Quarterly Bulletin

December 2004

South African Reserve Bank

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No 234

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http://www.reservebank.co.za ISSN 0038-2620

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Quarterly Economic Review

Introduction

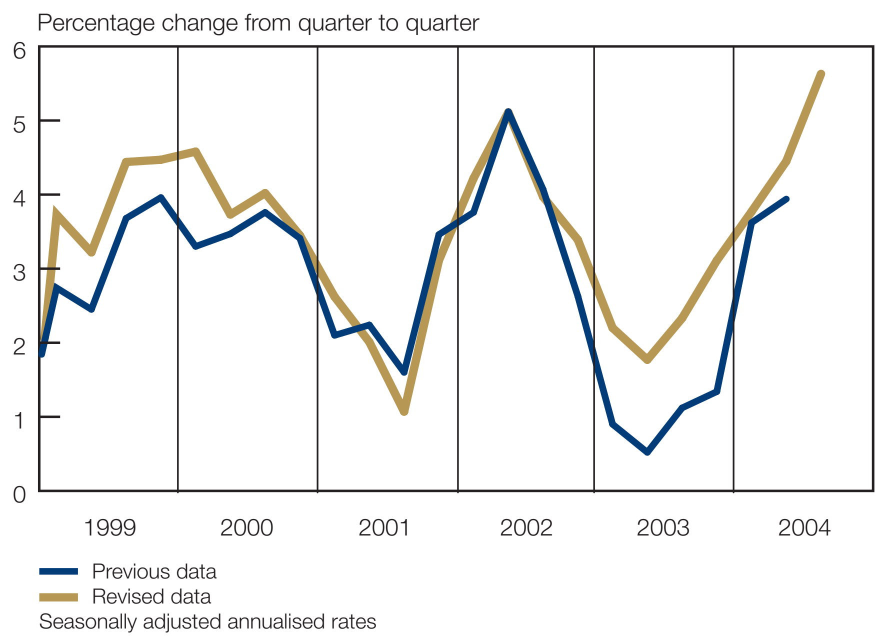
Global output growth gained momentum from around mid-2003, supported by fairly accommodative monetary and fiscal policies in the advanced economies. Following a "soft patch" of hesitant growth in the second quarter of 2004, growth in real world output accelerated onto firmer territory in the third quarter. Early estimates indicate an expected global growth rate of around 5 per cent in 2004; if realised, that would be the highest real growth since 1976[1]. On the African continent growth is projected to accelerate to 4½ per cent in 2004, the highest since 1996.

1 More recent estimates are slightly less optimistic.

The number of central banks raising their policy interest rates during the first eleven months of 2004 exceeded the number lowering them; the United States and China counted among the large economies facing higher short-term interest rates. Sustained large deficits on the current account of the United States' balance of payments and on its federal government budget contributed to further depreciation of the US dollar against other key international currencies during the course of 2004. The impact of the considerable increase in the dollar price of crude oil in international markets – the price occasionally exceeded 50 US dollars per barrel in October 2004 – was therefore softened when translated into these comparatively strong currencies. Nevertheless, higher energy prices, buoyant commodity prices and smaller output gaps (as actual production edged closer to potential output in most parts of the world) resulted in a modest acceleration of inflation in a number of the major economies.

The latest South African national accounts estimates reflect improved coverage of economic activity which has lifted the measured level of nominal gross domestic product by some 3½ per cent in recent quarters. Growth in real gross domestic product has also been raised on account of the revisions and rebasing to 2000 as base year. For instance,

Real gross domestic product



the average real growth rate from the second quarter of 1999 to the second quarter of 2004, which had amounted to 2,9 per cent per annum on the previous basis of measurement, has now been revised to 3,4 per cent. Firm growth over the medium term demonstrates the underlying resilience of the South African economy and the tangible benefits flowing from the country's commitment to sound economic policies.

Growth in real gross domestic product picked up further in the third quarter of 2004 to an annualised rate of 5½ per cent – the fifth successive quarter in which real growth accelerated. All the main sectors recorded strong growth in the third quarter of 2004. Real agricultural production expanded as field crop and horticultural output rose briskly. In mining, firm increases in production volumes in areas such as platinum, diamonds and coal more than neutralised the reduction in output of the gold industry. Manufacturing production expanded further on account of robust growth in domestic demand and in export demand for some categories of manufactured goods. In the tertiary sector sturdy growth was recorded in most subsectors, with transport, storage and communication, commerce, and financial and business services displaying the highest growth rates.

Growth in real gross domestic expenditure decelerated considerably in the third quarter of 2004. Real final consumption expenditure by households gained further momentum and was accompanied by an increase in household debt. General government's real final consumption expenditure displayed very little growth. The tempo of growth in real fixed capital formation halved in the third quarter of 2004, as some aircraft were sold (but their services reacquired under operational lease agreements) by South African Airways. Having been boosted by an exceptionally strong increase in oil stocks in the second quarter of 2004, real inventories recorded a more subdued increase in the third quarter; accordingly, the ratio of inventories to production remained almost unchanged from the second to the third quarter.

Enterprise-surveyed employment in the formal non-agricultural sectors of the economy recorded uninterrupted increases in each of the four quarters to June 2004, resulting in a cumulative employment gain of about 196 000 workers or 3,1 per cent. The increase in employment came mainly to the fore in the number of private-sector rather than public-sector employees. This increase was also corroborated by the results of the latest *Labour Force Survey*.

Real output per worker increased slightly during the year to the second quarter of 2004. With nominal remuneration per worker rising by 7,6 per cent over the same one-year period, the cost of labour per unit of output rose by 7,1 per cent.

Inflation in the prices of goods remained low, contributing to moderation of the inflation process in general. The production prices of imported goods declined by 0,3 per cent over the year to October 2004 as the recovery in the exchange rate of the rand continued. At the production level domestically produced goods recorded a year-on-year rate of price inflation of 2,7 per cent in October 2004, slightly less than in CPIX goods prices. However, twelve-month CPIX services price inflation amounted to 6,3 per cent over the same period, pushing CPIX inflation up to 4,2 per cent. CPIX inflation has nevertheless remained in the 3-to-6-per-cent target range since September 2003, i.e. for 14 successive months, as the strengthening of the exchange rate of the rand and the sustained disciplined stance of monetary policy moderated price pressures.

Relatively favourable global economic conditions were accompanied by buoyant commodity prices and a further marginal improvement in South Africa's terms of trade. This resulted in a moderate improvement in South Africa's export performance and accordingly a somewhat smaller deficit on the current account of the balance of payments in the third quarter of 2004. At the same time, an inflow of investment capital was recorded – the sixth successive quarterly net inflow – to an amount exceeding the deficit on the current account. This left the country with a surplus on the overall external account and an increase in net holdings of international reserves over the period, and contributed to an increase of 10 per cent in the weighted exchange rate of the rand from the end of 2003 to the end of November 2004. Other factors reinforcing the positive sentiment towards the rand in the market for foreign currency included positive pronouncements by two international credit ratings agencies regarding South Africa's credit ratings, the relatively attractive domestic interest rates, subdued inflation, evidence of rising growth rates and the improvement in the terms of trade.

The M3 money supply recorded brisk rates of growth in each of the first three quarters of 2004, consistent with the strength of domestic production and final expenditure. Positive wealth effects on account of rising prices of real estate and financial assets also supported the demand for money. Banks' loans and advances to the domestic private sector benefited from these positive wealth effects. Mortgage credit and instalment sale and leasing finance grew exceptionally briskly as house prices continued to climb and as consumers' high confidence levels and lower interest rate costs were translated into the acquisition of vehicles and other durable items. However, overdrafts and other advances displayed little growth as household and corporate cash flows were improving on account of the lower interest rate environment, while some companies also made more extensive use of foreign funding.

Money-market interest rates generally moved in step with the Reserve Bank's repurchase rate, declining after the largely unexpected reduction in the repurchase rate in August 2004 and then moving broadly sideways. On occasions when the exchange rate of the rand strengthened or when lower-than-expected inflation data were released, the more forward-looking money-market rates indicated expectations of further policy easing in the near term. Long-term bond yields declined further during the second half of 2004, largely in response to the more benign inflation environment.

Despite the expected impact of a stronger rand exchange rate on corporate profitability in the export and import-competing industries, domestic share prices rose considerably in the second half of 2004. Share prices reached an all-time high on 29 November 2004 as firm commodity prices, strong consumer expenditure and the announcement of higher investment in infrastructure, supported investor sentiment.

The South African government again demonstrated its commitment to the pursuit of sound fiscal policies with the release of the *Medium Term Budget Policy Statement* in October 2004. The fiscal projections provide for a somewhat higher main budget deficit, peaking at 3,5 per cent of gross domestic product in fiscal 2005/06, but fully within the boundaries of sustainability. The public corporations have been mobilised, together with public-private partnerships, to step up investment in infrastructure.

The South African economy appears to have adjusted to the combination of a stronger world economy, favourable terms of trade, lower interest rates and less restrictive fiscal policies by stepping up real expenditure and production. In the process employment is also starting to increase, while inflation remains subdued under the current configuration of policies and exogenous factors. In such an economic environment the South African Reserve Bank will continue to remain vigilant in the battle against inflation. Change in this configuration is inevitable with the passage of time; this underlines the need for robustness and prudence in the economic conduct of households and businesses alike.

Domestic economic developments

Domestic output[2]

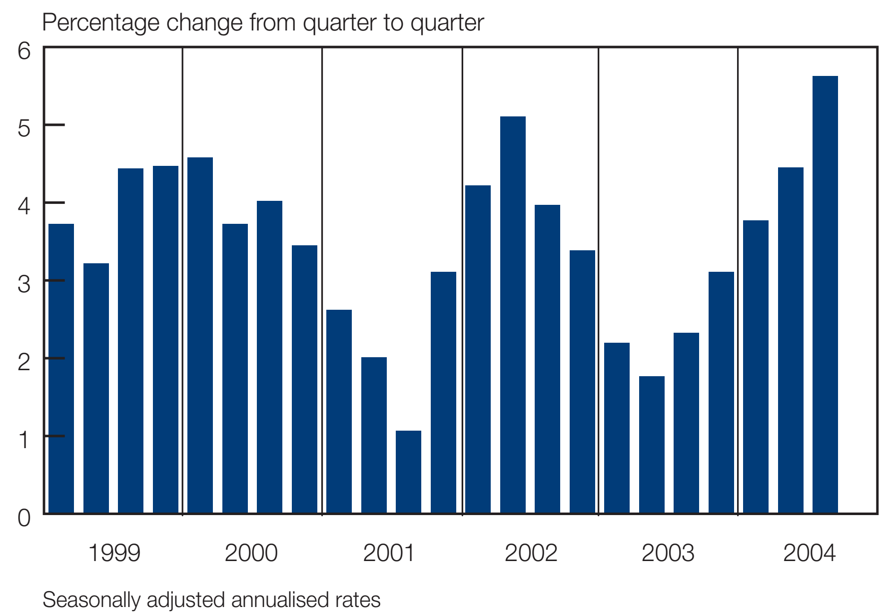
Real economic growth in South Africa accelerated further in the third quarter of 2004. After recording quarter-to-quarter annualised growth rates of 4 per cent in the first quarter of 2004 and 4½ per cent in the second quarter, growth in real *gross domestic product* gathered further momentum to 5½ per cent in the third quarter. Likewise, the growth in real value added by the non-agricultural sectors of the economy also accelerated from annualised rates of 4 per cent in the first two quarters of 2004 to 5½ per cent in the third quarter.

The primary, secondary and tertiary sectors of the economy all experienced stronger growth in real value added in the third quarter of 2004. Despite the brisk quarter-to-quarter growth, the level of the real gross domestic product in the first three quarters of 2004 was only about 3½ per cent higher than in the corresponding period of 2003.

2 The analysis in this section of the review is based on an extensively revised set of national accounts estimates. These revisions are based on more detailed or more appropriate data that have become available. In addition, the national accounts estimates at constant prices have been rebased from 1995 prices to 2000 prices. The revisions are introduced in a note elsewhere in this *Bulletin*.

The quarter-to-quarter growth rates referred to in this section are based on seasonally adjusted data.

Real gross domestic product



The real value added by the *primary sector* increased at an annualised rate of 8½ per cent in the third quarter of 2004 following an increase of 8 per cent in the second quarter. Strong increases in real value added were recorded by both the agricultural sector and the mining sector. The increase in real agricultural production was particularly noticeable in the volume of field crops and horticultural production and, to a lesser extent, in the real value added by livestock farming. However, the level of real value added by the agricultural sector in the first three quarters of 2004 was lower than in the corresponding period of 2003, notwithstanding a broadly unchanged level of maize production. The maize crop amounted to 9,7 million tons in 2004, compared with 9,6 million tons in 2003.

The growth in real value added by the *mining sector* accelerated from an annualised rate of 3 per cent in the second quarter of 2004 to 6 per cent in the third quarter. The increase in real value added in the mining sector in the third quarter of 2004 was the net result of an increase in the volume of production in the platinum group metals subsector as well as in diamond, coal and "other" mining, which more than neutralised a decrease in output recorded by the gold-mining industry. The increase in platinum and diamond production could partly be attributed to higher world demand. The real value added by the gold-mining subsector was affected negatively by difficult operational conditions at some mines during the third quarter. As a result of these developments the level of total real gross value added by the mining sector in the first three quarters of 2004 was about 4 per cent higher than in the same period of 2003.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2003					2004		
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	0	-2	-2	0	1	5	8	8½
Agriculture................	-6½	-19½	-21	-5½	-6	8½	22	14½
Mining......................	3½	6½	7	2	4½	3½	3	6
Secondary sector	-2	-3	-1	0	0	5	6	6½
Manufacturing	-3	-4	-2	-1	-1	5	6	6½
Tertiary sector	4	4	4	4½	4	3½	4	5
Non-agricultural sector ..	*2½*	*2½*	*3*	*3*	*3*	*4*	*4*	*5½*
Total	2	2	2½	3	3	4	4½	5½

The real value added by the *secondary sector* increased at an annualised rate of 6½ per cent in the third quarter, following increases of 5 and 6 per cent in the first and second quarters of 2004. This strong expansion in real value added was noticeable in all the subsectors of the secondary sector. Despite the sturdy quarter-to-quarter growth rates in the first three quarters of 2004, the growth over one year in the real value added by the secondary sector during this period amounted to only about 2½ per cent.

After the real value added by the *manufacturing sector* had increased by 6 per cent in the second quarter of 2004, a further increase at an annualised rate of about 6½ per cent was recorded in the third quarter. This stemmed from higher real output by the subsectors which manufacture food and beverages, base metal products and transport equipment.

The increase in real manufacturing production in the third quarter of 2004 can be attributed to robust growth in domestic demand which was in keeping with an increase in the utilisation of production capacity and the improvement in business confidence. In addition, the export demand for some manufactured goods also increased. The growth over one year in the real value added by the manufacturing sector amounted to about 2 per cent in the first three quarters of 2004, compared with a decline of 1 per cent in 2003 as a whole.

Growth in the real value added by the sector supplying *electricity, gas and water* accelerated from an annualised rate of 2 per cent in the second quarter of 2004 to 3½ per cent in the third quarter. This was mainly evident in the growth in real value added by the electricity generating subsector. The real value added by the *construction sector* continued to increase in the third quarter of 2004 on account of the buoyancy of building construction. Civil construction was negatively affected by subdued business conditions in new mining and public-sector infrastructural projects. Measured over one year the level of real value added by the construction sector increased by about 6 per cent in the first nine months of 2004, which was slightly more than the increase of 5 per cent recorded in 2003 as a whole.

The real value added by the *tertiary sector* increased at an annualised rate of 5 per cent in the third quarter of 2004, following increases of 3½ per cent and 4 per cent in the first and second quarters. This acceleration could be attributed to sturdy growth in real value added by most of the subsectors of the tertiary sector. Measured over one year the real value added by the tertiary sector increased by about 3½ per cent in the first three quarters of 2004.

The growth in the real value added by the *commerce sector* accelerated from an annualised rate of 5 per cent in the second quarter of 2004 to about 5½ per cent in the third quarter. Higher levels of real value added by retail and motor trade contributed significantly to the faster growth in the third quarter of 2004. Retailers benefited from strong growth in consumer demand. The growth in real value added by the motor-trade subsector was supported by firm consumer and investment demand. Stable prices, a decline in interest rates, improved business and consumer confidence and rising income contributed to the upsurge in consumer and investment demand. The growth in the real value added by the subsector catering and accommodation fell back somewhat in the third quarter of 2004.

The real value added by the *transport, storage and communication services sector* rose at an annualised rate of 6½ per cent in the third quarter of 2004, following strong increases of 6 per cent in the first quarter and 6½ per cent in the second quarter. The ongoing buoyancy of the telecommunication subsector largely drove these relatively high growth rates as the expansion in the cellular network, internet and call-centre activity continued. The firm pace of real growth recorded by the transport subsector was broadly maintained on account of the relatively strong growth in domestic output and foreign trade.

The real value added by the *financial intermediation, insurance, real-estate and business services sector* rose at an annualised rate of 5½ per cent during the third quarter of 2004, following a growth rate of 3½ per cent in each of the first two quarters. This could mainly be attributed to further increases recorded by the subsectors rendering financial and business services that complemented strong growth in real-estate activities. The improvement in real value added by the financial and business services subsectors could mainly be attributed to the more buoyant conditions in the securities markets and the higher level of international trade.

Domestic expenditure

The growth in total *real gross domestic expenditure* slowed down significantly in the third quarter of 2004 after a sharp increase at an annualised rate of 9½ per cent had been recorded in the second quarter. This development was the result of slower growth in real domestic final demand and a slowdown in inventory accumulation. Despite the slower growth in the third quarter, the growth in aggregate real gross domestic expenditure, measured over one year, amounted to about 6 per cent in the first three quarters of 2004. The growth momentum of gross domestic expenditure was significantly stronger than that of gross domestic product, resulting in an excess of spending over income or equivalently, an excess of imports over exports.

Real *final consumption expenditure by households* increased at an annualised rate of 6½ per cent in the third quarter of 2004, following a similar increase in the second quarter. The sustained growth in real household spending in the third quarter of 2004 was broadly based, but was particularly evident in expenditure on durable and semi-durable goods. Measured over one year, real final consumption expenditure by households increased by 6 per cent in the first three quarters of 2004, compared with a rate of increase of 3½ per cent in 2003 as a whole.

Real gross domestic expenditure

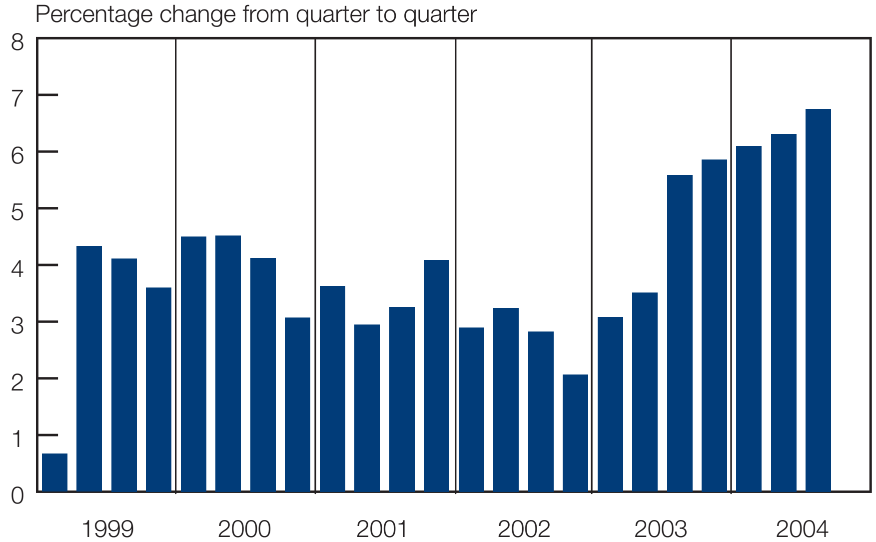
Percentage change at seasonally adjusted annualised rates

	2003					2004		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure by households	3	3½	5½	6	3½	6	6½	6½
Final consumption expenditure by general government	6	6½	6½	14	6½	6	6	0
Gross fixed capital formation	8	4½	7	10	9	10½	5½	2½
Change in inventories (R billions)*	7,6	10,5	9,2	9,2	9,2	8,3	12,9	11,4
Gross domestic expenditure	**8½**	**5**	**5½**	**7½**	**5½**	**4½**	**9½**	**2½**

* At constant 2000 prices

Households' real expenditure on *durable goods* increased at an annualised rate of 19 per cent in the third quarter of 2004, following rates of increase of 13½ per cent in the first quarter and 19 per cent in the second quarter. The highest growth was recorded in real outlays on personal transport equipment and furniture, but the growth in real expenditure on the other subcategories of durable goods also remained relatively strong in the third quarter of 2004.

Real final consumption expenditure by households



Seasonally adjusted annualised rates

Real outlays on *semi-durable goods* increased at an annualised rate of about 13 per cent in the third quarter of 2004. The increase in the third quarter was particularly evident in real expenditure on clothing and footwear and household textiles and furnishings.

The annualised growth in real expenditure on *non-durable goods and services* remained at relatively high levels of 4 per cent in the second quarter and 4½ per cent in the third quarter of 2004. Firm growth was recorded in almost all the non-durable goods and services subcategories.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

	2003					2004		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods..............	9	9½	30	6½	7½	13½	19	19
Semi-durable goods	4½	4½	7½	16½	6	20	13	13
Non-durable goods	1	1	1½	2½	1	3½	4½	6
Services........................	3	4	4½	6½	4	3½	3½	3½
Total	3	3½	5½	6	3½	6	6½	6½

The strong growth in real final consumption expenditure by households in the first three quarters of 2004 could be ascribed to a combination of factors, including

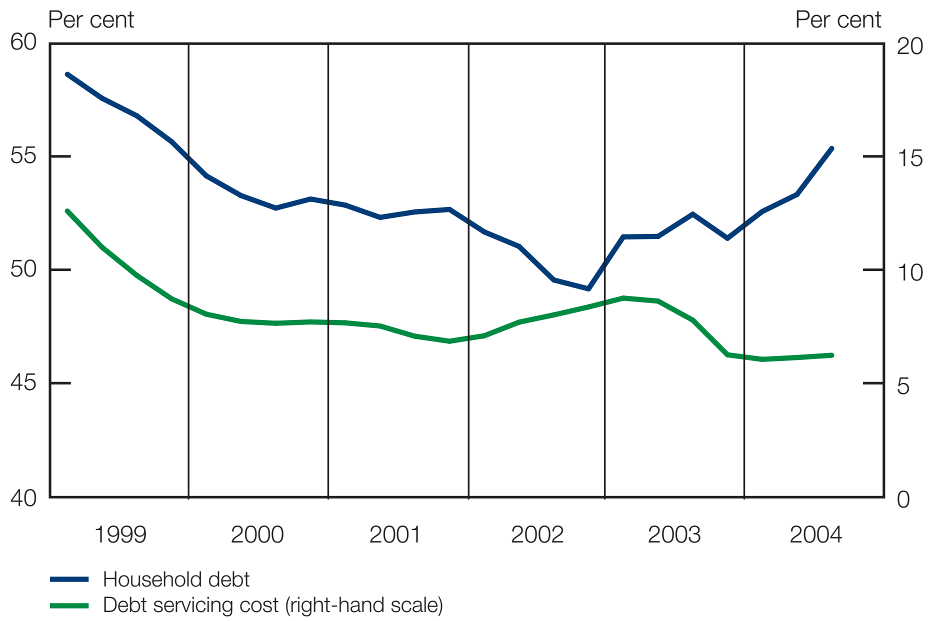
- sturdy growth in the real disposable income of households, which, measured over one year, amounted to 5½ per cent in the first nine months of 2004;
- positive wealth effects arising from increases in the prices of real estate, shares and bonds;
- an increase in consumer confidence and rising employment;
- the lower level of nominal interest rates; and
- the continuing firmness in the exchange value of the rand, which led to moderation and even decreases in the prices of imported and import-competing goods.

Consumers took advantage of the lower interest rate environment by increasing their debt relative to disposable income from 51½ per cent at the end of 2003 to 55½ per cent in the third quarter of 2004. Despite the higher debt levels, the financing cost of household debt amounted to only 6 per cent of disposable income in all three quarters of 2004. For 2003 as a whole this ratio stood at 8 per cent.

The growth in real *final consumption expenditure by general government* slowed down substantially from an annualised rate of 6 per cent in the second quarter of 2004 to almost no growth in the third quarter. The lower rate of spending growth in the third quarter followed the acquisition of three naval vessels in each of the preceding three quarters.

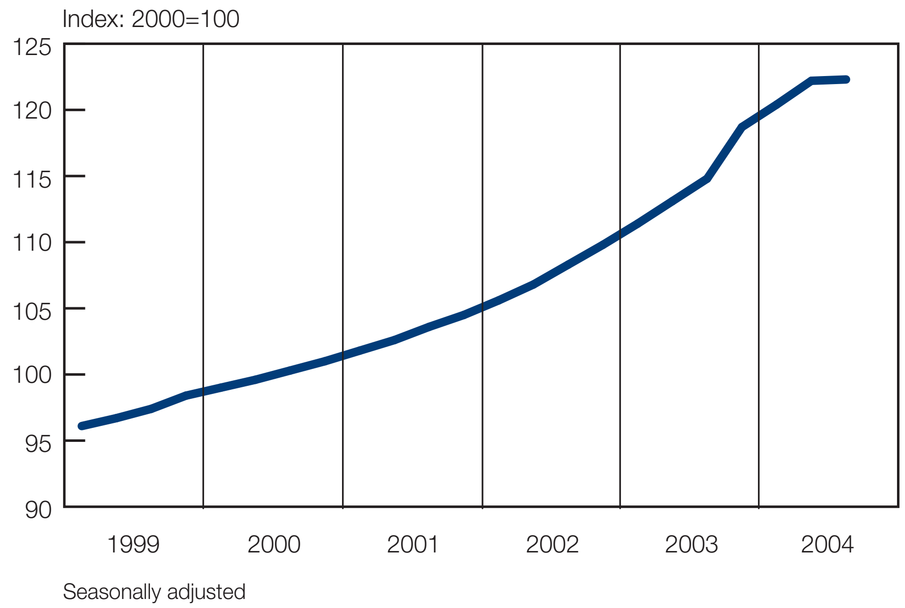
Nevertheless, real final consumption expenditure by general government in the first nine months of 2004 was about 7½ per cent higher than its level in the corresponding period of the previous year, mainly on account of an increase in real outlays on intermediate goods and services. Consequently, the ratio of general government final consumption expenditure to gross domestic product rose in the first three quarters of 2004 to an average level of 19½ per cent, compared with a ratio of 19 per cent in 2003.

Household debt and debt servicing cost as percentage of disposable income



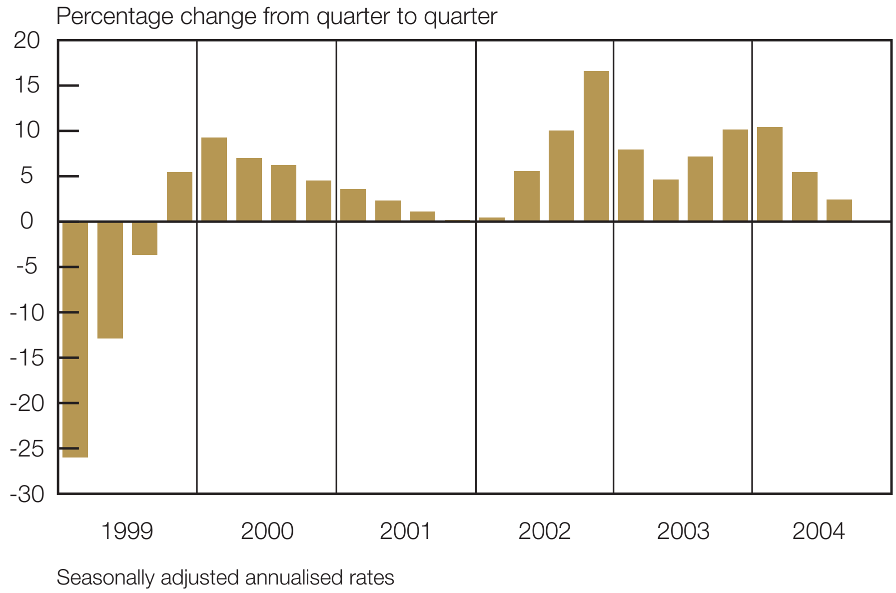
Total real *gross fixed capital formation* increased at an annualised rate of 2½ per cent in the third quarter of 2004, following increases of 10½ per cent in the first quarter and 5½ per cent in the second quarter. The growth in real gross fixed capital formation was evident in the private sector and in the general government sector.

Real final consumption expenditure by general government



Real fixed capital expenditure by *public corporations* declined in the third quarter of 2004 mainly as the result of a novel transaction by the South African Airways. Aircraft were acquired during the first and second quarters of 2004 on financial lease contracts and were accordingly recorded as imports and capital formation. During the third quarter some of these contracts were changed into operational lease contracts with a non-resident lessor. This necessitated recording the aircraft as exported on the one hand and as negative capital formation on the other. The level of public corporations' total real fixed capital formation in the first three quarters of 2004 was, however, still about 10½ per cent higher than the level in the corresponding period of 2003. Capital formation so far in 2004 has been boosted by an increase of more than 17 per cent in real gross fixed investment by Eskom reflecting capital expenditure on, *inter alia*, refurbishment of previously mothballed power stations to cope with projected increases in the demand for electricity.

Real gross fixed capital formation



Real gross fixed capital formation in the *private sector* increased further in the third quarter of 2004 at an annualised rate of 13 per cent. As a result, the level of private fixed capital formation in the first three quarters of 2004 was 7½ per cent higher than in the corresponding period of 2003. An analysis of real outlays on fixed capital in the private sector according to economic activity shows that higher levels of expenditure were registered in all the main sectors in the third quarter of 2004.

Significant increases were recorded in the mining sector, with the expansion of capacity by the platinum mines, and in the transport and communication sectors, with investment in new infrastructure by the cellular telephone industry and the expansion and renewal of vehicle fleets by transport companies. In addition, real capital expenditure in the retail trade sector increased as property developers and owners, as well as retailers tried to benefit from the surge in retail spending and the growing disposable income of consumers. In addition, the ongoing expansion of new residential developments – especially in the large metropolitan areas – created a demand for new retail outlets, and financial and other business services.

Real fixed capital spending by the *general government* recorded little growth in the third quarter of 2004. This can be attributed to subdued spending on road infrastructure.

Following the substantial increase in the level of *inventories* in the second quarter of 2004, these levels rose further in the third quarter, but at a slightly slower pace. As a result of the slower accumulation of inventories in the third quarter of 2004, inventory investment made a negative contribution of about ½ a percentage point to the growth in real gross domestic expenditure. The slower pace of inventory accumulation was particularly evident in the inventories of the manufacturing industry and wholesale trade.

Despite these developments, the level of industrial and commercial inventories as a percentage of the non-agricultural gross domestic product remained at a level of 15½ per cent in the third quarter of 2004, similar to the ratios recorded in the first and second quarters.

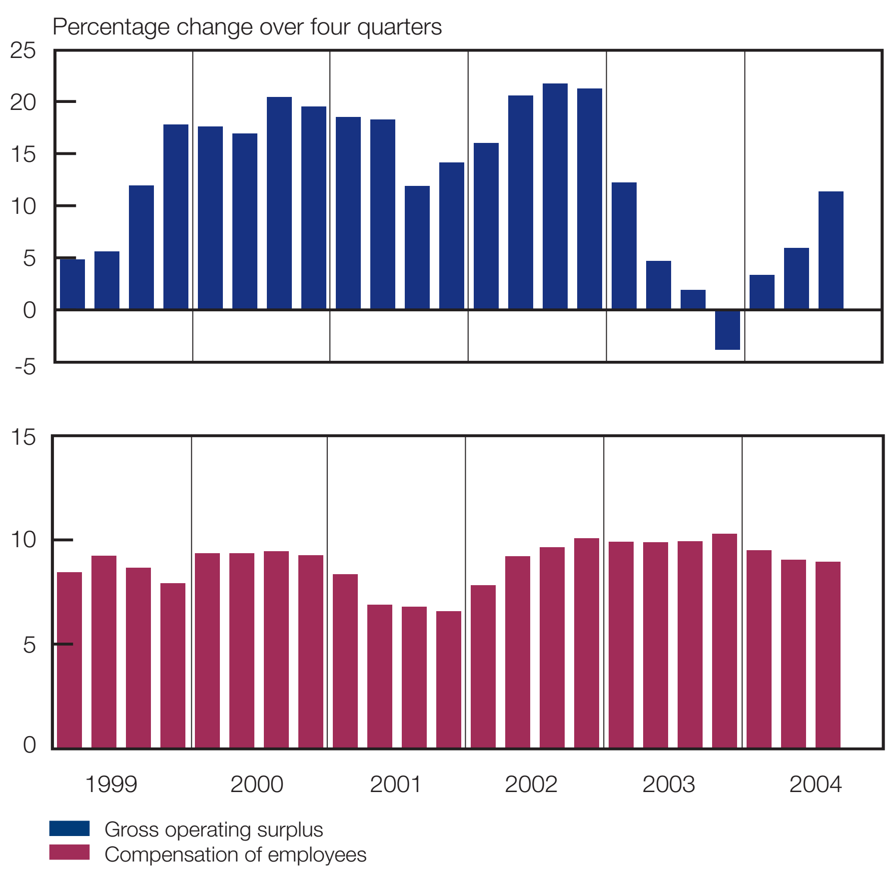
Factor income

The growth over four quarters in *total nominal factor income* accelerated from 6½ per cent in the first quarter to 7½ per cent in the second quarter and to about 10 per cent in the third quarter of 2004. This development was particularly evident in the faster growth in operating surpluses of business enterprises.

The rate of increase over four quarters in *total compensation of employees* declined from 9½ per cent in the first quarter of 2004 to 9 per cent in both the second and the third quarter. Wage settlements moderated over the past year but remained substantially higher than the prevailing general price increases. The sustained growth in total salaries and wages was evident in most sectors of the economy. Compensation of employees as a percentage of total factor income decreased from 51½ per cent in the first quarter to 51 per cent in the third quarter of 2004.

The growth in the total *nominal gross operating surplus* measured over four quarters increased from 3½ per cent in the first quarter to 11½ per cent in the third quarter of

Gross operating surplus and compensation of employees



2004. Higher increases were mainly registered by the mining, manufacturing and commerce sectors. The stronger growth in the gross operating surpluses of business enterprises was *inter alia* the result of sturdy growth in overall demand.

Gross saving

Gross saving as a percentage of gross domestic product weakened from 16 per cent in the first quarter of 2004 to 14 per cent in the second quarter, but recovered somewhat to 14½ per cent in the third quarter. Gross saving of general government and that of households remained weak in the third quarter of 2004, but an improvement was particularly evident in corporate saving.

Gross saving by the corporate sector as percentage of gross domestic product increased from 11½ per cent in the second quarter of 2004 to 12 per cent in the third quarter. This can mainly be ascribed to the faster growth of operating surpluses, while the growth in interest payments remained low. The gross saving by households as a percentage of gross domestic product remained at a level of about 2½ per cent in the first three quarters of 2004. This development was the result of the brisk increases in household consumption expenditure, which neutralised the strong growth in disposable income. The ratio of net household saving to disposable income remained at ½ a per cent during the first three quarters of 2004.

Gross saving by the general government as a percentage of gross domestic product has deteriorated steadily since the end of 2002 when a gross saving ratio of 2 per cent of gross domestic product was registered. In the third quarter of 2004 virtually no gross saving by general government was registered. The weakening in the gross saving by general government came mainly from a sharp increase in nominal final consumption expenditure, which offset lower debt servicing costs and healthy tax income.

Total gross saving fell short of total gross capital formation by an average of almost 13½ per cent during the first three quarters of 2004, compared with about 5 per cent in 2003 as a whole. This shortfall, equal to the deficit on the current account of the balance of payments, was readily financed by inflows of capital.

Employment

Following a prolonged period of decline in employment in the main formal non-agricultural sectors, the latest official labour market statistics indicate a welcome reversal of this trend. Since reaching its nadir in the second quarter of 2003, *enterprise-surveyed formal non-agricultural employment* has expanded by roughly 196 000 jobs or by 3,1 per cent to June 2004. Statistics obtained from the *Survey of Employment and Earnings* by Statistics South Africa indicate that the quarter-to-quarter pace of increase in employment accelerated meaningfully from an annualised rate of 2,2 per cent in the third quarter of 2003 to 5,0 per cent in the second quarter of 2004.

As the pick-up in employment gained momentum, gains in the second quarter of 2004 alone accounted for roughly 40 per cent of the additional employment opportunities in the formal non-agricultural sector during the year. The bulk, i.e. around 90 per cent of the employment gains during the four quarters to June 2004, occurred in the private sector. The employee complement in the public sector also expanded further in the second quarter of 2004, albeit at a slower pace, contributing to the rise in the overall level of formal non-agricultural employment.

The recovery in *private-sector employment* from the second quarter of 2003 onwards was fairly widespread as only the gold-mining and construction sectors were still shedding jobs up to the first quarter of 2004. The quarter-to-quarter pace of employment loss in the gold-mining sector actually accelerated further in the second quarter of 2004, but employment numbers in the construction sector picked up somewhat. The increase in construction-sector employment in the second quarter of 2004 was due to the appointment of more employees for new projects resulting from a strong increase in construction-sector activity. Civil engineering, electrical contracting, and construction in other building sub-industries all reflected quarterly increases in employment numbers.

According to the *Business Confidence Index* of the Bureau for Economic Research and Rand Merchant Bank, confidence in the building industry remained at high levels in the third quarter of 2004 – index levels that were previously attained in the 1980s. Disconcerting, however, is the fact that 89 per cent of the building contractors that were surveyed indicated a shortage of skilled labour, especially for artisan-type jobs. While this constraint could impair growth and increase labour costs in future, it is nevertheless expected that activity in the construction sector will increase further in the fourth quarter of 2004.

Annualised quarter-to-quarter change in non-agricultural private-sector employment in the second quarter of 2004

Sector	Percentage change
Gold mining	-10,1
Non-gold mining	19,9
Manufacturing	0,6
Electricity supply	-1,7
Construction	1,5
Trade, catering and accommodation services	8,5
Transport, storage and communication	6,4
Financial intermediation, insurance, real-estate and business services	3,4
Washing and laundry services	20,2
Total private sector	5,3

Source: Statistics South Africa, *Survey of Employment and Earnings*

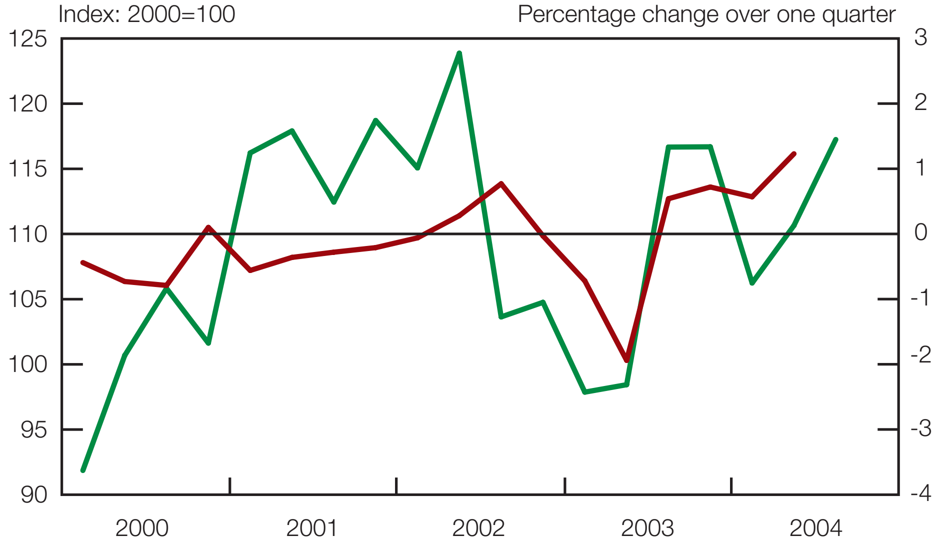
Unlike the continued contraction in gold-mining employment, employment in the non-gold mining sector expanded at a robust pace. When measured over one quarter and expressed at an annualised rate, non-gold mining employment increased at a rate of 19,9 per cent in the second quarter of 2004. It rose by no less than 24,2 per cent in the year to the second quarter. The prices of especially platinum group metals have been favourable over the past year, while new mining facilities have become operational, following planning and investment over the past few years. This has spilled over into new jobs being created.

The expansion in employment in the trade, catering and accommodation services sector in the second quarter of 2004 was concentrated in restaurants, bars and canteens, and wholesale trade of foodstuffs. The employment increase in the financial intermediation, insurance, real-estate and business services industry in the second quarter of 2004 resulted from the appointment of new employees by labour recruitment and personnel agencies, with investigation and security activities also providing more jobs.

Increases in *public-sector* employment in the second quarter of 2004 occurred on almost all levels of the civil service and amounted to an annualised rate of 4,1 per cent. The growth in employment numbers in the public sector was curbed only by declines in employment by public-sector institutions in the transport, storage and communications industry. The personnel complement in the public sector rose almost without interruption during the seven-quarter period to the second quarter of 2004, raising the overall level of employment by almost 40 000 jobs.

The general improvement in employment prospects in recent months is corroborated by the findings of the latest *Labour Force Survey* by Statistics South Africa. Results from this household-based survey indicate that formal non-agricultural employment expanded somewhat in the six months to March 2004. Increased employment over this period offset the influx of additional entrants to the labour market, leaving the official unemployment rate slightly lower at 27,8 per cent in March 2004, down from 28,4 per cent in September 2003.

Job advertisement space in print media and employment in formal non-agricultural sectors



The further increase in the volume of job advertisements in the print media in the third quarter of 2004, an indicator that has historically related fairly well to changes in formal non-agricultural employment, is encouraging. While the employment component of the *Investec Purchasing Managers Index* fell back somewhat during June and July 2004, the indicator rose again in the subsequent months to September as prospects in the manufacturing sector improved. The utilisation of production capacity in the manufacturing sector also increased considerably in the early part of 2004, which may in time contribute to increased labour absorption, given the expected further increase in production in the months ahead, as indicated by the Purchasing Managers Index.

Alongside the improvement in employment prospects, workers were more inclined to engage in strike activity during the more recent past. In fact, according to Andrew Levy Employment Publications the number of man-days lost due to strikes and other forms of industrial action rose from 375 000 in the first nine months of 2003 to 1,08 million in the same period in 2004. Wage-related issues accounted for the bulk of the man-days lost during this period as employees were generally more willing to back up their wage demands with strike action.

Labour cost and productivity

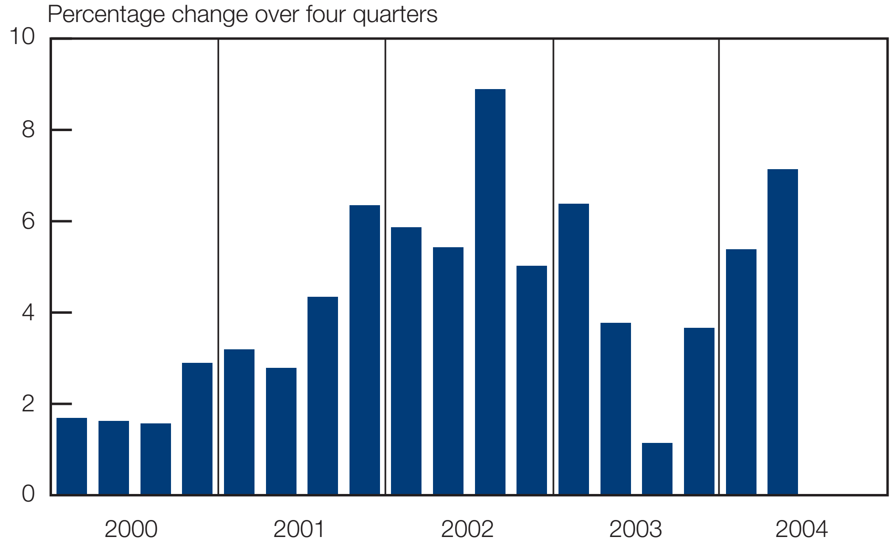
Alongside the deceleration in consumer price inflation since late 2002, the rate of increase in *nominal remuneration per worker* in the formal non-agricultural sector moderated from 9,6 per cent in 2002 to 8,7 per cent in 2003 and further to 7,6 per cent in the year to the second quarter of 2004. The deceleration in nominal wage growth during the past two-and-a-half years was evident in both the private and public sectors, according to data collected by Statistics South Africa.

The moderation in wage pressures in the economy is corroborated by results from the *Wage Settlement Survey* conducted by Andrew Levy Employment Publications. According to this survey the average settlement rate in collective bargaining agreements declined from 8,9 per cent in the first nine months of 2003 to 6,7 per cent in the same period of 2004. The increase in the average *minimum wage* so far in 2004 has, however, amounted to 12,1 per cent, representing a significant real gain to recipients.

Economy-wide labour productivity growth at an average rate of around 4,5 per cent in 2003 surpassed that in the preceding year. Increases in employment numbers in the first quarter of 2004 outstripped the rise in production volumes in the economy, weighing on labour productivity growth. In fact, year-on-year increases in *real output per worker in the formal non-agricultural sectors* of the economy fell to 2,4 per cent in the first quarter of 2004. The subsequent strong pick-up in formal non-agricultural employment resulted in labour productivity growth slowing down markedly to 0,5 per cent in the year to the second quarter of 2004. Contrary to the slowdown in labour productivity growth in the economy as a whole, production per worker in the *manufacturing sector* rose by 1,4 per cent in the year to the second quarter of 2004; it had been decreasing in preceding quarters.

The increase in the *cost of labour per unit of production* in the formal non-agricultural sector was contained at a year-to-year rate of 4,0 per cent in 2003, somewhat lower than the 6,0-per-cent increase in 2002. Despite the slowdown in nominal wage growth, the year-on-year rate of increase in nominal unit labour cost rose to 5,4 per cent in the first quarter of 2004 and 7,1 per cent in the second quarter, as labour productivity

Non-agricultural nominal unit labour cost

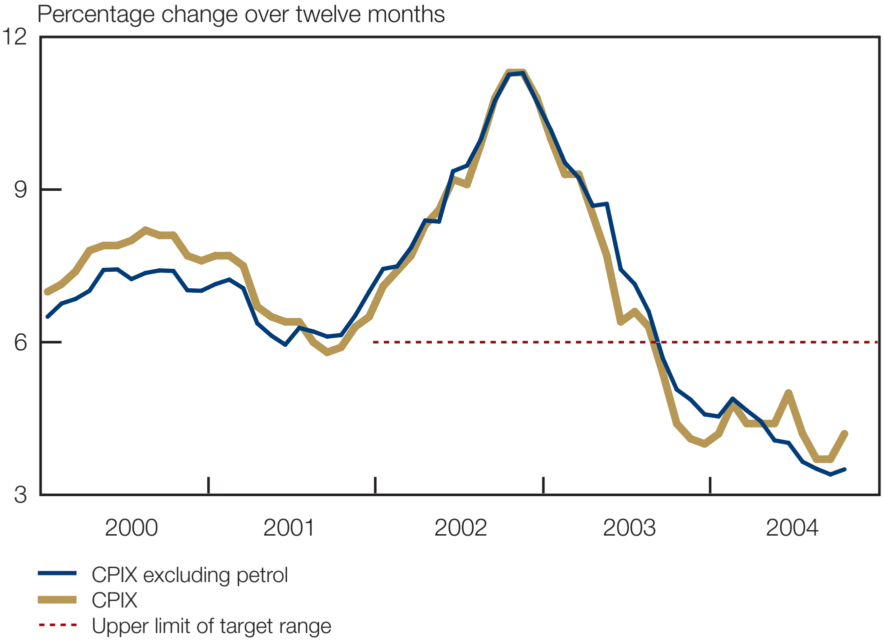


growth decreased. At these rates, the increase in labour cost exceeded the 6-per-cent upper limit of the inflation target range.

Prices

CPIX inflation has receded to historically low levels and has consistently remained within the target range of 3 to 6 per cent in the fourteen months to October 2004. Muted inflationary pressures resulted from the consistent application of disciplined monetary and fiscal policies alongside the meaningful recovery in the exchange rate of the rand. While food prices at both the production and retail level recorded exceptionally low increases, the recent rise in the international price of crude oil drove domestic fuel prices higher, preventing a further deceleration in price inflation. In fact, higher petrol prices added some 0,7 percentage points to year-on-year CPIX inflation in October 2004, keeping it at 4,2 per cent.

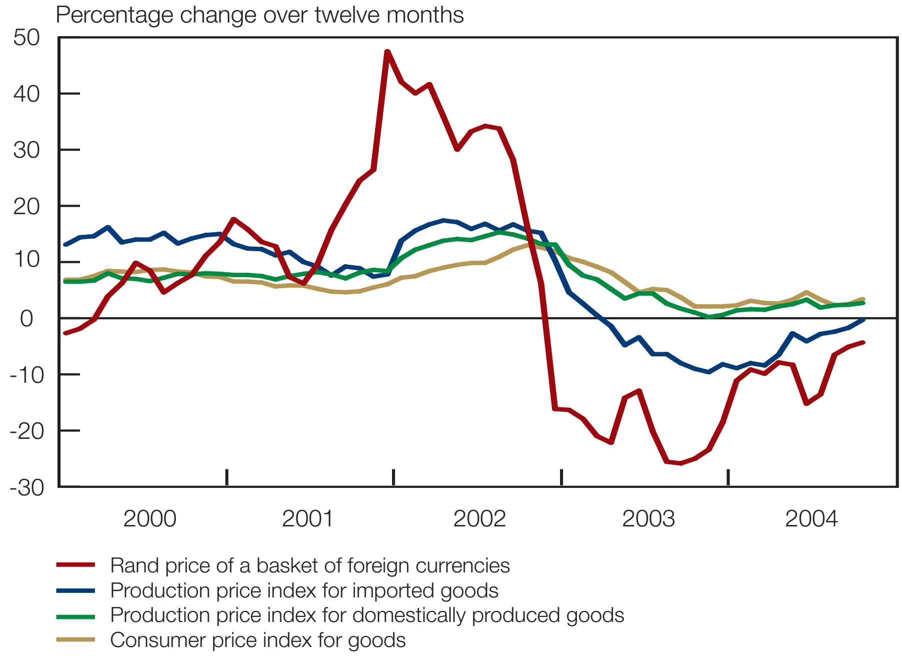
CPIX



The price-containing effects of the recovery in the exchange rate of the rand are clearly illustrated by developments in the *production prices of imported goods.* The prices of imported goods that increased by as much as 17,2 per cent in the year to April 2002, actually started to decrease from April 2003. Since then these prices have decreased continuously for a period of eighteen months. In October 2004 the price level of imported goods had fallen by as much as 9,3 per cent from its peak in October 2002.

The year-on-year rate of *decline* in the prices of imported goods moderated, on balance, from 9,6 per cent in November 2003 to 0,3 per cent in October 2004 as energy prices rose consistently. The pace of decline in the prices of imported goods was further moderated by a pick-up in production price inflation in South Africa's main trading-partner countries. These countries also experienced increased cost pressures as oil prices rose. In fact, the monthly average price of Brent crude oil rose from around US$30 per barrel in December 2003 to around US$50 per barrel in October 2004. Consequently, year-on-year increases in the composite wholesale price index of South Africa's main trading-partner countries accelerated from 0,8 per cent in March 2004 to 4,6 per cent in September.

Pass-through of exchange rate changes



Notwithstanding continued declines in the prices of imported goods when measured over periods of twelve months, the quarter-to-quarter rate of change reverted from prices decreasing at an annualised rate of 6,9 per cent in the first quarter of 2004 to prices increasing at an annualised 4,6 per cent in the second quarter. The marked acceleration in the quarter-to-quarter pace of increase in the prices of imported goods over this period can mainly be attributed to the higher prices of imported crude oil. Following declines in the prices of a broad range of imported goods due to the renewed appreciation of the rand on international currency markets in recent months, the quarter-to-quarter rate of increase in the prices of imported goods subsided to 1,1 per cent in the third quarter of 2004.

Cheaper imports reduced the intermediate input cost of domestic production and led to intensified price competition in general, moderating the rise in the prices of *domestically produced goods.* The year-on-year rate of increase in the prices of domestically produced goods accordingly slowed down markedly from 15,3 per cent in August 2002 to 2,7 per cent in October 2004. Notwithstanding the general waning of *domestically*

Production prices

Quarter-to-quarter percentage changes at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2002:	**Year**	**13,5**	**15,5**	**14,2**
2003:	1st qr	0,0	-8,9	-2,6
	2nd qr	-0,1	-11,7	-3,3
	3rd qr	4,8	-8,0	1,2
	4th qr	-2,2	-7,0	-3,3
	Year	**3,9**	**-4,2**	**1,7**
2004:	1st qr	3,5	-6,9	0,9
	2nd qr	4,8	4,6	4,7
	3rd qr	3,0	1,1	2,3

produced goods price inflation, certain production prices experienced marked increases. Alongside the general rise in international commodity prices, domestic coal prices, for instance, increased at a year-on-year rate of 31,3 per cent in October 2004. Albeit less significant, the price of other mining products increased by 11,2 per cent in the year to October 2004, while the prices of petrol and other products of petroleum and coal rose by 23,8 per cent over the same period. These increases were largely offset by declines in the prices of agricultural and manufactured food products. Declines also occurred in the prices of leather and leather products, paper and paper products, wood and wood products as well as textiles, clothing and footwear.

The quarter-to-quarter and annualised rate of change in the prices of domestically produced goods reverted from prices declining at a rate of 2,2 per cent in the fourth quarter of 2003 to prices increasing at a rate of 4,8 per cent in the second quarter of 2004. This acceleration resulted from steeper increases in the prices of electricity, gas, water and mining products, as well as in the prices of alcoholic beverages and tobacco, and basic metals and metal products. Following declines in the prices of agricultural, forestry and fishing products as well as in manufactured food, and textiles, clothing and footwear, the quarter-to-quarter pace of increase in domestically produced goods slowed down to 3,0 per cent in the third quarter of 2004.

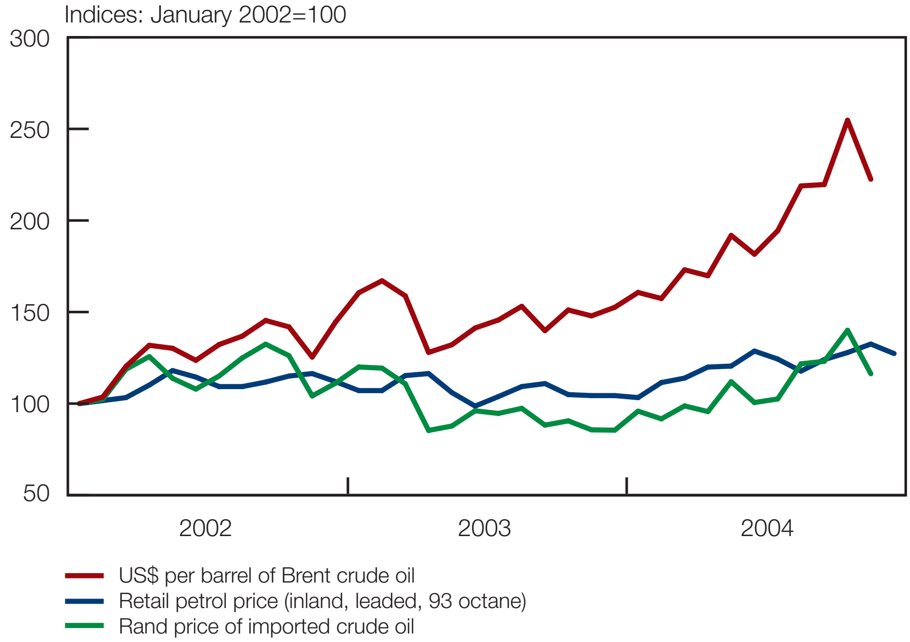
As a result of the slowdown in domestically produced goods price inflation and *declining* prices of imported goods, the year-on-year rate of increase in the *all-goods production price index* declined steeply from 15,4 per cent in September 2002 to 0,2 per cent in August 2003. In the ensuing eight months the average level of all-goods production prices actually fell below that of the corresponding month in the preceding year. However, from May 2004 all-goods production prices were marginally higher than a year earlier and by October 2004 had risen by 1,9 per cent over the year.

The short-term pace of increase in all-goods production prices in recent months outpaced that of the year-on-year measure of price increase. When measured from quarter to quarter and expressed at an annualised rate, all-goods production price inflation picked up from 0,9 per cent in the first quarter of 2004 to 4,7 per cent in the second quarter. Following lower rates of increase in the prices of both imported and domestically produced goods, all-goods production price inflation moderated to an annualised rate of 2,3 per cent in the third quarter of 2004.

Mainly as a consequence of the rise in petrol prices, *twelve-month CPIX inflation* (i.e. changes in the overall consumer price index for metropolitan and other urban areas, excluding the interest cost of mortgage finance) rose from 4,0 per cent in December 2003 to 5,0 per cent in June 2004. Following a moderation in both CPIX goods and services price inflation, overall year-on-year CPIX inflation then declined to 3,7 per cent in both August and September 2004 – the lowest rate of increase since the inception of the CPIX measure of inflation in 1997. Over and above the steep increases in petrol prices, higher inflation in the prices of alcoholic beverages and tobacco and services not related to housing or transport added to inflationary pressures and pushed year-on-year CPIX inflation to 4,2 per cent in October 2004.

CPIX goods price inflation recorded a year-on-year rate of 2,4 per cent in September 2004, having generally remained below 3 per cent during the twelve months to September 2004. Higher petrol prices added some 1,2 percentage points to year-on-year goods price inflation in October 2004 to amount to 3,1 per cent. However, the appreciation in the exchange rate of the rand helped to contain the rise in the retail price of petrol and diesel. When measured from January 2002 to November 2004, the average price of Brent crude oil had risen by around 123 per cent, while the *rand price* of imported crude oil rose by 16,2 per cent and the retail price of petrol by 32,5 per cent. Muted increases in the prices of food products, however, offset the inflationary effects of higher energy prices somewhat in recent months. The dampening effect of sustained rand strength also led to declines in the prices of furniture and equipment, clothing and footwear and vehicles in the past year or so.

Crude oil and domestic petrol prices



Contrary to goods price inflation, *CPIX services price inflation* consistently remained in excess of 6 per cent per annum since 1997. Nonetheless, year-on-year CPIX services price inflation moderated from 8,6 per cent in September 2003 to 6,3 per cent in October 2004. Housing services price inflation fell back from rates in excess of 10 per cent in the closing months of 2003 and the first few months of 2004 to 6,6 per cent in the year to October 2004. Notwithstanding rising energy costs, overall CPIX services price inflation benefited from relatively low increases in transport services prices at year-on-year rates of around 3 per cent in the eight months to October 2004.

Inflation in the components of CPIX

Percentage change over same period in the previous year

	Weights	2003 (annual average)	Oct 2004
Transport running cost	5,7	-0,4	17,0
Alcoholic beverages and tobacco	3,1	11,2	9,4
Services excluding housing and transport	16,5	7,3	6,8
Total housing services	13,4	9,7	6,6
Total transport services	*3,9*	*5,5*	*3,1*
Total other goods	*17,5*	*5,9*	*3,0*
Food	26,9	8,5	1,9
Furniture and equipment	3,2	4,1	0,0
Vehicles	5,7	4,2	-0,9
Clothing and footwear	4,1	2,0	-4,6
Total CPIX	*100,0*	*6,8*	*4,2*

Italics denote year-on-year increases within inflation target range of between 3 and 6 per cent for the latest available observation

In contrast to the inflation-moderating effects of monthly *decreases* in domestic worker wages that applied from March to August 2004, monthly wage increases of 0,8 per cent will apply in the subsequent period up to February 2005, based on results from the most recent *Labour Force Survey*. When annualised, these increases amount to 10 per cent, well in excess of recent economy-wide nominal wage growth per worker.

Notwithstanding CPIX inflation remaining within the inflation target range for fourteen consecutive months by October 2004, continued high international crude oil prices, nominal unit labour cost increases in excess of the inflation target range and high increases in certain administered prices, pose a near-term risk to the future inflation outcome. But the fiscal prudence applied by government, the recovery in the exchange rate of the rand, an improved outlook for food prices despite drought conditions in some parts of the country, the commitment by the public authorities to contain administered prices, as well as muted consumer price inflation in the rest of the world, are likely to mitigate inflationary pressures in the months ahead.

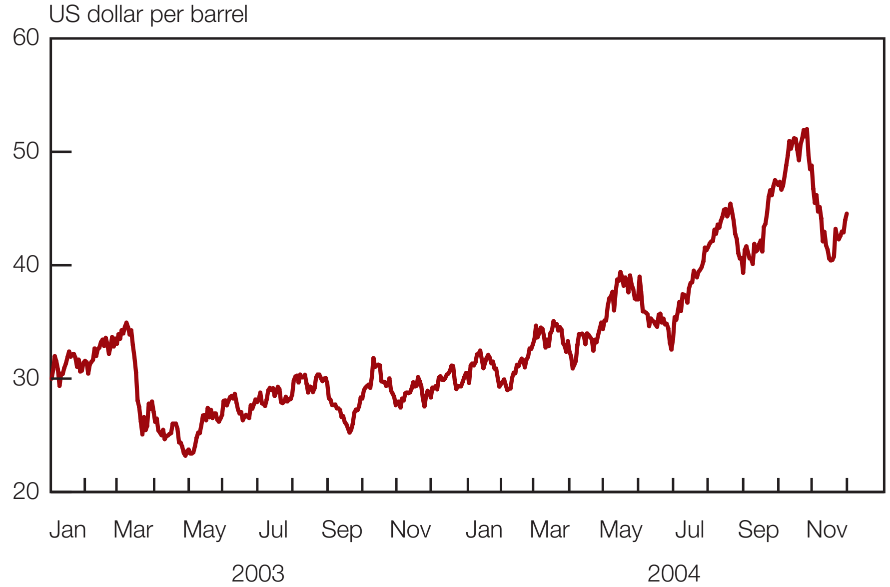
Foreign trade and payments

International economic developments

After moderating slightly in the second quarter of 2004, growth in the global economy regained some momentum in the third quarter. In September 2004 the International Monetary Fund (IMF) revised its global growth projection for 2004 upward to 5 per cent – the highest in almost three decades. On account of the sharp increase in oil prices, the steady decline in output gaps across the world and the ongoing withdrawal of fiscal and monetary stimulus, the IMF forecast a moderation in global growth to 4,3 per cent in 2005. Growth in the advanced economies was projected at 3,6 per cent in 2004 before declining to 2,9 per cent in 2005. Economic growth in emerging-market and developing countries appears to be robust, despite the adverse impact of higher oil prices on many countries. Growth on the African continent was expected to accelerate to 4,5 per cent in 2004, the highest in eight years. In November the IMF downgraded its previous forecast for global growth in 2005 due to high oil prices.

The global economic recovery has been accompanied by a strong rebound in global trade, some of which has exerted upward pressure on commodity prices. In addition, Brent crude oil prices reached record-high levels around US$52 per barrel in the middle of October 2004, representing an increase of more than 70 per cent since the beginning of the year. The sharp increase in oil prices was due to a combination of unexpectedly strong global oil demand as well as supply concerns in several major oil-exporting countries including Iraq, Nigeria, Norway, Russia and Venezuela. The disruption of the oil production in the Gulf of Mexico due to *Hurricane Ivan* also had a negative effect on the supply of crude oil. Crude oil prices started to decline towards the end of October after the Norwegian government intervened to end a four-month strike in the oil industry. Oil prices dropped further after US oil inventories increased unexpectedly along with the first interest rate increase in China in nine years. The Chinese government is concerned about the overheating of its economy which grew by 8,2 per cent in the third quarter of 2004, following an increase of 2,6 per cent in the previous quarter, and the interest rate increase is expected to cause growth in the economy to slow and result in lower demand for oil.

Price of Brent crude oil



Crude oil prices again started to increase since mid-November on concerns that heating-fuel inventories could remain vulnerable, as winter approaches in the northern hemisphere.

Many countries have increased official interest rates after global economic conditions started to improve since mid-2003 (see the accompanying table). For instance, the US Federal Open Market Committee (FOMC) increased the target for the federal funds rate in November 2004 to 2 per cent, the fourth consecutive 25-basis-point increase from the record low 1 per cent which applied from June 2003 to June 2004. The FOMC believes that output growth has regained some momentum and that labour markets have improved modestly.

Net changes in key central bank interest rates, 1 January to 30 November 2004

Changes in basis points

Mexico	260	Australia	0	Canada	-25
New Zealand	150	Chile	0	Korea	-50
Poland	125	Denmark	0	**South Africa**	**-50**
Hong Kong SAR	100	Euro area	0	Sweden	-75
United Kingdom	100	Japan	0	Israel	-90
United States	100	Malaysia	0	Hungary	-250
Brazil	75	Philippines	0	Russia	-300
Czech Republic	50				
Switzerland	50				
Thailand	50				
China	27				

Source: National central banks

Current account

Continued relatively favourable global economic conditions contributed to a further moderate improvement in South Africa's export performance in the third quarter of 2004. By contrast, the value of goods imported contracted somewhat over the same period, but from an exceptionally high base in the second quarter. As a result, South Africa's trade balance reverted from an annualised deficit of R4,6 billion in the second quarter of 2004 to a surplus of R12,1 billion in the third quarter. Together with a widening of the shortfall on the country's net service, income and current transfer account with the rest of the world, this caused the deficit on the current account to narrow from R48,4 billion in the second quarter of 2004 to R35,0 billion in the third quarter. As a ratio of gross domestic product, the current-account deficit amounted to 2½ per cent in the third quarter of 2004 compared with 3½ per cent in the second quarter.

The value of *merchandise exports* advanced by 4½ per cent from the second quarter of 2004 to the third quarter, notwithstanding an increase in the average external value of the rand. Increases which caused the rand prices of merchandise exports to fall by 1½ per cent were noted in the categories for mining and manufactured goods; in particular, in the value of exports the category for vehicle and transport equipment rallied as South African Airways relinquished ownership of some previously acquired aircraft in favour of a foreign operational lessor. The physical quantity of merchandise exports, which had increased by 7 per cent in the second quarter of 2004, rose by a further 6½ per cent in the third quarter.

Balance of payments on current account

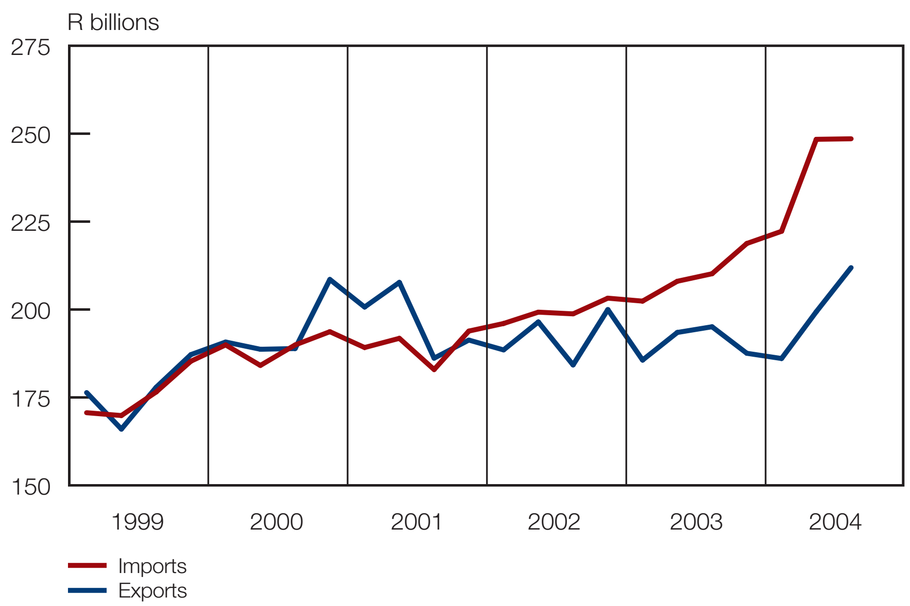
Seasonally adjusted and annualised
R billions

	2003			2004		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	258,5	244,5	256,0	258,4	281,5	294,6
Net gold exports	29,5	35,9	34,2	33,4	33,5	31,5
Merchandise imports	-260,9	-266,2	-262,8	-270,0	-319,6	-314,0
Trade balance	27,1	14,2	27,4	21,8	-4,6	12,1
Net service, income and current transfer payments	-39,9	-36,3	-38,6	-35,4	-43,8	-47,1
Balance on current account	-12,8	-22,1	-11,2	-13,6	-48,4	-35,0

While the physical quantity of *gold exports* contracted by 2½ per cent in the third quarter of 2004, the value of net gold exports declined by about 6 per cent over this period. Mainly due to the further appreciation of the exchange rate of the rand, the average realised price of gold decreased by 3½ per cent from R2 603 per fine ounce in the second quarter of 2004 to R2 510 in the third quarter. The London fixing price of gold rose from US$393 per fine ounce to US$401 over the period.

The volume of *merchandise imports* remained largely unchanged in the third quarter of 2004 notwithstanding a substantial decline in the physical quantity of imported crude oil. The international price of crude oil, which had averaged US$41 per barrel in the third quarter of 2004, rose to almost US$50 per barrel in October. However, largely due to the strengthening of the external value of the rand, the rand prices of imported goods declined by 2 per cent from the second to the third quarter of 2004. The volume of non-oil merchandise imports increased by about 1½ per cent due to higher manufacturing imports, in particular in the subcategories for machinery and electrical equipment, textiles and textile articles, and chemical products. Essentially as a result of a decline in rand prices, the value of merchandise imports fell by 2 per cent in the third quarter of 2004, after having increased by 18½ per cent in the second quarter.

Real merchandise imports and exports



Seasonally adjusted and annualised at constant 2000 prices

South Africa's foreign trade with China

The People's Republic of China has emerged as one of the most vibrant developing economies, consistently recording high rates of growth. With the buoyancy and size of the Chinese economy countering the geographical distance between the countries, an increasing share of South African imports originates in China and a rising share of South African exports is destined for China. The bilateral trade balance favours China by a significant margin.

Contribution of People's Republic of China to South Africa's merchandise imports and exports*
Per cent

Period	Imports	Exports*
2000	3,7	1,0
2001	4,1	1,5
2002	5,3	1,5
2003	6,3	2,3
2004**	6,7	2,2

* Including gold
** First nine months of the year

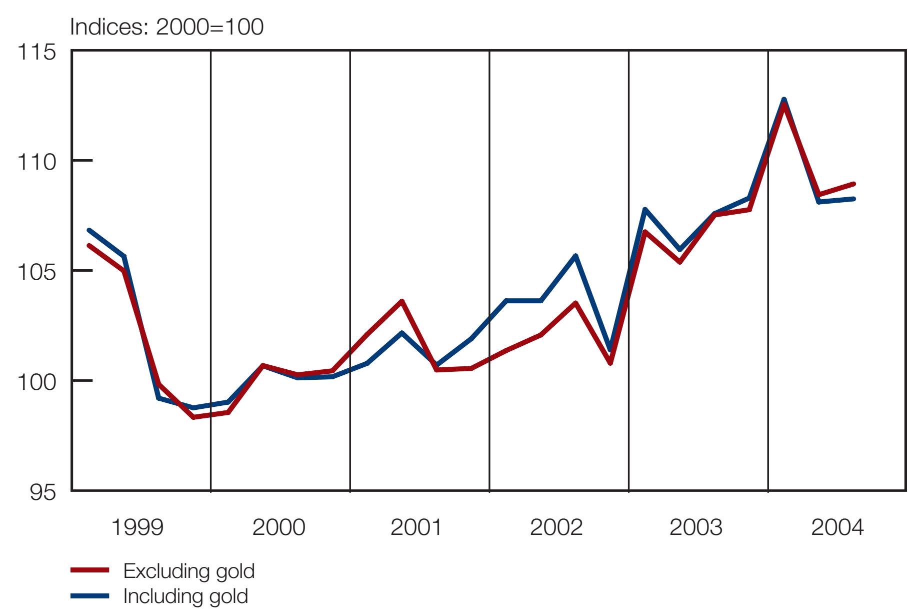
The deficit on the service, income and current transfer account widened from R43,8 billion in the second quarter of 2004 to R47,1 billion in the third quarter. Payments for services rose marginally from R58,8 billion in the second quarter of 2004 to R59,8 billion in the third quarter while receipts for services rendered to non-residents contracted from R52,7 billion in the second quarter of 2004 to R49,0 billion in the third quarter. Net payments for international trade in services accordingly increased from R6,1 billion to R10,8 billion over this period.

At the same time, income payments (i.e. interest and dividend payments) to non-resident investors declined from R50,5 billion in the second quarter of 2004 to R48,1 billion in the third quarter whereas income received on investments abroad fell from R24,1 billion in the second quarter of 2004 to R22,4 billion over the same period. Net income payments to the rest of the world accordingly narrowed from R26,4 billion in the second quarter of 2004 to R25,7 billion in the third quarter.

Terms of trade

With export prices declining marginally less than import prices, South Africa's terms of trade improved by ½ a per cent in the third quarter of 2004. Largely due to the favourable

Terms of trade



run in commodity prices, the terms of trade including gold recorded a cumulative increase of 9,6 per cent from its recent low point in the fourth quarter of 1999 to the third quarter of 2004, as depicted in the graph on the opposite page.

Financial account

The first three quarters of 2004 were characterised by a substantial net inward movement of capital to an amount of R60,4 billion – more than double the inflow of capital of R28,5 billion that was registered during the same period of 2003. A net inflow of capital to the value of R20,6 billion was recorded in the third quarter of 2004, compared to a net inflow of R25,9 billion in the preceding quarter. Both the net inflow of portfolio funds and the net inflow of other investment capital contracted from the second to the third quarter of 2004.

Net financial transactions not related to reserves

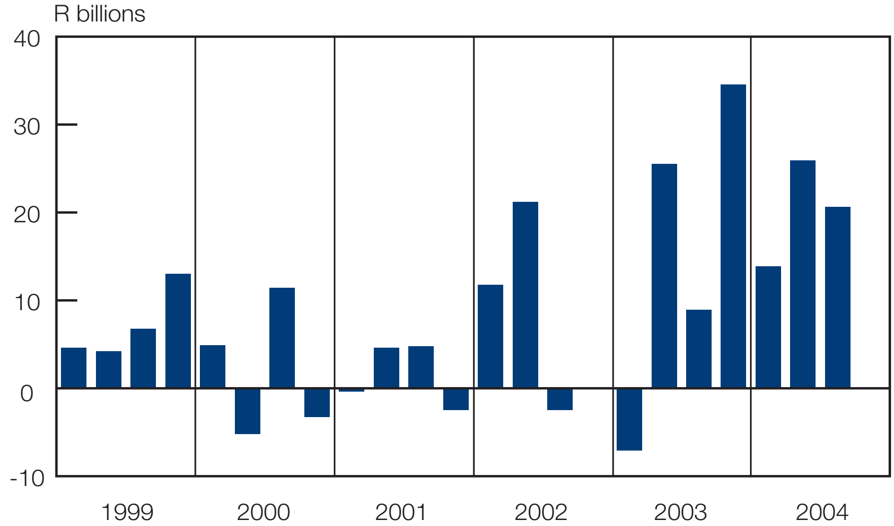
R billions

	2003			2004		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	1,8	3,4	5,7	7,8	-1,8	0,1
Portfolio investment	-4,3	-6,2	7,9	5,1	14,1	3,0
Other investment	-1,7	11,6	13,5	4,5	4,0	-2,9
Change in assets						
Direct investment	-1,5	-1,8	-5,4	1,0	-10,2	-0,7
Portfolio investment	-0,3	-0,5	-1,0	0,0	-1,4	-0,3
Other investment	5,8	10,8	23,5	-3,8	6,4	4,1
Total financial transactions*	**10,3**	**34,5**	**63,1**	**14,1**	**25,9**	**20,6**

* Including unrecorded transactions

In the *Medium Term Budget Policy Statement*, which was delivered by the Minister of Finance on 26 October 2004, further exchange control relaxations were announced, as follows:

Balance of payments: Financial account



Balance on financial account, including unrecorded transactions

- Exchange control limits were abolished on new outward foreign direct investments by South African institutions. Application to the South African Reserve Bank's Exchange Control Department will, however, still be required in terms of existing foreign direct investment criteria, including demonstrated benefit to South Africa.

- South African institutions will in future be allowed to retain foreign dividends offshore. Foreign dividends repatriated to the country after 26 October 2004 may be transferred offshore again at any time for any purpose.

- All restrictions on investment by South African individuals in securities of foreign companies, governments and institutions listed on the South African bond and securities exchanges were lifted.

Foreign-owned assets in South Africa

Foreign direct investment into South Africa changed from an outflow of R1,8 billion in the second quarter to a marginal inflow of R0,1 billion in the third quarter. The inflow during the third quarter of 2004 resulted from increased equity investment into South African companies, which was partly countered by the repayment of long-term loan capital by direct investment enterprises in South Africa.

Foreign portfolio investors increased their holdings of South African equity and fixed-interest securities in the third quarter of 2004; in total a net amount of R3,0 billion was invested in the country. The net inward movement of capital in the third quarter of 2004 probably both contributed to and was reinforced by the improved performance of the South African equity and debt markets during August and September. This was the third consecutive quarter that an inflow had been recorded, following inflows of portfolio capital of R5,1 billion and R14,1 billion in the first and second quarters of 2004, respectively.

Other foreign investment into South Africa, which had registered inflows of R4,5 billion and R4,0 billion in the first and second quarters of 2004 respectively, changed to an outflow of R2,9 billion in the third quarter of 2004. The outflow resulted from the repayment of short-term loans and a decline in non-resident foreign-currency denominated deposits with South African banks. The decline in other investment liabilities was partly countered by an increase in non-resident rand-denominated deposits with South African banks, as well as drawings on long-term loans by the government and private sector.

South African-owned assets abroad

The acquisition of outward *direct investment assets* contracted from R10,2 billion in the second quarter of 2004 to R0,7 billion in the third quarter, as South African companies acquired a controlling interest in offshore companies and supplied loan capital to direct investment entities abroad.

Portfolio investment abroad (i.e. the acquisition of foreign debt and equity securities) by South African institutional investors declined during the third quarter of 2004, recording an outflow of R0,3 billion, compared to an outflow of R1,4 billion in the second quarter of 2004.

Other outward investment from South Africa shrank by R4,1 billion in the third quarter of 2004, compared with R6,4 billion in the second quarter. The inflow of funds during the third quarter of 2004 resulted mainly from a decrease in loans extended to foreign banks.

Foreign debt

South Africa's total outstanding foreign debt contracted from US$39,2 billion at the end of March 2004 to US$38,8 billion at the end of June 2004, or by US$0,4 billion. This decline could mainly be attributed to a decrease of US$0,5 billion in foreign-currency denominated debt; rand-denominated debt increased by US$0,1 billion over the same period.

Foreign debt of South Africa
US$ billions at end of period

Period	2002	2003	2004	
			1st qr	2nd qr
Foreign-currency denominated debt...	**25,0**	**27,4**	**27,9**	**27,4**
Bearer bonds	7,8	9,7	9,6	9,5
Public sector	5,0	4,9	4,4	4,6
Monetary sector	6,3	5,9	7,4	7,0
Non-monetary private sector	5,9	6,9	6,5	6,3
Rand-denominated debt	**7,7**	**9,8**	**11,3**	**11,4**
Bonds	4,5	4,2	4,4	3,9
Other	3,2	5,6	6,9	7,5
Total foreign debt	**32,7**	**37,2**	**39,2**	**38,8**

The decrease in foreign-currency denominated debt during the second quarter of 2004 can be attributed to a reduction in non-residents' foreign-currency deposits with South African banks, as well as a decline in the use of foreign short-term trade financing by South African importers. Furthermore, the government increased its long-term loan liabilities in terms of the arms procurement programme.

Rand-denominated debt remained largely unchanged, as non-residents sold locally issued public-sector bonds to residents, countered by increases in the private sector's long-term and short-term loan liabilities.

Expressed in rand, South Africa's total outstanding foreign debt decreased by R4,6 billion from R247,8 billion at the end of March 2004 to R243,2 billion at the end of June 2004. The strengthening in the exchange rate of the rand as well as a decline in the US-dollar denominated debt contributed to the decline in the foreign debt expressed in rand terms.

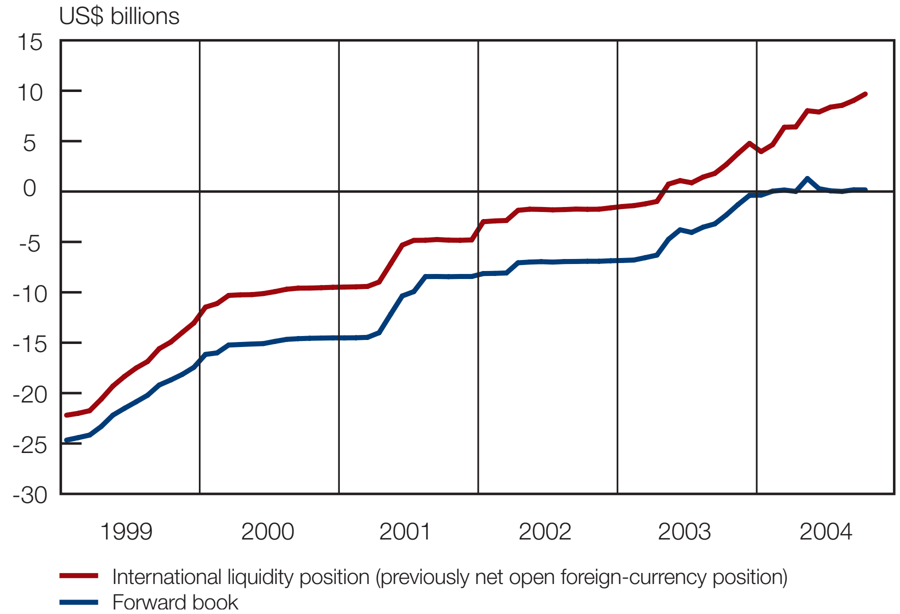
International reserves and liquidity

South Africa's net accumulation of international reserves due to balance-of-payments transactions amounted to R9,9 billion in the third quarter of 2004 compared with R12,3 billion in the second quarter. The country's net international reserves rose by R35,5 billion from the end of December 2003 to the end of September 2004, well above the increase of R23,1 billion recorded in the same period of 2003.

The gross gold (valued at the statutory price) and other foreign reserves of the South African Reserve Bank increased from US$11,2 billion to US$12,2 billion from the end of the second quarter to the end of the third quarter of 2004, and to US$12,8 billion at the end of October. Short-term credit facilities utilised by the Bank decreased from

US$3,7 billion at the end of June 2004 to US$3,5 billion at the end of September and remained at that level at the end of October. The private banks' gross foreign assets also increased from US$16,7 billion at the end of June 2004 to US$16,9 billion at the end of September 2004. The gross foreign assets of the country covered 21,2 weeks' worth of imports at the end of June 2004; this ratio rose to 23 weeks at the end of September.

The international liquidity position and forward book of the South African Reserve Bank



The international liquidity position of the Reserve Bank increased from US$7,9 billion at the end of June 2004 to US$9,0 billion at the end of September and further to US$9,7 billion at the end of October.

Exchange rates

The nominal effective exchange rate of the rand which, on balance, had appreciated in the first two quarters of 2004, depreciated by 3,2 per cent during the third quarter of 2004. During the third quarter the rand recorded its largest depreciation against the US dollar and the euro. From the end of September 2004 to 30 November the nominal effective exchange rate of the rand increased by 5,2 per cent.

Exchange rates of the rand

Percentage change

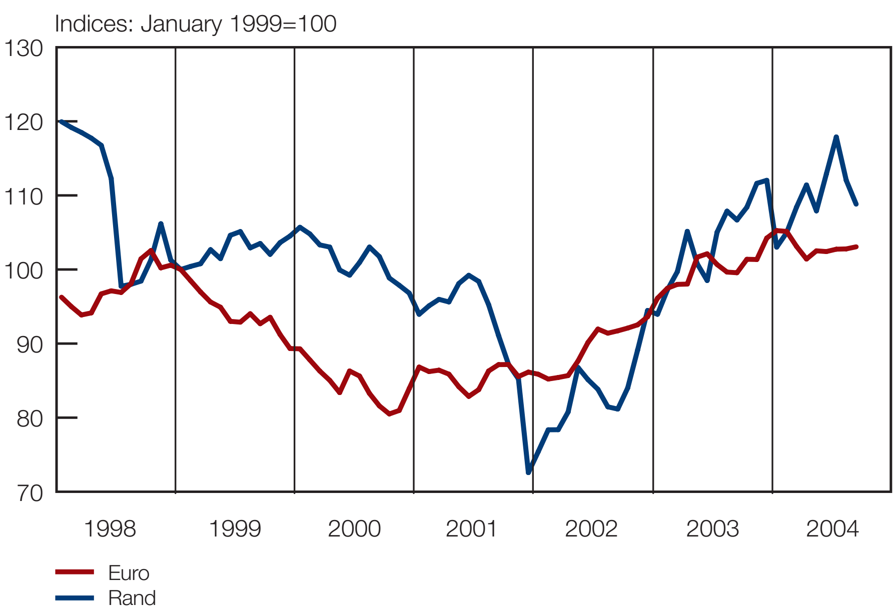
	31 Dec 2003 to 31 Mar 2004	31 Mar 2004 to 30 Jun 2004	30 Jun 2004 to 30 Sep 2004	30 Sep 2004 to 30 Nov 2004
Weighted average*	5,7	2,4	-3,2	5,2
Euro	8,3	2,0	-4,3	3,3
US dollar	5,1	1,0	-2,6	11,1
British pound	2,1	2,6	-2,2	5,6
Japanese yen	1,8	6,1	-0,8	3,2

* Against a basket of 13 currencies

A factor contributing to the depreciation of the rand from the end of June 2004 to the end of September 2004 was the largely unexpected interest rate reduction at the August meeting of the Reserve Bank's Monetary Policy Committee. However, the subsequent stabilisation of the rand during October and November 2004 could be attributed to expectations of significant future foreign direct investment inflows, a possible improved international credit rating of the country by international ratings agencies, and US dollar weakness. A significant fundamental factor supporting the rand was the overall balance-of-payments position, which recorded a sixth consecutive quarterly surplus.

The real effective exchange rate of both the rand and the euro appreciated in real terms since the beginning of 2002, but the appreciation of the rand exceeded the appreciation of the euro by a considerable margin. However, the extraordinarily low base level of the rand at the beginning of 2002 should be kept in mind in this comparison. The real effective exchange rate of the rand was also substantially more volatile than that of the euro since the beginning of 2002, as is evident in the coefficient of variation of 13,0 and 6,6 for the rand and the euro, respectively. High volatility usually has a negative influence on business and investor confidence and resource allocation.

Real effective exchange rates



The net average daily turnover in the domestic market for foreign exchange, which had decreased to US$10,9 billion in the second quarter of 2004, declined marginally further to US$10,8 billion in the third quarter of 2004. The value of transactions in which non-residents participated, decreased from US$7,7 billion per day to US$7,4 billion over the same period. Participation by resident parties increased from US$3,2 billion from the second quarter of 2004 to US$3,4 billion in the third quarter.

The real effective exchange rate of the rand depreciated by 2,9 per cent from December 2003 to September 2004. The average real effective exchange rate of the rand was 7,9 per cent higher in the first nine months of 2004 compared with the corresponding period in 2003.

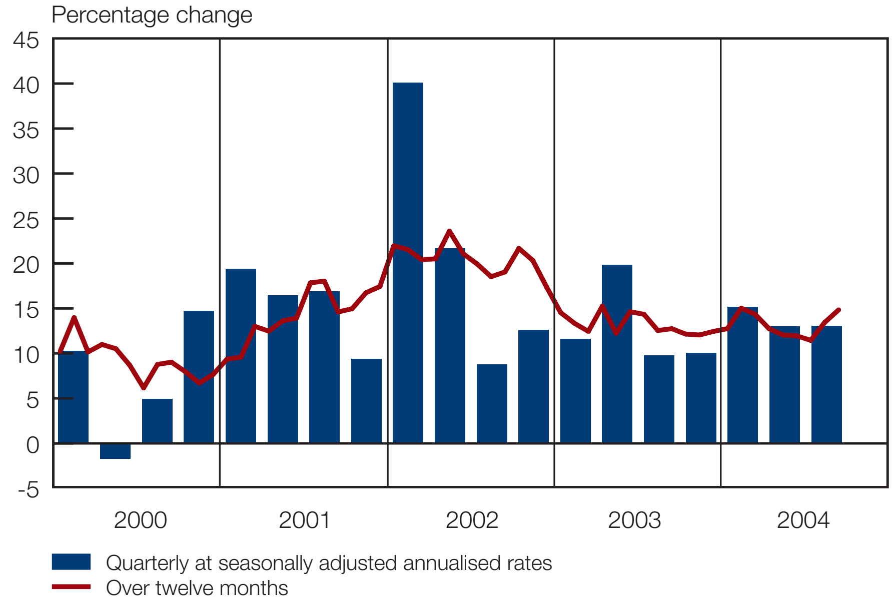
Monetary developments, interest rates and financial markets

Money supply[3]

3 The quarter-to-quarter growth rates referred to in this section are seasonally adjusted and annualised.

Growth in the broadly defined money supply, M3, continued at a firm pace during the third quarter of 2004, consistent with the developments in the real economy. The quarter-to-quarter growth in M3 decelerated from 15,2 per cent in the first quarter of 2004 to 13,0 per cent in the second quarter and remained unchanged at that level in the third quarter.

Growth in M3

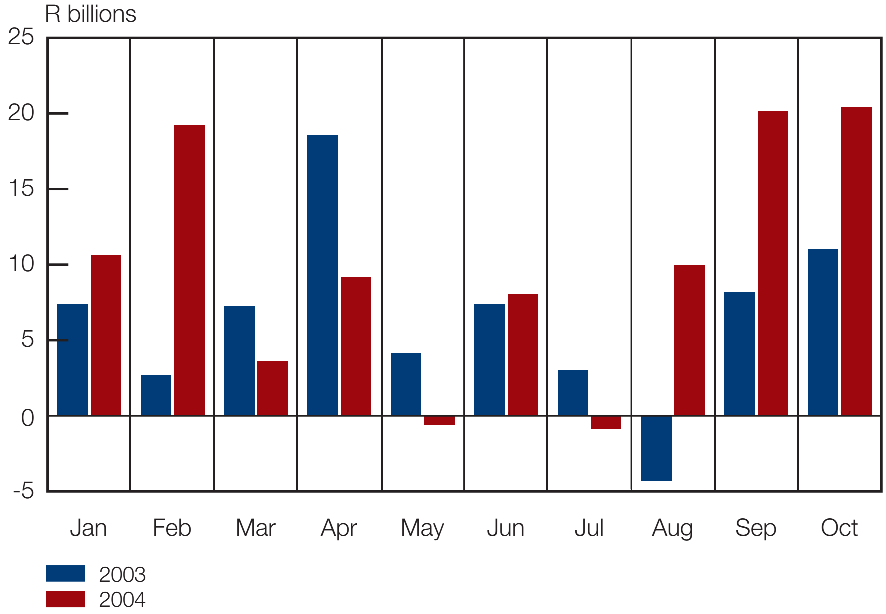


Robust monetary growth in the third quarter was consistent with the brisk pace of increase in domestic production, income and final expenditure, as well as the wealth effects emanating from rising prices of real estate, shares and bonds. Both M3 and credit extension by the banking sector were also raised somewhat when banks acquired non-bank companies' debtor books. The repatriation of foreign currency proceeds by the corporate sector gave further support to the growth in M3 in the third quarter.

On a month-to-month basis, exceptionally strong growth in M3 was recorded in both September and October 2004. This was also evident in the twelve-month growth rates, as M3 accelerated from 11,8 per cent in June 2004 to 14,7 per cent in September and further to 15,7 per cent in October. The acceleration in M3 growth was restrained to some extent by an increase in government deposits in preparation for coupon interest and bond redemption payments.

The quarterly growth in the narrower monetary aggregates displayed mixed trends during the third quarter of 2004 with growth in M1A decelerating as growth in M1 and M2 picked up noticeably. Among the higher interest-yielding deposit categories, the shortest maturity – non-cheque demand deposits – recorded the strongest increase, with rates of growth lower for other short and medium-term deposits and still lower for long-term deposits. This pattern could imply a view held by the public that deposit interest rates may have moved close to a lower turning point.

Month-to-month changes in M3



The reduced opportunity cost of holding cash and monetary deposits and robust growth in domestic expenditure and production were also reflected in the double-digit twelve-month growth rates in the narrow aggregates.

Growth in monetary aggregates

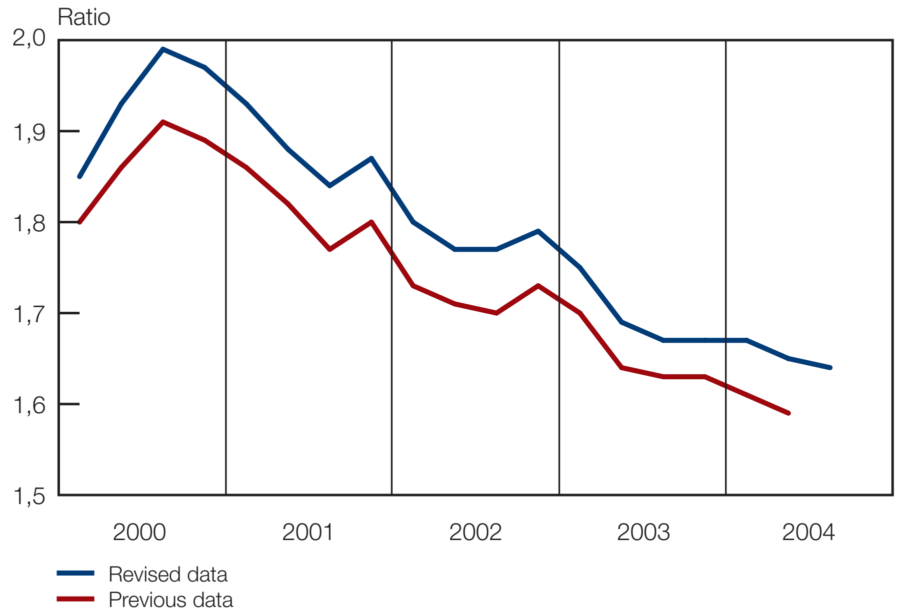
Per cent at seasonally adjusted annualised rates

	2004		
	1st qr	2nd qr	3rd qr
Notes and coin in circulation	25,2	5,9	18,2
Cheque and transmission deposits	35,9	-3,1	3,6
M1A	**40,6**	**8,1**	**0,7**
Non-cheque demand deposits	41,1	-12,6	20,1
M1	**37,3**	**-1,2**	**10,0**
Other short and medium-term deposits	-13,8	13,9	17,8
M2	**10,2**	**5,9**	**13,8**
Long-term deposits	63,1	97,1	12,1
M3	**15,2**	**13,0**	**13,0**

The increase in M3 deposits during the third quarter of 2004 was concentrated in the short and medium-term deposits of the corporate sector. The corporate sector's deposits holdings rose by R22,0 billion in the third quarter of 2004 while those of the household sector rose by R7,3 billion. Household sector deposits and bank intermediation in general are likely to expand on account of the launch on 25 October 2004 of the National Bank Account, partly fulfilling the requirements of the Financial Sector Charter adopted on 17 October 2003.

Growth in M3 exceeded growth in nominal gross domestic product by 1,9 percentage points in the third quarter of 2004. As a result, the income velocity of circulation of M3 declined to a low of 1,64 in the third quarter of 2004. As shown in the accompanying graph, the latest revision of national accounts data uncovered higher levels of nominal income, thereby raising the income velocity of circulation of M3.

Income velocity of M3



As reflected in the accompanying table, the most significant counterparts to the increase in M3 during the third quarter of 2004 were the increases in the claims on the private sector – mainly reflecting the strong growth in total loans and advances – and the net foreign assets of the monetary sector. These increases were partly neutralised by the decline in the net claims on the government sector mainly on account of the increase in deposits in preparation for the settlement of transactions stated above.

Counterparts of change in M3

R billions

	2004			
Counterparts	2nd qr		3rd qr	
Net foreign assets		10,7		16,1
Net claims on the government sector		5,9		-26,2
Gross claims	10,3		-7,0	
Government deposits (decrease +; increase -)	-4,4		-19,2	
Claims on the private sector		2,6		45,0
Investments and bills discounted	-7,6		2,1	
Total loans and advances	10,2		42,9	
Net other assets and liabilities		-2,6		-5,6
Total change in M3		**16,6**		**29,2**

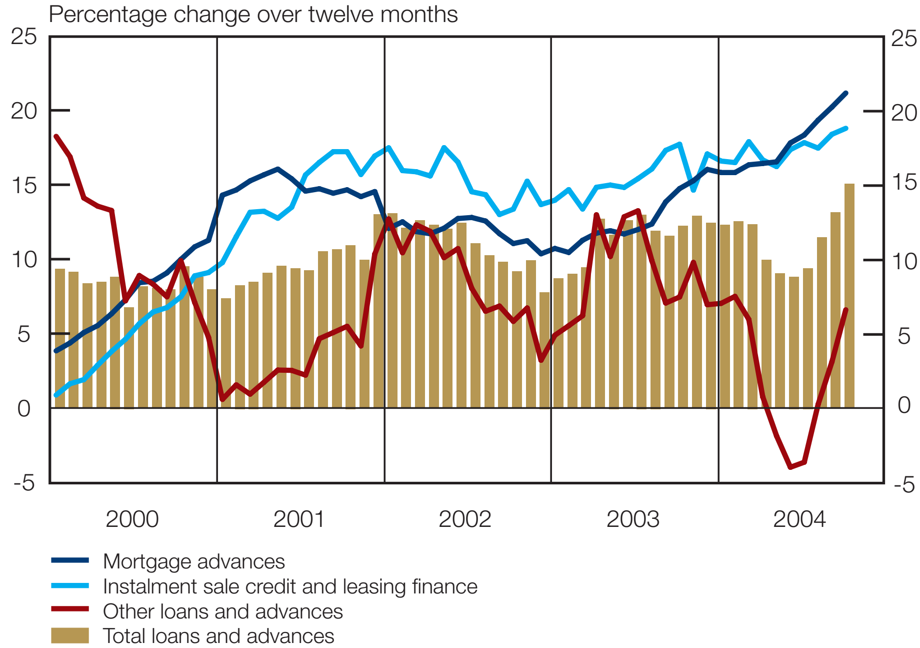
During the third quarter of 2004 the contribution to the increase in the net foreign assets of the monetary sector was more or less evenly spread between the Reserve Bank and the private banks.

Credit extension

Growth in banks' total loans and advances[4] extended to the private sector remained firm during the third quarter of 2004, supported by brisk demand for asset-backed credit and a rebound in the corporate sector's demand for bank-intermediated funding. Credit extension to the private sector continued to benefit from the increase in households' real disposable income, lower interest rates, positive wealth effects associated with the sustained increases in real-estate prices, and stronger business confidence in the economy.

4 *Total loans and advances to the domestic private sector consist of instalment sale credit, leasing finance, mortgage advances, overdrafts, credit card advances and general advances. The first three categories are referred to as* asset-backed credit, *while the last three categories together are referred to as* other loans and advances.

Loans and advances to the private sector



The quarter-to-quarter seasonally adjusted growth in banks' total loans and advances to the private sector accelerated from 10,2 per cent in the second quarter of 2004 to 12,4 per cent in the third quarter. During the third quarter banks' total loans and advances expanded by R42,9 billion; its disaggregation by type of credit is reflected in the accompanying table.

Contribution to changes in total loans and advances by type of credit
R billions

	2004	
Component	2nd qr	3rd qr
Mortgage advances	16,8	21,4
Instalment sale credit and leasing finance	5,7	7,3
Other loans and advances	-12,3	14,2
Total change	**10,2**	**42,9**

Asset-backed credit continued to be the main driver of growth in banks' total loans and advances although there was a simultaneous revival of growth in the other loans and advances category. Quarterly growth in asset-backed advances accelerated from 18,8 per cent in the second quarter of 2004 to 22,9 per cent in the third quarter.

The most significant contribution to the increase in asset-backed credit came from *mortgage advances*. Of the R21,4 billion increase in mortgage advances during the third quarter of 2004, the household sector accounted for R15,9 billion with the remainder being taken up by the corporate sector. Twelve-month growth in mortgage advances accelerated from 17,8 per cent in June 2004 to 21,2 per cent in October. Growth in this category remained aligned with buoyant trading conditions in the real-estate market.

Twelve-month growth in *instalment sale credit and leasing finance* remained brisk at rates of increase of around 18 per cent during the third quarter of 2004. Growth in this credit category reflected buoyant demand for new vehicles and other durable goods, consistent with the strong growth in domestic final demand within an extremely competitive trading environment characterised by continued restraint on price increases. During September 2004 the absorption of a non-bank institution's leasing finance book by a bank added to the tempo of increase in the instalment sale and leasing finance credit category.

The strong growth in the instalment sale credit and leasing finance category was also reflected in the seasonally adjusted value of banks' new business payouts which amounted to R24,2 billion in the third quarter of 2004 – the highest value on record.

Growth over twelve months in *other loans and advances* reverted from the negative rates registered in the period May to July 2004 and accelerated to 6,6 per cent in October. This partly reflected the corporate sector's recourse to bank-sourced funding which could be related to its need for working capital and the competitive pricing offered by the banking sector. Simultaneously, however, bank credit extension to the corporate sector was held back by further disintermediation as corporate entities issued loan stock and commercial paper and also undertook securitisation.

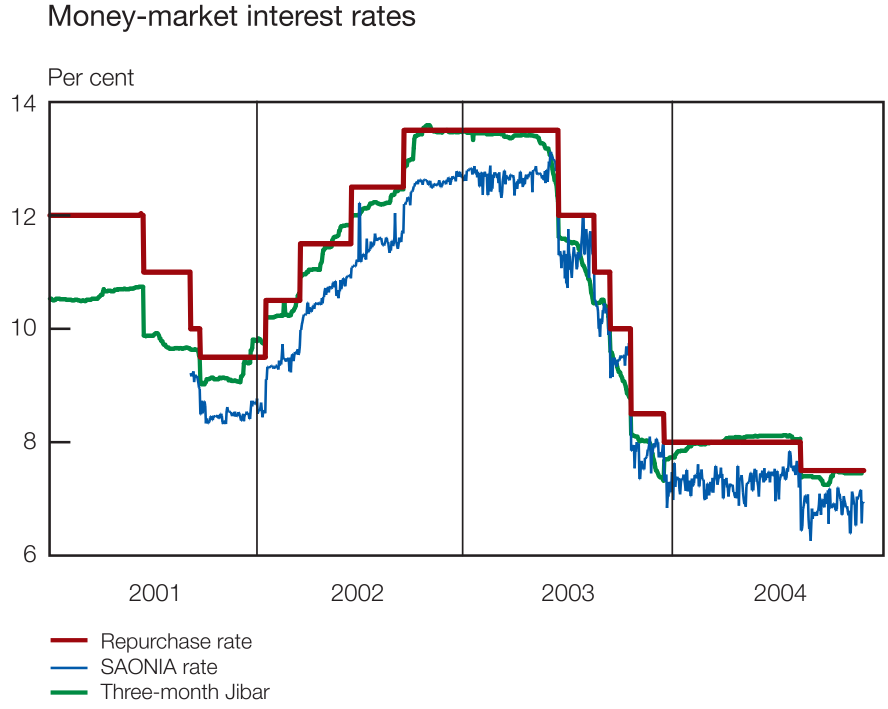
During the third quarter of 2004 the increase in total loans and advances extended to the private sector was more or less evenly distributed between the household and corporate sectors.

Interest rates and yields

Having left the repurchase rate unchanged at 8,00 per cent since December 2003, the Monetary Policy Committee (MPC) decided to reduce the rate by 50 basis points to 7,50 per cent at its August 2004 meeting. The decision was taken on account of an improved outlook for inflation. The committee did not observe a significant further improvement in inflation prospects at its October 2004 meeting and accordingly left the repurchase rate unchanged at 7,50 per cent. *(The October MPC statement discussing in detail developments underlying the decision is reproduced in full elsewhere in this* Bulletin*).*

Other money-market interest rates fell across the entire maturity spectrum following the largely unexpected 50 basis point reduction in the repurchase rate in August 2004. After the committee had decided to keep policy interest rates unchanged at its October 2004 meeting, money-market interest rates remained largely unchanged but had a marginal upward bias when international oil prices increased to near-record high levels and softened again when the oil price receded and the exchange rate of the rand appreciated in late October and November.

The South African Overnight Interbank Average (SAONIA) rate broadly followed movements in the repurchase rate. Having fluctuated around an average level of 7,30 per cent from the beginning of the year to 12 August, its average level in the ensuing 3½ months to the end of November 2004 was 6,75 per cent.



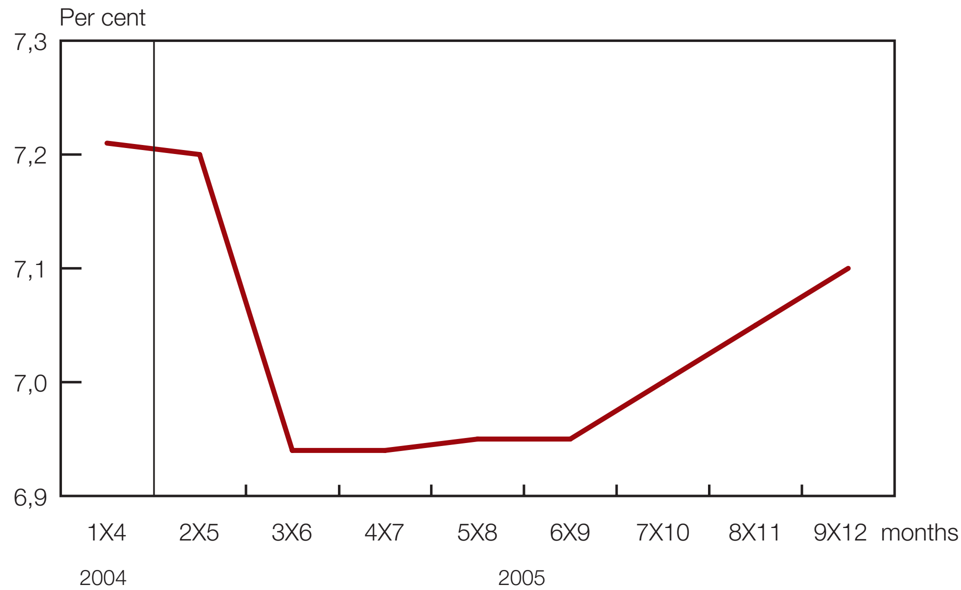
The tender rate on 91-day Treasury bills declined by 68 basis points from 7,88 per cent on 12 August 2004 to 7,20 per cent on 19 August and further to 7,10 per cent on 30 September. However, the downward trend in the Treasury bills rate reversed marginally during October and November, partly aligned to the trend in other money market interest rates and the increase in the amount on offer at the weekly tender from R2,1 billion up to 15 October to R2,5 billion from 22 October. The rate amounted to 7,20 per cent on 26 November.

Movements displayed by the three-month Johannesburg Interbank Agreed Rate (Jibar) also largely reflected the trend in the repurchase rate. The Jibar declined from 8,05 per cent on 2 August 2004 to 7,40 per cent at the end of August and reached a low of 7,25 per cent towards the end of September. However, the downward trend was reversed during the first week of October and the rate stabilised around 7,45 per cent in the remainder of October and November 2004.

Low inflation and the firmness of the exchange rate shaped interest rate expectations in November 2004. Rates on forward rate agreements (FRAs) indicated market participants' view that the repurchase rate might be lowered in the near term. The longer end of the FRA yield curve suggested market expectations of a modest tightening of monetary policy during the second half of 2005, as shown in the graph on the following page.

Having followed the 50 basis points reduction in the Reserve Bank's repurchase rate in August 2004, the private-sector banks have subsequently left their *prime overdraft rate*

Forward-rate agreements yield curve at end November 2004



and predominant rate on mortgage loans unchanged at 11 per cent. These rates are currently at their lowest level in twenty-four years, following an overall reduction of 6 percentage points from June 2003 to August 2004.

Following the launch of RSA Government Retail Bonds in May 2004, the National Treasury lowered the rates on Retail Bonds by one percentage point, effective from 1 September 2004. Banks' offered rates on fixed deposit investments increased fairly substantially after the launch, reflecting the additional element of competition introduced by the Retail Bonds. However, banks' deposit rates declined in step with the reduction in the repurchase rate in August 2004.

The upward bias in the *predominant rate on twelve-month fixed deposits*, which rose from 6,1 per cent in December 2003 to 7,8 per cent in June 2004, was halted when the private banks lowered these deposit rates in the subsequent months to 6,8 per cent in October. The reduction of 100 basis points exceeded the reduction of 50 basis points in the repurchase rate over the same period.

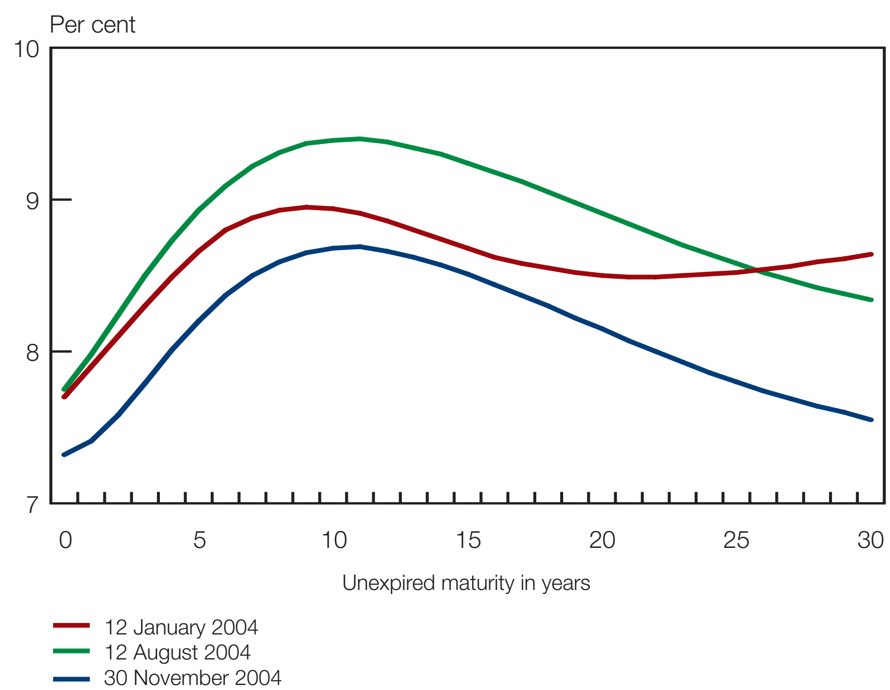
Key administered interest rates were adjusted following the reduction in the repurchase rate in August 2004. The *official rate of interest* applicable to fringe benefit taxation, as defined by the Income Tax Act, was lowered from 9,0 per cent to 8,5 per cent, effective from 1 September 2004. On 17 September 2004 the *maximum annual finance charge rates* on money loans and credit and leasing transactions, as laid down by the Usury Act, were lowered by one percentage point to 20 per cent for amounts of R10 000 or less and to 17 per cent for amounts above R10 000, but not exceeding R500 000.

The *daily average yield* on the long-term R157 government bond (maturing in 2015) increased from 8,88 per cent on 12 January 2004 to a recent high of 10,53 per cent on 15 June, responding to, among other things, increased issuance of bonds, fluctuations in the exchange value of the rand, weaker global bond markets and expectations of mounting risks to inflation. Subsequently the daily average yield fluctuated around a downward trend to 9,12 per cent on 21 September as the inflation outlook improved and the market digested the reduction in the repurchase rate in August. However, the decline was interrupted by an increase to 9,44 per cent on 4 October when renewed inflation concerns emanating from the persistent high price of oil and the strength of the domestic equity market served to reduce the attractiveness of investment in bonds. The daily average bond yield again resumed its downward trend to 8,69 per cent at the end of November. The bull run in the bond market during the second half of 2004 was supported by, among other things,

- the continued strength of the exchange value of the rand;
- low domestic inflation;
- the revision of South Africa's credit-rating outlook during October from stable to positive by Fitch Ratings, and the announcement by Moody's Investor Service of a review of the country's sovereign debt rating;
- the market's positive response to the government's Medium Term Budget Policy Statement delivered in October; and
- declining bond yields in major international markets as investors apparently became wary of the possible impact of the persistently high price of oil on global growth.

During the first half of 2004 the upward slope of the *yield curve* steepened as bond yields at the longer end of the maturity spectrum moved upward in response to the steady supply of bonds and expectations of somewhat higher inflation. The yield curve initially flattened from July 2004 as the inflation outlook became more benign before declining decisively at the short end in August as bond yields across the maturity spectrum responded to the lowering of the repurchase rate. The level of the yield curve moved lower from the end of August with both the shorter and longer ends declining to new lows during October, surpassing the recent lows reached during January 2004. The yield curve, however, retained a steep upward slope up to the ten-year category, reflecting, among other things, unease regarding the medium-term impact of the sharply higher price of oil on domestic inflation. Low inflation and the strengthening of the exchange value of the rand during November increased expectations of further monetary policy easing over the short term, and the level of the yield curve continued to move lower to the end of November.

Yield curve



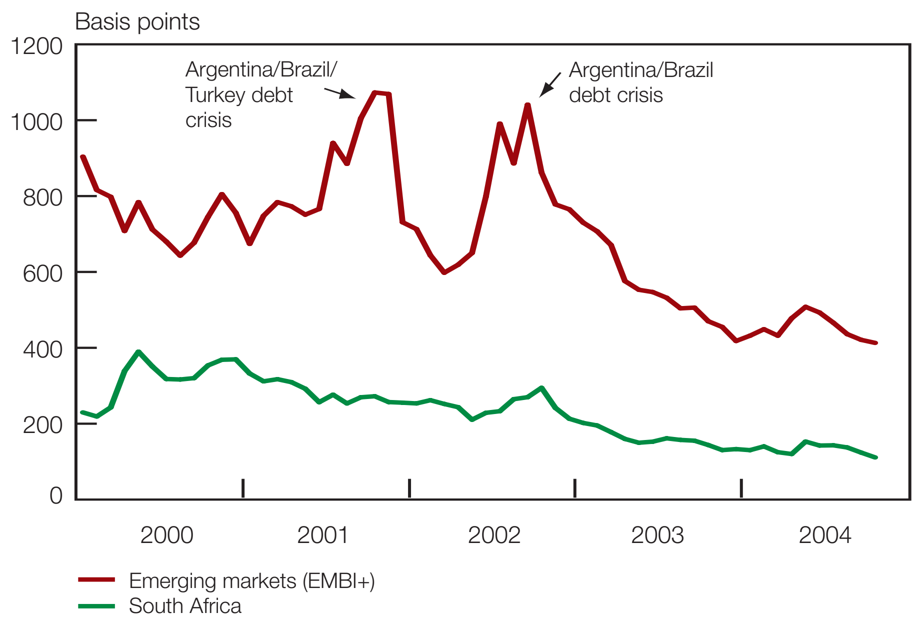
An improvement in the inflation outlook from mid-2004 was evident from the movements in the *break-even inflation rate*. The release of subdued inflation figures in the first ten months of 2004, together with the 50 basis points reduction in the repurchase rate from 13 August, contributed to a narrowing of the gap between the nominal yield on conventional bonds and the real yield on inflation-linked government bonds. Proxied in this way, expected long-term inflation in the five-to-nine-year maturity range declined from a recent high of 6,3 per cent on 14 May 2004 to 4,3 per cent at the end of November – a significant reversal from the upward trend experienced from October 2003.

Subdued inflation in the first nine months of 2004 resulted in the *real* or *inflation-adjusted yield on long-term government bonds* (using historical year-on-year increases in CPIX as an indicator of expected future price changes) rising from 4,4 per cent in February 2004 to 5,8 per cent in August, the highest real yield since June 2000. Subsequently, the real yield declined to 4,7 per cent in October, reflecting the decline in nominal bond yields and the increase in the recorded inflation rate.

The relatively accommodative monetary policy stance, improving inflationary conditions and the sustained recovery of the exchange value of the rand supported a significant narrowing of the *currency risk premium* on South African government bonds at the shorter end of the maturity spectrum. The differential between nominal yields on South African government bonds in the five-to-six-year maturity range issued in the domestic market and those issued in the United States market narrowed by 122 basis points from March 2004 to September. This differential widened by 8 basis points in October when yields on South Africa's foreign listed bonds declined sharply following positive announcements by international ratings agencies Moody's Investor Services and Fitch Ratings regarding South Africa's sovereign credit rating.

The *sovereign risk premium* on the South African government's US dollar-denominated bonds narrowed by 46 basis points from May 2004 to October. At the same time the yield spread of emerging markets' sovereign debt over benchmark United States Treasury Bonds (as measured by the JP Morgan Emerging Markets Bond Index or

Yield spreads over US federal government bonds of emerging-market foreign-currency denominated debt

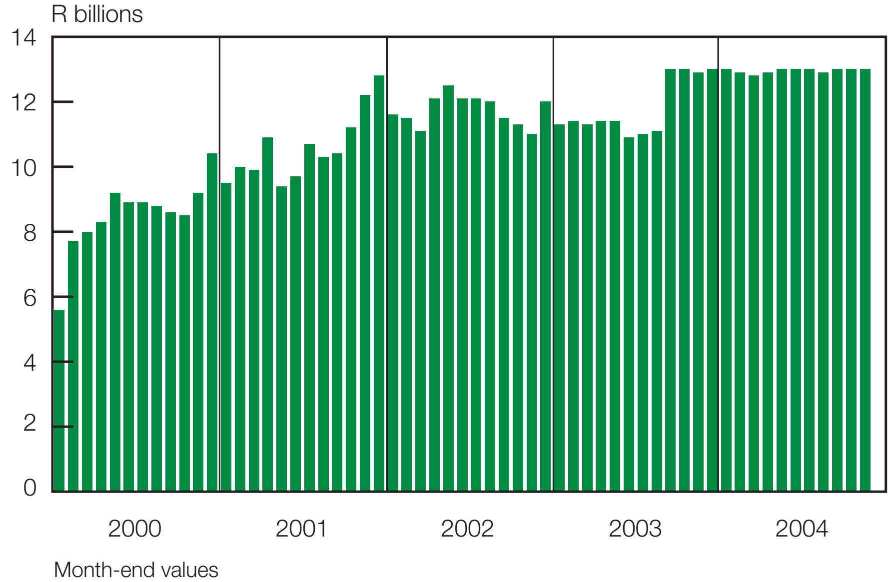


EMBI+) narrowed by 95 basis points from May 2004 to October. In absolute terms, the sovereign risk premium of South African government foreign-currency denominated debt is far less than that of typical emerging-market debt.

Money market

The amount of liquidity provided at the weekly main refinancing auction has been maintained at levels around R13,0 billion from late September 2003, with the Reserve Bank utilising a range of instruments to keep it stable.

Liquidity provided through the main repurchase auction



The statistical counterparts of the money-market liquidity flows since mid-2004 are summarised in the accompanying table.

Money-market liquidity flows

R billions (easing +, tightening –)

	2004	
	Jul – Sep	Oct – Nov
Notes and coin in circulation	-1,4	-3,5
Required cash reserve deposits	-2,9	-1,1
Redemption of foreign loans by National Treasury	-0,1	-2,6
Money-market effect of Reserve Bank's foreign exchange transactions	5,9	14,3
Government deposits	0,0	1,3
Use of liquidity management instruments*	-3,7	-3,9
Outright sales of government bonds	-1,0	-0,3
Other items net	3,2	-4,2
Banks' liquidity requirement	**0,0**	**0,0**

* Reserve Bank debentures and reverse repurchase transactions

Notes and coin in circulation outside the Reserve Bank rose by R1,4 billion in the third quarter of 2004, tightening liquidity in the money market. This continued during October and November as the level of notes and coin rose by a further R3,5 billion.

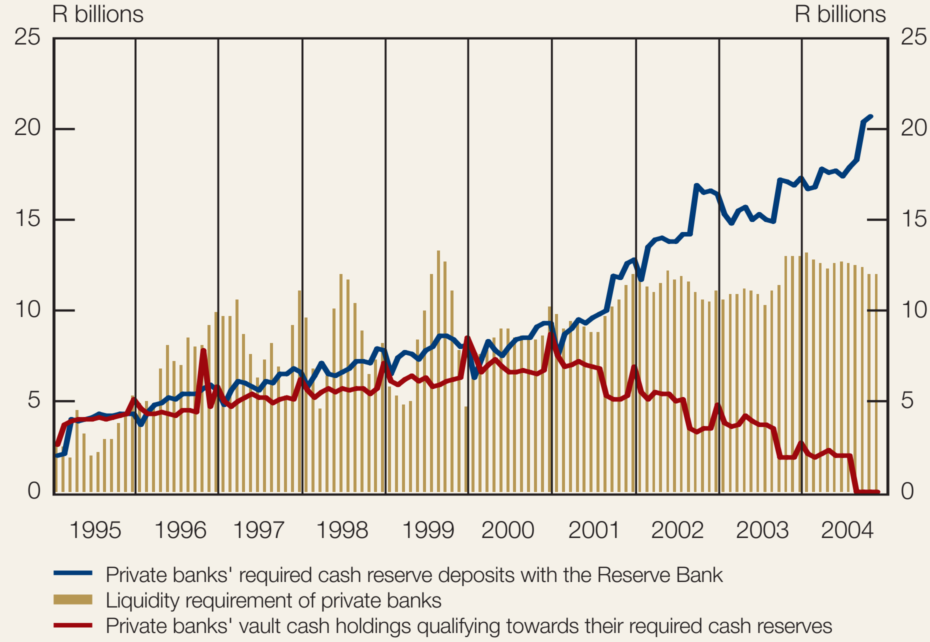
The banks' cash reserve balances increased from R17,9 billion at the end of July 2004 to R20,4 billion at the end of September, reflecting the phasing out of the final 25-per-cent vault cash deduction in calculating their required cash reserve deposits with the Reserve Bank. This has brought the cumulative money-market effect of the vault cash exclusion to some R7,1 billion since September 2001. *(This aspect is explored further in the accompanying box.)*

Cash reserve requirements and the status of vault cash

The South African Reserve Bank Act of 1990 requires banks to hold compulsory deposits on account with the Reserve Bank as minimum required reserve balances based on the banks' liabilities to the public. Compliance with minimum reserve requirements is determined on the basis of the average daily balances on a bank's reserve deposit account over a one-month maintenance period. The formula for calculating minimum reserve requirements has been adjusted on many occasions. From April 1998 the cash reserve requirement has essentially been set at 2,5 per cent of a bank's total liabilities to the public.

In 1985 banks were granted the concession to include the monthly average of their daily holdings of vault cash (i.e. their holdings of notes, coin and gold coin in vaults, tills and automated teller machines) in their calculation of holdings of cash reserves for purposes of meeting the minimum cash reserve requirements. This concession was introduced on the consideration that notes and coin were distributed to the general public by banks on behalf of the Reserve Bank. Vault cash was also counted as part of minimum cash reserves in order to limit the financial, logistical and administrative costs of excessive daily shipment of vault cash between the banks and the Reserve Bank. The concession represented a substantial advantage to banks since vault cash represented a significant portion of the total minimum reserve requirement, lowering the amount which had to be deposited interest-free with the Reserve Bank.

Minimum required reserve balances, liquidity requirement and qualifying vault cash



From the 15th business day of September 2001 the gradual phasing out of the vault cash concession was implemented. The amount of vault cash eligible for inclusion as required reserves was reduced from 100 per cent to 75 per cent of total vault holdings that year, with three further 25 percentage points reductions in each of the subsequent years. In September 2004 the concession was fully phased out.

The termination of the concession was mainly based on the fact that it penalised smaller banks since most of them held little if any vault cash as they were not conducting a meaningful amount of retail banking business. Terminating the concession levelled the playing field between larger and smaller banks. It was also meant to align the cash reserve dispensation in South Africa with international practice.

The Reserve Bank uses the minimum reserve requirement to help ensure that the banks experience an ongoing liquidity requirement, making the repurchase rate effective as banks are compelled to borrow from the Bank. As shown in the accompanying graph, rising reserve deposit balances have been the counterpart of the diminishing amount of vault cash qualifying towards the required level of cash reserves.

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The Reserve Bank managed the amount of liquidity-draining instruments in such a way that other factors impacting on money-market liquidity were broadly offset. The outstanding amount of interest-bearing liquidity-draining instruments declined from R21,1 billion at the end of July 2004 to R18,7 billion at the end of October but rose again to the end of November. The composition by type of money-market intervention instrument is provided in the table below.

Outstanding balances of selected money-market intervention instruments

End of	Reserve Bank debentures	Reverse repurchase agreements	Total instruments outstanding
2004: Apr	4,8	6,0	10,8
May	5,9	8,5	14,4
Jun	5,1	10,5	15,6
Jul	9,1	12,0	21,1
Aug	9,0	11,0	20,0
Sep	7,8	9,5	17,3
Oct	8,2	10,5	18,7
Nov	9,9	11,3	21,2

During the third quarter of 2004 the Bank again expanded its liquidity management operations by conducting outright sales of government bonds in its monetary policy portfolio. The Bank sold R750 million in R151 bonds and R250 million in R152 bonds outright on 16 September 2004. A summary of the outright sales conducted by the Bank so far in 2004 is outlined on the table below.

Reserve Bank's outright sales of government bonds

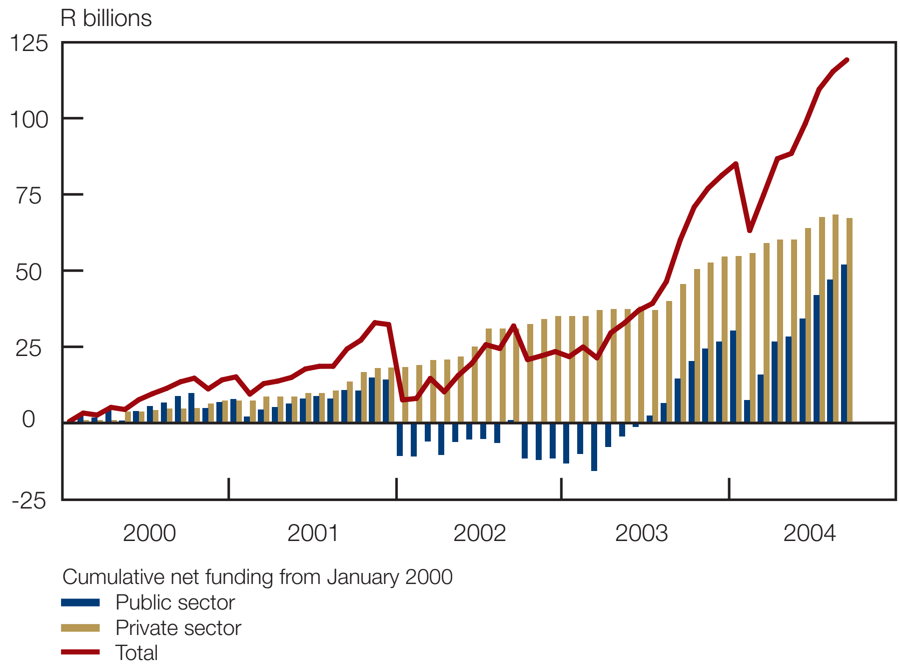
	Outright sales				
	Code of securities switched				
	R151s	R152s	R194s	R201s	Total
2004: Jan to Jun			0,5	0,5	1,0
Jul to Sep	0,75	0,25			1,0
Oct to Nov		0,30			0,3

At the end of August 2004, a total of R12,7 billion worth of coupon interest payments on government bonds were made to non-bank private parties. This was partly financed from tax and loan accounts, which reduced the balance from R17,6 billion at the end of July 2004 to R10,2 billion at the end of August. Subsequently, this balance increased to R23,4 billion at the end of September in preparation for coupon interest payments and the redemption of some government bonds in mid-October 2004, December 2004 and February 2005.

Bond market

The supply of debt instruments continued to expand in the course of 2004. After increasing by R31,5 billion in fiscal 2003/04, total net issues of fixed-interest securities by *public-sector borrowers* in the domestic primary bond market increased by a further R36,1 billion in the first six months of fiscal 2004/05. On a quarterly basis public-sector borrowers redeemed fixed-interest securities to the net amount of R10,8 billion in the first quarter of 2004, but then issued new debt to the net amount of R18,4 billion and R17,7 billion in the second and third quarters, respectively. Since the initial launch of RSA Government Retail Bonds in May 2004, National Treasury has also raised R861 million through this borrowing instrument up to the end of October. The government's domestic bond issuance was projected to remain high in fiscal 2004/05 as stated in the Medium Term Budget Policy Statement of October 2004.

Funding in the domestic primary bond market



The government's offshore borrowing programme for the 2004/05 fiscal year was carried forward with the successful issuance of a US$1 billion ten-year global bond in the *international bond markets* which mobilised funds to the amount of R6,4 billion in June 2004. Foreign debt was, however, reduced by R2,4 billion in October 2004 when a Euro bond, issued in 1999, was repaid.

Municipalities returned to the capital market during 2004, empowered by the new Municipal Finance Management Act, Act 56 of 2003, which allows municipalities to borrow without national or provincial government guarantees. On 6 April 2004 the City of Johannesburg raised R1 billion by issuing a bond with a coupon rate of 11,95 per cent and maturing in 2010 – the first municipal bond issue since 1990. The City of Johannesburg issued a further R1 billion bond on 23 June 2004 with a coupon rate of 11,90 per cent and maturing in 2016. In October 2004 the City of Johannesburg announced the launch of a R6 billion six-year funding programme to support its capital investment initiatives. The funding programme will include the issuance of institutional and retail bonds, commercial paper and bank loans.

The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa increased by R12,6 billion from R58,4 billion in December 2003 to R71,0 billion in October 2004. However, the issuance of such instruments fell back from a record high of R9,1 billion in the fourth quarter of 2003 to R3,3 billion in the third quarter of 2004. No issuance of private-sector loan stock took place in the month of October. Of the total amount in issue in October 2004, private-sector banks accounted for R28,1 billion, or 40 per cent of the total. This included 43 tradeable securities issued by seven private-sector banks.

A banking group, together with two listed property companies, launched South Africa's first commercial property securitisation programme in October 2004. The total funding programme of R2 billion, named Prime Realty Obligors Packaged Securities (Props), started with an initial listing on the Bond Exchange of South Africa of R800 million. The credit rating obtained from Moody's Investor Services, equivalent to the credit rating of the South African government, was also a first in South Africa for bonds ultimately secured by a portfolio of commercial properties. Along with the popularity of this type of debt funding around the world, similar initiatives by other significant South African commercial property companies are expected to follow as financing through securitisation compares favourably to bank debt.

The financing needs of the private sector were furthermore supplemented by the issuance of short-term *commercial pape*r. The outstanding nominal value of commercial paper listed on the Bond Exchange increased by R4,7 billion in the ten months to October 2004 to reach R14,5 billion.

In the *international bond markets* non-residents' interest in issuing rand-denominated bonds rebounded during the first months of 2004. After net redemptions of R2,5 billion in 2003, net issues in the ten months up to October 2004 amounted to R3,4 billion. The largest part of the issuance took place in the first quarter of 2004 when net issues amounted to R2,4 billion. Net redemptions occurred in the subsequent two quarters followed by net issuance of R1,5 billion in October.

Turnover in the *domestic secondary bond market* improved markedly from May 2004, benefiting from the downward movement in bond yields from mid-June and the lowering of the repurchase rate on 13 August. The quarterly value of bonds traded increased from R2,1 trillion in the second quarter of 2004 to R2,6 trillion in the third quarter. Turnover on the Bond Exchange of South Africa of R8,0 trillion in the first ten months of 2004 was, however, still 21 per cent lower than in the corresponding period of 2003.

Non-residents' interest in the domestic secondary bond market fluctuated during the first eleven months of 2004. Net sales of R4,6 billion in the first half of 2004 were followed by net purchases of R1,3 billion in the third quarter of the year. Further net purchases amounting to R4,0 billion occurred in October and November. Non-residents' cumulative bond market transactions in the first eleven months of 2004 reflected net purchases of R0,7 billion – a substantial improvement from the net amount of R8,1 billion sold in 2003.

Share market

The total value of equity capital raised in the domestic and international *primary share markets* by companies listed on the JSE Securities Exchange South Africa (JSE) amounted to R39,1 billion in the first ten months of 2004, exceeding the R22,7 billion raised in 2003. However, the quarterly value of capital raised declined sharply from R28,7 billion in the second quarter of 2004 to R4,7 billion in the third quarter. Equity financing amounted to R1,8 billion in October. The resources sector accounted for the greater part of this activity thus far in 2004, raising R25,8 billion which included dual-listed companies acquiring complementary businesses.

Turnover in the *secondary share market* remained buoyant in 2004, although it slowed down from a record high of R254 billion in the first quarter of 2004 to R239 billion in the third quarter. In the first ten months of 2004 the value of shares traded on the JSE amounted to R823 billion, exceeding turnover in the corresponding period of 2003 by 32 per cent. The market capitalisation of the JSE, which decreased by 32 per cent from May 2002 to April 2003, subsequently rose by 80 per cent to reach an all-time high of R2 345 billion in October 2004. Exchange control liberalisation announced in the government's Medium Term Budget Policy Statement, already referred to above, may ultimately increase the attractiveness of inward listings by foreign companies.

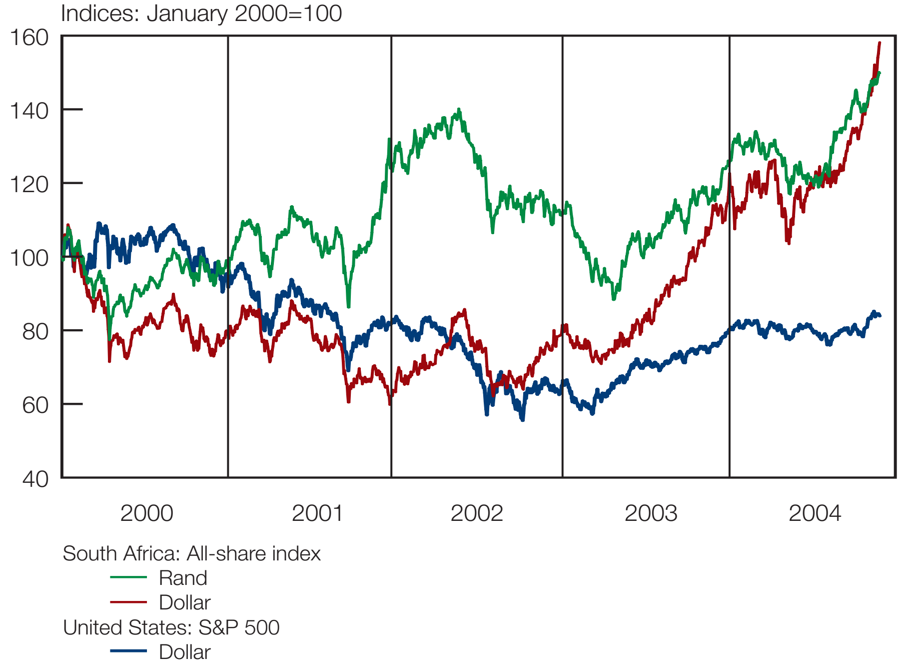
Alt^{x}, the alternative exchange of the JSE, concluded its first year of existence on 27 October 2004, although the first company only listed in January. At the end of October 2004 a total of eight companies were listed on Alt^{x}, following the listing during October of the first telecommunications firm on this exchange. The market capitalisation of Alt^{x} improved markedly from January 2004, increasing seven-fold to R380 million in October.

In October 2004 the JSE announced a new interest rate exchange, *Yield-X*, to be launched early in 2005. Yield-X will focus on interest rate derivatives and will be the JSE's fourth electronic clearing and settlement platform, alongside equities, financial futures and agricultural products. The aim of Yield-X is to expand the range of products in the interest rate market and it is expected to attract various investors, from large institutional investors to retail investors, thereby encouraging liquidity and market efficiency.

Non-residents recorded healthy net purchases of shares of R6,2 billion in October and R7,8 billion in November 2004, their highest monthly net purchases since July 1999. These monthly purchases surpassed their quarterly net purchases of R5,0 billion and R4,9 billion recorded in the first and second quarters of 2004. Non-residents' cumulative net purchases of shares in the first eleven months of 2004 amounted to R25,9 billion, a significant turnaround from the net sales of R0,4 billion recorded in the year 2003 as a whole.

After declining by 7 per cent from February 2004 to July, partly on account of a fall-back in international commodity prices and the impact of the sustained recovery of the exchange rate of the rand, the *monthly average price level of all classes of shares* listed on the JSE Securities Exchange SA increased by 17 per cent to a new record high in October 2004. The domestic share market has outperformed most major international markets in the course of 2004. The S&P500 composite index of the United States, for example, has moved largely sideways since January 2004, declining by 1 per cent to October. In rand terms the monthly average price level of all classes of shares increased by 8 per cent, and in dollar terms by 17 per cent from January 2004 to October. This may partly explain the vigorous net purchases of shares by non-residents during 2004.

Share prices



The strong performance of the share market was fairly widespread across the various sectors. The monthly average price level of the resources sector increased by 19 per cent from July 2004 to October as the upward momentum in the share market was supported by strong demand for resources shares. *Financial shares* picked up from June 2004 and increased by 19 per cent to October, benefiting from the lower interest rate environment and news of a foreign bank's interest in acquiring a controlling stake in a large domestic bank. From May to October *industrial share prices* increased by 16 per cent, reflecting the general optimism concerning South Africa's domestic growth prospects.

After declining by 13 per cent from 3 March 2004 to 18 May, the *daily closing level of the all-share price index* increased by 24 per cent to a then all-time high on 8 October alongside general optimism regarding domestic economic growth prospects, benign inflation data, higher commodity prices and support from world equity markets. The all-share index declined by 4 per cent to 20 October following some profit-taking, lower commodity prices and weaker international equity markets due to concerns that the rising price of oil may dampen global growth. A decline in the price of oil and the conclusion of the American presidential elections contributed to the all-share index increasing by 8 per cent to a new record high on 29 November.

The *dividend yield* on all classes of shares fluctuated between a low of 2,8 per cent in February 2004 and a high of 3,2 per cent in July, before falling back to 2,8 per cent in October when share prices increased. Mirroring the share price movements, the *earnings yield* on all classes of shares increased from 6,7 per cent in February 2004 to 7,6 per cent in July, before declining to 6,8 per cent in October. Conversely, the *price-earnings ratio* of all classes of shares increased to 14,8 in October 2004, from a recent low of 13,2 in July 2004.

Market for derivatives

The total number of *futures and options on futures contracts* traded on the Financial Derivatives Division of the JSE Securities Exchange SA slowed down from a recent high of 10,0 million contracts in the first quarter of 2004 to 7,9 million in the second quarter, before increasing to 8,6 million contracts in the third quarter. Trading activity became livelier from August 2004 alongside steadily rising prices in the underlying securities markets. In October trading activity remained brisk with 2,9 million contracts traded, representing the quarterly equivalent of 8,7 million contracts. The total number of futures and options on futures contracts traded in the first ten months of 2004 surpassed trade over the same period in 2003 by 17 per cent.

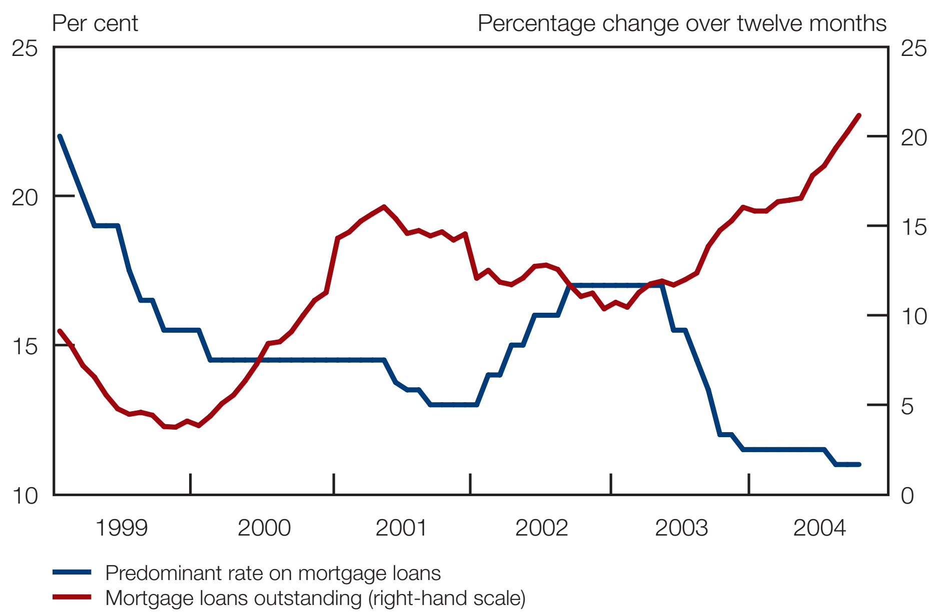
The significant decline in maize prices since February 2004, due to ample domestic supply, the firm exchange value of the rand and prospects of a bumper crop in America, ultimately influenced trade in commodity derivative instruments during 2004. Maize contracts generally account for more than three quarters of all commodity related contracts traded. The number of *commodity futures contracts and options* on such contracts traded on the Agricultural Products Division of the JSE Securities Exchange SA declined from 593 000 contracts in the first quarter of 2004 to 379 000 and 434 000 contracts in the second and third quarters, respectively. In total the number of contracts traded up to October 2004 was 22 per cent lower than in the corresponding period of 2003.

The number of *warrants* traded on the JSE in the ten months to October 2004 was 2 per cent higher than in the corresponding period of 2003. After gradually improving from 1,5 billion contracts in the first quarter of 2004 to 1,6 billion contracts in the second quarter, the number of warrants traded decreased moderately to 1,3 billion contracts in the third quarter. In October trade at a quarterly rate came to 1,5 billion contracts. The focusing of investor interest on a narrower set of products in this market, notwithstanding the steadily rising share prices, is evident in the decline in the number of listed warrants from 410 in March 2003 to 313 in October 2004.

Real-estate market

The *real-estate market* remained buoyant during 2004, supported by lower interest rates. The value of turnover in the real-estate market, measured by *transfer duty paid,* increased by 55 per cent in the first ten months of 2004 compared with the corresponding period of 2003. Both the number of transactions and the average transaction price rose considerably.

Home-loan market



The buoyancy in the real-estate market is also reflected by the growth in the *home loan market*. The year-on-year growth in outstanding home-loan balances of banks accelerated from an average of almost 13 per cent in 2003 to 18 per cent in the first ten months of 2004. The decline in the cost of mortgage finance affected the affordability of property, raising demand and increasing the year-on-year rate of increase in house prices. The year-on-year rate of increase in *residential property prices*, as measured by Absa, accelerated almost uninterruptedly from January 2002 and recorded rates of increase of around 32 per cent in the first ten months of 2004. However, the month-on-month rate of increase in house prices slowed down from a most recent high of 3,2 per cent in January 2004 to 2,0 per cent in October.

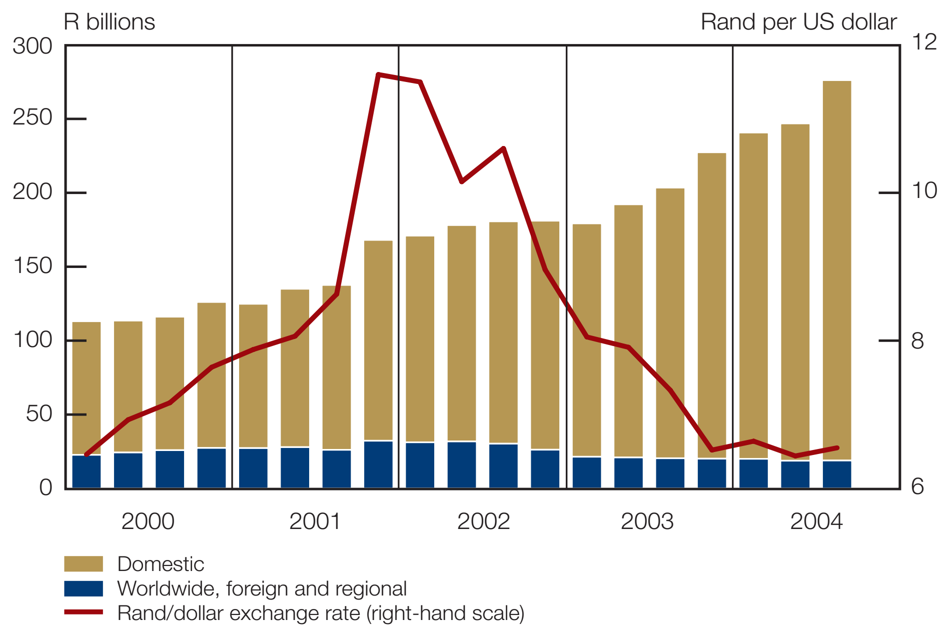
Non-bank financial intermediaries

After experiencing a significant slowdown in portfolio growth from the second half of 2002, the portfolio growth of non-bank financial intermediaries[5] recovered steadily from the first quarter of 2003. Non-bank financial institutions were able to increase the value of their assets by directing their investments mainly towards the domestic market.

5 *These consist, among other things, of unit trusts, long and short-term insurers, official and private pension funds and provident funds.*

The market value of the net assets of the unit trust industry, for example, increased from R179 billion in the first quarter of 2003 to R276 billion in the third quarter of 2004, representing an increase of 54 per cent. The market value of the net assets of worldwide, foreign and regional unit trusts, which focus their investment towards international markets, by contrast decreased from R21 billion in the first quarter of 2003 to R19 billion in the third quarter of 2004. With the continued strength of the exchange value of the rand, improved domestic growth prospects and the positive returns achieved by domestic investments, investors are likely to remain reluctant to increase their exposure to offshore investments for the time being.

Unit trusts: Market value of net assets



Related to the rising domestic share market, institutional and retail purchases of units in unit trusts reached an all-time high level in the third quarter of 2004, when the inflow into these trusts amounted to R15,8 billion. The previous high of R14,1 billion was recorded in the fourth quarter of 2003.

Public finance

Non-financial public-sector borrowing requirement

The public sector's cash deficit moderated in the first half of fiscal 2004/05. The *borrowing requirement of the non-financial public sector* (calculated as the cash shortfall of the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations) decreased from R20,1 billion in the July-September quarter of 2003, to R15,1 billion in the July-September quarter of 2004. For the first six months of fiscal 2004/05 the cash deficit amounted to R21,0 billion – approximately R0,8 billion less than in the corresponding period of the previous fiscal year. As a ratio of gross domestic product, the borrowing requirement for the first six months of fiscal 2004/05 amounted to 3,0 per cent, lower than the 3,5 per cent deficit recorded in the corresponding period of the previous fiscal year.

Non-financial public enterprises and corporations continued to record financial surpluses; these increased marginally from R5,9 billion in the first six months of fiscal 2003/04 to R7,0 billion in the first six months of fiscal 2004/05.

Non-financial public-sector borrowing requirement

R billions

	Apr – Sep 2003	Apr – Sep 2004
Consolidated general government	27,7	28,0
Non-financial public enterprises and corporations...........	-5,9	-7,0
Total	21,9	21,0

The analysis of *national government* finance statistics indicates that cash receipts from operating activities increased by 12,8 per cent in the first six months of the current fiscal year when compared with the same period of the previous fiscal year. During the corresponding period cash expenditure for operating activities increased by 15,3 per cent. Including the net cash outflow amounting to R1,9 billion due to investment in non-financial assets, national government's cash deficit amounted to R31,0 billion in the first six months of fiscal 2004/05 compared with a cash deficit of R25,3 billion recorded in the same period of the previous fiscal year.

Provincial governments recorded a cash *surplus* of R1,2 billion in the July-September quarter of 2004, bringing the provincial cash *surplus* for the first six months of fiscal 2004/05 to R8,7 billion – more than double the surplus of R3,8 billion recorded in the same period of the previous fiscal year. The main source of provincial governments' cash receipts – grants received from national government – amounted to R93,4 billion which was 18,4 per cent higher than in the corresponding period of the previous fiscal year. This transfer was originally budgeted to increase at a rate of 12,1 per cent for the fiscal year as a whole.

The cash surplus of the provincial governments was reflected in an increase in their bank deposits from R8,4 billion at the end of March 2004 to R13,5 billion at the end of September 2004, while their overall indebtedness to banks remained broadly unchanged at around R3,2 billion between these dates.

From April to September 2004 the cash deficit of *local governments* was estimated at R10,3 billion. This was higher than the R9,4 billion deficit recorded in the same period of the previous fiscal year. Preliminary estimates of the financial statements of the *extra-budgetary institutions* and *social security funds* indicate cash surpluses for both categories in the first six months of fiscal 2004/05, as was the case during the same period of the previous fiscal year.

At the level of consolidated *general government*, a cash deficit of R28,0 billion was recorded in the first six months of fiscal 2004/05, compared with R27,7 billion in the same period of the previous fiscal year.

Budget comparable analysis of national government finance

National government expenditure in the first six months of fiscal 2004/05 amounted to R180,8 billion, representing a year-on-year rate of increase of 11,5 per cent. This rate of increase was lower than the 13,0 per cent recorded in the first half of the previous fiscal year but exceeded the average growth rate of 8,5 per cent recorded in the first six months of the five fiscal years prior to 2003/04. Expenditure incurred represented 49,0 per cent of the originally budgeted expenditure for the full fiscal year. The *Budget Review 2004* projected that national government expenditure would increase by 12,2 per cent to amount to R369 billion for the fiscal year 2004/05 as a whole.

For the period under review, interest paid on national government debt amounted to R24,1 billion, representing an increase of 5,7 per cent compared with the corresponding period of the previous fiscal year. Government's interest costs were moderated by the lower interest rates at which debt instruments were issued – one of the benefits of a low-inflation environment.

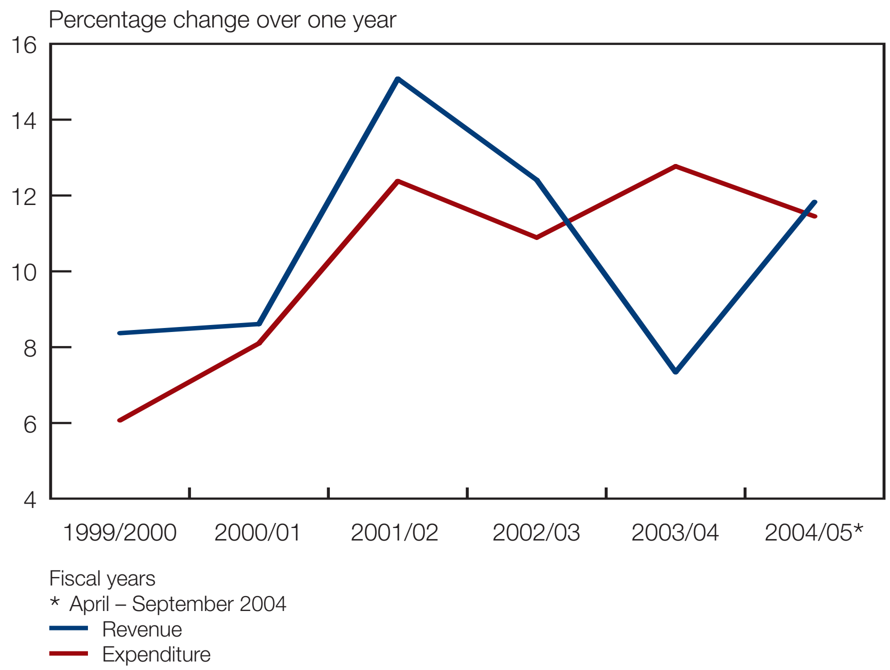
The equitable share of revenue transferred to provincial governments increased in April – September 2004, growing at a rate of 16,8 per cent compared with the same period in 2003. Although these transfers tend to fluctuate considerably, the recent increase is partly due to the increased provision for services delivered by the provincial governments. These transfers to provincial governments amounted to almost half of total national government expenditure in April – September 2004.

Payments for capital assets amounted to R1,9 billion in the first six months of fiscal 2004/05, or 26,3 per cent more than in the same period of the previous fiscal year. The original Budget projected that payments for capital assets would amount to R5,2 billion in fiscal 2004/05.

National government expenditure as a ratio of gross domestic product amounted to 26,1 per cent in the first six months of fiscal 2004/05, higher than the ratio of 25,8 per cent recorded in the corresponding period of the previous fiscal year.

After allowing for cash-flow adjustments (i.e. transactions recorded in the government accounting system but not yet cleared in the banking system, and late departmental requests for funds) cash expenditure amounted to R179,5 billion, representing an increase of 11,5 per cent in the first half of fiscal 2004/05 when compared with the corresponding period of the previous fiscal year.

National government revenue in the first six months of fiscal 2004/05 amounted to R157,8 billion, representing a year-on-year rate of increase of 11,8 per cent. This rate of increase was significantly higher than the rate recorded in the same period of fiscal 2003/04, but lower than the average growth rate of 12,4 per cent recorded in the same period of the preceding five fiscal years. The *Budget Review 2004* estimated that national government revenue would grow by 9,2 per cent to amount to R327 billion for fiscal 2004/05 as a whole.



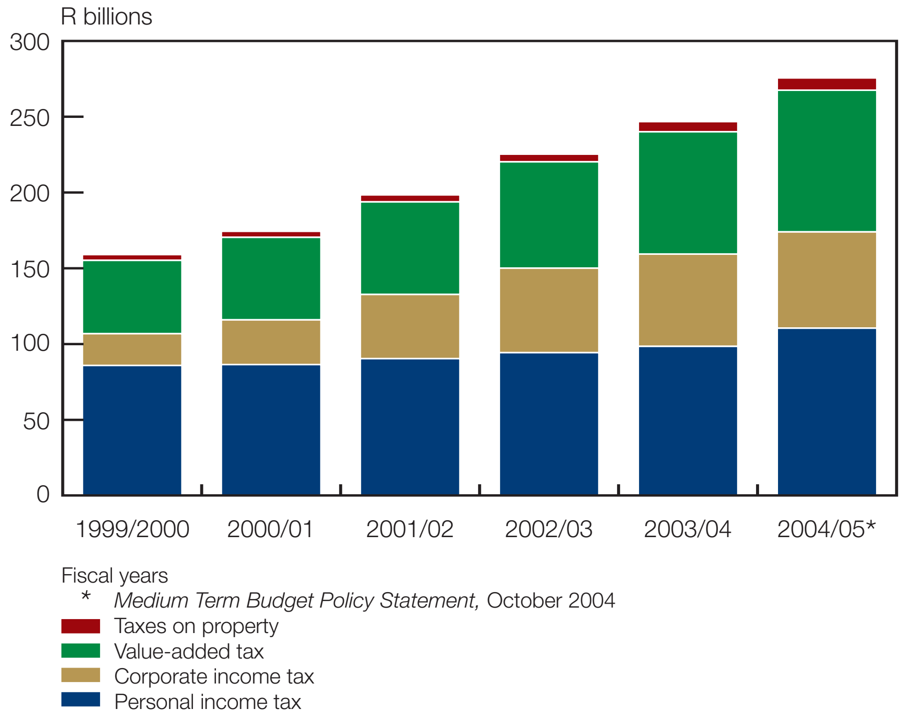
As shown in the accompanying table, taxes on income, profits and capital gains showed an increase of 6,7 per cent in the first six months of fiscal 2004/05 compared with the same period a year earlier. This increase was mainly the result of an increase in personal income tax receipts, while corporate income tax collections weakened. Higher imports contributed to higher collections of taxes on international trade and transactions. All major components of domestic taxes on goods and services recorded strong growth rates; the largest, i.e. value-added tax collections, reflected the buoyancy in consumer spending.

National government revenue in fiscal 2004/05

	R billions		
Revenue source	Originally budgeted	Actual Apr – Sep 2004	Percentage change*
Taxes on income, profits and capital gains	189,2	89,4	6,7
Payroll taxes	4,3	2,1	13,3
Taxes on property	6,9	4,2	32,4
Domestic taxes on goods and services	121,5	59,8	21,5
Taxes on international trade and transactions	10,5	5,7	46,0
Other revenue	7,9	3,2	-19,0
Less: SACU** payments	13,3	6,7	37,1
Total revenue	**327,0**	**157,8**	**11,8**

* April – September 2003 to April – September 2004
** Southern African Customs Union

National government revenue components



National government revenue as a ratio of gross domestic product amounted to 22,8 per cent in the first six months of fiscal 2004/05, slightly higher than the ratio of 22,4 per cent recorded in the corresponding period of the previous fiscal year. This ratio was also lower than that of 24,6 per cent recorded in the original Budget proposals, partly due to the upward revision of the gross domestic product estimates released on 30 November 2004. After taking into account cash-flow adjustments due to timing differences between the recording of transactions and bank clearances, national government's cash revenue amounted to R156,6 billion in the first six months of fiscal 2004/05, representing an increase of 10,6 per cent compared with the same period of the previous fiscal year.

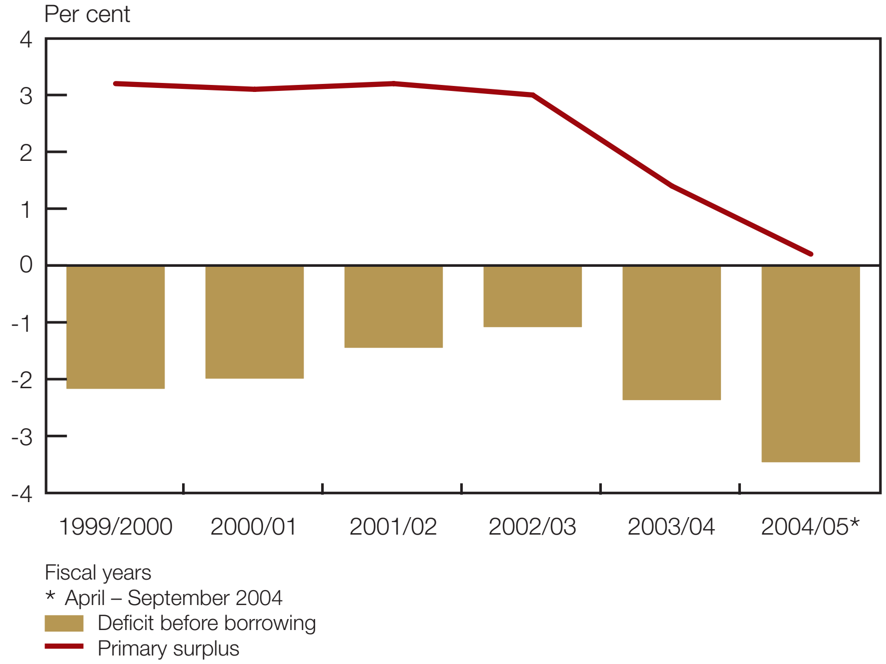
The net result of the recorded revenue and expenditure of national government in the first six months of fiscal 2004/05 was a cash book deficit of R23,0 billion – slightly higher than the deficit of R21,1 billion recorded in the same period in 2003/04. A deficit of R41,9 billion was originally budgeted for 2004/05 as a whole. As a ratio of gross domestic product, the national government deficit amounted to 3,3 per cent, slightly lower than the ratio recorded in the corresponding period a year earlier.

The *primary balance* (i.e. the deficit recalculated by excluding interest payments from total expenditure) reached a surplus of 0,2 per cent of gross domestic product in the first six months of fiscal 2004/05, slightly lower than the 0,3 per cent surplus recorded in the corresponding period a year earlier.

On top of the R23,0 billion cash deficit before borrowing and debt repayment in the first six months of fiscal 2004/05, an extraordinary payment was recorded in respect of the issue of zero-coupon bonds with a face value of R7,0 billion to the South African Reserve Bank. This issue, which was provided for in the original Budget for fiscal 2004/05, was made in April 2004 to defray part of the realised losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). The cost on revaluation of maturing foreign bonds and loans amounted to R0,8 billion in the first six months of fiscal 2004/05.

Although an amount of R2,7 billion was projected to be received as extraordinary receipts in fiscal 2004/05 – mainly funds obtained from the restructuring of state-owned enterprises – virtually no funds have been received from this source in the first half of the current fiscal year.

National government balances as ratio of gross domestic product



As indicated in the accompanying table, the net borrowing requirement in the first six months of fiscal 2004/05 was financed mainly through the issuance of long-term bonds in the domestic capital market, with net proceeds amounting to R32,3 billion. In the first six months of fiscal 2004/05, short-term instruments were sold at an average rate of 7,7 per cent per annum and long-term fixed-interest bonds were issued at an average yield of 9,7 per cent per annum.

National government financing in fiscal 2004/05

R billions

Item or instrument	Originally budgeted	Actual Apr – Sep 2004
Deficit	**41,9**	**23,0***
Plus: Extraordinary payments	7,0	7,1
Cost/profit on revaluation of foreign loans at redemption**	2,2	0,8
Less: Extraordinary receipts	2,7	0,0
Net borrowing requirement	**48,4**	**30,9**
Treasury bills	6,0	2,3
Domestic government bonds	34,3	32,3
Foreign bonds and loans	8,1	7,5
Change in available cash balances ***	0,0	-11,2
Total net financing	**48,4**	**30,9**

* Cash-flow deficit
** Cost +, profit -
*** Increase -, decrease +

In May 2004, the National Treasury launched the RSA Government Retail Bond; these bonds yielded a net amount of R737 million in May to September 2004. In addition, the National Treasury issued the new fixed income R203 bond which carries an annual coupon rate of 8,25 per cent and matures in September 2017, yielding R1,3 billion to the National Revenue Fund. In June 2004, the National Treasury issued a 10-year global bond to the amount of US$1 billion, carrying a coupon rate of 6,5 per cent per annum. This bond yielded R6,4 billion to the National Revenue Fund. In August 2004 the National Treasury issued a further fixed income R204 bond, yielding R667 million to the National Revenue Fund.

The issues and redemptions of domestic marketable bonds led to the average outstanding maturity on these bonds decreasing from 98 months at the end of March 2004 to 94 months at the end of September. Conversely, the average outstanding maturity of government's foreign bonds and loans lengthened from 79 months to 81 months over the same period. During the first six months of fiscal 2004/05 an amount of R2,9 billion was drawn on the foreign export credit facilities for the financing of the Strategic Defence Procurement Programme.

The funding activities of national government resulted in an increase of R11,2 billion in government bank balances during the first six months of fiscal 2004/05, bringing the level of these balances to R23,8 billion at the end of September 2004.

Total loan debt of national government increased from R455,1 billion at the end of March 2004 to R498,4 billion at the end of September. This caused the national government total loan debt as a ratio of gross domestic product to increase from 35,6 per cent at the end of March 2004 to 37,2 per cent at the end of September 2004. As a proportion of total loan debt, foreign debt amounted to 14,4 per cent at the end of September 2004 compared with 14,2 per cent at the end of March 2004. The revaluation of outstanding foreign loans at a stronger exchange rate had a moderate downward impact on the level of foreign debt in the first six months of fiscal 2004/05.

While the increase in total loan debt could largely be attributed to net borrowing by national government, it was also partly the result of the restructuring of the composition of total debt of national government due to the issuance of zero-coupon bonds in part payment of the outstanding balance on the GFECRA. As the official balance on this account decreased from R18,0 billion at the end of March 2004 to R11,0 billion at the end of September 2004, there was a simultaneous increase in outstanding government bonds to the same value. Consequently, total debt of national government was not affected by this transaction.

Total debt of national government (comprising loan debt and the balance on the GFECRA) increased from R473,1 billion at the end of March 2004 to R509,4 billion at the end of September. As a ratio of gross domestic product, the total debt aggregate increased from 37,0 per cent at the end of March 2004 to 38,0 per cent at the end of September.

Adjusted estimates of national government finance

The *Adjusted Estimates of National Expenditure 2004*, tabled in the National Assembly by the Minister of Finance on 26 October 2004, sought approval for additional government spending to the amount of R7,7 billion during fiscal 2004/05. The additional expenditure was provided for in terms of section 30(2) of the Public Finance Management Act. However, R3,5 billion of this amount would be defrayed from the contingency reserve and other unallocated amounts for unforeseen expenses already provided for in the main estimates presented to Parliament in February 2004, leaving a net increase in spending in the current fiscal year of R2,8 billion.

A large part of the increase in unforeseen and unavoidable expenditure was allocated to provincial governments in order to provide for the higher-than-anticipated wage settlement and growth in social grant beneficiary numbers. Also included in this amount were allocations to the National Empowerment Fund to finance proposed Black Economic Empowerment financing products, emergency drought relief, the settlement of outstanding claims for rates and service charges owed to municipalities, and costs associated with the settlement of land restitution claims. The Department of Sport and Recreation is to receive an additional allocation for its added responsibilities relating to the 2010 Soccer World Cup. The *Adjusted Estimates* also provided for R2,0 billion of departmental expenditure originally approved for fiscal 2003/04, but rolled over to be spent in fiscal 2004/05.

Savings and underspending to the amount of R1,4 billion were envisaged in the *Adjusted Estimates*. National government was anticipating a cost saving mainly resulting from the downward revision in the cost of the Strategic Arms Procurement Programme of the Department of Defence. A saving of R0,8 billion in interest payments resulting from the revised financing requirement, lower interest rates and lower rand costs of servicing foreign debt was also envisaged. This saving would bring the debt service costs, of which interest payments constitute the lion's share, down to 3,7 per cent of estimated gross domestic product from 3,8 per cent in the previous year, again releasing resources for allocation to social service delivery. The adjustments provided for brought the revised estimate of national government expenditure to R371,7 billion in fiscal 2004/05.

Revised budget estimates for fiscal 2004/05

	R billions
Originally budgeted expenditure	368,9
Plus: Additional expenditure	4,2
Less: Savings and underspending	-1,4
Total adjusted expenditure	371,7
Originally budgeted revenue	327,0
Plus: Increase in domestic taxes on goods and services	4,4
Less: Decrease in taxes on income and profits	-3,2
Total adjusted revenue	328,2
Adjusted deficit	43,5

National government revenue was expected to increase by R1,2 billion against the original budget projection. This was partly because of a more healthy pace of growth in the domestic economy. However, corporate profits were being hindered partly as a result of the appreciation of the rand, but this was counteracted by the sustained high commodity prices. On balance, total adjusted revenue for the full fiscal year was estimated to amount to R328,2 billion or 24,5 per cent of the estimated gross domestic product – almost equal to the target set in the original Budget in February 2004. The revised projections implied a slight increase in the budgeted deficit before borrowing and debt repayment. This estimated deficit of R43,5 billion (originally budgeted at R41,9 billion) was expected to equal 3,2 per cent of the estimated gross domestic product for the full fiscal year compared with 3,1 per cent indicated in the original Budget. The deficit would be financed mainly through the issuance of long-term bonds in the domestic capital market as well as by utilising government's available cash balances.

The *Medium Term Budget Policy Statement*

On 26 October 2004 the Minister of Finance also presented the *Medium Term Budget Policy Statement 2004* (MTBPS) in the National Assembly. Due to the favourable economic outlook the government has adopted a medium-term strategic framework focused on five policy priorities for the period ahead to expand public service delivery and promote broad-based development:

- Increasing the rate of output growth and productive investment;
- promoting economic and social mobility, encouraging links between the first and second economies through employment and enterprise development;
- social development, income support and mobilising human resources;
- improving the State's capacity to promote growth, broaden development and combat crime; and
- fostering international relations which open up growth and development opportunities.

In determining the vision for economic growth and broad-based development over the next decade the government aims to increase the rate of investment from the current 16 per cent of gross domestic product to 25 per cent by 2014. Key investment priorities for the public sector are the public transport systems, investment in ports and renewal of rail rolling stock, health and education infrastructure, roads, housing, water, and electricity services.

To further complement the global expansion and international competitiveness of South African companies, exchange controls were relaxed as discussed above in the *Foreign trade and payments* section of the review.

Tax reforms foreseen in 2005/06 and beyond are expected to include simplifying tax compliance for small enterprises, revised treatment of health care benefits and motor vehicle allowances and amendments to facilitate the hosting of the 2010 Soccer World Cup. Retirement funding arrangements, a review of mining industry taxation and fiscal reform relating to protection of the environment are under consideration. A number of provinces are considering the impositioning of taxes to raise additional own revenue, and the reform of the Regional Service Council Levy for municipalities is also under discussion.

The proposed 2005 Medium Term Expenditure Framework (MTEF) focuses on expanding participation in the economy while continuing to contribute to investment for economic growth and social assistance. It provides for

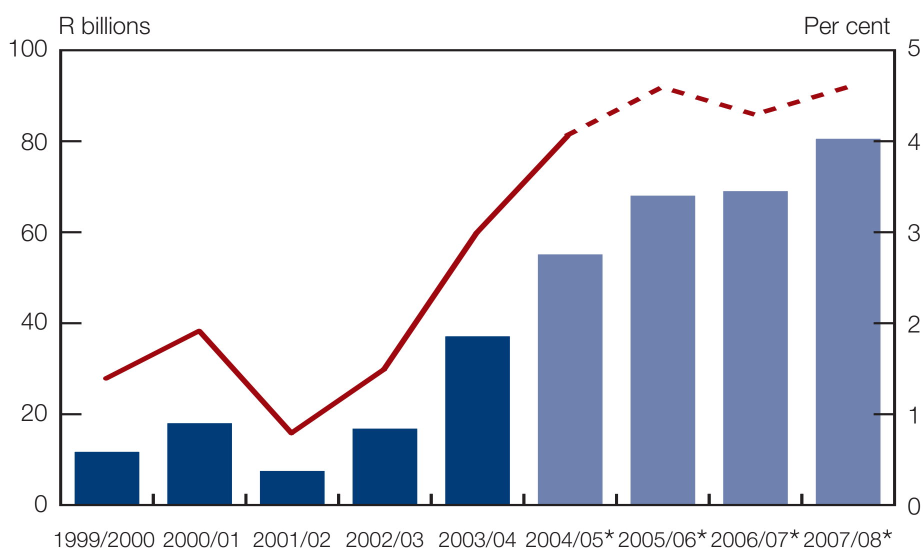
- rapidly growing disability and foster-care grant numbers;
- stepping up the pace of land restitution and creating support for the new direction in housing delivery;
- additional resources for road infrastructure;
- improving the quality of the schooling system and focused attention on further education and training colleges, while additional funding for the National Student Financial Aid Scheme will be allocated;
- continued improvement of public health services through hospital revitalisation;
- expanded capacity in water resource management;
- improved salaries for police and educators;
- re-engineering the core government services in the Home Affairs Department; and
- continued support for the African agenda, including hosting the Pan African Parliament.

As indicated in the accompanying table, government once again envisages that fiscal prudence will prevail at all levels of the public sector. The national government deficit for the current fiscal year is projected to amount to 3,2 per cent of the estimated gross domestic product and, despite rising to 3,5 per cent in 2005/06, to average 3,1 per cent over the three-year period. Consolidated general government's borrowing requirement is projected to average 3,9 per cent of estimated gross domestic product over the same period. Similarly, the public-sector borrowing requirement is projected to be maintained at around 4,5 per cent of gross domestic product over the medium term.

Fiscal projections

	Revised estimates 2004/05	Medium-term estimates		
		2005/06	2006/07	2007/08
	R billions			
National government				
Revenue	328,2	363,0	399,1	440,5
Expenditure	371,7	413,6	449,7	488,2
Deficit before borrowing	43,5	50,6	50,6	47,7
Consolidated general government borrowing requirement	54,8	64,5	59,4	63,1
Public-sector borrowing requirement	55,3	68,2	69,2	80,7
	Ratio of gross domestic product Per cent			
National government				
Revenue	24,5	24,7	25,0	25,1
Expenditure	27,7	28,2	28,1	27,8
Deficit before borrowing	3,2	3,5	3,2	2,7
Consolidated general government borrowing requirement	4,1	4,4	3,7	3,6
Public-sector borrowing requirement	4,1	4,6	4,3	4,6

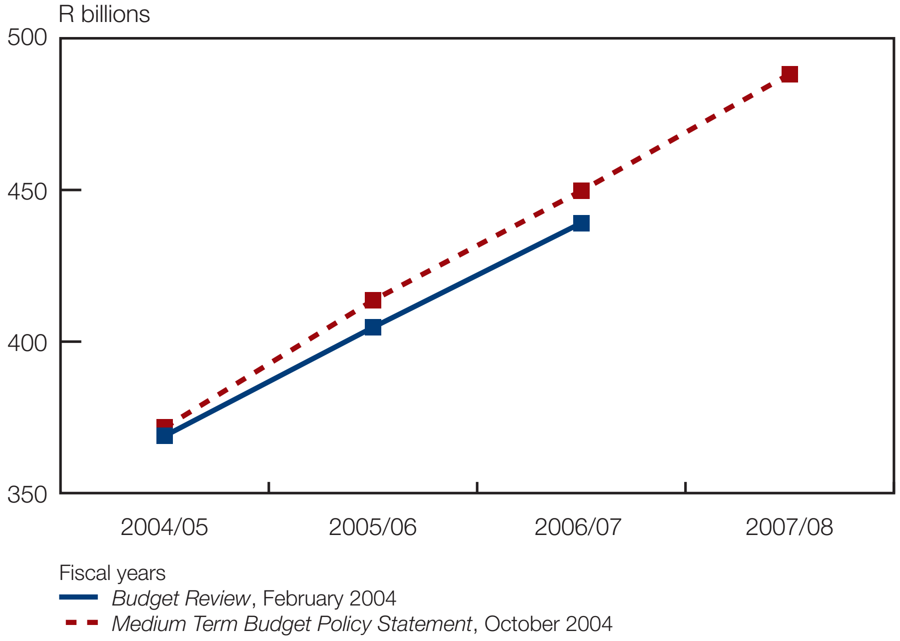
Non-financial public-sector borrowing requirement



Fiscal years
* *Medium Term Budget Policy Statement,* October 2004
R billions
Per cent of gross domestic product (right-hand scale)

National government's real non-interest expenditure is projected to increase by 4,3 per cent per annum over the medium term. Debt service costs are expected to stabilise at 3,6 per cent of estimated gross domestic product.

Projected national government expenditure



Compared to the February 2004 Budget, the MTEF envisages a higher level of government expenditure, especially in the area of income support and social development. The social grants programme will be shifted from provinces to the National Department of Social Development.

Over the MTEF period, capital spending by non-financial public enterprises is expected to increase significantly but is expected to be financed through borrowing and the proceeds from the sale of assets.

Projected extraordinary payments in fiscal 2005/06 include the issuing of a further R7 billion in zero-coupon bonds to the South African Reserve Bank to defray the outstanding balance on the GFECRA. In fiscal 2007/08 the contingent liability of about R4,5 billion, relating to Saambou Bank, will be realised.

Domestic long-term loans will be the primary instrument used to finance the budget deficit over the medium term. Total gross loan debt is estimated to amount to 37,6 per cent of the estimated gross domestic product at the end of fiscal 2004/05, increasing to 40,0 per cent of the estimated gross domestic product at the end of fiscal 2007/08. Foreign debt as a percentage of total loan debt is projected to increase from 14,4 per cent at the end of fiscal 2004/05 to 15,3 per cent at the end of fiscal 2007/08.

Statement of the Monetary Policy Committee

14 October 2004

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

Introduction

Inflation has receded to historically low levels and has consistently remained within the CPIX inflation target of between 3 and 6 per cent in the past twelve months. This favourable outcome is mainly the result of disciplined monetary and fiscal policies pursued by the authorities. The low rates of increase in the general price level of South Africa have been recorded in an economic environment characterised by an expansion in real gross domestic product, which has now lasted for nearly 6 years, notwithstanding the recent period of slower growth in the world economy. Achieving low inflation has allowed interest rates to be reduced and has provided an additional platform for economic growth. Increases in the volume of exports were at first mainly responsible for the steady growth in domestic production. More recently, growth in real gross domestic expenditure picked up considerably and reached a level at a seasonally adjusted and annualised rate of 13 per cent in the second quarter of 2004.

The inflation outcome

The twelve-month rate of increase in the consumer price index for metropolitan and other urban areas excluding the interest cost of mortgage bonds (the CPIX) decreased from a peak of 11,3 per cent in October and November 2002 to 5,4 per cent in September 2003. CPIX inflation then remained within the inflation target range and declined further to 3,7 per cent in August 2004. If energy prices are omitted, year-on-year CPIX inflation amounted to 3,5 per cent in August 2004.

The deceleration in inflation can mainly be attributed to slower rates of increase in the prices of consumer goods. The year-on-year rate of increase in the prices of consumer goods decreased from 13,0 per cent in October 2002 to 3,8 per cent in September 2003 and 2,0 per cent in December. It then fluctuated between 2 and 4 per cent in the ensuing period largely depending on adjustments in the prices of petrol and diesel. In August 2004 the year-on-year rate of increase in these prices amounted to 2,1 per cent.

In contrast to the prices of consumer goods, the prices of consumer services remained stubbornly high owing especially to continued high increases in administered prices. The twelve-month rate of increase in the prices of consumer services included in the CPIX at first increased from 7,4 per cent in October 2002 to 8,6 per cent in September 2003. It then declined marginally to 8,1 per cent in February 2004, before moving down more markedly to 6,6 per cent in August.

The significant effect that the recovery in the exchange rate of the rand has had on the improvement in domestic inflation is clearly illustrated by developments in the prices of producer goods. The prices of imported goods, which had increased at a year-on-year rate of 17,2 per cent in September 2002, started to decline from April 2003. Since then these prices have declined continuously for a period of seventeen months. In August the index value of the prices of imported goods was approximately 10 per cent lower than at its peak in October 2003.

The decline in the prices of imported goods has materially influenced the adjustments in the prices of domestically produced goods. Although the prices of goods produced in South Africa continued to increase, the rate of increase slowed down considerably and amounted to a year-on-year level of 2,3 per cent in August 2004. As a result, the year-on-year rate of increase in the all-goods production index was 1,1 per cent in this month.

The inflation outlook

The low rate of increase in production prices augers well for inflation going forward. Thus the inflation outlook over the longer term is promising. The Bank's forecasts show that CPIX inflation should stay within the boundaries of the inflation target range over the next two years, moving moderately higher over the coming year, but thereafter easing somewhat.

A number of factors are probably responsible for this favourable inflation outlook. One of the developments that has led to lower recorded inflation has been the decline in inflation expectations. According to the Survey of Inflation Expectations by the Bureau for Economic Research at the University of Stellenbosch commissioned by the South African Reserve Bank, expected CPIX inflation has declined to within the inflation target range for the three years from 2004 to 2006. This is the first time since the inception of the survey in the third quarter of 2002 that CPIX inflation expectations for all three forecast years have fallen within the target range. This is a welcome development indeed.

A number of other factors support a low inflation outcome. These include the fiscal prudence applied by government, an improved outlook for food prices (despite the serious drought in some parts of the Western Cape), commitment by the public authorities to contain administered price increases and low inflation, on average, in the rest of the world.

As already indicated, the recovery in the external value of the rand since the beginning of 2002 has been a significant factor supporting the positive inflation outcome. The external value of the rand has been relatively steady in 2004. The volatility in the exchange rate of the rand has moderated and the rand has become generally more stable in the foreign exchange markets over this period.

Going forward it is difficult to predict movements in exchange rates. To a large extent the external value of the rand will depend on balance-of-payments developments. The deficit on the current account of South Africa's balance of payments widened in the first half of 2004 to a seasonally adjusted and annualised value of R31,8 billion, or 2,5 per cent of gross domestic product. Preliminary trade figures for July and August indicate that a further deficit on the current account will probably be recorded in the third quarter of 2004.

The deficit on the current account was comfortably financed by large financial inflows. The net financial inflow into the country (including unrecorded transactions) amounted to approximately R40 billion in the first six months of 2004. These inflows consisted mainly of government long-term loans, increases in the short-term liabilities of banks, portfolio capital and trade finance provided by non-residents. The large net financial inflows enabled the Bank to increase the official foreign exchange holdings of the country from US$8,0 billion on 31 December 2003 to US$12,4 billion at the end of September 2004.

The rates of increase in consumption expenditure and capital formation have also led to an acceleration in the growth of gross domestic product and have probably narrowed the gap between potential and actual domestic production.

The favourable projected inflation outcome could also be at risk due to developments in the international oil market. The monthly average Brent crude price of oil has increased from a lower turning point of US$18,60 per barrel in December 2001 to US$29,88 per barrel in December 2003 and US$42,81 per barrel in September 2004. At present Brent crude oil is trading around US$50 per barrel. This increase in international oil prices occurred despite an increase in the production of oil by OPEC countries. Geopolitical developments and a number of disruptions to oil production have led to perceived tight supply conditions, while demand has remained strong as a result of the world economic recovery, particularly high economic growth in China, and stock building.

Over the longer term continued high increases in nominal unit labour cost could put pressure on price increases. Having averaged 5,0 per cent in 2003, the rate of increase in labour cost per unit of production in the formal non-agricultural sectors of the economy rose to a year-on-year rate of 6,3 per cent in the first quarter of 2004 and 7,8 per cent in the second quarter. These increases in unit labour cost were recorded in spite of the fact that the rate of increase in nominal remuneration per worker in the formal non-agricultural sectors of the economy slowed down. However, labour productivity growth decreased in the first quarter of 2004, and in the second quarter of this year labour productivity declined in absolute terms.

In addition, the growth of the monetary aggregates suggests that some inflation pressures could arise over the long term. Growth in the broadly defined money supply (M3), which had been relatively firm in the first six months of 2004 when measured on a year-on-year basis, rose from 11,8 per cent in June to 13,3 per cent in August. The more narrowly defined monetary aggregates increased at even considerably higher rates in July and August 2004. Moreover, the increases in the money supply aggregates were moderated to some extent by disintermediation, i.e. the extension of loans between organisations in the non-bank private sector.

The twelve-month growth rate in credit extension to the private sector, excluding investments and bills discounted, rose from a low of 8,9 per cent in June 2004 to 11,5 per cent in August. In evaluating these growth rates it is important to take into account that they were influenced by the disintermediation practices just referred to, as well as by a shift from domestic to foreign financing of international trade. It was mainly enterprises that undertook these transactions, while households increasingly made use of bank credit extension. This is clearly reflected in the growth of asset-backed loans of banks, which are mainly made to households. In August 2004 these kinds of loans were 18,8 per cent above their level in the same month of the preceding year.

Cognisance may usefully be taken also of the likely impact of external developments, in particular the timing and manner of the processes of adjustment to existing international imbalances.

Monetary policy stance

The Monetary Policy Committee has concluded that leaving the repo rate unchanged at 7,5 per cent per annum at this meeting would be consistent with CPIX inflation remaining within the target range in the forecast period. However, the Committee will continue to monitor the various factors which impact on inflation and will accordingly make any decisions based on the inflation outlook going forward.

Note on the benchmarking and rebasing of South Africa's national accounts

by T H Mantshimuli[1]

Introduction

South Africa's national accounts are estimated in accordance with the *1993 System of National Accounts* (SNA). The SNA is a set of guidelines that provides a comprehensive conceptual and accounting framework for compiling a macroeconomic database suitable for analysing and evaluating economic performance. One of the recommendations of the SNA is that the base year of constant price estimates be changed periodically. The current base year, 1995, was introduced five years ago in 1999.

In South Africa the compilation of the national accounts is a joint responsibility of Statistics South Africa (Stats SA) and the South African Reserve Bank. Stats SA is officially responsible for estimating gross domestic product based on the production and income approaches while the Bank is responsible for estimating gross domestic product in terms of the expenditure approach. In addition, the Bank compiles institutional sector accounts, which include estimates of national saving, household debt and net lending or borrowing among institutional sectors and to and from the rest of the world.

In South Africa the base year of constant price estimates is consistently revised at five-year intervals. Simultaneously most national accounts aggregates are benchmarked and revised, ensuring data consistency and accuracy over time. Benchmarking and rebasing are done over and above the normal revisions that are made annually to national accounts aggregates. Accordingly, the base year of national accounts aggregates was changed from 1995 to 2000, and the revised estimates are presented in this issue of the *Quarterly Bulletin.* A comprehensive historical analysis of South Africa's national accounts will be published in a supplement to a later edition of the *Quarterly Bulletin.*

Changing the base year refers to the process of changing the reference period of the real or constant price estimates of the national accounts. This process may or may not be accompanied by benchmarking. Benchmarking refers to the utilisation of more comprehensive data with a lower frequency of availability in order to determine reliable and accurate levels of the economic aggregates. In view of this, the process of benchmarking will necessarily impose certain changes to previously estimated national accounts aggregates. Material changes in levels could have a noticeable impact in other areas, such as in the calculation of growth rates, ratios and in some cases even trends.

Revisions

The current edition of the *Quarterly Bulletin* incorporates revised national accounts estimates at current prices and constant 2000 prices. In the interest of improving the estimates of the institutional sector accounts, some transactions between institutional sectors had to be reclassified.

The new constant price series using 2000 as base year were estimated from 1998. In order to preserve the previously estimated growth rates at constant prices prior to 1998, subtotals and totals have been converted to 2000 prices. As a result, these converted subtotals and totals for periods prior to 1998 are not equal to the sums of their components. This means that the constant price figures do not "add up" in an arithmetical sense.

1 *The author would like to thank staff members of the National Accounts Division for their valuable comments.*

Incorporation of new data that became available

Stats SA has improved the scope and coverage of estimates of the economy in the period since the previous comprehensive revisions. The improvements include
- a new business register based on firms liable for value-added tax (VAT) payments;
- the replacement of industry censuses by large sample surveys of various industries; and
- the introduction of sectoral Economic Activity Surveys (EASs). These EASs are based on financial information obtained from the records of enterprises and establishments. As with censuses in the past, the statistical units are classified according to the *Standard Industrial Classification of all Economic Activities* (SIC).

Information from the large sample surveys and the sectoral EASs and other data sources were used in revising the estimates of production, income and expenditure.

Re-classification of certain transactions

The South African Reserve Bank published a summary of the integrated economic accounts of South Africa in the September 2004 edition of the *Quarterly Bulletin.* These accounts provide a disaggregation of estimates of economic activity between the institutional sectors and the rest of the world.

The institutional sectors are the household sector (including non-profit institutions serving households), the non-financial corporate sector, the financial corporate sector and the general government sector. The disaggregation of economic activity according to these institutional sectors enhances the analytical capacity of the national accounts.

Revision of gross domestic product

The level of the nominal gross domestic product in the year 2000 was revised upward by an amount of almost R34 billion or by 4 per cent. The contributions of some of the economic sectors to total gross value added changed notably between 1995 and 2000,

Contribution of gross value added by kind of economic activity to total value added

Per cent

	At basic prices	
Sectors	1995	2000
Primary sector	**10,9**	**10,9**
Agriculture, forestry and fishing	3,9	3,3
Mining and quarrying	7,0	7,6
Secondary sector	**27,9**	**24,2**
Manufacturing	21,2	19,0
Electricity, gas and water	3,5	2,7
Construction	3,2	2,5
Tertiary sector	**61,3**	**64,9**
Wholesale and retail trade, catering and accommodation	14,3	14,6
Transport, storage and communication	8,9	9,6
Financial intermediation, insurance, real-estate and business services	16,4	18,6
General government services	16,2	15,9
Other	5,5	6,1
Total value added	**100,0**	**100,0**

but gross value added by the primary sector remained virtually unchanged between 1995 and 2000 (see table on previous page). Within the primary sector the contribution of the mining sector rose somewhat but this was offset by a decline in the relative importance of the agricultural sector. The mining sector benefited especially from the expansion in the production of platinum group metals.

The ratio of gross value added by the secondary sector to total value added declined from about 28 per cent in 1995 to 24 per cent in 2000. This was evident in all three subsectors in this sector of economic activity. The share of manufacturing declined from 21 per cent in 1995 to 19 per cent in 2000.

Percentage change in gross value added by kind of economic activity, 1998 to 2003

Sectors	Compound annual rates at 1995 prices	Compound annual rates at 2000 prices
Primary sector	**-0,1**	**0,4**
Agriculture, forestry and fishing	0,3	0,3
Mining and quarrying	-0,4	0,4
Secondary sector	**1,8**	**1,8**
Manufacturing	1,7	2,2
Electricity, gas and water	1,6	-1,2
Construction	2,5	2,3
Tertiary sector	**3,2**	**3,7**
Wholesale and retail trade, catering and accommodation	2,1	4,6
Transport, storage and communication	6,9	6,5
Financial intermediation, insurance, real-estate and business services	4,8	4,8
General government services	-0,3	-0,3
Other	2,6	4,1
Total gross value added at basic prices	**2,5**	**2,9**
Taxes net of subsidies on products	1,6	1,0
Gross domestic product at market prices	**2,4**	**2,7**

The ratio of gross value added by the tertiary sector to total value added increased from about 61½ per cent in 1995 to 65 per cent in 2000. The sectors transport, storage and communication and financial intermediation, insurance, real-estate and business services showed prominent increases. The communication sector in particular benefited from the introduction of the cellular telephone industry.

The compound growth rate in real gross domestic product from 1998 to 2003 was revised from 2,4 per cent per annum expressed at 1995 prices to 2,7 per cent at 2000 prices.

Revision of the components of gross domestic expenditure

The extensive revisions of estimates of final consumption expenditure by households were based on the Household Income and Expenditure Survey (IES) of 2000 and the 2001 Population Census. Various other data sources, such as reports by the Bureau of Market Research at Unisa and findings of other special research projects were also incorporated into the estimates of final consumption expenditure by households. The consolidated expenditure survey of general government provided the data source for estimating the final consumption expenditure and gross value added of general government. The revision of gross fixed capital formation was mainly based on the 2001 sectoral EASs. Other data sources at the disposal of the Bank were also used to improve the accuracy and credibility of the estimates.

Percentage change in components of gross domestic expenditure and gross domestic product, 1998 to 2003

Components	Compound annual rates at 1995 prices	Compound annual rates at 2000 prices
Final consumption expenditure by		
Households	2,6	2,9
General government	2,1	2,5
Gross fixed capital formation	2,2	2,8
Change in inventories*	1,2	0,9
Gross domestic expenditure	2,4	2,5
Exports of goods and services	2,4	2,2
Imports of goods and services	2,3	1,6
Expenditure on gross domestic product at market prices**	2,6	3,1
Gross domestic product at market prices ***	2,4	2,7

* Change in the variable as percentage of gross domestic product at the beginning of the period.
** Gross domestic product on expenditure base, i.e. the total of consumption expenditure, gross capital formation, exports of goods and services *minus* imports of goods and services.
*** Gross domestic product on the production base, i.e. real output *minus* intermediate input.

Households' average expenditure per population group was calculated for all provinces separately. The national aggregate was obtained by multiplying the average expenditure per household per province by the number of households in each province. The net result of the revisions was that real growth in overall final consumption expenditure by households for the period 1998 to 2003 improved from an average of 2½ per cent per annum to 3 per cent (see table above).

Final consumption expenditure by general government was revised on the basis of the latest available information on current expenditure by all levels of general government. Government expenditure on non-wage goods and services still rose steadily between 1998 and 2003 while the share of compensation of employees to final consumption expenditure by general government also declined. The average annual growth in real final consumption expenditure by general government from 1998 to 2003 was revised upwards from 2 per cent per annum at 1995 prices to 2½ per cent at 2000 prices.

The 2001 sectoral EASs were extensively relied upon to revise the estimates of gross fixed capital formation by the private sector. Extensive upward revisions were made to the levels of fixed investment by general government based on the latest available data on general government expenditure. Independent surveys conducted by the Bank on capital expenditure by public corporations were used to re-estimate gross fixed capital formation by public corporations. The level of aggregate gross fixed capital formation was raised and the growth in gross fixed capital formation from 1998 to 2003 was also increased from 2 per cent at 1995 prices to 3 per cent at 2000 prices.

Revision of gross saving

Estimates of gross saving were comprehensively revised. Information for the non-financial corporate sector was mainly obtained from the 2001 EAS. Information obtained from the sectoral EASs, from the consolidated balance sheets of banks, from the

McGregor BFA database and the JSE Securities Exchange SA provided the main statistical inputs for these revisions. An analysis of the assets and liabilities of households contributed to benchmarking the saving level of households.

Gross saving as a percentage of gross domestic product declined from 16½ per cent in 1995 to 16 per cent in 2000. The revised average ratio for the years from 1998 to 2003 increased to almost 16 per cent compared with just under 15½ per cent previously estimated. This was mainly as a result of a substantially stronger saving ratio of the corporate sector, which more than offset a lower saving ratio of the household and general government sectors.

Average ratio of gross saving to gross domestic product, 1998 to 2003

Per cent

Institutional sectors and total	Old ratios	Benchmarked ratios
Corporate saving	11,8	13,0
Government saving	0,6	0,3
Household saving	3,0	2,6
Total saving	**15,4**	**15,9**

The ratio of gross household saving to gross domestic product declined from nearly 4 per cent in 1995 to 2½ per cent in 2000 and further to 2 per cent in 2002, but increased somewhat to 2½ per cent in 2003. The ratio of gross household saving to gross domestic product was revised from an average of 3 per cent to 2½ per cent for the period 1998 to 2003. The lower ratio can partly be attributed to the stronger increase in the level of gross domestic product relative to the level of household saving.

Gross saving by the corporate sector as a percentage of gross domestic product increased on average to 13 per cent during the period 1998 to 2003 compared with an average of about 12 per cent estimated previously. This improvement is mainly due to the increased growth of the economy as a whole, and a bigger share of gross operating surpluses in total factor income.

The revised ratio of gross saving by general government to gross domestic product is lower than the previously estimated ratio.

Note on the measurement and presentation of South Africa's net gold exports

by S S Walters and Z L de Wet

Introduction

South Africa's reintegration into global financial markets in the second half of the 1990s together with the gradual relaxation of exchange controls paved the way for changes to the country's gold-trading arrangements. The key role that the South African Reserve Bank had played in the marketing of gold changed significantly when the South African government liberalised the procedures for trading gold at the end of 1997.

Although gold still plays an important role in the South African economy, the contribution of gold exports relative to total exports of merchandise and gold declined from roughly 50 per cent in 1980 to 12 per cent in 2003. Over the same period, the country's production of gold as a percentage of Western World gold production contracted from 70 per cent to 14½ per cent – an indication that the influence of the country in the international gold market has dissipated over time. Largely due to the successful development of a foreign exchange market in South Africa and the much reduced need for a centralised system for marketing the country's gold production, the then Minister of Finance announced in December 1997 that South African gold mines would no longer be required to sell all newly produced gold bullion to the South African Reserve Bank, but would be allowed to do their own marketing subject to the exchange controls over South African residents.

The calculation of South Africa's net gold exports

For many decades the value of South Africa's net gold exports, which is shown as a separate item on the balance of payments, has been calculated according to a directive in early versions of the United Nations' *System of National Accounts* and not in accordance with the guidelines provided by the International Monetary Fund's *Balance of Payments Manual.* The item *net gold exports* in the current account of the balance of payments accordingly reflected the value of gold exports (including gold coins) minus gold imports plus any change in the gold holdings of the South African Reserve Bank and private banking institutions during a given period. With the exception of small quantities of gold that were sold to domestic investors in the form of Krugerrands, to the domestic jewellery industry and the dental profession, the volume of net gold exports was virtually equal to the domestic production of gold.

The fifth edition of the *Balance of Payments Manual* of the International Monetary Fund (IMF) proposes that a distinction be drawn between monetary gold and non-monetary or commodity gold and that transactions in monetary and non-monetary gold be treated differently in balance-of-payments statistics. In addition, the reclassification of gold, from non-monetary to monetary or *vice versa* (i.e. the monetisation and demonetisation of gold) should not be recorded as part of balance-of-payments statements.

Monetary gold may be defined as gold owned by monetary authorities (or by other institutions subject to the effective control of the authorities) and held as an international reserve asset. To qualify as a reserve asset, monetary gold should be available for use on demand. Transactions in monetary gold occur only between monetary authorities (essentially central banks) and their counterparts in other economies or between monetary authorities and international monetary institutions such as the IMF. As transactions in monetary gold only reflect changes in the composition of international reserve assets of the respective monetary authority – i.e. an exchange of gold for foreign exchange or vice versa – these transactions are not recorded in the balance of payments of South Africa.

Non-monetary gold, by contrast, covers gold not held as part of international reserve assets. It is treated like any other commodity and holdings thereof by mines, jewellers and other non-central bank entities are classified as stock-in-trade. International transactions in non-monetary gold are recorded in the trade account of the balance of payments.

When central banks increase their holdings of monetary gold by acquiring commodity gold (i.e. newly mined gold or existing gold offered in the private market), they are seen to have monetised gold. Similarly, when central banks release monetary gold from their holdings for non-monetary purposes (i.e. for sale to private holders or users), they are seen to have demonetised gold. Monetisation could therefore be defined as the reclassification of non-monetary gold to monetary gold and demonetisation as the reclassification of monetary gold to non-monetary or commodity gold. In order to identify the monetisation and demonetisation of gold, a separate item was created in the the balance of payments of South Africa titled “net monetisation (credit) or demonetisation (debit) of gold”. Value changes resulting from the creation of reserve assets do not affect the net international reserve position owing to balance-of-payments transactions. In the international investment position of South Africa, value changes of this nature will be recorded as valuation adjustments.

Treatment of typical South African Reserve Bank transactions

In a nutshell, if the South African Reserve Bank purchases gold from a gold mine in one period and then sells it to a foreign jeweller in the next period at the same price, it would previously have been shown in the first period as net gold exports in the trade account with a corresponding increase in the net gold and other foreign reserves owing to balance-of-payments transactions and an increase in gross gold and other foreign reserves. In the second period no transaction flows would have been recorded, only a composition change with less gold and more foreign exchange in the gross gold and other foreign reserve holdings.

The new approach would show gold being monetised and an increase in gross gold and other foreign reserves in the first period. In the second period gold would be demonetised, the net gold exports in the trade account would increase, and the net gold and other foreign reserves owing to balance-of-payments transactions would also increase. The gross gold and other foreign reserves would remain unchanged.

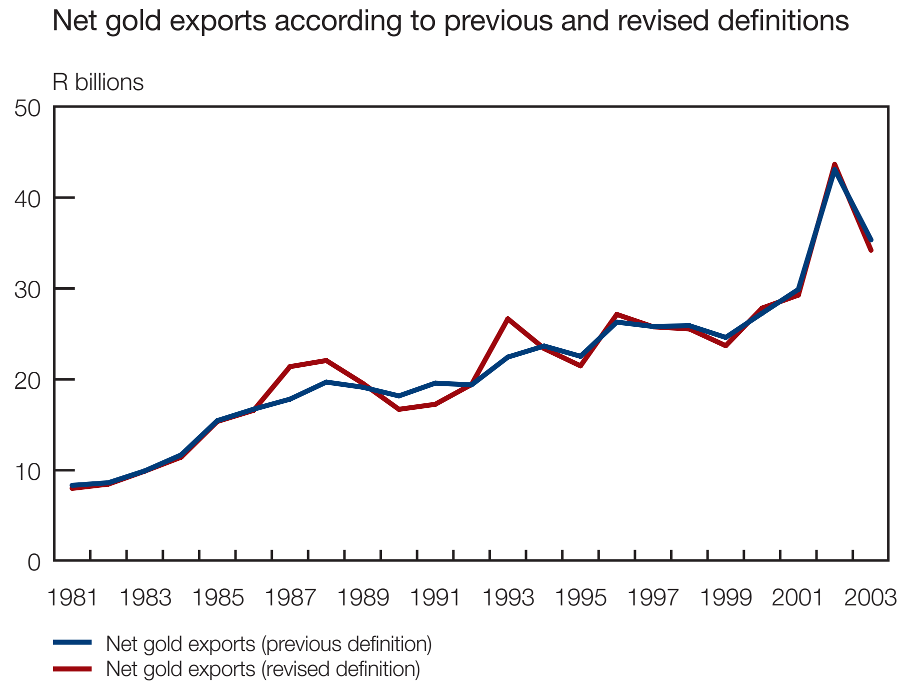
In this issue of the *Quarterly Bulletin*, the calculation of South Africa’s gold exports has been revised from 1981 onwards to conform to the guidelines of the fifth edition of the *Balance of Payments Manual* of the IMF.

Impact of the revised treatment of gold on macroeconomic statistics

The revision of the country’s gold exports impacts on the following economic aggregates:

- South Africa’s *net gold exports* (pages S-86 to S-89) were revised to reflect transactions in non-monetary or commodity gold. Transactions in monetary gold between the South African Reserve Bank and other central banks or international monetary institutions were excluded from net gold exports. The item “net gold exports” in the trade account of the balance of payments no longer reflects the change in the gold holdings of the Reserve Bank and private banking institutions.

Such changes are now shown against a newly created item titled "*net monetisation and demonetisation of gold*" in the presentation of the balance of payments.



- Changes in the country's *net gold and other foreign reserves owing to balance-of-payments transactions* (pages S-86 to S-87 and S-108) were revised to exclude the net monetisation or demonetisation of gold as well as transactions in monetary gold.

- South Africa's *overall terms of trade* on page S-89 was revised to reflect the adjustments made to gold export proceeds.

- The item *net foreign assets* in the monetary analysis (page S-24) was revised to exclude the net effect of the monetisation or demonetisation of gold.

- The *financing of gross capital formation* (page S-132) was amended to reflect the reclassification of gold from non-monetary to monetary gold, and vice versa.

Note on the revision and significance of the composite lagging business cycle indicator

by J C Venter[1]

Introduction

1 The author wishes to thank Mr W S Pretorius for his valuable contributions in preparing this note.

The identification of new economic indicators, the discontinuation of existing indicators, as well as changes in the size and structure of the economy, necessitate revisions to the composite business cycle indicators from time to time. In March 2004 the South African Reserve Bank revised its composite leading and coincident business cycle indicators (Venter and Pretorius, 2004). As indicated at the time, the composite lagging business cycle indicator was revised separately and the results are published in this note. The composite lagging business cycle indicator was last revised in 1994 (Van der Walt and Pretorius, 1994).

The three composite business cycle indicators represent three samples of economic time series that are grouped together according to their ability to lead, coincide with or lag movements in the business cycle. Since each business cycle is unique, the behaviour of individual economic time series tends to vary during different business cycles, thereby affecting the degree of reliability of these individual time series as business cycle indicators from one business cycle to another. The combination of individual time series into composite indicators results in the composite indicators exhibiting more consistency and a more reliable timing relationship with changes in the business cycle than each individual economic time series in isolation. In addition, composite business cycle indicators tend to be smoother than their individual component time series due to the offsetting of measurement errors and other irregularities or random deviations in the individual time series when grouped with others.

The purpose of this note is firstly to describe and explain the changes made to the component time series of the composite lagging business cycle indicator. Secondly, the revised composite lagging business cycle indicator is evaluated in terms of its timing relationship with the reference turning points of the business cycle. In the final section the composite lagging business cycle indicator's importance and usefulness – often neglected during business cycle analysis – are highlighted.

Component time series of the composite lagging business cycle indicator

A revision of the component time series of the composite lagging business cycle indicator was deemed necessary when it recently became evident that some of these time series no longer consistently lagged movements in the business cycle. Similar to the component time series of the composite leading business cycle indicator (Venter and Pretorius, 2004:67), this breakdown in the relationship was, among other things, due to the implementation of changed policies and the opening up of new opportunities following South Africa's first all-inclusive democratic election in 1994.

Over and above the eight component time series previously incorporated into the composite lagging business cycle indicator, eight more indicators were evaluated. All of these indicators were subjected to the same evaluation system applied during the 1994 revisions. The main criteria for inclusion were:
- the economic significance of the process represented by the indicator;
- the statistical adequacy of the data;

- the historical conformity to and timing relationship with the business cycle;
- the smoothness of the time series; and
- the timeliness of the data.

On the basis of these criteria seven of the sixteen indicators were chosen. The eight components previously included in the composite lagging business cycle indicator and the new set of seven time series included in the revised composite lagging business cycle indicator are shown in Table 1. For methodology applied in compiling composite indices, see Van der Walt (1983) and Van der Walt and Pretorius (1994).

Table 1 Component time series of the composite lagging business cycle indicator

Previous components	New components
Value of non-residential buildings completed at constant prices	Value of non-residential buildings completed at constant prices
Value of fixed investment in machinery and equipment	Ratio of gross fixed capital formation in machinery and equipment to final consumption expenditure on goods by households
Value of industrial and commercial inventories at constant prices	Ratio of inventories to sales in the manufacturing and trade sectors
Nominal labour cost per unit of production in the manufacturing sector	Nominal labour cost per unit of production in the manufacturing sector (percentage change over four quarters)
Physical volume of building materials produced by the mining sector	Cement sales in tons
Value of unfilled orders as percentage of sales in manufacturing	Ratio of households' use of instalment sale credit to their disposable income
Employment in non-agricultural sectors	Predominant prime overdraft rate of banks
Total number of hours worked by production workers in the construction sector	

The only component time series that was retained unaltered in the revised composite lagging business cycle indicator is the value of non-residential buildings completed. The two component time series that were included for the first time are:
- the ratio of households' use of instalment sale credit to their disposable income; and
- the predominant prime overdraft rate of banks.

For different reasons, three previously utilised component time series were omitted from the new list of components of the composite lagging business cycle indicator, namely:

- The value of unfilled orders as a percentage of sales in the manufacturing sector, since Statistics South Africa discontinued the publication of data measuring unfilled orders in the manufacturing sector.

- The time series measuring the number of people employed in the formal non-agricultural sectors of the economy is now included in the composite coincident business cycle indicator (Venter and Pretorius, 2004:71).

- The time series depicting the total number of hours worked by production workers in the construction sector was omitted because of its inconsistency over time.

A number of component time series previously included in the composite lagging business cycle indicator were replaced by related or comparable series measuring similar economic processes. These include the following:

- The value of fixed investment in machinery and equipment that was replaced by the ratio of gross fixed capital formation in machinery and equipment to final consumption expenditure on goods by households.

- The value of industrial and commercial inventories at constant prices that was replaced by the ratio of inventories to sales in the manufacturing and trade sectors.

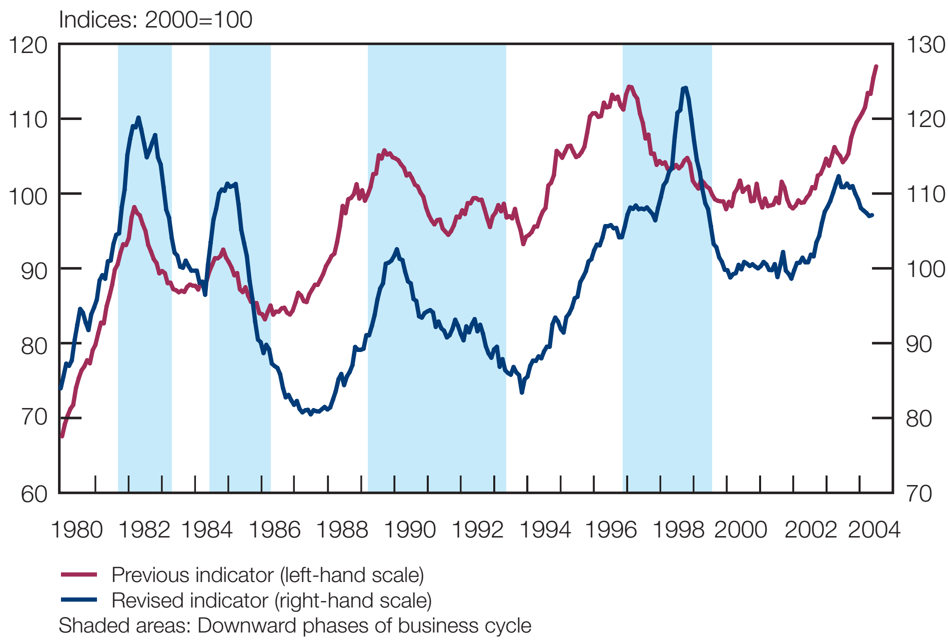
- Nominal labour cost per unit of production in the manufacturing sector that was replaced by the percentage change over four quarters in the same indicator.

- The physical volume of mining production of building materials that was replaced by cement sales in tons.

Timing relationship of the composite lagging business cycle indicator

The previous and the revised composite lagging business cycle indicators are shown in Graph 1. Since 1980, the revised composite lagging business cycle indicator has displayed a longer lag time than the previous composite indicator at all four of the subsequent business cycle peaks and at two of the four business cycle troughs.

Graph 1 Composite lagging business cycle indicator



Among the peaks, the difference between the previous and the revised composite indicators is most noticeable around the November 1996 business cycle peak. The previous composite lagging business cycle indicator reached a peak in January 1997, roughly coinciding with the reference peak. The revised indicator only peaks in October 1998, thereby lagging the reference peak in the business cycle by 23 months. Similar improvements in the lag time of the revised indicator occurred at the business cycle troughs in March 1983 and March 1986.

The revised composite lagging business cycle indicator reached its most recent high point in May 2003, thereby following the movement in the composite coincident business cycle indicator. The previous composite lagging business cycle indicator failed to capture this downward movement in the coincident indicator.

The timing relationship of the previous and revised composite lagging business cycle indicators, as well as the reference turning points of the business cycle starting with the peak in August 1981, are shown in Table 2. It is clear from this table that the revised composite lagging business cycle indicator represents a significant improvement on the previous indicator, both in terms of the number of reference turning points lagged as well as the average number of months lagged.

Table 2 Timing relationship between the composite lagging business cycle indicator and reference turning points of the business cycle

Reference turning points		Timing relationship in months	
Peaks	Troughs	Previous indicator	Revised indicator
August 1981		+7	+9
	March 1983	+4	+14
June 1984		+5	+7
	March 1986	-1	+16
February 1989		+7	+12
	May 1993	+6	+6
November 1996		+2	+23
	August 1999	+28	+28
Average:		+7½	+14½
Median:		+5½	+13

A plus (minus) sign indicates that the indicator lags (leads) the reference turning point

The importance of the composite lagging business cycle indicator

The economic time series classified as lagging business cycle indicators tend to change direction after reference turning points in the business cycle have been reached, thereby confirming changes that were first indicated by the leading indicators and then the coincident indicators.

This behaviour displayed by the lagging indicators also assists business cycle analyses in providing an advance signal of a possible turning point in the business cycle. When the lagging indicators start to change direction they are the first to reflect imbalances that are intensifying or subsiding in the economy. The influence of movements in the lagging indicators on subsequent movements in the leading indicators helps to explain the view that one business cycle generates the next one. For example, a continued increase in the level of inventories (i.e. an increase in the lagging indicator) is likely to prompt a cutback in new orders (i.e. a decrease in the leading indicator). Likewise, an increase in the prime overdraft rate (i.e. an increase in the lagging indicator) may at some stage result in decisions by home-owners and developers not to invest in new residential buildings, resulting in a reduction in the number of residential building plans passed (i.e. a decrease in the leading indicator). It is evident from the above-mentioned examples that feedback relationships exist between the lagging indicators and the subsequent turns in the opposite direction in the leading indicators. Stated differently, the turning points in the *inverse* of the lagging indicator should lead the turning points in the leading indicator.

Another way of determining whether imbalances in the economy are intensifying or subsiding is to view the movements in the lagging indicators relative to those of the coincident indicators. This comparison is expressed by the ratio of the composite coincident business cycle indicator to the composite lagging business cycle indicator. For example, if the lagging indicator increases at a slower pace than the coincident indicator (i.e. the ratio increases), this signals that scope exists for further economic expansion before constraints are likely to start emerging. Conversely, if the lagging indicator increases at a faster pace than the coincident indicator (i.e. the ratio decreases), this points to diminishing scope for further economic expansion as imbalances are developing at a faster pace than the economy is expanding.

Following from the analysis above, the sequence of related turning points in the composite business cycle indicators could, on average, be observed in the following chronological order:
- Firstly, the inverse of the composite lagging business cycle indicator;
- then the composite leading business cycle indicator;
- then the ratio of the composite coincident to the composite lagging indicator;
- then the composite coincident business cycle indicator, and
- lastly, the composite lagging business cycle indicator.

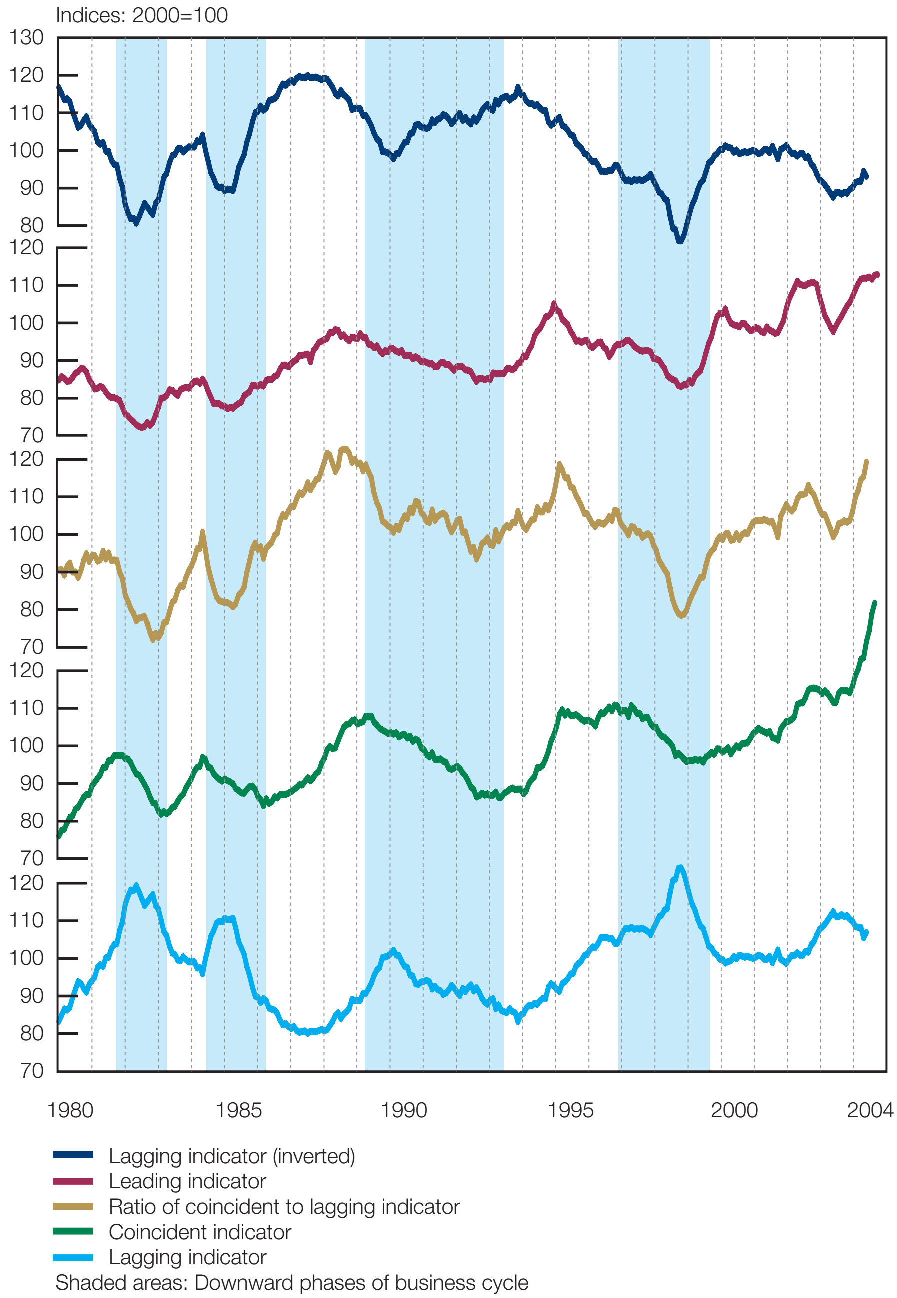
This chronological order based on the timing relationship between the reference turning points in the business cycle and the different composite business cycle indicator measures is confirmed by the current analyses and presented in Table 3, as well as in Graph 2, for the period since 1980.

Table 3 Timing relationship between the composite business cycle indicators and reference turning points of the business cycle

Reference turning points		Timing relationship in months				
Peaks	Troughs	Lagging indicator (inverted)	Leading indicator	Ratio of coincident to lagging indicator	Coincident indicator	Lagging indicator
August 1981		-30	-11	-3	+4	+9
	March 1983	-10	-8	-4	-1	+14
June 1984		-1	-1	-1	-1	+7
	March 1986	-14	-13	-11	0	+16
February 1989		-19	-9	-6	+4	+12
	May 1993	-39	-9	-9	-1	+6
November 1996		-36	-23	-21	-1	+23
	August 1999	-10	-10	-10	-2	+28
Average:		-20	-10½	-8	0	+14½
Median:		-16½	-9½	-7½	-1	+13

A plus (minus) sign indicates that the indicator lags (leads) the reference turning point

Graph 2 Composite business cycle indicators



Conclusion

The revised composite lagging business cycle indicator consistently lags the reference turning points in the business cycle by an average of 14½ months. The consistency and longer lag time of the revised composite lagging business cycle indicator increase its usefulness in business cycle analysis. The lagging indicator also provides a mechanism for the early identification of emerging imbalances in the economy, as well as the early identification of the dissipation of imbalances.

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