

TWO DECADES OF FREEDOM

What South Africa Is Doing With It, And What Now Needs To Be Done



Goldman
Sachs

TWO DECADES OF FREEDOM— A 20-YEAR REVIEW OF SOUTH AFRICA

“The people of South Africa have spoken ... They want change! And change is what they will get. Our plan is to create jobs, promote peace and reconciliation, and to guarantee freedom for all South Africans”
– President Nelson Mandela, inaugural speech, May 1994

As the 20th anniversary of the birth of democracy in South Africa, on April 27 2014, approaches, it seems a perfect opportunity to take a step back and get a long-range perspective on the important question: “So, what has Nelson Mandela’s South Africa done with its freedom?”

Goldman Sachs has produced this report in the hope of contributing towards a more balanced narrative on South Africa; one, which in the wake of 2012’s tragic events at Marikana, had become somewhat hysterical, short-term and often negative.

The report provides a data-rich, empirical analysis of how South Africa has changed in the past 20 years, and its position in the world, and identifies:

- The 10 areas in which South Africa has made structural advances in this time
- The 10 large challenges that remain to be tackled
- The 10 key issues now to be addressed

We have privately presented to, discussed and iterated this report in private audiences with the South African government, some of South Africa’s top political leaders, the South African Reserve Bank, business leaders, boards of leading companies, business organisations and leading academic institutions.

The report aims and hopes to present a balanced picture, at a time after close on 20 years of democracy, when it is possible to reflect, take stock and get a clear picture of the challenges ahead for South Africa.

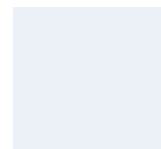
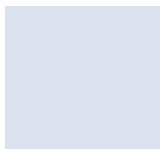
We also hope that by providing this balanced perspective on South Africa’s achievements in the past 20 years, and identifying in factual relief the challenges which remain, all South Africans will be in a better position to chart the way forward to realising Nelson Mandela’s vision.

Colin Coleman
Partner Managing Director, Head of South African Office and Investment Banking Division, Sub-Saharan Africa, Goldman Sachs International

Johannesburg, 4 November 2013



COLIN COLEMAN



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- i How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...



South Africans now and at the dawn of democracy

Based on National Census 1996 and 2011

		1996	2011
✓ ?	Population (m) – Total	40.6	+11.2m (27.6%) 51.8
	- African	31.4	+9.6m (30.6%) 41.0 79%
	- Other	9.2	+1.6m (17.4%) 10.8
✓	GDP (\$bn)	143.8	404.3 2.8x
✗	Unemployment (millions)	4.7	5.6
✓ ?	Employment (millions)	9.0	13.2 (now 15.2m)
✓	Functional illiteracy ¹ (%)	33.6%	19.1%
	Access to services (%)		
✓	Electricity ²	58.2%	84.7%
✓	Water ³	60.8%	73.4%
✓	Sanitation ⁴	50.3%	62.6%
✓ ?	Social Welfare (millions)	2.4	14.6 (now 16.6m)

Source: National Census, Stats SA

¹ Defined as the number of persons aged 15 years and older with no schooling or whose highest levels of education are less than Grade 7

² Based on % of population that use electricity for lighting in the home

³ Based on % of population that have access to piped water inside the dwelling/yard

⁴ % of households that have flush or chemical toilets

How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...

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The South African population is even more African dominated today

- Based on information provided by the 1996 and 2011 census, the African population is the fastest growing population group and now accounts for c.79% of the South African population. This fact dominates the political and commercial landscape and makes the African community the key determinant of the political and economic life of the country
- Economic growth shows strong improvement but unemployment is sticky
- GDP, on a dollarised basis, has grown more than 2.8x over the period to around \$400bn
- Whilst unemployment has remained high with a net 900,000 added to the unemployed between 1996 and 2011, those with employment have in fact grown by 4.2 million in the period and by 6.2 million to 2014. Employment has therefore grown, albeit at an insufficient rate to bring the aggregate % unemployed down

The poor have benefited from cash and non-cash state transfers

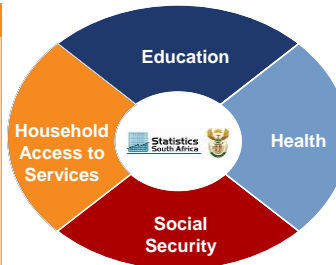
- Non-cash transfers by the State in the form of providing public sector goods and services to the poor is evident in areas such as education (functional illiteracy improving from 34% to 19%), access to electricity (improving from 58% to 85%) and access to water and sanitation facilities (both reaching an additional 13% of the population)
- Social welfare monthly cash grants are now afforded to over 16m people in need, which corresponds to the number of people living below the \$2/day poverty line in South Africa, at an annual current cost to the fiscus of over \$10bn
- The combination of these cash and non-cash transfers of value represents a vital safety net and cushion for the poor and supports their ability to acquire their basic needs

Education

- 57% of learners had benefitted from the 'no fee' system vs. 1% in 2002
- 93% of South Africans can read and write
- 29% of people older than 20 have grade 12 as their highest level of education vs. 22% in 2002

Household Access to Services

- Households with electricity increased from 77% in 2002 to 85% in 2012
- 91% of households have access to piped or tap water in the dwelling, off-site or on-site vs. 56% in 2002
- 94% of households have access to either landlines or cellular phones in 2012
- 41% of households had at least one member who used the Internet either at home, work, place of study, or Internet cafés
- Between 2002 and 2012, the percentage of individuals who experienced hunger decreased from 24% to 11%



Health

- 70% of households went to public clinics and hospitals first vs. 57% in 2002
- 79% of households that attended public health-care facilities were either very satisfied or satisfied with the service they received

Social Security

- The percentage of individuals that benefited from social grants has increased from 13% in 2002 to 30% in 2012
- The percentage of households that received at least one grant increased from 30% to 44%

Source: Statistics SA (General Household Survey)

Note: The target population of the survey consists of all private households. The survey does not cover other collective living quarters such as students' hostels, old-age homes, hospitals, prisons and military barracks, and is therefore only representative of non-institutionalised and non-military persons or households in South Africa

How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...

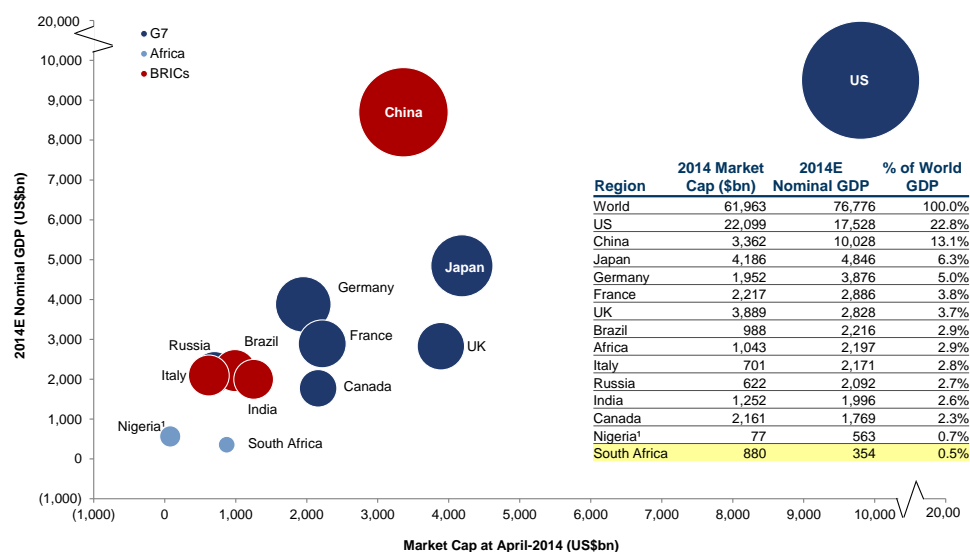
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The Stats SA General Household Survey, provides a picture of broad improvements for poorer communities

- One example to highlight is health, where 70% of households made use of public clinics (vs. 57% in 2002) and around 80% recorded being satisfied or very satisfied with the service received
- This stands counter to prevailing public perception of the state of public health facilities and, whilst not evenly performing, on aggregate the data reflects that public health services is deemed by its client users to have improved

The US still dominates the world as we know it today

South Africa a small economy



Source: Bloomberg, IMF WEO April 2014 Database

¹ Nigeria 2014E GDP based on revised GDP for 2013 of \$509.9bn and extrapolated for 2014 based on a constant multiple over previous estimates of 1.8x

How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...

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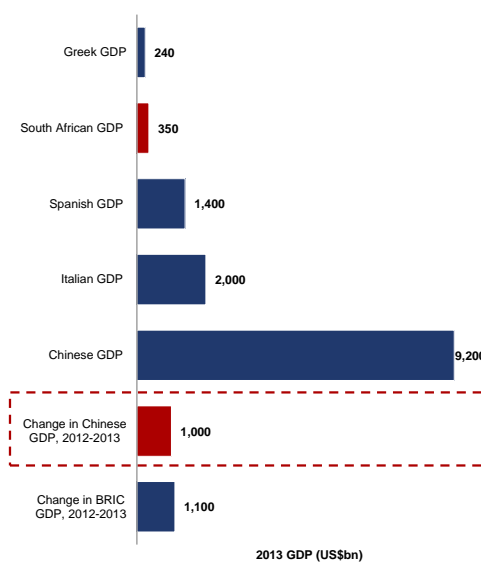
South Africa is a small economy when seen in a global context with only 0.5% of world GDP

- The US (\$17trn GDP) and China (\$10trn GDP) are the dominant, leading economies. The performance of these economies is central to South Africa's economic prospects
- South Africa's total equity market capitalisation is a standout 2.5x GDP, the highest market cap / GDP ratio of all countries shown on the table, and one key measure on which it compares favourably against other BRIC countries

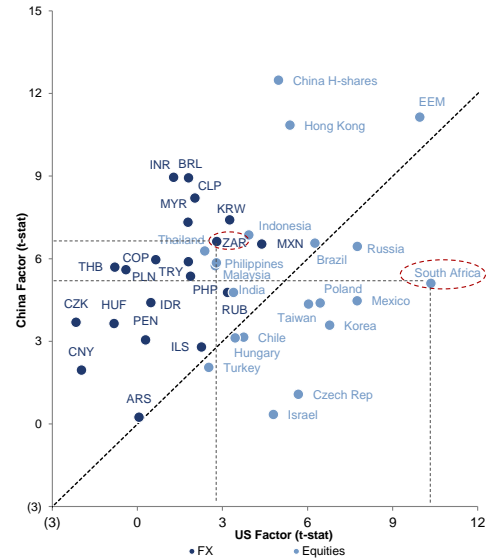
South Africa is leveraged to China's prospects

SA Equities (JSE) more correlated to US growth and SA FX (ZAR) more correlated to China growth

China Produces Three South Africa's a Year



FX and Equity Relationship with China and the US



Source: GSAM, Goldman Sachs Global Investment Research, IMF WEO April 2014 Database

How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...

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The importance of both China and the US for South Africa is further evidenced by their sheer size and influence over global FX and equity markets

- Even at a “slower” growth rate of c.7.5%, China is currently adding around \$1tn per annum to world GDP. This equates to adding an economy the size of Greece every 12 weeks or the size of South Africa every 4 months
- As a major commodity consumer and importer from South Africa and Africa, and given China's increasing overall importance as a trade partner for South Africa, its' economy is hugely influential in determining the overall health of South Africa's
- On the right hand side, we see that the ZAR's performance is more correlated to China (given the commodity factor) and the JSE is highly correlated to the performance of US equities. If the US economy enters a phase of sustained growth going forward this should be good news for the JSE

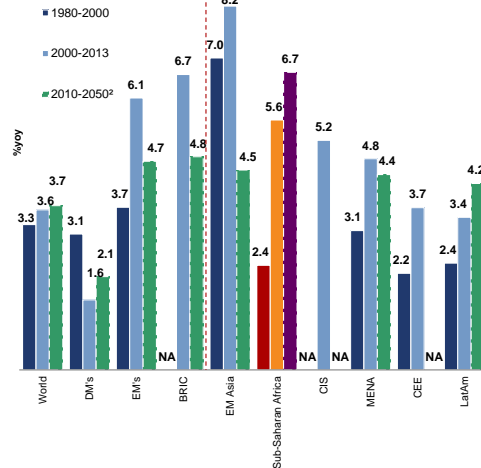
Well positioned to benefit from the high potential across Africa

We now live in a "good neighbourhood"

Africa's Rapid Growth Should be Supportive to South Africa's Potential

Sub-Saharan Africa to grow at an average rate of more than 6.5% p.a. to 2050

Real GDP
Average Growth
Rate¹:



Source: Goldman Sachs Global Economics

¹ Geometric average growth rates (CAGR)

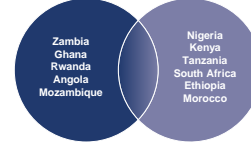
² Growth rate ppp weighted

³ The GES is an index developed to measure the extent to which structural conditions and policy settings in a country are conducive to transforming the economic potential of the BRICs, Next 11 and other countries into reality. A higher score denotes a more conducive environment

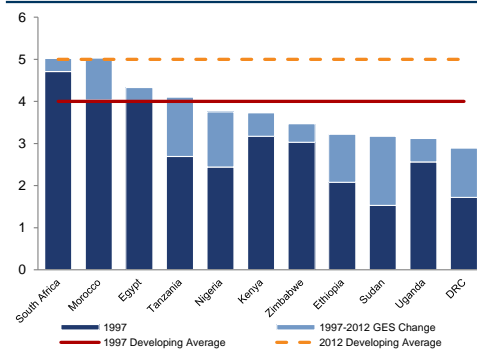
Top 11 High-potential African Economies

Stronger Track Record

Larger Population



Africa 11 Growth Environment Scores³



How South Africa has changed in the almost two decades since 1994, and how it is now positioned in the world...

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- In 1994 South Africa suffered from a "bad neighbourhood" syndrome, particularly highlighted by the political and economic state of Zimbabwe. The Sub-Saharan Africa region grew at only 2.4% real GDP average growth rate from 1980-2000
- However, in the last 13 years the region actually recorded a 5.6% average growth rate. We forecast this to rise to 6.7% into 2050 which will produce a region the size of \$14trn, ranking as one of the fastest growing regions in the world. South Africa and its companies are now ideally positioned to benefit from the growth potential of the continent
- Using the Growth Environment Scores as a measure of progress, we see countries universally improving their performance since 1997, albeit off a low base, in providing an environment that is conducive to economic growth

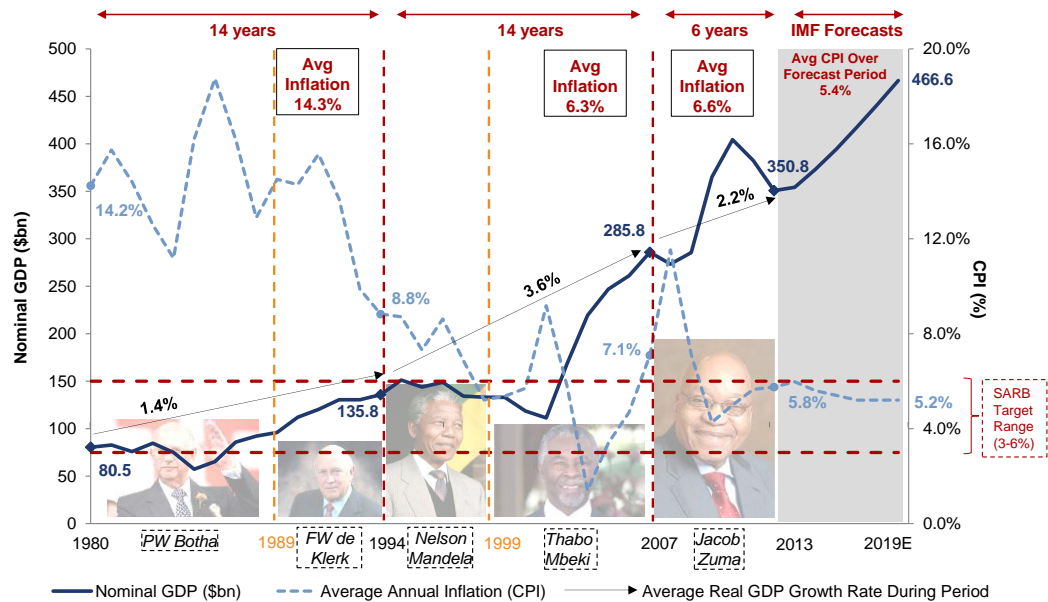
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- ii ...South Africa has made significant structural advances since 1994...
-

South Africa has in the two decades since 1994 made decisive structural advances in 10 key areas

- 1 Macro fiscal and monetary balances have improved
- 2 Government debt costs have trended lower and foreign reserves have risen
- 3 Overall cost of capital has declined
- 4 Corporate valuations have improved relative to global peers
- 5 Real asset ZAR returns have compared favourably
- 6 China and African trade rise has largely offset European trade decline
- 7 Disposable income of South Africans has risen
- 8 The rise of the black middle class has led to a structural boost in spending
- 9 Wage inflation and government grants have supported this trend
- 10 Per unit labour productivity has improved

Macroeconomic, fiscal and monetary balances have improved

1994 – 2007 a golden period of higher growth and lower inflation

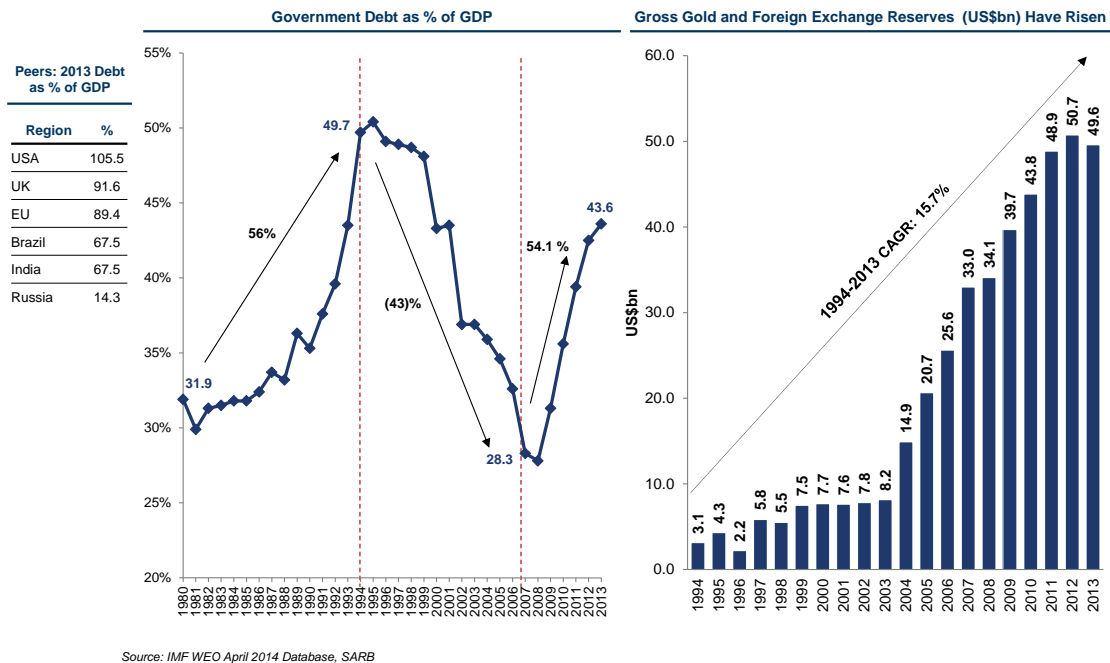


Source: IMF WEO April 2014 Database, Stats SA

Macro fiscal and monetary balances have improved

This graph tells a remarkable story about economic growth in South Africa before and after 1994

- Between 1980 and 1994, when South Africa was at the height of the anti-apartheid conflict (with associated sanctions, repression, labour and political unrest), it achieved a 1.4% average GDP growth rate, accompanied by average inflation in the period of 14.3%
- Notwithstanding inheriting this dire economic legacy, junk status sovereign credit rating (Standard & Poors BB) and a practically empty bank account (Net Open forward position of -\$25bn), South Africa recorded an average GDP growth rate of 3.6% between 1994-2007 and brought inflation down (with the introduction of inflation targeting) to an average in the period of only 6.3%. This was a "golden period" of economic performance and a peace dividend for South Africa
- Post 2007, the changes brought about by the ANC's Polokwane conference and the onset of the global financial crisis had the effect of moderating this growth, which resulted in a more subdued but still positive average GDP growth rate of 2.2%, and average inflation of 6.6% in the period 2007 to 2013
- Importantly, this impressive performance has, through the period, transformed South Africa from an \$80bn economy to a \$350bn economy today, accompanied by prudent monetary and fiscal policy



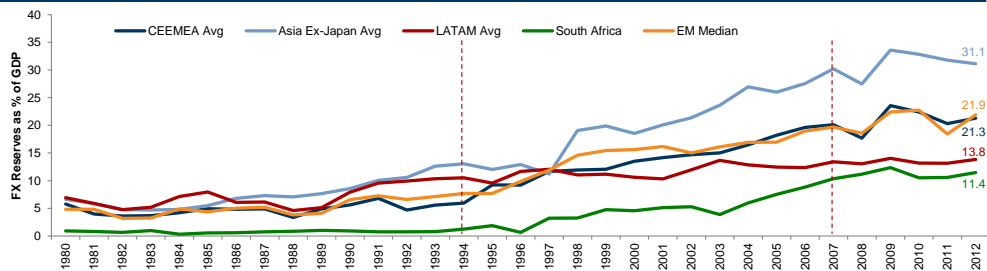
Government debt costs have trended lower and foreign reserves have risen

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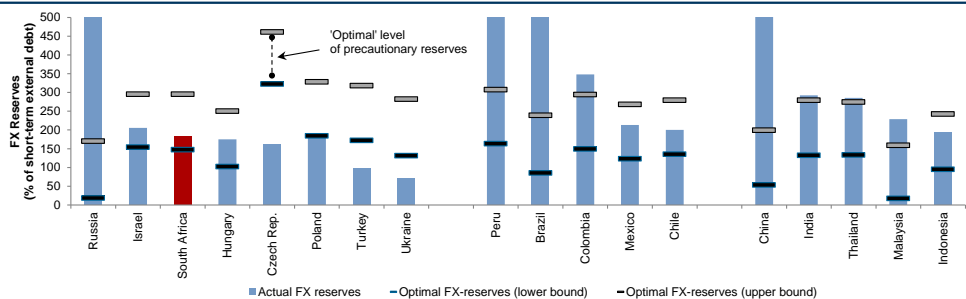
- Government debt as a % of GDP shot up through the pre-1994 period to 50%, declined through policies of fiscal prudence in the "golden period" to 28% in 2007 and, since the onset of the global financial crisis, has risen again to 44%, still way below the developed world benchmark in the UK, EU and USA
- The IMF recently warned South Africa that a 1% decline in growth could see a rapid rise in Debt/GDP to around 60%
- The National Treasury's recent forecasts aims to keep South Africa well clear of the high indebtedness recorded in certain developed markets, and certainly below 50% in the next 4 years
- Gross gold and foreign exchange reserves in 1994 were only \$3bn (before the negative Net Open Forward Position). As the \$(25bn) position closed around 2003, the reserves rose rapidly to around \$50bn

...although there is room to accumulate further FX reserves

Emerging market central banks have accumulated large FX reserves, especially since the mid-1990s



Actual FX reserves level vs. the 'optimal' level of precautionary reserves¹

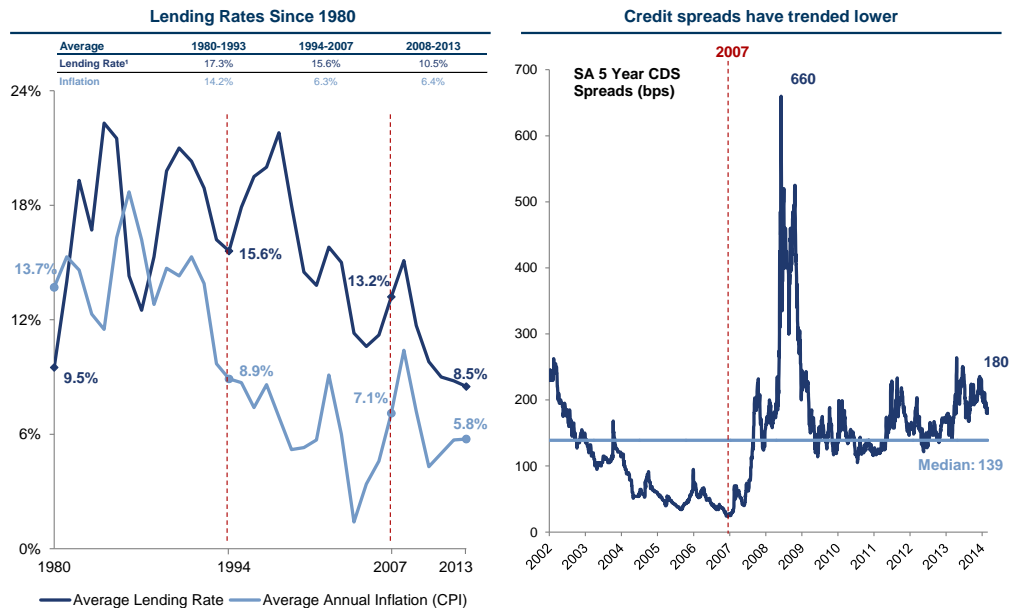


Source: World Bank, IMF, Goldman Sachs Global Investment Research

¹ Goldman Sachs research has defined the optimal level of FX reserves as the level where the marginal benefits of higher FX reserves equal the marginal costs

Government debt costs have trended lower and foreign reserves have risen

- However, South Africa still has room on an absolute and relative (to other growth markets) basis to accumulate further reserves to get to the “optimal” level of precautionary reserves. Such a higher level of reserves theoretically affords the central bank with a cushion and flexibility to deal with any currency shocks
- The chart at the bottom shows South Africa’s position in the red bar and highlights that at this point there is room to accumulate further reserves between the current levels and the optimal level as defined by Goldman Sachs Global Investment Research



Source: Euromonitor, Bloomberg as of Apr-14

¹ Average lending rates which usually meet the short-and medium-term financing needs of the private sector. These rates are normally differentiated according to creditworthiness of borrowers and objectives of financing

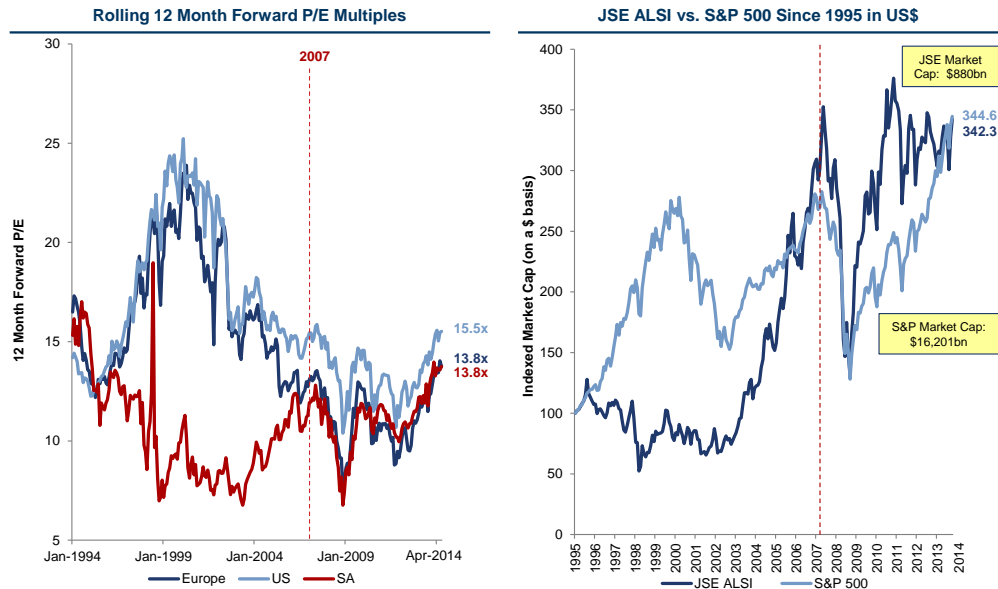
Overall cost of capital has declined

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- On the LHS, we see that the cost of capital has, in line with falling inflation, declined over the period from an average lending rate from 1980 to 1994 of around 17% to around 11% in the last 5 years. This benefits all members of society from corporates to consumers
- The sovereign spreads have largely improved with the exception of the spike in 2008 off very tight pre global financial crisis levels
- The recent slightly elevated levels reflect growing risk across growth markets as the US Fed prepares to taper it's quantitative easing program

Valuation differences have largely closed

The JSE has shown solid relative growth



Source: Datastream as of Apr-2014

Corporate valuations have improved on relative basis to global peers

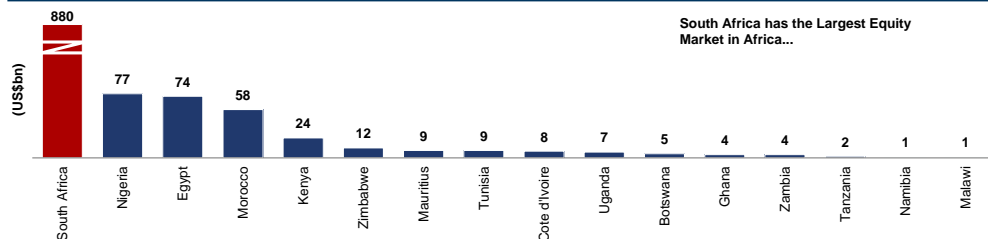
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- On the LHS, it is clearly visible that around the period of 2000, there was a large differential (equal to about 15x) in the value attributed to US and European companies vs. South African companies, based on one year forward P/E multiples
- This made it difficult for South African companies to use their stock as currency for acquisitions globally as they were relatively undervalued and at an impossible competitive disadvantage
- At least partly as a result, companies like Old Mutual, Anglo American, SAB Miller and Dimension Data moved their primary listings to the London Stock Exchange, inter alia, in the hope of an upward multiple rerating towards LSE valuations to compete on the global stage
- Over time, however, this valuation differential reduced as South Africa's Golden Period of economic prosperity assisted in re-rating JSE listed companies upwards, and US and European multiples fell into and beyond the Global Financial Crisis, thereby compressing the valuations close together
- South Africa's current 1 year forward P/E multiple of 13.8x is now on par with the 13.8x of Europe, but lags the 15.5x of the US by only 1.7x. It will be interesting to see if the historic multiple differential re-emerges in future. In the meantime, South African companies are at better comparative valuations on aggregate than they have been since 1994
- The chart on the RHS reinforces the point that on a relative basis to the S&P500 Index, the JSE in US\$ terms has performed in line since 1995 despite the effect of a deteriorating exchange rate

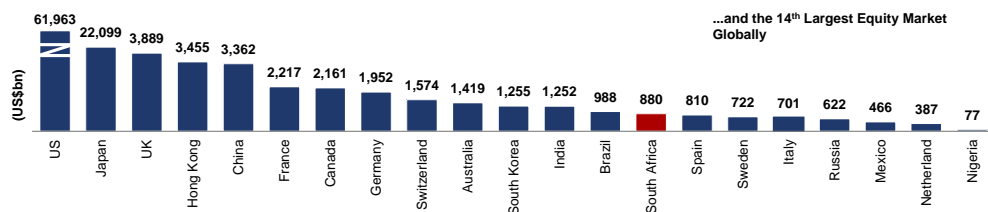
The JSE is ideally positioned as Africa's investment hub

The JSE's Market Cap / GDP ratio is over 2x and represents 80% of all African equity capital market flows

Equity Market Capitalisation



Equity Market Capitalisation



Black ownership of JSE-listed shares increased from c.5% in 1995 to c.21% in 2012¹

Source: Bloomberg as at April-14

¹ 1995 figure based on the Solidarity South African Transformation Monitor and 2012 figure based on a report released by the JSE in Dec-12, based on the top 100 companies on the JSE, which account for almost 90% of the listed shares on the exchange.

Corporate valuations have improved on relative basis to global peers










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The JSE is the only viable, liquid entry point into Africa's equity capital markets

- South Africa's corporate equity market cap, at c.\$880bn, is more than 11x larger than any other African stock exchange, with Nigeria's \$77bn market cap exchange the next largest. The JSE represents 80% of all Africa's equity capital markets. On a liquidity basis, South Africa trades c.\$2bn average daily trading value (ADTV) vs. Nigeria's \$20m. Therefore, international investors, sovereign wealth funds and multinationals such as Walmart, Vodafone & ICBC consistently choose South African companies as the platform for their Africa strategy
- The high standards of corporate governance, excellence of management teams and the liquid capital markets make South African companies attractive targets and partners for African expansion
- On a global scale, the JSE as the 14th largest stock exchange compares favourably to fellow BRIC nations such as Russia

4 South African companies which have been established or listed since 1994

SA "born free" companies have created significant value in both ZAR and USD since 1994

	Listing Date on the JSE	Market Cap at Listing (Rbn)	Current Market Cap (Rbn)	Annual % Growth		Money Multiple	
				ZAR	USD	ZAR	USD
 aspen	12-Aug-98	0.6 (\$0.1bn)	124.4 (\$11.9bn)	40.6%	36.3%	209.7x	127.5x
 Steinhoff	23-Sep-98	3.3 (\$0.6bn)	104.3 (\$9.9bn)	25.0%	20.5%	32.1x	18.2x
 exxaro <small>POWERING POSSIBILITY</small>	27-Nov-06	17.4 (\$2.5bn)	50.6 (\$4.8bn)	15.6%	9.6%	2.9x	2.0x
 Discovery	21-Oct-99	3.0 (\$0.5bn)	50.5 (\$4.8bn)	21.5%	17.1%	16.8x	9.9x
 CORONATION <small>FUND MANAGERS</small>	13-Jun-03	1.3 (\$0.2bn)	34.2 (\$3.3bn)	35.4%	31.8%	26.7x	20.0x
 NETCARE	5-Dec-96	0.4 (\$0.1bn)	32.6 (\$3.1bn)	29.2%	23.3%	84.9x	37.8x
 REDEFINE <small>REDEFINING THE FUTURE</small>	23-Feb-00	0.5 (\$0.1bn)	29.3 (\$2.8bn)	34.1%	29.4%	63.3x	38.1x
 CAPITEC <small>BANK</small>	18-Feb-02	0.1 (\$0.01bn)	24.0 (\$2.3bn)	54.7%	55.9%	199.9x	219.8x
 rbh	08-Nov-10	10.7 (\$1.6bn)	10.9 (\$1.0bn)	0.8%	(10.9)%	1.0x	0.7x

Source: Datastream as of April 2014

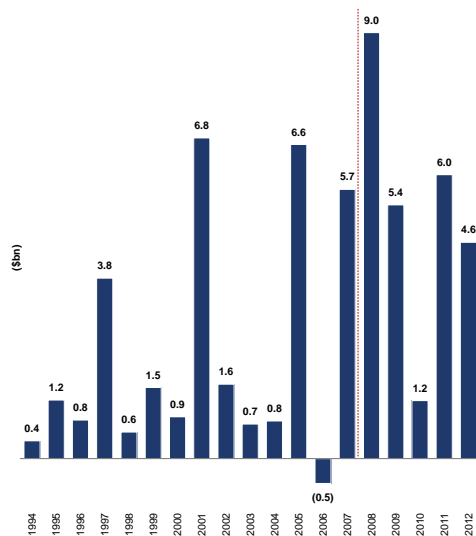
Corporate valuations have improved on relative basis to global peers

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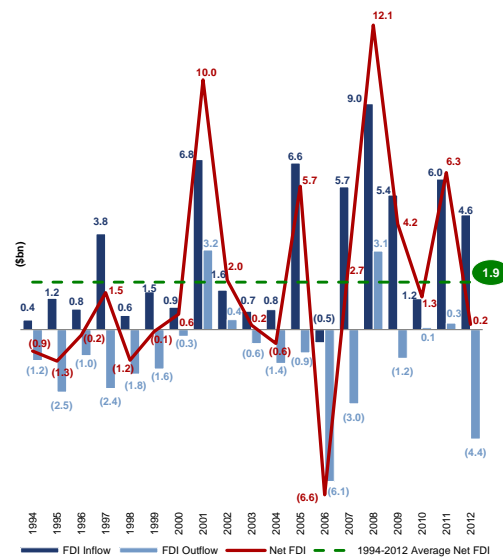
- South African companies which have been established (or listed on the JSE) post democracy have been able to benefit from the positive trading environment and create significant value for shareholders in both ZAR and USD terms
- These companies have also successfully created over 60,000 new jobs in South Africa

While inward FDI has been on an upward trend, net FDI has been volatile...

Foreign Direct Investment into South Africa Since 1994 (\$bn)



Net Foreign Direct Investment in South Africa Since 1994 (\$bn)



Source: UNCTAD

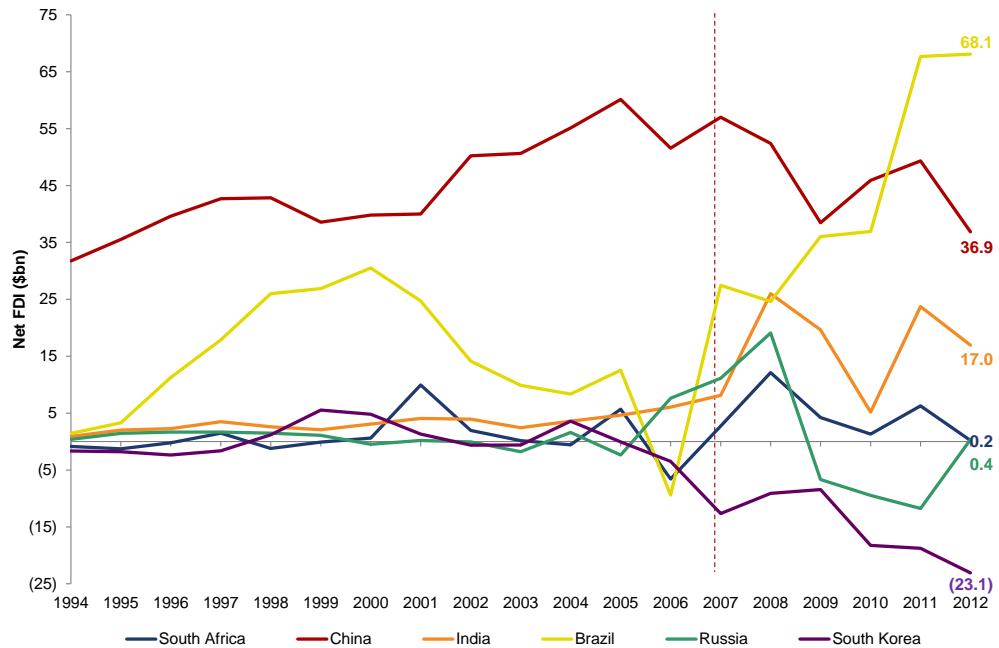
Corporate valuations have improved on relative basis to global peers

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- The chart on the left shows that there has been improvements in inward FDI to South Africa, however on a net basis, after accounting for outflows such as dividends to international investors, particularly post 2000, as a result of offshore listings, dividends or outward bound FDI, we see that net FDI has been volatile
- Through the period 1994 -2012, net annual FDI has been on average only \$1.9bn with only 2 years (2001 and 2008) in which net FDI has exceeded \$10bn

...and lags the major BRIC economies

Net foreign direct investment of other emerging economies (\$bn)



Source: UNCTAD

Corporate valuations have improved on relative basis to global peers

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In comparison with India, China and Brazil, South Africa's net FDI has lagged (in line with Russia)

- As we show later, in respect of funding the current account deficit, South Africa should aim to lift the average annual net FDI closer to the \$5-10bn range. This requires decisive steps to improve the climate for foreign investment across the economy, and to aggressively compete globally for that investment

Real asset returns compare favourably

Historical returns and rates from 1980 to 2012

Local Nominal and Real Returns Across Major Markets (1980-2012)

	Japan	Switzerland	Germany	US	France	Australia	UK	Italy	South Africa
Nominal Asset Returns									
Cash	2.4%	3.1%	4.7%	5.1%	5.2%	8.5%	7.3%	6.1%	12.8%
Bonds	6.7%	5.4%	7.6%	10.0%	11.2%	10.1%	11.0%	10.7%	13.4%
Stocks	2.9%	8.6%	9.1%	11.1%	10.9%	11.7%	12.4%	9.7%	18.0%
Exchange Rate vs. USD	3.1%	1.7%	0.5%		(0.6)%	(0.2)%	(0.9)%	(1.8)%	(6.8)%
Inflation	0.9%	1.9%	2.2%	3.4%	3.3%	4.4%	4.3%	5.4%	9.5%
Real Asset Returns									
Cash	1.5%	1.2%	2.4%	1.6%	1.8%	3.9%	2.9%	0.7%	3.0%
Bonds	5.7%	3.4%	5.3%	6.4%	7.6%	5.5%	6.4%	5.0%	3.6%
Stocks	2.0%	6.6%	6.8%	7.4%	7.4%	7.0%	7.8%	4.1%	7.8%

Higher inflation, depreciating currency, but similar long term real returns for ZAR investors

Real Returns to ZAR Investors (1980-2012)

	Japan	Switzerland	Germany	US	France	Australia	UK	Italy	South Africa
Real Returns in ZAR									
Cash	3.5%	2.8%	3.1%	2.9%	2.4%	6.1%	4.2%	2.1%	3.0%
Bonds	7.7%	5.0%	6.0%	7.8%	8.3%	7.7%	7.8%	6.5%	3.6%
Stocks	4.0%	8.2%	7.5%	8.8%	8.1%	9.2%	9.2%	5.6%	7.8%

Source: Dimson, Marsh & Staunton, Global Investment Returns Sourcebook 2013, Credit Suisse

Real asset ZAR returns have compared favourably

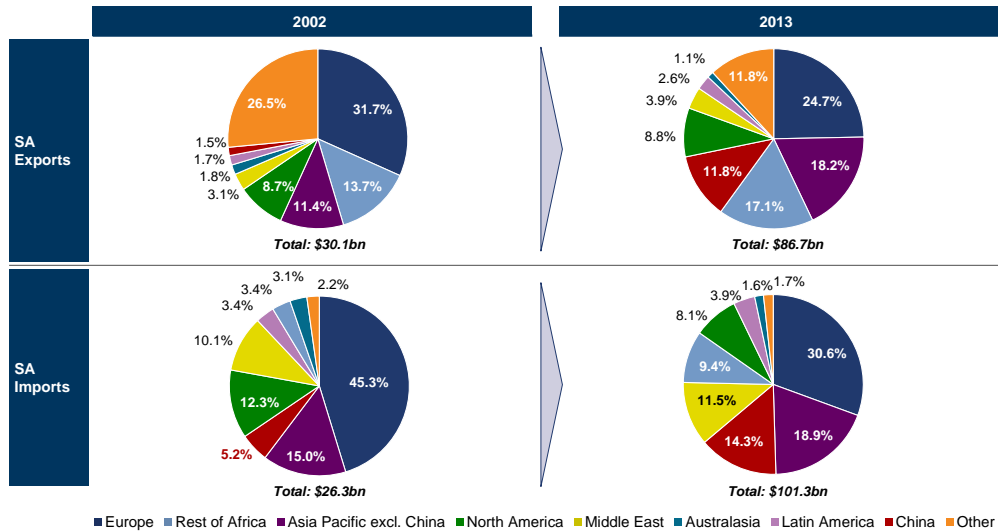
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- This analysis, summarised in the box on the bottom of the RHS as highlighted in yellow, demonstrates the comparative returns for a ZAR investor if they were free to invest, after removing all currency effects, freely in cash, bonds and stocks across these markets over the period 1980 to 2012
- The results reveal that the performance of South African cash and stocks are largely in line on a global basis, although bonds have underperformed
- This picture reflects favourably on returns for SA investors notwithstanding exchange controls, inflation and currency effects

6 China dominates growth in SA trade

Europe's contribution largest but falling rapidly

Since 2002, SA's exports to China have increased at a CAGR of 33% (total export CAGR of 10%) and SA's imports from China have increased at a CAGR of 24% (total import CAGR of 13%)



China's FDI presence in SA has grown from c.R340m in 2005 to c.R50bn in 2012, according to the SARB

Source: Euromonitor database

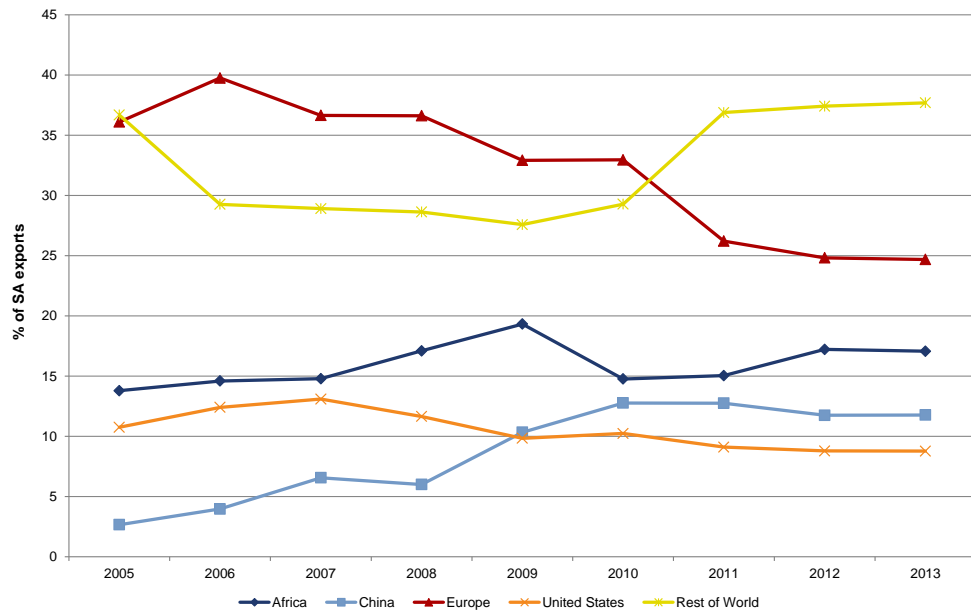
China and African trade rise has largely offset European trade decline

19

The increasing volume of imports from and exports to China has somewhat compensated for the decline in trade with Europe

- Whilst exports to Europe decreased from 32% to 25% since 2002, exports to China increased from 1.5% to 12%
- Similarly, while imports from Europe have decreased from 45% to 31%, imports from China have increased from 5% to 14%
- This reflects the growing importance of China. Africa's contribution to trade is also an improving trend though more should be done to accelerate intra Africa trade

A rise in China exports has offset the fall to Europe and Africa potential remains



Source: Euromonitor database

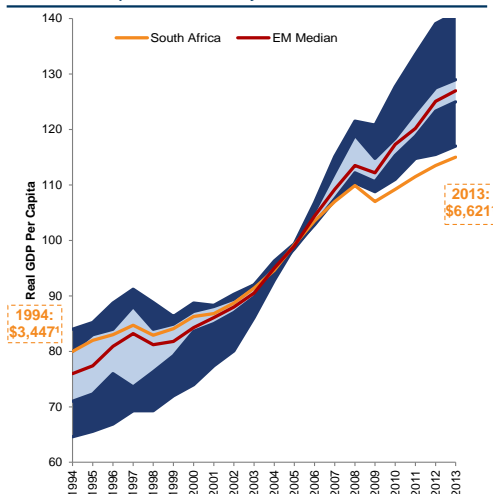
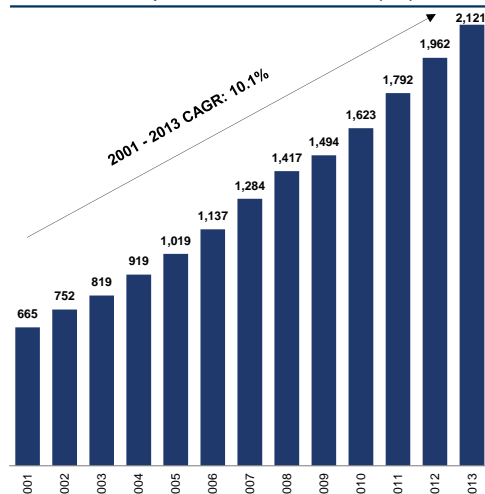
China and African trade rise has largely offset European trade decline

20 |

- This graph shows how China's rise in trade, supported by a moderate increase from Africa, is offsetting Europe's declining trade contribution (off a high base)
- Corporate expansion into Africa is helpful and should be further encouraged and facilitated to increase trade linkages across sectors
- Goldman Sachs forecasts 2014 GDP growth for Europe of 1.7% from (0.5)% in 2013, a positive swing of 2.2% in 2014. This will hopefully also see Europe's declining pattern of trade with SA stabilise

Annual disposable income of South Africans has increased in line with real GDP per capita gains

Real GDP Per Capita has Increased by About 90% Over the Last 19 Years

Annual Disposable Income of South Africans (Rbn)²

South Africa's registered individual taxpayer base has increased from 1.7m people in 1994 to 15.3m in 2013³, resulting in an increase of tax revenues from R114bn in 1994 to R900bn³ in 2013 (at a CAGR of 11.5%)

Source: IMF, Euromonitor, National Treasury, Stats SA

¹ Based current prices as per IMF data

² Defined as gross income minus social security contributions (e.g. pensions) and income taxes; excludes illegal income.

³ Based on National Treasury estimates in the 2014/15 National Budget

Disposable income of South Africans has risen

21

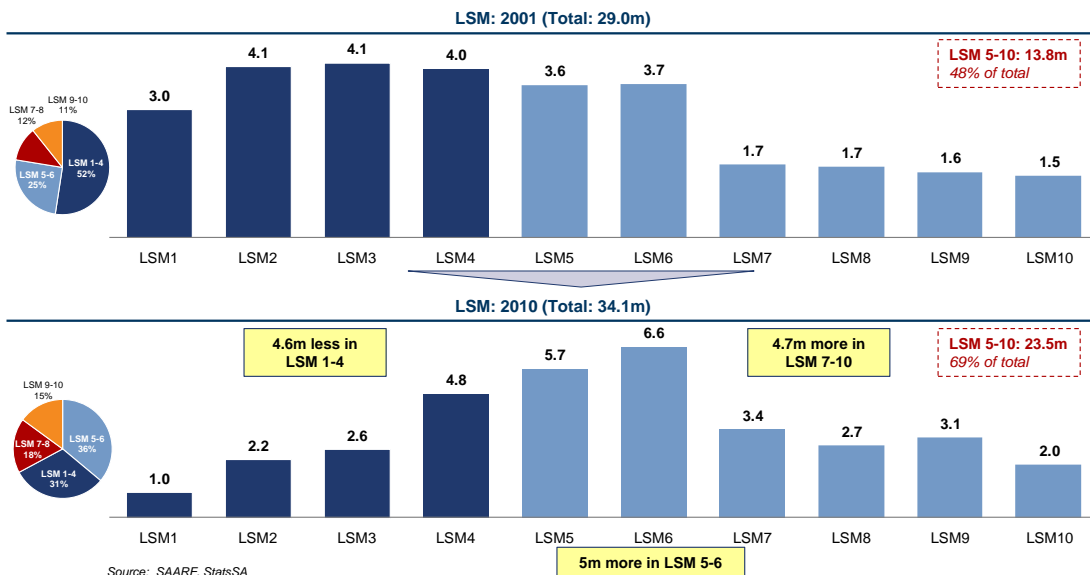
- The graph on the LHS shows the rise, according to a recent IMF report, in real GDP per capita from just under \$3,500 in 1994 to \$6,621 in 2013, a 90% increase
- The evolution of the poor and the rise of the African middle class are particularly important demographic shifts
- The effect of this is depicted on the RHS, as the graph shows cumulative annualised growth in the annual disposable incomes of South Africans of 10.1% in the period to R2,121bn
- Remarkably, and thanks to the improving efficiency of the widely lauded SARS administration of tax collection, SA's registered tax payers increased from 1.7m in 1994 to 15.3m with tax collections dramatically increasing from R114bn in 1994 to R900bn in 2013

Around 10 million South Africans have entered LSM 5-10 in one decade

INVESTMENT BANKING
DIVISION

Improvement in Living Standards Measure¹ (LSM) Since 2001

The percentage of population falling in the LSM 1-4 bracket has materially decreased, with a corresponding shift in higher income consumers



Source: SAARF, StatsSA

¹ LSM is a wealth measure based on standard of living rather than income.

The rise of the black middle class has led to a structural boost in spending

22

The rise in disposable incomes of South Africans has resulted in a remarkable progression in the LSM (Living Standard Measure) profile of the country

- This is a standard method used to measure the population in 10 income categories
- Between 2001 and 2010, the number of people in the LSM 1-4 categories (which is the lower income group) decreased significantly from 52% to 31%, resulting in 4.6m less people in the lower income group. And the number of people in the LSM 5-10 increased from 48% to 69%, resulting in almost 10 million more people graduating into the middle to upper band. This was an average of 1 million people per year over a 10 year period, a truly remarkable development
- The largest numbers of people are now in LSM 5-6 (middle income) with 12.3m from 7.3m a decade earlier

8 The African middle class has more than doubled from 1993 to 2008

The biggest shifts over the period are a rise in African entrants into the middle class and a rise in white entrants into the upper class segment

Race and Class Size (in Thousands of Individuals)

		Lower Class	Lower Class	Middle Class	Upper Class	Total
		Below Poverty Line	Above Poverty Line			
		< R515 ¹	R515 - R1,399 ¹	R1,400 - R10,000 ¹	> R10,000 ¹	
African	1993	21,399 (70%)	6,755 (22%)	2,235 (7%)	19 (0%)	30,408
	2000	23,053 (66%)	7,769 (22%)	4,006 (12%)	112 (0%)	34,940
	2008	23,438 (61%)	9,361 (24%)	5,377 (14%)	257 (1%)	38,433
White	1993	183 (4%)	375 (7%)	4,158 (81%)	400 (8%)	5,116
	2000	87 (2%)	298 (7%)	3,055 (75%)	650 (16%)	4,090
	2008	125 (3%)	473 (11%)	2,958 (67%)	888 (20%)	4,444

But 85% of Africans remain poor and 87% of whites remain middle-upper class

Source: Project for Statistics and Living Standards 1993, the Income and Expenditure Survey 2000 and the National Income Dynamics Study 2008
¹ Defined as the monthly income per capita in constant 2008 prices (measured in after-tax earnings)

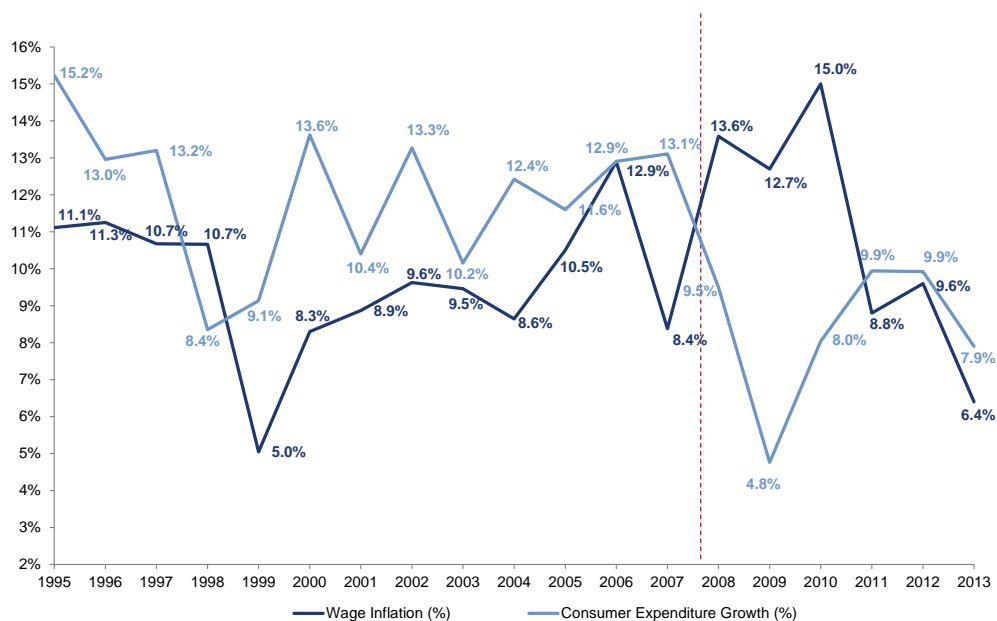
The rise of the black middle class has led to a structural boost in spending

23 |

These shifts in income or wealth can be further analysed by race

- The middle class has doubled from 7% of the African population in 1993 to 14% in 2008, a rise of 3.1m more Africans in the period to 5.4m
- Over the same period, the white middle class decreased from 4.2m people to 3.0m. Of that decrease, 0.5m whites graduated to the upper class income and the other 0.7m people emigrated (as evidenced by the overall decline in the white population from 5.1m to 4.4m over the period)
- Therefore, in absolute terms, Africans now dominate the middle class consumer segment, while white people who stayed have on aggregate become wealthier
- The stark reality is that 85% of Africans still remain poor (shown by the red circles), while 87% of white South Africans are in the middle to upper class categories (shown by the green circles)

Consumer expenditure growth supported by wage inflation and government grants...



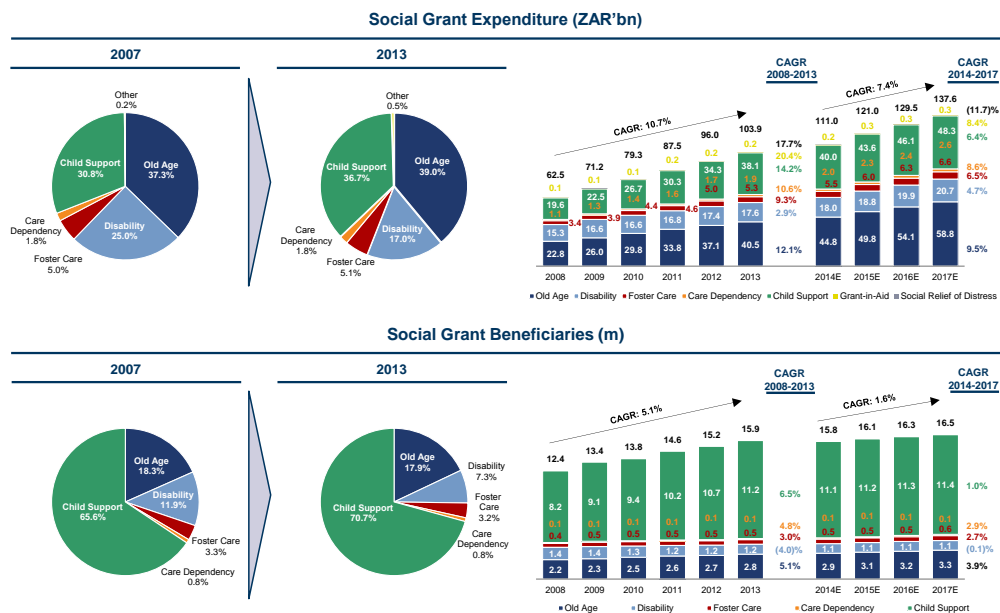
Source: Euromonitor, StatsSA, ILO

Wage inflation and government grants have supported this trend

- Real wage inflation of around 4% per annum and social grants have boosted consumer expenditure

...which are expected to increase albeit at a less accelerated rate

Social grants



Source: Natural Treasury Budget Review 2014/15 and 2009

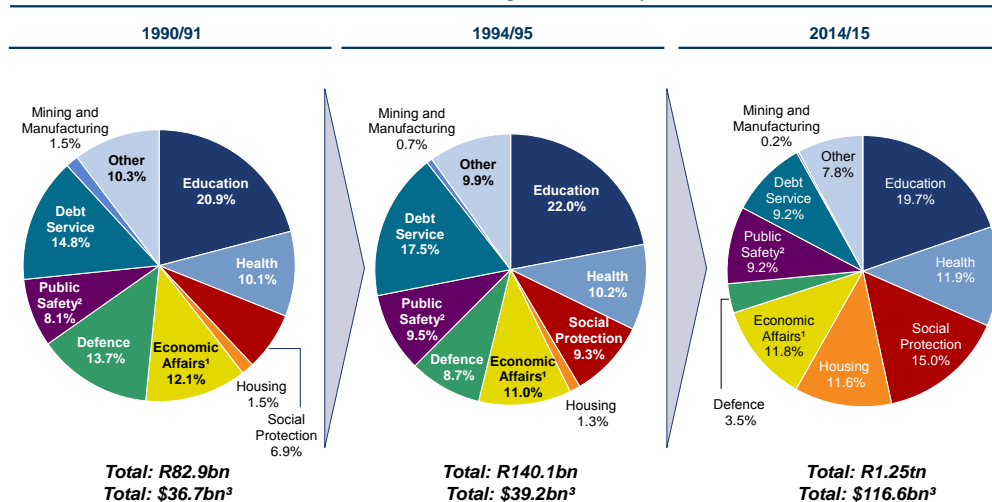
Wage inflation and government grants have supported this trend

Government grants are now distributed to around 16m people

- The value of the grants has been similar between children and the old age, who are the major beneficiaries
- Children are the dominant beneficiaries by number of people (around 70% of total grants)
- These trends are expected to continue through to 2017, with a CAGR of around 7% in total expenditure, a slightly lower pace of growth than the 5-year CAGR since 2008
- Treasury remains committed to sustaining this programme

Social protection and housing expenditure has expanded whilst defence spend and debt service has reduced

South African National Budget Allocations by Function



Source: National Treasury

¹ Includes general economic and labour affairs, agriculture, forestry, fishing, fuel and energy, transport, communication and environmental protection² Includes police services, law courts, prisons and other safety services³ Converted at the average ZAR/USD rate for each respective year and the spot rate on 1-Mar-14 for the 2014/15 budget

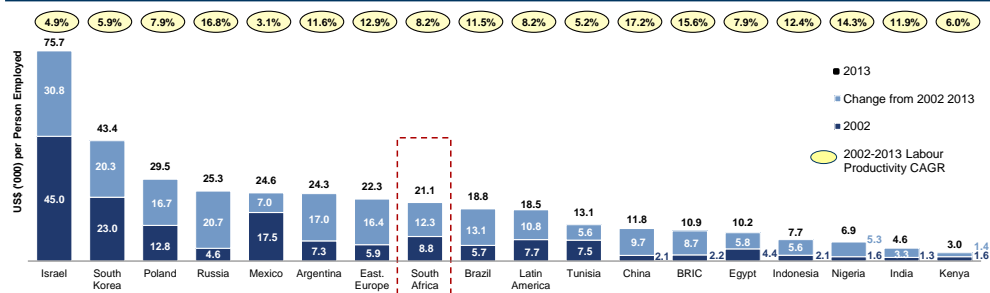
Wage inflation and government grants have supported this trend

26 |

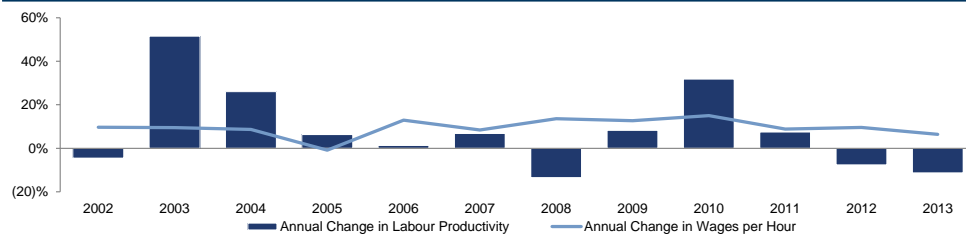
- A review of the National Budget reveals that in US dollar terms, expenditure has increased by over 3x from \$37bn in 1990 to \$117bn in 2014
- In 1990, the combined expenditure on the non-productive areas of debt service and defence was 28.5%, compared to only 12.7% in 2014; effectively more than halving as a % of total allocated expenditure
- A more prudent fiscal approach has resulted in a reduction in debt service costs from c.15% of total budget allocation in 1990 to just over 9% today
- The combined increased spend on social protection, housing and education from 29.3% in 1990 to 46.3% in 2014 of total budget allocation is reflective of changing priorities geared towards human development and a larger focus on narrowing the poverty gap

Labour productivity has improved on a per unit basis... but not in line with labour cost increases

Labour Productivity of South Africa and Other Emerging Markets¹



However, Labour Cost Constantly Rising Relative to Productivity Over the Period



Source: Euromonitor International from International Labour Organisation (ILO)/Eurostat/National Statistics, Statistics South Africa

¹ Productivity defined as the output of goods and services in the economy per employed person. It is calculated as gross domestic product divided by employed population.

Per unit labour productivity has improved

27

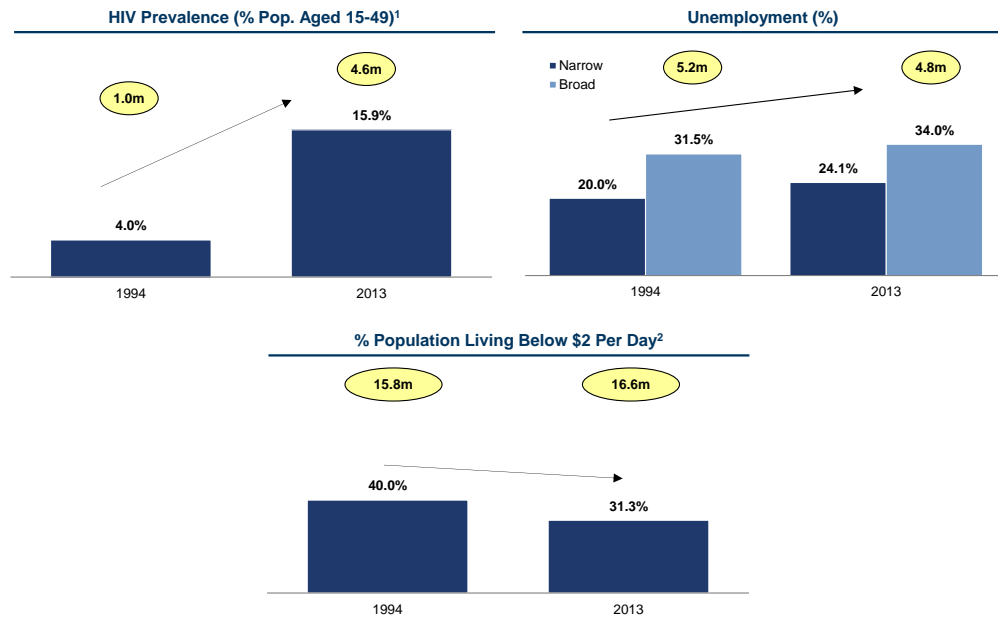
South Africa's per unit labour productivity has improved over the last decade by 8% per annum

- Productivity output has increased from \$8,849 per worker in 2002 to \$21,100 in 2013, positioning SA well relative to other growth markets on this measure
- However, nominal unit labour costs over the period have risen at a higher frequency than labour productivity
- In essence, fewer workers are producing more; however the value of productivity gains are not keeping pace with the rising cost of the workforce
- Should SA find a formula for employing more people at a cost lower than the value of associated production, the good news is that individual employee productivity is healthy by global growth market standards and such job creation should lead to expansion of GDP

-
- iii ...but large challenges to further transform the economy and defend structural advances remain...
-

Decisive improvement is required in the following 10 key areas

- 1 Unemployment and inequality
- 2 Current account deficit
- 3 Recent fiscal trends and volatility of currency
- 4 Savings rate and consumer indebtedness
- 5 Manufacturing / mining sectors
- 6 Labour instability and wage inflation
- 7 Education / health outcomes and public sector productivity
- 8 Infrastructure
- 9 Computer & internet access / research & development / patents
- 10 Sovereign credit ratings under pressure



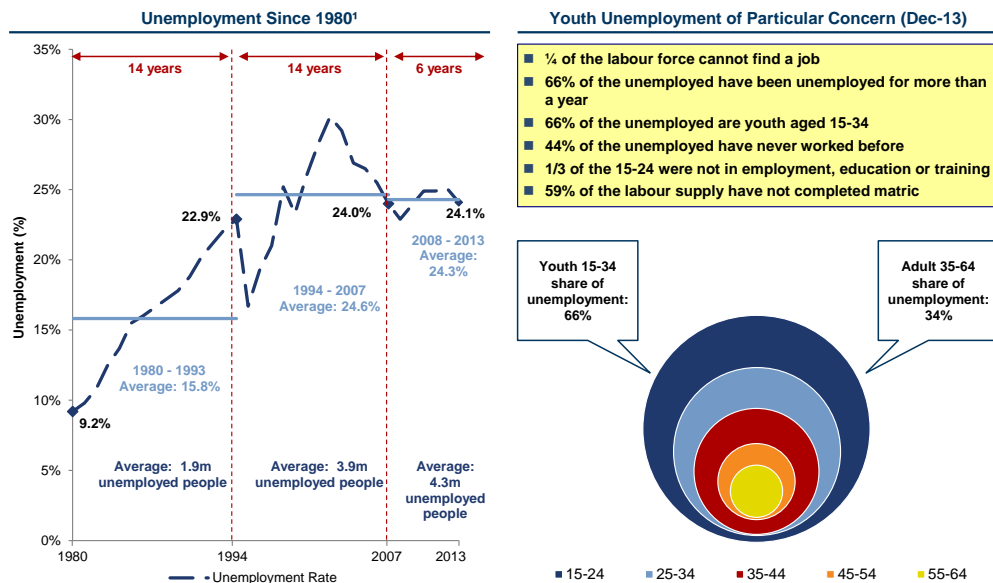
Source: World Bank, SA Labour Force Survey

¹ Based on latest available estimates² Based on latest available % from the World Bank database applied to SA population from IMF WEO Database as at April 2014

Unemployment and inequality

30 |

- 4.6 million people between the age of 15 and 49 in SA live with HIV and 6.4 million of the total population are infected. The expansion of the current ARV programmes and the lowering rate of infection are positive signs of the effects of a rising attack by South Africans on the disease
- 4.8 million people are looking for and cannot find jobs, and another 2.2 million have given up looking for work. Together this represents a broad unemployment rate of 34%
- 17 million people today live below the commonly used \$2/day poverty line
- This is SA's triple challenge of HIV, unemployment and poverty still affecting the lives of around one third of the population



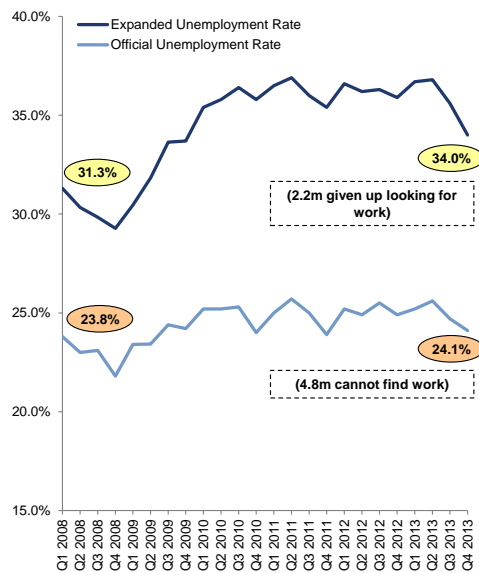
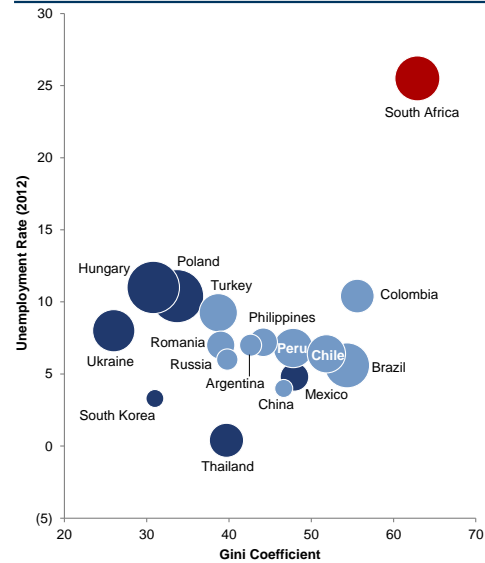
Source: Euromonitor, Stats SA Quarterly Labour Force Survey

¹ Unemployment according to the narrow definition i.e. unemployed workers are those who are currently not working but are willing and able to work for pay, currently available to work, and have actively searched for work.

An understanding of the nature of SA's unemployment challenge is of paramount importance to effectively address the situation

- In the period leading up to 1994, the unemployment rate rose quite significantly as we experienced an era of sanctions, unrest and de-industrialisation. Whilst the chart reflects a steep rise in unemployment from a base of around 9% in 1980, this is probably understated as the former "Bantustan" areas (which were home to high unemployment levels) were likely not reflected in the statistics
- Democratic South Africa inherited an unemployment rate of 23%
- Unfortunately, this rate has remained static around the mean of c.24% (excluding the broader unemployment definition)
- Of the almost 5 million unemployed people, 66% are youth aged between 15 and 34, making it a largely youth unemployment problem
- 59% of the labour supply have not completed the matric school leaving qualification

South Africa's Unemployment by Definition: 2008-2013

High Unemployment and Inequality¹
(Latest Available Observation)

Source: Statistics South Africa, IMF

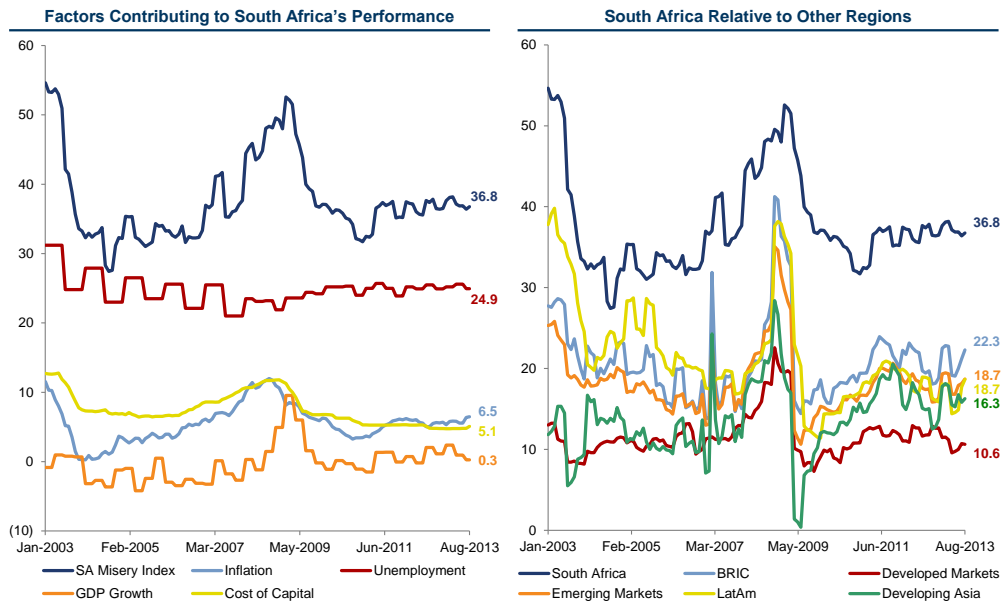
¹ Blue represents a decrease and red an increase in unemployment between 2008 and 2012. The size of the bubble illustrates magnitude of the change in unemployment

Unemployment and inequality

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- 4.8m people cannot find work and a further 2.2m (and rising over the last 5 years) have given up looking for work, so in total around 7m South Africans are unemployed (or 34% of the labour force) whilst 15m have jobs
- South Africa has the highest gini coefficient (measure of the income inequality of the population) amongst peers, although now down from its peak of 72 in 2006 to 69 in 2011 (latest available data)
- Brazil by comparison has, through economic growth and social distribution, improved from a high of 61 to now 55 over a decade period

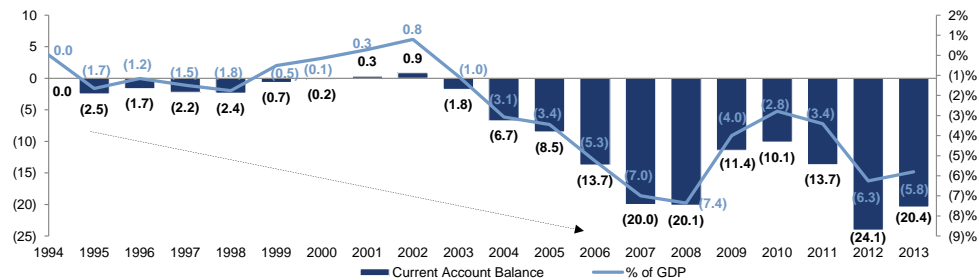
Unemployment remains South Africa's biggest hurdle... "Misery Index"¹



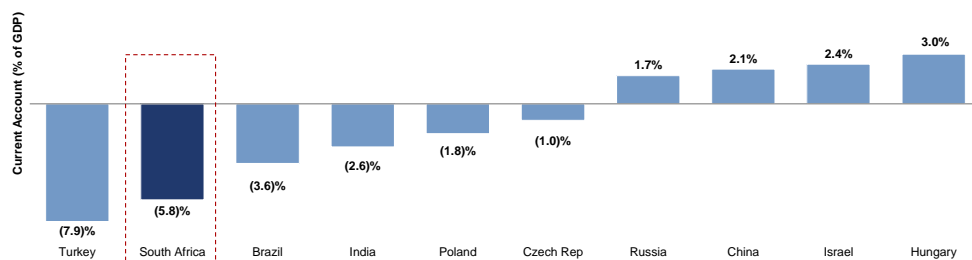
- The "Misery Index" is a global economic tool used to measure the macroeconomic hardship of countries based on inflation, unemployment, GDP growth relative to potential GDP and cost of capital
- Not surprisingly, we see that the largest contributor to South Africa's "misery" score is the high unemployment rate, accounting for 24.9 of the 36.8 index rating as shown by the red line on the LHS graph
- GDP, cost of capital and inflation factors are stable and trending lower
- The RHS graph shows that in the last decade, South Africa has underperformed on a relative basis relative to other markets. Unemployment remains the Achilles heel

The current account deficit remains high...

Current account deficit (\$bn)



High Deficit vs. Other Countries



Source: Euromonitor, South African Reserve Bank Quarterly Bulletin, GS Research

Current account deficit

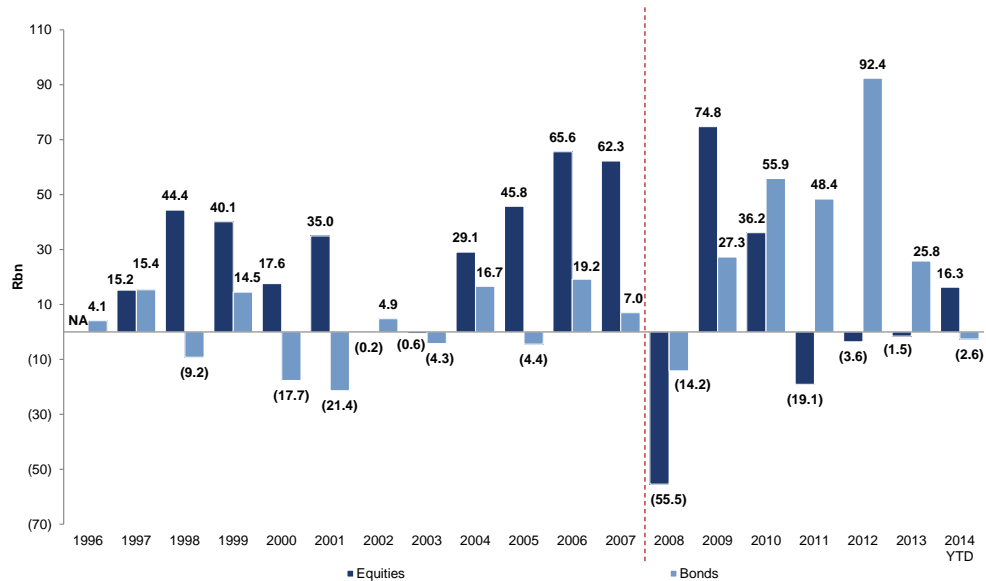
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At the top of the page, we see a gradual worsening of the current account deficit, now at 5.8% of GDP or around \$20bn

- From 1994 - 2003, the current account deficit was always less than 2%. From 2004 it rose to the lows seen in 2008 of 7.4%, returning to around 3-4% until 2012 when it returned to an elevated level around 6%
- This currently places South Africa at the highest end of the spectrum in terms of our peers, as can be seen at the bottom of the page, with Turkey, Brazil and India other high current account deficit countries
- National Treasury expects this deficit to remain stagnant at around the 6% level, decreasing only to 5.5% by 2016

...making the portfolio flows a source of vulnerability

Net foreign purchases/sales of SA equities and debt



Source: Bloomberg as of Apr-2014

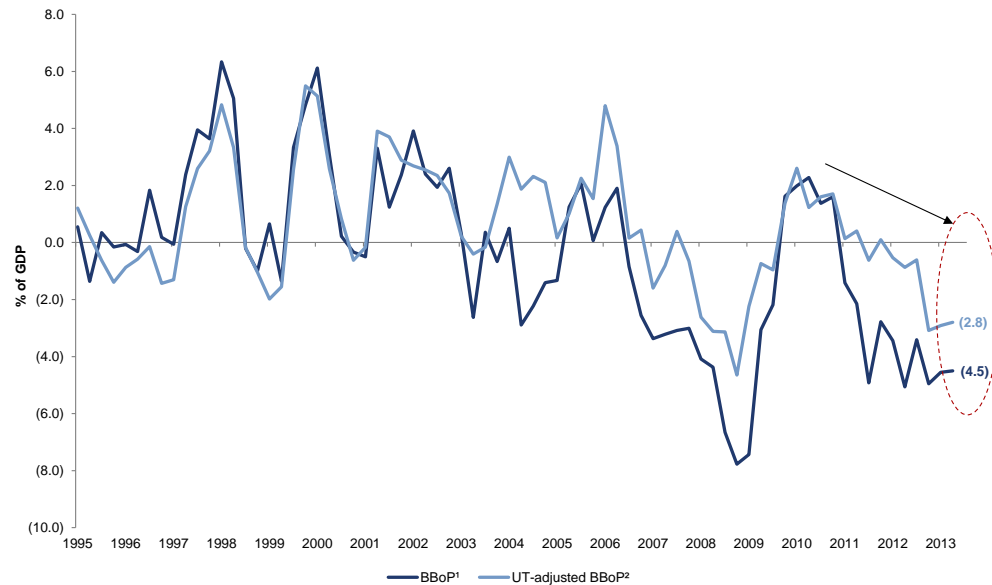
Current account deficit

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- The chart shows the portfolio flows into South Africa over the period, which is particularly important in the context of financing the current account
- The volatility of equity and bond flows can be observed over the period, demonstrating the vulnerability of South Africa should we rely on these flows as a major source of finance
- The increase in bond purchases (light blue bars) post the 2008 financial crisis as developed market yields fell is clearly noticeable. But as yields inevitably rise in developed markets in response to the tapering of quantitative easing the relative attraction of all growth markets, including SA on a risk adjusted basis, is likely to see a proportional decline in bond purchases. This can be seen in the negative bond purchases YTD in 2014

Removing the external vulnerability requires a significant correction...

c. 2% of GDP is required to restore the external balance



Source: Goldman Sachs Global Investment Research

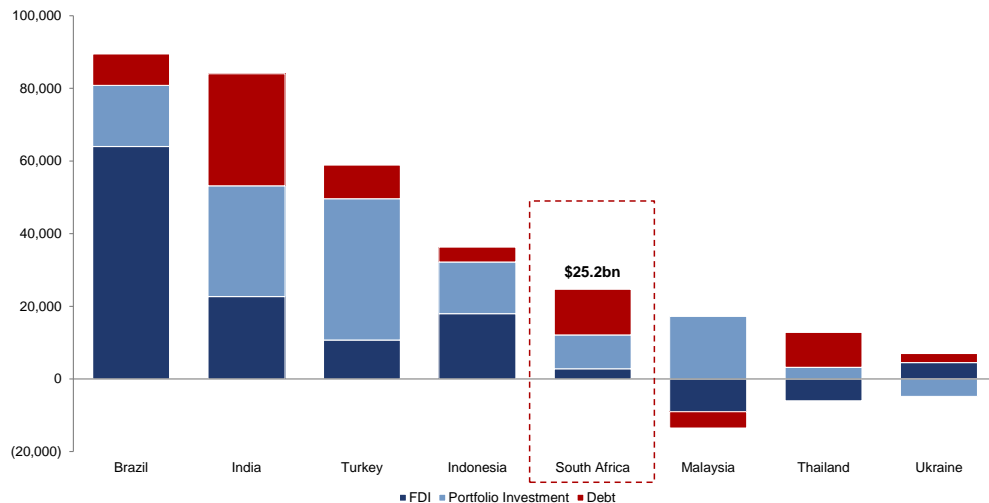
¹ BBOP denotes broad balance of payments (defined as Current Account plus net portfolio flows and net direct investments)

² UT is the unrecorded transactions or errors and omissions (in SA usually resulting from to lags occurring between the recording of individual transactions and the time of the actual payments flow)

- Goldman Sachs estimates that a correction equivalent to around 2% of GDP is required to remove the vulnerability and to restore the external balance

The composition of the capital account exposes India, Turkey and South Africa as the most vulnerable to a reversal of portfolio and external financing flows

Breakdown of Capital Account (2012, \$m)



Source: IMF, Goldman Sachs Research

Current account deficit

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South Africa, together with India and Turkey, is vulnerable to a reversal of portfolio and external financing flows

- The majority of the capital account of \$25bn is funded by debt and portfolio inflows. The former gets more expensive to the extent the local currency depreciates and the latter is volatile and uncertain
- Therefore, while South Africa needs to revitalise its export sector (in particular mining and manufacturing) and bring down the current account deficit, South Africa also needs to take aggressive steps to attract FDI to fund it. A range of \$5-10bn net FDI per annum would significantly assist and improve the quality of financing available
- South Africa needs to work hard on improving the framework and picture for FDI by welcoming investors, improving the labour environment, and by decreasing the overall costs and complexity of doing business. South Africa needs to find a better balance of attractive returns for investors whilst requiring investor compliance with empowerment, licensing, taxation and other domestic requirements

The global backdrop is of elevated risk to emerging markets

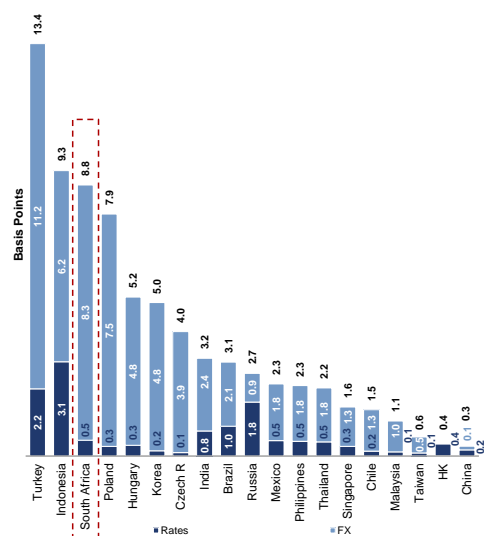
EMs have displayed significant vulnerability to US “policy shocks”

Historical Perspective and Importance of “Global Variables”



The EM market sell-off which started in May-2013 on the back of “Fed tapering” talk has triggered a profound change in EM outlook with market participants being reminded of earlier episodes of EM stress when (1) core yields rose (2) the USD rose (3) commodities fell

Total Local Response¹ to a 1bp Shock to US Rates Caused by Change in US Policy (Average from 2001 – Present)



Source: GS FX Sales Strats (GS Securities Division) as of Aug-2013. Past performance not an indicator of future returns
¹ Predicted Response to 1 bp change in US Rates (in bp).

The global backdrop is one of elevated risk for growth markets as the "Fed tapering" is set to get underway

- The chart highlights historical crises related to growth markets
- South Africa's currency is highly sensitive to US interest rate changes

FX exchange rate is the shock absorber

ZAR evolution vs. USD



Source: Datastream as of Apr-2014

Recent fiscal trends and volatility of currency

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The ZAR, one of the most liquid and tradable currencies globally, serves as the shock absorber for these market forces

- Historically, the ZAR has been highly volatile. In the 14 years up to 1994 the ZAR/\$ traded at an average of R2/\$, in the 14 years post 1994 the average was R6.30/\$ and in the last 6 years it has been at an average of just over R8/\$

Although EM currencies are vulnerable as a result of low commodity prices

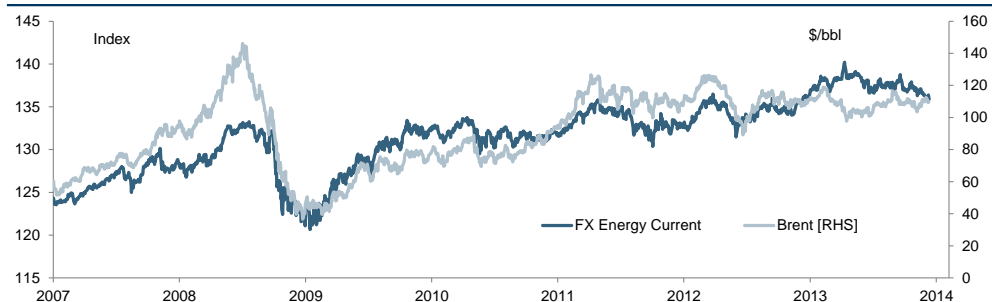
Net commodity exporters expected to experience downward FX pressures

Copper and oil have the closest link with exporter currencies – which is unsurprising given these commodities dominate the share of exporters' trade balances

Key Trends

- After a decade of elevated commodity prices, Goldman Sachs expects the supply response to result in a continued decline in prices through 2014
- This presents a high downside risk for large commodity exporting emerging markets (EMs), particularly those with large deficit balances such as South Africa
- Copper and oil demonstrate the highest correlation with EM forex movements as can be seen below
- South Africa and Peru, as the largest exporters of gold, remain vulnerable to the precious metal's performance

High Correlation of Energy Exporters FX to Oil Prices

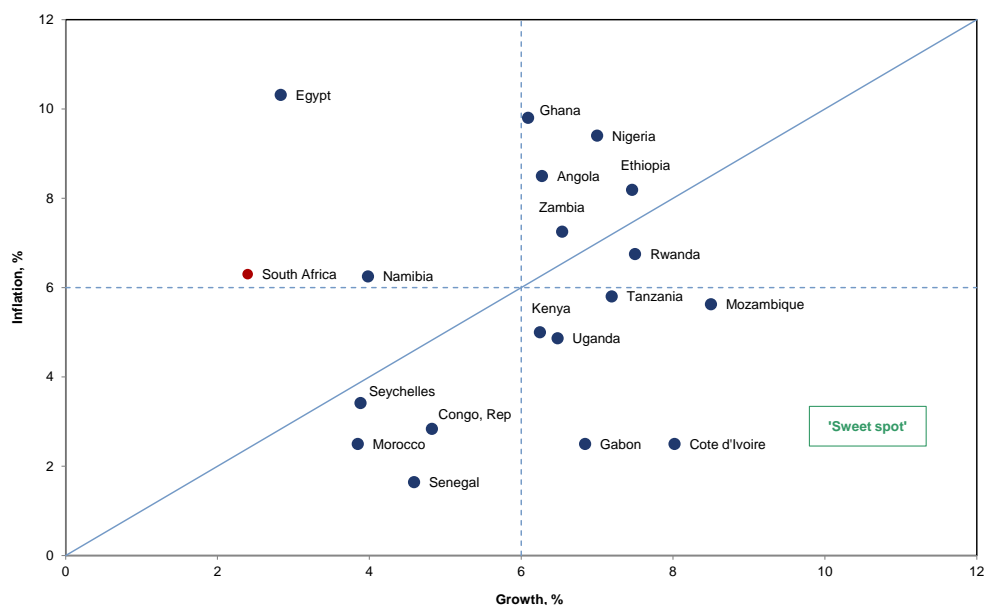


Source: GS Global Investment Research

Recent fiscal trends and volatility of currency

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- Goldman Sachs research finds a significant correlation between the performance of export-driven emerging market currencies and movements in commodity prices over time
- As global commodity prices continue to experience downward pressure, economies like South Africa remain vulnerable as large net exports (as a % of GDP) and current account deficits limit the resistance against FX movements



Source: Haver Analytics, Goldman Sachs Global Investment Research

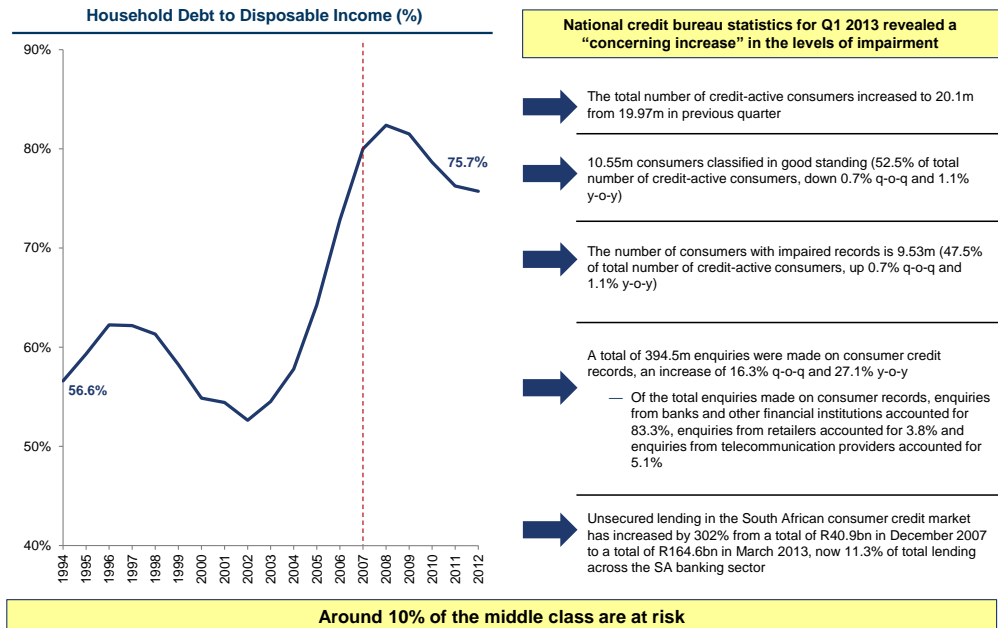
Recent fiscal trends and volatility of currency

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- The re-pricing of emerging market (EM) risk in developed markets is augmented by a cyclical macro deterioration – marked by slower growth, inflationary pressure and widening twin deficits in African countries – which we believe is not yet fully priced into the “Africa premium”
- The combination of a low growth environment together with a high current account deficit results in increasingly significant vulnerability, evidenced by the few countries in the ‘sweet spot’ of relatively low inflation and high growth
- South Africa’s current real GDP growth of around 2% therefore places it at the unattractive end of relative risk-reward quartiling. Increasing growth rates must therefore be a priority

South African savings rates remains low and the SA consumer is now highly indebted

47.5% or 9.5m South Africans have impaired credit records



Source: National Credit Bureau, GS Global ECS Research

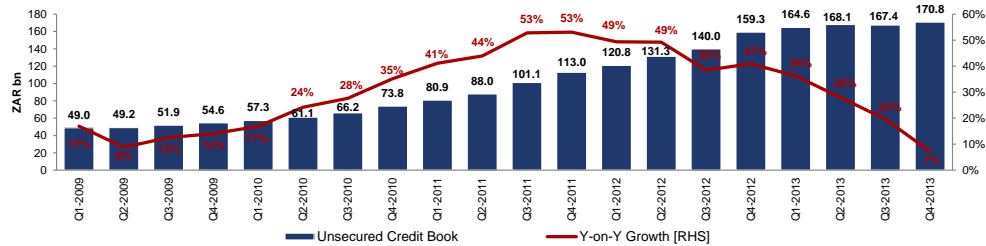
Savings rate and consumer indebtedness

42 |

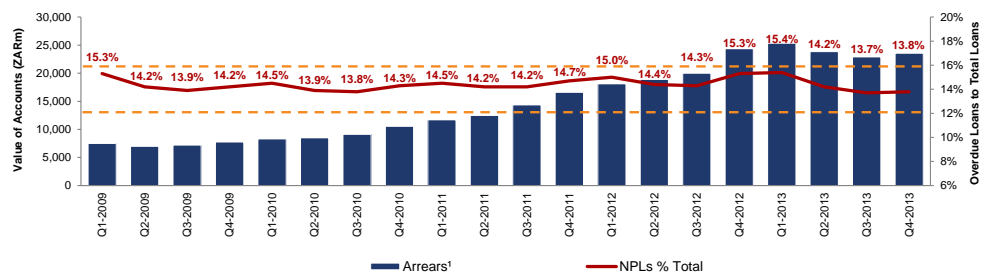
- As household debt to disposable income has built up to 76% now from 57% in 1994, it is natural to expect some "indigestion" from over indebtedness accompanying the rise of the middle class
- The growth in unsecured lending is a contributor to the trend (growing by 302% since 2007)
- However, unsecured lending makes up just over 11% of total lending in South Africa and so is not a systemic issue for the banking system
- The National Credit Regulator measures around 20m credit-active consumers, 9.5m of which have some impairment on their credit records
- Examining the non-performing loan ratios and debt recovery rates suggests that around 10% of those struggling with credit could default, slipping back into the lower income bracket, most likely from the LSM 5-6 category

4 The unsecured lending market is growing

High growth in South Africa's unsecured lending market



Arrears¹ to total loans have been in a band between 12% and 16%



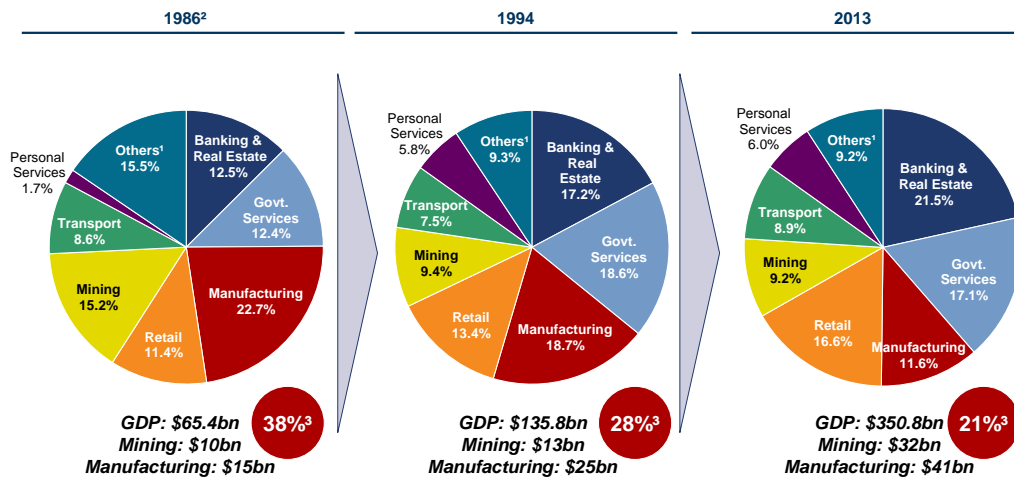
Source: National Credit Regulator; National Credit Bureau
¹ Defined by the National Credit Bureau as 1-2 months in arrears

- The peak of the year-on-year growth in unsecured lending (which shot up from 2010) was in 2H 2011 at around 53%. There has since been a major correction in the market and growth has tapered off to around 7% but now off a higher base of a total unsecured book of R170bn
- Arrears to total loans has trended within a consistent band of 12-16%, currently around the midpoint of 14%

Manufacturing and mining are falling as contributors to South African GDP

Banking and real estate rises the most

Composition of the South African Economy (Contribution to GDP at Current Prices)



Although mining now contributes c.9% to GDP, it accounted for 38% of total South African exports in 2012

Source: IMF, Statistics South Africa and SA Chamber of mines
¹ Others consists of Construction, Agriculture and Electricity, Gas and Water
² Earliest data available
³ Represent the sum contribution of Mining and Manufacturing to GDP

We have analysed the nature of the mix of GDP in the SA economy

- Mining and manufacturing's combined contribution to GDP has declined from 38% in 1986 to 21% in 2013. Given their contribution to both exports and jobs, this is a concerning trend
- Banking and real estate's contribution almost doubled from 12.5% to 21.5%
- Government services increased its contribution from 12% in 1986 to 18.6% in 1994 and, despite an increase in the number of public sector employees, has since declined to 17% in 2013
- Mining and manufacturing's multiplier effect on jobs and its outsized contribution to exports brings into focus the need to revitalise these sectors as critical to the overall health of the SA economy

5 Mining down, finance and government services up as contributors to GDP

% Change in the Quarterly Value Added by Industry to GDP (Constant 2005 Prices)

Driven by Secondary Industries

yoy %	2011		2012				2013			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture & allied	0.9	1.5	5.3	6.2	(2.8)	(2.2)	4.9	6.8	(2.9)	(1.9)
↓ Mining	(3.7)	(4.7)	(9.4)	(1.3)	(0.7)	(3.1)	3.5	(2.8)	2.7	9.4
Manufacturing	2.4	3.2	0.6	2.0	2.2	3.3	(0.3)	2.6	(0.4)	1.1
Utilities	1.1	0.5	(0.5)	(2.0)	(1.5)	(2.5)	(2.7)	0.1	0.9	0.0
Construction	0.6	0.4	1.3	1.6	2.7	3.6	2.0	2.2	2.4	4.5
Wholesale / Retail trade	4.4	5.0	4.7	4.2	3.5	3.1	2.2	2.4	2.0	2.1
Transport / Communication	3.0	3.2	3.0	2.7	2.2	1.9	1.8	1.8	2.1	2.0
↑ Finance / Real Estate	5.1	5.5	5.5	4.2	2.7	2.4	1.7	3.6	3.3	1.1
Government services	4.3	4.6	3.1	2.6	2.7	2.7	2.2	1.7	1.0	1.2
Personal services	1.6	1.5	1.6	3.0	2.8	0.8	1.9	1.5	1.8	1.9
Total value added	3.1	3.5	2.5	2.9	2.2	2.1	1.6	2.3	1.7	1.9
Taxes less subsidies on products	4.8	5.7	4.1	3.4	1.7	1.7	1.5	2.3	1.9	2.7
GDP at market prices	3.3	3.7	2.7	2.9	2.2	2.1	1.6	2.3	1.7	2.0

Source: SARB data, Stats SA

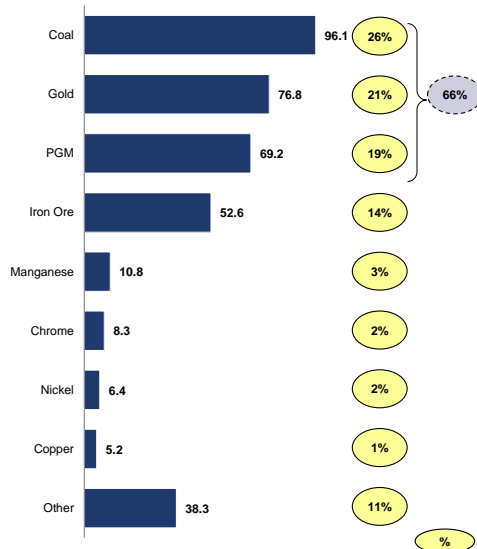
Manufacturing / mining sectors

45 |

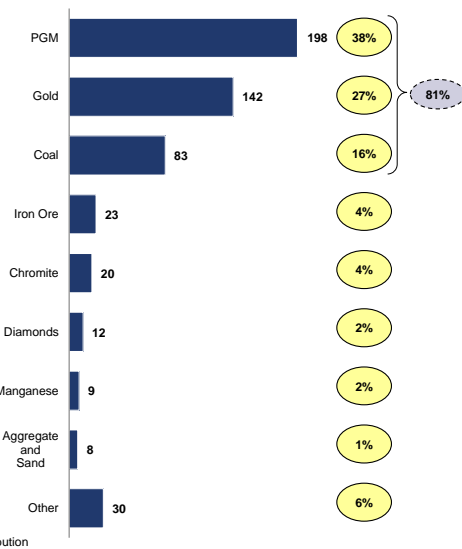
- The last 2 years have continued to see this trend as further evidenced by the consistent decline (in red) in the contribution of mining to real GDP growth and the simultaneous increase (in green) in the contribution of the finance, real estate and government services sectors

5 Platinum, gold and coal are 66% and 81% of revenue and employment contributors from mining

Sales Contribution Within Mining Sector¹ (ZARbn, 2012)



Direct Employment by Commodity ('000s, 2012)



Source: Global Insights, StatsSA, Chamber of Mines; DMR

¹ Represents nominal figures of commodity/basic material sales contribution as reported by Chamber of Mines, for primary production.

Despite its relative decline in contribution to GDP, mining remains a crucial aspect of the growth of South Africa, given our rich commodity base

- Within the mining sector, platinum, coal and gold account for 66% of the revenue and 81% of direct employment
- The future of the coal industry is linked for domestic uses to Eskom. Recent increases in BEE procurement requirements has raised additional hurdles for mining majors
- The platinum and gold sectors are experiencing challenging profit margins due to rising costs and labour unrest

Mining sector and labour uncertainties unsettle markets

JSE Resources Index impacted by labour unrest in 2012 and 2013



Source: Bloomberg as of Apr-2014

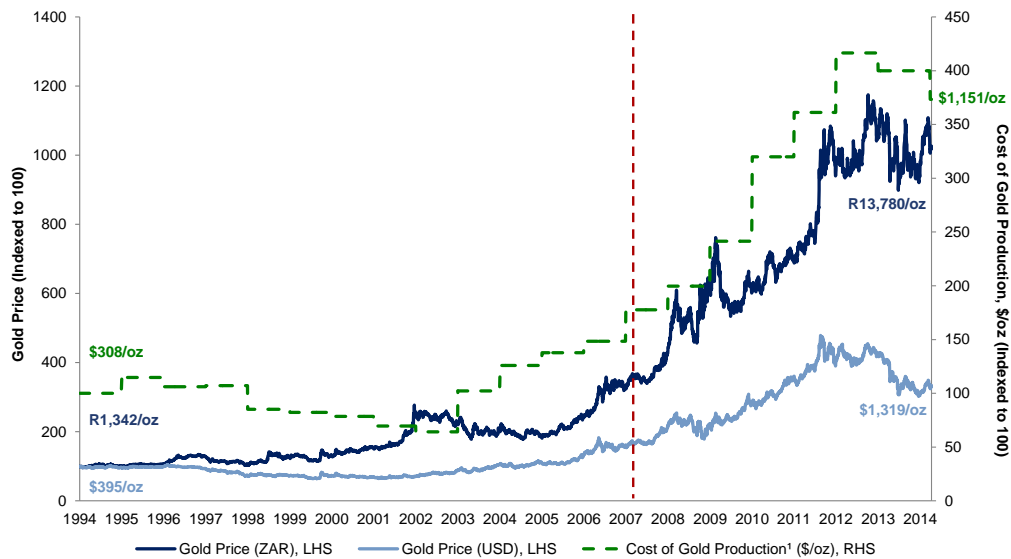
Manufacturing / mining sectors

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- The troubled post Marikana environment in the mining sector has seen a 40% underperformance of the JSE Resources Index (in light blue) relative to the overall JSE (in dark blue) since the beginning of 2012

ZAR gold price has increased significantly but cost rises offset commodity price gains

Mining “cost inflation” above CPI



The World Gold Council has recently published a guidance note on an “all-in sustaining costs” metric to provide further transparency into the costs associated with producing gold. This includes 17 sustaining cost items, among them royalties, community costs and permits

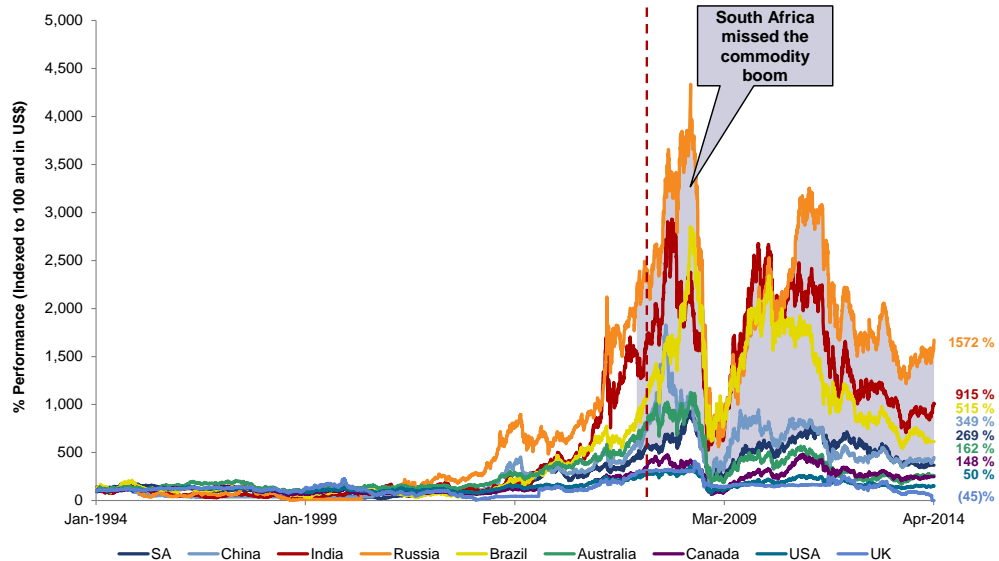
Source: Datastream as of Apr-2014; Wood Mackenzie Database

¹ Cost of production is derived by aggregating the cost of gold production for all mines in South Africa

- Notwithstanding a rise of the Rand gold price over the period of around 10x in ZAR terms since 1994 to just under R14,000/oz, profit margins in the gold industry have not improved
- The dotted green line shows a simultaneous rise in cost of gold production, largely related to increases in the cost of power and wages

South African natural resources stocks have underperformed BRICs since 1994 but outperformed developed markets

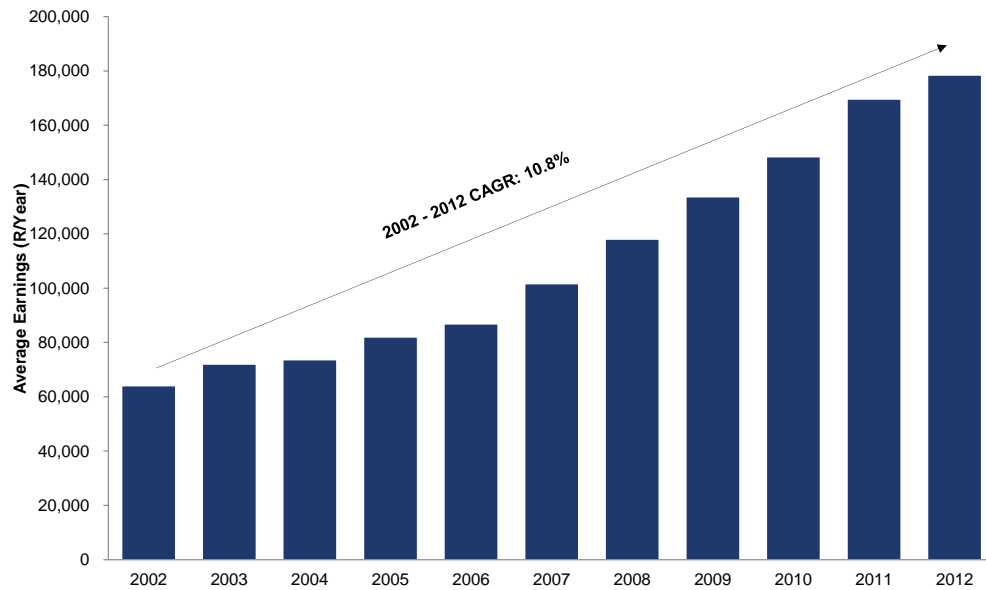
South African resources stocks have outperformed all developed markets since 1994 despite a more challenging macroeconomic and political environment



- Using the performance of the resource indices of various countries as a measure of the gains from the commodity boom, we see in the grey highlighted area that despite a global commodity price boom, South Africa failed to take advantage or benefit from this boom
- The overall regulatory approach to licensing, BEE, taxation, health and safety, environmental issues, labour and other areas has acted as a handbrake on investment in the mining sector in SA

5 Mining sector wage inflation at 11% over 10 years...

Average earnings in the mining sector (2002-2012)



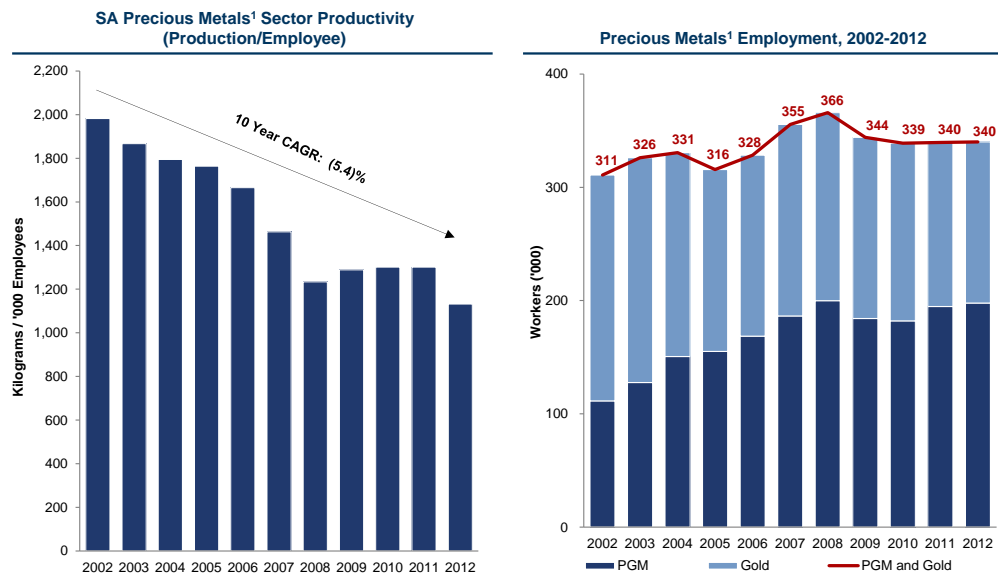
Source: SA Chamber of Mines

Manufacturing / mining sectors

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- One of the key contributing factors to this lower profitability of the sector has been the rising wage inflation of 11% per annum recorded over a 10 year period
- The recent wage settlements of around 8% is below this long-term trend and a step in the right direction for a sustainable mining sector

...while at the same time, PGM productivity has been falling by c.5% per year and employment has been broadly flat

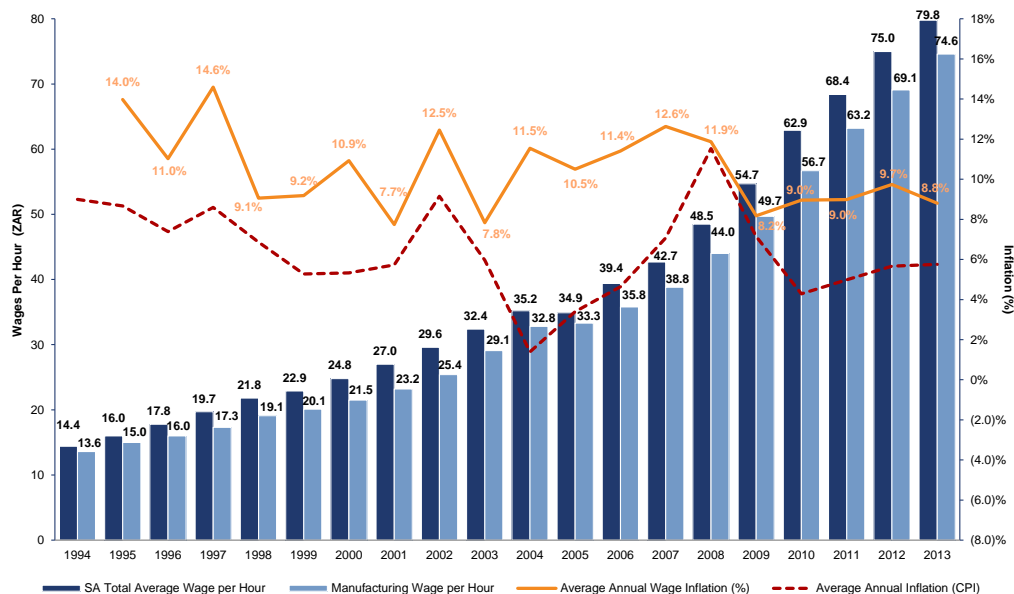


Source: SA Chamber of Mines, UBS Research
¹ Note: Consolidated Gold and PGM sector

- Whilst wage inflation has risen by 11%, productivity in the gold and platinum sectors (measured by tons per employee) has declined around 5% per annum over a 10-year period off a labour force that has remained relatively stable, albeit in a different labour mix between platinum and gold
- This trend of rising real wages and falling productivity is clearly unsustainable

Wages have grown at a consistently higher rate than inflation since 1994

Average wages per hour have grown at a 9.4% CAGR since 1994



Source: EuroMonitor; ILO, National Statistics

Labour instability and wage inflation

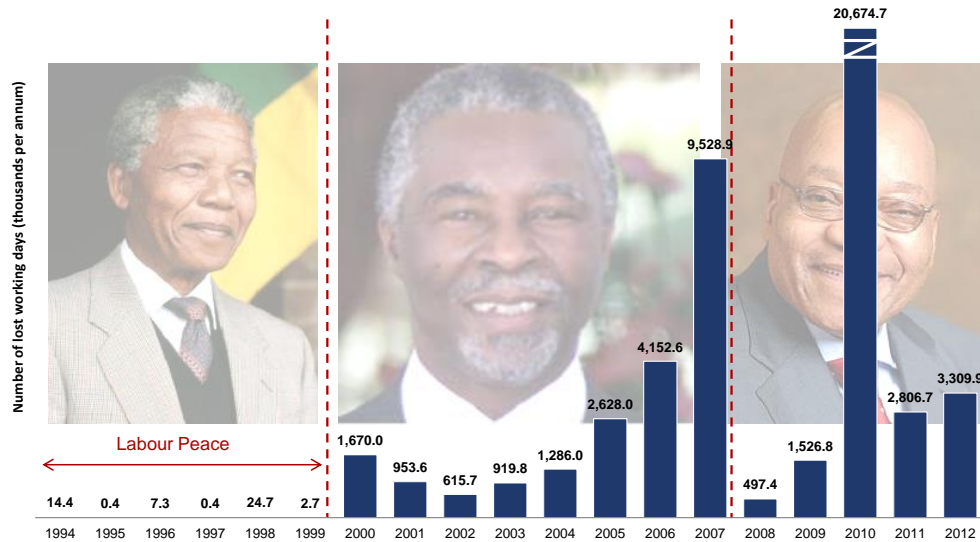
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- Since 1994, real wages across SA's economy have grown on average by around 4% per annum. The change in average annual CPI inflation (red line) is consistently lower than the average annual wage inflation (orange line) demonstrating the rebalancing of wages that has taken place since 1994. The employed have thus benefited significantly from these gains, however at a cost to broader growth, investment and job creation

Industrial strike action has increased significantly since 2005

The public sector is the focus for growth of trade unions

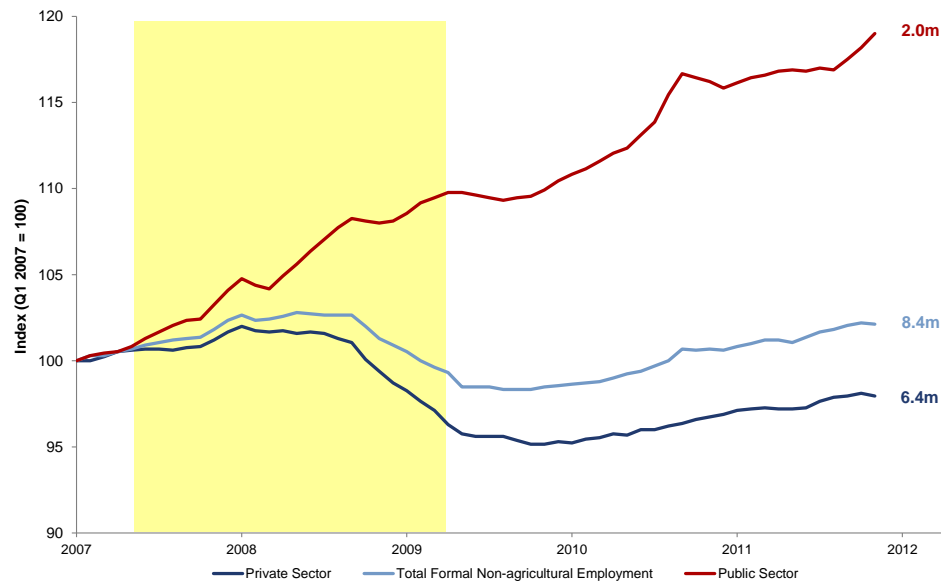
- Between 1994 and 2012, union membership in South Africa increased by c.23% to 3m people
- COSATU¹ has grown its public sector membership from 7% of total membership to 39% in 2012
- Total COSATU membership has grown from 1.3m in 1994 to 2.2m, with the largest affiliate being the NUMSA



Source: International Labour Organisation; SA Department of Labour
¹ Congress of South African Trade Unions

- Under President Nelson Mandela, SA witnessed a period of complete labour peace. Although some evidence of industrial action emerged under President Thabo Mbeki, industrial action was muted until 2005 when, in the run-up to the ANC's Polokwane elective conference, labour unrest significantly ramped up. In the midst of and the aftermath following the global financial crisis and post Polokwane with the election of President Jacob Zuma, SA experienced 2 years of relative labour peace. But since 2010, SA has experienced a significant upsurge in violence and strikes, including unprecedented inter-union rivalry and conflict
- Overall union membership increased by c.23% over the 20 years to around 3m people
- COSATU, with over 2m members, interestingly, has grown its public sector membership from only 7% of its own members at the start of the period to 39% in 2012
- Therefore, the SA Government has, in the ruling ANC parties' alliance structure, not only a political relationship with the unions but an intimate and complex employer relationship with its public sector union partners

7 Public sector employment has grown rapidly since 2007...



Source: SARB Quarterly Bulletin

Note: Indices first quarter 2007=100, seasonally adjusted, shaded area indicates a downward phase in the business cycle.

Education / health outcomes and public sector productivity

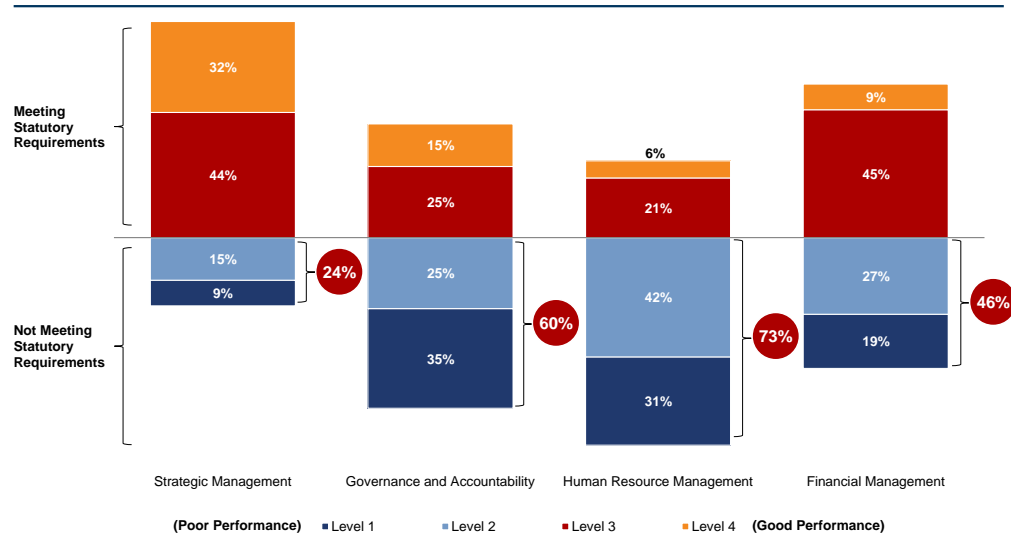
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- This chart illustrates the growth of the public sector to 2m people, now accounting for about a quarter of the 8.4m in total formal non-agricultural employment
- The public sector labour force comprised about 1.7m in 1994. The composition of the public sector (and its de-racialisation) has transformed since 1994

The Presidency Management Performance Assessment Tool

Performance lagging

2013 Total % Distribution of Final Scores Per Key Performance Area



Source: MPAT report, Management Assessment Tool: Statement of management practices in the Public Service

Education / health outcomes and public sector productivity

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The government, to its credit, recently published a self-assessment scorecard compiled by the Department of Performance Monitoring and Evaluation, under Minister in the Presidency, Collins Chabane

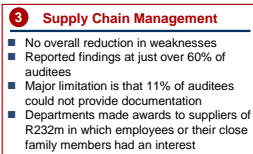
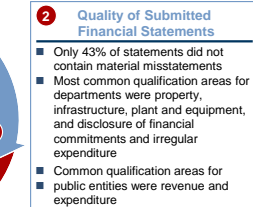
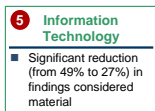
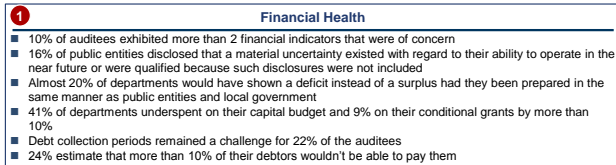
- The scope of the performance spans across all government departments across the entire public service administration
- The horizontal line/axis differentiates between where the government believes it is meeting its own statutory requirements (red and orange) and not meeting their requirements (dark and light blue)
- The area of strategic management is the one broad category on which the report ranks its performance a success
- But the areas of governance and accountability and human resource management (in particular) are cause for concern as they achieve a 60% and 73% failure rate respectively
- Financial management is an area with significant scope for improvement across Government
- It is clear that there is significant scope, based on this report, for a dramatic improvement in the public service administration

The performance of South Africa's government departments and public entities

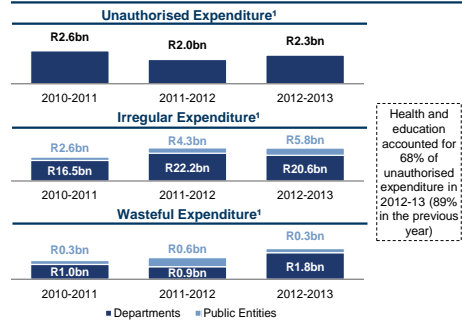
Key findings of the 2012-13 Auditor-General report

The report analyses all government departments (provincial and national level) and 313 public entities, collectively regarded as "auditees"

Key Areas of Risk

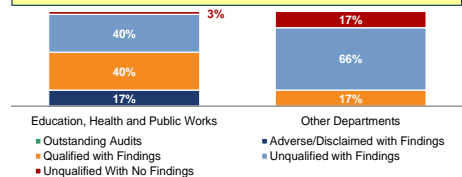


Unauthorised, Irregular and Wasteful Expenditure



Health, Education and Public Works Remains a Concern

57% of departments in Education, Health and Public Works (which contributed c.80% of total spending by departments) received a financially qualified opinion vs. 17% of other departments



Source: Auditor-General South Africa Annual Consolidated General Report 2012-2013

¹ Unauthorised expenditure is expenditure by departments that was not made in accordance with the approved budget. Irregular expenditure is expenditure that was not incurred in the manner prescribed by legislation. Fruitless and wasteful expenditure is expenditure that was made in vain and that could have been avoided had reasonable care been taken.

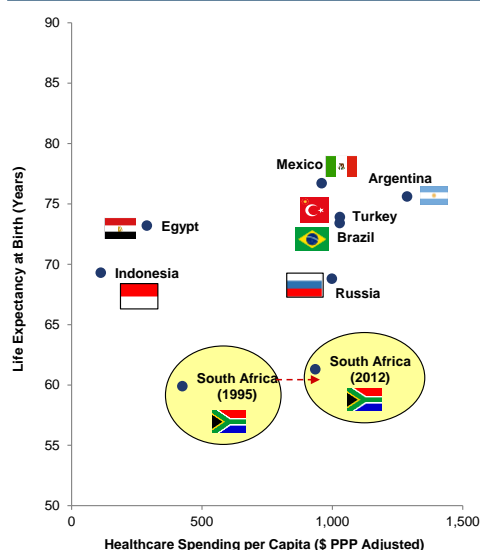
Education / health outcomes and public sector productivity

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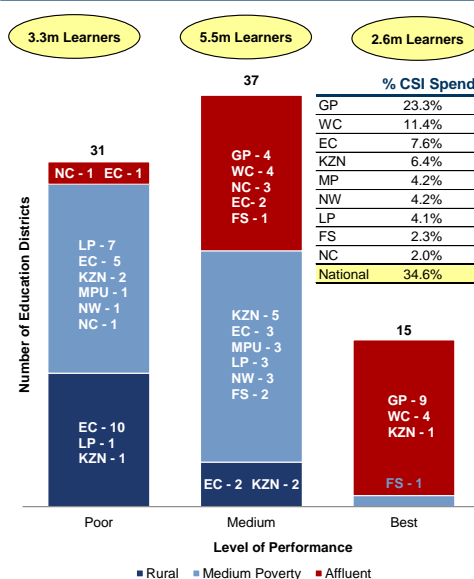
- Wasteful expenditure, defined as expenditure that was made in vain and that could have been avoided had reasonable care been taken, increased by 40% in the last reported year from R1.5bn in 2012 to R2.1bn in 2013
- Health and education accounted for 68% of unauthorised expenditure in 2012-13 (89% in the previous year)
- Education, Health and Public Works (which contributed c.80% of total spending by departments) remain a concern as the reports of these key areas continue to receive financially qualified opinions

7 Education/healthcare and public sector productivity remain a challenge

As Fiscal Spending Grows, Life Expectancy Remains Below Emerging Market Peers



District Performance and Poverty Levels: Rural/Poor Districts Perform Badly



% CSI Spend	
GP	23.3%
WC	11.4%
EC	7.6%
KZN	6.4%
MP	4.2%
NW	4.2%
LP	4.1%
FS	2.3%
NC	2.0%
National	34.6%

Source: IMF, WDI, WHO, JET

Education / health outcomes and public sector productivity

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- Whilst spending on healthcare per capita doubled from 1995 to 2012, life expectancy rose marginally from 60 to 61 years in 2012. Allowing for the effects of HIV on decreased life expectancy, spending increases have seemingly failed to have the desired impact
- According to a JET study, in measuring the government school sector across 11.4 learners, schools in rural and medium-poverty areas will likely deliver a poor to medium quality of education to learners, whilst government schools serving more affluent communities will likely deliver medium to best quality education to learners. In aggregate, 8.8m of the 11.4 learners, i.e. 77%, will receive poor-medium quality of education, thereby potentially reproducing another generation of poorly educated children

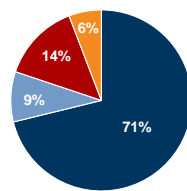
Majority of basic education and health expenditure on public sector employee compensation

Health and education expenditure for 2013/14

National Budget	USDm
Consolidated Revenue ¹	110,043
Consolidated Expenditure ¹	(128,315)
Budget (Deficit)/Surplus	(18,272)
% of GDP	(4.6)%

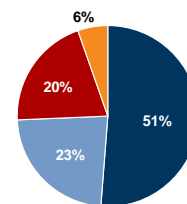
Basic Education

Economic Classification	USDm
Current Payments	16,885
Compensation of Employees	(14,997)
Goods and Services	1,889
Transfers and Subsidies	2,962
Payments for Capital Assets	1,222
Total Expenditure	21,069



Health

Economic Classification	USDm
Current Payments	13,266
Compensation of Employees	(9,143)
Goods and Services	4,123
Transfers and Subsidies	3,625
Payments for Capital Assets	956
Total Expenditure	17,847

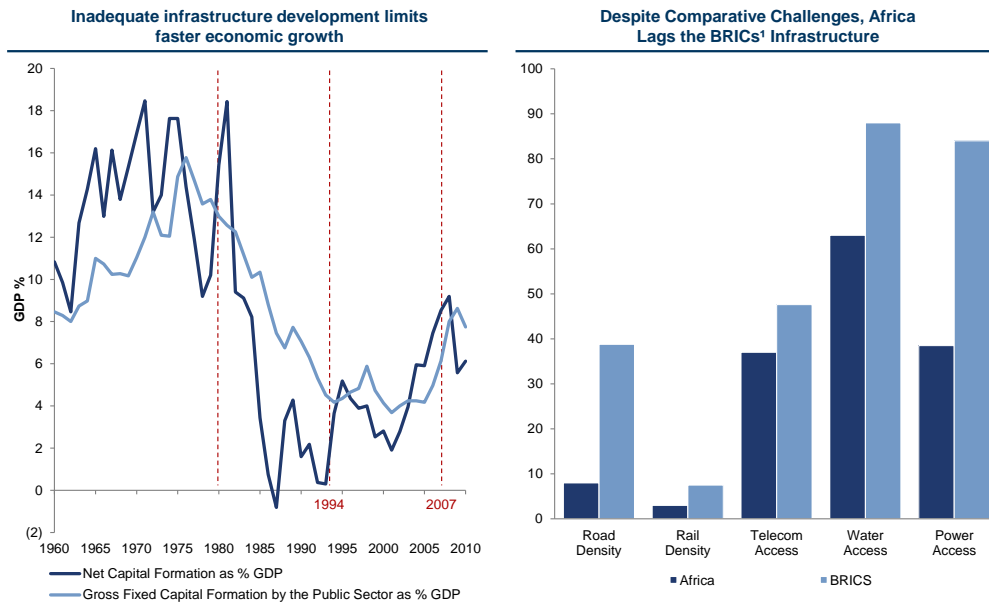


■ Compensation of Employees ■ Goods and Services ■ Transfers and Subsidies ■ Payments for Capital Assets

Source: The Estimates of National Expenditure 2013, published by the South African National Treasury
Note: Figures converted using a ZAR/USD exchange rate of 8.96 as at 6-May-2013

¹ Flows between national, provincial, social security funds and public entities are netted out

- When examining government expenditure on health and education, of the \$21bn allocated to basic education, 71% is spent on government education employee (salaries of teachers, administrators, principals, inspectors etc.) compensation, while in the health sector, 51% of the \$18bn was spent on compensating employees (salaries for nurses, administrators etc.)
- A significant component of this workforce is unionised and part of the ruling party's governing alliance with the unions to which these employees belong
- Improving the performance and outputs of the education and health sectors requires a more productive and efficient relationship between the Government, as employer, and its unionised employees



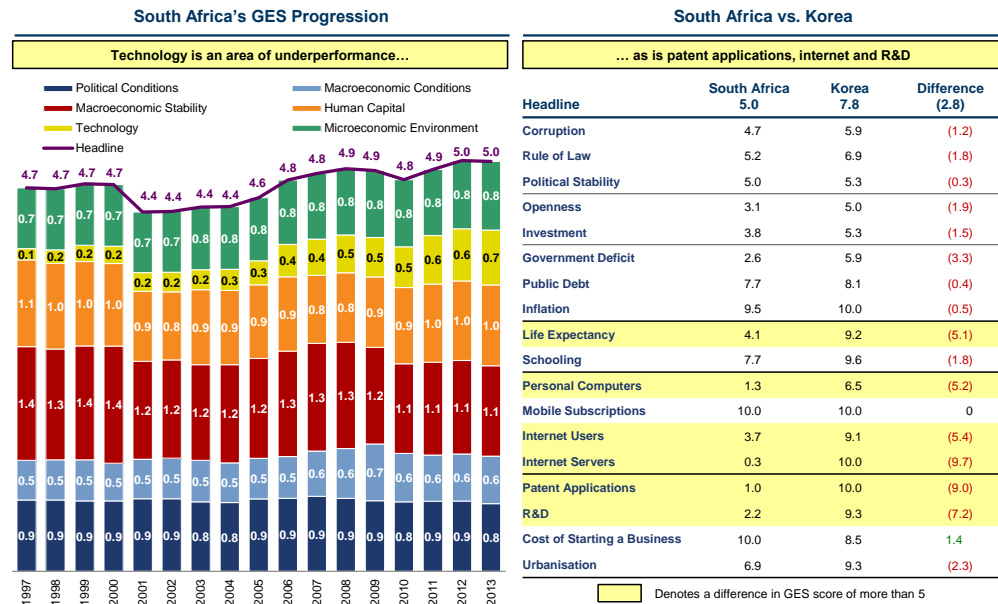
Source: National Planning Commission, Standard Bank; McKinsey Global Institute, World Development Indicators

¹ Russia is excluded from the BRIC average for road and rail. Road and rail density is measured in km per 1,000 square km; telecom and power access as a percentage of the total population with access to these services; and water access is measured as a percentage of the total population with access to an improved water source.

- Capital formation as a % of GDP declined significantly into 1994, recovered in the 2000-2007 period, but since declined
- South Africa, and Africa more broadly, has a significant current infrastructure deficit, particularly in power, transport and roads
- Financing and executing this infrastructure investment is a key challenge for expanding the overall economic capacity (including facilitating production and exports) and overall size of the SA economy
- South Africa, with its' advanced financial and engineering capacity, is well placed, as seen in the building of the 2010 Soccer World Cup infrastructure to implement an ambitious and necessary infrastructure programme domestically and in the region.

South Africa can make significant improvements

Growth Environment Scores (GES)¹



Source: GS Global ECS Research

¹ The GES is an index developed to measure the extent to which structural conditions and policy settings in a country are conducive to transforming the economic potential of the BRICs, Next 11 and other countries into reality. A higher score denotes a more conducive environment.

Computer & internet access / research & development / patents

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Goldman Sachs produces Growth Environment Scores (GES) which benchmarks the performance of countries against various parameters

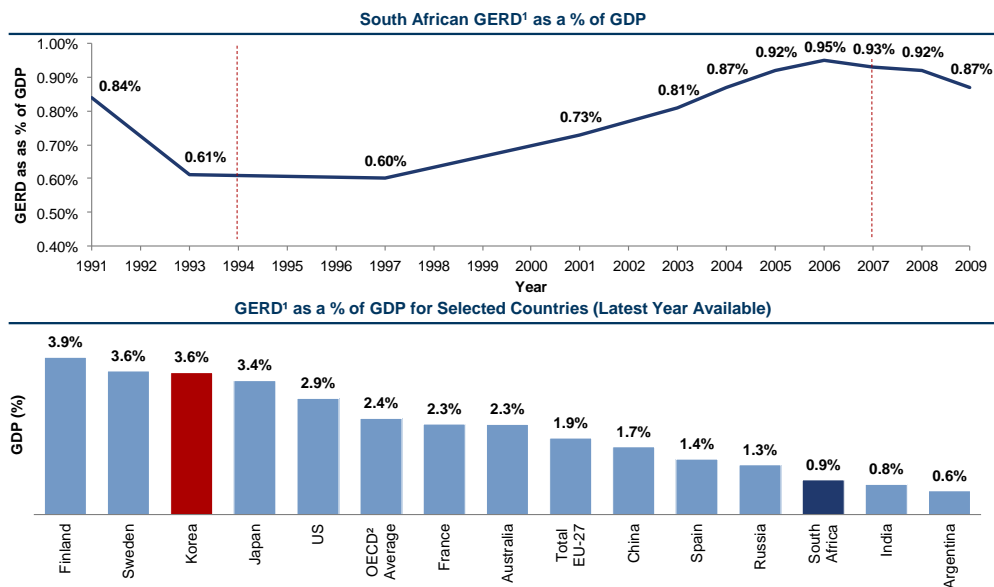
- SA's overall score has marginally improved from 4.7 in 1997 to 5.0 today
- The biggest area of underperformance is technology

When we benchmark South Africa against the best-in-class growth market peer, South Korea, we identified those areas in which SA lagged by more than 5

- South Africa significantly underperforms South Korea in the areas of patent applications, internet access, personal computers, and R&D
- By making improvements in these areas with large potential impacts, South Africa could show significant progress. Finding a way to fund and roll out computers and internet access to communities at large would be one way in which South Africa could address this issue

R&D spend lags the rest of the world

GERD¹ as a percentage of GDP



Source: Human Sciences Research Council (HSRC) National Survey of Research and Experimental Development

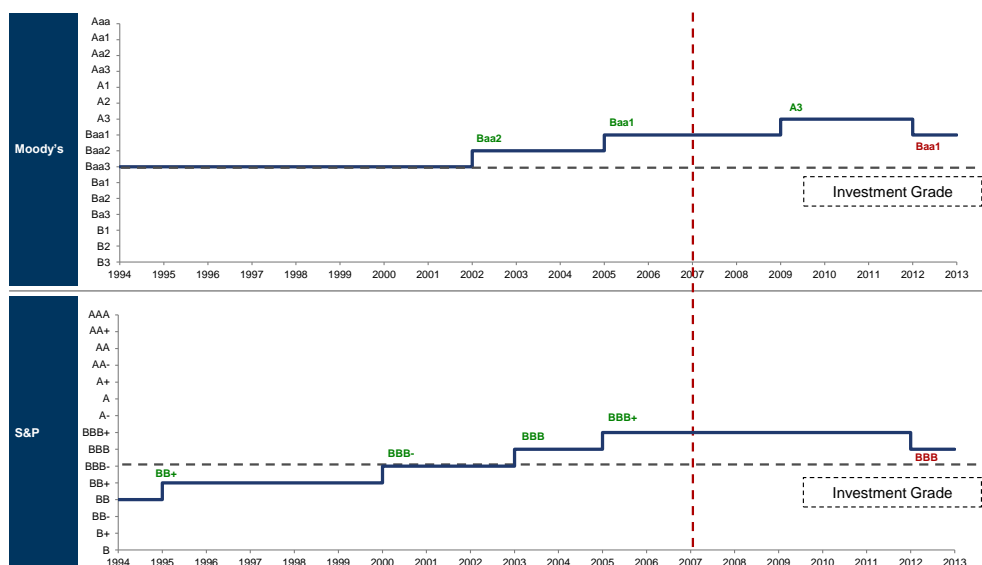
¹ Gross Expenditure on Research and Development.

² Organisation for Economic Cooperation and Development.

The expenditure on R&D, shown on the top chart, does not exceed 1% of GDP at any point since 1994

- This ranks SA at the bottom end of the global spectrum compared to countries like Korea (at 3.6%), Japan (3.4%), China (1.7%) and the US (2.9%) and requires a step-up in investment

Improved sovereign credit ratings performance recently under pressure

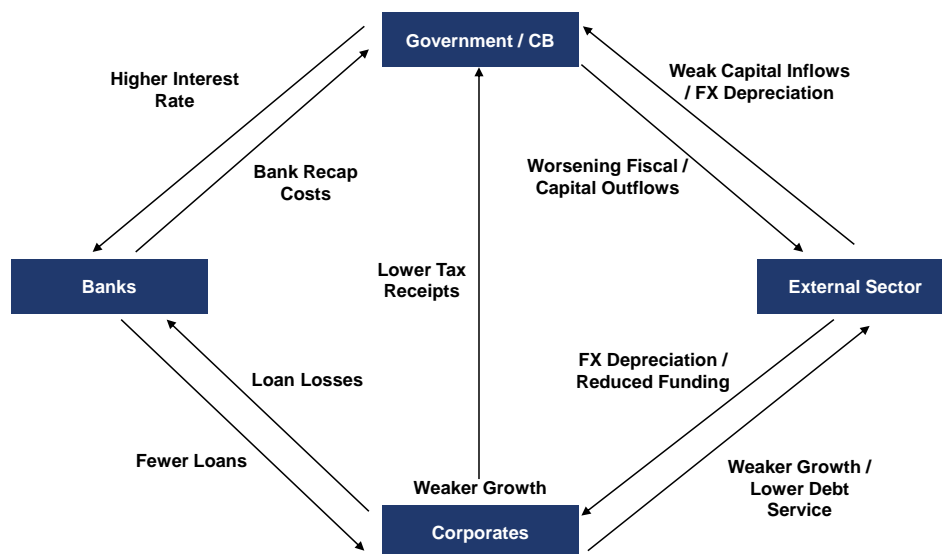


Source: Moody's credit rating service; S&P credit rating service

Sovereign credit ratings under pressure

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- South Africa excelled in improving its' sovereign credit rating from non-investment grade BB in 1994 ("junk status") up to investment grade BBB+ (in the case of the S&P rating), notwithstanding the recent downgrade to (still investment grade) BBB
- However, it is imperative to focus on maintaining and improving these ratings as any further downgrade (to below investment grade) would have significant knock-on effects on corporates and sovereign borrowing costs



Source: Goldman Sachs Global Investment Research

...but large challenges to further transform the economy and defend structural advances remain...



Conclusion

Two Decades of Freedom

Summary key advances and challenges remaining

Advances				Challenges	
	1994		Now		
S&P Credit Rating	■ BB (Sub Investment Grade)	✓	■ BBB (Investment Grade)	✗	15m people working and 7m not
GDP	■ \$136bn	✓	■ \$350bn	✗	70% of the unemployed are under 34
Inflation	■ 1980-1994 Average: 14%	✓	■ 1994-2013 Average: 6%	✗	85% of Africans poor, 87% of whites middle or upper income
Tax Receipts	■ R114bn / 1.7m people	✓	■ R900bn / 15.3m people	✗	Mining and manufacturing % of GDP now 21%
Gross Gold and FX Reserves	■ \$3bn	✓	■ \$50bn	✗	Mining wage inflation 11% over 10 years whilst productivity fell 5%
JSE Market Cap	■ \$230bn	✓	■ \$880bn	✗	Current account deficit equals 5.8% or \$20bn
Labour Productivity per Worker	■ \$8,800 (2002)	✓	■ \$21,100 (2013)	✗	Net FDI averages only \$1.9bn since 1994
LSM 5-10	■ 13.8m people (2001)	✓	■ 23.5m people (2010)	✗	Household debt to disposable income of 76%
Social Grants	■ 2.4m people	✓	■ 16.6m people	✗	Lost labour working days in last decade 10x more than previous
Household Electricity	■ 58% (1996)	✓	■ 85% (2011)	✗	Health, education and R&D

Source: IMF, Bloomberg, National Treasury, Stats SA, Euromonitor, SARB, S&P Ratings Agency, SAARF and independent Research

- 1 Social welfare support for SA's poorest 16m people
- 2 Social service delivery improvements
- 3 A significant rise in the African middle class
- 4 Integration into BRICs and Africa
- 5 Transformation of the public service
- 6 Stability, respect for institutions of democracy and the constitution

But the (youth) unemployment problem remains its biggest vulnerability. Threat to sustainability of fiscal expenditures and defence of the rising middle class remain key risks

South Africa has the institutional infrastructure but needs to continue to invest in its people

World Economic Forum Global Competitiveness Index: South Africa's Performance (2006-2013, Rank in Parenthesis)

Top 5 Categories					Bottom 5 Categories				
2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
Regulation of securities exchanges (2)	Regulation of securities exchanges (1)	Regulation of securities exchanges (1)	Regulation of securities exchanges (1)	Regulation of securities exchanges (1)	HIV prevalence, % (131)	HIV prevalence, % (136)	Cooperation in labor-employer relations (138)	HIV prevalence, % (141)	Business impact of HIV/AIDS (143)
Strength of auditing and reporting standards (2)	Strength of auditing and reporting standards (1)	Strength of auditing and reporting standards (1)	Strength of auditing and reporting standards (1)	Strength of auditing and reporting standards (1)	Business costs of crime and violence (133)	Business costs of crime and violence (137)	Flexibility of wage determination (138)	Quality of math and science education (143)	HIV prevalence, % (144)
Efficacy of corporate boards (3)	Trustworthiness and confidence (2)	Trustworthiness and confidence (2)	Trustworthiness and confidence (1)	Protection of minority shareholders (1)	Quality of math and science education (133)	Quality of math and science education (137)	Hiring and firing practices (139)	Hiring and firing practices (143)	Quality of educational system (146)
Financing through local equity market (4)	Efficacy of corporate boards (2)	Efficacy of corporate boards (2)	Efficacy of corporate boards (1)	Efficacy of corporate boards (1)	Business impact of HIV/AIDS (133)	Business impact of HIV/AIDS (138)	HIV prevalence, % (139)	TB cases/100,000 pop. (143)	TB cases/100,000 pop. (147)
Legal rights index ¹ (5)	Soundness of banks (6)	Soundness of banks (2)	Legal rights index ¹ (1)	Legal rights index ¹ (1)	TB cases/100,000 pop. (133)	TB cases/100,000 pop. (138)	TB cases/100,000 pop. (141)	Cooperation in labor-employer relations (144)	Quality of math and science education (148)

Most Improved Since 2006

- Legal rights index (from 45 to 1)
- Trustworthiness and confidence (from 37 to 1)
- Total tax rate (from 70 to 48)
- Mobile telephone subscriptions (from 56 to 35)
- Financial market development (from 24 to 3)

Worst Performing Since 2006

- Primary education (from 48 to 125)
- Government procurement of advanced tech products (from 29 to 105)
- Burden of government regulation (from 59 to 123)
- Government budget balance (from 42 to 105)
- Favouritism in decisions of government officials (from 56 to 110)

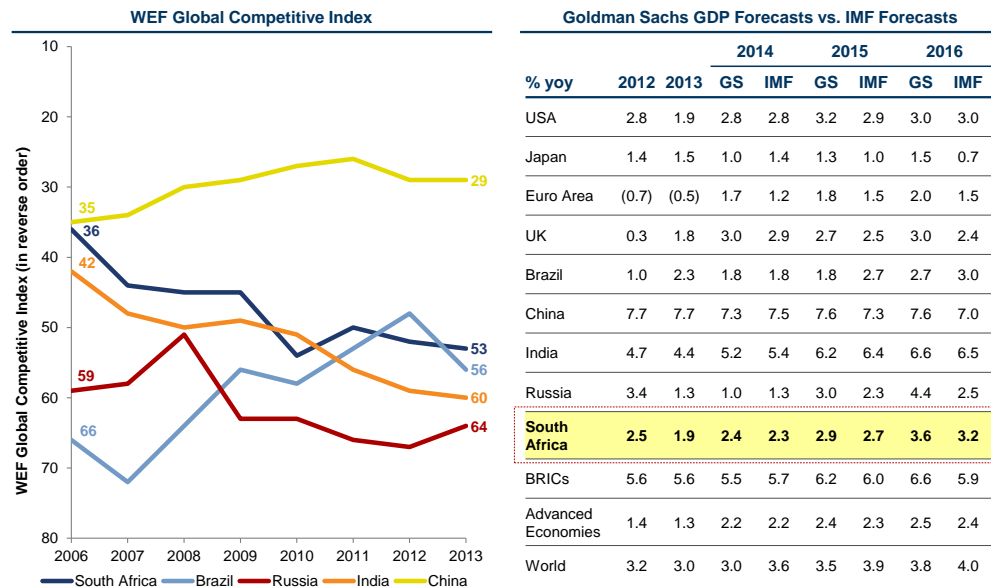
Note: WEF Global Competitive Index Report

¹ Measures the degree to which collateral and bankruptcy laws protect borrowers' and lenders' rights and thus facilitate lending.

This summarises an analysis of the World Economic Forum's Global Competitiveness Index identifying the top and bottom 5 categories, as well as most improved and worst performing areas since 2006

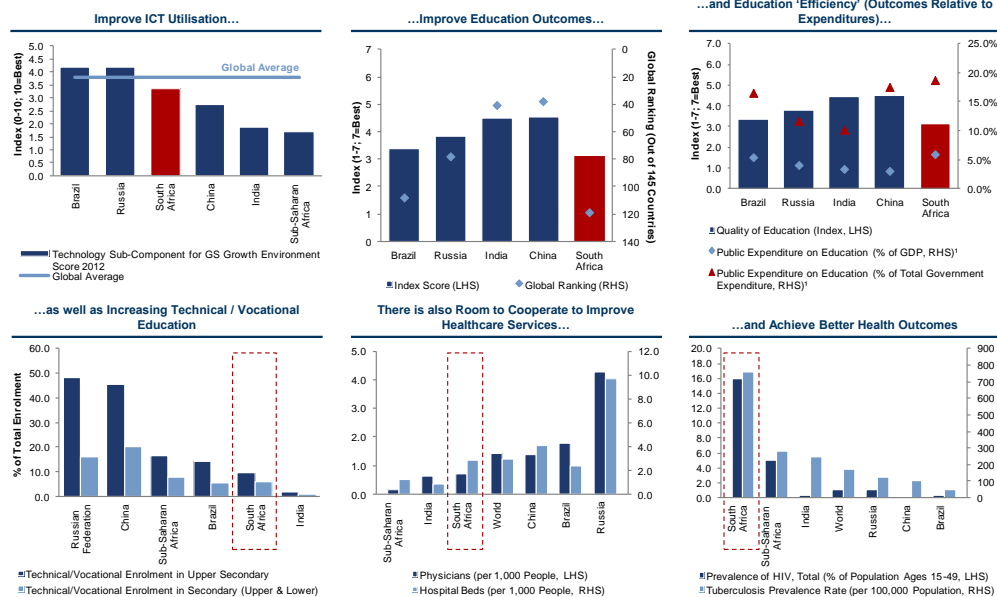
- Best ranked is SA's securities exchange, corporate law and financial market development
- Worst are human development indicators in particular quality of education, labour employer relations and health
- Notable improvements include tax and mobile phone subs, and notable declines include the burden of government regulation and favouritism in decisions of government officials

South Africa's global competitiveness has declined as we enter an uneven global macro recovery



Source: WEF Global Competitive Index Report, Goldman Sachs Investment Research, IMF WEO Database

- Whilst South Africa's overall ranking has worsened from 36 to 53, it is still ahead of Brazil, Russia and India, although well behind China
- Goldman Sachs' forecast for 2016 GDP growth for SA is 3.6%. This is a return to the higher average cyclical growth



Source: GS Global ECS Research (Summarizes data from the World Bank on: Use of Mobile phones. Computers. Internet Subscriptions and the number of Secure Servers); WEF Global Competitiveness Index; World Bank; Haver Analytics
¹ Using latest available data.

Two Decades of Freedom

What achievable performance targets do we aspire to in the next 20 years?

	South Africa		Target Metric ¹
Real GDP Growth	■ 2%	➡	■ 5%
GDP (\$bn)	■ \$350bn	➡	■ c.\$1 trillion
GDP per capita	■ \$6,621	➡	■ c.\$13,500
Current Account Deficit	■ 5.8%	➡	■ 3.5%
Net FDI p.a	■ \$1.9bn ²	➡	■ \$7.5bn
Gross Gold and FX Reserves	■ \$50bn (200% of short term debt)	➡	■ \$60bn (250% of short term debt)
Gini coefficient	■ 69	➡	■ 60
Unemployment	■ 24%	➡	■ 12%
Debt / GDP	■ 44%	➡	■ 20%

¹ Based on historical performance of South Africa's economy since 1994 and comparison with a benchmark of countries including: Brazil, China, India, Indonesia, Korea, Poland, Mexico, Nigeria, Russia, Turkey

² Average since 1994

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- 1 Public sector
 - Productivity: "bang for buck" especially in the areas of health and education
 - Exercise good management practices to meet own performance requirements
 - Education fit for employment
 - 2 Special focus on unemployed/unemployable youth
 - 3 Labour pact for
 - Sustainable growth and employment
 - Balanced wage/productivity growth
 - 4 Defending the rise of the African middle class
 - 5 Creating fiscal space to sustain spending on the poor by optimising state assets
 - 6 Driving economic growth through
 - Promoting industry and driving new frontiers for growth
 - Building economic linkages with Africa
 - Creating visible economic wins from "BRICs"
 - 7 Driving FDI through building investor confidence
 - 8 Driving innovation via increased investment in research and development and technology
 - 9 A common effort to protect the sovereign rating and cost of capital
 - 10 Leadership driving a culture of accountability and teamwork
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10 initiatives South Africa's top CEOs would like to see implemented

Agenda for unlocking earnings growth, job creation and capital investment

- 1 **A complete overhaul of SA's labour relations architecture**
 - The effect of the current labour relations system is higher real wages for fewer workers, lower productivity and job losses and lower exports
 - A less restrictive, more responsive labour system with a partnership approach between business, government and labour designed to avoid strikes, drive job creation, attract investment and skill is needed
- 2 **Lifting the administrative burdens on business**
 - Requires simplification of regulatory requirements including onerous license regimes, empowerment requirements, complex planning consents, customs clearing procedures and immigration procedures for hiring skilled expats
 - Improvement of the public administration and eradication of corruption
- 3 **A flexible and responsive trade policy**
 - Create a more partnership-driven approach between government and business to unlock jobs and growth through a dynamic trade policy
- 4 **Free movement of capital**
 - The removal of the exchange controls architecture would be a progressive step in supporting corporate South Africa's global competitiveness
- 5 **Administrative excellence**
 - The deployment of capable leaders into the public service to ensure that policies are executed well is a top priority for the 5th State administration
- 6 **Prosecuting corrupt officials**
 - Ensure prosecution with full enforcement of sentences for corrupt government officials. A State Tender Board is seen as a positive in this regard
- 7 **Regional integration**
 - Improving African regional trade and market viability, including improving cross-border logistics and reduced waiting time at border posts
- 8 **Unlocking cheap, clean energy in Africa**
 - Includes accessing viable gas resources in the region, considering Liquid Natural Gas (LNG) imports and collaborating on gas-to-power plants
- 9 **Advancing the provision of infrastructure**
 - Long term stability, availability and affordability of power and other infrastructure is essential to, inter-alia, the mining industry
 - Efficiency, reliability and productivity, and pricing impacts should be foremost in the minds of the SOEs
 - Coherence between South Africa's cR4.5tn pension funds and other long-term savings and funding the infrastructure is essential
- 10 **Certainty of operating environment**
 - Private sector needs certainty for long term investment and job creation; it's imperative that regulatory authorities set rules and don't change them

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- Much progress recorded in two decades of democracy
 - Significant challenges remain
 - Achievements need to be defended
 - We live in a “good neighborhood” but a mixed, challenging world
 - Business, government, labour and civil society “in it together”
 - We need a “Team South Africa” response
 - The currency and our sovereign credit rating is the country’s ‘share price’ and ‘report card’
 - We know what needs to be done, we need effective ‘team work’ and ‘execution excellence’
 - We have the people and the capital, we have the ‘talent’ and the ‘tools’ to execute well
 - Leaders across Government, business, labour, academia, institutions and civil society need to take individual and collective decisive actions to improve South Africa’s competitiveness and overall performance



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