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February 2010

Economic Outlook

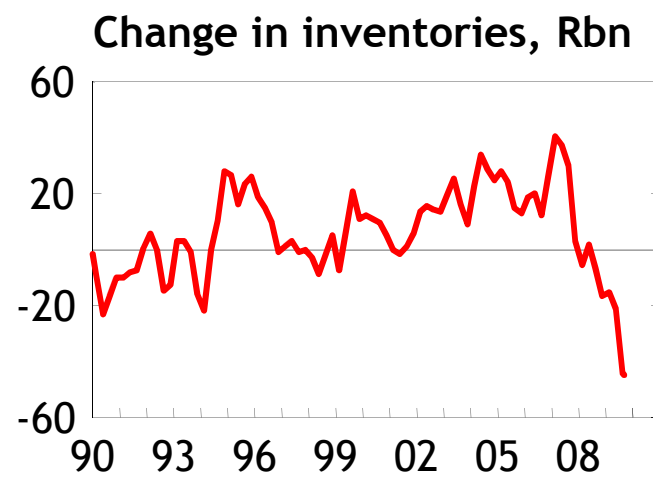
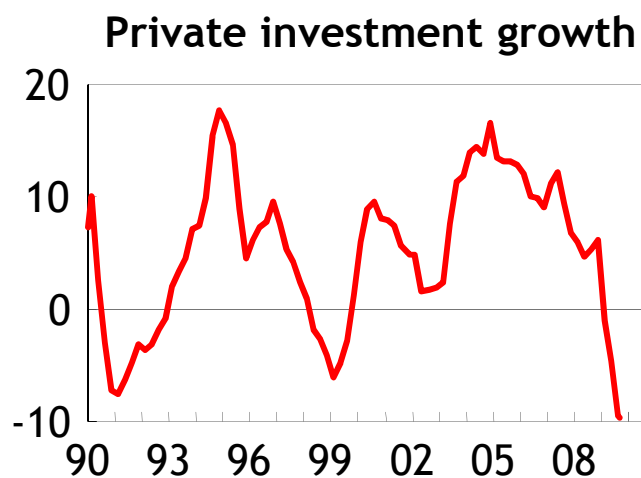
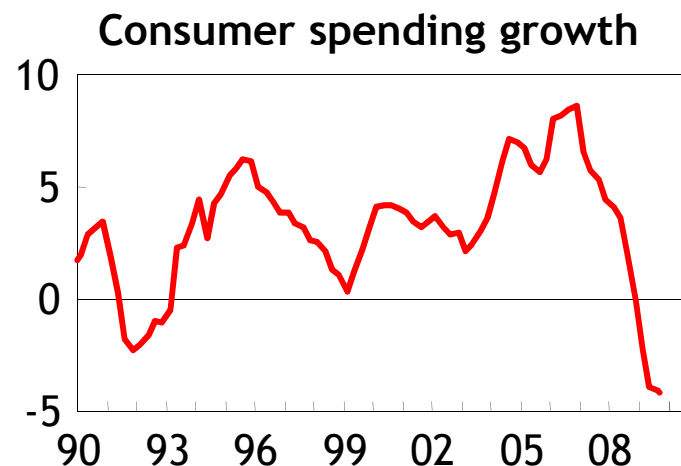
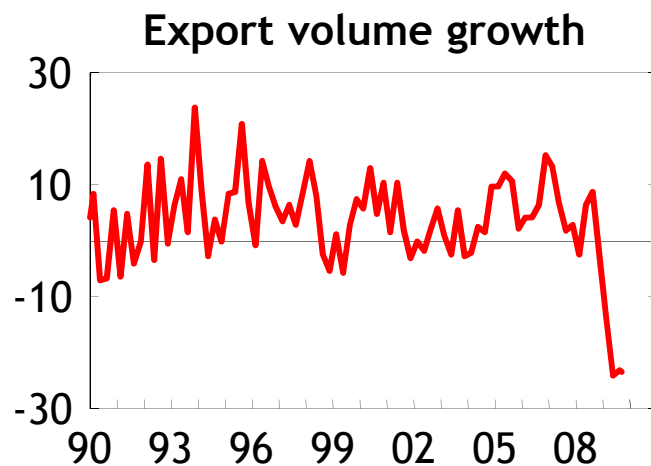
Johann Els

South Africa Looking back at 2009 - a year of big macro-economic surprises

- ***Growth*** weakened much more than expected (especially HCE & exports)
- ***Current account*** narrowed much more than expected
- ***Rand*** firmed much more than expected
- ***Budget deficit*** widened much, much more than expected
- ***Inflation*** fell less than expected
- ***Interest rates*** fell more than expected

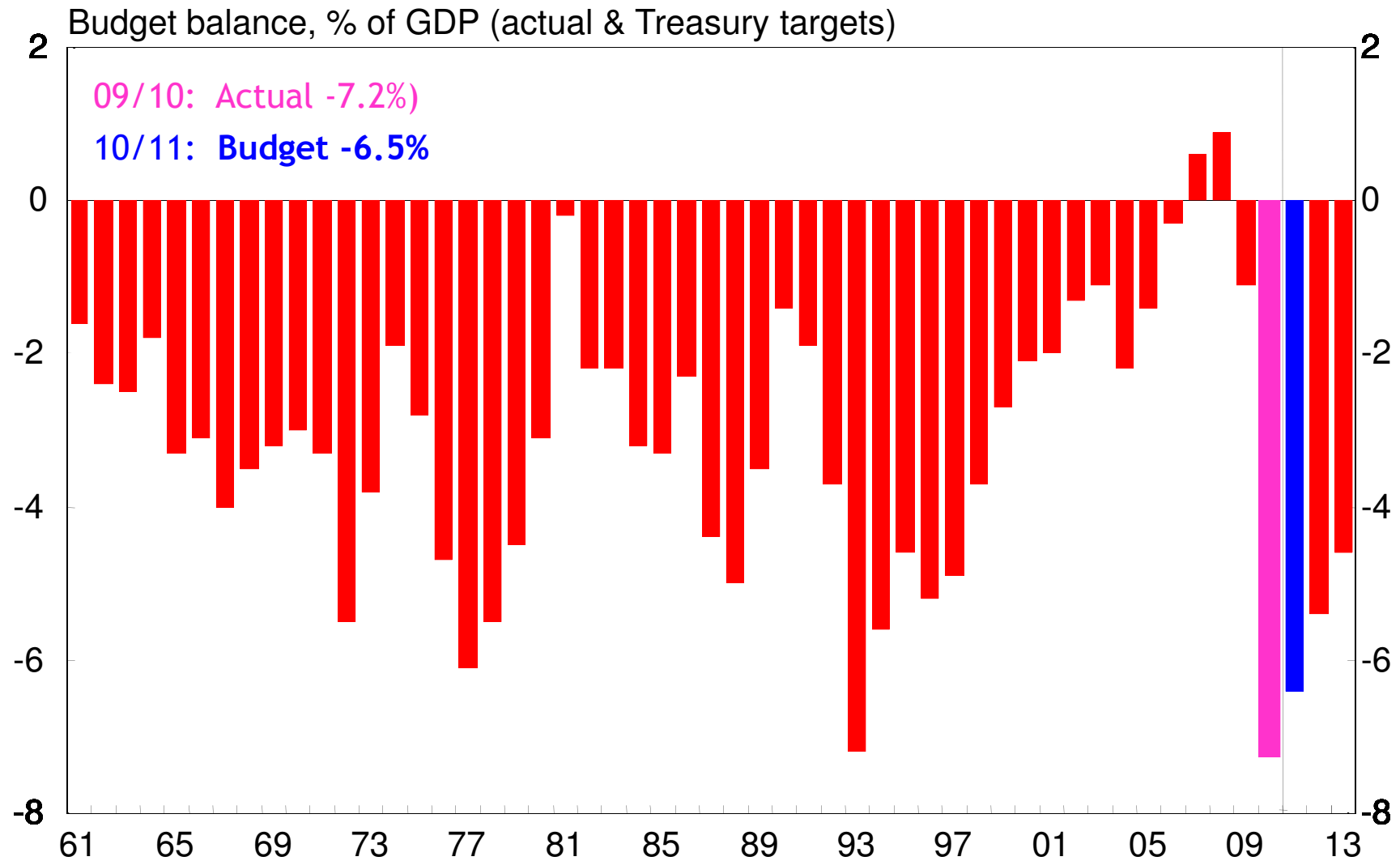
- **Will 2010 be more predictable?**

Last year's growth drags



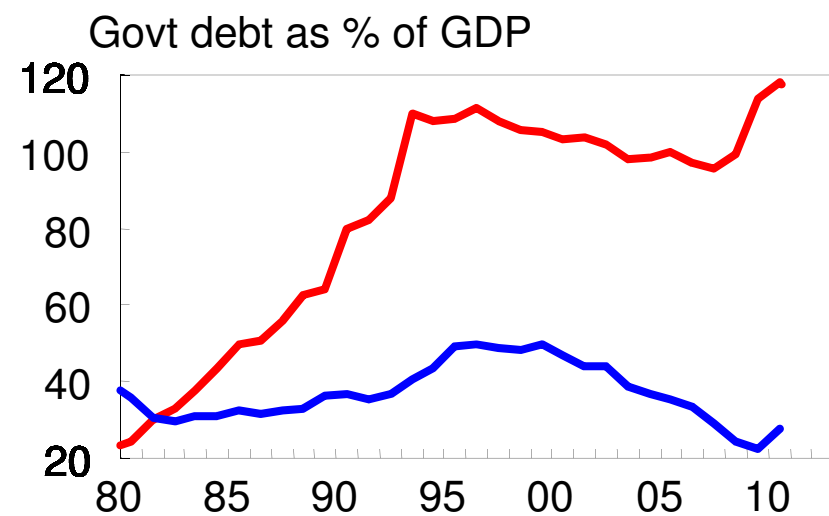
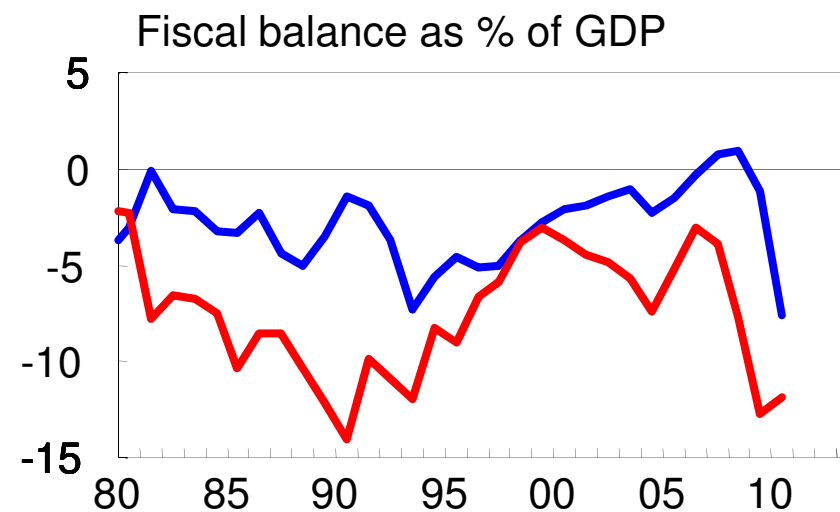
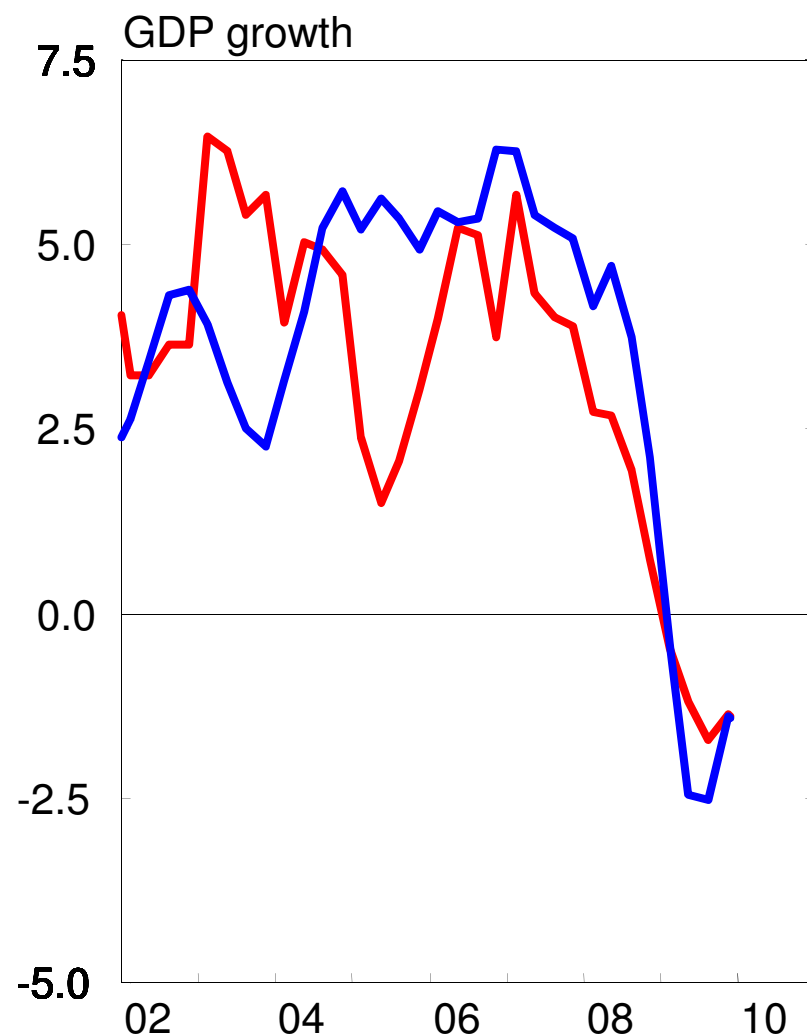
- **Main features**
 - Deficit direction
 - SA's relative fiscal position healthy
 - Budget also growth supportive
 - CPI target unchanged
 - Reserve bank's mandate unchanged
 - No “pegging” of the Rand!
 - No tax surprises
- **Other features**
 - Tax relief for individuals
 - Slower expenditure growth next few years
 - Conservative assumptions
 - NHI to be investigated further

Fiscal deficit trend to improve



SA looking much better than some other economies

Greece South Africa



PIGIS' troubles

(Portugal, Ireland, Greece, Italy, Spain)

	Current account balance, % of GDP, 2009	Budget balance, % of GDP, 2009	Public debt, % of GDP, 2009	Public debt service, % of GDP, 2010
Spain	-6.1	-11.4	55.2	4.7
Italy	-3.5	-5.4	113.9	14.1
Greece	-11.9	-12.7	113.4	11.6
Portugal	-10.1	-9.3	76.6	3.9
Ireland	-3.0	-11.6	64.5	6.2
SA	-4.5	-7.6	29.2	2.9

Weak growth aggravates PIGIS' debt trouble

reducing deficits is hard if the economy is not growing

	GDP growth 2007 actual	GDP growth 2008 actual	GDP growth 2009 estimate	GDP growth 2010 forecast	GDP growth 2011 forecast
Spain	3.6	0.9	-3.6	-0.6	1.1
Italy	1.5	-1.0	-4.8	1.3	1.6
Greece	4.0	2.0	-1.2	-0.3	1.6
Portugal	1.9	0.0	-2.7	0.9	1.2
Ireland	6.0	-3.0	-6.7	0.2	1.7
SA	5.5	3.7	-1.8	3.5	4.0

▲ Growth:

- Private sector demand weak for another quarter or so
- Public sector, exports and inventory cycle now lending support
- Inventory cycle can deliver strong boost to production side of the economy
- Growth momentum to accelerate from Q2
- Upside surprise possible from Q2: *we have above consensus 2010 forecast*

▲ External accounts & ZAR

- Current account deficit to widen moderately through 2010
- ZAR should have weaker bias (eventually - we still think it is 'too strong')

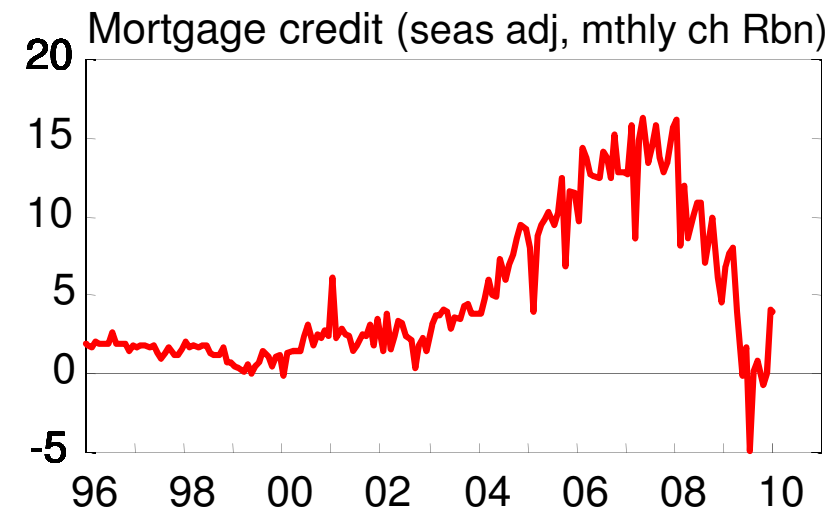
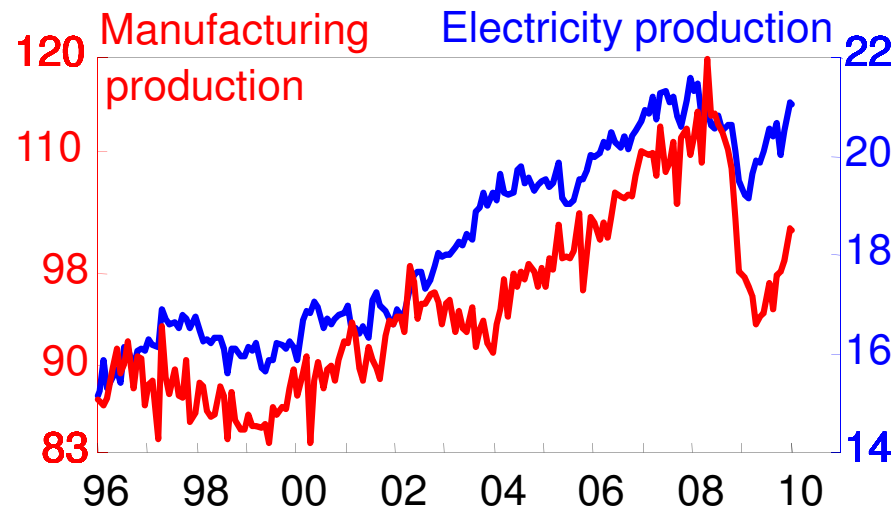
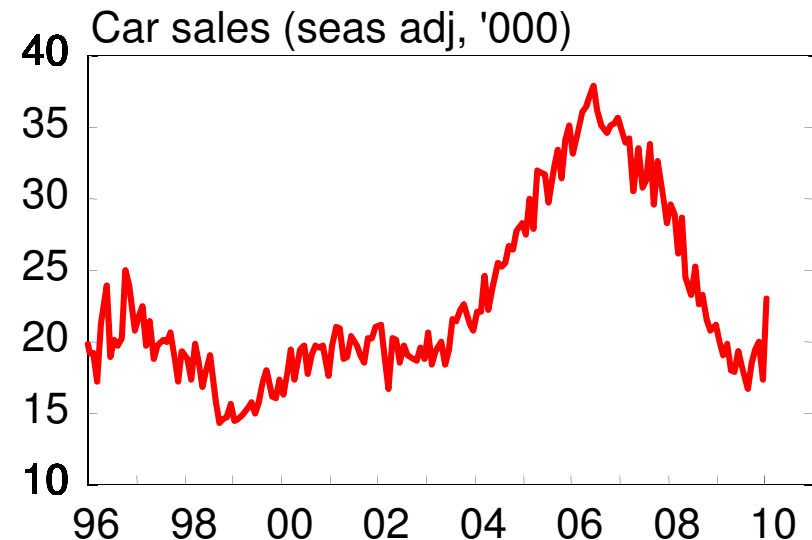
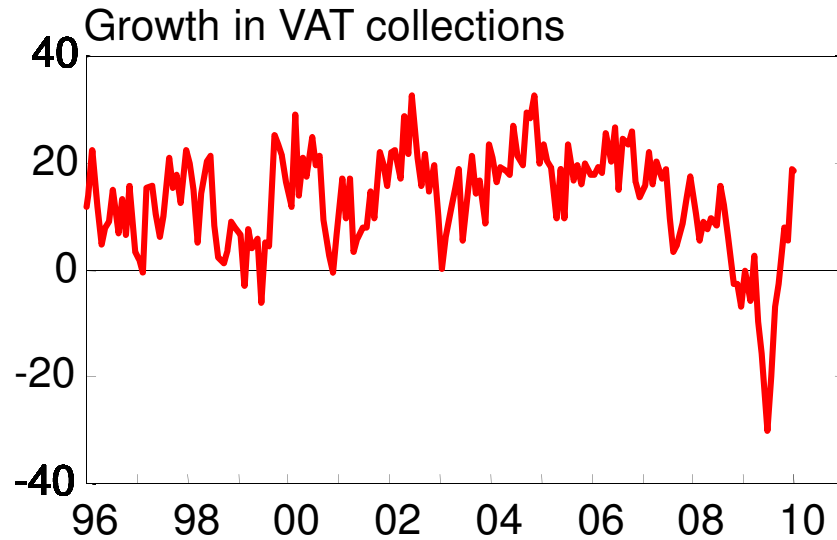
▲ Inflation

- To dip into range, stay just inside, barring any shocks (oil, ZAR, food)
- Medium term prospects still a concern

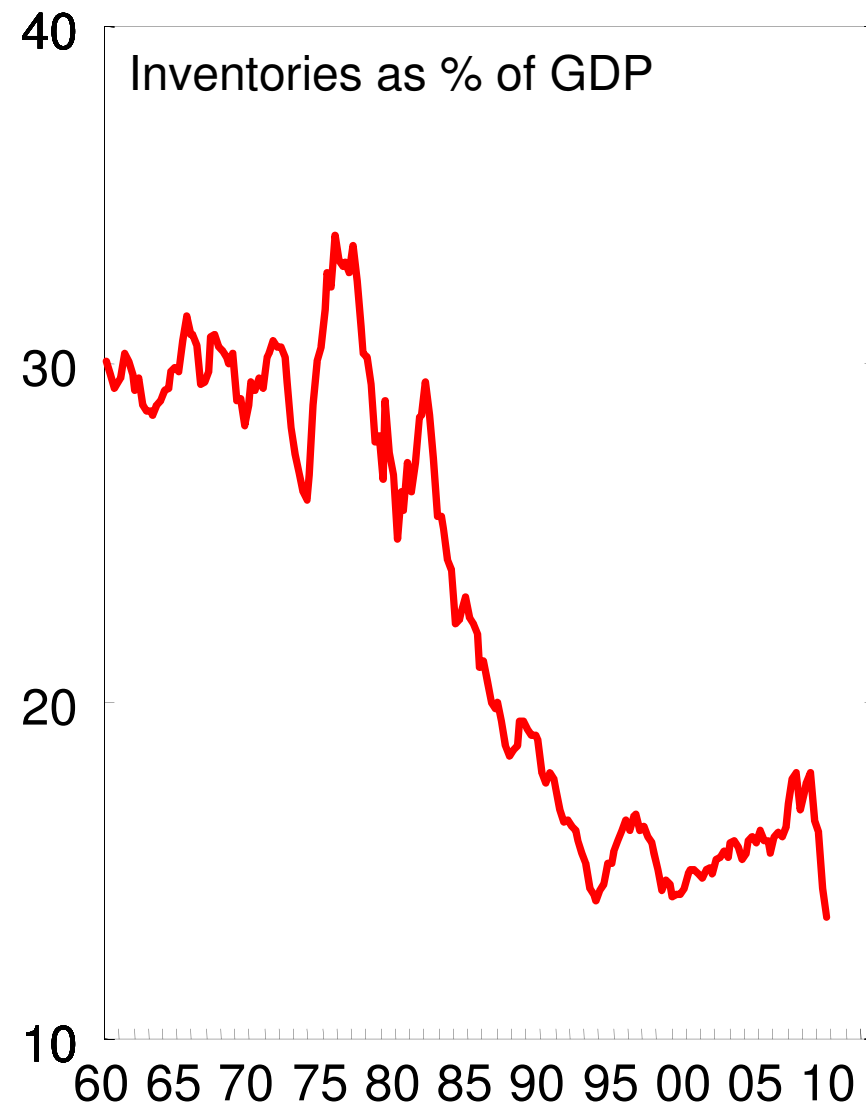
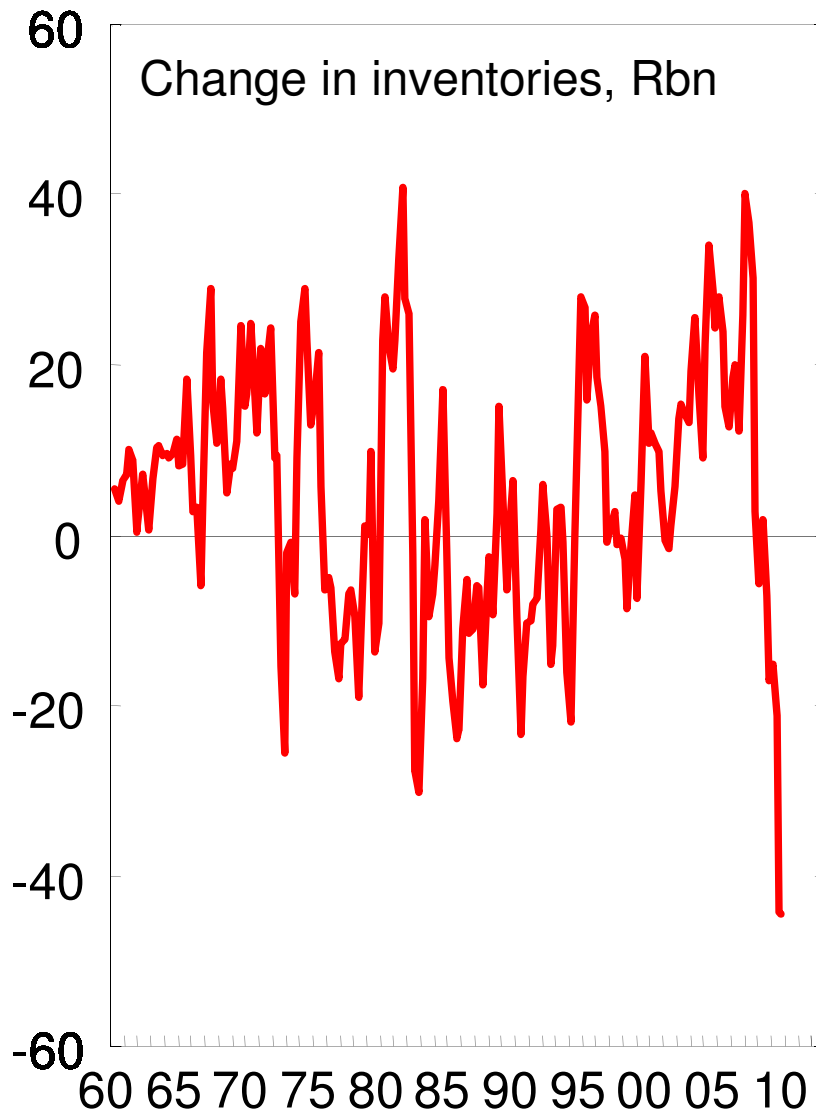
▲ Interest rates

- Some chance of another cut
- Rates to remain flat likely through 2010

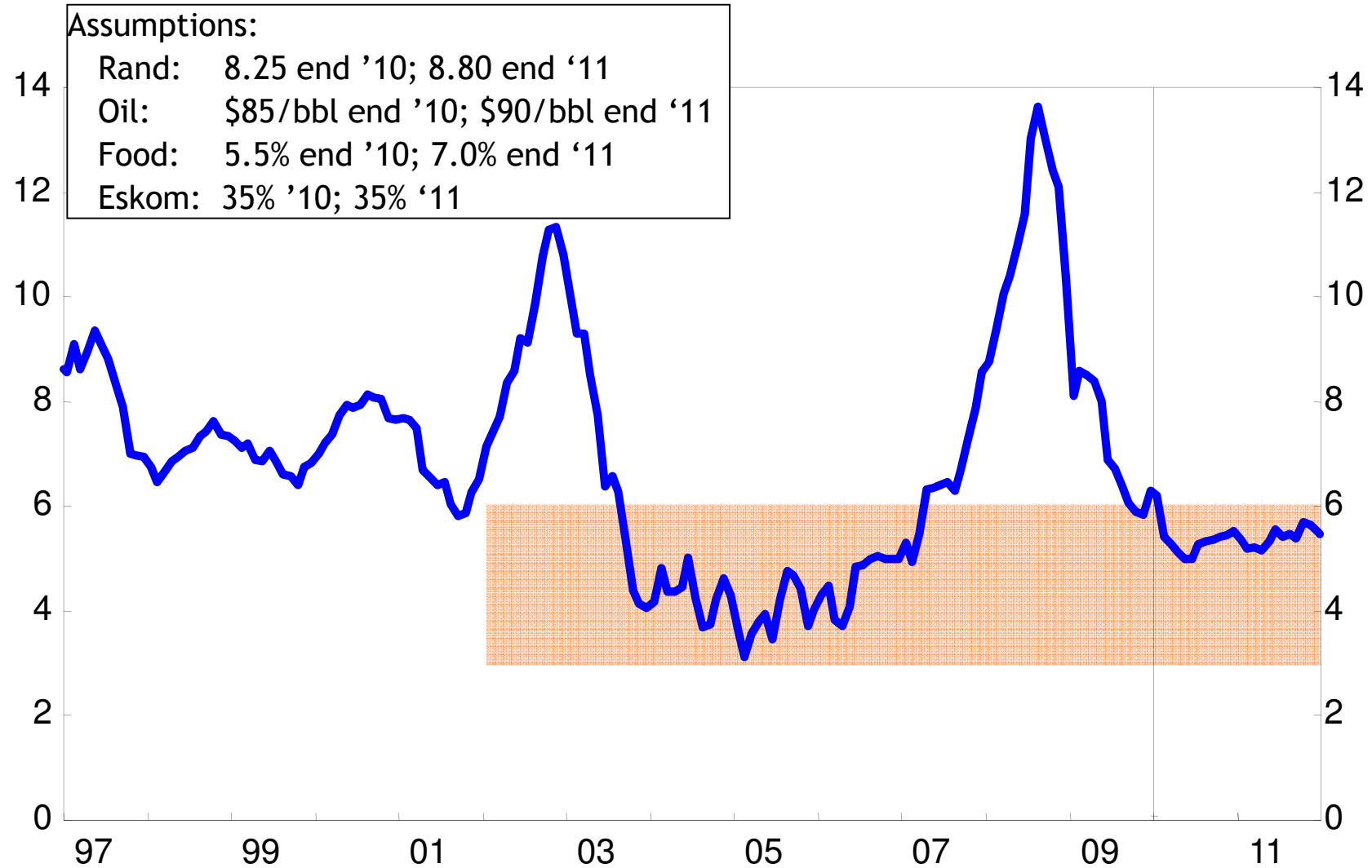
SA economy looking up



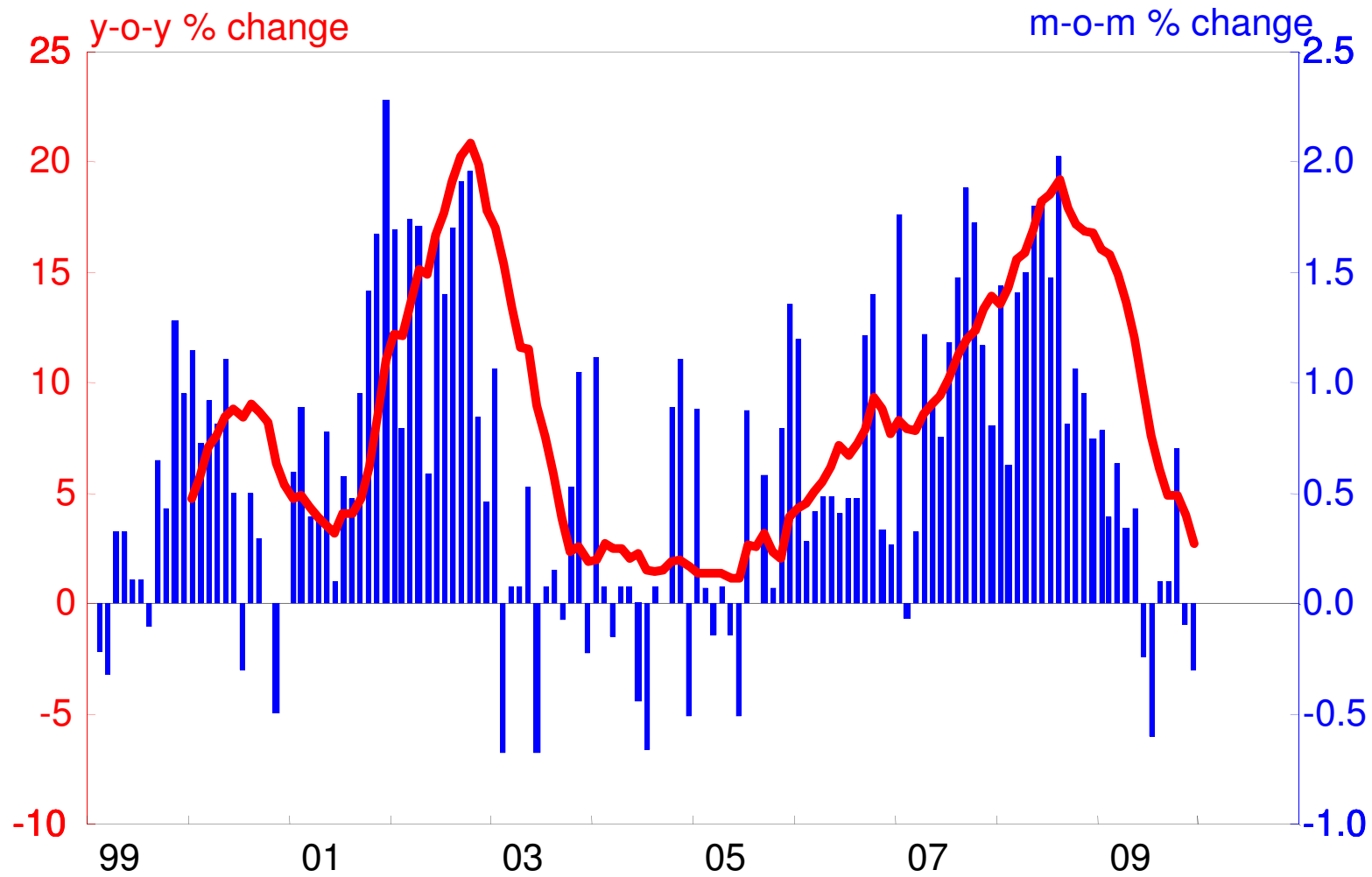
Inventory cycle could support production more than expected in 2010



No change to inflation target

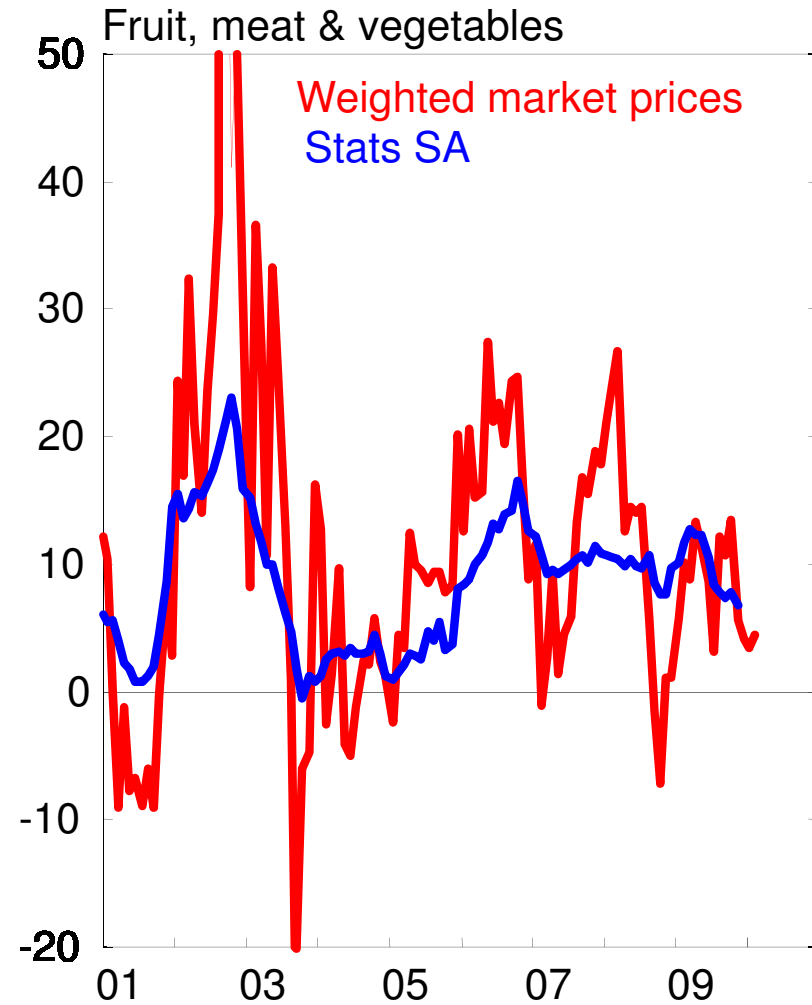
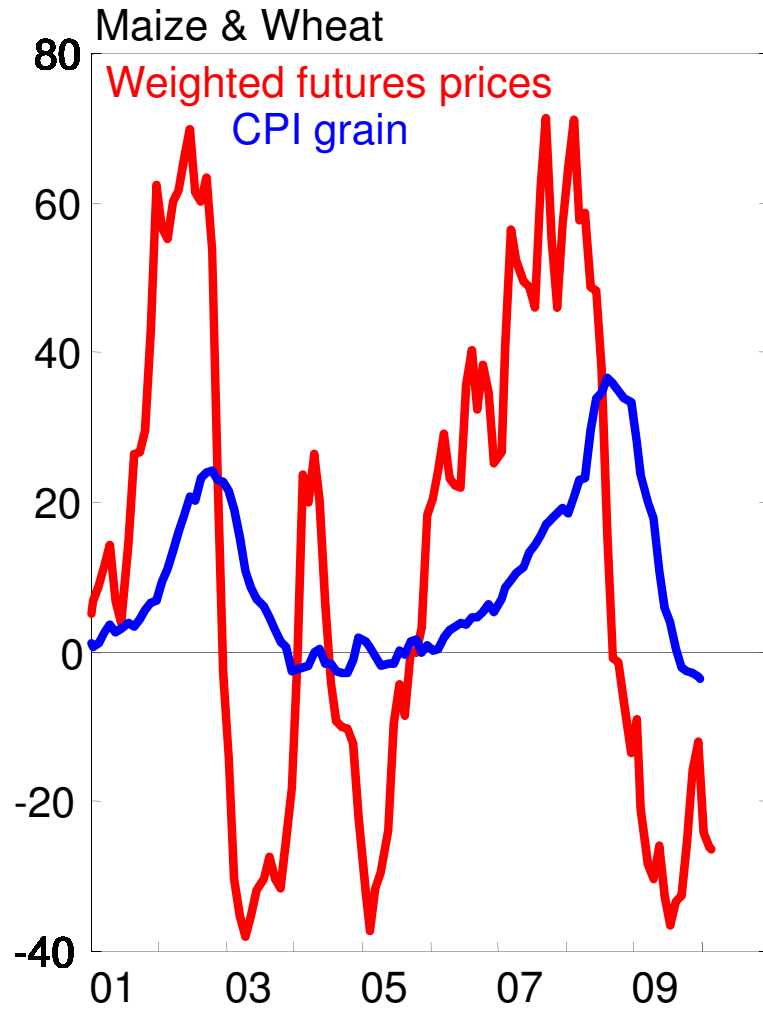


CPI food inflation



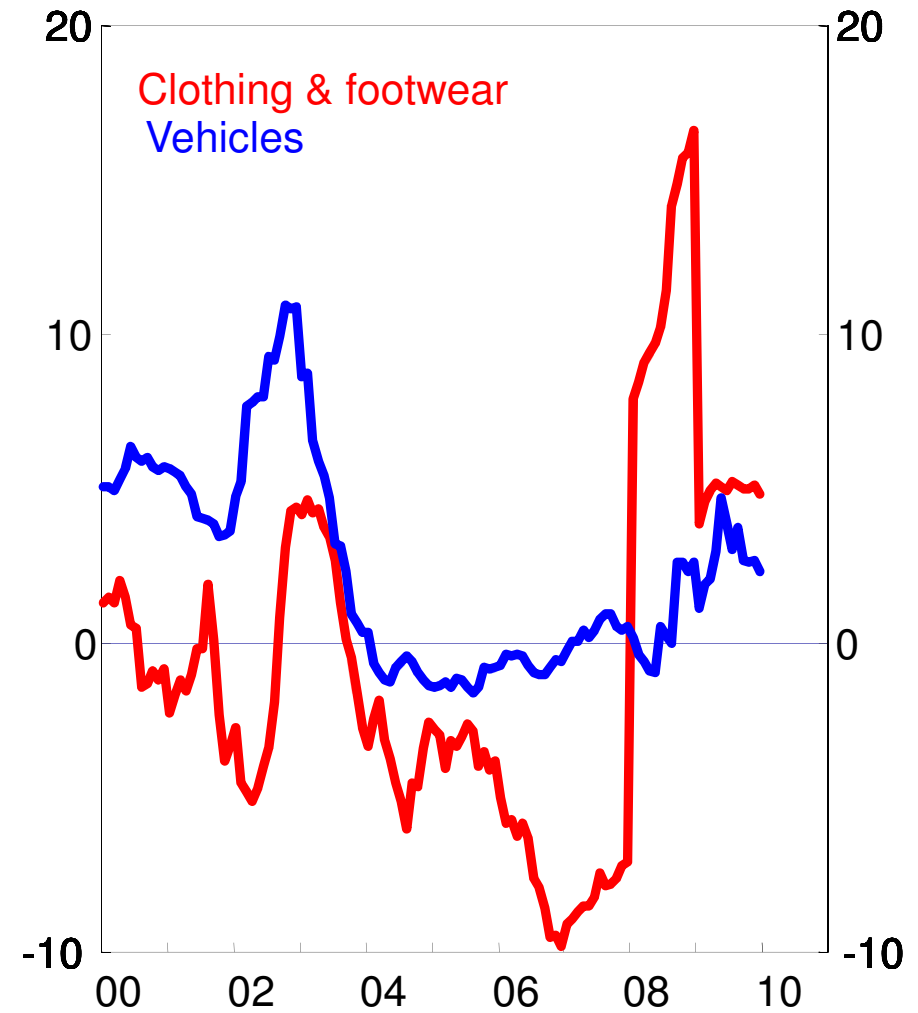
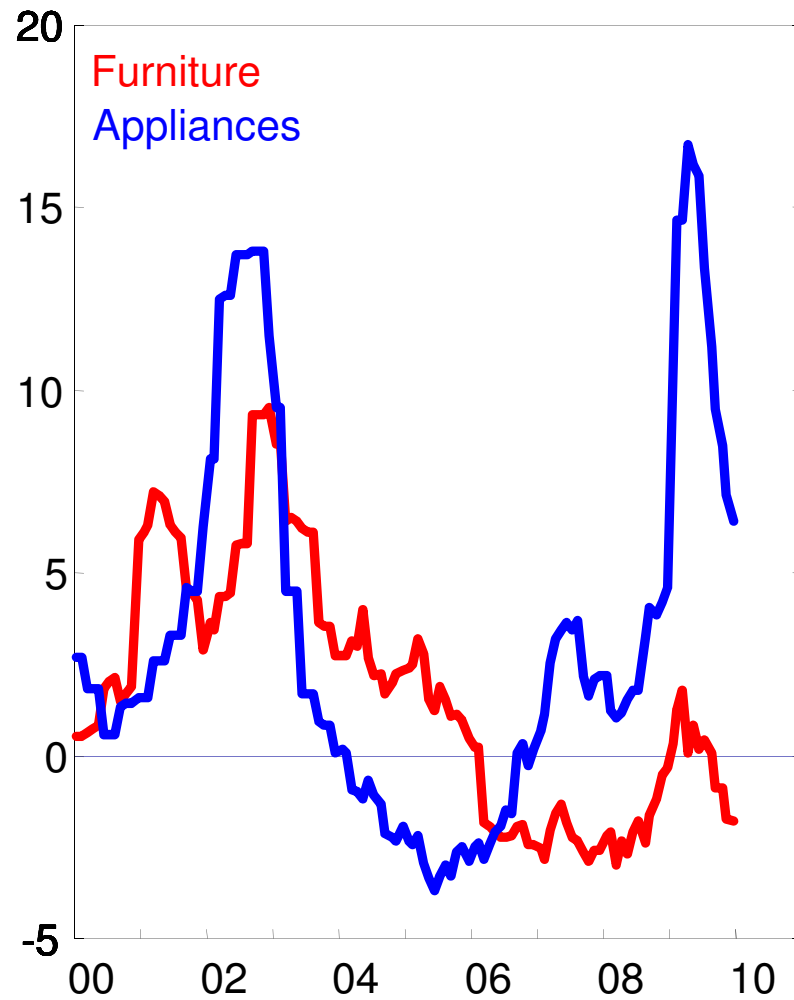
Food price trends

Y-o-y % change

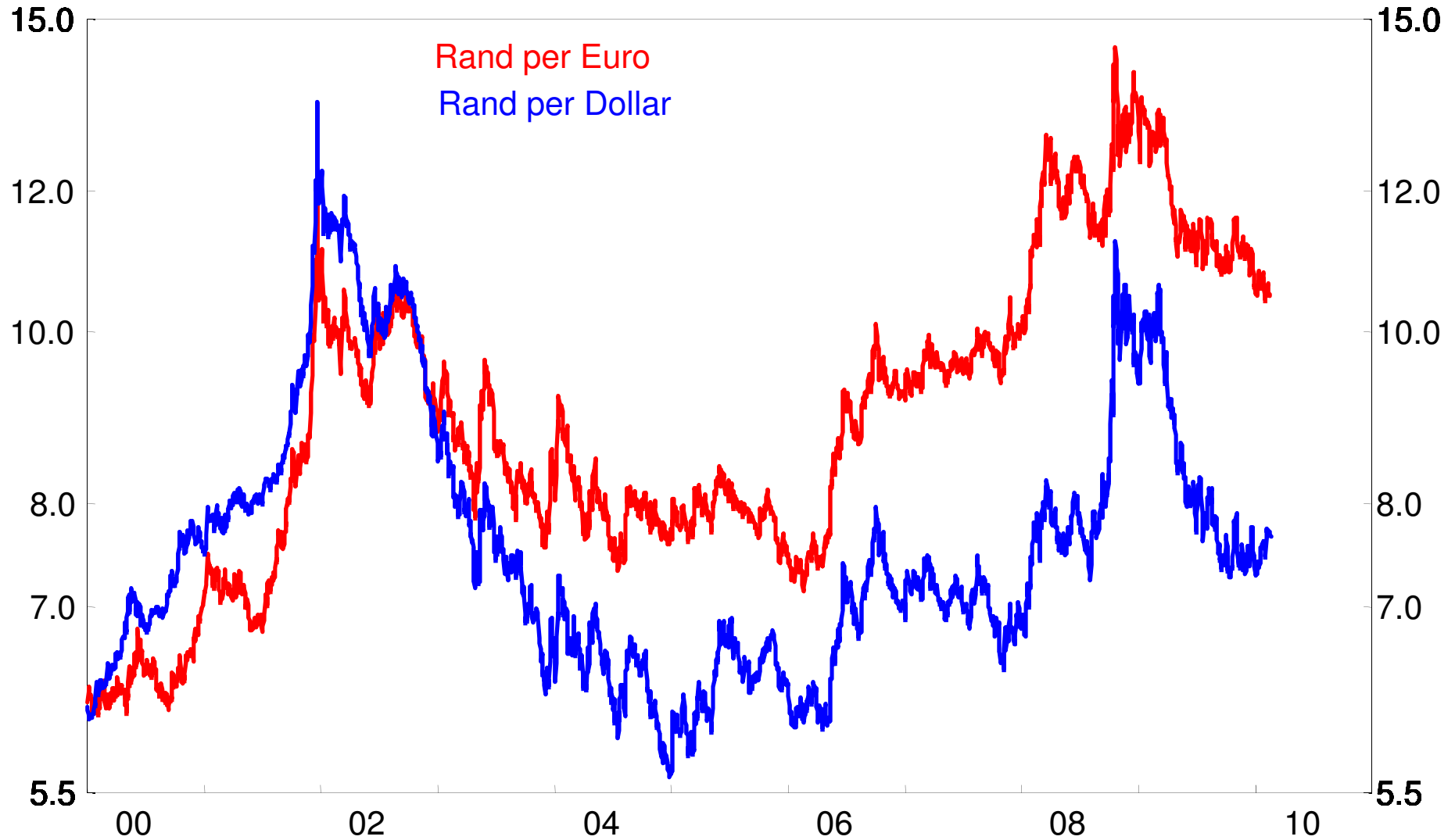


Goods inflation rates

Y-o-y % change

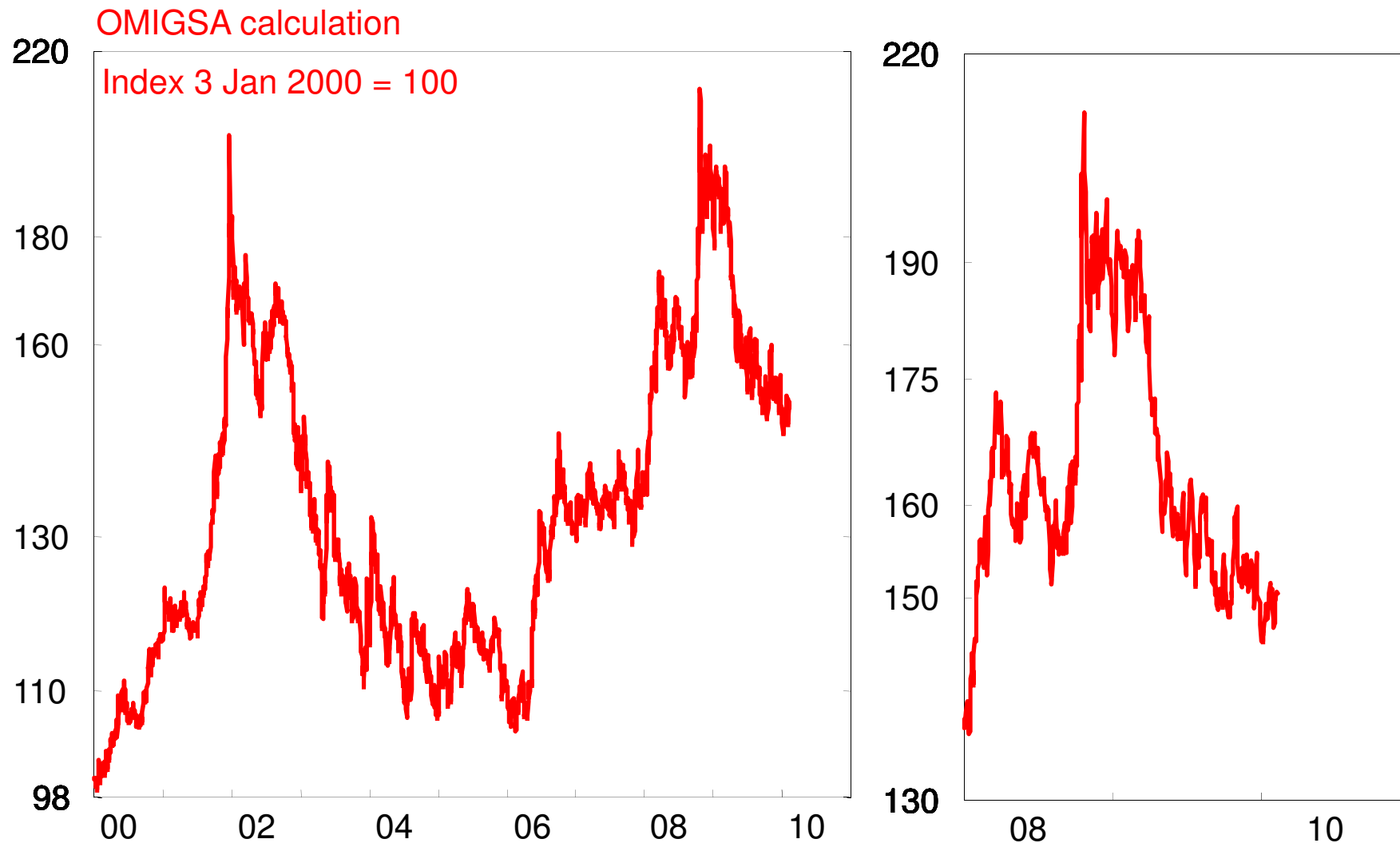


No “pegging” the Rand



Rand is holding firm

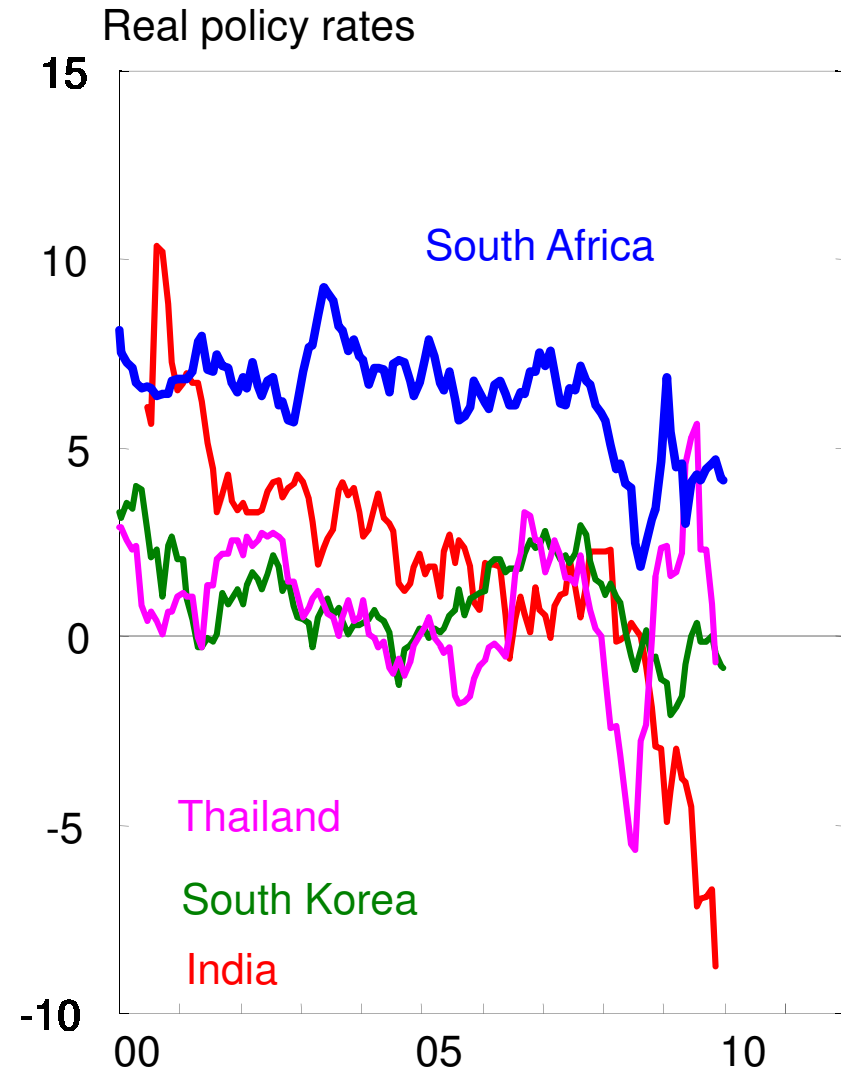
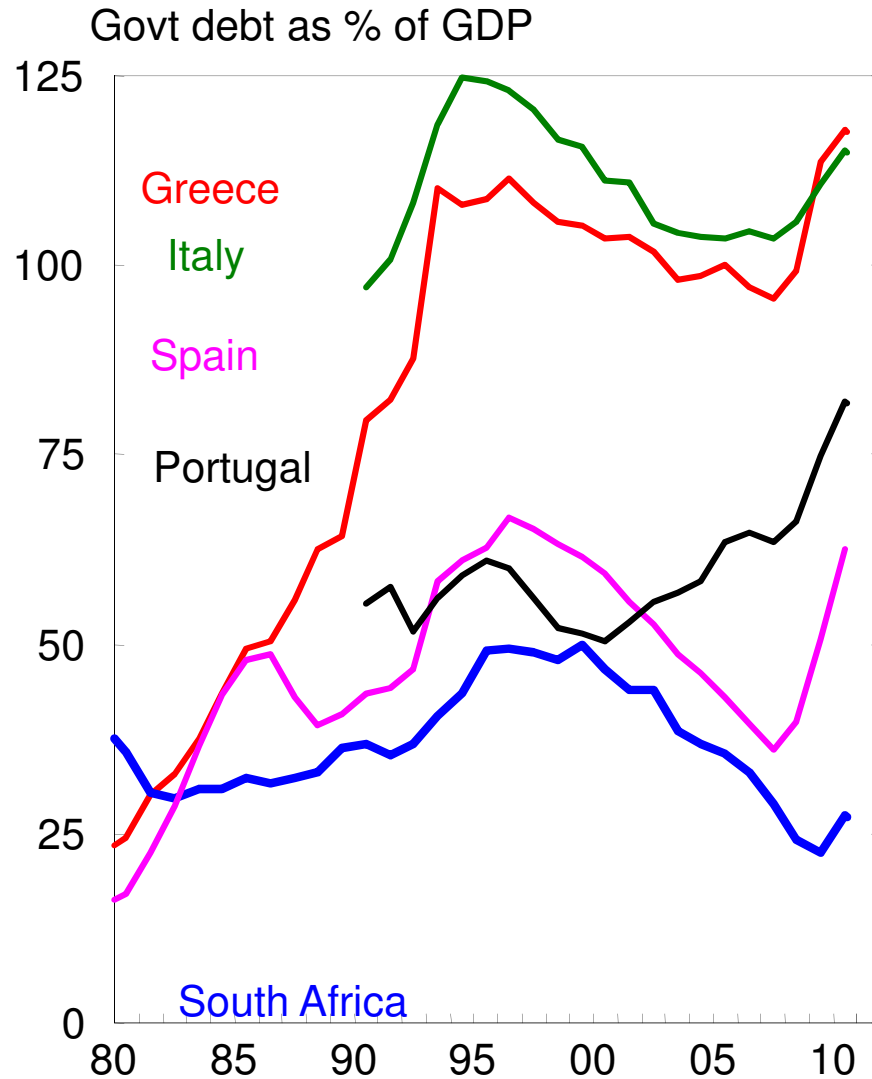
Nominal trade weighted Rand



Why has the Rand behaved so well?

- ▲ Combination of: fiscal situation, real rates, growth outlook
- ▲ Fiscal situation
 - SA Budget deficit large, but...
 - Govt debt level & debt service still low
 - Public commitment from Govt to lower the deficit back over time (Budget delivers good intentions, must be met)
- ▲ Real rates
 - ▲ Still relatively high in global context
 - ▲ So, less need to tighten (harming growth outlook)
- ▲ Growth prospects
 - Economy to grow faster 2009/10, good for revenues

Thanks to healthy fundamentals



SA Summary

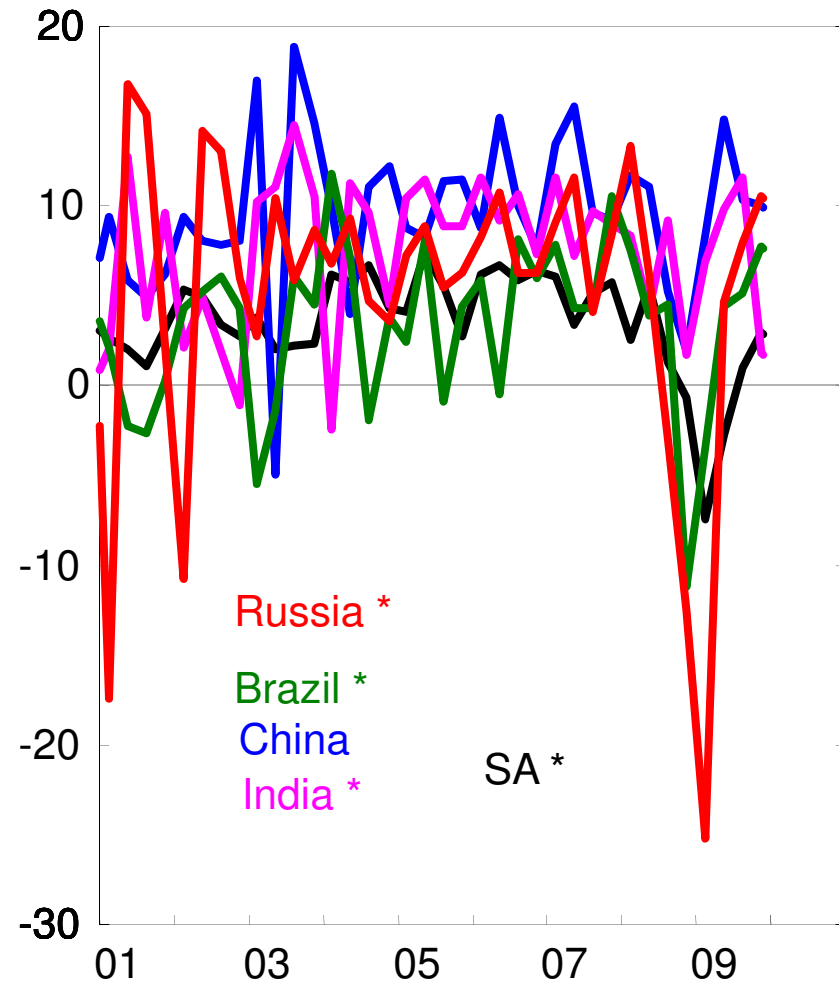
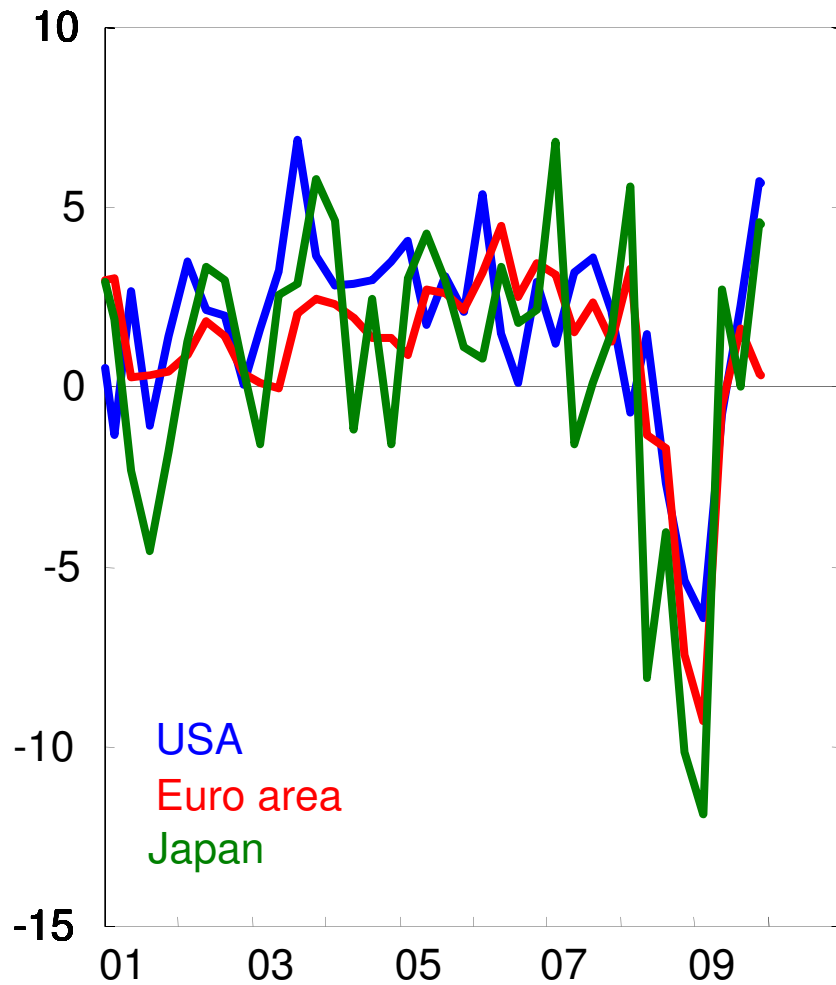
- Economy recovering, still unevenly & slowly:
 - But already starting to gather momentum?
- Inflation sticky, outlook improving a bit on the margin
- Current account improving as imports remain depressed, exports recover moderately
- ZAR firm, may remain so for a while longer

Global economy: What was the key call and its implications in 2009?

- Global recovery would be V-shaped (at least initially)
 - Driven by policy stimulus, slower inventory cutbacks, foreign trade recovery
- Drove investors out of panic mode into renewed risk appetite

Sharp slump, sharp recovery

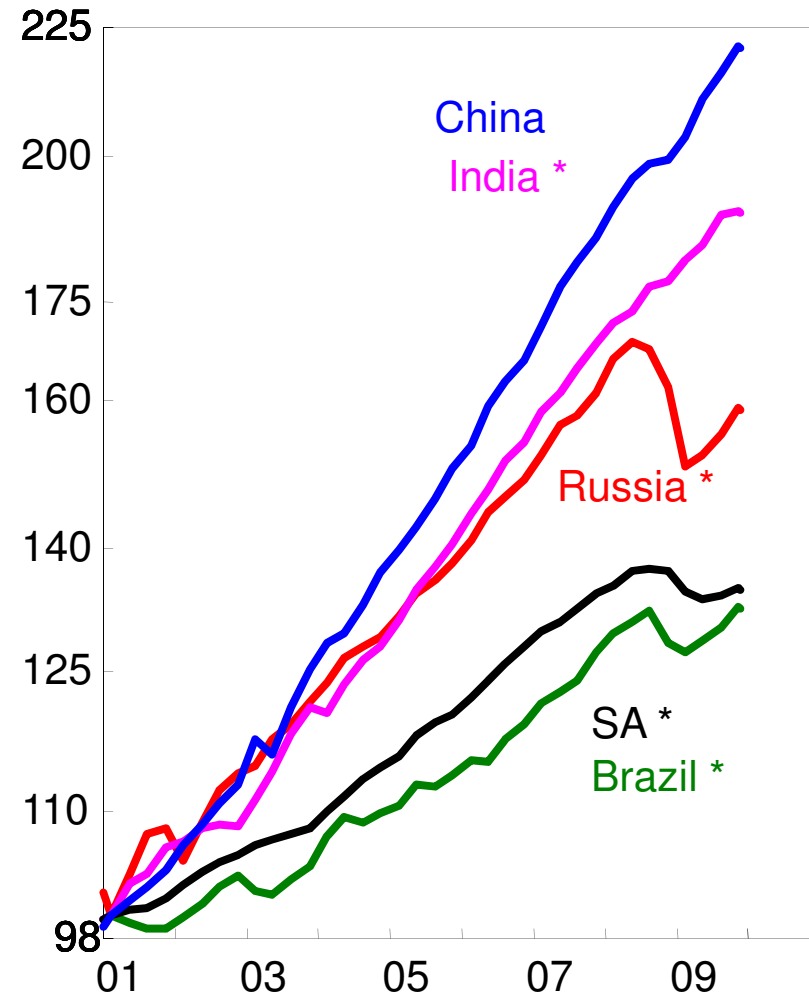
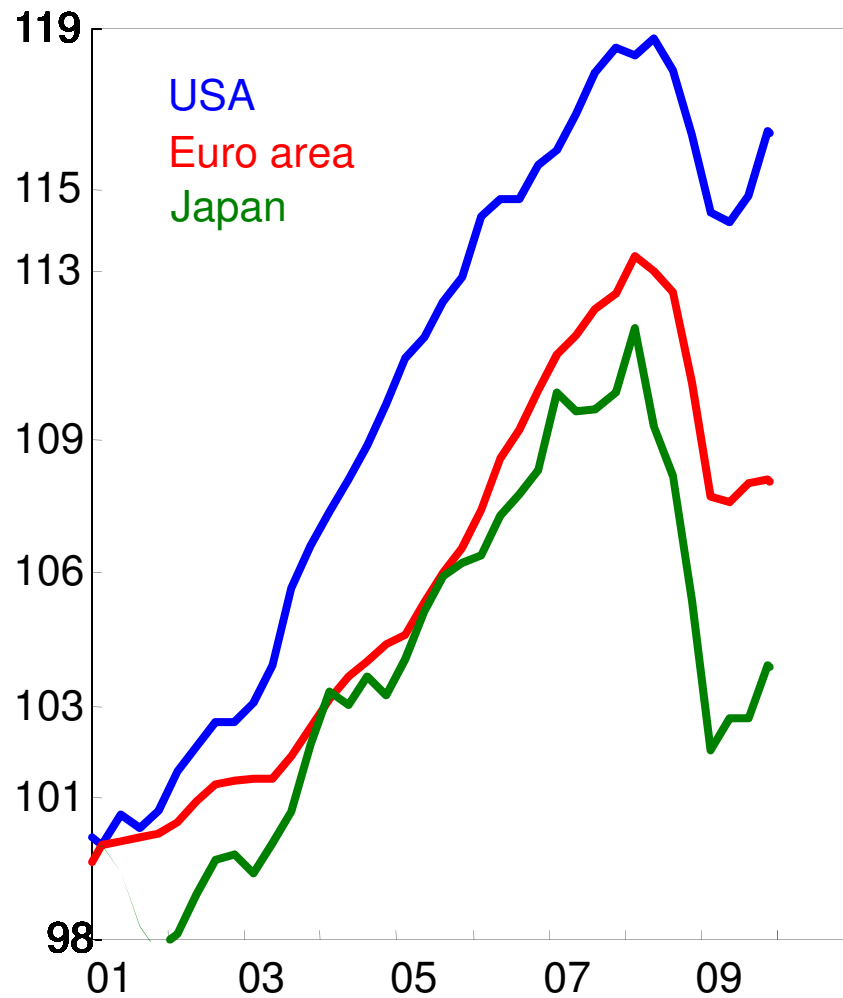
GDP growth quarter on quarter annualised



* indicates Q4 '09 data are estimates

But look at the levels!

Real GDP levels (index 2000 = 100)

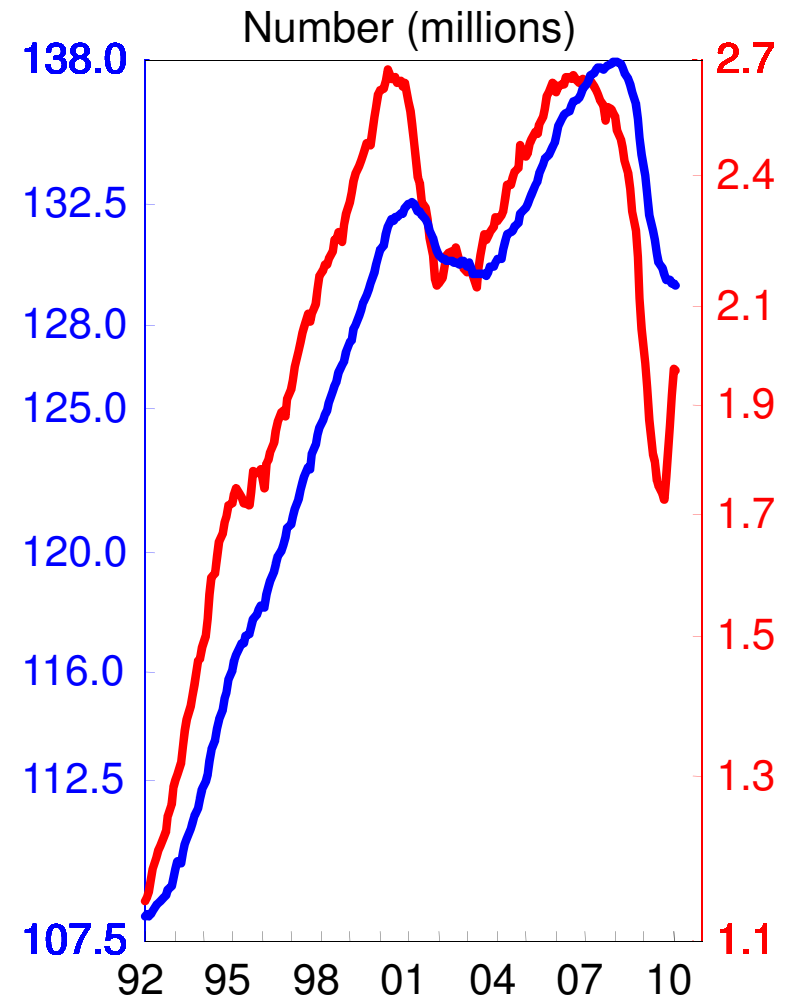
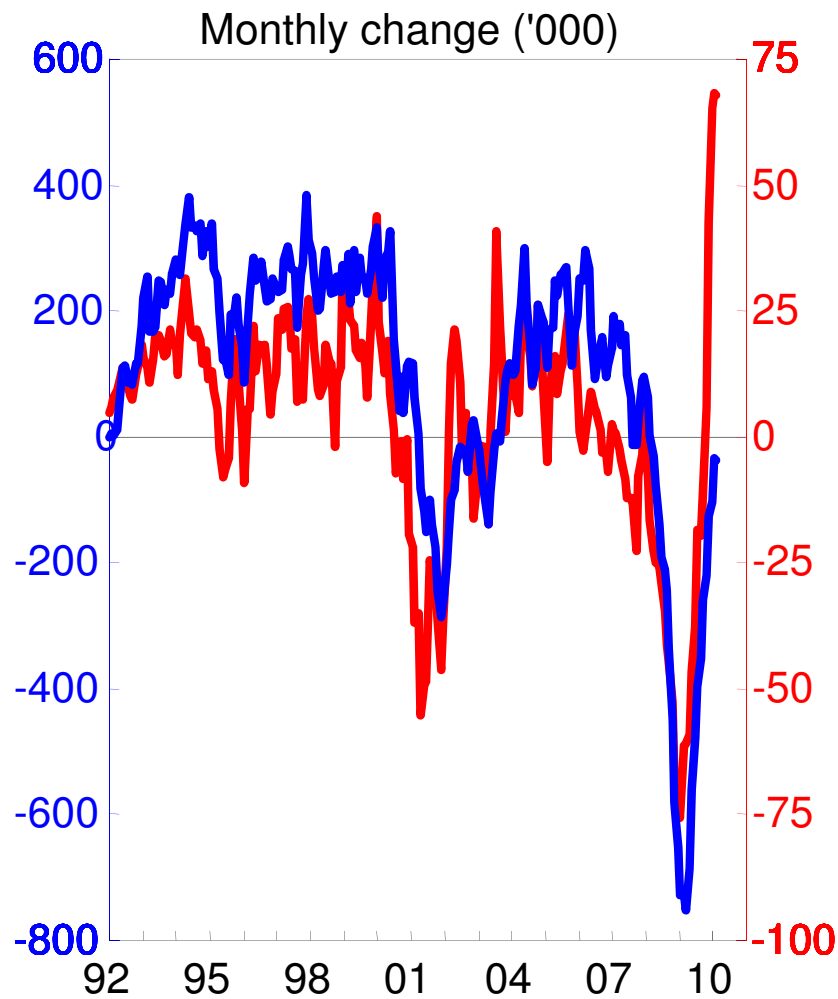


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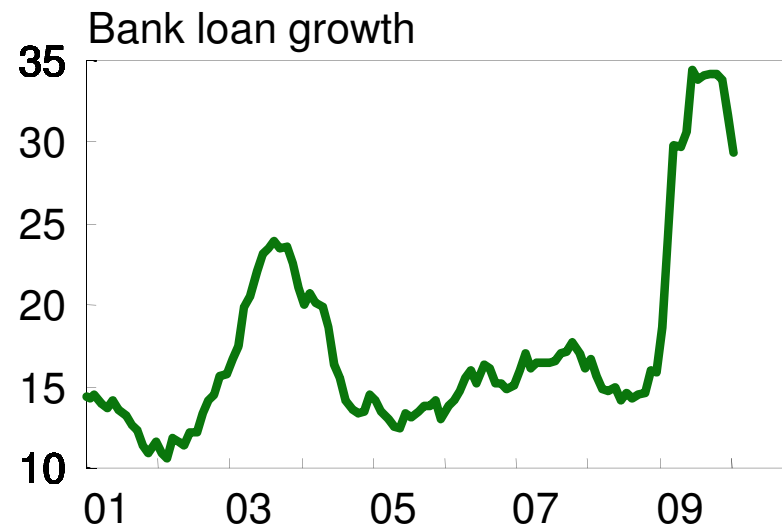
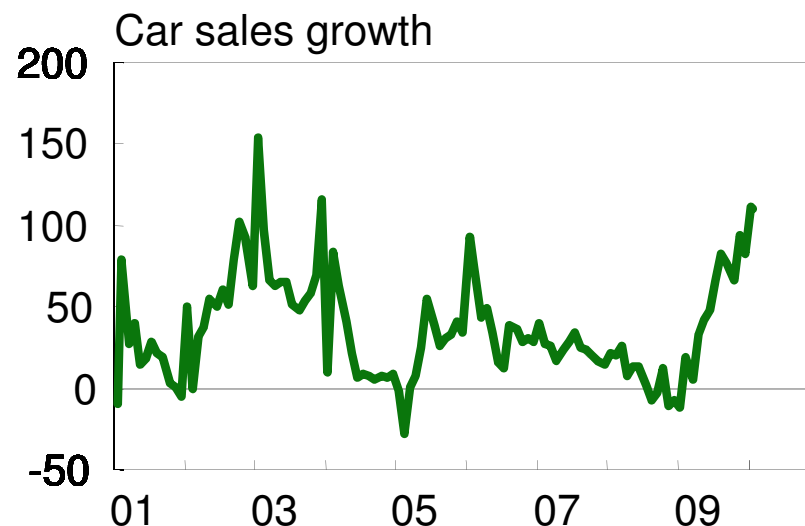
- **Global recovery: Boom, moderate growth or renewed downturn?**
 - Recovery will be sustained (why?), but at moderate pace
 - Policy tightening will broaden in 2010, nature & tempo slow/well 'signalled'
 - W-shaped cycle risk small
- **Why sustained recovery?**
 - *Policy settings remain broadly expansionary*
 - *From recession drivers to growth drivers:* inventories, foreign trade, housing, labour markets & capex
 - Asset price recovery aiding required *balance sheet adjustments*
 - *China* set to sustain solid growth

USA employment recovery

Total non-farm workers Temporary workers

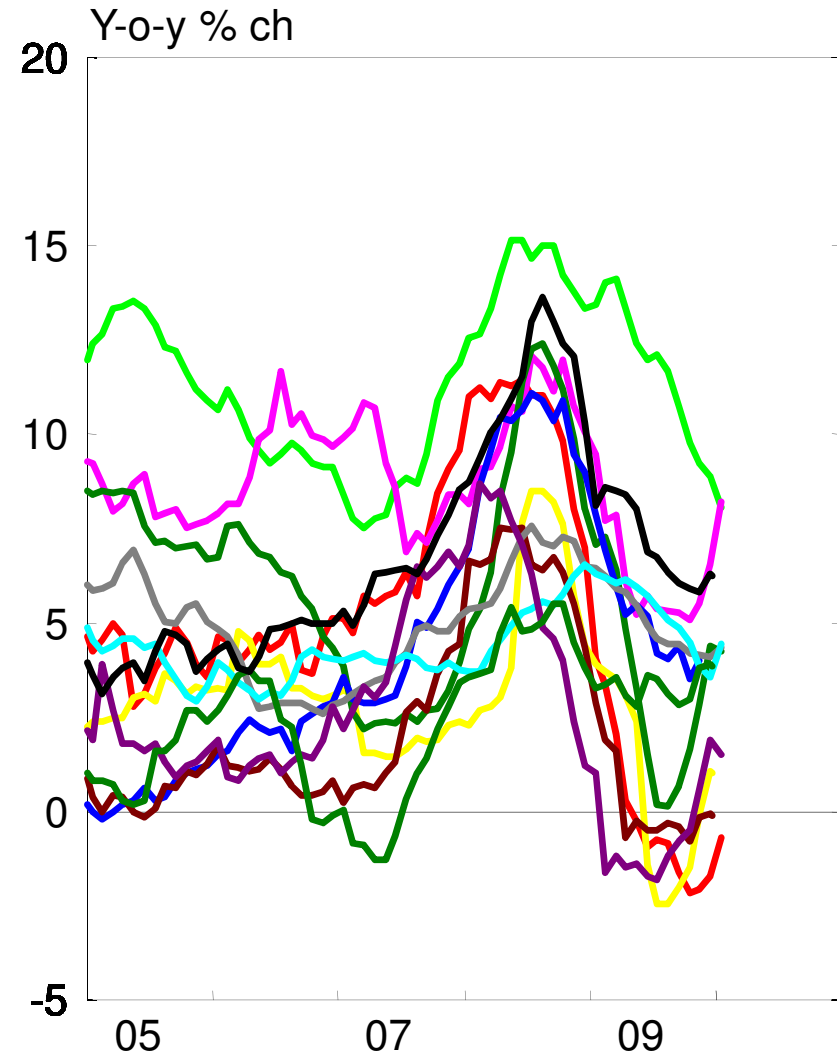
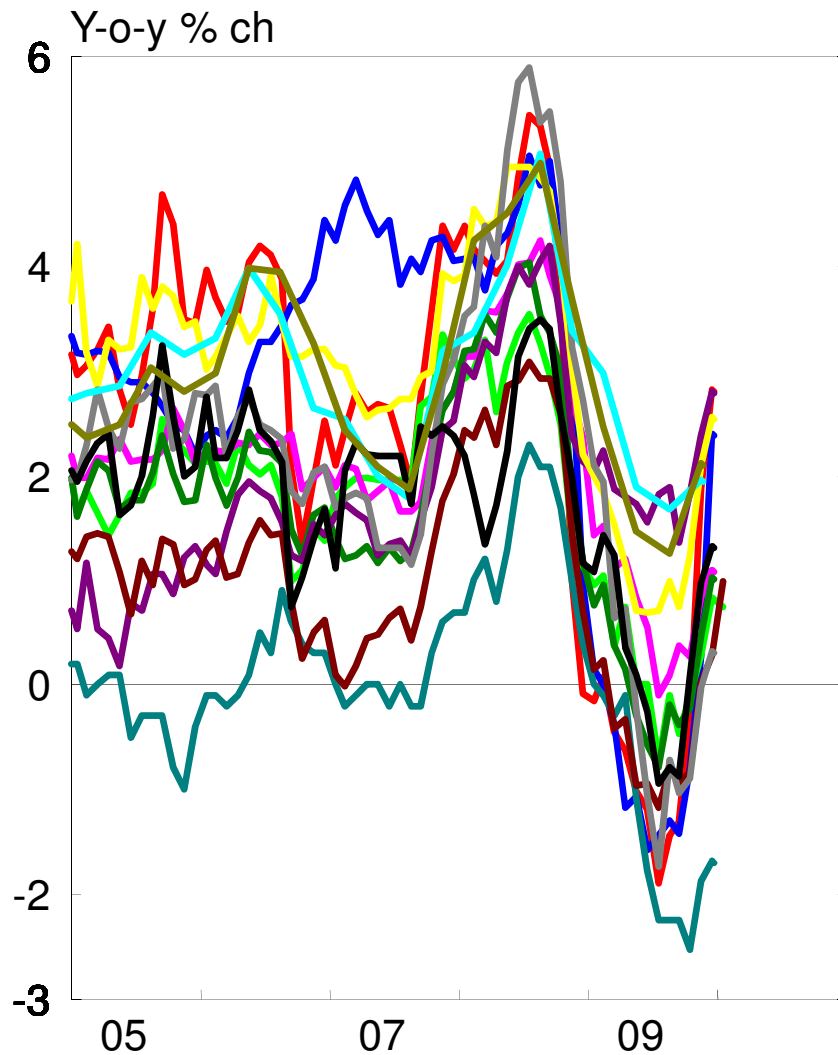


Chinese growth remains robust

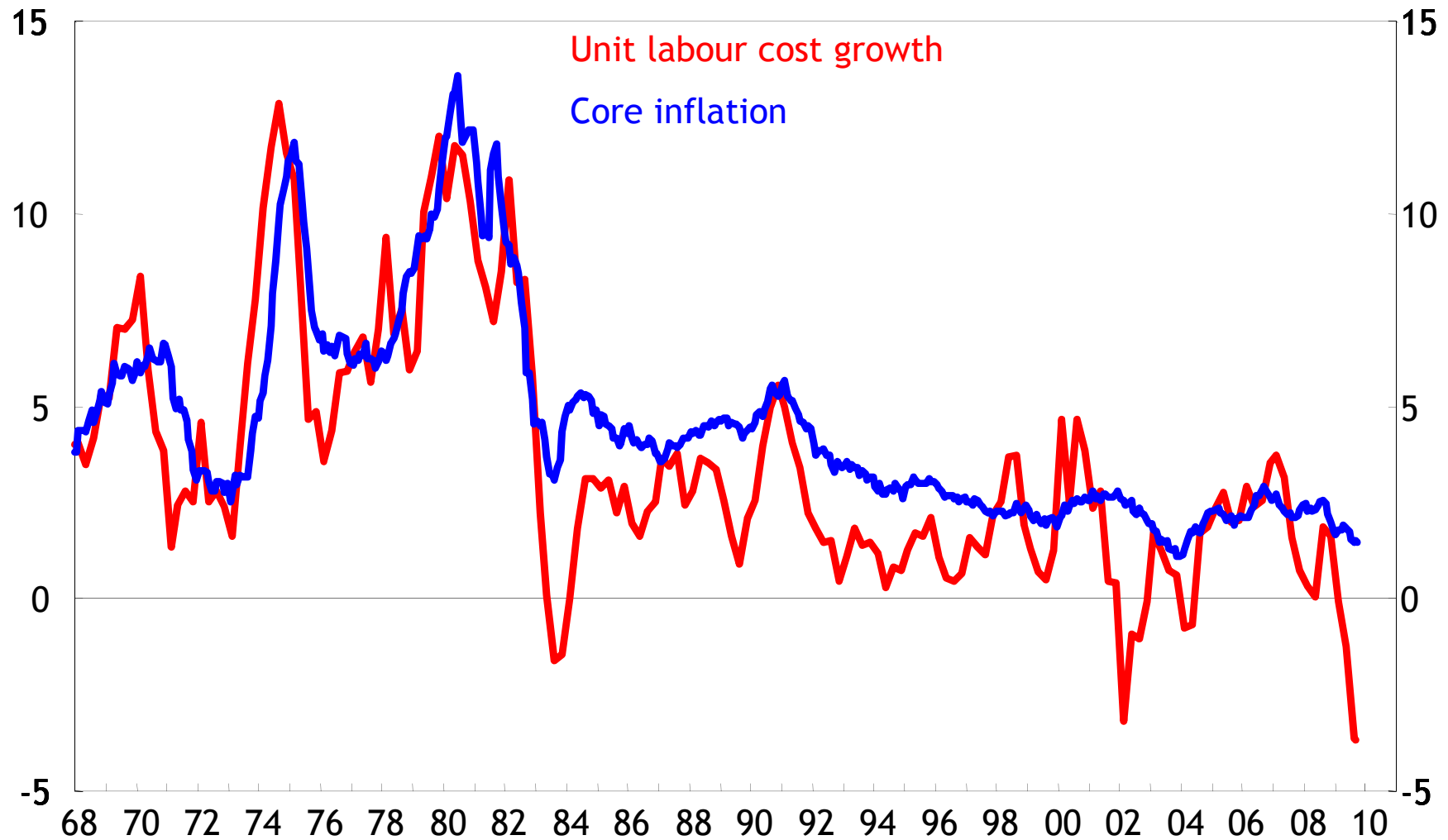


- Global recovery: Boom, moderate growth or renewed downturn?
- **Will inflation become a problem?**
 - Headline rates rising on commodity price recovery/base effects, core contained
 - No serious threat in 2010, some risks for 2011/12 (but worry more about policy?)

Global inflation picture



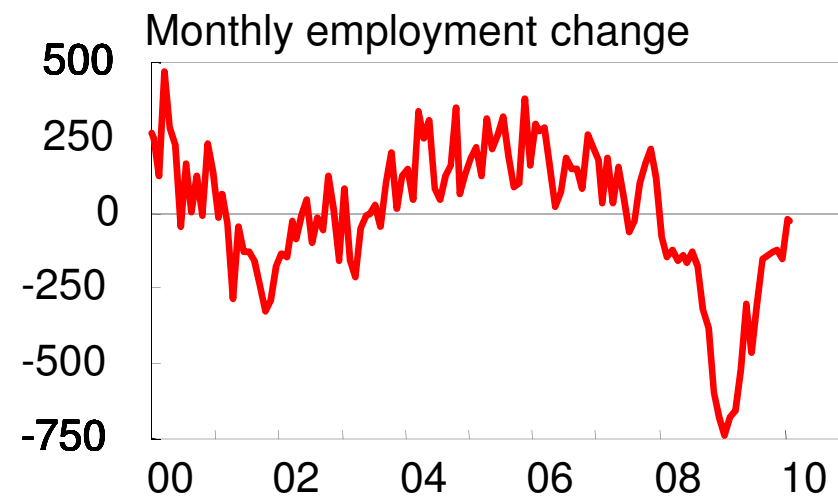
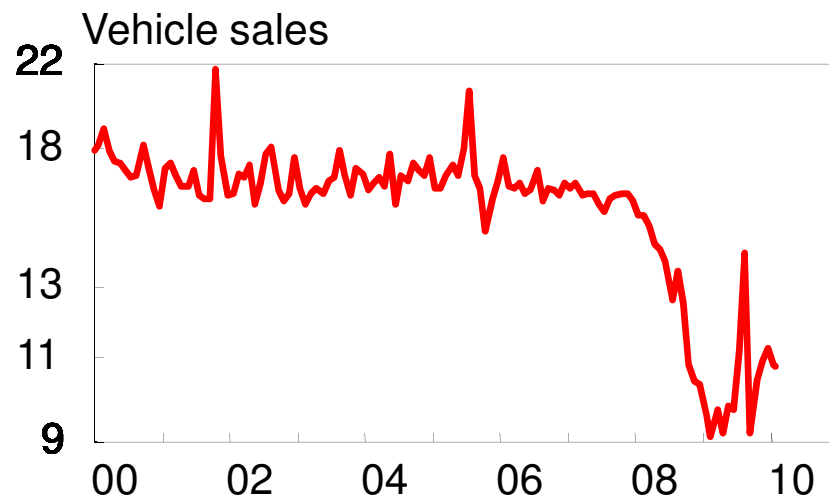
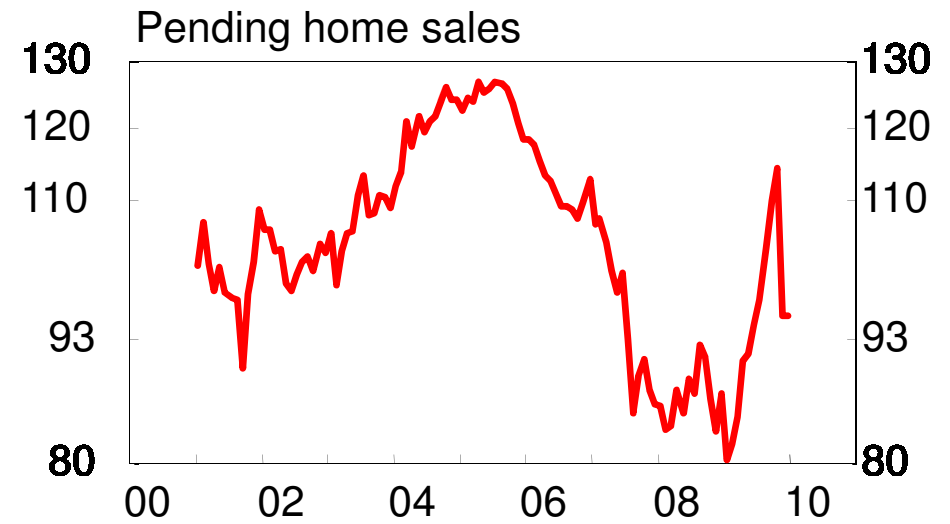
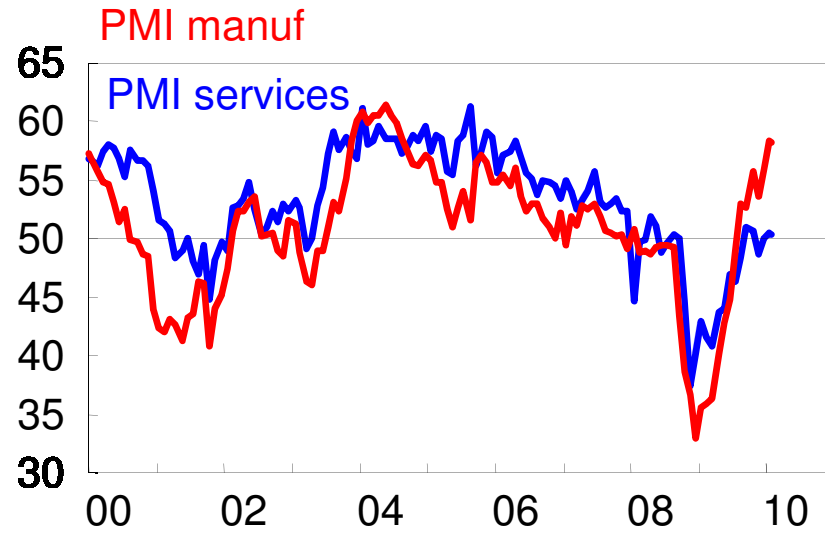
Collapsing effective labour costs keep core inflation under control - USA



- Global recovery: Boom, moderate growth or renewed downturn?
- Will inflation become a problem?
- **Are there any remaining serious potential shocks?**
 - Shocks can not be predicted, but there are remaining drags/risks
 - Key **drags**: pressured consumers, stingy banks, fiscal constraint coming
 - Key **risks**: country (fiscal), commercial property & policy error
 - No real loud voices about any specific looming large disasters, but some ‘mini-shocks’ still very possible

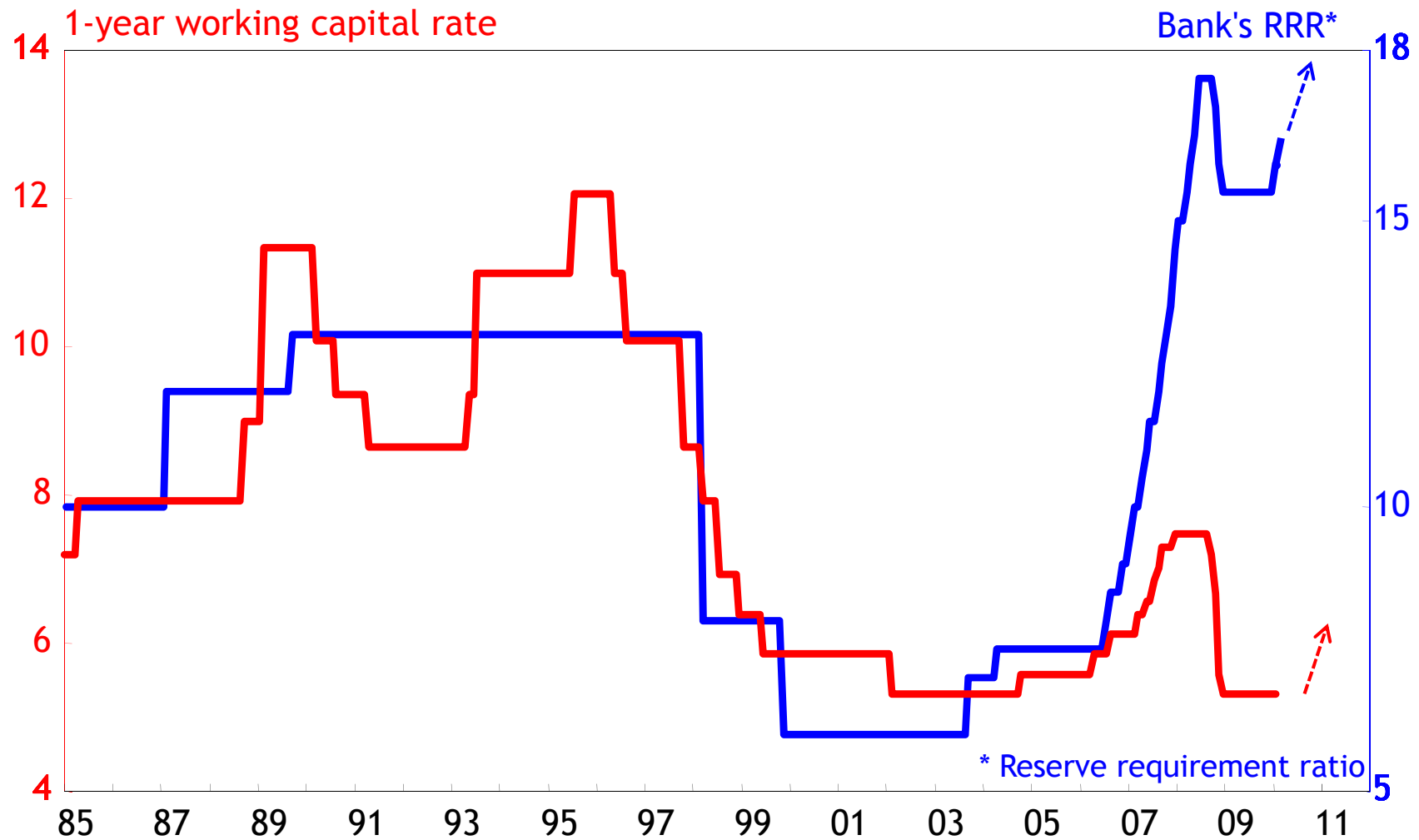
- **Slowdown worries**
 - Recent US, Eurozone, UK data softer than expected
 - Worries China's policy tightening will slow economy sharply
 - Worries that fiscal consolidation will inhibit growth more broadly too
- **PIGIS: (Portugal, Ireland, Greece, Italy, Spain)**
 - Panic Greece will default - deficit reduction plans viewed with scepticism
 - Growing view € too strong given region's troubles (ECB can't raise rates)
 - Worries over €-zone as an 'entity'
 - So, € fall no real surprise
- **Lingering policy worries**
 - Korea, India, Thailand inflation exceeds CB policy rates - rates to rise
 - China expected to tighten further
 - Fiscal tightening & medium term implications the key worry
 - Real policy rates also unsustainably low in many countries, need to rise

USA data soft past few weeks



Chinese authorities starts gradual tightening process

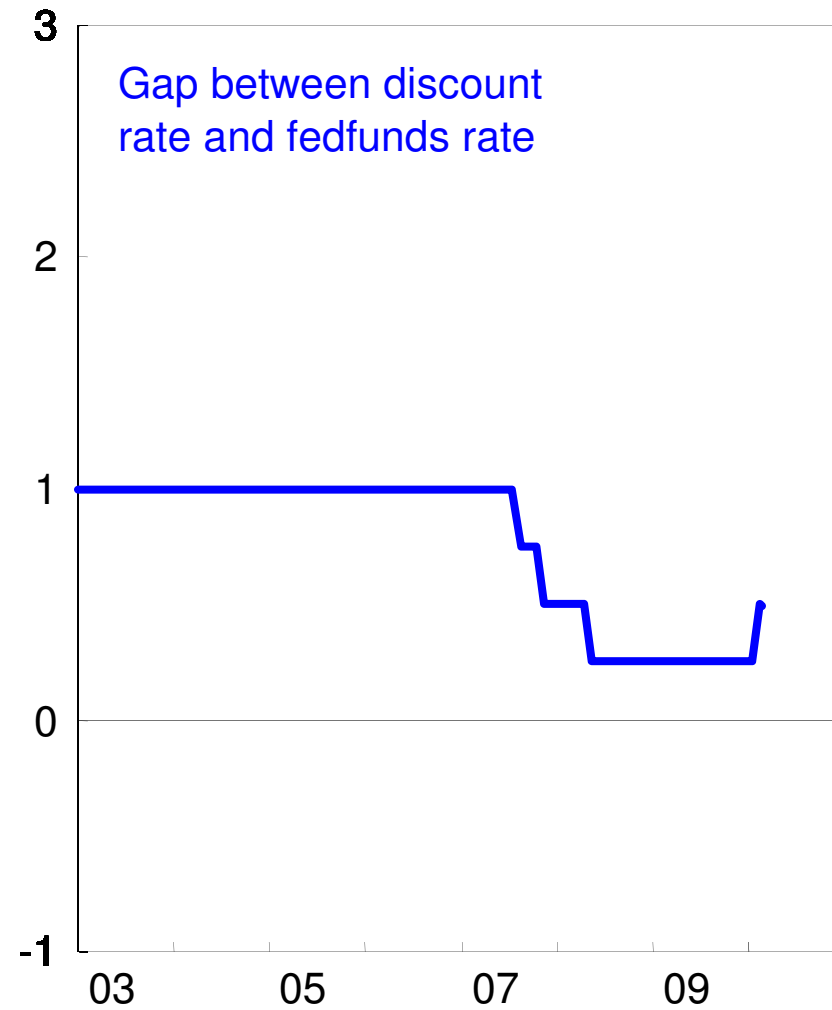
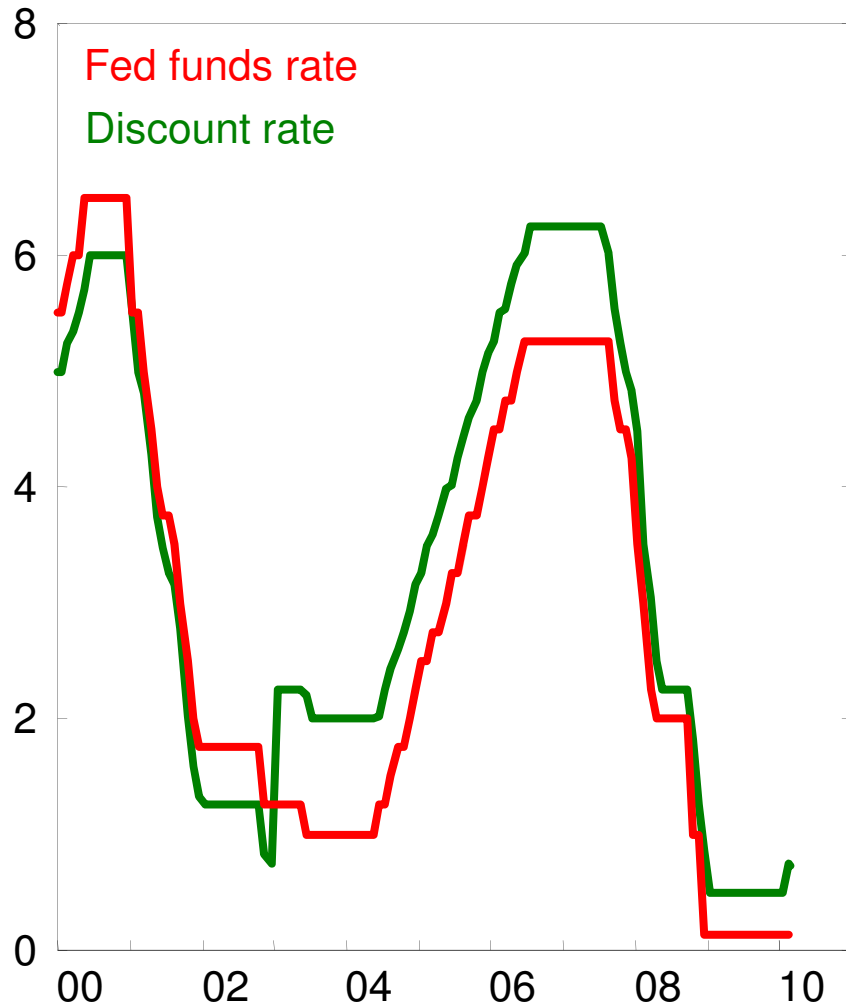
Chinese interest rate & reserve requirement ratio



Fed raises Discount Rate (DR): what does this mean?

- Fed at pains to emphasise this is:
 - A normalisation of its operating procedures as funding markets return to normal
 - Not a tightening of policy: “...do not signal any change in the outlook for the economy or for monetary policy...” and repeats “...economic conditions are likely to warrant exceptionally low levels of the FF rate for an extended period.”
- What should we read into this?
 - Fed sees less stress and freer flow of liquidity in funding markets
 - Fed is keen to normalise its operating procedures
 - This is not the end of easy money, but the beginning of the end

Fed's interest rate actions



- ▲ Markets waking up to some painful realities, rather than moving into entirely different scenario
 - The fiscal troubles have been lingering around for a while
 - Recent slowdown signs *are not unexpected*
 - A major renewed global slump still looks unlikely: policy still supportive, labour shake-out ending, world trade recovering, housing stabilising, China to continue on solid growth path
 - Market turmoil & downside growth risks will keep policy tightening slow (may even postpone it?)

- ❖ Growth outlook has not been fundamentally changed by recent events

- ❖ Rather, they have highlighted the drags on global growth over the medium term, as well as the downside risks

- Global environment unfolded broadly as expected in 2009
 - Earlier & stronger recovery than consensus expected
- Outlook 2010
 - Macro trends broadly settled & outcomes look fairly predictable
 - Recovery to continue, but not without setbacks, mini-shocks & worries (there always are, as is happening as we speak)
- Policy outlook:
 - Policy to remain very expansionary until all doubts about sustainability of recovery have been removed
 - Gradual tightening to spread
 - Fiscal positions in focus - limited scope for further support, serious troubles in some countries