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Message from the CEO

>BUSA CEO Jerry Vilakazi

BUSA is continuing to develop its relationships with both its internal and external stakeholders. Increasingly, BUSA is improving its credibility as the voice of business in South Africa, and internationally. I am aware that we may not have been very visible in the media in the most recent past. However we have been participating and engaging at very important platforms for business. Vic van Vuuren has recently participated in a meeting of the Governing Body of the International Labour Organisation (ILO) in Geneva where he made sure that the voice of South African business was heard in these important debates. He is one of only eight employer representatives from the entire African continent who serve on the ILO's Governing Body and,I believe, that this bears testimony to the pivotal role that BUSA plays amongst African employers' organisations. The latter on its own requires that South African business continues at an accelerated pace on the path of transformation.

I have just returned from a very successful trade mission led by President Mbeki to Italy. Beside the government delegation, BUSA was part of a large group of South African businessmen and women looking at doing business with their Italian counterparts. The group comprised representatives from large companies, small and medium businesses, as well as state owned enterprises such as Eskom and Transnet. Our delegation met with more than two hundred Italian businesses of all sizes and hopefully some business deals will come out of the visit. With a view to promoting the economic and technological cooperation between South African and Italian companies, BUSA and Confindustria (the Confederation of Italian Industry) have agreed to establish and strengthen their cooperation leading to the signing of a Memorandum of Understanding to guide the relationship. The President has requested BUSA and Confindustria to identify at least six or seven areas for business focus and cooperation between the two countries. We are also looking forward to hosting a large delegation of businessmen and women from Italy in 2007.

Closer to home, on 10 March we were invited to address Parliament on the 2006/ 2007 National Budget. In our presentation, we expressed our support for the Accelerated Shared Growth Initiative for South Africa (ASGISA), focused on economic and taxation issues and also outlined some proposals that we believe should be dealt with in the 2007/2008 budget. In regard to the latter, we proposed that serious attention should be given to a critical review of the corporate tax rate structure, including secondary tax on companies. In addition we have proposed that the retirement tax should be abolished. We have also appealed for greater emphasis to be given to partnerships between the private sector and government in the delivery of services and infrastructure projects. Our presentation was well-received by the parliamentarians and we trust that we will have further opportunities to interact with these important decision-makers in the future. We are planning this year to meet more frequently with key portfolio committees through their chairpersons outside of the routine public hearings.

As we have noted in a previous edition of the Bulletin, trade issues are assuming increased prominence on the BUSA agenda. On 13 March a BUSA delegation met with Dr Rob Davies, Deputy Minister of Trade and Industry. The Deputy Minister gave us the benefit of his insights on matters such as South Africa's stance regarding the World Trade Organisation (WTO) negotiations, the United States – Southern African Customs Union Free Trade Agreement, the Economic Partnership Agreement and the Trade and Development Co-operation Agreement between the European Union and South Africa and our relationship with China. In addition, BUSA had the opportunity to brief the

Deputy Minister on some of its own views on these issues. The Deputy Minister has agreed to have regular engagement with BUSA in order to share views and ideas, and this is something that BUSA will definitely pursue. We have also had a fruitful meeting with representatives of the Department of Home Affairs covering a range of issues from migration matters to work permits for scarce skills. This meeting was aimed to be the prelude to a meeting which is planned with the Minister in late April.

The Deputy President formally launched the Joint Initiative on Priority Skills Acquisition (JIPSA) at a function at the Presidential Guest House on 27 March 2006. This will be a key initiative underpinning the success of ASGISA, and it is simply imperative that our national skills development strategy be aligned with the needs of business and employment creation. BUSA is represented on the Technical Working Group of this initiative and the BUSA Sub-Committee on Education and Training (SCET) is working hard to prepare all the necessary position papers and proposals that can be tabled in this forum. I would urge our member organisations to ensure that they are represented on the SCET so that they can participate in these discussions. It is often more useful to become involved at the conceptual stage of policy development than to be presented with a final draft position paper at the end of a process. In addition, the nature of the processes and structure of JIPSA may not provide for our routine mandating processes.

We have noted with concern the power failures experienced in the Western Cape in the past month. We are aware of the possible cost implications for many businesses as a result of such power failures.

We have since been talking to Eskom and will arrange a meeting with the CEO of Eskom in April. As BUSA we would like to get assurances from Eskom that the power failures are under control and that there is no need to fear a possible spread to areas beyond those affected in the past weeks.

Jerry Vilakazi

>ECONPOL Competition Policy

Acting Deputy General of the Department of Trade and Industry (dti), Mr Tshediso Matona, met with BUSA on 8 February 2006. BUSA was represented by BUSA Economic Consultant, Professor Raymond Parsons, BUSA COO, Vic Vuuren, Lebogang Montjane, Nico Vermeulen, Mandu Nkomo and BUSA Economist, Ms Nwabisa Matoti.

The meeting served as a platform for sharing thoughts on competition policy issues and the outcome would be used as preparation for a meeting with Minister Mpahlwa in April 2006.

The BUSA delegation expressed the need for the coordination of government policies around the goals of the Accelerated and Shared Growth Initiative for South Africa (ASGISA). In addition, concerns were expressed about the undefined relationship between competition policy and industrial policy.

Mr Matona said the need for reviewing competition policy was brought about by the 10-year policy review that the government had embarked on. The-10 year review is aimed at assessing the impact of government's policies on economic growth, and on finding ways in which these policies could be improved. Within this context, it has been decided that a range of policies need to be reviewed, including competition policy.

The BUSA delegation was advised that the competition review is still an internal process whereby the dti is conducting research with the assistance of competition experts from the World Bank. Linkages between competition policy and industrial policy were also being investigated. The dti is still in an information gathering stage and on completion of this stage will deliberate on ways in which the consultation process should be dealt with.

The dti indicated that it would welcome input from BUSA on competition policy issues that would assist it in its internal review process. The dti also advised that it would welcome further engagements with BUSA on competition policy issues, and also on other issues that could contribute to economic growth.

>East Central Southern Africa Employers Organisations Conference

BUSA Chief Officer Strategic Services, Friede Dowie, attended the East Central Southern Africa Employers Organisations Conference (ECSAEOC) held in Arusha, Tanzania, on 23 and 24 February 2006.

ECSAEOC members present were Norman Moleele(Botswana), newly appointed Executive Director of the FKE Jacqueline Mugo(Kenya), Thabo Makeka (Lesotho), Zakes Nkosi (Swaziland), Nicholas Mbwanji, Dann Musenge and Dr Aggery Mlimuka, Executive Director of ATE (Tanzania). About 30 Tanzanian delegates were also in attendance. Representatives from the International Organisation of Employers (IOE), the International Labour Organisation (ILO) and the East African Community were present. The IOE and ILO derive valued support from the ECSAEOC as it is the only formalised structure for English speaking African employer organisations to meet on a structured and regular basis.

The conference was opened by the Tanzanian Deputy Minister of Labour Employment and Youth Development, Mr JS Sumari. Presentations were made by Con Omore from Transparency International – Kenya, and Oswald Urassa of the Dar es Salaam Stock Exchange. As is customary, the conference was chaired by the host country.

The issues raised and considered during the event included focus sessions on corruption and good corporate governance, and strategic planning in organised business. The importance of business taking a strong lead in these areas was stressed.

The future of employer organisations - with a single focus on industrial relations and social issues - was discussed. The limitations of such organisations was highlighted, as was the fact that they would have to broaden their agendas to include economic and trade issues if they wanted to remain relevant and survive. In particular, the conference agreed that business required a comprehensive service from these organisations - as opposed to having to be affiliated to two separate organisations, one that offered advice, support and services with regard to industrial relations, and another that dealt with broader economic issues.

The host country for the next annual event (2007) will be Botswana.

>Possible Southern Africa Customs Union (SACU) – United States (US) Free Trade Agreement (FTA)

The American Chamber of Commerce in South Africa (AmCham) in partnership with BUSA, Business Leadership SA and the SA Institute of International Affairs (SAIIA) held a morning seminar on FTAs on 23 March 2006. The seminar was chaired by BUSA's Friede Dowie and the speakers included Messrs Iqbal Sharma, Acting Deputy Director General of the Department of Trade and Industry, Lebogang Montjane of Business Leadership SA, Peter Draper of SAIIA, Daniel Christman of the International US Chamber and Matthew Stern a researcher / consultant.

The morning's discussions confirmed the uncertainties regarding the actual support for moving forward on a SACU-US FTA. It was however also clear that there were considerable advantages in SACU concluding a FTA with the biggest world economy. Some time was devoted to the different issues and interests that would have to be accommodated. It was also noted that FTAs were about managed trade as opposed to free trade. A FTA with the US would have to accommodate the developmental goals of SACU and investment related issues such as the processing of disputes would have to be addressed.

>Small Business: Soweto Small Business Executive Council

The Soweto Small Business Executive Council (SOBEC) and Soweto Accommodation Ubuntu (SAU) celebrated the establishment of a gateway office in London, through the London Joburg Initiative(LJI). The gateway is a major boost for the development of small businesses through international trade development. A welcome reception was sponsored by the North West London Chamber. SOBEC President Jerry Moloi was presented with a civic plaque by the Mayor of Harrow Cllr Paddy Lyne.

Mr Moloi led the Soweto Development delegation of 29 business owners and service providers. They attended business networking meetings and held one-on-one sessions with potential partners, community leaders and educators.

The second Soweto Intellectual Capital (Knowledge Economy) Forum held a seminar at the Harrow Hotel, focused on "Developing Effective Strategies for 2010 World Cup South Africa and London Olympics 2012".

The LJI management team also announced new initiatives for Soweto First 2007 comprising of Football Futures affiliated with Harrow St Mary's Youth FC; a Soweto International Business Expo London (SIBEX) and a joint London Joburg Initiative visit to Kingston during the Caribbean World Cup 2007.

SOBEC will be celebrating its 5th anniversary with the themes "Unlocking business growth opportunities for the next generation" and "Women in business and politics" to guide its April 2006 conferences. Civic and business leaders from London have been invited to give keynote addresses.

For more information, please contact Rudi Page at the the SOBEC London, Tel: +44 (0) 20 8861 6167, Fx: +44 (0) 20 8582 0858,Mobile: +44 (0)7958744660 or email info@statecraft.net or post Dovedale House, 339 Kenton Rd, Harrow, Middx, HA3 OXS, England. SOBEC Joburg, Jerry Moloi, Tel: + (0)82 958 9846 or email Joanne@ultrapack.co.za

Confederation of Associations in the Private Employment Sector

Business Unity South Africa is pleased to introduce the Confederation of Associations in the Private Employment Sector (CAPES) as its latest member organisation.

CAPES is generally recognised as the representative body for employers of atypical employees and private employment agencies in South Africa. CAPES has as its members three associations, namely, the Association of Personnel Service Organisations, the Constructional Employers Association and the Amalgamated Nursing Association. Collectively, it represents the interests of some 600 companies in the private employment sector.

CAPES addresses primarily legal and business growth areas of the industry by engaging various stakeholders. The organisation's vision is to be generally recognised as the undisputed representative body for employers of atypical employees and private employment agencies in South Africa. One of CAPES' goals is to ensure the justified long term growth and recognition of the industry. In light of this, it will be directly involved in legislative developments, lobbying stakeholders, engaging in educational programmes and conducting research and development that directly impacts on economic and social growth.

CAPES is strategically positioned between worker or work seeker and business user and therefore fulfils a critical role in influencing business growth as well as ensuring employment justice. The Associate Members of CAPES (which are voluntary industry associations) currently drive industry ethics, legislative compliance and stakeholder capacity building on a voluntary basis.

CAPES is strategically positioned between worker or work seeker and business user and therefore fulfils a critical role in influencing business growth as well as ensuring employment justice.

In order to drive self-regulation in the industry, CAPES has instituted a requirement that its members' constitutions ensure the following practices amongst their members:

- Legal registration and compliance with all labour laws;
- Best practice contractual and employment standards;
- Ethical conduct involving one another and clients;
- Promotion of Broad Based Black Economic Empowerment (BBBEE);
- Ensuring representivity, integrity and credibility; and
- Professional practices.

>CAPES Chief Operations Officer John Botha

CAPES is located in Bryanston, Johannesburg and is led by Chief Operations Officer John Botha. His background includes being a labour relations specialist for a Petrochemical Company and the Executive Group Human Resources Director for Adcorp Holdings. He is also the current Joint Managing Director for a leading labour relations and business consulting firm, Global Business Solutions.

BUSA Opinion Piece: 2nd Phase of the BBBEE Codes

Following extensive debates and consultations amongst its member organisations regarding the 2nd Phase of the Codes of Good Practice on Broad Based Black Economic Empowerment (BBBEE), BUSA has finalised and submitted its position paper on the Codes to the Department of Trade and Industry.

Given the broad diversity of BUSA membership, it has been difficult to reach consensus on each and ever aspect of the Codes. However, considerable progress has been made in reducing divergent viewpoints. The following summarises the main thrust of the BUSA comments on the 2nd Phase of the Codes.

While business has made great strides in the implementation of various initiatives intended to promote the objectives of BBBEE in the economy, there is a concern that the pace of BBBEE implementation in the economy has been somewhat slow and uneven. The situation is a source of concern to the business community, and calls for the adoption of innovative measures to expedite the implementation of the objectives of BBBEE in the economy.

BUSA recommends that the dti should consider initiating discussions with other relevant government departments to amend the black economic empowerment provisions of their pieces of legislation to be in line with the BEE Act and its Codes of Good Practice on BBBEE, which is the law of general application in respect of the economic empowerment of black people. This is necessary to ensure that the objectives of BBBEE are implemented in a coordinated and integrated manner, and that there is uniformity in the measurement of transformation and empowerment initiatives undertaken in the various sectors of the economy.

BUSA welcomes the use of targets as a yardstick to measure the progress made by business to achieve the objectives of BBBEE. In addition, BUSA supports the setting of stretch targets to guide the process. However, BUSA recommends that empirical evidence should be used as the basis for determining targets that are realistic, and which will simultaneously have the desired effect of expediting the transformation of the socio-economic landscape.

The dti should encourage all the Transformation Charters developed before the release and after the finalisation of the Codes to be 'substantially aligned' with the Codes of Good Practice within a specified timeframe. Again, this is desirable to ensure that the objectives of BBBEE are implemented in a coordinated and integrated manner, and that there is uniformity in the measurement of transformation and empowerment initiatives.

BUSA contends that internships, cadet schemes, apprenticeships and most importantly, experiential training of learner technicians from universities of technology should all form an integral part of the learnership strategy and thus be eligible to earn points on the scorecard if targeting the beneficiaries of BBBEE. Further, unemployed graduates should feature prominently in the country's skills development initiatives, and enterprises that commit resources to unemployed graduates that are beneficiaries of BBBEE should earn points on the scorecard.

The dti should put in place mechanisms to minimise the costs of verification and to limit the commercialisation of verification processes for all businesses, with particular emphasis for small businesses.

BUSA is of the view that (i) the threshold turnover used to define "Qualifying Small Enterprises" in Annex 1000-B be tripled; and (ii) the number of employees should not be used as the basis for determining the QSEs, as this could impact adversely on job creation.

BUSA proposes that medical aid and pension fund contributions should be included in procurement spend to facilitate the entry of black people into the medical aid and pension fund industries.

BUSA proposes that the enterprise development scorecard should allocate points to both non-recoverable and recoverable contributions made to beneficiary entities that are operating in the same industry as the measured entity. This could be achieved by splitting the existing points as follows: 3 points to non-recoverable for beneficiary entity in the same industry as the measured entity and the other 3 points for any other beneficiary entity. With regards to recoverable, the points should be split as follows: 2 points should be allocated for beneficiary entity operating within the same industry as the measured entity and the other 2 points for any other beneficiary entity.

BUSA welcomes the well-worked definition of CSI and the range of eligible corporate social investment initiatives enumerated in paragraph 5.1 of statement 700. BUSA proposes that the weighting points should be restructured in such a way that a measured entity could only earn the full points if and only if it contributes to the entire range of eligible corporate social investment initiatives.

Very stiff sanctions should apply if a company is found to have intentionally falsified its BBBEE-related information. The dti should declare illegal any nomination whether intentional or unintentional, that will yield a better empowerment and gender status of any entity, as that would legalise fronting. It must be illegal therefore for a white person to nominate a black person, or a male to nominate a female as a shareholder in a company, and all such nomination agreements should be rendered void.

BUSA Opinion Piece: 2nd Phase of the BBBEE Codes

BUSA proposes that companies should not split up their reporting into divisions and individual operations, with each needing a separate verification, but that reporting should be incorporated. As a general consideration, BUSA suggests that employment equity figures within a group of companies should be capable of attribution as some groups leverage a common staff pool within individual subsidiaries for the entire group.

BUSA argues that the maximum duration of the holding of an equity interest by the Warehousing Fund must not exceed 18 months (not 3 years) to ensure that the fund remains the transitional arrangement it is intended to be. Further, to ensure that BEE investment promotes stability in the market, it is suggested that BEE investors must have a minimum period of 3 to 5 years in the entity before they are eligible to transfer their equity to a warehousing fund.

Clearer guidance should be provided in the Code as to the type of public schemes envisaged. Private schemes that contribute to the overall objectives of BEE should be permitted as well and guidance as to what would be acceptable should be provided in the Code. BUSA recommends that the statement should make it clear that local Multinational Enterprises are required to evidence either all of the requirements or any one of the requirements identified.

The skills development scorecard should make allowance in the form of points for black people at artisan and semi-skilled levels and for the recognition of prior learning.

BUSA has recommended that the criterion for the inclusion of people with disabilities should be defined as follows: 'Black people with disabilities employed by the Measured Entity as a percentage of all full-time employees in all occupational levels provided for in Form EEA9 of the Employment Equity Act.' In addition 'full-time' should be defined to mean: 'an employee whose employment with the employer is of indefinite duration'.

As a general rule, BUSA recommends that a Measured Entity should receive additional points if it exceeds the compliance targets. This would ensure that the Measured Entity continues to strive to attain the compliance targets in respect of all the criteria.

The definition of "core skills" is very narrow, especially for manufacturing concerns, and should be extended to include technical skills. While companies should give priority to the development of skills required for their core business, they should also contribute towards developing technical skills that will benefit the broad labour market.

BUSA proposes that, where local production is insufficient, any importation to make up for the local shortfall should be excluded from total measured procurement. This is so because local production could not be economically viable or sustainable because of insufficient demand or irregular demand.

The definition of "Beneficiary Entity" is silent on whether enterprises owned by related parties may be treated as `beneficiary entity' for the purposes of the enterprise development scorecard.BUSA recommends that enterprises owned by related parties be explicitly excluded from the definition of `beneficiary entity'.

BUSA urges the dti to redefine contribution beneficiaries along the following lines: "any contribution program or product recognised in a Sector Code upon the terms stated in that Sector Code; provided that: where contributions made to such an organisation directly benefit natural persons, only that portion of the contribution value that is directly applied to the benefit of black natural persons will be measured under Statement 700".

The use of the term "facilitate access to the economy" narrows the scope of this element more than reflected in the original scorecard. BUSA contends that any contribution to enhance the ability of black people to engage in the broader developing society whether through direct access to the economy or otherwise should be included here.

The Preferential Procurement Code is ambiguous on whether pension fund and medical aid contributions are excluded or included. In one part of the Code it states that contributions to pension funds and medical aid are included in procurement spend (less administration costs). However, in another part of the Code it states that contributions are excluded. Clarity on the matter is desirable.

The obscure language used in the draft Codes makes it difficult for an average reader to understand the main thrust of the Codes. This makes the Codes unnecessarily complex. Further considerations for using plain language, where feasible, need to be explored.

The Codes contain numerous mathematical formulae for the calculation of points under the different elements of the BBBEE scorecard. To simplify the calculation, BUSA proposes that in each instance where a formula is given, examples of how to undertake the calculation should be included in the statements.

BUSA will now engage with the dti on the Codes. A Nedlac process on the Codes has already commenced.

Queries/Feedback

The Communications Team would like to encourage members to continue giving feedback regarding the Bulletin. Please send us your views by calling 011-784 8000 or email busa@busa.org.za

Economic Commentary: Emerging markets: Hiccup or turning point? Jac Lauscher – Sanlam

"Fed tightening is furthermore likely to have a negative impact on the appetite for relatively more risky asset classes, and leveraged positions in commodity and emerging markets could come under pressure. An increase in global bond yields will exacerbate the situation. Capital flows to emerging markets could become less favourable, and countries with current account deficits (including South Africa) will bear the brunt of the enforced adjustment." - *Economic and Financial Market Review, February 2005*.

Recent events in emerging markets served as a stark reminder of the validity of the comments quoted above that I made just more than a year ago. They seem to indicate that investors are having a re-think regarding emerging markets' prospects. Emerging market bears are interpreting this as the beginning of the end for the asset class, at least in the short term. Bulls are shrugging it off as a mere correction in a bull market that got temporarily overextended.

Who is right? And what are the implications for South Africa?

The correction has been quite broad based, affecting emerging market currencies, bonds and equities. Its causes can be found in a number of events:

- Firstly, the announcement by Fitch, one of the top three international rating agencies, that it is downgrading its outlook for Iceland, served as a reminder to markets that risk has been priced to perfection. To a market that has become used to a stream of rating upgrades, the Fitch announcement served as a rude wake-up call.
- Secondly, markets have become increasingly aware of the fact that sustained strong global economic growth is chipping away at the output gap, causing inflation risk to rise. Markets therefore have to come to grips with the possibility that monetary policy will be tightened by more than previously expected, in particular that the US federal funds rate might not peak at the expected level of 5% but continue to be raised beyond that. The increase in the 10-year US bond yield to its highest level since June 2004 serves as evidence of this concern.

  The ECB has likewise been signalling that markets should not be too complacent about when it will stop raising its repo rate, pointing out that policy remains very accommodative even after the repo rate has been hiked twice since December 2005.
- Thirdly, the announcement by the Bank of Japan that it intends ending its policy of quantitative easing in the wake of deflation coming to an end in its view, even though an increase in interest rates is still some way off, caused the ongoing viability of the carry trade to be questioned. Note the ensuing weakness in carry currencies, e.g. the New Zealand dollar. It also implies that for the first time in many years, the three major central banks, viz. those in the USA, the Eurozone and Japan, will be raising interest rates simultaneously, resulting in the contraction in global liquidity being accelerated.

The starting point in putting these events into perspective is to note that emerging markets have developed a certain seasonal pattern in recent years, ending the year on a strong note that spills over into the new year, only to be followed by a correction during the northern hemisphere spring. At the moment it looks as if 2006 will be no exception, and if this is the case further weakness is to be expected in the next two to three months.

But that would still leave unanswered the question whether the bull market in emerging market assets is coming to an end. Emerging markets have attracted an enormous amount of capital recently compared to the past, which causes one to question the sustainability of these flows – according to Emergingportfolio.com, the week to 17 March 2006 was the first this year to suffer a net outflow of funds from emerging market equities. However, the fact of the matter is that emerging market assets still constitute only a relatively small percentage of global assets, and the asset class continues to attract new investors.

The positive rerating of emerging assets can to some extent be ascribed to improved fundamentals, as reflected in declining risk premiums in all asset classes. However, the tightening in spreads within rating classes indicates that it has also been caused by greater risk appetite.

However, more importantly, the improvement in emerging market fundamentals that played such a decisive role in the positive rerating of these markets, remains in place.

Macro-economic reforms include fiscal consolidations delivering primary surpluses, improved external debt dynamics, and the introduction of inflation-targeting regimes. Potential economic growth is enhanced by lower cost of capital. Declining interest rate differentials have reduced the cost of currency hedging. Some investors are even questioning the emerging market status ascribed to some countries, arguing that they are rapidly converging with at least the bottom rung of developed countries.

Forecasts for global economic growth in 2006 and 2007 are being upgraded, supporting the idea that commodities will remain caught up in a

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Economic Commentary: Emerging markets: Hiccup or turning point? Jac Lauscher - Sanlam

so-called super cycle. The positive momentum is being pushed along by the additional demand for investment in exchange-traded commodity funds from a diversifying client base, including pension funds. However, the question should be asked to what extent the last-mentioned development is distortin commodity prices, steering them away from underlying demand and supply balances.

The reduction in emerging market currency risk brought about by improved current account balances and rising foreign exchange reserves is judged to be unlikely to be threatened.

The sharp decline in emerging market bond spreads, and improved risk ratings by the major international rating agencies as a consequence of fiscal consolidation in emerging countries, are holding up. In fact, recent announcements by Venezuela, Brazil and Colombia that they are to buy back a large chunk of their outstanding Brady bonds, support the expectation of further rating upgrades and even tighter risk spreads in 2006.

In addition, it has been mooted that countries in the Middle East (viz. oil producers) and Asia are planning to buy a large amount of emerging market debt to diversify their holdings and improve returns. Local currency debt markets are developing rapidly, reducing emerging market issuers' vulnerability to exchange rate fluctuations.

As for equities, which have attracted the bulk of recent inflows into emerging markets in the wake of an increasing imbalance between demand and supply in the bond market, economic growth in emerging economies remains strong and is increasingly driven by domestic forces rather than exports. The outlook for earnings growth in emerging economies to outperform that in developed economies therefore remains intact.

As for market ratings, emerging equities have not been rerated nearly to the same extent as bonds and should there fore be less vulnerable to correction. Investors are increasingly arguing that emerging equities should be valued as growth stocks, rather than value cyclicals, because of their increased ability to set prices rather than being mere price-takers. Stronger domestic institutions are furthermore contributing to better corporate governance, enhancing the credibility of financial results.

But financial markets are all about momentum and relative value, and this is where things may be changing. In spite of the outlook remaining positive, the question is what has been priced in. If current prices are discounting too much of the good news, prospective returns will not be that attractive, causing some portfolio rebalancing.

In other words, investors could prefer to take some risk off the table. The starting point for this is to ask who is the most vulnerable, requiring greater differentiation between emerging markets instead of treating the asset class as one amorphous whole, as indicated by the recent trend for sovereign risk premiums to converge. The answer to the question is then quite clear, i.e. those countries that are running a deficit on the current account of the balance of payments, especially if it is expected to widen further, because of their dependence on a continuing inflow of foreign capital. The countries in the forefront of the correction in emerging markets have therefore predictably been Iceland, New Zealand, Hungary, and Turkey

> *Although underlying fundamental conditions continue to support emerging markets, risk appetite seems to be wavering and volatility is increasing.*

Where does this leave South Africa?

Although South Africa's current account deficit is not of the same magnitude as that of the countries mentioned above, it is nevertheless one of the few emerging economies that is running a widening deficit at a time when commodity prices are booming to the benefit of export proceeds. The argument that a large part of this deficit is due to high international oil prices, in the absence of which the deficit would be much smaller, is invalid because one would then also have to exclude commodity exports which have by and large benefited from the same international conditions as oil.

When comparing South Africa to the countries that have suffered most in the recent market correction, there are therefore differences of degree, but less so of principle. Of the four countries mentioned above, South Africa is usually bunched together with New Zealand because both are commodity exporters. Movements in the exchange rate of the Rand display a strong correlation to those in the New Zealand dollar. And the medium-term outlook for the NZ dollar is generally regarded as being negative.

It is worth remembering that markets price assets relative to one another: as some asset prices fall, even for idiosyncratic reasons, other comparable assets will also be repriced to preserve relative value at an acceptable level. Contagion effects can after all not always be rejected as merely irrational phenomena.

Bearing in mind the dominance of equity portfolio investment in capital flows, South Africa cannot afford its growth momentum faltering.

In conclusion, although underlying fundamental conditions continue to support emerging markets, risk appetite seems to be wavering and volatility is increasing. South Africa is also being affected by the changing sentiment towards risky assets. For the moment it looks like a correction within a bull market, but the appropriate response is to be more aware of the risks and not to succumb to a blind faith in ever-rising markets.

This conclusion is nevertheless complicated by the relatively short history of emerging markets as an asset class, which leaves one with questionable benchmarks for emerging market valuations.