Quarterly Bulletin

September 2007

South African Reserve Bank

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Introduction

Global economic activity continued to be fairly robust in the first half of 2007, and continued to support international trade volumes and commodity prices. This buoyancy extended to most countries in Africa. While global inflation remained fairly benign, there was nevertheless an acceleration in many parts of the world as international oil prices again trended strongly upward from their recent lows in January 2007. Simultaneously, partly in response to prospects of more agricultural output being diverted to biofuels production, food price inflation picked up significantly.

Some concern regarding the health of the housing market in the United States (US) continued to linger, and intensified in August 2007 when a number of institutions with significant exposure to the risky sub-prime mortgage market in the US ran into financial difficulty. This initiated an international repricing of risk and also reduced liquidity in the credit markets to such an extent that in several of the mature economies, central banks decided to inject liquidity into the financial markets and relax their lending conditions.

In South Africa real economic growth eased slightly from an annualised rate of 4¾ per cent in the first quarter to 4½ per cent in the second quarter of 2007 – a rate which is probably well-aligned with the country's current growth potential, although structural changes which may raise the potential growth rate further are in progress. In the second quarter the construction sector recorded the fastest rate of growth with agriculture, financial services and transport also expanding briskly. Growth waned in the manufacturing sector as the production of vehicles responded to lower domestic sales, along with a deceleration in several other subsectors. Consistent with the slowdown in real final demand, the trade sector also registered slightly slower growth over the period.

Following an extended period of expansion at annualised rates of more than 7 per cent, real final consumption expenditure by households rose at a more sedate pace of 5½ per cent in the second quarter of 2007. Households' purchases of durable goods contracted during the quarter under review. Final consumption expenditure by government also declined during the second quarter as no expensive military items were procured, unlike in the preceding quarter. Strike action by civil servants also weighed on real expenditure and real production of government services, and simultaneously bolstered the number of mandays lost due to strike action to 11,5 million in the first half of 2007.

During the second quarter capital expenditure rose at a slower pace than before, but nevertheless continued rising strongly, consistent with high levels of capacity utilisation in the economy. Inventories continued to accumulate, although at a slightly slower rate than in the first quarter. Early harvesting of the maize crop supported the inventory investment in the second quarter of 2007.

The deceleration in growth in domestic expenditure was reflected in a slight decline in the volume of imports during the second quarter, alongside a moderate increase in export volumes. Overall import volumes declined despite a significant increase in oil imports during this period. Given a modest improvement in South Africa's terms of trade, the international trade deficit narrowed significantly in the second quarter of 2007. At the same time net service, income and current transfer payments to the rest of the world rose considerably, offsetting much of the improvement on the trade account. This was mainly due to increased payments of dividends to non-residents who had increased their investment in South African shares over time and were rewarded with strong dividend growth on account of rising corporate profits. The net effect of these developments was a narrowing of the deficit on the current account of the balance of payments to 6,5 per cent of gross domestic product in the second quarter of 2007 – well below the most recent peak of 7,8 per cent in the final quarter of 2006.

The deficit on the current account continued to be more than fully financed by financial inflows from abroad. In the second quarter of 2007 inward portfolio investment dominated the financial flows, as non-residents increased their holdings of both South African equity and debt securities. However, significant amounts in direct and other investment into South Africa were also recorded, partly related to private equity funding and black economic empowerment activity.

South Africa's net gold and foreign-exchange reserves continued to rise during the second quarter as well as in July and August 2007. The exchange value of the rand displayed limited fluctuations during this period, although the re-pricing of risk on financial markets in August was initially accompanied by a fairly sharp depreciation of the rand – much of which was subsequently reversed.

Partly as a result of the earlier depreciation of the rand in 2006 and partly due to the increases in the international price of oil from January 2007, inflationary forces intensified. This was further fuelled by rising food prices at all levels, from producers in agriculture and manufacturing to the consumer level. From early 2007 twelve-month production price inflation straddled 10 per cent, while CPIX inflation breached the 6-per-cent upper limit of the inflation target band from April 2007 and amounted to 6,5 per cent in July. Furthermore, the acceleration in underlying measures of inflation during the first seven months of 2007 suggested that the price pressures were becoming more pervasive, with a significant risk of sustained second-round effects. Wage settlements also appeared to be drifting higher during the first eight months of 2007.

Assessing the outlook for inflation, the Monetary Policy Committee of the South African Reserve Bank (the Bank) deemed it necessary to raise the repurchase rate by 50 basis points in June and again in August 2007. This brought the cumulative increase in the repurchase rate from the first time policy was tightened in June 2006 to 300 basis points.

In May 2007 the Bank began to accept certain parastatal bonds in its repurchase auctions, thereby expanding the range of assets that may be used as eligible collateral in its refinancing operations.

Growth in the money supply remained at relatively high levels, reflecting continued strength of nominal domestic income and expenditure, buoyant turnover in the financial markets and positive wealth effects. Banks' extension of loans and advances also maintained strong upward momentum in the second quarter, despite some securitisation transactions which reduced the level of advances stated on the balance sheets of the banks. Mortgage and general advances, in particular, registered strong increases, the former being mainly absorbed by the household sector and the latter by the corporate sector. At least initially, the introduction of the National Credit Act from 1 June 2007 did not appear to have much impact on the extension of loans and advances by banks. As the household debt service ratio edged higher, however, signs of moderation in the pace at which the household debt ratio increased were observed.

House prices continued to rise throughout the first eight months of 2007, although the pace of increase slowed. Bond yields rose considerably during 2007 to date, mainly reflecting a worsening of inflation expectations. Share prices in most parts of the world receded significantly in August 2007, reflecting turmoil in the financial markets in general and concerns regarding exposure to US sub-prime mortgages in particular. South African share prices also receded in sympathy with the global trend. However, some of the losses were later regained as most commodity prices remained firm, corporate profits continued to rise and central banks injected liquidity into the financial markets.

Government finances continued to be supportive of financial discipline and the pursuit of the inflation target. During the first four months of the 2007/08 fiscal year the national budget deficit broadly followed the same pattern as in the corresponding period a year earlier. The generally conservative management of the country's finances was recognised by two international ratings agencies who changed South Africa's foreign-currency ratings outlook from neutral to positive in mid-2007.

Domestic economic developments

Domestic output[1]

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

Real output growth in the South African economy slowed somewhat in the second quarter of 2007. Following annualised growth of 4¾ per cent in the first quarter of 2007, South Africa's *real gross domestic product* increased at a rate of 4½ per cent in the second quarter. The slower growth momentum was confined mainly to the secondary sector. Growth in the primary sector rebounded following a decline in the first quarter of 2007 while that in the tertiary sector accelerated moderately.

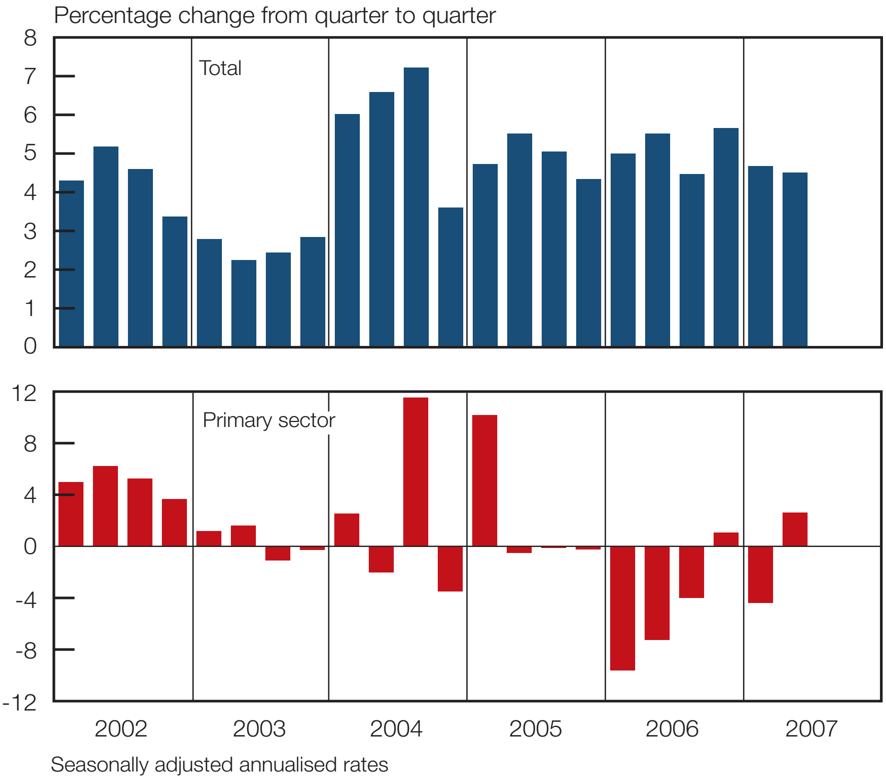
Real gross domestic product

Percentage change at seasonally adjusted annualised rates

	2006					2007	
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sector	-9½	-7¼	-4	1	-4½	-4½	2½
Agriculture................	-18¾	-30	-15	-8½	-13	6	10½
Mining	-5½	3½	¼	4½	-¾	-7¾	0
Secondary sector	4¾	7¼	5¾	8¾	5¾	7	2¾
Manufacturing	3¼	6¼	4¾	8¼	4¾	4¾	½
Tertiary sector	7¼	6¼	4¾	5	6	5	5½
Non-agricultural sector ..	*5¾*	*6¼*	*4¾*	*6*	*5½*	*4½*	*4½*
Total	5	5½	4½	5½	5	4¾	4½

Quarter-to-quarter change in the real value added by the *primary sector* reverted from an annualised rate of decline of 4½ per cent in the first quarter of 2007 to a 2½-per-cent

Real gross domestic product



rate of increase in the second quarter. This was as a result of stronger growth in the real output by the agricultural sector as well as a sideways movement in the real value added by the mining sector as opposed to the contraction recorded in the first quarter of 2007.

Growth in real output by the *agricultural sector* accelerated from an annualised rate of 6 per cent in the first quarter of 2007 to 10½ per cent in the second quarter. The stronger increase can be attributed to higher field crop production and livestock farming output. By contrast, horticultural production contracted from the first to the second quarter of 2007.

The bulk of South Africa's maize crop was harvested in the second quarter of 2007. The country, which normally produces enough maize for domestic consumption and some international demand, will probably record a harvest deficit for the second consecutive year. The estimated commercial maize crop of 6,9 million tons for the 2007 harvesting season is more than one million tons short of annual domestic demand.

Following an annualised decline of 7¾ per cent in the first quarter of 2007, the real value added by the *mining sector* was essentially unchanged in the second quarter. Although lower production was registered in most of the non-gold mining sectors, the real value added by the coal-mining industry in particular, declined substantially. Real value added by the gold-mining sector remained broadly unchanged from the first to the second quarter of 2007. However, the decline registered in real value added by the platinum mines in the first quarter of 2007 was reversed in the second quarter. Platinum production returned to almost full-capacity as all smelters became operational again in the second quarter. This increase in production was, however, partly offset by the suspension of production at one of the largest platinum mines due to safety concerns.

After recording an annualised growth rate of 7 per cent in the first quarter of 2007, growth in real value added by the *secondary sector* slowed to a rate of 2¾ per cent in the second quarter. This slowdown was mainly the result of subdued growth in the real output of the manufacturing sector. In addition, in the second quarter of 2007 slower growth in real value added was also recorded by the construction sector as well as the sector that supplies electricity, gas and water.

The growth in real value added by the *manufacturing sector* decelerated from an annualised rate of 4¾ per cent in the first quarter of 2007 to just ½ a per cent in the second quarter. Although the slowdown of production in manufactured goods was broad-based, it was more pronounced in the subsectors responsible for the manufacturing of petroleum products, chemical, rubber and plastic products; basic iron and steel; and motor vehicles, parts and accessories and other transport equipment.

Despite the slower growth, the real value added by the manufacturing sector in the second quarter of 2007 benefited from the relatively strong domestic demand for locally produced goods. Firm growth was recorded in the manufacturing of products in the food and beverages industry and in the production of cement. Consequently, the utilisation of production capacity in the manufacturing sector increased from a level of 86,6 per cent in the first quarter of 2007 to 86,8 per cent in the second quarter.

The growth in real value added by the sector that supplies *electricity, gas and water* slowed from an annualised rate of 3½ per cent in the first quarter of 2007 to 3 per cent in the second quarter. This moderate slowdown was concentrated in the production of electricity and water. Electricity production capacity nevertheless edged higher in the second quarter as two gas-fired generation plants were brought into operation.

After accelerating for six consecutive quarters, growth in real value added by the *construction sector* moderated slightly in the second quarter of 2007. Real output by the construction sector increased at an annualised rate of 14½ per cent in the second quarter of 2007 compared with a growth rate of 21¼ per cent in the first quarter. Growth in this industry nevertheless remained very strong and relatively broad-based, encompassing residential, non-residential and civil construction activities.

The real value added by the *tertiary sector* rose at an annualised rate of 5½ per cent in the second quarter of 2007, slightly higher than the rate of increase of 5 per cent recorded in the first quarter. The faster growth performance in the second quarter was mainly due to increased activity in the financial intermediation, insurance, real-estate and business services sector as well as the transport, storage and communication sector, which more than neutralised a moderation in the real value added by the trade sector.

Real output originating in the *commerce sector* increased at an annualised rate of 4½ per cent in the second quarter of 2007 compared with a rate of 5 per cent recorded in the first quarter. The slower growth in the commerce sector can be attributed to modest growth registered in the real value added by the wholesale and retail sectors, in keeping with the slowdown in real consumption demand in the second quarter of 2007. In addition, the real value added by the motor-trade sector contracted for the second consecutive quarter, reflecting the tapering off of the brisk pace of demand for new motor vehicles recorded throughout 2006.

The real value added by the *finance, insurance, real-estate and business services sector* increased firmly at an annualised rate of 7½ per cent in the second quarter of 2007, compared with a growth rate of 5¾ per cent recorded in the first quarter. The faster growth could largely be attributed to an increase in real output by banks as the demand for loans edged higher prior to the introduction of the National Credit Act in June 2007.

Growth in the real value added by the *transport, storage and communication sector* accelerated moderately from a robust rate of 5¾ per cent in the first quarter of 2007 to 6 per cent in the second quarter.

Real production by *general government increased* at a rate of 3½ per cent in the second quarter of 2007, notably lower than the growth rate of 4½ per cent recorded in the first quarter. This can partly be ascribed to the loss in value added by general government due to the prolonged strike by civil servants in June 2007.

Growth in real gross national income slowed from 8¾ per cent in the first quarter of 2007 to 3½ per cent in the second quarter. This notable slowdown was due to a strong increase in net primary income payments to the rest of the world which more than neutralised the improvement in the terms of trade.

Domestic expenditure

Annualised growth in aggregate *real gross domestic expenditure* slowed from a rate of 5¾ per cent in the first quarter of 2007 to 1 per cent in the second quarter. This slowdown reflected slower growth in real domestic final demand and a further slowdown in inventory accumulation. All three components of final demand – final consumption expenditure by households and by general government, and gross fixed capital formation – lost momentum in the second quarter of 2007.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

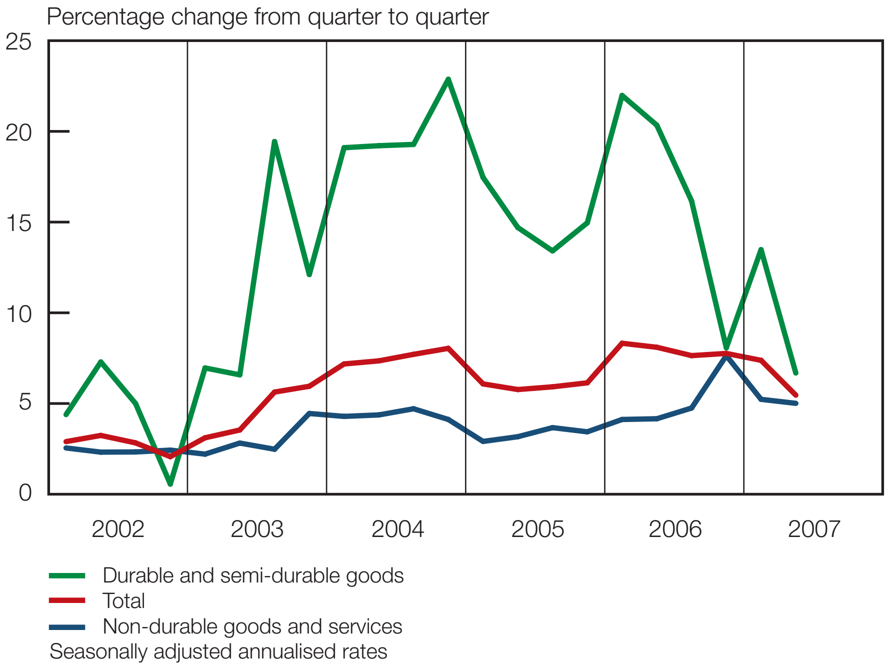
Components	2006					2007	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure by households	8¼	8	7½	7¾	7¼	7½	5½
Final consumption expenditure by general government	-3¼	15¾	-4½	4¾	5½	14	-3
Gross fixed capital formation	14	12¾	14	16½	12¾	21¾	14¼
Change in inventories (R billions)*	15,9	16,3	9,0	21,8	15,8	11,8	10,5
Gross domestic expenditure	15	9	1½	12¼	8¾	5¾	1

* At constant 2000 prices

Growth in *real final consumption expenditure by households* slowed from an annualised rate of 7½ per cent in the first quarter of 2007 to 5½ per cent in the second quarter. This was mainly due to a contraction in real expenditure on durable goods. In addition, growth in household spending on non-durable goods slackened in the second quarter of 2007.

Real expenditure on *durable goods* declined at an annualised rate of 10 per cent in the second quarter of 2007. Although the contraction in spending on durable goods was broad-based, real expenditure on the purchases of new motor vehicles in particular declined significantly in the second quarter. Higher prices of new motor vehicles and the higher cost of credit made new cars less affordable, while teething problems with the implementation of the new e-Natis system may also have delayed some transactions in the motor trade sector. In addition, the stricter requirements set by the National Credit Act may have contributed to the decline in sales. Notwithstanding a price decline

Real final consumption expenditure by households



reported in the recreational and entertainment goods sector, expenditure on these items still slowed. Most of the expenditure in this category is of a discretionary nature and consumers tend to reduce their expenditure when interest rates are higher and their ability to spend is reduced.

Growth in real outlays on *semi-durable goods* accelerated from an annualised rate of 18 per cent in the first quarter of 2007 to 21 per cent in the second quarter. Expenditure on clothing and footwear, in particular, continued to rise at a strong pace. The sustained decline in prices in both the clothing and footwear segments boosted expenditure in this category. Household expenditure on car tyres, parts and accessories and recreational and entertainment goods, however, tapered off in the second quarter of 2007.

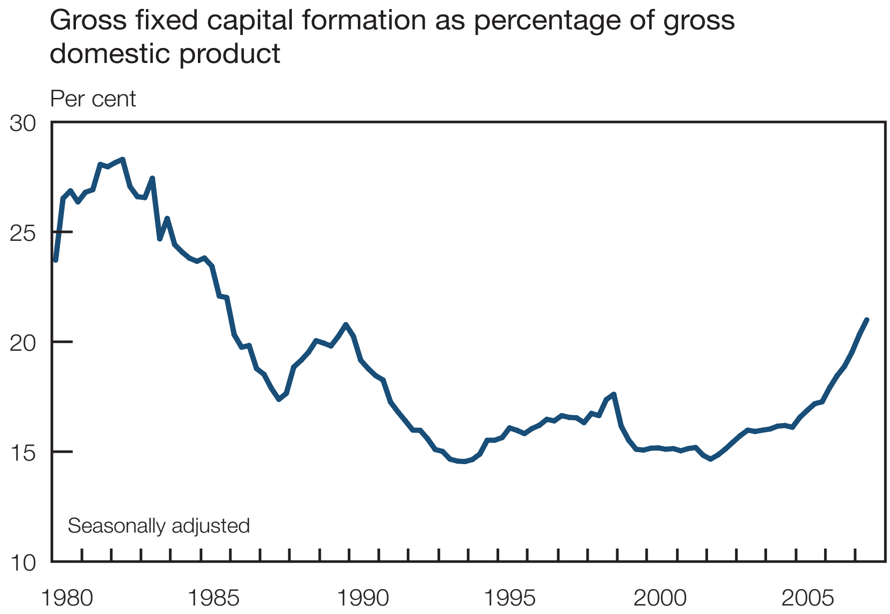
Growth in real expenditure on *non-durable goods* slowed from an annualised rate of 7 per cent in the first quarter of 2007 to 3¼ per cent in the second quarter. Higher prices of food, beverages and tobacco and petroleum products were the main drivers of the slowdown. Price increases were particularly prominent in the case of petroleum products where prices rose at an annualised rate of 13¾ per cent in the first quarter and 20¾ per cent in the second quarter of 2007. Real purchases of household fuel, power and water was exceptionally high in the first quarter of 2007 but receded to more normal levels in the second quarter.

Real outlays on *services* accelerated from an annualised rate of increase of 3¾ per cent in the first quarter of 2007 to 6½ per cent in the second quarter. This was mainly due to brisk expenditure on transport, communication and financial services.

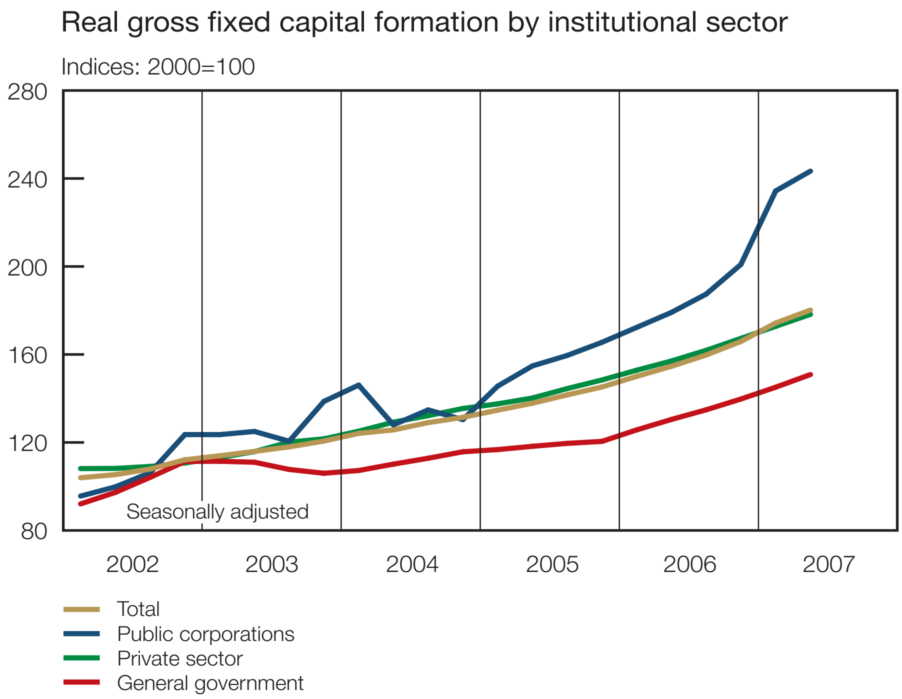
The tighter monetary policy stance and retraction in spending on durable goods affected the rate at which households acquired new debt. *Household debt* increased by R39,6 billion in the second quarter of 2007 compared with an increase of R48,4 billion in the first quarter. This was mainly a result of a slowdown in instalment sale and leasing transactions, while mortgage advances extended to households continued to expand vigorously. Although the pace of increase in household debt slowed somewhat, the ratio of *household debt to disposable income* rose further from 76 per cent in the first quarter to 76½ per cent in the second quarter of 2007.

Growth in *real final consumption expenditure by general government* reversed from an annualised rate of 14 per cent in the first quarter of 2007 to a rate of contraction of 3 per cent in the second quarter. The contraction followed high levels of expenditure on non-wage goods and services in the preceding quarter, due to the purchase of another submarine in the first quarter of 2007. In addition, real compensation of employees edged lower during the second quarter of 2007 as a result of lower salaries and wages paid to those employees who participated in the four-week public-sector strike. During these four weeks, while many government employees continued working, numerous schools were forced to close and some public hospitals and government offices had to operate with skeleton staff. Consequently, the ratio of final consumption expenditure by general government to gross domestic product declined to 19¼ per cent in the second quarter of 2007 compared with a ratio of 19½ per cent in the first quarter.

Real gross fixed capital formation increased further in the second quarter of 2007, albeit at a slower rate than in the first quarter. Annualised growth in real gross fixed capital formation moderated from a robust rate of 21¾ per cent in the first quarter of 2007 to 14¼ per cent in the second quarter. The less buoyant growth in the second quarter could mainly be attributed to a slower pace of growth in real capital outlays by public corporations. The rate of increase in real capital expenditure by private business enterprises also moderated somewhat, whereas that of general government accelerated. Relative to gross domestic product, gross fixed capital formation nevertheless increased from 20¼ per cent in the first quarter of 2007 to 21 per cent in the second quarter.



Growth in real gross fixed capital formation by the *private sector* tapered off slightly in the second quarter of 2007. Following an annualised increase of 13¾ per cent in the first quarter of 2007, growth in real capital expenditure by the private sector moderated to a rate of 13¼ per cent in the second quarter. Slower growth in real fixed capital outlays by the agricultural, manufacturing, transport and communication sectors more than neutralised stronger increases in real capital investment by the mining, construction, trade and finance sectors. Real gross fixed capital formation by private contractors as well as in the trade sector benefited from the buoyant state of activity in building and



infrastructural development projects. In addition, sales of commercial vehicles continued to grow on the back of positive investment trends.

Growth in real capital investment by *public corporations* expanded at an annualised rate of 16¼ per cent in the second quarter of 2007, notably less than the exceptionally buoyant rate of 85 per cent recorded in the first quarter of 2007. The high base in the first quarter of 2007 reflected extraordinary high capital outlays by the electricity sector, with the completion of the construction of certain plants to meet the ongoing power demand. Real capital outlays recorded by the electricity sector edged lower in the second quarter of 2007, while growth in investment expenditure by the transport sector also slowed. This was softened somewhat by increased spending on network equipment in the communication subsector.

The upgrading of public roads by provincial governments continued in the second quarter of 2007. In addition, expenditure on water and sanitation projects and on stadiums, all which are largely financed by local governments, rose further over this period. Following an increase of 16¼ per cent in the first quarter, capital expenditure by *general government* accordingly increased at an annualised rate of 17 per cent in the second quarter of 2007.

Annualised *real inventory accumulation* (at constant 2000 prices) edged lower from R11,8 billion in the first quarter of 2007 to R10,5 billion in the second quarter. Lower inventory investment was mainly evident in the mining and manufacturing sectors. The slower pace of inventory accumulation in the second quarter of 2007 in the mining sector was broad-based, except for an increase in gold inventories. Inventory investment in the manufacturing sector slowed in almost all subsectors except for oil inventories. By contrast, the trade sector recorded a build-up of inventories. This resulted from increased agricultural stocks-in-trade as by the end of the second quarter about three-quarters of the 2007 maize crop had already been delivered by producers and mainly stored in silos. Inventory accumulation in the motor trade sector not only reflected the decline in domestic sales of passenger and light commercial vehicles but probably also some restocking from earlier very low levels. As a result, real inventory investment subtracted about ½ a percentage point from annualised growth in real gross domestic expenditure in the second quarter. This stood in contrast to the first quarter, when inventory investment subtracted 3¼ percentage points from growth in aggregate domestic expenditure.

Factor income

The growth over four quarters in *total nominal factor income* edged higher from 14½ per cent in the first quarter of 2007 to 15½ per cent in the second quarter. This reflected stronger momentum in the gross operating surplus of business enterprises. Compensation of employees rose at a slightly lower rate in the second quarter of 2007 compared with the first quarter.

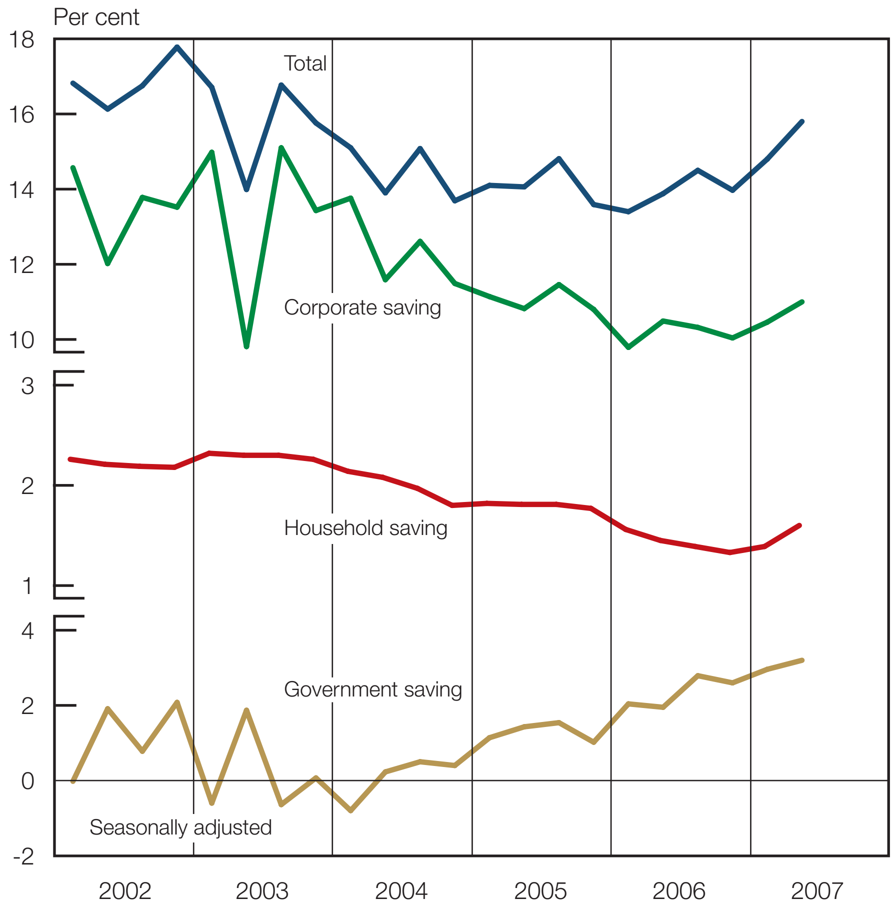
The year-on-year growth in the *gross operating surplus* of business enterprises accelerated from 19 per cent in the first quarter of 2007 to 21¼ per cent in the second quarter. Better performances were spread throughout all sectors of the economy, except for the mining and finance sectors.

Measured over one year, an increase of 9½ per cent was recorded in *total compensation of employees* in the second quarter of 2007, slightly lower than the rate of 9¾ per cent in the first quarter. Lower growth in total salaries and wages was recorded throughout the economy with the exception of the electricity and general government sectors where growth in compensation of employees increased from the first to the second quarter of 2007.

Gross saving

The national saving ratio, i.e. the ratio of *total gross saving to gross domestic product*, increased moderately from 14¾ per cent in the first quarter of 2007 to 16 per cent in the second quarter. The rise in the saving ratio can be attributed to improved saving ratios in the household, corporate and general government sectors. As counterpart to the higher level of gross domestic saving in the second quarter of 2007, less than 30 per cent of South Africa's capital formation was financed by foreign capital in the second quarter of 2007 compared with a dependency rate of 32 per cent in the first quarter.

Gross saving as percentage of gross domestic product



In the second quarter of 2007 the household sector's disposable income increased at a slightly faster rate than its final consumption expenditure, consequently improving the household saving ratio. Gross *household saving* as a percentage of gross domestic product increased from about 1½ per cent in the first quarter of 2007 to marginally above that in the second quarter.

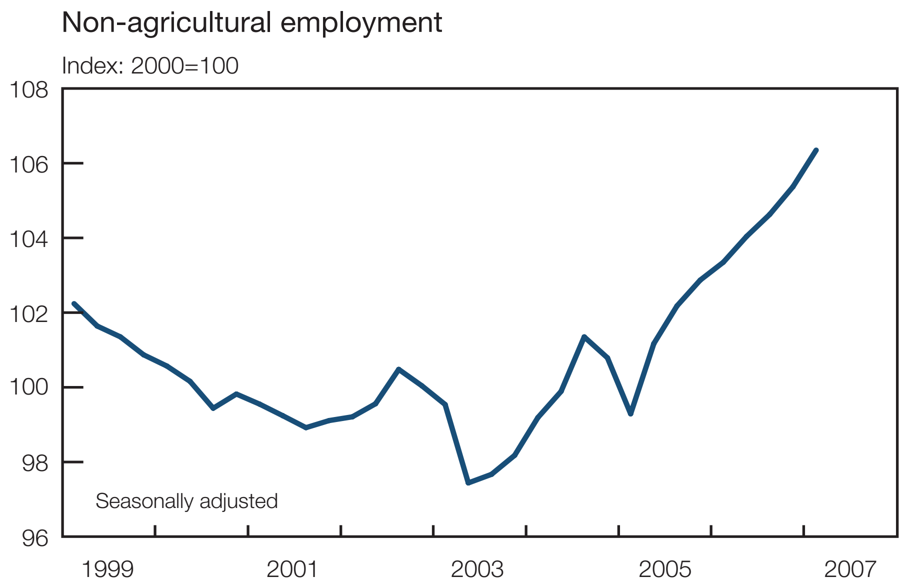
On the back of faster growth in operating surpluses, the gross saving ratio of the *corporate sector* increased modestly from 10½ per cent in the first quarter of 2007 to 11 per cent in the second quarter. Buoyant demand and sustained strong infrastructural spending boosted income in the corporate sector.

The gross saving ratio of *general government* edged higher from 3 per cent in the first quarter of 2007 to 3¼ per cent in the second quarter. In the second quarter of 2007 saving by general government continued to benefit from the sustained efficiency in the collection of tax. At the same time, current expenditure by government moderated as no high-value military items were acquired while salary and wage payments accruing to government employees were held back on account of strike activity.

Employment

Following a prolonged period of marginal employment gains, growth in employment accelerated markedly over the past eight quarters. Total employment in the formal non-agricultural sector rose by 76 400 workers in the first quarter of 2007 compared with the fourth quarter of 2006, implying a seasonally adjusted and annualised rate of increase of 3,8 per cent.

The improved employment prospects since the first quarter of 2005 have been evident in both the public and private sectors. Over the year to the first quarter of 2007, public-sector employment advanced by a healthy 3,9 per cent, whereas private-sector employment increased by 2,6 per cent. Despite the faster pace of job creation in the public sector, the bulk of new jobs created were in the private sector as it comprises a larger share of total formal non-agricultural employment.



The June 2007 *Quarterly Employment Statistics* (QES) survey of Statistics South Africa indicated that employment creation was fairly widespread throughout the economy in the first quarter of 2007. Employment gains were evident in construction, mining, finance, insurance, real-estate and business services, in trade, catering and accommodation, as well as in electricity supply, when compared with the fourth quarter of 2006.

Persistent strong fixed investment encouraged employment creation in especially the construction sector. Apart from buoyant building activity in the residential and non-residential markets, infrastructural development also gained momentum in recent years. Accordingly, confidence in the civil construction sector remained high, despite indications of shortages of skilled labour and building materials, employment by the sector stood close to levels last registered in the early eighties.

Change in non-agricultural private-sector employment in the first quarter of 2007

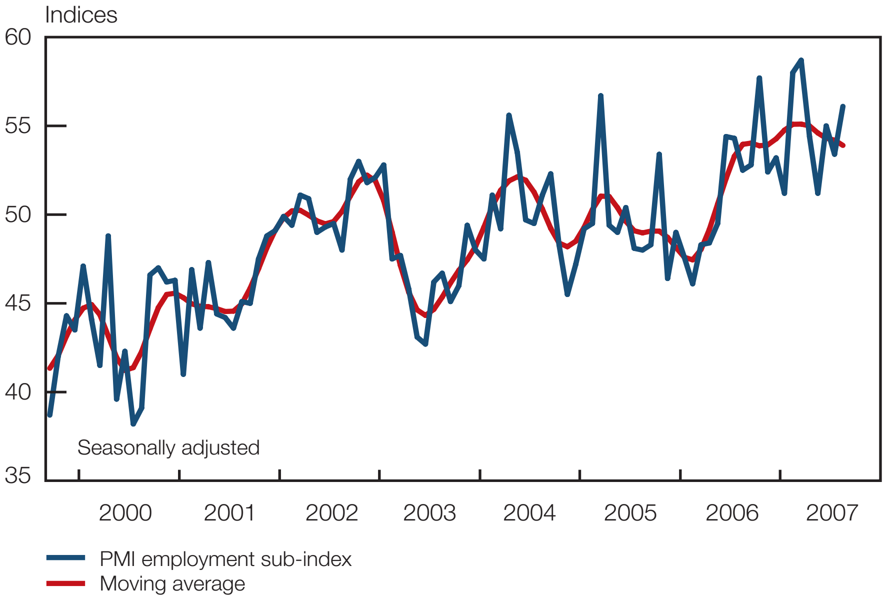
Quarter-to-quarter annualised rates

Sector	Percentage change
Gold mining	1,1
Non-gold mining	6,4
Manufacturing	-2,8
Electricity supply	3,2
Construction	18,0
Trade, catering and accommodation	5,0
Transport, storage and communication	-2,9
Financial intermediation and insurance	5,0
Total private sector	2,9

The non-gold mining sector recorded substantial growth in employment as favourable prices of especially platinum and base metals translated into new jobs being created. In addition, employment in the gold-mining sector increased meaningfully during the past five quarters. By the end of 2006 employment levels in the platinum-mining sector exceeded those in the gold-mining sector. However, due to a higher level of mechanisation in the industry, the coal-mining sector experienced a moderate decline in employment levels in recent years.

The transport, storage and communication sector as well as the manufacturing sector registered a decrease in employment numbers in the first quarter of 2007 compared with the final quarter of 2006. According to the latest Investec Purchasing Managers Index (PMI) released by the Bureau for Economic Research (BER), the sub-index for employment in the manufacturing sector remained above the neutral value of 50 but moderated from a recent peak of 58,7 in March 2007 to 56,1 in August.

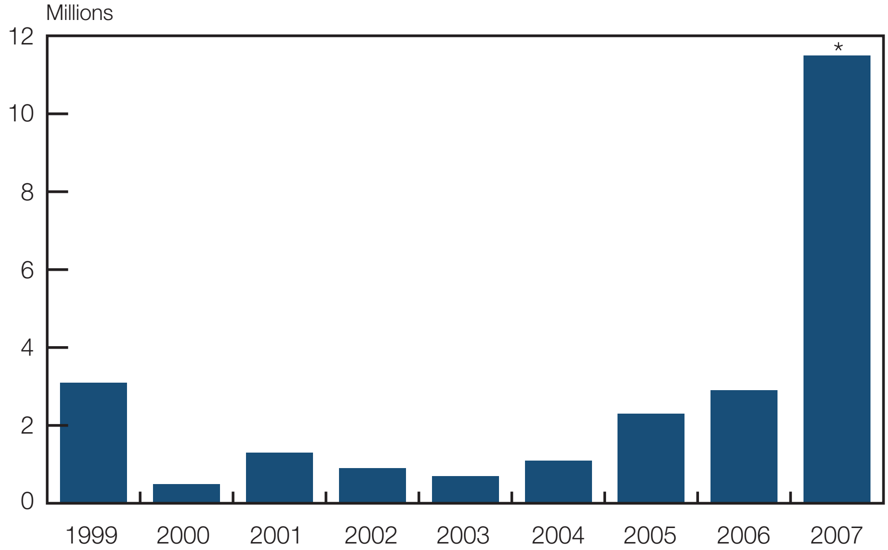
BER/Investec PMI employment sub-index



In the first quarter of 2007 the public sector recorded a seasonally adjusted and annualised increase in employment numbers of 7,1 per cent, attributable to employment growth in the national and provincial government and public corporations.

With wage increases demanded by trade unions generally far above wage increases offered by employers in the first six months of 2007, the scene was set for widespread industrial action. Andrew Levy Employment Publications, a private-sector employment consultancy, indicated that the number of mandays lost due to strike action, bolstered by a strike in the civil service, rose to 11,5 million in the first half of 2007 compared with 1,6 million in the corresponding period in 2006. This exceeded the previous high, set in 1987, when labour action was more strongly focused on political rather than economic goals and 9,0 million mandays were lost in the year as a whole.

Number of mandays lost due to strike action



* First half of 2007

Source: Andrew Levy Employment Publications

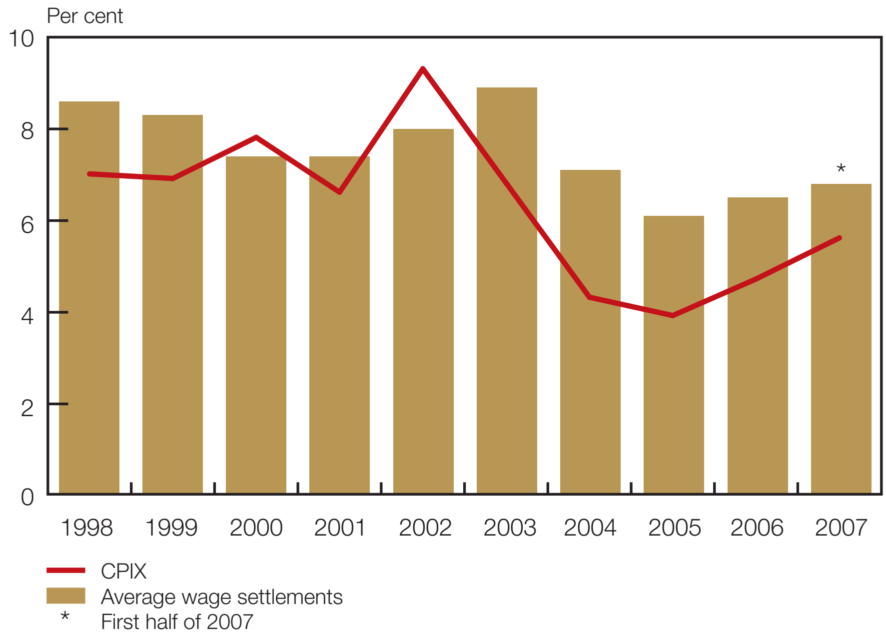
Labour cost and productivity

Growth in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy accelerated from a year-on-year rate of 6,0 per cent in the second quarter of 2006 to 8,6 per cent in the fourth quarter, before decelerating to 4,6 per cent in the first quarter of 2007. This trend was substantiated by the Automated Clearing Bureau (ACB) system for salaries, wages and pensions deposited into bank accounts of about five million salaried and retired workers. The ACB system indicated a year-on-year growth rate of 11,7 per cent in the third quarter of 2006 which moderated to 7,3 per cent in the first quarter of 2007.

Year-on-year growth in nominal remuneration per worker in the private sector outpaced that in the public sector in the first quarter of 2007. Growth in average remuneration per worker in the private sector slowed to a year-on-year rate of 5,1 per cent while growth in public-sector remuneration decelerated to 3,1 per cent over the period. Exceptionally high growth rates were noted in the community, social and personal services sector (17,0 per cent) as well as in the electricity sector (9,8 per cent). In the public sector, the highest year-on-year remuneration increases were noted at provincial level (6,0 per cent) and at national government departments (4,1 per cent).

According to Andrew Levy Employment Publications, the average rate of wage settlements amounted to 6,5 per cent in 2006, rising to 6,8 per cent in the first half of 2007. Settlements ranged from 4,5 per cent in the transport sector to 12,0 per cent in the retail sector. On average, management's initial offer amounted to 4,8 per cent in the second quarter of 2007 compared with 3,6 per cent in the second quarter of 2006. Wage demands by trade unions averaged 14,2 per cent in the first half of 2007 and ranged from 10 to 32 per cent.

Wage settlement rates and CPIX inflation



Source: Andrew Levy Employment Publications and Statistics South Africa

In recent quarters, output growth in the economy outpaced employment gains. This led to an acceleration in economy-wide labour productivity growth from a year-on-year rate of 2,5 per cent in the second quarter of 2006 to 3,1 per cent in the fourth quarter, before proportionally larger gains in employment moderated productivity growth to 2,4 per cent in the first quarter of 2007.

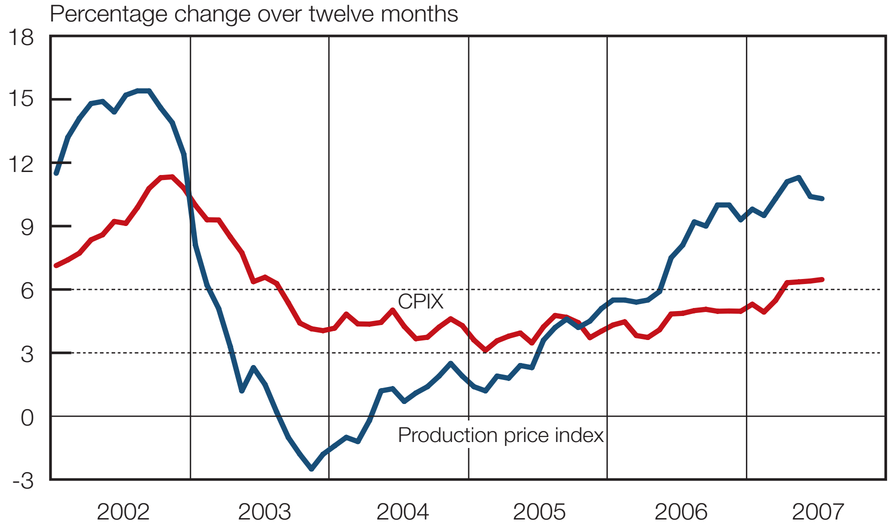
Largely on account of the significant moderation in growth in total salaries and wages in the first quarter of 2007, the year-on-year rate of increase in nominal unit labour cost decelerated from 5,3 per cent in the fourth quarter of 2006 to 2,2 per cent in the first quarter of 2007.

Prices

Price pressures in the domestic economy mounted in the second quarter of 2007, primarily due to rising international crude oil prices and sharply higher food price inflation, but increasingly displaying signs of a more generalised higher inflation. Year-on-year CPIX inflation fluctuated within the inflation target range of between 3 and 6 per cent for 43 successive months from September 2003, amounting to 5,5 per cent in March 2007. In April 2007, however, it breached the 6-per-cent upper limit of the inflation target range, reaching 6,3 per cent. CPIX inflation edged higher to a year-on-year rate of 6,5 per cent in July 2007.

Inflation

Percentage change over twelve months



Driven mainly by the persistent increases in international crude oil prices, rising prices of imported agricultural and manufactured food products and depreciating external value of the rand, 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. From January 2006 to October the rand depreciated by no less than 20 per cent against a basket of currencies. Thereafter, the rate of increase in imported goods prices fell to 9,9 per cent in March 2007 along with a decline in mineral product prices and moderate recovery in the exchange rate. Due to further sizeable increases in especially the international dollar price of crude oil which rose by 44,9 per cent between January 2007 and July, this rate of increase once again accelerated to 11,7 per cent in May 2007 before moderating to 9,2 per cent in July.

Production prices

Quarter-to-quarter percentage changes at annualised rates

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

Inflation in the *production prices of domestically produced goods* accelerated markedly and more than doubled from a year-on-year rate of 5,0 per cent in March 2006 to 11,2 per cent in April 2007 before decelerating to 10,6 per cent in July 2007. The initial build-up in production price inflation was largely due to a surge in the agricultural product prices category which reflected substantial increases across most sub-components, including food and non-food agricultural products. Agricultural food price inflation, which had amounted to 23,5 per cent in the year to August 2006, decelerated to 12,2 per cent in December before accelerating again to 19,2 per cent in March 2007. The rate of increase moderated in the subsequent three months before accelerating once more to 19,0 per cent in July. 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. In the ensuing period it decelerated somewhat to 10,0 per cent in February 2007 before picking up sharply to 15,1 per cent in July.

As a result of the higher rates of increase in the prices of imported goods and the acceleration in domestically produced goods price inflation, *all-goods production price inflation* rose to a year-on-year rate of 11,3 per cent in May 2007 – the highest rate in fifty-two months. This rate of increase then moderated to 10,3 per cent in July 2007, in part due to a high base recorded. When the rapidly rising energy and food prices are excluded from the all-goods production price index, an increase of 8,9 per cent was recorded in the year to July 2007. This rate of increase is more than three times higher than the 2,7 per cent recorded eighteen months earlier in February 2006.

The quarter-to-quarter pace of increase in the all-goods production price index accelerated from an annualised rate of 4,3 per cent in the first quarter of 2007 to 14,4 per cent in the second quarter.

Food prices

Percentage change over twelve months

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

The differential between all-goods production price inflation and consumer price inflation widened from 1,5 percentage points in January 2006 to 4,4 percentage points in May 2007. By reducing their profit margins, retailers seemed to be absorbing some of the higher production prices, thereby delaying the pass-through to consumer prices. Year-on-year *CPIX inflation* amounted to 6,5 per cent in July 2007 compared with 3,7 per cent in April 2006. Following the significant increase in the production prices of food, year-on-year CPIX consumer food price inflation more than doubled from 4,3 per cent in January 2006 to 9,4 per cent in October before falling back to 7,8 per cent in March 2007. However, the food component still accounted for the bulk of the increase in

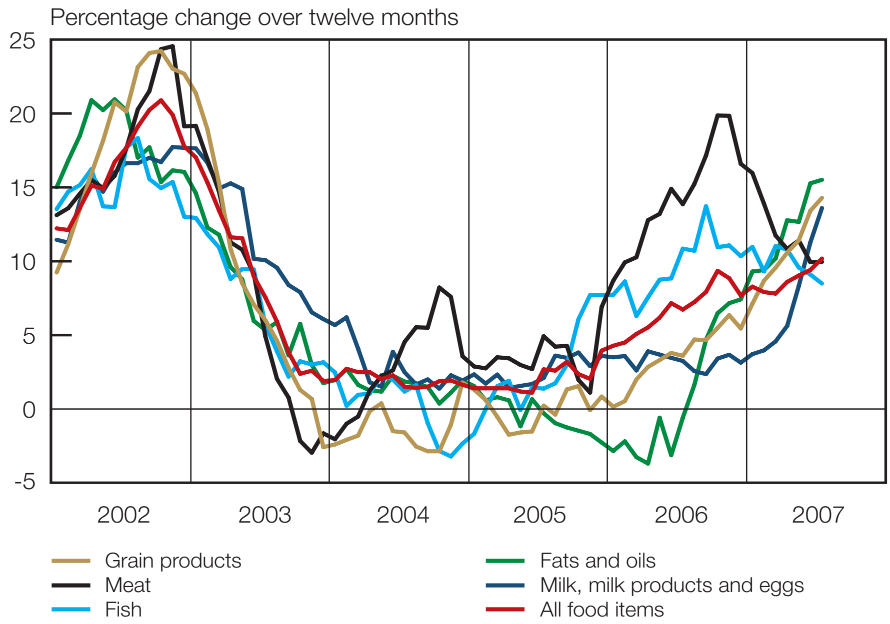
CPIX inflation. Subsequently, this rate of increase resumed its upward trend, amounting to 10,2 per cent in July 2007. In fact, if food prices were to be excluded from the index, CPIX inflation would have amounted to only 5,1 per cent in the year to July 2007 – more than a full percentage point lower than the overall CPIX inflation measure.

The quarter-to-quarter rate of CPIX inflation accelerated from a seasonally adjusted and annualised rate of 3,9 per cent in the fourth quarter of 2006 to 9,1 per cent in the second quarter of 2007 as higher energy and food prices impacted on the price index.

Year-on-year *CPIX goods price inflation* accelerated from 5,0 per cent in February 2007 to 6,8 per cent in July. Petrol price increases in the opening months of 2007 together with the rapid acceleration in consumer food prices were the main drivers of the acceleration in CPIX goods price inflation.

Due to increases in international commodity prices of white and yellow maize, wheat, and sunflower seeds, exacerbated by drought conditions during the domestic production season and a weaker exchange rate of the rand from 2006, food price inflation exceeded the upper end of the inflation target band for fifteen consecutive months. In the year to July 2007 CPIX food price inflation rose to a year-on-year rate of 10,2 per cent, accompanied by double-digit inflation numbers recorded in the prices of grain products, meat, fats and oils as well as milk products. Due to shortages experienced in the local milk industry, the prices of milk products increased. Although inflation in the prices of food in the CPIX basket was initially mainly restricted to fish, grain products and meat, it became more widespread recently.

Selected consumer food prices



Alongside the acceleration in CPIX goods price inflation, *CPIX services price inflation* also accelerated from a year-on-year rate of 4,6 per cent in January 2007 to 5,7 per cent in July. Services price inflation continued to remain within the inflation target range despite the fact that over the past eighteen months a number of CPIX services components hovered above the 6-per-cent level. Higher rates of increase in CPIX services price inflation were prevalent in the housing services components – in particular domestic workers' wages and homeowners' costs – as well as in licence-related expenses, dry-cleaning, medical and education services.

As indicated in the accompanying table, four of the ten main components, constituting virtually half of the overall CPIX index, increased at a year-on-year rate in excess of 6 per cent in July 2007, explaining the continued breaching of the upper limit of the inflation target range in that month. Year-on-year inflation in the prices of three components, with a combined weight of only 13,0 per cent, fell below the lower boundary of the inflation target range while three components, with a combined weight of almost 38 per cent, fell within the inflation target range.

Inflation in CPIX components

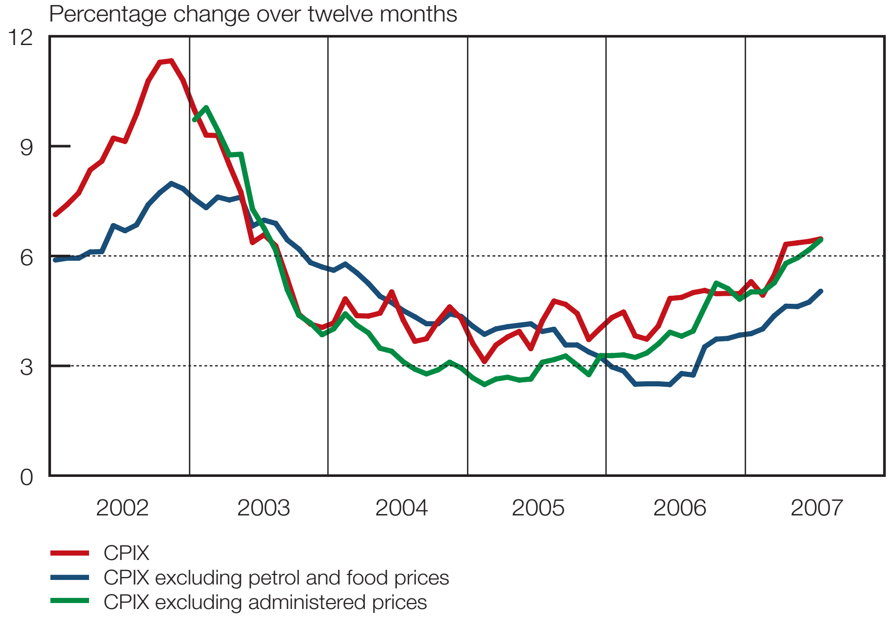
Percentage change over twelve months

	Weights	July 2007
Transport running cost	5,7	6,4
Food and soft drinks	26,9	9,9
Alcoholic beverages and tobacco	3,1	10,2
Total housing services	13,4	6,7
Total other goods (not included elsewhere)	17,5	***5,8***
Services excluding housing and transport	16,5	***5,5***
Total transport services	3,9	***3,4***
Furniture and equipment	3,2	0,2
Vehicles	5,7	0,8
Clothing and footwear	4,1	-7,4
Total CPIX	**100,0**	**6,5**

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

In April 2007 year-on-year CPIX inflation breached the upper limit of the inflation target range for the first time in 44 months when it accelerated to 6,3 per cent. However, when the combined effect of rising energy and food prices – the main drivers of CPIX inflation – are omitted from the calculation, CPIX inflation would have amounted to only 5,0 per cent in the year to July 2007. Nevertheless, this measure of underlying inflation picked up significantly over the past year. A similar result holds if administered prices are excluded from the calculation of CPIX inflation. Year-on-year inflation in the prices of administered goods and services amounted to 8,3 per cent in April 2007 before falling to 6,6 per cent in July.

CPIX and underlying inflation



Foreign trade and payments

International economic developments

The expansion in global economic activity recorded in the first quarter of 2007 was largely maintained in the second quarter, driven by strong growth in China and in emerging markets in general. The composite leading indicator of the Organisation for Economic Co-operation and Development (OECD) suggested a continued moderate expansion in the OECD area in the medium term.

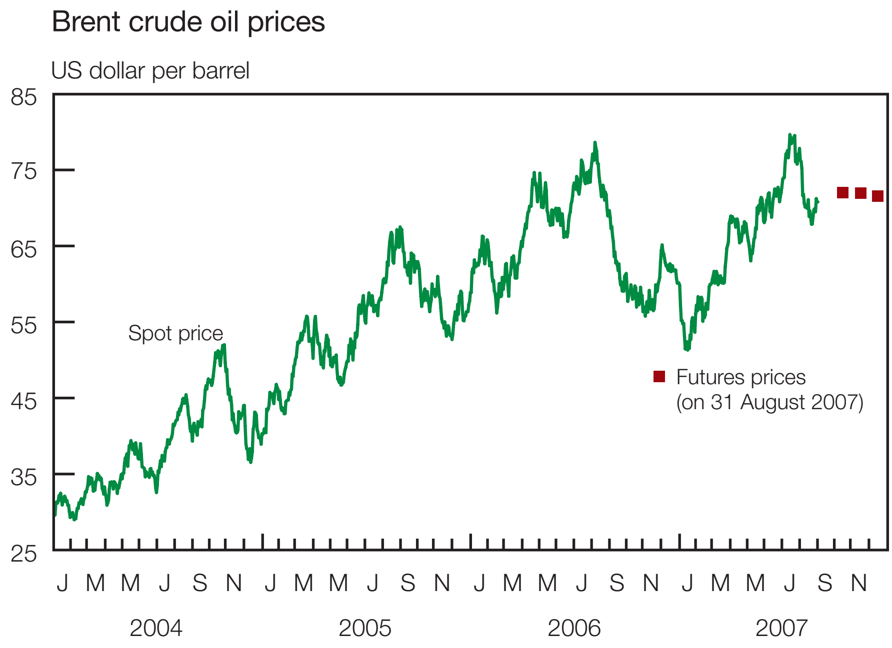
Concerns regarding a possible disorderly unwinding of global imbalances moderated somewhat after current-account positions as a percentage of gross domestic product stabilised in 2006. In August 2007 turmoil erupted in the United States (US) sub-prime mortgage market, causing significant volatility in global financial markets which could have a negative impact on global growth and stability. In response, major central banks intervened to provide liquidity and the US Federal Reserve also reduced its discount rate by 50 basis points. Other risks to the global growth and inflation outlook included high and volatile oil prices and the effects of tighter monetary policy.

Economic activity in the US rebounded in the second quarter of 2007, largely as a result of a revival in external trade conditions and positive growth in non-residential fixed investment and personal consumption expenditure. By contrast, construction activity in the residential market remained sluggish. The Japanese economy slowed more than expected in the second quarter of 2007, partly reflecting a moderation in the growth of private consumption and exports as well as a contraction in private investment. Recent estimates indicated that economic activity in the euro area moderated somewhat during the same period.

Accelerating economic growth in major emerging-market countries continued to support global economic activity. The Chinese economy in particular expanded by a robust 15,7 per cent in the second quarter of 2007, underpinned by strong external demand, elevated growth in fixed investment and rising domestic consumption. The solid pace of expansion in Africa in recent years was maintained in 2006 as the continent benefited from the sustained global economic expansion, improved macroeconomic policies, debt relief and favourable fuel and non-fuel commodity prices.

Brent crude oil prices rebounded from levels of around US$51 per barrel in mid-January 2007 to around US$72 per barrel at the end of June. Upward pressure on oil prices throughout this period stemmed from tight US fuel supplies, supply disruptions in Nigeria, supply restrictions by the Organization of the Petroleum Exporting Countries (OPEC), US refinery interruptions and geopolitical tensions in Nigeria and the Middle East. The oil price increased further into the third quarter of 2007, reaching levels close to US$80 per barrel in mid-July amid security concerns in the United Kingdom, continued attacks on oil installations in Nigeria and seasonal maintenance and unplanned production cuts in the North Sea. In addition, the nationalisation of the Venezuelan oil industry lent support to prices. Crude oil prices declined during August to levels of around US$68 per barrel due to rising US fuel stocks, a downward revision of Atlantic hurricane forecasts, increased OPEC output and concerns that the effects of the US sub-prime mortgage market could slow economic growth. Oil prices again picked up towards the end of the month on declining US crude oil and fuel stocks.

While overall consumer price inflation in the US could not escape the impact of higher energy and food prices, core inflation remained subdued in the first seven months of



2007, partly due to a marked slowdown in housing costs. After rising modestly at the end of 2006 due to higher energy costs, inflation in Japan receded. The annual rate of change in core consumer prices is expected to remain at around zero per cent in the near future. In the euro area inflation remained well contained during the past few months. In emerging-market countries annual consumer price inflation remained fairly steady in the second quarter of 2007. Brazil, China, the Czech Republic, Korea, Poland and Russia, however, are among the major countries that are experiencing mounting inflationary pressures.

With the global inflation outlook adversely affected by robust domestic demand, capacity constraints as well as escalating energy and food prices, monetary policy has been tightened in many countries since April 2007. These include Australia, Canada, Chile, China, the Czech Republic, the euro area, Mexico, New Zealand, Poland, South Korea, Switzerland, Taiwan and the United Kingdom. By contrast, some emerging-market countries such as Brazil, Hungary, Russia and Thailand have lowered their policy rates.

Current account[2]

The continued global economic expansion, underpinned by brisk economic activity in China and India, raised the demand for South African exports in the second quarter of 2007. The improved export performance coincided with slower growth in gross domestic expenditure and a contraction in the physical quantity of merchandise imports. Consequently, the trade deficit narrowed from R50,9 billion in the first quarter of 2007 to R31,4 billion in the second quarter.

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

At the same time net service, income and current transfer payments to the rest of the world rose considerably, offsetting much of the improvement on the trade account. The current-account deficit of the balance of payments accordingly narrowed from R130,5 billion in the first quarter of 2007 to R125,2 billion in the second quarter. Relative to gross domestic product, the deficit on the current account narrowed from 6,9 per cent to 6,5 per cent over the period.

Balance of payments on current account

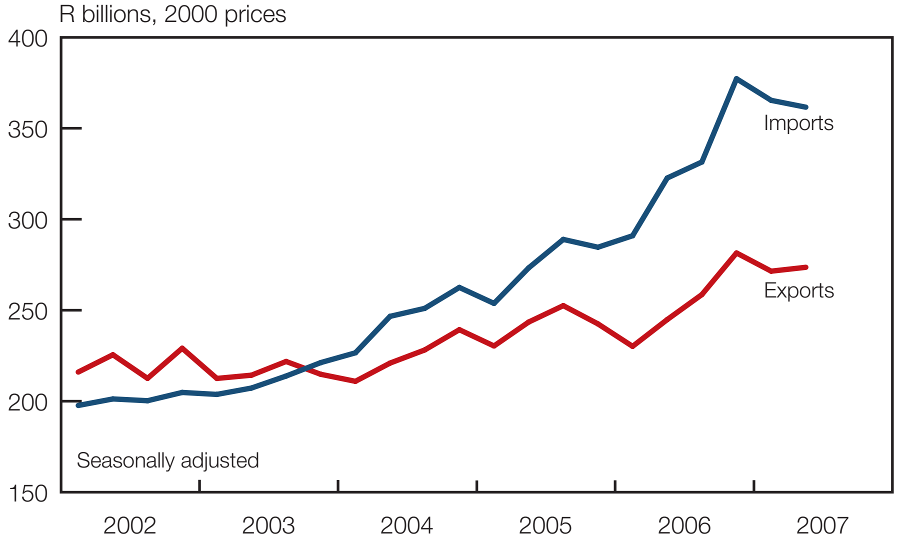
Seasonally adjusted and annualised
R billions

	2006				2007	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	369,7	425,7	472,6	398,5	466,8	494,9
Net gold exports	33,7	39,4	39,5	35,5	37,3	36,3
Merchandise imports	-444,4	-497,7	-577,7	-476,5	-555,0	-562,6
Trade balance	**-41,0**	**-32,6**	**-65,6**	**-42,5**	**-50,9**	**-31,4**
Net service, income and current transfer payments	-60,8	-67,3	-77,4	-69,9	-79,6	-93,8
Balance on current account	**-101,8**	**-99,9**	**-143,0**	**-112,4**	**-130,5**	**-125,2**
As percentage of gross domestic product	*-6,1*	*-5,7*	*-7,8*	*-6,5*	*-6,9*	*-6,5*

The value of *merchandise exports* increased by 6 per cent in the second quarter of 2007 following a brief decline in the preceding quarter. A renewed surge in international commodity prices, especially metal prices, largely contributed to the higher value of exported mining products. Simultaneously, the value of exported manufactured products advanced further as the export of vehicles and transport equipment benefited in part from the reduction in tariffs on trade in motor vehicles between South Africa and the European Union. This increase was, however, partly offset by a decline in the exported value of textiles and articles thereof as well as chemical products. The higher value of exported manufactured goods was also supplemented by a rise in the export earnings of agricultural products.

The average rand price of merchandise exports rose by 5 per cent in the second quarter of 2007 as an increase in international commodity prices more than offset the impact of the appreciation of the rand. In US-dollar terms, the price of South African export commodities surged by about 10 per cent over the period. In addition to the higher rand prices of exports, export proceeds also gained from a 1-per-cent increase in the volume of goods exported in the second quarter. The international demand for domestically

Real imports and exports of goods



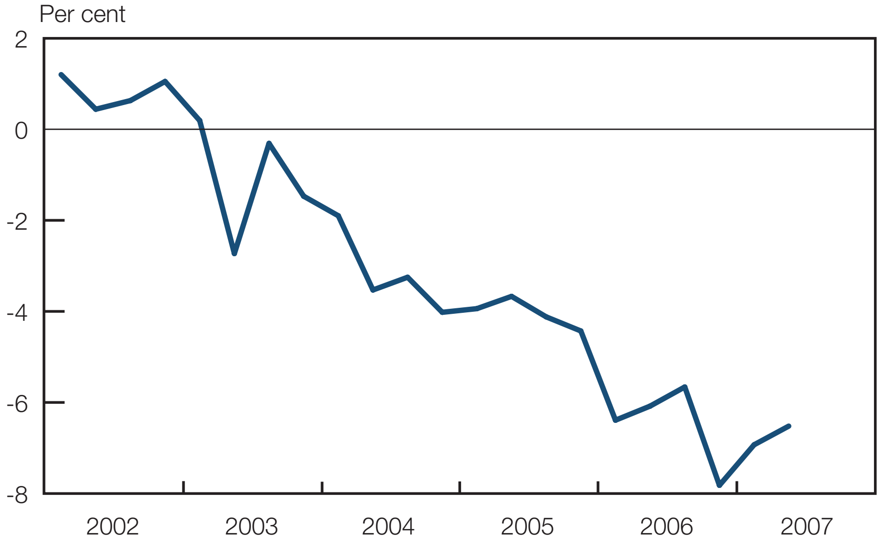
produced manufactured goods was apparently adequately met by domestic supply. However, in the case of mining products inventory levels were reduced to meet international demand. The volume of merchandise exports had previously contracted by 3,1 per cent in the first quarter of 2007.

The export earnings of South African gold producers contracted by 2½ per cent in the second quarter of 2007 mainly on account of a decline in the volume of gold exports. The volume of net *gold exports* receded by 3 per cent in the second quarter of 2007, continuing the decline recorded in the first quarter of 2007. This decline in export volumes more than neutralised an increase of ½ a per cent in the average realised rand price of gold. The fixing price of gold on the London market rose by 2½ per cent from the first to the second quarter of 2007 to register a new record-high quarterly average of US$667 per fine ounce. The higher gold price resulted mainly from strong demand in an environment of declining global production and rising international commodity prices.

The moderate slowdown in domestic demand was accompanied by a decrease in the volume of goods purchased abroad. The volume of *merchandise imports* contracted by 1 per cent in the second quarter of 2007 despite an increase of 27 per cent in the physical quantity of crude oil imports over the period. Despite the lower import volumes to satisfy domestic demand, the import penetration ratio remained sturdy when compared with preceding quarters.

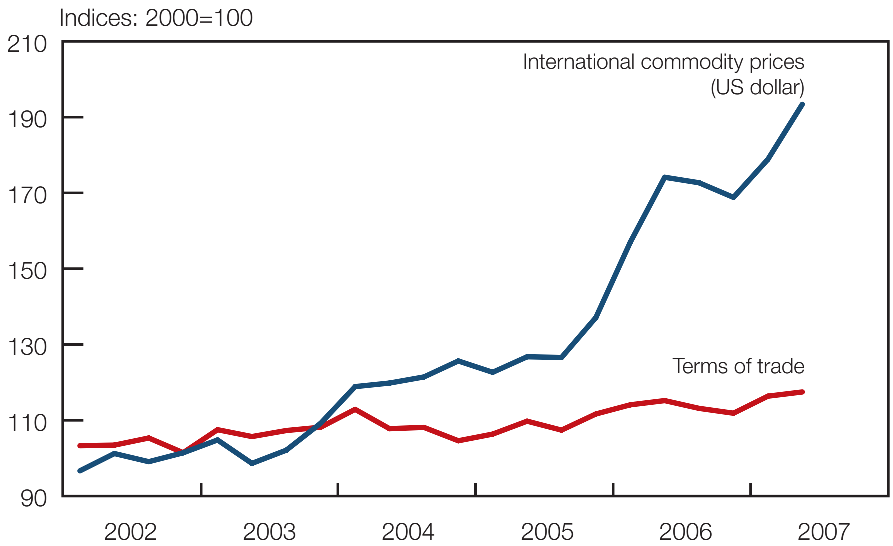
The revival of international oil and other prices more than outweighed the appreciation of the rand during the second quarter of 2007, raising the rand price of merchandise imports by 2½ per cent over the period. As a consequence, the value of merchandise imports advanced by 1½ per cent from R555,0 billion in the first quarter of 2007 to R562,6 billion in the second quarter.

Ratio of current-account balance to gross domestic product



The shortfall on the net service, income and current transfer account with the rest of the world increased considerably from R79,6 billion in the first quarter of 2007 to R93,8 billion in the second quarter. The larger negative imbalance could be attributed to a substantial increase in net income payments to non-resident investors and foreign creditors. The increase in dividend payments resulted from the sustained high profit margins of South African companies together with the sizeable increase in non-resident holdings of domestic securities during the past 2½ years. These payments were, however, partly offset by an increase in the dividend receipts by South African residents on their investments abroad as well as higher receipts for other services rendered to non-residents.

International commodity prices and terms of trade



South Africa's terms of trade continued its broad upward trend, improving marginally in the second quarter of 2007.

Financial account

The net inflow of capital related to balance-of-payments transactions increased from R32,5 billion in the first quarter of 2007 to R47 billion in the second quarter. While portfolio capital continued to dominate inward capital flows, a direct investment inflow was also recorded on a net basis. As a ratio of gross domestic product, the total net inward movement of foreign capital amounted to 2,4 per cent over the period.

Net financial transactions not related to reserves
R billions

	2006				2007	
	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities						
Direct investment	3,8	-1,1	-14,0	-2,9	3,8	12,0
Portfolio investment	36,0	23,9	31,5	144,3	24,5	42,0
Other investment	27,5	17,4	1,0	62,4	3,3	18,8
Change in assets						
Direct investment	-9,1	-35,0	1,1	-45,2	-1,4	-7,9
Portfolio investment	-3,3	-2,5	-4,5	-13,7	-3,7	-7,1
Other investment	-16,9	14,9	2,9	-43,1	13,2	-20,5
*Total financial transactions**	*28,6*	*36,4*	*43,0*	*142,0*	*32,5*	*47,0*

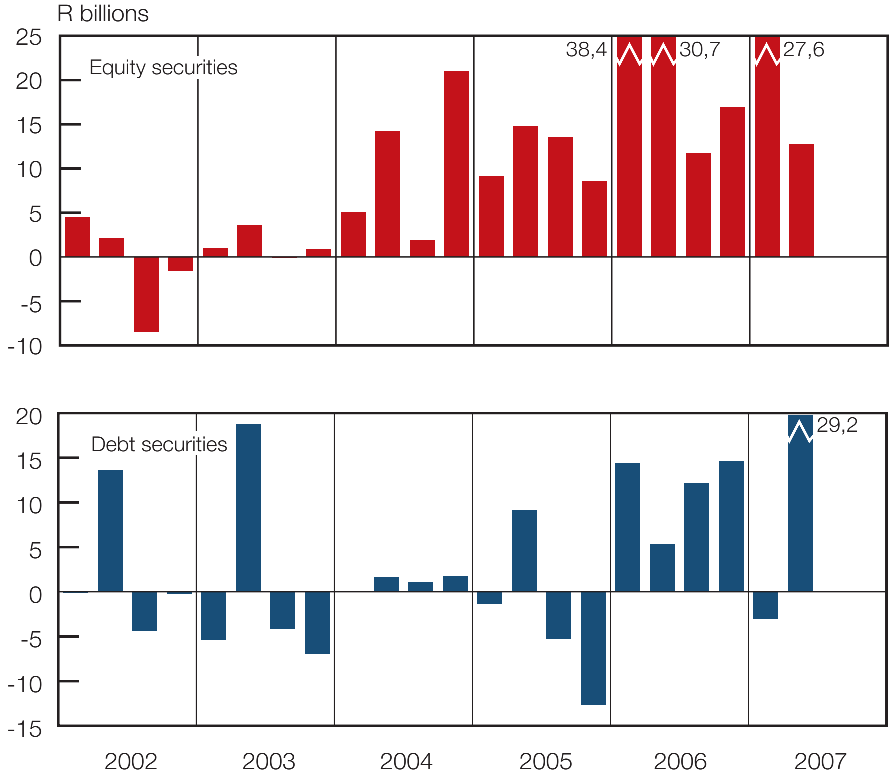
* Including unrecorded transactions

Foreign-owned assets in South Africa

Foreign direct investment into South Africa increased from R3,8 billion in the first quarter of 2007 to R12 billion in the second quarter. The increase in direct investment liabilities in the second quarter of 2007 was mainly due to the acquisition of shares in domestic glass manufacturing and retail clothing companies by private equity funds. These capital inflows were partly neutralised by foreign investors' sale of a stake in a South African cement company to a black economic empowerment group. Cumulatively, the increase in the country's direct investment liabilities amounted to R15,8 billion in the first half of 2007 compared with an outflow of capital (i.e. a reduction in direct investment liabilities) of R15,1 billion in the second half of 2006.

Foreign portfolio investors increased their holdings of South African equity and fixed interest securities by R42 billion in the second quarter of 2007, following an inflow of R24,5 billion in the first quarter. Contrary to previous quarters, a significant portion of these inflows constituted investment in newly issued debt securities. Private-sector companies in the glass manufacturing and retail clothing sectors issued euro-denominated bonds to the value of R21,4 billion to partly finance the buy-out by private equity fund managers. The inflow of debt capital was further supplemented by the issuance of international bonds by the National Treasury and the banking sector. These inflows were countered in part by the early redemption of an international foreign-currency denominated bond to the value of approximately R8,7 billion by the National Treasury.

Inward portfolio investment flows



Other foreign investment into South Africa increased by a further R18,8 billion in the second quarter of 2007 as a black economic empowerment consortium obtained a foreign loan to finance part of the acquisition of a majority stake in a domestic cement company. The inward movement of capital also reflected the drawdown of foreign-currency denominated long-term loans by the South African banking sector and an increase in rand-denominated deposits of non-resident investors with South African banks. Over the same period, non-resident investors reduced their foreign-currency deposits held with South African banks, as well as short-term loans extended to South African parties.

South African-owned assets abroad

The outflow of capital related to *direct investment* abroad by South African entities increased markedly from R1,4 billion in the first quarter of 2007 to R7,9 billion in the second quarter. The acquisition of foreign entities by platinum-mining and telecommunications companies as well as the continuing investment abroad by a South African petro-chemical company were responsible for this outflow of capital. The increasing momentum of direct investment abroad by South African companies could have been partly encouraged by the further relaxation of exchange controls.

Portfolio investment abroad (i.e. the acquisition of foreign debt and equity securities), mainly by South African institutional investors, amounted to R7,1 billion in the second quarter of 2007. This ongoing diversification of portfolio assets followed an increase of R3,7 billion in the first quarter.

Other *outward investment* changed to an outflow of R20,5 billion in the second quarter of 2007 from an inflow of R13,2 billion in the first quarter. The outflow of funds in the second quarter was mainly due to an increase in foreign-currency denominated deposits with and loans and advances extended to foreign banks and, to a lesser extent, rand-denominated deposits with and loans and advances to foreign banks.

Foreign debt

South Africa's total outstanding foreign debt contracted from US$59,2 billion in the fourth quarter of 2006 to US$57,6 billion in the first quarter of 2007, or by US$1,6 billion. This decline could be attributed to a decrease of US$0,9 billion in foreign-currency denominated debt and a decline of US$0,7 billion in rand-denominated debt.

Foreign debt of South Africa

US$ billions at end of period

	2006				2007
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Foreign-currency denominated debt...	**29,7**	**33,1**	**35,4**	**35,8**	**34,9**
Bearer bonds	10,1	10,7	10,5	10,5	10,3
Public sector	4,5	4,6	4,8	5,2	5,2
Monetary sector	8,6	10,1	10,7	10,3	10,7
Non-monetary private sector	6,5	7,7	9,4	9,8	8,7
Rand-denominated debt	**25,9**	**24,2**	**21,6**	**23,4**	**22,7**
Bonds	6,6	6,0	6,3	7,5	6,1
Other	19,3	18,2	15,3	15,9	16,6
Total foreign debt	**55,6**	**57,3**	**57,0**	**59,2**	**57,6**

The decrease in foreign-currency denominated debt during the first quarter of 2007 can be attributed to the redemption of bridging finance obtained by South African companies in the fourth quarter of 2006. An increase in the drawings on short-term loans by the banking sector was partly matched by a decline in the foreign-currency deposits with domestic banks over the period. The country's rand-denominated debt decreased during the first quarter of 2007 mainly as a result of the redemption of a rand-denominated domestic bond as well as a payment by the government related to accrued Southern African Customs Union (SACU) commitments in the first quarter of 2007.

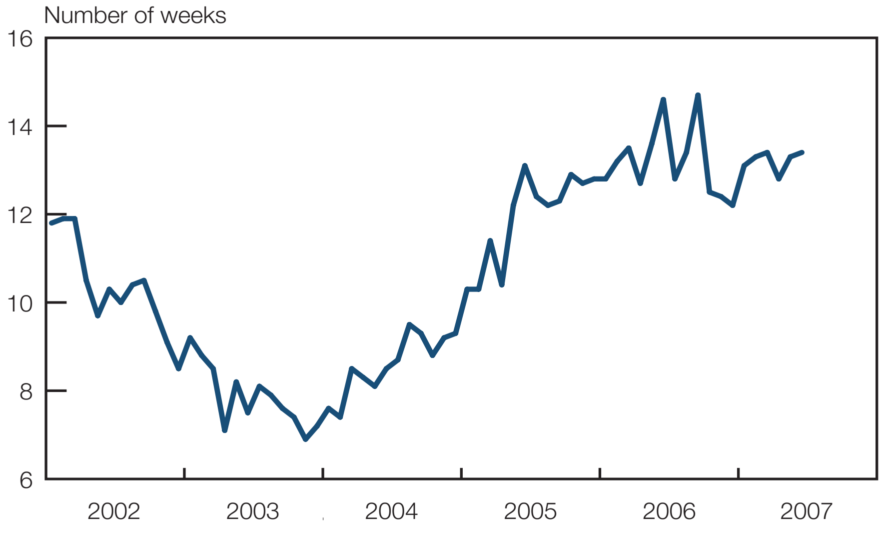
Measured in rand, South Africa's total foreign debt increased by R5 billion in the first quarter – from R412 billion in the fourth quarter of 2006 to R417 billion in the first quarter of 2007.

International reserves and liquidity

Net inflows of capital on the financial account of the balance of payments were more than sufficient to finance the deficit on the current account. As a result, 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 R13,3 billion in the second quarter of 2007 compared with a surplus of R5,7 billion in the first quarter.

In US-dollar terms, the value of the Bank's international reserves before accounting for reserve-related loans increased from US$26,5 billion at the end of March 2007 to US$28,3 billion at the end of June and further to US$29,8 billion at the end of August. The Bank's short-term credit facilities utilised declined from US$2,8 billion at the end of December 2006 to US$2,5 billion at the end of June 2007 and remained unchanged up to the end of August. The level of import cover (i.e. the value of gross international reserves relative to the value of imports of goods, services and income) increased from 12 weeks at the end of December 2006 to 13½ weeks at the end of June 2007. This ratio nearly doubled from the end of 2003.

Imports covered by reserves



The Bank's international liquidity position increased from US$23,0 billion at the end of December 2006 to US$25,9 billion at the end of June 2007 and further to US$27,4 billion at the end of August.

Exchange rates

The nominal effective exchange rate of the rand increased by 1,8 per cent from the end of March 2007 to the end of June 2007, following a decline of 4,4 per cent in the first quarter. The strengthening of the exchange rate of the rand during the second quarter of 2007 can be attributed to a further surge in international commodity prices and positive sentiment surrounding large foreign inflows from private equity investors. The credit rating agencies Fitch and Moody's changed South Africa's foreign-currency ratings outlook to positive during the period. Against a basket of the currencies of South Africa's most important trading-partner countries, the exchange rate of the rand weakened significantly towards the end of July 2007 and in the first half of August following the re-pricing of risk on financial markets. This risk assessment was based on concerns about future leveraged buy-outs, the worsening housing market and consumer demand in the US, as well as rising oil prices.

The real effective exchange rate of the rand appreciated, on balance, by 1,8 per cent in the first half of 2007, following a depreciation of approximately 11 per cent in 2006.

Exchange rates of the rand
Percentage change

	30 Sep 2006 to 29 Dec 2006	29 Dec 2006 to 31 Mar 2007	31 Mar 2007 to 29 Jun 2007	29 Jun 2007 to 31 Aug 2007
Weighted average*	7,7	-4,4	1,8	-1,5
Euro	6,2	-5,0	1,3	-1,6
US dollar	10,5	-4,0	2,4	-0,2
British pound	5,2	-3,7	0,1	-0,8
Japanese yen	11,3	-4,7	7,0	-6,0

* Against a basket of 13 currencies

The average daily turnover in the domestic market for foreign exchange increased from US$15,3 billion in the first quarter of 2007 to a new high of US$16,1 billion in the second quarter. This increase can largely be attributed to an increase in equity and debt flows through the financial account of the balance of payments. The value of foreign-exchange transactions in which non-resident parties participated decreased from 78 per cent to 76 per cent over the period.

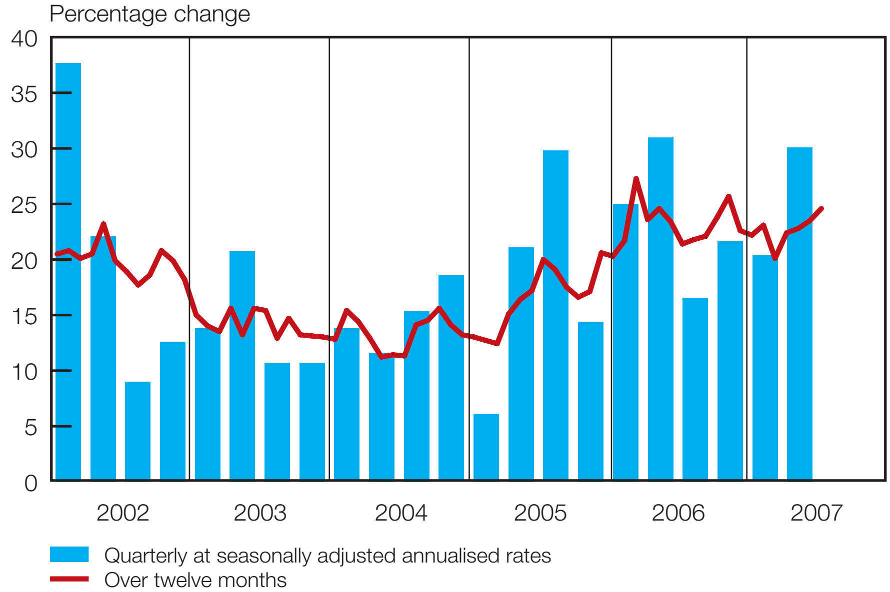
Effective exchange rates of the rand

Monetary developments, interest rates and financial markets

Money supply

The broadly defined money supply (M3) recorded exceptionally strong growth in the second quarter of 2007. This increase in M3 partly reflected rising income and expenditure, buoyant turnover in the financial markets, wealth effects emanating from the rising prices of financial assets and defensive strategies among those investors who viewed asset prices as too high. This was reinforced by the increase in relative returns offered by bank deposits on account of the upward trend in domestic interest rates.

Growth in M3



The quarter-to-quarter seasonally adjusted and annualised growth rate in M3 accelerated significantly from 20,4 per cent in the first quarter of 2007 to 30,2 per cent in the second quarter. Measured over twelve months, growth in M3 accelerated from 20,0 per cent in March 2007 to 23,4 per cent in June and further to 24,5 per cent in July.

The narrower aggregates also accelerated markedly during the second quarter of 2007, as reflected in the table below.

Growth in monetary aggregates

Per cent at seasonally adjusted annualised rates

	2007	
	1st qr	2nd qr
Notes and coin in circulation	1,8	17,0
Cheque and transmission deposits	26,0	38,2
M1A	22,5	36,7
Other demand deposits	8,2	31,5
M1	14,8	34,1
Other short and medium-term deposits	4,0	16,3
M2	8,1	26,1
Long-term deposits	121,5	43,0
M3	20,4	30,2

The increase in M3 during the second quarter of 2007 was characterised by healthy increases in all deposit categories, most noticeably in cash and demand as well as long-term deposits. Growth in notes and coin in circulation accelerated significantly from 1,8 per cent in the first quarter of 2007 to 17,0 per cent in the second quarter, probably on account of the Easter weekend and a number of other holidays which occurred during this period. Even though growth in long-term deposits slowed significantly from an exceptionally high level in the first quarter, the growth remained robust as turbulence in financial markets, together with rising interest rates, contributed towards the precautionary and speculative motives for holding monetary assets. The corporate sector's holdings of bank deposits accounted for R53,9 billion of the overall increase of R76,0 billion in M3 in the second quarter of 2007, with the balance of R22,1 billion accounted for by the household sector.

The income velocity of money in circulation continued to decline during the first half of 2007, extending the declining trend set in recent years. The quarter-to-quarter seasonally adjusted and annualised growth in M3 exceeded growth in nominal gross domestic product by 22 percentage points in the second quarter of 2007. As a result, the income velocity of circulation of M3 declined from 1,36 in the first quarter of 2007 to a record low of 1,30 in the second quarter.

The statistical counterparts of changes in M3 are presented in the accompanying table. The most prominent among the accounting counterparts of the increase in M3 in the second quarter of 2007 were increases in claims on the private sector and net foreign assets. This effect was partly neutralised by the decline in net claims on the government sector as government deposits increased substantially on account of high tax collections.

Counterparts of changes in M3
R billions

	2007	
	1st qr	2nd qr
Net foreign assets	-11,1	20,0
Net claims on government sector	26,3	-14,1
Claims on private sector	74,9	69,9
Net other assets and liabilities	8,0	0,1
Total change in M3	**98,1**	**76,0**

Credit extension

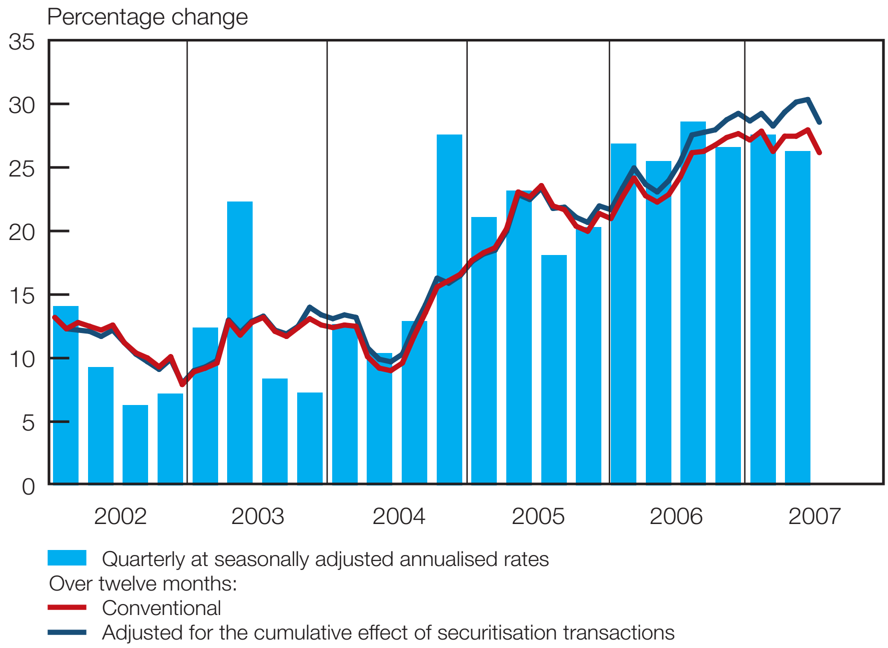
3 Total loans and advances to the domestic private sector consist of instalment sale credit, leasing finance, mortgage advances, overdrafts, credit card and general advances. The first three categories are referred to as asset-backed credit, while the last three categories together are referred to as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

Banks' total loans and advances[3] remained firm during the second quarter of 2007. Growth in this credit category apparently remained resilient, notwithstanding the progressive tightening of monetary policy from June 2006, especially when securitisation transactions are taken into account in the growth calculation.

The quarter-to-quarter annualised growth in total loans and advances decelerated moderately from 27,6 per cent in the first quarter of 2007 to 26,1 per cent in the second quarter. Significant increases in asset-backed credit extension reflected sustained increases in income and positive wealth effects associated with the strength in asset prices. In this credit category, growth in demand for bank-intermediated funding by the corporate sector generally exceeded growth in demand by households. From April to June 2007 the growth over twelve months in total loans and advances remained around

27 per cent, before declining slightly to 26 per cent in July. Adjusted for the cumulative effect of securitisation transactions, twelve-month growth accelerated from 28,2 per cent in March 2007 to 30,2 per cent in June, but fell back to 28,5 per cent in July.

Total loans and advances to private sector



In value terms, banks' total loans and advances rose by R71,4 billion in the second quarter of 2007. Asset-backed credit grew strongly during the period under review, accounting for 58 per cent of the overall increase, while other loans and advances explained the remainder.

Despite rising interest rates, *mortgage advances* displayed strong momentum during the second quarter of 2007. This category recorded all-time high month-to-month increases of R16,4 billion in May 2007 and R17,3 billion in July. Mortgage activity continued to benefit from buoyancy in the real-estate market, in particular the medium to lower-end of the market. However, measured over twelve months, growth in mortgage advances showed signs of slower growth, declining from rates of around 30 per cent recorded throughout 2006 and the first two months of 2007 to 26,7 per cent in July 2007.

Quarterly changes in banks' total loans and advances by type

R billions

	2007	
	1st qr	2nd qr
Mortgage advances	31,1	42,3
Instalment sale credit and leasing finance	11,4	-0,9
Other loans and advances	37,2	30,0
Overdrafts	*9,7*	*5,7*
Credit card advances	*4,1*	*4,1*
General advances	*23,4*	*20,2*
Total loans and advances	**79,8**	**71,4**
Of which: To household sector	39,2	32,6
To corporate sector	40,6	38,8

Securitisation transactions to the value of R10 billion, entered into during the second quarter of 2007, dampened growth in *instalment sale credit and leasing finance* somewhat. This credit category is mainly directed at financing expenditure on motor vehicles and other durable goods. Growth over twelve months in this credit category decelerated from 17,2 per cent in March 2007 to 11,7 per cent in July. Adjusted for the cumulative effect of securitisation transactions, growth remained at levels in excess of 20 per cent.

Other loans and advances, which are usually dominated by the corporate sector's use of overdrafts and general advances, remained high in the first seven months of 2007, maintaining the momentum set during the last quarter of 2006. Growth over twelve months accelerated considerably from 28,1 per cent in March 2007 to 36,7 per cent in June, the highest rate of growth since February 1982, before declining to 32,6 per cent in July. The corporate sector's elevated demand for bank-intermediated funding could partly be attributed to the brisk economic activity which required more working capital and encouraged companies to expand capacity.

The household sector continued to account for the largest share of the stock of bank loans and advances in the second quarter of 2007. However, the loans and advances to companies grew at a significantly higher rate than those to households. Growth over twelve months in bank loans and advances to companies exceeded 30 per cent from February 2007, while growth in credit to households slowed from 25 per cent in January 2007 to 22 per cent in July.

The National Credit Act was fully implemented on 1 June 2007, with the aim of facilitating access to credit while preventing over-indebtedness and reckless lending in the credit market. However, it is too early to establish the likely full impact of the Act on credit extension.

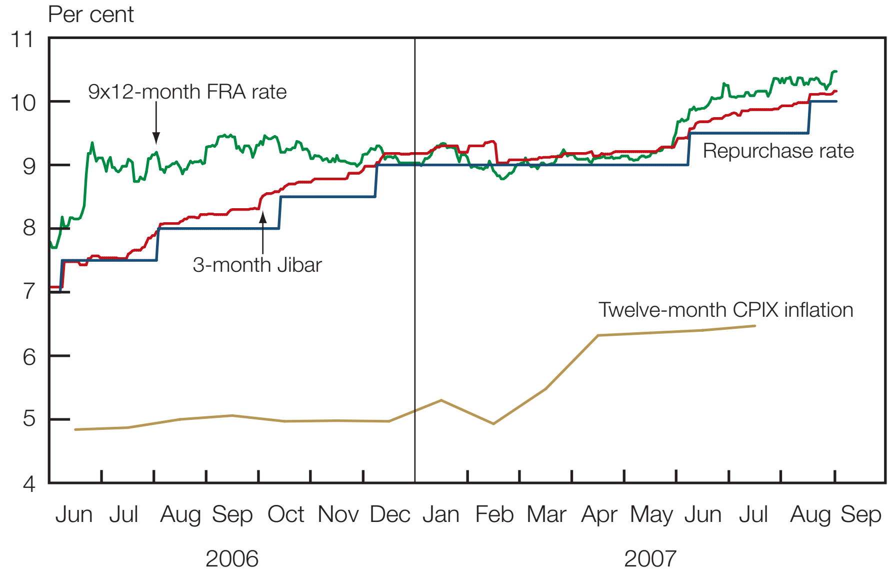
Banks' non-performing loans, on a gross basis and as a percentage of total loans and advances, edged higher but from a relatively low base. It usually takes a fairly long time for non-performing loans to respond to changes in the interest rate environment.

Interest rates and yields

From June 2006 the Monetary Policy Committee (MPC) increased the repurchase rate by a total of 300 basis points through six 50-basis-point increases, bringing the rate to a level of 10,0 per cent by mid-August 2007. The resumption of further tightening in June and August 2007 was the result of a deterioration in the inflation outlook and was aimed to ensure that inflation and expectations thereof revert to within the target range over the monetary policy time horizon. The MPC statement discussing developments underlying the August 2007 decision is reproduced in full elsewhere in this *Bulletin*.

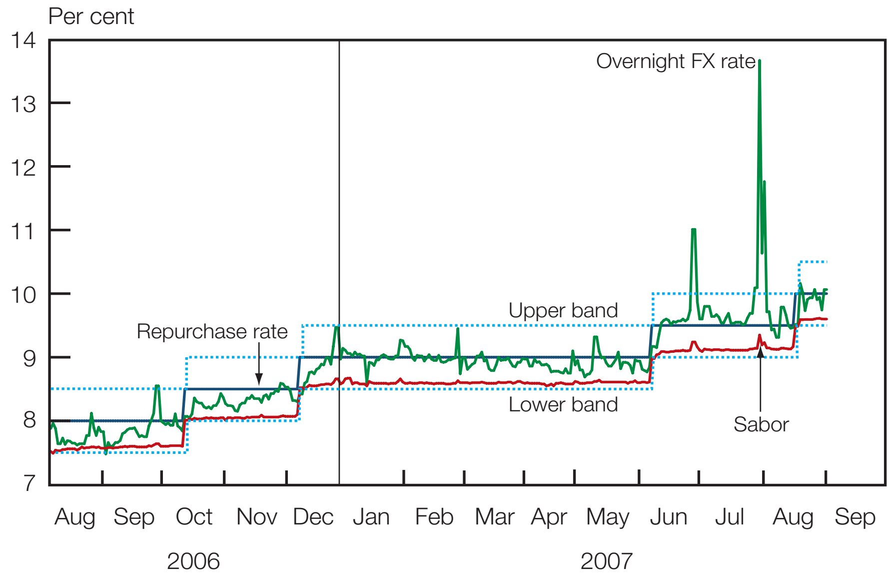
Given the increases in the repurchase rate, other money-market interest rates generally adjusted higher between May and mid-August 2007 (as depicted on the accompanying graph) before stabilising thereafter. The three-month Johannesburg Interbank Agreed Rate (Jibar), for instance, increased by 90 basis points from 9,21 per cent at the beginning of May 2007 to 10,11 per cent on 17 August 2007. The Jibar then moved marginally higher and amounted to 10,16 per cent on 31 August 2007.

Money-market rates and inflation



Rates on forward rate agreements (FRAs) also exhibited an upward trend. For instance, the 9x12-month FRA rate increased by 124 basis points from 9,14 per cent at the beginning of May 2007 to 10,38 per cent on 6 August 2007. It then receded somewhat, in accordance with the strengthening of the exchange rate of the rand and lower oil price before increasing to 10,47 per cent on 31 August 2007. Following the MPC decision to raise the repurchase rate by a further 50 basis points from 17 August, FRA rates no longer projected significant expectations of further monetary policy tightening for the remaining part of 2007.

Benchmark overnight rates



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) remained largely within the standing facility rate limits with extended periods of limited volatility – indicative of a well-functioning and efficient overnight funding market. Outliers in these rates were infrequent, and reflected fairly normal frictions and liquidity pressures in the money market. The Sabor rate fluctuated between 8,59 per cent and 9,61 per cent between May and August 2007, adjusting its range in conformity with the increases in the repurchase rate.

Both the *prime overdraft rate* and the *predominant rate on mortgage loans* of the private-sector banks followed the further tightening of the monetary policy stance in June and August 2007, increasing by 50 basis points on each occasion to 13,50 per cent from 17 August 2007.

The *predominant rate on twelve-month fixed deposits* of the private-sector banks amounted to 8,4 per cent in March 2007 and remained at this level in the subsequent months to May before increasing to 9,5 per cent in August.

On 17 August 2007 the *prescribed interest rates*, as laid down by the National Credit Act, increased as indicated in the accompanying table, following the change in the repurchase rate.

National Credit Act maximum interest rates

Category	Maximum rate per annum Per cent
Mortgage agreements	25,9 to 27
Credit facilities	30,9 to 32
Unsecured credit transactions	40,9 to 42
Development credit agreements:	
For the development of a small business	40,9 to 42
For low-income housing (unsecured)	40,9 to 42
Short term credit transactions	60
Other credit agreements	30,9 to 32
Incidental credit agreements	24

Similarly, on 24 August 2007 the *maximum annual finance charge rates* on money loans and credit and leasing transactions, as laid down by the Usury Act, were increased by one percentage point to 24 per cent for amounts less than R10 000 and to 21 per cent for amounts above R10 000, but not exceeding R500 000. These rates apply to credit agreements entered into before June 2007.

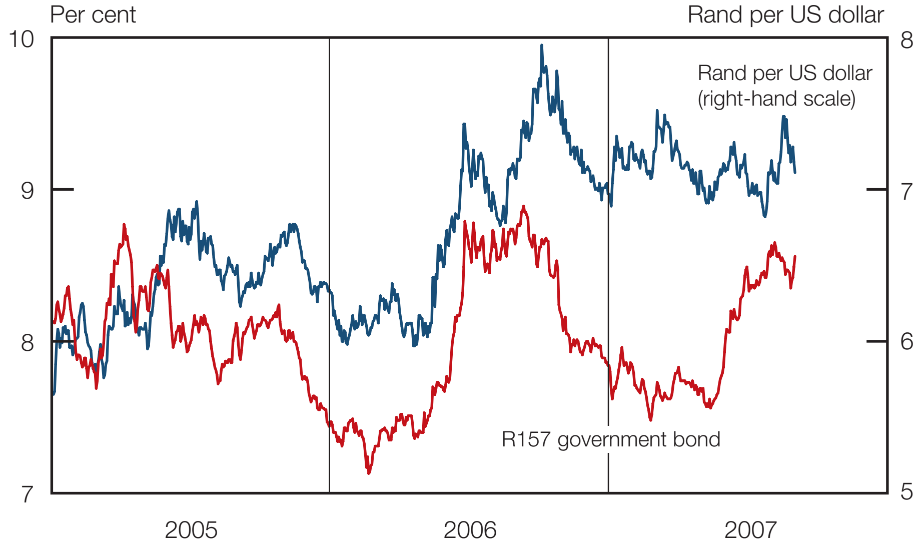
Interest rates on the *RSA Government Retail Bonds*, as priced off the government bond yield curve, are changed when the yields on equivalent government bonds move by more than 50 basis points. The accompanying table depicts the changes in these rates from August 2006.

Interest rates on RSA Retail Bonds
Per cent

Effective from	2-year bond	3-year bond	5-year bond
1 Aug 2006	8,50	8,75	9,00
1 Mar 2007	8,50	8,75	8,00
1 Jul 2007	9,00	8,75	8,50
1 Sep 2007	9,25	9,25	8,75

From a recent low of 7,48 per cent on 23 February 2007, the *daily average yield on the long-term R157 government bond* (maturing in 2015) increased significantly to 8,56 per cent on 31 August as the rate of inflation, the price of oil and the repurchase rate increased. The South African bond market was also adversely affected by the return of adverse investor appetite for emerging-market assets, following the US sub-prime market concerns. By contrast, the US 10-year bond yield continued its downward trend from 5,28 per cent on 13 June 2007 to 4,57 per cent on 31 August. Consequently, the spread between the South African R157 bond yield and the US 10-year bond yield widened from 277 basis points on 23 February 2007 to 399 basis points at the end of August.

Long-term bond yield and exchange value of the rand



The level of the *yield curve* moved higher from February 2007 to August as bond yields over all maturities reacted to higher inflation data. The *yield gap*, computed as the difference between the yields at the extreme long and short ends of the curve, narrowed from a negative 193 basis points on 3 January 2007 to a negative 49 basis points on 26 July, before widening to a negative 183 basis points on 31 August.

The *break-even inflation rate* in the six-year maturity range moved higher from 4,71 per cent on 23 February 2007 to 5,76 per cent on 27 July as the release of worse-than-expected inflation, the increase in the repurchase rate and the persistent higher international price of crude oil triggered a significant increase in the yields on conventional bonds while the real yields on inflation-linked bonds increased marginally. This proxy for expected inflation then declined to 5,29 per cent on 31 August.

The *currency risk premium*[4] on South African government bonds widened from 197 basis points in January 2007 to 253 basis points in August, as the yield on South African domestic rand-denominated bonds increased more than the yield on foreign-currency denominated South African bonds.

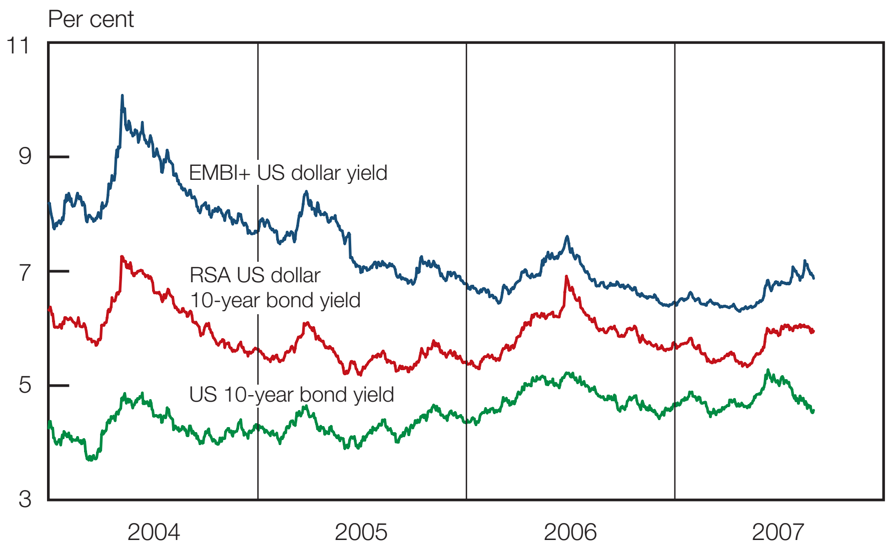
The JP Morgan Emerging Markets Bond Index (EMBI+)[5] narrowed from 208 basis points at the end of September 2006 to a record low of 153 basis points in May 2007. However, the subsequent emergence of risk concerns towards emerging markets resulted in the index widening to 223 basis points at the end of August. Similarly, the

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

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

sovereign risk premium on South African foreign-currency denominated bonds trading in international markets narrowed from an average of 103 basis points in September 2006 to 67 basis points in May 2007, before widening to 125 basis points in August.

US dollar-denominated bond yields



Money market

During the second quarter of 2007 and the first two months of the third quarter, the average daily liquidity requirement of the private-sector banks fluctuated between R9,3 billion and R14,6 billion. The amount of liquidity provided by the Bank at the weekly main refinancing tender varied between R10,3 billion and R14,1 billion over the same period. The cover ratio, measured as the ratio of amounts tendered to the amounts offered in the main refinancing auction, generally declined during the second quarter of 2007, implying fairly favourable borrowing conditions in the interbank market.

Banks continued to use their cash reserve accounts with the Bank during the period under review in an effort to square off their end-of-day positions. They occasionally utilised the available standing facilities.

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

Money-market liquidity flows

R billions (easing +, tightening -)

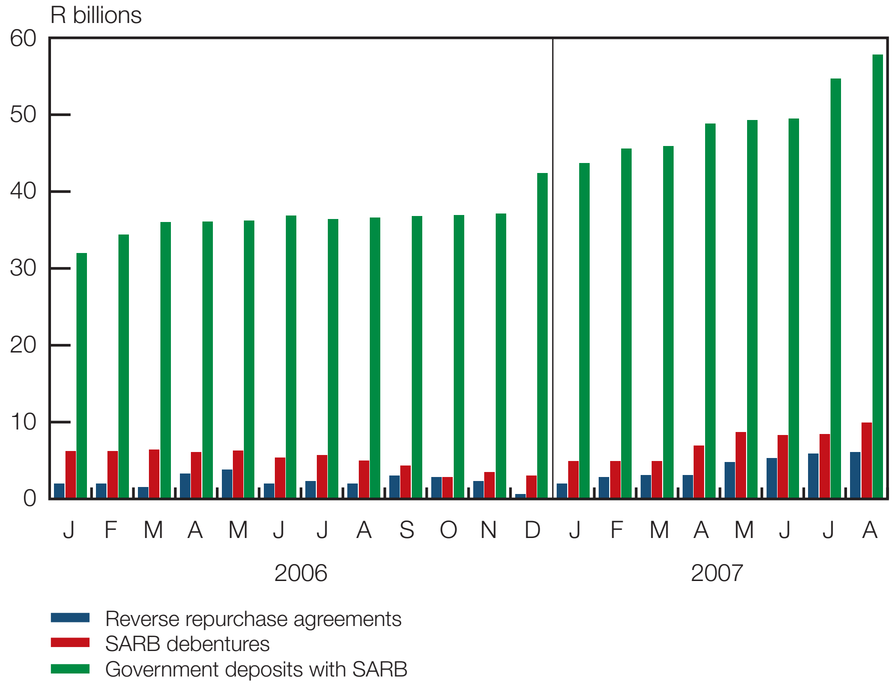
	Apr – Jun 2007	Jul – Aug 2007
Notes and coin in circulation	-1,0	-0,5
Required cash reserve deposits	-3,2	0
Money-market effect of SARB foreign-exchange transactions	18,8	10,2
Government deposits with SARB	-3,7	-8,3
Use of liquidity management instruments	-5,6	-2,4
Reverse repurchase transactions	-2,2	-0,8
SARB debentures	-3,4	-1,6
Other items net	-3,2	2,6
Banks' liquidity requirement (decrease +; increase -)	**2,1**	1,6

Net foreign-exchange purchases from the market added liquidity amounting to R18,8 billion during the second quarter of 2007 and an additional R8,3 billion in the ensuing two months to the end of August 2007. The improvement in net foreign-exchange reserves emanated from normal foreign-exchange operations conducted in the market, after netting out the prepayment in April 2007 of a 3-year US$1 billion syndicated term loan entered into in 2004.

Other factors, such as increases in the use of liquidity draining instruments, higher government deposits with the Bank, rising cash reserve deposits as well as higher notes and coin in circulation had a contractionary effect of R24,7 billion over the same review period.

The outstanding amount of interest bearing liquidity-draining instruments utilised by the Bank, i.e. reverse repurchase agreements and SARB debentures, increased by R7,5 billion in the five months to August 2007. This not only helped to manage the money-market liquidity conditions, but also helped to alleviate the shortage of liquid assets. A broadening of securities accepted as collateral in the Bank's refinancing operations was also announced in May 2007 (see the box on eligible collateral on the next page). The accompanying graph illustrates the structure of, and developments in, money-market intervention instruments utilised.

Liquidity-draining operations: Outstanding balances



The Bank's monetary policy portfolio of government bonds remained unchanged at R7,5 billion during the second quarter of 2007.

Eligible collateral for the Bank's repurchase auctions

With effect from 23 May 2007 the Bank began to accept certain parastatal bonds in its repurchase auctions, thereby extending the range of securities which may be used as collateral in its refinancing system. This followed a process of consultation between the Bank and its major counterparties in the refinancing system, and would provide the banks with additional flexibility in their management of liquidity.

Previously the only assets routinely accepted in the Bank's repurchase auctions were: Government bonds denominated in rand; Treasury bills; Land Bank bills; South African Reserve Bank debentures; and separate trading of registered interest and principal of securities (STRIPS), issued under the Public Finance Management Act of 1999.

The table below lists the assets which were added as eligible collateral as from 23 May.

Additional securities accepted in repurchase auctions

Bond code	Issuer	Maturity
DV07	Development Bank of Southern Africa	2010-09-30
ES09	Eskom Holdings Limited	2009-06-01
E170	Eskom Holdings Limited	2020-08-01
ES33	Eskom Holdings Limited	2033-09-15
SZ25	SA National Roads Agency	2025-09-30
T011	Transnet Limited	2010-04-01
WS03	Trans-Caledon Tunnel Authority	2010-09-15
WS04	Trans-Caledon Tunnel Authority	2016-05-30

The securities which have been added to the list of eligible assets consist of a selection of bonds included in the All Bond Index (ALBI), as determined by the Bond Exchange of South Africa (BESA). They do not qualify as liquid assets in terms of the Banks Act.

Bond market

Public-sector borrowers' demand for funds in the domestic primary bond market waned in the first seven months of 2007, resulting in net redemptions of fixed-interest securities amounting to R19,9 billion, compared with net issues of R0,9 billion in the corresponding period of 2006. By contrast, the private sector continued 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 R29,0 billion to reach R194,3 billion at the end of July – 39 per cent higher than the amount in issue in July 2006.

The finance available to the private sector was further supplemented by the issuance of short-term commercial paper. The outstanding nominal value of commercial paper listed on BESA increased by R6,9 billion in the first seven months of 2007 to reach R47,1 billion at the end of July. The total outstanding nominal value of debt listed on BESA increased by R17,5 billion in the first seven months of 2007 to R738,3 billion at the end of July, lower than the market capitalisation of R818,5 billion.

Fund-raising activity by private-sector borrowers in the *international bond markets* picked up from April 2007 to July. In addition, the National Treasury issued a US$1 billion fifteen-year bond in May 2007. The R39,0 billion raised by public and private-sector borrowers in the seven months to July was roughly three times as high as the R13,8 billion raised in the international bond markets in the whole of 2006.

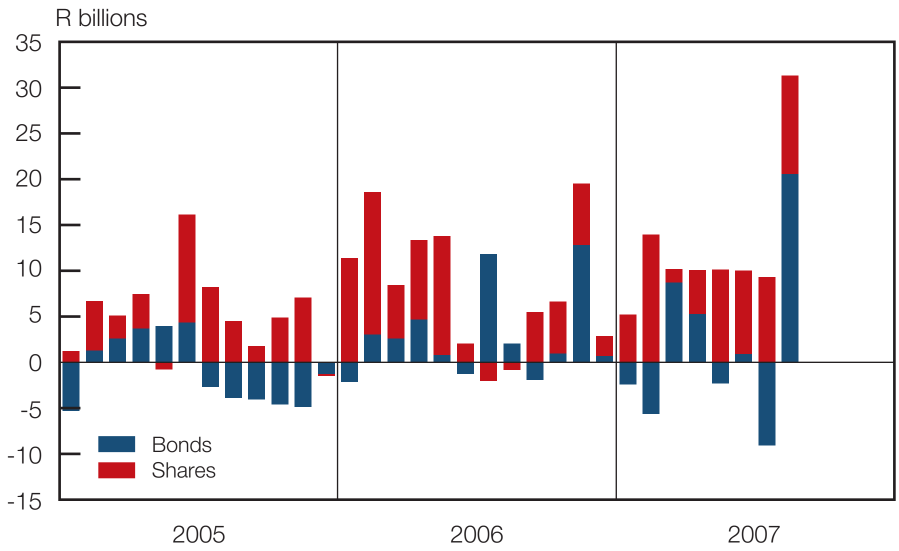
In the *European bond markets*, non-resident issuer interest in rand-denominated bonds rebounded during 2007. Issues of rand-denominated bonds exceeded redemptions by R9,7 billion in the first eight months of 2007, compared with net issues of R2,8 billion in the corresponding period of 2006. Thirteen different issuers were responsible for the 30 issues in the first eight months of 2007, compared with 9 issuers participating in the 29 issues of rand-denominated bonds over the same period of 2006.

In addition to issuance in the European bond markets, the issuance of rand-denominated bonds by foreign borrowers in the *Japanese Uridashi bond market* also accelerated during the first eight months of 2007. Following net issues of R4,8 billion in 2006, the nominal value of rand-denominated bonds issued by non-residents in the Uridashi market amounted to R8,3 billion in the first eight months of 2007.

Although bond yields moved higher, the high number of trades ensured an increase in the value of turnover in the *domestic secondary bond market* in 2007. Turnover on BESA in the first eight months of 2007 was 25 per cent more than in the corresponding period of 2006, with the average value traded per day of R54,8 billion in 2006 increasing to an average of R65,8 billion in the first eight months of 2007. This included a record-high daily average turnover of R73,6 billion in July. The annualised liquidity ratio, measured as the nominal value of bonds traded relative to the nominal value of bonds listed, reached 18,5 in the first seven months of 2007. The R157 bond (maturing in 2015) was the most liquid government bond traded with turnover that was 36 times more than the amount in issue, followed by the R153 bond (maturing in 2010) with a liquidity ratio of 35.

Non-residents' net purchases of bonds increased from R0,6 billion in the first quarter of 2007 to R3,9 billion in the second quarter. Thereafter they registered record-high net sales of R9,1 billion in July 2007 before registering record-high net purchases of

Net purchases of shares and bonds by non-residents

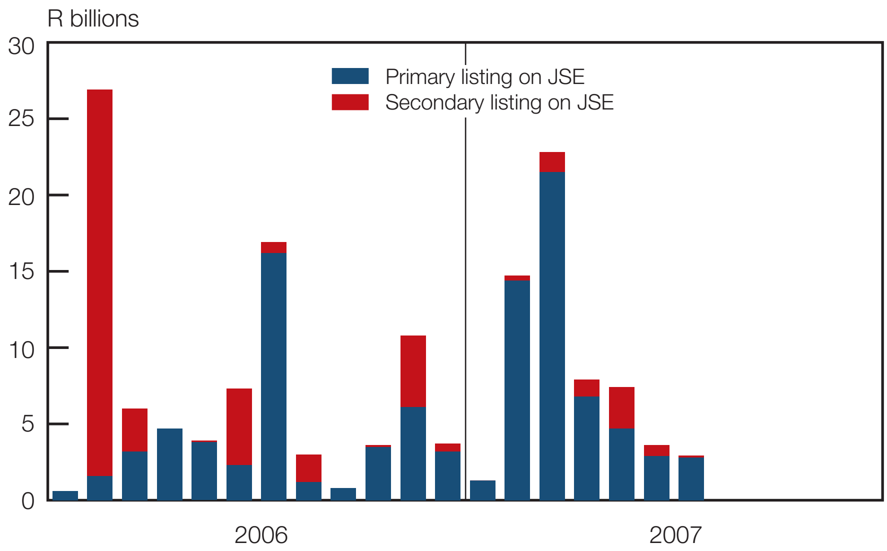


R20,6 billion in August. In the first eight months to August 2007, non-residents' cumulative net purchases of bonds amounted to R16,1 billion compared with net purchases of R21,5 billion in the same period of 2006. Non-residents' participation in the domestic bond market averaged 19 per cent in 2006 as well as in the first eight months of 2007.

Share market

The total *value of equity capital raised in the domestic and international primary share markets* by companies listed on the JSE Limited (JSE) amounted to R60,6 billion in the first seven months of 2007 – 8 per cent higher than the amount raised in the corresponding period of 2006. Companies with primary listings on the JSE raised the bulk, namely R54,4 billion, of total funding in the seven months to July 2007, with companies in the resources sector accounting for more than half of the total capital-raising activity thus far in 2007.

Total capital raised by companies listed on the JSE



In the share market, suspensions and the increase in private equity buy-outs led to 33 company de-listings in the first seven months of 2007. There were 22 new listings over the same period, compared with 15 new listings and 19 de-listings over the corresponding period of 2006. The new listings on the JSE in 2006 and in the first seven months of 2007 included 10 foreign inward listings of which 9 were mining and exploration companies, as the resources sector continued to attract inward listings.

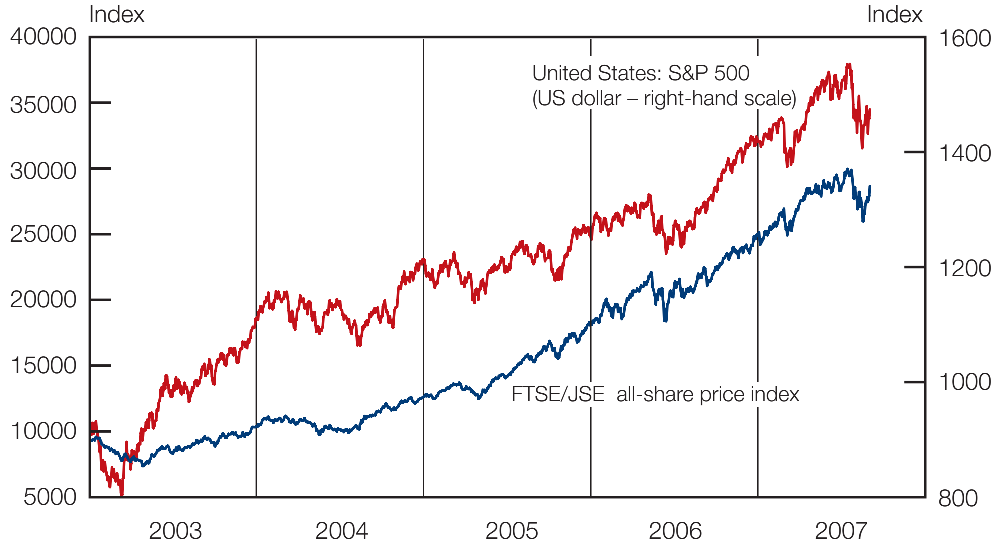
Despite lower trade volumes, *turnover* in the secondary share market remained high in the first eight months of 2007, boosted by record high share prices. The value of shares traded on the JSE amounted to R1,9 trillion in the first eight months of 2007 and exceeded turnover in the corresponding period of 2006 by 32 per cent. From a daily average turnover of R7,1 billion in December 2006, turnover increased to a record high of R12,4 billion in August.

The total *market capitalisation* of the JSE increased from R5 042 billion at the end of December 2006 to an all-time high of R5 780 billion in March 2007, before declining to R5 605 billion in August. Market liquidity, measured by annualised turnover as a percentage of market capitalisation, increased significantly from 33 per cent in December 2006 to 61 per cent in August 2007.

Non-residents' appetite for domestic equities has remained strong so far in 2007. Their net purchases of shares amounted to R64,7 billion in the first eight months of the year. Non-residents' participation in the share market averaged 21 per cent in 2006 and remained at this level in the first eight months of 2007.

The *all-share price index* declined by 7 per cent from 26 February 2007 to 5 March, following a global market sell-off triggered by a sharp decline in Chinese equities after the tightening of regulations by the Chinese government. Share prices subsequently rebounded, recovering their losses and increasing by 20 per cent to reach a new all-time high on 13 July 2007, supported by robust economic growth, higher commodity prices and stronger global equity markets. The all-share price index then fell by 13 per cent to 17 August in tandem with global markets as growing concerns regarding credit markets, as well as the possible spill-over effects of the US sub-prime mortgage market problems on the broader economy, led to a sudden reversal in global risk sentiment and pricing. However, as global fears regarding potential contagion effects moderated, share prices recovered gradually and increased by 10 per cent to 31 August.

Share prices



Factors contributing to the strong increase in share prices during 2007 included continued foreign acquisition of local equities, robust local economic growth which, in turn, has been stimulated by increased infrastructure spending, as well as reports of positive corporate earnings growth. In the first eight months of 2007 the resources sector, supported by high commodity prices, outperformed the other key sectors and recorded share price growth of 22 per cent. Industrial share prices increased by 14 per cent while financial shares recorded a gain of only 4 per cent as they came under pressure due to the rising interest rate environment as well as expectations that the National Credit Act may have a constraining effect on business.

In the first eight months of 2007 the all-share price index of the JSE, measured in US-dollar terms, and the Morgan Stanley Capital International (MSCI) Emerging Market

Index outperformed both the MSCI World Index and the FTSE All World Index. The JSE all-share price index increased by 13 per cent during this period and the MSCI Emerging Markets Index rose by 19 per cent, compared with the FTSE All World Index and the MSCI World Index which increased by 6 per cent and 7 per cent, respectively.

The *dividend yield* on all classes of shares declined from 2,5 per cent in March 2007 to 2,1 per cent in June before increasing to 2,5 per cent in August. Similarly, the *earnings yield* on all classes of shares declined from 6,6 per cent in March 2007 to 6,1 per cent in June before increasing to 7,0 per cent in August. Conversely, the *price-earnings ratio* of all classes of shares increased from 15,1 in March 2007 to 16,4 in June before declining to 14,3 in August.

Alt^{x} experienced rapid growth during 2007, with 21 new listings recorded in the first eight months of 2007 to reach a total of 57 companies at the end of August. One company de-listed from Alt^{x} in July 2007 and transferred to the main board of the JSE. The total market capitalisation of all the companies listed on Alt^{x} increased sturdily from R3,2 billion in August 2006 to a new record high of R21,4 billion in August 2007. Turnover on Alt^{x} amounted to R3,5 billion in the first eight months of 2007, an increase of 204 per cent from the R1,2 billion traded in the whole of 2006.

Market for exchange-traded derivatives

In the first seven months of 2007, trading activity in the *financial derivatives market* remained robust due to bullish underlying share market conditions. Although single-stock futures accounted for only 8 per cent of total turnover by value in the first seven months of 2007, they accounted for 86 per cent of total number of contracts traded.

Turnover in *commodity futures and options* almost doubled in the seven months to July 2007, as local grain prices rose sharply due to supply constraints in the domestic market. Turnover in *warrants* lost ground, falling by a substantial margin compared with the same period in 2006. Turnover in derivatives on the JSE for the first seven months of 2007 is indicated in the accompanying table.

Derivatives turnover on the JSE, January to July 2007

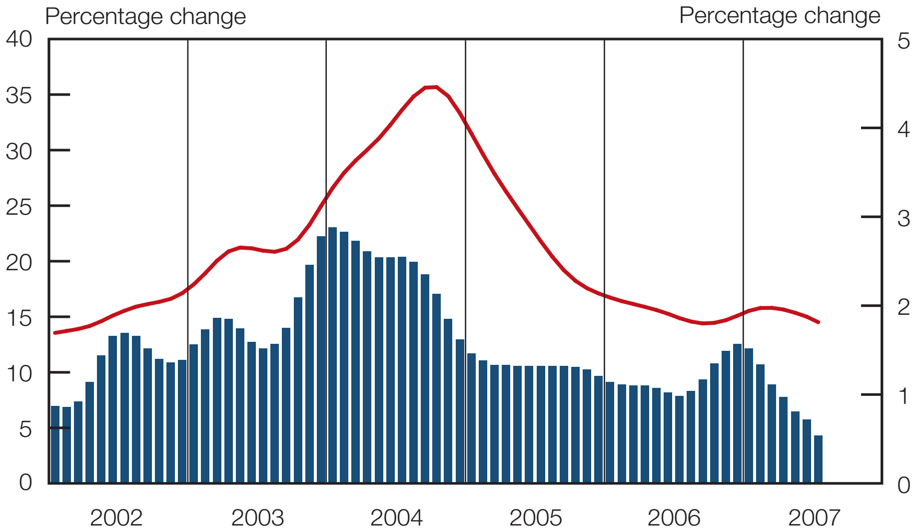
		Change over one year
	R billions	Per cent
Financial futures and options on futures	2 391	45
Warrants	2	-69
Agricultural commodity futures and options	154	91
Interest rate derivatives	20	38

Trading activity on *Yield–X* gained momentum in the seven months to July 2007. On 18 June 2007 currency futures commenced trading on Yield-X and turnover of these instruments amounted to R235 million for June and July. Although accounting for only 4 per cent of total turnover by value in these two months, currency futures accounted for 87 per cent of the total number of contracts traded over the same period.

Real-estate market

The deceleration in the rate of increase in residential real-estate prices resumed in the second quarter of 2007. The year-on-year rate of increase in average residential property prices in the middle segment of the market, as measured by Absa, decelerated from 15,8 per cent in March 2007 to 14,5 per cent in July. Similarly, the month-on-month increase in nominal house prices slowed from 1,6 per cent in December 2006 to 0,5 per cent in July 2007, probably in response to, among other things, the cumulative increases in the repurchase rate and cost of mortgage finance as well as the implementation of the National Credit Act.

House prices



Percentage change in nominal house prices:
Month on month (right-hand scale)
Over twelve months
Source: Absa

Non-bank financial intermediaries

In balancing risk and return considerations, asset managers set strategic asset allocation percentages for the various asset classes to manage different types of exposure, such as market exposure and interest rate exposure. Non-bank financial institutions[6] exercise varying degrees of portfolio diversification.

Market conditions caused a breach in the historic strategic asset distribution of the official pension and provident funds, and since September 2005 equities have replaced fixed-interest instruments as the dominant asset class in their asset portfolio, mainly as a result of rising share values due to the bull-run in the equities market.

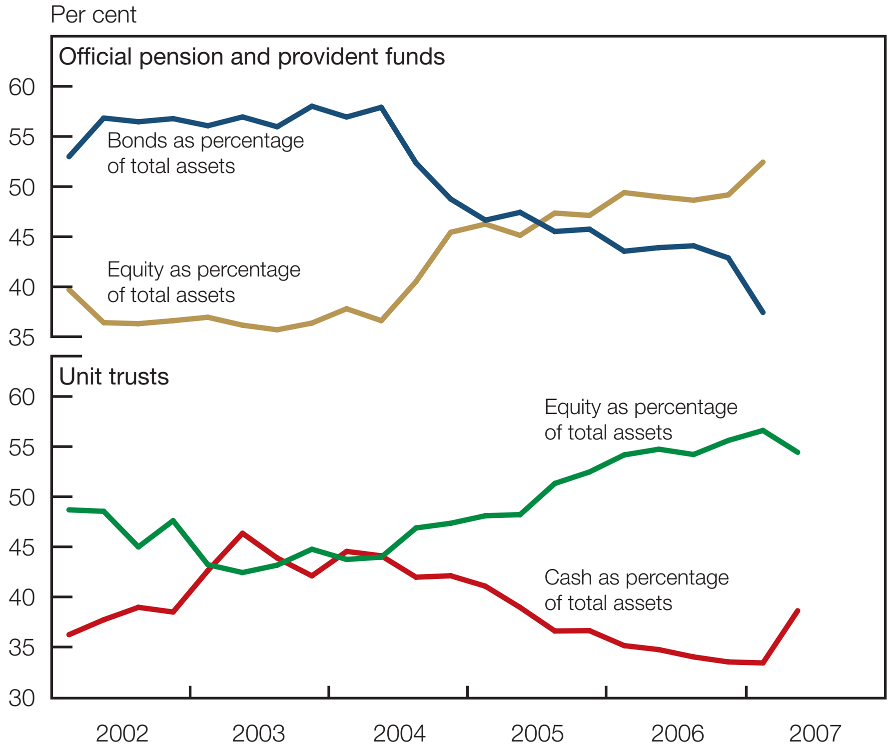
In the case of insurers and private pension and provident funds, equities remained the preferred asset class over time. The equity portfolio of long and short-term insurers increased from a low of 42 per cent of their total assets in the first quarter of 2003 to 50 per cent in the first quarter of 2007. By contrast, investment in fixed-interest instruments declined from 21 per cent of total assets to 14 per cent over the same period. Similarly, private pension and provident funds' holdings of equities made up 56 per cent of their total assets in the first quarter of 2003 and gradually increased to reach a level of 63 per cent

6 Include unit trusts, long and short-term insurers, official and private pension and provident funds.

in the first quarter of 2007. Over the same period their holdings of fixed-interest instruments declined from 22 per cent of total assets to 18 per cent.

Unit trusts' asset distribution shifted from cash and deposits to shares, especially from 2004. In the first quarter of 2004 cash and deposits constituted 45 per cent of the total assets of unit trusts and equities 44 per cent. This changed to 33 per cent in cash and 57 per cent in equities by the first quarter of 2007. In the second quarter of 2007 the trend reversed somewhat as cash and deposits as a percentage of total assets of unit trusts increased to 39 per cent, with equities decreasing to 54 per cent alongside greater caution regarding exposure to shares.

Financial assets of non-bank financial institutions



From the second half of 2006, volatility in the financial markets prompted non-bank financial institutions as a group to gradually increase their holdings of cash and deposits. Their cash holdings as a percentage of total non-bank financial-institution assets increased to levels of around 15 per cent in the first quarter of 2007, compared with levels of around 12 per cent a few years ago.

Public finance

Non-financial public-sector borrowing requirement[7]

The *non-financial public sector* recorded a cash surplus of R5,2 billion in the April-June quarter of 2007. This was lower than the cash surplus of R10,2 billion recorded in the April-June quarter of 2006. As a ratio of gross domestic product, the cash surplus in April – June 2007 amounted to 1,1 per cent, compared to a surplus of 2,4 per cent recorded in the same period a year earlier. This decrease in the surplus could mainly be attributed to an increase in net investment in non-financial assets for all levels of government which amounted to R19,2 billion in the April-June quarter of 2007, compared with an amount of R15,3 billion in the corresponding quarter of the previous year.

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

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

Non-financial public-sector borrowing requirement
R billions

Level of government	Apr – Jun 2006*	Apr – Jun 2007*
National government	4,0	5,9
Extra-budgetary institutions	-2,2	-2,3
Social security funds	-0,1	-1,5
Provincial governments	-10,5	-13,0
Local governments	2,4	3,0
Public enterprises and corporations	-3,7	2,6
Total**	-10,2	-5,2

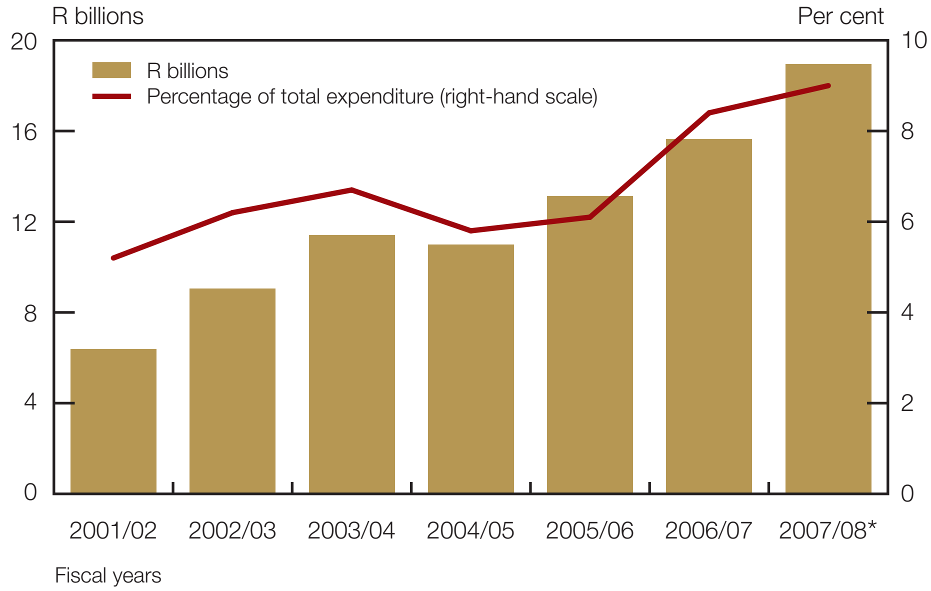
* Deficit +, surplus -
** Individual amounts may not add up to the total due to rounding

The activities of the *non-financial public-sector enterprises and corporations* resulted in a cash *deficit* of R2,6 billion in the April-June quarter of fiscal 2007/08, compared with a cash *surplus* of R3,7 billion in the same period of the previous fiscal year. The cash deficit was the result of increased net investment in non-financial assets by major non-financial public enterprises which amounted to R9,2 billion in April – June 2007, thereby exceeding the R7,5 billion recorded in the corresponding period a year earlier and demonstrating the drive to improve the country's infrastructure. Infrastructure spending was estimated to grow by around 14 per cent per annum over the medium term according to the *Budget Review 2007.*

An analysis of *national government* finance statistics indicated that cash receipts from operating activities in April – June 2007 amounted to R128 billion. This represented a year-on-year rate of increase of 17,8 per cent when compared with the same period in 2006. For the period under review, cash payments for operating activities increased by 18,9 per cent from the same period a year earlier to amount to R133 billion. The net cash flow from operating activities of national government, together with the net investment in non-financial assets, resulted in a cash deficit of R5,9 billion in the first quarter of fiscal 2007/08. This deficit can be compared with a deficit of R4,0 billion recorded in the corresponding period a year earlier.

The cash surplus of *provincial governments* amounted to R13,0 billion in the April-June quarter of 2007, compared with R10,5 billion recorded in the same period of the previous fiscal year. The main source of provincial governments' cash receipts – grants received from national government – amounted to R55,0 billion, which was 16,2 per cent more than in the corresponding period of the previous fiscal year. Included in the grants to provincial governments are the equitable share transfers as well as conditional grants earmarked for specific purposes.

Payments for capital assets by provinces



* *Budget Review 2007*

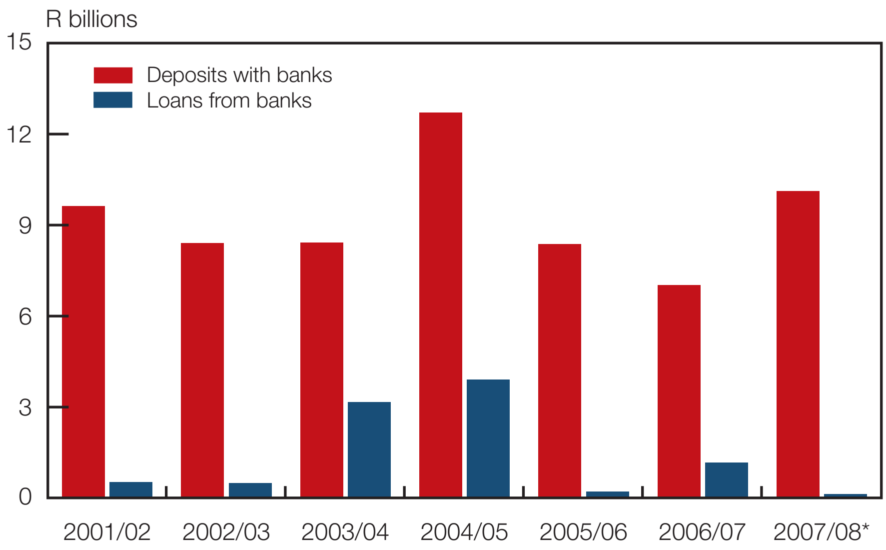
Provincial governments' cash payments for operating activities in the first quarter of fiscal 2007/08 amounted to R40,8 billion, representing a year-on-year increase of 13,7 per cent when compared with the same quarter a year earlier. In accordance with the *Budget Review 2007*, the bulk of the cash payments by provincial governments was in respect of education and health services. For the period under review, net investment in non-financial assets by provinces amounted to R3,1 billion, representing an increase of 26,9 per cent when compared to the same quarter of the previous fiscal year.

The cash surplus of the provincial governments during April – June 2007 was partly reflected in an increase in deposits on the provincial investment accounts with the Corporation for Public Deposits (CPD). Alongside this increase in deposits with the CPD, the provincial governments' deposits with banks increased from R7,0 billion at the end of March 2007 to R10,1 billion at the end of June. At the same time, their overall indebtedness to banks decreased from R1,2 billion to R0,1 billion.

The estimated cash deficit of *local governments* in the April-June quarter of 2007 amounted to R3,0 billion, which was higher than the amount of R2,4 billion recorded in the same quarter of the previous fiscal year. The slight increase in the deficit of local governments could mainly be attributed to an increase in net investment in non-financial assets.

A provisional estimate on the finances of *extra-budgetary institutions* signalled a cash surplus of R2,3 billion in the April-June quarter of fiscal 2007/08, almost equivalent to the surplus recorded in the same period a year earlier. The cash surplus of the *social* *security funds* showed a strong increase and amounted to R1,5 billion in the first three months of fiscal 2007/08. This cash surplus was significantly higher than the surplus recorded in the same period of the previous fiscal year.

Finances of provincial governments



As at 31 March of each fiscal year
* As at 30 June 2007

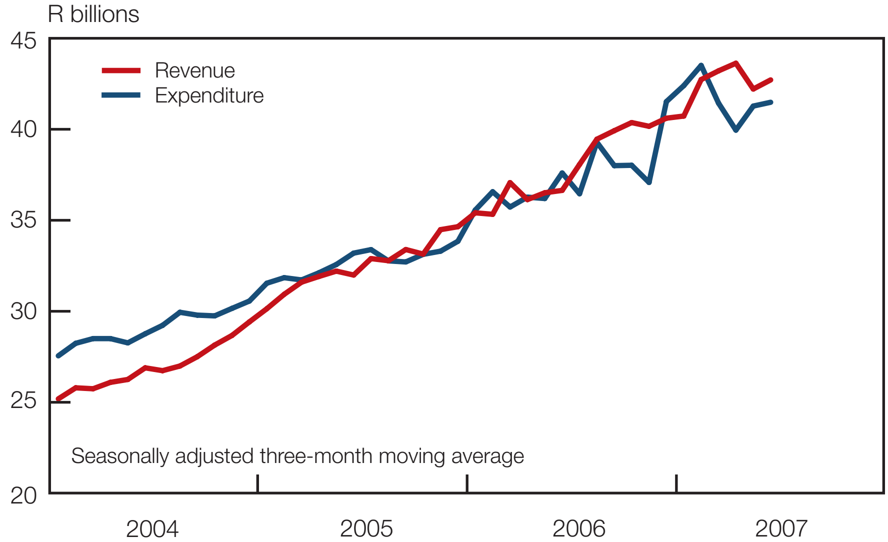
Budget comparable analysis of national government finance

National government expenditure in the first quarter of fiscal 2007/08 amounted to R126 billion, representing an increase of 16,8 per cent when compared with the same period a year earlier. This increase was markedly higher than the 10,2 per cent rate of increase recorded in the corresponding period of fiscal 2006/07, and also higher than the average year-on-year rate of increase of 12,0 per cent in the same period during the five years prior to fiscal 2007/08. The *Budget Review 2007* estimated that national government expenditure would increase by 13,5 per cent for the current fiscal year as a whole. As a ratio of gross domestic product, expenditure amounted to 26,3 per cent in April – June 2007, which was a slight increase from the 25,8 per cent recorded in the same period a year earlier.

Interest payments by national government during the quarter under review amounted to R9,1 billion, representing an increase of 13,8 per cent when compared with the corresponding period of the previous fiscal year. This increase was mainly due to higher interest rates which applied when Treasury bills and other instruments were rolled over, as well as an increase in funding volume in the April-June quarter of 2007. Budget projections provided for interest payments to increase by only 1,3 per cent in fiscal 2007/08. As a ratio of gross domestic product, interest payments amounted to 1,9 per cent in the April-June quarter of fiscal 2007/08, unchanged from the ratio recorded in the same period a year earlier. The *Budget Review 2007* projected that debt service costs – comprising mainly interest payments by national government – would decrease to 2,1 per cent of estimated gross domestic product in fiscal 2009/10.

After allowing for cash-flow adjustments (i.e. entries resulting from differences between the recording of transactions and bank clearances, and late departmental requests for funds), national government's cash-flow expenditure in the April-June quarter of 2007 was almost equivalent to its cash book expenditure.

National government revenue and expenditure



National government revenue during April – June 2007 amounted to R121 billion, representing a year-on-year increase of 15,8 per cent. The strong growth in revenue was mainly driven by taxes on income, profits and capital gains as well as taxes on international trade and transactions, mainly customs duties. This increase was almost equivalent to the growth rate recorded in fiscal 2006/07, but was higher than the average growth rate of 14,8 per cent recorded in the same period of the five fiscal years prior to fiscal 2007/08.

As shown in the accompanying table, taxes on income, profits and capital gains increased strongly in the April-June quarter of 2007 when compared with the same quarter in fiscal 2006/07. This was led by company tax collections.

National government revenue in fiscal 2007/08

Revenue source	Originally budgeted		Actual Apr – Jun 2007	
	R billions	Percentage change	R billions	Percentage change*
Taxes on income, profits and capital gains	312,2	11,6	73,3	19,6
Payroll taxes	6,5	10,3	1,7	35,3
Taxes on property	11,0	6,4	2,8	7,3
Domestic taxes on goods and services	199,0	14,0	42,6	13,1
Taxes on international trade and transactions	27,5	14,4	5,6	17,7
Other revenue	11,5	-1,7	2,2	34,2
Less: SACU** payments	23,1	-8,5	7,4	50,3
Total revenue	**544,6**	**13,2**	**120,8**	**15,8**

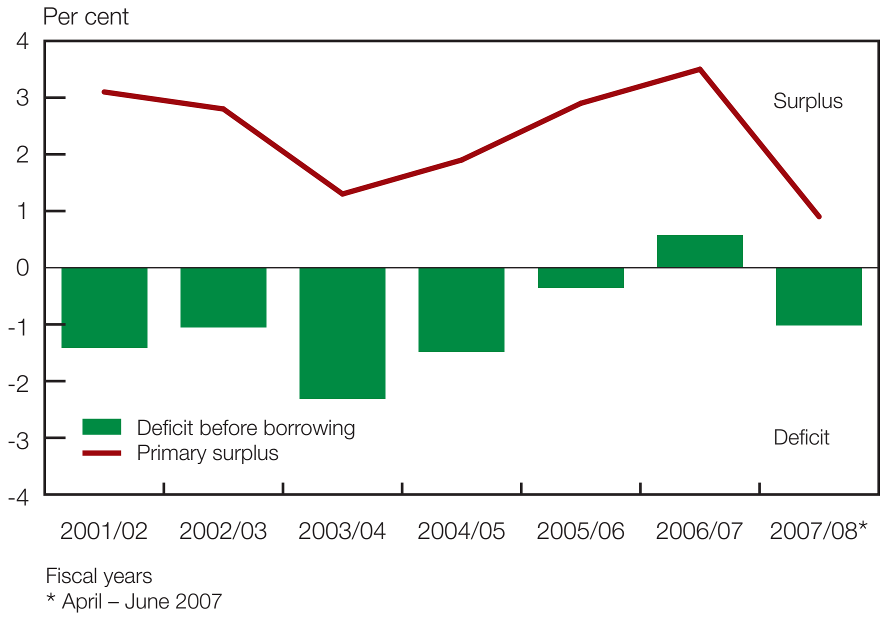
* April – June 2006 to April – June 2007
** Southern African Customs Union

Taxes on property increased at a year-on-year rate of 7,3 per cent in the first quarter of fiscal 2007/08, compared to the same period a year earlier. All major components of domestic taxes on goods and services recorded strong growth rates. The largest component – value-added tax – reflected the buoyancy in consumer spending. Taxes on international trade and transactions also rose strongly, consistent with the brisk increase in imports.

Transfers to the other Southern African Customs Union (SACU) member countries – Botswana, Lesotho, Namibia and Swaziland – increased considerably in the first quarter of the current fiscal year due to an additional amount of R1,7 billion that was paid in June 2007 relating to fiscal 2005/06.

The net result of national government revenue and expenditure in the April-June quarter of 2007 was a cash book deficit before borrowing and debt repayment of R4,9 billion, which was R1,6 billion more than the cash book deficit recorded in the same period of the previous fiscal year. As a ratio of gross domestic product, the deficit amounted to 1,0 per cent in the first three months of the current fiscal year, compared with a deficit ratio of 0,8 per cent recorded in the same period of fiscal 2006/07.

National government balances as ratio of gross domestic product



National government recorded a cash-flow deficit before borrowing and debt repayment of R5,4 billion in the first quarter of fiscal 2007/08, slightly higher than the R4,6 billion recorded in the corresponding period of the previous fiscal year. After taking into account extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement of national government for the period under review amounted to R7,0 billion, compared with a net borrowing requirement of R5,0 billion recorded in the same period of the previous fiscal year.

As indicated in the table on the following page, the net borrowing requirement of the national government in the April-June quarter of 2007 was financed mainly through the issuance of debt instruments in the domestic capital market.

National government financing in fiscal 2007/08

R billions

Item or instrument	Originally budgeted	Actual Apr – Jun 2007	Actual Apr – Jun 2006
Budget balance	-10,7	5,4[1]	4,6[1]
Plus: Extraordinary payments	0,4	0,7	0,0
Cost/profit on revaluation of foreign debt at redemption[2]	0,5	1,4	0,4
Less: Extraordinary receipts	0,3	0,5	0,0
Net borrowing requirement[3]	**-10,1**	**7,0**	**5,0**
Treasury bills	5,7	2,5	5,4
Domestic government bonds	-8,0	7,1	11,2
Foreign bonds and loans	-2,1	0,6	2,5
Change in available cash balances[4]	-5,7	-3,2	-14,1
Total net financing	**-10,1**	**7,0**	**5,0**

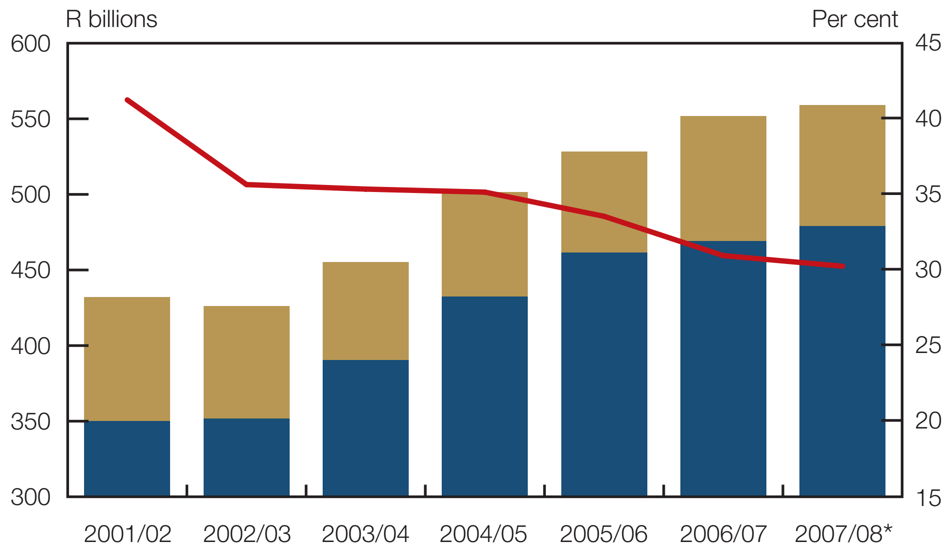
1 Cash-flow deficit +, surplus -
2 Cost +, profit -
3 Deficit +, surplus -
4 Increase -, decrease +

Domestic long-term funding was obtained at an average rate of 7,9 per cent per annum, while domestic short-term instruments were sold at an average of 8,8 per cent – both higher than a year earlier.

The average maturity of the domestic marketable bonds of national government in issue decreased from 102 months at the end of March 2007 to 100 months at the end of June 2007.

Net funding through foreign bonds and loans amounted to R0,6 billion during April – June 2007. Apart from switches and buybacks, government issued a new US-dollar

National government loan debt



As at 31 March of each fiscal year
*As at 30 June 2007
Foreign debt
Domestic debt
Total: Percentage of gross domestic product (right-hand scale)

denominated note in May 2007, that matures on 30 May 2022 and yielded R4,0 billion to the National Revenue Fund. The addition of this bond contributed to an increase in the average maturity of the foreign marketable bonds of national government from 67 months at the end of March 2007 to 85 months at the end of June.

The financial activities of national government resulted in an increase in government's bank balances from R75,3 billion at the end of March 2007 to R78,6 billion at the end of June.

Total loan debt of national government increased from R552 billion at the end of March to R559 billion at the end of June 2007. Foreign debt as a portion of total loan debt decreased slightly from 15,0 per cent to 14,3 per cent between the above-mentioned dates. As a ratio of gross domestic product, total national government loan debt amounted to 30,2 per cent at the end of June 2007, compared with 30,9 per cent at the end of March 2007.

Government-guaranteed debt inched lower from R66,9 billion at the end of December 2006 to R66,5 billion at the end of March 2007.

National government finance in July 2007

National government expenditure in July 2007 amounted to R46,4 billion, bringing the cumulative expenditure in the first four months of fiscal 2007/08 to R172 billion, which was 17,5 per cent more than in the same period of the previous fiscal year.

National government revenue amounted to R32,3 billion in July 2007 and to R153 billion in the first four months of fiscal 2007/08 representing a year-on-year rate of increase of 14,6 per cent. Taxes on income, profits and capital gains increased by 18,3 per cent in the first four months of fiscal 2007/08 compared with the corresponding period a year earlier. All the other categories of revenue also reflected strong growth when compared with the originally budgeted revenue.

National government financing in fiscal 2007/08

R billions

Item or instrument	Originally budgeted	Actual Apr – Jul 2007	Actual Apr – Jul 2006
Budget balance	**-10,7**	**18,3**[1]	**12,5**[1]
Plus: Extraordinary payments	0,4	0,7	0,0
Cost/profit on revaluation of foreign debt at redemption[2]	0,5	1,0	0,4
Less: Extraordinary receipts	0,3	1,6	1,3
Net borrowing requirement[3]	**-10,1**	**18,4**	**11,6**
Treasury bills	5,7	4,6	8,5
Domestic government bonds	-8,0	8,4	14,5
Foreign bonds and loans	-2,1	-3,4	3,4
Change in available cash balances[4]	-5,7	8,8	-14,8
Total net financing	**-10,1**	**18,4**	**11,6**

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

The net result of national government's revenue and expenditure in the first four months of fiscal 2007/08 was a cash book deficit of R19,0 billion compared with R12,5 billion in the same period of the previous fiscal year. As indicated in the table on the previous page, the deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R18,3 billion. After taking into account extraordinary transactions and the cost on revaluation of foreign debt at redemption, the net borrowing requirement amounted to R18,4 billion. The net borrowing requirement was mainly financed through the issuance of government bonds and Treasury bills in the domestic capital market.

Statement of the Monetary Policy Committee

16 August 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

The Monetary Policy Committee (MPC) met and evaluated domestic and international economic developments as well as the prospects for inflation going forward. In this context the MPC noted that recent financial market developments in some of the developed economies have had spill-over effects on emerging markets including South Africa.

A number of central banks have responded by injecting significant amounts of liquidity into their banking systems to ensure an orderly adjustment to the liquidity squeeze that was being experienced. The focus of the South African Reserve Bank (the Bank) remains to ensure a return of the inflation rate to within the target range.

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 6,4 per cent in both May and June 2007, following an increase of 6,3 per cent in April. CPIX inflation has exceeded the upper end of the inflation target range of 6 per cent for the past three months. The main causes of the upward trend in inflation remain food and energy, but broader underlying pressures are also evident. If food and energy prices were excluded, CPIX inflation would have measured 4,6 per cent in May and 4,7 per cent in June, compared to 3,8 per cent in December 2006. This indicator has been rising consistently since the middle of 2006 when it measured 2,5 per cent.

Food prices increased at year-on-year rates of 9,0 per cent and 9,4 per cent in May and June 2007, respectively, with grain product prices increasing by 13,4 per cent in June. Meat price inflation has been declining steadily since it peaked late last year, but nevertheless recorded an increase of 9,9 per cent in June. Petrol prices increased at year-on-year rates of 13,7 per cent in May and 11,1 per cent in June as a result of a cumulative increase of R0,57 per litre in these two months.

Prices of services, which tend to adjust more slowly than those of goods, have also been displaying an upward trend, having increased at a year-on-year rate of 5,7 per cent in June compared to 4,6 per cent in January 2007. The higher inflation trend is also observed in administered prices excluding petrol which have increased at rates of around 5,5 per cent since October 2006. Price declines in clothing, footwear and furniture continue to moderate pressures on inflation.

Production price inflation remains high, but declined to a year-on-year rate of 10,4 per cent in June following rates in excess of 11 per cent in the previous two months. The prices of agricultural goods have been increasing at year-on-year rates of almost 20 per cent since March 2007, whereas manufactured goods prices increases moderated to 6,4 per cent in May and June. Imported goods inflation declined from 11,7 per cent in May 2007 to 9,4 per cent in June.

The outlook for inflation

The most recent central forecast of the Bank indicates a slight deterioration in the inflation outlook, particularly in the short term, when compared to the previous forecast. CPIX inflation is now expected to remain above the upper level of the inflation target range at an average of around 6,3 per cent before declining to within the inflation target range in the second quarter of 2008. Thereafter it is expected to follow a downward path, to reach around 5,1 per cent by the end of 2009. The higher trend results from a higher-than-expected second quarter outcome which raised the starting point of the forecast, and a revised assumption for international oil prices.

The MPC identified a number of upside risks to the inflation outlook. These include oil and food prices, and high rates of household consumption expenditure. The assessment of most of the other variables was relatively unchanged, although there is some uncertainty about the potential impact of international financial market developments.

Food prices remain a threat to the inflation outlook despite the declining trend in meat price increases. High rates of increase in the spot prices of maize and wheat during the first half of this year are expected to sustain the higher food inflation. Of further concern are the year-on-year increases in June in the prices of agricultural products and manufactured food at the producer price level measuring 18,7 per cent and 15,0 per cent, respectively. These indicate possible further pressures on food prices at the retail level in coming months.

North Sea Brent crude oil is currently trading at around US$72 per barrel, which is similar to prices prevailing at the time of the previous MPC meeting. During July, however, the price rose to levels slightly below US$80 per barrel. More recently, prices have moderated partly as a result of concerns about the growth outlook in the United States and the sell-off in financial markets. The domestic petrol price declined in July and August by a total of R0,23, reflecting exchange rate and product price movements. Despite this recent respite, risks to inflation emanating from this source are still considered to be on the upside.

There is little evidence of a sustained slowdown in household consumption expenditure growth. The FNB/BER Consumer Confidence Index still remains near record levels despite a moderate decline in the second quarter of 2007. Retail sales growth remains robust, although the most recent data show that the year-on-year increase in June declined to 6,4 per cent compared to rates of growth of 5,9 per cent and 9,2 per cent in April and May, respectively. Retail sales of household furniture, appliances and equipment declined by 13,5 per cent in June compared to a year ago. Sales of private motor vehicles have also continued to decline. The seasonally adjusted number of new passenger vehicles sold in the three months to July 2007 reflected a decrease of 5,4 per cent compared to the previous three months.

Growth in credit extension to the private sector remains high although it is premature to assess the impact on credit extension due to the introduction of the National Credit Act in June. Twelve-month growth in banks' loans and advances extended to the private sector increased at a rate of 27,9 per cent in June. Adjusted for securitisation transactions, the increase would have been 30,3 per cent. Growth in loans and advances to the corporate sector measured 36,2 per cent in June compared to 33,3 per cent in May, while growth in credit extended to the household sector moderated from 22,8 per cent in May to 21,5 per cent in June. Year-on-year growth of asset-backed credit has been declining steadily over the past few months, recording a growth rate of 23,6 per cent in June.

Wage settlements have been trending upwards. According to Andrew Levy Employment Publications the average level of wage settlements measured 6,5 per cent in 2006. In the first half of 2007 wage settlement rates have averaged 6,8 per cent, but a growing number of recent settlements have been closer to 8 per cent. This may still be consistent with the inflation target if labour productivity growth is accounted for. Nevertheless, the upward trend is of some concern given the importance of wage developments in the price formation process.

As a result of the uncertainties in the international financial markets and the strengthening of the US dollar, the rand exchange rate has depreciated somewhat, particularly over the past few days. Before the onset of the current round of global financial market volatility, the rand had appreciated due to, among other factors, the weakness in the US dollar against other currencies and anticipated capital inflows related to possible merger and acquisition activity. At one stage the rand had reached levels slightly below R6,80 at a time when the US dollar had reached an historic low against the euro. However, the increased global risk aversion and a recovery in the US dollar reversed this trend and the rand is currently trading at a level of around R7,45 compared to R7,22 at the time of the previous meeting. Since the beginning of the year the nominal effective exchange rate of the rand has declined by 6,2 per cent.

Despite the global financial market developments noted above, non-resident interest in South African assets, in particular equities, has remained positive. Since 20 July when emerging-market spreads started to widen, non-residents have been net purchasers of equities totalling in excess of R11 billion, although in the past few days they have been moderate net sellers to the value of around R150 million. The sustainability of these inflows will depend in part on global liquidity conditions as well as domestic growth prospects.

Conditions in the local foreign-exchange market during July allowed for further accumulation of foreign-exchange reserves. At the end of July gross gold and foreign-exchange reserves had increased by US$1,06 billion to US$29,33 billion, while the international liquidity position had increased to US$26,97 billion.

The domestic economy continues to grow at a brisk pace but there are some signs of moderation. Gross domestic product (GDP) grew at an annualised rate of 4,7 per cent in the first quarter of 2007, down from 5,6 per cent in the final quarter of 2006. Mining production has continued to disappoint despite favourable commodity prices. In the second quarter of 2007 the physical volume of mining production remained under pressure, declining by 1,4 per cent compared to the previous quarter. The physical volume of manufacturing production also came under pressure in the second quarter when it grew by only 0,1 per cent. Nevertheless, the index of utilisation of productive capacity in the manufacturing sector increased to 86,8 per cent in the second quarter. The RMB/BER Business Confidence Index declined marginally in the second quarter of 2007. A more positive outlook is provided by the Investec/BER Purchasing Managers Index which increased in July 2007 following three consecutive monthly declines. Despite some negative indications, growth is expected to be underpinned in the coming months by the continued acceleration in the growth of real gross fixed capital formation which increased at a year-on-year rate of almost 22 per cent in the first quarter of 2007 and brought the ratio of fixed capital formation to GDP to over 20 per cent.

At this stage there is no evidence that the recent turbulence in the international financial markets will have marked effects on the domestic growth outlook, although this will depend to some extent on the impact of these developments on the United States' growth performance. To date the impact has been felt in the exchange rate and, to a greater extent, on the capital market. Although the prices of equities on the JSE Limited declined from their recent elevated levels, at the end of trade on 15 August the all-share index was still over 8 per cent higher than that prevailing at the beginning of the year. This suggests that the possible impact on consumption via the wealth effect and on investment is likely to be limited.

The international environment has become increasingly volatile and uncertain. The updated IMF *World Economic Outlook* forecasts published in July this year show a 0,3-per-cent increase in expected world GDP growth for both 2007 and 2008. World inflation is expected to remain more or less unchanged and average 3,5 per cent for 2007 and 2008. This forecast was made before the recent turmoil on the international financial markets and it is too early to assess the risks that these developments may pose to the global growth and inflation outlook.

Monetary policy stance

Having considered recent developments, the MPC has decided that a further adjustment in the monetary policy stance is required to ensure that CPIX inflation returns to within the target range. Accordingly, the repo rate is adjusted by 50 basis points to 10,0 per cent per annum with effect from 17 August 2007. The MPC will continue to monitor the relevant economic and financial developments to ensure that its mandate is fulfilled.