Dynamic Wealth
Established in 1971

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ECONOMIC
& MARKET ANALYSIS

Dynamic Wealth is an Authorised Financial Services Provider

MAY 2008

MARKET ANALYSIS

TABLE 1: KEY MARKET INDICATORS FEBRUARY 2008

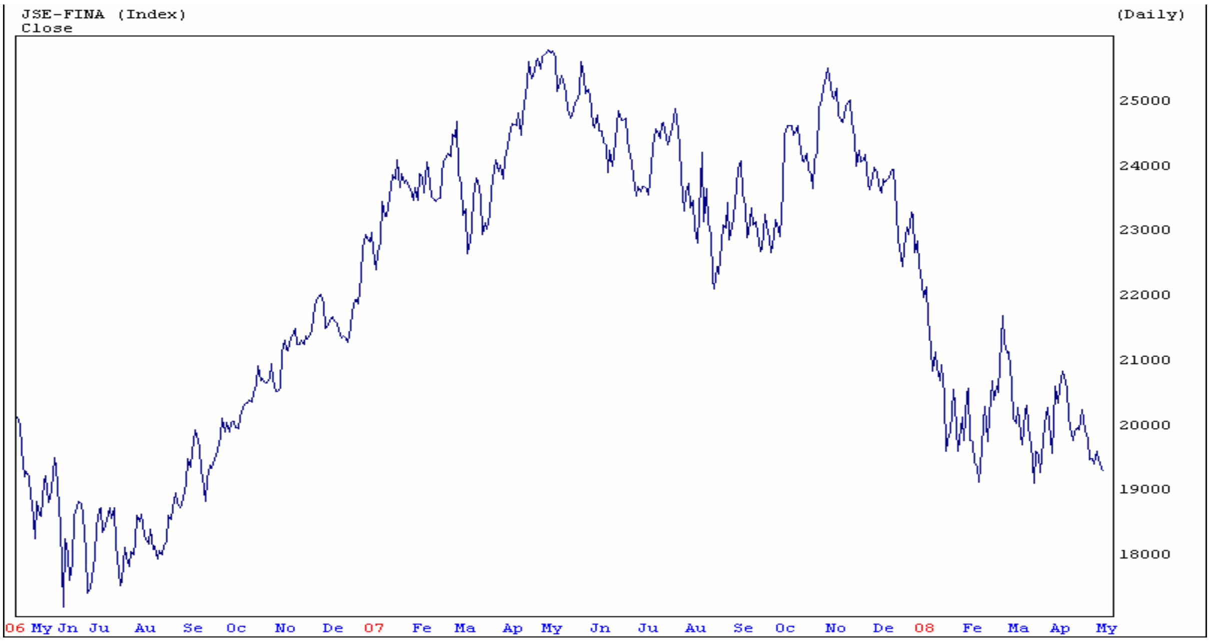
INDICATOR	31 April closing	Monthly movement	Expectation for the month
ALSI	30743	+1155 (+3.9%)	Increase
Industrial Index	24338	1043 (+4.48%)	Increase
Gold Index	2280	-237(9.42%)	Volatile
Financial Index	19592	34 (0.17%)	Decrease
SA Property Index	288	+19(-6.19%)	Decrease
Rand/dollar	R7.56	-57 (-7.07%)	R7.35-R7.70
Gold Price	$886	-$48(-5.09%)	$830-$880
Dow Jones	12892	+241(+1.91%)	Increase
FTSE-100	6087	+385 (6.67%)	Increase
Nikkei	13849	+1324 (+10.57%)	Increase
Hang-Seng	25755	+2906(+12.73%)	Increase
R157	9.50%	+30 (+3.09%)	Increase

Although still uncertain, more and more signs of global calmness in financial markets are returning. The US recession and international oil price ghosts are likely to haunt share and bond markets over the next few months, but market sentiment is slowly turning positive. In the US, news that fewer job losses (20 000) were recorded since October 2007 than initially expected (70 000), as well as the latest US cut in interest rates are leading the positive sentiment. In reaction, the Dow Jones recovered quickly during April (+1.91%) and broke through the 13 000 level during the beginning of May 2008. This slight improvement in the prospects for the US economy filtered through to almost all other bourses over the globe. Especially the FTSE-100 (6.67%), Nikkei (10.57$) and the Hang Seng (12.73%) indices recorded large gains during April.

The current debate on the US recession will still remain with us for at least the next three to five months. The dollar will determine the direction of the debate. The currency has already appreciated almost 4.5 cents or 2.3% against the euro since 22 April, sparking the current strong recovery in US share prices. This rally immediately brought speculation onto South African markets that the current run in the gold price may be over. Gold lost more than $70 (7.8%) over the last five weeks. It is clear that if the dollar continues to appreciate, the sparkle of gold will diminish. At the same time, it is also clear that a stronger US economy will boost the demand for other resources like coal, oil, steel and platinum even higher. Therefore, fundamentally, share prices for resources on the JSE will stay bullish. The oil price has already increased rapidly and burst through the $120 per barrel level during the first week of May 2008.

Domestically, the drivers of inflation are intensifying. These drivers are the petrol price, food prices, prices for clothing and administered prices. In reaction to the sharp increase in inflation, the Monetary Policy Committee (MPC) lifted the repo rate by 0.5% in April. This move intensified the already negative sentiment towards financial and listed property shares. The financial index lost almost 4% from the beginning of April, whereas the property index decreased by almost 7.0%. It is expected that these inflation drivers will continue to push up the inflation rate for at least the next three to four months. Therefore one can expect that if the MPC is consistent, the repo rate may increase with at least another 1%. Volatility due to uncertainty in the industrial, financial and property markets are likely to continue.

Figure 1: The strong downward correction of financial shares due to five repo rate increases since the middle of 2007



TECHNICAL ANALYSIS

Figure 2: THE JSE TOP 40 INDEX

In the March issue of technical analysis, the following was forecast: 'I am of the opinion that **after** this current correction that is now taking place the Top 40 index will push **through** the October 2007 highs and make new all-time highs'.

As can be seen from the chart above, the Top 40 index did indeed push through the October 2007 high. Technically, the market is in an upward trend and should continue for the next few months. The Top 40 index will be at risk, should it fall below the upward trend line. Investors should HOLD.

ECONOMIC ANALYSIS

INTERNATIONAL

Though it was expected that world economic growth for 2008 and 2009 will be way below the highs of 4% to 5% recorded over the past few years, such slowdown might be more severe than initially anticipated.

However, it can be safely assumed that the drivers of both economic growth and international capital flows will undergo significant changes during the next two years as the international economy adapts to policy changes. In order to keep up with these developments, the South African policymakers will have to adapt, or again lose out in terms of comparable international progress.

According to the International Monetary Fund (IMF) international economic growth of 3.7% in 2008 and 3.8% in 2009 is expected. In September last year, the forecasts were 4.2% and 4.4% respectively. And the IMF says there is a 25% chance that world economic growth may fall to below 3% this year.

The main reason for the lower expected international growth rate stems from relatively large downward adjustments in the growth rates for the USA, China and India – three of the five largest economies in the world. The USA's expected growth rate for 2008 is now 0.5% compared to 1.5%, that of China 9.3% compared to 10% and India is now expected to register growth of 7.9% compared to the September 2007 forecast of 8.4%.

The bulk of these adjustments stems from the sub-prime crisis in the USA, as well as higher international food and oil prices (set to continue for a prolonged period) which contributed to higher inflation and hence interest rates in many developed and developing countries.

In order to deal with theses problems, the USA's Federal Reserve Bank again cut interest rates by 25 basis points to 2%. The rate was 4.25% at the beginning of this year. Though the Fed's statement showed that the Fed is more worried about growth than inflation, the concern seems to be abating – as sentences pointing to downside risks to growth had been removed.

However, a real concern about growth in the Eurozone is starting to set in – especially as inflation is dominating Euroland's prospects. A recovery in the US dollar against the euro has therefore started with the dollar gaining 4% from the lows of $1.60/E recorded last month. The expectation is for the recovery to continue over the short run, which might be the start of a longer term trend.

SOUTH AFRICA

Unfortunately, headlines are still and will for some time be dominated by the electricity and inflationary problems. A period of higher interest rates for longer would therefore seem to be in the offing. However, the longer term picture looks much brighter as the authorities are executing policy to tackle the problems.

ECONOMIC GROWTH

Economic growth for the first quarter due to be released by STATSSA on 27 May is expected to show a dramatic slowdown from the 5.3% of the fourth quarter. Lower growth in especially the mining and consumer related sectors are expected, while construction and some investment related sectors should post reasonable growth rates.

TABLE 2: KEY ECONOMIC INDICATORS

ECONOMIC INDICATOR	Period	Latest*	Previous	2007	2006	2005
Consumer Price Inflation (CPI)	Mar	**10.6%**	9.8%	7.1%	4.7%	3.3%
Inflation Target (CPIX)	Mar	**10.1%**	9.4%	6.5%	4.6%	3.9%
Production Price Inflation: PPI	Mar	**11.8%**	11.2%	10.0%	7.7%	3.2%
M3-Money Supply Growth	Mar	**21%**	20.9%	22.2%	22.8%	16.0%
Private Sector Credit Growth	Mar	**22.6%**	20.8%	23.7%	24.1%	20.4%
Repo Rate; Prime Rate	April	**11.5%;15%**	11%	11.0	8.0	7.0
Current Account Deficit (CAD) – actual amount (billion)	2007	**R145**	-	R145	R112.4	R62.3
Trade Deficit(-)/surplus (billion) – SARS amount**)	Jan-Mar	**-R21.5**	R16.1	R69.3	-R68.6	-R21.3
Net foreign purchases of shares and bonds (billion)	Jan-Mar	**-R22**	-R29.5	R83.8	R107.8	R39.5
Reserves accumulated after financing of the CAD (billion)	Jan-Mar	**R6.8**	R5.6	R47.8	R29.7	R34.3
Net cum. foreign reserves of SARB (billion)	Mar	**$33.1**	$32.7	$31.3	$22.98	$17.2
Economic Growth	Q 4	**5.3%**	4.8%	5.1%	5.4%	5.0%
Retail Sales	Feb	**2.5%**	0.7%	5.1%	9.6%	6.7%
Manufacturing Production-Volume	Mar	**-1.1%**	3.9%	4.1%	4.8%	3.5%
Unemployment (official definition)	Sept 2007	**23%**	25.5%	25.5	25.6%	30.5%

* The terms period, latest and previous refer to year-on-year growth for the latest and previous months. Economic growth refers to quarter-on-quarter growth expressed in annual terms adjusted for seasonal factors – previous refers to the same growth rate between the previous two quarters. Cumulative numbers refer to the total amount from the beginning of the year to the respective months.
** The trade deficit of the South African Revenue Service differs from the South African Reserve Bank amount – the latter is used for calculating the CAD.

Rising inflation and interest rates should have taken its toll on the retail and financial services sectors. Retail sales are already down at the 2% growth level compared to 9% last year. And initial numbers show a sharp increase in bad debt numbers which must have affected the performance of the financial sector.

As in the case of mining, manufacturing will show a poor return due to, amongst others, load shedding and sharp increases in input costs. The Investec PMI for March deteriorated to below 50 points, thereby pointing to negative growth in the manufacturing sector. In addition, production shrank 1.1% in March. However, the construction and transport sectors should have performed relatively well due to the country's infrastructure investment needs. As such, economic growth might be stronger than currently expected by the market.

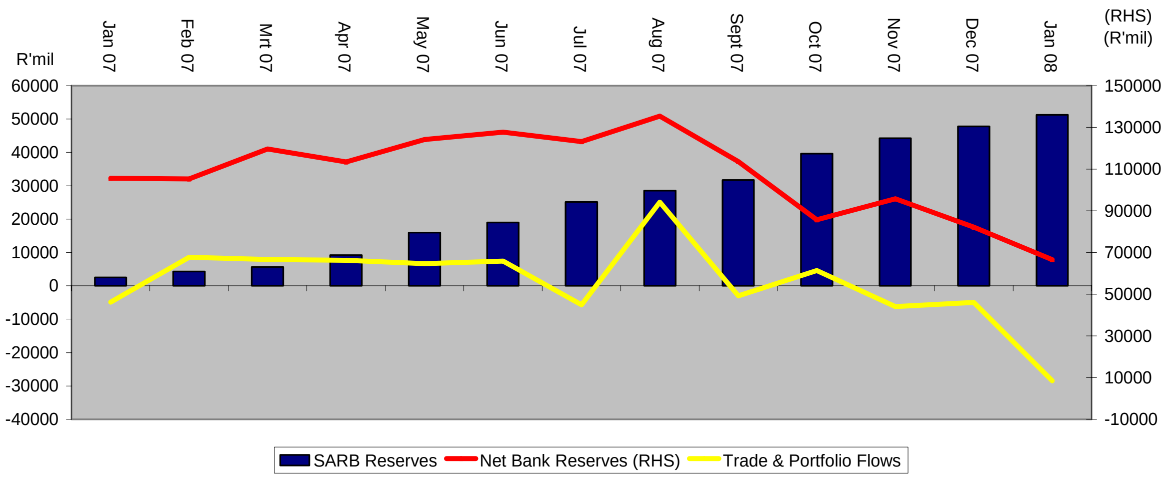
INFLATION AND INTEREST RATES

Inflation X, reaching 10.1% in March, will test the 11% level in due course. The main drivers remain food, petrol and other administered prices. These non-interest rate sensitive prices increased by 14.5% in March, while interest rate sensitive inflation was up 5.9%. Concerning is the fact that interest rate sensitive inflation has reached the upper level of the inflation targeting band of 3% to 6%. This points to second-round effects stemming from petrol and other administered price increases. And third-round effects accruing from higher than inflation wage increases of 11% and more will add to the inflation pressure. As a result, more increases in interest rates are now a strong possibility.

CURRENT ACCOUNT DEFICIT

Though non-interest rate sensitive prices will remain the largest inflation driver, the biggest inflation risk stems from financing (or the lack thereof) of the deficit on the current account (CAD) of the balance of payments.

Figure 3: SA Banks' foreign reserves used to finance CAD



The deficit currently is (to a large extent) financed through short-term foreign capital attracted by the high interest rates. This implies that interest rates will have to remain high in order to keep the financing going. Conversely, a lack of enough foreign capital will trigger a weakening of the rand exchange rate – and for that matter higher inflation.

During the first quarter of 2008, South Africa recorded a trade deficit of R21 billion (approximately R15 billion in Reserve Bank terms), as well as portfolio outflows of R22 billion. This implies capital inflows of at least R36 billion (yellow line in Figure 3) were needed to finance the CAD. According to the Reserve Bank, this did indeed happen. In fact, more than enough was received and foreign reserves of R6.8 billion were accumulated in the first quarter (blue bars in Figure 3).

However, the concerning factor is the source of capital inflows. During January, South African banks' reserves were used to partly finance the CAD (red line in Figure 3), while carry trade (high interest rates attracting foreign inflows) was the main source of financing in March. February's financing is unclear at this stage.

This is a very dangerous situation as 'these extraordinary sources of capital inflows' are not sustainable. Moreover, it also points to interest rates having to increase further in order to keep the capital inflows continuing (as other regions competing for the same inflows are also busy or contemplating interest rate increases).

In addition, higher rates will have to play the dual role of also having to stem the already fragile consumer demand further – to reduce imports of consumer products in order to create room for the investment imports needed to improve the country's infrastructure. If not, the trade deficit, already 43% higher in the first quarter (compared to a year ago), will add pressure on the CAD to increase and increase the need for larger foreign capital inflows.

But, MTN could be the CAD rescuer this year. The announcement of Bharti Airtel, a leading cellphone company in India, and rumours of a rival offer by Vodafone for a stake in MTN to the value of $18.5 billion and £20 billion respectively, will go a long way in financing the CAD. Should the majority of the purchase be financed with inflows to South Africa, the CAD will be financed easily. And it will put a ceiling on rand weakening, reducing the pressure on the CPIX and interest rates to increase excessively.

OUTLOOK

Lower economic growth, high inflation and more pressure on interest rates seem to be the prospect until at least the end of the year. Consumers will feel the brunt of these difficult times. However, the current situation is not yet comparable to the difficult times of 1998 and 2002. In fact, consumers in general are in a better state to handle the situation as they now possess much stronger balance sheets. Rate increases will therefore not be a train smash.

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May 2008