STANLIB

Weekly Focus

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STANLIB

Economic Update

Offshore markets, once again, were unsure how to react to the various economic figures released. The OECD (Organisation for economically cooperative and developed countries) leading indicator continues to point to a sharp slowdown in world growth, especially within the G7. This would argue for weaker commodity prices, however growth in China and Brazil is holding up well.

In the US house prices declined by less than expected in June (-15.9%y/y/) but many strategists warn that we have not seen the bottom of the housing recession yet. August US consumer confidence numbers were better than expected, however this was off a very low base, thus consumer spending remains under intense pressure. Finally US Q2 GDP (Gross domestic production) figures were sharply revised up to 3.3%q/q from an initial 1.9%q/q. The key issue is whether the growth rate cannot be sustained in H2 2008?

In South Africa we were also treated to a mixture of the good and the bad:

Good…

- *Unemployment eased to 23.1% during Q2 2008, as the SA economy successfully created 106 000 new jobs!*
- *Both private sector credit extension and M3 money supply eased during July.*

And the bad…

- *Both Consumer and Producer inflation July figures released were higher than market consensus.*
- *We recorded a shock trade deficit of R14.3bn in July, mainly as a result of an R8bn increase in oil imports.*

This Thursday the SARB (South African Reserve Bank) releases its Quarterly Bulletin, and we expect household consumption expenditure and debt to remain under pressure. On the back of the massive infrastructure spend by both the private and public sectors, fixed capital formation should continue to be the main engine of our growth.

GLOBAL

OECD LEADING INDICATOR CONTINUES TO POINT TO A SHARP SLOWDOWN IN WORLD GROWTH

- **The OECD leading economic indicator continues to point to a sharp slowdown in growth, especially within the G7 economies**, which comprise around 61% of world GDP. (The latest data is for June 2008). The OECD-Total covers the following 29 countries, namely: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States.
- In contrast the latest data for major non-OECD member economies point to expansion in China and Brazil but a downturn in India and Russia.
- There is a fairly strong relationship between the OECD leading indicator and industrial production, which suggests that industrial production will moderate further in the months ahead.
- There is only a very basic relationship between the OECD leading indicator and industrial/metal prices. **While this relationship would suggest a further moderation in commodity prices over the next 6 to 12 months**, it needs to be recognized that the OECD leading indicator excludes the BRIC countries, which are obviously also key to the price outlook.
- Unfortunately, while various indicators are pointing to a sharp slowdown in growth, **inflation has moved noticeably higher to 4.5% June.** This compares with a 10-year average of 3.0%.

The OECD CLI (composite leading index) is designed to provide early signals of turning points (peaks and troughs) between upswings and downswings in the growth cycle of economic activity.

USA

US CONSUMER CONFIDENCE IMPROVED MORE THAN EXPECTED IN AUGUST

- In August 2008, the estimate of US consumer confidence, as measured by the Conference Board, rose noticeably to 56.9 from 51.9 in July. The market was expecting an increase to 53.0. The Present Situation Index actually decreased, while the key expectations index rose. This is the second consecutive monthly improvement in the index, but off an extremely low base. Overall the index is still well below the level just 12 months ago of 105.6 and the long-term average of around 100.0.
- **According to the Conference Board Director:** "Consumer confidence readings suggest that the economy remains stuck in neutral, but may be showing signs of improvement by early next year. Declines in the Present Situation Index, both in terms of business conditions and the labor market, appear to be moderating. The Expectations Index, which posted a significant gain this month, suggests better times may be ahead. However, overall readings are still quite low by historical standards and it is still too early to tell if the worst is behind us."
- There is an important relationship between consumer confidence and employment conditions as well as between consumer confidence and consumer spending. The overall level of confidence is still consistent with a very weak economy.
- *The Consumer Confidence Survey is based on a representative sample of 5 000 US households.*
- **Over the past two years the US consumer has been impacted by a large number of negative events** including severe fluctuations in interest rates, a persistently high oil price that resulted in a record gasoline price, a weakening labour market, declining house prices, high debt levels, weakening equity markets and the ongoing war in Iraq. The latest improvement is relatively to an extremely low base. In fact, in June the Present Situation Index at its lowest level ever.
- **Consumer activity is likely to continue to remain under pressure in the months ahead.**

US Q2 2008 GDP ESTIMATE REVISED UP DRAMATICALLY

- The initial estimate of US Q2 2008 GDP growth was 1.9%q/q, annualised. This has now been revised up to 3.3%q/q. The market was expecting an upward revision to around 2.7%q/q. The revision is part of a normal process. This is because additional information become available after the initial data is released. The current revision is the first of two revisions. (The first revision is normally the most significant.)
- **The main reason for the significant upward revision was an increase in exports and hence a reduction in the trade deficit.**
- The key question is whether or not this growth rate can be sustained. There is little doubt that the tax reduction in Q2 2008 boosted consumer spending in the quarter. In fact household taxes fell by $183 billion in the quarter, mostly due to the tax relief programme, and most of this money was spent. This will not be repeated in Q3 2008, hence one could reasonably expect consumer spending to slow in Q3 2008.
- The boost to net exports is unlikely to remain as strong in Q3 2008, partly due to base effects and partly because the dollar has since strengthened somewhat. In addition, housing activity remains weak. Correspondingly, GDP growth is likely to slow very noticeably in Q3 2008.

SOUTH AFRICA

SA CREDIT GROWTH SLOWED IN JULY, ESPECIALLY KEY AREAS OF CONSUMER CREDIT

- In July 2008, SA growth in **broad money supply (M3)** was recorded at a more encouraging 18.5%y/y, down from 20.3%y/y in June. The market was expecting growth to slow to 19.1%y/y. Overall, while M3 growth remains high; there is clear evidence to suggest a further slowdown in the months ahead.
- The growth in **private sector credit** eased to 19.8%y/y in July, from 20.4%y/y in June. Markets were expecting a slowdown to 19.2%y/y. While private credit demand continues to grow at a relatively robust pace, the growth rate has slowed measurably over the past 12 months. In particular, mortgage credit is now growing at only 19.1%y/y, well down from a recent peak of 30.9%y/y in October 2006. Similarly,

credit card growth has eased to an annual rate of only 8.4%y/y (which is negative in real terms). This compares with growth of well over 35%y/y throughout most of 2007.

- Encouragingly, from an interest rate perspective, consumer credit is subsiding, especially the granting of new credit facilities. Much of the existing growth in household debt is being driven by either by a draw-down of existing credit facilities or distress borrowing, or both.
- In real terms (adjusting for inflation), the growth in private sector credit (excluding investments) has obviously slowed noticeably, mostly due to the rise in inflation. Real credit is now growing at only 6.4%y/y, well down from the recent peak of 20.8%y/y in February 2007. During that time inflation has risen from 5.7% to 13.4%, a rise of almost 8 percentage points.
- **On a trend basis, the annual growth in credit demand is showing signs of slowing, albeit relatively slowly. There is evidence that the prior increases in interest rates, the introduction of the NCA, and slowdown in disposable income growth is having a moderating impact on overall demand for credit as well as consumer and housing activity. This is expected to continue throughout the remainder of this year and well into 2009.**
- **Unfortunately, there is growing evidence that consumer debt defaults are rising sharply. Most banks and retailers have reported a noticeably increase in bad debts in the past year. In addition, insolvencies is showing a noticeably increase, albeit off a very low base. These trends are likely to intensify in the months ahead.**

SA CPIX (CONSUMER INFLATION) NOW UP AT 13.0% AS EXPECTED. HIGHEST LEVEL SINCE THE INCEPTION OF THE INDEX

- In July 2008, headline CPI inflation rose by a massive 2.1%m/m, with the annual rate rising to 13.4%y/y from 12.2%y/y in June. This was actually slightly lower than market expectations for a rise to 13.6%. CPIX inflation also rose by a massive 2.5%m/m in July, with the annual rate increasing to 13.0%y/y, from 11.6%y/y in June. This was slightly above expectations for a rise to 12.9%y/y. (Stanlib 13.0%y/y).
- It was surprising that some analysts had forecast CPIX actually falling this month, especially considering the large increases in electricity and petrol prices. **This is the 16th consecutive month that CPIX inflation has been above the target range of 3% to 6% and the highest level of CPIX recorded since the inception of CPIX.**

- The main reason for the increase in CPIX during July was again food and transport costs, but also the higher electricity tariffs and a large increase in rental costs and municipal tariffs. Together these factors accounted for all of the monthly increase in CPIX. CPIX excluding food and fuel moved sharply higher to 7.4%y/y from 6.3%y/y in June, mainly due to the higher electricity tariffs.
- The longer CPIX stays above the target, inflation expectations and wages will be impacted negatively. A number of wage agreements have been settled at above 10% already. In addition, a breakdown of CPIX by income group shows that for very low income earners (as defined by Stats SA); inflation is now up at 16.0%! The main reason is that food alone accounts for 51% of the basket! This could reflect in ongoing protests about the high food/fuel/electricity price.
- **As expected the electricity tariffs increased significantly in July.** In fact there was a 23%m/m increase in the fuel and power category, which was largely expected. Unfortunately, it is very likely that not all of the electricity tariff adjustments were implemented by the municipalities in July. This would suggest that there will be a further relatively large monthly increase in electricity next month, even though it is not a regular survey month for electricity. **The fuel and power category added a substantial 1 percentage points to the monthly increase in CPIX.**
- During July, **food prices** (within CPIX) rose by a further 1.5%m/m, adding 0.5 percentage points to the monthly increase in CPIX. Overall food inflation is now up at 18.5%y/y. While international food prices have moderated a little in the past few months, there is still significant upward pressure on domestic prices at both the producer and consumer level.
- **Vehicle running costs** rose by another 5.2%m/m in July, which reflects mostly the 74c/l increase in the petrol price in July. The annual rate of increase in vehicle running costs is now 36.1%y/y. This contributed 0.6 percentage points to the monthly increase in inflation in July, and was obviously expected given the prior knowledge of fuel price changes. Fortunately, there was a price reduction of 30c/l in August and a further price decrease of around R1.00/l is expected in September. This bodes well for inflation in H2 2008.
- There was a large 3.2%m/m increase in the **housing category** (which contributed 0.4 percentage points to the monthly increase). This stemmed from a combination of higher rental costs and municipal tariffs.
- **Looking forward, CPIX inflation is expected to hold at around 13% next month, but then start to ease off towards the end of the year, especially given the reduction in the petrol price and the high base that has been established in food.**

- Going into 2009, the re-weighting of CPI basket combined with the high base effect should create a more favourable outlook for inflation. This is especially the case if the international oil and food prices can hold-onto recent downward trends.
- **At this stage it is entirely possible the CPIX inflation moves back-inside the target range by the end of 2009, which should allow for interest rates cuts during the course of 2009.**

SA PPI (PRODUCER INFLATION) MUCH HIGHER THAN EXPECTED AT 18.9%Y/Y IN JULY

- **In July 2008, SA PPI increased by a huge 2.7%m/m**, taking the annual rate of change in PPI inflation up to 18.9%y/y from 16.8%y/y in June. This was above market expectations for a rise to 17.5%y/y. There was once again a very wide range of forecasts on PPI inflation this month, with at least one analysts as low as 15.4%y/y? Stanlib 18.0%y/y.
- **The worse than expected outcome was mainly due to another large increase in electricity tariff. There were also a broad range of other fairly large prices increases, which is concerning!**
- **The latest PPI inflation reading is the highest since October 1986, or the highest in almost 22 years!**
- **Electricity prices** rose by a further 25.8%m/m in July, following a 44.4%m/m increase in June. While this increase sounds extreme it is part of the shift by Eskom from summer to winter tariffs coupled with the overall tariff increase. The increase in July added a massive 1.6 percentage points to the monthly increase in PPI.
- **Agricultural prices** are notoriously extremely volatile and very difficult to forecast. During July agricultural prices rose by a substantial 2.6%m/m, but are only up 1.8% over the past year. This reflects the positive impact of the high base established last year.
- Around 63% of the current PPI inflation rate is caused by four categories, namely mining products (including coal, and metal ores), refined fuel, basic metal products (including iron and steel) and electricity. Interestingly, agriculture and food prices now account for slightly less than 10% of the PPI inflation, which is significantly less than a year ago.

- **In 2007 PPI inflation averaged 10.0%.** PPI has now been above 6% for more than two years and is expected to average at least 16.0% in 2008. The new definition and measure of PPI does imply increased volatility month-by-month given the inclusion of many more commodity prices changes, which are significant in weight.

SA RECORDED A SHOCK TRADE DEFICIT OF R14.3BN IN JULY

- In July 2008, South Africa's **trade account recorded a shock trade deficit of R14.33bn.** This compares with a deficit of only –R0.18bn in June. The market was expecting a deficit of R3.8bn for some reason, but the trade balance is notoriously difficult to forecast. The trade account has recorded a deficit in each of the last 19 months and in 30 out of the last 31 months.
- During July 2008, exports rose by a disappointing 1.8%m/m, **while imports surged by 25.3%m/m.** The increase in imports, which amounted to R15bn during the month, was **mainly due to an R8.2bn increase in mineral imports (oil),** an R2bn increase in imports of precious stones/metals, and an R1bn increase in imports of vehicles. On the export side, foreign sale of precious metals fell by R3.1bn. This was offset by an R1.6bn increase in exports of coal, and an R1.4bn increase in exports of base metals.
- **The latest trade deficit is obviously a shock, but the previous two month's trade deficits were uncharacteristically small.** Furthermore, if the increased oil imports are excluded the trade deficit would have amounted to a more respectable R6.3bn, which is in fact in-line with the 12-month average.
- Overall, the growth in imports, especially consumer goods, could slow a little over the next year as the economy slows. Off course, the strong growth in infrastructure projects will result in increased capital goods imports, but hopefully the large purchases of capital equipment will only occur in later years as the projects mature.
- In the past couple of years SA exports have actually been disappointing, especially considering the record high commodity prices. However, the reduction in electricity disruptions coupled with some weakness in Rand should encourage exports.
- **The expected slowdown in imports coupled with some improvement in exports should allow the trade deficit to at least stabilise and possibly improve on a trend basis over the next year. This coupled with some moderation in net foreign dividend outflows (as domestic corporate earnings**

growth slows) within the services account, should allow the current account to improve modestly from the scary 9% of GDP recorded in Q1 2008

Kevin Lings and Melissa Rankin

STANLIB Economics and Group Retail Investing

Rates

The following yields are calculated using an annualised seven-day rolling average as per the unit trust industry standard. These rates are expressed in normal and effective terms and should be used for indication purposes ONLY.

STANDARD BANK MONEY MARKET FUND

Nominal: 11.80% per annum

Effective: 12.46% per annum

A constant unit price will be maintained. Past performance is not necessarily a guide to future performance. A schedule of fees and charges and maximum commission is available on request from the Manager. Commission and incentives may be paid and if so, are included in the overall costs. The yield is calculated using an annualised seven-day rolling average as at 31 August 2008.

STANLIB CASH PLUS FUND

Effective Yield: 12.64%

This is a current yield as at 29 August 2008.

Glossary of Terminology

Bonds	A bond is an interest-bearing debt instrument, traditionally issued by governments as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bonds issued by the central government are often called “gilts”. Bond issuers pay interest (called the “coupon”) to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds/gilts generally have a lower risk than shares because the holder of a gilt has the security of knowing that the gilt will be repaid in full by government or semi-government authorities at a specific time in the future. An investment in this type of asset should be viewed with a 3 to 6 year horizon.
Cash	An investment in cash usually refers to a savings or fixed-deposit account with a bank, or to a money market investment. Cash is generally regarded as the safest investment. Whilst it is theoretically possible to make a capital loss investing in cash, it is highly unlikely. An investment in this type of asset should be viewed with a 1 to 3 year horizon.
Collective Investments	Collective investments are investments in which investors’ funds are pooled and managed by professional managers. Investing in shares has traditionally yielded unrivalled returns, offering investors the opportunity to build real wealth. Yet, the large amounts of money required to purchase these shares is often out of reach of smaller investors. The pooling of investors’ funds makes collective investments the ideal option, providing cost effective access to the world’s stock markets. This is why investing in collective investments has become so popular the world over and is considered a sound financial move by most investors.
Compound Interest	Compound interest refers to the interest earned on interest that was earned earlier and credited to the capital amount. For example, if you deposit R1 000 in a bank account at 10% and interest is calculated annually, your balance will be R1 100 at the end of the first year and R1 210 at the end of the second year. That extra R10, which was earned on the interest from the first year, is the result of compound interest ("interest on interest"). Interest can also be compounded on a monthly, quarterly, half-yearly or other basis.
Dividend Yields	The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. The higher the yield, the more money you will get back on your investment.
Dividends	When you buy equities offered by a company, you are effectively buying a portion of the company. Dividends are an investor’s share of a company’s profits, given to him or her as a part-owner of the company.
Earnings per share	Earnings per share is a measure of how much money the company has available for distribution to shareholders. A company’s earnings per share is a good indication of its profitability and is generally considered to be the most important variable in determining a company’s share price.
Equity	A share represents an institution/individual’s ownership in a listed company and is the vehicle through which they are able to “share” in the profits made by that company. As the company grows, and the expectation of improved profits increases, the market price of the share will increase and this translates into a capital gain for the shareholder. Similarly, negative sentiment about the company will result in the share price falling. Shares/equities are usually considered to have the potential for the highest return of all the investment classes, but with a higher level of risk i.e. share investments have the most volatile returns over the short term. An investment in this type of asset should be viewed with a 7 to 10 year horizon.
Financial Markets	Financial markets are the institutional arrangements and conventions that exist for the issue and trading of financial instruments.

Financial Sector Funds	These funds invest in financial services companies, including banks, insurance companies, brokerage firms and other companies whose principal business operations involve the provision of various financial services or where at least 50% of their earnings are derived from the provision of such financial services.
Fixed Interest Funds	Fixed interest funds invest in bonds, fixed-interest and money market instruments. Interest income is a feature of these funds and, in general, capital should remain stable.
Gross Domestic Product (GDP)	The Gross Domestic Product measures the total volume of goods and services produced in the economy. Therefore, the percentage change in the GDP from year to year reflects the country's annual economic growth rate.
Growth Funds	Growth funds seek maximum capital appreciation by investing in rapidly growing companies across all sectors of the JSE. Growth companies are those whose profits are in a strong upward trend, or are expected to grow strongly, and which normally trade at a higher-than-average price/earnings ratio.
Industrial Funds	Industrial funds invest in selected industrial companies listed on the JSE, but excluding all companies listed in the resources and financial economic groups.
Investment Portfolio	An investment portfolio is a collection of securities owned by an individual or institution (such as a collective investment scheme). A funds' portfolio may include a combination of financial instruments such as bonds, equities, money market securities, etc. The theory is that the investments should be spread over a range of options in order to diversify and spread risk.
JSE Securities Exchange	The primary role of the JSE Securities Exchange is to provide a market where securities can be freely traded under regulated procedures.
Price to earnings ratio	Price to earnings ratio or p:e ratio, is calculated by dividing the price per share by the earnings per share. This ratio provides a better indication of the value of a share, than the market price alone. For example, all things being equal, a R10 share with a P/E of 75 is much more "expensive" than a R100 share with a P/E of 20.
Property	Property has some attributes of shares and some attributes of bonds. Property yields are normally stable and predictable because they comprise many contractual leases. These leases generate rental income that is passed through to investors. Property share prices however fluctuate with supply and demand and are counter cyclical to the interest rate cycle. Property is an excellent inflation hedge as rentals escalate with inflation, ensuring distribution growth, and property values escalate with inflation ensuring net asset value growth. This ensures real returns over the long term.
Resources and Basic Industries Funds	These funds seek capital appreciation by investing in the shares of companies whose main business operations involve the exploration, mining, distribution and processing of metals, minerals, energy, chemicals, forestry and other natural resources, or where at least 50 percent of their earnings are derived from such business activities, and excludes service providers to these companies.
Smaller Companies Funds	Smaller Companies Funds seek maximum capital appreciation by investing in both established smaller companies and emerging companies. At least 75 percent of the fund must be invested in small- to mid-cap shares which fall outside of the top 40 JSE-listed companies by market capitalisation.
Value Funds	These funds aim to deliver medium- to long-term capital appreciation by investing in value shares with low price/earnings ratios and shares which trade at a discount to their net asset value.

Sources: Unit Trust and Collective Investments (September 2007), The Financial Sector Charter Council, Personal Finance (30 November 2002), Introduction to Financial Markets, Personal Finance, Quarter 4 2007, Investopedia (www.investopedia.com) and The South African Financial Planning Handbook 2004.

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