Industrial Development Corporation

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Economic Overview

Recent developments in the global and South African economies

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Department of Research and Information

HIGHLIGHTS

The progressive tapering of quantitative easing in the US, as its economic recovery gathers momentum, is having highly destabilising effects in emerging markets. The exodus of capital had begun earlier in anticipation of the tapering programme, but the sell-off of emerging market assets escalated once its timing and pace became clearer. Large net capital outflows have weakened emerging market currencies, brought along inflationary pressures and have destabilised equity and bond markets, among other negative consequences. The Federal Reserve Chair, Janet Yellen, recently stated, however, that the tapering of asset purchases "was not on a pre-set course".

In an effort to contain inflation pressures, curb capital flight and protect their currencies, central banks in several emerging markets have been raising policy rates, possibly to the detriment of future growth. Turkey surprised markets by more than doubling its benchmark repo rate in the closing week of January. South Africa and India also tightened monetary policy around the same time, albeit to a much lesser extent. While it remains to be seen whether such moves indeed succeed in achieving the intended goals, downside risks include dampening effects on economic growth, which in certain cases remains fragile.

The overall contribution of emerging markets and developing economies to world growth is, nonetheless, expected to increase largely on the back of improving demand for their exports in recovering advanced economies. Global GDP is forecast by the IMF to expand by 3.7% in 2014, up from 3% in 2013, with the US contribution as a key driver. The pace of economic expansion in the US is expected to accelerate to 2.8% and the Eurozone should post positive growth of around 1%, after last year's contraction. Firm domestic demand and a better export performance are expected to underpin 6.1% growth in Sub-Saharan Africa in 2014, compared to 5.1% in 2013.

Downside risks to the global outlook abound. The potential for heightened financial market instability in emerging markets is considerable, especially if capital flight is protracted and remains excessive, with domestic weaknesses aggravated by monetary policy tightening. The increased clout of emerging markets in the global economy implies that the repercussions could be widespread and damaging. China's economy claims a major portion of the emerging market weight from a global perspective and hence the extent of its anticipant slowdown in 2014 is also critical to the outlook.

South Africa's economic growth moderated considerably towards an estimated 1.9% in 2013, and some of the underlying causes remained in place at the start of the new year. Protracted and intense industrial action and infrastructural challenges continue to constrain the supply side of the economy. On the demand front, household consumption expenditure has been losing momentum and consumer expectations of further interest rate hikes may aggravate the trend. Government spending, in turn, is being restrained by fiscal limitations.

The deficit on the balance of trade widened sharply to almost R70 billion for 2013, from R34.7 billion in 2012. A combination of weak demand conditions globally and supply-side disruptions domestically, particularly in key sub-sectors of mining and manufacturing, culminated in a disappointing export performance, whilst import demand remained relatively strong.

The African continent has become an increasingly important market for South Africa's manufactured exports. Merchandise exports to the continent, including exports to other SACU member states, totalled R264 billion in 2013, representing 28.5% of the overall merchandise export basket and being 14.7% higher than in 2012.

South Africa's inflation outlook has deteriorated substantially, largely on the back of a sharply weaker rand. In response, the Monetary Policy Committee of the South African Reserve Bank decided to raise interest rates at its meeting in late January – the first rate hike since June 2008 - to anchor inflation expectations. Should monetary policy be tightened further, possibly by an additional 100 basis points over the remainder of 2014, the adverse consequences on growth will be transmitted through household consumption spending.

South Africa's GDP is projected to expand by 2.9% in real terms in 2014, with the improved performance largely support by increased export demand.

IMPLICATIONS FOR SOUTH AFRICAN BUSINESS

- The performance of the global economy is expected to improve this year as the recovery strengthens in the world's advanced countries. Fiscal and monetary policy stimuli are bearing fruit in the United States (US) and the United Kingdom (UK), while the Eurozone's recovery is still being weakened by fiscal austerity (the lowest European Central Bank rates since November 2009 have yet to impact meaningfully on consumer and investment spending). **These are key markets for South African manufactured exports.**

- Although emerging markets and other developing economies have been the pillar of global growth in recent years, the momentum is decelerating. China's growth is moderating and key emerging economies such as India, Brazil, Turkey and Indonesia are struggling to sustain their rates of expansion under tighter macroeconomic policy environments. Furthermore, much depends on the impact of continued US QE tapering on these economies, including South Africa, judging from the harsh effects felt in recent times. **Some of these emerging markets, especially China and India are key for South Africa's commodity exports, but many are fierce competitors in the global marketplace.**

- The robust growth outlook for Sub-Saharan Africa provides a strong measure of optimism for South Africa's export sector, since the basket is not only diversified, but it also has a relatively high concentration of manufactured goods and is expanding rapidly. However, downside risks remain, given the region's strong reliance on external demand for its commodities. **Due to its regional proximity, South Africa can and must tap further into this critical growth region to counter the weak demand conditions on the home front and in developed economies.**

- The rebound in world trade volumes is expected to gain momentum in 2014 and to strengthen further in 2015. Supported by a weaker currency, which may provide improved price competitiveness in global markets at least in the shorter term, **South Africa's export sector is likely to post an improved performance, although downside risks prevail in the form of supply-side challenges.**

- Subdued inflation in the advanced economies is still providing room for monetary authorities to keep interest rates low. The same cannot be said about emerging markets, since interest rates have been hiked in several economies in an attempt to stem capital outflows, currency depreciations and imported inflationary pressures. Others, such as Mexico and Thailand, have managed to cut rates to stimulate domestic growth. In the process, **relative risk profiles, including South Africa's, are changing rapidly, with implications for economic performance**.

- **The recent corrections in global equity markets were widely anticipated** and may not as yet have reached the potential low-point. Major portfolio adjustments are being made in terms of regional and individual country exposures, as well as in asset classes.

- On the local front, economic growth and hence private sector investment activity remain subdued due to weak external and domestic demand as well as undue levels of uncertainty. **The demand-side picture going forward is somewhat mixed:**

  - Although demand for locally manufactured exports is expected to improve gradually on the back of US and UK growth, as well as rapid expansion in Sub-Saharan Africa, improvements in Eurozone demand are likely to lag behind. South African exporters, should strive to recover and sustain market shares in traditional export destinations as their local demand gradually improves.

  - With respect to certain commodity exports, volumes and prices may remain under pressure due to moderating Chinese demand, while Indian demand for fertilisers, for instance, could remain constrained by a weakened rupee and serious fiscal deficits, which reduce the Indian government's subsidisation ability.

  - Domestically, expenditure by South African households is likely to remain under pressure for various reasons, including high levels of indebtedness and moderating demand for credit, highly stretched budgets aggravated by accelerating inflation, as well as weak employment growth, while the expectation of further interest rate hikes may damper their spending propensity further.

- **A weakened currency should assist exporting firms in developing or expanding international markets, as well as raise the rand earnings of commodity exporting entities**. However, such competitive advantages will only be sustainable if domestic cost increases are contained and, furthermore, relative exchange rate developments across currencies of competing economies must also be taken into consideration.

- **Moreover, much depends on the ability of the supply-side of the South African economy to rise up to the export opportunities in the offing**. In this regard, it is critical that excessive and/or protracted industrial action be avoided not only in mining but also in manufacturing, as evidenced by the highly adverse impact on production volumes and export capabilities in recent years. Addressing the physical infrastructure bottlenecks, as well as related inefficiencies and high relative costs, are also key to alleviate supply-side constraints.

- **Inflationary pressures of a cost-push nature are building up, while demand conditions remain weak:** These are likely to squeeze household budgets even further, as well as business margins. Constrained household spending may limit the ability of producers to pass higher costs on to consumers, as well as the scope for wage increases in real terms and for enhanced job creation. Since such developments may impact on the viability of business enterprises, it could lead to higher default rates, company failures and employment losses.

- **Tighter monetary policy will exert even more pressure on the South African economy and the growth outlook will deteriorate if further rate hikes are forthcoming.** Consumer spending will be adversely affected, particularly interest rate sensitive consumer categories, such as motor vehicles and household appliances. The cost of capital will also rise, making investment decision even more challenging in light of a still fragile domestic economic recovery due to weak global and domestic demand.

GLOBAL ECONOMIC CONDITIONS

The Federal Reserve in the United States commenced the long-awaited tapering of its extraordinary liquidity stimulus, having initially reduced the monthly total from USD85 billion to USD75 billion in January 2014 and to USD65 billion in the following month. The adverse impact on emerging markets had been widely anticipated. The massive liquidity injections since the start of quantitative easing had led to excessive flows of capital to emerging markets in search of higher yields, in the process resulting in substantial currency appreciations, weakened global competitiveness and deteriorating current account balances.

The reversal of such flows in anticipation of the Fed's tapering announcement intensified as the roll-out plan and monthly quantum became clearer. Not necessarily based on significant changes in economic fundamentals, the large exodus of capital from the bond and equity markets of several emerging economies, towards those of developed countries, triggered a rapid depreciation of their currencies and the build up of inflationary pressures. The South African rand has depreciated by over 30% since the start of 2013, slightly more than the 27% and 26% weakening of the Indonesian rupiah and Turkish lira, respectively. South Africa and Turkey have been facing sizeable current account deficits (see Table 1 below), making them especially vulnerable to capital flows. Although most emerging markets experienced a significant weakening of their currencies, countries such as Mexico (3.3% depreciation since the beginning of 2013) and Nigeria (4.2%) have fared substantially better.

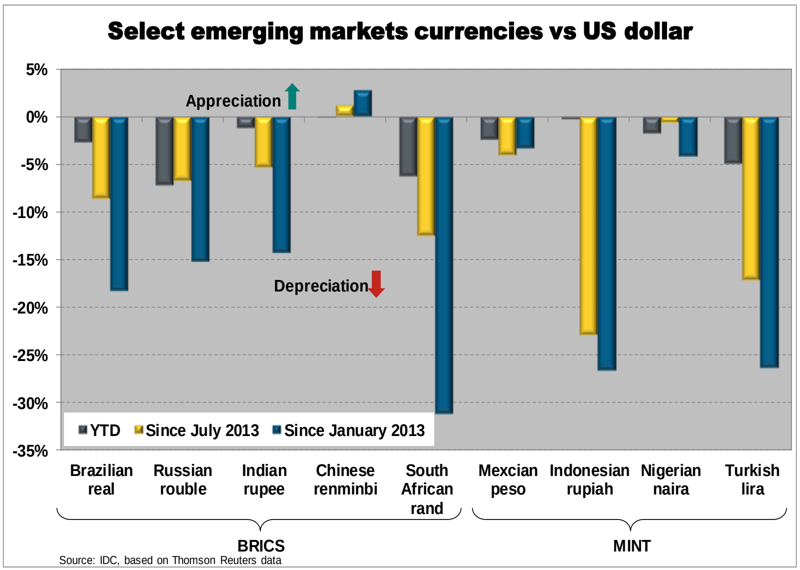


Table 1: Economic indicators in select emerging markets (the so-called BRICS and MINT countries)

Country	GDP (US$ bn, PPP)	GDP growth (% change y-o-y)		Current account balance (% of GDP)		Budget balance (% of GDP)		Inflation (% change y-o-y)	
	2013e	2013e	2014f	2013e	2014f	2013e	2014f	2013e	2014f
Brazil	2 422	2.3	2.3	-3.4	-3.2	-3.0	-3.2	6.3	5.8
Russia	2 558	1.5	2.0	2.9	2.3	-0.7	-0.3	6.7	5.7
India	4 962	4.4	5.4	-4.4	-3.8	-8.5	-8.4	10.9	8.9
China	13 374	7.7	7.5	2.5	2.6	-2.4	-2.1	2.7	3.0
South Africa	596	1.8	2.8	-6.1	-6.1	-4.9	-4.7	5.9	5.5
Mexico	15 608	1.2	3.0	-1.3	-1.5	-3.8	-4.1	3.6	3.0
Indonesia	5 182	5.3	5.5	-3.4	-3.1	-2.2	-2.4	7.3	7.5
Nigeria	479	6.2	7.4	3.2	3.6	-1.8	-1.7	9.9	8.2
Turkey	1 167	3.8	3.5	-7.4	-7.2	-2.3	-2.3	7.7	6.5

Source: IMF WEO database

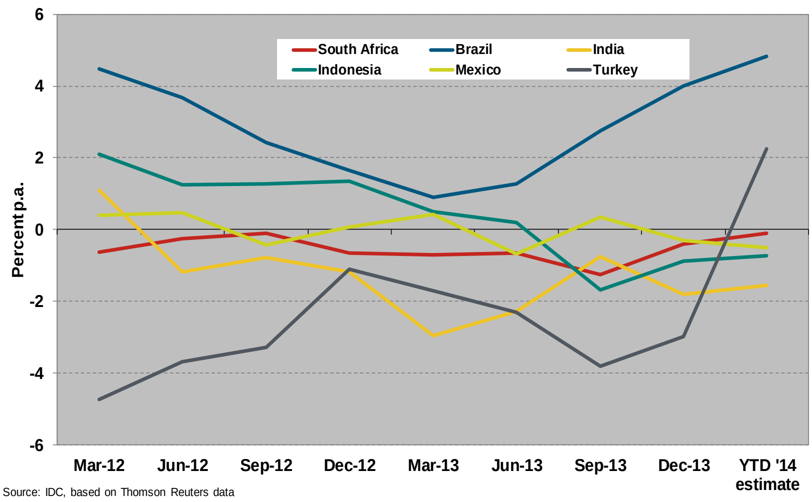
A weaker exchange rate may be seen as generally providing an instant improvement in external price competitiveness for an exporting country in global markets, at least in the short-term. However, not only does this depend on demand conditions in traditional and potential export markets, but also on the relative performance of competitor countries' currencies.

Considering relatively weak demand conditions in advanced economies, particularly a Eurozone just out of a protracted recession and struggling to elevate growth, as well as yet fragile economic recoveries in countries such as the United States, Japan and the United Kingdom, the improved external price competitiveness afforded by a weaker currency will not necessarily translate into higher export volumes in the near- to short-term. Turkey and South Africa are cases in point in this regard. However, as a result of currency depreciation, exporters will generally earn higher proceeds in domestic currency for current transactions denominated in, for example, US dollars or euros. Therefore, potential export sector gains in parts of the emerging world as a result of substantially weaker currencies may take some time to materialise.

On the import side, however, exchange rate depreciation generally results in higher local currency costs associated with import requirements, including essential items such as crude and refined fuels, intermediate inputs for production processes, capital equipment and other investment related items, as well as consumer goods. Over and above the negative current account effects, sharp increases in import costs, if sustained, are transmitted domestically through both producer and consumer price inflation, affecting future inflation expectations. Monetary policy tightening may ensue as the central bank attempts to anchor inflation expectations, to potentially prevent further currency depreciation or reverse the downward trend by attracting capital inflows and/or to at least partly address the prevailing current account imbalance by reducing import demand.

Turkey's central bank raised all of its key interest rates dramatically on 28 January 2014 (its one-week repo rate by a whopping 5.5 percentage points to 10%) to support the lira. Its Indonesian counterpart had been raising rates for a while, from 5.75% in mid-2013 to 7.5% presently. Facing the highest average inflation of the BRICS, the Reserve Bank of India hiked interest rates in mid-2013, while the Brazilian monetary authorities have been raising interest rates steadily since the start of 2013, from 7.25% to the current 10.5%, to contain inflationary pressures. Concerned with a deteriorating inflation outlook and surrounded by EM rate tightening, the South African Reserve Bank hiked its repo rate by 50 basis points to 5.5% from 30 January 2014 – the first increase since June 2008. The adjoining chart illustrates the evolution of policy rates in six emerging markets, in real terms, since early 2012. As shown, Brazil currently has the highest real rates, followed by Turkey. South Africa's repo rate in real terms is marginally negative.

Central bank policy rates in select emerging markets (quarterly average rates in real terms)



Source: IDC, based on Thomson Reuters data

These developments in emerging markets are compounding their challenges, affecting the performance of their real economies, as well as business and consumer sentiment.

Manufacturers in **Brazil** reported a weaker rate of output growth in January, although new orders rose at the fastest pace in 11 months, thus reflecting improved demand conditions domestically, particularly in the consumer goods category. Input cost pressures are visible, partly due to exchange rate movements, but competitive pressures are keeping selling price increases at bay. Overall employment continues on a downward trend. The HSBC Manufacturing Purchasing Managers' Index (PMI) for Brazil remained marginally above the important 50 "no-change" level, confirming very modest expansion.

Manufacturing sector conditions are clearly worsening in **Russia**, with shrinking order books reflecting weak private consumption spending, low levels of investment activity and insufficient export demand. Consequently, job losses continue being reported, albeit at a slower pace. The January PMI reading, at 48, is not only back in contractionary territory, but the lowest since June 2009.

In contrast, manufacturing sector conditions in **India** have improved substantially in recent times, with production growth accelerating on the back of improved domestic as well as external demand for consumer goods, robust expansion in new orders placed, and signs of increased pressure on operating capacity.

Operating conditions have deteriorated in **China**, with manufacturing output expanding marginally, new orders either stagnant or, in the case of export business in key markets, lower, and employment levels declining noticeably. Production costs have fallen, assisted by a stronger renminbi and relatively low commodity prices, and the benefits are being largely passed on to customers through lower prices. China's PMI reading for January remained marginally below the important 50 threshold. Governmental attempts to stem leverage in the economy may hinder growth to some extent, but anticipated improvements in the export sector's performance and household consumption are likely to compensate. China's reform programme, which aims to reduce the economy's heavy reliance on investment activity and external demand as drivers of growth, while elevating the contribution made by domestic consumption and its services sectors, will alter the country's import requirements over time, with implications for commodity-exporting economies.

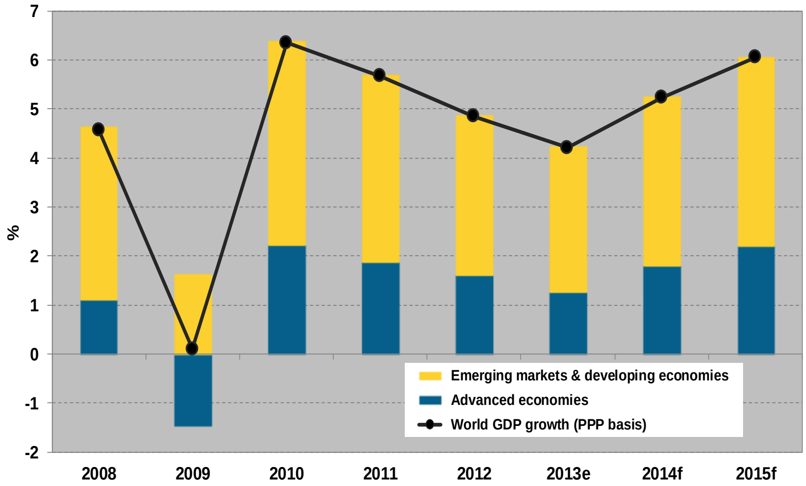
Although mixed, manufacturing sector performance in the MINT countries has seemingly been more solid than amongst the BRICS. In **Mexico**, robust growth in volume of new orders has underpinned expanding production and rising employment. **Indonesia**'s manufacturing sector has been reporting a surge in new orders from the local customer base, which is somewhat surprising in the light of monetary policy tightening since May 2013 as well as the fact that production costs increases are seemingly being passed on to clients. In **Turkey**, manufacturing output growth appears to be slowing and producers are passing on higher costs, trends that are likely to deteriorate going forward as the impacts of sharply higher interest rates and a weaker lira start being felt. As such, Turkey's GDP growth projection as indicated in Table1 is likely to be revised downwardly in due course.

Increased industrial activity in advanced economies is supporting their recovery momentum. The PMIs for the United States and the Eurozone remained above 50 in January, indicating continued improvement. In the near-term, however, industrial activity and supply chains in the **United States** are likely to be disrupted by severe winter weather conditions. Furthermore, employment gains in January fell short of expectations – the second consecutive disappointing monthly figure after the strong rebound in October and November. Nonetheless, the unemployment rate has improved substantially to 6.6%, from the 10% peak recorded in 2009. The US budget deficit, in turn, has receded to far more comfortable levels, at USD680 billion in 2013 or 3% of GDP, although the spectre of renewed bi-partisan negotiations over the debt ceiling is again looming.

Upward trending PMI readings in the **Eurozone** have been supported by expanding production and new business, including export orders that have risen at the fastest pace since April 2011. The growth momentum in countries on its periphery is showing signs of improvement, further supporting the outlook for 2014. The unemployment rate in the regional bloc, however, still exceeds the 12% level. In **Japan**, manufacturing output growth accelerated strongly in January, for the eleventh consecutive month, on the back of sharp increases in new order volumes.

Despite the difficulties facing emerging markets, which have been the drivers of global economic expansion in recent years, they are expected to make, in conjunction with other developing economies, progressively higher contributions to world growth over the next two years, as illustrated in the accompanying graph. The on-going recovery in advanced economies will greatly reinforce the momentum. The most recent International Monetary Fund (IMF) forecasts point to a rebound in **world** GDP growth, on a purchasing power parity basis, to 3.7% in 2014 (from 3% in 2013), accelerating to 3.9% in 2015. The forecast expansion in the United States (2.8% growth in GDP in 2014, compared to 1.9% last year) and in the Eurozone (1%, up from -0.4% in 2013) should be supportive of global trade volumes and hence export sector performance in several emerging markets, including South Africa.

Contribution of advanced economies and emerging markets/developing economies to world GDP growth



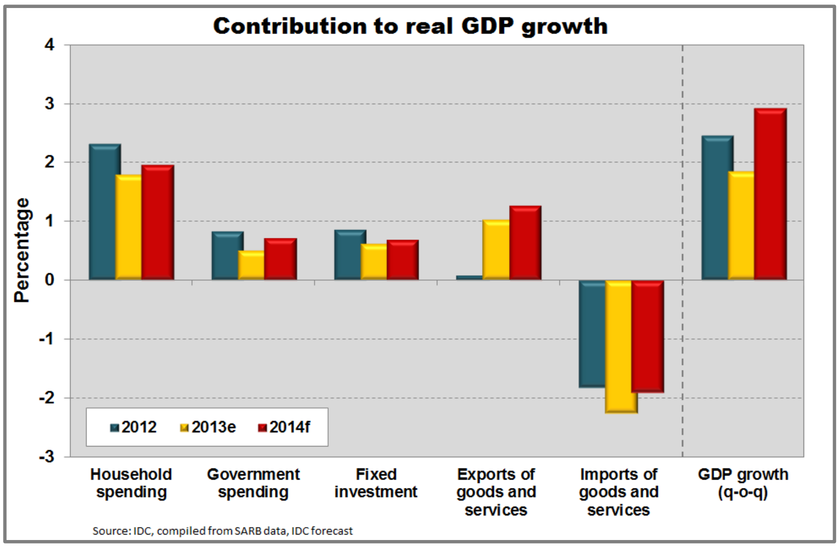
Source: IDC, based on IMF WEO January 2014 data

Growth prospects for **Sub-Saharan Africa** remain very positive, but with significant differences between countries. Firm domestic demand and the expected strengthening in external demand are expected to underpin the growth rates of 6.1% and 5.8% forecast by IMF for the region in 2014 and 2015, respectively, up from 5.1% in 2013.

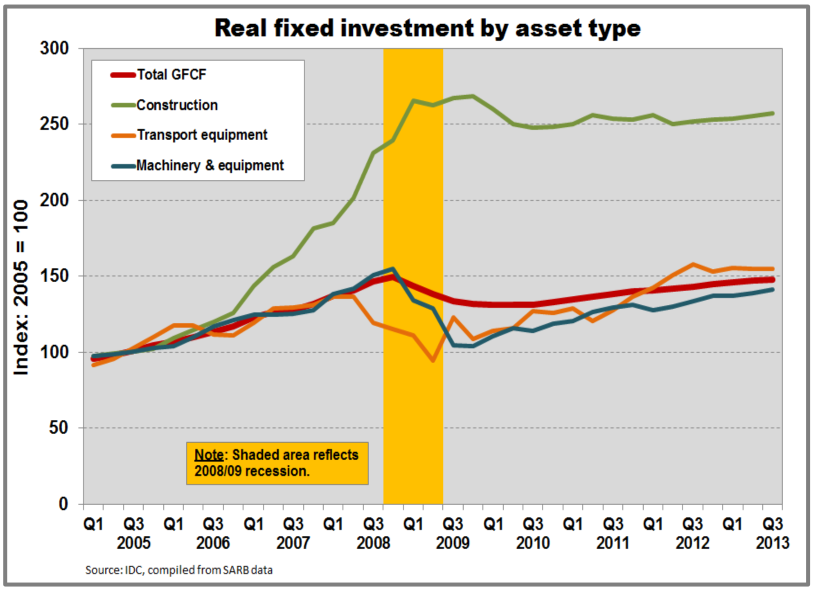
Downside risks to the global outlook include the potential for heightened financial market instability in and excessive capital flight from emerging markets, aggravated by possibly intensifying domestic weaknesses as a result of monetary policy tightening. The adverse repercussions could be spread widely, considering the greater weight of emerging economies from a global perspective, while the systemic financial challenges faced by the advanced world are not fully resolved.

ECONOMIC DEVELOPMENTS IN SOUTH AFRICA

South Africa's growth momentum has been decelerating markedly. The production side of the economy continues to be plagued by serious home-grown factors. Intense and protracted industrial action has held back output in critical export-oriented sub-sectors of mining and manufacturing, particularly platinum mining and the automotive industry, while infrastructure constraints in the electricity sector and in the transportation and logistics network continue to constrain production activity in certain industries and/or preventing the efficient and distribution of their products to final markets, whether local or external. Furthermore, cost structures are under significant pressure due to escalating administered prices, aggravated by the impact of a sharply weaker rand on imported raw materials, intermediate inputs and capital equipment.



On the expenditure side, household consumption has been moderating, with the slowdown being particularly pronounced where durable and non-durable goods purchases are concerned. Consumer confidence and spending propensity are being constrained by excessive indebtedness and stretched household budgets, with the situation aggravated by rising inflation. Demand for and access to new credit has been moderating, and, since the recent monetary policy tightening, expectations of further interest rate hikes are likely to exacerbate the slowdown in credit extension. Importantly, weak employment growth is placing a damper on household confidence and constraining income generation.



Fixed investment activity recently showed encouraging signs of improvement, with the ratio of gross fixed capital formation to GDP rising to 19.2% in the third quarter of 2013. However, investment growth has been off a low base and mainly the result of a rebound in capital outlays by general government, which is being increasingly constrained by limited fiscal space. Although the export sector witnessed an improved performance, import demand increased at a faster pace last year, with net exports thus remaining a drag on overall GDP growth. The rate of expansion of the domestic economy in 2013 is estimated at 1.9% - a significant deceleration from the 3.6% and 2.5% recorded in 2011 and 2012, respectively.

Supply-side disruptions and weak global demand culminated in a substantial deterioration in South Africa's balance of trade, with the cumulative deficit widening to R69.9 billion for 2013 as whole, from R34.7 billion in 2012. The heavy reliance on commodity exports makes the country extremely vulnerable to developments that affect adversely the mining sector's performance, as evidenced by disappointing mineral exports in 2012 and 2013. Moreover, the sizeable deficit on the services account aggravated the balance of payments.

A highly encouraging trend on the external front has been the increased penetration of South African exports in other African markets. Preliminary estimates from the South African Revenue Services indicate that exports to the rest of the African continent amounted to R264.2 billion in nominal values (including South African exports to Botswana, Lesotho, Namibia and Swaziland, which are co-members of the Southern African Customs Union (SACU)), from ZAR230.4 billion in 2012. Claiming 28.5% of South Africa's overall merchandise export basket in 2013, up from 28.2% in 2012, the African continent is the second largest regional destination for domestic exports after Asia (32.2% share).

Importantly, the export basket to African markets remained highly diversified, with the leading exports (per chapter groupings) being machinery, mineral products, vehicles and aircraft, basic iron and steel, chemicals and processed food (refer to Table 2 below). Over the 2011 to 2013 period, most export product categories destined for the rest of the African continent showed strong growth, averaging approximately 16% per year. Outside of SACU, the largest export markets on the continent were Mozambique, Zambia, Zimbabwe, the Democratic Republic of the Congo and Angola, with these five countries absorbing about 38% of South Africa's exports last year.

Table 2: South Africa's export trade with the rest of Africa

Major South African export categories to the rest of Africa (chapters)	Value of exports in 2013 (Rand billion)	% share of total	Average annual % growth in export values, 2011-13
Machinery	46.6	17.7	18.0
Mineral products	38.2	14.5	18.4
Vehicles, aircraft and vessels	31.7	12.0	19.3
Iron and steel products	27.6	10.5	7.8
Chemicals	27.3	10.3	17.8
Prepared foodstuffs	22.5	8.5	13.7
Plastics and rubber	14.8	5.6	17.7
Vegetables	12.5	4.7	17.5
Textiles	7.3	2.8	15.7
Wood pulp and paper	6.5	2.4	12.7
Other (including unclassified items)	29.2	11.0	19.0
Total	**264.2**	**100**	**15.9**
SA exports to the rest of Africa as a % of SA exports to world at large	**28.5**		

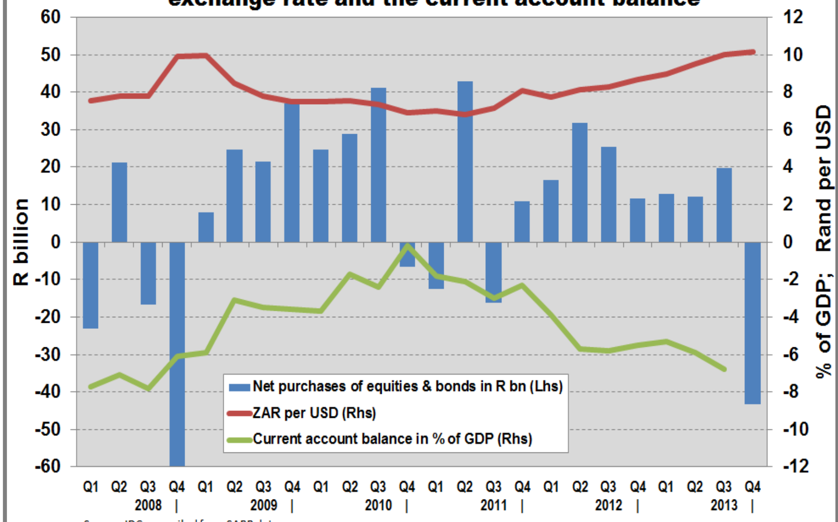
Source: IDC calculations, based on SARS data

The robust growth outlook for Sub-Saharan Africa provides a strong measure of optimism for South Africa's export sector, since the basket is not only diversified but expanding rapidly. However, downside risks remain, given the region's strong reliance on external demand for its commodities. Due to its regional proximity, South Africa can and must tap into this critical growth region to counter the weak demand conditions on the home front and in its traditional markets.

South Africa's inclusion among the so-called "Fragile Five" emerging market economies has been motivated by its large current account and budget deficits, a heavy reliance on foreign capital inflows, a relative weak economic growth performance and modest prospects in the short- to medium term, its excessive unemployment rate, rising inflationary pressures and substantial currency weakness.

As highlighted in the global section, several emerging markets have been witnessing an exodus of foreign capital, initially triggered by the anticipated US Federal Reserve tapering of quantitative easing. The sell-off progressively intensified due to investor perceptions of increased emerging market risk. In South Africa, cumulative net purchases of local bonds and equities by non-residents amounted to a mere R1.2 billion in 2013, compared to R85.2 billion in 2012. Net outflows of portfolio capital towards the end of the year basically wiped out the net receipts recorded in the first three quarters, as illustrated in the adjoining graph. Since the start of 2014, net sales of equities and bonds by non-residents amounted to R19.3 billion, mostly bond sales.

Net foreign purchases of equities and bonds, the ZAR-USD exchange rate and the current account balance

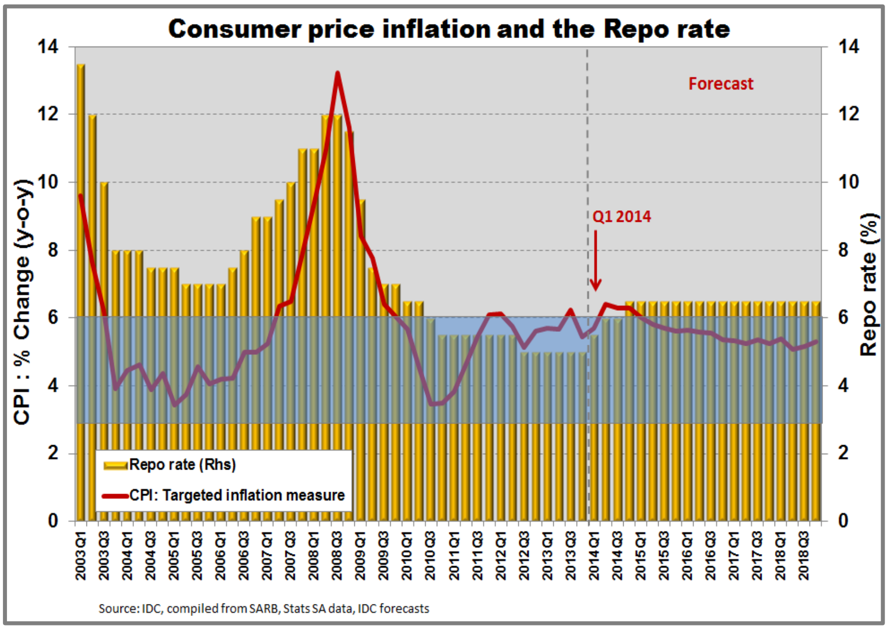


Source: IDC, compiled from SARB data

Concerned with a substantial deterioration in the inflation outlook, largely but not exclusively due to significant currency weakness, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) decided to raise the repo rate by 50 basis points to 5.5%, effective 30 January 2014. Consumer price inflation was forecast to breach the inflation target in 2014 and during the first half of 2015. In tandem with other emerging markets, capital outflows had been intensifying, the currency was weakening rapidly and other central banks were tightening policy rates, with a massive move having just been announced in Turkey.

The MPC's decision, which was admittedly not unanimous and not taken lightly due to weak economic growth and poor employment gains, has most likely signalled the start of the tightening cycle, with more rate hikes expected later this year and perhaps even in 2015.

However, rates are not expected to be raised substantially due to the detrimental effect this would have on a fragile growth performance, especially in the face of South Africa's enormous socio-economic challenges. The Reserve Bank Governor has allegedly indicated that it is not the intention of the MPC to take interest rates to positive territory in real terms, considering the prevailing economic conditions. Furthermore, inflationary pressures have clearly been of a cost-push nature, exacerbated by the impact of a sharply weaker rand on imported inflation, and certainly not due to demand-pull factors. Hence, barring further excessive and protracted depreciation of the currency and capital market instability, the repo rate is expected to be raised by a further 100 basis over the course of 2014, with individual hikes in the order of 50 basis points possibly in the second and fourth quarters of the year. Monetary policy would still be relatively accommodative, whilst anchoring inflation expectations to a significant extent.



The South African economy is expected to witness higher levels of economic activity in 2014, largely due to an anticipated improvement in the export sector's performance. The manufacturing sector, which recorded 2.4% growth on a quarter-on-quarter basis in the final quarter of 2013, is expected to benefit significantly from increased export demand. This should underpin a degree of fixed investment spending, especially in industries where production capacity may be under pressure, as well as reasonable job creation. According to the latest Quarterly Labour Force Survey, overall employment in South Africa increased by 653 000 in 2013, 141 000 of which in the fourth quarter of the year, taking the revised unemployment rate to 24.1%, from 24.5% in the previous quarter.

Even though the household sector will remain constrained in 2014, increased employment and remuneration may support a slightly greater contribution to growth. In similar vein, tax revenue and by implication government spending are likely to benefit from modestly higher GDP growth, which is forecast at 2.9% for the year.