STANLIB's

WeeklyFocus

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STANLIB

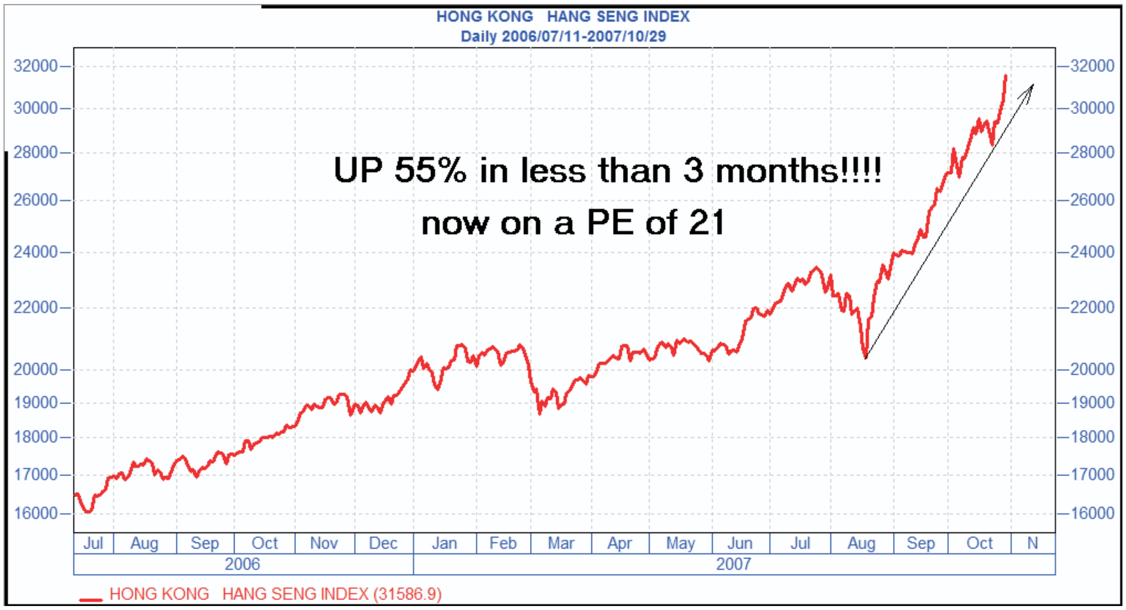
Items covered: China hits the news in SA, SA banking shares, Commodity currencies, Snippets

1. <u>CHINA AND BCA's VIEW ON THE WORLD</u>

- The Chinese growth continued with GDP growth up 11.5%, retail sales up 17%, industrial production up 18.9% and CPI inflation slightly lower at 6.2%. Powerful numbers to be sure. Take out food and oil and the CPI inflation rate is at 1%, with record high pork prices causing much of the high food inflation. (our SA comparable rate is 4.8%)
- Partly on the back of a weaker and weaker US dollar - but mostly because of continuing strong demand (with China clearly playing a big role, what with manufacturing up almost 19% year-on-year) and constrained supply (low inventories) - the commodity boom continues unabated.
- The housing crisis in the US continues so far to have a very muted effect on commodity prices. One reason is that the US consumes just 12% of annual copper production, far less than the 29% consumed by Europe and the 25% consumed by China.
- Platinum is again at a new all-time record high today, followed closely by oil and gold.
- Even though the pall of possible recession continues to hang over the US economy, BCA's impressive Managing Editor, Chen Zhao (who visited STANLIB last week, making a big impression with his extraordinarily broad knowledge and understanding of world markets) pointed out to us how the Baltic Dry Index (shipping costs) continues to soar….meaning there is no sign of any global recession because world trade continues to boom.
- Chen was born and bred in China, before leaving to study a PhD in the US and joining BCA in Montreal, Canada in the early 1990's.
- He puts the credit sell-off in perspective with a chart showing how the junk bond yield spread above US government bond yields is still below the average spread of the past 22 years.
- He also notes how manufacturing in the emerging markets is beginning to pick up again (up 11.5% year-on-year), but especially in Asia, where it is now over 14% higher than a year ago.
- Asian exports to China are now 27% of total exports to China, compared with only 10% from the US.
- Another fascinating statistic from Chen is that the total personal consumption spending of the BRIC countries of Brazil, Russia, India and China now equates to 30% of US personal consumption spending. Five years ago it was only 18%. But he concedes that China remains a very poor country, with a net worth of only $2,000 per Chinese person versus $30,000 per person in Japan.

- Chen says US exports are growing strongly, with some 40% of US growth in 2008 expected to come from US export growth (1% out of 2.5% growth expected by BCA next year).
- Chen, who is not a “fence sitter” - he has strong, highly educated views on everything - believes that US consumer spending is already bottoming and will surprise on the upside next year, eventually causing US interest rates to rise in 2008.
- He sees US capital spending picking up and says there is absolutely no empirical evidence to indicate that the slump in US housing is affecting the US consumer! This is a BIG statement because many other forecasters believe the opposite. Chen says the research shows that income and job security are far more important and so far those two factors are in good shape.
- Global efficiency continues with Chinese unit labour costs still declining (meaning more profits for companies). US, Japanese and German manufacturing labour unit costs are also declining, implying more profits for their companies too.
- **How about the oil price issue?** With great confidence Chen says it is not the actual price of oil that is the crucial issue, but rather the percentage change in the oil price from year to year. In euro terms the oil price is only 5% higher than the high of July 2006 (14% higher in dollar terms). So although it is a headwind, the record high oil price is not quite as bad as one thinks. Today's FT has a graph of the real oil price (adjusted for inflation) and how the real price is fast approaching its previous record high of 1979 (“equivalent to about $100-$110 in today's money”).
- **How long will the 'party' last** (global equity bull market, commodity bull market etc)? Chen guesses about another year, at which stage the Chinese stock market bubble will likely be pricked (probably because of rising interest rates). He says the Chinese stock market is now important enough in the whole Chinese economy because its total value equates to 70% of the total Chinese GDP. So a collapse in the stock market will probably have negative consequences for Chinese economic growth and therefore for commodities and other global stock markets. So if Chen's informed guess is right, in one year investors may need to be in cash!
- One of the most impressive stock market moves so far in 2007 continues to come from the soaring Hong Kong stock market (Hang Seng Index), which jumped over 1,000 points today (3.3%) to over 30,000 (see chart below). Both the strength in Chinese H shares (Chinese shares listed in Hong Kong) as these shares play catch-up with the high mainland prices of the same companies as well as Chinese reserve funds earmarked for investment are contributing to this; but lower interest rates in the US are also playing a role as Hong Kong pegs its currency and interest rates to those of the US.

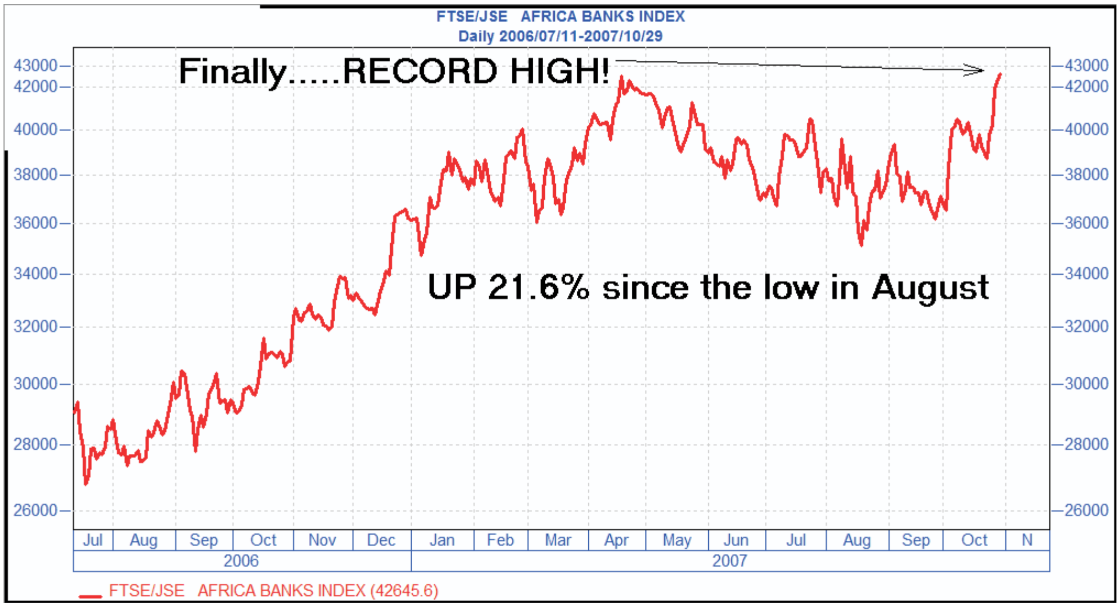
- In the STANLIB Offshore South-east Asia Fund, Hong Kong shares comprise 9.5% of fund, whereas Chinese shares comprise 26% of fund. South Korean shares have the biggest allocation in the fund (29% of fund).



2. SA BANKING SHARES SPRING TO LIFE WITH CHINESE DEAL

- WOW…hats off to Standard Bank's super top management team for arranging one of the great deals of the decade (even century) for an SA banking group and for SA!! One suspects that it pays for a top CEO like Jacko Maree to be in his position for a good period of time (8 years in Jacko's case) because he and his team develop the confidence and knowledge to be able to go for something as big as this Chinese deal. A less aware management team (lacking that crucial confidence) may have missed the opportunity.
- SA bank shares, which have looked cheap for so long - especially with fantastic returns on equity of 24/25% - finally sprang to life and have reached new record highs today (see chart below of the Banks Index).
- The Chinese ICBC Bank is apparently trading on a PE in Hong Kong of 40 (historic) - forward PE of 22 to end 2008 - versus the historic PE for Standard Bank of 13. Standard Bank is not only much cheaper on a PE basis but its return on equity of 25% is also much higher than that of ICBC (approximately 16%, but rising to 19% in 2009).
- ICBC's earnings are expected by UBS to grow by 29% next year, better than the 17% forecast for Standard Bank.

- ICBC's share price has appreciated by 40% in the past month!! It is estimated by UBS that the 20% holding in Standard Bank would contribute 2.6% of ICBC's net profit for 2008.
- The banks index is up 21.6% from the low in August and most of this move has come in two big weeks, as can be seen from the chart below.



- The Financials Index has not quite reached a new record but seems headed in that direction.
- It has been reported that China needs African banking expertise as well as telecommunications expertise in its drive for both resources and land on the continent; hence the big move in MTN shares on Friday on the back of rumours of another Chinese buyout. This rumour has surfaced before. MTN is now on a forward price-to-earnings ratio of 15.8 to end 2008, which is still not overly expensive considering its growth potential.

3. COMMODITY CURRENCIES STRONG

- The SA rand is benefiting alongside all other commodity currencies from the ongoing commodity boom, apart from the huge Chinese investment in Standard Bank and rumours of other possible investments.
- So far in 2007 the Canadian dollar is up 10% against the strong euro, while the Aussie dollar is up 6% against the strong euro. The Canadian dollar has in fact passed the one-to-one rate versus the US dollar and is now at $1.04, ie 4% stronger than the US dollar. This is an all-time record high for the Canadian currency, surpassing the previous highs of 33 years ago.

- While the rand has strengthened lately against the Aussie dollar (from 6.18 in early October to 5.95), it is still almost 8% lower so far in 2007, probably because our big current account deficit is being largely financed by stock market inflows rather than foreign direct investments like Australia enjoys. The Standard Bank deal should, however, help the FDI flows into SA.

4. SNIPPETS OF INFO

- Stock markets globally are to some extent being driven by expectations of another cut in interest rates this Wednesday by the US Fed (at least a quarter point cut to 5.5% because of strong downside risks to the economy from the slumping housing industry and the credit crunch).
- Late on Friday in the US Microsoft reported their sales growing at their fastest pace in 8 years (27%). The share jumped 9.5%, which is an extraordinary jump for what is probably still the Nasdaq's biggest share.
- So far this year the Nasdaq Index is up 16%, almost double the jump in the S&P 500 Index's 8.3%. So tech stocks generally seem set to continue to outperform most financial and industrial shares.

Paul Hansen
Director, Group Retail Investing

The local market was kept on its toes last week with the release of the September consumer and producer inflation numbers, and again this morning with the release of money supply and private sector credit demand data. All the data is crucial ahead of the final interest rate decision by the MPC (Monetary Policy Committee) in December 2007. Acknowledging risks to the upside, STANLIB currently anticipates no further rate hikes this year.

Headline consumer inflation (CPI) at 7.2%y/y as well as CPIX inflation at 6.7%y/y were both higher than consensus and up from their previous levels last month. We are still expecting CPIX to breach the 7% barrier before starting its slow retreat back to within the inflation target in the second half of 2008. Producer Inflation (PPI) remained unchanged and below consensus at 9.4%y/y. SA credit growth remained above 20%y/y for the 21st consecutive month in September, but is expected to slow steadily over the coming months as higher interest rates become more effective.

Our Chief Economist, Kevin Lings, attended the IMF (International Monetary Fund), World Bank and IIF (Institute of International Finance), annual conference in Washington from 19 to 22 October 2007. We will be taking a look at the main economic discussion points that surfaced during the conference.

- In September, SA growth in broad money supply **(M3)** was recorded at 24.9%y/y, down marginally from 25.8%y/y in August, which was above market expectations. As pointed-out for many months now, overall M3 growth remains exceptionally high, having accelerated substantially from around 12%y/y in March 2005. This has been mostly on the back of a substantial increase in net claims on the domestic private sector (bank credit).
- The growth in private sector credit eased to an annual rate of 22.5% in September, down from a revised 23.2%y/y in August. Excluding the investments category (which is a more appropriate measure of the trend in credit demand); the growth in private sector credit remained high, but is down fractionally from August. **Overall, while it is clear that there is a slowdown in credit growth, this slowdown is relatively modest and reflects mostly the high base effect**
- In value terms, during the past year, total private sector credit has risen by R305.8bn and by R580.6bn over the past 2 years. More importantly, in real terms (adjusting for inflation), the growth in private sector credit (excluding investments) is still growing by around 17%, which is extremely high by historical standards, although there are signs of a slowdown.
- In evaluating the growth in bank credit it is important to recognise that there has been a significant increase in securitisation transactions by the banking sector during the past year, which has the effect of understating total bank credit. In fact, during the last 12 months, there have been securitisation deals of at least R36.4bn relating mostly to vehicle finance and mortgage credit.

- **Mortgage lending grew by a relatively robust 1.8%m/m in September and by 26.1% over the past year, which is still extremely high.** In value terms mortgage advances increased by R14.45bn in September. During 2006 mortgage debt increased by an average of R13.1bn a month. In 2005, the average monthly increase in mortgage credit was only R9.5bn, which was well above the average of R6.7bn in 2004. In 2007 the average monthly increase has been R13.66bn for the first nine months of the year.
- Instalment sales (mostly car finance) rose again in September, which may in part, still reflect an improvement off a low base given the earlier problems with vehicle registrations. Overall instalment credit increased by 17.8%y/y. On a trend basis, instalment sales have clearly slowed, reflecting the current slowdown in passenger car sales as well as the increased securitisation issues. In total, the rate of growth in asset based finance (instalment sales, mortgage advances and leasing) remained relatively high at 23.5y/y in September.
- Interestingly, the growth in individual's credit card debt remains exceedingly high at 41.1%y/y. This is despite the 350bp increase in interest rates. This is hardly suggestive of a substantial slowdown in the consumer's appetite for debt.
- According to the September Reserve Bank's Quarterly Bulletin the ratio of **household debt to disposable income rose to 76.6% in Q2 2007**, compared with 75.9% in Q1 2007 and 73.7% in Q4 2006. This is obviously the **highest level of households debt ever recorded in South Africa**. At the same time, net personal savings was measured at a slightly improved -0.1% of disposable income, which is better than the -0.6% of disposable income recorded in Q1 2007. Given the higher domestic short-term interest rates, the interest cost of servicing household debt has risen to around 10%, which is the highest level in just over 8 years, and is starting to hurt the consumer.
- Over the past few months there has been the massive acceleration in the category "**other loans and advances" which represents mostly corporate credit.** In September, this category rose by 3.3%m/m, following an increase of 0.5%m/m in August. While many Corporates are relatively cash-flush, there are clear signs of a relatively broad-based pick-up in corporate restructuring as well as fixed investment activity, which is likely to reflect to sustained growth in corporate credit demand.
- **Overall, while the annual growth in credit demand shows some signs of slowing off a high base, the monthly demand remains extremely high, especially mortgages advances. There is little evidence that the increase in interest rates as well as the introduction of the NCA is having a significant impact on overall demand for credit.**

Main economic discussion points from the IMF, World Bank and IIF (Institute of International Finance), annual conference in Washington during 19 to 22 October 2007:

- The IMF revised down world growth for 2008 by 0.4 percentage points to a still respectable 4.8%.
- The 2008 growth forecast for all developed markets has been revised lower, especially the United States, which was revised down 0.9 percentage points to 1.9%.
- Most of the analysts that presented on the US, suggested that there is a 30% to 40% chance of the US going into recession within the next 12 months.
- The immediate focus of policymakers is to restore more normal financial market conditions.
- The only regions of the world that had their growth rate revised up was revised Africa, including Sub-Sahara, up 0.3 percentage points to 6.8% and the Middle East, up 0.4 percentage points to 5.9%. Both regions are expected to benefit from higher oil and commodity prices.
- Emerging markets are considered to have solid economic fundamentals and a strong growth momentum.
- Net private equity flows to emerging markets are now estimated at an amazing $620 billion, the largest annual inflow on record.
- The risk to world growth is firmly to the downside, centred on concern that financial market strains could deepen and trigger a more pronounced global slowdown.

- The **main risks** identified by the IMF are:
  - The current financial market turmoil, linked to the US housing market and concerns about a slowdown in domestic demand in the US
  - Potential inflation pressure
  - Volatile oil markets
  - The impact on emerging markets of strong foreign exchange inflows.

- Longer-term issues were also discussed such as:
  - Population aging
  - Increasing resistance to globalisation (increased protectionism)
  - Global warming

Kevin Lings and Melissa Rankin
STANLIB Economics and Group Retail Investing

The following yields are calculated using an annualised seven-day rolling average as per the unit trust industry standard. These rates are expressed in nominal and effective terms and should be used for indication purposes ONLY.

Standard Bank Money Market Fund

Nominal: 9.46% per annum
Effective: 9.88% per annum

A constant unit price will be maintained. Past performance is not necessarily a guide to future performance. A schedule of fees and charges and maximum commissions is available on request from the Manager. Commission and incentives may be paid and if so, are included in the overall costs. The yield is calculated using an annualised seven-day rolling average as at 26 October 2007.

STANLIB Cash Plus Fund

Effective Yield: 10.06%

This is a current yield as at 26 October 2007

Protection Series Rates

These rates are indicative and are subject to change

Fund	18 Months	36 Months
STANLIB Prosperity Fund	17.26%	34.86%
STANLIB Gold Fund	19.23%	48.70%
STANLIB International Equity Fund of Funds	17.26%	34.86%
STANLIB Multi-National Fund	17.26%	34.86%
STANLIB Alsi 40 Fund	11.85% (12 months only)	-

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