south africa

Demographics

Population	48 375 645 (July 2014 est.)
Population: world ranking	28 out of 240 countries (CIA)
Life expectancy (years)	Total population: 59.6; male: 57.7; female: 61.4 (2013 est.)
Main ethnic groups	Black African 79.8%, white 8.7%, coloured 9%, Indian/Asian 2.5% (2013 est.)
Business language	English, Afrikaans, Xhosa, Zulu
Urban population	62.4%
Population below national poverty line	23% (2006 est.)

Sources: CIA, World Bank

Geography

Area in sq km	1 219 090
Area: World ranking	25 out of 252 countries (CIA)
Climate	Mostly semiarid; subtropical along east coast; sunny days, cool nights
Natural resources	Gold, chromium, antimony, coal, iron ore, manganese, nickel, phosphates, tin, rare earth elements, uranium, gem diamonds, platinum, copper, vanadium, salt, natural gas

Sources: CIA, World Bank

Sovereign ratings

S&P	BBB-/Stable
Fitch	BBB/Negative
Moody's	Baa1/Negative

Source: NKC Research

Economy in 2013

Nominal GDP (US$bn)	355.93	Total government debt as % of GDP	46.35
Nominal GDP: World ranking	33 out of 188 countries (IMF)	Total external debt as % of GDP	45.20
Real GDP (% change, y-o-y)	1.89	Consumer price inflation (average, %)	5.75
GDP growth: World ranking	127 out of 189 countries (IMF)	Current account balance as % of GDP	-5.80
GDP per capita (US$)	6,743.64	Equity market: Size in US$	US$512bn
Agriculture as % of GDP	2.55	Equity market: Listed companies	399 primary listings
Industry as % of GDP	28.57	Bond market size	US$119bn govt bonds outstanding in the domestic market
Services as % of GDP	68.89		

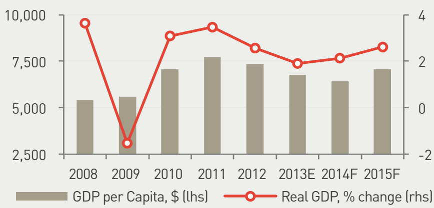
Sources: IMF, NKC Research

Political environment	
Government type	Republic
Head of state	President Jacob Zuma
Head of government	President Jacob Zuma
Ruling political party	African National Congress (ANC)
Main opposition partners	Democratic Alliance (DA), Economic Freedom Fighters (EFF), Inkatha Freedom Party (IFP)
Elections	Election last held on 7 May 2014 (next to be held in 2019)

Source: NKC Research

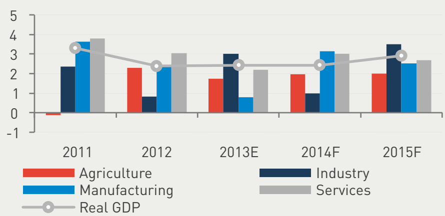
Economic outlook

GDP per capita vs real GDP



Source: NKC Research

Real GDP by sector (% change pa at factor costs)



Source: NKC Research

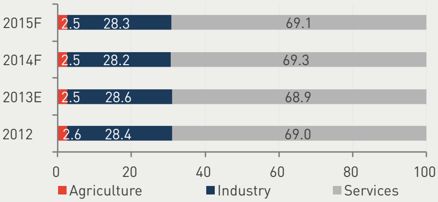
South Africa is the continent's second-largest economy, having ceded the top spot to Nigeria during March 2014 following a rebasing of GDP by the latter. The economy is productive and industrialised around urban nodes, but at the same time exhibits many characteristics associated with developing countries, including a big divide between formal and informal sectors.

South Africa has almost all the commodities essential for international competition except crude petroleum products and bauxite (which is used in the manufacturing of aluminium). Structural constraints on economic activity include strict labour laws, a poor track record on implementing economic policy reforms, electricity supply challenges, and amongst the world's largest inequalities in income distribution.

The South African economy contracted by 0.6% q-o-q during Q1 of 2014 as a result of a near-25% q-o-q drop in mining activity due to a strike in the platinum sector that started on 23 January. The Rand Merchant Bank (RMB)/Bureau for Economic Research (BER) business confidence index (BCI) showed downbeat sentiment amongst private enterprise during the first half of 2014, with a reading of 41 during both the first and second quarters – anything below 50 is negative.

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

GDP by sector (% of GDP)



Source: NKC Research

These readings indicated that almost six out of 10 respondents were unhappy with prevailing business conditions. Overall, GDP growth is currently projected at 2% (at best) during 2014. This is woefully inadequate to create jobs for the millions of people from South Africa and elsewhere on the continent seeking jobs locally; our projections point to an unemployment rate of more than 25% over the medium term.

International trade

South Africa's export revenues declined by 4.1% during 2013 to US$95.5 billion and we expect a recovery of only 1.6% this year to US$97 billion as a result of a projected 6% drop in the value of precious metal and stone shipments. The trade deficit is projected at US$8.5 billion during 2014 (the largest ever at an equivalent 2.5% of GDP) and the current account deficit is forecast to rise by 3% to US$21.25 billion. This will translate into the current account deficit equalling 6.2% of GDP, which will be the highest since the tough economic times of 2007-08. While our outlook is for improved current account dynamics over the medium term, the short term will see pressure on the exchange rate continue and vulnerability to capital outflows intensify. Moody's Investor's Service was correct in its assertion during May that the platinum strike would hold back the normalisation of the current account deficit. However, South Africa's dependence on mineral exports (from an industry prone to strikes) is a structural issue: mineral ores and concentrates, as well as precious metal and stones, accounted for a third of export revenues during 2013.

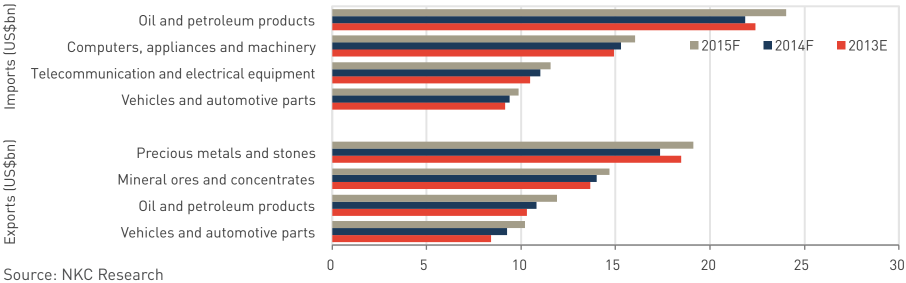
Foreign trade flows, 2013

Main exports	(US$ billion)	Main imports	(US$ billion)
Precious metals and stones	18.48	Oil and petroleum products	22.42
Mineral ores and concentrates	13.65	Computers, appliances and machinery	14.90
Oil and petroleum products	10.30	Telecommunication and electrical equipment	10.48
Vehicles and automotive parts	8.42	Vehicles and automotive parts	9.16

Source: NKC Research

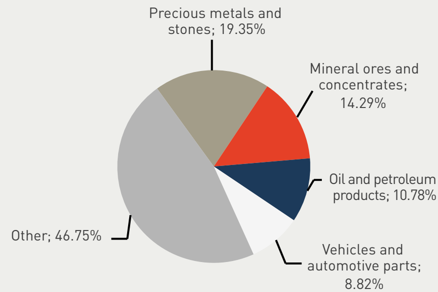
Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

South Africa top four exports and imports (US$ billion)



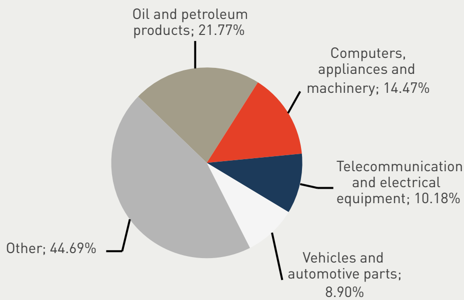
Source: NKC Research

2013 exports (% of total)



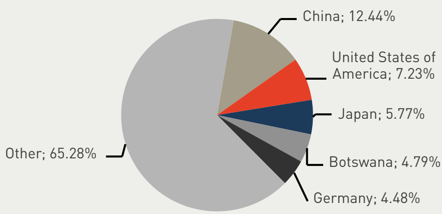
Source: NKC Research

2013 imports (% of total)



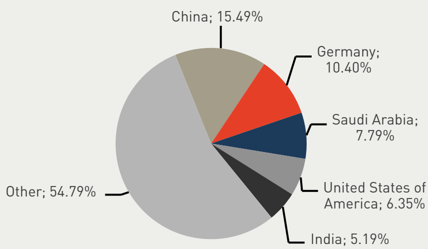
Source: NKC Research

2013 top destinations of exports (% of total)



Source: Trade Map

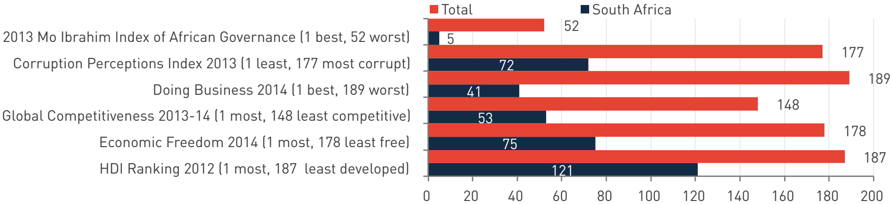
2013 top origins of imports (% of total)



Source: Trade Map

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Business development indicators



Source: NKC Research

Policy environment

Monetary policy:

The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) voted 5:2 in favour of keeping interest rates on hold at its latest meeting on 20 to 22 May 2014. Governor Gill Marcus reiterated that further monetary policy tightening can be expected over the short term and that this will be data dependent, especially on inflation and inflation expectations reports. (Policymakers see inflation outside the target range for another 12 months). It is also still possible that changes to interest rates could occur in 25 basis points intervals last seen more than a decade ago. The central bank will try to increase real interest rates as it raises the repo rate away from multi-decade lows. We do not see the repo rate rising by more than 50 basis points towards the end of 2014, and that this adjustment could be larger were it not for the slow pace of economic growth currently being experienced.

Exchange rate policy:

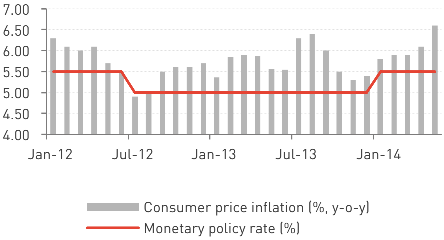
The rand is a free floating currency and amongst the most liquid emerging market currencies. This makes it prone to volatility and shifts in global investor sentiment, and makes the South African economy vulnerable to higher import prices should sentiment deteriorate. Both the SARB and National Treasury admit that they have limited tools to help stabilise the currency during times of volatility. The latest SARB Quarterly Bulletin reaffirmed the central bank's position against using reserves to intervene in the currency market.

'The risks attached to intervention in the foreign-exchange market by selling foreign currency to protect the exchange rate was illustrated when intervention by the Argentinian central bank failed due to a depletion of its reserves, thereby rendering the country very vulnerable,' stated the document.

Fiscal policy:

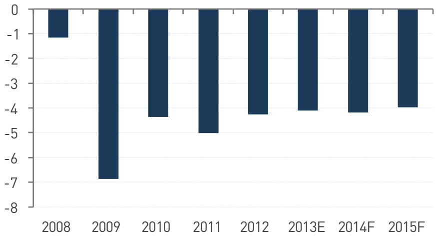
South Africa's external debt levels climbed to their highest since the foreign debt standstill era of the mid-1980s by September 2013 at an equivalent 38.2% of GDP, according to the SARB. This is not surprising considering the expansive fiscal budget deficit seen since the 2008/09 financial year. (By the close of last year, 50% of external obligations were held by public authorities and corporations.) The government has, since 2008, implemented a counter-cyclical policy stance on top of an expansion of its social safety net towards its 'developmental state' strategy. This is set to continue with the appointment of Minister of Finance, Nhlanhla Nene. He was elevated from the deputy position with the appointment of the new Cabinet late in May. However, while his knowledge of state finance matters cannot be questioned, it must be kept in mind that Mr Nene is an African National Congress (ANC) loyalist, and that he might not be as forceful in defending the National Treasury's views when it comes to interacting with the rest of the executive. He already indicated on 29 May 2014 that disappointing GDP data for Q1 will slow the narrowing of the fiscal deficit.

Consumer price inflation and monetary policy rate



Sources: SARB, Statistics South Africa

Budget balance (% of GDP)



Source: NKC Research

Regulatory and tax environment:

Not much has happened in South Africa during the first five months of 2014 from an economic policy perspective as political parties were in full election mode. One of the first jobs of the new Cabinet will be to formulate and approve the five-year Medium-Term Strategic Framework (MTSF) for 2015 onwards that will be the tool used to implement the vision of the National Development Plan (NDP). With the appointment of ANC Deputy President, Cyril Ramaphosa, as head of the National Planning Commission (NPC), implementation of the framework is set to receive renewed attention. However, the NPC has no executive powers, and the success of the NDP will be dependent on government departments implementing the scheme. Elsewhere, the Davis Tax Committee continues its investigation into the 'role of the tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability.' Its findings are expected to eventually translate into higher taxes given our view that the National Treasury has based its long-term planning for the country on faster GDP growth rates (and accompanied increases in tax receipts) than seen of late and projected over the medium term.

Political environment

Despite inroads made by the opposition Democratic Alliance (DA), the ruling African National Congress (ANC) has received a fresh mandate by securing 62.4% of the votes in the May 2014 national elections.

However, apart from the encouraging sign that Cyril Ramaphosa has been installed as heir apparent to the presidency, and Minister of Trade and Industry, Rob Davies, retained his job, the new Cabinet is singularly uninspiring. There is little to suggest that this new executive is going to take the hard decisions and embrace adverse political conditions for the sake of the greater good. The influence of organised labour, although weakened by its internal faction fighting, will remain a key element of the political environment, and one which will prevent any major economic liberalisation or labour market reform.

President Jacob Zuma delivered his State of the Nation address on 17 June to South Africans seeking answers on how to kick-start the country's flailing economy. As for any 'radical transformation of the economy' that has been punted by the ANC of late, there was not a single hint apart from new 'interventions' the state will make, the combined impact of which will put the country's twin deficits and credit ratings under even more pressure. South Africa needed something close to sensational from the president and his State of the Nation address, but it was not forthcoming. He promised higher/expanded minimum wages, that investment in welfare will be increased, and that the Expanded Public Works Programme (EPWP) will add another two million jobs towards 2019.

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Economic environment

Ratings:

Standard & Poor's (S&P) downgraded South Africa's long-term Issuer Default Rating (IDR) from 'BBB' (negative outlook) to 'BBB-' (stable outlook) on 13 June – this was not unexpected. On the same day, Fitch Ratings put its 'BBB' rating on a negative watch, with Moody's Investors Service also having a negative outlook on its 'Baa1' rating. Both S&P and Fitch lamented the continued decline in economic momentum that manifested into a 0.6% q-o-q contraction in GDP during Q1 of 2014 as a result of the protracted platinum strike. S&P's downgrade reflects lacklustre economic growth, continued large twin deficits, rising government debt, and the potential volatility and cost of external debt. Fitch analysts, after indicating downside risks to the performance of the new Cabinet, indicated that its negative outlook could translate into a downgrade (its next review is expected during December) if the government fails to implement structural reforms aimed at boosting economic growth, there is material slippage against current fiscal projections, and if the current account deficit is not narrowed. In response to Fitch's rating announcement, the National Treasury indicated that the government 'will redouble its efforts to improve the regulatory environment, reduce the skills shortage and accelerate its infrastructure investment programme so as to reduce the bottlenecks constraining growth.' In the aftermath of the S&P downgrade announcement, it said that the state's commitment to and ability to service debt has not changed.

Key indicators to watch

Inflation	The central bank targets y-o-y consumer price inflation in a band of 3% to 6% over an 18 to 24 month period. The current outlook is for headline inflation to average above 6% y-o-y over the coming 12 months and that the weak rand exchange rate poses upside risk to this outlook. The SARB is committed to an upward trend in interest rates, with inflation and inflation expectations the key variables in this trajectory.
Exchange rate	The rand was previously seen as a gauge for global risk appetite. However, since early-2012, the currency has more directly reflected sentiment towards the South African economy. It currently reflects a weak local economy, some lingering post-election uncertainty about political matters, more labour strikes, and no intervention by the SARB. The outlook also includes no effective intervention in the economy by political leaders.
Precious metal prices	The platinum price climbed to an eight-month high during May, finally showing some reaction to strikes on the platinum belt. Platinum mining companies were, during the first few months of the strike, able to sell off stockpiles of white metals and have recently started to purchases platinum and related metals on the open market to satisfy customers.

Source: NKC Research

Key vulnerabilities	What is the government doing to address this?
Rising social unrest and political tension as the government fails to live up to their voters' expectations.	Not much, apart from continuously increasing social grants. Electioneering leading up to the May 2014 elections left policy making muted for several quarters.

Key vulnerabilities (continued)	What is the government doing to address this? (continued)
Low economic growth is not keeping pace with employment creation and poverty reduction needs.	The government is continually increasing its spending on public employment and social grants, and is unwilling to admit any failure in policy formulation.
Electricity supply under increasing pressure; winter months in 2014 will see sporadic power blackouts.	State and parastatal expenditure on capacity expansion is on-going and has already shown some success.

Source: NKC Research

Market participation	
Foreign investors	There are no restrictions on foreign investor participation. South African debt markets have been open to foreign issuers under certain criteria: Mauritius and Namibia have issued bonds in the country, while other African sovereigns are also considering this option.
Local investors	Local market participation is made up of the banking and pension fund sector, institutional investors (asset managers and hedge funds), as well as retail investors. The latter can obtain direct market access through brokers or institutional investors.

Source: NKC Research

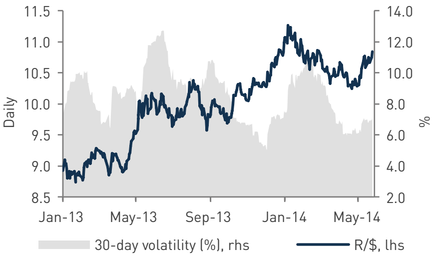
Financial market

Foreign exchange

Security	Average size of a single transaction	Average daily turnover range	Bid/offer spread	Tenor/ maturity	Quotation/ settlement	Reuters page	Additional information
Spot	US$5m	US$9bn	25 – 75 bps	-	T+2	ZAR=	Main cross is US$/ZAR
Forwards (deliverable)	US$1m - US$20m	US$2.8bn	50 bps up to 6 months and 100 bps up to 1 year	Liquid up to 1 year; pricing out to 10 years	T+2	ZAR-FWD=	Main benchmark is US$/ZAR
Swaps	US$1m - US$5m	US$15.6bn	Variable	Liquid up to 10 years, pricing out to 30 years	-	-	Main benchmark is US$/ZAR
Options	US$1m - US$10m	US$450m	1 vols	1 – 24 months, pricing available on 5 and 10-year options	-	-	Main benchmark is US$/ZAR

Sources: Reuters, AfDB

Exchange rate
South African rand



Source: Reuters

A survey by a South African bank published during March 2014 found that currency volatility was ranked by two out of three respondents as a major concern, along with cash flow, commodity prices and political risk. This exposure to currency volatility was found across all industries and company sizes. It was therefore good news that the rand regained some lost ground early in 2014, with an accompanied decline in volatility. The rand returned to below the R11/US$ late in February and was back at R10.50/US$ by early-May. This came in the wake of investors moving money out of Russia and surrounding countries (and into other emerging markets) given the continued tense situation between Moscow and the West around Crimea. Reuters IFR Markets also reported real money inflows (i.e. not speculative) supporting the Malaysian and South African currencies at the end of Q1 and early in the second quarter. Peaceful local elections, continued conflict in Ukraine, and a rally in local bonds all supported the rand during the second quarter. The recovery was also in general attributed to an ebbing in emerging market pessimism, the oversold nature of the local currency, and a struggling US dollar. The rand appreciated to a five-month high of R10.22/US$ on 13 May in the wake of peaceful national elections, and has since been on a weaker footing once more.

The negative impact the protracted strike in the important platinum mining industry translated into weak economic data being released during the second half of Q2. Disappointing GDP growth data and weak mining and manufacturing production numbers sent the rand back on a trajectory towards R11/US$ as the quarter wound down, with little hope that the new Cabinet would be able to do something to arrest the situation. The medium-term outlook for the rand is for a slow appreciation against major currencies, but with volatility and bouts of weakness factored into this trajectory.

Equities

Stock market	Listed companies	Liquidity	Total market capitalisation	Settlement	Most liquid sector	Daily trading volume
Johannesburg Securities Exchange (JSE)	399 primary listings	Very liquid	US$512bn primary listings	T+5	Consumer goods and services; Mining	300m shares

Sources: Bloomberg (Stock market), SARB (Bond market)

The Johannesburg Stock Exchange (JSE) has been on a broad positive run since mid-March and posted fresh all-time highs on many occasions, Emerging stock markets elsewhere were running on a similar trend, while Wall Street indices were trotting rather than galloping. At the same time, local platinum mining stocks ran out of steam as hopes were dashed for a resolution to the country's costliest strike ever. Gold stocks had no clear direction as weakness in the international gold price and a recovery in the rand weighed on their earnings outlook. Rather, the JSE's gains were driven by stronger financial stocks: this sector gained some 20% during the February to

May period compared to the All Share and Top-40 indices rising around 12.5%. Banking stocks in particular – up 25% since the start of February – performed well, with Vunani Private Clients commenting recently that banks' valuations are still below those of the overall market. Some analysts are expecting a pull back in the All Share in coming months after it cracked the 50 000 level on 22 May, arguing that the gains seen in 2014 so far do not reflect current and short-term economic fundamentals.

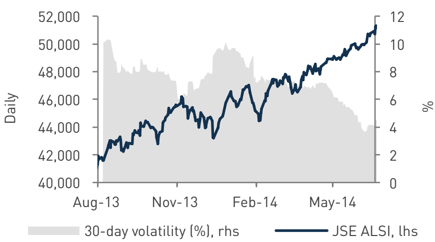
A database glitch delayed the start of trading on the JSE for an hour on 23 April 2014, the latest in a string of errors that have hampered Africa's biggest bourse in recent years. Trade did not start until 08:00 GMT, compared to the usual opening time of 07:00 GMT. Investors shrugged off the delay, however, with the benchmark Top-40 Index hitting another record high soon after the delayed opening. The bourse operator said in a statement that the error was 'related to a JSE database' and not the two-year-old Millennium Exchange trading platform that it had promised would put an end to its stability problems. The JSE moved to the Millennium platform, which was developed by a unit of the London Stock Exchange Group in 2012 to increase trading speeds and in a bid to prevent the network errors that have disrupted trade in recent years. The glitches have been an embarrassment to the JSE, which is looking to court more overseas investors and market itself as a gateway to Africa's growing capital markets.

The bourse announced during May 2014 that it will launch new services aimed at attracting foreign company listings, and that the new range of services – e.g. investor meetings and seminars at the exchange – will support companies in identifying prospective investors and interacting with existing investors.

Top-five listed companies	Market capitalisation
British American Tobacco Plc	US$120bn
SABMiller Plc	US$92bn
Glencore Plc	US$72bn
BHP Billiton Plc	US$67bn
Compagnie Financière Richemont	US$54bn

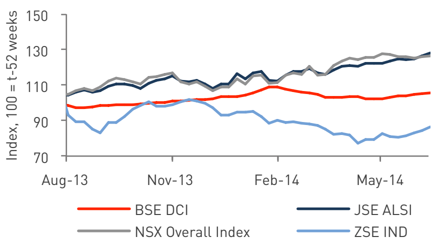
Source: Bloomberg

JSE All Share Index



Source: Reuters, JSE

South Africa and neighbours' SEs performance indices



Sources: NKC Research, Reuters

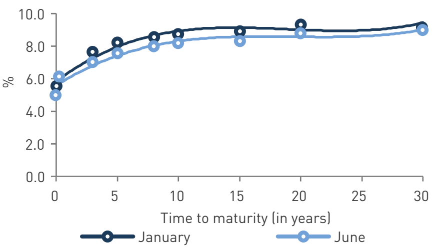
Fixed income

Security	Tenor/maturity	Auction frequency	Liquidity	Quotation/ settlement	Auction participation	Bid/offer spread
Treasury bill	91, 182, 273 and 364 day	Weekly	Liquid	T+0, T+3 at auctions	Institutions, commercial banks	2.5 bps to 5 bps
Treasury bonds	Up to 39 years	Weekly	Very liquid	T+3	Institutions, hedge funds, investment banks	Size-dependent; 1 bpt or above

Source: SARB, JSE

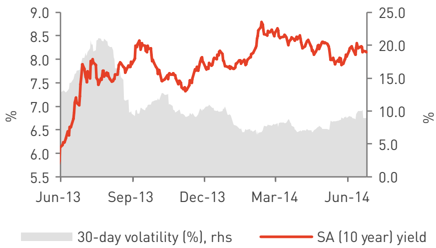
The South African National Treasury issues bills at auctions and by other means, such as a private placement. Registered users may obtain direct access through the Money Market Internet System. Government bonds are issued as a means of financing the country's fiscal budget. Auctions of instruments are held in accordance with an issuance calendar drawn up to facilitate coordination for public sector borrowing with state-sponsored and corporate issuers. The primary bond market is exclusively a wholesale market, open only to primary dealers. Government bonds represent around half of all sales (by value), while municipal and parastatal debt (around 15% of market value) is also well established. The JSE took over the Bond Exchange of South Africa (BESA) during 2009, and currently administers the most diverse and liquid capital market on the continent (both from a government and private issuance perspective). Government paper now has maturities of more than three decades, with the R157 and R186 instruments the most traded. Around a third of the market's trading volumes are from foreign buyers, with South Africa seen as a dynamic emerging market economy from this perspective, rather than an African market. Private non-bank investors (both domestic and abroad) hold around half of the issued debt, with another third held by pension funds. The balance is owned by commercial banks. Transactions on the secondary market are dominated by banks and fund management firms.

South Africa (benchmark) yield curve



Sources: Reuters

South Africa 10-year government bond



Sources: Reuters

Data from the JSE shows that foreign investors sold a net R9.6 billion in bonds during the first five months of 2014 compared to net purchases of R31.4 billion in January to May of last year. Nonetheless, the government's benchmark 10-year bond yield has over the past four months been on a choppy downward trend from the 11-month high near 8.8% seen at the start of February, declining to below the 8% level on 9 May. The sovereign benefitted from some money escaping Russia and Eastern Europe as a result of the on-going geopolitical tensions in and around Ukraine. A stronger rand – which is closely correlated with local long-term yields – also supported stronger interest in the sovereign's debt instruments. From a fiscal perspective, the 2014/15 fiscal budget (released late in February) and the subsequent outturn of the 2013/14 financial year (ending 30 March) carried no big surprises, and reaffirmed the state's intentions to narrow the fiscal deficit in coming years.

Macroeconomic data and forecasts

Key annual economic data	2009	2010	2011	2012	2013E	2014F	2015F
Real GDP (% change)	-1.53	3.09	3.46	2.55	1.90	2.12	2.62
Nominal GDP (US$bn)	283.99	363.24	401.80	384.31	355.93	341.37	377.38
Consumer price inflation (average, %)	7.13	4.26	5.28	5.41	5.75	6.36	5.91
Budget balance, incl grants (% of GDP)	-6.86	-4.36	-5.00	-4.25	-4.09	-4.18	-3.97
- Revenue (% of GDP)	27.59	28.47	25.45	28.77	29.51	30.69	31.80
- Expenditure (% of GDP)	34.45	32.83	30.46	33.02	33.60	34.87	35.77
Government debt (% of GDP)	31.96	37.25	40.71	43.28	46.35	50.90	55.12
Current account balance (% of GDP)	-4.00	-3.91	-4.90	-5.18	-5.80	-6.22	-5.78
Trade balance (% of GDP)	0.20	-0.32	-0.96	-1.10	-2.11	-2.49	-2.12
ZAR/US$	8.47	7.32	7.26	8.21	9.62	10.50	10.00
Short-term interest rate (%)	11.71	9.83	9.00	8.75	8.50	8.63	9.25
Foreign reserves (US$bn)	35.24	38.18	42.60	44.00	44.20	45.91	48.91
Months of import cover	5.88	5.86	4.83	5.00	4.79	4.62	4.53

Source: NKC Research

Key monthly indicators	End-10	End-11	End-12	End-13	Mar-14	Apr-14	May-14
Consumer price inflation (% y-o-y)	3.5	6.1	5.7	5.4	5.9	6.1	6.6
Monetary policy rate (%)	5.5	5.5	5.0	5.0	5.5	5.5	5.5
Foreign reserves (US$bn)	43.83	48.86	50.74	49.59	49.45	49.56	49.21
91-day treasury bill rate (% eop)	6.01	6.16	5.27	5.25	5.85	5.85	5.80
ZAR/US$ (eop)	6.60	8.07	8.45	10.45	10.52	10.47	10.57
Platinum (US$/oz, eop)	1,767.50	1,393.00	1,537.32	1,367.50	1,409.20	1,422.00	1,444.70

Sources: Reuters, Bloomberg, SARB

Note: In the table above, E and F are the abbreviations for estimate and forecast respectively.