SOUTH AFRICA
Potential for sustainable returns in a stable, low-risk, growing economy

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South Africa's consistent economic growth (average of 3.0% in real GDP) since the birth of its democracy in 1994 reached 5.7% q/q in the third quarter of 2004. Such growth rates were rare pre-1994 indicating a shift towards higher potential growth rates (The South African Reserve Bank and the National Treasury predict a growth rate of 4% within the next four years). The driving force has been the strong global environment and the successful implementation of sound macroeconomic policies like inflation-targeting and a sound fiscal policy. This resilience stems from both a strong domestic economy driven by historically low inflation and interest rates supported by an emerging black middle-class, and from a progressively strengthening international integration of the economy through trade and investment. This is most evident in the booming retail and property sectors, where residential property prices have recorded strong growth rates (32.1% in 2004 alone) over the last four years.

Despite this, South Africa continues to face several challenges including relatively high poverty levels, a backlog in service delivery due to local authority bottlenecks, reform of the healthcare sector – specifically to respond effectively to HIV/AIDS and the alignment of the education sector to the skills demands of the economy. South Africa has made considerable progress in the areas of land reform, housing, corruption, political stability, international relations, crime and unemployment.

The proposed acquisition of a 60% interest by Barclays Plc in ABSA bank for R33bn (the single largest Foreign Direct Fixed Investments ever in the country and the largest investment by Barclays Plc outside the UK) and the hosting of the FIFA World Cup in 2010 have improved the confidence in South Africa's future in international circles. Prudent economic policies have also led to considerable opportunities for investors – both in South Africa and abroad - as an ideal gateway to the rest of Africa. This article provides a concise, comprehensive and balanced insight into the cross-border and local opportunities of the key economic sectors: mining, information communication technology, financial services, the restructuring of state assets, automotives, agro-processing and tourism.

The outlook for economic growth

The growth of the South African economy reached a peak of 5.7% q/q in the 3rd quarter of 2004, and an overall 2004 performance of 3.7%, which is substantially better than the 2.8% in 2003. While growth has subsequently slowed to 3.5% q/q in the first quarter of 2005, it is expected to remain robust. Although this makes South Africa's outlook brighter than that of Europe and marginally the USA, if South Africa is to achieve the growth performance of China, its economy will have to find effective answers to the major challenges facing it. A breakdown as well as the recent history of key economic sectors is shown in Figure 1 below.

Figure 1: Growth in key economic sectors*

	2003				2004				2005
Sectors	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Agriculture	-6,6	-19,5	-20,9	-5,7	8,4	17,6	11,7	4,1	2,7
Mining	3,4	6,6	6,8	2,0	3,7	3,2	8,9	-1,1	9,1
Manufacturing	-3,0	-4,1	-2,1	-0,9	4,9	6,1	6,3	2,5	-1,9
Energy/Water	-1,2	-0,5	0,0	1,0	3,1	2,1	3,5	3,1	1,2
Construction	4,5	3,8	4,5	4,7	6,7	6,5	10,3	7,5	5,1
Wholes/Retail	6,0	9,0	9,7	9,2	4,2	4,8	5,7	6,9	4,2
Transp/Comm	5,0	3,6	3,3	4,7	6,0	6,6	6,7	6,8	5,8
Financial serv.	4,6	3,5	2,4	3,9	3,3	3,6	5,5	6,0	5,9
Personal serv.	5,6	4,7	4,2	3,9	3,6	2,7	5,8	3,4	4,5
Government	0,7	1,0	1,2	1,0	1,3	1,4	1,3	1,3	1,5
Total economy	2,3	1,9	2,2	3,0	4,0	4,6	5,7	4,1	3,5

* Seasonally adjusted real annualised change from previous quarter (Source: STATS SA)

The transformation of the South African economy is characterised by black economic empowerment, international and pan-African integration, liberalisation of various sectors such as energy and telecoms, public-private initiatives, an emerging black middle-class and a growing informal sector.

The stimulating effect of historically low interest rates (Repo rate of 7%) and a strong Rand (when compared to earlier periods), have led the South African Reserve Bank to keep inflation at a targeted band of between 3%-6% despite the country's strong growth.

The strength of its national finances also enables South Africa to embark on major, strategically important infrastructure projects. Some examples include the R8bn Gautrain project (an 80km speed-rail link), the allocation of more than R60bn by the National Treasury ("Treasury") for infrastructure spending to national and provincial government and municipalities. This excludes the R20bn that Eskom and Transnet will spend this financial year as well as other funds in public-private partnerships. Treasury estimates for the 2007/2008 financial year show that R90bn is to be allocated directly from the budget. In addition, Transnet has a five-year capex programme totaling R40bn.

All of these, together with FIFA's award to South Africa to host the FIFA World Cup in 2010 (which is expected to inject R21.3bn into the economy), have raised the government expenditure for infrastructure projects from 5% to 9% of GDP. The 2010 FIFA World Cup will contribute to the establishment and confirmation of the process of democratization and unification that started about a decade ago.

The strong Rand has also enabled South Africa to absorb much of the recent oil price shocks. Furthermore, the positive dynamics noted above have enabled the robust economy to largely absorb the negative effect of the strong Rand on the mining, textiles, manufacturing and resources sectors. However, calls for a more "competitive" exchange rate are placing mounting pressure on the rand to weaken.

Cross-border opportunities: international & pan-African integration

President Thabo Mbeki is playing a leading role in the New Partnership for Africa's Development (NEPAD), and is as such involved in a range of African initiatives of which conflict resolution and peace-keeping are the most prominent. He has strengthened ties with Brazil, India and the Far East to accelerate the development of South-South economic relations. Trevor Manuel, the Minister of Finance, is well-recognised internationally for his achievements and is a strong advocate for international debt relief. At the recent meeting of the Group of Seven (G-7) finance ministers, where Trevor Manuel represented South Africa, it was agreed that the debts of 18 of the poorest countries to the World Bank, the IMF and the African Development Bank will be cancelled.

South Africa's political framework is conducive to participation by multinationals and international funding institutions in a relatively liberal and investor-friendly business environment. Barclays Bank Plc (finance), Tata Africa Holdings (telecoms, technology and vehicles), BMW (motor industry), General Electric (power generation), Standard Chartered (banking) and Bouygues Travaux Pulbics SA (70.63% shareholder in Basil Read Construction) are international companies all currently involved in South Africa.

The rest of the African continent offers many opportunities for companies active in South Africa, and most multinational companies consider South Africa as an investment gateway to the rest of the continent. In particular, the telecoms, IT, banking, media and advertising industries have all made big strides into the rest of the continent: South Africa's share of economic activity, as a percentage of the activity of Africa, sub-Saharan Africa and the SADC-countries, is 19%, 32% and 65% respectively[1].

In addition, South African companies are also taking their rightful place in the international economy. Old Mutual, Anglo American, Sasol, MTN, South African Breweries, Didata, Standard Bank, Industrial Development Corporation, and the Airports Company of South Africa are all South African companies that are increasingly discovering their strong competitive positioning relative to pan-Africa and other emerging markets. And all of them are building up an enviable track-record.

Information Communication Technology

The telecommunications sector was liberalized on 1 February 2005, ending Telkom's monopoly. Consumers and businesses are anticipating definite benefits from the "imminent" launch of the second network operator (SNO), which will be in much-needed competition to Telkom. The selection of the India-based Tata Group, represented in South Africa by Tata Africa Holdings, to acquire a 26% stake in the SNO ends the search for an appropriately qualified technical partner with financial substance.

Competition from Sentech, Wireless Business Solutions, Vodacom, MTN and the SNO has led Telkom to cut its prices for costly broadband internet access and international private leased circuit as it battles tougher competition.

[1] Financial Mail, May 6, 2005, page 18, 19, 20.

Vodacom (with 15.5m customers in Africa - of which 12.8m are in South Africa)[2]; MTN (with 14.3m customers in Africa - of which 8m are in South Africa and 4.4m in Nigeria)[3]; and Celtel International (over 6m customers in 13 African countries)[4] are all competing for the African market. This competition is further illustrated by MTN's offer of US$ 2.7bn to acquire Celtel, which lost to Kuwait's Mobile Telecommunications Company winning bid of US$ 3.4bn.

British entrepreneur Richard Branson is currently negotiating an entry into the South African mobile phone market with his Virgin brand via a joint venture with the country's third-ranked operator Cell C. The two firms would set up a 50/50 joint venture to market Cell C services under Branson's Virgin airlines-to-mobile phone brand.

Financial services

The South African financial sector is recognised as world class in terms of its skilled workforce, adequate capital resources, infrastructure and technology. It is also highly regarded due to its conducive operating, regulatory and supervisory environment.

The sector independently developed its own charter on Black Economic Empowerment (The Financial Sector Charter, the "Charter"), which was approved by government. The Charter establishes responsibilities to track and evaluate BEE progress, small medium enterprise development, provision for low-cost housing and increased access to financial services by low-income earners. One of the Charter's conditions is to channel R124bn into infrastructure and BEE projects by 2008.

On the private equity and venture capital arena, South Africa's Private Equity industry had R42,7bn funds under management as at December 2004 (a 7% increase from 2003), according to the 2004 SAVCA KMPG Private Equity survey. R3,6bn (2003:R1,4bn) of these funds are invested in black owned, empowered or influenced companies. Undrawn commitments as at December 2004 were R14,4bn (2003: R13,8bn)[5] .

South African banks are either following their corporate clients into the rest of the continent or are taking advantage of the relatively under-serviced African market. The acquisition of 60% of ABSA by Barclays Plc will result in ABSA, which already has 5 operations outside South Africa, purchasing Barclays' 10 African operations. The success of the deal will catapult ABSA to the same league as Standard Bank, which already has operations in 16 African countries.

Mining and resources

South Africa is one of the world's and Africa's most important mining countries in terms of the variety and quantity of minerals produced. The main mineral raw materials are gold, diamonds, platinum, chromium, vanadium, manganese, uranium, iron ore and coal. It is the leading producer for nearly all of Africa's metals and minerals production apart from diamonds (Botswana and the DRC), uranium (Niger), copper and cobalt (Zambia and the DRC) and phosphates (Morocco).

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[2] Vodacom Group (Pty) Ltd 31 March 2005 Annual Report
[3] MTN Group Ltd 31 March 2005 Annual Report
[4] www.celtel.com/en/news/index.html
[5] 2004 KPMG SAVCA Private Equity survey, page 4

As the South African mining industry is still predominantly white controlled, emphasis is being placed on stimulating black empowerment in the industry. As a result, several black or union owned firms are now beginning to play an important role in the industry. This is particularly the case following the impending legislation of the Minerals Bill that favours involvement of previously disadvantaged communities in South Africa's mineral resources.

Prominent black companies in the mining industry include Shanduka Group, Mvelaphanda Resources, African Rainbow Minerals and Incwala Resources.

The process of black economic empowerment, coupled with the anticipated change in mineral rights legislation in the country, should see South Africa developing its mineral resources to the benefit of all South Africans.

Figure 2: Black Economic Empowerment Deals in Cross Border Opportunities

Industrial Sector	Target Company	Source Company	%	Rm
Telecommunications	Gateway/Link Africa	Batsalani	60	600
Telecommunications[1]	Spescom Ltd	Vantage Capital	25	24
Telecommunications[1]	Thintana Communications	Public Investment C.	15	6 600
Telecommunications[1]	MTN Group Ltd	Umthunzi	5	2 500
Resources[1]	Idwala Industrial Ltd	Tiso Group	52	938
Financial Services	ABSA	Barclays	60	33 500
Financial Services[1]	Standard Group	Tutuwa Consortium	10	4 100

1 Source; Business Map Foundation, BEE 2005: Behind The Deals

Opportunities in local sectors

The sectors of the South African economy that are thriving are: retail, property, construction, energy & utilities, infrastructure, financial services, telecoms, agriculture, agro-processing and chemicals. This is due largely to the stimulus package and burgeoning black middle-class. The export sectors, in particular mining, agriculture, manufacturing, textiles and tourism, are troubled by the strong Rand. While these are cyclically affected, they are invariably resilient enough to rebound when the Rand weakens against the US dollar.

Restructuring of state assets

The appointment of Alec Erwin (former minister of Trade and Industry), as the Minister of Public Enterprises (DPE), has coincided with a new phase in improving the performance of such state enterprises as Transnet (transport), Eskom (electricity) and Denel (defence products). Their CEOs - Maria Ramos (Transnet), Khaya Ngqula (South African Airways), Shaun Liebenberg (Denel) and Thulani Gcabashe (Eskom) - are all either newly appointed, or have been given the priority of getting their enterprises to focus on their core business. The earlier approach of privatisation is, due to the poor conditions of these enterprises and the healthy state of government finances, being replaced by possible Public-Private-Initiatives (PPIs) [6]. This will not only appease the labor federations but will also address the backlog in investment that these enterprises need if they are to be efficient.

Only non-core assets - some 30 entities in Transnet and Eskom alone - are available for privatisation; these include, for example, IT and courier services. The privatisation of Telkom and the Airports Company has proved how successful privatisations can be when properly targeted and effectively managed.

[6] Euromoney Yearbook, 2004–2005, page 19-25

Automotive Industry

The outlook for the South African automotive industry is much brighter than that of the global sector. While CEOs around the globe are concerned about profitability, overcapacity, record oil prices, erratic economic growth and consumer confidence, manufacturers in South Africa (Ford, General Motors, Toyota, Volkswagen and DaimlerChrysler) have aggressive ambitions for both their local market and their exports to the Far East, into Africa and back to Europe. These ambitions range from expanding product ranges (Ford, Volkswagen), regaining market share (Ford), acquisitions and share buy backs (General Motors, Toyota).

Toyota will double its production in the next five years, aiming at a production of 250,000 automobiles, exports of 100,000 and local South African sales – by 2010 - of 150,000, up from its present level of 113,534. DaimlerChrysler produced a record of 52,274 cars in its East London factory and an increase in revenue of nearly 10% to R24,7bn. The output, however, could not meet the demand and the company is planning a 5% annual growth in revenue.

Agro-processing

South Africa covers 1.2 million square kilometres of land, has a coastline of over 3,000 km served by seven commercial ports, and contains seven climatic regions that range from Mediterranean to subtropical and semi-desert. The fact that its seasons run counter to those of Western Europe means that it offers a fertile ground for joint ventures with European companies. The product range comprises citrus, subtropical fruit, grain, wool, cut flowers, livestock, game and ostriches at highly competitive input costs. The sector has, over the years, been successful in replacing its central boards (setting volumes and prices for each product, for example, maize) and leaving the international markets to balance supply and demand, while using financial instruments to protect itself against business risks. In the process, it has developed increasingly open trade relations with USA and Europe.

Tourism

The job-creation potential is yet to be fully unlocked. Each year, over 5.9 million tourists visit South Africa. The country is highly diverse in terms of climate, culture, tourist activities and natural beauty, making it attractive for a variety of tourists. New investments have taken place in hotels, golf estates, residential and leisure property developments and port facilities. Service levels are arguably of international standard. The FIFA World Cup in 2010 is expected to have a substantial impact on the tourism sector.

Figure 3: Black Economic Empowerment Deals in local sectors[1]

Industrial Sector	Target Company	Source Company	%	Rm
Real Estate	Capital Property Fund	Shanduka Properties	5	50
Automobiles (parts)	Timken	Bokamusa	26	39
Food processing	Premier Foods Ltd	Fabcos Investments	23	700
Transport	Putco Ltd	Safika Investments	33	145
Training/Development	Primserv Group Ltd	Kgorong	26	143
Training/Development	Isilumko Staffing	Hosken Investments	30	14
Tourism	Gatsby Hotels	Community Investment	51	40
Tourism	Halycon Hotels	Akani Hotels	100	35

1: Source; Business Map Foundation, BEE 2005: Behind The Deals

Black Economic Empowerment

The dynamics of the South African economy can be better understood by assessing the advances Black Economic Empowerment (BEE) continues to make. The empowerment framework was laid down in the code on BEE and has been prudently developed. Sector-specific BEE charters lay down the framework of conditions and are generally accepted as instrumental to achieving the objective of a more even distribution of economic power. They are based on a balanced score card approach, one that rewards pro-active enterprises and avoids direct government intervention. Without consistency in application, the effectiveness of the charters is limited.

The early empowerment initiatives in the mid-1990s were plagued by the lack of value-addition, un-commercial or skilled management participation, unimpressive stock markets, and considerable political opportunism. But now the previously disadvantaged South African communities are demanding their rightful share of the economic power through broad community- based alliances that will bring them directly into the economic mainstream. Broad-based empowerment aims not only at equity ownership but also at participation in management positions and supply side empowerment, such as that achieved in the recent Old Mutual deal[7] and in the programme developed by African Bank Investment Limited[8] to transfer over time a 7% stake in its business to possibly up to 30 000 individuals.

Contrary to the sensational media exposure of the enrichment of a few well-connected individuals, the reality is that much empowerment activity is generated by smaller and medium-sized entities that include very creative structures for broad-based communities and employee participation. BEE is, in fact, such a vibrant sector that some 75% of all corporate activity in South Africa is empowerment-based, and needs prioritisation by serious investors.

The Economist of 23 April, 2005, summarised the situation aptly by noting that if empowerment comes at a cost to the economy in the short-term, it must surely be a very small price to pay for the considerable structural advantages it brings to the economy in the longer term, not to mention the underlying social stability it will also create.

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[7] R7.2bn value of shares were transferred (13.5% Old Mutual SA, 11.5% Nedcor and 11% of M&tF) to staff (39%), clients and distributors (27%) communities (10%) and new black business partners (24%).

[8] Business Day Tuesday 17 May

Figure 4: Additional Black Economic Empowerment deals

Industrial Sector	Target Company	Source Company	%	Rm
Forestry, paper	Mondi SA	Shanduka Resources	42	2 450
Oil and Gas Services	Uhambo Oil Ltd	Tshwarisano	25	5 000
Construction	Aveng Ltd	Qakazana	25	496
Industrials	Rebserve Holdings	Mvelephanda	53	1 500
Chemicals	AECI	Empco	25	401
Steel	Kulungi Metals	Pamodzi Investments	30	200

The fundamentals[9] and challenges of an emerging robust democracy

The outlook for economic growth for South Africa described above is based on the stable economic environment created since 1994. Financial authorities have complimented South Africa on its determined pursuit of a prudent economic policy[10]. This policy continues to be subject to an open and healthy debate as evidenced by the recent African National Congress (ANC) papers - covering the balance between on occasions conflicting dimensions of economic policy like flexibility of labour law, position of the currency, BEE, levels of investments, employment and reduction in poverty - in preparation of its national general council meeting in June 2005[11].

Despite the continued uncertain global economic outlook, the country continues to strengthen its consistent growth pattern: growth in its GDP rose from -2.1% in 1992 to 4.2% in 2000 and 3.5% in Q1,2005 while, according to the recent budget speech, economic growth of 4.3% is expected for 2005[12]. Inflation[13] has also been reduced: from an average of 12.5% between 1990 and 1994, to an historic low of 4.3% in 2004 and 3.9% in Q1, 2005. While inflation is rising it should remain comfortably within the 3-6% target of the Central Bank. The budget deficit has also narrowed: from 10% in 1993/4 to 1.1% in 2002/2003. Subsequently is has been allowed a controlled rise to 3.1% in 2005/06. And finally, after the sudden rise in the prime rate in 2002 to 17.0%, interest rates have also fallen sharply again, to the present level of 10.5%. Worldwide, the Rand continues to be a strong performer against the US dollar: from an average of 6.44R=1US$ during 2004[14], to its present level of around 6.9R=1US$, strengthened from almost 14.00R=1US$ in December 2001. As a result, the South Africa Confidence index has reached its highest level in 15 years.

South Africa's strengths lie in its constitutional democracy, its strong banking and legal systems, good communications infrastructure, mineral resources, English-speaking business community, strategic geographical position, climate and, not least, its proud track record in negotiating practical political solutions. The land-reform program appears to be going well and is a proactive approach to securing longer term socio-economic stability. South Africa's free press, tolerance of political opposition, and strongly independent judicial system are also all vital cornerstones for its democratic future.

However, although apartheid has ended, racism has not. Despite the achievements of the last eleven years, race is still a dominant factor in the distribution of resources, skills and opportunities.

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[9] Euromoney, Venture Capital & Private Equity Yearbook, 2000/2001, page 83-86.
[10] The Economist, October 12, 1996; December 13, 1997; May 29, 1999; February 24, 2001; IMF and World Bank; Financial Times, November 26, 2001.
[11] Business Day May 18 2005
[12] Budget speech, 23 February, 2005.
[13] CPIX inflation (consumer prices excluding mortgage interest).
[14] Financial Times Special Report Tuesday 24 May 2005

Figure 4: Structure of the South African economy

GDP (Rbn)[1]	2001	%	2002	%	2003	%	2004	%
Agriculture[2]	26.6	3.1	28.3	3.2	26.6	2.9	26.9	2.8
Mining	63.3	7.3	63.9	7.2	66.7	7.3	69.4	7.3
Manufacturing	164.1	19.0	168.7	18.9	167.3	18.2	171.6	18.0
Energy/Water	22.0	2.5	22.0	2.5	22.1	2.4	22.5	2.4
Construction	22.2	2.6	23.4	2.6	24.7	2.7	26.2	2.7
Wholes/Retail	125.0	14.5	127.9	14.3	136.5	14.8	145.4	15.2
Transport[3]	85.6	9.9	93.4	10.5	98.3	10.7	103.7	10.9
Financial serv.	169.0	19.6	179.6	20.1	187.0	20.3	194.1	20.3
Government	131.9	15.3	132.6	14.8	133.9	14.6	135.5	14.2
Personal serv.	52.5	6.1	53.9	6.0	56.5	6.1	58.7	6.2
Total value added (basic prices)	**862.3**	**100.0**	**893.7**	**100.0**	**919.3**	**100.0**	**954.0**	**100.0**

1. STATS SA 2. Including Forestry and Fishing. 3. Including communications.

While the South African government has a comprehensive programme on HIV/AIDS, including the recent introduction of anti-retroviral treatment in the public health sector, the burden on the economy is showing. It should be noted, however, that private sector initiatives have been taken to protect the interests of employees and companies alike.

The ambitious infrastructure plans from the government may make South Africa face a real capacity problem of qualified professionals, a problem which could partly be resolved by foreign consultants or by South African nationals repatriating from abroad.

As a result of the high unemployment, labour relations in South Africa remain delicate. Depending on how unemployment is measured, the percentage is anywhere between 25% (according to the official ILO definition) and 40% (according to the expanded definition) [15]. Traditionally, the unions have been, and still are, strong. However, they are also pragmatic and have adjusted to the requirements of a global economy, and putting privatisation on the back burner in favour of PPIs is likely to improve the stability of labour relations. The good news is that since 2003, the economy is generating more jobs than it is shedding. Small and medium-sized enterprises (SMEs) are likely to generate the new jobs, which will be subject to more flexible labour laws. It should be noted that all the sectors covered in this chapter can be supplied by SMEs.

A number of specific programmes support economic growth: the Strategic Industrial Projects (SIP), the Industrial Development Zone Programme (IDZ), the Small and Medium Enterprises Programme (SMEDP), the Skills Support Programme (SSP) the Foreign Investment Grant Programme (FIG) and the Critical Infrastructure Programme (CIP). A lowering of the corporate tax rate to 29% has also helped competition.

[15] The Economist, January 22, 2005, page 27

Conclusion

South Africa has made significant progress since 1994 in building a solid base for its economic growth, something it has achieved largely by its own efforts. The outlook for the South African economy is excellent and offers a variety of opportunities for the national and international investor. The confidence of the international businesses community has also risen and led to several concrete investments (for example, by Barclays and several mining companies).

A balanced perspective on the fundamentals described above show that investment and business is burgeoning in South Africa, driven by both internal, as well as considerable foreign, interest. South Africa's physical location also makes it an ideal gateway to the African continent, and to specific growth areas within the country for the international investor.

Successful investment must, however, show extreme sensitivity to the ongoing 'struggle' to make up for the imbalances and injustices of the past. It must also have confidence in the robustness of the Black Economic Empowerment program. For this reason, to be successful in such a dynamic, rapidly changing and potentially prosperous environment, investors are well advised to work with credible South African partners.

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