Quarterly Economic Review

Introduction

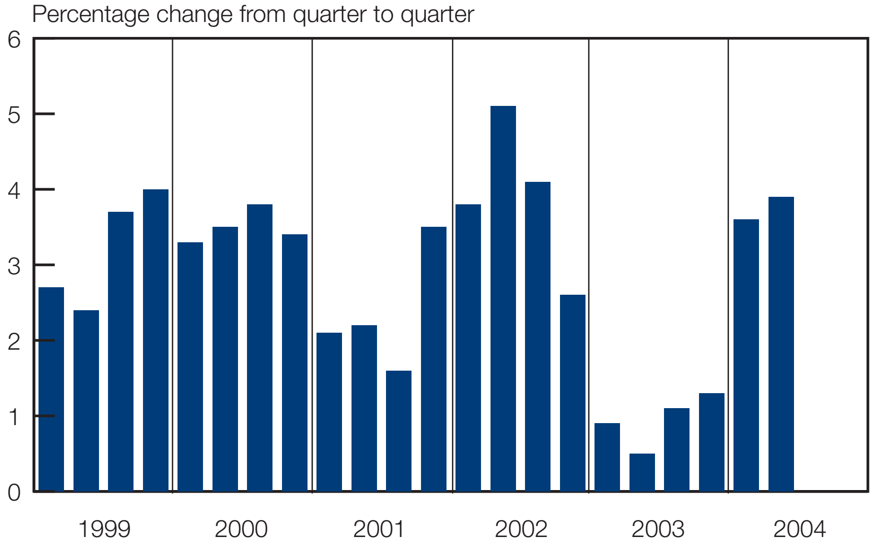
During the first half of 2004 the world economy continued along its stronger expansion path which started around mid-2003. This occurred despite disappointing growth in Japan in the second quarter of 2004 and tentative signs that the steps taken by the Chinese authorities to rein in growth were successful. Nevertheless, overall activity levels rose further and with international trade volumes expanding briskly, commodity prices remained high.

In the third quarter of 2004 the price of crude oil reached levels previously observed 14 years earlier around the time of the Gulf War. Strong world demand for petroleum and petroleum products was complemented by fears of supply disruptions. Against the background of fairly accommodative monetary and fiscal policies in most parts of the world, this contributed to an acceleration in inflation – quite modest in most instances, but more noticeable in a number of Asian economies. In the SADC region inflationary pressures are expected to subside somewhat on account of sustained policy discipline and improved food supply conditions in most parts of the subcontinent.

While levels of short-term interest rates generally remained fairly low, a number of central banks pre-emptively started raising interest rates from late 2003 in order to contain future inflation. Having maintained the federal funds target rate at 1 per cent since 2003, the Federal Open Market Committee in the United States raised the target policy rate by 25 basis points in June 2004 and by a further 25 basis points in August.

Economic activity in South Africa picked up further in the second quarter of 2004, with the real gross domestic product expanding for the twenty-third consecutive quarter – the longest period of uninterrupted quarter-to-quarter growth since quarterly data became available in 1960. Supported by lower interest rates, a moderately higher budget deficit

Real gross domestic product



Seasonally adjusted annualised rates

and favourable international terms of trade, the annualised pace of growth accelerated to 4 per cent in the second quarter of 2004 from an upwardly revised 3½ per cent in the first quarter. The growth trajectory has steepened noticeably since the second quarter of 2003, with each quarter's growth rate being higher than the one preceding it.

The improvement in the economic growth rate in the second quarter of 2004 was broadly based. Growth in the primary sector accelerated on account of an improvement in agricultural output, while higher growth in production in the secondary sector was led by manufacturing. In the tertiary sector growth was maintained at a brisk pace, with real output originating in the transport and communication subsector rising most noticeably. As in the first quarter, all sectors and subsectors registered increases in real output in the second quarter of 2004.

The pace of expansion in real gross domestic expenditure was more than three times as fast as that of gross domestic production in the second quarter of 2004. A sharp acceleration in inventory accumulation in the second quarter contributed to this divergence; an important element in this build-up was the exceptionally high quantity of crude oil which was imported and added to inventories.

Growth in domestic final demand, while remaining brisk, decelerated somewhat in the second quarter of 2004. Real gross fixed capital formation, while losing some momentum following the very high purchases of capital equipment by public corporations during the first quarter, still rose at a rate of more than 10 per cent in the second quarter. Growth in real final household consumption decelerated marginally as expenditure on semi-durable and durable goods lost some of its earlier momentum. Another corvette – the third in as many quarters – was acquired by the South African Navy during the second quarter of 2004, but growth in real government consumption expenditure moderated slightly.

South Africa's export volumes rose considerably in the second quarter of 2004, following a protracted lull since mid-2001 when the world economy moved into growth recession. Growth in mining exports was led by platinum and coal, while the volume of manufacturing exports also recorded a sizeable increase as foreign demand strengthened and producers started to come to terms with the recovery in the exchange rate. Import volumes increased even more briskly than exports as a number of aircraft, the abovementioned corvette and exceptionally large quantities of crude oil were imported. Accordingly, despite the favourable terms of trade, South Africa recorded the first trade-account deficit in 22 years and a current-account deficit of nearly 4 per cent of gross domestic product during the second quarter of 2004.

The deficit was again comfortably financed by capital inflows, enabling the Reserve Bank to continue its accumulation of foreign exchange reserves. The effective exchange rate of the rand continued its upward trend, resulting in further year-on-year declines in the rand prices of imported goods at the production level. Together with prudent financial policies this resulted in CPIX inflation remaining within the target range; July 2004 was the eleventh consecutive month in which the rate of CPIX inflation fell within the 3-to-6-per-cent target range. The latest available data on unit labour cost also display rates of increase marginally below 6 per cent.

Inflation outcomes so far in 2004 were generally lower than expected, feeding back into lower expectations of future inflation. Having maintained an unchanged level of the repurchase rate for a period of eight months, at its August 2004 meeting the Monetary Policy Committee reviewed prospects for inflation and concluded that a further reduction of 50 basis points in the repurchase rate would be consistent with projected CPIX inflation remaining in the target range. When this reduction was announced, the exchange rate of the rand immediately depreciated; this was in contrast to the experience in 2003 when the exchange rate appeared to be oblivious to interest rate reductions. The narrower margin between interest rates in South Africa and in the rest of the world might have contributed to this greater sensitivity of exchange rate changes to interest rate movements.

There was a deceleration in growth across the spectrum of the monetary aggregates in the second quarter of 2004, after a sharp increase in the preceding quarter. This deceleration in part reflected a reversal of the exceptionally high increase in money balances at the end of February caused by coupon interest payments on government bonds and the redemption of a maturing government bond. Measured over twelve months, growth in M3 receded somewhat to levels of around 12 per cent in the period April to July 2004.

The stimulus to consumer and business sentiment induced by lower interest rates, rising house prices and rising real income was reflected in brisk expenditure growth which in turn was partly financed through rising credit extension by the banking system. Growth in asset-backed loans and advances accelerated further during the first seven months of 2004, from already high levels. The modest level of overdue loans encouraged banks to accommodate the higher demand for mortgage, instalment sale and leasing advances. The demand for other loans and advances – often seen as a sign of corporate distress borrowing – tended downward in recent months as lower interest rates and the use of non-bank funding mechanisms made themselves felt.

Higher mortgage lending by the banking sector in turn supported residential property prices whose yearly rates of increase in the first eight months of 2004 were without precedent. Nevertheless, the monthly increases in house prices have lately decelerated somewhat.

Bond yields reached a peak in June 2004 and fluctuated around a declining trend in the ensuing period as the domestic inflation outlook improved. A mild softening in global bond yields reinforced the decline in domestic yields as markets apparently discounted less buoyant global economic conditions against the backdrop of high oil prices. South African share prices, which were rather lacklustre from March 2004, picked up from mid-August in response to the decline in the exchange value of the rand.

The authorities continued to pursue a cautiously expansionary fiscal policy. While the twelve-month growth in government revenue from taxes on income and profits in April – July 2004 was below the projected growth for the full 2004/05 fiscal year, the budget deficit remained well-contained and easily financed. Although the bulk of the deficit was financed through issues of conventional bonds in the domestic capital market, a foreign bond was also launched as well as a government bond series for retail investors. The latter bond series became available on 24 May 2004, and more than R600 million was raised by the end of August.

Domestic economic developments

Domestic output[1]

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

Following a rather subdued performance in 2003, the South African economy gained momentum in the first half of 2004. Growth in *real gross domestic product* accelerated from an annualised rate of only 1½ per cent in the fourth quarter of 2003 to 3½ per cent in the first quarter and 4 per cent in the second quarter of 2004. That this took place against a background of ongoing constraints faced by some sectors of the economy was indicative of the inherent resilience of the South African economy. The major contributors to the enhanced performance of the economy were the primary and secondary sectors of the economy where growth accelerated at a progressively firmer pace in the first and second quarters of 2004. Growth in the tertiary sector was maintained at the same solid rate in each of the first two quarters of 2004.

When comparing the second quarter of 2004 with the corresponding quarter in 2003, the level of real gross domestic product was 2½ per cent higher, thereby exceeding the 2-per-cent growth rate attained in 2003 as a whole.

The firm expansion in the agricultural and mining sectors boosted the real output of the *primary sector* in the second quarter of 2004. Quarter-to-quarter growth in this sector accelerated from an annualised rate of 4 per cent in the first quarter of 2004 to 5 per cent in the second quarter. Despite the firm quarter-to-quarter growth, the level of the real output of the primary sector in the second quarter of 2004 was only about ½ a per cent higher than in the second quarter 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
Primary sector	-2½	-6½	-6½	-4	-1	4	5
Agriculture	-5½	-19½	-22	-9½	-6	4½	7½
Mining	½	5	6	0	2½	3½	3½
Secondary sector	-3	-3	-½	-1½	0	4½	5
Manufacturing	-4½	-4½	-1½	-3½	-1	4½	5½
Tertiary sector	3	3	3	3	3	3½	3½
Non-agricultural sector ..	*1*	*1½*	*2*	*1½*	*2*	*4*	*4*
Total	1	½	1	1½	2	3½	4

The quarter-to-quarter growth in the real value added by the *agricultural sector* accelerated from an annualised rate of 4½ per cent in the first quarter of 2004 to 7½ per cent in the second quarter. The firm expansion in the second quarter of 2004 can mainly be ascribed to robust growth in the output of the horticultural sector. The contribution of field crops to growth in the agricultural sector in the second quarter was rather subdued. This was in part due to the late start of the harvesting of the maize crop. Moreover, the maize crop harvested in 2004 was smaller than that of the previous year, despite upward revisions to the crop estimates as 2004 progressed.

The real value added by the *mining sector* increased further in the second quarter of 2004. After increasing by 2½ per cent for 2003 as a whole, the real value added by the mining sector accelerated to an annualised growth rate of 3½ per cent in the first and the second quarters of 2004. The performance of the mining sector in the second quarter was primarily due to increased gold and platinum production, which more than outweighed declines in diamond and coal mining.

Despite the pressure on the income of the mining industry, real output of gold and platinum mining increased from the first to the second quarter of 2004. Gold mines increased their output by mining higher grade ore, which enabled them to operate at prevailing high costs notwithstanding subdued income in the wake of the appreciation of the currency. The sustained demand for platinum metal products absorbed higher production in the second quarter.

Growth in the real value added by the *secondary sector* accelerated moderately in the second quarter of 2004. Following a decline of 1½ per cent in the fourth quarter of 2003, the real value added by the secondary sector grew at an annualised rate of 4½ per cent in the first quarter of 2004 before accelerating further to 5 per cent in the second quarter. This was the result of firm growth in the manufacturing and construction sectors, which was offset to some extent by slower growth in the sector that supplies electricity, gas and water.

The recovery in real manufacturing output which started in the first quarter of 2004 continued in the second quarter. After expanding at an annualised rate of 4½ per cent in the first quarter, growth in the real value added by the *manufacturing sector* accelerated to 5½ per cent in the second quarter of 2004. The increase in real manufacturing output was evident in enhanced production volumes of several subsectors. It was, however, more pronounced in the manufacture of food and beverages, wood and wood products, petroleum products, glass and non-metallic mineral products, as well as basic iron and steel.

Amidst the general resurgence of manufacturing production, there were indications that the export-oriented sectors remained under some pressure as their international competitiveness was eroded by the recovery in the currency. Import-competing sectors were likewise affected. However, manufacturing export volumes rose in the second quarter, while the buoyancy of domestic demand as well as exceptionally high business confidence also lifted the level of manufacturing production.

Growth in the real value added by the sector that supplies *electricity, gas and water* slowed down from an annualised rate of 3 per cent in the first quarter to 1½ per cent in the second quarter of 2004. This can partly be ascribed to the late onset of what turned out to be a relatively mild winter. In addition, there were increased imports of gas and electricity from neighbouring countries. However, the lively activity in the mining and manufacturing sector provided some support to the real output of the electricity and water subsectors.

The prolonged brisk demand for new residential units continued to underpin activity in the *construction sector*. This sector was further supported by improved conditions in the non-residential building sector. However, activity in the civil engineering sector remained subdued due to lack of new projects initiated in the mining sector, where new projects were put on hold while the industry grappled with constraints imposed by the appreciation of the rand. In addition, the delay in infrastructure investment took its toll on the civil engineering sector. Accordingly, growth in the real value added by the construction sector slowed down somewhat from an annualised rate of 6½ per cent in the first quarter of 2004 to just over 6 per cent in the second quarter.

Growth in the real value added by the *tertiary sector* remained brisk at an annualised rate of 3½ per cent in the first two quarters of 2004. Within the tertiary sector the highest growth rates recorded in the second quarter were those of the transport, storage and communication and the financial intermediation, insurance, real-estate and business services sectors.

Following an increase at an annualised rate of 3½ per cent in the fourth quarter of 2003, growth in the real value added by the *commerce sector* accelerated to 4 per cent in the first and second quarters of 2004. The solid performance of the retail and motor trade subsectors lifted the level of output in the commerce sector in the second quarter. The retail sector benefited from the robust domestic demand for consumer goods. The moderation in the price increases of new cars and the purchasing of fleet cars by businesses boosted growth in the real value added by the motor trade subsector.

The brisk performance of the retail and motor trade subsectors was counterbalanced to some extent by the weak real output of the catering and accommodation subsector. Activity in this sector was somewhat muted compared with most of 2003. This could partly be attributed to slightly smaller numbers of foreign tourists visiting the country.

Growth in the real value added by the *transport, storage and communication sector* slowed down from the rate of 6 per cent recorded in all four quarters of 2003 to 5½ per cent in the first quarter of 2004. However, this was short-lived and growth subsequently accelerated to 6½ per cent in the second quarter of 2004. The expansion in the second quarter can be attributed to faster growth in the transport sector and steady growth in the communication sector. Innovative products and competitive packages continued to attract new subscribers and contributed to solid increases in the real output of the cellular telephone communication subsector. The high volume of imports underpinned growth in the real value added by the transport sector.

The real value added by the *financial intermediation, insurance, real-estate and business services sector* increased firmly at an annualised rate of 4 per cent in the second quarter of 2004, marginally higher than the rate of 3½ per cent attained in the first quarter. This can mainly be attributed to a brisk increase in the real output of banks and other financial intermediaries. Activity in commercial banks was lively, aligned with firm domestic demand conditions and the high levels of business and consumer confidence. The performance of the housing market added a fillip to real value added by the real-estate sector.

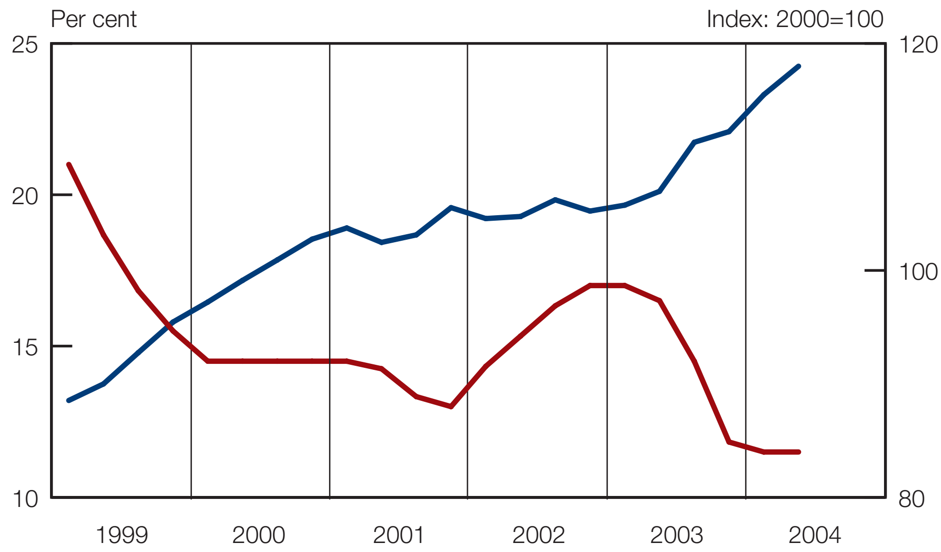
The real value added by *general government* increased at an annualised rate of 1 per cent in the second quarter of 2004, the same rate attained in the first quarter. The stable rate of output by general government is a reflection of government's determination to maintain fiscal discipline to support economic growth and job creation.

Domestic expenditure

Growth in *aggregate real gross domestic expenditure* surged from a quarter-to-quarter and annualised rate of 3 per cent in the first quarter of 2004 to 13 per cent in the second quarter. This can mainly be attributed to a sharp increase in the pace of real inventory investment. In addition, aggregate real domestic final demand still increased strongly, albeit at a slower pace than in the first quarter.

Real final consumption expenditure by households remained strong in the second quarter of 2004. Growth in real outlays on consumer goods and services slowed down somewhat from an annualised rate of 5 per cent in the first quarter of 2004 to 4½ per cent in the second quarter. When compared with the first two quarters of 2003, growth in real final consumption expenditure by households increased by 4 per cent over a year. This was substantially higher than the 3-per-cent growth attained in the calendar year 2003. The protracted strength in household spending was evident in all the major spending categories.

Prime overdraft rate and households' real final consumption expenditure on durable goods



Prime overdraft rate
Expenditure on durable goods* (right-hand scale)
* Seasonally adjusted annualised rates

The growth in expenditure on real *durable goods* lost some momentum in the second quarter of 2004. Following an increase of 12 per cent in the first quarter of 2004, from this high base growth in real outlays on durable goods slowed down to an annualised rate of 9 per cent in the second quarter. The slower growth in real outlays on durable goods occurred in most spending categories, but was particularly evident in furniture and household appliances. Household spending on recreational and entertainment goods remained strong.

The downward trend in growth in household spending was also evident in real outlays on semi-durable goods. By contrast, growth in real expenditure on non-durable goods and services accelerated from an annualised rate of 3 per cent in the first quarter to 3½ per cent in the second quarter of 2004. This could partly be attributed to higher expenditure on food which more than offset lower spending on household fuel and power. This was in line with the late start of winter and the annual increase in electricity tariffs.

The sustained increase in real household disposable income, albeit at a slower pace than in the first quarter, enabled households to maintain spending at a relatively brisk pace in the second quarter of 2004. However, it is evident that household spending, particularly on durable goods, was in part financed by credit. As a result, the ratio of household debt to disposable income rose from 54 per cent in the first quarter of 2004 to 55 per cent in the second quarter.

Growth in *real final consumption expenditure by general government* decelerated from an annualised rate of 4½ per cent in the first quarter to 4 per cent in the second quarter of 2004. This was mainly a result of marginally lower growth in expenditure on non-wage goods and services, while real compensation of employees did not display any significant change. However, the South African Navy acquired a vessel in each of the first two quarters of 2004. Despite the lower quarter-to-quarter growth rate, when evaluated over a period of one year, the level of government spending in the first two quarters of 2004 was 6½ per cent higher than in the same period of 2003. Accordingly, the ratio of final consumption expenditure by general government to gross domestic product increased from 19 per cent in the first quarter to 19½ per cent in the second quarter of 2004.

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
Final consumption expenditure by households....................	2½	3	4	4	3	5	4½
Final consumption expenditure by general government	4	4½	4½	13	4½	4½	4
Gross fixed capital formation	5	3	7½	8½	8½	14½	10½
Change in inventories (R billions)*....................	6,3	9,2	7,9	7,9	7,8	3,1	13,6
Gross domestic expenditure..................	**2½**	**3½**	**4½**	**7**	**4**	**3**	**13**

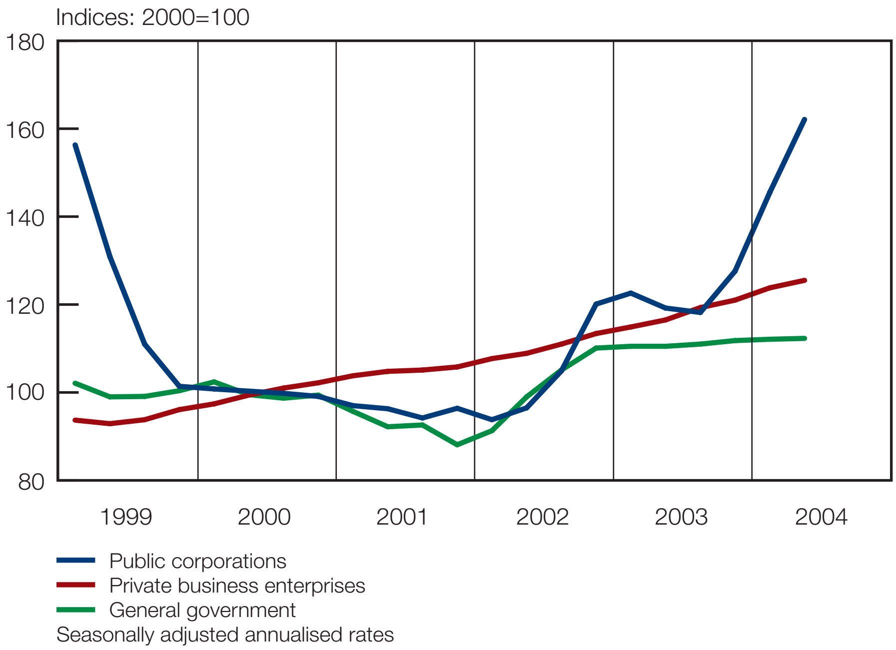
* At constant 1995 prices

Real gross fixed capital formation increased further in the second quarter of 2004 though at a slower pace than in the first quarter. Following an annualised increase of 14½ per cent in the first quarter of 2004, growth in real gross fixed capital formation slowed down to 10½ per cent in the second quarter of 2004. All institutional sectors nevertheless continued to raise their rate of investment spending.

Growth in real gross fixed capital formation by the *private sector* slowed down from 9½ per cent in the first quarter to an annualised rate of 5½ per cent in the second quarter of 2004. This can mainly be attributed to a decline in real capital outlays by the agricultural sector as the prices of agricultural commodities steadily receded in the second quarter of 2004. The bulk of new capital formation took place in the manufacturing sector; relatively high imports of capital equipment by manufacturers to some extent compensated for the slow-growing expenditure in the other sectors. The continuance of existing projects in mining, particularly platinum mining, contributed to the level of real investment in the second quarter.

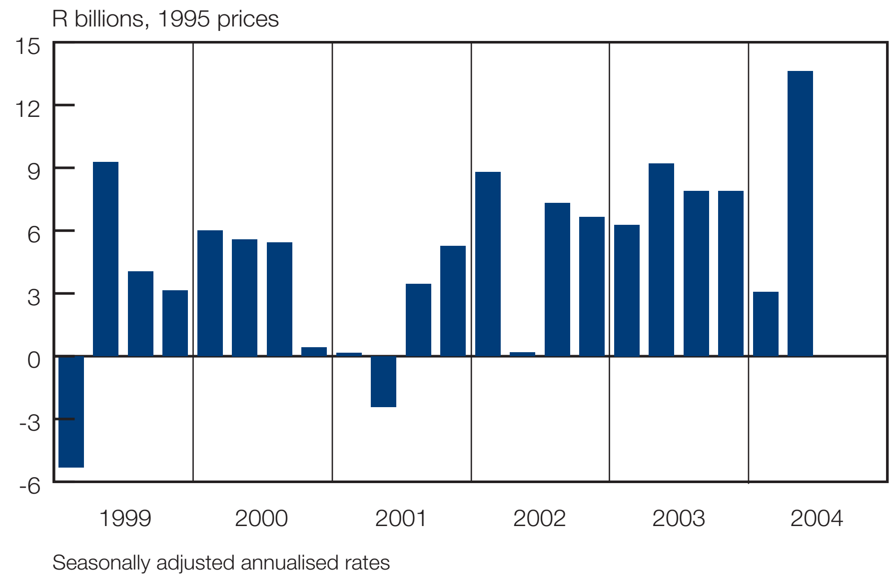
Real fixed capital outlays by *public corporations* increased further in the second quarter of 2004. This was underpinned by steady real capital expenditure by most public corporations. South African Airways continued with the acquisition of new aircraft to replace and add to its existing fleet. Infrastructure maintenance in the communication sector provided further impetus to capital formation by public corporations. The quarter-to-quarter growth in real fixed capital outlays by *general government* remained at comparatively low levels throughout the first two quarters of 2004.

Real gross fixed capital formation



Real inventory investment increased from R3,1 billion in the first quarter of 2004 to R13,6 billion in the second quarter. In contrast to the first quarter, when inventories subtracted almost 3 percentage points from the growth in gross domestic expenditure, inventory investment contributed 6½ percentage points to growth in gross domestic expenditure in the second quarter of 2004. Most of the inventory accumulation took place in the manufacturing sector of the economy. This was underpinned by a large volume of oil imported. The rate of inventory accumulation by the commerce sector was distinctly lower compared with that of the manufacturing sector. The strength of domestic demand could have contributed to lower inventory accumulation in this sector. As a result of these developments, the ratio of industrial and commercial inventories to non-agricultural gross domestic product increased from 15½ per cent in the first quarter to 16 per cent in the second quarter of 2004.

Change in inventories



Factor income

Growth in *total nominal factor income*, measured over four quarters, accelerated from 7 per cent in the first quarter of 2004 to 7½ per cent in the second quarter. This was mainly due to faster growth in the gross operating surpluses of business enterprises. While growth in compensation of employees increased at the same rate as in the first quarter, the level remained quite high.

Growth in compensation of employees, measured over one year, was sustained at a rate of 9 per cent in the first and second quarters of 2004. The firm growth was evident throughout most sectors of the economy with the exception of the mining, construction, commerce and financial services sectors where compensation growth slowed down. There appears to be a realignment of wage settlements in these sectors to reflect the downward trend of the inflation rate.

The four-quarter rate of increase in *gross operating surpluses* of business enterprises accelerated from 5 per cent in the first quarter of 2004 to 6 per cent in the second quarter. The improved performance in operating surpluses was broad-based and occurred in most economic sectors. However, the income of the agricultural sector remained under pressure as prices of agricultural commodities receded and the operating surplus contracted from the first to the second quarter of 2004.

Operating surpluses of the manufacturing sector benefited from improved production and sales. The buoyant conditions in the commerce sector and the lively activity in the finance, insurance, real-estate and business services sector further boosted growth in total operating surpluses. Despite the stronger growth in gross operating surpluses, the ratio of gross operating surplus to total factor income declined from 48½ per cent in the first quarter of 2004 to 48 per cent in the second quarter.

Gross saving

The national saving ratio or *gross saving as percentage of gross domestic product* weakened from 15½ per cent in the first quarter of 2004 to 14½ per cent in the second quarter. This can mainly be attributed to weaker corporate and government saving relative to gross domestic product. Gross saving by households as a ratio of gross domestic product remained broadly around the same rate as in the first quarter. As a result, South Africa could not finance gross capital formation without relying on a substantial amount of foreign resources. This was apparent in that foreign investment (net of reserve accumulation) was relatively high, amounting to nearly 4 per cent of gross domestic product.

Gross saving by the *corporate sector* as percentage of gross domestic product declined from 12 per cent in the first quarter to 11½ per cent in the second quarter of 2004, similar to the average rate of 11½ per cent recorded for the 2003 calendar year. Companies generally increased their dividend payments instead of retaining profits within the enterprises. Dividend payments to non-resident shareholders in particular rose faster in the second quarter of 2004, which rather neutralised the higher operating surpluses.

Gross saving by *households* as a percentage of gross domestic product remained around 3 per cent in the first and the second quarters of 2004. Despite an improvement in real disposable income, the saving of households remained under pressure as final consumption expenditure by households maintained a relatively high level.

The faster pace of expenditure by *general government* and lower year-on-year growth in tax revenue took its toll on government saving. The ratio of gross government saving to gross domestic product weakened sharply from the first to the second quarter of 2004.

Employment

According to the latest *Survey of Employment and Earnings* by Statistics South Africa, the level of enterprise-surveyed employment in the *formal non-agricultural sectors of the economy* fell by 0,4 per cent in the three months to March 2004. The contraction in employment in the opening months of 2004 trimmed some 27 600 jobs from the gain of roughly 80 600 jobs during the third and fourth quarter of 2003. The first-quarter 2004 employment losses occurred in both the private and public sectors of the economy, lowering the employment level by 1,1 per cent compared with the same period in the preceding year.

Despite the fall-back in *overall private-sector employment* in the initial months of 2004, employment gains were still recorded in a number of industries. These included manufacturing, electricity generation, non-gold mining, trade, catering and accommodation services, and washing and laundry services. Employment losses in the first quarter of 2004 were mainly concentrated in the finance, insurance, real-estate and business services industry as well as in the construction industry.

Job losses in the finance, insurance, real-estate and business services industry in the first quarter of 2004 could be attributed to the ending of activities, and the retrenchment of employees. The decrease in employment numbers in the construction industry in this quarter resulted mainly from the completion of some projects. However, employment losses in the construction industry were partially counteracted by employment gains in site preparation activities, which might point towards renewed vigour in building-sector activities in the coming months.

Quarter-to-quarter change in non-agricultural private-sector employment at annualised rates in the first quarter of 2004

Sector	Percentage change
Gold mining	-2,4
Non-gold mining	2,5
Manufacturing	3,1
Electricity supply	3,9
Construction	-8,8
Trade, catering and accommodation services	6,9
Transport, storage and communication	-1,4
Finance, insurance, real-estate and business services	-17,3
Washing and laundry services	9,0
Total private sector	-1,5

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

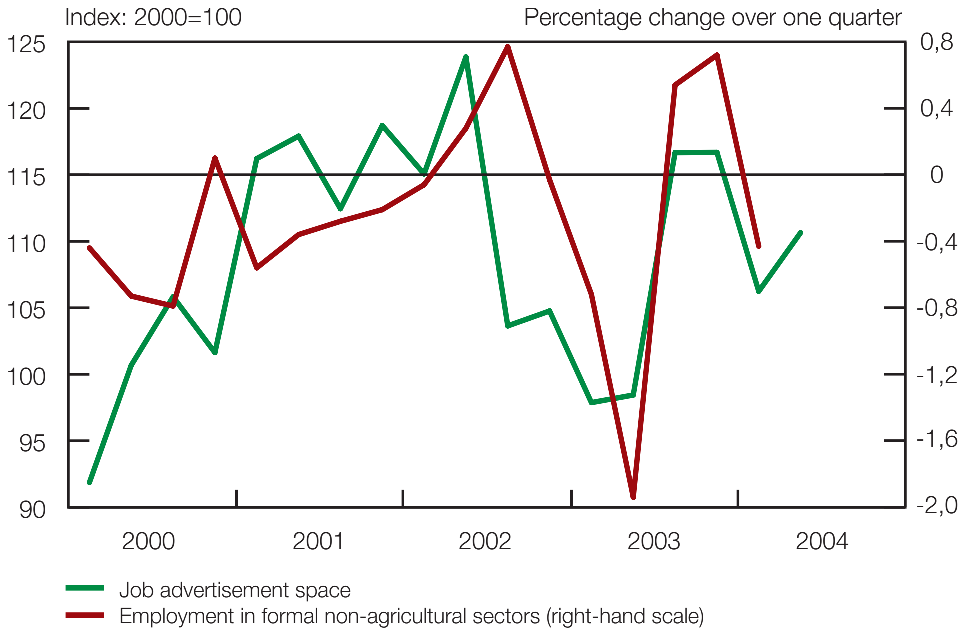
Business confidence in the building sector increased in the second quarter of 2004 following strong growth in the residential property market and heightened activity in the non-residential market. According to the business confidence index compiled by the Bureau for Economic Research, confidence in the building industry has risen to its highest level since the early 1980s. Contractors in the residential building industry also indicated an increase in employment levels, with an expectation of continued favourable conditions in coming months.

The Investec Purchasing Managers Index, representing purchasing managers' expectations in the manufacturing sector, reached its highest level since September 2002 in July 2004, indicating an improvement in manufacturing-sector prospects. During the five-month period to May 2004 the employment component of the index also picked up, but tapered off somewhat in June and July as expectations of further expansion in the industry moderated somewhat in accordance with the strong showing of the rand in international currency markets. The index has, however, remained above the 50-per-cent level, suggesting continued net growth in employment opportunities in the manufacturing sector, albeit at a reduced rate.

The decrease in *public-sector employment* in the first quarter of 2004 was more pronounced than in the private sector, amounting to an annualised rate of 2,3 per cent. Employment losses in the public sector were fairly pervasive with the main contraction occurring at local government level. Employment gains occurred at national department level and at parastatals, universities and other public corporations outside the transport and communication area. Despite a quarterly decrease in public-sector employment in the first quarter of 2004, the level of employment remained higher than at its nadir in the second quarter of 2003.

Job advertisement space in the print media is related closely to changes in formal non-agricultural employment. Notwithstanding the small size of the sample of advertisement statistics, there is a close relationship between changes in advertisement space and changes in non-agricultural employment. Based on this relationship, it can be expected that the increase in job advertisements in the second quarter of 2004 will lead to an increase in employment in coming months, as qualified candidates are appointed to these vacant positions.

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



According to Andrew Levy Employment Publications (a private-sector labour consultancy) the number of workdays lost due to strikes and other forms of industrial action fell further from 240 000 in the first half of 2003 to 233 000 in the same period of 2004. Since the bulk of wage negotiations takes place in the third quarter of each year the propensity for strike action increases during this period, normally resulting in a more-than-proportionate increase in workdays lost. In fact, the number of workdays lost during the first half of 2003 only accounted for 34 per cent of the total number of workdays lost for the year as a whole. Significantly, there was a reduction in workdays lost during the first half of 2004, compared with the same period in 2003.

Labour cost and productivity

Despite the decline in consumer price inflation in the past year or so, the rate of increase in *nominal remuneration per worker* in the formal non-agricultural sector rose from an annual average of 8,7 per cent in 2003 to 9,4 per cent in the year to the first quarter of 2004. The acceleration in nominal wage growth was evident in the private sector, while public-sector wage growth remained at around 9,5 per cent in both the fourth quarter of 2003 and the first quarter of 2004.

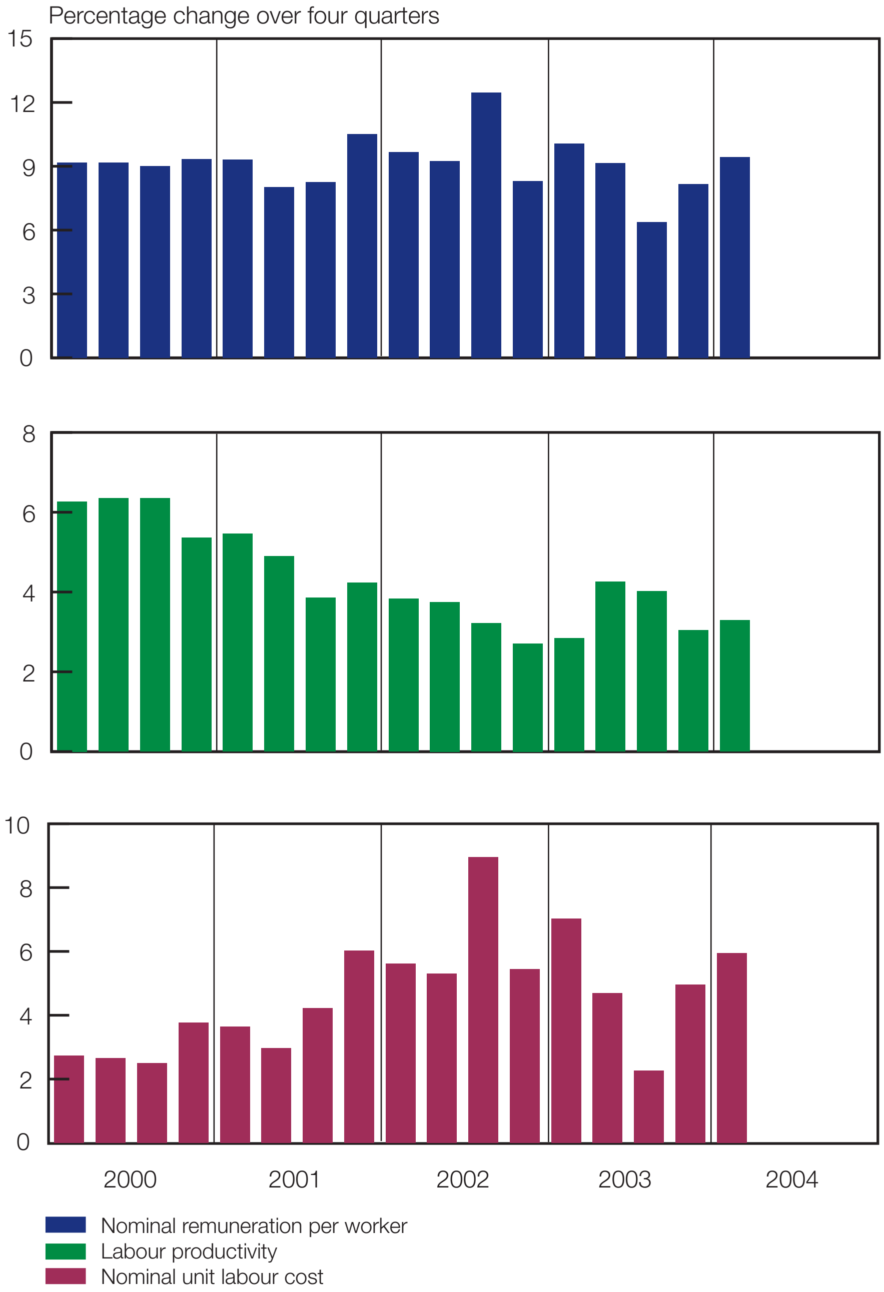
According to Andrew Levy Employment Publications, the average settlement rate in collective bargaining agreements fell to 7,3 per cent in the first half of 2004 compared with 8,9 per cent in the same period of the preceding year. The increase in the average *minimum wage per worker* at a year-on-year rate was somewhat less at 5,3 per cent in the first half of 2004, bringing the minimum wage to R2 646. Employers, especially in export-oriented industries, are likely to keep a lid on salary and wage increases during the current round of wage negotiations as their international competitiveness suffered a setback because of the recovery in the exchange rate of the rand in recent months. Salary and wage increases in the public sector are also likely to be moderated by government's commitment to low inflation.

Consistent with lower settlement rates, the rate of increase over four quarters in the average salary or pension payment per recipient paid into recipients' bank accounts slowed down appreciably from 7,3 per cent in the third quarter of 2003 to 3,9 per cent in the first quarter of 2004 and even further to 2,1 per cent in the second quarter.

Economy-wide labour productivity growth at average annual rates of around 3,5 per cent in the past two years was more sedate than in preceding years. The slight fall-back in the level of employment in the first quarter of 2004, alongside increases in production volumes, resulted in an increase of 3,3 per cent in the *real output per worker in the formal non-agricultural sectors* of the economy in the year to the first quarter of 2004. This rate of increase was somewhat lower at 3,0 per cent in the fourth quarter of 2003. Unlike increases in labour productivity in the economy as a whole, production per worker in the *manufacturing sector* fell by 3,1 per cent in 2003 as manufacturing production volumes declined without a concomitant fall in employment. When measured over periods of four quarters, production per worker in the manufacturing sector essentially remained unchanged in the first quarter of 2004 but there was an increase of 1 per cent from the fourth quarter of 2003 to the first quarter of 2004.

Absenteeism from the workplace results in a direct cost to the economy which is conservatively estimated to exceed R12 billion a year, according to AIC Insurance, a company specialising in the underwriting of the direct cost of absenteeism. It is normal for absenteeism to be higher in the manufacturing industry than in the financial services industry, but lower than in the mining industry where the work environment is more hazardous. However, the degree of absenteeism management and control will influence comparisons among sectors. The average sick leave per person taken per year is currently at around 7 workdays. Observing changes in sick leave taken may be useful in assessing the influence of illness-related work absence on variables such as labour productivity and labour costs.

Remuneration, labour productivity and unit labour cost in non-agricultural sectors



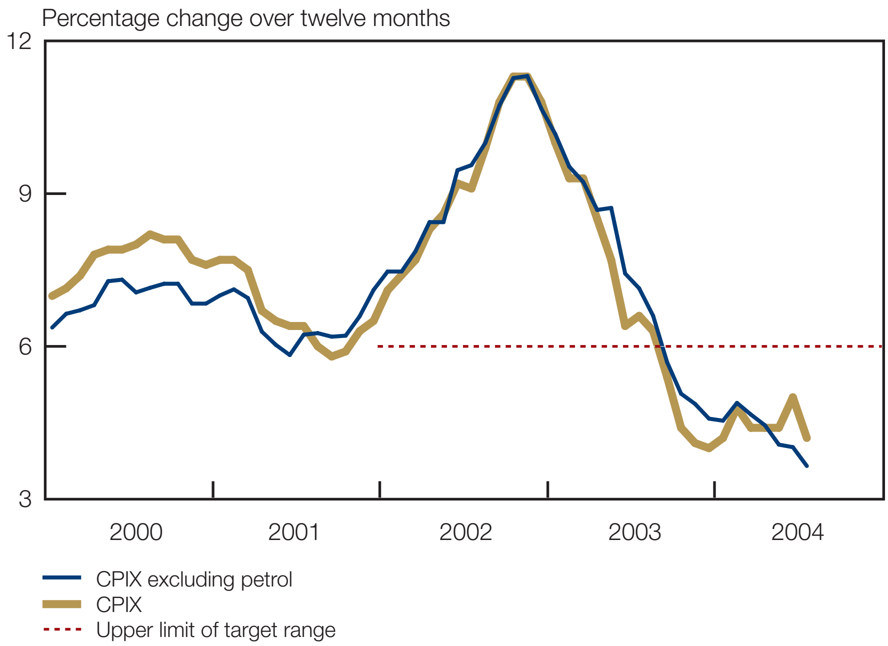
The increase in the *cost of labour per unit of production* in the entire formal non-agricultural sector was contained at a year-to-year rate of 5,0 per cent in 2003, somewhat lower than the 6,0 per cent increase in 2002. Notwithstanding the slight pick-up in labour productivity growth, increases in nominal wages pushed the year-on-year rate of increase in nominal unit labour cost higher to 5,9 per cent in the first quarter of 2004. Had it not been for higher labour productivity, growth in nominal unit labour cost in the first quarter of 2004 would have surpassed the upper limit of the inflation target range of 6 per cent.

The higher production volumes in the first quarter of 2004, accompanied by a slowdown in nominal wage growth, held back the increases in nominal unit labour cost in the manufacturing sector, but the year-on-year rate of increase in nominal unit labour cost was still high at 15,1 per cent in the fourth quarter of 2003 and 9,1 per cent in the first quarter of 2004. These high cost increases compressed profitability somewhat, thereby slowing the pace of employment growth.

Prices

Price inflation receded to historically low levels in the closing months of 2003 mainly on account of the disciplined monetary and fiscal policy environment and the continued appreciation of the value of the rand on international currency markets. Goods prices, particularly at the production level, recorded significant absolute declines. More recently, the marked rise in the international price of crude oil and associated increases in domestic petrol and diesel prices, impacted on consumer and production price inflation. In fact, when rising energy prices are omitted, year-on-year CPIX inflation would have moderated to only 3,7 per cent in July 2004, as opposed to the comparatively higher level in overall CPIX inflation in recent months.

CPIX



Consistent with the appreciation in the exchange rate of the rand, year-on-year inflation in the *prices of imported goods* fell from a high of 17,4 per cent in April 2002 to 0,5 per cent in March 2003. Thereafter the production prices of imported goods decreased by as much as 9,6 per cent in the year to November 2003. The year-on-year rate of decline in the prices of imported goods subsequently moderated, on balance, to 2,8 per cent in

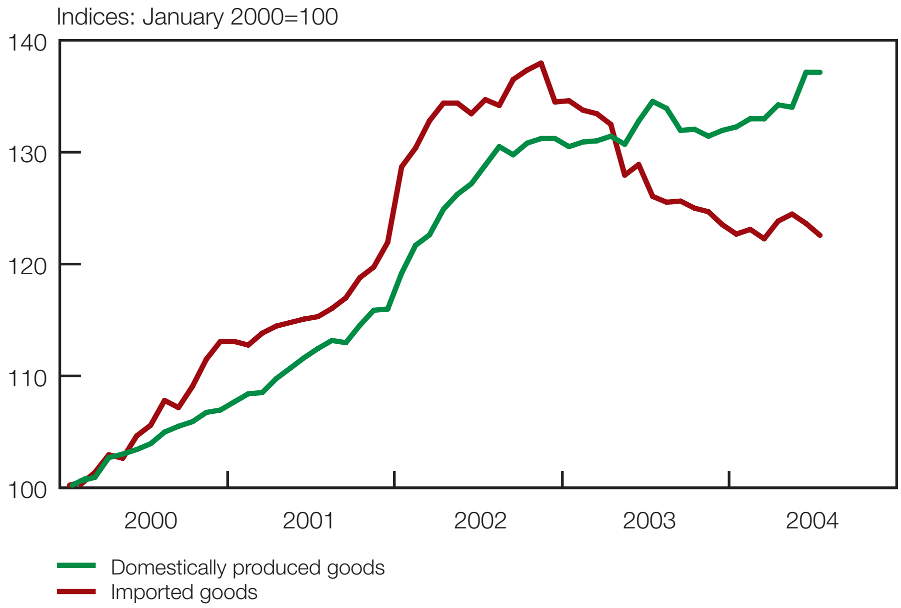
July 2004 as energy prices rose. The pace of decline in the prices of imported goods was also moderated by a pick-up in inflation pressures in South Africa's main trading-partner countries. Year-on-year rates of increase in the composite foreign wholesale price index of these countries rose strongly from 0,9 per cent in February 2004 to 3,8 per cent in June.

In recent months, declines occurred in the prices of a broad range of imported products as the exchange rate of the rand appreciated further. This contributed significantly to the waning of inflation pressures. The price-reducing effect of rand strength was most noticeable in the categories for imported food, apparel and computing equipment. The prices of computing equipment fell by as much as 14,2 per cent in the year to July 2004. Purchases of these lower-priced imported goods contributed to the buoyancy of consumption expenditure in recent months.

Notwithstanding continued declines in the prices of imported goods when measured over periods of twelve months, the short-term rate of change reverted from prices falling at an annualised 8,3 per cent in the first quarter of 2004 to prices rising at an annualised 4,9 per cent in the second quarter. The pick-up in the quarter-to-quarter pace of increase in the prices of imported goods can mainly be attributed to the increase in the prices of imported crude oil. Had it not been for the further appreciation in the exchange rate of the rand, higher international crude oil prices would have translated into even steeper increases in the retail prices of petrol and diesel.

Unlike the consistent decline in the price level of imported goods from November 2002 to March 2004, the level of *domestically produced goods* prices rose continuously during this period, albeit at a decelerating pace. When measured over periods of twelve months, inflation in the prices of domestically produced goods declined from 15,3 per cent in August 2002 to 0,2 per cent in November 2003. Thereafter, the year-on-year rate of increase rose progressively to 3,3 per cent in June 2004 as energy prices escalated. Following decreases in the prices of especially agricultural products, year-on-year inflation in domestically produced goods prices fell to 1,9 per cent in July 2004. Excess capacity in industry and the threat of imports at relatively low prices were important factors in limiting the acceleration of domestically produced goods inflation in recent months.

Production price index



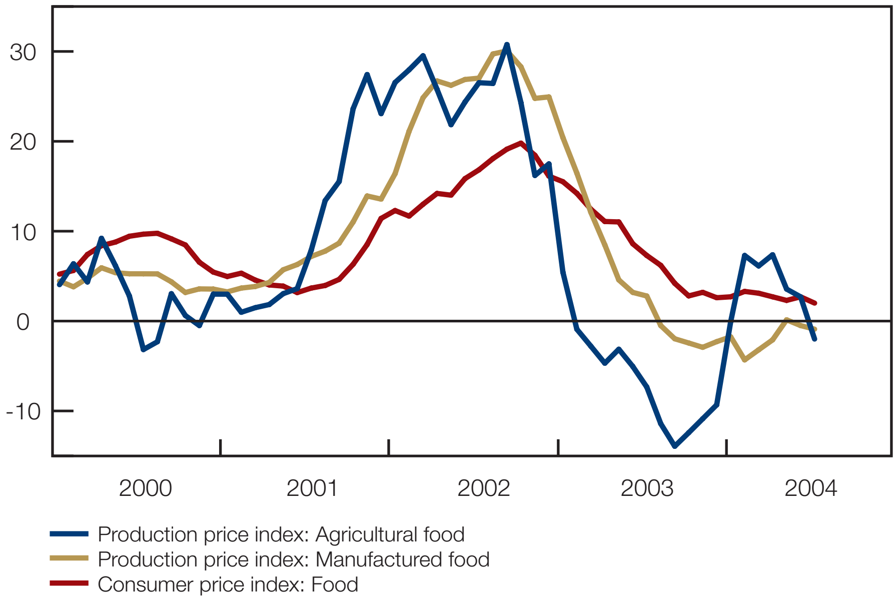
The quarter-to-quarter pace of increase in the prices of domestically produced goods rose from an annualised rate of 3,2 per cent in the first quarter of 2004 to 5,0 per cent in the second quarter. In the second quarter, higher rates of increase were recorded in the prices of electricity, gas, water and mining products, as well as in alcoholic beverages and tobacco, and basic metals and metal products.

The increase in electricity prices in June 2004 as charged by Eskom, the national electricity utility, aligned with its cost-related electricity tariff structure is most notable. According to this price structure, electricity tariffs are raised during high usage months, i.e. June to August of each year, but lowered with the onset of the summer months. Notwithstanding a month-to-month increase of 48 per cent in electricity tariffs in June 2004, electricity tariffs had only risen by 4,3 per cent over the year to June, and by 3,3 per cent over the year to July.

Following drought conditions in certain parts of the country, twelve-month inflation in the production prices of agricultural food products rose abruptly to levels around 7 per cent in February to April 2004 after it had been *negative* for twelve consecutive months up to January 2004. The recent improvement in agricultural conditions helped contain the year-on-year rate of increase in agricultural food prices to 2,7 per cent in June 2004. The prices of agricultural and manufactured food products both declined in the year to July 2004. To some extent, muted inflationary pressures in the production prices of food served as an offset to the rise in energy prices.

Food prices

Percentage change over twelve months



In addition to improved rainfall in the earlier part of 2004, the continued appreciation in the exchange rate of the rand also helped to contain food price inflation by driving import and export parity prices down. The spot prices of yellow maize, for instance, decreased from around R1 400 per ton in early February 2004 to around R900 per ton at the end of July – a decrease of about 55 per cent. Wheat prices have also declined by 21 per cent during the three months to the end of July 2004. Favourable trends in international food prices as well as in local maize and wheat prices suggest that food price inflation will remain subdued for the immediate future.

As a result of the slowdown in domestically produced goods inflation and *declining* prices of imported goods, the year-on-year rate of increase in the *all-goods production price index* fell from 15,4 per cent in September 2002 to 0,2 per cent in August 2003. When measured over periods of twelve months, all-goods production prices actually fell for eight consecutive months to April 2004. However, by May 2004 all-goods production prices began to increase and by June these prices had risen by 1,3 per cent over the year. Subsequently, all-goods production price inflation moderated to 0,7 per cent in the year to July 2004 as domestically produced goods inflation subsided.

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.....................................	-0,5	-10,3	-3,1
	2nd qr	0,1	-11,4	-3,6
	3rd qr	5,5	-7,1	2,1
	4th qr	-2,6	-6,7	-3,3
	Year.......................................	**3,9**	**-4,2**	**1,7**
2004:	1st qr.....................................	3,2	-8,3	0,0
	2nd qr	5,0	4,9	4,8

The short-term pace of increase in the all-goods production price index picked up more decisively than the year-on-year rate of increase. When measured from quarter to quarter and expressed at an annualised rate, all-goods production prices remained unchanged in the first quarter of 2004 but increased by 4,8 per cent in the second quarter – the highest rate of increase in the past six quarters.

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 bonds) rose from a nadir of 4,0 per cent in December 2003 to 5,0 per cent in June 2004. The pick-up in CPIX inflation over this period resulted mainly from the effect of higher petrol prices. Subsequently, year-on-year CPIX inflation moderated to 4,2 per cent in July 2004 as petrol prices declined temporarily. Alongside the resultant still high increase in transport running cost, year-on-year rates of increase in the prices of alcoholic beverages and tobacco and total housing services (excluding mortgage interest cost) and services not related to housing and transport exceeded the upper limit of the inflation target range in July 2004. However, year-on-year changes in the prices of 61 per cent of the goods and services contained within the CPIX measure fell below the upper limit of the inflation target range in July 2004, with some prices even declining.

CPIX goods price inflation more than doubled from a year-on-year rate of 2,0 per cent in December 2003 to 4,1 per cent in June 2004. Subsequently, CPIX goods price inflation declined to 3,0 per cent in the year to July 2004. Inflation in the prices of all the main consumer goods categories, however, remained fairly stable at their respective levels during the past six months or so. The only exception was transport running cost increases, which accelerated steeply to June 2004, thereafter decelerating in July. When the rise in petrol and diesel prices is not accounted for, year-on-year CPIX goods price inflation would have remained below the lower limit of the inflation target range at around 2,5 per cent during the four months to June 2004, and at 2,0 per cent in July. The quarter-to-quarter and annualised rate of increase in overall CPIX goods prices was also contained at 3,0 per cent in the second quarter of 2004.

Inflation in the components of CPIX

Percentage change over same period in the previous year

	Weights	2003	July 2004
Transport running cost	5,7	-0,4	14,7
Alcoholic beverages and tobacco	3,1	11,2	8,4
Total housing services	13,4	9,7	8,4
Services excluding housing and transport	16,5	7,3	6,3
Total other goods	*17,5*	*5,9*	*3,7*
Total transport services	*3,9*	*5,5*	*3,3*
Food	26,9	8,5	1,5
Furniture and equipment	3,2	4,1	0,9
Vehicles	5,7	4,2	-0,6
Clothing and footwear	4,1	2,0	-5,1
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

As a consequence of the appreciation of the rand, the prices of motor vehicles, clothing and footwear declined in recent months. Year-on-year increases in the prices of furniture and equipment were also well contained at around 1 per cent since the closing months of 2003. Following initial declines and subsequent moderate increases in the prices of agricultural food products in the past year or so, year-on-year consumer food price inflation remained subdued at around 3,0 per cent since October 2003, declining to 1,5 per cent in July 2004.

Year-on-year increases in the prices of alcoholic beverages and tobacco remained consistently above the 8-per-cent level during the past decade and outpaced inflation in all other price categories over this period. These high rates of increase are partly accounted for by persistent annual increases in excise duties. Inflation in this category receded from a year-on-year rate of 13,6 per cent in July 2003 to a still high rate of 8,4 per cent in July 2004.

While CPIX goods price inflation picked up during the first half of 2004 *CPIX services price inflation* which remained at around 8 per cent during most of 2003, subsided somewhat to 6,8 per cent in the year to July 2004. Overall CPIX services price inflation was pulled lower by relatively low increases in transport services prices at year-on-year rates of around 3 per cent in recent months to July 2004. During this period, year-on-year inflation in the prices of transport services was almost outpaced three-fold by CPIX housing services price inflation. Year-on-year increases in the prices of services not related to housing or transport subsided to 5,9 per cent in June 2004 – within the inflation target range – but picked up slightly to 6,3 per cent in July. Also, the quarter-to-quarter pace of increase in overall CPIX services prices slowed down from an annualised rate of 6,7 per cent in the first quarter of 2004 to 6,1 per cent in the second quarter.

The setting of increases in administered prices also contributed to the slowdown in overall consumer price inflation. Administered prices excluding petrol still continued to increase at a faster pace than overall CPIX in recent months, but low increases in electricity, water and telephone tariffs in early 2004 helped to slow down the pace of increase in administered prices and in CPIX. According to Reserve Bank calculations, administered prices increased by 9,0 per cent in the year to July 2004 while administered prices excluding petrol increased by 7,3 per cent.

Foreign trade and payments

Current account[2]

2 The current-account flows referred to in this section are seasonally adjusted and annualised.

After 22 years of consecutive quarterly trade surpluses, South Africa's trade balance with the rest of the world moved into deficit in the second quarter of 2004. This turnaround reflected a rapid acceleration in domestic expenditure, which was accompanied by robust growth in the volume of imports. In the second quarter the volume of exported goods responded positively to the apparent upswing in global economic activity, even though the further increase in the nominal effective exchange rate of the rand weighed down on the growth in export volumes. With imports rising more strongly than exports, the trade balance was turned into a deficit of R5,5 billion in the second quarter of 2004 from a surplus of R21,0 billion in the first quarter.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2003					2004	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	262,8	258,3	258,5	244,5	256,0	257,0	281,5
Net commodity gold exports	36,6	34,2	34,7	35,9	35,3	33,5	32,6
Merchandise imports	-262,0	-262,1	-260,9	-266,2	-262,8	-269,5	-319,6
Trade balance	**37,4**	**30,4**	**32,3**	**14,2**	**28,5**	**21,0**	**-5,5**
Net service, income and current transfer payments	-37,8	-40,7	-40,0	-36,3	-38,6	-35,4	-43,8
Balance on current account	**-0,4**	**-10,3**	**-7,7**	**-22,1**	**-10,1**	**-14,4**	**-49,3**

This negative imbalance on the trade account together with an increase in the shortfall on the net services, income and current transfer account with the rest of the world caused the deficit on the current account of the balance of payments to widen significantly to R49,3 billion in the second quarter of 2004. Expressed as a ratio of the country's gross domestic product, the deficit on the current account increased from 1,1 per cent in the first quarter of 2004 to 3,8 per cent in the second quarter.

The value of *merchandise exports* rose by a robust 9½ per cent in the second quarter of 2004. Having increased by 9 per cent in the first quarter of 2004, the rand *prices* of exported goods fell by 3 per cent in the second quarter, mainly due to an increase in the average nominal effective exchange rate of the rand. The decline in the aggregate export-price level was further reinforced by a decline in the international prices of South Africa's non-gold export commodities.

The impact of lower rand prices of exported goods was more than fully countered by an increase of 12½ per cent in the physical *quantity* of exported goods. Led by platinum and coal, the physical quantity of mining products exported rose solidly in the second quarter of 2004. At the same time, the physical quantity of manufactured exports also picked up somewhat.

Real imports and exports* of goods and non-factor services

* Including gold

As South African producers began to benefit from increased foreign demand, the ratio of real merchandise exports to real gross domestic product rose from 16,6 per cent in the first quarter of 2004 to 18,5 per cent in the second quarter. This ratio was, however, still lower than the average ratios which had been recorded in 2000 and 2001.

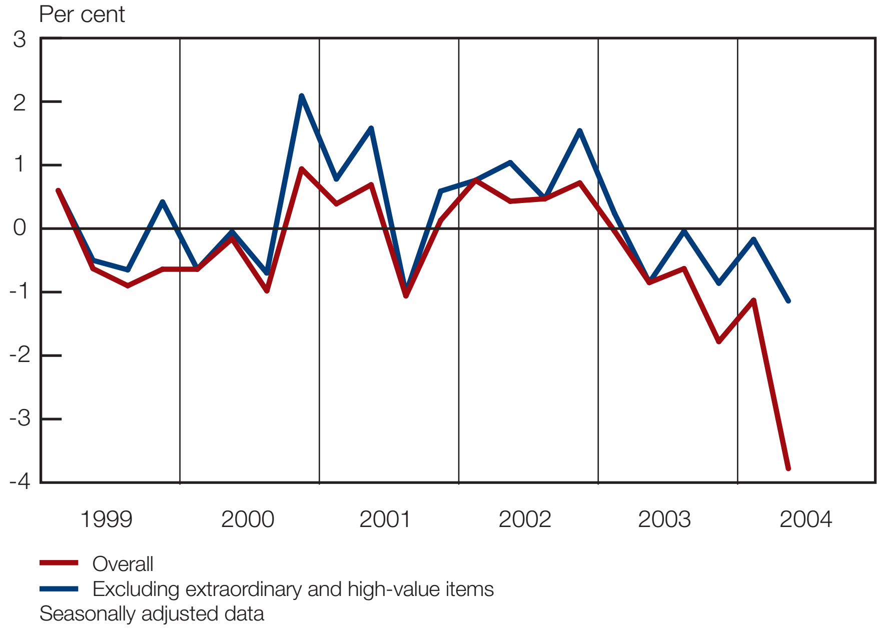
The value of South Africa's net *gold exports* continued to decline in the second quarter of 2004, despite an increase of almost 2½ per cent in the physical *quantity* of gold exported. While the average London fixing price declined significantly from US$409 per fine ounce to US$393 per fine ounce from the first to the second quarter of 2004, the average realised price of gold in rand recorded a more pronounced decline from R2 736 per fine ounce to R2 603 per fine ounce over the same period. The value of net gold exports accordingly fell by a further 2½ per cent in the second quarter of 2004, having already declined by 7 per cent in the first quarter.

After having receded marginally in the first quarter of 2004, the physical *quantity of merchandise imports* advanced by 20½ per cent in the second quarter. This increase could partially be attributed to a sharp increase in the volume of crude oil imported, the acquisition of a third corvette by the South African Navy and purchases of aircraft. Leaving these large-item imports aside, the deficit on current account would have been considerably smaller, as illustrated in the graph on the following page.

The strengthening of the external value of the rand countered the higher international price of crude oil and a slight acceleration in wholesale price inflation in South Africa's major trading-partner countries, causing the rand prices of imported goods to decline by about 1½ per cent in the second quarter of 2004.

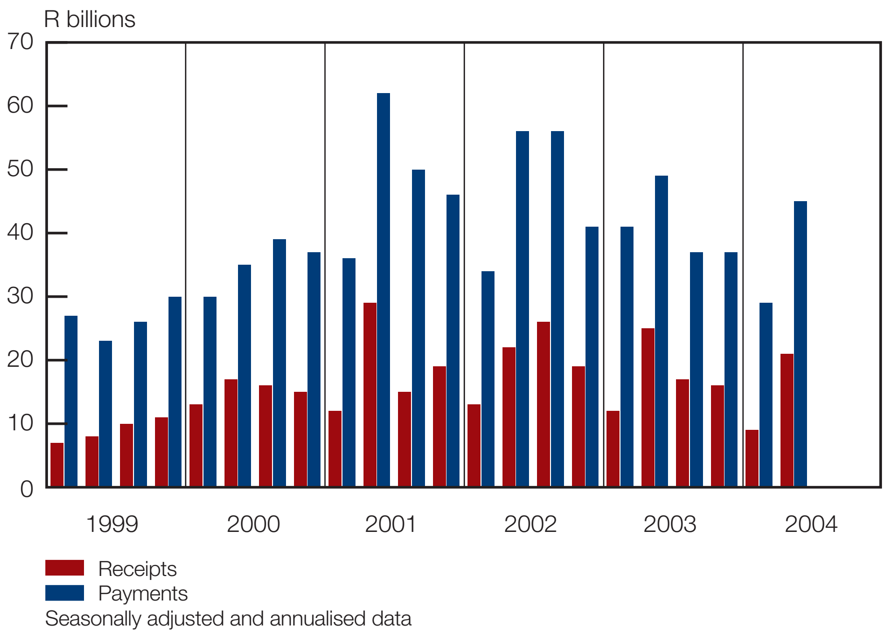
The sharp increase in the physical quantity of imported goods contributed materially to an increase of 18½ per cent in the *value* of merchandise imports in the second quarter of 2004. The value of imported manufactured goods rose by about 5 per cent over the period as the growth in aggregate domestic demand spurred the demand for imported intermediate, capital and consumer goods. Of note was the sharply higher volume of oil imports which, together with the steep rise in the price of crude oil, increased the value of oil imports by more than 200 per cent over the period. Relative to the value of total merchandise imports, imports of crude oil constituted 16 per cent in the second quarter of 2004 compared with 5 per cent in the first quarter.

Ratio of current-account balance to gross domestic product



The deficit on the net service, income and current transfer account with the rest of the world widened from a seasonally adjusted and annualised value of R35,4 billion in the first quarter of 2004 to R43,8 billion in the second quarter. Higher dividend payments to non-resident investors as well as an increase in interest payments on government's foreign

Investment income



debt raised total foreign income payments from R35,8 billion in the first quarter of 2004 to R50,5 billion in the second quarter. Although larger income receipts were registered in the second quarter of 2004, the magnitude of these inward flows was not sufficient to counteract the outward income payments.

The rand prices of both exports and imports receded in the second quarter of 2004. Lower non-gold commodity export prices together with receding prices of other merchandise exports, gold and non-factor services rendered to non-residents were offset by a decline in import prices. This caused South Africa's terms of trade to remain broadly unchanged, but still at a relatively favourable level in the second quarter of 2004.

Terms of trade and non-gold commodity prices

Financial account

The net inward movement of capital into the South African economy continued unabatedly in the second quarter of 2004 when an inflow of R25,9 billion was recorded, compared with an inflow of R14,1 billion in the first quarter. From the first quarter of 2003

Net financial transactions not related to reserves

R billions

	2003					2004	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities							
Direct investment	0,1	0,4	1,8	3,4	5,7	7,8	-1,8
Portfolio investment	-4,0	22,4	-4,3	-6,2	7,9	5,1	14,1
Other investment	-1,2	4,8	-1,7	11,6	13,5	4,5	4,0
Change in assets							
Direct investment	-2,8	0,7	-1,5	-1,8	-5,4	1,0	-10,2
Portfolio investment	-0,4	0,2	-0,3	-0,5	-1,0	0,0	-1,4
Other investment	5,2	1,7	5,8	10,8	23,5	-3,8	6,4
Total financial transactions*..............	-7,5	26,0	10,4	34,5	63,4	14,1	25,9

* Including unrecorded transactions

to the second quarter of 2004 total net financial flows into the economy (including unrecorded transactions) amounted to R103,4 billion, somewhat less than the cumulative net inflow of capital of R129,3 billion in the nine-year period from the first quarter of 1994 to the final quarter of 2002.

Foreign-owned assets in South Africa

Foreign direct investment flows changed to an outflow (i.e. a decline in foreign direct investment liabilities) of R1,8 billion in the second quarter of 2004 compared with an inflow of R7,8 billion in the first quarter of 2004. This outflow resulted mainly from the disposal of foreign direct investors' equity holdings in Telkom, as well as the selling of shares in a domestic short-term insurance company by a non-resident company. These outflows were partly countered by the acquisition of a domestic energy exploration company by a non-resident company.

Portfolio investment flows into South Africa improved from an inflow of R5,1 billion in the first quarter of 2004 to an inflow of R14,1 billion in the second quarter. Foreign portfolio investors were net buyers of domestic shares, but net sellers of domestic bonds during the quarter. An inflow also occurred when a South African gold-mining company issued shares to non-residents in order to finance the acquisition of a foreign gold-mining company. The National Treasury issued a new international bond to the value of US$1 billion in the international capital markets during the second quarter, while a Samurai bond of 40 billion yen was repaid.

Other foreign investment into South Africa recorded an inflow of R4,0 billion in the second quarter of 2004, compared with an inflow of R4,5 billion in the first quarter. This inflow can be attributed to an increase in short-term loans of the banking sector, as well as further drawings by the government on long-term loans pre-arranged for the funding of the armaments programme.

South African-owned assets abroad

Outward direct investment switched from an inflow of R1,0 billion during the first quarter of 2004 to an outflow of R10,2 billion during the second quarter. These outflows occurred as South African companies continued their offshore expansion and was strengthened through the acquisition by a South African gold-mining company of a foreign gold-mining company.

Portfolio investments by South African entities abroad increased to an outflow of R1,4 billion during the second quarter of 2004. This outflow occurred as institutional investors increased their investments abroad in terms of the existing exchange control dispensation.

Other outward investment from South Africa changed from an outflow of R3,8 billion in the first quarter of 2004 to an inflow of R6,4 billion in the second quarter. The factors contributing to the inflow in the second quarter of 2004 included a decline in rand-denominated deposits of the South African banking sector abroad. The delayed repatriation of proceeds resulting from the sale of shares in a South African mining company to a non-resident shareholder in the first quarter of 2004 also contributed to the inflow of other investment capital.

Foreign debt

South Africa's total outstanding foreign debt increased by US$2,0 billion from the end of December 2003 to US$39,2 billion at the end of March 2004. Increases were recorded in both rand-denominated debt and, to a lesser degree, foreign-currency denominated debt.

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

Period	2001	2002	2003	2004 1st qr
Foreign-currency denominated debt...	24,0	25,0	27,4	27,9
Bearer bonds	6,0	7,8	9,7	9,6
Converted long-term loans	0,1	0,0	0,0	0,0
Public sector	3,0	5,0	4,9	4,4
Monetary sector	8,9	6,2	5,9	7,4
Non-monetary private sector	6,0	6,0	6,9	6,5
Rand-denominated debt	6,8	7,7	9,8	11,3
Bonds	4,3	4,5	4,2	4,4
Other	2,5	3,2	5,6	6,9
Total foreign debt	30,8	32,7	37,2	39,2

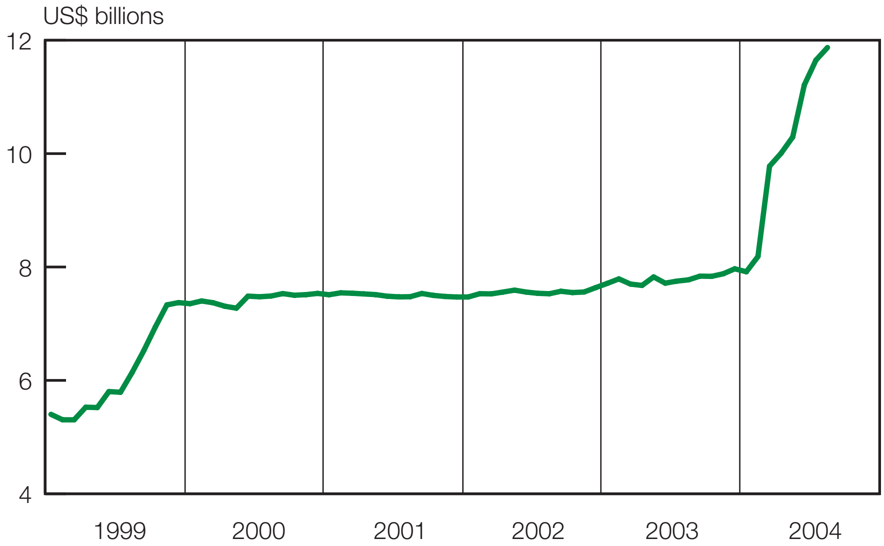
Foreign-currency denominated debt increased from US$27,4 billion at the end of December 2003 to US$27,9 billion at the end of March 2004. This increase can be attributed to an increase in non-residents' foreign-currency denominated deposits with South African banks as well as an increase in the Reserve Bank's use of its foreign credit facilities.

Measured in rand, South Africa's total foreign debt increased marginally from R247,2 billion at the end of December 2003 to R247,8 billion at the end of March 2004. The strengthening of the exchange rate of the rand resulted in only a marginal increase in the total foreign debt measured in rand, compared with a far larger increase in the total foreign debt measured in US dollars.

International reserves and liquidity

The surplus on the financial account during the second quarter of 2004 more than compensated for the growing deficit on the current account of the balance of payments. The country's net international reserves accordingly rose by R12,1 billion during the second quarter of 2004, following an increase of R13,4 billion in the first quarter.

Gross gold and other foreign exchange reserves of South African Reserve Bank



The South African Reserve Bank's gross gold and other foreign reserves increased from US$9,8 billion at the end of March 2004 to US$11,2 billion at the end of June and US$11,9 billion at the end of August. Simultaneously the private banks' gross foreign assets, which rose rapidly during 2003, fluctuated around US$17 billion throughout the first seven months of 2004.

The international liquidity position of the Reserve Bank improved from US$6,4 billion at the end of March 2004 to US$7,9 billion at the end of June, and further to US$8,4 billion at the end of July.

Exchange rates

On balance, the nominal effective exchange rate of the rand appreciated by 2,4 per cent from the end of March 2004 to the end of June. During the subsequent six weeks to 12 August it increased marginally further. However, following the announcement by the Bank of a 0,5-percentage-point reduction in the repurchase rate, the trade-weighted exchange rate of the rand depreciated by 4,5 per cent from 12 to 13 August 2004. This may partly be attributed to the narrowing interest rate differential between South Africa and its main trading-partner countries, as the US Federal Reserve increased its federal funds target rate by 0,25 percentage point prior to the decline in the repurchase rate.

In 2003 the exchange rate of the rand was impervious to the series of reductions in the repurchase rate of the Reserve Bank, possibly because of the considerable magnitude of the interest rate differential.

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 31 Aug 2004
Weighted average*	5,7	2,4	-6,1
Euro	8,3	2,0	-6,1
US dollar	5,1	1,0	-6,4
British pound	2,1	2,6	-5,8
Japanese yen	1,8	6,1	-5,5

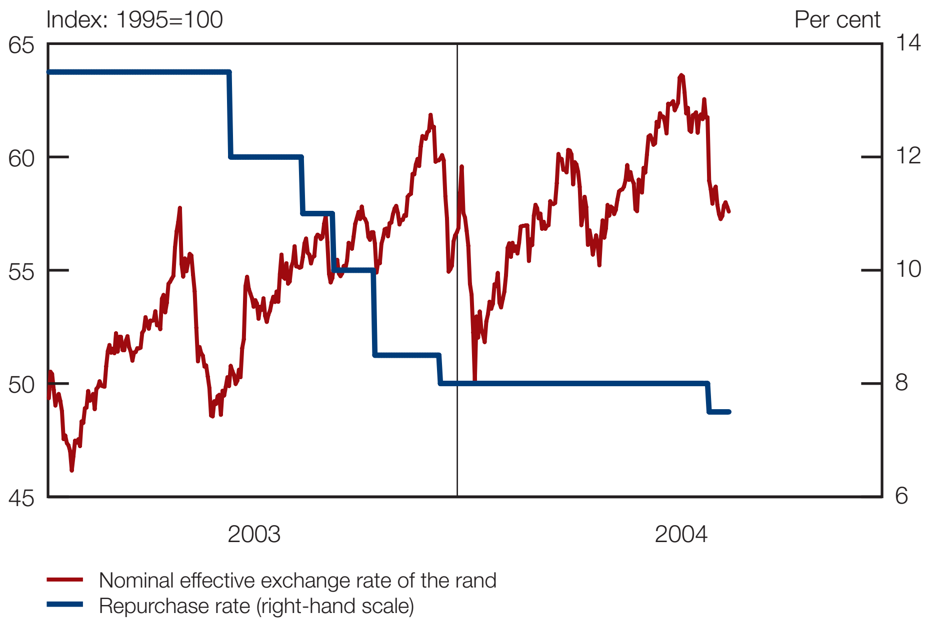
* Against a basket of 13 currencies

When the movements in the exchange rate of the rand against the US dollar from the end of December 2003 up to 31 August 2004 are compared with that of other commodity and/or high-yielding currencies, the rand was the strongest performer, depreciating by 0,7 per cent. Over this period, the New Zealand dollar depreciated by 0,8 per cent, the Canadian dollar by 1,7 per cent, the Australian dollar by 6,8 per cent and the Turkish lira by 7,5 per cent.

The net average daily turnover in the domestic market for foreign exchange decreased marginally from US$11,0 billion in the first quarter of 2004 to US$10,9 billion in the second quarter. Non-resident participation in this market increased marginally from US$7,6 billion in the first quarter to US$7,7 billion in the second quarter of 2004.

The inflation-adjusted effective exchange rate of the rand appreciated by only 1,1 per cent from December 2003 to June 2004, having appreciated by 54,4 per cent from December 2001 to December 2003.

Nominal effective exchange rate of the rand and South African Reserve Bank's repurchase rate



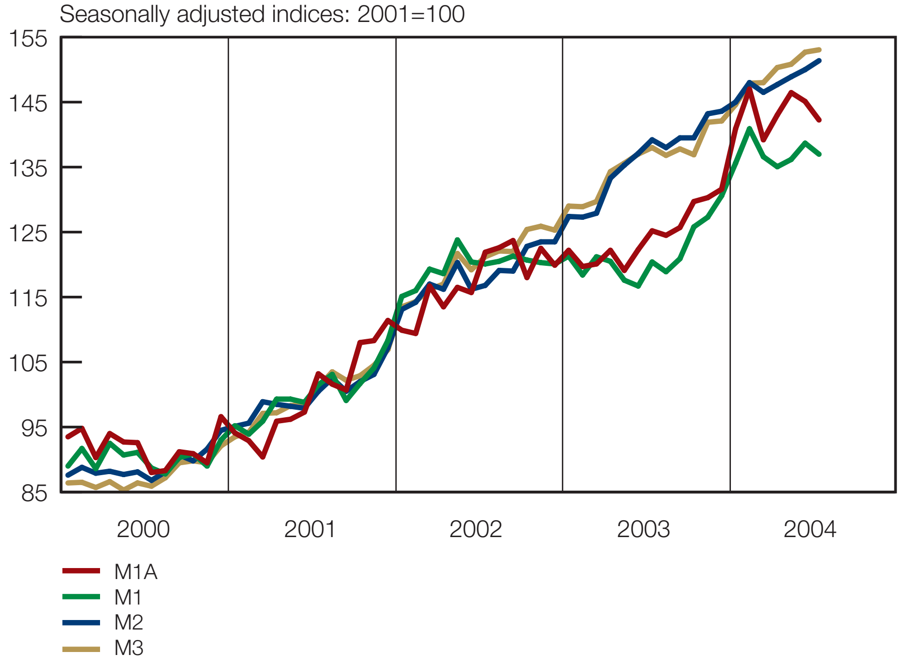
Monetary developments, interest rates and financial markets

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) decelerated somewhat during the second quarter of 2004. The slowdown in M3 growth was to some extent a reflection of the reversal of the uncharacteristic increase in private-sector deposits with banks at the end of February 2004 due to the payment of coupon interest and the redemption of some government bonds. Disintermediation – where both bank loans and deposits are substituted by non-bank financing mechanisms such as the issue of corporate bonds – also moderated money supply growth. Mergers and acquisitions activity and the reallocation by some investors of deposits to other asset classes in accordance with their expected return relative to monetary assets might also have played a role in slowing down M3 growth. Nevertheless, growth in M3 remained firm, consistent with the robust growth in domestic production and expenditure.

Monetary aggregates



Having accelerated to 19,3 per cent in the first quarter of 2004, quarter-to-quarter growth in M3 decelerated to 13,3 per cent in the second quarter. This trend was also evident in the twelve-month growth rate as it decelerated from a recent high of 14,9 per cent in February 2004 to 11,3 per cent in July.

Quarterly growth in the other monetary aggregates broadly resembled the trend in M3 growth, as reflected in the table on the opposite page. The narrow aggregates, M1A and M1, decelerated markedly from the high growth rates recorded during the first quarter of 2004 – with M1 recording a negative rate of 1,2 per cent during the second quarter of 2004. This partly reflected the reversal of the flows of funds between government and private-sector deposits in February, as mentioned above.

Growth in monetary aggregates

Per cent at seasonally adjusted annualised rates

	2003	2004	
	4th qr	1st qr	2nd qr
Notes and coin in circulation	24,1	25,2	5,9
Cheque and transmission deposits	32,7	35,9	-3,1
M1A	**16,9**	**40,6**	**8,1**
Demand deposits	30,6	41,4	-12,5
M1	**25,0**	**37,3**	**-1,2**
Short and medium-term deposits	-3,8	-7,7	14,5
M2	**8,7**	**13,8**	**6,2**
Long-term deposits	-15,3	73,7	96,9
M3	**6,5**	**19,3**	**13,3**

Twelve-month growth in the narrow aggregates M1A and M1 accelerated to fairly high levels in the first seven months of 2004: In July 15,0 per cent in the case of M1A and 14,2 per cent in the case of M1. This partly reflected the low base in 2003 of year-on-year growth calculations and the decline in interest rates, which reduced the opportunity cost of holding the assets included in M1A and M1. Growth in M2 decelerated, reflecting a growing preference for deposits with maturities of more than six months (which are included in M3 but not in M2). This was consistent with the increase in interest rates on such deposits offered by banks, probably in response to the competition posed by other investment vehicles such as the retail bonds issued by the National Treasury and expectations in some quarters of increases in official interest rates towards the end of 2004 and in 2005.

The corporate sector's deposit holdings rose by R9,1 billion in the second quarter of 2004, largely concentrated in deposits with maturities of more than six months. The household sector's deposit holdings rose by R7,6 billion over the same period, partly reflecting the growth in real disposable income.

Growth in M3 exceeded growth in nominal gross domestic product by 5,0 percentage points in the second quarter of 2004. As a result, the income velocity of circulation of M3 declined further from 1,60 in the first quarter of 2004 to a record low of 1,59 in the second quarter, signalling the availability of ample liquidity in the economy.

The counterparts of change in M3 are presented in the accompanying table.

Counterparts of change in M3

R billions

	2004			
Counterparts	1st qr		2nd qr	
Net foreign assets		9,8		10,7
Net claims on the government sector		9,2		5,9
Gross claims	-9,9		10,3	
Government deposits (decrease +; increase -)	19,1		-4,4	
Claims on the private sector		-3,4		2,2
Investments and bills discounted	-24,7		-8,0	
Total loans and advances	21,3		10,2	
Net other assets and liabilities		17,8		-2,2
Total change in M3		**33,4**		**16,6**

A significant part of the increase in M3 during the second quarter of 2004 was on account of the increase in net foreign assets of the monetary sector. The increase in the Reserve Bank's foreign reserves contributed to the increase in the net foreign assets of the monetary sector. The Bank's reserves benefited from normal market operations and customer transactions – essentially the acquisition of the foreign currency proceeds of the government's issue of a US$1 billion ten-year global bond.

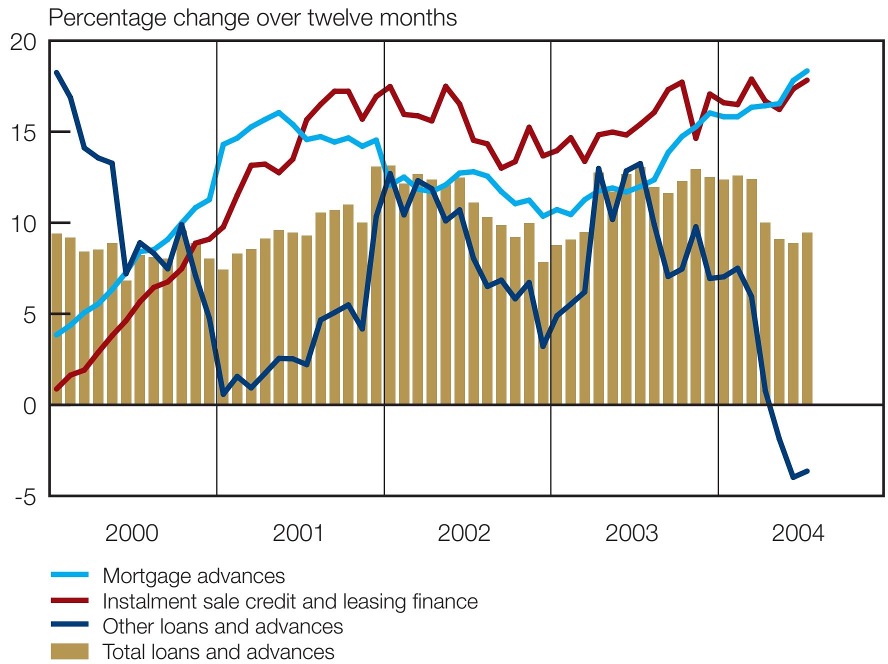
Net claims on the government sector increased during the second quarter, mainly on account of the issuing of R7 billion in zero-coupon bonds to the Bank as part payment of the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account. Coupon interest payments on some government bonds reduced the level of government deposits, but this was overshadowed by the increase in government deposits, partly due to the rand proceeds received for the US$1 billion global bond issue.

Credit extension

During the second quarter of 2004 the growth in banks' total loans and advances[4] was held back by disintermediation, evidenced by the funding of corporate sector capital outlays outside the banking sector and by mergers and acquisitions activity. Quarter-to-quarter growth in loans and advances decelerated from 12,8 per cent in the first quarter of 2004 to 10,2 per cent in the second quarter. However, the rate of growth remained firm, bolstered by significant increases in asset-backed credit extension which continued to benefit from the increase in real disposable income, lower interest rates and the positive wealth effects associated with the sustained increases in real-estate prices.

4 Total loans and advances to the domestic private sector consist of instalment sale credit, leasing finance, mortgage advances, overdrafts, credit card 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



Quarterly growth in asset-backed credit accelerated from 15,3 per cent in the first quarter of 2004 to 18,8 per cent in the second quarter. The asset-backed credit category expanded by R22,5 billion during the second quarter of 2004, in contrast with the significant decline recorded in other loans and advances.

Mortgage advances dominated the recent increases in credit extension, contributing R16,8 billion to the overall increase in asset-backed credit during the second quarter of 2004. The household sector accounted for R12,7 billion of the increase in asset-backed credit and the corporate sector for R4,1 billion. Quarterly growth in mortgage advances accordingly accelerated from 15,2 per cent in the first quarter of 2004 to 19,1 per cent in the second quarter of 2004. Seasonally adjusted gross amounts granted and paid out through mortgage accounts reached record-high levels of R3,8 billion and R2,5 billion, respectively, during the second quarter of 2004. This strong growth was consistent with the buoyant trading conditions in the real-estate market.

Changes in total loans and advances by type of credit

R billions

Component	2004	
	1st qr	2nd qr
Mortgage advances	13,1	16,8
Instalment sale credit and leasing finance	5,3	5,7
Other loans and advances	3,1	-12,3
Total change	21,5	10,2

The extension of instalment sale credit and leasing finance, which is mainly directed at financing expenditure on motor vehicles and other durable goods, remained strong and recorded growth rates of around 17 per cent during both the first and the second quarter of 2004. Brisk growth in this credit category reflected the strong growth in cyclically sensitive components of domestic expenditure; the buoyant demand for new vehicles was underpinned by moderation in car price inflation, attractive packages offered by the motor industry and fleet replacement by various sectors of the economy. More generally, the enhanced price competitiveness of imported durable consumer and capital goods which followed the recovery in the exchange rate of the rand stimulated demand for a wide range of items.

Other loans and advances declined by R12,3 billion during the second quarter of 2004. The quarterly growth in other loans and advances decelerated from 5,6 per cent in the first quarter of 2004 to a negative rate of 9,0 per cent in the second quarter. Growth in this credit category continued to be restrained by disintermediation evidenced by subdued demand for bank loans by the corporate sector and heightened demand for funding outside the banking sector. A sharp contraction in this credit category was recorded in May 2004 when the assets of a monetary institution were absorbed by a non-monetary institution.

The household sector's use of loans and advances during the second quarter of 2004 rose by R17,2 billion whereas that of the corporate sector declined by R7,0 billion.

Twelve-month growth in banks' asset-backed credit has remained above 10 per cent since November 2000 and accelerated further to levels above 15 per cent since September 2003, suggesting prolonged easy bank lending conditions. The declining trend displayed by banks' non-performing loans suggests that the banking sector has not been extending loans and advances imprudently.

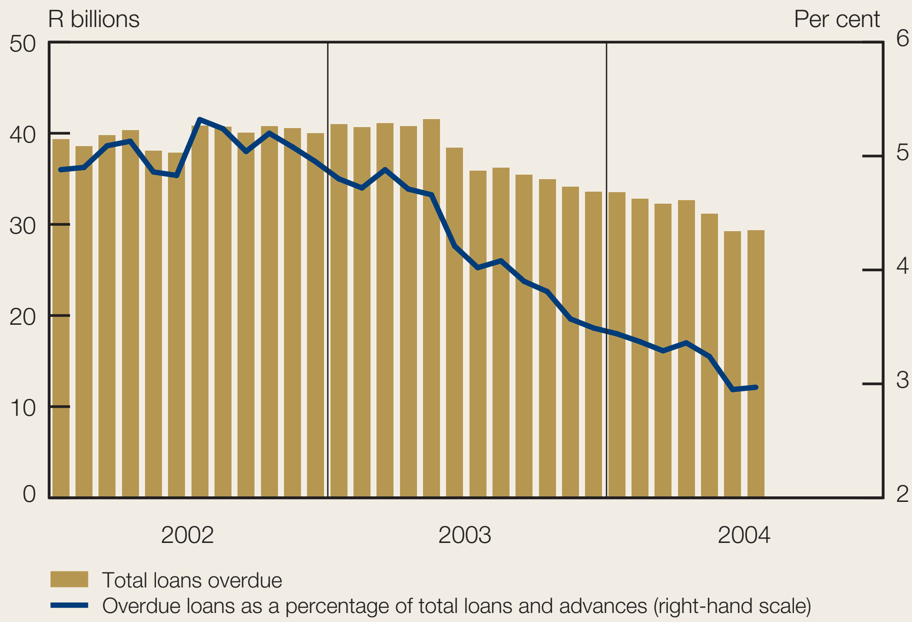
Developments in non-performing loans of the banking sector

The practice in South Africa is to consider a loan as overdue or non-performing when the borrower fails to repay specified instalments or contractual amounts for the period of three months or longer. Overdue loans are used as early warning indicators for assessing the credit risk run by banks, the stability of the banking sector and economic conditions in general.

The growth in banks' total loans and advances to the domestic private sector averaged 10 per cent per annum from the beginning of 2000 to July 2004. Within the broader category of loans and advances the twelve-month growth in asset-backed credit has been particularly brisk, accelerating to levels of more than 15 per cent since September 2003. The reduction in interest rates since mid-2003 contributed to easier bank lending conditions and stronger demand for such loans.

As shown in the accompanying graph the value of overdue loans remained relatively stable during 2002 and 2003 despite the interest rate increases effected in the first nine months of 2002. The fact that the initial debt levels of both the household and corporate sectors were well contained contributed to this outcome.

Total loan overdues



From around mid-2003, lower interest rates, rising incomes and positive wealth effects arising from increases in house prices contributed to a significant decline in the level of overdue loans. Current levels of the South African banking sectors' overdue loans compare favourably with those of the past and with those in other parts of the world.

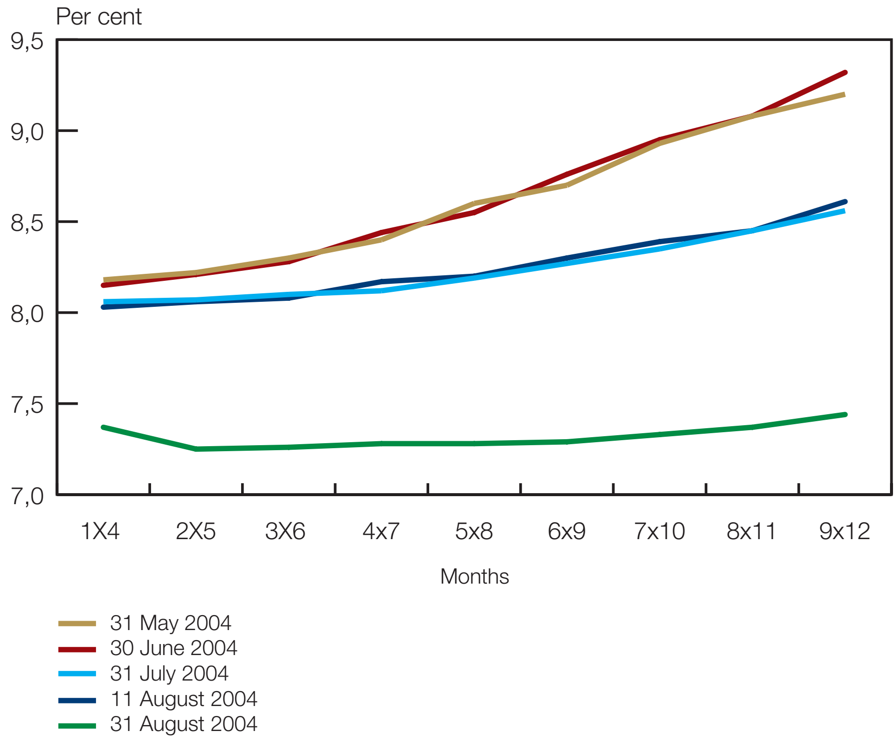
M A Brits and N Gumata

Interest rates and yields

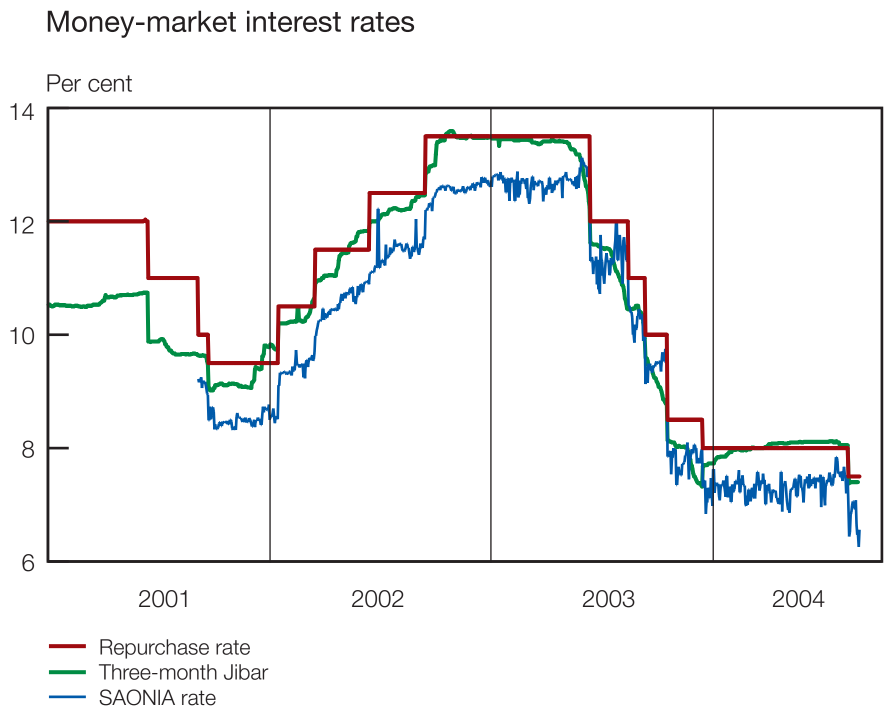
The Monetary Policy Committee (MPC) left the repurchase rate unchanged at 8 per cent at its February, April and June 2004 meetings, guided by, among other things, the expectation of CPIX inflation remaining within the target range in 2004 and 2005. Mainly as a consequence of the availability of economic indicators pointing to a more favourable outlook for CPIX inflation than previously thought, the committee decided to reduce the repurchase rate by 50 basis points to 7,5 per cent at its August 2004 meeting. (The August MPC statement discussing developments underlying the decision is reproduced in full of on pages 53 – 56 of this *Quarterly Bulletin*). This brought the Bank's official policy rate to its lowest level since February 1981.

As depicted in the accompanying graph, in May and June 2004 forward money-market interest rates reflected expectations of sizeable increases in rates, with the 9x12-month forward rate, for example, a full percentage point higher than the current 3-month rate. During July the continued strength of the exchange rate of the rand and lower-than-expected inflation data contributed to more bullish expectations, causing a noticeable reduction in forward interest rates. The largely unanticipated reduction in the Reserve Bank's repurchase rate announced on 12 August led to declines in both current and forward interest rates. However, the forward rate curve initially remained mildly upward-sloping, suggesting that money-market participants expected the next movement in the policy rate to be upward, albeit well into the future. Following the release of a further round of encouraging inflation data, the forward rate curve assumed a horizontal shape towards the end of August 2004.

Forward rate agreements yield curve



Having adjusted to the less-than-expected reduction in the repurchase rate at the December 2003 MPC meeting, money-market interest rates moved broadly sideways from early 2004 to the second week in August 2004. For example, the South African Overnight Interbank Average (SAONIA) rate fluctuated in a range between 6,86 per cent and 7,84 per cent from the beginning of 2004 to the morning before the announcement of the MPC's August decision. In response to the decline in the official rate, the SAONIA rate receded from 7,45 per cent on 12 August 2004 to between 6,44 per cent and 7,05 per cent in the subsequent week. The rate recorded a level of 6,79 per cent on 10 September 2004.



Similarly, having remained around the 8,00 per cent mark from the beginning of March 2004, and registering 8,06 per cent on the morning of 12 August, the 3-month Johannesburg Interbank Agreed Rate (Jibar) declined by 68 basis points to 7,38 per cent on 13 August and remained around this level until 10 September 2004.

Following the abolition of stamp duties on negotiable certificates of deposit (NCDs) announced in the February 2004 Budget and effected on 1 April 2004, private banks reverted to issuing NCDs as opposed to promissory notes. The rate on 3-month NCDs moved in tandem with other 3-month money-market interest rates and declined by slightly more than 50 basis points in reaction to the decline in the repurchase rate. It stood at 7,39 per cent on 10 September 2004.

Having remained unchanged at R1,8 billion in the seven months to July, the amount of 91-day Treasury bills on offer each week was increased by R200 million to R2,0 billion from 30 July 2004, partly to raise additional funding for coupon interest payments to be effected at the end of August 2004. Accordingly, the rate on 91-day Treasury bills increased from 7,91 per cent on 23 July 2004 to 7,87 per cent on 30 July and 7,88 per cent on 6 August but declined to 7,20 per cent on 13 August in response to the decline in the repurchase rate. The rate on 91-day Treasury bills amounted to 7,13 per cent on 10 September 2004.

Following the reduction in the Reserve Bank's repurchase rate, the *prime overdraft rate* as well as the *predominant rate on mortgage loans* were lowered to 11 per cent during August 2004, having been unchanged at 11½ per cent since December 2003.

The private banks increased their *predominant rate* on *twelve-month fixed deposits* from 6,1 per cent in December 2003 to 7,8 per cent in July 2004. Market expectations of interest rate increases and the availability of alternative savings mechanisms to investors, such as the RSA Government Retail Bond series launched in May 2004, might have contributed to the upward bias in deposit rates. Subsequently, banks lowered this twelve-month deposit rate to 7,10 per cent in late August 2004 in response to the reduction in the repurchase rate.

As shown in the accompanying table, banks' offered rates on fixed deposits have increased noticeably since the launch of RSA Government Retail Bonds in May 2004. However, following the decline in the repurchase rate effective from 13 August 2004, other interest rates have declined or are being reviewed. On 1 September 2004, rates on RSA Government Retail Bonds of all three maturities were lowered by one percentage point.

Interest rates on RSA Government Retail Bonds and fixed deposits with banks

	2004	
	May	June – July
RSA Government Retail Bond		
Minimum balance R1 000 to R1 million		
2 years	9,25	9,25
3 years	9,50	9,50
5 years	10,00	10,00
Banks		
Fixed deposit of R10 000 to R99 999*		
2 years	6,50 – 8,35	8,50 – 9,35
3 years	8,40 – 9,20	8,70 – 9,90
5 years	8,60 –10,20	8,90 –10,20

* Minimum and maximum rates offered by SA's four biggest banks

Bond yields started to rise early in 2004 in response to, among other things, rising issues of bonds, fluctuations in the exchange rate of the rand, weaker global bond markets and expectations of growing risks to inflation. The *monthly average yield on long-term government bonds* in the ten-to-twelve-year maturity range initially increased at a moderate pace from 9,1 per cent in October 2003 to 9,4 per cent in February 2004 before rising more vigorously to a recent high of 10,4 per cent in June 2004. The yield then declined moderately to 10,1 per cent in July as the strength of the exchange value of the rand partly allayed fears about the impact of rising oil prices on inflation. The lowering of the repurchase rate in August resulted in a further decline in the monthly average yield on long-term government bonds to 9,7 per cent.

After increasing to a recent high of 10,53 per cent on 15 June 2004, the *daily average yield* on the long-term R157 government bond fluctuated around a declining trend as the exchange value of the rand appreciated and the inflation outlook improved. This occasioned widely held expectations that short-term interest rates would remain broadly unchanged for a longer period than previously thought. The daily average bond yield receded to below the level of 10 per cent on 4 August, whereafter the lowering of the repurchase rate on 13 August resulted in a further decline from 9,66 per cent on 12 August to 9,56 per cent on 13 August. Bond yields continued to decline to 9,36 per cent on 10 September despite the weaker exchange value of the rand. The recent decline in domestic bond yields followed in the steps of a similar decline in international bond yields as global markets seemed to attach more significance to the expected impact of surging oil prices on the pace of growth rather than on inflation.

The change in the inflation outlook was also evident from the movements in the *break-even inflation rate*. This approximation of expected long-term inflation is calculated as the difference between the nominal yield on conventional bonds and the real yield on inflation-linked bonds within the five-to-nine-year maturity range. After progressively declining from above 6 per cent in early 2003 to a recent low of 4,6 per cent on 30 October 2003, break-even inflation increased to above the 6-per-cent mark early in May 2004, reaching 6,3 per cent on 14 May. Subsequently, break-even inflation within the five-to-nine-year maturity range fell back to below 6 per cent during July and came down to just below 5,0 per cent towards the end of August and the first 10 days of September.

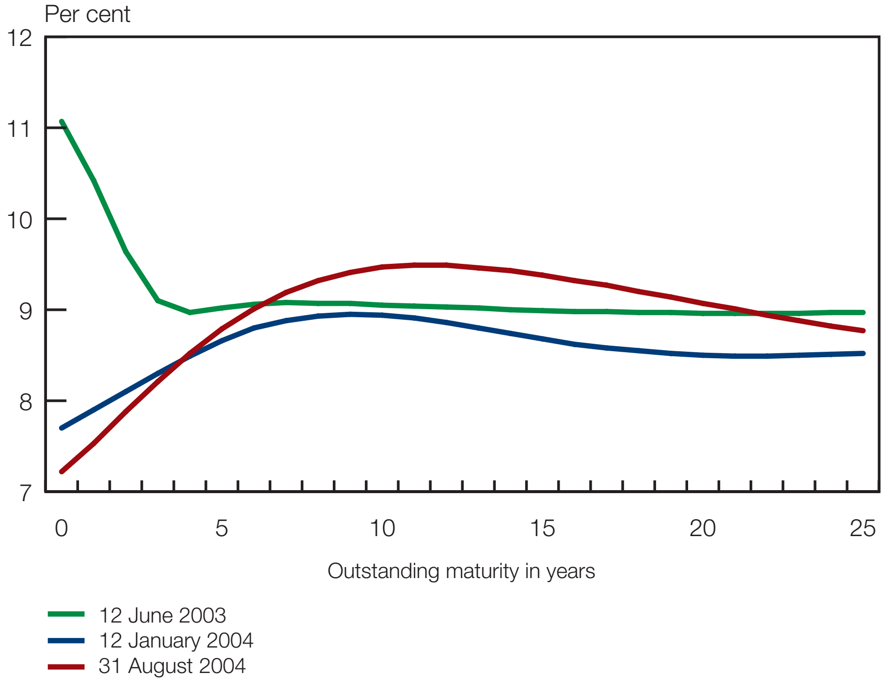
Break-even inflation rate

Difference between the nominal yield on conventional R153 bond and real yield on inflation-linked R189 bond

The higher bond yields in the first seven months of 2004 together with the subdued inflation during this period 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) increasing to 5,6 per cent in July 2004, the highest real yield since June 2000. South African long-term bond yields continued to offer investors higher real returns than developed markets, such as the United States, United Kingdom and euro area.

Following five successive relaxations in the monetary policy stance during 2003 the *yield curve* reached its lowest level on 12 January 2004, as bond yields across the maturity spectrum declined to levels previously experienced in the 1980s. Subsequently, the slope of the yield curve steepened. Yields on short-dated bonds remained anchored to the repurchase rate while bond yields across the rest of the maturity spectrum moved upward in response to the steady supply of bonds and expectations of somewhat higher inflation later in 2004. The yield curve flattened during July 2004 as the inflation outlook became more benign and declined further in August as bond yields across the maturity spectrum reacted to the lowering of the repurchase rate. At the end of August 2004 bond yields beyond the six-year maturity interval were above the levels recorded on 12 June 2003 – immediately before monetary policy became more accommodative. The *yield gap*, i.e. the difference between bond yields at the extreme long and short ends of the curve, declined from 186 basis points on 15 June 2004 to a low of 83 basis points on 12 August, before widening to 155 basis points at the end of August as the lowering of the repurchase rate resulted in sharper declines at the shorter end than at the longer end of the curve.

Yield curve



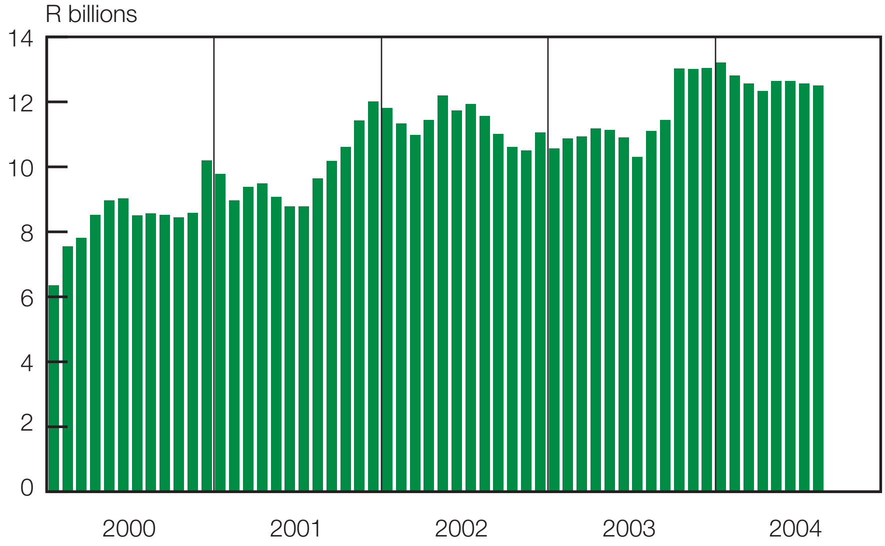
Rising oil prices gave cause for concern about the sustainability of economic growth in the United States and resulted in a decline in long-term bond yields in the United States from June 2004 – at the same time strengthening the demand for high-yielding emerging-market debt. The yield spread of emerging markets' sovereign debt over benchmark United States Treasury bonds (measured by the JP Morgan Emerging Markets Bond Index or EMBI+) subsequently narrowed from 508 basis points in May 2004 to 436 basis points in August. Broadly echoing these developments, the issue by South Africa of a ten-year US dollar-denominated bond at the end of May 2004 was priced at only 195 basis points above US Treasury notes of similar maturity – the country's lowest spread ever in the dollar bond market. The yield spread on this bond narrowed to 155 basis points in August, substantially lower than the sovereign risk premium of emerging markets in general.

Money market

Money-market conditions remained fairly stable during the second quarter of 2004 and the first two months of the third quarter. The monthly average of the daily liquidity requirement of the private banks remained around R12,6 billion throughout this period, while the amounts of repurchase transactions at the weekly main auctions stood at levels around R13,0 billion. Supplementary and final repurchase transactions together with banks' recourse to their cash reserve accounts successfully absorbed the temporary deviations from the Bank's desired level of the daily liquidity requirement of the private banks.

The Reserve Bank's foreign exchange transactions had a considerable impact on the money market during the first eight months of 2004. Following the squaring off of the oversold forward foreign exchange book in February 2004, the Bank gradually increased its foreign exchange reserves through measured buying of foreign exchange from the market and purchasing foreign exchange from the National Treasury. These purchases raised the Bank's foreign exchange reserves from US$8,2 billion at the end of February to US$11,9 billion at the end of August 2004 and expanded money-market liquidity by R8 billion in the second quarter and by a further R9 billion in July and August 2004.

Total liquidity requirement



Monthly average of daily values

On balance, changes in the amount of notes and coin in circulation outside the Reserve Bank tightened money-market liquidity by R0,5 billion in the second quarter of 2004 and by a further R1,0 billion in July and August 2004.

The main forces impacting on money-market liquidity from April to August 2004 are summarised in the accompanying table.

Money-market liquidity flows

R billions (easing +, tightening –)

	2004	
	1 April – 30 June	1 July – 31 August
Notes and coin in circulation	-0,5	-1,0
Required cash reserve deposits	0,4	-0,9
Money-market effect of Reserve Bank's foreign exchange transactions	8,0	9,0
Government deposits	0,0	0,0
Other items net	0,6	-3,9
Use of liquidity management instruments*	-8,3	-3,4
Banks' liquidity requirement	0,2	-0,2

* Reserve Bank debentures and reverse repurchase transactions

The Bank utilised its liquidity-draining instruments in such a way that other factors impacting on money-market liquidity conditions were broadly offset. The total amount of interest-bearing liquidity-draining instruments issued by the Bank amounted to R19,0 billion at the end of August 2004 compared with a total outstanding amount of R10,8 billion at the beginning of the second quarter of 2004. The amounts outstanding per individual instrument are reflected on the opposite page. The liquidity-draining effect of the use of these instruments was complemented by the profits realised on the Bank's maturing forward foreign exchange contracts.

Outstanding balances of selected money-market intervention instruments

R billions

End of		Forreign-currency swaps with deposits	Reserve Bank debentures			Reverse repurchase agreements			Total instruments outstanding
			28 days	91 days	Total	28 days	91 days	Total	
2003:	Jul	17,6	2,4	5,6	8,0	0,5	9,8	10,3	36,3
	Aug	15,3	2,8	5,2	8,0	0,6	9,7	10,3	34,0
	Sep	11,0	2,6	5,1	7,8	2,1	7,6	9,7	29,1
	Oct	3,6	4,0	3,0	7,0	5,7	2,9	8,6	19,2
	Nov	0,0	3,0	3,7	6,7	5,8	2,8	8,6	15,8
	Dec	0,0	0,5	2,8	3,2	2,8	2,5	5,2	8,5
2004:	Jan	0,0	5,4	1,5	6,9	3,1	0,3	3,4	10,3
	Feb	0,0	4,4	0,7	5,1	1,8	0,0	1,8	6,9
	Mar	0,0	6,0	0,3	6,3	3,5	0,0	3,5	9,8
	Apr	0,0	4,5	0,3	4,8	6,0	0,0	6,0	10,8
	May	0,0	5,6	0,3	5,9	8,5	0,0	8,5	14,4
	Jun	0,0	4,8	0,3	5,1	10,5	0,0	10,5	15,6
	Jul	0,0	8,3	0,3	8,6	12,0	0,0	12,0	20,6
	Aug	0,0	7,7	0,3	8,0	11,0	0,0	11,0	19,0

On 19 July 2004 the Reserve Bank concluded a new three-year syndicated term loan facility amounting to US$1,0 billion. The proceeds of this loan were utilised to partially repay the US$1,25 billion due in respect of a 2001 dual currency syndicated foreign loan, which was payable on 30 July 2004. This transaction had a neutral effect on money-market liquidity as the simultaneous use of the facility and the repayment of the outstanding loan cancelled each other out, with the remaining balance financed through the use of the Bank's foreign currency reserves.

Bond market

Funding by *public-sector borrowers* through the net issuance of fixed-interest securities in the domestic primary bond market amounted to R29,0 billion in the first four months of the fiscal year 2004/05, significantly more than the R18,0 billion raised in the corresponding period of fiscal 2003/04, while net issuance amounted to R31,5 billion in the fiscal year as a whole. During the current fiscal year National Treasury favoured the issuance of longer-dated bonds comprising the R201 (maturing in 2014) at 31 per cent of issuance, followed by the R203 (2017) at 26 per cent, the R194 (2008) at 10 per cent and the R186 (2026) at 8 per cent of the new issues. National Treasury also raised R605 million through the RSA Government Retail Bonds up to the end of August 2004.

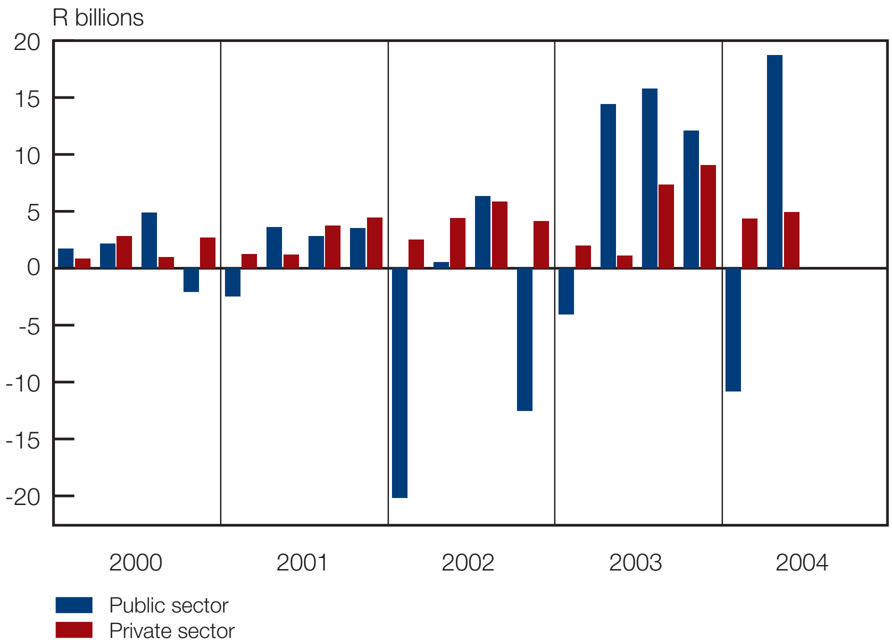
The issuance of stripped bonds, introduced by a private-sector issuer, Stripco, in September 2000, initially grew rapidly after the government entered that market from January 2002. The total outstanding amount of stripped bonds in issue increased from R37 million in September 2000 to a high of R17,0 billion in October 2002. Subsequently, the market lost its lustre and the total outstanding amount of stripped bonds gradually declined to R12,9 billion in August 2004. Stripped bonds involve the listing of the interest and principal components of bonds as separate financial instruments. Government bonds currently used for these purposes are the R153, the R194, the R157 and the R186.

In the February 2004 Budget, the issuance of two new conventional bonds that would lengthen the maturity profile of government debt was announced. The first bond, the R203 maturing in 2017, was issued from May 2004. The second bond, the R204 maturing in 2018, was first issued on 10 August with a small initial offering of R200 million. Low demand through a bid/offer ratio of less than three signalled the market's lack of enthusiasm for new issues in this area of the curve.

A similar lack of demand for *inflation-linked bonds* also resulted in the National Treasury cutting back the normal monthly offering of these bonds. In the first four months of 2004 the National Treasury offered inflation-linked bonds worth R1 billion once a month, but thereafter scaled this down by more than half. In June, inflation-linked bonds to the value of only R385 million were auctioned, followed by R400 million in July and August. Inflation-linked bonds subsequently regained favour and R1 billion were issued early in September. Thus far in the 2004/05 fiscal year, National Treasury raised R3,2 billion through the issuance of inflation-linked bonds, favouring short and medium-term bonds.

Activity in the corporate bond market continued along a rising trend in 2004 as the private sector increasingly sourced funding in the primary bond market. The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa increased from R58,4 billion in December 2003 to R72,2 billion in August 2004. Banks accounted for 40 per cent of the increase of R13,8 billion in the first eight months of 2004. Asset-backed securitisation and collateral debt obligations – mainly vehicle, credit card and mortgage securitisation – accounted for 40 per cent of the issues, while conventional corporate bond issuance accounted for the remaining 20 per cent.

Net issues in the domestic primary bond market



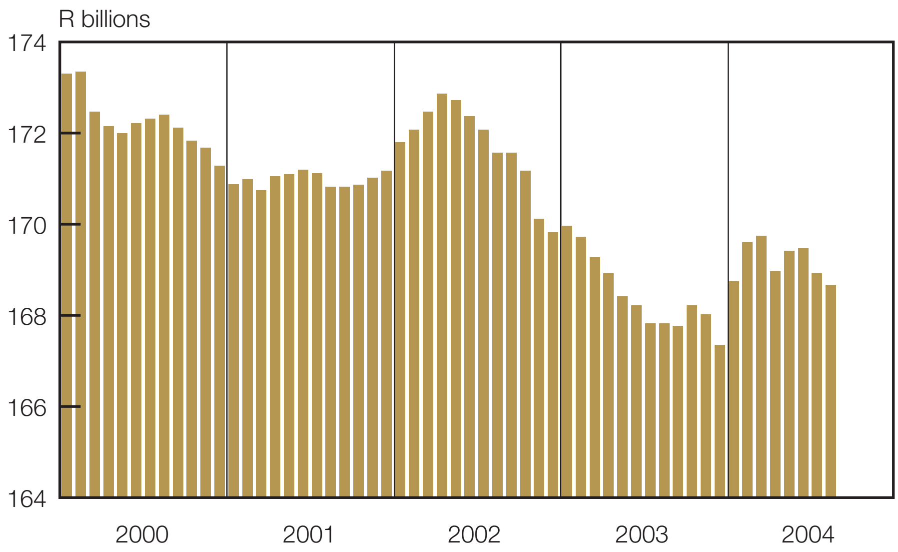
Short-term funding in the form of *asset-backed commercial paper* maintained its momentum and increased by R3,6 billion in the first eight months of 2004 to reach R13,4 billion in August. The number of active conduits in this market amounted to 5 at the end of August.

The government's offshore borrowing programme for the 2004/05 fiscal year was completed 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. However, later in June foreign debt was reduced by R2,4 billion when a bond denominated in Japanese yen and issued in 1997 reached maturity. Other public-sector borrowers steered clear of the international bond markets in 2003 and so far in 2004.

Investors' interest in rand-denominated bonds in the *European bond markets* rebounded during 2004. New issues of rand-denominated bonds by non-residents exceeded scheduled redemptions by R1,3 billion during the first eight months of 2004. In 2003 net redemptions amounted to R2,5 billion. A total of 23 issues were made in the first eight months of 2004 compared with only 12 issues in 2003 as a whole. The European Investment Bank (EIB) was responsible for twelve of the issues during 2004.

Outstanding balance of eurorand bonds issued by non-residents



Trading activity on the Bond Exchange of South Africa amounted to R6,4 trillion in the first eight months of 2004, 20 per cent less than the turnover of R8,0 trillion recorded in the corresponding period of 2003. Influenced by rising bond yields, turnover reached a low point in the second quarter of 2004. Subsequently the bond market benefited from the downward movement in bond yields from mid-June and the lowering of the repurchase rate by the Monetary Policy Committee on 13 August 2004. Turnover improved markedly from a low R580 billion in April 2004 to R906 billion in August.

The dissipation of *non-residents'* interest in South African debt securities from the second half of 2003 continued into the first months of 2004. Non-resident transactions in bonds reverted from net purchases of R8,3 billion in the second quarter of 2003 to net sales of R4,7 billion in the second quarter of 2004. Total cumulative net sales of bonds amounted to R2,6 billion in the first eight months of 2004. Non-residents' net purchases of bonds, calculated on a cumulative basis over a rolling twelve-month period, indicate that their interest in the bond market started to wane from December 2002, as bond yields declined. Calculated in this manner their bond transactions changed from cumulative net purchases of R0,3 billion in December 2002 to cumulative net sales of R15,4 billion in June 2004, whereafter the net sales position receded to R8,2 billion in August 2004.

Share market

After slowing down in 2003, the total value of equity capital raised in the domestic and international *primary share markets* by companies listed on the JSE Securities Exchange SA (JSE) increased markedly from early 2004. Equity financing amounted to R36,7 billion in the first eight months of 2004, exceeding the R22,7 billion raised in the year 2003 as a whole. Of the total amount raised, the resources sector accounted for R25,2 billion, mainly the result of the acquisition of complementary businesses by mostly dual-listed companies.

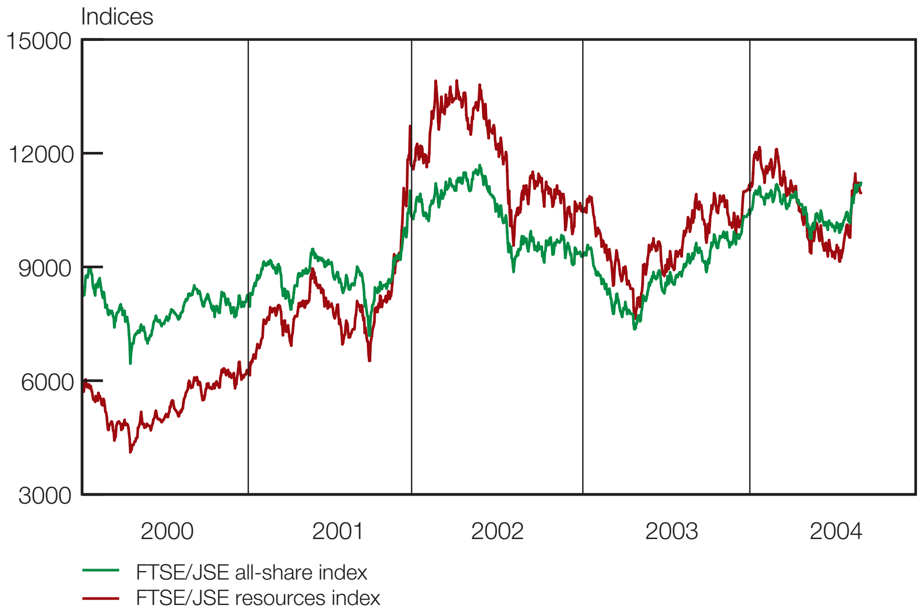
Buoyed by the recovery in share prices from April 2003, turnover in the *secondary share market* improved from R176 billion in the second quarter of 2003 to a record high of R254 billion in the first quarter of 2004. The value of listed shares traded on the JSE contracted somewhat in the subsequent months as the appreciation in the exchange value of the rand and the concomitant decline in overall share prices dampened trading activity. Turnover nonetheless amounted to R647 billion in the eight months to August 2004, an increase of 35 per cent over the R479 billion recorded in the corresponding period of 2003. The market capitalisation of the JSE recovered by 68 per cent from April 2003 to R2 185 billion in August 2004. In July the market capitalisation of the JSE placed it at number 15 in the world league as rated by the World Federation of Exchanges.

The number of companies listed on the Alt^{X} alternative exchange stood at six at the end of August 2004. After commencing with trading from the end of January 2004 when the first companies listed, the value of shares traded on Alt^{X} up to August amounted to R8,4 million. By comparison, turnover in the Venture Capital and Development Capital Markets amounted to R22,3 million in the first eight months of 2004, far lower than the R53,2 million traded in the same period of 2003. The JSE initially intended to close the Venture Capital and Development Capital Markets because of the limited success and low liquidity of these markets, but after consultation with interested parties decided to keep them open. The intention is that these companies should eventually apply for transfers to the main board or to the new Alt^{X} alternative exchange.

Non-residents increased their holdings of shares by R10,1 billion in the first eight months of 2004, compared with net sales of R0,4 billion for 2003 as a whole. In 2004, non-residents recorded net purchases of shares in all the months, with the exception of net sales during March and August. Their net purchases of shares, calculated on a cumulative basis over a rolling twelve-month period, indicate that their interest in the share market started to improve from May 2003 as the share market recovered. Calculated in this manner their share transactions changed from cumulative net sales of R13,0 billion in April 2003 to cumulative net purchases of R11,4 billion in August 2004. However, during this period non-residents' participation in the share market, measured as purchases and sales as a percentage of the total value of shares traded on the JSE, moderated from 23 per cent in June 2003 to 18 per cent in August 2004.

A recovery in world bourses, favourable commodity prices and the more accommodative monetary policy environment resulted in the *daily closing level of the all-share price index* posting a gain of 52 per cent from a recent low on 25 April 2003 to 3 March 2004. Since then the all-share index declined by 11 per cent to 19 July, following the downward trend of international equity markets in the wake of weaker commodity prices, the higher oil price and rising international interest rates. The all-share price index increased by 13 per cent to 10 September when commodity prices once again rose sharply while the exchange rate of the rand depreciated.

Share prices



Buoyed by the improved global economic outlook, rising commodity prices and the depreciation of the exchange value of the rand during December 2003 and January 2004, the monthly average price level of the *resources sector* of the JSE increased by 36 per cent from April 2003 to January 2004. The improvement in global economic activity since the conclusion of the war in Iraq, coupled with the weak US dollar, has contributed to an extended bull market in international commodity prices since mid-2001. The appreciation of the exchange value of the rand, however, moderated the impact of the stronger dollar prices of commodities. Measures introduced by the Chinese authorities to curb the robust economic growth in that country, resulted in a further fall-back in commodity prices. The monthly average price level of resources shares subsequently declined by 21 per cent from January 2004 to July, led by a sharp fall of 38 per cent in the prices of gold-mining shares and 28 per cent in the prices of platinum-mining shares. Higher commodity prices and a weaker rand during August boosted investors' optimism about the future earnings potential of the mining sector, and resources shares subsequently gained some 12 per cent during the month.

The prices of *financial shares* improved markedly from April 2003 and increased by 28 per cent to August 2004 as banking shares benefited from higher levels of consumer and business demand boosted by lower domestic inflation and interest rates. The buoyant residential property market, record vehicle sales and the conclusion of significant empowerment deals in order to fulfil the obligations of the Financial Sector Charter, underpinned investor interest in financial shares.

The prices of *industrial shares* similarly benefited from the lower interest rate environment since June 2003. Many companies in this sector are less exposed to developments in the exchange value of the rand and rely mostly on earnings generated by South African operations. Domestic growth prospects resulted in an increase of 59 per cent in the monthly average price level of industrial shares from April 2003 to August 2004.

The strong rise in share prices during 2003 took the *price-earnings ratio* of all classes of shares from 9,7 in April 2003 to 15,0 in February 2004. The upward movement came to an end in February and the price-earnings ratio declined to 13,2 in July as share prices weakened before improving to 13,5 in August as the share market recovered. The *dividend yield* on all classes of shares also changed course during 2004 and increased from a low of 2,8 per cent in February 2004 to 3,2 per cent in July before declining to 2,9 per cent in August.

Market for derivatives

The stronger exchange value of the rand and fluctuating share prices coincided with sluggishness in the formal market for equity derivative products. The number of *warrants* traded on the JSE fell by 70 per cent from 19,6 billion contracts in 2002 to 5,8 billion contracts in 2003. In the first eight months of 2004 the 4,0 billion contracts traded represented an increase of only 5,5 per cent when compared to the same period in 2003.

By contrast, the total number of *futures and options contracts* traded on the Financial Derivatives Division of the JSE in the first eight months of 2004 was 17 per cent higher than in the corresponding period of 2003. The value of turnover in this market improved noticeably during the course of 2003 – boosted by the recovery in the underlying share market – but stabilised somewhat in the first eight months of 2004.

The prices of agricultural products, which generally declined following the improved supply prospects and the sustained appreciation in the exchange value of the rand, dampened trading in commodity derivative instruments on the Agricultural Products Division of the JSE. Trading in *commodity futures contracts and options* on such contracts declined by 21 per cent from the first eight months of 2003 to the first eight months of 2004. Turnover weakened in July and August even though the prices of agricultural products increased alongside a weaker exchange rate of the rand from the end of July.

Real-estate market

The *real-estate market* remained buoyant so far in 2004. The overall seasonally adjusted value of turnover, measured by *transfer duty paid*, increased by 29 per cent in 2003 and by 57 per cent in the first seven months of 2004 when compared with the same period of 2003.

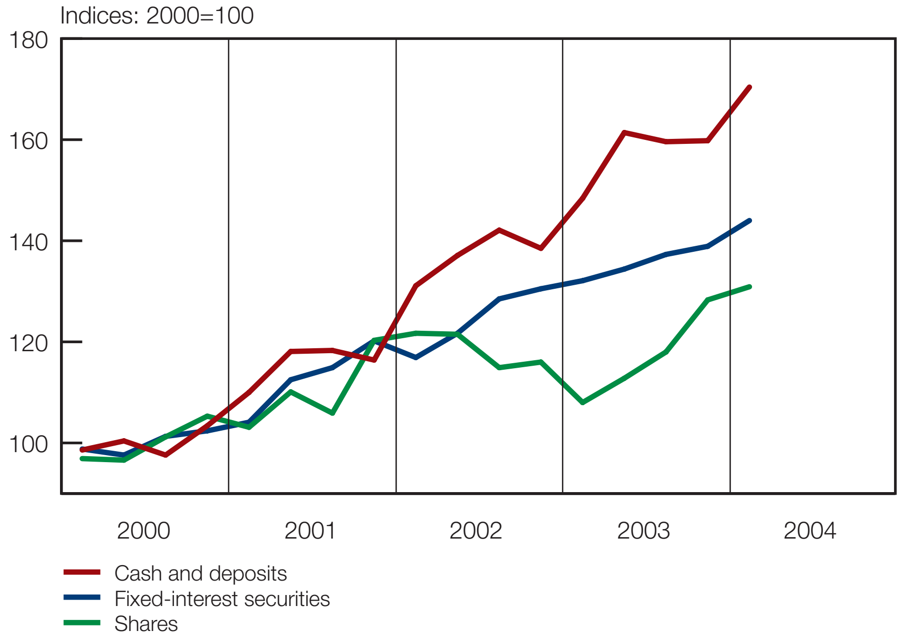
Year-on-year increases in *residential property prices*, as measured by Absa, accelerated almost uninterruptedly from January 2002 and recorded rates of increase of around 25 per cent in the first eight months of 2004. However, the month-on-month rate of increase in house prices receded from February 2004. Demand for residential property is likely to be supported by the recent lowering of the repurchase rate in August.

Non-bank financial intermediaries

In March 2004 the non-bank financial intermediaries, defined as unit trusts, long and short-term insurers, official and private pension and provident funds and financial public enterprises, collectively held over 80 per cent of their total assets in domestic financial instruments. This placed non-bank financial intermediaries among the largest holders of domestic financial instruments. Their other funds are mostly held in the form of physical assets, such as real-estate, and foreign assets.

The non-bank financial intermediaries have, on balance, recently displayed a slight shift in their investment preference. Prompted by fluctuations and uncertainty in the financial markets the non-bank financial institutions adopted a more cautious approach and their holdings of fixed-interest securities and cash and deposits increased. The preference of investors for safer investments is also evident from the rapid growth in money-market unit trusts. The market value of the net assets of these funds more than doubled from R39,0 billion in December 2001 to R87,4 billion in June 2004. Over the same period the market share of money-market funds in relation to the total unit trust industry increased from 23 per cent to 35 per cent.

Non-bank financial intermediaries: Financial assets

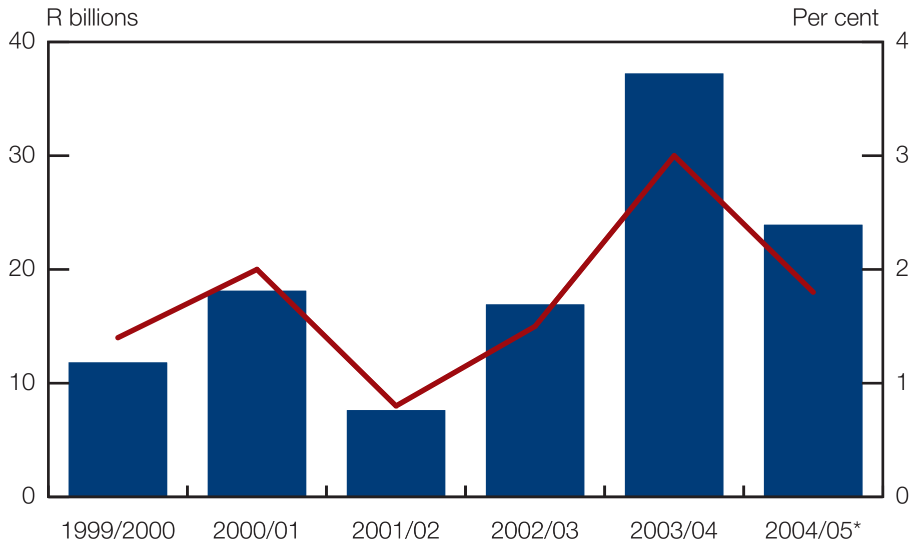


Public finance

Non-financial public-sector borrowing requirement

The *borrowing requirement of the non-financial public sector* (calculated as the cash deficit of the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations) increased from R1,8 billion in the April-June quarter of 2003 to R6,0 billion in the April-June quarter of 2004, or from 0,6 per cent to 1,8 per cent of gross domestic product. A R7,0 billion capital transfer by the national government to the South African Reserve Bank made a major contribution to the increase in the non-financial public-sector borrowing requirement. This sector's net investment in non-financial assets amounted to R9,6 billion in April – June 2004, compared with an investment amount of R13,4 billion in the corresponding quarter of the previous year.

Non-financial public-sector borrowing requirement



Fiscal years
* April – June 2004, annualised
R billions
Per cent of gross domestic product (right-hand scale)

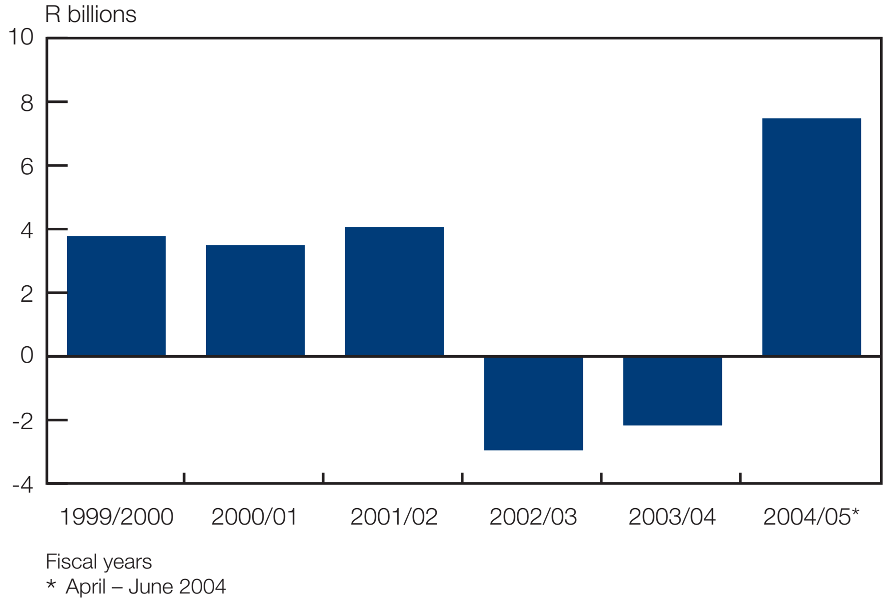
The net cash flow from operating activities exceeded the net investment in non-financial assets of the *non-financial public-sector enterprises and corporations*, resulting in a cash surplus of R2,3 billion in the April-June quarter of 2004 compared with a cash surplus of R2,2 billion in the April-June quarter of the previous fiscal year. Included among the net acquisitions of non-financial assets were new aircraft purchased by the South African Airways.

At the level of *consolidated general government,* there was a cash deficit amounting to R8,3 billion in the April-June quarter of 2004 compared with R4,0 billion in the same period of the previous fiscal year. This increase was essentially due to the operating activities at the level of national government.

An analysis of *national government* finances indicates that cash receipts from operating activities increased by 11,0 per cent in the April-June quarter of 2004 compared with the same period in the previous fiscal year. Cash payments for operating activities of national government increased by 27,9 per cent. Transfers to provincial governments constituted the bulk of those payments. The national government operating activities together with the net investment in non-financial assets resulted in a cash deficit of R17,9 billion in the April-June quarter of 2004 compared with a cash deficit of R5,2 billion recorded in the same period of the previous fiscal year. The cash deficit was financed through the issuance of long-term bonds in the domestic and international capital markets and a reduction in the amount of cash on hand.

The *Statement of revenue, expenditure and borrowing of provincial governments* indicates that the provincial governments recorded a cash surplus of R7,5 billion in the April-June quarter of 2004 compared with a cash surplus of R4,6 billion recorded in the same quarter of the previous fiscal year. Grants received from national government – the main source of provincial governments' cash receipts – amounted to R49,2 billion which was 24,7 per cent higher than in the corresponding period of the previous fiscal year. Growth in cash payments for operating activities amounted to 19,1 per cent, which was consistent with the objective of improving service delivery. Viewed by function, expenditure was for the most part incurred in respect of education, social services and healthcare.

Provincial governments' surplus or deficit



The cash surplus of the provincial governments was largely reflected in an increase in their bank deposits from R8,4 billion at the end of March 2004 to R12,8 billion at the end of June 2004, while their overall indebtedness to banks increased slightly from R3,2 billion to R3,3 billion between these two dates.

The estimated cash deficit of *local governments* in the April-June quarter of 2004 was R1,9 billion, which was lower than the amount of R4,8 billion recorded in the same quarter of the previous fiscal year. The new Municipal Finance Management Act 2003, which deals, *inter alia,* with independent borrowing by local authorities, provided the framework for the issue of marketable bonds to the amount of R2,0 billion in the first quarter of fiscal 2004/05. Preliminary analysis of the data on *extra-budgetary institutions* indicates a cash surplus of R2,4 billion in the April-June quarter of 2004 compared with a cash surplus of R0,1 billion in the same period of the previous fiscal year. During the quarter under review, the activities of *social security funds* resulted in a cash surplus of R1,7 billion compared with a cash surplus of R1,4 billion a year earlier.

Budget comparable analysis of national government finance

National government expenditure in the first quarter of fiscal 2004/05 amounted to R85,5 billion, representing a year-on-year rate of increase of 15,8 per cent. This increase was significantly higher than the 8,1 per cent recorded in the April-June quarter of 2003 and also outpaced the average rate of increase of 7,9 per cent evidenced in the same period of the preceding five fiscal years. The *Budget Review 2004* projected that national government expenditure would increase at a rate of 12,1 per cent to amount to R368,9 billion for the fiscal year 2004/05 as a whole.

For the period under review, interest paid on national government debt amounted to R5,6 billion, representing an increase of 27,0 per cent compared with the corresponding period of the previous fiscal year. This increase could be ascribed to government's restructuring of its domestic bond liabilities: Government bonds with interest payment dates in August were converted to bonds with interest payable in June. The budget estimate indicates that interest payments would increase at a rate of 8,9 per cent for fiscal 2004/05 as a whole.

The equitable share of revenue transferred to provincial governments increased strongly in April – June 2004, growing at a rate of 25,8 per cent compared with the same quarter in 2003. Although the changes in these transfers tend to fluctuate widely, the recent increase is partly due to the increased provision for services delivered by the provincial governments. These transfers to provincial governments amounted to 52,4 per cent of total national government expenditure in the April-June quarter of 2004.

Payments for capital assets amounted to R0,6 billion in the April-June quarter of 2004, or 12,5 per cent more than in the same period of the previous fiscal year. The Budget projected that payments for capital assets would amount to R5,2 billion for fiscal 2004/05 as a whole.

National government revenue in the first quarter of fiscal 2004/05 amounted to R75,4 billion, representing a year-on-year rate of increase of 9,8 per cent. This rate of increase was significantly higher than the rate recorded in the same period of fiscal 2003/04, but still markedly lower than the average growth rate of 14,8 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 9,4 per cent to amount to R327,0 billion for fiscal 2004/05 as a whole.

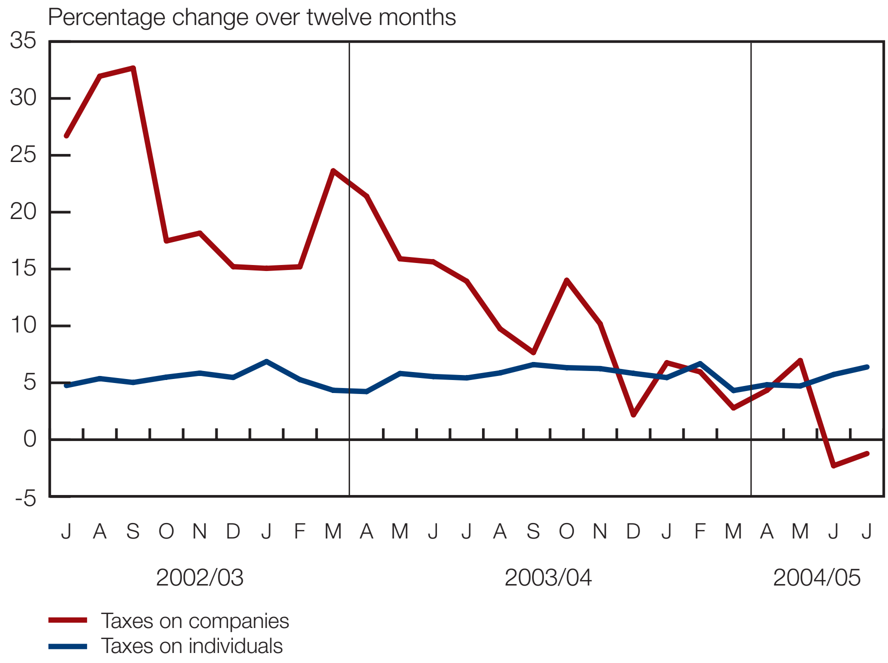
As shown in the table on the opposite page, taxes on income, profits and capital gains showed an increase of 0,8 per cent in the April-June quarter of 2004 compared with the same period a year earlier. This slight increase was mainly as a result of a decline in corporate income tax collections, which could partly be ascribed to the effects of the strengthening of the exchange rate of the rand on corporate profits. The recovery in the exchange rate of the rand also contributed to lower 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. The *Budget Review 2004* provided for a sharp increase in transfers to the Southern African Customs Union (SACU) partners – Botswana, Lesotho, Namibia and Swaziland – which came into effect from the April-June quarter of 2004, thereby detracting from national government revenue.

National government revenue in fiscal 2004/05

Revenue source	R billions: Originally budgeted	R billions: Actual Apr – Jun	Percentage change*
Taxes on income, profits and capital gains	189,2	43,0	0,8
Payroll taxes	4,3	1,0	16,5
Taxes on property	6,9	2,1	50,7
Domestic taxes on goods and services	121,5	28,9	30,5
Taxes on international trade and transactions	10,5	2,6	-1,3
Other revenue	7,9	1,2	-17,8
Less: SACU payments	13,3	3,3	37,1
Total revenue	**327,0**	**75,4**	**9,8**

* April – June 2003 to April – June 2004

Twelve-month moving average of national government revenue



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 R74,1 billion in the first quarter of fiscal 2004/05, representing an increase of 7,5 per cent compared with the same period of the previous fiscal year.

The net result of national government revenue and expenditure in the April-June quarter of 2004 was a deficit before borrowing and debt repayment of R10,1 billion, which was almost double the deficit recorded in the same period of the previous fiscal year. As a ratio of gross domestic product, this cumulative deficit amounted to 3,1 per cent in the first three months of fiscal 2004/05 compared with 1,7 per cent in the same quarter of fiscal 2003/04. For the period under review, the cash-flow deficit amounted to R11,7 billion.

During April 2004 government issued R7,0 billion in zero-coupon bonds to the Reserve Bank to defray the costs associated with the losses on the Gold and Foreign Exchange Contingency Reserve Account. These bonds were subsequently converted into interest-bearing bonds. During the first quarter of fiscal 2004/05 national government also incurred costs related to the revaluation of maturing foreign loans at redemption. After taking these extraordinary items into account, the net borrowing requirement amounted to R19,5 billion. The *Budget Review 2004* indicated that the cost of revaluation of foreign loans at redemption would amount to R2,2 billion, while extraordinary receipts – mainly funds obtained from the restructuring of state-owned enterprises – would generate R2,7 billion towards the financing of national government in fiscal 2004/05.

National government financing in fiscal 2004/05
R billions

Instrument	Originally budgeted 2004/05	Actual Apr – Jun 2004
Deficit	**41,9**	**11,7***
Plus: Extraordinary payments	7,0	7,0
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**	**19,5**
Treasury bills	6,0	0,0
Domestic government bonds	34,3	17,7
Foreign loans	8,1	5,9
Change in available cash balances ***	0,0	-4,1
Total net financing	**48,4**	**19,5**

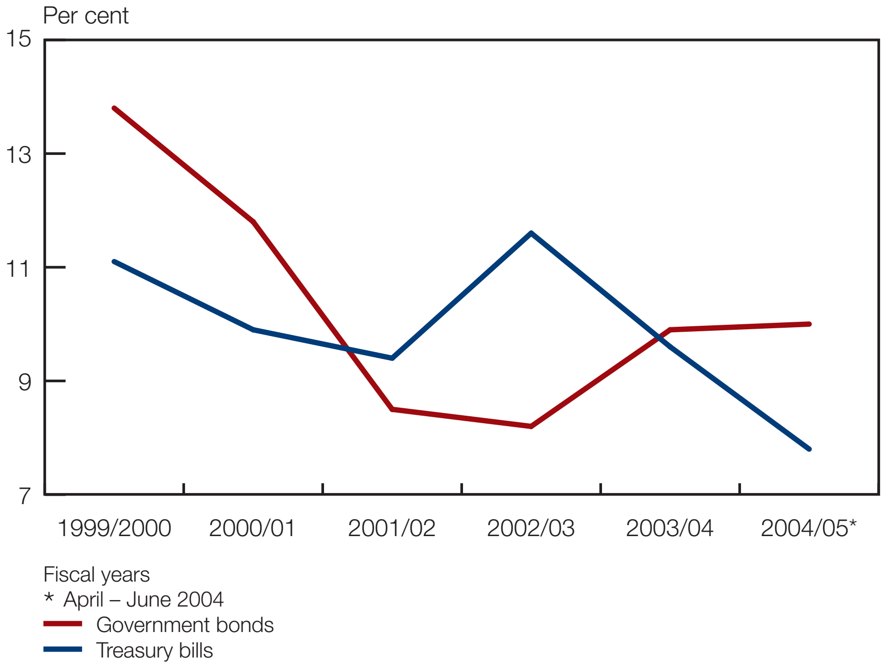
* Cash-flow deficit
** Cost +, profit -
*** Increase -, decrease +

As indicated in the accompanying table, the net borrowing requirement of the national government in the April-June quarter of 2004 was financed mainly through the issuance of long-term bonds in the domestic capital market. Net receipts from government bonds issued in the domestic capital market amounted to R17,7 billion during the April-June quarter of 2004. Long-term fixed-interest bonds were issued at an average rate of 10,0 per cent, and short-term bills at an average rate of 7,8 per cent. In May 2004, the National Treasury launched the RSA Government Retail Bond; these bonds raised R197 million in May – June 2004.

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. The average outstanding maturity of government's foreign bonds lengthened from 79 months at the end of March 2004 to 84 months at the end of June 2004. In the first quarter of fiscal 2004/05, an amount of R1,3 billion was also drawn on foreign export credit facilities for the financing of the strategic defence procurement programme.

These funding activities resulted in an increase of R4,1 billion in government cash balances in the April-June quarter of 2004, bringing the cash balances to R16,7 billion at the end of June.

Average interest rate on government bonds and Treasury bills



Total national government debt rose from R473,0 billion at the end of March 2004 to R487,7 billion at the end of June 2004 due to both domestic and foreign issues of debt instruments. Foreign debt amounted to 14,3 per cent of the total national government loan debt at the end of June 2004 compared with 17,4 per cent at the end of March 2003. The value in rand of foreign-currency denominated debt declined as a consequence of the recovery in the exchange rate of the rand. Along with the redemption of certain foreign debt commitments, this contributed to the decline of the relative share of foreign debt in total national government debt.

As a ratio of gross domestic product, total national government debt amounted to 38,8 per cent at the end of June 2004 compared with 38,4 per cent at the end of March 2004. Foreign debt as ratio of gross domestic product increased slightly from 5,2 per cent at the end of March 2004 to 5,4 per cent at the end of June 2004.

National government finance in July 2004

National government expenditure in July 2004 amounted to R26,6 billion, bringing the cumulative expenditure in the first four months of fiscal 2004/05 to R112,1 billion which was 12,9 per cent more than in the same period of the previous fiscal year. The cash-flow adjusted expenditure for the first four months of fiscal 2004/05 amounted to R112,4 billion which was 14,2 per cent more than in the corresponding period of the previous fiscal year.

National government revenue amounted to R21,6 billion in July 2004 and to R97,0 billion in the first four months of fiscal 2004/05, representing a year-on-year rate of increase of 8,4 per cent. After the usual adjustment for cash flows, revenue amounted to R96,4 billion in the first four months of fiscal 2004/05, which was 7,5 per cent more than in the corresponding period of fiscal 2003/04.

The net result of the national government's revenue and expenditure in the first four months of fiscal 2004/05 was a deficit of R15,1 billion compared with R9,8 billion in the same period of the previous fiscal year. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R16,0 billion. After taking into account the extraordinary receipts and payments, this resulted in a net borrowing requirement of R23,9 billion which was mainly financed by issuing government bonds in the domestic capital market.

Financing of the deficit of national government

R billions

Instrument	Fiscal 2004/05 Originally budgeted	Actual Apr – Jul 2004
Deficit	**41,9**	**16,0***
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**	**23,9**
Treasury bills	6,0	0,0
Domestic government bonds	34,3	21,9
Foreign loans	8,1	7,4
Change in available cash balances ***	0,0	-5,4
Total net financing	**48,4**	**23,9**

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