SOUTHERN AFRICA QUARTERLY OVERVIEW AND ANALYSIS

1ST QUARTER 2012

ISSUE N° 4

ANGOLA
BOTSWANA
LESOTHO
MADAGASCAR
MALAWI
MAURITIUS
MOZAMBIQUE
NAMIBIA
SOUTH AFRICA
SWAZILAND
ZAMBIA
ZIMBABWE

BANQUE AFRICAINE DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK
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FONDS AFRICAIN DE DEVELOPPEMENT

1ST QUARTER 2012 **http://www.afdb.org/en/countries/southern-africa/**

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PREFACE

The Southern Africa Quarterly Overview and Analysis is produced by the Southern Africa Resource Center (SARC) and the Southern Africa Regional Department B (ORSB) of the African Development Bank. The publication is part of the African Development Bank's surveillance of economic and policy developments in Southern African countries. It also attempts to draw some implications of quarterly developments for the outlook period. The report is prepared by the Country Economists and is produced from information gathered through consultations, review of country documents, and other relevant sources.

Preparation of the Report was coordinated by Albert Mafusire, Oscar Pitti Rivera and Imen Chorfi under the supervision of Kennedy Mbekeani (Regional Economist, SARC) and Ernest Addison (Lead Economist, ORSB) and the overall guidance of Ebrima Faal (Regional Director, SARC) and Chiji Ojukwu (Regional Director, ORSB).

I. REGIONAL OVERVIEW

The economies of most southern Africa economies are growing with the exception of Swaziland which is yet to recover from the worst fiscal crisis that hit the country since independence in 1966. The economies of Angola, Zimbabwe and Mozambique are expected to grow by over 7 percent in 2012, making them the fastest growing economies in the region (Figure 1). Angola's growth has been driven largely by strong oil output, while good performance in mining and agriculture has buoyed growth in Zimbabwe. The tertiary sector, mainly transport and communication, and the opening of two new coal mines were the major contributor to growth in Mozambique. During the first quarter of 2012 most of the countries, especially South Africa and Mauritius, revised their economic growth downward due to the deepening economic crisis in the euro zone which is a major export market for the region.

As a result of tight monetary policies, the region's average inflation rate has been kept at single-digit levels (Figure 2). However, inflationary pressures are persisting, with average annual rate for 2012 projected to rise slightly to 6.8 percent from to 6.7 percent in 2011. Inflation has largely been driven by rising international fuel and food prices. Angola and Malawi had the highest inflation rates in the region, exceeding 11 percent during the first quarter of 2012. Madagascar had the lowest inflation at 0.7 percent followed by Mozambique at 3.2 percent and Zimbabwe and Mauritius at 4.2 percent. Zimbabwe's low inflation is a result of the adoption of the multi-currency regime in 2009. This notwithstanding, prices of food, non-alcoholic beverages, health, education and services are expected to increase during 2012.

The rise in SACU transfers to an estimated R42.2 billion in 2012/13 (from R21.8 billion in 2011/12) is expected to result in the narrowing of fiscal deficit in the smaller SACU countries. Swaziland's fiscal position is expected to ease in 2012 with SACU revenues rising by almost 145 percent. Botswana is expecting to a surplus of 0.9 percent of GDP reflecting improved revenue collection and expenditure prioritization. Angola is expecting a surplus of 3.5 percent of GDP in 2012/13 reflecting prudent fiscal policy.

Overall balance of payments and reserve positions improved in most of the countries. However, Malawi, Mauritius and Swaziland experienced deficits. In Malawi, the balance of payments deficit is projected to worsen to 9.5 percent of GDP in 2012 compared to 7.8 percent the previous year. International goodwill, following coming into power of the new President following the death of President Bingo wa Mutharika and efforts to normalize relations with the major donors, may mitigate the deteriorating external position of the country. In Mauritius the widening deficit is mainly due to the economic slowdown in the euro zone economies, the country's major trade partner.

Worsening rankings in the overall doing business indices in 2011 compared to 2010 reflect poor policy and institutional environment in most of the Southern Africa region countries. South Africa, Botswana, Mauritius, Namibia and Zambia are the top regional performers (Figure 3). Zimbabwe and Angola are considered the least competitive economies in the region with an overall doing business ranking of 171 and 172 out of 183, respectively. According to the 2012 Doing Business Report, the worst performances were in indicators for "registering property" and "getting credit". To improve the business environment, Zambia and Madagascar implemented some reforms to ease business start-ups by eliminating the minimum capital requirement and streamlining procedures at the one-stop investment shops. Corruption, access to finance and high tax rates remain the top constraints to investment in the region.

AFDB

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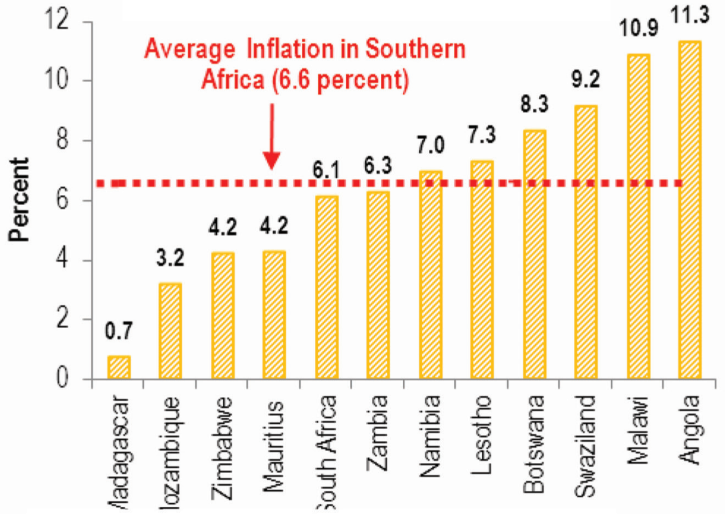
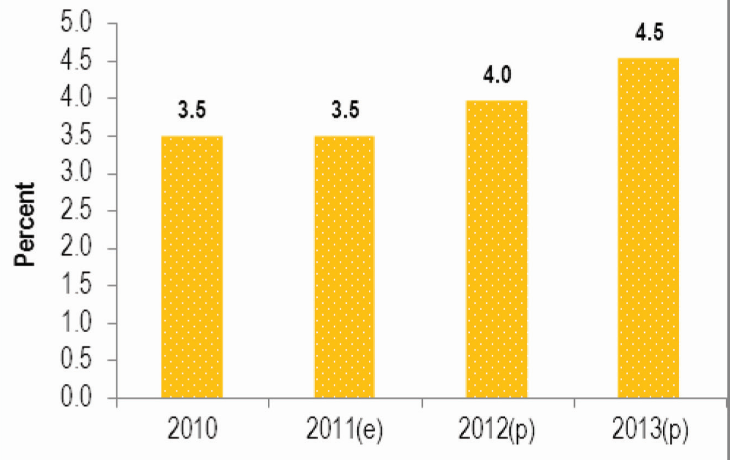
Selected Macroeconomic Indicators for Southern Africa

Figure 1. Inflation (Year-on-Year)



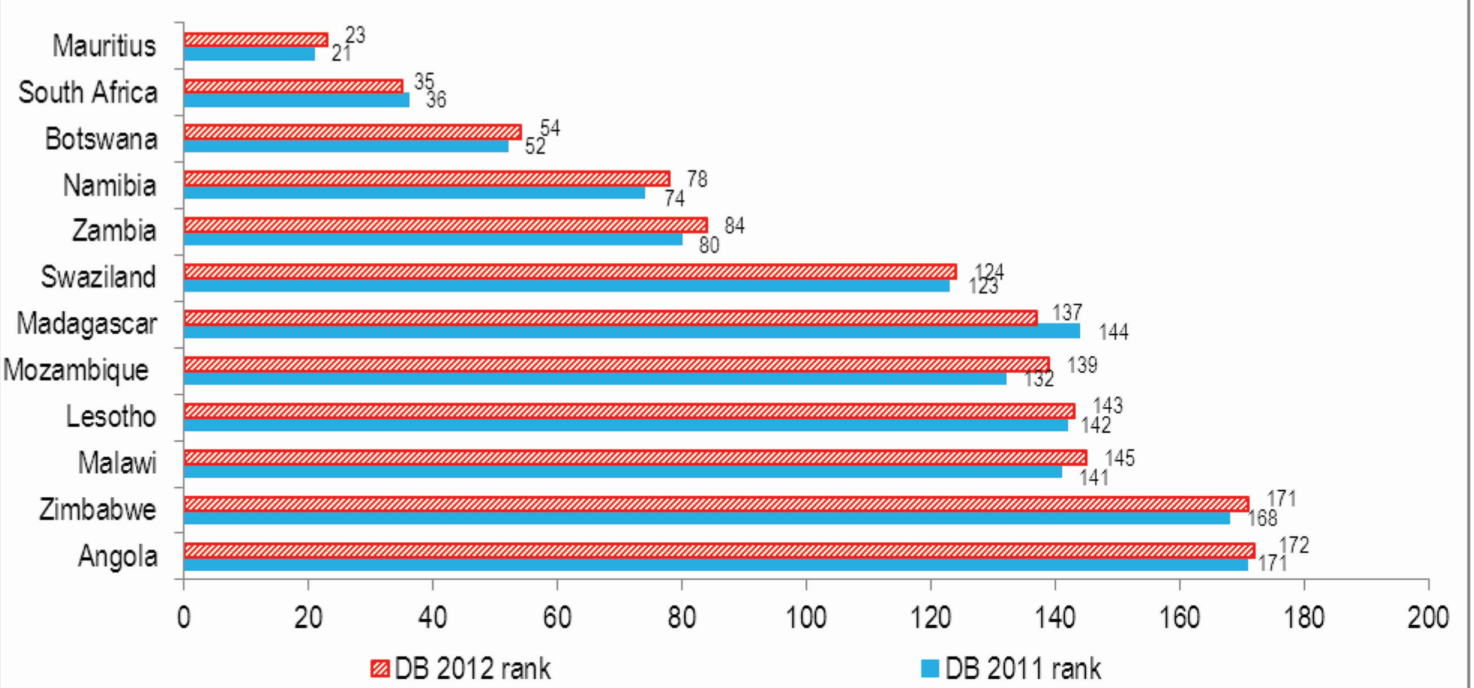
Source: National Authorities, Southern Africa

Figure 2. Real GDP Growth



Source: African Economic Outlook, AfDB

Figure 3. Overall Business Ranking for Southern Africa Countries



Source: Doing Business 2012, World Bank

II. COUNTRY ANALYSES

ANGOLA

HIGHLIGHTS

- Macroeconomic performance is improving as Angola continues to implement economic reforms that started in 2009.
- With elections due in 2012, capital expenditure remained high in the first quarter.
- In March 2012 the IMF completed its sixth Stand-by-Arrangement (SBA) review with the final disbursement of $132.9 million, bringing the total for the 27-month program to $1.33 billion.

I. MACROECONOMIC MANAGEMENT OVERVIEW

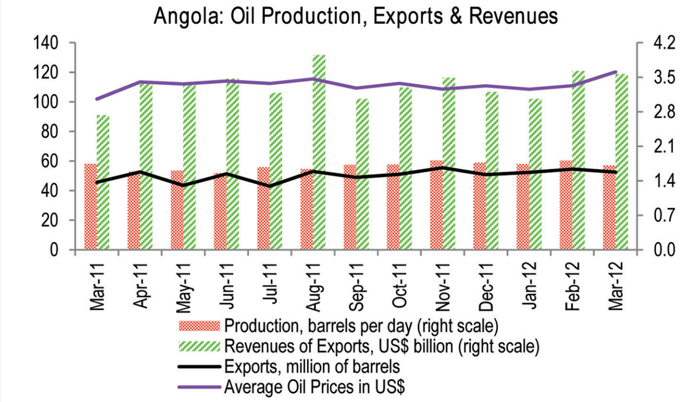
Economic Growth: Liquefied natural gas production that was expected to start in the 1st quarter was postponed to late June 2012. The postponement has negative implications for growth and fiscal revenues for 2012. As a result, in April 2012 the IMF revised Angola growth estimate for 2012 downwards from 10.5 percent to 9.7 percent. Oil production in the 1st quarter remained above 1.7 million barrels per day (bpd). Angola's oil output is expected to surpass the 2011 level to reach 1.9 million bpd in 2012. Despite the capital-intensive activities in oil and gas, a weak link to the rest of the economy remains and job creation limited. Unemployment rate is still estimated at 26 percent and poverty is still prevailing at 36 percent. Activity in the non-oil sector in the 1st quarter has been strong, as expected, especially in the construction sector. Non-oil is expected to grow by 10.9 percent in 2012.

Monetary Policy and Banking System: Macroeconomic policy coordination between the Government and the National Central Bank is continuing to pay dividends. Despite a slow start, the economy remains within the three main programmatic objectives for the year: (i) increase gross international reserves (from USD 27 billion in December 2011 to USD 29.2 billion at the end of the first quarter,); (ii) gradual adjustment of the Kwanza to be in line with market fundamentals; (iii) bringing down 12-month inflation to 11.12 percent at the end of the quarter (from 11.38 in December 2011).

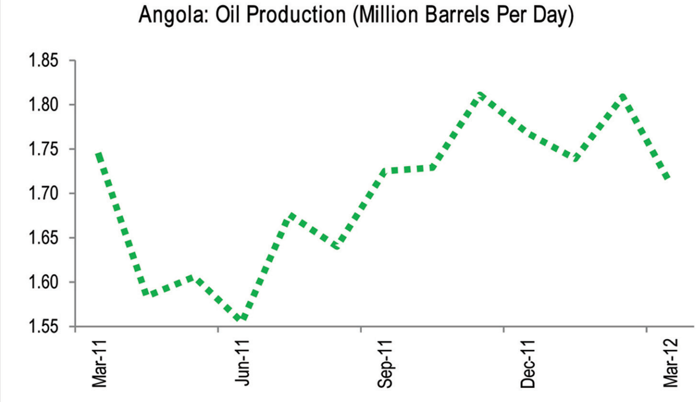
In order to foster economic growth and ease access to credit, the Monetary Policy Committee reduced the reference-lending rate (the BNA rate) in January 2012, from 10.5 percent to 10.25 percent. In spite of this reduction, Kwanza interest rates from commercial banks reversed last year's downward trend, with the 181 days to 1-year lending interest rate to individuals increasing from 13.1 percent in December 2011, to 16.33 percent in March 2012. In addition, the government is going ahead with plans to launch the stock market, which is expected to start operating later this year. At its initial stages the capital market is most likely to be dominated by financial sector companies and therefore less robust.

The proportion of medium-term credit increased in the 1st quarter of 2012 from 46 percent in December 2011 to 48.8 percent in March 2012. As confidence in the local currency continues to improve, the Kwanza made further gains as the main credit currency in the first quarter (58.56 percent of credit at the end of March).

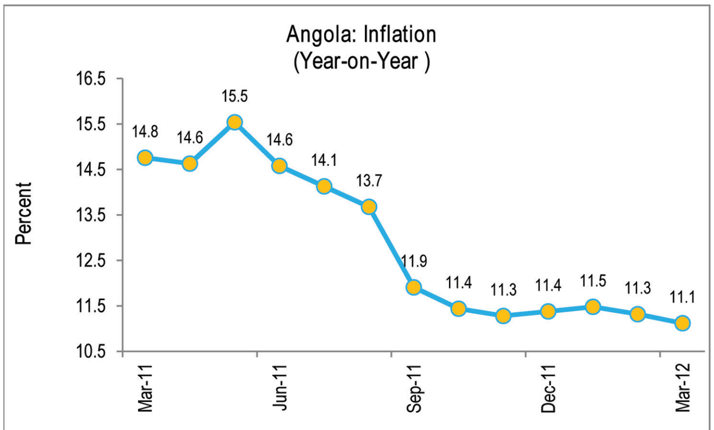
Fiscal Policy: In spite of the continued high levels of capital expenditure under the National Reconstruction Program in the first quarter of 2012 and preparations for the elections, the government is committed to pursuing fiscal prudence.



Source: Ministry of Finance, Angola; Organization of Petroleum Exporting Countries (OPEC)



Source: Ministry of Finance, Angola; Organization of Petroleum Exporting Countries (OPEC)



Source: The National Statistics Institute (INE), Angola

ANGOLA

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Public Sector Management: The government has continued with the reforms that started in 2009. Recently it has requested support from the IMF to develop a medium-term fiscal framework, an indication of the desire forlonger term planning and a move towards the Medium Term Expenditure Framework and Program Based Budgeting. In January 2012 the new foreign exchange law for the oil sector was approved. The law requires oil companies to transact in the local currency through local banks. Given the likely high impact on the financial sector, especially domestic banks, law will be implemented gradually within the next 24 months. In addition, in March a presidential decree directed that that effective December 2012 the national oil company, Sonangol, should declare to the Ministry of Finance the amount of oil revenue destined for foreign debt repayment, as of December 2012. The improvement in timeliness of Sonangol's transfers is expected to improve budget planning. These measures are expected to further increase transparency and predictability of the annual budget.

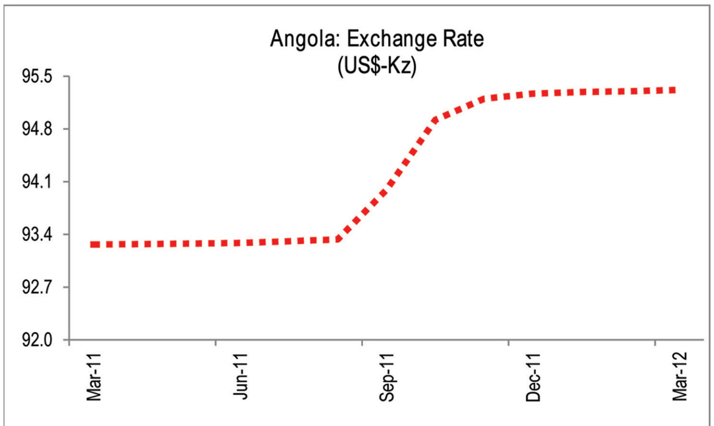
Private Sector Reform: The subsidized loans and State credit guarantees extended to businesses under the government Program to incentivize entrepreneurship (PFE) were launched in March 2012. SMEs are estimated to currently represent 5percent of national GDP, a weight expected to increase with the implementation of the PFE measures.

III. DONOR COORDINATION ACTIVITIES

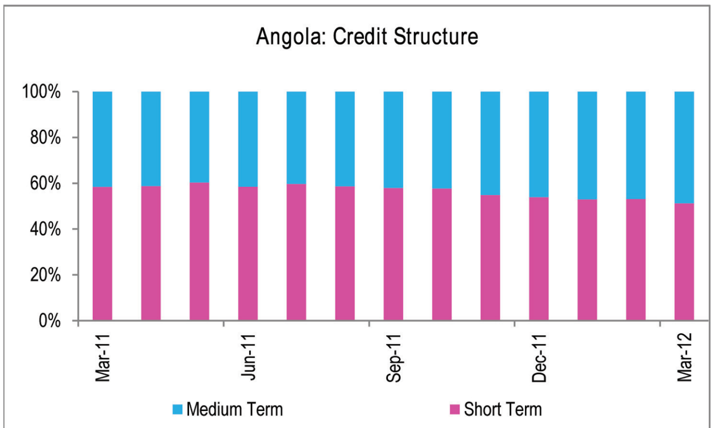
In the first quarter of 2012 dialogue between the different stakeholders operating in the country has continued, as well as several consultations with government and private sector representatives in order to assess the country's needs, allowing for an improvement in donor coordination.

IV. ISSUES NEEDING PARTICULAR ATTENTION

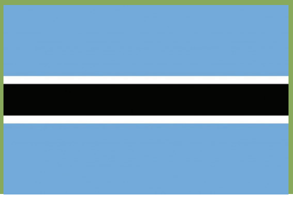
With elections in 2012 the country is facing increased social pressure. In March 2012 a popular demonstration, which demanded the replacement of the president of the National Elections Committee, was violently repressed by a group of individuals. Officials attributed the unrest to a clash of two groups of youth demonstrators



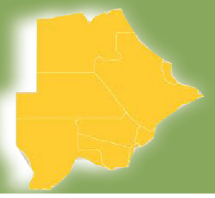
Source: National Bank of Angola



Source: National Bank of Angola



BOTSWANA



HIGHLIGHTS

- In 2011 growth decelerated from 7 percent in 2010 to 5.1 percent.
- Commendable improvements in the fiscal balance were achieved; the budget deficit narrowed to 3.3 percent of GDP in 2011/1and a modest surplus of 0.9 percent of GDP is expected in 2012/13.

I. MACROECONOMIC MANAGEMENT OVERVIEW

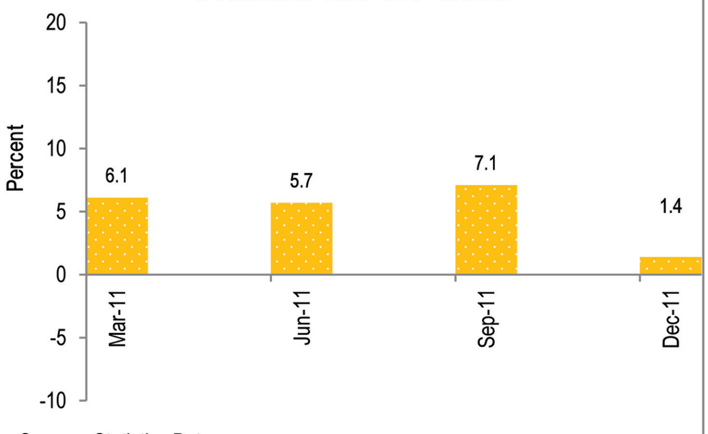
Economic Growth: The economy grew by 5.1 percent in 2011, though much lower compared to 7.0 percent attained in 2010. The slow growth in real GDP was mainly due to the negative growth of 1.3 percent in the mining sector. The high growth rates in construction (25.1 percent), manufacturing (12.1 percent), and agriculture (7.8 percent) could not offset the decline in mining. Although the mining sector remains the major contributor to GDP, its share has been declining since 2007. In 2011 it contributed 28.4 percent to total GDP, slightly lower compared to 30.3 percent in 2010. For 2012, real GDP growth is estimated at 4.4 percent while projections for 2013 stand at 3.9 percent.

Monetary Policy and Banking System: Since the second quarter of 2010 inflation rate has ranged far beyond the Bank of Botswana's objective target range of 3 – 6 percent. Inflation peaked to 9.2 percent in December 2011 but declined to 8 percent at the end 1st quarter of 2012. Improved food supply and persistent low domestic demand pressure are the major factors that contributed to the decline in the rate of price increases. Due to the slowdown in inflation and in an attempt to stimulate growth in the private sector, the Bank of Botswana has maintained the lending rate at 9.5 percent. Growth in money supply is modest and was recorded at 4.4 percent in 2011.

Fiscal Balance: Botswana's medium term budget is geared towards attainment of fiscal sustainability and promotion of economic growth. The revised budget outturn indicates significant improvement in both expenditure prioritization and revenue collection. The budget deficit has significantly narrowed, declining from an earlier estimate of 5.6 percent of GDP to 3.3 percent in 2011/12. For the 2012/13 fiscal year, a modest surplus of 0.9 percent of GDP is expected on account of improved revenue collection and expenditure prioritization. While total revenue is expected to improve by 1.1 percentage points to 34.2 percent of GDP in 2012/13, total expenditure is estimated to decline by 3.2 percentage points to 33.2 percent of GDP, as most of the ongoing infrastructure projects are approaching completion.

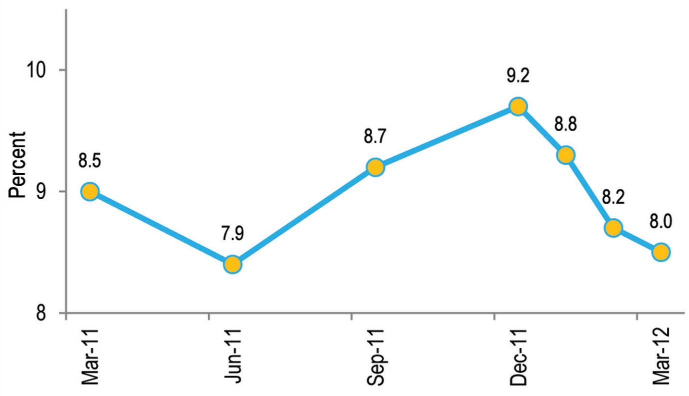
External Sector: Botswana recorded significant improvement in its external balance, as the recovery in world demand for diamonds led to substantial increase in export receipts. The total value of exports increased from P32 billion (about US$4.7 billion) in 2010 to P40 billion. Diamond exports accounted for 75.6 percent of total export receipts in 2011, bolstered by high demand in East Asia. Tourism is also a major sector in foreign earnings. According to recent statistics by the Ministry of Environment, Tourism and Wildlife, there has been a sharp increase in the utilization of lodges by tourists. International tourists' arrivals in 2010 were around 2.1 million, coupled with an average length of stay of 5.3 nights and total expenditure of around P5.1 billion (about US$750 million).

Botswana: Real GDP Growth



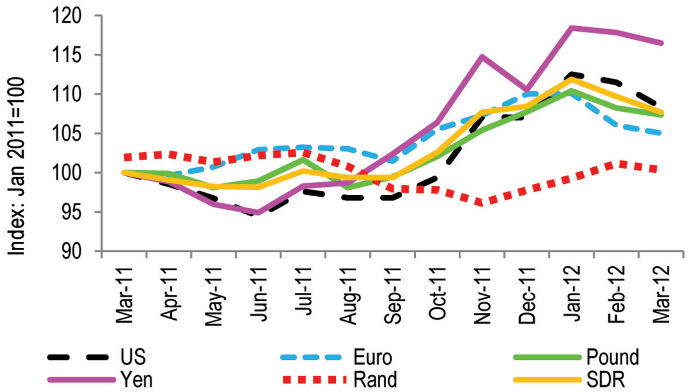
Source: Statistics Botswana

Botswana: Inflation (Year-on-Year)



Source: Statistics Botswana

Echange Rate Movement



Source: Bank of Botswana

In line with the increase in export earnings, gross foreign reserves remained high at US$8.1 billion in December 2011, equivalent to 19 months of imports. The current account deficit is expected to narrow to around 3 percent of GDP, compared to 5 percent in 2010.

The value of the Botswana Pula declined against major foreign currencies. The Pula depreciated by 11.6 percent against the Euro, 14.1 percent against the British Pound, and 14.4 percent against the US Dollar. Although in 2010 the Pula weakened by 7.4 percent against the rand, it appreciated by 5.8 percent in 2011.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Botswana's major structural reforms relate to diversifying the economy from its reliance on the mining sector, particularly diamonds. Despite many reform initiatives towards this end, including the recent "Economic Diversification Drive" strategy, challenges still remain. While the private sector is considered instrumental for realization of the strategy, it continues to be narrow, with weak inter-sectoral diversity and production links. Issues pertaining to labour productivity, trade support institutions, regulatory frameworks and policies, remain among major constraints to private sector competitiveness.

LESOTHO

HIGHLIGHTS

- Modest growth is likely in the medium-term, driven by investments in the second phase of Lesotho highland project and diamond production.
- Government is to rationalize spending in line with revenue performance.
- Inflation is expected to continue to rise above 6 percent in the medium-term in response to international price developments for fuel.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy of Lesotho has recovered from the impact of the global financial and economic crisis despite the slowdown in real GDP growth to 4.2 percent in 2011 compared to 5.4 percent in 2010. Over the short to medium-term economic growth will remain moderate, underpinned by the good performance of the mining sector, reconstruction activities to repair the damage done by the floods in early 2011, construction activities by Millennium Challenge Account and investment in Phase II of Lesotho Highland project. In addition, government support to public-private partnership in irrigation infrastructure is expected to boost agricultural growth.

Monetary Policy and Banking System: The Central Bank of Lesotho continued increasing its holdings of foreign reserves. By April 2012 the reserves had surpassed the target of US$ 699 million needed to ensure parity of the loti to the South Africa rand. Money supply broadly defined recorded an annual increase of 12 percent by end March 2012 up from 1.1 percent the same period last year. Even though private sector credit as a percentage of GDP decreased by 5 percent, it increased by 1 percent. However, the velocity of broad money remained unchanged at 2.9.

Since October 2011 inflation has consistently been above 6 percent reaching a peak of 7.7 percent in December before decreasing to 7.2 percent at end March 2012. The rise was mainly driven by increases in the prices of food and non-alcoholic beverages, transport, as well as housing, water, electricity, gas and other fuels in part reflecting increases in fuel prices. In spite of the rise in inflation, which is now expected to remain above 6 percent throughout 2012, the macroeconomic situation is likely to remain stable.

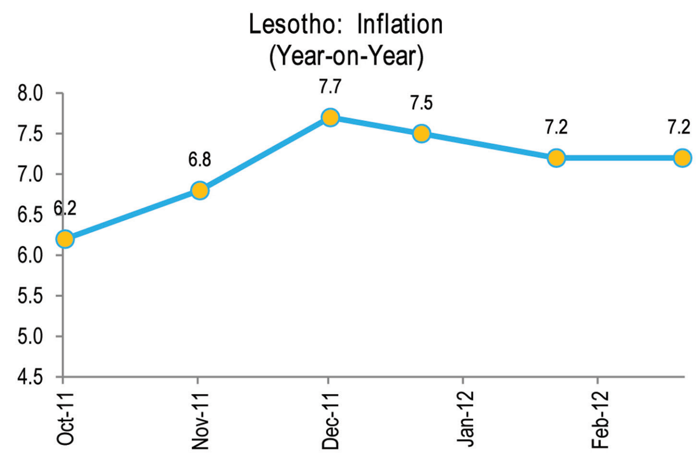
Access to long term financing by the private sector is likely to improve once the planned credit bureau becomes operational. At present, the banking sector currently holds excess liquidity but cannot lend due to lack of credit history of the borrowers, especially the small and medium scale enterprises (SMEs). The Lesotho National Development Corporation (LNDC) is also making plans to build the capacity of SMEs in an attempt to boost lending to the private sector.

Fiscal Policy: Lesotho is committed to fiscal consolidation in 2012 in order to come to terms with the fiscal realities dictated by a drop in SACU revenues. A fiscal deficit of 0.9 percent is targeted for 2012/13, down from 12.3 percent in the previous year. The marked decline in the fiscal deficit is to be achieved through expenditure rationalization involving elimination of unproductive expenditures, which is a key component of fiscal consolidation.

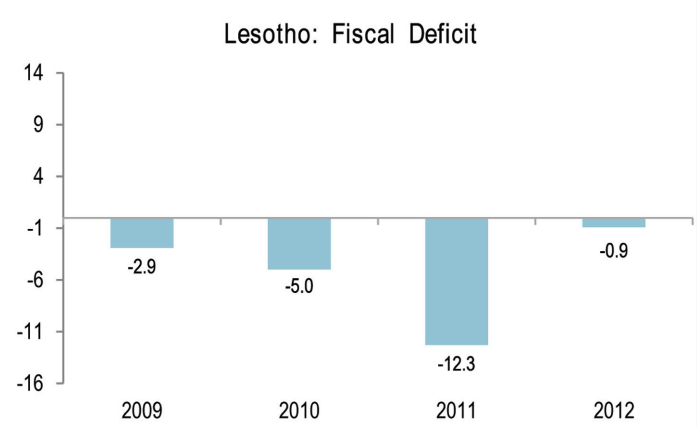
Lesotho Financial Aggregates

	Actual 2011	Proj 2011
Claims On Private Sector (Mn Maloti)	2,326	2,836
Net Claims On Govt (Mn Maloti)	-2,922	-1,378
Broad Money (Mn Maloti)	6,213	6,979
Currency In Circulation (Mn Maloti)	529	786
Private Sector Credit (12 Month Percentage Change)	26.9	21.9
Private Sector Credit/GDP	12.8	13.8
Velocity (GDP/Broad Money)	2.9	2.9

Source: Lesotho authorities and IMF estimates



Source: Lesotho Authorities



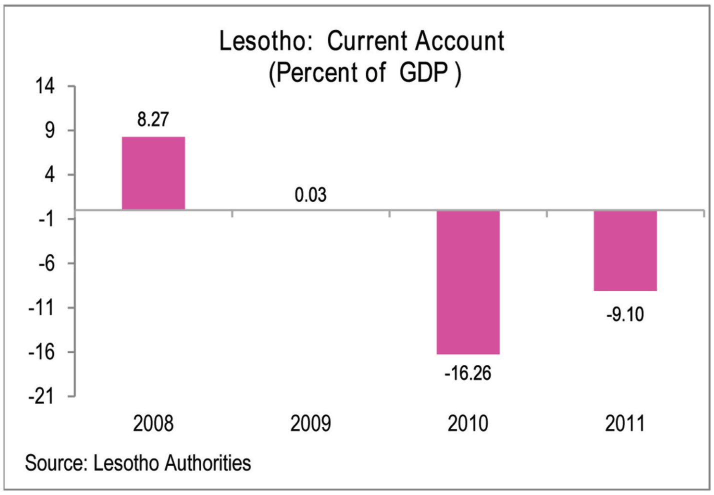
Source: Lesotho Authorities

External Sector: Since 2010, Lesotho has continued to experience a current account deficit. However, as a percentage of GDP, current account narrowed from 16.3 percent of GDP in 2010 to 9.1 percent in 2011. The improvement was at the back of good performance in the trade balance as import absorption reduced and exports increased. Services also contributed to improvement in the current account. This was achieved despite the drop in SACU receipts.

II. ISSUES NEEDING PARTICULAR ATTENTION

Resource Mobilization: The Global financial crisis which lead to a permanent drop in the SACU revenues coupled with dwindling concessional donor resources has created a financing challenge which requires of government to intensify resource mobilization to sustain its fiscal policy.

Capacity building: There is a general lack of adequate capacity across government to implement various reforms required for economic transformation. There are glaring capacity gaps in the areas of public finance management, procurement and statistics which present critical challenges thereby calling for capacity building interventions.



MADAGASCAR

HIGHLIGHTS

- The political crisis and the worsening social tensions continue to compromise the environment for doing business and economic growth in the country.
- The first quarter of 2012 was characterized by a significant increase in prices of local products.
- The tourism sector continues its recovery, with the number of tourists rising by 7.1 percent in the first quarter of 2012 compared to the same period in 2011.

I. MACROECONOMIC MANAGEMENT OVERVIEW

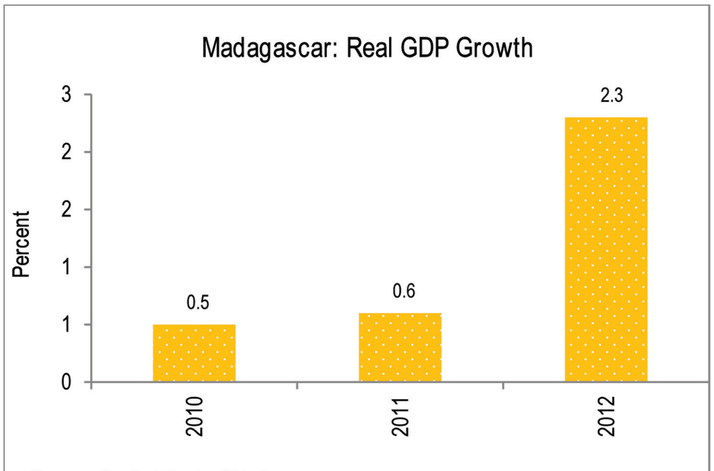
Economic Growth: The economy grew by a mere 0.6 percent in 2011. Forecasts for 2012 indicate a recovery in growth to 2.3 percent. The mining sub-sector will remain the main driver of growth with the opening of the country's largest mining project, Ambatovy. The economy will also benefit from the revitalization of the tourism sector. Nevertheless, the performance of the agricultural sub-sector is expected to remain modest in 2012, due to the adverse weather experienced.

Given the continuing political crisis, the investment climate remains unattractive despite the tax incentives provided in the 2012 budget. Notably, uncertainty regarding the return to political stability, insecurity and harassment, and increasing levels of corruption are impacting negatively on foreign investment. According to the Madagascar Business Association, only 35 to 60 percent of production capacity is being used in the industry sector and turnover has declined by 60 percent. Also, almost all the companies that were benefiting from the AGOA have disappeared, leading to a loss of nearly 25,000 direct jobs.

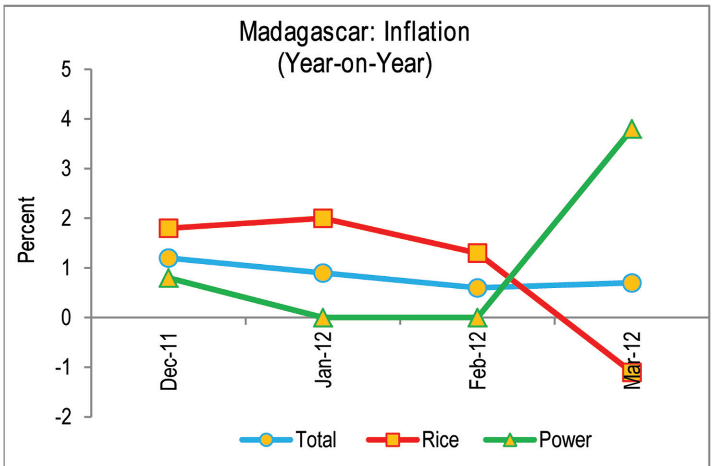
Monetary Policy and Banking System: The consumer price index (CPI) rose by 2.2 percentage points during the first quarter of 2012, with year-on-year inflation recorded at 4.9 percent at end-March. Inflation was mainly driven by rising prices of local products, recorded at more than 5 percent. Food prices rose by up to 4 percent during the same period.

Central Bank interventions during the first quarter of 2012 contributed to relative stability of the local currency against major foreign currencies. Despite the January 2012 depreciation of the Ariary by 3.5 percent and 1.3 percent against the USD and the Euro, respectively, the currency appreciated against the two currencies in February and March. The Central Bank reported a decline in foreign reserves to about 3.6 months of import cover in April 2012 from to 3.9 months in December 2011. Consistent with forecast growth, credit to the private sector rose by a cumulative annual increase of 3.1 percent to 2.2 billion Ariary in March 2012.

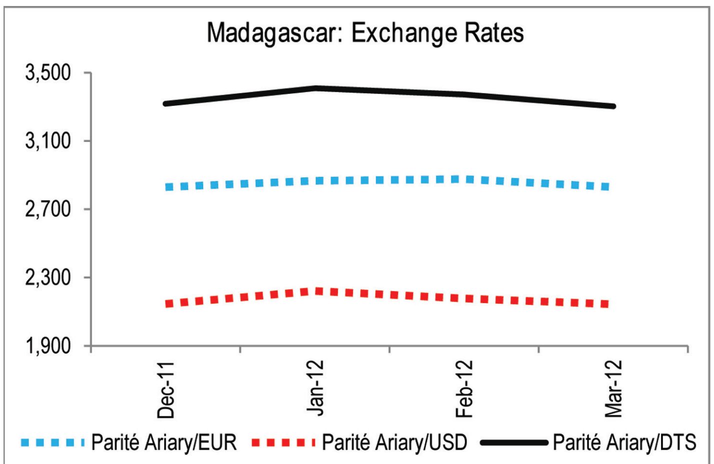
Fiscal Policy: The 2012 budget law points to continuing fiscal austerity and efforts towards broadening the tax base. In an attempt to support private sector activities and attract new foreign investments, the government reduced taxes on investments in renewable energy by 50 percent and income tax by 1 percent. Downside risks on the country's fiscal performance exist, especially as the pressure to increase public sector salaries is building while external grants are not forthcoming.



Source: Central Bank of Madagascar



Source: National Institute of Statistics, Madagascar



Source: National Institute of Statistics, Madagascar

MADAGASCAR

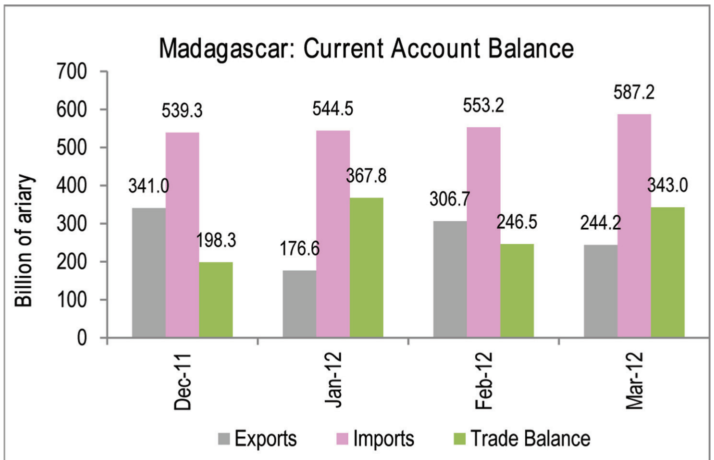
External Sector: According to preliminary data from INSTAT, export of goods increased by 32.4 percent over the previous year, reaching MGA727.5 billion at end-March 2012. During the same period, imports of goods reached MGA1,684.8 billion (an increase of 11.7 percent over the previous year). Notably, rice imports increased by 56.8 percent followed by energy (28.7 percent), other foods (26.4 percent) and cement (19.1 percent).

II. ISSUES NEEDING PARTICULAR ATTENTION

Particular attention should be paid to resolving the political crisis that is impeding economic and social progresses. The Bank should continue to support development efforts of the country to prevent further economic decline. A proposal to extend the Bank's strategy in Madagascar for the period 2012-2013 provides is an important step in this direction.

III. DONOR COORDINATION

The political crisis affected the coordination between donors and the Government. However, donors have been trying to improve the coordination between them through a number of sectoral groups (private sector, governance, rural development, environment, decentralization, transport, education and health) meetings. The Bank is currently leading the sectoral group on water supply and sanitation. The Bank is also represented in the country team, which is coordinated by the United Nations.



Source: National Institute of Statistics, Madagascar

MALAWI

HIGHLIGHTS

- President, Bingu wa Mutharika died in April 2012.
- The private sector is bearing the burden of the foreign exchange, energy and fuel shortages, fueling a thriving parallel market at the expense of the formal market.
- The mid-year review of implementation of the FY2011/2012 budget highlighted that zero-deficit budget for the fiscal year 2011/12 (July-June) experienced poor revenue performance and resulted in expenditures exceeding revenues. The gap was financed largely from domestic borrowing, which saw government's contribution to domestic credit increase by 11 percent.

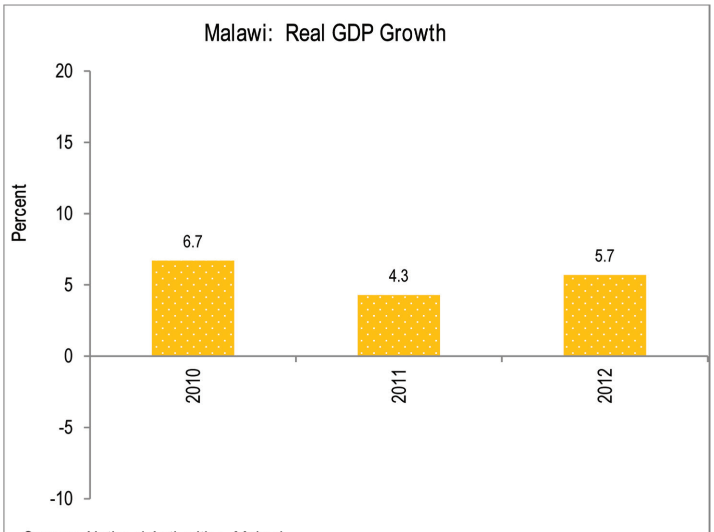
I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Economic Growth slowed down considerably at the end of 2011, with real GDP growth estimated at 4.3 percent - a downward revision from a projected growth of 6.0 percent. The slowdown mainly reflects shortages of foreign exchange, fuel and imported inputs that have hit hard the performance in manufacturing, construction, mining, transport and wholesale and retail trade sectors. In addition, 2011 saw a poor agricultural season, particularly a decline in tobacco output, Malawi's major export earner. Tobacco production declined by 36 percent, from 237 million kilograms in 2010 to 151.5 million kilograms in 2011.

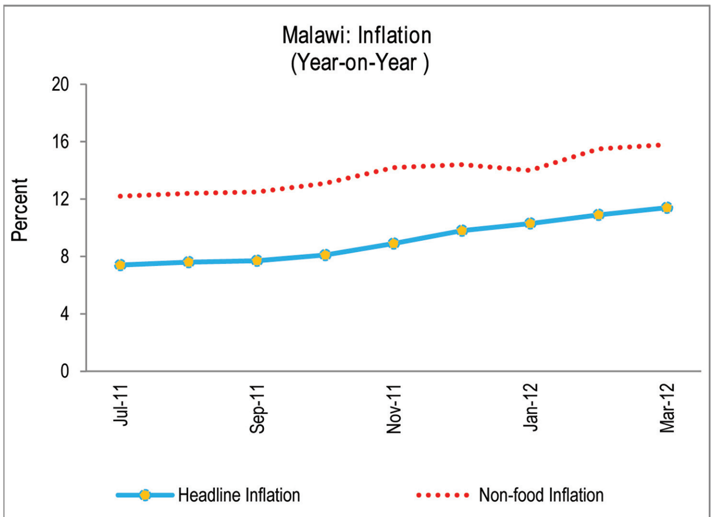
In spite of the improved performance in the agriculture sector, particularly improved tobacco prices and increased maize production, growth in 2012 is likely to remain flat at 4.3 percent before rebounding to 5.7 percent in 2013.

Monetary Policy and Banking System: During the first quarter of 2012, inflation edged upwards reaching 11.4 percent at the end of March 2012. This compares unfavorably to the 9.8 percent year-on-year headline inflation in December 2011 and 7.2 percent in March 2011. The increase is largely attributed to the rise in non-food inflation as a result of high fuel prices and rising import prices that are pegged to the parallel market rate.

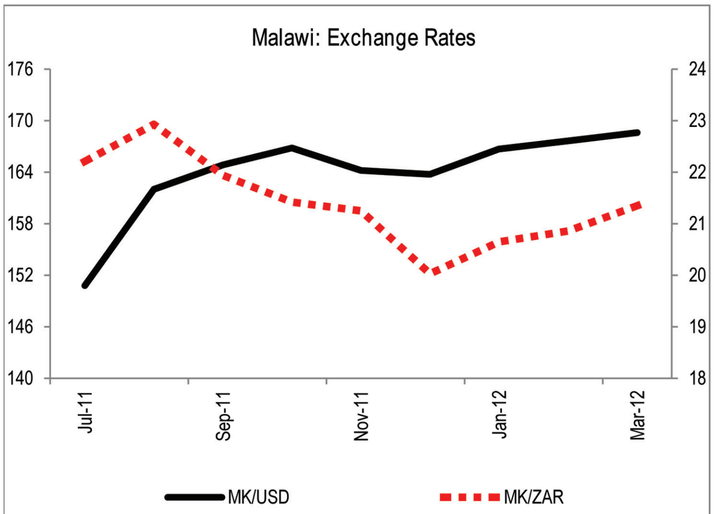
While the bank rate, the commercial bank's prime lending and saving rates remained unchanged during the quarter at 13 percent, 17.5 percent and 3.75 percent respectively, the inter-bank rates declined from 7.1 percent at the end of December 2011 to 5.7 percent at end-March 2012. This was largely driven by the excess liquidity in the banking system resulting from expansionary fiscal operations during the period. Money supply increased by 3.4 percent within the first quarter from K305.5 billion in January to K315.9 billion in March. Resultantly excess reserves averaged MK 10. 6 billion per day during the period under review, compared to MK 5billion in December 2011. Domestic credit increased by 5.5 percent (from K335.3 billion in December 2011 to K353.7 billion in March 2012) of which 44.2 percent was government and 50 percent private. Government credit rose by 11 percent, while private credit rose by 2.5 percent during the period. Monetary policy tended to accommodate governments financing needs - open market operations have been expansionary, through maturing repos



Source: National Authorities, Malawi



Source: National Authorities, Malawi



Sources: Reserve Bank of Malawi

operations and purchases of securities from the market. To reduce the volume of currency needed for transactions purposes, the Central Bank announced plans to issue a new note of MK 1000 note at the end of the second quarter of 2012 (currently the largest note is MK 500).

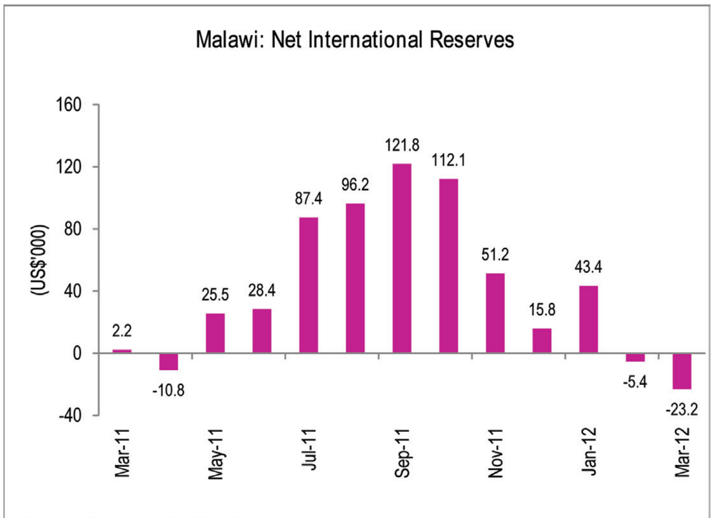
The Malawi Kwacha weakened by 2.9 percent against the US dollar and traded at MK166.86 as at end-March 2012 from MK163.75 at end-December 2011. The Kwacha also depreciated against the South African rand trading at MK21.35 per rand as at end-March 2012 from MK20.03 per rand in December 2011. This decline in the value of the local currency reflects the low foreign exchange reserves, which fell from US$217.70 million (1.53 months of import cover) to US$186.20 million (1.19 months import cover) between January and March 2012. The Government responded by tightening restrictions on foreign exchange particularly operations of foreign exchange bureaus, and is making efforts to negotiate a new IMF program following the inconclusive implementation of the Extended Credit Facility program.

Fiscal Policy: Taking into account the economic slowdown, the absence of budget support, the implementation of the 2011/12 "zero deficit" budget and the resultant dismal revenue performance; government loosened its fiscal policy stance in the first quarter. Fiscal balance worsened to a deficit of 2.9 percent of GDP at the end of 2011, from a surplus position of 1.1 percent of GDP in 2010. Large contributors to this were the increased costs due to higher fuel and fertilizer imports that required government financing.

External Sector: According to preliminary data, the external sector continues to record an overall deficit which is expected to widen from 7.8 percent of GDP in 2011 to a projected 9.5 percent in 2012. As at end February 2012 trade balance recorded a deficit of MK8.7 billion compared to MK 5.2 billion during the same period the previous year. In line with the needs of farming season, the main imports were fuel and fertilizers, while main exports were tobacco and uranium. The weak external position resulted in a decrease in gross international reserves to 1.1 months of import cover by the end of March compared to 1.5 months at the end of 2011.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Private Sector Reform: Malawi's ranking in the World Bank's 2012 Doing Business Report, dropped by 3 places to 145th position with respect to the ease of doing business. The country's performance regressed due to the long time required to register property and higher tax payments by private business entities and individuals. Significant progress has been made in resolving solvency - Malawi adopted new rules providing clear procedural requirements and time frames for winding up a company. The government is drafting a national export strategy that seeks to develop the export capacity of the country beyond traditional cash crops such as tobacco, sugar, and groundnuts, among others. The thrust of the policy intervention is in investing in skills as a key input into export capacity and enhancing a business enabling environment.



Source: National Authorities, Malawi

III. ISSUES NEEDING PARTICULAR ATTENTION

Financing needs are expected to become more critical during the second half of implementation of the FY 20121/12 budget. On account of reduced grants by K20 billion, financing in some of the key areas such as Health may be reduced as suggested by the government. This has potential to spill over to other investment areas. In addition, government domestic borrowing may increase further crowding out the private sector. Furthermore, government may consider the introduction of additional taxes or fees (these were increased significantly during the current budget) to increase domestic revenue. Preparation of the next budget and re-alignment of the MTEF will be crucial during the next quarter.

The death of Malawi's President, Bingu wa Mutharika, at the beginning of the second quarter of 2012 is likely to result in significant changes in the political and economic arena in the country, with potential changes in donor relationships.

MAURITIUS

HIGHLIGHTS

- Due to the deepening fiscal crisis and rising unemployment in the Eurozone, the country's main trading partner, the government revised GDP growth forecast for 2012 from 4.0 percent to 3.75 percent in the first quarter of the year,
- IMF Article IV consultations concluded in March 2012 commended the authorities for "the skillful policy response to the global crisis which has enabled strong economic recovery and contained inflationary pressures".
- The Bank Group opened its Liaison Office in March, 2012.

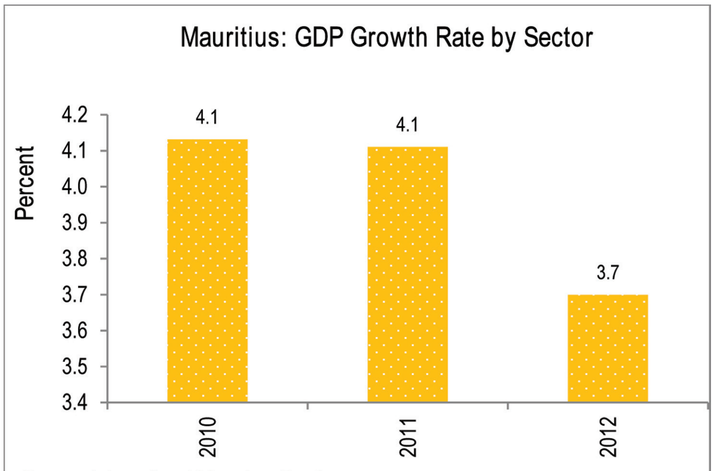
I. MACROECONOMIC MANAGEMENT

Economic Growth: The deepening fiscal crisis and rising unemployment in the Eurozone, Mauritius' main trading partner, has dampened growth prospects for 2012. While estimates show that the sugar and construction sectors will post stronger growth rates in 2012 compared to 2011, tourism, which is the country's main economic sector, appears to slow down. The Eurozone accounts for about two thirds of the country's total exports and is the main source of tourists for Mauritius. In December 2011 tourist arrivals were recorded at 112,295; this lower than the same period in 2010. Tourist arrivals are expected to fall even further; 98,837 tourists were recorded in January 2012 (about 3 percent lower than the same period in 2011). In this context and in line with IMF projections, the Bank of Mauritius' revised its GDP growth forecasts for 2012 from 4 percent to 3.5 percent.

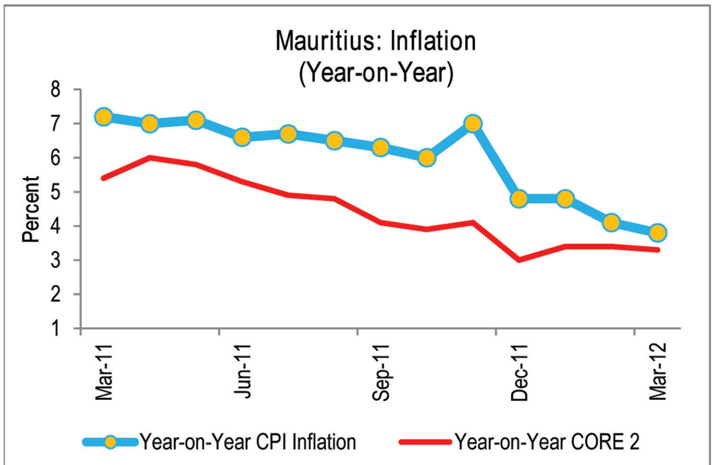
Monetary Policy and Banking System: The CPI year-on-year inflation moderated in the first quarter, falling from 4.8 percent in January 2012 to 3.8 percent in March 2012. A rebound in global commodity prices, particularly, crude oil (Brent) which steadily rose from US$107.7/barrel in December 2011 to US$124.5/barrel in March 2012 remain a threat to inflation. Acknowledging that the downward risk to domestic growth outlook significantly outweighed the upward risk to inflation, the Monetary Policy Committee lowered the key repo rate by 10 basis points in December 2011 and a further 50 basis points in March 2012 bringing the repo rate to 4.9 percent..

Mauritian Banks are liquid, well capitalised and profitable with 14.1 percent of regulatory Tier 1 capital to risk weighted assets, 2.6 percent non-performing loans as a proportion of total loans and 21.5 percent return on equity. Credit to private sector rose by about 8 percent to MUR224 billion in a year to February 2012. The largest share of the credit was to construction and tourism sectors which took MUR56 billion and MUR42 billion, respectively.

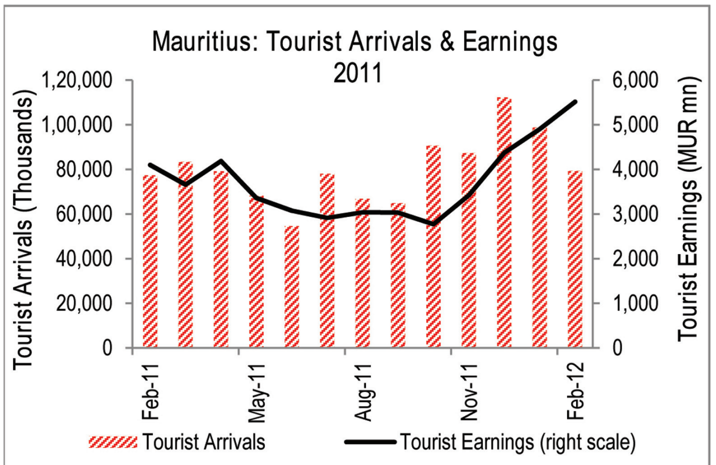
Fiscal Policy: The 2012 budget is modestly expansionary. A fiscal deficit of 3.4 percent of GDP compared to 2.4 percent in 2011 is expected. The budget provides for a contingency of about 1.5 percent of GDP in case of a serious global economic downturn. Public investment spending is planned at 4percent of GDP to reduce structural bottlenecks and creater



Source: International Monetary Fund



Source: Statistics Mauritius



Source: Ministry of Tourism and Leisure & Bank of Mauritius Statistics Div

demand. Tax revenue is expected to remain stable at around 18 percent of GDP. Government plans to finance the deficit using modest public secto borrowing. Public sector debt is estimated to stand at 57 percent of GDP in 2012. Moody's has put Mauritius' debt on a positive upgrade watch.

MAURITIUS

External Sector: The current account balance is projected to widen from -9.9 percent of GDP in 2011 to -10.2 percent in 2012. Although the merchandise trade deficit is projected to narrow from -15.7 percent of GDP in 2011 to -13.8 percent in 2012, it remains high. In addition, foreign direct investments are projected to remain within the medium term trend of about MUR8 billion. However, the capital account outflows are expected to be much larger, offsetting the gains from the trade balance. Mauritius' gross international reserves have been consistently above the minimum requirement of 3 months; Import cover reached 4.6 months in March 2012 from 4.3 month in March 2011.

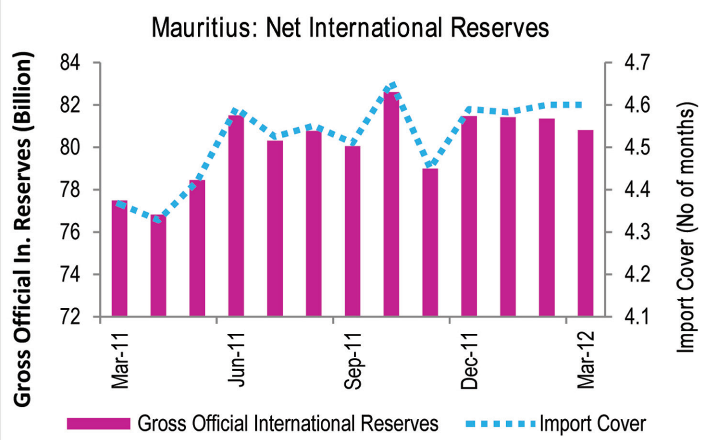
II. INSTITUTIONAL AND STRUCTURAL REFORMS

Public Sector Management and Private Sector Reform: A March 2012 IMF report on Mauritius, observed that the 2011 payments on the social insurance scheme exceeded 4 percent of GDP, with over 1.3 percent of GDP spent on basic retirement payment scheme. Over 40 percent of the basic retirement payments go to the richest 20 percent, leaving the 80 percent of retirees having to share only 60 percent of the funds available. In response, the Government has recently adopted a social register to improve beneficiary targeting. To increase the opportunities for local firms, Mauritius concluded a framework Agreement on Trade and Economic Cooperation with the Turkey.

Aid Coordination: In an effort to meet the specific needs of Mauritius as a Middle Income Country, in January 2012 the African Development Bank established the Mauritius Liaison office. The Government signed a EUR1.9 million grant with the EU on Fisheries Partnership Agreement and accessed a US$250 million credit line from India. The World Bank approved two Development Policy Loans amounting to US$35 million for public and private sector reforms.

III. ISSUES NEEDING PARTICULAR ATTENTION

The country's competitiveness is constrained by inadequate physical and human capital investments. To ensure sustainable economic recovery and inclusive growth, the Government should continue with the on-going policy reforms, improve public sector management and social service delivery.



Source: Statistics Division, Mauritius

MOZAMBIQUE

HIGHLIGHTS

- Headline yearly inflation in February 2012 was 2.5 percent, the lowest level ever recorded in decades. March inflation marginally increased to 2.7 percent, mainly due to food prices.
- From the yearly assessment of the Government's performance during 2011, the Programatic Aid Partners consider that there is a satisfactory basis to continue general budget support.
- Natural Gas reserves findings in Mozambique have once again been revised upwards to above 70 trillion cubic feet.

I. MACROECONOMIC MANAGEMENT OVERVIEW

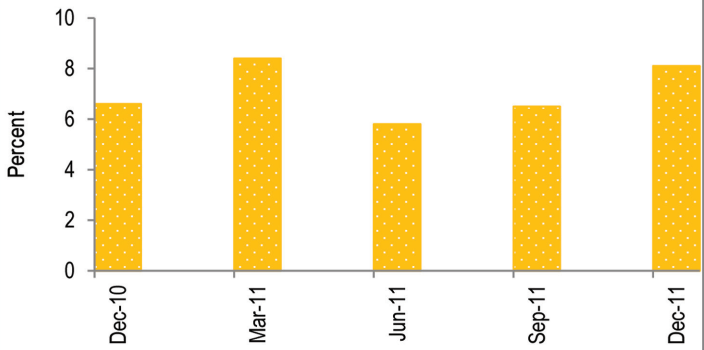
Economic Growth: Real GDP growth in the last quarter of 2011 was recorded at 8.1 percent, pushing annual growth to 7.2 percent. Growth was driven by 9.8 percent expansion in the primary sector. The agriculture sector grew by 8.4 percent. Of significance was the 35.5 percent growth in the extractive industries. This highlights the impact of the coming on line of the first coal mining mega-projects. Also notable is the 16.1 percent growth in Construction and 10.9 percent in Transport and Communications, reflecting the large investments in infrastructure in the country. As a result of positive economic news, the Economic Confidence indicator switched to positive during the 4th quarter 2011, after six months of negative values. The opening of new coal mining mega-projects, and other mineral mines should boost GDP growth even further.

Agriculture, livestock and related activities still represent the biggest share of GDP, accounting for 15 percent in the 4th quarter of 2011. New investments in the hydrocarbons sector may result in a fall in the share of agriculture in GDP in the near future. For example, natural gas reserves have been revised upwards to above 70 trillion cubic feet. The announcements by Andarko and ENI now make the Rovuma basin reserves the largest in Africa.

Monetary Policy and Banking System: The tight monetary policy implemented by Bank of Mozambique since 2010, coupled with a supportive fiscal stance, drove monthly inflation to a historical low of 2.5 percent in February 2012. However, March inflationmarginally increased to 2.7 percent due to food price increases. The 12 month average inflation has maintained its downward trend, reaching 7.2 percent in February 2012. A relaxation in monetary policy stance and the high economic growth present upside risks on inflation. In addition, the external macro framework presents serious inflationary challenges; the oil price reference for Brent has increased by 14.2 percent during the 1st quarter and the Metical has depreciated by 8.7 percent against the South African rand which is the main source of food imports.

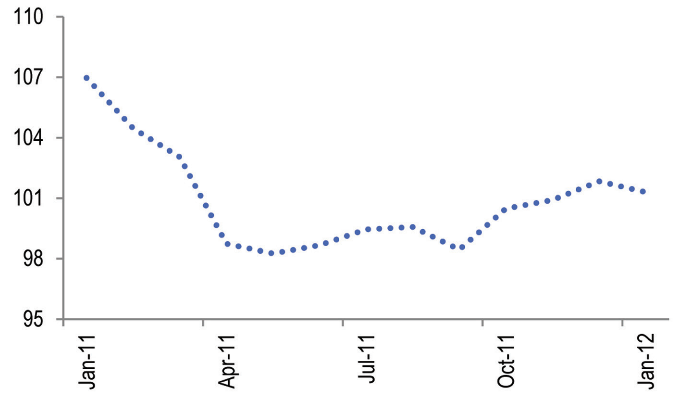
Since December 2011 the Bank of Mozambique has cut the Standing Lending Facility interest rate and the reserve requirements ratio three times. The deposit standing facility interest rate has also been cut twice over the same period. So far the credit market has not responded to the cuts. During the 1st quarter, the 1 year lending rate to the public remained at nearly 24 percent while 1 year deposit rates stand at 13.2 percent. Credit expansion in the year was therefore recorded at only 2.3 percent in spite of the strong appetite from SMEs.

Mozambique: Real GDP Growth



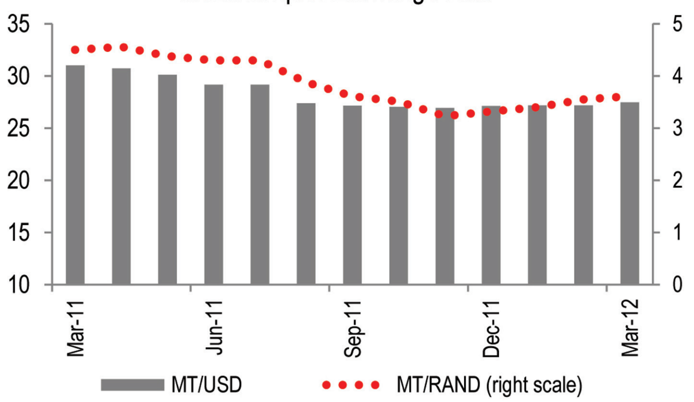
Source: Mozambique Authorities

Mozambique: Economic Confidence Index



Source: National Institute of Statistics, Mozambique

Mozambique: Exchange Rate

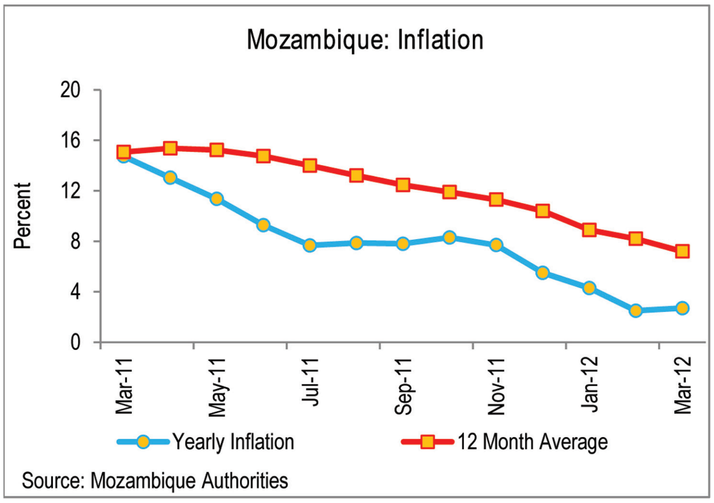


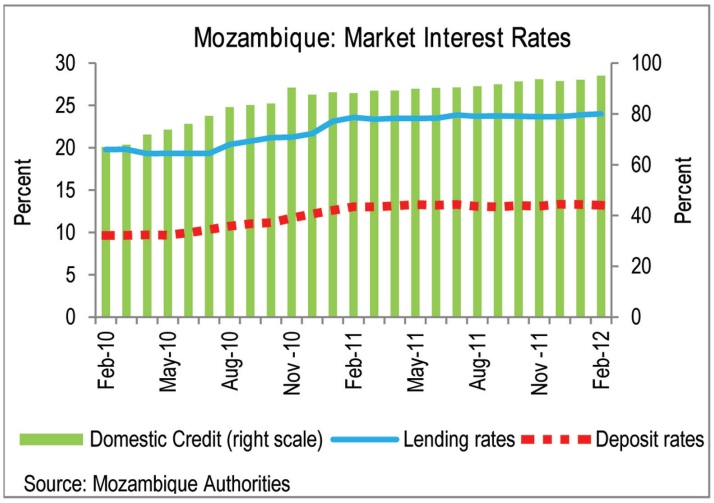
Source: Mozambique Authorities

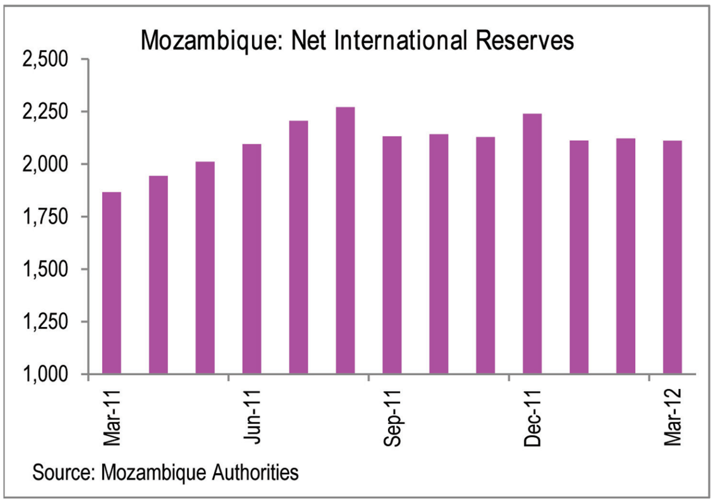
MOZAMBIQUE

Fiscal Policy: In response to potential global economic slowdown, the Government plans to increase expenditure in 2012 thereby widening the fiscal deficit from 3.5 percent to 5.8 percent of GDP. In spite of the anticipated improvement in revenue from 20.7 percent to 22 percent of GDP, this increase will not be sufficient to off-set the budgetary expansion in infrastructure investment and social development programs. Expenditure targeting priority sectors directly linked to the poverty reduction strategy will increase by 20.2 percent, representing 26.2 percent of total budget. Special focus will be on direct social protection transfer programs and the creation of a productive public works program for unemployed urban youth. Additional pressure on the deficit will come from the 1.6 percent decrease in grants, bringing ODA's contribution to the budget to 39 percent.

External Position: At the end of 1st quarter 2012, net international reserves stood at US$ 2.1 billion, sufficient to cover 5-months of imports. Offloading of US dollars to domestic banks, in part to finance fuel imports, was offset by inflow of foreign exchange from foreign direct investment and for budget support. Coal exports have been hampered by logistical constrains. Coal export earnings are however expected to rise during 2012 as the logistical constraints ease, thereby boosting foreign reserves. Current account estimates for 2011 show a widening deficit after-grants of US$ 1.4 billion from US$1.1 billion in 2010. However, given the high economic growth the country has experienced in the past year, the current account to GDP ratio decreased by 0.5 percent to 11.2 percent. The deficit expanded mostly due to the 16 percent increase in the trade deficit (which reached US$1,380), while the financing of the deficit relied mainly on the US$ 1billion million inflow of FDI (which increased by 26 percent).







II. INSTITUTIONAL AND STRUCTURAL REFORMS

Natural Resource Management: Mozambique is developing a "road map for the green economy" and a national report for the Rio Earth Summit. The road map has three main pillars: (i) agriculture –the main productive and job generating sector in the country; (ii) energy – to unveil the country's considerable hydropower and renewable energy capacity; (iii) urban centers – to address the challenges of the rapid urbanization due to high economic development.

Anti-Corruption Law: The anti-corruption law package is at the forefront of political discussion with the donor community. In March the budget support donors' group agreed with the Government on a new set of indicators for the implementation of the anti-corruption measures, including the passing of the law in 2012.

Business Environment: After dropping 7 places in the World Bank's 2012 Doing Business ranking, the Government continues its efforts to improve the business environment. The Council of Ministries expanded the regime for simplified licensing to 9 by adding fisheries and culture (the others are construction, tourism, agriculture, transport and communications, industry, trade and services, and sport). The operationalization of Single Attendance Counters (BAUs) will now accept electronic requests and this will speed up the approval process. The decree also established that all simplified licensing procedures will pay the same fee, set at 50 per cent of the minimum monthly wage paid in the public administration, currently set around US$88.

III. DONOR COORDINATION ACTIVITIES

During the 1st quarter of 2012, the donor signatories to the MoU for budget support performed the yearly assessment of the Government's performance in 2011. Even though the Government's performance in

2011 did not improve compared to 2010, there were notable positive steps taken in 2011. These include finalization of the Comprehensive Africa Agriculture Development Program (CAADP) and the Plan for Agriculture and Sector Development (PEDSA), the delivery of the anti-corruption legislative package to the Assembly, efforts to increase the capacity of local levels of the government, and the development of a number of key sector strategies. The donors therefore agreed to continue providing budget support.

IV. ISSUESS NEEDING PARTICULAR ATTENTION

- To avoid igniting inflationary pressures, the Government needs to exercise caution as it moves to loosen monetary policy to support credit supply to the SME sector.
- Reforms in the financial and banking sector to enhance competition are increasingly important to ensure credit extension to the economy.

NAMIBIA

HIGHLIGHTS

- Following severe flooding in some parts of Namibia and lacklustre global economic growth, economic growth slowed down in 2011.
- Inflation accelerated to 7.4 percent in February 2012 (the highest since August 2009) before slowing down to 6.9 percent in March 2012. It has, however, remained above the Common Monetary Area (CMA) upper bound of 6 percent for the past six months.

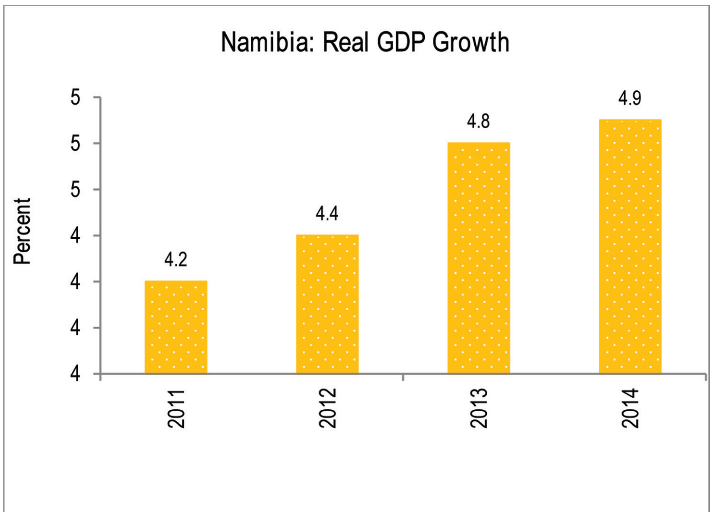
I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic growth: The Namibian economy is estimated to have slowed down in 2011, with GDP estimated to have grown by 4.2 percent, down from 6.6 percent in 2010. The moderate performance reflects the contraction in the primary industry, particularly in mining and agricultural activities, which were hampered by adverse weather conditions and industrial action, as well as weak demand for mineral products arising from the fragile global economy. Construction and manufacturing activities were the main drivers for the secondary sector, owing to increased infrastructure development supported by the rolling out of the three-year Targeted Intervention Programme for Employment and Economic Growth (TIPEEG). However, growth in manufacturing activities was depressed due to sluggish growth in the beneficiation of minerals and the setback in cement exports from Ohoronga following Angola's ban on importation of cement from Namibia. The tertiary sector is estimated to have expanded strongly, especially in the wholesale and retail trade category, benefitting from the continued accommodative monetary policy and expansionary fiscal stance pursued by the authorities in recent years.

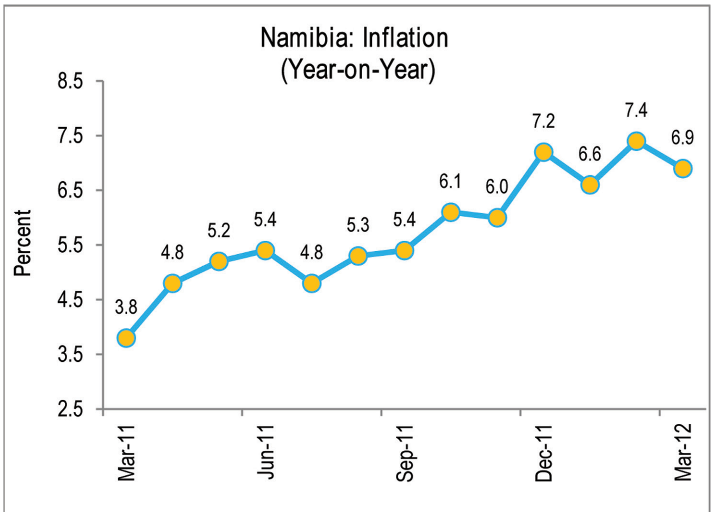
Economic growth, driven by a broad recovery in major sectors of the economy, including mining, manufacturing and agriculture, is expected to increase to 4.4 percent in 2012 and reach 5 percent in 2014.

Monetary Policy and Banking System: Inflation risks still remain, in spite of the decline in the rates of price increases to 6.9 percent in March 2012, as inflation has consistently been above the CMA upper bound of 6 percent for the past six months. Annual inflation rose to 7.2 percent in December 2011 before easing to 6.6 percent in January 2012. However, inflation accelerated to 7.4 percent in February 2012, the highest since August 2009. Key factors that have pushed inflation upward in recent months include a surge in food prices and international oil prices. The authorities expect inflation to remain within tolerable levels in the medium-term, in line with the South African Reserve Bank's projection for inflation to peak in the second quarter of 2012.

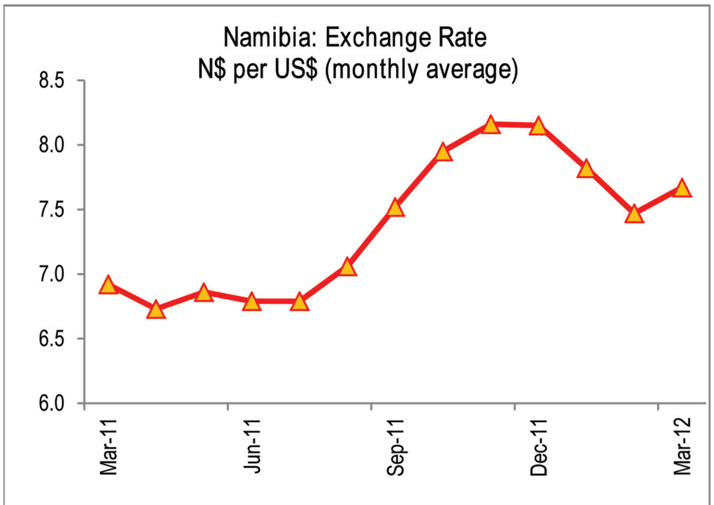
Growth in credit extended to the private sector slowed to 10.2 percent at the end of February 2012 from 11.2 percent in the preceding month. This was on account of the moderation in credit advanced for mortgages and overdrafts. Since December 2010, the Bank of Namibia has kept the Repo rate unchanged at 6 percent with the aim of supporting domestic economic growth.



Source: Namibia Authorities



Source: Namibia Authorities



Source: Namibia Authorities

NAMIBIA

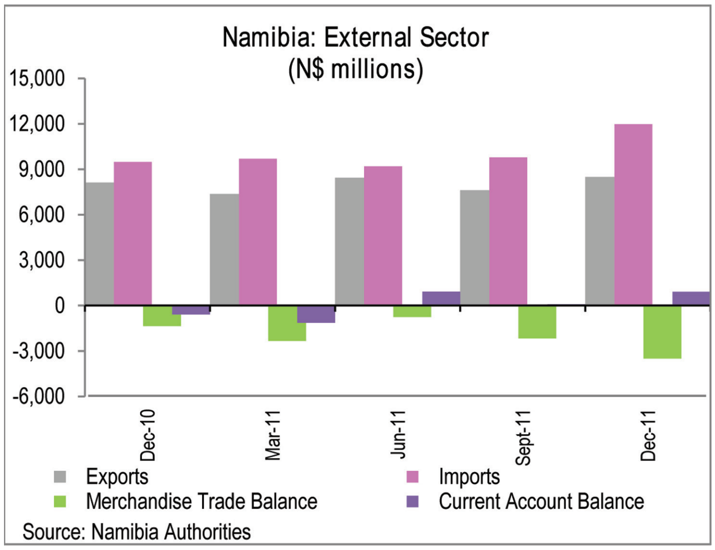
Fiscal performance: The 2012/13 budget unveiled on 29 February 2012 continues with the expansionary fiscal policy the authorities have been pursing since 2009/10. The expansionary fiscal stance aims at cushioning the domestic economy from the severe impact of the global economic downturn. Government spending is expected to increase by 2.5 percentage points to 39.2 percent of GDP in 2012/13. Most of this increase is aimed at continuing with the TIPEEG thrust to boost growth and job creation. The TIPEEG also seeks to address persistently high rates of unemployment, poverty and inequality. The projected 5.5 percent increase in total revenue, owing to the windfall from Southern Africa Customs Union (SACU) revenue transfers, is expected to result in the fiscal deficit narrowing to 4.6 percent of GDP.

Financing of the deficit is mainly from domestic borrowing. The Government has recently been using the domestic debt financing of the deficit as one of the strategies to support capital market development, with foreign borrowing used sparingly. Reflecting high public spending, Namibia's total public domestic debt stood at 17.4 percent of GDP in March 2012, compared to 11.9 percent in March 2011.

External sector: The current account recorded a deficit of 1.8 percent of GDP in 2011, compared with a surplus of 0.3 percent of GDP registered in 2010. The deficit was on account of a considerable increase in imports relative to exports, partially reflecting increased domestic demand arising from the expansionary fiscal and monetary stance. While exports, particularly minerals, rose by 7.9 percent supported by the depreciation of the Namibian dollar, import payments increased at a faster rate. Consequently, Namibia's merchandise trade deficit worsened. A huge surplus in the capital and financial account, including proceeds from the US$ 500 million Eurobond, outweighed the trade deficit resulting in a balance of payments surplus of N$4.2 billion in in 2011 from a deficit of N$3.8 billion the previous year. Reflecting these developments, Namibia's gross reserves recorded a substantial increase of 42.5 percent to N$14.6 billion at the end of 2011, equivalent to 3.8 months of import cover.

II. ISSUES NEEDING PARTICULAR ATTENTION

The Government's intention to maintain high expenditure up to 2013/14, within the context of the medium-term expenditure framework, requires some caution. There is a considerable uncertainty over SACU revenues prospects, which have historically accounted for about a third of Government revenues. In addition, downside risks remain in the global economic recovery, especially as growth in the Eurozone is likely to be depressed in the medium term.



SOUTH AFRICA

HIGHLIGHTS

- Buoyed by normalization of production in mining and manufacturing following prolonged strikes during the third quarter, real GDP growth accelerated to 3.2 percent in the fourth quarter of 2011 from a revised 1.7 percent during the previous quarter.
- During the first year of the New Growth Path strategy, about 365,000 new jobs were created.
- Rating agencies downgraded South Africa's credit outlook from stable to negative. Similarly, senior debt and deposit ratings of five major banks and the South African Road Agency Limited (SANRAL) were downgraded by one notch.

I. MACROECONOMIC MANAGEMENT OVERVIEW

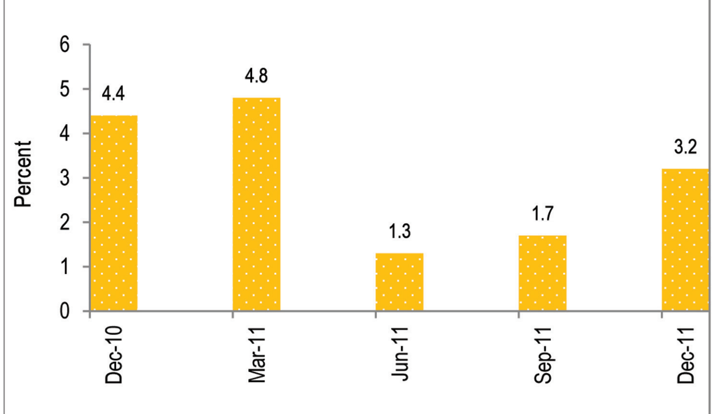
Economic growth: Real GDP grew by 3.2 percent in the final quarter of 2011 from 1.7 percent recorded during the previous quarter. Growth was driven mainly by manufacturing output which expanded 4.2 percent. The relatively strong performance was accompanied by the creation of 365,000 jobs during the first year of the implementation of the New Growth Path strategy. The 4.1 percent growth in manufacturing in February was offest by a 14.5 percent decline in mining output on a year-on-year basis. Power shortages in the next two years are expected to result in mining companies holding back planned investments. Economic growth in the outlook period is therefore likely to be dampened.

On the demand side, real final private consumption growth continued during the fourth quarter, anchored by growth in disposable income and low interest rates. Real expenditure by households increased by 4.6 percent during the fourth quarter of 2011 compared to 3.8 percent during the previous quarter.

Monetary Policy and Banking System: After breaching the upper bound policy target of 6 percent in November 2011, headline consumer price inflation edged upwards to 6.3 percent in January before declining to 6 percent in March 2012. The decline in inflation has revived hopes that the current monetary policy stance will continue for the rest of the year. The favourable inflation outcome was due primarily to the moderation in food price inflation from 10.7 percent in January to 8.6 percent in March 2012. The rise in administered prices, such as petrol, electricity, and municipal levies, as well as insurance premiums contributed to high prices in January. Administered price inflation has been above the policy target range for over two years reaching 11.2 percent in March 2012. Core inflation has also been rising, reaching 4.3 percent in February 2012 compared to 3 percent the same period, the previous year. The sharp weakening of the rand that was triggered by volatility in short term capital flows and heightened risk aversion against the emerging market assets towards the end of 2011 helped push inflation higher.

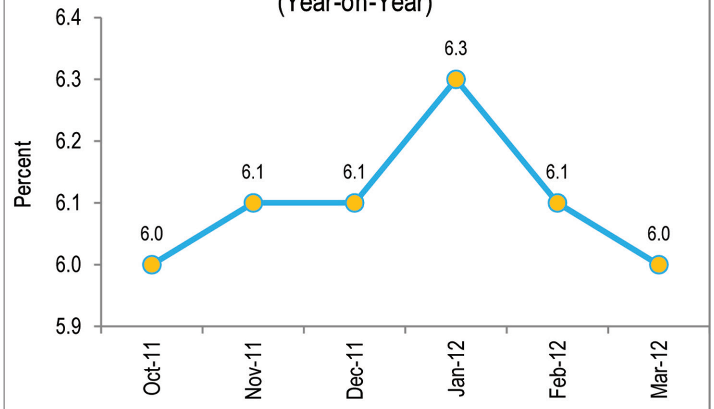
Broad money supply (M3) grew by 5. 9 percent in February 2012 compared to 6.7 percent during the preceding month while the growth in quasi-money (M2) expanded from 6.6 percent in January to 6.9 percent in February 2012. Demand for credit by the private sector expanded by 7.9 percent in February 2012 compared to 7.3 percent during the previous month, highlighting improved private sector investment appetite.

South Africa: Real GDP Growth



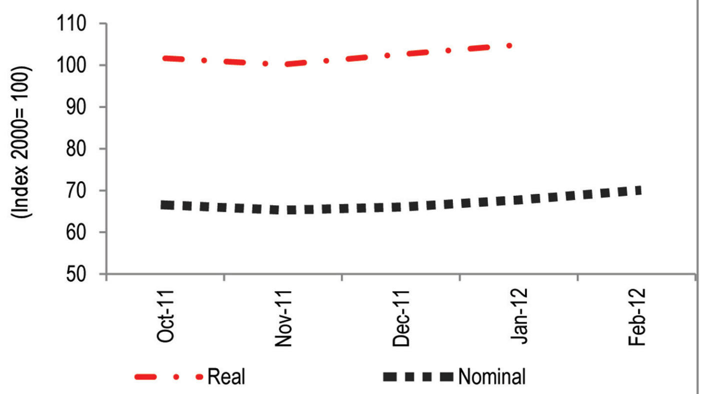
Source: Statistics South Africa

South Africa: Inflation (Year-on-Year)



Source: South African Reserve Bank

South Africa: Nominal and Real Effective Exchange Rates



Source: South African Reserve Bank

Fiscal performance: The primary balance amounted to a deficit of R66.8 billion, or 3 percent of GDP by end-2012, marginally lower than the same period the previous year. During the first nine months of fiscal year 2011/12 total tax revenue, net of SACU payments, was R526.8 billion while national government spending amounted to R649 billion. Current payments, transfers and subsidies have been growing. Current public spending, at 28.7 per cent of GDP, during the first nine months of fiscal year 2011/12 was higher that recorded during the same period the previous year. Public foreign debt increased from R97.9 billion to R111 billion, mainly due to the depreciation of the rand against other major currencies. As a result total gross public debt reached R1.1 trillion at the end of December 2011 (equivalent to 38.6 percent of GDP).

External sector: The current account deficit fell from 4.1 percent of GDP in the third quarter to 3.6 in the fourth quarter of 2011 resulting in the overall deficit of 3.3 percent of GDP for 2011. Trade deficit for February 2012 declined to R7.5 billion from R13.5 billion during the preceding month mainly due to increased exports of vehicles, machinery and electrical appliances and decreased imports of the same products. Foreign direct investment reached R18.7 billion during the fourth quarter of 2011 compared to R2.8 billion in the third quarter. Total foreign direct investment reached R42.1 billion in 2011. Gross foreign reserves fell to US$50.7 billion in March 2012 from US$51.9 billion during the previous month mainly due to the valuation adjustments arising from lower gold prices and the appreciation of US dollar against the major currencies.

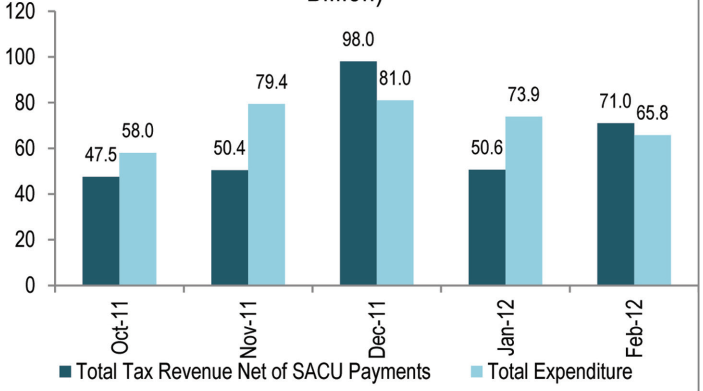
II. INSTITUTIONAL AND STRUCTURAL REFORMS

The cabinet approved the Basic Conditions of Employment Amendment Bill and the Labour Relations Amendment Bill after prolonged negotiations in the National Economic Development and Labor Council. The bills will address the controversial issues of labour broking, introduced new regulations pertaining to child labour to be consistent with international standard, and strengthen the mechanisms for the enforcement of basic conditions of employment, including minimum wages. Meanwhile, the Congress of South African Trade Unions launched its anti-corruption unit, Corruption Watch, to fight a growing tendency of malfeasance in public institutions, which currently accounts for an estimated 20 percent wastage in public procurement.

III. ISSUES NEEDING PARTICULAR ATTENTION

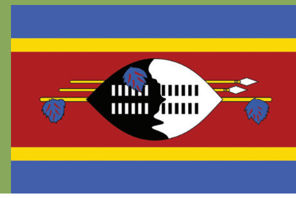
The demand for electricity in South Africa has reached the pre-crisis level of 2008 and the impending supply shortages will severely affect the mining sector and the economy at large. Accelerated infrastructure investment therefore remains critical to the government's plan to rejuvenate the job creation potential of the private sector.

South Africa: Government Revenue and Expenditure (Rand Billion)



Source: National Treasury, South Africa

SWAZILAND



HIGHLIGHTS

- The Government revised its 2011 estimate for real GDP growth from 1.1 percent to 1.3 percent on the back of better than expected performance of the agricultural and agro-processing sector.
- In his presentation of the 2012/13 National Budget, the Minister of Finance emphasized the need for fiscal discipline inorder to restore confidence in the economy, in view of the challenges faced in mobilizing resources to finance Government programs.
- His Majesty King Mswati III re-launched the Swaziland Investor Roadmap, which aims to improve the business environment and spur private sector development

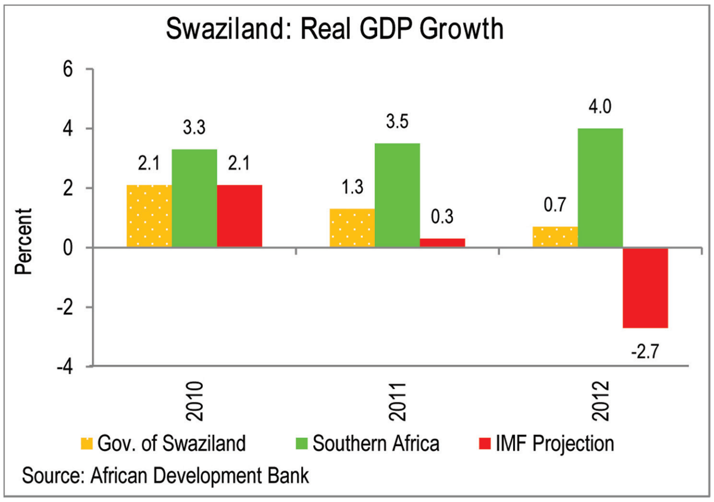
I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In spite of the 2012/13 SACU revenue transfers windfall, Swaziland's growth performance in 2012 is projected to be worse than its peers in the region. The primary sector, which accounted for about 10 percent of the 2011 GDP, faces downside risks as global commodity prices decline. The non-fuel commodity price index has fallen from about 200 in Quarter 1 (Q1), 2011 to 173 in Q1, 2012. Global weak demand in face of the eurozone crisis is likely to hit hard sugar export, Swaziland's main export commodity. These developments, coming on the heels of the country's worst fiscal crisis in decades, leave it less prepared to respond. The 2012 GDP is projected to grow at 0.7 percent, almost half the level achieved in 2011.

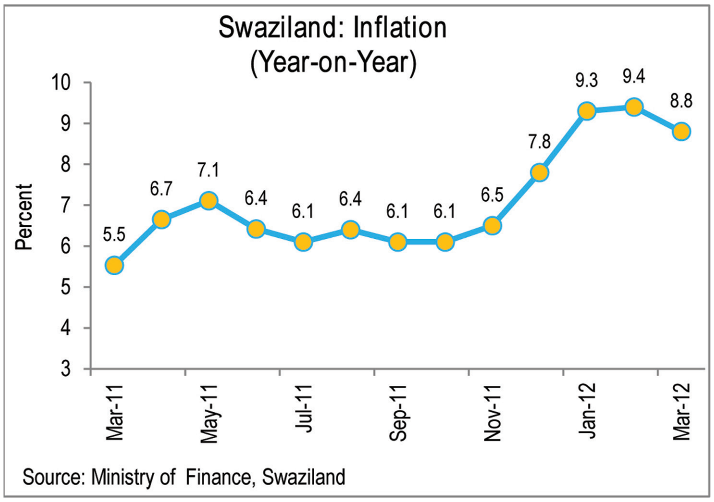
Monetary Policy and Banking System: Headline inflation, which had been increasing since November 2011, dropped to 8.8 percent in March 2012. At this level, inflation is more than 2 percentage points above the Common Monetary Area (CMA) upper bound of 6 percent. The steep depreciation of the rand against major currencies towards the end of 2011, coupled with rising food and fuel prices, had a negative impact on import prices. Food, transport, rentals and utilities costs were the main drivers of inflation over this period. The decline in inflation in March also shows that the lagged impact of the appreciation of the rand, to which the lilangeni is pegged at par, are beginning to be felt. The introduction of VAT and upward adjustments in administered prices is likely to reverse the March decline in inflation.

Inflation is therefore likely to remain well above that of other CMA countries in the outlook period. Credit extended to the private sector is beginning to show signs of recovery. In March 2012 annual private sector credit grew [at] by 18.9 percent, was almost 3 percentage points higher than in January. A similar trend was observed with regards to household borrowing, which grew by 20.7 percent in March 2012 compared to 12.2 percent in January 2012, over the same period. Despite the inflation risk and in line with the decision by the South African Reserve Bank, Swaziland's central bank kept policy interest rates unchanged at 5.5 percent.

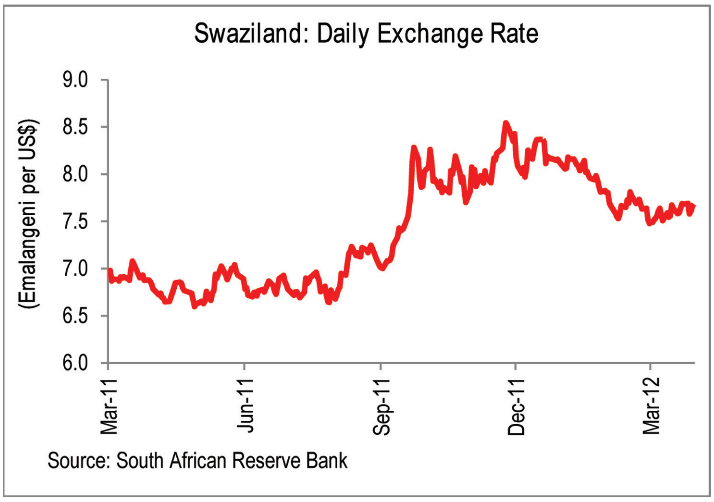
While gross official reserves in January 2012 improved compared to their level in December 2011, for the following two months to end-March, foreign reserves declined to their lowest level since 2007 and far below the target of 3 months import cover. Foreign reserves stood at E 3,770.9 million at the end-March 2012, equivalent to 1.9 months of import, reflecting a decline of 6.7 percent over the month. The decline in foreign reserves was largely due to financing of government's external obligations. The foreign currency value of foreign reserves was also affected by the depreciation of the lilangeni over the month.



Source: African Development Bank



Source: Ministry of Finance, Swaziland



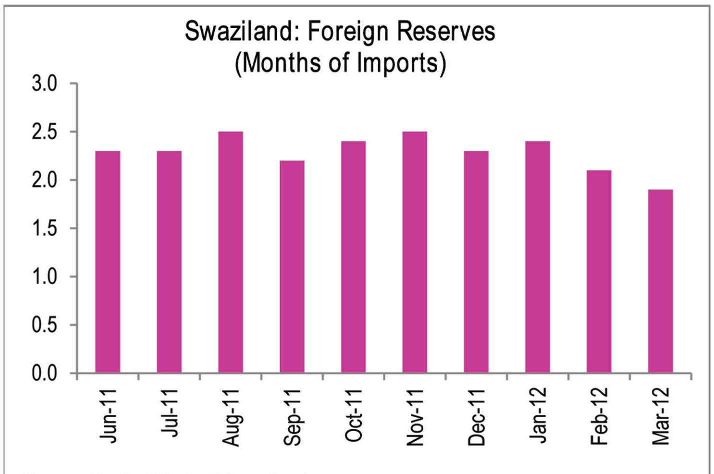
Source: South African Reserve Bank

SWAZILAND

Fiscal Policy: As private sector confidence waned in 2011, the Government found it difficult to raise financing while costs for borrowing increased. Government's difficulties in securing financing had some positive effect in that a lower fiscal deficit is expected than it would otherwise have been. The lower fiscal deficit, however, was achieved at a cost in terms of suspended infrastructure projects, for which government had to pay penalties. In his presentation of the national budget the Finance Minister noted the importance of restoring private sector confidence in rebuilding the economy. The Government was still struggling to meet its expenditures during the last quarter of fiscal year 2011/12, with end-January 2012 accumulated arrears having risen to E 1.6 billion compared to E 1.2 billion in November 2011. The higher inflow of SACU receipts beginning April 2012 is likely to ease the fiscal constraint, giving the government a window to rebuild its deposits at the central bank and clear arrears.

The 2012/13 approved budget estimates revenues will rise to E 12.2 billion, buoyed by a 145 percent increase in SACU transfers to E 7.1 billion from E 2.9 billion in the 2011/12 fiscal year. With expenditures pegged at about E 11.6 billion during the 2012/13 fiscal year, a surplus of about 1 percent of GDP is expected. Projections, however, point to a deficit in the fiscal balance during the 2013/14 fiscal year. Depending on how the Government responds to increasing demands for civil service wage increases, there is also a risk that the small surplus could turn into a deficit.

External Sector: A deficit of E 570.2 million was recorded on Swaziland's balance of payments by end of September 2011, representing about 2 percent of GDP. Contributing to the external account deficit was the Government's resort to running down reserves to finance its obligations. While global economic developments, including the likelihood of a decline in commodity prices, the windfall from SACU should more than offset a widening trade deficit in 2012. A slight improvement is therefore expected over the year.



Source: Central Bank of Swaziland

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Following the non-implementation of most recommendations in the 2005 Investor Road Map, His Majesty, King Mswati III re-launched the Investor road Map in April 2012. The King noted that in the past Swaziland was considered an attractive investment destination, however, it has lost that image. The revised Investor Road Map seeks a government-wide coordinated approach with clear objectives, responsibilities and accountability. Indeed the country's ranking in the World Bank's 2012 Doing Business Report slid to 124 from 123 in 2011. Swaziland performs the worst in contract enforcement where it ranks 171 out of 183 countries. The country also ranks as one of the 20 worst performers in terms of starting a business.

III. DONOR COORDINATION ACTIVITIES

The Government has started to be proactive in its relationship with the donor community, having convened a donors' meeting in January 2012 to seek assistance in the implementation of the public financial management reforms. A reform matrix was developed soon after the meeting and awaiting finalization and implementation.

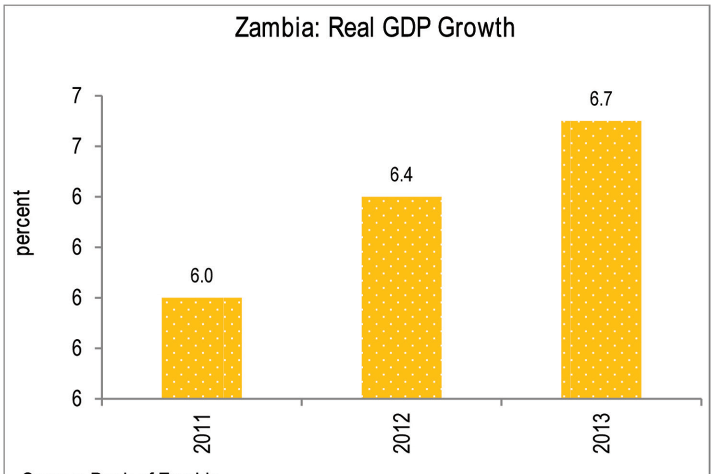
IV. ISSUES NEEDING PARTICULAR ATTENTION

Slow and limited actions in reducing the wages bill and improve resource allocation would leave the county's public finances in a vulnerable situation, especially as transfers from the SACU revenue pool have proved to be volatile. The Government should be encouraged to take bold actions now to ensure access to external financing in coming fiscal year when SACU transfers are expected to fall.

ZAMBIA

HIGHLIGHTS

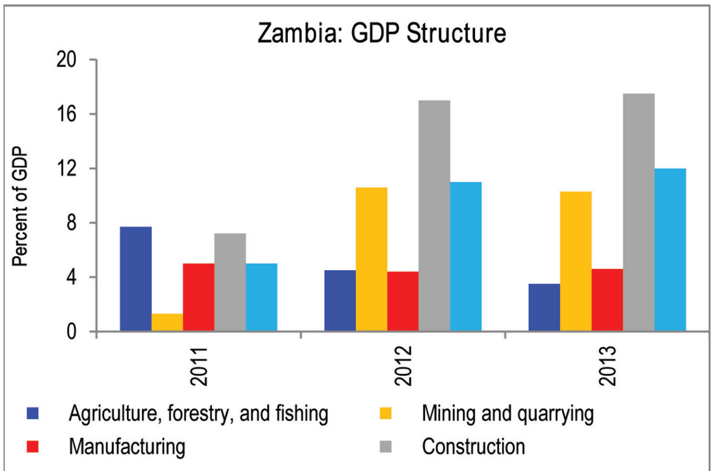
- The Government raised public sector salaries by 15 percent, increased taxes in the mining industry and lauded its cooperation with China in stark contrast to the pre-election anti-China rhetoric.
- After a rise of 6.6 percent in 2011, GDP growth is expected at just over 6 percent this year.
- On 23 January 2012 the authorities announced plans to rebase the Zambian kwacha and dropping three zeros from the local currency in order to increase confidence in the currency and stabilize the fluctuations.



Source: Bank of Zambia

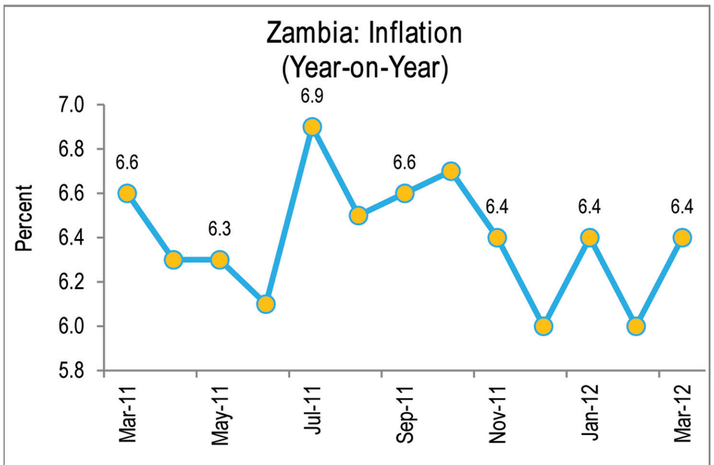
I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Zambia's macroeconomic framework has delivered high growth, low inflation, rising levels of foreign exchange reserves and exchange rate stability. The economy is expected to have continued to grow during Q1 2012. While the 6 percent growth outturn for 2011 was lower than expected, it was robust and projected at 6.4 percent and 6.7 percent for 2012 and 2013, respectively. The copper industry remains the main driver of growth, with production rising by 19 percent at end 2011 to 853,000 tonnes. Growth has been also driven by agriculture, construction, manufacturing, and transport and communications.



Source: Zambian Authorities

Monetary Policy and Banking System: Zambia continues to manage inflation at single digit levels. The inflation outturn at the end of Q1 2012 was 6.4 percent. The relatively low rate of inflation is attributed to stable food prices, following bumper maize harvests during the previous two years. Low inflation has also been attained through prudent management of growth in money supply and liberalization of financial markets. These measures helped create an environment of stability and increased foreign and domestic private investors' participation in the Zambian economy. However, the increase in electricity, generous pay settlements and the weaker kwacha point to higher inflation later this year. Going forward, there are indications of changes to the inflation management framework. In Q1 of 2012, the authorities made it clear there would be a shift away from targeting money supply towards a framework that uses interest rates as the main anchor of inflation.



Source: Central Statistical Office, Zambia

In efforts to strengthen the banking sector, the Government announced that it would raise capital requirements to K104 billion and K250 billion for national and foreign commercial banks, respectively.

Fiscal Policy: The 2012 budget targets a fiscal deficit of 4.1 percent of GDP compared to just over 3 percent in 2011. The higher deficit, mainly due to the increase in wages, will be funded from borrowing and recovery of tax arrears, especially from the mining sector and re-allocations from under spent budget heads including carry-overs from 2011, as well as donor funds which were not reflected in the original budget.

ZAMBIA

Recent public-sector pay increases have been well in excess of inflation, but similar increases are not expected in the medium term. Following these wage increases for civil servants and public-sector health workers, expenditure overruns are likely although this was partly offset by lower than budgeted capital spending.

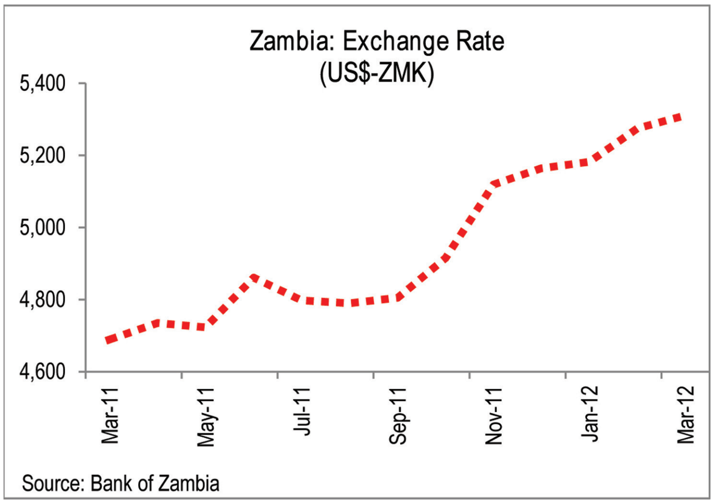
External Sector: Despite rising copper prices, the current account surplus narrowed in Q1 of 2012, mainly reflecting a strong expansion in imports and a decline in grants. For the rest of 2012, the current account surplus is projected to remain broadly unchanged, while gross international reserves are expected to continue to grow, reaching the equivalent of 3.3 months of prospective imports.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Private Sector Developments: There were clear indications in Q1 of 2012 that the Government would pursue nationalization of some of the country's leading corporations. This followed the renationalization of the telecoms operator Zamtel indications that the Government would be looking to buy out the foreign ownership in Zanaco Bank.

III. ISSUES NEEDING PARTICULAR ATTENTION

Despite the favorable macroeconomic results, there is an urgent need to re-orient policies to ensure that economic growth and macroeconomic stability are accompanied by strong employment growth and poverty reduction. Looking forward, it will be important for the Government to implement policies to diversify the economy and ensure that growth is more inclusive. Key areas will include: (1) tax policy, tax administration, and public financial management to create fiscal space for increased infrastructure spending and improve technical capacity to efficiently administer a larger capital budget; (2) maize marketing and pricing policies and the development of a broad-based reform strategy for the agricultural sector; (3) increasing access to financial services by small and medium enterprises without jeopardizing financial sector stability; and, (4) removing the incentives for the proliferation of informal business and employment arrangements.



ZIMBABWE

HIGHLIGHTS

- GDP is projected to grow by 9.4 percent in 2012 driven largely by mining and agriculture. Electricity outages and liquidity constraints still threaten the economic recovery process.
- The first draft of the new constitution for Zimbabwe was produced on 9 February 2012 and is currently going through a review process.

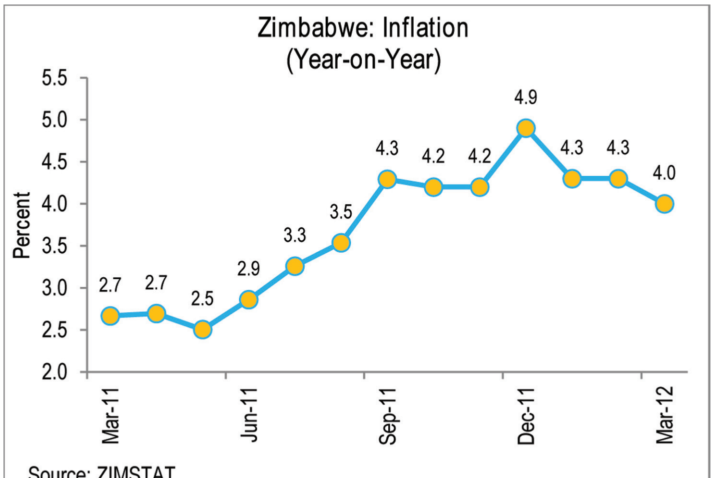
I. MACROECONOMIC DEVELOPMENTS

Economic growth continues to improve from a low base of 2007/08, though recovery remains fragile. Real GDP growth decelerated to 6.8 percent in 2011, from 9 percent in 2010 and is projected to decelerate further to about 6 per cent in 2012. The subdued growth reflects challenges facing the economy, including limited sources and high cost of capital, uncertainties arising from policy inconsistencies, especially with respect to economic empowerment and indigenization regulations, dilapidated infrastructure, obsolete technologies and frequent breakdown of machinery as well as power and water shortages. These downside risks are further being compounded by the contestations among the Inclusive Government partners on issues of the new Constitution, the national referendum to adopt it, as well as the pending national elections.

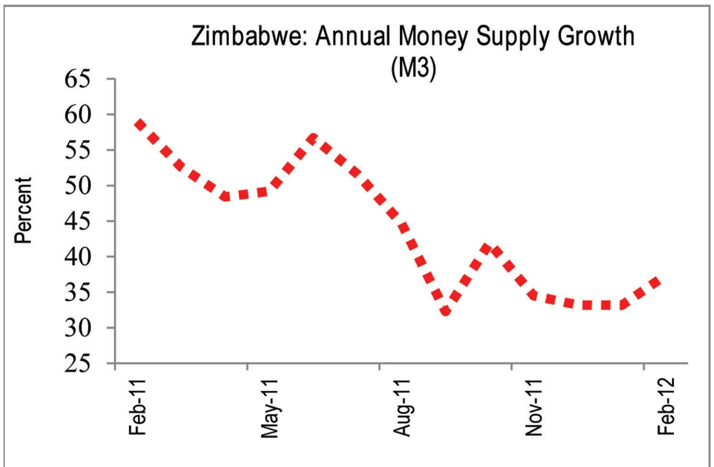
Monetary Policy and Banking System: In spite of the liquidity constraint since the adoption of the multi-currency use for transactions in the country, inflation has slowly been rising. Annual inflation increased from 2.7percent in March 2011 to about 4percent in March 2012. Inflation has largely been driven by price increases for communication (11.7percent); rentals and utilities, gas and other fuels (10.7percent); and restaurants and hotels (8.7percent). On a month-on-month basis, inflation decreased from 0.5percent in February 2012 to 0.4percent in March 2012.

Annual broad money supply (M3) growth declined from 59percent in February 2011 to 37.4percent in March 2012. On a month-on-month basis, M3 growth accelerated from 1.4percent in January 2012 to 7.4percent in February 2012. The increases in month-on-month M3 growth, which reflects an increase in total banking sector deposits is favourable given the prevailing liquidity constraints in the economy. Annual total banking sector deposits increased by about 20 percent from US$3.2 billion to US$3.8 billion in February 2012. Despite this increase in banking sector deposits, their composition remains unfavourable for long-term lending and investment. The composition of deposits is still skewed towards short-term deposits, which suggests weak depositor confidence.

Commercial and merchant bank weighted average base lending rates increased during the first two months of 2012. Lending rates for commercial and merchant banks rose by less than a per cent to 14 percent and 20 percent per annum, respectively, between January and February 2012. Despite the increase in lending interest rates, the 3-month deposit and savings rates remained unchanged at their January 2012 levels of 9.5percent per annum and 2.6percent per annum, respectively.



Source: ZIMSTAT

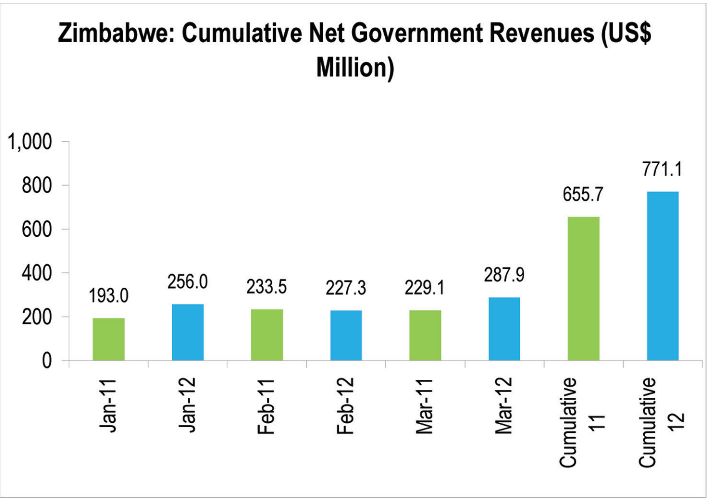


Source: ZIMSTAT

ZIMBABWE

Fiscal Balance: The fiscal out-turn for 2012 shows that cumulative government revenues for the first two months (January and February 2012) amounted to US$483.3 million against a target of US$549.5 million. Total Government revenues for February 2012 amounted to US$227.3 million. Cumulative expenditures to February 2012 were contained within the available revenues at US$444.5 million, hence a net surplus of US$38.8 million for the two months. Following the salary adjustments effected in January 2012, cumulative employment costs for the first two months amounted to US$257.4 million, or 53.3 percent of total revenues and 57.9 percent of total cumulative expenditures, which is a significant increase from the US$162 million or 38 percent of revenue and 48percent of cumulative expenditures for the same period in 2011. This development further constraints the government's capacity to investment in growth enhancing capital expenditures.

External Sector: Between 1 January 2012 and 2 March 2012 export shipments increased by 6.2percent compared to the same period in 2011. The mining sector contributes about 71 percent. The sector also registered significant growth in exports compared to the same period in 2011. However, tobacco, the second major export earner failed to maintain the 2011 momentum. Tobacco export receipts in 2012 are expected to be 42.6 percent less than their level in 2011. Lower tobacco export receipts are on account of depressed prices, which outweighed the 20 percent increase in quantities



III. SPECIAL THEME: MANUFACTURING, PRODUCTIVITY, INNOVATION AND JOBS IN SOUTH AFRICA— A COMPARISON WITH THE BRIC

SPECIAL THEME

MANUFACTURING, PRODUCTIVITY, INNOVATION AND JOBS IN SOUTH AFRICA—A COMPARISON WITH THE BRIC-OVERVIEW

I. INTRODUCTION

The manufacturing sector is at the center of the Government of South Africa's development strategy. Growth in manufacturing is seen as critical to enhancing economy wide growth and creating employment. However, over the last two decades, South Africa's manufacturing performance has been weak on many fronts, including its contribution to GDP, employment and innovation. The sector's sub-optimal performance is particularly striking when compared to that of other emerging markets, especially the comparator BRIC economies (Brazil, Russia, India and China).

In recent years, South Africa's manufacturing sector's *value added* as a percentage of GDP has been almost at par with Brazil, Russia, and India, but way below China. While manufacturing employment in India and China has increased significantly, data for South Africa point to consistent declines over the last two decades. In terms of *innovation*, South Africa also emerges as a poor performer.

The comparative picture of South Africa's manufacturing development begs two critical questions:

- First, what has constrained the development of more technologically sophisticated manufactures in South Africa and what are the future prospects for such sectors? This is a critical question as South Africa seeks to enhance the sophistication of its exports away from dependence on commodities, notably minerals.
- Second, what are the implications of any possible future expansion in manufacturing for employment within manufacturing and in the broader economy? Again, this is a critical issue in the light of South Africa's major unemployment problem and of government's attempts to place manufacturing at the center of its growth strategy.

The note makes a comparative analysis and provides answers to these pertinent questions in the South African context. It concludes by suggesting some policy recommendations that need to be considered to address the poor performance.

II. MANUFACTURING PRODUCTIVITY AND JOBS

In South Africa, manufacturing sector's share of GDP reached its peak at the end of the 1980s at 25 percent. Since then, there has been a steady and consistent decline such that by 2010, the sector's share of GDP had declined to 15 percent. While this was almost at par with the outcome in Brazil, India and Russia, it was half of that of China. Another notable feature is that China, India and Russia exhibit very little change in the share of manufacturing in GDP over time. In South Africa and Brazil, by contrast, manufacturing's share has declined. Manufacturing value added in Brazil and South Africa peaked at a very similar time, at the end of the 1980s, and declined thereafter (see table 1).

In spite of the similarity in the MVA between Brazil and South Africa, there are significant differences between the two countries. In the case of Brazil, the country has witnessed significant growth in primary production, both in agriculture and in mining since the onset of the commodities boom. The recent declining share of manufacturing is, therefore, partly relative and reflects growth in commodity production and higher prices for commodities. In South Africa, by contrast, mineral production has been in persistent decline, even during the commodity boom. Moreover, manufacturing export growth has been substantially lower in South Africa than in India and China, somewhat lower than in Brazil and somewhat higher than in Russia (see Table 2).

Table 1. Manufacturing Value Added (MVA) as percent of GDP: BRICS, 1980 - 2010

	'80	'90	'95	2000	2002	2004	2005	2006	2007	2008	2009	2010
Brazil	33	30	19	17	17	19	18	16	15	17	16	16
Russia	…	…	…	…	17	17	18	18	18	18	15	16
India	16	17	18	16	15	15	15	16	16	15	15	14
China	40	33	34	32	31	32	33	33	33	33	32	30
South Africa	22	24	21	19	19	19	18	17	17	17	15	15

Source: World Bank Development Indicators

Table 2. Manufacturing Exports, Trade Value. BRICS, 1995 - 2010 (current $US millions)

	1995	2000	2005	2010	percent change 1995 - 2010
Brazil	24,703	31,987	62,534	72,467	193
China	125,168	219,841	700,075	1,476,007	1,979
India	23,277	32,970	71,319	140,471	503
Russia	23,061	24,323	45,278	58,696	154
South Africa	12,200	14,149	26,435	33,169	171

Source: COMTRADE

South Africa's export performance in the labour intensive products (textiles, clothing and footwear) has been particularly weak. Textile exports have consistently underperformed and clothing and footwear exports in 2010 were below those in 1995.

With regard to high technology, there has been some growth in South African exports. However, growth has been limited and has been significantly slower than in China, India and Brazil and somewhat slower than in Russia. In 2010, the latest year for which data is available, high technology exports were 7.2 percent for India, 8.85 percent for Russia, 11.4 percent for Brazil and only 4.28 percent for South Africa. Moreover, high technology exports as a share of manufactured exports in South Africa have been declining.

As opposed to China, India and Brazil, South African manufacturing employment has been falling steadily. South Africa's manufacturing employment peaked at a little over 1.5 million in 1989-1990 and has declined steadily since then. South Africa's decline in manufacturing employment is in sharp contrast with China, India and Brazil. These countries have had considerable increases in manufacturing employment and have not yet reached their peak employment levels. The most noticeable loss in employment occurred in textiles, clothing and footwear sectors. The collective share of textiles, clothing and footwear in manufacturing employment declined from 17 per cent in 1995 to 8 per cent in 2011.

III. TECHNOLOGY AND INNOVATION

Various indicators suggest that South Africa performs poorly in comparison with the other BRIC countries with regard to technology and innovation. The country's gross expenditure on R&D has been increasing and is currently very close to the government's declared target of 1 percent of GDP. This is somewhat below that of Russia, China and Brazil – but higher than India. As South Africa's economy is significantly smaller than the other BRIC countries, overall expenditure on R&D in South Africa is significantly lower. Moreover, since GDP has tended to rise more slowly in South Africa, particularly by comparison with China and India and, more recently with Brazil, this means that South Africa is, over time, devoting comparatively less overall resources to R&D.

South Africa has a far lower share of population engaged in R&D than China, Russia or Brazil – but a higher share than India. The rate of growth has been lower than in Brazil, India and particularly China. In 2007 South Africa had 396 researchers in R&D per million population compared to 658 for Brazil, 3,274 for Russia and 1,077 for China.

A look at the number of South African patents at the Unites States Patent Office (USPTO) also points to the country's declining performance. Pre-1998, the number of South African patents significantly exceeded that of any of the other BRIC countries. While patents registered at the USPTO by all the other BRIC countries have increased significantly every year after 1998, for South Africa, the number of patents registered per annum have effectively stagnated. At the end of 2011, the number of South African patents was 13 percent of all the other BRIC countries combined.

IV. CONSTRAINTS TO DEVELOPMENT OF TECHNOLOGICALLY SOPHISTICATED MANUFACTURES IN SOUTH AFRICA

Firm level interviews supplemented by survey data reveal that the most widespread constraint for technology based firms in South Africa is the shortage of skills. While the high quality of many South African graduates is a major factor underpinning the success of many technology based firms, such graduates however remain in very short supply. Moreover, there are indications that the quality of graduates was declining. Larger and better established firms are able to partially mitigate the skills constraint by offering high salaries and graduate bursaries. These options are not available to smaller and newly established firms. The incidence of a shortage of skills and a consequent tight labor market fall disproportionately on the smaller and less capitalized firms, and on the firms in formation.

The shortage of finance is the second most significant constraint cited by technology based firms. Again, these constraints are clearly most binding to newly established firms or firms that have not yet entered the market. Black economic empowerment (BEE) may also have an important impact. There appears to be a near absence of new entrant black-owned technology based firms. Black graduates, particularly those with technical and engineering skills, can readily find high paying posts in well established companies. They are consequently far less likely to engage in risk taking new ventures. Black entrepreneurs too are likely to find far more lucrative opportunities with existent firms.

V. THE LINKAGES OF THE MANUFACTURING SECTOR TO THE REST OF THE ECONOMY

Available evidence suggests that the manufacturing sector's linkages to the rest of the economy are declining – both forward and particularly backward linkages. Declining linkages combined with a reduced overall share for manufacturing in the economy and the changing composition within manufacturing away from the more labor intensive sectors – all imply that the capacity for manufacturing to drive the economy wide output increase and enhance employment is limited and declining.

The comparison of linkages and employment multipliers across sectors is valuable in determining which sectors and subsectors have the strongest linkages and multipliers, particularly in comparing manufacturing with the rest of the economy. This could have implications *inter alia* for industrial policy in considering which sectors should be prioritized. The key empirical findings reveal the following:

- The strongest forward linkages are to be found in the electricity, gas and water sector, followed by agriculture;
- When comparing import-adjusted forward linkages for the years 2000 and 2009, the strength of the forward linkages declined for manufacturing;

- Backward linkages are strongest for construction, followed by manufacturing;
- The import-adjusted backward linkages of manufacturing declined between the years 2000 and 2009;
- The highest employment multipliers are in agriculture, followed by other services, general government services and construction, and manufacturing;
- The manufacturing employment multiplier has been declining.

The strength of sectors' backward linkages and employment multipliers were amongst the factors which the South African government took into account when prioritizing sectors for industrial policy support in the Industrial Policy Action Plans (IPAPs). The sectors prioritized in the IPAPs in turn constitute the priority manufacturing sectors identified in the New Growth Path framework (NGP), for employment creation in particular. Alongside those manufacturing sectors the NGP also identifies as job drivers infrastructure, the agricultural value chain, the mining value chain, the green economy, and tourism and certain high-level services.

VI. POLICY RECOMMENDATIONS

There are three major conclusions for the broad strategic direction of government's industrial policy:

- Much more attention needs to be paid to enhancing the employment intensity of manufacturing. In particular, industrial policy will need to be complemented by labor market reforms;
- More attention needs to be paid to the constraints faced by new manufacturing firm entrants and to addressing the constraints that such firms face; and,
- Policy supports that aim to enhance economy wide output and employment growth should pay more attention to the significant heterogeneity of linkages and of employment intensity of the different subsectors in manufacturing as well as to the linkage and employment intensity of other non-manufacturing sectors.

Innovation will be vital to spur growth and prosperity, otherwise South Africa will continue to lose its comparative advantage in the emerging markets. It is clear that South Africa has to foster an economy driven by innovation, exports, Green Growth opportunity and clean energy. This will require investment in human capital and infrastructure to adopt new regimes for trade, patents, immigration and technology transfer; to devise methods for government to work more effectively, and to restore fiscal prudence to budget and debt policies.

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