Economy

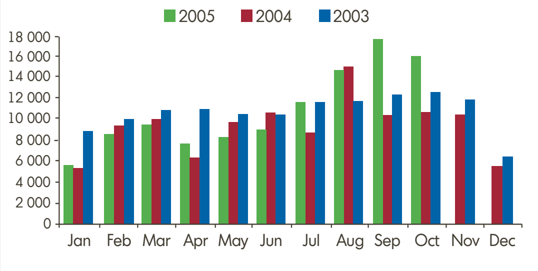
South Africa has experienced strong economic growth since the end of apartheid in the early 1990s. A profound restructuring of the economy has borne fruit in the form of macro-economic stability, booming exports and improved productivity in both capital and labour.

The performance of the South African economy in 2004 was encouraging, with growth accelerating above 5% in the second half of the year. By February 2005, the economy was growing more strongly than at any time in the previous 20 years.

South Africa's fiscal deficit was reduced from 46% of gross domestic product (GDP) in 1996 to 1,5% in 2005.

Not surprisingly, South Africa's global competitiveness has soared. Manufactured value-added products are now increasingly eating into commodities' traditionally dominant share of exports.

South African vehicle exports



Source: National Association of Automobile Manufacturers of South Africa

Domestic output

Real economic activity in South Africa improved in 2004. Real GDP, which increased by 2,8% in 2003, rose a further 3,7% in 2004. It was expected to accelerate to 4,3% in 2005 and to average 4,2% a year over the next three years.

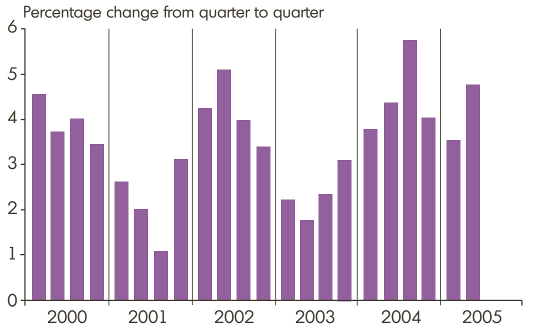
The enhanced performance was particularly evident in the middle quarters of 2004 when quarter-to-quarter growth accelerated from an annualised rate of 4% in the first quarter to 4% and 5% in the second and third quarters, respectively.

In 2004, the level of real output in the primary sector rose by 3% compared with an increase of only 1% in 2003, mainly as a recovery in the real value added by the agricultural sector.

Following a decline of 6% in 2003, the real value added by the agricultural sector increased by 1% in 2004 mainly on account of higher field crop production, particularly maize.

Growth in the real value added by the mining sector amounted to 4%, which is comparable to the rate of 4% recorded in 2003.

Inflation rates



Source: *Quarterly Bulletin* September 2005

In October 2005, Cabinet received a report of the task team headed by the Deputy President dealing with the Accelerated and Shared Growth Initiative for South Africa. The initiative deals with challenges of ensuring that the country raises the trajectory of growth to average at least 4,5% in the next five years and about 6% between 2010 and 2014.

Domestic expenditure

All the major components of real domestic final demand rose strongly in 2004, which impacted on the accelerated growth in real gross domestic expenditure for 2004 as a whole.

Growth in aggregate real gross domestic expenditure increased from an annualised rate of 2% in the third quarter of 2004 to 4% in the fourth quarter.

The level of real gross domestic expenditure was 6% higher in 2004 than in 2003.

The buoyancy in consumer spending was also reflected in a year-on-year growth rate of 6% in 2004 compared with a growth rate of 3% in 2003.

The strong household spending was underpinned by several factors, including:

- An increase of 5% in real household disposable income in 2004, partly due to wage settlements which remained above the contemporaneous inflation rate and income tax rates which were lowered marginally.
- The steady decline in bank lending rates in 2003 and 2004, culminating in the lowest nominal short-term interest rates since 1998. This reduced the debt-servicing cost of households as a percentage of disposable income from 8% in 2003 to 6% in 2004.
- The high levels of consumer confidence recorded in 2004, previously observed in 1997.
- The wealth effects arising from the exceptional increase in property and other asset prices.

Price inflation

The rate of increase in the consumer price index for metropolitan and other urban areas less mortgage interest cost (CPIX) has remained within the mandated target range of 3% to 6% since September 2003. Year-on-year CPIX inflation rose from the February 2005 low of 3,1% to 3,6% and 3,8% in March and April 2005, respectively. This upward trend was due almost entirely to consecutive increases in the petrol price totalling 82 cents per litre in March and April. Most of the short-term volatility in the inflation rate can be attributed to petrol price developments. If petrol and diesel prices are excluded, annual CPIX inflation increased marginally from 3,2% in February 2005 to 3,3% in March and April 2005. The annualised quarter-on-quarter seasonally adjusted rate of increase of CPIX in the first quarter of 2005 amounted to 2,1% compared with 5% in the fourth quarter of 2004.

Exchange rates

The weighted exchange rate of the Rand, which appreciated by 16,2% between the end of December 2002 and the end of December 2003, improved by a further 11,7% between the end of December 2003 and the end of December 2004.

The net average daily turnover in the domestic market for foreign exchange, which decreased to US$10,8 billion in the third quarter of 2004, rose to US$12,4 billion in the fourth quarter of 2004 – its highest level to date.

The average monthly real effective exchange rate of the Rand increased by 4,3% from December 2003 to December 2004.

Foreign trade and payments

Growth in the global economy accelerated to nearly 4% in 2004, from 2,4% in 2003.

The deficit on the current account of the balance of payments widened considerably from R18,9 billion in 2003 to R44,4 billion in 2004. As a ratio of GDP, the deficit rose to 3,2%.

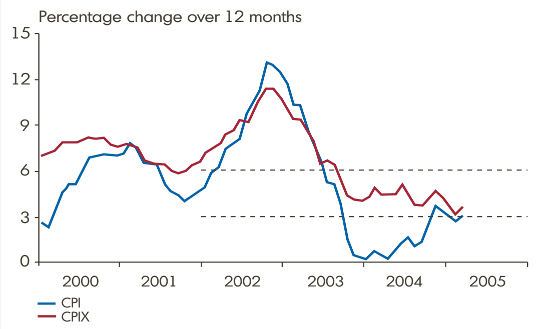
The significant widening of the deficit on the current account in 2004 resulted mainly from the sustained high level of real economic activity and concomitant strong increase in merchandise imports.

Robust domestic demand and the strengthening of the exchange rate of the Rand were reflected in the physical quantity of imported goods, which advanced by no less than 16,5% over the period.

As could be expected against the background of a vigorous upturn in economic activity, South Africa's trade balance with the rest of the world deteriorated considerably from a surplus of R25,6 billion recorded in 2003 to a deficit of R0,2 billion in 2004.

The value of merchandise exports increased throughout 2004. For the year as a whole, export values were 8,8% higher at R278,9 billion, from R256,3 billion in 2003. In particular, mining export values increased by no less than 13,5% in 2004, while manufactured goods increased by only 3% over the period.

Repo and short-term interest rates



Source: South Africa Reserve Bank

The Rand prices of goods exported from South Africa in 2004 increased by about 3%, while the Rand prices of commodity exports increased by about 5%.

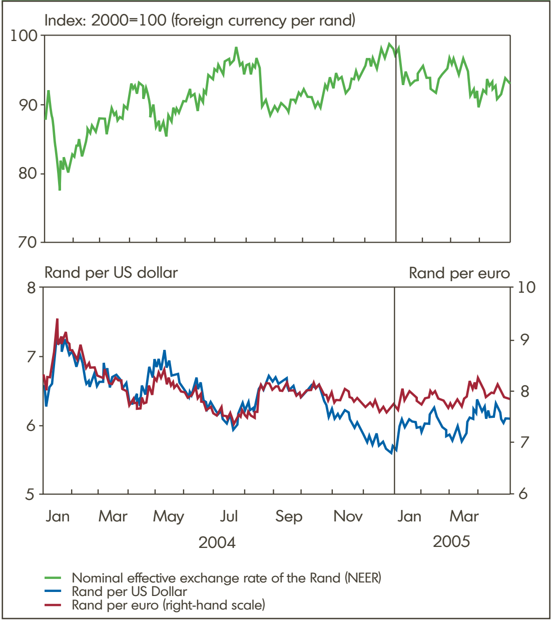
The further widening of the current account deficit in 2004 was also brought about by a decrease of 4% in the value of net gold exports from R34,2 billion in 2003 to R32,8 billion in 2004.

Trade relations

Africa

South Africa's economy is inextricably linked to that of the southern African region, and its continued growth to the

Exchange rates of the Rand



Source: South African Reserve Bank

economic recovery of the continent through the New Partnership for Africa's Development. Most of South Africa's investment into the rest of Africa is aimed at infrastructural development.

Africa is an important market for South African exports. In 2003, about 23% of South Africa's exports were destined for the continent. There was a huge increase in imports from the continent. In 2003, only 4% of total imports came from Africa. However, this increased to 40% in 2004.

Southern African Development Community (SADC)

The centrepiece of South Africa's foreign economic policy is the SADC. Within the SADC, South Africa, Botswana, Lesotho, Namibia and Swaziland have organised themselves into the Southern African Customs Union (SACU). SACU shares a common tariff regime without any internal barriers.

Two-way trade between South Africa and the rest of the SADC member states is characterised by the prevailing trade imbalance in terms of exports, versus imports from the region.

A sizeable share of South Africa's exports (estimated at over R38,5 billion at the end of 2004) is destined for SACU and other SADC countries. South African trade with this region increased significantly between 2002 and 2004, from R15 billion to R38,8 billion. Trade with SADC countries

New research by the South African Advertising Research Foundation shows that between 1998 and 2004 more than two million people moved out of the poorer end of the scale of living standards measures (LSMs), which ranks the poorest at one and the richest at 10.

- In 1998, the poorest four categories represented 48% of the population. In 2004, the figure was 42%.
- LSM 5 grew by 1,4 million adults with virtually all the newcomers moving up from poor groups.
- LSM 6 grew by 1,6 million adults, including those who had moved up from LSM 5.

Source: *BuaBriefs Issue 69*

also increased from R32 billion to about R38 billion between 2002 and 2004.

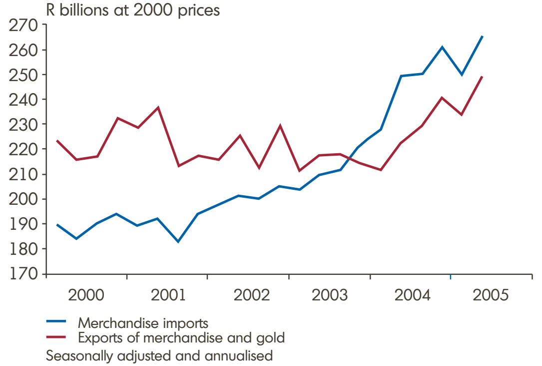
Europe

Europe is the largest source of investment for South Africa and accounts for almost half of South Africa's total foreign trade. In 2003, Europe accounted for 40% (R92 billion) of South Africa's total exports, and 45,8% (R116,59 billion) of its total imports.

The historic Trade, Development and Co-operation Agreement, which was provisionally implemented in January 2000, established a free trade agreement between South Africa and the European Union (EU). South Africa will grant duty-free access to 86% of EU imports over a period of 12 years, while the EU will liberalise 95% of South Africa's imports over 10 years.

The agreement provides a legal framework for ongoing EU financial assistance for development co-operation, which amounts to R900 million per year.

Real imports and exports



Source: *Quarterly Bulletin, September 2005*

United States of America (USA)

The USA is South Africa's number one trading partner in terms of total trade. Exports to the USA rose in nominal terms from R29 billion in 2003 to R30 billion in 2004. Imports from the USA recorded a paltry increase in nominal terms from R25 billion in 2003 to R26 billion in 2004. South Africa is a beneficiary of the USA's Generalised System of Preferences (GSP), which grants duty-free treatment for more than 4 650 products, and of the Africa Growth and Opportunity Act, in terms of which an additional 1 783 products were added to the existing GSP products.

Latin America

South Africa's major trading partners in South America are Brazil, Argentina, Chile, Mexico and Peru. South Africa and the Mercosur states signed a framework agreement in 2000, which commits them to working towards a free trade agreement. Trade between South Africa and Mercosur grew from R2,7 billion in 1994 to R12,7 billion in 2004. About 62,5% of total trade between South Africa and Mercosur is with Brazil.

Asia

Between 1995 and 2002, trade with the Indian Ocean Rim Association for Regional Co-operation accounted for 14% of South Africa's global trade.

Trade with India has grown particularly rapidly. Total two-way trade between South Africa and India reached R8,26 billion in 2004.

Japan is South Africa's biggest trading partner in Asia and was its third-largest export destination during 2004, with total trade between the two countries reaching R47,5 billion.

From March to September 2005, South Africa participated in the World Exposition in Aichi, Japan. South Africa showcased itself as a trading nation whose sophisticated infrastructure, natural environment, rich cultural heritage and history make it one of the world's top investment and travel destinations.

Total trade between South Africa and the People's Republic of China grew from R5,3 billion in 1998 to R29,6 billion in 2004.

South African trade with the Association of South-East Asian Nations region totalled R1,64 billion in 2004, and is set for continued growth.

Economic transformation

Small is big

The Government's National Strategy for Small Business aims to boost small enterprises, equalise income and wealth and create long-term jobs. Fostering entrepreneurship among women is a particular focus.

The development of small, medium and micro enterprises has attracted more and more attention in South Africa during recent years, as an engine for general economic growth as well as for employment creation and equity acceleration.

The Department of Trade and Industry launched the Small Enterprise Development Agency (SEDA) in December 2004.

SEDA, which provides non-financial support to small and medium enterprises (SMEs), was formed through the merger of Ntsika Enterprise Promotion Agency and the National Manufacturing Advisory Centre.

National Empowerment Fund (NEF)

The NEF was launched in May 2004 to finance Black Economic Empowerment (BEE) businesses and reduce the real risk by developing creative and unique products that respond appropriately to the circumstances faced by black businesses.

The fund received its first boost of R150 million during the 2004/05 financial year and was allocated a further R400 million in 2005/06.

The fund has also introduced new products and services such as the Group Entrepreneurial Schemes (loans and equity finance to BEE SMEs) and Market Making (larger BEE transactions finance in capital markets, warehousing and strategic projects).

The fundamental difference between the NEF and the existing finance institutions is its approach to evaluating businesses, the scope of business sizes that it will be financing, and its range of products.

Industrial Development Corporation (IDC)

During 2004, the IDC approved projects worth R6,2 billion, representing a growth of 26% from 2003.

More than 17 000 job opportunities created by IDC financing during 2004, and 74% of the number of approvals, were directed to SMEs.

Some 46% of the number and 33% of the value of approvals were allocated to historically disadvantaged people.

For the first time in history, the IDC received the investment grade rating of Baa2 awarded by Moody's Investor Service, which was in line with South Africa's sovereign debt rating.

Business Partners Ltd

Business Partners Ltd is a specialist investment group, providing customised investment, mentorship and property-management services to SMEs in South Africa.

In 2004/05, it boasted an investment portfolio of R1,066 billion, with equity-based investments amounting to 42% of the portfolio. A total of 538 investments valued at

fact

According to Ernst & Young, the number of Black Economic Empowerment (BEE) transactions in South Africa in 2004 increased by 29% to 244 from 189 in 2003. BEE deal value increased from R42,2 billion in 2003 to R52,9 billion in 2004.

R660,5 million were approved in 2004/05. Of these, 213 investments to the value of R265,9 million were approved for historically disadvantaged entrepreneurs, and 159 investments amounting to R154,4 million were approved for female entrepreneurs.

State-owned enterprises (SOEs)

The Department of Public Enterprises ensures that SOEs play an upliftment and development role.

In June 2005, government announced a major investment drive which includes a R40-billion and R95-billion investment plan over five years for Transnet and Eskom, respectively.

The money will be used for construction, renovation and expansion, including:

- R15 million for the rehabilitation of the three Eskom power stations – Camden, Grootvlei and Komati
- R2,9 billion for the expansion and redesign of Pier 1 and the widening of the entrance at the Durban Harbour
- R2,6 billion for the container terminal at Ngqura/Coega
- R1,4 billion for the expansion of the Cape Town container terminal.

Expanded Public Works Programme (EPWP)

The EPWP celebrated its first anniversary in April 2005. It is the largest job-creating initiative to be undertaken by government. The EPWP is expected to create over 300 000 work opportunties by April 2007.

The EPWP is operational in all nine provinces. Projects include the construction of rural or low-volume roads, water and sanitation trenches and sidewalks.

In addition, government will increase spending on the maintenance of schools, clinics and other government buildings. EPWP projects will also be launched in the area of home-based care for people affected by HIV and AIDS, childcare projects, and in environmental projects like LandCare and clearing alien vegetation from river banks.

Global car-makers and aerospace companies view South Africa as one of the most attractive destinations worldwide for foreign direct investment (FDI), according to a survey, the *Annual FDI Confidence Index*, by global management consulting firm AT Kearney. South Africa ranked seventh-most attractive destination globally for investment in the transportation equipment sector. This was partly the result ofw government assistance in the form of the Motor Industry Development Programme, which has helped global car-makers operating in South Africa to grow car exports nine-fold over the past decade.

While most of the jobs created will be for a limited period, people employed will receive basic training that will allow them to find jobs in future. Government will be spending almost R20 billion on this programme over the next five years.

The EPWP is on course to reach its target of one million job opportunities in five years. By September 2005, some 223 400 gross work opportunities had been created from 3 400 EPWP projects nationwide in the first year of the EPWP, yielding at least R823 million in total wages paid. Of those who benefited from these projects in the first year of the programme, 38% were women, 41% youth, and 0,5% people with disabilities.