

## Economic review



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### Resilient global economy in 2005

After expanding by 5,1% in 2004, the world economy is estimated to have grown by 4,3% last year. In the face of record high oil prices and despite mounting global imbalances, corporate profitability remained firm, bond yields low and underlying inflation muted. The global economy's resilience in 2005 was centrally tied to excess market liquidity brought about by the major central banks' monetary accommodation.

The United States led the positive economic performance, while the Japanese and Euro-zone economies showed identifiable signs of recovery. Of the East-Asian economies, China aggressively leveraged its export prowess, while India benefited from external cyclical stimuli. Relative to other emerging markets, by recent historical contrast, Latin America and Africa recorded above-average economic performance.

### Sustained, firm growth for major economies

In 2006, the global economy is likely to closely match the growth rate recorded in 2005, aided by the increasing thrust from Germany and Japan.

Aggressive restructuring by firms in conjunction with moderate wage increments should help Germany expand at twice the pace it did in 2005 and, accordingly, act as Europe's growth engine. Japan's economy should find relief from the combination of rising personal incomes, company profitability and sustained accommodative monetary policy. Japan's investment cycle should underpin future growth.

Meanwhile, the United States is expected to maintain its established performance, despite the successive increments in short-term interest rates since June 2004. Prospective economic growth should be supported by healthy employment and income growth, strengthening capital expenditure and a firm external dynamic.

### Favourable prospects for emerging economies

Emerging economies have profited from the benign global conditions in recent years. Investment inflows to these markets, aided by global liquidity and enhanced investor risk appetite, have buoyed economic growth. Also, strengthening local currencies reduced foreign-currency debt burdens and dampened inflation. Consequently, many emerging economies have experienced structural changes.

The outlook for emerging economies in 2006 is reasonably positive, given the excess global market liquidity. However, in some markets, concerns will centre on overvalued local currencies and prudent monetary management as foreign capital flows inwards.

Among the key markets, the Chinese and Indian economies are likely to expand by 8,5% and 6,5% respectively in 2006, both modestly softer than in 2005. In China, exports are showing signs of fatigue and the fixed investment cycle is straining due to overcapacity and falling profits. In India, a likely rise in short-term rates will weigh on the strong leveraged consumption growth, although the economy should be cushioned by a pick-up in corporate investment.

Russia's economy is extremely energy-dependent and a buoyant commodity cycle will sustain growth momentum. Strong export income has raised Russia's domestic demand and consumer confidence is high. Latin America should be supported by positive global conditions and should record above-trend growth. Africa also appears to be establishing superior trend growth, strengthened by a more productive political and macroeconomic profile as well as lively commodity markets. Debt relief should unlock financial resources for social and infrastructure investment.

## Positive outlook for South Africa

A benign global environment bodes well for South Africa. Domestic export growth was reasonably healthy in 2005 because of firm global aggregate demand and the strong commodity cycle, despite a generally strong rand. The expected recovery in Europe should be positive for the local economy as Europe absorbs more than one-third of South Africa's manufacturing output.

South Africa's internal growth dynamic, on the back of strong household expenditure, was the mainstay of its economic performance in 2005. In 2006, households' real income growth should slip, but only moderately. Household credit demand is likely to move sideways. Households have also found relief in tax and interest rate reductions. The fixed investment cycle is likely to surge and therefore contribute more to total output this year, especially as the private sector is more enthused and the public sector has a renewed focus on meeting delivery targets. South Africa's economy is therefore expected to expand by 4,8% in 2006, about matching last year's vigorous performance.

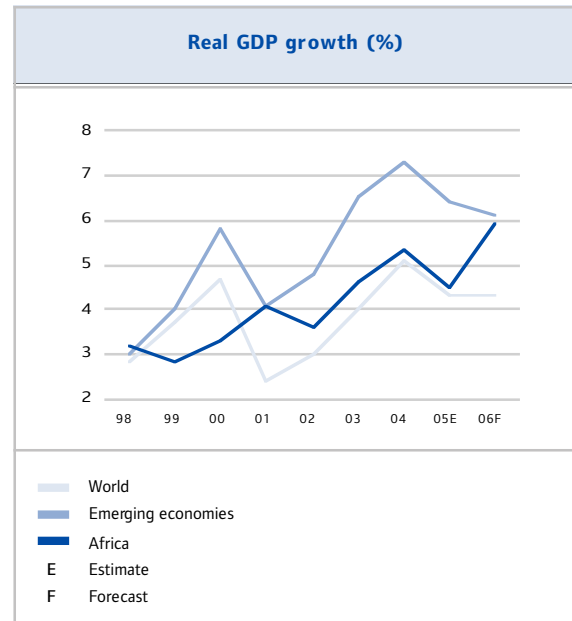
Households' demand for credit has risen appreciably over the last two years – the aggregate household debt to income ratio has risen from 53,9% in the first quarter of 2004 to 65,6% in the last three months of 2005. Notably, though, households' debt finance costs as a proportion of income rose far less sharply, from 6,3% to 7% over the period. Fundamentally, this reflects the favourable impact of the structural decline in interest rates on debt affordability, and the prospect that further credit deepening can be absorbed by the economy.

In summary, the South African economy is underpinned by responsive monetary and fiscal policies, as well as a developing and constructive structural strategy. Other emerging economies generally also demonstrate healthy internal growth dynamics, and will benefit from a benign global economic climate. Africa is leveraging the heightened demand for resources and, coupled with an improving political and economic context, should grow faster in 2006.

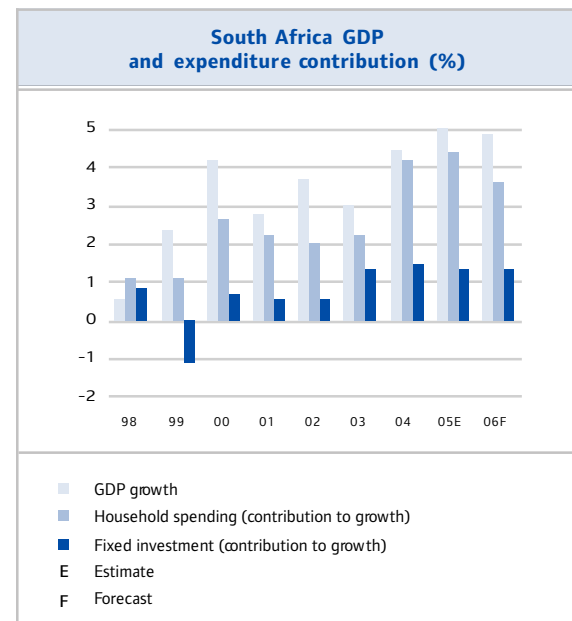
There are, however, a few notable assumptions underlying this baseline scenario:

- the normalisation of excessive US consumption, alongside increased internally generated demand and reduced savings in Asia, will be orderly;
- any slackening in global residential property markets will not be perceptible;
- China's pending slowdown must not be marked;
- oil quotes must not experience renewed and sustained surges; and
- the US dollar must not fall sharply.

Global economic growth could fall significantly should these assumptions not materialise, and the world economy is perhaps more fragile than it was in 2005.



Source: World Economic Outlook – September 2005 IMF



Sources: SA Reserve Bank, Standard Bank

## Group at a glance

