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The global economy continues to deteriorate. While consumer spending has held up fairly well, there has been a rapid deceleration in investment spending and in world trade. Only in China growth continues to be strong. South Africa's GNP grew 2.3% in the second quarter up from 2.0% in the first quarter. While this is typical of global growth rates, it is disappointing because export revenues have been exceptionally buoyant.

The most notable feature of the financial markets during August was a significant change in exchange rates. Since the end of June the dollar and the rand have respectively depreciated against the Euro by 7 and 12.5%. Adverse sentiment regarding the rand has been exacerbated by the crisis in Argentina, Zimbabwe and a sudden deterioration in labour relations in South Africa. In real terms, the rand has reached levels last experienced during the political crisis in the mid-1980's when the country was subject to financial sanctions. The consequences of the rand's devaluation are not entirely negative because it enhances the international competitiveness of South African businesses and creates investment opportunities, which partly explains why the All Share Index has appreciated by 6% in August and is up 5% relative to Morgan Stanley World Index.

August is seasonally the weakest period of demand for commodities. Metal prices rallied from the lows reached in the early part of the month, which together with the weak rand, caused a rise in the Resources Index from 7,000 to 8,000.

One of the features of the market continues to be the outperformance of small and medium cap. companies relative to the ALSI40.

The uncertainty regarding the Telkom privatisation has also contributed to the rand's weakness. While government is strongly committed to the process, market conditions do not favour an early sale.

The Reserve Bank remains confident that inflation will be below its 6% target during 2002, but the combination of a series of high wage settlements in the private sector and the weakness of the rand present it with difficult choices at its September monetary policy meeting, as it tries to seek a balance between a weak economy and a sudden unexpected resurgence in inflationary pressures. The bond market has reflected these tensions. While it still is priced on the assumption that there will be further rate cuts this year, the 10-year bond yield increased from a low of 10.5% on 13 August to 11.0% on 23 August.

Commentary by Sandy McGregor: Director

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