Quarterly Bulletin

March 2006

South African Reserve Bank

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March 2006

No 239

South African Reserve Bank

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ISSN 0038-2620

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Quarterly Economic Review

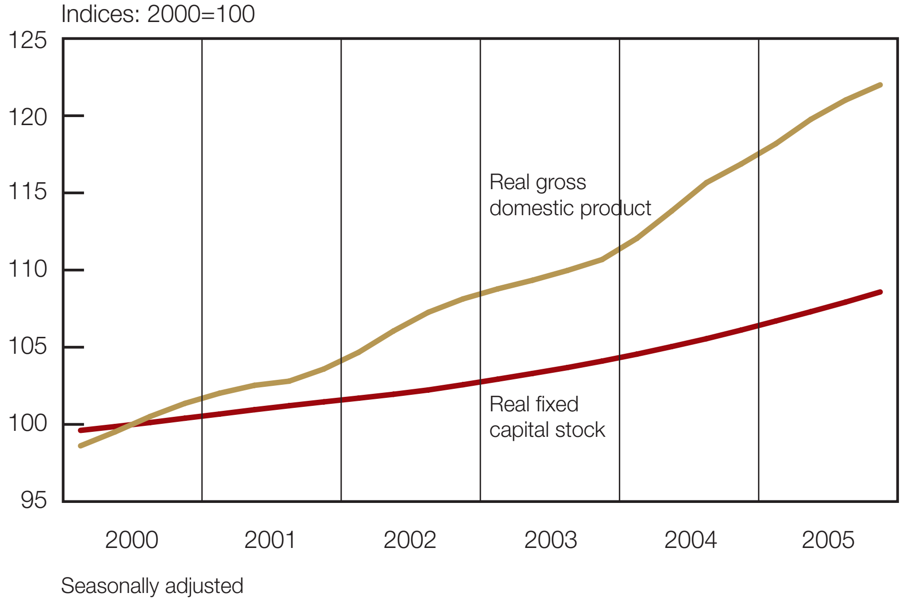
Introduction

The real growth rate of the South African economy picked up from 4½ per cent in 2004 to virtually 5 per cent in 2005 – the highest annual growth rate since 1984. The rapid expansion in real gross domestic product in 1984 was short-lived, falling between two years of negative growth, and was prompted by a brief and unsustainable episode of fiscal expansion. By contrast, the current sound economic policies and robust policy framework, and the way in which the growth momentum has developed over the past number of years suggest a far more resilient process of growth.

A relatively benign international economic environment contributed to the improved prospects facing the South African economy in 2005. Global output growth continued at a firm pace, rendering support to international trade volumes and commodity prices. At the same time world inflation remained low, with little evidence that the increases in the prices of crude oil and other commodities would trigger a more generalised inflationary spiral.

In recent years the rate of real output growth in the South African economy has exceeded the pace of expansion in the real fixed capital stock by a considerable margin, resulting in a declining capital-output ratio. As the use of capital stock is increasingly stretched to its limits, it is likely to prompt higher fixed capital formation in order to boost the capital stock and accommodate a sustained acceleration in output growth. This outcome was observed as capital expenditure again rose briskly in 2005, but not sufficiently to prevent a further reduction in the capital-output ratio. Further substantial strides in fixed capital formation are required – including the increases to which the public sector is committed, congruent with the Accelerated and Shared Growth Initiative of South Africa (Asgisa).

Real output and the fixed capital stock



In 2005 all three of the main components of domestic final demand – final consumption expenditure by households, final consumption expenditure by government, and gross fixed capital formation – rose at strong real growth rates ranging from 5½ to 8 per cent. Household expenditure on durable and semi-durable goods recorded further buoyant increases in 2005, supported by high consumer confidence, rising income and the lowest nominal interest rate levels in 25 years. Real final consumption expenditure by general government was driven by actions to improve service delivery as well as defence procurement. The private sector – particularly the manufacturing, commerce and construction sectors – was responsible for most of the growth in real fixed capital formation in 2005, although public corporations also increased their expenditure on the upgrading of the electricity distribution network and on harbour facilities.

Real value added by the primary sector picked up in 2005 on account of a significantly higher level of agricultural production. The secondary and tertiary sectors broadly retained their earlier growth momentum in 2005. However, quarterly growth rates were erratic, with the mining sector for instance experiencing strongly positive growth rates in the first half of 2005 but reductions in real production in the second half of the year, partly on account of scheduled maintenance of a smelter. Erratic behaviour was observed in the real value added by manufacturing which registered a contraction in the first quarter of 2005, strong increases in the middle quarters, and again a marginal contraction in the final quarter when petroleum refinery output was temporarily held back by plant conversions to replace leaded fuel. Summing across all sectors, quarter-to-quarter growth in real gross domestic production reached its peak in the second quarter of 2005 and decelerated somewhat in the subsequent two quarters.

Strong domestic production and expenditure in 2005 were accompanied by buoyant demand for imports. For the year as a whole, the volume of merchandise imports rose by 11½ per cent. Over the same period merchandise export volumes expanded by 8½ per cent, consistent with the solid performance of the world economy. Both the trade deficit and the deficit on the service, income and current transfer account widened in 2005, resulting in a deficit on the current account of the balance of payments amounting to 4,2 per cent of gross domestic product. The deficit in the fourth quarter also widened despite the meaningful narrowing of the trade deficit.

The financial account of the balance of payments registered a larger surplus in 2005 than in 2004. A large foreign direct investment transaction in the banking sector contributed significantly towards this outcome and also helped to stimulate interest in investment in South Africa generally. Portfolio investment into South Africa also continued in 2005 and mainly involved investment in shares. The continued surplus on the financial account in respect of the final quarter of 2005 reflected, among other things, further direct investment activity as well as flows related to the domestic private-banking sector.

During each of the quarters of 2005 the overall balance of payments registered a surplus. This was reflected in further increases in the gross holdings of gold and foreign exchange of the South African Reserve Bank (the Bank), which doubled in less than two years, reaching US$20,6 billion at the end of December 2005. The gross reserves came to US$22,5 billion at the end of February 2006. Given the overall balance-of-payments surplus, alongside sustained high prices of commodity exports and widespread interest in South Africa as an investment destination, the nominal effective exchange rate of the rand, on balance, declined very little in 2005 – a 9-per-cent depreciation of the exchange value of the rand in the first half of the year was largely reversed in the second half. Some further appreciation of the rand followed in early 2006.

Overall employment in South Africa increased by a welcome 658 000 jobs, or by 5,7 per cent, over the year to September 2005. Wage settlements and increases in nominal remuneration per worker moderated somewhat in 2005, and increases in unit labour cost were fully aligned with the inflation target. However, at the same time the number of man-days lost due to strikes and other work stoppages more than doubled to 2,3 million.

CPIX inflation continued along its disciplined path, recording its 29th successive month within the target area of 3 to 6 per cent in January 2006. Both the goods and the services components were within the target area. If the price of petrol is excluded from the inflation calculation, administered price inflation fell close to the midpoint of the target range. Similarly, production price inflation remained well contained.

The M3 money supply rose at brisk rates in 2005 and January 2006, consistent with the strength of domestic production and expenditure. Positive wealth effects on account of rising prices of real-estate and financial assets also supported the demand for money. Monetary institutions' loans and advances to the domestic private sector maintained strong momentum over the past year, with mortgage and credit card advances recording exceptionally high rates of increase – symptomatic of the buoyancy of the real-estate and household goods and services markets, respectively. As a counterpart to these developments, the household debt ratio rose from 58 per cent of disposable income in the fourth quarter of 2004 to a new record level of 65½ per cent in the fourth quarter of 2005.

Interest rates in the money market remained aligned with the Bank's repurchase rate. This policy rate was adjusted only once in 2005, when a reduction from 7½ per cent to 7 per cent was announced in mid-April. Other money-market rates generally declined by a similar margin. Yields on long-term rand-denominated bonds of the South African government trended down during 2005 and reached 35-year lows in February 2006, reflecting the modest Budget deficit and confidence that inflation would remain under control.

With mortgage interest rates at relatively low levels and displaying a high degree of stability, while real income and employment continued to expand, house prices again recorded double-digit rates of increase in 2005 and the first few months of 2006. Sentiment in the real-estate market was also supported by the reduction in transfer duty announced in February 2006.

Reflecting the sound performance of the economy, high international commodity prices, strong profit growth and upbeat expectations, South African share prices rose by 43 per cent from the end of 2004 to the end of 2005 – the seventh highest local-currency price performance in the world according to the World Federation of Exchanges. While share prices reached successive record highs in 2005 and early 2006, on each of these occasions the historical price-earnings ratio of JSE Limited (JSE) shares still fell short of its upper turning points in a number of previous instances. Non-residents' net purchases of shares on the JSE reached a record high level in 2005 and continued apace in the first two months of 2006.

National government revenue was exceptionally buoyant in fiscal 2005/06, exceeding the initially budgeted amount by a significant margin as a reflection of the strength of domestic production and expenditure, as well as further improvements in tax administration. Government expenditure progressed in broad conformity with the initial Budget. As a result, the latest estimates provide for a 2005/06 national government deficit before borrowing and debt repayment of only 0,5 per cent of gross domestic product, compared with an originally budgeted ratio of 3,1 per cent. The strong fiscal position made it possible for government to provide for significant tax relief and increases in real non-interest expenditure in 2006/07, while still restricting the deficit ratio to 1,5 per cent of gross domestic product and allowing the ratio of government debt to gross domestic product to somewhat decline further.

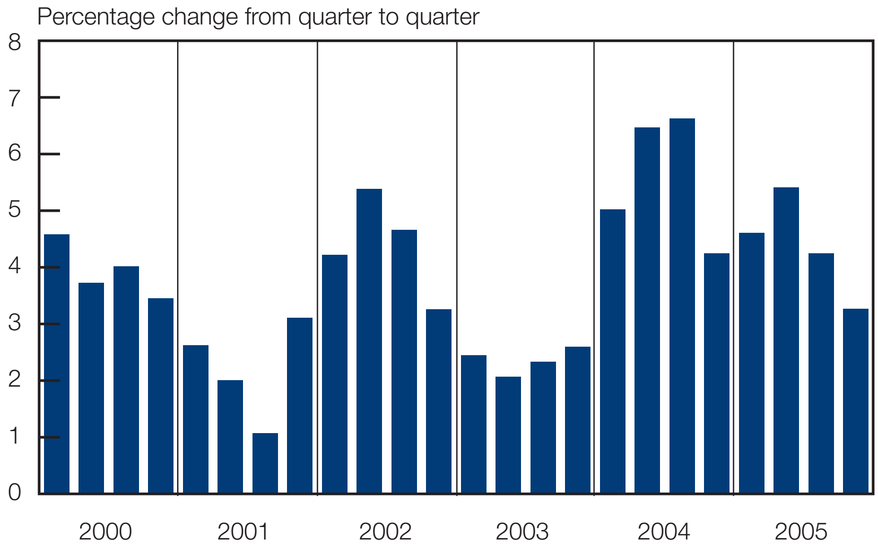
Domestic economic developments

Domestic output[1]

The South African economy registered a real growth rate of virtually 5 per cent in 2005, the highest since 1984. This solid performance followed the attainment of an already brisk rate of growth of 4½ per cent in 2004. On a quarterly basis, *real economic growth* lost some momentum in the second half of 2005 and decelerated from an annualised rate of 4 per cent in the third quarter of 2005 to 3½ per cent in the fourth quarter. The diminished performance in the final quarter of 2005 mainly reflected a decline in the real value added by the primary sector and slower growth in the real value added by the secondary sector.

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

Real gross domestic product



Seasonally adjusted annualised rates

Following an increase of 2½ per cent in the third quarter of 2005, the real value added by the *primary sector* declined at an annualised rate of 2 per cent in the fourth quarter. This contraction was the net result of a slowdown in the real value added by the agricultural sector, while the real value added by the mining sector declined. However, on an annual basis, real production of the primary sector improved from an increase of 1½ per cent in 2004 to 4 per cent in 2005.

Growth in the real value added by the *agricultural sector* slowed from an annualised rate of 10 per cent in the third quarter of 2005 to 4 per cent in the fourth quarter partly due to a decline in horticultural output; livestock production continued to edge higher over the period. However, for 2005 as a whole, the real value added by the agricultural sector increased at a rate of 5½ per cent, following a decline of 1½ per cent in 2004.

The real value added by the *mining sector* declined marginally in the third quarter of 2005 but fell at an annualised rate of 4½ per cent in the fourth quarter. This notable contraction was mainly due to a decline in the real value added by the platinum-mining sector. The production of platinum group metals was adversely affected by the scheduled maintenance of a smelter at one of the platinum mines. The dampening effect of the stronger rand on export earnings might also have constrained mining production somewhat.

The secular decline in the real value added by the gold-mining sector was interrupted in the fourth quarter of 2005. Following a decline in the third quarter of 2005, gold mining output inched higher in the fourth quarter. Gold production was partly boosted by the re-opening of certain mining operations that were previously closed and by a reduction in the number of working days lost due to work stoppages. The real value added by diamond mining also increased over the same period. Despite a gradual deterioration in the quarter-to-quarter rate of growth in the real value added by the mining sector, the increase in real value added was maintained at 3 per cent in 2005 as a whole.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

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

Growth in the real value added by the *secondary sector* slowed from 7½ per cent in the second quarter of 2005 to 5½ per cent in the third quarter and to 1½ per cent in the fourth quarter. This could mainly be attributed to a decline in the growth in manufacturing output. Although growth in real value added accelerated in the sector supplying electricity, gas and water as well as in the construction sector, these increases were not sufficiently strong to offset the decline in manufacturing production.

In *manufacturing* an annualised rate of growth of 5½ per cent in the third quarter of 2005 made room for a marginal contraction in the fourth quarter. Quarter-to-quarter growth rates ranging between -2½ and 8 per cent brought the growth in real manufacturing production for 2005 as a whole to 4 per cent, a slight deceleration from the 4½ per cent growth recorded in 2004.

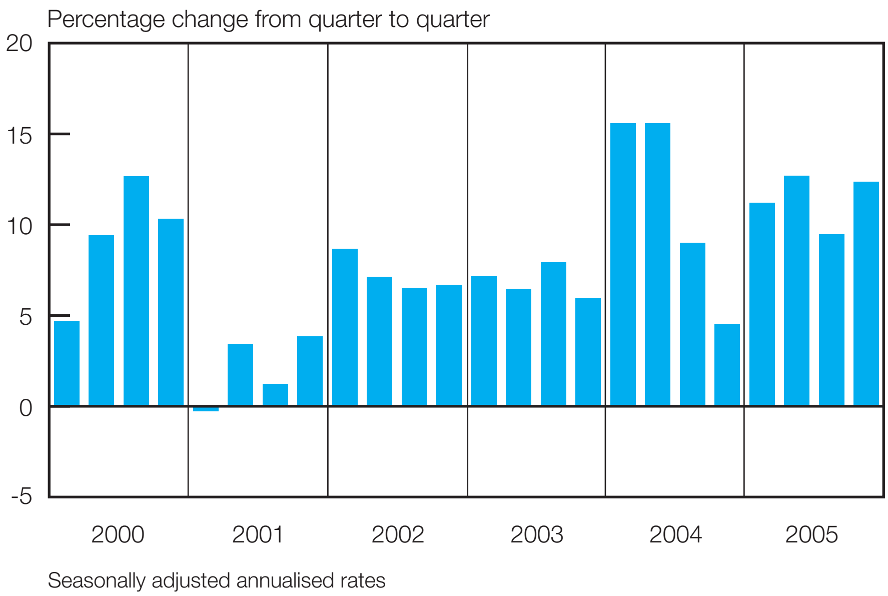
The decline in the real value added by the manufacturing sector in the fourth quarter of 2005 occurred in a number of subsectors. Real output of manufactured food and beverages, petroleum, chemical and plastic products as well as electrical machinery contracted. The plant conversions related to the change-over from leaded to unleaded and lead replacement fuel adversely affected production in the petroleum and chemical products subsector over the period. However, the real output of manufacturers of basic iron and steel products as well as transport equipment increased over the same period.

The fourth-quarter contraction in the real value added by the manufacturing sector was probably also fuelled by increased competitive pressures from abroad, making it difficult for local manufacturers to capitalise on the buoyant domestic demand for consumer goods due to cheaper imports. Export volumes also receded somewhat in the final quarter of 2005.

Following a decline of 1½ per cent in the third quarter of 2005, growth in the real value added by the sector supplying *electricity, gas and water* accelerated to an annualised rate of 3½ per cent in the fourth quarter. The increased output was mainly evident in electricity production. However, for the year as a whole growth in the real value added by the sector supplying electricity, gas and water slowed from 2½ per cent in 2004 to 1½ per cent in 2005 as the latter year was characterised by an exceptionally mild winter which weighed on electricity consumption.

Growth in the real value added by the *construction sector* accelerated from an annualised rate of 9½ per cent in the third quarter of 2005 to about 12½ per cent in the fourth quarter – mainly reflecting the continued buoyancy of residential and non-residential building activity. In addition, provincial governments stepped up the pace of civil construction works. Growth in the real value added by the construction sector amounted to 10 per cent in 2005, much the same as the buoyant increase of 10½ per cent recorded in 2004.

Real gross value added by the construction sector



The real value added by the *tertiary sector* grew at an annualised rate of 5 per cent in the fourth quarter of 2005, slightly higher than the growth rate recorded in the second and third quarters. The relatively robust quarter-to-quarter rates of increase during 2005 lifted the real value added by the tertiary sector by 5 per cent for the year as a whole, following an increase of 4½ per cent in the preceding year.

In the *trade sector* growth in the real value added accelerated to a robust 9 per cent in the fourth quarter of 2005 after recording a growth rate of 6½ per cent in the third quarter. The brisk performance mainly reflected buoyant activity in the retail and motor trade sectors. Against the backdrop of favourable consumer confidence, real spending on durable consumer goods surged in the fourth quarter of 2005, lifting the real value added of the retail subsector. The sale of new motor vehicles surged in the fourth quarter of 2005 and for the calendar year 2005, total new motor vehicles sold amounted to 565 000 or 24½ per cent more than the previous record of 454 000 new motor vehicles sold in 1981.

The real value added by the *transport, storage and communication sector* increased at brisk annualised rates of 6 per cent in the third quarter of 2005 and 6½ per cent in the fourth quarter. This was broadly in keeping with the sustained high level of domestic demand which led to an increase in the usage of land freight transport across the country. The real value added by the communication subsector was sustained at a high level in the third and fourth quarters of 2005. The strong quarter-to-quarter growth in the transport, storage and communication sector throughout the year culminated in an annual growth rate of 5½ per cent in 2005 as a whole, compared to the 4½ per cent increase recorded in 2004.

Growth in the real value added by the *finance, insurance, real-estate and business services sector* eased from an annualised rate of 4½ per cent in the third quarter of 2005 to 3½ per cent in the fourth quarter. A slowdown in the real value added by banks was not fully offset by the increased output of other subsectors. Positive sentiment towards equity investment on the Johannesburg Securities Exchange (JSE) lifted the real value added by securities dealers in the fourth quarter. In addition, the real output of the real-estate sector continued to benefit from sustained buoyancy in fixed property transactions.

Growth in the real value added by *general government* accelerated from an annualised rate of 1 per cent in both the second and third quarters of 2005 to 2 per cent in the fourth quarter.

Growth in *real gross national income* slowed from 5½ per cent in 2004 to 5 per cent in 2005 mainly due to a sharp increase in net primary income payments made to the rest of the world, which more than neutralised an improvement in South Africa's terms of trade. Accordingly, growth in real gross national income *per capita* also slowed from a rate of 4 per cent in 2004 to 3½ per cent in 2005.

Domestic expenditure

Growth in *aggregate real gross domestic expenditure* slowed considerably from an annualised rate of 7½ per cent in the third quarter of 2005 to 4 per cent in the fourth quarter. A substantial slowdown in the pace of inventory investment more than countered a marked acceleration in real domestic final demand. For the calendar year 2005, aggregate real gross domestic expenditure increased by 6 per cent compared with an increase of 7½ per cent in 2004.

After having recorded growth at an annualised rate of 6 per cent in the third quarter of 2005, growth in *real final consumption expenditure by households* accelerated to an annualised rate of 7 per cent in the fourth quarter. Brisk household spending on durable goods was primarily responsible for the buoyant growth in real household consumption expenditure. Growth in the demand for semi-durable goods moderated over the period. Nevertheless, the growth in real household expenditure for 2005 as a whole amounted to 7 per cent compared with an increase of 6½ per cent in 2004. This was the highest annual growth rate in real consumption expenditure by households registered since 1981.

Robust discretionary spending boosted the surge in real outlays on *durable consumer goods* from an annualised growth rate of 8 per cent in the third quarter of 2005 to 24½ per cent in the fourth quarter. Relatively stable prices of new vehicles and interest rates which remained at 25-year low levels contributed to the high level of spending on personal transport equipment, especially on new motor vehicles. Growth in real outlays on furniture, household appliances and medical equipment slowed in the fourth quarter of 2005.

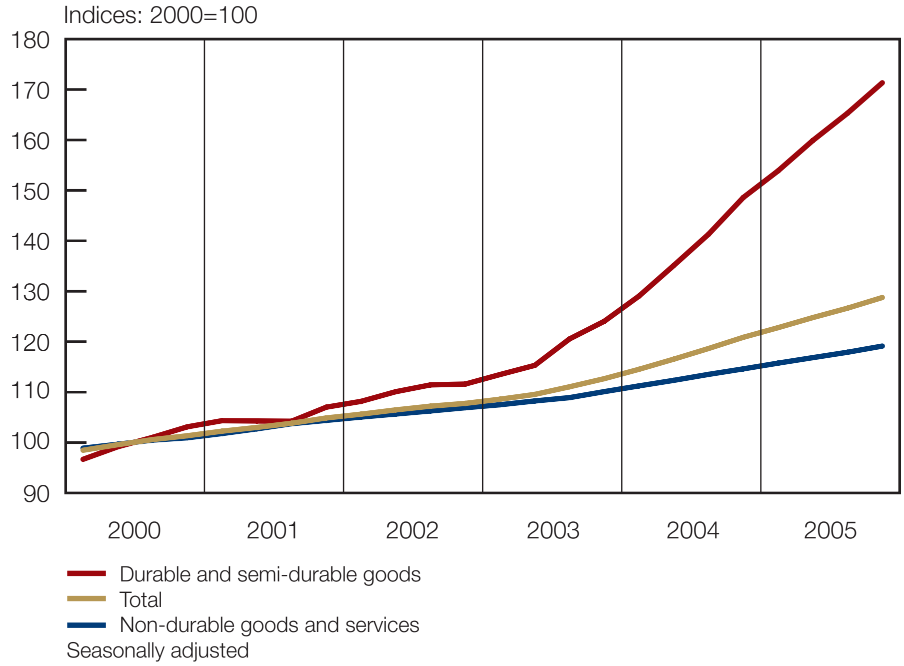
Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

	2004					2005				
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure by households	6½	7	7½	7½	6½	6½	6½	6	7	7
Final consumption expenditure by general government	5½	6	0	12½	7	1	6	5½	14½	5½
Gross fixed capital formation	11½	10	7½	9½	9	10	4½	7	7½	8
Change in inventories (R billions)*	10,9	16,7	17,8	12,7	14,5	12,3	6,1	13,3	2,9	8,6
Gross domestic expenditure	9½	9½	4½	4	7½	7	6	7½	4	6

* At constant 2000 prices

Real final consumption expenditure by households



Real final consumption expenditure on *semi-durable goods* levelled off in the fourth quarter of 2005, decelerating from a growth rate of 19½ per cent in the third quarter of 2005 to 8½ per cent in the fourth quarter. Slower growth was evident in all the spending categories of semi-durable goods.

Real final consumption expenditure by households

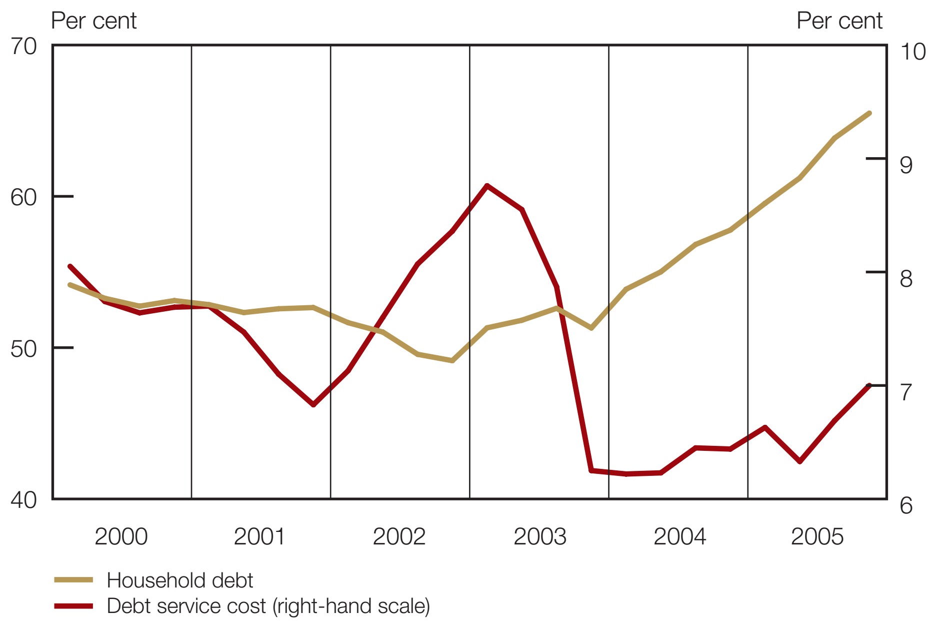
Percentage change at seasonally adjusted annualised rates

	2004					2005				
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods...............	10½	17	23	26	16	12	20½	8	24½	18
Semi-durable goods......	23	23	17	19½	18	17½	13½	19½	8½	17
Non-durable goods	3	5	6	5½	4	5½	4½	4½	6	5
Services.........................	5	3	3	2½	4	3	3½	3	3	3
Total	6½	7	7½	7½	6½	6½	6½	6	7	7

Growth in real household expenditure on *non-durable goods* and *services* in the fourth quarter of 2005 continued at the modest pace set in the previous quarters. Growth in real outlays on household fuel and power, medical and pharmaceutical products as well as some services accelerated moderately over the period.

A steady increase in *real household disposable income* underpinned the robust household spending. In addition, households also incurred more debt to satisfy their appetite for consumer goods and property acquisition. As a result, household debt as a percentage of household disposable income rose from 63½ per cent in the third quarter of 2005 to a new record of 65½ per cent in the fourth quarter. The ratio of debt service payments to disposable income edged higher to 7 per cent in the final quarter of 2005.

Household debt and debt service cost as percentage of disposable income



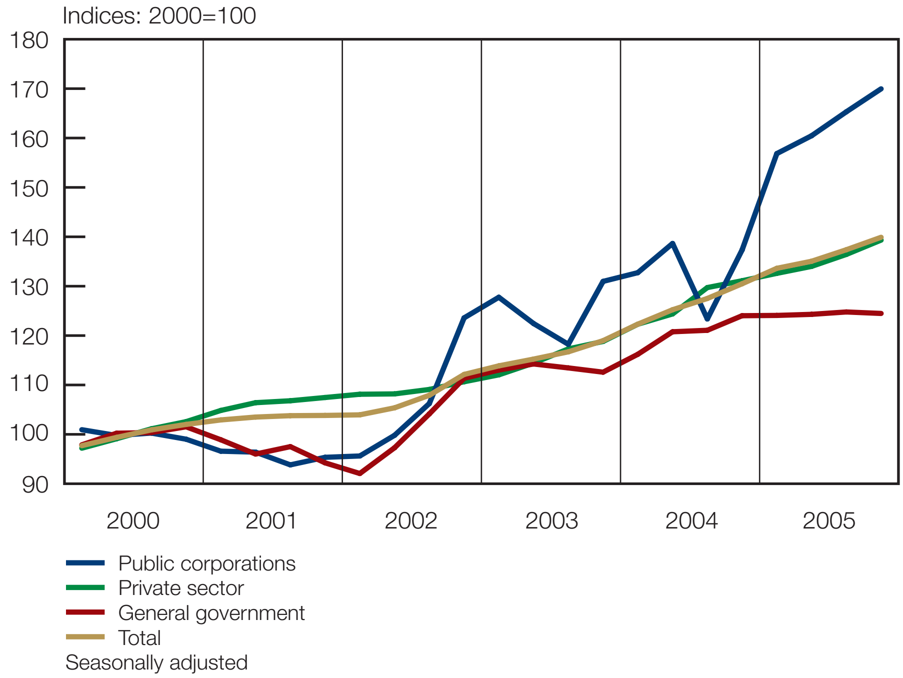
Subsequent to an annualised increase of 5½ per cent in the third quarter of 2005, *real final consumption expenditure by general government* gained further momentum in the fourth quarter of 2005, recording an annualised increase of 14½ per cent. This was the result of an increase in real expenditure on goods and non-wage services, which *inter* *alia* included the acquisition of a submarine by the South African Navy as part of the defence procurement programme. Final consumption expenditure by general government as a percentage of gross domestic product consequently increased from 20 per cent in the third quarter of 2005 to 20½ per cent in the fourth quarter. However, year-on-year growth in real final consumption expenditure by general government decelerated from 7 per cent in 2004 to 5½ per cent in 2005.

Real gross fixed capital formation

Real gross fixed capital formation rose at brisk annualised rates of 7 per cent in the third quarter of 2005 and 7½ per cent in the fourth quarter. The increase in the fourth quarter reflected a solid expansion of real capital outlays by private business enterprises and public corporations, whereas real gross fixed capital formation by general government recorded no growth over this period. The year-on-year level of total real gross fixed capital formation rose by 8 per cent in 2005, just short of the 9-per-cent increase attained in 2004.

Growth in real gross fixed capital formation in the *private sector* picked up from 7½ per cent in the third quarter of 2005 to 8 per cent in the fourth quarter. The manufacturing, construction and commerce sectors stepped up real gross fixed capital formation which more than offset a contraction in real capital expenditure by the agriculture and mining sectors. Capital investment by the agricultural sector remained low partly on account of the lustreless performance of key agricultural product prices. Real fixed investment by manufacturing rose as the automotive and steel manufacturers continued to expand capacity in response to domestic and global demand. Briskly expanding construction activity and the prospect of further projects in the pipeline contributed to higher real capital expenditure in the construction sector. Moreover, the sustained high level of activity in retail and motor trade boosted growth in real gross fixed capital formation in the commerce sector.

Real gross fixed capital formation



Real gross fixed capital formation by public corporations picked up momentum from annualised growth of 12 per cent in the third quarter of 2005 to 15½ per cent in the fourth quarter. *Public corporations* stepped up spending to upgrade the capacity of the electricity distribution network and to expand ports and harbours so as to relieve congestion and accommodate larger container ships, thereby facilitating increased external trade.

Gross fixed capital formation by *general government* lagged that of the other institutional sectors partly due to capacity constraints. Capital expenditure on key projects to address infrastructure backlogs is to be stepped up in later periods. However, the provincial government increased capital investment in the fourth quarter of 2005, mostly geared towards the maintenance of the road network.

Current estimates indicate that, following strong accumulation in the third quarter of 2005, *real inventories* rose very little in the fourth quarter. Inventory investment slowed in the manufacturing sector partly due to low imports of crude oil and problems experienced with the change-over to unleaded fuel in the country. Inventories were actually depleted in the mining and trade sectors, with the depletion in the trade sector mainly in agricultural stock-in-trade. Accordingly, real inventories subtracted about 4 percentage points from the rate of growth in gross domestic expenditure in the fourth quarter of 2005. The ratio of industrial and commercial inventories relative to gross domestic product declined from 15 per cent in the third quarter of 2005 to 14½ per cent in the fourth quarter.

Factor income

The growth in total *factor income*, measured over four quarters, accelerated from 8 per cent in the third quarter of 2005 to 10½ per cent in the fourth quarter. This was mainly a reflection of faster growth in the operating surpluses of business enterprises, while the rate of increase in compensation of employees remained virtually unchanged from the second and third quarters of 2005.

The year-on-year rate of increase in *compensation of employees* amounted to 9 per cent in the fourth quarter of 2005. An analysis of compensation of employees by economic sector indicates that growth in compensation of employees remained broadly the same in most sectors from the third to the fourth quarter. A gradual downward trend in the annual growth of compensation of employees emerged with growth slowing from 10 per cent in 2002 to 9 per cent in 2005.

In contrast to compensation of employees, growth in the *gross operating surpluses* of business enterprises, measured over a year, accelerated from 7½ per cent in the third quarter of 2005 to 12½ per cent in the fourth quarter. The main beneficiaries of the strong increase were the construction sector, trade and the finance, insurance, real-estate and business services sectors. These increases reflected the higher output in these economic sectors during the fourth quarter. Notwithstanding these developments, the ratio of gross operating surplus to total factor income remained at roughly 50 per cent in both the third and fourth quarters of 2005.

Gross saving

The national savings ratio or *gross saving as a percentage of gross domestic product* declined from 14 per cent in the third quarter of 2005 to 13 per cent in the fourth quarter. The decline in the savings ratio in the fourth quarter was mainly due to a weaker saving performance of the general government which offset the saving of the corporate sector. Gross saving of the household sector as a percentage of gross domestic product was sustained at the same rate as in the third quarter. The national savings ratio for the year 2005 amounted to 13½ per cent, down from 14 per cent recorded in 2004, on account of a decline in saving by the private sector.

Gross saving by the *corporate sector* as a percentage of gross domestic product increased from 10½ per cent in the third quarter of 2005 to 11 per cent in the fourth quarter, mainly on account of strong growth in operating surpluses of business enterprises. Despite the improved performance in the fourth quarter, the corporate savings ratio declined from 12 per cent in 2004 to 11 per cent in 2005. This deterioration was due to strong growth in dividends declared – stronger than the growth in operating surpluses. As a matter of fact, for 2005 as a whole the growth in dividends declared was double the growth in operating surpluses. Corporations were able to declare sizeable increases in dividends partly on account of substantial cash holdings.

The growth in real disposable income of households for 2005 amounted to 6½ per cent, but final real consumption expenditure increased by 7 per cent, thus putting the saving of the *household sector* under some strain. Accordingly, the gross savings ratio of households declined slightly from 2 per cent in 2004 to just below 2 per cent in 2005.

Although the gross saving by *general government* as a percentage of gross domestic product weakened from 1½ per cent in the third quarter of 2005 to less than ½ a per cent in the fourth quarter, the savings ratio improved substantially to 1 per cent for 2005 as a whole, compared to a ratio of less than zero per cent recorded in 2004. This was mainly due to an increase in tax revenue collected, which comfortably offset growth in recurrent expenditure.

Employment

The most recent *Labour Force Survey* (LFS) released by Statistics South Africa indicates that in the year to September 2005 overall employment in South Africa rose at a significantly faster pace than in preceding years. The number of employed persons increased by 658 000, or by 5,7 per cent, over the year to around 12,3 million in September 2005. Notwithstanding the generally improved prospects for employment, the rate of unemployment remained broadly unchanged at 26,7 per cent in September 2005 compared with 26,2 per cent in September 2004. The increase over this period in the number of people officially classified as unemployed could partly be explained by the fact that about 600 000 discouraged job-seekers, who previously did not actively seek employment, started to engage in active job-searching and accordingly qualified for inclusion as part of the officially unemployed. Following a persistent upward trend in unemployment to roughly 5,1 million in March 2003, unemployment declined to around 4,1 million in September 2004 before rising again to 4,5 million in September 2005.

Enterprise-surveyed formal non-agricultural employment increased meaningfully during the six months to September 2005, following job losses in the closing months of the preceding year and the opening months of 2005. According to the *Quarterly Employment Statistics* (QES) survey by Statistics South Africa, enterprise-surveyed formal non-agricultural employment increased at an annualised quarter-to-quarter rate of 7,8 per cent in the second quarter of 2005 and 5,9 per cent in the third quarter, with a total of around 235 000 job gains over this two-quarter period. Consistent with the continued robust performance of the domestic economy, employment gains were fairly widespread throughout the economy with both the private and public sector expanding their employee complements over this period.

Enterprise-surveyed *private-sector* employment shrank in the six months to March 2005 but rebounded during the subsequent six months. Employment rose at annualised rates of 9,8 per cent in the second quarter and 6,3 per cent in the third quarter of 2005, with the strongest third-quarter increases recorded in the transport, storage and communication sector. Meaningful increases were also registered in the construction sector, the trade, catering and accommodation services sector, as well as in the finance, insurance, real-estate and business services sector over the same period. In the mining sector, however, some labour paring was registered in the third quarter of 2005.

The firm upward trend in the level of *public-sector* employment from the middle of 2002 lost some momentum in the first half of 2005 but regained its vigour in the third quarter. Moreover, the pace of increase in employment gains accelerated significantly from an annualised quarter-to-quarter rate of 1,4 per cent in the second quarter of 2005 to 4,7 per cent in the third quarter. Employment gains at local government level significantly outpaced those at other levels of the public sector over the period – limited employment losses were registered only in the governmental transport, storage and communication sector. Measured over four quarters, public-sector employment increased by as much as 3,7 per cent in the third quarter of 2005 – the fastest pace of increase in public-sector employment in the current expansionary phase of employment growth which started in the third quarter of 2002.

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

	Sep 2004 to Mar 2005	Mar 2005 to Sep 2005	Total for year to Sep 2005	Percentage change
Gold mining	-16 000	-12 000	-28 000	-15,3
Non-gold mining	6 000	8 000	14 000	5,1
Manufacturing	-38 000	20 000	-18 000	-1,5
Electricity supply	-300	800	500	1,2
Construction	19 000	66 000	85 000	23,8
Trade, catering and accommodation	25 000	46 000	71 000	5,4
Transport, storage and communication	7 000	25 000	32 000	16,1
Finance, insurance, real-estate and business services	-216 000	53 000	-163 000	-9,8
Community, social and personal services	14 000	4 000	18 000	6,2
Total private sector	**-199 000**	**211 000**	**12 000**	**0,2**
National, provincial and local government	40 000	27 000	67 000	4,9
Public-sector enterprises	-6 000	-3 000	-9 000	-4,9
Total public sector	**34 000**	**24 000**	**58 000**	**3,7**
Grand total	**165 000**	**235 000**	**70 000**	**1,0**

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

Indications are that labour market conditions remained favourable for further employment gains in the closing months of 2005. The volume of job advertisements in the print media, which has historically been fairly well correlated with formal non-agricultural employment, rose further in the fourth quarter of 2005. At the same time, business confidence according to the Rand Merchant Bank/Bureau for Economic Research Business Confidence Index remained at exceptionally high levels in all sectors of the economy.

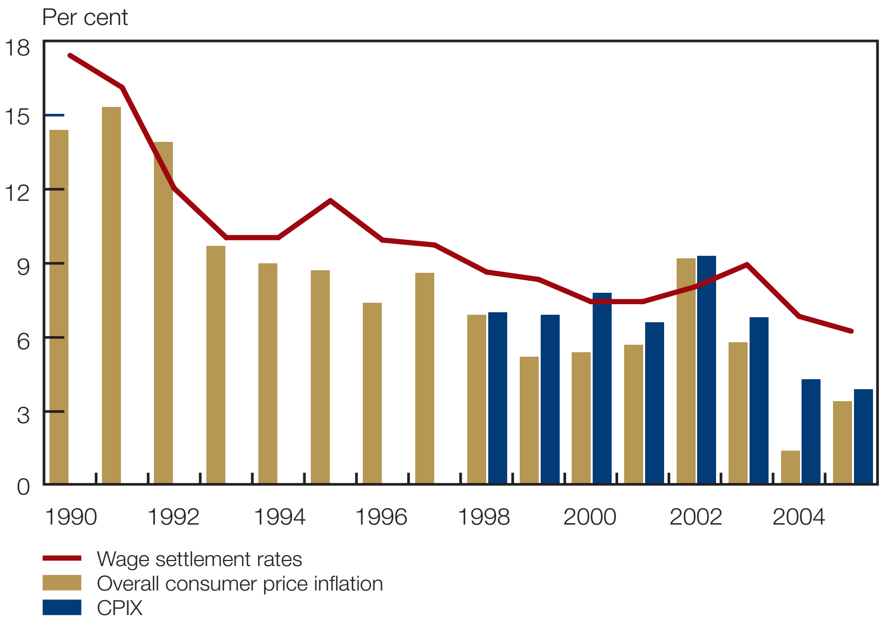
The number of man-days lost due to strikes and other forms of work stoppages more than doubled from 1,1 million in 2004 to 2,3 million during 2005. Industrial action related to wage disputes accounted for 88,9 per cent of the number of man-days lost during the year. Industrial action occurred in almost 25 per cent of all wage negotiations in 2005, compared with a more sanguine labour relations environment in 2004 when industrial action occurred in only about 7 per cent of instances.

Labour cost and productivity

Consistent with the general moderation of inflationary pressures in 2005, the pace of increase in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy slowed from an annual average rate of 9,1 per cent in 2004 to 7,6 per cent in the year to the second quarter of 2005. Job losses in the mining sector were biased towards workers on the lower remuneration scales, thereby pushing up the average remuneration earned by those remaining in employment and leading to accelerated remuneration growth per worker in the mining sector in the third quarter of 2005. Consequently, nominal wage growth per worker in the formal non-agricultural sector accelerated somewhat to 7,9 per cent in the year to the third quarter of 2005 but remained below the rates of increase in preceding years. In contrast with the acceleration in private-sector nominal remuneration growth in the year to the third quarter of 2005, public-sector nominal remuneration growth decelerated somewhat over this period.

When measured over four quarters, average salaries, wages and pensions deposited into the bank accounts of almost 5 million salaried and retired workers, as indicated by the Automated Clearing Bureau, increased by 7,7 per cent in the fourth quarter of 2005.

Wage settlement rates and consumer price inflation

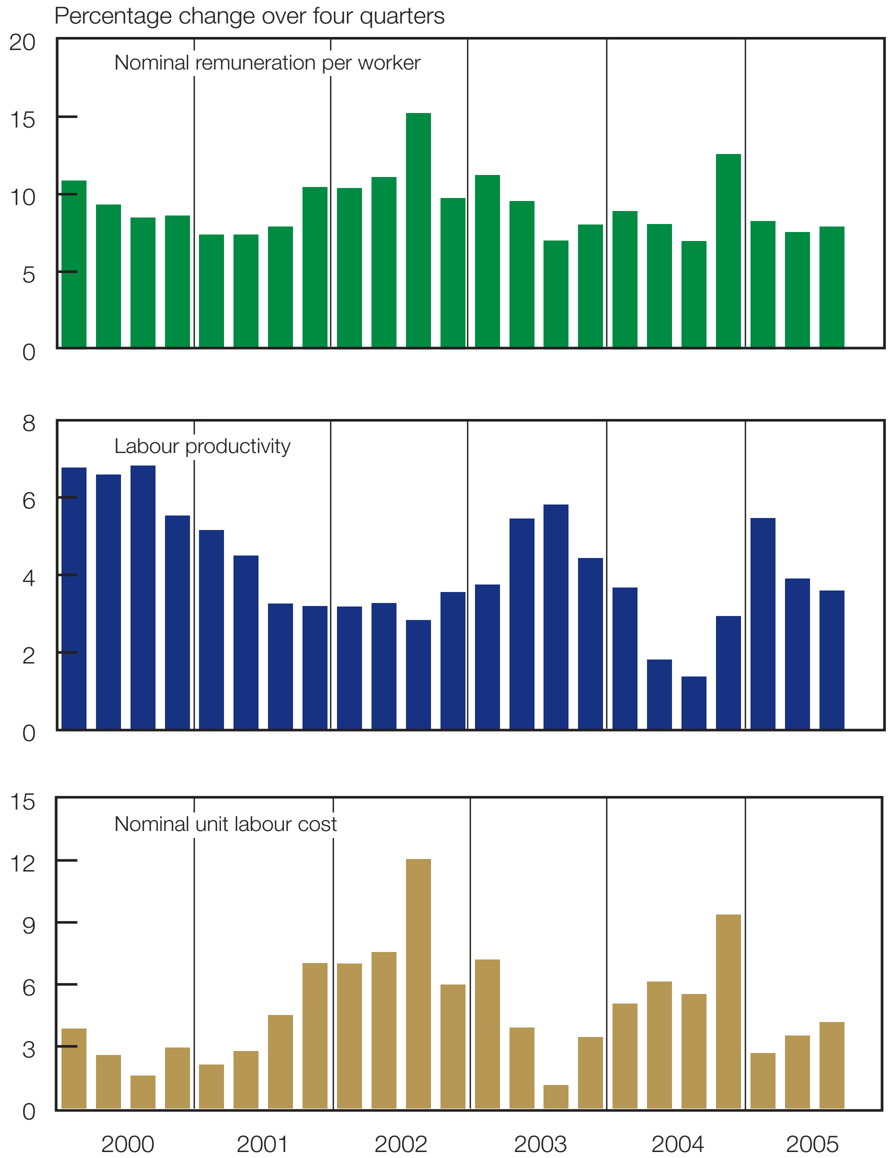


This rate of increase was only marginally higher than in the third quarter. According to Andrew Levy Employment Publications, the average wage settlement rate in collective bargaining agreements decreased from 6,8 per cent in 2004 to 6,3 per cent in 2005. The growth in the average *minimum* monthly wage paid across all sectors, however, accelerated from 7,4 per cent in 2004 to 8,4 per cent in 2005. A sectoral determination governing the increases in minimum wages for workers in the wholesale and retail sector afforded these workers an increase of 5,6 per cent, effective from 1 February 2006. A higher rate of increase of 8,8 per cent was effected in February 2005.

The growth in nominal remuneration per worker in the *public sector* decelerated from an annual average rate of 9,1 per cent in 2004 to 6,9 per cent in the year to the first quarter of 2005, but accelerated to 9,2 per cent in the year to the second quarter. This rate of increase subsequently slowed to 8,0 per cent in the third quarter of 2005 as nominal remuneration increases moderated in the overall public sector, except at national department level.

Unlike the slowdown in the year-on-year pace of increase in nominal wage growth in the public sector from the second to the third quarter of 2005, remuneration increases granted by *private-sector* enterprises rose somewhat over this period, i.e. from a year-on-year rate of 6,6 per cent to 7,5 per cent. In conjunction with the already mentioned acceleration in nominal wage growth in the mining sector, higher rates of increase in average remuneration

Nominal remuneration per worker, labour productivity and unit labour cost in the non-agricultural sector



per worker in the finance, insurance, real-estate and business services sector also pushed overall private-sector wage growth higher. Apart from these two sectors, wage growth actually slowed in the remaining sectors in the third quarter of 2005.

With formal non-agricultural employment declining steeply in the first quarter of 2005, *labour productivity growth* accelerated to a year-on-year rate of 5,5 per cent in that quarter. Following a renewed increase in employment, year-on-year growth in real production per worker slowed to 3,9 per cent in the second quarter of 2005 and to 3,6 per cent in the third quarter. Even though labour productivity growth in the manufacturing sector also decelerated, amounting to a year-on-year rate of 5,3 per cent in the third quarter of 2005, it still exceeded economy-wide labour productivity growth by a fair margin.

The increase in the *cost of labour per unit of production* in the formal non-agricultural sector was contained at a year-on-year rate of 2,7 per cent in the first quarter of 2005, meaningfully lower than the annual average increase of 6,5 per cent in 2004. Following the moderation in labour productivity growth in the second and third quarters of 2005, the year-on-year rate of increase in nominal unit labour cost accelerated to 4,2 per cent in the third quarter. Unlike the acceleration in the pace of increase in nominal unit labour cost in the overall formal non-agricultural sectors of the economy in the third quarter of 2005, unit labour cost growth in the manufacturing sector slowed quite substantially. The pace of increase in nominal unit labour cost in the manufacturing sector decelerated from a year-on-year rate of 4,4 per cent in the first quarter of 2005 to almost zero in the third quarter, as production rose.

Prices

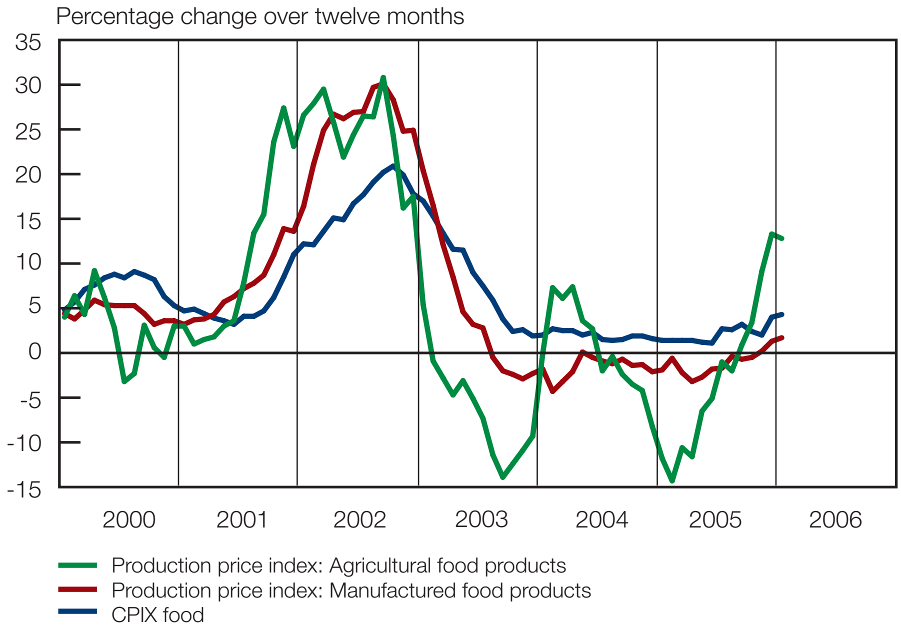
CPIX consumer price inflation remained well contained in 2005. Year-on-year CPIX inflation has remained within the inflation target range of between 3 and 6 per cent for 29 consecutive months up to January 2006, while in the past year CPIX inflation has remained mostly below the midpoint of the range. Having amounted to 9,3 per cent as recently as 2002, CPIX inflation moderated to 4,3 per cent in 2004 and 3,9 per cent in 2005. The appreciation in the exchange value of the rand in the second half of 2005, together with relatively subdued rates of increase in food prices, helped to keep a lid on consumer price inflation. At the same time production price inflation picked up from an average annual rate of 0,6 per cent in 2004 to a still-low 3,1 per cent in 2005, mainly due to a persistent increase in international crude oil prices.

International Brent crude oil prices rose from a monthly average of US$40 per barrel in December 2004 to US$57 per barrel in December 2005 and to US$63 per barrel in January 2006. As a result, year-on-year inflation in the *production prices of imported goods* accelerated substantially from 0,3 per cent in January 2005 to 6,4 per cent in January 2006. Inflation in the prices of imported agricultural products, inclusive of food, also contributed to the acceleration in imported goods price inflation in recent months. When measured from quarter to quarter and expressed at an annualised rate, inflation in the prices of imported goods nonetheless decelerated meaningfully from 13,9 per cent in the third quarter of 2005 to only 0,8 per cent in the fourth quarter. This could largely be attributed to a decline in international crude oil prices from US$61½ per barrel to US$57 per barrel over the same period.

While the import prices of goods in the mining and quarrying category (inclusive of crude oil), weighing 9,9 per cent in the imported goods price index, rose by no less than 48,1 per cent in the year to January 2006, various other categories with a combined weight of about 32 per cent were still experiencing rates of price *decline* over this period. These price declines mainly reflected the renewed appreciation of the exchange value of the rand from the second half of 2005. The most prominent among these categories experiencing price declines were radio, television and communication equipment as well as office, accounting and computing machinery. More generally, international production price pressures remained well contained: The year-on-year rate of increase in the composite wholesale price index of South Africa's main trading-partner countries decelerated from around 4,5 per cent in the closing months of 2004 to 3,4 per cent in December 2005.

Year-on-year inflation in the production prices of *domestically produced goods* picked up decisively from around the 2-per-cent level during the first half of 2005 to 5,2 per cent in January 2006. Over and above the steep increases in the prices of petroleum and coal products in the year to January 2006, the production prices of fishing products rose by 15,0 per cent, agricultural food products by 12,8 per cent and electrical machinery and apparatus by 12,2 per cent over the period. Inflation pressures in the prices of the other categories of domestically produced goods were relatively muted. In contrast to the marked acceleration in inflation in the prices of agricultural food products, the prices of manufactured food products increased by only 1,7 per cent in the year to January 2006. This rate of increase nonetheless was significantly higher than in preceding months when manufactured food prices generally declined.

Food prices



From fairly subdued year-on-year rates of increase in the opening months of 2005, *all-goods production price* inflation started to advance at a relatively brisk pace towards the end of 2005. The pace of increase in the all-goods production price index actually accelerated almost five-fold in the year to January 2006, i.e. from a year-on-year rate of 1,2 per cent in February 2005 to 5,5 per cent in January 2006. However, when omitting the rise in energy prices from the calculation, all-goods production prices would have increased by 3,5 per cent in the year to January 2006. Following a deceleration in the quarter-to-quarter pace of increase in the prices of both imported and domestically produced goods, all-goods production price inflation decelerated meaningfully to an annualised rate of 3,5 per cent in the fourth quarter of 2005, less than half of what it had been in the preceding quarter.

Price movements in the building and construction industry

Activity in the building and construction industry gained considerable momentum from 2003. As shown in the accompanying graph, this was reflected in a rise in building costs beyond the overall pace of inflation in the economy, as the buoyancy of activity plays a pivotal role in price movements in this cyclically sensitive industry.

When price changes are analysed for the building and construction industry, a distinction may be drawn between changes in the cost of building materials and the cost to the client, i.e. the homeowner or property investor, of the completed building. The cost to the client (or so-called tender price) allows not only for building materials but also for items such as labour, fuel and the profit margin of the contractor. The building cost index of the Bureau for Economic Research (BER) is an indicator of tender prices.

According to the BER building cost index *tender prices,* or the cost of newly completed buildings, rose by around 85 per cent in the past six years. It thereby outpaced the general price level, as proxied by CPIX or by overall production prices, by a considerable margin. Factors accounting for the difference between these rates of change include the degree of competition in the tendering process as well as the availability of labour and material inputs, and are strongly related to the stance of the business cycle. When conditions are booming in the building industry, tender prices rise more rapidly than input costs as building contractors find themselves in a better position to widen their profit margins. Inversely, during a recessionary phase in the building industry, tender prices rise less rapidly than input costs.

The prices of *building materials* are also sensitive to demand conditions, although not necessarily to the same extent as building contractors' margins. According to the production price index for building and construction material as published by Statistics South Africa, the prices of building and construction materials rose by around 60 per cent from January 2000 to September 2005, while the prices of new buildings completed, as already mentioned and indicated by the BER building cost index, rose by around 85 per cent over the same period. The increase in the production prices of building and construction materials of 60 per cent from January 2000 to January 2006 was well in excess of the rise in the all-goods production price index of around 40 per cent over the same period. Increases in the prices of individual materials varied around the average rise of 60 per cent over this period. Examples exceeding the average include stock bricks, with an increase of 99 per cent; face bricks, 87 per cent; cement, 99 per cent; structured steel products, 75 per cent; and cement building blocks, 108 per cent. By contrast, the production price of glass rose by only 6 per cent and that of floor and wall tiles by 9 per cent.

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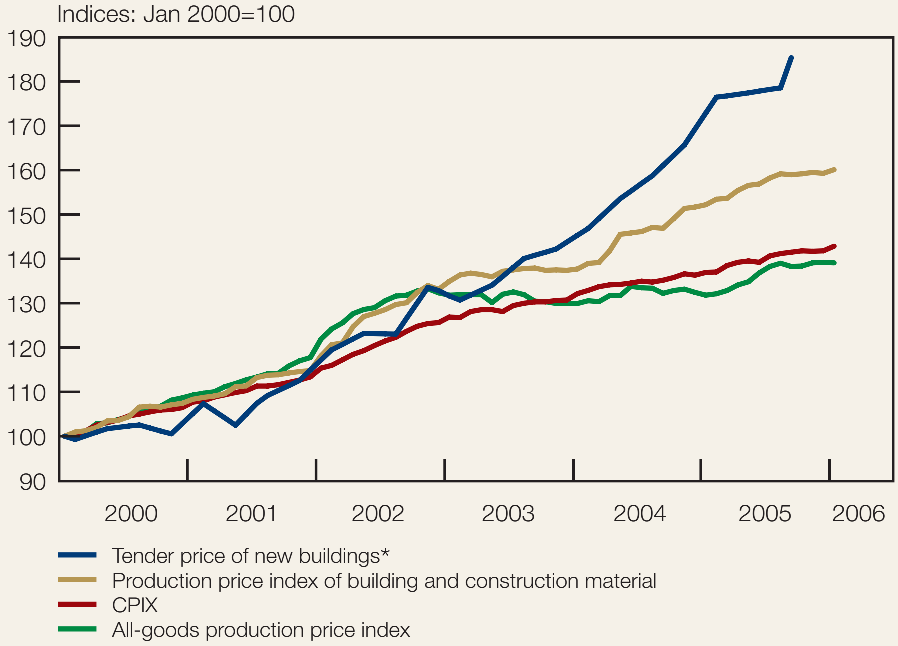
Building and construction cost



* As captured by the BER building cost index

Production prices

Quarter-to-quarter percentage change at annualised rates

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

In the course of 2005, *CPIX inflation* initially accelerated significantly as domestic petrol prices were raised in response to the increase in the international price of crude oil. The domestic price of petrol rose by as much as 60 per cent in the 21 months to October 2005, but subsequently decreased, on balance, by about 9 per cent to February 2006. CPIX inflation accordingly decelerated from a most recent high of 4,8 per cent in the year to August 2005, to 3,7 per cent in the year to November as petrol price declines were effected. The already mentioned increases in agricultural food prices elevated the average level of consumer food prices, leading to an acceleration in year-on-year CPIX inflation to 4,3 per cent in January 2006.

Despite some upward movement in year-on-year consumer price inflation in December 2005, the quarter-to-quarter pace of CPIX inflation decelerated to an annualised rate of 2,9 per cent in the fourth quarter of the year. This rate of increase was less than half of what it had been in the third quarter of 2005 and also slightly below the lower limit of the inflation target range. A decline in the domestic price of petrol was not the only factor which moderated the quarter-to-quarter pace of increase in CPIX inflation in the fourth quarter of 2005, but was reinforced by declines in the prices of new and used vehicles, clothing and footwear as well as furniture and equipment. These decreases were most probably related to the appreciation in the value of the rand during that period.

While year-on-year CPIX goods price inflation became fairly erratic in recent months due to changes in the price of petrol, *CPIX services* price inflation decelerated consistently during the second half of 2005. Since subsiding to below the upper limit of the inflation target range from July 2005, CPIX services price inflation progressively slowed to a year-on-year rate of 4,3 per cent in January 2006 – the lowest rate of increase since the inception of the CPIX measure in January 1997. At a quarter-to-quarter and annualised rate of 3,4 per cent, CPIX services price inflation in the fourth quarter of 2005 also receded to its lowest level recorded since the existence of the indicator. The slowdown in CPIX services price inflation was mainly the result of waning housing services price inflation, which fell from an annualised rate of 7,8 per cent in the second quarter of 2005 to only 1,0 per cent in the fourth quarter. Disconcerting is the acceleration in price inflation in the category for services other than housing and transport in the fourth quarter of 2005.

CPIX goods price inflation generally remained below 3 per cent during the first half of 2005, but accelerated to a year-on-year rate of 4,4 per cent in September as higher petrol prices added to inflationary pressures. Receding energy price inflation in subsequent months and outright declines in the prices of furniture and equipment, clothing and footwear as well as new and used vehicles, contained goods price inflation to 3,7 per cent in the year to December 2005, despite a pick-up in consumer food price inflation. As consumer food price inflation rose further, CPIX goods price inflation rebounded to 4,4 per cent in the year to January 2006. At a year-on-year rate of 4,2 per cent in January 2006, *CPIX food price inflation* had more than tripled from seven months earlier. As far as the remaining goods in the CPIX basket are concerned, their twelve-month rates of price increase remained fairly stationary at around the 3-per-cent level during the past year. The pass-through from petrol prices to prices of other goods therefore remained fairly limited.

As indicated in the accompanying table, only three of the ten main components, constituting roughly a quarter of the overall CPIX, increased at an average annual rate in excess of six per cent in 2005. Year-to-year inflation in the prices of five components, with a combined weight of around 44 per cent, fell below the lower boundary of the inflation target range, while only two components fell within the range. Year-to-year inflation in transport running cost, being directly related to petrol prices, exceeded price increases in all other categories of goods and services in the past two calendar years.

Inflation in CPIX components

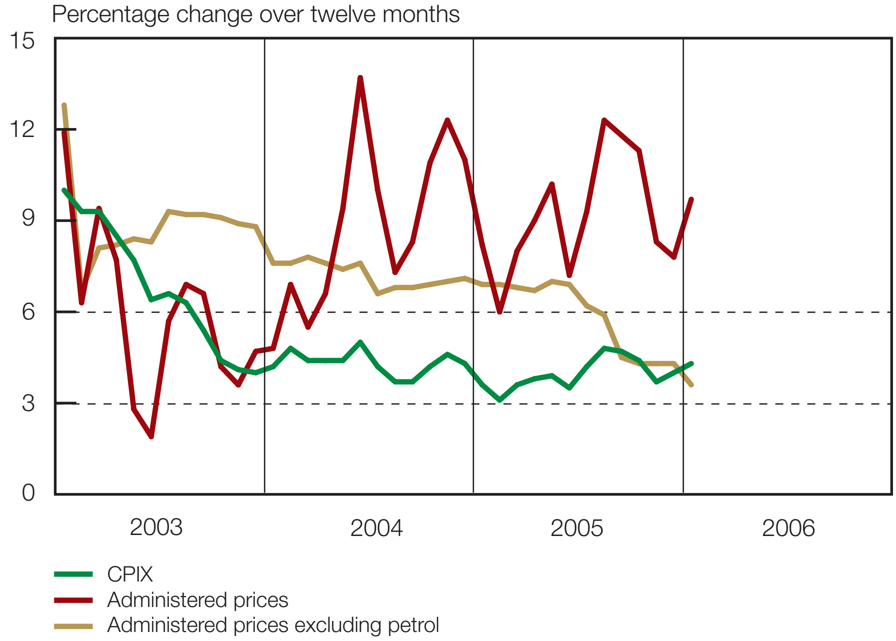
Percentage change over one year

	Weights	2004 (annual average)	2005 (annual average)
Transport running cost	**5,7**	**10,2**	**14,0**
Alcoholic beverages and tobacco	3,1	10,1	8,1
Services excluding housing and transport	16,5	6,5	6,2
Total housing services	13,4	8,7	*5,9*
Total other goods (not included elsewhere)	17,5	*3,6*	*3,1*
Food	26,9	2,0	2,1
Total transport services	3,9	*3,5*	1,9
Furniture and equipment	3,2	0,5	-0,5
Vehicles	5,7	-0,8	-1,2
Clothing and footwear	4,1	-3,8	-3,4
Total CPIX	**100,0**	***4,3***	***3,9***

Italics denote values inside the inflation target range of between 3 and 6 per cent

In January 2006, year-on-year inflation in the prices of administered goods and services amounted to 8,6 per cent, 4,3 percentage points higher than overall CPIX inflation in that month, but nevertheless substantially lower than the rate of 11,2 per cent four months earlier. However, if petrol prices were excluded, administered prices would have increased at a year-on-year rate of 3,7 per cent in January 2006, even less than overall CPIX inflation. Despite the general deceleration in the twelve-month rate of increase in administered prices, average annual inflation in administered prices remained around 8 per cent during the past two calendar years. Of note is the outcome of the multi-year price determination process, whereby Eskom (the national electricity utility) has been awarded increases in electricity tariffs of 5,1 per cent for the period 1 April 2006 to 31 March 2007, 5,9 per cent in the following twelve-month period and 6,2 per cent in the subsequent twelve-month period by the National Electricity Regulator.

CPIX and administered prices



While rising international crude oil prices and accelerating food price inflation may pose some risk to the inflation environment in coming months, the more recent decline in non-energy administered price inflation was gratifying news.

Foreign trade and payments

International economic developments

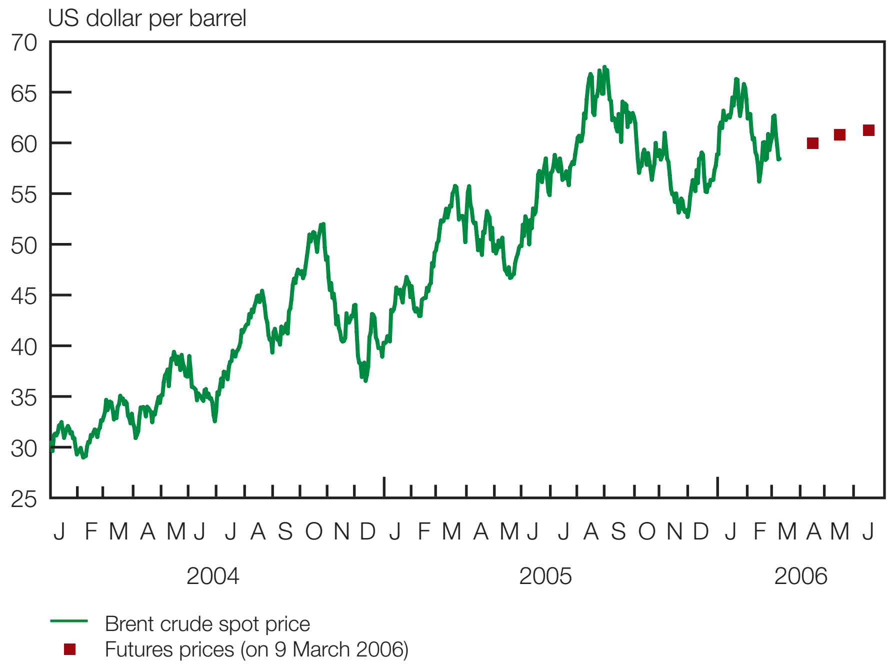
Latest estimates indicate that the global economy continued to expand at a relatively robust pace in the second half of 2005. Output growth is expected to moderate from more than 5 per cent in 2004 to around 4 per cent in 2005, continuing the steady global performance during the past few years driven largely by economic activity in the United States and emerging economies such as China and India.

Real gross domestic production in the United States expanded by 3½ per cent in 2005 notwithstanding slower real economic growth in the fourth quarter. The euro area experienced a modest recovery in 2005 and the Japanese economy displayed signs of emerging from a period of prolonged stagnation. Most major developing economies in Latin America and particularly in Asia continued to grow at a relatively robust pace in the third quarter of 2005. The latest available data releases indicate that many emerging Asian countries also continued to expand rapidly in the final quarter of 2005.

While the outlook for the global economy remains positive, concerns linger regarding the sustained high oil prices and risk of a disorderly adjustment of global current-account imbalances. Concerns have been expressed in some quarters regarding the possibility of an avian influenza pandemic.

After approaching US$70 per barrel at the end of August 2005, the price of Brent crude oil receded below US$53 per barrel towards the end of November before increasing again to levels of around US$66 per barrel at the end of January 2006. The rising trend in crude oil prices since late 2005 could mainly be attributed to the unrest in Nigeria's oil-rich delta and concerns about Iran's nuclear programme. Brent crude oil prices, however, fell below US$57 per barrel in mid-February after a US government report

Brent crude oil prices



showed that US fuel supplies stood at an eleven-month high, while concerns started to fade that Iran would halt crude oil exports if the United Nations considered sanctions on account of its nuclear programme. Crude oil prices again increased towards the end of February, but declined below US$60 per barrel in early March after the Organization of the Petroleum Exporting Countries decided to maintain its current production quotas. Futures prices suggest Brent crude oil prices of around US$61 per barrel in the second quarter of 2006.

Global current-account imbalances have been widening with the increasing US deficit and corresponding surpluses in countries such as Russia, Saudi Arabia, Japan, China and other emerging Asian countries fuelling concerns about sustainability and the potential for a disorderly correction.

After increasing substantially in the second half of 2005, headline inflation rates in the major industrialised countries moderated towards the end of 2005. Core inflation rates (headline inflation excluding energy prices), however, increased slightly. Although annual consumer price inflation increased in most emerging Latin American and Asian economies in the fourth quarter of 2005, inflation remained moderate in these regions.

Since mid-2005 monetary policy has been tightened in Canada, Chile, the Czech Republic, Denmark, the euro area, Hong Kong, India, Indonesia, Israel, Malaysia, New Zealand, South Korea, Sweden, Switzerland, Taiwan, Thailand and the United States. However, the central banks of Brazil, Hungary, Mexico, Poland, Russia and the United Kingdom have lowered interest rates.

Current account[2]

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

In the mature phases of a South African business cycle upswing, domestic expenditure on imported goods and services is buoyant and usually gives rise to growing current-account deficits. This behaviour again came to the fore in 2005: For the year as a whole the negative imbalance on the current account amounted to 4,2 per cent of gross domestic product, compared with approximately 3,4 per cent in 2004.

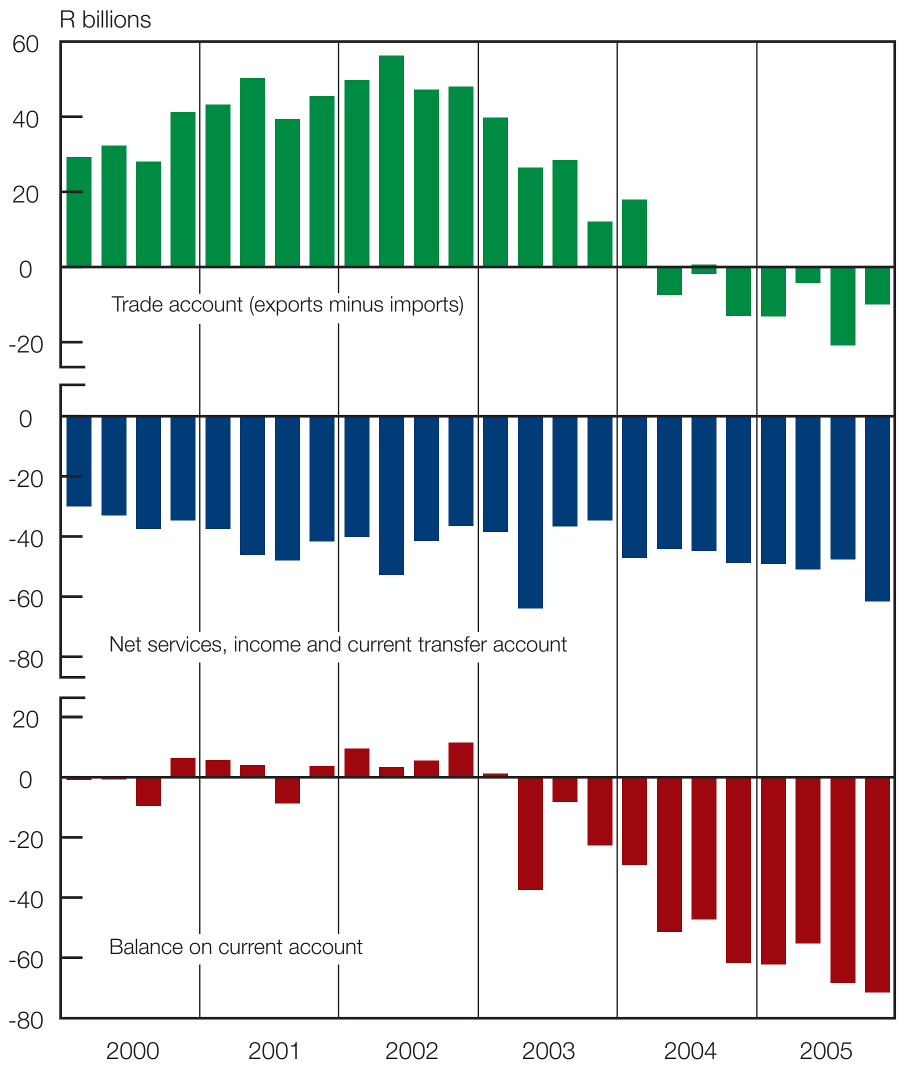
Balance of payments on current account
Seasonally adjusted and annualised
R billions

	2004	2005				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	281,8	281,1	326,7	337,3	337,6	320,7
Net gold exports	28,7	24,9	25,9	26,0	31,3	27,0
Merchandise imports	-311,8	-319,0	-356,8	-384,0	-378,9	-359,7
Trade balance	**-1,3**	**-13,0**	**-4,2**	**-20,7**	**-10,0**	**-12,0**
Net service, income and current transfer payments	-46,2	-49,2	-51,0	-47,7	-61,6	-52,4
Balance on current account	**-47,5**	**-62,2**	**-55,2**	**-68,4**	**-71,6**	**-64,4**

The deficit on the trade account of the balance of payments narrowed considerably in the fourth quarter of 2005, notwithstanding the relative strength of aggregate domestic demand. This smaller trade deficit of 2005 could only partly offset the increased net service, income and current transfer payments to the rest of the world, and the current-account deficit accordingly widened from R68,4 billion in the third quarter of 2005 to R71,6 billion in the fourth quarter.

The smaller trade deficit in the final quarter of 2005 can be attributed mainly to a strong recovery in the value of net gold exports and a decline in the value of imported goods; the value of non-gold merchandise exports remained broadly unchanged over the period.

Balance of payments: Current account



After having increased by 6½ per cent and 3½ per cent in the second and third quarters of 2005, respectively, the *volume of merchandise exports* contracted by about 3½ per cent in the fourth quarter. The decline in export volumes in the final quarter of 2005 can be attributed mainly to a decrease in the physical quantity of manufactured goods exported. Despite the hesitation in the final quarter, South African export volumes rose by no less than 8½ per cent in 2005 as a whole compared with an increase of 5½ per cent in 2004, consistent with the strength of the world economy. As a percentage of gross domestic product, real merchandise exports accordingly increased from 19,2 per cent to 19,9 per cent over the same period. The *prices* of merchandise exports benefited from the robust increase in international commodity prices and rose by about 3½ per cent in the fourth quarter of 2005 despite the appreciation of the rand. Expressed in rand, international commodity prices were approximately 18 per cent higher in the final quarter of 2005 compared with the corresponding period in 2004.

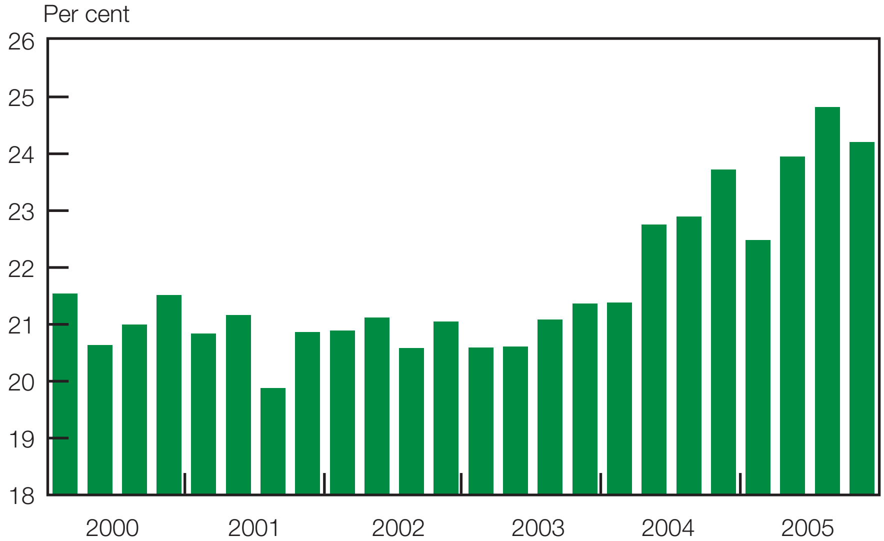
Overall, the nominal value of merchandise exports moved sideways in the fourth quarter of 2005. The value of mining and agricultural goods exported increased whereas the value of manufactured goods receded somewhat. Exports in the category for vehicles and transport equipment and machinery and electrical equipment were mainly responsible for the decline in the value of manufactured exports.

The foreign earnings of South African gold producers remained broadly unchanged in the second and third quarters of 2005, but rose considerably in the fourth quarter. The higher value of *net gold exports* in the fourth quarter resulted from a rise in both volume and price. Having shrunk unabatedly in the first three quarters of 2005, the volume of gold exports rose by about 8½ per cent in the fourth quarter mainly due to a higher average grade of gold-bearing ore milled and a run-down of the stockpile of the gold producers. For the year as a whole, the physical quantity of gold exported nevertheless declined by 12½ per cent.

Having remained fairly stable at a level of around US$428 per fine ounce in the first eight months of 2005, the average fixing price of gold on the London market thereafter rallied, supported by increasing investment demand and geo-political tension, reaching a 25-year high of US$537 per fine ounce on 12 December 2005. The appreciation of the external value of the rand in the fourth quarter of 2005 partly neutralised the higher dollar price of gold; on balance, the average realised rand price of gold increased by 11 per cent from the third to the fourth quarter of 2005, and the value of net gold exports by 20½ per cent.

Mainly on account of a decline in the value of mineral imports, the *value of merchandise imports* declined by 1½ per cent in the fourth quarter of 2005. The acquisition of a naval vessel during this quarter, together with the importation of three aeroplanes in the first quarter of the year, lifted the import value of the category for vehicles and transport equipment by about 20 per cent in 2005 as a whole. At the same time, local producers'

Real imports as a ratio of gross domestic expenditure



acquisition of capital goods led to an increase of 15 per cent in the value of imported machinery and electrical equipment. The value of overall merchandise imports surged by 15½ per cent in 2005.

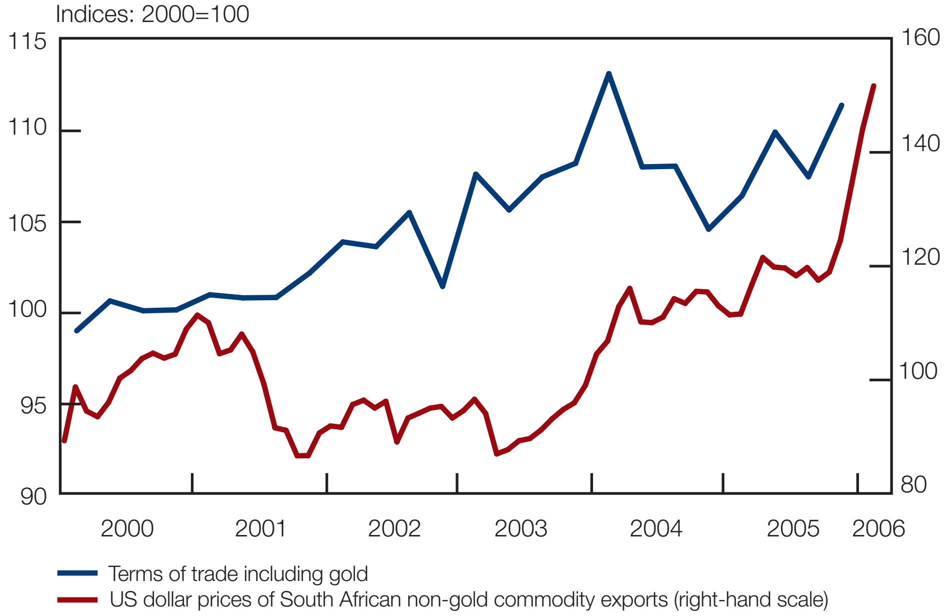
The somewhat slower growth in gross domestic expenditure in the fourth quarter of 2005 coincided with a contraction of about 1½ per cent in the *volume* of *merchandise* imports. For the year as a whole, the volume of merchandise imports nevertheless rose by 11½ per cent. This increase was mainly noted in the category for non-oil imports, as crude oil imports dropped by almost 23 per cent in 2005. The share of oil in the value of merchandise imports fell from 12,1 per cent in 2004 – a year of exceptionally strong oil imports – to 11,6 per cent in 2005. Strong domestic demand for internationally produced goods raised South Africa's import penetration ratio from 22½ per cent in the first quarter of 2005 to 24,2 per cent in the fourth quarter.

Rising output prices in South Africa's main trading-partner countries were partly countered by an increase in the average effective exchange rate of the rand. As a result, import prices moved broadly sideways from the third to the fourth quarter of 2005. Owing mainly to higher international oil prices, the average rand price of imported goods rose by 3½ per cent in 2005 as a whole.

Net service, income and current transfer payments to non-residents increased from R47,7 billion in the third quarter of 2005 to R61,6 billion in the fourth quarter. The larger imbalance on the services account mainly reflected higher dividend payments to non-resident investors following the large-scale acquisition of South African equity securities in 2004 and 2005 – these payments were only partly offset by an increase in tourism expenditure in the country. Furthermore, income receipts from the rest of the world also declined over the period.

South Africa's terms of trade rebounded in the fourth quarter of 2005, after having deteriorated in the third quarter. This improvement resulted from the renewed upward trend in the international prices of commodities produced in South Africa, alongside the more subdued behaviour of international crude oil prices.

Terms of trade and commodity prices



Financial account

Sound macroeconomic policies in South Africa and continued positive investor sentiment towards emerging markets in general gave rise to sizeable capital inflows into the country in 2005. The net capital inflow on the financial account of the balance of payments amounted to R98,4 billion in 2005 – the largest annual inflow ever to be recorded. In the fourth quarter of 2005 the net inward movement of capital came to R22,8 billion; this inflow largely comprised net inflows of direct and other investment capital which was only partly offset by a net outflow of portfolio investment capital.

Net financial transactions not related to reserves
R billions

	2004	2005				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	5,1	1,4	1,4	32,2	5,7	40,7
Portfolio investment	44,9	7,8	25,3	7,3	-4,1	36,3
Other investment	10,9	22,3	-2,4	1,9	0,3	22,1
Change in assets						
Direct investment	-8,8	-0,6	3,2	-1,7	-1,3	-0,4
Portfolio investment	-6,0	2,3	-1,5	-3,2	-3,4	-5,8
Other investment	-2,1	-6,3	0,7	-26,4	9,2	-22,8
Total financial transactions*......	**84,6**	**16,3**	**35,1**	**24,2**	**22,8**	**98,4**

* Including unrecorded transactions

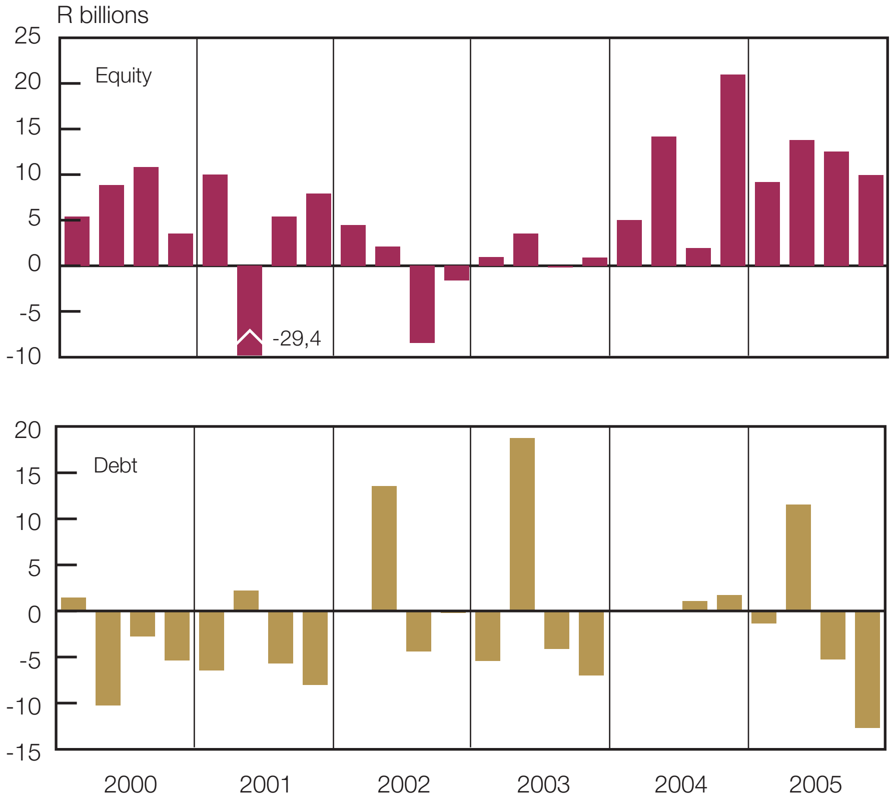
Foreign-owned assets in South Africa

Foreign direct investment into South Africa remained positive in the fourth quarter of 2005. The large inflow of capital in the third quarter of 2005 when a bank domiciled in the United Kingdom obtained the controlling interest in a local bank, was followed by a much smaller inflow of R5,7 billion in the fourth quarter. This inflow of capital resulted largely from the merger of a local and foreign commodity company and the acquisition of a local construction equipment company by a foreign company. A United Kingdom cellular company also initiated the purchase of shares in a South African listed holding company with the eventual aim of acquiring all the shares in this company. Foreign direct investment into South Africa amounted to R40,7 billion in 2005 compared with an inflow of R5,1 billion in 2004, demonstrating increased non-resident appetite for such investment.

After having recorded capital inflows for seven consecutive quarters, *foreign portfolio investment* into South Africa registered an outflow of R4,1 billion in the fourth quarter of 2005. The turnaround in inward portfolio investment could be attributed to a reduction in non-resident investors' holdings of South African fixed-interest securities as well as the redemption of a euro-denominated bond to the value of R1,6 billion by a South African parastatal. For 2005 as a whole inward portfolio investment nevertheless amounted to a healthy R36,3 billion, which may be compared with an inflow of R44,9 billion in the preceding year.

Other foreign investment into South Africa declined from an inflow of R1,9 billion in the third quarter of 2005 to an inflow of R0,3 billion in the fourth quarter. The inflow of capital in the fourth quarter of 2005 mainly reflected an increase in foreign loan finance and in non-resident investors' foreign-currency deposits with South African banks, which was only partly offset by a sizeable decrease in the foreign investors' short-term rand-denominated deposits with South African banks. Largely due to a substantial increase in foreign deposits with South African banks in the first quarter of 2005, the increase in other investment liabilities amounted to R22,1 billion in 2005 – more than double the inflow of capital recorded in 2004.

Portfolio investment liabilities



South African-owned assets abroad

Outward direct investment (i.e. the acquisition of foreign direct investment assets) declined from R1,7 billion in the third quarter of 2005 to R1,3 billion in the fourth quarter. The outflow of capital in the fourth quarter partly reflected an expansion of the equity capital in an Australian mining company held by a local mining company. At the same time a South African business services company reduced its foreign direct investment assets. For 2005 as a whole, outward foreign direct investment amounted to R0,4 billion, i.e. much less than in 2004.

Outward investment in portfolio assets increased from R3,2 billion in the third quarter of 2005 to R3,4 billion in the fourth quarter. In addition to the acquisition of foreign portfolio assets by South African institutional investors, private individuals also increased their holdings of foreign portfolio assets over the period. Cumulatively, the purchase of foreign equity and debt securities came to R5,8 billion in 2005 – roughly the same amount invested in 2004.

Other outward investment contracted by R9,2 billion in the fourth quarter of 2005 compared with an increase of R26,4 billion recorded in the third quarter. The reduction in the claims of South African entities on non-resident parties emanated from a decrease in both rand and foreign-currency deposits of South African banks abroad. For the year 2005 as a whole, other foreign investment assets increased by R22,8 billion, substantially higher than the capital outflow of R2,1 billion recorded in 2004.

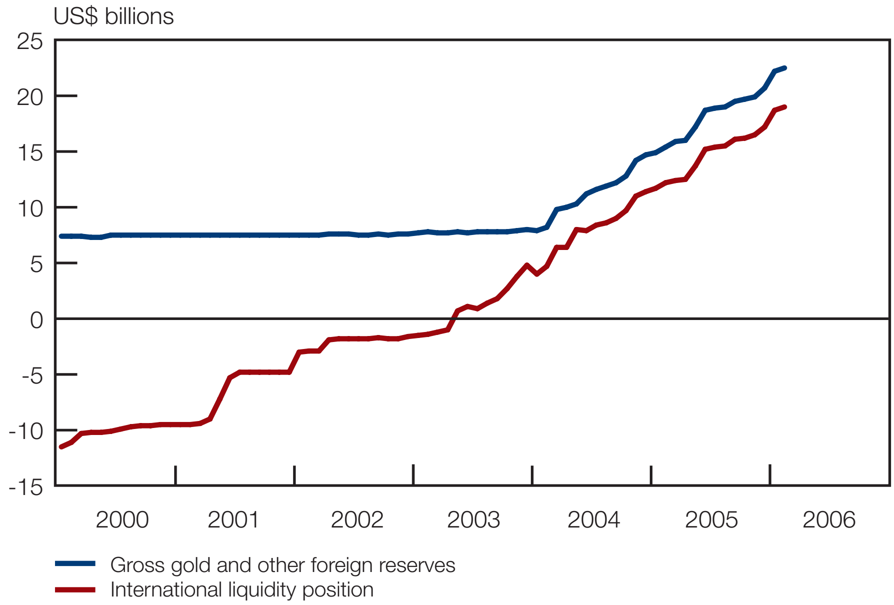
Continuing to pursue the existing strategy of gradual relaxation of exchange control regulations, the Minister of Finance announced the following further relaxations in the February 2006 Budget:

- The offshore foreign currency allowance for individuals was increased from R750 000 to R2 million.
- South African corporates could henceforth undertake foreign direct investment into Africa by acquiring 25 per cent of the target company, instead of the 50 per cent which was previously required.

International reserves and liquidity

The sizeable net inflow of capital in the fourth quarter of 2005 was sufficient to finance the shortfall on the current account. South Africa's overall balance of payments (i.e. the change in the country's net international reserves due to balance of payments transactions) accordingly improved by R6,6 billion in the fourth quarter of 2005 following an increase of R4,6 billion in the preceding quarter. The country's overall balance of payments registered sizeable consecutive surpluses amounting to no less than R37,5 billion and R34,3 billion in 2004 and 2005, respectively.

Gross gold and other foreign reserves and international liquidity position of the Bank



Measured in US dollars, the value of the gross gold and other foreign reserves of the South African Reserve Bank increased from US$19,5 billion at the end of September to US$20,6 billion at the end of December 2005 and further to US$22,5 billion at the end of February 2006. On balance, the country's official reserves rose by US$5,9 billion in

2005. The utilisation of short-term credit facilities by the Bank remained roughly unchanged at US$3,5 billion from the end of July 2004 to the end of February 2006.

The South African Reserve Bank's international liquidity position improved from US$16,1 billion at the end of September 2005 to US$17,2 billion at the end of December and further to US$19,0 billion at the end of February 2006.

Gold and foreign exchange reserves of selected emerging-market countries

End December 2005	Gold and foreign exchange reserves		Short-term foreign debt/ gold and foreign exchange reserves (per cent)*
	Total US$ billion	Per capita US$	
Argentina	28,1	728	n/a
Brazil	53,8	292	30,8
Egypt	21,9	313	n/a
India	137,2	141	5,8
Indonesia	34,7	151	n/a
Malaysia	70,5	2 698	22,3
Mexico	68,7	705	n/a
Poland	42,7	1 118	57,8
Russia	182,2	1 195	25,4
Thailand	52,1	835	33,6
Turkey	52,4	727	84,9
South Africa	**20,6**	**439**	**69,5**

* Based on end September 2005 data

Despite the gradual accumulation of foreign reserves, with total holdings rising from US$7,7 billion at the beginning of 2003 to US$20,6 billion at the end of December 2005, the level of South Africa's gross gold and foreign reserves still remains relatively modest when compared with the international reserve assets of many other emerging-market countries, as shown in the table.

Foreign debt

South Africa's total outstanding foreign debt rose from US$46,1 billion at the end of June 2005 to US$46,8 billion at the end of September. This increase can be attributed entirely to an increase in rand-denominated debt, since foreign-currency denominated debt remained roughly unchanged during the third quarter of 2005.

Foreign debt of South Africa

US$ billions at end of period

Period	2004	2005		
		1st qr	2nd qr	3rd qr
Foreign-currency denominated debt	**27,9**	**28,8**	**28,3**	**28,3**
Bearer bonds	9,7	9,4	9,1	9,8
Public sector	4,9	4,6	4,5	4,6
Monetary sector	7,0	8,1	8,1	7,5
Non-monetary private sector	6,3	6,7	6,6	6,4
Rand-denominated debt	**15,4**	**17,7**	**17,8**	**18,5**
Bonds	5,5	6,1	7,3	6,5
Other	9,9	11,6	10,5	12,0
Total foreign debt	**43,3**	**46,5**	**46,1**	**46,8**

The reduction in non-residents' foreign-currency denominated deposits with and loans extended to South African banks in the third quarter of 2005 was countered by the issuance of international bonds by the private sector. By contrast, the decline in non-residents' holdings of domestically issued bonds was more than offset by the increase in non-resident investors' rand-denominated deposits with South African banks.

Measured in rand, South Africa's foreign debt decreased from R308 billion at the end of June 2005 to R298 billion at the end of September. The decline in rand terms can mainly be attributed to the appreciation of the rand during the period.

Relative to other emerging-market countries, South Africa's outstanding foreign debt has been well contained. The prudent fiscal and monetary policy stance and the relatively low level of South Africa's external debt contributed to the lowering of the country's risk rating. As a result, international rating agencies have afforded South Africa an above-investment-grade rating. Malaysia and Poland have higher credit ratings, while Thailand and Mexico have the same credit rating as South Africa.

External debt and credit ratings of selected emerging-market countries

US$ billions and credit rating

	External debt US$ bn	Debt/export ratio (estimates)	Moody's Investors service rating	Standard & Poor's rating
Poland	126,9	114,5	A2 – Stable	BBB+/Positive
Malaysia	58,0	34,8	A3 – Stable	A-/Stable
South Africa	**46,8**	**65,3**	**Baa1 – Stable**	**BBB+/Stable**
Mexico	128,2	54,8	Baa1 – Stable	No rating
Thailand	51,6	36,1	Baa1 – Stable	BBB+/Stable
Russia	228,3	76,1	Baa2 – Stable	BBB/Stable
India	122,1	n/a	*Baa3 – Stable*	*BB+/Stable*
Egypt	29,7	89,8	*Ba1 – Stable*	BB+/Stable
Brazil	202,0	131,0	*Ba3 – Positive*	*BB-/Positive*
Turkey	165,3	134,4	*Ba3 – Stable*	*BB-/Positive*
Indonesia	140,1	159,1	*B2 – Positive*	*B+/Stable*
Argentina	117,2	220,9	*B3 – Stable*	*B-/Stable*

External debt at end September 2005
Ratings in italics depict speculative grade

Exchange rates

Following three years of significant appreciation, the nominal effective exchange rate of the rand displayed notable fluctuations during the course of 2005, as shown in the accompanying graph. On balance, however, it declined slightly – by 2 per cent – over the course of 2005, having depreciated by 9 per cent during the first half of the year before recovering nearly all the lost ground during the second half. From the end of December 2005 to 28 February 2006, the nominal effective exchange rate of the rand appreciated by a further 2,1 per cent.

Factors influencing the performance of the rand over the past year included strong commodity prices and a strengthening of foreign direct investment into South Africa.

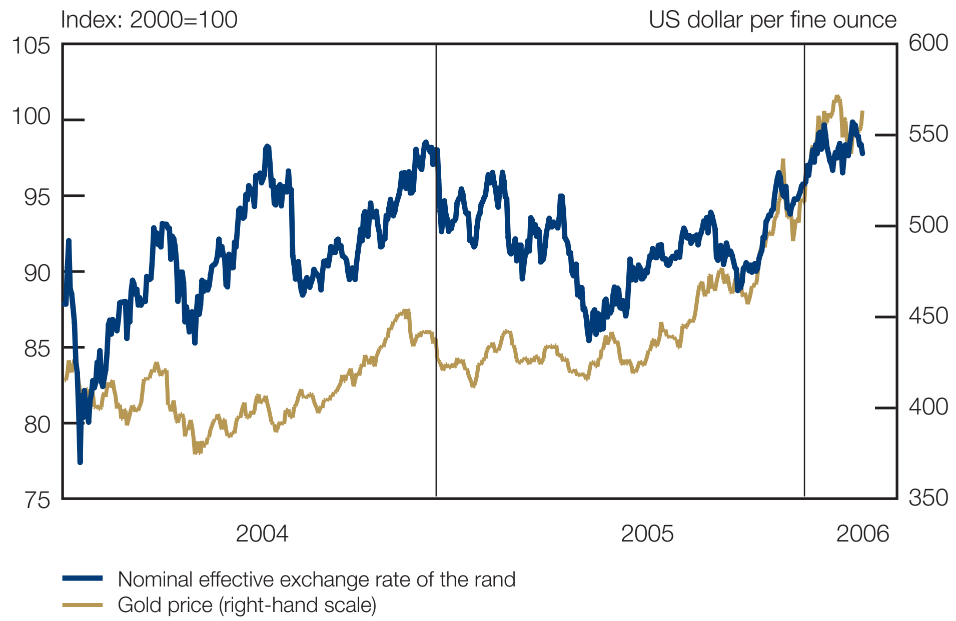
Exchange rates of the rand
Percentage change

	31 Mar 2005 to 30 Jun 2005	30 Jun 2005 to 30 Sep 2005	30 Sep 2005 to 30 Dec 2005	30 Dec 2005 to 28 Feb 2006
Weighted average*	-2,4	5,6	2,0	2,1
Euro	0,3	5,3	2,1	2,4
US dollar	-6,5	4,8	0,8	2,4
British pound	-2,5	7,5	2,6	1,7
Japanese yen	-3,4	7,5	4,3	1,5

* Against a basket of 13 currencies

The *real* effective exchange rate of the rand declined by only 0,7 per cent from the end of 2004 to the end of 2005 signalling that, on balance, there was little net change to the international competitiveness of South African exporters.

Nominal effective exchange rate of the rand and the gold price



The average daily turnover in the domestic market for foreign exchange which increased to US$13,8 billion in the third quarter of 2005, declined to US$12,0 billion in the fourth quarter. The value of transactions in which non-residents participated decreased from US$10,2 billion per day to US$8,8 billion over the same period.

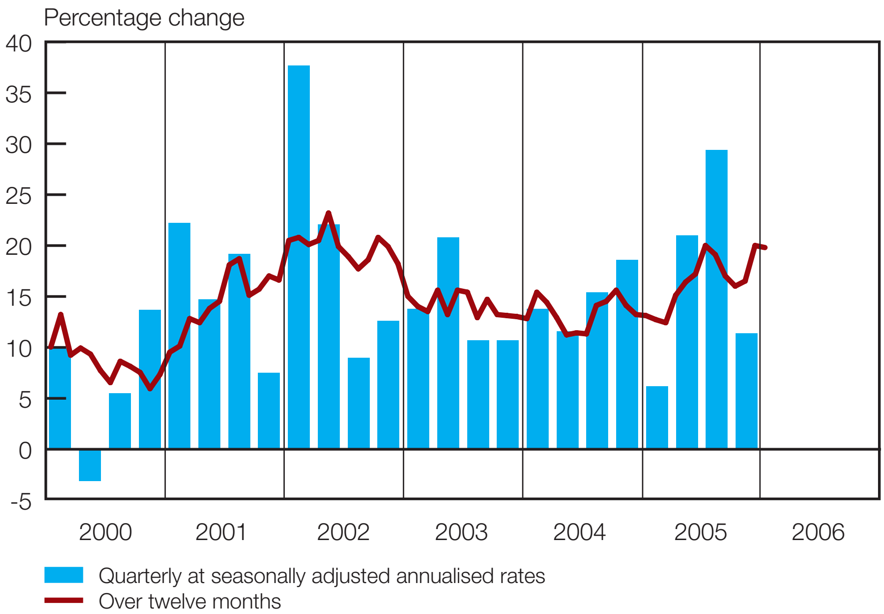
Monetary developments, interest rates and financial markets

Money supply[3]

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

Growth in the broadly defined money supply, M3, trended higher during the course of 2005, recording brisk rates of increase reflective of continued robust real economic activity. Strong business and consumer confidence, encouraged in part by rising employment and the reduction in the repurchase rate in the second quarter of 2005, underpinned the vigorous performance of the economy. Under these circumstances asset prices also exhibited vibrant increases, which reinforced the growth in money supply.

Growth in M3



The twelve-month growth in M3 accelerated from around 13 per cent in the early months of 2005 to 19,9 per cent in July, at a time when deposits with banks benefited from a large foreign direct investment transaction involving the purchase of shares from residents by a bank domiciled abroad. Subsequently, money growth decelerated to 15,9 per cent in October, from which point it reaccelerated to 19,9 per cent in December and 19,7 per cent in January 2006.

Quarter-to-quarter growth in M3 was uneven during 2005, as shown in the table at the top of the following page. The quarterly growth in the narrower monetary aggregates broadly resembled that of M3. The low growth rate in the monetary aggregates during the fourth quarter of 2005 was partly related to the high base set in the previous quarter and to a brisk accumulation of government deposits on account of buoyant tax receipts; government deposits do not form part of the monetary aggregates.

During the course of 2005, the build-up in M3 was more strongly concentrated in the deposits of the corporate sector than in those of the household sector. Non-bank financial institutions, in particular, increased their deposits with the banks, against the backdrop of buoyant financial market turnovers and rising asset values.

Growth from quarter to quarter in monetary aggregates

Per cent at seasonally adjusted annualised rates

Component	2005			
	1st qr	2nd qr	3rd qr	4th qr
M1A	18,0	36,7	26,8	2,3
M1	0,5	32,3	36,9	8,4
M2	5,2	21,0	29,8	9,4
M3	6,2	21,1	29,3	12,5

Annualised growth in nominal gross domestic product exceeded growth in M3 by 2,5 percentage points during the fourth quarter of 2005. As a result, the income velocity of circulation of M3 increased marginally to 1,50 in the fourth quarter of 2005.

The total change in M3 in the fourth quarter of 2005 was R48,0 billion; the statistical counterparts of this increase are shown in the accompanying table.

Counterparts of change in M3

R billions

	2005		
	3rd qr	4th qr	Year
Net foreign assets	30,3	-3,6	52,4
Net claims on the government sector	-9,9	-14,0	-40,7
Claims on the private sector	61,0	54,2	186,9
Net other assets and liabilities	-34,0	-11,4	-16,5
Total change in M3	47,4	48,0	182,1

Statistically the increase in M3 during the fourth quarter of 2005 was more than fully explained by the increase in the banks' claims on the private sector, mainly reflecting strong growth in loans and advances. This was partly counteracted by the decline in net claims on the government sector as government deposits with the monetary sector rose vigorously.

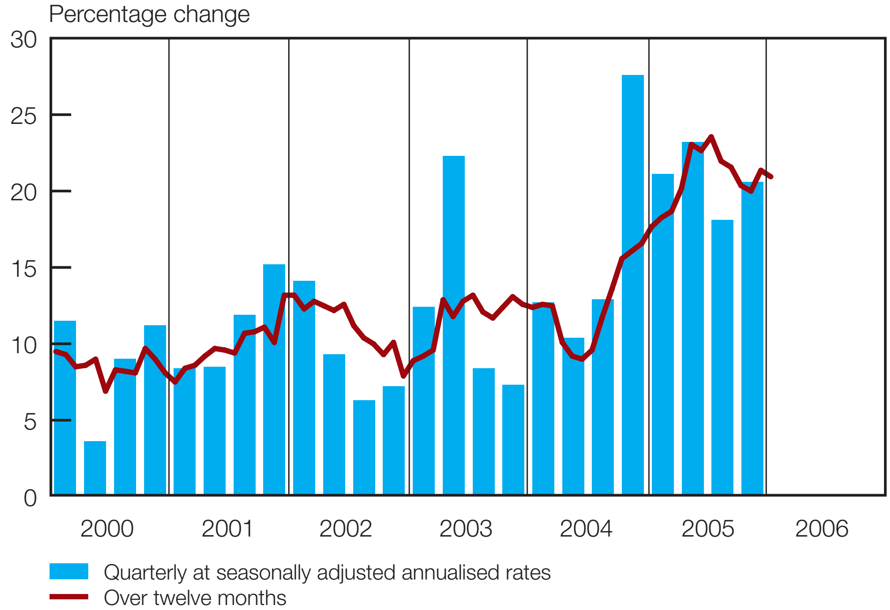
Credit extension

Continued robust growth in total loans and advances[4] extended to the private sector in 2005 was supported by favourable lending and borrowing conditions, rising real disposable income, strong growth in domestic expenditure, resilient consumer and business confidence, and the prolonged buoyancy of the real-estate market. Even the conclusion of the largest traditional securitisation transaction by a single bank to date, could not cause a significant slowdown in overall growth in bank credit.

Annualised quarterly growth in total loans and advances accelerated from 18,1 per cent in the third quarter of 2005 to 20,5 per cent in the fourth quarter. The twelve-month rate of growth in total loans and advances accelerated beyond the 20-per-cent mark from April 2005 to reach a peak of 23,5 per cent in July before decelerating moderately to 19,9 per cent in November. It rebounded to 21,3 per cent in December and 20,9 per cent in January 2006.

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

Total loans and advances to the private sector



Total loans and advances extended to the private sector rose by a record amount of R55,1 billion during the fourth quarter of 2005, following five successive quarterly increases in excess of R40 billion. Asset-backed loans constituted the bulk of the increase in overall credit extension throughout 2005. More specifically, *mortgage advances* was singularly responsible for well in excess of half of the overall increase in loans and advances as housing advances extended to the household sector remained strong during the fourth quarter of 2005. Mortgage advances registered twelve-month growth rates of around 28 per cent from July 2005, consistent with buoyant turnover, rising prices and the broadening of home ownership in the real-estate market.

The growth in *instalment sale and leasing finance*, which is directed at financing expenditure on motor vehicles and other durable goods, continued apace at twelve-month rates of increase in a narrow range between 18 per cent and 22 per cent from September 2004. The strong demand for durable goods finance was supported by relatively stable prices – in some instances declining prices – of such goods, and by the lower level of interest rates.

Other loans and advances, which are mainly dominated by the corporate sector's use of overdrafts and general loans contributed some R12,8 billion, or roughly a quarter, to the overall increase in total loans and advances during the fourth quarter of 2005, as the corporate sector increased its use of bank-intermediated funding. Growth over twelve months in other loans and advances decelerated from 13,3 per cent in September 2005 to 9,9 per cent in November but accelerated to 13,4 per cent in December and to 13,0 per cent in January 2006. However, the credit card advances subcategory of other loans and advances recorded very brisk twelve-month growth rates of 47,4 per cent in December 2005 and 41,4 per cent in January 2006. While not a large component of total bank loans and advances in absolute terms, the exuberant growth in credit card advances probably reflect a combination of the buoyancy of household expenditure, a shift in payment habits, and more relaxed attitudes regarding debt.

The household sector accounted for most of the increase in total loans and advances during the fourth quarter of 2005. This sector's use of bank credit rose by R36,9 billion whereas that of the corporate sector increased by R18,1 billion. For 2005 as a whole, advances to households similarly rose more rapidly than advances to the corporate sector.

Bank loans and advances

Component	Outstanding balance		
	End 2004 R bn	End 2005 R bn	Percentage change
Mortgage advances	413	527	27,6
Instalment sale and leasing finance	153	183	19,6
Other loans and advances	304	345	13,4
Overdrafts	89	84	-5,6
Credit card advances	21	31	47,6
General advances	194	230	18,6
Total loans and advances	**870**	**1 055**	**21,3**

Banks' non-performing loans remained low throughout 2005, reflecting the improved performance of the economy and beneficial impact of lower interest rates on debtors' cashflows.

Interest rates and yields

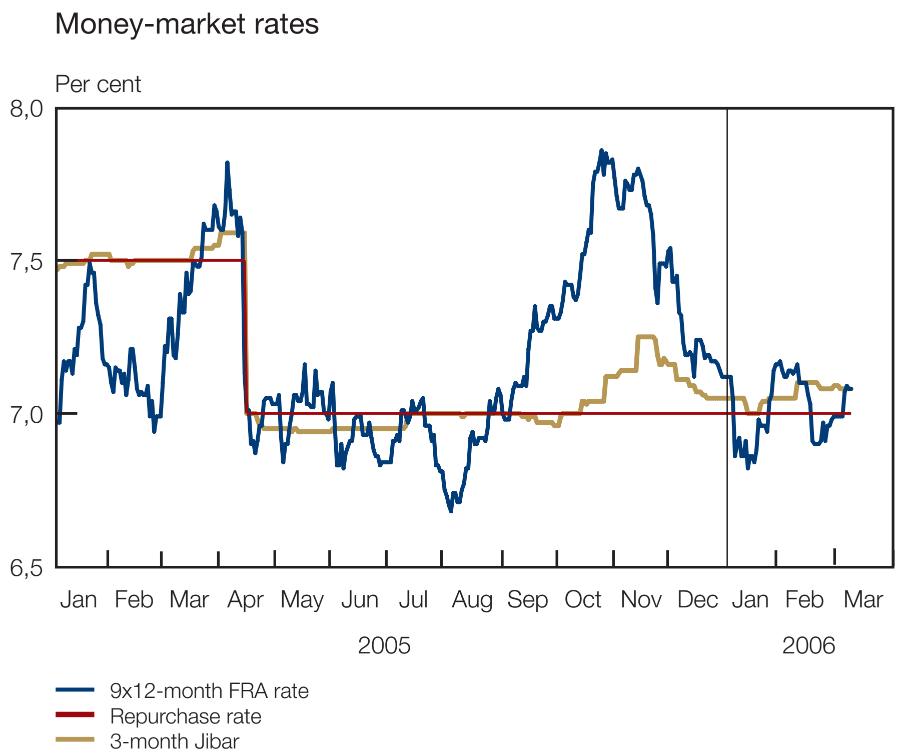
The Bank's Monetary Policy Committee (MPC) left the repurchase rate unchanged at 7 per cent at the October, December 2005 and February 2006 MPC meetings, mindful of significant risk factors present in the inflation picture but positive that these risks were balanced enough not to require an adjustment to the policy stance. The February 2006 MPC statement discussing the developments underlying the decision at that time is reproduced in full elsewhere in this *Bulletin*.

Having decreased in mid-April 2005 when the monetary policy stance was adjusted, both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private banks have subsequently remained unchanged at 10½ per cent.

The South African Overnight Interbank Average (SAONIA) rate moved within a range of 6,28 per cent and 6,77 per cent during the fourth quarter of 2005. Sizeable participation of international banks was encountered in the overnight interbank market. In the first 2½ months of 2006 the SAONIA rate fluctuated between a low of 6,51 per cent and a high of 6,95 per cent. The rate amounted to 6,58 per cent on 9 March 2006.

Other money-market interest rates generally were on the increase from early October 2005, reaching a peak towards the end of November. The three-month Johannesburg Interbank Agreed Rate (Jibar), for instance, increased from 6,96 per cent on 1 October 2005 to a high of 7,25 per cent on 22 November, reflecting expectations arising from the depreciation of the exchange value of the rand and the upward trend in international crude oil prices. Alongside the strengthening of the exchange value of the rand from November 2005, the Jibar subsequently declined, reaching 7 per cent on 12 January 2006. The Jibar amounted to 7,08 per cent on 9 March 2006.

Similarly, the tender rate on 91-day Treasury bills trended higher from 6,79 per cent on 1 October 2005 to 6,97 per cent on 18 November, from which level it declined to 6,69 per cent on 11 February 2006. With the R152 bond falling due for redemption at the end of February 2006, demand for liquid assets remained high in the weekly tender auctions as evidenced by the continued decline in the 91-day Treasury bill rate in early 2006. The rate amounted to 6,56 per cent on 9 March 2005. Similar trends were observed for the 181-day and 273-day Treasury bill tender rates.



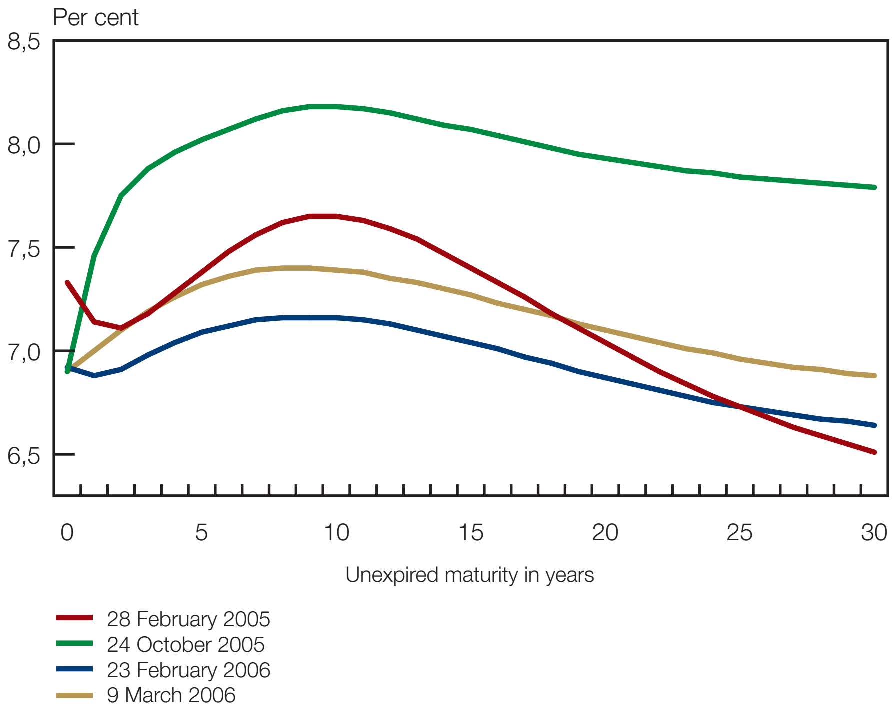
Rates on forward rate agreements (FRAs) also reflected the changing expectations in the money market. For instance, the 9x12-month FRA rate picked up from 7,31 per cent on 1 October 2005 to 7,85 per cent on 27 October. Positive sentiment stemming mainly from benign inflation outcomes, lower international oil prices and the notable recovery of the foreign exchange value of the rand in the final two months of 2005 underpinned the subsequent decline in the FRA rate to 6,86 per cent on 5 January 2006. Mildly disappointing economic data outcomes thereafter drove FRA rates higher from 16 January 2006. The rate stood at 7,08 per cent on 9 March.

Following an increase of 30 basis points in November 2005, the *predominant rate on twelve-month fixed deposits* with the private-sector banks again decreased by 10 basis points in December and by 20 basis points in February 2006 to reach 6,2 per cent. In *real terms*, using historical year-on-year increases in CPIX to adjust nominal rates, the twelve-month fixed deposit rate rendered investors an average real rate of return before tax of 2,3 per cent in 2005, somewhat lower than the rate of 2,6 per cent recorded in 2004. In January 2006, the real deposit rate came to 2,0 per cent.

Having remained unchanged throughout 2005, the interest rate on the 5-year *government retail bond* was reduced to 7,75 per cent, with reductions of 25 basis points in January and March. By contrast, the prevailing interest rates on 2-year and 3-year bonds were initially maintained at their respective levels up to February 2006, before being reduced to 7,25 per cent and 7,50 per cent, respectively, effective from 1 March 2006. Launched in May 2004 in order to encourage a savings culture amongst citizens, the prevailing interest rates on the retail bonds are priced off the yield curve and are changed by the National Treasury when the yields on conventional government bonds of similar maturity move either negatively or positively by more than 50 basis points.

In 2005 and early 2006 long-term government bond yields receded to levels previously observed in the early 1970s. From a recent high of 8,24 per cent on 25 October 2005, the *daily average yield* on the long-term R157 government bond (maturing in 2015) fluctuated around a declining trend in the subsequent months to reach a low of 7,31 per cent on 16 January 2006. The bull run in the bond market occurred in an environment of subdued consumer and production price inflation, which frequently fell below market expectations, while the appreciation of the exchange value of the rand from November 2005 also helped to counter inflation fears. During this period the level of the *yield curve* drifted lower and flattened, while a moderate inversion (short rates exceeding long rates) was experienced from 12 December 2005. A renewed increase in the price of oil and moderately higher-than-expected domestic inflation and money supply data interrupted the downward trend in long-term bond yields from mid-January 2006. This coincided with a general rising trend in bond yields in the major international markets on concerns regarding the inflationary impact of the high oil price. However, the yield on the R157 bond again fell to a new record low of 7,13 per cent on 20 February, alongside the resilience of the exchange value of the rand in early 2006, which served to lessen medium-term inflation concerns, and a lowering of the tax rate on interest income for the retirement fund industry, announced in the February 2006 Budget. On 9 March the yield on the R157 bond came to 7,42 per cent.

Yield curves

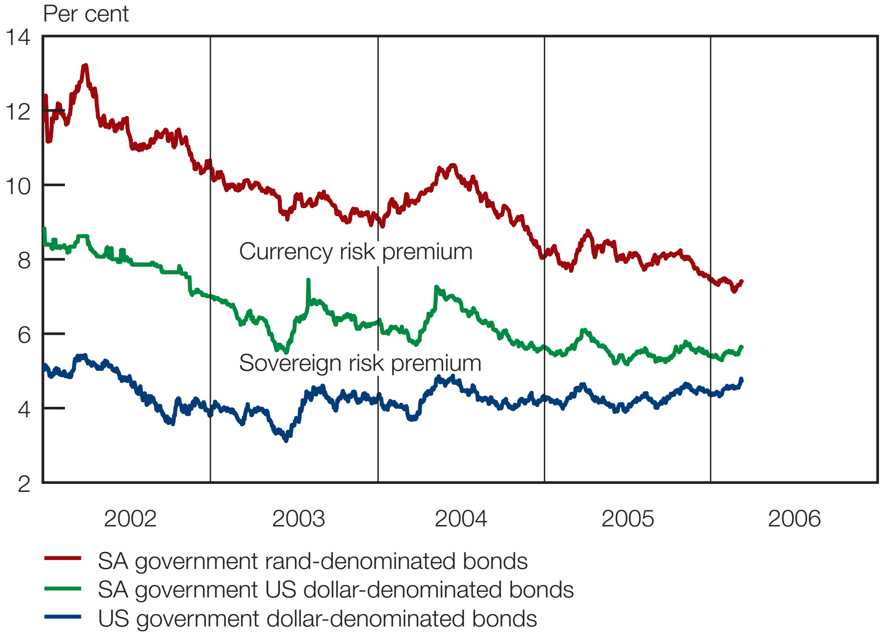


Bond yields remained largely unaffected by large financial market flows towards the end of February 2006. The R152, the last of the three tranches of the R150 government bond, was redeemed on 28 February 2006. The capital redemption value of the bond amounted to R26 billion. At the same time coupon payments on these and other outstanding government bonds put a further R12 billion in cash in the hands of investors.

Real yields on inflation-linked government bonds displayed little movement in late 2005 and early 2006, with the real rate on the R189 bond maturing in 2013, for example, remaining around 2,6 per cent. However, the stronger exchange value of the rand from November 2005 and inflation figures which frequently fell below market expectations contributed to a narrowing of the gap between the nominal yield on conventional bonds and the real yield on inflation-linked government bonds towards the end of 2005 and in early 2006. The *break-even inflation rate* in the five-to-eight-year maturity range initially increased from 4,0 per cent on 5 August 2005 to 5,1 per cent on 13 October due to a moderate increase in the yields on conventional bonds and a sharp decline in the market-determined yields on inflation-linked bonds over the period. From late October yields on conventional bonds declined to reach 35-year lows in February 2006, resulting in a decline in the break-even rate to 4,33 per cent on 21 February. Subsequently, the break-even rate edged higher towards the end of February and stood at 4,7 per cent on 9 March. However, this approximation of expected long-term inflation continued to reflect expectations that inflation would remain reasonably benign, supported by, among other things, the long period during which the CPIX inflation rate has remained within the target range.

Tracking a narrowing of emerging-market bond spreads due to continued favourable global conditions, the *sovereign risk premium* on South Africa's foreign-currency denominated bonds trading in international markets declined to record low levels in February 2006. The spread on the ten-year South African government US dollar-denominated bond, issued at 195 basis points above United States federal government securities of similar maturity at the end of May 2004, on balance, receded to a spread of 68 basis points in February 2006. Simultaneously, 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, narrowed by 150 basis points from April 2005 to December, and by a further 54 basis points in the first two months of 2006.

Yields on long-term government bonds



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 nine-to-eleven-year maturity range issued in the domestic market and dollar-denominated debt issued in the United States market) narrowed from 308 basis points in May 2005 to 184 basis points in February 2006. The narrowing occurred mostly as a result of the continued decline in bond yields in the domestic market, while the equivalent yields on foreign-issued South African bonds recorded a slight increase over the same period.

Money market

Overall money-market conditions remained stable during 2005, and adjusted smoothly to the enhancements to the accommodation system which the Bank introduced in May. At the weekly main refinancing tenders, banks generally tendered for amounts close to the expected average liquidity requirement for the week as calculated and announced by the South African Reserve Bank. During the final quarter of 2005 the weekly main repurchase tender amount varied between R10,65 billion and R12,95 billion, and in the first two months of 2006 between R11,1 billion and R13,15 billion. Over and above the use of repurchase transactions, banks continued to utilise the standing facilities and their cash reserve accounts in order to square off their end-of-day positions.

The major flows in money-market liquidity from October 2005 to February 2006 are summarised in the accompanying table.

Money-market liquidity flows

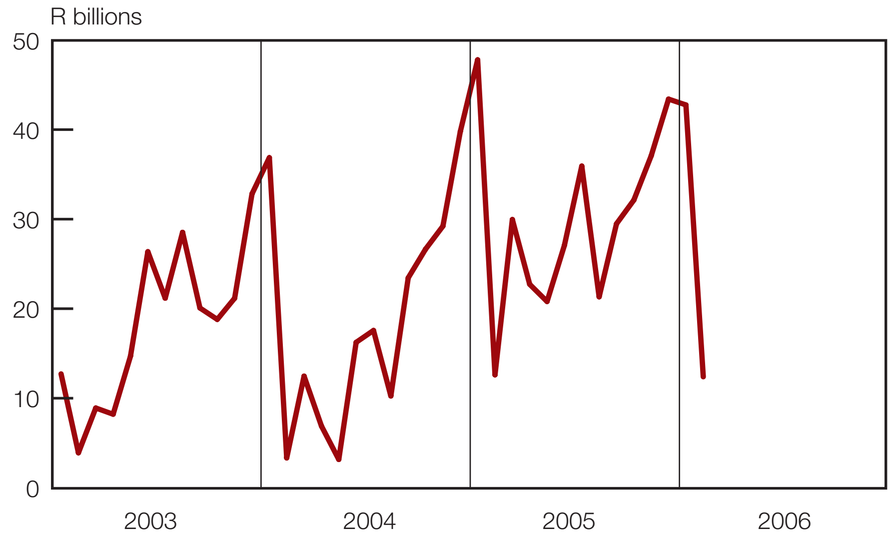
R billions (easing +, tightening -)

	Oct – Dec 2005	Jan – Feb 2006
Notes and coin in circulation	-3,9	1,8
Required cash reserve deposits	-1,1	-1,0
Money-market effect of foreign exchange transactions of the SARB	5,7	11,1
Government deposits	-6,0	-9,1
Use of liquidity management instruments*	8,5	2,9
Government redemption and interest payments to SARB	-0,1	-3,1
Redemption of foreign loans by National Treasury	-0,3	-0,7
Other items net	-3,9	-1,4
Banks' liquidity requirement (decrease +; increase -)	**-1,1**	**0,5**

* South African Reserve Bank debentures and reverse repurchase transactions

The accompanying graph shows the build-up in cash balances in the government Tax and Loan accounts with the private banks, part of which was in preparation for large payments at the end of February each year: Apart from coupon interest payments, the

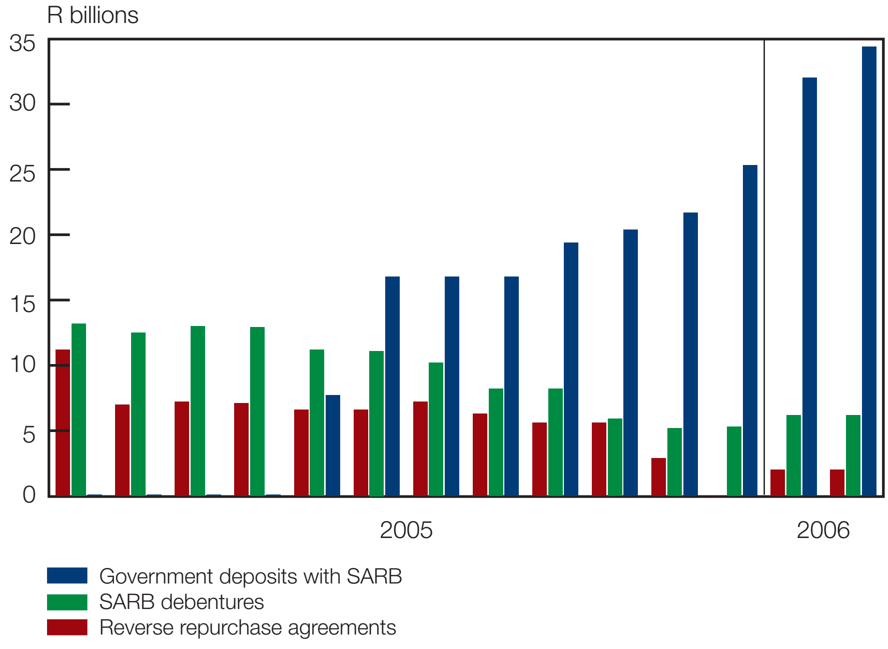
Government deposits in the tax and loan accounts



capital redemption of the three tranches of the R150 government bond was effected at the end of each February from 2004 to 2006. Over the past number of years government accordingly accumulated high cash balances in the run-up to February, in order to effectively pay capital and interest to aggregate amounts of approximately R39 billion at the end of each February. The government Tax and Loan deposits rose from R21,3 billion in August 2005 to R46,8 billion in January 2006. It is noteworthy that an amount of R3,1 billion paid to the Reserve Bank at the end of February 2006 in respect of government bonds in its Monetary Policy Portfolio also assisted to sterilise liquidity which had previously been injected in the accumulation of foreign exchange reserves.

The total amount of liquidity absorbed from the money market through reverse repurchase agreements and SARB debentures was reduced from R13,8 billion at the end of the third quarter of 2005 to R5,3 billion at the end of the fourth quarter, partly in order to avoid undue tightening in money-market liquidity conditions over the festive season. The accompanying graph shows the structure of and developments in money-market intervention instruments utilised. Liquidity created through the purchase of foreign exchange from the market was largely countered by moving government deposits from the private-sector banks to the Bank, to a cumulative amount of R34,4 billion by the end of February 2006.

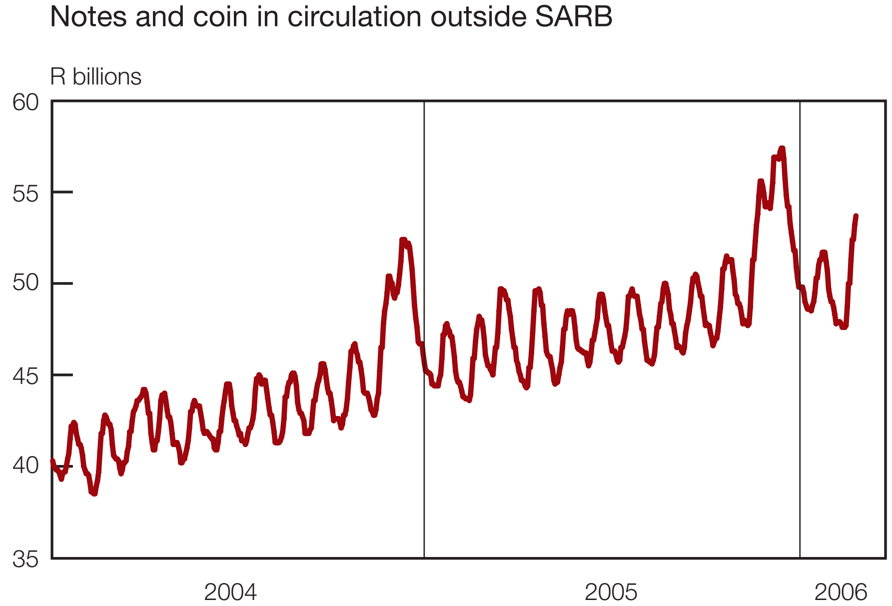
Liquidity draining operations



Notes and coin in circulation outside the Reserve Bank increased by R3,5 billion from R50,3 billion at the end of September 2005 to R53,8 billion at the end of November. The table and graph on the following page show that during the month of December 2005, the value of notes and coin in circulation rose to a peak of R57,4 billion, thereby draining liquidity from the market. Currency in circulation declined to R54,2 billion by month-end, counteracting undue tightening in the banks' liquidity position. The downward trend continued during January 2006 and February, as notes and coin declined by R1,8 billion, thereby easing liquidity conditions.

Notes and coin in circulation outside the Reserve Bank
R million

Year	Peak date	Peak level	Year-end level	Change, end Nov to end Dec
2000	27 December	34 728	33 619	3 181
2001	27 December	37 995	36 138	2 764
2002	24 December	42 058	39 488	2 150
2003	24 December	47 766	44 671	2 087
2004	17 December	52 387	48 831	305
2005	23 December	57 445	54 236	395



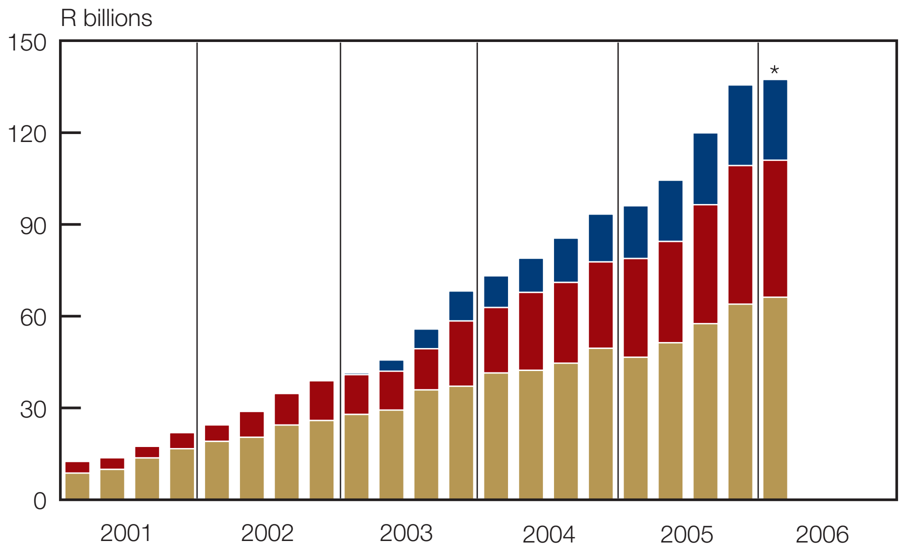
In order to improve the composition of the Reserve Bank's Monetary Policy Portfolio of government bonds, the Bank continued to restructure its holdings of interest-bearing government bonds. The Bank conducted a switch auction to a total value of R0,5 billion on 24 November 2005, acquiring R152 bonds and releasing R202 bonds to its counterparts in the process.

Bond market

Public-sector borrowers raised R38,0 billion through net issues of fixed-interest securities in the domestic primary bond market from April 2005 to January 2006 (the first ten months of fiscal 2005/06), compared with an amount of R55,5 billion raised over the same period of fiscal 2004/05. The National Treasury also raised R0,5 billion through RSA Government Retail Bonds up to the end of February 2006, substantially less than the R1,3 billion raised over the same period of the previous fiscal year when this instrument was issued for the first time. In the Budget of the national government, presented in February 2006, the issuance of domestic fixed-income bonds was envisaged to remain the principal means of financing, and an amount of R10,2 billion was projected to be raised through net issuance in fiscal 2006/07.

Private-sector funding through the bond market reached record levels in 2005 and activity remained brisk in the first months of 2006. The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (BESA) increased from R77,7 billion in December 2004 to R109,2 billion in December 2005. Issuance accelerated substantially from R6,7 billion raised in the first half of 2005 to R24,8 billion in the second half of the year. Funding through asset-backed securitisation dominated activity as it increased from 36 per cent of total issuance in 2004 to 54 per cent in 2005. Private-sector listings increased by a further R1,8 billion in the first two months of 2006.

Private-sector funding in the interest-bearing securities markets



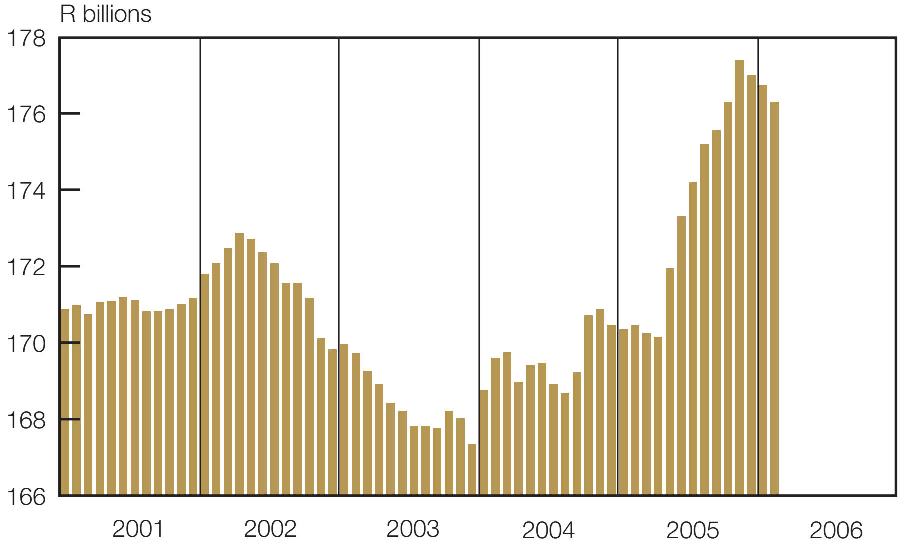
Outstanding nominal value at end of period
Bonds
Asset-backed securities
Commercial paper
* February

The value of *commercial paper* listed on BESA increased by R10,7 billion in the calendar year to December 2005 to reach R26,4 billion. The listed amount remained unchanged to February 2006. From its inception in April 2005 to December, the electronic settlement of *non-listed commercial paper* on BESA amounted to R9,3 billion, in 505 trades. A further 151 trades to the value of R3,0 billion were effected in the subsequent months to February 2006.

In the *international bond markets* non-resident issuer interest in rand-denominated bonds remained buoyant in 2005, extending the recovery in interest which started a year earlier. The net issuance of such instruments, totalling R6,5 billion in 2005, was more than double the amount of R3,1 billion raised in 2004. In the first two months of 2006 net redemptions by non-residents of rand-denominated bonds amounted to R0,7 billion.

In addition to the issuance of eurorand bonds, the issuance of rand-denominated bonds by foreign borrowers in the *Japanese Uridashi market* continued to grow during 2005. Rand-denominated bonds were issued in the Uridashi market for the first time in July 2004 and the total nominal value of issues for that year amounted to R2,5 billion, followed by net issuances of R8,8 billion in 2005 and R0,2 billion in the two months to February 2006.

Outstanding balance of eurorand bonds issued by non-residents



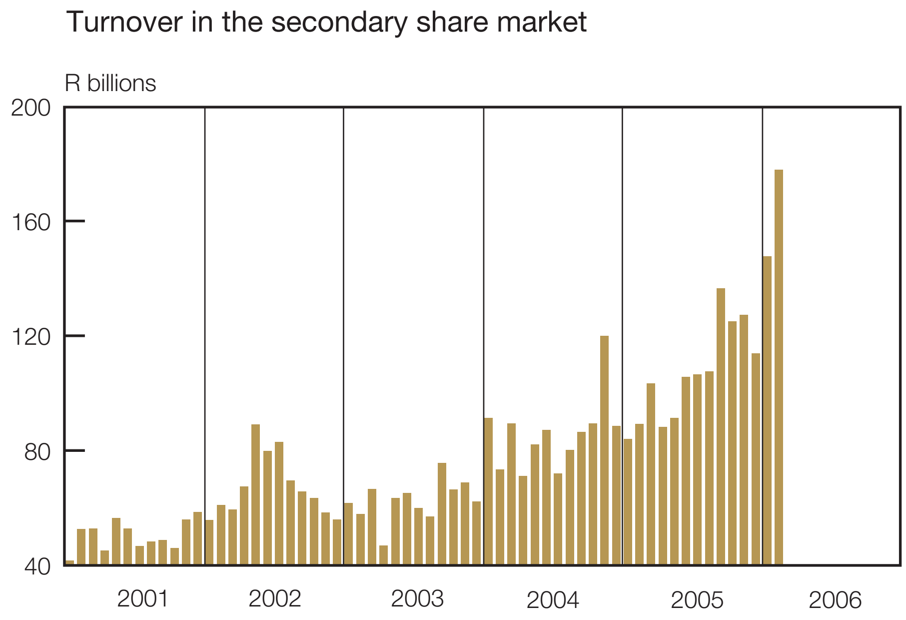
Trading activity in the *domestic secondary bond market* amounted to R9,8 trillion in 2005, some 3 per cent higher than in 2004. The value of turnover on BESA amounted to R1,8 trillion in the first two months of 2006. Alongside a renewed downward trajectory in bond yields from the end of October 2005, the average daily turnover reached a recent high of around R42 billion in November, maintained a high average of R39 billion in January 2006, and accelerated to R51 billion in February. For the year 2005 as a whole the average daily turnover amounted to R39 billion.

Non-residents' net sales of South African debt securities through BESA amounted to R10,7 billion in 2005, compared to net purchases of R0,4 billion in 2004. Net purchases of R10,6 billion in the first half of 2005 were followed by net sales of R21,3 billion in the second half of the year. Non-resident participation in trading on BESA, measured as the sum of their purchases and sales as a percentage of total purchases and sales of bonds, averaged around 16 per cent in 2005, up from 13 per cent in 2004 and 11 per cent in 2003. From the beginning of 2006 to the end of February, non-residents' net cumulative purchases of bonds amounted to R0,9 billion.

Share market

The total value of equity capital raised in the domestic and international *primary share markets* by companies listed on the JSE amounted to R82,2 billion in 2005, nearly double the R42,1 billion raised in 2004. Dual-listed companies contributed to the heightened capital-raising activity in 2005. Companies constituting the industrial sector accounted for 70 per cent of the total amount raised in 2005, while the financial sector accounted for 18 per cent and the resources sector for 8 per cent. Equity financing amounted to R27,4 billion in the first two months of 2006.

The market capitalisation of the JSE set new record levels in 2005 and continued to increase to an all-time high of nearly R4 trillion in January 2006, before declining somewhat in February. The JSE's gains in market capitalisation from the end of 2004 to the end of 2005, expressed in dollar terms, placed it at number 19 in a world ranking by the World Federation of Exchanges, an international association comprising the world's leading bourses.



Trading activity in the *secondary* share market remained lively in 2005 and the R1,3 trillion traded on the JSE in that year exceeded the trade in 2004 by 24 per cent. Buoyed by the continued upward trajectory in share prices, turnover on the JSE scaled new heights. The average daily turnover reached a record high of R5,9 billion in September 2005, receding to R5,5 billion in December before picking up to a new record average of R8,5 billion per day in February 2006, as share prices continued to rise.

The number of companies listed on *Alt*^{x}, the JSE's bourse for small to medium-sized companies, was reduced by one in December 2005 when a pharmaceutical company became the first company to transfer from the alternative exchange to the main board of the JSE. Turnover on Alt^{x} amounted to R300 million in 2005, significantly higher than the R44 million traded in 2004, which was its first year of existence. In the first two months of 2006 turnover on this exchange amounted to R100 million.

Non-residents' net purchases of shares on the JSE of R48,2 billion in 2005 was a further improvement on the net purchases of R32,9 billion recorded in 2004. Net purchases of shares exceeded R13 billion in both the second and third quarters of 2005, before declining somewhat to R11,7 billion in the fourth quarter. Subsequently, the well-performing South African market continued to attract non-residents as their cumulative net purchases of shares amounted to R27,0 billion in the first two months of 2006.

As from 3 January 2006, all JSE-listed companies were re-classified according to the Industry Classification Benchmark (ICB) standard, replacing the FTSE Global Classification System previously used by the JSE. The ICB was developed by the FTSE Group and Dow Jones with the aim to standardise the classification of equities on a worldwide basis.

The *daily closing level of the all-share price index* set a number of record highs during 2005 and ended the year 43 per cent higher than at the end of 2004. This placed the performance of the JSE's all-share price index, in local currency terms, at number 7 in a world ranking by the World Federation of Exchanges. As shown in the table on the facing page, the best performance in 2005 was recorded by the Colombia Stock Exchange.

Share prices fell behind the prices of some of the other main asset classes as recently as 2002 and 2003, but the rapid growth in share prices subsequently reversed the situation.

Top 10 share markets in 2005, in local currency terms

Exchange	Percentage change in share prices
1. Columbia Stock Exchange	118,9
2. Malta Stock Exchange	63,4
3. Istanbul Stock Exchange	59,3
4. Korea Exchange	54,0
5. Osaka Securities Exchange	50,6
6. Tokyo Stock Exchange	43,5
7. JSE Limited	*43,0*
8. Wiener Börse	42,7
9. Bombay Stock Exchange	42,3
10. Budapest Stock Exchange	41,0

Source: World Federation of Exchanges. Changes calculated from end 2004 to end 2005 using broad share price indices

Share prices matched money-market returns in 2003, equalling the increase of 12 per cent in the Short-term Fixed Interest Index. Share prices accelerated in the subsequent years and exceeded the year-on-year growth in property prices, bond and cash investments by a wide margin in 2005. From the end of 2005 to the end of February 2006, share prices improved by a further 5,5 per cent, while real-estate prices and the all-bond index increased by close to 2 per cent and money-market investments by 1,1 per cent.

Share prices and price-earnings ratio

The buoyancy in share prices in the first months of 2006 culminated in the all-share index reaching an all-time high on 2 February 2006. This represented an increase of 61 per cent from a recent low on 28 April 2005 and was led by strong price increases of 85 per cent in resources shares and 51 per cent in industrial shares, while financial shares improved by 41 per cent over the same period. Subsequently, the daily all-share index fell by 6 per cent to 9 March alongside weaker global equity markets and a decline in commodity prices.

The *dividend yield* on all classes of shares receded from 2,8 per cent in August 2005 to 2,4 per cent in February 2006 as share prices rose somewhat more briskly than historical dividends paid.

The monthly average *earnings yield* on all classes of shares decreased from 7,3 per cent in May 2005 to 6,2 per cent in January 2006, before increasing to 6,3 per cent in February. Conversely, the *price-earnings ratio* of all classes of shares declined to 15,9 in February 2006, after it had risen from 13,7 in May 2005 to 16,2 in January 2006. Levels exceeding 16 were last recorded in February 2000. Since January 2004 the price-earnings ratio has exceeded its long-term average (calculated from January 1996 to December 2005) of 13,4, and increased even further in 2005 and early 2006, reflecting that share prices are becoming expensive relative to historical earnings.

Market for derivatives

As shown in the accompanying table, during 2005 and early 2006 the financial derivatives turnover on the JSE was bolstered by the buoyant share-market conditions. Commodity derivatives turnover, by contrast, lost some ground.

Derivatives turnover

Change over one year in number of contracts traded on JSE

	2005	Jan – Feb 2006
	Per cent	Per cent
Financial futures and options on futures	36	122
Warrants	99	286
Agricultural commodity futures and options	-6	-2

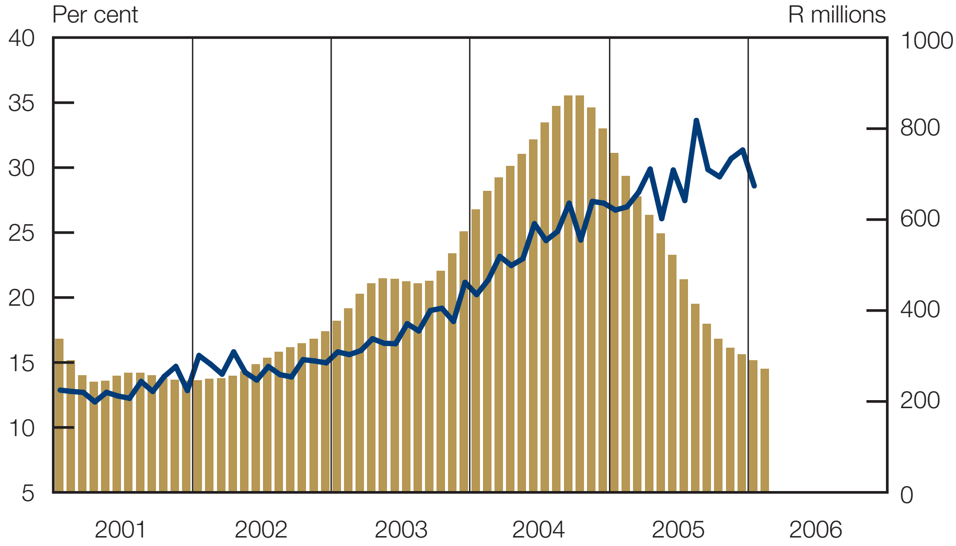
Turnover on Yield-X, the interest rate derivative market of the JSE which commenced trading on 28 February 2005, amounted to R11,1 billion to the end of December 2005, gaining momentum as time progressed. In January and February 2006 turnover amounted to R3,5 billion.

Real-estate market

Although turnover in the *real-estate market* remained brisk in 2005, the growth in activity slowed from the previous year. The overall value of turnover, measured by transfer duty paid, increased by 25 per cent in 2005 compared with an increase of 54 per cent in 2004. In January 2006, the average level of *transfer duty paid* increased by 9 per cent compared to January 2005. In the 2006/07 Budget of the national government, the transfer duty exemption threshold was raised from R190 000 to R500 000.

The year-on-year rate of increase in house prices, as measured by Absa, continued to decelerate from a most recent high of 35,5 per cent in September 2004 to 14,5 per cent in February 2006. The month-on-month rate of increase in house prices receded from 2,9 per cent in January 2004 to 0,9 per cent in February 2006. Over the different price categories, the year-on-year rate of increase of property in the luxury market segment fell sharply, recording a *decrease* of 1,9 per cent in the fourth quarter of 2005. The year-on-year rate of increase in residential property prices in the affordable houses category

Real-estate market



* Source: Absa

fell from its recent high of 21,1 per cent in the third quarter of 2004 to 8,6 per cent in the fourth quarter of 2005. Over the same period, growth in property prices in the middle segment declined from 34,6 per cent to 15,7 per cent.

House price changes in different price classes

Percentage change over four quarters

	September 2004	December 2005
Affordable (40m² to 79m², below R193 000)	21,1	8,6
Middle segment (80m² to 400m², below R2,2 million)	34,6	15,7
Small (80m² to 140m²)	39,0	11,5
Medium (141m² to 220m²)	37,7	17,5
Large (221m² to 400m²)	32,1	19,3
Luxury segment (between R2,2 million and R8,2 million)	22,0	-1,9

Source: Absa

Public finance

Non-financial public-sector borrowing requirement

The borrowing needs of the non-financial public sector (i.e. the consolidated central, provincial, local governments and non-financial public-sector business enterprises) remained quite limited through the first nine months of fiscal 2005/06. The sector recorded a cash surplus of R12,9 billion in the October-December quarter of 2005 – R5,7 billion higher than the cash surplus recorded in the corresponding quarter of 2004. In the first nine months of fiscal 2005/06 a cash *surplus* amounting to R22,4 billion was registered compared to a cash deficit of R15,0 billion recorded in the same period a year earlier. As a ratio of gross domestic product, the surplus for the first nine months of the current fiscal year amounted to 1,9 per cent, compared with a borrowing requirement of 1,4 per cent recorded in the same period of the previous fiscal year.

Non-financial public-sector borrowing requirement
R billions

Level of government	2004/05*	2005/06*
National government	24,1	4,0
Extra-budgetary institutions	-0,2	2,3
Social security funds	-3,4	-2,9
Provincial governments	-6,5	-10,3
Local governments	11,7	0,4
Non-financial public enterprises	-10,6	-15,9
Total	15,0	-22,4

* April – December of each fiscal year. Deficit +, surplus -

The cash surplus of *non-financial public enterprises* widened to R15,9 billion in the first nine months of fiscal 2005/06 compared to a cash surplus of R10,6 billion recorded in the corresponding period of the previous fiscal year. Investment in net acquisition of non-financial assets by the major public corporations and enterprises amounted to R19 billion, which was 28,1 per cent more than in the same period a year earlier. It is set to continue rising briskly in order to support sustained strong economic growth.

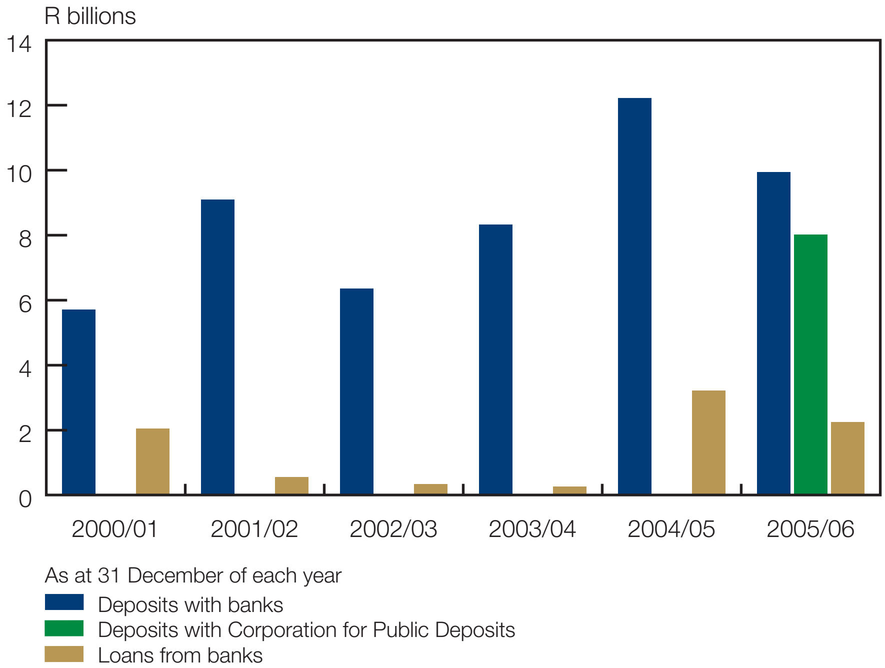
The financial activities of the *national government* resulted in a cash deficit of R4,0 billion for the first nine months of fiscal 2005/06, compared with the cash deficit of R24,1 billion recorded in the same period of the previous fiscal year. This significant narrowing of the deficit was mainly the result of the higher-than-budgeted revenue collections.

Preliminary data indicate that *extra-budgetary institutions* recorded a cash deficit of R2,3 billion in the first nine months of 2005/06, compared with a very small surplus during the same period of the previous fiscal year. For the period under review the cash surplus of *social security funds* was lower than the surplus recorded a year earlier.

The *provincial governments* recorded a cash deficit of R1,5 billion in the October-December quarter of 2005, which lowered their cash *surplus* for the first nine months of fiscal 2005/06 to R10,3 billion in comparison with a cash surplus of R6,5 billion recorded in the same period of the previous fiscal year. Provinces' net acquisition of non-financial assets for the first nine months of fiscal 2005/06 amounted to R7,6 billion, which represented a year-on-year rate of increase of 28,3 per cent when compared with the same period of the previous fiscal year.

The deposits of provincial governments with the private-sector banks declined from R12,7 billion at the end of March 2005 to R9,9 billion at the end of December, but their overall indebtedness also declined from R3,9 billion to R2,3 billion between these dates. On the other hand, the deposits of provinces with the Corporation for Public Deposits (CPD) rose significantly from virtually a nil balance to R8,0 billion over the same period.

Bank deposits and debt of provincial governments

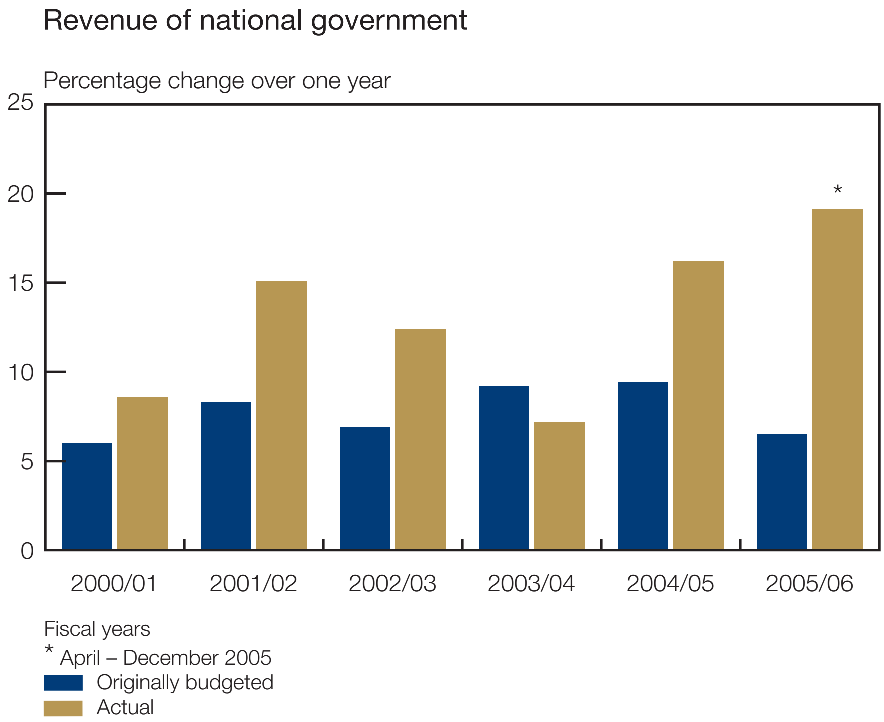


Budget comparable analysis of national government finance

During the first nine months of the fiscal year 2005/06 government expenditure progressed much as had been budgeted originally, but government revenue exceeded the initial projections by a considerable margin. *Expenditure* by *national government* in the first nine months of fiscal 2005/06 amounted to R298 billion, or 12,9 per cent more than in the corresponding period of the previous fiscal year. This was closely aligned with the initially budgeted increase of 13,4 per cent for the full fiscal year.

After allowing for cash-flow adjustments (i.e. transactions recorded in the government accounting system but not yet cleared in the banking system, and late departmental requests) cash-flow expenditure in the first nine months of fiscal 2005/06 amounted to R299 billion, representing an increase of 14,1 per cent when compared to the corresponding period of the previous fiscal year.

National government revenue in the first nine months of fiscal 2005/06 amounted to R296 billion, representing an above-budgeted year-on-year rate of increase of no less than 19,1 per cent. The *Budget Review 2005* estimated an increase in national government revenue of 6,5 per cent for fiscal 2005/06 as a whole.



As shown in the accompanying table, taxes on income, profits and capital gains, the main contributor to total revenue, recorded an increase of more than 18 per cent in the first nine months of fiscal 2005/06 when compared with the same period a year earlier. This increase was mainly the result of strong growth in corporate income tax collections, signalling the increased profitability of companies as well as continued improvements in tax-collection efficiency.

National government revenue in fiscal 2005/06

Revenue source	R billions	Percentage change	
	Actual Apr – Dec 2005	Originally budgeted full year	Actual* Apr – Dec 2005
Taxes on income, profits and capital gains	167,2	2,9	18,4
Payroll taxes	3,6	10,5	12,2
Taxes on property	8,2	9,0	24,6
Domestic taxes on goods and services	107,1	8,8	14,3
Taxes on international trade and transactions	13,6	-0,7	42,4
Other revenue	6,9	38,4	55,8
Less: SACU** payments	10,4	-9,6	4,5
Total revenue	**296,2**	**6,5**	**19,1**

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

Taxes on international trade and transactions and taxes on property recorded sparkling increases during the period under review, reflective of strong demand for imports and buoyant real-estate activity, respectively. However, in absolute terms these two revenue sources are not as important as domestic taxes on goods and services such as value-added tax; collections of the latter tax rose solidly as domestic expenditure recorded robust growth.

The net result of these developments in revenue and expenditure was a *cash book deficit* of R1,9 billion in the first nine months of fiscal 2005/06, compared to a deficit of R15,4 billion in the same period a year earlier. The *Budget Review 2005* projected a national government deficit of R48,0 billion in fiscal 2005/06 as a whole, but this estimate was reduced to R15,7 billion in the *Medium Term Budget Policy Statement 2005.*

The *cash-flow deficit* before borrowing and debt repayment amounted to R2,8 billion in the first nine months of fiscal 2005/06 – some R11,2 billion less than in the corresponding period of the previous fiscal year. In addition, an extraordinary payment was recorded in respect of the issue of zero-coupon bonds with a face value of R4,5 billion to the South African Reserve Bank, which were subsequently converted into interest-bearing instruments. This issue, which was provided for in the original Budget for fiscal 2005/06, was made in April 2005 to defray part of the realised losses on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). Extraordinary receipts in the first nine months of fiscal 2005/06 included proceeds from the foreign exchange amnesty dispensation and a special dividend from Telkom, each amounting to R1,0 billion and both received in July 2005. In August 2005, Eskom paid a special dividend of R0,7 billion to national government. The cash-flow deficit together with these extraordinary transactions resulted in a net borrowing requirement of national government of R4,5 billion in the first nine months of fiscal 2005/06, compared to a net borrowing requirement of R22,5 billion recorded a year earlier.

National government financing in fiscal 2005/06

R billions

Item or instrument	Originally budgeted full year	Actual Apr – Dec 2005
Deficit	48,0	2,8*
Plus: Extraordinary payments	7,0	4,5
Cost on revaluation of foreign loans at redemption	0,7	0,0
Less: Extraordinary receipts	1,0	2,8
Net borrowing requirement	54,7	4,5
Treasury bills	5,0	3,9
Domestic government bonds	26,3	37,8
Foreign bonds and loans	12,8	1,9
Change in available cash balances **	10,6	-39,1
Total net financing	54,7	4,5

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

As indicated in the accompanying table, the greater part of the net borrowing requirement of national government during the period under review was financed through the issuance of debt instruments in the domestic capital market. Domestic short-term instruments were sold at an average rate of 6,8 per cent per annum, whereas domestic long-term funding was obtained at an average rate of 8,0 per cent per annum in the first nine months of fiscal 2005/06.

During the first nine months of 2005/06 the National Treasury introduced several new bills and bonds, including 273-day Treasury bills and bonds of various maturities. The average maturity of national government's domestic marketable bonds decreased from 99 months at the end of March 2005 to 94 months at the end of December.

Net issues and use of foreign bonds and loans in the first nine months of fiscal 2005/06 amounted to R1,9 billion. Also included in foreign loans was an amount of R2,4 billion drawn from the foreign export credit facilities for the financing of the Strategic Defence Procurement Programme. During the period April to December 2005, foreign bonds and loans to the amount of R0,6 billion were redeemed. The issues and redemptions of foreign marketable bonds led to the average outstanding maturity on these bonds decreasing from 78 months at the end of March 2005 to 69 months at the end of December 2005.

Government's cash balances increased by R39,1 billion in the first nine months of fiscal 2005/06, largely in preparation for the redemption of and coupon payments on domestic marketable bonds at the end of February 2006.

Total debt of national government remained well contained, increasing from R507 billion at the end of March 2005 to R545 billion at the end of December 2005. As a ratio of gross domestic product, this corresponded to 35,7 per cent and 35,8 per cent on these respective dates.

The Budget for the fiscal years 2006/07 to 2008/09

The Minister of Finance presented the 2006 Budget to Parliament on 15 February 2006, building on a sound and sustainable macroeconomic platform and positive economic outlook. The stable foundation laid by prudent monetary and fiscal policies resulted in low inflation and interest rates, and reduced cost of servicing the government debt, thus freeing additional resources for social spending. Government's fiscal plans also emphasised investment spending as government and public enterprises launch substantial infrastructure programmes. Private-sector investment spending was also expected to remain robust.

The 2006 Budget continued the fiscal approach initiated five years ago by providing additional resources for investment in infrastructure and increasing spending on social and economic services. The tax reforms implemented by the government in the past years, alongside stronger economic growth, resulted in buoyant revenue collections. Over the Budget time horizon, the tax framework was set to support the goals of accelerated and shared economic growth through tax relief measures promoting long-term retirement savings, and reducing the compliance costs and tax burden on all businesses.

Supported by government's economic reforms and a buoyant international economic environment, the economy was placed in a position to grow at a faster pace. Further reforms to address constraints hampering economic expansion and improve competitiveness would continue.

National government expenditure in fiscal 2006/07 was budgeted to amount to R473 billion, representing a year-on-year rate of increase of 12,8 per cent. This represents 27,6 per cent of the estimated gross domestic product, which can be compared with a revised estimate of 26,9 per cent of gross domestic product in fiscal 2005/06. It was estimated that national government expenditure would increase at an average rate of 10,9 per cent and be kept around 27 per cent of gross domestic product over the three-year budget period.

Revised estimates of the state debt cost for fiscal 2005/06 were lower than the originally budgeted amount, resulting from prudent debt management, lower borrowing requirements, lower interest rates and currency appreciation. It was projected that the state debt cost would increase at a subdued average rate of around 3 per cent per annum over the medium-term budget cycle, allowing more funds to be utilised for service delivery and infrastructure provision: Expenditure excluding state debt cost was budgeted to increase from R368 billion in fiscal 2005/06 to R516 billion in fiscal 2008/09, or by an average rate of 11,9 per cent per annum over the medium term. Non-interest spending would therefore record substantial real increases, giving greater impetus to social development, public service delivery and poverty reduction. The additional expenditure was provided for to support a wide range of public-sector programmes, with strong emphasis on economic infrastructure, education and health, and fighting crime.

Fiscal projections: National government

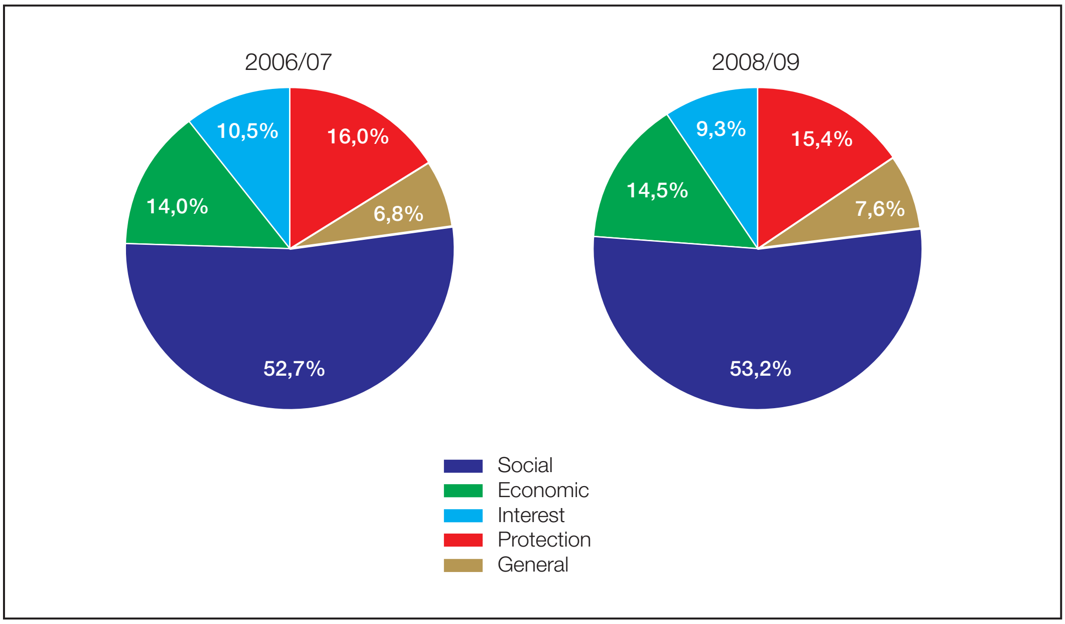
	2005/06		2006/07		2007/08		2008/09	
	Revised estimate		Medium-term estimates					
		Annual change		Annual change		Annual change		Annual change
	R bn	Per cent	R bn	Per cent	R bn	Per cent	R bn	Per cent
Expenditure	**419,0**	**13,7**	**472,7**	**12,8**	**519,2**	**9,8**	**571,3**	**10,0**
State debt cost*	51,2	4,7	52,0	1,7	53,3	2,4	55,7	4,5
Current payments	77,7	14,0	87,8	12,9	95,4	8,6	102,4	7,4
Transfers and subsidies .	284,4	15,6	323,8	13,9	357,6	10,4	395,6	10,6
Payments for capital assets............................	5,7	4,4	6,0	5,7	6,6	10,5	7,4	12,6
Contingency reserve and unallocated funds...........	-		3,1		6,3		10,1	
Revenue	**411,1**	**18,2**	**446,4**	**8,6**	**492,0**	**10,2**	**547,1**	**11,2**
Deficit before borrowing and debt repayment	**7,9**		**26,4**		**27,2**		**24,2**	
Deficit as ratio of GDP	*-0,5%*		*-1,5%*		*-1,4%*		*-1,2%*	
Deficit as ratio of GDP: October 2005 MTBPS.........	*-1,0%*		*-2,2%*		*-2,1%*		*-2,0%*	

* Includes interest, management cost and the cost of raising loans

The division of revenue among the three spheres of government (national departments, provincial governments and local governments) reflected a shift in favour of provincial and local governments, which are at the centre of social service delivery.

As indicated in the graph on the following page, spending on social services would still remain the largest functional category of government spending, estimated to amount to 52,7 per cent of the consolidated national and provincial government and social security funds' expenditure in fiscal 2006/07. Spending on social services was expected to increase at an average annual rate of 11,6 per cent over the three-year budget period. Within the protection services cluster, expenditure on defence and intelligence was set to decline as a share of the total, as outlays on the Strategic Defence Procurement Programme would be phased down, while strong growth was anticipated in police and justice functions. Provision was made for an average growth rate of 9,6 per cent per year in spending on police services. Although the provision for general government services seemed to increase, it was essentially due to the inclusion of a contingency reserve to the amount of R2,5 billion in fiscal 2006/07, R5 billion in fiscal 2007/08 and R8 billion in fiscal 2008/09. The contingency reserve provides for future unforeseen and unavoidable spending.

Functional classification of budgeted government expenditure*



* Consolidated national and provincial government and social security funds

The total revised *revenue of national government* was estimated to increase by 8,6 per cent from fiscal 2005/06 to fiscal 2006/07, and by a further 10,2 per cent for 2007/08. An increase of 11,2 per cent was estimated for fiscal 2008/09. As a ratio of gross domestic product, national government revenue was estimated to average 26,1 per cent over the medium term.

Due to higher-than-projected customs duties and increased imports from South Africa to other members of the customs union, transfers to Southern African Customs Union (SACU) partners would exceed the estimates in the 2005 Budget.

Specific tax adjustments were announced in the Budget, rendering a net tax relief of R19,1 billion in fiscal 2006/07. The tax relief primarily related to adjustments in personal income tax and, to a lesser extent, taxes on businesses.

Major tax proposals included an income tax rate reduction of R13,5 billion for individuals, with adjustment of the income tax brackets for individuals providing relief across the income spectrum; tax relief of R7 billion for businesses resulting from the abolition of regional services council levies; and a reduction in the tax on retirement funds' interest and rental income from 18 per cent to 9 per cent.

Transfer duty on houses below R500 000 was also abolished, while a 5-per-cent rate would apply between R500 000 and R1 million, and 8 per cent above R1 million. The monetary threshold for qualifying small businesses was increased, as were the monetary thresholds for capital gains and estate duty. Alcohol and tobacco taxes were customarily raised, while certain *ad valorem* excise duties were abolished.

The net result of the budgeted revenue and expenditure of national government for the 2006/07 fiscal year was an estimated deficit before borrowing and debt repayment of R26,4 billion. As a ratio of gross domestic product, the deficit would amount to 1,5 per cent. It was envisaged that this ratio would recede to 1,4 per cent in fiscal 2007/08 and 1,2 per cent in fiscal 2008/09. The primary balance (i.e. the deficit before borrowing excluding state debt cost) for 2005/06 was expected to be a surplus amounting to

2,8 per cent of gross domestic product. This surplus would decline to approximately 1,5 per cent for fiscal 2006/07 and beyond.

As indicated in the accompanying table, the net borrowing requirement of national government for fiscal 2005/06 was determined after providing for certain extraordinary receipts and payments. Included in the extraordinary payments was an amount of R4,5 billion paid to the South African Reserve Bank to defray losses made on the GFECRA. A liability of R4,3 billion relating to Saambou Bank originally expected to be paid in fiscal 2007/08 would be settled in fiscal 2005/06.

Financing of national government deficit

R billions

Item or instrument	Revised estimate	Medium-term estimates		
	2005/06	2006/07	2007/08	2008/09
Deficit	**7,9**	**26,4**	**27,2**	**24,2**
Plus: Extraordinary payments[1]	8,9	-	-	-
Cost/profit on repayment of maturing foreign loans[2]	0,5	1,4	0,6	2,5
Less: Extraordinary receipts[3]	4,5	0,2	0,3	0,3
Net borrowing requirement	**12,8**	**27,6**	**27,5**	**26,4**
Treasury bills	5,9	5,8	5,7	5,8
Domestic government bonds issued[4]	25,3	10,2	17,7	24,2
Foreign bonds and loans[5]	1,2	3,8	4,3	4,8
Changes in available cash balances[6]	-19,6	7,8	-0,2	-8,4
Total net financing	**12,8**	**27,6**	**27,5**	**26,4**

1 Including payments on the Gold and Foreign Exchange Contingency Reserve Account and premiums paid on debt portfolio restructuring previously included in state debt cost expenditure
2 Revaluation gains or losses. Cost (+)/profit (-)
3 Including proceeds from the restructuring of state assets and strategic stocks
4 Including premiums and book profits resulting from debt restructuring previously included in revenue
5 Excluding revaluation of maturing foreign loans
6 Increase (-), decrease (+)

Although extraordinary receipts of only R1,0 billion in fiscal 2005/06 were provided for in the 2005 Budget, this was revised to R4,5 billion on account of foreign exchange amnesty proceeds and special dividends from Eskom and Telkom.

Sound debt management was set to continue, managing the cost of servicing debt within an acceptable risk management framework. Government intended increasing the stock of Treasury bills annually by R6 billion from fiscal 2006/07 to 2008/09. It was envisaged that financing through the issuance of fixed-income bonds in the domestic capital market would remain the principal means of financing for national government over the medium term, with net issuance more than doubling from fiscal 2006/07 to 2008/09. New fixed-income bonds in the 2021 and 2036 maturity areas would be introduced to spread issuance over the medium to long term. In fiscal 2006/07 an amount equivalent to US$1 billion would be borrowed in the international markets mainly to cover the maturing foreign debt.

It was estimated that national government gross loan debt would increase from R534 billion at the end of fiscal 2005/06 to R554 billion at the end of March 2007 and to R640 billion at the end of March 2008. As a ratio of gross domestic product, national government gross loan debt was expected to decrease from 34,2 per cent at the end of fiscal 2005/06 to 32,3 per cent at the end of fiscal 2006/07, and eventually to 30,5 per cent at the end of fiscal 2008/09.

Infrastructure programmes involve not only the various levels of general government, but the public sector at large. Spending on infrastructure by the public sector is expected to amount to R372 billion over the next three years. Several investment programmes, industrial policy initiatives and regulatory reforms aim to ensure that both infrastructure capacity and improved economic performance underpin accelerated economic growth and rising living standards. The public-sector borrowing requirement as a ratio of gross domestic product was projected to decrease to 0,6 per cent in fiscal 2005/06 from 1,2 per cent stated in the *Medium Term Budget Policy Statement* in October 2005. The borrowing requirement is projected to increase to 2,4 per cent in fiscal 2006/07 and to be broadly maintained at that level over the medium term, as shown in the accompanying graph.

Non-financial public-sector borrowing requirement

It was expected that this increase in the borrowing requirement would translate into greater economic growth as a result of investment in productive capacity. Over the medium term infrastructure and capital expenditure at all levels of government were projected to accelerate. Part of this would be financed through greater claims by the public sector on the capital market.

Public-sector borrowing requirement
R billions

Level of government	Revised estimate	Medium-term estimates		
	2005/06	2006/07	2007/08	2008/09
National government	10,3	24,7	25,7	22,7
Reconstruction and Development (RDP) Fund	-0,4	-0,2	-0,2	-0,2
Extra-budgetary institutions	-1,6	-1,6	-1,5	-1,2
Social security funds	-6,5	-5,0	-4,5	-4,7
Provincial governments	-1,8	0,6	-0,0	-0,8
Local authorities and local government enterprises	9,2	10,1	11,0	12,1
General government	9,2	28,5	30,5	27,9
Non-financial public enterprises	0,9	12,0	13,0	21,5
Public-sector borrowing requirement	10,1	40,5	43,5	49,4
Per cent of GDP	*0,6*	*2,4*	*2,3*	*2,4*

Statement of the Monetary Policy Committee

8 December 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

Inflation has remained under control and within the inflation target range, and growth in gross domestic product (GDP) has been robust. The recent revisions of the GDP data show that the economy has been growing at a faster rate than previously estimated. The most significant change was to the 2004 growth rate, which is now estimated to have been 4,5 per cent. A slightly higher growth rate is expected to be achieved this year, although there are signs that the economy might be losing some of its earlier momentum.

At the October MPC meeting, the inflation outlook had deteriorated somewhat, which was a cause for concern. Since then, however, recorded outcomes have been better than anticipated, and the outlook has changed somewhat. However a number of significant risks remain.

Recent inflation developments

Inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) declined to 4,7 per cent in September, and 4,4 per cent in October following its peak of 4,8 per cent in August. The decline occurred despite the increases in local petrol prices in September and October of R0,29 and R0,12, respectively. Since then the petrol price has been reduced by R0,31 in November and R0,30 in December. If petrol price increases were excluded from this index, CPIX inflation in September and October would have measured 3,5 per cent and 3,2 per cent, respectively, reflecting a continued absence of marked second-round effects from petrol price increases.

These more favourable outcomes have been due to a number of factors which partly offset the impact of the petrol price increases. Notable among these were the year-on-year declines in the prices of clothing and footwear, furniture and equipment, and homeowners' costs. Year-on-year food price inflation also remained low, measuring 2,5 per cent in October compared to 3,3 per cent in September. Services inflation moved further within the inflation target range, having declined to 5,2 per cent in October, compared to goods price inflation of 4,1 per cent. Of significance is the fact that administered prices excluding petrol declined to 4,5 per cent and 4,3 per cent in September and October, respectively. This can be compared to a rate of increase of 7 per cent in May. Administered price inflation including petrol amounted to 10,0 per cent in October.

Production price inflation also reversed its recent upward trend in October when it measured 4,2 per cent, compared to 4,6 per cent in September. Prices of domestically produced goods rose by 3,8 per cent and 3,5 per cent in September and October, respectively, while price increases of imported goods amounted to 6,8 per cent and 5,8 per cent. The food price category continued to exhibit price declines.

The outlook for inflation

As a result of the lower inflation outcomes as well as the changes in some of the determinants of the inflation outlook, CPIX inflation is now forecast to run at a level somewhat below the previous forecast and reach a level of around 5 per cent by the end of 2007.

There are a number of changes that have occurred since the previous meeting of the MPC which have led to this improved inflation outlook. Perhaps the most significant have been developments in the international oil market. In the aftermath of the series of hurricanes and the build-up of oil inventories in the United States, oil prices have moderated somewhat and Brent crude has averaged around US$55 since November. At the time of the previous MPC meeting, the price of Brent crude had fallen to just below US$60 per barrel, having averaged around US$64,50 per barrel in August and US$63 per barrel in September. The current levels are therefore significantly lower than they have been for some time. However given the risks and volatility in the oil markets, including uncertainties related to the Northern Hemisphere winter, this situation could change very rapidly, and will therefore be carefully monitored.

The resultant R0,61 cumulative decline in domestic petrol prices in November and December will be reflected in the CPIX outcomes for these months. Currently there is a significant overrecovery on the petrol price which, if sustained, is likely to result in a further petrol price reduction in January.

To date the overall impact of the international oil price increases on inflation and output has been far more muted than originally expected, both domestically and internationally. World growth is expected to remain relatively vigorous, particularly in the United States and Asia, and according to IMF projections, world inflation is expected to moderate next year to an average rate below 4 per cent.

According to the inflation expectations survey conducted by the Bureau for Economic Research at the University of Stellenbosch, overall CPIX inflation expectations in the fourth quarter of 2005 remained unchanged compared to the third quarter. All categories of respondents still expect inflation to remain within the target range over the next two years. CPIX inflation is expected to average 5,2 per cent in both 2006 and 2007. This represents an unchanged picture for 2006, compared to the previous survey, but the expectations for 2007 are now 0,2 percentage points lower than in the third quarter. The expectations of trade unionists and business people increased marginally for next year, but this was offset by the decline in the expectations of analysts.

Inflation expectations as indicated in the long-term break-even inflation rates, measured as the yield differential between conventional bonds and inflation-linked bonds, point to some improvement in inflation expectations. The break-even inflation rate in the five-to-eight year maturity range decreased from a recent high of 5,1 per cent in mid-October to 4,8 per cent at the end of November.

Exchange rate developments have reinforced the impact of the lower international oil prices on the domestic petrol prices. The rand initially depreciated against the dollar after the previous MPC meeting, but in recent weeks it has appreciated against most currencies. Since the previous meeting the nominal effective exchange rate of the rand has appreciated by almost 7 per cent. This recent rand strength is explained in part by improved international perceptions of South Africa's growth prospects and higher commodity prices. In recent days the platinum price has breached the US$1 000 level, and the gold price has exceeded US$500.

Wage growth has remained moderate with unit labour cost increases in the first half of the year being well within the inflation target range. Revised year-on-year increases in unit labour costs in the formal non-agricultural sector measured 3,8 per cent and 4,5 per cent in the first two quarters of this year respectively, while unit labour cost increases in the manufacturing sector measured 4,4 per cent and 0,2 per cent in these quarters. Surveys by Andrew Levy Employment Publications show that wage settlements for the first 9 months of this year averaged 6,2 per cent, down from 6,7 per cent in the same period of 2004.

Regarding fiscal policy, the October *Medium Term Budget Policy Statement* indicated that the budget deficit for the current fiscal year is now expected to be approximately one per cent of GDP compared to an initial budgeted estimate of 3,1 per cent. Furthermore, the projected deficits for the forthcoming two fiscal years are expected to be around 2 per cent of GDP.

Output and expenditure trends, however, are likely to be a source of upward pressure on inflation. According to the recently revised data, the economy grew at an annualised rate of 5,2 per cent in the first two quarters of 2005 before slowing to 4,2 per cent in the third quarter. Manufacturing capacity utilisation also remained high in the third quarter and the composite leading business cycle indicator has continued its rising trend. Although growth is expected to continue at a robust pace, there are also some indications of a slowdown in manufacturing-sector growth as seen in the significant decline in the Investec/BER Purchasing Managers Index over the past four months, and the 4,9 per cent decrease in real manufacturing production in October.

Expenditure also remains robust with real gross domestic final demand growing at a rate of around 6 per cent in the first three quarters of this year. Real household expenditure has been growing at a similar rate. Motor vehicle sales continued to reach new highs, but the rate of increase has declined. In October, the number of new motor vehicles sold decreased by 1,7 per cent compared to September sales. The strong demand is underpinned by the current level of interest rates and strong asset prices, with the JSE Securities Exchange reaching new record highs in November. Although house prices continue to rise, the rate of increase has declined significantly. These favourable conditions have resulted in household debt as a percentage of disposable income rising to 63,5 per cent in the third quarter of 2005.

Money supply and credit extension growth remain at high rates consistent with expenditure growth, but there may be some signs of moderation. M3 money supply decelerated from a year-on-year rate of 19,0 per cent in August 2005 to 16,8 per cent and 16,4 per cent in September and October, respectively. Growth in total loans and advances, driven mainly by asset-backed credit, declined marginally from 21,9 per cent in August to 20,5 per cent in October. Part of this could be due to increased securitisation. Mortgage advances in particular remained strong, reflecting continued buoyancy in the housing market.

The increasing deficit on the current account of the balance of payments is a potential concern. The latest data show that the current account deficit increased to 4,7 per cent of GDP in the third quarter, up from a revised deficit of 3,7 per cent in the second quarter. These deficits are a reflection of higher domestic expenditure and are not in themselves inflationary. To date the deficits have been more than adequately financed by capital inflows which, in turn, are being attracted by the improved growth prospects in the economy. The overall balance of payments has remained in surplus, and the level of gross gold and foreign exchange reserves increased slightly above the US$20 billion level to date.

Monetary policy stance

Taking the above factors into consideration, the Monetary Policy Committee has decided to leave the repo rate unchanged at 7 per cent per annum. The MPC will, as is usually the case, remain vigilant in order to ensure that CPIX inflation stays within the inflation target range. Should the outlook deteriorate, the MPC will not hesitate to adjust the repo rate in the appropriate direction.

Statement of the Monetary Policy Committee

2 February 2006

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

Introduction

The inflation outlook remains promising despite the risks posed by an uncertain global environment. World growth is expected to remain buoyant in most regions, although international oil price developments continue to weigh on global growth and inflation prospects. At the same time, world growth has underpinned international commodity prices which, along with positive non-resident investor sentiment, have contributed to the recent strength in the rand. This has been despite monetary policy tightening in a number of countries, in particular the United States of America and the euro area.

Domestically, there are few signs of a slowdown in domestic demand. Output growth in the manufacturing and mining sectors have shown some signs of moderation in the final quarter of 2005, although overall growth is expected to remain relatively strong. Domestic demand conditions and oil price uncertainties pose the biggest risk to the inflation outlook.

Recent inflation developments

Inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) declined to 3,7 per cent in November, but increased to 4,0 per cent in December. Although domestic petrol prices were decreased by a total of R0,61 in these two months, these prices nevertheless increased on a year-on-year basis by 17,7 per cent and 16,0 per cent, respectively. If petrol prices were excluded from this index, CPIX inflation would have measured 3,0 per cent and 3,4 per cent in November and December, respectively. For the year as a whole, CPIX inflation averaged 3,9 per cent in 2005 compared to 4,3 per cent in 2004.

Services price inflation has declined consistently since June 2005, and measured 5,0 per cent and 4,7 per cent in November and December, respectively, compared to 5,2 per cent in October. Administered price inflation has also continued to decline, falling to 7,5 per cent and 7,0 per cent in November and December, respectively. If petrol prices were excluded, administered prices would have increased at a year-on-year rate of 4,3 per cent in each of the three months to December 2005, more or less in line with overall CPIX inflation.

Clothing and footwear continue to put downward pressure on inflation, and prices in these two categories declined at year-on-year rates of around 4 per cent in the last four months of 2005. By contrast, food prices rose at an annual rate of 4,0 per cent in December, compared to the average for the year of 2,1 per cent. The December increase in food prices mainly was attributable to meat prices which rose at a year-on-year rate of 6,9 per cent, compared to 1,1 per cent the previous month.

Production price inflation has exhibited a more discernible rising trend, with year-on-year producer price inflation measuring 4,5 per cent and 5,1 per cent in November and

December, respectively. Imported goods inflation measured 5,7 per cent and 6,5 per cent in these two months while domestically produced goods increased by 4,0 per cent and 4,6 per cent, respectively. Producer price inflation for 2005 as a whole averaged 3,1 per cent compared to 0,6 per cent the previous year.

The outlook for inflation

Since the previous MPC meeting, the inflation forecast of the South African Reserve Bank has changed somewhat, with the inflation trajectory now expected to follow a more moderately rising trend compared to that discussed at the previous meeting. According to the central forecast, CPIX inflation is expected to peak at around 4,9 per cent in the first quarter of 2007 whereafter it is expected to decline slowly to reach around 4,7 per cent at the end of the forecast period.

As usual the MPC considered the factors that brought about this outlook as well as the related risks. The robust domestic demand is an important factor which could negatively affect the inflation outcome. To date, however, there have not been any significant inflationary consequences, although this could change if demand growth were to accelerate unchecked.

Indications are that household consumption expenditure growth has remained strong. According to the latest FNB/BER survey, consumer confidence reached a record high in the fourth quarter of 2005. New vehicle sales reached an all-time high in December, and increased by 25,7 per cent over the year as a whole. Retail sales have also continued to grow robustly, and recent trading and earnings updates from retailers, as well as credit extension data, suggest that sales growth in November and December of 2005 probably matched or exceeded the 7,7 per cent year-on-year growth recorded in October.

The strong domestic demand has been underpinned by the growth in credit extension. Total loans and advances to the private sector grew at year-on-year rates of around 20 per cent during October and November 2005, and rose to 21,4 per cent in December. This growth in total loans and advances has been driven mainly by an increase in asset-backed credit. Mortgage advances extended to the household sector remain particularly strong.

Asset price developments and their related wealth effects have probably also contributed to the consumption boom. The housing market remains buoyant, although the rate of increase in house prices has moderated somewhat. In December 2005, the Absa house price index increased on a month-on-month basis by 0,7 per cent. Moreover, the recent stellar performance of the JSE Securities Exchange could also impact on consumer demand. In the past few months, share prices have continued to reach new highs. Since reaching a low point for 2005 in April, the all-share index has increased by approximately 60 per cent.

The brisk domestic demand has had an impact on the current account deficit which increased to 4,7 per cent of GDP in the third quarter of 2005.

A sizeable trade surplus was recorded in December following a sharp decline in imports. This has contributed to a significant narrowing of the trade deficit from R19,6 billion in the third quarter to R1,4 billion in the fourth quarter of 2005. This is likely to result in a narrowing of the current account deficit in that quarter.

Continued strong domestic demand is expected to maintain pressure on the current account. However the current account deficit continues to be more than adequately financed by capital inflows which, in turn, are being attracted by improved economic growth prospects in South Africa. The overall balance of payments has remained in surplus, and the level of official gross gold and foreign exchange reserves increased to US$22,2 billion at the end of January 2006.

The coincident business cycle indicator declined slightly in October 2005, although indications are that the economy is still growing at a healthy but perhaps more moderate pace. The physical volume of mining production declined in October and November, while manufacturing output declined in October, mainly as a result of supply issues in the petroleum industry related to the change to lead-free fuel. Although refinery shut-downs continued into November, manufacturing output recovered somewhat in that month, recording a year-on-year growth of 2,1 per cent. The latest Investec Purchasing Managers Index (PMI) also indicates that there might be a general slackening in manufacturing-sector growth. The various business confidence indices indicate that confidence generally remains at high levels.

Two exogenous factors, namely oil and food price developments, are potential risks to the inflation outlook. At the time of the previous MPC meeting the price of Brent crude oil was around US$55 per barrel, but since the beginning of 2006 international oil prices have again risen to levels of around US$65 per barrel. Apart from continued strong demand for oil, upward pressure on prices has emanated from supply threats related to geo-political concerns. The higher prices have already resulted in a domestic petrol price increase of R0,14 per litre in February, which more than offset the R0,06 per litre decrease in January.

Developments in food price inflation are also a potential concern. As noted earlier, food price inflation has accelerated but is still relatively low. Food price inflation is expected to be higher in 2006, partly as a result of the low base in 2005. Furthermore, the higher food price inflation evident in production prices, along with higher maize prices, also point to a possible acceleration in retail food price inflation going forward.

There are a number of factors which have contributed to the positive inflation outlook. These include continued fiscal discipline, low world inflation and well-anchored inflation expectations. Inflation expectations as indicated in the long-term break-even inflation rates, measured as the yield differential between conventional bonds and inflation-linked bonds, point to some improvement in inflation expectations since the previous meeting.

Nominal wage growth recorded a year-on-year increase of 7,9 per cent in the third quarter of 2005. However, positive productivity growth ensured that unit labour cost increases have remained consistent with the inflation target. Unit labour cost in the formal non-agricultural sectors recorded annual increases of 3,5 per cent and 4,2 per cent in the second and third quarters of 2005, respectively. Unit labour cost in manufacturing grew at an annual rate of 0,2 per cent in the third quarter. These moderate trends in wage increases are consistent with the latest Andrew Levy Employment Publications report which shows that average wage settlements declined from 6,9 per cent in 2004 to 6,3 per cent in 2005.

Since the previous meeting of the MPC, the nominal effective exchange rate of the rand has appreciated by approximately 1,7 per cent. During this period, the rand has fluctuated between R6,75 to the US dollar in November 2005 and R5,95 in January, and is currently trading at levels of around R6,10. The strengthening of the rand was in part a reflection of US dollar depreciation. In addition, the rand was supported by high commodity prices, expectations of further foreign direct investment inflows, positive South African economic data as well as strong demand from non-residents for South African equities.

Monetary policy stance

There are significant risk factors to the inflation outlook that the Monetary Policy Committee is mindful of. Nevertheless, the Monetary Policy Committee has decided for now to leave the repo rate unchanged at 7 per cent per annum. The MPC will continue to exercise vigilance in order to ensure that CPIX inflation stays within the inflation target range.

Note on flows of funds in South Africa's national financial accounts for the year 2004

by Z Nhleko and D H Meyer[1]

Introduction

The national financial accounts, also referred to as the flow-of-funds accounts, summarise the financial relationships that exist among the monetary and financial statistics, national accounts, balance of payments and government finance. South Africa's national financial accounts for 2004 are presented on pages S-44 to S-53 of this issue of the *Quarterly Bulletin*.

This note is a concise analysis of both the real and financial activities of the various institutional sectors within the South African economy. The national financial accounts provide a framework for the analysis of lending and borrowing behaviour in the economy and economic agents' changing financial instrument preferences. Changes in the regulation of the financial system and financial markets play a crucial role in the process of financing sectoral deficits.

Institutional sector data used to compile the national financial accounts are obtained from surveys and other sources of information available to the Research Department of the South African Reserve Bank. Eleven institutional sectors are balanced individually and consolidated by way of contra-entry accounting in two-dimensional tables[2].

Financing balances

The uses of funds to invest in any sector cannot exceed saving unless it is supplemented by inflows from other sectors. The saving-investment imbalance within each of the individual sectors is resolved by net lending to or borrowing from the other sectors. Table 1 summarises the saving and investment activity in South Africa for 2003 and 2004 across the main sectors.

The foreign sector was a net supplier of funds to the domestic economy in both years as gross capital formation in the South African economy outstripped the available gross saving. Accordingly, South Africa ran current-account deficits; the extent to which domestic economic activities are funded by the rest of the world mirrors the balance on the current account of South Africa.

Private non-financial business enterprises are generally both large savers and large investors. In 2004 private non-financial business enterprises recorded gross saving equal to 8 per cent of gross domestic product and gross capital formation equivalent to 10 per cent of gross domestic product. Although private non-financial business enterprises were responsible for more than 44 per cent of total gross saving in 2004, the sector was a net borrower of funds. General government also remained a net borrower of funds, and was in fact the largest net borrower in both years under review. Financial intermediaries, public non-financial business enterprises and households were net lenders of funds.

1 The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank. The Bank wishes to express its sincere appreciation to all the reporting organisations – government departments, financial market and other public and private-sector institutions – for their co-operation in furnishing the data used for the compilation of South Africa's financial accounts.

2 For a further technical analysis on the compilation of the accounts see Kock, M A and Meyer, D H. 2001: "A note on flows of funds in South Africa's national financial accounts for the year 1999." Quarterly Bulletin*, No 219, March.*

Table 1 Financing balances[1,2] 2003 and 2004

R millions Surplus units (+)/deficit units (-)

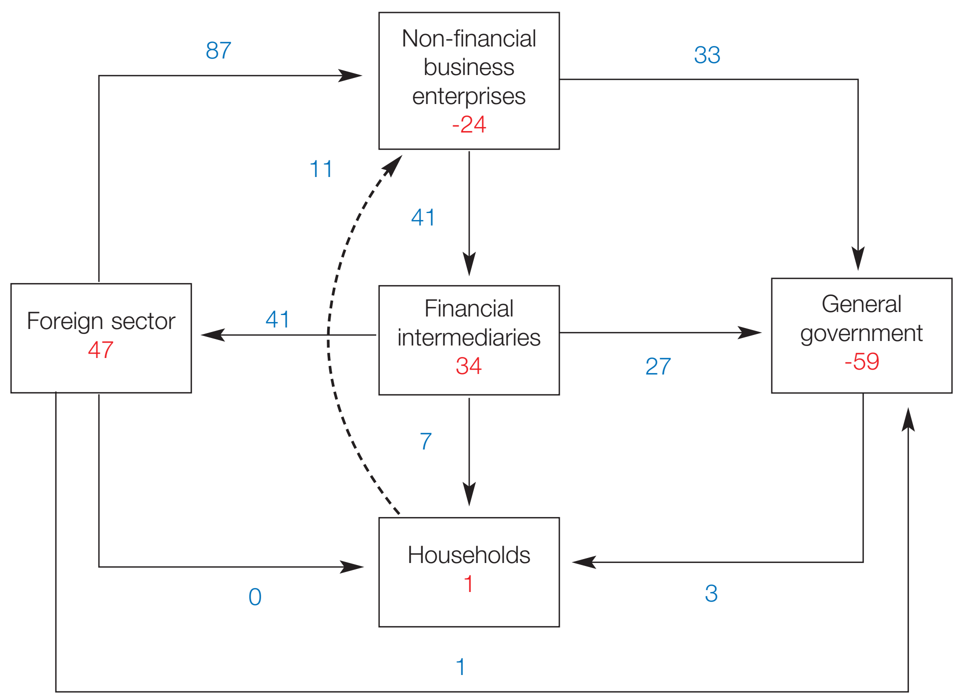
	2003			2004		
	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)
Foreign sector[3]	16 761	-	16 761	47 127	-	47 127
Financial intermediaries ...	30 135	4 232	25 903	41 204	7 020	34 184
General government........	-11 231	38 871	-50 102	-20 786	37 887	-58 673
Non-financial business enterprises						
Public	33 877	22 949	10 928	34 720	24 044	10 676
Private	106 966	120 480	-13 514	106 981	141 736	-34 755
Households[4]	36 487	26 463	10 024	33 521	32 080	1 441
Total...............................	212 995	212 995	-	242 767	242 767	-

1 Gross saving plus net capital transfers less gross capital formation. Gross capital formation consists of total fixed-capital formation and total changes in inventories, before providing for consumption (depreciation) of fixed capital.
2 A positive amount reflects a net lending position and by implication a net acquisition of financial assets, whereas a negative amount reflects a net borrowing position and by implication a net incurrence of financial liabilities.
3 A positive amount reflects a surplus for the rest of the world and is therefore a deficit on South Africa's balance on current account of the balance of payments. A negative amount represents a deficit for the rest of the world and is a surplus on South Africa's balance on current account of the balance of payments.
4 Including unincorporated business enterprises and non-profit institutions serving households.

The accompanying diagram depicts a condensed sector-to-sector net flow-of-funds analysis showing the main financial relationships among the various sectors. The net lending or borrowing positions of the various sectors are shown inside the boxes and the

Net intersectoral flow of funds, 2004

R billions



inter-sectoral flow of funds are shown outside the boxes. The net lending or borrowing position of the sectors is calculated by treating inflows as negatives and outflows as positives. Financial intermediaries played a pivotal role in the financial system and interacted with all sectors as they received R41 billion from private and public non-financial business enterprises and transferred R27 billion to the general government. The bulk of foreign funding in 2004 went to non-financial business enterprises as they were able to attract an R87 billion net flow from the foreign sector. A net flow of R33 billion was recorded from non-financial business enterprises to the general government in 2004.

Sectoral analysis

In the process of financing shortfalls or allocating savings, certain patterns of behaviour develop in the various economic sectors. The lending and borrowing needs of individual sectors and changes in preference for financial markets instruments are briefly reviewed in this section.

Foreign sector

The foreign sector represents the mirror image of South Africa's balance of payments and includes all non-resident units that enter into transactions with South African residents.

Table 2 Flow of funds: Foreign sector and combined domestic sectors, 2004

R millions

	Domestic institutional sectors	Rest of the world	Total
Gross saving	195 640	47 127	242 767
Gross capital formation	242 767	-	242 767
Net lending (+)/net borrowing (-)	**-47 127**	**47 127**	-
Net acquisition of financial assets	477 176	104 435	581 611
Net incurrence of financial liabilities	524 303	57 308	581 611

In 2004 South Africa was a net borrower of funds from the rest of the world in order to finance the deficit of R47,1 billion on the current account of the balance of payments. As depicted in Table 2, this meant that the domestic economy's total incurrence of financial liabilities exceeded its net acquisition of financial assets by a similar amount. Net inflows from the rest of the world served to fill the gap between domestic saving and investment. These inflows occurred mainly as non-residents increased their holdings of domestic shares and extended trade credit and short-term loans to domestic sectors. Gold and foreign exchange reserves held by the monetary authority[3] increased significantly in 2004.

3 *For an analysis on the recent redefinition of the country's gold and foreign reserves see Motsumi, L and Balance of Payments Division. 2005. "Note on the redefinition of gold and other foreign reserves in the balance of payments."* Quarterly Bulletin, *No 238, December.*

Financial intermediaries

As depicted in the diagram at the beginning of this note, financial intermediaries play a pivotal financial intermediation role in the economy. These institutions convert deposits and investments into financial asset and liabilities that attract financial flows from entities with surplus funds while meeting the financial requirements of those seeking funding. Financial intermediaries in South Africa are grouped into five subsectors and consist of both banks and non-bank institutions. The five subsectors are the monetary authority, other monetary institutions, the Public Investment Corporation, insurers and retirement funds, and other financial institutions. These are discussed individually in the following paragraphs.

Monetary authority

The monetary authority sector consists of the South African Reserve Bank and the Corporation for Public Deposits. While fulfilling its functions such as formulation and implementation of monetary policy, bank supervision and international reserves management, this sector interacts mostly with other monetary institutions, the central government and the foreign sector.

Significant deposits amounting to R13,6 billion were made by banks with the South African Reserve Bank in 2004 in order to comply with the cash reserve requirement. The monetary authority took advantage of the strength of the exchange value of the rand to increase its foreign exchange reserves. Calculated in rand terms and adjusted for valuation, gold and other foreign exchange reserves held by the monetary authority increased by R40,5 billion in 2004.

Realised losses incurred by the South African Reserve Bank in conducting its foreign exchange operations, which were previously accumulated on the Gold and Foreign Exchange Contingency Reserve Account, were reduced by R7,0 billion by the National Treasury in 2004, thereby improving the balance sheet of the monetary authority sector. Movements in other monetary flows not related to money supply led to significant declines in other financial assets.

Other monetary institutions

The other monetary institutions sector comprises the consolidated accounts of banks, mutual banks, the Land Bank and the Postbank. Table 3 shows that this sector was a financing-surplus sector and therefore able to provide funds, on a net basis, to other sectors.

Other monetary institutions incurred financial liabilities of R111,3 billion during the period under review, of which R115,4 billion were monetary deposits. Supported by the low interest rate environment as well as a robust real-estate market, the intermediation of funds to deficit sectors was effected mainly through loans. Bank loans and advances amounting to R44,4 billion and mortgage loans to the value of R80,9 billion were extended to deficit sectors during 2004. Other monetary institutions also reduced bills, bonds and loan stock in issue.

Other monetary institutions increased their gold and other foreign assets by R12,5 billion in 2004. This amount no longer forms part of the official reserves of South Africa and for the purposes of the flow of funds is now included in deposits with other foreign institutions.

In 2004, other monetary institutions invested 96 per cent of their total resources in financial assets. This sector's asset flows accounted for close to 40 per cent of financial intermediary asset flows and 15 per cent of total asset flows. The sector's total asset and liability flows amounted to 9 per cent of gross domestic product in 2004.

Table 3 Flow of funds: Other monetary institutions, 2004

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	17 544	
Gross capital formation		5 230
Net lending (+)/net borrowing (-)	12 314	
Net financial investment (+/-)		12 314
Net incurrence of financial liabilities	111 345	
Net acquisition of financial assets		123 659
Monetary deposits	115 394	3 510
Deposits with other institutions	-	13 984
Foreign	-	12 498
Domestic	-	1 486
Bank loans and advances	-50	44 424
Bills, bonds and loan stock	-945	13 713
Mortgage loans	-	80 875
Other assets/liabilities	-3 054	-32 847
Total sources/liabilities and uses/assets	**128 889**	**128 889**
	Per cent	
Percentage of total sources used for gross capital formation	4,0	
Percentage of total sources used to acquire financial assets	96,0	
Percentage of total asset flows	15,0	
Percentage of total financial intermediary asset flows	37,0	
Total assets/liabilities as a percentage of GDP	9,0	

The flow-of-funds account for this sector highlights the steep increase of bank loans and advances as well as mortgage loans in 2004. These were mainly taken up by the household sector whose willingness to utilise credit facilities was raised by the favourable economic conditions and enhanced affordability of credit.

Public Investment Corporation[4]

The main function of the Public Investment Corporation is to invest funds on behalf of public-sector entities. The largest scheme looked after is the government employees' pension and provident funds. The Public Investment Corporation received inflows of R41,3 billion in 2004 and invested R8,7 billion of this amount in domestic shares and R13,4 billion in government bonds. The Public Investment Corporation increased the amount allocated to external fund managers in 2004. The share of the Public Investment Corporation in financial intermediation is gradually declining, as reflected in the corporation accounting for 12 per cent of the total financial intermediary asset flows in 2004; in 2003 the sector accounted for 13 per cent of these asset flows and in 2002 for 15 per cent.

4 The Public Investment Commissioners was corporatised in April 2005, and renamed Public Investment Corporation in the flow of funds

Insurers and retirement funds

Insurers and retirement funds recorded a net financing surplus of R7,9 billion in 2004, lower than the R10,5 billion recorded in 2003. Despite the smaller surplus compared with the previous year, insurers and retirement funds accounted for over a quarter of financial intermediary flows and was outdone only by other monetary institutions. As indicated in Table 4, the insurers and retirement funds received the bulk of their funds through premium contributions by members amounting to R52,3 billion in 2004.

Table 4 Flow of funds: Insurers and retirement funds, 2004

	R millions
Financing balance	**7 932**
Net incurrence of financial liabilities	**86 669**
Members' interest in the reserves of retirement and insurance funds	52 309
Other liabilities	34 360
Net acquisition of financial assets	**94 301**
Monetary deposits	20 386
Other deposits	38 725
Public Investment Corporation	35 843
Foreign deposits	-818
Other	3 700
Bills and bonds	26 854
Short-term government bonds	1 115
Long-term government bonds	26 864
Other	-1 125
Other loan stock and preference shares	689
Domestic	1 084
Foreign	-395
Shares	-14 402
Domestic	-16 902
Foreign	2 500
Other assets	32 349
	Per cent
Percentage of total asset flows	11,0
Percentage of total financial intermediary asset flows	27,0
Total assets/liabilities as percentage of GDP	7,0

Uncertain global market and risk containment considerations contributed to a preference for investment in those domestic financial instruments carrying limited risk. This was reflected in significant increases in holdings of government bonds and monetary deposits, while investments in shares decreased in the year 2004. The official pension and provident funds increased their investment portfolios with the Public Investment Corporation by R35,8 billion. This sector's total asset and liability flows amounted to 7 per cent of gross domestic product in 2004.

Other financial institutions

Other financial institutions comprise, among other things, collective investment schemes, finance companies and public financial enterprises. Collective investment schemes, in turn, comprise unit trusts and participation bond schemes. Unit trusts dominate the activities of the other financial institutions sector. The sector acquires funds and carries out investments through sales of units in unit trusts, purchasing of securities, lending and similar activities. Table 5 shows that during 2004 other financial institutions received funds from investors amounting to R42,4 billion. Institutional investment with unit trusts grew at a faster pace than that of households and made non-financial business enterprises the largest contributors to the financial activity of the other financial institutions sector in 2004.

Table 5 Flow of funds: Other financial institutions, 2004

	R millions
Financing balance	**12 642**
Net incurrence of financial liabilities	**43 196**
Deposits received	42 384
Long-term loans	1 523
Other liabilities	-711
Net acquisition of financial assets	**55 838**
Monetary deposits	36 274
Other deposits	3 929
Foreign deposits	4 016
Other	-87
Bills and bonds	135
Short-term government bonds	-1 562
Long-term government bonds	-721
Other	2 418
Trade credit and short-term loans	4 387
Other loan stock and preference shares	5 504
Domestic	5 149
Foreign	355
Shares	19 818
Domestic	23 874
Foreign	-4 056
Other assets	-14 209
	Per cent
Percentage of total asset flows	7,0
Percentage of total financial intermediary asset flows	16,0
Total assets/liabilities as percentage of GDP	4,0

Similar to insurers and retirement funds, other financial institutions also preferred investment in the domestic financial markets. Their investment in 2004 focused on monetary deposits and shares. Smaller investments in domestic loan stock and preference shares as well as foreign deposits also occurred. This sector accounted for 16 per cent of the total financial intermediary asset flows in 2004, somewhat lower than the 18 per cent recorded in 2003. The total asset and liability flows of other financial institutions amounted to 4 per cent of gross domestic product in 2004.

Central and provincial governments

In 2004 the financing deficit of the central and provincial governments amounted to R33,2 billion or 2 per cent of gross domestic product, a ratio similar to 2003. To finance the deficit, financial assets were increased by R6,2 billion while an amount of R39,3 billion was raised in the financial markets, as represented in Table 6.

Table 6 Flow of funds: Central and provincial governments, 2004

	R millions
Financing balance	**-33 170**
Net acquisition of financial assets	6 162
Net incurrence of financial liabilities by financial instrument	**39 332**
Treasury bills	9 273
Short-term government bonds	3 142
Long-term government bonds	33 798
Non-marketable government bonds	-2 346
Other	-4 535
Financing by sector	**39 332**
Foreign sector	1 698
Public Investment Corporation	14 460
Insurers and retirement funds	28 655
Other financial institutions	1 479
Other domestic sectors	-6 960

The financing included the issuance of R9,3 billion in Treasury bills and R36,9 billion in government bonds. Financing occurred mainly in the domestic market, accounting for R37,6 billion of the total amount raised. The Public Investment Corporation and the insurers and retirement funds were the two main sectors which took up new issuances of instruments in 2004.

Local governments

Local governments recorded a substantial overall financing deficit of R25,5 billion in 2004, almost equalling that of central government. They financed this deficit by raising funds in the domestic financial markets through issuing securities and taking up loans and trade credit from financial institutions. They also supplemented their equitable share from national government by collecting rates, fines and levies.

Public non-financial corporate business enterprises

The public non-financial corporate business enterprises sector recorded a net financing surplus of R10,7 billion in 2004. With its capital spending still relatively low, the sector was therefore able to finance its gross capital formation and remained with excess funds to channel to deficit sectors. The excess funds, together with a decrease in financial assets, made it possible for this sector to reduce its financial liabilities by a significant amount.

Private non-financial corporate business enterprises

Private non-financial corporate business enterprises recorded a financing deficit of R34,8 billion in 2004, significantly higher than the deficit of R6,7 billion recorded in 2003. In order to finance the deficit, the sector utilised a wide range of funding alternatives in the financial markets. This included the issuance of shares mainly in foreign financial markets, bank loans, non-bank long-term loans and mortgage loans, as well as the issuance of bills, bonds and loan stock. Excess funds were deposited with monetary institutions and other non-bank financial institutions while some investment also flowed into foreign shares. However, the gross capital formation of R141,7 billion represented almost 60 per cent of the total domestic gross capital formation in 2004 and, as such, indicates the continued importance of this sector towards real economic activity. The total asset and liability flows of private non-financial business enterprises amounted to 14 per cent of gross domestic product in 2004.

Table 7 Flow of funds: Private non-financial corporate business enterprises, 2004

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	105 926	
Capital transfers	1 060	5
Gross capital formation		141 736
Net lending (+)/net borrowing (-)	-34 755	
Net financial investment (+/-)		-34 755
Net incurrence of financial liabilities	86 699	
Net acquisition of financial assets		51 944
Monetary deposits	-	4 778
Other deposits	-1 976	13 984
Bank loans and advances	14 561	-
Trade credit and short-term loans	40 156	-13 749
Bills, bonds and loan stock	13 752	-7 499
Shares	49 739	15 105
Domestic	-1 396	-82
Foreign	51 135	15 187
Long-term and mortgage loans	29 568	4 134
Other assets/liabilities	-59 101	35 191
Total sources/liabilities and uses/assets	**193 685**	**193 685**
	Per cent	
Percentage of total sources used for gross capital formation	73,0	
Percentage of total sources used to acquire financial assets	27,0	
Percentage of total asset flows	23,0	
Total asset/liabilities as percentage of GDP	14,0	

Households

The gross saving of households in 2004 was just sufficient to finance their gross capital formation. Households took up more credit as they accessed additional funding through mortgage loans, other bank loans and advances. The growth in mortgage advances to households both reflected and contributed to the strong growth in house prices in 2004. Households' interest in retirement and life funds continued to rise while excess funds were deposited with banks and other financial institutions, such as unit trusts. Investment also flowed into shares issued by other institutions.

Summary and conclusion

The environment of lower inflation and interest rates provided a stable setting within which flow-of-funds decisions could be made and, coupled with the firm exchange value of the rand, boosted domestic financial market activity in 2004.

In conclusion, the analysis of South Africa's national financial accounts for the year 2004 reveals the following:

- the continued interest of non-resident investors in South African financial assets resulting in a net inflow of funds from the rest of the world;
- the rising gold and foreign exchange reserve holdings of the monetary authorities aided by the strength of the exchange value of the rand;
- continued buoyancy of credit extended by banks to households, alongside a more modest expansion in credit to private non-financial corporate business enterprises;
- continued preference by general government to finance its net borrowing requirement predominantly in the domestic financial markets;
- the significant contribution of private non-financial business enterprises towards capital formation; and
- the continued importance of financial intermediaries as net providers of funds to deficit sectors.

References

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Note to tables

Share prices, yields and stock exchange activity – Tables S–32 and S–33

From 3 January 2006, all companies listed on the JSE were re-classified according to the Industry Classification Benchmark standard, replacing the FTSE Global Classification System previously used by the JSE. The new classification system was developed by the FTSE Group and Dow Jones with the aim to standardise the classification of equities on a worldwide basis. The revised classification system necessitated a number of changes to the series covering share prices and yields.

Non-financial and financial public enterprises – Tables S–84 and S–85

The instruments and sectors covered in the balance sheets of the non-financial as well as financial public enterprises have been amended in conformity with the recommendations of the *Government Finance Statistics (GFS) Manual 2001.*

Inflation expectations survey – Table S–159

Table S-159 has been added to the *Quarterly Bulletin* to reflect the results of the Inflation Expectations Survey conducted by the Bureau for Economic Research (BER) at the University of Stellenbosch.