Quarterly Economic Review

Introduction

During the third quarter of 2007 global financial markets were unsettled by the considerable losses suffered in the United States (US) sub-prime mortgage market. This gave rise to increased levels of uncertainty, higher risk premia and a strong reduction in investor interest in structured products, in particular the numerous types of securities based on or related to sub-prime mortgage advances. The stifling of liquidity and turmoil in the credit markets prompted the US authorities to initiate a downward adjustment in short-term interest rates. The US Federal Reserve first reduced its discount rate and then lowered its key policy rate, the federal funds rate, by 50 basis points in mid-September 2007 and by a further 25 basis points in late October.

Notwithstanding the turmoil related to the sub-prime market, global economic growth remained brisk in the first three quarters of 2007. Emerging-market economies including China, India and virtually all the oil-exporting countries continued to bolster global production volumes, offsetting the hesitation in some of the developed economies. In Africa it seemed likely that the real growth rate for 2007 would exceed 5½ per cent for the fourth successive year, aided by the strong momentum of the world economy, high commodity prices and improved economic policies.

In South Africa the real economic growth rate for 2006 was revised upward to 5,4 per cent – a rate previously encountered in 1981. Growth in the first three quarters of 2007 fell marginally below that rate, displaying a slight reacceleration in the third quarter. The services sectors, and in particular the finance, real-estate and business services sector, made the strongest contribution to growth in the third quarter of 2007 as banks' balance sheets and revenues continued to expand apace. Trade and construction also recorded robust increases. By contrast, the real value added in manufacturing contracted in the third quarter as production was hampered by strike activity in the motor industry and slowing demand alongside a relatively strong exchange value of the rand. Capacity utilisation in manufacturing also receded significantly in the third quarter from earlier exceptionally high levels. At the same time mining output recovered as platinum and diamond production responded to favourable international prices, whereas growth in agriculture decelerated in the third quarter as field crop production declined.

From very strong rates of increase in the first quarter of 2007, growth in both real final consumption expenditure by households and real fixed capital formation decelerated in the subsequent two quarters. Tighter monetary conditions probably contributed to the slower pace of increase in household consumption and in some of the components of capital spending. Household debt nevertheless edged higher to a record level. Real inventory investment slowed in the third quarter of 2007, as the pace of inventory accumulation lost momentum in most sectors of the economy. By contrast, the government's real final consumption expenditure reverted to strong growth in the third quarter, reflecting the acquisition of military items and the normalisation of real compensation of employees which had previously been dragged down by the strike in the public service during the second quarter of 2007.

Despite the moderation in the pace of increase in real fixed capital expenditure, this component of aggregate final demand still rose at a double-digit annualised rate in the third quarter of 2007. Accordingly, some further rebalancing from household consumption to capital expenditure was recorded. Under these circumstances real imports edged higher, whereas export volumes recorded a marginal decline. Furthermore, import prices were bolstered by the further surge in international crude oil prices, while considerably higher dividend payments to non-resident investors contributed to a widening of the deficit on the services and income account of the balance of payments. The net result of these forces was that the deficit on the current account of the balance of payments widened to 8,1 per cent of gross domestic product in the third quarter of 2007 – the highest ratio since the 9,2 per cent registered in the first quarter of 1982.

However, this deficit was again readily financed by non-resident capital inflows. In fact, such inflows were enough to enable the South African Reserve Bank (the Bank) to purchase an amount of more than US$2 billion in the foreign-currency market during the third quarter alone. Further additions to the Bank's reserves in October and November 2007 brought the level of the gross gold and foreign-exchange reserves to more than US$32 billion at the end of November 2007 – four times as much as at the end of 2003. Recently the official gross reserves have covered the country's foreign-currency denominated external debt maturing within one year almost twofold. The net inward movement of capital was recorded in all investment categories, although more prominent in the category for inward portfolio investment.

The nominal effective exchange rate of the rand depreciated significantly from late July to mid-August 2007 following the eruption of turmoil in international credit markets, but subsequently recovered as it became clear that emerging markets were not directly affected. The US dollar, by contrast, reached successive record lows against the euro in recent months. News in late October 2007 of the acquisition of a 20-per-cent stake in a South African bank by a Chinese bank provided further support to the exchange value of the rand. In the second half of November, however, the rand's earlier gains were largely reversed.

The short-term momentum of inflation was fuelled by record-high international oil prices and a substantial acceleration in food prices in the course of 2007. Twelve-month CPIX inflation rose above the target range in April 2007 and subsequently remained above 6 per cent, reaching 7,3 per cent in October. Measures of underlying inflation such as CPIX excluding food and fuel also accelerated, suggesting that more widespread inflationary pressures were at work. Wage settlements also edged higher in the course of 2007.

In order to prevent the temporary acceleration in inflation from becoming entrenched, the Monetary Policy Committee of the Bank raised the repurchase rate by 50 basis points on each occasion at its meetings in June, August and October 2007. This came in addition to four increases of a similar magnitude which were implemented during the final seven months of 2006. Other money-market interest rates rose broadly in line with the repurchase rate. Despite significant increases in both nominal and real interest rates, banks' loans and advances to the domestic private sector continued to rise briskly. Loans extended to the corporate sector continued to rise strongly, consistent with the strength of fixed capital formation. Mortgage advances to the household sector also maintained brisk momentum during the first ten months of 2007, although tentative signs of moderation started to emerge recently. On the other side of the banks' balance sheet the money supply continued to grow rapidly, reflecting positive wealth effects, rising income and expenditure levels, as well as buoyant financial market turnover. Some investors also decided to keep more of their assets in the form of cash, probably for precautionary and speculative reasons.

Anchored by the repurchase rate, short-term interest rates rose considerably more than long-term rates over the past 18 months and the yield curve became inverted. Bond yields moved higher on account of worsening inflation risks, but nevertheless continued to reflect a conviction in the market that over the longer run inflation would remain firmly under control, even if partly influenced by limited supply.

South African share prices broadly emulated share prices in the major centres of the world, declining significantly in the wake of the credit market turbulence in the third quarter of 2007. South African share prices subsequently recovered as it was realised that emerging markets had limited, if any, exposure to the structured products in question. In November share prices again receded somewhat as confidence waned and some commodity prices moderated.

Higher mortgage interest rates probably contributed to a slowdown in the pace of fixed property price increases during the first ten months of 2007. The South African consumer's net worth nevertheless continued to benefit from the appreciation in house prices which softened some of the impact of rising household debt.

The Minister of Finance projected a disciplined fiscal stance in the October 2007 *Medium Term Budget Policy Statement*, with expected fiscal surpluses in each of the fiscal years up to 2010/11. Government introduced the concept of a structural budget balance which reflects the conventional balance adjusted for cyclical factors, mainly as they affect revenue collection. Recognising that the budget position was strengthened by the robust upswing in the business cycle and favourable prices of export commodities, it was estimated that the structural budget balance of the national government was in deficit and would continue to reflect a deficit of around 0,6 per cent of gross domestic product over the three-year forecast period. Government's approach would be to use the windfall revenues from favourable economic conditions to invest in physical infrastructure and human capital formation and to raise the level of savings. Should these windfall revenues abate, resources would be available to continue spending on key priorities without placing an unpalatable financing burden on the economy.

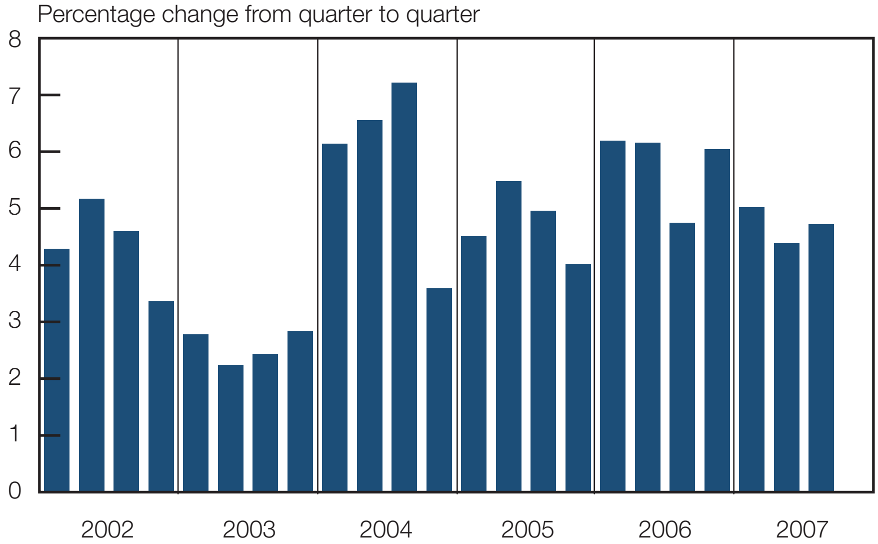
Domestic economic developments

Domestic output[1]

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

The South African economy continued to grow in the third quarter of 2007. Growth in *real gross domestic product* accelerated from an annualised rate of 4½ per cent in the second quarter of 2007 to 4¾ per cent in the third quarter. This was the result of stronger growth in the real output of both the primary and tertiary sectors. Third-quarter growth in the secondary sector was substantially slower compared with growth recorded in the second quarter of 2007.

Gross domestic product



Seasonally adjusted annualised rates

Following revisions, the real value added by the *primary sector* declined by 1 per cent in the second quarter of 2007, but reverted to positive growth at an annualised rate of 3 per cent in the third quarter. Increased activity in the third quarter was due to a turnaround in output growth in the mining sector which more than offset slower growth in the agricultural sector.

Real gross domestic product

Percentage change at seasonally adjusted annualised rates

Components	2006					2007		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sector	-6¼	-2½	-3	5	-2½	-6	-1	3
Agriculture	-14¾	-17½	-9¾	-5¼	-8	2	4½	½
Mining	-2½	4¼	-¼	9	0	-8¾	-3	4
Secondary sector	6½	8¼	7¼	8¼	6¼	7¾	2	½
Manufacturing	5¼	6¾	6	7½	5¼	4½	0	-2½
Tertiary sector	7¾	6¼	4¾	5½	6	5½	6	6¾
Non-agricultural sector	*6¾*	*6½*	*5*	*6¼*	*5¾*	*5*	*4½*	*5*
Total	6¼	6¼	4¾	6	5½	5	4½	4¾

The growth in real value added by the *agricultural sector* decelerated from an annualised rate of 4½ per cent in the second quarter of 2007 to just ½ a per cent in the third quarter. This slower growth was mainly a result of a decline in the volume of field crop production, which was partly offset by fairly solid production volumes of livestock and horticultural production.

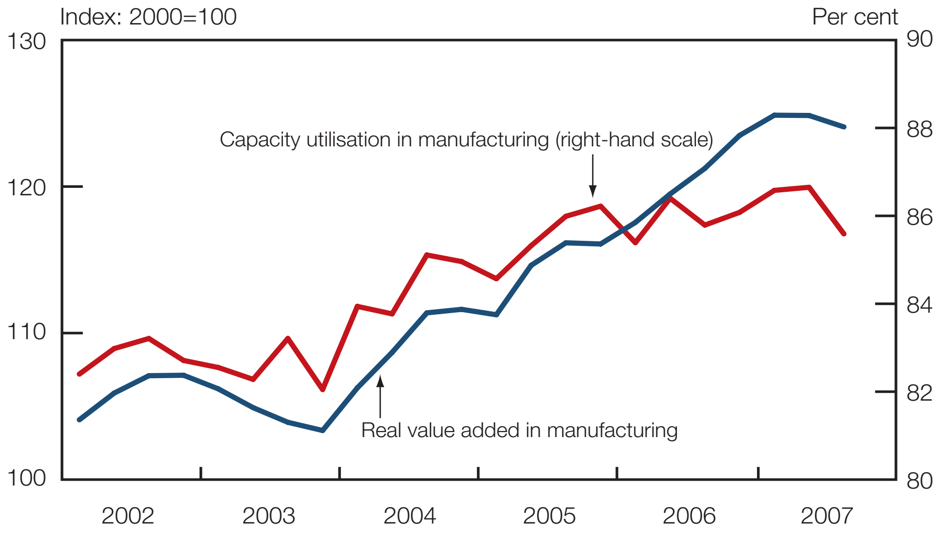
The expected wheat crop of 1,757 million tons is 16,5 per cent less than the crop of 2,105 million tons harvested in the 2006 season partly due to a much smaller area planted. It is estimated that the area planted with wheat was reduced by 17,4 per cent to 632 000 hectares in 2007 – the lowest level since 1934, partly because of adverse weather conditions.

Real mining output strengthened in the third quarter of 2007 after contracting in both the first and second quarters. Subsequent to an annualised decline of 3 per cent in the second quarter of 2007, real output of the *mining sector* increased at an annualised rate of 4 per cent in the third quarter of 2007, thereby contributing a ¼ percentage point to quarterly gross domestic product growth. This turnaround was primarily due to an improvement in non-gold mining, particularly the production of diamonds and platinum. The real value added by the gold-mining sector moved sideways in the third quarter, while production of coal was hampered by climatic conditions which influenced open-cast mining operations. The platinum group of metals benefited from firmer international commodity prices and the increased demand for emission control catalysts and jewellery. Gold mining was adversely affected by the continued increase in input costs, with South Africa's gold production costs among the highest in the world.

Growth in real value added by the *secondary sector* lost further momentum in the third quarter of 2007. Following slower growth in the second quarter of 2007, real output growth in the secondary sector decelerated to a mere ½ per cent in the third quarter – the lowest annualised rate recorded since the first quarter of 2005. This slower growth in the secondary sector resulted primarily from a poor performance by the manufacturing sector. Both the construction sector and the sector that supplies electricity, gas and water registered marginally higher growth rates in real value added over the period.

After recording no growth in the second quarter of 2007, real output in the *manufacturing sector* declined at an annualised rate of 2½ per cent in the third quarter.

Real value added and capacity utilisation in manufacturing sector



Seasonally adjusted

Consequently, the manufacturing sector subtracted ½ a percentage point from real economic growth in the third quarter of 2007 after a broadly sideways movement in the second quarter. The contraction was also in keeping with the decrease in the utilisation of production capacity from 86,6 per cent in the second quarter of 2007 to 85,6 per cent in the third quarter.

Although the contraction in real manufacturing production was spread over several subsectors including food and beverages, glass and non-metallic mineral products, and basic iron and steel, it was particularly pronounced in the sector manufacturing motor vehicles, parts and accessories. Manufacturing output in the latter subsector was held back by a spate of strike actions and work stoppages during September 2007. The contraction was partly softened by higher production by the subsectors manufacturing textiles, clothing, leather and footwear, and petroleum, chemical products, rubber and plastic products.

Apart from rising input costs, the manufacturing sector had to deal with slower growth in domestic and foreign demand for locally produced goods and a firmer exchange rate during the third quarter of 2007. In addition, a shortage of skilled and semi-skilled workers adversely affected the ability of the manufacturing sector to compete with cheaper imports from the rest of the world.

Growth in real value added by the sector that supplies *electricity, gas and water* inched higher from 2¾ per cent in the second quarter of 2007 to 3 per cent in the third quarter. The marginal increase was mainly confined to stronger growth in the electricity-generating subsector, despite a recent reduction in the export of electricity to neighbouring countries.

Real output by the *construction sector* maintained its strong upward momentum in the third quarter of 2007 and increased at an annualised rate of 14¾ per cent compared with a revised rate of 11¾ per cent in the second quarter. Slower growth in the construction of residential buildings could be ascribed to the reduced affordability of housing, while growth in non-residential construction accelerated due to the increased demand for office and retail space. The civil construction industry benefited from activities related to the maintenance and upgrading of infrastructure. Real construction output in the first three quarters of 2007 rose by 18½ per cent compared with the corresponding period in the previous year; for 2006 as a whole growth amounted to 14¾ per cent.

Owing mainly to an increase in the real value added by general government and the finance sector, the real value added by the *tertiary sector* accelerated at an annualised rate of 6¾ per cent in the third quarter of 2007. This was slightly higher than the rate of increase of 6 per cent recorded for 2006 as a whole.

Alongside the slowdown in consumer demand, growth in the real value added by the *commerce sector* moderated from an annualised rate of 4¾ per cent in the second quarter of 2007 to 4½ per cent in the third quarter. This moderation could mainly be attributed to somewhat weaker demand in the retail sector. Growth in the real output originating in the wholesale and motor-trade sectors, however, accelerated marginally over the period. Comparing the level of the real value added by the trade sector in the first three quarters of 2007 with the corresponding period in 2006, growth amounted to 5¾ per cent, somewhat lower than the rate of 7 per cent posted for 2006 as a whole.

Growth in real value added by the *transport, storage and communication sector* slowed from an annualised rate of 6 per cent in the second quarter of 2007 to 4½ per cent in the third quarter due to slower momentum in both transport and communication activities.

Output growth in the *finance, insurance, real-estate and business services sector* accelerated from an annualised rate of 10½ per cent in the second quarter of 2007 to 12 per cent in the third quarter. Real output by the banking sector continued to rise alongside the persistent increase in the demand for credit by businesses. In addition, the real output of securities dealers also advanced in the third quarter of 2007.

Growth in real value added by *general government* increased at a rate of 3¼ per cent in the third quarter of 2007, notably more than the rate of 1¼ per cent recorded in the second quarter. This can partly be ascribed to the normalisation of the government's wage bill in the third quarter of 2007 after allowing for the loss in real value added by general government due to the public-sector strike in the previous quarter.

Domestic expenditure

Growth in aggregate *real gross domestic expenditure* accelerated from a rate of 2¾ per cent in the second quarter of 2007 to 5¾ per cent in the third quarter. Slower growth in consumer spending and a reduced pace of inventory investment were more than offset by a further moderate increase in gross fixed capital formation and the resumption of growth in final consumption expenditure by general government.

Real gross domestic expenditure

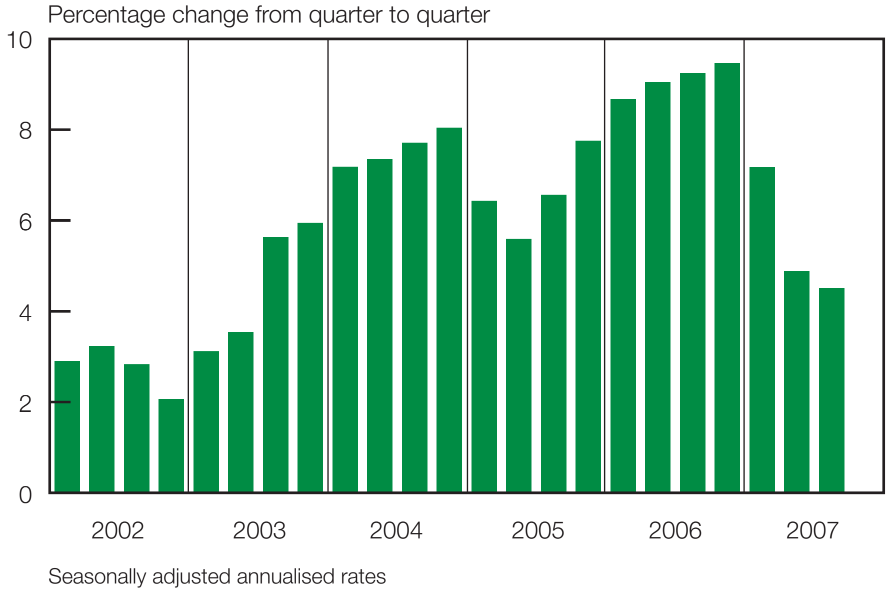
Percentage change at seasonally adjusted annualised rates

	2006					2007		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure by households	8¾	9	9¼	9½	8¼	7¼	5	4½
Final consumption expenditure by general government	-3½	15¾	-4½	4½	5¼	14	-3¾	8¾
Gross fixed capital formation	15½	14¼	15¾	16½	13¾	19¼	12½	13
Domestic final demand	**7½**	**11¼**	**7¾**	**9¾**	**8½**	**10½**	**4½**	**6¾**
Change in inventories (R billions)*	19,1	13,7	8,8	24,4	16,5	12,9	9,1	6,0
Total	**16¼**	**9½**	**1¾**	**12¾**	**9¼**	**6½**	**2¾**	**5¾**

* Constant 2000 prices

Concurrent with the lower consumer confidence index that slipped by 3 index points to 18 in the third quarter of 2007, spending by households lost further momentum over the period. Growth in *real final consumption expenditure by households* peaked in the fourth quarter of 2006 before trending down to a revised annualised rate of 5 per cent in the second quarter of 2007 and 4 ½ per cent in the third quarter. The slower rate of growth could be attributed to a marked deceleration in real expenditure on semi-durable goods. In addition, growth in household spending on services moderated slightly in the third quarter of 2007. The real demand for durable goods which contracted in the second quarter of 2007 picked up again in the third quarter. The contribution of household spending to growth in gross domestic expenditure declined from 3,1 percentage points in the second quarter of 2007 to 2,9 percentage points in the third quarter. Higher interest payments and moderate growth in property income hampered growth in real disposable income of households in the third quarter of 2007, and contributed to the moderation in overall household consumption expenditure growth.

Final consumption expenditure by households



The quarter-to-quarter growth in real outlays by households on *durable goods* accelerated at an annualised rate of 8¾ per cent in the third quarter of 2007 following a 15¾-per-cent contraction in the second quarter. This was mainly due to stronger annualised growth in household expenditure on personal transport equipment in the third quarter of 2007 as opposed to two consecutive quarterly contractions in the first half of 2007. However, real outlays on furniture and household appliances contracted in the third quarter compared with the second quarter of 2007.

The better performance of personal transport equipment in the third quarter compared to the second quarter of 2007 was mainly due to the very low base in the second quarter – the lowest level of real purchases of new motor vehicles since the first quarter of 2005. Transitional frictions on account of the introduction of the National Credit Act (the Act) from 1 June 2007 as well as the implementation of the new e-Natis licensing system contributed to this low base. However, consumers and lenders apparently adjusted rather speedily to the structural changes introduced by the Act. Although individuals faced somewhat stricter credit screening requirements, more flexible and affordable choices of financing were also introduced by the same Act. In terms of private leasing agreements, customers can choose to purchase vehicle mobility instead of ownership.

On a year-on-year basis, real expenditure on durable goods, however, lost further momentum in the third quarter of 2007. Upward pressure on new vehicle prices, higher interest rates and somewhat lower consumer confidence levels reduced consumers' appetite for new vehicles. In addition, sales of new motor vehicles were also affected by the strike in the automotive sector during September, leading to a decline in real spending on personal transport equipment in the third quarter compared with the same quarter in 2006.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

	2006					2007		
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods	16	15½	9¼	14½	16	9½	-15¾	8¾
Semi-durable goods	19¼	26	22½	19¾	20	10¼	22¾	3½
Non-durable goods	4½	7	4½	7½	5½	6¼	4	5¼
Services	7	3½	9	6	5	6	6	3
Total	8¾	9	9¼	9½	8¼	7¼	5	4½

Subsequent to brisk growth at an annualised rate of more than 22 per cent in the second quarter of 2007, real expenditure on *semi-durable goods* decelerated to a rate of increase of 3½ per cent in the third quarter. Although lower rates of growth in consumer spending were registered by most categories of semi-durable goods, they were especially prominent in spending on clothing and footwear.

Growth in real household spending on *non-durable goods* accelerated from an annualised rate of 4 per cent in the second quarter of 2007 to 5¼ per cent in the third quarter. This was mainly due to an increase in consumer spending on household fuel and power, and petroleum products. However, substantially lower outlays on food, beverages and tobacco were recorded, mainly because of persistently higher prices of these products.

Real outlays on *services* slowed from an annualised rate of 6 per cent in the second quarter of 2007 to 3 per cent in the third quarter. Slower growth was mainly concentrated in the financial services sector, in particular consumer spending on banking services.

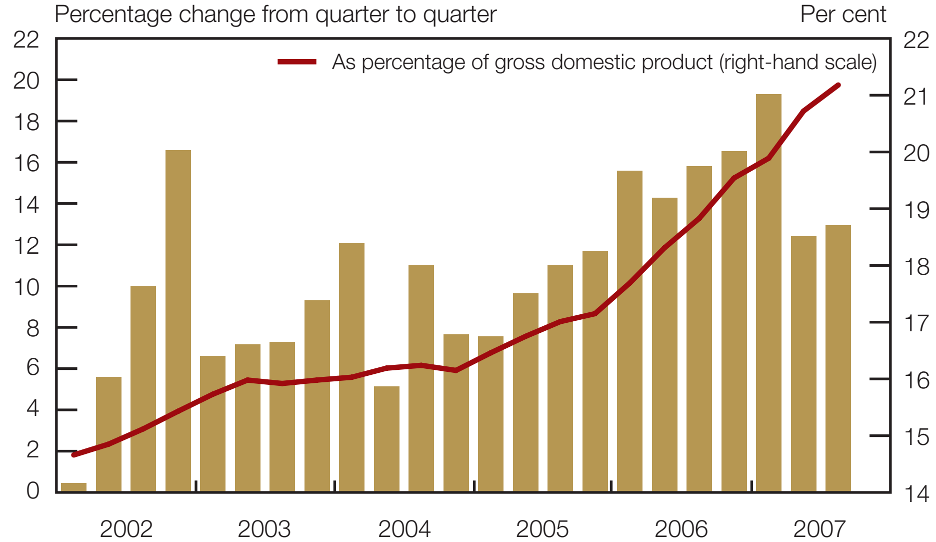
Despite the tighter monetary policy environment, household indebtedness in South Africa rose further to a new record of 77½ per cent of *household disposable income* in the third quarter of 2007 compared with a revised rate of 76 per cent in the second quarter. *Debt service cost* rose in tandem with higher interest rates; relative to the disposable income of households, debt service cost amounted to 10¼ per cent in the third quarter of 2007 compared with 9½ per cent in the second quarter.

Following a rate of contraction of 3¾ per cent in the second quarter of 2007, *real final consumption expenditure by general government* reverted to an annualised rate of growth of 8¾ per cent in the third quarter. The stronger growth was evident in increased spending on compensation of employees, the biggest subcomponent of general government expenditure. Real compensation of employees normalised in the third quarter as lower salaries and wages accrued to employees who participated in the public-sector strike during the second quarter. Real spending on goods and services was also boosted by the purchase of four helicopters as part of the defence procurement programme.

Real gross fixed capital formation rose at very strong annualised rates of 12½ per cent in the second quarter and 13 per cent in the third quarter of 2007. Strong capital outlays by the general government and public corporations contributed to the expansion in the third quarter. Real gross fixed capital formation by the private sector, however, slowed marginally from the second to the third quarter of 2007.

Lively capital investment across all three institutional sectors reflected the need to address restraining bottlenecks and high rates of capacity utilisation. Relative to gross domestic product, gross fixed capital formation consequently increased from 20¾ per cent in the second quarter of 2007 to 21¼ per cent in the third quarter – the highest ratio since 1985. The contribution of real fixed investment to the growth in real gross domestic expenditure edged higher from 2,2 percentage points in the second quarter of 2007 to 2,4 percentage points in the third quarter.

Gross fixed capital formation



Seasonally adjusted annualised rates

Real capital outlays by the *private sector* moderated from an annualised rate of 13 per cent in the second quarter of 2007 to 12¾ per cent in the third quarter. The slower growth mainly resulted from a moderation in capital expenditure by the manufacturing and finance sectors. In manufacturing the slackening was visible in smaller short-term projects rather than in ongoing long-term projects. Slower growth in real capital formation in the finance sector reflected a moderation in residential property investment. However, investment in the expansion of the distribution network continued in order to improve the accessibility of banking services, not only in big cities but also in remote towns and villages.

The growth in real capital expenditure by *public corporations* accelerated from 14½ per cent in the second quarter of 2007 to an annualised rate of 16½ per cent in the third quarter. Increased expenditure in the third quarter occurred predominantly in the transport and communication sectors. Capital investment by the transport sector was mainly geared towards infrastructural development projects including development at the Port of Ngqura (Coega), a further increase in rolling stock, as well as improvements to the rail infrastructure and airports. In the communication sector, network development continued. Despite the somewhat lower level of real capital spending by the electricity sector in the third quarter of 2007, such expenditure was still more than 25 per cent higher when compared with its level in the same quarter of 2006.

Capital expenditure by *general government* increased at an annualised rate of 10¼ per cent in the third quarter of 2007 compared with a revised rate of 6¾ per cent in the second quarter. Increased capital investment by general government reflected spending on water, sanitation and low-income housing alongside the upgrading and development of infrastructure and stadiums.

Shifting the focus to fixed capital formation by *type of asset,* growth in capital expenditure on non-residential buildings outpaced that of residential buildings in the third quarter of 2007. Real gross fixed investment in residential buildings moderated in the third quarter of 2007 mainly due to affordability reasons – higher interest rates and increased building costs. Growth in real expenditure on construction works, however, still accelerated.

Commercial vehicle sales rose further in the third quarter of 2007, with the increase in demand primarily from the transport and storage, trade, construction and business services sectors. Furthermore, an additional aircraft was purchased by South African Airways in the third quarter of 2007, adding to capacity and fuel efficiency. Investment spending on transport equipment consequently increased by 25 per cent in the third quarter of 2007, following an increase of 22½ per cent in the second quarter.

Real inventory accumulation slowed in the third quarter of 2007. Following annualised accumulation of R9,1 billion (at 2000 prices) in the second quarter of 2007, *real inventory* investment receded to R6,0 billion in the third quarter, thereby subtracting 1 percentage point from growth in gross domestic expenditure over the period. A slowdown in inventory accumulation was reported by most sectors of the economy, with lower imports of oil mainly accounting for the smaller build-up of inventories in the manufacturing sector in the third quarter. Lower inventory investment in the mining sector was the net effect of a build-up in platinum inventories which was offset by a reduction in gold and coal inventories. Favourable prices most probably encouraged the increased sales of both gold and coal in the third quarter of 2007.

Factor income

The growth in *total nominal factor income*, measured over one year, decelerated from 15¾ per cent in the second quarter of 2007 to 13¾ per cent in the third quarter. Despite the slowdown in the third quarter of 2007, total factor income rose by 15 per cent in the first nine months of 2007 compared with the same period of 2006, comfortably outperforming the increase of 12¾ per cent recorded for 2006 as a whole. The deceleration in growth in the third quarter of 2007 could mainly be ascribed to slower growth in gross operating surpluses of business enterprises while growth in the compensation of employees accelerated moderately over this period.

The year-on-year growth in *compensation of employees* edged higher from 11½ per cent in the second quarter of 2007 to 12 per cent in the third quarter on account of more aggressive wage demands, higher wage settlements and increases in employment. Although the increase in the compensation of employees in the third quarter of 2007 was fairly broad-based, it was particularly pronounced in the general government sector. Lower growth in compensation of employees was recorded in the sector providing financial intermediation, insurance, real-estate and business services. The overall compensation of employees increased by 11½ per cent in the first nine months of 2007 compared with the same period in 2006, somewhat more than the 10½ per cent recorded in 2006 as a whole.

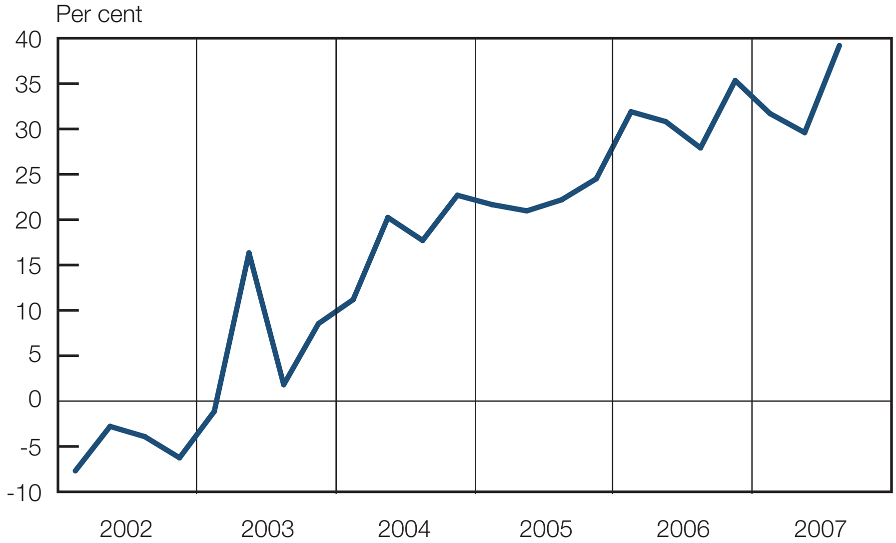
Following the sustained acceleration in the year-on-year growth in *the gross operating surpluses of business enterprises* from the first quarter of 2006 to the first quarter of 2007, growth slowed in the second and third quarters. Year-on-year growth increased over this period from 11 per cent in the first quarter of 2006 to 21½ per cent in the first quarter of 2007 before decelerating to 20 per cent in the second quarter and further to 15½ per cent in the third quarter. The slower growth in gross operating surpluses in the third quarter of 2007, with the exception of transport and finance, was evident in all sectors of the economy and reflected, among other things, a moderation in sales, higher input cost and a strong surge in imports of goods and services relative to exports.

Despite the slowdown in the growth in gross operating surpluses of business enterprises in the third quarter of 2007, the growth for the first nine months of 2007 amounted to 18¾ per cent compared with 15 per cent recorded in 2006 as a whole.

Gross saving

The ratio of *total gross saving to gross domestic product* declined to 13¾ per cent in the third quarter of 2007 from 15¼ per cent in the second quarter. The worsening saving performance in the third quarter was evident in the corporate sector as well as general government, while the saving performance of the household sector remained broadly unchanged. Notwithstanding the decline in the third quarter of 2007, the national saving ratio for the first nine months of 2007 amounted to 14½ per cent, marginally higher than the 14 per cent registered in 2006. The country's use of foreign capital to finance gross capital formation subsequently increased to a new record high of 37 per cent in the third quarter of 2007.

Proportion of gross capital formation financed by foreign capital



Seasonally adjusted

The gross saving ratio of the *household sector* remained more or less unchanged at 1½ per cent during the first three quarters of 2007. However, gross saving of the *corporate sector* as a percentage of gross domestic product declined from 11 per cent in the second quarter of 2007 to 10 per cent in the third quarter. This can be attributed to a slowdown in the growth in gross operating surpluses of business enterprises and continued large dividend payments which were bolstered by an exceptionally large payment by the steel industry. Although the corporate saving ratio declined in the third quarter of 2007, the saving ratio for the first nine months of the year amounted to 10¼ per cent – marginally higher than the ratio recorded in 2006.

Gross saving by *general government* as a percentage of gross domestic product eased to 2¼ per cent in the third quarter of 2007 from 3 per cent in the second quarter. This decline was due to increased spending on consumable goods and services and included arms procurement deliveries. The saving ratio for the first nine months of 2007, however, amounted to 3 per cent, previously surpassed in 1981. This can be ascribed to prudent and efficient fiscal management and a broader tax base which has given rise to a steady increase in tax revenue since 2004.

Employment

Domestic production volumes expanded by 5 and 5½ per cent, respectively, in 2005 and 2006 and at a somewhat slower pace in the first half of 2007. As a result, enterprise-surveyed formal non-agricultural employment increased by 1,1 per cent in 2005 and 2,9 per cent in 2006. The *Quarterly Employment Statistics* (QES) survey of Statistics South Africa (Stats SA) indicated that employment in the total formal non-agricultural sector of the economy increased at a year-on-year rate of 2,9 per cent in the second quarter of 2007. Employment numbers increased by roughly 238 000 in the year to the second quarter of 2007.

Consistent with the moderate slowdown in economic growth in the first half of 2007, the annualised quarter-to-quarter pace of increase in formal non-agricultural employment slowed from 4,0 per cent in the first quarter of 2007 to 2,6 per cent in the second quarter. Private-sector employment growth accelerated from 3,3 per cent in the first quarter of 2007 to 3,6 per cent in the second quarter, whereas public-sector employment growth reverted from an increase of 7,1 per cent to a decrease of 1,0 per cent over the same period.

In the private sector almost all industries recorded meaningful employment gains in the second quarter of 2007 compared with the preceding quarter, except for the transport, storage and communication sector in which employment numbers contracted at a seasonally adjusted and annualised rate of 6,7 per cent. Employment growth in the non-gold mining; trade, catering and accommodation; finance, insurance, real-estate and business services sectors; as well as in the construction sector exceeded 4 per cent in the second quarter of 2007. In the manufacturing sector, employment numbers increased at a rate of only 0,6 per cent over this period.

Change in enterprise-surveyed formal non-agricultural employment: June 2007

Sector	Over four quarters		Over one quarter*
	Number	Percentage	Percentage
Mining	34 651	7,6	6,4
Gold mining	8 955	5,6	2,9
Non-gold mining	25 696	8,6	8,2
Manufacturing	-8 569	-0,6	0,6
Electricity supply	2 937	5,7	1,2
Construction	19 100	4,2	4,2
Trade, catering and accommodation	69 461	4,1	5,7
Transport, storage and communication	2 556	1,0	-6,7
Finance, insurance and real estate	89 438	5,1	4,2
Community, social and personal services	-22 377	-5,2	4,5
Total private sector	**187 197**	**2,9**	**3,6**
National, provincial and local government	47 078	3,3	-1,1
Public-sector enterprises	3 349	1,5	0,6
Total public sector	**50 427**	**3,0**	**-1,0**
Grand total	**237 624**	**2,9**	**2,6**

* Seasonally adjusted annualised rates

The Investec Purchasing Managers Index, an indicator compiled by the Bureau for Economic Research (BER) which assesses conditions and prospects in the domestic manufacturing sector, declined sharply from an index peak of 60,5 in February 2007 to 51,6 in September 2007. However, mainly following an acceleration in the growth of new sales orders in October the index picked up somewhat. In November it edged lower due to a decline in new sales orders. The seasonally adjusted employment sub-index recovered slightly in October and November, suggesting further moderate gains in manufacturing employment during this period.

The *FNB Composite Building Confidence Index*, a BER survey of business confidence among major players and suppliers in the building industry, indicated that overall business confidence in the building industry remained high in the third quarter of 2007. The index decreased only slightly from 88 in the second quarter of 2007 to 85 in the third quarter. The decline partly reflected a deterioration in business confidence among almost all constituencies. However, wholesalers of building materials appeared to be generally more positive. Building activity in the sector for non-residential buildings remained robust and contractors were expecting further employment growth, although at a slightly slower pace. Shortages of labour and building materials continued to adversely affect business operations in this sector.

The quarter-to-quarter rate of decrease in public-sector employment of 1,0 per cent in the second quarter of 2007 resulted mainly from employment losses in national departments at a rate of 7,8 per cent. Job losses also occurred in public-sector corporations, while employment levels in businesses engaged in transport, storage and communication remained essentially unchanged from the first quarter of 2007 to the second quarter.

According to the September 2007 *Labour Force Survey* (LFS), a biannual household survey conducted by Stats SA, the total number of South Africans in employment increased by 197 000 over the year to March 2007 despite a decrease of 59 000 jobs in the informal sector and a decrease of 243 000 jobs in the agricultural sector. The unemployment rate as measured by the LFS accordingly inched lower from 25,6 per cent in March 2006 to 25,5 per cent in March 2007.

Economically active and employed persons

Actual numbers (millions)

	2002	2003	2004	2005	2006	2007
Formal non-agricultural employment*	7,7	7,7	7,7	7,7	8,0	8,3
Total employed persons	11,6	11,3	11,4	11,9	12,4	12,6
Economically active population	16,5	16,4	15,8	16,2	16,7	17,0
Unemployment rate (per cent)	29,7	31,2	27,9	26,5	25,6	25,5

* *Quarterly Employment Statistics* numbers

Sources: Statistics South Africa, *Labour Force Survey*, September 2007 and *Quarterly Employment Statistics*, September 2007

In March 2007, total employment was estimated at 12,6 million. The sectors responsible for most employment gains in the combined formal and informal sectors over the year to March 2007 were the wholesale and retail trade industry followed by the community and personal services industry as well as manufacturing. Formal non-agricultural employment increased by 364 000 over this period. Employment losses in the formal and informal agricultural sector resulted in part from the negative impact of the drought during the harvesting season, a period which usually attracts seasonal workers.

According to the September 2007 *Quarterly Wage Settlement Report* compiled by Andrew Levy Employment Publications, a private-sector labour consultancy, 12,6 million mandays were lost due to industrial strike action in the first nine months of 2007 compared with 2,6 million in 2006. Although strike action was prevalent across all economic sectors, the public-sector strike in June 2007 accounted for the bulk of the number of mandays lost. The motivation for strike action was predominantly a demand for higher wages.

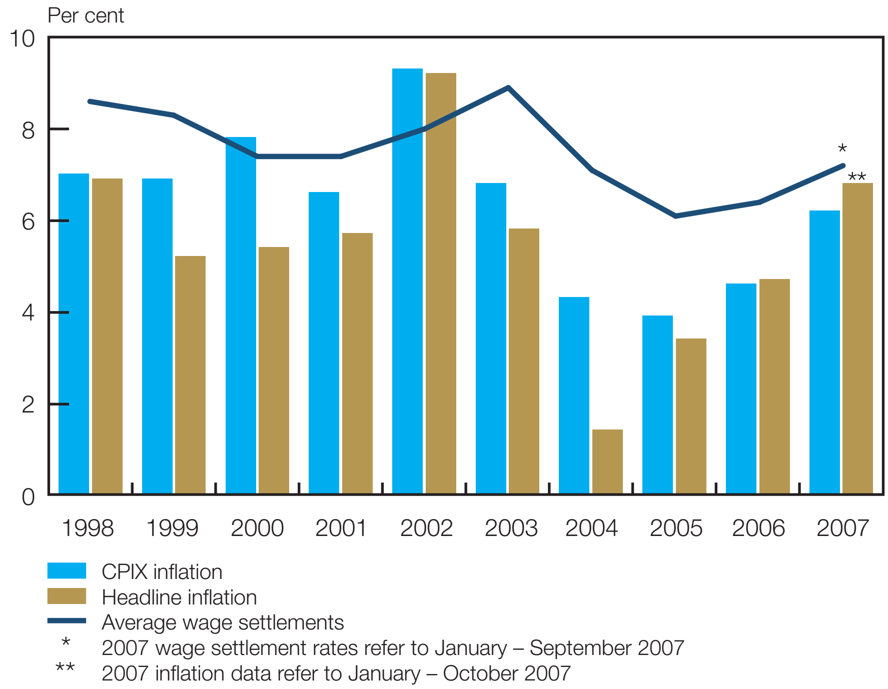
Labour cost and productivity

Growth in *nominal remuneration per worker* in the formal non-agricultural sectors of the economy accelerated from a year-on-year rate of 4,9 per cent in the first quarter of 2007 to 7,5 per cent in the second quarter. Within the private sector, the gold-mining as well as the trade, catering and accommodation services sectors were the only sectors that recorded nominal wage growth per worker lower than, or equal to, the upper end of the inflation target range, with rates of 4,8 per cent and 6,0 per cent, respectively. In the electricity sector nominal remuneration per worker increased by no less than 13 per cent – the highest rate of increase recorded over the period.

The fairly volatile year-on-year rate of increase in nominal remuneration per worker in the public sector more than doubled, accelerating from 3,0 per cent in the first quarter of 2007 to 7,1 per cent in the second quarter. Nominal remuneration per worker in the government transport, storage and communication services sector increased by 10,8 per cent over this period; in national departments by 9,8 per cent and in provincial governments by 6,3 per cent.

According to Andrew Levy Employment Publications, the average rate of wage settlements amounted to 7,2 per cent in the first nine months of 2007, compared with 6,4 per cent for the same period in 2006. Settlement rates ranged from 4,5 per cent in the transport sector to 12 per cent in the retail sector. The majority of settlements – 88 per cent – were concluded for a one-year period, while others will last up to 4 years.

Wage settlement rates and inflation



Following the continued increases in employment, labour productivity growth decelerated from a year-on-year rate of 2,7 per cent in the first quarter of 2007 to 2,2 per cent in the second quarter. The growth in output per worker in the formal non-agricultural sectors of the economy slowed from 3,9 per cent in 2005 to 2,7 per cent in 2006. Productivity growth in the manufacturing sector followed the same trend and decelerated from a year-on-year rate of 6,8 per cent in the first quarter of 2007 to 5,3 per cent in the second quarter.

The acceleration in wage growth together with weaker productivity growth caused nominal unit labour cost increases to accelerate from a year-on-year rate of 2,1 per cent in the first quarter of 2007 to 5,2 per cent in the second quarter. Changes in nominal unit labour cost generally precede changes in consumer price inflation. The higher rate of increase in nominal unit labour cost could therefore pose additional inflation risk in future.

Prices

Inflationary pressures in the domestic economy intensified concurrently at the producer and consumer price levels from the middle of 2006, primarily due to a sustained increase in food prices. Year-on-year inflation in the consumer price index excluding mortgage interest cost for metropolitan and other urban areas (CPIX) breached the upper limit of the inflation target range in April 2007, amounting to 6,3 per cent, before accelerating to 7,3 per cent in October. This follows a period of 43 consecutive months, from September 2003 to March 2007, when CPIX inflation fluctuated between 3 and 6 per cent, the official target range. Inflation expectations also rose substantially in the third quarter and edged higher in the fourth quarter of 2007 according to the BER inflation expectations survey.

Driven mainly by persistent increases in international crude oil prices, and the escalating prices of imported agricultural food, mining products and other minerals, the twelve-month rate of increase in the *production prices of imported goods* accelerated from 4,7 per cent in May 2006 to 11,7 per cent in May 2007 – the highest rate of increase since November 2002. Thereafter, this rate of increase fell to 7,5 per cent in October 2007 as the prices of especially base metals and imported agricultural food fell.

Production prices

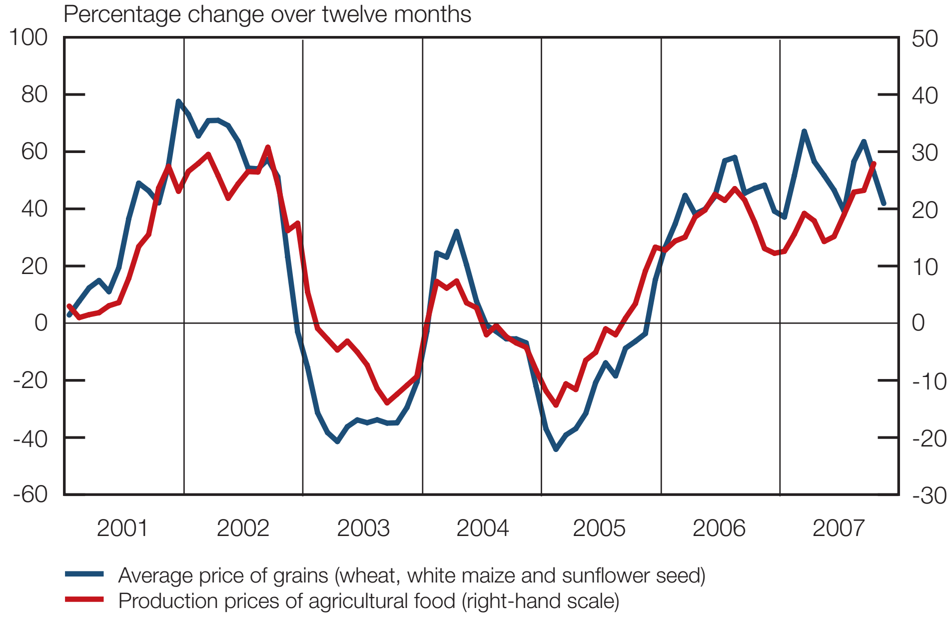
Quarter-to-quarter percentage change at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2006:	1st qr	6,3	2,3	3,9
	2nd qr	9,9	8,8	10,3
	3rd qr	16,2	20,7	18,9
	4th qr	6,5	9,7	6,6
	Year	**9,7**	**10,4**	**9,9**
2007:	1st qr	7,0	2,6	4,3
	2nd qr	14,8	9,8	14,4
	3rd qr	11,1	14,0	13,8

Domestically produced goods price inflation accelerated markedly over the past eighteen months and more than doubled from a year-on-year rate of 5,0 per cent in March 2006 to 11,2 per cent in April 2007. This acceleration could largely be ascribed to a surge in the agricultural-product prices category, which culminated in substantial increases across both food and non-food agricultural-product categories. In October 2007 the year-on-year rate of increase in agricultural food prices amounted to 27,9 per cent while manufactured food price inflation accelerated to 17,5 per cent due mainly to increases in the prices of a number of grain products.

Grain prices and production prices of agricultural food

Percentage change over twelve months



Following these higher rates of increase in the prices of imported and domestically produced goods, *all-goods production price inflation* picked up momentum, accelerating from a year-on-year rate of 5,4 per cent in March 2006 to 11,3 per cent in May 2007 – the highest rate of increase in 52 months. Subsequently, the rate of increase moderated to 9,5 per cent in October 2007 as base effects impacted favourably on the index. If the rapid rise in energy and food prices is excluded from the all-goods production price index, an increase of 6,1 per cent was registered in October 2007.

Year-on-year *CPIX inflation* amounted to 6,5 per cent in July 2007, compared with 3,7 per cent 14 months earlier in April 2006. This surge in CPIX inflation in recent months compelled it to surpass the upper limit of the inflation target range of 6 per cent in April 2007, as already indicated. Following the significant increase in the production prices of food, year-on-year CPIX consumer food price inflation accelerated from 4,3 per cent in January 2006 to 9,4 per cent in October before falling to 7,8 per cent in March 2007. In the succeeding months, this rate of increase resumed its upward trajectory, amounting to 12,4 per cent in October 2007. If food prices were to be excluded from the index, CPIX inflation would have amounted to only 5,5 per cent in the year to October 2007.

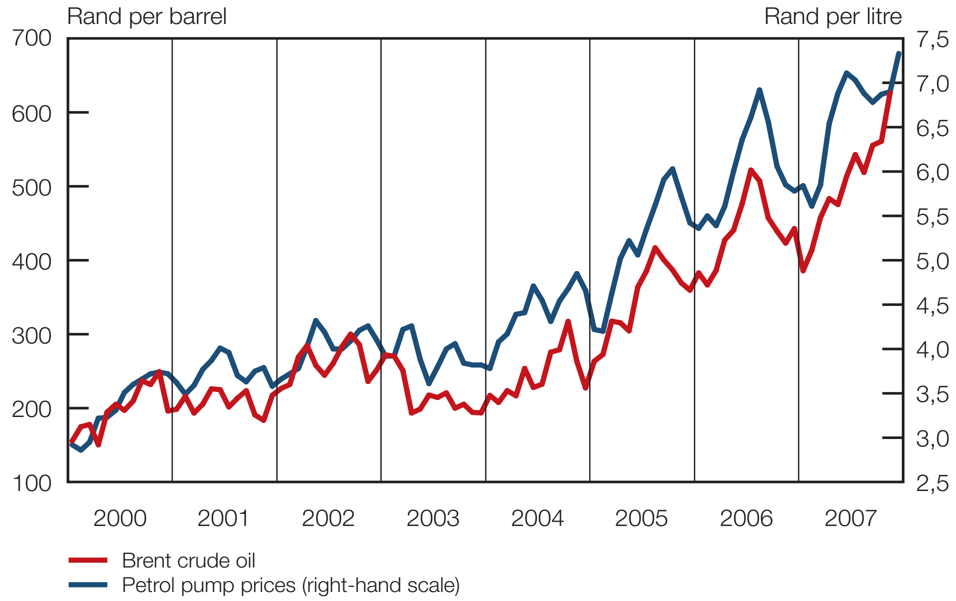
Measured from quarter to quarter and annualised, CPIX inflation accelerated from a seasonally adjusted and annualised rate of 4,8 per cent in the first quarter of 2007 to 8,1 per cent in the third quarter, with food and energy prices being the main drivers.

Food prices
Percentage change over twelve months

Period		Domestic production prices of food			CPIX consumer food prices
		Agricultural food	Manufactured food	Total	
2006:	Jan	12,8	1,7	6,2	4,3
	Feb	14,4	2,5	7,2	4,5
	Mar	15,1	4,0	8,5	5,1
	Apr	18,6	5,4	10,6	5,5
	May	19,8	6,0	11,5	6,2
	Jun	22,5	6,0	12,6	7,2
	Jul	21,5	7,5	13,1	6,7
	Aug	23,5	8,7	14,6	7,2
	Sep	21,5	10,0	14,7	7,9
	Oct	17,7	12,0	14,3	9,4
	Nov	13,1	12,0	12,5	8,9
	Dec	12,2	11,4	11,8	7,7
	Year	**17,7**	**7,3**	**11,5**	**6,7**
2007:	Jan	12,6	10,9	11,6	8,3
	Feb	15,6	10,0	12,4	7,9
	Mar	19,2	10,7	14,3	7,8
	Apr	17,9	11,7	14,3	8,6
	May	14,3	13,5	13,9	9,0
	Jun	15,2	15,0	15,1	9,4
	Jul	19,0	15,1	16,7	10,2
	Aug	22,9	14,9	18,4	11,3
	Sep	23,2	15,5	18,9	12,0
	Oct	27,9	17,5	22,0	12,4

Year-on-year *CPIX goods price inflation* reached the upper limit of the inflation target range of 6 per cent in August 2006 before falling to 5,0 per cent in February 2007. Thereafter it accelerated steadily to a rate of 8,2 per cent in October 2007. Petrol price increases in the opening months of 2007, together with the rapid acceleration in consumer food prices, were the main drivers of the acceleration in CPIX goods price

Brent crude oil and petrol prices



inflation. Other components that significantly influenced CPIX goods price inflation comprised water, fuel and power, tobacco products and motor spares.

Due to increases in international grain prices, the drought conditions during the planting and harvesting seasons and a weaker exchange rate, particularly in the first half of 2006, food price inflation already exceeded the upper end of the inflation target range for 18 consecutive months. In October 2007, CPIX food price inflation accelerated to a year-on-year rate of 12,4 per cent. Although the price pressures within the food basket were initially restricted to grain and meat products, they have recently become broad-based, extending to milk, milk products and eggs, and vegetables. These developments in domestic consumer food prices were also evident on the international front as demonstrated by the acceleration in food prices in numerous other countries over the past two years.

CPIX services price inflation accelerated steadily from a year-on-year rate of 3,3 per cent in June 2006 to 5,9 per cent in October 2007. Within the basket of services, homeowners' costs, domestic workers' wages, educational costs, licence fees, and registration and related fees have all increased at rates in excess of the inflation target range since the beginning of 2007.

Inflation in CPIX components

Percentage change over twelve months

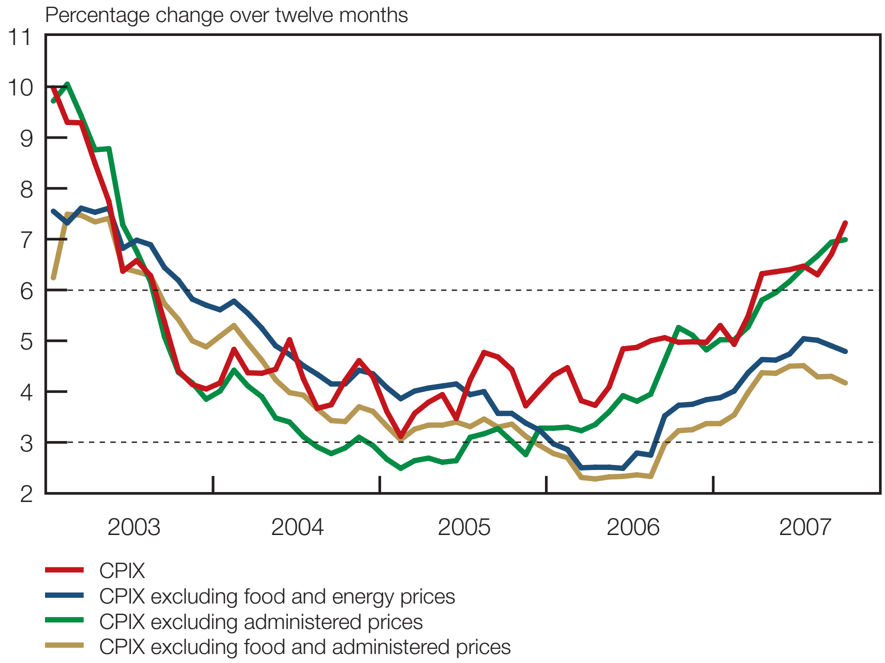
	Weights	Mar 2007	Oct 2007
Transport running cost	5,7	8,2	12,4
Food and soft drinks	26,9	7,6	12,1
Alcoholic beverages and tobacco products	3,1	7,5	8,5
Total housing services	13,4	5,8	6,9
Services excluding housing and transport	**16,5**	**5,0**	***5,7***
Total other goods (not included elsewhere)	**17,5**	**5,3**	***5,5***
Total transport services	**3,9**	**4,4**	***3,3***
Vehicles	5,7	0,1	0,5
Furniture and equipment	3,2	0,1	-0,8
Clothing and footwear	4,1	-8,7	-7,6
Total CPIX	100,0	5,5	7,3

Bold italics denote values inside the inflation target range of between 3 and 6 per cent in October 2007

In the above table, the overall CPIX basket is decomposed into its ten main components and a comparison is made between the months of March and October 2007, displaying the year-on-year rates of change when CPIX inflation was within and outside the inflation target range. Transport running cost, food and soft drinks, and alcoholic beverages and tobacco products with a total weight of more than 35 per cent all hovered above the inflation target range in March 2007. Over the six-month period, inflation in the transport running cost component slowed substantially to the lower half of the target band. However, in the year to October 2007 it accelerated sharply – primarily on account of petrol price inflation, and was more than double the upper target band. The remaining components, i.e. food and soft drinks as well as alcoholic beverages and tobacco products consistently remained above the target range and price inflation in these accelerated further. In both months three components with a combined weight of about 52 per cent continued to remain within the 3-to-6-per-cent target range. The total housing services cost component also moved higher in the latter month.

When the combined effect of rising energy and food prices – the main drivers of CPIX inflation – is omitted from the calculation, CPIX inflation amounted to a year-on-year rate of 4,6 per cent in April 2007 and advanced to around 5,0 per cent in the ensuing months to October. Inflation in the prices of administered goods and services slowed from 8,3 per cent in April 2007 to 5,8 per cent in September. In the next month it jumped to 8,5 per cent mainly due to higher petrol prices. If all administered prices as well as the price of food are excluded, the resultant measure of underlying CPIX inflation picked up noticeably in 2006 and 2007 but levelled at year-on-year rates of around 4,3 per cent in recent months.

Measures of underlying inflation



Inflation expectations as surveyed by the BER increased substantially during the third quarter of 2007, but edged only marginally higher during the fourth quarter of the year. In the fourth-quarter survey, CPIX inflation was expected to average 6,0 per cent during 2007, 5,9 per cent during 2008 and 5,6 per cent during 2009.

Foreign trade and payments

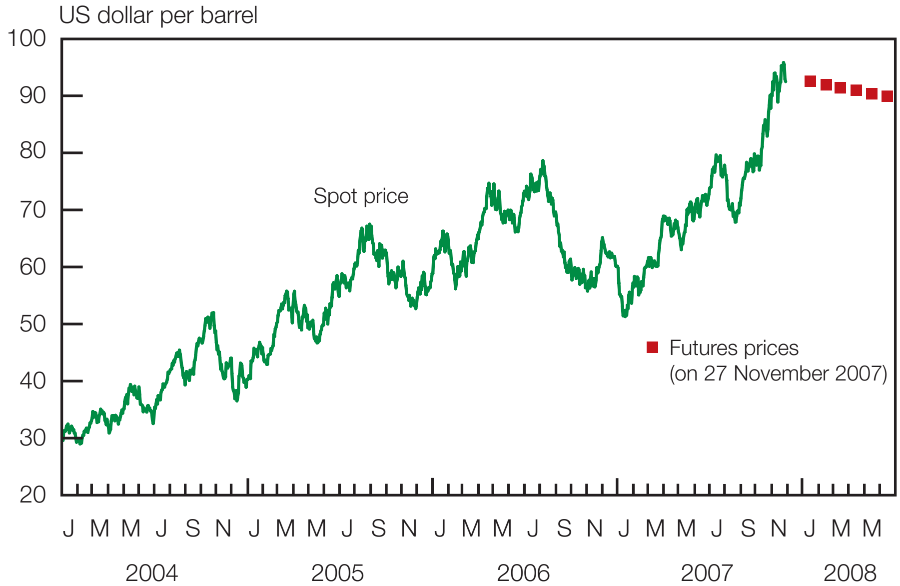
International economic developments

Although global economic growth remained strong during the first three quarters of 2007, prospects for 2008 could be adversely affected by the recent turbulence in financial markets stemming from the upheaval in the United States (US) sub-prime mortgage market. According to the October 2007 edition of the IMF *World Economic Outlook*, global growth projections for 2007 remained unchanged at 5,2 per cent, while forecasts for 2008 have been revised downward to 4,8 per cent. The downside risks to the growth outlook have, however, increased as a result of financial market instability, concerns about domestic demand in the US, euro area and Japan, persistent large global imbalances, volatility in oil markets and inflationary pressures.

Economic growth in the US remained solid in the third quarter of 2007, but is expected to slow in the near term following developments in the US housing market. Following a contraction in the second quarter of 2007, real gross domestic production in Japan rebounded in the third quarter, mainly due to higher exports. Although economic growth in the euro area moderated during the second quarter of 2007, economic activity rebounded again in the third quarter. Real output growth in most major emerging-market economies in Asia, Europe and Latin America remained resilient in recent quarters. In China, the rate of economic expansion moderated in the third quarter of 2007, following double-digit growth rates recorded in the preceding two quarters. Sub-Saharan Africa is currently enjoying its longest period of sustained economic growth, reflecting improvements in the region's terms of trade, improved macroeconomic management and increased capital inflows.

Following a sharp fall during most of August 2007, Brent crude oil prices rebounded to levels of around US$80 per barrel at the end of September. Upward pressure on oil prices stemmed from a series of US refinery interruptions, declining US crude oil stocks, weather-related production disruptions in the Gulf of Mexico and supply concerns ahead of the northern hemisphere winter. In addition, a US interest rate cut, financial flows into energy markets and geopolitical tensions in Israel, Syria, Iran, Mexico and Nigeria lent

Brent crude oil prices



further support to prices. The decision by the Organization of the Petroleum Exporting Countries (OPEC) in September 2007 to raise output by 500 000 barrels per day, effective from 1 November, failed to dampen the surge in crude oil prices. Crude oil prices started to increase significantly from mid-October reaching a new record-high level of around US$96 per barrel on 23 November 2007. This increase was largely due to weather-related oil production disruptions in the North Sea, supply concerns ahead of peak northern hemisphere winter demand and geopolitical tensions between Turkey and Kurdish separatists in northern Iraq. This was reinforced by dollar weakness which diverted investment into commodities. The decline in the exchange value of the US dollar to record-low levels against the euro was aided by sub-prime fears, declining US interest rates and concerns that China and other countries could diversify their foreign-exchange reserves by holding fewer dollars. The oil price, however, subsequently moderated towards the end of November on expectations of increased OPEC production and concerns about the US economy.

Rising food and energy prices have recently contributed to increased inflationary pressures in several countries. Headline consumer price inflation in the US increased sharply in September and October 2007, but core inflation has declined moderately since the beginning of the year. In the euro area, annual headline inflation remained well contained until August 2007, but since September has exceeded the European Central Bank's aim of maintaining inflation below but close to 2 per cent due to higher food, housing and energy prices. Japan's year-on-year rate of change in core consumer prices, however, remained in negative territory from January 2007. In emerging-market countries annual consumer price inflation accelerated, in general, in the Asian and Latin American regions in the third quarter of 2007, while inflation developments were mixed in the European region. Peru, Singapore and Taiwan counted among the countries that recorded the fastest acceleration in their respective inflation rates, while the rate of deceleration was the fastest in Poland, Turkey and Venezuela. Food inflation pressures continue to mount in emerging-market economies, particularly in Venezuela, China and Indonesia.

Since the beginning of September 2007, monetary policy has been tightened in Australia, Chile, China, the Czech Republic, Mexico, Poland, Sweden, Switzerland and Taiwan in response to strengthening inflationary pressures. By contrast, monetary policy has been relaxed in Brazil, Hong Kong, Hungary, Turkey and the US. The US Federal Open Market Committee cut its target for the federal funds rate by 50 basis points in September 2007 and by a further 25 basis points in October to counter the disruptions in financial markets and promote growth.

Current account[2]

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

A further increase in capital formation by the public and private sector continued to render support to domestic economic activity, but simultaneously contributed to a renewed widening of South Africa's trade deficit from R31,4 billion in the second quarter of 2007 to R52,1 billion in the third quarter. Increased expenditure on infrastructural development projects raised the value of merchandise imports in the third quarter of 2007 whereas the value of exported goods remained broadly unchanged over the period.

The larger deficit on the trade account coincided with a further marked increase in the shortfall on the service, income and current transfer account with the rest of the world as the wave of foreign investment in South African equities over the past few years translated into larger dividend payments to non-resident investors. The current-account deficit consequently widened to a record R162,6 billion in the third quarter of 2007, equal to 8,1 per cent of gross domestic product. On average, the balance on the current account as a percentage of gross domestic product amounted to 7,1 per cent in the first three quarters of 2007 compared with 6,0 per cent in the corresponding period of 2006.

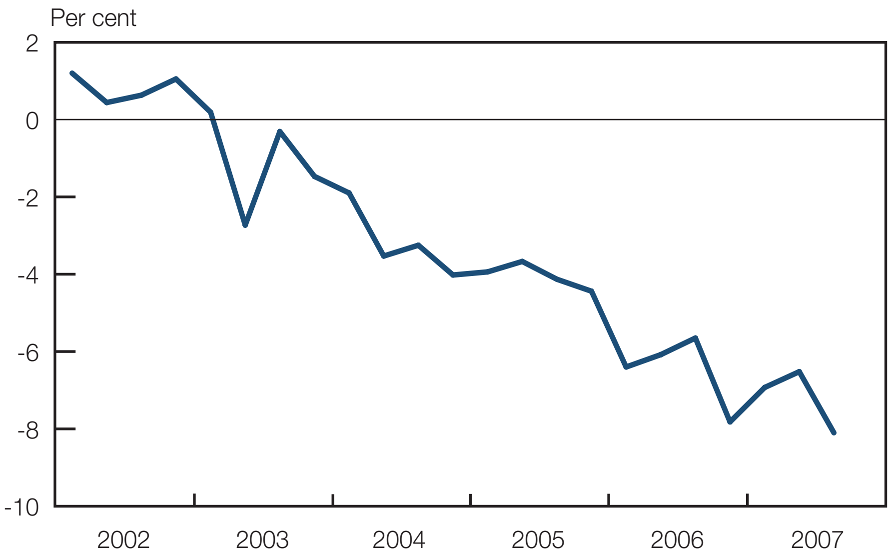
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2006			2007		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Merchandise exports	426,2	473,1	399,0	466,8	494,9	494,6
Net gold exports	39,4	39,5	35,5	37,3	36,3	41,0
Merchandise imports	-497,7	-577,7	-476,5	-555,0	-562,6	-587,7
Trade balance	-32,1	-65,1	-42,0	-50,9	-31,4	-52,1
Net service, income and current transfer payments	-68,5	-78,2	-70,3	-79,6	-92,7	-110,5
Balance on current account	-100,6	-143,3	-112,3	-130,5	-124,1	-162,6
As percentage of gross domestic product	*-5,7*	*-7,8*	*-6,5*	*-6,9*	*-6,5*	*-8,1*

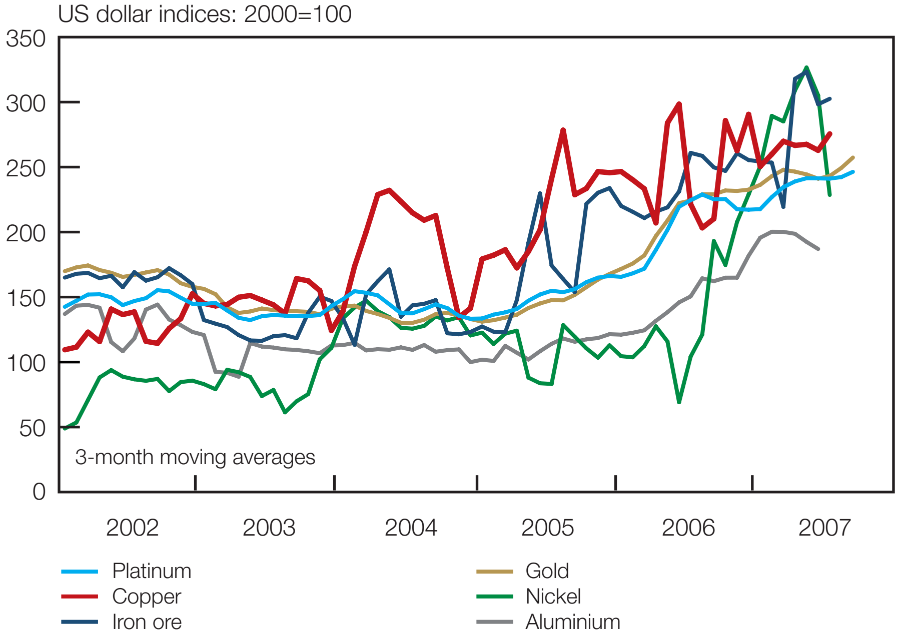
The value of *merchandise exports*, which rose by 6 per cent in the second quarter of 2007, moved essentially sideways in the third quarter as a small decline in the volume of merchandise exports was offset by an increase in price. The unit price of exports in rand terms rose by 1 per cent in the third quarter of 2007 compared with an increase of almost 5 per cent in the preceding quarter. International commodity prices were adversely affected by turbulence in financial markets during August 2007 caused by the sub-prime mortgage crisis. Overall, commodity prices in US dollar terms receded by 1,6 per cent in the third quarter of 2007 with declines noted in especially metal prices. Notwithstanding this decline, international commodity prices in dollar were, on average, still 10,9 per cent higher in the first three quarters of 2007 when compared with the corresponding period in 2006.

Ratio of current-account balance to gross domestic product



Having advanced by 1 per cent in the second quarter of 2007, the volume of merchandise exports shrank by a percentage point in the third quarter. Supply constraints in certain mining operations probably adversely affected the exportation of domestically produced mining products. However, the decline was partly countered by a marginal increase in the volume of exported manufactured goods despite lacklustre production by the industry. In contrast with previous upward phases in the business cycle, the ratio of non-gold merchandise exports to gross domestic product initially fell from 22,3 per cent in the fourth quarter of 2000 to 18,3 per cent in the first quarter of 2004 before increasing again to the somewhat higher level of 20,9 per cent in the first three quarters of 2007.

Prices of selected commodities: Metals



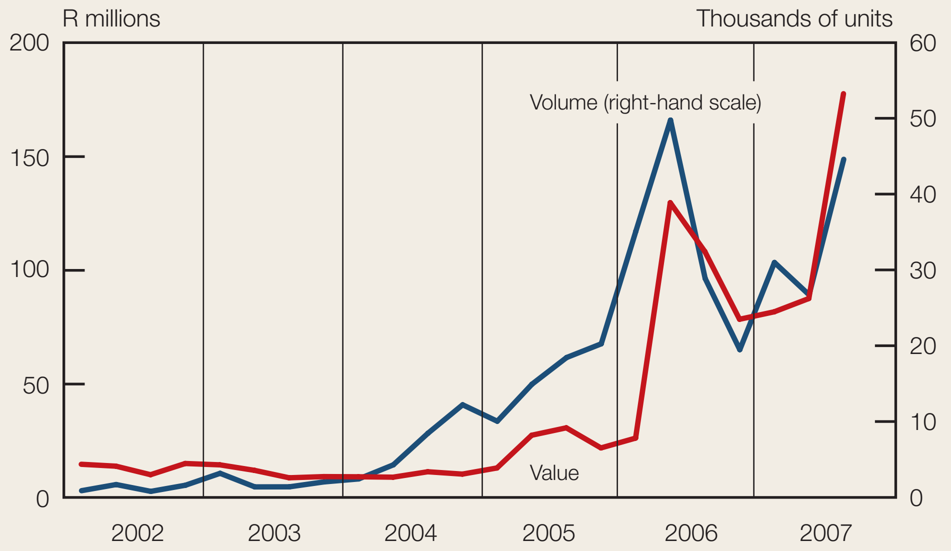
The value of South Africa's net *gold exports* rose by 13 per cent from R36,3 billion in the second quarter of 2007 to R41,0 billion in the third quarter as gold producers stepped up the volume of gold exports. Having declined for two consecutive quarters, the physical quantity of gold exported advanced by 9 per cent in the third quarter of 2007 in part due to a run-down of inventory levels which, in turn, could have been encouraged by the higher US dollar price of gold. The fixing price of gold on the London market was partly boosted by the weakness of the US dollar and rose by 2 per cent from the second to the third quarter of 2007 to US$680 per fine ounce. In the subsequent period the price of gold advanced even further to trade at $842 per fine ounce on 7 November 2007 – the highest gold price recorded since 21 January 1980.

After having declined in the second quarter of 2007, the volume of *merchandise imports* advanced by 1 per cent in the third quarter. The higher level of domestic spending on imported goods was mainly evident in the categories for agricultural products and manufactured goods. In particular, the importation of four helicopters for use by the South African Air Force contributed to the increase in the volume of vehicles and transport equipment, while the imports of chemical products and machinery and electrical equipment surged on account of ongoing fixed capital investment projects. Relative to gross domestic expenditure, non-oil merchandise imports rose from 25,1 per cent in the second quarter of 2007 to 25,6 per cent in the third quarter. The increase in the volume of non-oil imports was, however, largely countered by a contraction in the volume of crude oil imports during the period.

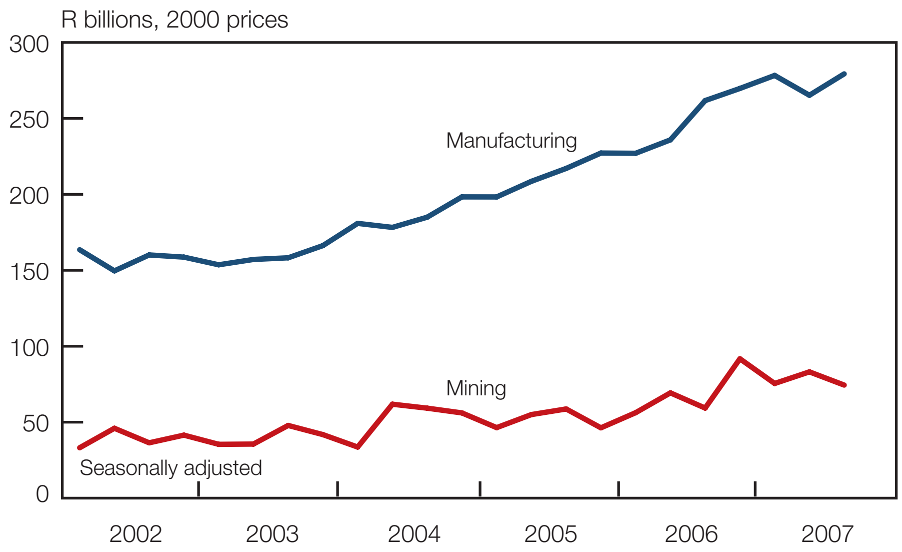
Imports of electricity generators

Rising demand for electricity has not been fully met by increases in capacity in recent years, resulting in an increase in the frequency of load-shedding in South Africa. As a result, businesses and households have increasingly acquired standby generators in order to ensure a continuous supply of electricity. The rising trend in the importation of generators is illustrated in the accompanying graph.

Imports of petrol and diesel-based electric generating sets



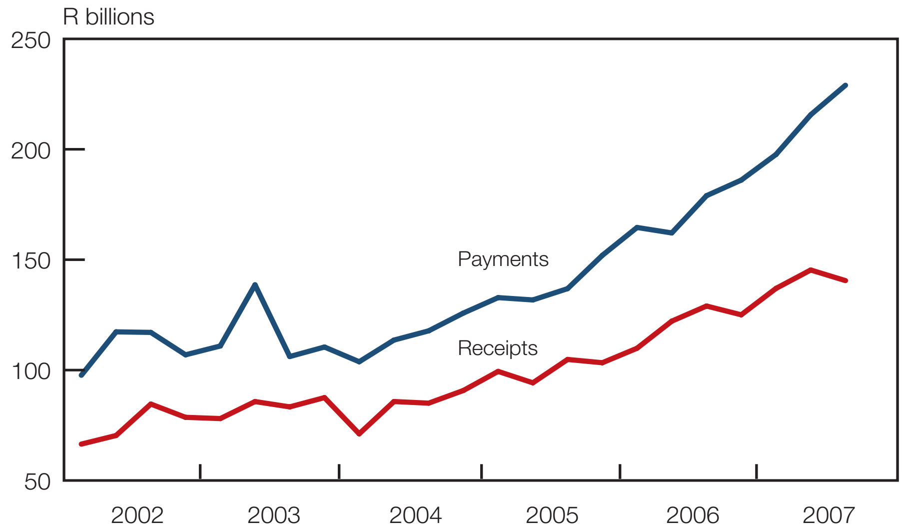
Volume of merchandise imports



Higher international crude oil prices and a marginal increase in the wholesale prices of the country's trading-partner countries raised the rand prices of merchandise imports by 3 per cent in the third quarter of 2007. As a result, the value of imported goods increased to R587,7 billion over the period.

The traditional negative imbalance in net services, income and current transfer payments to the rest of the world widened by about 19 per cent from R92,7 billion in the second quarter of 2007 to R110,5 billion in the third quarter. The further deterioration reflected a 6-per-cent increase in total services and income payments which coincided with a 3½-per-cent decline in total receipts for services rendered to and income received from non-residents. This was largely due to considerably higher dividend payments to non-resident investors which rose by about 28 per cent in the third quarter of 2007. Over the same period, an increase in the receipts for "other" services rendered to non-resident parties was not sufficient to compensate for the decline in travel receipts and investment income accruing to South African investors from abroad.

Balance of payments: Gross income and services transactions



South Africa's terms of trade weakened slightly as a decline in international commodity prices restrained the prices of merchandise exports during the third quarter of 2007. The resurgence of higher international crude oil prices, in particular during September 2007, contributed to higher prices of merchandise imports.

Financial account

Sustained favourable macroeconomic fundamentals together with a positive outlook for growth supported the financial attractiveness of emerging-market economies during the global repricing of risk in the aftermath of the sub-prime mortgage turbulence since August 2007. Demonstrating their resilience, the South African financial markets attracted a further net inflow of capital to the value of R58,2 billion in the third quarter of 2007, exceeding the net inflow of R47,9 billion registered in the second quarter. The net inward movement of capital was recorded in all investment categories, although it was more prominent in the category for net inward portfolio investment.

Foreign-owned assets in South Africa

The inflow of *foreign direct investment* into South Africa amounted to R11,1 billion in the second quarter of 2007 and R11,8 billion in the third quarter. During the third quarter a non-resident direct investor acquired a South African hotel group. In addition, a foreign private equity fund acquired a domestic financial services company and foreign banks recapitalised their operations in South Africa. This most recent increase in direct investment liabilities constituted the third consecutive quarterly direct investment inflow into South Africa.

Net financial transactions not related to reserves
R billions

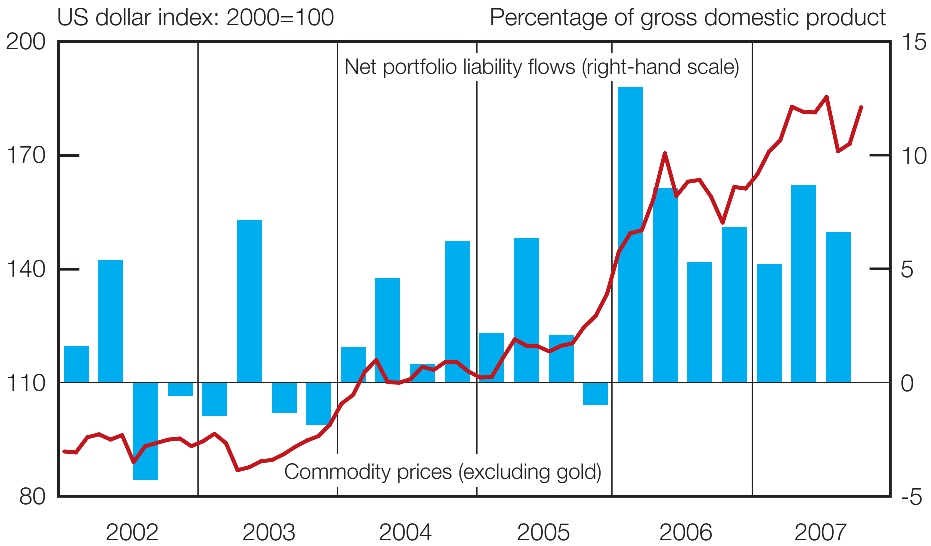
	2006			2007		
	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Change in liabilities						
Direct investment	-2,6	-14,1	-3,6	2,6	11,1	11,8
Portfolio investment	23,9	31,5	144,3	24,5	42,0	33,7
Other investment	17,6	2,6	64,2	2,6	19,8	33,9
Change in assets						
Direct investment	-36,0	1,1	-45,4	-1,3	-10,2	-2,2
Portfolio investment	-2,8	-4,5	-15,0	-4,4	-6,4	-4,5
Other investment	15,0	3,8	-42,2	12,8	-15,8	-30,2
Total financial transactions......*	*36,3*	*42,9*	*142,0*	*32,6*	*47,9*	*58,2*

* Including unrecorded transactions

Despite the turbulence in financial markets, *foreign portfolio investors* continued to increase their holdings of both South African equity and fixed-interest securities during the third quarter of 2007, albeit at a slower pace than before. The net inflow of portfolio capital amounted to R33,7 billion in the third quarter compared with the inflow of R42,0 billion recorded in the preceding quarter. The inward movement of portfolio capital in the second quarter of 2007 was supplemented by the issuance of an additional euro-denominated bond by the banking sector.

Portfolio inflows were partly negated by the redemption of a yen-denominated government bond over the same period. Excluding the trade in shares between parties in a private equity transaction, the net purchases of equity securities through the JSE Limited (JSE) moderated from R24,0 billion in the second quarter of 2007 to R18,9 billion in the third quarter. The slower pace of net acquisitions of South African equity securities, which mainly comprised resources stocks, corresponded with a decline in international commodity prices during August and early September 2007 and a somewhat stronger external value of the rand.

Commodity prices and net portfolio liability flows



Other investment flows into South Africa increased from R19,8 billion in the second quarter of 2007 to R33,9 billion in the third quarter. This inflow was mainly in the form of foreign loans extended to South African entities augmented by an increase in the non-resident foreign-currency denominated deposits with the South African banking sector. Non-resident investors, however, reduced their rand-denominated deposits with South African banks over the period.

South African-owned assets abroad

Outward direct investment or the acquisition of foreign direct investment assets by South African companies recorded a capital outflow of R2,2 billion in the third quarter of 2007 compared with an outflow of R10,2 billion in the second quarter. South African companies continued to diversify their business through the acquisition of companies abroad, albeit at a slower pace than in the second quarter of 2007.

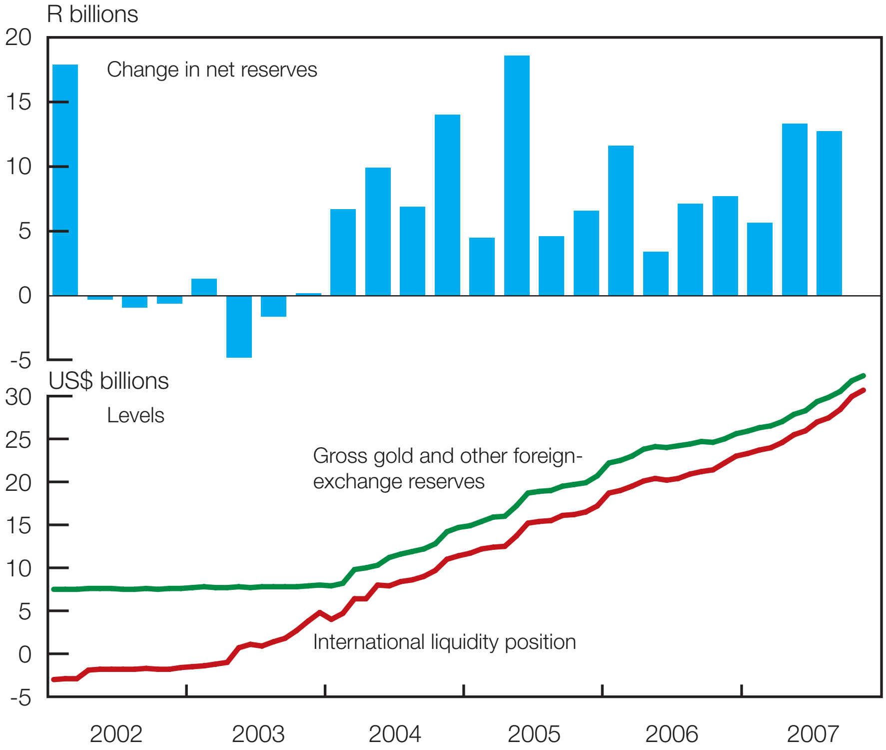
The acquisition of *foreign portfolio assets* by South African entities gave rise to an outflow of R4,5 billion in the third quarter of 2007 compared with an outflow of R6,4 billion recorded in the second quarter. South African institutional and individual investors have consistently made use of exchange control concessions to diversify their investment portfolios since the second quarter of 2005.

Other outward investment from South Africa increased from R15,8 billion in the second quarter of 2007 to R30,2 billion in the third quarter. This capital outflow could mainly be attributed to a further increase in the foreign-currency deposits of South African banks abroad as well as the settlement of non-resident rand-denominated bond purchases abroad.

International reserves and liquidity

Persistent inflows through the financial account of the balance of payments were more than adequate to finance the deficit on the current account in the third quarter of 2007. South Africa's overall balance of payments (i.e. the change in the country's net

Foreign reserves



international reserves due to balance-of-payments transactions) accordingly displayed a further surplus to the amount of R12,7 billion in the third quarter. The cumulative surplus for the first three quarters of 2007 amounted to R31,7 billion, more than the surplus of R29,8 billion recorded for the year 2006 as a whole.

Measured in US dollar, the value of the gross gold and other foreign reserves of the South African Reserve Bank (the Bank) increased from US$28,3 billion at the end of June to US$30,5 billion at the end of September 2007 and further to US$32,4 billion at the end of November. The utilisation of foreign short-term credit facilities by the Bank declined from US$2,5 billion at the end of June 2007 to US$2,3 billion at the end of September and further to US$1,7 billion at the end of November.

The Bank's international liquidity position increased from US$25,9 billion at the end of June 2007 to US$28,4 billion at the end of September and US$30,7 billion at the end of November.

Foreign debt

South Africa's total outstanding foreign debt increased from US$57,6 billion at the end of the first quarter of 2007 to US$66,2 billion at the end of the second quarter. The US$8,6-billion increase in the second quarter of 2007 can be ascribed to an increase in both foreign-currency and rand-denominated debt.

Outstanding foreign-currency denominated debt rose by US$4,7 billion primarily due to the issuance of various euro-denominated bonds by companies in the manufacturing and retail sectors in an effort to partly finance the buy-out by private equity managers. In addition, the National Treasury and the banking sector issued international bonds over the period. The National Treasury, however, pre-redeemed international foreign-currency denominated bonds to the value of R8,7 billion, thereby partly countering the increase in debt-related liabilities.

Foreign debt of South Africa

US$ billions at end of period

	2006			2007	
	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Foreign-currency denominated debt...	**33,1**	**35,3**	**35,8**	**34,9**	**39,6**
Bearer bonds	10,7	10,5	10,5	10,3	13,9
Public sector	4,6	4,8	5,2	5,2	5,5
Monetary sector	10,1	10,7	10,3	10,7	11,2
Non-monetary private sector	7,7	9,3	9,8	8,7	9,0
Rand-denominated debt	**24,4**	**21,9**	**23,6**	**22,7**	**26,6**
Bonds	6,0	6,3	7,5	6,1	7,1
Other	18,4	15,6	16,1	16,6	19,5
Total foreign debt	**57,5**	**57,2**	**59,4**	**57,6**	**66,2**

The increase in rand-denominated debt mainly reflected portfolio investment in South African bonds and an increase in long-term loans granted to domestic companies by non-residents. During the second quarter of 2007 a black economic empowerment consortium obtained a loan to partly fund the acquisition of a majority stake in a domestic cement company.

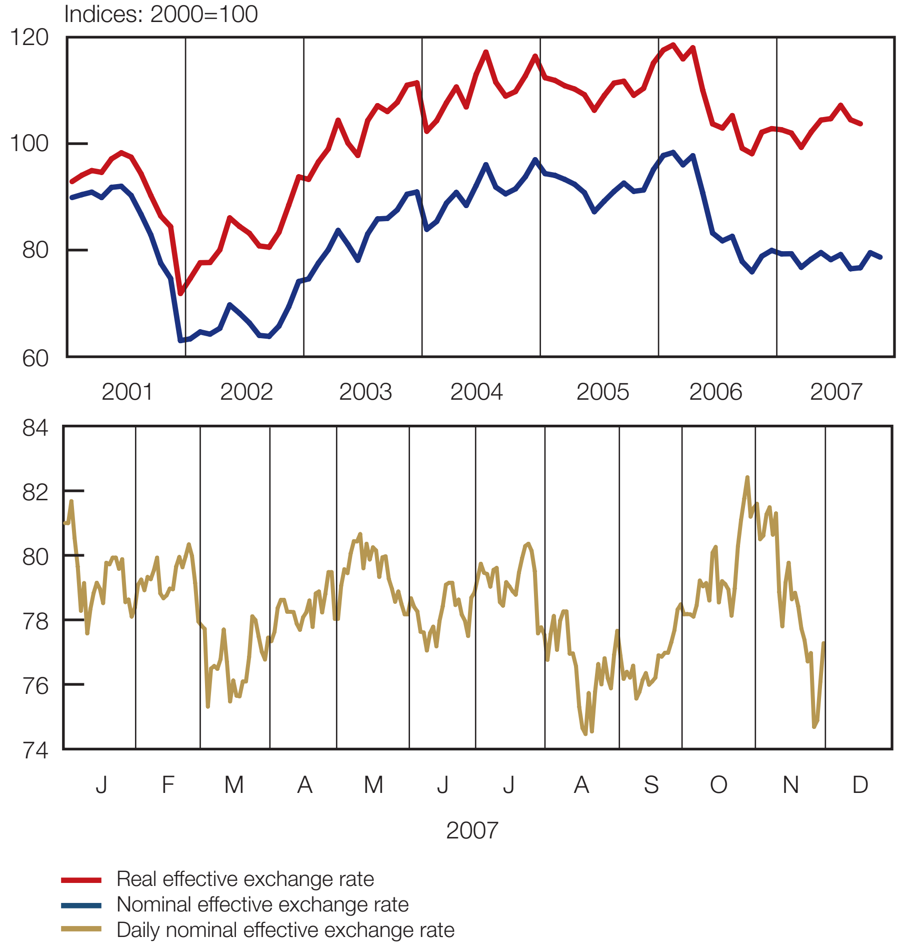
Despite the appreciation of the exchange rate of the rand against the US dollar, South Africa's foreign debt, expressed in rand, increased from R417 billion at the end of March 2007 to R464 billion at the end of June 2007.

Moody's, a ratings agency, revised the outlook for South Africa's foreign-currency denominated debt from stable to positive in the second quarter of 2007. During the third quarter of 2007 the US ratings agency, Standard & Poor's, kept the country's sovereign credit rating unchanged at BBB+ with a stable outlook.

Exchange rates

The nominal effective exchange rate of the rand depreciated significantly from late July to mid-August 2007 following the emergence of the US sub-prime turmoil, but strengthened thereafter as it was realised that emerging markets were not directly affected. The recovery of the exchange rate of the rand during the latter half of the third quarter was also supported by a reduction in interest rates by the US Federal Reserve and stronger international prices of precious metals. On balance, the nominal effective exchange rate of the rand displayed little change from the end of June to the end of September, but declined by 3,3 per cent in the first nine months of 2007. From the end of the third quarter of 2007 to early November 2007 the exchange value of the rand strengthened markedly due to a weaker US dollar and the announcement that a Chinese

Exchange rates of the rand



bank would acquire an interest of 20 per cent in a major South African bank. During the remainder of November, however, the rand's earlier gains were largely reversed. Volatility in the foreign-currency market increased somewhat in recent months.

The real effective exchange rate of the rand strengthened by 5,4 per cent from December 2006 to October 2007 and by 10,5 per cent over the twelve-month period to October 2007.

Exchange rates of the rand

Percentage change

	29 Dec 2006 to 30 Mar 2007	30 Mar 2007 to 29 Jun 2007	29 Jun 2007 to 28 Sep 2007	28 Sep 2007 to 30 Nov 2007
Weighted average*	-4,4	1,8	-0,5	-1,5
Euro	-5,0	1,3	-2,1	-2,8
US dollar	-4,0	2,4	3,1	1,1
British pound	-3,7	0,1	1,8	-0,8
Japanese yen	-4,7	7,0	-3,7	-3,5

* Against a basket of 13 currencies

The average daily turnover in the domestic market for foreign exchange, which increased to US$16,1 billion in the second quarter of 2007, rose further to US$17,4 billion in the third quarter. These increases coincided with high levels of activity in the South African capital markets. The value of transactions in which non-residents participated increased from US$12,3 billion per day to US$13,3 billion over the same period. According to the April 2007 *Triennial Survey* which reviews average daily turnover conducted by the Bank of International Settlements (BIS), the rand emerged as the fifth most actively traded emerging-market currency after those of Hong Kong, Mexico, Singapore and Korea.

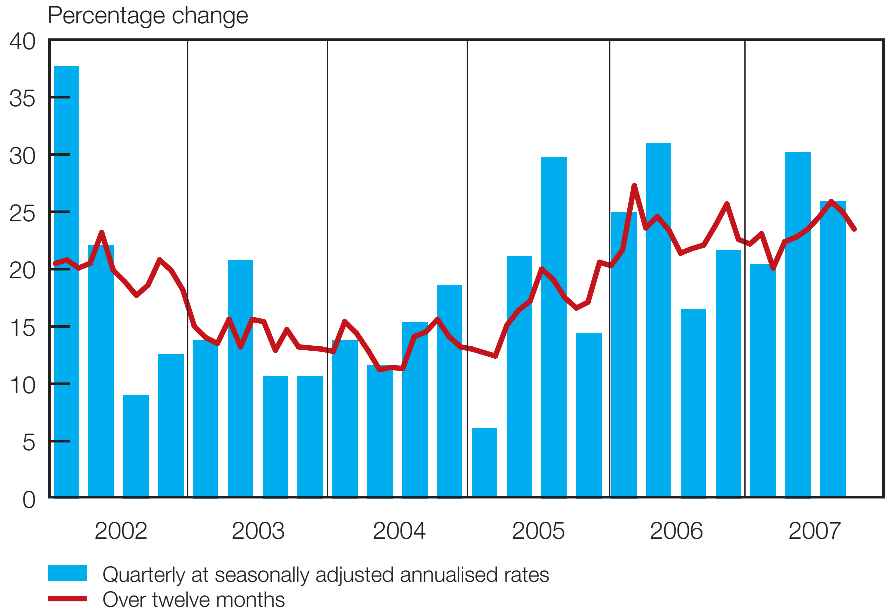
Monetary developments, interest rates and financial markets

Money supply

Growth in the broadly defined money supply (M3) moderated somewhat in the third quarter of 2007 but remained exceptionally strong. The growth in M3 during the third quarter reflected not only rising levels of nominal income and expenditure, but also coupon interest payments on government bonds received by the corporate sector, and a stronger preference for liquid monetary assets following the recent episode of heightened risk aversion towards securities markets. The preference for less risky assets was further bolstered by higher rates of return on bank deposits on account of the increase in domestic interest rates.

The quarter-to-quarter seasonally adjusted and annualised growth in M3 decelerated from 30,2 per cent in the second quarter of 2007 to 25,9 per cent in the third quarter. Growth over twelve months in M3 initially accelerated from 23,4 per cent in June 2007 to 25,8 per cent in August, but decelerated to 24,9 per cent in September. In October the year-on-year growth amounted to 23,4 per cent.

Growth in M3



Both the household and the corporate sectors increased their holdings of M3 deposits during the third quarter of 2007, displaying a strong preference for call, overnight and other short and medium-term deposits. The corporate sector's deposit holdings accounted for 81 per cent of the overall increase, with the household sector accounting for the remaining 19 per cent. Within the corporate sector, the non-financial institutions accounted for the bulk of the increase in M3. This contrasted with the previous three quarters when financial institutions were the largest contributors.

Growth in the narrower monetary aggregates decelerated in the third quarter of 2007, which could have been a reflection of the increased opportunity cost of holding the non-remunerated component of the aggregates. Long-term deposits were liquidated in the third quarter, possibly indicating a reversal of the earlier view that interest rates had peaked.

Simultaneously, demand and shorter-term deposits gained favour. This could have been driven by a precautionary motive for holding more liquid deposits as risk aversion was amplified in the wake of the sub-prime related turbulence in financial markets.

Growth in monetary aggregates
Per cent at seasonally adjusted annualised rates

	2007	
	2nd qr	3rd qr
Notes and coin in circulation	29,0	6,1
Cheque and transmission deposits	39,0	14,5
M1A	36,7	6,8
Other demand deposits	31,5	50,2
M1	34,1	24,5
Other short and medium-term deposits	16,3	47,5
M2	26,1	33,9
Long-term deposits	43,0	-11,0
M3	30,2	25,9

The growth in M3 has exceeded growth in nominal gross domestic product on a regular basis over the past seven years. The outcome in the third quarter of 2007 was no exception, as seasonally adjusted and annualised growth in M3 exceeded growth in gross domestic product by 12 percentage points. As a result, the income velocity of circulation of M3 reached a low of 1,28 in the third quarter of 2007 from 1,31 in the second quarter.

As indicated in the accompanying table, the most significant statistical counterpart to the increase in M3 in the third quarter was the increase in claims on the private sector, indicative of the prolonged strong growth in loans and advances.

Counterparts of change in M3
R billions

	2007	
	2nd qr	3rd qr
Net foreign assets	20,0	0,9
Net claims on the government sector	-14,1	2,6
Claims on the private sector	69,9	88,0
Net other assets and liabilities	0,1	-10,7
Total change in M3	**76,0**	**80,9**

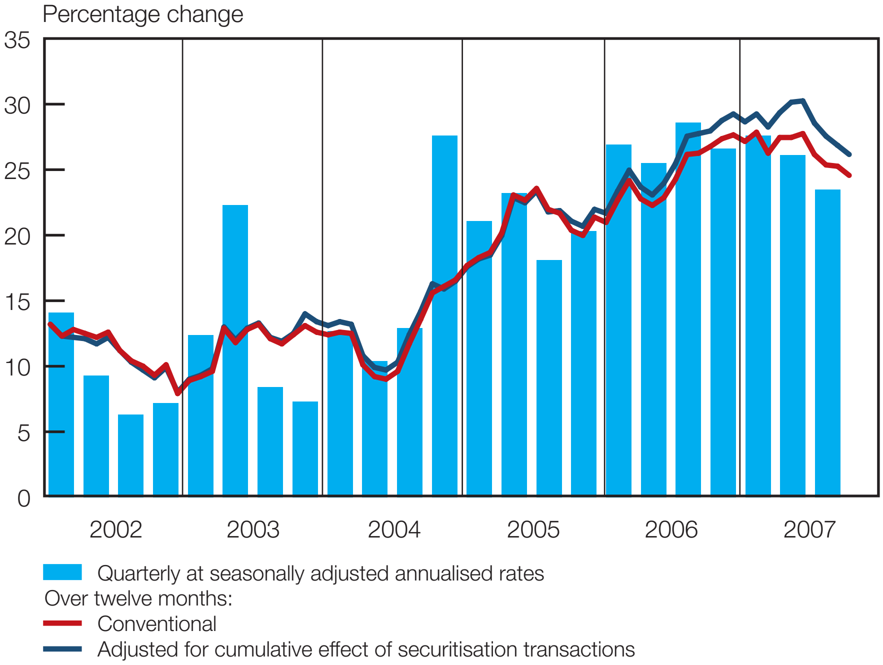
Credit extension

Following strong growth in the first quarter of 2007, growth in banks' total loans and advances[3] extended to the private sector lost some momentum in both the second and third quarters of 2007. The moderation in growth in total loans and advances was partly a consequence of a softening in domestic consumer demand, underpinned by rising domestic interest rates and some deterioration in consumer and business sentiment. The growth measure of total loans and advances, which is adjusted for the cumulative effect of securitisation activity by banks, exhibited a similar pattern of moderation.

3 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 form part of other loans and advances.

The quarter-to-quarter seasonally adjusted and annualised rate of growth in total loans and advances decelerated from 26,1 per cent in the second quarter of 2007 to 23,5 per cent in the third quarter. Twelve-month growth in total loans and advances tapered off from a high of 27,7 per cent in June 2007 to 25,2 per cent in September and 24,5 per cent in October. Adjusted for the cumulative effect of securitisation transactions, growth over twelve months decelerated from 30,2 per cent in June 2007 to 26,2 per cent in October.

Total loans and advances to private sector



In value terms, banks' total loans and advances rose by R83,2 billion in the third quarter of 2007. Asset-backed credit grew strongly during the period under review, accounting for 71 per cent of the overall increase in total loans and advances, with mortgage advances being the main contributor to this category.

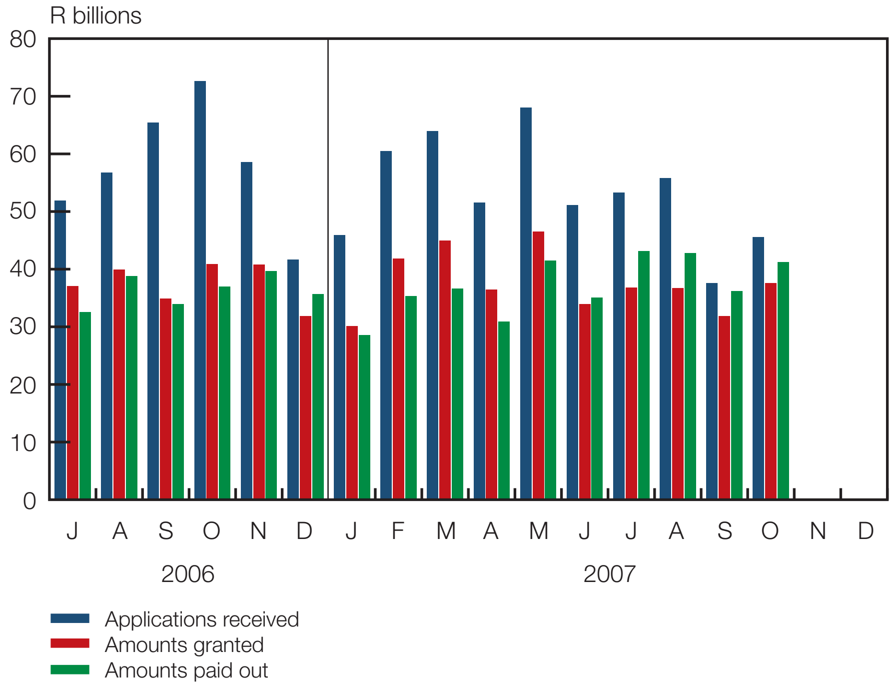
Quarterly changes in banks' total loans and advances by type

R billions

	2007	
	2nd qr	3rd qr
Mortgage advances	42,3	49,5
Instalment sale credit and leasing finance	-0,9	9,5
Other loans and advances	30,0	24,2
Overdrafts	5,7	8,9
Credit card advances	4,1	2,2
General advances	20,2	13,2
Total loans and advances	**71,4**	**83,2**
Of which: To household sector	32,6	40,4
To corporate sector	38,8	42,8

Mortgage advances increased at a robust pace in the third quarter of 2007, posting record-high month-on-month increases in both July and August. The significant increase in mortgage advances granted in the third quarter possibly reflected some overflow of pre-emptive mortgage applications before the implementation of the National Credit Act in June 2007. In addition, the public-service work stoppage in June may have pushed bond registrations into the third quarter. Applications for mortgage advances, amounts granted and amounts paid out all remained firm up to October 2007.

Mortgage advances

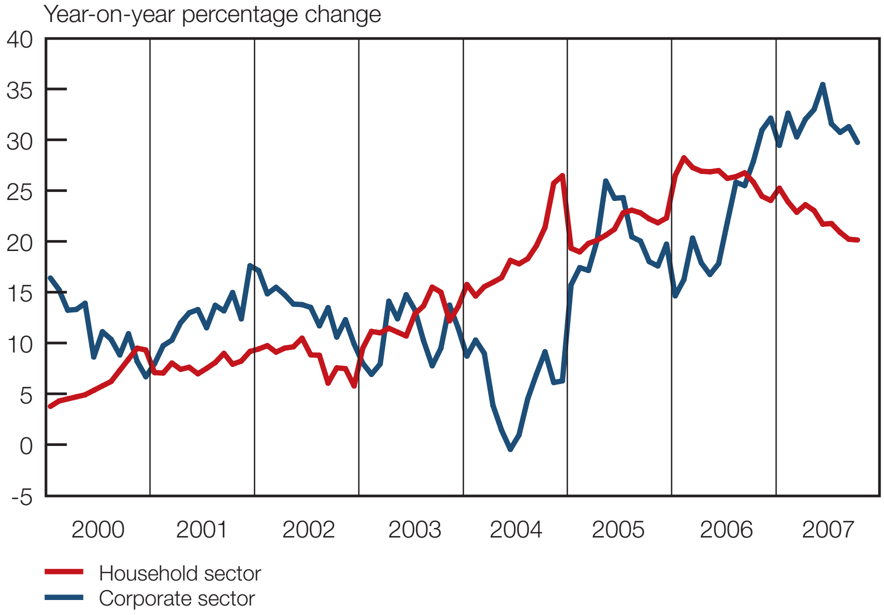


Growth over twelve months in *instalment sale credit and leasing finance,* mainly directed at financing expenditure on motor vehicles and other durable goods, accelerated somewhat from 12,1 per cent in June to 15,2 per cent in September, but fell to 14,7 per cent in October. Adjusted for the cumulative effect of securitisation transactions, growth in this credit category has remained stable at around 20 per cent throughout 2007.

During the third quarter of 2007, growth in *other loans and advances*, which are dominated by the corporate sector's use of overdrafts and general advances, moderated from elevated levels recorded in the second quarter. Growth in this credit category may have been affected by some deterioration in business sentiment, alongside a tighter monetary policy stance and uncertainty emanating from the US sub-prime related turbulence. Growth over twelve months in other loans and advances decelerated from a peak of 36,7 per cent in June 2007 to 27,7 per cent in October.

The household sector continued to account for the largest share of bank loans and advances in the third quarter of 2007. However, growth over twelve months in loans and advances extended to the household sector fell from average increases of 26,4 per cent in 2006 to 22,3 per cent in the first ten months of 2007. By contrast, growth over twelve months in credit extended to the corporate sector accelerated sharply from an average of 22,3 per cent in 2006 to 31,6 per cent in the ten months to October 2007. Accordingly, monetary policy tightening from mid-2006 seems to have had a greater impact on households than on the corporate sector.

Credit to the household and corporate sector



In the wake of the upward movement in borrowing costs since June 2006, banks' non-performing loans, in value terms, drifted higher in the first three quarters of 2007. However, expressed as a percentage of total loans and advances, non-performing loans increased only marginally from 2,0 per cent in December 2006 to 2,2 per cent in September 2007.

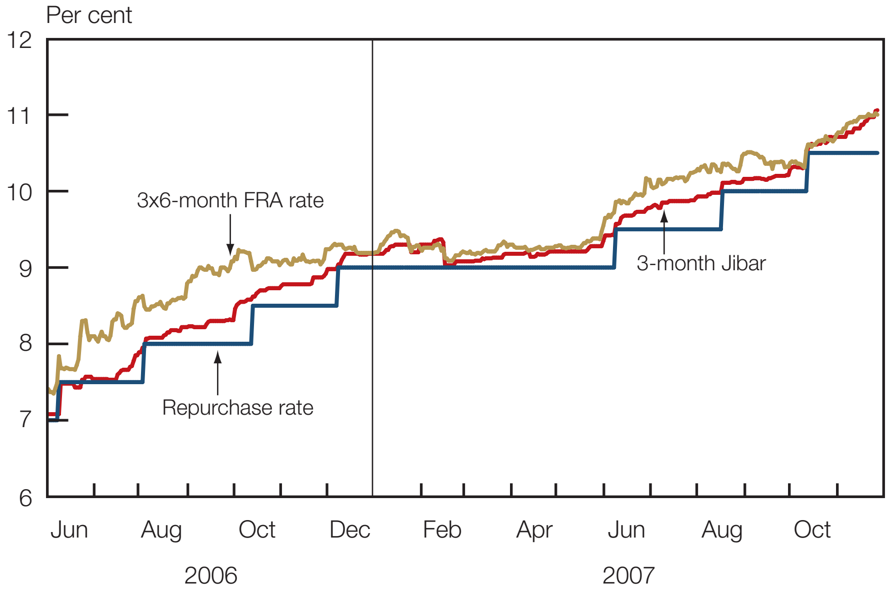
Interest rates and yields

At its October 2007 meeting, the analysis of the Monetary Policy Committee (MPC) suggested a further deterioration in the risks to the inflation outlook. The MPC accordingly increased the repurchase rate by a further 50 basis points to 10,5 per cent, effective from 12 October. This followed similar increases in June and August 2007, and brought the cumulative increase in the repurchase rate since June 2006 to 350 basis points, reversing more than half of the 650-basis-point reductions undertaken between 2003 and 2005. The MPC statement discussing developments underlying the October 2007 decision is reproduced in full elsewhere in this Bulletin.

Other money-market interest rates in general rose during the past half-year, partly in anticipation of and partly following the increases in the repurchase rate (as illustrated in the accompanying graph). The three-month Johannesburg Interbank Agreed Rate (Jibar) initially increased to 10,71 per cent on 26 October, following the 12 October 2007 increase in the repurchase rate, before continuing its upward trend to 11,07 per cent on 30 November 2007.

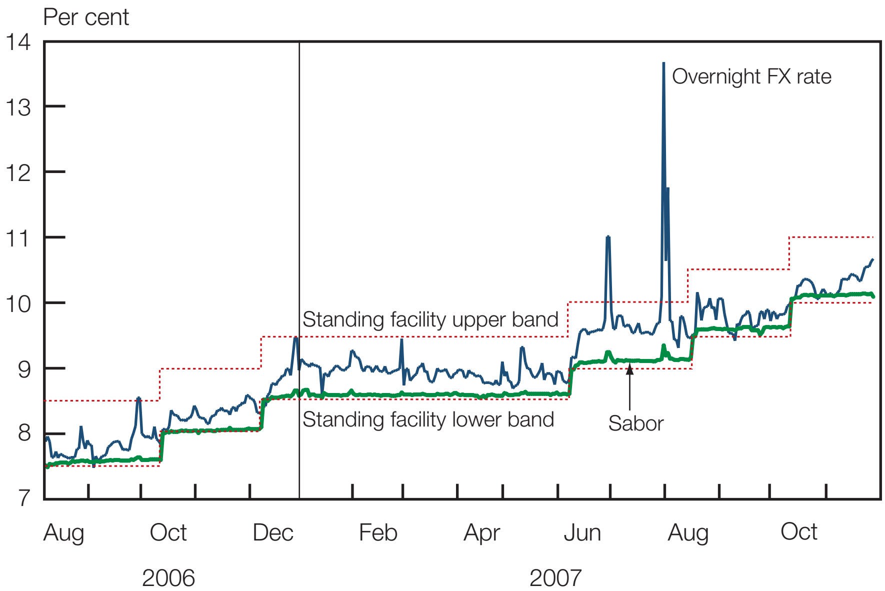
Rates on forward rate agreements (FRAs) exhibited an upward trend from June 2007, similarly partly leading and partly following increases in the repurchase rate.

Money-market rates



The South African Benchmark Overnight Rate on deposits (Sabor) continued its customary pattern in the second half of 2007, remaining just above the lower standing facility rate of the Bank and responding immediately to changes in the Bank's repurchase and other refinancing rates. The implied rate on one-day rand funding in the foreign-exchange swap market (overnight FX rate) registered short-lived outliers around the June and July 2007 month-ends, but otherwise exhibited low volatility during the period under review, generally within the standing facility limits as may be expected in a well-functioning and efficient overnight funding market. At the end of November 2007 Sabor stood at 10,10 per cent.

Benchmark overnight rates



Both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private-sector banks were increased by a further 50 basis points on 12 October 2007 to 14,0 per cent.

Following a decrease of 20 basis points in February 2006, the *predominant rate on twelve-month fixed deposits* with private-sector banks started edging higher. It eventually rose by a total of 350 basis points to reach 9,7 per cent in November 2007. In real terms the twelve-month fixed deposit rate rendered investors an average real rate of return before tax of 2,3 per cent in 2005 and 2006, somewhat lower than the rate of 2,6 per cent recorded in the first ten months of 2007. In October 2007, the real deposit rate came to 2,2 per cent.

The *standard interest rate* on loans granted by the government from the State Revenue Fund as defined in the Public Finance Management Act, increased from 12 per cent to 13 per cent on 1 September 2007. The *official rate of interest* applicable to fringe benefit taxation, as defined in the Income Tax Act, was raised from 10 per cent to 11 per cent also with effect from 1 September 2007.

On 12 October 2007 the *maximum prescribed interest rates* as laid down by the National Credit Act increased as indicated in the accompanying table.

National Credit Act maximum interest rates

Category	Maximum rate per annum Per cent
Mortgage agreements	27 to 28,1
Credit facilities	32 to 33,1
Unsecured credit transactions	42 to 43,1
Developmental credit agreements:	
For the development of a small business	42 to 43,1
For low-income housing (unsecured)	42 to 43,1
Short-term credit transactions	60
Other credit agreements	32 to 33,1
Incidental credit agreements	24

Similarly, on 19 October 2007 the *maximum annual finance charge rates* on money loans and credit and leasing transactions, as laid down by the Usury Act, were increased by one percentage point to 25 per cent for amounts less than R10 000 and to 22 per cent for amounts above R10 000, but not exceeding R500 000.

The accompanying table depicts how the *RSA government retail bond rates* have changed since March 2007.

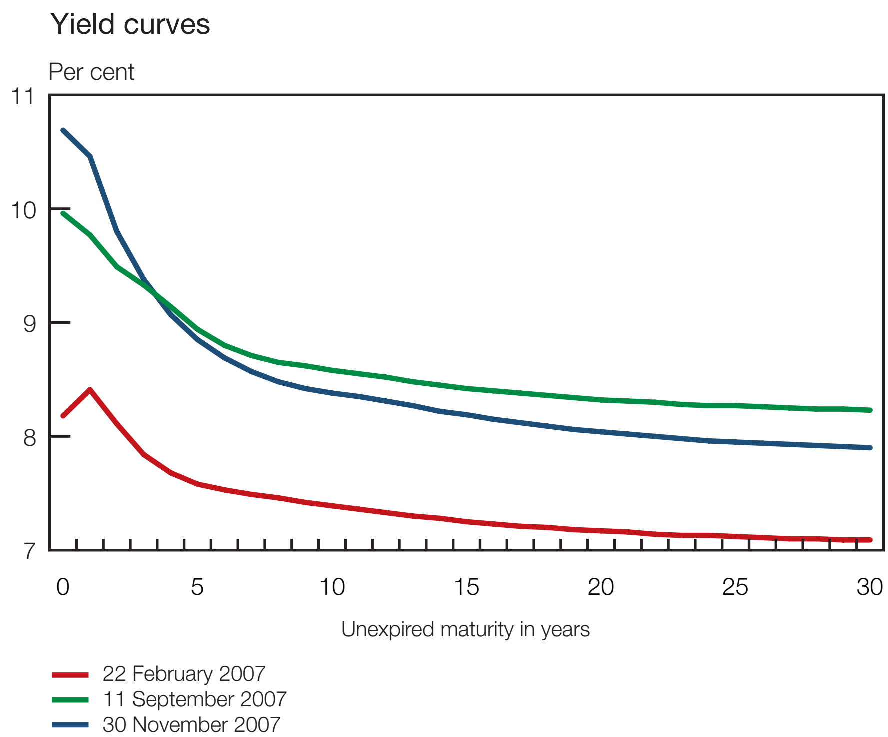
Interest rates on RSA retail bonds
Per cent

Effective from	2-year bond	3-year bond	5-year bond
1 Mar 2007	8,50	8,75	8,00
1 Jul 2007	9,00	8,75	8,50
1 Sep 2007	9,25	9,25	8,75
1 Oct 2007	9,50	9,75	10,00

In addition to its fixed-rate retail bond which was launched in May 2004, the National Treasury introduced an inflation-linked retail savings bond from April 2007. The inflation-linked retail bond consists of 3-year, 5-year and 10-year maturities. The value of the capital invested in the inflation-linked bond will change every six months in line with inflation (using the consumer price index), and added to this inflation-adjusted amount an investor will earn interest. The current real floating interest rate of 2,75 per cent will be adjusted every six months, that is in May and November, to align it with the government inflation-linked bond yield curve.

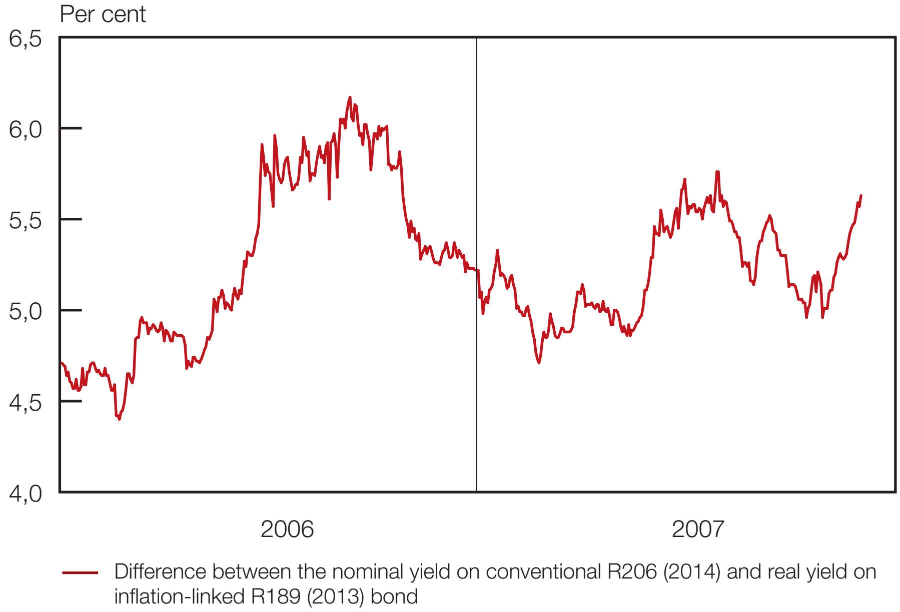
The *daily average yield on the long-term R157 government bond* (maturing in 2015) increased from a low of 7,48 per cent on 23 February 2007 to 8,71 per cent on 13 September in response to, among other things, the depreciation in the exchange value of the rand, increases in the repurchase rate, worse-than-expected inflation figures released and an increase in the international oil price. The long-term bond yield, however, edged lower to 8,09 per cent on 29 October in response to an appreciation in the exchange value of the rand, before increasing to 8,53 per cent on 30 November. The daily closing yield on the US 10-year bond increased from 4,45 per cent on 5 March 2007 to 5,28 per cent on 13 June before declining to 4,03 per cent on 30 November. The spread between the South African R157 bond yield and the US 10-year bond yield widened from 277 basis points on 23 February 2007 to 450 basis points on 30 November.

After increasing across all maturities from the end of February 2007 to September, the level of the yield curve became more inverted towards the end of November as the short end of the curve increased in accordance with the tightening of the monetary policy stance, while the medium-to-long end of the curve moved lower alongside the stronger exchange value of the rand. The *yield gap*, calculated as the difference between the yields at the extreme long and short ends of the curve, widened from a negative 90 basis points on 27 February 2007 to a negative 279 basis points on 30 November.



The *break-even inflation rate* in the six-year maturity range fluctuated lower from a high of 5,76 per cent on 27 July 2007 to 4,96 per cent on 29 October as the conventional bond yield receded following the stronger exchange value of the rand, while the real yield on inflation-linked bonds increased somewhat. Subsequently, the break-even inflation rate increased to 5,62 per cent on 30 November.

Break-even inflation rate



The *currency risk premium*[4] on South African government bonds widened from 197 basis points in January 2007 to 288 basis points in November as the yield on South African domestic rand-denominated bonds increased while the yield on dollar-denominated South African bonds declined.

The JP Morgan Emerging Markets Bond Index (EMBI+)[5] widened from a record low of 153 basis points in May 2007 to 246 basis points in November as risk concerns towards emerging markets remained. The *sovereign risk premium* on South African foreign-currency denominated bonds trading in international markets followed a similar trend, widening from an average of 67 basis points in May 2007 to 135 basis points in November.

4 Measured as the differential between South African government bond yields on rand-denominated debt in the eight-to-ten-year maturity range issued in the domestic market and South African dollar-denominated debt issued in the United States market.

5 EMBI+ measures total returns for external-currency denominated debt instruments of emerging markets.

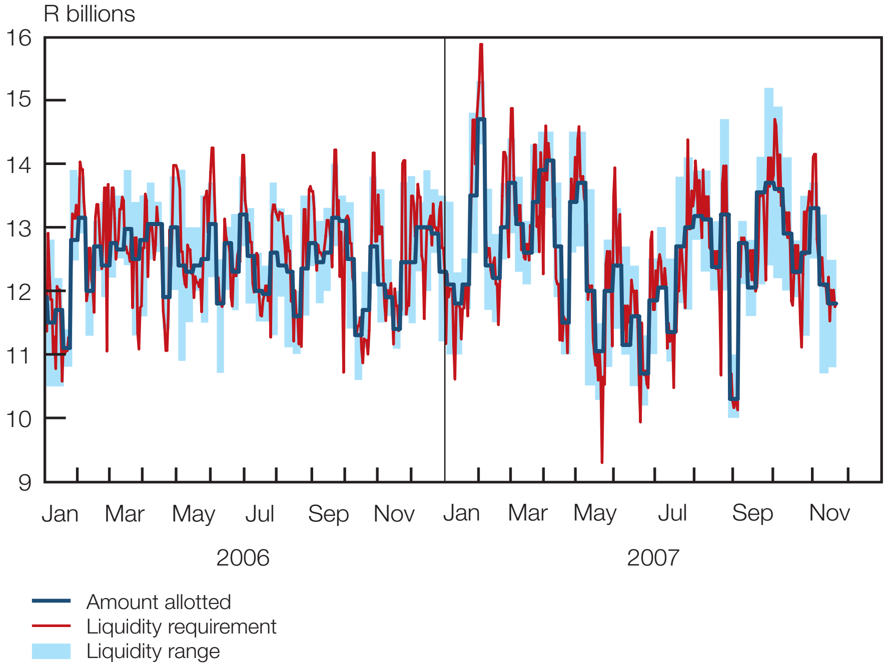
Money market

In the third quarter of 2007 and the ensuing two months to November 2007, the daily liquidity requirement of the private-sector banks fluctuated between R11,1 billion and R14,7 billion, occasionally breaching the upper and lower liquidity level ranges. This was mainly on account of the volatility experienced in note flows and larger-than-usual transactions in the accounts of other financial institutions held with the Bank. The liquidity provided by the Bank at the weekly main refinancing tender varied between R11,8 billion and R13,7 billion over the corresponding period.

To square off banks' daily positions in the interbank market, banks predominantly utilised their cash reserve accounts with the Bank. On occasion, standing and supplementary reverse repurchase transaction facilities were utilised to square off end-of-day positions.

Such tenders were conducted more frequently during the month of August in an effort to smooth liquidity.

Liquidity requirement, ranges and amount allotted



The accompanying table depicts the statistical counterparts of money-market liquidity flows from July to November 2007.

Money-market liquidity flows

R billions (easing +; tightening -)

	Jul – Sep 2007	Oct – Nov 2007
Notes and coin in circulation	-1,6	-3,8
Required cash reserve deposits	-0,1	-1,9
Money-market effect of SARB foreign-exchange transactions	14,0	12,9
Government deposits with SARB	-10,2	-1,4
Use of liquidity management instruments	-4,4	-0,9
Reverse repurchase transactions	-1,3	-0,2
SARB debentures	-3,1	-0,7
Other items net	0,4	-3,8
Banks' liquidity requirement (decrease +; increase -)	**-1,9**	**1,1**

The Bank's purchases of foreign exchange injected liquidity to an amount of R12,9 billion into the money market during the two months to November 2007, compared with R14,0 billion in the third quarter. The expansionary effect on the Bank's net foreign-exchange reserves mainly reflected normal funding operations, boosted by favourable market conditions during September and October 2007, as well as the restructuring of foreign loan facilities, which included the prepayment of US$250 million on a 5-year US$1,5 billion dual-currency syndicated term loan entered into in July 2005.

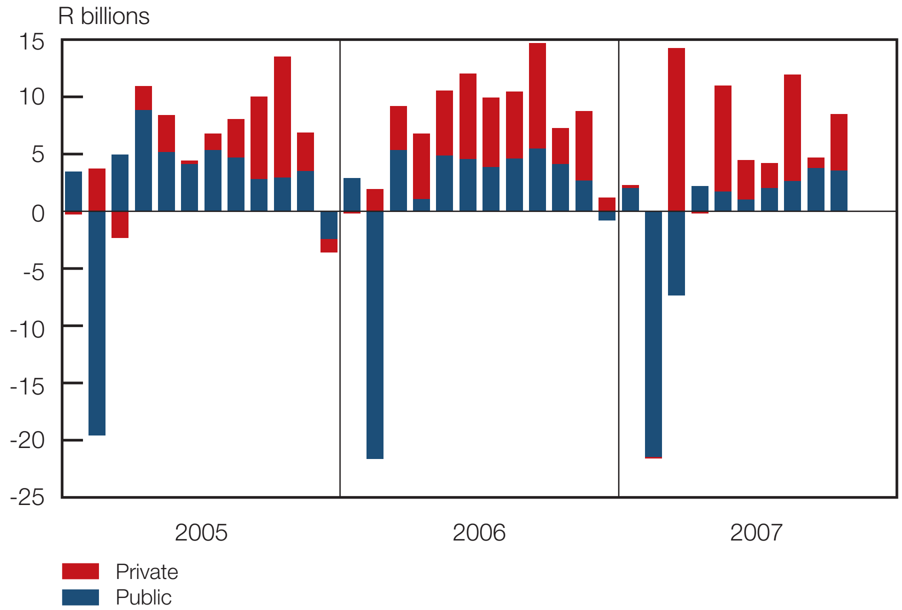
The excess liquidity was partly neutralised by the sizeable increase in government deposits with the Bank as well as the use of liquidity management instruments by the Bank, i.e. reverse repurchase agreements and SARB debentures. An increase of R5,3 billion in the total amount of outstanding interest-bearing liquidity-draining instruments utilised in the five months to November 2007 reflected large increases in SARB debentures made available to the market and was aligned with the continued strong demand for liquid assets.

The nominal value of government bonds in the Bank's monetary policy portfolio remained unchanged at R7,5 billion in the third quarter of 2007.

Bond market

Total net issues of fixed-interest securities by *public-sector borrowers* in the domestic primary bond market switched from R17,0 billion in 2006 to net redemptions amounting to R9,9 billion in the first ten months of 2007, largely reflecting national government's budget surplus. By contrast, the private sector increasingly sourced funding through the domestic bond market in 2007. After increasing by R31,5 billion in 2005 and R56,0 billion in 2006, the *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (BESA) increased by a further R44,2 billion in the first ten months of 2007 – of which R22,1 billion represented securitisation.

Public and private-sector funding in bond market



The National Treasury issued a new inflation-linked bond, the R210, with a real coupon interest rate of 2,60 per cent and a maturity date of 31 March 2028. The R210 bond was well received by the market as indicated by a tendered amount that was more than seven times larger than the amount offered at the initial auction on 21 September 2007. The new issue was in line with the announcement in the 2007 Budget that the diversity of maturities in the government's inflation-linked portfolio will be enhanced to develop a full inflation-linked yield curve. It brought the complete inflation-linked class of government bonds to comprise bonds maturing in 2008, 2013, 2023, 2028 and 2033.

Inflation-linked bonds: Real yields and amounts outstanding on 30 November 2007

	Real yield Per cent	Amount outstanding R billions	Maturity date	Coupon rate Per cent
R198	4,00	6,0	31 Mar 2008	3,80
R189	2,88	19,8	31 Mar 2013	6,25
R197	2,54	16,5	7 Dec 2023	5,50
R210	2,50	0,6	31 Mar 2028	2,60
R202	2,45	6,7	7 Dec 2033	3,45

The outstanding nominal value of *commercial paper* listed on BESA increased by R6,8 billion in the first ten months of 2007 to R47,0 billion at the end of October. Of this amount, the public sector accounted for only R0,9 billion. The *total outstanding nominal value of all debt* listed on BESA increased by R40,4 billion in the first ten months of 2007 to R761,2 billion at the end of October, lower than the concurrent market capitalisation of R824,6 billion.

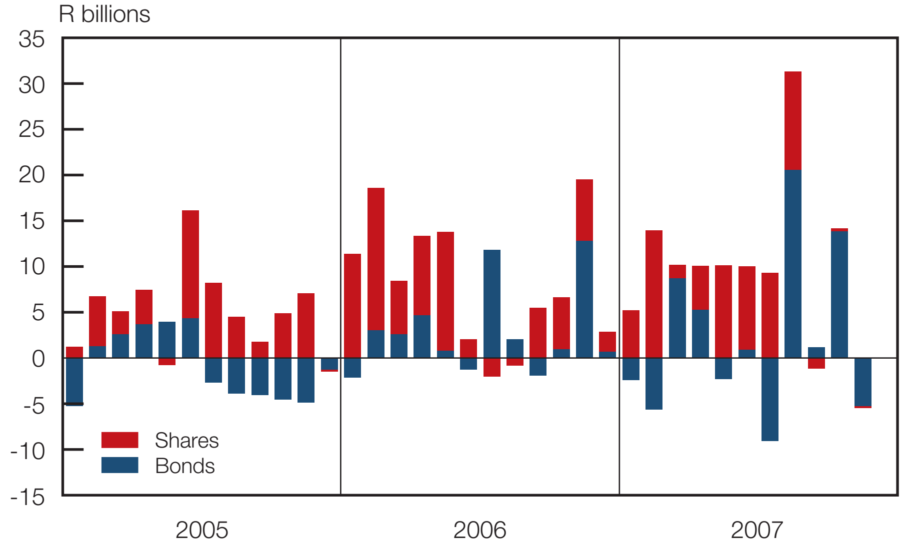
In the *European bond markets*, non-resident issuer interest in rand-denominated bonds rebounded during 2007 with net issues recorded in each of the first eleven months, except in May. Rand-denominated bond issues by non-residents of R15,2 billion from January 2007 to November were considerably more than the R9,1 billion raised in 2006 as a whole. During the first eleven months of 2007, issues exceeded redemptions by R12,6 billion compared with net issues of R6,2 billion in the corresponding period of 2006.

The issuance of rand-denominated bonds by foreign borrowers in the *Japanese Uridashi market* was also brisk in 2007. The total nominal value of issues more than doubled from R4,8 billion in 2006 to R12,6 billion in the first eleven months of 2007.

The renewed interest in the domestic bond market by non-residents alongside significant changes in interest rates and rebalancing of portfolios, among other things, contributed to an increase in the value of turnover in the *domestic secondary bond market* in 2007. The value of turnover on BESA of R15,2 trillion in the first eleven months of 2007 was 19 per cent more than the value traded in the corresponding period of 2006. The average value traded per day of R54,8 billion in 2006 increased to an average of R65,6 billion in the first eleven months of 2007, which included a record-high daily average turnover of R73,6 billion in July. The annualised liquidity ratio, measured as the annualised nominal value of bonds traded relative to the nominal value of bonds listed, reached 18,6 in the first ten months of 2007, compared with 16,3 in the corresponding period of 2006.

Non-residents' interest in the domestic bond market recently escalated with their net purchases of bonds rising from R0,6 billion in the first quarter of 2007 to R12,7 billion in the third quarter, as the asset composition of portfolios was re-balanced. Non-residents' cumulative net purchases of bonds amounted to R25,9 billion in the first eleven months of 2007, thereby falling short of their net purchases of R34,1 billion in 2006 as a whole. Record-high net sales of R9,1 billion were recorded in July, and record-high net purchases of R20,6 billion in August. Non-residents' contribution to turnover in the domestic bond market averaged 19 per cent in both 2006 and the first eleven months of 2007.

Net purchases of shares and bonds by non-residents



Transactions on the JSE and BESA

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 R101,3 billion in the first ten months of 2007, exceeding the R87,8 billion raised in 2006 as a whole. Companies with primary listings on the JSE were responsible for 69 per cent of this capital-raising activity in 2007. Companies in the resources sector accounted for 62 per cent of the total amount raised thus far in 2007, while the industrial sector accounted for 18 per cent and the financial sector for 16 per cent.

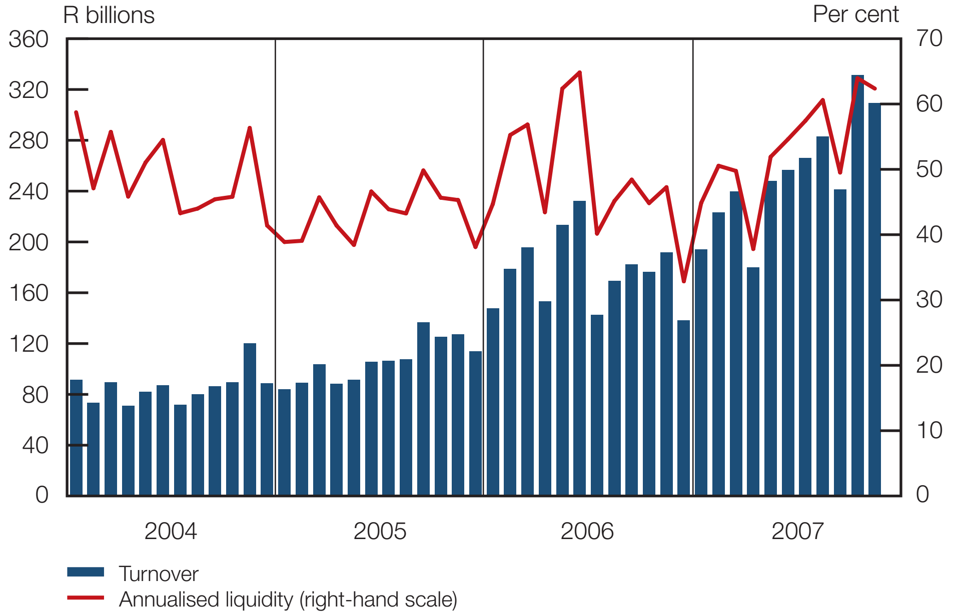
The number of new listings on the JSE equalled 41 and the number of delistings 38 in the first ten months of 2007, resulting in 403 companies being listed at the end of this period compared with 400 at the start of the period. The number of securities listed also increased from 1 047 at the end of December 2006 to 1 177 at the end of October 2007.

Buoyed by the upward trajectory in share prices, *turnover* in the secondary share market remained strong in the first eleven months of 2007. The value of turnover amounted to R2,8 trillion in the first eleven months of 2007, some 40 per cent more than the turnover in the corresponding period of 2006. The daily average turnover increased from R8,4 billion in January 2007 to a new record high of R13,2 billion in October 2007, before receding to R12,8 billion in November. In the first eleven months of 2007, the daily average turnover amounted to R11,3 billion.

The total *market capitalisation* of the JSE declined from a high of R5,8 trillion in March 2007 to R5,6 trillion in July and subsequently increased to a new record high of R6,2 trillion in October before declining to R5,9 trillion in November. Market liquidity, measured by annualised turnover as a percentage of market capitalisation, increased from an average of 49 per cent in 2006 to 53 per cent in the first eleven months of 2007.

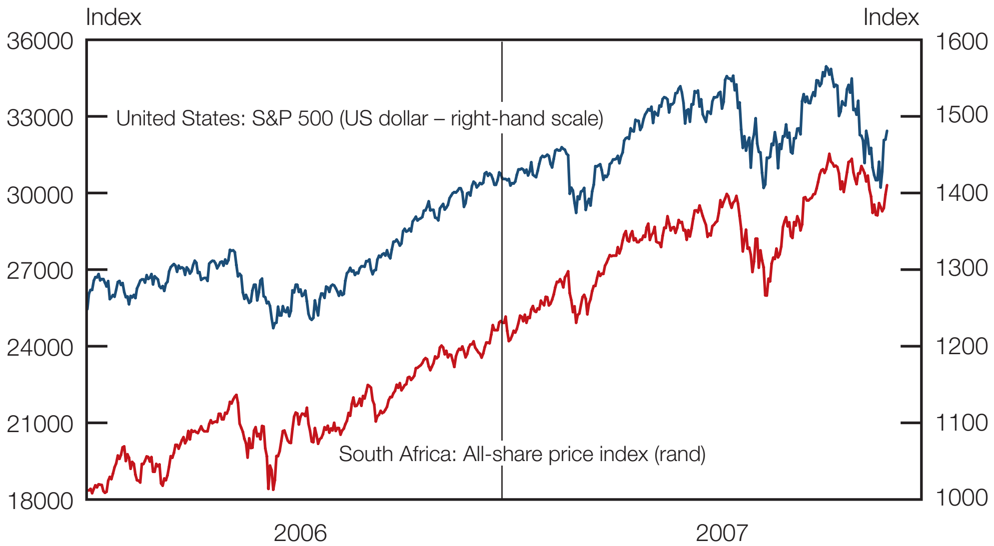
Non-residents' net purchases of domestic shares amounted to a quarterly average of R21,2 billion in the first three quarters of 2007, despite the reduction in share holdings as from September 2007 – the first such occurrence since August 2006. In the first eleven months of 2007, non-residents' net purchases of shares amounted to R63,7 billion, somewhat less than the R71,5 billion recorded in the corresponding period of 2006. Non-residents' appetite for South African shares was probably influenced by developments in the global credit markets and in commodity prices. Non-residents' participation in the share market averaged 21 per cent in 2006 and remained at this level in the first eleven months of 2007.

Secondary share market turnover and liquidity ratio



The *all-share price index* of the JSE declined by 13 per cent from 13 July 2007 to 17 August as global equity markets slumped in reaction to a worldwide repricing of risk following concerns of possible contagion effects from problems in the US sub-prime housing market. It subsequently increased by 21 per cent to a new all-time high on 11 October. This was despite the continuous deterioration in the US housing market, a stronger exchange value of the rand, slowing US consumer spending, record-high oil

Share prices



prices and a less liquid market for sub-prime linked securities as excesses were being unwound, with large global banking institutions announcing write-downs of their sub-prime bad debts as part of their financial results for the third quarter. Confidence was, however, boosted by the intervention of leading US banking groups which, with the encouragement of the US Treasury, announced plans to create a Master Liquidity Enhancement Conduit (M-LEC) designed to enhance liquidity in debt markets by aiding US banks that sponsor and provide liquidity lines to structured investment vehicles. The all-share price index then declined by 4 per cent to 30 November, partly in response to weaker global equity markets.

The JSE continued to advance strongly during 2007 as the local share market benefited significantly from sound domestic economic fundamentals, buoyant commodity prices as well as the steady increase in investment spending by both the corporate and government sectors.

Supported by the continuing global bull-run in commodity prices, the resources sector recorded robust price increases of around 34 per cent in the first eleven months of 2007, outperforming other key sectors in the economy. Industrial shares recorded a gain of 18 per cent while financial shares increased by 5 per cent, reflecting concerns regarding spill-over effects from the US sub-prime mortgage market, rising interest rates and the possible impact of the National Credit Act on business.

The all-share price index of the JSE, measured in US-dollar terms, and the Morgan Stanley Capital International (MSCI) Emerging Markets Index outperformed both the MSCI World Index and the FTSE All World Index in the first eleven months of 2007, as emerging markets remained resilient. In US dollar terms, the all-share price index increased by 25 per cent during this period and the MSCI Emerging Markets Index rose by 36 per cent, while the FTSE All World Index and the MSCI World Index increased by 10 per cent and 11 per cent, respectively.

The *price-earnings ratio* of all classes of shares decreased from 16,4 in June 2007 to 14,3 in August, as share prices fell in August, before increasing to 15,6 in November. Conversely, the *earnings yield* on all classes of shares increased from 6,1 per cent in June 2007 to a high of 7,0 per cent in August, before declining to 6,4 per cent in November. Similarly, the *dividend yield* on all classes of shares increased from 2,1 per cent in June 2007 to 2,5 per cent in August, before receding slightly to 2,3 per cent in November.

From January 2007, some 38 companies were listed and 1 transferred from *Alt^x*, resulting in 74 companies being listed at the end of November. The combined market capitalisation of all the companies listed on Alt^x increased from R9,1 billion in December 2006 to a record high of R30,7 billion in November 2007. Turnover on Alt^x amounted to R5,5 billion in the first eleven months of 2007, surpassing the R1,2 billion traded in the whole of 2006 by 372 per cent.

Market for exchange-traded derivatives

Trading activity in the *financial derivatives market* remained strong in the first ten months of 2007 on the back of robust growth in the underlying share market. Single-stock futures (including dividend futures) continued to account for the largest part – namely 89 per cent – of the total number of contracts traded. However, in value terms equity index products accounted for 92 per cent of trade over the same period.

As indicated in the accompanying table, turnover in *agricultural commodity futures and options* grew steadily in the first ten months of 2007, as grain prices continued to soar after a poor domestic maize harvest placed upward pressure on the already buoyant price of maize. High global demand for grain, especially in the US, where maize is increasingly used to produce bio-fuels, has also spilled over to prices in South Africa and this is expected to persist for the rest of the current year. Turnover in warrants continued to weaken in 2007 compared with the same period in 2006.

Derivatives turnover on the JSE, January to October 2007

	R billions	Change over one year Per cent
Financial futures and options on futures	3 760	55
Warrants	2	-65
Agricultural commodity futures and options	227	79
Interest rate derivatives	38	38

On 2 October 2007, the product range on *Yield-X* was enhanced as rand/euro and rand/pound currency futures contracts were launched for trading on the JSE. This followed the commencement of currency futures trading on Yield-X on 18 June 2007, when only rand/dollar contracts were available. Trading activity on Yield-X continued to gain momentum in 2007.

Real-estate market

Residential real-estate prices continued to grow at a decreasing pace in 2007. The year-on-year rate of increase in average residential property prices in the middle segment of the market, as measured by Absa, declined from 15,8 per cent in March 2007 to 13,6 per cent in October. In real terms, the twelve-month rate of growth declined from 9,5 per cent in February 2007 to 5,2 per cent in October. Similarly, the month-on-month increase in nominal house prices slowed from 1,6 per cent in December 2006 to 0,6 per cent in October 2007. The moderation in residential property prices is likely to continue on account of the higher level of interest rates.

The non-residential property market continued to perform well over the past year. Office property demand strengthened with vacancy rates declining in all four major central business districts (CBDs) from the third quarter of 2006 to the third quarter of 2007. Cape Town recorded the strongest increase in office rental rates over the past year. Industrial rentals have also enjoyed significant growth over the past year as indicated in the table on the following page.

Non-residential vacancy and rental rates
Per cent

Vacancy rates (as at end of quarter)	3rd qr 2006	3rd qr 2007
CBD office space*		
Durban	18,5	16,8
Johannesburg	17,2	15,1
Cape Town	5,9	5,8
Pretoria	4,8	3,4
Rental rates (change over four quarters)		
CBD A-grade offices (R/m²)*		
Durban	-11,3	0,0
Johannesburg	2,9	0,0
Cape Town	-8,3	50,0
Pretoria	10,9	27,3
Industrial (R/m² for 500m²)**		
Durban	21,6	17,8
Central Witwatersrand	7,3	33,6
Cape Town	13,7	22,4
Pretoria	40,2	5,7

* Source: South African Property Owners' Association
** Source: Rode and Associates

Non-bank financial intermediaries

Non-bank financial intermediaries continued to record positive balance-sheet growth in 2007, despite the sub-prime mortgage turmoil which affected spread products and, consequently, returns on various instruments in which they invest. The strong asset growth was supported by robust international and domestic economic growth, increased business confidence and lively financial markets. For example, the market value of the net assets of worldwide, foreign and regional unit trusts increased from R32 billion in the fourth quarter of 2006 to R42 billion in the third quarter of 2007. The market value of the net assets of money-market funds also recorded an increase of 16 per cent over the corresponding period and the continued buoyancy in the underlying share market contributed to an increase of 15 per cent in the share portfolio of unit trusts from the fourth quarter of 2006 to the third quarter of 2007.

The accompanying table depicts the portfolio composition of the various non-bank financial intermediaries, and indicates a moderate shift into cash for unit trusts during the second quarter of 2007.

Composition of non-bank financial intermediaries' asset portfolios
Percentage of total assets

	2007					
	Cash		Bonds		Shares	
	1st qr	2nd qr	1st qr	2nd qr	1st qr	2nd qr
Insurers	12	13	14	14	50	50
Unit trusts	33	39	7	7	57	54
Official pension and provident funds	9	7	37	38	52	53
Private pension and provident funds	10	11	18	18	63	61

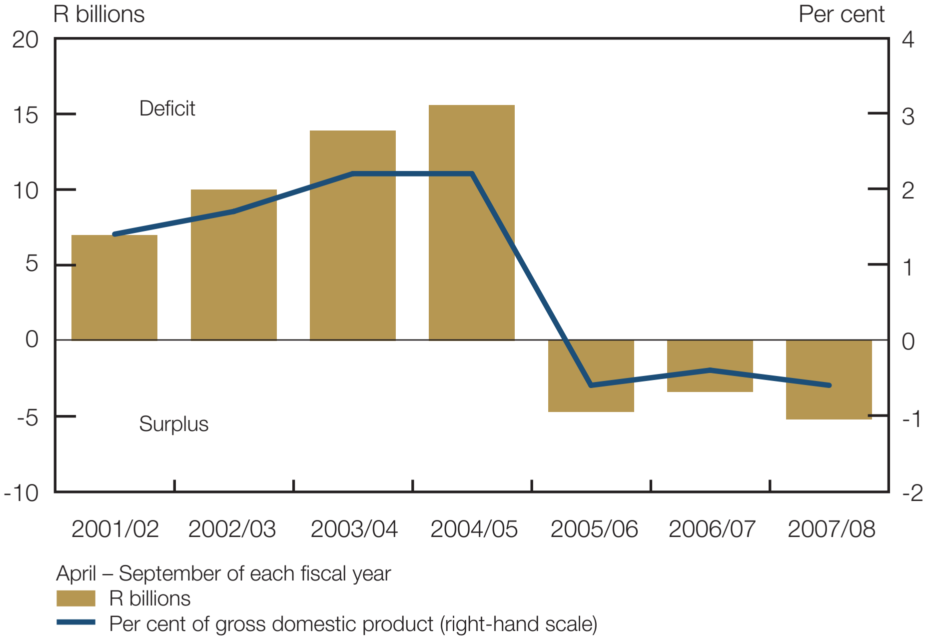
Public finance

Non-financial public-sector borrowing requirement[6]

The cash surplus of the *non-financial public sector* amounted to R1,5 billion in the July-September quarter of 2007. This brought the cash surplus for the first six months of fiscal 2007/08 to R6,0 billion or 0,6 per cent of gross domestic product. A surplus of R3,4 billion or 0,4 per cent of gross domestic product was recorded in the corresponding period of the previous fiscal year. The increase in the cash surplus can mainly be attributed to higher surpluses recorded by social security funds and provincial governments.

6 Calculated as the cash deficit/surplus of the consolidated central, provincial and local governments and non-financial public enterprises and corporations.

Non-financial public-sector borrowing requirement



The financial activities of the non-financial public sector are disaggregated in the accompanying table.

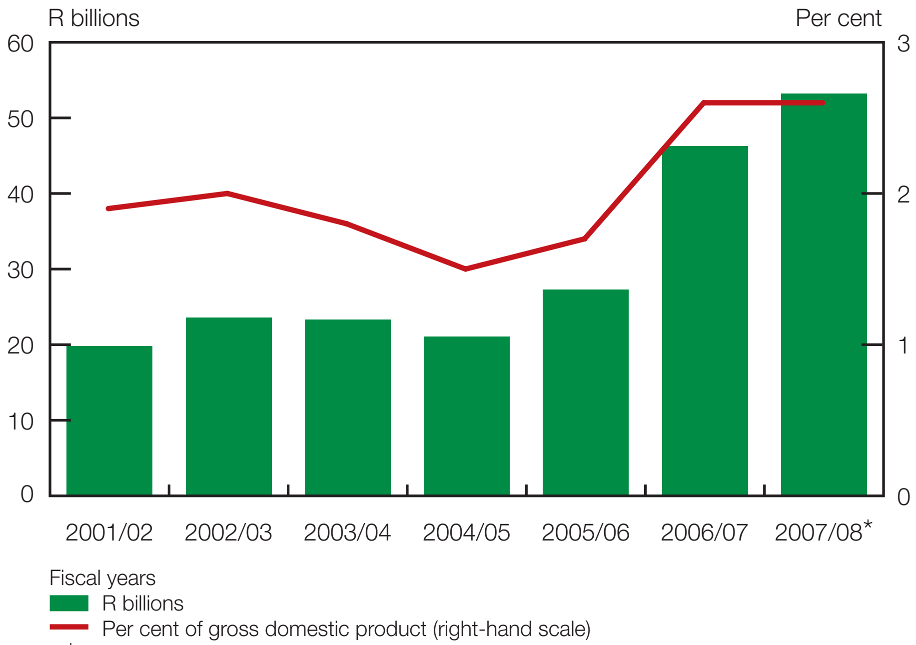
Non-financial public-sector borrowing requirement
R billions

Level of government	Apr – Sep 2006*	Apr – Sep 2007*
National government	7,4	7,2
Extra-budgetary institutions	-3,2	-3,0
Social security funds	-2,5	-3,8
Provincial governments	-10,1	-11,1
Local governments	4,3	4,2
Non-financial public enterprises and corporations	0,7	0,5
Total	-3,4	-6,0

* Deficit +, surplus -

The *non-financial public enterprises and corporations* recorded a *surplus* in the July-September quarter of 2007, which was a turnaround from the deficit recorded in the same period of the previous fiscal year. Preliminary indications are that both operating revenue and expense in April – September 2007 were lower when compared with the same period a year earlier. The net investment in non-financial assets trended higher and amounted to R22,5 billion in the first six months of fiscal 2007/08. This represented an increase of 24,4 per cent when compared with the same period a year earlier, reflecting government's commitment to infrastructural investment as a prerequisite for sustainable economic growth and development.

Investment in non-financial assets by non-financial public enterprises and corporations



* *Medium Term Budget Policy Statement*, October 2007

Provincial governments recorded a cash *deficit* of R1,9 billion in the July-September quarter of 2007, which brought their cash surplus for the first six months of fiscal 2007/08 to R11,1 billion – R1,1 billion more than the cash surplus recorded a year earlier. The *Provincial Budgets and Expenditure Review 2003/04 – 2009/10*, published by the National Treasury on 5 September 2007, projected a virtually balanced budget for fiscal 2007/08 as a whole.

The equitable share of nationally raised revenue transferred to provincial governments for the period April – September 2007 amounted to R89,1 billion, representing an increase of 13,6 per cent when compared with the same period a year earlier. This was similar to the originally budgeted rate of increase for the current fiscal year as a whole. Cash payments by provincial governments increased at a year-on-year rate of 18,8 per cent in the July-September quarter of 2007, bringing the total payments in the first half of fiscal 2007/08 to R89,7 billion. This represented a growth rate of 16,4 per cent when compared with the same period of the previous fiscal year.

Provincial governments' spending on non-financial assets for the quarter under review amounted to R4,0 billion. This brought their total investment in non-financial assets to R7,1 billion for the first six months of fiscal 2007/08, which was 26,8 per cent more than in the same period of the previous fiscal year.

The cash surplus of the provincial governments was partly reflected in an increase in their bank deposits from R7,0 billion at the end of March 2007 to R9,7 billion at the end of September. At the same time, their overall indebtedness to banks decreased from R1,2 billion to a negligible amount between the same dates.

The estimated cash deficit of *local governments* in April – September 2007 amounted to R4,2 billion, which was almost equivalent to the deficit recorded in the same period of the previous fiscal year. One of the major municipalities incurring deficits in upgrading its infrastructure has been the City of Johannesburg, which introduced and started issuing conventional bonds three years ago. Cumulatively R3,7 billion had been issued by the end of September 2007. In addition, Johannesburg introduced Jozi retail bonds in July 2007 to raise more funds and simultaneously encourage savings. These bonds can be purchased through the South African Post Office or JSE brokers.

Preliminary estimates show that *extra-budgetary institutions* recorded a cash surplus of R0,6 billion in the July-September quarter of 2007, bringing the cash surplus for the first six months of fiscal 2007/08 to R3,0 billion. This can be compared with a cash surplus of R3,2 billion recorded in April – September 2006. From April to September 2007 the cash surplus of the *social security funds* was bolstered by higher contributions received by the Unemployment Insurance Fund and amounted to R3,8 billion. This was R1,3 billion higher than the surplus recorded in the same period of fiscal 2006/07.

Budget comparable analysis of national government finance

Expenditure by national government in the first six months of fiscal 2007/08 amounted to R261 billion, which was 14,7 per cent more than in the same period of the previous fiscal year. The increase was 3,0 percentage points higher than the growth rate recorded in the same period in fiscal 2006/07. National government spent 49 per cent of the original full-year budget in the first half of fiscal 2007/08, broadly equivalent to the average ratio spent in the first six months of the previous five fiscal years prior to fiscal 2007/08. National government expenditure as a ratio of gross domestic product amounted to 26,3 per cent in the first six months of fiscal 2007/08, slightly higher than the ratio of 26,1 per cent recorded in the corresponding period of the previous fiscal year.

The increase in expenditure in the first half of fiscal 2007/08 was boosted by strong growth in transfers and subsidies by the economic services and infrastructure development cluster. The larger contributors to the increase in expenditure were the Department of Transport as well as the Department of Provincial and Local Government. Transfers and subsidies by the Department of Transport were specifically made to the Gauteng Provincial Government for the Gautrain project, the South African Rail Commuter Corporation, and private enterprises for bus subsidies. The Department of Provincial and Local Government made further Municipal Infrastructure Grant transfers, over and above the equitable share transfers to municipalities.

Payments for capital assets amounted to R2,2 billion in the first six months of fiscal 2007/08, which was 54,9 per cent more than in the same period of the previous fiscal year. The original budget projected that payments for capital assets would amount to R6,6 billion in fiscal 2007/08 as a whole. The bulk of the spending on capital projects is expected to be undertaken by the other levels of government, particularly the provincial and local governments, and by public corporations.

Interest paid on government debt amounted to R26,7 billion in the period under review, representing an increase of 3,6 per cent when compared with the corresponding period of the previous fiscal year. This increase was mainly due to higher interest rates applicable at the time when Treasury bills and other instruments were rolled over in the first six months of fiscal 2007/08.

7 The cash-flow adjustments result from timing differences between the recording of transactions and bank clearances, and late departmental requests for funds.

After taking into account cash-flow adjustments[7], national government cash-flow expenditure amounted to R259 billion in the first half of fiscal 2007/08, representing an increase of 15,1 per cent compared with the same period of the previous fiscal year.

National government *revenue* in the first six months of fiscal 2007/08 amounted to R255 billion, representing a year-on-year rate of increase of 14,0 per cent. This rate of increase was significantly lower than the rate of increase recorded in the same period of fiscal 2006/07. National government revenue as a ratio of gross domestic product amounted to 25,7 per cent in the first six months of fiscal 2007/08, virtually the same as the ratio recorded in the corresponding period of the previous fiscal year.

The *Budget Review 2007* estimated that national government revenue would grow by 13,2 per cent to amount to R545 billion for the fiscal year as a whole. Halfway through the fiscal year, national government had collected 46,9 per cent of the originally budgeted revenue for the full year, somewhat lower than the average proportion collected in the first half of the five fiscal years prior to 2007/08.

National government revenue in fiscal 2007/08

Revenue source	Originally budgeted		Actual Apr – Sep 2007	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains	312,2	11,5	151,6	17,7
Payroll taxes	6,5	16,1	3,2	19,7
Taxes on property	11,0	6,4	6,0	15,9
Domestic taxes on goods and services	199,0	14,0	87,9	9,3
Taxes on international trade and transactions	27,5	14,5	12,6	11,6
Other revenue	11,5	-3,7	7,1	33,7
Less: SACU** payments	23,1	-8,5	13,2	33,5
Total revenue	**544,6**	**13,2**	**255,1**	**14,0**

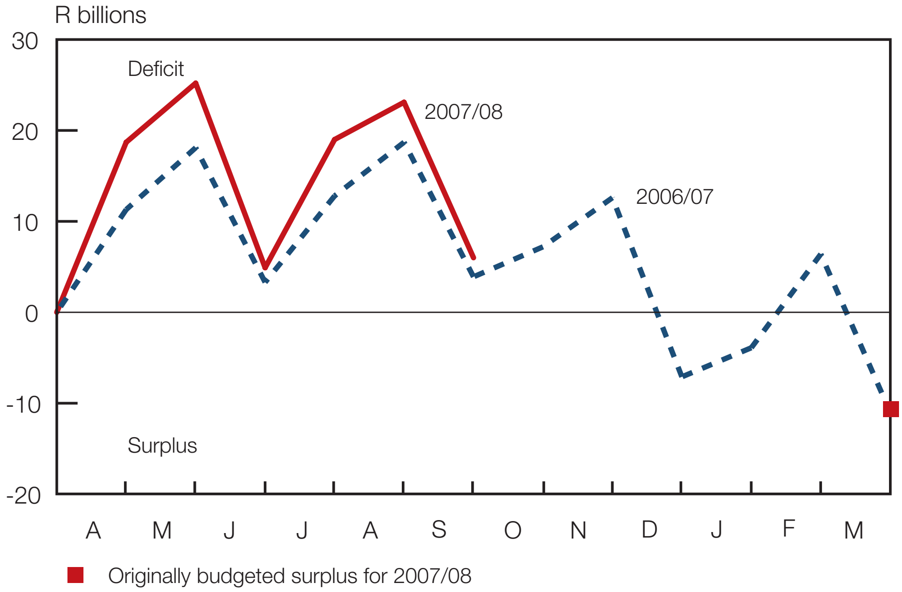
* April – September 2006 to April – September 2007
** Southern African Customs Union

The strong growth in national government revenue was driven by brisk collections in taxes on income, profits and capital gains as well as taxes on property. Taxes on income, profits and capital gains increased by 17,7 per cent, driven by strong growth in both individual and corporate income tax collections. The growth in individual tax collections was mainly due to above-inflation wage settlements, rising employment levels and lower tax refunds. The lower tax refunds resulted from the postponement of the due date for the submission of tax returns from July to October. The above-budgeted corporate income tax collections were primarily the result of sustained strong corporate profitability. Taxes on property increased at a brisk pace in the first six months of fiscal 2007/08 when compared with the same period a year earlier. The major components of domestic taxes on goods and services recorded strong growth rates, with the increase in value-added tax collections being consistent with buoyant local demand. Taxes on international trade and transactions also accelerated strongly in the first half of fiscal 2007/08 as customs duties collected surged, consistent with a strong increase in imports.

After taking into account cash-flow adjustments, national government cash-flow revenue in April – September 2007 was slightly lower than its cash book revenue, increasing at a year-on-year rate of 13,8 per cent when compared with the same period of the previous fiscal year.

The net result of national government revenue and expenditure was a cash book deficit before borrowing and debt repayment of R6,0 billion in April – September 2007. This can be compared with a deficit of R3,9 billion recorded in the same period a year earlier.

Cumulative balance of national government



The cash-flow deficit before borrowing and debt repayment in the first six months of fiscal 2007/08 amounted to R5,2 billion, compared with a deficit of R2,0 billion recorded in the corresponding period of the previous fiscal year. After taking into account extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement of national government for the period under review amounted to R5,7 billion compared with a borrowing requirement of R4,7 billion in the same period of the previous fiscal year.

As indicated in the table on the following page, the net borrowing requirement of national government in the first half of fiscal 2007/08 was more than fully financed through the issuance of short and long-term debt instruments in the domestic capital market, with the surplus proceeds utilised to build up government deposits and (to a lesser extent) to repay foreign borrowing.

Domestic long-term funding was obtained at an average rate of 8,0 per cent per annum, while domestic short-term instruments were sold at an average rate of 8,9 per cent in the first six months of fiscal 2007/08. The average outstanding maturity on domestic marketable bonds receded from 102 months at the end of March 2007 to 98 months at the end of September.

Inflation-linked bonds as a proportion of total loan debt amounted to 11,4 per cent at the end of September 2007, much the same as the ratio recorded at the end of March.

These bonds have nevertheless increased in importance since their introduction in fiscal 2000/01, rising from only 0,9 per cent of total loan debt at the end of March 2001 to their current levels.

National government financing in fiscal 2007/08

R billions

Item or instrument	Originally budgeted	Actual Apr – Sep 2007	Actual Apr – Sep 2006
Budget balance*	-10,7	5,2**	2,0**
Plus: Extraordinary payments	0,4	1,0	3,8
Cost on revaluation of foreign debt at redemption	0,5	1,0	0,4
Less: Extraordinary receipts	0,3	1,6	1,5
Net borrowing requirement*	-10,1	5,7	4,7
Treasury bills	5,7	5,9	7,4
Domestic government bonds	-8,0	13,1	22,4
Foreign bonds and loans	-2,1	-3,2	3,9
Change in available cash balances***	-5,7	-10,1	-29,0
Total net financing	-10,1	5,7	4,7

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

As part of its foreign debt strategy, government entered into liability management transactions comprising switches and buybacks. A new 5,875-per-cent US dollar bond due on 30 May 2022 was issued in May 2007 and yielded R4,0 billion to the fiscus. Net foreign funding included amounts drawn on the export credit facility which had been arranged for financing of the Strategic Defence Procurement Programme to the amount of R1,8 billion. Significant buybacks were also concluded. As a result of the transactions mentioned above, national government recorded net redemptions of foreign bonds and loans to the value of R3,2 billion during the first six months of fiscal 2007/08, while the average maturity of the foreign marketable bonds of national government increased from 67 months at the end of March 2007 to 87 months at the end of September.

The financial activities of national government resulted in an increase in government's cash balances during the first half of fiscal 2007/08, bringing these balances to R85,4 billion at the end of September 2007.

Domestic debt increased from R469 billion at the end of March 2007 to R489 billion at the end of September, amounting to 86,5 per cent of total loan debt. This was higher than the ratio recorded at the end of March 2007. Conversely, foreign debt of national government decreased from R83 billion at the end of March 2007 to R77 billion at the end of September. This brought about a decrease in the proportion of foreign debt to total loan debt from 15,0 per cent at the end of March 2007 to 13,5 per cent at the end of September.

Total loan debt of national government increased from R552 billion at the end of March 2007 to R566 billion at the end of September. Nevertheless, the national government total loan debt as a ratio of gross domestic product decreased slightly from 30,5 per cent at the end of March 2007 to 29,4 per cent at the end of September.

The unaudited profits on the Gold and Foreign Exchange Contingency Reserve Account amounted to R29 billion at the end of September 2007. Government-guaranteed debt increased from R67 billion in March 2007 to R68 billion in June.

Adjusted estimates of national government finance

The *Adjusted Estimates of National Expenditure 2007*, tabled in the National Assembly by the Minister of Finance on 30 October 2007, sought approval by Parliament for additional government spending to the amount of R11,5 billion during fiscal 2007/08. In addition to appropriations in the *Budget Review 2007*, the Minister of Finance tabled a Special Adjustments Appropriation Bill on 5 September 2007 that recommended additional spending to the value of R5,2 billion. Of this amount, R2,4 billion was appropriated to supplementary allocations announced in the Budget, R222 million allocated to Denel, R700 million to the Land Bank and R1,9 billion for 2010 FIFA World Cup stadiums. Provision was made for a contingency reserve of R3 billion and other unallocated funds to the amount of R0,7 billion. Consequently, part of the additional expenditure would be defrayed from these amounts already provided for in the main estimates presented to Parliament in February 2007. Furthermore, the *Adjusted Estimates* made provision for about R5,2 billion in underspending and savings. This was expected to bring the net increase in spending in fiscal 2007/08 to R8,5 billion, raising estimated national government expenditure from R533,9 billion to R542,4 billion or 26,9 per cent of estimated gross domestic product.

Revised budget estimates for fiscal 2007/08

	R billions
Originally budgeted expenditure	533,9
Plus: Additional expenditure	13,7
Less: Savings and underspending	-5,2
Total adjusted expenditure	**542,4**
Originally budgeted revenue	544,6
Plus: Increase in taxes on income and profits	15,1
Increase in taxes on payroll and workforce	0,3
Increase in taxes on property	1,1
Increase in taxes on international trade and transactions	0,5
Increase in other taxes	0,6
Increase in other revenue	0,7
Less: Decrease in domestic taxes on goods and services	-8,1
Increase in SACU* payments	-1,7
Total adjusted revenue	**553,1**
Originally budgeted surplus	**10,7**
Adjusted surplus	**10,8**

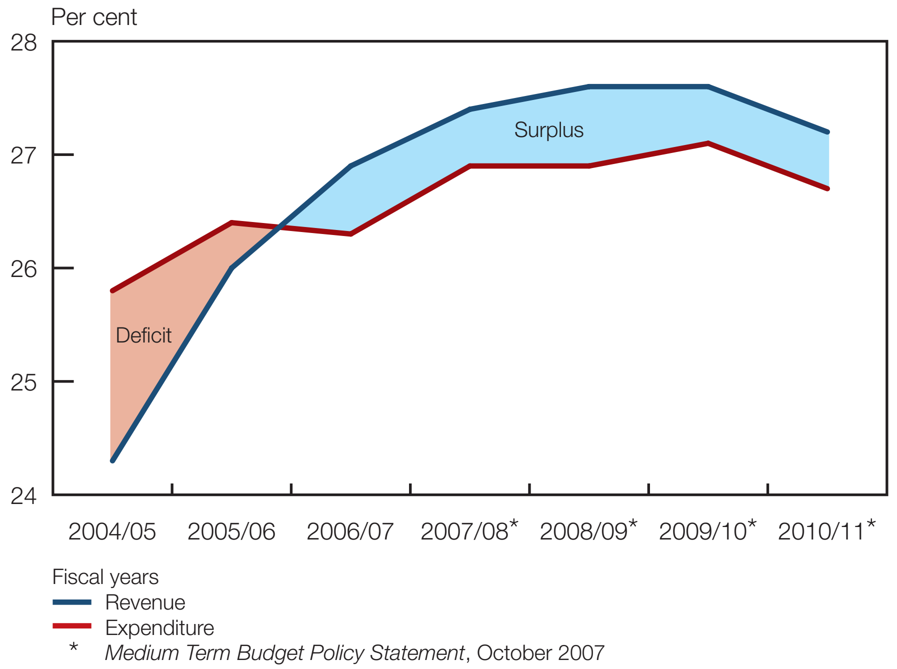
* Southern African Customs Union

Source: *Medium Term Budget Policy Statement*, October 2007

Revised macroeconomic projections and the revenue collection trends for the first six months of fiscal 2007/08 suggested a tax revenue overrun of R9,5 billion in the current fiscal year. This was mainly due to the momentum of extra revenues arising from personal income tax, secondary income tax on companies and corporate income tax. Although the revised tax revenue estimates for 2007/08 exceeded the February 2007 budgeted amount, the anticipated overrun was more modest than those of the previous three fiscal years.

The estimated Southern African Customs Union payments to the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) – largely a function of customs revenue – were raised by R1,7 billion to amount to R24,7 billion. The adjusted *main budget* revenue – including non-tax revenue less the estimated SACU payments – for the full fiscal year was projected to amount to R553,1 billion or 27,4 per cent of the estimated gross domestic product.

National government finances as ratio of gross domestic product



The revised projections indicated a budget surplus of R10,8 billion, almost the same as the February 2007 Budget estimate. This surplus was expected to equal 0,5 per cent of the estimated gross domestic product for the full fiscal year compared with 0,6 per cent indicated in the original Budget. The surplus was projected to average around 0,6 per cent of gross domestic product over the next three years. The projected moderate budget surplus would provide government with the fiscal space to increase borrowing to finance expenditure priorities, should the economic cycle turn, without placing an excessive financing burden on the economy.

The *Medium Term Budget Policy Statement 2007*

The Minister of Finance presented the *Medium Term Budget Policy Statement 2007* (MTBPS) to Parliament on 30 October 2007. The 2007 MTBPS focused on accelerating social progress through sustaining rapid economic growth and employment creation over the long term. The MTBPS introduced the concept of a structural budget balance to take account of cyclical factors, mainly as they affect revenue collection. Government's approach was to use the windfall revenues from favourable economic conditions to invest in physical and human infrastructure and to increase the level of savings so that, should these windfall revenues abate, resources will be available to spend on key priorities.

Over the Medium Term Expenditure Framework (MTEF) period up to 2010/11, expenditure growth was expected to average 6,4 per cent a year in real terms, with additional resources being earmarked for higher increases in government employees' salaries, social grants, new projects and enhanced service delivery.

The MTBPS confirmed that the core objectives of economic policy were to accelerate growth, raise employment and provide poor and marginalised communities with the human capital and physical infrastructure needed to participate in the formal economy. To address poverty and expand employment the economy needed to absorb more labour which, in turn, implied a need for more rapid growth in production and more efficient use of available human, physical and financial capital by businesses.

Robust economic growth over the past five years had provided greater fiscal resources to support growth in government expenditure. Higher spending over the MTEF period would continue to be financed mainly by tax revenue. Fixed investment expenditure had grown strongly across all sectors of the economy. The pace of capital outlays by public corporations had accelerated significantly over the past two years. Taking into account the substantial investment plans over the next decade, borrowing by state-owned enterprises was expected to increase.

As indicated in the accompanying table, fiscal prudence evidenced in the previous fiscal years was expected to continue at all levels of government. The current fiscal year's surplus was kept essentially unchanged at 0,5 per cent of gross domestic product. Continued strong revenue collections contributed towards a conversion from previously projected deficits in fiscal 2008/09 and 2009/10 to surpluses averaging 0,6 per cent of gross domestic product over the medium term. The healthy revenue performance primarily resulted from above-inflation wage settlements, increasing employment and sustained high profitability in the corporate sector.

Fiscal projections

	Revised estimates	Medium-term estimates		
	2007/08	2008/09	2009/10	2010/11
	R billions			
National government				
Revenue	553,1	616,0	679,6	740,5
Expenditure	542,4	599,9	665,6	726,2
Budget balance	10,8	16,2	14,0	14,3
Consolidated general government balance	14,4	13,6	9,7	9,6
Non-financial public-sector balance	-5,5	-18,5	-26,8	-31,9
	Percentage of gross domestic product			
National government				
Revenue	27,4	27,6	27,6	27,2
Expenditure	26,9	26,9	27,1	26,7
Budget balance	0,5	0,7	0,6	0,5
Consolidated general government balance	0,7	0,6	0,4	0,4
Non-financial public-sector balance	-0,3	-0,8	-1,1	-1,2

Source: *Medium Term Budget Policy Statement*, October 2007

Real non-interest spending by national government was projected to increase by 6,4 per cent per annum over the medium term. In line with decreasing public debt, debt service cost as a percentage of estimated gross domestic product was expected to decline further to 1,9 per cent in fiscal 2010/11, providing fiscal space to accommodate cyclical volatility to finance new priorities in the years ahead. The budgeted surpluses in recent years would reduce the debt burden on future generations.

The 2008 MTEF provides for additional spending of R81,4 billion over the 2007 Budget forward estimates. Of the proposed additional allocations, R32,7 billion was earmarked for national departments, R36,1 billion for provinces and R12,6 billion for local government. National departments were asked to save R2,3 billion over the following three years by limiting unnecessary expenditure. Provinces were set to gain relative to the national sphere due to higher allocations for improving the quality of health services, education, welfare and social security as well as the criminal justice system. Additional allocations proposed for municipalities were set to put local government in a better position to support expanded community access to potable water, sanitation and electricity. The equitable share transfers to municipalities would also increase to enable municipalities to provide free basic services to poor households.

The public-sector borrowing requirement was set to increase significantly from 0,3 per cent of gross domestic product in fiscal 2007/08 to 1,2 per cent by fiscal 2010/11. This increase would be driven by accelerating capital investment programmes at all levels of the public sector, in particular the non-financial public enterprises. The improved fiscal position of national government would create the space for public enterprises, municipalities and the private sector to increase their borrowing for capital purposes, without placing undue pressure on capital market interest rates.