POLITICAL OVERVIEW

The Twin Changes – breaking two bad habits

Two significant changes have come into maturity this February. Both have had quite an impact on the investment environment. Both tell us something about political will and policy.

Capex

Firstly, the annual budget maintained the trend that started in 2001 – higher capital expenditure by the government. In that year capital expenditure rose by 58%. Thereafter, it kept on increasing by double digits and by a margin comfortably more than the nominal growth in the economy.

The result is that capital expenditure rose both as a percentage of GDP and as a percentage of total budget expenditure. In the 2004 budget, capital expenditure will reach 4.4% of the total budget, up from 2.9% in 2000. As a percentage of GDP it will rise from less than 1% in 2000 (0,76% to be precise) to 1,32% of estimated 2004 GDP. Since GDP is increasing, a higher percentage actually means a double whammy: more rands and a higher percentage of more rands.

	2000	2001	2002	2003	2004	2005	2006
	outcome	outcome	outcome	outcome	budget	estimate	estimate
Rs million							
Total capital expenditure	6,970.9	11,065.2	13,438.9	15,470.1	17,582.2	19,883.8	21,495.3
GDP	914,634.0	1,010,921.0	1,149,890.0	1,223,197.8	1,331,795.7	1,455,626.1	1,592,571.4
as % of GDP	0.76%	1.09%	1.17%	1.26%	1.32%	1.37%	1.35%
% change in Rands		58.73%	21.45%	15.11%	13.65%	13.09%	8.10%

So what?

Government is again investing in its infrastructure and capital goods in a meaningful way. This will have three consequences:

- The capacity of the economy is enhanced, thus allowing more to be produced
- Jobs will be created
- It will stimulate more private sector investment, thus improving overall investment in the economy.

We expect these numbers to improve further over the next few years, simply because the cabinet lekgotla held in July 2003 decided on a further meaningful increase in capital expenditure. According to senior civil servants, this decision must still be worked into the budgets of future years. So expect more.

Foreign reserves

Also in February, the Reserve Bank closed down the forward book - established when exchange control was introduced by the Reubicon speech in 1985. It is really the end of an era.

The forward book became controversial after the financial crises of 1998 when a debt of about $25 billion was run up in an effort to defend the rand. The various mega-transactions around Mutual and Anglo moving to London, the delisting of De Beers, the two Telkom privatisation tranches and several foreign loans all helped to clear the forward book.

No doubt the weakness of the US dollar also created a huge window of opportunity.

So what?

Make no mistake, SA’s net foreign reserves are still very low. It will take some time to build them up. But at least with the forward book out of the way, this can now be done.

The main implication is that the rand is probably no longer the one-way bet it was seen to be a year ago.

Conclusion

If it is true that a currency is a reflection of underlying realities, then the reversal of capital expenditure trends and the accumulation of forex reserves, create two realities very different from what they were in the past.

Markets always overshoot. As Warren Buffet put it in his disarmingly blunt way: “If markets were efficient, I would not be rich.” So yes, the value of the currency will not always reflect the underlying realities. But as Buffet also reminds us, the market always goes back from overshoot to real value. So take note of the two new realities created in our environment.