Quarterly Bulletin

September 2005

South African Reserve Bank

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Quarterly Economic Review

Introduction

Global economic activity lost some of its earlier vigour in the first half of 2005, but still maintained a sturdy and probably more sustainable pace of growth so far in the current year. The intensity of policy stimulation feeding through to the world economy was gradually reduced by rising policy interest rates in the United States and a number of other countries. Simultaneously, overall growth also seemed to be held back by frictions arising from the transfer of purchasing power from oil-importing to oil-exporting countries, as international oil prices scaled record heights. On top of the strong global demand for oil and geopolitical tensions, natural disasters which disrupted production and distribution networks propelled the oil price to levels approaching US$70 per barrel.

During the course of 2005 inflation edged higher in many parts of the world in the wake of rising oil and high commodity prices generally. However, the overall inflation picture remained well contained as global competition continued to discipline price and wage behaviour.

Exchange rate adjustment, as one of the mechanisms to address imbalances, was brought into play by Botswana, where a 12-per-cent devaluation of the pula was announced on 30 May 2005, and by China, where the yuan, having been pegged to the US dollar for a period of eight years, was revalued by 2,1 per cent on 21 July 2005 as an important step towards greater exchange rate flexibility.

Economic activity in South Africa regained momentum in the second quarter of 2005, with real growth accelerating to an annualised rate of 5 per cent. A thorough investigation of business cycle developments in the recent past furthermore confirmed that this was the twenty-third quarter of uninterrupted economic expansion. Episodes of hesitation which have been encountered since a lower turning point was reached in the third quarter of 1999 were too limited in length, intensity and scope to qualify as downward phases of the business cycle.

The improvement in growth in the second quarter of 2005 was mainly brought about by a sharp increase in real value added in manufacturing, which reflected rising domestic final demand and stronger export demand for certain categories of goods, alongside a somewhat more competitive level of the exchange value of the rand. Real output of the agricultural sector was bolstered by a bumper maize crop which was predominantly harvested in the second quarter, while almost all the other main sectors of the economy simultaneously displayed solid growth.

Having decelerated somewhat in the first quarter of 2005, growth in real final consumption expenditure by households picked up in the second quarter. This was led by a surge in real outlays on durable goods as expenditure on new motor vehicles, in particular, scaled new heights. Apart from sustained strong increases in households' real disposable income, more intensive use of bank credit facilities also underpinned the robust growth in household final consumption expenditure – especially as far as durable and semi-durable goods purchases were concerned.

Government's real final consumption expenditure exhibited a significantly higher growth rate in the second quarter of 2005 than in the first quarter. However, growth in real gross fixed capital formation slowed noticeably in the second quarter, mainly due to less buoyant increases in the public corporations' capital expenditure.

Inventory accumulation picked up somewhat in the second quarter of 2005, following very sluggish inventory investment in the first quarter. The inventory build-up in the first two quarters of 2005 occurred at a considerably slower pace than in the preceding two years, with most of the adjustment to the lower interest cost of holding inventories already having taken place.

Growth in real gross domestic expenditure picked up to broadly match the growth in real gross domestic product in the second quarter of 2005. The *level* of expenditure nevertheless continued to exceed that of production, as had been the case since the beginning of 2003.

Enterprise-surveyed employment outside the agricultural sector recorded successive increases in each of the five quarters to September 2004. Private-sector job opportunities benefited most from the economic recovery, but there was also a moderate increase in public-sector employment. The pick-up in enterprise-surveyed employment was, however, not sustained in the last quarter of 2004 and the first quarter of 2005. The decline in employment, in turn, contributed to an acceleration in labour productivity growth in the year to the first quarter of 2005.

Nominal remuneration per worker rose by 8,7 per cent in the year to March 2005, notably slower than previously. Allowing for productivity changes, unit labour cost increased by 5,9 per cent in the year to March 2005 – almost 1½ percentage points lower than the average rate of increase in 2004. Wage settlements averaged 6 per cent in the first half of 2005. Workers were more inclined to engage in strike action in the recent past: Man-days lost to industrial action more than tripled from the first half of 2004 to the first half of 2005.

In July 2005 CPIX inflation registered its 23rd successive month inside the inflation target range of 3 to 6 per cent, and its 8th successive month below the 4½-per-cent midpoint of the target range. However, both consumer and production price increases started to accelerate in recent months, mainly on account of steep increases in fuel prices.

With strong increases displayed by the most import-intensive components of gross domestic expenditure, such as spending on machinery and equipment, the current account of the balance of payments recorded a deficit during each of the past ten completed quarters. The volume of imports of goods and services generally rose faster than the volume of exports of goods and services over this period. Export volumes rose slightly more than import volumes in the second quarter of 2005, buoyed by strong international demand for mining products and a shift in the destination of exports in favour of Asia, where some of the highest growth countries in the world are located. This accordingly contributed to a modest reduction in South Africa's deficit on the current account of the balance of payments, from 3,8 per cent of gross domestic product in the first quarter of 2005 to 3,4 per cent in the second quarter.

The successive deficits on the current account were more than fully balanced by surpluses on the financial account of the balance of payments, leading to uninterrupted quarterly surpluses on the overall balance of payments and increases in reserves since early 2003. In the second quarter of 2005 the South African Reserve Bank (the Bank) utilised the opportunities arising from a large foreign direct investment transaction to further step up its holdings of gold and foreign exchange reserves to a level exceeding 13 weeks' worth of imports. While the nominal effective exchange rate of the rand continued to fluctuate and, on balance, depreciated by 7 per cent during the first eight months of 2005, the amplitude of these movements remained moderate.

Consistent with the zestful performance of the economy, growth in the broadly defined money supply accelerated further to reach a twelve-month rate of increase just a touch short of 20 per cent in July 2005. Banking institutions' loans and advances extended to the private sector also displayed vigorous increases and recorded a twelve-month growth rate of some 23 per cent in July 2005, supported by rising levels of income and expenditure, strong business and consumer confidence, the buoyancy of the fixed property and securities markets, and lower interest rates. Mortgage advances in particular displayed rapid growth. The greater part of banks' credit extension over the past year flowed to the household sector, and was reflected in an increase in household debt to 62 per cent of annualised disposable income by mid-2005 – its highest level in six years.

Having reduced the repurchase rate by 50 basis points in April 2005, the Bank's Monetary Policy Committee decided to keep its key policy interest rate unchanged at its meetings in June and August 2005. Money-market interest rates remained aligned with the repurchase rate.

Yields on domestic long-term government bonds, which reached a record low of 7,69 per cent on 28 February 2005, picked up to 8,77 per cent on 5 April 2005, coinciding with fluctuations in the exchange value of the rand and rising bond yields in the major international financial centres. In the ensuing period bond yields resumed their generally declining tendency and by early August, when a prominent credit-rating agency upgraded South Africa's sovereign credit rating, reached levels quite close to their low point at the end of February. Towards the end of August yields on long-term bonds rose materially as crude oil prices surged and worse-than-expected data on domestic inflation and money supply growth were released.

The upward trend in share prices on the JSE Limited was interrupted from the second half of March to late April 2005, but subsequently resumed, successively setting new record highs from the end of May. Accelerating growth in economic activity, the relatively low interest rate environment, robust commodity prices and the moderate depreciation of the exchange value of the rand since the beginning of 2005 counted among the factors supporting the share market. The all-time peak in the JSE all-share price index that was reached on 12 September represented an increase of 29 per cent from late April 2005.

The real-estate market remained buoyant during the past year. Whereas the tempo of increase in house prices decelerated significantly over this period, it continued to exceed the pace of consumer price inflation and the level of nominal interest rates on mortgage advances by a considerable margin.

Tax collections remained robust in the first four months of the 2005/06 fiscal year, consistent with the underlying strength of the economy. Even allowing for the projected increase in the deficit later in the fiscal year, its magnitude is set to remain well contained, demonstrating government's continued commitment to the pursuit of sound fiscal policies.

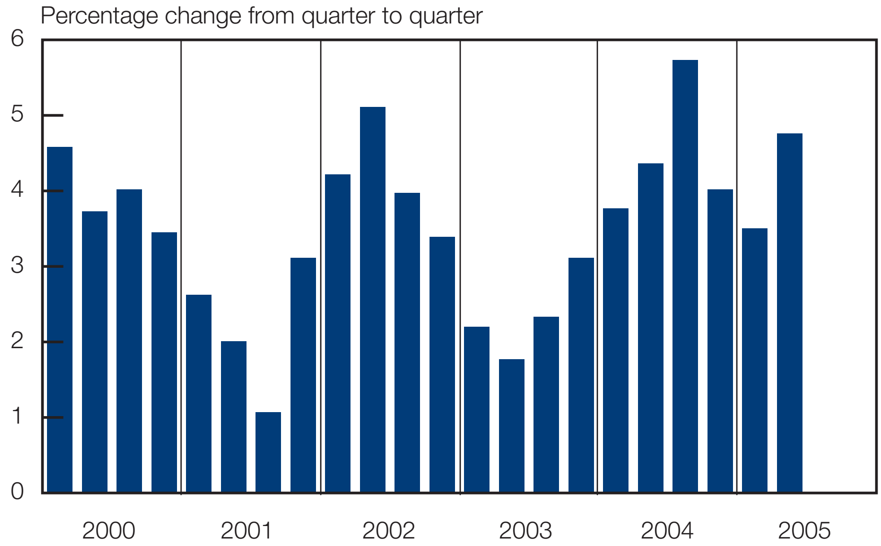
Domestic economic developments

Domestic output[1]

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

Growth in South Africa's *real gross domestic product* accelerated from an annualised rate of 3½ per cent in the first quarter of 2005 to 5 per cent in the second quarter. This robust growth can be attributed to a strong increase in the real value added by the secondary sector which was accompanied by solid growth in the real output of the tertiary sector of the economy. The real value added by the primary sector also increased, but at a slower pace than in the first quarter of 2005. Real gross domestic product increased at a rate of 4½ per cent in the first two quarters of 2005 compared with the first two quarters of 2004.

Real gross domestic product



Seasonally adjusted annualised rates

Growth in the real value added by the *primary sector* slowed from an annualised rate of 7½ per cent in the first quarter of 2005 to 5½ per cent in the second quarter. This was mainly on account of a sharp slowdown in growth in the mining sector which was counteracted by an improvement in real agricultural output.

The real value added by the *agricultural sector* increased at a solid pace in the second quarter of 2005. Growth in real agricultural output accelerated from an annualised rate of 4 per cent in the first quarter of 2005 to 10 per cent in the second quarter. Agricultural production benefited from a bumper maize crop of more than 12 million tons which was predominantly harvested in the second quarter. In addition, horticultural and livestock production held up fairly well from the first quarter of 2005 to the second quarter.

Growth in the real value added by the *mining sector* tapered off from an annualised rate of 9 per cent in the first quarter of 2005 to 3½ per cent in the second quarter. Mining output was adversely affected by a decline in the mining of gold, diamonds and platinum. The decline in the real value added by the gold-mining industry occurred despite the mining of ore with a higher gold content. Growth in the real value added by platinum and diamond-mining industries was subdued in the second quarter of 2005.

After a contraction in the real value added by the *secondary sector* in the first quarter of 2005, growth subsequently accelerated to an annualised rate of 6½ per cent in the second quarter. Increased production could mainly be attributed to higher growth in the real value added by the manufacturing and construction sectors, while the real value added by the sector supplying electricity, gas and water showed virtually no change from the first to the second quarter of 2005.

Output in the manufacturing sector rose at an annualised rate of 7½ per cent in the second quarter, following a decline of about 2 per cent in the first quarter of 2005. This acceleration in manufacturing output growth is explained by a rise in real domestic final demand and stronger export demand for certain categories of manufactured goods, given a somewhat more competitive level of the exchange rate of the rand in the first half of 2005. Increased production activity was observed mainly in the manufacturing of food and beverages, wood and wood products, petroleum and chemical products, basic iron and steel products as well as in the manufacturing of motor vehicles, parts and accessories and other transport equipment.

In the sector supplying *electricity, gas and water*, real output was virtually unchanged from the first quarter of 2005 to the second quarter. This was not only due to the mild winter temperatures experienced in large parts of the country, but also to an increase in the volume of imported electricity.

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
Primary sector	5	7	9½	½	3½	7½	5½
Agriculture................	8½	17½	11½	4	1	4	10
Mining......................	3½	3	9	-1	4	9	3½
Secondary sector	5	6	6½	3	3	-1	6½
Manufacturing...........	5	6	6½	2½	2½	-2	7½
Tertiary sector	3½	4	5	5	4	4½	4½
Non-agricultural sector ..	*4*	*4*	*5½*	*4*	*4*	*3½*	*4½*
Total	4	4½	5½	4	3½	3½	5

In contrast to the sector supplying electricity, gas and water, growth in the real value added by the *construction sector* accelerated from an annualised rate of 5 per cent in the first quarter of 2005 to 6 per cent in the second quarter. New building construction, particularly of non-residential buildings, and to a lesser extent of residential buildings, boosted growth in this sector. In addition, alterations to existing buildings in the drive to renew inner-city urban areas as well as new infrastructural projects by general government contributed to the improved fortunes of the construction sector.

Growth in the *tertiary sector* continued at a steady rate of 4½ per cent in the second quarter of 2005. This firm growth was underpinned by increased activity in the trade and the transport, storage and communication sectors. While remaining quite brisk, output growth in the *finance, insurance, real-estate and business services sector* lost some momentum in the second quarter.

Growth in the real value added by the *commerce sector* accelerated from an annualised rate of 4 per cent in the first quarter to 5 per cent in the second quarter of 2005. The acceleration in growth can be attributed to the buoyancy of the motor trade, with some support from the retail trade sector. Consumer demand for new motor vehicles remained robust in the second quarter of 2005, while the retail subsector continued to benefit from high real outlays on durable and semi-durable goods.

Growth in the real output originating in the *transport, storage and communication sector* edged higher from an annualised rate slightly below 6 per cent in the first quarter of 2005 to 6½ per cent in the second quarter on account of improved activity in both the transport and communication subsectors. Real economic activity in the transport subsector benefited from increased volumes of imports and exports and the normalisation of operations following a transport-worker strike in the first quarter.

The *financial intermediation, insurance, real-estate and business services sector's* real growth rate slowed from an annualised 6 per cent in the first quarter of 2005 to 4 per cent in the second quarter. Banks, other financial services and the real-estate sector continued to benefit from high turnovers in the traded-securities markets and in the real-estate market. Growth in the real value added by *general government* accelerated from an annualised rate of 1½ per cent in the first quarter of 2005 to 2 per cent in the second quarter as more employees were recruited by the civil service.

Domestic expenditure

Growth in aggregate *real gross domestic expenditure* accelerated from an annualised rate of 1½ per cent in the first quarter of 2005 to 5 per cent in the second quarter. This acceleration resulted from faster growth in real final consumption expenditure by households and general government as well as an acceleration in the pace of inventory accumulation, which more than offset a slowdown in growth in real gross fixed capital formation over the period. The level of real gross domestic expenditure in the first two quarters of 2005 was 4 per cent higher than in the corresponding period of 2004, signalling slower growth than the 6½ per cent recorded in 2004.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

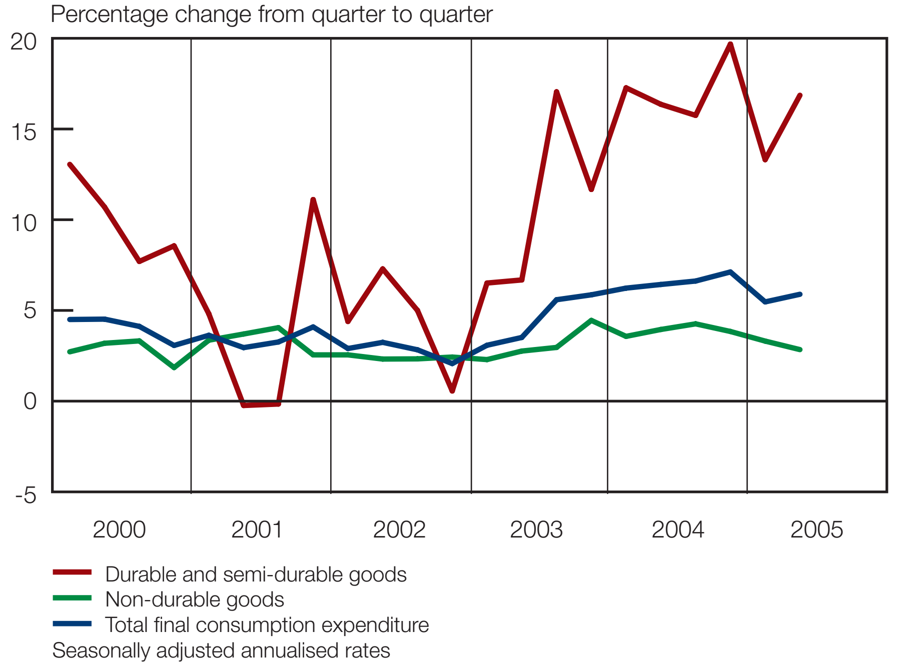
	2004					2005	
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure by households	6	6½	6½	7	6	5½	6
Final consumption expenditure by general government	6	6	0	13	7	1	5½
Gross fixed capital formation	11½	10	7½	9	9½	10	5½
Change in inventories (R billions)*	9,6	14,9	13,6	7,6	11,4	1,0	2,1
Gross domestic expenditure	**5½**	**9**	**2½**	**4½**	**6½**	**1½**	**5**

* At constant 2000 prices

Brisk spending by consumers boosted *real final consumption expenditure by households* in the second quarter of 2005. Following a slight levelling off in the rate of expansion in the first quarter of 2005, real final consumption expenditure by households accelerated from an annualised rate of 5½ per cent in the first quarter of 2005 to 6 per cent in the second quarter. Durable goods, which typically have a high import content, were especially in strong demand. Household expenditure on the other major spending categories held firm in the second quarter, but growth rates were somewhat down from the previous quarter.

Robust consumer spending on personal transport equipment, especially new cars, was primarily responsible for the surge in real outlays on *durable goods* from an annualised growth rate of 12 per cent in the first quarter of 2005 to 26½ per cent in the second quarter. The high level of household expenditure on durable goods reflected high consumer confidence levels, low interest rates and attractive sales incentives which enhanced the affordability of new vehicles. Growth in real spending on furniture, household appliances, medical equipment and recreational goods tapered off in the second quarter. Similarly, the tempo of increase in real expenditure on *semi-durable* and *non-durable goods* lost some momentum in the second quarter of 2005, while real spending on *services* expanded at the same rate as in the first quarter.

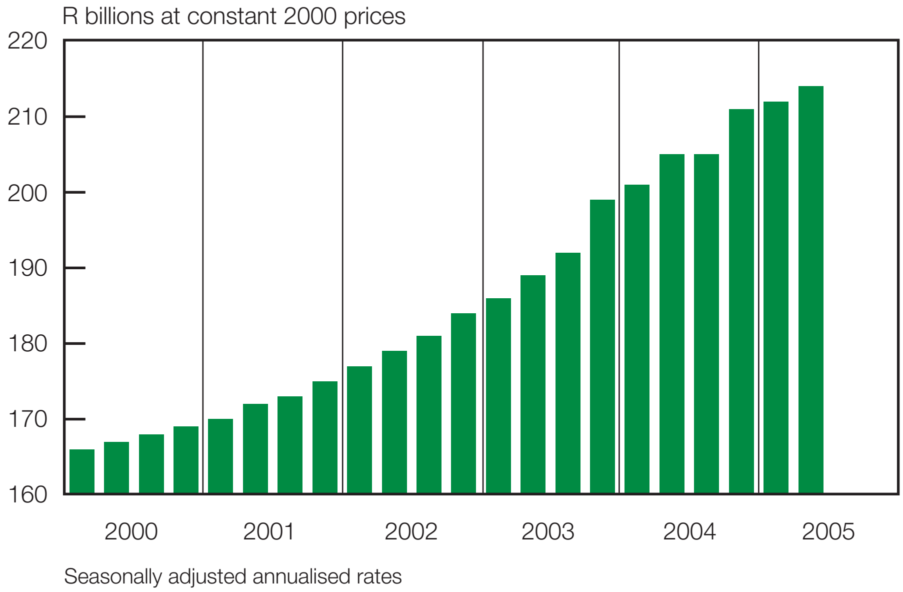
Real final consumption expenditure by households



The increase in real spending by households in the second quarter of 2005 was underpinned by relatively strong growth in their real disposable income. Growth in *real disposable income of households* accelerated from 4 per cent in the first quarter of 2005 to 5½ per cent in the second quarter mainly due to an increase in the remuneration of employees and relatively high transfer payments by general government to households. However, a substantial portion of households' expenditure on durable goods continued to be financed by credit, as was much of their purchases of real estate. Accordingly, household debt as percentage of disposable income rose from 60 per cent in the first quarter of 2005 to 62 per cent in the second quarter.

Real final consumption expenditure by general government increased at an annualised rate of 5½ per cent in the second quarter of 2005, substantially higher than the rate of 1 per cent recorded in the first quarter. This acceleration could primarily be attributed to increased spending on intermediate goods and services, although real compensation of employees also picked up slightly. Relative to gross domestic product, final consumption expenditure by general government came to 20 per cent in the second quarter of 2005, marginally higher than the 19½ per cent recorded in the preceding quarter.

Real final consumption expenditure by general government



Growth in *real gross fixed capital formation* slowed down from an annualised rate of 10 per cent in the first quarter of 2005 to 5½ per cent in the second quarter, mainly on account of less buoyant increases in public corporations' capital expenditure.

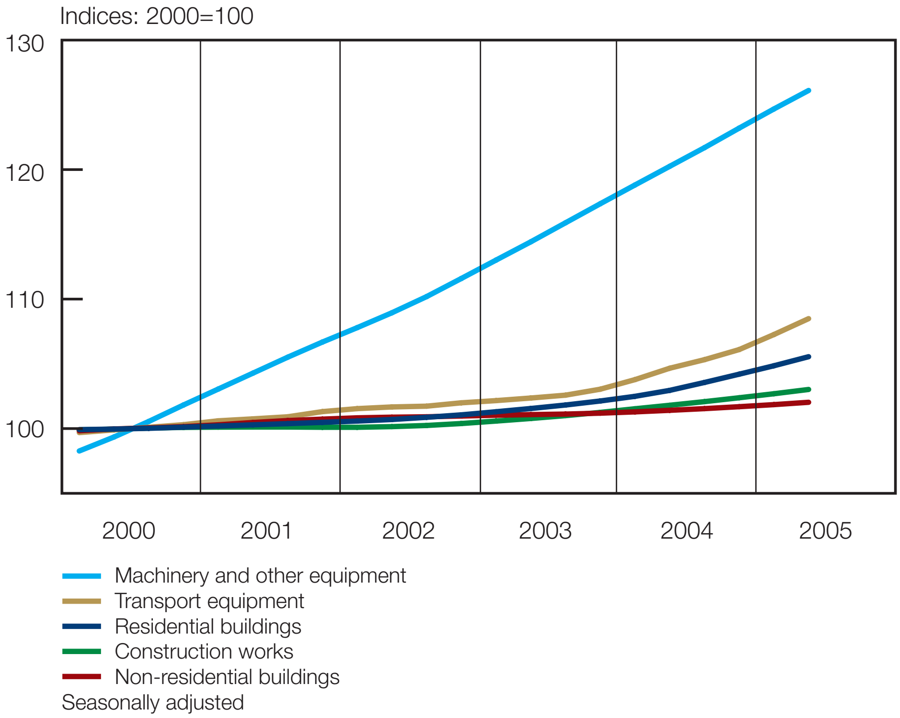
Real fixed capital expenditure by *public corporations* remained relatively strong in the second quarter of 2005, mainly due to investment in the sector supplying electricity, gas and water. The electricity utility sector stepped up real capital investment to deal with the projected shortfalls in electricity supply capacity. While public corporations' real fixed capital formation expanded at a healthy annualised rate of 17 per cent in the second quarter, this was considerably less buoyant than the rate of 68 per cent registered in the first quarter of 2005, when South African Airways acquired several new aircraft.

Gross fixed capital formation by *general government* increased in the second quarter of 2005 as all tiers of government raised their capital spending to address infrastructural backlogs and step up service delivery.

Following an increase of 4½ per cent in the first quarter, growth in real fixed capital outlays by *private business enterprises* slowed marginally to an annualised rate of 4 per cent in the second quarter of 2005. Strong increases in real fixed capital outlays by the commerce, transport, storage and communication, and real-estate sectors were more than neutralised by contractions in real capital investment in the agriculture, mining and manufacturing sectors. The perennial buoyant consumer demand provided an incentive for a further expansion in shopping facilities, which lifted the real fixed capital outlays of the commerce sector. The firm demand for cellular phones contributed to the increased capital investment on network infrastructure in the second quarter of 2005. By contrast, farmers in particular cut back on investment expenditure as they faced unfavourably low prices of some of their key products.

An analysis of the fixed capital stock by *type* of *asset* indicates that the strongest increases in the capital stock since the turn of the century have been recorded by machinery and equipment, followed by transport equipment and residential buildings. Despite the moderation in the pace of increase in house prices over the past year, lower interest rates continued to support investment in the property market, leading to sustained increases in the stock of residential buildings. As shown in the accompanying graph, the stock of transport equipment rose strongly over the past few years as companies and unincorporated business enterprises stepped up investment in commercial vehicles and airlines expanded and modernised their operations. Nevertheless, over the past five years net capital expenditure on machinery and other equipment exceeded capital spending on other asset types by a significant margin. As productive capacity was modernised and expanded, the stock of machinery and other equipment increased rapidly.

Fixed capital stock by type of asset



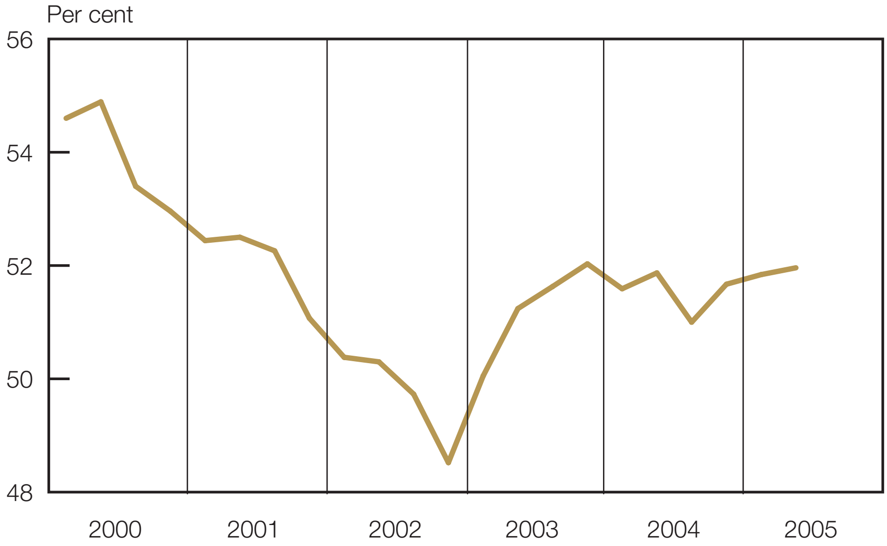
Real inventories rose at an annualised rate of almost R1 billion in the first quarter of 2005 and by R2,1 billion in the second quarter. The real inventory accumulation in the second quarter occurred mainly in the manufacturing and wholesale, retail, and motor trade sectors. The increase in inventories in the manufacturing and trade sectors might have been a reflection of generally rising turnovers. Real inventory investment contributed about ½ a percentage point to growth in real gross domestic expenditure in the second quarter of 2005. The ratio of industrial and commercial inventories to non-agricultural gross domestic product amounted to just more than 15 per cent in the second quarter, marginally lower than the ratio registered in the preceding quarter.

Factor income

The growth in total *nominal factor income*, measured over a year, was sustained at 8½ per cent in the second quarter of 2005 as the gross operating surpluses of business enterprises as well as compensation of employees increased at rates that were very similar to those attained in the first quarter of 2005.

The rate of increase in *compensation of employees*, measured over four quarters, remained unchanged at 9 per cent in both the first and second quarters of 2005. Increases in compensation of employees accelerated in the agriculture, finance and general government sectors. General government hired more workers to implement programmes targeted at improving service delivery. By contrast, remuneration increases occurred at a slower pace in the mining, manufacturing, electricity as well as the transport, storage and communication sectors. The ratio of compensation of employees to total factor income remained at 52 per cent in the first two quarters of 2005 compared with an average of 51½ per cent in 2004.

Compensation of employees as percentage of total factor income



Seasonally adjusted

Measured over a year, the *gross operating surpluses* of business enterprises rose by marginally less than 8 per cent in the second quarter of 2005 compared to a rate of increase of 8 per cent attained in the first quarter. A decline in the operating surplus of the agricultural sector in the second quarter was offset by faster growth in the operating surpluses of the mining, manufacturing and trade sectors. The decline in the operating surplus of the agricultural sector occurred against the backdrop of subdued prices of most agricultural commodities, exacerbated by rapid growth in input prices. By contrast, higher prices of mining commodities in the second quarter of 2005 boosted growth in the operating surpluses of the mining sector.

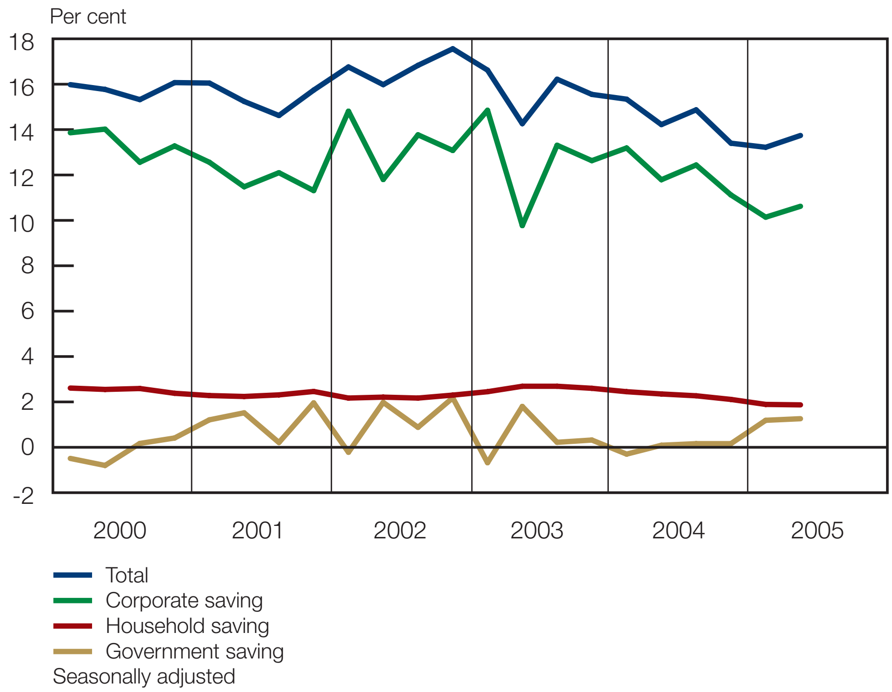
Gross saving

The country's *savings ratio* (gross saving as percentage of gross domestic product) improved from 13 per cent in the first quarter of 2005 to 13½ per cent in the second quarter. Saving by the corporate sector increased while that of households and general government remained broadly unchanged relative to gross domestic product.

The ratio of *household saving* to gross domestic product remained at 2 per cent in both the first and second quarters of 2005, somewhat lower than the average ratio of 2½ per cent attained in 2004. Owing to solid increases in general government revenue which offset rising current expenditure, gross saving by *general government* as percentage of gross domestic product remained slightly below 1½ per cent in both the first and the second quarters of 2005.

Gross saving by the *corporate sector* as percentage of gross domestic product increased from 10 per cent in the first quarter of 2005 to 10½ per cent in the second quarter. This improved savings ratio reflected comparatively healthy operating surpluses. In addition, dividend and tax payments were contained at about the same level as in the first quarter of 2005.

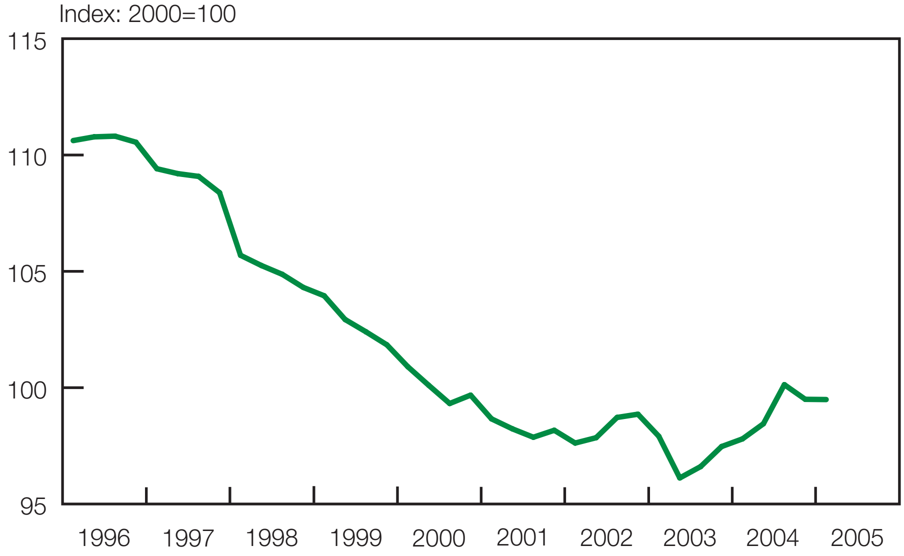
Gross saving as percentage of gross domestic product



Employment

Meaningful gains in overall employment in the formal non-agricultural sector of the economy since the third quarter of 2003 were tempered somewhat by job losses in the six-month period to March 2005. According to revised estimates based on Statistics South Africa's *Survey of Employment and Earnings* (SEE), formal non-agricultural employment declined in the fourth quarter of 2004 and remained at broadly the same level in the first quarter of 2005. Employment losses occurred primarily in the private sector; public-sector institutions consistently expanded their employee numbers over this period. Notwithstanding the decline in private-sector employment during the two quarters to March 2005, the overall level of enterprise-surveyed formal non-agricultural employment increased by 1,7 per cent or about 111 000 employees in the year to March 2005.

Enterprise-surveyed formal non-agricultural employment



Results from the most recent household-based *Labour Force Survey* (LFS) indicate an even more impressive rise in formal non-agricultural employment of 3,6 per cent or 267 000 persons in the year to March 2005. According to the LFS, which is conducted twice a year, other employment – essentially in the informal, domestic service and agricultural sectors – increased by 248 000 over the same period. For the economy as a whole, as many as 515 000 new jobs were therefore created in the twelve months to March 2005, lifting the overall level of employment to about 11,9 million. However, the official unemployment rate remained around 26 per cent in both September 2004 and March 2005, implying that the number of new employment opportunities created in the six months to March 2005 roughly equalled the number of new entrants to the labour market over this period.

In order to improve the coverage and comprehensiveness of labour market statistics, Statistics South Africa introduced a new enterprise-based *Quarterly Employment Statistics* (QES) survey which is set to replace the existing SEE after a two-quarter parallel run. The first QES survey (based on an expanded sample of 25 000 income-tax-paying employing enterprises in the formal non-agricultural sectors of the economy) measured an overall level of formal-sector non-agricultural employment of around 7,1 million employees in December 2004. This was roughly 8 per cent higher than the employment numbers of December 2004 indicated by the SEE, mainly on account of greater coverage of small businesses.

As indicated in the table on the next page, *private-sector employment* growth in the year to March 2005 was severely hampered by job losses in the gold-mining, manufacturing and finance, insurance, real-estate and business services sectors. Mainly due to robust domestic expenditure, these employment losses were more than fully offset by meaningful employment gains in the trade, catering and accommodation services sector. Employment numbers were further bolstered by increases in employment opportunities in the community, social and personal services sector, as well as in the construction, non-gold mining and transport, storage and communication sectors.

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

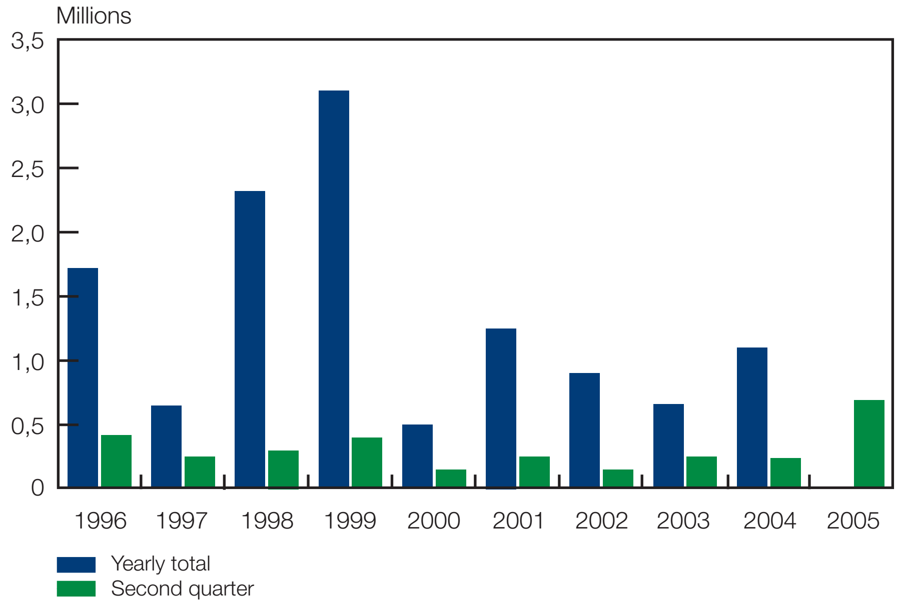
Sector	Number	Percentage change
Gold mining	-14 200	-7,5
Non-gold mining	13 800	5,3
Manufacturing	-43 000	-3,4
Electricity supply	1 400	3,3
Construction	15 500	5,8
Trade, catering and accommodation	86 300	6,7
Transport, storage and communication	9 200	5,4
Finance, insurance, real-estate and business services	-44 400	-4,1
Community, social and personal services	36 800	11,2
Total private sector	**61 300**	**1,3**
National, provincial and local government	44 800	3,3
Public-sector enterprises	5 000	2,5
Total public sector	**49 800**	**3,2**
Grand total	**111 100**	**1,7**

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

Unlike the private sector where job losses were reported during recent quarters, employment in the *public sector* expanded almost consistently during the past two years to March 2005. In fact, the level of public-sector employment rose by as much as 3,2 per cent or by roughly 50 000 jobs in the year to March 2005. Job gains in national and provincial departments in the year to March 2005 exceeded job losses in public-sector transport and communication enterprises and local government. Employment losses were most severe at Transnet and Telkom.

With official employment data for the second quarter of 2005 not yet available, several indicators show encouraging signs of improved employment prospects. Job advertisement space in the print media increased further in the second quarter of 2005.

Number of man-days lost through industrial action



Source: Andrew Levy Employment Publications

The Investec Purchasing Managers sub-index for employment, indicating purchasing managers' expectations regarding the level of employment, rose meaningfully in June 2005, before receding somewhat in July. The Bureau for Economic Research's manufacturing survey for the second quarter of 2005 indicated better employment prospects with the confidence index for the building industry in particular rising strongly.

Alongside the improvement in employment prospects, there was an increase in strike activity during the recent past. In fact, according to Andrew Levy Employment Publications (a private-sector labour consultancy), the number of man-days lost due to strikes and other forms of industrial action more than tripled from 220 000 in the first half of 2004 to 706 000 in the first half of 2005. Wage-related issues accounted for the bulk of the man-days lost during this period as employees were generally more willing to back their wage demands with strike action.

Labour cost and productivity

Nominal remuneration per worker in the formal non-agricultural sectors of the economy rose by 8,7 per cent in the year to March 2005, meaningfully lower than the increases of 12,4 per cent in the year to December 2004 and 9,2 per cent in the calendar year 2004 as a whole. Increases in the fourth quarter of 2004 reflected special performance rewards made to certain public-sector employees as well as generous bonuses paid to many private-sector employees following the achievement of business targets. In the first quarter of 2005, nominal wage growth slowed in both the public and the private sector.

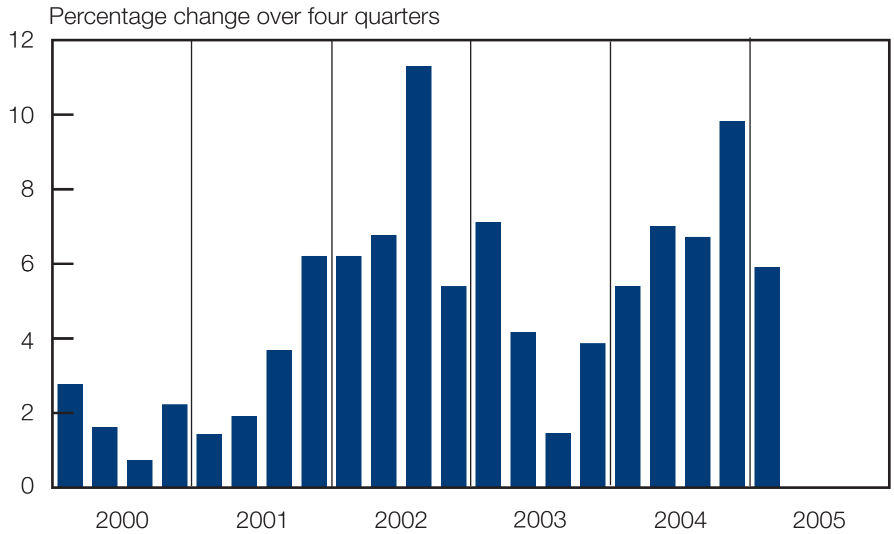
The slowdown in nominal wage growth in the formal non-agricultural sectors of the economy in the first quarter of 2005 is corroborated by information furnished by the Automated Clearing Bureau (ACB) on the average salaries, wages and pensions deposited into the bank accounts of almost 5 million salaried and retired workers. However, information for the second quarter of 2005 indicates an acceleration in the rate of increase in these payments. According to Andrew Levy Employment Publications, the average settlement rate in collective bargaining agreements declined to 6,0 per cent in the first half of 2005 from 7,3 per cent in the same period in the preceding year and 6,8 per cent in 2004 as a whole. High-profile settlements in the first part of the third quarter ranged from 5 per cent to 8 per cent.

The pace of increase in nominal remuneration per worker in the *public sector* slowed from a year-on-year rate of 12,4 per cent in the fourth quarter of 2004 to 6,6 per cent in the first quarter of 2005. The exceptionally high rate of public-sector wage increases in the fourth quarter of 2004 was mainly the result of steep increases at local government level as well as in provincial governments. While year-on-year increases at local government level remained high in the first quarter of 2005, compensation per employee in provincial governments rose fairly slowly over the same period.

The Independent Commission for the Remuneration of Public Office Bearers has after wide consultation recommended that the salaries, benefits and allowances of *public office bearers* be increased by 5,75 per cent in the financial year 2005/06, with effect from 1 April 2005. A process of evaluation, benchmarking and grading all positions of public office bearers is also underway.

In contrast to the slowdown in nominal wage growth in the public sector from the fourth quarter of 2004 to the first quarter of 2005, remuneration increases granted by *private-sector* enterprises were, on average, more generous. When measured over periods of four quarters, nominal wage growth in the private sector slowed from 12,4 per cent in the fourth quarter of 2004 to 9,4 per cent in the first quarter of 2005. Nominal wage growth also varied considerably within the private sector. The year-on-year growth in private-sector nominal remuneration per worker in the first quarter of 2005 ranged from a low of 7,7 per cent in the gold-mining sector to 14,1 per cent in the finance, insurance, real-estate and business services sector. In the non-gold mining sector average remuneration per worker contracted in the year to March 2005 as employment numbers picked up meaningfully, with most new workers receiving wages below those of more experienced workers.

Non-agricultural nominal unit labour cost



Alongside meaningful increases in the overall level of employment, *economy-wide labour productivity growth* slowed markedly during the first three quarters of 2004. The year-on-year rate of increase in real production per worker decelerated from 3,3 per cent in the first quarter of 2004 to 0,5 per cent in the third quarter. Mainly as a result of the slower increase in the level of employment, labour productivity growth picked up to 2,6 per cent in the year to the first quarter of 2005. The year-on-year rate of increase in production per worker in the *manufacturing sector* was more pronounced at 7,4 per cent in the first quarter of 2005 as employment numbers contracted.

Consistent with the acceleration in labour productivity growth and moderating rates of increase in nominal remuneration per worker, the *rate of increase in the cost of labour per unit of production* in the formal non-agricultural sector decelerated from 7,2 per cent in 2004 to 5,9 per cent in the year to the first quarter of 2005. The year-on-year rate of increase in nominal unit labour cost in the *manufacturing sector* decelerated even more impressively to 5,4 per cent in the first quarter of 2005 from 7,4 per cent in 2004.

Prices

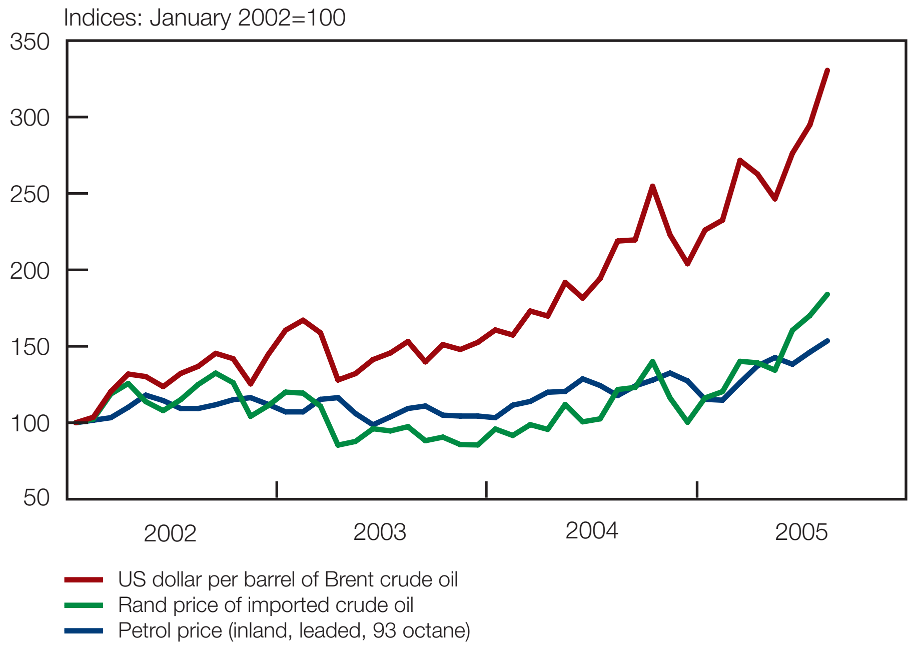
Although CPIX inflation has remained within the inflation target range of between 3 and 6 per cent for twenty-three consecutive months since September 2003, month-to-month changes in CPIX inflation recently became more volatile. Sizeable monthly changes in the price of petrol – mostly increases – introduced this heightened volatility to the measured inflation rates and contributed to a modest pick-up in inflation. Over and above the renewed rise in the international price of crude oil to levels well in excess of US$60 per barrel in recent months, the moderate depreciation in the exchange value of the rand in the opening months of 2005 raised the cost of imports. The effect of these inflationary factors was mitigated somewhat by a slowdown in consumer food price inflation.

All-goods production price inflation accelerated on a year-on-year basis from 1,2 per cent in February 2005 to 3,6 per cent in July and on a quarter-to-quarter and annualised basis from 1,3 per cent in the first quarter of 2005 to 5,1 per cent in the second quarter. Higher rates of increase in the prices of both imported and domestically produced goods contributed to the acceleration in production price inflation.

Higher crude oil prices also influenced production price inflation in South Africa's main trading-partner countries in recent months. The year-on-year rate of increase in the composite wholesale price index of South Africa's main trading-partner countries accordingly accelerated from about 0,9 per cent in March 2004 to roughly 3 per cent by mid-2005. Despite the acceleration in production price inflation, underlying inflationary pressures in these countries generally remained muted, particularly in the euro area, acting as a brake in the transmission of price pressures to the South African economy.

Declines during the first half of 2005 in the import prices of agricultural and manufactured food products, as well as in the prices of accounting and computing machinery, were more than offset by increases in the prices of crude oil, basic metals, chemicals and chemical products and plastic products. Reflecting mainly the rise in the international price of crude oil, year-on-year changes in the prices of imported goods reverted from a decrease of 0,7 per cent in February 2005 to an increase of 5,2 per cent in July. In particular, the average rand price of crude oil imports increased by approximately 46 per cent in the year to July 2005. The quarter-to-quarter pace of change in imported goods prices reverted from an annualised rate of decrease of 3,2 per cent in the first quarter of

Crude oil and domestic petrol prices



2005 to an increase of 13,7 per cent in the second quarter. The acceleration resulted from the combined effect of the depreciation of the rand in the first months of 2005 and rising international prices of crude oil.

Benign increases in the prices of certain imported goods contributed to the fairly moderate rise in *domestically-produced goods prices* during the opening months of 2005. Lately, the twelve-month rate of increase in domestically-produced goods prices, on balance, rose from 1,9 per cent in April 2005 to 3,0 per cent in July. 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 3,9 per cent in the second 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

Over and above brisk year-on-year increases in the prices of electricity, gas and water, tobacco and basic metals in the first half of 2005, the prices of coal-mining products rose by 12,8 per cent and the prices of products of petroleum and coal by 11,6 per cent in June 2005. In the year to July 2005 the prices of products of petroleum and coal rose by no less than 31,2 per cent. Inflation pressures were relatively moderate in the other categories of domestically produced goods. In fact, the production prices of agricultural products, manufactured food as well as textiles, clothing and footwear declined in the year to July 2005. Inflation in the prices of key food items is expected to remain muted in the second half of 2005 as maize futures are trading at relatively low levels and official crop estimates for maize production suggest a bumper crop in the current harvest season.

Alongside the pick-up in production price inflation, consumer price inflation accelerated somewhat in recent months. Consumer price inflation as measured by the year-on-year rate of increase in the *consumer price index for metropolitan and other urban areas excluding interest cost on mortgage bonds* (CPIX) accelerated, on balance, from an all-time low of 3,1 per cent in February 2005 to 4,2 per cent in July. The main driving forces behind accelerating CPIX inflation during the first half of 2005 were the depreciation of the exchange rate of the rand and the rise in international crude oil prices. This led to an increase in the domestic inland price of petrol from R4,20 per litre in February 2005 to R5,62 per litre in August – an increase of almost 34 per cent. The quarter-to-quarter pace of CPIX inflation more than doubled from an annualised rate of 2,4 per cent in the first quarter of 2005 to 4,6 per cent in the second quarter.

As with production prices, the high degree of variability resulting from month-to-month changes in petrol prices is clearly evident in the evolution of *CPIX goods price inflation* in recent months. Year-on-year CPIX goods price inflation vacillated between 1,8 per cent

Inflation in CPIX components

Percentage change over same period in previous year

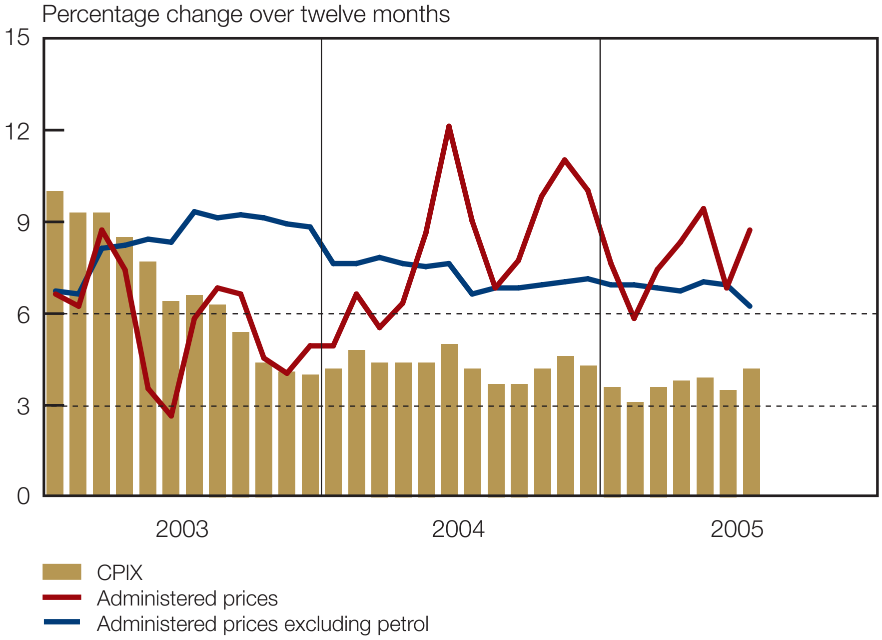
	Weights	July 2005
Transport running cost	5,7	14,6
Alcoholic beverages and tobacco	3,1	8,5
Housing services	13,4	6,7
Services excluding housing and transport	*16,5*	*6,0*
Other goods (not included elsewhere)	17,5	2,8
Food	26,9	2,7
Transport services	3,9	1,5
Furniture and equipment	3,2	-0,6
Vehicles	5,7	-1,4
Clothing and footwear	4,1	-2,6
Total CPIX	*100,0*	*4,2*

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

and 3,6 per cent during the past twelve months, amounting to 3,4 per cent in July 2005. Unlike the general rise in energy prices, prices in most of the other goods categories experienced either very moderate increases or even declines during recent months. The prices of clothing and footwear, furniture and equipment as well as vehicles decreased almost consistently during the past year, whilst year-on-year food price inflation remained fairly benign at around the 1,5 per cent level, accelerating to 2,7 per cent in July 2005. An acceleration in the quarter-to-quarter pace of CPIX goods price inflation to an annualised rate of 3,9 per cent was registered in the second quarter of 2005.

Whereas year-on-year increases in consumer goods prices fell below the lower limit of the inflation target range, *CPIX services price inflation* approximated the upper limit of the inflation target range during the first six months of 2005. Year-on-year CPIX services price inflation decelerated from approximately 8 per cent in 2003 as a whole to around 5,9 per cent in July 2005. Contrary to the fairly stable year-on-year rates of increase in

CPIX and administered prices



CPIX services prices in recent months, the quarter-to-quarter and annualised rate of increase accelerated from 4,9 per cent in the first quarter of 2005 to 7,1 per cent in the second quarter. This acceleration resulted principally from increases in the prices of housing-related services, as well as other services that are not related to housing and transport. Housing-related service prices were strongly influenced by a monthly rate of increase of 1,3 per cent in domestic workers' wages since March 2005 as indicated by results from the September 2004 LFS. Transport services prices, being partly subsidised, have not responded to the rise in energy costs and essentially remained unchanged from the first quarter of 2005 to the second quarter, restraining services price inflation.

Although relatively muted increases in the prices of a wide spectrum of consumer goods and services persist, the rate of inflation in the prices of some administered goods and services remained well in excess of the inflation target range. In July 2005 year-on-year inflation in the prices of administered goods and services excluding petrol amounted to 6,2 per cent, while for petrol it came to no less than 16,2 per cent.

Foreign trade and payments

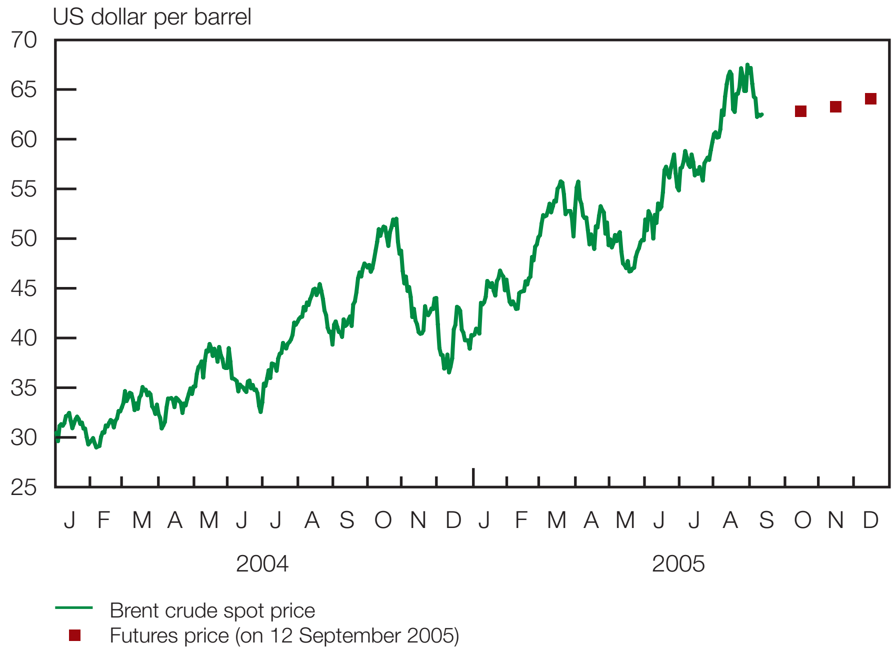
International economic developments

The global economy continued to grow at a fairly strong pace during the first half of 2005. Following buoyant first-quarter growth, real output in the United States of America (US) increased at a solid but somewhat slower pace in the second quarter of 2005. Output growth in the euro area remained subdued over the first half of the year, but recent indicators suggest economic growth could improve in the second half of 2005. The Japanese economy moderated in the second quarter of 2005 following a pick-up in economic output in the first quarter. Economic growth in China and some of the other major emerging-market countries in Asia moderated slightly in the second quarter of 2005. In Africa the overall growth picture so far in 2005 is encouraging, but non-oil-producing and drought-stricken countries are likely to lag behind.

Large current-account imbalances continued to be recorded in many parts of the world. The current-account deficit of the US reached a record high 6,4 per cent of the country's gross domestic product in the first quarter of 2005, while current-account surpluses in Japan, emerging Asia and some oil-exporting countries widened further. The replacement on 21 July 2005 of the eight-year-long peg of the Chinese yuan to the dollar by a more flexible exchange rate system and the subsequent 2,1-per-cent appreciation of the yuan could help towards reducing some of the imbalances in the world economy.

Robust growth in global economic activity boosted demand for energy. Crude oil prices more than doubled from the beginning of 2004 to record-high levels which approached US$70 per barrel in nominal terms towards the end of August 2005. The Organization of the Petroleum Exporting Countries (OPEC) raised its official output quotas on several occasions since mid-2004 in order to meet the increased global demand for crude oil with only a limited effect on oil prices. Spare oil production capacity in OPEC recently declined to historic low levels of around 2 million barrels per day. In addition, geopolitical factors, adverse weather conditions and disruptions in production of oil in some countries also

Brent crude oil prices



adversely affected crude oil prices. A devastating hurricane damaged refining capacity along the coast of the Gulf of Mexico on 29 August, causing oil prices to increase to record levels, before declining below US$63 per barrel in mid-September 2005 after the International Energy Agency revised its 2005 global oil demand growth downward and US refineries started to recover from hurricane damage.

The sharp increase in commodity prices, especially oil prices, contributed to moderate increases in headline inflation in most countries during the past eighteen months. Exceptionally high levels of oil prices also seemed set to cause more and more friction in the process of expansion in global economic activity.

Short-term interest rates in the US continued to edge higher to remove excessive levels of monetary accommodation, with the federal funds target rate being raised to 3,50 per cent in August 2005 – its tenth 25-basis-point increase since mid-2004. Since the beginning of 2005 monetary policy was also tightened in a number of countries including Australia, Brazil, Canada, Chile, Hong Kong, India, Mexico, New Zealand, Taiwan and Thailand. By contrast, the central banks of the Czech Republic, Hungary, Israel, Poland, Sweden and the United Kingdom lowered their official interest rates during this period. The European Central Bank has kept interest rates unchanged since 2003, while the Bank of Japan eased monetary policy several times during 2003 and in January 2004 by increasing the target range for the outstanding balance on reserve accounts held by commercial banks.

Current account [2]

Notwithstanding the somewhat slower pace of global economic expansion since the middle of 2004, South Africa's merchandise export volumes rallied strongly in the second quarter of 2005. The impressive export performance was partly offset by a further contraction in the physical quantity of net gold exports and a substantial increase in the volume of imported goods in response to continued strong growth in gross domestic expenditure. On a net basis, South Africa's trade deficit with the rest of the world narrowed from R7,1 billion in the first quarter of 2005 to R2,2 billion in the second quarter.

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

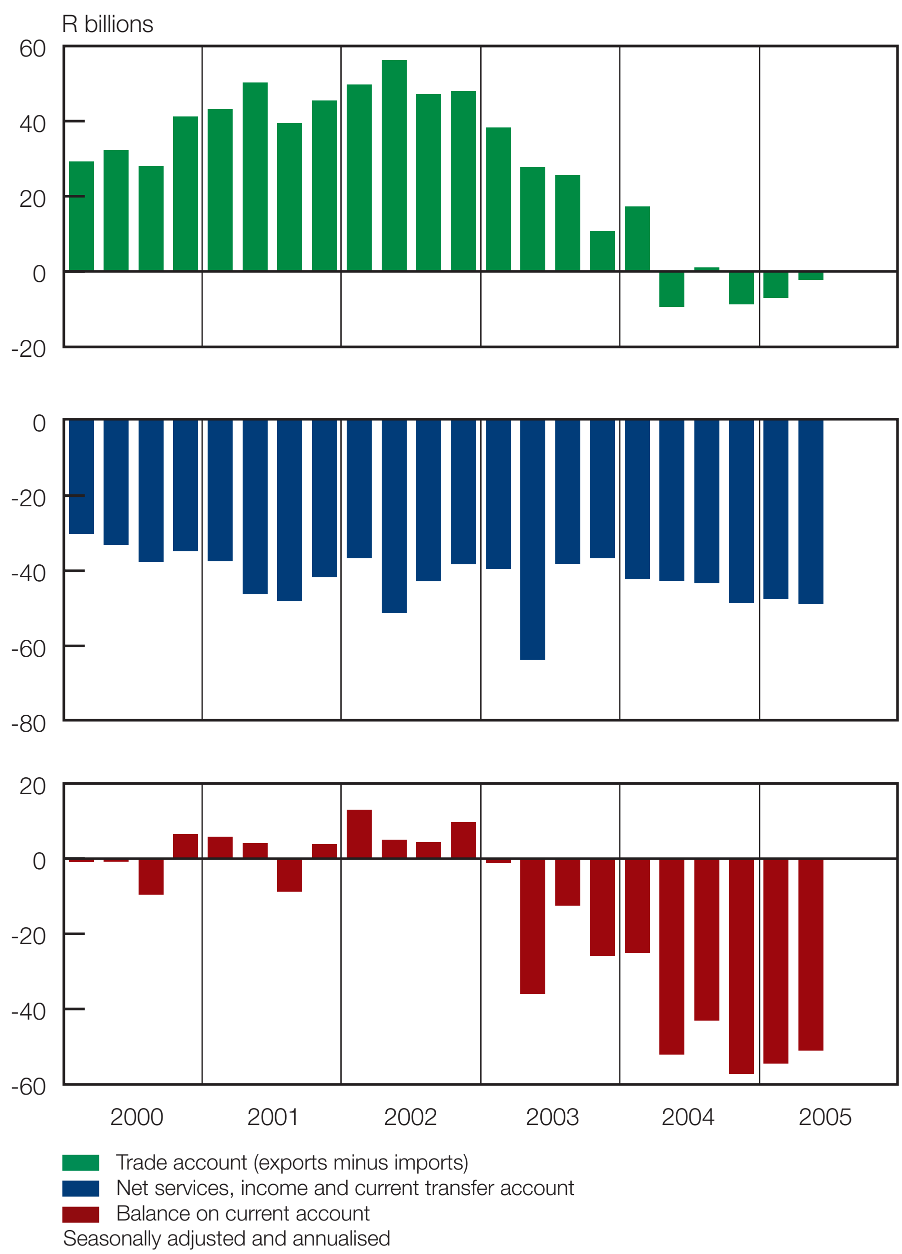
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2004				2005	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	278,0	286,3	290,7	278,9	282,1	330,0
Net gold exports	33,3	29,7	35,0	32,8	28,4	27,9
Merchandise imports	-320,7	-315,7	-334,4	-311,9	-317,6	-360,1
Trade balance	**-9,4**	**0,3**	**-8,7**	**-0,2**	**-7,1**	**-2,2**
Net service, income and current transfer payments	-42,7	-43,4	-48,6	-44,2	-47,4	-48,8
Balance on current account	**-52,1**	**-43,1**	**-57,3**	**-44,4**	**-54,5**	**-51,0**

The improvement in the trade balance, partly offset by a somewhat larger deficit on the country's services and income account with the rest of the world, narrowed the deficit on the current account of the balance of payments from R54,5 billion in the first quarter of 2005 to R51,0 billion in the second quarter. Relative to gross domestic product, the current-account deficit contracted from 3,8 per cent to 3,4 per cent over the period.

Balance of payments: Current account

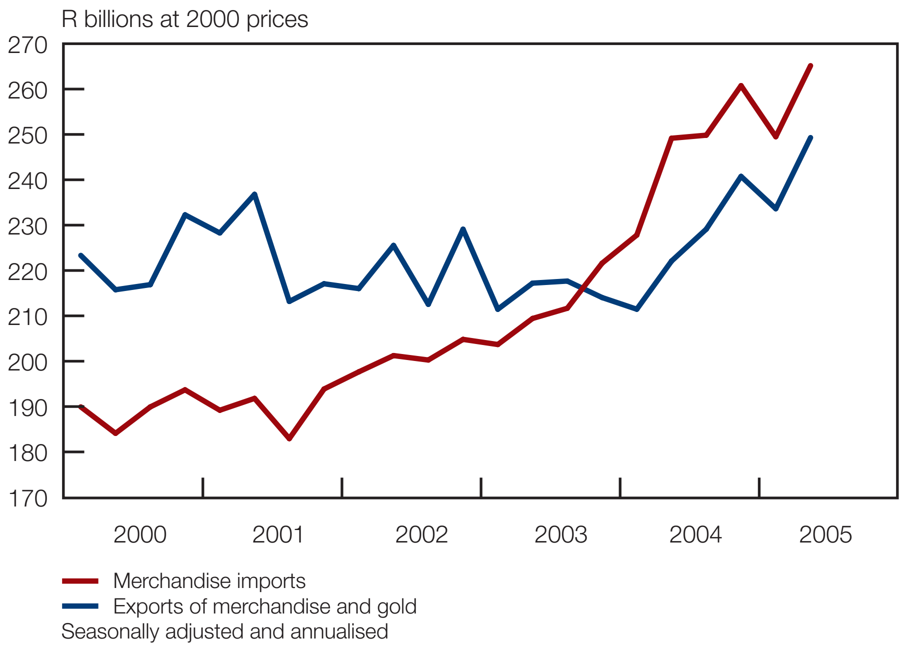


Export volumes contracted by 1½ per cent in the first quarter of 2005. However, the steady pace of global economic activity and the lagged effect of the depreciation of the rand since the end of 2004 created additional demand for domestically produced goods and this lifted the volume of merchandise exports by 8½ per cent in the second quarter of 2005 relative to the first quarter. Exporters of mining products – in particular platinum, coal, iron ore, manganese ore, chrome, ferrochrome and ferromanganese, copper, nickel and asbestos – benefited most from the international demand for commodities. As a percentage of total merchandise exports, the value of exports destined for Asian countries increased from 24,5 per cent in the first quarter of 2005 to 28,6 per cent in the second quarter. At the same time, the share of South Africa's exports to Europe declined somewhat, while export sales to North and South America remained broadly unchanged.

Moderate increases in international commodity prices together with the depreciation of the rand against most currencies, caused the average price level of merchandise exports to rise by about 8 per cent in the second quarter of 2005. These price increases, combined with significantly greater export volumes, raised the value of merchandise exports from R282,1 billion in the first quarter of 2005 to R330,0 billion in the second quarter, or by 17 per cent. The overall rise in the value of exported goods was observed in all the main export categories, namely agriculture, mining and manufactured products.

The continuing decline in gold production reduced the value of net gold exports for the second consecutive quarter from R28,4 billion in the first quarter of 2005 to R27,9 billion in the second quarter – the lowest level since the second quarter of 2001. Prolonged operational difficulties in the gold-mining industry caused the physical quantity of gold exports to fall by 9 per cent in the second quarter of 2005, following a decline of almost 17 per cent in the first quarter. Although the average fixing price of gold on the London gold market remained broadly unchanged at US$427 per fine ounce in the first half of 2005, the average realised price increased moderately from R2 560 per fine ounce in the first quarter of 2005 to R2 762 per fine ounce in the second quarter.

Real imports and exports



The higher level of domestic expenditure lifted spending on imported goods by 13½ per cent to R360,1 billion in the second quarter of 2005. Solid increases occurred mainly in the subcategories for mineral products (crude oil) and imported manufactured goods, essentially machinery and electrical equipment. In contrast to previous quarters, no aircraft, ships or other high-value military equipment in terms of the government's arms procurement programme were imported in the second quarter of 2005.

Merchandise import volumes, which had declined by almost 4½ per cent in the first quarter of 2005, rose by 6½ per cent in the second quarter. The volume of crude oil imports, which had been declining since the third quarter of 2004, increased by about

15 per cent in the second quarter of 2005. Rising production prices in South Africa's trading-partner countries, together with the decline in the nominal effective exchange value of the rand and higher international crude oil prices, raised import prices on average by 6½ per cent in the second quarter of 2005.

Net services and income payments to non-residents, together with net current transfer payments to the rest of the world, increased marginally from R47,4 billion in the first quarter of 2005 to R48,8 billion in the second quarter. Higher interest payments to non-residents were almost fully matched by an increase in dividends received by South African investors on their offshore investments during this period.

The downward trend in South Africa's terms of trade was reversed in the second quarter of 2005 when export prices rose at a marginally faster pace than import prices. Apart from the depreciation of the rand, export prices were influenced by an increase in international commodity prices, while import prices rose mainly on account of higher international crude oil prices.

Financial account

Surplus liquidity in international financial markets, together with the search for high-yielding investments by foreign investors, continued to underpin strong capital flows into emerging markets. South Africa accordingly experienced a further improvement in the financial account of the balance of payments; the net inward movement of capital into the country accelerated from R11,7 billion in the first quarter of 2005 to R36,5 billion in the second quarter. Cumulatively, the net inflow of capital (including unrecorded transactions) amounted to R96,4 billion in 2004. The major portion of the surplus on the financial account of the balance of payments in the second quarter of 2005 was attributable to net inward portfolio investments.

Net financial transactions not related to reserves
R billions

	2004				2005	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	-1,6	1,7	-5,0	3,8	1,3	-0,1
Portfolio investment	14,1	3,0	22,7	44,9	7,8	22,1
Other investment	4,5	-2,9	7,8	13,5	24,7	-1,8
Change in assets						
Direct investment	-9,4	-0,6	-0,8	-10,4	-0,7	3,9
Portfolio investment	-1,5	-1,3	-3,2	-6,0	2,6	-1,5
Other investment	6,2	4,0	10,9	18,1	-11,5	3,6
Total financial transactions*	**27,1**	**22,6**	**31,4**	**96,2**	**11,7**	**36,3**

* Including unrecorded transactions

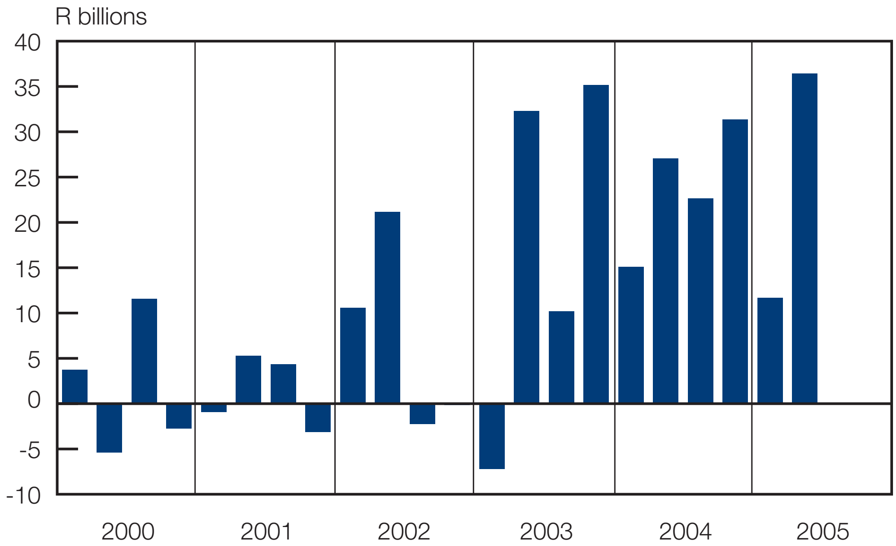
Foreign-owned assets in South Africa

Foreign direct investment into South Africa changed from an inflow of R1,3 billion in the first quarter of 2005 to an outflow of R0,1 billion in the second quarter. The net outflow of capital resulted from the disinvestment by a non-resident investor from a South African furniture retailer which was partly neutralised by a non-resident investor's acquisition of a controlling interest in a South African mining company. The repayment of other loan capital previously borrowed from affiliated enterprises abroad also contributed to the net outflow of capital in the second quarter.

Portfolio investment flows into South Africa increased substantially from R7,8 billion in the first quarter of 2005 to R22,1 billion in the second quarter – the sixth consecutive quarter in which inflows were recorded. Foreign portfolio investors increased their holdings of both fixed-interest securities and shares while a number of South African companies also issued corporate bonds to international investors during the second quarter of 2005. These high-yielding bonds, which were issued at relatively favourable rates, will mature between 2012 and 2015. The inflow of portfolio investment in the second quarter of 2005 was partly offset by the redemption of a euro-denominated international bond to the value of €500 million by a South African public corporation. Preliminary indications are that the net inflow of portfolio capital continued in July and August 2005; foreign investors were, however, again net sellers of debt securities over the period.

Other foreign investment into South Africa recorded an outflow of R1,8 billion in the second quarter of 2005 compared with an inflow of R24,7 billion in the first quarter. This outflow could mainly be attributed to foreign investors reducing their rand-denominated deposits with South African banks.

Balance on financial account



Balance on financial account including unrecorded transactions

South African-owned assets abroad

Outward direct investment changed from an outflow of R0,7 billion in the first quarter of 2005 to an inflow of R3,8 billion in the second quarter. The net inward movement of capital reflected the repatriation of the proceeds from the selling of a foreign subsidiary by a South African retail company.

Portfolio investment by South African entities abroad switched from an inflow of R2,6 billion in the first quarter of 2005 to an outflow of R1,5 billion in the second quarter. The increase in foreign portfolio assets could be ascribed to the net acquisition of offshore equity and debt securities by South African institutional investors and individuals in terms of the prevailing exchange control regulations.

Other outward investment from South Africa (i.e. claims on non-residents not recorded as direct or portfolio investment) changed from an outflow of R11,5 billion in the first quarter of 2005 to an inflow of R3,6 billion in the second quarter. This decrease in claims by South African entities on non-residents resulted in part from a decline in rand-denominated deposits by South African banks with foreign domiciled banks.

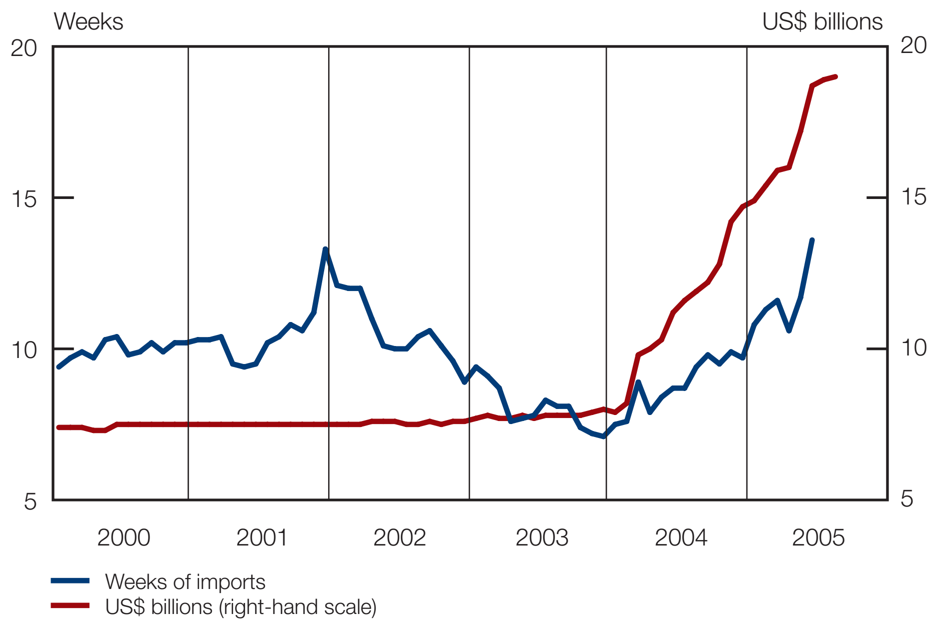
International reserves and liquidity position

As a result of the positive balance on the financial account, South Africa's overall balance of payments recorded its ninth consecutive surplus in the second quarter of 2005. The surplus came to R21,5 billion, having amounted to R0,9 billion in the first quarter of the year.

Measured in US dollar, the value of the South African Reserve Bank's international reserves (i.e. the Bank's gross gold and other foreign reserves before accounting for reserve-related liabilities) increased from US$15,9 billion at the end of March 2005 to US$18,7 billion at the end of June and US$19,0 billion at the end of August. At the end of June 2005, the value of the Bank's gross international reserves covered broadly 13½ weeks' worth of imports of goods and services. The value of the private banking sector's liquid international assets remained broadly unchanged at US$16,5 billion from the end of March 2005 to the end of June.

From the end of March 2005 to the end of June, the Bank's international liquidity position improved from US$12,4 billion to US$15,2 billion; at the end of August 2005, this position amounted to US$15,5 billion.

Gross international reserves of South African Reserve Bank



Foreign debt

South Africa's outstanding foreign debt rose substantially in the first quarter of 2005. This increase could be attributed to higher levels of both foreign-currency and rand-denominated debt. In total, the country's debt stock increased by US$3,1 billion from US$42,3 billion at the end of 2004 to US$45,4 billion at the end of the first quarter of 2005.

Foreign debt of South Africa

US$ billions at end of period

Period	2002	2003	2004	2005 1st qr
Foreign-currency denominated debt...	**25,0**	**27,4**	**27,9**	**28,8**
Bearer bonds	7,8	9,7	9,7	9,4
Public sector	5,0	4,9	4,9	4,6
Monetary sector	6,2	5,9	7,0	8,1
Non-monetary private sector	6,0	6,9	6,3	6,7
Rand-denominated debt	**7,7**	**9,8**	**14,4**	**16,6**
Bonds	4,5	4,2	5,5	6,1
Other	3,2	5,6	8,9	10,5
Total foreign debt	**32,7**	**37,2**	**42,3**	**45,4**

The increase in foreign-currency denominated debt in the first quarter of 2005 resulted primarily from an increase in non-residents' foreign-currency denominated deposits with and loans extended to South African banks. Private-sector enterprises also borrowed extensively in foreign markets during the period.

The increase in rand-denominated foreign debt in the first quarter of 2005 resulted primarily from increases in non-resident deposits with South African banks and foreign investors' net acquisition of South African issued public-sector bonds. Measured in rand, the country's foreign debt rose by R45,3 billion from R238,3 billion at the end of 2004 to R283,6 billion at the end of March 2005.

Standard and Poor's upgraded South Africa's long-term foreign and local currency sovereign credit ratings from BBB to BBB+ and from A to A+, respectively, in August 2005. Two other credit-rating agencies had announced upgrades of South Africa's rating in the first eight months of 2005.

Exchange rates

The nominal effective exchange value of the rand, on balance, depreciated by 2,4 per cent in the second quarter of 2005, before appreciating by 2,3 per cent in July and August. The depreciation of the exchange rate of the rand during the second quarter of 2005 could partly be attributed to the rebound of the US dollar on international foreign exchange markets and the narrowing of the interest rate differential between South Africa and its most important trading-partner countries.

The exchange rate of the rand has regained some ground since the start of the third quarter. Factors which might have contributed to this appreciation include, firstly, further sizeable inflows of portfolio investment into the country, secondly, an upgrade of the country's credit rating by a leading international rating agency, thirdly, the continued high level of international commodity prices, and finally, US dollar weakness.

Exchange rates of the rand
Percentage change

	31 Dec 2004 to 31 Mar 2005	31 Mar 2005 to 30 Jun 2005	30 Jun 2005 to 31 Aug 2005
Weighted average*	-6,8	-2,4	2,3
Euro	-4,9	0,3	1,5
US dollar	-9,7	-6,5	2,6
British pound	-7,5	-2,5	3,7
Japanese yen	-5,9	-3,4	3,5

* Against a basket of 13 currencies

The real or inflation-adjusted effective exchange rate of the rand depreciated by 4,3 per cent from March 2005 to June. This followed a real depreciation of 4,4 per cent in the first quarter and implies that South African producers regained some competitiveness in the first half of 2005.

The average daily turnover in the domestic market for foreign exchange decreased from US$13,9 billion in the first quarter of 2005 to US$13,5 billion in the second quarter. Transactions in which non-residents participated decreased from US$10,5 billion per day to US$10,0 billion over the same period.

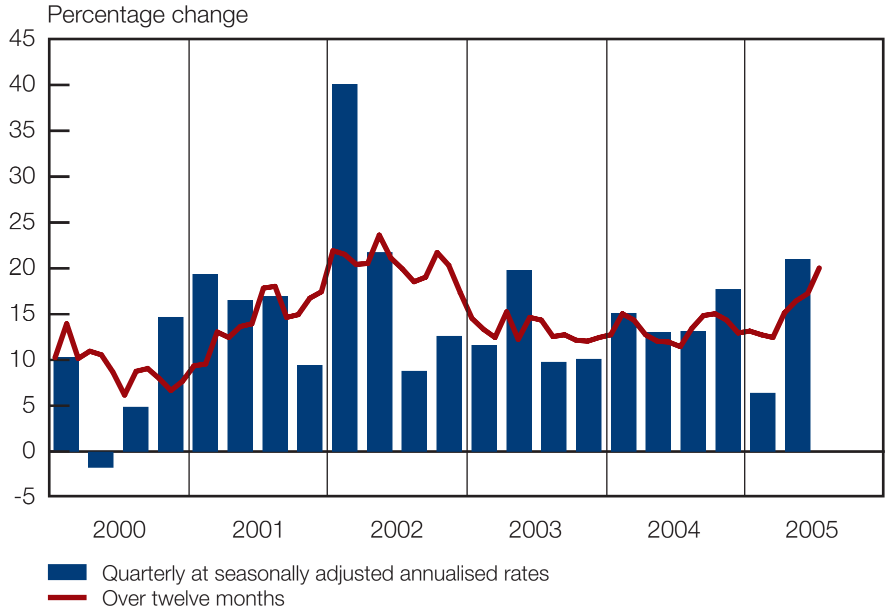
Monetary developments, interest rates and financial markets

Money supply[3]

The level of the broadly defined money supply (M3) surpassed the trillion-rand mark in June 2005 as the growth rate of M3 accelerated sharply in the second quarter. This was partly a recovery from exceptionally low growth in the first quarter, but also reflected the brisk real economic activity in the second quarter, which was supported by strong business and consumer confidence. This was reinforced by the further reduction in the repurchase rate during the second quarter, alongside positive wealth effects arising from continued increases in asset prices.

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

Growth in M3

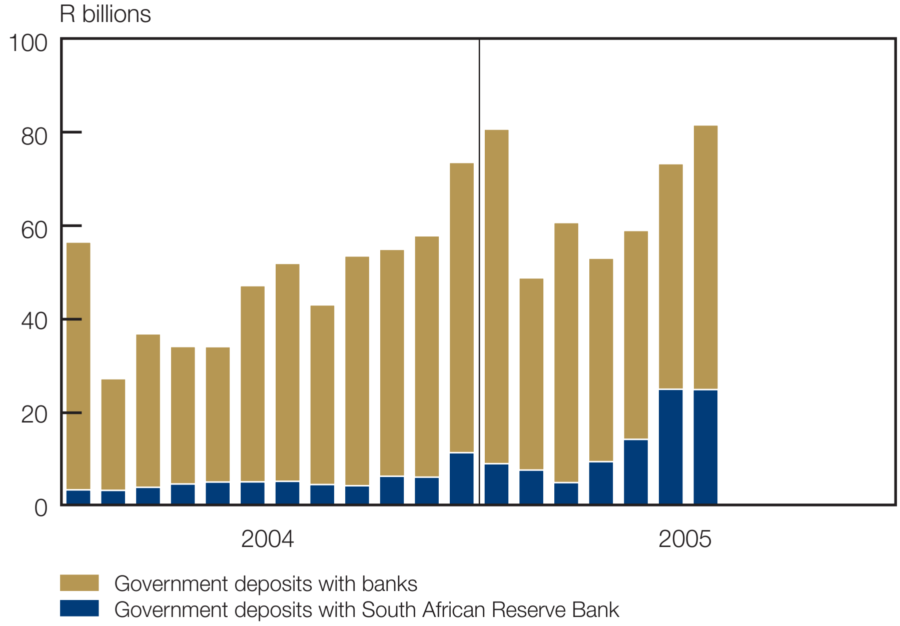


The quarter-to-quarter growth in M3 accelerated from 6,3 per cent in the first quarter of 2005 to 21,0 per cent in the second quarter. Measured over twelve months, growth in M3 accelerated from 12,3 per cent in March 2005 to 19,9 per cent in July. However, M3 growth over twelve months was restrained to some extent by the accumulation of government deposits on account of higher-than-expected tax revenue in the early part of the fiscal year, some of which could be utilised for the coupon interest payments on government bonds at the end of August 2005.

As shown in the table on the next page, growth trends in all the other monetary aggregates broadly resembled that of M3 as rates of increase accelerated strongly during the second quarter of 2005.

All domestic parties increased their M3 deposit holdings during the second quarter of 2005. The corporate sector accounted for 74 per cent of the overall increase in M3 deposits with the remainder attributable to the household sector. The increase in the corporate sector's deposit holdings was concentrated in short-term monetary assets (i.e. deposit with maturities of less than 32 days), illustrating companies' strong preference for liquidity. This preference was supported by strong precautionary and speculative motives, in a market where a range of asset prices repeatedly broke through previous record levels. From the table below, it is noteworthy that the narrower monetary aggregates experienced faster growth than the broader aggregates during the second quarter of 2005.

Government deposits



Growth in monetary aggregates

Per cent at seasonally adjusted annualised rates

	2004	2005	
	4th qr	1st qr	2nd qr
M1A	3,5	18,0	36,7
M1	10,3	0,5	32,3
M2	20,5	5,2	21,0
M3	18,6	6,3	21,0

Annualised growth in M3 exceeded growth in nominal gross domestic product by 12,5 percentage points during the second quarter of 2005. As a result, the income velocity of circulation of M3 declined from 1,57 in the first quarter of 2005 to an all-time low of 1,53 in the second quarter, signalling the availability of ample liquidity to finance expenditure in the economy.

The counterparts of change in M3, as shown in the table on the following page, reveal that in a statistical sense strong growth in total loans and advances extended to the private sector accounted for most of the increase in M3 during the second quarter of 2005.

Counterparts of change in M3

R billions

Counterparts	2005 1st qr		2005 2nd qr	
Net foreign assets		3,2		14,8
Net claims on the government sector		-12,6		-4,0
Gross claims	-25,4		8,6	
Government deposits (decrease +; increase -)	12,8		-12,6	
Claims on the private sector		25,0		45,0
Investments and bills discounted	-14,3		1,8	
Total loans and advances	39,3		43,1	
Net other assets and liabilities		17,9		-2,6
Total change in M3		33,5		53,2

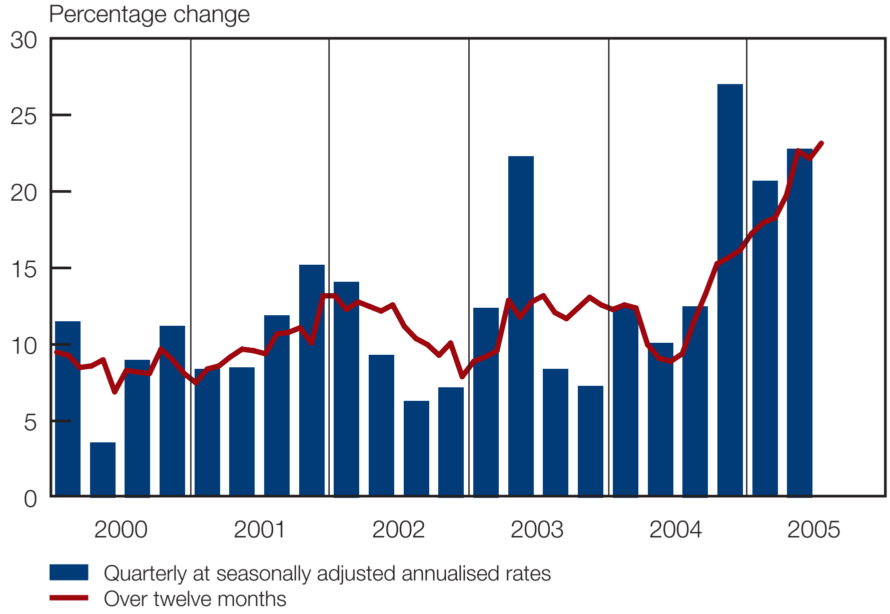
Net foreign assets of the monetary sector also rose during the second quarter of 2005, and were a reflection of an increase in foreign assets of both the Bank and private-sector banks. The Bank's foreign assets increased due to market operations in foreign exchange for the Bank's own portfolio as well as on behalf of its customers, including foreign exchange purchases arising from a foreign direct investment transaction.

Credit extension

Growth in total loans and advances[4] extended to the private sector by the banking sector remained strong during the first seven months of 2005, in an environment characterised by resilient asset price increases and rising income levels. Positive wealth effects associated with the prolonged period of brisk increases in house prices played a prominent role in bolstering credit extension, alongside robust consumer and business sentiment and the stimulatory effect of lower interest rates.

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

Total loans and advances to the private sector



Given the generally favourable lending and borrowing conditions outlined above, annualised quarterly growth in total loans and advances accelerated from 20,7 per cent in the first quarter of 2005 to 22,8 per cent in the second quarter. Twelve-month growth in this aggregate also accelerated significantly from 18,2 per cent in March 2005 to 23,1 per cent in July.

The strong growth in total loans and advances extended to the private sector was mainly driven by very robust increases in asset-backed credit, in particular mortgage advances. As shown in the accompanying table, asset-backed credit accounted for more than 80 per cent of the overall increase in loans and advances during the second quarter of 2005.

Loans and advances to the private sector

Component	Quarterly changes R billions		Contribution to increase in total loans and advances Per cent	
	2005		2005	
	1st qr	2nd qr	1st qr	2nd qr
Asset-backed credit	23,5	36,2	59,8	84,0
Instalment sale credit and leasing finance	6,0	7,4	15,3	17,2
Mortgage advances	17,5	28,8	44,5	66,8
Housing loans – Individuals	16,2	19,2	41,2	44,5
– Companies	0,9	1,8	2,3	4,2
Other mortgage advances*	0,4	7,8	1,0	18,1
Other loans and advances	15,9	6,9	40,5	16,0
Total loans and advances	**39,3**	**43,1**	**100,0**	**100,0**

* Such as farm and commercial mortgage advances

Mortgage advances continued to expand and gained further momentum during the second quarter of 2005. The increase in mortgage advances was mainly driven by strong demand for housing loans from the household sector, consistent with buoyant conditions in the real-estate market, which in turn were reinforced by favourable lending and borrowing conditions. For the first time mortgage advances rose by amounts in excess of R10 billion per month for three successive months, starting in May 2005. Under these conditions, twelve-month growth in such advances accelerated from 24,1 per cent in March 2005 to 27,3 per cent in July.

Instalment sale credit and leasing finance, which is directed at financing expenditure on motor vehicles and other durable goods, remained relatively strong during the second quarter of 2005, aligned with brisk domestic expenditure, sustained stable prices and attractive incentives on new motor vehicle and other durable goods. The twelve-month growth in this credit category remained at robust rates of around 20 per cent in the period November 2004 to July 2005.

Twelve-month growth in *other loans and advances* accelerated significantly from 12,9 per cent in April 2005 to 19,1 per cent in May and 19,2 per cent in July. The high rate of growth in May was mainly a reflection of the low base in the previous year when the assets of one of the monetary institutions were absorbed by a non-monetary institution.

The household sector accounted for most of the increases in total loans and advances during the second quarter of 2005. This sector's use of bank credit rose by R28,2 billion, whereas that of the corporate sector increased by R14,9 billion.

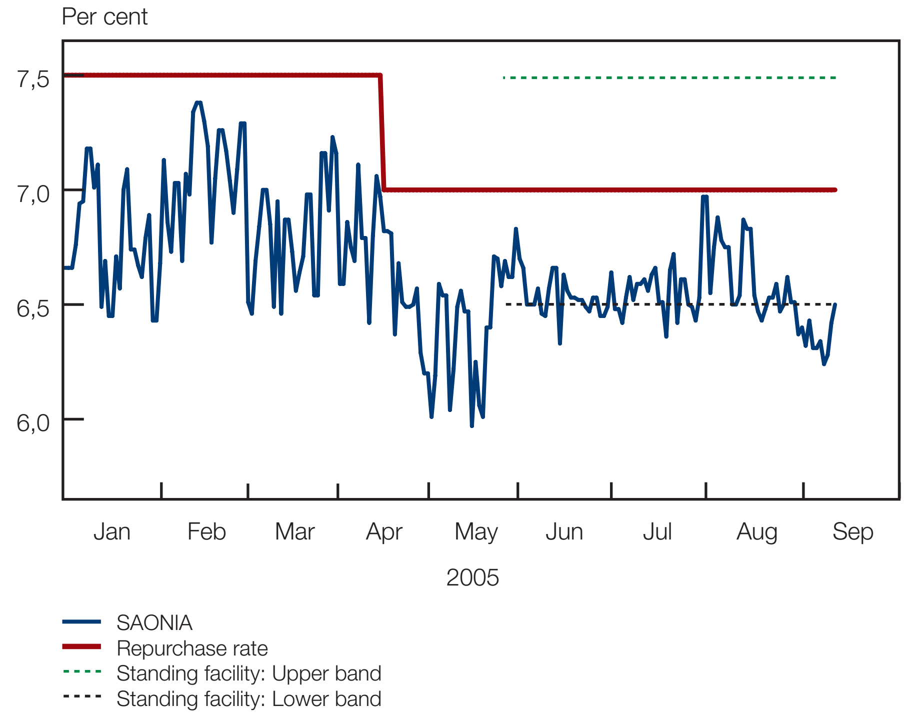
Interest rates and yields

The South African Reserve Bank's Monetary Policy Committee (MPC) left the repurchase rate unchanged at 7,0 per cent at its June and August 2005 meetings, after a reduction of 50 basis points on 14 April 2005. Central bank accommodation is currently provided at the lowest interest rate since 1980. (The MPC statement discussing developments underlying the committee's August 2005 decision is reproduced in full elsewhere in this Bulletin.)

In tandem with the April 2005 reduction in the repurchase rate, the private banks lowered their predominant rate on mortgage loans and their prime overdraft rate by half a percentage point to 10½ per cent from mid-April, and maintained them at this level to the end of August.

The South African Overnight Interbank Average (SAONIA) rate fluctuated between 5,97 per cent and 6,82 per cent from 15 April 2005 to 24 May, partly reflecting an active overnight interbank funding market. Following the introduction of the new refinancing procedures on 25 May 2005, the volatility in the SAONIA rate receded, as shown in the accompanying graph. The spread between the SAONIA rate and the repurchase rate has also narrowed since the introduction of the new standing facilities, while the SAONIA rate has consistently fallen below the repurchase rate. On occasion, the SAONIA rate has declined below the standing facility rate for absorbing banks' surplus funds, but only by a small margin. The SAONIA amounted to 6,34 per cent on 9 September 2005.

Money-market interest rates

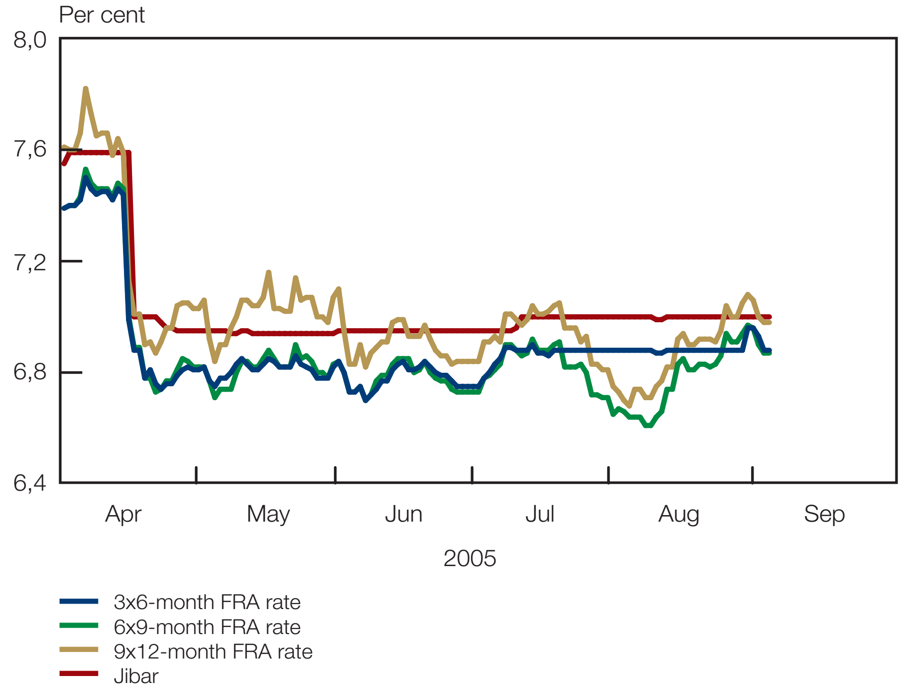


In general, money-market interest rates were fairly stable during the period under review. The three-month Johannesburg Interbank Agreed Rate (Jibar) declined marginally by 5 basis points from 7,0 per cent on 15 April 2005 to 6,95 per cent on 9 July, but reversed its trend back to 7,0 per cent on 9 September 2005.

The tender rate on 91-day Treasury bills also displayed little movement and was stable around 6,76 per cent from 15 April 2005 to 30 June before declining marginally by 3 basis points to 6,73 per cent on 27 July. This was mainly due to a slight increase in demand by investors for paper with liquid asset status. On 9 September 2005, the 91-day Treasury bill tender rate stood at 6,74 per cent. Similarly, rates on 182-day and 273-day Treasury bills remained fairly stable during this period.

In the second quarter of 2005, forward rate agreements (FRAs) continued to be responsive to movements in the exchange rate and the broader inflation outlook. Rates on both the 3x6 and 6x9-month FRA remained, on average, some 20 basis points below the three-month Jibar, as shown in the accompanying graph. This suggested that market participants anticipated that the repurchase rate would remain unchanged with a slight bias towards a possible reduction. Oil price and inflation increases undermined this view over the subsequent two months and brought the FRA levels to (marginally above) the three-month Jibar by early September 2005.

Rates on forward agreement and the Johannesburg interbank agreed rate



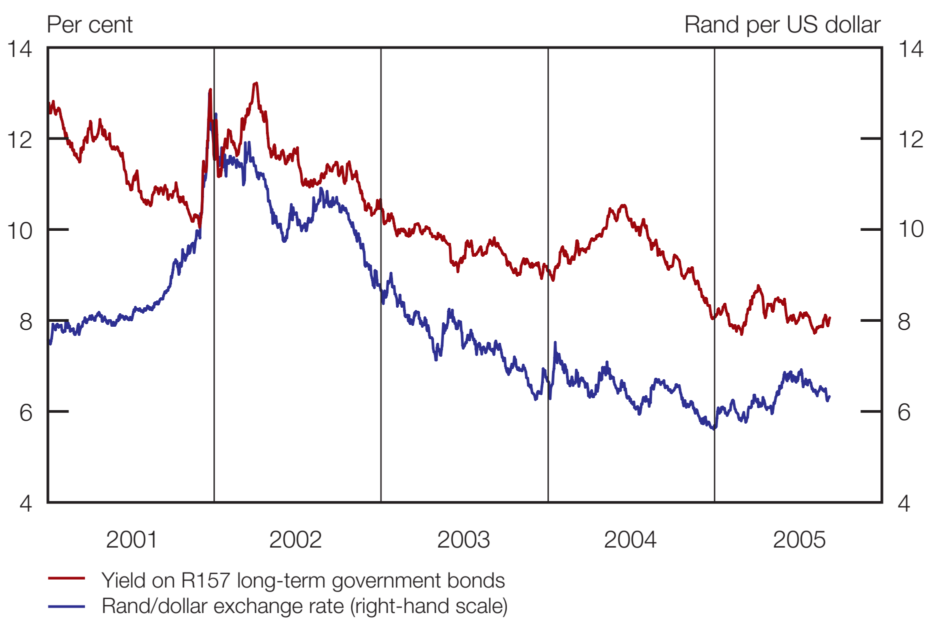
After a reduction of 20 basis points in May 2005, the *predominant rate on twelve-month fixed deposits* of the private-sector banks remained at 6,2 per cent to the end of August, reflecting the unchanged monetary policy stance.

Interest rates on government retail bonds remained unchanged following their reduction by 75 basis points in January 2005. At the end of August 2005 the rates on these bonds amounted to 8,25 per cent for the 5-year bond, 7,75 per cent for the 3-year bond and 7,50 per cent for the 2-year bond.

After remaining unchanged since September 2004, the *official rate of interest* applicable to fringe benefit taxation, as defined by the Income Tax Act, was reduced by 50 basis points to 8,0 per cent, effective from 1 September 2005.

Long-term bond yields initially displayed an upward bias from the end of February 2005 as persistently high oil prices revived inflation concerns. The *daily average yield* on the long-term R157 government bond (maturing in 2015) increased from a record low of 7,69 per cent on 28 February 2005 to 8,77 per cent on 5 April, its highest level in the first eight months of 2005. This coincided with fluctuations in the exchange value of the rand and an upward movement in bond yields in the major international financial centres from February to March 2005. Bond yields receded after the lowering of the repurchase rate on 14 April, but bouts of rising rates occurred during periods of rising oil prices and general weakness in the exchange value of the rand. The yield on the R157 bond for instance increased from 8,06 per cent on 20 April to 8,50 per cent on 18 May, before resuming a downward trajectory. Bond yields declined to as low as 7,72 per cent on 5 August, when the downward movement in domestic bond yields was somewhat at variance with a renewed upward trend in bond yields in developed markets. This decline in domestic long-term bond yields occurred against the backdrop of subdued consumer and production price inflation, which frequently fell below market expectations; better sovereign credit ratings for South Africa accorded by Standard & Poor's in early August; better-than-anticipated revenue collections by the South African National Treasury (National Treasury) which raised expectations of a lower supply of bonds in the second half of the fiscal year than projected earlier; and the appreciation of the exchange value of the rand from July 2005, after some depreciation had occurred in the first half of the year.

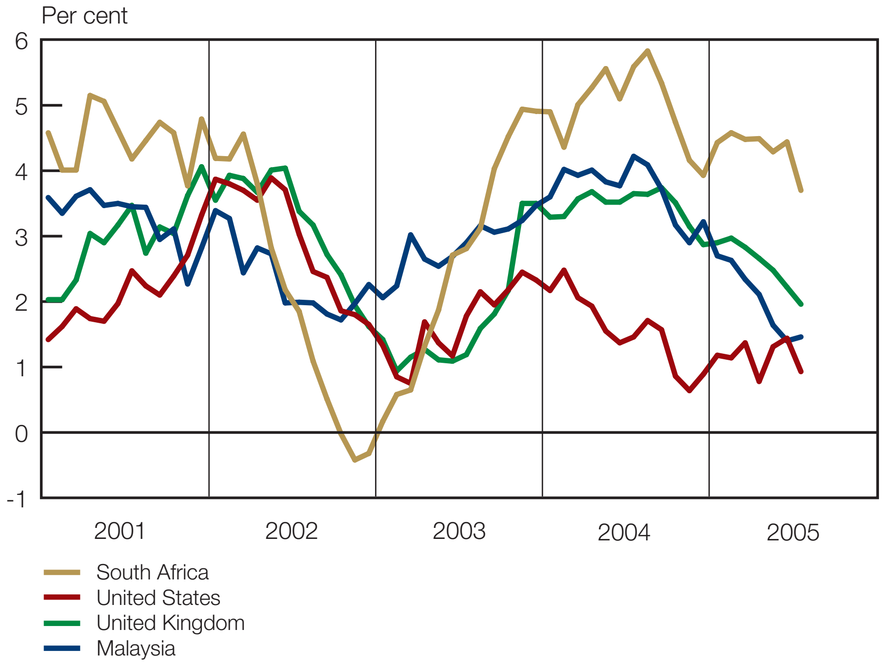
Long-term bond yield and the exchange rate



Towards late August 2005 long-term domestic bond yields rose substantially as crude oil prices surged and worse-than-expected data on domestic inflation, money supply and credit extension were released. The yield on the R157 bond reached 8,12 per cent on 30 August before declining to 8,05 per cent on 9 September.

The *real or inflation-adjusted yield on long-term government bonds* (using historical year-on-year increases in CPIX as an indicator of expected future price changes) remained relatively steady around a level of 4,5 per cent in the first six months of 2005: Movements in nominal bond yields broadly matched the movements in the recorded inflation rate over the period. In July 2005, moderately higher inflation and rather flat bond yields resulted in the real yield declining to 3,7 per cent. South African long-term bonds are still presenting higher real returns than similar bonds in developed markets such as the US and the United Kingdom as well as in developing markets, such as Malaysia.

Real yields on long-term government bonds

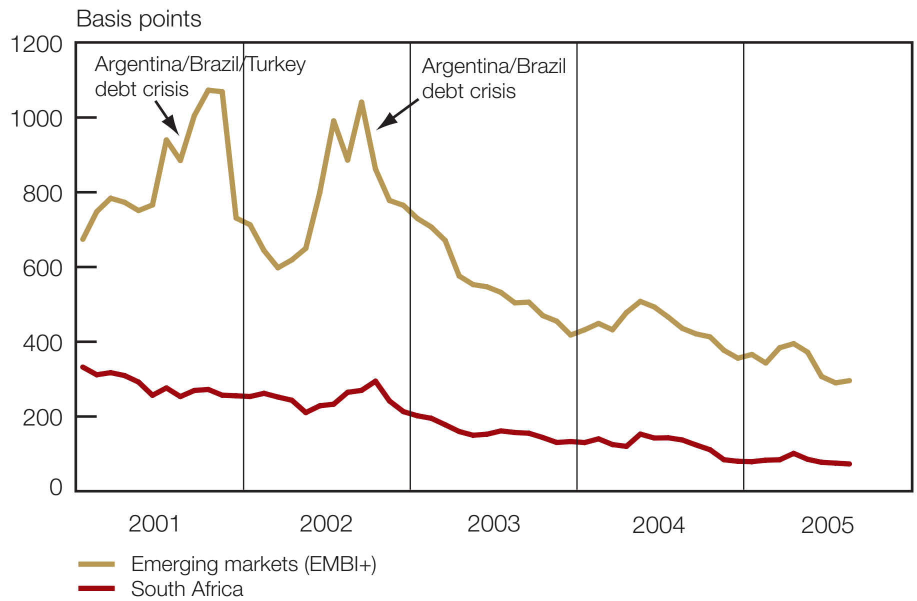


After an initial decline in response to the 14 April 2005 MPC decision to lower the repurchase rate, the level of the yield curve again moved higher to 17 May, mainly on account of a weaker exchange value of the rand. The level of the yield curve then started to drift lower as inflationary pressures remained subdued despite rising international oil prices. The short end of the curve remained anchored to the repurchase rate while the longer end of the curve moved lower due to positive domestic factors already mentioned. The yield curve declined to a recent low on 4 August following the release of better-than-expected inflation figures in July and the improved sovereign credit rating of South Africa by Standard & Poor's in early August.

The *break-even inflation rate*, a barometer of longer-term inflation expectations, is calculated as the difference between the nominal yield on conventional bonds and the real yield on inflation-linked bonds within the five-to-eight-year maturity range. The break-even inflation rate fluctuated around a rising curve from a historical low of 3,66 per cent on 28 February 2005 to 4,56 per cent on 5 April, but subsequently moderated to a low of 4,02 per cent on 5 August. The break-even rate again rose to 4,67 per cent on 9 September.

Notwithstanding an increase in long-term bond yields in the US from July 2005 to mid-August, demand for high-yielding emerging-market debt remained robust as various emerging-market countries benefited from improvements in global growth and better country credit ratings by international rating agencies. The yield differential of the JP Morgan Emerging Markets Bond Index (EMBI+), which indicates total returns for external-currency denominated debt instruments of the emerging markets, declined by 105 basis points from April 2005 to a record-low differential of 290 basis points in July 2005 before increasing to 296 basis points in August. Broadly echoing these developments, the *sovereign risk premium* on South Africa's foreign-currency denominated bonds trading in international markets also declined appreciably as it benefited from better international credit ratings announced in October 2004 and again in January and August 2005. The differential between the yield on the ten-year South African government US-dollar denominated bond and the yield on United States federal government securities of similar maturity, declined from an original differential of 195 basis points at the end of May 2004 to an average differential of 90 basis points in August 2005.

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



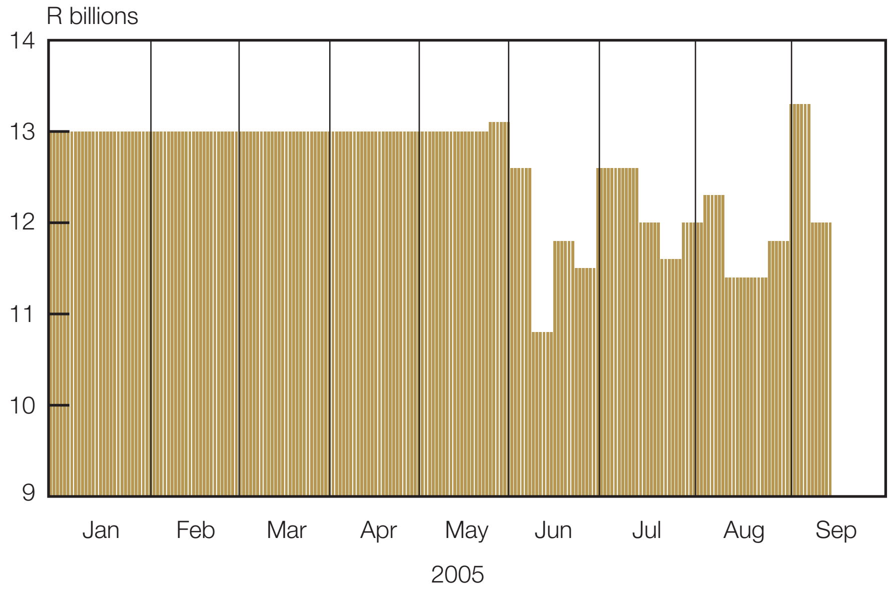
The *currency risk premium* on South African government bonds (measured as the differential between South African government bond yields on rand-denominated debt in the ten-to-twelve-year maturity range issued in the domestic market and dollar-denominated debt issued in the US market) also narrowed from 308 basis points in May 2005 to 234 basis points in July. The currency risk premium again widened to 280 basis points in August when rising bond yields in the domestic market contrasted with a decline in yields on foreign-issued South African bonds which decreased alongside their foreign counterparts.

On 14 June 2005, JP Morgan launched its new Government Bond Index–Emerging Markets (GBI-EM+), which provides a summary measure of the prices of local-currency denominated bonds issued by governments of emerging-market economies. The index currently includes 19 countries from 4 regions. In August 2005, the seven South African bond issues of different maturities included in the index constituted the fourth highest weight and yielded the fourteenth highest return of all the countries represented in the index.

Money market

Before the introduction of the changes to the Bank's refinancing operations on 25 May 2005, the amount of accommodation provided at the weekly main repurchase auction remained stable at levels around R13 billion. Thereafter, the amounts on offer at the weekly main refinancing auctions varied, with generally higher levels around month-ends and lower levels – as low as R11,3 billion – towards the middle of the month. In order to square off the banks' end-of-day positions, standing facilities and cash reserve accounts were utilised. Supplementary auctions were rarely used.

Main repurchase auction amounts



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

Money-market liquidity flows

R billions (easing +, tightening -)

	Apr – Jun 2005	Jul – Aug 2005
Notes and coin in circulation	0,5	0,0
Required cash reserve deposits	-1,2	-0,8
Money-market effect of Reserve Bank's foreign exchange transactions	20,3	1,6
Government deposits	-16,7	0,0
Use of liquidity management instruments*	2,5	3,2
Government redemption and interest payments to Bank	-9,5	-0,3
Other items net	4,5	-4,4
Change in main repurchase amount (decrease +; increase -)	0,4	-0,7

* Reserve Bank debentures and reverse repurchase transactions

On balance, changes in the nominal value of notes and coin in circulation outside the Bank tightened liquidity by R0,5 billion during the second quarter of 2005.

The Bank continued to gradually increase its foreign exchange reserves through measured buying of foreign exchange from the market, raising the Bank's foreign exchange reserves by US$2,8 billion from the end of April 2005 to the end of June and by a further US$0,1 billion to the end of August. These transactions, some of which were related to a foreign direct investment transaction, expanded money-market liquidity by R29,4 billion over this five-month period. Government increased its deposits with the Bank in the second quarter of 2005 and thus counteracted much of the expansion that occurred on account of the Bank's purchases of foreign exchange.

In order to keep the private banks dependent on the Bank for the provision of liquidity, the Bank furthermore utilised various intervention instruments, as illustrated in the accompanying table. The total amount of interest-bearing liquidity-draining instruments issued by the Bank amounted to R14,5 billion at the end of August 2005 compared with a total outstanding amount of R20,2 billion at the beginning of the second quarter of 2005. South African Reserve Bank debentures were utilised to a greater extent than reverse repurchase transactions in conducting these operations.

Outstanding balances of selected money-market intervention instruments

R billions

End of		Reserve Bank debentures			Reverse repurchase agreements			Total instruments outstanding
		28 and 91 days	56 days	Total	28 and 91 days	56 days	Total	
2003:	Dec	3,2	0,0	3,2	5,2	0,0	5,2	8,5
2004:	Aug	9,0	0,0	9,0	11,0	0,0	11,0	20,0
	Sep	7,8	0,0	7,8	9,5	0,0	9,5	17,3
	Oct	8,2	0,0	8,2	10,5	0,0	10,5	18,7
	Nov	9,9	0,0	9,9	11,3	0,0	11,3	21,2
	Dec	8,8	3,1	11,9	7,6	0,0	7,6	19,5
2005:	Jan	12,0	1,2	13,2	11,2	0,0	11,2	24,4
	Feb	12,5	0,0	12,5	7,0	0,0	7,0	19,5
	Mar	10,2	2,8	13,0	5,9	1,3	7,2	20,2
	Apr	6,7	6,2	12,9	4,6	2,5	7,1	20,0
	May	6,1	5,1	11,2	4,7	1,9	6,6	17,8
	Jun	7,3	3,8	11,1	5,2	1,4	6,6	17,7
	Jul	7,5	2,7	10,2	4,0	3,2	7,2	17,4
	Aug	4,6	3,6	8,2	2,4	3,9	6,3	14,5

On 18 July 2005 the Bank successfully concluded a US$1,5 billion dual-tranche syndicated term loan. Tranche A (US$1 billion) constituted a three-year maturity and tranche B (US$500 million) a five-year maturity. The proceeds from the facility were used to finance the prepayment of the US$1 billion dual-currency term loan facility concluded on 16 June 2003, which was payable on 29 July 2005 and the second tranche of the dual- currency term loan facility dated 9 July 2002 which was payable on 20 June 2005. The transaction had no impact on money-market liquidity conditions.

Bond market

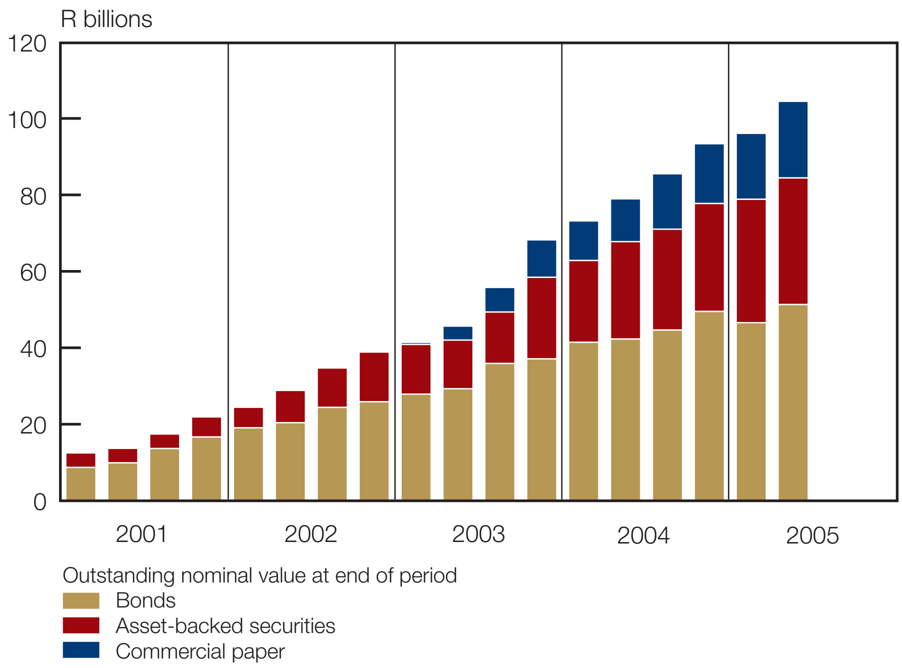
Funding by *public-sector borrowers* through the net issuance of fixed-interest securities in the domestic primary bond market amounted to R22,6 billion from April 2005 to July. This was somewhat less than the R26,1 billion raised in the corresponding period of fiscal 2004/05. In fiscal 2004/05 as a whole, net issuance amounted to R40,8 billion. National Treasury also raised R0,3 billion through the government retail bonds from April 2005 to August, but this was less than the R0,6 billion raised in the corresponding period of fiscal 2004/05.

In the February 2005 Budget, the issuance of three new government bonds was announced. The R207 bond with a fixed coupon rate of 7,25 per cent (maturing in January 2020) was first issued on 14 June 2005, followed by the R205 variable coupon bond (maturing in March 2012), issued from 1 July 2005. The R206 bond with a fixed coupon rate of 7,5 per cent (maturing in January 2014) was first issued on 10 August.

Revenue overruns enabled 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. However, some private-sector borrowers made their debut on the international bond market from June 2005, apparently encouraged by what they assessed to be attractive costs and terms. On 27 June 2005 one such borrower issued bonds to the amount of €175 million maturing in 2012, priced at a yield of 8,875 per cent. Shortly thereafter a second borrower followed with two issues, namely a seven-year €400 million bond placed at 8,625 per cent and ten-year US$270 million notes, placed at 11 per cent. A third company raised €300 million through a five-year investment grade bond placed at a yield of 3,414 per cent, contributing to the total amount of R8,9 billion raised by the private sector in the international bond markets from June 2005 to August.

The issuance of fixed-interest securities in the domestic primary corporate bond market continued in 2005. After increasing by just more than R19 billion in both 2003 and 2004,

Private-sector funding in the interest-bearing securities markets

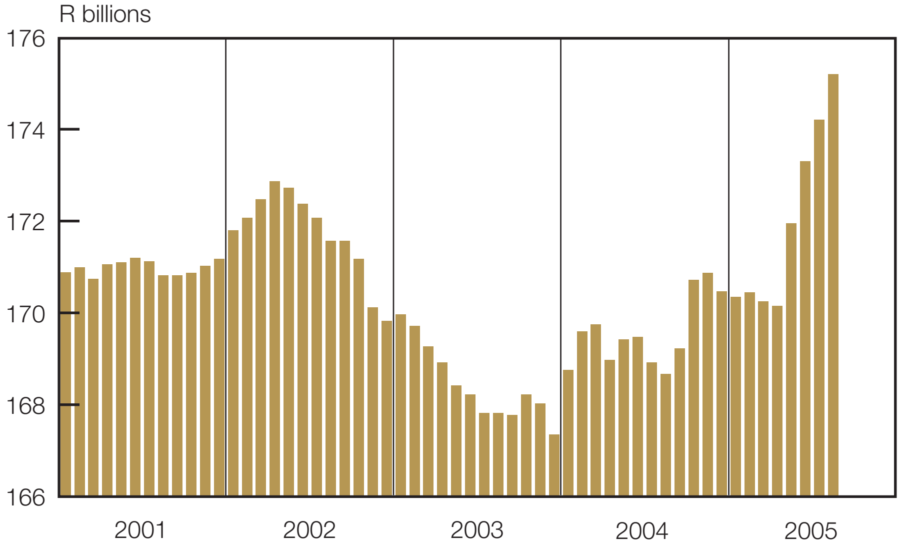


the *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (BESA) increased by a further R11,5 billion in the first eight months of 2005 to reach R89 billion. This included the first issue by a South African branch of a foreign bank, which raised R1,3 billion through the issuance of a five-year bond in July 2005, priced at 33 basis points above the R153 government bond.

Of the total amount of private-sector loan stock in issue, asset-backed securities and collateral debt obligations increased by R7,7 billion in the first eight months of 2005 to reach R36 billion. Mortgage securitisation accounted for 63 per cent of these net issues in 2005. This included the issued portion of the first listed warehousing conduit for residential mortgages which provides for underlying notes of various maturities. The outstanding nominal value of *commercial paper* listed on the BESA increased by R6,6 billion in the first eight months of 2005 to reach R22,2 billion.

After net redemptions of R325 million occurred in the first four months of 2005, foreigners' interest in rand-denominated bonds in the *international bond markets* rebounded. New issues of rand-denominated bonds by non-residents exceeded scheduled redemptions by R4,7 billion during the first eight months of 2005. In 2004 the net issuance of such instruments amounted to R3,1 billion. A total of 42 issues were made in the first eight months of 2005, compared with 36 issues in 2004 as a whole.

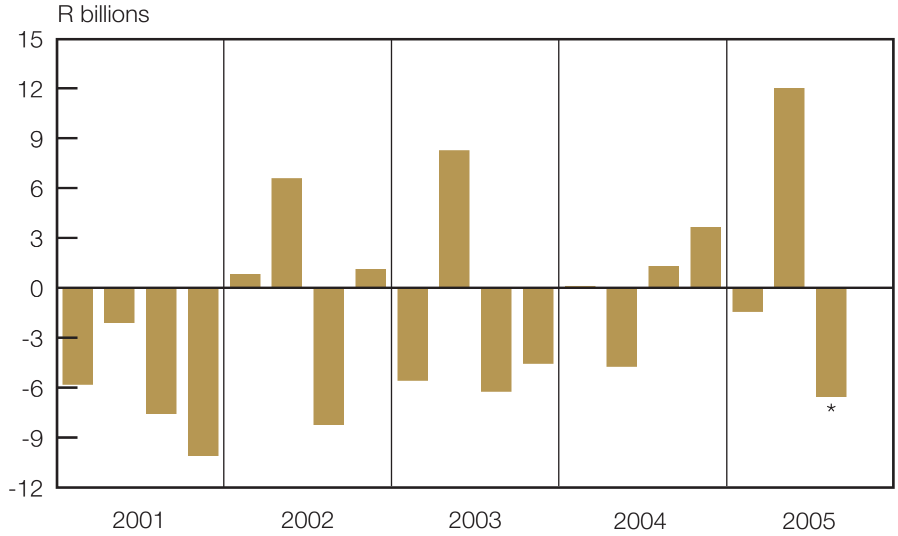
Outstanding balance of eurorand bonds issued by non-residents



Alongside the decline in bond yields from mid-June 2004, *trading activity* on the BESA rose significantly. The quarterly value of bonds traded increased from R2,1 trillion in the second quarter of 2004 to just below R2,5 trillion in the second quarter of 2005. Turnover remained robust in July and August, amounting to a quarterly rate of R2,6 trillion. In the first eight months of 2005 the R153 government bond (maturing in 2010) was the most liquid government bond, with an annualised turnover ratio of 32,6 – measured as the annualised nominal value of trade in these bonds relative to their listed nominal value. The second most liquid bond was the R157 government bond (maturing in 2015) with an annualised turnover ratio of 24,8, followed by the R204 bond (maturing in 2018) with a turnover ratio of 19,9.

After recording net sales of R5,3 billion in January 2005, *non-residents* reverted to net purchases of South African debt securities from February to June. Record high net purchases of R12,0 billion were recorded in the second quarter of 2005; the previous record of R10,1 billion was registered in the first quarter of 1998. Net sales were again recorded in July and August 2005. Non-residents' cumulative net purchases of bonds amounted to R4,0 billion in the first eight months of 2005.

Net purchases by non-residents in the secondary bond market



* July and August

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 from R8,3 billion in the first quarter of 2005 to R2,6 billion in the second quarter. In July and August, equity financing rebounded to R10,1 billion. Of the total amount of R20,9 billion raised in the first eight months of 2005, the bulk of funding, namely 40 per cent, was raised by the financial sector while the industrial sector accounted for 37 per cent and the resources sector for 15 per cent.

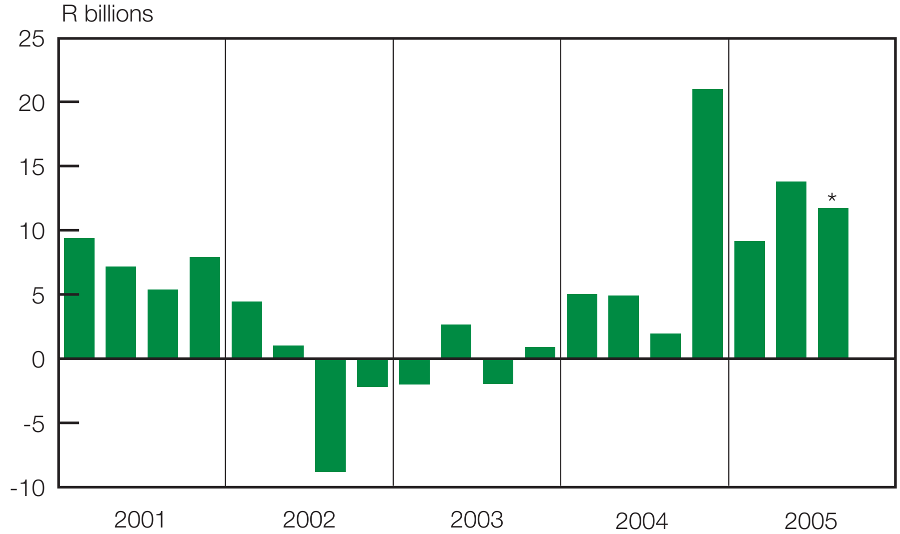
Trading activity in the *secondary* share market remained lively in the first eight months of 2005, buoyed by the continued upward trajectory in share prices. During this period, turnover on the JSE amounted to R776 billion, exceeding trade in the corresponding period of 2004 by 20 per cent.

Turnover on Alt^{x}, the alternative exchange of the JSE for small to medium-sized companies, amounted to R118,2 million in the first eight months of 2005, surpassing the R44,4 million traded in the whole of 2004 by 166 per cent.

Non-residents maintained their interest in the South African share market in 2005. In the first eight months of 2005, their cumulative net purchases already amounted to

R34,7 billion, exceeding their net purchases of R32,9 billion in 2004 as a whole. Record high net purchases of R11,8 billion were recorded in the month of June alone. Non-residents' participation in the share market, measured as their purchases and sales as a percentage of the total value of purchases and sales on the JSE, averaged around 20 per cent in the first eight months of 2005, on a par with their average participation in 2004.

Net purchases by non-residents in the secondary share market



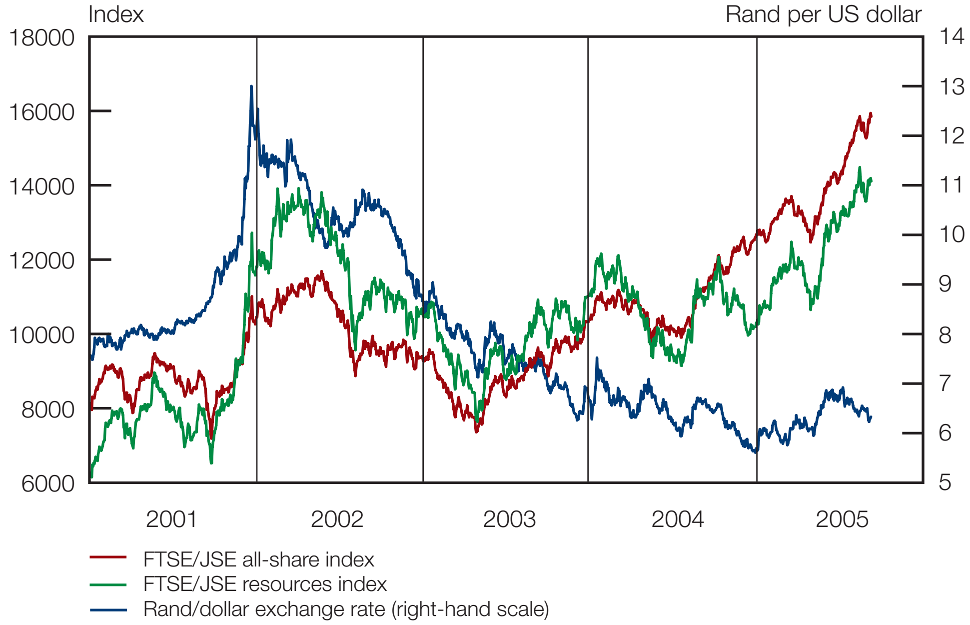
* July and August

The strong upward movement in share prices since the second half of 2004 was interrupted in April 2005 when share markets globally became apprehensive of the high price of oil and its impact on global growth. From May 2005 domestic share prices recovered and resumed an upward trajectory in the ensuing months, reaching successive new record high levels. The *monthly average price level of all classes of shares* listed on the JSE increased by 17 per cent from April 2005 to August and by 51 per cent from a recent low in July 2004. The rise in domestic share prices was supported by firm domestic growth, subdued inflation, lower interest rates than before and general optimism in the global equity markets.

The buoyant share market conditions in the first eight months of 2005 were fairly widespread across the various sectors. The monthly average price level of shares listed in the resources sector increased by 46 per cent from July 2004 to August 2005, with a more pronounced increase from the beginning of 2005. The share market benefited from improvements in commodity prices and the depreciation of the exchange value of the rand in the early months of 2005. Financial shares displayed an upward bias from June 2004 and increased by 61 per cent to August 2005, benefiting from the relatively low interest rate environment and the acquisition of a controlling interest in a domestic bank by a foreign-owned bank. The monthly average price level of industrial shares also recorded a gain of 56 per cent from May 2004 to August 2005 as it reflected accelerating growth in economic activity and sustained increases in consumer demand.

After a brief decline of 9 per cent from 17 March 2005 to 28 April, the *daily closing level of the all-share price index* increased rapidly and reached new all-time highs from the end of May. Its record-high level which was reached on 12 September represented an increase of 29 per cent from 28 April 2005 and an increase of 65 per cent from the recent low recorded on 18 May 2004.

Share prices and the exchange rate



Mirroring the strong rise in share prices, the *earnings yield* on all classes of shares fell from 7,6 per cent in July 2004 to 7,0 per cent in August 2005. Conversely, the *price-earnings ratio* on all classes of shares increased from 13,2 in July 2004 to 15,2 in January 2005 before declining to 14,2 in August 2005. The *dividend yield* on all classes of shares declined from 3,2 per cent in July 2004 to 2,8 per cent in August 2005.

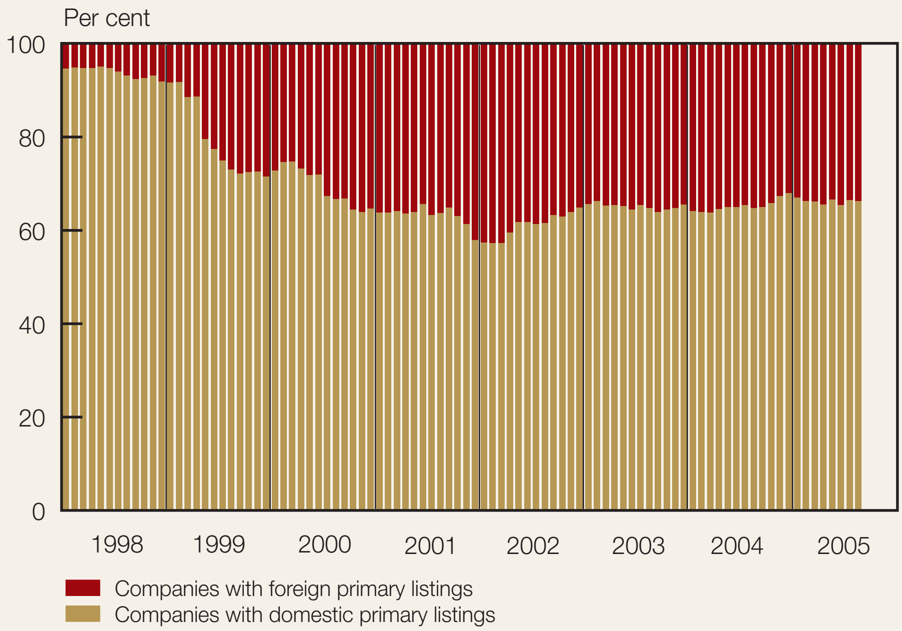
The impact of dual-listed[1] companies with primary listings on foreign bourses on domestic share prices

Price movements of companies with *primary listings on foreign stock exchanges* and secondary listings on the JSE were separated from companies with *primary listings on the JSE.* Price indices for the two categories were compiled and then compared to the movements in the all-share price index.

From January 1998 to July 2000 the number of companies with secondary listings on the JSE and primary listings on foreign bourses increased steadily from fourteen to twenty as these companies sought the financial, marketing and public relations benefits associated with off-shore listings. Since July 2000 the number of companies with foreign primary listings remained fairly steady and amounted to nineteen companies[2] at the end of August 2005.

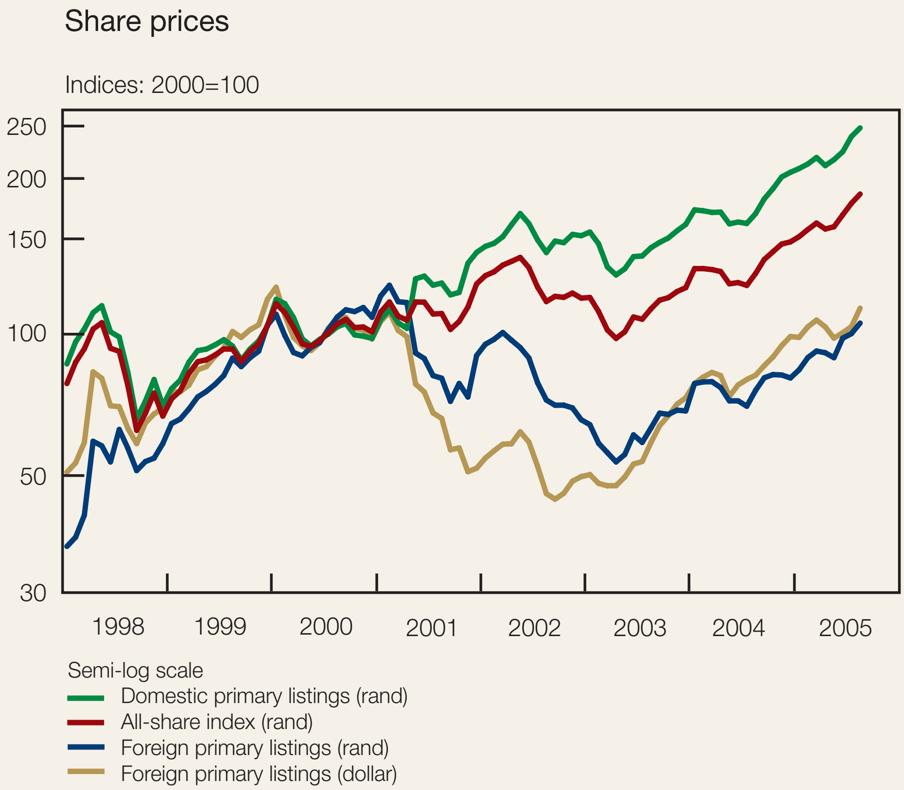
The contribution of companies with foreign primary listings to the total market capitalisation of the JSE increased significantly from 5 per cent in January 1998 to 43 per cent in February 2002, receding to 34 per cent by the end of August 2005.

Contribution to market capitalisation of the JSE



In recent years the share prices of companies with domestic primary listings benefited from declining interest rates, slowing inflation and accelerating growth in South Africa. The share prices of companies with foreign primary listings are generally influenced by earnings generated from business operations outside South Africa and reflect more closely the fundamental economic and market conditions in those economies, as well as the exchange rate effect of price conversion into rand.

The extent to which the share prices of companies with foreign primary listings influenced the all-share price index of the JSE varied over time. The share prices in rand of the foreign primary listed companies initially lent support to the domestic share market from January 1998 to February 2001, benefiting from, among other things, the depreciating exchange value of the rand. However, the rand-denominated share prices of the foreign primary listed companies subsequently fell from February 2001 to April 2003, initially accompanied by weaker share prices on foreign bourses and later largely in response to the appreciation of the exchange value of the rand. Since April 2003 the recovery in the all-share price index was occasioned by broadly similar price increases recorded by companies with domestic primary listings and the price movements of companies with foreign primary listings. From April 2003 to August 2005 the monthly average all-share price index recorded an increase of 93 per cent as the share prices of domestic primary listed companies increased by 95 per cent, appreciably more than the 88-per-cent increase in the share prices of foreign primary listed companies.



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1 Companies listed on more than one exchange. A primary listing is the official quotation of a company's share price on its home exchange whereas a secondary listing is the quotation of such share prices on an exchange other than the company's home exchange.

2 The list includes ten plc companies, such as Anglo American and Old Mutual, listed on the London Stock Exchange. The nine non-plc companies with foreign primary listings include Richemont Securities listed on the Schweizer Borse Swiss Exchange, Wankie Colliery and Bicc Cafca on the Zimbabwe Stock Exchange, Namibian Sea Products on the Namibian Stock Exchange, Brait SA, Conafex Holdings, Halogen Holdings and Monteagle Holdings on the Luxembourg Stock Exchange and Aquarius Platinum on the Australian Stock Exchange.

Market for derivatives

The total number of *futures and options on futures contracts* traded on the Financial Derivatives Division of the JSE continued along an upward trend in 2005. Turnover increased from 7,9 million contracts traded in the second quarter of 2004 to a new record high of 11,7 million contracts in the second quarter of 2005, mostly due to the rise in trade in futures contracts. In the first eight months of 2005, trade in futures contracts accounted for 67 per cent of total trade, compared to 43 per cent in the corresponding period of 2004. Non-residents' exposure to listed South African derivatives, measured as their open interest as a percentage of total open interest, declined steadily from an average of 48 per cent in 1999 to 32 per cent in 2004 and receded even further to 25 per cent in the first eight months of 2005.

Turnover on Yield-X, the interest rate derivative market of the JSE which commenced trading on 28 February 2005, exceeded R100 billion up to the end of August. A total of 105 deals representing 11 479 contracts were concluded during this period.

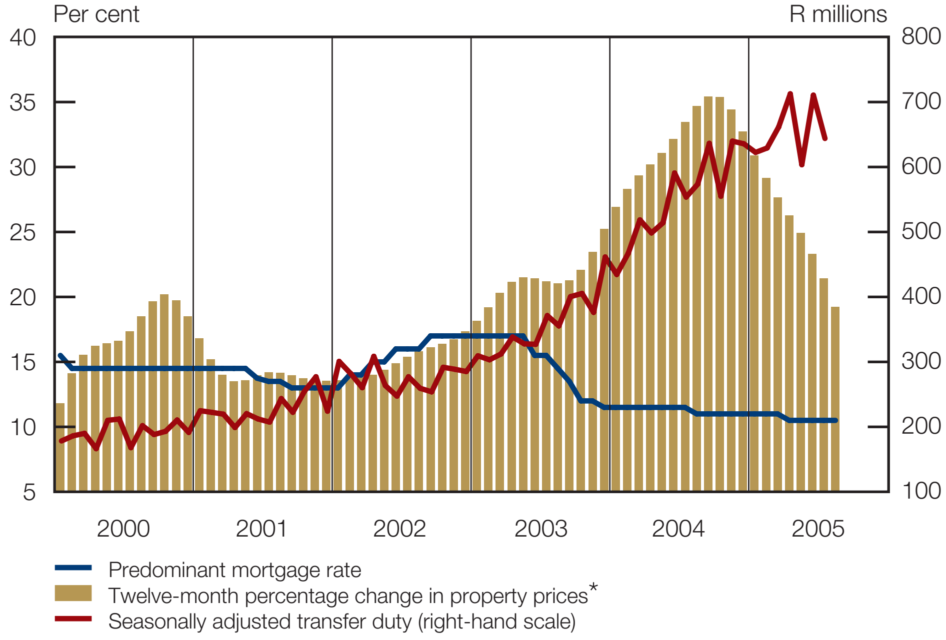
Trading activity in *commodity futures contracts and options* on such contracts declined from 488 000 contracts in the fourth quarter of 2004 to 355 000 contracts in the second quarter of 2005 and a quarterly rate of 377 000 contracts in July and August. The total number of contracts traded up to August 2005 was 16 per cent less than in the corresponding period of 2004. Trade declined alongside falling maize prices as farmers harvested a maize crop that is widely expected to be the largest since 1981.

The number of *warrants* traded on the JSE in the first eight months of 2005 was 54 per cent more than in the corresponding period of 2004. Trade in warrants nearly doubled from 1,3 billion contracts in the third quarter of 2004 to 2,4 billion contracts in the second quarter of 2005. In July and August 2005, trade at a quarterly rate came to 3,0 billion contracts. The number of warrants listed on the JSE increased, on balance, from 297 in January 2004 to 410 in August 2005.

Real-estate market

The *real-estate market* remained buoyant 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 seven months of 2005 when compared with the same period of 2004.

Real-estate market



* Source: Absa

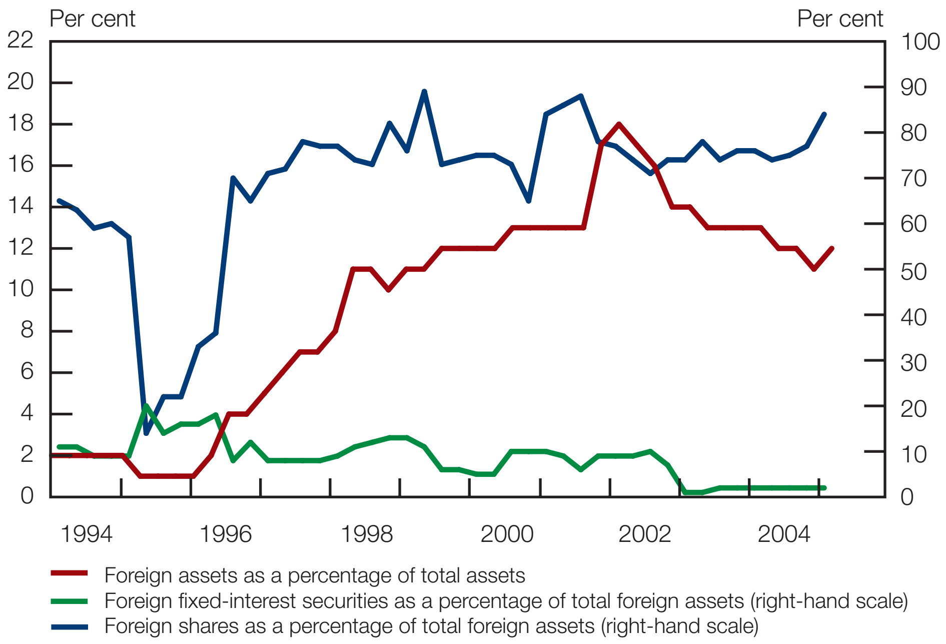
Year-on-year increases in *residential property prices,* as measured by Absa, moderated from 35 per cent in September 2004 to a still-high rate of 19 per cent in August 2005. This exceeded the predominant mortgage rate, which amounted to 10½ per cent in August 2005, by a substantial margin. The month-on-month rate of increase in house prices receded from a most recent high of 3,0 per cent in January 2004 to 0,6 per cent in August 2005.

Non-bank financial intermediaries

Over the past ten years various financial institutions increased their foreign exposure in response to the gradual liberalisation of exchange controls from 1995. The total foreign assets of long-term insurers, for example, increased from 2 per cent of total assets in the first quarter of 1994 to more than 10 per cent by 2000, and rose as high as 18 per cent in the first quarter of 2002 in the wake of an extreme depreciation of the exchange value of the rand. Their foreign asset ratio subsequently declined to 12 per cent of total assets in the first quarter of 2005, as the appreciation of the exchange value of the rand lowered the value of foreign-asset holdings and the appetite for offshore investments waned. Fixed-income securities and shares dominated in this asset class.

Long-term insurers preferred to limit their exposure to foreign fixed-income securities. While their holdings of foreign fixed-income securities remained low, the percentage of the foreign assets of long-term insurers allocated to shares rose steadily from 14 per cent of total foreign assets in the second quarter of 1995 to 89 per cent in the first quarter of 2005.

Long-term insurers: Foreign assets

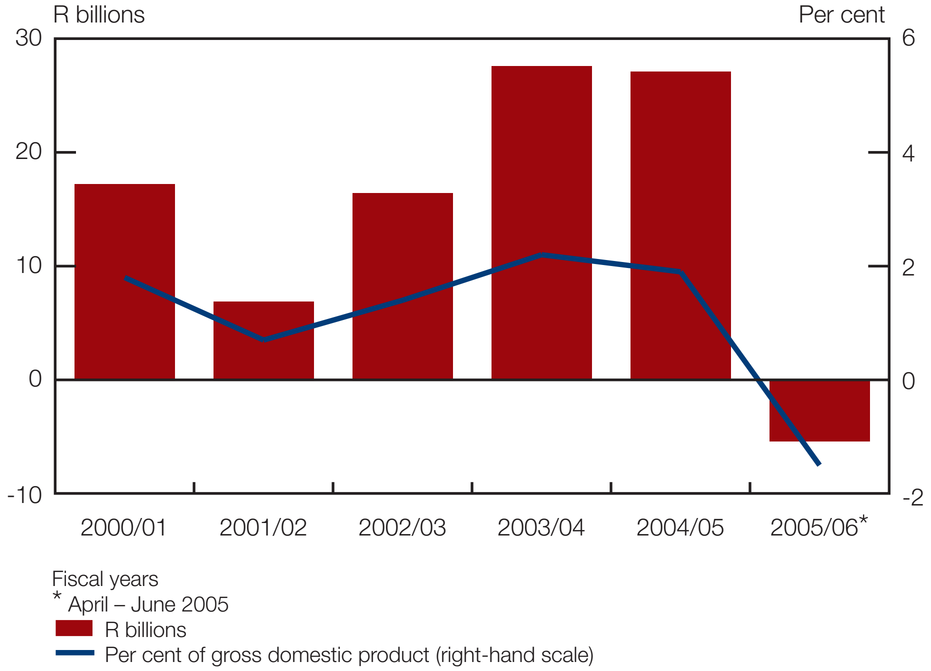


Public finance

Non-financial public-sector borrowing requirement

The *borrowing requirement of the non-financial public sector* (calculated as the cash deficit of the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations) amounted to R9,2 billion in the April-June quarter of 2004 but reversed to a cash surplus of R5,4 billion in the April-June quarter of 2005, or from a deficit of 2,7 per cent of gross domestic product to a surplus of 1,5 per cent. The non-financial public-sector's net investment in non-financial assets amounted to R11,7 billion in April to June 2005, compared with an investment amount of R11,0 billion in the corresponding quarter of the previous year.

Non-financial public-sector borrowing requirement



At the level of *consolidated general government*, a cash *surplus* amounting to R6,6 billion was recorded in the April-June quarter of 2005 compared to a deficit of R9,8 billion in the same period of the previous fiscal year. This outcome emanated from a *decrease* in the national government deficit together with an increase in the cash surplus of provincial governments.

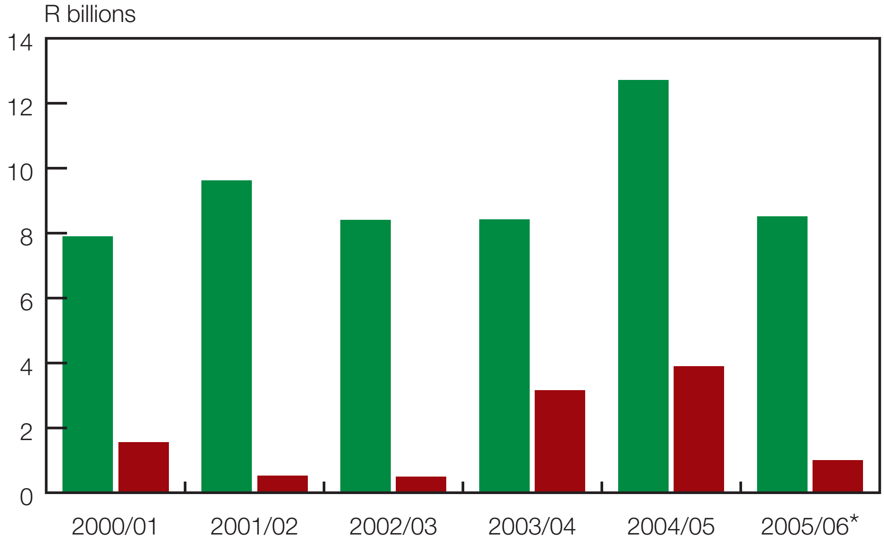
An analysis of *national government* finances indicates that cash receipts arising from tax collections and other operating activities increased by 18,4 per cent in the April-June quarter of 2005 compared to the same quarter in 2004. Cash payments for operating activities of national government increased by 9,0 per cent over the same period. The national government net cash flow from operating activities, together with the net investment in non-financial assets, resulted in a cash deficit of R12,1 billion in the April-June quarter of 2005 compared to a cash deficit of R17,9 billion recorded in the same period a year earlier. The more recent cash deficit was financed mainly through the issuance of domestic debt instruments.

Provincial governments recorded a cash *surplus* of R11,6 billion in the April-June quarter of 2005, well above the cash surplus of R7,4 billion recorded in the same quarter of the previous fiscal year. The main source of provincial governments' cash receipts – grants received from national government – amounted to R57,1 billion, which was 16,1 per cent higher than in the corresponding period of the previous fiscal year. Included in the grants to provincial governments was an equitable share amounting to R37,7 billion, reflecting a decrease of 15,8 per cent when compared with the same period of fiscal 2004/05. This decrease was due to the shift in the financing conduit for social security transfers from the provincial equitable share to two conditional grants.

Payments for operating activities by provincial governments amounted to R44,9 billion in the first quarter of fiscal 2005/06, increasing at a rate of 8,8 per cent when compared with the same period of the previous fiscal year. Viewed by function, these payments were for the most part concentrated in the areas of education, healthcare and social services.

The cash surplus of the provincial governments from April to June 2005 was partly reflected in an increase in deposits on the provincial investment accounts with the Corporation for Public Deposits (CPD).

Balances of provincial governments



As at 31 March of each fiscal year
* As at 30 June 2005
Deposits with banks
Loans from banks

Alongside this increase in deposits with the CPD, the provincial governments' deposits with banks decreased from R12,7 billion at the end of March 2005 to R8,5 billion at the end of June, while their overall indebtedness to banks decreased from R3,9 billion to R1,0 billion between the end of March and the end of June 2005.

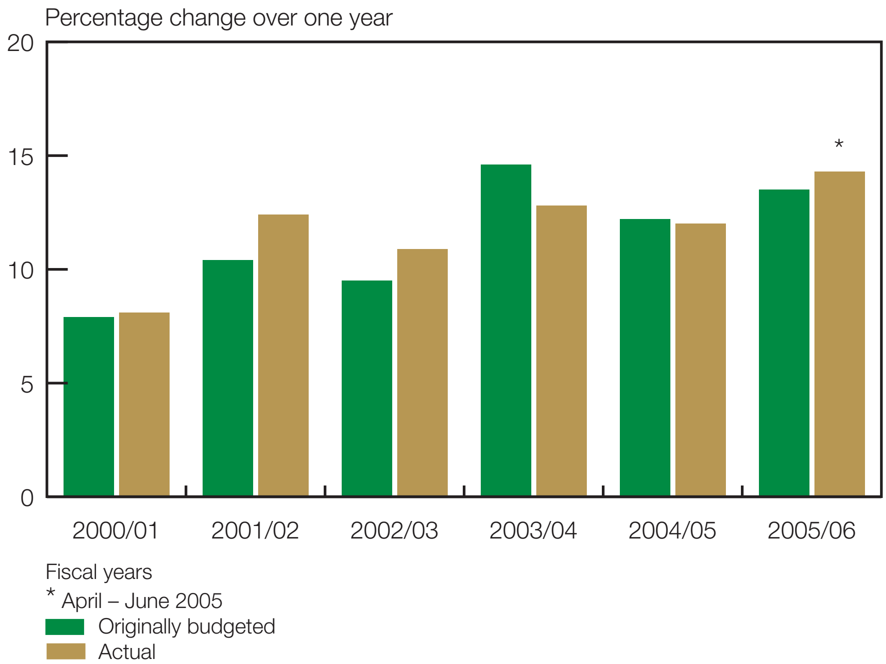
The activities of *local governments* in the April-June quarter of 2005 resulted in an estimated cash surplus of R0,4 billion – a turnaround from a cash deficit of R2,8 billion recorded in the same quarter of the previous fiscal year.

A preliminary analysis of the data on *extra-budgetary institutions* indicates a cash *surplus* of R3,8 billion in April to June 2005 compared with a surplus of R2,0 billion in the same period of the previous fiscal year. The activities of the *social security funds* in the April-June quarter of 2005 resulted in a cash *surplus* of R2,9 billion compared with a cash surplus of R1,5 billion recorded in the same quarter a year earlier.

Budget comparable analysis of national government finance

National government expenditure in the first quarter of fiscal 2005/06 amounted to R97,7 billion, representing a year-on-year rate of increase of 14,3 per cent. This increase outpaced the average year-on-year rate of increase of 10,1 per cent in the same period during the five years prior to fiscal 2005/06. The *Budget Review 2005* projected that national government expenditure would increase at a rate of 13,5 per cent in the fiscal year 2005/06 as a whole.

Expenditure by national government



During the period under review, interest paid on national government debt amounted to R7,2 billion, representing an increase of 28,0 per cent compared with the corresponding period of the previous fiscal year. This increase could be ascribed to an increase in the funding volume as well as greater reliance on instruments paying interest in the April-June quarter. The Budget projections were for interest payments to increase at a rate of 8,9 per cent for the full fiscal year 2005/06.

The equitable share of revenue transferred to provincial governments decreased in April – June 2005 compared with the same quarter in 2004, following the decision to shift social grant funding from the provincial governments to a national government agency. Simultaneously, national government expenditure on transfers and subsidies rose strongly.

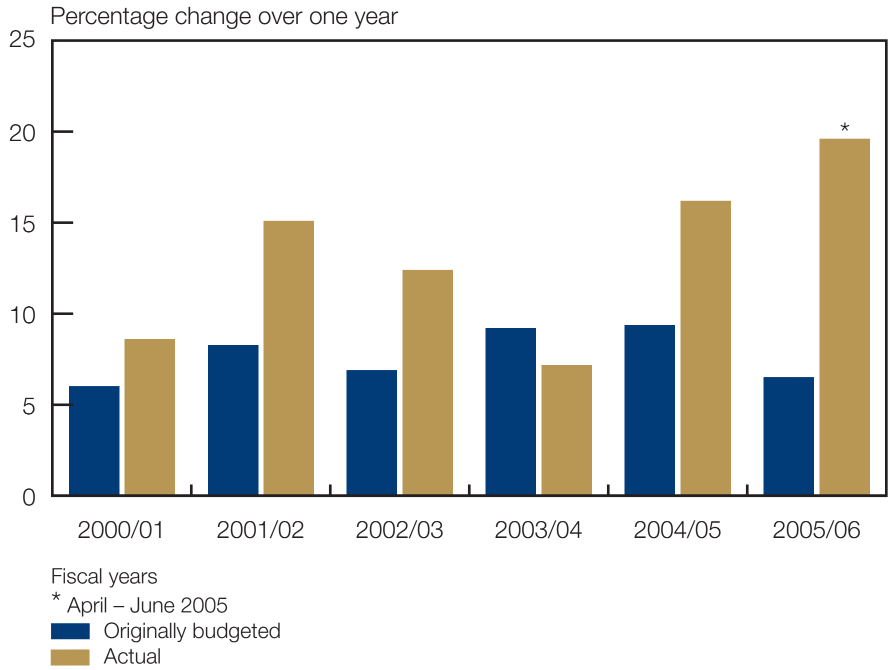
Payments for capital assets amounted to R0,6 billion in the April-June quarter of 2005, or 6,1 per cent less than in the same period a year earlier. The Budget projected that payments for capital assets would amount to R6,2 billion in fiscal 2005/06 as a whole.

After taking into account cash-flow adjustments (i.e. transactions recorded as a result of timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), national government's cash expenditure amounted to R96,8 billion in the first quarter of fiscal 2005/06, representing an increase of 12,8 per cent compared with the same period of the previous fiscal year.

National government expenditure as a ratio of gross domestic product amounted to 26,4 per cent in the first quarter of fiscal 2005/06, higher than the ratio of 25,2 per cent recorded in the corresponding quarter of fiscal 2004/05.

National government revenue in the first quarter of fiscal 2005/06 amounted to R90,2 billion, representing a year-on-year rate of increase of 19,6 per cent. This rate of increase was markedly higher than the average growth rate of 14,2 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 in fiscal 2005/06.

Revenue of national government



As shown in the table on the following page, taxes on income, profits and capital gains increased by 23,1 per cent in the April-June quarter of 2005 compared with the same quarter in 2004. This increase was mainly the result of the strong growth in corporate income tax collections. Year-on-year growth in taxes on property showed signs of slowing, as it amounted to 24,0 per cent during the period under review compared to 50,7 per cent in the same quarter of the previous fiscal year. All major components of domestic taxes on goods and services recorded strong growth rates; the largest, i.e.

value-added tax collections, reflected the buoyancy in consumer spending. Taxes on international trade and transactions displayed the strongest growth rate among the revenue components, consistent with the brisk increase in imports.

Transfers to the Southern African Customs Union partners – Botswana, Lesotho, Namibia and Swaziland – are budgeted to decrease at a rate of 9,6 per cent for fiscal 2005/06 following the introduction of a new formula.

National government revenue in fiscal 2005/06

Revenue source	R billions		
	Originally budgeted	Actual Apr – Jun	Percentage change*
Taxes on income, profits and capital gains	200,9	52,9	23,1
Payroll taxes	4,9	1,2	13,5
Taxes on property	9,8	2,6	24,0
Domestic taxes on goods and services	143,0	31,9	10,6
Taxes on international trade and transactions	13,2	3,4	29,2
Other revenue	10,2	1,3	8,7
Less: SACU** payments	12,1	3,0	-8,7
Total revenue	**369,9**	**90,2**	**19,6**

* April – June 2004 to April – June 2005
** Southern African Customs Union

National government revenue as a ratio of gross domestic product amounted to 24,4 per cent in the first quarter of fiscal 2005/06, appreciably higher than the ratio of 22,2 per cent recorded in the first quarter of fiscal 2004/05.

The net result of national government revenue and expenditure in the April-June quarter of 2005 was a *cash book* deficit before borrowing and debt repayment of R7,5 billion, which was R2,6 billion lower than the deficit recorded in the same period of the previous fiscal year. As a ratio of gross domestic product, the deficit amounted to 2,0 per cent in the first three months of fiscal 2005/06 compared with 3,0 per cent in the same period of fiscal 2004/05.

The *cash-flow* deficit before borrowing and debt repayment amounted to R8,2 billion in the first quarter of fiscal 2005/06, compared with R11,7 billion recorded in the corresponding period of the previous fiscal year. National government's net borrowing requirement in the first three months of fiscal 2005/06 was influenced by extraordinary payments. Extraordinary payments essentially consisted of R4,5 billion paid to the Bank to defray losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). Although an amount of R1,0 billion was originally projected to be *received* as extraordinary receipts in fiscal 2005/06, virtually no funds have been received from this source in the first quarter of 2005/06. Extraordinary transactions increased the net borrowing requirement of national government to R12,7 billion in the first quarter of 2005/06 compared with a net borrowing requirement of R19,6 billion recorded a year earlier.

As indicated in the table on the following page, the greater part of the net borrowing requirement of national government in the first quarter of fiscal 2005/06 was financed through the issuance of securities in the domestic capital market. Domestic long-term funding was obtained at an average rate of 8,4 per cent per annum, while domestic short-term instruments were sold at an average rate of 6,8 per cent. The latter included 273-day Treasury bills which were introduced in May 2005. The average maturity of national government's domestic marketable bonds decreased slightly from 99 months at the end of March 2005 to 97 months at the end of June.

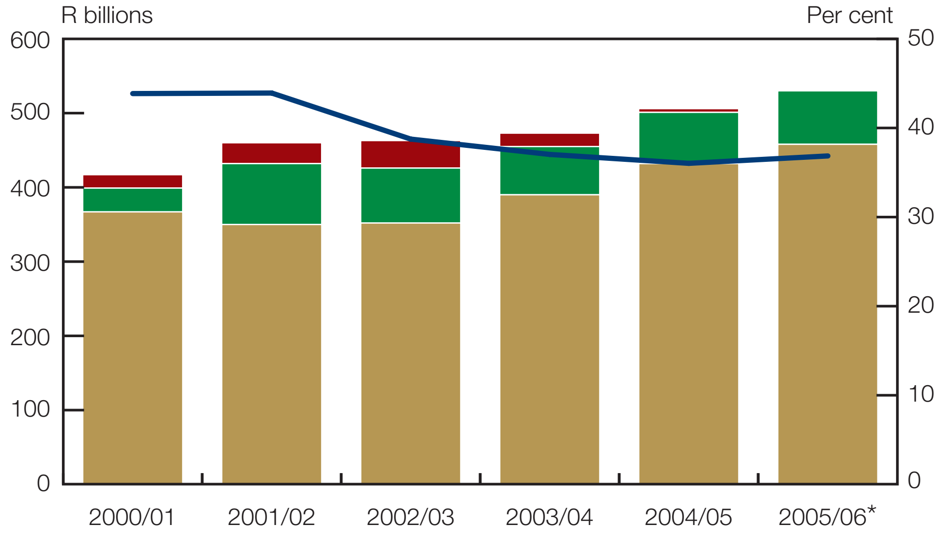
National government financing in fiscal 2005/06
R billions

Item or instrument	Originally budgeted	Actual Apr – Jun 2005
Deficit	**48,0**	**8,2***
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	0,0
Net borrowing requirement	**54,7**	**12,7**
Treasury bills	5,0	8,3
Domestic government bonds	26,3	17,2
Foreign bonds and loans	12,8	0,2
Change in available cash balances **	10,6	-13,0
Total net financing	**54,7**	**12,7**

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

Net issues of foreign bonds and use of loans amounted to R0,2 billion during the first quarter of 2005/06. Net foreign funding included amounts drawn on the export credit facility which had been arranged for the financing of the Strategic Defence Procurement Programme, to the amount of R0,4 billion. The average maturity of the foreign marketable bonds of national government decreased from 78 months at the end of March 2005 to 75 months at the end of June 2005.

Total national government debt



As at 31 March of each fiscal year
*As at 30 June 2005
Gold and Foreign Exchange Contingency Reserve Account
Foreign debt
Domestic debt
Total debt as percentage of gross domestic product (right-hand scale)

The financial activities of national government resulted in an increase in government's bank balances from R30,9 billion at the end of March 2005 to R43,8 billion at the end of June 2005.

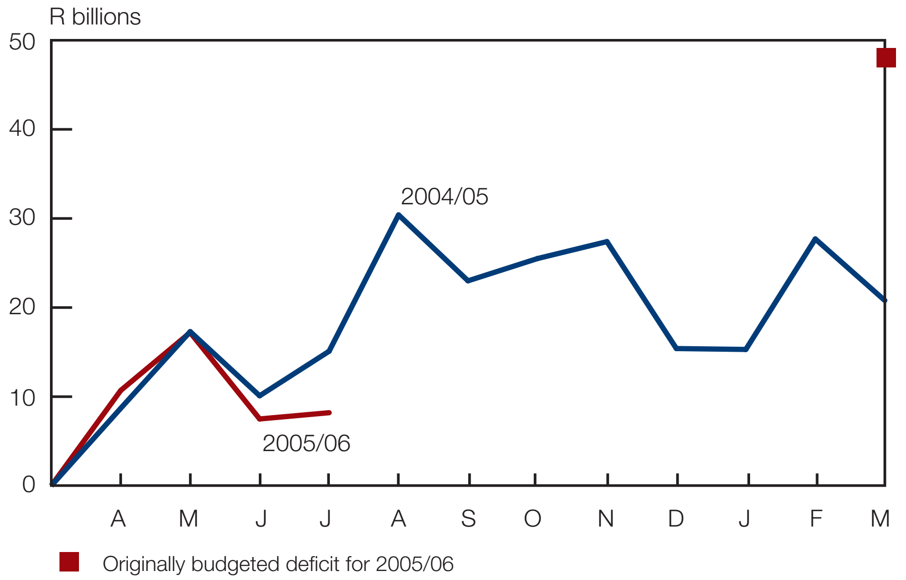
Total loan debt of national government increased from R502 billion at the end of March 2005 to R529 billion at the end of June 2005. Foreign debt as a portion of total loan debt decreased slightly from 13,8 per cent to 13,5 per cent between the above-mentioned dates. As a ratio of gross domestic product, total national government loan debt amounted to 36,8 per cent at the end of June 2005 compared with 35,7 per cent at the end of March 2005.

The outstanding balance on the GFECRA at the end of March 2005 amounted to R5,3 billion, but was virtually wiped out by the amount of R4,5 billion received from National Treasury in April 2005 to defray the losses on this account. Including this balance, total debt of national government increased from R507 billion at the end of March 2005 to R530 billion at the end of June 2005. Total national government debt as a ratio of gross domestic product amounted to 36,1 per cent at the end of March 2005 and rose to 36,9 per cent at the end of June 2005.

National government finance in July 2005

National government expenditure in July 2005 amounted to R28,1 billion, bringing the cumulative expenditure in the first four months of fiscal 2005/06 to R125,8 billion which was 12,2 per cent more than in the same period of the previous fiscal year. The cash-flow adjusted expenditure for the first four months of fiscal 2005/06 amounted to R126,4 billion which was 12,5 per cent more than in the corresponding period a year earlier. National government revenue amounted to R27,4 billion in July 2005 and to R117,6 billion in the first four months of fiscal 2005/06, representing a year-on-year rate of increase of 21,2 per cent. Taxes on income, profits and capital gains increased by 21,8 per cent in the first four months of fiscal 2005/06 compared with the corresponding period a year earlier. As a component of this category of revenue, corporate income tax collections continued to grow strongly at a year-on-year rate of 32,1 per cent. All the other categories of revenue also reflected strong growth when compared with the originally budgeted revenue.

Cumulative deficit of national government



The net result of national government's revenue and expenditure in the first four months of fiscal 2005/06 was a *cash book* deficit of R8,2 billion compared with R15,1 billion in the same period of the previous fiscal year. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R9,2 billion. Extraordinary receipts included proceeds of the foreign exchange amnesty and Telkom Initial Public Offering (IPO), to the amount of R1,0 billion each in July 2005. This resulted in a net borrowing requirement of R11,5 billion which was mainly financed by issuing government bonds in the domestic market.

National government financing in fiscal 2005/06

R billions

Item or instrument	Originally budgeted	Actual Apr – Jul 2005
Deficit	**48,0**	**9,2***
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	2,2
Net borrowing requirement	**54,7**	**11,5**
Treasury bills	5,0	10,4
Domestic government bonds	26,3	21,6
Foreign bonds and loans	12,8	1,4
Change in available cash balances **	10,6	-21,9
Total net financing	**54,7**	**11,5**

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

Statement of the Monetary Policy Committee

11 August 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

The South African economy is continuing to show signs of robust growth and inflation has remained at low levels. Since the previous meeting of the Monetary Policy Committee (MPC), international oil prices have risen to new highs, the rand exchange rate has appreciated moderately and domestic expenditure has remained strong. Oil price increases could be a major source of inflation pressure and pose the greatest risk to future inflation outcomes.

Improved international perceptions of South Africa have been reflected in developments during the past two months. The recent ratings upgrade by Standard and Poor's of South Africa's external debt rating to BBB+, the completion of the purchase by Barclays Bank plc of a controlling share in Absa Bank and the recent successful conclusion by the SA Reserve Bank with 33 banks of a $1,5 billion dual-term syndicated loan facility at far more favourable margins reflect the growing positive sentiment towards South Africa by international investors. In conjunction with the higher level of foreign exchange reserves, such developments can be expected to underpin a greater degree of stability of the macroeconomic environment.

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) has remained within the inflation target range of 3 – 6 per cent for the past 22 months. For the past three months, CPIX inflation has been below the market consensus forecasts. In June, CPIX inflation was 3,5 per cent, down from the 3,9 per cent measured the previous month. The lower inflation has become increasingly broad based, and a significantly larger number of categories of goods and services are now within the inflation target range. Prices have continued to decline in a number of categories, including clothing and footwear, furniture and equipment, and some food items such as vegetables and grain.

Although services inflation has been declining in recent months there is still a significant difference between goods inflation and services inflation. In June, for example, services inflation measured 6,1 per cent compared to 2 per cent for goods inflation. Although the decline in services inflation has been slow, it nevertheless compares favourably with the 7,0 per cent measured in June 2004. Part of the sluggishness of services inflation can be attributed to the behaviour of administered prices excluding petrol. Although administered price inflation declined significantly from the middle of 2003, since mid-2004 it has remained relatively unchanged. In May and June 2005, administered price inflation excluding petrol measured 7,0 and 6,9 per cent, respectively.

Production price inflation has also remained subdued. In June 2005, the percentage change over twelve months was 2,3 per cent, compared to 2,4 per cent the previous month. Although imported goods prices showed an increase from 1,8 per cent to 3,4 per cent from May to June, prices of goods produced domestically rose at a year-on-year rate of 1,9 per cent, down from 2,6 per cent the previous month. This decline was mainly a result of falling prices in the agricultural sector.

The outlook for inflation

The central outlook for inflation remains generally favourable and CPIX inflation is expected to remain within the 3-to-6-per-cent target range for the forecast period to the end of 2007. Although the inflation rate over the past few months has been below 4 per cent, it is expected to increase over the next few months, partly as a result of the higher petrol prices. According to our central forecast, CPIX inflation will begin to rise moderately and peak marginally below 5,5 per cent in the first quarter of 2006, whereafter it is expected to decline moderately. This is marginally higher than the previous forecast and reflects changes in oil price and exchange rate assumptions.

The favourable inflation outlook is underpinned by a number of factors which have improved since the previous meeting. These include the low food price and producer price inflation, and the lower-than-expected inflation outcomes referred to above.

Since the previous MPC meeting there has been a moderate appreciation of the exchange rate of the rand. At the time of the June meeting the rand was trading at a level of around R6,80 to the US dollar. Since then the dollar has weakened against the euro. Having reached a level below US$1,19 to the euro, the dollar is currently trading at levels of around US$1,24. This development explains in part the strengthening of the rand exchange rate to current levels of around R6,37. A further factor that contributed to the strengthening of the rand was the ratings upgrade from Standard and Poor's. On a trade-weighted basis, the rand appreciated by 6,8 per cent in the period following the previous MPC meeting, although it has depreciated by 6,1 per cent since the beginning of the year. The rand will continue to be influenced mainly by dollar developments, which remain uncertain.

The trend of wage settlements and unit labour costs are closely watched by the MPC. At the April meeting we commented on the divergence between wage settlement trends and unit labour cost trends. Although we would not expect these two measures to coincide exactly, they should move in broadly the same direction. Since then there has been greater consistency in the two measures. In the first quarter of 2005, unit labour costs in the non-agricultural sectors increased by 5,9 per cent, compared to the first quarter of 2004. This was a decline from the revised figure of 9,8 per cent measured in the fourth quarter of 2004. Average wage settlements, as surveyed by Andrew Levy Employment Publications, were 6 per cent for the first half of 2005, compared to 6,8 per cent in 2004 as a whole. Although it is too early to tell if this lower trend will continue, it is a positive development from an inflation perspective. However, much will depend on the outcome of the current round of wage negotiations that are taking place in a number of sectors.

Fiscal policy continues to be supportive of monetary policy. Despite the mildly expansionary Budget tabled in February this year, the tax revenues in the current fiscal year to date significantly have exceeded budgeted revenues, primarily as a result of higher-than-expected corporate taxes. Expenditure is broadly in line with budget. Given the volatility of expenditures and revenues, it is probably premature to draw firm conclusions about the likely fiscal outcome for the year, but it appears unlikely that the budgeted deficit will be exceeded.

International developments remain broadly supportive of a favourable inflation environment. Although there are some signs of inflation pressures in a number of countries related to oil price increases, the longer-term outlook remains benign. Interest rate trends have varied, and in general, interest rates in fast-growing countries such as the United States have been increasing, while those in the slower-growing economies have either remained unchanged, as in the euro area, or have recently declined, as in the United Kingdom and Sweden.

There are, however, a number of threats to the inflation outlook. The most significant emanates from the international oil prices which have reached new record highs in recent days. The monthly average spot price of Brent crude oil increased from US$53,86 per barrel in June to US$57,49 in July. Since then prices have breached the US$64 per barrel level, and prices for future delivery over the next three months are currently above this level as well. These price increases have occurred despite several increases since 2004 in the official production quotas of the Organization of the Petroleum Exporting Countries. The full impact of these developments are yet to be reflected in the inflation numbers. In July and August the petrol price increased by a total of almost 60 cents per litre, and the current underrecovery points to a further possible increase in September. The recent strengthening of the rand against the dollar has, however, helped to mitigate the impact of the rise in international crude oil prices on domestic petrol prices.

Although gross domestic product (GDP) growth figures for the second quarter of the year are not yet available, indications are that the real economy has continued to grow at a robust pace. The composite leading business cycle indicator has increased significantly since March of this year and initial indications are that this indicator will increase further in June. Manufacturing production appears to have recovered from the slowdown experienced at the end of 2004. Manufacturing production increased by 3,2 per cent in the second quarter of 2005, following a contraction of 1,9 per cent in the first quarter. The Investec/BER Purchasing Managers Index, which reached its highest level ever in June, indicates that this recovery is expected to remain intact. The various business confidence and trade activity indices also show that expectations are strongly positive. Mining production has also remained strong, with the seasonally adjusted physical volume of total mining production for the three months to May 2005 reflecting a 4,1-per-cent increase compared to the preceding three months.

According to surveys, consumer confidence is also still at a high level, and consumption expenditure appears to be continuing at a strong pace. New vehicle sales peaked at record levels of 31 per cent year-on-year growth in June, although this rate of increase declined to 19,4 per cent in July. Retail sales grew in real terms by 4,8 per cent in May 2005 compared with May 2004. The housing market, although still strong, has shown signs of moderation. House prices increased at an annual rate of 21,4 per cent in July of this year having peaked at an annual rate of increase of over 35 per cent in September 2004. The month-on-month increase is now less than one per cent, down from 3 per cent in January 2004.

The continued high levels of expenditure are still being reflected in the rates of growth in money supply and credit extension. The twelve-month growth in M3 accelerated from 15 per cent in April 2005 to 17,1 per cent in June. Growth in total loans and advances to the private sector increased from 19,7 per in April to 22,1 per cent in June, driven primarily by an increase in asset-backed credit, in particular mortgage advances, which grew at an annual rate of 26,6 per cent in June.

The robust expenditure has been reflected in part in increases in imports. However, because the increase in the value of merchandise exports exceeded that of merchandise imports, the trade deficit in the second quarter of 2005 narrowed, and the current-account deficit, which measured 3,8 per cent of GDP in the first quarter, is expected to contract moderately as well. Non-resident net purchases of bonds and equities have amounted to almost R40 billion in the year to date. Capital inflows increased in the second quarter compared to the first quarter, implying that the current-account deficit was comfortably financed, and allowed for further reserve accumulation. At the end of July, gross reserves in the balance sheet of the Bank had increased to US$18,9 billion, and the international liquidity position to US$15,4 billion.

Monetary policy stance

Although the outlook for inflation is generally favourable as described above, the Monetary Policy Committee has decided that it would be inappropriate at this stage to change the monetary policy stance in view of the risks to the inflation outlook. The repo rate therefore remains unchanged at 7 per cent per annum. The MPC will continue as usual to monitor closely all the developments in the economy and the factors influencing inflation, and will stand ready to adjust the stance in either direction if necessary, depending on the outlook for inflation.

Reference turning points in the South African business cycle: Recent developments

by J C Venter[1]

Introduction

The South African Reserve Bank (the Bank) had previously established reference turning points in the South African business cycle for the period 1946 to 1999. These historic reference turning points were discussed in various articles and notes published in earlier editions of the South African Reserve Bank's *Quarterly Bulletin*. The most recently identified trough (lower reference turning point) in the business cycle occurred in August 1999 (Venter and Pretorius, 2001).

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

During the current business cycle expansion, the Bank's composite coincident business cycle indicator exhibited two short periods of decline, i.e. in the second and third quarters of 2001 and again during the first half of 2003. These downward movements necessitated an evaluation of the possible occurrence of reference turning points in the periods mentioned.

The purpose of this article is to describe the methodology applied by the Bank to determine reference turning points in the business cycle, as well as to present the outcome of the analysis applied for identifying potential recent reference turning points.

Defining business cycles

The most comprehensive and widely quoted definition of the business cycle was first formulated by Mitchell in 1927. It was later modified slightly by Burns and Mitchell (1946:3), to read as follows:

> "Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organise their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle; this sequence of change is recurrent but not periodic; in duration business cycles vary from more than one year to ten or twelve years; they are not divisible into shorter cycles of similar character with amplitudes approximating their own."

This definition was originally formulated to define classical business cycles, i.e. *absolute* declines in aggregate economic activity followed by *absolute* increases in aggregate economic activity. It also applies to growth cycles, which represent the fluctuations around the long-term growth trend of aggregate economic activity, i.e. the trend-adjusted business cycle.

From the outset, the South African Reserve Bank monitored cyclical changes in the South African economy in terms of growth cycles. When dates indicating the reference turning points in the South African business cycle were first published in 1970, the analysis was done on the cyclical components of the time series considered, implying that the long-term trend was eliminated from each time series considered (Smit and Van der Walt, 1970:24). The Bank's business cycle chronology, published regularly in the *Quarterly Bulletin,* therefore represents reference turning point dates that distinguish between periods when aggregate economic activity increased by more than its long-term growth trend (upward phases) and periods when aggregate economic activity either contracted, or increased by less than its long-term growth trend (downward phases).

The Burns and Mitchell definition recognises three significant features of business cycles that are particularly relevant when determining reference turning points in the business cycle, namely *duration, amplitude* and *scope.* This definition imposes fairly broad limits on the duration of a full cycle: More than a year to ten or twelve years. No limitations are placed on the duration of either an expansion or a contraction. According to Moore (1980:14), however, past experience suggests that contractions (or expansions) that fit the definition in other respects, should last for at least six months.

Furthermore, Moore (1980:14) suggests that the requirement in terms of amplitude is that expansions and contractions should reflect an absolute rise and an absolute fall in aggregate economic activity. In the case of growth cycles, this implies an absolute rise and an absolute fall in trend-adjusted aggregate economic activity. The requirement that cycles must not be "divisible into shorter cycles of similar character with amplitudes approximating their own" implies that if, for example, a long upward phase is interrupted by a decline, the decline should be recognised as a downward phase if, and only if, it lasts as long as the shortest downward phase in the historical record.

Although the concept *aggregate economic activity* is not clearly defined, this reference to the scope of the business cycle certainly does not imply some limited measure of economic activity. In fact, Moore (1980:15) states that no single index of economic activity has been found to be superior to every other. The definition states that expansions or contractions occur "at about the same time in many economic activities". This illustrates the one common characteristic of business cycles, namely the high cyclical conformity or coherence of numerous variables, or the pervasive nature of business cycles (Moore and Zarnowitz, 1984:3). Reference turning points in the business cycle can therefore never be determined by merely analysing a single measure of economic activity, such as gross domestic product, or only a limited number of individual indicators.

The three features of business cycles discussed above have also been referred to as "the three Ps" (Achuthan and Banerji, 2004), i.e. aggregate economic activity should change direction in a way that is *persistent, pronounced* and *pervasive.*

Methods used in determining reference turning points in the business cycle[2]

2 For a detailed discussion of these methods, see Smit and Van der Walt (1970).

The South African Reserve Bank employs several methods to establish whether a reference turning point in the business cycle occurred. Firstly, the three composite business cycle indicators, released monthly on the Bank's Internet website, are analysed. Should sufficient evidence of a possible turning point in the business cycle be found, two comprehensive diffusion indices, namely the historical diffusion index and the current diffusion index, are constructed.

The identification of a reference turning point in the business cycle can never be reduced to a purely statistical calculation. Important economic events and developments occurring in the vicinity of a possible turning point, as well as various other macroeconomic indicators, must be considered, since the statistical methods employed seldom all point to exactly the same turning point date. Indeed, some of the statistical methods employed may not even indicate the occurrence of a turning point.

Composite business cycle indicators

A composite business cycle indicator is compiled by integrating various economic indicators into a single indicator time series. The three composite business cycle indicators comprise three samples of economic indicators that are grouped together according to their ability to lead, coincide with, or lag movements in the business cycle.

The first sign of a possible turning point in the business cycle is usually when the *composite leading business cycle indicator* clearly changes direction for a period of at least six months. Another leading indicator of movements in aggregate economic activity, which could be used to confirm movements in the composite leading business cycle indicator, is the ratio of the composite coincident business cycle indicator to the composite lagging business cycle indicator (Venter, 2004). When the change in direction in the leading indicator is followed by a similar change in direction in the composite coincident business cycle indicator for a period of at least six months, the likelihood of a turning point in the business cycle rises significantly. Apart from its use in the ratio described above, the composite lagging business cycle indicator will usually change direction after the coincident indicator, confirming the movements in the other two composite business cycle indicators.

Historical and current diffusion indices

When movements in the composite business cycle indicators reflect the possible occurrence of a turning point in the business cycle, historical and current diffusion indices are constructed to confirm or refute the occurrence of such a reference turning point in the business cycle. During the current analysis, a total of 190 seasonally-adjusted economic time series were used to construct the two diffusion indices. These time series cover all the relevant economic processes in the different sectors of the economy such as production, sales, employment, income, investment, monetary aggregates, international trade and government activities, as well as capital market developments.

The *historical diffusion index* can be defined as a measure of the dispersion of the changes in a number of economic time series in a specific period, mostly a calendar month. This index is constructed by first determining the specific turning points in the cyclical component (deviation from trend) of each of the 190 time series considered. A set of peak and trough dates is thus obtained for each time series. A series is regarded as increasing for each period subsequent to a trough, up to and including the following peak. Conversely, a series is regarded as decreasing for each period subsequent to a peak, up to and including the following trough. The historical diffusion index value for a particular month is then obtained by expressing the number of increasing time series (relative to their long-term trends) in that month as a percentage of the total number of time series considered. An index value exceeding 50 therefore indicates that more than half of the series considered are increasing during a particular month, implying that the economy is in an upward phase of the business cycle. Similarly, an index value below 50 implies that the economy is in a downward phase of the business cycle. Turning points in the historical diffusion index therefore occur when the index passes through the 50-per-cent mark.

The *current diffusion index* is a comprehensive composite index compiled from the actual month-to-month changes in each of the total number of seasonally-adjusted time series considered. As an approximation of the growth cycle, the deviation of the current diffusion index from its long-term trend provides a quantitative indication of the cyclical movement in aggregate economic activity. For the construction of both the historical and the current diffusion indices, the sectoral contributions are weighted according to each sector's contribution to gross value added.

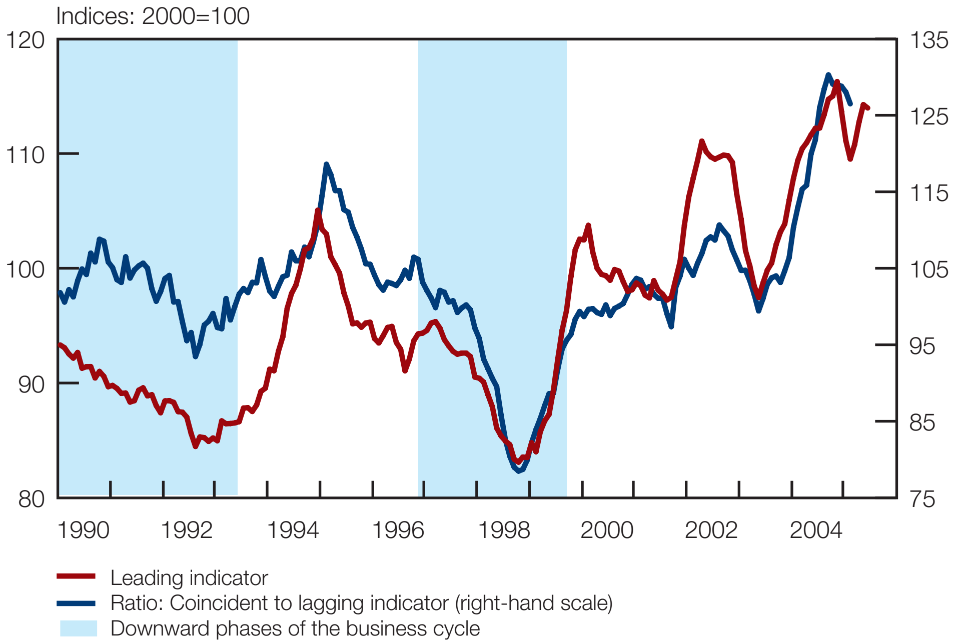
Statistical results

In the introduction to this article, mention was made of two periods during which the current expansion might have been ended by short downward phases of the business cycle. Since reference turning points in the business cycle are not revised after the event and due to various data constraints, such as changes to a number of statistical surveys released by Statistics South Africa, as well as changes in the base year of constant price estimates of South Africa's national accounts statistics, the investigation into the occurrence of these two possible downward phases of the business cycle was delayed until a consistent data set has become available. During the current analysis, the various methods described in the previous section show conflicting results, both with regard to the timing and the occurrence of turning points. These results are presented graphically and discussed in more detail below.

Composite business cycle indicators

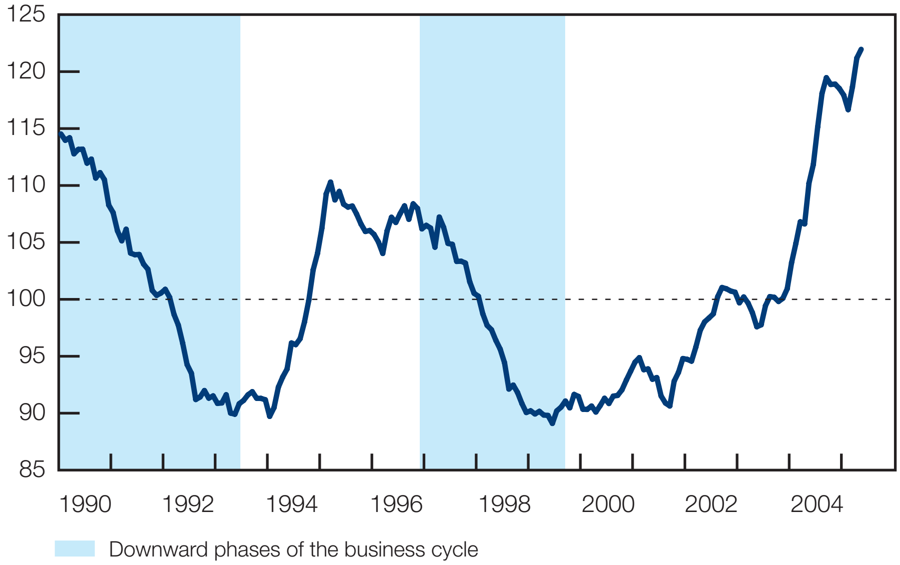
The first indication of a possible turning point in the business cycle was provided by the composite leading business cycle indicator. The leading indicator reached a peak in February 2000, whereafter it followed a downward trend up to August 2001. The indicator then reached another peak in April 2002 and retracted sharply until May 2003. Although the turning points have not corresponded exactly, these movements in the leading indicator have been corroborated by the movements in the ratio of the composite coincident business cycle indicator relative to the composite lagging business cycle indicator. This ratio, as well as the composite leading business cycle indicator, is depicted in Graph 1.

Graph1: Composite business cycle indicators



The deviation of the composite coincident business cycle indicator from its long-term trend (shown in Graph 2) also exhibited two short periods of decline. These periods were from February 2001 to September 2001 and again from September 2002 to May 2003.

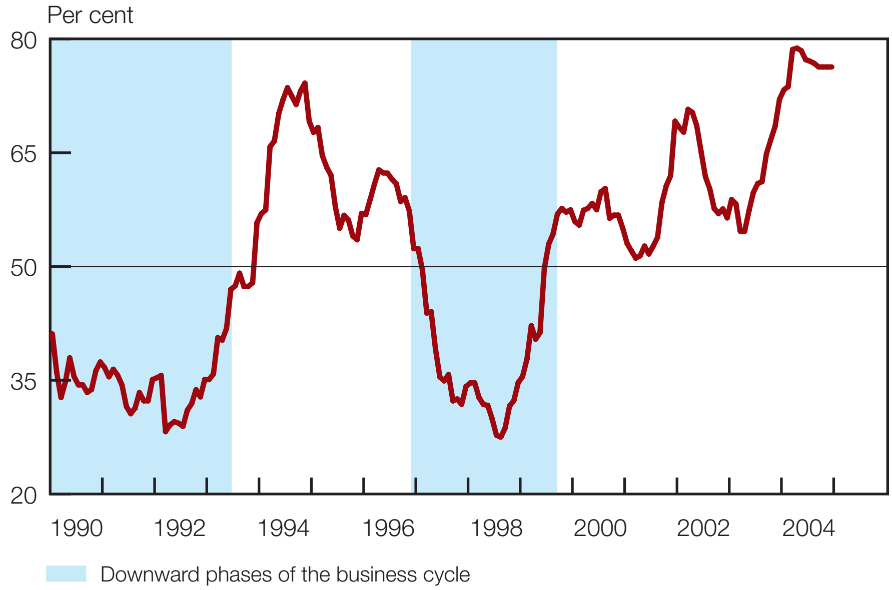
Graph 2: Composite coincident business cycle indicator (deviation from long-term trend)



Historical and current diffusion indices

The historical diffusion index is depicted in Graph 3. According to this index, the upward phase of the business cycle that started in September 1999 clearly lost some

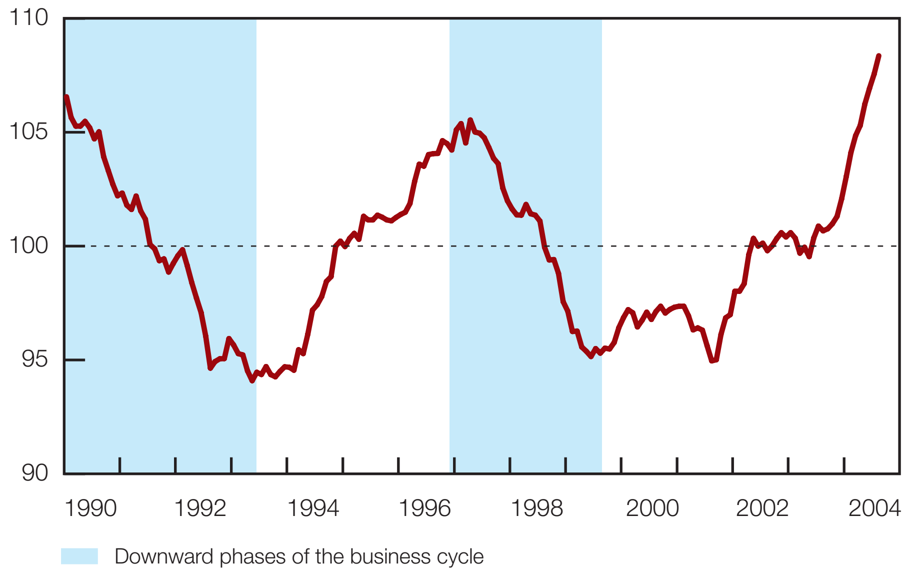
Graph 3: Historical diffusion index



momentum during the first half of 2001 and again in 2002. However, the index never fell below the 50-per-cent mark, implying that more than half of the time series considered continued to increase relative to their long-term trends throughout the current upward phase of the business cycle.

The deviation of the current diffusion index from its long-term trend decreased for a period of exactly six months, between February 2001 and August 2001. This measure of aggregate economic activity again declined slightly during the first half of 2003, albeit only for a period of four months (see Graph 4).

Graph 4: Current diffusion index (deviation from long-term trend)



An analysis of the historical and current diffusion indices of the various sectors of the economy provides further clarity on the cyclical behaviour of the economy during the two periods of economic slowdown currently under review. The mining and manufacturing sectors were the only two sectors that showed periods of decline of at least six months during the periods in question in both the historical and current diffusion indices. The historical diffusion index of the mining sector fell below the 50-per-cent mark for 18 consecutive months, from June 2002 to November 2003. The deviation from trend of the mining sector's current diffusion index reached a peak in November 2002 and a subsequent trough in November 2003. Economic activity in the manufacturing sector declined in both periods under review. The historical diffusion index of the manufacturing sector fell below the 50-per-cent mark for eight consecutive months, from January 2001 to August 2001, and again for 13 consecutive months, from September 2002 to September 2003. The deviation from trend of the manufacturing sector's current diffusion index reached a peak in December 2000 and a subsequent trough in August 2001. The indicator then peaked again in September 2002 and reached a trough in August 2003.

As the mining and manufacturing sectors are to a large extent export-oriented, they are amenable to fluctuations in economic activity in South Africa's main trading-partner countries, as well as to movements in commodity prices and the exchange rate of the rand. Towards the end of 2000 and in 2001, growth in the global economy slowed down meaningfully, most notably in the United States, where a recession occurred for the first time in a decade. International commodity prices also fell quite sharply throughout 2001. As a result of these developments, manufacturing exports were almost stagnant in 2001 and manufacturing production declined between February and August 2001. The sharp depreciation in the exchange rate of the rand during the second half of 2001, coupled with rising commodity prices at the end of 2001 and the first half of 2002, aided the recovery in the manufacturing sector. This is evidenced by the strong growth recorded in manufacturing production as well as manufacturing exports in the second half of 2001 and the first half of 2002.

From January 2002 onwards, the exchange value of the rand appreciated significantly up to the end of 2004. This development, which severely eroded the price competitiveness of exporters in the mining and manufacturing sectors, was accompanied by weak economic growth in the euro area – South Africa's major export market. These developments eventually led to a decline in mining and manufacturing production and exports during the second half of 2002 and throughout 2003. This is also reflected in the movements of the historical and current diffusion indices of the mining and manufacturing sectors.

Throughout all these developments, domestic demand continued to expand at a solid pace, supported by continued declines in the prices of imported goods in 2002 and 2003, lower rates of inflation and a less restrictive monetary policy from mid-2003. Domestic demand was therefore not as adversely affected by these global economic and exchange rate developments as was domestic production.

Comparing previous downward phases

The two apparent downward phases of the business cycle in 2001 and 2003 were also compared with previous downward phases of the business cycle in terms of duration, amplitude and scope. Firstly, the movements in the deviation from trend of the composite coincident business cycle indicator were compared for five previous downward phases of the business cycle and the two periods currently under review. The first two downward phases chosen, occurring during the 1960s, were both relatively short and can therefore be assumed to resemble the two recent declines in the coincident indicator. The three most recent identified declines were also included in the sample. The seven periods of decline in the coincident indicator were compared in terms of duration and amplitude. This comparison is shown in Table 1.

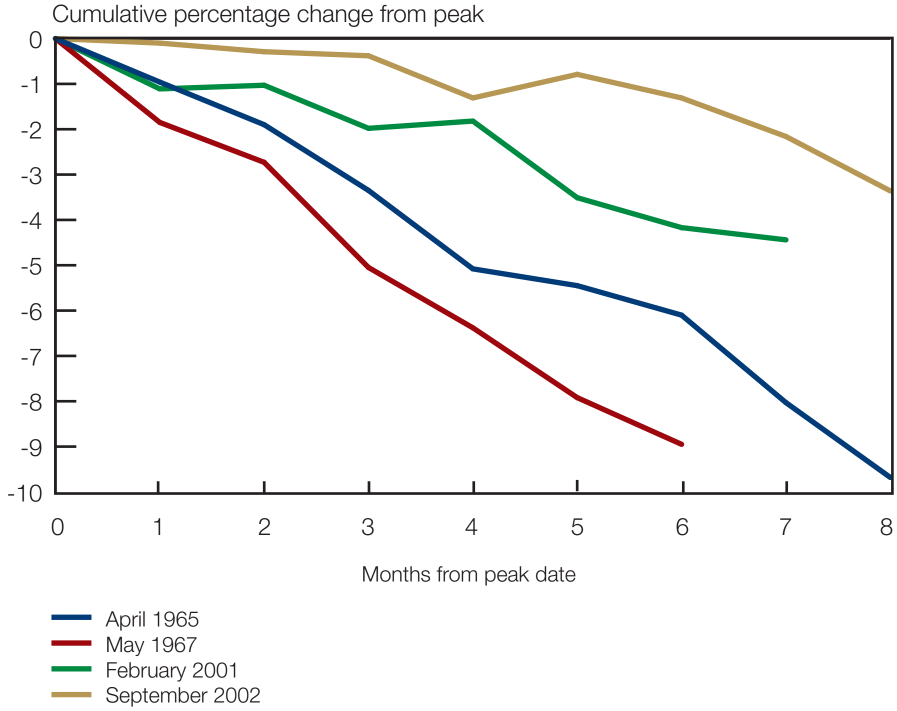
Table 1: Composite coincident business cycle indicator (deviation from trend) – downward phase comparison

Downward phase of the business cycle	Duration (months)	Percentage change: Peak to trough
May 1965 to December 1965	8	-9,7
June 1967 to December 1967	7	-9,0
July 1984 to March 1986	21	-15,1
March 1989 to May 1993	51	-23,7
December 1996 to August 1999	33	-16,4
March 2001 to September 2001*	7	-4,4
October 2002 to May 2003*	8	-3,4

* Period of decline in the deviation from trend of the composite coincident business cycle indicator

In terms of duration, both periods of recent decline (i.e. during 2001 and 2003) in the coincident business cycle indicator are similar to the previous two shortest downward phases of the business cycle (during the 1960s). However, the amplitudes of the coincident indicator (measured as the percentage change from peak to trough in the deviation from trend of the coincident indicator) during both of these two recent periods of decline are significantly smaller than the amplitudes of the other periods considered, even that of the two short declines of the 1960s. The cumulative percentage changes in the deviation from trend of the composite coincident business cycle indicator for the two short downward phases in the 1960s and for the two recent declines in the coincident indicator are illustrated in Graph 5.

Graph 5: Composite coincident business cycle indicator (deviation from trend) – downward phase comparison



A similar comparison was done by using the deviation from trend of the current diffusion index. The current diffusion index was only compiled for the period starting 1985, allowing the inclusion of only the three most recent periods of decline in this analysis. Since the deviation of the current diffusion index from its trend declined for a period of only four months in 2003, implying that no downward phase occurred, this period was excluded from the comparison. The current diffusion index comparison is shown in Table 2. The duration of the 2001 decline was exactly six months, the shortest period required for recognising this as a business cycle phase. Regarding amplitude (measured as the percentage change from peak to trough in the deviation from trend of the current diffusion index), the 2001 decline is once again significantly smaller than those of the other periods considered.

The historical diffusion index, which was discussed in the previous section, provides a close approximation of the scope, or pervasiveness, of the decline in trend-adjusted aggregate economic activity. This measure clearly shows that during both periods under review, the decline in economic activity was not nearly as pervasive as in previous downward phases of the business cycle. In fact, the index never subsided below the 50-per-cent mark, indicating that more than half of the time series considered still increased relative to their long-term trends.

Table 2: Current diffusion index (deviation from trend) – downward phase comparison

Downward phase of the business cycle	Duration (months)	Percentage change: Peak to trough
July 1984 to March 1986	21	-6,9
March 1989 to May 1993	51	-13,7
December 1996 to August 1999	33	-9,8
March 2001 to August 2001*	6	-2,5

* Period of decline in the deviation from trend of the current diffusion index

Conclusion

This analysis confirms that no downward phase of the business cycle has yet occurred in the South African economy after September 1999. Although a slight slowdown in the expansion of aggregate economic activity occurred in 2001 and again from late 2002 to early 2003, neither of these qualified as downward phases of the business cycle, according to the definition of a business cycle. The criteria, as set out in the definition, were not all met, especially in terms of amplitude and scope. The amplitudes of the two declines under review are significantly smaller than those of the previous downward phases considered. As the historical diffusion index never declined below the 50-per-cent mark, the criteria were not met in terms of scope either. Regarding duration, the requirement of at least six months was met for both periods of decline in the case of the composite coincident business cycle indicator and only for the earlier period in the case of the current diffusion index. In the case of the historical diffusion index, it was not met at all.

The results obtained from the various sectors of the economy reveal that the observed slowdown in economic activity during the periods under review was much more pronounced in the export-oriented sectors of the economy. The deceleration in the growth rate of aggregate economic activity was also much more noticeable on the supply side of the economy than on the demand side. The results obtained during this study therefore emphasise the importance of evaluating all aspects of aggregate economic activity, i.e. all the relevant economic processes and the different sectors of the economy before firm conclusions can be drawn regarding the stance of the business cycle. Reliance on one or a few economic indicators alone when determining reference turning points in the business cycle will, in many instances, not render convincing results.

The current business cycle expansion is confirmed as the longest on record. The previous two longest expansions, from September 1961 to April 1965 and from January 1978 to August 1981, both lasted 44 months. The duration of the expansion that started in September 1999 moved beyond the duration of those expansions in May 2003, and still seems to be progressing unabatedly.

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