~ JANUARY 2012 ~

SYGNALS

KEY INDICATORS

		1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years
J203T	FTSE/JSE All Share Index	5.7%	4.8%	10.1%	10.8%	15.6%	21.2%	8.8%
J200T	FTSE/JSE Top 40 Index	6.0%	4.2%	10.1%	10.2%	14.9%	20.6%	8.4%
J210T	FTSE/JSE Resources 20 Index	8.3%	4.7%	9.5%	1.5%	10.1%	16.4%	7.1%
J211T	FTSE/JSE Industrials 25 index	3.5%	2.2%	9.3%	19.2%	22.2%	25.7%	12.8%
J212T	FTSE/JSE Financials 15 Index	6.5%	9.8%	14.3%	15.0%	13.3%	21.9%	3.9%
J403T	FTSE/JSE SWIX Index	4.5%	5.1%	9.9%	12.7%	16.3%	21.6%	8.9%
J303T	FTSE/JSE CAPI Index	5.6%	4.8%	10.2%	11.5%	16.0%	21.6%	9.4%
ALBI	BESA All Bond Index	2.1%	2.8%	7.0%	13.5%	12.8%	9.0%	8.9%
STeFI	STeFI Index	0.5%	1.4%	2.8%	5.7%	6.3%	7.1%	8.5%
	MSCI World Index in SA Rands	1.4%	0.3%	11.8%	5.3%	8.8%	6.5%	-0.2%
	Rand/US Dollar Exchange Rate	-3.5%	-2.0%	16.5%	8.6%	1.1%	-8.5%	1.5%
	Rand/Euro Exchange Rate	-2.6%	-7.5%	7.7%	3.6%	-1.7%	-8.1%	1.7%
	Headline CPI	0.2%	0.9%	2.4%	6.1%	4.8%	5.3%	6.8%
	Core CPI	0.3%	0.4%	1.7%	4.3%	4.0%	4.9%	5.3%
	PPI	0.0%	-0.1%	0.2%	9.8%	7.8%	5.3%	7.3%

"There are a number of features common to all successful currency unions. A central bank that can comprehensively stand behind the currency and financial system. The deepest possible economic integration with the flexibility to deal with economic shocks. And a system of fiscal transfers and collective debt issuance that can deal with the tensions and imbalances between different countries. Currently it's not that the euro zone doesn't have all of these - it's that it doesn't really have any of these."

David Cameron, UK Prime Minister, Davos 2012

GREECE BACK ON THE AGENDA

The year started on an unexpectedly upbeat note as the US economic data painted a picture of steady recovery. From stronger retail sales and manufacturing figures, to rising consumer confidence, the US is looking healthier.

Elsewhere, however, manufacturing activity was subdued with the euro zone's industrial sector suffering its fifth straight month of declines in December and Asian factories mostly stuck in a rut. Only China and India surprised on the upside.

Both the World Bank and the IMF cut their global economic growth forecasts for 2012. The World Bank projects global growth of 2.5% in 2012 and 3.1% in 2013, down from previous estimates of 3.6% for both years. The US is expected to grow at 2.2%, Japan at 1.9%, China at 8.4%. The IMF was more optimistic with global growth expected at 3.3%, and the euro zone shrinking by 0.5%.

Other significant economic data included the Chinese economy growing by 9.2% in 2011, below the 10.4% growth of 2010, but well ahead of expectations. Inflation has also slowed to 4.1% year-on-year in December, after peaking at a three year high of 6.5% in July, giving the government some leeway to ease credit restrictions. China's growth rate compares to 0.9% growth in the UK, half the pace recorded in 2010, 1.7% in the US, down from 3.0% in 2010, and 3.0% in Germany, down from 3.7% in 2010. In terms of short term growth, the UK and German economies contracted by 0.2% and 0.25% quarter-on-quarter respectively in the fourth quarter, while the US expanded by a below-expectations 2.8%.

Euro zone inflation eased from last year's peaks to 2.8% in December and looks likely to fall below the ECB's 2% price stability ceiling by the middle of the year.

US unemployment fell to its lowest rate since February 2009 at 8.5% in December, from a revised 8.7% in November. In comparison the unemployment rate in the euro zone was unchanged at 10.3% in November, matching forecasts.

The Bank of England, Bank of Japan and the ECB left key interest rates at record lows, as expected.

Oil prices rose sharply in January as the US, the EU, South Korea and Japan announced sanctions against Iran in response to growing concerns about its nuclear programme. Iran owns around 10% of the world's total oil supply. Oil industry experts believe energy markets can afford to lose half of Iran's supply, which would be roughly equivalent to supplies lost during Libya's civil war in 2011, as Saudi Arabia can fill the gap. China and Russia stand to gain the most from the sanctions. Provided Iran does not cut back on oil production, China is set to become its most significant client, placing Beijing in a strong negotiating position. Russia, on the other hand, as the world's biggest oil producer, is well positioned to raise its market share in Europe. Oil union strikes in Nigeria added to the upward momentum.

Liquidity of the euro zone banks, and their willingness to lend to each other, remained a concern as overnight deposits at the ECB reached a number of all-time highs through the month. This is especially significant as it comes after euro zone banks borrowed €489 billion from the ECB last month in a three-year lending facility.

Hungary, which has defied the EU by introducing a raft of radical constitutional reforms, was forced to cancel a bond auction as yields soared on a bet that Hungary could become the first EU country to default on its debts. Borrowing costs in other central European countries, including Poland and the Czech Republic, rose in sympathy. The potential exposure to Hungarian debt added to the fears about the liquidity of European banks, particularly in Austria and Italy.

Greece spent the month in negotiations with private bond holders to forgive at least half of its debt ahead of a decision on the next bail out instalment. If Greece fails, it may face default as early as March when €14.5 billion of its bonds mature. Increasingly, the troika of foreign lenders, the ECB, the EU and the IMF, has come to believe that the country has neither the ability nor the will to carry out the economic reforms it has promised in exchange for aid. It has thus made the next instalment contingent on reaching an agreement. The yield on 10-year Greek bonds rose to 35.5%.

On a positive note, successful bond auctions by Italy, Portugal, Spain, France, Germany and Belgium cheered the markets. The success is in no small measure attributable to the €489 billion disbursed by the ECB to the euro zone banks.

The IMF managing director, Christine Lagarde, toured Africa, including South Africa, highlighting the threat that the EU crisis posed to the continent.

Stocks rallied again on an upbeat start to the US earnings reporting season, but wobbled as China announced that its trade surplus shrank to US$155.1 billion in 2011 from US$181.5 billion in 2010 as import and export growth slowed on a drop in domestic consumption and foreign demand.

On the corporate front, earnings-per-share topped estimates for 66% of the 169 companies in the S&P500 that reported results in January. Carnival, owner of the Costa Concordia cruise liner that capsized off Italy's coast, saw its shares freefall after it announced that the impact on 2012 earnings for "loss of use" alone could reach US$95 million. Eastman Kodak filed for bankruptcy protection. And Apple reported fiscal first quarter earnings well ahead of estimates, with sales of both iPhones and iPads more than doubling from a year earlier. Apple single-handedly erased a drop in S&P 500 earnings for the December quarter. Excluding Apple, earnings had declined by 4.2% for the other companies that had reported results.

Stock markets fell again when S&P stripped France of its top AAA credit rating on the risks emanating from the euro zone crisis. S&P also downgraded Austria, Malta, Slovakia, Slovenia, Italy, Portugal, Spain and Cyprus. Portugal's debt is now rated junk, leading to its borrowing costs rising to record highs of over 14%. This was quickly followed by a downgrade of the European Financial Stability Facility from AAA rating to AA+. S&P said the cut reflected the fact that bonds issued by the EFSF "are no longer fully supported by guarantees from EFSF guarantor members rated AAA by S&P".

Markets largely ignored the downgrades, particularly after Moody's joined Fitch in affirming France's AAA credit rating. Moody's warned however that it was reviewing its "stable" outlook.

Stocks rose again after China announced better than expected economic growth in the last quarter of 2011 and after the US Federal Reserve said it will not raise interest rates until, at earliest, late 2014. The rand rose to R7.79/US$ as foreign investors added to their carry trade positions.

US President Barack Obama used the State of the Union address to position his re-election campaign as based on dealing with the imbalances between the wealthy elite and the rest of America. Obama pledged to increase spending on education, infrastructure and job creation and called for Congress to put into place his "Buffett Rule" whereby people making more than US$1 million a year would pay a minimum effective tax rate of at least 30% in income taxes.

Two years after it requested US$500 billion to fight off a global slump, the IMF called for a further US$600 billion to boost its lending capacity, currently estimated at around $380bn, to enable it to limit the fallout from Europe's debt crisis. Unsurprisingly there was no stampede to commit the cash. EU members have agreed to inject US$200 billion, but countries like the US, Canada, China and Japan have asked EU to take more decisive steps before committing money.

Europe's woes topped the agenda at the World Economic Forum in Davos.

UK Prime Minister David Cameron used the platform to launch an attack on Europe for failing to deal with its "perilous" financial crisis and warned that the euro does not have the qualities of a successful single currency. Mario Draghi, president of the ECB, highlighted that the European banks narrowly escaped a major funding crisis because of actions by the ECB, including interest rates cuts, three-year refinancing loans, and revised eligibility rules for collateral. Both the US and the IMF warned the EU against complacency and emphasised the need for stronger defences to ring-fence the rest of Europe should Greece default.

The month ended on a more sombre note than it began. Fitch downgraded five euro zone countries, Italy, Spain and Slovenia by two notches and Belgium and Cyprus by one notch, warning that the euro zone crisis would only be resolved "as and when there is broad economic recovery" and with "greater fiscal integration". The US economy grew less than forecast in the final quarter of last year, signalling that the first three months of this year are likely to be weaker.

The EU summit in Brussels resulted in an agreement on tighter budgetary rules, hailed as a first step towards a fiscal union, and finalisation of the permanent bail-out fund, the European Stability Mechanism. The fiscal treaty, to be formally signed in March, will require governments to introduce laws on balanced budgets and impose near automatic sanctions on countries that violate deficit rules. Only those countries that sign up will be able to access bail-out aid from a new rescue fund. Britain and the Czech Republic opted not to adopt the measures. And while European leaders agreed to bring the

ESM into existence earlier than previously foreseen, they postponed any final decisions on its ultimate size and how it will be financed.

The Greek crisis threatened to pull Portugal into the maelstrom as yields on its 10-year bonds rose above 15%.

And in a bit of electioneering, France pledged to introduce a 0.1% tax on financial transactions from August. Earlier in the month British Prime Minister David Cameron announced he would veto a European-wide financial transaction tax unless it was imposed globally. The EC agreed on a financial transaction tax last year.

SOUTH AFRICA FACES RATING RISKS

South Africa faced a slew of growth forecast cuts for 2012. The IMF cut its growth projections down to 2.5% from 3.6%. The Reserve Bank lowered its forecast from 3.1% to 2.8%, and Finance Minister Pravin Gordhan announced that he expects to revise the government's official growth forecast of 3.4% to below 3% in the February 22nd budget. This reinforces the fact that the main challenge for South Africa is weathering the effects of the sovereign debt crisis in Europe. To place these numbers in a peer group context, the IMF expects growth in emerging and developing economies to average 5.8% this year, a significant slowdown from the 6.8% growth rate in 2010 and 2011.

Following a similar move by Moody's in November 2011, Fitch cut South Africa's BBB+ rating outlook from stable to negative, citing limited progress on several long-standing structural issues. Fitch criticised the country's inability to create jobs as putting pressure on growth and narrowing the tax base. The country's external finances, though better than its peers, were seen as deteriorating on failure to accelerate growth.

The Reserve Bank kept the repo rate unchanged at 5.5% and made clear that it would continue to do so in the face of slowing growth and rising inflation. It predicts that inflation will stay above its official 3%-6% target range for the rest of this year, peaking at 6.6% in the second quarter.

Consumer inflation held steady at 6.1% year-on-year in December, while producer inflation, which represents domestic output, slowed to 9.8% from 10.1% in November. But hope that inflation would remain in check were dashed by rising food prices. Upward pressure on food prices is set to persist in the first half of this year due to rising global grain prices and a weaker local harvest, until the effects of improved supply and a stronger rand come through.

Sanctions on Iran are bad news for South Africa. Although Iran sells large volumes of oil to China, India, South Korea, Japan and Italy, it is Turkey, South Africa and Sri Lanka who rely most heavily on Iranian oil. In fact, South Africa is the 9th largest buyer of Iranian oil and Iranian oil constitutes 25% of all our oil imports. Should these be curtailed many of South African refineries designed to treat Iranian crude would need to upgrade to handle other crudes. South Africa has not as yet received a formal request from the US to halt or reduce Iranian crude imports.

On a positive note South Africa sold US$1.5 billion of 12-year global bonds in a deal that was twice oversubscribed. The bond was priced at a yield of 4.66 %. That represents a spread of 270 basis points over US Treasuries and compares favourably with spreads for Spanish debt, which stand at 372, Italian debt at 531, and Irish debt at 636 basis points.

GLOBAL SNAPSHOTS

Hungary

Hungary serves as a cautionary tale for those who argue that Greece could regain competitiveness by reintroducing its own currency. Hungary faces massive problems due to the foreign currency property loans taken out by its population. In addition, the erratic policies of the Hungarian Prime Minister, Viktor Orban, have scared off foreign investors, prompted credit rating agencies to downgrade government bonds to junk and punished the currency, the forint.

In theory, the plunge in the currency should help exports. But the advantages have been cancelled out by soaring prices for imports, including fuel, and higher payments on foreign currency loans. With 10.7% unemployment and 4.3% inflation Hungary is in a dire economic situation.

Hungary, which became the first EU country to receive an IMF bailout in 2008, shunned fresh aid in 2010 when Orban came to power. He has since passed a flurry of power-grabbing laws, including curtailing the independence of the central bank and nationalisation of private pensions to reduce the budget deficit. This has prompted the EU to threaten legal action against Hungary, while the IMF warned it needed to see tangible policies aimed at stabilising the economy before it will engage with Hungary on a new financing programme.

Hungary, which must roll over nearly €5 billion of external debt this year, is due to start repaying the 2008 loan to the IMF in February. With long term bond yields hovering around 10%, its options are narrowing rapidly.

France

As President Nicolas Sarkozy contemplates his bid for re-election, he is confronted with an economy reeling from the euro crisis and nearly zero growth. The unemployment rate, at 9.9%, is at a 12-year high, and rising. France has also lost its AAA credit rating, making it more difficult for the country to pretend to be Germany's equal in the EU and hence challenge the German recipe of austerity.

The main criticism of Sarkozy is that while he promised to modernise France's heavily state-dominated economy by liberalising the tax system, eliminating the 35-hour workweek, and reducing bureaucracy, he has accomplished little in the face of political and union opposition. 8.5% of the 65 million people are in state employ, compared with 6.1% in Germany. Government spending represents about 56.6% of the French economy, compared with about 46% in Germany. France has fallen behind in global competition and production. According to a recent study, the French work six fewer weeks a year than the Germans, fewer hours than the Greeks and 236 fewer hours a year than they did in 1998.

Greece (again)

January saw Greece embroiled in dual negotiations with private and public sector creditors, seeking to persuade the former to accept more losses on their bond holdings, and the latter to release a scheduled allotment of bailout money ahead of Greece's next bond repayment of €14.5 billion in March.

Creditors are willing to accept a loss of 50% on their holdings, but want yields of 4%. Greece and its backers have been pushing for an interest rate below 3.5%. The deal would reduce Greece's €350 billion debt burden by about €100 billion. The ECB is also in negotiations to ensure that it does not suffer any losses on its own €55 billion portfolio of Greek bonds.

Unfortunately Greece is effectively bankrupt, staggering under a debt load that the IMF estimates at 160% of its GDP. Unemployment has surged to 18.8% from 13.3% a year ago. After two years of tax increases and wage cuts, Greek civil servants have seen their income shrink by 40%, more than US$75 billion has left the country in savings moved abroad, 68 000 businesses closed in 2010, and another 53 000 out of 300 000 still active are said to be close to bankruptcy.

The most recent bailout agreement was based on two assumptions, that the private sector would voluntarily accept at least a 50% loss on its debt, and that these savings, together with other austerity measures, would bring Greece's debt down to 120% of GDP by 2020. The IMF's latest 2020 debt forecasts, at 135% of GDP, cast doubts on the viability of these assumptions. The reasons for the upward revision of debt numbers include a collapsing economy, estimated to have shrunk by 6% in 2011, the economic slump in Europe, an inability to shrink Greece's budget deficit to the target of 8% of

GDP due to weak tax collection and high public sector spending and the government's continued difficulty in passing legislation that would lead to the long-term economic change, including lower wages.

The new IMF forecasts present the disturbing prospect that even after years of austerity, Greece would have only marginally reduced its debt burden by 2020.

The problem is that Lucas Papademos, the technocratic Prime Minister, is finding it difficult to govern in the face of political jostling ahead of the national elections to be held in April. Although the government has passed the 2012 budget, it has failed to implement the unpopular changes mandated by the loan agreements, such as a sale of US$65 billion in state assets, and a cut in 30 000 public sector jobs. In contrast, Italian Prime Minister Mario Monti could appoint his own cabinet, all nonpoliticians, with new elections not due until 2013.

German demands for independent scrutiny and management of Greece's finances by an EU budget commissioner drew sharp criticism from Greece itself and the rest of the EU. Because Greece has repeatedly failed to meet its fiscal targets, and has made little progress on public-sector reforms, there is a growing concern that Athens may need more than the €130 billion agreed last October.

WORLD STAGE EVENTS EXPLAINED

World Economic Forum 2012 risk menu

The World Economic Forum's 2012 Global Risks report based on a survey of 469 experts and industry leaders has identified a number of threats facing the world in 2012.

Severe income disparity and precarious government finances rank as the biggest economic threats. This is followed by rising youth unemployment, a retirement crisis among pensioners dependent on debt-burdened states and a yawning wealth gap. Other threats include the risks posed by cyber-attacks against individuals, corporations and nations, the risk that financial and other regulatory systems designed to safeguard the modern world may no longer be up to the job, as well as rising greenhouse gas emissions and looming water shortages.

Roubini at Davos

Economist Nouriel Roubini, nicknamed "Dr. Doom" for his gloomy predictions in the run-up to the financial crisis four years ago, used the Davos platform to warn that the fallout from the crisis could last the rest of this decade. According to Roubini, until Europe radically reforms itself and the US gets serious about its debts, the world economy will continue to stumble along to the detriment of large percentage of the world's population who will continue to see their living standards under pressure. He painted a grim picture of the euro zone in a recession and key emerging markets in China, India, Brazil and South Africa slowing down in response. The possibility of a conflict with Iran could lead oil prices, now hovering around US$100 a barrel, to spike to US$150 per barrel, leading to a global recession. He also warned that unemployment and economic insecurity are causing political and social instability.

Internet companies flex their muscle

Millions of people only heard about the Stop Online Piracy Act and the Protect Intellectual Property Act when Wikipedia went offline and Google blacked out its logo. Supporters of the bills, which include major US media and entertainment companies, say their only intention is to go after foreign websites that distribute unauthorised copies of software, videos and music. But the technology industry maintains that the language in the bills is too broad, posing a threat to free speech. The bills could also make sites responsible for all content or links posted by their users. In the resulting groundswell of negativity, lawmaker after lawmaker in the US renounced support for the legislation.

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