Quarterly Bulletin

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South African Reserve Bank

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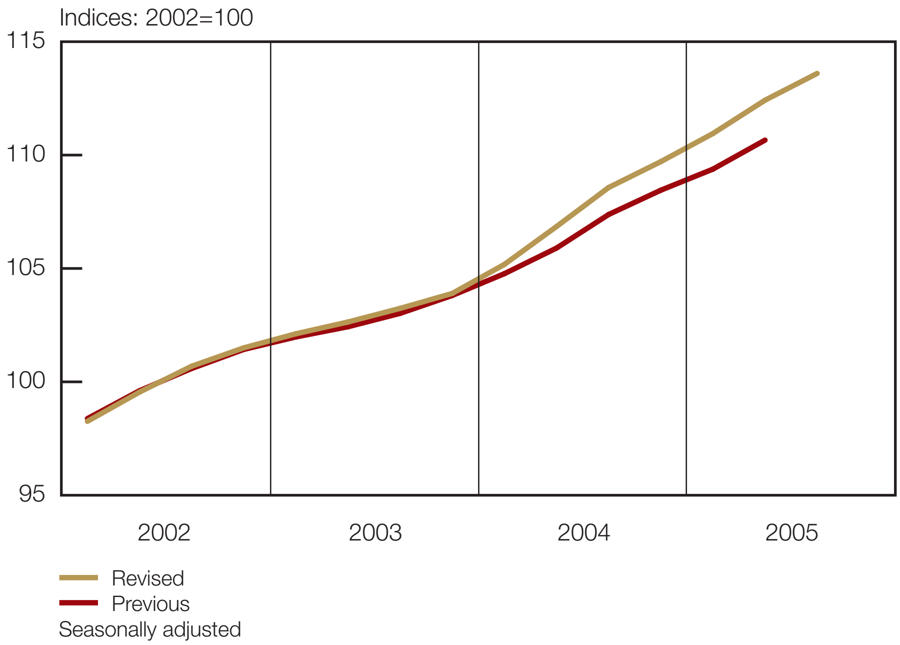
Introduction

The world economy continued to enjoy robust economic growth in the first three quarters of 2005 and is likely to register real growth of almost 4½ per cent in 2005 as a whole, well above the trend growth rate. At the same time global inflation remained moderate, accelerating only slightly despite oil prices having soared to record levels in the third quarter of the year. In the three months to November, the international price of oil receded significantly from the exceptionally high levels registered in the wake of the devastating hurricanes which disrupted refining capacity along the coast of the Gulf of Mexico towards the end of August 2005. The international prices of most non-energy commodities nevertheless held up well as oil prices declined.

Against this fairly benign background, the economic upswing in South Africa continued and completed twenty-four quarters of uninterrupted expansion in the third quarter of 2005. Revisions to the national accounts data, based on comprehensive information which mostly becomes available with a fairly long time lag, resulted in the growth rate of real gross domestic product for 2004 now being estimated at 4,5 per cent, instead of the previously calculated 3,7 per cent. In similar vein, real growth rates in respect of the first two quarters of 2005 were also revised upwards by more than ½ a percentage point.

Annualised growth in real gross domestic product reached a peak of 5½ per cent in the second quarter of 2005 but subsequently slowed to 4 per cent in the third quarter. The slowdown was mainly due to a contraction in real mining output on account of disappointing gold and diamond production, and to slower growth in the real value added by the manufacturing sector. This was exacerbated by a decline in electricity production, as the winter was fairly mild and output growth in some energy-intensive subsectors of the economy was subdued.

Real gross domestic product



Growth in real gross domestic expenditure picked up considerably in the third quarter of 2005 as both fixed capital formation and inventory accumulation gained momentum. Growth in real fixed capital formation accelerated mainly on account of higher capital spending by the private sector – within this institutional grouping several sectors, including manufacturing, contributed to the increase. Among public corporations, the main source of the acceleration in real capital formation was higher expenditure on telecommunications infrastructure. Real fixed investment by the general government inched slightly higher in the third quarter.

Real inventory investment accelerated considerably in the third quarter, with the strong pace of inventory accumulation mainly evident in the manufacturing and trade sectors, the latter inclusive of agricultural stock-in-trade.

By contrast, growth in real final consumption expenditure by households moderated slightly in the third quarter of 2005, but still registered a buoyant annualised rate of increase of 6 per cent, similar to the rate of increase in real household disposable income. The lower growth in real household consumption expenditure was essentially a consequence of a slowdown in the growth in demand for durable goods, especially for new motor vehicles. Nevertheless, household indebtedness rose to a record-high level as households continued to finance the acquisition of fixed property as well as consumer goods by incurring debt. This was prompted by rising income levels, favourable borrowing conditions and solid consumer confidence. Servicing the interest on consumer debt proved comparatively easy for most households as the ratio of interest payments to disposable income remained quite low in a historical context, given the current lower level of nominal interest rates.

Real final consumption expenditure by general government also registered a slightly slower pace of increase in the third quarter of 2005 than in the second quarter. While real compensation of employees rose quite modestly in the third quarter, real spending on non-wage goods and services expanded briskly, despite decelerating marginally in comparison with its second-quarter growth rate.

The robust pace of economic growth over the past year was reflected in rising employment levels. Wage settlements remained well contained in the first three quarters of 2005. Increases in average remuneration per worker exceeded increases in consumer prices by a significant margin, signifying higher standards of living of those in gainful employment. Higher labour productivity helped to check the cost of labour per unit of production, which for the latest available quarter registered an increase over four quarters of 4½ per cent. However, industrial action – largely related to wage disputes – picked up in the first three quarters of 2005.

Inflation picked up in the second half of 2005 in response to the increase in the prices of crude oil and its derivative products. However, when crude oil and petrol are excluded from the production price index and consumer price index baskets, the inflation in the prices of the remaining items remained quite subdued, suggesting no firm evidence of second-round inflationary effects arising from the oil price increase. Moreover, the targeted twelve-month CPIX inflation rate – which incorporates petrol price inflation – only accelerated to a high point of 4,8 per cent in August 2005 and subsequently receded to 4,4 per cent in October, partly on account of the somewhat lower levels of international oil prices. So far, the high oil price has therefore not prevented CPIX inflation from remaining comfortably within the target range of 3 to 6 per cent – an outcome which has been maintained for 26 successive months, and which in itself also helps to anchor inflation expectations.

The deficit on the current account of the balance of payments widened further in the third quarter of 2005. Relative to gross domestic product, the deficit reached 4,7 per cent – the highest deficit ratio since the fourth quarter of 1983. Despite an increase in merchandise exports, the trade balance registered a larger deficit in the third quarter as the value of imports expanded strongly, reflecting the needs of a growing economy as well as the record high level of the international price of crude oil. At the same time the shortfall on the services and income account also widened further.

The wider deficit on the current account in the third quarter of 2005 coincided with a substantial surplus on the financial account. Foreign direct investment into South Africa was bolstered by the acquisition of a majority interest in a South African bank by an international banking group, as well as by increased shareholding by a non-resident investor in a domestic telecommunications company. The overall balance of payments remained in surplus in the third quarter, but by a lesser amount than in the second quarter of 2005.

During the first eleven months of 2005 the repurchase rate of the South African Reserve Bank (the Bank) was adjusted only once, namely in April, when it was lowered by ½ a percentage point to a level of 7 per cent. But for this change, money-market interest rates were relatively steady during this period. In October 2005 the more expectations-sensitive rates rose somewhat, following indications that the risk of inflation testing the upper limit of the target range might have increased, but in November lower international oil prices, a firm exchange rate of the rand and the release of benign inflation data contributed to a partial reversal of such expectations and money-market rates. At the same time, interest rates in the capital market also receded somewhat.

Given the relatively favourable economic environment and outlook, corporate profits in most sectors recorded healthy gains in 2005 and share prices registered successive record high levels, the latest record being set in mid-November. At the same time real-estate prices continued rising briskly. Although the tempo of house-price increases moderated considerably in the past year, it continued to exceed consumer price inflation by a substantial margin. In response to these price signals, a strong pace of residential property development and construction was maintained.

Bank loans and advances continued to reflect the strength of the economy, the stability of interest rates and the generally favourable lending and borrowing conditions, and expanded briskly during the past year. In the third quarter and in October 2005 the measured growth rate decelerated somewhat, partly on account of securitisation activity. Mortgage advances to the household sector remained the mainstay of bank credit extension over the past year, in alignment with the upward trend in real-estate prices and building activity.

Growth in the M3 money supply was exceptionally strong in the third quarter of 2005, bolstered by robust economic activity, strong confidence levels, somewhat higher inflation, continued increases in asset values and the absorption of funds arising from foreign direct investment transactions. Securitisation activity contributed to lower growth in M3 in September and October 2005. Nevertheless, the income velocity of circulation of M3 reached a new record low in the third quarter.

Consistent with the stronger performance of the South African economy, tax collections have so far in the 2005/06 fiscal year risen at rates well above those anticipated in the February 2005 Budget. Accordingly, in the October 2005 *Medium Term Budget Policy Statement* the national government deficit projection for the full fiscal year was lowered from approximately 3 per cent to 1 per cent of gross domestic product. At the same time, it was foreseen that the deficit would rise to not much more than 2 per cent of gross domestic product from 2006/07 onward, as more resources would be directed towards infrastructure development and the improvement of service delivery.

Domestic economic developments

Domestic output[1, 2]

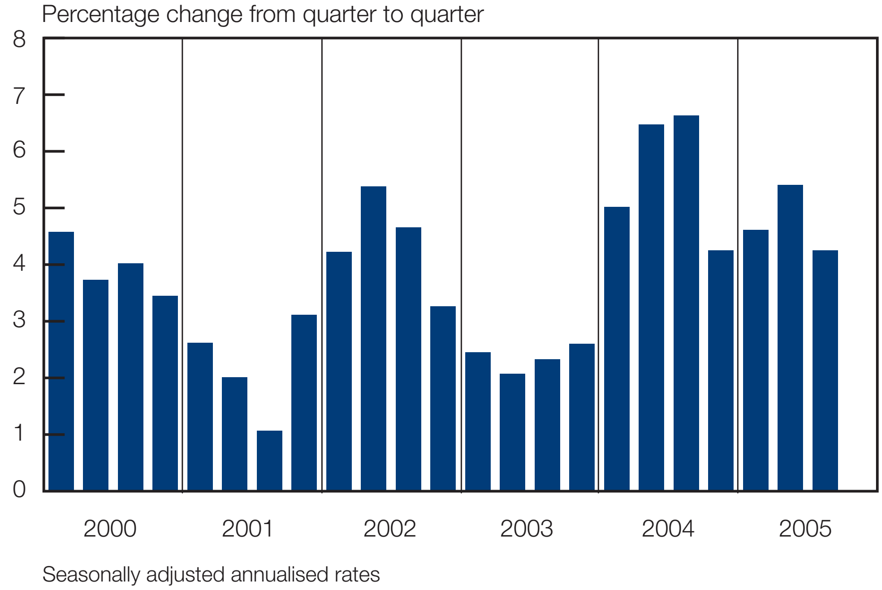
1 In accordance with normal practice during the final quarter of every year, the national accounts data were revised and the revised estimates are incorporated in this issue of the Quarterly Bulletin. These revisions are based on more detailed or more appropriate data that became available. In addition, seasonal factors were updated.

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

Estimated growth in South Africa's real gross domestic product in 2004 was recently revised upwards from 3,7 per cent to 4,5 per cent, or by approximately ¾ of a percentage point. The revised higher rate also set the tone for growth in the first three quarters of 2005.

South Africa's *real gross domestic product* increased further in the third quarter of 2005, albeit at a slower pace than in the second quarter. Real economic growth slowed from an annualised rate of 5½ per cent in the second quarter to 4 per cent in the third quarter of 2005. The slower pace of growth was evident in the primary and secondary sectors, while growth in the tertiary sector maintained its momentum. Despite the lower quarterly growth rate in the third quarter, real gross domestic product was 5 per cent higher in the first three quarters of 2005 compared to the same period in 2004, thereby exceeding the growth rate of 4½ per cent recorded for 2004 as a whole.

Real gross domestic product



Growth in the real value added by the *primary sector* slowed from an annualised rate of 3½ per cent in the second quarter of 2005 to 2½ per cent in the third quarter. This was mainly due to a contraction in real output originating in the mining sector. The growth in real value added by the agricultural sector accelerated appreciably from the second to the third quarter of 2005.

The real value added by the *agricultural sector* increased robustly in the third quarter of 2005, mainly on account of a solid expansion in field crop production. In addition, horticultural output and livestock production increased at rates roughly similar to those recorded in the second quarter. Accordingly, growth in the real value added by the agricultural sector as a whole accelerated from an annualised rate of 3 per cent in the second quarter of 2005 to 10 per cent in the third quarter.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2004					2005		
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	1½	2	7½	-1	1½	8½	3½	2½
Agriculture................	2½	3½	7	3½	-1½	6½	3	10
Mining	1	1½	7½	-3	3	9½	4	-½
Secondary sector	9	11	10	3	5	-½	7½	5½
Manufacturing	9	11½	11	3	4½	-2½	8	5½
Tertiary sector	4	5½	5½	5½	4½	6	4½	4½
Non-agricultural sector ..	*5*	*6½*	*6½*	*4½*	*4½*	*4½*	*5*	*4*
Total	5	6½	6½	4½	4½	4½	5½	4

Following an increase at an annualised rate of 4 per cent in the second quarter of 2005, the real value added by the *mining sector* declined at an annualised rate of ½ a per cent in the third quarter. Gold and diamond-mining output contracted in the third quarter of 2005. Gold production was adversely affected by rising input costs and disruptions in activity at some mines, while revenue increased at a slower pace. The growth in the real value added by coal and platinum mining slowed in the third quarter of 2005. By contrast, real output originating in copper mining rose sharply in the third quarter.

Growth in the real value added by the *secondary sector* slowed from an annualised rate of 7½ per cent in the second quarter of 2005 to 5½ per cent in the third quarter. This could mainly be attributed to slower growth in the real output of the manufacturing sector, exacerbated by a decline in the real value added of the sector that supplies electricity, gas and water. Growth in the real value added by the construction sector edged lower in the third quarter of 2005 but still recorded a near-double-digit rate.

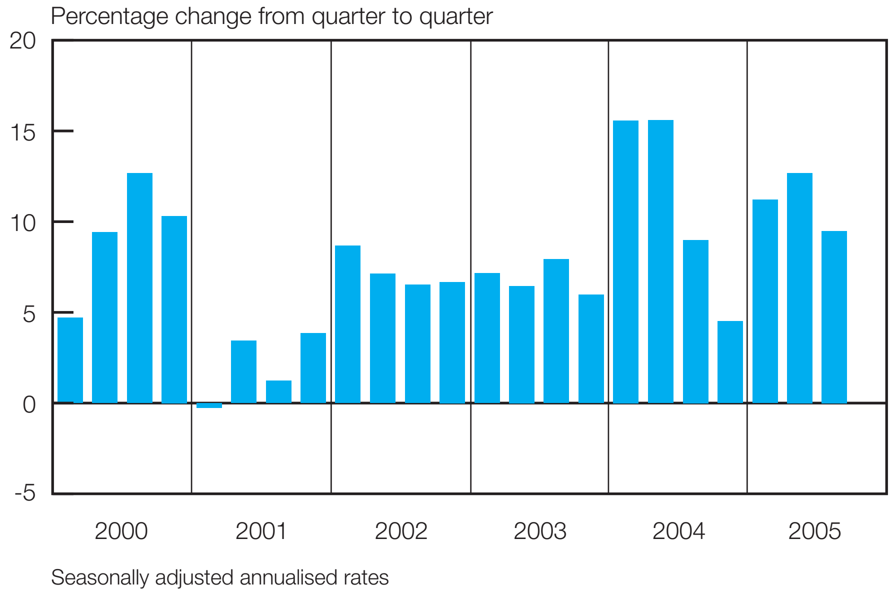
Growth in the real value added by the *manufacturing sector* slowed from an annualised rate of 8 per cent in the second quarter of 2005 to 5½ per cent in the third quarter. Manufactured exports continued to benefit from somewhat stronger foreign demand for domestically produced goods in the third quarter, but domestic sales lost some of their earlier vigour.

Solid increases in production were recorded in the subsectors that manufacture motor vehicles and transport equipment, petroleum and chemical products, rubber and plastic products, as well as food and beverages. The sustained increase in production in the motor-vehicle subsector in the third quarter was consistent with the overall brisk demand for vehicles. While the level of domestic sales of vehicles remained high, its quarter-to-quarter growth rate faltered, but this was countered by a sharp increase in motor-vehicle exports. However, the real value added of several manufacturing subsectors declined in the third quarter of 2005. These include the sectors that produce basic iron and steel, non-ferrous metal products, metal products and machinery, as well as textiles, clothing, leather and footwear. Growth in the real value added by the manufacturing sector amounted to about 4 per cent in the first three quarters of 2005, just falling short of the rate of 4½ per cent recorded in the calendar year 2004 as a whole.

The real value added by the sector that supplies *electricity, gas and water* contracted in the third quarter of 2005, especially in the electricity-generating subsector. The mild winter made itself felt in the quantity of electricity consumed, in South Africa as well as in neighbouring countries, while output in some energy-intensive subsectors of the economy was fairly subdued.

In the *construction sector* buoyant conditions were experienced in 2004 and in the first three quarters of 2005. The level of the real value added by the construction sector in the first three quarters of 2005 was 10 per cent higher than in the first three quarters of 2004, almost equal to the annual growth of 10½ per cent recorded for 2004 as a whole.

Real gross value added by the construction sector



During the third quarter of 2005, residential building construction recorded a slightly lower pace of increase than before. Simultaneously, non-residential building activity picked up, while sustained growth was observed in civil construction as roads were surfaced or otherwise improved and the construction of dams progressed. As a result of these developments, annualised growth in the real value added by the construction sector amounted to 9½ per cent in the third quarter of 2005, compared with 12½ per cent in the second quarter.

Growth in the real value added by the *tertiary sector* maintained an annualised rate of 4½ per cent in both the second and the third quarters of 2005. This reflected the reduced buoyancy of the trade and the transport, storage and communication sectors that was neutralised by somewhat higher growth in the finance, insurance, real-estate and business services sector.

In the *trade sector*, growth in real output slowed from an annualised rate of 7 per cent in the second quarter of 2005 to 6½ per cent in the third quarter. Lower growth was registered in the real value added by the retail and wholesale trade sectors, mirroring the lower pace of growth in consumer demand for goods and services. Whereas the level of spending remained high, the rate of spending growth started to edge down in the third quarter of 2005. This was also evident in the real value added of the motor-trade sector where the quarter-to-quarter growth rate lost momentum.

The real value added by the *transport, storage and communication sector* increased further in the third quarter of 2005 but at a marginally slower pace than before, receding from annualised growth of 6½ per cent in the second quarter to 6 per cent in the third quarter of 2005. This can mostly be ascribed to a slowdown in the growth in real value added by the transport sector. The perennial strong increase in the real value added by the communication sector, in particular cellular phone communication, neutralised the slowdown in the transport sector to some extent.

Growth in the real value added by the *finance, insurance, real-estate and business services sector* accelerated from an annualised rate of 4 per cent in the second quarter of 2005 to 4½ per cent in the third quarter. Alongside the solid performance of the real output of banks and the real-estate subsector, higher trading volumes on the JSE Limited impacted positively on the real output of securities dealers in the third quarter of 2005. Although activity in the residential real-estate sector remained lively, quarter-to-quarter growth slowed as some buyer resistance to high prices started to emerge.

The real value added by *general government* increased at an annualised rate of 1 per cent in both the second and the third quarters of 2005. This essentially reflected the steady pace at which government employment continued to rise.

Domestic expenditure

Aggregate real gross domestic expenditure recorded virtually no growth in the second quarter of 2005, but picked up to expand at an annualised rate of 6 per cent in the third quarter. The sharp increase in real domestic expenditure was the result of faster growth in gross capital formation, i.e. real gross fixed capital formation and real inventory investment. Growth in real final consumption expenditure by households slowed marginally while that of real final consumption expenditure by general government increased at a rate comparable to that of the second quarter. Cumulatively, developments in the first three quarters of 2005 resulted in the level of real gross domestic expenditure being 5 per cent higher than in the first three quarters of 2004 – lower than the rate of increase registered in 2004 as a whole.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

	2004					2005		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure by households......................	6½	7	7½	7½	6½	6	6½	6
Final consumption expenditure by general government.....................	5½	6	0	12½	7	1	6	5½
Gross fixed capital formation.........................	11½	10	7½	9½	9	10	4½	7
Change in inventories (R billions)*.......................	10,9	16,7	17,8	12,7	14,5	8,1	1,9	8,9
Gross domestic expenditure	**9½**	**9½**	**4½**	**4**	**7½**	**7**	**0**	**6**

* At constant 2000 prices

The buoyant growth in *real final consumption expenditure by households* moderated slightly in the third quarter of 2005. Growth in real household spending slowed to an annualised rate of 6 per cent in the third quarter of 2005, following an increase of 6½ per cent in the second quarter. This development was essentially the consequence of a notable slowdown of the growth in the demand for durable goods, which more than offset the stronger growth in the real outlays on semi-durable goods. Household expenditure on the other major spending categories held firm in the third quarter of 2005. Despite the slower growth in the third quarter, the growth in real expenditure by households amounted to 7 per cent in the first three quarters of 2005 compared with the corresponding period in 2004.

After growing at an annualised rate of 21 per cent in the second quarter of 2005, consumer spending on *durable goods* lost some of its earlier momentum in the third quarter of 2005, but still recorded a brisk growth rate of 8 per cent. Lower growth in spending on personal transport equipment, especially on new motor vehicles, was partly offset by an acceleration in spending on furniture and household appliances, medical equipment as well as on recreational and entertainment goods in the third quarter. The growth momentum slowed partly on account of a high base in the second quarter of 2005 and the absence of further interest rate reductions in the third quarter. However, measured over a year, real outlays by households on durable goods rose by 17 per cent in the third quarter of 2005, an improvement on the rate of 16 per cent attained in 2004.

Growth in real final consumption expenditure by households on *semi-durable goods* accelerated from an annualised rate of 13½ per cent in the second quarter of 2005 to 19½ per cent in the third quarter. Although the acceleration was evident in all spending categories, it was especially pronounced in the motorcar tyres, parts and accessories subsector. In addition, robust growth in real outlays on clothing and footwear as well as household textiles, furnishings and glassware also boosted growth in semi-durable goods purchases.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

	2004					2005		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods..............	10½	17	23	26	16	11	21	8
Semi-durable goods	23	23	17	19½	18	16	13½	19½
Non-durable goods	3	5	6	5½	4	5	4½	4½
Services........................	5	3	3	2½	4	3	3½	3
Total	**6½**	**7**	**7½**	**7½**	**6½**	**6**	**6½**	**6**

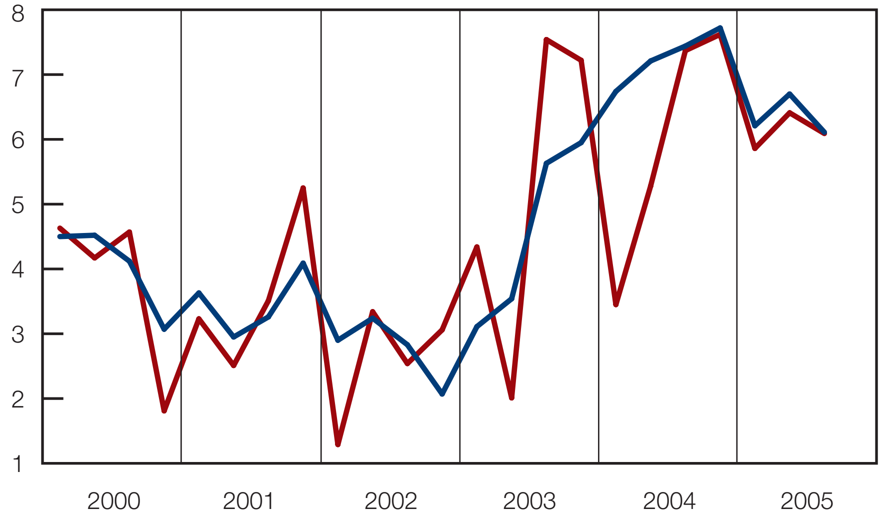
Sustained growth in real household spending on *non-durable goods* in the third quarter of 2005 was mainly a result of stronger growth in real outlays on food, beverages and tobacco as well as on medical and pharmaceutical products. Spending on household fuel and power held up well in the third quarter of 2005, but real purchases of petrol and diesel receded on account of the negative impact of higher petrol prices.

The robust consumer spending reflected similar brisk increases in real disposable income. Growth in *real disposable income of households* inched marginally lower to 6 per cent in the third quarter from 6½ per cent in the second quarter of 2005.

With relatively favourable lending and borrowing conditions, rising income and expenditure, strong consumer confidence and buoyant conditions in the real-estate market, household debt as a percentage of annualised disposable income rose from 61 per cent in the second quarter of 2005 to 63½ per cent in the third quarter – a new record high. The rise in the ratio of household debt service payments to disposable income was very small and, at approximately 6¾ per cent in the third quarter, this ratio was still only half its record high level recorded in 1998.

Household final consumption expenditure and disposable income

Percentage change from quarter to quarter



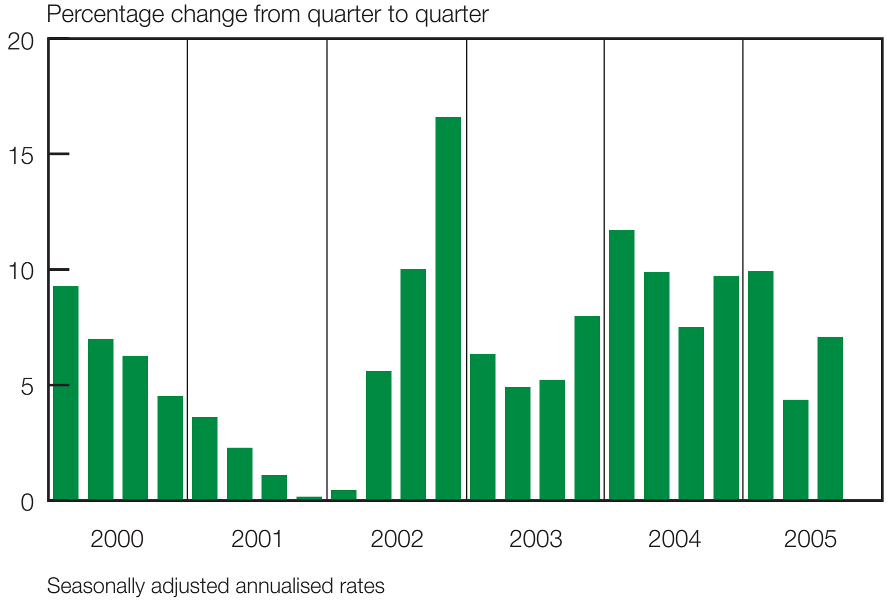
Final consumption expenditure
Disposable income
Constant prices, seasonally adjusted annualised rates

Real final consumption expenditure by general government increased at an annualised rate of 5½ per cent in the third quarter of 2005, slightly slower than the growth rate in the previous quarter. While real compensation of employees rose quite modestly in the third quarter, real spending on non-wage goods and services expanded briskly, albeit slightly less buoyant than before. The sustained solid pace of growth in consumption expenditure in the third quarter of 2005 lifted aggregate real final consumption expenditure by general government to a level which was 5½ per cent higher in the first three quarters of 2005, compared with the corresponding period in 2004. The ratio of nominal final consumption expenditure by general government to nominal gross domestic product declined marginally from 20½ per cent in the second quarter of 2005 to 20 per cent in the third quarter, but trended gently higher over the past four years.

Regaining some of its earlier momentum, *real gross fixed capital formation* increased at an annualised rate of 7 per cent in the third quarter of 2005 compared with 4½ per cent in the second quarter. All the major institutional sectors, i.e. the private sector, public corporations and general government, experienced higher growth than before in real capital expenditure in the third quarter.

Growth in real gross fixed capital formation by the *private sector* accelerated from an annualised rate of 4½ per cent in the second quarter to 7½ per cent in the third quarter of 2005. Stronger rates of growth in real capital outlays were recorded in several sectors of the economy, including manufacturing, construction, commerce as well as the transport and communication sectors.

Real gross fixed capital formation



Real investment in the manufacturing sector benefited from capital outlays by vehicle manufacturing plants as they positioned themselves to take advantage of the strong domestic and international demand for domestically produced vehicles. In addition, the construction of new shopping malls gave a fillip to gross fixed capital formation by the private sector. However, the rate of real growth in the construction of private residential buildings decelerated in the third quarter of 2005.

Real gross fixed capital formation by *public corporations* accelerated further in the third quarter of 2005. All the major public corporations increased their real fixed investment. However, the main source of the acceleration in real fixed capital formation was a sharp increase in the purchase of telecommunications equipment.

Growth in real gross fixed capital formation by *general government* inched higher from an annualised rate of ½ a per cent in the second quarter to 1½ per cent in the third quarter of 2005. Most of the fixed investment occurred at the provincial government level to provide infrastructure needed for bolstering both service delivery and overall economic development.

Estimates indicate that *real inventory accumulation* increased from an annualised level of R2 billion in the second quarter of 2005 to R9 billion in the third quarter. The strong pace of inventory accumulation was mainly evident in the manufacturing and trade sectors. Inventory accumulation in the trade sector was bolstered by increases in agricultural stock-in-trade as further quantities of maize were accumulated.

By contrast to the second quarter when inventory investment subtracted 2 percentage points from growth in real gross domestic expenditure, the expansion of real inventory investment contributed 2½ percentage points to expenditure growth in the third quarter of 2005. The level of industrial and commercial inventories as a percentage of the non-agricultural gross domestic product edged lower in the third quarter.

Factor income and saving

The year-on-year growth in *total nominal factor income* amounted to 8 per cent in the third quarter of 2005, compared with 7½ per cent in the second quarter. This mild acceleration was entirely due to sturdy growth in gross operating surpluses.

With moderate wage settlements alongside some gains in employment, the rate of increase in *compensation of employees*, measured over four quarters, amounted to 9 per cent in both the second and third quarters of 2005. The share of labour in total factor income, fluctuating around an essentially horizontal trend line since mid-2003, receded to roughly 51 per cent in the third quarter of 2005, as shown in the accompanying graph.

Compensation of employees as percentage of total factor income

Seasonally adjusted

The growth, measured over four quarters, in the aggregate nominal *gross operating surplus* picked up from 6 per cent in the second quarter of 2005 to 7½ per cent in the third quarter. There was an improvement in the fortunes of the agricultural sector as production expanded and some agricultural commodity prices started to recover from a previous slump. Profitability in the construction sector reflected the heightened activity levels in this sector. The gross operating surpluses of the other sectors of the economy increased at rates that were virtually unchanged from the second to the third quarter of 2005.

Gross saving as a percentage of gross domestic product edged down from 13½ per cent in the second quarter of 2005 to 13 per cent in the third quarter. Government saving improved marginally in the third quarter, but this improvement was offset by slightly weaker saving by the corporate sector.

Gross saving by the *corporate sector* as a ratio of gross domestic product receded from 10½ per cent in the first quarter of 2005 to 10 per cent in the second and third quarters.

The weaker performance of corporate saving was mainly a result of an increase in dividend payments by business enterprises. In addition, tax payments by the corporate sector increased in the third quarter.

Despite the slower quarter-to-quarter growth in real final consumption expenditure, household spending remained at a rather high level. That, together with the slowdown in the growth of real disposable income, contributed to a lacklustre saving performance by the household sector. *Household saving* as percentage of gross domestic product remained low at 2 per cent in both the second and third quarters of 2005.

Having amounted to 1 per cent in the first quarter of 2005, the ratio of gross saving by *general government* to gross domestic product inched higher to 1½ per cent in the second and third quarters of 2005. This was mainly the result of an increase in tax revenue.

Employment

The most recently published *Labour Force Survey* released by Statistics South Africa indicates that the level of overall employment in the South African economy rose virtually uninterruptedly from 11,2 million in September 2001 to 11,9 million in March 2005. These revised statistics incorporate the population estimates released in February 2005 and were also benchmarked to the Census 2001 results in order to establish a consistently estimated time series of labour market data. These estimates furthermore indicate that the number of unemployed persons decreased from 5,1 million in March 2003 to 4,3 million in March 2005. The estimated unemployment rate accordingly was lowered from 31,2 per cent in March 2003 to 26,5 per cent in March 2005.

According to the recently introduced *Quarterly Employment Statistics* (QES) survey by Statistics South Africa, enterprise-surveyed formal non-agricultural employment fell in both the fourth quarter of 2004 and the first quarter of 2005. Subsequently, formal non-agricultural employment increased at a seasonally adjusted and annualised quarter-to-quarter rate of 7,6 per cent in the second quarter of 2005. Employment numbers increased by 1,2 per cent or by around 84 000 over the year to the second quarter of 2005. Private-sector employment increased by 0,7 per cent over this four-quarter period while the increase in public-sector employment of 3,0 per cent was far more pronounced.

With the introduction of the new QES by Statistics South Africa in June 2005, replacing the *Survey of Employment and Earnings* (SEE) from the fourth quarter of 2004, the coverage and representativeness of official labour market statistics improved significantly. In fact, the overall level of formal non-agricultural employment, as indicated by enterprises, has been revised upward to around 7,1 million employees. This represents an increase of about 8 per cent over the estimated level indicated by the SEE in December 2004 and resulted from improved coverage of small businesses in particular[3].

3 In order to facilitate time-series analysis, a statistically linked employment series was constructed by the Bank, factoring in the difference in the indicated levels of employment between the SEE and the QES. It was assumed that the historical seasonal patterns in the SEE data also apply to the new QES data – proper seasonal adjustment of the new QES data will only be possible in due course as more observations become available.

The QES survey is based on a sample of 24 000 income-tax-paying employing enterprises in the formal non-agricultural sector, whereas the discontinued SEE was based on a narrower sample of 10 000 private and public enterprises with value-added tax turnover exceeding R300 000 per annum in the formal non-agricultural sectors of the economy.

The recovery in enterprise-surveyed *private-sector employment* faltered somewhat in the final quarter of 2004 and the first quarter of 2005. Job losses in the manufacturing and gold-mining sectors were primarily responsible for the decline in employment numbers during the six months to March 2005. The recovery in private-sector employment in the second quarter of 2005 was fairly widespread as only the gold-mining and electricity-generating sectors reduced staff numbers in that quarter. The quarter-to-quarter pace of employment losses in the gold-mining sector also decelerated further in the second quarter of 2005. A sizeable increase in construction-sector employment was recorded in the second quarter of 2005 due to the appointment of more employees on new projects resulting from a strong increase in construction-sector activity. Civil engineering, electrical contracting, and construction in other building sub-industries all reflected quarterly increases in employment numbers. Increases in employment numbers in the non-gold mining as well as transport, storage and communication sectors were also fairly pronounced in the second quarter of 2005.

A firm upward trend in the level of *public-sector* employment developed from mid-2002, but this lost some momentum recently as the pace of employment gains levelled off to annualised rates of around 0,5 per cent in the two quarters to June 2005. Employment gains at provincial government level outweighed job losses at public-sector enterprises in the second quarter of 2005. Notwithstanding the slower pace of job gains in the first half of 2005, the level of public-sector employment still rose by as much as 3,0 per cent in the year to June 2005, or by almost 46 000 jobs.

Change in enterprise-surveyed formal non-agricultural employment over four quarters to June 2005

Sector	Number	Percentage change
Gold mining	-20 300	-11,0
Non-gold mining	13 500	4,9
Manufacturing	-16 600	-1,4
Electricity supply	-200	-0,5
Construction	83 900	24,9
Trade, catering and accommodation	99 500	7,8
Transport, storage and communication	24 100	12,3
Finance, insurance, real-estate and business services	-165 500	-10,1
Community, social and personal services	20 000	7,0
Total private sector	**38 500**	**0,7**
National, provincial and local government	55 800	4,1
Public-sector enterprises	-9 800	-5,2
Total public sector	**45 900**	**3,0**
Grand total	**84 400**	**1,2**

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

Signs of employment prospects in the third quarter of 2005 are generally positive. The volume of job advertisements in the print media rose further in the third quarter of 2005 and business confidence, according to the Rand Merchant Bank/Bureau for Economic Research Business Confidence Index, remained at exceptionally high levels in all sectors of the economy during that quarter. However, the Investec Purchasing Managers sub-index for employment points to a possible slight contraction in manufacturing-sector employment in the third quarter of 2005.

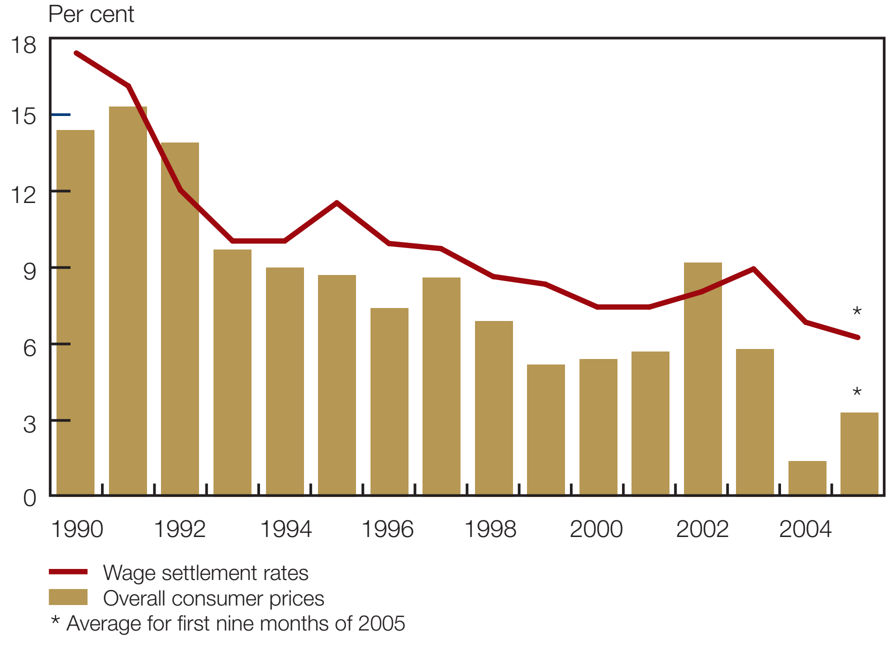
Man-days lost to strikes and other forms of work stoppages more than doubled from 1,05 million during the first three quarters of 2004 to 2,2 million during the same period in 2005. Industrial action was largely related to wage disputes, which accounted for 88,7 per cent of the number of man-days lost during the first three quarters of 2005.

Labour cost and productivity

The pace of increase in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy slowed from an annual average rate of 9,1 per cent in 2004 to 8,3 per cent in the year to the first quarter of 2005 and to 7,9 per cent in the year to the second quarter. This deceleration in nominal wage growth resulted from a slowdown in the pace of increase in private-sector nominal remuneration per worker, since average remuneration in the public sector rose more rapidly in the second quarter of 2005 than in the first quarter.

The moderation in wage pressures in the economy seemed likely to have continued in the third quarter of 2005 as suggested by a slower pace of increase in average salaries, wages and pensions deposited into the bank accounts of almost 5 million salaried and retired workers in that quarter, as indicated by the Automated Clearing Bureau. According to Andrew Levy Employment Publications, the average settlement rate in collective bargaining agreements decelerated to 6,2 per cent in the first nine months of 2005 from 6,7 per cent in the same period of the preceding year. Wage growth at the lower pay levels was more sedate at around 4 per cent when the first nine months of 2005 are compared with the same period in 2004.

Wage settlement rates and year-on-year consumer price inflation



The growth in nominal remuneration per worker in the *public sector* decelerated from an annual average rate of 9,1 per cent in 2004 to 6,9 per cent in the year to the first quarter of 2005, but accelerated substantially to 8,7 per cent in the year to the second quarter. The acceleration in nominal wage growth in the public sector in the second quarter of 2005 occurred at all levels of the public sector with the exception of the local government level. Despite the slowdown in the pace of increase in nominal remuneration per worker at local government level, the rate of increase was still well in excess of those at the other levels of government.

Unlike the faster pace of increase in nominal wage growth in the public sector from the first quarter of 2005 to the second quarter, remuneration increases granted by *private-sector* enterprises slowed somewhat. The sharp deceleration in nominal wage growth in the manufacturing sector and a decline in average remuneration per worker in the construction sector were key to the deceleration in private-sector nominal wage growth in the second quarter of 2005. It is likely that the significant increase in employment in the construction sector in the second quarter involved mainly new recruits remunerated at entry-level wages, thereby pulling down the average remuneration level.

With formal non-agricultural employment declining in the two quarters to March 2005, labour productivity growth picked up to a year-on-year rate of 4,3 per cent in the first quarter of 2005. Following a renewed increase in employment in the second quarter of 2005, real production per worker increased at a lower rate of 3,2 per cent in the year to the second quarter. Even though labour productivity growth in the manufacturing sector decelerated to a year-on-year increase of 4,9 per cent in the second quarter of 2005, it still exceeded economy-wide productivity growth by a fair margin.

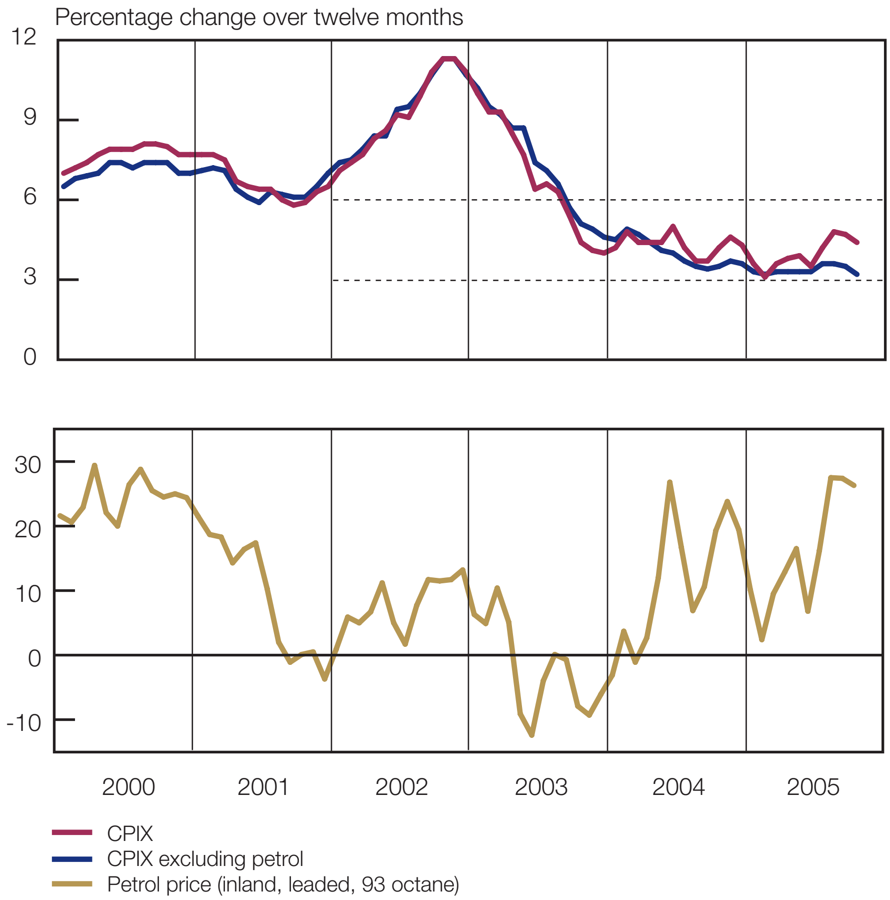
The increase in the *cost of labour per unit of production* in the formal non-agricultural sector was contained at a year-on-year rate of 3,8 per cent in the first quarter of 2005, meaningfully lower than the annual average increase of 7,3 per cent in 2004. Following the moderation in labour productivity growth in the second quarter of 2005, the year-on-year rate of increase in nominal unit labour cost accelerated somewhat to 4,5 per cent in that quarter. Unlike the acceleration in the pace of increase in nominal unit labour cost in the overall formal non-agricultural sectors of the economy in the second quarter of 2005, unit labour cost growth slowed quite substantially in the manufacturing sector. The pace of increase in nominal unit labour cost in the manufacturing sector decelerated from an annual average of 4,5 per cent in 2004 to only 0,2 per cent in the year to the second quarter of 2005 as nominal wage growth slowed and real output picked up.

Prices

Price inflation in the domestic economy accelerated considerably in recent months, mainly as a consequence of steep increases in international crude oil prices. The inflationary effects of higher oil prices were, however, partly mitigated by a recovery in the external value of the rand in the third quarter of 2005, leading to a decline in import costs and intensified price competition in the domestic economy. Relatively low rates of increase in food prices also had a substantial dampening effect on accelerating price inflation. Despite these moderating factors, twelve-month CPIX inflation accelerated from a recent low of 3,1 per cent in February 2005 to 4,8 per cent in August, decelerating somewhat to 4,4 per cent in October. In both September and October 2005 as much as 1,2 percentage points, or a quarter of the CPIX rate of inflation, could be attributed directly to the rise in petrol prices.

Driven by supply disruptions, under-investment in refining capacity over an extended period of time and relatively brisk global economic conditions, leading to an increase in demand, the monthly average international price of crude oil rose markedly from around US$40 per barrel in December 2004 to US$63 per barrel in September 2005. This was followed by some decline in crude oil prices to levels of around US$53 per barrel in late November 2005. Inflation in the *production prices of imported goods* reflected these higher energy prices and accelerated substantially from a year-on-year rate of 0,3 per cent in January 2005 to 6,8 per cent in September – the highest rate of increase in almost three years. Following an easing in the rand price of imported crude oil, year-on-year inflation in the prices of imported goods declined to 4,2 per cent in October 2005. When measured from quarter to quarter and expressed at an annualised rate, changes in the prices of imported goods reverted from a decline of 3,2 per cent in the first quarter of 2005 to an increase of as much as 13,9 per cent in the third quarter.

CPIX and petrol prices



While the import prices of goods in the mining and quarrying category (including crude oil, with a weight of 9,9 per cent in the imported goods price index) rose by no less than 47,8 per cent in the year to October 2005, various other categories with a combined weight of almost 33 per cent were still experiencing rates of price *decline* over that period. The most prominent among these latter categories were office, accounting and computing machinery, as well as radio, television and communication equipment and apparatus. Their disinflationary effects were not only counteracted by the already mentioned high crude oil prices but also by accelerating inflation in the prices of basic metal products, wood and wood products, agricultural and manufactured food, and beverages.

Contrary to the acceleration in production price inflation in the domestic economy in recent months, production price pressures moderated somewhat in South Africa's main trading-partner countries. The year-on-year rate of increase in the composite wholesale price index of South Africa's main trading-partner countries decelerated from around 4,5 per cent in the closing months of 2004 to 3,1 per cent in September 2005, despite the adverse impact of rising crude oil prices.

Relatively small increases in the prices of certain imported goods contributed to the fairly moderate rise in the production prices of *domestically produced goods* during the first half of 2005. From twelve-month rates of increase of around 2 per cent during the first half of 2005, domestically produced goods price inflation accelerated to 3,8 per cent in September and 3,5 per cent in October. Measured from quarter to quarter and expressed at an annualised rate, domestically-produced goods price inflation accelerated from 1,9 per cent in the first quarter of 2005 to 5,8 per cent in the third quarter.

Production prices

Quarter-to-quarter percentage changes at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2003:	**Year**	**3,9**	**-4,2**	**1,7**
2004:	1st qr	5,7	-3,8	3,7
	2nd qr	3,3	4,8	2,5
	3rd qr	0,5	-1,9	0,6
	4th qr	2,2	0,9	1,7
	Year	**2,3**	**-3,9**	**0,6**
2005:	1st qr	1,9	-3,2	1,3
	2nd qr	3,9	13,7	5,1
	3rd qr	5,8	13,9	8,6

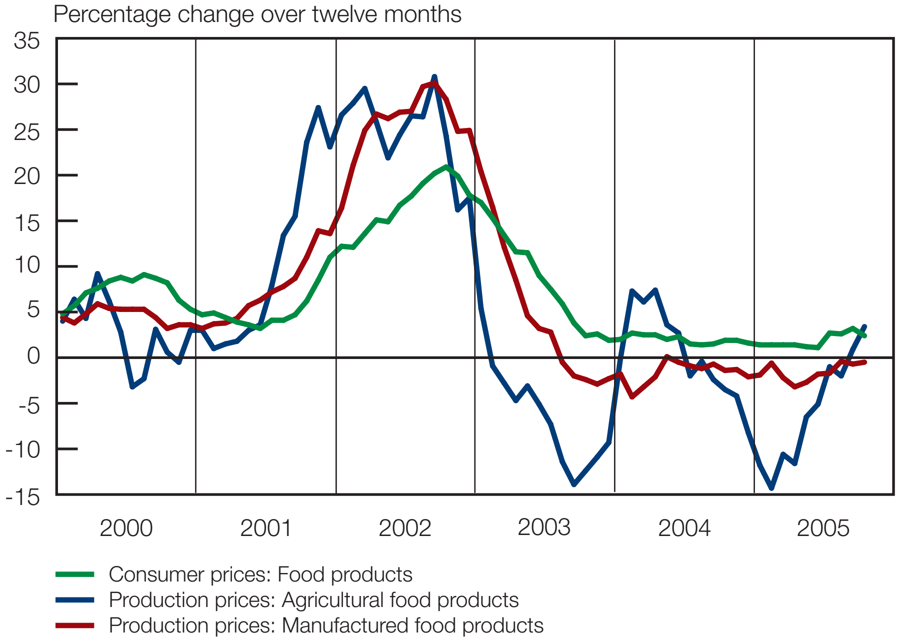
Over and above the steep increases in the prices of petroleum and coal products, the production prices of fishing products rose by 18,6 per cent in the year to October 2005, basic ferrous metals by 10,4 per cent, tobacco products by 9,8 per cent and wood and wood products by 9,3 per cent. Inflation pressures were relatively muted in the other categories of domestically produced goods. In fact, the production prices of coal, manufactured food, leather and leather products as well as footwear declined in the year to October 2005. Nevertheless, factors such as higher transport costs, an increase in the cost of plastic packaging materials and higher maize prices are likely to increasingly make themselves felt in food price inflation in particular.

While increases in the *all-goods production price index* were fairly subdued during the opening months of 2005, the pace of increase doubled from a year-on-year rate of 2,3 per cent in June 2005 to 4,6 per cent in September. This rate of increase slowed somewhat to 4,2 per cent in October 2005. When rising energy prices are excluded from the all-goods production price index, production prices would have *declined* by 2,4 per cent in the year to October 2005. When measured from quarter to quarter and expressed at an annualised rate, all-goods production price inflation accelerated to 8,6 per cent in the third quarter of 2005 due to higher prices of both imported and domestically-produced goods.

Mainly as a consequence of the increase in crude oil prices, leading to a rise in the domestic price of petrol by as much as 60 per cent in the 21 months to October 2005, *CPIX inflation* accelerated. While year-on-year CPIX services price inflation inched below the upper limit of the inflation target range of 6 per cent during the nine months to September 2005 and fell to 5,2 per cent in October, CPIX goods price inflation accelerated substantially over this period. In addition to the steep increases in petrol prices, higher inflation in the prices of alcoholic beverages and tobacco as well as of housing services pushed year-on-year CPIX inflation higher. The quarter-to-quarter pace of CPIX inflation accelerated from 2,4 per cent in the first quarter of 2005 to 6,3 per cent in the third quarter.

CPIX goods price inflation generally remained below 3 per cent during the first half of 2005, but accelerated to a year-on-year rate of 3,4 per cent in July 2005 and came to 4,4 per cent in September 2005 and 4,1 per cent in October. Higher petrol prices added some 2,0 percentage points to year-on-year CPIX goods price inflation in October. Outright declines in the prices of furniture and equipment, clothing and footwear as well as new and used vehicles, moderated inflation in the year to October 2005. Despite a slight acceleration in recent months to a year-on-year rate of 3,2 per cent in September 2005, food price inflation still remained well contained, falling to 2,4 per cent in October. As far as the remaining goods in the CPIX basket are concerned, their twelve-month rates of price increase remained fairly stationary at around the 3-per-cent level during the past year. This indicates that the pass-through from petrol prices to prices of other goods has been fairly limited up to now.

Food prices



Contrary to the acceleration in CPIX goods price inflation in recent months, *CPIX services price inflation* drifted down from year-on-year rates of around 8 per cent in the closing months of 2003 to 5,2 per cent in October 2005. Housing-services price inflation, however, accelerated from a year-on-year rate of 5,3 per cent in February 2005 to 7,0 per cent in August. This acceleration in housing-services price inflation resulted mainly from the steeper increases in domestic-worker wages. Following the implementation of the results of the latest *Labour Force Survey*, the index for domestic-worker wages declined at a month-to-month rate of 0,2 per cent in October 2005. This rate of decline will also apply to the ensuing four months. As a consequence, housing-services price inflation decelerated somewhat to 6,1 per cent in the year to October 2005.

CPIX-services price inflation during the five months to October 2005 was contained by exceptionally low rates of increase in the prices of transport services. In fact, when measured over periods of twelve months, CPIX transport-services prices increased by only 1,3 per cent in October 2005, in stark contrast to the 12,3 per cent increase in transport goods prices.

A disaggregation of price changes in CPIX indicates that six out of the ten main components, with a combined weight of 61,3 per cent, fell below the lower boundary of the inflation target range in October 2005. Year-on-year inflation in three components exceeded the upper boundary of the target range, while only one component fell within the range. Year-on-year inflation in transport running cost, which is directly influenced by the higher price of petrol, exceeded the rates of price increase in the other categories by a considerable margin.

Inflation in CPIX components

Percentage change over twelve months

	Weights	October 2005
Transport running cost	5,7	23,6
Alcoholic beverages and tobacco	3,1	7,6
Housing services	13,4	6,1
Services excluding housing and transport	16,5	*5,3*
Other goods (not included elsewhere)	17,5	2,4
Food	26,9	2,9
Transport services	3,9	1,3
Vehicles	5,7	-0,8
Furniture and equipment	3,2	-0,9
Clothing and footwear	4,1	-3,5
Total CPIX	100,0	*4,4*

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

The year-on-year inflation in the prices of administered goods and services *excluding petrol* has receded to within the inflation target range and amounted to 4,3 per cent in October 2005. With around a quarter of the administered prices basket comprising petrol, the all-inclusive administered prices index increased by as much as 10,0 per cent in the year to October 2005.

The deterioration in inflation outcomes in recent months due to the surge in international crude oil prices and in the prices of certain administered goods and services as well as a brisk pace of increase in domestic demand conditions, necessitates continued vigilance in the fight against inflation. Promising, however, is the more recent decline in crude oil prices.

Foreign trade and payments

International economic developments

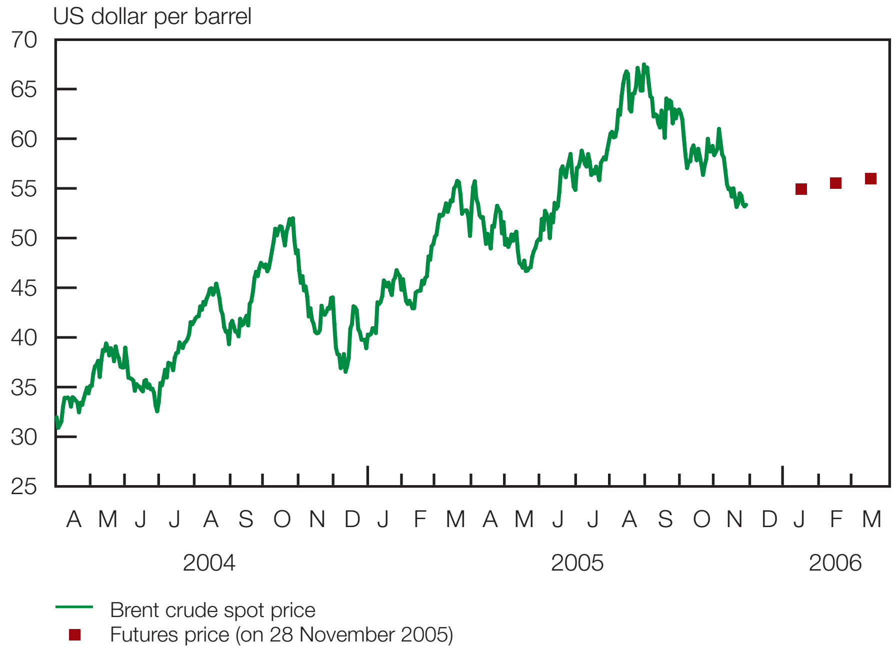
In the first three quarters of 2005 the world economy continued to grow at a fairly strong pace despite a slowdown in economic activity in some countries. The latest projections provide for a real increase in global production of around 4½ per cent in 2005 – which comfortably exceeds the trend growth rate. The United States remained one of the major contributors to the global expansion, recording annualised growth in real gross domestic product of almost 4½ per cent in the third quarter of 2005. In the euro area the pace of economic activity picked up notably in the third quarter of 2005, while real growth in Japan decelerated at the same time. China, India and Russia counted among the larger developing economies recording continued strong growth and contributing to a rising volume of international trade.

The fairly robust performance of the world economy was reflected in strong demand for exports and high international commodity prices. Alongside favourable financing conditions, this rendered support to growth in most emerging economies, countering the dampening effect of surging oil prices on business and consumer confidence.

In the international environment, global imbalances – most notably the current-account deficit of the United States – continued to be a cause for concern, with some of the rebalancing scenarios unfavourable for continued global growth. Rising protectionist tendencies could also be cited as a threat to world economic growth. Finally, the inflationary spectre of high oil prices remained. While underlying or core inflation rates continued to be fairly subdued in recent months, the rise in headline inflation rates clouded global inflation expectations. This prompted many central banks to confirm their vigilance in order to prevent indirect (or second-round) effects of the high oil prices from taking hold.

The price of Brent crude oil decreased from a peak level of around US$70 per barrel in late August 2005 to around US$53 per barrel at the end of November. On balance, it

Brent crude oil prices



nevertheless still rose considerably over the past year, while concerns regarding refinery constraints continued to focus further attention on energy prices. Inflationary concerns have intensified in many countries, with monetary policy having recently been tightened in Canada, Chile, the Czech Republic, the euro area, Hong Kong, India, Israel, New Zealand, South Korea, Taiwan, Thailand and the United States. However, the central banks of Brazil, Hungary, Mexico, Poland, Sweden and the United Kingdom have recently lowered interest rates.

Current account [4]

South Africa's trade balance with the rest of the world recorded its sixth consecutive quarterly deficit in the third quarter of 2005. This was also the largest recorded deficit, and could largely be ascribed to the sustained buoyancy of real domestic expenditure, which gave rise to a sharp increase in the value of merchandise imports. The higher level of merchandise imports in the third quarter was only partly offset by the improved performance of merchandise exports.

4 Unless stated otherwise, the current-account flows referred to in this section are all seasonally adjusted and annualised.

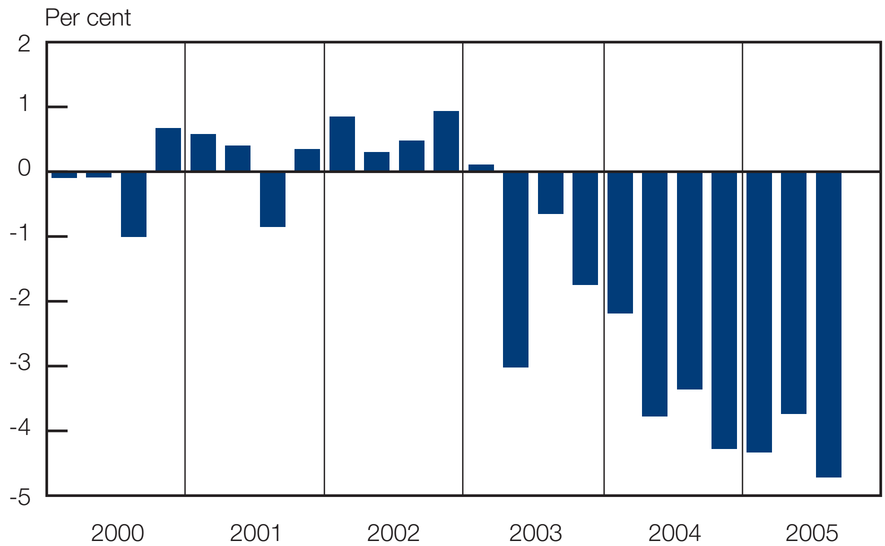
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2004			2005		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	289,1	293,1	281,8	281,3	327,0	338,4
Net gold exports	25,8	30,6	28,7	24,9	25,9	26,0
Merchandise imports	-317,4	-336,7	-311,8	-319,5	-357,3	-384,1
Trade balance	**-2,5**	**-13,0**	**-1,3**	**-13,3**	**-4,4**	**-19,7**
Net service, income and current transfer payments	-44,8	-48,8	-46,2	-50,1	-51,1	-53,2
Balance on current account	**-47,3**	**-61,8**	**-47,5**	**-63,4**	**-55,5**	**-72,9**

The sizeable trade deficit, together with a growing shortfall on the services and income account, caused the ratio of the current-account deficit to gross domestic product to increase from 3,7 per cent in the second quarter of 2005 to 4,7 per cent in the third quarter – the highest deficit ratio since the final quarter of 1983.

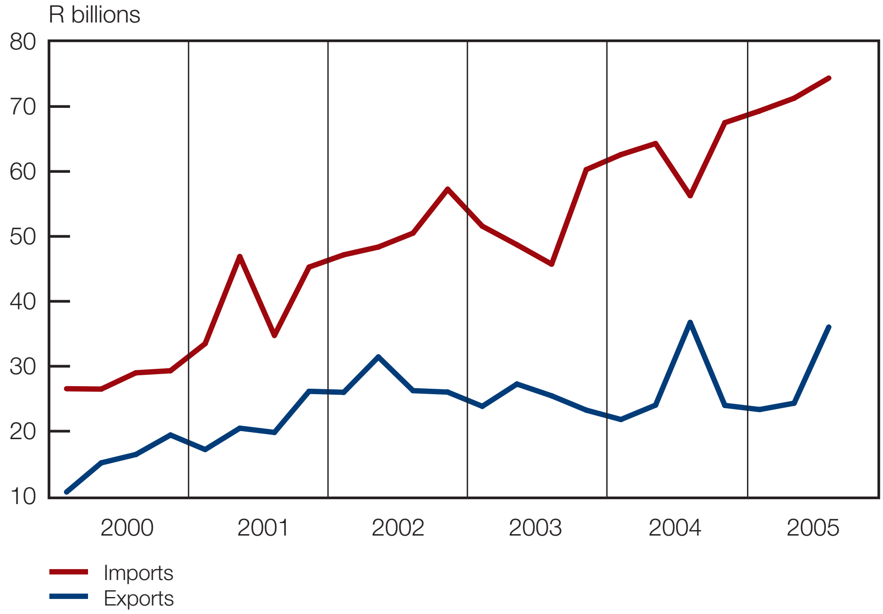
Ratio of current-account balance to gross domestic product



While in dollar terms international commodity prices were on average still 4 per cent higher in the first ten months of 2005 compared with the corresponding period of 2004, they edged lower in the third quarter of 2005. Mainly owing to the modest decline in international commodity prices, the rand prices of *merchandise exports* receded by 1½ per cent in the third quarter of 2005, reversing the increase recorded in the second quarter. The modest decline in the unit price of exports coincided with an increase of 5 per cent in the physical quantity of merchandise exports, as the global demand for domestically produced goods picked up. Export proceeds accordingly rose by 3½ per cent in the third quarter of 2005. Increases in the value of exported manufactured goods outweighed the marginal decline in the value of exported mining and agricultural products.

Within the manufacturing sector, the strongest increases in the third quarter of 2005 were recorded in the subcategories for vehicles and transport equipment, and machinery and electrical equipment. The exports of motor vehicles rose dramatically from the first quarter to the second and third quarters of 2005, as existing and new vehicle export programmes gained momentum. Cumulatively, the value of vehicle exports rose by 13½ per cent in the first nine months of 2005 compared with the corresponding period of the previous year.

Vehicles and transport equipment



Seasonally adjusted and annualised

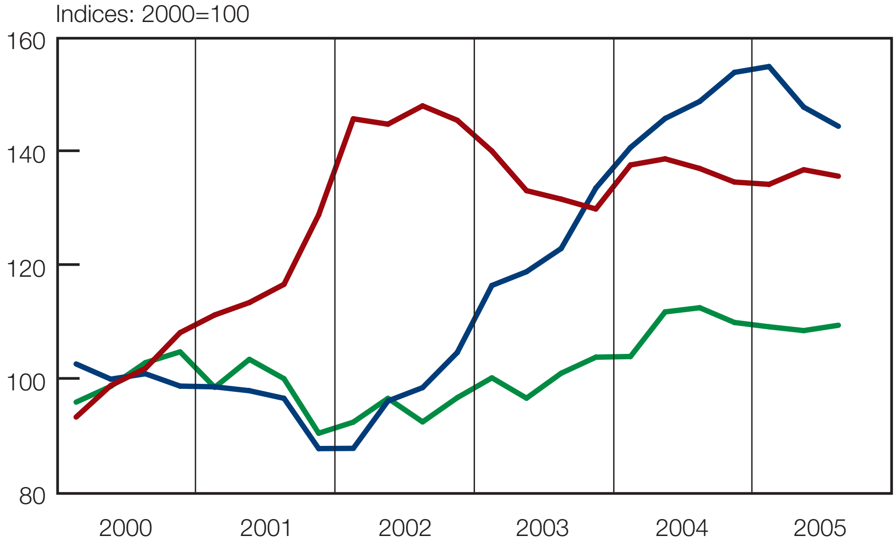
Although the physical quantity of *gold exported* declined further by 2 per cent in the third quarter of 2005, net gold export earnings increased by ½ a per cent during the same period. The increase in the value of net gold exports resulted entirely from the higher US dollar price of gold, which more than countered the mild appreciation of the exchange value of the rand. The average realised rand price of gold per fine ounce increased by almost 2½ per cent in the third quarter of 2005, having advanced sharply by 8 per cent in the second quarter. The average fixing price of gold on the London market reached a 17-year peak of US$477 per fine ounce on 12 October 2005. On average, the dollar price of gold rose from US$427 per fine ounce in the second quarter of 2005 to US$439 per fine ounce in the third quarter and US$470 per fine ounce in October 2005.

After increasing vigorously in the second quarter of 2005, the value of *merchandise imports* rose by a further 7½ per cent in the third quarter. The importation of more vehicles, parts and equipment by automobile manufacturers, necessitated by rising domestic and export sales, boosted the overall value of imported manufactured goods, while the value of mining products imported also rose markedly from the second to the third quarter of 2005 as crude oil prices escalated. The rise in the international price of crude oil was partially offset by a modest increase in the nominal effective exchange rate of the rand. On balance, the rand prices of merchandise imports rose by 2 per cent in the third quarter of 2005. At the same time, the physical quantity of merchandise imports increased by 5½ per cent as the volume of imported crude oil edged higher, augmented by a sizeable expansion in the volume of non-oil imports.

The net services, income and current transfer payments by South African residents to the rest of the world rose from R51,1 billion in the second quarter of 2005 to R53,2 billion in the third quarter. In particular, higher payments by residents for freight services rendered by non-residents were registered in the third quarter of 2005. The mounting deficit was partially countered by an increase in income receipts as more dividends were declared to South African investors on their investments abroad.

Adversely affected by the modest decline in commodity prices, the overall price of merchandise exports receded in the third quarter of 2005 while higher international crude oil prices raised the rand prices of imported goods. These changes in relative prices caused South Africa's terms of trade to decline in the third quarter of 2005.

South African export prices



Rand
US dollar
Euro

Financial account

The positive sentiment towards investment in South Africa which emerged in 2002 gained momentum in 2003 and 2004, and continued unabatedly during the first three quarters of 2005. This was especially evident in the third quarter, when an international banking group made a significant foreign direct investment into South Africa. Strong net inward flows of capital, amounting to R35,4 billion in the second quarter of 2005 and R26,6 billion in the third quarter, were recorded. Cumulatively, the net inflow of capital amounted to R78,5 billion in the first three quarters of 2005 compared with R84,6 billion in 2004 as a whole.

Net financial transactions not related to reserves

R billions

	2004			2005		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	2,0	-3,9	5,1	1,4	1,4	32,2
Portfolio investment	3,0	22,7	44,9	7,8	25,3	7,3
Other investment	-2,9	3,8	10,9	22,3	-2,4	1,9
Change in assets						
Direct investment	-0,4	1,2	-8,8	-0,6	3,2	-1,7
Portfolio investment	-1,3	-3,2	-6,0	2,3	-1,5	-3,2
Other investment	1,6	4,1	-2,1	-6,3	0,7	-26,4
Total financial transactions*	**21,4**	**27,9**	**84,6**	**16,5**	**35,4**	**26,6**

* Including unrecorded transactions

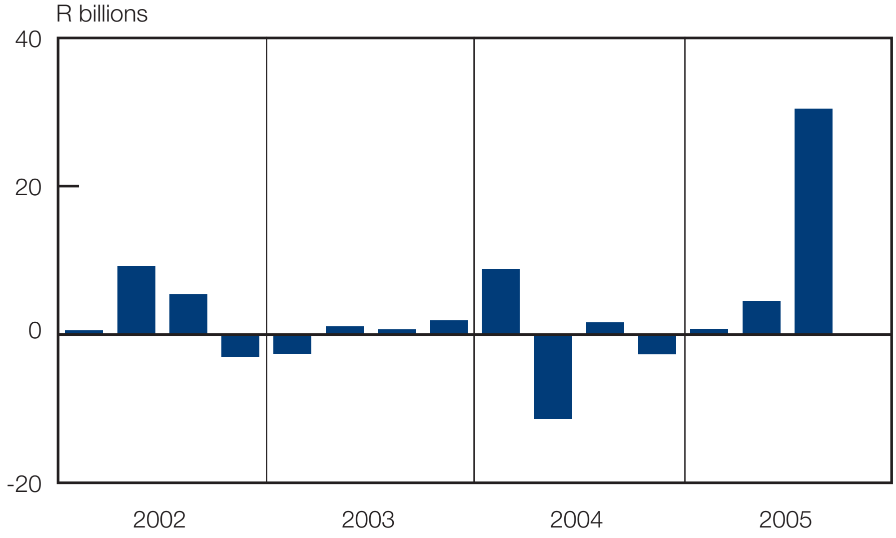
In the 2005 *Medium Term Budget Policy Statement* (MTBPS), the Minister of Finance took the government's commitment to the gradual liberalisation of exchange controls a step further, mindful of the need for continued macroeconomic stability and sound financial regulation when liberalising. The Minister announced that South African banks would in future be allowed to hold foreign assets up to an amount equal to 40 per cent of their domestic regulatory capital, as part of the shift from exchange controls to the prudential regulation of banks' foreign exposures. Non-African foreign assets would be restricted to 20 per cent, while African assets could constitute up to the entire 40 per cent. Furthermore, the foreign exposure limit on collective investment schemes was increased from 20 per cent to 25 per cent of total retail assets, and for investment managers from 15 per cent to 25 per cent of total retail assets.

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded an inflow of R32,2 billion in the third quarter of 2005 compared with an inflow of R1,4 billion in the second quarter. The significant increase in the third quarter was mainly due to an international banking group, based in the United Kingdom, having acquired a controlling interest in a major South African bank, but also included the increased shareholding by a non-resident investor in a domestic telecommunications company.

Foreign portfolio investors increased their holdings of South African equity but decreased their holdings of South African fixed-interest securities in the third quarter of 2005. Foreign investment in fixed-interest securities declined despite an international euro-denominated bond issue by a South African telecommunications company. On balance, a net inflow of portfolio capital amounting to R7,3 billion was recorded in the third quarter of 2005, significantly less than the R25,3 billion recorded in the second quarter.

Net foreign direct investment



Other investment flows into South Africa recorded R1,9 billion in the third quarter of 2005 compared with an outflow of R2,4 billion in the second quarter. The small inflow in the third quarter was mainly due to an increase in the rand-denominated deposits of non-residents with South African banks, although it was partly countered by a reduction in the other short-term liabilities of the private banking sector.

South African-owned assets abroad

Outward direct investment resulted in an outflow of R1,7 billion in the third quarter of 2005 compared with an inflow (i.e. a reduction in direct investment assets) of R3,2 billion recorded in the second quarter. The outflow of capital in the third quarter was due to a number of South African companies which made offshore acquisitions, mostly in Africa. In total, South African companies reduced their foreign direct investment assets by R0,9 billion in the first nine months of 2005.

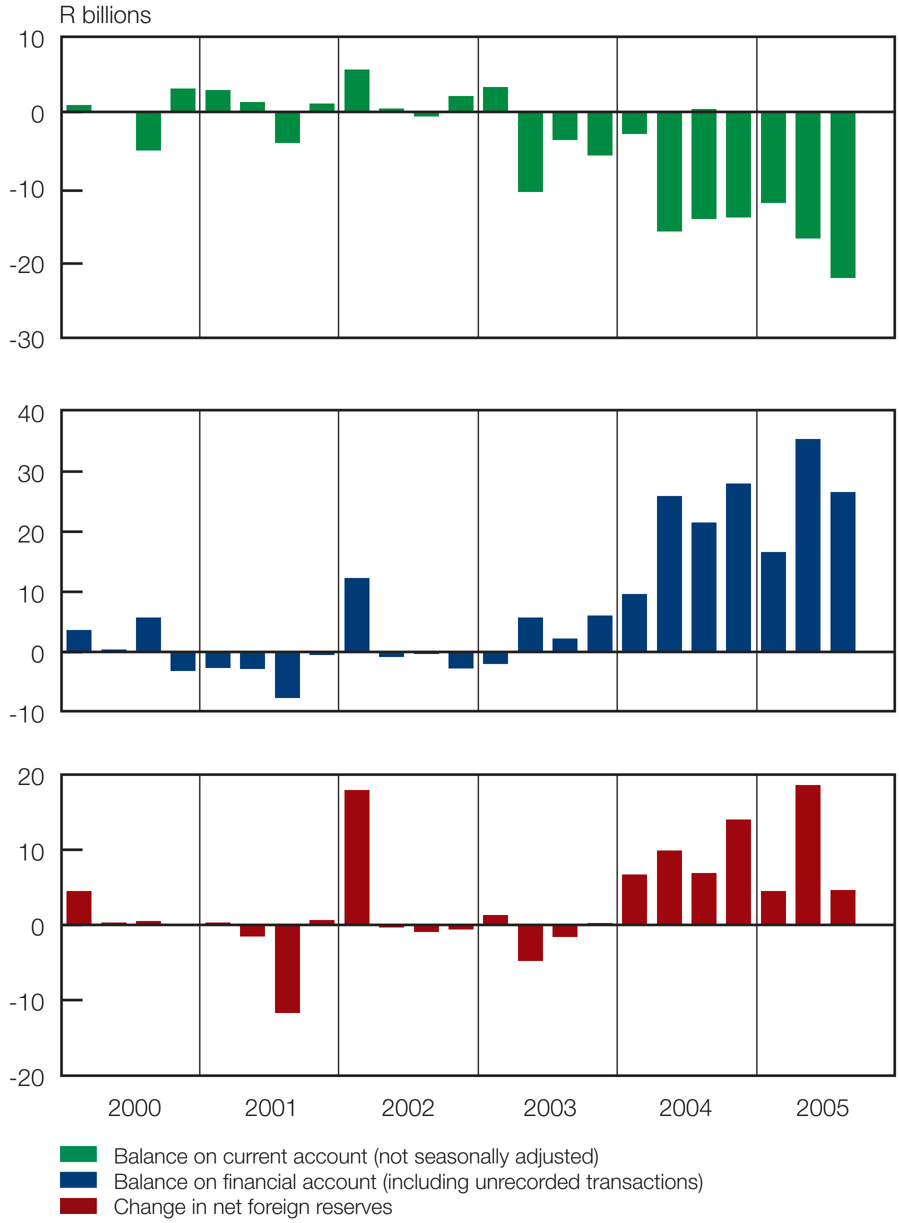
Portfolio investment by South African entities abroad recorded an outflow of R3,2 billion in the third quarter of 2005, higher than the outflow of R1,5 billion registered in the second quarter. South African institutional investors now face less onerous controls when acquiring foreign portfolio assets.

Other outward investment from South Africa amounted to R26,4 billion in the third quarter of 2005 compared with an inflow of R0,7 billion in the second quarter. The change in this category was largely due to an increase in the foreign-currency assets of the South African private banking sector in the third quarter, as it digested, among other things, the inflow of foreign currency arising from the inward foreign direct investment transactions referred to earlier.

International reserves and liquidity

As a result of the further sizeable net inflow of capital, which substantially outweighed the larger deficit on the current account, South Africa’s overall balance of payments recorded a surplus of R4,6 billion in the third quarter of 2005, considerably less than the increase of R18,6 billion recorded in the second quarter. The net international reserves rose by a total of R27,7 billion in the first three quarters of 2005, slightly more than the build-up of R23,5 billion in the corresponding period of the preceding year.

Balance of payments: Overall balance



Measured in US dollars, the value of the gross gold and other foreign reserves of the Bank increased from US$18,7 billion at the end of June 2005 to US$19,5 billion at the end of September 2005 and marginally further to US$19,7 billion at the end of October. The gold holdings, which had constituted about 9,6 per cent of foreign reserves at the end of May 2005, remained broadly unchanged at the end of October. At the end of September 2005, the gross international reserves of the Bank were equal to the value of imports of goods and services for a period of 12½ weeks.

The international liquidity position improved from US$15,2 billion at the end of June 2005 to US$16,1 billion at the end of September, edging higher to US$16,2 billion at the end of October.

Foreign debt

South Africa's total outstanding foreign debt, which had risen in the first quarter of 2005, contracted by US$0,4 billion to a level of US$46,1 billion at the end of June 2005. This decrease can be attributed to a decline in foreign-currency denominated debt. The decline in the country's foreign-currency denominated debt in the second quarter of 2005 was mainly due to the redemption of a €500 million bearer bond by a public corporation. This outflow of capital was, however, partly offset by international issues of private-sector bonds over the same period. The dollar equivalent of rand-denominated debt increased marginally as the increase in domestic bond holdings by non-residents outweighed the reduction in non-residents' rand-denominated deposits with South African banks.

Owing to the depreciation of the rand against the dollar in the second quarter of 2005, the rand value of total external debt rose by 6,1 per cent from R290 billion at the end of March to R308 billion at the end of June 2005.

Foreign debt of South Africa

US$ billions at end of period

Period	2003	2004	2005	
			1st qr	2nd qr
Foreign-currency denominated debt...	**27,3**	**27,9**	**28,8**	**28,3**
Bearer bonds.......................................	9,6	9,7	9,4	9,1
Public sector	4,9	4,9	4,6	4,5
Monetary sector*	5,9	7,0	8,1	8,1
Non-monetary private sector	6,9	6,3	6,7	6,6
Rand-denominated debt	**10,8**	**15,4**	**17,7**	**17,8**
Bonds..	4,2	5,5	6,1	7,3
Other	6,6	9,9	11,6	10,5
Total foreign debt................................	**38,1**	**43,3**	**46,5**	**46,1**

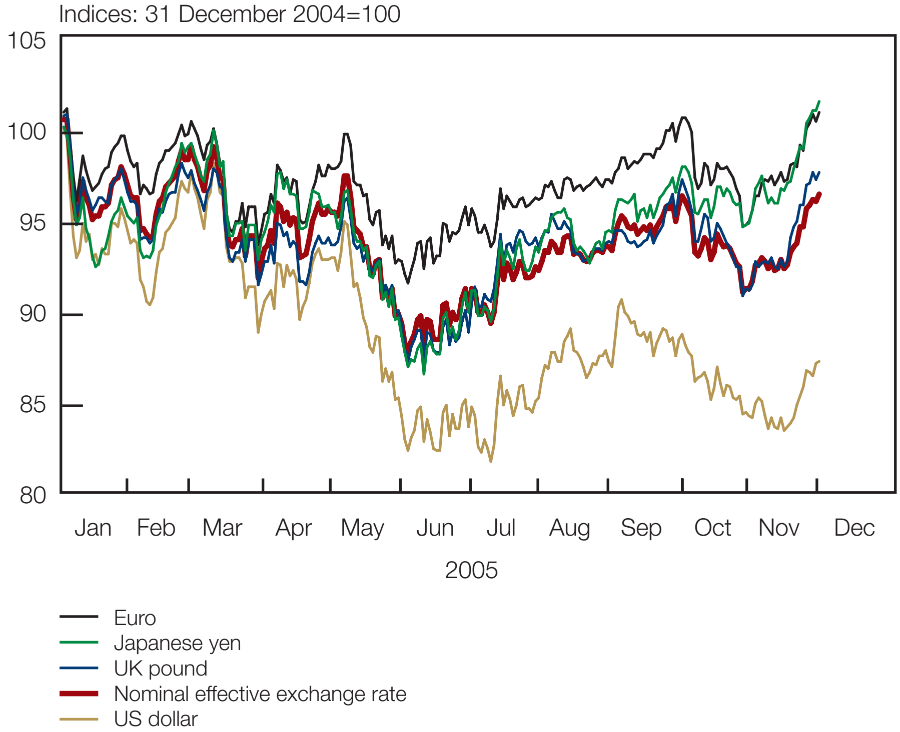
* Including the monetary authorities and the private banking sector

Exchange rates

The nominal effective exchange rate of the rand, on balance, moved downwards to a low point on 2 June 2005 – more than 12 per cent down from its relatively high base level at the end of 2004. Over the subsequent four months to the end of September 2005 the nominal effective exchange rate trended upwards, and, on balance, strengthened by almost 10 per cent. Factors contributing to this renewed strengthening of the rand included the sizeable inflow of direct investment capital, strong non-resident investor interest in South African shares as share prices rose briskly, and an upgrade in South Africa's sovereign debt rating from BBB to BBB+ by both Standard and Poor's and Fitch Ratings.

In October and November 2005 the nominal effective exchange rate of the rand, on balance, increased marginally by 0,1 per cent. As shown in the accompanying graph, the rand depreciated considerably more against the US dollar than against the other major currencies in the course of the first eleven months of 2005; against the dollar the rand depreciated by 13 per cent. This depreciation was largely a reflection of the strength displayed by the US dollar against virtually all currencies, as interest rates in the United States rose steadily and investor sentiment shifted in favour of American assets.

Daily exchange rates of the rand



The real effective exchange rate of the rand declined by 3,4 per cent from December 2004, when it was relatively strong, to September 2005. Indicating changes in the international competitiveness of the South African manufacturing industry, the real effective exchange rate has in fact moved sideways since August 2004 with little variability, apart from outliers in December 2004 and June 2005.

The average daily net turnover in the domestic market for foreign exchange inched lower to an average of US$13,7 billion in the second quarter of 2005, increasing marginally to US$13,8 billion in the third quarter. The value of transactions in which non-residents participated increased from US$10,0 billion to US$10,2 billion per day over the same period.

Monetary developments, interest rates and financial markets

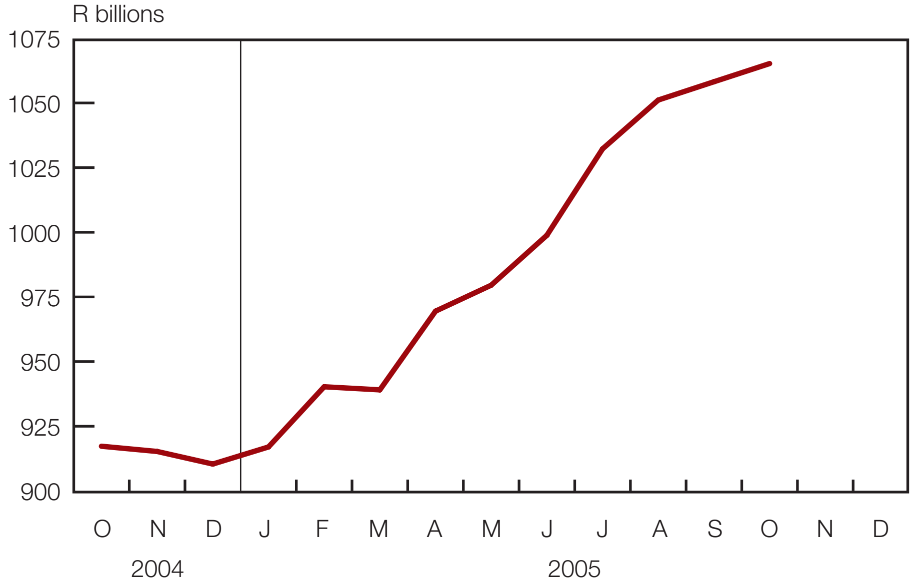
Money supply [5]

Robust domestic economic activity, higher inflation, the absorption of funds arising from foreign direct investment transactions, and continued increases in asset values supported by strong business and consumer confidence were reflected in strong growth in the broadly defined money supply (M3) during the third quarter of 2005.

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

Annualised quarter-to-quarter growth in M3 accelerated from 21,0 per cent in the second quarter of 2005 to 29,3 per cent in third quarter. However, M3 growth measured over twelve-month periods decelerated from a recent high of 19,9 per cent in July 2005 to 19,0 per cent in August and to 16,4 per cent in October. An exceptionally strong increase in M3 deposits was recorded in July when residents deposited in bank accounts the funds received from a non-resident institution in payment for their shareholding in a South African bank. Conversely, in September brisk increases in government deposits on account of continued strong tax revenue collection dampened growth in M3 deposits with banks.

M3 money supply



Seasonally adjusted

Growth in the narrower monetary aggregates broadly resembled the buoyancy of M3 in the second and third quarters of 2005, as shown in the table on the following page.

Analysed by maturity, the increase in M3 deposits in the third quarter of 2005 was mainly in deposits with maturities of less than 32 days, signalling strong liquidity preference. Both household and corporate sector M3 deposits increased during the third quarter of 2005. The corporate sector's deposit holding accounted for 80 per cent of the overall increase, and that of the household sector for the remaining 20 per cent. Within the corporate sector, financial institutions were responsible for the bulk of the increase in M3.

Annualised quarter-to-quarter growth in M3 exceeded growth in nominal gross domestic product by 11,8 percentage points in the third quarter of 2005. The income velocity of circulation of M3 accordingly declined from 1,53 in the second quarter of 2005 to 1,49 in the third quarter – the lowest value ever recorded.

Growth from quarter to quarter in monetary aggregates
Per cent at seasonally adjusted annualised rates

	2005	
	2nd qr	3rd qr
M1A	36,7	26,8
M1	32,3	36,9
M2	21,0	29,8
M3	21,0	29,3

The statistical counterparts to the changes in M3 are shown in the accompanying table, indicating that the increase in M3 during the third quarter of 2005 could be statistically explained by increases in claims on the private sector and net foreign assets. These increases were counteracted to some extent by the decline in net other assets.

Counterparts of change in M3
R billions

	2005			
	2nd qr		3rd qr	
Net foreign assets		14,2		34,8
Net claims on the government sector		-4,0		-9,9
Gross claims	8,6		2,0	
Government deposits (decrease +; increase -)	-12,6		-11,9	
Claims on the private sector		45,8		61,0
Investments and bills discounted	1,8		15,1	
Total loans and advances	44,0		46,0	
Net other assets		-2,8		-38,5
Total change in M3		53,2		47,4

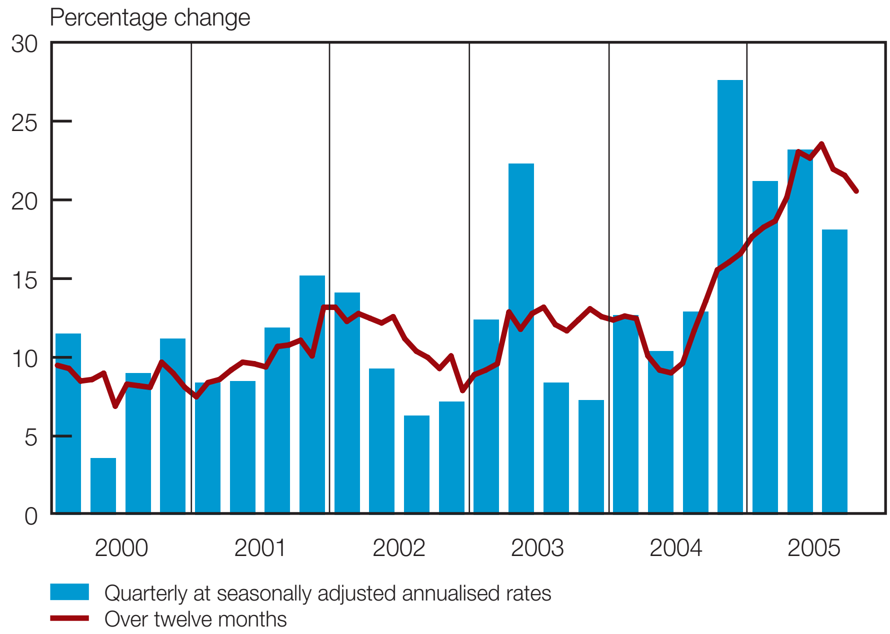
The increase in net foreign assets of the monetary sector during the second and third quarter of 2005 was a reflection of an increase in the foreign assets of both the Bank and the private banks. The increase in the Bank's foreign assets arose from ordinary market operations as well as foreign exchange purchases arising from a large foreign direct investment transaction.

Credit extension

Favourable lending and borrowing conditions, strong business and consumer confidence, and positive wealth effects associated with sustained increases in real-estate prices continued to support growth in bank credit extension to the private sector during the first ten months of 2005. However, the securitisation by one of the reporting banks of assets in its instalment sale and leasing book to the value of R3,0 billion in September 2005, and in its residential mortgage advances book to the value of R4,5 billion in

October 2005, resulted in a technical slowdown in growth in the respective credit categories. (The impact of securitisation transactions on the credit aggregates is explored further in a note published elsewhere in this *Quarterly Bulletin.*)

Total loans and advances to the private sector



The quarter-to-quarter seasonally adjusted growth in the total loans and advances by banks to the private sector decelerated from 23,2 per cent in the second quarter of 2005 to a still high rate of 18,2 per cent in the third quarter. Measured over twelve months, growth in the total loans and advances by banks decelerated from 23,5 per cent in July 2005 to 20,5 per cent in October as the household debt-to-income ratio reached new highs. Non-performing loans remained at low levels.

The brisk growth in total loans and advances continued to receive its strongest impetus from mortgage advances, which accounted for three quarters of the overall increase in total loans and advances in the third quarter of 2005.

Twelve-month growth in *mortgage advances* has remained above 24 per cent since December 2004, and reached 28,0 per cent in October 2005. The increase in mortgage advances emanated mainly from the strong demand for housing loans by individuals, consistent with buoyant activity and rising prices in the real-estate market, which supported and was at the same time supported by favourable lending and borrowing conditions.

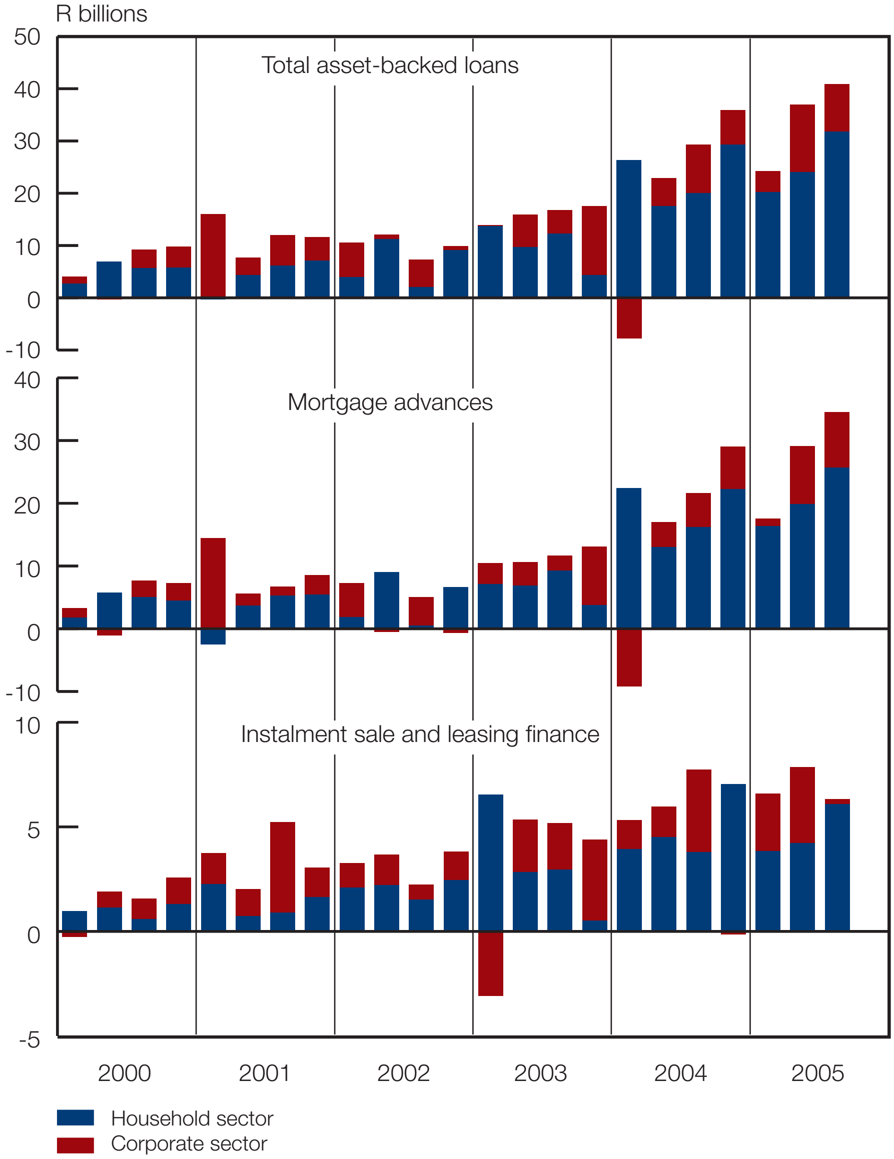
Growth over twelve months in *instalment sale credit and leasing finance*, which is directed at financing expenditure on motor vehicles and other durable goods, decelerated from 21,0 per cent in July 2005 to 19,0 per cent in September on account of the securitisation transaction mentioned earlier, and 18,4 per cent in October. Nevertheless, growth in instalment sale credit and leasing finance remained strong, supported by rising income, the lower level of interest rates and attractive vehicle-finance packages offered by banks.

Credit aggregates

Component	Quarterly changes R billions		Percentage contribution to change in total loans and advances	
	2005		2005	
	2nd qr	3rd qr	2nd qr	3rd qr
Asset-backed credit	37,0	40,8	84,1	88,9
Instalment sale credit and leasing finance	7,9	6,3	18,0	13,7
Mortgage advances	29,1	34,5	66,1	75,2
Housing loans – Individuals	19,2	25,3	43,6	55,1
– Companies	1,8	4,2	4,1	9,2
Other mortgage advances*	8,1	5,0	18,4	10,9
Other loans and advances	7,0	5,1	15,9	11,1
Total loans and advances	44,0	45,9	100,0	100,0

* Other is the summation of farm mortgages, commercial and other mortgage advances

Contributions to quarterly changes in asset-backed credit



Twelve-month growth in *other loans and advances* decelerated from 19,3 per cent in July 2005 to 14,2 per cent in August and to 12,3 per cent in October. This slowdown partly reflected the corporate sector's increased use of non-bank sources of funding such as the issuance of corporate bonds and commercial paper.

The household sector accounted for a significant increase in total outstanding bank loans and advances during the third quarter of 2005. This sector's use of credit rose by R35,6 billion, whereas the corporate sector's use increased by only R10,3 billion.

Interest rates and yields

Following a 50-basis-point reduction in the repurchase rate on 14 April 2005, the Monetary Policy Committee (MPC) of the Bank left the repurchase rate unchanged at 7 per cent at successive meetings until October 2005. The October MPC statement discussing the developments underlying the decision at that time is reproduced in full elsewhere in this Bulletin.

With the repurchase rate unchanged at 7 per cent, the private-sector banks have kept their prime overdraft rate and predominant rate on mortgage loans unchanged at 10½ per cent since April 2005.

The South African Overnight Interbank Average (SAONIA) rate fluctuated around a broadly horizontal trend, recording an average level of 6,54 per cent during the period from the beginning of July to the end of November 2005, compared with an average level of 6,60 per cent from April to June 2005. The rate amounted to 6,66 per cent on 30 November 2005.

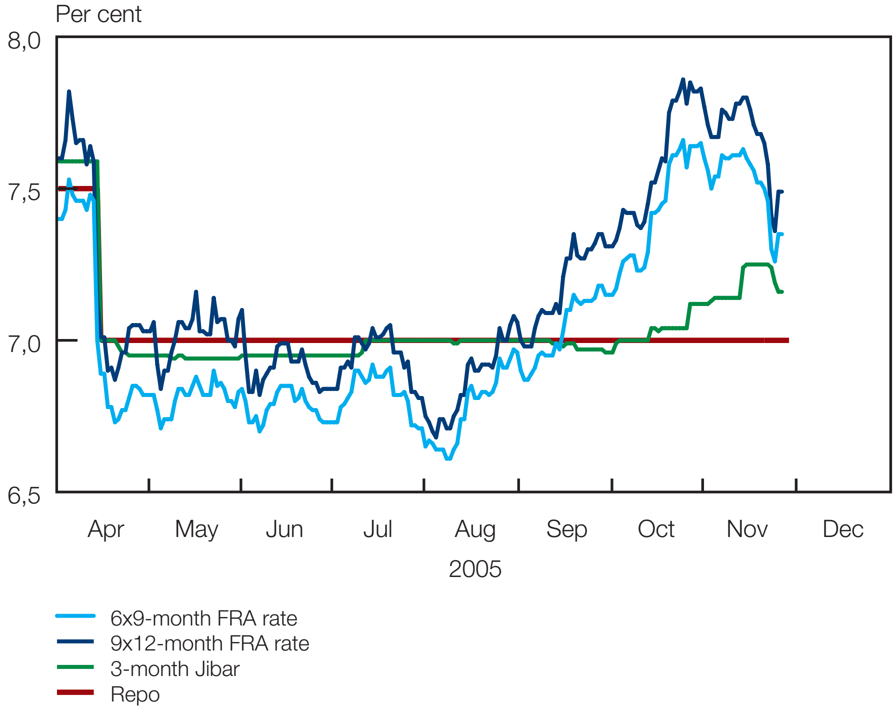
Movements in other money-market interest rates remained fairly muted during the period under review. The three-month Johannesburg Interbank Agreed Rate (Jibar), for instance, increased by 30 basis points from 6,95 per cent to 7,25 per cent between 1 July 2005 and 22 November 2005. The Jibar amounted to 7,16 per cent on 30 November 2005.

The tender rate on 91-day Treasury bills also exhibited little variation, declining by 4 basis points from the end of June 2005 to the end of August 2005, following the National Treasury's reduction of the Treasury bill amount on offer by R0,5 billion to R2,2 billion on 5 August 2005. The rate then retraced and increased to 6,79 per cent by the end of September 2005 and further to 6,89 per cent on 25 November 2005. A similar trend was observed for the181-day and 273-day Treasury bill tender rates.

Expectations of future interest rate reductions waned from mid-August 2005, as suggested by the rates on forward rate agreements (FRAs) shown in the graph on the following page. During September the rates on FRAs rose above the Jibar as inflation and inflation expectations deteriorated. By 17 October 2005, the rate on 6x9-month FRAs stood at 43 basis points above the three-month Jibar, signalling strong expectations of monetary policy tightening. These expectations softened considerably towards late November as the market received an improvement in the outlook for inflation.

Following a reduction of 20 basis points in May 2005, the *predominant rate on twelve-month fixed deposits* of the private-sector banks remained unchanged at 6,2 per cent to October, before increasing to 6,5 per cent in November.

Money-market rates



The *interest rates on government retail bonds* were maintained at their respective levels from February 2005 to November due to the relatively flat trajectory of yields on conventional bonds. The prevailing interest rates on the 2-year, 3-year and 5-year bonds are priced off the yield curve and are changed by the National Treasury when the yields on equivalent traded government bonds move either negatively or positively by more than 50 basis points. Since inception in May 2004 the rates on these bonds were lowered by 100 basis points in September 2004 and by 75 basis points in January 2005.

The *daily average yield* on the long-term R157 government bond (maturing in 2015) recorded a recent high of 8,77 per cent on 5 April 2005, but declined after the lowering of the repurchase rate on 14 April. The long-term bond yield declined to a low of 7,72 per cent on 5 August alongside subdued consumer and production price inflation; the announcement of a sovereign credit rating upgrade for South Africa by two rating agencies in August; and the appreciation of the exchange value of the rand from July 2005.

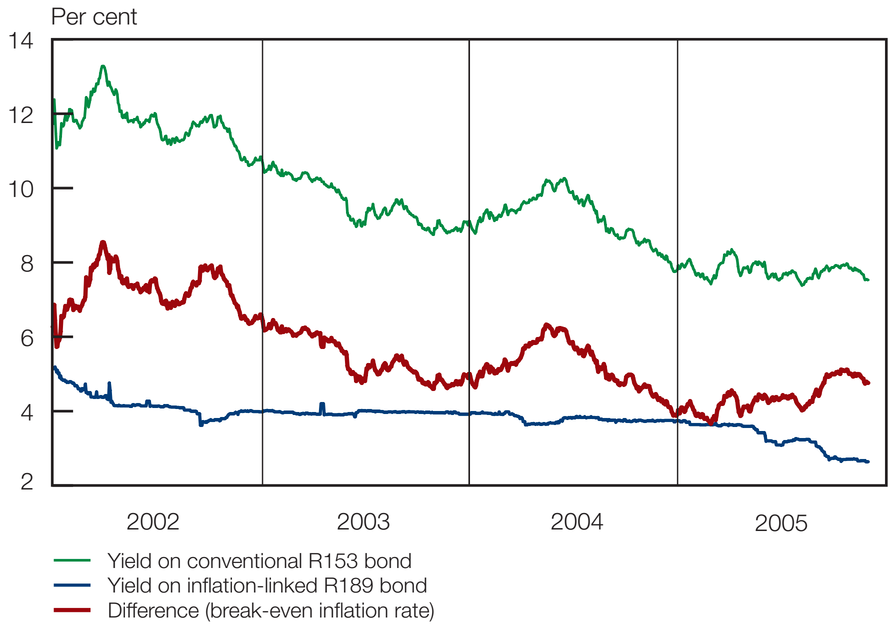
Bond yields again rose substantially from late August 2005 as crude oil prices surged and worse-than-expected data on domestic inflation, money supply and credit extension were released. Bond yields continued to trend higher during September and reached a high of 8,24 per cent on 25 October as the high price of oil persisted and the exchange value of the rand weakened. At the same time the strength of the equity market served to reduce the attractiveness of investment in bonds. The upward bias in domestic bond yields coincided with an upward movement in international bond yields. Bond yields in the major international markets generally started to increase from early September 2005, alongside growing concerns of the impact of high oil prices on global inflation. The yield on the R157 bond again declined from the end of October following projections of lower-than-previously-anticipated government bond supply in the coming fiscal years, announced in October in the *Medium Term Budget Policy Statement* (MTBPS), and the release of lower-than-expected inflation data for September and October. On 30 November the bond yield came to 7,76 per cent.

The *real yield* on long-term government bonds (adjusted for inflation using historical year-on-year increases in CPIX) declined from a recent high of 5,8 per cent in August 2004 to 3,9 per cent in December and then remained relatively steady at levels of around 4,5 per cent in the first six months of 2005. The real yield declined to 3,0 per cent in August due to moderately higher inflation and rather flat bond yields before increasing to 3,6 per cent in October.

From a recent low on 4 August 2005 the level of the *yield curve* drifted higher and steepened at the short end following the unchanged monetary policy stance at the August and October MPC meetings. The level of the yield curve rose as expectations of further interest rate cuts faded amid heightened volatility in global oil prices and a weakening in the inflation outlook. The worsening of the inflation outlook was reflected by the widening of the yield gap between the extreme long and short ends of the curve, which increased to 89 basis points on 24 October, from 23 basis points on 4 August 2005. Subsequently, a moderation of inflation fears resulted in a narrowing of the yield gap to 26 basis points at the end of November.

A general rising trend in the yields on conventional bonds and a progressive decline in the real yield on inflation-linked government bonds resulted in an upward trajectory in the *break-even inflation rate* during 2005. Yields on inflation-linked bonds recorded pronounced declines from May 2005, along with concerns regarding a pick-up in inflation. The daily average yield on the R189 bond, for example, reached 2,64 per cent at the end of November 2005 – a substantial decline from 3,74 per cent recorded at the end of December 2004. Accordingly, the break-even inflation rate in the five-to-eight-year maturity range increased from an all-time low of 3,7 per cent on 28 February 2005 to a recent high of 5,1 per cent on 13 October before declining to 4,8 per cent at the end of November.

Bond yields



The *sovereign risk premium* on South Africa's foreign-currency denominated bonds shrank considerably from May 2004 to October 2005. The yield differential on the ten-year US dollar-denominated government bond, issued at the end of May 2004, more than halved as it declined from an original differential of 195 basis points above United States federal government securities of similar maturity, to an average differential of 81 basis points in September 2005 and 85 basis points in October. This followed an improvement in South Africa's international credit ratings announced by various agencies in October 2004 and again in January and August 2005. The decline coincided with a decline to record low levels of the yield spreads of emerging markets' sovereign debt over benchmark United States Treasury Bonds (measured by the JP Morgan Emerging Markets Bond Index or EMBI+). Various emerging-market countries benefited from improvements in global growth and better country credit ratings by international rating agencies. Emerging-market yield spreads widened moderately in October and November 2005.

The *currency risk premium* on South African government bonds (measured as the differential between South African government bond yields on rand-denominated debt in the ten-to-twelve year maturity range issued in the domestic market and dollar-denominated debt issued in the US market) widened from a recent low of 205 basis points in February 2005 to 280 basis points in August due to rising bond yields in the domestic market. Since then the risk premium has narrowed to 220 basis points in November due to a rise in yields on foreign-issued South African bonds and a decline in bond yields in the domestic market.

Money market

From July to November 2005, the amount of liquidity provided at the weekly main refinancing auction fluctuated between R10,6 billion and R13,3 billion. At the end of November the amount of liquidity provided rose to R12,3 billion, its increase not fully reflecting the seasonally higher level of notes in circulation. Standing facilities and cash reserve accounts continued to be utilised in order to square off the banks' end-of-day positions.

The main factors impacting on money-market liquidity from July to November 2005 are summarised in the accompanying table.

Money-market liquidity flows

R billions (easing +, tightening -)

	Jul – Sep 2005	Oct – Nov 2005
Notes and coin in circulation	-1,4	-3,5
Required cash reserve deposits	-0,5	-0,3
Money-market effect of Bank's foreign exchange transactions	4,2	3,3
Government deposits	-2,6	-2,1
Use of liquidity management instruments*	3,9	5,0
Government redemption and interest payments to Bank	-0,4	0,0
Other items net	2,8	-3,1
Banks' liquidity requirement (decrease +; increase -)	0,4	-0,7

* South African Reserve Bank debentures and reverse repurchase transactions

Gradual foreign exchange purchases from the market raised the Bank's foreign exchange reserves by US$0,6 billion from the end of September to the end of November 2005. These transactions expanded money-market liquidity by R4,4 billion.

The total amount of liquidity absorbed from the money market through the use of interest-bearing liquidity-draining instruments declined from R17,7 billion at the end of the second quarter of 2005 to R13,8 billion at the end of the third quarter and R8,8 billion at the end of November 2005, as reflected in the table on the following page. The use of both SARB debentures and long-term reverse repurchase transactions was curtailed, with the latter action resulting in an increase in the amount of unutilised government securities in the monetary policy portfolio of the Bank.

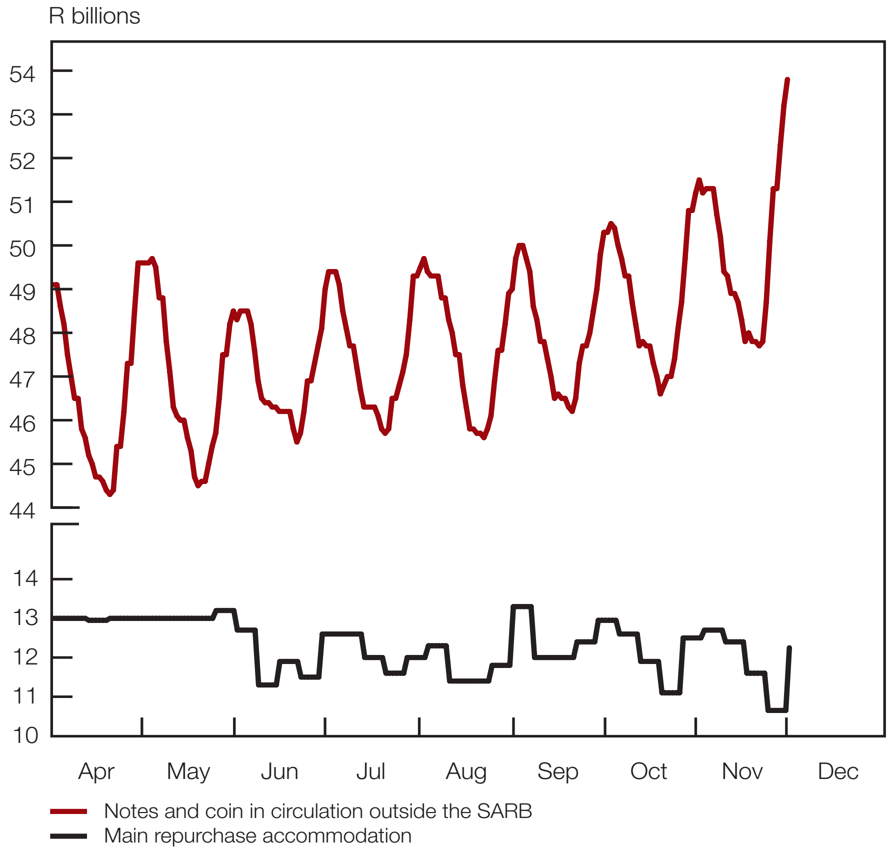
Outstanding balances of selected money-market intervention instruments

R billions

End of		South African Reserve Bank debentures	Reverse repurchase agreements	Total instruments outstanding
2004:	Dec	11,9	7,6	19,5
2005:	Jan	13,2	11,2	24,4
	Feb	12,5	7,0	19,5
	Mar	13,0	7,2	20,2
	Apr	12,9	7,1	20,0
	May	11,2	6,6	17,8
	Jun	11,1	6,6	17,7
	Jul	10,2	7,2	17,4
	Aug	8,2	6,3	14,5
	Sep	8,2	5,6	13,8
	Oct	5,9	5,6	11,5
	Nov	5,9	2,9	8,8

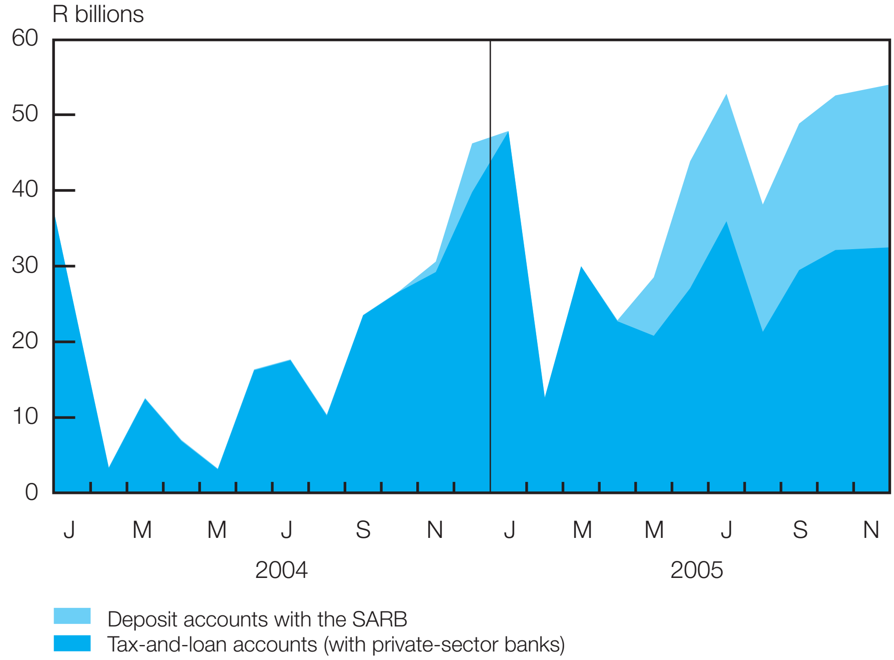
One of the factors which allowed the Bank to reduce its use of liquidity-draining instruments was the increase in the stock of notes and coin in circulation outside the Bank. On balance, notes and coin in circulation tightened liquidity in the money market by R1,4 billion in the third quarter of 2005 and by an additional R3,5 billion in October and November.

Currency in circulation and main repurchase accommodation



By the end of August 2005, a total of R12 billion in coupon interest payments on government bonds were made, including an amount of R0,4 billion on government bonds held in the Bank's monetary policy portfolio. During September a further payment of R4 billion in interest on government bonds was made. Government deposits in the tax-and-loan accounts with the private-sector banks, while fluctuating considerably, generally remained at high levels in 2005 to date, and came to R32,5 billion at the end of November 2005. At that time a further R21,5 billion was held on deposit with the SARB.

Central government deposits



Bond market

After amounting to R40,8 billion in fiscal 2004/05 as a whole, total net issues of fixed-interest securities by *public-sector borrowers* in the domestic primary bond market came to R18,2 billion and R12,8 billion in the second and third quarters of 2005, respectively. The National Treasury in addition raised R0,3 billion through the government retail bonds from April 2005 to October, somewhat less than the R0,9 billion raised in the corresponding period of fiscal 2004/05. In the October 2005 MTBPS it was indicated that government's domestic bond issuance programme would remain mostly unchanged for the remainder of fiscal 2005/06. The net issuance of government bonds in fiscal 2007/08 was expected to be more than R30 billion less than previously estimated due to revenue outperforming budget expectations, and is projected to be some R26 billion less in 2008/09.

With revenue exceeding the budgetary provisions, this helped the National Treasury to cut back on its net issuance of *foreign-currency denominated debt* to below the originally budgeted amount for fiscal 2005/06. Private-sector borrowers raised R8,9 billion through their first entries into the high-yield international bond market in June and July 2005, but refrained from any further foreign issues up to October.

As from 1 November 2005 the National Treasury embarked on a programme to split the three-legged R194 bond into three separate bullet bonds, similar to that previously offered on the R150 bond. The new bonds will consist of the R007 bond (maturing on 28 February 2007), the R195 bond (maturing on 28 February 2008) and the R196 bond (maturing on 28 February 2009). As in the original bond the coupon rate on all three bonds will be 10 per cent. The split facility offered on the R194 bond will be an optional choice available to investors and will remain available until 28 February 2007, which is the first maturity date. From the beginning of October 2005 the National Treasury changed the auction system for new issues of inflation-linked government bonds from a multiple-price to a single-price system – the same as the system used for nominal-yield bonds.

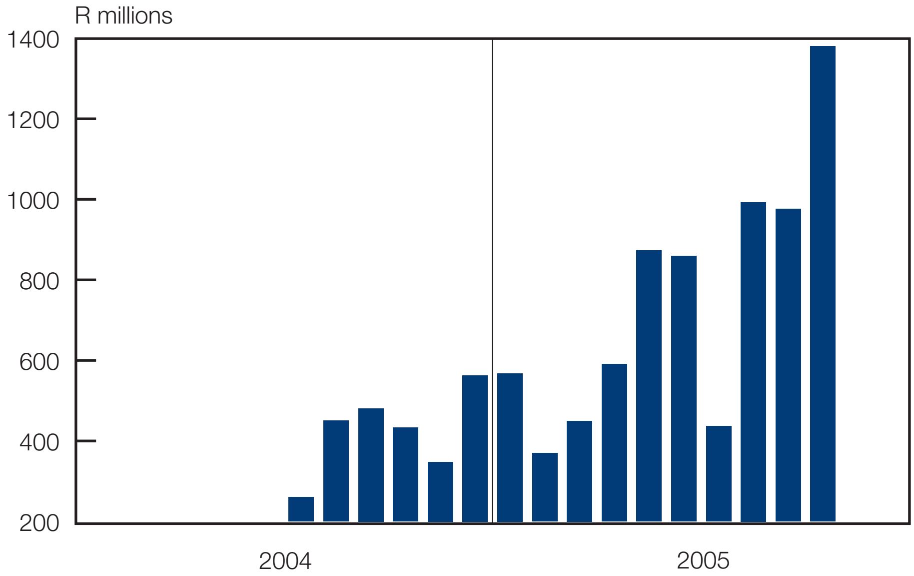
The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (BESA) increased by R29,3 billion from R77,7 billion in December 2004 to R107,0 billion in October 2005. Such listings increased by an all-time quarterly high of R12,0 billion in the third quarter of 2005 and by a further R10,6 billion in October. Bond issues in October included, among other things, an issue of asset-backed notes secured by the home loans of a bank and an issue of subordinated unsecured secondary capital callable bonds by a major insurance company to enhance its regulatory capital ratios and diversify its funding sources in an environment of low interest rates.

The financing needs of the private sector were furthermore supplemented by the issuance of short-term *commercial paper*. The value of commercial paper listed on BESA increased by R9,5 billion in the first ten months of 2005 to reach R25,2 billion in October. From its inception in April 2005 up to October, the electronic settlement of *non-listed* commercial paper on BESA comprised 312 trades to the value of R6,0 billion.

In the *international bond markets* non-resident issuer interest in rand-denominated bonds rebounded. New issues exceeded redemptions by R5,8 billion in the first ten months of 2005 and exceeded the net issuance of R3,1 billion recorded in the whole of 2004. More than half of the 51 issues in the first ten months of 2005 were made by the European Investment Bank (EIB) and Kreditanstalt für Wiederaufbau (KFW). Several new issuers also entered the market.

The issuance of rand-denominated bonds by foreign borrowers in the Japanese Uridashi market also continued to grow during 2005. An Uridashi bond is a foreign-currency bond sold by a non-Japanese issuer to Japanese retail investors and generally offers a

Issuance of rand-denominated bonds in the Uridashi market by non-residents



yield that is more attractive than the yields offered on similar bonds issued in Japanese yen. Rand-denominated bonds were first issued in the Uridashi market in July 2004 and total issues for that year amounted to R2,5 billion. In the first ten months of 2005 the nominal value of rand-denominated bonds issued by non-residents in the Uridashi market amounted to R7,5 billion, with the World Bank being the most prominent issuer.

Trading activity in the *domestic secondary bond market* continued at a steady pace in 2005. Turnover on BESA of R9,2 trillion in the first eleven months of 2005 was around 3 per cent higher than in the corresponding period of 2004, and benefited from the lowering of the repurchase rate in April 2005 and somewhat higher levels of non-resident activity. *Non-resident participation* in trading on BESA, measured as the sum of their purchases and sales as a percentage of total purchases and sales of bonds, averaged around 16 per cent in the first eleven months of 2005, compared with an average of 13 per cent in 2004 and 11 per cent in 2003.

Non-residents increased their holdings of South African debt securities by R12,0 billion in the second quarter of 2005 but recorded substantial net sales of R10,6 billion in the third quarter of the year. On a cumulative basis, non-residents' net sales of bonds amounted to R9,4 billion in the eleven months to November 2005. In 2004 non-residents recorded net purchases of bonds to the value of R0,4 billion.

Share market

The total value of equity capital raised in the domestic and international *primary share markets* by companies listed on the JSE Limited (JSE) declined sharply from R28,7 billion in the second quarter of 2004 to only R2,6 billion in the second quarter of 2005, before increasing to R10,9 billion in the third quarter. Equity financing rebounded to a record high of R47,1 billion in October when a dual-listed brewery company acquired complementary international assets. This brought the total amount raised thus far in 2005 to R68,8 billion, exceeding by a substantial margin the amount of R42,1 billion raised in the whole of 2004.

Trading activity in the *secondary* share market remained lively in the first eleven months of 2005. Buoyed by the continued upward trajectory of share prices, turnover on the JSE reached a record high of R351 billion in the third quarter of 2005. For the eleven months to October, turnover amounted to R1,2 trillion, exceeding trade in the corresponding period of 2004 by 24 per cent. The market capitalisation of the JSE reached record levels in 2005. After declining by 7 per cent from February 2005 to April the market capitalisation of all listed shares increased by 32 per cent to an all-time high in November.

Alt^{X}, the alternative exchange of the JSE, concluded its second year of existence in October 2005. From a recent low in April 2005 the market capitalisation of the 16 companies listed on Alt^{X} recorded a three-fold increase to R2,5 billion by the end of September 2005, before declining to R2,3 billion in November.

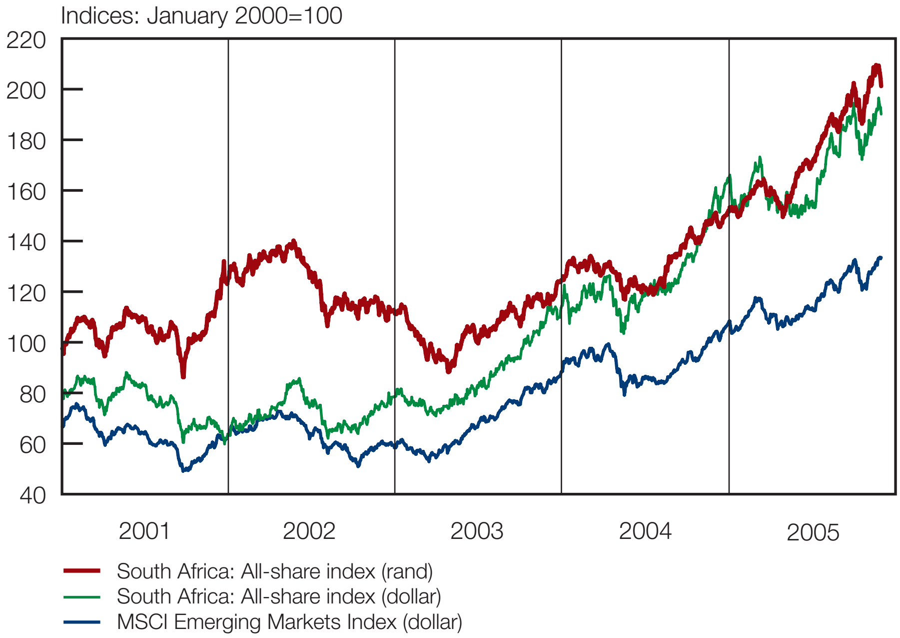
Non-residents maintained their interest in the South African share market in 2005. Net purchases of shares rose from R9,2 billion in the first quarter of 2005 to amounts exceeding R13 billion in both the second and third quarters. From the beginning of 2005 to the end of November, non-residents' cumulative net purchases in the secondary share market amounted to R48,4 billion.

The JSE, in conjunction with a bank, listed two new exchange traded funds (ETFs) on 10 October 2005, which passively track movements in international indices. The two ETFs are listed under the name Itrix on the main board of the JSE and are regarded as collective investment schemes in foreign securities. The ETFs enable South African individuals to invest in baskets of international equities on the JSE without exchange control restrictions, although investment by institutional investors remains subject to exchange controls based on their offshore investment limits. The Itrix FTSE 100 tracks the 100 largest shares in terms of market capitalisation listed on the London Stock Exchange, while the Itrix Dow Jones Euro Stoxx 50 tracks the 50 most liquid blue-chip shares from countries within the euro zone.

Supported by firm domestic growth, low interest rates, higher commodity prices and general optimism in the global equity markets, the *daily closing level of the all-share price index* increased by 35 per cent from 28 April 2005 to a recent high on 30 September. The rebound was led by an increase of 51 per cent in the prices of resources shares while the industrial index increased by 32 per cent and the financial index by 20 per cent over the same period. The daily all-share index subsequently decreased by 8 per cent to 19 October alongside weaker international equity markets and concerns regarding the high price of oil and its impact on global growth and inflation. From 19 October the all-share index rebounded by 12 per cent to a new all-time high on 18 November. The recovery was prompted by improvements in global equity markets associated with lower oil prices, and by positive economic and corporate news which served to reduce inflation concerns. From 18 November to the end of the month the all-share index fell by 4 per cent alongside weaker global equity markets, a strong rand and a decline in commodity prices.

Emerging markets globally have experienced bull market conditions since April 2003 and the movements displayed by South African share prices continued to match developments in these markets. The Morgan Stanley Capital International (MSCI) Emerging Markets Index, which measures the equity market performance in the

Share prices



global emerging markets, increased by 26 per cent from a recent low on 18 April 2005 and reached a high on 4 October. South African share prices, expressed in dollar terms, recorded an increase of similar magnitude over the same period. After falling back from a recent high on 9 March 2005 while the rand generally depreciated, the dollar index of South African share prices rebounded from mid-July to reach a peak on 30 September. Since then both the MSCI Index and the South African all-share index had fallen back to mid-October, before recovering during November. From 19 October to the end of November the MSCI Index improved by 11 per cent, slightly exceeding the increase of 10 per cent in the equivalent South Africa all-share dollar index over the same period.

The *dividend yield* on all classes of shares remained relatively steady around an average of 2,7 per cent in the first eleven months of 2005, despite the rise in share prices.

The *earnings yield* on all classes of shares increased from 6,6 per cent in January 2005 to 7,3 per cent in May, before declining to 6,8 per cent in November. Conversely, the *price-earnings ratio* of all classes of shares increased to 14,8 in November 2005, from a recent low of 13,7 in May 2005.

Market for derivatives

Trading activity on the Financial Derivatives Division of the JSE continued its upward trend in the first ten months of 2005, boosted by the buoyancy in the underlying share market. The total number of *futures and options on futures contracts* traded exceeded 10 million contracts in the fourth quarter of 2004 and increased further to reach consecutive record highs of 11,7 million contracts in the second quarter of 2005 and 13,4 million contracts in the third quarter. Consequently, the cumulative number of contracts traded in the first ten months of 2005 exceeded trade in the corresponding period of 2004 by 32 per cent.

Trade in *warrants* also benefited from the buoyant share-market conditions. The number of warrants traded on the JSE more than doubled from 1,3 billion contracts in the third quarter of 2004 to 3,1 billion contracts in the third quarter of 2005. The cumulative number of trades in the first ten months of 2005 was 77 per cent more than in the corresponding period of 2004. The marked improvement in trade volumes fuelled an increase in new listings during 2005. The number of warrants listed on the JSE stood at 443 in October 2005, from a recent low of 297 in January 2004.

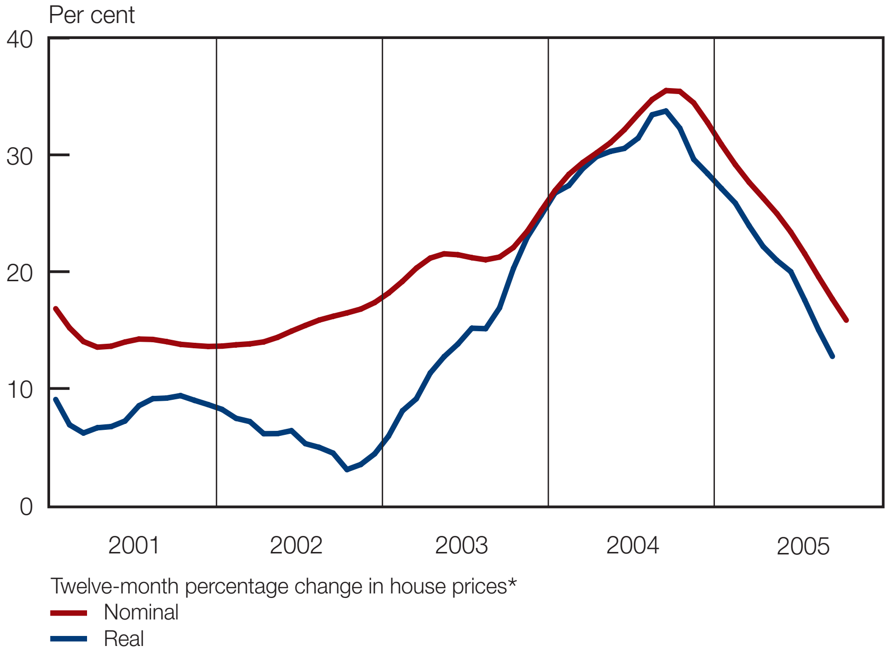
Turnover on Yield-X, the interest rate derivative market of the JSE which commenced trading on 28 February 2005, amounted to R9,4 billion up to the end of October. During the period a total of 219 deals representing 13 065 contracts were concluded.

The number of *commodity futures contracts and options on such contracts* traded on the Agricultural Products Division of the JSE fluctuated somewhat during 2005. Trade declined from 488 000 contracts in the fourth quarter of 2004 to 355 000 contracts in the second quarter of 2005 when an expected bumper crop resulted in sharply lower maize prices. An improvement in maize prices from a monthly average of R533 per ton in March 2005 to R836 per ton in October resulted in trade improving to 421 000 contracts in the third quarter of 2005. The number of commodity derivative contracts traded from January 2005 to October was nonetheless 10 per cent lower than in the corresponding period of 2004.

Real-estate market

Real-estate prices continued rising apace but slowed down in 2005. The year-on-year rate of increase in residential property prices, as measured by Absa, for middle-segment houses of between 80m^2 and 400m^2, priced up to R2,2 million, slowed down from 35,5 per cent in September 2004 to 15,8 per cent in October 2005. The prices of luxury houses, priced between R2,2 million and R8,2 million, recorded an even more pronounced slowdown in growth, decelerating from 22,9 per cent in the second quarter of 2004 to only 4,9 per cent in the third quarter of 2005. In real terms, the twelve-month rate of growth in house prices in the middle segment declined from a high of 33,7 per cent in September 2004 to 12,7 per cent in September 2005. Progressively higher monthly repayments on new mortgage bonds due to rising house prices may partly explain the slowdown in growth in property prices.

House prices



* Source: Absa

Turnover in the real-estate market continued at a brisk pace in 2005. The overall seasonally adjusted value of turnover, measured by *transfer duty collected by the tax authorities*, increased by 54 per cent in 2004 and by 28 per cent in the first ten months of 2005 when compared to the same period of 2004.

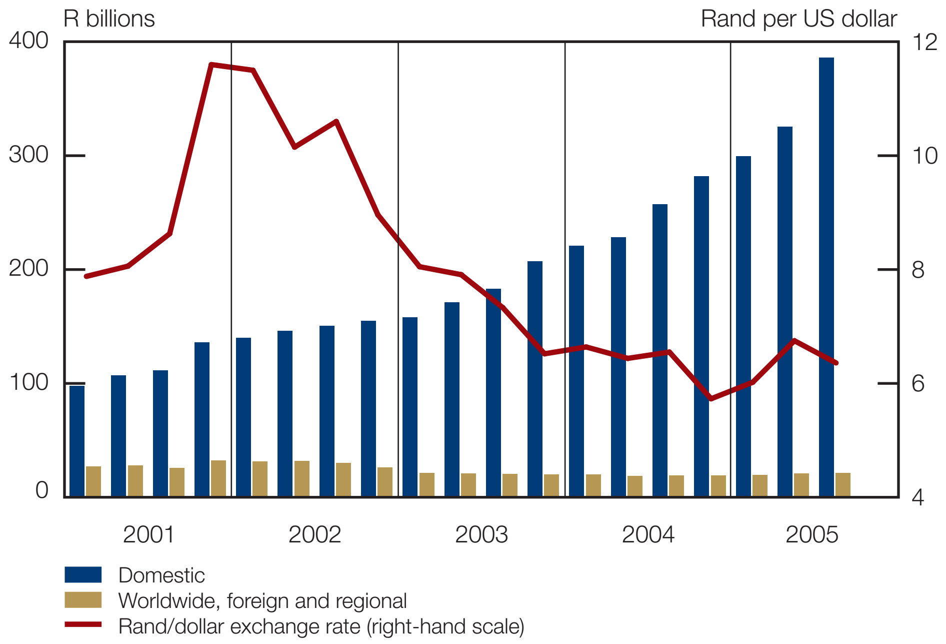
Declining mortgage rates from 2003, together with the brisk growth in property prices, contributed to heightened construction activity in the residential property market. The seasonally adjusted *value of residential buildings completed* increased by 39 per cent from R12,2 billion in 2003 to R17,2 billion in 2004. In the first nine months of 2005 the value of buildings completed amounted to R17,1 billion, an increase of 47 per cent when compared to the same period of 2004.

Non-bank financial intermediaries

In the MTBPS of October 2005 further steps in the liberalisation of exchange controls were announced. Banks are to be allowed to hold non-African foreign assets of up to 20 per cent of their domestic regulatory capital, and African foreign assets of up to 40 per cent. The foreign exposure limit on collective investment schemes (such as unit trusts) was increased from 20 per cent to 25 per cent of total retail assets, while for investment managers the corresponding limit was raised from 15 per cent to 25 per cent of total retail assets.

The unit trust industry experienced rapid growth in recent years while directing its investments mainly towards the domestic market. The market value of the net assets of the unit trust industry increased from R241 billion in the first quarter of 2004 to R386 billion in the third quarter of 2005, representing an increase of 60 per cent. By contrast, the market value of the net assets of worldwide, foreign and regional unit trusts – a subcomponent of the industry with a focus on international markets – decreased from R20 billion in the first quarter of 2004 to R19 billion in the second quarter of 2004, before edging higher to R21 billion in the third quarter of 2005. The continued relative strength of the exchange value of the rand, robust domestic growth and excellent returns on domestic investments, contributed to subdued interest and growth in offshore investments.

Unit trusts: Market value of net assets



Public finance

Non-financial public-sector borrowing requirement

The *borrowing requirement of the non-financial public sector* (calculated as the cash shortfall of the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations) turned around from a cash deficit of R12,3 billion in the July-September quarter of 2004, to a cash *surplus* of R0,8 billion in the July-September quarter of 2005. This reversal can be attributed to improved revenue collection and restrained expenditure at almost all levels of government.

The cash surplus of the non-financial public sector for the first six months of fiscal 2005/06 amounted to R9,6 billion compared with a cash deficit of R21,6 billion in the corresponding period of the previous fiscal year. As a ratio of gross domestic product, the surplus for the first six months of fiscal 2005/06 amounted to 1,3 per cent, compared with the deficit of 3,1 per cent recorded in the corresponding period of the previous fiscal year.

The cash surplus of the *non-financial public enterprises and corporations* increased substantially from R3,8 billion in the first six months of fiscal 2004/05 to R11,7 billion in the same period of the current fiscal year. Over the same period, net investment in non-financial assets by the major non-financial public enterprises remained virtually unchanged.

The fiscal performance of *national government* continued to be characterised by strong growth in tax revenue, with cash receipts from operating activities increasing by 21,3 per cent in the first six months of the current fiscal year when compared to the same period of the previous fiscal year. During the period under review, cash payments for operating activities increased by only 9,9 per cent. The national government net cash flow from operating activities, together with the net investment in non-financial assets, resulted in a cash deficit to the amount of R15,2 billion in the first six months of fiscal 2005/06 compared to a cash deficit of R31,0 billion recorded in the same period of the previous fiscal year.

Provincial governments recorded a cash *surplus* of R0,3 billion in the July-September quarter of 2005, bringing the provincial cash surplus for the first six months of fiscal 2005/06 to R12,0 billion – R3,2 billion more than the surplus recorded in the same period of the previous fiscal year. The recently released *Provincial Budgets and Expenditure Review 2001/02 – 2007/08* estimated a surplus of R1,4 billion for fiscal 2005/06 as a whole. The main source of provincial governments' cash receipts remained grants received from national government.

Regarding the bank balances of provincial governments, their deposits with the private-sector banks declined from R12,7 billion at the end of March 2005 to R9,6 billion at the end of September 2005. Their overall indebtedness to banks also declined from R3,9 billion to R1,3 billion between these dates. However, their deposits with the Corporation for Public Deposits (CPD) strengthened significantly from virtually nil to R9,3 billion over the same period.

Preliminary data of *extra-budgetary institutions* indicated a cash deficit of R1,1 billion in the first six months of fiscal 2005/06 compared with a cash surplus of R2,5 billion during the same period of the previous fiscal year. The cash surplus of the *social security funds* decreased to R2,2 billion in the first six months of fiscal 2005/06, compared to a cash surplus of R3,0 billion during the same period in fiscal 2004/05.

At the level of *consolidated general government*, a cash deficit of R2,1 billion was recorded in the first six months of fiscal 2005/06, compared with a cash deficit of R25,4 billion in the same period of the previous fiscal year. This significant decrease was essentially due to the revenue overrun as well as the subdued pace of cash payments for operating activities at the national and local government level.

Budget comparable analysis of national government finance

Expenditure by national government in the first six months of fiscal 2005/06 was well contained and amounted to R204 billion, representing a year-on-year rate of increase of 12,6 per cent. This rate of increase was moderately higher than the average year-on-year rate of increase of 10,5 per cent recorded in the same period during the five fiscal years prior to 2005/06. The *Budget Review 2005* projected that national government expenditure would increase by 13,4 per cent to amount to R418 billion for the full fiscal year.

The equitable share of nationally-raised revenue transferred to provincial governments decreased considerably in the period April to September 2005 compared with the same period of 2004, due to the transfer of social grant pay-outs from the provincial governments to the national government. This also resulted in a strong rate of increase in national government expenditure on transfers and subsidies.

Payments for capital assets amounted to R1,8 billion in the first six months of fiscal 2005/06, or 4,8 per cent less than in the same period of the previous fiscal year. The original Budget projected that payments for capital assets would amount to R6,2 billion in fiscal 2005/06 as a whole.

National government expenditure as a ratio of gross domestic product amounted to 26,8 per cent in the first six months of fiscal 2005/06, slightly higher than the ratio of 25,9 per cent recorded in the corresponding period of the previous fiscal year.

After taking into account cash-flow adjustments (i.e. adjustments resulting from timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), national government's cash expenditure amounted to R204 billion in the first half of fiscal 2005/06, representing an increase of 13,7 per cent compared with the same period of the previous fiscal year, just about equivalent to the budgeted increase for the full fiscal year.

National government *revenue* collections continued at a brisk pace in the first six months of fiscal 2005/06 and amounted to R190 billion, representing a year-on-year rate of increase of 20,5 per cent. This rate of increase was significantly higher than the average growth rate of 12,0 per cent recorded in the same period during the five years prior to fiscal 2005/06. The *Budget Review 2005* estimated that national government revenue would grow by 6,5 per cent to amount to R370 billion for the fiscal year as a whole.

The strong revenue performance was broad based as shown in the table on the opposite page. Taxes on income, profits and capital gains increased by 20,4 per cent in the first six months of fiscal 2005/06 compared with the same period a year earlier. This increase was mainly the result of strong growth in corporate income tax collections, signalling the increased profitability of companies as well as the continued improvement in tax-collection efficiency. Taxes on property, while still growing strongly, lost some of their earlier vigour as they increased by 26,8 per cent in the first half of fiscal 2005/06 compared with 32,4 per cent in the same period of the previous fiscal year.

National government revenue in fiscal 2005/06

Revenue source	R billions: Originally budgeted	R billions: Actual Apr – Sep 2005	Percentage change*
Taxes on income, profits and capital gains	200,9	107,6	20,4
Payroll taxes	4,9	2,4	12,5
Taxes on property	9,8	5,3	26,8
Domestic taxes on goods and services	143,0	68,1	13,8
Taxes on international trade and transactions	13,2	8,3	44,3
Other revenue	10,2	5,2	65,5
Less: SACU** payments	12,1	6,7	1,2
Total revenue	**369,9**	**190,2**	**20,5**

* From April – September 2004 to April – September 2005
** Southern African Customs Union

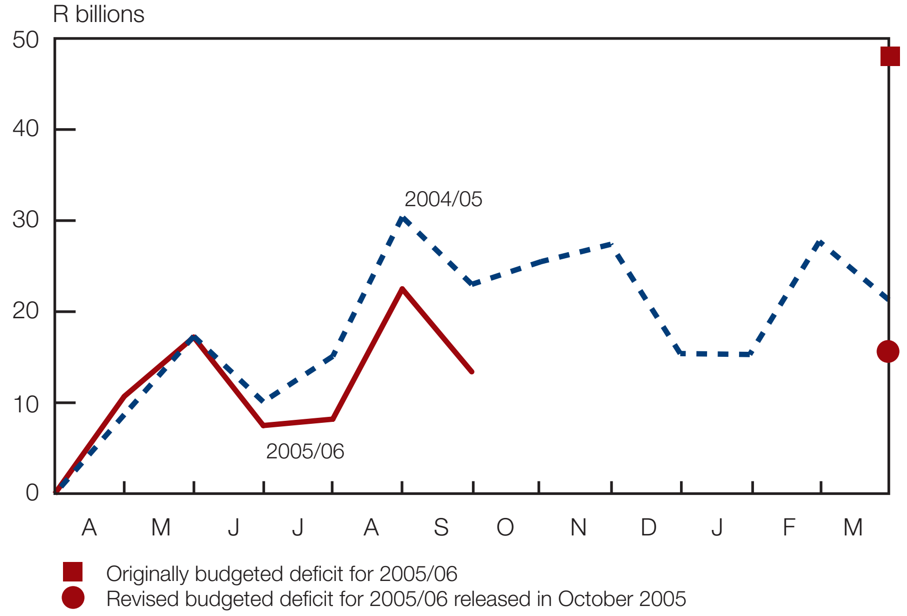
All major components of domestic taxes on goods and services recorded strong growth rates. The increase in the largest category of this component, i.e. value-added tax collections, was consistent with strong local demand for durable and semi-durable items. Taxes on international trade and transactions grew strongly in the first half of fiscal 2005/06 mainly due to a strong increase in customs duties collected, consistent with the strong increase in imports.

National government revenue as a ratio of gross domestic product amounted to 25,0 per cent in the first six months of fiscal 2005/06, significantly higher than the ratio of 22,6 per cent recorded in the corresponding period of the previous fiscal year.

The net result of the recorded revenue and expenditure of national government in the first six months of fiscal 2005/06 was a *cash book* deficit before borrowing and debt repayment of R13,4 billion – R9,6 billion lower than the deficit recorded in the same period of fiscal 2004/05. A deficit of R48,0 billion was originally budgeted for 2005/06 as a whole. As a ratio of gross domestic product, the national government deficit amounted to 1,8 per cent, significantly lower than the ratio of 3,3 per cent recorded in the corresponding period a year earlier.

The *cash-flow* deficit before borrowing and debt repayment amounted to R15,2 billion in the first half of fiscal 2005/06, compared to R23,0 billion recorded in the first half of fiscal 2004/05. In addition, an extraordinary payment was recorded in respect of the issuance of zero-coupon bonds with a face value of R4,5 billion to the Bank. This issue was made in April 2005 to defray part of the realised losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). Extraordinary receipts in fiscal 2005/06 included proceeds of foreign exchange amnesty and special dividends from Telkom to the amount of R1,0 billion each in July 2005. In August 2005, Eskom paid a special dividend to the amount of R0,7 billion to national government.

Cumulative deficit of national government



As indicated in the accompanying table, the net borrowing requirement in the first six months of fiscal 2005/06 was financed mainly through the issuance of securities in the domestic bond market. During this period, short-term instruments were issued at an average rate of 6,8 per cent and long-term fixed-interest bonds at an average yield of 8,1 per cent per annum.

National government financing in fiscal 2005/06

R billions

Item or instrument	Originally budgeted	Actual Apr – Sep 2005
Deficit	**48,0**	**15,2***
Plus: Extraordinary payments	7,0	4,5
Cost on revaluation of foreign bonds and loans at redemption	0,7	0,0
Less: Extraordinary receipts	1,0	2,8
Net borrowing requirement	**54,7**	**16,9**
Treasury bills	5,0	3,9
Domestic government bonds	26,3	29,5
Foreign bonds and loans	12,8	1,4
Change in available cash balances**	10,6	-17,9
Total net financing	**54,7**	**16,9**

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

The National Treasury introduced several new bills and bonds in the first six months of fiscal 2005/06, including 273-day Treasury bills and bonds of various maturities. The average maturity of national government's domestic marketable bonds decreased slightly from 99 months at the end of March 2005 to 95 months at the end of September.

Net issues of foreign bonds and use of foreign loans amounted to R1,4 billion during the first six months of fiscal 2005/06. Net foreign funding included an amount of R1,7 billion drawn on the export credit facility which had been arranged for the financing of the Strategic Defence Procurement Programme. The average outstanding maturity of government's foreign bonds decreased from 78 months to 72 months over the same period.

The funding activities of national government resulted in an increase of R17,9 billion in government's bank balances during the first six months of fiscal 2005/06, bringing the level of these balances to R48,7 billion at the end of September 2005.

Total loan debt of national government increased from R502 billion at the end of March 2005 to R536 billion at the end of September 2005. Foreign debt as a portion of total loan debt amounted to 13,0 per cent at the end of September 2005 compared with 13,8 per cent at the end of March 2005. As a ratio of gross domestic product, national government total loan debt increased from 35,3 per cent at the end of March 2005 to 36,1 per cent at the end of September 2005.

The outstanding balance on the GFECRA at the end of March 2005 amounted to R5,3 billion, but was almost completely redeemed by the amount of R4,5 billion paid by the National Treasury in April 2005 to defray losses on this account. Including this balance, total debt of national government increased from R507 billion at the end of March 2005 to R536 billion at the end of September 2005. Total debt of national government as a ratio of gross domestic product increased from 35,7 per cent at the end of March 2005 to 36,2 per cent at the end of September 2005.

Adjusted estimates of national government finance

The *Adjusted Estimates of National Expenditure 2005*, tabled in the National Assembly by the Minister of Finance on 25 October 2005, sought approval for additional unforeseen and unavoidable government spending during fiscal 2005/06. However, part of the additional expenditure would be defrayed from the contingency reserve and other unallocated amounts for unforeseen expenses already provided for in the main estimates presented to Parliament in February 2005. Furthermore, considerable savings and underspending – including a reduction of R1,3 billion in projected state debt costs – were also provided for in the *Adjusted Estimates,* leaving a net decrease in spending in the current fiscal year to the amount of R2,1 billion. This brought the revised estimate of national government expenditure in fiscal 2005/06 to R415,8 billion.

Revised budget estimates for fiscal 2005/06

R billions

Originally budgeted expenditure	417,8
Plus: Additional expenditure	0,5
Less: Savings and underspending	-2,5
Total adjusted expenditure	**415,8**
Originally budgeted revenue	369,9
Plus: Increase in taxes on income and profits	19,6
Increase in taxes on property	1,2
Increase in domestic taxes on goods and services	9,3
Increase in taxes on international trade and transactions	3,1
Less: Decrease in other revenue	-1,0
Increase in SACU payments	-2,0
Total adjusted revenue	**400,1**
Originally budgeted deficit	**47,9**
Adjusted deficit	**15,7**

Source: *Medium Term Budget Policy Statement*, October 2005

National government revenue in 2005/06 is expected to exceed the original budget estimates by no less than R30,2 billion, based on revised macroeconomic projections and the revenue trends for the first six months of the current fiscal year. This partly reflects the momentum of revenue flows arising from brisk economic growth as well as the associated increased demand for domestic goods and services and imported goods, and higher corporate earnings.

The Southern African Customs Union payments to the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) – largely a function of customs revenue – are to increase by R2,0 billion to amount to R14,1 billion. On balance, total adjusted revenue for the full fiscal year was projected to amount to R400,1 billion or 25,9 per cent of the estimated gross domestic product.

The revised projections imply a substantial decrease in the budgeted deficit before borrowing and debt repayment. This estimated deficit of R15,7 billion (originally budgeted at R48,0 billion) is expected to equal 1,0 per cent of the estimated gross domestic product for the full fiscal year compared with 3,1 per cent indicated in the original Budget. The deficit would be financed mainly through the issuance of long-term bonds in the domestic bond market as well as by utilising government's available cash balances.

The *Medium Term Budget Policy Statement 2005*

The Minister of Finance presented the *Medium Term Budget Policy Statement 2005* (MTBPS) to Parliament on 25 October 2005. In order to promote economic and social development, the MTBPS 2005 provides the resources needed to boost investment spending in order to support accelerated and shared economic growth. It recognises that South Africa's developmental objectives have to be met within a sound and expansive budget framework. The MTBPS 2005 addresses key areas for accelerating growth and investment, broadening economic participation as well as social security, health and human development.

The accelerated and shared growth strategy of the government aims to reinforce modernisation and deepen the competitiveness of the economy, while also broadening economic participation and addressing structural constraints that inhibit the development of small businesses and cohesive communities. Regulatory reform to ease the compliance burden on small businesses and facilitating integration into the formal economy is under consideration.

In the areas of social security, health care and human development government will increase income support to the most vulnerable and progressively extend welfare services for children and the elderly to improve their livelihood. Government will shift its priority for the decade ahead from income support for the poor to strengthening and improving public health care and education. Several reforms relating to the wider social insurance environment are under way. For instance, with effect from 2006, medical scheme contributions by lower-income groups will be treated more favourably for tax purposes.

Further steps in the gradual liberalisation of exchange controls were announced in the MTBPS. Government also reiterated its commitment to better service delivery in the public sector, *inter alia,* through initiatives to develop managerial capacity, improve financial management systems, and provide support for municipalities facing financial difficulties.

Fiscal prudence evidenced in the previous fiscal years is expected to continue at all levels of government, as indicated in the table on the opposite page. The national government

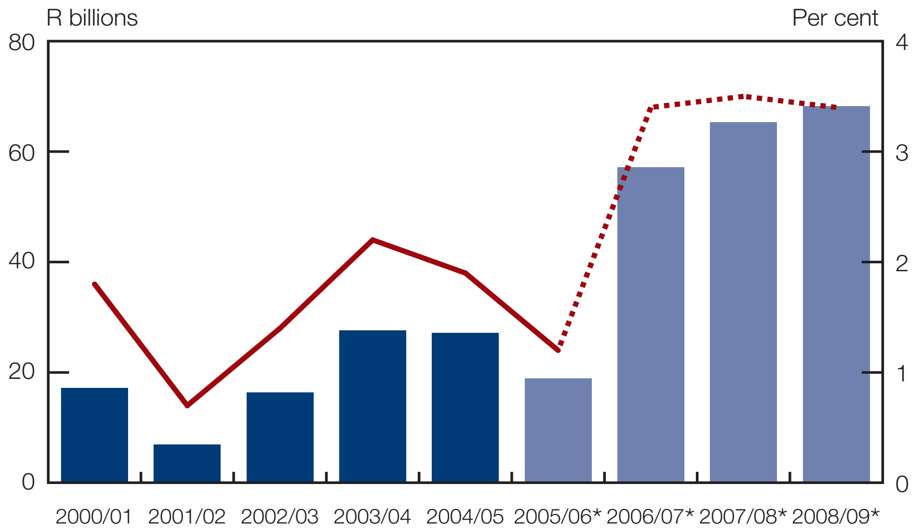
Fiscal projections

	Revised estimates 2005/06	Medium-term estimates 2006/07	2007/08	2008/09
	R billions			
National government				
Revenue	400,1	437,0	479,0	527,2
Expenditure	415,8	474,0	518,3	568,7
Deficit before borrowing	15,7	37,0	39,3	41,5
Consolidated general government borrowing requirement	17,1	44,0	50,9	52,1
Public-sector borrowing requirement	18,9	57,1	65,3	68,2
	Ratio of gross domestic product			
	Per cent			
National government				
Revenue	25,9	25,8	25,8	25,9
Expenditure	27,0	28,0	27,9	28,0
Deficit before borrowing	1,0	2,2	2,1	2,0
Consolidated general government borrowing requirement	1,1	2,6	2,7	2,6
Public-sector borrowing requirement	1,2	3,4	3,5	3,4

Source: *Medium Term Budget Policy Statement*, October 2005

deficit for the current fiscal year is expected to amount to 1,0 per cent of the estimated gross domestic product, rising to levels of around 2 per cent in the ensuing three years. The borrowing requirement of the consolidated general government is projected to average 2,6 per cent of gross domestic product over the same period. The public-sector borrowing requirement is set to increase from 1,2 per cent in 2005/06 to around 3,4 per cent over the medium term.

Non-financial public-sector borrowing requirement



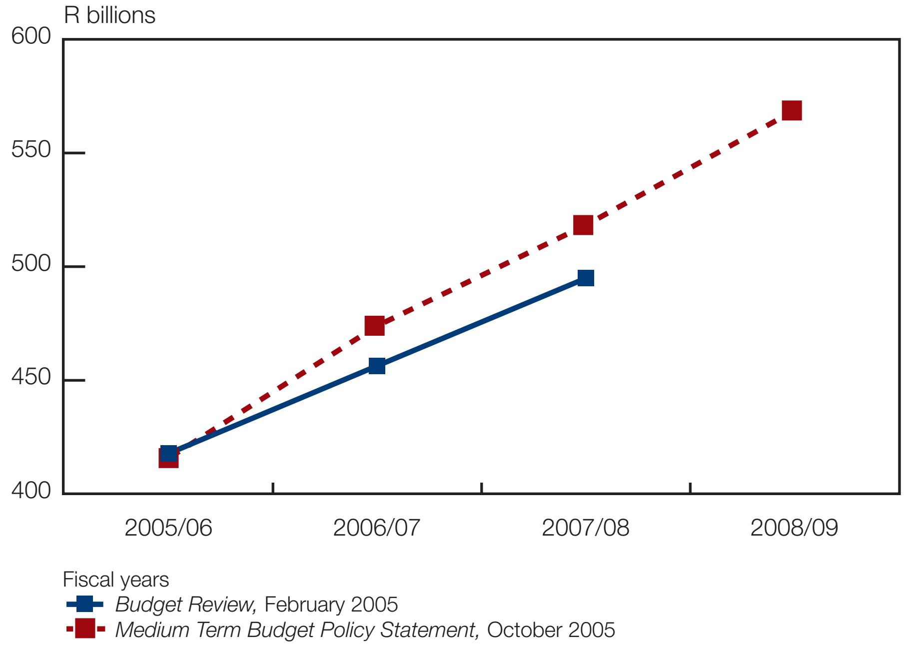
Fiscal years
* *Medium Term Budget Policy Statement,* October 2005
Rand billions
Per cent of gross domestic product (right-hand scale)

National government's real non-interest expenditure is projected to increase by 6,3 per cent per annum over the medium term, excluding the transfers to municipalities to replace Regional Service Council (RSC) levies. Debt service costs as a percentage of estimated gross domestic product were expected to decline further to 2,8 per cent in 2008/09.

Compared to the February 2005 Budget, the *Medium Term Expenditure Framework* (MTEF) envisages a generally higher level of government expenditure, especially in the area of income support and social development. Over the MTEF period, capital spending by non-financial public enterprises is expected to increase significantly, bringing them into a deficit position and representing a greater claim by the public sector on capital markets.

The MTBPS 2005 indicated additional transfers of R46 billion to provincial and local governments. This will strengthen their ability to improve public services through proper targeting of services and improved governance as well as increased investment in poorer communities to ensure sustainable livelihoods.

Projected national government expenditure



Projected extraordinary payments in fiscal 2005/06 allowed for the issuing of R4,5 billion in bonds to the Bank to defray the outstanding balance on the GFECRA. This amount was R2,5 billion lower than the originally budgeted amount due to higher bond issues to the Bank in 2004/05. In fiscal 2007/08 the contingent liability of about R4,2 billion, relating to Saambou Bank, would be realised.

Domestic long-term loans would be the primary instrument used to finance the budget deficit over the medium term. Total gross loan debt was estimated to amount to 35,0 per cent of the gross domestic product at the end of fiscal 2005/06, decreasing to 31,5 per cent of the gross domestic product at the end of fiscal 2008/09. Foreign debt as a percentage of total gross loan debt was projected to increase from 13,5 per cent at the end of fiscal 2005/06 to 16,0 per cent at the end of fiscal 2008/09.

Statement of the Monetary Policy Committee

13 October 2005

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

Introduction

For the past two years, CPIX inflation has been within the inflation target range of 3 – 6 per cent. In recent months, however, oil price developments have posed an increasing risk to the continued attainment of the inflation target and since the previous meeting of the Monetary Policy Committee (MPC), CPIX inflation has risen by 1,3 percentage points. These increases were in line with expectations, and our current forecasts show that we should remain within the target range over the forecast period. More recently there has been some respite in the oil market, and prices have moderated from recent peaks caused by hurricanes Katrina and Rita. However, oil prices remain at high levels and continue to be of concern.

Despite the petrol price increases, the economy continues to perform at a robust pace, domestic demand remains strong, and formal-sector employment has increased.

Recent inflation developments

Inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) reached a low of 3,1 per cent in February and then began to increase, mainly as a result of petrol price movements. After measuring 3,5 per cent in June, CPIX inflation increased to 4,2 per cent and 4,8 per cent in July and August, respectively. During these two months, the petrol price increased by a total of R0,56. Excluding petrol and diesel costs, CPIX inflation measured 3,6 per cent in both July and August having averaged 3,4 per cent for the previous 12 months. This indicates that thus far there has been limited pass-through from petrol prices to prices of other goods and services.

Other categories of goods and services that have shown significant price increases are tobacco products, domestic workers' wages, medical costs and education. In contrast, prices of clothing and footwear have continued to fall, while most other categories show very subdued price increases. Despite recent increases in the maize price, food price inflation has remained low, measuring 2,7 per cent in August. Administered prices excluding petrol rose at 5,9 per cent, marginally below the upper limit of the inflation target range. However, if the petrol price is included, administered prices increased by 11,2 per cent.

Production price inflation has also displayed a marked upward trend, reflecting to a significant degree the higher energy prices. Having measured 2,4 per cent in May 2005, production price inflation increased steadily, reaching 4,2 per cent in August. Imported goods inflation increased from an annual rate of 1,8 per cent in May to 6,2 per cent in August, while domestically produced goods inflation increased from 2,6 per cent to 3,6 per cent over the same period.

The outlook for inflation

Owing mainly to the adverse oil price developments, the Bank's inflation forecast has deteriorated somewhat since the previous MPC meeting. However, CPIX inflation is expected to remain within the target range of 3 – 6 per cent over the forecast period.

The upper turning point is expected to occur in the first two quarters of 2006 at a level just below 6 per cent. Thereafter, CPIX inflation is expected to resume a moderate downward trajectory. Although there are no clear signs of second-round effects, the longer the upward trend and volatility of oil prices persist, the more likely the price increases will continue to impact on expectations and feed through to other prices. Monetary policy has to remain vigilant in anticipating such developments.

Since the previous meeting of the MPC, the international crude oil prices reached new record levels of almost US$70 per barrel in the wake of the hurricanes in the United States. The price of Brent crude averaged around US$64,50 per barrel in August and US$63 in September, compared to US$58 in July. These developments resulted in further increases in the domestic petrol price of R0,29 and R0,12 per litre in September and October, respectively, and will contribute to further upward pressure on CPIX in those months. More recently crude oil prices have declined to below US$60 per barrel and if this trend continues, we could see a moderate decline in petrol prices in November. However, the volatility of international oil prices means that significant upside risk remains.

There are a number of other developments that also pose risks to the inflation outlook. The latest inflation expectations survey conducted by the Bureau for Economic Research at the University of Stellenbosch indicates that there has been a marginal deterioration in inflation expectations which may be a result of the impact of the higher petrol prices. CPIX inflation is now expected to average 5,2 per cent next year, and 5,4 per cent in 2007, up 0,3 per cent and 0,4 per cent, respectively. The deterioration in inflation expectations was also reflected in the increase in the breakeven inflation rates, measured by the spreads between the yields on South African CPI inflation-linked bonds and conventional nominal bonds of the same maturity. If the deterioration in inflation expectations were to continue, it would be a cause for concern given the critical role of expectations in the price and wage formation process.

The economy has continued to grow at a robust pace, with quarter-on-quarter annualised real GDP growth accelerating from 3,5 per cent in the first quarter of 2005 to 4,8 per cent in the second quarter. This acceleration was attributed in part to the strong increase in the real value added by the manufacturing sector, which appears to have recovered from the contraction in the first quarter. The utilisation of production capacity in manufacturing, having fallen back in the previous two quarters, picked up again in the second quarter of 2005. The physical volume of manufacturing production continued on an upward trend in the third quarter and the most recent value of the Investec/BER Purchasing Managers' Index (PMI) also indicates that the recovery in this sector has continued, although at a more moderate pace. Most other sectors have also remained buoyant and the composite leading business cycle indicator shows a favourable growth outlook.

This positive growth performance had a positive effect on employment. According to the Quarterly Employment Statistics survey, formal non-agricultural employment increased at an annualised quarter-on-quarter rate of 7,6 per cent in the second quarter of this year. Over the past year this reflects an increase of 84 000 employees.

Domestic demand shows few signs of significant moderation and all components of final demand grew at a healthy rate in the second quarter. New motor vehicle sales reached new record highs in September, although there was a moderate slowdown in the growth of motor vehicle sales which increased by 25,3 per cent over the year. The strong domestic demand has been underpinned by low nominal interest rates, higher real incomes and increases in asset prices. Share prices on the JSE Limited, for example, reached new record highs, and since the previous MPC meeting the all-share price index increased by 4 per cent.

The vigorous demand was financed in part by increased borrowing, and the household debt ratio continued to rise in the second quarter. Household debt as a percentage of disposable income rose from 60 per cent in the first quarter to 62 per cent in the second quarter of 2005. However, because of the low nominal interest rate environment, debt servicing cost as a percentage of disposable income remained unchanged at a relatively low level of 6½ per cent.

The monetary and credit aggregates have also been increasing at rates consistent with strong domestic demand. Year-on-year growth in M3 picked up from 17,1 per cent in June 2005 to 19,9 per cent in July and 19,0 per cent in August. Total domestic credit extension grew by 18,0 per cent in July and 18,3 per cent in August. Twelve-month growth in bank loans and advances to the private sector remained above 20 per cent, with increases in mortgage advances reaching 26 per cent in August. The latter reflects continued buoyancy in the housing market, although the rate of increase in house prices has fallen steadily since September 2004.

Strong domestic demand and high international crude oil prices have impacted on the current account of the balance of payments. Although the deficit on the current account of the balance of payments as a percentage of GDP contracted to 3,4 per cent in the second quarter of 2005, data for July and August indicate a possible widening of the trade deficit in the third quarter. The current account, however, remains financed by capital inflows, and the international liquidity position of the Bank increased to a level of US$16,1 billion at the end of September.

World inflation is expected to be negatively affected by higher oil prices. The IMF now predicts that world inflation in 2006 will average 3,7 per cent, compared to the April forecast of 3,1 per cent for the same period. Nevertheless this is lower than the revised 3,9 per cent average expected for 2005 and indicates that world inflation appears to be well contained. World growth is expected to be sustained at a robust rate of 4,3 per cent in 2006 although it has moderated somewhat since last year.

Not all developments have been negative from an inflation perspective. Although inflation expectations have deteriorated moderately, there is no evidence that this has impacted on wage settlements. Unit labour costs in the first half of this year increased at rates within the inflation target range, measuring 4,6 per cent and 5,3 per cent in the first two quarters of this year.

The nominal effective exchange rate of the rand depreciated by 0,3 per cent since the previous meeting of the MPC, but it has been relatively stable over the period. The volatility that did occur was to a large extent a reflection of movements between the euro and the US dollar. Positive international perceptions of South Africa were further confirmed with the recent sovereign credit rating upgrade by the Fitch rating agency.

Monetary policy stance

The deterioration in the inflation outlook cannot be ignored. The increased risk of possible pass-through leading to pronounced second-round effects on CPIX inflation must inform policy going forward. Although there is no conclusive evidence of pass-through at present, and the Monetary Policy Committee has not judged it necessary to change the monetary policy stance at this meeting, these developments will be closely monitored. The Committee stands ready to take the appropriate action in order to ensure that the inflation target mandate continues to be achieved. At this meeting the MPC has decided therefore that the repurchase rate will remain unchanged at 7 per cent per annum.

Note on the redefinition of gold and other foreign reserves in the balance of payments

by L Motsumi and Balance of Payments Division

Introduction

A country's international reserve position is a key component of the balance of payments statistics. Recent developments necessitated reconsideration of the appropriateness of the international reserve asset definition used in South Africa. This note introduces the amended definition to users of economic statistics, and indicates which data series in the statistical tables of the *Quarterly Bulletin* have been changed.

Current concept

According to the fifth edition of the International Monetary Fund's *Balance of Payments Manual,* international reserves consist of those external assets that are readily available to and effectively controlled by the monetary authorities. The reserve assets should be available to the monetary authorities, should the need arise to provide liquidity to the foreign exchange market.

South Africa's *gross international reserve assets* currently comprise official gold and other foreign exchange reserves of the South Africa Reserve Bank (the Bank) and the central government, as well as the foreign currency assets of the South African private banking sector. The rationale for including the international reserves of the private banking sector was that the foreign currency assets of the private-sector banks were effectively under the control of the monetary authorities. The exchange control rules and regulations, for instance, required that the placement of foreign currency holdings should be in the name of the domestic authorised dealer (bank) concerned, should be with another bank and should be restricted to the range of assets prescribed by the exchange control authorities.

A related concept in the balance of payments area is South Africa's *net international reserves.* This is currently derived by deducting the so-called liabilities related to reserves – the Bank's foreign borrowing, as well as the foreign loan commitments of the central government to international organisations – from the gross international reserves. Changes in such foreign borrowings are deemed not to result from the normal balance of payments transactions, but from the need to ensure an adequate level of gross international reserves and, on occasion, to ensure an adequate supply of foreign-currency liquidity to the foreign exchange market. It should be noted that the foreign liabilities of the private banking sector do not form part of the liabilities related to reserves, but are reflected in the category "other investment liabilities" in the financial account of the balance of payments.

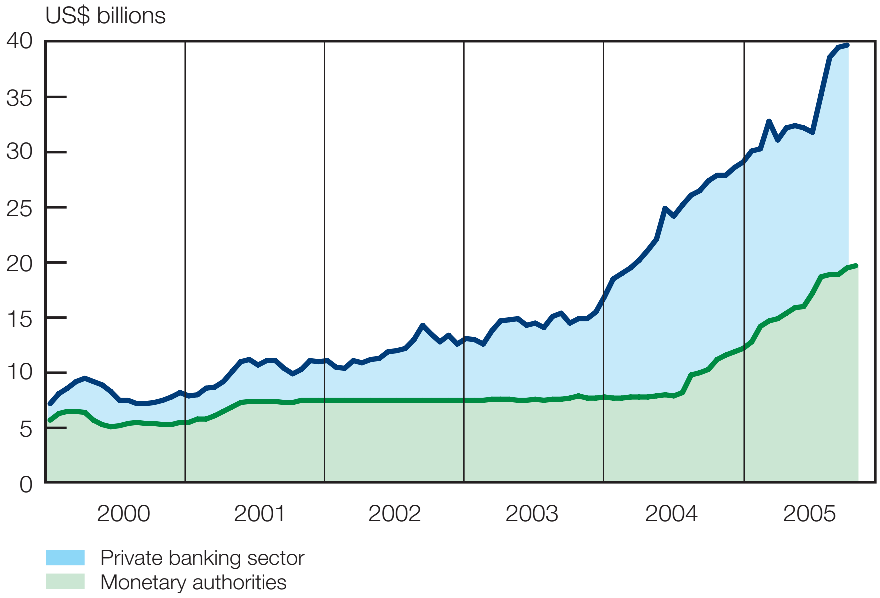
Revised international reserve asset concepts

In the 2005 *Medium Term Budget Policy Statement,* the Minister of Finance announced steps to further ease the exchange controls imposed on banks, as part of the shift from exchange controls to the prudential regulation of banks' foreign exposures. South African banks would henceforth be allowed to hold foreign assets with a value of up to 40 per cent of their domestic regulatory capital. Foreign assets invested outside Africa would be restricted to 20 per cent, while assets invested in Africa could constitute up to the entire 40 per cent.

This further relaxation of the exchange control measures brought matters to the point where, in the judgement of the Bank, the foreign currency assets of the private banking sector could no longer reasonably be considered as subject to the authorities' direct and effective control. Accordingly, only the international reserve assets of the South African Reserve Bank and those of the central government will in future be considered as the official international reserve assets of the country. Changes in the international reserves of the private banking sector will, therefore, in future be recorded in the category "other investment assets" in the financial account of the balance of payments.

The level of gross international reserves including and excluding the international reserve assets of the private banking sector are shown in the graph below, illustrating that in recent months the foreign currency assets of the private banking sector were of similar magnitude to the holdings of foreign assets by the Bank and the central government.

Gross gold and other foreign reserves



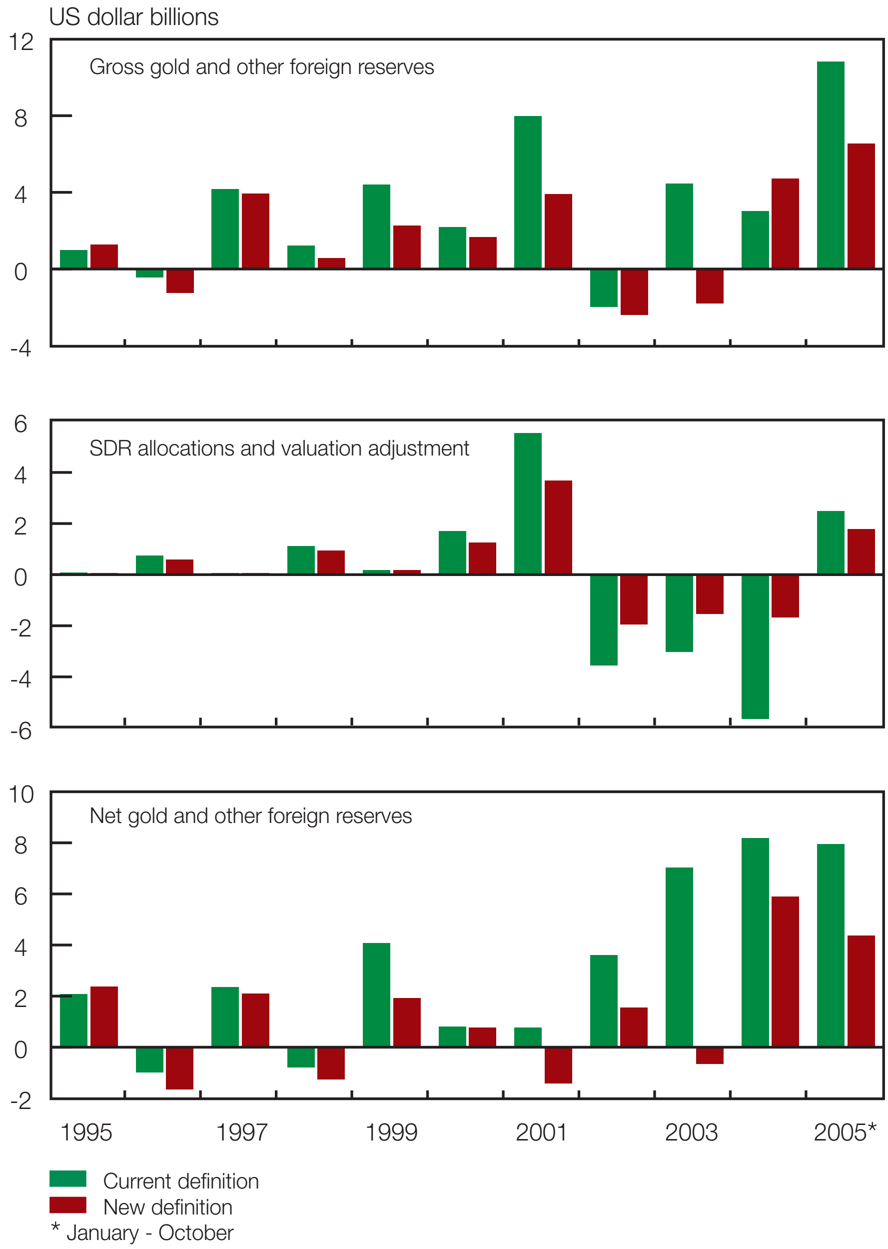
Adopting the narrower concept of foreign reserve assets implies that the net reserve position will in future truly reflect the foreign reserve position of the monetary authorities. Furthermore, South Africa's official foreign reserve position will be directly comparable with the official gross foreign reserve position of other countries. At the same time, the concern that the net reserves concept was defined in an asymmetric way, by taking into account both foreign assets and liabilities of the monetary authorities but only foreign assets of the private banking sector, will no longer be valid.

Related to redefining the levels of the gross and net reserves, the *changes in the net international reserves owing to balance of payments transactions* were also revised. The accompanying graph illustrates the difference between these changes using the current and new reserve definition.

The strong increases in the net international reserves owing to balance of payments transactions since 2002 were largely due to the significant accumulation of foreign exchange reserves by the private banks. Moving to the new definition of reserves therefore, involves recording significantly smaller increases in the net foreign reserves than before.

Incorporating the changes in the international reserve assets of the private banking sector in the "other investment asset" category of the financial account of the balance of payments did not affect the magnitude of *unrecorded transactions* in the balance of payments. The adjustment to the change in the net international reserves owing to balance of payments transactions was offset by an equal adjustment to the balance on the financial account.

Change in foreign reserves



Dissemination of revised data

The analytical statement of the balance of payments was revised since 1960 in order to conform to the guidelines of the fifth edition of the *Balance of Payments Manual* of the IMF. The revised data series are available on the Bank's website. Below is a summary of the *Quarterly Bulletin* tables and items on the balance of payments that were affected by the revisions.

Page	Balance of payments items
S86, 87:	Changes in gross gold and other foreign reserves now exclude foreign assets of the private-sector banks. SDR allocations and valuation adjustments now involve foreign assets and liabilities of the monetary authorities only. Changes in net gold and other foreign reserves owing to balance of payments transactions now relate only to the monetary authorities. Changes in other investment assets now include changes in foreign assets of the private-sector banks. Adjustments to the balance on the financial account correspond to the adjustments to the change in net foreign reserves.
S92, 93:	Foreign assets: Other investment assets of the banking sector now include the foreign-currency assets of private banks.
S108:	Rest of monetary sector (i.e. private banking sector) is now omitted from the table, and gross foreign reserves are reduced accordingly.
S152:	The import cover ratio of reserves is now lower on account of the narrower reserve definition adopted.

Note on the impact of securitisation transactions on credit extension by banks

by N Gumata and J Mokoena

Introduction

Securitisation is still at an early stage of development in South Africa, but has grown rapidly in recent years. The objective of this note is to introduce briefly the concept of securitisation, and to outline and quantify the impact of securitisation transactions on the credit aggregates released by the South African Reserve Bank (Bank).

The concept of securitisation[1]

Securitisation is defined as the process by which a company converts various assets on its balance sheet into marketable securities which can then be sold to investors and traded in the capital markets.

A securitisation issue is usually structured by an arranger, and involves three key steps: *Firstly*, the company that originally owns the asset (the originator) sells them to a newly formed company or trust known as the issuer; *secondly*, the issuer issues securities (either bonds or notes) secured by the cash flows of the underlying assets; and *thirdly*, the securities are purchased by investors, usually institutions, who either trade them or place them in their investment portfolios.

With securitisation transactions the transfer of rights to an asset can take one of two forms, namely traditional or synthetic securitisation.

A *traditional* securitisation scheme involves the legal and economic transfer of assets to a special-purpose vehicle [2] (SPV) issuing asset-backed securities that are claims against a specific asset pool. In such a scheme, different classes of asset-backed securities may be issued, and each class has a different priority claim on the cash flows originating from the underlying pool of assets. Under a traditional securitisation scheme a true sale takes place and all rights and obligations are transferred to the SPV. This is the type of securitisation scheme that typically affects the measurement of the bank credit aggregates.

A *synthetic* securitisation scheme, on the other hand, refers to a structured transaction whereby an institution uses a portfolio of credit derivative instruments[3] to tranche and transfer the credit risk and/or market risk[4] associated with a specified pool of assets to the SPV. The resulting credit exposures have different levels of seniority. Under a synthetic securitisation scheme, the underlying assets are not necessarily moved off the originator's balance sheet.

Motives underlying securitisation

The potential benefits of securitisation to the originator include, among other things, the following:

1. *More efficient financing and profit maximisation.* Securitisation may be used to lower the firm's weighted average cost of funds. This is possible as highly rated debt can be issued into capital markets with strong investor demand driving down financing costs.

2. *Improved balance sheet structure and financial ratios.* Securitisation can enhance managerial control over the size and structure of a firm's balance sheet. For example,

1 For a more detailed discussion, the reader is referred to the sources listed at the end of this note.

2 A special purpose vehicle in this context is defined as a company incorporated or a trust created, insolvency-remote from the institution transferring the assets in terms of a securitisation scheme, and solely for the purpose of the implementation and operation of a securitisation scheme.

3 A credit derivative instrument is any contract in terms of which the credit risk (default risk) associated with a financial asset is isolated from the other risks associated with that financial asset and which credit risk is transferred from one counterparty (the protection buyer or credit risk seller), to another counterparty (the protection seller or buyer of the credit risk).

4 Credit risk is the risk that a counterparty to a financial obligation, such as a loan, will default on repayments linked to the obligation. Market risk is the risk that the market price of an asset may change, which may result in a loss to the reporting bank on realisation of that asset.

accounting de-recognition of assets (i.e. removal from the balance sheet) can improve gearing ratios as well as other measures of economic performance such as return on equity, and in a banking environment can also curtail costs attached to bank intermediation such as those arising from cash reserve requirements.

3. *Improved risk management.* Securitisation often reduces funding risk by diversifying sources of funds. Financial institutions also use securitisation to eliminate interest rate mismatches.

4. *Lower economic and regulatory capital requirements*. Securitisation also releases capital for other investment opportunities. This may generate economic gains if external borrowing sources are constrained, or if there are differences between internal and external financing costs.

Securitisation of bank loans and its impact on the monetary and credit aggregates

When securitisation transactions occur, particularly traditional securitisation schemes, assets are transferred from the balance sheet of the originating bank to a SPV. These assets are typically loans which, while still on the bank's balance sheet, would be included in the measured level of credit extension to the private sector by the monetary sector as released by the Bank. While SPVs are usually created by banks, they are classified as *other financial intermediaries* in the monetary and financial statistics, which makes them part of the other private-sector financial institutions and not the monetary sector. SPV assets are therefore excluded from the calculation of credit extension by the monetary sector. Likewise, SPV liabilities are not liabilities of the monetary sector and therefore cannot form part of the monetary aggregates. What typically happens is that the SPV issues securities which are purchased by institutional investors. The institutional investors typically buy the securities by drawing down their deposits with banks, such deposits having formed part of the broadly defined money supply, M3.

The overall effect of securitisation is therefore likely to be a reduction in the level of credit extension by the monetary sector and a reduction of similar magnitude in the M3 money supply. In essence, the banking sector would have collapsed its balance sheet by setting off some loans against some M3 deposits. However, the original borrowers still have obligations (but to a SPV, not to a bank), and the institutional investors still own assets (but these are now tradable securities, not M3 deposits).

Magnitude of securitisation transactions involving domestic banks

Although securitisation is still at an early stage of development in South Africa, it has grown rapidly in recent years. The accompanying table shows that issuance by private banks has increased from R250 million in 1989 to a cumulative total of R26,0 billion by the end of October 2005. Synthetic securitisation transactions have grown to account for no less than 40 per cent of the total amount of transactions undertaken by the private banks in recent years, but traditional securitisation schemes remain quantitatively more important.

Table 1: South African banks' securitisation transactions

Issuer	Assets securitised	Value R million	Originator	Arranger	Period
Traditional securitisation or asset-backed securitisation					
United Building Society Ltd	Residential mortgage loans	250	United Building Society	United Building Society	Nov 1989
Sasfin Asset Securitisation (Pty) Ltd	Equipment leases	60	Sasfin Bank	Sasfin Bank	Jun 1991
Private Mortgages 1 (Pty) Ltd	Residential mortgage loans	1 000	Investec Bank	Investec Bank	Dec 2002
Private Mortgages 2 (Pty) Ltd	Residential mortgage loans	1 400	Investec Bank	Investec Bank	Nov 2003
Collateralised Auto Receivables Securitisation (CARS) 1 (Pty) Ltd	Instalment sale agreements	3 000	Absa Corporate and Merchant Bank (ACMB)	Absa Asset and Vehicle Finance	Nov 2003
Equipment Rentals Securitisation No 1 (Pty) Ltd (ERS)	Equipment leases	670	Sasfin Bank	Sasfin Bank	Nov 2003
Accelerator fund 1	Motor vehicle loans	3 000	Standard Bank	Standard Corporate and Investment Bank	Sep 2005
Blue Granite Investments No 1	Residential mortgage loans	4 500	Standard Bank	Standard Corporate and Investment Bank	Oct 2005
Synthetic securities					
Firstrand 2000A	Credit card – Future Flows	1 800	FirstRand Bank	Rand Merchant Bank/Credit Suisse First Boston	Jun 2000
RMB CDO 1 Ltd	Corporate loans Collateralised Debt Obligation (CDO)	3 900	Rand Merchant Bank	Rand Merchant Bank/Morgan Stanley	Sep 2000
Kiwane	Corporate loans Collateralised Debt Obligation (CDO)	500	Gensec/Real Africa	Gensec/JP Morgan	Aug 2000
RMB CDO 2 Ltd	Corporate loans Collateralised Debt Obligation (CDO)	2 900	Durolink Rand Merchant Bank	Rand Merchant Bank/Goldman Sachs	Aug 2001
Procul Ltd	Instalment sale agreements	1 960	FirstRand Bank and Wesbank	Rand Merchant Bank	Jun 2002
Lexpub 15 Investment Ltd ta Fresco 1	Corporate loans Collateralised Debt Obligation (CDO)	1 082	FirstRand Bank	Rand Merchant Bank	May 2002

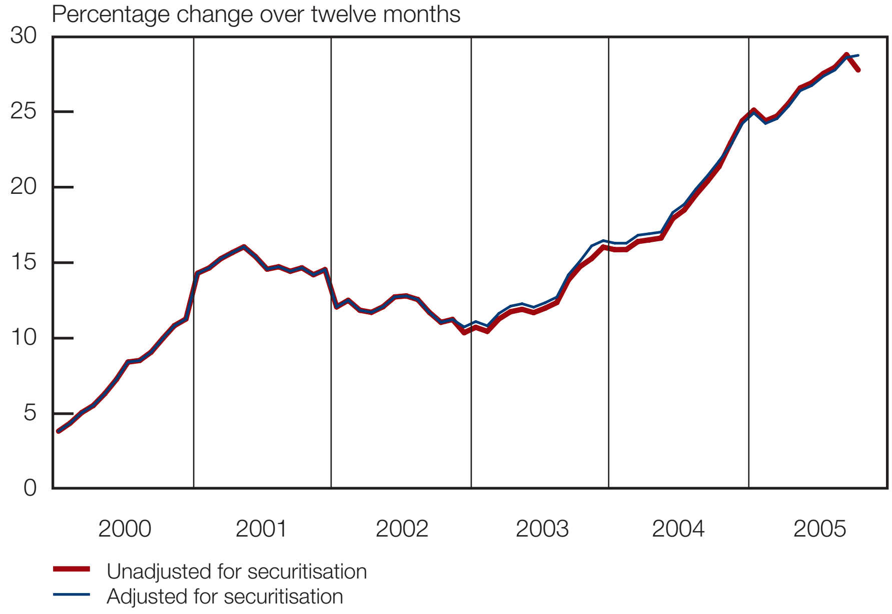
Source: ACMB Captial and Debt Markets, 2005; Van Vuuren, 2004

Table 2: Credit aggregates unadjusted and adjusted for securitisation transactions

		Mortgage advances	Mortgage advances adjusted for cumulative effect of securitisation	Instalment sale and leasing advances	Instalment sale and leasing advances adjusted for cumulative effect of securitisation
		(R billions)			
2002:	Jan	261,0	261,0	95,7	95,7
	Feb	265,0	265,0	96,7	96,7
	Mar	266,4	266,4	98,5	98,5
	Apr	268,6	268,6	99,2	99,2
	May	271,9	271,9	101,1	101,1
	Jun	274,9	274,9	101,9	101,9
	Jul	277,8	277,8	102,7	102,7
	Aug	280,3	280,3	103,9	103,9
	Sep	280,0	280,0	104,2	104,2
	Oct	281,8	281,8	105,6	105,6
	Nov	284,8	284,8	107,6	107,6
	Dec	286,0	287,0	108,0	108,0
2003:	Jan	289,0	290,0	109,0	109,0
	Feb	292,7	293,7	110,9	110,9
	Mar	296,5	297,5	111,7	111,7
	Apr	300,1	301,1	113,9	113,9
	May	304,3	305,3	116,2	116,2
	Jun	307,1	308,1	117,0	117,0
	Jul	311,1	312,1	118,5	118,5
	Aug	314,9	316,0	120,6	120,6
	Sep	318,7	319,7	122,2	122,2
	Oct	323,3	324,3	124,3	124,3
	Nov	328,3	330,7	123,3	127,0
	Dec	331,8	334,2	126,4	130,0
2004:	Jan	334,8	337,2	127,3	131,0
	Feb	339,1	341,5	129,4	133,1
	Mar	345,1	347,5	131,9	135,6
	Apr	349,7	352,1	133,2	136,9
	May	354,9	357,3	135,5	139,2
	Jun	362,1	364,5	137,9	141,6
	Jul	368,6	371,0	140,3	144,0
	Aug	376,3	378,7	142,5	146,2
	Sep	383,7	386,1	145,6	149,3
	Oct	392,4	394,8	148,8	152,4
	Nov	403,7	406,1	150,6	154,2
	Dec	412,8	415,2	152,5	156,2
2005:	Jan	418,9	421,3	154,6	158,2
	Feb	421,9	424,3	156,7	160,3
	Mar	430,4	432,8	159,1	162,8
	Apr	439,0	441,4	161,5	165,1
	May	449,2	451,6	164,3	168,0
	Jun	459,5	462,0	167,0	170,6
	Jul	470,0	472,4	169,8	173,5
	Aug	481,5	483,9	172,9	176,6
	Sep	494,1	496,5	173,3	180,0
	Oct	501,3	508,2	176,1	182,8

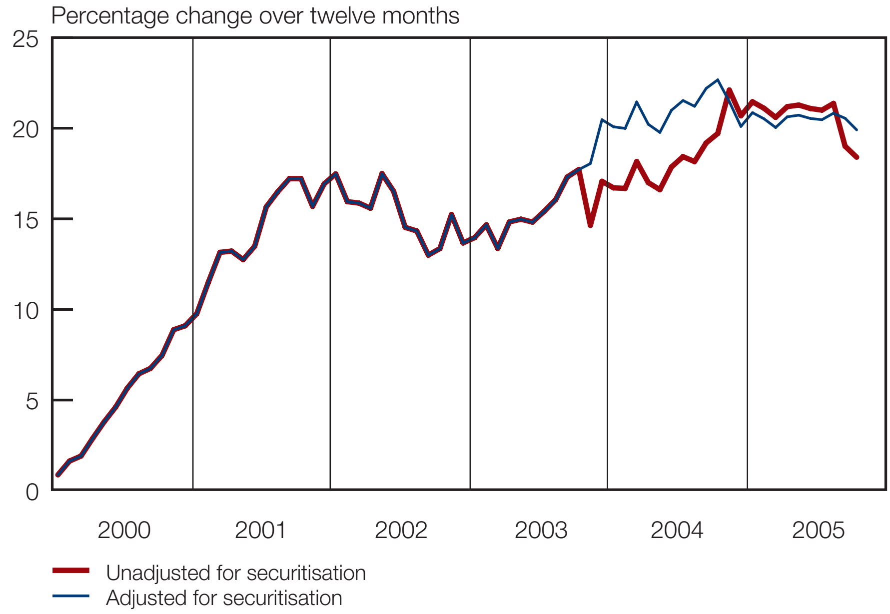
A graphic comparison of twelve-month percentage changes (see Graph at top of following page) shows that growth in mortgage advances adjusted for the cumulative effect of securitisation transactions is generally quite close to that of the measure that is unadjusted.

Mortgage advances



However, in the case of instalment sale and leasing transactions, more significant differences may be observed between the recent twelve-month rates of growth in the measures adjusted and unadjusted for the cumulative effect of securitisation transactions, as shown in the Graph.

Instalment sale and leasing finance



Conclusion

Securitisation activity in South Africa expanded rapidly in recent years. Where banks engage as originators in traditional securitisation transactions, it is likely to result in a reduction in both bank credit extension and M3 money supply. In interpreting short-term changes in the credit aggregates and money supply, it is helpful to take securitisation activity into consideration. However, it should be noted that this is only one of a multitude of mechanisms through which disintermediation and reintermediation take place continuously, thereby reducing or expanding the balance sheet of the monetary sector.

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