Quarterly Bulletin

June 2007

South African Reserve Bank

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Introduction

Following strong growth in 2006, early indications are that the pace of expansion of the global economy was broadly maintained in the first quarter of 2007, as robust growth in other parts of the world largely compensated for a lull in output growth in the United States of America. Buoyant global demand resulted in sustained high prices for most commodities in the first five months of 2007, favouring commodity-exporting countries and rendering support to their growth momentum. Under these circumstances, consumer price inflation accelerated in a number of countries, in many instances pushed higher by the prices of food and energy. The acceleration was nevertheless moderated by the favourable impact on inflation expectations of a long period of well-contained prices, reinforced by a generally conservative monetary policy stance.

Against this backdrop, it is expected that growth on the African continent will remain brisk. However, during the early part of 2007 accelerating food inflation emerged as a problem in many African countries. It was strongly reflected in increases in the cost of living, given the proportionately higher weight of food in the typical expenditure basket in lower-income countries.

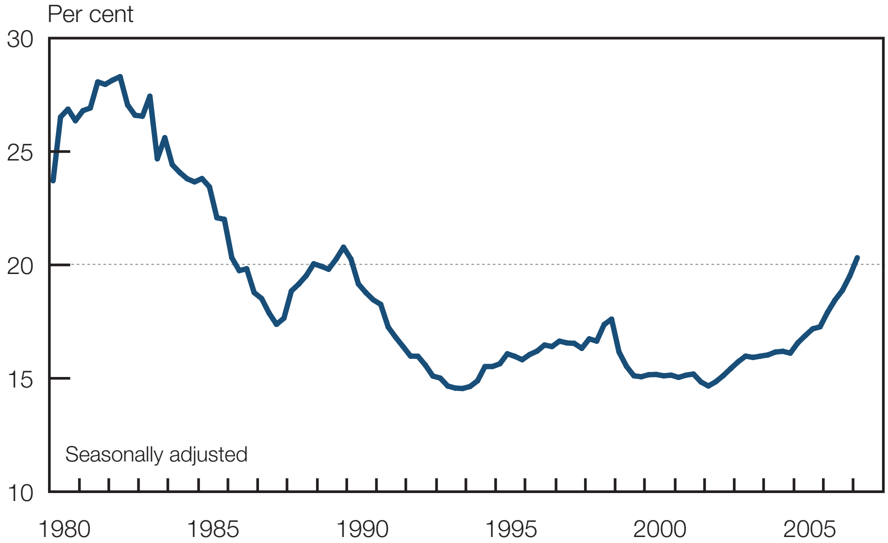
In South Africa, further brisk economic growth was registered in the first quarter of 2007, although the pace of expansion decelerated somewhat compared with the fourth quarter of 2006. Real production in mining contracted in the first quarter of 2007 as platinum output receded mainly due to the scheduled maintenance of a smelter and a labour dispute, while the real value added in diamond mining also declined. Growth in the real value added by the manufacturing sector moderated from a blistering pace of increase in the final quarter of 2006, but was still strong enough to push the utilisation of production capacity in manufacturing to a new high.

To the contrary, the services sectors maintained their earlier solid growth momentum in the first quarter of 2007, while agricultural output recovered on account of the drought-induced early harvesting of field crops and a sustained increase in the production of livestock. First-quarter 2007 growth in the construction industry was exceptionally strong, reflecting buoyant non-residential building activity and a significant acceleration in civil construction activities.

Although still exceeding the rate of growth in gross domestic product, the rate of growth in real gross domestic expenditure slowed considerably in the first quarter of 2007. This deceleration was mainly due to a significantly slower pace of inventory accumulation: After oil inventories had been replenished through exceptionally high imports of mineral products in the final quarter of 2006, crude oil imports returned to a normal level in the early months of 2007. Growth in real final consumption expenditure by households edged marginally lower in the first quarter of 2007 but remained strong, supported by rising levels of employment and disposable income.

By contrast, real final consumption expenditure by government picked up strongly as the South African Navy acquired another submarine. At the same time real fixed capital formation steamed ahead, reflecting attractive returns on fixed investment against the background of high levels of capacity utilisation. In the first quarter of 2007 real capital expenditure rose at an annualised rate of more than 21 per cent. Although public corporations, and especially the electricity subsector within that grouping, contributed the most to this acceleration, general government and the private sector also stepped up their real fixed capital formation. This brought the ratio of fixed capital expenditure to gross domestic product in the first quarter of 2007 to more than 20 per cent – the first time since 1989 that such a high value has been registered, and an important milestone in raising the economy's growth potential on a sustainable basis.

Gross fixed capital formation as percentage of gross domestic product



Concurrent with this high fixed capital formation ratio, the share of the gross operating surplus in total value added in the economy reached an all-time high in the first quarter of 2007 as the rate of increase in the operating surplus continued to exceed the pace of increase in compensation of employees.

The strength of domestic final demand in the first quarter of 2007 was reflected in high imports, although the normalisation of crude oil imports helped to moderate the import bill for the quarter concerned. Both the volume and rand price of imported merchandise receded somewhat. Simultaneously, the volume of exported goods – in particular mining and mineral exports – declined, although this was partly countered by a modest increase in the average prices of such goods. Net services, income and current transfer payments to non-residents inched higher during the quarter. The net result of these changes was a noticeable narrowing of the deficits on the trade account and on the current account of the balance of payments in the first quarter of 2007.

As before, the deficit on the current account of the balance of payments was comfortably financed by net financial inflows. In the first quarter of 2007 the most important form of such inflows was foreign portfolio buying of South African shares. At the same time, foreign investment in South African debt securities on the domestic secondary market was more than neutralised by the redemption of a rand-denominated domestic bond as well as the early repayment of part of a Yankee bond by the South African government. Despite these transactions, the official net gold and other foreign reserves of the Bank continued to rise during the quarter concerned.

Non-resident investors' interest in South African shares was boosted by the continued upward trend in share prices, which was in turn supported by strong growth in company profits. Notwithstanding some temporary setbacks, share prices reached successive record highs in the first five months of 2007. Bond yields fluctuated lower in the early months of 2007 alongside the subdued need for borrowing by the public sector, but picked up significantly towards the end of May with the release of unfavourable data. Amid the dearth of government debt issues, the private sector increasingly turned to the issuing of bonds to finance its activities. Securitisation also gained in importance.

Average house prices continued to rise in the early part of 2007, both supporting and being supported by strong growth in mortgage lending. More generally, banks' loans and advances continued to rise briskly. At the same time, the ratio of household debt to disposable income rose to a new record high at the end of March 2007. Nevertheless, the strongest increases in bank lending were concentrated in advances to the corporate rather than the household sector, consistent with the exceptional strength of fixed capital formation.

The National Credit Act came into full effect on 1 June 2007 and is set to improve consumer protection in the area of lending.

The government finances continued to reflect strong growth in tax revenue, with the national government registering a fiscal surplus in 2006/07 and projecting another surplus in 2007/08. However, as the public corporations and enterprises stepped up capital expenditure their cash surpluses made way for a significant borrowing requirement, at least for that part of the public sector.

With confidence high, the economy growing briskly, domestic expenditure strong, employment rising, credit extension buoyant and asset prices increasing and being reflected in positive wealth effects, the potential for adverse price shocks to fan the flames of inflation is amplified. The price pressures which built up from 2006 and in which food and energy prices played such an important role, culminated in an acceleration in twelve-month CPIX inflation to 6,3 per cent in April 2007 – the first time since August 2003 that CPIX inflation fell outside the target range of 3 to 6 per cent. At the same time, wage pressures also built up, with workers in the public sector participating in strike action in early June 2007 to support their wage demands.

At its meeting in early June 2007 the Monetary Policy Committee (MPC) analysed these developments and decided to increase the repurchase rate by 50 basis points to 9,50 per cent. The MPC felt that this increase, together with the four increases of the same magnitude implemented during 2006, would ensure that CPIX inflation returns to within the inflation target range over time.

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 first quarter of 2007, albeit at a slower rate than in the fourth quarter of 2006. Growth in *real gross domestic product* moderated from an annualised rate of 5½ per cent in the fourth quarter of 2006 to 4¾ per cent in the first quarter of 2007. The slower growth in the first quarter of 2007 was mainly due to a decline in the real value added by the primary sector. In addition, growth in real value added by the secondary sector slowed.

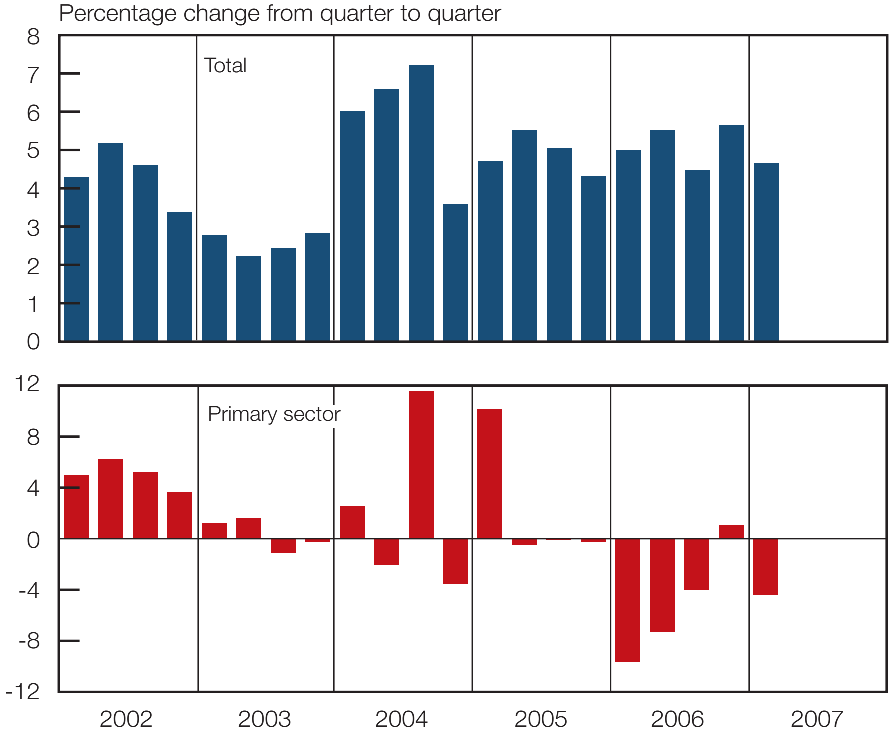
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2006					2007
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sector	-9½	-7¼	-4	1	-4½	-4½
Agriculture	-18¾	-30	-15	-8½	-13	6
Mining	-5½	3½	¼	4½	-¾	-7¾
Secondary sector	4¾	7¼	5¾	8¾	5¾	7
Manufacturing	3¼	6¼	4¾	8¼	4¾	4¾
Tertiary sector	7¼	6¼	4¾	5	6	5
Non-agricultural sector............	*5¾*	*6¼*	*4¾*	*6*	*5½*	*4½*
Total	5	5½	4½	5½	5	4¾

Following a slight recovery in the fourth quarter of 2006, real value added by the *primary sector* declined at an annualised rate of 4½ per cent in the first quarter of 2007. A contraction in real output by the mining sector more than neutralised an increase in the real value added by the agricultural sector in the first quarter of 2007.

Real gross domestic product



Seasonally adjusted annualised rates

Real value added by the *agricultural sector* recovered from a decline of 8½ per cent in the fourth quarter of 2006 to increase at an annualised rate of 6 per cent in the first quarter of 2007. This was mainly the result of the early harvesting of part of the maize crop due to the severe drought conditions in the main maize-producing areas, and a sustained increase in the production of livestock. However, measured over a year, agricultural production remained under pressure. Real value added by the agricultural sector contracted by 3 per cent in the first quarter of 2007 compared with the same period in 2006. The deteriorating conditions in the agricultural sector can largely be ascribed to the negative effect of the dry weather spell experienced during the last quarter of 2006 and the first quarter of 2007.

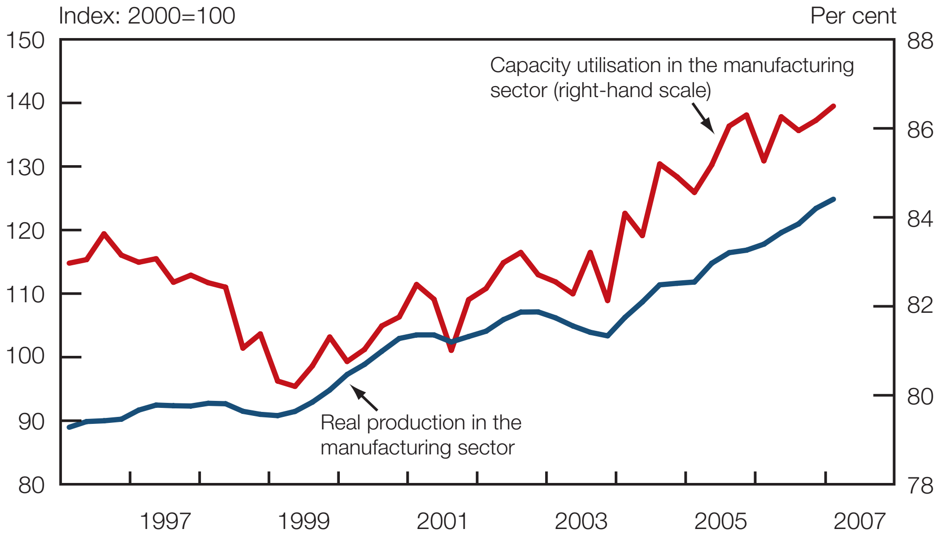
Following annualised growth of 4½ per cent in the fourth quarter of 2006, real value added by the *mining sector* contracted at a rate of 7¾ per cent in the first quarter of 2007, reflecting lower production by platinum and diamond mining. The growth in real value added by platinum mining contracted on account of the scheduled maintenance of a smelter at one of the platinum mines in the first quarter of 2007. This was reinforced by industrial action at some of the platinum mines, and resulted in a decline in platinum exports. Real output by diamond mines declined alongside weaker demand in the corresponding period.

Following a decline in the fourth quarter of 2006, real value added by the gold-mining industry inched higher in the first quarter of 2007. Likewise, the real value added by the coal-mining industry was boosted by an increase in the demand for coal. In addition, coal exports increased from the fourth quarter of 2006 to the first quarter of 2007.

Growth in real value added by the *secondary sector* slowed from a revised annualised rate of 8¾ per cent in the fourth quarter of 2006, to a rate of 7 per cent in the first quarter of 2007. This was mainly due to slower growth recorded in real output by the manufacturing sector. However, the growth in real value added by both the construction sector and the sector that supplies electricity, gas and water accelerated from the fourth quarter of 2006 to the first quarter of 2007.

Growth in real value added by the *manufacturing sector* slowed from an annualised rate of 8¼ per cent in the fourth quarter of 2006 to 4¾ per cent in the first quarter of 2007. This slackening was mainly evident in the subsectors responsible for the manufacturing of wood and wood products, petroleum products, chemicals, rubber and plastic products and motor vehicles, parts and accessories, and other transport equipment.

Real production and capacity utilisation in manufacturing



Seasonally adjusted

Production increased in the subsectors that manufacture food and beverages, radios, television and computer equipment as well as basic iron and steel, non-ferrous metal products and machinery. Activity in the latter subsector accelerated, reflecting higher spending on transport infrastructure and other investments. However, the utilisation of production capacity increased slightly from 86,2 per cent in the fourth quarter of 2006 to 86,5 per cent in the first quarter of 2007.

Growth in real value added by the sector supplying *electricity, gas and water* accelerated from an annualised rate of 1½ per cent in the fourth quarter of 2006 to 3½ per cent in the first quarter of 2007. Increased production of electricity was evident despite a few power disruptions experienced in some areas during this period. In addition, the real value added by the water subsector increased due to the exceptionally dry and hot weather conditions experienced during the first three months of 2007.

Growth in real value added by the *construction sector* accelerated from a revised annualised rate of 16½ per cent in the fourth quarter of 2006 to 21¼ per cent in the first quarter of 2007. This was mainly a reflection of the buoyant pace of activity in the construction of non-residential buildings as well as the significant expansion of civil construction activity. The latter benefited from infrastructural development projects to accommodate the 2010 FIFA World Cup as well as the general improvement and expansion of infrastructure. These developments more than offset the slower rates of growth recorded in the construction of residential buildings in the corresponding period.

The real value added by the *tertiary sector* rose at an annualised rate of 5 per cent in the first quarter of 2007, the same rate attained in the fourth quarter of 2006. This was the net result of marginally higher growth rates in real value added by the subsectors transport, storage and communication, and community, social and personal services, which were fully offset by slower growth in real output recorded by the commerce and the finance, insurance, real-estate and business services subsectors.

Growth in real value added by the *trade sector* slowed marginally from an annualised rate of 5½ per cent in the fourth quarter of 2006 to 5 per cent in the first quarter of 2007. The slower growth was a reflection of a moderation in activity in the retail sector. In addition, the real value added by the motor trade subsector decreased as demand for new motor vehicles lost further momentum in the first quarter of 2007. By contrast, growth in real value added by wholesale trade increased over the period.

The growth in real value added by the *transport, storage and communication sector* increased marginally from an annualised rate of 5½ per cent in the fourth quarter of 2006 to 5¾ per cent in the first quarter of 2007. This can mainly be ascribed to the increase in real value added by the communication sector, on account of the buoyancy in the use of cellular telephones. Real value added by the transport subsector also increased marginally.

Growth in real value added by the *finance, insurance, real-estate and business services sector* slowed from a revised annualised rate of 6½ per cent in the fourth quarter of 2006 to 5¾ per cent in the first quarter of 2007. The slower growth was mainly due to a slowdown in the real value added by banks.

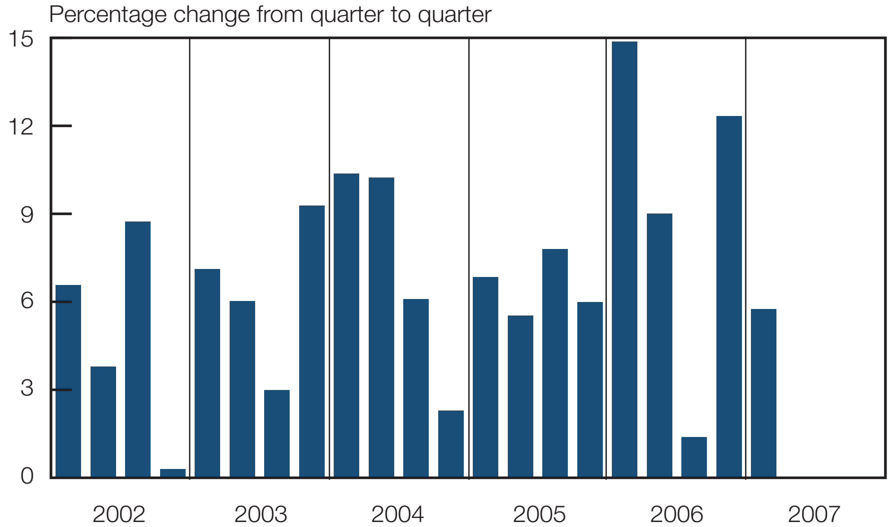
Real value added by *general government* increased at an annualised rate of 3½ per cent in the fourth quarter of 2006, rising to a rate of 4 per cent in the first quarter of 2007, slightly higher than the annual growth rate attained in 2006 as a whole.

The improvement in South Africa's terms of trade and lower net primary income payments to the rest of the world raised the level of *real gross national income*, particularly in the first quarter of 2007. As a result, growth in real gross national income accelerated substantially from an annualised rate of 3¼ per cent in the fourth quarter of 2006 to 8¾ per cent in the first quarter of 2007. This trend started in 2003 and gained momentum from 2005. The annualised growth in the real gross national income from the first quarter of 2005 to the first quarter of 2007 amounted to 6½ per cent, compared with a rate of growth of 5 per cent in gross domestic product.

Domestic expenditure

Growth in *aggregate real gross domestic expenditure* slowed from an annualised rate of 12¼ per cent in the fourth quarter of 2006 to 5¾ per cent in the first quarter of 2007. The slower growth in real gross domestic expenditure could mainly be attributed to a much slower pace of inventory accumulation, while growth in real final consumption expenditure by households was marginally below that of the final quarter of 2006. By contrast, growth in real final consumption expenditure by general government and gross fixed capital formation accelerated significantly in the first quarter of 2007.

Real gross domestic expenditure



Seasonally adjusted annualised rates

Real final consumption expenditure by households increased at an annualised rate of 7½ per cent in the first quarter of 2007 compared with a growth rate of 7¾ per cent in the fourth quarter of 2006. This slight moderation in growth was mainly due to much slower growth in spending on services over the period. However, growth accelerated in the semi-durable and non-durable spending categories.

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
Final consumption expenditure by households	8¼	8	7½	7¾	7¼	7½
Final consumption expenditure by general government	-3¼	15¾	-4½	4¾	5½	14
Gross fixed capital formation	14	12¾	14	16½	12¾	21¾
Change in inventories (R billions)*	15,9	16,3	9,0	21,8	15,8	11,8
Gross domestic expenditure	15	9	1½	12¼	8¾	5¾

* At constant 2000 prices

Growth in real final consumption expenditure by households on *durable goods* slowed from 8½ per cent in the fourth quarter of 2006 to an annualised rate of 8 per cent in the first quarter of 2007. The slowdown was mainly due to a decline in household spending on personal transport equipment – especially on new motor vehicles. This was partly offset by sustained brisk real spending over this period on furniture and household appliances, medical equipment as well as recreational and entertainment goods.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

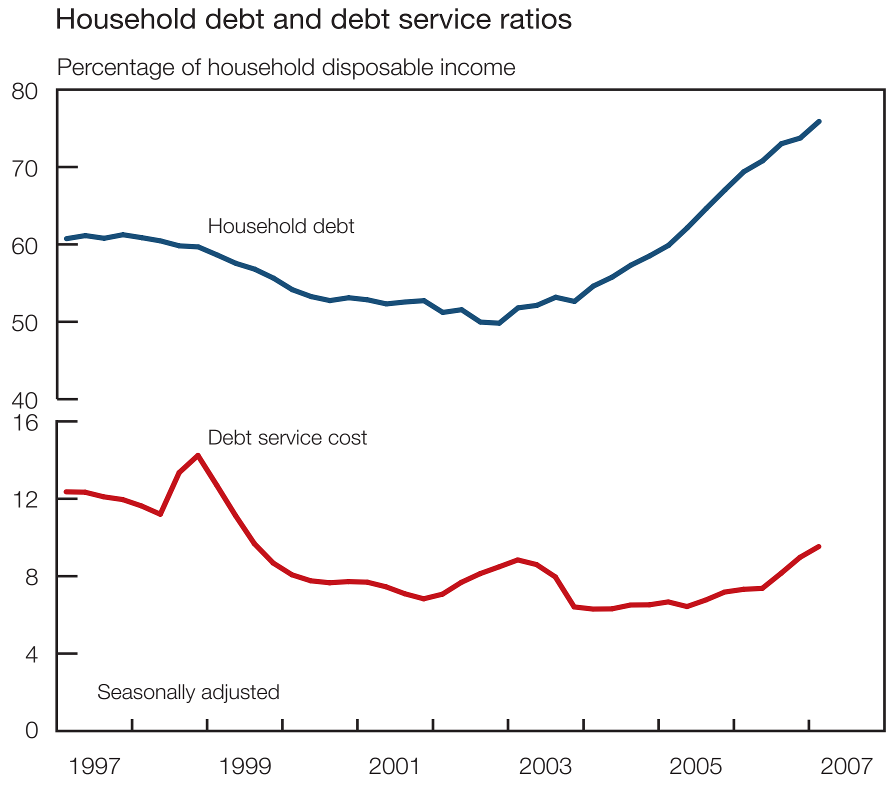
	2006					2007
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods	19¾	13	7	8½	15½	8
Semi-durable goods	23¾	26½	24	8	18½	18
Non-durable goods	4	6¾	3¼	6½	4¾	7
Services	4	1¾	6	8¾	3½	3¾
Total	**8¼**	**8**	**7½**	**7¾**	**7¼**	**7½**

Growth in real outlays on *semi-durable goods* surged from an annualised rate of 8 per cent in the fourth quarter of 2006 to 18 per cent in the first quarter of 2007. This was mainly due to buoyant expenditure on clothing and footwear, and car tyres, parts and accessories. Expenditure on household textiles, furnishings and glassware fell slightly further in the first quarter of 2007.

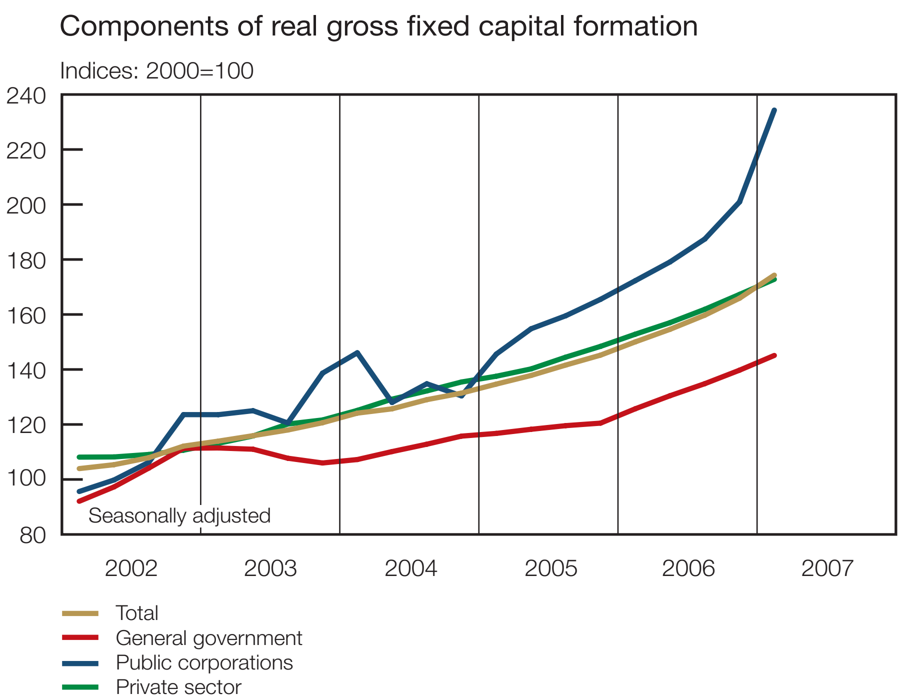
Real expenditure on *non-durable goods* increased at annualised rates of 6½ per cent in the fourth quarter of 2006 and 7 per cent in the first quarter of 2007. The slight acceleration was the net result of higher growth in real outlays on food, beverages and tobacco, household fuel and power, and household consumer goods that were partly offset by a decline in real household spending on medical and pharmaceutical products. In addition, expenditure on petroleum products stagnated, partly in response to these products' high prices. Real outlays on *services* advanced at an annualised rate of 3¾ per cent following a rate of 8¾ per cent in the fourth quarter of 2006.

The robust pace of consumer spending, despite the higher interest rate environment, was largely based on a strong increase in the *real disposable income of households*. Growth in real disposable income accelerated from an annualised rate of 7¼ per cent in the fourth quarter of 2006 to 7½ per cent in the first quarter of 2007. This can mainly be attributed to an increase in employment and the fact that wage settlements were, on average, above the upper limit of the inflation target range. Household debt as a percentage of disposable income increased from 73¾ per cent in the fourth quarter of 2006 to 76 per cent in the first quarter of 2007.

Having recorded an annualised increase of 4¾ per cent in the fourth quarter of 2006, *real final consumption expenditure by general government* accelerated further at a rate of 14 per cent in the first quarter of 2007. This raised the ratio of final consumption expenditure by general government to gross domestic product slightly to 19½ per cent from 19¼ per cent in the fourth quarter of 2006. The higher level of expenditure can partly be explained by the purchase of another submarine during the first quarter of 2007. Excluding the cost of the submarine, the increase in real consumption expenditure by general government in the first quarter of 2007 would have been roughly similar to the 5½-per-cent growth rate recorded for 2006 as a whole.



Growth in *real gross fixed capital formation* accelerated considerably from an annualised rate of 16½ per cent in the fourth quarter of 2006 to 21¾ per cent in the first quarter of 2007. This was mainly due to buoyant growth in real gross fixed capital formation by public corporations. In addition, real gross fixed capital formation by both private business enterprises and general government continued to increase in the first quarter of 2007. Consequently, the ratio of gross fixed capital formation to gross domestic product rose from 19½ per cent in the fourth quarter of 2006 to 20¼ per cent in the first quarter of 2007. This is much higher than the average ratio of 16 per cent recorded between 1995 and 2005.



In the *private sector*, real gross fixed capital formation increased at a fairly robust rate of 13¾ per cent in the first quarter of 2007. Although the pace of expansion in real capital outlays in the manufacturing, commerce, transport and communication subsectors slowed in the first quarter of 2007, growth rates in these subsectors were still very strong. Real gross fixed capital formation by private contractors maintained its upward trend in the first quarter of 2007. Construction work on the Gautrain project progressed over this period.

Real capital outlays by *public corporations* expanded briskly in the first quarter of 2007, particularly in the electricity subsector. The tempo of investment spending by the electricity subsector rose mainly due to progress with the construction of two open-cycle gas turbine plants. These projects were running ahead of schedule and were set to be completed before mid-winter, adding significantly to electricity production capacity. Continuous capital investment in the transport sector was mainly focused on programmes to restore and increase rail transport capacity.

Annualised growth in real gross fixed capital formation by *general government* increased from 15½ per cent in the fourth quarter of 2006 to 16¼ per cent in the first quarter of 2007. This was mainly due to increased capital expenditure by both provincial and local governments, driven by the need to further upgrade and maintain general infrastructure. Government accelerated spending on transport infrastructure to accommodate the 2010 FIFA World Cup, and construction work on new and existing stadiums moved ahead.

Annualised *real inventory investment* declined from R21,8 billion in the fourth quarter of 2006 to R11,8 billion in the first quarter of 2007. Part of the slower pace of inventory accumulation in the first quarter of 2007 could be ascribed to a reduction in inventories in the mining sector, especially in platinum and gold mining. Inventory investment slowed in the manufacturing sector mainly due to lower imports of crude oil, after exceptionally high imports in the preceding quarter. In the wholesale, retail and motor trade sector, the slower inventory accumulation resulted from lower inventories of agricultural stocks-in-trade. As a result of these developments, real inventory investment subtracted 3¼ percentage points from growth in real gross domestic expenditure in the first quarter of 2007 compared with a positive contribution of 4¼ percentage points in the fourth quarter of 2006.

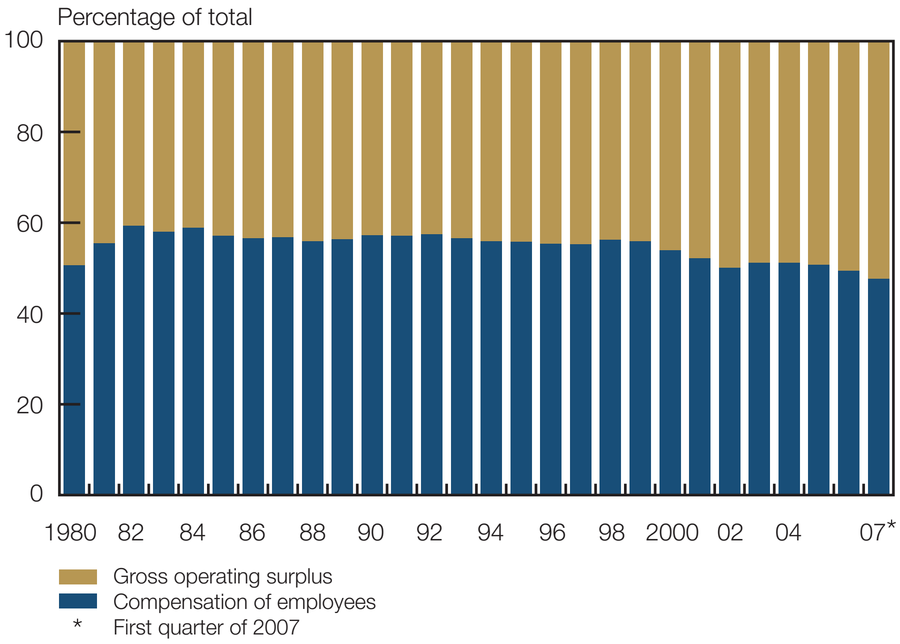
Factor income

The growth over one year in *total nominal factor income* accelerated from 14 per cent in the fourth quarter of 2006 to 14¼ per cent in the first quarter of 2007. This was the result of substantially stronger growth recorded in the gross operating surplus of business enterprises and a sustained increase in the overall compensation of employees.

The year-on-year growth in *compensation of employees* was sustained at a rate of 9¾ per cent in both the fourth quarter of 2006 and the first quarter of 2007. An increase in employment levels and sustained increases in wages against the backdrop of higher inflation in consumer prices, were the main drivers of the acceleration in growth in the compensation of employees in several sectors including mining, manufacturing, construction, trade and finance. This was neutralised by lower growth in compensation of employees in the government and transport sectors.

Sustained lively domestic demand conditions bode well for the *gross operating surplus* of business enterprises. The year-on-year growth in the gross operating surplus of

Factor shares



business enterprises increased briskly from an already high rate of 18½ per cent in the fourth quarter of 2006 to 19 per cent in the first quarter of 2007. This followed an increase of 15 per cent for the year 2006 as a whole. Several economic sectors contributed to the buoyant aggregate gross operating surplus in the first quarter of 2007, notably the agricultural, mining and manufacturing sectors. Consequently, the share of gross operating surplus in total factor income rose to an all-time high of 52½ per cent in the first quarter of 2007, compared with 51¼ per cent in the fourth quarter of 2006.

Gross saving

After fluctuating between 13½ per cent and 14½ per cent in 2006, the ratio of *gross saving to gross domestic product* increased to 14¾ per cent in the first quarter of 2007. This welcome improvement in the national saving ratio was the result of improved saving ratios in the household, corporate as well as the general government sectors. Nevertheless, the utilisation of foreign capital to finance the rapid growth in gross capital formation remained high. This dependency rate eased from 36 per cent recorded in the fourth quarter of 2006 to 32 per cent in the first quarter of 2007.

Gross saving by the *corporate sector* as a percentage of gross domestic product increased from a recent low of 10 per cent in the fourth quarter of 2006 to 10½ per cent in the first quarter of 2007. Strong growth in gross operating surpluses of business enterprises in the first quarter of 2007 boosted the saving level of the corporate sector.

Gross saving by *general government* as a percentage of gross domestic product increased strongly from 2½ per cent in the fourth quarter of 2006 to 3 per cent in the first quarter of 2007. This improvement in the general government's saving ratio can mainly be attributed to a surge in tax collections in the first quarter of 2007. Strong increases were recorded in several tax categories, supporting the current income of general government.

The long-standing declining trend of the gross saving ratio of the *household sector* was arrested in the first quarter of 2007. After reaching its lowest ratio of 1¼ per cent of gross domestic product in the fourth quarter of 2006, it increased slightly to 1½ per cent in the first quarter of 2007. This was the result of a marginal slowdown in the growth of final consumption expenditure by South African families in the first quarter of 2007, together with an acceleration in growth in their disposable income.

Employment

The sustained expansion in overall economic activity continued to have a positive impact on the South African labour market. Aggregate employment in the formal non-agricultural sectors of the economy increased by a further 2,6 per cent, or by 206 000 jobs, in the year to the fourth quarter of 2006. In particular, employment gains in the public sector outpaced those in the private sector by a slight margin over the period.

According to the recently enhanced enterprise-based *Quarterly Employment Statistics* (QES) survey by Statistics South Africa, employment growth occurred at an annualised rate of 5,9 per cent in the fourth quarter of 2006 – the strongest growth rate since the second quarter of 2005. Employment gains were registered in all sectors except for the electricity generation, and community, social and personal services sectors. Pronounced increases were noted in the mining as well as the trade, catering and accommodation services sectors, while moderate employment growth was registered in the construction and finance, insurance, real-estate and business services sectors over the period.

Public-sector employment growth picked up from an annualised rate of 1,1 per cent in the third quarter of 2006 to 5,4 per cent in the fourth quarter. Additional job opportunities were created at all tiers of the public sector in the fourth quarter of 2006, especially in the national departments and provinces as well as in the transport, storage and communication sector.

The *Labour Force Survey* (LFS), a household survey conducted on a bi-annual basis by Statistics South Africa, indicated that employment in the South African economy as a whole increased by about 500 000 from September 2005 to September 2006. The agricultural sector made the largest contribution to employment growth by providing 160 000 new jobs over this period. In total, South Africa's official unemployment rate declined from 26,7 per cent in September 2005 to 25,5 per cent in September 2006. The lower level of unemployment also coincided with a decline in the number of discouraged work-seekers, suggesting that as more jobseekers were successful in gaining employment, more people started to actively search for work.

Employment
Millions

	Sep 2002	Sep 2003	Sep 2004	Sep 2005	Sep 2006
Labour force	16,2	15,9	15,8	16,8	17,2
Total employment	11,3	11,4	11,6	12,3	12,8
Formal non-agricultural employment	7,2	7,4	7,7	8,0	8,4
Unemployment rate (per cent)	30,4	28,0	26,2	26,7	25,5

Source: Statistics South Africa, *Labour Force Survey*, September 2006

Employment prospects in the manufacturing sector were measured on a par with levels previously witnessed in the 1970s and 1980s. Manufacturers have not been this positive since 2002. These findings of improved job prospects in the manufacturing sector were corroborated by the employment sub-index of the Investec Purchasing Managers Index which remained in positive territory, although it moderated in May 2007.

Although the overall business confidence in the building industry remained at elevated levels, the Bureau for Economic Research (BER) composite Business Confidence Index for the building industry declined marginally by one index point to 88 in the first quarter of 2007. Most contractors indicated that they were struggling to obtain the required number of skilled people and were experiencing shortages of building materials. According to the BER quarterly survey of expectations and activity in the retail, wholesale and motor trade sectors, the number of respondents indicating an increase in employment decreased from 46 per cent in the fourth quarter of 2006 to 31 per cent in the first quarter of 2007.

Labour cost and productivity

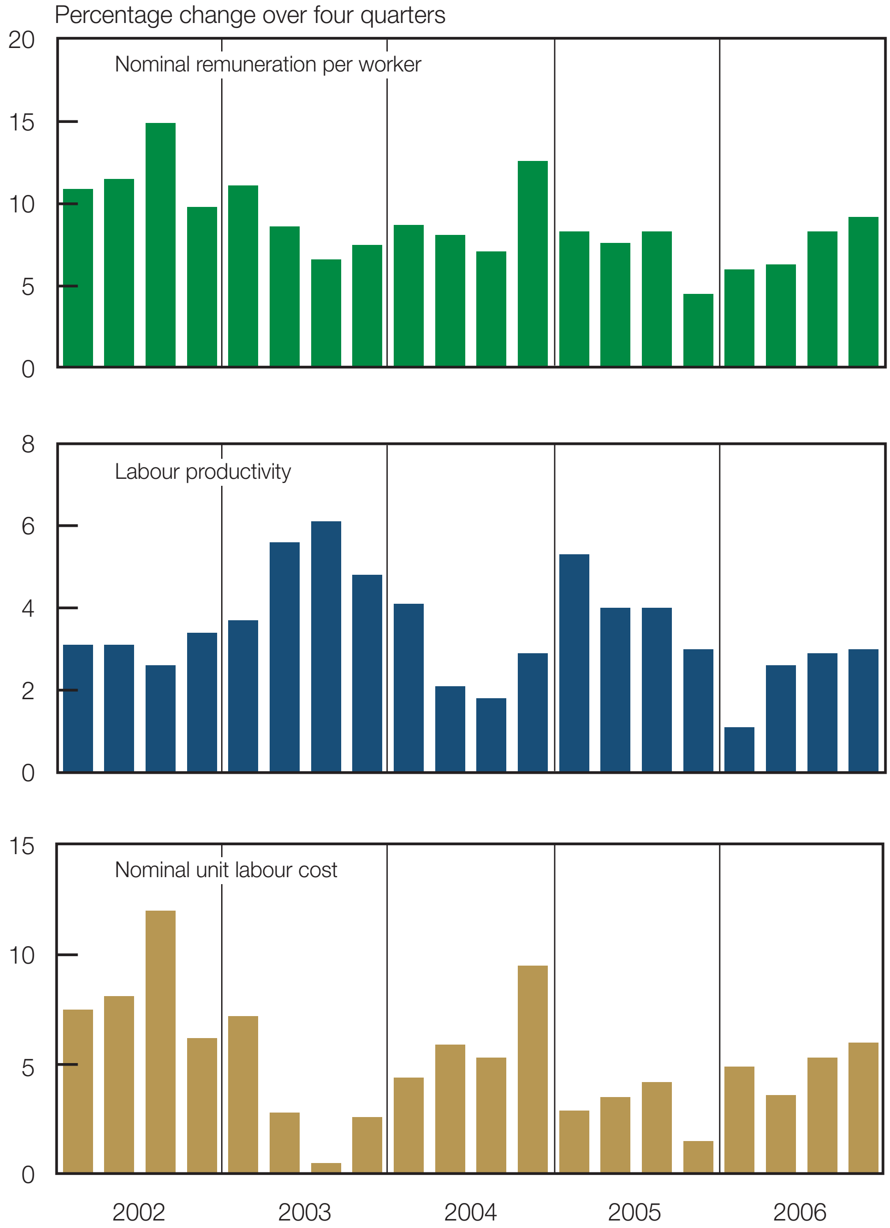
Growth in nominal remuneration per worker in the formal non-agricultural sector accelerated rapidly from a year-on-year rate of 4,5 per cent in the fourth quarter of 2005 to 8,2 per cent in the third quarter of 2006 and to 9,1 per cent in the fourth quarter – the highest growth rate in the past two years. For 2006 as a whole, annual wage growth averaged 7,5 per cent, which was slightly higher than the 7,1 per cent recorded for 2005.

Growth in nominal remuneration per worker in the private sector outpaced that in the public sector in the fourth quarter of 2006; average remuneration growth in the private sector accelerated to a year-on-year rate of 10,1 per cent while growth in the public sector slowed to 6,1 per cent over the period. In the private sector, remuneration increases in excess of 10 per cent were recorded in the finance, insurance, real-estate and business services sector (13,2 per cent), the community, social and personal services sector (15,5 per cent), and in the non-governmental transport, storage and communication sector (23,5 per cent). In the public sector, the highest year-on-year remuneration increases in the fourth quarter of 2006 were registered in the transport, storage and communication sector (9,7 per cent), national departments (7,7 per cent) and provincial governments (6,5 per cent).

According to Andrew Levy Employment Publications (a private-sector labour consultancy), the average rate of wage settlements amounted to 6,5 per cent in 2006 and remained unchanged at this rate in the first quarter of 2007. Wage settlements ranged from 4,5 per cent in the transport sector to 8 per cent in the agricultural sector in the first quarter of 2007. The consultancy anticipated that wage settlement rates would increase in line with increased wage pressures as the year progresses.

Output growth in the economy outpaced employment gains in recent quarters, leading to an acceleration in labour productivity growth from a year-on-year rate of 1,1 per cent in the first quarter of 2006 to 3,0 per cent in the fourth quarter. Notwithstanding rising labour productivity growth in recent quarters, the annual average increase of 2,4 per cent recorded in 2006 fell short of the 4-per-cent rate attained in 2005. Despite a 6,0-per-cent year-on-year rate of increase in labour productivity in the manufacturing sector in the fourth quarter of 2006, growth in labour productivity in the sector moderated from 5 per cent in 2005 to 3,9 per cent in 2006.

Labour cost and productivity in the formal non-agricultural sector



The year-on-year rate of increase in nominal unit labour cost, i.e. the cost of labour per unit of production, accelerated meaningfully from 5,2 per cent in the third quarter of 2006 to 5,9 per cent in the fourth quarter. Changes in nominal unit labour cost normally precede or coincide with changes in consumer price inflation. Annual average growth in nominal unit labour cost picked up significantly from 3,0 per cent in 2005 to 5,0 per cent in 2006. Growth in nominal unit labour cost in the manufacturing sector, however, slowed to a year-on-year rate of 1,4 per cent in the fourth quarter of 2006, mainly due to labour productivity growth accelerating at a faster pace than remuneration growth over this period.

Revisions to the composite leading and coincident business cycle indicators

The South African Reserve Bank previously revised the composition of the composite leading and coincident business cycle indicators in 2004.[1] Recently, a number of minor adjustments were effected to these composite indicators. The purpose of this box is to briefly discuss these changes.

The composite leading business cycle indicator

The objectives of the changes to the component time series of the composite leading business cycle indicator were twofold. Firstly, practical experience with the indicator suggested an over-reliance on manufacturing and a need to expand the processes incorporated in the indicator. Accordingly, an adjustment was made to redress the representation of some economic processes and sectors reflected in the composite leading business cycle indicator. Secondly, the format in which some component time series are incorporated into the composite leading business cycle indicator was amended to reduce the indicator's sensitivity to erratic short-term impulses.

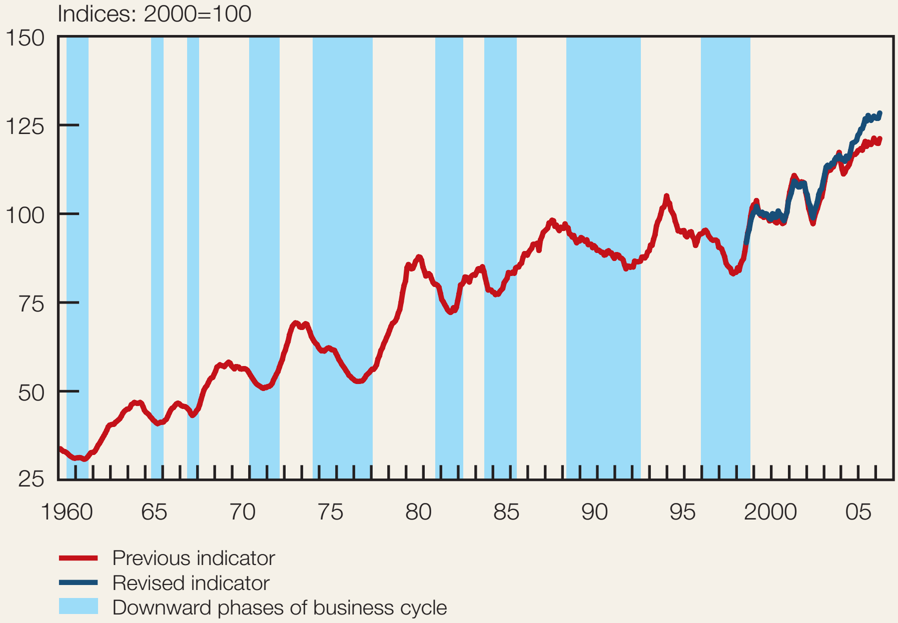
Regarding the first objective, a number of changes were made to the composition of the composite leading business cycle indicator. The time series representing the number of new passenger vehicles sold (percentage change over twelve months) was added, thus providing an additional early indication of domestic demand conditions in the South African economy. The total weighting of the manufacturing sector in the leading indicator was reduced. This was achieved by omitting two previously included component time series, namely the six-month smoothed growth rate in labour productivity in the manufacturing sector and the opinion survey of stocks in relation to demand in the manufacturing and trade sectors.[2] Also, the weights of two manufacturing-sector related component time series were halved, implying that together they weigh the same as each component time series on its own. They are the following:

- The net balance of manufacturers observing an increase in the average number of hours worked per factory worker; and
- the net balance of manufacturers observing an increase in the volume of orders received.

Furthermore, the format of three other component time series included in the composite leading business cycle indicator was changed. The six-month smoothed growth rate in the number of column centimetres devoted to job advertisements in the *Sunday Times* newspaper was replaced by the percentage change over twelve months in that indicator. The six-month smoothed growth rate in the prices of all shares traded on the JSE Limited (JSE) was replaced by the index (in levels form) of the prices of all shares traded on the JSE. The six-month smoothed growth rate in commodity prices, measured in US dollars, for a basket of South Africa's export commodities was replaced by the index (in levels form) of these commodity prices.

The revised composite leading business cycle indicator was linked to the historical composite leading business cycle indicator in 1999. Graph 1 shows the previous and the revised composite leading business cycle indicators.

Graph 1 Composite leading business cycle indicator



1 Venter, J C and Pretorius, W S. 2004. Note on the revision of composite leading and coincident business cycle indicators. *Quarterly Bulletin*, No 231, March. Pretoria: South African Reserve Bank.

2 All the opinion survey data included in the composite leading business cycle indicator are published by the Bureau for Economic Research, University of Stellenbosch.

Table 1 shows the 13 component time series previously included in the composite leading business cycle indicator and the 12 component time series that are now included in the revised composite leading business cycle indicator.

Table 1 Component time series of the composite leading business cycle indicator

Previous components	New components
Job advertisement space in the *Sunday Times* newspaper: Six-month smoothed growth rate	Job advertisement space in the *Sunday Times* newspaper: Percentage change over twelve months
Number of residential building plans passed for flats, townhouses and houses larger than 80m^2	Number of residential building plans passed for flats, townhouses and houses larger than 80m^2
Interest rate spread: 10-year government bonds less 91-day Treasury bills	Interest rate spread: 10-year government bonds less 91-day Treasury bills
Index of prices of all classes of shares traded on the JSE: Six-month smoothed growth rate	Index of prices of all classes of shares traded on the JSE
Real M1 money supply (deflated with CPI): Six-month smoothed growth rate	Real M1 money supply (deflated with CPI): Six-month smoothed growth rate
Index of commodity prices in US dollar for a basket of South Africa's export commodities: Six-month smoothed growth rate	Index of commodity prices in US dollar for a basket of South Africa's export commodities
Composite leading business cycle indicator of South Africa's major trading-partner countries: Percentage change over twelve months	Composite leading business cycle indicator of South Africa's major trading-partner countries: Percentage change over twelve months
Gross operating surplus as a percentage of gross domestic product	Gross operating surplus as a percentage of gross domestic product
Opinion survey of business confidence: Manufacturing, construction and trade	Opinion survey of business confidence: Manufacturing, construction and trade
Net balance of manufacturers observing an increase in the average number of hours worked per factory worker	Net balance of manufacturers observing an increase in the average number of hours worked per factory worker (half weight)
Net balance of manufacturers observing an increase in the volume of orders received	Net balance of manufacturers observing an increase in the volume of orders received (half weight)
Opinion survey of stocks in relation to demand: Manufacturing and trade	Number of new passenger vehicles sold: Percentage change over 12 months
Labour productivity in manufacturing: Six-month smoothed growth rate	

The composite coincident business cycle indicator

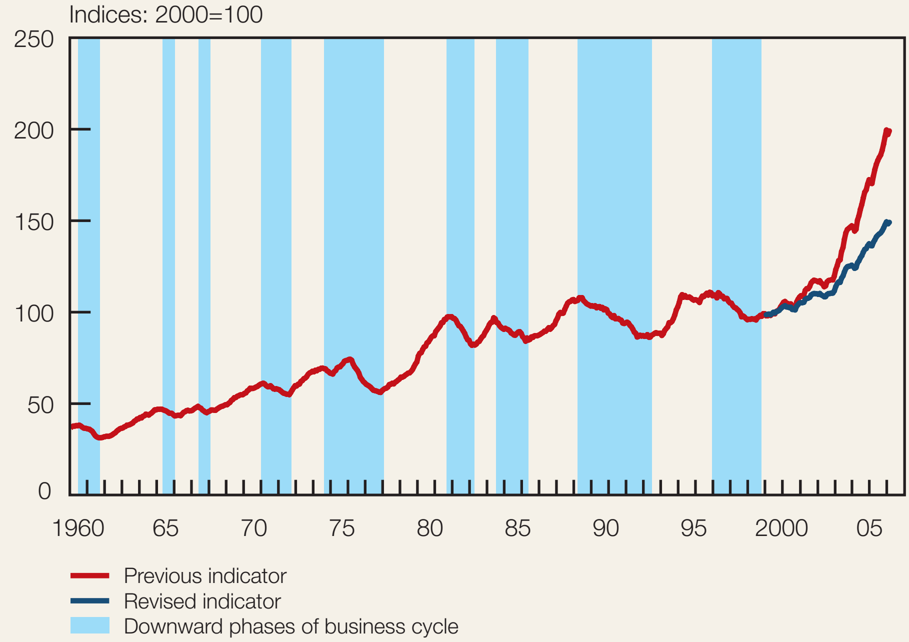
The five component time series of the composite coincident business cycle indicator that were introduced in the 2004 revisions have been retained unchanged. The only change made to the composite coincident business cycle indicator involved an adjustment to its long-term trend.

When calculating the composite coincident business cycle indicator, the final step in the methodology is to adjust the long-term trend of this indicator to match the long-term trend in the real gross value added in the economy at basic prices, excluding agriculture. During the 2004 revisions, the inherent long-term trend in the composite coincident business cycle indicator was outpaced by the growth trend in the non-agricultural real gross value added for the period that was considered at the time. The trend adjustment procedure therefore resulted in the inherent long-term trend of the composite coincident business cycle indicator being adjusted upwards to match the long-term trend in the non-agricultural real gross value added.

The lower growth trend in the composite coincident business cycle indicator occurred mainly as a result of the structural decline in the level of total formal non-agricultural employment during most of the 1990s until 2003. From the third quarter of 2003, however, total formal non-agricultural employment has been trending upwards. This, together with strong increases in all the other component time series of the composite coincident business cycle indicator – most notably the rapid growth recorded in the value of wholesale, retail and new vehicle sales at constant prices – resulted in the inherent growth trend of the composite coincident business cycle indicator outstripping that of the non-agricultural real gross value added in recent years.

The trend has therefore been amended so that the long-term trend in the composite coincident business cycle indicator now more accurately reflects the long-term trend in the real gross value added, excluding agriculture. The revised composite coincident business cycle indicator was linked to the historical composite coincident business cycle indicator in 2000, from where the new long-term trend applies. Graph 2 shows both the previous and revised composite coincident business cycle indicators.

Graph 2 Composite coincident business cycle indicator

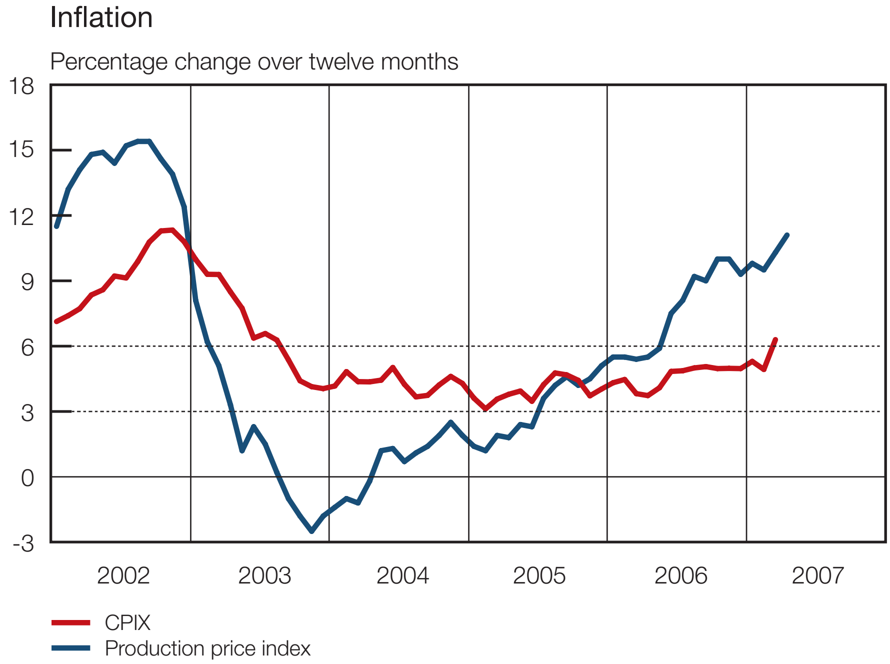


J C Venter

Prices

Price inflation accelerated considerably in the opening months of 2007 mainly on account of rising food price inflation, steep increases in international crude oil prices as well as escalating housing services prices. Notwithstanding this acceleration, year-on-year CPIX inflation remained within the inflation target range of 3 to 6 per cent, amounting to 5,5 per cent up to March 2007. However, in April it breached the 6-per-cent upper boundary of the inflation target to reach 6,3 per cent – the highest level since August 2003.

Part of the inflationary momentum can be traced back to developments in production prices. Driven mainly by the depreciation in the exchange rate of the rand and persistent increases in international crude oil prices, the twelve-month rate of increase in the *production prices of imported goods* accelerated from 4,7 per cent in May 2006 to 11,3 per cent in November – the highest rate of increase since November 2002. Thereafter, this rate of increase fell to 9,9 per cent in March 2007 but picked up again to 10,5 per cent in April.



When measured from quarter to quarter and expressed at an annualised rate, imported goods price inflation accelerated to 21,2 per cent in the third quarter of 2006 before decelerating meaningfully to 10,1 per cent in the fourth quarter of 2006. In the first quarter of 2007, the prices of imported goods decreased at an annualised rate of 0,4 per cent as crude oil import prices dipped.

Production prices

Quarter-to-quarter percentage change at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2006:	1st qr	5,6	0,0	4,1
	2nd qr	10,6	10,8	10,7
	3rd qr	16,9	21,2	17,8
	4th qr	5,9	10,1	6,9
	Year	**7,6**	**7,7**	**7,7**
2007:	1st qr	6,2	-0,4	4,9

Domestically produced goods price inflation accelerated markedly and more than doubled from a year-on-year rate of 5,0 per cent in March 2006 to 11,1 per cent in April 2007. This was largely due to a surge in the agricultural product prices category, which reflected substantial increases across most subcomponents, including both the food and non-food agricultural product categories. In the year to August 2006 agricultural food price inflation accelerated to 23,5 per cent but subsequently decelerated to 12,2 per cent in December, before accelerating again to 19,2 per cent in March 2007 and 17,9 per cent in April. Manufactured food price inflation also increased significantly from a year-on-year rate of 1,7 per cent in January 2006 to 12,0 per cent in November, declining only slightly to 11,7 per cent in April 2007.

The quarter-to-quarter rate of increase in domestically produced goods price inflation decelerated from 16,9 per cent in the third quarter of 2006 to 5,9 per cent in the fourth quarter, but accelerated again to 6,2 per cent in the first quarter of 2007, driven mostly by the increases in the prices of agricultural food products, textiles, clothing and footwear.

Resulting from higher rates of increase in the prices of imported goods and the acceleration in domestically produced goods price inflation, overall *production price inflation* rose from a year-on-year rate of 5,0 per cent in March 2006 to 11,1 per cent in April 2007 – the highest rate in fifty-one months. When the rapidly rising energy and food prices are excluded from the overall production price index, an increase of 10,3 per cent was recorded in the year to April 2007. This is more than three times higher than the 2,9-per-cent rate of increase recorded in April 2006.

The quarter-to-quarter pace of increase in the all-goods production price index decelerated abruptly to annualised rates of 6,9 per cent in the fourth quarter of 2006 and 4,9 per cent in the first quarter of 2007 – in the third quarter of 2006 the rate of increase had been as high as 17,8 per cent.

As already indicated, year-on-year *CPIX inflation* amounted to 6,3 per cent in April 2007, around three percentage points higher than a year earlier. Despite this surge in CPIX inflation in recent months, it nonetheless remained within the inflation target range of between 3 and 6 per cent for the forty-third consecutive month in March 2007. Following the significant increase in the production prices of food, CPIX consumer food price inflation more than doubled from a year-on-year rate of 4,3 per cent in January 2006 to 9,4 per cent in October before falling somewhat to 8,6 per cent in April 2007, still accounting for the bulk of the increase in CPIX inflation. If food prices were to be excluded from the price index, CPIX inflation would have amounted to 5,5 per cent in the year to April 2007 – almost a full percentage point lower than the all-inclusive CPIX inflation rate for that month.

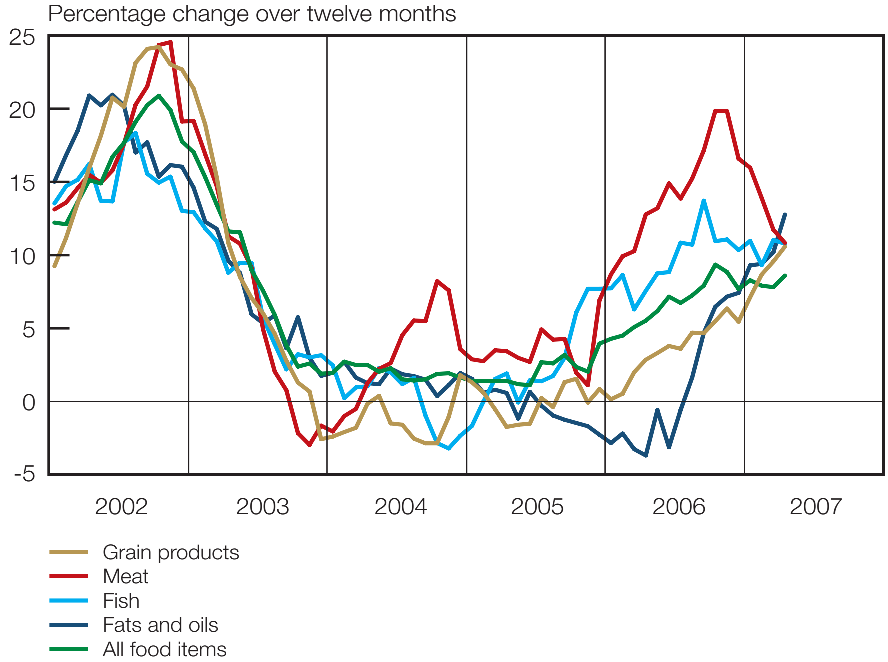
Food prices

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

Selected consumer food prices

Percentage change over twelve months



The quarter-to-quarter rate of CPIX inflation slowed from a seasonally adjusted and annualised 8,4 per cent in the third quarter of 2006 to 3,4 per cent in the fourth quarter. Subsequently, this rate of increase reaccelerated slightly to 4,1 per cent in the first quarter of 2007 as higher energy prices and less deflation in the prices of clothing and footwear started to have an impact on the index.

Year-on-year *CPIX goods price inflation* touched the upper limit of the inflation target range of 6 per cent in August 2006 but thereafter decelerated marginally, remaining consistently at an elevated level of around 5,5 per cent during the six-month period to April 2007.

Unlike the fairly steady state in CPIX goods price inflation in recent months, *CPIX services price inflation* accelerated markedly from a year-on-year rate of 3,3 per cent in June 2006 to 5,5 per cent in April 2007. Higher rates of increase in CPIX services prices were fairly pervasive, led by increases in domestic workers' wages, sundry services and education costs.

Inflation in CPIX components

Percentage change over twelve months

	Weights	April 2007
Transport running cost	5,7	15,1
Alcoholic beverages and tobacco	3,1	7,9
Food and soft drinks	26,9	8,4
Total housing services	13,4	6,1
Total other goods (not included elsewhere)	17,5	*5,5*
Services excluding housing and transport	16,5	*5,3*
Total transport services	3,9	*4,1*
Furniture and equipment	3,2	0,4
Vehicles	5,7	0,4
Clothing and footwear	4,1	-8,5
Total CPIX	**100,0**	**6,3**

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

As indicated in the table on the previous page, four of the ten main components, constituting roughly 50 per cent of the overall CPIX, increased at year-on-year rates in excess of six per cent in April 2007. Year-on-year inflation in the prices of three components, with a combined weight of 13 per cent, fell below the lower boundary of the inflation target range in April 2007, while three components, constituting approximately 40 per cent of the basket, remained within the inflation target range. Year-on-year inflation in the prices of food and soft drinks, with the highest individual category weight, jumped from only 2,2 per cent in November 2005 to no less than 8,3 per cent in April 2007.

Inflation in the prices of *administered goods and services* decelerated from a year-on-year rate of 9,3 per cent in February 2006 to 8,3 per cent in April 2007. However, if petrol prices were excluded, administered price inflation would have remained steady at a year-on-year rate of 5,6 per cent for the fourth consecutive month in April 2007. Recent announcements regarding the possible tariff implications of rising electricity infrastructure investment are noteworthy, with future developments in this area having a significant bearing on the outlook for administered price inflation.

CPIX inflation expectations have worsened slightly according to the most recent Inflation Expectations Survey of the BER at the University of Stellenbosch. The survey conducted in the second quarter of 2007, showed that participants on average expected annual average CPIX inflation to amount to 5,4 per cent in 2007, an acceleration of 0,2 percentage points compared with the outcome of the previous triparty survey conducted in the first quarter of 2007. All participants surveyed expected inflation to remain comfortably within the inflation target range during all three forecast years.

CPIX inflation expectations

Per cent, as surveyed in the second quarter of 2007

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2007	5,5	5,3	5,5	5,4
2008	5,0	5,4	5,5	5,3
2009	4,7	5,4	5,4	5,2

After having increased to 5,3 per cent in the first quarter of 2007, *household inflation expectations* rose further to 5,5 per cent in the second quarter of 2007. The higher household inflation expectations resulted mainly from an increase in the expectations of the high-income group. This group's inflation expectations increased to 5,7 per cent, whereas low-income earners' inflation expectations increased marginally to 5,5 per cent in the second quarter.

Foreign trade and payments

International economic developments

Preliminary estimates suggest that global output growth steamed ahead in the first quarter of 2007, underpinned largely by rapid growth in major emerging-market countries in Asia. According to the latest *World Economic Outlook* of the IMF, global economic growth is expected to moderate to around 5 per cent in both 2007 and 2008. Downside risks to global economic growth include an abrupt slowdown in the United States of America (US), volatility in financial markets, capacity constraints in many economies and a disorderly unwinding of global imbalances.

Real economic growth in the US slowed to a four-year low in the first quarter of 2007, partly due to a sharp downturn in the housing sector and a deteriorating external sector. Economic growth in Japan moderated in the first quarter of 2007 on account of a decline in private investment, while weaker household spending and net exports led to slower economic growth in the euro area in the same quarter.

In most emerging-market economies the pace of increase in real gross domestic product remained robust in the final quarter of 2006 despite a general moderation in growth rates. The emerging Asian region rebounded in the first quarter of 2007, led by brisk expansions in China and India, notwithstanding the tightening measures introduced by the authorities. Economic growth in Africa continued at a solid pace in 2006 and early 2007, bolstered by the sustained global economic expansion, improved macroeconomic stability, debt relief, increased oil production and strong demand for non-fuel commodities.

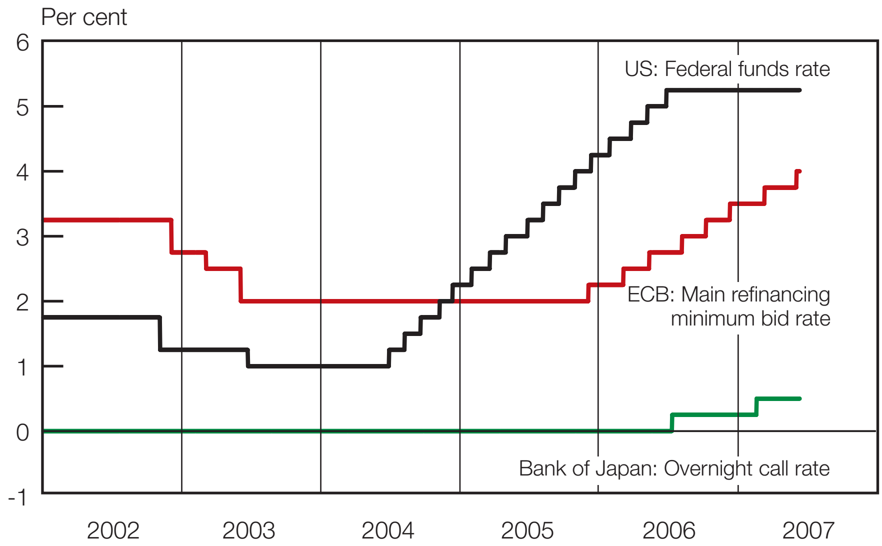
From lower levels in the first quarter of 2007, Brent crude oil prices rose to almost US$70 per barrel at the beginning of April. The increase in crude oil prices was largely due to supply concerns ahead of the US summer driving season and geopolitical tensions in Iran and Nigeria. These concerns were exacerbated by declining US fuel inventories, a protracted strike at a French oil terminal, and geopolitical tensions surrounding Iran's nuclear programme and elections in Nigeria. In addition, a leak at a major Canadian pipeline, a potential refinery strike in Belgium and an unsuccessful attack on oil facilities in Saudi Arabia

Brent crude oil prices

lent support to prices. Brent crude oil prices receded to US$64 per barrel during the first week of May on account of rising US crude oil inventories, an announcement by the US government that crude oil purchases for the strategic reserves had been suspended, news that the Belgian strike had been averted and the release of foreign oil workers seized by militants in Nigeria. Oil prices rebounded to levels above US$71 per barrel in the first week of June due to supply disruptions in West Africa, geopolitical tensions in Iran and Nigeria, US refinery outages and continued concern over below-average US gasoline supplies.

Inflation in the advanced countries has remained fairly muted alongside monetary policy tightening and lower oil prices since August 2006. Inflationary pressures in major emerging-market economies also remained well contained, although in China and India inflation accelerated notably in recent quarters. With output gaps narrowing and domestic demand in some instances rising as a consequence of higher asset prices, monetary policy has been tightened since the beginning of 2007 by central banks in countries such as China, the Czech Republic, Denmark, the euro area, India, Japan, Mexico, New Zealand, Poland, Sweden, Switzerland, Taiwan and the United Kingdom.

Central bank policy rates



After increasing rates during 2006, central banks in Australia, Canada, Hong Kong, Hungary, Malaysia, South Korea and the US have left policy rates unchanged so far in 2007. By contrast, some emerging-market countries, including Brazil, Chile, Indonesia, Israel, Russia and Thailand, eased their policy rates in the early part of 2007.

Current account[2]

A substantial decline in crude oil imports more than compensated for a decrease in mining exports in the first quarter of 2007. South Africa's trade deficit subsequently narrowed from R65,6 billion in the fourth quarter of 2006 to R50,9 billion in the first quarter of 2007. While the improvement in the trade deficit was partly countered by a further widening of the deficit on the country's services and income account with the rest of the world, the current-account deficit nevertheless shrank from R143,0 billion in the fourth quarter of 2006 to R131,0 billion in the first quarter of 2007. As a ratio of gross domestic product, the deficit shrank from 7,8 per cent to 7,0 per cent over the period.

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

Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2006					2007
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Merchandise exports	326,1	369,7	425,7	472,6	398,5	466,8
Net gold exports	29,3	33,7	39,4	39,5	35,5	37,3
Merchandise imports	-386,4	-444,4	-497,7	-577,7	-476,5	-555,0
Trade balance	-31,0	-41,0	-32,6	-65,6	-42,5	-50,9
Net service, income and current transfer payments	-73,8	-60,8	-67,3	-77,4	-69,9	-80,1
Balance on current account	-104,8	-101,8	-99,9	-143,0	-112,4	-131,0
As percentage of gross domestic product	*-6,4*	*-6,1*	*-5,7*	*-7,8*	*-6,5*	*-7,0*

The value of *merchandise exports* lost some vigour in the first quarter of 2007 and contracted by 1 per cent to R466,8 billion. The decline in export values could mainly be attributed to a reduction of 3 per cent in the physical quantity of merchandise exports. Mining and mineral exports in particular were negatively affected, as the South African mining industry faced various challenges in the opening months of 2007. These ranged from a loss of production due to scheduled maintenance on aluminium smelters and strikes at certain platinum mines to logistical problems related to the transportation of coal to South African harbours. These setbacks were, however, partly offset by an

Composition of visible exports

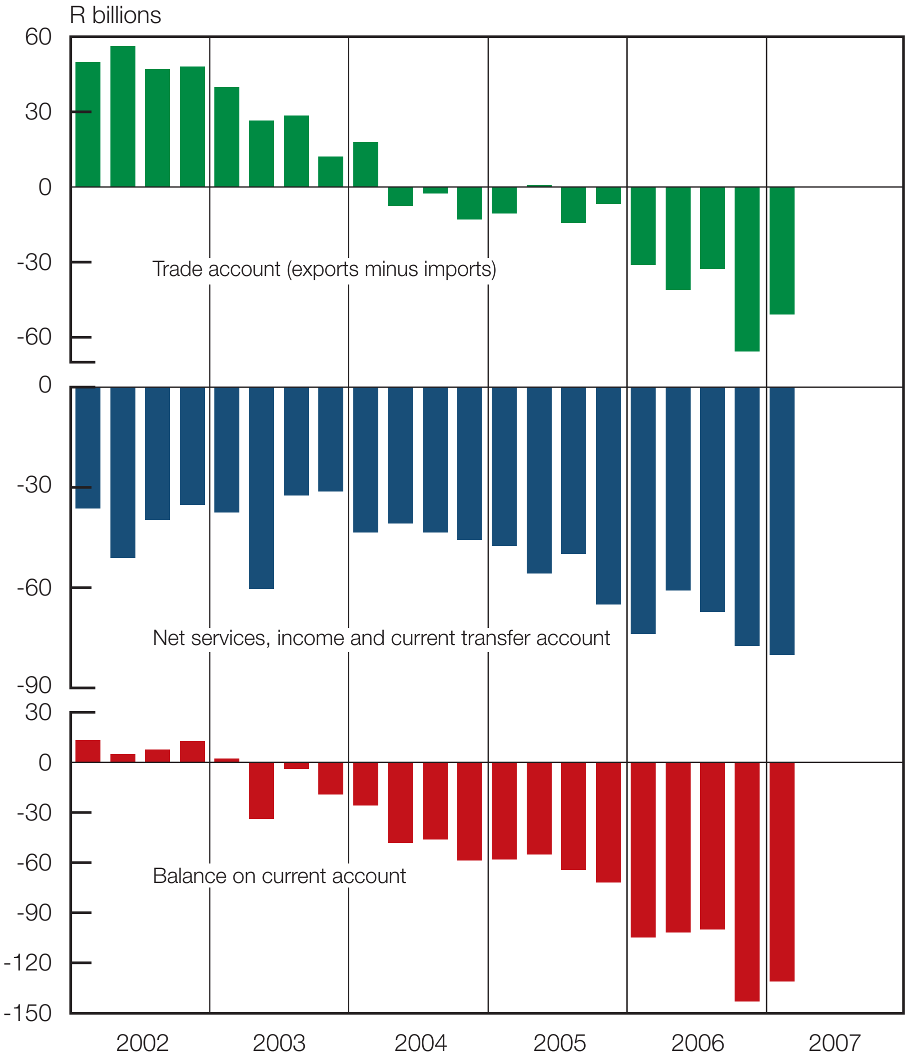
Seasonally adjusted and annualised

increase in the volume of manufactured exports, in turn probably encouraged by the sustained growth in the world economy and the more competitive level of the exchange rate of the rand from around mid-2006. The volume of exported agricultural products, especially vegetable products, also increased somewhat in the first quarter of 2007.

The impact of the decline in the volume of exported goods was partly offset by an increase of about 2 per cent in the rand prices of such goods as the dollar price of international commodities rebounded in the first quarter of 2007. In dollar terms, international commodity prices rose by 6½ per cent from the fourth quarter of 2006 to the first quarter of 2007.

Having remained broadly unchanged in the third and fourth quarters of 2006, the physical quantity of net *gold exports* shrank by 9½ per cent in the first quarter of 2007. This decline in production was partly offset by a 4½-per-cent increase in the average realised price of gold. The value of net gold exports accordingly fell by 5½ per cent over the period. On the London market, the fixing price of gold rose by 6 per cent to a new all-time-high quarterly average of US$650 per fine ounce in the first quarter of 2007 before rising further to US$673 per fine ounce in April and May.

Balance of payments: Current account



Seasonally adjusted and annualised

From an exceptionally high base in the fourth quarter of 2006, a decline in the volume of imported goods together with a marginal drop in import prices caused the value of *merchandise imports* to decrease by 4 per cent to R555,0 billion in the first quarter of 2007. The lower value of merchandise imports in the first quarter of 2007 reflected a decline in crude oil imports which was partly countered by a further moderate increase in the value of machinery and electrical equipment, and vehicles and transport equipment.

The volume of merchandise imports, which had grown unabatedly throughout 2006, receded by 3 per cent in the first quarter of 2007. This decline could be attributed to a decrease in the quantity of imported crude oil, which more than offset an increase of 1 per cent in the volume of non-oil merchandise imports. Non-oil imports included the acquisition of a second submarine by general government during the period. Notwithstanding the decline in overall merchandise import volumes, the country's import penetration ratio remained on a relatively high level of 27,9 per cent over the period. The marginal strengthening of the rand, together with the lower international price of crude oil, caused the rand prices of imported goods to decline by almost 1 per cent in the first quarter of 2007.

The negative imbalance on the net service, income and current transfer account widened steadily from R77,4 billion in the fourth quarter of 2006 to R80,1 billion in the first quarter of 2007. As a ratio of gross domestic product, the deficit on the services account amounted to 4,3 per cent. The larger shortfall stemmed mainly from increased net income payments to non-resident investors in the first quarter of 2007. Interest payments, in particular, rose by 13½ per cent following a strong increase in loans and trade credit extended by foreign creditors to the domestic private sector and public corporations. Interest payments were further affected by the acquisition of debt securities by non-resident investors during 2006. These payments were partially neutralised by lower net payments for freight and insurance services owing to the reduction in merchandise imports.

Higher commodity export prices alongside receding import prices gave rise to a moderate improvement in South Africa's terms of trade in the first quarter of 2007.

Financial account

Positive sentiment towards emerging-market economies in general continued in the first quarter of 2007. South Africa accordingly recorded a surplus on the financial account of

Net financial transactions not related to reserves
R billions

	2006					2007
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Change in liabilities						
Direct investment	8,4	3,8	-0,3	-14,0	-2,1	3,8
Portfolio investment	52,9	36,0	23,9	31,5	144,3	24,5
Other investment	15,2	27,5	17,4	1,0	61,1	3,3
Change in assets						
Direct investment	-2,2	-9,1	-35,0	1,1	-45,2	-1,4
Portfolio investment	-3,4	-3,3	-2,5	-4,5	-13,7	-3,7
Other investment	-44,0	-16,9	14,9	2,9	-43,1	13,2
*Total financial transactions**	*32,3*	*28,5*	*36,4*	*43,0*	*140,8*	*32,7*

* Including unrecorded transactions

the balance of payments for the sixteenth consecutive quarter. Net inflows of capital were registered in all three main functional investment categories, resulting in a surplus of R32,7 billion in the first quarter of 2007 compared with a surplus of R43,0 billion in the fourth quarter of 2006.

Foreign-owned assets in South Africa

Foreign direct investment into South Africa recorded an inflow of R3,8 billion in the first quarter of 2007 following capital outflows in the third and fourth quarters of 2006. Whereas the outward movement of capital in the fourth quarter of 2006 partly reflected the partial repayment of loans previously extended by foreign direct investors to direct investment enterprises in South Africa, the inflow of capital in the first quarter of 2007 primarily comprised loans granted to direct investment enterprises.

Foreign portfolio investors increased their holdings of mainly South African equity securities in the first quarter of 2007. The inflow of capital through the JSE Limited was supplemented by the share placement of a South African mining enterprise abroad. At the same time, foreign investment in South African debt securities on the domestic secondary market was more than neutralised by the redemption of a rand-denominated domestic bond as well as the early repayment of part of a Yankee bond by the South African government. Portfolio investment into the country nevertheless recorded a sizeable inflow of R24,5 billion in the first quarter of 2007 compared with an inflow of R31,5 billion in the fourth quarter of 2006.

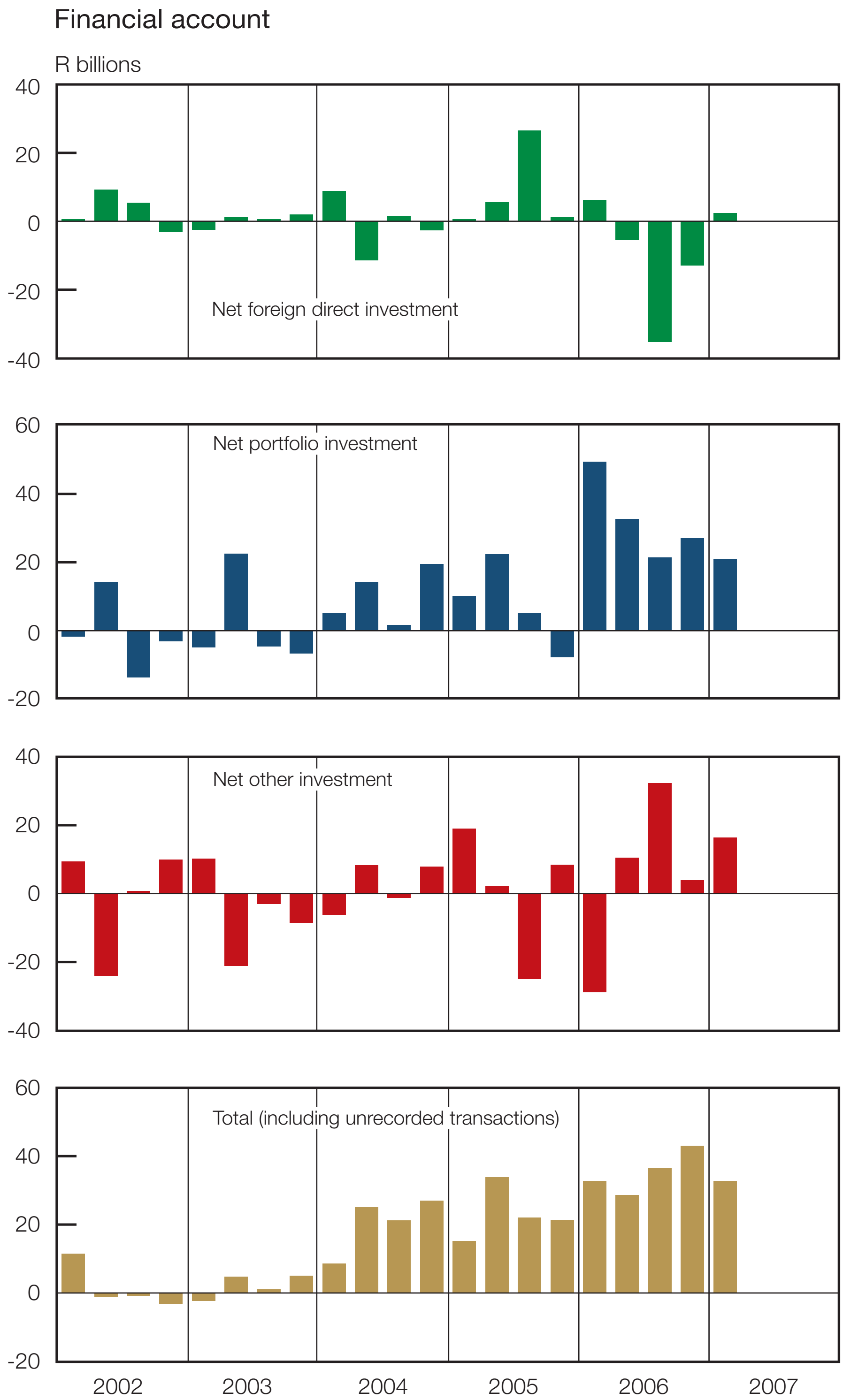
Other investment into South Africa showed an inflow of R3,3 billion in the first quarter of 2007 compared with an inflow of R1,0 billion in the fourth quarter of 2006. The recent inflows could be attributed to increased drawings on short-term loans by the banking sector which outpaced a decline in non-resident foreign-currency deposits with South African banks and the repayment of short-term foreign bridging finance. An accrued payment, related to Southern African Customs Union (SACU) commitments, by the government also countered the inflow in this category.

South African-owned assets abroad

Outward direct investment recorded an outflow (i.e. an increase in direct investment assets) of R1,4 billion in the first quarter of 2007 after registering an inflow of R1,1 billion in the fourth quarter of 2006. The outward movement of capital in the first quarter of 2007 reflected the acquisition of foreign direct investment enterprises by South African investors. The outflow of investment capital was partly offset by the redemption of loan capital previously extended by the South African parent companies to their direct investment enterprises in the rest of the world.

Portfolio investment abroad by South African entities recorded a further outflow of R3,7 billion in the first quarter of 2007 as institutional investors and private individuals continued to accumulate foreign portfolio assets. The outflow of capital amounted to R4,5 billion in the fourth quarter of 2006.

Other outward investment from South Africa recorded an inflow (i.e. a reduction in other investment assets) of R13,2 billion in the first quarter of 2007 following an inflow of R2,9 billion in the fourth quarter of 2006. In particular, deposits of the South African banking sector with non-resident banks declined significantly over the period. Private-sector companies also reduced their holdings of other foreign short-term assets in the first quarter of 2007.



Foreign debt

South Africa's total outstanding foreign debt increased by US$2 billion from US$55,1 billion at the end of the third quarter of 2006 to US$57,1 billion at the end of the fourth quarter. In particular, the country's rand-denominated debt increased by US$1,6 billion due to non-resident investors' net purchases of domestic bonds over the period. The country's outstanding foreign-currency denominated debt, which had increased unabatedly during the first three quarters of 2006, remained broadly unchanged at US$35,8 billion at the end of the fourth quarter of 2006.

Foreign debt of South Africa
US$ billions at end of year

	2006			
	1st qr	2nd qr	3rd qr	4th qr
Foreign-currency denominated debt ..	**29,7**	**33,1**	**35,4**	**35,8**
Bearer bonds	10,1	10,7	10,5	10,5
Public sector	4,5	4,6	4,8	5,2
Monetary sector	8,6	10,1	10,7	10,3
Non-monetary sector	6,5	7,7	9,4	9,8
Rand-denominated debt	**23,3**	**22,0**	**19,7**	**21,3**
Bonds	6,5	6,0	6,3	7,5
Other	16,8	16,0	13,4	13,8
Total	**53,0**	**55,1**	**55,1**	**57,1**

Measured in rand, South Africa's foreign debt declined from R424 billion at the end of September 2006 to R397 billion at the end of December. The decrease in rand terms can mainly be attributed to the appreciation of the rand in the fourth quarter of 2006.

As a result of the increase in the total external debt during 2006, the ratio of external debt to gross domestic product advanced from 19,1 per cent at the end of 2005 to 22,4 per cent at the end of 2006. Over the same period the ratio of total external debt to total export earnings increased from 64,9 per cent to 69,5 per cent.

The table below shows that South Africa's ratio of total external debt to gross domestic product has been relatively stable around the 20-per-cent level and compares favourably with similar ratios for other emerging and developing markets. While the ratios for South Africa and central and eastern Europe have increased recently, in part due to rising current-account deficits, some other emerging-market groupings have lowered their external debt relative to gross domestic product considerably over the past five years. In the case of the Commonwealth of Independent States this can primarily be attributed to large current-account surpluses, while debt forgiveness has played an important role in Africa and the western hemisphere.

Ratio of foreign debt to gross domestic product: Emerging-market and developing countries
Per cent at end of period

	2001	2002	2003	2004	2005	2006	Current-account balance 2006**
Africa*..	61,9	60,4	54,0	46,9	37,0	28,1	2,2
Sub-Saharan Africa*	67,0	65,2	58,1	51,1	40,0	30,9	-1,3
South Africa..............................	**26,2**	**29,7**	**22,9**	**20,1**	**19,1**	**22,4**	**-6,5**
Central and eastern Europe........	52,9	52,7	53,7	54,0	49,9	52,9	-6,7
Commonwealth of Independent States	45,7	43,1	41,8	36,3	33,5	30,0	7,7
Developing Asia..........................	27,7	25,7	23,7	22,1	20,2	19,1	5,4
Middle East	25,4	26,1	25,2	25,3	23,6	24,0	18,1
Western hemisphere*	39,6	44,1	43,7	38,2	29,5	24,6	1,7

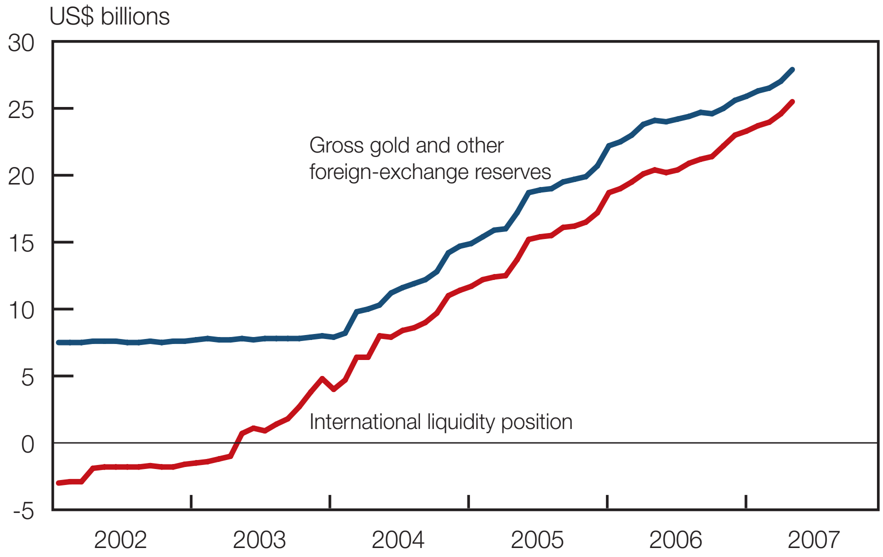
* After adjustment for debt forgiveness
** Per cent of gross domestic product

Source: IMF, *World Economic Outlook*, April 2007

International reserves and liquidity

South Africa's overall balance of payments (i.e. the change in the country's net international reserves due to balance-of-payments transactions) recorded a surplus of R5,7 billion in the first quarter of 2007 as the net inflows on the financial account of the balance of payments continued to finance the shortfall on the current account. This net accumulation was less than the R7,7 billion recorded in the fourth quarter of 2006.

Gross reserves and international liquidity position of the South African Reserve Bank



Measured in US dollars, the value of the gross gold and other foreign reserves of the South African Reserve Bank (i.e. the international reserves before accounting for reserve-related loans) increased from US$25,6 billion at the end of December 2006 to US$26,5 billion at the end of March 2007 and further to US$27,9 billion at the end of May. The Bank's short-term credit facilities utilised simultaneously declined from US$2,8 billion at the end of December 2006 to US$2,5 billion at the end of May.

The country's international liquidity position increased from US$23,0 billion at the end of December 2006 to US$24,0 billion at the end of March 2007 and US$25,5 billion at the end of May.

Exchange rates

On balance, the nominal effective exchange rate of the rand declined by 4,4 per cent during the first quarter of 2007, compared with a 7,7-per-cent increase in the fourth quarter of 2006. The domestic market for foreign exchange experienced some volatility in the first quarter of 2007 following a reassessment of risk towards emerging-market economies, movements in commodity prices, periodic nervousness regarding the size of the current-account deficit, a sharp correction in the Chinese stock exchange and a report of a proposed windfall tax on the entire South African resources industry.

The exchange value of the rand recovered somewhat during April 2007, partly as a result of further US dollar weakness following weaker-than-expected US gross domestic product data for the first quarter of 2007 and expectations of a further domestic interest rate increase in response to higher-than-expected South African inflation data. Positive sentiment resulting from the shareholder approval of the proposed foreign acquisition of a large South African retail group and stronger commodity prices also supported the exchange rate of the rand.

Exchange rates of the rand
Percentage change

	30 Jun 2006 to 30 Sep 2006	30 Sep 2006 to 29 Dec 2006	29 Dec 2006 to 30 Mar 2007	30 Mar 2007 to 31 May 2007
Weighted average*	**-7,2**	**7,7**	**-4,4**	**0,9**
Euro	-7,0	6,2	-5,0	0,4
US dollar	-7,3	10,5	-4,0	1,4
British pound	-9,2	5,2	-3,7	0,4
Japanese yen	-4,6	11,3	-4,7	4,5

* Against a basket of 13 currencies

The average daily turnover in the domestic market for foreign exchange increased from US$14,6 billion in the fourth quarter of 2006 to US$15,3 billion in the first quarter of 2007 mainly as a result of non-resident investors' participation in the South African securities markets. The value of transactions in which non-residents participated accordingly increased from US$10,6 billion per day to US$11,9 billion over the period.

Daily nominal effective exchange rate of the rand

The real effective exchange rate of the rand declined by 14,4 per cent in the twelve months to March 2007, leading to a substantial increase in the competitiveness of South African exporters in international markets.

Monetary developments, interest rates and financial markets

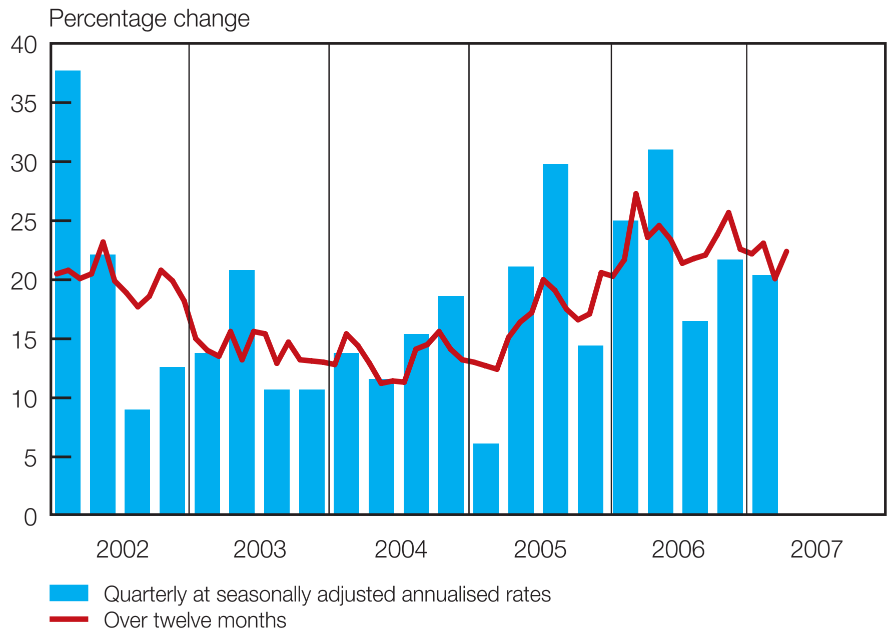
Money supply[3]

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

Growth in the broadly defined money supply (M3) maintained a robust pace in the first quarter of 2007. This was partly a reflection of the increase in the deposits of the non-bank private sector arising from the capital redemption and coupon interest payments on government bonds at the end of February 2007. Growth was also supported by buoyant turnover in the financial markets and sustained wealth effects emanating from rising prices of financial assets and real estate.

The annualised quarterly growth in M3 decelerated marginally from 21,7 per cent in the fourth quarter of 2006 to 20,4 per cent in the first quarter of 2007. Measured over twelve months, growth in M3 decelerated moderately from 22,5 per cent in December 2006 to 20 per cent in March 2007 but accelerated again to 22,3 per cent in April.

Growth in M3



Strong growth in M3 was equally evident in the narrower monetary aggregates with the exception of M2, where growth decelerated markedly partly due to a high base in the previous quarter.

The maturity structure of the public's holdings of M3 deposits shifted in favour of long-term deposits in the final quarter of 2006 and especially in the first quarter of 2007. This was consistent with the higher interest rates offered on these deposits and desire among some depositors to lock in such higher rates for longer periods. Conversely, growth in notes and coin in circulation decelerated considerably in the first quarter of 2007.

The corporate sector's deposit holdings continued to rise robustly in the first quarter of 2007 alongside precautionary and speculative motives for holding monetary assets. This sector contributed 83 per cent to the overall increase in money supply during the first quarter of 2007. Within the corporate sector it was especially the financial companies that built up their deposit holdings.

Growth in M3 by maturity category

Per cent at seasonally adjusted annualised rates

Component	2006			2007
	2nd qr	3rd qr	4th qr	1st qr
Notes and coin	21,1	13,8	15,1	1,8
Cheque and transmission deposits	6,7	16,9	22,9	22,3
Short and medium-term deposits	17,1	12,1	35,1	4,0
Long-term deposits	72,0	-3,8	40,3	121,6

The annualised growth in M3 exceeded growth in nominal gross domestic product by 9,2 percentage points in the first quarter of 2007. Consequently, the income velocity of circulation of M3 declined from 1,38 in the fourth quarter of 2006 to 1,35 in the first quarter of 2007.

M3 rose by R98,1 billion from the end of the fourth quarter of 2006 to the end of the first quarter of 2007. The statistical counterparts of changes in M3 are presented in the table below.

Counterparts of change in M3

R billions

	4th qr 2006	1st qr 2007
Net foreign assets	1,5	-11,1
Net claims on the government sector	-9,6	26,3
Claims on the private sector	73,1	74,7
Net other assets and liabilities	0,4	8,2
Total change in M3	65,3	98,1

Banks' claims on the private sector recorded the strongest increase among the counterparts during the first quarter of 2007. Net claims on the government sector were bolstered by the redemption and coupon interest payments on government bonds at the end of February 2007, which reduced government deposits with the monetary sector.

Credit extension

Strong business and consumer confidence alongside contained levels of debt servicing costs, rising income levels and positive wealth effects continued to support firm growth in banks' total loans and advances[4] extended to the private sector during the first quarter of 2007. Nevertheless, during this quarter growth in loans and advances was restrained somewhat by securitisation to the value of R8,7 billion involving some of the banks' mortgage books.

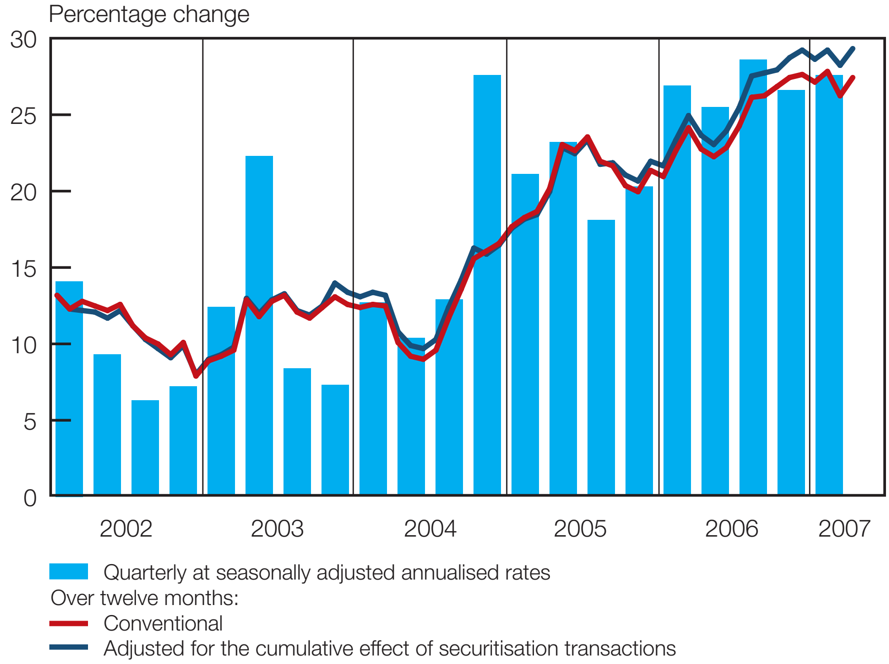
Having fluctuated above 27 per cent from November 2006, twelve-month growth in total loans and advances moderated slightly to 26,3 per cent in March 2007 but accelerated

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

to 27,4 per cent in April. Adjusted for the cumulative effect of securitisation transactions, twelve-month growth remained around 29 per cent over the same period.

Quarter-to-quarter growth in total loans and advances remained around 27 per cent in the fourth quarter of 2006 and the first quarter of 2007. Banks' loans and advances extended to the private sector increased by R80 billion in the first quarter of 2007 with all credit categories recording significant increases. Asset-backed credit accounted for 53 per cent of the overall increase while other loans and advances explained the remainder.

Total loans and advances to the private sector



Within asset-backed credit, *mortgage advances* remained exceptionally strong despite the securitisation transactions referred to earlier. Measured over twelve months, growth in mortgage advances remained around 30 per cent from February 2006 but decelerated to 27,6 per cent in April 2007. Adjusted for the cumulative effect of securitisation transactions, growth remained around 31 per cent.

Changes in credit aggregates

R billions

	4th qr 2006	1st qr 2007
Mortgage advances	44,1	31,2
Instalment sale credit and leasing finance	10,1	11,4
Other loans and advances	28,8	37,2
Overdrafts	4,7	10,4
Credit card advances	4,3	4,1
General advances	19,8	22,7
Total loans and advances	**83,0**	**79,8**
Of which: To household sector	30,1	40,1
To corporate sector	52,9	39,7

Brisk increases in *instalment sale credit and leasing finance* continued to support the strong growth in domestic expenditure during the first quarter of 2007. This credit category is directed at financing expenditure on motor vehicles and other durable goods. Its rate of growth over twelve months accelerated from 15,8 per cent in December 2006 to 16,9 per cent in April 2007.

Other loans and advances was dominated by the corporate sector's use of overdrafts and general advances, and maintained robust momentum in the first quarter of 2007. Growth over twelve months accelerated from 30,2 per cent in December 2006 to 32,3 per cent in April 2007.

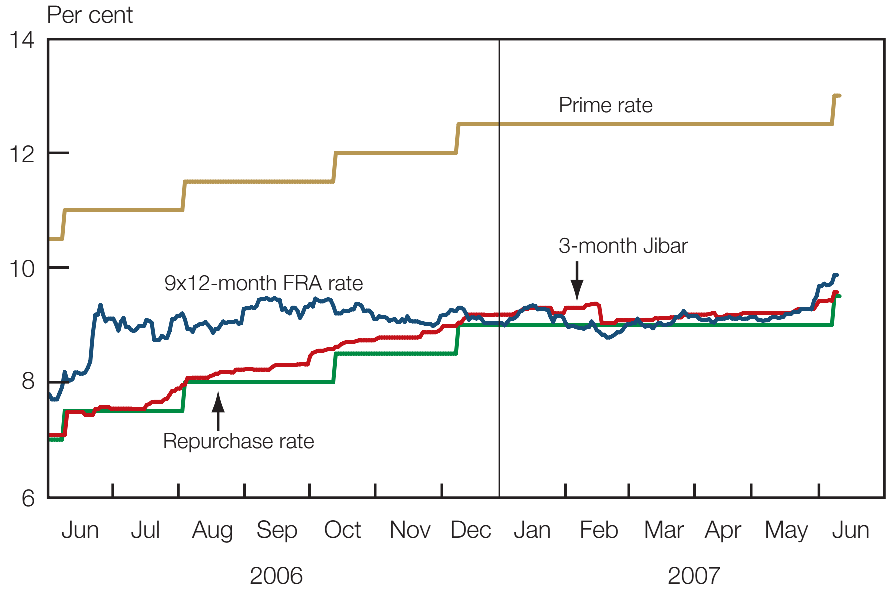
In recent years banks' non-performing loans have remained low, both in absolute terms and as a percentage of total loans and advances. Rising income levels, positive wealth effects and moderate levels of interest rates have contributed to this state of affairs, which was also conducive to a continued expansion in bank lending. Some components of lending could be affected by the full introduction of the National Credit Act on 1 June 2007.

Interest rates and yields

While the Monetary Policy Committee (MPC) noted a moderate deterioration in the inflation outlook between February and April 2007, the repurchase rate was left unchanged at both the February and April meetings. However, in June the MPC identified various upside risks which may lead to a further deterioration in the inflation outlook and accordingly increased the repurchase rate to 9,5 per cent. The June 2007 MPC statement discussing the developments underlying the decision at that time is reproduced in full elsewhere in this *Bulletin*.

Other money-market interest rates generally edged higher during the first five months of 2007, mainly on account of movements in the exchange rate and international oil prices. The three-month Johannesburg Interbank Agreed Rate (Jibar), for instance, increased by 19 basis points from 9,18 per cent at the beginning of January 2007 to 9,37 per cent on 14 February 2007. On balance, it fluctuated higher and amounted to 9,57 per cent on 8 June 2007 following the adjustment in the repurchase rate.

Money-market rates



Rates on forward rate agreements (FRAs) displayed more pronounced movements with the 9x12-month FRA rate, for instance, receding from 9,34 per cent in mid-January 2007 to 8,78 per cent on 19 February 2007. Subsequently, this FRA rate fluctuated higher to 9,72 per cent on 7 June as the market increased its focus on the risks to the domestic inflation outlook and harboured expectations of an imminent increase in the repurchase rate. It increased futher to 9,87 per cent on 8 June following an increase in the repurchase rate.

To improve the functioning of the domestic money market, the Bank introduced new benchmark interest rates on banks' overnight funding during March 2007. The new rates, namely the South African Benchmark Overnight Rate on deposits (Sabor) and the implied rate on one-day rand funding in the foreign-exchange swap market (Overnight FX rate) replaced the South African Overnight Index Average (Saonia) rate and other overnight interest rates calculated and published by the Bank. (This aspect is discussed in more detail in the accompanying box.)

Benchmark overnight funding rates

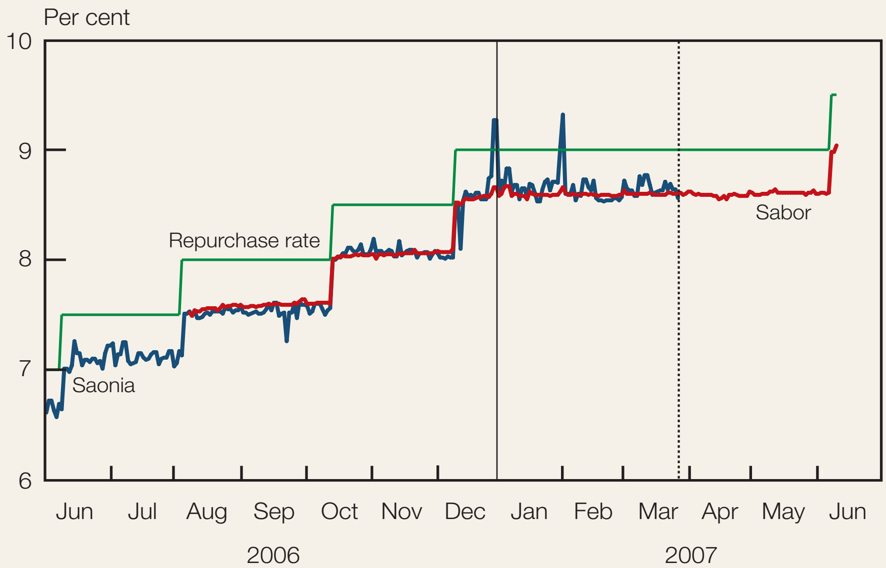
Following a test period which started on 7 August 2006, the Bank discontinued and replaced the previous overnight interbank rates with new benchmark call rates, with effect from 27 March 2007.[5]

5 For further reading on the changes which were introduced, the reader is referred to the SARB website address: http://www.reservebank.co.za

Discontinued rates	New rates
South African Overnight Interbank Average (Saonia)	South African Benchmark Overnight Rate on deposits (Sabor)
Saonia+	–
Foreign exchange forward rate	Overnight foreign exchange rate
Carry rate	–

The South African Benchmark Overnight Rate on deposits (Sabor), replaced the South African Overnight Interbank Average (Saonia) and the Saonia+ (as depicted in the graph below), while the overnight foreign exchange rate replaced both the foreign exchange forward rate and the carry rate.

Benchmark overnight rates and repurchase rate



The replacement of the four discontinued overnight rates with two new less volatile rates was the result of a number of deficiencies which had been identified in the former rates. The deficiencies had prevented these rates from becoming true benchmark reference rates for pricing in the overnight portion of the money market as well as providing a link through which monetary policy is executed, as was originally intended.

The new and improved benchmark rates aim to address these shortcomings, and consequently reflect a broader base to include interbank funding, non-bank wholesale funding and currency overnight funding.

In addition, measures have been put in place to improve the credibility of these new rates in an attempt to increase reliability and decrease the ability of a single institution to influence them. These developments, set to provide an improved and credible benchmark for funding available on demand, are seen as a stride forward in enhancing efficiency at the shorter end of the money market.

By N Nhlapo and G Setou

Since their inception on 27 March 2007, both the Sabor and the Overnight FX rate have displayed limited volatility, with the Sabor fluctuating within a narrow range of 8,55 per cent to 8,62 per cent over the review period. Following the increase in the repurchase rate on 8 June 2007, the Sabor increased by 37 basis points to 8,98 per cent.

Following the further tightening of the monetary policy stance in December 2006, both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private-sector banks increased by 50 basis points to 12,5 per cent and remained at this level in the subsequent months to May 2007. Both rates were raised by a further 50 basis points after the MPC increased the repurchase rate in early June.

The *predominant rate on twelve-month fixed deposits* offered by the private-sector banks reached 8,5 per cent in January 2007 – its highest level since July 2003 – before receding marginally to 8,4 per cent in March, remaining unchanged in the subsequent months to May.

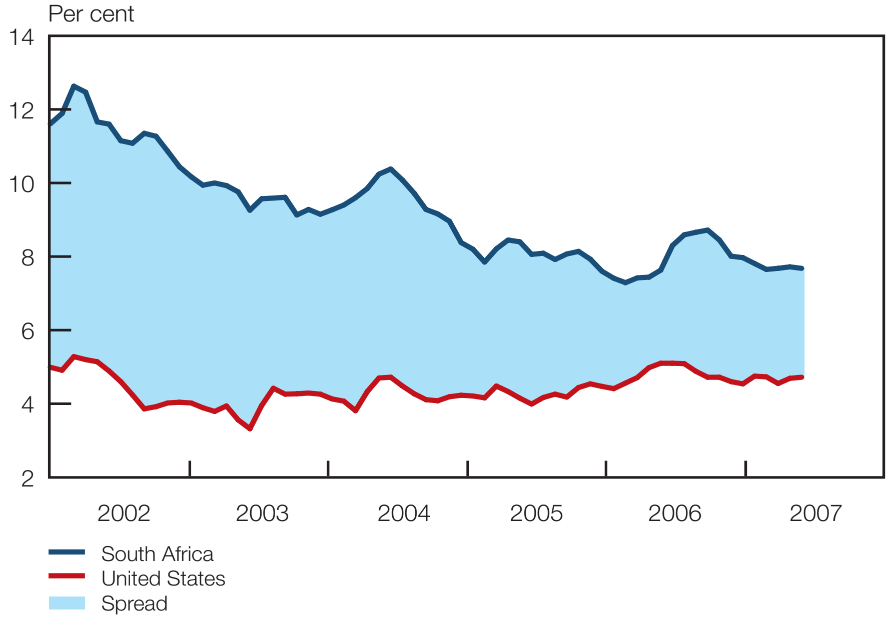
The *standard interest rate* on loans granted by the government from the State Revenue Fund as defined in the Public Finance Management Act, increased from 11 to 12 per cent on 1 January 2007. The *official rate of interest* applicable to fringe benefit taxation, as defined in the Income Tax Act, was raised from 9 to 10 per cent with effect from 1 March 2007.

On 5 March 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 three percentage points to 23 per cent for amounts below R10 000 and to 20 per cent for amounts above R10 000, but not exceeding R500 000. This was the first increase since September 2004 and these percentages will henceforth be adjusted seven days after any change in the repurchase rate.

Priced off the yield curve, the rates of interest on the 2-year and 3-year *government retail bonds* have remained unchanged since August 2006 at 8,50 per cent and 8,75 per cent, respectively. However, the rate of interest on the 5-year bond was lowered from 9,00 per cent to 8,00 per cent on 1 March 2007 and remained at this level to May.

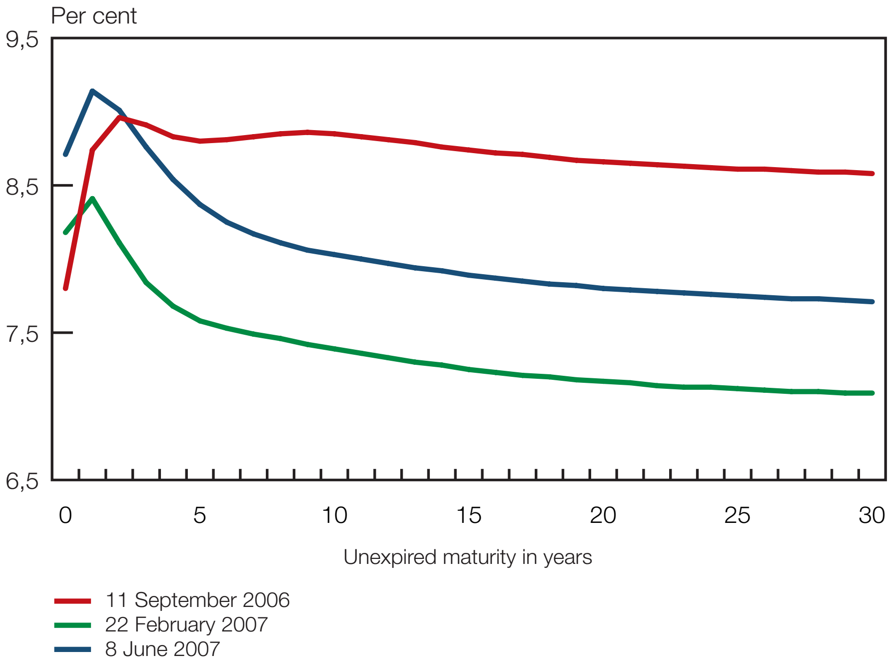
The *daily average yield on the R157 long-term government bond* (maturing in 2015) trended downwards from a high of 8,89 per cent on 11 September 2006. The long-term government bond yield declined to 7,48 per cent on 23 February 2007, alongside a stronger exchange value of the rand and projected lower supply of government bonds announced in the February 2007 Budget. Subsequently, the bond yield edged higher to 8,20 per cent on 8 June as the exchange value of the rand weakened and worse-than-expected inflation numbers were released. The daily closing yield on 10-year bonds of the United States government followed a similar trend during 2007, fluctuating around an average of 4,69 per cent in the first five months of 2007 and causing the spread between the South African R157 bond yield and the US 10-year bond yield to widen marginally from 294 basis points at the end of January 2007 to 306 basis points at the end of May.

Government bond yields



From September 2006, the level of the *yield curve* moved lower and became inverted from mid-October as the short end of the curve increased in accordance with the tighter monetary policy stance. The medium-to-longer end of the curve moved lower, probably as a result of projected lower bond supply, the appreciation in the exchange value of the rand and expectations that inflation would remain within the target range of 3 – 6 per cent over the longer term. From the end of February 2007, bond yields across the entire maturity spectrum responded to the weakness in the exchange value of the rand and higher inflation by moving higher, resulting in an upward movement in the yield curve to 8 June. The *yield gap*, measured as the difference between the yields at the extreme long and short ends of the curve, widened from a negative 80 basis points on 5 March 2007 to a negative 100 basis points on 8 June.

Yield curves



The *break-even inflation rate*, as approximated by the difference between the nominal yield on conventional government bonds and the real yield on inflation-linked government bonds within the six-year maturity range, declined from 6,17 per cent on 11 September 2006 to 4,71 per cent on 23 February 2007, attributable to a firmer exchange value of the rand and favourable inflation figures released during this period. This measure of expected inflation then fluctuated upwards to reach 5,55 per cent on 8 June. Inflation expectations rose with the weaker exchange value of the rand alongside the tighter monetary policy stance in early June, leading to an increase in the yields on conventional bonds while real yields on inflation-linked bonds declined somewhat.

The *currency risk premium*[6] on South African government bonds widened from 197 basis points in January 2007 to 233 basis points in May as the yield on foreign-currency denominated South African bonds declined while the yield on South African domestic rand-denominated bonds increased.

After narrowing to a low of 169 basis points in December 2006, the yield differential as measured by the JP Morgan Emerging Markets Bond Index (EMBI+)[7] widened to 185 basis points in February 2007, before declining to a record low of 153 basis points in May. Benefiting from the general contraction of emerging-market bond spreads, the *sovereign risk premium* on South Africa's foreign-currency denominated bonds trading in international markets also narrowed from an average of 115 basis points in July 2006 to 67 basis points in May 2007. The sovereign risk premium is computed as the yield differential between the seven-year South African government US dollar-denominated bond and US government securities of similar maturity.

6 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 dollar-denominated debt issued in the United States market.

7 EMBI+ indicates total returns for external-currency denominated debt instruments of the emerging markets.

Money market

During the first five months of 2007, the amount of liquidity provided by the Bank at the weekly main refinancing tender varied between R11,1 billion and R14,7 billion. The average daily liquidity requirement of the private-sector banks fluctuated between R9,3 billion and R15,9 billion over the same period, occasionally breaching the upper and lower limit of the estimated weekly ranges. To square off the shortfall between the liquidity provided and the liquidity required, banks predominantly used their cash reserve accounts with the Bank and only occasionally utilised the standing facilities.

The major flows in money-market liquidity from January to May 2007 are summarised in the accompanying table.

Money-market liquidity flows

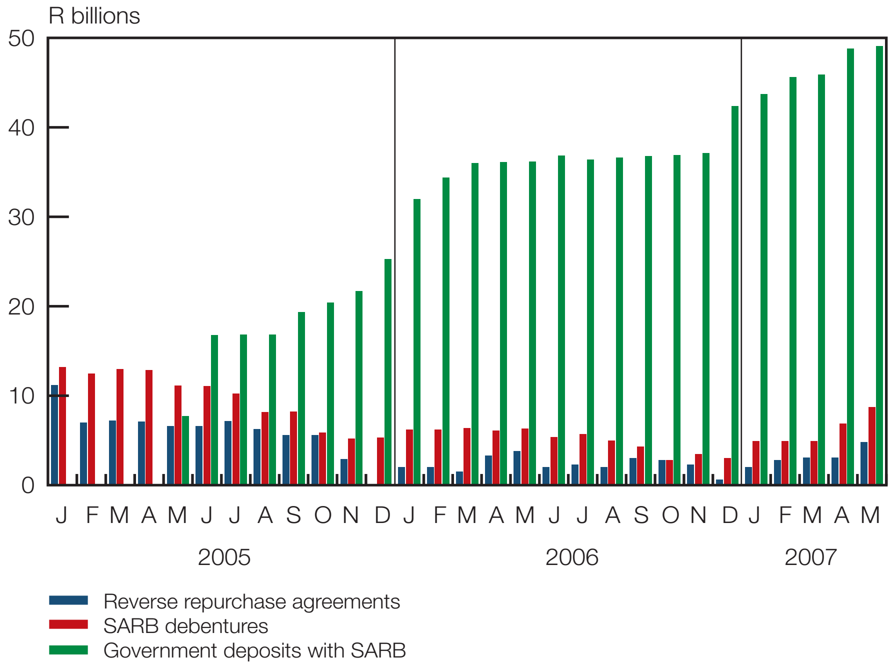
R billions (easing +, tightening -)

	Jan – Mar 2007	Apr – May 2007
Notes and coin in circulation	5,1	-0,5
Required cash reserve deposits	-1,9	-1,5
Money-market effect of SARB foreign-exchange transactions	7,4	15,9
Government deposits with SARB	-3,4	-3,5
SARB holdings of government bonds	- 0,1	0,0
Use of liquidity management instruments	-4,4	-5,5
Reverse repurchase transactions	-2,5	-1,7
SARB debentures	-1,9	-3,8
Other items net	-4,3	-3,0
Banks' liquidity requirement (decrease +; increase -)	-1,6	1,9

The purchase of foreign exchange from the market by the Bank expanded money-market liquidity by R23,3 billion in the five months to May 2007. The government increased its deposits with the Bank by R6,9 billion during the period under review, thereby draining some liquidity.

The amount of liquidity-draining instruments employed by the Bank was managed in such a way that factors impacting on money-market liquidity conditions were broadly offset. The outstanding amount of long-term reverse repurchase agreements and SARB debentures increased from R3,6 billion at the end of December 2006 to R13,5 billion at the end of May 2007. The accompanying graph illustrates the structure of and developments in money-market intervention instruments utilised.

Liquidity-draining operations: Outstanding balances



Following a decline of R6,4 billion in notes and coin in circulation outside the Reserve Bank during January and February 2007, an increase of R2,8 billion in cash in circulation was recorded during March and April, partly on account of increased demand during the Easter holiday period. Notes and coin eased liquidity by R1,0 billion in May 2007.

The amount of the Bank's monetary policy portfolio of government bonds remained unchanged at R7,5 billion during the period January to May 2007.

Bond market

The City of Johannesburg plans to launch the country's first municipal *retail bonds* in July 2007. The bonds, which are only available to Johannesburg Metro residents, will help to fund the city's expenditure programmes, and issues up to R1 billion have been authorised. The national government has raised R2,3 billion through its retail bonds since their launch in May 2004.

Public-sector borrowers' demand for funds in the domestic primary bond market declined in the first months of 2007. This was evident in the weekly supply of government bonds made available on auction which averaged only R375 million in the five months to May 2007, compared to an average of R650 million in the corresponding period of 2006. Net redemptions of fixed-interest securities amounted to R22,0 billion in the first five months of 2007 and included the repayment of the first of three tranches of the R194 government bond, namely the R007, which matured on 28 February 2007.

By contrast, the private sector continued sturdily to utilise the primary bond market for funding during 2007. The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (BESA) increased by R23,5 billion over a five-month period to reach R188,7 billion at the end of May, some 49 per cent higher than the amount in issue in May 2006. Of this amount net issues of asset-backed securities and collateral debt obligations accounted for 49 per cent, normal bond issues by banks accounted for 27 per cent and issues by non-bank private companies for the remainder.

The value of *commercial paper* listed on BESA increased by R13,8 billion in the twelve months to December 2006 and by a further R5,0 billion to May 2007. The total market capitalisation of BESA amounted to R825 billion in May 2007.

In May 2007, National Treasury maintained its presence in the international bond markets by issuing a US$1 billion 15-year bond with a coupon rate of 5,875 per cent at a spread of 120 basis points over the 10-year US Treasuries. Around R7 billion was raised through this issue.

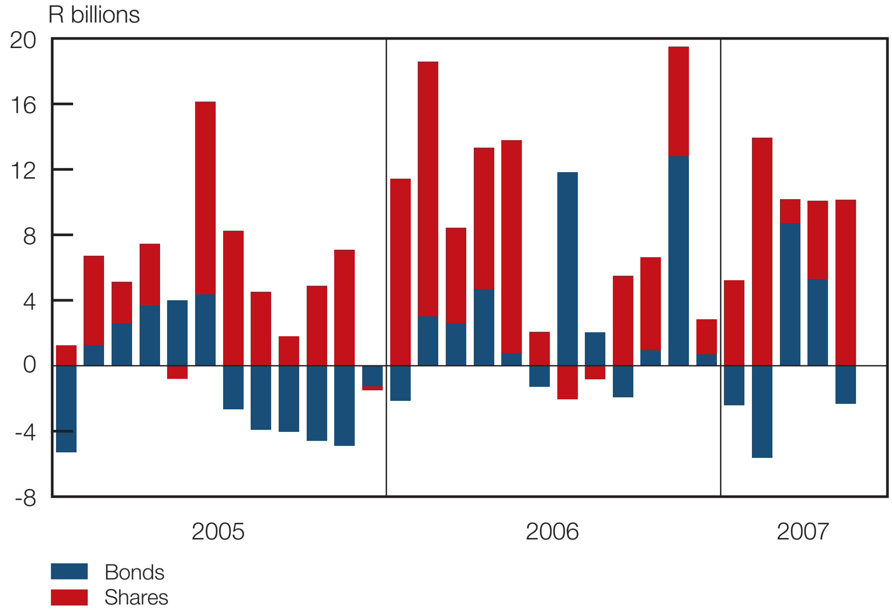
Improved liquidity conditions in the global financial markets led to increased issuance of *rand-denominated bonds in the European bond markets* from the second half of 2006. The appetite in this market can also be attributed to positive sentiment towards the rand and an overall positive performance by global fixed-income markets. During the first five months of 2007, gross issuance by residents and non-residents amounted to R7,7 billion, while R1,9 billion matured, bringing net issues to R5,8 billion, compared to the net amount of R5,0 billion raised in 2006 as a whole. For the first time since March 1999, a South African resident issued rand-denominated bonds in the offshore markets in April 2007, raising an amount of R0,9 billion. The type of credit issued remained predominantly AAA-rated, with maturities of up to five years.

Favourable foreign borrower appetite for rand-denominated bonds in the international bond markets was also reflected in the issuance of rand-denominated debt in the *Japanese Uridashi bond market*. The total nominal value of issues amounted to R4,2 billion in the first five months of 2007, significantly more than the R0,8 billion raised during the corresponding period of 2006.

Trading activity in the *domestic secondary bond market* continued at a sturdy pace in 2006 and early 2007, partly benefiting from the high levels of non-resident participation. Turnover on BESA of R6,4 trillion in the first five months of 2007 was 29 per cent more than in the corresponding period of 2006. The average value traded per day of around R55 billion in 2006, increased to an average of R62 billion in the first five months of 2007 and this included a record-high daily average turnover of R69 billion in February.

Non-residents were net purchasers of bonds to the amount of R34,1 billion in 2006. The renewed interest was more pronounced in the third and fourth quarters of 2006, when net purchases of respectively R12,0 billion and R14,5 billion were recorded. Non-residents were net sellers of bonds to the value of R8,1 billion in the first two months of 2007, before reverting to net purchases of R14,0 billion in March and April. Non-residents again became net sellers of bonds to the value of R2,3 billion in May. Cumulative net purchases of domestic debt amounted to R3,6 billion in the first five months of 2007. Non-resident participation, measured as the sum of their purchases and sales as a percentage of total purchases and sales of bonds, averaged 19 per cent in both 2006 and in the first five months of 2007.

Net purchases of shares and bonds by non-residents

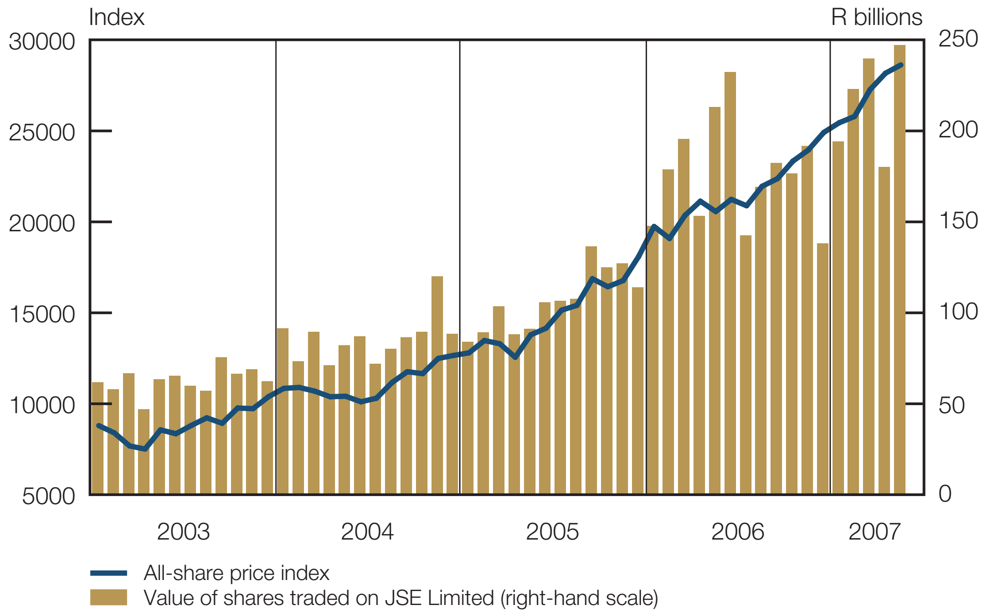


Share market

Companies listed on the JSE Limited (JSE) raised R46,8 billion in *equity capital in the domestic and international primary share markets* in the first four months of 2007, or 23 per cent more than the R38,0 billion raised in the corresponding period of 2006. Companies with primary listings on the JSE were mainly responsible for the capital-raising activity in the first four months of 2007. The resources sector accounted for 58 per cent of the funding while the industrial sector accounted for 28 per cent and the financial sector for 9 per cent.

Trading activity in the secondary share market remained vibrant in the first five months of 2007, buoyed by the continued upward trajectory in share prices. The value of

Turnover in the secondary share market



turnover amounted to R1,1 trillion in the first five months of 2007, 22 per cent higher than the turnover recorded in the corresponding period of 2006 but falling short of the 34-per-cent increase in average share prices between these two periods. From a daily average turnover of R7,1 billion in December 2006, turnover increased to a record high of R11,0 billion in March 2007, contributing to a daily average turnover of R10,1 billion in the first five months of 2007.

The total *market capitalisation* of the JSE reached new record levels in the first three months of 2007, increasing by 15 per cent from the end of December 2006 to an all-time high of R5 780 billion in March 2007, before declining slightly by 1 per cent to R5 730 billion in May. The World Federation of Exchanges ranked the market capitalisation of the JSE number 17 in the world league as at the end of March 2007. Market liquidity – the annualised turnover as a percentage of market capitalisation – fell somewhat from an average of 49 per cent in 2006 to 47 per cent over the first five months of 2007. For the first time since 1998 new listings exceeded de-listings in 2006: The strength of and confidence in the equity market led to 37 new listings of companies on the JSE, while the number of de-listings amounted to 24. However, in the first five months of 2007, only 11 new listings were recorded compared to the wave of 24 de-listings from the JSE, primarily as a result of suspensions and the acceleration in private equity buyouts. (A private equity buyout arises when an investor, usually in the form of a private equity fund, purchases all the shares of a listed company, thereby causing such company to de-list.)

The number of companies listed on *Alt^x*, the JSE's bourse for small to medium-sized companies, more than doubled from 15 at the end of December 2005 to 41 at the end of May 2007. The combined market capitalisation of all the companies listed on Alt^x increased uninterruptedly from R3,2 billion in August 2006 to a record high of R14,7 billion in May 2007. Turnover on Alt^x amounted to R2,0 billion in the first five months of 2007, 67 per cent more than the R1,2 billion traded in the whole of 2006. Liquidity on Alt^x nevertheless remained much lower than on the main board of the JSE.

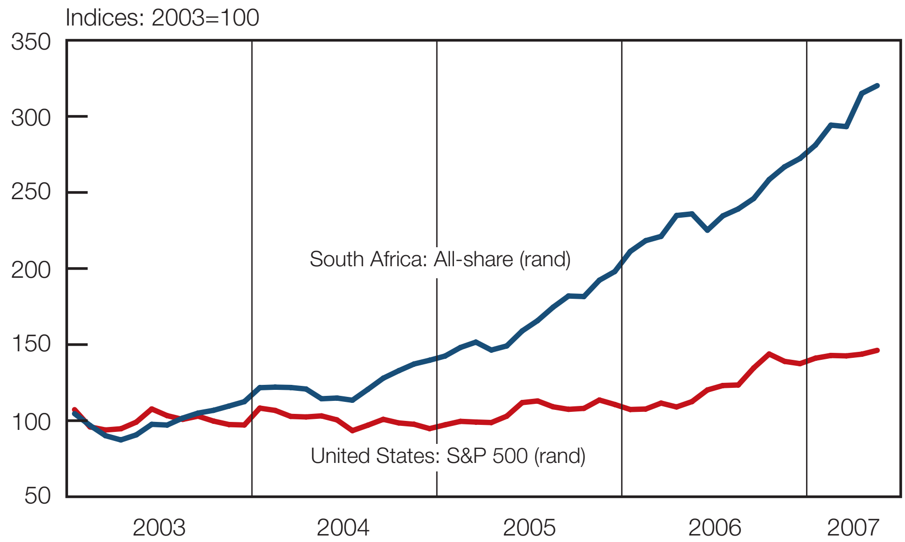
Non-residents' interest in the local share market continued unabated in 2006 as reflected in their net purchases of shares amounting to R73,7 billion during the year, and was followed by further net purchases of R35,5 billion in the first five months of 2007. In both 2006 and thus far in 2007, non-residents' participation, measured as their total purchases and sales of shares as a percentage of the total value of shares traded on the JSE, averaged 21 per cent.

The current bull-run in the share market is one of the longest and most robust in recent history, as share prices have soared by 283 per cent in the four years since their low point in April 2003. Priced in gold, the *daily closing level of the all-share price index* almost doubled from an average of 24 ounces of gold in April 2003 to 43 ounces in May 2007.

The index continued to fluctuate higher to reach successive record levels in early 2007, and broke through the 29 000 level in May. This was supported by robust economic growth prospects, upbeat global equity markets, strong commodity prices and positive growth in company profits. The upward momentum was temporarily interrupted from 26 February 2007 as the all-share price index declined by 7 per cent to 5 March in response to lower commodity prices and weaker global equity markets emanating from contagion effects of a decline in share prices in China. Subsequently, the all-share price index continued its upward trend, increasing by 17 per cent to an all-time high on 23 May alongside renewed increases in commodity prices and global equity prices, before declining by 3 per cent to 8 June.

The 2006/07 bull market was fairly widespread across all sectors. In 2006, the prices of resources and industrial shares increased by 41 per cent and 39 per cent, respectively, while financial shares lagged behind with an increase of 31 per cent. In the first five months of 2007, resources, industrial and financial share prices increased by 20 per cent, 13 per cent and 8 per cent, respectively. The general retailers share price index, a subcategory of the industrial index, rose by 19 per cent as it benefited from private equity deals proposed and concluded during this period. These, among other deals, included the R25 billion buyout of one of South Africa's fashion retailers by a US-based private equity company in April 2007.

Share prices



The performance of the South African share market surpassed those of developed markets during 2006 and early 2007. In US dollar terms, the all-share price index of the JSE increased by 44 per cent from 13 June 2006 to 8 June 2007 and outperformed both the FTSE All World Index and the Standard & Poor's 500 Index which respectively increased by 29 per cent and 23 per cent over the same period. However, in US dollar terms the performance of the MSCI Emerging Markets Index surpassed that of the all-share price index and increased by 51 per cent from 13 June 2006 to 8 June 2007.

The strong rise in share prices raised the historical *price-earnings ratio* of all classes of shares from 13,7 in May 2005 to 17,3 in January 2007 – its highest level since 1998. The price-earnings ratio then declined to 16,2 in May. Conversely, the dividend yield on all classes of shares decreased from 2,8 per cent in May 2005 to 2,2 per cent in May 2007. Similarly, the *earnings yield* on all classes of shares declined from a high of 7,3 per cent in May 2005 to 5,8 per cent in January 2007, as share prices rose more briskly than historical earnings, before increasing to 6,2 per cent in May.

Market for exchange-traded derivatives

Turnover in financial derivatives trading on the JSE was bolstered by the buoyant conditions in the underlying share market in the first five months of 2007. Boosted by high local grain prices, turnover in commodity futures and options doubled in the five months to May 2007, compared to the same period in 2006. Turnover in derivatives on the JSE for the first five months of 2007 is indicated in the table on the following page.

Turnover in warrants traded on the JSE lost momentum in the five months to May 2007, while turnover on interest rate derivatives traded on Yield-X increased slightly. BESA also facilitated the trading of listed derivatives with turnover on these instruments amounting to R16 million in the first five months of 2007, in comparison with R274 million in the corresponding period of 2006.

On 18 June 2007 the JSE commenced trading of rand currency futures as an outflow of the exchange control reforms announced in this year's Budget.

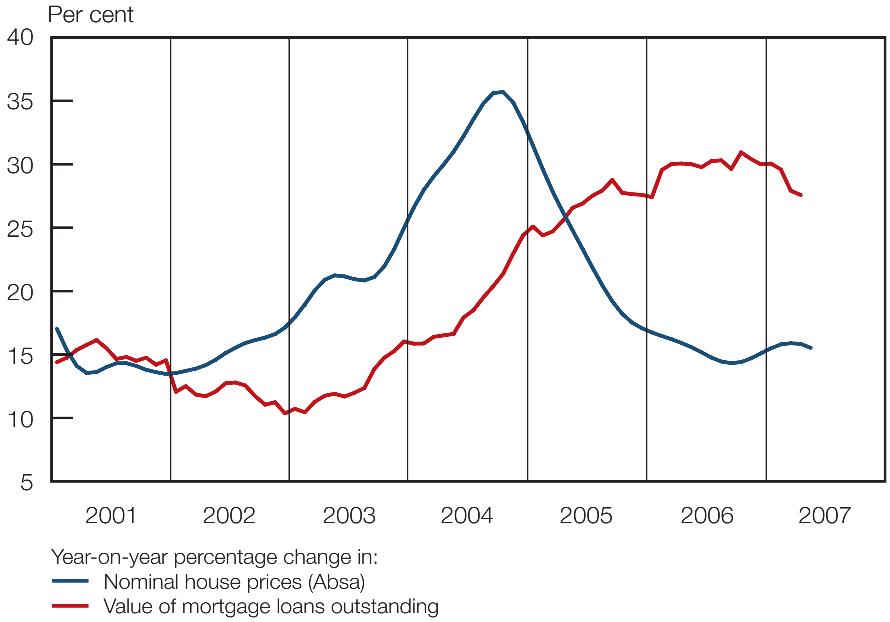
Derivatives turnover on the JSE, January to May 2007

	Change over one year	
	R billions	Per cent
Financial futures and options on futures	1418	44
Warrants	1	-68
Agricultural commodity futures and options	97	100
Interest rate derivatives	14	7

Real-estate market

The deceleration in the rate of increase in residential real-estate prices slowed from the end of 2006. The average year-on-year growth of residential property prices in the middle segment of the market, as measured by Absa, decelerated from 35,7 per cent in October 2004 to 14,3 per cent in September 2006, on the back of a simultaneous rise in the cost of mortgage finance and higher house prices. Thereafter it increased to 15,5 per cent in May 2007, bringing the average house price to R921 000. However, the month-on-month nominal growth in house prices decelerated from 1,6 per cent in December 2006 to 0,8 per cent in May 2007. Standard Bank reported more pronounced changes in the year-on-year rate of growth in the median price of all property which it financed, as reflected by a slowdown from 35,5 per cent in October 2004 to 7,4 per cent in April 2007, before accelerating to 11,1 per cent in May.

House prices



An analysis by price category indicates that the year-on-year rate of increase of residential property prices in the luxury market segment, as measured by Absa, decelerated significantly from 11,1 per cent in the third quarter of 2006 to only 7,6 per cent in the first quarter of 2007. By contrast, the corresponding rate of increase of house prices in the affordable houses category accelerated from 14,1 per cent in the third quarter of 2006 to 18,1 per cent in the first quarter of 2007.

House price changes in different price classes

	Percentage change over four quarters		
	3rd qr 2006	4th qr 2006	1st qr 2007
Affordable (40m^2 to 79m^2, below R193 000)	14,1	15,7	18,1
Middle segment (80m^2 to 400m^2, below R2,6 million)	14,5	14,8	15,5
Small (80m^2 to 140m^2, below R2,6 million)	15,6	13,6	12,6
Medium (141m^2 to 220m^2, below R2,6 million)	16,0	16,6	18,4
Large (221m^2 to 400m^2, below R2,6 million)	12,2	14,8	16,1
Luxury segment (between R2,6 million and R9,5 million)	11,1	9,6	7,6

Source: Absa

Non-bank financial intermediaries

The unit trust industry continued its strong growth in the first quarter of 2007. The market value of the net assets of the industry increased by 27 per cent from R452 billion in the second quarter of 2006 to R576 billion in the first quarter of 2007. Of the R124 billion increase over this period, some R24 billion or 19 per cent were real inflows into the industry. The market value of share holdings by unit trusts accounted for 6 per cent of the JSE market capitalisation. The market value of the share portfolio of the unit trust industry, for example, increased by 32 per cent from the second quarter of 2006 to the first quarter of 2007.

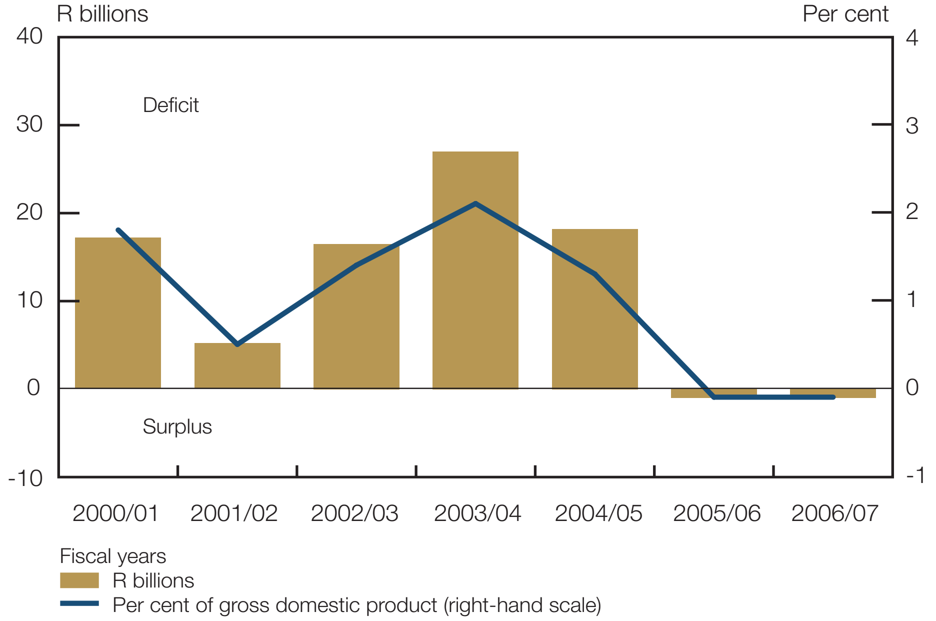
Public finance

Non-financial public-sector borrowing requirement[8]

As part of an accelerated infrastructure drive, major public corporations have stepped up their net investment in non-financial assets in recent quarters. This resulted in a significant change in the financial balance of the non-financial public enterprises and corporations, reverting from a surplus recorded in fiscal 2005/06 to a deficit in 2006/07.

8 *Calculated as the cash deficit of the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations.*

Non-financial public-sector borrowing requirement



The *non-financial public sector* as a whole recorded a cash surplus of R1,0 billion in fiscal 2006/07, virtually equivalent to the cash surplus recorded in the previous fiscal year. As a ratio of gross domestic product, the non-financial public-sector cash surplus remained unchanged at 0,1 per cent in fiscal 2006/07 compared with the previous fiscal year.

The activities at the various levels of government influencing the non-financial public-sector borrowing requirement are summarised in the accompanying table.

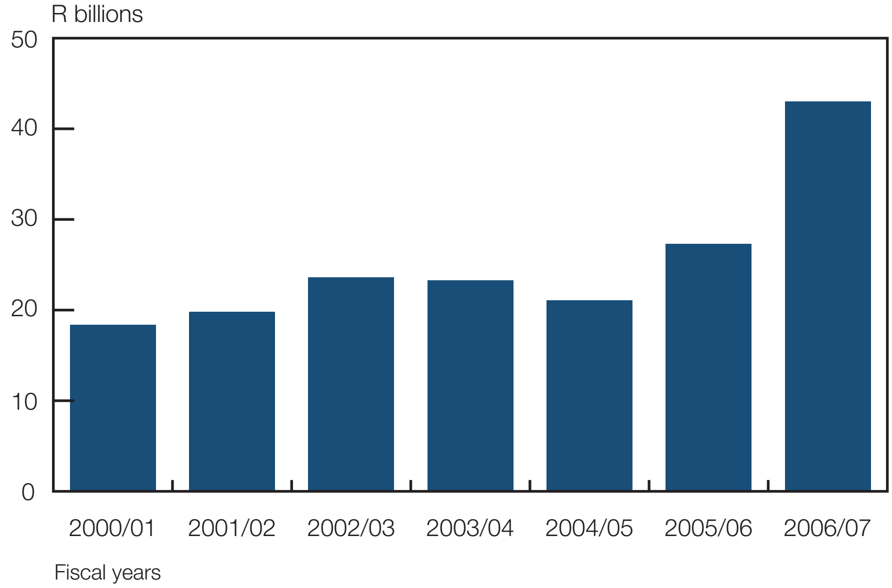
Non-financial public-sector borrowing requirement
R billions

Level of government	2005/06*	2006/07*
National government	6,9	-5,7
Extra-budgetary institutions	-2,7	-3,7
Social security funds	-7,5	-6,3
Provincial governments	-0,3	-0,0
Local governments	8,2	6,8
Non-financial public enterprises and corporations	-5,6	8,0
Total	**-1,0**	**-1,0**

* Deficit +, surplus -
** Individual amounts may not add up to the total due to rounding

The *non-financial public enterprises and corporations* recorded a cash *deficit* amounting to R8,0 billion in fiscal 2006/07, compared with a cash *surplus* of R5,6 billion in fiscal 2005/06. This turnaround in the finances of the major public entities was mainly due to their increased net investment in infrastructure, which amounted to R41,7 billion in fiscal 2006/07, 67,8 per cent higher than a year earlier. Infrastructure spending by non-financial public enterprises and corporations was set to increase further and was projected to grow at an average rate of 14,1 per cent per annum over the medium term.

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



As in fiscal 2005/06, national government's tax revenue collected in fiscal 2006/07 was substantially higher than the original budget projection. An analysis of *national government* finance statistics indicated that cash receipts from operating activities increased by 18,1 per cent in fiscal 2006/07 when compared with the previous fiscal year. During the period under review, cash payments for operating activities increased by 15,4 per cent. The net cash flow from operating activities of national government, together with the net investment in non-financial assets, resulted in a cash *surplus* to the amount of R5,7 billion in fiscal 2006/07. This surplus can be compared with a cash *deficit* of R6,9 billion recorded in the previous fiscal year.

An analysis of the *Provincial Revenue Fund Statements* indicated that provincial governments recorded a cash *deficit* of R8,4 billion in the January-March quarter of 2007. After taking into account the net investment in financial assets of R0,4 billion, the cash *surplus* amounted to a negligible *R7,5 million* for the fiscal year 2006/07 as a whole. This can be compared with a cash surplus of R0,3 billion recorded in fiscal 2005/06 and was significantly lower than the cash surplus of R0,2 billion estimated in the *Provincial Budgets and Expenditure Review 2002/03 – 2008/09.*

The main source of provincial governments' cash receipts – grants from national government – amounted to R178,2 billion in fiscal 2006/07, or 14,4 per cent less than in the previous fiscal year. Grants include the equitable share of revenue allocated to provinces and conditional grants which are earmarked for specific purposes.

Cash payments for operating activities amounted to R169,9 billion in fiscal 2006/07, representing a decrease of 15,7 per cent when compared with the previous fiscal year. This decline was due to the exclusion of social assistance grants of provincial social development departments, which were shifted to the South African Social Security Agency (SASSA) with effect from 1 April 2006. Net investment in non-financial assets amounted to R15,6 billion, which was 19,6 per cent more than in the previous fiscal year.

The deposits of the provincial governments with the private-sector banks decreased from R8,4 billion at the end of March 2006 to R7,0 billion at the end of March 2007, while their overall indebtedness to banks increased from R0,2 billion to R1,2 billion between these respective dates. The provincial governments' deposits with the Corporation for Public Deposits increased slightly from R2,2 billion to R2,7 billion over the same period.

Estimates for local governments indicated a lower cash deficit in 2006/07. The estimated cash deficit of local governments amounted to R6,8 billion in fiscal 2006/07, compared with a deficit of R8,2 billion recorded in the previous fiscal year.

Preliminary indications are that the financial position of *extra-budgetary institutions* improved in fiscal 2006/07, recording a cash surplus of R3,7 billion compared with a cash surplus of R2,7 billion in the previous fiscal year. *Social security funds* recorded a cash surplus of R6,3 billion in fiscal 2006/07, compared with a cash surplus of R7,5 billion recorded in the preceding fiscal year. This surplus, which includes that of the newly established South African Social Security Agency, was moderately lower than a year earlier, but is expected to remain positive over the three-year budget period.

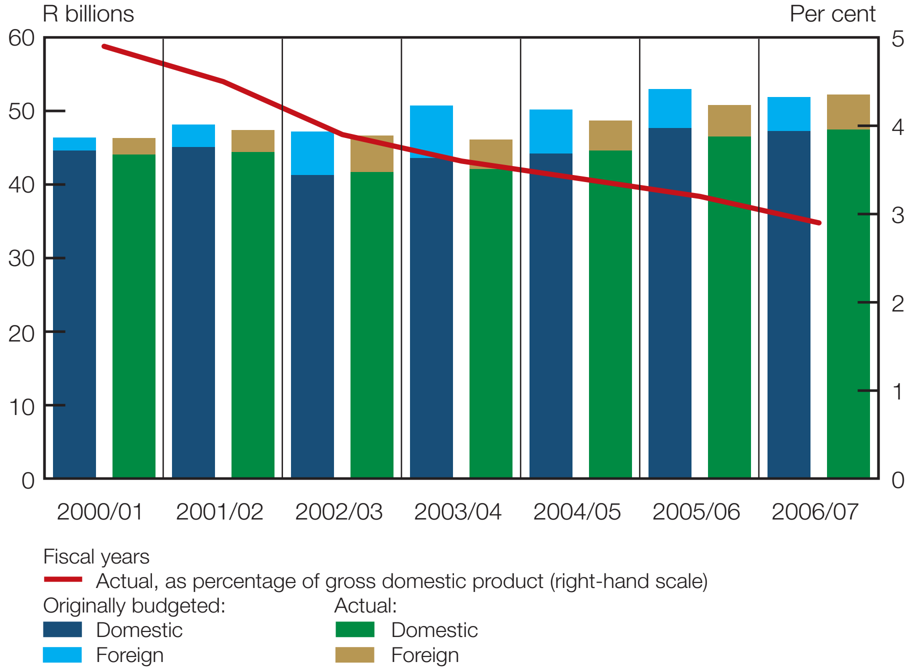
Budget-comparable analysis of national government finance

National government expenditure was well contained and amounted to R471 billion in fiscal 2006/07 – R2,2 billion less than the original budgetary provision. The preliminary outcome was, however, equivalent to the revised estimate presented to Parliament by the Minister of Finance in February 2007. This resulted in a year-on-year rate of increase in national government expenditure of 12,9 per cent in fiscal 2006/07. This growth rate was slightly lower than both the original budget provision of 13,4 per cent and the growth rate of 13,1 per cent recorded in the previous fiscal year. In real terms, national government expenditure increased at a year-on-year rate of 8,0 per cent in fiscal 2006/07, compared with a rate of increase of 8,9 per cent recorded in the previous fiscal year.

National government expenditure as a ratio of gross domestic product amounted to 26,3 per cent in fiscal 2006/07, compared with the ratio of 26,4 per cent recorded in the preceding fiscal year. This ratio was slightly lower than the originally budgeted ratio of 27,6 per cent and almost the same as the revised ratio indicated in the *Budget Review 2007*.

Interest paid on national government debt continued on its subdued trajectory with a preliminary outcome of R52,2 billion or an increase of 2,6 per cent in fiscal 2006/07. The growth rate in fiscal 2006/07 was lower than the rate of 4,5 per cent recorded in the previous fiscal year. The downward trend in interest payments on national government debt was the result of a lower borrowing requirement, lower debt stock and a stable interest rate environment. The decline in debt service costs had the effect of freeing up resources which could be channelled towards more productive expenditure. In fiscal 2006/07 interest payments as a ratio of gross domestic product amounted to 2,9 per cent, compared with 3,2 per cent in fiscal 2005/06.

Interest payments by national government



National government transferred R151 billion, equivalent to 32,0 per cent of its total expenditure, to provincial governments during 2006/07 as their equitable share of nationally raised revenue. Simultaneously, the share of social assistance transfers to households increased from approximately 10 per cent of expenditure in fiscal 2005/06 to 15 per cent in fiscal 2006/07. Payments for capital assets amounted to R6,5 billion in fiscal 2006/07, or 11,3 per cent less than in the previous fiscal year. This rate of decrease was lower than the originally budgeted rate of decrease of 17,9 per cent. However, capital expenditure by general government continued to grow, with major projects targeted at transport and community-related infrastructure. The transfers and subsidies of national government included many of the large capital investment projects that will be undertaken by the other levels of government such as provincial and local government.

After allowing for cash-flow adjustments (i.e. entries resulting from timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), national government cash-flow expenditure amounted to R467 billion in fiscal 2006/07, which was 13,1 per cent higher than in the previous fiscal year. The difference between the cash book and cash-flow expenditure was mainly the surrenders of R3,5 billion for 2005/06 paid back to the National Revenue Fund in fiscal 2006/07.

The *Statement of National Revenue, Expenditure and Borrowing* indicates that unaudited national government revenue in fiscal 2006/07 increased by 17,0 per cent to amount to R481 billion – R34,6 billion more than the original budget estimate. This rate of increase was significantly higher than the rate of increase of 8,6 per cent originally envisaged in the 2006 Budget and higher than the revised increase of 15,7 per cent stated in the *Budget Review 2007*.

Almost all components of revenue outperformed the original budget projections as shown in the accompanying table. This reflected, among other things, the improved tax compliance and administration. The buoyant taxes on income, profits and capital gains reflected the strong growth in corporate income tax collections as well as rising employment. High commodity prices and strong domestic demand bolstered the profitability of companies. Domestic taxes on goods and services also grew strongly as buoyant consumer spending boosted value-added tax collections. The high demand for imported goods resulted in robust growth in taxes on international trade and transactions. Only taxes on property contracted, after the threshold property values below which no transfer duties are payable, were raised in February 2006.

National government revenue in fiscal 2006/07

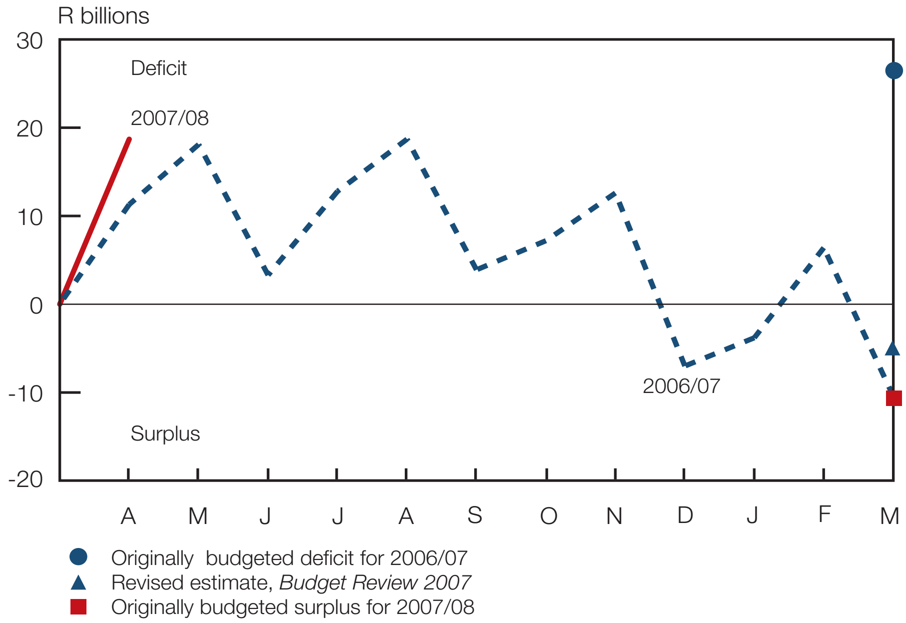
Revenue source	Originally budgeted		Actual	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains......	245,8	6,5	279,6	21,2
Payroll taxes..	5,6	14,9	5,9	21,0
Taxes on property	8,9	-19,9	10,3	-7,2
Domestic taxes on goods and services.........	171,7	14,0	174,5	15,8
Taxes on international trade and transactions ...	23,6	29,7	24,0	32,0
Other revenue	10,5	8,7	11,7	21,6
Less: SACU** payments...............................	19,7	39,6	25,2	78,1
Total revenue...	**446,4**	**8,6**	**480,9**	**17,0**

* Fiscal 2005/06 to fiscal 2006/07
** Southern African Customs Union

National government cash-flow revenue (adjusted for timing differences between the recording of transactions and bank clearances) was almost equivalent to the cash book revenue. As a ratio of gross domestic product, national government revenue amounted to 26,9 per cent in fiscal 2006/07, moderately higher than the ratio of 26,0 per cent recorded in the previous fiscal year. National government revenue was originally budgeted to amount to 26,0 per cent of gross domestic product in the February 2006 budget estimates, but was revised upwards to 27,1 per cent in the *Budget Review 2007.*

The net result of the higher-than-budgeted revenue and lower-than-budgeted expenditure in fiscal 2006/07, was a cash book *surplus* of R10,4 billion compared with a *deficit* of R5,6 billion recorded a year earlier. This surplus – the first ever to be recorded

Cumulative balance of national government



at national government level – was in contrast to the originally budgeted deficit of R26,4 billion. The surplus was also higher than the estimated revised surplus of R5,2 billion presented to Parliament in February 2007. As a ratio of gross domestic product, the national government surplus before borrowing and debt repayment amounted to 0,6 per cent in fiscal 2006/07 compared with a deficit ratio of 0,4 per cent recorded in the previous fiscal year. The *Budget Review 2007* projected a surplus relative to gross domestic product ratio of 0,3 per cent.

Consistent with government's borrowing and debt sustainability strategy, the debt of national government as a ratio of gross domestic product receded substantially, contributing to lower interest costs. As a result, the *primary balance* (i.e. the deficit recalculated by excluding interest payments from total expenditure) reached a surplus of 3,5 per cent of gross domestic product in fiscal 2006/07, higher than the 2,9 per cent surplus recorded in the previous fiscal year. The higher primary surplus released further resources for infrastructure and other essential spending.

The cash-flow *surplus* in fiscal 2006/07 amounted to R14,0 billion compared with a cash-flow *deficit* of R1,0 billion in the previous fiscal year. After taking into account extraordinary transactions as well as the cost on revaluation of maturing foreign bonds and loans, the surplus amounted to R10,5 billion in 2006/07. Extraordinary payments essentially consisted of a payment of R3,8 billion relating to the Saambou Bank liability. Extraordinary receipts included premiums of R0,9 billion for bonds issued and also special dividends of R828 million from Telkom as well as R668 million from the Airports Company of South Africa. Foreign-exchange amnesty proceeds to the amount of R365 million were received in fiscal 2006/07. The abolition of the Lebowa Minerals Trust resulted in extraordinary receipts to the amount of R467 million. A transfer of R200 million into the National Revenue Fund from the Agricultural Debt Account was also made.

The surplus recorded in fiscal 2006/07 was utilised to increase the cash balances of national government by R17,1 billion. Simultaneously, national government borrowed less than originally budgeted in both the domestic and foreign capital markets. Both domestic long-term and short-term funding in fiscal 2006/07 were obtained at an average interest rate of 7,9 per cent per annum.

Financing of national government budget balance in fiscal 2006/07

R billions

Item or instrument	Originally budgeted	Revised[1] estimate	Actual
Budget balance	**26,4**	**-5,2**	**-14,0**[2]
Plus: Extraordinary payments	0,0	4,2	4,2
Cost on revaluation of maturing foreign debt	1,4	1,8	1,8
Less: Extraordinary receipts	0,2	2,5	2,5
Net borrowing requirement[3]	**27,6**	**-1,7**	**-10,5**
Treasury bills	5,8	5,8	5,3
Domestic government bonds	10,2	2,3	-0,6
Foreign bonds and loans	3,8	2,5	1,9
Changes in available cash balances[4]	7,8	-12,3	-17,1
Total net financing	**27,6**	**-1,7**	**-10,5**

1 *Budget Review 2007*
2 Cash-flow deficit +, surplus -
3 Deficit +, surplus -
4 Increase -, decrease +

The average maturity of national government's domestic marketable bonds increased slightly from 98 months at the end of March 2006 to 102 months at the end of March 2007.

Net issues of foreign bonds and incurrence of foreign loans amounted to R1,9 billion during fiscal 2006/07. A new foreign bond which matures in 2016 was issued in April 2006 and yielded R5,5 billion to the National Revenue Fund. This was, however, partly offset by the redemption of a foreign bond to the amount of R3,3 billion in May 2006. Net foreign funding included R3,7 billion drawn on the export credit facility which had been arranged for the financing of the Strategic Defence Procurement Programme. In early February 2007 government redeemed a foreign bond to the amount of R1,2 billion. The average maturity of the foreign marketable bonds of national government decreased slightly from 68 months at the end of March 2006 to 67 months at the end of March 2007. (Average maturity lengthened again in the first two months of fiscal 2007/08 with the issue of a new long-term foreign bond and the redemption of another foreign bond at more or less the same time.)

The financial activities of national government, notably the increased revenue collections, resulted in an increase in government's bank balances from R58,2 billion at the end of March 2006 to R75,3 billion at the end of March 2007.

Total loan debt of national government increased from R528 billion at the end of March 2006 to R552 billion at the end of March 2007. The share of foreign loans in the total loan debt increased from 12,6 per cent at the end of March 2006 to 15,0 per cent at the end of March 2007. Since fiscal 2003/04, foreign debt revalued at prevailing exchange rates has been lower than the rand value of foreign debt as at the time of issue. This stood in contrast to the four fiscal years preceding 2003/04, and reflected the effect of the strengthening exchange rate of the rand on the outstanding value of foreign bonds and loans in rand terms. This trend reversed again in fiscal 2006/07 following the depreciation of the exchange rate of the rand. Total loan debt as a ratio of gross domestic product decreased from 33,5 per cent at the end of March 2006 to 30,9 per cent at the end of March 2007. Simultaneously, government-guaranteed debt declined slightly from R67,9 billion at the end of March 2006 to R66,9 billion at the end of December 2006.

It was announced that the unaudited surplus on the Gold and Foreign Exchange Contingency Reserve Account amounted to R28,5 billion at the end of March 2007 compared with a surplus of R1,8 billion at the end of March 2006.

Statement of the Monetary Policy Committee

12 April 2007

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

Introduction

Since the previous meeting of the Monetary Policy Committee (MPC) in February 2007, the inflation outlook has deteriorated somewhat, despite the most recent inflation outcomes. The less favourable outlook has been brought about primarily by petrol and food price increases. Domestic demand pressures and credit extension have remained strong with only tentative signs of moderation in response to the tighter monetary policy stance.

At the same time, the South African economy has been growing at a robust pace and employment growth has also been encouraging. Domestic growth prospects remain positive despite the temporary sell-off in the international markets in late February. The appetite for emerging-market assets has rebounded.

Recent developments in inflation

Year-on-year inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) increased at a year-on-year rate of 5,3 per cent in January 2007, following a rate of increase of 5,0 per cent in the previous three months. In February, year-on-year CPIX inflation declined to 4,9 per cent. Food and energy remained the main drivers of inflation. If these categories were excluded, CPIX inflation would have measured 3,9 per cent and 4,0 per cent in January and February, respectively.

Food prices increased at a year-on-year rate of 7,7 per cent in February this year, following an 8,1-per-cent increase in January. Meat price inflation, which was the largest contributor to overall CPIX inflation, declined from 16,0 per cent in January to 13,9 per cent in February. The elevated spot prices of maize and wheat resulted in grain product prices accelerating at a rate of 8,7 per cent in February, compared to 7,1 per cent in January. Petrol price changes over the past few months have been a reflection of the volatility in international oil prices and the exchange rate. In February 2007, year-on-year petrol price inflation measured 1,8 per cent compared to 8,2 per cent the previous month. This is, nevertheless, significantly lower than the increases in excess of 20 per cent that were experienced in the middle of last year. By contrast, the prices of a number of goods continued to decline in February. Clothing prices declined by 7,8 per cent, footwear prices by 11,0 per cent and those of furniture by 2,8 per cent.

In January and February 2007, goods price inflation measured 5,7 per cent and 5,0 per cent, respectively, compared to services price inflation of 4,6 per cent and 4,8 per cent in the same months. Administered prices increased by 6,4 per cent and 4,1 per cent in January and February, respectively, while administered prices excluding petrol increased at a year-on-year rate of 5,7 per cent in those months, compared to 3,1 per cent in June 2006.

Production price inflation continued to increase at high rates across a broad range of categories, although below the peak of 10,0 per cent seen in October and November 2006. Measured year on year, production price inflation declined to 9,5 per cent in

February, compared to 9,8 per cent in January. Imported goods inflation measured 9,7 per cent in February compared to domestically produced goods inflation of 9,4 per cent.

The outlook for inflation

The most recent central forecast of the Bank's forecasting model indicates a deterioration in the inflation outlook, mainly as a result of adverse developments in the international oil markets and administered prices. The forecast, which takes into account the petrol price increases of March and April, projects that CPIX inflation will increase to slightly below the upper level of the inflation target in the second quarter of 2007. Thereafter, apart from a technical decline in the third quarter, CPIX inflation is expected to remain at rates of around 5,9 per cent until the second quarter of 2008 and then follow a downward trajectory to reach 5 per cent by the final quarter of that year.

The latest survey of inflation expectations conducted on behalf of the Bank by the Bureau for Economic Research (BER) at the University of Stellenbosch indicates that CPIX inflation expectations in respect of both 2007 and 2008 have declined compared to the previous survey. This may indicate that inflation expectations are not always backward looking, and have remained entrenched within the inflation target range. Inflation expectations declined from 5,4 per cent to 5,2 per cent for 2007, and from 5,4 per cent to 5,1 per cent for 2008, while CPIX inflation is expected to average 5,1 per cent in 2009 . All categories of respondents lowered their expectations for 2007, while business executives and trade union officials lowered their expectations for 2008.

As usual, the MPC analysed the factors impacting on inflation and assessed the risks to the forecast. In some instances, these risks were perceived to have increased, whereas in other cases there had been no major change to our previous assessment. In particular, the risks posed by oil and food prices appeared to have increased.

International oil price developments have been dominated by heightened geopolitical tensions, supply disruptions and declining inventory levels. The price of North Sea Brent crude oil increased to around US$70 per barrel in recent weeks, compared to a level of around US$56 per barrel at the time of the February MPC meeting. As a result, the domestic petrol price increased by R0,24 per litre in March, and R0,68 per litre in April. A decomposition of the April price increase shows that of the R0,68 increase in April, about R0,09 was attributable to exchange rate changes, R0,10 to fuel taxes announced in the February Budget, and the remainder to changes in the international price of oil. International oil prices are expected to remain vulnerable to geopolitical developments and therefore continue to pose a significant risk to the outlook.

The spot prices of white and yellow maize have increased significantly over the past two years as a result of domestic drought conditions and increases in international prices. Grain product prices, which have a weight of 4,8 per cent in CPIX, are expected to increase further as they have not yet fully reflected these increases. The higher maize prices have also affected meat prices through their impact on cattle and chicken feed prices. However, meat price inflation could be moderated somewhat as more cattle are brought to market during periods of drought. This effect, while possibly significant, is expected to be relatively short-lived.

Despite the tighter monetary stance since June last year, household consumption expenditure growth, which measured almost 8 per cent in the fourth quarter of 2006, continues to pose a risk to inflation. In January of this year, retail sales increased at a year-on-year rate of 9,4 per cent compared to 6,7 per cent in December 2006. There is, however, some evidence of moderation in the growth of interest-sensitive durable goods consumption. In particular, a softening trend in motor vehicle sales has been observed in recent months. The seasonally adjusted number of new vehicles sold in the first quarter of 2007 declined by 2,9 per cent compared to the fourth quarter of 2006.

Consumer confidence remains at a high level. According to the latest FNB/BER Consumer Confidence Index (CCI), the CCI increased significantly during the first quarter of 2007 to reach the highest level ever recorded in the 25-year existence of the index. Factors underpinning the strong demand include the further increases in asset prices. The housing market remains buoyant and the JSE Securities Exchange has reached new highs despite the short-lived downturn in March.

Credit extension by banks to the private sector has continued at uncomfortably high levels. Twelve-month growth in banks' loans and advances extended to the private sector has grown at a rate of around 27 per cent since November 2006, and increased to 27,7 per cent in February this year. Asset-backed credit growth, however, showed a modest decline in February to 25,5 per cent. Instalment sale and leasing finance growth declined from 15,8 per cent in December to 14 per cent in February, reflecting the moderation in demand for motor vehicles. Growth in total loans and advances to households has been on a somewhat declining trend compared to the strong upward trend in credit extension to the corporate sector. Nevertheless, the ratio of household debt to disposable income increased further in the fourth quarter of 2006 to almost 74 per cent and the cost of servicing the debt has been steadily increasing.

The South African economy has grown at a rate of 5 per cent in each of the past three years, a level which we estimate to be slightly above potential. Indications are that growth rates around this level are likely to be sustained during 2007. Capacity utilisation in the manufacturing sector increased further in the fourth quarter to a new level of 86,6. The Investec Purchasing Managers Index (PMI) reflects continued buoyant conditions in the manufacturing sector, and despite a marginal decline in the RMB Business Confidence Indicator, business confidence remains high and broad based.

Underpinning this positive outlook is a strong trend in the growth of investment expenditure. Gross fixed capital formation increased at an annualised rate of 16,6 per cent in the fourth quarter of 2006, and 12,8 per cent for the year. As a ratio to gross domestic product (GDP), gross fixed capital formation has increased from around 15 per cent in the early part of the decade to over 19 per cent in the final quarter of 2006. While this bodes well for current and future growth, the concurrent decline in the savings ratio has seen the current-account deficit of the balance of payments widening to 6,4 per cent of GDP in 2006, and 7,8 per cent of GDP in the final quarter of the year.

The good growth prospects for the economy continued to ensure that the current-account deficit has been adequately financed. Since the beginning of this year, net non-resident purchases of bonds and equities have totalled R20,3 billion. The Bank has also been able to continue with its gradual build-up of international reserves. Official gross gold and other foreign exchange reserves stood at US$26,5 billion at the end of March 2007 and the international liquidity position amounted to US$24,0 billion.

Since the February meeting of the MPC, the exchange rate has been relatively stable, apart from the reaction to the transitory sell-off in international financial markets in late February. The exchange rate reached a level of R7,55 to the US dollar in response to the heightened risk in the markets, but by late March the rand had returned to levels below R7,30. The rand is currently trading at around R7,15 to the US dollar, compared to

R7,20 at the previous meeting. The trade-weighted rand exchange rate is also relatively stable compared to February. Other factors impacting on the exchange rate during this period included movements in the US dollar against other currencies and commodity price fluctuations.

The outlook for global growth appears to be positive, despite the recent market volatility. The rerating of risk, particularly in emerging markets, resulted in significant adjustments in exchange rates and stock market valuations globally. Most markets have since recovered to a large extent, including those in South Africa. Strong growth in most regions is expected to be sustained, although there is the risk of a slowdown in the United States. The continued resilience of the world economy also bodes well for commodity prices. Global inflation is expected to remain under control despite the firmer oil prices, and the international interest rate cycle appears to have peaked. However, monetary policies are unlikely to become generally more accommodating in the short term in the face of the positive growth outlook.

Monetary policy stance

The MPC has decided that despite the slight deterioration in the inflation outlook, an unchanged monetary policy stance continues to be appropriate for now. The repo rate will therefore remain at 9 per cent per annum.

Statement of the Monetary Policy Committee

7 June 2007

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

Introduction

CPIX inflation breached the upper end of the inflation target range in April 2007 for the first time since August 2003. The year-on-year increase of 6,3 per cent was higher than that expected by the Bank and most forecasters. The petrol price had increased by R0,69 per litre in April, and this was expected to contribute to an increase in the inflation rate. This was compounded by strong increases in food prices as well as generalised increases in some other categories.

The breach of the target is in the past and there is nothing that monetary policy can do about past inflation. Nevertheless, the Monetary Policy Committee (MPC) cannot ignore the possible impact of this breach on inflation expectations and the public's understanding of the monetary policy process. Monetary policy acts with a lag, and the focus of the MPC will remain, as always, on the medium-term inflation outlook which is the period over which monetary policy can be effective.

Recent developments in inflation

Year-on-year inflation as measured by the consumer price index for metropolitan and other urban areas excluding the interest cost on mortgage bonds (CPIX) increased at a year-on-year rate of 6,3 per cent in April 2007 compared to 4,9 per cent in February and 5,5 per cent in March. Food and petrol price increases accounted for most of the increase, but more broad-based pressures are also becoming evident. If food and energy were excluded, CPIX inflation would have measured 4,6 per cent in April compared to 3,9 per cent in January. Although this measure is still well within the target range, the recent strong upward trend is indicative of more broadly-based price pressures.

The biggest impetus to the increase in the inflation rate in April came from the petrol price. Petrol prices increased at a year-on-year rate of 15,5 per cent in April 2007 compared to 7,9 per cent in March. Food price inflation also continued its upward trend measuring 7,8 per cent and 8,6 per cent in March and April, respectively. The higher food price inflation in April was driven mainly by grain product and meat price increases. Grain product prices increased at a year-on-year rate of 10,6 per cent compared to meat price increases of 10,8 per cent. The latter, although still high, are significantly lower than the peak increases of almost 20 per cent in October and November last year. Prices of household consumables increased by 8 per cent in April, compared to 6,1 per cent in February.

Services price inflation has also been increasing steadily, having measured 5,5 per cent on a year-on-year basis in April compared to 4,6 per cent in January. Certain components of housing services made a significant contribution to this upward trend. Pressures on inflation continue to be moderated by price declines in clothing, footwear, furniture, and recreation and entertainment.

Production price inflation increased at a year-on-year rate of 11,1 per cent in April compared to 9,5 per cent and 10,3 per cent in February and March, respectively. These developments point to further pressures on CPIX inflation in the coming months. The April increase has been the highest since December 2002. Apart from textiles, clothing and footwear, the increases were across a wide spectrum. Prices of domestically produced goods increased by 11,2 per cent in April compared to 10,5 per cent for imported goods.

The outlook for inflation

The most recent central forecast of the Bank's models indicates a further deterioration in the inflation outlook compared to the previous forecast. The forecast, which takes account of the petrol price increases of May and June, projects that CPIX inflation will remain marginally above the upper level of the inflation target range in the second quarter of 2007. After a technical decline in the third quarter, CPIX inflation is expected to marginally exceed 6 per cent in the subsequent two quarters, peaking at an average of 6,3 per cent in the first quarter of 2008. Thereafter, CPIX inflation is projected to follow a downward trajectory and to average 5,3 per cent in the fourth quarter of 2008. The higher trend of the forecast in the near term compared to the previous forecast is a result of a slightly higher oil price assumption. The committee continues to view the risks to the outlook to be strongly on the upside.

Inflation expectations are an important indicator of possible future inflation trends because of their impact on wage and price setting processes. According to the most recent inflation expectations survey conducted in May on behalf of the Bank by the Bureau for Economic Research at the University of Stellenbosch, there had been some deterioration in inflation expectations which had moved back to the levels of the fourth quarter of 2006. Nevertheless, inflation expectations still remained within the inflation target range. Respondents expected CPIX inflation to average 5,5 per cent this year, and to moderate to 5,3 per cent and 5,2 per cent, respectively, in the coming two years. Expectations of trade unionists has increased the most since the previous survey. Labour and business expectations were then significantly higher than those of analysts, but all groups were within the target range for all three survey years.

The bond markets have also shown evidence of some deterioration in expectations. In reaction to the April inflation data, long-term bond yields increased further and the yield curve shifted upwards, although it remained inverted. The break-even inflation rate, which is the difference between the yield on conventional bonds and the yield on inflation-linked bonds, increased by about 50 basis points to around 5,6 per cent from the end of May.

The MPC identified a number of upside risks to the outlook. These include food and oil prices and continued high rates of household consumption expenditure. The assessment of most of the other variables has been relatively unchanged since the previous meeting.

Oil remains an upside risk to the inflation outlook. The price of North Sea Brent crude oil has averaged US$68 per barrel since the previous MPC meeting and is currently trading above US$72 per barrel. International prices remain dominated by geopolitical tensions, fluctuating inventory levels and supply disruptions in a number of oil-producing countries. Futures prices suggest that upward pressure on oil prices is expected to persist in the near future. The domestic petrol price was increased by R0,34 and R0,23 per litre in May and June, respectively. These increases, which were due to international product price increases, were cushioned to some extent by the behaviour of the exchange rate.

Pressure on inflation emanating from food price increases is expected to persist for some time. This may be attributed to international food price developments which have seen the diversion of grain products to biofuel production and increased food demands as a result of higher global real incomes.

Household consumption expenditure has remained strong although preliminary estimates suggest that there has been a slight moderation in the first quarter. Growth in new passenger motor vehicle sales has been declining since late last year, but the most recent trend has been distorted by problems related to the teething challenges during the introduction of a new electronic licensing system. Sales of commercial and heavy vehicles remain strong, reflecting the strong state of the economy. Growth in retail sales declined to a year-on-year rate of 8,0 per cent in February compared to 9,9 per cent the previous month, but accelerated to a year-on-year rate of 10,1 per cent in March.

The continued underlying strength in household consumption expenditure is reflected in the high rates of domestic credit extended to the private sector. Twelve-month growth in banks' loans and advances extended to the private sector measured 26,2 per cent in March before increasing to 27,4 per cent in April. Adjusted for the cumulative effect of securitisation transactions, growth has remained at around 29 per cent. Growth in mortgage advances, which had previously exhibited a slight declining trend, increased at a year-on-year rate of 27,6 per cent in April. In line with the declining trend in passenger motor vehicle sales, instalment sale and leasing finance increased by 17,2 per cent and 16,9 per cent in March and April, respectively. Consistent with the growth in fixed capital formation, advances to the corporate sector accounted for the strongest increases in bank lending.

The sustained strength in consumer demand has been underpinned by higher levels of employment, higher real incomes and improved household balance sheets. Higher equity and house prices contributed to this positive wealth effect. The all-share index on the JSE Limited reached new heights in the past weeks, in tandem with strong equity market performances in a number of countries. According to the Absa and Standard Bank house price indices, house prices continue to increase although at moderately slower rates.

South Africa's economic growth rate declined moderately in the first quarter of 2007 to an annualised quarter-on-quarter rate of 4,7 per cent. The decline is attributable mainly to a contraction in the mining sector and slower manufacturing-sector growth. The construction sector grew at over 21 per cent mainly as a result of non-residential construction and civil engineering projects. This strong performance is indicative of the continuing domestic investment boom which has been given further impetus by the investment activities of public corporations. The economy is still growing at a rate of around estimated potential and the higher rate of fixed capital formation, which is now in excess of 20 per cent of gross domestic product (GDP), is expected to sustain economic growth going forward as well as increase the growth potential of the economy. The utilisation of production capacity in manufacturing increased by a further 0,3 percentage points in the first quarter of 2007 to 86,5 per cent. However, growth in the manufacturing sector appears to have moderated somewhat. Manufacturing output declined between March and April of this year, and the most recent Investec Purchasing Managers Index (PMI) also indicates a slowdown of the manufacturing sector's growth momentum.

According to the most recent Wage Settlement Survey by Andrew Levy Employment Publications, wage settlements averaged 6,5 per cent in 2006 and remained at this rate in the first quarter of 2007. These increases are consistent with the inflation target if positive changes in labour productivity are taken into account.

The exchange rate of the rand is trading at levels similar to those prevailing at the time of the previous MPC meeting. The volatility observed since the last meeting can be attributed mainly to movements of the US dollar against other currencies.

The deficit on the trade account of the balance of payments narrowed as a result of an expected decline in the volume of imported oil. Preliminary data suggest that the deficit on the current account of the balance of payments in the first quarter of 2006 was narrower than that experienced in the final quarter. As before, this deficit was comfortably financed by net financial inflows. In the year to date, non-resident net purchases of bonds and equities have totalled around R45 billion. The bulk of this has been equity investments, reflecting continued confidence in South Africa's macroeconomic policy framework and the related growth prospects. This is also illustrated further by the revision of the outlook from stable to positive of South Africa's external sovereign debt rating by Moody's rating agency. Further progress was also made with international reserve accumulation. As at the end of May, official gross gold and other foreign exchange reserves had increased to US$ 27,9 billion, while the international liquidity position had risen to US$ 25,5 billion.

Aside from oil and food price developments, the international economic environment remains relatively favourable. World growth is expected to remain strong although slightly lower than that achieved last year. The main risk to growth is seen to emanate from the housing market in the United States, although this risk appears to have dissipated somewhat. In general, international interest rates are not expected to decline in the near future, while further increases may still occur in some regions. The generally tighter monetary policy stance is expected to keep inflation contained despite pressures from rising oil and food prices. Growth prospects in the CMA region remain positive, although member countries are also experiencing inflationary pressures from food and oil prices.

Monetary policy stance

The MPC has decided that in view of the further deterioration in the inflation outlook, the monetary policy stance needs to be adjusted to ensure that CPIX inflation returns to within the inflation target range over time. Accordingly, the repo rate will be increased by 50 basis points to 9,5 per cent per annum with effect from Friday 8 June 2007. The MPC will continue to monitor developments which have a bearing on inflation outcomes and will not hesitate to adjust the policy stance as may be appropriate.

Note to tables

Money-market and related interest rates – Table S-28

With effect from 27 March 2007, the South African Reserve Bank replaced the overnight interbank rates, published daily by the Bank, with new benchmark call rates. The rates replaced are the South African Overnight Interbank Average (Saonia) rate, the interbank carry rate, and the foreign exchange forward rate. These rates are replaced by two new rates, namely the South African Benchmark Overnight Rate on deposits (Sabor) and the implied rate on both overnight call deposits and tomorrow-next funding in the foreign-exchange swap market (the overnight foreign-exchange rate).