussed

- Are we moving into another slump?
- Stagnation ahead or simply slow growth for some time?
- USA back into recession?
- SA economic cycle
- SA structural problems

Global scenarios

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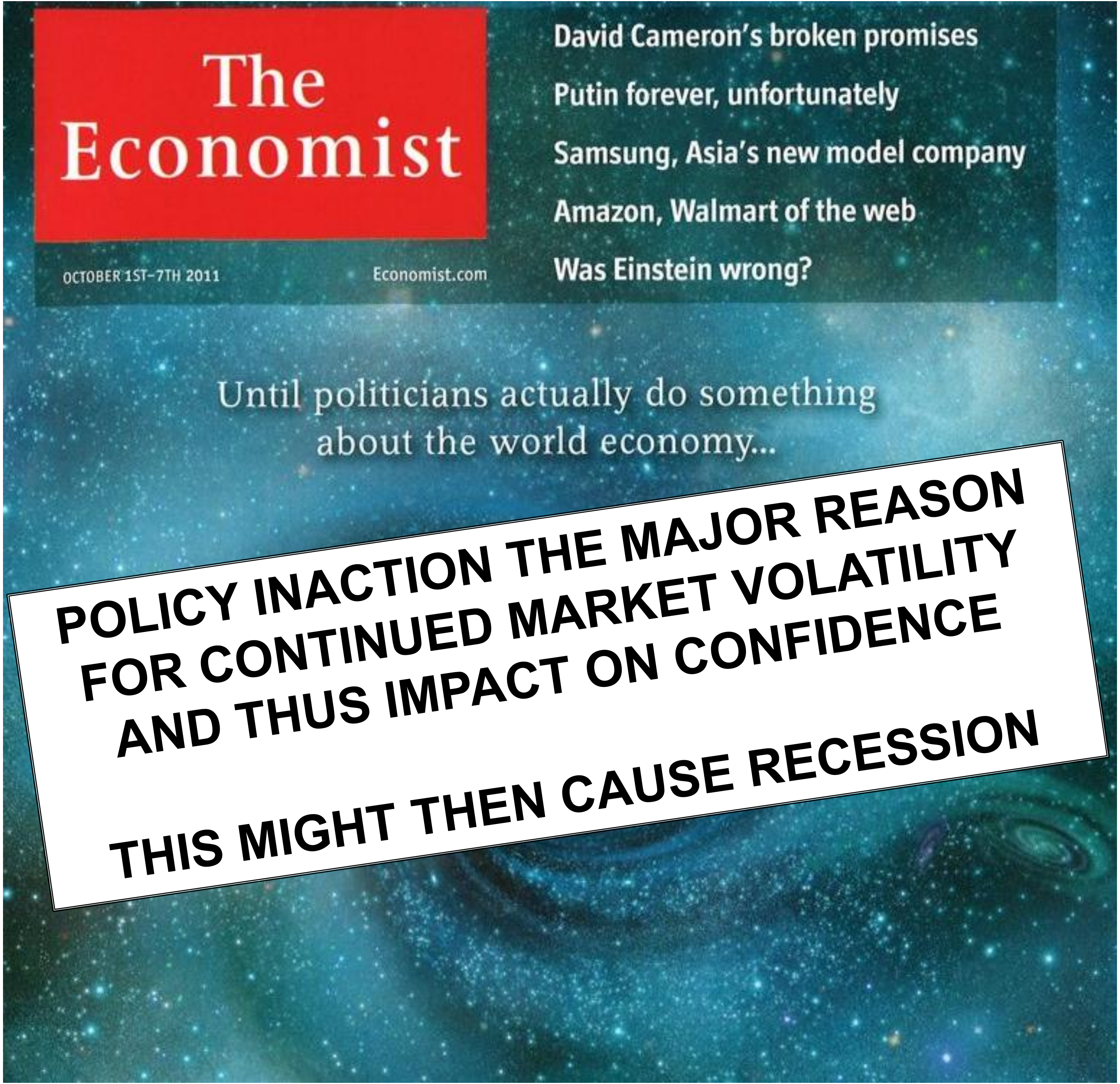


POLICY INACTION THE MAJOR REASON FOR CONTINUED MARKET VOLATILITY AND THUS IMPACT ON CONFIDENCE

THIS MIGHT THEN CAUSE RECESSION

Global Scenarios: 2011/2013

- **Base Case:** Slow global growth **55%**
  - SLOW global growth
  - Inflation not a *major* problem

- **Alternative 1:** Inflation troubles **30%**
  - Inflation spikes sharply
  - Policy tightened everywhere
  - Sharp growth slowdown

- **Alternative 2:** Growth slump **15%**
  - Growth slumps
  - Commodities, inflation turn down
  - Deflation fears return, aggressive M easing & QE3, 4, 5…

Global Scenarios: 2011/2013

Markets now pricing growth slump

Slow growth still more likely than growth slump

Actual data not (yet) signalling recession
But risks have certainly increased significantly recently
Wealth impact of market turmoil, another crisis or more policy (political) errors may be tipping points

Uncertainties mean continued volatility

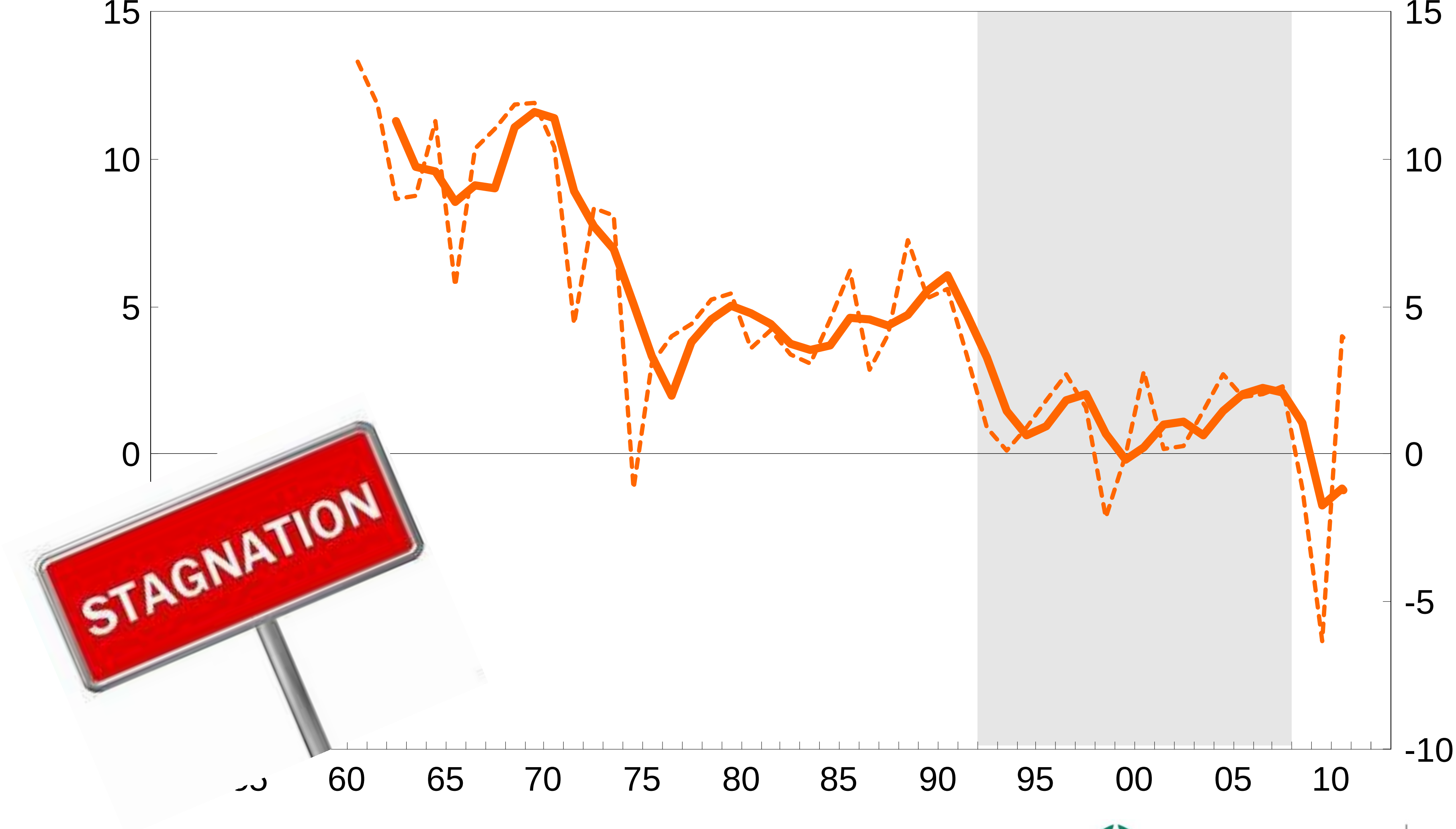
For now – watch the data

Policy action <u>needed</u> to move us even further away from growth slump

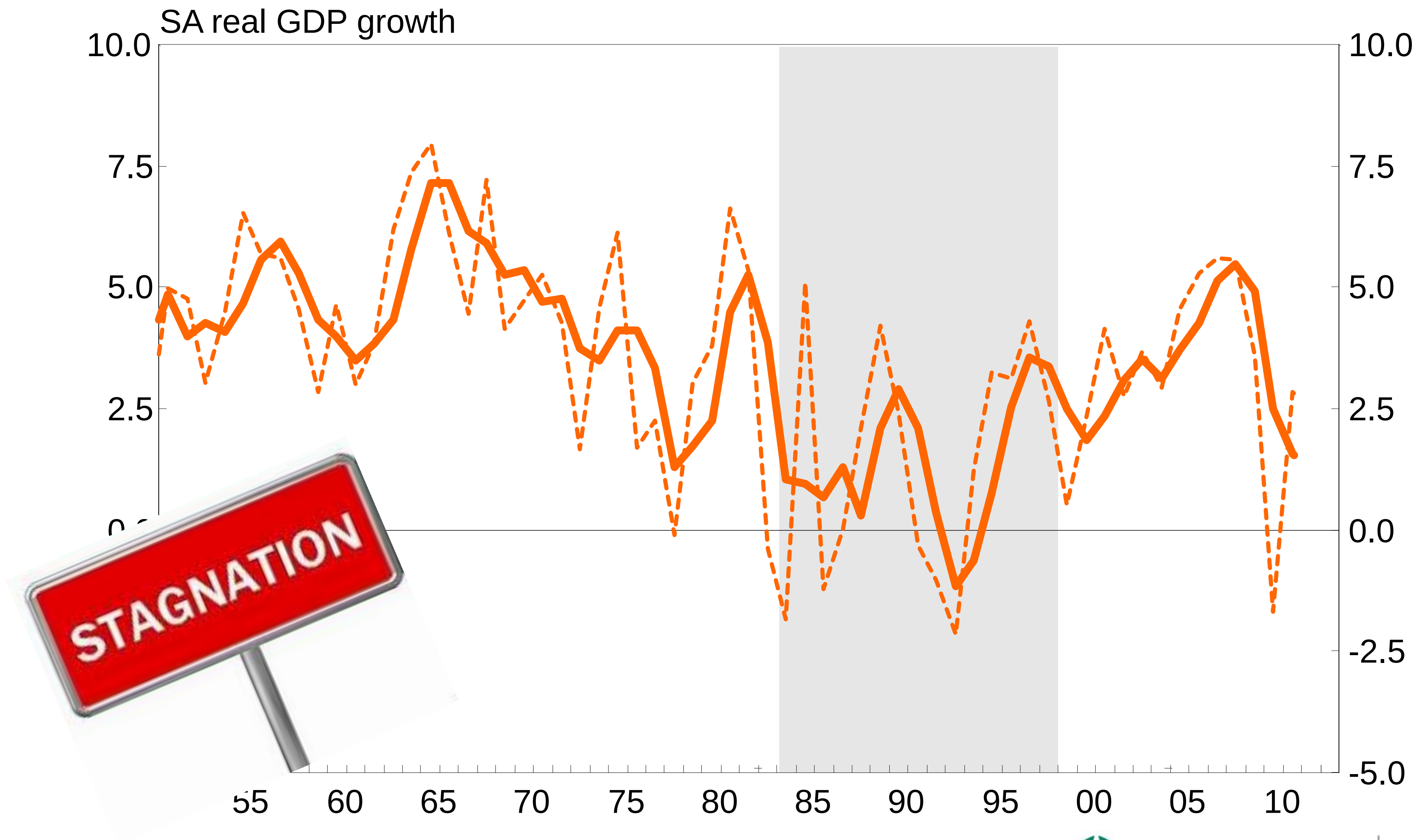
What about stagnation?

Japan’s stagnation of the 1990’s

Japan real GDP growth



South Africa’s own stagnation period in the 1980’s and early 1990’s



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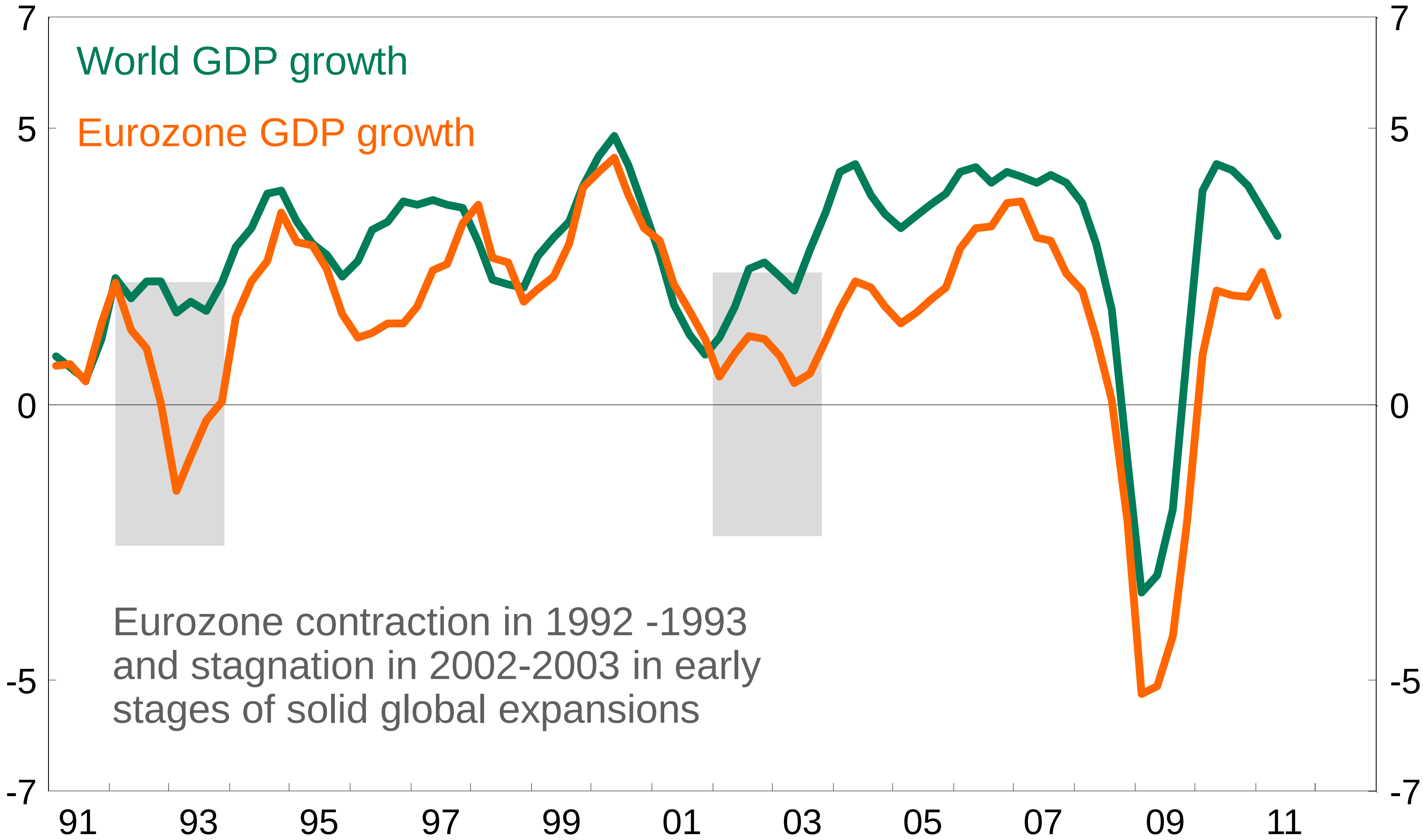
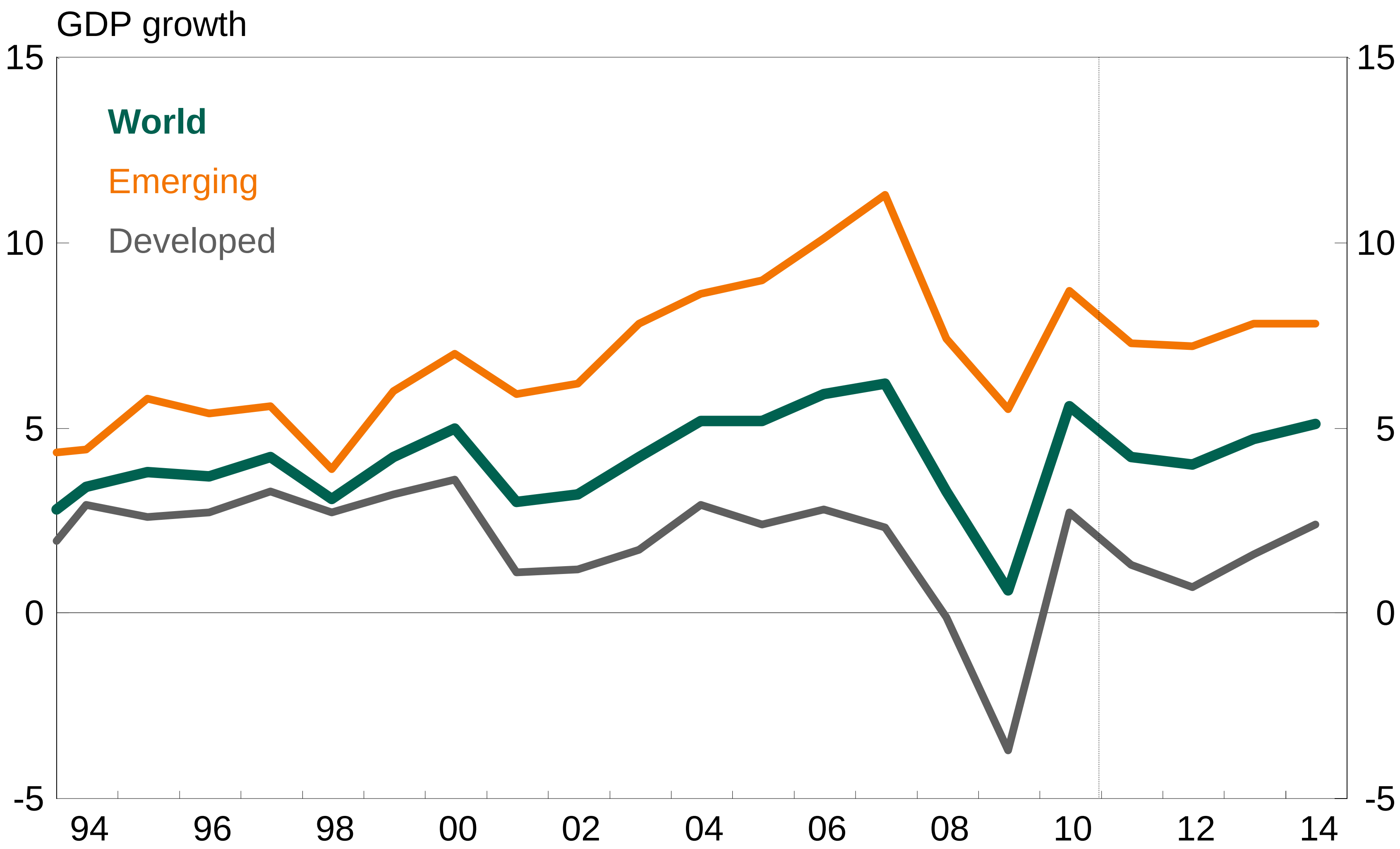
Also, widely expected Eurozone recession does not automatically mean a global recession



Global growth likely to be slow, largely due to weak developed world growth



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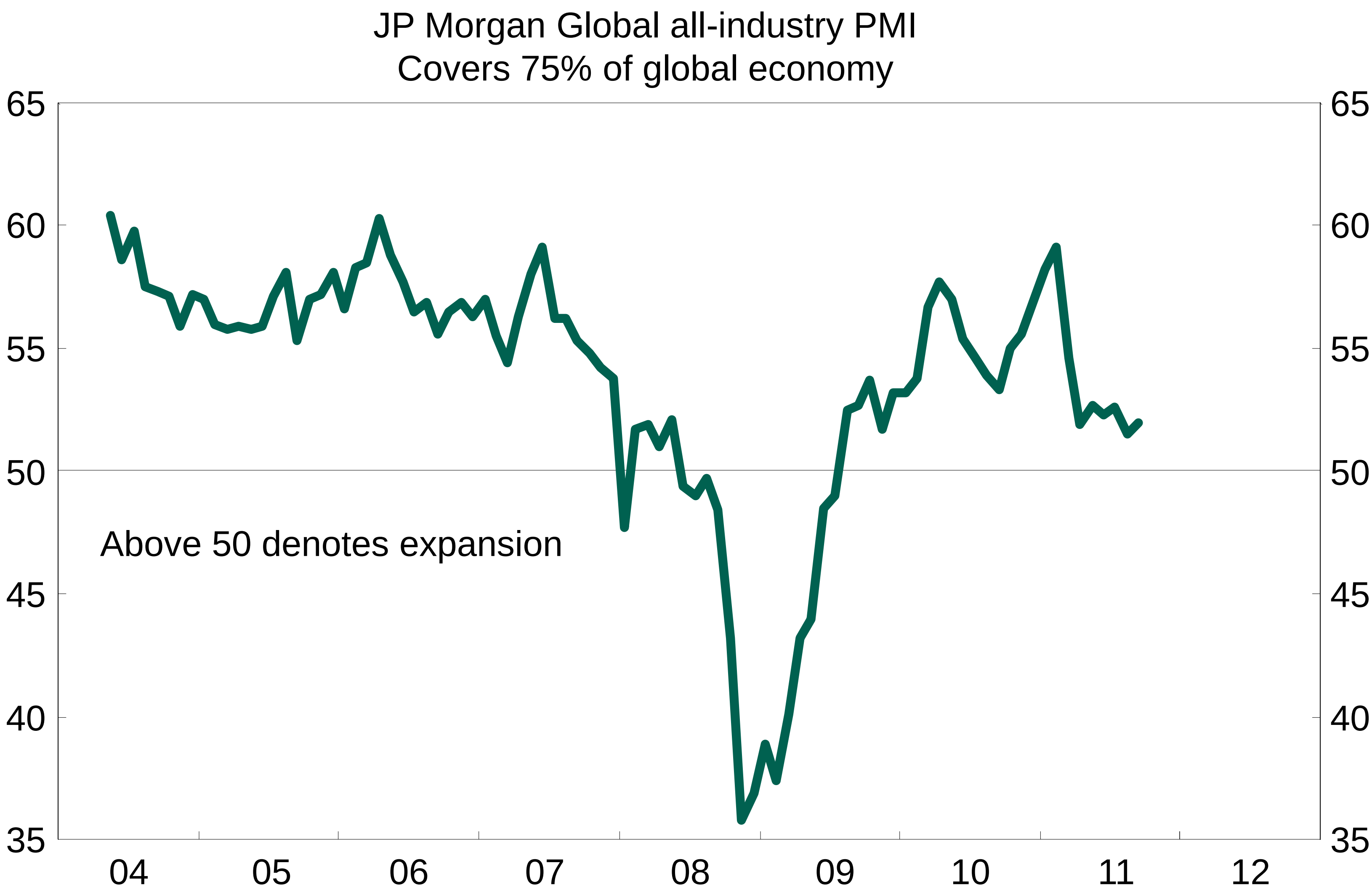
So, global economy in slow growth mode, but global recession not a given



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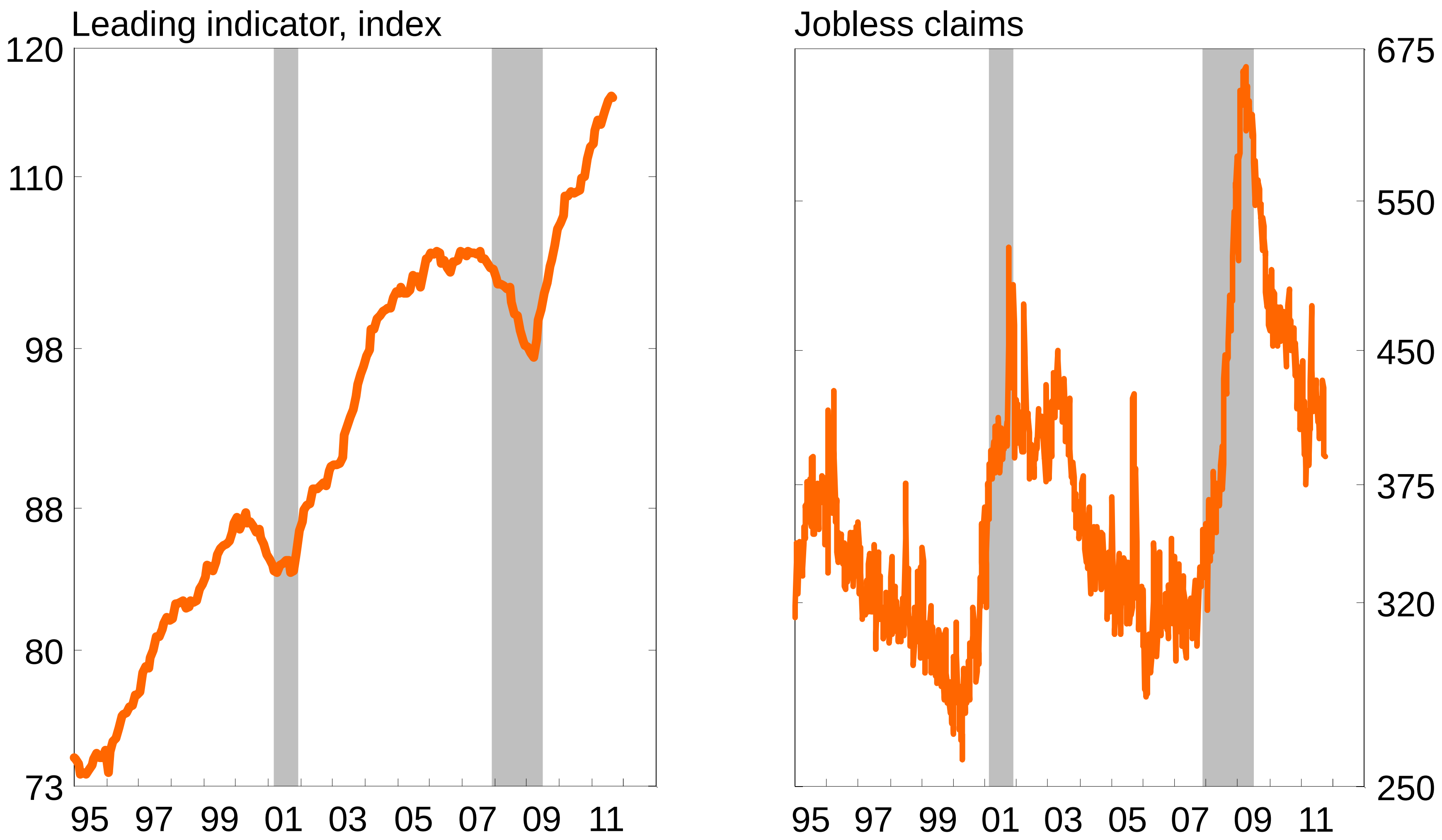
USA back into recession?

Despite worries and some weak indicators, USA recession not a foregone conclusion; if it comes it will likely be mild



USA recessions shaded

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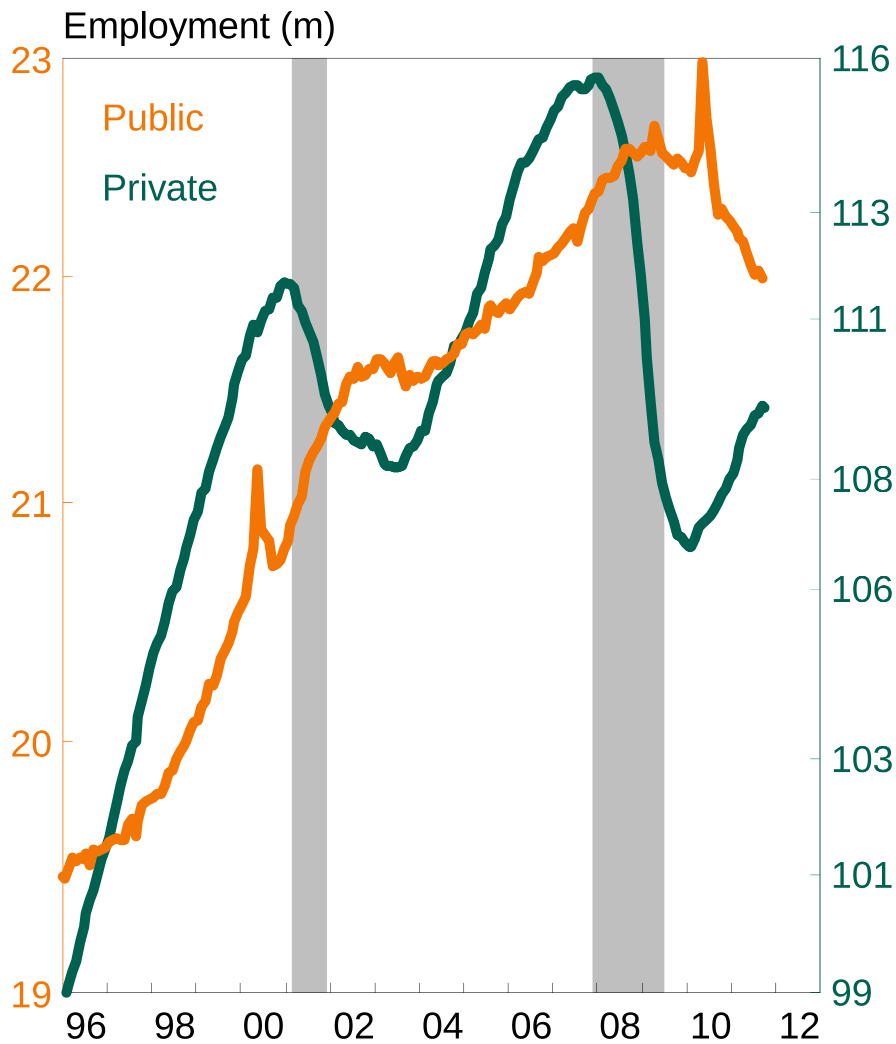
USA: Private employment not vastly slower than previous cycles



USA recessions shaded

Upcycles in private employment compared		
	Total change	*Avg pm*
Current cycle		
Jan '10 to Sep '11	+2.6m	+130k
2003 cycle		
Aug '03 to Mar '05	+2.8m	+140k
1992 cycle		
Feb '92 to Sept '93	+2.8m	+140k

Upcycles in public employment compared		
	Total change	*Avg pm*
Current cycle		
Jan '10 to Sep '11	-0.5m	-25k
2003 cycle		
Aug '03 to Mar '05	+0.2m	+10k
1992 cycle		
Feb '92 to Sept '93	+0.4m	+20k

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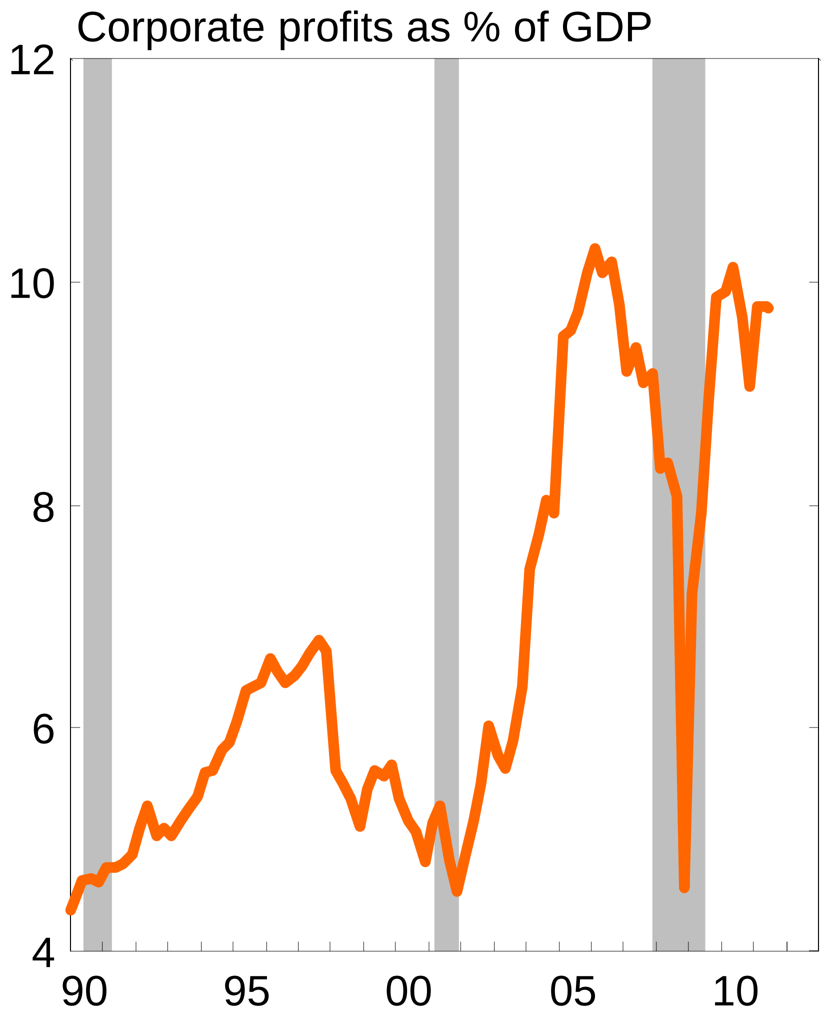
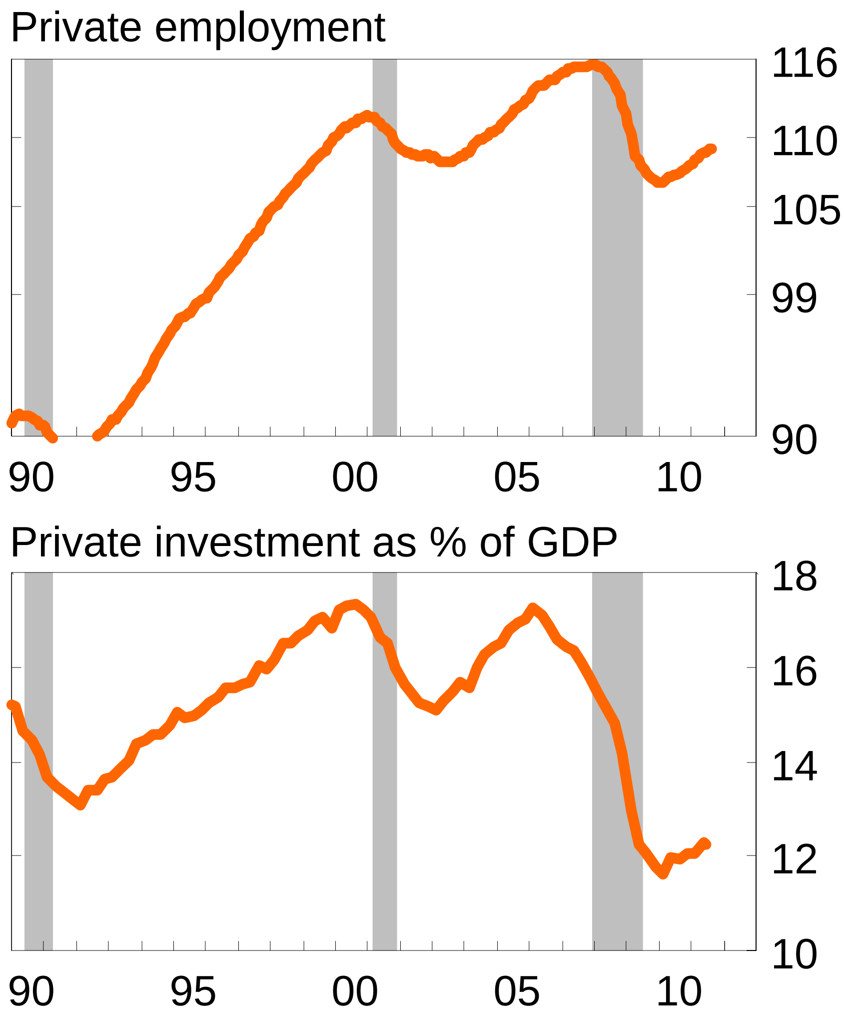
USA economy not hugely vulnerable

Profits healthy; corporates very cautious and thus very lean





USA recessions shaded

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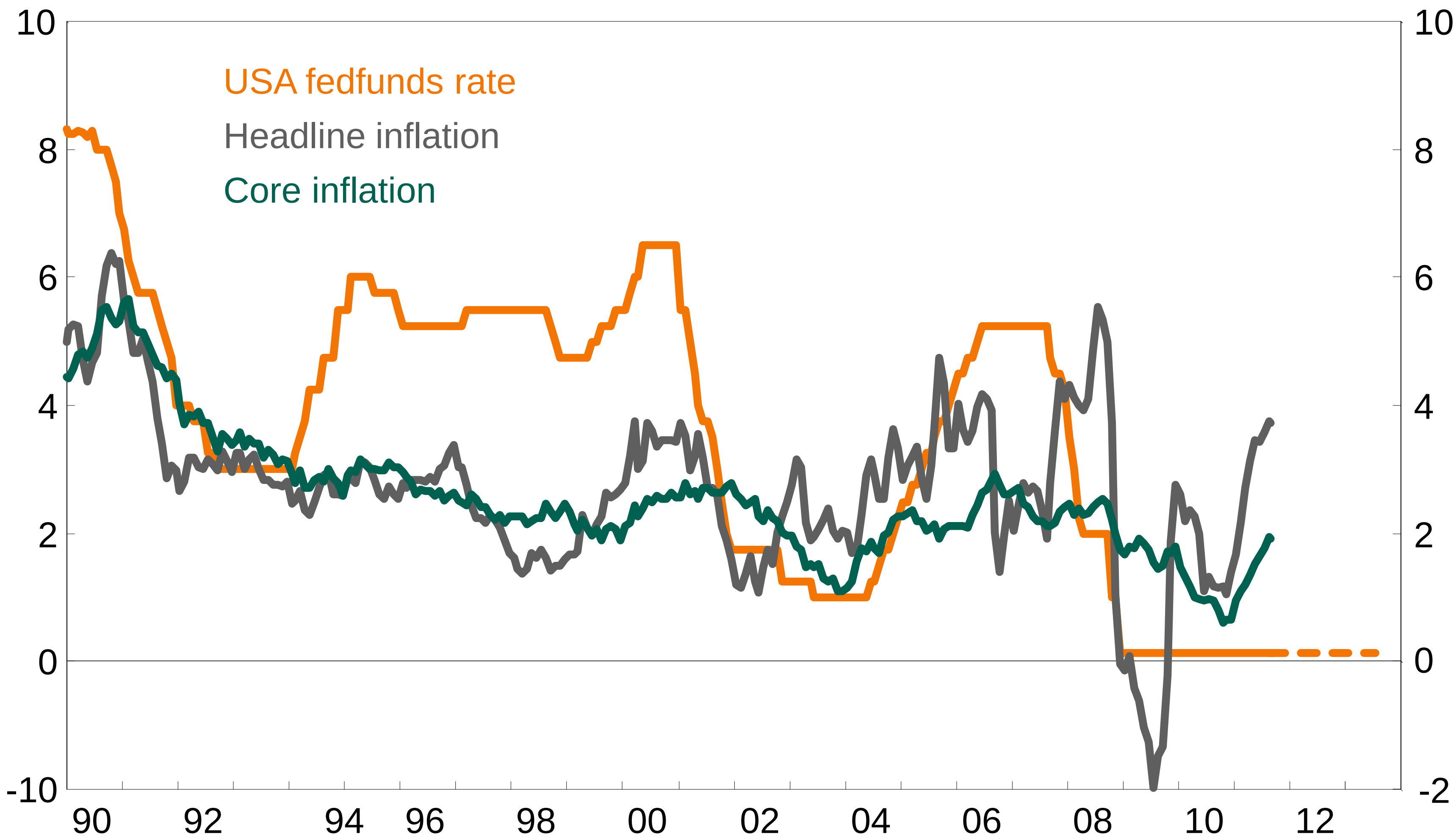
Another conundrum: rising inflation in the USA
Fed clearly more concerned about the economy…



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SA's economic cycle

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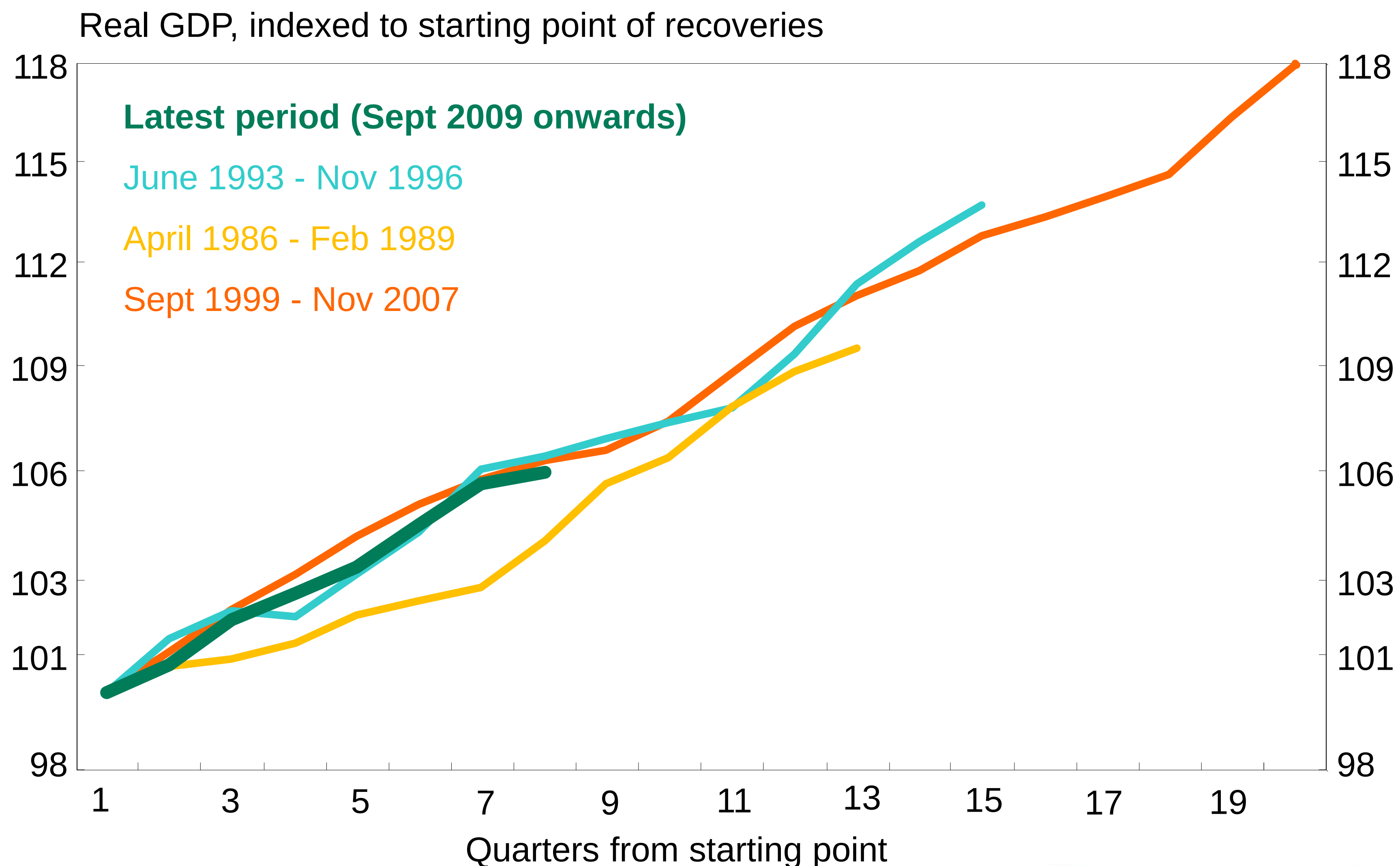
SA GDP growth roughly on average when compared to previous recoveries



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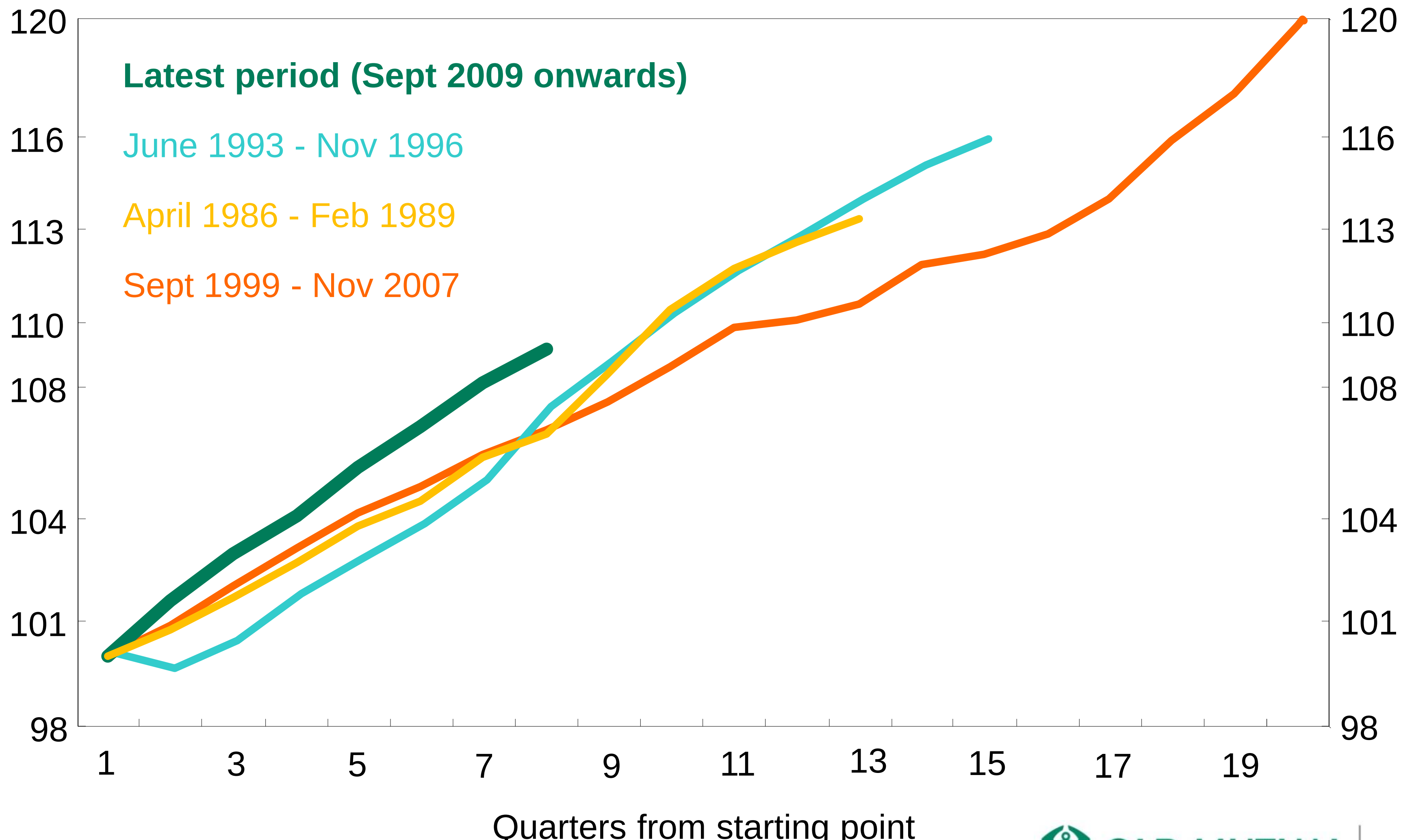
And HCE actually stronger than in previous 3 recoveries

Real household consumption expenditure (HCE), indexed to starting point of recoveries



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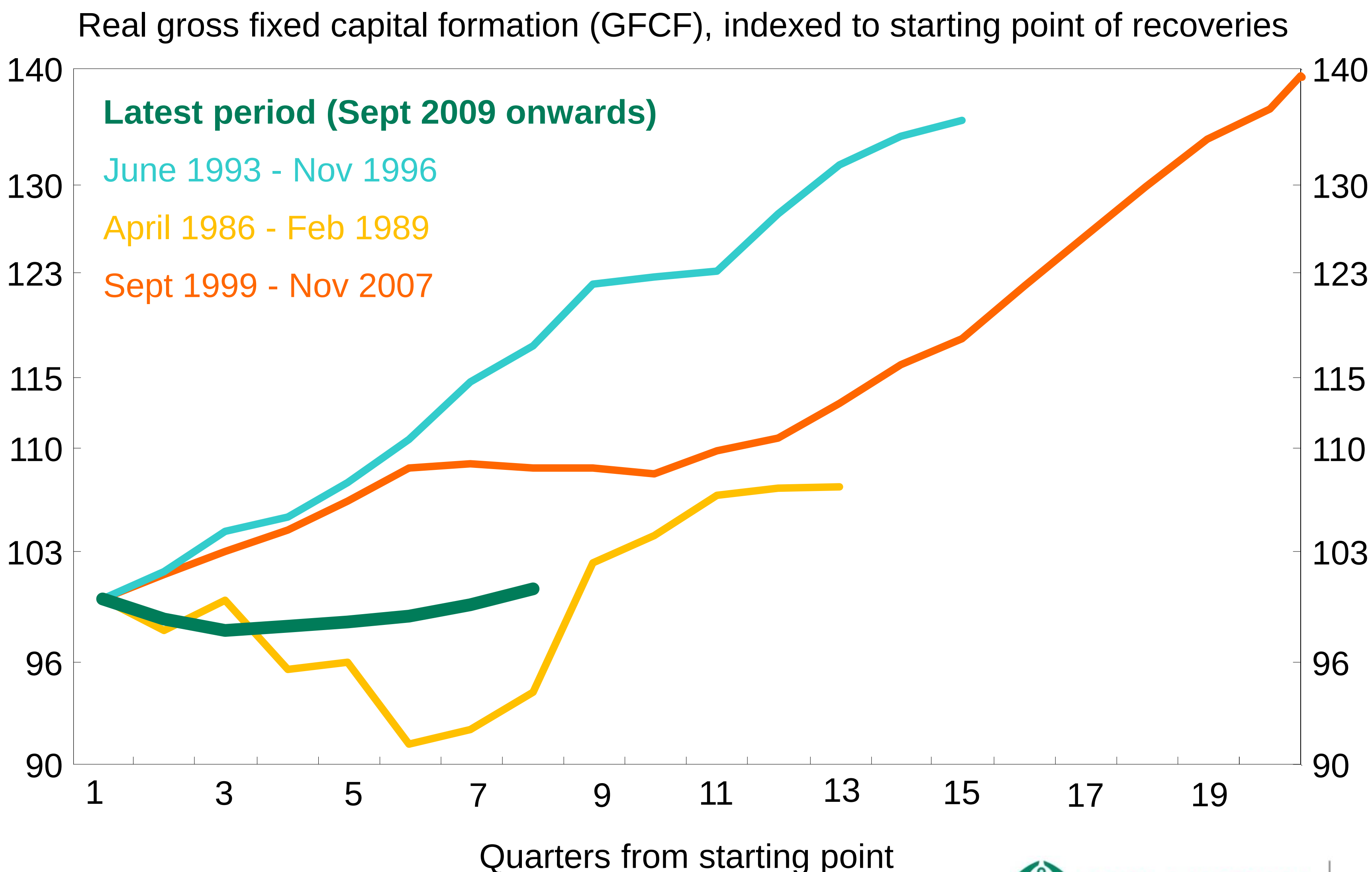
But fixed investment slower in this cycle compared to previous two cycles…



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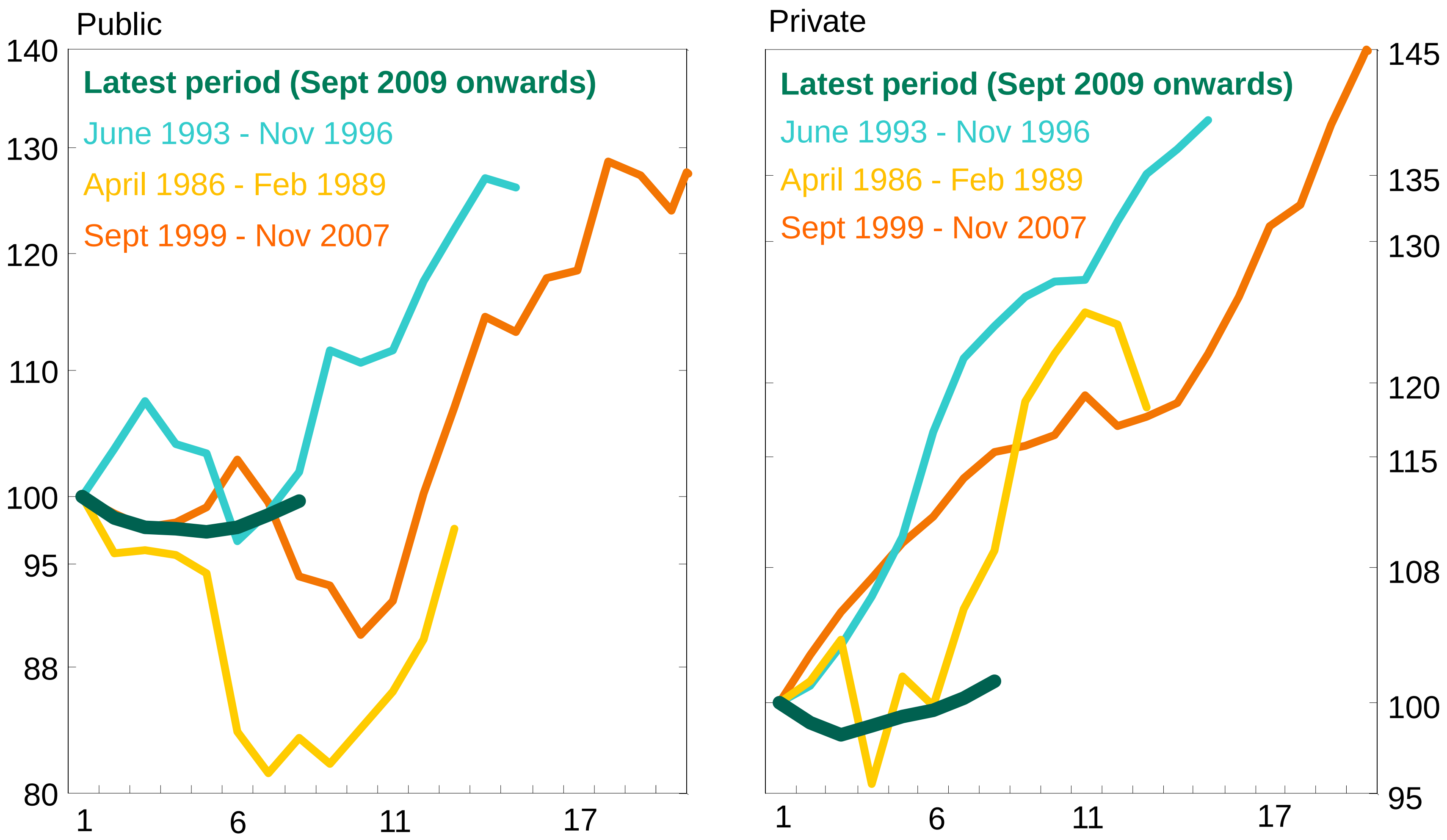
...but not only due to public sector as widely assumed

Real GFCF, indexed to starting point of recoveries



Quarters from starting point

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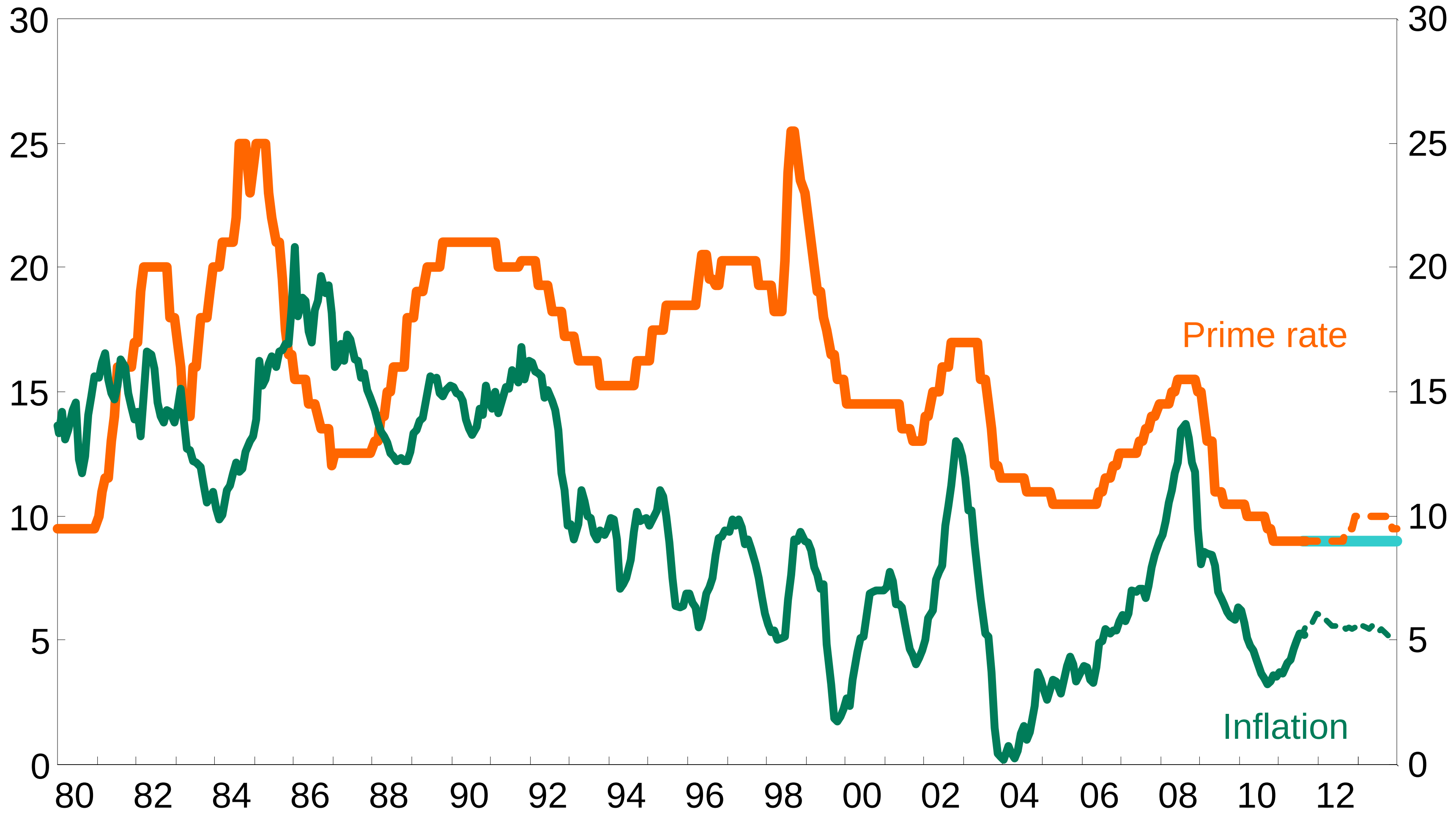
What about the Rand?

- Rand has weakened in line with global risk aversion
  - There are still risks
  - Foreigners have lots of assets to sell

- Strong local fundamentals suggest Rand should stabilise again
  - Fiscal position
  - Relative interest rates
  - Commodity prices
  - Current account deficit not a worry at present

- Rand should stabilise again if Europe is sorted out

If global situation improves, rand holds and inflation flattens out, rates could stay flat…



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SA structural problems

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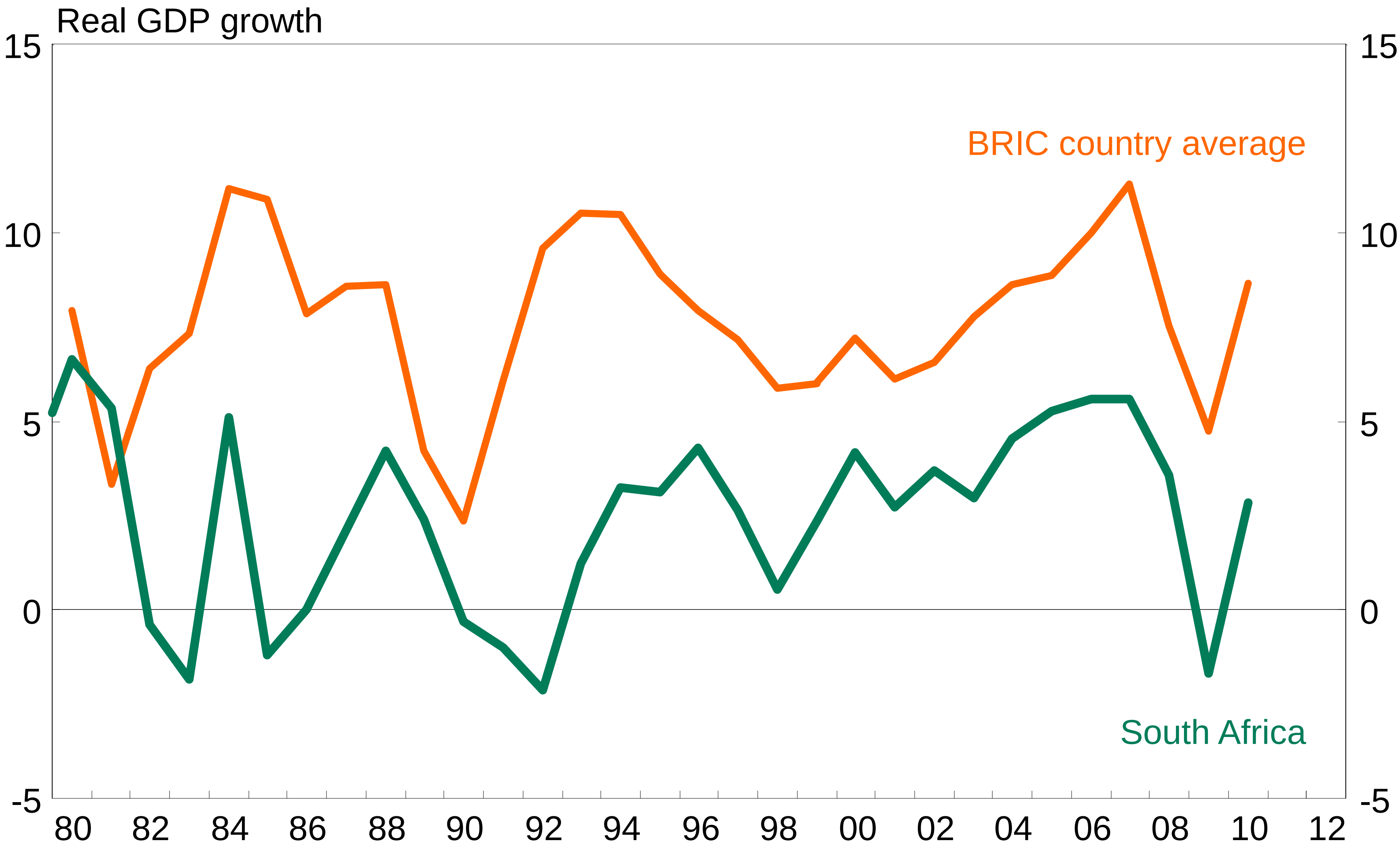
SA has a growth mountain to climb
Real GDP growth rates, annual averages



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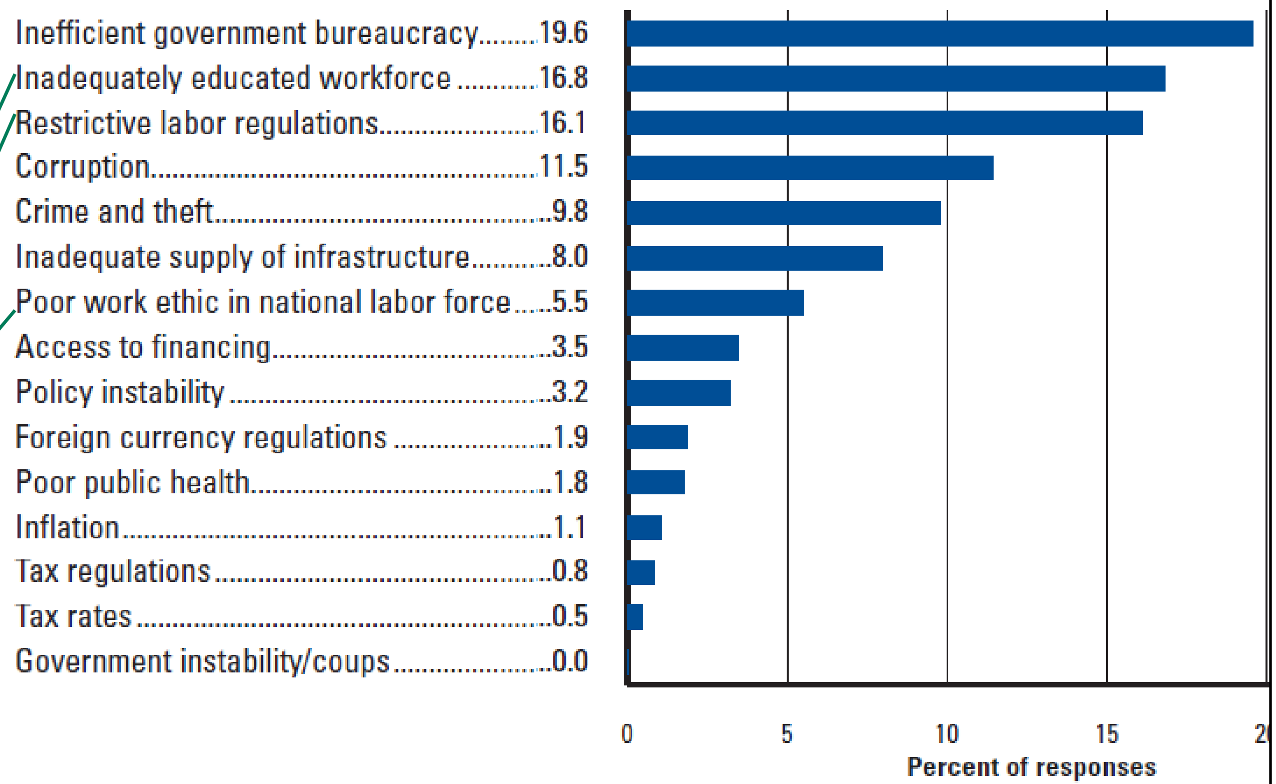
Global competitiveness index
World Economic Forum 2011 – 2012 report

<u>Overall position out of 142 countries</u>:

China	26
South Africa	**50**
Brazil	53
India	56
Russia	66

Labour issues = 38.4

The most problematic factors for doing business



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Global Competitiveness Index: SA details

SA's ranking out of 142 countries

Auditing standards	1
Securities exch regulation	1
Soundness of Banks	2
Efficacy of corp boards	2
Financial services availability	3
Minority shareholder protection	3
Competition policy	7
Legal rights	8
Legal system: settling disputes	16
Air transport quality	17
Legal system: challenging	19

Burden of Govt regulation	112
Favouritism in official decisions	114
Primary education quality	127
Life expectancy (HIV & TB)	130
Pay & productivity	130
Higher education quality	133
Business costs of crime	136
Labour/employer co-operation	138
Flexibility of wage setting	138
Hiring & firing practices	139

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SA structural challenges

- SA not making much progress in raising growth structurally

- What needs to be done?
  - Lift SA's relative competitiveness (currently 50 out of 142)
    - Infrastructure investment
    - More competitive and productive labour force
    - Keep inflation low
    - Improve service delivery
    - Business friendly environment
    - Improve education

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Summary

- We stick to slow growth scenario, but lots of risks…
- Growth likely to be slow – even stagnating…
  - Renewed USA recession not likely
  - Euro-area recession very likely – but unlikely to pull world down
  - We do not expect a hard landing in China

- SA's recovery notably slower recently
- Structural problems unlikely to sorted out soon
- Global events likely to continue to impact local economy and Rand
- Next move in local interest rates delayed due to global events
  - But should still be up, cycle very moderate though
- There are lots of risks out there – for now, markets waiting for Europeans…

Regulatory Information

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