Quarterly Bulletin

June 2005

South African Reserve Bank

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Quarterly Economic Review

Introduction

Global output growth moderated in the second half of 2004, but still expanded at a pace of 5,1 per cent for the year as a whole. This solid expansion helped to underpin increases in international trade volumes and commodity prices, enabling economic growth in most emerging-market as well as developing countries to exceed expectations in 2004. Countries in the emerging Asian region again outperformed most other economies, with China and India recording exceptional growth. Real output growth in Africa, with its mix of agricultural and mining exporters as well as oil importers and exporters, also recorded an acceleration in 2004. The available data suggest that global growth remained somewhat hesitant in the first half of 2005. Little progress was made in resolving key imbalances and problems which characterise the international economic landscape. The magnitude of the saving and fiscal shortfall in the United States, the lethargic pace of Europe's economic expansion and the inflexibility of some Asian exchange rates counted among these largely unresolved issues.

In South Africa real output growth decelerated further in the first quarter of 2005. Having peaked at 5½ per cent in the third quarter of 2004, quarter-to-quarter growth in gross domestic product receded to 3½ per cent in the first quarter of 2005, still broadly consistent with the long-run growth capacity of the economy. Primary-sector growth picked up in the first quarter, mainly on account of increases in platinum and diamond-mining output. Real output originating in the secondary sector recorded a marginal contraction in the first quarter, partly on account of competition from foreign producers that was intensified by the relatively strong international exchange value of the rand. In the tertiary sector growth in real value added remained brisk, but was marginally slower than before.

The rate of increase in real household consumption slowed down somewhat in the first quarter of 2005, but remained buoyant. Inflation-adjusted household disposable income continued to rise, with solid consumer confidence and relatively low nominal interest rates also encouraging household consumption expenditure. Real government consumption expenditure growth slowed abruptly in the first quarter of 2005, essentially because the acquisition of a corvette by the South African Navy in the fourth quarter of 2004 was not repeated in the first quarter of 2005.

Growth in real fixed capital formation slightly accelerated further in the first quarter of 2005, led by a pick-up in capital spending by public corporations. Overall, the rate of increase in aggregate real final demand in the first quarter of 2005 exceeded the rate of growth in real gross domestic product.

The tempo of real inventory accumulation decelerated considerably in the first quarter of 2005; accordingly, the ratio of inventories to production declined somewhat. The deceleration in inventory accumulation alongside the slower growth in domestic final demand reduced the growth in real gross domestic expenditure to a subdued rate of just 1½ per cent in the first quarter of 2005.

As inventory build-ups usually contain an appreciable portion of imported goods, it is not surprising that the slower pace of inventory build-up coincided with a contraction in the volume of imports in the first quarter of 2005. Real merchandise exports also declined in the first quarter, albeit marginally, whereas the physical quantity of gold exported fell back noticeably as the industry continued to encounter rising costs and declining revenues. The international terms of trade of the country weakened slightly in the first quarter of 2005. However, the decline in import volumes was so large that it produced a slightly smaller seasonally adjusted deficit on the trade account of the balance of payments. The deficit on the service, income and current transfer account also narrowed slightly. As a result the current-account deficit receded to 3,8 per cent of gross domestic product in the first quarter of 2005 from 4,0 per cent in the preceding quarter.

The deficit on the current account continued to be financed comfortably by inflows of foreign funds. Both portfolio and other investment (such as loan finance) significantly contributed to the inflows of financial capital experienced in the first quarter of 2005. Under these circumstances the South African Reserve Bank continued increasing its gross gold and other foreign reserves; these came to US$17,2 billion at the end of May 2005. Further opportunities to improve the country's international liquidity position could arise from the planned acquisition of a controlling interest in Absa by Barclays Bank plc, for which regulatory approval was granted in May 2005.

Despite sustained large deficits on the current account of the United States' balance of payments and on the federal government budget, the US dollar appreciated, on balance, against other key international currencies. The steadily rising money-market interest rate brought about by the Federal Reserve, and indications that United States' economic growth is likely to continue to exceed growth in other mature economies, might have contributed to the recent appreciation of the US dollar against major currencies. The strengthening of the US dollar was also an important contributory factor in the recent depreciation of the rand. From the end of 2004 to mid-June 2005 the rand, on balance, depreciated by 17 per cent against the US dollar and by 10,8 per cent against a basket of currencies.

Enterprise-surveyed employment in the formal non-agricultural sectors of the economy recorded uninterrupted increases in each of the six quarters to December 2004, resulting in a cumulative increase of 339 000 employment opportunities over this period. While jobs were lost in some subsectors such as gold mining, there was, on balance, a considerable increase in private-sector employment alongside a moderate increase in public-sector employment. This expansion in job opportunities was also corroborated by a moderate decrease in the unemployment rate as reflected by the results of the latest *Labour Force Survey*.

Alongside the strong increase in formal non-agricultural employment, real output per worker only rose marginally during the year to the fourth quarter of 2004. Nominal compensation per worker rose strongly, boosted by the payment of performance bonuses to staff, and early estimates accordingly show that the cost of labour per unit of output rose by 10,5 per cent in the year to the fourth quarter of 2004. Wage settlements in the first quarter of 2005, however, averaged only 6 per cent.

Inflation in the prices of goods remained low, contributing to a moderation of the inflation process in general. The production prices of imported goods rose by 1,4 per cent in the year to April 2005, largely because of the relative stability in the exchange rate of the rand. At the production level domestically produced goods prices recorded a year-on-year rate of price inflation of 1,9 per cent in April 2005. CPIX goods price inflation similarly recorded a twelve-month rate of increase of only 2,7 per cent in April 2005, with the prices of clothing, footwear and vehicles actually declining marginally. However, mainly as a consequence of an increase in petrol prices, twelve-month CPIX inflation rose from its most recent low of 3,1 per cent in February 2005 to 3,8 per cent in April. CPIX inflation has remained in the 3-to-6-per-cent target range since September 2003, i.e. for 20 successive months. The prices of services contained in the CPIX basket rose consistently faster than goods prices throughout this 20-month period.

The M3 money supply continued to increase at a brisk rate in 2004 and the first four months of 2005, consistent with the strength of domestic production and final demand. Positive wealth effects following rising prices of real-estate and financial assets also supported the demand for money. Banks' loans and advances to the domestic non-bank private sector gained further momentum in recent months and reached a twelve-month rate of increase of more than 19 per cent in April 2005. Mortgage advances displayed the highest rate of increase among the various types of loans and advances. With rising real income levels, rising house prices, confident consumers and relatively low nominal interest rates reinforcing one another, the strong growth in loans and advances was not surprising. It was also reflected in an increase in the household debt ratio from 58 per cent of disposable income in the fourth quarter of 2004 to 60 per cent in the first quarter of 2005.

At its meeting in April 2005 the Reserve Bank's Monetary Policy Committee (MPC) noted, among other things, a slowing of activity in some areas of the economy, and projected that inflation was likely to remain within the target range over the period to the end of 2006. The committee welcomed the evidence of a further material decline in inflation expectations in the latest survey showing a fall by a full percentage point from the final quarter of 2004 to the first quarter of 2005. The committee decided to reduce the repurchase rate by 50 basis points. Other money-market interest rates followed, declining to nominal levels previously encountered more or less a quarter of a century ago. At the June 2005 meeting of the MPC the repurchase rate was kept unchanged at 7,0 per cent.

From 25 May 2005 the South African Reserve Bank introduced a number of modifications to its refinancing operations. Among other things, the Reserve Bank started announcing an estimate of the average liquidity requirement for the forthcoming week prior to the main repurchase tender on Wednesdays – in future it would normally allot the full amount tendered by each bank to the bank concerned – and implemented standing facilities through a repurchase mechanism which enabled banks to deposit surplus funds overnight with the Reserve Bank at 50 basis points below the main repurchase rate, or to borrow overnight at 50 basis points above the main repurchase rate. The central feature of the Reserve Bank's system of monetary policy implementation – control over short-term interest rates through a repurchase rate set by the Monetary Policy Committee and made effective by ensuring that the banks jointly have a cash deficit which has to be refinanced through weekly tenders at that rate – remained unchanged.

Against the background of fewer and smaller decreases in mortgage interest rates since late 2003, the rate of increase in real-estate prices – at times exceeding 35 per cent on a year-on-year basis – started decelerating during the course of 2004 and continued doing so in the first five months of 2005.

Having increased by more than a third from mid-2004 to March 2005, share prices hesitated in April and the first part of May 2005. However, the recent depreciation in the exchange value of the rand had a favourable impact on share prices, which again reached an all-time high on 13 June 2005. By contrast the prices of longer-term bonds declined somewhat in recent months, partly on account of fears that exchange rate depreciation might increase the risk of a temporary setback to the process of disinflation.

Fiscal 2004/05 ended with buoyant government revenue collections in March 2005. The national government deficit before borrowing and debt repayment amounted to 1,5 per cent of gross domestic product in fiscal 2004/05, compared with an originally budgeted ratio of 3,1 per cent. The deficit was eventually predominantly financed by issues of domestic government bonds. For fiscal 2005/06 a deficit of 3,1 per cent of gross domestic product has been budgeted for, again to be financed primarily through domestic bond issues.

Domestic economic developments

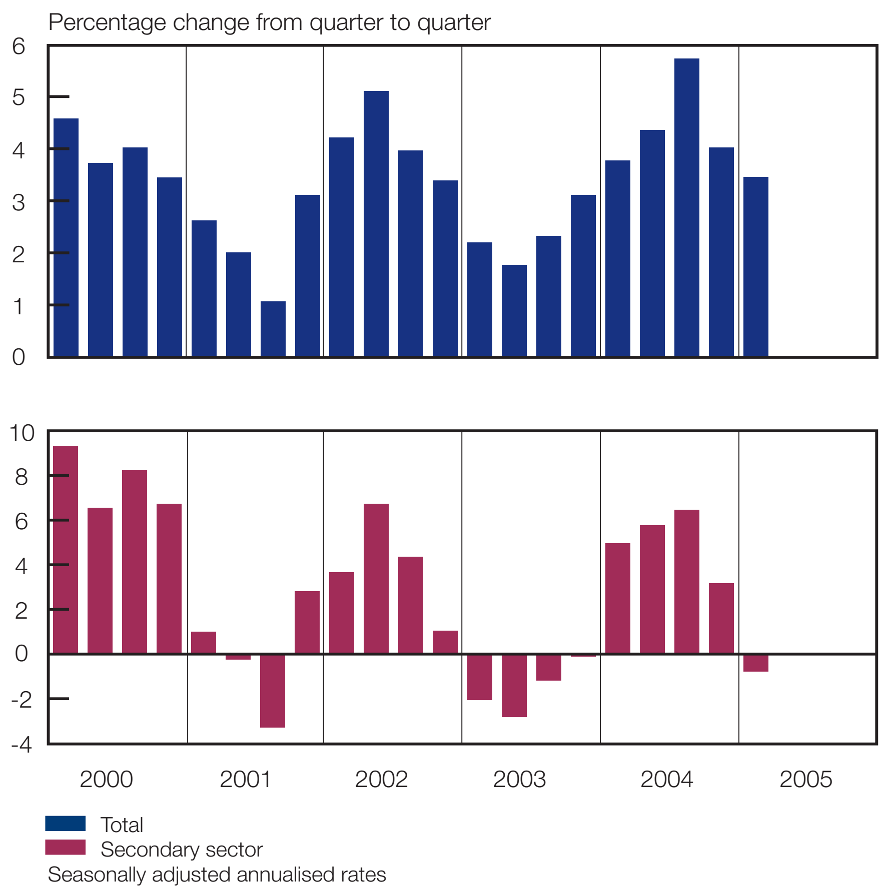
Domestic output[1]

South Africa's real economic growth slowed from an annualised rate of 4 per cent in the fourth quarter of 2004 to 3½ per cent in the first quarter of 2005. Similar growth rates were recorded when agriculture is excluded from the calculation. The slower growth in the first quarter was the net result of a decline in the real value added by the secondary sector and a slowdown in growth in the real output of the tertiary sector. By contrast, growth in the real value added by the primary sector accelerated noticeably on account of increased output originating in the mining sector.

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

Despite the slower quarter-to-quarter growth in *real gross domestic product,* the domestic economic expansion was still fairly robust in the first quarter of 2005 following the surge in domestic final demand in the second half of 2004. Measured over one year, real gross domestic product increased by 4 per cent in the first quarter of 2005 which compares favourably with the growth of 3½ per cent attained in 2004. The resilience of the economy was reflected in firm consumer and business confidence in the country's economic prospects.

Real gross domestic product



Growth in the real value added by the *primary sector* accelerated in the first three quarters of 2004 before slowing markedly in the fourth quarter. This slowdown was brief and growth subsequently accelerated from an annualised rate of just ½ a per cent in the fourth quarter of 2004 to 7½ per cent in the first quarter of 2005. Robust growth in the mining sector was largely responsible for the boost in real output in the primary sector. This more than offset a slowdown in the real value added by the agricultural sector.

The real value added by the *agricultural sector* increased at an annualised rate of 2½ per cent in the first quarter of 2005, lower than the rate of 4 per cent attained in the fourth quarter of 2004. This can be ascribed to weaker output recorded in field crop and horticultural production, which offset an increase in real livestock production.

Having contracted at a rate of 1 per cent in the fourth quarter of 2004, real value added by the *mining sector* grew at a brisk annualised rate of 9 per cent in the first quarter of 2005. The major contributors to the higher output growth were the diamond, platinum and "other mining" subsectors. Diamond mining benefited from stronger world demand. The output of platinum mines expanded as new production facilities became operational in response to increased demand for platinum in production processes domestically and abroad and the associated higher prices of platinum group metals. The strong performance of these sectors more than neutralised a decline in the real value added by gold and coal mining.

In 2004 the volume of gold production, which constitutes about a quarter of total mining output, declined to its lowest level in more than seven decades. The sustained increases in input cost in the face of a lacklustre rand gold price put the gold-mining industry under considerable pressure. Under these circumstances, some marginal mines could not be operated profitably, resulting in the closure of a number of older mine shafts.

The real value added by the *secondary sector* declined in the first quarter of 2005. After increasing at an annualised rate of 3 per cent in the fourth quarter of 2004, real output in the secondary sector declined at a rate of 1 per cent in the first quarter of 2005. This could mainly be attributed to a decline in the real value added by the manufacturing sector and significantly slower growth in the real value added by the sector that supplies electricity, gas and water. In addition, growth in the real value added by the construction sector also tapered off in the first quarter of 2005.

Following quarter-to-quarter annualised growth rates of between 2½ and 6½ per cent in 2004, the real value added by the *manufacturing sector* contracted at a rate of 2 per cent in the first quarter of 2005. The decline was evident in a number of subsectors, including some export-oriented sectors which experienced difficulties in remaining competitive internationally, partly as a result of the relatively strong exchange value of the rand. These included the subsectors producing basic iron and steel as well as petroleum, chemical, rubber and plastic products.

While the robust domestic demand stimulated output in a number of manufacturing subsectors, some subsectors like the textile, clothing, leather and footwear sector came under pressure from cheaper imports. As a result, growth in real manufacturing output by these subsectors slowed down. By contrast, the real value added by the motor vehicles, parts and accessories and other transport equipment subsector recorded firm growth. The increased output originating in the latter sectors can be linked to an improvement in export orders for these items.

Growth in the real value added by the sector supplying *electricity, gas and water* slowed down from an annualised rate of 3 per cent in the fourth quarter of 2004 to 1 per cent in the first quarter of 2005. This slowdown was consistent with the generally slower pace of economic activity, particularly in the manufacturing sector. In addition, exports of electricity to neighbouring countries were lower during the first quarter of 2005 than during the corresponding quarter in 2004.

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

The real output of the *construction sector* continued to increase in the first quarter of 2005, albeit at a somewhat slower pace than in the preceding four quarters. Compared to the fourth quarter of 2004 when the real value added by the construction sector increased at a rate of 7½ per cent, growth moderated to an annualised rate of 5 per cent in the first quarter of 2005. The increase in the real value added by the construction sector during the first quarter was underpinned by buoyancy in the construction of both residential and non-residential buildings. But with new dwellings becoming less affordable as building costs rose, the contribution of residential buildings to output originating in the construction sector started to recede.

Growth in the real value added by the *tertiary sector* accelerated to an annualised rate of 5 per cent in the third and fourth quarters of 2004 before edging lower to 4½ per cent in the first quarter of 2005. This could be attributed to weaker growth in the real value added by the commerce and the transport, storage and communication sectors where real output growth slowed for the first time in four quarters. Real output growth by the financial intermediation, insurance, real-estate and business services sector was sustained at roughly the same pace as in the fourth quarter of 2004.

After recording an annualised growth rate of 7 per cent in the fourth quarter of 2004, growth in the real value added by the *wholesale and retail trade, catering and accommodation sector* slowed down substantially to 4 per cent in the first quarter of 2005. This was the result of weaker real output growth recorded in the wholesale, retail and motor trade subsectors. The slower growth in the real value added by the retail subsector probably reflected the tapering off of consumer demand following an exceptionally strong expansion in the last quarter of 2004. To some extent, the impact of lower interest rates on the demand for durable goods might have started to peter out. Likewise, the growth in the demand for new cars cooled off somewhat after brisk selling had occurred in the fourth quarter of 2004.

The real value added by the rapidly expanding *transport, storage and communication services sector* increased at an annualised rate of 6 per cent in the first quarter of 2005, just slightly slower than the growth of 7 per cent attained in the last quarter of 2004. The slowdown could be attributed to marginally slower growth in the transport subsector, reflecting the combined effect of a decline in the real output by air transport and slower growth in the real value added by land transport. This was broadly consistent with sluggish import and export volumes. The ongoing buoyancy of the cellular communication subsector boosted growth in the real value added by the communication subsector.

The real value added by the *financial intermediation, insurance, real-estate and business services sector* grew at an annualised rate of 6 per cent in both the fourth quarter of 2004 and the first quarter of 2005. This was mainly on account of an increase in the real output originating in banks and other financial intermediaries. Buoyant domestic demand and a vibrant real-estate sector underpinned the real output by banks. By contrast, the real output of securities dealers faltered somewhat as trading volumes on the JSE Securities Exchange slowed down.

Growth in the real value added by *general government* amounted to an annualised rate of 1½ per cent in the first quarter of 2005, slightly higher than the annual growth rate attained in 2004 as a whole.

Domestic expenditure

The growth in *aggregate real gross domestic expenditure* slowed in the first quarter of 2005. Following an increase at an annualised rate of 4½ per cent in the fourth quarter of 2004, growth in real gross domestic expenditure slowed to 1½ per cent in the first quarter of 2005. This was the net effect of a slowdown in growth in real final consumption expenditure by households and general government as well as a much slower pace of real inventory accumulation. Real gross fixed capital formation increased at a fast clip in the first quarter of 2005. The level of real gross domestic expenditure in the first quarter of 2005 was 4½ per cent higher than in the corresponding quarter of 2004.

Growth in *real final consumption expenditure by households* slowed down from 7 per cent in the fourth quarter of 2004 to 5½ per cent in the first quarter of 2005. This slowdown was prevalent in the real outlays on all the major spending categories. Although the moderation in the quarter-to-quarter growth seems to suggest that the strongest part of the expansion of household consumption expenditure might have run its course, the level of real spending in the first quarter of 2005 was still about 6½ per cent higher than in the first quarter of 2004.

The spending momentum by households on *durable goods* hesitated from the fourth quarter of 2004 to the first quarter of 2005. The slowdown was evident in all spending categories, particularly in furniture and household appliances, personal transport equipment as well as recreational and entertainment goods. Following robust spending in the fourth quarter, household spending on most of these discretionary items eased off. However, the level of durable goods expenditure in the first quarter of 2005 was still 19 per cent higher than in the corresponding quarter in 2004.

Growth in real final consumption expenditure by households on *semi-durable goods* edged lower from an annualised rate of 15 per cent in the fourth quarter of 2004 to 14½ per cent

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

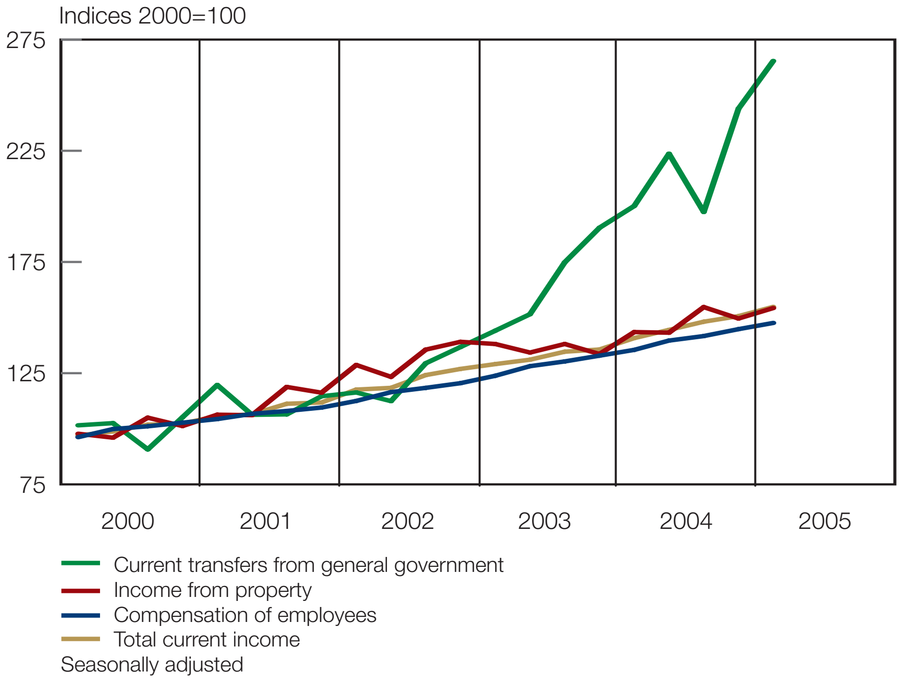
	2004					2005
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Final consumption expenditure by households	6	6½	6½	7	6	5½
Final consumption expenditure by general government	6	6	0	13	7	1
Gross fixed capital formation	11½	10	7½	9	9½	10
Change in inventories (R billions)*	9,6	14,9	13,6	7,6	11,4	1,0
Gross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

* At constant 2000 prices

in the first quarter of 2005. This was the net effect of marginally slower growth in the real outlays on clothing and footwear which offset a firm increase in consumer spending on household textiles and furnishings. While the cheaper imports of clothing might have had a negative impact on textile and clothing manufacturers, consumers generally benefited from lower prices of these items.

Household spending on *non-durable goods* also edged down from the fourth quarter of 2004 to the first quarter of 2005. This partly was a result of lower real outlays on food and beverages as well as on household fuel and power. Spending on petroleum products, for the most part a non-discretionary item, held up well in the first quarter of 2005.

Household current income



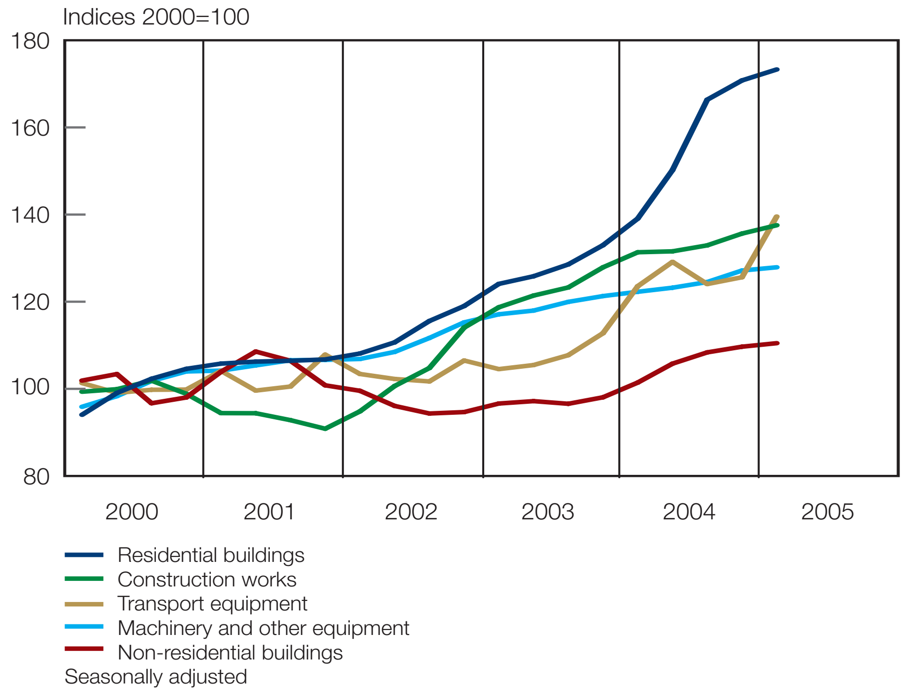
The steady increase in real household disposable income partly financed real final consumption expenditure by households in the first quarter of 2005. Real household disposable income was boosted by an increase in the level of employment and higher transfer payments (such as the child support grant) from government to households. However, households also incurred more debt to finance expenditure. As a result, household debt as percentage of disposable income increased further from 58 per cent recorded in the fourth quarter of 2004 to 60 per cent in the first quarter of 2005.

Real final consumption expenditure by general government increased further in the first quarter of 2005, but far less briskly than in the fourth quarter of 2004. Following an increase at an annualised rate of 13 per cent in the fourth quarter of 2004, growth in the real final consumption expenditure by general government slackened to an annualised rate of 1 per cent in the first quarter of 2005. This slowdown was not an indication of an enduring slowdown in government spending. The quarter-to-quarter growth in the fourth quarter of 2004 was elevated by the purchase of a corvette by the South African Navy. Omitting the cost of the corvette, growth in government spending in the first quarter of 2005 would have been more or less the same as in 2004 as a whole. The ratio of final consumption expenditure by general government to gross domestic product decreased slightly from 20 per cent in the fourth quarter of 2004 to 19½ per cent in the first quarter of 2005.

Growth in *real gross fixed capital formation* accelerated from 9 per cent in the fourth quarter of 2004 to 10 per cent in the first quarter of 2005. This can mainly be attributed to a strong increase in real capital outlays by public corporations which was further supported by continued growth in real gross fixed capital formation by the private sector. Real fixed capital formation by general government slowed from the fourth quarter of 2004 to the first quarter of 2005.

An analysis of real fixed capital expenditure in the *private sector* by type of economic activity in the first quarter of 2005 indicated some increase, albeit at a slower pace than in the fourth quarter, in real capital outlays by the manufacturing, commerce, and transport and communication sectors. The addition of retail space in response to buoyant consumer demand lifted the growth momentum of real gross fixed capital formation by the commerce sector. The decline in real fixed capital outlays by the agricultural and mining sectors also moderated in the first quarter of 2005. Consequently, real gross fixed capital formation by the private sector increased at an annualised rate of 4½ per cent in the first quarter of 2005, the same rate attained in the fourth quarter of 2004.

Real gross fixed capital formation by type of asset



Public corporations stepped up spending on electricity and transport infrastructure. In the electricity sector, real capital outlays were increased on new infrastructure and on the activation of mothballed power stations to increase capacity. The purchase of three aircraft by the South African Airways further boosted real gross fixed capital formation by public corporations. Real fixed capital expenditure by *general government* slowed down in the first quarter of 2005.

An analysis of real gross fixed capital formation by *asset type* yields a mixed picture. While investment on residential and non-residential buildings remained high, growth slowed down from the fourth quarter of 2004 to the first quarter of 2005. This might partially be due to rising building costs. Growth in real capital expenditure on transport equipment accelerated from an annualised rate of 5 per cent in the fourth quarter to 52½ per cent in the first quarter of 2005. This asset type benefited from the acquisition of new aircraft by the South African Airways as well as from firms taking advantage of low interest rates and the current relative price stability to replace ageing commercial vehicles.

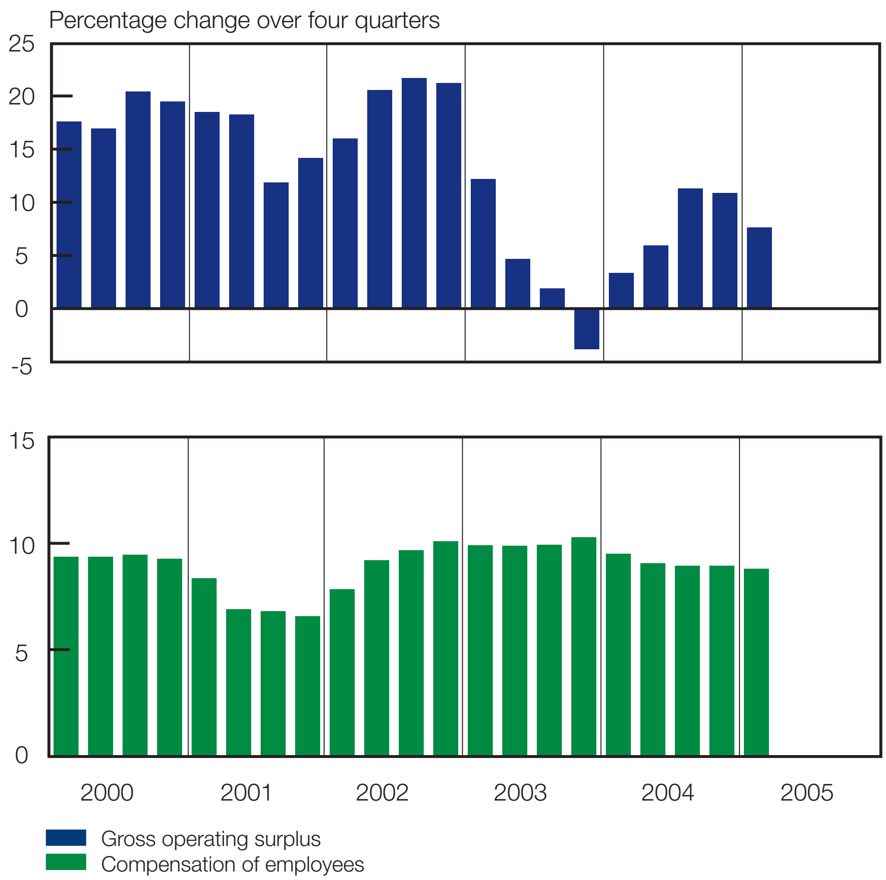
Real inventory investment at 2000 prices amounted to R7,6 billion in the fourth quarter of 2004 but reverted to a smaller build-up of about R1 billion in the first quarter of 2005. Most sectors of the economy recorded a slower pace of inventory accumulation. However, a depletion in inventories occurred in the mining, manufacturing as well as the transport, storage and communication sectors. Manufacturers drew down their inventories partly to meet brisk domestic demand as manufacturing production declined. In addition, the lower imports of oil in the first quarter of 2005 resulted in a smaller contribution to the build-up of inventories in the manufacturing sector. In the mining sector gold inventories were depleted, albeit at a more moderate pace than in the fourth quarter. The slowdown in inventory accumulation subtracted about 2½ percentage points from growth in real gross domestic expenditure in the first quarter of 2005. As a ratio of non-agricultural gross domestic product, industrial and commercial inventories amounted to 15,3 per cent in the first quarter of 2005, slightly lower than the ratio of 15,5 per cent recorded in the fourth quarter of 2004.

Factor income

Growth in total *nominal factor income*, measured over four quarters, decelerated from 10 per cent in the fourth quarter of 2004 to 8½ per cent in the first quarter of 2005. The weaker total nominal factor income was mainly the result of substantially slower growth in gross operating surpluses of business enterprises while compensation of employees maintained approximately the same growth rate as in the fourth quarter of 2004.

Growth in *total compensation of employees*, measured over one year, was sustained at a rate of 9 per cent, the same rate attained in the previous quarter. An analysis of

Gross operating surplus and compensation of employees



compensation of employees by sector of economic activity indicates that all sectors recorded steady growth with the exception of the construction, trade and transport sectors where growth accelerated. As a result of these developments, the employees' share of total factor income increased from 51½ per cent in the fourth quarter of 2004 to 52 per cent in the first quarter of 2005.

The rate of increase in *nominal gross operating surplus*, measured over four quarters, slackened from 11 per cent in the fourth quarter of 2004 to 7½ per cent in the first quarter of 2005. This was a result of a slowdown in economic activity in most sectors of the economy. Lower growth was recorded in the operating surpluses of the manufacturing, construction and commerce sectors, while operating surpluses in the agricultural and mining sectors declined. Prices of agricultural commodities continued to decline from the fourth quarter into the first quarter of 2005, while input costs remained relatively high. Profit margins in the mining sector were compressed, particularly in the gold-mining sector where the rand price of gold remained low relative to input costs. As consumer demand growth gradually tapered off from the high level attained in the better part of 2004, growth in gross operating surpluses in the manufacturing and commerce sectors also slowed down. Consequently, the ratio of aggregate gross operating surplus to total factor income declined from 48½ per cent in the fourth quarter of 2004 to 48 per cent in the first quarter of 2005.

Gross saving

Gross saving as a percentage of gross domestic product edged down from 13½ per cent in the fourth quarter of 2004 to 13 per cent in the first quarter of 2005. This development was the net result of an improved saving ratio of general government which was offset by a weaker saving performance by the corporate sector. The ratio of household saving relative to gross domestic product remained virtually unchanged from the fourth quarter of 2004 to the first quarter of 2005.

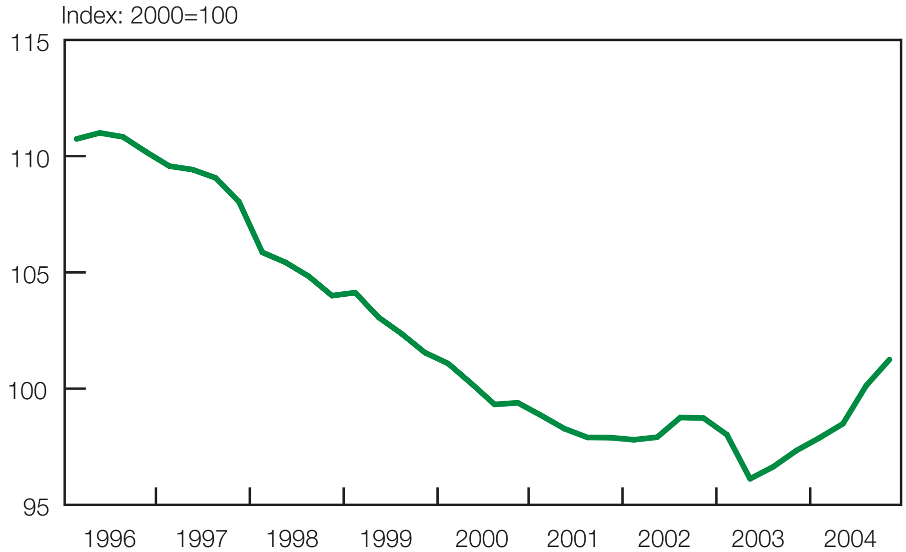
Gross saving by the *corporate sector* as a percentage of gross domestic product amounted to 10 per cent in the first quarter of 2005, compared to a ratio of 11 per cent in the fourth quarter of 2004. Corporate-sector saving was constrained by weaker growth in the gross operating surpluses of business enterprises as well as higher dividend payments.

Growth in household disposable income held up well in the first quarter of 2005, but final consumption expenditure by households also remained relatively high. Accordingly, the ratio of *gross saving by households* to gross domestic product remained at a low level of 2 per cent. *Gross saving by general government* relative to gross domestic product, which approached zero per cent in the fourth quarter of 2004, rose to 1 per cent in the first quarter of 2005. This was mainly due to higher tax collections and lower interest paid on government debt while the growth in government consumption expenditure remained contained.

Employment

Firm increases in economic activity in recent quarters improved employment prospects materially. According to Statistics South Africa's *Survey of Employment and Earnings*, enterprise-surveyed formal non-agricultural employment increased consistently during each of the six quarters to December 2004. By December 2004 the level of formal non-agricultural employment had risen by as much as 5,3 per cent or 339 000 persons from its nadir in the second quarter of 2003. This translates into a gain of around 19 000 employment opportunities per month during that period. Despite continued increases in employment numbers, the quarter-to-quarter pace of expansion decelerated somewhat in the fourth quarter of 2004 as job losses occurred in sectors producing internationally tradable goods, mostly the mining and manufacturing sectors. These job losses may have been related to intensified international competition experienced in an environment of increasing globalisation and relative strength of the rand.

Formal non-agricultural employment



Employment growth in the *private sector* decelerated from a quarter-to-quarter and annualised rate of 8,0 per cent in the third quarter of 2004 to 5,1 per cent in the fourth quarter. Both these rates were still higher than during any of the preceding four quarters of the current expansion in employment. The loss of job opportunities in manufacturing and gold mining during the closing months of 2004 was more than offset by strong increases in employment numbers in especially the trade, catering and accommodation services sector. Employment growth was also assisted by an expansion in employment in the community, social and personal services industry, as well as in the transport, storage and communication sector. The employment gains which were recorded in the *non-gold mining sector* could probably partly be associated with high international commodity prices. While employment in the construction sector picked up meaningfully during the last three quarters of 2004, its level contracted sharply in the first quarter. This can partly be explained by delays in the launch of certain large projects and the employment of large numbers of temporary workers in the industry probably resulting in some workers not being captured by official employment statistics.

Alongside the continued increases in non-agricultural private-sector employment, *public-sector* employment totals also expanded, albeit at a slower pace than in the private sector. When measured from quarter to quarter and expressed at an annual rate, public-sector employment increased by 3,0 per cent in both the third and fourth quarter of 2004. Notwithstanding the fallback in public-sector employment in the opening months of 2004, staff numbers in the public sector expanded by 1,1 per cent in the year as a whole. Employment gains in national and provincial government departments as well as at local government level exceeded losses in public-sector transport, storage and communication enterprises in 2004.

Corroborating the expansion in employment opportunities during the past year or so, the results of Statistics South Africa's most recent household-based bi-annual *Labour Force Survey* indicate a gain of about 251 000 jobs in the six months to September 2004. These employment gains were largely due to robust growth in the construction and trade sectors. The official unemployment rate accordingly decreased from a revised 27,9 per cent in March 2004 to 26,2 per cent in September.

Changes in non-agricultural employment

Four quarters to December 2004

Sector	Number	Percentage change
Gold mining	-7 700	-4,0
Non-gold mining	30 700	12,4
Manufacturing	25 100	2,0
Electricity supply	1 600	3,7
Construction	-5 400	-1,9
Trade, catering and accommodation	94 700	7,4
Transport, storage and communication	7 600	4,4
Finance, insurance, real-estate and business services	43 400	4,0
Community, social and personal services	40 700	12,7
Total private sector	**230 800**	**4,7**
National, provincial and local government	33 400	2,3
Public-sector enterprises	-5 200	-4,8
Total public sector	**28 200**	**1,8**
Grand total	**259 000**	**4,0**

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

While official employment data for the first quarter of 2005 have not yet been released, job advertisement space in the print media increased further in the first quarter of 2005. Furthermore, the Investec Purchasing Managers' employment sub-index continued to improve during the four months to March 2005, thereby reflecting purchasing managers' expectations of likely further net employment gains. These sanguine expectations were not upheld in April 2005 when the index fell steeply, but was re-established in May.

Labour cost and productivity

The year-to-year rate of increase in *average nominal remuneration per worker* amounted to 8,7 per cent in 2004. This rate of increase was roughly on a par with that of 2003 and somewhat lower than in 2002. When measured over periods of four quarters, growth in nominal remuneration per worker, however, rose abruptly to 10,5 per cent in the fourth quarter of 2004. Not only can special performance awards for certain public-sector employees explain this abrupt rise in nominal wage growth, but increases in excess of 10 per cent were also fairly pervasive in the private sector as sales and other business targets were exceeded, resulting in high bonuses being paid.

According to Andrew Levy Employment Publications (a private-sector labour consultancy), the average level of *wage settlements* in collective bargaining agreements declined from 6,8 per cent in 2004 to 6,0 per cent in the first quarter of 2005. This consultancy furthermore expects the average settlement rate for 2005 as a whole not to exceed the 6,5-per-cent level. Various multi-year salary agreements linked to official inflation measures also lend support to the view that nominal wage growth again will moderate to a level consistent with past and expected consumer price inflation in the coming months.

Although private-sector nominal wage growth accelerated strongly in the fourth quarter of 2004, the increase of 8,7 per cent in 2004 as a whole was not significantly different from wage growth in 2003. In 2004 the most generous increases in nominal remuneration per worker occurred in the construction, electricity generation and gold-mining sectors. The rates of increase in nominal remuneration per worker in the non-gold mining sector as well as in the community, social and personal services sector were, however, meaningfully lower. In gold mining it seems likely that the closing of marginal shafts, where workers' wages were the lowest, resulted in an increase in the average remuneration of the remaining workers in the sector.

The pace of increase in *public-sector* nominal remuneration per worker amounted to 9,0 per cent in both 2003 and 2004, somewhat lower than what it had been in 2002. The brisk rate of increase in nominal remuneration per worker in the public sector resulted largely from exceptional increases at local government level in 2004. When measured over one year, nominal remuneration per worker increased by more than 15 per cent for local government employees, well above the rate of pay increase for those employed at other levels of government. Nominal wage growth per worker in the year to the fourth quarter of 2004 was also well in excess of 10 per cent for employees of public-sector transport, storage and communication enterprises, as well as of provincial governments.

Following meaningful increases in the overall level of employment, economy-wide labour productivity growth slowed down considerably in the course of 2004. The year-to-year rate of increase in *real output per worker in the formal non-agricultural sectors* of the economy decelerated to 1,3 per cent in 2004, compared with an increase of 4,5 per cent in the preceding year. When measured over periods of four quarters, increases in labour productivity slowed from 3,3 per cent in the first quarter of 2004 to only 0,4 per cent in the fourth quarter. Contrary to the deceleration in labour productivity growth in the economy as a whole, the pace of increase in production per worker in the *manufacturing sector* picked up meaningfully to 4,4 per cent in the year to the fourth quarter of 2004.

Consistent with the lower increase in labour productivity and the relatively rapid pace 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 accelerated from 4,0 per cent in 2003 to 7,3 per cent in 2004. Year-on-year increases in nominal unit labour cost in the *manufacturing sector* also rose somewhat to 7,4 per cent in the fourth quarter of 2004. At an average rate of 7,4 per cent in 2004 as a whole, the increase in nominal unit labour cost in the manufacturing sector was, however, somewhat lower than in 2003 when production volumes had declined steeply.

Prices

Since late 2003 price inflation has been decelerating to relatively low rates mainly due to the appreciation of the rand, exceptionally low increases in food prices over an extended period of time and, more fundamentally, the consistent application of prudent fiscal and monetary policies. Accordingly, CPIX inflation decelerated to within the inflation target range of between 3 to 6 per cent in the twenty consecutive months to April 2005. The rise in the international price of crude oil, however, pushed domestic fuel prices higher, preventing a further reduction in price inflation.

Following the appreciation of the rand since the middle of 2002, the average level of the prices of *imported goods* started to decline from December of that year and by March 2004 had fallen by as much as 11,1 per cent. In the subsequent period, the average level of imported goods prices remained fairly constant. Further meaningful declines in the prices of a range of imported goods categories were largely countered by a consistent rise in energy prices. Accordingly, the year-on-year rate of *decline* in the prices of imported goods moderated, on balance, from 9,6 per cent in November 2003 to 0,3 per cent in October 2004. In the ensuing five months, year-on-year changes in the prices of imported goods remained muted and vacillated within a range between -0,7 per cent and 0,7 per cent. Subsequently, this rate of increase rose to 1,4 per cent in April 2005 as international crude oil prices pushed the index higher.

Over and above the direct impact of the rise in energy prices in recent months, the pace of change in the prices of imported goods was also influenced by a substantial pick-up in production price inflation in South Africa's main trading-partner countries as rising energy prices and accommodative financial policies also influenced price developments in these economies. The monthly average spot price of Brent crude oil rose from around US$30 per barrel in December 2003 to around US$51 per barrel in April 2005 after it had only briefly declined to around US$40 per barrel in December 2004. As a result, year-on-year increases in the composite wholesale price index of South Africa's main trading-partner countries accelerated from 0,9 per cent in March 2004 to 4,7 per cent in November, before decelerating somewhat to around 4 per cent in the early months of 2005.

Despite slight increases in the prices of imported goods in January and March 2005, when measured over periods of twelve months imported goods prices fell from quarter to quarter, recording an annualised rate of decrease of 3,2 per cent in the first quarter of 2005. This compares with an increase of 0,9 per cent in the fourth quarter of 2004. The decline in the prices of imported goods in the first quarter of 2005 resulted mainly from lower prices of wearing apparel, paper and paper products and printing, non-electrical machinery and equipment, as well as office, accounting and computing machinery – all of which were influenced by the continued strength of the rand.

In addition to the direct cost-reducing effects of declining imported goods prices, cheaper imported goods also intensified price competition in the domestic market, leading to a general moderation in price inflation. Accordingly, the year-on-year rate of increase in the prices of *domestically produced goods* decelerated markedly from a high of 15,3 per cent in August 2002 to 0,2 per cent in November 2003. Subsequently, as imported goods price *deflation* attenuated, the prices of domestically produced goods rose somewhat. Over the year to April 2005 the prices of domestically produced goods rose by 1,9 per cent. Increases in the prices of domestically produced goods nevertheless remained subdued in recent months due to declines in the prices of agricultural and manufactured food products as well as textiles, clothing and footwear. These declines offset the inflationary pressures emanating from rising energy prices to a large degree.

The quarter-to-quarter and annualised rate of increase in the prices of domestically produced goods decelerated, on balance, from 4,8 per cent in the first quarter of 2004 to 0,7 per cent in the first quarter of 2005. The quarter-to-quarter pace of increase in the prices of domestically produced goods in the first quarter of 2005 was restrained by decreases in the prices of agricultural goods, manufactured food products, textiles, clothing and footwear, products of petroleum and coal as well as non-ferrous basic metals.

Following the earlier slowdown in domestically produced goods price inflation and declining prices of imported goods, the year-on-year rate of increase in the *all-goods production price index* decelerated markedly from a most recent high of 15,4 per cent in September 2002 to 0,2 per cent in August 2003. In the ensuing eight months the average level of all-goods production prices fell below that of the corresponding month in the preceding year. However, in May 2004 all-goods production prices were marginally higher than a year earlier and by April 2005 had risen, on balance, by 1,8 per cent over the year. However, when the effect of rising energy prices, the main inflation driver in recent months, is omitted from the calculation, all-goods production prices actually declined by 1,5 per cent in the year to April 2005.

Production prices

Quarter-to-quarter percentage changes at annualised rates

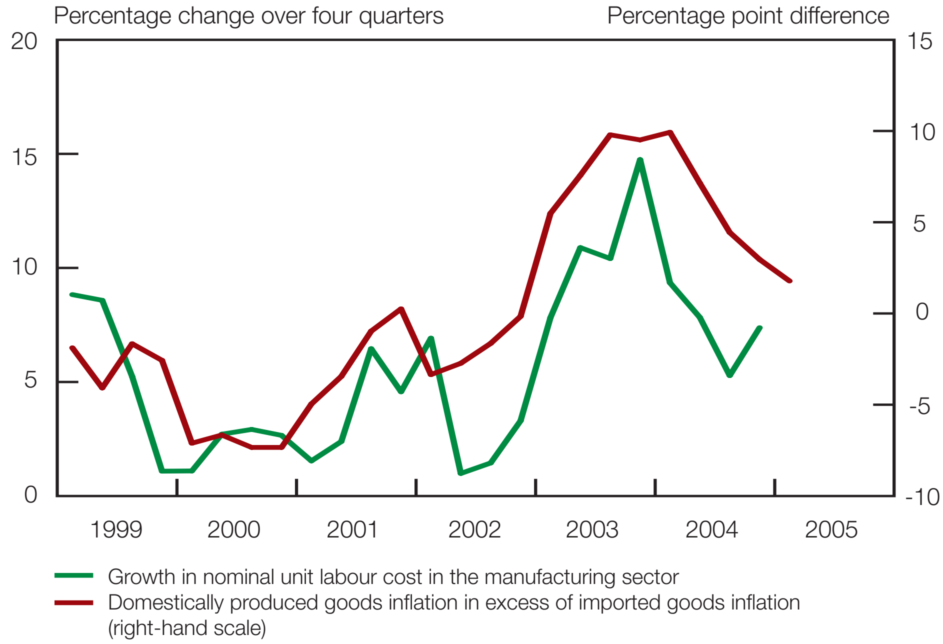
Period		Domestically produced goods	Imported goods	Overall production prices
2003:	1st qr	0,8	-6,1	-1,5
	2nd qr	0,9	-11,4	-3,6
	3rd qr	4,3	-10,6	0,4
	4th qr	-3,7	-7,7	-3,4
	Year	**3,9**	**-4,2**	**1,7**
2004:	1st qr	4,8	-3,8	1,8
	2nd qr	5,4	4,8	4,4
	3rd qr	2,5	-1,9	1,5
	4th qr	-0,9	0,9	0,8
	Year	**2,3**	**-3,9**	**0,6**
2005:	1st qr	0,7	-3,2	-0,5

While increases in the all-goods production price index occurred in the first three months of 2005 when measured on a year-on-year basis, production prices declined absolutely from the fourth quarter of 2004 to the first quarter of 2005. This decline amounted to an annualised rate of 0,5 per cent and was entirely due to lower prices of imported goods, as domestically produced goods prices rose somewhat.

An analysis of price movements shows that when inflation in the prices of domestically produced goods exceeds that in the prices of imported goods, this can largely be attributed to a rise in the cost of labour per unit of production. Compensation of employees is an important component of overall production cost, accounting for roughly 51,5 per cent of all income accruing to the different production factors in 2004. It can therefore be expected that changes in nominal unit labour cost should broadly move in tandem with the difference between domestically produced goods inflation and imported goods inflation. Generally smaller increases in nominal unit labour cost in the manufacturing sector in the past year or so contributed to the containment of domestically produced goods price inflation. Consequently, the gap between domestically and imported goods price inflation was further reduced, amounting to only 0,5 percentage points in April 2005 compared with 10,3 percentage points in January 2004. This relationship is clearly indicated in the graph on the following page.

Mainly as a consequence of the rise in petrol prices, *twelve-month CPIX inflation* (i.e. changes in the overall consumer price index for metropolitan and other urban areas, excluding the interest cost of mortgage finance) rose from its most recent low of 3,1 per cent in February 2005 to 3,8 per cent in April. Over and above the steep increase in petrol prices, higher inflation in the prices of services not related to transport pushed year-on-year CPIX inflation higher in April 2005. Notwithstanding the slight acceleration in CPIX inflation in March 2005, the quarter-to-quarter pace of increase remained muted at an annualised rate of 2,1 per cent in the first quarter of 2005, down from 5,0 per cent in the preceding quarter.

Domestically produced goods inflation in excess of imported goods inflation versus growth in nominal unit labour cost in the manufacturing sector



CPIX goods price inflation recorded a year-on-year rate of 2,7 per cent in April 2005 of which 0,9 percentage points were accounted for by the higher petrol prices in that month. Subdued year-on-year increases in food prices, which almost consistently remained below the 3-per-cent level during the 19 months to April 2005, offset the inflationary effects of higher energy prices in recent months. The price-reducing effect of sustained rand strength also led to declines in the prices of clothing, footwear and vehicles as well as muted increases in the prices of furniture and equipment in the past year or so. Consequently, the quarter-to-quarter pace of increase in CPIX goods prices decelerated meaningfully to an annualised rate of only 0,6 per cent in the first quarter of 2005, from higher rates of increase in preceding quarters.

Inflation in CPIX components

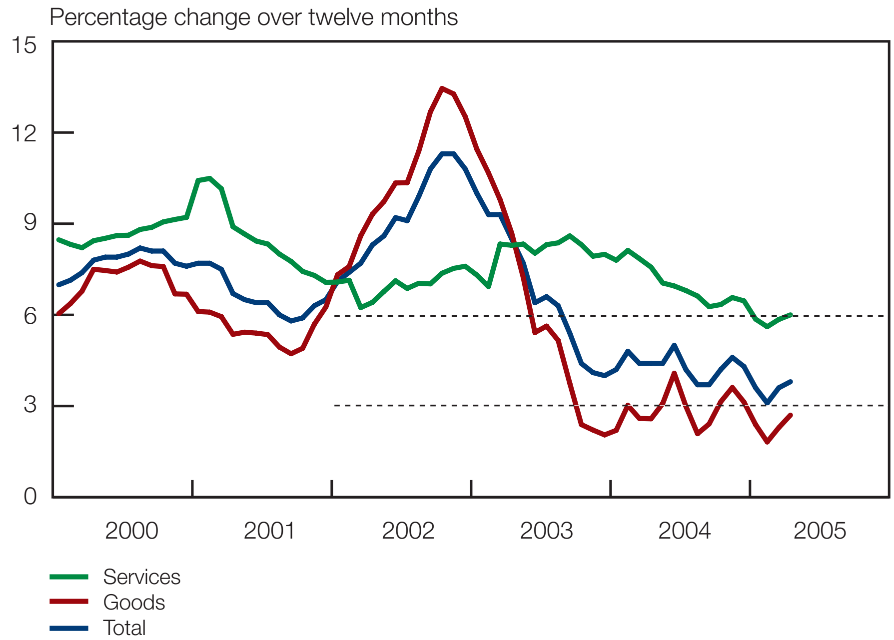
Percentage change over same period in the previous year

	Weights	April 2005
Transport running cost	5,7	11,5
Alcoholic beverages and tobacco	3,1	7,7
Services excluding housing and transport	16,5	6,8
Housing services	13,4	*5,9*
Other goods (not included elsewhere)	17,5	*3,4*
Transport services	3,9	2,5
Food	26,9	1,4
Furniture and equipment	3,2	-0,1
Vehicles	5,7	-1,4
Clothing and footwear	4,1	-3,1
Total CPIX	100,0	*3,8*

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

Notwithstanding being substantially higher than CPIX goods price inflation during the past two years, *CPIX services price inflation* decelerated consistently from a year-on-year rate of 8,6 per cent in September 2003 to 5,6 per cent in February 2005, picking up somewhat to 6,0 per cent in April. These were the lowest rates of increase in CPIX services prices since the inception of the CPIX measure of price change in January 1997. The quarter-to-quarter pace of increase in CPIX services prices broke through the upper limit of the inflation target range to within the target, amounting to an annualised rate of 4,0 per cent in the first quarter of 2005. This slowdown in services prices was fairly pervasive as all services price categories experienced lower rates of increase in the first quarter of 2005.

CPIX



Notwithstanding the success being achieved in lowering CPIX inflation to within the inflation target range, continued high and volatile international crude oil prices seem likely to restrict the further moderation in inflation in coming months. Fairly sizeable increases in the prices of certain administered goods and services, i.e. water, education, assessment rates and medical services in particular, countered the moderation of CPIX inflation in recent months. In fact, when omitting these administered price increases from the calculation, the level of year-on-year CPIX inflation in the other components of the index would have been below 3 per cent in April 2005. Continued buoyancy in domestic demand conditions is also expected to restrict the deceleration of inflation. By contrast, muted increases in consumer food prices and lower wage settlement rates as well as reasonably contained international price inflation, are likely to alleviate inflationary pressures in the months ahead.

Foreign trade and payments

International economic developments

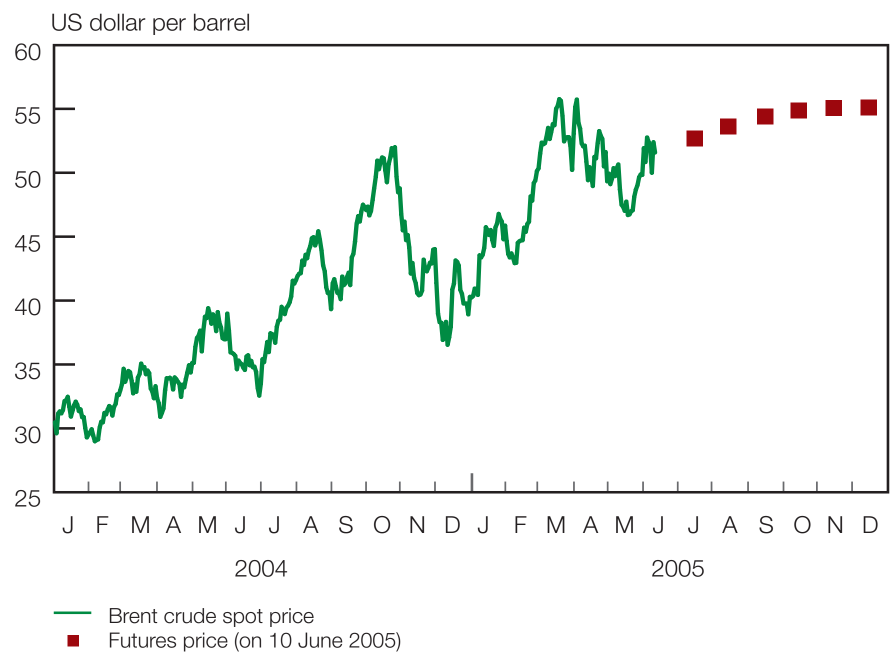
Global economic growth moderated in the second half of 2004, but still expanded at a rapid pace of 5,1 per cent for the year as a whole. This slowdown in global growth is, however, expected to bottom out in 2005. The International Monetary Fund projected in its latest *World Economic Outlook* that global real gross domestic product would advance by a solid 4,3 per cent in 2005, underpinned by ongoing accommodative macroeconomic policies, improving corporate balance sheets, supportive financial market conditions, a gradual rise in employment and strong growth in China.

Among the developed economies, Japan surged in the first quarter of 2005 with real value added increasing at a rate of 4,9 per cent following virtual stagnation in the previous quarter. Economic growth in the euro area moderated in the second half of 2004 due to slower global growth, the strengthening of the euro and persistently high oil prices, but expanded by 2,0 per cent in the first quarter of 2005. In the United States real output growth moderated in the first quarter of 2005.

Economic activity in most emerging-market and developing countries exceeded expectations in 2004. Countries in the emerging Asian region, especially China and India, again outperformed most other countries. Economic output also picked up in most Latin American countries, reflecting a combination of improved domestic policies and external factors such as higher commodity prices. The increase in non-fuel commodity prices benefited exporters of metals and agricultural commodities, while high oil prices favoured oil-exporting countries like Mexico, Venezuela, Russia and Nigeria. Real output growth in Africa, with its mix of agricultural and metals exporters as well as oil importers and exporters, was also, on balance, moderately higher in 2004.

The current world economic outlook is still clouded by risks such as growing global imbalances and high oil prices. Crude oil prices continued to be volatile and reached

Brent crude oil prices



levels of around US$47 per barrel towards the end of January 2005 before dropping below US$43 per barrel in early February after the elections in Iraq passed without disruptions to oil production. Prices started to increase towards the end of February and accelerated further during March after the International Energy Agency (IEA) increased its estimate for global oil demand in 2005 for the third consecutive month. Fuelled by a research report foreseeing a much higher range for the oil price, crude prices increased above US$55 per barrel in early April. Crude oil prices remained volatile but declined to levels of around US$47 per barrel towards the end of May after the IEA lowered its forecasts for global oil demand slightly in April and May. Prices again increased towards the end of May and early June due to lower US oil inventories and concerns of higher demand during the summer travel season. Oil prices have since declined to US$50 per barrel after the US distillate fuel inventories increased, but rebounded on 9 June 2005 on concern that the Organization of the Petroleum Exporting Countries would be unable to increase production due to limited spare capacity. Current oil futures prices suggest oil prices of around US$55 per barrel in the fourth quarter of 2005.

Since 1 January 2005, monetary policy has been tightened in countries such as Australia, Brazil, Chile, Hong Kong, India, New Zealand, Taiwan, Thailand and the United States. The central banks of the Czech Republic, Hungary, Israel and Poland have, however, decided to lower their official interest rates since the beginning of 2005. The Bank of Japan has kept official interest rates unchanged since 2001, but eased monetary policy several times during 2003 and again in January 2004 by increasing the target range for the outstanding balance on reserve accounts at the Bank of Japan.

Current account [2]

Following the sharp deterioration in the fourth quarter of 2004, the deficit on the current account of the balance of payments contracted moderately to an annualised value of R54,5 billion in the first quarter of 2005. Expressed as a ratio of the country's gross domestic product, the deficit on the current account receded to 3,8 per cent in the first quarter of 2005, from 4,0 per cent in the final quarter of 2004. The sizeable deficit in the first quarter of 2005 was easily matched by surplus savings from the rest of the world.

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

Ratio of current-account balance to gross domestic product

In the first quarter of 2005 both the trade deficit and the deficit on the service, income and transfer account narrowed, as shown in the accompanying table.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2004					2005
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Merchandise exports	260,7	278,0	286,3	290,7	278,9	282,1
Net gold exports	33,4	33,3	29,7	35,0	32,8	28,4
Merchandise imports	-276,9	-320,7	-315,7	-334,4	-311,9	-317,6
Trade balance	17,2	-9,4	0,3	-8,7	-0,2	-7,1
Net service, income and current transfer payments	-42,3	-42,7	-43,4	-48,6	-44,2	-47,4
Balance on current account	-25,1	-52,1	-43,1	-57,3	-44,4	-54,5

Mainly on account of fairly robust international demand for South African mining products, the physical quantity of exported goods increased throughout 2004. However, in the first quarter of 2005 the volume of *merchandise exports* declined by about 1½ per cent. Over the same period, the rand prices of merchandise exports decreased by 1½ per cent on account of a decline in international commodity prices.

The value of merchandise exports accordingly declined by 3 per cent from the fourth quarter of 2004 to the first quarter of 2005. In value terms the significant decreases noted in almost all the subcategories of mining products were to some extent neutralised by an increase in manufacturing exports, particularly in the subcategories vehicle and transport equipment and chemical products.

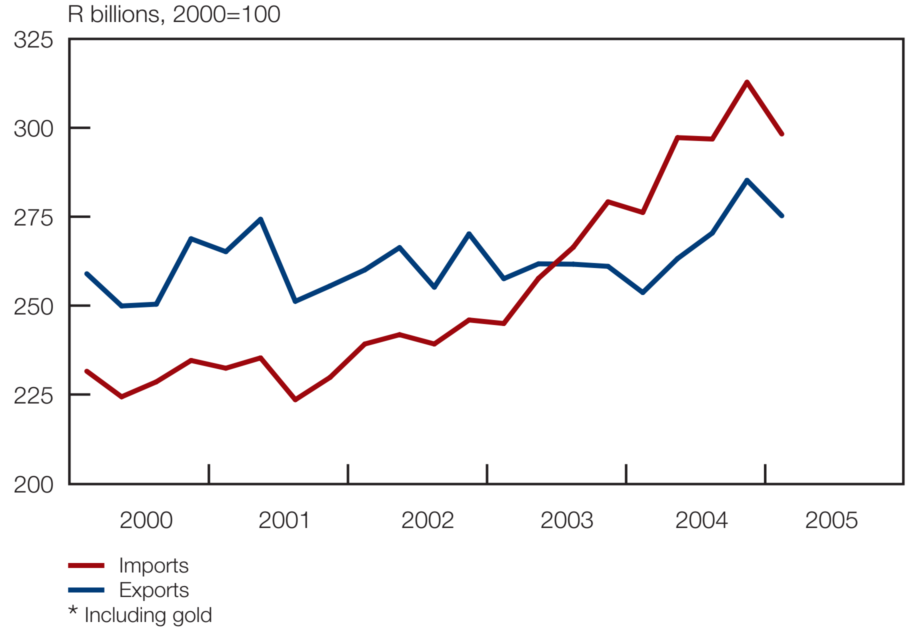
South Africa's *net gold exports* declined by no less than 18½ per cent from R35,0 billion in the fourth quarter of 2004 to R28,4 billion in the first quarter of 2005. The physical quantity of gold exported fell by almost 17 per cent from the high level in the fourth quarter of 2004 when gold exports were lifted by sales from inventories. Over the longer term gold output and export volumes drifted downwards, owing to, among other things, persistent increases in the operating cost of the South African gold-mining industry as mines are ageing. Recently strikes, operational shut-downs and the high number of public holidays in the first quarter of 2005 also took their toll, as did some mines' strategy to process smaller quantities of ore with a high gold content in order to remain profitable.

In addition to the reduced production volumes, the realised price of gold in rand per fine ounce declined by 2 per cent in the first quarter of 2005. Owing in part to the appreciation of the US dollar, the average fixing price of gold on the London market declined from US$434 per fine ounce in the fourth quarter of 2004 to US$427 per fine ounce in the first quarter of 2005.

The value of *merchandise imports* declined by 5 per cent from the fourth quarter of 2004 to the first quarter of 2005, primarily attributable to a decline in the value of mining products, especially mineral products. The value of manufactured imports decreased by 1,1 per cent, despite the importation of three passenger planes in the first quarter of 2005.

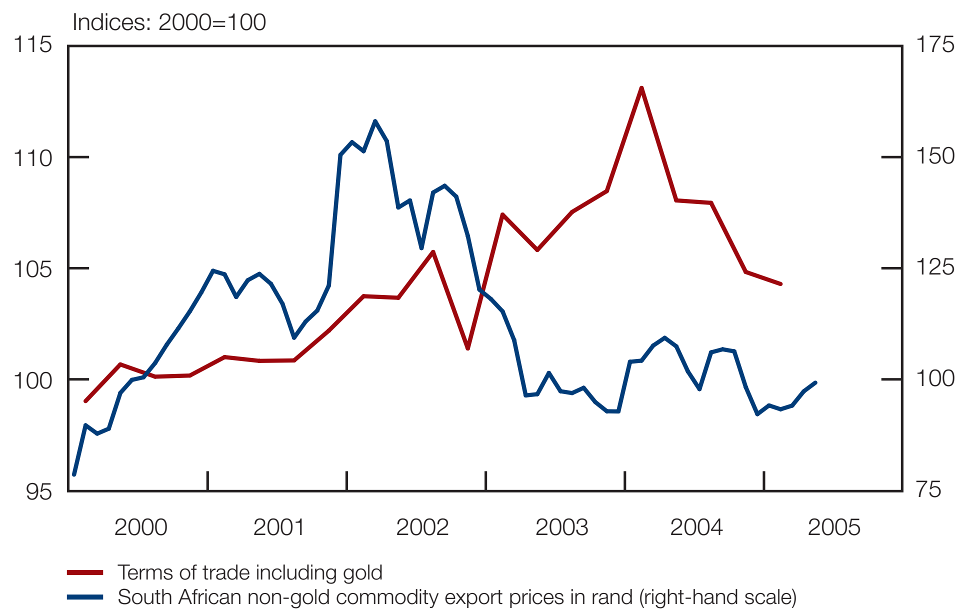
Because of South Africa's high propensity to import, a slowdown in gross domestic expenditure is usually accompanied by a weakening of merchandise imports. The volume of imports, which had increased by 4½ per cent in the fourth quarter of 2004, decreased by an almost equal magnitude in the first quarter of 2005 as domestic expenditure hesitated. The first-quarter decline in the volume of imports could partly be ascribed to a smaller volume of crude oil imported. Aggregate rand prices of merchandise imports declined by 1 per cent in the first quarter of 2005.

Real imports and exports of goods* and services



Apart from the smaller trade deficit, the improvement on the current-account balance was also enhanced by the narrowing of the services and income account deficit from R48,6 billion in the fourth quarter of 2004 to R47,4 billion in the first quarter of 2005. Higher dividend payments to non-resident investors and a slight increase in payment for travel

Terms of trade and non-gold commodity prices



services were more than offset by a sizeable reduction in interest payments on government's foreign debt as well as reduced payments for transportation. The lower payments for transportation were consistent with a decline in the volume of imported goods.

Although the rand prices of both exports and imports continued to decline in the first quarter of 2005, the decline in import prices was not sufficient to offset the decline in commodity export prices and in the prices of other merchandise exports. Consequently, South Africa's terms of trade deteriorated slightly further in the first quarter of 2005.

Financial account

The surplus on the financial account of the balance of payments (including all unidentified transactions on South Africa's external account) was almost halved from R31,4 billion in the fourth quarter of 2004 to R11,7 billion in the first quarter of 2005. As in the preceding three quarters, the net inward movement of capital consisted mainly of portfolio and other investment capital, which may be highly sensitive to global investor sentiment.

Net financial transactions not related to reserves

R billions

	2004					2005
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Change in liabilities						
Direct investment	8,7	-1,6	1,7	-5,0	3,8	1,3
Portfolio investment	5,1	14,1	3,0	22,7	44,9	7,8
Other investment	4,1	4,5	-2,9	7,8	13,5	24,7
Change in assets						
Direct investment	0,4	-9,4	-0,6	-0,8	-10,4	-0,6
Portfolio investment	0,0	-1,5	-1,3	-3,2	-6,0	2,6
Other investment	-3,0	6,2	4,0	10,9	18,1	-11,5
Total financial transactions*	**15,1**	**27,1**	**22,6**	**31,4**	**96,2**	**11,7**

* Including unrecorded transactions

Foreign-owned assets in South Africa

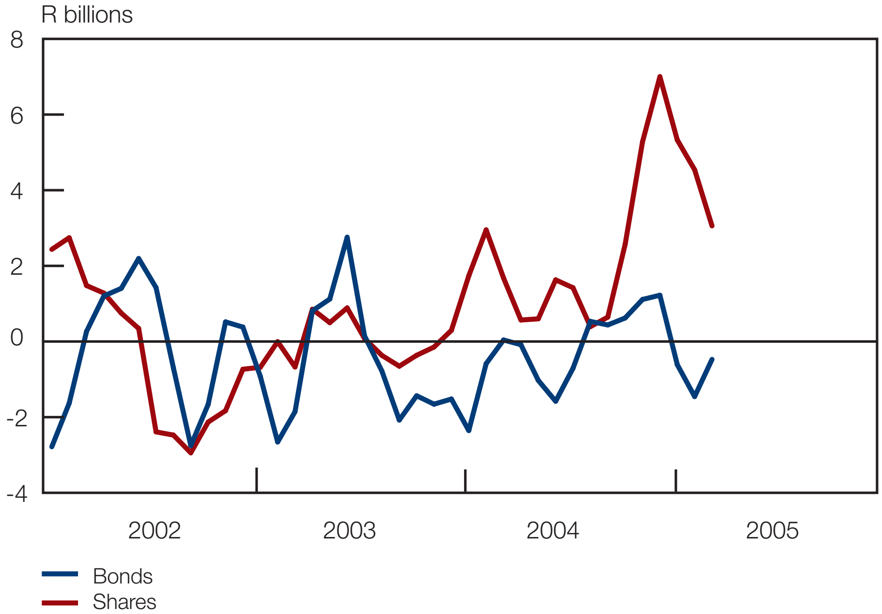
Foreign direct investment into South Africa changed from an outflow (i.e. a reduction in foreign direct investment liabilities) of R5,0 billion in the fourth quarter of 2004 to an inflow of just R1,3 billion in the first quarter of 2005. This inflow of capital in the first quarter resulted from the utilisation of credit facilities extended by foreign direct investors to direct investment enterprises in the domestic economy.

Portfolio investment flows into South Africa declined from R22,7 billion in the fourth quarter of 2004 to R7,8 billion in the first quarter of 2005. Non-resident investors continued to accumulate South African equity assets through the Johannesburg Securities Exchange SA (JSE) to the net value of R9,2 billion in the first quarter of 2005, but they became net sellers of debt securities to the value of R0,6 billion in that quarter.

Other foreign investment into South Africa recorded an inflow of R24,7 billion in the first quarter of 2005, which was almost twice the amount registered in the calendar year 2004 as a whole. This sizeable inflow could be attributed to a sharp increase in non-resident rand-denominated deposits with South African banks. In addition, the private-banking sector also increased its short-term loans from non-resident parties in the first quarter of 2005.

In May 2005 regulatory approval was granted to Barclays Bank plc to acquire a controlling interest in Absa Bank in a multibillion rand foreign direct investment transaction.

Non-resident net purchases of shares and bonds



3-month moving average – excluding share placements

South African-owned assets abroad

Direct investment abroad by South African entities, which increased by R0,8 billion in the fourth quarter of 2004, rose by a broadly similar amount in the first quarter of 2005 as South African companies continued to expand their holdings of foreign direct investment assets in the rest of the world.

Portfolio investment abroad by South African institutional investors switched from an outflow of R3,2 billion in the fourth quarter of 2004 to an inflow of R2,6 billion in the first quarter of 2005. This inflow was mainly related to the repatriation of funds held in foreign debt securities by the private sector.

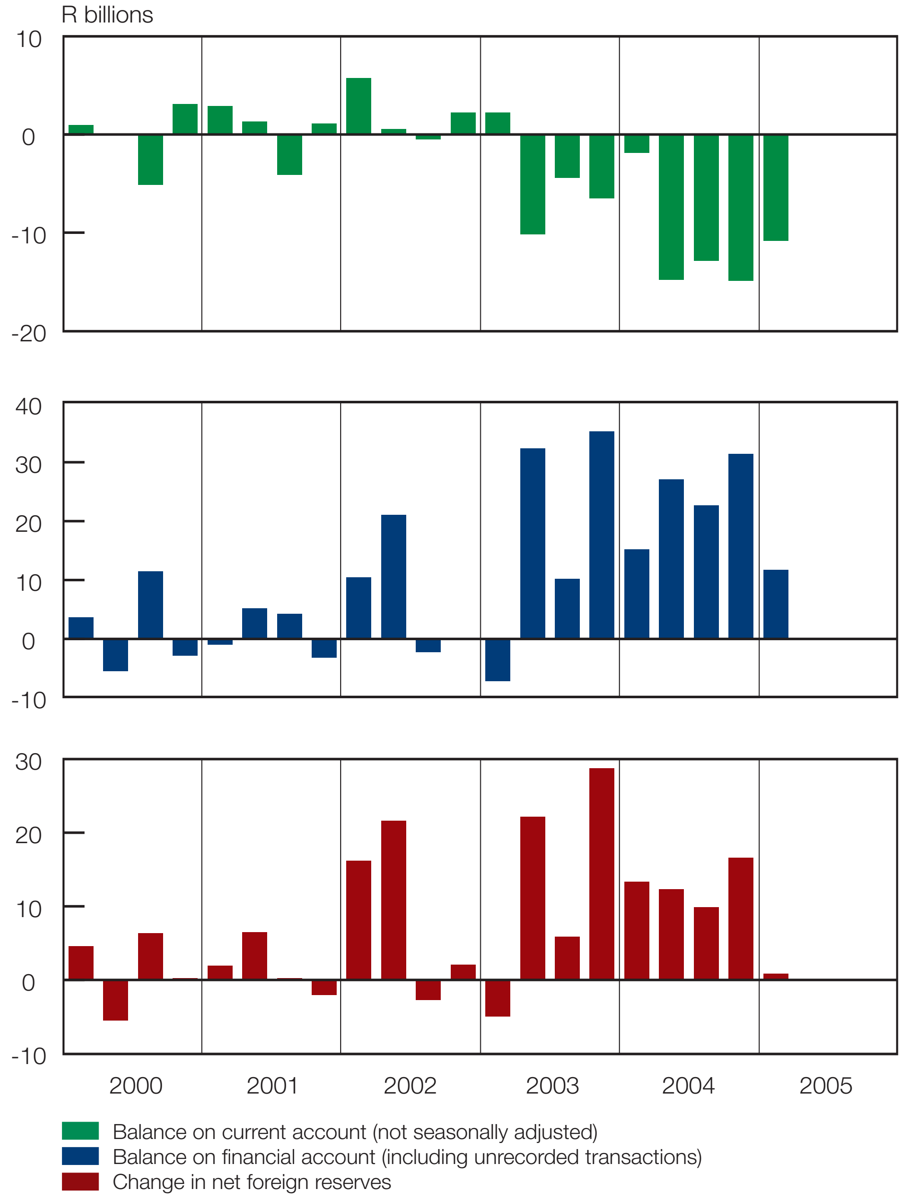
Other outward investment increased by R11,5 billion in the first quarter of 2005 compared with a contraction of R10,9 billion in the fourth quarter of 2004. The increased claims of South African entities on non-resident parties emanated from an increase in rand-denominated deposits by South African banks abroad, as well as an increase in loans extended to non-resident banks.

International reserves and liquidity position

South Africa's accumulation of international reserves owing to balance of payments transactions amounted to only R0,9 billion in the first quarter of 2005 compared with R16,6 billion in the fourth quarter of 2004. In the preceding two calendar years, the country's net international reserve position improved by R51,8 billion and R52,1 billion, respectively.

The South African Reserve Bank's gross gold and other foreign reserves increased gradually from US$14,8 billion at the end of December 2004 to US$15,9 billion at the end of March 2005. The method for valuing the gold component of the reserves was changed from March; whereas up to February 2005 gold was valued at 90 per cent of the average of the last ten fixing prices of the month on the London bullion market, from March this was changed to 100 per cent of the price on the afternoon of the final trading day of the month. This is aligned with modern accounting practice, and made a difference of US$42 per ounce, or US$170 million in total, to the value of the reserves at the end of March 2005. Official gross reserves rose further to US$17,2 billion at the end of May. Simultaneously, the value of the private sector's gross foreign assets declined from US$18,0 billion at the end of December 2004 to US$16,5 billion at the end of March 2005.

Balance of payments: Overall balance



The international liquidity position of the Reserve Bank improved from US$11,4 billion at the end of December 2004 to US$12,4 billion at the end of March 2005 and US$13,7 billion at the end of May.

Foreign debt

Owing mainly to increased non-resident foreign-currency deposits with and loans extended to the South African banking sector, the country's outstanding foreign-currency denominated debt rose by US$1,5 billion from the end of September to the end of December 2004. Over the same period, outstanding rand-denominated debt increased by US$1,3 billion as private-sector parties raised their long-term foreign borrowings. Accordingly, South Africa's total outstanding debt increased by US$2,8 billion from US$39,5 billion at the end of September 2004 to US$42,3 billion at the end of December.

Foreign debt of South Africa

US$ billions at end of period

	2003	2004			
	Year	1st qr	2nd qr	3rd qr	4rd qr
Foreign-currency denominated debt...	**27,4**	**27,9**	**27,4**	**26,4**	**27,9**
Bearer bonds.................................	9,7	9,6	9,5	9,6	9,7
Public sector..................................	4,9	4,4	4,6	4,7	4,9
Monetary sector.............................	5,9	7,4	7,0	6,0	7,0
Non-monetary private sector...........	6,9	6,5	6,3	6,1	6,3
Rand-denominated debt	**9,8**	**11,3**	**11,4**	**13,1**	**14,4**
Bonds...	4,2	4,4	3,9	5,1	5,5
Other	5,6	6,9	7,5	8,0	8,9
Total foreign debt................................	**37,2**	**39,2**	**38,8**	**39,5**	**42,3**

The ratio of total foreign debt to gross domestic product declined considerably from 22,4 per cent in 2003 to 19,8 per cent in 2004, essentially reflecting the strengthening of the exchange rate of the rand over that period. In comparison with other developing countries these debt ratios were low.

Exchange rates

The nominal effective exchange rate of the rand decreased by 6,8 per cent from end December 2004 to the end of March 2005, with the largest depreciation recorded against the US dollar and the British pound. From the end of March 2005 to end May, the nominal effective exchange rate of the rand declined further by 4,4 per cent.

Exchange rates of the rand

Percentage change

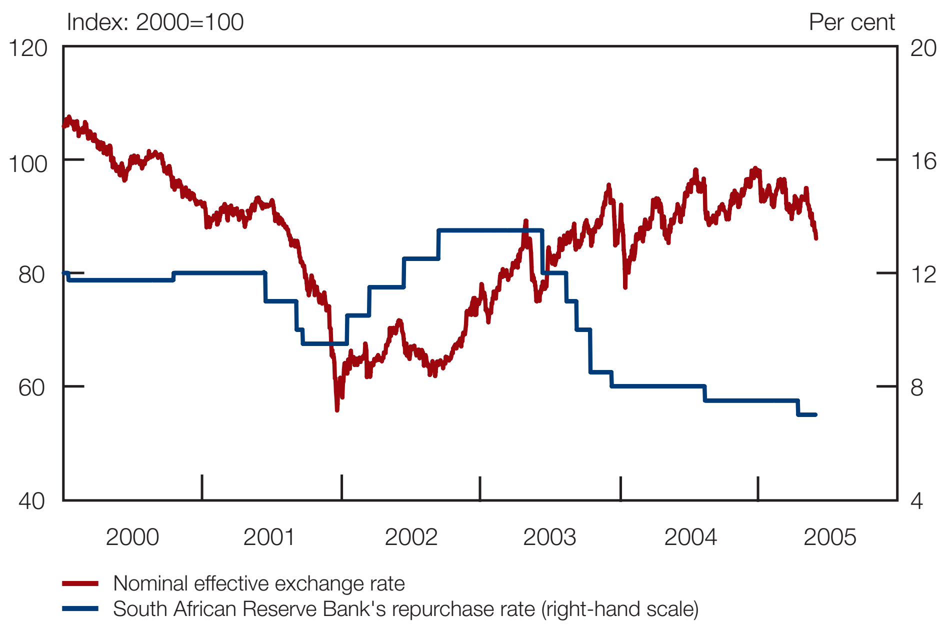
	31 Mar 2004 to 30 Jun 2004	30 Jun 2004 to 30 Sep 2004	30 Sep 2004 to 31 Dec 2004	31 Dec 2004 to 31 Mar 2005	31 Mar 2005 to 31 May 2005
Weighted average*	2,4	-3,2	6,6	-6,8	-4,4
Euro.....................................	2,0	-4,3	3,3	-4,9	-2,7
US dollar	1,0	-2,6	14,3	-9,7	-7,0
British pound	2,6	-2,2	6,6	-7,5	-3,8
Japanese yen	6,1	-0,8	5,7	-5,9	-6,0

* Against a basket of 13 currencies

The somewhat weaker performance of the rand during the first five months of 2005 could probably be attributed, among other things, to:
- a rise in global interest rates;
- somewhat lower international commodity prices;
- the recovery of the US dollar;
- a weaker overall balance-of-payments position; and
- the interest rate cut at the April meeting of the South African Reserve Bank's Monetary Policy Committee.

The real effective exchange rate of the rand decreased by 4,4 per cent from December 2004 to March 2005, after having increased on balance by 4,3 per cent over the twelve months to December 2004.

Nominal effective exchange rate of the rand and repurchase rate



The heightened volatility in the foreign-currency market pushed the net average daily turnover in the domestic market for foreign exchange to US$13,9 billion in the first quarter of 2005, from US$12,4 billion in the fourth quarter of 2004. The value of transactions in which non-residents participated increased from US$9,2 billion per day to US$10,5 billion per day over the same period. Participation by resident parties also increased from an average of US$2,9 billion per day in the fourth quarter of 2004 to US$3,1 billion per day in the first quarter of 2005.

Monetary developments, interest rates and financial markets

Money supply [3]

Growth in the broadly defined money supply, M3, accelerated to 18,6 per cent in the fourth quarter of 2004 but decelerated to 5,8 per cent in the first quarter of 2005. The moderation in the growth rate in M3 in the first quarter of 2005 was partly related to the high base set in the previous quarter and the accumulation of government deposits in January and March 2005 which was a reflection of better-than-expected government revenue collections. (Government deposits are not part of M3.) Nevertheless, in absolute terms the increase in M3 in the first quarter of 2005 remained firm, consistent with the rapid growth in nominal income and expenditure and the rise in asset values.

3 The analysis in this section is based on revised data, as discussed in the note on the corporatisation of the Public Investment Commissioners elsewhere in this Quarterly Bulletin. *The quarter-to-quarter growth rates referred to in this section are seasonally adjusted and annualised.*

Growth over twelve months in M3 remained firm and broadly unchanged at levels of around 12 per cent in the two months to March 2005 as real final demand and prices in the economy broadly maintained their earlier momentum, but then accelerated to 15,0 per cent in April alongside indications of strong expenditure and economic activity.

Growth in the narrower monetary aggregates displayed diverging trends during the first quarter of 2005, as shown in the accompanying table. Call and overnight deposits declined in the first quarter, while cheque and transmission deposits rose briskly – a phenomenon which partly may be explained by the prevailing relatively low interest rates.

Monetary aggregates

Per cent at quarter-to-quarter seasonally adjusted annualised rates

	Quarter-to-quarter growth	
	4th qr 2004	1st qr 2005
M1A	3,5	15,9
M1	10,3	-0,7
M2	20,5	4,5
M3	18,6	5,8

The private corporate sector accounted for the bulk of the increase in M3 deposits during the first quarter of 2005. This sector's M3 deposit holdings increased by R32,1 billion whereas those of the household sector declined by R0,2 billion. The increase in corporate-sector deposit holdings was concentrated in deposits with maturities of less than 32 days.

The accumulation of and preference for low interest-yielding but liquid deposits by the corporate sector partly could be a reflection of a strong liquidity preference owing to the relatively low interest rates, brisk output growth, and the need to hold money in order to capitalise on speculative opportunities in the securities and real-estate markets.

The quarter-to-quarter seasonally adjusted and annualised growth in nominal gross domestic product exceeded growth in M3 by 3,0 percentage points in the first quarter of 2005 – the first time since the fourth quarter of 2002 that income growth exceeded that of M3. Consequently, the income velocity of circulation of M3 increased from 1,56 in the fourth quarter of 2004 to 1,57 in the first quarter of 2005. Nevertheless, the income velocity of circulation of M3 remained close to historically low levels.

M3 increased by R32,0 billion from the end of the fourth quarter of 2004 to the end of the first quarter of 2005. The accounting counterparts of these increases are tabled below.

Counterparts of change in M3

R billions

	2004		2005	
Counterparts	4th qr		1st qr	
Net foreign assets		3,2		3,2
Net claims on the government sector		-0,1		-12,8
Gross claims	18,5		-25,5	
Government deposits (decrease +; increase -)	-18,6		12,7	
Claims on the private sector		68,5		22,1
Investments and bills discounted	22,6		-14,3	
Total loans and advances	45,9		36,4	
Net other assets and liabilities		-54,7		19,5
Total change in M3		**17,0**		**32,0**

The most prominent among the counterparts of the increase in M3 in the first quarter of 2005 were increases in net other assets and liabilities, and claims on the domestic private sector. The increase in other assets and liabilities emanated from the requirement that banks account for their positions in derivative instruments according to market valuation, which in this instance caused a decline in the value of other liabilities. The increase in banks' claims on the private sector was mainly driven by the strong growth in total loans and advances.

Net claims on the government sector were strongly affected by the redemption and coupon interest payments on government bonds at the end of February 2005. The decline in government deposits at the end of February 2005 was later partly reversed by the higher-than-expected tax revenue collections towards the end of March 2005.

Credit extension

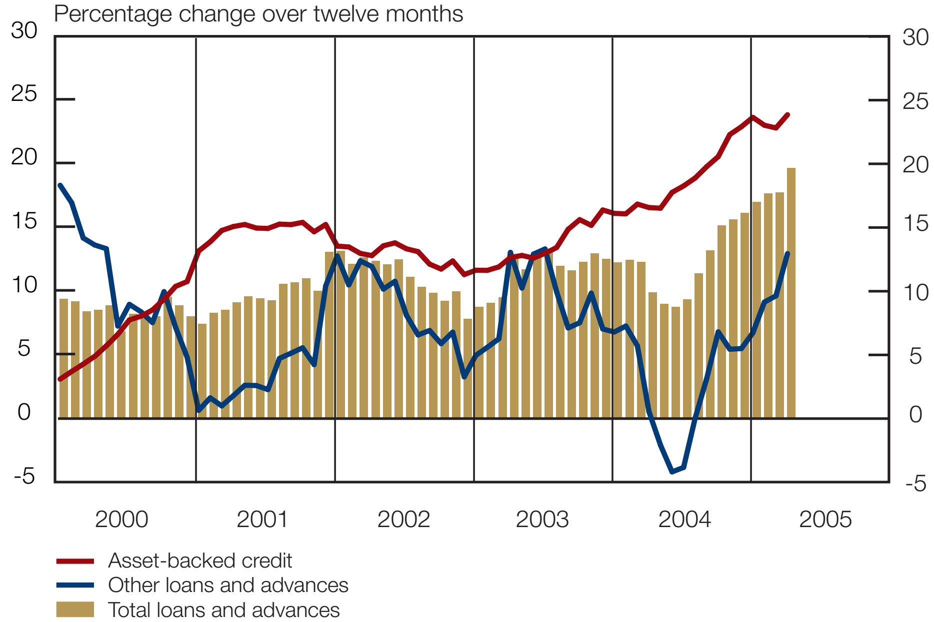
Favourable lending and borrowing conditions, strong business and consumer sentiment, a rebound in the corporate sector's demand for bank-intermediated funding and the buoyancy of the real-estate and financial markets continued to support the strength of private-sector credit extension. Growth over twelve months in bank loans and advances extended to the domestic private sector continued at a brisk rate of around 17 per cent in the two months to March 2005, but accelerated to 19,7 per cent in April. The quarter-to-quarter seasonally adjusted and annualised growth in loans and advances decelerated from 27,0 per cent in the fourth quarter of 2004 to 20,0 per cent in the first quarter of 2005.

Total loans and advances[4] increased by R36,4 billion during the first quarter of 2005. Asset-backed credit accounted for R22,1 billion of the overall increase in loans and advances extended to the private sector. The quarterly growth in the asset-backed category decelerated from 28,8 per cent in the fourth quarter of 2004 to 22,5 per cent in the first quarter of 2005.

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.

Growth in *mortgage advances* was restrained by some financial restructuring during the first quarter of 2005: One of the reporting banks' mortgage book was absorbed by a non-monetary institution in February, reducing banks' mortgage advances, but the non-monetary entity was financed by bank advances, thereby raising *other loans and*

Total loans and advances



advances extended by banks. However, despite this shift mortgage advances still recorded a considerable increase of some R16,1 billion in the first quarter of 2005. The household sector was the main contributor to the overall increase in mortgage advances. Twelve-month growth in such advances has remained at levels of around 24 to 25 per cent since December 2004, consistent with the buoyant conditions in the real-estate market.

Instalment sale and leasing finance, which is mainly intended for financing expenditure on motor vehicles and other durable goods, increased by R6,0 billion in the first quarter of 2005. Growth over twelve months in this aggregate has remained strong at levels of around 20 per cent since December 2004, associated with brisk aggregate spending growth which was also supported by the relatively stable prices of new motor vehicles and other durables and attractive incentives offered to prospective buyers.

Credit aggregates

Component	Quarterly changes R billions		Percentage contribution to change in total loans and advances	
	2004 4th qr	2005 1st qr	2004 4th qr	2005 1st qr
Asset-backed credit	35,1	22,1	76,4	60,7
Instalment sale credit and leasing finance	6,4	6,0	14,0	16,5
Mortgage advances	28,7	16,1	62,5	44,2
Other loans and advances	10,8	14,3	23,5	39,3
Total loans and advances	**45,9**	**36,4**	**100,0**	**100,0**

Growth over twelve months in *other loans and advances* accelerated from 5,4 per cent in December 2004 to 12,9 per cent in April 2005. Such loans increased by R14,3 billion in the first quarter of 2005, mainly reflecting more intensive use of this type of bank-intermediated funding by the corporate sector.

The continued firm growth in asset-backed loans at rates of more than 10 per cent since November 2000 suggests prolonged favourable bank lending conditions, as also reflected by the non-performing loans of the banking sector declining as a percentage of total loans and advances.

Interest rates and yields

Against the backdrop of a significant decline in inflation expectations and a generally favourable outlook for inflation, the Reserve Bank's Monetary Policy Committee (MPC) reduced the repurchase rate by 50 basis points to 7 per cent on 14 April 2005, having kept the rate unchanged at 7½ per cent since 13 August 2004. At the June 2005 meeting, the MPC decided to keep the repurchase rate unchanged at 7,0 per cent. The repurchase rate (or lowest rate at the Reserve Bank's accommodation window) is currently at its lowest level since 1980. The April and June 2005 MPC statements discussing the background to these decisions are reproduced in full elsewhere in this *Bulletin.*

The private-sector banks followed the lead of the Reserve Bank and lowered their prime overdraft rates and predominant rate on mortgage loans by half a percentage point to 10½ per cent on 15 April 2005. With the repurchase rate unchanged at the June 2005 MPC meeting, banks left their lending rates unchanged.

The South African Overnight Interbank Average (SAONIA) rate varied around an average level of 6,62 per cent in the three months to 31 March 2005. The SAONIA rate declined later by a cumulative 105 basis points from 7,06 per cent on 13 April 2005 to 6,01 per cent on 3 May 2005, partly reflecting the cut in the repurchase rate and developments in the interbank funding market. It amounted to 6,33 per cent on 13 June 2005.

Other money-market interest rates remained relatively stable during the first quarter of 2005, but declined alongside the repurchase rate in April 2005. For instance, the three-month Johannesburg Interbank Agreed Rate (Jibar) increased marginally by 12 basis points from the beginning of January 2005 to 7,59 per cent on 14 April 2005 but declined by 59 basis points to 7,00 per cent on 15 April 2005. It amounted to 6,95 per cent on 10 June 2005.

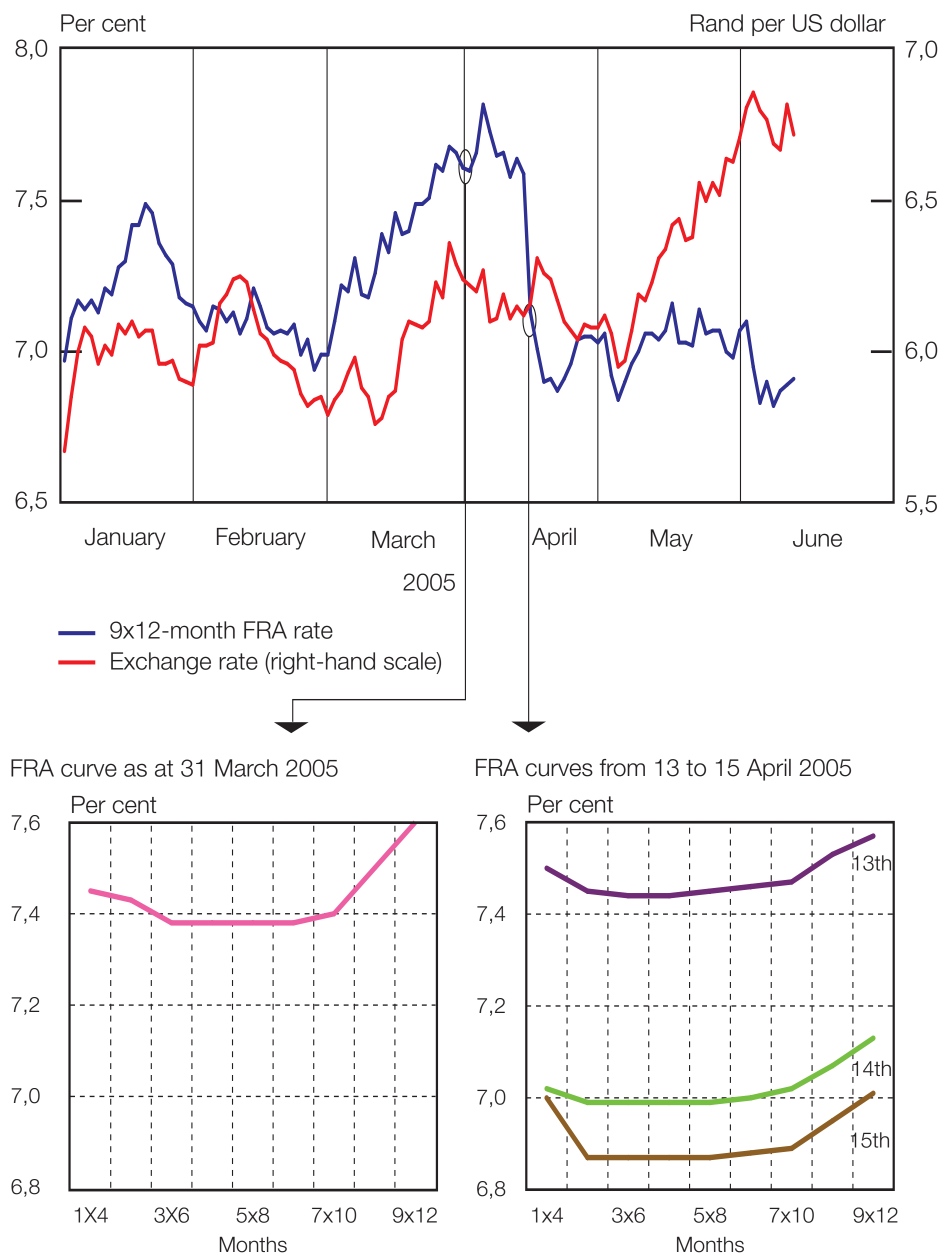
Money-market interest rates

Similarly, the tender rate on 91-day Treasury bills stabilised around 7,20 per cent in the three months to 14 April 2005 but declined to 6,75 per cent on 15 April. Stable demand for liquid assets helped to ensure very little variation in the 91-day Treasury bill rate, which came to 6,73 per cent at the end of April and 6,76 per cent on 10 June 2005.

In order to widen the range of short-term government debt instruments the authorities started issuing 273-day Treasury bills from 29 April 2005. By 10 June 2005 a total amount of R350 million in 273-day bills was outstanding with the latest tender rate at 6,65 per cent.

Movements in forward rate agreements (FRAs) recently displayed a systematic correlation with changes in the exchange rate of the rand, but reflected the full impact of the April change in the repurchase rate, as shown in the accompanying graph. The

Forward rate agreements and the exchange rate of the rand



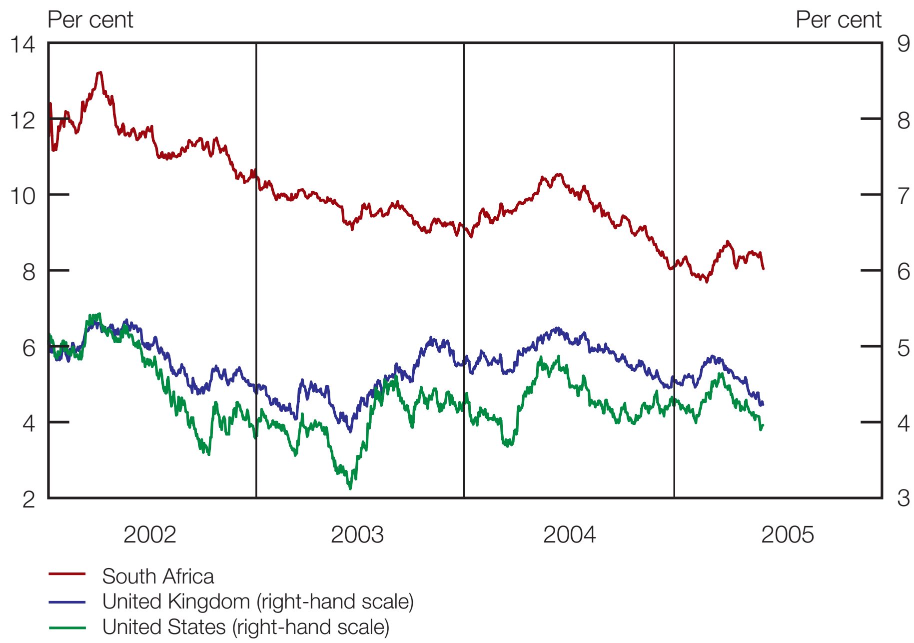
rate on the 9x12-month forward rate agreement rose by 85 basis points from 4 January to 5 April 2005 but declined by almost 60 basis points in the 24 hours following the 14 April 2005 reduction in the repurchase rate, and declined somewhat further to a low point of 6,87 per cent on 20 April. The 9x12-month FRA subsequently rose marginally to 6,91 per cent on 10 June 2005.

After a decline of 140 basis points from July 2004 to December 2004 the *predominant rate on twelve-month fixed deposits* of the private-sector banks remained at 6,4 per cent to April 2005, despite the lowering of the repurchase rate in that month. In May 2005 the predominant twelve-month fixed deposit rate was lowered to 6,2 per cent. The *maximum annual finance charges rates* on money loans and credit and leasing transactions, as laid down by the Usury Act, have remained unchanged since 17 September 2004.

After a reduction of 75 basis points in January 2005 the rates of interest on RSA Government Retail Bonds remained unchanged to the end of June and amounted to 8,25 per cent on the 5-year bond, 7,75 per cent on the 3-year bond and 7,50 per cent on the 2-year bond. The prevailing interest rates are priced off the government bond yield curve and are changed when the yields of equivalent government bonds move either negatively or positively by more than 50 basis points.

From record low levels previously experienced in the early 1970s, long-term bond yields displayed an upward bias from the end of February 2005 when persistently high oil prices revived inflation concerns. The *daily average yield* on the long-term R157 government bond (maturing in 2015) initially fluctuated around a declining trend from a recent high of 10,53 per cent on 15 June 2004 to a record low of 7,69 per cent on 28 February 2005 as the exchange value of the rand appreciated and the inflation outlook improved. The downward momentum in the long-term bond yield slowed down after the repurchase rate was kept unchanged at the February 2005 meeting of the MPC. Subsequently, long-term bond yields increased to 8,77 per cent on 5 April, coinciding with fluctuations in the exchange value of the rand and an upward movement in bond yields in the major international financial centers from February 2005 to March. Bond yields fell to 8,06 per cent on 20 April after a brief rally in the bond market when the repurchase rate was

Yields on long-term government bonds



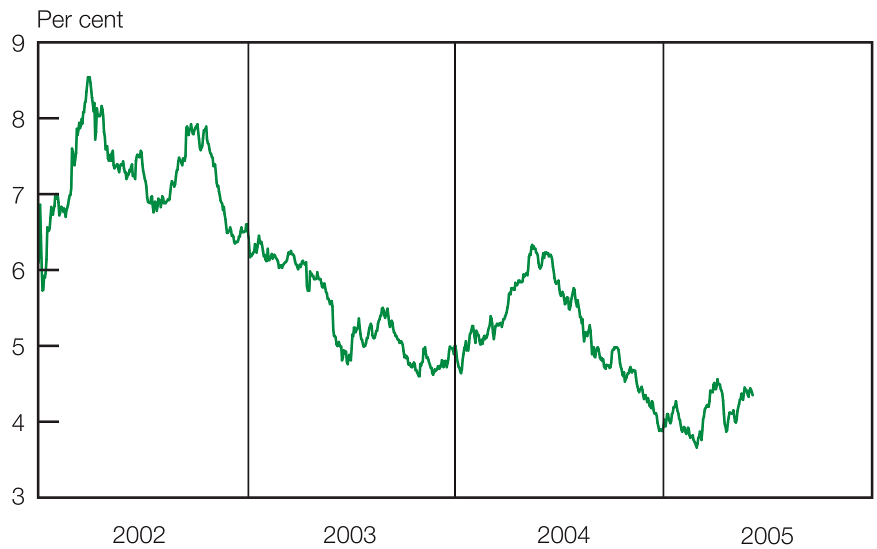
lowered on 14 April, but thereafter rose to 8,50 per cent on 18 May before declining to 8,01 per cent on 10 June. The upward bias in domestic bond yields from the end of April 2005 was in contrast to a renewed downward movement in bond yields in the major international markets. Bond yields in the major international markets generally started to trend downwards from mid-March 2005, reversing an upward trend from mid-February 2005, alongside growing concerns regarding a possible prolonged slowdown in global growth.

Due to the brisk decline in nominal bond yields from June 2004 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) declined from a recent high of 5,8 per cent in August 2004 to 3,9 per cent in December. Subsequently, the real yield increased to 4,5 per cent in April as nominal bond yields increased while inflation remained relatively subdued.

From record low levels at the end of February 2005 the level of the *yield curve* moved upwards during March 2005 as the somewhat weaker exchange value of the rand and the increase in the price of oil stifled expectations of declining inflation. Yields at the extreme short end of the curve generally remained anchored to the repurchase rate while pronounced increases were evident along the rest of the curve. The upward movement continued into April before bond yields across the curve responded to the 14 April MPC decision to lower the repurchase rate: The short end of the curve declined sharply while the rest of the curve also moved lower as demand for longer duration assets increased. The long end of the yield curve moved higher to 10 June 2005 as a weaker exchange value of the rand and high oil prices heightened short-term inflation concerns.

Some deterioration in the inflation outlook was apparent from the recent upward trajectory in the *break-even inflation rate*. This approximation of expected long-term inflation is calculated as the difference between the nominal yield on conventional bonds and the real yield on inflation-linked bonds within the five-to-eight-year maturity range. After decreasing sharply from above the 6-per-cent level early in May 2004 to a historical low of 3,66 per cent on 28 February 2005, expected long-term inflation derived in this way fluctuated

Break-even inflation rate



Difference between the nominal yield on conventional R153 (maturing in 2010) and real yield on inflation-linked R189 (maturing in 2013) bonds higher to 4,41 per cent at the end of May 2005. The rate came to 4,26 per cent on 10 June 2005. The upward movement in break-even inflation was magnified somewhat by declining market-determined real yields on inflation-linked bonds from mid-January 2005 to 10 June as demand for these bonds increased.

Tracking a widening of emerging-market bond spreads due to a reversal in global risk appetite, the *sovereign risk premium* on South Africa's foreign currency-denominated bonds trading in international markets started to increase from February 2005. After declining by 106 basis points from May 2004 to January 2005, the spread of the ten-year South African government US dollar-denominated bond over the yield on United States Federal Government securities of similar maturity, increased by 17 basis points to a spread of 105 basis points in May 2005. The yield spread of the JP Morgan Emerging Markets Bond Index (EMBI+), which traces total returns for external currency-denominated debt instruments of the emerging markets, declined by 165 basis points from May 2004 to February 2005 before widening by 29 basis points to May.

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 United States market) also increased from 205 basis points in February 2005 to 308 basis points in May. However, the widening occurred mostly as a result of an increase in bond yields in the domestic market while the equivalent yields on off-shore bonds moved mostly sideways over the same period.

Money market

During the first part of 2005 until late May, the Reserve Bank maintained the amount of liquidity it was ready to supply at the weekly main repurchase tender at a level of R13 billion.

The statistical counterparts of the money-market liquidity flows from January to May 2005 are shown in the accompanying table.

Money-market liquidity flows

R billions (easing +, tightening -)

	Jan-Mar 2005	Apr-May 2005
Notes and coin in circulation	-0,6	1,0
Required cash reserve deposits	0,3	-1,1
Money-market effect of Reserve Bank's foreign exchange transactions	6,1	10,7
Government deposits	6,4	-7,6
Use of liquidity management instruments*	-0,7	2,4
Government redemption and interest payments to Bank	-10,1	0,0
Other items net	-1,4	-5,4
Banks' liquidity requirement	0,0	0,0

* Reserve Bank debentures and reverse repurchase transactions

The Reserve Bank's *creaming-off* operations continued through measured buying of foreign exchange from the market, raising the Bank's foreign exchange reserves by US$2,5 billion and expanding money-market liquidity by R16,8 billion in the five months to the end of May 2005.

The amount of liquidity-draining instruments employed by the Reserve Bank was managed in such a way that factors impacting on money-market liquidity were broadly offset. Having declined by R4,9 billion during February 2005 to R19,5 billion over the month-end, the outstanding amount of interest-bearing liquidity-draining instruments decreased marginally to R17,8 billion at the end of May. Of note is that at the end of February 2005, the outstanding longer-term reverse repurchase transactions with private-sector banks reached a low of R7,0 billion – partly attributable to the reduction of bonds in the Bank's Monetary Policy Portfolio with the redemption of the R151 government bond. The use by type of money-market intervention instrument is reflected in the accompanying table, which also captures the lengthening of the maturity of Reserve Bank debentures which was brought about from March 2005.

Outstanding balances of selected money-market intervention instruments

R billions

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

During February 2005, the Bank received zero-coupon bonds to the value of R2,5 billion as part of the R7 billion directed to defray the losses on the Gold and Foreign Exchange Contingency Reserve Account. On 1 April 2005, National Treasury paid the remaining R4,5 billion in zero-coupon bonds to the Bank. The bonds received from the National Treasury were subsequently exchanged for marketable bonds which are used in the Bank's open-market operations.

Following a decline of R2,0 billion in notes and coin in circulation outside the Reserve Bank during January and February 2005, an increase of R2,7 billion was recorded in March, mainly on account of the higher demand for cash during the holiday period. Notes and coin, on balance, fell by an amount of R1,0 billion in April and May 2005.

Changes to refinancing operations

Subsequent to the release of a consultative paper titled "Modifications to the Money Market Operations of the South African Reserve Bank" on 10 December 2004, the South African Reserve Bank consulted extensively with market participants. The changes ultimately decided upon were implemented from 25 May 2005. The following changes were introduced:

- The Reserve Bank started announcing its estimate of the average daily market liquidity requirement and the expected range thereof for the coming week on the Wednesday morning prior to the main weekly repurchase auction. This would assist the banks in tendering. While normally the full amount tendered by each bank would be allotted, this would remain at the Bank's discretion.

- Whereas previously supplementary square-off tenders at the fixed repurchase rate were frequently conducted, they would henceforth be restricted to instances where unexpected developments occurred giving rise to significant liquidity imbalances. This facility could also be offered towards the end of the reserve maintenance period to assist banks in complying with the averaging of reserves against their liquidity requirements.

- The rule in terms of which a bank first had to withdraw funds from its cash reserve account before making a deposit was abolished since the supplementary clearing and reverse facilities were phased out as regular features. This was expected to promote more active use of banks' cash reserve balances.

- Standing facilities (previously referred to as final clearing or reverse repurchase tenders) to accommodate banks with short or long liquidity positions would henceforth be available at a spread of 50 basis points above or below the prevailing repurchase rate. The spread was also expected to act as a corridor within which interbank overnight rates would vary. These facilities would be available to all banks (both clearing and non-clearing), over and above the weekly main repurchase tenders and access to cash reserves.

- The South African Multiple Option Settlement (SAMOS) system penalty rate at a fixed 500 basis points above the prevailing repurchase rate would replace the marginal lending facility. This facility provides a final but expensive option to bridge banks' temporary liquidity needs, with its high cost encouraging banks to settle their overdrawn positions in the position window period.

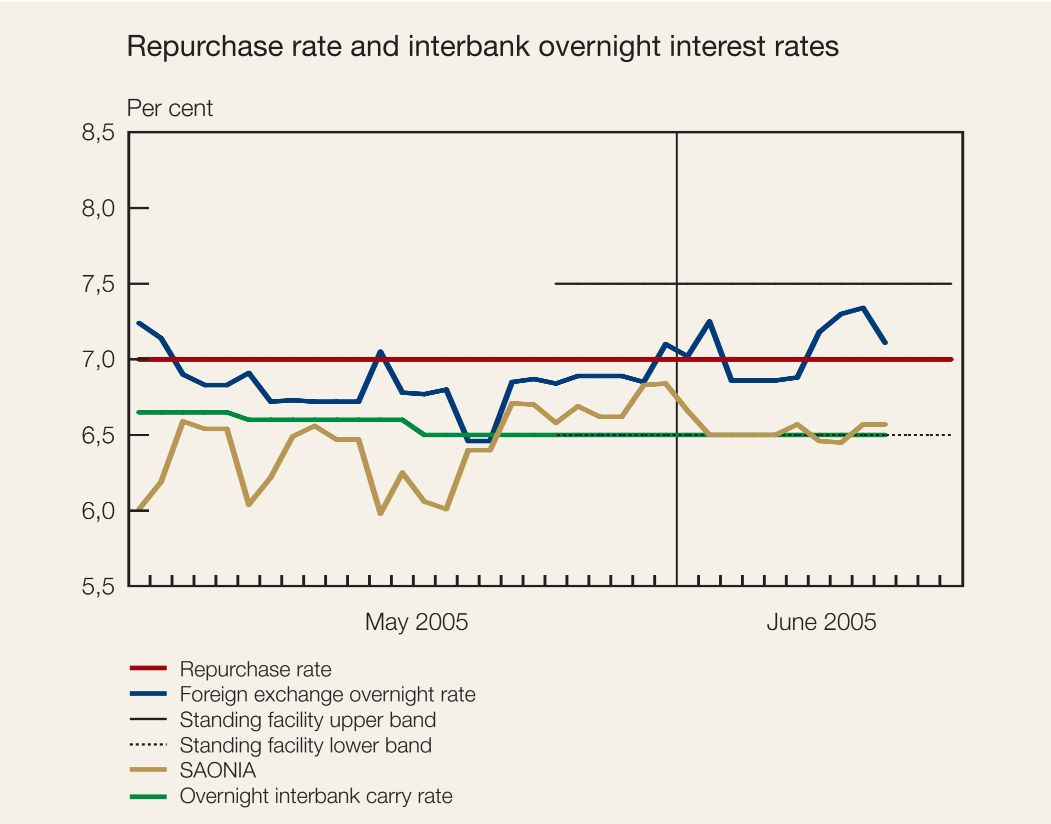
As could be expected, from 25 May the recently implemented changes resulted in variability in the repurchase agreement amounts allotted at the Wednesday auctions. This is illustrated in the accompanying table. As expected, banks also immediately started using the standing facilities alongside their cash reserve balances at the Bank to square-off their end-of-day positions. So far no supplementary repurchase auctions have needed to be conducted.

Amounts allotted at the main repurchase auctions on Wednesdays

R billions

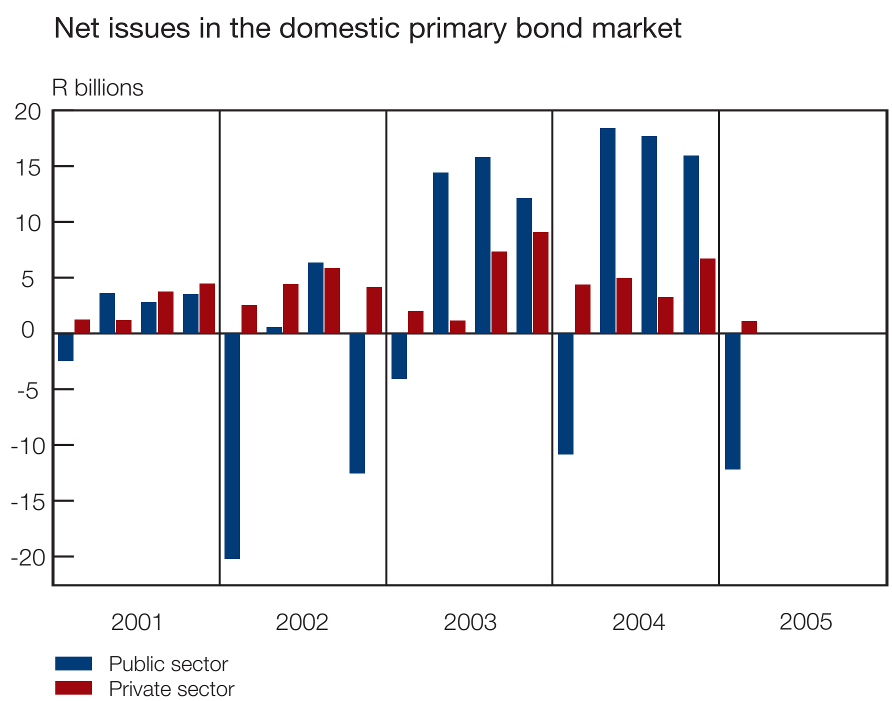
Date	Amount
4 May 2005	13,0
11 May 2005	13,0
18 May 2005	13,0
25 May 2005	13,2
1 June 2005	12,7
8 June 2005	11,3

Interbank overnight rates have varied within the interest rate range set by the standing facilities, as shown in the graph on the following page.



Bond market

Total net issues of fixed-interest securities by *public-sector borrowers* in the domestic primary bond market amounted to R39,8 billion in fiscal 2004/05 compared to net issues of R31,5 billion in fiscal 2003/04. Net redemptions of government bonds to the value of R19,6 billion occurred in February 2005, somewhat less than the R22,9 billion redeemed the previous February, and included the repayment of the R151 government bond, the



second of the three tranches of the R150 government bond. The remaining daughter tranche of the R150 government bond, namely the R152, matures on 28 February 2006.

On 20 April 2005 the National Treasury confirmed that the borrowing requirement to be financed in the domestic market, despite revenue overruns, would remain unchanged. In the 2005/06 Budget national government projected an amount of R25,8 billion to be raised through net domestic bond issuance in fiscal 2005/06. However, *foreign-currency denominated debt* would not be issued in the current fiscal year due to the strong revenue overruns. An amount of R12 billion was originally projected to be raised through foreign loans in the 2005/06 Budget. National government previously raised R6,4 billion through the issuance of a US$1 billion ten-year global bond in the international bond markets in June 2004, the only such issue by the South African Government in fiscal 2004/05.

Since its launch in May 2004 sales of the RSA Government Retail Bonds have reached R1,417 billion up to the end of May 2005. The 2-year bond proved to be the most popular investment, representing 56 per cent of total sales.

In April 2005 the City of Johannesburg launched an eight-year R700 million bond, bringing its total nominal value of bonds in issue to R2,7 billion since entering the capital market during 2004.

The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa increased from R58,4 billion in December 2003 to R77,7 billion in December 2004. Subsequently, the issuance of such instruments fell back from R6,7 billion in the fourth quarter of 2004 to R1,1 billion in the first quarter of 2005. Further listings of R5,3 billion occurred in April and May 2005, bringing the total outstanding nominal value to R84,2 billion.

Short-term funding maintained its momentum in 2005 and the value of *commercial paper* listed on the Bond Exchange of South Africa increased by R3,9 billion in the first five months to reach R19,6 billion. In line with the intention to centralise the clearing and settlement of the over-the-counter market the Bond Exchange announced that it facilitated the first electronic settlement of non-listed commercial paper in April 2005. Up to the end of May 73 trades in non-listed instruments were effected through the formal exchange, amounting to R1,5 billion.

Investors' interest in rand-denominated bonds in the *international bond markets* waned in the first four months of 2005 before rebounding in May. New issues of rand-denominated bonds by non-residents exceeded scheduled redemptions by R1,5 billion during the first five months of 2005. In 2004, when nominal yields on rand-denominated bonds were higher than in 2005, the net issuance of such instruments amounted to R3,1 billion.

Trading activity on the Bond Exchange of South Africa amounted to R4,1 trillion in the first five months of 2005, 8 per cent higher than the turnover of R3,8 trillion recorded in the corresponding period of 2004.

After recording net sales of R5,3 billion in January 2005, *non-residents* reverted to being net purchasers of South African debt securities from early in February 2005. Their interest continued to improve and net purchases of bonds were recorded in the subsequent months up to the end of May 2005. Notwithstanding the large net sales in January total cumulative net purchases of bonds amounted to R6,2 billion in the first five months of 2005. In 2004 non-resident net purchases of bonds amounted to only R0,4 billion.

Share market

After a sharp decline from R28,7 billion in the second quarter of 2004 to R4,7 billion in the fourth quarter, the total value of equity capital raised in the domestic and international *primary share markets* by companies listed on the JSE increased markedly to R8,3 billion in the first quarter of 2005. Equity financing amounted to a further R2,0 billion in April and May 2005. Of the total amount of R10,3 billion raised in the first five months of 2005, the industrial sector accounted for 72 per cent. In 2004 companies in the resources sector accounted for more than 60 per cent of the total capital raising activity while the industrial sector accounted for only 11 per cent.

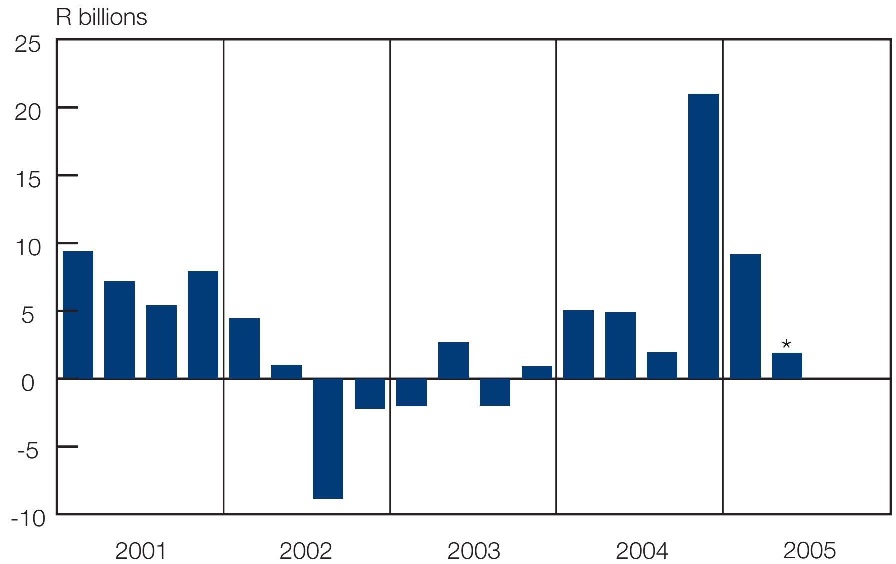
Along with the upward trajectory in share prices, turnover in the *secondary share market* continued at a brisk pace in the first five months of 2005. From a record high of R298 billion in the fourth quarter of 2004 turnover amounted to a still high R277 billion in the first quarter of 2005. Trading activity on the JSE remained lively in the ensuing months when share prices reached new record high levels in May. Turnover in the five months to May 2005 amounted to R456 billion, representing an increase of 12 per cent over the R407 billion traded in the corresponding period of 2004.

The number of companies listed on *Alt^x*, the alternative exchange of the JSE for small to medium-sized companies, stood at 11 at the end of May 2005. After becoming active from the end of January 2004 turnover on Alt^x gradually improved and amounted to R44 million for the year 2004 as a whole. In the first five months of 2005 the value of shares traded on Alt^x amounted to R46 million.

Subsequent to commencing trade on 28 February 2005 *Yield-X*, the new interest rate platform of the JSE, recorded 45 deals which represented 5 799 contracts to the value of R3,6 billion up to the end of May. The focus of the exchange is on interest rate derivatives, and trade in futures on FRAs dominated turnover on Yield-X in the initial months of its existence.

Non-residents' net purchases of shares amounted to R9,2 billion in the first quarter of 2005, down from the record-high net purchases of R21,0 billion recorded in the fourth

Net purchases by non-residents in the secondary share market



* April and May

quarter of 2004. Subsequently, non-residents maintained their interest in the South African share market with further net purchases in April 2005 before they became net sellers of shares in May. From the beginning of 2005 to the end of May, non-residents' net purchases of shares amounted to R11,2 billion. In the corresponding period of 2004 non-residents' net purchases of shares amounted to R8,9 billion while net purchases of R32,9 billion were recorded in the year as a whole.

After reaching new record highs in March 2005, partly on account of general optimism regarding domestic economic growth, benign inflation data, higher commodity prices and support from world equity markets, share prices fell back in April alongside weaker global equity markets. The *monthly average price level of all classes of shares* listed on the JSE increased by 33 per cent from July 2004 to March 2005, before declining by 3 per cent to April 2005. Share prices then increased by 1 per cent to May alongside a weaker exchange value of the rand and a mild improvement in global equity markets. The domestic share market outperformed most major international markets in the course of 2004 and the first months of 2005. In rand terms the monthly average price level of all classes of shares increased by 23 per cent, and in dollar terms by 42 per cent from January 2004 to March 2005. In comparison the S&P 500 composite price index of the United States stock market declined by 5 per cent from February 2004 to August before increasing by 10 per cent to March 2005. However, the domestic all-share price index subsequent to March 2005 declined by 2 per cent in rand terms and by 7 per cent in dollar terms to May 2005, with the latter decline surpassing the decline of 1 per cent recorded in the S&P 500 index over the same period. This partly may explain the net selling of shares by non-residents in May after vigorous net purchases were recorded during 2004 and the first months of 2005.

Share prices

All the major sectors benefited from the strong performance of the share market during 2004 and the early months of 2005. The monthly average price level of the *resources sector* increased by 25 per cent from July 2004 to March 2005 as the upward momentum in the share market was supported by strong demand for resources shares. *Financial shares* already picked up from June 2004 and increased by 45 per cent to March 2005, benefiting from the lower interest rate environment and news of Barclays Bank plc's interest in acquiring a controlling interest in Absa Bank. Over the same period *industrial shares* increased by 37 per cent, reflecting the general optimism concerning South Africa's domestic growth prospects. From these high levels domestic share prices initially fell back in April alongside lower commodity prices and weaker global equity markets before recovering to new record highs towards the end of May and early June.

From a then all-time high on 17 March 2005 the *daily closing level of the all-share price index* declined by 9 per cent to 28 April following some profit-taking, lower commodity prices and weaker international equity markets due to concerns that the rising price of oil may dampen global economic growth. The daily all-share index then rebounded by 14 per cent to a new all-time high on 13 June alongside a weaker exchange value of the rand and support from world markets. The rebound was led by an increase of 23 per cent in resources shares while the industrial index increased by 11 per cent and the financial index by 8 per cent over the same period. On balance, the record high of the all-share index on 13 June 2005 represented an increase of 46 per cent from a recent low on 18 May 2004.

The strong rise in share prices from the second half of 2004 took the *price-earnings ratio* of all classes of shares from 13,2 in July 2004 to 15,2 in January 2005. The upward movement halted in January and the price-earnings ratio declined to 13,7 in May. The *dividend yield* on all classes of shares also changed course over the same period and decreased from a high of 3,2 per cent in July 2004 to 2,7 per cent in February 2005, before increasing to 2,8 per cent in May.

Market for derivatives

Trading activity on the Financial Derivatives Division of the JSE waxed and waned somewhat during the course of 2004 but showed a marked improvement towards the end of 2004 and the first months of 2005. Alongside the strengthening in the underlying share market, the total number of *futures and options on futures contracts* traded increased from 7,9 million contracts in the second quarter of 2004 to trades in excess of 10 million contracts in both the last quarter of 2004 and the first quarter of 2005. Although trade fell back to a quarterly rate of less than 10 million contracts in April and May 2005, the cumulative number of trades in the first five months of 2005 at 16,3 million contracts still exceeded the total number of contracts traded in the corresponding period of 2004 by 13 per cent.

The number of *warrants* traded on the JSE also rose from 1,3 billion contracts in the third quarter of 2004 to 1,7 billion contracts in the first quarter of 2005. Despite the fluctuations in share prices, trade in warrants increased to a quarterly rate of 2,3 billion contracts in April and May 2005. Cumulative trade in the first five months of 2005 was 30 per cent higher than in the corresponding period of 2004. The high trade volumes probably encouraged new listings and the number of warrants listed on the JSE continued to increase steadily from 297 in January 2004 to 374 in May 2005.

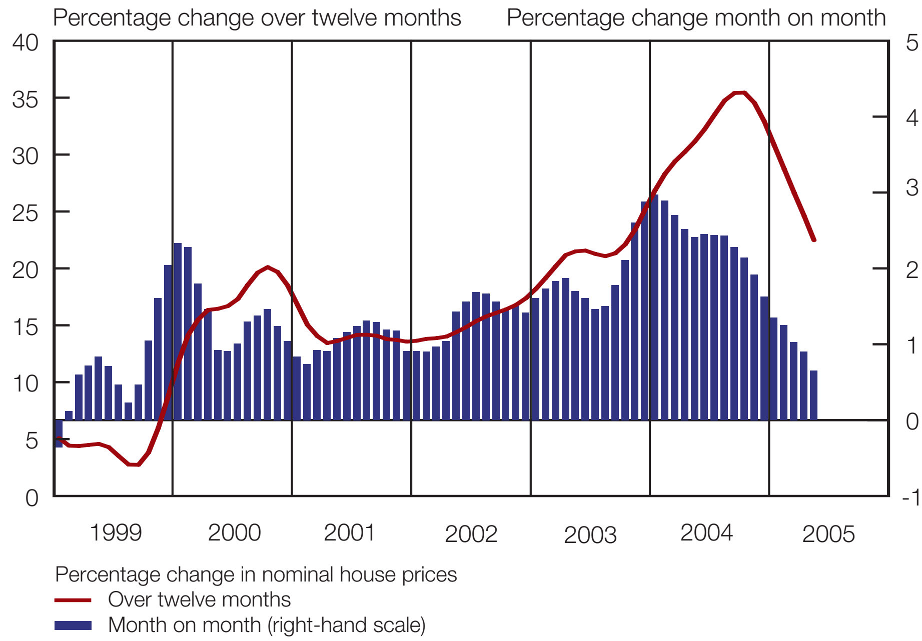
The number of *commodity futures contracts and options* on such contracts traded on the Agricultural Products Division of the JSE increased from 379 000 contracts in the second quarter of 2004 to 488 000 contracts in the fourth quarter, before falling back to 483 000 contracts in the first quarter of 2005. Trade decreased to a quarterly rate of only 279 000 contracts in April and May 2005, influenced by, among other things, large carry-over maize stocks and expectations of a record supply of maize in the current season. The spot price of white maize as quoted by the JSE Agricultural Products Division more than halved as it fell back from R1 025 on 1 November 2004 to as low as R471 per ton on 25 February 2005. Maize prices subsequently edged higher to an average of R562 per ton in May 2005. Prices this low were previously experienced in September 2000.

Real-estate market

The *real-estate market* continued to remain buoyant in the first four months of 2005. The overall seasonally adjusted value of turnover, measured by *transfer duty paid,* increased sharply from an average monthly level of R504 million in the first half of 2004 to R599 million in the second half before accelerating even further to an average of R638 million in the first quarter of 2005. In 2005 the first four months' average level of transfer duty paid represented an increase of 37 per cent when compared with the same period of 2004.

An indication of a slowdown in the growth of real-estate prices is, however, evident from the deceleration in the year-on-year rate of increase in house prices, as measured by Absa, from a most recent high of 35,4 per cent in October 2004 to 22,5 per cent in May 2005. The decelerating momentum was also evident from the progressive slowing in the month-on-month rate of increase from 3,0 per cent in January 2004 to 0,7 per cent in May 2005.

House prices



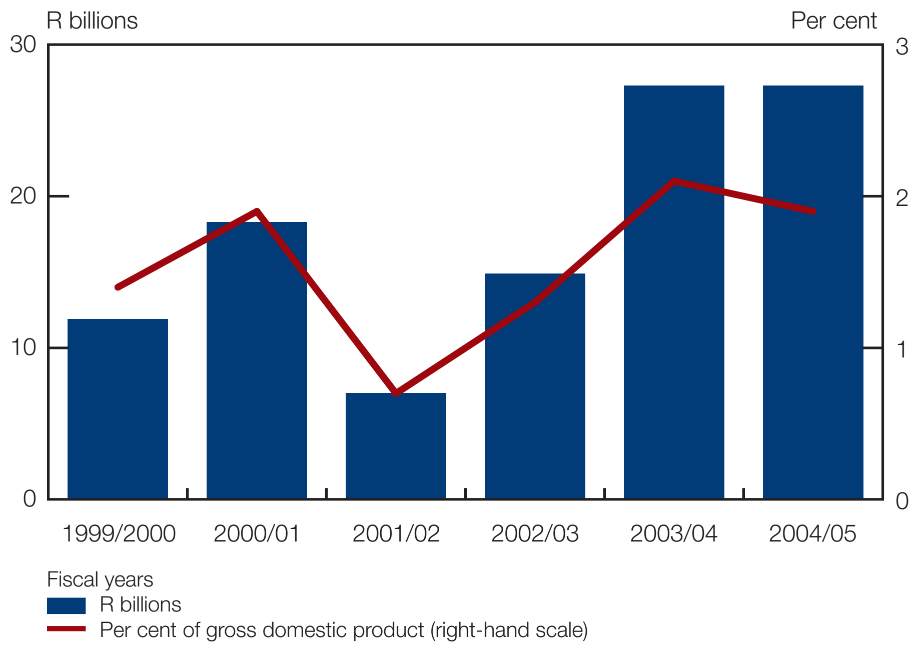
Source: Absa

Public finance

Non-financial public-sector borrowing requirement

The activities of the *non-financial public sector* (i.e. the consolidated central government, provincial and local governments and non-financial public-sector business enterprises) resulted in a cash *deficit* of R27,3 billion in fiscal 2004/05, virtually the same amount as in the previous fiscal year. As a ratio of gross domestic product, the non-financial public-sector cash deficit amounted to 1,9 per cent in fiscal 2004/05 compared with 2,1 per cent in fiscal 2003/04.

Non-financial public-sector borrowing requirement



The activities at the various levels of government influencing the non-financial public-sector borrowing requirement are summarised in the accompany table. Notably, at the level of national government, a revenue overrun led to a decrease in the cash deficit from R34,2 billion in fiscal 2003/04 to R32,0 billion in fiscal 2004/05.

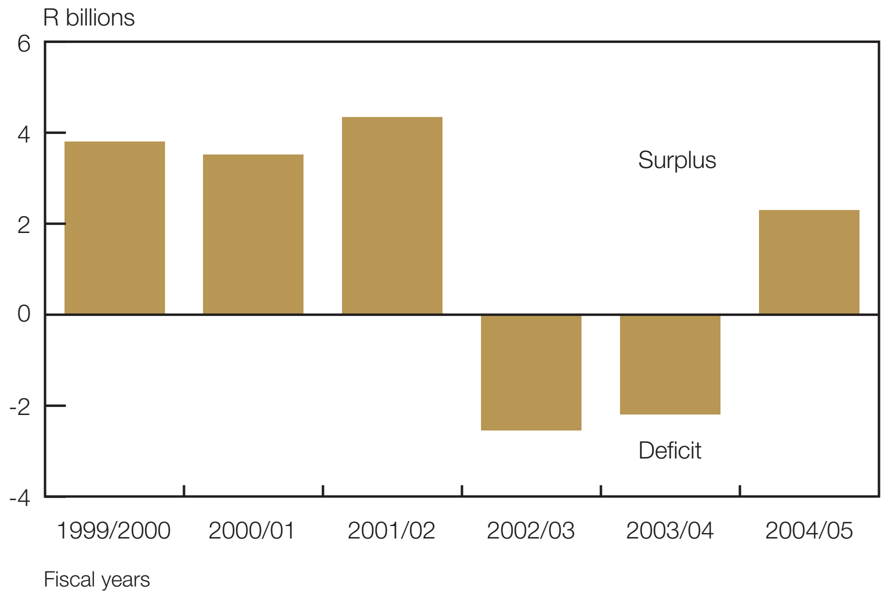
Non-financial public-sector borrowing requirement
R billions

Level of government	2003/04*	2004/05*
National government	34,2	32,0
Extra-budgetary institutions	-1,2	-1,1
Social security funds	-4,4	-4,1
Provincial governments	2,2	-2,3
Local governments	5,1	8,6
Non-financial public enterprises	-8,6	-5,8
Total	**27,3**	**27,3**

* Deficit +, surplus –

An analysis of the *Provincial Revenue Fund Statements* indicates that provincial governments recorded a cash deficit of R4,2 billion in the January-March quarter of 2005, bringing the cash surplus to R2,3 billion in fiscal 2004/05. A cash deficit of R2,2 billion was recorded in the previous fiscal year. The main source of provincial governments' cash receipts – grants from national government – amounted to R185,1 billion in fiscal 2004/05 or 14,6 per cent more than in fiscal 2003/04. Grants include the equitable share of revenue allocated to provinces and conditional grants, which are earmarked for specific purposes. The provincial governments' bank deposits increased from R8,4 billion at the end of March 2004 to R12,7 billion at the end of March 2005, while their overall indebtedness to banks increased from R3,2 billion to R3,9 billion over the same period.

Cash surplus/deficit of provincial governments



National government finance

Unaudited data indicate that national government expenditure in fiscal 2004/05 amounted to R368,1 billion – R0,8 billion less than the original budgetary provision and R2,0 billion less than the revised estimate presented to Parliament by the Minister of Finance in February 2005. This resulted in a year-on-year rate of increase in national government expenditure of 12,0 per cent in fiscal 2004/05, which was less than the original budget target of 12,2 per cent. The year-on-year rate of increase in national government expenditure in fiscal 2004/05 was lower than the increase of 12,8 per cent recorded in the previous fiscal year and exceeded the average year-on-year rate of increase of 9,0 per cent in the five fiscal years prior to 2003/04. In real terms national government expenditure increased at a year-on-year rate of 7,9 per cent in fiscal 2004/05 compared with a rate of increase of 7,2 per cent recorded a year earlier.

Payments for capital assets amounted to R5,7 billion in fiscal 2004/05, or 18,6 per cent more than in the same period of the previous fiscal year when capital asset acquisition was at a low ebb. This rate of increase is significantly higher than the originally budgeted increase of 6,8 per cent provided for the full fiscal year. The *Budget Review 2004* projected that payments for capital assets would amount to R5,2 billion for fiscal 2004/05 as a whole.

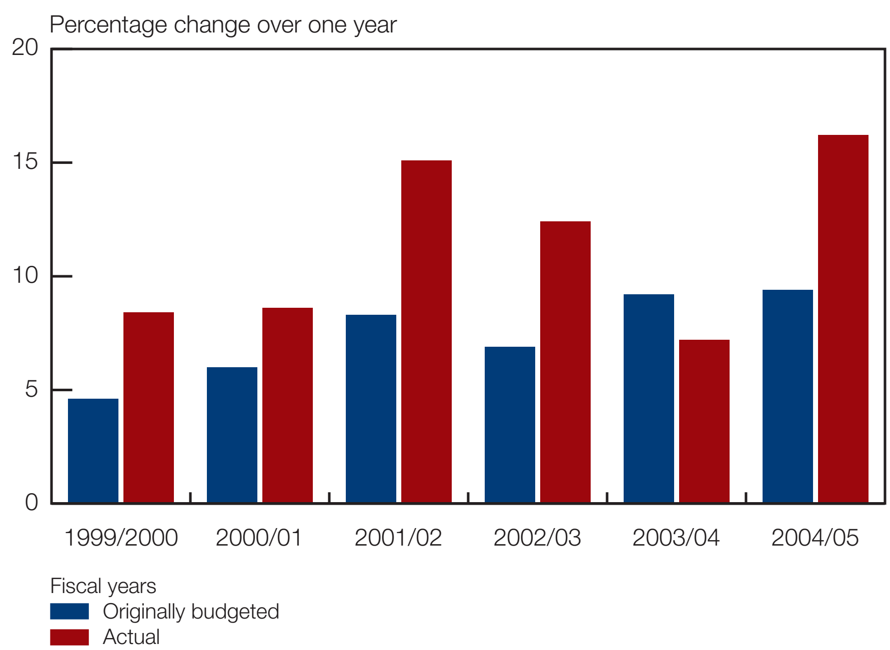
Interest paid on national government debt was well contained, increasing by 5,6 per cent to amount to R48,7 billion in fiscal 2004/05. Interest payments were originally budgeted to increase at a rate of 8,9 per cent in fiscal 2004/05. This saving was the result of, among other things, the lower domestic interest rates and the lower interest payments to non-residents due to the stronger exchange rate of the rand. Domestic interest payments amounted to R44,6 billion compared with an original budget provision of R44,2 billion, whereas interest paid on foreign debt amounted to R4,1 billion compared with R6,0 billion originally budgeted for 2004/05. In fiscal 2004/05 interest payments as a ratio of gross domestic product amounted to 3,5 per cent, compared with 3,6 per cent in fiscal 2003/04.

National government transferred R164,1 billion, equivalent to 44,6 per cent of its total expenditure, to provincial governments as their equitable share of nationally raised revenue. In fiscal 2004/05 these transfers increased by 13,4 per cent which was also higher than the originally budgeted increase of 10,5 per cent.

National government expenditure as a ratio of gross domestic product amounted to 26,2 per cent in fiscal 2004/05, higher than the 25,7 per cent recorded in the preceding fiscal year. This ratio was slightly lower than the originally budgeted ratio of 27,7 per cent and almost the same as the revised ratio indicated in the *Budget Review 2005*. After allowing for 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 R363,7 billion in fiscal 2004/05, which was 11,0 per cent higher than in the previous fiscal year.

The *Statement of national government revenue, expenditure and borrowing* indicates that unaudited national government revenue increased by 16,2 per cent to amount to R347,3 billion in fiscal 2004/05, R20,3 billion more than the original budget estimate and R9,3 billion more than the revised estimate of R338,0 billion presented to Parliament in

Revenue of national government



February 2005. This rate of increase was much higher than the rate of increase of 9,4 per cent originally envisaged in the Budget for fiscal 2004/05 and also higher than the revised increase of 13,1 per cent stated in the *Budget Review 2005*. It was also substantially higher than the rate of increase of 7,2 per cent recorded in the previous fiscal year, and higher than the average year-on-year rate of increase of 11,2 per cent in the five fiscal years preceding 2003/04.

Almost all the components of revenue outperformed originally budgeted revenues. Taxes on property continued to reflect the robust trading activity in the real-estate market. Domestic taxes on goods and services also grew strongly, indicating the continued buoyancy in consumer spending. The strong growth in taxes on international trade and transactions reflects the rising import volumes related to buoyant domestic expenditure and the relative strength of the exchange value of the rand.

National government revenue in fiscal 2004/05

Revenue source	R billions: Originally budgeted	R billions: Actual	Percentage change*
Taxes on income, profits and capital gains	189,2	195,6	13,7
Payroll taxes	4,3	4,4	14,0
Taxes on property	6,9	9,0	34,4
Domestic taxes on goods and services	121,5	131,3	19,2
Taxes on international trade and transactions	10,5	13,3	58,5
Other revenue	7,9	7,0	-6,7
Less: SACU** payments	13,3	13,3	37,1
Total revenue	**327,0**	**347,3**	**16,2**

* Fiscal 2003/04 to fiscal 2004/05
** Southern African Customs Union

National government revenue as a ratio of gross domestic product amounted to 24,7 per cent in fiscal 2004/05, moderately up from the ratio of 23,4 per cent recorded in the previous fiscal year. National government revenue was originally budgeted to amount to 24,6 per cent of gross domestic product in the February 2004 budget estimates, but was revised to 24,1 per cent in the *Budget Review 2005*. National government's cash revenue (adjusted for timing differences between the recording of transactions and bank clearances) in fiscal 2004/05 virtually equalled the cash book revenue.

The net result of the higher-than-budgeted revenue and lower-than-budgeted expenditure according to the *Statement of national government revenue, expenditure and borrowing* was a cash book *deficit* of R20,8 billion in fiscal 2004/05 compared with a deficit of R29,9 billion a year earlier. This deficit was much lower than the originally budgeted deficit of R41,9 billion, and also lower than the revised estimate of R32,2 billion presented to Parliament in February 2005. The national government deficit before borrowing and debt repayment as a ratio of gross domestic product amounted to 1,5 per cent in fiscal 2004/05 compared with a ratio of 2,3 per cent recorded in the previous fiscal year. The originally budgeted deficit relative to gross domestic product was estimated at 3,1 per cent.

The *primary balance* (i.e. the deficit recalculated by excluding interest payments from total expenditure) reached a surplus of 2,0 per cent of gross domestic product in fiscal 2004/05, higher than the 1,3 per cent recorded in the previous fiscal year.

The *cash-flow deficit* in fiscal 2004/05 amounted to R15,9 billion compared with a cash-flow deficit of R28,4 billion in the previous fiscal year. National government's net borrowing requirement in fiscal 2004/05 was affected by extraordinary payments and receipts. Included among extraordinary payments were the payments made by the National Treasury to the South African Reserve Bank in April 2004 and February 2005 of R7,0 billion and R2,5 billion, respectively. This was in partial payment of the liability resulting from losses incurred on the Gold and Foreign Exchange Contingency Reserve Account, which is managed by the Bank on behalf of the National Treasury. Government also incurred a cost of R1,3 billion on the revaluation of foreign loans at redemption in fiscal 2004/05. Although the extraordinary receipts were originally budgeted to amount to R2,7 billion in fiscal 2004/05 – mainly proceeds expected to derive from the restructuring of state assets – only R28,5 *million* was collected from this source. These extraordinary transactions increased the net borrowing requirement of national government to R27,0 billion in fiscal 2004/05 compared with a net borrowing requirement of R32,4 billion recorded a year earlier.

National government financing in fiscal 2004/05

R billions

Item or instrument	Originally budgeted	Revised estimates	Actual
Deficit	**41,9**	**32,2**	**15,9**[1]
Plus: Extraordinary payments	7,0	7,1	9,8
Cost/profit on revaluation of foreign loans at redemption[2]	2,2	1,3	1,3
Less: Extraordinary receipts	2,7	1,7	0,0
Net borrowing requirement	**48,4**	**38,9**	**27,0**
Treasury bills	6,0	6,0	6,2
Domestic government bonds	34,3	31,1	33,2
Foreign bonds and loans	8,1	6,1	5,8
Changes in available cash balances[3]	0,0	-4,3	-18,2
Total net financing	**48,4**	**38,9**	**27,0**

1 Cash-flow deficit
2 Cost +, profit -
3 Increase -, decrease +

The greater part of the net borrowing requirement of national government in fiscal 2004/05 was financed through the issuance of bonds in the domestic capital market, as indicated in the accompanying table. Domestic long-term funding in fiscal 2004/05 was obtained at an average rate of 9,2 per cent per annum. Domestic short-term instruments were sold at an average rate of 7,5 per cent per annum. These yields can be compared with the budget assumptions of 9,0 per cent and 9,9 per cent, respectively.

The National Treasury launched new fixed-income bonds in May and August 2004, coded R203 and R204, respectively. From May 2004 to March 2005 these bonds yielded R19,6 billion to the National Revenue Fund. In May 2004, the National Treasury launched RSA Government Retail Bonds, which yielded a total of R1,3 billion from May 2004 to March 2005.

The average maturity of national government's domestic marketable bonds increased slightly from 98 months at the end of March 2004 to 99 months at the end of March 2005.

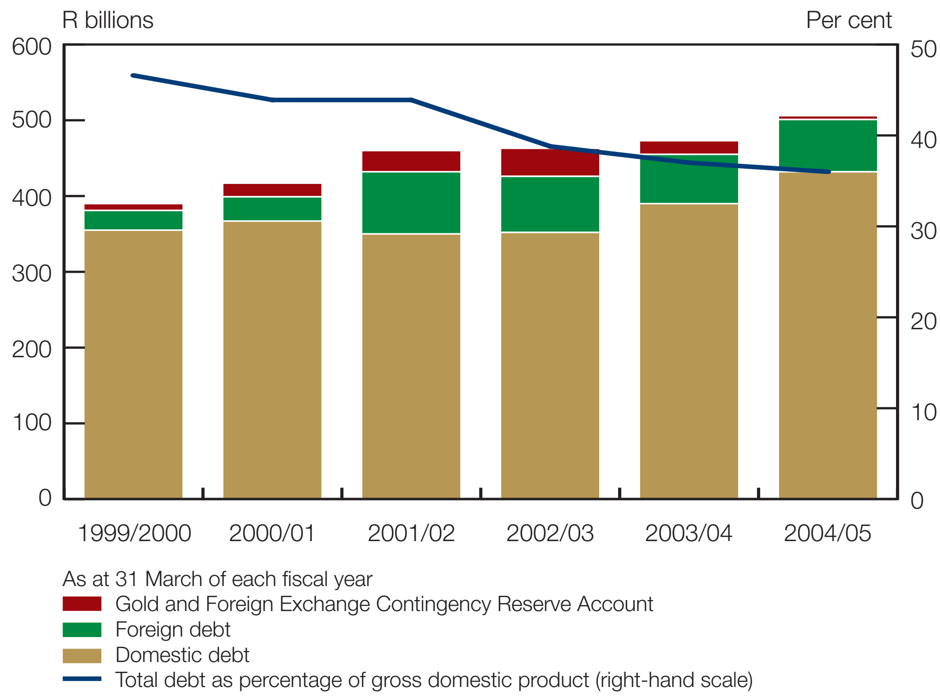
Net issues of foreign bonds and use of foreign loans amounted to R5,8 billion during fiscal 2004/05. Net foreign funding included amounts drawn on the export credit facility which had been arranged for the financing of the Strategic Defence Procurement Programme to the amount of R3,4 billion. In June 2004, the National Treasury issued a 10-year global bond yielding R6,4 billion.

The average maturity of the foreign marketable bonds of national government decreased slightly from 79 months at the end of March 2004 to 78 months at the end of March 2005.

The financial activities of national government resulted in an increase in government's bank balances from R12,7 billion at the end of March 2004 to R30,9 billion at the end of March 2005.

The net borrowing requirement of the national government, together with the discount on new government bonds issued, led to an increase in the total loan debt of national government from R455,1 billion at the end of March 2004 to R501,7 billion at the end of March 2005. The share of foreign loans in the total loan debt decreased slightly from 14,2 per cent at the end of March 2004 to 13,8 per cent at the end of March 2005. Since fiscal 2003/04 foreign debt revalued at prevailing exchange rates has been lower than the rand value of foreign debt as at the time of issue. This stood in contrast to the four fiscal years preceding 2003/04, and reflected the effect of the strengthening exchange rate of the rand on the outstanding value of foreign bonds and loans in rand terms. Total loan debt as a ratio of gross domestic product remained broadly unchanged at 35,7 per cent at the end of March 2005 when compared with the ratio at the end of March 2004.

Total national government debt



It was also announced that the unaudited balance on the Gold and Foreign Exchange Contingency Reserve Account amounted to R5,3 billion on 31 March 2005, compared with R18,0 billion a year earlier. These transactions brought the total debt of national government to R507,0 billion at the end of March 2005 compared with R473,1 billion at the end of March 2004. As a ratio of gross domestic product, total national government debt decreased from 37,0 per cent at the end of March 2004 to 36,1 per cent at the end of March 2005. Government-guaranteed debt also declined from R79,6 billion at the end of March 2004 to R75,9 billion at the end of December 2004.

Gold and Foreign Exchange Contingency Reserve Account
R billions

Date	
Balance as at 31 March 2004	18,0
Minus payment by Treasury, 1 April 2004	-7,0
Minus payment by Treasury, 25 February 2005	-2,5
Minus forward cover and revaluation profits, 2004/05	-3,2
Balance as at 31 March 2005	5,3

Statement of the Monetary Policy Committee

14 April 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

Over the past two months, the global environment has continued to be characterised by uncertainty. International oil prices have reached record highs despite increases in output quotas by the Organization of the Petroleum Exporting Countries (OPEC) and have confounded expectations of a short-lived spike. Higher oil prices have resulted in a downward revision of global growth estimates. The imbalances in the US remain, and the outlook for the dollar remains uncertain. Against the dollar, the rand has generally traded in a range higher than that in 2004.

Domestically, expenditure remains strong and the robust economic growth has been accompanied by six consecutive quarters of employment growth in the formal non-agricultural sectors of the economy. However, there has recently emerged evidence of some slackening of activity in the manufacturing sector. Despite the uncertain global environment, the inflation outlook remains favourable.

Recent developments in inflation

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 18 months. After declining to 3,6 per cent in January of this year, it declined further to 3,1 per cent in February. This is the lowest rate of increase of CPIX since the inception of this measure of inflation. The recent downward movement was due, in part, to consecutive decreases in the petrol price totaling 65 cents per litre between December 2004 and February 2005.

Increases in most of the other components of the CPIX were also well contained, while footwear and clothing prices continued to decline. Food prices also continued to increase at a subdued year-on-year rate of 1,6 per cent in February while total goods price inflation measured 1,8 per cent. Of particular significance is the fact that services inflation has continued its gradual downward trend. In January year-on-year services inflation declined below the upper end of the inflation target range to 5,9 per cent, and declined further to 5,6 per cent in February. This was the first time since the introduction of inflation targeting that services inflation had been at these levels. This partly reflects progress made by the public authorities in curbing administered price increases. The overall administered price index however remains above the target range because of the impact of the petrol price, which has a significant weighting in this index.

Production price inflation has also remained low, to an important degree due to the impact of the exchange rate of the rand. In January and February, the respective year-on-year inflation rates for the overall production price index (PPI) were 1,4 per cent and 1,2 per cent. Prices of imported goods increased year on year by 0,3 per cent in January, and declined by 0,7 per cent in February. However, the prices of domestically produced goods also remained well contained. In the first two months of this year, the year-on-year inflation in these prices declined to 1,9 per cent and 1,8 per cent, respectively, as the prices of agricultural products, manufactured foodstuff and textiles declined.

The outlook for inflation

Despite the uncertainties created by the oil market developments, the outlook for inflation remains favourable. The continued low level of production price inflation indicates that significant generalised upward pressure on consumer prices is not expected in the short term. However, the recent increases in the petrol price of 42 cents per litre in March and 40 cents per litre in April and possible further increases expected next month suggest that CPIX inflation may have reached its low turning point in February. According to our central forecast, CPIX inflation will begin to rise moderately over the coming months to peak at a level of around 5,25 per cent early next year before resuming a downward trajectory towards the mid-point of the inflation target range.

This favourable forecast is underpinned by a number of factors. The latest inflation expectations survey conducted on behalf of the Bank by the Bureau for Economic Research (BER) at the University of Stellenbosch shows a significant decline in inflation expectations. According to the survey, CPIX inflation expectations have reached their lowest level since the BER started the survey in 2000. For the first time, all groups of respondents expect inflation to be below the upper end of the inflation target band. On average CPIX inflation is expected to be at 4,5 per cent, the mid-point of the band for 2005, down from 5,5 per cent in the previous survey. CPIX inflation is also expected to remain within the target range for the next 3 years. This outcome indicates that there is an increasing acceptance by the South African population that the low levels of inflation achieved over the past 18 months can be sustained. These improved expectations are corroborated by the gap between the nominal yield on conventional bonds and the real yield on inflation-linked bonds. Although the expected long-term inflation implied by these yields has risen since the February lows, it nevertheless indicates longer-term expectations comfortably within the target range.

Government's fiscal policies also remain supportive of monetary policy. Higher than expected tax revenues have resulted in a deficit before borrowing significantly lower than the original estimate of 3,1 per cent and the revised estimate of 2,3 per cent of gross domestic product (GDP) announced in the Budget. Other positive factors include continued low world inflation, progress being made with respect to administered prices and low levels of food price increases in part as a result of the bumper maize crop.

Not all the positive factors identified in the previous statement of the Monetary Policy Committee (MPC) have improved, however. Unit labour cost developments present a mixed picture. The previous MPC statement commented on the marked moderation in salary and wage increases. Revisions to the *Survey of Employment and Earnings* undertaken by Statistics South Africa now indicate that average earnings rose by 7,2 per cent and 10,5 per cent in the third and fourth quarters, respectively. With labour productivity growth declining to 0,6 per cent and 0,4 per cent in those quarters, it implies an increase in unit labour cost in the formal non-agricultural sectors of the economy of 6,6 per cent in the third quarter compared to the original estimate of 4,9 per cent, and 10,1 per cent in the fourth quarter. The average unit labour cost increase for 2004 was 7,3 per cent compared to 4,0 per cent in the previous year. While these figures taken at face value should be a cause for concern, they do not necessarily reflect a reversal of the downward trend in reported nominal wage settlements which, according to recent surveys, averaged below 7 per cent in 2004 and around 6 per cent in the first quarter of 2005. These figures appear to confirm the lagged nature of wage settlements and the continuing adjustment to lower inflation rates. Because of their importance to the inflation process, these developments will be closely monitored by the MPC.

There are a number of upside risks to the inflation outlook which the MPC has taken cognisance of. The most important risk factor remains the uncertainty relating to international oil prices. The price of Brent crude has averaged around US$54 per barrel since the beginning of April compared to US$45 per barrel in February, and the outlook for oil prices has become increasingly uncertain.

Domestic expenditure continues to be robust. Growth in real gross domestic expenditure averaged 6,5 per cent in 2004 and real final demand averaged 6,8 per cent. This was a result of acceleration in real household and government consumption expenditure and real gross fixed capital formation. The strong growth in private-sector consumption continues to be sustained by relatively low nominal interest rates, higher asset prices, higher levels of consumer confidence and increased real disposable incomes.

The higher levels of expenditure continue to be reflected in the money supply aggregates and credit extension by the banking sector. Although the year-on-year monthly rates of increase in M3 have remained fairly stable at around the 12 per cent level, the quarter-to-quarter annualised rate of increase in the fourth quarter of 2004 amounted to 17,6 per cent. In January and February of 2005 the month-on-month annualised growth rate of loans and advances of banks to the private sector was 22,5 per cent and 20,6 per cent, respectively. This was mainly the result of asset-backed credit growth which recorded similar rates of increase. However, the rate of increase in house prices has been moderating for the past year.

Real gross domestic product growth averaged 3,7 per cent in 2004 compared to 2,8 per cent in 2003. As expected, the quarter-on-quarter annualised growth rate of 4,0 per cent in the fourth quarter of 2004 was slower than the previous quarter rate of 5,7 per cent. Moreover, there is evidence of a slackening of activity in the manufacturing sector. The outlook for growth, and for exports in particular, will depend to a significant degree on growth developments internationally.

Although output growth has been robust, the higher expenditure growth has continued to put pressure on the current account of the balance of payments. The current account deficit widened in the fourth quarter of 2004 to 4,0 per cent of GDP, up from 3,1 per cent in the third quarter. It measured 3,2 per cent of GDP for the year as a whole. However as has been the case for the past three years, these deficits continue to be comfortably financed by inflows on the financial account of the balance of payments. This enabled the Bank to continue building up the levels of foreign exchange reserves at a moderate pace – gross foreign exchange reserves rose to US$15,9 billion and the international liquidity position to US$12,4 billion at the end of March.

The prospects for the international economy have become more uncertain and the International Monetary Fund (IMF) and the World Bank have both revised down their forecast for growth in 2005, particularly in the euro area and Japan. The IMF has also warned of an increasingly unbalanced global expansion and the risks posed by higher oil prices, rising inflationary pressures, and the large and growing indebtedness of the United States to the rest of the world. Given the continued imbalances in the US economy, the outlook for the US dollar remains uncertain.

The rand exchange rate will continue to be affected by these developments. The rand strengthened after the previous MPC meeting, but has weakened more recently as a result of the stronger dollar and the generalised weakness in emerging-market assets. It is nevertheless slightly stronger than it was at the time of the previous meeting and has traded over the past six months at a range higher than for the main part of 2004.

Monetary policy stance

The MPC has carefully reviewed the above-mentioned developments and future prospects for inflation of the economy, taking particular account of the areas of uncertainty identified and the associated risks.

The MPC welcomed the evidence of a further material decline in inflation expectations and noted that, on balance, the outlook for inflation on the basis of the central forecast was that CPIX inflation would remain comfortably within the target range of 3 – 6 per cent over the next two years, even taking account of the impact of the recent rise in oil prices. Although the overall performance of the South African economy seems to be reasonably well sustained, the MPC noted with concern evidence of some slackening in activity in some sectors of the economy as a result of the move by the rand to a higher trading range over the past six months. It remains the view of the MPC that a competitive and stable exchange rate would contribute to continuing sustainable growth in output and employment. Taking all of the above-mentioned developments into consideration, the MPC has decided to reduce the repo rate by 50 basis points to 7,0 per cent per annum with immediate effect. The MPC is convinced that this is appropriate in the circumstances, and consistent with maintaining inflation within the target range.

The MPC will continue to monitor domestic and international developments closely, and will not hesitate to adjust rates as and when necessary to ensure that inflation remains within the target range mandated by the government of 3 – 6 per cent.

Statement of the Monetary Policy Committee

9 June 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

Since the previous meeting of the Monetary Policy Committee (MPC) there have been a number of developments significant for monetary policy. Although still at relatively high levels, the international oil price appears to have stabilised somewhat at more moderate levels than in March and April. At the same time there has been a significant strengthening of the US dollar against the euro, which contributed to the recent depreciation of the rand. Domestically, expenditure and credit extension remain robust, while a contraction in the manufacturing sector has resulted in a moderation of overall output growth. Although the inflation outlook has changed somewhat, CPIX inflation is still expected to remain well within the target range during the forecast period.

Recent developments in inflation

The rate of increase in the consumer price index for metropolitan and other urban areas less mortgage interest cost (CPIX) has remained within the mandated target range of 3 – 6 per cent since September 2003. Year-on-year CPIX inflation rose from the February low of 3,1 per cent to 3,6 per cent and 3,8 per cent in March and April, respectively. This recent upward trend has been due almost entirely to consecutive increases in the petrol price totalling 82 cents per litre in March and April. Most of the short-term volatility in the inflation rate over the past few months can be attributed to petrol price developments. If petrol and diesel prices are excluded, annual CPIX inflation increased marginally from 3,2 per cent in February to 3,3 per cent in March and April. The annualised quarter-on-quarter seasonally adjusted rate of increase of CPIX in the first quarter of this year amounted to 2,1 per cent compared to 5,0 per cent in the fourth quarter of 2004.

Inflation in the other categories of the CPIX index has remained well contained, although services prices have increased marginally over the past two months to a year-on-year 6 per cent rate in April compared to 5,6 per cent in February. Goods price inflation over the same period rose from 1,8 per cent to 2,7 per cent. Food price inflation remained subdued at 1,4 per cent in April while prices of furniture, vehicles and clothing and footwear continued to decline. Administered prices (as measured by Statistics South Africa) were strongly influenced by petrol price changes. However, if we exclude this component, annual administered price inflation continued its declining trend from 6,9 per cent in February to 6,7 per cent in April, still above the upper end of the inflation target range.

The higher international oil prices also had an impact on production price inflation, although the impact was cushioned in part by the rand exchange rate. Year-on-year changes in production prices measured 1,9 per cent and 1,8 per cent in March and April respectively, up from the 1,2 per cent measured in February of this year.

The outlook for inflation

The inflation outlook, although still generally favourable, has changed somewhat as a result of a number of recent developments. Perhaps the most significant development since the previous MPC meeting has been the behaviour of the rand exchange rate.

Since the previous meeting the rand has moved from R6,18 against the US dollar to a level of around R6,80 on 9 June, after having reached levels of over R6,90 during May.

Although the rand exchange rate was affected primarily by US dollar movements, the rand depreciated moderately against the euro as well. On a trade-weighted basis, the rand has depreciated by about 5,7 per cent since the previous meeting. At current levels the rand is within the range in which it traded for much of last year, although the move back to this trading range is unlikely to have a significant impact on the inflation outlook.

The rand exchange rate is likely to continue to be dominated by US dollar developments. Although US growth estimates for 2005 have been scaled back moderately, it is expected to significantly outperform growth in the euro area, Japan and the United Kingdom. Nevertheless, significant macroeconomic imbalances remain, contributing to the uncertain outlook for the US dollar.

Although the inflation outlook is not expected to be markedly affected by these recent exchange rate developments, in the near term the impact will be seen on the petrol prices which are determined primarily by the international crude oil prices and the exchange rate. The international price of Brent crude oil declined from levels of around US$55 per barrel at the time of the previous MPC meeting and stabilised at lower levels, averaging around US$48 per barrel in May. The lower international oil price allowed for a 16 cents per litre petrol price reduction in June, after the further 20 cent per litre increase in May. Although the international oil prices have moved in a relatively narrow trading range over the past few weeks, Brent crude has risen again above the US$50 per barrel level in the past few days, reflecting the uncertainty and volatility in the market. The combination of these higher prices and the current levels of the rand are likely to result in a further increase in the domestic petrol price in July.

Domestically, expenditure continues to expand at a robust pace, although there were signs of some moderation in the first quarter of 2005. The twelve-month rate of increase in real retail sales was 6,8 per cent in March, up from the 3,4 and 6,0 per cent increases in January and February respectively, but below the annual average increase of almost 10 per cent in 2004. Motor vehicle sales again reached record levels in May when a year-on-year increase of 30,7 per cent was recorded. The property market has also remained firm, although the rate of increase in prices has moderated significantly. Higher real disposable incomes as a result of wage settlements in excess of inflation, together with lower interest rates are likely to give continued support to domestic demand. Provisional estimates show that household debt as a proportion of disposable income rose to 60 per cent in the first quarter of this year compared to 58 per cent in the fourth quarter of 2004. The debt service ratio, however, remains low at around 6,5 per cent.

The high levels of expenditure have been reflected in stronger growth in the money supply and credit extension in particular. Growth in M3 has continued at an annual rate of around 12 per cent, although it accelerated by 13,9 per cent in April. M3 deposit holdings of households increased by 9 per cent year on year, compared to 16,5 per cent for the corporate sector. The twelve-month growth in total loans and advances increased to 19,7 per cent in April, compared to increases of around 17 per cent in the previous three months. The year-on-year growth in asset-backed credit remained at around 23 per cent in March and April, reflecting the strong demand for durable goods and mortgage advances.

Lower inflation expectations remain entrenched, with the latest survey from the Bureau for Economic Research at the University of Stellenbosch showing little change from the previous quarter. Inflation expectations for all categories of respondents are still comfortably within the inflation target range for the next three years. Although there was a slight increase in the forecasts of the market analysts, this was offset by a similar decline in inflation expectations of the trade unionists. Also noteworthy is the fact that new business executive respondents had the same low expectations as those who have participated for some time.

Potential pressure on inflation from the supply side of the economy has dissipated. Growth in gross domestic product (GDP) declined from an annualised rate of 4,0 per cent in the fourth quarter of 2004 to 3,5 per cent in the first quarter of 2005. As expected, the slower growth was due primarily to the 1,9 per cent contraction in the manufacturing sector. This was partly a consequence of the strong rand which impacted negatively on the export and import-competing subsectors of manufacturing. This trend was also reflected in the continued downward trend in the leading business cycle indicator and the decline in manufacturing capacity utilisation from 85,5 per cent in the third quarter of 2004 to 84,6 per cent in the first quarter of this year. The slower rate of growth of 2,7 per cent in the agricultural sector also contributed to the overall slowdown. By contrast, the mining sector grew by an annualised rate of 9,1 per cent. The volume of gold production, however, declined to its lowest level since the 1930s. When measured over four quarters, GDP growth was 4,2 per cent.

The high expenditure growth has also resulted in a higher value of merchandise imports, although the increase of 2,5 per cent in April was significantly less than the 10,1 per cent increase recorded in March. Exports, however, which have been increasing steadily since February rose by 7,1 per cent in April. These developments have resulted in an improvement in the trade balance, and may result in a moderate decline in the overall current account deficit which measured 4 per cent of GDP in the fourth quarter of last year. By the end of May gross foreign exchange reserves had increased to US$17,2 billion, and the international liquidity position had increased to US$13,7 billion. The increase in reserve levels reflects a combination of foreign exchange operations conducted by the Bank for own account as well as on behalf of customers, including foreign exchange purchases arising from a foreign direct investment (FDI) transaction.

Other supportive factors include the benign world inflation which has been affected only marginally by the higher international oil prices, and continued fiscal discipline in South Africa. Administered price increases are still above the upper end of the inflation target range, but the downward trend continues, although at a slow pace. Food price inflation has remained low while production price developments also indicate that there are few pressures emanating from rising input costs in the short run.

The risks to the inflation outlook appear to be fairly evenly balanced. According to the forecasting model of the Bank, CPIX inflation is still expected to remain comfortably within the target range of 3 – 6 per cent for the forecast period. The central forecast is for CPIX inflation to peak in the first quarter of 2006 at a slightly higher level than previously forecast, and then to decline to a level of around 4,8 per cent at the end of the fourth quarter of 2006. This moderately higher forecast is in part a consequence of revised expectations relating to petrol prices and the exchange rate, and the easing in monetary conditions.

Monetary policy stance

Taking all of the above into consideration the Monetary Policy Committee has come to the conclusion that the current monetary policy stance remains appropriate to maintain inflation within the target range. This means that the repo rate 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.

Note on developments in self-employment[1]

by M Lehutso-Phooko and T Hlekiso

Introduction

Self-employment is widely viewed as an important engine of economic and employment growth. There is ongoing debate regarding the dynamic inverse relationship between self-employment and unemployment, with not all commentators convinced that more self-employment is a sign of progress. Changing business models such as franchising, outsourcing and growth in the number of small-scale production enterprises, driven by technological developments and diversification of consumption patterns, merit careful analysis as these are factors influencing self-employment and employment generally. Trends in self-employment are also studied to better understand the impact of tax regimes, access to capital and entrepreneurship on the pace of employment growth.

The purpose of this note is to highlight the sectoral, age, gender, occupational and educational profile of non-agricultural self-employment in the South African economy as revealed by Statistics South Africa's *Labour Force Survey* (LFS). Critical data issues are outlined before describing the pattern of self-employment. The note ends with a few concluding remarks.

Definitional issues and data sources

Most international definitions consider *self-employment* as the residual category of employment that is not compensated through wages or salaries. The International Labour Organisation (ILO) includes more positive criteria in the definition of self-employed such as the control exercised over the business venture by the self-employed individual, the extent of risk-taking and the responsibility resting upon the self-employed for the success or failure of his or her undertaking. These are criteria more closely related to the definition of entrepreneurs. The following analysis seeks to identify broader patterns and its scope is largely dictated by the available official data.

Most national and international information on self-employment comes from household surveys of the labour force. In South Africa the LFS is used as the official source of information on self-employed workers. For purposes of this analysis, the self-employed are identified directly through respondents' own self-assessment[2]. This analysis considers self-employment in all the non-agricultural sectors, disaggregated into formal and informal self-employed workers. It uses the results of the September 2003 LFS[3], which is based on a national sample of 30 000 households.

International comparison

Figure 1 gives an overview of the extent of self-employment in a selection of countries including South Africa.

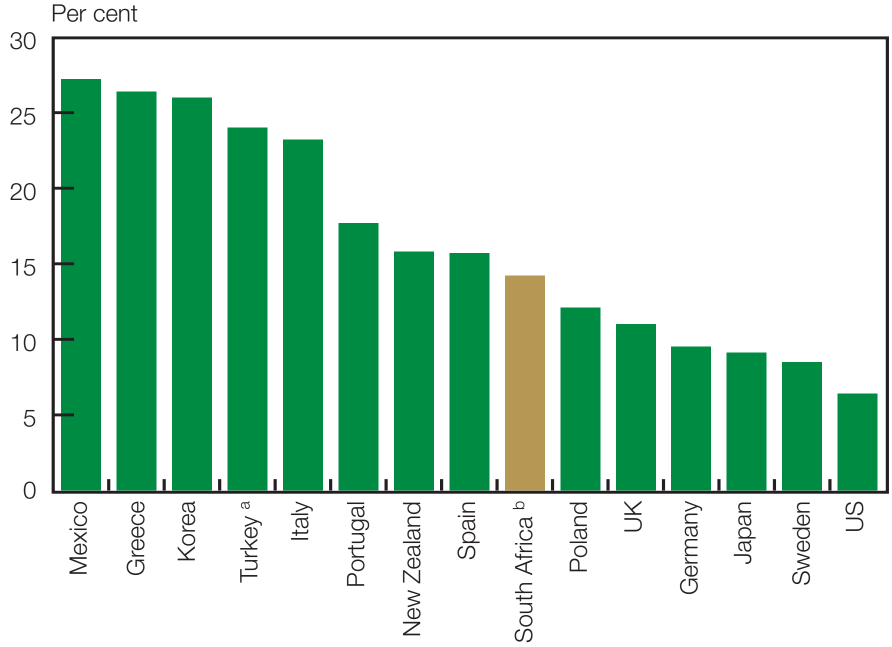
Self-employment as a percentage of total non-agricultural employment is generally higher among the Organization for Economic Co-operation and Development (OECD) countries. South Africa is seemingly more comparable to less industrialised than to more advanced OECD economies. According to the LFS, self-employment constituted 14,2 per cent (approximately 1,3 million workers) of total non-agricultural employment in September 2003.

1 The authors wish to thank Ms N Mahlo and Ms A Bosch for their valuable contributions to data compilation.

2 Question 4.14 of the LFS questionnaire is used to establish the type of business activity as well as the self-employment/employee status. In LFS 2003 questionnaires, the question reads 'Is the business or enterprise/branch where [the respondent] works…?'. The possible answers given include the category '8 – Self-employed'. International experience shows that classification of self-employment can be reliably based on respondents' own assessment because it tends to be consistent with other 'indirect' criteria that might be applied to confirm the workers' status.

3 The informal sector excludes domestic workers.

Figure 1 Self-employment as a percentage of non-agricultural employment in selected OECD and some emerging economies, 2002



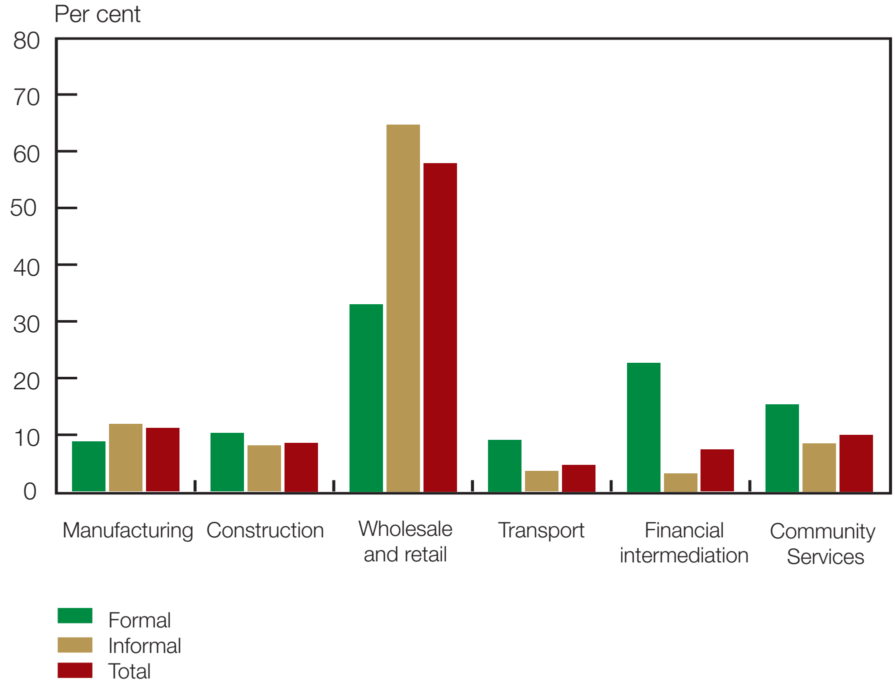
Source: Blanchflower, D.G. 2004. *Self-employment: More may not be better.* National Bureau of Economic Research. Working Paper No. 10286, March: Cambridge.
a. 2001
b. Own calculation based on *Labour Force Survey*, September 2003.

The percentage share of males was marginally higher (51,5 per cent) than that of females (48,5 per cent) in total non-agricultural self-employment in 2003. The rate of male participation in *formal* sector self-employment was overwhelmingly higher (72,7 per cent) than that of females (27,3 per cent). There were, however, more females in *informal* sector self-employment at 54,2 per cent in 2003.

In the same manner as in the OECD and consistent with international trends, the bulk of non-agricultural self-employed workers is found in wholesale and retail trade with 57,9 per cent (approximately 758 000 workers) of the total self-employed population. This is followed by manufacturing with 11,2 per cent (approximately 147 000 workers), and community, social and personal services with 10,0 per cent (approximately 131 000 workers) of total self-employed in 2003. South Africa is comparable to OECD economies in that mining and quarrying, electricity, gas and water supply contribute very little to self-employment. The sectors with the highest number of women in self-employment are the formal wholesale and retail trade with 40,0 per cent (approximately 30 000 female workers) and community, social and personal services with 26,6 per cent (approximately 20 000 female workers) in 2003.

Self-employment as a whole is skewed towards lower occupational skills. However, a distinction between the formal and informal sector showed an overwhelming bias towards *higher* occupational skills in the formal sector. Elementary occupations comprise the largest share of total self-employed at 36,9 per cent (approximately 482 000 workers) followed by craftsworkers with 20,8 per cent (approximately 273 000 workers) and service workers at 15,3 per cent (approximately 201 000 workers). Formal

Figure 2 Non-agricultural self-employment by industry: Percentage of the total share, 2003



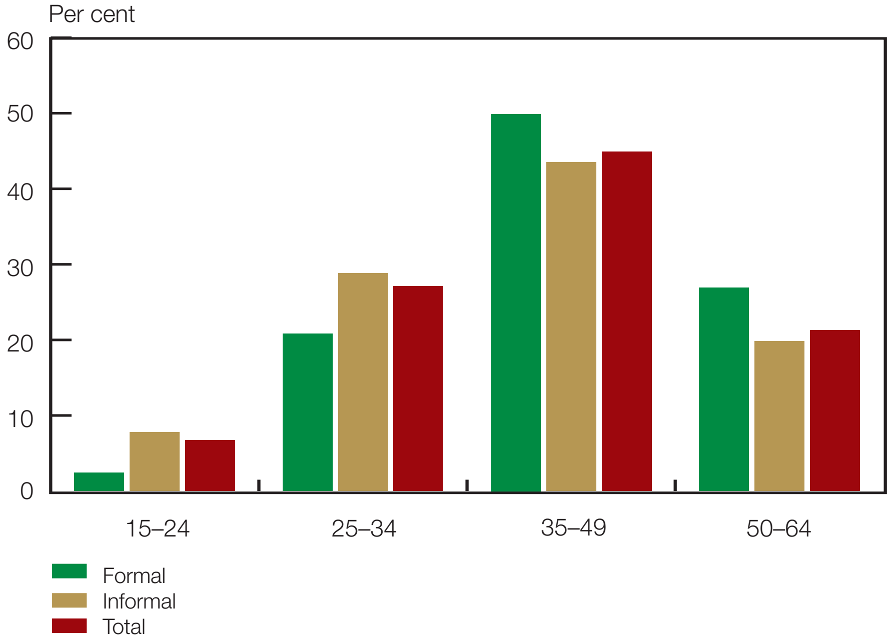
Source: Own calculation, based on *Labour Force Survey*, September 2003.

self-employment is dominated by higher occupational categories. Managers comprise approximately half of the total self-employed at 49,2 per cent (or approximately 137 000 workers) followed by craftsworkers with 10,7 per cent (30 000 workers) and service workers at 10,6 per cent (29 500 workers) in 2003. Elementary occupations dominate the informal sector with 45,6 per cent (approximately 470 000 workers), followed by craftsworkers at 23,5 per cent (approximately 243 000 workers) and service and sales workers at 16,6 per cent (approximately 171 000 workers) in 2003.

Other features that tend to have an influence on self-employment are age and educational qualification. Non-agricultural self-employment is generally not conducive to labour market entrants. In relative terms it is easier for labour market entrants to enter informal than formal self-employment. Among the older total self-employed workers (25 to 64 years of age), the dominant sub-group in 2003 was the 35-49-year age group constituting 48,1 per cent of the total self-employed or approximately 585 000 workers. In second place was the age group 25 – 34 at 29,1 per cent (approximately 353 000 workers).

Classified by educational qualification, total self-employment is dominated by workers with some secondary education, at 34,5 per cent (approximately 449 000) followed by those with some primary education at 26,5 per cent (approximately 345 000). Workers with secondary education constituted 20,1 per cent (approximately 261 000) of total self-employment in 2003. Overall, only about 31,0 per cent of self-employed workers had secondary education or a higher educational qualification in 2003, indicating that a substantial proportion of total self-employed workers have relatively low skill levels. Nearly 72 per cent of self-employed workers in the *formal* sector had secondary education or a higher educational qualification in 2003, indicating a significant skill bias in formal non-agricultural self-employment in the country. The *informal* sector indicated a tendency towards low-level educational qualifications with 80,1 per cent (approximately 820 000 self-employed workers) without secondary education.

Figure 3 Non-agricultural self-employment by age: Percentage of the total share, 2003



Source: Own calculation, based on Stats SA, 2003

Concluding remarks

According to recent LFS results, mainstream *formal* sector self-employment is relatively scarce in South Africa. Most self-employment is found in the *informal* sector which is biased towards females with a focus on wholesale and retail trade and with participants that tend to be relatively low skilled and younger. Similar to aggregate employment and economic activity in general, most self-employment is located in the services sectors. Nevertheless, it is noteworthy that those in manufacturing and construction constituted almost a fifth of total self-employment.

With regard to the occupation and education profile of the self-employed, South Africa's self-employment is generally associated with relatively low-skilled occupational categories and involves substantial numbers of workers without secondary education. However, in the formal sector those in self-employment tend to have either secondary education or a higher qualification.

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Note on the corporatisation of the Public Investment Commissioners

by N Gumata and M Magadze[1]

Introduction

1 The authors wish to express their sincere appreciation to the Money and Banking Division for their valuable contributions.

The Public Investment Corporation Act came into effect on 1 April 2005, replacing the 1984 Public Investment Commissioners Act. The Act converted the Public Investment Commissioners (PIC) into a statutory body, owned solely by government, which is to function as a non-bank provider of financial services. The institution will be subject to the Financial Advisory and Intermediary Services Act and will be governed by the Companies Act.

The corporatisation of the Public Investment Commissioners affects the compilation and comparability of some time series released by the Bank and published in the statistical tables of the *Quarterly Bulletin*. This note is intended to provide brief background information on the historical development of the institution and to outline how its new legal status will be accommodated in the monetary statistics.

Historical development

The Public Investment Commissioners evolved from the Public Debt Commissioners which was established by the Public Debt Commissioners Act, 1911, as an independent board of commissioners entrusted with the custody and investment of certain funds, mainly owned by the public sector. The objective was to place the administration and management of public-sector pension funds under the control of one authority.

With effect from 31 March 1984 the amended Public Debt Commissioners Act, 1969, was superseded by the Public Investment Commissioners Act, 1984, and the Corporation for Public Deposits Act, 1984. The new Acts provided for the rationalisation of the functions of the Public Debt Commissioners. All the short-term pooled funds were transferred to the newly formed Corporation for Public Deposits – a wholly-owned subsidiary of the South African Reserve Bank. The remaining assets and liabilities (essentially long term in nature) were transferred to the Public Investment Commissioners.

Statistical treatment of PIC deposits with banks

In the monetary analysis the Corporation for Public Deposits was classified as part of the monetary banking sector because of its activities as a taker of short-term deposits, its close relationship with the Reserve Bank and the availability of its deposit liabilities for furthering the efficiency of monetary policy management.

The entity Public Investment Commissioners was not classified as part of the monetary banking sector. Accordingly, deposits entrusted to it by the public-sector pension funds and other institutions were excluded from the monetary sector's deposit liabilities. The reasoning was that these deposits with the Public Investment Commissioners were longer-term funds that were subject to fluctuations in value. They were largely invested in securities which did not belong to the Public Investment Commissioners as the Commissioners were merely acting as investment nominees on behalf of various investment accounts of public and private institutions. Moreover, these funds were largely used to finance government expenditure and would find their way back to the monetary system in the normal course of events.

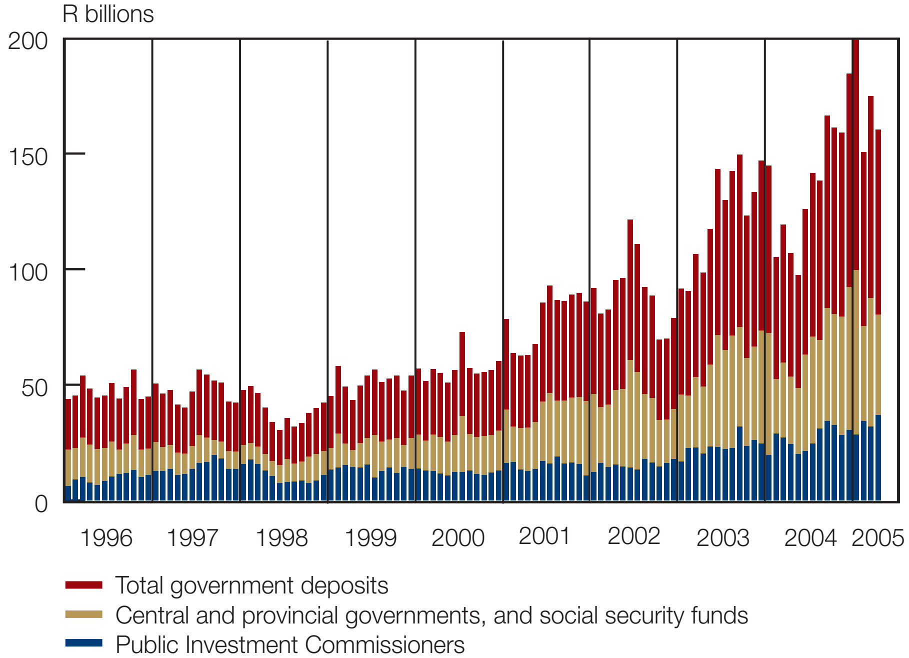
In the monetary analysis the Public Investment Commissioners was treated as part of the government sector. The corporatisation of the Public Investment Commissioners necessitates a re-classification in the monetary analysis from the government sector to the "private and other domestic sectors" category. This implies that the Public Investment Commissioners' deposits with banks should be included in M3. It may be noted that in the national financial accounts the Public Investment Commissioners has always been treated as a separate institutional sector. In that area no statistical changes therefore need be contemplated.

The inclusion of PIC deposits in broad money supply

As mentioned earlier, the Public Investment Commissioners has been classified since their inception in 1984 as part of the government sector in the monetary sector accounts. The accompanying graph shows the contribution of the Public Investment Commissioners' deposits to the overall level of government deposits[2].

2 It should be noted that monthly data for the Public Investment Commissioners' deposits with the monetary sector are only available from January 1996. As a result, the inclusion of the Public Investment Commissioners' deposits in the monetary aggregates could only be effected since that date.

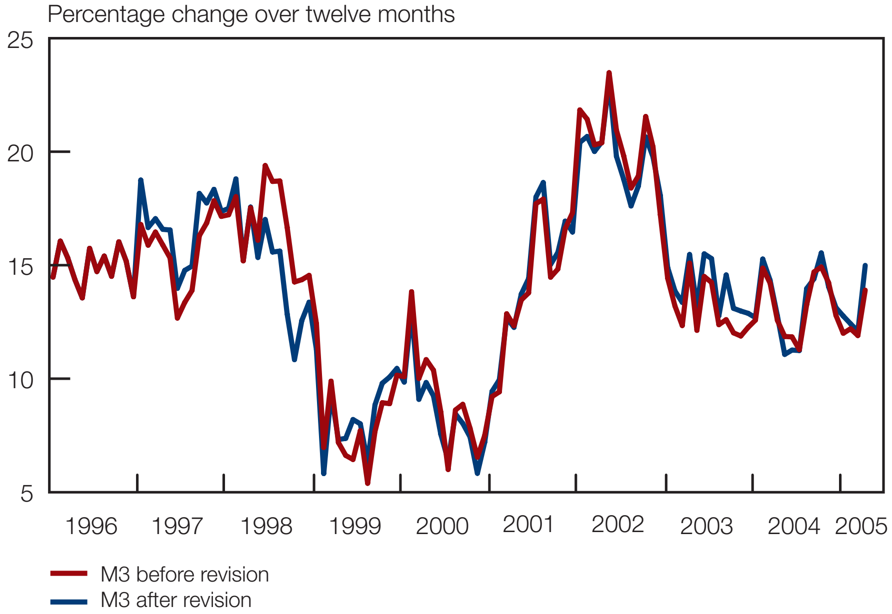
Government deposits with the monetary sector



On average, since 1996 the Public Investment Commissioners' deposit liabilities have contributed 40 per cent to total government deposits. The re-classification of the Public Investment Commissioners requires that these deposits should now be included in the broadly defined money supply (M3). At the same time, the government deposits with the monetary sector have to be reduced by a similar magnitude while net claims on the government sector of the monetary sector have to be raised.

In summary, the classification of the Public Investment Commissioners as a non-bank public-sector financial entity will raise the level of all the monetary aggregates. Doing this will affect twelve-month growth rates only marginally. The impact of the inclusion of the Public Investment Commissioners' deposits in M3 is shown in the accompanying graph.

Growth in M3



For ease of comparison, attachments are provided on the following pages showing original and revised data for M1A, M1, M2 and M3. *Quarterly Bulletin* tables S – 10, 18, 19, 23, 24 and 148 will also be affected. In all statistical tables references to the Public Investment Commissioners have been changed to Public Investment Corporation.

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Original and revised M1A data

R billions

		Excluding PIC	Including PIC
1996:	Jan	61,4	67,5
	Feb	64,5	71,9
	Mar	65,4	72,7
	Apr	66,1	71,0
	May	68,4	73,4
	Jun	70,5	76,0
	Jul	68,1	74,6
	Aug	72,7	80,4
	Sep	73,8	82,7
	Oct	72,1	81,1
	Nov	77,5	84,6
	Dec	82,3	89,9
1997:	Jan	76,9	85,0
	Feb	80,1	87,6
	Mar	82,2	87,5
	Apr	82,4	86,9
	May	80,3	84,9
	Jun	87,7	93,2
	Jul	85,3	92,8
	Aug	85,6	93,6
	Sep	92,4	104,6
	Oct	94,3	104,4
	Nov	97,6	102,8
	Dec	101,2	105,1
1998:	Jan	94,7	100,3
	Feb	104,0	113,2
	Mar	102,8	110,7
	Apr	110,3	116,4
	May	102,3	105,7
	Jun	108,2	109,7
	Jul	104,1	104,9
	Aug	108,5	110,7
	Sep	108,7	113,1
	Oct	112,4	114,8
	Nov	113,7	116,0
	Dec	114,8	118,2
1999:	Jan	109,3	113,5
	Feb	109,1	113,6
	Mar	115,7	121,2
	Apr	114,6	121,4
	May	116,2	120,8
	Jun	124,1	129,6
	Jul	121,7	126,8
	Aug	129,4	137,2
	Sep	131,1	140,2
	Oct	130,5	137,1
	Nov	140,2	148,0
	Dec	145,1	152,2
2000:	Jan	137,6	145,0
	Feb	141,1	147,8
	Mar	137,0	143,2
	Apr	138,4	144,7
	May	136,7	142,3
	Jun	139,3	145,7
	Jul	129,2	135,5
	Aug	132,0	139,0
	Sep	140,2	145,5
	Oct	137,2	141,5
	Nov	138,5	144,0
	Dec	147,6	152,7
2001:	Jan	137,9	142,6
	Feb	141,5	147,1
	Mar	135,4	138,1
	Apr	142,8	146,0
	May	140,6	144,9
	Jun	148,6	154,3
	Jul	149,7	154,6
	Aug	152,2	159,7
	Sep	152,8	155,5
	Oct	159,6	163,6
	Nov	166,5	169,8
	Dec	175,3	176,1
2002:	Jan	162,8	164,3
	Feb	166,7	172,0
	Mar	173,4	176,5
	Apr	169,2	174,3
	May	170,5	174,6
	Jun	175,2	180,4
	Jul	176,7	182,4
	Aug	182,5	192,5
	Sep	185,1	193,5
	Oct	176,3	181,3
	Nov	188,5	193,3
	Dec	191,0	197,0
2003:	Jan	181,3	185,4
	Feb	180,2	188,2
	Mar	180,3	187,3
	Apr	181,4	185,3
	May	174,2	179,3
	Jun	183,3	187,7
	Jul	182,5	186,1
	Aug	184,3	191,0
	Sep	190,4	204,6
	Oct	192,7	198,0
	Nov	201,3	211,0
	Dec	211,0	219,0
2004:	Jan	209,4	214,1
	Feb	220,0	232,7
	Mar	207,2	215,5
	Apr	212,1	220,3
	May	211,9	217,5
	Jun	216,7	225,4
	Jul	209,9	219,0
	Aug	215,1	229,7
	Sep	222,1	234,5
	Oct	221,5	229,3
	Nov	229,1	235,5
	Dec	236,9	244,5
2005:	Jan	230,6	235,8
	Feb	233,6	244,7
	Mar	235,0	241,2
	Apr	247,8	261,3

Original and revised M1 data

R billions

		Excluding PIC	Including PIC			Excluding PIC	Including PIC
1996:	Jan	105,9	112,0		Sep	261,0	268,1
	Feb	112,5	121,4		Oct	257,9	264,0
	Mar	118,6	127,7		Nov	258,8	266,6
	Apr	119,5	126,0		Dec	266,9	274,4
	May	121,8	127,7	2001:	Jan	263,8	272,4
	Jun	126,2	132,8		Feb	265,2	274,2
	Jul	122,8	130,8		Mar	268,8	275,4
	Aug	128,7	137,1		Apr	274,8	281,7
	Sep	132,8	142,3		May	274,2	281,7
	Oct	134,9	146,1		Jun	279,5	288,3
	Nov	140,2	148,3		Jul	280,4	289,1
	Dec	147,6	156,1		Aug	287,9	299,5
1997:	Jan	140,0	149,7		Sep	289,0	295,9
	Feb	145,3	154,9		Oct	288,4	295,9
	Mar	154,2	163,4		Nov	302,0	308,6
	Apr	146,4	154,1		Dec	313,2	315,6
	May	147,0	154,7	2002:	Jan	321,7	324,7
	Jun	150,3	159,5		Feb	327,2	335,2
	Jul	146,1	159,4		Mar	335,2	341,2
	Aug	152,9	166,7		Apr	332,3	340,0
	Sep	164,3	180,6		May	343,2	350,0
	Oct	166,1	181,9		Jun	339,7	347,0
	Nov	173,0	183,2		Jul	331,7	339,4
	Dec	173,1	182,4		Aug	336,8	349,0
1998:	Jan	171,1	184,4		Sep	348,4	359,3
	Feb	178,5	192,8		Oct	339,9	346,3
	Mar	177,2	190,3		Nov	346,4	353,0
	Apr	183,4	194,0		Dec	350,6	358,3
	May	185,1	193,0	2003:	Jan	342,2	347,0
	Jun	203,3	208,0		Feb	336,8	345,2
	Jul	205,5	210,4		Mar	344,4	352,9
	Aug	219,6	225,0		Apr	341,6	347,0
	Sep	219,6	226,3		May	329,7	335,9
	Oct	210,3	216,1		Jun	331,2	336,8
	Nov	216,1	223,0		Jul	331,8	336,4
	Dec	213,9	223,0		Aug	332,6	339,7
1999:	Jan	209,8	220,6		Sep	346,3	362,1
	Feb	205,0	216,2		Oct	352,6	359,7
	Mar	216,1	227,9		Nov	362,4	373,7
	Apr	212,4	224,4		Dec	378,2	387,8
	May	213,3	225,2	2004:	Jan	386,8	392,1
	Jun	220,4	232,7		Feb	401,9	415,7
	Jul	220,7	228,0		Mar	392,7	402,2
	Aug	227,5	237,7		Apr	386,0	395,3
	Sep	228,9	241,2		May	382,5	389,1
	Oct	238,2	247,8		Jun	393,7	403,3
	Nov	255,3	267,1		Jul	382,2	392,5
	Dec	258,3	269,3		Aug	391,2	407,0
2000:	Jan	246,2	257,3		Sep	406,6	420,2
	Feb	256,7	266,7		Oct	404,9	415,4
	Mar	252,7	262,7		Nov	412,7	419,9
	Apr	256,1	264,7		Dec	412,3	421,5
	May	251,5	259,3	2005:	Jan	408,9	416,0
	Jun	257,4	265,9		Feb	418,6	431,8
	Jul	244,9	253,3		Mar	425,6	432,6
	Aug	246,5	255,1		Apr	440,0	455,6

Original and revised M2 data

R billions

		Excluding PIC	Including PIC			Excluding PIC	Including PIC
1996:	Jan................	237,8	244,0		Sep...............	443,0	452,6
	Feb	247,5	256,4		Oct................	441,1	450,6
	Mar	255,1	265,2		Nov...............	450,0	461,3
	Apr................	257,2	264,8		Dec...............	462,2	474,8
	May...............	263,3	270,0	2001:	Jan................	459,6	474,1
	Jun................	268,5	276,8		Feb	467,3	483,0
	Jul.................	266,8	277,1		Mar	479,6	491,4
	Aug...............	270,4	281,8		Apr................	479,3	490,8
	Sep...............	271,6	283,3		May...............	479,3	491,5
	Oct................	274,0	287,0		Jun................	478,8	492,8
	Nov...............	279,7	289,8		Jul.................	485,7	497,9
	Dec...............	284,4	295,3		Aug...............	498,2	513,4
1997:	Jan	283,2	295,6		Sep...............	496,9	508,2
	Feb	290,8	303,0		Oct................	497,9	510,4
	Mar	300,6	313,7		Nov...............	510,9	522,8
	Apr................	299,1	309,5		Dec...............	535,1	544,1
	May...............	305,7	316,6	2002:	Jan................	551,2	560,8
	Jun................	303,5	316,5		Feb	558,8	573,4
	Jul.................	301,8	317,4		Mar	571,6	585,1
	Aug...............	308,6	324,6		Apr................	567,2	581,2
	Sep...............	319,0	338,3		May...............	581,8	594,4
	Oct................	325,5	343,2		Jun................	568,0	579,1
	Nov...............	334,8	348,0		Jul.................	563,7	573,8
	Dec...............	337,5	350,8		Aug...............	577,2	591,4
1998:	Jan................	336,1	351,6		Sep...............	585,7	598,3
	Feb	346,2	363,5		Oct................	597,8	607,6
	Mar	346,1	361,5		Nov...............	610,1	621,4
	Apr................	354,1	366,7		Dec...............	618,7	632,6
	May...............	356,5	366,6	2003:	Jan................	626,2	639,5
	Jun................	368,6	376,0		Feb	628,4	646,3
	Jul.................	367,5	375,3		Mar	632,7	651,0
	Aug...............	377,2	385,3		Apr................	654,8	671,3
	Sep...............	379,2	387,5		May...............	660,8	680,4
	Oct................	370,9	378,3		Jun................	665,5	684,5
	Nov...............	380,9	389,2		Jul.................	669,0	687,0
	Dec...............	383,4	394,0		Aug...............	671,1	690,0
1999:	Jan................	376,1	389,1		Sep...............	680,1	706,7
	Feb	366,1	380,0		Oct................	692,8	711,1
	Mar	376,1	391,6		Nov...............	699,7	721,1
	Apr................	381,4	395,4		Dec...............	712,9	733,5
	May...............	382,9	396,9	2004:	Jan................	719,0	734,9
	Jun................	392,7	408,0		Feb	732,4	756,8
	Jul.................	397,7	407,6		Mar	726,0	748,5
	Aug...............	401,1	413,7		Apr................	729,8	750,7
	Sep...............	413,4	427,4		May...............	730,7	748,2
	Oct................	416,3	426,8		Jun................	730,2	749,0
	Nov...............	427,7	440,3		Jul.................	728,6	748,7
	Dec...............	435,5	447,1		Aug...............	739,7	766,8
2000:	Jan................	427,3	439,0		Sep...............	762,1	790,4
	Feb	432,9	443,6		Oct................	778,2	807,5
	Mar	428,5	439,0		Nov...............	780,3	805,3
	Apr................	431,4	440,7		Dec...............	791,7	818,7
	May...............	429,3	437,9	2005:	Jan................	794,7	817,8
	Jun................	431,4	441,2		Feb	815,3	840,4
	Jul.................	423,4	433,3		Mar	817,6	835,1
	Aug...............	429,7	440,0		Apr................	846,5	870,2

Original and revised M3 data
R billions

		Excluding PIC	Including PIC
1996:	Jan	273,4	279,6
	Feb	282,7	291,7
	Mar	289,2	299,3
	Apr	291,4	299,0
	May	298,1	304,8
	Jun	304,4	312,7
	Jul	302,4	312,8
	Aug	306,4	317,9
	Sep	308,5	320,3
	Oct	311,3	324,3
	Nov	316,1	326,2
	Dec	319,4	330,4
1997:	Jan	319,3	332,1
	Feb	327,6	340,3
	Mar	336,8	350,4
	Apr	337,7	348,6
	May	343,8	355,2
	Jun	343,0	356,4
	Jul	342,8	359,0
	Aug	349,0	365,5
	Sep	358,8	378,5
	Oct	363,7	381,9
	Nov	372,5	386,1
	Dec	374,2	387,8
1998:	Jan	374,3	390,2
	Feb	386,6	404,3
	Mar	387,9	403,6
	Apr	396,9	409,8
	May	399,2	409,7
	Jun	409,5	417,1
	Jul	406,9	415,0
	Aug	414,3	422,6
	Sep	418,6	427,1
	Oct	415,6	423,2
	Nov	426,0	434,6
	Dec	428,7	439,7
1999:	Jan	420,8	434,2
	Feb	413,6	427,8
	Mar	426,3	441,5
	Apr	425,4	439,9
	May	425,6	439,9
	Jun	435,9	451,3
	Jul	438,2	448,2
	Aug	436,6	449,3
	Sep	450,7	464,9
	Oct	452,8	464,7
	Nov	463,9	478,3
	Dec	472,2	485,6
2000:	Jan	463,3	477,0
	Feb	470,8	483,6
	Mar	469,0	481,6
	Apr	471,6	483,1
	May	469,7	480,5
	Jun	473,1	485,4
	Jul	464,5	476,8
	Aug	474,3	487,2
	Sep	490,7	502,2
	Oct	488,2	499,2
	Nov	494,2	506,2
	Dec	507,6	520,6
2001:	Jan	505,9	522,0
	Feb	515,1	531,8
	Mar	529,3	542,6
	Apr	529,7	542,3
	May	533,0	546,5
	Jun	538,2	555,3
	Jul	546,8	562,7
	Aug	559,2	578,1
	Sep	561,7	577,7
	Oct	560,6	576,9
	Nov	576,3	592,0
	Dec	595,5	606,3
2002:	Jan	616,4	628,5
	Feb	625,5	641,7
	Mar	636, 8	651,2
	Apr	637,7	653,1
	May	658,2	672,9
	Jun	651,0	665,2
	Jul	655,1	668,4
	Aug	662,1	679,9
	Sep	668,1	684,5
	Oct	681,4	696,0
	Nov	692,8	709,1
	Dec	698,0	715,8
2003:	Jan	705,4	722,2
	Feb	708,1	730,6
	Mar	715,3	738,2
	Apr	733,9	754,2
	May	738,0	761,3
	Jun	745,4	768,4
	Jul	748,4	770,6
	Aug	744,1	766,7
	Sep	752,2	784,2
	Oct	763,3	787,2
	Nov	775,1	801,1
	Dec	783,6	808,0
2004:	Jan	794,2	813,8
	Feb	813,4	842,2
	Mar	817,0	844,1
	Apr	826,1	850,5
	May	825,6	845,5
	Jun	833,6	855,0
	Jul	832,7	857,2
	Aug	842,7	873,8
	Sep	862,8	897,1
	Oct	877,1	909,6
	Nov	885,4	913,6
	Dec	883,8	914,1
2005:	Jan	889,3	917,7
	Feb	912,5	946,8
	Mar	914,2	946,1
	Apr	941,1	978,0

Note to tables

Changing the base year of the effective exchange rate of the rand – Table S–111

The South African Reserve Bank changed the base year of the indices of the nominal and real effective exchange rates of the rand from 1995 to 2000 with effect from 1 May 2005. The number of trading-partner countries which are taken into account in the calculation of the weighted average exchange rate of the rand as well as their respective weights were, however, left unchanged. Percentage changes over time in both the nominal and real effective exchange rates of the rand will therefore be identical, no matter which of the two base years is used. Revised time series data, dating back to 1990, are available on the South African Reserve Bank's website: http://www.reservebank.co.za.