



financial services group

## MONTHLY MARKET REPORT FEBRUARY 2010

# Asset Management

### FEBRUARY 2010 COMMENTARY

#### It's not all doom and gloom...

Recently released economic data in South Africa indicates that it is unlikely we'll see further interest rate cuts. Unlikely, not impossible. And on further reflection an additional 50 or even 100 basis points reduction in interest rates is largely irrelevant in the context of a rate-cutting cycle that has seen rates fall 500 basis points to this point. Largely irrelevant in the broader economic sense. In the more individual-specific context another rate cut if you are paying off any kind of debt - particularly long-term debt - or if you are drawing an income is highly relevant.

Consumer inflation remains above the recently reconfirmed inflation target range upper limit of 6%, though it is widely expected that inflation will fall to within the target range shortly and that it will remain there for the remainder of this year. Most economic commentators expect inflation to bump along just under the 6% upper limit, though there are those who anticipate that inflation may fall as low as the middle of the target range. We're in the former camp, anticipating an average inflation rate for 2010 of between 5.5 and 6%.

Producer price inflation, however, has accelerated sharply, moving from deflationary territory quickly back into inflationary territory. At levels of around 2.7% producer inflation doesn't present an immediate present-day threat, though it is representative of the resumption of inflationary conditions some time down the road.

Money supply and private credit extension have both decelerated dramatically (see charts).

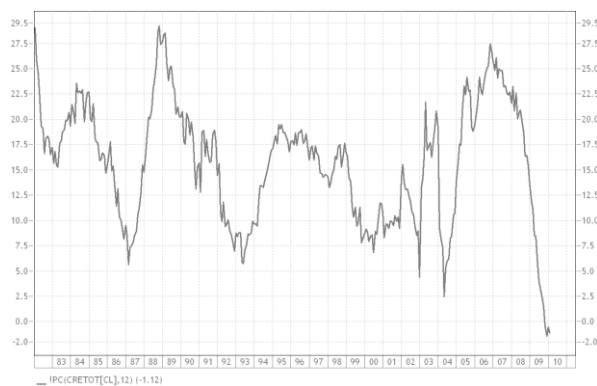
As welcome as current levels of consumer inflation, money supply and credit extension are (offset slightly by accelerating producer inflation) we submit that the most important economic data driving this month's forthcoming decision on interest rates will be the better-than-expected economic growth rates the economy enjoyed in the last quarter of 2009.

Growth rates of 3.2% - though below the 5% rate that would ensure some form of employment growth, our country's number one economic malady - are most welcome even though they may very well spell the end of the interest rate cutting cycle. Economic growth - not lower interest rates - is the key to reducing unemployment and thereby spurring on further economic growth. Though interest rates have a role to play in this space, flexible labour markets, reduced red-tape and other measures can be and often are more effective.

Money Supply (M3), Annual Change, Monthly  
1982 - 2010



Private Sector Credit Extension, Annual Change, Monthly  
1982 - 2010

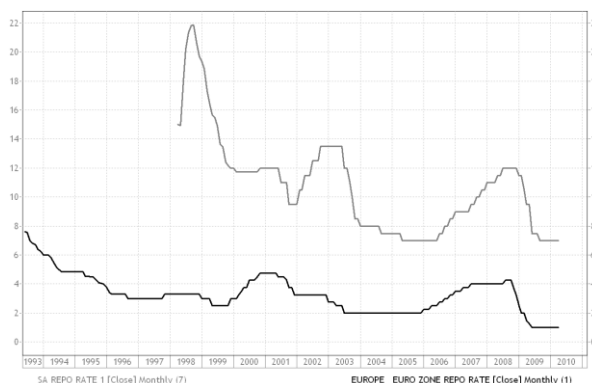


Moving on from economic data and borrowing slightly from March's activity - this is February's Monthly Market Report after all - we were pleased with Government's most recent offshore bond market auction. Whilst the \$2bn raised is far short of overall public sector borrowing requirements, the rate at which government managed to get the debt away at is remarkable. Greece - the inventor of democracy and a member of the European Monetary Union (EMU) - recently held a bond auction and were only able to get funding at rates in excess of 6% per annum. South Africa's \$2bn bond attracted an interest rate of only 5% per annum.

This is where South Africa's fiscal prudence pays off. We have a public debt to GDP ratio of just 24% (Greece: 120%) that may rise to around 40% over the next two to three years as government embarks on various stimulatory spending programmes; in addition South Africa's budget deficit is around 7% (Greece: 10%). Given that Spain, Portugal, Italy and Ireland (and France to some extent) all suffer from debt to GDP and budget deficits akin to those of Greece we submit that South Africa's fiscal position is *ahead* of those of 5 members of the European Monetary Union.

Given that background and local rates of 10.5% it's not difficult to see why the rand has been so strong against the euro where interest rates are at just 1%. Look for upgrades to South Africa's international debt ratings or reductions in those of the nations we've mentioned.

### South African v European Interest Rates 1993 - 2010



...though it may feel that way if you're in Europe.

### EURUSD Jan 08 - Mar 10



Speaking of the euro it has not escaped our attention that the dollar has been significantly strong against the euro over the course of 2010. At present - and until Europe, through Germany, the EMU, the IMF (International Monetary Fund) or a coalition of its members, comes to the aid of Greece - we anticipate that the euro will continue to be weak against the USD.

Now is not the time to make radical currency trades and a well-diversified currency basket makes a great deal of sense, particularly as we can make an equally bleak case against the USD, starting with sub-prime related bank failures and working our way through to unfunded social security and medicare liabilities; problems which haven't gone away as the credit crisis has unfolded.

## FEBRUARY 2010 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	7.00%	0.00%	0.00%	-3.50%
JSE ALSI	26,764.61	0.33%	-3.26%	44.95%
ALBI	305.87	2.02%	2.29%	6.80%
R157	8.17%	8.38%	8.39%	8.07%
USDZAR	7.69	0.98%	3.94%	-23.62%

All charts and data are sourced from I-Net Bridge.