

Business Monitor International's monthly regional report on political risk and macroeconomic prospects

SOUTH AFRICA

ECONOMIC OUTLOOK

The good, the bad, and the rand

The strong exchange rate is hurting inward tourism, but not all is bleak as locals take advantage to travel abroad. **BMI View:** The economy will just have to learn to live with a buoyant rand and indeed, recent economic growth figures indicate that it is doing just that.

The recent history of the rand is quite extraordinary. During significant parts of 2001 and 2002, it effectively collapsed against the dollar for reasons that have never been wholly explained, but which were likely to have been attributable to tight liquidity in the market, as well as speculative attacks by market traders seeking profits in a domestic market characterised by high interest rates. But during 2004, the rand benefited from a weak greenback and growing overseas confidence in South Africa's political and economic prospects, gaining 20% in value during the year, making it the world's best-per-

forming significant currency against the US counter.

As could be expected, the new paradigm has brought different challenges and opportunities to the major productive sectors. One industry that is having to adapt is tourism, which accounts for 7% of GDP, and is now bigger even than mining (which brings 5%). Crucially, it has also become a major source of employment for the lower-skilled, and has largely proved positive in environmental terms, bringing development to communities that have little else to rely on. In the past, the

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ZIMBABWE

POLITICAL OUTLOOK

Beware the ides of March

There has been a purge within the ruling ZANU-PF party. **BMI View:** The upheaval will increase, rather than lessen, political instability. There are now a number of still-powerful figures bearing grudges against Mugabe, who looks increasingly dependent on the military and police to maintain his position.

The ruling ZANU-PF held a party congress in December ahead of March's parliamentary elections. Usually such gatherings are effectively non-events,

serving only to rubber-stamp the policies and the position of the ruling elite. But this time a number of internal pre-

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THIS MONTH'S TOP STORIES

Frelimo wins again in Mozambique

The ruling Frelimo party has won a landslide victory in general elections. **BMI View:** The vote was marred by irregularities, but these were more due to administrative failings than fraud. The result is good for political stability and will ensure pro-market policy continuity.

page 9

Malawi: Poor relations

A recent IMF review highlights the poor implementation capacity of the state sector. **BMI View:** There is an ample good-will on the part of the international community towards Malawi. The current administration is an improvement on the past, but the country remains badly served by its leaders.

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SA: Data revisions less than anticipated

page 3

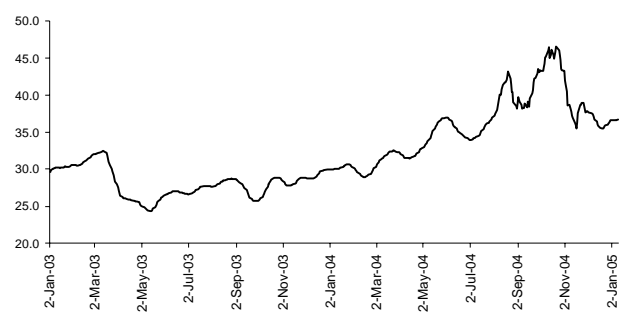
A good year in store for SA

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Regional macroeconomic data & forecasts

page 12

OIL MARKET OUTLOOK



OPEC basket, US\$/b. Source: Reuters

The price of the OPEC basket fell sharply from its high of US\$46/b in late October, ending the year just over US\$36/b. The fall was attributable to over-supply in the market which allowed unseasonal stockbuild. The market will tighten again in 2005, as OPEC cuts output, but we do not anticipate any new sharp falls in the price. Indeed, we have raised our average price forecast for the OPEC basket to US\$33.0/b (from US\$31.0/b). Furthermore, with continued risks to supply and OPEC likely to cut further if demand softens, the risks to our forecast remain to the upside.

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RISK SUMMARY

POLITICAL RISK

Risks Rise In Zimbabwe

The ANC will remain politically dominant over the forecast period and beyond. Consequently, the principal risks to our ratings are largely long term – the high instance of HIV/AIDS – and external – the level of political instability in Zimbabwe. The recent upheaval within Zimbabwe's ruling ZANU-PF suggests that a succession struggle is brewing. Coupled with likely unrest around the March general election, it appears that the possibility of a greater breakdown in governance in SA's largest neighbour is rising. This may offer an opportunity for SA to demonstrate a more concerted, and effective, foreign policy, but the risks remain to the downside.

Our short-term political rating is static at 83.0, comparing favourably against regional peers.

ECONOMIC RISK

Growth Is Set Fair

The revision of GDP data in November was smaller than expected. However, growth in 2003 was higher than originally anticipated, driven by strong domestic demand, especially from consumers. With these trends continuing throughout 2004, the risks to our growth forecast of 2.1% is firmly to the upside, although rising growth is likely to be accompanied by an expansion of the current account deficit.

Our short-term economic rating has risen to 59.0 (from 57.0), as a result of moving the rated period forward to 2004-2006 (from 2003-2005). There is ongoing upside risk.

BUSINESS ENVIRONMENT

Interest Rates On Hold In December

A falling output gap, alongside rising wage and credit growth, persuaded SARB to keep rates on hold in December. However, notwithstanding strong domestic demand, rand strength and falling oil prices should contain inflation in 2005 and the chance of a further rate cut in February is falling.

Our business environment rating is 68.1. Our short-term composite rating is 70.0.

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sheer affordability of SA as a destination helped overcome concerns about crime. Although the price and availability of flights has always been, and remains, an issue, at the trough of the exchange rate in 2002 a room in a luxury hotel in Cape Town could be had for US\$44 a night, but this has now risen to US\$77 (still extremely cheap by international standards), and the average occupancy rate in the most upmarket establishments has dropped to only 56.4%. If the rand stays strong over the foreseeable future, as **BMI** expects, strategies will need to be rethought.

Visitors from Africa make up about 70% of the total, and leaving aside the countries grouped within the Southern African Customs Union (SACU), whose currencies are pegged to the rand, the chronic weakness of other African monies is a problem for all but the wealthiest visitors from the continent. For the industry, it is has traditionally been high-spending Europeans that have underpinned its expansion. In 2002 these numbers grew by an astonishing 30%, followed by a 5.3% rise in 2003, before falling by 3.1% during the first nine-months of 2004.

ECONOMIC OUTLOOK

Sibling rivalries

Public companies are essential to the government's development strategy, but their performance is uneven. **BMI View:** Eventually, privatisation is the answer, but that is some way off for political and financial reasons.

Frustrated with the private sector's inability to create mass unemployment, but pleased with its propensity to fill its tax coffers, last year the government moved to a more interventionist development strategy emphasising public spending, but not at the risk of fiscal responsibility. The key factor in the equation is the sprawling transport conglomerate, **Transnet**, which has been given a new top-class management team. Although its net loss improved in 2004 to ZAR22mn from a massive ZAR1bn in the previous year, its main operating arm, the rail operator **Spoornet**, moved from a profit to a net loss in 2004. Its rolling stock suffers from years of under-investment, poor revenue collection, and an inability to actually get freight to its destination in the time required. New CEO Maria Ramos says it will take possibly five years to turn the company around and has budgeted ZAR37bn in investment to achieve a modern operation. Another poor performer during 2004 was **Denel**, the state-

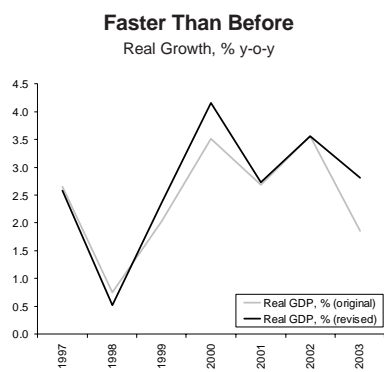
owned arms manufacturer. Although internationally respected for its technical prowess and products, its strategic focus has been diluted by a move into non-core businesses that have brought the company down to a net loss of ZAR377mn during the 2003/04 financial year.

More positively, electricity giant **ESKOM**, fixed-line telephone operator **Telkom**, and airports operator **Acsa** all posted solid results for the year. Telkom is already partially privatised, and Acsa is 20% owned by **Aeroporti di Roma**. Eskom would be snapped up by international investors if it was floated – it is one of the world's most efficient power generators – but there is significant labour resistance. However, after years of carrying overcapacity, it now needs to invest ZAR107bn between 2005-2009 to meet demand. The government has said that it will meet 70% of that sum, but some form of private involvement is looking increasingly inevitable.

Data revisions less than anticipated

Statistics South Africa revised its estimate of the economy upwards in 2003. **BMI View:** The change was smaller than anticipated and, consequently, its implications are less serious than initially thought.

A spectre had been stalking economic analysts for most of 2004, the spectre of substantial revisions to GDP data. However, when finally released by Statistics South Africa (Stats SA) in November, the actual changes were far less severe than feared. Overall, while it appeared that growth was higher in 2003 than previously assumed, there has not been the fundamental reappraisal that was initially thought likely, although the data may offer further evidence that trend growth is higher than had been considered.



The collation of statistics is a fraught issue in many states. Statistical agencies struggle to build a representative sample from which to draw extrapolations not only due to the dynamic nature of economies, but also from the very real incentive of many people and companies to hide from official agencies. Essentially, not only do they not know what they don't know, but are actively lied to – not a good start for those charged with providing clear and unambiguous information for policy-makers. As a result of these problems, discrepancies creep in and tend to get reinforced over time.

Given the size of the black economy in South Africa and the speed of its post-apartheid transition, it had been assumed that Stats SA's long-heralded November revision of data would put a much higher figure on GDP. It did not. Overall, the economy, at ZAR1,251bn in 2003, was only 3.5% higher than previously estimated, a comparatively

small sum given the real possibility of a 10% rise that had been mooted prior to the announcement. Furthermore, while the figure of real GDP growth in 2003 was revised upwards substantially to 2.8% (from 1.8%), the rise in five of the previous six years were far smaller.

Limited Implications – In truth, statistical revisions in themselves are largely irrelevant for most people. Indeed, even if the economy is ZAR42.0bn larger in 2003 than previously thought, no new jobs were created as a result of the correction (save perhaps for statisticians). However, a more accurate picture of the state of the economy is vital for decision makers. For them, the change may have provided one significant insight. This is that there is some evidence that the trend rate of growth may be higher than assumed.

Indeed, the most interesting amendment was the hike in real growth data for 2003. Overall, inflation was relatively subdued in 2003, with the targeted index, CPIX (consumer prices minus mortgage interest repayments), ending the year at 4.0% y-o-y. This is relatively consistent with an economy growing below trend – as the earlier figure of 1.8% real growth suggests. However, it is less consistent with growth of 2.8%.

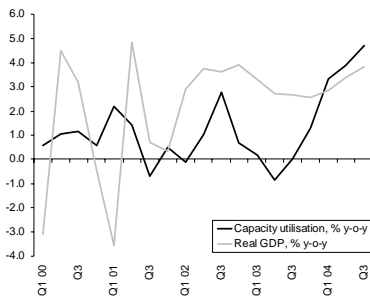
On its own, the 2003 data do not tell us the whole story. Certainly, inflation is affected by demand growth in the economy, but other factors, such as imported costs, must also be taken into account. However, given that the economic expansion had been marginally higher than several years previously, there is reason to believe that the long-awaited increase in South Africa's non-inflationary growth rate may be occurring. This suggests that the South African Reserve Bank (SARB)'s Monetary Policy Committee (MPC) may be more sanguine about rising domestic demand than originally assumed, with the implication that the peak of interest rates will be lower than earlier thought over the cycle, which will give more purchasing power to consumers and businesses.

ECONOMIC OUTLOOK

A good year in store

The tempo of economic growth continues to impress and has, as yet, had few inflationary implications. **BMI View:** The growth is broad-based across the economy and, while inflation does not look likely to exceed the top end of SARB's target band any time soon, falling spare capacity and the rand's recent sell-off suggests that rates will not be cut further.

Rising Capacity Utilisation
Capacity utilisation and real growth, % y-o-y



Source: South African Reserve Bank.

Has It Peaked?
South Africa, ZAR/US\$



Source: Reuters/BMI.

The economy continued its relentless expansion in Q304, growing by a substantial 3.8% y-o-y in real terms, its fastest rate since Q202. While the SARB was relatively sanguine about the implications of such rapid growth for consumer prices when it met in December – indeed, given the low level of inflation, the focus prior to the meeting was the prospect of a further cut – the outlook for 2005 is more difficult to call. However, although evaluating SARB's likely next move is useful, a focus on the interest rate cycle alone obscures the fact that the South African economy is heading for another good year, albeit not one without risks.

In truth, our current estimates of real GDP growth in 2004 are probably too bearish. Although exporters are having a torrid time, the economy generally is rising solidly, propelled by solid private consumption growth – which reached a whopping 6.2% y-o-y in Q304 – and an expansionary fiscal policy, with government spending rising by over 6.3% in real terms for four consecutive quarters. Furthermore, despite high oil prices throughout 2004, economic growth has been accompanied by relatively low inflation, with CPIX rising by only 4.6% y-o-y in November, well within SARB's 3-6% target band. The principal reason is that the rand has been exceptionally strong, peaking around ZAR5.6/US\$ in late-December – which has subdued import costs.

The big question, however, is how long this benign circle can continue. As ever, the signals are mixed, although in this instance, **BMI** believes that the good times may be coming to an end. Most industries are at present enjoying a buoyant period, a fact reflected in the Q4 RMB/BER business confidence index reaching a level not seen since 1980. Importantly, the positive news is spread across the economy, with only the manufacturing sector – which is more exposed to exports than, say, construction – failing to report record levels of confidence. Furthermore, while strong economic growth is being reflected in rising house prices, it does not appear that consumers and businesses are being carried away by the good

times, with credit growth expanding by only 7.1% y-o-y in September, which is, surprisingly, below the growth of nominal GDP, which stood at 9.9% y-o-y in Q304.

Modest, But Real, Risks – That said, arguments that there is enough slack in the economy to maintain current growth rates without stoking inflation look overblown to **BMI**. Total capacity utilisation jumped to 85.3% in Q304, up from 83.7% in Q204 and the highest level since Q182. If this continues, then it is highly likely that input and marginal production costs will rise for firms.

Another issue is that, despite high oil prices, inflation was subdued in 2004 due to the rand's relentless rise. This, however, peaked at the end of the year, and the currency suffered a sharp sell-off in the first week of January, moving from ZAR5.6/US\$ to ZAR6.15/US\$ between December 28 and January 7, due to the recovery of the US dollar and falling gold prices. While the fall is unlikely to turn into a rout, further declines may occur, which would feed through to import prices and, eventually, inflation. Furthermore, with the trade deficit widening to US\$1.8bn in January-November according to data from the South African Revenue Service, there are worries that growth is increasingly unbalanced, with the current account deficit relying on uncertain capital account flows to finance it.

The corollary is that, while prospects for 2005 are buoyant, it should not be assumed that the pace of economic expansion will rise even further. Indeed, given the volatility of the rand, there are good reasons for SARB to continue to be cautious when the MPC meets again in February 9-10 in order to ensure that the economy does not over-heat. Certainly, unless the rand plummets or new data indicate that consumers binged over Christmas, we do not anticipate a rate hike. However, the chances of a further cut are fading. Overall, the outlook is better than at any time in recent memory, but the economy must wean itself off of its over-reliance on domestic demand if the current level of real GDP growth is to be sustained.

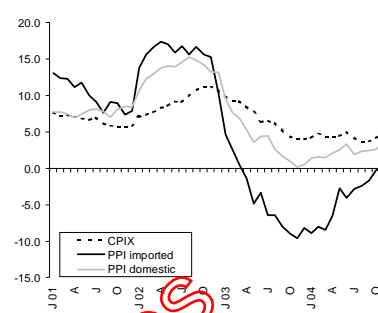
LATEST DATA RELEASES

CPIX Of 4.6% y-o-y Will Trend Upwards

By November, the targeted inflation rate, CPIX (consumer prices excluding mortgage interest payments) had been within SARB's 3-6% target band for 15 consecutive months. However, with the exception of oil prices, most trends are going against SARB. Indeed, after reaching a low of 0.2% y-o-y in November 2003, domestic producer prices have risen in 10 out of the following 12 months, indicating that diseconomies of scale may have set in, a conclusion supported by capacity utilisation, which at 85.3% in Q304

is at its highest since 1982. Furthermore, despite the rand's appreciation in 2004, imported prices deflation slowed, and by November, price rises were back in positive territory, which is not a good sign given the rand's weakness in January. Finally, drought conditions are likely to feed through to food prices domestically, which will add to the usual increase in housing and education costs. Overall, while prices are unlikely to breach the top of the target, substantial further easing may be difficult to justify.

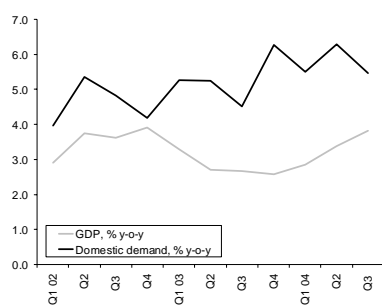
PPI Edges Up
Inflation, % y-o-y



Source: Statistics South Africa

Whither Exports?

Real GDP and private demand growth



Source: SARB.

Growth Accelerates Again

2004 was a good year for the South African economy. Although full-year data will not be available until March, there are clear upside risks to our modest forecast of 1.8% real expansion. In Q1-3, real GDP was up 3.2% y-o-y, with Q3 data an impressive 3.8% y-o-y higher.

The problem, however, is that the economy is increasingly unbalanced, due to the strength of the rand. Indeed, the drag of net exports (exports minus imports) on

growth can be seen by the gap between overall GDP expansion and that of domestic demand, which rose by 5.5% y-o-y in Q3. While it is too early to talk about over-heating, capacity utilisation is at a 22-year high and, with domestic producer prices rising, it looks as though the economy is running close to its full potential. The outlook for 2004 is good, but ministers would sleep easier if export markets made a greater contribution to growth.

BMI RATINGS

In The Chasing Pack

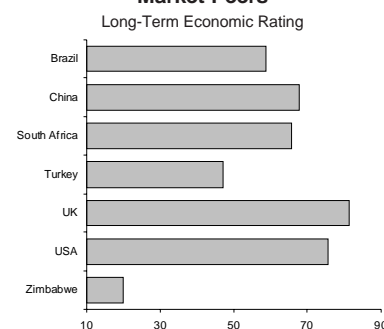
South Africa fares well on BMI's long-term economics ratings (which encompasses data from 1999-2006). While more developed states such as the UK and US achieve higher scores – mainly due to the stability of their indicators over this period and for lower unemployment rates – the more interesting comparison is with some of the more highly rated emerging markets.

China achieves a higher score, mainly because of its strong growth and current ac-

count dynamics, although if its export-led growth faltered (which we do not currently anticipate), the SA economy looks more structurally sound.

However, SA scores higher than both Brazil and Turkey – both of which are major emerging markets – at least partially due to the economic crises in both states within the rated period, both of which dwarf the externally induced slowdown that SA suffered in 2001.

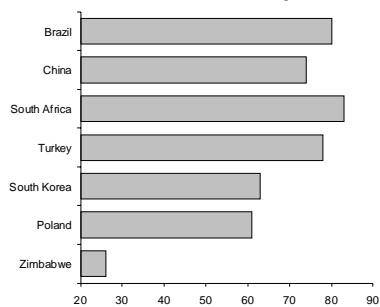
Comparing Favourably To Emerging Market Peers



Source: BMI.

Above Emerging Market Peers

Short-Term Political Rating



Source: BMI.

Punching Below Its Weight

There is a strong correlation between our short-term political risk (STPR) and investment in emerging markets, although the linkage is higher for short-term capital flows than foreign direct investment. However, a striking feature of the South African economy is that, despite a comparatively high STPR rating, it has failed to attract the high level of investment enjoyed by other states. The discrepancy here is likely to be due to a number of factors. In terms of port-

folio investment, the poor data made available by SARB are likely to obscure the true level of inflows. However, notwithstanding this – and certainly in terms of foreign direct investment – it is possible that South Africa is being judged in more exacting terms than other states. This may be due to the relatively small size of the regional market, as well as the uncertainty surrounding Black Economic Empowerment and the post-apartheid transition.

DATA & FORECASTS

BMI View: In light of recently released Q3 data, our forecasts are beginning to look somewhat unbalanced. While we anticipated the rand-related downturn in the current account, the sharp and sustained rise in domestic demand has caught us out. We are due to revise our forecasts over the next month, although we are cautious about raising our forecasts for economic growth in 2005 and beyond too high, given that the falling output gap means that monetary policy will have to be tightened at some point to slow domestic demand in order to stem inflation.

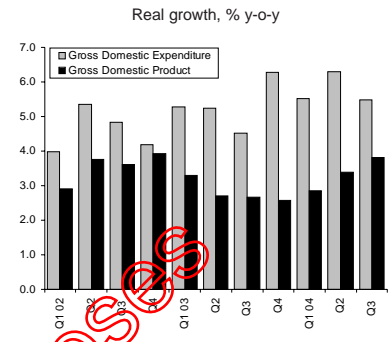
Consensus View*: The consensus forecast of 2.9% real growth in 2004 looks generally

sound, although the forecast for the current account balance (-1.6% of GDP) suggests that, like **BMI**, most institutions have underestimated the strength of domestic demand. Most institutions are bullish for prospects in 2005 although, as ever, there is some doubt as to the value of the rand.

Government View: The government forecasts that GDP will come in at 3.9% in 2004, while CPI will average 5.1%. After looking over-optimistic for most of the year, the growth forecast now looks relatively sound.

* Consensus forecast based on data from the following institutions: Merrill Lynch, Goldman Sachs, JP Morgan, ING Barings, Deutsche Bank, Lehman Brothers, Standard Bank, Nedcor.

Domestic Demand Exceeds Overall Growth



CONSENSUS FORECASTS

	2004			2005		
	Latest Forecasts*	Previous Forecasts**	Trend	Latest Forecasts*	Previous Forecasts**	Trend
Real GDP Growth	2.9	2.8	↕	3.2	3.2	↔
Inflation (% annual avg)	4.5	5.0	↘	4.8	5.1	↘
Fiscal balance (% of GDP)	-3.1	-3.0	↔	-3.0	-3.31	↕
Current account balance (% of GDP)	-2.2	-1.6	↘	-1.5	-1.5	↘
Exchange rate (ZAR/US\$ eop)†	6.8	7.0	↕	7.3	7.6	↕

Trend arrows indicate movement of ± 2.5%. † Upward trend arrows indicate currency appreciation; * 19/10/04, ** 09/08/04. Sources: ABN AMRO, ABSA, Deutsche, Goldman Sachs, IMF, JP Morgan, Lehman Brothers, Merrill Lynch, Nedcor Bank, Standard Bank, West LB.

DATA & FORECASTS

	2001	2002	2003	2004e	2004 Latest period		2005f	2006f
Real GDP growth (% y-o-y)	2.7	3.6	2.8	2.1	3.8	Jul-Sep	3.0	2.9
Nominal GDP (US\$bn) ^{1,2}	118.5	111.3	165.5	204.4	-	-	191.3	191.1
GDP per capita (US\$) ^{1,2}	2644	2454	3655	4485	-	-	4157	4139
Fiscal balance (% of GDP)* ³	-1.8	-3.7	-4.2	-5.3	-	-	-5.6	-5.7
CPIX, eop (% y-o-y) ³	5.8	10.8	4.0	4.0	4.6	Nov	5.5	5.0
PPI, eop, (% y-o-y) ³	0.6	0.8	-1.8	4.8	-	-	3.4	4.0
Repo rate (%) ³	9.50	13.50	8.00	7.50	7.5	Dec	8.25	8.25
Exchange rate (ZAR/US\$) ⁴								
- End period	11.97	8.55	6.64	5.60	5.96	Jan-10	7.80	8.20
Exports (US\$bn) ³	30.79	31.47	38.54	46.59	36.0	Jan-Sep	51.32	53.44
Imports (US\$bn) ³	25.70	26.80	34.76	45.36	34.8	Jan-Sep	48.44	51.84
Trade balance (US\$bn) ³	5.10	4.67	3.79	1.23	1.2	Jan-Sep	1.09	-0.52
Current account balance (US\$bn) ³	0.04	0.64	-1.34	-3.04	-4.0	Jan-Sep	-2.20	-4.05
Current account balance (% of GDP) ^{3,2}	0.03	0.57	-0.81	-1.49	-	-	-1.15	-2.12
Reserves (ex-gold, US\$bn) ⁴	6.05	5.90	6.50	10.33	11.2	Oct	10.55	10.95
Import cover (months)** ^{3,2}	2.38	2.64	2.24	2.73	-	-	2.61	2.53
Total external debt (US\$bn) ³	43.3	27.1	32.7	35.0	-	-	36.8	39.2
- % of GDP ^{3,2}	36.5	24.3	19.8	17.1	-	-	19.3	20.5

e/f = BMI estimates/forecasts (bold). ^ seasonally adjusted and annualised figure. * FY to end March, 1997=1997/1998. Latest figure is annualised result. ** Number of months imports (cif) covered by FX reserves plus gold. **** medium and long term debt only. Sources: 1 Statistics South Africa, 2 BMI Calculation, 3 South African Reserve Bank, 4 IMF.

continued from front page

tenders to the octogenarian Mugabe's throne sensed that he is more vulnerable now than at any time in his more than two decades in power, not least because of the growing trend away from 'presidents for life' in the region. A number of the potential challengers are also of a similar age, and may have come to the conclusion that time is running out for their aspirations. In addition, following the demise of the previous elderly incumbent, one of the country's two vice-presidencies, which are traditionally the most likely path to the highest office, had been vacant for months, increasing the value of a successful political bid for Mugabe's *imprimatur*. However, underestimating Mugabe's political skills has always been a dangerous practice, which the latest events show.

Mugabe is an increasingly inscrutable personality, who seems to prefer concentrating on real or imagined problems emanating from the colonial and cold war eras, rather than the day to day problems of governance in Zimbabwe. However, he is a master of domestic power-broking and taking him on him directly is a risky affair, as a number of ZANU-PF stalwarts have found

Tainted Victory
2000 Election Result

Party	% of vote	Seats
ZANU-PF	48.6	62
MDC	47.0	57
Other	4.4	1 (ZANU-Ndonga)

Source: US Government.

out to their cost.

Late last year, a group of senior party officials, including provincial party chairmen, attended a meeting said to have been organised by Information Minister Jonathan Moyo, one of Mugabe's most prominent supporters, at which discussions are said to have taken place as to how best to manoeuvre Parliamentary Speaker Emmerson Mnangagwa into the vacant vice-presidency. Mugabe was reportedly furious, and the meeting may have contributed to his decision to drop Moyo from the party central committee as well as the list of ZANU-PF list of candidates for March, thereby effectively ending his political career. Justice Minister Patrick Chinamasa and Finance Minister Chris Kuruneru suffered the same fate, as did prominent businessman Philip Chiyangwa, who the Zimbabwe Independent reported in late-December has been in prison on charges of espionage, along with

several others. Also, the six provincial party chairmen that attended the meeting have been suspended from ZANU-PF for five years.

Strengthening His Hand – Mugabe has also purged the leadership of the infamous 'war veterans' quasi-paramilitary group linked to ZANU-PF. Furthermore, the 49-year old former water affairs minister Joyce Mujuru has been appointed as Zimbabwe's new co-vice president.

Mujuru is now the clear favourite to succeed Mugabe, who has said he will likely retire no later than 2008. The choice of Mujuru has been painted as a move towards gender equality, but is more likely to be part of the broader clean-out of ZANU-PF. The same can be said of the decision to reserve some three dozen constituencies held by ZANU-PF for female candidates, a move that has infuriated the male incumbents, many of whom have invested considerable sums of personal money in their districts. So far the security forces have been left alone – not least because they are the only real immediate potential threat to the status quo – but it is possible that the leadership may seek to strengthen support there if required.

Waiting For The Poll – The electoral implications of recent events within ZANU-PF are incredibly difficult to predict. However, Mugabe has more than enough power to deal with any trouble-making by disgruntled cadres. Crucially, while some sitting MPs that have been displaced have said they might run as independents, they will find it almost impossible to counter the muscle of the ZANU-PF political machine that will be ranged against them unless they have been able to build a strong local support base.

One powerful weapon in the government's armoury is the state's monopoly of food reserves and their distribution. Some 40% of the population need aid and the figure will rise because only one-quarter of land available for planting has been prepared for the current crop season. This gives the party large powers of patronage across the state. Another factor in the state's favour is its control of the electoral process. Given current restrictions on the press, it looks unlikely that it will allow truly independent international election observers, although it may permit supervision by the Southern African Development Community (SADC), which can be expected to be far more diplomatic in any unfavourable assessment than western observers.

RISK SUMMARY

POLITICAL RISK

Biting The Hands That Feed

Roughly 3.3mn Zimbabweans are thought to be food insecure. While the world feels antipathy towards the regime, charities are willing to help the needy, but are being prevented from so doing by the government. The UN's World Food Programme has been essentially expelled from the country while according to a law passed in late-2004 foreign NGOs must be licensed to operate in Zimbabwe and their local counterparts are to be banned from receiving foreign funding.

Our short-term political rating is static at 26.0, with the risks weighted to the downside.

ECONOMIC RISK

Buddy, Can You Spare A Dime?

The government wants to invest in infrastructure but has no money to spend. It has 58 projects to implement, in areas such as railways and telecommunications, including ZWD 1.5bn in electricity stations alone. It has said that in principle it would welcome foreign investment, but apart from predatory interest from SA, multinationals will remain cautious, not least due to concerns about property rights after the expropriation without compensation of white-owned farms.

Our short-term economic rating has risen to 16.0, although this is due to a technical revision to our ratings period (2004-2006, rather than 2003-2005), rather than an improved outlook.

BUSINESS ENVIRONMENT

Another Casualty Of Inflation

Rampant inflation has caused numerous economic dislocations, with one notable example being the insurance business. Aligning premiums and future liabilities in such an environment is an actuarial nightmare, especially in the case of 'with profits' policies. The market leader, **Old Mutual**, has said that because of the impossibility of carrying out meaningful risk assessments, it will not renew some 200,000 policies that could well end up being worthless to holders upon maturity.

Our business environment rating is 21.8. Our short-term composite rating is 20.4.

continued from previous page

MDC To Contest – After some five months of uncertainty, the main opposition Movement for Democratic Change (MDC) has said it will field a full list of candidates for the March election, despite the fact that it will contest with the odds stacked against it. The MDC has been under considerable pressure from SADC to participate, and after consulting its own membership decided that it had to be part of the process.

Overall, **BMI** believes that the MDC's threat of a boycott was mostly a tactic to attempt to reduce the threat of violence to its canvassers, especially in the rural areas that are ZANU-PF's stronghold. Non-participation would have also opened the door for a large enough ZANU-PF majority in the 120-seat parliament to allow it to change the constitution at will, which would have allowed it to perpetuate its stay in power. At the last election ZANU-PF took 62 seats and the MDC 57, but the ruling party has topped its total in a series of dubious by-elections since then, while a further 30 seats are filled by appointment.

Leaving to one side the disarray within ZANU-PF, if the MDC is to improve on its

previous performance the level of turn-out will be critical. The opposition's core support is in the cities, and it is uncertain to what extent poverty, hunger and unemployment will result in urban voter apathy. In turn, ZANU-PF depends on the rural vote, which partly explains the land grab of white-owned farms since 2000. But the government has failed miserably to provide the new smallholders with the support they need to produce, and many are disillusioned and some have even abandoned their plots to look for work in towns. In other words, ZANU-PF's land reforms may not prove to be the vote-winner intended.

At this stage all that can be said is that the MDC has the potential to advance. But although it has not been said in public, a number of regional leaders actually fear an MDC clear majority and the constitutional crisis that would follow. Mugabe would have little choice but to negotiate a transitional power-sharing deal with the MDC that would include a presidential election earlier than the scheduled 2008. But he is not a man to go quietly, and action by the military at that stage to keep him in power, although unlikely, cannot be totally ruled out.

DATA & FORECASTS

BMI View: Given the highly uncertain political situation and the sharp decline in industrial output over the past few years, prospects for 2005 and beyond are modest at best. Consequently, we have not materially changed our forecasts this month and are disregarding the impossibly optimistic scenario for 2005 painted in the recent 2005 budget. To achieve the inflation goal, monetary policy would need to be draconian and further resources sucked out of the domestic banking system. However, the central bank spent most of 2004 trying to reduce interest rates, while the financial sector is already groaning under the weight of semi-voluntary lending to the fiscus. Importantly, the budget will do little to bridge the policy gap with the IMF, which still has a decision pending on whether or not to formally expel Zimbabwe.

Government View: In the 2005 budget, the government anticipates 3.5% real growth this year, based on a 28.4% y-o-y rise in agricultural production. It also anticipates that inflation will average 100% over the year, despite government spending rising by 114% in real terms.

	2003e	2004e	2004-05 latest period		2005f	2006f
Real GDP growth (%) ¹	-10.1	-7.0	-	-	-3.5	5.0
Population (mn) ²	13.0	13.1	-	-	13.2	13.3
CPI, eop (% y-o-y) ³	598.7	300.0	148	Nov	250.0	200.0
Lending rate (% p.a.) ³	97.3	150.0	-	-	100.0	80.0
Exchange rate (ZWD/US\$, eop)* ³	798.8	6000.0	5570	12-Jan	6000.0	6000.0
Exports (fob, US\$m) ^{***1}	1225	1000	-	-	1100	1100
Imports (fob, US\$m) ^{***1}	1627	1700	-	-	1700	1700
Trade balance (fob, US\$m) ^{***1}	-402	-700	-	-	-600	-600
Current account balance (US\$m) ¹	-421	-300	-	-	-300	-200
Reserves (ex-gold, US\$m) ³	10	10	-	-	10	5
Import cover (months) ^{3,4}	0.2	0.1	-	-	0.1	0.1
Public Sector Debt (US\$bn) ⁵	4.7	4.0	-	-	4.3	3.6

e/f = BMI estimate/forecasts (bold); *official exchange rate. *** monthly figures on a cash basis. Sources:¹ Central Statistical Office, ² World Bank, ³ IMF, ⁴ BMI calculation ⁵ Reserve Bank of Zimbabwe.

POLITICAL OUTLOOK

Frelimo wins again

The ruling Frelimo party has won a landslide victory in general elections. **BMI View:** The vote was marred by irregularities, but these were more due to administrative failings than fraud. The result is good for political stability and will ensure pro-market policy continuity.

Mozambique held a general election in early December. The exercise was especially significant because the incumbent president, Joaquim Chissano of Frelimo, chose voluntarily not to run after 18 years in power, saying that it was time to open-up the country's 'political space'. The main challenger was once again the veteran leader of Renamo, Alfonso Dhlakama, who was probably taking his last shot at the top job. Frelimo chose as its candidate Armando Guebuza (60), a wealthy businessman who has been party secretary general since 2002. While far from ideologically radical, Guebuza is a somewhat controversial figure. As interior minister after independence from Lisbon in 1975 he summarily expelled Portuguese citizens and in the 1980s was the architect of a scheme that aimed to consign prostitutes, petty criminals and the unemployed to prison camps. Guebuza is now a model capitalist.

As predicted, Guebuza won the election with an overwhelming share of the vote of 63.74%, against Dhlakama's 31.74%, leaving Frelimo with 160 MPs and Renamo just 90. One major disappointment was the very low voter turnout of about 30%, which may

be indicative of apathy amongst the young. Unlike in similar transitions in the region, Chissano does not seem inclined to interfere in the new administration. He is highly respected as an African statesman and is expected to apply his talents to an international position. In any case, Guebuza can be relied upon to continue his predecessor's market-friendly policies.

Although the outcome minimises political risk, Guebuza's mandate is tainted by the opinion of international monitors that the exercise was marred by a number of irregularities. Although it is unlikely that these changed the overall outcome, they have given Renamo, which feels it actually won a much larger share of the vote, grounds upon which to be obstructive. Dhlakama regularly threatens to boycott the assembly and is demanding a fresh election in 2005. Such tactics are well-trodden ground for Renamo, and Dhlakama is receiving no support from abroad. Although unfortunate, the irregularities need to be viewed in the context of the limited administrative capacity of one of the poorest countries on earth, and a concerted effort to alter the outcome is unlikely.

DATA & FORECASTS

The external position has improved with the coming-on-stream of the giant **Mozal** aluminium sector project. Export growth will now slow from the rates seen in recent years, but revenues will remain high and the foreign liquidity position has improved. However, reflecting the unbalanced nature of the economy, both the budget and external current account deficits will continue to be sustainable only on the basis of donor support: domestic income to the exchequer is almost insignificant. Positively, both the IMF and bilateral official creditors are supportive, which means that Mozambique will be able to balance its Treasury book over our forecast period.

	2001	2002	2003	2004f	2005f	2006f
Real GDP growth (% y/y) ¹	13.0	8.3	7.0	8.4	6.8	6.5
GDP per capita (US\$) ^{1,2}	189	188	229	286	360	427
CPI, eop (% y/y) ³	21.9	9.0	10.8	10.8	9.5	8.0
Budget balance, % of GDP* ¹	-21.2	-20.5	-19.5	-20.0	-15.0	-15.0
Exchange rate (MZM/US\$, eop) ¹	23,320	23,854	23,857	18,678	17,800	16,850
Exports (fob, US\$m) ³	703.1	679.3	880.2	1000.0	1200.0	1300.0
Imports (fob, US\$m) ³	957.1	1215.7	1228.2	1750.0	1850.0	1700.0
Trade balance (fob, US\$m) ³	-254.0	-536.4	-348.0	-750.0	-650.0	-400.0
Current account balance (US\$m) ³	-639.7	-711.6	-521.3	-750.0	-720.0	-625.0
Reserves (ex-gold, US\$m) ¹	715.6	819.2	998.5	1000.0	900.0	860.0
Import cover (months) ^{1,2}	5.5	5.5	6.7	5.1	4.5	6.1
Total external debt (US\$bn) ¹	4.47	4.20	4.00	3.80	3.70	3.70
- % of GDP ^{1,2}	130.0	120.2	92.6	69.1	52.5	0.0

e/f = BMI estimates/forecasts. * = before grants. Sources: ¹ IMF, ² BMI calculation, ³ Instituto Nacional de Estatística/Banco de Mocambique/IMF/BMI

RISK SUMMARY
POLITICAL RISK
A Work In Progress

The country's polity has come a long way since 1992, when decades of internal war finally came to an end. However, the legacy of internecine conflict has yet to be fully erased. The two main political parties, ruling Frelimo and opposition Renamo, were the main protagonists of the war and remain deeply distrustful of each other, which makes any meaningful level of policy consensus extremely rare. Corruption remains a problem, although less of one than in many other African countries, and the media has at times suffered from intimidation. But despite such issues, Mozambique is largely regarded as a functioning democracy, albeit a flawed one.

Our short-term political rating has risen marginally to 68.0 in the aftermath of the election.

ECONOMIC RISK
Split Personality

Mozambique has consistently recorded one of the highest rates of economic growth in Africa. However, the impetus has come from a series of 'megaprojects' in areas such as aluminium and transport, which have done little directly for the vast bulk of the population that still relies on basic farming. Unemployment is estimated at about 50%, and two-thirds of the population lives on less than US\$1 per day. Poverty reduction is increasingly at the fore of the government's agenda, but it will take decades to achieve a more balanced economy.

Our short-term economic rating has risen to 45.0 after we moved our rated period forward to 2004-2006 (from 2003-2005).

BUSINESS ENVIRONMENT
Delays Possible

Booming exports mean that import cover has risen to over seven months, also bringing currency appreciation. Although the external liquidity position is comfortable, payments for foreign trade can still be held-up by inefficiencies in government and the banking system.

Our business environment rating is 44.8. Our short-term composite rating is 55.3.



RISK SUMMARY

POLITICAL RISK

Trouble At The Top

President Bingu wa Mutharika, a technocrat, was plucked from political obscurity to lead the country by his predecessor, Bakili Muluzi. Mutharika holds no formal position in the ruling United Democratic Front (UDF), which is still chaired by Muluzi. Mutharika has been trying to battle corruption, but is opposed by some major vested interests. The UDF is increasingly splintered, and despite a recent meeting between the two men aimed at resolving their differences, their relationship remains poor.

Our short term political rating has risen marginally to 57.0, although downside risks remain.

ECONOMIC RISK

Economic Risk – Softly, Softly

Malawi depends on aid to survive. Humanitarian assistance has been maintained, but since 2001 donors have declined funding for development expenditure in protest at corruption under the previous regime. The current president understands the problem, and his efforts to curb graft are likely to see a resumption of aid in the near future, although there is great scepticism about Malawi's ability to spend aid wisely. Economic risk will remain high: Malawi's only viable export is tobacco, a product that has poor long term prospects.

Our short term rating has risen to 32.0 (from 29.0), due to the shift of our rated period to 2004-2006 (from 2003-2005).

BUSINESS ENVIRONMENT

Business Environment – Not Much Happening

Malawi's private sector is miniscule, and mostly engaged in basic activities such as retailing. There are regional initiatives to increase the level of investment in poorer states, but for the foreseeable future agribusiness, banking, and perhaps telecommunications, are about the only attractive sectors.

Our short term composite rating is 42.7.

ECONOMIC OUTLOOK

Poor relations

A recent IMF review highlights the poor implementation capacity of the state sector. **BMI View:** There is an ample good-will on the part of the international community towards Malawi. The current administration is an improvement on the past, but the country remains badly served by its leaders.

The IMF has recently published a rare introspective analysis of its long-term engagement with Malawi. Blame is not apportioned, but despite the Fund's support over many years, problems of under-development and poverty remain unresolved. Quite clearly, successive governments dating back to the ill-fated post-independence dictatorship under Hastings Banda have much to answer for, but the Fund can also be held to account for imposing over-ambitious targets and failing to install a sense of "ownership".

For a country as desperately poor as Malawi, with very limited technical resources attempting to achieve 'western' levels of economic performance, structural reform, and poverty reduction is nearly impossible. Changes and improvements to governance are obviously needed, but the real problem is finding economic activities that can empower the poor. Furthermore, while there is some potential in textiles, the most pressing need is to boost food production.

It is here that problems remain. Notwith-

standing allegations of profiteering from grain stores by officials, the issue of food security remains at the centre of policy debate: the IMF has sanctioned expenditure on fertilisers and other basic inputs for small holders, but the country remains highly vulnerable to starvation. At present, the IMF is limiting its presence to a Staff Monitored Programme (SMP), adopted in July 2004, which mimics a full facility but does not obligate the IMF to any actual lending.

Renewed Fund lending is absolutely crucial, as the government has been forced into borrowing heavily from the domestic banking system, with the result that its internal interest obligations are nearing unsustainable levels. In addition, the present value of external debt in relation to exports has risen to around 327% because of poor export performances. Essentially, the current economic position is unviable. It is far from clear how Malawi will be able to lift itself out of aid-dependency, but the starting point must be better political management of the economy.

DATA & FORECASTS

The economy will continue to grow, but forecasts are vulnerable to the unpredictable effect of weather on the all-important agricultural sector. The portends are not encouraging for the next harvest, which looks likely to be disappointing. The IMF estimates that an annual average real GDP growth rate of 5% is needed to make real inroads into poverty levels, but this looks out of reach at present. Moreover, there is a major problem with the quality of data on the economy: the reality is that neither the government or donors really know the true situation, not least because much of the workforce has been forced into the informal economy.

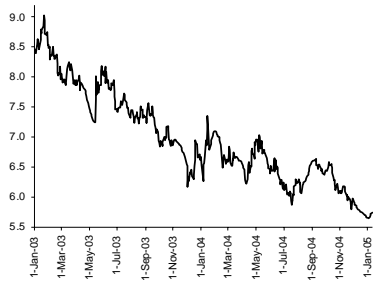
	2001	2002	2003	2004e	2005f	2006f
Real GDP growth (% y/y) ¹	-4.1	1.8	4.4	4.6	4.5	4.0
GDP per capita (US\$) ^{1,2}	147	169	155	165	188	217
Population (mn) ³	11.6	11.9	12.1	12.4	12.6	12.6
Fiscal balance incl. grants (% of GDP)* ¹	-5.9	-8.5	-7.7	-6.0	-4.0	-4.0
CPI, average (% y/y) ⁴	27.2	27.8	10.1	15.0	12.0	12.0
Lending Rate (%) ¹	56.2	50.5	48.9	37.0	37.0	37.0
Exchange rate (MWK/US\$, eop) ¹	67.29	87.14	108.57	108.00	110.00	110.00
Exports (fob, US\$m) ⁴	426.6	413.5	369.3	470.0	484.0	470.0
Imports (fob, US\$m) ⁴	443.6	594.7	594.2	703.0	693.0	650.0
Trade balance (fob, US\$m) ⁴	-17.0	-181.2	-224.9	-233.0	-209.0	-180.0
Current account balance (US\$m) ⁴	-177.7	-374.0	-360.1	-165.0	-155.0	-145.0
Current account balance (% of GDP) ^{4,2}	-7.7	-6.7	-5.7	-4.0	-3.0	-2.0
Reserves (ex-gold, US\$m) ¹	206.7	165.2	126.5	110.0	130.0	130.0

e/f = BMI estimate/forecast (bold). * FY to end June, 1998=1997/1998. Sources: ¹IMF, ²BMI calculation, ³World Bank, ⁴Reserve Bank of Malawi.



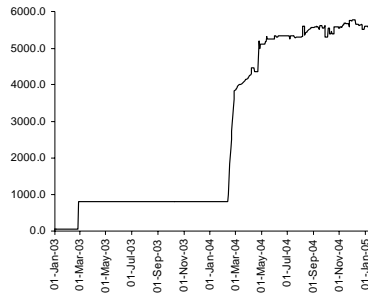
EXCHANGE RATES

Off Recent Highs
South Africa, ZAR/US\$



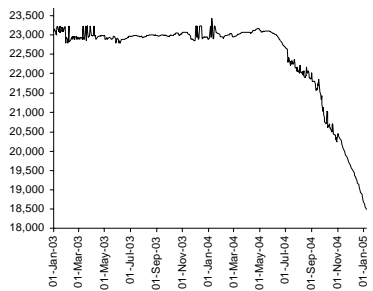
Source: Reuters

Still Massively Overvalued
Zimbabwe, ZWD/US\$



Source: Reuters

Election Gives Further Boost
Mozambique, MZM/US\$



Source: Reuters

Steady
Malawi, MWK/US\$

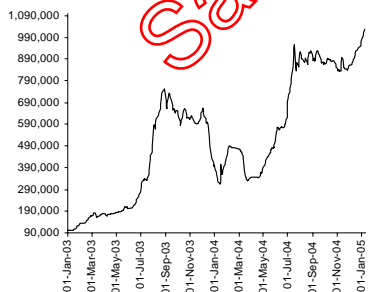


Source: Reuters

The big news in December was the rand's relentless appreciation, which caused many institutions to revise upwards their forecasts for 2005. However, in the early days of January, the rand fell sharply, declining to around ZAR6.1/US\$ (from ZAR5.6/US\$ on December 27). The main cause of the fall was the dollar's recovery and the concomitant decline in gold prices (which are negatively related to the US dollar as they are seen as a safe haven at times when the dollar is weak). Given the fall in gold prices, the rand's depreciation was marked against other currencies as well, including the euro. Although the dollar may strengthen from its current level over the short term, the large current account and fiscal deficits suggest that it will continue to remain weak over the medium term. The corollary is that while the rand may find it difficult to remain below ZAR6.0/US\$ for long periods, a break above ZAR7.0/US\$ looks unlikely. It looks set to be another bad year for exporters.

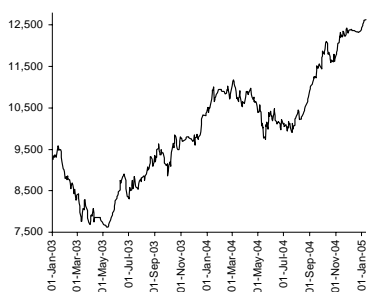
STOCK MARKETS

The Only Game In Town
Zimbabwe Industrial Index



Source: Reuters

Powering Ahead
JSE All Share Index



Source: Reuters

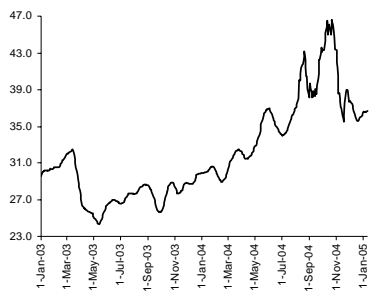
Strong domestic demand growth is underpinning the Johannesburg Stock Exchange, which has now risen approximately 30% since September. While mining companies will suffer from the rand's strength and weakening gold prices, companies oriented towards the domestic market look likely to perform well over the next year. Furthermore, there may be some technical buying in progress, with the likelihood that inflation will be contained despite rapid growth suggesting that interest rates will peak at a lower level than previously assumed in the current economic cycle, thereby reducing demand for bonds.



COMMODITY PRICES

Off Recent Peaks

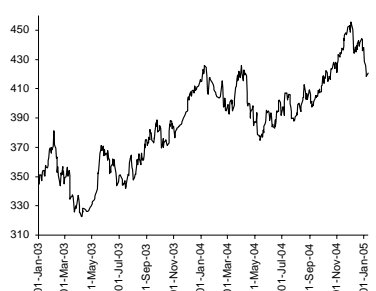
OPEC basket, US\$/b



Source: Reuters

US Dollar Bounce

Gold, US\$/ounce



Source: Reuters

Testing Recent Highs

LME 3-Month Copper Price, US\$/ounce



Source: Reuters

Demand Growth Softens

Platinum, US\$/ounce



Source: Reuters

After several years of strong prices, the outlook for commodities in 2005 is more mixed. We expect global growth to moderate to around 3.1% this year (from 3.6% in 2004), led by a slowdown in China (albeit to 8% real growth from over 9% in 2004). This will reduce demand growth for commodities such as platinum and copper, where global capacity has built in recent years. It will also have an impact on oil prices, although continued OPEC cohesion due to many member states determination to keep prices high to offset the weakening dollar (whose currency many petro-exporters are linked to) will prevent oil slipping substantially. Indeed, in light of only limited stock build in 2004, we have raised our forecast for the OPEC basket to US\$33/b (from US\$31/b). The big question is gold. Assuming continued US dollar weakness, we expect gold to remain strong in 2005, possibly recovering from recent losses. However, should the US dollar staged a sustained recovery (it is hovering around US\$1.3/EUR) then gold may have further to fall.

REGIONAL MACROECONOMIC DATA & FORECASTS

	GDP (US\$bn)			Real GDP Growth (% y-o-y)			GDP Per Capita (US\$)		
	2003	2004e	2005f	2003	2004e	2005f	2003	2004e	2005f
Angola	10.9	15.6	16.8	4.5	10.0	12.0	736	1025	1067
Botswana	6.6	9.2	10.3	6.5	5.5	4.5	3,655	4,937	5,352
Malawi	1.9	2.0	2.3	4.4	4.6	4.5	155	165	185
Mozambique	4.3	5.5	7.1	7.0	8.4	6.8	229	286	360
Namibia	4.3	5.4	5.2	3.7	3.5	3.9	2,138	2,633	2,480
South Africa	165.5	204.4	191.3	2.8	2.1	3.0	3,655	4,485	4,157
Zambia	4.3	4.5	6.4	7.1	5.2	5.1	367	372	519
Zimbabwe*	11.8	7.0	30.4	-10.1	-7.0	-3.5	911	537	2,309

	Inflation (% y/y)			Current Account (% of GDP)			Trade Balance (US\$m)		
	2003	2004e	2005f	2003	2004e	2005f	2003	2004e	2005f
Angola	76.6	50.0	45.0	15.2	38.3	39.6	5,504	9,807	10,471
Botswana	6.4	6.9	6.5	6.5	4.3	1.9	500	300	300
Malawi	10.1	15.0	10.0	-19.1	-7.3	-6.4	-225	-230	-220
Mozambique	10.8	10.8	9.5	-12.1	-13.6	-10.2	-348	-750	-650
Namibia	2.0	3.6	3.8	2.6	2.8	3.4	-469	-300	-150
South Africa	4.0	4.0	5.5	-0.8	-1.5	-1.2	3,785	1,230	1,094
Zambia	17.2	18.0	17.4	-14.6	-10.1	-7.0	-271	-250	-250
Zimbabwe	598.7	300.0	250.0	-3.6	-4.3	-1.0	-402	-700	-600

* Calculations from ZWD to US\$ are based on official rate which grossly exaggerates GDP and GDP per capita data. e/f = BMI estimates/forecasts. na= not available. Source: National Central Banks/National Statistical Agencies/BMI



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